



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 2013, 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 2013 is incorporated in Bank Negara Malaysia's Financial Stability and Payment Systems Report 2013 which forms an integral part of this Annual Report 2013.

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

Zeti Akhtar Aziz
Chairman
Board of Directors

19 March 2014

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

Dr. Sukhdave Singh

Deputy Governor

Tan Sri Dr. Mohd Irwan Serigar bin Abdullah

P.S.M., 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

Encik Chin Kwai Yoong was reappointed as a member of the Board effective 1 March 2013.

Dr. Sukhdave Singh was appointed as a member of the Board effective 16 April 2013.

Dato' Muhammad bin Ibrahim was reappointed as a member of the Board effective 16 June 2013.

Datuk Nor Shamsiah binti Mohd Yunus was reappointed as a member of the Board effective 16 November 2013.

SHARIAH ADVISORY COUNCIL MEMBERS

Dr. Mohd Daud bin Bakar

Chairman

Prof. Madya Dr. Mohamad Akram bin Laldin

Deputy Chairman

Tun Abdul Hamid bin 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

YB Dato' Seri Haji Hassan bin Haji Ahmad

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

Prof. Dr. Ashraf bin Md. Hashim

Prof. Dr. Engku Rabiah Adawiah binti Engku Ali

Prof. Madya Dr. Rusni binti Hassan

Prof. Madya Dr. Asmadi bin Mohamed Naim

Dr. Shamsiah binti Mohamad

En. Burhanuddin bin Lukman

Governor	Tan Sri Dr. Zeti Akhtar Aziz
Deputy Governor	Dato' Muhammad bin Ibrahim
Deputy Governor	Datuk Nor Shamsiah binti Mohd Yunus
Deputy Governor	Dr. Sukhdave Singh
Secretary to the Board	Abu Hassan Alshari bin Yahaya
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	Mohamad Muhsin bin Mohd Anas
<i>Economics</i>	
Economics	Fraziali bin Ismail
Monetary Assessment and Strategy	Dr. Norhana binti Endut
International	Nazrul Hisyam bin Mohd Noh
Statistical Services	Toh Hock Chai
<i>Regulation</i>	
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	Marina binti Abdul Kahar
Payment Systems Policy	Tan Nyat Chuan
Consumer and Market Conduct	Suhairi bin Ali
Money Services Business Regulation	Shahariah binti Othman
<i>Supervision</i>	
Financial Conglomerates Supervision	Che Zakiah binti Che Din
Insurance and Takaful Supervision	Yap Lai Kuen
Banking Supervision	Cindy Siah Hooi Hoon
Specialist Risk Unit	Charles Sandanasamy*
Financial Intelligence and Enforcement	Abd. Rahman bin Abu Bakar
<i>Investment and Operations</i>	
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
<i>Organisational Development</i>	
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
<i>Centralised Shared Services</i>	
General Manager	Dato' Mohd Nor bin Mashor
CSS Management Office	Azmi bin Abd Hamid
Facility Management Services	Myrzela binti Sabtu
Hospitality Services	Lim Foo Thai
Security Services	Dato' Badaruddin bin Mohd Isa
Museum, Art Gallery and KM Centre Services	Lucien de Guise
<i>Chief Representative</i>	
Beijing Representative Office	Albert See Choon Kwang
London Representative Office	Azizul bin Amiludin*
New York Representative Office	Harris bin Hassan
<i>Regional Office</i>	
Johor Bahru	Raman A/L Krishnan
Pulau Pinang	Mohd Daud bin Dahar
<i>Branch Manager</i>	
Kota Kinabalu	Kamalullail bin Ramli
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 year 2014 marks a year of transition for the world economy. As the recovery in the major advanced economies is sustained, the prolonged period of monetary accommodation will shift towards normalisation. While the structural adjustments and institutional changes being implemented will also contribute towards strengthening the growth process, challenges remain in managing this period of transition so as not to undermine the recovery. The emerging economies, in particular in Asia, have been resilient during this period of prolonged global slowdown, and will benefit from the global recovery. Most emerging economies have continued with the reforms to strengthen the medium-term growth outlook, while addressing the areas of vulnerabilities.

While the normalisation of monetary conditions in the advanced economies will be positive for the world economy given that it reflects improved economic conditions, this has been followed by heightened volatility in the international financial markets. During this period, the emerging economies have experienced sharp reversals of capital flows. The policy spillovers and contagion effects are potential risks confronting the emerging economies in this year of transition. The emerging economies have been affected by these developments in varying degrees. The earlier reforms and a broader policy toolkit have, however, allowed most emerging economies to more effectively manage these highly uncertain and volatile conditions.

Economic conditions in Malaysia have also continued to improve, and the Malaysian economy is expected to remain on a steady growth path going into 2014 and 2015. While the economy will continue to benefit from the gradual global recovery, the private sector-led domestic demand remains the key driver of growth. The economy has benefitted from the earlier reforms and initiatives introduced, which have provided a conducive environment for private investment. Projected to register its fifth consecutive year of strong growth, the broad-based capital spending across the economic sectors and geographical areas reflects the ongoing efforts to transition towards becoming a higher value-added economy. The household sector has also remained resilient. Private consumption activity is supported by the sustained income growth and stable labour market conditions.

As a highly open economy and an increasingly more liberalised financial system, Malaysia is significantly affected by external developments. Despite the increased capital flow volatility during the recent months, the domestic financial markets have remained orderly, and financial intermediation has not experienced any disruptions. This is largely from the payoffs from the decade of reforms to develop a more resilient domestic financial system. Additionally, the high level of international reserves, the low level of external indebtedness

and the balance of payments current account surplus continue to reinforce the strength of the Malaysian economy and its capacity to cope with external shocks. Beyond the prevailing short-term volatility, structural adjustments and economic transformation efforts currently being implemented will strengthen the fundamentals and growth prospects over the medium term.

In the domestic economy, the focus has been on the management of a number of key challenges to strengthen the potential for the sustainability of our medium-term growth prospects. Following rising costs, the domestic economy is entering a period of higher prices. Inflation in 2014 and 2015 is projected to be above its historical average, and to be between 3-4%. The revisions to a number of administered prices, higher domestic cost factors and the implementation of the Goods and Services Tax (GST) in 2015, are taking place at a time of modest global commodity prices, moderate domestic demand pressures and anchored inflationary expectations. These price adjustments are, therefore, expected to have a transitory effect on inflation. The impact of these adjustments is projected to diminish over time, and inflation is expected to stabilise in the region of its long-term average of 3%. The continued productivity enhancements and efficiency improvements by businesses will contribute towards containing the pass-through of the higher costs to consumers.

As the Government proceeds with its ongoing plans to contain the fiscal deficit and the level of public sector indebtedness, the challenge is to achieve these fiscal sustainability efforts while remaining supportive of growth. These fiscal reforms are essential to strengthen the overall resilience of the economy, and to increase the fiscal space to manage future unanticipated shocks. The fiscal consolidation process has, for the main part, been implemented gradually to minimise its potential adverse implications on the economy, with some supporting pro-growth measures to avoid disruptions in economic activity and dislocations to the vulnerable segments of society. The improved revenue position and the more efficient public sector spending will increase the potential for the development of a more comprehensive social protection system and further investments in infrastructure development in Malaysia.

In this more complex and challenging environment, the focus of attention of the appropriate policy mix by the Bank has been on preserving macroeconomic and financial stability, while also addressing the risks arising from the build-up of destabilising financial imbalances, and at the same time, supporting an inclusive growth. While monetary policy is an important policy lever, the Bank has also relied on a range of policy tools to achieve these objectives. The focus of monetary policy remains on preserving price stability in an environment of sustainable growth. However, also embedded within the considerations for the policy is to ensure that the interest rate setting does not result in widespread financial distortions or excessive risk-taking behaviour in the economy. For sector-specific risks of financial imbalances, a specifically more targeted approach, in the form of macroprudential and microprudential measures, has been implemented. While this broader policy toolkit has been relied upon, these measures are not a substitute for the monetary policy stance that is consistent with the prospective economic and financial conditions in the country.

During the year, initiatives were also continuously undertaken to further enhance the structure of the financial system, to facilitate more effective intermediation and to improve the risk management practices. In the further development of the bond market, the issuance of notes with a 30-year maturity period by the Government strengthens the depth of our bond market, and provides a benchmark for long-term project financing by the private sector. Another important development that is set to come into effect in 2015 is the introduction of a new reference rate, the Base Rate, for the pricing of floating-rate bank loans, to replace the Base Lending Rate that has been in place for more than 30 years. This enhancement to the interest rate framework aims to increase the relevance of the reference rate to the financial sector, improve the pricing mechanism that is more market-based, and at the same time, ensure greater transparency for households and businesses.

As financial integration in the region deepens, central bank cooperation to enhance collective resilience has also been strengthened further during the year. The cooperation has been strengthened in the area of cross-border surveillance, and in the development of an integrated crisis management framework to address pre-emptively threats to regional macroeconomic and financial stability. Financial resources available for crisis management have been, and will continue to be, enlarged through cross-border collateral arrangements and new bilateral swap arrangements. The Chiang Mai Initiative Multilateralisation (CMIM) is also being enhanced to strengthen the regional financial safety net. Cumulatively, these initiatives advance and strengthen the institutional arrangements and mechanisms, as part of the overall regional financial architecture to support regional stability.

During the year, the Bank established the Bank Negara Malaysia Representative Office in Beijing. This marks a significant milestone for the Bank. As the third overseas representative office after London and New York, it serves as an important liaison point with China's regulators and financial market participants to support a deeper understanding of the country's economic and financial developments.

In the Bank, efforts continued in enhancing organisational capacity to ensure that the Bank continues to remain effective in delivering our mandates. Equally important is that we are in a state of readiness to deal with future eventualities. Ongoing investments in talent management practices, over the years, have contributed to strengthening our institutional resilience. During the year, more structured programmes have been introduced to accelerate the time to competence, while more targeted leadership development programmes were provided for the mission critical positions. Guided by the Bank's business planning and enhanced risk management practices, the clear focus on strategic outcomes and awareness of potential risk areas ensure that mitigating and contingency measures have been put in place to facilitate the management of these risks and unexpected developments. Rigorous financial and operational management further supports the effective allocation of resources, and the management of multiple demands with varying priorities. During the year, our engagement and interface with partner institutions, including across borders, was also strengthened further, with several formal arrangements entered into to enhance greater collaboration efforts.

Going forward, the international and domestic environment will continue to place significant demands on the capacity and capability of the Bank. The continued readiness and effectiveness of the Bank in fulfilling our responsibilities will require a cohesive workforce that is dedicated to performance and strong collaboration with our institutional partners. On behalf of the Board and the management, I wish to express our appreciation to all staff of the Bank for their commitment and professionalism to ensure that the Bank continues to serve the best interests of the nation. I am also grateful for the unwavering support and guidance of the Board of Directors, who is an integral part of the governance at the Bank. 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.

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

Zeti Akhtar Aziz
Governor
19 March 2014

2013

EXECUTIVE SUMMARY



EXECUTIVE SUMMARY

In 2013, the global economy expanded at a modest pace amid an uneven growth environment across economies. In the advanced economies, growth continued to improve gradually. The pace of recovery, however, was modest as policy uncertainties and structural constraints continued to weigh on overall demand. Growth in emerging economies moderated as domestic demand was affected by the prolonged weakness in external demand. In a number of emerging economies, growth was also affected by policy measures introduced to manage domestic vulnerabilities. In addition, the shift in market expectations for reduction in monetary accommodation in the US towards the second half of the year led to large capital flow reversals from the emerging economies. Against this backdrop, global inflation slowed, reflecting the moderate demand conditions in many economies and lower non-energy commodity prices.

Despite the weaker external environment, the Malaysian economy continued to expand in 2013, driven by the continued strong growth in domestic demand. 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 amid the ongoing global economic and financial developments and the key challenges going forward. The report also highlights the organisational changes in the Bank to further strengthen its governance and capacity through enhancements in strategic management, risk management and talent development.

The Malaysian Economy in 2013

The Malaysian economy expanded by 4.7% in 2013 (2012: 5.6%), driven by the continued strong growth in domestic demand. Despite the weaker external environment in the first half of the year, domestic demand remained resilient throughout the year, led by robust private sector activity. Private consumption was supported mainly by favourable employment conditions and wage growth. Private investment was underpinned by capital spending in the mining, services and manufacturing sectors. The more moderate growth performance in 2013 was, to a

large extent, attributable to developments in the external sector. Slower demand from the advanced and regional economies in the first half of the year contributed to the overall decline in real exports during the year. This was compounded by the continued expansion in real imports throughout 2013 arising from the sustained growth in domestic investment and consumption, which contributed to the contraction in net exports.

Private consumption growth remained strong at 7.6% in 2013, underpinned mainly by the favourable employment conditions and wage growth. Private consumption was also supported by Government transfers to low- and middle-income households and continued access to financing for creditworthy borrowers. Public consumption recorded a higher growth of 6.3% in 2013 due mainly to higher expenditure on supplies and services.

Although the pace of investment activity moderated from the exceptionally strong growth in 2012, it continued to be supported by private sector capital expenditure. Private investment continued to register double-digit growth of 13.6%, driven by capital spending by both the domestic and foreign investors in the mining, services and manufacturing sectors. Public investment recorded a small positive growth of 0.7%, following the decline in the Federal Government development expenditure. Nevertheless, this was offset by higher capital spending by the public enterprises, which was channelled mainly into the oil and gas, transportation and energy sectors.

From the supply perspective, the continued firm growth in domestic demand contributed to the expansion in the domestic-related activity in the services and manufacturing sectors during the year. The export-oriented industries in the manufacturing sector benefited from the improvement in external conditions in the second half of the year. The robust activity in the residential and civil engineering sub-sectors contributed to the continued strong growth of the construction sector.

Labour market conditions remained favourable in 2013, as the continued expansion in economic

activity across all sectors supported the demand for labour. Employment recorded a strong growth of 4.8% while total retrenchments decreased, suggesting that most firms were able to adapt to the minimum wage policy. During the year, the unemployment rate remained low at 3.1%.

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), remained modest at 2.1% in 2013 (2012: 1.6%). The average inflation was low at 1.7% in the first eight months of the year before increasing to 2.9% in the remaining four months of 2013. The higher inflation in the latter part of the year was driven by domestic cost and supply factors, arising from upward adjustments to administered prices and weather-related domestic supply shortages. Despite the strong growth in private consumption and sustained wage growth during the year, adequate productive capacity in the economy helped contain demand pressures. Hence, core inflation, an indicator of demand-driven pressures, moderated to 1.8% in 2013.

Malaysia's external sector remained resilient in 2013 amid a challenging global economic and financial environment. The overall balance of payments remained strong, as the current account surplus more than offset the net outflows in the financial account. In the first half of the year, the current account recorded a smaller surplus of RM11.2 billion, on account of a smaller trade surplus amid lower services and income deficits. The continued economic weakness in the advanced countries, slower-than-expected growth in regional economies and the lower prices of Malaysia's key commodities resulted in a marked decline in Malaysia's exports. The services and income deficits narrowed due mainly to higher net travel receipts following stronger intra-regional tourism, and lower net primary income payments, reflecting higher profits of Malaysian companies investing abroad. In the second half of the year, the current account surplus widened to RM26.1 billion as export growth returned to positive territory, driven by higher demand across both manufactured products and commodities. This was further reinforced by the more favourable prices of CPO and LNG relative to the first half of 2013. Growth in imports remained strong throughout the year, given the robust domestic demand. For the year as a whole, the current account registered a surplus of RM37.3 billion (2012: RM57.3 billion).

The financial account continued to experience sustained two-way flows involving cross-border financial transactions by both residents and non-residents. The economy's performance and growth prospects continued to support international investors' confidence, leading to significantly higher inward direct investment flows. Foreign direct investment (FDI) inflows were fairly broad-based across sectors, with significant inflows into the manufacturing and mining sectors. Outward direct investment, however, moderated in tandem with the moderation in the growth outlook for regional economies. Malaysia's deep capital markets and relatively favourable growth prospects remained attractive to foreign portfolio investors. These portfolio flows, however, exhibited considerable volatility during the year. Net inflows of non-resident portfolio investment was strong in the early part of 2013, but following the indication by the Federal Reserve (Fed) of a possible scale-back of its asset purchase programme in May, there were strong portfolio outflows between May and August. For the year, non-resident portfolio investment recorded a smaller net inflow. Overall, the financial account registered a net outflow of RM15 billion in 2013.

Malaysia's external debt amounted to RM318.1 billion (USD95.8 billion) as at end-2013 (2012: RM252.8 billion), equivalent to 33.5% of GNI (2012: 27.9% of GNI). Higher medium- and long-term external debt during the year mainly reflected the net drawdown of external borrowing by the public enterprises and the non-bank private sector. The Federal Government continued to register net repayment of external debt. The higher short-term external debt in 2013 was largely the outcome of the net drawdown of interbank borrowing, mainly for the management of foreign exchange liquidity positions. The appreciation of some major and regional currencies against the ringgit during the year also contributed to the higher external debt in ringgit terms. Overall, Malaysia's external debt remained manageable. The debt profile continued to be skewed towards a longer maturity structure, with medium- and long-term debt accounting for 59.7% of total external debt.

The international reserves of Bank Negara Malaysia increased by RM14.6 billion to RM441.9 billion at end-2013 (end-2012: RM427.2 billion). As at 28 February 2014, the reserves level amounted to RM427.6 billion (equivalent to USD130.6 billion), which is sufficient to finance 9 months of retained

imports and is 3.3 times the short-term external debt. The international reserves held by the Bank remain usable and unencumbered.

Economic and Monetary Management in 2013

Monetary policy in 2013 was focused on balancing the risks surrounding the outlook for domestic growth and inflation. Against a backdrop of increased uncertainties on the balance of risks to the growth and inflation outlook, the Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.00% during the year. Although the risks to domestic growth and inflation was assessed to be broadly in balance in the earlier part of the year, the uncertainties surrounding the balance of risks increased towards the second half. While the growth momentum was expected to improve in the second half of the year and into 2014, uncertainties on the strength of the global recovery and the extent to which the fiscal consolidation and subsidy rationalisation would affect domestic demand, remained as the key downside risks to growth. Following the upward adjustments to administered prices in the later part of the year, the inflation dynamics shifted and inflation was expected to increase for the remainder of year and into 2014. Based on its assessment of the possible downside risks to growth and upside risks to inflation, the MPC viewed that holding the OPR steady would provide the best outcome for its monetary policy objectives. Also, given that the risks of financial imbalances were confined to certain segments of the economy, the MPC decided that other tools would be better suited to address these risks. Consequently, macroprudential measures were introduced in July to manage such financial risks in a more targeted manner.

A key development in the second half of the year was the capital flow reversals from the emerging market economies following the Fed's indication of a possible scale-back of its asset purchase programme. Despite the increase in the size and volatility of capital outflows since May 2013, adjustments in the domestic currency and financial markets were orderly. The managed float exchange rate system accorded flexibility for the ringgit exchange rate to facilitate adjustments. The depth of the financial system also ensured that these volatile flows were intermediated without causing disruptions to economic activity. The growing demand from the domestic institutional investors provided the underlying support to the bond market and contained the increase in borrowing costs that were benchmarked against the bond

yields. There were consequently minimal spillovers to the real economy.

