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 2012, 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 2012 is incorporated in Bank Negara Malaysia's Financial Stability and Payment Systems Report 2012 which forms an integral part of this Annual Report 2012.

Zeti Akhtar Aziz
Chairman
Board of Directors

20 March 2013

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' Muhammad bin Ibrahim
P.J.N., D.P.M.S.
Deputy Governor

Datuk Nor Shamsiah binti Mohd Yunus
P.M.W.
Deputy Governor

Dato' Sri Dr. Mohd Irwan Serigar bin Abdullah*
S.S.A.P., D.C.S.M., D.P.S.K., D.I.M.P., S.A.P.

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

*Dato' Sri Dr. Mohd Irwan Serigar bin Abdullah was appointed as a member of the Board with effect from 24 August 2012. Tan Sri Dato' Sri Dr. Wan Abdul Aziz bin Wan Abdullah resigned from the Board with effect from 23 August 2012 on completion of his term as Secretary General to the Treasury.

**Tan Sri Dato' Seri Dr. Sulaiman bin Mahbob was reappointed as a member of the Board effective 16 November 2012.

SHARIAH ADVISORY COUNCIL MEMBERS

Dr. Mohd Daud bin Bakar
Chairman

Dato' Dr. Abdul Halim bin Ismail
D.S.D.K

Tun Abdul Hamid bin Haji Mohamad
S.S.M, D.U.P.N, S.P.C.M, D.M.P.N, D.P.C.M, K.M.N, P.J.K

Tan Sri Sheikh Ghazali bin Abdul Rahman
P.S.M, P.J.N, D.S.D.K, S.D.K, A.M.N

Y.B. Dato' Seri Haji Hassan bin Haji Ahmad
P.M.P, D.S.P.N, P.J.N, D.G.P.N

Dr. Muhammad Anwar Ibrahim

Prof. Dr. Ashraf bin Md. Hashim

Prof. Madya Dr. Mohamad Akram bin Laldin

Prof. Madya Dr. Engku Rabiah Adawiah binti Engku Ali

Prof. Madya Dr. Rusni binti Hassan

Dr. Aznan bin Hasan

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

* Administrative Head

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GOVERNOR'S STATEMENT

The global economy entered 2013 with improved economic and financial conditions. The overall global situation, however, continues to remain challenging. The pace of recovery prevailing in several of the advanced economies remains constrained by the unresolved fiscal, financial and structural concerns. While affected by global developments, emerging economies have continued to perform well. Emerging economies in Asia, in particular, have continued to be resilient, sustained by domestic demand and robust domestic fundamentals.

The Malaysian economy is expected to continue to remain on a solid and steady growth trajectory in 2013. The favourable economic performance has benefitted from the restructuring of the economy during the recent decade, the resilience of the financial sector and the potential flexibility of policy. Following the economic restructuring, domestic demand has increasingly been the driver of growth. The growth has essentially been sustained by the strong private consumption and, more recently, the resurgence of private investment. The sources of economic growth have also become more diversified and balanced across economic sectors and across trade partners. Of greater significance is the increasing role of the private sector in the economy.

Malaysia's economic performance has importantly been well-supported by a resilient financial sector. Despite the increased volatility experienced in the domestic financial markets following developments in the global economy and financial system, domestic financial intermediation has continued uninterrupted. A strong banking system and a well-developed domestic bond market have not only provided continued access for financing of the economy, but it has served to disperse the concentration of risk in the financial system. Additionally, the progressive liberalisation and the greater foreign presence has not only increased competition in the financial system but has contributed to increased two-way capital flows and thus orderly market conditions. Moving forward, the continued financial reforms and development will aim at enhancing financial sector resilience and ensuring that the financial sector will continue to best serve the economy.

Equally important in supporting the economy is the potential flexibility of the domestic macroeconomic policies, particularly in an increasingly complex and challenging environment. The Bank has always been pragmatic in the design and use of its policies, relying on a comprehensive set of measures to achieve the desired objectives. While monetary policy remains the main policy lever, other complementary measures such as macroprudential policies have been relied upon to address risks in specific segments of the financial system and the economy, thus broadening the policy space and avoiding an over-reliance on monetary policy. Coordination with fiscal policy has also enhanced the impact and effectiveness of the policies in influencing the economy.

While inflation has trended downwards to the lows of 1.3% at the start of 2013, the focus of monetary policy during the year will be on managing the risk of rising prices while supporting sustained domestic economic growth. Given the assessment on the domestic and global economic prospective conditions, the expectation is for inflation to remain modest. The Bank will continue to be forward-looking and take a medium-term perspective given that monetary policy is most effective when used pre-emptively. Consideration will also be given towards avoiding the build-up of financial imbalances that could adversely affect macroeconomic and financial stability over the medium term. Lessons can be drawn from the crisis-ridden economies on the consequences of excessive build-ups of household indebtedness which would eventually have adverse and prolonged effects on consumption, the broader economy and financial stability. While the assessment is that household indebtedness in Malaysia and the risk to financial stability remains contained, a number of measures have already been implemented as a pre-emptive step to prevent it from becoming a problem.

Recent data shows that the growth of credit to households has begun to moderate. In addition, the growth of credit to households has been supported by a comprehensive and well-developed infrastructure to manage the risks. These include a well-functioning credit information registry that allows banks to make an informed assessment on the aggregate borrowings and creditworthiness of a borrower, a targeted financial education programme for new and young borrowers and a well-structured debt resolution and counselling mechanism to facilitate orderly management of potential financial problems among households. Through the supervisory assessment, the underwriting and risk management practices of banks has also been upgraded and become more robust.

As a highly open economy and with an increasingly more liberalised financial system, Malaysia is vulnerable to international shocks. Increased regional and global integration has in particular strengthened our economic and financial links with other economies in Asia. This has resulted in a greater diversification of the sources and destinations of trade and investment flows. Recent progress towards greater regional financial integration has also allowed for a more efficient and effective intermediation of funds within the region, improved risk diversification and provided the needed financing to support the investment activities in the region. The greater international and regional integration has brought with it increased challenges, including the risk of contagion from other parts of the world. This has prompted policymakers in the region to work together to pre-empt any incipient risks to the regional financial systems and economies. This is particularly important in the present circumstances where the region is being affected by volatile capital flows.

Among the regional central banks, there is a shared appreciation and strong commitment for combined efforts to secure regional macroeconomic and financial stability. Under the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), there is greater collective action in forming surveillance frameworks for early detection of risks and vulnerabilities to the region. Also being put in place is the pre-emptive preparations for an integrated framework for crisis management for the region. Reinforcing this is the ASEAN+3 financial initiatives which have strengthened and expanded the liquidity support mechanisms through the Chiang Mai Initiative Multilateralisation (CMIM). It enables a prompt response to any impending stress to the balance of payments or to a short-term liquidity position in the region. The South East Asia Central Banks Research and Training Centre (SEACEN) also has a key role in facilitating greater and more inclusive regional collaboration among the regional central banks. The extensive membership of SEACEN, including the major central banks in the region, has significantly deepened the collective pool of talent and resources in its core activities. SEACEN's unique regional position has facilitated a number of high-impact capacity building activities and collaborative research, as well as providing an inclusive platform for rigorous high-level policy discussions on issues of common strategic interest.

From the medium-term perspective, the main challenge for Malaysia is to successfully manage the transition towards a higher value-added economy, in which growth is private sector-driven and characterised by greater productivity and innovation, while at the same time being sustainable and inclusive. Key structural reform initiatives are currently being undertaken towards achieving this transformation, while taking into consideration the domestic realities and a more dynamic global environment. In this regard, the role of macroeconomic policy will be to ensure stability, and to provide the right incentives for the private sector to participate in this economic transformation process. As part of this transformation, the financial sector is envisaged to assume an important role in the efficient intermediation of funds, not only within Malaysia but increasingly also in the region and in other emerging economies. This will require new financial products and services to meet the requirements of a more knowledge- and innovation-intensive domestic economy and the financial infrastructure that will support the regional intermediation of funds for productive purposes.

During the year, the Bank has continued to modernise and strengthen its organisational capacity. The Bank is now well into the third phase of its organisational transformation, to ensure our continued effectiveness and to bring the Bank to the next level of performance. Key to the transformation is the Bank's three-year Business Plan, which provides focus and organisation-wide clarity on the strategic directions of the Bank, as well as a greater appreciation of the interdependencies of the desired outcomes. This has also strengthened horizontal collaboration within the Bank.

The Bank achieved several key milestones during the year. This included the enactment of the new Financial Services Act 2013 and Islamic Financial Services Act 2013, which merged several existing acts to provide a more uniform framework for the regulation of the financial sector and to provide the Bank with the necessary powers to act effectively in a much more complex financial landscape. Another milestone was the establishment of a centralised shared services division in the Bank to enhance the productivity and the level of professionalism in the delivery of support services to the Bank. There has also been more targeted talent development, with an increased focus on leadership development throughout the Bank, to ensure the readiness of the Bank's succession plan. Finally, the Bank introduced in 2012 the new currency series for all denominations of its notes and coins, with designs that distinctly reflect Malaysia and incorporating the latest security features and banknote technology.

The Bank has undergone many changes that have ensured that we remain effective and are in a state of readiness to meet the greater demands and challenges before us. Central to these efforts is the unwavering dedication and professionalism of the Bank's staff. On behalf of the Board and the management, I wish to express our appreciation to the staff of the Bank for their commitment to achieving our strategic goals and the economic and financial well-being of our nation. I also thank the Board of Directors for their continued support and guidance. With more challenges ahead of us, the Bank will continue to strive towards achieving the highest standards of excellence in fulfilling our responsibilities and upholding the trust that is placed upon us, guided by our vision, resolve, and shared values.

Zeti Akhtar Aziz
Governor
20 March 2013

2012

EXECUTIVE SUMMARY

In 2012, global economic growth moderated amid a more challenging environment compared to 2011. In the advanced economies, growth was uneven, with the US experiencing a fragile recovery and the euro area remaining in recession. The weakened economic conditions in the advanced economies affected international trade, which in turn affected domestic economic activity in the emerging economies. Weaker global growth prospects, coupled with the ongoing fiscal uncertainties in the advanced economies also contributed to sustained volatility in the international financial markets. Nonetheless, market sentiments improved towards the latter part of the year following stronger commitments and important steps taken by authorities in resolving the European sovereign debt crisis.

Despite the weak external environment, the Malaysian economy performed better than expected, delivering faster and higher quality growth. The Annual Report provides an analysis of the developments in the Malaysian economy and the policies pursued by the Bank during the year. It also provides an assessment of the prospects of the Malaysian economy amidst the ongoing developments in the global economic and financial landscape and the key challenges going forward. In addition, 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 2012

The Malaysian economy performed better than expected in 2012, recording a strong growth of 5.6%. The overall growth performance was driven by higher growth in domestic demand, which outweighed the negative impact from the weak external environment. Domestic demand recorded the highest rate of expansion over the recent decade, underpinned by higher consumption and investment spending. Despite the uncertainties in the external environment, domestic consumer confidence picked up amidst positive income growth, continued strength in the labour market, the low inflation environment and supportive financing conditions.

Investment activity was a key driver of the domestic economy during the year, with increased capital spending by both the private and public sectors. Private investment was particularly robust, recording a double-digit growth of 22%. The share of private investment rose to 15.5% of GDP in 2012, the highest since 1998. This was led by strong capital spending in the consumer-related services sectors, domestic-oriented manufacturing sectors and the implementation of major infrastructure projects. Public investment also registered a strong growth of 17.1%, driven by higher capital spending by public enterprises. In addition, the strong investment performance was also attributed to the commencement and progress of several infrastructure projects, including those under the Economic Transformation Programme (ETP), and the steady improvement in the investment climate.

Private consumption registered a firm growth of 7.7% in 2012. The strong performance was attributed to favourable income growth, Government transfers to low- and middle-income households, and supportive financing conditions. In the public sector, public consumption recorded a moderate growth of 5% amidst continued fiscal consolidation efforts during the year.

On the supply side, all economic sectors continued to expand in 2012. The construction sector benefited from the strong expansion in investment activity, registering its highest pace of growth since 1995. While the growth of export-oriented activities was dampened by the slowdown in external demand, the growth of domestic-related activities, particularly in the services and manufacturing sectors, was supported by the strong performance of domestic demand.

Labour market conditions remained stable in 2012 with continued gains in employment, observed mostly in the services and agriculture sectors. However, total retrenchments increased due mainly to higher layoffs in the manufacturing sector. During the year, the unemployment rate declined marginally to 3%.

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), averaged 1.6% in 2012 (2011: 3.2%).

Inflation was lower than expected, on account of the slower rate of price increases in the *food and non-alcoholic beverages* and *transport* categories. Food items, which have been the main drivers of inflation in recent years, registered more moderate price increases following modest external price pressures and significant improvements in domestic food supplies. The magnitude of the adjustments to administered prices was also lower than in the previous year. Core inflation, an indicator of demand-driven price pressures, moderated to 2.4% in 2012 (2011: 2.7%).

Malaysia's external position remained resilient in 2012 despite the challenging external environment. The overall balance of payments remained strong as the current account surplus was more than adequate to meet the net outflows in the financial account. Reflecting the cyclical and structural adjustments taking place in both the global and domestic economy, the current account surplus was lower at RM60 billion in 2012 (2011: RM97.1 billion) due mainly to a smaller goods surplus and larger deficits in the services and income accounts. The moderation in the goods surplus was a result of robust import growth, following the improvement in domestic demand, amid lower export growth caused by the weak external demand and lower commodity prices. The services account registered a larger deficit due to higher payments for imported transportation services and lower net travel receipts, while the larger net income payment reflected the higher income accrued to foreign companies operating in Malaysia.

On the financial account, Malaysia continued to experience two-way capital flows, with foreign inflows attracted by the resilient growth prospects. Despite significant global uncertainties, foreign direct investment (FDI) inflows were sustained and remained broad-based, with significant inflows into high-growth areas, such as the oil and gas sector and the communication services sub-sector. Some of the funds were also channelled into projects under the ETP. Direct investment abroad (DIA), were largely undertaken by companies in the services and oil and gas sectors, and continued to be channelled into the regional economies, reflecting the deepening economic integration in Asia.

Malaysia's external debt declined to RM252.8 billion (USD81.7 billion) as at end-2012 (2011: RM257.4 billion), equivalent to 28% of GNI (2011: 30% of GNI). During the year, the medium- and long-term external debt of the private sector increased. This, however, was largely offset by the net repayment of public sector medium- and long-term external debt and the net repayment of short-term interbank borrowings. The appreciation of the ringgit against some of the major currencies during the year also contributed to the lower value of external debt in ringgit terms. Overall, Malaysia's external debt profile continued to be skewed towards a longer maturity structure, with medium- and long-term debt accounting for 63.2% of total external debt. The external debt continues to be well supported by the country's strong economic fundamentals.

Net international reserves increased by RM3.9 billion to RM427.2 billion (equivalent to USD139.7 billion), as at 31 December 2012. As at 28 February 2013, the reserves level amounted to RM429 billion (equivalent to USD140.3 billion), which is adequate to finance 9.5 months of retained imports and is 4.6 times the short-term external debt. The international reserves held by the Bank remain usable and unencumbered.

Economic and Monetary Management in 2012

Monetary policy in 2012 was focused on managing the downside risks to growth amid moderating inflation. Although the Malaysian economy remained on a steady growth path and inflation was on a downward trend, the high degree of global economic and financial uncertainty remained a risk to the Malaysian economy's growth prospects. In balancing the risks to inflation and growth of the economy, the Monetary Policy Committee (MPC) considered the prevailing Overnight Policy Rate (OPR) level to be appropriate, and kept the policy rate unchanged at 3.00% throughout 2012.

Strong loan demand throughout the year, while warranting close monitoring, was not a concern as total loan growth was supported mainly by lending to businesses, with lending primarily supporting expansion of the domestic-oriented industries and the ETP-related projects. While there were concerns over the potential risk of excessive indebtedness of the household sector, the risk was assessed to be confined to specific household segments. As such, the MPC was of the view that a change in monetary policy stance was not appropriate. These trends were also being addressed by macroprudential measures and the guidelines issued on responsible financing practices that was introduced at the beginning of the year to promote prudent and responsible lending and borrowing behaviour. Nevertheless, the MPC continued to assess developments in household credit to ensure the risk of household indebtedness becoming excessive remained contained.

Monetary policy was also confronted with the challenge of sustained large and volatile portfolio flows throughout the year. There continued to be large global surplus liquidity in search of higher yields, which were attracted to the emerging economies, including Malaysia, given the relatively stronger fundamentals. The developments in the advanced economies and the rapid changes in sentiments in the global financial markets further contributed to the volatility of portfolio flows. For the most part, the financial system was able to effectively intermediate these flows without generating substantial distortions in domestic financial markets and monetary conditions. This reflected the cumulative policy efforts by the Bank to deepen and increase the resilience of the Malaysian financial system over the recent decade.

The performance of the ringgit during the year was influenced by the global and regional developments amid periods of heightened volatility in the global financial markets. From January to early March of 2012, the ringgit strengthened due to portfolio inflows, supported by the continued underlying strength of the Malaysian economy amid the positive growth prospects of Asia and the prolonged low interest rate environment in the advanced economies. The appreciating trend of the ringgit reversed temporarily between March and June, as renewed uncertainties over the situation in key economic regions led to concerns over the prospects for global and regional economic growth and prompted the unwinding of the holdings of financial assets in the region by investors. The depreciation trend, however, was brief as portfolio inflows resumed towards the second half of the year, attracted by the strong performance of the domestic economy. The ringgit ended the year at RM3.0583 against the US dollar, thus recording a year-on-year appreciation of 3.9%.

During the year, the yields of Malaysian Government Securities (MGS) were largely influenced by a combination of external and domestic factors. Despite renewed concerns over the European sovereign debt crisis, firm demand from non-residents kept yields low. However, strong domestic fundamentals and increased supply of government bonds exerted some upward pressure on yields. The domestic private debt securities market (PDS) registered high growth amid ample liquidity and strong demand for financing to support infrastructure-related projects, including those under the ETP. The FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) advanced by 10.3% to close at 1,689 points in 2012 (2011: 0.8%). The positive performance was driven mainly by the favourable outlook for the domestic economy.

Liquidity conditions in the banking system remained ample throughout 2012. Private sector liquidity continued to expand, mainly on account of favourable credit conditions and continued inflows of foreign funds. Liquidity conditions in the interbank money market were more stable compared to 2011, reflecting more balanced two-way flows from trade and investment activity. Sterilisation operations by Bank Negara Malaysia were conducted to prevent the build-up of liquidity that could give rise to financial imbalances.

Financing conditions remained supportive of economic activity. The strength in financing growth during the year was attributable mainly to business financing. Demand for loans by households, while still remaining relatively strong, moderated. Net financing through the banking system and the capital market expanded at an annual rate of 12.4% (2011: 12.5%).

Outlook for the Malaysian Economy in 2013

The Malaysian economy is expected to remain on a steady growth path, with an expansion of 5-6% in 2013. Economic activity will be anchored by the continued resilience of domestic demand, and supported by a gradual improvement in the external sector. Private investment is expected to remain robust, driven by capacity expansion by the domestic-oriented firms and the continued implementation of projects with long gestation periods. Investments by the external-oriented businesses is also expected to be higher amid the gradual improvement in external demand, while private consumption is projected to grow at a more moderate rate in the second half of the year, although it will continue to be well supported by sustained income growth and positive labour market conditions. Government spending is expected to record a lower growth given the ongoing consolidation of the

Government's fiscal position and as the role of the private sector gains greater significance. In line with the more favourable external sector, gross exports are projected to record a higher growth in 2013 supported by the export of manufactured products. Gross imports are expected to moderate, in tandem with the projected trend in domestic demand. Overall, this is expected to result in a lower negative contribution to real GDP from net exports. As import growth continues to outpace export growth amid the continued deficit in the income account and in current transfers, the current account surplus, while still remaining significant is expected to narrow further in 2013.

On the supply side, all major economic sectors are expected to record continued expansion in 2013. The services and manufacturing sectors are expected to be the key contributors to overall growth, driven by the continued resilience of domestic demand and supported by higher international trade activity. Growth in the construction sector is projected to remain strong, supported by the implementation of major infrastructure projects. In the commodities sector, the growth of agriculture is expected to improve due to the higher output of crude palm oil and food commodities while the mining sector is expected to strengthen following the higher production of natural gas, crude oil and condensates.

Headline inflation is expected to average 2-3% in 2013. This inflation projection takes into account the expected higher global prices of selected food commodities and the adjustments to domestic administered prices. Demand-driven price pressures are expected to be moderate. The wider forecast range reflects the greater uncertainty in the external and domestic environment.

Overall, the growth prospects of the Malaysian economy will continue to be underpinned by the strength of its fundamentals. Of importance, labour market conditions will remain favourable, with the unemployment rate projected to remain low at 3.1% of the labour force in 2013. In addition, the financial system continues to demonstrate resilience against the challenging external environment, with financial intermediation expected to continue to provide strong support to domestic economic activity. The introduction of macroprudential and other policy measures have helped to manage the risks from the increase in household indebtedness. Malaysia's favourable external position is to remain intact, with international reserves at healthy levels and a low external debt that is within prudent limits.

Given the challenging external environment, there, however, remain risks to the economic outlook. The potential re-emergence of instability in the euro area and slower growth in Malaysia's major trading partners would affect the Malaysian economy. While pressures from global commodity prices have receded, upside risks from non-fundamental factors, such as adverse weather conditions and geopolitical developments, could push commodity prices higher and adversely affect the growth prospects of economies that are major trading partners of Malaysia. Potential upside to the domestic economy could emerge if the recovery in the advanced economies turns out to be better than expected.

Economic and Monetary Management in 2013

Under this challenging global economic environment, the focus of policies by the Government and the Bank will be on supporting the Malaysian economy to grow at a sustainable level while mitigating the risks arising from the global environment, including possible shocks to inflation.

Monetary policy in 2013 will focus on addressing potential risks to inflation and growth. The MPC considered the prevailing level of the OPR and the current monetary policy stance to be appropriate for the inflation and growth outlook. In addition to domestic conditions, the MPC will continue to carefully assess the global economic and financial developments and their implications on the overall outlook for inflation and growth of the Malaysian economy.

Fiscal policy in 2013 will continue to focus on sustaining the growth momentum of the domestic economy and facilitating the long-term transformation of the economy, while ensuring the sustainability of public finances. The 2013 Budget placed emphasis on ensuring the efficient use of fiscal resources, achieving inclusive growth and strengthening fiscal management, all within the path of a sustained and gradual fiscal consolidation plan.

Organisational Development and Governance

In 2012, the Bank further reinforced its efforts in organisational development and achieving more effective governance. During the year, the Board of Directors met each month to deliberate on various aspects of the Bank's operations, including the performance of the Bank in effecting monetary and financial stability, and matters pertaining to the Bank's financial position, reserves management, currency management and the management of its staff. The Board was supported by three Board Committees that were chaired by non-executive directors, namely the Board Governance, Audit and Risk Committees, which collectively have the role of ensuring the effectiveness of the internal audit function, as well as pre-emptively managing risks that may hinder the achievement of the Bank's objectives.

During the year, initiatives were implemented to ensure continued strategic focus and a robust risk management culture in all aspects of the Bank's operations. 2012 marked the first year of the Bank's second cycle of its three-year Business Plan, which sets the medium-term strategic direction and aligns the Bank's resources towards achieving the Bank's objectives. A major milestone in 2012 was the passing of the new legislation, the Financial Services Act 2013 and the Islamic Financial Services Act 2013, which have been designed to provide a modern and cohesive regulatory framework for the financial sector. Another initiative was to improve the organisational efficiency and productivity in the area of support services. All departments offering such support services were restructured into a new division, with the aim of professionalising the services. In sustaining a high performing workforce, the Bank continued to modernise its human capital policies and practices with the introduction of a new Job Family framework. The principles of the new framework aim to attract, assess, develop, reward and retain talent in the Bank.

The Bank also continued an active two-way communication on the Bank's policies and developments in the financial system. Efforts were intensified through various channels to promote awareness and provide greater clarity on the Bank's key initiatives, including on the financial inclusion agenda, the internationalisation of Islamic finance, the circulation of the new currency series, and the wider usage of renminbi for trade settlement and investment. A major initiative in the communication drive and financial education awareness campaigns was on financial scams to highlight to investors and the public on the dangers of investing in such schemes.

As part of the continued effort to enhance regional and international cooperation among central banks and regulatory authorities, the Bank continued to provide a broad range of technical cooperation programmes, to share Malaysia's experience in central banking and to facilitate knowledge sharing with counterparts from central banks across the globe. The Bank's facilities at Lanai Kijang and Sasana Kijang were fully utilised for this endeavour.

Bank Negara Malaysia's Audited Financial Statement for 2012

The financial position of Bank Negara Malaysia, as audited and certified by the Auditor General, remained strong in 2012. The total assets of Bank Negara Malaysia amounted to RM476.3 billion, with a net profit of RM5.6 billion for the financial year ended 31 December 2012. Bank Negara Malaysia declared a dividend of RM1.5 billion to the Government for the year 2012.

2012

ECONOMIC DEVELOPMENTS IN 2012

THE INTERNATIONAL ECONOMIC ENVIRONMENT

In 2012, the international economic landscape became more challenging relative to the preceding year. Global growth experienced a synchronised moderation as weakening economic conditions in several key economies affected international trade and subsequently had adverse spillover effects on domestic activity in the emerging economies. The lower global growth prospects, coupled with the ongoing fiscal uncertainties in the advanced economies, cumulatively contributed to sustained volatility in the financial markets. In the commodity markets, with the exception of crude oil prices that had remained elevated, the prices of other commodities were lower on account of weaker global demand and more favourable supply conditions. This subsequently led to more subdued inflationary pressures. In response to the uncertain external environment, many countries pursued further monetary easing to support growth.

Global growth experienced a synchronised moderation amid heightened downside risks while inflationary pressures remained subdued

Moderation in global growth

In 2012, global economic growth moderated, continuing a downtrend that had begun in early 2011. Most emerging regions expanded at rates significantly lower than their pre-crisis averages, as weakness in key economies spilled over to the rest of the world.

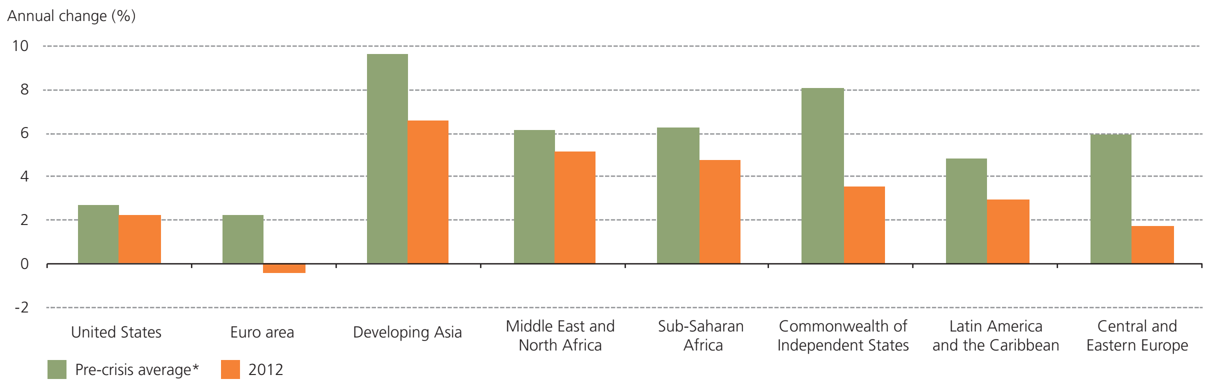
The growth momentum in the advanced economies was uneven. The US continued to experience an ongoing but fragile recovery, while several other major economies registered weak growth. The US economic recovery was modest, dampened by both domestic and external weaknesses. Domestically, this reflected mainly the sluggish conditions in the housing and labour markets, continued deleveraging by banks and households, and increased uncertainty arising from fiscal concerns. Growth in the US was also affected by negative business sentiments and a slowdown in exports attributable largely to the economic weakness in Europe. Towards the latter half of the year, however, the housing and labour markets recorded signs of stabilisation, providing some support to growth.

The euro area, however, experienced a recession amid a widespread decline in economic activity amongst the member economies. The series of measures undertaken by the authorities contributed to stabilising the financial market conditions during the year, but they fell short of providing a comprehensive resolution to the crisis. Growth in the crisis-affected economies continued to be weighed down by fiscal austerity measures, high unemployment and impaired financial intermediation. As the year progressed, growth in the core economies also decelerated, albeit to a lesser extent, with Germany recording a slower expansion on account of weakening investment, and economic activity in France stagnating amid anaemic domestic demand. Similarly, the UK economy recorded protracted weakness in growth, reflecting the negative impact of ongoing fiscal consolidation and declining exports to the euro area. In Japan, while growth initially benefited from the reconstruction-related demand as the economy gradually recovered from the previous year's natural disaster, the effect tapered off towards the second half of the year. This was further exacerbated by continued weakness in the external environment and a slowdown in consumption as the policy support for the purchase of energy-efficient cars diminished.

In Asia, the moderation in growth which had begun in late 2011 continued into the year, reflecting mainly the weakness in external demand. In the Newly Industrialised Economies (NIEs), the moderation intensified towards the middle of the year on account of adverse spillover effects from the external sector on domestic demand. In PR China, the growth slowdown was also attributable to policy tightening measures that had

Chart 1.1

Current Growth vs Pre-Crisis Averages



*Refers to real GDP growth average in 2003-2007

Source: International Monetary Fund (IMF)

been implemented in the property sector over the recent two years. In addition, the government did not announce any major pro-growth policies as efforts were increasingly geared towards growth stabilisation and the rebalancing of the economy. Nevertheless, domestic economic activity improved towards the end of the year, supported by infrastructure investments and some stabilisation in the property market. In contrast to the broad trend of moderation in the region, many ASEAN economies registered relatively robust growth rates. This was underpinned by government-led initiatives and resilient domestic demand, which was supported by favourable labour market conditions, continued access to financing and rising incomes.

Improvement in international financial conditions

In the first quarter of the year, the **international financial markets** were characterised by improved sentiments as the severity of the European sovereign and banking crises subsided following the measures introduced by the European Central Bank (ECB), the Federal Reserve (Fed) and the Bank of Japan (BOJ). In addition, better global growth prospects arising from positive economic developments in the US and the continued resilience of emerging economies had altered investors' risk appetites. As a result, equity prices recovered and emerging market economies recorded an inflow of capital.

These favourable trends reversed in April following renewed concerns on the euro area, particularly in Spain. Spain's borrowing costs increased on concerns over the domestic banking system and a deepening of the recession in the country. In addition, an inconclusive election outcome in May led to heightened fears of a potential exit of Greece from the single currency union. Contagion risks also rose when the credit ratings of sovereigns and banks in several major economies, including the US and core European economies, were downgraded. Incipient signs of weakening growth in the US and PR China contributed to further volatility in the global financial markets. The decline in market sentiments and confidence was reflected in deposit flight from some European countries, a fall in global equity market indices and increased demand for safe haven assets. Following these developments, government bond yields in the US, Germany and Switzerland declined. Similarly, the global uncertainties also culminated in the reversal of capital flows from the Asian region.

In the second half of the year, sentiments improved, benefiting from the announcements of several proposals to address the European sovereign debt crisis. These measures were aimed to break the negative feedback loop between the national banking systems and the sovereign fiscal positions and to restore confidence in the currency union. The proposed measures included direct recapitalisation of banks, the formation of a banking union and a €120 billion growth pact to support economic activity in the euro area. In July, the ECB President's statement to "do whatever it takes" to preserve the euro led to improved market confidence and sentiments. In particular, 10-year government bond yields of crisis-affected countries

Table 1.1

World Economy: Key Economic Indicators

	Real GDP Growth (%)		Inflation (%)	
	2011	2012*e*	2011	2012*e*
World Growth	**3.9**	**3.2**	**-**	**-**
World Trade	**5.9**	**2.8**	**-**	**-**
Advanced Economies				
United States	1.8	2.2	3.2	2.1
Japan	-0.6	2.0	-0.3	-0.1
Euro area	1.4	-0.6	2.7	2.5
United Kingdom	0.9	0.2	4.5	2.8
Developing Asia	**8.0**	**6.6**	**-**	**-**
Asian NIEs[1]	**4.0**	**1.7**	**3.5**	**2.6**
Korea	3.6	2.0	4.0	2.2
Chinese Taipei	4.1	1.3	1.4	1.9
Singapore	5.2	1.3	5.3	4.6
Hong Kong SAR[2]	4.9	1.4	5.3	4.1
The People's Republic of China	**9.3**	**7.8**	**5.4**	**2.6**
ASEAN-4	**4.3**	**6.2**	**4.5**	**3.3**
Malaysia	5.1	5.6	3.2	1.6
Thailand	0.1	6.4	3.8	3.0
Indonesia	6.5	6.2	5.4	4.3
Philippines	3.9	6.6	4.8	3.1
India[3]	**7.8**	**4.0**	**9.5**	**7.5**

[1] Newly Industrialised Economies
[2] Inflation refers to composite price index
[3] Inflation refers to wholesale price index; GDP at market prices for the calendar year
e Estimate

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

such as Spain and Italy retreated moderately from their peak. Investor concerns of a sharp slowdown in global growth also receded as key economies started to show signs of stabilisation and modest improvements. This was also reflected in the resumption of capital flows into emerging economies, particularly in the Asian region. Despite these positive developments, considerable risks remained. In Europe, while there was greater clarity in key policy initiatives to manage the crisis, uncertainty remained over implementation details. In the US, heightened concerns over the expiration of fiscal stimulus weighed on financial markets towards the end of the year.

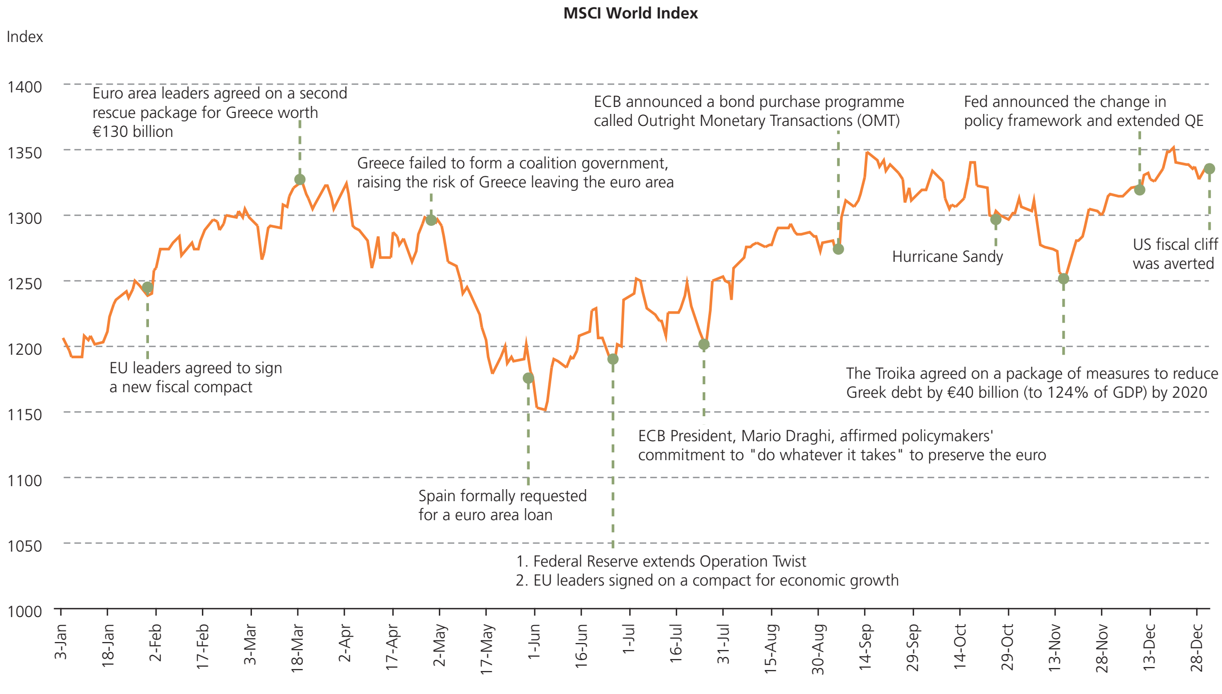
In the **foreign exchange market,** the currencies of most advanced and Asian economies appreciated against the US dollar in 2012. The euro and pound sterling strengthened following a general improvement in sentiments amid some progress towards resolving the European sovereign debt crisis. There were, however, periodic episodes of depreciation of the euro and pound sterling attributable to policy uncertainties in Greece, fiscal and banking issues in Spain, as well as releases of weak economic data. While Asian currencies depreciated in the second quarter following greater concerns over the strength of global growth, the trend reversed in the second half of the year as sentiments were buoyed by the favourable policy actions of several major central banks to support growth. Unprecedented policy easing measures undertaken by the Fed, the BOJ, and the ECB led investors to seek higher yielding assets, contributing to the general appreciation of most Asian currencies against the dollar. Against this trend, the Indonesian rupiah weakened by 7.3% against the US dollar due to concerns on the nation's external position. While safe haven demand drove the appreciation of the Japanese yen in the first half of 2012, the trend reversed in the latter part of the year against the backdrop of weaker economic data and expectations of further monetary easing by the BOJ.

Continued volatility in commodity prices

Global commodity prices remained volatile in 2012, attributable to both demand and supply factors. In the energy market, Brent crude oil price recorded an average of USD112 per barrel (p/b) in 2012, close to the USD111 p/b registered in 2011. However, prices fluctuated throughout the year due to geopolitical developments in the Middle East and growth concerns in key economies. While slower global economic activity exerted downward pressure on crude oil prices, persistent uncertainties in global supply conditions kept prices at elevated levels. In the first quarter, the potential imposition of sanctions on oil exports from Iran, the fourth largest oil producer, caused oil prices to reach an 11-month high of USD126 p/b. The upward trend reversed in April following talks between Iran and key global powers, as well as higher OPEC oil production. Prices rebounded in July as the negotiations failed. Towards the end of the year, political tensions in Egypt and other parts of the region led to heightened uncertainties. On the demand side, weaker economic data in the US, Europe, and PR China raised concerns of a slowing global growth. On the non-energy commodities front, metal prices declined as the slowdown in PR China led to lower demand for iron ore and copper. Food prices were also lower during the

Chart 1.2

Selected Events That Affected the Global Financial Environment in 2012



Source: Bloomberg

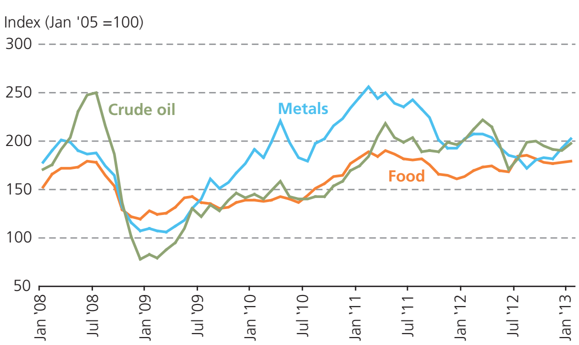
year as the weaker global consumption offset tight supply conditions caused by low inventories and weather-related reductions in crop yields especially during the second half of the year.

Easing inflationary pressures

In 2012, global **inflationary pressures moderated,** reversing the upward trend experienced in the previous year. Two underlying trends contributed to this development. Firstly,

Chart 1.3

Indices of Primary Commodity Prices



Source: International Monetary Fund (IMF)

the general slack in economic activity following weaker overall demand contributed to more muted demand-driven pressures. Secondly, the lower increase in energy prices also had a direct impact in slowing the rise in consumer prices, particularly in the advanced economies. While headline inflation movements in the US varied in tandem with fluctuations in energy and commodity prices, core inflation moderated throughout the year, indicating the absence of demand pressures. In the euro area and the UK, consumer prices continued on a downward trend amid receding energy price pressures. Japan's headline consumer prices (less food) remained in deflationary mode, reflecting the persistent negative output gap and broad-based weakness in prices across all components. Similarly, inflation in Asia was relatively modest, attributable mainly to the relatively benign increases in food and commodity prices. Of significance, domestic prices of staple foods in the region, such as rice, stabilised with support from lower global demand and market intervention by several governments. The downward pressures on inflation differed across economies, reflecting country-specific factors such as higher accommodation costs (Singapore and Hong Kong SAR) and transitory increases in food prices following adverse weather conditions in several regional countries (PR China, Chinese Taipei, Korea and the Philippines). Core inflation was however generally contained.

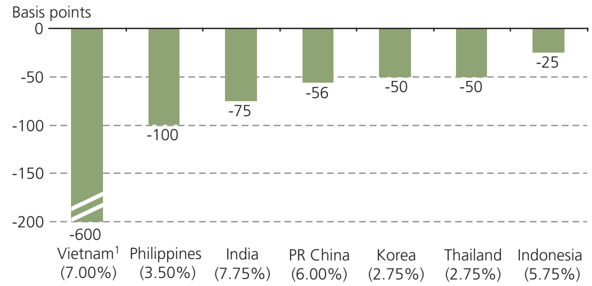
Further monetary easing
Amid relatively weaker growth prospects and subdued inflationary pressures, **monetary policy** remained accommodative in both the advanced and Asian economies as central banks were concerned about the risks to growth throughout the year.

In the US, the Fed maintained its highly accommodative monetary policy, implemented through its maturity extension programme (Operation Twist) to exert downward pressures on longer-term interest rates and thus make broader financial conditions more accommodative. In October, the Fed announced further quantitative easing measures through the purchase of mortgage-backed securities, and again in December with an outright purchase of long-term Treasuries. Notably, the Fed shifted from a time-based to an indicator-based approach by pledging to maintain the current accommodative stance as long as the unemployment rate remains above 6.5% and inflation between one and two years ahead is no more than 2.5%.

In Europe, the ECB reduced its policy rate by 25 bps to a low of 0.75%. It also expanded the range of assets that could be used as collateral to improve the access to liquidity by the banking sector in the euro area. In the UK, the Bank of England (BOE) increased the size of its asset purchase programme by £50 billion in February and another £50 billion in July to a total of £375 billion during the year. In addition, the BOE and the British government jointly unveiled a lending plan for households and businesses. Concerned with the weakening domestic economy and the continued risk of deflation, the BOJ expanded the amount of its asset purchase programme five times to a total of ¥101 trillion. The BOJ also announced an inflation goal of 1% to manage expectations, while increasing the size of its Growth-Supporting Funding Facility, and providing unlimited amount of affordable loans to financial institutions to stimulate bank lending. In January 2013, the BOJ introduced a price stability target of 2% and an 'open-ended asset purchasing method' under the Asset Purchase Programme to overcome the deflation and to spur growth.

Chart 1.4

Cumulative Movements of Policy Rates Since 2012



[1] Refers to rediscount rate
Note: Current policy rates in parentheses, as at end-January 2013
Source: National Authorities

In the Asian region, central banks in PR China, India, Korea, Thailand, the Philippines, Indonesia and Vietnam reduced their key policy rates between 25 and 600 bps. The decisions were undertaken to support growth given the heightened downside risks from the external environment. Notably, the central banks in the region were vigilant against the risk of negative spillovers from the external sector on domestic economic activity.

THE MALAYSIAN ECONOMY

Overview
The Malaysian economy performed better than expected in 2012, with a higher growth of 5.6% (2011: 5.1%). The strong growth was supported by resilient domestic demand, which cushioned the negative impact of the weak external environment. Domestic demand recorded its highest rate of expansion for the decade, supported by stronger consumption and investment spending. Unlike in 2009 when the weakness in external demand had significantly affected domestic economic activity through its impact on private investment and private consumption, domestic demand had remained resilient in 2012. The continued resilience in domestic demand was underpinned largely by sound macroeconomic fundamentals, the more diversified and balanced economic structure, the stronger and more developed financial system, and greater macroeconomic policy flexibility.

Building on the trends observed since 2011, gross fixed capital formation registered robust growth in 2012. Private investment sustained

Table 1.2

Malaysia - Key Economic Indicators

	2010	2011	2012*p*	2013*f*
Population (million persons)	28.6	29.0	29.3	29.7
Labour force (million persons)	12.3	12.7	13.1	13.5
Employment (million persons)	11.9	12.3	12.7	13.1
Unemployment (as % of labour force)	3.3	3.1	3.0	3.1
Per Capita Income (RM)	26,882	29,661	30,809	33,015
(USD)	8,346	9,693	9,974	10,760[6]
NATIONAL PRODUCT (% change)				
Real GDP at 2005 prices[1]	7.2	5.1	5.6	5.0 ~ 6.0
(RM billion)	674.9	709.3	749.1	789.9
Agriculture, forestry and fishery	2.4	5.9	0.8	4.0
Mining and quarrying	-0.4	-5.7	1.4	5.0
Manufacturing	11.9	4.7	4.8	4.9
Construction	6.0	4.6	18.5	15.9
Services	7.2	7.0	6.4	5.5
Nominal GNI	10.0	11.8	5.2	8.5
(RM billion)	768.5	859.1	903.9	981.0
Real GNI	4.3	4.9	4.3	6.7
(RM billion)	633.8	664.6	693.5	739.7
Real aggregate domestic demand[2]	7.0	8.2	10.6	8.1
Private expenditure	8.3	8.2	10.7	9.1
Consumption	6.6	7.1	7.7	7.1
Investment	15.5	12.2	22.0	15.6
Public expenditure	3.8	8.4	10.3	5.4
Consumption	2.9	16.1	5.0	3.6
Investment	5.0	-0.3	17.1	7.5
Gross national savings (as % of GNI)	35.4	35.5	33.0	32.9
BALANCE OF PAYMENTS (RM billion)				
Goods balance	134.7	148.1	125.2	102.3
Exports (f.o.b.)	640.0	696.6	702.9	713.1
Imports (f.o.b.)	505.3	548.5	577.7	610.8
Services balance	1.7	-8.0	-13.4	-12.7
(as % of GNI)	0.2	-0.9	-1.5	-1.3
Income, net	-26.5	-22.0	-33.7	-27.2
(as % of GNI)	-3.4	-2.6	-3.7	-2.8
Current transfers, net	-21.8	-21.0	-18.2	-19.6
Current account balance	88.1	97.1	60.0	42.7
(as % of GNI)	11.5	11.3	6.6	4.4
Bank Negara Malaysia international reserves, net[3]	328.6	423.3	427.2	-
(in months of retained imports)	8.6	9.6	9.5	-
PRICES (% change)				
CPI (2010=100)[4]	1.7	3.2	1.6	2.0 ~ 3.0
PPI (2005=100)[5]	5.6	9.0	0.1	-
Real wage per employee in the manufacturing sector	6.4	0.6	4.6	-

[1] Beginning 2012, real GDP has been rebased to 2005 prices, from 2000 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 2013
p Preliminary
f Forecast

Note: Numbers may not necessarily add up due to rounding

Table 1.3

Malaysia - Financial and Monetary Indicators

FEDERAL GOVERNMENT FINANCE (RM billion)	**2010**	**2011**	**2012*p***
Revenue	159.7	185.4	207.9
Operating expenditure	151.6	182.6	205.5
Net development expenditure	51.3	45.3	44.3
Overall balance	-43.3	-42.5	-42.0
Overall balance (% of GDP)	-5.4	-4.8	-4.5
Public sector net development expenditure	103.0	101.8	163.9
Public sector overall balance (% of GDP)	2.5	-3.5	-10.2
EXTERNAL DEBT			
Total debt (RM billion)	227.1	257.4	252.8
Medium- and long-term debt	147.6	153.5	159.8
Short-term debt[1]	79.4	103.9	93.0
Debt service ratio[2] (% of exports of goods and services)			
Total debt	7.6	10.3	10.2
Medium- and long-term debt	7.6	10.2	10.1

MONEY AND BANKING	**Change in 2010**		**Change in 2011**		**Change in 2012**	
	RM billion	**%**	**RM billion**	**%**	**RM billion**	**%**
Money supply M1	23.5	11.7	33.8	15.1	28.9	11.2
M3	68.8	6.8	154.8	14.3	109.4	8.8
Banking system deposits	75.0	7.1	161.0	14.1	109.4	8.4
Banking system loans[3]	99.8	12.7	120.2	13.6	104.5	10.4
Loan-deposit ratio (end of year)[4]	81.5		80.9		82.1	
Financing-deposit ratio[4, 5]	88.0		86.6		89.2	

INTEREST RATES (AS AT END-YEAR)	**2010**	**2011**	**2012**
	%	**%**	**%**
Overnight Policy Rate (OPR)	2.75	3.00	3.00
Interbank rates (1-month)	2.83	3.05	3.06
Commercial banks			
Fixed deposit 3-month	2.74	2.99	2.98
12-month	2.97	3.22	3.15
Savings deposit	1.00	1.15	1.03
Base lending rate (BLR)	6.27	6.53	6.53
Treasury bill (3-month)[6]	2.82	2.99	3.04
Malaysian Government Securities (1-year)[6]	2.85	2.82	3.01
Malaysian Government Securities (5-year)[6]	3.39	3.23	3.24

EXCHANGE RATES	**2010**	**2011**	**2012**
Movement of Ringgit (end-period)	**%**	**%**	**%**
Change against SDR	13.1	-2.8	3.9
Change against USD[7]	11.1	-2.9	3.9

[1] Excludes currency and deposits held by non-residents with resident banking institutions
[2] Includes prepayment of medium- and long-term debt
[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] Refers to data from FAST, Bank Negara Malaysia
[7] 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

impressive growth rates throughout the year, with broad-based investment activity undertaken by firms across most sectors. Investments in the oil and gas sector reflected the concerted efforts by both the public and private sectors to increase oil production through new investments in deepwater and marginal oil fields. The continued strong growth in private consumption had the effect of spurring more investments in the consumer-related services and manufacturing sectors, while firm regional demand provided strong incentives for investments in the tourism-related services sectors, such as the airline industry, medical and education services. The conducive financing environment in the banking sector and the capital market also supported the financing of the capital spending. In addition, the commencement and progress of several infrastructure projects, including those under the Economic Transformation Programme (ETP) such as the MY Rapid Transit, had also provided significant positive spillover effects to activities in the domestic manufacturing and services sectors. Reflecting these developments, value-added in the construction sector registered robust growth in 2012.

The Malaysian economy registered a better-than-expected growth of 5.6% in 2012, supported by stronger domestic demand amid the weak external environment

Despite the uncertainties in the external environment, consumption activity remained strong during the year. This was attributable mainly to favourable income growth, the low inflation environment, and supportive financing conditions. Household spending also received further support from the Government transfers to low and middle-income households. Although income in the rural areas was affected by the decline in the prices of rubber and palm oil, this was in part mitigated by the payment of RM15,000 to the FELDA settlers, which amounted to a total of RM1.7 billion.

The improvement in domestic economic activity during the year had resulted in sustained strong growth in the import of goods and services. The strong growth largely reflected the robust imports of capital goods, led by the import of machineries,

Table 1.4

Real GDP by Expenditure (2005=100)

	2011	2012*p*	2011	2012*p*
	Annual change (%)		Contribution to growth (ppt)	
Domestic Demand[1]	**8.2**	**10.6**	**6.9**	**9.2**
Consumption	8.9	7.1	5.4	4.5
Private sector	*7.1*	*7.7*	*3.5*	*3.8*
Public sector	*16.1*	*5.0*	*1.9*	*0.7*
Gross Fixed Capital Formation	6.5	19.9	1.5	4.7
Private sector	*12.2*	*22.0*	*1.5*	*3.0*
Public sector	*-0.3*	*17.1*	*-0.0*	*1.7*
Change in stocks			**-0.7**	**0.3**
Net exports of goods and services	**-7.4**	**-29.4**	**-1.1**	**-3.8**
Exports	*4.2*	*0.1*	*4.3*	*0.1*
Imports	*6.2*	*4.5*	*5.4*	*3.9*
Real Gross Domestic Product (GDP)	**5.1**	**5.6**	**5.1**	**5.6**

[1] Excluding stocks
p Preliminary

Source: Department of Statistics, Malaysia

telecommunications equipment and passenger aircrafts. The import of consumption goods also expanded in line with the stronger growth in consumer spending. The import of services was also driven mainly by higher payments for professional

Table 1.5

Real GDP by Sector (2005=100)

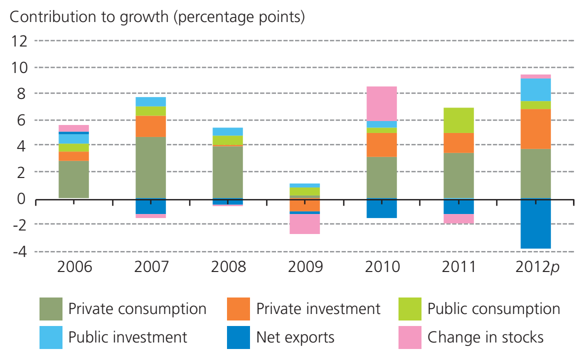
	2011	2012*p*	2011	2012*p*
	Annual change (%)		Contribution to growth (ppt)[1]	
Agriculture	5.9	0.8	0.4	0.1
Mining & quarrying	-5.7	1.4	-0.6	0.1
Manufacturing	4.7	4.8	1.2	1.2
Construction	4.6	18.5	0.1	0.6
Services	7.0	6.4	3.7	3.5
Real Gross Domestic Product (GDP)	**5.1**	**5.6**	**5.1**	**5.6**

[1] Numbers do not add up due to rounding and exclusion of import duties component
p Preliminary

Source: Department of Statistics, Malaysia

Chart 1.5

Real GDP by Expenditure



p Preliminary

Source: Department of Statistics, Malaysia

and construction services, given the strong investment and construction activities during the year. Travel payments were also higher, reflecting the higher number of Malaysians travelling abroad for leisure.