The performance of the ringgit during the year was influenced mainly by two-way portfolio and trade flows, reflecting both international and domestic developments. In the first four months of the year, the ringgit was relatively stable. Subsequently, the indication of a possible scale-back in the Fed's asset purchase programme shifted market expectations and prompted a reversal of portfolio flows from most regional markets, resulting in the depreciation of most regional currencies, including the ringgit. For the year as a whole, the ringgit depreciated by 6.8% to end the year at RM3.2815 against the US dollar.

During the year, yields on Malaysian Government Securities (MGS) were driven primarily by external factors. While the Fed's indication of a possible scale-back of its asset purchase programme led to significant portfolio reversals in the bond market, the increases in MGS yields were generally smaller compared to markets across the region, due to the support of domestic institutions in the MGS market. In the private debt securities (PDS) market, the cost of private debt financing increased but remained supportive of fund raising activity. The FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) increased by 10.5% (2012: 10.3%) to close at 1867.0 points. The underlying performance of the market was supported by investors' confidence in the positive economic outlook for the Malaysian economy.

Liquidity conditions remained stable throughout 2013, despite heightened volatility in the global financial markets and capital flow reversals. Notwithstanding the net withdrawal of liquidity due to net foreign outflows during the year, surplus liquidity placed with Bank Negara Malaysia remained high. Private sector liquidity, as measured by broad money or M3, continued to expand, albeit at a more moderate pace of 8.1% during the year (2012: 9.0%).

Financing continued to support domestic economy activity. While growth in net financing moderated, the level of loans disbursed and funds raised in the capital market remained favourable. The overall demand for gross financing by businesses was sustained following continued strength in private consumption and investment activity. Demand for loans by households was also sustained, supported

by favourable employment conditions and wage growth. Of significance, the growth rate of outstanding loans for *personal use* moderated to 4.6% in 2013 (2012: 9.1%), partly as a result of the pre-emptive measures introduced by the Bank in July 2013 to reinforce responsible lending practices. For the year, net financing to the private sector through the banking system and the PDS market expanded at an annual rate of 9.8% (2012: 12.4%).

Outlook for the Malaysian Economy in 2014

The Malaysian economy is expected to remain on a steady growth path in 2014, expanding by 4.5%-5.5%. Domestic demand will remain the key driver of growth, albeit at a more moderate pace. Private investment is forecast to register robust growth for the fifth consecutive year, driven by the ongoing implementation of multi-year projects and the improvement in external demand. Public investment is projected to register a higher growth, supported by both Government and public enterprise capital spending. Private consumption will be underpinned by healthy labour market conditions and sustained income growth. Public consumption is anticipated to record a lower growth due to the ongoing fiscal consolidation.

In line with the improvement in external demand, Malaysia's export performance across most product categories is expected to pick up in 2014. Exports is expected to be further supported by a small positive growth in commodity exports and the stronger services exports, supported by Visit Malaysia Year 2014. At the same time, gross imports is projected to increase at a faster pace, driven mainly by higher intermediate imports. With import growth remaining robust, the current account surplus is projected to narrow in 2014.

On the supply side, all economic sectors are expected to register positive growth in 2014. The services and manufacturing sectors will be the key drivers to the overall growth, benefiting from the improvement in the global economic environment. The construction sector is expected to continue recording high growth, albeit at a more moderate pace, as the completion of several large civil engineering projects will more than offset the progress in existing projects in the transport, utility, and oil and gas sectors. The growth in the agriculture sector is expected to improve on account of higher production of palm oil as both yields and the number of matured palm trees increase. In the mining sector, better performance is projected due to higher crude oil and natural

gas production from deepwater and marginal fields; and enhanced oil recovery.

Headline inflation is projected to average 3%-4% in 2014, due mainly to domestic cost factors. These include the recent price adjustments arising from the subsidy rationalisation and the spillover effects of these adjustments on the prices of other goods and services. The higher cost pressures, however, will be partly contained by subdued external price pressures, continued expansion in domestic capacity and a moderation in domestic demand.

Notwithstanding the moderation in domestic demand, the underlying fundamentals of the Malaysian economy remain strong. Growth will be driven by the private sector across a diversified range of economic activities. Of importance, employment remains strong and incomes are rising. The financial system is resilient with financial intermediation expected to provide continued support to investment and consumption. The strength of Malaysia's external position also remains intact, with international reserves at healthy levels and external debt within prudent limits.

Downside risks to global growth, however, could affect the performance of the domestic economy in 2014. The advanced economies will continue to experience excess capacity in the labour and product markets, while fiscal uncertainties may affect the pace of recovery. In several of the emerging economies, there could be slower-than-expected domestic demand amid policy measures to address risks arising from high growth in credit and asset prices. In addition, volatility in global financial markets could contribute to large and volatile capital flows. While the environment will continue to be challenging, the economy could also register stronger growth performance if the pace of global recovery exceeds expectations.

Economic and Monetary Management in 2014

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, inflation and the buildup of financial imbalances.

Monetary policy in 2014 will aim to support the sustainable growth of the Malaysian economy while mitigating any potential vulnerabilities arising from inflation and the buildup of financial imbalances. While price pressures are expected to be stronger,

the source of inflation is primarily due to cost-push factors. Monetary surveillance, however, will remain focused on identifying signs of inflation becoming more pervasive and persistent, whereby a monetary policy response would become appropriate. Of significance, the prolonged period of relatively low international and domestic interest rates could encourage excessive risk-taking behaviour. To the extent that this occurs within specific segments of the economy, other targeted policy instruments such as macroprudential measures would be deployed to address these risks. Such measures are, however, complementary in nature and not a substitute for interest rate policy. Given the expected large shifts in global liquidity and capital flows, it is important to ensure that the monetary and financing conditions do not become destabilising and continue to be supportive of the economy.

Fiscal policy in 2014 is aimed at strengthening and consolidating the fiscal position, while ensuring continued support for domestic growth and the protection of the well-being of the society. Fiscal reforms are being pursued gradually to avoid undermining growth. Concurrently, fiscal resources will be directed towards key economic sectors to accelerate the shift towards a high value-added, high-income economy. In June 2013, the Fiscal Policy Committee (FPC) was established to serve as the central policy-making committee for the formulation and implementation of fiscal strategies and giving due consideration to their impact on overall macroeconomy.

Organisational Development and Governance

In 2013, the Bank completed most of the targeted initiatives for the year and sustained the progress of its three-year Business Plan. During the year, the Board of Directors met monthly to consider key economic and financial conditions and the Bank's policy responses, as well as to deliberate on the Bank's financial condition, reserves and currency management, and talent management issues. The official opening of the Bank's Beijing Representative Office witnessed the first occasion where a Board meeting was conducted abroad, in conjunction with other activities to further strengthen bilateral ties with PR China. The Board is supported by three non-executive Board Committees, namely the Board Governance Committee (BGC), the Board Audit Committee (BAC) and the Board Risk Committee (BRC).

The Bank's organisational development strategies were aimed at sustainability and preparedness as it continues to deliver the core mandates amid the challenging global economic and financial environment. This was achieved through organisation-wide clarity and focus on key outcomes and deliverables anchored to the Business Plan. During the year, steps were taken to further integrate elements of business strategy, risk, human capital and financial resources for a more holistic view of organisation performance management and more informed decision-making.

The Bank's communications role was intensified in 2013 in view of heightened challenges and uncertainties, especially in the global environment. More intensive engagements were carried out with various stakeholders, explaining the international and domestic economic and financial developments and their implications on the Malaysian economy and the financial system. Communication efforts were also focused in driving the Bank's strategic initiatives, including explaining the new Financial Services Act 2013 and the Islamic Financial Services Act 2013, and a nationwide campaign on 'Experience IBG', or Interbank GIRO, to encourage the switch from cheques to IBG services.

The Bank continues to engage with the global central banking community including in the area of capacity building. To enhance the knowledge and skills of policymakers and regulators globally in their pursuit of greater financial inclusion, the Bank and the Alliance for Financial Inclusion (AFI) signed a Letter of Cooperation for capacity building in August 2013. The Bank also intensified its capacity building efforts to support the Association of South East Asian Nations (ASEAN) financial integration agenda through the conduct of technical cooperation programmes. Capacity building programmes in the development of an effective and well-regulated Islamic financial system also continued to be a major focus area in 2013.

Bank Negara Malaysia's Audited Financial Statements for 2013

The financial position of Bank Negara Malaysia, as audited and certified by the Auditor General, remained strong in 2013. The total assets of Bank Negara Malaysia amounted to RM474.2 billion, with a net profit of RM5.5 billion for the financial year ending 31 December 2013. Bank Negara Malaysia declared a dividend of RM1.5 billion to the Government for the year 2013.

2013

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THE INTERNATIONAL ECONOMIC ENVIRONMENT

The global economy expanded at a modest pace in 2013, with uneven momentum across economies. In the advanced economies, growth remained on a path of gradual improvement, led by a private-sector recovery in the US. The euro area emerged from recession while economic activity improved in Japan following the introduction of stimulative policies. The pace of recovery, however, was modest as policy uncertainties and structural constraints continued to weigh on overall demand. Following the above-trend growth over the last few years, growth in the emerging economies moderated as a prolonged weakness in external demand spilled over to the domestic economy. A number of emerging economies had also introduced policy measures to manage potential domestic vulnerabilities, which led to some moderation in domestic demand. In addition, the shift in market expectations of a normalisation in US monetary policy towards the second half of the year led to large capital flow reversals from the emerging economies. Against this backdrop, global inflation slowed, reflecting the moderate demand conditions in many economies and lower non-energy commodity prices.

The global economy expanded at a modest pace in 2013, with uneven momentum across economies

A modest and uneven global recovery

While the global economic environment experienced gradual improvement throughout the year, growth was weak at the start of 2013. Policy uncertainties weighed on the pace of expansion in the advanced economies. The increase in payroll tax and the automatic government spending cuts in the US dampened consumption activity and resulted in a further decline in government spending. In the euro area, uncertainties emanating from the crisis in Cyprus reignited

sovereign debt concerns and exacerbated the existing weakness in private-sector sentiments. In Asia, the prolonged weakness in the external environment, coupled with country-specific factors, affected the strength of domestic economic activity. In PR China, ongoing efforts to re-balance growth to a more sustainable and consumption-driven path also led to more moderate growth. While domestic demand remained as the key contributor to growth in the ASEAN economies, the waning effect of previous stimulus measures amid weak external demand weighed on economic activity.

Overall global growth began to gain momentum in the second quarter of 2013. The improvement in the advanced economies was driven by different underlying factors, underscoring a divergence in growth dynamics. Economic recovery in the US benefitted from gradual improvements in the labour and housing markets. In spite of fiscal risks from the debt ceiling debate and government shutdown in late 2013, private investment began to rise, providing further support to the private sector-led growth. In the euro area, economic activity improved marginally, supported by a slower pace of fiscal consolidation. However, private sector demand remained weak, constrained by post-crisis structural impediments such as high unemployment, tight credit conditions and elevated debt levels. In Japan, the coordinated introduction of fiscal and monetary stimulus under a new leadership ('Abenomics') led to improved business and consumer sentiments, and subsequently, a reduction in deflationary pressures.

Amid signs of more entrenched improvements in the labour market, the Federal Reserve (Fed) indicated a possible scale-back of quantitative easing (QE) in May 2013. The news caused investors to reassess and rebalance their portfolio positions in the emerging markets in response to expectations of tighter financial conditions and narrowing interest rate differentials. This led to capital outflows from the emerging economies and triggered large movements in the global financial markets, with adverse effects on the foreign exchange, equity and bond markets in the emerging economies.

(More discussion on this can be found in the box article 'QE Spillovers on Asia' in Chapter 2.)

These developments, however, had limited impact on real economic activity in Asia. In tandem with a recovery in the advanced economies, tentative signs of improvement began to emerge in the second half of 2013, particularly for the more open economies. Of significance, in several advanced Asian economies, dissipating external weakness and targeted stimulus measures provided some support to growth. In PR China, the economy benefited from 'mini' stimulus measures implemented by the government in July 2013. These included tax cuts for small-medium enterprises (SMEs), streamlining customs regulations to facilitate exports and reforms in the Value Added Tax (VAT).

Table 1.1

World Economy: Key Economic Indicators

	Real GDP Growth (%)		Inflation (%)	
	2012	2013e	2012	2013e
World Growth	3.1	3.0	-	-
World Trade	2.7	2.7	-	-
Advanced Economies				
United States	2.8	1.9	2.1	1.5
Japan	1.4	1.5	0.0	0.4
Euro area ¹	-0.7	-0.5	2.5	1.4
United Kingdom	0.2	1.8	2.8	2.6
Emerging Asia²	6.5	6.4	2.7	2.7
Other Advanced Asian Economies	1.8	2.7	2.6	1.6
Korea	2.0	2.8	2.2	1.3
Chinese Taipei	1.5	2.1	1.9	0.8
Singapore	1.9	4.1	4.6	2.4
Hong Kong SAR ³	1.5	2.9	4.1	4.3
The People's Republic of China	7.7	7.7	2.6	2.6
ASEAN-4	6.3	5.1	3.3	4.4
Malaysia	5.6	4.7	1.6	2.1
Thailand	6.5	2.9	3.0	2.2
Indonesia	6.3	5.8	4.3	7.0
Philippines	6.8	7.2	3.2	3.0
India	4.7	4.6	9.7	10.1

¹ Refers to EU-17

² Emerging Asia refers to Chinese Taipei, Hong Kong SAR, Indonesia, Korea, Malaysia, Philippines, PR China, Singapore and Thailand

³ Inflation refers to composite price index
e Estimate

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

Global inflation moderated

Inflation moderated across regions, reflecting subdued demand conditions in many economies. The lower price pressures were also in part attributable to lower commodity prices.

During the year, amid increased supply and lower demand growth from key emerging economies, commodity prices continued to moderate from the peak recorded in early 2011. Record production of grains, primarily corn and rice, along with higher stocks dampened food prices. The increased supply of metals, amid weak demand, led to lower non-energy commodity prices. Oil prices were sustained at 2012 average levels. During the first half of the year, oil prices fell due to growth concerns in major oil importing economies in Asia. However, as these concerns abated, geopolitical developments in the Middle East took precedence. Brent crude oil price rose to a six-month high of USD118 per barrel (p/b) in August, amid escalations in geopolitical tensions in Egypt and Syria. Prices stabilised at the end of the year to average USD109 p/b for the year.

In the advanced economies, core inflation rates, which exclude food and energy prices, remained subdued following weak domestic demand as high unemployment continued to suppress wages and consumption. In the US and euro area, headline inflation rates declined to levels below targets set by the central banks. Downward adjustments to wages in the crisis-affected economies in the euro area, stemming from unit labour cost realignments to improve competitiveness, reinforced the lower inflationary pressures. In contrast, the price level in Japan reached its highest since end-2008 due partly to increases in the cost of energy. Notably, core inflation turned positive towards the end of the year, supported by stronger domestic demand. In Asia, lower commodity prices and the moderation in growth exerted downward pressures on inflation. Nevertheless, India and Indonesia experienced elevated inflation rates, reflecting the adverse impact of currency depreciation and adjustments to administered fuel prices. In India, inflation was also driven by acceleration in food prices, particularly vegetables, rising wages, and supply-chain constraints.

Global policy responses remained supportive of growth

Confronted with a challenging operating environment, policymakers pursued measures to support growth and mitigate concerns driven

by domestic factors. Monetary policy remained accommodative across regions. In the advanced economies, monetary authorities placed greater emphasis on forward guidance to minimise market uncertainties on future policy directions. The pace of fiscal consolidation moderated in some advanced economies, while targeted fiscal support was introduced in some Asian economies. Macroprudential measures were also undertaken in Asia to address financial imbalances such as rapid credit growth and rising asset prices.

In the advanced economies, policies were geared towards supporting the economic recovery. Amid low policy rates, monetary authorities used 'forward guidance', a communication tool to manage market expectations of future interest rates. While the Fed maintained its numerical thresholds for unemployment and inflation rates introduced in December 2012, it highlighted at the end of 2013 that interest rates would be kept low, well beyond the threshold where the unemployment rate falls below 6.5%. Following cumulative improvement in labour market conditions, the Fed announced that it would reduce its asset purchases by USD10 billion in December 2013 and subsequently, in January 2014 to USD65 billion per month. Similarly, the Bank of England (BOE) indicated that an unemployment rate threshold of 7% would apply before it considered adjustments to the Bank Rate. In addition, it announced changes to the Funding for Lending Scheme, by refocusing incentives from households to SMEs. The European Central Bank (ECB) lowered its key policy rate in May and November by a total of 50 basis points (bps) to 0.25% on account of low underlying price pressures. Further, the ECB stated that key interest rates would remain at prevailing or lower levels for an extended period of time with no explicit thresholds.

On the fiscal front, consolidation remained in place, albeit at varying speeds across economies. The US averted the fiscal cliff¹ through the American Taxpayer Relief Act which provided for permanent and temporary extensions of fiscal measures including tax relief. However, the

government allowed automatic spending cuts to take effect in March under the Budget Control Act 2011. In the euro area, the pace of fiscal consolidation slowed as policymakers initiated pro-growth strategies, including measures to improve lending to SMEs and to increase youth employment. Of significance, countries such as France, Spain and Portugal were given extensions in timelines to reduce budget deficits.

In Japan, 'Abenomics' was introduced, consisting of a three-pronged plan of fiscal stimulus, monetary easing and structural reforms. A fiscal stimulus was announced in January, directed at accelerating post-disaster reconstruction, disaster prevention and stimulating private investment. A supplementary budget, unveiled in December, was aimed at offsetting the potential impact from an increase in consumption tax in April 2014. This underscored the government's efforts in balancing between supporting growth and reducing the high public debt. On the monetary policy front, the Bank of Japan introduced the Quantitative and Qualitative Monetary Easing in April to achieve the inflation target of 2% within two years. By the second half of the year, structural reforms encompassing measures for the labour market, private investment and competitiveness were laid out.

Policies in Asia were shaped primarily by domestic concerns amid a challenging external environment. Throughout most of the first half of 2013, growth concerns arising from protracted weakness in the external environment led most national authorities to adopt accommodative monetary policies to support growth against the backdrop of benign inflationary pressures. Central banks in India, Thailand and Korea lowered their policy rates by between 25 bps and 75 bps. However, in May 2013, following the Fed's indication of a possible QE scale-back, investors began to reassess their investment strategies. Asia's fundamentals came under greater scrutiny and countries with both current account and fiscal deficits experienced large capital reversals. Bank Indonesia increased its benchmark rate to reinforce its policy mix, which was aimed at anchoring inflation expectations, while stabilising the rupiah and ensuring the sustainability of the current account position. The Reserve Bank of India also raised interest rates on inflationary concerns and instituted measures to narrow the current account deficit. Most Asian economies have demonstrated resilience in managing the volatility arising from capital flows, due in part to the enhanced buffers built post-Asian Financial Crisis

¹ 'Fiscal cliff' refers to a set of tax increases and spending cuts that were estimated to reduce the US fiscal deficit by USD502bn in FY2013. The Congressional Budget Office (CBO) projected that if these policies had taken effect, the US economy would have returned to recession in FY2013. The American Taxpayer Relief Act in January 2013 eliminated part of the fiscal cliff.