The export of goods and services moderated significantly amidst weaker external demand from both the advanced and regional economies. The lower growth in gross exports was due mainly to the weaker demand for crude commodities and non-electrical and electronics (E&E) products. In the first half of the year, growth in non-E&E exports was supported by regional demand. In the second half of 2012, however, demand from the region for both manufactured and commodity exports declined, following slower growth in the major regional economies. Of significance, the lower demand for crude palm oil and natural rubber coincided with the slowdown in growth in PR China and the recession in the euro area. The contraction in the export of commodities was also compounded by the lower production of crude palm oil and disruptions in the production of natural gas. The export of E&E, while registering a marginal improvement, nevertheless, remained fragile due to the weak investment and consumption trends in the advanced economies. The export of services improved slightly, mainly on account of higher receipts from the provision of computer and information and communications technology (ICT) services, and business and professional services by Malaysian companies. Receipts from transportation services declined sharply, following the moderation in the export of goods and lower tourist arrivals. The slower growth in tourist arrivals also weighed down on receipts from tourism activities for the year.

The higher growth of imports of goods and services relative to exports led net exports of goods and services to register a higher contraction in 2012, resulting in a larger negative contribution to overall GDP growth. This was nevertheless more than offset by the higher contribution from the stronger domestic demand.

Stronger domestic demand

Domestic demand registered a strong expansion of 10.6% in 2012 (2011: 8.2%), and contributed significantly to overall GDP growth. This was attributable to the robust expansion in total gross fixed capital formation and stronger growth in private consumption.

Gross fixed capital formation (GFCF) registered a marked expansion of 19.9% in 2012, underpinned by higher capital spending in both

Table 1.6

External Trade & Services Account

	2011	2012*p*
	Annual change (%)	
Gross exports	**9.2**	**0.6**
Manufactures	3.5	3.1
Electronics and electrical (E&E)	*-3.7*	*-1.8*
Non-E&E	*12.7*	*8.4*
Commodities	28.2	-6.7
Agriculture	*33.0*	*-15.3*
Minerals	*23.8*	*1.9*
Gross imports	**8.5**	**5.9**
Capital goods	8.7	20.5
Intermediate goods	5.5	-3.4
Consumption goods	19.0	11.6
Services exports	**4.6**	**6.4**
Transportation	-1.8	-10.5
Travel	1.9	1.5
Other services	12.8	22.1
Government services n.i.e.	6.2	-17.8
Services imports	**14.0**	**10.5**
Transportation	6.2	1.3
Travel	29.0	12.4
Other services	12.2	18.0
Government services n.i.e.	2.6	-13.8

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Continued Expansion across All Economic Sectors

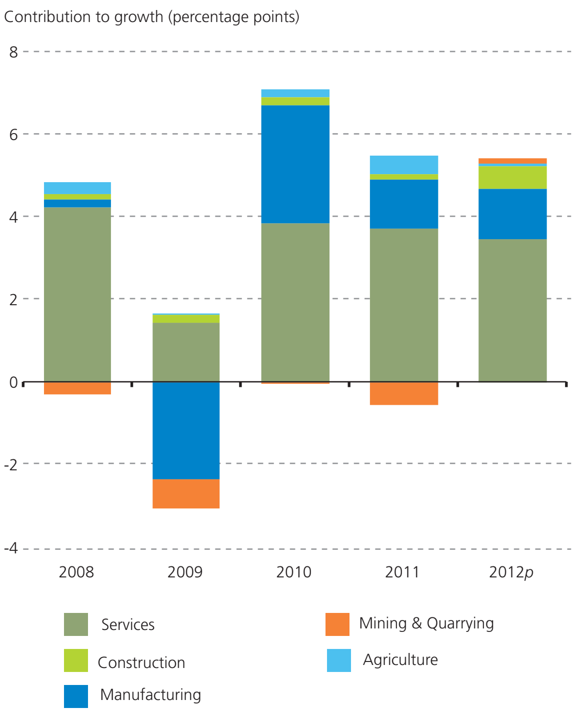
On the supply side, all economic sectors continued to expand in 2012, with significant improvement registered in the construction sector. The robust growth of the construction sector (see Information Box: Strong Performance of the Construction Sector) reflected mainly the significant progress in civil engineering projects. The continued growth in domestic demand, particularly in private sector spending, contributed to growth in domestic-related activities in the services and manufacturing sectors, while the slowdown in external demand affected the performance of trade-related services.

The services sector remained the largest growth contributor (3.5 percentage points of overall GDP growth), as sub-sectors catering to the domestic market, namely retail and telecommunications, benefited from strong consumer spending. The finance and insurance sub-sector recorded higher growth, reflecting continued financing, particularly to businesses, coupled with higher fee-based income and stronger growth of earnings from insurance premiums. Trade-related services, particularly the wholesale and transportation sub-sectors, moderated in tandem with slower external trade activities.

The manufacturing sector expanded by 4.8%, with both the export-and domestic-oriented industries registering better growth. In the export-oriented industry, production in the E&E cluster, particularly in semiconductors, normalised, following the major disruptions arising from the natural disasters in Japan and Thailand in 2011. The continued demand for chemicals and petroleum products, mainly from the region, contributed to the expansion of output of the primary-related cluster. The improvement in the domestic-oriented industries was due to the better performance of the construction- and consumer-related clusters, driven by higher domestic construction activity and robust private consumption.

Chart 1

Real GDP by Economic Activity



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Source: Department of Statistics, Malaysia

The agriculture sector recorded a more moderate growth of 0.8% in 2012. CPO output was affected by deteriorating weather conditions in the first half of the year, leading to a sharp decline in yields. This, however, was offset by strong growth in key food commodities, such as livestock, vegetables and paddy, amid strong domestic demand.

The value-added of the mining sector turned around to record a growth of 1.4%, reflecting the recovery in the production of crude oil and condensates. This was driven mainly by higher output from oil fields located offshore from Peninsular Malaysia and Sabah. The higher oil output was also contributed by the commencement of production from marginal and new oil fields. Output of natural gas declined marginally, affected by a prolonged shutdown of several facilities in Sarawak for maintenance purposes during the middle of the year.

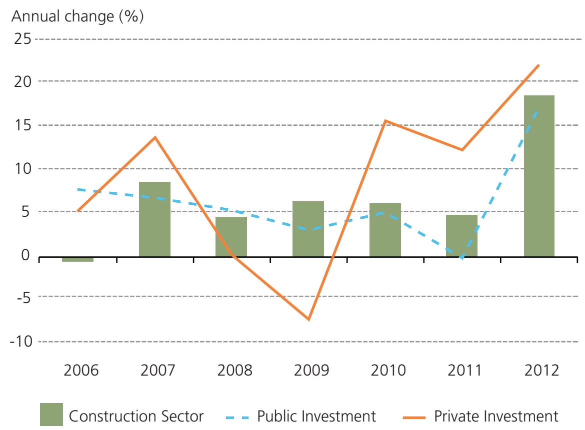
the private and public sectors. Higher capital spending was widespread across the economic sectors, particularly in the services, manufacturing and mining sectors, driven by strong domestic consumption activity, resilient regional demand and firm crude oil prices. Contributing further to the strong investment performance was the commencement and continued progress of several infrastructure projects, including those under the ETP and the regional growth corridors. The investment performance during the year also reflected the steady improvement in the investment climate, following the introduction of measures to further enhance the conditions for doing business in Malaysia.

Investment activity accelerated, supported by strong capital spending by both the private and public sectors

Private investment recorded a double-digit growth of 22%, attributable to capital spending in the consumer-oriented services sectors, domestic-oriented manufacturing sectors, and the implementation of major infrastructure projects, particularly in the mining sector. In the services sector, capital spending was driven by investments in the consumer-related sub-sectors, such as communications and wholesale and retail trade, and benefited from continued high consumer spending and efforts by firms to upgrade existing infrastructure and services. Real estate investment registered rapid expansion with higher residential and non-residential construction, following the strong growth in property launches between 2010 and 2011. Higher capital expenditure was also evident in the transportation services sub-sector, particularly in the airline industry, in response to sustained demand for air travel. Underpinned by firm energy prices and further supported by tax incentives to encourage the development of deepwater and marginal oil fields, mining investment increased significantly, with capital spending channelled mainly into oil field development and enhanced output recovery from existing fields. In the manufacturing sector, investment was attributable mainly to capacity expansion by the domestic-oriented firms, particularly in the consumer-related clusters. Investment by the export-oriented manufacturing firms reflected the implementation of approved

Chart 1.6

Growth in Public and Private Investments versus Construction Sector



Source: Department of Statistics, Malaysia

manufacturing projects in the primary-related clusters, and investments in new technology for product diversification and in new growth areas, namely medical and telecommunications equipment. Investment was also supplemented by investments in automation to enhance productivity and upgrade technology to mitigate the impact of high energy prices and labour costs.

Public investment recorded a strong growth of 17.1%, driven by higher capital spending by public enterprises in the oil and gas sector, and the transportation, utilities, and telecommunications services sub-sectors. Major projects in the oil and gas sector included the exploration and development of new oil and gas fields, the rejuvenation of existing oil fields, and the construction of the regasification terminal in Melaka. Construction of the new terminal for low-cost carriers (KLIA2), aircraft fleet modernisation, the extension of the Light Rail Transit and purchases of equipment to improve urban rail services were the main areas of investment in the transportation sub-sector. Investment in the utilities and telecommunications sub-sectors included the building of power plants and infrastructure to broaden the coverage of the High-Speed Broadband (HSBB) network. The Federal Government's development expenditure in the economic sector was directed mainly to transportation, public utilities and trade and industry (particularly to upgrade infrastructure facilities in industrial areas). In the social services sector, investment was focused mainly on education and health.

Strong Performance of the Construction Sector

In 2012, the construction sector recorded a robust growth of 18.5%, the highest since 1995 (21.1%), driven mainly by the civil engineering sub-sector. This reflected the efforts to improve road and rail accessibility, enhance electricity generation capacity, and increase oil and gas output in Malaysia. Compared to the rapid growth in 1995, existing major projects are more broad-based in terms of sector and geographical location, covering areas beyond the Klang Valley (see Table 1). The strong growth was reflected in higher construction-related financing, manufacturing sales and production activity in 2012 (see Table 2).

Growth in the sector was also contributed by the residential and non-residential sub-sectors. The performance of the residential sub-sector was underpinned by the construction of high-end properties in the Klang Valley, Penang and Johor, following robust launches in 2010 and 2011 (see Table 2). Industrial projects in the Samalaju Industrial Park, tourism projects in Iskandar, and commercial projects in the Klang Valley supported growth in the non-residential sub-sector. Construction of learning and health institutions, such as the University Teknologi Mara campuses and National Cancer Institute, also provided further impetus to this sub-sector.

Table 1

List of Selected Key Civil Engineering Projects

Sector	Projects	Location
Transport	MRT (Sungai Buloh–Kajang)	Klang Valley
	LRT extension	Klang Valley
	KLIA2	Klang Valley
	Second Penang Bridge	Penang
	Seremban-Gemas Double Track	Negeri Sembilan
	Rural Road Programme	Various states
Utilities	Janamanjung Power Plant	Perak
	Tanjung Bin Power Plant	Johor
	Pahang-Selangor Raw Water Transfer[1]	Pahang & Selangor
Oil & Gas	Melaka LNG Regasification Terminal	Melaka
	Sabah-Sarawak Gas Pipeline	Sabah & Sarawak
	Sabah Oil and Gas Terminal	Sabah
	Gumusut-Kakap Deepwater Project	Sabah

[1] Excluding Langat 2 Water Treatment Plant

Source: News flows and Budget 2012

Table 2

Value-added and Selected Indicators for the Construction Sector

Annual change (%)	2008	2009	2010	2011	2012
Value-added	4.4	6.2	6.0	4.6	18.5
Loans disbursed for the construction sector	6.8	16.6	5.5	5.4	20.7
Industrial production					
Other articles of concrete, cement and plaster	*9.5*	*-2.7*	*-7.0*	*5.5*	*6.7*
Structural non-refractory clay and ceramic	*-2.1*	*-14.4*	*2.7*	*-4.5*	*5.1*
Manufacturing sales					
Forging, pressing, stamping and roll-forming metal	*10.6*	*-22.7*	*5.6*	*-0.1*	*15.6*
Treatment and coating of metals and machining[1]	*10.2*	*57.6*	*-19.6*	*-18.4*	*6.6*
Launches of new residential units	-3.4	1.3	11.7	7.1	-11.2[2]

[1] Includes cleaning, welding and cutting of metal, sandblasting and boring
[2] 1Q-3Q 2012 (preliminary)

Source: Bank Negara Malaysia, Department of Statistics, Malaysia and National Property Information Centre

Overall, growth of GFCF was broad-based, with higher growth in both investment in structures and machinery and equipment (46.5% and 45% share to GFCF respectively). Investment in structures registered rapid expansion of 27.2% in 2012 (2011: 4.9%), and was evident in all construction segments, namely civil engineering, residential and non-residential.

In addition, capital spending in machinery and equipment grew by 15.5% in 2012 (2011: 4.2%), as reflected in the increase in the import of capital goods. The import of capital goods expanded by 20.5% in 2012 (2011: 8.7%), supported by the import of machinery for manufacturing (2012: 22.3%; 2011: 3.3%), telecommunications equipment (2012: 16.4%; 2011: 12.3%), mining

Stable Labour Market Conditions

Employment growth was higher at 3.6% (2011: 3.2%), with a net addition of 438,800 jobs. Gains in employment were registered mostly in the services and agriculture sectors. The unemployment rate declined marginally to 3% (2011: 3.1%).

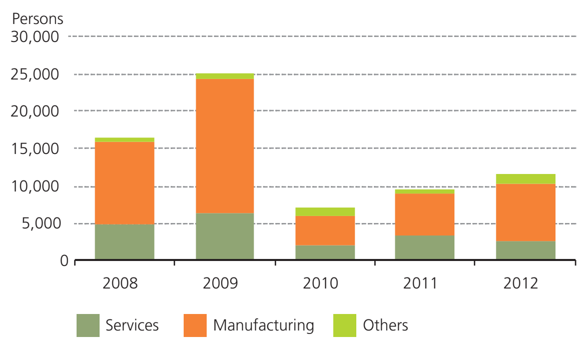
Total retrenchments increased to 11,494 persons from 9,450 in the previous year, due mainly to higher layoffs in the manufacturing sector (7,616 persons; 2011: 5,635 persons). The agriculture and services sectors, however, recorded lower retrenchments during the year.

Based on a survey conducted by Bank Negara Malaysia, average nominal salary in the private sector increased by 5% in 2012 (2011: 4%), with average increments of 3.4% and 5.4% in the manufacturing and non-manufacturing sectors respectively (2011: 2.2% and 4.5% respectively). Increments for executives grew at a higher rate of 5.2% (2011: 3.7%). Non-executives also received a higher increment of 4.7% (2011: 3.9%).

As at end-2012, the number of registered foreign workers[1] in Malaysia decreased marginally to 1,571,589 workers (end-2011: 1,573,061 workers). Foreign workers accounted for 12.4% of employment in Malaysia, and were mostly employed in the manufacturing (39%), agriculture (29%) and construction (14%) sectors.

Chart 1

Retrenchment by Sector



Note: Others refer to the agriculture, mining and construction sectors

Source: Ministry of Human Resources

Table 1

Selected Labour Market Indicators

	2008	2009	2010	2011	2012
Employment ('000 persons)	10,659.2	10,899.0	11,899.5	12,284.4	12,723.2
Labour force ('000 persons)	11,028.1	11,315.3	12,303.9	12,675.8	13,119.6
Unemployment rate (% of labour force)	3.3	3.7	3.3	3.1	3.0
Retrenchments (persons)	16,469	25,064	7,085	9,450	11,494

Note: Beginning 2010, employment and labour force data was based on new population estimates and cannot be directly compared to previous years' data

Source: Department of Statistics, Malaysia and Ministry of Human Resources

[1] Excludes expatriates and foreign workers legalised by the 6P Programme.

and construction equipment (2012: 20.5%; 2011: 35.2%) and transport equipment (2012: 43.1%; 2011: 14.9%).

Despite the more adverse external environment, foreign direct investment continued to register a sizeable net inflow, albeit to a lesser extent. The inflows were broad-based, and were channelled into both the domestic- and export-oriented sectors. During the year, there were also fewer mergers and acquisitions of Malaysian companies by the multi-national corporations, due to the uncertainties in global growth prospects. Of importance, there were significant inflows into high-growth areas, such as the oil and gas sector and the communication services sub-sector. Some of the funds were also for projects under the ETP.

Private consumption strengthened, underpinned by income growth, Government transfers and supportive financing conditions

Private consumption registered a healthy growth of 7.7% in 2012 (2011: 7.1%). The strong performance was attributable to three main factors. First is the favourable income growth amid the stable labour market conditions during the year. The low unemployment rate (3%; 2011: 3.1%) and the high demand for labour had led to higher nominal wage growth in the private sector (see information box: Stable Labour Market Conditions). Civil servants and pensioners also received higher incomes under the improved Malaysian Remuneration Scheme (SSM). Nevertheless, income in the rural areas faced downward pressures as rubber and palm oil prices declined by 29.3% (2011: +30.9%) and 13% (2011: +21.1%) respectively. However, for the FELDA settlers, this was mitigated in part by the payment of RM15,000, which had been disbursed in three phases to each FELDA settler, in conjunction with the listing of FELDA Global Ventures Holdings. This amounted to a total of RM1.7 billion.

Second, private consumption benefited from the Government transfers to low- and middle-income households during the year. These included the Bantuan Rakyat 1Malaysia (BR1M), Baucar Buku 1Malaysia (BB1M) and the schooling assistance for primary and secondary students. These targeted income transfers had sizeable effects on aggregate private consumption, as the benefiting households generally have relatively high marginal propensity to consume (see box article: Variations in Household Propensity to Consume across Income Segments).

Finally, financing conditions remained supportive of consumer spending in 2012, with the average lending rate (ALR) on new loans to households declining to 4.6% (2011: 4.8%). Although households were subjected to stricter criteria for loan applications following the introduction of the Guidelines on Responsible Financing that had come into effect on 1 January 2012, creditworthy households continued to have access to financing. Total bank financing to households grew by 11.6% in 2012 (2011: 12.9%).

Public consumption recorded a more moderate increase of 5% in 2012, due mainly to the significant moderation in expenditure on supplies and services as the Government continued with its fiscal consolidation efforts. Expenditure on emoluments remained high due to the higher salary increments and bonus payments to the civil servants, which also contributed to sustaining private consumption during the year.

EXTERNAL SECTOR

Malaysia's external sector remained resilient amid continued uncertainties and challenges in the global economic and financial environment. The overall balance of payments (BOP) remained strong. The current account surplus was more than adequate to meet the net outflows in the financial account. The level of reserves remained at comfortable levels, and was more than sufficient to meet the short-term obligations and provide a buffer against volatile short-term capital flows.

Lower current account surplus amidst weak external demand and strong expansion in domestic activity

Malaysia's current account surplus was lower at RM60 billion in 2012 (2011: RM97.1 billion), reflecting the cyclical and structural adjustments that are taking place in both the global and domestic economy. This development can be assessed from two inter-related perspectives – namely, in terms of Malaysia's international trade performance, and the national saving-investment gap.

Table 1.7

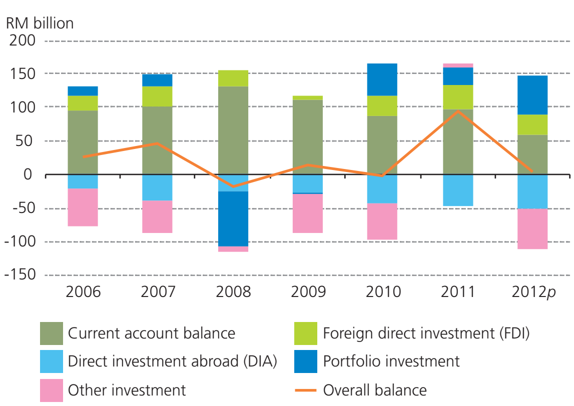
Balance of Payments

Item	2011			2012p		
	+	-	Net	+	-	Net
	RM billion					
Goods	696.6	548.5	148.1	702.9	577.7	125.2
Services	110.1	118.1	-8.0	117.1	130.5	-13.4
Balance on goods and services	**806.7**	**666.6**	**140.1**	**820.0**	**708.2**	**111.9**
Income	52.4	74.4	-22.0	42.3	76.0	-33.7
Current transfers	4.7	25.6	-21.0	6.9	25.1	-18.2
Balance on current account	**863.8**	**766.7**	**97.1**	**869.2**	**809.2**	**60.0**
% of GNI			**11.3**			**6.6**
Capital account			-0.2			0.1
Financial account			22.3			-22.5
Direct investment			-10.1			-21.9
Abroad			*-46.7*			*-51.0*
In Malaysia			*36.6*			*29.1*
Portfolio investment			25.8			59.2
Financial derivatives			-0.1			0.9
Other investment			6.6			-60.7
Balance on capital and financial accounts			**22.1**			**-22.5**
Errors and omissions			-24.5			-33.6
of which:						
Foreign exchange revaluation gain (+) or loss (-)			*7.6*			*-7.7*
Net E&O as % of total trade			*-2.6*			*-2.0*
Overall balance			**94.7**			**3.9**
Bank Negara Malaysia international reserves, net			**423.3**			**427.2**
USD billion equivalent			**133.6**			**139.7**

p Preliminary
Note: Numbers may not necessarily add up due to rounding
Source: Department of Statistics, Malaysia

Chart 1.7

Balance of Payments (BOP)



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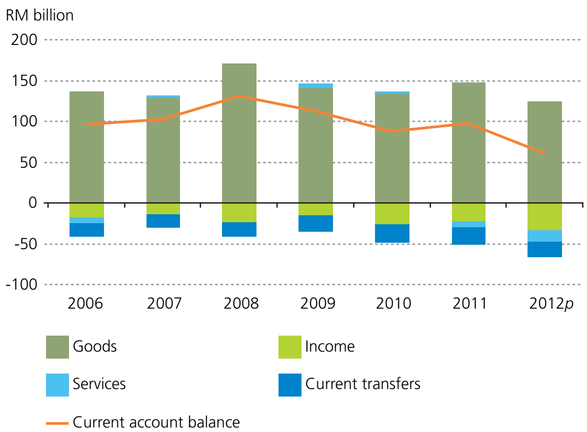
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Malaysia's external sector remained resilient despite continued uncertainties and challenges in the global environment

From the international trade perspective, the lower current account surplus was due mainly to the lower goods surplus amid larger deficits in the services and income accounts. In the goods account, the deceleration in gross exports was due to the weak external demand and lower commodity prices. While demand for manufactured goods from the advanced economies was weak throughout the year, the

Chart 1.8

Current Account



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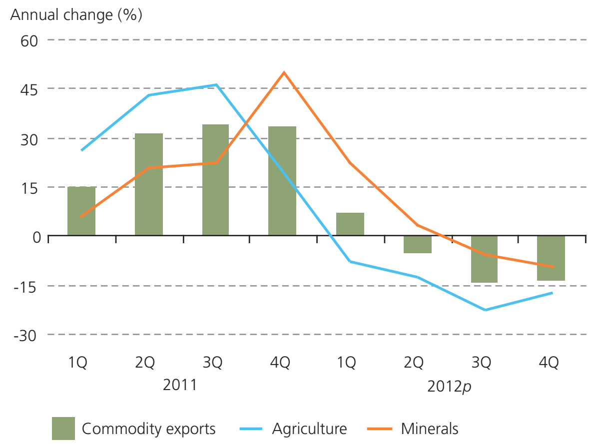
Source : Department of Statistics, Malaysia

Chart 1.9

Commodity Export Performance



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Source: Department of Statistics, Malaysia and Bank Negara Malaysia

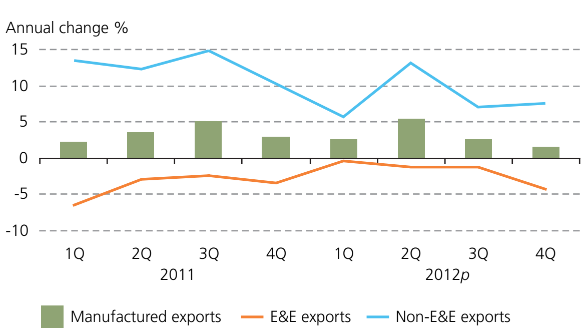
export of non-E&E products were supported by strong regional demand, especially in the first half of the year. However, slower economic growth in the region in the second half of the year led to a moderation in demand for non-E&E products and commodities. The lower demand for non-E&E products and commodities was further compounded by the decline in the prices of major commodities, particularly crude palm oil and natural gas. In contrast, exports of E&E products registered a smaller contraction, arising from the normalisation of E&E production, arising from the supply disruption following the severe floods in Thailand in 2011.

There was strong growth in the import of capital and consumption goods following the improvement in domestic demand. In particular, the robust growth in domestic investment activity led to a marked increase in the import of machinery, telecommunications equipment and passenger aircrafts. The strength in consumer spending activity saw continued strong growth in the import of consumption goods, particularly the import of durable and semi-durable consumer goods. The import of intermediate goods, which are used mostly as inputs for manufactured exports, however, registered a contraction.

The services account registered a larger deficit due mainly to the higher deficit in the transportation account and lower net receipts from the travel account. The larger drag from the transportation account reflected the higher payments for imported freight services, in line with the strong import growth. Tourism receipts were lower in 2012

Chart 1.10

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



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Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.11

Imports by Category

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

as tourist arrivals into Malaysia grew at a more moderate pace, reflecting the slower growth in the regional economies.

The larger deficit in the income account reflected the higher income accrued to foreign companies in Malaysia, mainly in the manufacturing and mining sectors, and financial services sub-sector. On the other hand, income accrued to Malaysian companies investing abroad was lower in 2012, following the increased global uncertainty and lower commodity prices.

The lower current account surplus also reflected the lower surplus of national savings over domestic investment spending. Public sector savings increased by 10.1% to RM71.2 billion or 7.9% of gross national income (7.5% of gross national income (GNI) in 2011). Meanwhile, private sector savings declined by 5.3% to RM227.5 billion or 25.2% of GNI in 2012 (2011: RM240.2 billion or 28%). Overall, gross national savings (GNS) declined by 2% to RM298.7 billion in 2012. Nevertheless, the ratio of GNS to GNI remained high at 33% (2011: 35.5%). Given the decline in GNS and the faster pace of growth in gross domestic investment, the savings-investment surplus declined to RM60 billion or 6.6% of GNI in 2012 (2011: RM97.1 billion or 11.3%).

Continued two-way flows of capital

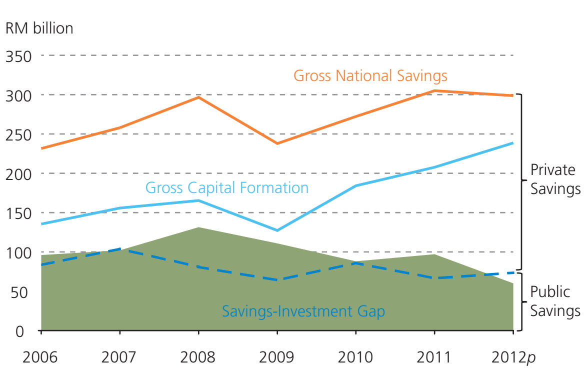
Given the excess global liquidity, Malaysia continued to experience two-way financial flows in 2012, with inflows of foreign funds attracted mainly to the country's resilient growth prospects. These inflows were almost entirely offset by resident outflows, reflecting the increasing interest and ability on the part of domestic financial institutions and companies to expand their global and regional presence by acquiring foreign assets and diversifying their investments abroad.

Continued inflows of FDI and portfolio funds amidst higher outflows of DIA

Foreign direct investment (FDI) continued to register a sizeable net inflow of RM29.1 billion or 3.1% of GDP (2011: RM36.6 billion) in 2012. FDI inflows were mainly in the form of equity capital investment and higher corporate profitability during the year. Sizeable earnings were retained by the multi-national corporations for re-investment within the domestic economy. The export-oriented sector and other sectors directly linked to external demand, however, experienced a slight moderation in FDI inflows, given the increased uncertainties surrounding global growth prospects. The manufacturing sector, in particular, had been affected by the slowdown in global trade, given its close integration with the regional supply chain network. FDI into the finance and insurance sub-sector moderated as well, reflecting the volatility experienced in the global financial markets. Nevertheless, inflows into the oil and gas sector and the communications sub-sector registered increases, following the steady implementation of

Chart 1.12

Gross National Savings & Savings-Investment Gap



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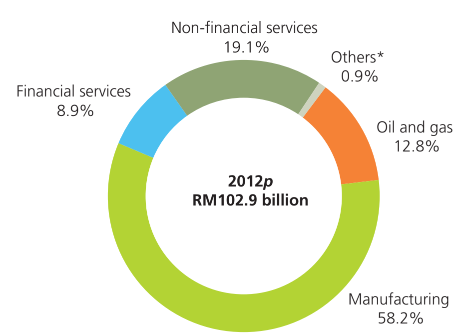
Source: Department of Statistics, Malaysia
Ministry of Finance, Malaysia

Chart 1.13

Gross FDI Inflows by Sectors



* Refers to agriculture and construction sectors
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Source: Department of Statistics, Malaysia

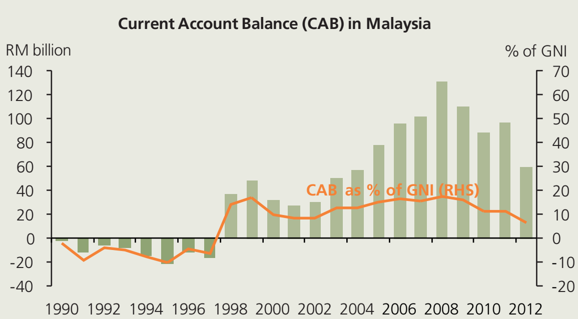
Current Account Balance in Malaysia: Recent Developments and Outlook

Introduction

Since the Asian financial crisis, Malaysia's current account balance has consistently recorded a surplus. Exports of goods have outpaced imports, and have more than offset the deficit in the services and income accounts. The strong performance of Malaysia's exports was due, in large part, to the broad diversification of products and the expansion of trade in new markets. In particular, commodity exports, which have low import content, played an important role in contributing to the increase in the current account surplus. In line with rising commodity prices in 2008, the current account surplus peaked at 17.6% of GNI in 2008. The Global Financial Crisis (GFC), however, marked the beginning of a moderating trend in the current account surplus (Chart 1). Weaker global demand and lower commodity prices have resulted in lower exports for Malaysia in recent years. Imports, on the other hand, increased significantly, driven by stronger domestic demand. The outcome of these trends has been the narrowing of the savings-investment surplus.

Chart 1

Current Account Balance Narrowing After More Than a Decade of Surplus



Source: Department of Statistics, Malaysia

Although the current account balance reflects the excess of exports over imports, it also mirrors the savings-investment surplus in an economy. In other words, the current account balance can be assessed in terms of both the international trade perspective and the savings-investment behaviour in an economy. In a closed economy, investment activity is funded solely from domestic savings. However, in an open economy such as Malaysia, investment activity may be funded by domestic or foreign savings. If an economy is saving more than it is investing, the economy would register a current account surplus. These excess savings can be used to accumulate reserves to provide a buffer against external vulnerabilities or channelled abroad to finance the consumption and investment activities of other economies, either in the form of extension of loans or investments abroad. In contrast, a current account deficit would indicate that an economy is investing more than it is saving. In this case, the economy would either borrow funds from abroad or receive inflows of foreign investment to finance its domestic consumption and investment requirements.

This box article explores the recent narrowing trend of the current account surplus from the two interrelated perspectives, namely the international trade and the savings-investment position.

I. International trade perspective

In the international trade perspective, developments in the current account balance can be viewed in terms of the changes in the exports and imports of goods and services, and the net balances of income and current transfers. In Malaysia, the current account surplus has been driven mainly by the surplus in the goods account, while the other components have remained in deficit[1] (Chart 2).

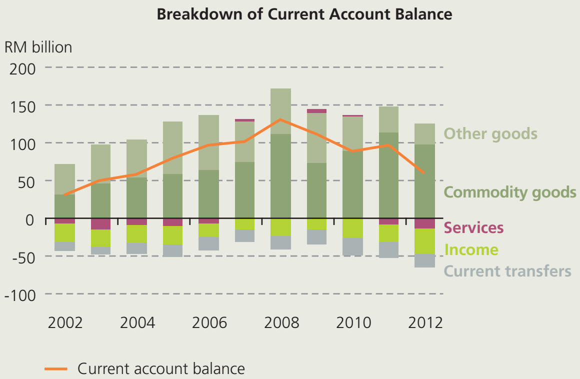
The goods surplus widened significantly after the Asian financial crisis as the growth of imports weakened following a substantial decline in domestic investment activity. At the same time, gross exports continued to expand[2], underpinned by the diversification in export products and markets. However, following the GFC, Malaysia's exports have expanded at a more modest pace. The weak

[1] In 2007-2010, the services account registered small surpluses.

[2] Gross exports expanded by an annual average rate of 8.7% in 2000-2008.

Chart 2

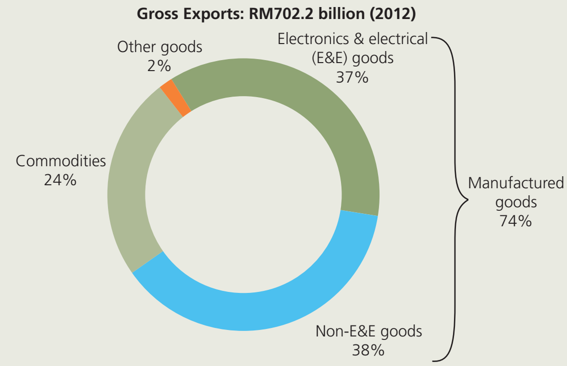
Current Account Surplus Narrowed Due Mainly to Lower Goods Surplus



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 3

Exports of Manufactured Goods Account for the Bulk of Gross Exports



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

global economy has reduced the demand for Malaysia's manufactured and commodity exports (74% and 24% share of gross exports respectively, Chart 3) and this has been further compounded by lower commodity prices.

Conversely, amid stronger domestic demand, imports have risen steadily since 2009 (Chart 4), due mainly to import of capital and consumption goods (16% and 8% share of gross imports respectively). Reflecting the increase in investment activity by both the public and private sectors, capital imports rose at an average annual rate of 13.8% during 2010-2012. Similarly, import of consumption goods increased by an average of 13.4% over the same period, supported by stronger domestic consumption, and to a smaller extent, the appreciation of the ringgit. Import of intermediate goods (61% of gross imports, Chart 5), on the other hand, recorded a moderation in growth, given that the bulk of these imports are used as inputs for the production of manufactured exports. This close relationship between manufactured exports and intermediate imports acts as an automatic stabiliser for the current account balance.

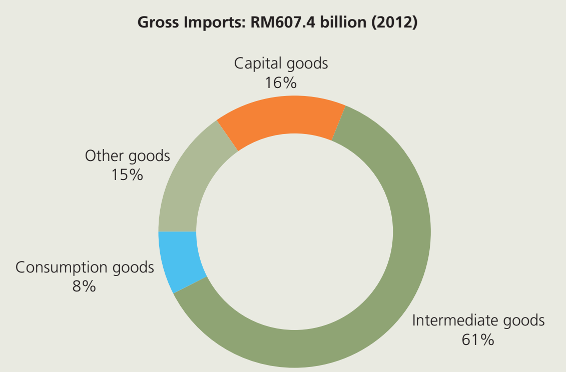
Chart 4

Growth of Imports Has Outpaced Exports in Recent Years

Source: Department of Statistics, Malaysia

Chart 5

Intermediate Imports Account for 61% of Gross Imports

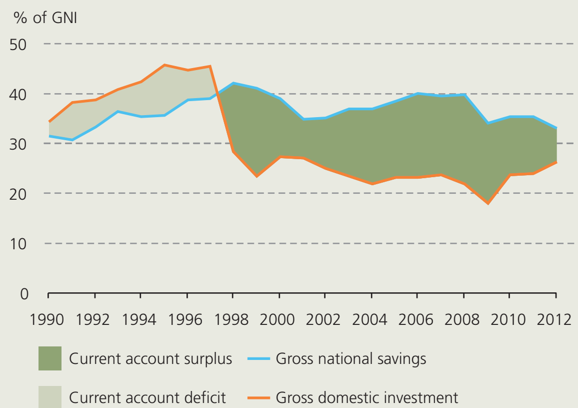


Source: Department of Statistics, Malaysia

Chart 6

Current Account Surplus Narrowed as Investment Increased Amid Lower Savings

Savings-Investment Gap in Malaysia

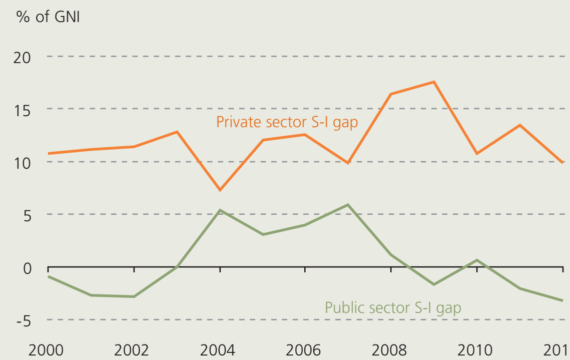


Source: Department of Statistics, Malaysia

Chart 7

Private Sector Remains a Net Saver while the Public Sector Has Turned into a Net Investor in Recent Years

Savings-Investment (S-I) Gap by Public and Private Sectors



Source: Department of Statistics, Malaysia

II. Savings-investment gap perspective

The current account balance is also an outcome of the inter-temporal investment and consumption decisions of both the public and private sectors in an economy. In the case of Malaysia, the sustained current account surplus since the Asian financial crisis reflected the sharp decline in investment amid a sustained high level of savings. In contrast, beginning 2010, gross fixed capital formation has been on the rise. This upturn in investment activity has resulted in a narrowing of the savings-investment gap (Chart 6).

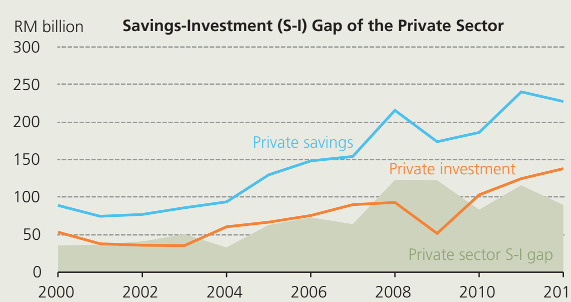
As shown in Chart 7, Malaysia's savings-investment surplus has been driven mainly by the private sector, which has constantly registered an excess of savings over investment in the last decade. Prior to the GFC, the surplus of the private sector was attributable to both the elevated savings rate and low growth of investment (Chart 8). Nevertheless, in 2012, as investment strengthened while savings declined, the savings-investment surplus of the private sector narrowed.

Private investment has emerged as a major contributor to growth in recent years on account of strong corporate profits, high capacity utilisation, continued access to financing and the favourable investment climate[3]. In particular, major investments have been undertaken in the oil and gas, infrastructure, manufacturing and services sectors. Private investment has also been spurred by the implementation of the Economic Transformation Programme, which has catalysed investments in new growth areas, high value-added industries and infrastructure. Of significance, the rise of private investment is expected to enhance Malaysia's productive capacity, improve efficiency, and drive the

Chart 8

Private Savings Moderated while Private Investment Expanded

Savings-Investment (S-I) Gap of the Private Sector



Source: Department of Statistics, Malaysia

[3] For a detailed discussion, please refer to the box article entitled 'Private Investment in Malaysia: Drivers and Sustainability".

growth of high value-added exports in the future. In the near term, it is expected that the expansion in investment activity will contribute to a further narrowing in the current account surplus.

The high level of savings by the corporate sector and households is attributable to two main factors. First, corporate profits have increased following sustained external demand for resource-based products, especially prior to the GFC. Second, mandatory contributions to the Employee Provident Fund, coupled with sustained wage growth, have supported household savings. Going forward, the savings rate is expected to remain elevated amid firm income growth.

As for the public sector[4], the savings-investment gap registered a small surplus, averaging 3.2% of GNI[5], in 2003-2008 (Chart 9). This surplus has turned into a deficit since 2009, when public expenditure increased significantly following the introduction of the two economic stimulus packages by the Federal Government to mitigate the impact of the global economic slowdown. The sustained capital spending by public enterprises have also contributed to the expansion in public investment. The public sector savings-investment gap widened in 2011 and 2012.

Going forward, given the Government's fiscal consolidation efforts through expenditure rationalisation and improvements in revenue collection, savings of the Federal Government are expected to remain firm. The operating surpluses of the public enterprises, however, would depend mainly on the strength of the recovery in the global economy and the resilience of domestic demand.

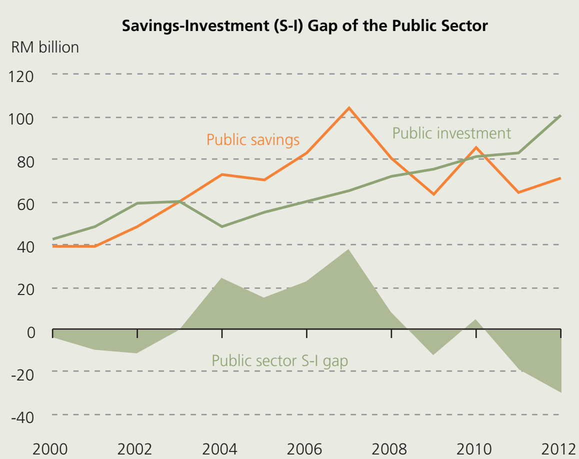
Conclusion

The recent narrowing of the current account surplus in Malaysia and several other Asian countries is consistent with the ongoing global rebalancing, underpinned by shifts in the sources of growth in the regional economies. For Malaysia, resilient domestic demand has supported the strong growth of imports, in turn outpacing exports which has been weighed down by weak external demand and lower commodity prices. Similarly, the stronger growth in investment activity and lower savings have resulted in a narrower current account surplus.

Going forward, amid a modest recovery in global growth and the continued expansion in domestic demand, Malaysia's current account surplus can be expected to narrow in the near term. As a highly open economy, changes in Malaysia's current account, particularly exports, will be highly dependent on factors that are exogenous to the economy. On the domestic front, the ongoing fiscal consolidation by the Government is expected to improve public savings, while private savings will be a function of the strength of private consumption. Over the longer term, the ongoing structural changes in the economy will be a key factor in determining the future path of Malaysia's current account balance. The continued investment in new growth areas and high value-added industries is expected to further diversify Malaysia's exports and enhance its areas of comparative advantage, thereby supporting export growth and the sustainability of the current account balance.

Chart 9

Public Savings Declined Amid Continued Rise in Public Investment



Source: Department of Statistics, Malaysia

[4] Public sector refers to the General Government and public enterprises.
[5] Public sector registered a deficit of 2.2% of GNI in 2000-2002.

the ETP projects and continued inflows into the consumer-related sectors. The diversified profile of the FDI inflows had facilitated to contain Malaysia's exposure to external risks. While the export-oriented manufacturing sector continued to be the largest recipient of FDI (58% of gross FDI inflows), the mining sector increased its share of FDI inflows to 13%. The services sector received 28% of the gross inflows of FDI in 2012.

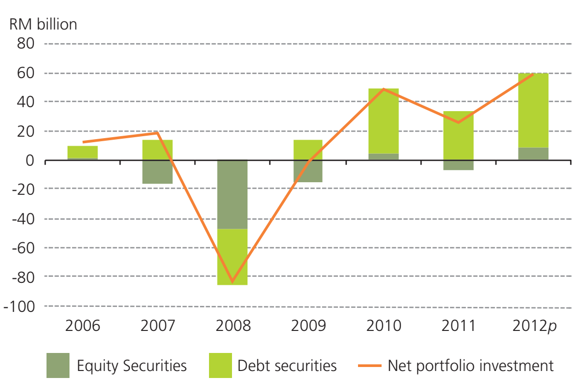
After a period of significant outflows in the second half of 2011, inflows of foreign portfolio funds resumed in 2012, registering significantly higher net inflows during the year (RM59.2 billion; 2011: RM25.8 billion). These inflows reflected mainly higher purchases of debt securities, particularly Bank Negara bills and notes and ringgit-denominated Government bonds. Net foreign inflows into equities remained modest.

Notwithstanding the higher net inflows of portfolio funds, there was a significant degree of volatility in these flows during the year, particularly in relation to events surrounding the European debt crisis. Market sentiments were also partly affected by economic developments in the US and China, amidst uncertainty on the pace of the sluggish US recovery and the fiscal cliff, and concerns over the economic outlook in China. In the first quarter of the year, improved market sentiments brought about a significant resumption of foreign capital inflows, particularly into ringgit-denominated debt securities. However, in the second quarter of the year, portfolio investments registered a small net outflow arising from the liquidation of short-term debt securities by non-residents, which was in response to the deterioration in financial market sentiments following concerns over the health of the Spanish banking system. Nonetheless, portfolio inflows resumed strongly in the second half of the year as investor sentiment recovered. Beyond Malaysia's favourable growth prospects and sound macroeconomic and financial conditions, the higher inflows of portfolio funds were also driven by investors' continued search for higher returns amidst the expansive global liquidity conditions following the additional monetary policy easing by the advanced economies. To a lesser extent, expectations for a further appreciation of the regional currencies were also a contributing factor to these capital inflows.

It is noteworthy that the non-resident inflows were offset by resident outflows through two main channels, namely via higher direct investment abroad (DIA) and outflows from the Other Investment account. DIA outflows amounted to RM51 billion in 2012 (2011: -RM46.7 billion), mainly reflecting higher outflows of equity capital and extensions of loans to subsidiaries abroad. DIA were mainly undertaken by companies in the services sector (60% of gross DIA outflows), particularly in the finance and insurance, and wholesale and retail trade sub-sectors. Companies in the oil and gas and manufacturing sectors also continued to be large contributors of DIA. Compared to its steady trend in the past, the relatively higher DIA was largely due to a one-off strategic acquisition of a Canadian-based energy company by a domestic oil and gas firm. Profitability of these investments abroad was sizeable during the year given that the bulk of investments was undertaken in the Asian emerging economies,

Chart 1.14

Portfolio Investment

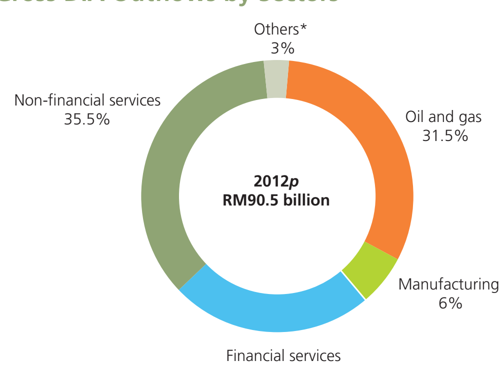


p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.15

Gross DIA Outflows by Sectors



* Refers to agriculture and construction sectors
p Preliminary

Source: Department of Statistics, Malaysia

where economic growth and business activity remains resilient.

Outflows from Other Investment reflected primarily outflows arising from continued net extensions of trade credits. The relatively stronger balance sheet positions continued to enable Malaysian exporters to extend trade credits to counterparts abroad amidst the weak global environment. There were also considerable outflows arising from the domestic banking institutions that placed assets abroad with foreign counterparties. This reflected the banks' liquidity and asset-liability management strategies, amid an environment of ample liquidity within the domestic financial system.

International reserves increased further and provided an adequate buffer against external shocks

The international reserves of Bank Negara Malaysia increased by RM3.9 billion to RM427.2 billion (equivalent to USD139.7 billion) as at 31 December 2012. The increase reflected the continued current account surplus, which more than offset net capital outflows. It has also taken into account the cumulative unrealised foreign exchange revaluation loss of RM7.7 billion, following the strengthening of the ringgit against selected major and regional currencies in 2012.

As at 28 February 2013, the reserves level amounted to RM429 billion (equivalent to USD140.3 billion), which is adequate to finance 9.5 months of retained imports and is 4.6 times the short-term external debt.

External debt declined

Malaysia's external debt declined to RM252.8 billion (USD81.7 billion) as at end-2012 (2011: RM257.4 billion), equivalent to 28% of GNI (2011: 30% of GNI). During the year, the medium- and long-term external debt of the private sector increased. This, however, was largely offset by net repayment of the public sector's medium- and long-term external debt and net repayment of short-term interbank borrowings. The appreciation of the ringgit against some of the major currencies during the year also contributed to the lower external debt in ringgit terms.

Overall, Malaysia's external debt profile continued to be skewed towards a longer maturity structure, with medium- and long-term debt accounting for 63.2% of total external debt. The debt service ratio remained manageable at 10.2% of exports of goods and services. Moreover, about two-thirds of private sector borrowings were sourced from offshore shareholders, parents and associated companies in the form of inter-company loans. These loans were generally of longer maturities, with more flexible terms.

Malaysia has greater latitude to effectively manage external risks

As a small and highly open economy, Malaysia is not insulated from the risks arising from the more challenging global economic landscape. Nevertheless, the resilience of Malaysia's external sector has accorded the country with greater policy flexibility in managing external shocks. The prudent macroeconomic management and policy reforms that have been implemented over the years has strengthened Malaysia's macroeconomic fundamentals and enhanced its growth prospects, while a wider range of money market instruments at the disposal of the Bank has allowed for a more effective conduct of monetary policy. The managed float exchange rate regime has also continued to

Table 1.8

Outstanding External Debt

	2011 RM billion	2012*p* RM billion	2011 USD billion	2012*p* USD billion
Total debt	**257.4**	**252.8**	**80.4**	**81.7**
Medium- and long-term	153.5	159.8	48.0	51.7
Short-term[1]	103.9	93.0	32.4	30.1
As % of total debt	*40.4*	*36.8*		
As % of net international reserves	*24.5*	*21.8*		
As % of GNI				
Total debt	30.0	28.0		
Medium- and long-term debt	17.9	17.7		
As % of exports of goods and services				
Total debt	31.9	30.8		
Medium- and long-term debt	19.0	19.5		
Debt service ratio (%)[2]	**10.3**	**10.2**		

[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

Changing Drivers of Economic Growth in Malaysia

Introduction

Malaysia has witnessed strong sustained growth over the last three decades, growing at an average annual rate of 5.8%. This sustained growth performance has been accompanied by significant structural shifts in the economy, reflecting the transformation of the Malaysian economy amid the changing global and domestic environment. From a primary producer with a gradual industrialisation strategy, the Malaysian economy has undergone transformation into a highly-open economy through greater trade and financial integration since the late 1970s. As a result, Malaysia's trade openness is among the highest in the region, reaching a peak of 192% of GDP in 2000. More recently however, strengthening domestic demand has become a key driver of growth, underpinning the continued resilience of the economy despite the challenging external environment.

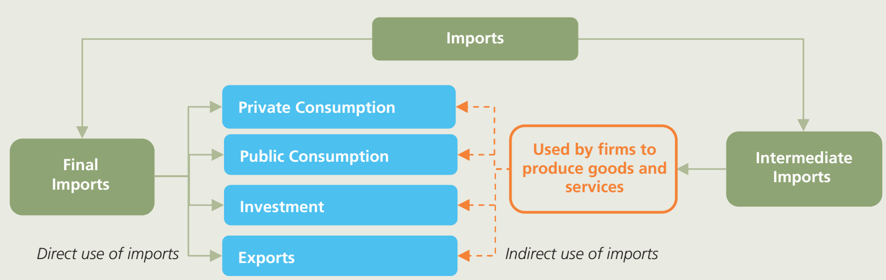
This article aims to shed light on the structural changes in the Malaysian economy in terms of the drivers of its growth. The analysis finds quantitative evidence that while Malaysia remains a highly-open economy, domestic demand has increasingly become an important driver of growth in recent years. This has in turn induced structural changes within the economy, with stronger growth and job creation in the domestic-oriented industries.

Methodology: An Alternative Approach in Estimating the Contribution to Growth

Demand in the economy takes two forms: Domestic demand (private consumption, public consumption and total investment) and external demand (exports). Imports, on the other hand, represent a leakage from the economy. For example, a good that is consumed domestically could be directly imported or produced domestically but contain imported content used in its production (Chart 1). These imports help satisfy domestic demand but do not themselves represent value-added by domestic industries. Domestic demand and exports contain varying degrees of import content which must therefore be subtracted from each of the demand components to better understand their net contribution to the economy.

Chart 1

Final Use of Imports

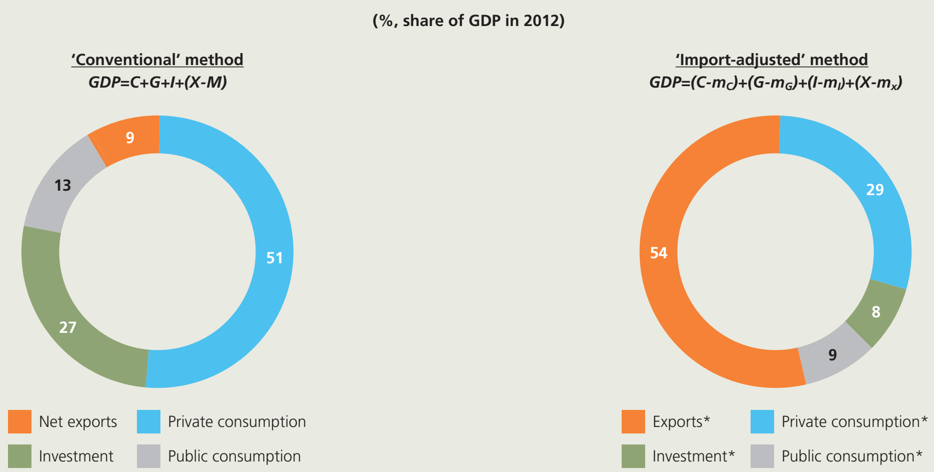


In determining the sources of growth, the quick conventional method is to use private consumption, investment, public consumption and net exports as a share to GDP. The advantages of this approach lie in its simplicity and the fact that net exports immediately highlight the net contribution of foreign trade to economic growth. However, a limitation of this method is that it is not representative of the true relative contribution of domestic and external demand in driving growth. Imports that help satisfy domestic demand are not netted out from domestic demand, overstating the true impact of domestic demand on domestic value-added.