Table 1.2

Malaysia - Key Economic Indicators

	2011	2012	2013 ^p	2014 ^f
Population (million persons)	29.1	29.5	29.9	30.4
Labour force (million persons)	12.7	13.1	13.8	14.3
Employment (million persons)	12.3	12.7	13.3	13.8
Unemployment (as % of labour force)	3.1	3.0	3.1	3.1
Per Capita Income (RM)	29,683	30,667	31,698	34,175
(USD)	9,700	9,928	10,060	10,337 ⁶
NATIONAL PRODUCT (% change)				
Real GDP at 2005 prices ¹	5.1	5.6	4.7	4.5 ~ 5.5
(RM billion)	711.4	751.5	786.7	828.1
Agriculture, forestry and fishery	5.8	1.0	2.1	3.8
Mining and quarrying	-5.5	1.4	0.5	1.6
Manufacturing	4.7	4.8	3.4	3.5
Construction	4.7	18.1	10.9	10.0
Services	7.0	6.4	5.9	6.2
Nominal GNI	11.9	4.9	4.9	9.4
(RM billion)	862.7	905.2	949.3	1,038.8
Real GNI	4.9	3.9	5.1	5.8
(RM billion)	666.9	693.1	728.3	770.2
Real aggregate domestic demand ²	7.9	10.6	7.6	6.9
Private expenditure	7.6	10.7	9.0	8.3
Consumption	6.8	7.7	7.6	6.9
Investment	10.5	21.9	13.6	12.6
Public expenditure	8.9	10.3	3.7	2.9
Consumption	15.8	5.1	6.3	3.0
Investment	1.0	17.1	0.7	2.9
Gross national savings (as % of GNI)	35.7	33.1	31.2	31.4
BALANCE OF PAYMENTS (RM billion)				
Goods balance	151.6	125.6	102.7	93.7
Exports	699.6	703.2	690.9	714.6
Imports	548.0	577.5	588.2	620.9
Services balance	-6.3	-14.0	-15.0	-11.9
Primary income, net	-21.8	-36.0	-35.2	-34.9
Secondary income, net	-21.1	-18.2	-15.2	-16.0
Current account balance	102.4	57.3	37.3	30.8
(as % of GNI)	11.9	6.3	3.9	3.0
Bank Negara Malaysia international reserves, net ³	423.3	427.2	441.9	-
(in months of retained imports)	9.6	9.5	9.5	-
PRICES (% change)				
CPI (2010=100) ⁴	3.2	1.6	2.1	3.0 ~ 4.0
PPI (2005=100) ⁵	9.0	0.1	-1.9	-
Real wage per employee in the manufacturing sector	0.6	4.7	5.6	-

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 2014

^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)	2011		2012		2013^p	
Revenue	185.4		207.9		213.4	
Operating expenditure	182.6		205.5		211.3	
Net development expenditure	45.3		44.3		40.7	
Overall balance	-42.5		-42.0		-38.6	
Overall balance (% of GDP)	-4.8		-4.5		-3.9	
Public sector net development expenditure	101.3		135.2		180.2	
Public sector overall balance (% of GDP)	-3.4		-4.5		-13.6	
EXTERNAL DEBT						
Total debt (RM billion)	257.4		252.8		318.1	
Medium- and long-term debt	153.6		159.8		190.0	
Short-term debt ¹	103.8		93.0		128.1	
Debt service ratio ² (% of exports of goods and services)						
Total debt	10.4		10.1		10.3	
Medium- and long-term debt	10.3		10.1		10.3	
MONEY AND BANKING						
	Change in 2011		Change in 2012		Change in 2013	
	RM billion	%	RM billion	%	RM billion	%
Money supply M1	34.6	15.4	30.8	11.9	37.8	13.0
M3	155.6	14.3	111.2	9.0	109.5	8.1
Banking system deposits	160.9	14.1	109.4	8.4	119.1	8.5
Banking system loans ³	120.2	13.6	104.5	10.4	117.7	10.6
Loan-deposit ratio (end of year) ⁴	80.9		82.1		84.6	
Financing-deposit ratio ^{4,5}	86.2		88.7		91.2	
INTEREST RATES (AS AT END-YEAR)						
	2011		2012		2013	
	%		%		%	
Overnight Policy Rate (OPR)	3.00		3.00		3.00	
Interbank rates (1-month)	3.05		3.06		3.20	
Commercial banks						
Fixed deposit 3-month	2.99		2.97		2.97	
12-month	3.22		3.15		3.15	
Savings deposit	1.15		1.03		0.99	
Base lending rate (BLR)	6.53		6.53		6.53	
Treasury bill (3-month)	2.99		3.04		3.00	
Malaysian Government Securities (1-year) ⁶	2.82		3.01		3.03	
Malaysian Government Securities (5-year) ⁶	3.23		3.24		3.66	
EXCHANGE RATES						
	2011		2012		2013	
	%		%		%	
Movement of Ringgit (end-period)						
Change against SDR	-2.8		3.9		-7.3	
Change against USD ⁷	-2.9		3.9		-6.8	

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 Excludes transactions between financial institutions

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

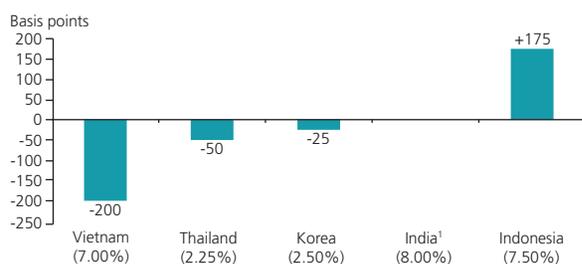
^p Preliminary

and the pre-emptive measures undertaken to ensure that capital outflows would not be disruptive.

To provide support to domestic economic activity, several Asian countries also announced stimulative fiscal measures. The stimulus packages were designed to aid SMEs, facilitate investment in infrastructure projects, provide tax incentives and support exports. Cognisant of financial imbalances arising from elevated debt levels and rising asset prices, several national authorities introduced further macroprudential policy measures. These measures included increasing minimum loan-to-value (LTV) ratios, hiking stamp duties and reducing loan tenures to address rising property prices.

Chart 1.1

Cumulative Movements of Policy Rates (Jan. 2013 - Feb. 2014)



¹ Reserve Bank of India lowered its policy rate by 75 bps in 1H 2013, raised it by 50 bps in 2H 2013 and subsequently increased it by 25 bps in 2014

Note: Current policy rates in parentheses, as at end-February 2014

Source: National Authorities

THE MALAYSIAN ECONOMY

Overview

The Malaysian economy expanded by 4.7% in 2013 (2012: 5.6%), driven by the continued strong growth in domestic demand. Despite the weaker external environment in the first half of the year, domestic demand remained resilient throughout the year, led by robust private sector activity. Private consumption was strong, supported mainly by favourable employment conditions and wage growth. Private investment registered a strong growth in 2013, continuing the momentum from the previous year. Growth was underpinned by capital spending in the mining, services and manufacturing sectors. Although the Federal Government's development expenditure declined during the year, growth in public investment remained positive as a result of the continued high capital spending by the public enterprises.

Table 1.4

Real GDP by Expenditure (2005=100)

	2012	2013 ^p	2012	2013 ^p
	Annual change (%)		Contribution to growth (ppt)	
Domestic Demand¹	10.6	7.6	9.2	6.9
Consumption	7.1	7.3	4.5	4.7
<i>Private sector</i>	7.7	7.6	3.8	3.8
<i>Public sector</i>	5.1	6.3	0.7	0.8
Gross Fixed Capital Formation	19.9	8.2	4.7	2.2
<i>Private sector</i>	21.9	13.6	3.0	2.1
<i>Public sector</i>	17.1	0.7	1.7	0.1
Change in Stocks			0.6	-0.2
Net Exports of Goods and Services	-31.7	-22.9	-4.2	-2.0
<i>Exports</i>	-0.1	-0.3		
<i>Imports</i>	4.7	1.9		
Real Gross Domestic Product (GDP)	5.6	4.7	5.6	4.7

¹ Excluding stocks

^p Preliminary

Source: Department of Statistics, Malaysia

The Malaysian economy expanded by 4.7% in 2013, driven by continued strong growth in domestic demand amid a weak external environment in the first half of the year

The more moderate growth performance in 2013 was to a large extent attributable to developments in the external sector. Real GDP registered a more moderate growth of 4.3% in the first half of the year (1H 2012: 5.4%), weighed down by prolonged weak external demand. Demand for Malaysia's exports, particularly for electronics and electrical (E&E) products, was affected by the slow growth in the US

Table 1.5

Real GDP by Sector (2005=100)

	2012	2013 ^p	2012	2013 ^p
	Annual change (%)		Contribution to growth (ppt) ¹	
Agriculture	1.0	2.1	0.1	0.2
Mining & quarrying	1.4	0.5	0.1	0.0
Manufacturing	4.8	3.4	1.2	0.8
Construction	18.1	10.9	0.6	0.4
Services	6.4	5.9	3.5	3.2
Real Gross Domestic Product (GDP)	5.6	4.7	5.6	4.7

¹ Numbers do not add up due to rounding and exclusion of import duties component

^p Preliminary

Source: Department of Statistics, Malaysia

and weak economic activity in most of the European economies. The prolonged weak demand from the advanced economies had also affected several regional economies, which in turn led to slower demand for Malaysia's non-E&E products. As a result, real exports of goods and services declined by 2.9% in the first half of 2013. Real imports of goods and services, on the other hand, expanded further in the first half-year following sustained growth in domestic investment and consumption. This contributed to a bigger contraction in net exports. As a result of the weak export performance, Malaysia's growth forecast for 2013 was revised downward to 4.5%-5% in August, from the earlier projection of 5%-6%. Growth forecasts were also revised downwards in some other regional economies. As the overall global growth gained momentum at the onset of the second quarter of the year, Malaysia's real exports improved to register a positive growth of 2.3% in the second half of the year. Consequently, despite the stronger expansion in real imports, net exports recorded a smaller contraction in the second half of 2013.

From the supply perspective, the continued firm growth in domestic demand contributed to the expansion in domestic-related activities in the services and manufacturing sectors during the year, while the export-oriented industries in the manufacturing sector benefitted from the improvement in external conditions in the second half-year. Meanwhile, the robust activity in the residential and civil engineering sub-sectors contributed to the continued strong growth in the construction sector.

Domestic demand remained the key driver of growth

Domestic demand remained the key driver of Malaysia's economy, expanding by 7.6% in 2013 (2012: 10.6%). This was attributable to the robust growth in private consumption and investment. Public expenditure growth moderated but remained supportive of overall growth.

Private consumption remained strong, supported mainly by favourable employment conditions and wage growth

Private consumption continued to register a strong growth of 7.6% in 2013. Spending was underpinned mainly by favourable employment conditions and wage growth. During the year, wages in the domestic-oriented industries in the manufacturing sector recorded a stronger growth (10.3%; 2012: 6.6%), whilst those in the export-oriented industries registered sustained growth (5%; 2012: 5.2%). The implementation of the minimum wage policy on 1 January 2013 also contributed to the higher wage levels. The new policy had minimal adverse effects on employment, and was confined mostly to the fourth quarter of 2012, during which, retrenchments were temporarily higher as companies started to implement the policy. Government transfers to low- and middle-income households continued to support private consumption, albeit to a lesser extent compared to 2012. These included Bantuan Rakyat 1Malaysia (BR1M), Baucar Buku 1Malaysia (BB1M), and schooling assistance to primary and secondary school students, which in total amounted to RM3.8 billion. Private consumption was also supported by continued access to financing for creditworthy households. Outstanding consumption credit to households continued to grow, albeit at a slower pace of 8.5% (2012: 13.3%), which was in part attributable to the pre-emptive macroprudential measures introduced by the Bank in July 2013.

Public consumption recorded a higher growth of 6.3% in 2013 (2012: 5.1%) due mainly to higher expenditure on supplies and services. Expenditure on emoluments was sustained.

Favourable Labour Market Conditions

In 2013, the labour market remained favourable, as continued expansion in economic activity across all sectors supported the demand for labour. During the year, employment recorded a strong growth of 4.8% (2012: 3.6%), representing a net addition of 613,000 jobs from the previous year. The unemployment rate remained low at 3.1% (2012: 3.0%).

The favourable labour market was also reflected in lower retrenchments reported to the Ministry of Human Resources. Total retrenchments decreased to 11,195 persons from 11,494 in the previous year, as the higher retrenchments in the manufacturing sector (7,940 persons; 2012: 7,616 persons) were offset by lower retrenchments in the services (2,605 persons; 2012: 2,639 persons) and construction (353 persons; 2012: 1,002 persons) sectors. In terms of sentiments, employees were more optimistic in finding employment, as evidenced by the higher JobStreet Employee Confidence Index (JECI) of 50.3 (2012: 48.8). Employers also reported an optimistic view of the job market as reflected in higher Jobstreet's Job Outlook Index of 54.4 (2012: 52.5).

The services sector added the most jobs during the year, contributing to 65% of the net job addition, followed by the agriculture (18%) and construction (16%) sectors. Mid-skill workers accounted for almost three quarters of the net job additions, followed by low-skill (19%) and high-skill (10%).

In terms of employment structure, the services sector remained the largest employer with 60% of employment, followed by the manufacturing (17%), agriculture (13%), construction (9%) and mining sector (0.7%). Employment by skill levels also remained unchanged, with mid-skill workers accounting for 63% of employment, followed by high-skill (25%) and low-skill (13%).

In 2013, the number of registered foreign workers increased markedly to 2.47 million workers (2012: 1.57 million workers). The significant increase can be attributed to the legalisation of foreign workers through the 6P programme. Most foreign workers were employed in the manufacturing (35% of total foreign workers), agriculture (26%) and construction (20%) sectors.

The national minimum wage policy was put into effect on 1 January 2013. The higher employment growth and lower retrenchments suggest that most firms were able to adjust to the minimum wage policy.

Based on a survey by the Malaysian Employers Federation, average salary in the private sector increased by 6.6% in 2013 (2012: 6.0%). On average, executives recorded a salary growth of 6.3% (2012: 6.3%) while non-executives registered a salary growth of 6.7% (2012: 5.8%), reflective of the minimum wage policy.

Table 1

Selected Labour Market Indicators

	2009	2010	2011	2012	2013 ^p
Employment ('000 persons)	10,899	11,900	12,284	12,723	13,336
Labour force ('000 persons)	11,315	12,304	12,676	13,120	13,763
Unemployment rate (% of labour force)	3.7	3.3	3.1	3.0	3.1
Retrenchments (persons)	25,064	7,085	9,450	11,494	11,195
Foreign workers ('000 persons)	1,918	1,818	1,573	1,572	2,470

^p Preliminary

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, Ministry of Human Resources, Ministry of Home Affairs and Bank Negara Malaysia

Gross fixed capital formation (GFCF) registered a lower growth of 8.2% in 2013, following a robust growth of 19.9% in 2012. The share of private investment to GFCF rose to 61% (2012: 58%), reflecting continued strong growth in private investment amid more modest growth in public investment.

The pace of investment activity moderated from the exceptionally strong growth in 2012, supported mainly by private sector capital expenditure

GFCF was supported by investment in both structures, and machinery and equipment. Investment in structures grew by 11.1% (2012: 25.1%), and was evident in all construction sub-sectors. Investments in machinery and equipment increased by 5.1% (2012: 16.9%). The moderation in machinery and equipment investment growth was reflected in the decline in imports of machinery for manufacturing (2013: -2.9%; 2012: 21%),

imports of office equipment (2013: -8.7%; 2012: 3.5%) and imports of locomotives (2013: -96.9%; 2012: 186.6%).

Private investment continued to register a double-digit growth rate of 13.6% (2012: 21.9%), well above the average growth rate of 8.8% over 2000 to 2012. Private investment was driven by capital spending by both the domestic and foreign investors in the mining, services and manufacturing sectors.

Services investments (48% share of private investment in 2013) were underpinned by capital spending in both the domestic- and export-oriented services sub-sectors. In the domestic-oriented services sector, investments were undertaken mainly in the distributive trade, telecommunication and private healthcare sub-sectors. Investments in the export-oriented sub-sectors were mainly for the expansion and upgrading of ports and petroleum storage terminals. Dwellings investment, as proxied by residential construction work done, continued to record strong growth (19.6%). Despite the robust pace, the share of dwellings investment to private investment was broadly unchanged at

Chart 1.2

Real Private Investment by Sector



e Estimate
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Continued Growth across All Economic Sectors

On the supply side, all economic sectors continued to grow in 2013, driven mainly by continued expansion in domestic demand and improving external conditions in the second half of the year.

The services sector expanded by 5.9% in 2013 and remained the largest contributor to growth (3.2 percentage points of overall GDP growth). Growth in the sector was underpinned largely by sub-sectors catering to domestic demand. In particular, the wholesale and retail trade sub-sector recorded higher growth benefitting from continued strength in households' retail spending. In the communication sub-sector, growth remained robust, mainly on account of continued demand for data communication services. Performance of the transport and storage sub-sector was sustained amid strong growth in passenger travel. On the other hand, growth in the finance and insurance sub-sector moderated following lower interest rate margins and insurance premiums.

The manufacturing sector expanded by 3.4%, attributable to the continued strength in the domestic-oriented industries and better performance of the export-oriented industries in the second half of 2013. Production in the export-oriented industries was supported by stronger exports in both the E&E and primary-clusters, amid a gradual recovery in the global economy. Domestic-oriented industries recorded sustained growth, mainly driven by robust private consumption and resilient construction activity.

Growth remained strong in the construction sector (10.9%), owing to robust activity in the residential and civil engineering sub-sectors. Growth in the residential sub-sector was underpinned by the construction of high-end and high-rise properties in the Klang Valley, Penang and Johor. In the civil-engineering sub-sector, activities in infrastructure, and oil and gas-related projects supported growth. Notable projects included Tanjung Bin and Janamanjung power plants, MRT, Sabah Oil and Gas Terminal, Sabah-Sarawak Gas Pipeline and the Keabangan Oil and Gas project.

In the agriculture sector, growth was stronger at 2.1% mostly on account of the higher CPO output, reflecting better yields amid favourable weather conditions. Production of food commodities, such as livestock, vegetables and fisheries, was also higher in 2013 following efforts to increase food security as well as ongoing efforts to further improve the agro-food and aquaculture industries.

The mining sector registered a slower growth of 0.5% in 2013, reflecting the reduction in crude oil production amid maintenance works that occurred in the latter half of the year. Output of natural gas, however, recorded stronger growth during the year, driven by higher demand from East Asia for electricity generation as well as commencement of higher production from marginal and new fields.

Chart 1

Real GDP by Economic Activity

Contribution to growth (percentage points)



p Preliminary

Source: Department of Statistics, Malaysia

17% as investments in other sectors also recorded strong growth rates.

Mining investment (17% share of private investment) remained strong in 2013, reflecting continued capital spending in major upstream projects, such as the Gumusut-Kakap deepwater field, Enhanced Oil Recovery of the Tapis oil field and the Berantai and Balai marginal fields. In the manufacturing sector (27% of private investment), investments were undertaken in both the export-oriented industries such as the E&E and medical devices, and the domestic-oriented industries, particularly in food manufacturing. This expansion reflected improving business sentiment following the gradual improvement in external demand and sustained strong domestic consumption.