For a more accurate estimation of the net effect of each demand component on value-added, it is necessary to remove, from each component of demand, its import content. In essence, this can be done by decomposing total imports according to the expenditure component that they were eventually intended for. The input-output cumulative production structure[1] (CPS) technique estimates the import content of the goods and services associated with each component of final demand for the economy. The difference between a particular final demand component and its import content is used to derive the net contribution of each demand component to overall GDP. For example, the net contribution of private consumption to GDP is private consumption minus both final imports for consumption and intermediate imports used by domestic firms to produce goods and services that are consumed. Chart 2 compares the conventional method and the import-adjusted method, highlighting the differences in interpretations of the role of domestic demand when each method is used.

Chart 2

Comparison between Import-Adjusted GDP by Expenditure Component with Conventional Practice



*Net of imports

Where C= private consumption, G= public consumption, I= investment, X= exports, M= total imports, M_C= imports for C, m_G= imports for G, m_I= imports for I, and m_X= imports for X

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

Results: Transformation of the Malaysian Economy

1970s to early 2000s: Towards a more export-oriented economy

Applying the import-adjusted method to the various components of demand in the economy[2], there is a clear indication that within three decades, the Malaysian economy had become increasingly open. Chart 3 shows the evolution of the net contribution of each demand component to GDP since 1978. The net contribution of exports to GDP almost doubled from 36% in 1978 to 61% in 2005. In other words, by 2005, external demand accounted for 61% of domestic value-added created in the economy. This increasing openness meant that the Malaysian economy was more dependent on international demand in 2005 than it was in the 1970s.

Mid-2000s to present: Emerging strength of domestic demand

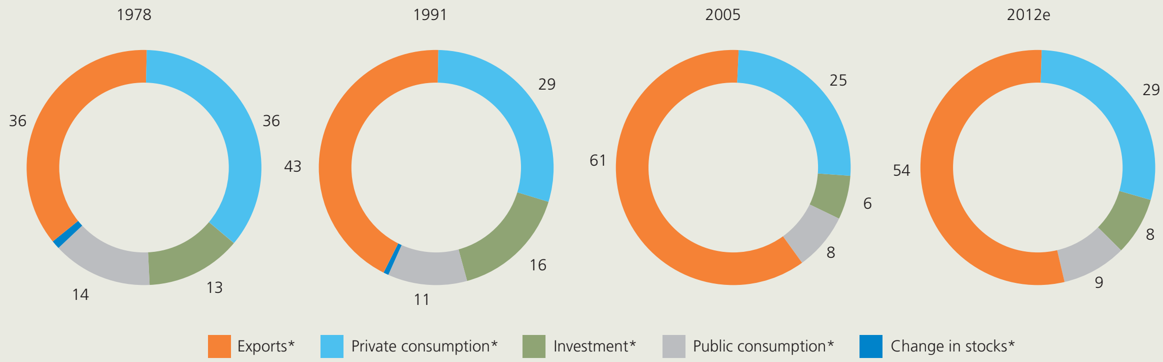
Since 2005, domestic demand has emerged as an increasingly important driver of growth. Estimates for 2012 in Chart 3 suggest that the net contribution of exports to GDP has fallen to 54% while domestic demand has increased to 46%. To further analyse this trend, the import-adjusted method is extended[3] to estimate the net contributions of domestic and external demand to GDP from 2005

[1] Klein, 1983.
[2] Using input-output tables published by the Department of Statistics, Malaysia for the years 1978, 1991 and 2005.
[3] Based on Kranendonk and Verbruggen, 2005, 2008.

Chart 3

Evolution of Malaysia's GDP by Import-adjusted Components

(% share of GDP in 2012)



* Net of imports

e Estimates based on 2005 Input-Output table

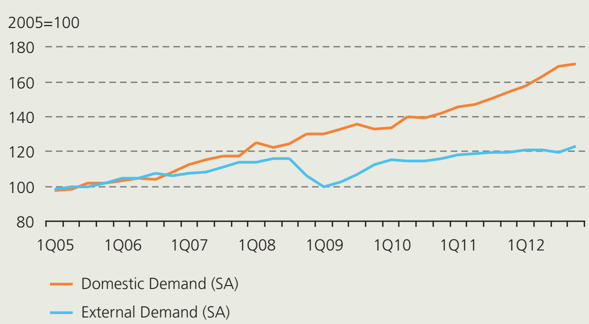
Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

onwards (Chart 4). Chart 4 depicts the strength of domestic demand which began to gain momentum in 2007, even before the external sector was affected by the financial crisis in the advanced economies. Since the crisis, it is evident that the growth of domestic demand has strengthened significantly while the performance of external demand has remained sluggish. From an overall growth perspective, the relative resilience of domestic demand has partly cushioned the economy from the adverse effects of the slowdown in exports.

The net contribution of each demand component to the growth of domestic value-added is estimated in Chart 5 using the import-adjusted method. Private consumption has played an increasingly important role in driving growth, particularly since late 2006 while investment has recorded markedly higher contributions to growth since 2011.

Chart 4

Net Contribution of Domestic and External Demand to GDP



CAGR,%	2005-06	2007-08	2009-10	2011-12
Domestic demand	4.8	9.2	5.2	9.1
External demand	5.6	3.2	1.0	2.5

Source: Bank Negara Malaysia estimates

Real GDP has continued to record an annual growth of over 5% since 2011, with domestic demand growing at a compounded annual growth rate of 9.1%, contributing a significant 74% of GDP growth. These trends all point to domestic demand emerging as a key source of growth in recent years.

Chart 5

Net Contributions to Growth by Expenditure

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

Implications: Structural Changes in Industries

The changing drivers of demand can lead to structural shifts in the economy as industries respond to the changing sources of demand. Given that a key source of demand is from the domestic market, industries that are domestic-oriented are likely to grow faster than export-oriented industries. Profitability of domestic-oriented firms will increase, attracting new firms and encouraging existing firms to expand capacity. Resources will shift towards these industries, leading to structural changes in the economy as firms respond to meet this new source of demand.

To verify this hypothesis, the domestic orientation of an industry is estimated. Input-output coefficients allow the estimation of the proportion of output of an industry that is consumed domestically (final goods and services) or indirectly used as an intermediate good for goods and services consumed domestically.

Table 1

Domestic Orientation of Industries

Sector	Domestic share (%)
Agriculture	**33.7**
Mining	**19.2**
Manufacturing	**19.3**
E&E-related industries	*6.7*
Primary-related industries	*21.6*
Consumer-related industries	*36.7*
Construction-related industries	*31.6*
Construction	**87.1**
Services	**52.9**
Wholesale and retail trade	*34.5*
Hotels and restaurants	*92.5*
Transportation	*41.0*
Communication	*59.4*
Finance and Insurance	*37.7*
Other services	*70.7*

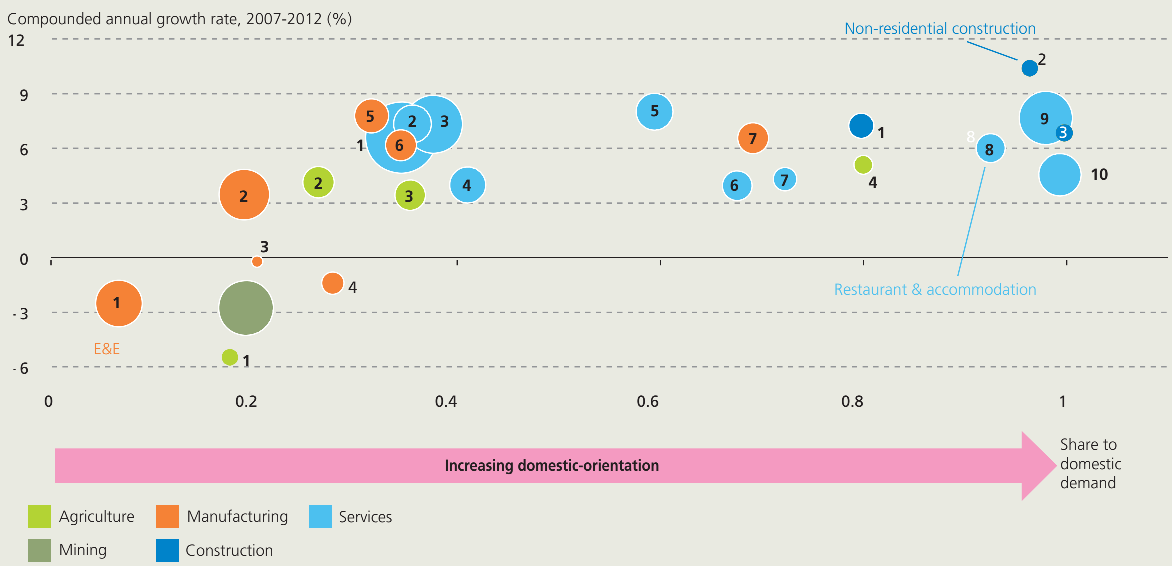
Source: 2005 Input-Output tables and Bank Negara Malaysia estimates

These estimates reveal the proportion of an industry's value-added that relies on domestic final demand. From Table 1, it can be seen that manufacturing and mining are more export-oriented while construction and services are more domestic-oriented.

Chart 6 plots the domestic orientation of sub-sectors in the economy against the average growth rate of each industry sub-sector between 2007 and 2012. As predicted, industry sub-sectors that are more domestic-oriented performed relatively better than those that are more export-oriented. There appears to be a positive correlation between the domestic orientation of an industry and its growth in 2007-2012. Of significance, the electrical and electronics manufacturing sector (export-oriented) experienced an average contraction of 2.5%, although industries catering to regional demand (construction-related and food and beverage manufacturing) had continued to record strong growth[4]. Meanwhile, the non-residential construction and accommodation and restaurant sectors (domestic-oriented) experienced strong growth of 10.4% and 6.0% respectively.

Chart 6

Faster Growth in Domestic-Oriented Industries



*The bubble size represents the relative size of value-added of the industry[5] in 2012

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

The performance of the domestic-oriented sectors has in turn supported favourable employment conditions, with the unemployment rate remaining stable at about 3%. The strength of domestic-oriented sectors has more than offset the weakness in the export-oriented sectors. This has allowed for sustained job creation, especially in the domestic-oriented sectors, and supported income growth over the last few years.

[4] Mining recorded a contraction due to depleting oil reserves that have affected production.

[5] Agriculture: 1=Forestry & logging, 2=Others, 3=Oil palm estate, 4=Fishing ; Manufacturing: 1=Electrical & Electronics, 2=Petroleum, chemical, rubber and plastic products, 3=Textiles products, 4=Wood products 5=Construction-related products, 6=Food, beverage and tobacco, 7=Transport equipment ; Services: 1=Wholesale and retail trade, 2=Business services, 3=Finance and insurance, 4=Transport and storage, 5=Communication, 6=Utilities, 7=Real estate, 8=Restaurants and accommodation, 9=Government services, 10= Others; Construction: 1=Civil Engineering, 2=Non-residential, 3=Residential.

Conclusion

Over the last few years, domestic demand has emerged as a key driver of growth. Private consumption and total investment have been resilient, enabling the economy to expand despite the sluggish performance of exports. Growth and employment have been supported by the domestic-oriented sectors, offsetting the weakness in export-oriented industries. In part, this has been achieved following years of structural reforms and sound economic policies.

Nevertheless, Malaysia remains a highly-open economy for which exports are a key source of demand. Therefore, investing strategically in the right growth industries is crucial to ensure that Malaysia is well-positioned to leverage on new opportunities in the changing global landscape. Encouragingly, export products and markets have become increasingly diversified, orientated towards new growth industries and fast-growing regional economies. This has enabled Malaysia to move up the value chain while capitalising on global growth centres.

Going forward, creating strong, sustainable and balanced growth would entail further reforms. Sustainable growth must be underpinned by productivity improvements and innovation, enabling the transition into a higher value-added and higher-income economy. Recent measures such as the introduction of the minimum wage policy and further liberalisation in selected industries will incentivise this transition, contributing to higher incomes, which would in turn support sustained growth in consumption. Developing a comprehensive social safety net, which includes improvements to the pension and healthcare systems, together with continued efforts to promote financial inclusion, will alleviate the need for precautionary savings and raise consumption. Success in sustaining the magnitude and quality of investments will depend on the progress of structural reforms, continuous financial sector development, favourable business conditions and the availability of skilled labour. These reforms, coupled with diversification in export markets and products, will have to continue to ensure sustained growth going forward.

Reference

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provide the necessary flexibility for the exchange rate to adjust to changes in the external conditions over the medium term. Furthermore, continued current account surpluses, sufficiently high level of reserves, coupled with sizeable liquid foreign assets in the banking sector, also provide additional buffer against any external shocks to the economy.

PRICE DEVELOPMENTS

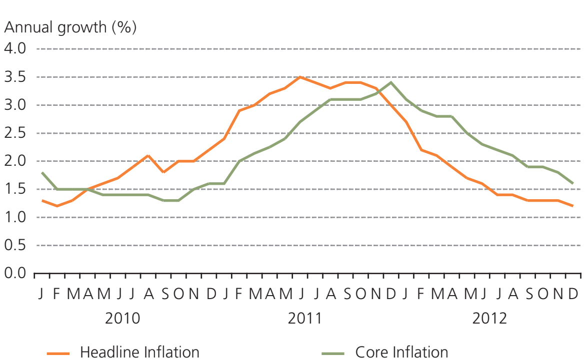
Consumer prices

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), averaged 1.6% in 2012 (2011: 3.2%). Headline inflation moderated substantially in the first half of the year, from 2.7% in January to 1.6% in June, and subsequently stabilised at 1.3% in the second half of 2012. For the year as a whole, headline inflation was below the expected range of 2.5-3.0%, due mainly to better-than-expected domestic food supply conditions and lower-than-expected inflation in the *transport* category. Subdued global price pressures arising from slower global growth and base effect from higher inflation in the previous year also contributed to lower inflation during the year. Core inflation, an indicator of demand-driven price pressures, moderated to 2.4% in 2012 (2011: 2.7%).

The moderation in inflation was broad-based and was observed across most CPI categories. Only two CPI categories registered slightly higher inflation in 2012, namely *furnishings, household equipment and routine household maintenance* and *education* (2012: 2.0% and 2.4% respectively; 2011: 1.9% and 2.2% respectively). The main contributors to lower inflation in 2012

Chart 1.16

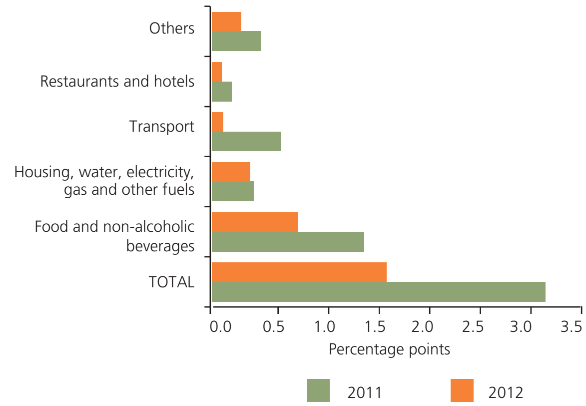
Consumer Price Inflation



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.17

Contribution to Inflation



Note: Others refers 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

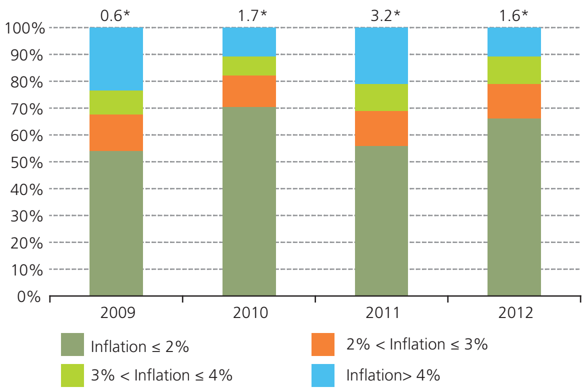
in terms of the CPI categories were the *food and non-alcoholic beverages* and *transport*, which together accounted for 78.5% of the overall decline in inflation during the year. Inflation in the *food and non-alcoholic beverages* category moderated to 2.7% (2011: 4.8%), mainly on account of a decline in the prices of meat and vegetables. The moderation in inflation in the *transport* category to 0.7% (2011: 4.4%) was due to the absence of adjustments to most fuel prices and the lower price of RON97 petrol. As a result of the lower inflationary pressures during the year, a more significant share of the CPI components recorded an inflation rate of less than 2% in 2012 (2012: 66.3% of the CPI components; 2011: 55.9%).

The moderation in inflation during the year was driven mainly by supply factors. First, external price pressures were more modest in 2012 due to more moderate increases in global energy prices and lower global food prices. While global crude oil prices were affected by bouts of volatility due to geo-political tensions in the Middle East and North Africa, average oil prices for the year as a whole remained stable, increasing only slightly from the previous year[1]. The modest increase in global crude oil prices reflected excess supply of oil due to higher

[1] The price of Brent crude oil averaged at USD112 per barrel in 2012 (average 2011: USD111 per barrel).

Chart 1.18

Percentage of CPI Components Above Specified Threshold

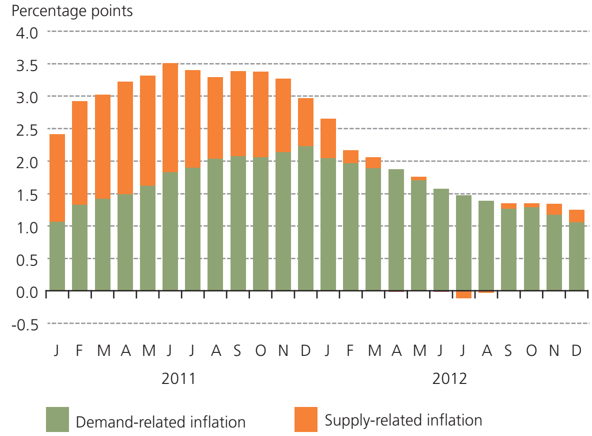


* Headline inflation

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.19

Demand-related and Supply-related Inflation



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

production and lower global demand. Global food prices were lower in 2012 compared to the previous year, despite the increases in prices of selected food commodities, such as corn and wheat, in the second half of the year. This was partly due to high stockpiles of most food commodities, especially in the first half of the year, amid weak global demand.

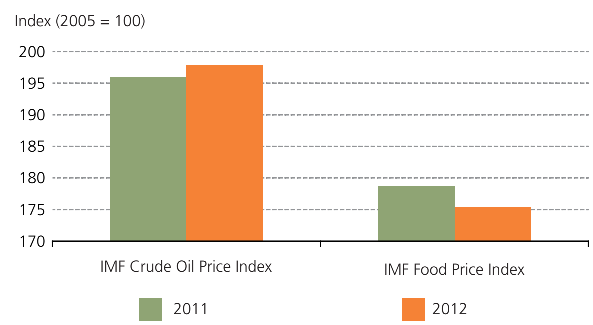
Malaysia's key import partners also experienced lower inflation during the year due to the more moderate global energy and food prices and slower growth in domestic demand in some of these economies. Overall, the softer global commodity prices and subdued inflationary pressures from Malaysia's key import partners coupled with continued ringgit appreciation reduced the direct and indirect external cost-related pressures on consumer prices.

Second, there were significant improvements in domestic food supplies during the year, resulting in lower food prices. In the poultry industry, amid stable feed prices, producers increased production of chicken due to expectations of higher demand for chicken. The actual outcome was an oversupply of chicken and eggs. The domestic supply of vegetables was also higher-than-expected, due to the opening of new farms and better weather conditions. The lower prices of meat and vegetables in turn helped to ease price pressures in the other food-related categories. Inflation in the *food away from home* sub-category, for example, moderated to 3.7% in 2012 (2011: 4.6%).

Third, the lower inflation was also due to the base effect following the sharp increase in the CPI during the previous year. In 2011, food prices rose sharply due to the increase in the price of chicken arising from higher feed prices, and higher vegetable prices due to poor domestic harvests and labour shortages. These factors, however, dissipated in 2012. There were also various one-off price adjustments in 2011 which were absent in

Chart 1.20

Global Crude Oil and Food Prices



Note:
1. IMF Crude Oil Price Index includes the simple average of three spot prices; Dated Brent, West Texas Intermediate, and the Dubai Fateh
2. IMF Food Price Index includes cereal, vegetable oils, meat, seafood, sugar, bananas, and oranges price indices

Source: International Monetary Fund (IMF)

Table 1.9

Adjustments to Administered Prices

Month	2011			2012		
	Item	Magnitude of adjustment	Net change	Item	Magnitude of adjustment	Net change
January	RON97 petrol	+10 sen/litre				
February	RON97 petrol	+10 sen/litre				
March						
April	RON97 petrol	+20 sen/litre		RON97 petrol	+10 sen/litre	
May	RON97 petrol	+20 sen/litre	RON97 petrol: +50 sen/litre Sugar: +20 sen/kg			RON97 petrol: -5 sen/litre Sugar: +20 sen/kg
	Sugar	+20 sen/kg				
June	RON97 petrol	-10 sen/litre		RON97 petrol	-10 sen/litre	
July				RON97 petrol	-20 sen/litre	
August				RON97 petrol	+10 sen/litre	
September				RON97 petrol	+30 sen/litre	
				Sugar	+20 sen/kg	
October				RON97 petrol	-10 sen/litre	
November				RON97 petrol	-5 sen/litre	
December				RON97 petrol	-10 sen/litre	

2012, namely the upward revisions in electricity tariffs and an increase in charges for satellite television services in mid-July 2011. While there continued to be upward adjustments to prices of RON97 petrol and sugar in 2012, the magnitude of the adjustments in 2011, in their totality, were larger, and occurred earlier in the year compared to those in 2012.

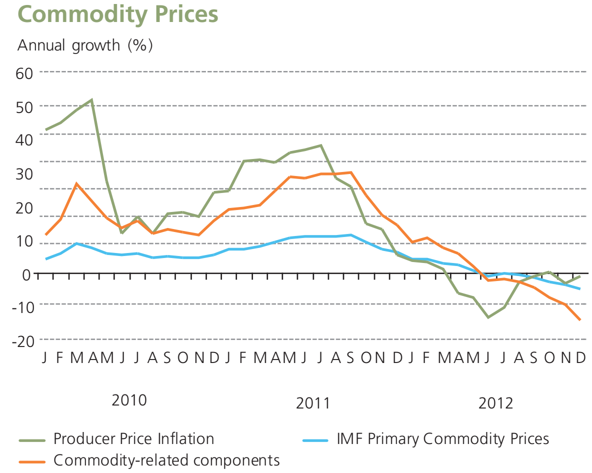
Despite strong domestic demand, demand-driven price pressures remained muted during the year for a number of reasons. While overall income continued to increase at a stable rate, efficiency gains from a stronger increase in productivity helped to attenuate demand pressures. Additionally, firms did not raise prices of goods and services by significant amounts despite strong consumption demand, as cost pressures were more subdued. To some extent, pressures on domestic prices were also alleviated through imports as reflected in the higher imports of consumption goods. Hence, core inflation, which is an indicator of demand-driven inflation, moderated in 2012.

Producer prices

Reflecting subdued cost pressures, producer price inflation, as measured by the annual percentage change in the Producer Price Index (PPI), slowed down to 0.1% in 2012 (2011: 9.0%), driven mainly by lower global commodity prices. In particular, the annual growth of commodity-related components of

Chart 1.21

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, International Monetary Fund (IMF) and Bank Negara Malaysia the PPI declined significantly to -0.5% during the year (2011: 23.6%), due mainly to lower inflation in the *mineral fuels, lubricants, etc.* and *crude materials, inedible* sub-categories (2012: 7.0% and -10.3% respectively; 2011: 24.2% and 23.2% respectively). The annual growth of non-commodity related PPI components was also lower at 0.5% (2011: 2.1%). The lower producer price inflation had reduced the pressure on the operating costs of firms and, consequently, eased the pressure on consumer prices.

In terms of composition, both the local and imported components of the PPI moderated during the year. PPI for local components declined by 0.2% (2011: 12.0%), while that for the imported components increased at a slower rate of 0.7% during the year (2011: 2.3%).

2012

MONETARY AND FINANCIAL CONDITIONS

INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

Global financial markets continued to be influenced by ongoing uncertainties arising from the challenging global environment. International investor sentiments in 2012 were driven by concerns over the protracted sovereign debt crisis and fiscal issues in several of the advanced economies amid a weak global recovery, easy monetary conditions and low interest rates environment. Emerging economies remained resilient, supported by sustained domestic demand, despite being affected by surges and reversals of capital flows given their greater financial openness and integration with global financial markets. Significant monetary easing in the advanced economies further amplified conditions in the financial markets of the emerging economies.

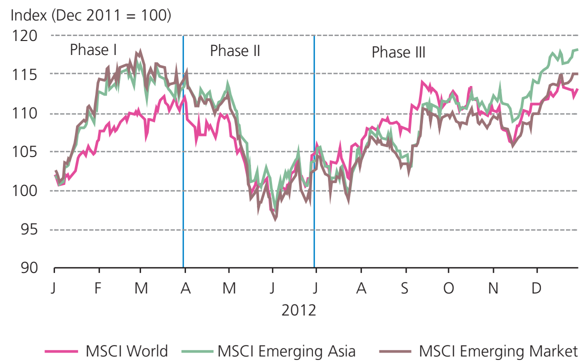
Protracted sovereign debt crisis and fiscal situations in several of the advanced economies continued to influence global financial conditions

During the course of 2012, developments in international monetary and financial conditions broadly followed three distinct phases. The first quarter of the year saw continuing recovery from the market turbulence experienced in the second half of 2011. However, optimism in the global financial markets diminished in the second quarter of the year amid renewed concerns on the economic, banking and political situation in the euro area, together with the prospect of a faltering global recovery. Market conditions recovered in the second half of the year as the troubled European countries received the required funding, while policy-makers in the advanced economies pledged further monetary easing.

At the beginning of 2012, the global financial markets continued to recover from the market turbulence experienced in the second half of the previous year. The positive sentiment in the global financial markets were supported by three key factors. Firstly, in January, the US Federal Reserve extended its pledge to keep interest rates low until late 2014, indicating the expectation for persistent unemployment and that inflation will be below its long-term objective until at least 2014[1]. Secondly, debt concerns in the euro area were temporarily alleviated following the success of the Greek government in securing a second financial package amounting to €130 billion and a €107 billion private sector debt write-off in February. Thirdly, the European Central Bank (ECB) provided an additional €529.5 billion of liquidity through its second 36-month Long-Term Refinancing Operation (LTRO2), which was participated by 800 euro area banks[2]. As a result, the global financial markets improved in the first quarter with the MSCI World index increasing by 10.9%, while measures of volatility such as the Chicago Board Options Exchange Volatility Index (VIX) and Merrill Lynch Option Volatility Estimate (MOVE), also trended downwards.

Chart 2.1

Selected Equity Market Indices



Source: Bloomberg

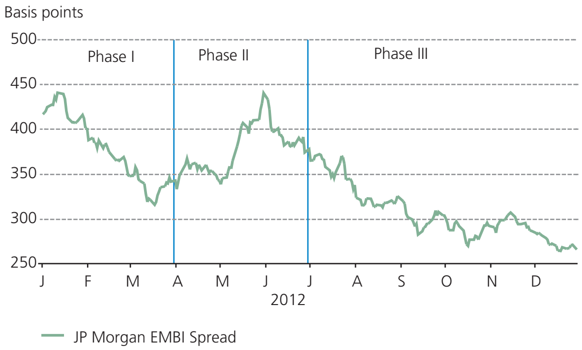
As global sentiment improved, investors also resumed their interest in the emerging economies given the favourable interest rate differentials and relatively stronger macroeconomic fundamentals

[1] Federal Open Market Committee's statement press release, January 25, 2012.

[2] ECB press conference, 8 March 2012.

Chart 2.2

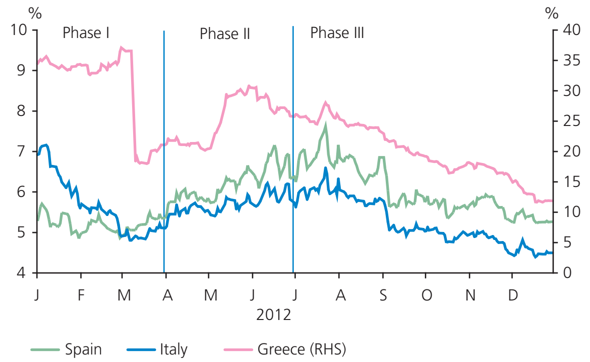
JP Morgan Emerging Markets Bond Index (EMBI) Spread



Source: Bloomberg

Chart 2.3

10-year Yields of Selected European Sovereign Debt



Source: Bloomberg

compared to the advanced economies. The additional global liquidity from the balance sheet expansion of the crisis-affected advanced economies, had led to strong net inflows of about USD42.3 billion[3] to the emerging economies in the first quarter. Reflecting these developments, the MSCI Emerging Markets index increased by 13.6% as regional equity markets increased by 4% to 17%. The JP Morgan Emerging Markets Bond Index (EMBI) spread between the emerging market bonds and US Treasuries also narrowed by 84.8 basis points, driven by the strong demand for emerging market bonds.

Despite the optimism in the global financial markets, structural weaknesses in the advanced economies continued to weigh down on the pace of global recovery. The International Monetary Fund (IMF), in its January 2012 World Economic Outlook (WEO) Update, lowered its global growth estimate for 2012 from 4% to 3.3%. Inflation in both the advanced and emerging economies was expected to be benign on account of slowing global growth, as well as the moderating commodity prices. Although oil prices were expected to remain relatively stable in 2012, non-oil commodity prices were projected to decline by 14% due to weaker global demand and improving supply conditions.

In the second quarter of 2012, concerns over the European sovereign debt crisis resurfaced following uncertainties over the political situation in Greece and the further deterioration in the health of the Spanish banking system. In Greece, the hung parliament in May triggered concerns on whether the country would be able to fulfil the conditions stipulated in its previous two financial packages. Speculation was rife that Greece may consider exiting the euro, thereby undermining the integrity of the monetary union. Simultaneously, the health of the Spanish banking system continued to deteriorate, raising doubts over the authorities' capacity to support the domestic banking system and the economy. In May, several Spanish banks were downgraded by Standard & Poor's, and the country's largest mortgage lender, Bankia, was nationalised. Sentiments began to worsen as it became increasingly clear that monetary policy alone would not be adequate to resolve the underlying issues in the euro area economies[4]. Market concerns were reflected in the sharp increase in sovereign yields for Greece, Portugal, Spain and Italy. Greece, in particular, saw its yields on 10-year sovereign debt increase by an unprecedented 1,025.7 basis points, while Portugal, Spain and Italy experienced a spike in yields by 92.7 basis points, 82.7 basis points and 46.1 basis points respectively by the end of May.

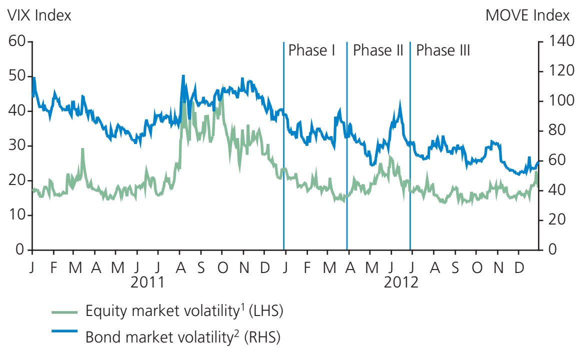
Speculation over the extent to which international rating agencies would downgrade the credit ratings of selected European countries and banks in the advanced economies was also a source of uncertainty. Moody's announced a ratings review for several US and European banks in February. Investors, however, remained uncertain of the magnitude of the potential downgrades.

[3] Source: Emerging Portfolio Fund Research (EPFR) Global.

[4] Source: BIS Quarterly Review, June 2012.

Chart 2.4

Global Financial Market Volatility



Note: [1]Refers to VIX Index
[2]Refers to MOVE Index

Source: Bloomberg

The confluence of these developments led to marked declines across financial markets globally. From end-March to the beginning of June, the MSCI World index declined by 12.3% and volatility reached its peak for 2012, though remaining lower than the volatility experienced in the second half of 2011.

The escalation of the European debt crisis amid incipient signs of a weaker recovery in the US and moderating growth in PR China had cast further doubt over the pace of global economic recovery. Rising concerns over the fragile global recovery prompted investors to slow their pace of accumulation of emerging market financial assets or to partly unwind their positions. As a result, equity markets of emerging economies experienced a total net capital outflow of about USD11.7 billion[5]. The bond markets in the emerging economies, however, continued to experience sustained inflows underpinned by the stronger fundamentals of the emerging economies. Hence, bond markets in the emerging economies were still receiving net capital inflows of USD10.2 billion, albeit lower than the USD19 billion received in the first quarter[6]. On balance, the heightened risk aversion saw a net capital outflow from the emerging markets during the second quarter.

By the second half of the year, sentiments started to recover as events in Europe began to point towards some resolution. In Greece, the political parties that were supportive of austerity measures were able to form a coalition government with a simple majority after the country's second election. Additionally, an EU summit held at end-June relaxed the strict requirements for access to financial assistance. Countries requesting aid were no longer subjected to the joint oversight of the European Commission, the IMF, and the ECB, and the aid could be directly provided to banks rather than through governments. This meant that future financial assistance could be negotiated and disbursed more quickly and flexibly. Additionally, the international rating agencies announced the extent to which certain countries and banks were to be downgraded. Moody's downgraded Spain's sovereign rating from A3 to Baa3, the lowest investment grade, in June. In the week after, the credit rating agency also downgraded 15 major US and European banks and placed Germany, the Netherlands and Luxembourg on negative outlook due to possible contagion from the European sovereign debt crisis. These announcements alleviated the uncertainties that had prevailed over the degree of potential rating downgrades.

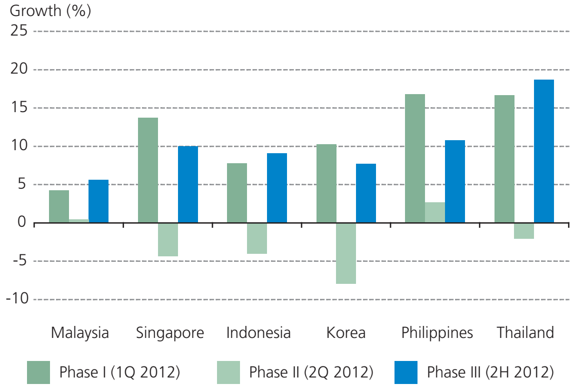
During the second half of the year, further easing of monetary policy globally and improving sentiments provided the impetus for stronger performance in the financial markets

Furthermore, pledges and ensuing actions by central banks in both the advanced and emerging economies to ease monetary policy saw a stronger performance in the global financial markets. The US Federal Reserve and the ECB first announced in July that further monetary easing measures were forthcoming. In September, the US Federal Reserve launched a USD40 billion a month, open-ended, bond purchasing programme for mortgage-backed securities while extending its pledge to maintain low interest rates until mid-2015. Concurrently, the ECB announced its Outright Monetary Transactions programme whereby the central bank would engage in the unlimited purchase of sovereign bonds from distressed member states that requested for assistance. Rising downside

[5] From end-March to end-June.
[6] Flows numbers in the paragraph are sourced from EPFR Global which are estimates.

Chart 2.5

Performance of Selected Regional Equity Indices



Source: Bloomberg

risks to growth also prompted several regional central banks to reduce their policy rates.

The various easing measures by central banks worldwide renewed market optimism and provided support for the global financial markets to maintain their upward trend until the end of the year. Optimism on the prospects of the emerging economies, given the resilience of domestic demand in most of these economies, attracted net inflows of USD76.1 billion[7] during the second half of the year. As a result, regional equity markets increased by 5% to 18%, while the JP Morgan EMBI spread declined by 108.4 basis points.

Although monetary easing and the other policy initiatives in the advanced economies improved sentiments in the global financial markets, investor sentiments remained erratic against new developments. While measures by the European policy-makers brought some relief to the international financial markets, the next phase of implementing the announced measures remains critical in sustaining investor confidence. Although emerging economies have been broadly resilient in managing the volatility of the global financial markets, challenges remained. As uncertainties and prolonged periods of monetary easing remained a feature of the global economic and financial landscape, the resilience of the financial markets in emerging economies will continue to be tested by developments in the advanced economies and the shifting investor sentiments.

[7] Source: Emerging Portfolio Fund Research (EPFR) Global.

DOMESTIC MONETARY AND FINANCIAL CONDITIONS

Exchange Rate

The exchange rate of the ringgit during the course of 2012 was driven by two-way flows of trade, direct investment and portfolio funds, which reflected a combination of external and domestic factors. In tandem with developments in the international financial markets, ringgit movements during the year followed three distinct phases. From January to early March, the ringgit strengthened due to portfolio inflows, driven mainly by optimism over the growth prospects for Asia amid the low interest rate environment in the advanced economies. Between March and June, however, increased uncertainty led to the unwinding of the holdings of financial assets in the region, thereby resulting in a depreciation of regional currencies, including the ringgit. From July to December, renewed optimism over the prospects for the global economy resulted in the resumption of portfolio inflows and ringgit appreciation. The ringgit ended the year at RM3.0583 against the US dollar, an appreciation of 3.9%.

Ringgit movements were driven by two-way flows of trade, direct investment and portfolio funds throughout the year

The ringgit appreciated by 6.0% from January to early March. The Malaysian economy showed continued underlying strength amid generally positive prospects for the region. This, coupled with expectations of a prolonged low interest rate environment in the advanced economies, attracted international investors towards regional financial assets. This resulted in net portfolio inflows of RM25.3 billion into Malaysia in the first quarter of the year. Against this backdrop, the ringgit reached RM2.9900 on 1 March 2012, the strongest intraday level since September 2011.

The appreciating trend of the ringgit and other regional currencies was interrupted over the March to June period. This was in reaction to renewed uncertainties over the sovereign debt crisis in Europe and concerns over the weakening US recovery and the moderation of PR China's

Commodity Price Boom: Is Financialisation a Factor?

Introduction

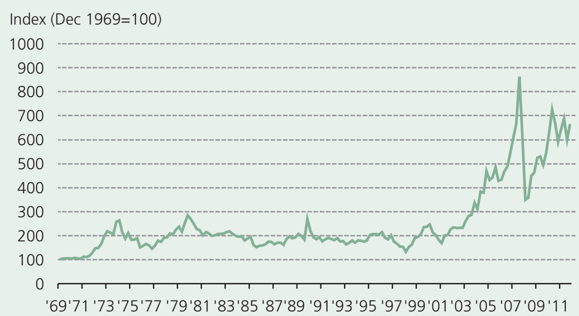
Following decades of relative stability, global commodity prices rose sharply during the recent decade and have experienced considerable volatility since then (Chart 1). This noticeable shift has generated considerable debate and polarised opinion on the drivers of commodity prices. Historically, the primary drivers of commodity prices have been fundamental changes in global demand and supply factors. Short-term shocks such as sudden disruptions in supply that create shortages globally have at times also affected commodity prices. These factors continue to be important. However, the acceleration and swings in commodity prices in recent years combined with the rapid proliferation of financial instruments indexed to commodity prices have raised questions on the role that financial market participants have in determining commodity prices. This article looks at both sides of the argument and leverages on available literature and studies to provide some insights on the extent that greater financialisation of commodities, through the creation of financial products based on commodities, drive the recent trends in commodity prices.

The role of demand and supply conditions in driving commodity prices

There is a general consensus that historically, fundamental factors such as changes in global demand and supply conditions have been important drivers of commodity prices. The recent acceleration in global commodity prices, specifically between 2004 and 2008, was no different.

Chart 1

Global Commodity Prices



Source: S&P GSCI Spot Index, Bloomberg

Following a sustained period of strong world economic growth, global oil consumption increased more rapidly between 2001 and 2007 than in the previous decades[1]. Most of this increase can be attributed to the rising demand from emerging economies (especially PR China and India), as a combination of steady income and population growth propelled the growth of economic activity. Emerging economies' energy and food consumption have been increasing steadily since 1996, growing at an annual rate of 3.0% and 1.7% respectively[2]. PR China's energy and food consumption alone grew at 7.1% and 1.8% over the same period. Conversely, in the advanced economies, energy consumption declined by 0.1% while food consumption grew at a modest rate of 0.8% during this period[3] (Charts 2 and 3).

The demand for agricultural inputs for the production of biofuels was another significant factor. The introduction of subsidies for biofuel production, especially in Australia, Canada, PR China, European Union and the US during the 2006-2009 period caused a diversion of some food commodities to the production of biofuels. As a result, biofuel production accounted for a significant share of global use of several food commodities – 20% for sugar cane, 9% for vegetable oil and coarse grains and 4% for sugar beet[4]. In fact, under the US law, 40% of the corn harvest must be used to make biofuel[5].

1 Based on European Central Bank (2010), the annual average growth of global oil consumption was about 27% between 2001 and 2007, compared to 19% and 2% in 1991-2000 and 1980-1990 respectively.

2 British Petroleum Statistical Review, FAO, OECD, and Bank Negara Malaysia calculations (Emerging economies include Brazil, PR China, India, Russian Federation, Bangladesh, Indonesia, Iran, Iraq, Kazakhstan, the Republic of Korea, Myanmar, Pakistan, the Phillipines, Saudi Arabia, Thailand, Turkey, Vietnam, Egypt, South Africa, Ethiopia, Nigeria, Mexico, Argentina, Chile, Colombia, Peru, Venezuala, Serbia and Ukraine).

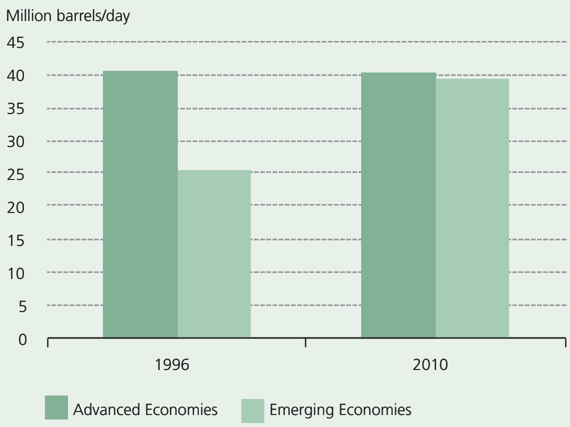
3 British Petroleum Statistical Review, FAO, OECD, and Bank Negara Malaysia calculations (Advanced economies include Australia, Canada, European Union, Japan and the US).

4 Policy report on Price Volatility in Food and Agricultural Markets contributed by FAO, IFAD, IMF, OECD, UNCTAD, WFD, World Bank, WTO, IFPRI and the UN HLTF.

5 Energy Independence and Security Act of 2007.

Chart 2

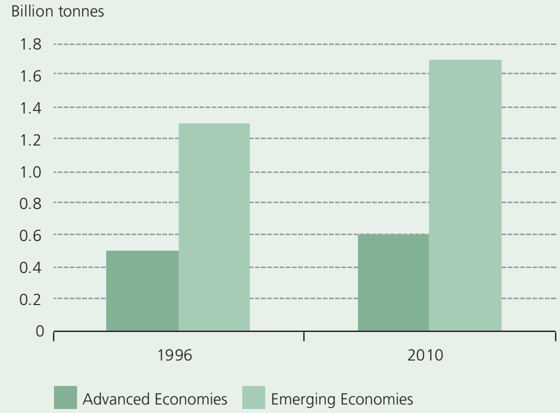
Global Energy (Crude Oil) Consumption



Source: British Petroleum Statistical Review

Chart 3

Global Food (Cereal) Consumption



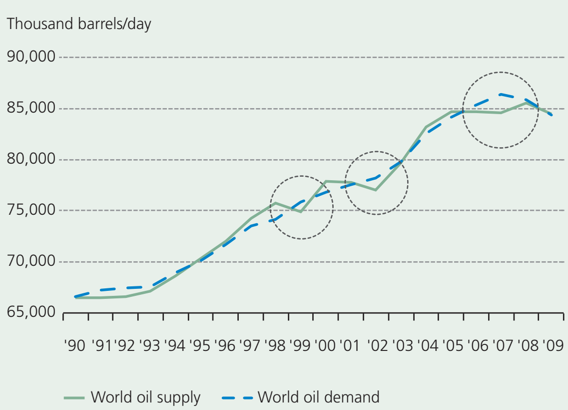
Source: Food and Agriculture Organisation of the United Nations (FAO), Organisation of Economic Co-operation and Development (OECD)

The rise in biofuel production also created pressure on prices of agricultural products which are not used in the production of biofuels, as more agricultural land was converted to produce crops needed for biofuel production.

The impact of rising demand for commodities on prices was more pronounced because supply could not keep up. For example, the sharp rise in global commodity prices occurred at a time when there was increasing tightness in global oil supply. World oil production began to stagnate between 2004 and 2009, mainly due to geological constraints in some of the large non-OPEC oil-producing countries. It has been viewed that the sudden slowdown in world crude oil production during this period contributed to the sharp rise in oil prices[6] (Chart 4).

Chart 4

World Oil Demand and Supply



Source: US Energy Information Administration (EIA)

Unexpected short-term supply disruptions from socio-political and weather-related events also caused surges in prices over this recent decade. Climatic factors, for example, were major contributors to the rise in prices of agricultural commodities between 2007 and 2010. In 2008, a drought in Australia, which is an important global supplier of wheat, led to a shortage of wheat supply in an already tight market, causing a sharp rise in prices[7]. More recently, in 2010, severe drought and wildfires in the Russian Federation destroyed one fifth of Russia's crop, which caused their annual wheat production to fall by 25 million tonnes. As a result, wheat prices rose sharply, from USD5 per bushel in August 2010 to a peak of USD9 per bushel in February 2011. The fall in supply and subsequent rise in prices were exacerbated by Russia's decision in August 2010 to ban grain exports for the remainder of that year.

[6] Kaufmann (2011), European Central Bank (2010).

[7] Wheat supply was already tight following consecutive droughts in Australia in 2006 and 2007 and a frost that damaged crops in the US in mid-2007.

Growing influence of non-commercial traders on the commodities market
While there is no doubt that the long-term trend of commodity prices can, for the most part, be attributed to fundamental shifts in global demand and supply of commodities, there are signs to suggest that financial market participants are increasingly becoming more influential in the commodity markets, relative to the traditional, commercial traders.

First, funds allocated to commodity derivatives have risen substantially since 2004. The increasing interest in the commodities market by non-commercial traders[8] has led to a more than six-fold increase in the outstanding futures and options contracts on commodity exchanges, from roughly 10 million contracts in 1999 to over 60 million contracts in 2011[9]. The low interest rate environment, which triggered investors to search for higher returns in non-traditional asset classes, and financial innovation allowing a wider base of investors to have exposure to the commodities market, are cited as reasons behind the rise and the attractiveness of commodities as investment alternatives.

Second, there has been unprecedented growth in index investment[10]. A major element behind the recent inflow of financial investments into commodities markets is the emergence of commodity index investors. The rise in index investment is substantial, with the estimated assets allocated to commodity index trading strategies rising from USD15 billion in 2003 to USD210 billion in 2012[11]. Collectively, index investors make up a significant portion of non-commercial participants in commodity markets. Their unique motivation and specific investment strategy[12], which could at times be detached from the fundamentals of the underlying commodities, coupled with the sheer volume of their investments have led many market observers to conclude that the participation of index investors could exert considerable influence on commodity price movements.

Third, non-commercial trades (speculators and index investors) outnumber commercial commodity trades. Financial market transactions currently overwhelm actual trading of physical commodities. A recent report[13] suggests that non-commercial trades now account for at least 64% of all recorded oil trading positions. In the past, non-commercial positions in oil trading usually accounted for 30% of total trades[14].

Fourth, there is a strong co-movement between speculative net buying and selling activities in the commodity futures market and commodity prices. To some extent, the net speculative positions of commodity futures contracts, which nets off the non-commercial traders' 'buy' and 'sell' orders, can be a reflection of investor sentiments and their views on the future[15].

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8 Agents in the commodities market are typically categorised into commercial and non-commercial traders. The United States Commodity Futures Trading Commissions (CFTC) defines commercial traders as those that either produce or consume physical commodities while non-commercial traders are purchasers of commodity futures that do not operate in the physical market and do not have exposure to the prices of the physical commodities. The non-commercial traders include not only the speculators, who can buy and sell commodity futures contracts based on their views, but also the index investors, who passively hold commodity futures position as a component of a diversified portfolio.

9 Bank for International Settlements (2011).

10 Index investment is no different from a mutual fund, whereby the funds invested in the commodity index are used to purchase the basket of commodities specified by the index, which explains the reason why index investors have only buy (long) positions in the commodities market.

11 US CFTC's Index Investing Data

12 Given their motivations to hold commodities as part of a diversification strategy, index investors may continue to maintain their commodity holdings regardless of market conditions or price movements. This provides artificial demand in the market. On the other hand, if investors decide to withdraw their investments due to reasons unrelated to the fundamentals of the underlying commodities, index managers in such indices will have no choice but to liquidate their positions, regardless of their outlook for the commodities. In addition, the rigidity of the weights attached to each commodity in an index may require the buying and selling of certain commodities to maintain the original allocation. Again, these transactions may not necessarily reflect the fundamental factors driving the commodities underlying the index.

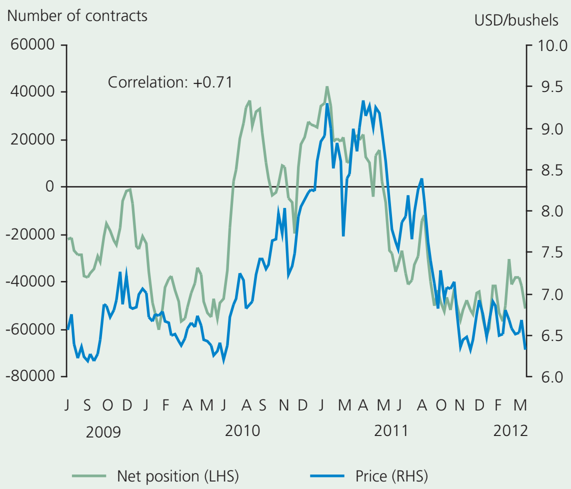
13 US CFTC Commitment of Traders Report 2012

14 Hall (2012)

15 Typically, in the commodities market, there are buyers and sellers of the futures contracts of the same commodity. The buyers' and sellers' orders, when 'netted out', becomes the net speculative position. When there are more buy orders relative to sell orders, there is a net speculative long position and when there are more sell orders compared to buy orders, there is a net speculative short position.

Chart 5

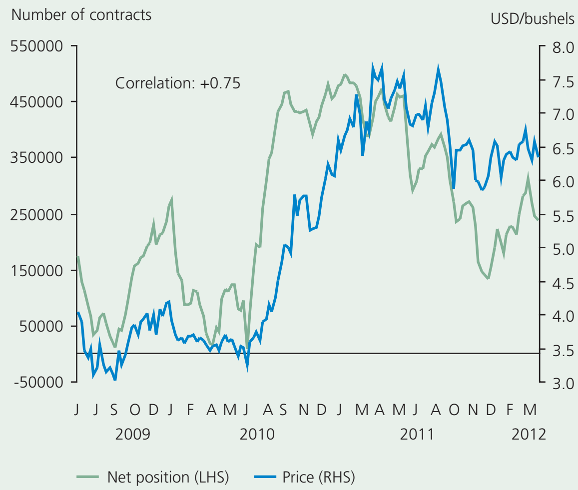
Net Speculative Positions on Wheat Futures Contracts and Impact on Price



Source: US Commodity Futures Trading Commission (CFTC)

Chart 6

Net Speculative Positions on Corn Futures Contracts and Impact on Price



Source: US Commodity Futures Trading Commission (CFTC)

The high degree of co-movement between net speculative positions and spot commodity prices provides some indication of the influence speculators have on commodity price movements (Charts 5 and 6).

Fifth, there is rising co-movement between global commodity indices and equity indices. Prior to 2004, movements in the commodity and equity markets appeared uncorrelated. Commodity prices were mostly influenced by the fundamentals behind each commodity while the equity market was more susceptible to swings in the risk appetite of investors. Since 2004, however, the increased participation of financial investors meant that global commodity markets became more sensitive to portfolio rebalancing by financial investors. This caused movements in commodity prices to be more correlated with prices in other asset markets, including the equity markets. Between the period 2006 and 2012, the correlation between commodity[16] and equity[17] indices rose substantially, from almost zero in 2004 to 0.6 in 2012[18].

The extent of influence of financialisation

Given the growing consensus that both fundamental and financial factors do, to varying degrees, have a role in influencing commodity price movements, research and studies have naturally turned to assessing their relative importance. The common conclusion from existing literature is that while global demand continues to account for the long-run trend of commodity prices, speculative investment flows into commodity markets amplify the movements in commodity prices[19]. Notwithstanding the different categorisation of financial participants in the commodities market and the varying methodologies applied, empirical evidence suggests that, on balance, fundamental factors appear to matter more in explaining commodity price trends. Financialisation of commodities, however, can and did exacerbate the boom-bust cycle in commodity prices in the short-run. More specifically, a range of studies found that speculative activities amplified commodity price movements by between 15-28% (Table 1).

[16] S&P GSCI Spot Index
[17] S&P 500
[18] Bank Negara Malaysia calculations.
[19] While some studies attribute speculative activities to all non-commercial investors and quantify their impact as a whole, others disaggregate the non-commercials to distinguish the impact of only the index investors given the nature of their investment strategies and the significant amount of their investments.