Public investment recorded a small positive growth of 0.7% (2012: 17.1%), following the decline in the Federal Government's development expenditure. Nevertheless, this was offset by higher capital spending by the public enterprises, which were channelled mainly into the oil and gas, transportation and energy sectors. The major projects in the oil and gas sector were Sabah Ammonia-Urea Plant, Sabah-Sarawak Gas Pipeline and Kinabalu Non-Associated Gas (NAG) upstream development. Investment in the transportation sub-sector was supported by the construction of the MY Rapid Transit (MRT) and further work on the Light Rapid Transit (LRT) extension. Investment in the utilities sub-sector included the building of power plants, such as in Tanjung Bin and Janamanjung. The Federal Government's development expenditure in the economic sector was directed mainly to transportation, and trade and industry, particularly to upgrade infrastructure facilities in industrial areas.

EXTERNAL SECTOR

In 2013, Malaysia's external sector remained resilient amid a challenging global economic and financial environment. The current account surplus narrowed, but more than offset the net outflows in the financial account. The level of international reserves of Bank Negara Malaysia remained high and was more than sufficient to meet short-term external obligations and to provide a buffer against external shocks.

Developments in the external sector in 2013 were broadly characterised by two distinct periods. In the first half of the year, the current account recorded a smaller surplus of RM11.2 billion (1H 2012: RM24.8 billion), on account of a

smaller trade surplus amid lower services and income deficits. The continued economic weakness in the advanced countries resulted in a marked decline in Malaysia's exports (1H 2013: -4%). Demand for E&E products remained weak (1H 2013: -3.9%), as exports of personal computers (PC) and electrical products were weighed down by a delay in the global IT replacement cycle. Lower-than-expected growth in regional economies also affected demand for non-E&E manufactured products (1H 2013: 3.4%) such as iron and steel, optical and scientific equipment, wood and rubber products. In addition, the lower prices of Malaysia's key commodities in the first half of the year also dampened the export performance. On the other hand, robust domestic investment and consumption activities continued to drive the growth of imports (1H 2013: 4.4%). The services and income deficits narrowed due mainly to higher net travel receipts and lower net primary income payments. The increase in net travel receipts was attributed to stronger intra-regional tourism, while higher profits of Malaysian companies investing abroad, particularly in the financial services sub-sector, contributed to the decrease in net primary income payments.

The external sector remained resilient amid a challenging global economic environment

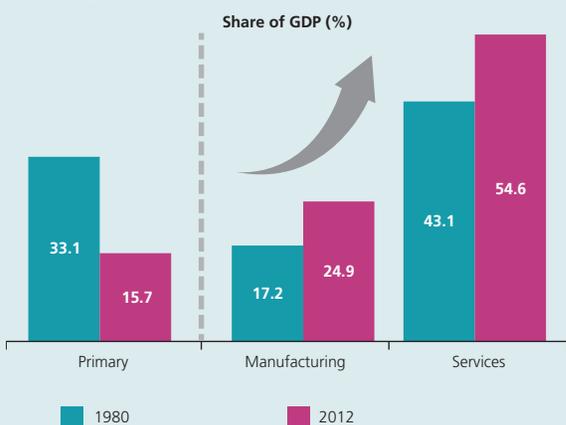
In the second half of the year, the current account surplus widened to RM26.1 billion as export growth returned to positive territory. The improvement in Malaysia's exports (2H 2013: 8.9%) was due to an increase in demand across both manufactured products and commodities. This was further reinforced by more favourable prices of CPO and LNG relative to the first half of 2013. Exports to the EU and the region were higher, in tandem with the improvement in economic activity in these economies. Imports grew at a stronger pace (2H 2013: 9.5%) as firm domestic demand contributed to imports of capital and consumption goods. In particular, sustained investment activity in the domestic-oriented sectors led to higher imports of telecommunication and construction services. The expansion in trade activity also resulted in higher payments for freight services. Net payments for other services components were sustained as the improvement in receipts offset the higher payments.

Further Diversification of Malaysia's Resource-based Industries

The heavy reliance on primary commodities in the earlier years posed considerable challenges to the Malaysian economy, particularly in terms of its vulnerability to swings in commodity prices. In 1980, primary commodities accounted for 33% of GDP and 77% of exports. Beginning in the early 1980s, Malaysia embarked on an economic diversification strategy with the objective of advancing into higher value-added activities, as well as reducing the over-concentration in upstream commodities, namely tin ore and rubber. With the inception of the National Industrial Policy and Industrial Master Plan in the mid-1980s, the Government implemented a series of policy measures to aggressively promote the manufacturing sector, and subsequently the services sector in the 1990s. This resulted in a rapid pace of horizontal diversification of the economy, with robust growth in the manufacturing and services sectors, and a significant reduction in the reliance on the primary sector (Chart 1). Of equal importance, the Malaysian economy also diversified vertically by moving up the commodities value chain from upstream to downstream activities (Chart 2).

Chart 1

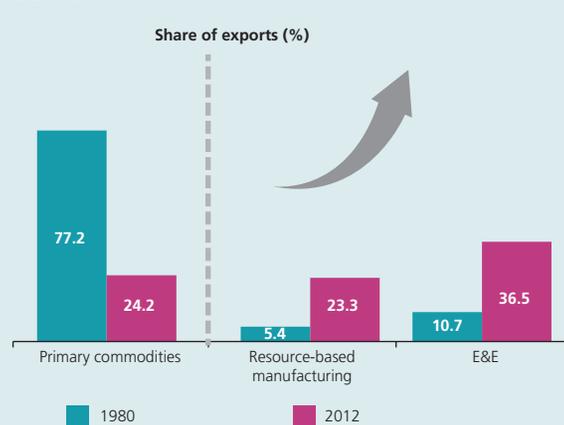
Horizontal Diversification Towards Other Sources of Growth



Source: Economic Planning Unit and Department of Statistics, Malaysia

Chart 2

Vertical Diversification Towards Higher Value-added Products



Source: Department of Statistics, Malaysia

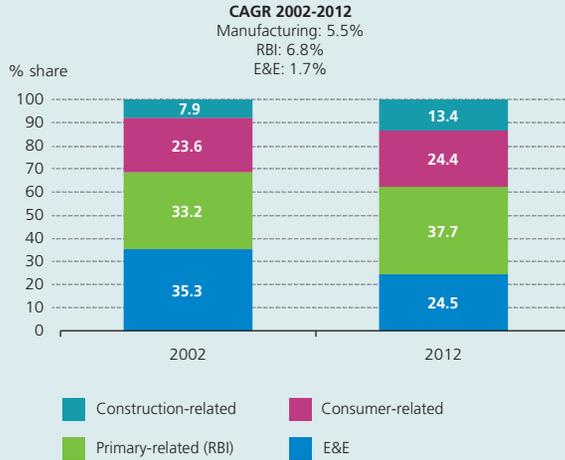
Resource-based industries have been the biggest growth driver of manufacturing sector over the past decade (2002-2012), encompassing mainly the manufacture of petrochemicals, oleochemicals, refined petroleum, palm oil, rubber gloves, tyres and prophylactics products. Rising commodity prices during this period subsequently led to higher prices of most products in the resource-based industries, providing further impetus to the growth of the sector. During this period, value-added of the resource-based industries increased by 6.8% on compounded annual growth rate (CAGR) basis, outpacing the growth of the electronics and electrical (E&E) subsector of 1.7%, thus becoming the largest manufacturing subsector from 2005 onwards (Chart 3). Resource-based industries contributed substantially to Malaysia's exports, growing by 12.4% on CAGR basis during the same period, resulting in the exports of resource-based products accounting for 32% of total manufactured exports in 2012 as compared with 17% in 2002¹ (Chart 4). Diversification into resource-based industries ensured that the share of manufactured exports to total exports remained high at 70-75%, even as primary exports rose in value during the period.

The First Industrial Master Plan launched in 1986 was particularly instrumental in driving the 'multi-sector agglomeration' development strategy for the manufacturing sector. It accelerated the diversification of

¹ The substantially high growth in the exports of resource-based industries during this period was also attributable to the higher commodity prices post 2002.

Chart 3

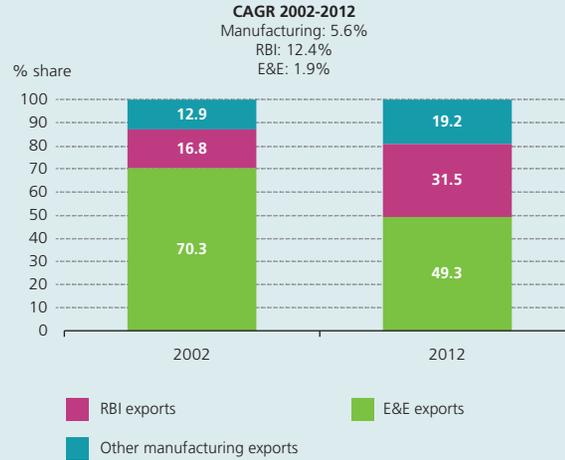
Manufacturing GDP Growth and Share of Key Components



Source: Department of Statistics, Malaysia

Chart 4

Manufactured Exports and Share of Key Components



Source: Department of Statistics, Malaysia

the domestic economy via the creation of wider range of manufacturing activities in the country, thereby reducing the over-concentration on primary commodities. The benefits of economic diversification can be seen from the increasing degree of intensity of economic activity across various interconnected industries over the years. Based on the Input-Output Tables² of the Malaysian economy, in 1960, the intensity level of economic activity was very low and mainly concentrated in few major industries. The intensity level increased through time and, by 2005, had risen significantly and became more diverse across most industries in the economy, underlining the extent of diversification.

The positive impact of vertical diversification in the resource-based industries has been very evident. First, it has facilitated the deepening of the forward and backward linkages in the economy, ensuring close interdependence and interconnectedness between upstream and downstream production³. Of significance, as the downstream production activities had intensified, higher value-added output was generated within the domestic economy. Second, the increased diversification has led to higher profits for firms, sustained increases in wages, and higher tax revenue for the Government. Third, the growth of the resource-based industries has led to an increase in productivity from the diversion of the underemployed or surplus labour force in the upstream agriculture sector to the manufacturing sector. This is seen in the share of employment in the agriculture sector, which fell from 31% in the 1980-1990 period to 15% in the 2000-2010 period. This was accompanied by the rising share of employment in the manufacturing sector from 16% to 20%. Finally, the diversification has been crucial in moderating the influence of commodity price volatility on the economy. Empirically, firm-level evidence indicates that commodity-based companies that have a larger share of downstream production generally have more positive and stable profits as compared to companies with a larger share of upstream activities.

The degree of vertical diversification, however, varies across the subsectors of resource-based industries. In the oil and gas industry, the strong institutional support provided by PETRONAS in championing investment in the downstream activities was a major enabling factor in the diversification process. Profit

² The Input-Output Tables provide a comprehensive aggregation of all production in the economy, tracking everything from sources of inputs to intermediate and final uses of products. The Malaysian Input-Output Tables are published by the Department of Statistics, Malaysia on a five-year basis, with the latest data available at base year 2005.

³ This is in line with the 'path dependency' theory where it is almost impossible for a country to shift entirely from a traditional sector into the high-technology manufacturing and services sectors without a gradual transformation period (Felipe et al., 2013).

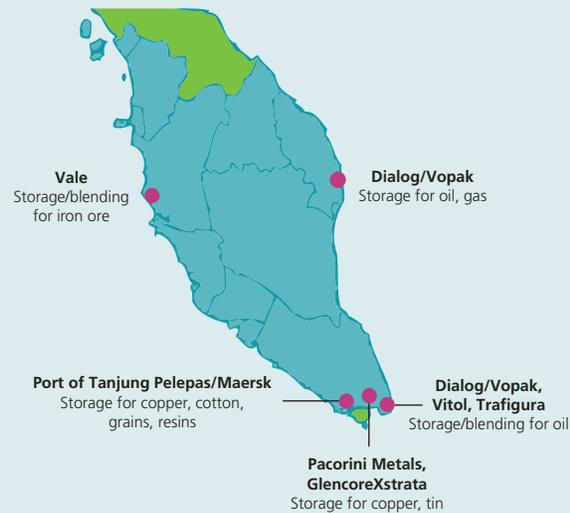
margins and fiscal factors were also crucial in encouraging PETRONAS to diversify. The low crude oil and natural gas prices in the 1980s and 1990s, coupled with the higher petroleum income tax rate of 38% imposed on upstream oil and gas production, enabled higher post-tax profits from various downstream manufacturing activities. The types of oil products produced in Malaysia have evolved from basic upstream output such as petrol, diesel and basic petrochemicals into lubricants, specialty jet fuel and advanced petrochemicals. At present, almost half of PETRONAS's revenue is derived from downstream activities.

The downstream diversification in the rubber industry is also noteworthy. Driven initially by small and medium enterprises (SMEs), the companies have evolved into public-listed entities valued at billions of ringgit, while becoming world leaders in the production of rubber gloves and prophylactics. Lower input costs from declining prices of natural rubber and the availability of low cost foreign labour spurred the development of the industry in the 1980s and 1990s. In contrast, there remains ample scope for greater downstream diversification in the palm oil industry. Among the factors that contributed to this are the higher margins at the upstream level, even when palm oil prices were at low levels. In addition, until March 2013, duty-free exemptions for exports of crude palm oil provided little incentive to move into higher value-added activities. In comparison, many of Malaysia's competitors in the industry have started venturing into various downstream activities, particularly in the production of oleochemicals and palm-based biodiesel.

The diversification strategy seen in the resource-based industries is now being pursued by the resource-based services (RBS) industry. Resource-based services are activities that provide support services to the commodities sector, such as enhancements to the oil and gas-related exploration and production activities, as well as the transshipment and warehousing of commodities. Resource-based services will enable Malaysia to complete the value chain in the commodities sector by moving further into higher value-added activities in the services sector. In relation to the oil and gas-related activities, Malaysia has experienced substantial growth of its homegrown oil service firms, most of which were developed under the Vendor Development Programme initiated by PETRONAS. For transshipment and warehousing activities, Malaysia's inherent advantages in terms of proximity to the Asia Pacific countries, high degree of competitiveness and compelling logistic solutions were key factors attracting

Chart 5

Malaysia is Becoming a Transshipment Hub for Commodities



Source: Various companies

many firms to set up their operations in Malaysia (Chart 5). Replicating the success of resource-based industries, the Government has taken the lead in promoting resource-based services. As an example, the Global Incentive for Trading (GIFT) programme was recently introduced to accelerate commodities trading in the country. The programme is targeted at attracting international trading companies to locate their regional operations, with the aim of establishing Malaysia as the key offshore trading hub in the region.

Going forward, resource-based industries and resource-based services are important sectors that can advance Malaysia's goal of becoming a high income nation by 2020. Even now, there is substantial evidence that Malaysia is already progressing in the right direction. Several manufacturers in the resource-based industries have already moved into producing higher value-added products, such as nitrile-based gloves for the healthcare industry. In terms of resource-based services, the rise in transshipment activities has been reflected in the sharp 44% year-on-year rise in re-exports in 2012 and a further 40% in 2013. This development will contribute towards further improving the country's fundamentals by creating higher value-added activities and by diversifying the sources of growth in the economy.

Reference

Felipe J., R. Briones, D.H. Brooks, A. Mehta and H. Verspagen (2013), 'Asia's Economic Transformation: Where to, How, and How Fast?'. Special chapter in Key Indicators for Asia and the Pacific 2013, Asian Development Bank (ADB).

Table 1.6

Balance of Payments¹

Item	2012			2013 ^p		
	+	-	Net	+	-	Net
	RM billion					
Goods	703.2	577.5	125.6	690.9	588.2	102.7
Services	117.0	131.0	-14.0	125.5	140.5	-15.0
Balance on goods and services	820.2	708.5	111.6	816.3	728.7	87.6
Primary Income	42.3	78.3	-36.0	47.5	82.6	-35.2
Secondary Income	6.8	25.1	-18.2	7.3	22.5	-15.2
Balance on current account	869.3	812.0	57.3	871.1	833.9	37.3
% of GNI			6.3			3.9
Capital account			0.2			-0.0
Financial account			-23.0			-15.0
Direct investment ²			-21.7			-4.1
Assets			-51.9			-40.6
Liabilities			30.2			36.5
Portfolio investment			58.4			-2.8
Assets			-21.5			-31.9
Liabilities			79.8			29.1
Financial derivatives			1.0			-0.1
Other investment			-60.6			-8.1
Balance on capital and financial accounts			-22.9			-15.1
Errors and omissions (E&O) ³			-30.6			-7.5
of which:						
Foreign exchange revaluation gain (+) or loss (-)			-7.7			18.6
Net E&O as % of total trade			-1.7			-1.9
Overall balance			3.9			14.6
Bank Negara Malaysia international reserves, net			427.2			441.9
USD billion equivalent			139.7			134.9

¹ The balance of payments is compiled in accordance with the Sixth Edition of Balance of Payments and International Investment Position Manual (BPM6) by the International Monetary Fund (IMF)

² Asset flows also referred to as 'Outward direct investment'; while liability flows are also referred to as 'Inward direct investment'

³ Includes unrealised foreign exchange revaluation gains/losses on international reserves

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

The current account surplus as reflected by the savings-investment (S-I) surplus has been narrowing in recent years due mainly to the stronger expansion in investment activity. This trend is expected to continue in the near-term as investment is expected to remain strong following the on-going transformation programme into a high-income economy. Total gross capital formation registered a stronger growth of 12.3% in nominal terms over the period 2012-2013 (2007-2011: 11%). At the same time, gross national savings was sustained following the strong growth in total

consumption (9.4%; 2007-2011: 10.1%). In 2013, the current account registered a smaller surplus of RM37.3 billion, or 3.9% of gross national income (2012: RM57.3 billion, 6.3% of GNI), reflecting the moderation in gross national savings to 31.2% of GNI (2012: 33.1% of GNI) amid a continued expansion in gross capital formation. The continued widening of the public sector S-I deficit contributed to the smaller savings-investment (S-I) surplus in 2013. Public sector savings declined by 48.7% to RM49.2 billion due to lower operating surplus of public enterprises amid continued positive growth in

Table 1.7

External Trade

	2012	2013 ^p
	Annual change (%)	
Gross exports	0.7	2.4
Manufactures	3.1	5.7
<i>Electronics and electrical (E&E)¹</i>	-1.7	2.9
<i>Non-E&E</i>	8.4	8.4
Commodities	-6.4	-5.6
<i>Agriculture</i>	-15.4	-17.0
<i>Minerals</i>	2.6	3.8
Gross imports	5.8	7.0
Capital goods	19.6	2.8
Intermediate goods	-3.4	4.3
Consumption goods	10.7	8.7

¹ Including machinery and equipment

^p Preliminary

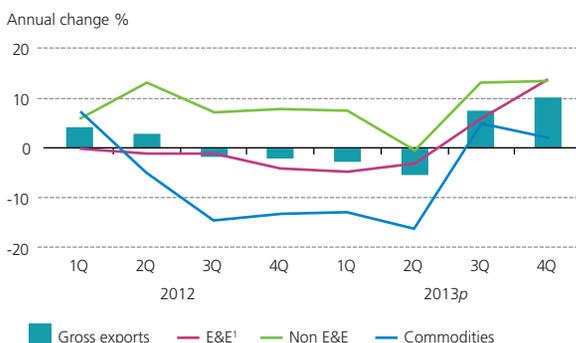
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

public gross capital formation (1.9%; 2012: 20.3%). On the other hand, private sector S-I surplus increased in 2013 as savings increased at a faster rate of 21.1% to RM247.1 billion (2012: -7.4%), while private gross capital formation expanded moderately by 10.3% (2012: 16.1%).