Table 1

Summary of Studies That Have Tried to Quantify the Impact of Speculative Activities in the Commodities Market

Studies	Impact (%)
Gilbert (2009)	~15
Van der Molen (2009)	26.8
Khan (2009)	19-28*
United Nations Conference on Trade and Development (2011)	20-25
Pollin and Heintz (2011)	26.5*
Davies (2011)	25*
Lombardi and Robays (2011)	15
Lenzner (2012)	22*
Juvenal and Petrella (2012)	~15

* Includes Bank Negara Malaysia calculations

Conclusion

The rapid increase and sharp swings in commodity prices in recent years have led to a reassessment on the drivers of commodity prices. While there is increased acceptance on the role that the financialisation of commodities has in driving commodity prices, its importance relative to fundamental factors remains an open question. Certainly, the impact that non-commercial traders have on global commodity price movements and the dynamics behind them needs to be better understood. An area of research interest which is largely absent in the existing literature is the relationship between monetary policy and commodity prices. Among key questions of interest are the extent to which highly accommodative monetary policy globally in recent years has contributed to the financialisation of commodities and hence commodity price swings, the impact on global food prices and the supply for human consumption, and the efficacy of monetary policy in addressing supply-related inflation, especially in highly-open emerging economies.

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Chart 2.6

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

¹Regional 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

economy, factors which had raised concerns over the prospects of global and regional economic growth. International investors consequently unwound holdings of emerging market assets. The increased global uncertainty also prompted higher hedging activity by local exporters, as reflected by the larger concentration of forward sales by local exporters in the 3-6 month tenure.

Portfolio inflows resumed in the second half of the year. Expectations for further monetary easing in the US and the eventual implementation of the policy, together with expectations for progress in resolving the European sovereign debt crisis, led to renewed investor optimism towards global and hence regional growth prospects. This in turn led to increased demand for regional financial assets. The release of positive economic data for Malaysia during the period provided additional impetus for the further strengthening of the ringgit. Consequently, the ringgit appreciated by 4.3% against the US dollar during this period.

Against other major currencies, the ringgit appreciated against the Japanese yen (15.2%) and the euro (1.7%), but depreciated against the pound sterling (-0.9%). The ringgit's performance against regional currencies was mixed. The ringgit appreciated against the Thai baht (0.2%), Chinese renminbi (2.5%) and Indonesian rupiah (9.2%), but depreciated against other regional currencies by between 2.4% and 4.2%. For the year as a whole, the ringgit's Nominal Effective Exchange Rate (NEER), a measure of the ringgit's performance against the currencies of Malaysia's major trading partners, appreciated by 3.0%.

The improved sentiments towards the ringgit in the second half of the year led to a decline in the demand for hedging. Foreign exchange forward activity fell by 21% during this period compared to the first half of the year. In addition, the improved sentiments also led to increased US dollar liquidity in the domestic market. An indication of this improved liquidity was that the 5-year USD/RM cross-currency swap points, which indicated the cost of raising US dollars in the domestic foreign exchange market, declined from 145 basis points in June to 125 basis points in December.

Chart 2.7

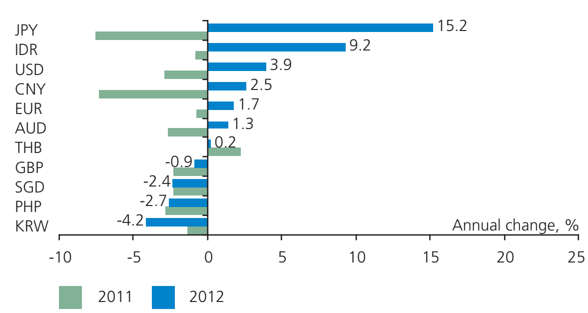
Exchange Rate of the Malaysian Ringgit (RM) Against Major Currencies

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

Source: Bank Negara Malaysia

Chart 2.8

Summary of Malaysian Ringgit (RM) Performance Against Major and Regional Currencies



Note: (+) indicates an appreciation of the ringgit against foreign currency

Source: Bank Negara Malaysia

The more balanced two-way trade and investment flows contributed to the orderly functioning of the Malaysian foreign exchange market, despite the sharp increases in volatility in the international currency markets. The 34% increase in gross inflows during the year coincided with a 39% increase in gross outflows. As a consequence, the Bank's international reserves position remained relatively stable over the course of the year, and the exchange rate was largely determined by market conditions.

Interest rates, bond yields and equity prices

After raising interest rates in 2010 and 2011, the Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.00% throughout 2012. Consequently, domestic monetary conditions remained supportive of economic activity, while minimising the risks of financial imbalances.

Interest rates remained stable in 2012, reflecting the stance of monetary policy to promote balanced and sustainable growth of the economy

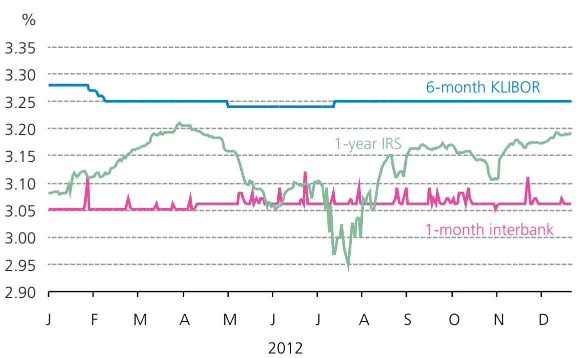
Reflecting the unchanged OPR, money market rates remained relatively stable throughout the year. The average overnight interbank rate (AOIR) traded close to the OPR, within a range of 2.89-3.00%, while interbank rates of other short-term tenures were also relatively unchanged. Medium-term money market rates however, were influenced by market expectations for OPR changes. In the first half of the year, KLIBOR and interest rate swaps (IRS) rates moderated slightly as markets anticipated a monetary policy response amid greater downside risks to the domestic economy given slower global growth. Market interest rates, however, normalised in the second half of the year as market participants revised their interest rate expectations in light of the resilience of the domestic economy.

Retail lending rates were also relatively stable during the year. The benchmark lending rate, as measured by the average base lending rate (BLR) of commercial banks, remained at 6.53%. At the same time, the weighted average lending rate (ALR) of total loans outstanding experienced a gradual moderation of 14 basis points, to end the year at 5.52%. This reflected the gradual maturing of older loans, which were contracted prior to the 2008 financial crisis when the OPR and hence borrowing costs were higher, and the addition of new loans at relatively lower rates.

Both businesses and households continued to benefit from low interest rates throughout 2012. The low retail lending rates reflected three factors. First, the cost of funds remained low as a result of the stable monetary policy stance. Second, with sustained domestic demand and income growth, the credit profile of borrowers in general remained healthy as evidenced by the low proportion of loan defaults. This prevented credit risk premiums from widening. Third, the increased competitive environment kept the margins charged on loans at low levels.

Chart 2.9

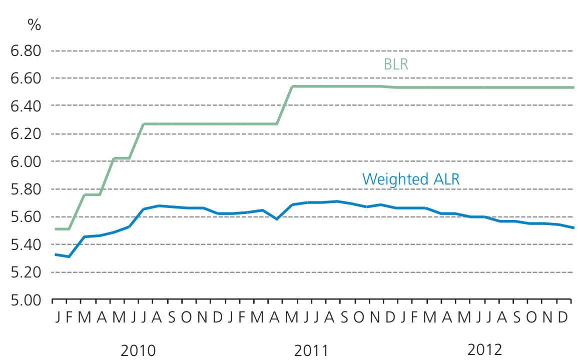
Money and Financial Market Rates



Source: Bank Negara Malaysia and Bloomberg

Chart 2.10

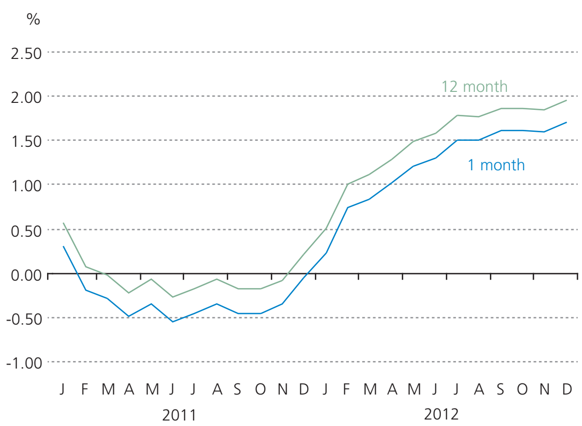
Commercial Banks' Lending Rates (at end-period)



Source: Bank Negara Malaysia

Chart 2.11

Real Fixed Deposit Rates



Source: Bank Negara Malaysia

Chart 2.12

MGS Yields

Source: Bank Negara Malaysia

Deposit rates of commercial banks were stable throughout the year. As at end-December 2012, the average quoted fixed deposit rates of commercial banks for the tenures of 1 to 12 months ranged between 2.90% and 3.15% respectively. Depositors continued to be compensated with increasing positive real rates of return, due in part to the downward trend in inflation during the course of the year.

MGS yields were largely shaped by a combination of external and domestic factors

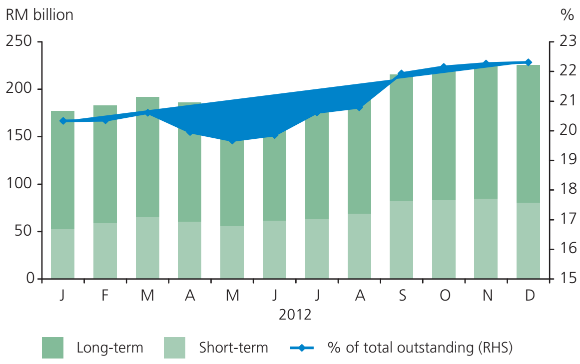
Movements in yields on Malaysian Government Securities (MGS) during the year were largely influenced by a combination of external and domestic factors. Market expectations for a lower OPR following concerns over the slowing global growth and the implications on the domestic economy, coupled with the increased non-resident demand for MGS kept yields low. However, a reversal of earlier market expectations for a decrease in policy rates combined with the larger government bond auctions did result in some upward pressure on yields during the year.

MGS yields started the year on a downward trend given market expectations of a policy rate cut. Yields on the 1-year MGS fell to a yearly low of 2.76% in February, well below the OPR rate of 3.00%. In March, however, yields increased, with the 1-year MGS yield rising by 19 basis points following the reversal of market expectations on the OPR. In the subsequent period, despite renewed concerns over the European sovereign debt crisis and the prospect of a faltering global recovery, non-resident holdings of MGS increased by RM10.9 billion from April to July, driven by the relatively strong fundamentals of the domestic economy. This contributed to a downward trend in MGS yields across all maturities. This trend was interrupted in August and September, as the large size of government bond auctions during the period resulted in some upward movement in the yields. Yields were broadly stable towards year-end, with the exception of a temporary decline in October following the announcement of further quantitative easing measures by the US Federal Reserve. Overall, the benchmark MGS yield curve flattened in 2012, reflecting a combination of a rise in short-term yields by 3 to 19 basis points and a decline in the 10-year MGS yields by 20 basis points.

Reflecting Malaysia's strong macroeconomic fundamentals, Malaysian government bonds remained attractive amongst international investors. Sustained non-resident inflows into the MGS market resulted in the share of non-resident holdings of MGS increasing sharply to a high of 44.4% of total outstanding MGS by end-December 2012. While such inflows contributed towards increasing the depth, breadth and vibrancy of the bond market and enhancing the efficiency of price discovery, it also suggested possible vulnerability of the bond market to a sharp and sudden

Chart 2.13

Outstanding Debt Securities Held by Non-Residents

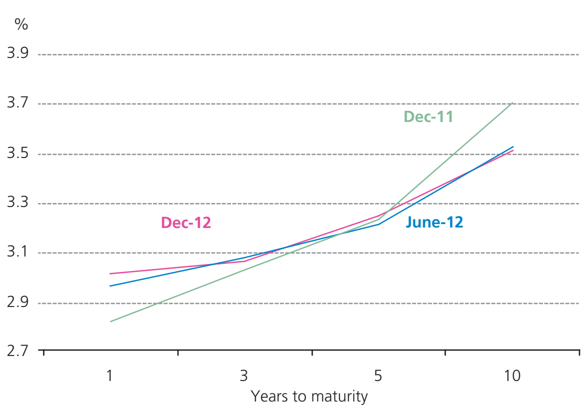


Source: RENTAS, Bank Negara Malaysia

withdrawal of non-resident funds, with destabilising consequences on the financial system. This, however, was not a concern based on three factors. First, Malaysia has a deep and liquid bond market that is able to effectively intermediate the inflows, being the fourth largest in Asia after Japan, PR China and Korea[8]. Including sukuk, private debt securities and central bank securities, non-resident holdings make up only 22.3% of the total domestic bond market. Second, the strong demand for MGS by local institutional investors would provide a backstop in the event of a reversal in flows. The bulk of the domestic investor base consists of pension funds and financial institutions, which also includes a more developed insurance industry, continue to demand investible assets given the growth in their liabilities. Third, despite the ongoing uncertainties in global financial markets, the underlying fundamentals such as growth and interest differentials will continue to provide support for the local bond market.

Chart 2.14

MGS Benchmark Yield Curve



Source: Bank Negara Malaysia

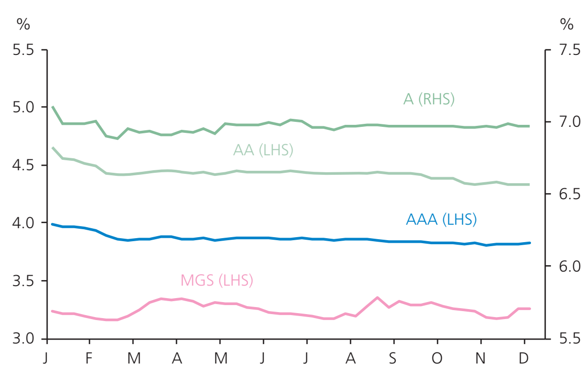
[8] In percentage of GDP, Malaysia's bond market is the third largest in Asia after Japan and Korea, while in terms of volume, it is the fourth largest after Japan, PR China and Korea.

PDS yields remained favourable for fund-raising amid high demand for financing from infrastructure and ETP-related projects

The domestic private debt securities market (PDS) registered strong growth in 2012 amid favourable market conditions. Fund-raising activity in the PDS market increased significantly, with new PDS issuances amounting to a record high of RM121.1 billion, reflecting the higher demand for financing from infrastructure-related projects and the Economic Transformation Programme (ETP). Despite the significant increase in the supply of PDS, the cost of bond market financing remained favourable. PDS yields declined across the board, with yields on the 5-year AAA, AA and A-rated papers registering a decrease of 18.5 basis points, 35.1 basis points and 12.6 basis points respectively for the year. Both liquidity and credit conditions also improved in 2012. Total turnover in the PDS market increased to RM161.4 billion in 2012 from RM112.3 billion

Chart 2.15

5-year MGS and 5-year PDS Yields



Source: Bank Negara Malaysia

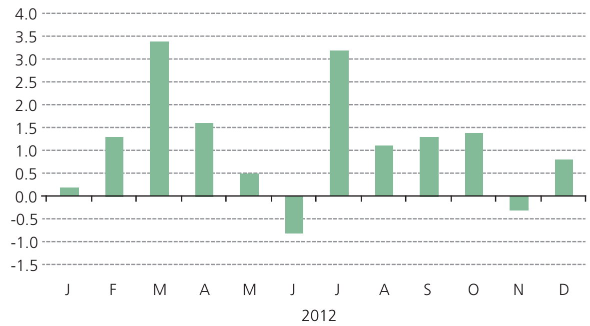
Chart 2.16

Regional Equity Indices

Source: Bloomberg

Chart 2.17

Net Buying of Equities by Non-Residents



Note: (-) indicates more selling activities by non-residents

Source: Bursa Malaysia

in 2011, while the number of negative rating actions during the year declined to 25 from 51 in 2011.

Domestic equity market remained resilient despite uncertainties surrounding the global economic outlook

Despite uncertainties surrounding the global economic outlook, the domestic equity market remained resilient. In 2012, the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) increased by 10.3% (2011: 0.8%) to close at 1,689 points. A broadly similar trend was also observed in other regional markets. The positive performance was driven by the favourable outlook for the domestic economy and demand from non-residents, despite there being several episodes of temporary withdrawals by non-residents following heightened global risk aversion.

The FBM KLCI, in tandem with other regional markets, increased in the first quarter of the year following improved market sentiments arising from positive developments in the European sovereign debt crisis and further easing by central banks in the advanced economies. Moreover, significant progress of the ETP projects, especially with the commencement of construction work for the Mass Rapid Transit (MRT) project, contributed to the improvement in investors' confidence, giving rise to more buying interest in the domestic equity market. The upward trend in the index, however, was interrupted in the subsequent quarter amid renewed uncertainty over the faltering global growth, leading to reduced holdings of local equities by non-residents and higher volatility of the FBM KLCI returns.

In the second half of 2012, domestic equity prices recovered strongly and reached historical highs as global uncertainties subsided and positive domestic fundamentals supported the equity market performance. Expectations for further stimulus measures in the advanced economies, reinforced by better-than-expected performance of the domestic economy in the second quarter

Chart 2.18

Volatility of Returns on the KLCI[1]

[1]Refers to 30-day rolling standard deviation of daily returns

Source: Bank Negara Malaysia calculations

Responsiveness of the Malaysian Government Securities Yield Curve to Movements of Sovereign Bond Yields Abroad

Introduction

The greater financial integration over the past decade has led to more synchronised movements of financial markets across the globe. As the domestic bond market, particularly the Malaysian Government Securities (MGS) market, deepens, the movements of the domestic yield curve are increasingly influenced by movements in foreign bond yields as both domestic and foreign investors respond to global developments and sentiments. Such inter-linkages may have resulted in stronger correlations between MGS yields and sovereign yields in other economies. In effect, at any given point in time, the shape of the MGS yield curve could be influenced by a change in foreign yields that are responding to shocks that may not have any influence on macroeconomic factors in Malaysia. As the yield curve provides important information on expectations of the economic conditions, it is therefore important to understand the extent of the co-movement between the domestic and foreign yield curves. Given this motivation, this study attempts to assess the importance of foreign yields in influencing the domestic yield curve. The study also evaluates whether there are any important differences in the response of the MGS yield curve to shocks originating from the advanced economies compared to those emanating from the regional bond markets.

Information content of the yield curve

The study of the yield curve is developed based on the term structure of interest rates, which is built upon the expectations hypothesis (EH)[1]. EH essentially equalises the long-term interest rates with short-term interest rates and market expectations of future interest rates[2] and a risk premium, reflecting the opportunity costs of holding bonds. The yield curve is a plot of yields on securities of different maturities at a particular point in time. These maturities range from the shortest period of one month, up to ten, or even thirty years for the more advanced markets. Accordingly, the shapes of the yield curve provide an indication of market expectations of the future path of short-term interest rates. A normal yield curve is upward sloping as longer-maturity bonds would carry higher yields due to an increase in risk associated with time. A steepening yield curve reflects market expectations of higher short-term rates in the future underpinned by anticipation of a higher policy rate following expectations of rising inflation. The reverse is true in the case of a flattening of the yield curve. The yield curve could also shift in a parallel manner, in which both short-term and long-term yields move in the same direction following a change in risk premia across all maturities. The risk premia for government bonds refers to the added compensation needed for investors to hold domestic bonds given the overall risk profile of a country, including its default risk, credit risk and liquidity risk. A country with weak fiscal discipline and rising credit risk, for instance, would have to offer a higher yield to draw investors into holding its bonds.

Estimating the response of the MGS yield curve to shocks from foreign government bond markets

One of the approaches in modeling the yield curve is the Nelson-Siegel (NS) exponential framework[3]. The model estimates three measures of the yield curve, which represent the level, slope and curvature components of the yield curve. These components refer to how the shape of the yield curve would change following a shock. The level component refers to the effect of the shock on long-term yields and such an effect is normally reflected in parallel shifts in yields of all maturities. A shift in the level component reflects structural influences such as a change in the market perceptions on a country's long-term inflation outlook, or a change in the assessment of credit worthiness of a country. The slope component reflects the effect of the shocks to short-term yields that will result in a change in the degree of steepness of the yield curve. The key factor that often alters the slope of the yield curve is a change in market expectations about domestic monetary policy decisions. As central banks

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1 Apart from EH, there are other theories used to explain the term structure of interest rates, and these include liquidity premium theory, market segmentation theory, pure expectations theory and preferred habitat theory.

2 $(1 + i_{lt})^n = \rho + (1 + i_{st})^1(1 + i_{st})^2 \ldots\ldots(1 + i_{st})^n$ where the subscripts lt, st are abbreviations for long-term and short-term respectively. ρ is the risk premium and the superscripts $1,2,\ldots\ldots n$ indicate the time periods.

3 The model is developed by Nelson and Siegel (1987) and extended by Diebold and Li (2006).

generally target a very short-term interest rate, a shift in the market's expectations towards a lower future policy rate for example, will cause the yield curve to flatten, reflecting lower short-term interest rates in the future. The curvature component refers to the effect of the shock on medium-term yields compared to other maturities, which would cause the yield curve to become more 'hump-shaped'. All these components are unobservable but the NS framework would allow the estimation for these underlying components. Through the estimation of these components, a time varying yield curve could be established and its dynamics could be tested against the relevant factors that drive the movements of short-term and long-term bond yields. In this study, the NS methodology is employed to distinguish the responses of the MGS yield curve to shocks that originate from either the advanced or regional markets. Using monthly data from four advanced economies and seven regional economies[4], the slope and level components of the yield curves are extracted for each of the eleven countries.

After obtaining the different components of the yield curves, the study adopts a two-step approach to test for co-movements. In the first step, a variance decomposition study is undertaken to assess the extent of co-movement of MGS yields vis-à-vis movements of the foreign sovereign bond yields. Next, the respective bond yield components from the regional and advanced markets are analysed along with the MGS yield components using the VAR model, in which the re-aggregated generalised impulse response function is generated to synthesise the dynamic responses of the MGS yield curve to shocks coming from the regional and advanced economies. This exercise would be useful in determining whether there are important differences in the responses of MGS yields to shocks from the regional and advanced economies.

Strong co-movement between MGS and foreign government bond yields

The results from the variance decomposition approach show the significant co-movements between foreign government bond yields and the MGS yields. In terms of the long-term yields, it appears that both regional and advanced markets collectively contribute by about 80% of the total variations in the long-term MGS yields with the advanced markets alone accounting for about 45% of the total variations. For the short-term MGS yields, the regional and advanced markets together contribute over two-third to the total variations in MGS yields. These results generally conform to empirical findings for financially open capital markets in which variations in yield curves globally could account for the majority of the variations in the slope and level factors[5]. In particular, the strong co-movement of yields reflects the importance of the advanced markets in influencing global asset prices (including sovereign yields). This is supported by the IMF Spillover Report for the US, which highlights that the US market represents close to two-thirds of the total equity and government bond market turnover of the five large and systemically-important economies[6]. Such a global dominance of the US financial markets has often contributed to large spillover effects of asset prices in the US on other markets[7].

MGS yield curve respond differently to shocks from advanced markets compared to shocks from regional markets

The results of the second part of the study are broadly summarised in Chart 1, which shows the impulse responses of the MGS level and slope components following shocks to the corresponding yield components of the advanced and regional markets. The impulse response is calculated over the 1-month, 3-month, 6-month and 12-month horizons. A notable pattern is observed in which the MGS yield curve responds differently to shocks from advanced markets vis-à-vis shocks from regional markets.

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[4] The advanced economies comprise of the euro area, the UK, the US, and Japan while regional markets include PR China, Hong Kong SAR, Indonesia, the Philippines, Singapore and Thailand. Data length varies for each country, from the earliest 1992 up to 2011.

[5] Diebold, Li and Yue (2008) shows that global level factors account for 60% to 80% of total variations in the US, Japan, Germany and the UK, while global slope factor accounts for almost entire variations for economies with common business cycle.

[6] The five 'systemic' economies are PR China, the euro area, Japan, the UK and the US. Sourced from The United States Spillover report by IMF, July 2011.

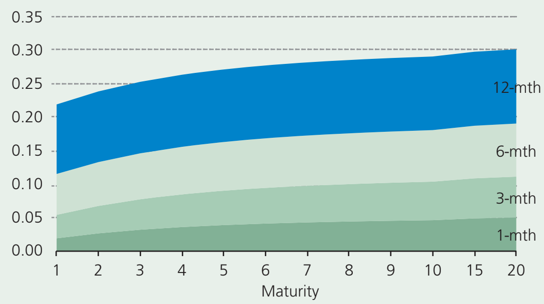
[7] The report indicated that the US interest rates and global risk measures explain over half of the variation in Emerging Market Economies (EME) spreads.

Chart 1

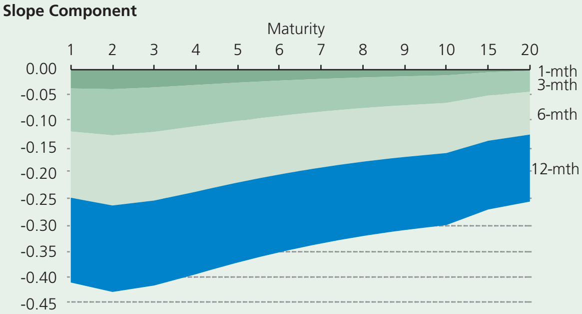
Re-aggregated Generalised Impulse Response Functions

Panel A: Dynamic Responses of the MGS Yield Curve to Shocks to Yields in the Advanced Markets

Level Component

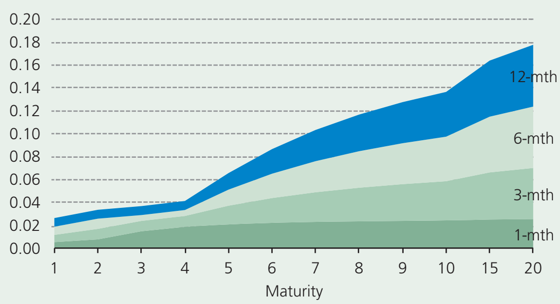


Slope Component

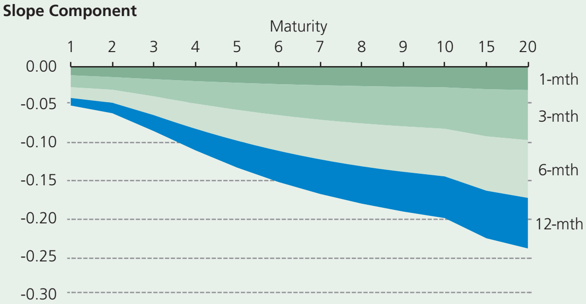


Panel B: Dynamic Responses of the MGS Yield Curve to Shocks to Yields in the Regional Markets

Level Component



Slope Component



Note: The R-GIRFs show the effect of yields compared to its baseline; a negative response of the R-GIRF means the yields fall below the baseline rather than implying a negative yield.

Source: Bank Negara Malaysia, Bloomberg

Shocks from advanced markets influenced the MGS yield curve through risk premium adjustments

A shock[8] in the slope and level components of the yield curves in the advanced economies leads to a parallel shift in the MGS yield curve (Panel A). The parallel shift in the yield curve suggests that the shock from the government bond markets in the advanced economies is transmitted to MGS yields through risk premium adjustments. For example, a negative shock to investors' balance sheets or increased uncertainty in the advanced markets would cause domestic and foreign investors to liquidate their assets in emerging markets in favour of more liquid assets in other markets[9]. This means that, for a given level of expected future growth and inflation in the domestic economy, investors would require a higher compensation for holding domestic bonds. The investor behavior in disengaging from the emerging markets could result in a tightening of liquidity conditions in the domestic market, which will be reflected as an increase in the risk premium, resulting in an upward shift in the yield curve. Such adjustments could take place even without substantial changes in the fundamentals of the domestic economy, hence causing a temporary disconnection between information retrieved from the yield curve and economic fundamentals.

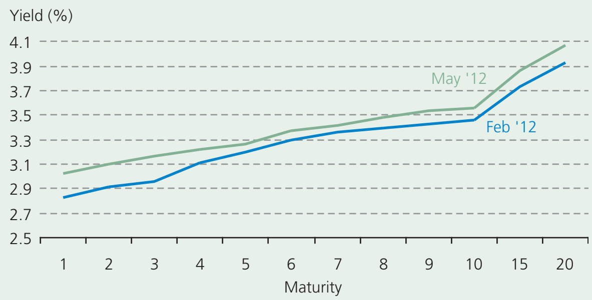
[8] This study is not meant to assess how different type of shocks could affect bond yields in advanced or regional markets. Nevertheless, for illustration purposes, a factor that could result in a parallel shift of the yield curve in advanced economies could be driven by heighten sovereign risks, which would result in a sharp rise in the bond yields across all maturities.

[9] See Krishnamurthy (2009) and Frankel and Schmukler (1998).

Chart 2 exemplifies the movement of the MGS yield curve following a heightening of risk aversion in the euro area in the second quarter of 2012. The MGS yield curve shifted up in parallel during this period despite an unchanged domestic monetary policy and macroeconomic conditions.

Chart 2

Impact of the Euro Area Sovereign Debt Crisis in 2012 on the MGS Yield Curve



Source: Bank Negara Malaysia

Shocks from regional markets influenced the MGS yield curve through growth and inflation expectations

A shock to the slope and level components of regional bond yields result in a tilting (flattening or steepening) of the MGS yield curve (Panel B) rather than a shift in yields of all maturities as observed in the case of the advanced markets. While economic fundamentals in the region varies, the tilting movement of the MGS yield curve broadly reflects the similarity in growth and inflation expectations in the regional markets, given the strong synchronisation of business cycles within the region, which is primarily driven by greater trade and financial integration[10]. Also, given the extensive production network within the region and its central role in the global supply chain, the region is likely to be exposed to common global shocks. For example, an adverse shock on global demand would be manifested into slower growth and more subdued inflation for regional economies and this will be translated into expectations of a policy rate cut. Such expectations in regional economies would be reflected in a flattening of the yield curve in the region. Investors, therefore, tend to assess the regional economies as a group and hence may fail to distinguish key differences between these economies. This leaves the regional markets exposed to more synchronised surges and reversals of capital flows.

Conclusion

The study indicates that there are important differences in the response of the MGS yield curve to shocks from the government bond markets in the advanced and regional economies. Shocks from the advanced markets would induce risk premia adjustments while shocks from the regional markets are reflected in changes in growth and inflation expectations. Such findings point towards the increasing influence of global sentiments in affecting the domestic government bond market. While the growing financial integration helps to deepen the domestic bond markets, it also brings many challenges. In particular, this article highlights that changes in global sentiments and regional economic outlook could alter the shape of the MGS yield curve, even in the absence of changes in the domestic economic conditions.

[10] Studies by Sato and Zhang (2006) and Rana (2007) provide support to the synchronisation of business cycles in the East Asian region.

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of 2012, improved market sentiments and kept the FBM KLCI on an upward trend. The performance of the domestic market also attracted buying interest from non-residents, with non-resident net purchases of equities averaging around RM1.3 billion per month in the second half of 2012. The index reached a new high of 1,675.7 points on 1 November 2012 before retracting in response to profit-taking and growing worries over the US fiscal cliff. In December, the upward momentum of the index resumed, with the index ending the year at another new high of 1,689 points. This renewed surge reflected optimism surrounding the resolution for the US fiscal cliff issue and higher demand for blue-chips stocks.

In terms of the domestic market fundamentals, equity prices during the year were driven mainly by the finance-related stocks due to the sustained favourable performance of firms within this sector. In addition, robust activity in the initial public offering (IPO) market provided further support to the domestic equity market following successful issuances of large IPOs such as Felda Global Ventures Holdings Bhd (fourth largest in the world[9]), IHH Healthcare Bhd and Astro Malaysia Holdings. Overall, market capitalisation increased to RM1.47 trillion as at end-2012 (2011: RM1.28 trillion), while daily average turnover increased to 1.36 billion units (2011: 1.34 billion units).

Liquidity and Monetary Aggregates

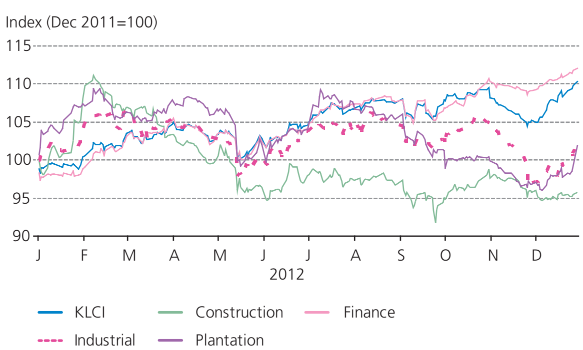
Liquidity in the banking system was ample throughout 2012. Bank Negara Malaysia's operations were focused on managing the surplus liquidity and maintaining stable monetary conditions. Private sector liquidity continued to expand mainly on account of favourable credit conditions and continued inflows of foreign funds into Malaysia.

In the banking system, ample liquidity conditions prevailed at both the system-wide and institutional levels. This was evidenced by the large number of financial institutions with net placements of funds in the interbank market. At the system level, compared to 2011, liquidity conditions in the interbank money market in 2012 were more stable, reflecting more balanced two-way flows from trade and investment. Overall, surplus liquidity placed with Bank Negara Malaysia grew by a modest 1.1% in 2012 (2011: 22.5%).

Bank Negara Malaysia conducted operations in the domestic money market to manage the surplus liquidity. A build-up of excess liquidity could give rise to financial distortions including an 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 misalignment in asset prices. Accordingly, excess liquidity in the banking system was absorbed through a wide range of market-oriented instruments including direct borrowing, and the Statutory Reserve Requirement (SRR). During the year, the ratio was maintained at 4.00%. Greater emphasis was accorded to the use of securities-based instruments such as repurchase agreements (repos) and Bank Negara Malaysia

Chart 2.19

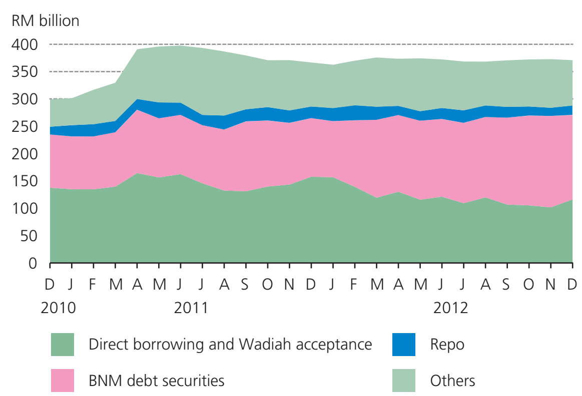
KLCI and Bursa Malaysia Sectoral Indices



Source: Bloomberg

Chart 2.20

Outstanding Liquidity Placed with BNM (at end period)

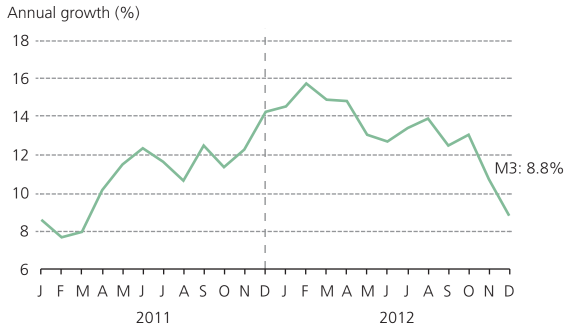


Source: Bank Negara Malaysia

[9] Source: Annual Report 2012, Bursa Malaysia.

Chart 2.21

Broad Money, M3



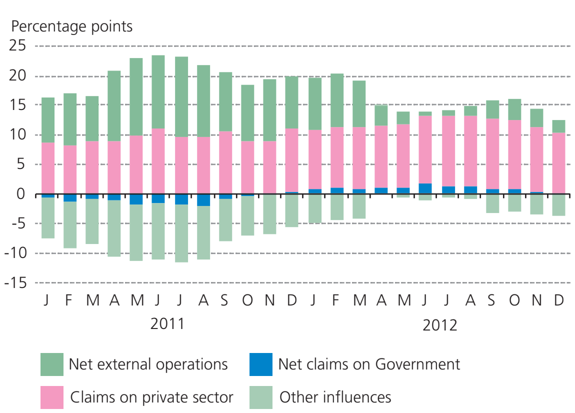
Source: Bank Negara Malaysia

Notes (BNMNs) for draining surplus liquidity from the system, as well as facilitating greater flexibility in liquidity management by financial institutions.

Private sector liquidity, as measured by broad money or M3, grew by 8.8% during the year. The increase was underpinned by both domestic and external factors. On the domestic side, private sector liquidity rose substantially on account of higher credit extension by banks to businesses and households, in line with the sustained domestic demand. On the external side, broad money expanded due to net foreign inflows, reflecting Malaysia's trade surplus and portfolio inflows. The expansion in M3, however, was contained in part by sterilisation operations by the Bank. This was reflected in the contraction of 'other influences'.

Chart 2.22

Contribution to M3 Growth



Source: Bank Negara Malaysia

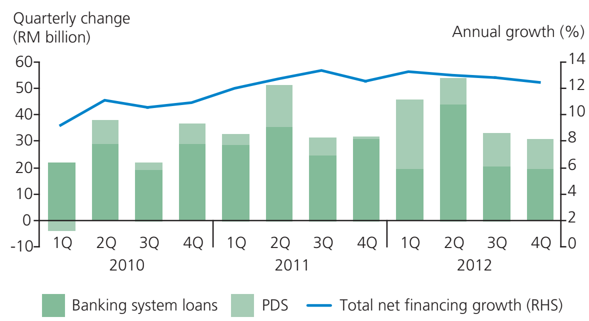
FINANCING OF THE ECONOMY

Financing to businesses and households remained supportive of domestic economic activity in 2012. The reasonable cost of borrowing and ample liquidity conditions in the financial system sustained financing to all segments of the economy.

Strong financing growth mainly reflected increased financing to domestic-oriented businesses

Chart 2.23

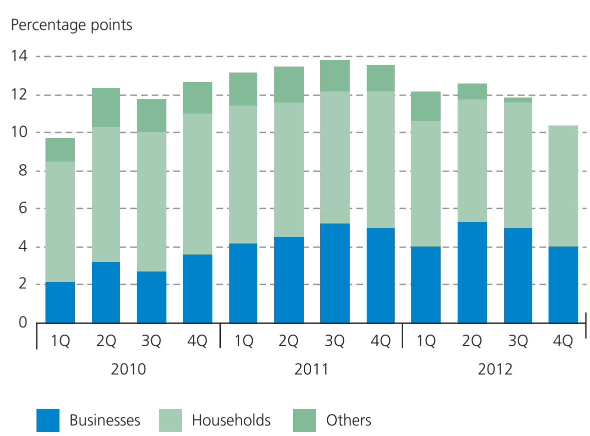
Total Net Financing to the Private Sector through Banking System Loans and PDS Issuances



Source: Bank Negara Malaysia

Chart 2.24

Contribution to Annual Growth in Total Loans Outstanding



Source: Bank Negara Malaysia

Private sector financing expanded in line with the continued expansion in domestic demand. For the year as a whole, net financing to the private sector through the banking system and the capital market expanded at an annual rate of 12.4% (2011: 12.5%). The strength in financing growth during the year was attributable mainly to business financing, which was driven by the strong performance of the domestic-oriented businesses and those involved in ETP-related projects. Demand for financing from households showed a gradual downward trend during the year.

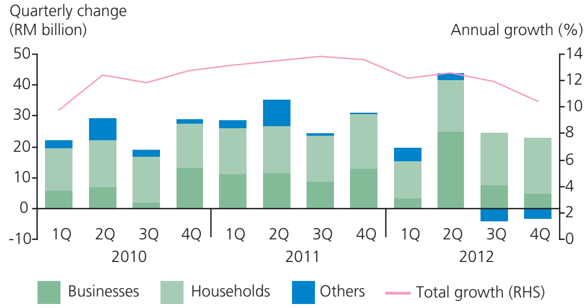
In the business sector, total financing extended through financial institutions and the capital market increased by 14.5% (2011: 11.5%). The expansion in banking system loans to businesses (2012: 10.9%; 2011: 13.5%) reflected the increase in loans disbursed mainly to finance the investment and working capital needs of domestic-oriented businesses, especially those involved in the ETP-related projects and commodity-related sectors. The bulk of the loans were extended to the *real estate; wholesale and retail, restaurants and hotels; finance, insurance and business services; agriculture* and *construction* sectors. Hence, notwithstanding a moderation in loan applications from the *manufacturing* sector due to weaker external demand conditions, the overall demand for loans by businesses remained strong, underpinned by the sustained growth in business and investment activity.

Business demand for funding from the capital market increased significantly, with issuances of PDS amounting to RM121.1 billion in 2012 (2011: RM69.6 billion). The bulk of the issuances were from the *finance, insurance, real estate and business services* and *transport, storage and communications* sectors to fund infrastructure and ETP-related projects as well as for working capital requirements. Financing via the equity market also increased significantly to RM27.4 billion (2011: RM12.6 billion), following several large IPOs from the *plantation* and *services* sectors.

Demand for loans by households, while still remaining relatively strong, showed signs of moderation. Outstanding loans increased by 11.6% in 2012 (2011: 12.9%), driven mainly by

Chart 2.25

Loans Outstanding by Borrowers

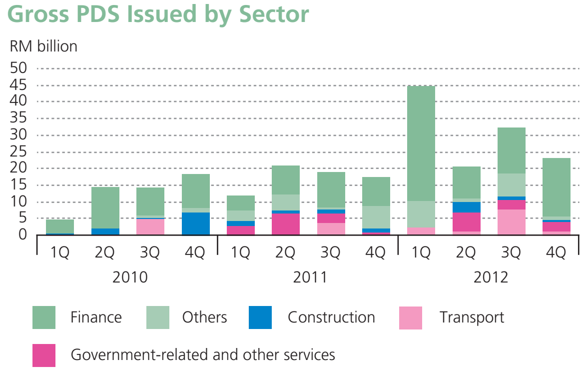


Source: Bank Negara Malaysia

loans for the *purchase of residential properties, passenger cars* and *securities*. Favourable employment prospects and sustained income growth supported the demand for financing from households during the year. Loan growth for the *purchase of passenger cars* increased to 7.7% in 2012 (2011: 5.9%). Loan growth from consumption credit moderated to 6.2% in 2012 (2011:15.4%), partly reflecting the pre-emptive measures instituted by the Bank to ensure prudent debt levels and to prevent potential risks arising from excessive credit expansion. The slowing trend in household loans was, however, gradual as loans for the *purchase of residential* and *non-residential properties*, which accounts for the bulk of household loans (56% of total household loans outstanding), continued to grow, albeit at a more moderate pace.

Chart 2.26

Gross PDS Issued by Sector



Source: Bank Negara Malaysia

2012

MONETARY POLICY IN 2012

MONETARY POLICY

Monetary policy in 2012 was focused on managing the downside risks to growth amid moderating inflation. Although the Malaysian economy remained on a steady growth path and inflation was on a downward trend, the high degree of global economic and financial uncertainty remained a risk. In balancing the risks to inflation and growth of the economy, the Monetary Policy Committee (MPC) was unanimous in the decision to maintain the Overnight Policy Rate (OPR) at 3.00% throughout 2012.

> Monetary policy in 2012 balanced between supporting growth and maintaining price stability

At the outset of 2012, the MPC assessed that the prospects for global growth had weakened compared to the previous year. The threat to global growth came predominantly from the economic and financial conditions in the advanced economies. The European sovereign debt crisis continued to affect the international financial markets. In the US and euro area, labour market conditions were still weak, fiscal consolidation was ongoing and policy uncertainties remained significant. Consequently, financial market volatility remained high and financial intermediation in these economies continued to be impaired. In the Asian region, while GDP growth was expected to be supported by domestic demand, the growth momentum was projected to moderate amid the weaker external environment. A distinguishing factor from the previous year was the additional uncertainty over the strength of economic activity in PR China and its ability to continue to support external demand in the region. In its January 2012 update of the World Economic Outlook (WEO), the International Monetary Fund (IMF) revised downwards its global growth forecast for 2012 from 4.0% to 3.3%. This meant that world growth in 2012 would be lower than the 3.9% recorded in 2011.

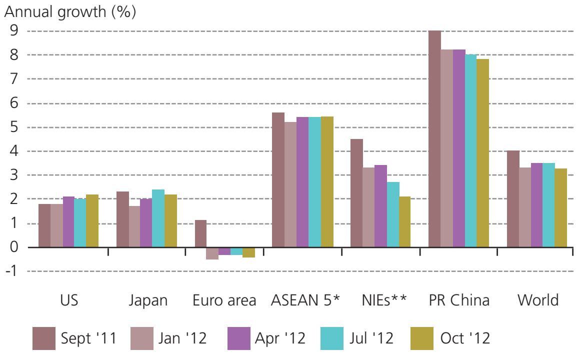
Given Malaysia's highly open economy, its growth would be affected by the moderation in global economic activity. Net exports was expected to contribute negatively to growth in 2012. Nevertheless, domestic demand was expected to support growth, driven by private sector activity and further reinforced by public sector spending. Private consumption would be supported by stable employment conditions, positive income growth and fiscal transfers to targeted households. Investment activity would be supported by capital spending in the domestic-oriented sectors, in the oil and gas industry and in projects related to the Economic Transformation Programme (ETP). With domestic demand supporting the Malaysian economy, GDP growth for 2012 was projected to be in the range of 4-5%.

In terms of inflation, the MPC assessed at the beginning of the year that the impact of domestic demand factors on inflation in 2012 would be contained. Despite the firm domestic demand, there was still excess capacity in the economy. Labour supply in the economy was adequate, and productivity would continue to improve. Cost-push inflation was expected to decline with the slowing global economic activity, alleviating the pressure on prices of key food and energy commodities. The subdued global inflation environment would also reduce imported inflation. Consequently, cost pressures were expected to be modest and firms were not expected to significantly raise retail prices. Headline inflation was therefore expected to moderate to a range of 2.5-3.0% in 2012, lower than the 3.2% recorded in 2011. Nevertheless, there were upside risks to inflation arising from potential global supply disruptions and the financialisation of commodities, which could result in higher commodity and food prices.

The MPC assessed that the risks to domestic growth and inflation were broadly in balance. Domestic growth was expected to be resilient but external developments created strong downside

Chart 3.1

Outlook for Real GDP Growth in 2012

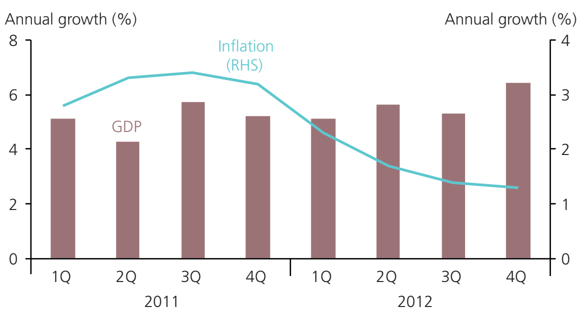


*Indonesia, Malaysia, Philippines, Thailand and Vietnam
**Newly Industrialised Economies

Source: IMF, WEO September 2011, January, April, July and October 2012

Chart 3.2

GDP and Inflation



Source: Department of Statistics and Bank Negara Malaysia

risks to the economic outlook. At the same time, while inflation was projected to moderate, potential disruptions to global supply and volatile commodity prices created upside risks to the inflation outlook. The OPR was therefore left unchanged at 3.00% in the first half of the year.

As the year progressed, there were tentative signs of improvements in the global economic and financial conditions. The recovery in the US economy showed signs of improvement, underpinned by positive credit growth, sluggish but improving labour market conditions and stabilisation of the housing market. Stress in the international financial markets was also partially alleviated by the introduction of measures to address the European sovereign debt crisis and further monetary easing by the advanced economies. Nevertheless, the underlying economic and financial conditions in the advanced economies remained vulnerable and uncertain. Concerns over fiscal sustainability in the US and euro area persisted. In the euro area, austerity measures and tight credit conditions continued to constrain growth. In the US, concerns increased over the possible discontinuation of a sizeable portion of the US fiscal support, which would have a significant impact on growth in the US. The reality was that the growth prospects of the advanced economies, and therefore for the global economy, remained fragile and subject to considerable downside risks.

By September, there was growing evidence that the global growth momentum had in fact moderated. Key indicators in the advanced economies still pointed towards weak economic activity, thus dampening prospects for the global economy for the remainder of 2012 and into 2013. At the same time, domestic demand in the Asian economies, including PR China, was showing signs of moderation. After having revised upwards the 2012 world GDP growth outlook to 3.5% in its April 2012 update of the WEO, the IMF subsequently revised its forecast downwards to 3.3% in October 2012. Similarly, the forecast for world GDP growth in 2013 was revised downwards from 4.1% to 3.6%.

While the domestic economy was affected by the weakness in the external environment, it became clearer as the year unfolded that the sustained expansion in domestic activity would be able to partially offset these external developments, as domestic consumption and investment recorded stronger-than-expected growth. Indicators and surveys of business conditions throughout the year pointed to the continued expansion of private consumption and business spending. In assessing the outlook for 2013, private consumption was expected to receive additional support from sustained positive consumer sentiments, income growth, the access to credit from the banking system, and the various fiscal transfers to households by the Government. In addition, the growth in private investment in the domestic-oriented sectors was likely to be high. Public investment would also be robust, with high capital spending by the public enterprises and continued growth in the Federal Government development expenditure. GDP growth in 2013 is expected to remain firm in the region of the level in 2012, with domestic demand continuing to have a significant role.

With regard to prices, headline inflation turned out to be below the Bank's initial forecast due to lower food prices amid better-than-expected domestic food supply conditions. The lower inflation was also due to the subdued global price pressures arising from slower global growth and the base effect following sharp and large increases in inflation in the previous year. The sustained domestic demand did not lead to significant increases in prices, as cost pressures were notably subdued during the year and there were efficiency gains from a stronger increase in productivity relative to income growth. In addition, the assessment was that while inflation might be higher in 2013 compared to 2012, it would remain moderate, as global energy and commodity prices were likely to be contained given the ongoing weak global conditions. Nevertheless, the upside risks to inflation emanating from possible global supply disruptions continued to be a source of vulnerability.

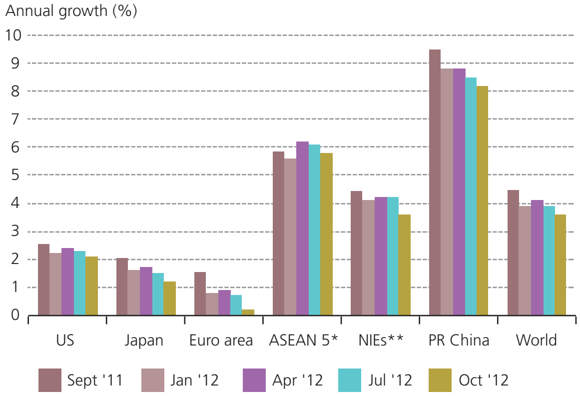
Despite the adverse external environment, the performance of the domestic economy continued to surprise on the upside, with a better-than-expected performance. The strong performance of the economy and relatively muted inflationary conditions led the MPC to maintain its monetary policy stance throughout the second half of the year.

MPC members viewed that the strong loan demand throughout the year, while warranting close monitoring, was not a concern, as total loan growth was supported mainly by lending to businesses, particularly to those in the domestic-oriented industries and ETP-related projects. Nevertheless, there were concerns over the potential risk of excessive indebtedness in certain segments of the household sector. The MPC was therefore of the view that a change in the monetary policy stance was not appropriate. The Bank had already introduced macroprudential measures and the guidelines issued on responsible financing practices at the beginning of the year and these were gradually having the effects of slowing loan growth to the household sector. The growth of banking system loans to households moderated from 12.9% in December 2011 to 11.6% in December 2012. Nevertheless, developments in household credit continued to be closely monitored to ensure that the risk of household indebtedness becoming excessive remained contained.

Monetary policy was also confronted with the challenge of sustained large and volatile capital flows throughout the year. The easy monetary policy and low interest rate environment in the advanced economies had created substantial global surplus liquidity that was in search of higher yields. Given the better yields and growth prospects of the emerging economies, including Malaysia, it attracted this surplus liquidity in the form of portfolio flows. Furthermore, developments in the advanced economies and changing sentiments in the global financial markets made

Chart 3.3

Outlook for Real GDP Growth in 2013

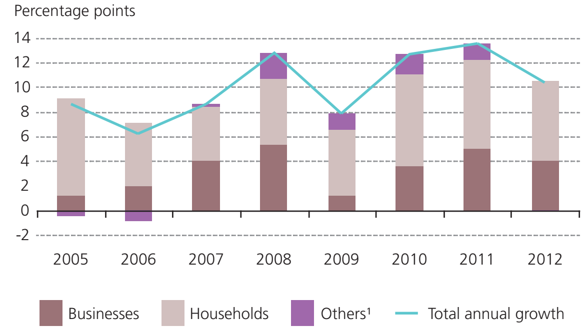


*Indonesia, Malaysia, Philippines, Thailand and Vietnam
**Newly Industrialised Economies

Source: IMF, WEO September 2011, January, April, July and October 2012

Chart 3.4

Contribution to Annual Growth in Total Loans Outstanding



[1] Others refers to government, financial institutions, foreign enterprises and other domestic entities

Source: Bank Negara Malaysia

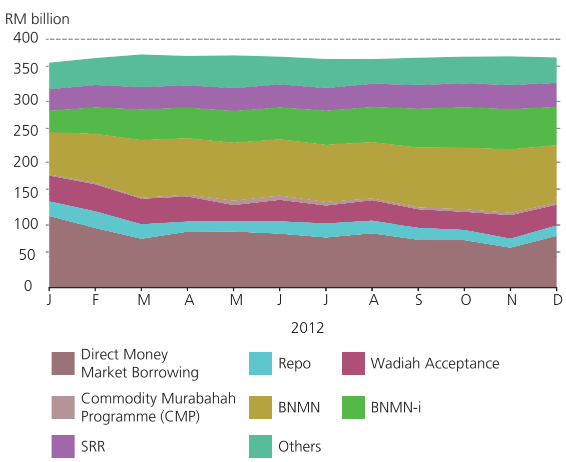
these flows highly volatile. For the most part, the financial system was able to effectively intermediate these flows without generating substantial distortions in the financial markets. The deepening of the Malaysian financial system over this recent decade had increased the capacity of domestic financial intermediaries and markets to intermediate the inward and outward movements of portfolio flows. In addition, the more liberalised environment generated two-way flows that moderated the volatility of the flows.

MONETARY OPERATIONS

During the year, the domestic money market remained stable amid ample liquidity in the domestic banking system despite the uncertainties and volatility in the global markets. The interbank market continued to record healthy levels of activity and trading volumes under the surplus liquidity environment. All participants were net lenders to the Bank. Average aggregate surplus liquidity for the year amounted to RM370.9 billion, with liquidity reaching a high of RM375.7 billion in March 2012. Interbank money market transactions recorded a volume of RM1,138 billion, an increase of 35% compared to the previous year. The bulk of the interbank money market transactions were focused on short-term maturities (overnight and 1-week), which were preferred by interbank market players for short-term liquidity management.

Chart 3.5

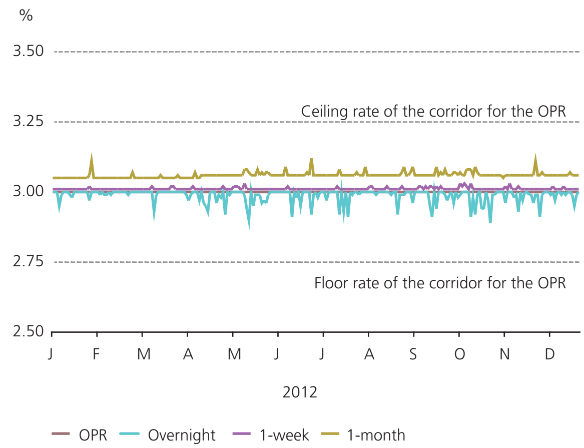
Outstanding Liquidity Placed with Bank Negara Malaysia



Source: Bank Negara Malaysia

Chart 3.6

OPR and Interbank Rates



Source: Bank Negara Malaysia

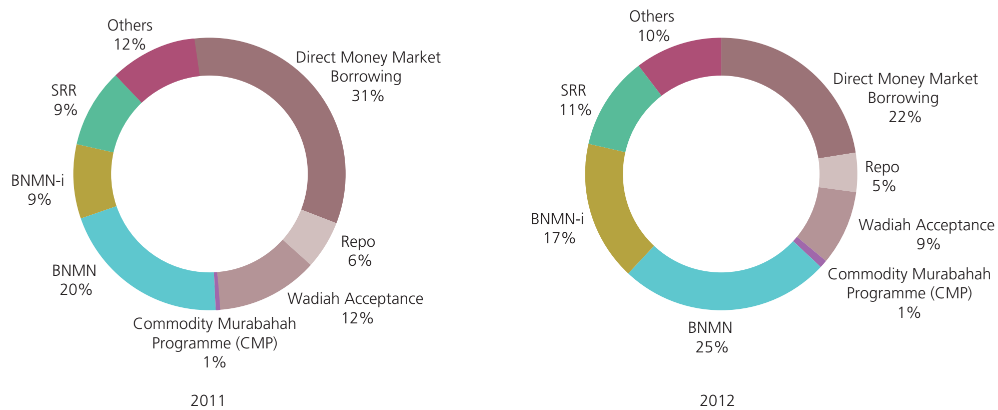
With the stable money market conditions, interbank rates across all tenures traded within fairly narrow spreads. The average overnight interbank rate (AOIR) tracked the OPR closely, ranging between 2.89% and 3.00%, with an average deviation (AOIR minus OPR) of 1 basis point.

In line with the recommendations outlined in the Financial Sector Blueprint 2011-2020 to promote an efficient and competitive money market with greater depth and liquidity, the Bank shifted the conduct of monetary operations to favour securities-based and collateralised transactions. During the year, the Bank gradually increased the issuance of conventional and Islamic Bank Negara Monetary Notes (BNMNs), thus reducing reliance on unsecured borrowings. Securities-based monetary operations increased from 36% to 48% of total operations in 2012.

The yields on BNMNs were below the OPR during the first quarter as market participants expected BNM to lower the OPR given the slower global growth outlook and its impact on the domestic economy. However, the yields normalised from the second quarter onwards as the financial markets settled on the view of an unchanged OPR at 3.00% throughout the year. The second half of the year also saw continued strong demand for BNMNs by banks and non-resident investors, which led to the yields trading closer to the OPR. The strong preference for BNMNs enabled the Bank to drain the surplus liquidity for a longer period and lengthen the maturity profile of its monetary instruments.

Chart 3.7

Breakdown of Outstanding Monetary Policy Instruments



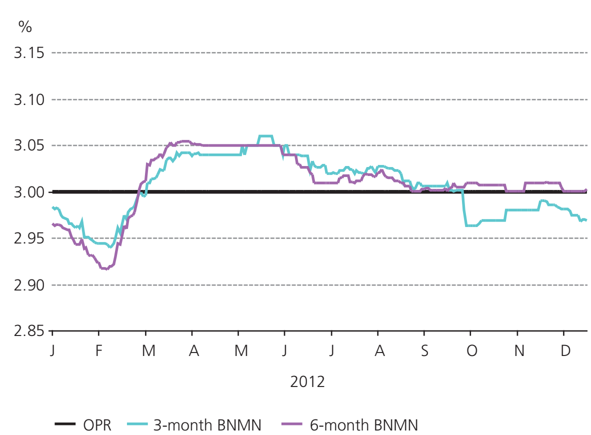
Source: Bank Negara Malaysia

The list of eligible collateral has been expanded to include non-ringgit securities issued by the Malaysian Government, securities issued by the governments and central banks of EMEAP-member economies in major and respective home currencies, as well as US Treasuries and UK Gilts

In May 2012, the Bank released a new guideline under the Standing Facility framework that expanded the list of eligible collateral to facilitate more robust liquidity management by financial market participants. The framework, which initially only accepted ringgit denominated securities, has been expanded to include non-ringgit securities issued by the Malaysian Government, securities issued by the governments and central banks of Executives' Meeting of East Asia Pacific Central Banks (EMEAP)-member economies in US dollars, pound sterling, euro, Japanese yen, and the respective home currencies, as well as US Treasuries and UK Gilts. In addition, the Bank will also accept home currency sovereign issues and the currencies of countries with which the Bank has signed cross-border collateral arrangements (CBCAs). Currently the Bank has such arrangements with Singapore and Thailand. The expanded framework is in line with efforts to strengthen cross-border liquidity management through the CBCAs, by allowing financial institutions operating in these countries to pledge foreign denominated securities and currencies to obtain liquidity from the respective central banks. This revision will also facilitate a greater regional orientation of financial institutions and increase cross-border activities within the region. In the revised guidelines, the Bank, in accepting securities issued in major currencies by multilateral development banks and multilateral financial institutions, will also recognise International Islamic Liquidity Management Corporation (IILM) securities as eligible collateral for the standing facility. IILM, an international institution established

Chart 3.8

BNMN Yields and OPR



Source: Bank Negara Malaysia

in October 2010 by central banks, monetary authorities and multilateral organisations, was set up to issue short-term Shariah-compliant financial instruments to facilitate effective cross-border Islamic liquidity management.

For Islamic money market operations, the Bank introduced Collateralised Murabahah in May 2012, as an alternative instrument for Islamic banks to obtain liquidity from the Bank under the standing facility. Collateralised Murabahah is essentially secured financing which combines the widely accepted Murabahah financing transaction with Sukuk to form the pledged collateral. The main objective of introducing Collateralised Murabahah is to offer a new low credit-risk financial instrument that promotes collateralised transactions in the Islamic money market in Malaysia. As an alternative to the existing sell buy back arrangement, the new instrument adds diversity to the repo-like liquidity management tool in the Islamic financial market. In future, it will also be expanded to facilitate daily Islamic money market operations (Islamic repos).

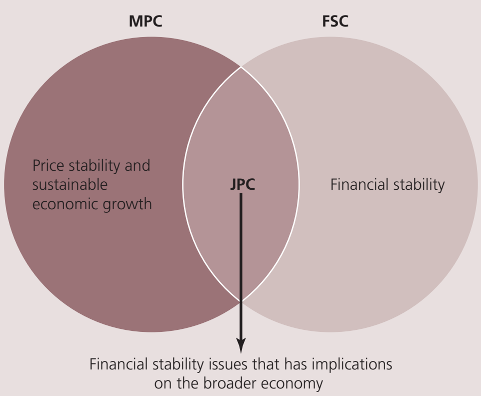
Bank Negara Malaysia's Joint Policy Committee

Bank Negara Malaysia has always recognised the interdependence of monetary policy and financial stability. The financial crisis in the advanced economies has amplified the importance of the relationship between these two types of policies. While the effective conduct of monetary policy presupposes a sound and stable financial system to provide an effective monetary transmission mechanism, continued financial stability, in turn, requires sound macroeconomic conditions, including an effective monetary policy. For example, given the pivotal role of the financial system in the intermediation process, a breakdown in financial stability can disrupt the monetary transmission mechanism by disrupting financial intermediation and the flow of credit to the economy, rendering monetary policy less effective. Similarly, a monetary policy stance that allows for prolonged low interest rates could lead to the build-up of financial imbalances, which in turn, increases the risks to financial stability.

As monetary and financial policies are highly interdependent, effective coordination of these policies is critical towards preserving sustainable macroeconomic conditions. In recognition of this, the Bank has established the Joint Policy Committee (JPC), a high-level internal policy committee, to deliberate on cross-cutting issues and to ensure the effective coordination of policies that may have an impact on the financial system and the broader economy. The joint forum framework facilitates broader surveillance and a more comprehensive risk assessment of issues by combining macroeconomic surveillance with micro-level analysis of the financial sector. This allows the Bank to act pre-emptively on emerging issues in a more coordinated and timely manner. The JPC is equipped with a broad range of powers and macroprudential instruments to undertake its mandates.

Chart 1

Demarcation of Responsibilities



The JPC is activated when either the Monetary Policy Committee (MPC) or Financial Stability Committee[1] (FSC) escalates an issue that has implications on both monetary and financial stability[2]. The Bank convened the inaugural JPC meeting on 7 September 2010. The current Committee consists of the Governor, Deputy Governors and Assistant Governors of the Bank.

Since its inception, several important issues have been brought to the attention of the JPC. Of significance, the JPC discussed the analysis of credit conditions from several perspectives. Given the downside risks to the domestic economy that were emanating from the weak global environment and the threat of higher inflation from rising global commodity prices in recent years, the JPC

[1] Refer to white box on 'Operationalisation of the Central Bank of Malaysia Act 2009', Annual Report 2010.
[2] As such, there is no fixed schedule or frequency for JPC meetings.

assessed the resilience of households to income shocks, with the evaluation being undertaken at both the aggregate level and at the disaggregated income levels. More recently, the JPC deliberated on the sustainability of household indebtedness, with detailed analysis of credit trends relative to the fundamentals of the economy and the health of household balance sheets across various income and age groups. This was supplemented by an assessment of the increasing role of non-bank financial institutions in the financing of the household sector. Another issue discussed was the developments in the property market and overall credit conditions in the residential and non-residential property sectors. The analysis on the property market was approached at both the national level, as well as by specific localities. The cumulative outcome of the JPC meetings was the implementation of several targeted macroprudential measures to ensure prudent levels of household debt and prevent excessive speculation in the property market.

Table 1

Outcome of the Joint Policy Committee (JPC) Meetings

Measure	Implementation		Rationale
Maximum loan-to-value (LTV) ratio for housing loans	Nov 2010	• Maximum LTV ratio of 70% applicable on the third and subsequent house financing facilities taken out by a borrower	• Mitigate excessive investment and speculative activity which was resulting in significant house price increases in certain locations
	Dec 2011	• Maximum LTV ratio of 60% for housing loans by non-individuals	
Guidelines on Responsible Financing	Jan 2012	• Financial institutions are required to make appropriate enquiries into a prospective borrower's income after statutory deductions for tax and retirement fund, and consider all debt obligations, in assessing the borrower's affordability • Maximum hire purchase financing of 9 years	• To promote prudent, responsible and transparent retail financing practices by financial institutions • To encourage sound borrowing by helping consumers to consider their ability to service all their debt obligations without recourse to further debt or substantial hardship
Propose for the increase of the real property gains tax (RPGT)	Jan 2012	• The Government increased the real property gains tax to 10% for sales of property within two years of purchase and to 5% for sales between 2 to 5 years	• To discourage speculative activity in the property market

OUTLOOK AND POLICY IN 2013

THE INTERNATIONAL ECONOMIC OUTLOOK

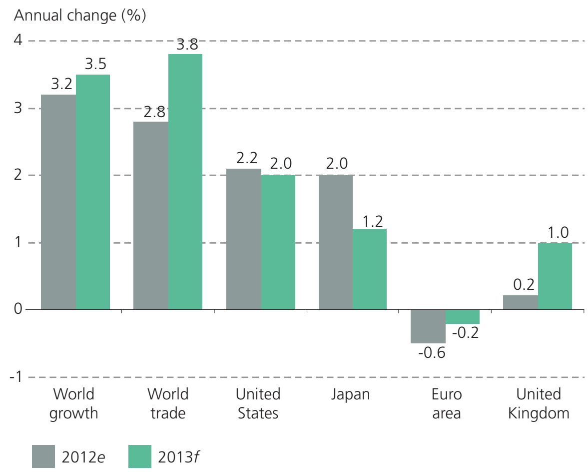
The global growth outlook is expected to improve in 2013. Financial and policy risks have receded compared to the situation over the recent two years. Policy measures introduced in the latter half of 2012 have reduced policy uncertainties and stress in the financial markets. In the advanced economies, the pace of recovery is likely to be weak, with the differential in national growth rates reflecting the degree of economic and financial stress in the individual economies. The outlook for the emerging economies is relatively more favourable, despite their vulnerability to external developments. For most of these economies, domestic demand remains the key driver of growth. Key to the trajectory of inflation will be the prices of commodities, in particular, oil and food crops. Overall, the pace of global growth would be contingent on the strength of the revival in private sector activity in the US, the commitment towards a credible and comprehensive set of crisis resolution policies in the euro area and the sustainability of domestic demand in the emerging economies.

Global growth is expected to improve in 2013

The **US** economy is expected to register modest growth, supported by an improvement in private demand which is expected to partially offset the ongoing fiscal consolidation. Consumption activity will remain a key driver of the private sector-led growth, supported by a recovery in the housing and labour markets. In the housing market, the improvements observed towards the second half of 2012 - in sales, construction starts and prices - are expected to continue in 2013 amid an accommodative interest rate environment. The positive developments in the housing market have already been translated into higher consumer confidence and employment, particularly in the construction sector. The labour market is benefiting from sustained job creation, although the degree of improvement will be constrained

Chart 4.1

World Growth, World Trade and Growth in Major Advanced Economies (2012-2013)



e Estimate
f Forecast

Source: International Monetary Fund and National Authorities

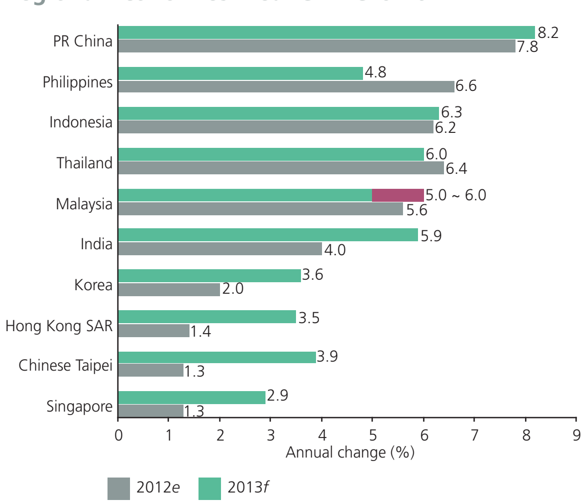
by prevailing structural weaknesses including the elevated long-term unemployment rate and the decline in the labour force participation rate. A significant development is the improvements in the household balance sheet and its effects on consumer confidence. By mid-2012, household net worth improved by 27% since 2009, bolstered by the recovery in house prices and the progress in deleveraging. Nevertheless, a faster pace of recovery of the economy continues to be constrained by the fiscal headwinds. Although the 'fiscal cliff' was partially averted following the agreement on 1 January 2013 to extend selected tax cuts and unemployment benefits, other measures, such as the expiration of payroll tax and sequester cuts, could dampen the pace of recovery.

Economic activity in the **euro area** is expected to remain weak due to structural constraints and the continued fiscal consolidation. While tensions in the financial markets have receded, fragile growth still persists particularly in the crisis-affected economies due to the ongoing fiscal austerity measures and structural adjustments. The sustainability of the fiscal position of the crisis-affected economies in the euro area remains a major concern, with public debt ranging between 90% and 171% in 2012. Private sector activity is further undermined by the tight financing conditions and weak labour markets. Financial institutions continue to be affected by their exposure to crisis-affected economies, hampering the provision of credit to the real economy. Labour market conditions are particularly weak in the crisis-affected economies such as Spain and Greece, where unemployment rates are at 26.2% and 26.6% respectively in November 2012. At the regional level, policy decisions directed towards the strengthening of the euro area, including in the area of banking union and greater fiscal cooperation, will continue to influence financial markets, business sentiments and subsequently growth.

In **Japan,** economic growth is expected to moderate, reflecting the diminishing effects from reconstruction-related demand over the recent two years, amid protracted weakness in domestic activity. While the nation's export performance is expected to recover gradually, growth will be supported primarily by more monetary and fiscal stimulus. Of significance, the Bank of Japan's recently introduced price stability target of 2% and commitment towards more aggressive monetary easing is expected to support the efforts to overcome deflation and promote growth. In addition, the newly-elected Japanese government has introduced a ¥10 trillion stimulus package (2.5% of GDP), comprising mainly of public work

Chart 4.2

Regional Economies: Real GDP Growth



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Source: International Monetary Fund and National Authorities

programmes and the provision of financial aid to businesses, which will cumulatively support the economic recovery. The growth trajectory, however, remains contingent upon the effective transmission of these policy measures to real economic activity.

The economic performance in **Asia** is likely to improve in 2013, driven mainly by resilient domestic demand and a modest strengthening in export demand, particularly from the region. Government-led infrastructure investment will likely underpin the strength in domestic demand, particularly in the ASEAN economies. These initiatives include private-public partnerships in the Philippines, major infrastructure projects in Indonesia and rail transport network expansion programmes in Thailand and Singapore. Consumption growth will continue to be buttressed by income growth amid favourable labour market conditions, continued access to financing and government policy support, such as the implementation of, and increases in, minimum wages in several of the regional economies. In the more open economies, growth will be lifted by the gradual increase in global demand as the external environment improves. The economic expansion in PR China is expected to remain robust, with domestic economic activity set to become stronger during the year. While the Chinese government remains committed to restructuring the economy through efforts to boost consumption, targeted investments, particularly in infrastructure projects, will continue to be a key contributor to growth in the near term.

Global inflation is expected to remain moderate in tandem with the modest improvement in global demand. In the advanced economies, underlying inflationary pressures are expected to be subdued, reflecting excess capacity and weak demand in these economies. There are, however, signs of demand-pull inflationary pressures in the emerging economies following the stronger domestic activity. Nevertheless, on the supply side, the risk of cost-push inflation is expected to remain restrained, given the expectations of modest increases in the prices of global commodities. There are, however, risks of periodic spikes in commodity prices as have been observed over the recent two years. In the oil market, an escalation of unrest in the Middle East and North Africa could lead to higher prices of crude

Post-Crisis Structural Changes in Global Growth Trends

Half a decade after the global financial crisis, the global economic environment remains confronted with challenges that are both structural and cyclical in nature. Economic activity in the advanced economies continues to be sluggish, as these economies deal with the legacy of excessive leverage, continued weaknesses in the labour markets and the challenge of reforming existing institutional frameworks. The emerging economies, however, are leading the global economic expansion, amid ongoing efforts in implementing structural reforms to accelerate the shift of the drivers of growth from exports towards domestic demand. These asymmetrical growth patterns are cumulatively contributing to the emergence of an increasingly multi-polar world which may have profound implications for economic relationships between nations and policies globally. This article aims to identify the structural changes that are driving global growth, with a special focus on Asia.

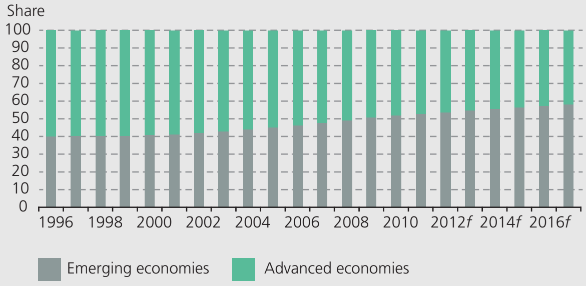
The Great Recession

In 2008-09, the global economy experienced the worst synchronised recession since World War II. Global output contracted by 2.2% while international trade activity weakened by 12% relative to 2005 levels. In response, the swift and aggressive countercyclical monetary and fiscal policy measures undertaken by both advanced and emerging economies managed to cushion the negative impact of the crisis and paved the way towards economic recovery in 2010.

While global output is gradually returning to the pre-crisis levels, the crisis exposed considerable structural weaknesses in the world economy, which are particularly acute in the advanced economies. In contrast, the emerging economies are exhibiting greater resilience and have accounted for more than three quarters of global growth between 2010 and 2012. Emerging economies' share of global growth also rose from 37% in 2000 to 49% in 2011 with a corresponding decline in the share of the advanced economies (Chart 1). Such heterogeneity in economic performance underscores the reshaping of the economic and financial landscape to a new global environment with multiple growth poles.

Chart 1

Share of Global GDP



f Forecast

Source: International Monetary Fund (IMF)

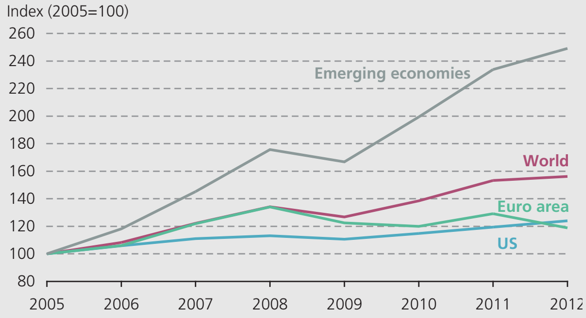
The Rise of a Multi-Polar World

Slow recovery in the advanced economies

In the past five years, growth in the advanced economies has averaged at a lower rate of 0.5% (2000-2007: 2.6%). The pace of increase in economic output in the major economies from pre-recession levels considerably lagged that of the emerging economies (Chart 2). The relatively muted growth prospects of these economies are attributable to several factors, namely private sector deleveraging, fiscal austerity, impaired financial intermediation and structural rigidities in the job market. These factors will be explored further in the next section.

Chart 2

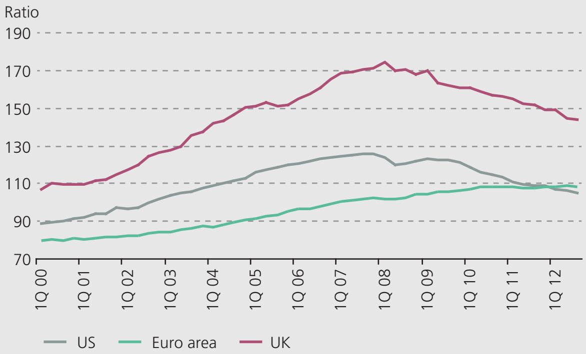
Economic Growth of Selected Major Economies since 2005



Source: Haver

Chart 3

Ratio of Household Debt to Personal Disposable Income



Source: Haver

1) *Continued deleveraging by private sector*

The most immediate constraint to a more robust economic recovery originates from the ongoing deleveraging process across most advanced economies. In the past two decades, several advanced economies experienced excessive debt growth which fuelled a prolonged consumption boom. Of significance, the rising trend of household indebtedness of several major economies was supported by a few key developments in the property and financial markets. The relaxation of mortgage underwriting rules in an environment of abundant liquidity allowed households with lower creditworthiness to purchase properties. Financial innovations also made it easier for homeowners to borrow on overvalued homes. The situation became unsustainable when falling house prices led to defaults, turning into a vicious cycle which cumulatively depressed aggregate demand. As a result, highly-indebted households have been forced to reduce debt and rebuild wealth positions that were severely affected by the negative equity in the housing market. A survey of past systemic crises has shown that in balance sheet recessions, the recovery process is often delayed and lengthy (Reinhart and Reinhart, 2010). Currently, household debt relative to personal income remains elevated by historical standards (Chart 3), indicating that the deleveraging process is still ongoing and would continue to inhibit private consumption activity.

2) *Fiscal austerity*

In response to the severe economic downturn, governments in the advanced economies undertook massive fiscal stimulus measures and provided support to troubled financial institutions through large-scale equity injections and debt guarantees. The deterioration of government finances was further compounded by the operation of automatic stabilisers such as higher expenditure on unemployment benefits and lower tax revenues. The IMF estimates that almost half of the public debt increase among advanced economies is attributable to automatic revenue losses, with another 17% being accounted for by the stimulus packages (Allen, 2012). As a result, the public debt of the advanced economies had escalated to very high levels after the crisis, reaching 105% of GDP in 2011 (2001: 72%), with a fiscal deficit of 4.7% of GDP (2001: +0.7%). Governments in the advanced economies are hence forced to cut spending and strengthen fiscal positions, thereby limiting the ability to further support economic recovery.

Beyond the immediate future, the restoration of sustainable fiscal positions remains challenging, due to other underlying structural impediments. In particular, unfavourable demographic trends of ageing population and rising dependency ratios will exert further strains on public finances. This will constrain the governments' ability to finance the increased public expenditure on healthcare and pension systems. In 2008, age-related spending such as health and pension expenditure averaged 13% of GDP in the advanced economies. By 2030, these expenditures are expected to increase further by as much as 4.5 percentage points to account for 17.5% of GDP, thereby placing further pressure on their fiscal positions (IMF, 2010).

3) Impaired financial intermediation

Financial institutions in the crisis-affected economies are also deleveraging to repair balance sheet positions that had impaired the banks' capacity to provide an adequate flow of credit to finance economic activity. The bursting of the housing bubbles caused an immediate and sizeable reduction in the value of bank assets as homeowners defaulted on mortgages and mortgage-based securities experienced a significant deterioration in value. Balance sheets were also affected by the diminishing value of sovereign paper holdings amid heightened fiscal sustainability concerns in several advanced economies. Compounding the situation is the tighter regulatory environment. In 2012, European banks underwent a recapitalisation exercise to raise capital buffers to 9% in core Tier 1 capital. The possible future implementation of more stringent requirements such as Basel III could indirectly tighten lending standards and increase borrowing costs for households, businesses and governments. While recent policy actions by central banks, such as the introduction of Operation Twist in the US and Outright Monetary Transactions in the euro area, have lowered the cost of short-term lending and somewhat eased funding strains, many challenges remain. European banks are estimated to still face a €400 billion shortfall in capital (4.5% of euro area's GDP). Insufficient provision of credit to the real economy may continue to be a major constraint to a full recovery.

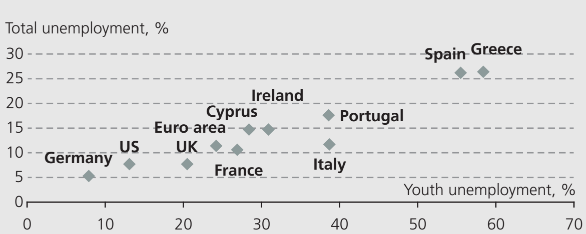
4) *Employment rigidities*
On the employment front, labour market conditions remain weak in most advanced economies. Of significance, the ongoing fiscal austerity in an increasingly uncertain economic environment have cumulatively dampened hiring rates and exacerbated the dislocation of workers from the labour market. In the US and UK, unemployment rates continue to hover around 8%, and in most euro area economies, the rate exceeds 11% (Chart 4). The slowdown in economic activity has had a disproportionate effect on workers in industries that were more affected by the crisis, such as construction and financial services. These job losses, however, are spreading to other sectors that were not directly implicated in the financial crisis such as the manufacturing sector, due in part, to weak consumer confidence and impaired credit flows to consumers.

The slower recovery in employment is also symptomatic of other trends that are structural in nature. Given the uncertain global environment, businesses are more cautious and increasingly opting to hire more temporary workers. Since the onset of the global crisis, part-time employment has increased in more than 60% of the advanced economies and temporary employment was higher in 25% of these economies (ILO, 2012). This is worsened by geographical mismatches; where workers with the desired skills are unable to accept employment in another geographic market, further contributing to the labour market rigidities and higher structural unemployment. In the US and UK, lower labour mobility also partly reflects the lingering effects of the collapse in the real estate market, where most individuals with negative equity mortgages are unable to relocate given the sharp fall in house prices.

The elevated long-term unemployment rates carry serious social and economic costs such as persistently high jobless claims, permanent loss of skills or hysteresis and an increased risk of social unrest and poverty. This has also affected the youth segment of the population more adversely than others. The ILO estimates that youth unemployment in the advanced economies has risen to almost 20% in 2012 from 11.7% in 2007. The situation is more severe in the economies that are in recession, such as Greece (55%), Spain (53%) and Portugal (39%). The exclusion of the young from the labour market may have detrimental effects on future employability and wage growth, especially when many young workers are currently employed in low productivity jobs.

Chart 4

Youth and Overall Unemployment Rates in Selected Advanced Economies

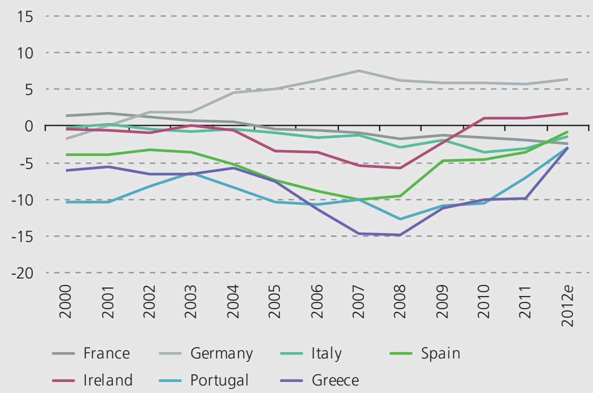


Source: National Authorities, Haver

The crisis has also highlighted other existing structural rigidities in the labour market which have significant bearing on the overall competitiveness of the advanced economies. Many advanced economies have high unit

Chart 5

Current Account Balance of Selected Euro Area Economies (% of GDP)



e Estimates

Source: International Monetary Fund (IMF), Eurostat

labour costs as a result of prevailing wage structures. This is not fully compensated with similar increases in productivity. Among the G7 economies, productivity growth (measured as the change in output per hour worked) has been on a weakening trend since 2005 before declining by 2.4% during the peak of the crisis in 2009. This is particularly acute in the euro area as the shift towards a monetary union has increased the importance of national competitiveness based on real factors such as unit labour costs. The difference in labour compensation and productivity has resulted in differing competitiveness among euro area economies, as reflected by the divergence of external imbalances within the region (Chart 5). In this respect, governments have been undertaking structural reforms in the product and labour markets to improve competitiveness, but the positive effects can only be observed in the real economy over the medium term. In the foreseeable future, the combination of slower economic activity and prolonged and deep weaknesses in the labour market will cause unemployment to remain high, depress income growth and create a huge strain on government finances.

Prospects for the emerging economies

Economic activity in emerging economies remains robust. The IMF projects that the emerging economies are expected to expand by an average of 6.0% annually over the next 5 years. In Asia, growth is increasingly underpinned by the rising strength in domestic demand, which contributed to more than two-thirds of the region's growth in 2011. The Asian economies have weathered the global economic upheaval relatively well compared to the advanced countries. In the immediate aftermath of the crisis, stimulus packages put in place by the authorities played a key role in mitigating the adverse impact of weaker global trade. In addition, policy and market reforms undertaken in response to the 1997/98 Asian financial crisis have enhanced the region's macroeconomic fundamentals and financial market resilience, which allowed for these countercyclical expansionary measures to be quickly transmitted to the real economy.

The experience from the global financial crisis provides several crucial insights to the region. Weakness in global demand has reinforced the need for ongoing economic reforms in Asia to reorient growth towards domestic demand. Beyond national borders, the crisis has also expedited efforts to advance greater intra-regional and inter-regional economic linkages. Given the prolonged nature of the current economic recovery, the growth challenge is premised upon efforts to generate and sustain new sources of growth whilst leveraging on existing favourable trends.

The sustainability of Asia's growth path going forward will also be underpinned by several structural factors. The **rapid expansion of the middle-class population** in Asia will contribute to a shift towards greater domestic consumption in regional economies. This transition is already underway, with private consumption contributing to almost half of Asia's growth in 2011. In Developing Asia[1], the share of the middle-class[2] population has doubled to 56% of total population in 2008 (1990: 21%).

1 Developing Asia - Armenia, Azerbaijan, Bangladesh, Cambodia, People's Republic of China, Georgia, India, Indonesia, Kazakhstan, Kyrgyz Republic, Lao People's Democratic Republic, Malaysia, Mongolia, Nepal, Pakistan, the Philippines, Sri Lanka, Tajikistan, Thailand, Turkmenistan, Uzbekistan, Vietnam (ADB, 2010).

2 Middle Class – population with expenditure of USD2-20/day.
High Class – population with expenditure >USD20/day (ADB, 2010).

By 2030, the middle-class population in developing Asia is expected to account for 42% of global expenditures, underscoring the region's evolving role as a significant consumer base for the global economy (Chun, 2010).

Furthermore, Asia is also experiencing an unprecedented rate of urbanisation and improvement in living standards. By 2025, more than 2 billion people in Asia, which accounts for half of the world's urban population, are expected to live in cities. This development is expected to contribute to the reorientation of regional economies towards stronger domestic-based growth. Furthermore, there will likely be more public investment initiatives to address the region's infrastructure needs. In particular, Asia's infrastructure investment needs are estimated at USD8 trillion for the period 2010-2020 (ADB, 2009).

On the international front, **closer economic linkages among the emerging economies** in the form of trade and investment flows will allow for greater diversification of markets, thereby reducing over-reliance on the advanced economies. The share of emerging East Asia's exports to advanced economies has been on a steady decline since 1990. Of significance, East Asia's[3] exports to G3 economies have fallen to 22% of total East Asian exports from 31% a decade earlier. This is largely attributed to the trend of rising intra-regional trade, which currently accounts for about half of Asia's total trade. Given the expected increase in consumption within the region itself, many Asian economies could leverage on this new international trade configuration to meet the greater domestic demand in the region. Foreign direct investment within the region has also grown in importance, expanding by 20% per annum over the past decade. This encouraging development is supported by the emergence of home-grown multinational firms as well as greater business opportunities in the region.

In Asia, the closer ties are also evident as authorities leverage on the existing intra-regional groupings and networks to foster greater collaboration and cooperation in key areas of interest. The reinforcement of alliances, such as the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) and ASEAN+3, highlight Asia's growing economic cooperation. Several regional countries have also established bilateral agreements to use domestic currencies for trade settlement and cross-border collateral agreements aimed at enhancing liquidity facilities to financial institutions. These have cumulatively contributed to the strengthening of economic and financial linkages within Asia.

Structural reforms have also been earnestly pursued. Regional governments are placing focus on promoting policies aimed at boosting household incomes and reducing precautionary savings. These include health insurance reforms and extended pension coverage and financial sector reforms to strengthen financial inclusion. In Asia, the enhancement of social safety net schemes such as the minimum wage has played a role in boosting the incomes of households with the highest propensity to consume and subsequently raise consumption activity.

Finally, the integration of **new global players** into the market will continue to reshape the global labour, consumption and production landscape. In the past few decades, new emerging regions have made significant strides towards establishing a more market-oriented economic system amid lower bureaucratic barriers to trade and investment activity. These reforms have taken strong root in Asia over the past decade. Emerging ASEAN nations such as Cambodia, Laos, Myanmar and Vietnam have undertaken deep and significant reforms which have facilitated the liberalisation of their domestic markets. While these four economies currently account for 9% of ASEAN's GDP (2011), growth has averaged 6.6% over the past 5 years, underlining the region's potential as a new consumption centre and investment base for investors. This would cumulatively elevate the Asian region's growth prospects.

[3] East Asian economies comprise of PR China, Hong Kong, Indonesia, Malaysia, the Philippines, Singapore, Korea, Chinese Taipei and Thailand.

A New Normal

The confluence of these developments suggests that the aftermath of this recent crisis is fundamentally different from previous crises. The global economy is currently navigating through a 'new normal'. Growth in advanced economies is expected to be weighed down by continued efforts to promote structural reforms and deleveraging by governments, financial institutions and consumers. Against these developments, the emerging economies, particularly those in Asia, will remain the key drivers of global growth, leveraging on favourable trends such as rising intra-regional trade and greater shift towards domestic demand-led growth. While these factors will play a crucial role in moderating the impact of lower demand in the advanced economies, the emerging economies are not fully insulated from the weaker external environment. In mid-2012, for example, domestic demand in Asia showed signs of moderation amid sustained weakness in the advanced economies. Taking all these factors together, while the global economy is expected to continue to improve, the recovery may face prolonged downside risks and remain unevenly distributed.

Looking further ahead, global structural trends such as continued urbanisation, technological advances and the changing demographics will also play a more prominent role in reshaping the global economic and financial landscape. Of significance, efforts to enhance economic resilience, flexibility and efficiency will be a key policy focus in most regions, particularly with regard to the allocation of scarce resources and the provision of sufficient infrastructure. Beyond the national borders, the 'new normal' requires policy perspectives to transcend cyclical and domestic considerations towards one that is pre-emptive and global in nature. In this respect, structural and institutional reforms will play an important role in creating more inclusive and sustainable growth.

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oil. In addition, food prices are susceptible to fluctuations given the low inventory levels of staple grains in some key export markets and potential supply disruptions due to adverse weather conditions. Upside risks to commodity prices may also emanate from greater demand following rising financial flows into these markets.

Notwithstanding the improving global growth prospects, **downside risks** remain considerable. In the euro area, the policy measures undertaken in the latter part of 2012 have reduced acute crisis risks but the key fundamental constraints remain unresolved. The sovereign debt crisis in Europe could re-intensify if further progress on the crisis resolution plans and reform measures is not realised. A renewed rise in government borrowing costs could jeopardise the fragile recovery process and would set back the progress that has been made. In addition, sharper-than-expected fiscal consolidation in the crisis-affected economies could also weaken growth prospects in the near term.

Given the divergent growth prospects between the advanced and emerging economies, the latter faces a different set of challenges. First, the large-scale policy easing in major economies has created massive amounts of liquidity, which has subsequently spurred a global search-for-yield. Thus, the strong inflows of capital into the emerging economies are expected to continue. These inflows could result in macroeconomic and financial instability and might lead to excessive increases in exchange rates and asset prices in the recipient countries. Second, emerging economies could face higher inflationary pressures due to rising food and commodity prices. Upward pressures on prices could materialise in the event of supply disruptions arising from adverse weather conditions amid low inventories of selected food commodities. A confluence of these factors would pose challenges to policymakers in balancing the risks between growth and inflation, given the continued uncertainty in the global economic environment.

It should be noted that there is some upside potential to growth. In the US, a stronger-than-expected recovery in the housing market may support business and consumer sentiments, cumulatively leading to a strengthening of private sector-led growth. Credible progress in policy setting in Europe has contributed to a gradual improvement in financial market conditions, which could facilitate an improvement in economic activity in the region. A firmer recovery would benefit the rest of the world through stronger trade activity and greater economic certainty.

MALAYSIAN ECONOMY

The Malaysian economy is expected to remain on a steady growth path with an expansion of 5-6% in 2013. Economic activity will be anchored by the continued resilience of domestic demand, and supported by a gradual improvement in the external sector.

> The Malaysian economy is expected to remain on a steady growth trajectory of 5-6% in 2013

Domestic demand, which recorded the highest rate of expansion over the recent decade in 2012, is expected to remain the key driver of growth in 2013, albeit at a more moderate pace. Growth in public and private investment is expected to remain strong, following the exceptional growth in capital spending in 2012. Private investment is still expected to record a double-digit rate of growth, driven by the continued capacity expansion of the domestic-oriented firms, ongoing implementation of projects with long gestation periods and a gradual improvement in external demand. Private consumption is projected to grow at a more moderate rate in the second half of the year, but it will continue to be supported by sustained income growth and healthy labour market conditions. Public sector spending is also expected to record lower growth given the ongoing consolidation of the Government's fiscal position and as the role of the private sector gains greater significance.

In line with the pace of expansion in domestic demand, imports of capital and consumption goods are also expected to moderate. However, imports of intermediate goods are projected to turn around and record positive growth as the improvement in the global economic environment leads to an increase in manufacturing exports. In particular, non-electrical and electronics (non-E&E) exports are expected to benefit from the positive growth prospects of the regional economies. Electrical and electronics (E&E) exports, meanwhile, are expected to experience a smaller contraction following manufacturers' continued efforts to diversify their production line-up and shift into the fast-growing mobile telecommunication sub-segment. The rebound in manufactured exports, however, will be partially offset by lower commodity exports, due to the expected softening of commodity prices. Services exports are expected to be higher due to a stronger travel account in line with the promotional campaigns for the run-up to the Visit Malaysia Year 2014, while growth in services imports is expected to be slower given the lower volume of imports. Overall, with the gradual recovery in exports and lower import growth, net export of goods and services is expected to exert a lower negative contribution to real growth in 2013. Nevertheless, the growth of imports is expected to continue to outpace exports amid the continued deficit in the income account and in current transfers. The current account surplus, while still remaining large, is expected to narrow further in 2013.

Table 4.1

Real GDP by Expenditure (2005=100)

	2012*p*	2013*f*	2012*p*	2013*f*
	Annual change (%)		Contribution to growth (percentage point)	
Domestic Demand[1]	**10.6**	**8.1**	**9.2**	**7.3**
Private sector expenditure	10.7	9.1	6.8	6.0
Consumption	*7.7*	*7.1*	*3.8*	*3.6*
Investment	*22.0*	*15.6*	*3.0*	*2.4*
Public sector expenditure	10.3	5.4	2.4	1.3
Consumption	*5.0*	*3.6*	*0.7*	*0.5*
Investment	*17.1*	*7.5*	*1.7*	*0.8*
Change in stocks			**0.3**	**-0.2**
Net exports of goods and services	**-29.4**	**-19.1**	**-3.8**	**-1.7**
Exports	0.1	1.8	0.1	1.7
Imports	4.5	3.9	3.9	3.4
Real Gross Domestic Product (GDP)	**5.6**	**5.0 ~ 6.0**	**5.6**	**5.0 ~ 6.0**

[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

The underlying fundamentals of the economy are expected to remain strong, and will continue to support the growth prospects for the economy. Of importance, labour market conditions will remain favourable, with the unemployment rate projected to remain low at 3.1% of the labour force in 2013. In addition, the financial system continues to demonstrate resilience against the challenging external environment, with financial intermediation expected to continue to provide strong support to domestic economic activity. The strength of Malaysia's external position remains intact, with international reserves at healthy levels and external debt continuing to be low and within prudent limits.

Headline inflation is expected to average 2-3% in 2013. This inflation projection takes into account the expected higher global prices of selected food commodities and adjustments to domestic administered prices. Demand-driven price pressures are expected to be moderate. The wider forecast range reflects the greater uncertainty in the external and domestic developments.

Headline inflation is expected to average 2-3% in 2013

Nevertheless, given the challenging external environment, there remain risks to the growth outlook. As in 2012, the potential re-emergence of instability in the euro area and slower growth in Malaysia's major trading partners may affect the Malaysian economy. While pressures from global commodity prices have receded, upside risks from non-fundamental factors such as adverse weather conditions and geopolitical developments could push commodity prices higher and adversely affect the growth prospects of Malaysia's major trading partners. Potential upside to the domestic economy could emerge if the domestic recovery in the advanced economies turns out to be better than expected. In particular, a stronger-than-expected recovery in the housing market may contribute towards a better performance in the US economy.

Broad-based Expansion across All Sectors

On the supply side, all the major economic sectors are expected to record continued expansion in 2013. The services and manufacturing sectors are expected to be the key contributors to overall growth, driven by the continued resilience of domestic demand and supported by the gradual improvement in the global economic environment, which will augur well for international trade activity.

Consumption-related activities in the services sector such as retail trade, accommodation and restaurants will continue to be supported by private sector spending. Tourist arrivals are expected to rise in response to the promotional campaigns for the upcoming Visit Malaysia Year 2014. Growth in the finance and insurance sub-sector is projected to be sustained, reflecting continued robust demand for financing particularly by businesses.

Table 1

Real GDP by Sector (2005=100)

	2012*p*	2012*p*	2013*f*	2012*p*	2013*f*
	% of GDP[1]	Annual change (%)		Contribution to growth (percentage point)[1]	
Services	54.6	6.4	5.5	3.5	3.0
Manufacturing	24.9	4.8	4.9	1.2	1.2
Mining & quarrying	8.4	1.4	5.0	0.1	0.4
Agriculture	7.3	0.8	4.0	0.1	0.3
Construction	3.4	18.5	15.9	0.6	0.5
Real GDP	**100.0**	**5.6**	**5.0 ~ 6.0**	**5.6**	**5.0 ~ 6.0**

[1] Numbers do not add up due to rounding and exclusion of import duties component
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The domestic-oriented industries within the manufacturing sector, in particular the consumer-related cluster, such as food and transportation, are likely to benefit from the continued growth of private consumption. The construction-related manufacturing cluster is also expected to perform well. Growth in the construction sector will be driven by the civil engineering sub-sector as the momentum of construction activity in the oil and gas, transportation and utilities sub-sectors is expected to remain strong.

The performance of the export-oriented manufacturing industries such as the E&E and primary-related clusters are expected to improve in tandem with the gradual recovery in the advanced economies and the sustained growth in the regional economies. The E&E cluster will continue to be supported by demand for products in the consumer and telecommunication segments. In the primary-related cluster, growth is projected to be supported by firm demand from the regional countries, particularly for resource-based products such as refined petroleum products, chemicals and chemical products as well as rubber products. The higher volume of trade and the better overall performance of the manufacturing sector will also benefit the trade- and manufacturing-related services sub-sectors, such as wholesale trade, transport and storage and utilities.

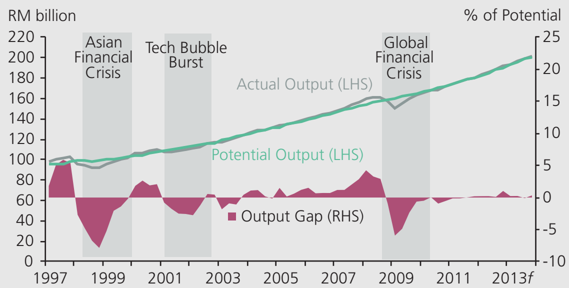
In the commodities sector, growth in agriculture and mining is expected to improve in 2013. The agriculture sector is expected to expand by 4% in 2013, supported by higher output of crude palm oil (CPO) and food commodities, especially livestock and vegetables. CPO production is expected to rise as yields improve with better weather conditions, supported by supply from newly maturing trees. The mining sector is expected to strengthen on higher production of natural gas, crude oil and condensates.

Potential Output of the Malaysian Economy

Potential output is an estimate of the highest level of output that an economy is capable of producing in a non-inflationary environment. It indicates the economy's sustainable growth path that is consistent with its available inputs for production – capital, labour and technology. When actual output is above potential output, the utilisation of productive inputs is high and inflationary pressures tend to build. Conversely, inflationary pressures usually abate when actual output falls below potential output.

Chart 1

Actual and Potential GDP



f Forecast

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

The latest estimates[1] indicate that Malaysia's potential output growth increased from a range of 4.5-5.0% in 2011 to 5.0-5.5% currently. Strong growth in both private and public investment in 2012 contributed to the robust pace of capital accumulation and, in turn, to the further expansion of potential output as the productive capacity of the economy was raised. Labour conditions also improved slightly as the labour force grew at a faster rate of 3.5% in 2012 (2011: 3%). The output gap, which captures deviations of actual output from potential output, remained close to zero. This indicates that the economy did not experience substantial price pressures, consistent with the stable inflation of 1.6% registered during the year.

In 2013, potential output is projected to continue growing within the 5.0-5.5% range, with the output gap remaining small. Potential output growth is expected to be driven by a growing labour force as well as an expansion in capital stock, due to sustained growth of private investment.

[1] Interested readers may refer to the technical note entitled 'Potential Output and the Output Gap in Malaysia' in the 2Q 2012 BNM Quarterly Bulletin (Pg. 59-65) for a detailed explanation of the methodology used to estimate potential output.

Domestic demand continues to anchor growth

Following the strong performance in 2012, domestic demand is expected to grow at the pace of 8.1% in 2013. Domestic demand is expected to remain the major contributor and driver of economic growth, supported mainly by private sector investment and consumption. Public sector spending, while remaining supportive of growth, is expected to increase at a more moderate rate in view of the Government's ongoing fiscal consolidation. Capital expansion by the public enterprises (PEs) will also provide support to public investment growth amid sustained Government development spending.

Private investment is expected to expand at a double-digit growth of 15.6% in 2013. Private investment will be underpinned by domestic consumption, the gradual recovery in external demand and the continued improvement in the investment climate. These favourable business conditions will continue to support the ongoing implementation of projects with long gestation periods. As observed in 2012, capital spending is again expected to be broad-based across sectors and regions.

Private sector spending remains resilient amid consolidation in the public sector

In the services sector, capital spending is projected to increase further, particularly in the domestic-oriented sectors. Firms in the retail trade and restaurants sub-sectors are expected to establish new outlets, while investments in the telecommunication and aviation segments will be driven by infrastructure upgrading and capacity expansion. Growth in residential investments is also expected to remain strong, supported by the construction of high-end residential properties and increasingly, activity in the mid-range residential property segment. Investment in the high value-added business services sub-sector, especially in engineering, architecture and IT services, is also expected to expand.

In the manufacturing sector, investment will be driven by the domestic-oriented and primary-related manufacturing clusters. Investment in the construction-related cluster, especially in steel and cement, will be driven by the demand from strong construction activity, while the expansion of firms in the consumer-related clusters, such as food and beverages and motor vehicles, will be underpinned by the steady growth of domestic consumption. In addition, regional demand and initiatives to deepen Malaysia's downstream petrochemical industry are expected to support the implementation of projects in the primary-related manufacturing cluster. Capacity expansion in the E&E industry will be supported by the gradual improvement in external demand and the diversification into new products and new growth areas, notably the medical devices industry and niche E&E components. Furthermore, initiatives by firms to automate and to invest in new machinery are expected to continue in 2013 as firms respond to rising costs and the implementation of the minimum wage policy. These developments are expected to spur the manufacturing industry into producing higher value-added goods.

The strong growth momentum in mining investment is expected to continue in 2013, underpinned by firm global energy prices, the ongoing construction of production facilities under existing projects and further supported by activity related to the exploration and survey of new fields. The implementation of upstream development projects such as the Gumusut-Kakap and Malikai deepwater and Kebabangan cluster fields will also benefit the civil engineering construction segment, particularly for the construction of production facilities and floating production storage and offloading vessels (FPSOs).

Oil and Gas Investments to Support Higher Production

The mining sector is projected to expand by 5% in 2013, due to a recovery in the production of natural gas, and supported by higher output of crude oil and condensates. The former is due to higher output of several gas fields offshore Sabah to meet the higher demand for liquefied natural gas (LNG) from PR China, while the latter is largely driven by the commencement of production from both marginal and new fields, such as Gumusut-Kakap in Sabah, and new wells in Sarawak and Terengganu.

Private Investment in Malaysia: Drivers and Sustainability

Introduction

Following Malaysia's steep decline in private investment during the 1997/98 Asian Financial Crisis, the gradual recovery of private investment had been punctuated by several episodes of global demand shocks. These included the bursting of the 'Tech Bubble' in 2001, the outbreak of the Severe Acute Respiratory Syndrome (SARS) epidemic in 2003, and more recently, the 2008/09 Global Financial Crisis (GFC). As a result, in contrast to the high average private investment of 22.9% of GDP during the 1990s, private investment had a more modest role in the economy in the period 2001-2011, averaging 11.8% of GDP.

Since the fourth quarter of 2011, however, private investment has emerged as a key contributor to growth. Following the strong growth of private investment in 2012 (22%), the share of private investment has risen to 15.5% of GDP in 2012. This strong growth momentum partly reflects the underlying shifts taking place in the Malaysian economy, particularly the strengthening of private consumption and the diversification of Malaysia's export structure. While private investment has benefited from this trend, it has also reinforced these structural shifts, contributing to the strengthening of domestic demand and further diversifying the sources of growth of the economy. Given the importance of private investment in raising the economy's productive capacity, accelerating technological progress and creating employment opportunities, this article aims to highlight the key drivers that have contributed to the rise of private investment. A broad assessment of its sustainability going forward and potential implications to growth is also explored.

Theoretical literature and empirical findings

Several frameworks that are available in the literature were used as references to determine the key drivers of private investment in Malaysia, namely: (i) The accelerator model; (ii) the expected profits model; (iii) the Jorgenson neoclassical model; and (iv) the Tobin's Q model[1]. Most of these models emphasise the importance of fundamental factors, such as demand, profitability, capacity utilisation and the cost of capital, in explaining private investment. More recent literature incorporate other determinants such as economic uncertainty and the availability of financing.