The financial account continued to experience sustained two-way flows involving cross-border financial transactions by both residents and non-residents. In the direct investment account, from an assets perspective, Malaysian companies continued to expand their international presence

Chart 1.3

Export Performance



¹ including machinery and equipment

^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.4

Import Performance



^p Preliminary

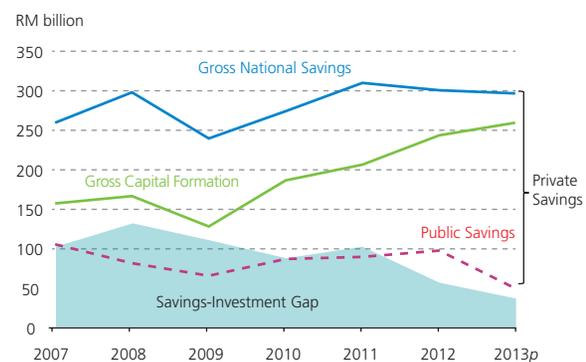
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

by undertaking direct investments abroad. From a liabilities perspective, Malaysia continued to attract direct investment from multinational companies (MNCs). The country's deep capital markets and relatively favourable growth prospects remained attractive to foreign portfolio investors as well. These flows, however, exhibited considerable volatility during the year. Thus, the financial account registered a net outflow of RM15 billion in 2013 (2012: net outflow of RM23 billion).

The economy's performance and growth prospects continued to support international investors' confidence, leading to significantly higher inward direct investment flows, amounting to RM36.5 billion, or 3.8% of GNI (2012: inflows of RM30.2 billion, or 3.3% of GNI). A major part of these flows were in the form of

Chart 1.5

Gross National Savings & Savings-Investment Gap



^p Preliminary

Source: Department of Statistics, Malaysia
Ministry of Finance

Classification of Direct Investment in BPM6

Beginning from the first quarter of 2013, Malaysia started to compile and disseminate the balance of payments (BOP) statistics based on the guidelines set forth in the Sixth Edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6).

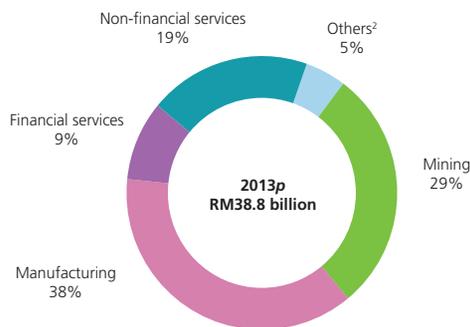
In the financial account, changes mainly affect the reporting format for direct investment, following the shift in reclassifying direct investment flows from directional basis to an asset-liability basis.

Accordingly, the term 'direct investment in Malaysia' (or foreign direct investment, FDI) is reclassified as direct investment liability flows or 'inward direct investment'. While the bulk of inward direct investment comprises FDI, it also includes intercompany loans to Malaysian companies extended by their subsidiaries abroad. This is a departure from the previous convention under BPM5, where these flows were registered under direct investment abroad (DIA). As a result of the change, inward direct investment now reflects the total incurrence of foreign liabilities by residents.

Likewise, 'direct investment abroad' is reclassified as direct investment asset flows, or 'outward direct investment'. While outward direct investments comprise mainly DIA flows, it also includes extensions of intercompany loans by FDI companies in Malaysia to their parent companies and affiliates abroad. Under BPM5, the extensions of intercompany loans by FDI companies would be recorded as FDI. As a result of the change, outward direct investment will now reflect the total acquisition of foreign assets by residents.

Chart 1.6

Net Foreign Direct Investment by Sectors¹



¹ Direct investment as defined according to the 5th Edition of the Balance of Payments Manual (BPM5) by the International Monetary Fund (IMF)

² Refers to agriculture and construction sectors

p Preliminary

Source: Department of Statistics, Malaysia

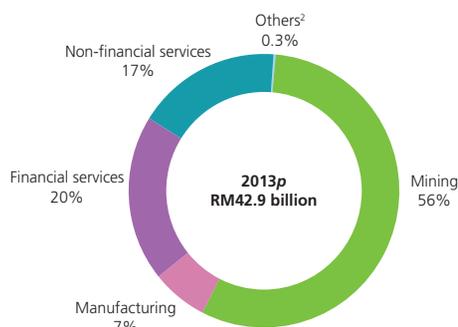
foreign direct investment (FDI), through greater injections of equity capital and intercompany loans, amid sustained levels of earnings retained for reinvestment during the year. FDI inflows were fairly broad-based across sectors. FDI into export-oriented sectors like manufacturing and selected services sub-sectors remained significant, despite the slowdown in export performance in the first half of the year. Foreign investment in

the mining sector increased, following steady implementation of ETP initiatives in the oil and gas sector. FDI in the financial services sub-sector was also sustained.

Outward direct investment moderated to RM40.6 billion or 4.3% of GNI in 2013, in tandem with the moderation in the growth outlook of regional economies (2012: outflow of RM51.9 billion or 5.7% of GNI). Outflows mainly reflected DIA flows, comprising larger outflows of equity capital and retained earnings, amid smaller extensions of intercompany loans. The share of DIA into the mining sector increased following the acquisition of a Norwegian firm by a domestic oil and gas company. DIA into the services sector also recorded strong performance, particularly in the financial services sub-sector, reflecting the increased regionalisation of Malaysia's domestic banks. Despite the moderation in outflows during the year, investments in these sectors were profitable, contributing to a larger accrual of direct investment income for domestic firms, and hence a smaller net income deficit in the current account.

Portfolio investment flows in 2013 were largely characterised by two distinct periods. In the first half of the year, broadly positive investor sentiments were supported by ample global liquidity and continued monetary accommodation

Chart 1.7

Net Direct Investment Abroad by Sectors¹

¹ Direct investment abroad as defined according to the 5th Edition of the Balance of Payments Manual (BPM5) by the International Monetary Fund (IMF)

² Refers to agriculture and construction sectors
p Preliminary

Source: Department of Statistics, Malaysia

in the advanced economies. As a result, in the first six months of the year, portfolio investment by non-residents registered a strong net inflow of RM23.9 billion, particularly into the equity market in the run-up and following the conclusion of the 13th General Election in early May, while foreign flows into the debt market remained significant. Foreign participation in the equity market trended up steadily while in the debt securities market, non-resident holdings of ringgit-denominated debt securities rose to 23.8% of total outstanding debt securities as at end-May (end-2012: 22.3%). Of these, non-resident holdings of Government securities were 32.4% of total outstanding Government securities (end-2012: 29.8%).

In the second half, non-resident portfolio inflows moderated to RM5.2 billion, following the Fed's indication of a possible scaling back of its asset purchase programme (or QE) in late May. The increased uncertainty in the financial markets surrounding the timing and magnitude of the QE scale-back led to heightened financial market volatility and resulted in a period of strong reversals of portfolio flows between May and August. These volatility and reversal of flows were broadly experienced by emerging market economies. Inflows resumed in September and October as expectations for the QE scale-back abated briefly following more clarification on policy direction by the Federal Open Market Committee (FOMC) in September. International investor sentiments, however, remained cautious towards the end of the year on renewed expectations of the eventual reduction of the

Fed's asset purchases. The QE scale-back was eventually announced to begin in January 2014 during the December FOMC meeting. Thus, for the year as a whole, non-resident portfolio investment recorded a smaller net inflow of RM29.1 billion (2012: net inflow of RM79.8 billion). During the year, domestic institutional investors undertook offshore investments amounting to net outflows of RM31.9 billion (2012: net outflow of RM21.5 billion). These outflows reflected resident investors' continued strategy of diversifying their portfolio investments abroad. For the year as a whole, total portfolio investments registered a small net outflow of RM2.8 billion (2012: net inflow of RM58.4 billion).

Although the gross volumes and volatility of portfolio flows were sizeable, the impact on financial markets and the economy was attenuated by several factors, namely the adjustments in the exchange rate, the depth of the financial markets and the role of domestic institutional investors. The role of domestic institutional investors in the capital markets was noteworthy as they provided a steady demand for domestic assets. Moreover, domestic institutional investors have exhibited their capacity for portfolio rebalancing while absorbing selling by non-residents. This was particularly evident in the bond market. As non-resident investors switched to debt papers of shorter tenures during the May-August period, domestic institutional investors simultaneously increased their purchases of Government securities and reduced their holdings of BNM bills, therefore limiting the volatility of the yields of these securities.

Chart 1.8

Portfolio Investment



p Preliminary

Source: Department of Statistics, Malaysia

Other investment recorded a smaller net outflow of RM8.1 billion for the year (2012: net outflow of RM60.6 billion), reflecting mainly continued extensions of trade credits amid banking inflows. During the year, Malaysian exporters facilitated trade activity in the challenging external environment by extending trade credits to their importing counterparts. These trade credit outflows were partially offset by inflows in the banking sector. In the first quarter, in times of foreign portfolio inflows and ample liquidity, the banking sector actively built an external asset position. This was subsequently unwound in the second and third quarter, in times of heightened financial market volatility. Additionally, the domestic banking sector also received larger placements of deposits by foreign financial institutions to manage their foreign exchange liquidity exposures.

The international reserves of Bank Negara Malaysia increased by RM14.6 billion to RM441.9 billion at end-2013 (end-2012: RM427.2 billion). The higher reserves reflected the continued current account surplus, which offset the net capital outflows from the financial account. It has also taken into account the cumulative unrealised foreign exchange revaluation gains following the depreciation of the ringgit against some major and regional currencies. As at 28 February 2014, the reserves level amounted to RM427.6 billion (equivalent to USD130.6 billion), which is sufficient to finance 9 months of retained imports and is 3.3 times the short-term external debt.

Manageable external debt levels

Malaysia's external debt amounted to RM318.1 billion (USD95.8 billion) as at end-2013 (2012: RM252.8 billion), equivalent to 33.5% of GNI (2012: 27.9% of GNI). Higher medium- and long-term external debt during the year mainly reflected the net drawdown of external borrowing by the public enterprises and the non-bank private sector. The Federal Government, on the other hand, continued to register net repayment of external debt. The higher short-term external debt was largely the outcome of the net drawdown of interbank borrowing mainly for the management of foreign exchange liquidity position. The appreciation of some major and regional currencies against the ringgit during the year also contributed to the higher external debt in ringgit terms.

Table 1.8

Outstanding External Debt				
	2012	2013 ^p	2012	2013 ^p
	RM billion	RM billion	USD billion	USD billion
Total debt	252.8	318.1	81.7	95.8
Medium- and long-term	159.8	190.0	51.7	57.2
Short-term ¹	93.0	128.1	30.1	38.6
<i>As % of total debt</i>	36.8	40.3		
<i>As % of net international reserves</i>	21.8	29.0		
As % of GNI				
Total debt	27.9	33.5		
Medium- and long-term debt	17.7	20.0		
As % of exports of goods and services				
Total debt	30.8	39.0		
Medium- and long-term debt	19.5	23.3		
Debt service ratio (%)²	10.1	10.3		

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

² Includes prepayment of medium- and long-term debt

^p Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Overall, Malaysia's external debt remained manageable. The external debt profile continued to be skewed towards a longer maturity structure, with medium- and long-term debt accounting for 59.7% of total external debt. The debt service ratio remained low at 10.3% of exports of goods and services. Moreover, about two-thirds of non-bank 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, and with more flexible terms. The external debt of the banking system was outweighed by their external assets and represents only a small proportion of the overall liabilities of the banking system.

Resilience against external shocks

As a highly open economy and in view of increasing integration with the global economy and financial markets, the experience of 2013 again showed that Malaysia is not insulated from the risks emanating from the external environment. The country, however, is well positioned to weather such external shocks. Domestic fundamentals remain sound, enabling

Broadening Economic Surveillance through Bank Negara Malaysia's Regional Offices

Economic surveillance by the Bank has in the recent years been strengthened by broadening the surveillance to the regional level through the Bank's Regional Offices. Regional economic surveillance entails the gathering and synthesising of quantitative and qualitative information on current economic and financial conditions at the regional level. The approach involves direct engagement with various economic agents in the different regions of the country. The regional surveillance complements the macro-level assessment of the economy by providing a perspective on the extent to which the regional conditions differ from, or reflect, the national outlook. It also provides information about how economic and financial conditions vary across regions and industries.

Strengthening economic analysis through regional economic surveillance

The geographic concentration of economic activity in Malaysia has become wider and more dispersed over the years. This trend has been further accentuated by the acceleration of growth in the regional economic corridors. Thus, surveillance undertaken at the regional level allows for a closer and deeper monitoring of the pulse of economic activity and emerging trends (refer to fact box on 'Re-export Activity Providing Growing Support to Malaysia's Trade' in Chapter 4). Direct and frequent engagements with businesses, industry associations, consumer groups and lead agencies provide a rich source of information for timely analysis of economic and financial conditions. Often, key insights are obtained well ahead of the release of macro-level statistics, giving a greater lead time for analysis and policy response. Direct engagements with the relevant stakeholders also provide an opportunity for the Bank to communicate and obtain their feedback on policy issues.

Experience of policymakers in other economies

Central banks around the world have expanded their surveillance framework to include regional economic surveillance, through a network of regional offices (Chart 1). The Bank of England's twelve regional offices (known as Agencies) are tasked to assess and provide lead assessments on economic conditions to the Monetary Policy Committee. Similarly, the Reserve Bank of Australia, through its four state offices, extensively monitors and analyses regional economic developments throughout Australia. In the ASEAN region, central banks such as the Bank of Thailand periodically report on domestic economic and monetary conditions from a regional perspective. The importance of expanding surveillance has also been recognised by multilateral agencies such as the International Monetary Fund, particularly when such surveillance incorporates a more active engagement with stakeholders to help promote an effective and timely policy response to emerging policy challenges and risks¹.

Chart 1

Selected Central Banks with Regional Economic Surveillance



Source: Central Bank websites

Note: The branches and regional offices excludes overseas representative offices

¹ Source: International Monetary Fund (2012), 'The IMF's Financial Surveillance Strategy'.

Expanding the role of BNM's Regional Offices

Prior to 2009, direct engagements with companies were conducted on a periodic basis, and supplemented by quarterly and annual surveys of businesses. Since 2009, the Bank has adopted a more systematic approach with wider coverage of companies in terms of economic activity and size. The engagements were designed to gauge real-time business conditions and projections on key variables such as revenue, production, sales, prices, investments and labour market conditions. In 2011, the Bank undertook a major initiative in expanding the role of the Bank's branches in Pulau Pinang and Johor towards becoming Regional Offices (ROs) with the objective of strengthening the Bank's outreach and presence at the regional level². The two ROs monitor the developments in the northern and southern regions of Peninsular Malaysia, which together account for about 28% of Malaysia's GDP in 2012³. This wide outreach is reflected in the increase in the total number of engagements conducted in the northern, central and southern region over the last three years (Chart 2).

Chart 2

Total Number of Engagements from 2011 to 2013



Source: Bank Negara Malaysia

The value of economic surveillance at the regional level can be assessed through its important role in complementing the Bank's overall surveillance. For example, when Thailand was struck by heavy floods in July 2011, surveillance by the ROs revealed a temporary relocation of production from Thailand to Malaysia, which subsequently resulted in a higher production of electronic and electrical (E&E) products, and food and beverages in Malaysia. This information provided an early assessment on the growth in the manufacturing sector in the second half of 2011, much earlier than the release of the official statistics. In 2013, engagements by the ROs deepened the Bank's understanding on the impact of the minimum wage implementation on inflation and growth. Furthermore, the role also enhanced the assessment on financing conditions across the various industries in the region. In recent months, the engagements have enabled better inferences on businesses' behaviour in reaction to policy measures such as the subsidy rationalisation and macroprudential measures targeting the property sector.

A key challenge in broadening the surveillance is in building trust and maintaining credible relationships with the private sector and relevant agencies. The Bank practises a strict confidentiality policy to preserve the sensitivity of the information disclosed by stakeholders. Discerning the value of information received from businesses is also a challenge. This requires striking a balance between synthesising information that merely represents firm-specific experience with other information, which best reflects the overall industry conditions.

The way forward

The expanded role of the ROs reflects the importance of broadening and deepening the surveillance process to complement the macroeconomic surveillance of the Bank. Moving forward, the planned expansion of the Bank's branches in Kuching and Kota Kinabalu to become ROs in 2014, is expected to further strengthen the Bank's overall macroeconomic and financial surveillance.

² In addition to the previous role of the branches in ensuring efficient cash management, the role of the ROs were expanded to include consumer financial redress and advisory services, undertaking economic and financial surveillance and driving greater financial inclusion agenda.

³ Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates.

strong defence against potential vulnerabilities arising from the external front. Well-developed capital markets, strong financial intermediaries, and the presence of large domestic institutional investors provide the financial system with greater resilience. The wide range of monetary instruments, high level of international reserves and manageable level of external debt accorded policy flexibility to absorb external shocks.

INFLATION DEVELOPMENTS

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), remained modest at 2.1% in 2013 (2012: 1.6%). The annual inflation rate averaged at the lower end of the Bank's earlier forecast of 2%-3%. During the first eight months of the year, the average inflation rate was low at 1.7%, rising from 1.3% in January to 1.9% in August. The average inflation rate for the remaining four months of 2013, however, increased to 2.9%, following the upward adjustments made to administered prices. Core inflation², an indicator of demand-driven price pressures, moderated to 1.8% in 2013 (2012: 2.1%).

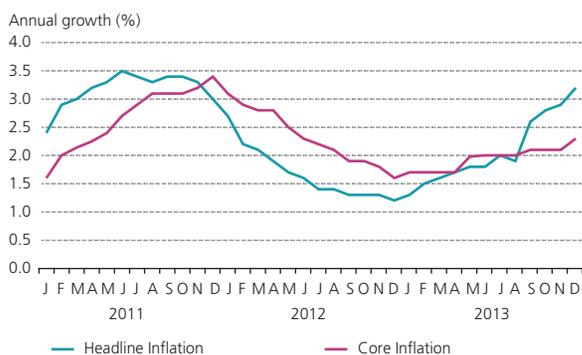
In terms of components, the main contributors to inflation were *food and non-alcoholic beverages*;

transport; and *housing, water, electricity, gas and other fuel*. These three categories together accounted for 87% of the overall increase in consumer prices during the year. Inflation in the *food and non-alcoholic beverages* category rose to 3.6% (2012: 2.7%), due to higher prices in the *fish and seafood, meat, and vegetables* sub-categories. Inflation in the *housing, water, electricity, gas and other fuels* category averaged 1.7% (2012: 1.6%), reflecting higher rental for housing, particularly for apartments and condominiums, and properties in urban areas. Inflation in the *transport* category more than doubled to 2.0% (2012: 0.7%), stemming from higher prices of fuel. Higher inflation during the year was, however, partially mitigated by continued price declines in the *communication and clothing and footwear* categories (-0.7% and -0.6% respectively). On the whole, only four categories of consumer goods and services registered higher inflation rates. Six categories recorded lower inflation, while two remained stable.