Empirical findings of the available literature show that output, profits and the level of capacity utilisation generally impact private investment positively. Furthermore, higher profitability and greater access to financing facilitate private investment through the availability of a higher level of funding. Similarly, higher interest rates and economic uncertainty can be expected to affect private investment negatively. High interest rates would also raise the cost of bank credit, and thus the cost of capital or the opportunity cost of retained earnings, while elevated levels of economic uncertainty may cause delays or even a reduction in investment.

Key determinants of private investment in Malaysia

In analysing the key determinants of private investment in Malaysia, a linear regression was estimated using a general-to-specific modelling strategy, with consideration being given to the major investment determinants that have been cited in the existing literature. Consistent with existing empirical findings, estimated results suggest that four major factors have a statistically significant impact on private investment, namely: (i) Profitability; (ii) the capacity utilisation rate[2]; (iii) the availability of financing; and (iv) the level of economic uncertainty.

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[1] See Chenery (1952), Chirinko (1993), Serven and Solimano (1992), Jorgenson (1971) and Tobin (1969) for conventional models of investment and Guimaraes and Unteroberdoerster (2006) for analysis specific to the case of Malaysia.

[2] The capacity utilisation rate used was specific to the manufacturing sector.

(i) *Company profitability*

Existing literature suggests that operating profits, the profits earned from firms' business operations, positively affect private investment. Empirical studies also show that previous or current profits are used as an indication of expected future profits[3], as profitability is a major incentive for investment and it also contributes to the availability of internal and external financing. In the case of Malaysia, firm-level data[4] reveals that the recent increase in private investment is positively associated with the strong company profitability in recent years, particularly in the resource-based and domestic-oriented industries[5]. In the resource-based industry, particularly in the oil and gas sector, high commodity prices have contributed to the significant increase in profitability, raising the expected rate of return on investment. Meanwhile, strong private consumption activity has raised profits in the domestic-oriented sectors, particularly in the services sector, such as the wholesale and retail, transportation and telecommunication sub-sectors, and the consumer-related cluster of the manufacturing sector.

(ii) *Capacity utilisation rate*

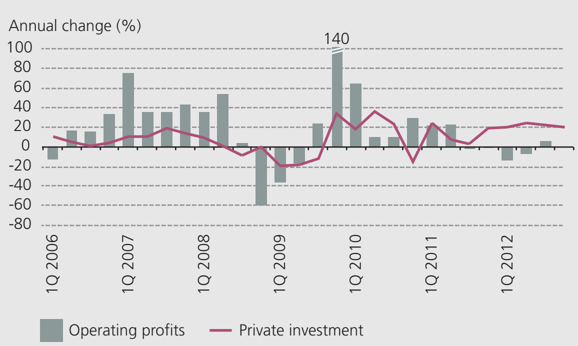
Similarly, the rate of capacity utilisation is found to exert a positive impact on private investment in Malaysia. In 2012, the capacity utilisation rate rose to 80.8% of installed capacity, higher than the average capacity utilisation rate of 76.9% in 2003-2007[6]. In line with the improvements in the capacity utilisation rate, manufacturing firms have embarked on capacity expansion to respond to the increased demand for their products (Chart 2). This was particularly evident in the domestic-oriented manufacturing sub-sectors, such as the consumer-oriented and construction-related manufacturing clusters, following the strengthening of domestic consumption and the rapid growth of construction-related activity respectively. In addition, the capacity utilisation rate has also remained high for firms in the primary-related manufacturing cluster, which has been supported by resilient regional demand.

(iii) *Availability of financing*

Access to financing also exerts a positive and significant influence on private investment in Malaysia, as access to bank credit[7] enables firms to obtain the required financing for investment. This is

Chart 1

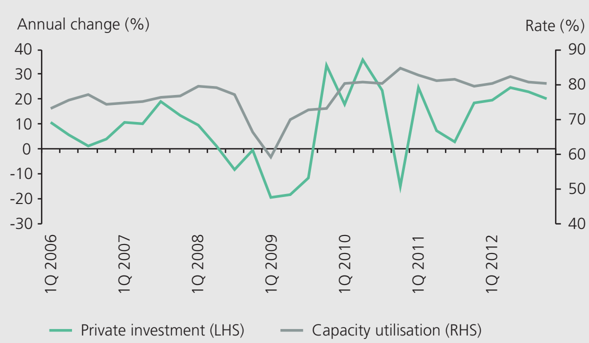
Operating Profits and Private Investment



Source: Bloomberg and Department of Statistics, Malaysia

Chart 2

Capacity Utilisation Rate and Private Investment



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

3 See Manjappa and Niranjan (2010).

4 Data from 250 companies listed on Bursa Malaysia and excludes firms classified as Public Enterprises in National Accounts statistics.

5 Resource-based industry refers to the mining, agriculture and primary-related manufacturing sectors, while domestic-oriented industry refers to the services and consumer-related manufacturing sectors.

6 2003-2007 was used as the reference period, taking into consideration data availability and the attempt to capture information from a relatively 'normal' period.

7 While it is acknowledged that firms, particularly large firms, also source funds from the capital markets, this study did not incorporate that data as it is highly volatile.

especially true for small and medium enterprises (SMEs), whereby bank credit is the main source of financing for their working capital and investment needs. In 2012, the financing environment remained supportive. While total credit disbursement for the year was 14.6%, credit disbursed to businesses registered a growth of 21.4% (2003-2007 average: 5.2%). Of significance, loans disbursed to SMEs expanded by 21% in 2012 (2004-2007 average: 13.1%), supported partly by various funds and programmes implemented by the authorities. The continued improvements in access to financing for businesses have also been reflected in Malaysia's favourable position in several international rankings measuring 'Ease of Access to Loans'. These include the World Bank's *Doing Business Report* (1st position for five consecutive years), and the World Economic Forum's *Global Competitiveness Report* (2012-2013: 8th position; 2010-2011: 10th position).

(iv) Economic uncertainty

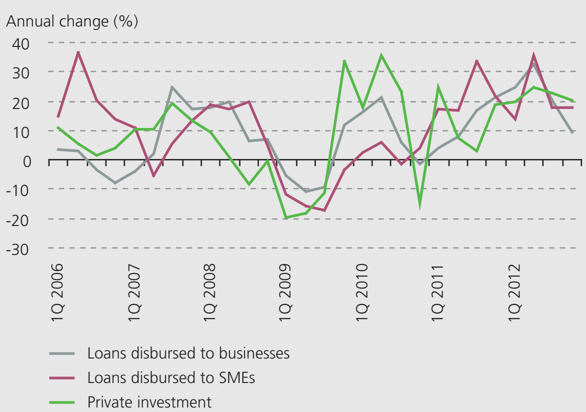
In recent quarters, private investment has also been supported by the greater economic certainty[8] prevailing in Malaysia (Chart 4). While economic uncertainty in the global economy has had an adverse impact on firms in the export sector, sustained domestic activity has generated relatively less economic uncertainty for domestic-oriented firms. Another contributing factor to greater economic certainty could be the ongoing efforts by the authorities to improve the business investment climate. In particular, various initiatives aimed at improving the ease of doing business and attracting quality investments in high value-added activity, have strengthened business sentiments and the domestic investment climate. These measures have also been reinforced by the implementation of the Economic Transformation Programme (ETP), which has provided greater policy clarity and investment opportunities for businesses.

The sustainability of private investment and its potential implications to growth

Going forward, several key underlying factors, such as favourable demand, financing conditions and the overall investment climate, are expected to continue to support private investment activity. The resilience in private consumption will also support capacity expansion in the domestic-oriented sectors, while continued efforts to enhance awareness of the access to financing and the advisory services available for SMEs will continue to facilitate investment activity by SMEs. Augmenting these favourable domestic factors, the gradual improvement in global growth prospects will also contribute towards improvements in

Chart 3

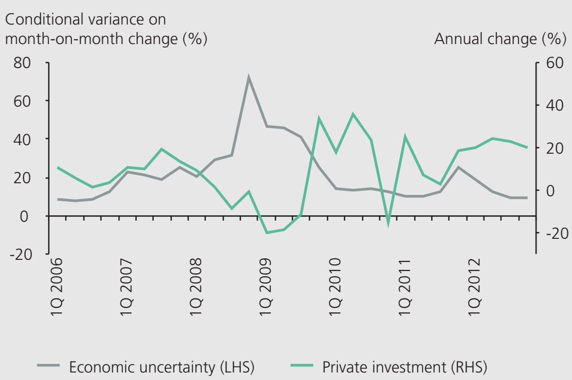
Loans Disbursed and Private Investment



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 4

Economic Uncertainty and Private Invesment



Source: FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI), Department of Statistics, Malaysia and Bank Negara Malaysia estimates

8 Economic uncertainty was measured by a conditional variance derived from a Garch (1,1) model of monthly returns in the KLCI. The use of firm-level data such as stock returns volatility to proxy for uncertainty is common in existing literature since it captures uncertainty closely related to a firm's environment, i.e. asset returns capture the effects of relevant aspects of a firm's environment which investors deem important (see Leahy and Whited (1996)).

business confidence. The timely implementation of reforms, the catalytic projects under the ETP, and the continued provision and upgrading of infrastructure will also provide a boost to private investment.

The sustained growth in private investment is expected to benefit the Malaysian economy mainly through the acceleration in technological progress and the enhancements to the economy's productive capacity. In particular, sizeable investments in the oil and gas sector, in both the upstream exploration and development activity, and the deepening of the downstream petrochemical industry, are expected to result in technological progress which will contribute directly to raising Malaysia's growth potential. The implementation of major infrastructure projects, such as in public transportation, airports, ports and telecommunication, is also expected to indirectly enhance the productive capacity of the economy through improving connectivity, both within Malaysia and with the rest of the world. An encouraging development is the increase in research and development (R&D) spending (2011 estimate: 0.8% share to GDP; 2006: 0.6% share to GDP), which augurs well in terms of contributing towards higher value-added activities.

Conclusion

Private investment has strengthened, driven mainly by strong corporate profits, high capacity utilisation in the manufacturing sector, access to financing, and a favourable investment climate. Going forward, these fundamental factors are expected to continue, thereby providing strong support for future private investment. As the economy undergoes a transformation towards a high value-added, high-income economy, the implementation of investments that will accelerate technological progress and enhance the productive capacity of the economy will also be important in ensuring the sustainable growth of the Malaysian economy.

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Growth in **private consumption** is expected to moderate but still remain strong in 2013, increasing by 7.1% (2012: 7.7%). This will be supported by the sustained growth in incomes, which is likely to benefit from the continued growth of the domestic-oriented sectors and the expected rebound in the export-oriented industries. The implementation of the minimum wage policy will also contribute to increase incomes. Softer commodity prices, however, are expected to weigh down on incomes and consumption spending, particularly among the rural households. Labour market conditions are projected to remain favourable. While the implementation of the minimum wage policy may lead to some adjustments by the affected firms to their workforce, overall employment conditions are expected to remain stable as the demand for labour remains strong. In particular, the expectation of an improvement in external demand conditions will support employment in the export-oriented sectors.

Government transfers to low- and middle-income households as announced under Budget 2013 will also provide support to household spending. These fiscal transfers include the RM500 assistance to households with a monthly income of RM3,000 and below (Bantuan Rakyat 1Malaysia or BR1M 2.0), the RM100 schooling assistance to primary and secondary school students and cash support to the armed forces.

Public expenditure is expected to moderate in 2013, in line with the Government's commitment to fiscal consolidation. Nonetheless, both public consumption and investment will remain supportive of growth. **Public consumption** is expected to record a positive growth of 3.6% in 2013, supported by the spending on emoluments and supplies and services.

Public investment is also expected to moderate in 2013 (7.5%). Federal Government development expenditure is expected to sustain, and a major portion of the expenditure will continue to be allocated to the economic sector, mainly to improve access and connectivity in both the urban and rural transportation infrastructure. Other key areas of development spending will be in the trade and industry sub-sector, such as upgrading of infrastructure facilities in industrial areas. Expenditure in the social services sector will continue to be channelled to the education and training sub-sectors.

Capital spending by the public enterprises (PEs) is expected to remain large, resulting in a steady growth in the overall public investment. Investments by PEs reflect the continued implementation of key infrastructure projects, particularly in the energy, transportation and communication sub-sectors. In the mining sector, capital spending will focus both on the upstream and downstream segments, particularly in the development of oil and gas fields. Investment in the transportation sub-sector will largely concentrate on the extension of rail-based public transport network as well as the continued fleet upgrading by the national airline. Capital spending in the utilities sub-sector will be mainly for the construction of the power plants in Janamanjung and Prai, while investment in the communication sub-sector is largely for further expansion of the coverage of High-Speed Broadband (HSBB) services.

The higher investment activity by both the private and public sectors are expected to provide longer term benefits to the economy through enhancing the future productive capacity and productivity of the overall economy.

Improvement in external demand

The global economic outlook is expected to improve in 2013. The better growth prospects for the regional economies are expected to provide strong support for Malaysia's exports. The subpar growth projection for the major advanced economies, however, is likely to constrain any further strengthening of international trade activity. Together with the softening of major commodity prices, Malaysia's gross exports of goods are expected to improve modestly by 1.4% in 2013.

External demand to improve as global economy recovers

The nascent recovery of manufactured exports, which was evident in the fourth quarter of 2012, is expected to continue, and will be supported mainly by non-E&E manufactured exports that are primarily demanded by the regional economies. In contrast, the growth of E&E exports will continue to be weighed down by the weakness in external

Variations in Household Propensity to Consume across Income Segments

Introduction

Private consumption was again a major driver of growth in 2012. Its robust performance of 7.7% was mainly supported by stable employment conditions and continued strong wage growth. However, at the micro level, there were also economic and policy developments that affected the incomes of different segments of households to varying degrees. The decline in crude palm oil prices in the second half of 2012 impacted the incomes of small-holders in that sector. Meanwhile, households earning less than RM3,000 per month benefited from a transfer of RM500 from the Government under Bantuan Rakyat 1Malaysia (BR1M).

To assess the aggregate effects of such developments on various income levels, it is necessary to identify: (1) Their magnitudes; and (2) the affected households and the likely change in their spending patterns. The latter requires knowledge of households' responsiveness to a change in income, which may vary according to the level of household income. This article highlights the diversity in households' propensity to consume from income, and the need to account for this heterogeneity while assessing the impact of income shocks.

Diversity in Household Consumption Behaviour across Income Segments

The literature posits that, in general, households aim to maintain a stable standard of living by avoiding excessive fluctuations in consumption in response to temporary changes in their income. Ideally, households would save more during periods of temporarily higher income and draw down on savings during periods of temporarily lower income. Alternatively, some households may access credit markets instead of drawing down from their savings. This concept, consumption smoothing, explains why temporary fluctuations in income are often observed to have less than proportionate effects on spending. In reality, despite the desire to smooth spending, households earning different income levels differ in their ability or willingness to do so. Lower income households are often less able to smooth expenditures and thus their spending behaviours display a higher sensitivity to fluctuations in income.

There are three main reasons underpinning this observation. Firstly, lower income households are often less able to save, mainly because this group tends to spend a higher share of total income on essential items such as food and utilities. The inability to accumulate sufficient savings results in their expenditures being more sensitive to changes in income. In the absence of credit, a drop in income will induce a household without savings to reduce its expenditures by an amount that corresponds to the decline in income, while a household with sufficient savings has the option of continuing to spend by using its savings. Secondly, within the context of imperfect credit market conditions, access to credit for lower income households is also more constrained, given the lower current and expected future incomes and the ability to secure collateral for borrowing. Households with limited access to credit, when faced with an adverse income shock, would have to reduce their expenditures by a greater magnitude compared to households who are able to borrow. Finally, studies have found that the spending behaviour across different income levels is also a function of the level of financial literacy. Lower income households with lower levels of financial literacy are less likely to purchase insurance, have a lower capacity to save and are more likely to undertake borrowing at a higher cost than necessary. These factors, taken together, would cumulatively inhibit the ability to smooth consumption against unanticipated income shocks, thus making expenditures of lower income households more sensitive to income shocks, relative to the higher income segments.

Empirical Evidence for Households in Malaysia

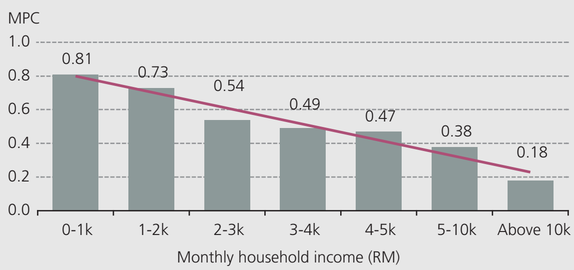
Consumption functions across income groups were estimated to capture the differing spending behaviour of households at various income levels. This was done using a cross-section of 21,641 households categorised into seven income brackets based on data from the 2009/2010 Household Expenditure Survey (HES). In the empirical specification, consumption was regressed on income, credit and wealth factors, and the life cycle stage of the households.

Chart 1 presents the main results, showing the estimated income elasticities vis-à-vis marginal propensity to consume (MPC) across income groups. Households earning less than RM1,000 per month will, on average, spend RM0.81 out of RM1 of additional income. This is much higher compared to the comparable estimate of RM0.18 for households earning more than RM10,000 per month.

Chart 2 shows the food-to-income ratio and household savings rate across income groups. The left panel shows a negative relationship between the food-to-income ratio, which proxies the extent to which income is spent on necessities, and income. The right panel shows a clear positive relationship between the ability/desire to save and income. The results support the *a priori* prediction that lower income households are more sensitive to income shocks. It is also consistent with the earlier hypothesis that lower income households tend to have lower savings as most of their expenditures are for necessities.

Chart 1

The MPC from Income across Income Groups



Source: Bank Negara Malaysia estimates based on HES 2009/2010, Department of Statistics, Malaysia

Overall, the significant differences in the MPCs across income segments suggest that applying the overall MPC across all income groups would not produce accurate results. This is illustrated in the assessment of the impact of BR1M, which disbursed RM500 to households earning less than RM3,000 per month in 2012. Two scenarios of the impact are computed. Scenario 1 uses the estimated MPC for each of the three income groups that received the RM500 payment. Scenario 2 uses a constant MPC of 0.51, the average across all income groups, for households

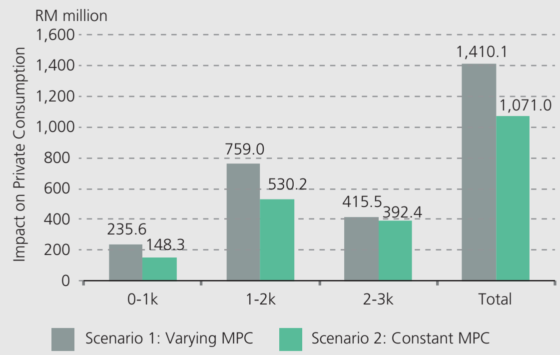
Chart 2

Spending and Saving Patterns across Income Groups

Source: Bank Negara Malaysia estimates based on HES 2009/2010, Department of Statistics, Malaysia in all three income groups. The difference in the estimated impact under both scenarios is shown in Chart 3[1]. The impact under Scenario 1, at RM1.4 billion, is larger compared to the RM1.1 billion estimate under Scenario 2 because the former is sensitive to the variations in the MPC across different income groups.

Chart 3

The Potential Impact of BR1M Using Varying and Constant MPCs



Source: Bank Negara Malaysia estimates based on HES 2009/2010, Department of Statistics, Malaysia

Conclusion

The empirical evidence indicates that households differ significantly in their consumption responses to income, with spending by lower income households being the most sensitive to income changes. This implies that recent policies such as 1Azam and BR1M, in addition to achieving their intended welfare objectives, have also generated an impact on aggregate private consumption. Looking ahead, as the country transitions to a high-income economy, the current policy framework needs to be complemented with a comprehensive social safety net system. Such an initiative will foster economic progress that is also inclusive.

[1] The estimates under both scenarios reflect only the direct impact of the policy on private consumption. There are also benefits from second-round effects through higher profits and employment in the consumption-related sectors which are abstracted from this example.

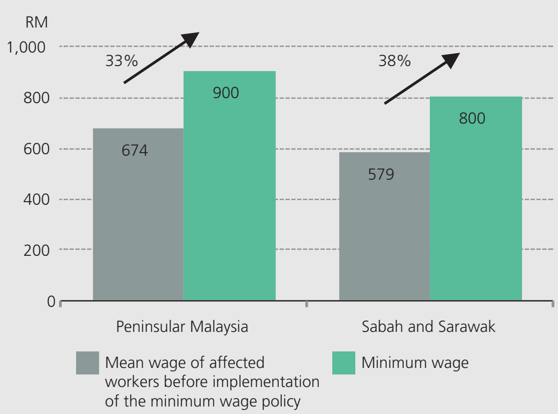
Potential Impact of the Minimum Wage Policy on the Malaysian Economy

Introduction

Malaysia implemented a minimum wage policy on 1 January 2013[1], thereby joining more than 150 other countries that already have minimum wage laws in place. The policy sets a minimum wage of RM900 per month (RM4.33 per hour) for Peninsular Malaysia and RM800 per month (RM3.85 per hour) for Sabah, Sarawak and the Federal Territory of Labuan, covering both the local and foreign workforce, except for domestic workers such as domestic helpers and gardeners. The minimum wage policy is intended to ensure that the basic needs of workers and their families are met, to reward and protect them from exploitation, and to incentivise firms to move up the value chain by investing in technology and boosting productivity[2].

Chart 1

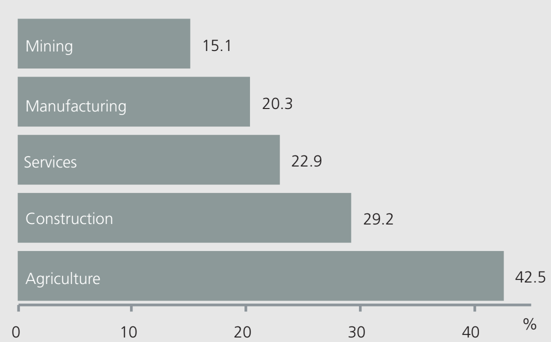
Wage Increases for Workers Affected by the Minimum Wage Policy



Source: Bank Negara Malaysia

Chart 2

Share of Workers Earning Below the Minimum Wage by Sector (Peninsular Malaysia)



Source: Bank Negara Malaysia

The minimum wage affects close to one-third of the workforce

The minimum wage policy is estimated to benefit about 27% of workers nationally[3]. On average, the affected workers in Peninsular Malaysia are expected to receive a 33% increase in wages, while those in East Malaysia would be given a 38% increment. By economic sector, the agriculture industry is expected to be the most affected, as 43% of workers in the sector received wages that were below the minimum wage prior to the implementation of the policy.

The minimum wage will improve worker welfare and facilitate transformation of the economy

The minimum wage policy is envisaged to have an important role in addressing inefficiencies in the labour market, and in improving the social welfare of low-paid workers. First, setting a minimum level for wages will alleviate labour market distortions and maximise the efficiency of labour usage in the economy. When wages are artificially suppressed below productivity levels, it would lead to low labour participation rates in the economy, as workers have less incentive to take part in the labour market. In some instances, wages have been suppressed at such low levels that local workers were displaced by low-waged foreign workers. In Malaysia, real wages have recorded a slower growth compared to real labour productivity

[1] Note: For microenterprises, the implementation date is 1 July 2013. A total of 635 firms and members of selected associations that were due to implement the minimum wage on 1 January 2013 have been granted extensions. The deadline for microenterprises to send in their applications for extension is 1 April 2013.

[2] Source: Ministry of Human Resources.

[3] Source: Bank Negara Malaysia.

growth, especially in the manufacturing sector, where wages increased by 2.4% per annum over the decade while labour productivity expanded by 5.0% per year over the same period[4]. The higher wage levels following the implementation of the minimum wage policy are expected to encourage greater participation in the labour market and improve the utilisation of labour in the economy.

Second, the increase in the incomes of low-wage workers, to levels that would fulfil their basic needs, would improve the economic welfare of workers by raising their standards of living. From a macroeconomic perspective, the increase in wages would also raise consumption and support domestic demand, as low-income groups tend to have a higher marginal propensity to consume *(see box article on Variations in Household Propensity to Consume across Income Segments).*

Third, consistent with the Government's objective of transforming Malaysia into a high-income and high-productivity economy, the minimum wage policy provides incentives to both firms and workers to undertake productivity-enhancing measures. As the relative cost between capital and labour narrows, firms may be encouraged to invest in automation and newer technologies that could enhance production capacity, rather than rely on low-cost foreign labour. Firms may also be incentivised to provide training to enhance the skills and productivity of their employees. With lower reliance on low-cost unskilled labour, firms may in turn be encouraged to move up the value chain to be more competitive. For workers, the greater availability of jobs with higher wages and the potential for the acquisition of higher skills would encourage increased participation in industries that were previously avoided. These changes would facilitate the transformation of Malaysia into a high value-added, high-income economy.

Short-term adjustment costs to be contained

In the short run, the minimum wage policy may subject firms to higher costs, especially those that have been highly dependent on low-wage workers. This could result in adjustments through several possible means, including by absorbing the increased cost through a reduction in margins, increasing productivity, reducing the overall costs through improved efficiency, and reducing the amount of labour used. Firms may also pass on some of the increase in costs to consumers, although this may not be a feasible option in an environment where firms face strong market competition. For the more labour-intensive and financially-constrained firms, immediate adjustment to the policy may result in cost-cutting or, where applicable, cost-passing measures.

Several studies on the impact of the minimum wage policy in other countries find a small negative effect on employment, particularly for young and low-skilled workers. The magnitude of this effect varies across countries due to differences in labour market characteristics and the prevailing economic environment. For Malaysia, while there may be some risk of lower employment, this effect is expected to be transitory and contained, given the country's strong economic fundamentals. Demand for labour is expected to continue to increase in the current environment of sustained growth and low unemployment. Any adjustment to employment as a result of the minimum wage policy will likely be temporary, as dislocated workers would be reabsorbed into the workforce given the relatively tight labour market. Indeed, job vacancies have been on an increasing trend since 2004[5], while Malaysia's unemployment rate has remained consistently low, with a historical average of 3.3% over the recent two decades.

Malaysia's low and stable inflation, together with the healthy profit margins of firms, would further aid in mitigating the extent of the pass-through of costs to consumers. The magnitude of price increases would also be constrained by the extent of adjustments that are made by the larger firms, which are generally price leaders and tend to be less affected by the minimum wage policy.

[4] Source: The World Bank's Malaysia Economic Monitor, April 2012.
[5] Vacancies refer to the number of job postings on the JobsMalaysia portal, as reported by the Ministry of Human Resources.

Findings from a survey conducted by Bank Negara Malaysia[6] in May 2012 suggest that the impact of the minimum wage policy will be manageable. Over 90% of firms that would be affected indicated they would not retrench workers in response to the policy, while only 25% indicated a reduction in hiring. The survey also showed that about half of the firms that would be affected did not have plans to pass on the cost increase to consumers. More importantly, close to 50% of the firms that would be affected indicated they had plans to increase training to enhance labour efficiency, while 40% indicated they would expand automation as an option to offset the increase in the cost of labour. The results of the survey reaffirm the expectation that firms will be able to adapt to the minimum wage policy, at the aggregate level, through a number of adjustment mechanisms without experiencing any significant economic disruptions.

Conclusion

Over the medium to long term, the minimum wage policy is expected to have a positive impact on the Malaysian economy. The short-term costs and risks of the minimum wage policy on inflation are expected to be well-contained. The impact on business cost will likely be small, as the increase in wages could be mitigated through improvements in productivity. Given that low-wage households tend to have a higher marginal propensity to consume, the increase in the incomes of the affected workers can be expected to result in higher consumer spending and economic activity.

The minimum wage policy is envisaged to be a positive step towards encouraging a fairer wage structure, and in contributing towards the promotion of higher value-added economic activities and higher-skilled jobs. To achieve its objectives, the policy is further complemented by other productivity-enhancing measures, such as the provision of training to up-skill workers, improvements in the quality of education, and the facilitation of investment in automation and advanced technology. With government and institutional support, as well as proper supervision and enforcement, the minimum wage policy is well-positioned to realise its goals.

[6] Bank Negara Malaysia conducted a Minimum Wage survey in May 2012. A total of 232 firms responded.

demand for personal computers, as consumers' preferences shift to mobile telecommunication devices, and manufacturers undertake inventory adjustments following the weak demand in 2012. Nevertheless, the contraction in E&E exports is anticipated to moderate as manufacturers continue to diversify their production line-up and shift into the fast-growing mobile telecommunication sub-segment.

The contraction in commodity exports, which began last year, is expected to continue in 2013, due mainly to further decline in prices, particularly for crude palm oil (CPO) and liquefied natural gas (LNG). In addition, the slower growth in global demand for commodities, coupled with increased global supply is likely to weigh down on the growth of commodity exports.

Services exports, particularly transportation and travel services, are expected to improve in 2013. While transportation services will benefit from the anticipated higher exports volume, travel services will be buoyed by higher tourist arrivals in response to the campaigns for the Visit Malaysia Year 2014. Overall, exports of goods and services are projected to register a modest growth of 2% in 2013.

Gross imports of goods are projected to increase but at a more moderate pace of 5.7% in 2013. After registering a contraction in 2012, intermediate imports, which form the bulk of Malaysia's imports, are expected to turn around to increase in 2013 as manufacturers increase production to meet rising export orders and replenish inventories. The expanding domestic investment and consumption activity, while more moderate than in 2012, will continue to support the growth of gross imports in 2013. In particular, investment activity will continue to result in the demand for imports, particularly the imports of capital goods for the oil and gas, manufacturing and services sectors. As consumers continue to experience sustained income growth, imports of consumption goods are also expected to increase. Services imports are, however, expected to expand at a slower rate. Overall, the imports of goods and services are projected to expand by 5.4% in 2013.

The net outflows in the income account in 2013 are likely to be smaller, as Malaysian companies with investments in the mining, services and manufacturing sectors are expected to provide a higher contribution to income inflows, given the improving economic outlook in the region. Profits and dividends accruing to multinational corporations

Table 4.2

External Trade

	2012*p*	2013*f*
	Annual change (%)	
Gross exports	**0.6**	**1.4**
of which:		
Manufactures	3.1	4.1
Agriculture	-15.3	-13.1
Minerals	1.9	-0.5
Gross imports	**5.9**	**5.7**
of which:		
Capital goods	20.5	18.5
Intermediate goods	-3.4	1.9
Consumption goods	11.6	9.6
Trade balance	**-23.7**	**-26.1**

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 4.3

Balance of Payments

	2012*p*	2013*f*
	RM billion	
Goods	125.2	102.3
Services	-13.4	-12.7
Balance on goods and services	**111.9**	**89.6**
Income	-33.7	-27.2
Current transfers	-18.2	-19.6
Balance on current account	**60.0**	**42.7**
% of GNI	***6.6***	***4.4***
Capital account	0.1	
Financial account	-22.5	
Balance on capital and financial accounts	**-22.5**	
Errors and omissions	-33.6	
of which:		
Foreign exchange revaluation loss	*-7.7*	
Overall balance	**3.9**	

Note: Numbers may not necessarily add up due to rounding
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

operating in Malaysia are projected to be sustained following the recovery in manufactured exports.

With investment-related imports remaining strong, and exports registering a modest recovery, the current account surplus of the balance of payments in 2013 is projected to amount to RM42.7 billion or 4.4% of GNI. This lower current account surplus also reflects the continued, albeit lower, deficits in the services and income accounts.

Inflation Outlook

Headline inflation is expected to average 2-3% in 2013. The higher inflation projection takes into account the expectation for higher global prices of selected food commodities and adjustments to domestic administered prices. Demand-driven pressures on prices are expected to be moderate. The wider forecast range reflects the greater uncertainty in the external and domestic environment, particularly in terms of the movement in global food and energy prices, and the timing and magnitude of the adjustments to administered prices.

Externally, the key factors driving inflation will be the prices of selected food commodities, while crude oil prices and inflation in import partner economies are expected to remain relatively stable. The Food and Agriculture Organisation of the United Nations (FAO), in its November 2012 edition of the Food Outlook, projected that selected food prices, especially corn and wheat, will continue to remain high in 2013, due to adverse weather conditions and low stockpiles. The persistently high corn and wheat prices could translate into increases in domestic meat prices through high cost of animal feed.

Headline inflation is expected to be higher but to still remain modest

Average global crude oil prices are expected to moderate slightly in 2013, as the global supply of oil is expected to exceed demand. Demand for crude oil is projected to be higher in the emerging economies, especially in PR China, given the more favourable growth outlook in these economies. However, this would be offset, to some extent, by the lower demand in the advanced economies amid weak economic activity. Global oil supply, meanwhile, will continue to increase, lifted by the resumption of oil production in South Sudan and additional supply from new oil fields in Brazil. The January 2013 update of the IMF's World Economic Outlook (WEO) projected global crude oil to trade at an average[1] of USD100 per barrel in 2013, marginally lower than the average price of USD105 per barrel in 2012. Inflationary pressures emanating from Malaysia's key import partners are also expected to be contained in 2013. The higher inflation projected for the emerging economies, following sustained growth in domestic demand and adjustments to administered prices in these economies, will be offset by the lower inflation in the advanced economies. Prevailing economic slack and weak demand conditions are expected to result in subdued price pressures in the advanced economies. The more moderate external price pressures would provide producers with greater flexibility to manage their overall operating costs, without having to resort to raising retail prices significantly.

In the domestic economy, the Government is expected to move towards a system of more targeted subsidies that will result in a series of adjustments to the prices of administered items in 2013. The overall impact on inflation will depend on the timing and magnitude of these price adjustments. These adjustments, however, are expected to be small and gradual, and hence, would not have a significant impact on the overall price level. The impact of the implementation of the minimum wage policy on total costs of firms is also expected to be modest (see box article on Potential Impact of the Minimum Wage Policy on the Malaysian Economy).

Price pressures arising from demand factors are also expected to be contained, in line with the more moderate growth in domestic demand. Private consumption will be supported by the overall stable labour market conditions and Government transfers to selected households under the 2013 Budget. The output gap will narrow as the economy expands at a rate close to its potential growth (see box article on Potential Output of the Malaysian Economy). This will result in higher inflation in 2013, but to a modest extent in view of the sustained investments to expand capacity and some moderation in income due to lower commodity prices.

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

Upside risks to inflation arising from both external and domestic factors cannot be ruled out. Externally, global food and energy prices could rise significantly should disruptions to global supplies of commodities occur. A prolonged drought in key food-producing countries and a resurgence of geopolitical risks in the Middle East and North Africa (MENA) region could contribute to higher prices. Domestically, upside risks could also emanate from larger-than-expected adjustments to administered prices, especially should global crude oil prices increase significantly. There is also the risk of stronger demand-driven price pressures in the event of a better-than-expected recovery in the external sector. Despite these risks, Malaysia projects that inflation will remain modest given that any adjustments are not likely to be significant and will be paced over an extended period of time. This will minimise its effects on inflation, thus providing an environment of macroeconomic stability.

MONETARY POLICY

The monetary policy operating environment in 2013 will continue to be shaped by the uneven economic recovery in the world economy, the persistent volatility in the financial and commodities markets, the large capital flows and by developments in the domestic economy. The Malaysian economy entered 2013 from a position of strength, providing the foundation for the sustained expansion of domestic demand. Domestic inflation is expected to be higher, but will remain contained. While there are upside risks to inflation, arising from both external and domestic factors, inflation in the last quarter of 2012 and early 2013 has remained low, in the region of 1.2% to 1.3%. Monetary policy in 2013 will focus on addressing potential risks to inflation and growth.

Globally, growth is projected to improve in 2013. Notwithstanding the recent improvements, the economic performance of the advanced economies continues to be uneven, restrained by prevailing structural weaknesses and ongoing strains in public finances. Significant challenges remain in the implementation of policies to resolve the European sovereign debt crisis, and the fiscal situation in the US remains highly uncertain. In Asia, despite being affected by the external shocks, economic activity is expected to continue to expand, underpinned by resilient domestic demand and a gradual recovery in the external sector.

Monetary policy in 2013 will focus on addressing potential risks to inflation and growth

In 2013, the Malaysian economy is expected to expand within a range of 5-6%. Domestic demand will continue to be the anchor for growth, while the expected gradual recovery in the external sector will provide additional support to the economy. Private investment is likely to remain firm, led by continued capital spending in the domestic-oriented sectors, the ongoing implementation of infrastructure projects, and a gradual improvement in external demand. Private consumption is expected to grow at a more modest rate, supported by sustained income growth and stable employment conditions. Further consolidation of the Government's fiscal position is projected to lower the growth of public sector spending. The key risk to the growth outlook emanates from the external sector, as the strength of the recovery in the crisis-affected advanced economies continues to be a major source of uncertainty for the growth outlook.

Inflation is expected to trend higher, but remain moderate within a range of 2-3% in 2013. Upward supply pressures on inflation are expected to emanate mainly from higher global prices for selected food commodities, which will contribute towards higher domestic costs. While sustained domestic demand may exert some pressure on domestic prices, the impact is not expected to be significant, given the more moderate increase in consumption and investment. Continued investment by firms to expand their productive capacity will also contribute to containing price pressures. Nevertheless, there are risks that, if manifested, will have implications for inflation. This includes supply disruptions that could result in increases in key commodity prices. The impact on domestic inflation will depend on the extent to which firms are able to offset the higher costs through increases in productivity and efficiency, and the extent to which producers absorb the increases in costs.

These factors will be taken into consideration in the setting of an appropriate monetary policy stance. Based on the Monetary Policy Statement (MPS) issued by the Monetary Policy Committee (MPC) in March 2013, the prevailing level of the Overnight Policy Rate (OPR) is appropriate for the inflation and growth outlook. In addition to domestic conditions, the MPC has indicated that it will continue to carefully assess the global economic and financial developments and their implications on the overall outlook for inflation and growth of the Malaysian economy.

FISCAL POLICY

Fiscal policy in 2013 continues to focus on sustaining the growth momentum of the domestic economy in the near term and facilitating the long-term transformation of the economy, while ensuring the sustainability of public finances. Towards this end, efforts are being centred on maximising the efficiency of fiscal resources and strengthening fiscal management. Given the challenging external environment, supporting domestic demand remains a key priority for the public sector, with greater emphasis on enhancing the country's productive capacity, a critical lever in Malaysia's transition towards becoming a high-income nation. At the same time, fiscal reforms are underway to enhance policy flexibility and to ensure fiscal sustainability. Such reforms, while necessary, need to be implemented gradually and in an orderly manner to ensure that it does not result in economic dislocation.

The Federal Government fiscal deficit is expected to consolidate further to 4% of GDP in 2013 from 4.5% of GDP in 2012. Revenue collection is expected to remain firm on account of stable corporate earnings amid resilient economic expansion and ongoing tax enhancement measures. Higher-than-expected revenue, as observed in the recent years, is expected to continue providing support to the fiscal consolidation plan. As the Government gradually reduces its role in the economy, total expenditure in 2013 is expected to be marginally reduced. The fiscal deficit will be primarily financed from domestic sources given the ample liquidity and high savings in the domestic economy.

In ensuring the efficient use of fiscal resources, the 2013 Budget continues to focus on enhancing the productive capacity of the domestic economy. Major initiatives to accelerate investment activity are being put in place with a greater focus on promoting higher value-added activity and quality investments by the private sector. Particular focus is dedicated to accelerating the growth of small and medium enterprises (SMEs). Provisions have been made to further enhance financing access for businesses, including incentives to encourage the issuances of retail bonds and

Table 4.4

Federal Government Finance

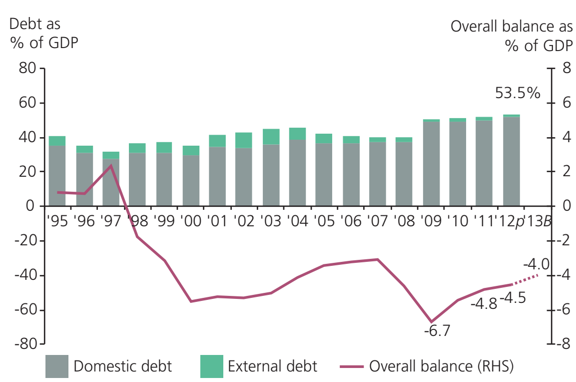
	RM billion		% change	
	2012*p*	2013*B*	2012*p*	2013*B*
Revenue	207.9	208.7	12.1	0.4
Total expenditure	252.5	249.7	10.2	-1.1
Operating expenditure	*205.5*	*201.9*	*12.6*	*-1.8*
Gross development expenditure	*46.9*	*47.8*	*1.1*	*1.7*
Loan recoveries	2.6	1.0		
Overall balance	**-42.0**	**-40.0**		
% of GDP	**-4.5**	**-4.0**		
Sources of financing:				
Net domestic borrowing	43.3	-		
Net external borrowing	-0.1	-		
Realisable assets[1] and adjustments	-1.3	-		

[1] A negative (-) sign indicates a build-up in assets
p Preliminary
B Budget
Note: Numbers may not add up due to rounding

Source: Ministry of Finance

Chart 4.3

Federal Government Fiscal Balance and Debt



p Preliminary
B Budget

Source: Ministry of Finance

retail sukuks. Such issuances of retail bonds and retail sukuks would contribute to the deepening of the Malaysian capital market, while offering a wider choice of instruments to retail investors, including households. Special emphasis is also being accorded to human capital enhancement through promoting early childhood education, training, and research and development, in order to develop the desired competencies and enhance employability in a rapidly evolving economy.

The 2013 Budget also places importance on achieving inclusive growth in the course of economic transformation. More targeted socioeconomic spending is allocated, particularly for the poor, disadvantaged and under-served groups, to strengthen social safety nets. These include increasing the availability of affordable housing and promoting home ownership, expanding the social safety net and enhancing public health facilities.

Ongoing fiscal reforms include consolidating the fiscal deficit to the target of 3% of GDP by 2015, through a comprehensive review of the tax system, subsidy rationalisation and measures to increase spending efficiency. In 2012, the Long-Term Fiscal Sustainability Steering Committee, an inter-agency committee, was established to focus on strategies to reduce public sector indebtedness. Among the areas under review include the administration of civil servant housing loans. In the interim, the Federal Government is also leveraging on various technical assistance programmes provided by multilateral institutions to further enhance the standards of fiscal management in Malaysia, in line with international best practices. Moving forward, the gradual implementation of the ongoing public finance reforms will accord a greater degree of policy flexibility, which is particularly vital in an uncertain global environment.

2012

GOVERNANCE, ORGANISATIONAL DEVELOPMENT AND COMMUNICATIONS

The Bank continued to place significant emphasis on its governance, organisational development and communications in delivering its mandates. As the global and domestic environment changes and new challenges emerge, the Bank has constantly aimed to elevate its performance. This includes its ability to address these more complex policy issues and the effective formulation and implementation of its policies. Having robust governance, combined with a high level of leadership and other important competencies would enable the Bank to deal effectively with the evolving challenges.

GOVERNANCE

The Bank's activities in the fulfillment of its functions and objectives are overseen by the Board of Directors (Board) and the three Board Committees. The ongoing strengthening of the oversight functions of the Board and enhancements to the Bank's internal governance framework and practices have continued to contribute towards ensuring a high level of corporate accountability and transparency. In addition, it promotes effective management and robust informed decision-making in the Bank.

The Board provides general oversight of the management and operations of the Bank. This includes its strategic planning and risk management practices, human capital management and its financial operations. The Board has a key role in providing oversight in ensuring that the Bank achieves its mandates of promoting monetary and financial stability in an environment that is conducive to the sustainable growth of the Malaysian economy. The Board comprises the Governor, two Deputy Governors and the Secretary-General of the Treasury as an ex-officio member of the Board and five independent directors who are non-executive members.

In 2012, the Board met monthly to deliberate on the various aspects of the Bank's operations. Among the key issues discussed were the developments in the global and domestic economic and financial environments, implications on the operations of the Bank and policy measures being considered to address emerging issues. Other key issues discussed regularly during the year included policy developments and the risk outlook in the conventional and Islamic financial systems, payment systems and the consequences for financial stability. Matters pertaining to the Bank's financial condition, reserves management, currency management and the Bank's management of its staff were also discussed.

During the year, several organisational development policy measures were discussed and approved by the Board. These included strengthening the performance of the Bank through the adoption of a new job family framework and a more differentiated reward structure. Another important initiative was the review of the Bank's operating plan that contributed to the implementation of a more rigorous budgetary process. This was part of the Bank's ongoing initiatives to foster greater financial discipline and ensure that its operating expenditures commensurate with the resources being allocated to achieve the Bank's mandates and desired outcomes. The Bank also continued to strengthen the various oversight functions and policy forums to draw on different perspectives to deal with the complex issues facing the Bank. This included the appointment of a new external member to the Financial Stability Executive Committee, and the adoption of a new framework governing the appointment of external candidates as members of the Monetary Policy Committee.

In performing its oversight function, the Board is supported by three Board Committees. These include the Board Governance Committee (BGC), the Board Audit Committee (BAC) and the Board Risk Committee (BRC). The members of the Board Committees consist solely of non-executive directors to strengthen independent oversight of the Bank's operations. The BGC is responsible for reviewing and recommending the principles and practices of governance for the Bank. In 2012, the BGC met four times and reviewed a number of key matters including the Code of Ethics for the staff of the Bank and Conflicts of Interest for members of the Board and other Committees, and the revision to the terms of reference for the Board Committees. The Committee also reviewed, for approval of the Board, the budget and operating plan of the Bank for 2013.

The function of the Board Audit Committee is to assist the Board in its oversight of the integrity of the Bank's accounts and financial statements, the effectiveness of the internal controls, the performance of the internal audit function, and compliance with legal and regulatory requirements. During 2012, the BAC convened four meetings to approve the audit plan, review the audit activities and performance of the internal audit function, and to deliberate on the audit findings and actions taken to ensure that the internal control system remains effective in addressing the key risks faced by the Bank.

The Board Risk Committee assists the Board in providing oversight over the Bank's management of risks that could lead to financial loss, disruption to operations, failure to meet its mandates or damage to the Bank's reputation. In 2012, the BRC met four times to monitor the Bank's management of enterprise-wide risks. Specifically, in the area of Treasury Operations, the BRC deliberated on the Bank's processes and approaches to investing in new asset classes and markets to ensure that adequate controls were in place to manage the associated risks.

Risk Management in the Bank

The Bank's risk management culture and practices continued to evolve in response to current and emerging risks in the environment. A notable development in 2012 was the merger of the risk and strategic management functions into one department in order to ensure that the understanding of risk factors contributes to more effective strategic planning processes. The Strategic and Risk Management Department (SRMD) serves as the secretariat for the Risk Management Committee and the forums for business planning and performance review. This enables the Bank's senior management to have a more holistic and integrated view of business strategies and risks. This in turn serves to strengthen the overall risk management at the Bank.

Risk Management Framework

The Bank's Enterprise Risk Management (ERM) framework outlines risk governance, policy and practices for effective management and supervision of risk in the Bank. The ERM encompasses the Operational Risk Management Framework (ORMF), Financial Risk Management Framework (FRMF) and Business Continuity Management Framework (BCMF), with the aim of nurturing a strong risk management culture within the Bank. The ORMF addresses specific risk event categories such as fraud, third-party relationships, technology, legal, employment and culture, process management and execution, safety and security, and guides the implementation of risk-mitigating measures in accordance with the Bank's risk appetite. The FRMF addresses all aspects of financial risk management including the sustainability of income and expenditure and the financial exposures facing the Bank. The Bank's BCMF outlines the main principles of business continuity management to protect the Bank's staff and assets and ensure continuity of operations in any crisis situation.

The Bank maintains the three lines of defence approach in its risk management practices. The first line of defence is the line departments, which address the risks on the ground, and are responsible for identifying, mitigating and managing risks within their area of operations. The second line of defence comprises of the Risk Policy Owners (RPO) and SRMD. RPO functions are designed to assist line departments in managing transversal risks which cut across the organisation, namely people, information technology, legal, business disruption, physical and information security. In 2012, the taxonomies for risk events and their root causes were revised to improve the assessment of risk factors at all levels. The third line of defence resides within the function of Internal Audit, which provides an independent assurance and verification of the effectiveness of the risk management policies and measures.

Risk Management Governance Structure

The Risk Management Committee (RMC), chaired by the Governor, deliberates on organisational risks related to the achievement of the Bank's mandates and strategic objectives and decides on appropriate policies to mitigate and manage such risks. Significant risk issues are escalated to the RMC by two sub-committees, namely the Operational Risk Management Committee and the Financial Risk Management Committee, each headed by a designated Deputy Governor. The key risks deliberated at RMC in 2012 were on the management of organisational risks which included transversal risks (specifically, people, legal and IT risks) and other emerging operational risks facing the Bank. The RMC also deliberated and approved the stakeholder engagement framework which identifies principles to be adopted in ensuring the Bank is effective in engaging and interacting with all of its stakeholders which is one of the key elements in ensuring policy outcomes are achieved.

The Operational Risk Management Committee (ORMC) ensures that Bank-wide operational risks are recognised and adequate controls are in place. The ORMC also performs the oversight function of monitoring information security and procurement management. In 2012, the ORMC extensively deliberated the management of transversal risks and provided pre-emptive mitigation plans to ensure that the identified risks were managed appropriately. The assessment of people risk highlighted the potential risks on staff capabilities in the more complex environment while risk assessment on IT addressed the plausible issues relating to information security concerns and areas that could disrupt the Bank's business operations. The ORMC also deliberated on the effectiveness of internal controls pertaining to the physical facilities and information security to ensure a safe and secure working environment in the Bank. For legal risk, an assessment was conducted on risks relating to potential non-compliance with relevant laws or contractual obligations that could expose the Bank to potential legal liability, financial loss or loss of reputation.

The Financial Risk Management Committee (FRMC) identifies Bank-wide financial risks and ensures that financial risks are adequately managed. FRMC also deliberates on policies, management strategies and positions relating to the Bank's balance sheet risks. The Reserves Management Committee (ReMC), chaired by the Governor, oversees risks and strategies related specifically to the management of the nation's international reserves. It provides a platform for discussions on the global economic and financial market outlook, investment themes and strategies, and a centralised and holistic review of the risks in reserves management and the impact on the Bank's financial position. The ReMC discusses the market, credit and operational risks of all investment exposures. Through this forum, the senior management of the Bank formulates or adjusts investment strategies as necessary. In 2012, the ReMC met four times and discussed various issues relating to reserves management, among others, the ongoing sovereign debt crisis in Europe and its impact on the international reserves investments of the Bank. All risks were within approved limits and were actively managed.

Key Initiatives in 2012

The Bank's capability to assess risk levels continued to improve with better reporting and appreciation of risks across the departments. For the year 2012, a consolidated Risk Control Self Assessment (RCSA) report was published. The main objective of the report is to facilitate the identification and management of common risks across the Bank, based on the operational risks declared by line departments.

Staff awareness and compliance to the Bank's risk policies were strengthened with the introduction of a web-based system named IComply which functions as a central repository and broadcast channel for all internal policies and guidelines in the Bank. In addition, the Incident Reporting (IR) process was re-engineered to better facilitate Bank-wide reporting of any operational incidents. The Bank also took the opportunity to share and learn new practices and approaches in risk management with central banks across the region, particularly with members of the South-East Asian Central Banks (SEACEN) Research and Training Centre. The Bank continued to have an active role in the International Operational Risk Working Group (IORWG) Committee as it provides an avenue to leverage on the international best practices of different central banks.

Strengthening of Business Continuity Management Practices

The Bank's Business Continuity Management (BCM) capabilities and methodologies were improved with enhancements to the recovery strategies for all critical business functions. The Bank has also put in place a clear escalation and communication mechanism to cooperate seamlessly with the National Security Council (*Majlis Keselamatan Negara)* should the need arise. In addition, the Bank's BCM infrastructure and standards were improved with the upgrading of the Bank's Recovery Centre into a 'mini central bank'. The upgraded facility can accommodate up to five hundred staff and house all the critical systems of the Bank. This allows the Bank to minimise potential risks of operational disruptions as well as any systemic impact on the financial system in the event of a disruption or during periods of crisis.

Internal Controls and Assurance

The Internal Audit Department (IAD) facilitates the work of the Board Audit Committee (BAC) by providing an independent and objective assessment of the adequacy and effectiveness of the risk management measures, internal controls and governance processes with respect to key functions and activities of the Bank and its related entities. The IAD adopts a Relationship Manager approach, where IAD staff are designated to specific departments and related third-party entities to ensure that its audit plan remains focused on the Bank's priority areas and key risks.

In 2012, the IAD continued its risk-based audit programme through an end-to-end review of the core functions and processes, and thematic reviews of common activities. The specific business functions reviewed during the year included regulatory functions, reserves management and back-office functions, currency operations, human resource management, risk management and thematic reviews of common processes such as procurement and expenditure management, information-security management and the safeguarding of assets.

The department conducted a review of the IT security measures, business continuity arrangements, maintenance and performance of the IT systems, and the risk mitigation measures needed to address specific key risks to the Bank's critical systems. IAD also assessed the operations of the Bank's related entities which undertake the operations of the systemically-important payment systems and functions which impact the monetary and financial stability mandates of the Bank. The IAD also reviewed the reliability of the Bank's financial records and reporting.

The appropriate recommendations by IAD to further improve the risk management and control functions of the Bank and its related entities were accepted and implemented. Additionally, the IAD in 2012 also undertook investigation work relating to disciplinary proceedings under the Bank's Code of Ethics and provided input to various working committees, line departments and related entities to improve the control and compliance environment.