In terms of determinants, inflation during the year was driven mainly by domestic cost and supply factors. Higher cost of poultry feed in the early part of 2013 and disruptions in domestic food supply due to adverse weather conditions, such as floods in the east coast of Peninsular Malaysia, were the main factors that led to higher food inflation. Towards the end of the year, the upward adjustments made to prices of several administered items also

Chart 1.9

Consumer Price Inflation

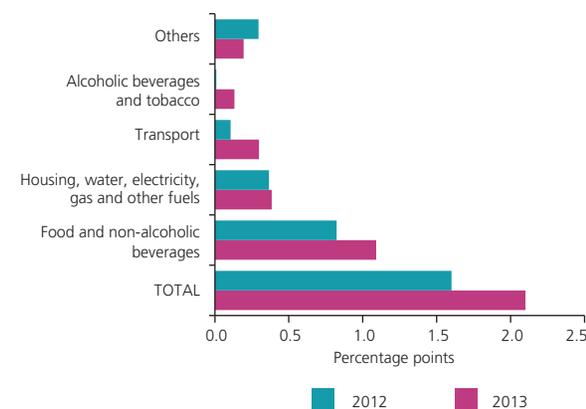


Source: Department of Statistics, Malaysia and Bank Negara Malaysia

² Core inflation is a measure of the underlying inflation rate, after excluding volatile and price-administered items, whose price movements are not likely to be related to changes in demand conditions. However, as it is not possible to distinctively separate demand-related and supply-related inflation, prices of goods and services in the core CPI basket are likely to also reflect transitory changes in cost and supply factors, such as improvements in supply conditions, supply disruptions and price adjustments.

Chart 1.10

Contribution to Inflation



Note: Others refers to *communication; clothing and footwear; health; recreation services and culture; furnishings, household equipment and routine household maintenance; restaurants and hotels; education; and miscellaneous goods and services*

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 1.9

Adjustments to Administered Prices in 2013

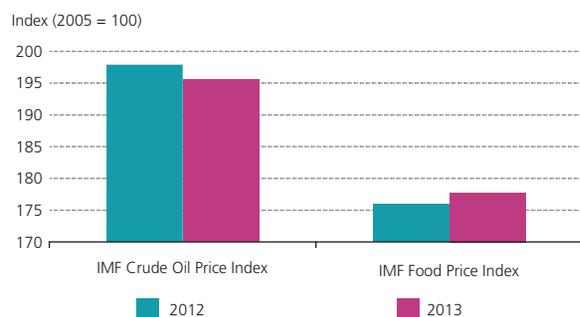
Date	Items	Quantum of adjustment	
		RM	%
15 January	Kesas toll	-20 sen	-9.1
3 June	Cigarettes	+30 sen/pack of 20s	2.9
3 September	RON 95 petrol Diesel	+20 sen/litre +20 sen/litre	10.5 11.1
30 September	Cigarettes	+RM1.50/pack of 20s	14.3
26 October	Sugar	+34 sen/kg	13.6

contributed to higher inflation in the *transport; food and non-alcoholic beverages; and alcoholic beverages and tobacco* categories.

On the external front, global commodity prices for the year moderated as the supply of commodities improved amid a modest increase in global demand. Global oil prices were lower during the year due to higher supply of crude oil from the United States and stable production from OPEC member countries. Although annual global food prices averaged slightly higher compared to 2012, prices declined sharply during the second half of 2013 due to better harvest, particularly from a higher acreage of crops and improved weather conditions in the United States

Chart 1.11

Global Crude Oil and Food Prices



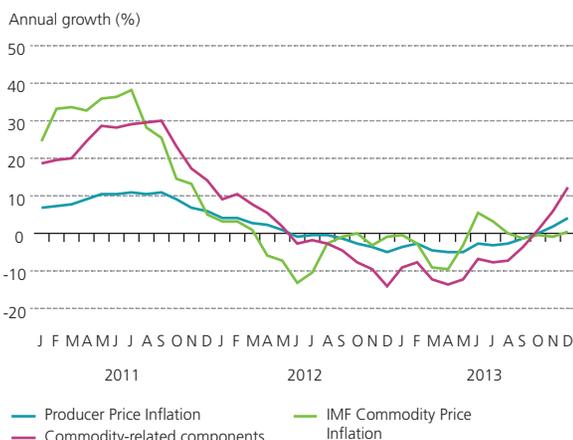
Note:

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)

Chart 1.12

Producer Price Inflation and IMF Commodity Price Inflation



- 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

and Europe. In addition, inflation in Malaysia's main import partners' economies was also lower, reflecting the decline in global commodity prices and their modest domestic demand conditions.

Amid the moderate external price pressures, producer prices, as measured by the Producer Price Index (PPI), declined by 1.9% in 2013 (2012: 0.1%). The decline in producer price inflation helped to ease cost pressures for firms and restrained the extent of knock-on effects from adjustments in administered prices to prices of other goods and services. The impact of the fuel price adjustments on the cost of production was also contained. Based on the survey by the Bank, transportation cost constitutes a relatively small share of the total operating cost of firms³. In addition, findings from the survey suggested that most firms were more inclined to adopt productivity enhancing measures and absorb the increase in costs rather than raising retail prices of goods and services. Evidently, the knock-on effect was limited. After the fuel price adjustments in September, non-administered prices⁴ increased

³ Based on the Bank's quarterly survey, transportation cost only accounts for 1.6 – 4.8% of total operating cost for firms producing consumer products and services.

⁴ Refers to CPI excluding items in which prices are administered by the Government such as RON95 petrol, diesel, electricity and cigarettes.

by only an average of 0.2% during the last four months of 2013, with close to 78% of the CPI items registering an inflation rate of 3% and below.

Despite the strong growth in private consumption and sustained wage growth during the year, demand-driven price pressures remained moderate with core inflation rising gradually from 1.6% in

January to 2.3% in December 2013. During the year, there was adequate productive capacity in the economy to help contain demand pressures. This was reflected in real GDP remaining at close to its potential in 2013, and the capacity utilisation rate in the manufacturing sector tapering to 79% (2012: 81%). In addition, the benign cost pressures have also helped to mitigate price pressures.

2013

MONETARY AND FINANCIAL CONDITIONS

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MONETARY AND FINANCIAL CONDITIONS

INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

Global financial markets in 2013 continued to face headwinds from policy uncertainties in the advanced economies. The financial markets of both the advanced and emerging economies experienced markedly different trends prior to and after 22 May 2013, which coincided with the Federal Reserve's (Fed) first indication of a possible scale-back of its asset purchase programme.

Global financial markets continued to be weighed down by policy uncertainties in the advanced economies in an environment of a modest and uneven global recovery

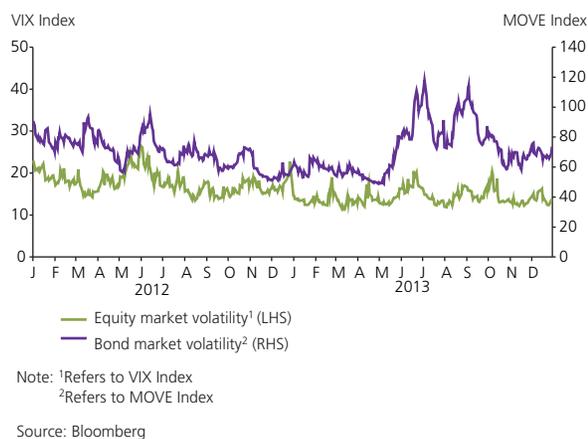
Global financial markets were relatively stable at the start of 2013 against the backdrop of ample global liquidity and a prolonged period of low interest rates in the advanced economies. Despite ongoing uncertainties, especially on fiscal concerns in both the euro-area and the US, international investor sentiments were broadly positive during this period. These positive sentiments mainly reflected the gradual improvement of economic conditions in most of the advanced economies. As a result, net capital inflows of about USD62.5 billion¹ were estimated to have entered emerging economies between January and April. During the period, regional equity markets increased by between 1.7% and 21.2%, while changes in the regional 5-year government bond yields ranged between a decline of 99 basis points and an increase of 12 basis points.

Global financial market volatility, however, increased significantly in May following heightened uncertainties over monetary policy adjustments in the advanced economies. Amid an improved economic outlook, the Fed's statement

¹ Source: Emerging Market Portfolio Research (EPFR) Global

Chart 2.1

Global Financial Market Volatility



was interpreted by the market as a start of a possible scale-back of its asset purchase programme. The expectation of a reduction in purchases of long-term securities and the subsequent decline in bond prices in the US led to the sell-off in the US long-term bonds in favour of more liquid short term securities and equities. This, in turn, resulted in an immediate increase in the benchmark bond yields and prompted a rebalancing of portfolio investments globally. As a result, the impact spilled over into a broad range of asset classes, and contributed to a decline in asset prices and a depreciation of currencies. Emerging markets were particularly affected by the strong reversal of portfolio flows between May and August. The pace of portfolio outflows from emerging markets were further exacerbated by the adverse sentiments surrounding emerging economies' moderating growth outlook amid weaker commodity prices and policies by the authorities to lean against the risk of financial imbalances. In some countries, concerns over the current account and fiscal positions further spurred the portfolio outflows. In managing the sharp outflows, some countries pursued current account management measures, including imposing or increasing duties on certain imports, as well as limiting resident direct investments abroad. Between May and August, the MSCI Emerging Market Index declined by 10.6% and

Chart 2.2

MSCI Emerging Market Index



Source: Bloomberg

Chart 2.3

JP Morgan Emerging Markets Bond Index (EMBI) Spread



Source: Bloomberg

the JP Morgan Emerging Market Bond Index (EMBI) spread widened by 83.8 basis points as the emerging economies recorded net capital outflows of USD60.5 billion.

Financial market conditions stabilised somewhat towards the end of the year. In the advanced economies, the resolution to end the US government shutdown and the return of the euro-area to positive growth provided a positive boost to market sentiments. In the emerging economies, improving economic indicators, especially from the external sector, alleviated some of the earlier concerns regarding the fundamentals of these economies. Despite the announcement by the Federal Open Market Committee (FOMC) to reduce its monthly bond purchases on 18 December 2013, the impact on emerging economies has been relatively small compared to the period between May and August. As a result, measures of volatility, such as the Chicago Board Options Exchange Volatility index (VIX) and

Merrill Lynch Option Volatility Estimate (MOVE) Index, declined to levels seen earlier in the year, while the pace of capital outflows from emerging economies moderated to USD28.2 billion for the period September to December. The MSCI Emerging Market Index recovered by 7.8% and the JP Morgan EMBI spread narrowed by 47.9 basis points.

Periodic spikes in market volatility are likely to remain a common feature in the global financial landscape as the global economy transitions into an environment of less accommodative monetary conditions. For advanced economies, greater clarity and timely communications will be key to avoiding market over-reaction. Resolution of the ongoing concerns on fiscal sustainability will also be important. For emerging economies, the challenge is to ensure the adjustments from capital outflows are orderly and do not pose risks to the domestic economy and financial system. The improved financial market resilience and capacity to intermediate potential outflows suggest emerging economies are now better prepared to manage adverse spillover effects (see box article 'Spillovers of Quantitative Easing on Asia'). However, policy makers must remain vigilant in managing any perception of domestic vulnerabilities, which could unduly exacerbate the volatility in the financial markets.

DOMESTIC MONETARY AND FINANCIAL CONDITIONS

Exchange rate

The ringgit exchange rate was influenced mainly by two-way portfolio and trade flows, reflecting both international and domestic developments. The ringgit was relatively stable in the first four months of the year, trading within the range of RM3.0040 and RM3.1400 against the US dollar. The conclusion of the 13th General Election in Malaysia in early May contributed to the strengthening of the ringgit, with the ringgit reaching RM2.9600 on 6 May 2013 against the US dollar, the highest level since 2 August 2011.

During the year, most emerging market currencies, including the ringgit, were affected by developments relating to the possible scale-back in the asset purchase programme in the US. Market expectations for a reduction in the asset purchase programme by the Fed prompted a reversal of portfolio flows from

Spillovers of Quantitative Easing on Asia

Introduction

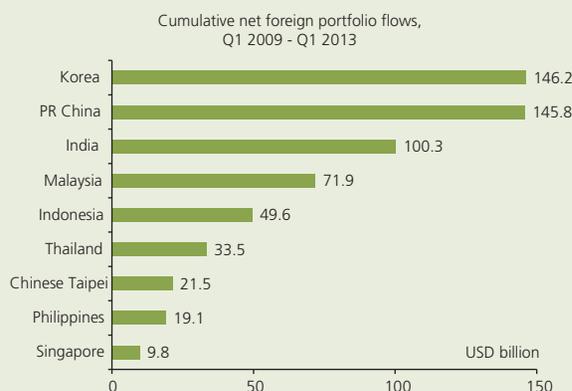
The Global Financial Crisis (GFC) triggered unprecedented policy interventions in the crisis-affected advanced economies. Major central banks reduced policy interest rates to close to zero and implemented unconventional monetary policies such as massive injections of liquidity through quantitative easing (QE). These measures have had a significant spillover impact on global economic and financial conditions. To some extent, these policies have contributed to stabilising financial conditions and supporting the recovery that is gaining momentum in these economies. While the avoidance of a more severe global economic recession has benefitted the emerging economies, there were unintended consequences from maintaining such policies for an extended period of time, particularly, large capital inflows into many emerging economies in search for higher yields. As economic recovery in the advanced economies becomes more entrenched, policymakers will eventually need to unwind these unprecedented injections of liquidity to achieve more normal monetary conditions. This transition, nevertheless, is likely to have an impact on the rest of the world through various channels and in varying degrees. This article explores the spillovers of QE on Asia and assesses the region's strengths and vulnerabilities in facing the challenges that will emerge from the reversal of the unconventional monetary policy measures by the advanced economies.

Impact of QE on Asia

The introduction of QE has led to a massive injection of liquidity into the financial systems of the advanced economies. The balance sheet of the Federal Reserve (Fed), for instance, grew by about four times between December 2006 and August 2013. The balance sheet of the Bank of England expanded by six times, while those of the European Central Bank and the Bank of Japan doubled. Cumulatively, global liquidity, as proxied by the GDP-weighted M2 of the US, euro area, Japan and the UK, increased from USD7.3 trillion in the third quarter of 2008 to about USD10 trillion in the first quarter of 2013. The massive build-up of liquidity and the search for yields caused large capital inflows into the emerging economies given their more favourable growth prospects and higher rates of return. Between 2009 and 2013, Asia received portfolio inflows amounting to USD597.7 billion, equivalent to 2.4% of its combined GDP¹ (Chart 1).

Chart 1

Impact of Quantitative Easing on Asia



Source: Haver and National Authorities

¹ Asia includes Chinese Taipei, India, Indonesia, Korea, Malaysia, Philippines, PR China, Singapore and Thailand.

This surge in capital inflows exerted significant upward pressure in the currency, equity and bond markets of these Asian economies (Chart 2). The decline in bond yields, in tandem with that of the advanced economies, contributed to a reduction in the domestic cost of financing. The lower interest rate environment and ample liquidity conditions may have contributed to the underpricing of risks, thereby encouraging excessive investments in risky assets and led to the build-up of financial imbalances. As a result, several Asian economies experienced high credit growth and rising property prices.

Chart 2

Impact of QE on Asian Currencies and Financial Markets



Source: Bloomberg and Bank Negara Malaysia

As the recovery in the advanced economies gains momentum, the unconventional policies and the highly accommodative monetary conditions will be gradually unwound. The transition, if not managed properly, could lead to sudden and sharp reversals of capital flows from the emerging economies, which would in turn trigger disruptions in the global financial markets and affect the pace of global recovery. This was evident in May 2013 following the initial indication of a potential QE scale-back. Uncertainty over the timing and magnitude of the QE scale-back, coupled with the rising expectations of narrowing interest rate differentials between the advanced and emerging economies, prompted investors to rebalance their portfolio position and rapidly unwind their investment positions in the emerging economies. Large capital outflows led to significant downward pressure on currencies and prices in equity and bond markets in the emerging economies between May and August 2013 (Chart 3). In some markets, the reversals caused excessive fluctuation in the bond and equity markets, and overshooting in the exchange rates.

In contrast, the Fed's announcement to begin reducing the pace of asset purchases in December 2013 initially had a more limited impact across economies, as investors had already built in the expectations of an eventual scale back in QE. The enhanced forward guidance in the December FOMC statement had realigned market expectations of the timing of the Fed's first rate hike to a later period. However, the December 2013 decision only marks the beginning of the policy transition in the US. Indications are that the path towards normalisation of monetary policy is expected to be gradual and would take place over a period of time, as well as being conditioned by the strength of the economic recovery. During this transition, the emerging economies will operate in a highly uncertain environment with frequent sharp increases in volatility in the financial markets as investors reassess and shift their positions. In the early part of 2014, volatility in the international financial markets has risen with several emerging economies being severely affected by massive capital outflows. It is also evident that there has been greater differentiation between emerging economies, as investors scrutinise the fundamentals of each country. The risk of contagion, nevertheless, still remains and is on the rise.

Chart 3

Impact of Potential Scaling-back of QE on Asian Currencies and Financial Markets



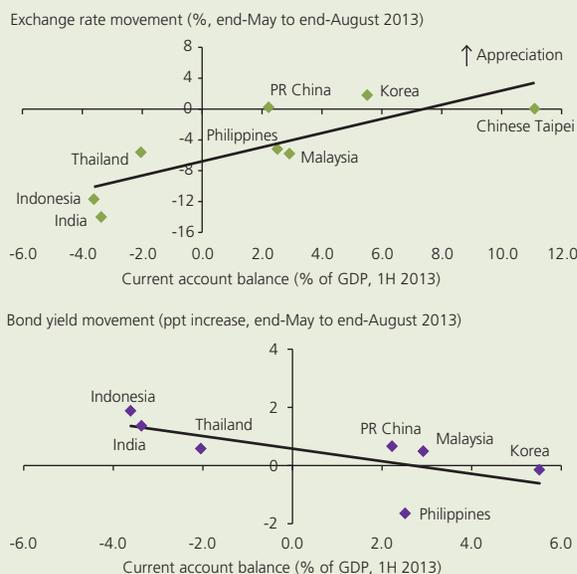
Source: Bloomberg and Bank Negara Malaysia

Asia's challenges and policy responses

While Asia is in a better position relative to the period prior to the Asian Financial Crisis (AFC), recent developments have highlighted the key challenges faced by the emerging economies in an environment of highly volatile capital flows. These include the sustainability of external positions, adequacy of policy space and the health of domestic balance sheets. In particular, countries that have twin deficits are judged to be more reliant on short-term funding and vulnerable to capital reversals (Chart 4). While the narrowing of the emerging economies' current account surplus post-GFC was initially welcomed as a sign of global rebalancing, it has subsequently been seen as increasing the likelihood of potential funding stress if the economies rely heavily on external short-term flows.

Chart 4

Exchange Rate and Bond Yield Movements versus Current Account Balances



Source: Bloomberg and Haver

Widening fiscal deficits and high public debt following large stimulus measures during the GFC raised concerns over the increase in debt servicing costs and the adequacy of fiscal space to embark on future counter-cyclical policies. Another concern is that rapid capital outflows could lead to sharp declines in asset prices with serious repercussions on household balance sheets.