ORGANISATIONAL DEVELOPMENT

Making the Quantum Leap

The Bank continued its transformation journey as a strategically-focused and performance-based organisation with the implementation of the second cycle of the three-year Business Plan. The Business Plan 2012-2014 provides enterprise-wide focus and clarity on the Bank's objectives. Strategies and action plans are aligned to seven focus areas, namely ensuring monetary stability, preserving financial system stability, ensuring effective financial intermediation, developing a more inclusive financial system, ensuring smooth migration to e-payments, promoting greater financial integration of Malaysia at the regional and global level and sustaining the high standards of performance of the Bank. In terms of improving the planning process, initiatives include strengthening the integrated corporate planning framework that encompasses the elements of business strategy, risk, financial resources and human capital management for sustainable organisation performance management. This enabled the Bank to better prioritise its financial and human capital resources for areas of importance.

In order to optimise the use of resources, strategies focused on strengthening the efficiency and effectiveness of the Bank's operations. In 2012, to enhance organisational effectiveness, the common support services were re-organised and consolidated with the establishment of an autonomous functional structure known as Centralised Shared Services (CSS). This new structure enables the Bank to enhance the level of professionalism in the delivery of common services (see white-box titled 'Establishment of the Centralised Shared Services Division'). In addition, the Bank restructured a number of departments to further increase synergies between complementary functions and roles, improving operating models and enabling more effective pooling of information and cross-functional efforts towards the achievement of common goals. This would also contribute towards the sustainability of financial and manpower resources. This included the merging of the Strategic Management Department and the Risk Management Department (now known as Strategic and Risk Management Department); the Financial Intelligence Unit with the Special Investigation Unit (now known as the Financial Intelligence and Enforcement Department); and the consolidation of the Central Banking Services function with the Human Capital Development Centre.

Governance and financial discipline were strengthened through revisions to the Bank's Procurement Management Policy and Procedures and the Outsourcing Framework, both of which serve to augment the Bank's cost-conscious culture and improve operational efficiency.

In view of the significant developments in global financial markets and major economies, the 15th Senior Management Conference 2012 was themed 'Re-thinking Central Banking in Evolving Times'. The theme was chosen to increase awareness of how the landscape for central banks continues to change and the need for the Bank to always be in a state of readiness to address the new emerging challenges. The Conference comprised panel discussions facilitated by members of the senior management of the Bank on areas related to central bank independence, clarity of mandates in light of global regulatory reforms, the need for effective stakeholder engagement for the achievement of the Bank's desired outcomes and the importance of developing organisational flexibility to continually elevate the Bank's performance.

Human Capital Management and Development

Human capital management and development remained a major area of focus in 2012, with significant changes instituted to modernise the Bank's human capital policies. The thrust of the transformation in 2012 was the introduction of a new Job Family framework, designed to modernise the human capital management practices in the Bank. The principles epitomised by the framework would form the basis for initiatives to attract, assess, develop, reward and retain talent in the Bank.

The Job Family Framework

The Job Family framework which was introduced in 2011 for graduate recruits was fully implemented in 2012, involving a holistic review of jobs and rewards to streamline and differentiate various aspects of talent management, including progression, development and rewards strategies. Jobs are now categorised into seven job families, namely Economic Policy, Regulatory Policy, Investment, Supervisory, Specialist, Corporate Strategy and Corporate Resources, based on the similarity of job functions and knowledge, experience and training requirements. Job titles were also reviewed to ensure alignment with the job family classification and new titles were introduced where appropriate.

Accordingly, the Bank implemented differentiated salary structures based on the seven job families, benchmarked against relevant market comparators. In line with the implementation of the Job Family framework, the Bank further refined the technical competencies framework and the learning roadmaps through the development of baseline and specific technical competencies for each job family. A key milestone in 2012 was the roll out of the revised Supervision job family's technical competencies, learning roadmap and structured curriculum for Bank supervisors.

In the efforts to strengthen talent management, the Bank reviewed and enhanced the assessment and evaluation of talent at different levels through the Leadership Profiling Centre, Middle Management Profiling Centre and Sourcing Profiling Centre. The enhanced framework is aimed at having in place robust assessment of talent, primarily to ensure that the right talent is identified for the various roles in the Bank. The profiling initiatives are aligned with the principle of differentiation by job families and optimal manpower planning and sourcing to ensure a healthy talent pipeline.

Developing the Bank's Workforce: Learning and Knowledge Management

In 2012, a key talent development initiative was the introduction of a leadership development framework which comprises the Leadership Development Programme (LDP) and the Corporate Talent Development Programme (CTD). The objective of this initiative is to ensure a healthy talent pipeline with the required leadership bench strength.

The LDP is a set of customised classroom and on-the-job programmes that aims to equip staff with the Bank's leadership competencies, build a common leadership language and to provide the appropriate framework and tools to facilitate behavioural change. The LDP has been customised to incorporate the Bank's strategic objectives, leadership competencies and core shared values. The LDP is complemented by the CTD Programme, a leadership development programme for high potential staff, designed to accelerate and provide additional targeted development opportunities.

The Bank also introduced the Individual Development Plan (IDP) initiative in 2012 to guide the staff in planning and managing self-development in a more effective and structured manner. The focus of the IDP is to enhance the staff's strengths and close development gaps through a continuous engagement process between the supervisors and direct reports, which include coaching conversations and feedback sessions. To ensure staff are properly guided in planning self-development, the Development Advisor (DA) programme offering multiple

Establishment of the Centralised Shared Services Division – Towards Enhancing Services Delivery in the Bank

Introduction

The Centralised Shared Services division (CSS) was established in 2012 as part of the Bank's continued efforts to enhance the effectiveness of the operations of its support services. This effort rationalised and consolidated a large number of common support services into one business division. By centralising these services under the CSS, significant improvements in organisational performance have been achieved with better decision-making processes, economies of scale and enhanced efficiency in the delivery of services. In addition, the establishment of CSS also provides for an autonomous operational structure, which focuses solely on the provision of support services and enables rapid assimilation of best practices, establishes more integrated business systems and allows for better talent management.

The CSS workforce comprises 615 personnel, who are organised into five functional departments, namely the CSS Management Office, Facilities Management Services, Hospitality Services, Security Services, and Museum, Art Gallery and Knowledge Management Centre Services. These departments provide 14 common services under the CSS, including facilities and events management, human resource administration services, security management and the operation of the Bank's Museum and Art Gallery. CSS provides a single point of contact for the delivery of these services, which promises more effective user relationship management and efficient utilisation of resources.

CSS Governance

The oversight of the operations of the CSS is performed by the Operations Management Committee (OMC), which is chaired by a Deputy Governor and comprises senior officials of the Bank. To further enhance its effectiveness, the OMC includes external members who are professionals in the areas of finance, shared services and facilities management. While the OMC remains accountable to the Management Committee of the Bank, the governance structure provides significant autonomy to the OMC and the management of the CSS. The operations of the CSS is headed by a General Manager.

A Business Plan to Operationalise the CSS Division

The CSS division has developed a three-year Business Plan, supported by Key Performance Indicators (KPIs) that focus on three objectives, namely, service excellence and effective stakeholder engagement; financial and operational efficiency and people management. The Business Plan also places emphasis on streamlining processes, increasing standardisation and introducing more automation, which is important in improving turnaround time and operational efficiency, as well as reducing the operating costs of the CSS. By implementing the strategic initiatives in the Business Plan, the CSS aspires to deliver the common services with a high level of professionalism that is supported by a dynamic work culture.

As the CSS is a new operating model for the Bank, its Business Plan and KPIs were communicated to both the staff of CSS and the rest of the Bank through a series of workshops and town-hall sessions. The increased awareness would facilitate staff of the Bank at large to adapt to this new operating model.

Performance-Oriented Culture

As a provider of professional shared services, it is critical for the CSS management to develop a high-performance workforce with a user-centric mindset. On that basis, a comprehensive Service Level Agreement (SLA) is being introduced to articulate the expectations between CSS and its user departments, in terms of the specific services and performance standards. As a tool to monitor the operations of the CSS and to develop more professional relationships with its users, the benefits of implementing the SLA for both the end user and the CSS include:

- Clarity in the roles and responsibilities of both parties, i.e. the CSS as the service provider and the departments as the users of its services;
- Basis for continuous improvements in the delivery of services to achieve a higher level of operational effectiveness and efficiency;
- Promote a culture of service orientation and meeting the needs of the user departments; and
- Basis for reviewing business priorities of the Bank and optimising the allocation of resources accordingly.

The first version of the SLA addressed a total of 32 sub-services based on 14 common services provided by the CSS. In conjunction with a common budgetary framework for the CSS, the SLA is expected to drive greater financial discipline in the acquisition of assets and the monitoring of expenditures.

Two key frameworks were also introduced to govern the operations of the CSS in the areas of financial management and governance for the procurement of assets by the CSS. The financial management framework aligns the CSS Operating Plan with the Bank's overall Business Plan to facilitate effective monitoring of financial resources. The governance framework aims to further strengthen the process with respect to the acquisition of assets by the CSS. This framework provides a dedicated structure of approving authority with well-defined roles and accountabilities for the CSS staff involved in asset procurement.

Change Management in Sustaining the Desired Change

A change management programme was implemented concurrently to ensure that the transition was undertaken in an effective and timely manner with a supportive environment for a sustainable change in the roles, expectations and accountabilities in the CSS. The change management efforts included engagement sessions with different stakeholders, including personal interviews and group dialogues. A post-implementation review was also conducted nine months after the inception of the CSS to provide a better understanding of the motivation, values and challenges faced by the staff in CSS and to identify further interventions that may be required. The change management programme will continue to be an important part of the transformation, with continuous two-way communications to clarify expectations and accountabilities as part of the process.

Moving Forward

As an autonomous division, the CSS has the potential to improve the level of professionalism in delivering support services and adopting new technologies and processes in a more seamless and cost-effective manner, as the services are delivered from common shared platforms. The end result expected is higher-quality services, increased productivity, more rewarding career progression opportunities, as well as more optimal use of resources in the Bank.

learning options and resources was developed. Apart from serving as a guide, the DA is aimed at cultivating self-directed learning among the staff. The DA complements the IDP by providing staff and supervisors with a range of options in planning the IDP.

Revision of the Code of Ethics

Over the years, there have been significant changes to employment laws and practices pertaining to managing staff conduct. Towards this end, the Bank introduced a new Code of Ethics (CoE) in 2012, to replace the Code of Conduct 1998. The CoE outlines the Bank's expectations with respect to the conduct of the staff, and aims to promote a positive, conducive and harmonious working environment. In particular, the staff of the Bank must at all times uphold the highest level of integrity and professionalism in carrying out responsibilities and act in the interest of the Bank and the nation.

Managing the Talent Pool

The Bank continues to award scholarships to outstanding Malaysian students to build its talent pool and also as the Bank's contribution to nation building. In 2012, 53 scholarships were awarded to excellent students, to pursue pre-university, first degree and post-graduate programmes in selected universities. Bank staff were also given the opportunity to pursue higher education in relevant fields through staff scholarship awards. The coveted *Kijang Emas* scholarship award for the nation's best and brightest was awarded to five students with outstanding results in *Sijil Pelajaran Malaysia* in 2012. With this, the Bank has endowed 40 *Kijang Emas* scholarships since its inception in 2004. Recipients of this scholarship are free to choose their own fields of study in selected top universities in the world, without any service bond with the Bank. However, recipients are required to return and work in Malaysia upon completion of studies.

Staff Strength

In 2012, the staff strength decreased by 0.6% to 2,820 from 2,838 in 2011. Attrition remained stable at 4.8% (2011: 4.7%). The ratio of executive to non-executive staff increased to 3.5:2 (2011: 3:2) as more new hires were recruited at the executive level.

International Technical Cooperation Programmes

In 2012, the Bank continued to provide a broad range of technical programmes to enhance cooperation among central banks and regulatory authorities. The technical cooperation programmes provide an opportunity to share Malaysia's experience in central banking as well as to learn from our counterparts. During the year, 836 officials from 84 countries participated in the Bank's technical cooperation programmes, in the areas of monetary policy and macroeconomic management, financial stability and supervision, organisational development, Islamic finance, payment and settlement systems and consumer protection and market conduct. These programmes, drawing on the expertise from within the Bank and international and domestic partners, allowed for knowledge sharing and deepening of the understanding of policy dimensions of different countries from Asia, Middle-East and Africa.

Efforts were also directed at establishing and strengthening alliances with various international partners to improve the outreach, breadth and depth of the technical cooperation programmes. International partners included the SEACEN Centre, the Islamic Financial Services Board (IFSB), the Alliance for Financial Inclusion (AFI), the World Bank, the International Finance Corporation (IFC), the Japan International Cooperation Agency (JICA), the Consultative Group to Assist the Poor (CGAP), the Organisation for Economic Cooperation and Development (OECD), the Islamic Development Bank (IDB) and the Toronto Centre.

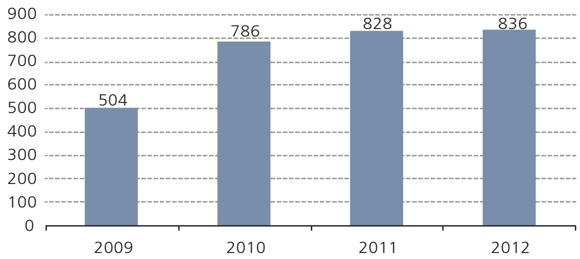
Capacity building programmes in the development, prudential regulation and supervision of Islamic finance remained one of the focus areas, given the strong interest and prospects for growth in the industry. An Executive Masterclass entitled 'Role of Islamic Finance and Global Financial Stability' was organised in conjunction with the Global Islamic Finance Forum (GIFF) held in Kuala Lumpur. The Masterclass was a joint collaboration with the International Centre for Education in Islamic Finance (INCEIF) and the World Bank. These programmes contribute towards the building blocks for an effective and well regulated Islamic financial system, thereby supporting financial stability in the Islamic financial system.

The Bank actively supported international efforts to develop more inclusive financial systems. Highlights of the year included the Financial Inclusion Advisers Programme and the Seminar on Islamic Microfinance, jointly organised with IFSB and in collaboration with CGAP, AFI and the Asian Institute of Finance (AIF); Business Conduct and Consumer Protection programme with OECD and AFI; the Supervision of Deposit-Taking Microfinance Institutions Course in collaboration with SEACEN, CGAP and Toronto Centre; and the 4th Global Credit Reporting and Risk Management Training in collaboration with the IFC. These international dialogues focused on topical issues such as microfinance, financial education, consumer protection, key institutional mechanisms, credit registries and the global trends and challenges in financial inclusion.

The Bank also participated in the sharing of experiences with other policymakers in various areas of institutional capacity building, including risk-based supervision, Basel II implementation, financial sector development, payment and settlement systems and talent management. The technical cooperation programmes will continue to provide an avenue for cross-border collaboration, knowledge sharing of best practices and capacity building and thus foster regional and international ties.

Chart 5.1

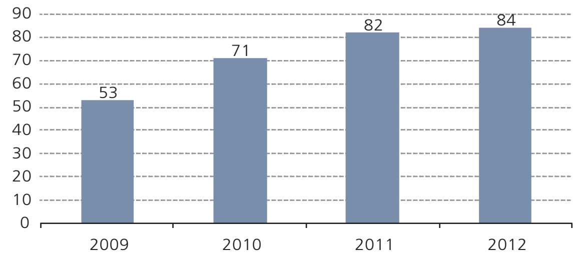
Technical Cooperation Programmes: No. of Participants



Source: Bank Negara Malaysia

Chart 5.2

Technical Cooperation Programmes: No. of Participating Countries



Source: Bank Negara Malaysia

Leveraging on ICT for a High-Performance Organisation

The focus of the ICT services in 2012 was on enhancing organisational effectiveness and productivity through greater work mobility, expanded and secured accessibility to information, and enhanced system resiliency.

Greater mobility and better accessibility of information

A suite of mobile applications was deployed in May 2012 for efficient management of information required for high-level meetings in the Bank. New workflows were introduced to enable electronic distribution, storage and access of documents, contributing to ease of information retrieval and updates while remaining physically mobile. This also reduced paper-based or manual processes, thus supporting the overall objective of improving the organisation's efficiency and effectiveness. The use of these mobile applications leveraged on a custom design-and-build 'private cloud' infrastructure, with the initial phase of the implementation focusing on information connectivity anywhere, anytime, in a secured manner.

Modernisation and extension of Bank's ICT applications and infrastructure

In 2012, the ICT strategies were geared towards the delivery and support of applications for global accessibility, with 24-by-7 service uptime, and continuous improvements to enable further business operations efficiency.

The Bank had implemented infrastructure enhancements with pro-active system capacity planning and monitoring in the Bank's critical systems such as Real-Time Electronic Transfer of Funds and Securities (RENTAS) to ensure no degradation in system performance even on a high business volume day. The Bank had also extended its Data Centre operating hours to include additional shifts in order to operate 24-by-7. Additionally, the network infrastructure in the Bank's Recovery Centre (RC) underwent an upgrading exercise, implemented in phases to ensure that the infrastructure remained resilient and agile.

Close collaboration and partnership within the Bank and with external entities enabled the delivery of ICT solutions that met with the operational needs of the Bank. This was exemplified by the Bank's initiative to extend straight-through processing (STP) in RENTAS beyond funds transfer to encompass securities settlement transactions. The STP solution could be adopted by the industry to allow for more efficient operations in treasury processes, from deal capture to treasury settlement.

In further advancing global and regional financial integration, the Bank implemented an infrastructure of settlement linkages and connections between RENTAS and International Centralised Securities Depositories (ICSDs) such as Euroclear to enhance cross-border debt securities settlement efficiency in the Asian region. The settlement platform also provides investors and market intermediaries with efficient and cost-effective cross-border access to bond markets in Malaysia.

COMMUNICATIONS

Amid the heightened uncertainties in the global economic and financial environment in 2012, the Bank's communications function assumed a greater role in assuring the key stakeholders on the stability of the Malaysian economy and financial system. The Bank shared its assessments of the global, regional and domestic economic and financial developments, and its policy responses, objectives and rationales. Communication efforts were also undertaken to create awareness on the Bank's key initiatives such as the internationalisation of Islamic finance, the wider usage of Renminbi and the financial inclusion agenda. Awareness campaigns on financial scams were initiated to highlight to investors and the public on the dangers of investing in such schemes.

Reinforcing the resilience of the Malaysian economy and its financial system

Communication strategies were aimed at providing a greater understanding of the resilience of the domestic economy and the strength of Malaysia's financial system. On the economy, the sustainability of growth amid a weak global economy, led by robust domestic demand in a low inflation environment was the key focus of communications. On the financial sector, it was its increased strength and resilience and the growing business dimension of Islamic finance and its role as a viable form of financial intermediation for economic activity.

Assessments of the Malaysian economy and financial system were highlighted during engagement sessions in conjunction with the release of the Annual Report and Financial Stability and Payment Systems Report and press conferences for the release of quarterly GDP growth figures. During the year, the Bank engaged with international and local media, and fund managers, analysts and economists and held dialogue sessions with specific industry groups and consumer associations. These sessions also gathered feedback and additional perspectives for the Bank's analysis and understanding.

A high-level roundtable meeting chaired by the Governor and attended by leading regional and local analysts and economists was held during the year. The key topics discussed were the developments in the global, regional and domestic economies and financial sectors, the effectiveness of policy responses and the economic prospects for Malaysia. The Bank in collaboration with the Department of Statistics Malaysia organised a seminar on the re-basing of Malaysian economic data to the year 2005 which provided the rationale and its impact. A media workshop was held during 2012 to facilitate the media community's understanding of the economy and the financial system and the policies of the Bank.

Monetary policy communications

Monetary policy communications are conveyed through the regular Monetary Policy Statements (MPS) issued by the Monetary Policy Committee (MPC) of the Bank following each Committee meeting. The MPS announces the decision of the MPC on the Overnight Policy Rate and provides assessments by the MPC of the global and regional economic and financial developments and their impact on the domestic economy and financial system. It also summarises the current outlook on inflation. The scheduled dates of MPC meetings and release of the MPS for the year is issued to the market well in advance to avoid uncertainty and promote orderly market conditions.

The resilience of the financial sector

A major advancement during the year was the Financial Services Act 2013 and Islamic Financial Services Act 2013 that were passed by Parliament in December 2012. Extensive consultations were conducted with the relevant stakeholders, including the Government, financial industry and other regulatory agencies, in developing the Acts. The Acts are designed to provide a modernised and cohesive regulatory framework for the financial sector.

Communication efforts were also centred on explaining the rationale for the introduction of macro-prudential measures, particularly the Responsible Financing Guidelines. At the macro level, the measures aimed to ensure that household debt remains at a healthy level, thus contributing to financial stability and sustainability of domestic consumption and economic growth. Consumers that had the capacity to borrow would however continue to have access to financing. While the Guidelines attracted some initial criticism, it was subsequently considered to be a prudent decision and in the best interests of the economy and the public. Prudent lending practices in the relatively low interest rate and highly competitive environment were particularly important.

Extensive communications on illegal investment schemes

During the year, the Bank continued its efforts to generate greater awareness amongst the public on illegal financial schemes through various channels. A financial consumer alert list was published on the Bank's website to enable the public to identify financial schemes offered by businesses that are not authorised or regulated by the Bank. On 1 October 2012, the Bank and other law enforcement agencies carried out raids on companies suspected of operating illegal gold-based investment schemes. Following the raids, the Bank provided regular public updates to keep all stakeholders abreast of key developments. This included the status of investigations and frequently asked questions on such schemes.

Awareness on the usage of renminbi for trade settlement

The Bank hosted a series of seminars, in collaboration with the Chinese authorities, to enhance public awareness on the use of renminbi (RMB) for trade settlement and investment. The seminars were held in Kuala Lumpur, Penang and Kuching. The seminars highlighted its value proposition and the experience in the use of the RMB by the business community.

Driving financial inclusion and financial literacy

The Bank continued its outreach programmes for SMEs on the availability of financing, on the awareness of redress avenues and on promoting good financial management. This was undertaken through participation in roadshows, dialogues and fairs for SMEs organised by various Ministries and agencies, and the dissemination of SME information materials in collaboration with the private sector and Government agencies. Agent banking, a new initiative arising from the Bank's financial inclusion agenda, was introduced with the official launch of the national agent banking logo. The national agent banking logo identifies and authenticates bona fide retail outlets as the appointed agents of relevant banks to provide basic banking services in rural areas.

The Bank's Regional Offices (ROs) in Penang and Johor Bahru have further enhanced the Bank's outreach and presence in the Northern and Southern regions respectively. In 2012, efforts were focused on educating the public on the modus operandi of financial scams such as 'get-rich-quick' schemes, credit card scams, illegal deposit-taking and gold schemes. Besides direct engagements, the ROs also leveraged on the state radio stations to reach out to the public. Meanwhile, financial consumers continued to benefit from the access to financial information and consumer redress mechanisms provided by the Bank through its one-stop contact centre known as Laman Informasi Nasihat dan Khidmat (LINK) that received 25% more enquiries of 400,971 from individuals and businesses in 2012 (2011: 320,028). These efforts have complemented the Bank's MobileLINK services during its nation-wide outreach activities. Since its launch in December 2011, the MobileLINK has served about 15,500 individuals from the underserved rural communities in 45 sub-districts nationwide.

The Bank's subsidiary, Credit Counselling and Debt Management Agency (AKPK) continued rolling out its POWER! Programme which targeted primarily young individuals and new borrowers. This has resulted in promoting good money management skills. A total of 115,000 participants enrolled in the programme during 2012 (2011: 23,000). In addition, AKPK provided financial counselling to 35,825 individuals (2011: 31,710) with 16,137 (2011: 16,910) being further assisted under its Debt Management Programme. These are part of its continuous efforts at promoting consumers' financial wellness. To encourage borrowers to take charge of their own financial positions, AKPK published the 'Self-Help Guide: Debt Relief Plan' (SHG) to provide borrowers with a guide to negotiate directly with their credit providers on loan restructuring/rescheduling. AKPK extended its public outreach by conducting financial counselling from additional offices at various financial institutions' premises apart from its own headquarters and ten branches. AKPK has also leveraged on new media tools to extend outreach to the Internet-savvy consumers and the digital community through Facebook, Twitter, YouTube, blogs and text messages.

The Financial Mediation Bureau (FMB), in close collaboration with other agencies such as the Malaysia Deposit Insurance Corporation, AKPK and the Federation of Malaysian Consumers Associations, has created greater awareness on the provision of its services, including hosting publicity events and roadshows. On complaints handling, the number of banking sector and insurance sector cases registered during the year declined to 1,919 (2011: 2,224 cases), due mainly to a decrease in internet banking cases following enhanced internet security. The total number of cases resolved was 2,718 (2011: 2,834 cases). The establishment of a separate Complaint Management Unit in the FMB has also provided dedicated resources for more effective handling of complaints. The efforts of the mediation team in resolving cases received by FMB have resulted in a reduction in the number of cases pending for resolution to 1,741 cases as at 31 December 2012 (2011: 2,540).

Growing online presence

The Bank's efforts at widening its outreach through the internet and social media have also shown positive results with the increased visits and interaction at its website and through social media. The Bank's website received about 5.6 million visits in 2012, and was once again awarded a 5-star rating in the Malaysian Government Portals and Websites annual rating exercise jointly conducted by the Malaysian Administrative Modernisation and Management Planning Unit and the Multimedia Development Corporation. In addition, the Bank's social media accounts have also seen a strong increase with Facebook fans of 18,839 (2011: 8,822), and Twitter followers of 14,603 (2011: 4,011).

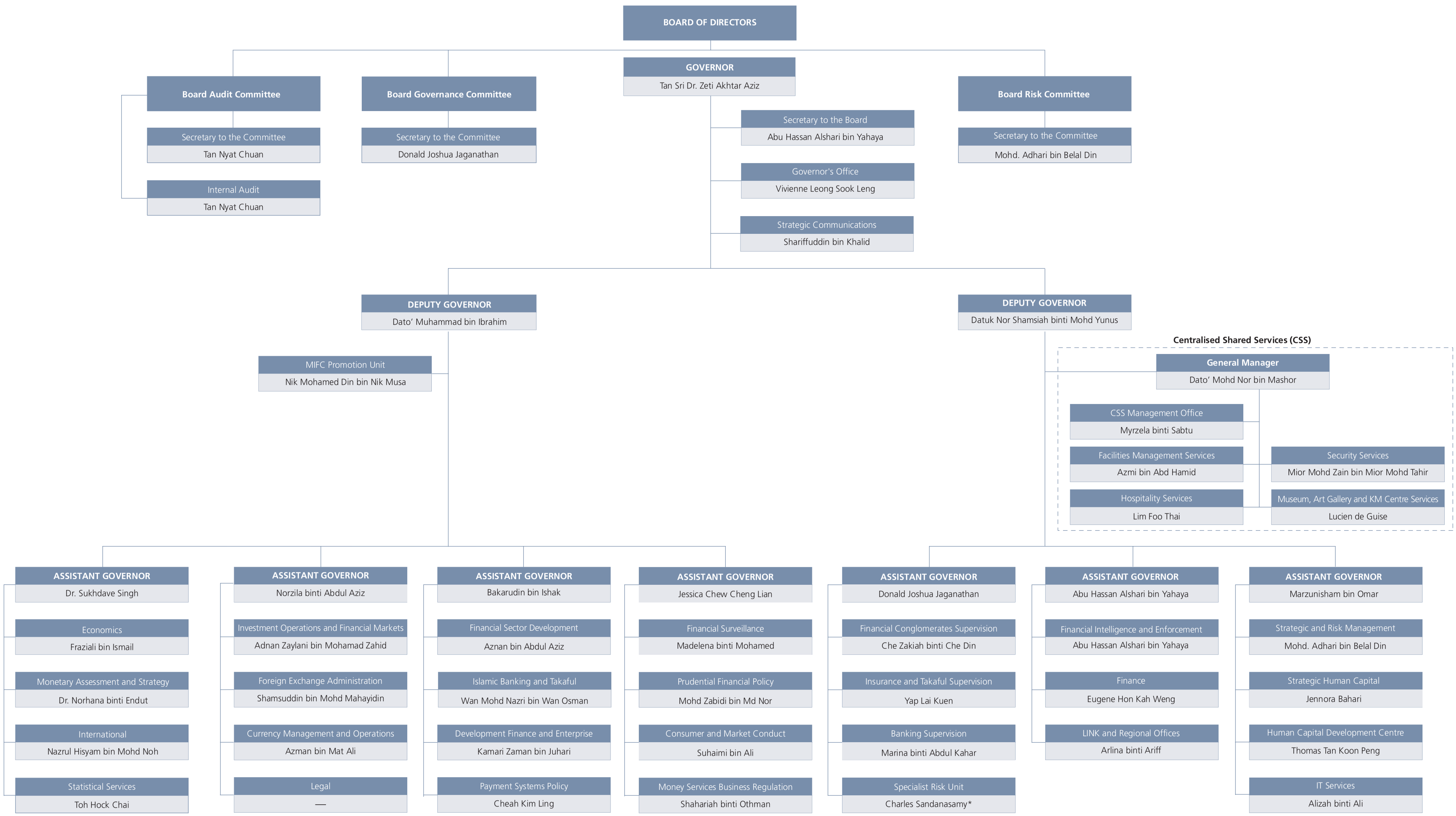
Circulation of new currency series

Following the launch of Malaysia's new currency series in 2011, the Bank embarked on an awareness campaign to highlight to the public about the co-circulation of the new and existing currency series and the security features and design of the new series. Themed 'Distinctively Malaysia', the latest banknotes series draws its inspiration from Malaysia's diverse culture, heritage and nature, and comprises all denominations. It incorporates enhanced security features in line with the latest advancements in banknote technology to ensure the integrity and quality of the currency. The new security features and design elements were featured in various communication materials, including videos, media interviews and advertisements. Prior to the issuance of the new series, the Bank engaged with vending machine and car park operators to ensure the efficient calibration of machines to accept the new series for the convenience of the public. The new currency series were well received by the public when it came into circulation in 2012.

Greater staff engagement and productivity

Collaboration and teamwork among departments are now firmly entrenched in the Bank. Engagements between the Management and staff took an added dimension as more sessions such as Tea-Talks, Townhall Meetings and other social activities were held in 2012. This provided opportunities for sharing of insights, and to forge stronger working relationship and trust. Greater staff engagement, a more robust business planning process that provides line of sight to the objectives of the Bank, and effective talent management and development practices have contributed towards increased productivity in the Bank.

BANK NEGARA MALAYSIA
Organisation Structure



*Administrative Head

2012

ANNUAL FINANCIAL STATEMENTS

CERTIFICATE OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF BANK NEGARA MALAYSIA FOR THE YEAR ENDED 31 DECEMBER 2012

I have audited the financial statements of Bank Negara Malaysia for the year ended 31 December 2012. 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 conducted in accordance with the Audit Act 1957 and in conformity with approved standards on auditing. Those standards require the 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 2012 and of the results of its operations for the year then ended in accordance with approved accounting standards.

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

PUTRAJAYA
12 MARCH 2013

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 2012 and of the results of operations for the year ended on that date.

On behalf of the Board,

ZETI AKHTAR AZIZ
CHAIRMAN

7 MARCH 2013
KUALA LUMPUR

On behalf of the Board,

OH SIEW NAM
DIRECTOR

7 MARCH 2013
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 7 March 2013.)

Before me,

PESURUHJAYA SUMPAH
W 541
ZULKIFLA MOHD DAHLIM
MALAYSIA

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

Bank Negara Malaysia

Statement of Financial Position as at 31 December 2012

	Note	2012 RM	2011 RM
ASSETS			
Gold and Foreign Exchange	3	418,534,966,977	414,432,520,031
International Monetary Fund Reserve Position		2,652,752,648	2,672,204,523
Holdings of Special Drawing Rights		6,043,522,017	6,252,997,720
Malaysian Government Papers	4	2,182,809,238	2,017,022,067
Deposits with Financial Institutions	5	28,235,130,500	28,797,250,000
Loans and Advances	6	9,550,114,161	10,671,155,047
Other Assets	7	9,131,723,239	8,126,397,188
Total Assets		**476,331,018,780**	**472,969,546,576**
LIABILITIES AND CAPITAL			
Currency in Circulation		67,124,370,608	61,874,099,518
Deposits from: Financial Institutions		180,812,181,557	214,905,708,306
Federal Government		14,708,467,629	10,817,830,921
Others	8	4,083,301,315	13,066,091,926
Bank Negara Papers		153,129,553,960	107,983,490,852
Allocation of Special Drawing Rights	9	6,326,742,220	6,548,320,169
Other Liabilities	10	21,711,608,582	25,844,324,400
Total Liabilities		447,896,225,871	441,039,866,092
Paid-up Capital	11	100,000,000	100,000,000
General Reserve Fund	12	14,368,713,485	14,368,386,506
Risk Reserve	13	13,966,079,424	17,461,293,978
Total Capital		28,434,792,909	31,929,680,484
Total Liabilities and Capital		**476,331,018,780**	**472,969,546,576**

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

Bank Negara Malaysia

Income Statement for the Year Ended 31 December 2012

	Note	2012 RM	2011 RM
Total Income	14	**6,912,371,963**	**6,071,018,517**
Less:			
Recurring Expenditure	15	1,151,187,009	964,570,808
Development Expenditure	16	160,857,975	382,022,681
Total Expenditure		**1,312,044,984**	**1,346,593,489**
Net Profit		**5,600,326,979**	**4,724,425,028**
Appropriation of Net Profit:			
Transfer to Risk Reserve	17	4,100,000,000	2,000,000,000
Transfer to General Reserve Fund		326,979	724,425,028
Amount Payable to Federal Government		1,500,000,000	2,000,000,000
Net Profit		**5,600,326,979**	**4,724,425,028**

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

Notes to the Financial Statements for the Year Ended 31 December 2012

1. **General Information**
   Bank Negara Malaysia (the Bank) is a statutory body established under the Central Bank of Malaysia Act 1958 which has been repealed by the Central Bank of Malaysia Act 2009. The principal place of business is located at Bank Negara Malaysia, Jalan Dato' Onn, 50480 Kuala Lumpur.

   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.

   The Board of Directors approved the annual financial statements on 7 March 2013.

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 (MFRS). 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 MFRS.

   (b) The preparation of the financial statements in conformity with the requirements of the MFRS requires the management to make judgements, estimates and assumptions based on available information that may affect the application of accounting policies and the reported amounts of assets and liabilities as well as 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 Basis of Accounting**
   The financial statements have been prepared on an accrual basis, using the historical cost convention, except as otherwise disclosed.

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 are translated into ringgit Malaysia at the rates of exchange prevailing on the balance sheet date. Transactions in foreign currencies during the year are measured in ringgit Malaysia at the 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 Risk Reserve.

2.4 **Securities and Investments**

Securities and investments are stated mainly at cost and provisions are made for diminution in value as at 31 December 2012. Financial instruments classified 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 Risk Reserve.

2.5 **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 available for distribution.

2.6 **Repurchase and Reverse-Repurchase Agreements**

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

2.7 **Fixed Assets**

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

3. **Gold and Foreign Exchange**

	2012 RM	**2011 RM**
Foreign Securities	369,087,355,757	359,284,482,783
Foreign Deposits	10,382,364,133	15,588,170,298
Balances with Other Central Banks, Bank for International Settlements (BIS) and International Monetary Fund (IMF)	7,123,144,900	6,036,194,304
Others	31,942,102,187	33,523,672,646
	418,534,966,977	414,432,520,031

4. **Malaysian Government Papers**

Malaysian Government Papers refer to holdings of Government debt instruments that were among the instruments that can be used in the Bank's monetary policy operations.

	2012 RM	**2011 RM**
Malaysian Government Securities	2,176,401,438	2,016,831,567
Sukuk 1Malaysia 2010	6,407,800	190,500
	2,182,809,238	2,017,022,067

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 48, 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 RM6,967,707,261 acquired under section 48(1) and section 100 of the Central Bank of Malaysia Act 2009.

8. **Deposits from 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 SDR1,346,143,721 equivalent to RM6,326,742,220.

10. **Other Liabilities**
Other liabilities include mainly placements by financial institutions under the repurchase agreements.

11. **Paid-up Capital**
The paid-up capital of RM100,000,000 is owned by the Government of Malaysia.

12. **General Reserve Fund**

	2012 RM	2011 RM
As at 1 January	14,368,386,506	13,643,961,478
Transfer from Net Profit	326,979	724,425,028
As at 31 December	14,368,713,485	14,368,386,506

13. **Risk Reserve**
This reserve is to account for unrealised revaluation gains or losses arising from changes in exchange rates and market prices and to absorb any potential future losses resulting from unfavourable circumstances not within the control of the Bank. The Exchange Rate Fluctuation Reserve, Revaluation Reserve and Contingency Reserve which were presented in the previous years as ‘Other Reserves’ have been consolidated and renamed as Risk Reserve.

14. **Total Income**
Total income comprises revenue from foreign reserves management which includes interest and dividends, non-treasury income, realised capital gains or losses, and is stated at net of amortisation/accretion of premiums/discounts and 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 Risk Reserve**
The transfer to Risk Reserve 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 2012 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 in 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 **Commitments**
Total commitments as at 31 December 2012 comprise the following:

(a) **Membership with IMF**

(i) The Bank has an obligation to pay to IMF an equivalent amount of RM5,857,006,246 in SDR or other convertible currencies which represents the unpaid portion of Malaysia's quota in the IMF under the Articles of Agreement.

(ii) 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 2012, 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 (equivalent to RM17,078,500,254).

(iii) The Bank has participated in the New Arrangements to Borrow (NAB), a set of credit arrangements between the 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. As at 31 December 2012, the amount that can be called for under the NAB credit arrangement is SDR303,500,000 (equivalent to RM1,426,419,954).

(iv) On 23 July 2012, the Bank has pledged a USD1,000,000,000 (equivalent to RM3,058,000,000) bilateral contribution to the IMF for precautionary and financial crisis resolution purposes.

(b) **Investment with Bank for International Settlements**
There is an uncalled portion of the 3,220 units of shares held by the Bank in the BIS which amounted to RM56,751,305. The amount is based on the nominal value (SDR5,000) of the uncalled portion and SDR rate as at the balance sheet date.

(c) **Swap Arrangements**

(i) **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 2012, the Bank's total commitment amounted to USD300 million (equivalent to RM917.4 million) and there has been no request for liquidity support under ASA from any member country during the financial year.

(ii) **Bilateral Swap Arrangement**

On 2 April 2010, the Bank renewed the Bilateral Swap Arrangement (BSA) agreement with the People's Bank of China 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 2012, the Bank's commitment under the BSA is USD1.5 billion (equivalent to RM4.6 billion) and there has been no request to activate the BSA during the financial year.

(iii) **Bilateral Currency Swap Arrangement**

On 8 February 2012, the Bank renewed 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 2012, the Bank's total commitment under the BCSA is RM90 billion and there has been no request to activate the BCSA during the financial year.

(iv) **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 2012, the Bank's total commitment is USD9.1 billion (equivalent to RM27.8 billion). For the financial year ended 31 December 2012, there was no request for liquidity support from any member country.

19. **Financial Risk Management**

The Reserve Management Committee oversees the 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. In undertaking this function and its activities, the major risks of the investments fall into the following areas:

(a) **Market Risk**

Market risk is the exposure of the Bank's investments to adverse movements in market prices such as foreign exchange rates, interest rates and equity prices. Market risk is monitored on a daily basis and all of the investments and instruments will have a marked-to-market value. Investments are guided by a benchmark policy approved by the Board of Directors which reflects the long-term investment objectives and acceptable risk-return profile. 'Active risk' may be taken through investments and instruments that can be different from the benchmark though must be within approved investment guidelines. The degree of 'active risk' is measured and controlled through using limits that must be adhered to. Sensitivity analysis and stress testing are undertaken to assess potential marked-to-market losses from adverse movements and volatility in the market.

(b) **Credit Risk**

Credit risk is the risk of investments not paying its principal and interest that has fallen due in a timely manner due to default of an issuer of the debt or failure of the counterparty to perform its contractual obligation to the Bank. A comprehensive rating-based credit risk framework exists to govern the permissible degree of credit exposure in the investments of the Bank. This ensures investments are with issuers and counterparties of high credit standing and the probability of losses from this risk is small. The framework, which is approved by the Board, also incorporates market-based credit indicators such as ratings implied from financial market prices. This enhances the credit framework by providing a more dynamic and up-to-date credit assessment.

(c) **Operational Risk**

Operational risk in treasury operations is the risk of financial losses 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 losses.

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.

2012

ANNEX

CONTENTS

Key Economic and Financial Statistics

Table A.1

Gross Domestic Product by Kind of Economic Activity at Constant 2005 Prices

	2008	2009	2010	2011	2012*p*	2013*f*
	RM million					
Agriculture	50,036	50,063	51,263	54,299	54,750	56,914
Mining and quarrying	70,996	66,386	66,122	62,334	63,220	66,351
Manufacturing	167,148	152,150	170,258	178,333	186,868	195,933
Construction	18,151	19,270	20,428	21,370	25,328	29,343
Services	325,712	335,027	359,215	384,272	408,926	431,226
Plus: Import duties	7,523	6,989	7,660	8,653	9,977	10,146
GDP at purchasers' prices[1]	**639,565**	**629,885**	**674,946**	**709,261**	**749,070**	**789,913**
	Annual change (%)					
Agriculture	3.8	0.1	2.4	5.9	0.8	4.0
Mining and quarrying	-2.4	-6.5	-0.4	-5.7	1.4	5.0
Manufacturing	0.8	-9.0	11.9	4.7	4.8	4.9
Construction	4.4	6.2	6.0	4.6	18.5	15.9
Services	8.6	2.9	7.2	7.0	6.4	5.5
Plus: Import duties	26.7	-7.1	9.6	13.0	15.3	1.7
GDP at purchasers' prices	**4.8**	**-1.5**	**7.2**	**5.1**	**5.6**	**5.0 ~ 6.0**

[1] 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)

	2009	2010	2011	2012	2010	2011	2012
	Index				Annual change (%)		
Export-oriented industries	**97.7**	**107.1**	**110.8**	**115.2**	**9.7**	**3.4**	**3.9**
Electronics and electrical products cluster	**83.2**	**97.7**	**94.2**	**96.3**	**17.4**	**-3.6**	**2.2**
Electronics	*85.5*	*88.1*	*77.8*	*81.1*	*3.1*	*-11.7*	*4.2*
Electrical products	*78.8*	*116.5*	*126.3*	*126.1*	*47.8*	*8.4*	*-0.2*
Primary-related cluster	**107.4**	**113.5**	**121.9**	**127.9**	**5.7**	**7.4**	**4.9**
Chemicals and chemical products	105.8	117.9	128.3	139.0	11.5	8.8	8.4
Petroleum products	116.5	113.7	120.7	125.9	-2.4	6.2	4.3
Textiles, wearing apparel and footwear	80.4	83.8	92.5	85.7	4.2	10.4	-7.4
Wood and wood products	76.0	84.9	79.9	85.7	11.7	-5.9	7.2
Rubber products	124.3	150.2	171.0	176.2	20.8	13.9	3.0
Off-estate processing	112.6	110.0	119.6	119.6	-2.3	8.7	0.0
Paper products	114.0	125.8	140.4	135.8	10.4	11.6	-3.3
Domestic-oriented industries	**114.6**	**132.5**	**143.3**	**155.2**	**15.6**	**8.2**	**8.3**
Construction-related cluster	**112.4**	**133.7**	**157.1**	**170.5**	**18.9**	**17.6**	**8.5**
Construction-related products	95.8	116.8	132.0	133.1	21.9	13.0	0.9
Non-metallic mineral products	*99.3*	*121.7*	*148.0*	*155.4*	*22.6*	*21.6*	*5.0*
Basic iron & steel and non-ferrous metal	*91.5*	*110.9*	*112.4*	*105.9*	*21.1*	*1.4*	*-5.8*
Fabricated metal products	144.6	166.3	205.9	242.8	15.0	23.8	18.0
Consumer-related cluster	**116.1**	**131.6**	**133.4**	**144.1**	**13.4**	**1.3**	**8.1**
Food products	129.8	133.8	140.1	152.3	3.1	4.7	8.7
Transport equipment	102.0	132.3	126.7	144.3	29.7	-4.3	13.9
Beverages	114.5	150.4	163.0	158.0	31.4	8.4	-3.0
Tobacco products	87.5	88.2	98.6	109.0	0.9	11.8	10.6
Others	129.1	115.4	114.0	112.7	-10.6	-1.2	-1.1
Total	**101.0**	**112.2**	**117.2**	**123.1**	**11.1**	**4.5**	**5.0**

Source: Department of Statistics, Malaysia

Table A.3

Services Sector Performance at Constant 2005 prices

	2008	2009	2010	2011	2012*p*	2008	2009	2010	2011	2012*p*
	Annual change (%)					Share to GDP (%)				
Services	**8.6**	**2.9**	**7.2**	**7.0**	**6.4**	**50.9**	**53.2**	**53.2**	**54.2**	**54.6**
Intermediate services	8.5	3.2	7.9	6.2	7.4	20.6	21.6	21.8	22.0	22.4
Finance and insurance	*9.7*	*4.4*	*8.2*	*6.5*	*7.9*	*8.5*	*9.0*	*9.1*	*9.2*	*9.4*
Real estate and business services	*8.9*	*3.6*	*7.1*	*5.5*	*7.1*	*5.1*	*5.4*	*5.4*	*5.4*	*5.5*
Transport and storage	*6.0*	*-3.0*	*6.9*	*5.4*	*4.9*	*3.7*	*3.7*	*3.7*	*3.7*	*3.6*
Communication	*8.0*	*6.2*	*9.1*	*7.6*	*9.1*	*3.3*	*3.6*	*3.6*	*3.7*	*3.8*
Final services	8.6	2.6	6.8	7.5	5.7	30.3	31.6	31.5	32.2	32.2
Wholesale and retail trade	*11.5*	*1.7*	*8.3*	*7.1*	*4.6*	*13.5*	*14.0*	*14.1*	*14.4*	*14.3*
Accommodation and restaurant	*7.4*	*4.5*	*6.8*	*6.0*	*5.4*	*2.3*	*2.4*	*2.4*	*2.5*	*2.5*
Utilities	*3.3*	*2.0*	*7.0*	*3.1*	*4.3*	*2.5*	*2.6*	*2.6*	*2.5*	*2.5*
Government services	*7.6*	*3.4*	*5.7*	*12.4*	*9.6*	*7.0*	*7.3*	*7.2*	*7.7*	*8.0*
Other services	*6.0*	*3.8*	*4.3*	*4.7*	*3.9*	*5.0*	*5.2*	*5.1*	*5.1*	*5.0*

p Preliminary
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Table A.4

Selected Indicators for the Services Sector

	2008	2009	2010	2011	2012
	Annual change (%)				
Utilities					
Electricity production index	-11.6	-20.5	8.8	2.0	5.1
Wholesale & Retail Trade and Accommodation & Restaurant					
Consumption credit disbursed	1.6	24.3	13.7	7.1	0.7
Tourist arrivals	5.1	7.2	3.9	0.6	1.3
Total sales of motor vehicles	2.8	7.1	12.8	-0.9	4.6
Finance & Insurance and Real Estate & Business Services					
Loans outstanding in the banking system	12.8	7.8	12.7	13.6	10.4
Insurance premiums	1.8	5.3	10.8	5.9	10.5
Bursa Malaysia turnover (volume)	-59.5	70.0	2.1	30.0	-3.1
Transport & Storage and Communication					
Total container handled at Port Klang and PTP (TEUs)	7.7	-1.8	15.6	11.3	3.4
Airport passenger traffic	5.9	6.9	12.2	10.6	4.9
Air cargo handled	-6.7	-13.7	14.2	-2.1	-1.7
SMS traffic	28.7	22.1	8.3	-3.8	-6.0
Penetration rate:	%				
- Broadband[1]	21.1	31.7	55.6	62.3	66.0
- Cellular phone[2]	98.9	106.2	119.2	127.7	141.6
- Fixed line[1]	44.9	44.0	42.5	37.3	34.4

[1] of household
[2] of population

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

Table A.5

GNI by Demand Aggregates

	2008	2009	2010	2011	2012*p*	2013*f*
	at Current Prices (RM million)					
Consumption	432,796	441,185	474,578	533,223	586,955	638,390
Private consumption	*344,215*	*348,168*	*377,631*	*418,473*	*460,208*	*505,110*
Public consumption	*88,581*	*93,017*	*96,947*	*114,750*	*126,747*	*133,280*
Investment	158,381	156,660	176,903	195,002	240,272	275,848
Private investment	*86,114*	*81,028*	*95,853*	*111,789*	*139,540*	*165,071*
Public investment	*72,268*	*75,633*	*81,050*	*83,213*	*100,731*	*110,777*
Change in stocks[1]	6,837	-29,517	7,133	12,797	-1,545	4,422
Exports of goods and services	766,096	651,671	745,310	806,703	820,043	836,245
Imports of goods and services	594,160	507,142	608,887	666,645	708,193	746,678
GDP at purchasers' prices	769,949	712,857	795,037	881,080	937,532	1,008,227
Balance of primary income	-23,034	-14,215	-26,514	-21,971	-33,683	-27,184
GNI	746,915	698,642	768,523	859,109	903,850	981,044
	at Constant 2005 Prices (RM million)					
Consumption	382,437	387,844	410,369	446,895	478,822	509,288
Private consumption	*307,467*	*309,169*	*329,433*	*352,919*	*380,116*	*407,028*
Public consumption	*74,970*	*78,675*	*80,936*	*93,976*	*98,706*	*102,259*
Investment	145,525	141,584	156,346	166,486	199,668	224,066
Private investment	*79,111*	*73,231*	*84,601*	*94,945*	*115,879*	*133,986*
Public investment	*66,414*	*68,353*	*71,745*	*71,541*	*83,789*	*90,080*
Change in stocks[1]	1,196	-8,682	8,161	3,243	5,220	3,685
Exports of goods and services	690,096	615,024	684,795	713,502	713,894	726,546
Imports of goods and services	579,688	505,886	584,726	620,864	648,533	673,671
GDP at purchasers' prices	639,565	629,885	674,946	709,261	749,070	789,913
Balance of primary income	-34,180	-21,941	-41,117	-44,652	-55,560	-50,262
GNI	605,385	607,944	633,829	664,609	693,510	739,651

[1] Includes statistical discrepancy
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.6

Savings-Investment Gap

	2008	2009	2010	2011	2012*p*
	RM million				
Public gross domestic capital formation	72,268	75,633	81,050	83,213	100,731
Public savings	80,880	63,905	85,898	64,674	71,231
Deficit/surplus	8,612	-11,728	4,848	-18,539	-29,500
Private gross domestic capital formation	92,951	51,511	102,986	124,586	137,995
Private savings	215,750	173,964	186,216	240,233	227,473
Deficit/surplus	122,799	122,453	83,230	115,647	89,478
Gross domestic capital formation	165,218	127,143	184,035	207,799	238,727
(as % of GNI)	22.1	18.2	23.9	24.2	26.4
Gross national savings	296,630	237,869	272,114	304,907	298,704
(as % of GNI)	39.7	34.0	35.4	35.5	33.0
Balance on current account	131,412	110,726	88,079	97,108	59,977
(as % of GNI)	17.6	15.8	11.5	11.3	6.6

p Preliminary

Source: Department of Statistics, Malaysia and Ministry of Finance

Table A.7

Labour Market: Selected Indicators

	2008	2009	2010	2011	2012
	(number of positions/persons)				
Vacancies by Industry[1]					
Agriculture, hunting, forestry and fishery	275,548	230,303	327,670	399,522	337,466
Mining and quarrying	1,450	1,377	2,517	3,369	2,180
Manufacturing	327,798	695,418	693,711	689,422	598,890
Construction	107,421	111,622	250,820	388,241	310,954
Services	346,763	507,627	512,503	778,994	369,983
Electricity, gas and water supply[(I)]	*2,047*	*4,367*	*8,269*	*15,091*	*6,521*
Wholesale and retail trade, hotels and restaurants[(II)]	*99,317*	*162,270*	*147,303*	*185,577*	*109,117*
Transport, storage and communication[(III)]	*15,264*	*15,090*	*17,888*	*20,100*	*17,921*
Financial intermediation, real estate, renting and business services[(IV)]	*125,821*	*148,001*	*168,067*	*372,346*	*114,099*
Public administration, defence and compulsory social security	*11,132*	*16,128*	*20,414*	*6,897*	*5,115*
Community, social and personal service activities	*93,182*	*161,771*	*150,562*	*178,983*	*117,210*
Total vacancies	**1,058,980**	**1,546,347**	**1,787,221**	**2,259,548**	**1,619,473**
Retrenchments by Industry					
Agriculture, hunting, forestry and fishery	398	278	866	172	156
Mining and quarrying	89	78	30	24	81
Manufacturing	11,014	17,850	3,854	5,635	7,616
Construction	199	503	262	290	1,002
Services	4,769	6,355	2,073	3,329	2,639
Electricity, gas and water supply[(I)]	*77*	*156*	-	*66*	*46*
Wholesale and retail trade, hotels and restaurants[(II)]	*2,052*	*1,429*	*662*	*1,322*	*743*
Transport, storage and communication[(III)]	*773*	*643*	*208*	*293*	*292*
Financial intermediation, real estate, renting and business services[(IV)]	*1,008*	*1,923*	*934*	*672*	*827*
Community, social and personal service activities	*859*	*2,204*	*269*	*976*	*731*
Total retrenchments	**16,469**	**25,064**	**7,085**	**9,450**	**11,494**
Employment by Industry ('000 persons)					
Agriculture, forestry, livestock and fishery	1,487.7	1,471.1	1,614.9	1,410.0	1,601.7
Mining and quarrying	54.2	64.7	57.2	76.0	80.6
Manufacturing	1,944.7	1,807.1	2,180.5	2,222.3	2,227.9
Construction	998.0	1,015.9	1,082.7	1,133.6	1,163.7
Services	6,174.6	6,540.2	7,036.4	7,442.6	7,649.2
Electricity, gas and water supply[(I)]	*60.5*	*58.1*	*122.2*	*122.4*	*142.5*
Wholesale and retail trade, hotels and restaurants[(II)]	*2,513.0*	*2,632.3*	*2,744.5*	*2,941.7*	*3,073.0*
Transport, storage and communication[(III)]	*583.4*	*592.0*	*733.6*	*812.8*	*833.2*
Finance, insurance, real estate and business services[(IV)]	*829.2*	*873.4*	*1,026.7*	*1,156.7*	*1,230.6*
Public administration, defence and compulsory social security	*751.1*	*813.8*	*787.7*	*749.0*	*697.6*
Community, social and personal service activities	*1,437.4*	*1,570.6*	*1,621.7*	*1,660.0*	*1,672.3*
Total employment	**10,659.2**	**10,899.0**	**11,899.5**	**12,284.4**	**12,723.2**
Unemployment rate (% of labour force)	**3.3**	**3.7**	**3.3**	**3.1**	**3.0**