The policy responses by Asian policymakers in addressing the challenges that have been highlighted can be segregated into two phases. Post-GFC, household balance sheet had been a core policy concern. Hence, policymakers in Asia have, since 2009, progressively implemented policies to tackle rising household indebtedness. In particular, countries such as Hong Kong SAR, Singapore and Malaysia have adopted pre-emptive measures including the implementation of macroprudential and demand management policies to address potential overheating in the property market and to slow the growth of credit. Beginning in 2013, the policy focus in several Asian countries has been extended to address the issue of twin deficits. These countries introduced a series of policies which included easing of export rules and improved management of foreign exchange liquidity to strengthen their external positions. In several economies, policy rates have been raised. Fiscal consolidation plans, including tax reforms and subsidy rationalisation, are also being used to restore the health of the government balance sheet. The credibility of these plans has been reinforced by the commitment of clear milestones for fiscal targets in the short and medium term.

Building greater resilience against external shocks

Beyond these immediate challenges, proactive efforts have been undertaken in the recent years to ensure that capital inflows and their subsequent reversal do not significantly disrupt the domestic financial system and economic activity. This has been complemented by structural reforms that have been steadily rolled out since the AFC to increase the resilience of economies, both at the national and regional level.

The strength in the emerging economies' growth in the five years after the GFC has been supported by more diversified sources of growth. In particular, Asia's domestic demand accounted for 86% of GDP in 2012 (1990: 81%). At the same time, regional economies have diversified their trade partners, with intra-regional trade accounting for close to 50% of total trade in 2012 (1990: 37%). Asia's resilience has also been enhanced by more flexible exchange rate regimes, as well as more developed and stronger financial sectors. Compared to the pre-AFC period, most Asian economies are now less reliant on short-term debt funding, have expanded the sources of funding for the economy and have higher level of foreign exchange reserves. In addition, the quality of foreign debt funding has also improved given the deeper and broader capital markets in many countries in the region. These have significantly improved the resilience of Asia in withstanding and responding to external shocks and safeguarding domestic financial and macroeconomic stability.

In addition, there is now greater regional financial integration and cooperation. Over the past decade, regional initiatives have been strengthened to provide a much stronger framework for cross-border financial assistance to improve the crisis readiness of the region. This includes the enhancement of multilateral liquidity support among the Asian economies, such as the Chiang Mai Initiative Multilateralisation (CMIM), which is complemented by economic surveillance conducted by the ASEAN+3 Macroeconomic Research Office (AMRO) and Monetary and Financial Stability Committee of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP). The recently enhanced Crisis Management and Resolution Framework among EMEAP member countries also serves as a mechanism for collective policy response, surveillance and information sharing. New financial arrangements to facilitate trade financing and settlement in domestic currencies, primarily through local currency swap arrangements between regional central banks have also added a degree of resilience as these have reduced the vulnerability of regional trade to global financial market volatility.

Conclusion

The implementation of unconventional monetary stimulus in the advanced economies was premised upon achieving domestic policy objectives but has had wide-ranging global spillovers. As the pace of economic recovery in the advanced economies gains momentum, the shift towards policy normalisation will eventually take place. This shift will have implications for global capital flows, in particular through the rebalancing of portfolio flows from the emerging economies back to the advanced economies. Against this backdrop, policymakers in Asia face the challenge of managing the impact of capital flow reversals on their domestic economic and financial conditions. Asia, as a whole, has exhibited greater resilience than in previous decades, reflecting in part, the dividends from the post-AFC reforms. In addition, a broader and enhanced policy toolkit will help manage the potential negative externalities that may arise. All these will not necessarily insulate the Asian economies from the spillover effects from policy normalisation in the advanced economies. However, pre-emptive response will enable Asia to alleviate some of these effects and maintain the resilience of the region.

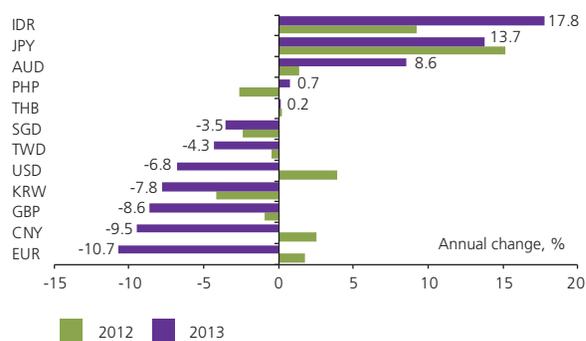
most regional financial markets, resulting in a depreciation of most regional currencies from May to August. Following a temporary period of currency strengthening, the depreciation trend resumed amid renewed expectations for such policy action from end-October and the eventual announcement at the end of the year of a reduction in the size of the Fed's asset purchase programme beginning January 2014.

Ringgit depreciated amid increased global financial market volatility

In the increasingly volatile market environment, more investors, corporates and resident companies proactively managed their currency exposure by using derivatives. The volume of ringgit forwards and swaps was higher during the May to August period compared to the first four months of the year. The volume of forward foreign exchange transactions, in particular, increased by 11.3%, contributed mainly by resident companies hedging their foreign currency exposure arising from international trade transactions. This increased demand for hedging, coupled with the high market volatility, resulted in an increase in the cost of borrowing in US dollars through the cross-currency USD/RM swap market. The 5-year USD/RM cross-currency swap rates widened from 84 basis points in May to 145 basis points in June. However, this subsequently declined to around 70 basis points by the end of the year as market volatility abated.

Chart 2.4

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

Chart 2.5

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

For the year as a whole, the ringgit depreciated by 6.8% to end the year at RM3.2815 against the US dollar. The ringgit also depreciated against the euro and pound sterling, but appreciated against the Japanese yen. Against regional currencies, the ringgit exhibited a mixed performance. The ringgit's Nominal Effective Exchange Rate (NEER), a measure of ringgit performance against the currencies of Malaysia's major trading partners, depreciated by 2.2%.

In the near term, intermittent spikes in currency volatility would remain a feature of the international financial markets. Sentiments will continue to be affected by uncertainty about the progress of the normalisation of financial conditions in the advanced economies and the resilience of some emerging economies. Nevertheless, as demonstrated throughout the year, the Malaysian economy and financial system have improved in their ability to withstand the spillovers from shocks in the external environment.

Interest rates, bond yields and equity prices

In balancing the risks surrounding the outlook for domestic growth and inflation, the Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.00% throughout 2013. Reflecting the unchanged OPR, money market rates remained broadly stable throughout the year. The daily weighted average overnight interbank rate (AOIR) traded close to the OPR, within a

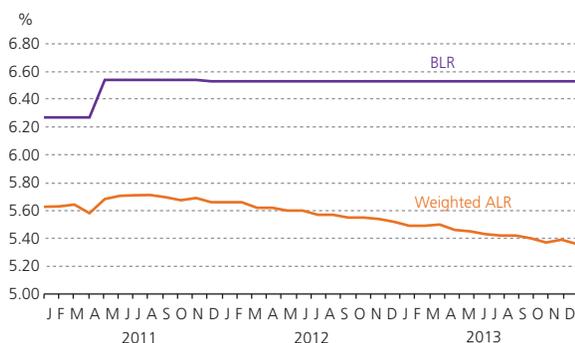
tight range of 2.88-3.00% over the period. Interbank rates for other short term tenures were also relatively stable. Movements in medium-term money market rates, however, were influenced by global financial market developments. Rates on interest rate swaps (IRS) increased towards the middle of the year as market expectations for a scale-back in the asset purchase programme by the Fed led to increases in financial market yields globally. Size and turnover of the ringgit IRS market continued to remain healthy, with the total outstanding notional contracts at RM595 billion and a turnover of RM269 billion in 2013. In terms of domestic interest rate expectations, market participants continued to expect BNM to leave the OPR unchanged, as reflected by the stable rates on the 6-month Kuala Lumpur Interbank Offered Rate (KLIBOR), during the year.

Interest rates remained stable and supportive of domestic economic activity

Retail lending rates were broadly stable throughout the period and unaffected by the increase in financial market volatility in the middle of the year. The benchmark lending rate, as measured by the average base lending rate (BLR), remained constant at 6.53%. Lending rates on new loans to businesses and households were generally stable across most sectors and purposes. The stable retail lending rates reflected the unadjusted monetary policy stance and the continued healthy credit profile of borrowers. The weighted average lending rate (ALR) on loans

Chart 2.7

Commercial Banks' Lending Rates (at end-period)



Source: Bank Negara Malaysia

outstanding continued on its gradual moderating trend which had started in 2011 (January 2013: 5.49%; December 2013: 5.36%). This reflected the maturing of loans that were contracted during the period of higher borrowing costs prior to the OPR reductions in 2008 and 2009, as well as the addition of new loans contracted at lower rates.

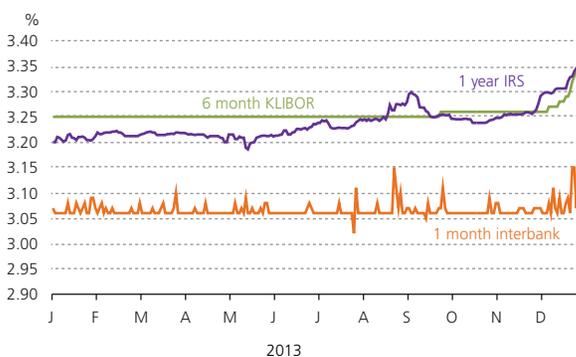
Deposit rates of commercial banks remained stable throughout the year. The average quoted fixed deposit (FD) rates for the tenures of 1 to 12 months were relatively unchanged, ranging between 2.91% and 3.15% respectively as at end-December 2013. Depositors continued to benefit from positive real rates of return, although real returns gradually moderated as inflation rose towards the end of the year.

Despite the volatile external environment, the spillover effects on MGS yields were relatively contained due to the support of domestic institutional investors

Yields on Malaysian Government Securities (MGS) were driven primarily by external factors, influenced by policy uncertainties in the advanced economies. As with other emerging markets, Malaysia has been experiencing sustained portfolio inflows since early 2009. The bulk of the portfolio inflows went into Government debt instruments, particularly the MGS. The pace of portfolio inflows accelerated

Chart 2.6

Money and Financial Market Rates



Source: Bank Negara Malaysia and Bloomberg

following the conclusion of the 13th General Election in May, causing downward pressure on yields. By mid-May, non-resident holdings of government debt instruments had increased to 32.4% (Dec 2012: 29.8%) as the share of non-resident holdings in MGS reached 49.8% (Dec 2012: 44.4%). MGS yields fell between 11 and 41 basis points across all maturities. Such a large exposure to non-residents holdings raised concerns about the potential vulnerability of the domestic financial system to a sudden and sharp withdrawal of non-residents' investment in the MGS market. To date, the risk remains manageable, underpinned by the strong domestic investor base comprising of financial institutions, insurance companies and provident funds. Given the growing demand from these investors for more investible assets in tandem with their growing liabilities, the unwinding of portfolio holdings by non-residents presented opportunities for domestic institutional investors to purchase these domestic assets at attractive yields. As these domestic participants stepped in to purchase these assets, the domestic financial market stabilised.

The support of domestic institutions in the MGS market was evident towards the end of May. The indication of a potential scale-back by the Fed of its asset purchase programme triggered a readjustment of expectations in the global financial markets towards the possibility of tighter global financial conditions. As a result, bond markets began to experience significant portfolio reversals that saw yields increasing across the region. The sizable portfolio outflows of RM19.0 billion from the MGS market between May and August caused MGS yields to increase

Chart 2.8

MGS Yields



Source: Bank Negara Malaysia

Chart 2.9

5-year Government Bond Yields



Source: Bank Negara Malaysia and Bloomberg

by between 16 and 68 basis points across the 1 to 10-year tenures. These increases were generally smaller compared to markets across the region. The depth and breadth of the domestic bond market had ensured that these volatile flows were intermediated without causing undue dislocation in the financial markets. In line with the efforts to deepen and diversify the domestic bond market, a RM2.5 billion 30-year MGS was also issued during the year. Despite the volatile environment, this inaugural long-term MGS issue attracted a bid-to-cover ratio of 2.44 times, reflecting investors' confidence on Malaysia's long-term economic prospects.

PDS yields remained attractive for fund-raising activities

During the year, the cost of private debt financing remained favourable, despite the uncertain external developments. Private debt securities (PDS) yields were stable, particularly during the first half of the year before registering an increase in the subsequent period. For the year, yields on the 5-year AAA, AA and A-rated papers registered a marginal increase of 15.4 basis points, 10.4 basis points and 3.7 basis points respectively. The stable PDS yields ensured that the fund-raising activity in the PDS market continued to support the economy. The liquidity and credit conditions in the PDS market also continued to remain healthy in 2013. Total turnover amounted to RM143.2 billion (2012: RM159.7 billion), while the number of negative rating actions during the year declined to 23 (2012: 25).

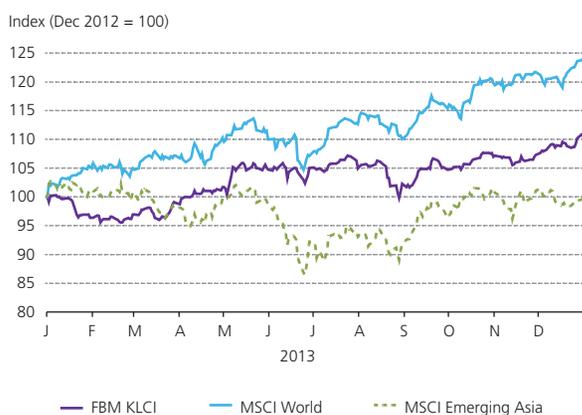
In 2013, the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) increased by 10.5% (2012: 10.3%) to close at 1,867.0 points. While sentiments in the market were affected by both domestic and external factors, the underlying performance of the equity market was supported by investors' confidence in the positive economic outlook for the Malaysian economy.

While the FBM KLCI was affected by external and domestic developments, investors' confidence remained anchored on the positive outlook for the economy

The domestic equity market entered the year amid cautious sentiments following the uncertainty on the timing of Malaysia's 13th General Election, which led to domestic investors reducing their holdings of equities. As the General Election concluded on 5 May, the FBM KLCI rose 3.4%, reaching a new high of 1,752.0 points on the first trading day post-election. The strong performance of the equity market was primarily driven by the construction and property sectors amid expectations of the continuation of projects under the Economic Transformation Programme (ETP). Subsequently, investor sentiments were affected by developments surrounding the possible scale-back of the

Chart 2.10

Equity Market Indices



Source: Bloomberg

Chart 2.11

Performance of Sectoral Indices



Source: Bloomberg

Fed's asset purchase programme, prompting non-resident investors to reduce their holdings of equities in emerging markets including Malaysia. The impact was, however, mitigated by positive sentiment with respect to the export sector due to the recovery in demand for electrical and electronics (E&E) exports and expectations of rising crude palm oil prices in the second half of the year. This kept the domestic equity market on an upward trend, which peaked at 1,872.5 points on 30 December 2013.

Liquidity and Monetary Aggregates

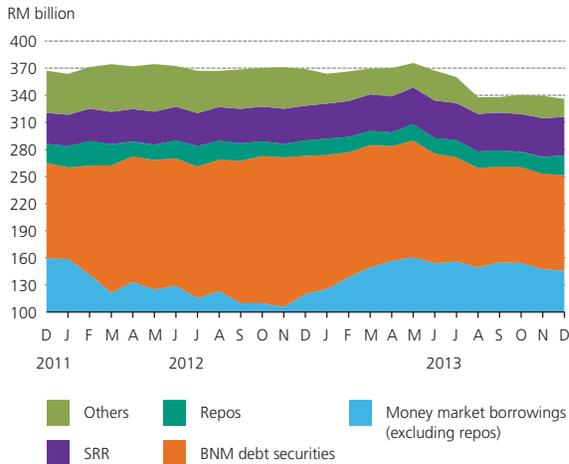
Liquidity conditions remained supportive of economic activity throughout 2013. Notwithstanding the net withdrawal of liquidity due to net foreign outflows during the year, overall surplus liquidity placed with Bank Negara Malaysia remained high with most banking institutions still operating within surplus liquidity positions.

Amid greater volatility in capital flows, the Bank's operations were focused on maintaining stable conditions in the interbank money market. During periods of outflows, the contractionary pressure on liquidity was offset by the net release of funds lent to the Bank. In this respect, the large placements by banks with Bank Negara Malaysia acted as a liquidity buffer for the banking system as a whole.

Private sector liquidity, as measured by broad money or M3, grew at a more moderate pace of 8.1% during the year (2012: 9.0%) due to both domestic and external factors. On the domestic front, M3 rose more gradually due to the slower

Chart 2.12

Outstanding Liquidity Placed with Bank Negara Malaysia (at end period)



Source: Bank Negara Malaysia

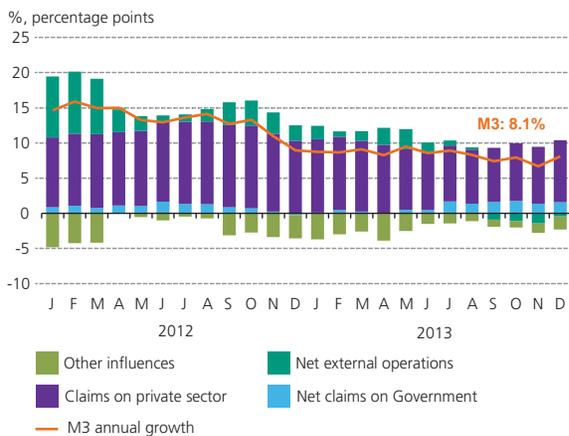
increase in bank lending to businesses and households. On the external front, M3 growth moderated due to outflows on both trade and financial accounts.

FINANCING OF THE ECONOMY

Financing continued to remain supportive of domestic economic activity in 2013. For the year as a whole, net financing to the private sector through the banking system and private debt securities (PDS) market expanded at an annual rate of 9.8% (2012: 12.4%).

Chart 2.13

Contribution to M3 Growth



Source: Bank Negara Malaysia

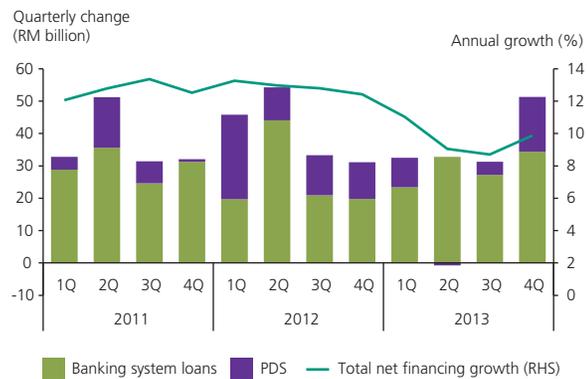
The moderation in the growth of net financing extended to businesses through the banking system and the PDS market (2013: 8.0%; 2012: 14.5%) partly reflected a normalisation from the relatively high level in 2012. The strong increase in 2012 was due to loans disbursed to businesses involved in projects under the Economic Transformation Programme (ETP) and the commodity-related sectors. Notwithstanding the moderation in outstanding loans growth, the overall demand for gross financing by businesses was sustained following continued strength in private consumption and investment activity. The level of loan disbursements to businesses, including SMEs was sustained (monthly average in 2013: RM55 billion; 2012: RM54.8 billion) with the bulk of the loans extended to the *wholesale and retail, restaurants and hotels; construction, agriculture and real estate* sectors.