[1] Refers to vacancies reported by employers through the JobsMalaysia portal (formerly known as Electronic Labour Exchange, ELX)
(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
Note: Beginning 2010, employment data was based on new population estimates and cannot be directly compared to previous years' data

Source: Department of Statistics, Malaysia and Ministry of Human Resources

Table A.8

Private Consumption Indicators

	2007	2008	2009	2010	2011	2012
Sales of passenger cars ('000 units)	442.9	497.5	486.1	543.6	535.1	552.1
Annual change (%)	18.4	12.3	-2.3	11.8	-1.6	3.2
Imports of consumption goods (RM billion)	28.9	32.3	31.4	34.5	41.0	45.8
Annual change (%)	8.4	11.8	-2.7	9.7	19.0	11.6
Tax collection						
Sales tax (RM billion)	6.6	8.4	8.6	8.2	8.6	9.5
Service tax (RM billion)	3.0	3.3	3.3	3.9	5.0	5.6
Narrow Money (M1)						
Annual change (%)	19.6	8.3	9.8	11.7	15.1	11.2
Loans disbursed by banking system						
Consumption credit (excl. passenger cars)						
Annual change (%)	18.2	2.2	19.7	12.5	13.3	-3.3
Wholesale and retail trade, restaurants and hotels						
Annual change (%)	0.8	24.5	-7.4	16.3	13.8	27.8
MRA retail sales (Annual change in %)	12.8	5.0	0.8	8.4	8.1	5.5
Credit card turnover spending[1] (RM billion)	55.4	63.4	68.1	78.0	86.8	91.9
Annual change (%)	17.1	14.4	7.5	14.5	11.2	5.9
MIER Consumer Sentiment Index[2]	110.7	71.4	109.6	117.2	106.3	118.7
FBM KLCI	1,445.0	876.8	1,272.8	1,518.9	1,530.7	1,689.0
Commodity prices						
CPO (RM/tonne)	2,472	2,875	2,257	2,752	3,279	2,864
Crude oil (USD/barrel)	76.5	102.1	64.3	79.8	113.8	118.6
Rubber (sen/kg)	736.4	828.8	642.8	1,069.6	1,366.5	962.4

[1] Resident spending only
[2] Refers to 4th quarter

Table A.9

Private Investment Indicators

	2007	2008	2009	2010	2011	2012
Sales of commercial vehicles ('000 units)	44.3	50.7	50.6	61.6	64.8	75.5
Annual change (%)	-62.0	14.4	-0.2	21.8	5.2	16.6
Imports of capital goods (RM billion)	69.9	69.9	65.8	73.8	80.2	96.6
Annual change (%)	9.0	0.0	-5.9	12.2	8.7	20.5
Approvals by MIDA (Manufacturing sector)						
No. of projects	949	919	766	910	846	804
Capital investment (RM billion)	59.9	62.8	32.6	47.2	56.1	41.1
Local	*26.5*	*16.7*	*10.5*	*18.1*	*21.9*	*20.2*
Foreign	*33.4*	*46.1*	*22.1*	*29.1*	*34.1*	*20.8*
New investment (% share)	52.0	66.9	67.6	50.6	59.0	65.4
Reinvestments (% share)	48.0	33.1	32.4	49.4	41.0	34.6
Loans disbursed by banking system						
Manufacturing sector						
Annual change (%)	13.5	12.4	-15.2	12.0	21.9	17.5
Construction sector						
Annual change (%)	6.9	6.8	16.6	5.5	5.4	20.7
Private Debt Securities (excluding Cagamas)						
Total funds raised (RM billion)	67.6	49.7	58.6	52.1	69.6	121.1
New activities	31.8	33.3	8.7	13.5	8.4	19.5
Initial Public Offerings (Bursa Malaysia)						
Total funds raised (RM billion)	2.5	1.3	12.2	19.8	7.4	22.9
MIER Business Conditions Survey						
Business Conditions Index[1]	105.5	53.8	118.8	99.5	96.6	94.1
Capacity Utilisation Rate[1]	82.0	74.4	81.4	82.9	81.2	80.9
MSC-Status Companies						
No. of companies	266	242	284	218	215	213
Approved investment (RM billion)	3.7	1.8	2.2	1.5	2.5	2.9

[1] Refers to 4th quarter

Table A.10

Balance of Payments

	2009			2010		
	+	-	Net	+	-	Net
	RM million					
Goods[1]	**553,290**	**412,565**	**140,725**	**640,043**	**505,317**	**134,726**
Services	**98,381**	**94,578**	**3,804**	**105,268**	**103,570**	**1,698**
Transportation	16,074	32,455	-16,381	15,095	38,248	-23,153
Travel	54,995	22,827	32,168	58,868	25,541	33,327
Other services	27,164	38,539	-11,375	31,045	38,998	-7,953
Government transactions n.i.e.[2]	148	757	-609	260	783	-523
Balance on goods and services	**651,671**	**507,142**	**144,529**	**745,310**	**608,887**	**136,424**
Income	**39,630**	**53,844**	**-14,214**	**38,297**	**64,811**	**-26,514**
Compensation of employees	3,986	5,449	-1,463	3,548	5,634	-2,086
Investment income[3]	35,644	48,395	-12,751	34,748	59,176	-24,428
Current transfers	**3,738**	**23,326**	**-19,587**	**1,855**	**23,686**	**-21,831**
Balance on current account	**695,039**	**584,312**	**110,727**	**785,462**	**697,383**	**88,079**
% of GNI			**15.8**			**11.5**
Capital account			**-126**			**-165**
Financial account			**-80,173**			**-19,827**
Direct investment			-22,315			-13,611
Abroad			*-27,436*			*-42,932*
In Malaysia			*5,121*			*29,322*
Portfolio investment			-1,781			48,457
Financial derivatives			2,369			-701
Other investment			-58,447			-53,973
Official sector			*-182*			*237*
Private sector			*-58,265*			*-54,211*
Balance on capital and financial accounts			**-80,300**			**-19,993**
Errors and omissions			**-16,596**			**-70,713**
of which:						
Foreign exchange revaluation gain (+) / loss (-)			10,698			-32,641
Overall balance (surplus + / deficit -)			**13,831**			**-2,628**
Bank Negara Malaysia international reserves, net[4]						
RM million			331,277			328,649
USD million			96,688			106,518
Reserves as months of retained imports			9.7			8.6

[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

2011			2012*p*			2013*f*		
+	-	Net	+	-	Net	+	-	Net
RM million								
696,614	**548,543**	**148,071**	**702,926**	**577,693**	**125,233**	**713,099**	**610,837**	**102,263**
110,088	**118,101**	**-8,013**	**117,118**	**130,500**	**-13,383**	**123,146**	**135,841**	**-12,695**
14,825	40,617	-25,792	13,272	41,144	-27,872	14,959	43,736	-28,777
59,973	32,940	27,033	60,859	37,033	23,825	64,127	38,823	25,305
35,014	43,742	-8,728	42,760	51,631	-8,870	43,792	52,463	-8,671
276	803	-527	227	692	-465	267	819	-552
806,703	**666,645**	**140,058**	**820,043**	**708,193**	**111,850**	**836,245**	**746,678**	**89,567**
52,449	**74,421**	**-21,972**	**42,296**	**75,978**	**-33,683**	**45,142**	**72,325**	**-27,184**
3,665	6,037	-2,372	4,061	7,108	-3,047	4,038	6,763	-2,725
48,784	68,384	-19,600	38,234	68,870	-30,636	41,104	65,563	-24,459
4,655	**25,634**	**-20,979**	**6,877**	**25,068**	**-18,191**	**5,652**	**25,300**	**-19,648**
863,807	**766,700**	**97,108**	**869,216**	**809,239**	**59,977**	**887,039**	**844,303**	**42,736**
		11.3			**6.6**			**4.4**
		-193			**64**			
		22,254			**-22,528**			
		-10,072			-21,907			
		-46,688			*-50,968*			
		36,616			*29,061*			
		25,798			59,224			
		-76			881			
		6,604			-60,726			
		-1,313			*-1,447*			
		7,917			*-59,279*			
		22,061			**-22,464**			
		-24,487			**-33,640**			
		7,566			-7,686			
		94,682			**3,873**			
		423,331			427,204			
		133,610			139,715			
		9.6			9.5			

Table A.11

Gross Exports

	2010	2011	2012*p*	2011	2012*p*	2012*p*
	RM million			Annual change (%)		% share
Manufactures	**486,849**	**504,127**	**519,908**	**3.5**	**3.1**	**74.0**
of which:						
Electronics, electrical machinery and appliances	271,147	261,006	256,423	-3.7	-1.8	36.5
Electronics	194,412	182,159	178,730	-6.3	-1.9	25.5
Semiconductors	*97,975*	*107,090*	*101,741*	*9.3*	*-5.0*	*14.5*
Electronic equipment & parts	*96,438*	*75,069*	*76,989*	*-22.2*	*2.6*	*11.0*
Electrical machinery & appliances	76,734	78,847	77,693	2.8	-1.5	11.1
Electrical industrial machinery and equipment	*24,655*	*27,659*	*29,214*	*12.2*	*5.6*	*4.2*
Industrial & commercial electrical products	*22,731*	*24,508*	*25,478*	*7.8*	*4.0*	*3.6*
Consumer electrical products	*25,804*	*22,866*	*18,714*	*-11.4*	*-18.2*	*2.7*
Household electrical appliances	*3,544*	*3,814*	*4,286*	*7.6*	*12.4*	*0.6*
Chemicals & chemical products	41,557	47,767	47,369	14.9	-0.8	6.7
Petroleum products	29,217	36,654	52,728	25.5	43.9	7.5
Manufactures of metal	26,201	31,011	29,487	18.4	-4.9	4.2
Optical and scientific equipment	18,319	18,760	22,922	2.4	22.2	3.3
Rubber products	15,454	17,516	19,468	13.3	11.1	2.8
Textiles, clothing and footwear	9,652	10,939	9,497	13.3	-13.2	1.4
Wood products	8,378	8,563	8,449	2.2	-1.3	1.2
Agriculture	**68,731**	**91,426**	**77,421**	**33.0**	**-15.3**	**11.0**
of which:						
Palm oil	44,730	60,310	53,171	34.8	-11.8	7.6
Rubber	9,210	13,481	7,864	46.4	-41.7	1.1
Minerals	**73,205**	**90,604**	**92,366**	**23.8**	**1.9**	**13.2**
of which:						
Liquefied natural gas (LNG)	38,742	52,049	55,526	34.3	6.7	7.9
Crude oil and condensates	30,765	32,452	31,951	5.5	-1.5	4.6
Others	**10,037**	**11,705**	**12,494**	**16.6**	**6.7**	**1.8**
Total	**638,822**	**697,862**	**702,188**	**9.2**	**0.6**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.12

Exports of Primary Commodities

	2010	2011	2012*p*	2010	2011	2012*p*
	Volume and value			Annual change (%)		
Commodity exports (RM million)	**141,937**	**182,031**	**169,787**	**28.8**	**28.2**	**-6.7**
Agriculture exports (RM million)	**68,731**	**91,426**	**77,421**	**28.8**	**33.0**	**-15.3**
of which:						
Palm oil						
('000 tonnes)	16,945	18,448	17,890	4.2	8.9	-3.0
(RM/tonne)	2,640	3,269	2,972	18.1	23.8	-9.1
(RM million)	44,730	60,310	53,171	23.1	34.8	-11.8
Palm kernel oil						
('000 tonnes)	1,021	1,083	1,294	-0.6	6.1	19.5
(RM/tonne)	2,494	3,557	1,874	56.0	42.6	-47.3
(RM million)	2,548	3,853	2,425	55.1	51.2	-37.1
Rubber						
('000 tonnes)	901	946	771	28.1	5.0	-18.5
(sen/kilogramme)	1,023	1,425	1,020	61.2	39.4	-28.4
(RM million)	9,210	13,481	7,864	106.5	46.4	-41.7
Saw logs						
('000 cubic metres)	4,329	3,315	3,013	2.8	-23.4	-9.1
(RM/cubic metre)	495	589	561	2.7	19.0	-4.6
(RM million)	2,142	1,952	1,691	5.6	-8.9	-13.3
Sawn timber						
('000 cubic metres)	2,152	2,085	2,043	27.5	-3.1	-2.0
(RM/cubic metre)	1,507	1,560	1,561	-18.1	3.5	0.1
(RM million)	3,243	3,252	3,188	4.3	0.3	-2.0
Cocoa beans						
('000 tonnes)	23.7	25.4	47.7	64.8	7.3	87.5
(RM/tonne)	11,534	10,038	8,372	27.3	-13.0	-16.6
(RM million)	273	255	399	109.7	-6.6	56.4
Mineral exports (RM million)	**73,205**	**90,604**	**92,366**	**28.9**	**23.8**	**1.9**
of which:						
Crude oil and condensates						
('000 tonnes)	16,373	12,506	11,863	-0.2	-23.6	-5.1
(USD/barrel)	76.55	111.67	114.98	32.0	45.9	3.0
(RM million)	30,765	32,452	31,951	21.3	5.5	-1.5
Liquefied natural gas (LNG)						
('000 tonnes)	22,953	24,848	23,769	3.9	8.3	-4.3
(RM/tonne)	1,688	2,095	2,336	28.5	24.1	11.5
(RM million)	38,742	52,049	55,526	33.5	34.3	6.7
Tin						
('000 tonnes)	33.7	42.3	37.2	47.3	25.5	-12.1
(RM/tonne)	61,831	76,460	64,794	35.1	23.7	-15.3
(RM million)	2,084	3,234	2,410	98.9	55.2	-25.5

p Preliminary

Source: Department of Statistics, Malaysia

Table A.13

Principal Markets for Manufactured Exports

	2008	2009	2010	2011	2012*p*	2008	2009	2010	2011	2012*p*
	RM million					% share				
ASEAN	**134,424**	**114,026**	**130,666**	**138,797**	**154,991**	**27.4**	**26.4**	**26.8**	**27.5**	**29.8**
Singapore	84,904	70,183	78,370	81,856	88,668	17.3	16.2	16.1	16.2	17.1
Thailand	25,643	24,148	28,285	28,521	30,679	5.2	5.6	5.8	5.7	5.9
Indonesia	16,319	13,016	15,675	18,925	25,485	3.3	3.0	3.2	3.8	4.9
Philippines	6,202	5,218	6,992	7,959	8,171	1.3	1.2	1.4	1.6	1.6
Brunei Darussalam	1,356	1,462	1,344	1,536	1,989	0.3	0.3	0.3	0.3	0.4
European Union	**63,361**	**52,830**	**58,527**	**58,707**	**50,428**	**12.9**	**12.2**	**12.0**	**11.6**	**9.7**
Germany	13,574	13,739	15,408	16,128	14,213	2.8	3.2	3.2	3.2	2.7
Netherlands	18,605	15,301	16,389	13,564	12,964	3.8	3.5	3.4	2.7	2.5
United Kingdom	8,587	6,657	6,801	6,587	6,351	1.7	1.5	1.4	1.3	1.2
Others	22,595	17,133	19,929	22,428	16,900	4.6	4.0	4.1	4.4	3.3
The People's Republic of China	44,396	51,254	61,027	63,749	67,331	9.0	11.9	12.5	12.6	13.0
United States	76,633	56,897	55,604	51,027	54,979	15.6	13.2	11.4	10.1	10.6
Japan	35,944	30,204	35,596	37,987	35,718	7.3	7.0	7.3	7.5	6.9
Hong Kong SAR	26,942	28,293	31,548	30,262	29,170	5.5	6.5	6.5	6.0	5.6
Middle East	23,342	20,659	21,273	22,646	22,994	4.8	4.8	4.4	4.5	4.4
Australia	14,794	13,927	13,154	14,037	15,161	3.0	3.2	2.7	2.8	2.9
India	10,119	8,319	11,508	14,220	14,733	2.1	1.9	2.4	2.8	2.8
Korea	10,294	9,895	12,313	12,996	14,146	2.1	2.3	2.5	2.6	2.7
Chinese Taipei	10,529	10,216	13,357	13,506	12,949	2.1	2.4	2.7	2.7	2.5
Latin American countries	9,172	7,362	9,063	9,849	9,727	1.9	1.7	1.9	2.0	1.9
Canada	2,964	2,630	2,977	2,589	2,788	0.6	0.6	0.6	0.5	0.5
Rest of the World	27,996	25,668	30,237	33,756	34,792	5.7	5.9	6.2	6.7	6.7
Total	**490,908**	**432,179**	**486,849**	**504,127**	**519,908**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

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

Table A.14

Principal Export Markets for Electronics

	2008	2009	2010	2011	2012*p*	2008	2009	2010	2011	2012*p*
	RM million					% share				
The People's Republic of China	27,298	34,862	38,326	38,644	38,101	13.9	19.3	19.7	21.2	21.3
Singapore	33,859	28,049	32,027	28,304	27,913	17.3	15.5	16.5	15.5	15.6
United States	43,365	28,170	24,605	20,384	21,644	22.1	15.6	12.7	11.2	12.1
Hong Kong SAR	17,434	20,283	22,500	21,464	21,307	8.9	11.2	11.6	11.8	11.9
Thailand	9,356	9,352	9,344	8,782	10,635	4.8	5.2	4.8	4.8	6.0
Japan	10,211	9,565	9,936	9,469	10,118	5.2	5.3	5.1	5.2	5.7
Netherlands	11,225	9,493	10,264	6,086	6,687	5.7	5.3	5.3	3.3	3.7
Chinese Taipei	4,517	5,851	6,242	5,696	6,033	2.3	3.2	3.2	3.1	3.4
Germany	6,588	7,658	8,413	8,019	5,542	3.4	4.2	4.3	4.4	3.1
Korea	3,621	3,547	4,369	5,281	3,940	1.8	2.0	2.2	2.9	2.2
Others	28,551	23,912	28,386	30,029	26,811	14.6	13.2	14.6	16.5	15.0
Total	**196,023**	**180,743**	**194,412**	**182,159**	**178,730**	**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 Electrical Products

	2008	2009	2010	2011	2012*p*	2008	2009	2010	2011	2012*p*
	RM million					% share				
United States	14,825	12,979	12,484	11,666	12,682	18.3	19.0	16.3	14.8	16.3
European Union	13,420	9,454	9,281	10,882	9,488	16.6	13.9	12.1	13.8	12.2
Singapore	10,838	8,190	8,470	8,419	8,895	13.4	12.0	11.0	10.7	11.4
Japan	7,269	6,961	9,251	9,507	7,115	9.0	10.2	12.1	12.1	9.2
Middle East	5,634	5,089	6,479	6,762	6,843	7.0	7.5	8.4	8.6	8.8
The People's Republic of China	3,824	3,201	3,972	4,238	4,222	4.7	4.7	5.2	5.4	5.4
Thailand	2,693	2,601	3,427	3,530	4,077	3.3	3.8	4.5	4.5	5.2
Australia	3,600	4,122	4,285	3,365	3,164	4.5	6.0	5.6	4.3	4.1
Hong Kong SAR	3,410	3,110	3,278	2,918	2,276	4.2	4.6	4.3	3.7	2.9
Others	15,386	12,499	15,807	17,560	18,930	19.0	18.3	20.6	22.3	24.4
Total	**80,899**	**68,205**	**76,734**	**78,847**	**77,693**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.16

Principal Export Markets for Chemicals and Chemical Products

	2008	2009	2010	2011	2012*p*	2008	2009	2010	2011	2012*p*
	RM million					% share				
The People's Republic of China	5,076	5,348	6,772	8,051	8,815	12.5	15.7	16.3	16.9	18.6
Indonesia	3,969	3,070	4,012	4,610	5,235	9.7	9.0	9.7	9.7	11.1
Thailand	3,658	2,764	3,295	4,185	4,236	9.0	8.1	7.9	8.8	8.9
Singapore	3,714	3,299	3,756	3,906	3,873	9.1	9.7	9.0	8.2	8.2
Japan	3,104	2,286	3,093	4,015	3,611	7.6	6.7	7.4	8.4	7.6
India	2,194	2,011	2,490	2,831	2,922	5.4	5.9	6.0	5.9	6.2
Korea	1,293	1,230	1,420	1,710	1,850	3.2	3.6	3.4	3.6	3.9
United States	1,567	1,166	1,339	1,543	1,385	3.8	3.4	3.2	3.2	2.9
Chinese Taipei	1,607	1,148	1,483	1,666	1,165	3.9	3.4	3.6	3.5	2.5
Hong Kong SAR	1,965	1,515	1,591	1,454	1,159	4.8	4.4	3.8	3.0	2.4
Others	12,576	10,241	12,306	13,796	13,118	30.9	30.1	29.6	28.9	27.7
Total	**40,723**	**34,079**	**41,557**	**47,767**	**47,369**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.17

Principal Export Markets for Palm Oil

	2008	2009	2010	2011	2012*p*	2008	2009	2010	2011	2012*p*
	'000 tonnes					% share				
The People's Republic of China	3,808	4,059	3,463	4,034	3,484	25.6	25.0	20.4	21.9	19.5
India	925	1,263	1,184	1,723	2,628	6.2	7.8	7.0	9.3	14.7
European Union	2,010	1,694	1,809	2,069	2,297	13.5	10.4	10.7	11.2	12.8
Netherlands	*1,333*	*1,117*	*1,133*	*1,293*	*1,511*	*8.9*	*6.9*	*6.7*	*7.0*	*8.4*
Italy	*165*	*151*	*188*	*212*	*291*	*1.1*	*0.9*	*1.1*	*1.1*	*1.6*
Germany	*105*	*154*	*160*	*127*	*115*	*0.7*	*0.9*	*0.9*	*0.7*	*0.6*
Sweden	*85*	*54*	*119*	*158*	*99*	*0.6*	*0.3*	*0.7*	*0.9*	*0.6*
Others	*323*	*219*	*209*	*279*	*281*	*2.2*	*1.3*	*1.2*	*1.5*	*1.6*
Middle East	1,257	1,364	1,864	1,775	1,505	8.4	8.4	11.0	9.6	8.4
Pakistan	1,291	1,764	2,134	1,851	1,359	8.7	10.9	12.6	10.0	7.6
United States	1,078	866	1,032	1,045	1,022	7.2	5.3	6.1	5.7	5.7
Japan	530	528	542	551	557	3.6	3.2	3.2	3.0	3.1
Korea	199	299	322	365	371	1.3	1.8	1.9	2.0	2.1
Bangladesh	254	113	171	149	249	1.7	0.7	1.0	0.8	1.4
Chinese Taipei	128	155	154	137	137	0.9	1.0	0.9	0.7	0.8
Australia	113	126	127	122	101	0.8	0.8	0.8	0.7	0.6
Others	3,304	4,025	4,143	4,626	4,181	22.2	24.8	24.4	25.1	23.4
Total	**14,894**	**16,256**	**16,945**	**18,448**	**17,890**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.18

Principal Export Markets for Rubber

	2008	2009	2010	2011	2012*p*	2008	2009	2010	2011	2012*p*
	'000 tonnes					% share				
The People's Republic of China	301	272	348	409	307	32.9	38.7	38.6	43.2	39.7
European Union	296	184	270	275	232	32.3	26.2	30.0	29.1	30.0
Germany	*123*	*82*	*118*	*114*	*112*	*13.5*	*11.6*	*13.1*	*12.0*	*14.5*
France	*32*	*18*	*22*	*16*	*12*	*3.5*	*2.6*	*2.4*	*1.7*	*1.6*
United Kingdom	*17*	*8*	*12*	*18*	*12*	*1.8*	*1.1*	*1.3*	*1.9*	*1.5*
Netherlands	*21*	*19*	*27*	*23*	*11*	*2.3*	*2.7*	*3.0*	*2.5*	*1.4*
Italy	*17*	*9*	*12*	*10*	*9*	*1.9*	*1.3*	*1.4*	*1.1*	*1.2*
Spain	*8*	*4*	*6*	*4*	*1*	*0.8*	*0.6*	*0.6*	*0.4*	*0.2*
Others	*78*	*44*	*74*	*89*	*75*	*8.5*	*6.3*	*8.2*	*9.4*	*9.7*
Middle East	69	54	64	55	55	7.5	7.7	7.1	5.8	7.1
Iran	*40*	*32*	*39*	*28*	*33*	*4.4*	*4.5*	*4.3*	*2.9*	*4.2*
Turkey	*21*	*17*	*20*	*21*	*16*	*2.3*	*2.4*	*2.2*	*2.3*	*2.0*
Others	*7*	*6*	*5*	*6*	*6*	*0.8*	*0.8*	*0.6*	*0.6*	*0.8*
United States	53	28	40	34	33	5.8	4.0	4.4	3.6	4.3
Korea	52	47	49	44	32	5.6	6.7	5.4	4.6	4.1
Brazil	35	23	27	21	23	3.8	3.3	3.0	2.3	2.9
Canada	12	9	9	7	4	1.4	1.3	1.0	0.8	0.6
Others	97	84	95	101	86	10.6	12.0	10.5	10.7	11.2
Total	**916**	**703**	**901**	**946**	**771**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary
Note: Numbers may not necessarily add up due to rounding
Source: Department of Statistics, Malaysia

Table A.19

Principal Export Markets for Crude Oil

	2008	2009	2010	2011	2012*p*	2008	2009	2010	2011	2012*p*
	'000 tonnes					% share				
Australia	3,272	3,321	5,166	3,729	4,521	19.5	20.2	31.5	29.8	38.1
India	3,890	2,872	2,320	2,454	1,952	23.2	17.5	14.2	19.6	16.5
Thailand	1,579	2,767	2,262	2,042	1,901	9.4	16.9	13.8	16.3	16.0
Japan	751	469	616	922	1,115	4.5	2.9	3.8	7.4	9.4
The People's Republic of China	837	1,429	1,382	944	581	5.0	8.7	8.4	7.5	4.9
New Zealand	356	214	539	409	544	2.1	1.3	3.3	3.3	4.6
Korea	1,356	877	950	865	498	8.1	5.3	5.8	6.9	4.2
Philippines	759	561	946	297	305	4.5	3.4	5.8	2.4	2.6
Singapore	2,497	1,428	896	169	170	14.9	8.7	5.5	1.4	1.4
Indonesia	1,289	2,098	682	153	112	7.7	12.8	4.2	1.2	0.9
Others	178	377	614	524	164	1.1	2.3	3.8	4.2	1.4
Total	**16,763**	**16,412**	**16,373**	**12,506**	**11,863**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.20

Principal Export Markets for LNG

	2008	2009	2010	2011	2012*p*	2008	2009	2010	2011	2012*p*
	'000 tonnes					% share				
Japan	13,350	12,877	13,990	15,416	14,808	57.6	58.3	60.9	62.0	62.3
Korea	6,541	5,659	4,839	3,972	4,152	28.2	25.6	21.1	16.0	17.5
Chinese Taipei	3,242	2,455	2,828	3,362	2,764	14.0	11.1	12.3	13.5	11.6
Others	31	1,104	1,296	2,097	2,045	0.1	5.0	5.6	8.4	8.6
Total	**23,164**	**22,095**	**22,953**	**24,848**	**23,769**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.21

External Debt and Debt Servicing

	2008	2009	2010	2011	2012*p*
	RM million				
Medium- and long-term debt:					
Gross borrowing	**26,112**	**35,839**	**53,354**	**76,806**	**86,010**
Federal Government	*479*	*459*	*4,493*	*6,561*	*625*
NFPEs	*5,952*	*17,900*	*4,076*	*3,043*	*8,612*
Private sector	*19,681*	*17,480*	*44,786*	*67,202*	*76,773*
Repayment and prepayment	**13,007**	**36,095**	**51,505**	**77,910**	**78,211**
Federal Government	*943*	*6,767*	*823*	*5,978*	*694*
NFPEs	*2,220*	*9,478*	*3,574*	*7,313*	*9,665*
Private sector	*9,844*	*19,850*	*47,109*	*64,620*	*67,853*
Net borrowing	**13,105**	**-256**	**1,849**	**-1,104**	**7,798**
Federal Government	*-463*	*-6,308*	*3,670*	*583*	*-69*
NFPEs	*3,732*	*8,422*	*502*	*-4,269*	*-1,053*
Private sector	*9,837*	*-2,371*	*-2,322*	*2,582*	*8,920*
Outstanding debt	**156,578**	**155,312**	**147,640**	**153,511**	**159,788**
Federal Government	*20,316*	*13,787*	*16,745*	*18,105*	*16,848*
NFPEs	*68,926*	*75,933*	*70,383*	*69,647*	*66,034*
Private sector	*67,336*	*65,591*	*60,511*	*65,759*	*76,906*
Short-term debt:					
Outstanding debt	**79,816**	**77,434**	**79,439**	**103,853**	**92,964**
Banking sector[1]	*72,170*	*68,572*	*67,982*	*92,302*	*80,488*
Non-bank private sector	*7,647*	*8,863*	*11,457*	*11,551*	*12,476*
Total external debt:	**236,394**	**232,746**	**227,078**	**257,364**	**252,752**
Total external debt (USD million)	**67,441**	**67,332**	**72,819**	**80,404**	**81,715**
% GNI	*31.6*	*33.3*	*29.5*	*30.0*	*28.0*
Annual change (%)	*26.1*	*-1.5*	*-2.4*	*13.3*	*-1.8*
Currency composition (% share)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
US dollar	*76.6*	*72.7*	*65.8*	*68.4*	*68.1*
Japanese yen	*9.2*	*8.4*	*8.8*	*8.2*	*6.7*
Others	*14.1*	*18.9*	*25.4*	*23.4*	*25.2*
Total servicing (including short-term interest payment)	**19,699**	**42,284**	**56,960**	**83,148**	**83,494**
of which:					
Medium- and long-term debt					
Repayment[2]	**13,007**	**36,095**	**51,506**	**77,910**	**78,211**
Federal Government	*943*	*6,767*	*823*	*5,978*	*694*
NFPEs	*2,220*	*9,478*	*3,574*	*7,313*	*9,665*
Private sector	*9,844*	*19,850*	*47,109*	*64,620*	*67,853*
Interest payment	**5,484**	**5,718**	**4,974**	**4,737**	**4,830**
Federal Government	*1,107*	*931*	*558*	*492*	*840*
NFPEs	*2,778*	*3,295*	*3,342*	*3,326*	*2,943*
Private sector	*1,599*	*1,492*	*1,074*	*919*	*1,047*
Debt service ratio (% of exports of goods and services)					
Total debt	**2.6**	**6.5**	**7.6**	**10.3**	**10.2**
Medium- and long-term debt	2.4	6.4	7.6	10.2	10.1
Federal Government	*0.3*	*1.2*	*0.2*	*0.8*	*0.2*
NFPEs	*0.7*	*2.0*	*0.9*	*1.3*	*1.5*
Private sector	*1.5*	*3.3*	*6.5*	*8.1*	*8.4*

[1] Excludes currency and deposits held by non-residents with resident banking institutions
[2] Includes prepayment
p Preliminary
Note: Numbers may not necessarily add up due to rounding

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Table A.22

Consumer Price Index

	Weights (%) (2010=100)	2009	2010	2011	2012
		Annual change (%)			
Total	**100.0**	**0.6**	**1.7**	**3.2**	**1.6**
of which:					
Food and non-alcoholic beverages	30.3	4.1	2.4	4.8	2.7
Alcoholic beverages and tobacco	2.2	6.1	4.0	4.6	0.4
Clothing and footwear	3.4	-0.9	-1.4	-0.2	-0.6
Housing, water, electricity, gas and other fuels	22.6	1.4	1.1	1.8	1.6
Furnishings, household equipment and routine household maintenance	4.1	2.9	0.7	1.8	2.0
Health	1.3	2.3	1.6	2.7	2.0
Transport	14.9	-9.4	1.6	4.4	0.7
Communication	5.7	-0.5	-0.2	-0.3	-0.6
Recreation services and culture	4.6	1.5	1.6	2.0	1.2
Education	1.4	2.4	1.7	2.2	2.4
Restaurants and hotels	3.2	2.9	2.0	5.9	2.9
Miscellaneous goods and services	6.3	3.8	2.7	2.4	2.0

Source: Department of Statistics, Malaysia

Table A.23

Producer Price Index

	Weights (%) (2005=100)	2009	2010	2011	2012
		Annual change (%)			
Total	**100.0**	**-7.1**	**5.6**	**9.0**	**0.1**
of which:					
Food	5.4	0.3	2.6	8.6	1.0
Beverages and tobacco	0.9	1.7	-0.5	3.7	0.3
Crude materials, inedible	5.4	-11.8	22.4	23.2	-10.3
Mineral fuels, lubricants, etc.	17.4	-22.0	12.8	24.2	7.0
Animal and vegetable oils and fats	4.2	-19.5	17.9	24.4	-11.7
Chemicals	7.0	-7.5	3.0	9.4	-0.5
Manufactured goods	10.9	-0.5	1.8	3.2	-0.5
Machinery and transport equipment	42.9	1.5	1.2	-0.6	0.8
Miscellaneous manufactured articles	5.4	1.5	0.6	2.5	0.6
Miscellaneous transactions and commodities	0.5	-6.2	12.2	6.2	1.3
Local production	65.6	-10.4	7.7	12.0	-0.2
Import	34.4	0.5	1.4	2.3	0.7

Source: Department of Statistics, Malaysia

Table A.24

Broad Money (M3)

	Annual change					As at end
	2008	2009	2010	2011	2012	2012
	RM million					
Broad money (M3)[1]	99,127	85,439	68,791	154,835	109,358	1,350,286
Currency in circulation[2]	4,178	3,015	4,246	5,142	3,971	56,798
Demand deposits	11,093	14,707	18,449	28,107	25,145	229,884
Broad quasi-money	83,856	67,717	46,096	121,585	80,241	1,063,604
Fixed deposits	*27,969*	*23,347*	*27,038*	*72,789*	*60,865*	*614,020*
Savings deposits	*7,786*	*10,050*	*2,675*	*10,728*	*8,070*	*123,740*
NIDs	*144*	*-8,583*	*-4,115*	*-1,239*	*-1,392*	*15,798*
Repos	*-3,046*	*898*	*655*	*-1,701*	*2,150*	*2,160*
Foreign currency deposits	*16,649*	*15,283*	*1,432*	*13,125*	*14,090*	*83,237*
Other deposits	*34,356*	*26,721*	*18,412*	*27,883*	*-3,542*	*224,649*
Factors Affecting M3						
Net claims on Government	33,649	25,808	-8,119	2,803	-3,301	48,599
Claims on Government	*33,652*	*35,919*	*-3,116*	*4,839*	*906*	*108,614*
Less: Government deposits	*3*	*10,110*	*5,003*	*2,035*	*4,207*	*60,015*
Claims on private sector	94,229	50,957	84,847	116,431	128,392	1,204,346
Loans	*76,903*	*46,481*	*91,981*	*111,787*	*105,508*	*1,080,306*
Securities	*17,326*	*4,476*	*-7,134*	*4,644*	*22,884*	*124,040*
Net foreign assets	-51,985	22,462	31,785	103,372	19,404	508,824
Bank Negara Malaysia[3]	*-18,265*	*7,343*	*-1,793*	*94,530*	*4,095*	*420,877*
Banking system	*-33,720*	*15,119*	*33,578*	*8,842*	*15,310*	*87,947*
Other influences	23,235	-13,789	-39,722	-67,772	-35,137	-411,483

[1] Excludes interplacements among banking institutions
[2] Excludes holdings by banking system
[3] Includes exchange rate revaluation loss/gain

Table A.25

Money Supply: Annual Change and Growth Rates

	2008		2009		2010		2011		2012	
	RM million	%	RM million	%	RM million	%	RM million	%	RM million	%
Currency in circulation	4,178	11.5	3,015	7.5	4,246	9.8	5,803	12.2	3,907	7.3
Demand deposits with commercial banks and Islamic banks	9,863	7.4	14,855	10.4	19,221	12.2	28,022	15.9	25,020	12.2
M1[1]	14,040	8.3	17,869	9.8	23,467	11.7	33,826	15.1	28,927	11.2
Other deposits with commercial banks and Islamic banks[2]	92,514	14.7	68,044	9.4	47,343	6.0	120,878	14.5	87,005	9.1
Deposits with other banking institutions[3]	-7,427	-20.7	-475	-1.7	-2,020	-7.2	131	0.5	-6,574	-25.2
M3[4]	99,127	11.9	85,439	9.2	68,791	6.8	154,835	14.3	109,358	8.8

[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] 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.26

Interest Rates (%)

	As at end-year						As at end-month in 2012											
	2006	2007	2008	2009	2010	2011	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
Overnight interbank	3.50	3.49	3.25	1.99	2.72	2.99	3.00	3.00	3.00	2.98	2.99	2.99	3.00	2.99	2.99	2.99	2.99	3.00
1-week interbank	3.53	3.52	3.27	2.00	2.77	3.01	3.01	3.02	3.01	3.01	3.01	3.01	3.01	3.01	3.01	3.01	3.01	3.01
1-month interbank	3.58	3.56	3.30	2.07	2.83	3.05	3.11	3.09	3.06	3.06	3.07	3.06	3.06	3.09	3.08	3.06	3.11	3.06
Commercial banks																		
Fixed deposit																		
3-month	3.19	3.15	3.04	2.03	2.74	2.99	2.99	2.99	2.98	2.97	2.97	2.99	2.98	2.98	2.98	2.98	2.98	2.98
12-month	3.73	3.70	3.50	2.50	2.97	3.22	3.21	3.21	3.21	3.19	3.19	3.19	3.18	3.17	3.16	3.16	3.15	3.15
Savings deposit	1.48	1.44	1.40	0.86	1.00	1.15	1.05	1.05	1.05	1.04	1.04	1.04	1.04	1.03	1.03	1.03	1.03	1.03
Base lending rate (BLR)	6.72	6.72	6.48	5.51	6.27	6.53	6.53	6.53	6.53	6.53	6.53	6.53	6.53	6.53	6.53	6.53	6.53	6.53
Treasury bills (91 days)[1]	3.43	3.39	2.94	1.98	2.82	2.99	2.97	2.99	3.04	3.04	3.05	3.04	3.03	3.03	3.03	3.04	3.04	3.04
Government Securities																		
1-year	3.55	3.53	2.89	2.12	2.85	2.82	2.78	2.83	3.02	3.03	3.03	2.96	2.98	2.99	3.00	2.97	3.01	3.01
5-year	3.70	3.78	3.00	3.79	3.39	3.23	3.19	3.20	3.34	3.31	3.26	3.21	3.21	3.27	3.31	3.24	3.26	3.24
Private debt securities																		
AAA																		
3-year	4.01	4.07	4.17	3.72	3.63	3.65	3.60	3.55	3.58	3.56	3.57	3.56	3.56	3.55	3.54	3.55	3.56	3.53
5-year	4.24	4.28	4.48	4.32	4.07	3.99	3.95	3.85	3.88	3.85	3.87	3.87	3.86	3.84	3.83	3.82	3.82	3.80
AA																		
3-year	4.38	4.39	4.95	4.50	4.34	4.29	4.18	4.08	4.11	4.08	4.10	4.09	4.08	4.08	4.07	4.04	4.05	4.04
5-year	4.71	4.64	5.31	5.07	4.75	4.65	4.51	4.42	4.45	4.42	4.44	4.44	4.43	4.43	4.39	4.33	4.34	4.30
A																		
3-year	5.91	6.06	6.90	6.80	6.90	6.57	6.41	6.36	6.32	6.35	6.35	6.37	6.34	6.34	6.32	6.32	6.33	6.34
5-year	6.53	6.51	7.43	7.57	7.53	7.11	6.98	6.96	6.91	6.92	6.98	7.00	6.97	6.97	6.97	6.96	6.97	6.98
BBB																		
3-year	9.57	9.71	10.32	10.18	10.40	10.21	10.19	10.17	10.17	10.20	10.15	10.08	10.08	10.08	10.09	10.07	10.10	10.06
5-year	10.51	10.72	11.36	11.32	11.43	11.24	11.21	11.19	11.18	11.20	11.19	11.16	11.16	11.16	11.17	11.15	11.16	11.14
BB & below																		
3-year	12.06	11.92	12.68	12.58	12.78	12.62	12.61	12.65	12.63	12.70	12.65	12.60	12.60	12.60	12.59	12.59	12.59	12.53
5-year	13.13	13.16	13.86	14.02	14.51	14.13	14.04	13.99	13.97	14.00	13.99	13.85	13.85	13.85	13.85	13.84	13.84	13.76

[1] Refers to data from FAST, Bank Negara Malaysia

Table A.27

Movements of the Ringgit

	RM to one unit of foreign currency[1]			Annual change (%)		Change (%)
	2005	2011	2012	2011	2012	21 Jul.'05 -
	21 Jul.[2]	End-Dec.				Dec. '12
SDR	5.5049	4.8621	4.6791	-2.8	3.9	17.6
US dollar	3.8000	3.1770	3.0583	-2.9	3.9	24.3
Singapore dollar	2.2570	2.4427	2.5030	-2.3	-2.4	-9.8
100 Japanese yen	3.3745	4.0975	3.5576	-7.6	15.2	-5.1
Pound sterling	6.6270	4.8962	4.9420	-2.3	-0.9	34.1
Swiss franc	2.9588	3.3755	3.3480	-3.1	0.8	-11.6
Euro	4.6212	4.1118	4.0412	-0.8	1.7	14.4
100 Thai baht	9.0681	10.009	9.9910	2.2	0.2	-9.2
100 Indonesian rupiah	0.0386	0.0347	0.0317	-0.9	9.2	21.8
100 Korean won	0.3665	0.2746	0.2865	-1.4	-4.2	27.9
100 Philippine peso	6.8131	7.2468	7.4446	-2.9	-2.7	-8.5
Chinese renminbi	0.4591	0.5034	0.4909	-7.4	2.5	-6.5

[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.28

Housing Credit Institutions

	Year of establishment	Objective	Lending rate for new housing loans (%)		No. of branches	
			2011	2012	2011	2012
Commercial banks	-		4.24[1,2]	4.30[1,2]	4197[3]	4228[3]
Treasury Housing Loans Division	1970	To provide housing loans to Government employees	4.00[1]	4.00[1]	2	1
Bank Kerjasama Rakyat Malaysia Berhad	1954	A co-operative society which collects deposits and provides banking facilities according to Syariah principles	7.00[1]	6.30[1]	134	140
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	7.29 ~ 7.31	7.35 ~ 7.41	35	38
Borneo Housing Mortgage Finance Berhad	1958	To provide housing loans mainly to Sabah and Sarawak State Government employees	6.75 ~ 7.50	6.75 ~ 7.50	2	2
Bank Simpanan Nasional	1974	To promote and mobilise savings particularly from small savers and to inculcate the habit of thrift and savings	4.45[1]	4.64[1]	390	396
Sabah Credit Corporation	1955	To uplift the social economic development of Malaysians in Sabah through the provision of easy access to financial credit	3.00 ~ 7.50	3.00 ~ 7.50	12	12

[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.29

Housing Loans Outstanding

	2011	2012*p*	2011	2012*p*	2011	2012*p*
	RM million		Annual change (%)		% share	
Commercial banks[1]	255,842	288,495	12.7	12.8	85.4	86.4
Treasury Housing Loans Division	31,208	32,982	20.0	5.7	10.4	9.9
Bank Kerjasama Rakyat Malaysia Berhad	3,382	2,978	-11.9	-11.9	1.1	0.9
Malaysia Building Society Berhad	5,160	4,947	-3.6	-4.1	1.7	1.5
Borneo Housing Mortgage Finance Berhad	652	641	-4.4	-1.7	0.2	0.2
Bank Simpanan Nasional	3,299	3,806	5.3	15.4	1.1	1.1
Sabah Credit Corporation	117	96	-17.3	-17.9	...	...
Total	**299,660**	**333,945**	**12.6**	**11.4**	**100.0**	**100.0**

[1] Includes Islamic banks
p Preliminary
... Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.30

Housing Loans Approved

	2011	2012*p*	2011	2012*p*	2011	2012*p*
	RM million		Annual change (%)		% share	
Commercial banks[1]	88,808	87,807	10.6	-1.1	91.3	88.4
Treasury Housing Loans Division	6,796	8,316	8.7	22.4	7.0	8.4
Bank Kerjasama Rakyat Malaysia Berhad	55	39	-6.8	-29.1	0.1	0.0
Malaysia Building Society Berhad	512	800	29.2	56.3	0.5	0.8
Borneo Housing Mortgage Finance Berhad	52	91	39.9	74.7	0.1	0.1
Bank Simpanan Nasional	1,042	2,237	15.8	114.6	1.1	2.3
Sabah Credit Corporation	0	0	...	...	...	...
Total	**97,266**	**99,290**	**10.6**	**2.1**	**100.0**	**100.0**

[1] Includes Islamic banks
p Preliminary
... Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.31

Financing of the Economy

By customer / By financing type/institution	Businesses[1] Total	Businesses[1] of which: SMEs[2]	Households	Government	Total Financing
	RM million				
Net Change in Financing (2011)					
Financial Intermediaries					
Banking Institutions	53,199	24,814	63,097	3,923	120,219
Development Financial Institutions (DFIs)[3]	2,138	(610)	4,527	-	6,666
Other Domestic Intermediaries[4]	10,397	(14)	4,963	-	15,361
Capital Market					
Bond Market[5]	27,198	-	-	45,221	72,419
Equity Market	12,621	-	-	-	12,621
External Financing					
Foreign Direct Investment	36,616	-	-	-	36,616
External Loan[6,7]	5,342	-	-	623	5,965
Total	**147,512**	**24,190**	**72,587**	**49,767**	**269,866**
Net Change in Financing (2012*p*)					
Financial Intermediaries					
Banking Institutions	38,995	23,785	63,840	1,666	104,501
Development Financial Institutions (DFIs)[3]	2,791	(81)	7,424	-	10,215
Other Domestic Intermediaries[4]	(12,479)	(35)	2,227	-	(10,253)
Capital Market					
Bond Market[5]	60,079	-	-	47,937	108,015
Equity Market	27,405	-	-	-	27,405
External Financing					
Foreign Direct Investment	29,061	-	-	-	29,061
External Loan[6,7]	12,072	-	-	(4,870)	7,202
Total	**157,922**	**23,670**	**73,491**	**44,733**	**276,145**

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 Treasury Housing Loan Division
5 Refers to change in private debt securities (PDS) outstanding 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)
p Preliminary

Table A.32

Consolidated Public Sector Finance

	2009	2010	2011	2012*p*	2013*f*
	RM billion				
Revenue[1]	132.9	127.2	161.4	185.9	180.4
% growth	*3.5*	*-4.3*	*26.9*	*15.2*	*-3.0*
Operating expenditure	170.6	167.1	197.2	223.8	220.6
% growth	*3.4*	*-2.0*	*18.0*	*13.5*	*-1.4*
Current surplus of NFPEs[2]	98.4	123.2	106.9	105.7	129.5
Current balance	**60.7**	**83.2**	**71.1**	**67.8**	**89.3**
% of GDP	***8.5***	***10.5***	***8.1***	***7.2***	***8.9***
Net development expenditure[3]	112.2	103.0	101.8	163.9	151.9
% growth	*-9.8*	*-8.2*	*-1.2*	*61.1*	*-7.4*
General Government[4]	56.5	53.7	51.7	52.1	54.3
NFPEs	55.7	49.3	50.0	111.8	97.5
Overall balance	**-51.5**	**-19.8**	**-30.7**	**-96.1**	**-62.6**
% of GDP	***-7.2***	***-2.5***	***-3.5***	***-10.2***	***-6.2***

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 governments, 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.33

Major Advanced Economies: Key Economic Indicators

	2008	2009	2010	2011	2012*e*	2013*f*
	Annual change (%)					
REAL GDP						
United States	-0.3	-3.1	2.4	1.8	2.2	2.0
Japan	-1.0	-5.5	4.7	-0.6	2.0	1.2
Euro area	0.4	-4.4	2.0	1.4	-0.6	-0.2
Germany	*1.1*	*-5.1*	*4.2*	*3.0*	*0.7*	*0.6*
United Kingdom	-1.0	-4.0	1.8	0.9	0.2	1.0
INFLATION						
United States	3.8	-0.4	1.6	3.2	2.1	1.8
Japan	1.5	-1.3	-1.0	-0.3	-0.1	-0.2
Euro area	3.3	0.3	1.6	2.7	2.5	1.6
Germany	*2.8*	*0.2*	*1.2*	*2.5*	*2.1*	*1.9*
United Kingdom	3.6	2.2	3.3	4.5	2.8	1.9
	% of labour force					
UNEMPLOYMENT						
United States	5.8	9.3	9.6	8.9	8.1	8.1
Japan	4.0	5.0	5.0	4.6	4.4	4.4
Euro area	7.6	9.6	10.1	10.2	11.4	11.5
Germany	*7.5*	*7.8*	*7.1*	*5.9*	*5.5*	*5.3*
United Kingdom	5.7	7.6	7.8	8.0	7.9	8.1
	% of GDP					
CURRENT ACCOUNT BALANCE						
United States	-4.7	-2.7	-3.0	-3.1	-3.1	-3.1
Japan	3.3	2.9	3.7	2.0	1.6	2.3
Euro area	-0.7	0.1	0.4	0.4	1.1	1.3
Germany	*6.2*	*5.9*	*6.0*	*5.7*	*5.4*	*4.7*
United Kingdom	-1.0	-1.3	-2.5	-1.9	-3.3	-2.7
FISCAL BALANCE[1]						
United States	-6.7	-13.3	-11.2	-10.1	-8.7	-7.3
Japan	-4.1	-10.4	-9.4	-9.8	-10.0	-9.1
Euro area	-2.1	-6.3	-6.2	-4.1	-3.3	-2.6
Germany	*-0.1*	*-3.1*	*-4.1*	*-0.8*	*-0.4*	*-0.4*
United Kingdom	-5.1	-10.4	-9.9	-8.5	-8.2	-7.3

[1] Refers to general government fiscal balance
e Estimate
f Forecast

Source: International Monetary Fund and National Authorities

Table A.34

Emerging Asia: Key Economic Indicators

	2008	2009	2010	2011	2012*e*	2013*f*
REAL GDP	Annual change (%)					
Regional Countries						
The People's Republic of China	9.3	8.8	10.4	9.3	7.8	8.2
Korea	2.3	0.3	6.3	3.6	2.0	3.6
Chinese Taipei	0.7	-1.8	10.8	4.1	1.3	3.9
Singapore	1.8	-0.8	14.8	5.2	1.3	2.9
Hong Kong SAR	2.1	-2.5	6.8	4.9	1.4	3.5
Malaysia	4.8	-1.5	7.2	5.1	5.6	5.0~6.0
Thailand	2.5	-2.3	7.8	0.1	6.4	6.0
Indonesia	6.0	4.6	6.2	6.5	6.2	6.3
Philippines	4.2	1.2	7.6	3.9	6.6	4.8
INFLATION	Annual change (%)					
Regional Countries						
The People's Republic of China	5.9	-0.7	3.3	5.4	2.6	3.0
Korea	4.7	2.8	2.9	4.0	2.2	2.7
Chinese Taipei	3.5	-0.9	1.0	1.4	1.9	2.0
Singapore	6.6	0.6	2.8	5.3	4.6	4.3
Hong Kong SAR[1]	4.3	0.6	2.3	5.3	4.1	3.0
Malaysia	5.4	0.6	1.7	3.2	1.6	2.0~3.0
Thailand	5.5	-0.9	3.3	3.8	3.0	3.3
Indonesia	9.9	4.8	5.1	5.4	4.3	5.1
Philippines	9.3	3.2	4.1	4.8	3.1	4.5
CURRENT ACCOUNT BALANCE	% of GDP					
Regional Countries						
The People's Republic of China	9.3	4.8	4.0	2.8	2.3	2.5
Korea	0.3	3.9	2.9	2.3	1.9	1.7
Chinese Taipei	6.9	11.4	9.3	8.9	10.4	7.3
Singapore	15.1	17.7	26.8	24.6	18.6	20.7
Hong Kong SAR	15.0	9.5	6.6	4.8	4.1	3.8
Malaysia	17.1	15.5	11.1	11.0	6.4	4.2
Thailand	0.8	8.3	4.1	3.4	-0.2	0.1
Indonesia	0.0	2.0	0.7	0.2	-2.1	-2.4
Philippines	2.1	5.6	4.5	3.1	3.0	2.6
FISCAL BALANCE[2]	% of GDP					
Regional Countries						
The People's Republic of China	-0.7	-3.1	-1.5	-1.2	-1.3	-1.0
Korea	1.6	0.0	1.7	1.8	2.0	2.7
Chinese Taipei	-2.2	-5.2	-4.1	-3.6	-3.7	-3.1
Singapore	6.5	-0.7	7.3	7.3	5.2	5.1
Hong Kong SAR	0.1	1.6	4.5	4.1	0.7	2.1
Malaysia[3]	-4.6	-6.7	-5.4	-4.8	-4.5	-4.0
Thailand	0.1	-3.2	-0.8	-1.6	-3.1	-3.8
Indonesia	0.0	-1.8	-1.2	-0.8	-1.6	-2.0
Philippines	0.0	-2.7	-2.2	-0.8	-1.9	-1.2

[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