While growth in net financing moderated, the level of loans disbursed and funds raised in the capital market remained favourable

Business demand for funding from the capital market in 2013 also remained healthy by historical standards, despite the absence of large scale issuances for ETP-related infrastructure projects and government divestment initiatives as seen in 2012. New PDS issuances amounted to RM83.9 billion

Chart 2.14

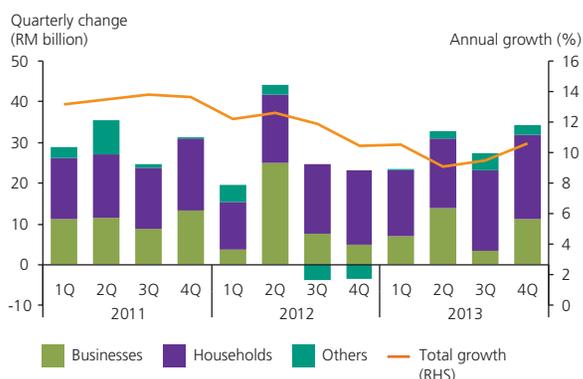
Total Net Financing to the Private Sector through Banking System Loans and PDS Issuances



Source: Bank Negara Malaysia

Chart 2.15

Loans Outstanding by Borrowers



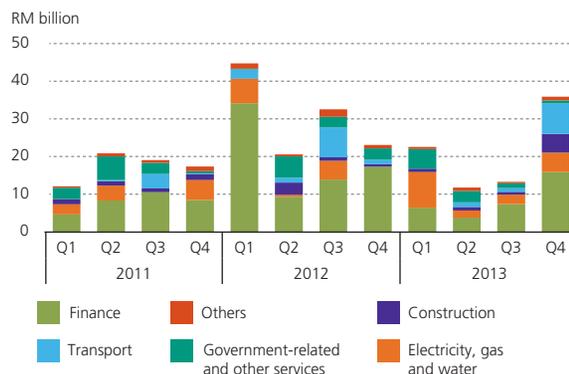
Source: Bank Negara Malaysia

in 2013 (2012: RM121.1 billion; average 2010-2012: RM80.9 billion)². The bulk of the issuances was from the *finance, insurance, real estate and business services* and *electricity, gas and water* sectors. Financing via the equity market amounted to RM16 billion (2012: RM27.4 billion), mainly by the *trading and services* sector.

Demand for loans by households was also sustained, with the growth in outstanding banking system loans to the sector remaining relatively stable at 12% in 2013 (2012: 11.6%). This was supported

Chart 2.16

Gross PDS Issued by Sector



Source: Bank Negara Malaysia

by favourable employment conditions and wage growth. Of note, the growth rate of outstanding loans for *personal use* moderated to 4.6% in 2013 (2012: 9.1%), partly as a result of the pre-emptive measures by the Bank in July 2013 to prevent excessive household indebtedness and to reinforce responsible lending practices. The overall growth of household loans, however, was relatively stable due to higher growth rates of loans for the *purchase of securities* and *credit card facilities*, and sustained growth in loans for the *purchase of properties*.

² PDS issuances in 2012 was exceptionally high at RM121.1 billion due to a RM30.6 billion single issuance by Projek Lebuhraya Usahasama Berhad

2013

MONETARY POLICY IN 2013

55 Monetary Policy
57 Monetary Operations

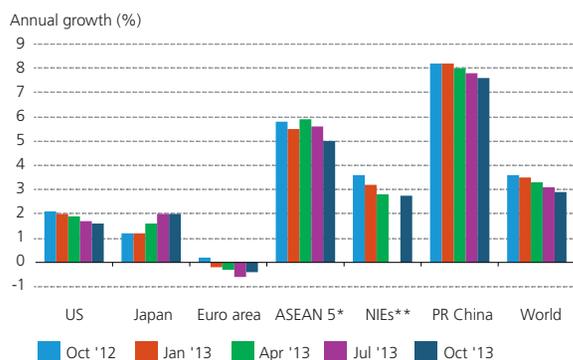
MONETARY POLICY

In 2013, against a backdrop of increased uncertainties on the balance of risks surrounding the outlook for domestic growth and inflation, the Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.00%.

At the beginning of 2013, the Malaysian economy was projected to remain on a steady growth trajectory, with GDP growth expected to be in the range of 5%-6%. Domestic demand was to be the key driver of growth, with expectations for a gradual improvement in global growth. Private consumption was expected to remain supported by income growth and stable employment conditions. Investment activity would be sustained, led by capital spending in the domestic-oriented industries, the oil and gas sector and the ongoing implementation of infrastructure projects. Nevertheless, it was recognised that there were downside risks to the growth outlook, emanating mainly from the external environment. Constrained growth in the advanced economies arising from their fiscal consolidation efforts and weak labour market conditions could adversely affect the external sector of the Malaysian economy.

Chart 3.1

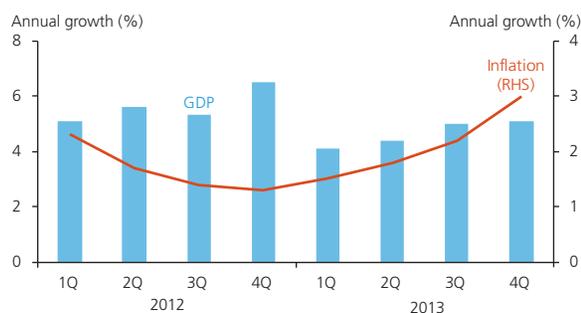
Outlook for Real GDP Growth in 2013



*Indonesia, Malaysia, Philippines, Thailand and Vietnam
 **Newly Industrialised Asian Economies. July 2013 data for NIEs are not published.
 Source: IMF, WEO October 2012, January, April, July and October 2013;
 Bank Negara Malaysia calculations

Chart 3.2

GDP and Inflation



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Inflation, as measured by the Consumer Price Index (CPI), was forecasted to be at 2%-3% in 2013, compared to the 1.6% outturn in 2012. The projected higher inflation was based on the expected higher domestic food prices arising from elevated global prices for key food commodities, higher costs arising from the implementation of the minimum wage policy and the possibility of adjustments to administered prices. However, demand pressures were not expected to be a significant factor behind price increases given the adequate productive capacity within the economy to generate new supply. Inflation risks were nevertheless on the upside as higher global commodity prices, a faster pace of subsidy rationalisation or stronger-than-projected demand pressures could all cause inflation to exceed the forecasted range.

The MPC had assessed the risks to domestic growth and inflation as being broadly in balance. Domestic growth was expected to be resilient but faced significant downside risks emanating from the external environment. Inflation risks were tilted to the upside. Given this uncertainty regarding the balance of risks to the growth and inflation outlook, the MPC viewed that a change in the OPR was not warranted. The MPC also considered the merits of using the OPR to manage the formation of financial imbalances. Keeping an interest rate environment that is too low for too long risked financial imbalances forming, which

could pose medium-term risks to macroeconomic and financial stability. The MPC decided that the level of the OPR was appropriate, and given that the risks of financial imbalances were confined to certain segments of the economy, other tools would be better suited to address these risks. Consequently, macroprudential measures were introduced in July to manage the risks of financial imbalances in a targeted manner (see Financial Stability and Payment Systems Report 2013).

By the middle of the year, however, the dynamics of both domestic growth and inflation had changed, and these increased the uncertainties surrounding the balance of risks. The release of the first quarter GDP growth data for the advanced economies showed that growth turned out to be below earlier expectations, weighed down by policy uncertainties. As a result, the growth forecasts for 2013 and 2014 for several advanced economies were revised downwards. Similar weaknesses were observed in the first quarter GDP growth data for several Asian economies which were mainly attributable to spillovers from prolonged weaknesses in external demand. In PR China, growth moderated more than initial expectations as the government showed firm commitment towards economic rebalancing. Consequently, the growth forecasts for several Asian economies were also revised downwards, factoring in the slower growth momentum in the advanced economies and PR China.

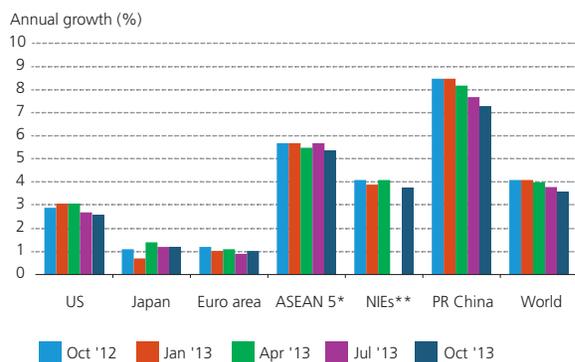
For the domestic economy, the growth of 4.3% in the first half of the year was lower than earlier

estimated. Net export growth was weak as export growth was affected by the prolonged slow growth in the US and weak economic activity in most of the European economies. Import growth expanded further following sustained growth in domestic investment and consumption. Consequently, the GDP forecast for the year was revised downwards in August to 4.5%-5.0%. While the annual growth was revised downwards given the slower expansion in economic activity in the first half of the year, the growth momentum was expected to improve in the second half of the year and into 2014. This was in line with the expectations for an improvement in global trade amid a recovery in the growth momentum of the advanced economies from the second half of 2013. However, uncertainty with regard to the domestic growth outlook for 2014 remained, especially on the strength of the global recovery. There was also uncertainty over the extent to which domestic factors such as the continued fiscal consolidation, rationalisation of subsidies and targeted measures to reduce the risks from vulnerabilities in the household sector, would affect domestic demand.

Inflation was expected to be within the lower end of the forecast range, as the key drivers of inflation identified at the beginning of the year did not materialise to the extent expected. Changes to administered prices had not occurred, while the projections for global food prices were revised downwards in line with the observed increase in global production. The extended deadline for the implementation of the minimum wage policy further eased pressure on costs. From September onwards, however, the inflation dynamics shifted and inflation was expected to increase for the remainder of the year and into 2014. This change was driven primarily by the upward adjustments in the prices of retail petroleum products and sugar in September and October, respectively; higher excise duties on tobacco products in the later part of the year; and the announced adjustment to electricity tariffs effective January 2014. A key risk the MPC had to consider was whether these price adjustments had the potential to set off a more sustained increase in prices across the economy. The subdued external price pressures and moderate domestic demand conditions were key mitigating factors to the prospect of broad-based price increases. The risks of second-round effects to inflation were also assessed to be limited, as the increase in inflation expectations remained confined to the prices of food and transportation.

Chart 3.3

Outlook for Real GDP Growth in 2014



*Indonesia, Malaysia, Philippines, Thailand and Vietnam
 **Newly Industrialised Asian Economies. July 2013 data for NIEs are not published.
 Source: IMF, WEO October 2012, January, April, July and October 2013;
 Bank Negara Malaysia calculations

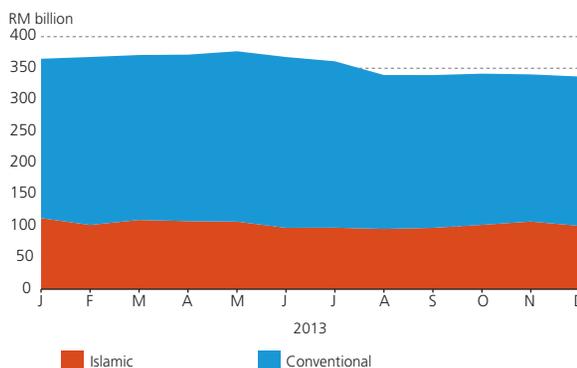
Wage pressures were moderate, with wage growth expected to be in line with the historical average. After careful consideration of these factors, the MPC assessed the risks of generalised price inflation to be limited.

Based on its assessment of the possible downside risks to growth and upside risks to inflation, the MPC viewed that holding the OPR steady would provide the best outcome for the intended monetary policy objectives. The level of interest rates was regarded as supportive to the economy. Given the reasons behind the increase in inflation and its sustainability, a monetary response was not considered as necessary.

A key development in the second half of the year was the capital flow reversal from the emerging economies due to the anticipated scale-back in the asset purchase programme of the Federal Reserve (Fed). Despite the increase in the size and volatility of capital outflows since May 2013, adjustments in the domestic currency and financial markets were orderly. The managed float exchange rate system accorded flexibility for the ringgit exchange rate to facilitate adjustments. The depth of the financial system also ensured that these volatile flows were intermediated without causing undue disruptions to economic activity. The growing demand from domestic institutional investors provided underlying support to the bond market and contained the increase in borrowing costs that

Chart 3.5

Outstanding Liquidity Placed with Bank Negara Malaysia (Conventional-Islamic)



Source: Bank Negara Malaysia

were benchmarked off bond yields. There were consequently minimal spillovers to the real economy.

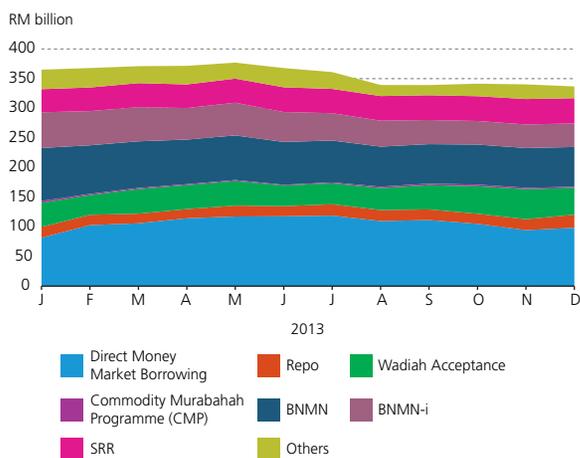
MONETARY OPERATIONS

Liquidity in the banking system remained stable throughout 2013, despite heightened volatility in global markets and larger swings in capital flows following the growing uncertainties surrounding the scale-back in the asset purchase programme by the Fed. Ringgit money market conditions were stable and continued to operate under a surplus liquidity environment, with participants placing their net surplus liquidity with the Bank throughout the year. Aggregate surplus liquidity for the year rose from RM370.8 billion as at end-2012 to a high of RM376.9 billion in May 2013, before declining to RM336.8 billion at the end of the year, consistent with the trend of capital flows.

During the year, total interbank money market transactions, which comprised deposits, banker’s acceptance (BA), and negotiable instrument of deposits (NID) in both the conventional and Islamic money markets, recorded a volume of RM3.1 trillion, lower by 11.2% compared to 2012. Conventional deposits, which were unsecured borrowing and lending, became the main instrument of trading as it took up 71.8% of the total volume. However, this trading of deposits was lower in 2013 and amounted to RM2.2 trillion compared to RM2.6 trillion in 2012. The lower trading volumes for 2013 were due to the lower volumes from the month of June onwards

Chart 3.4

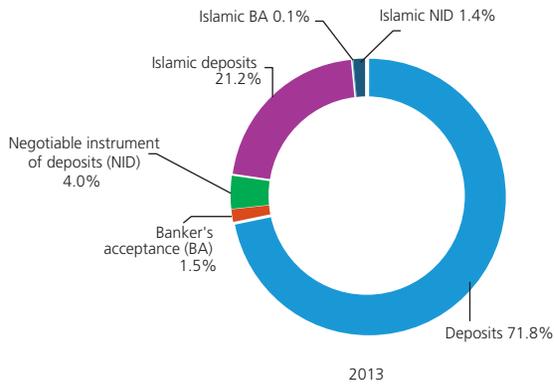
Outstanding Liquidity Placed with Bank Negara Malaysia



Source: Bank Negara Malaysia

Chart 3.6

Breakdown of Interbank Money Market Transactions

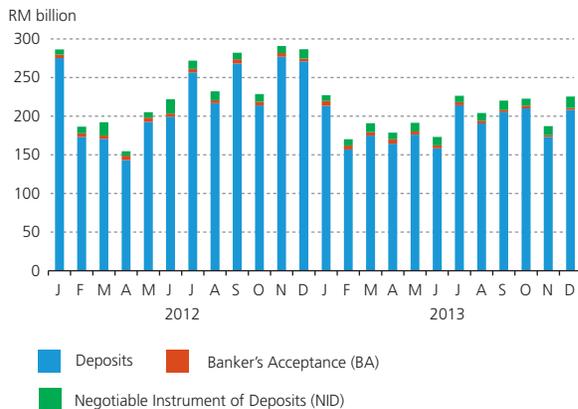


Source: Bank Negara Malaysia

to the end of the year when compared to the same period the previous year. This coincided with the reduction in overall liquidity in the system following the outflows arising from uncertainties in global financial markets over the Fed's asset purchase programme. Banks exercised caution in managing their surplus liquidity, and were more measured in interbank lending to preserve liquidity as a precaution to address any potential outflows. Despite this, expectations for domestic interest rates were well anchored, with no changes expected for the OPR. The average overnight interbank rate (AOIR), which tracked the OPR closely, ranged between 2.88% and 3.00%, with an average deviation (AOIR minus OPR) of 1 basis point. Interbank rates across all tenures traded within fairly narrow ranges, and transactions were concentrated in maturities of up to 1 month.

Chart 3.7

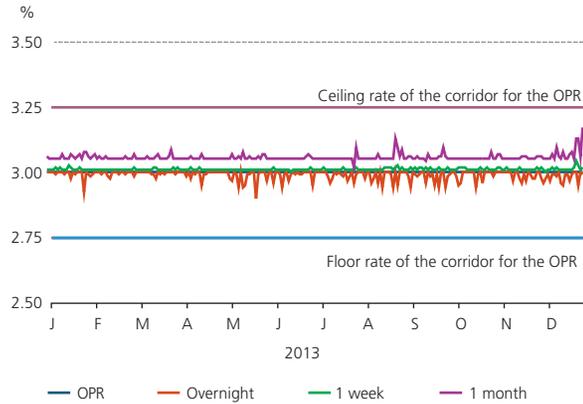
Conventional Interbank Money Market Transactions



Source: Bank Negara Malaysia

Chart 3.8

OPR and Interbank Rates

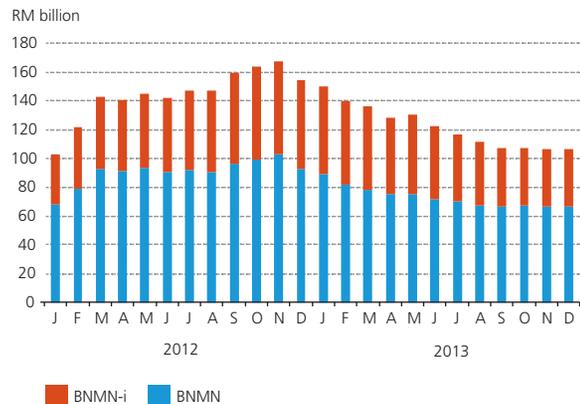


Source: Bank Negara Malaysia

As ringgit money market liquidity and trading adjusted to the outflows which were taking place across the emerging economies from May to August, the Bank shifted the profile of monetary operations in favour of shorter-term instruments. Instead of the typical weekly operations, the Range Maturity Auction (RMA) was used more frequently over the period to provide more flexibility to financial institutions in managing their excess liquidity. In 2013, short-term borrowings, which comprised of conventional money market borrowings, Wadiah Acceptance and Commodity Murabahah Programme, increased from 32% in 2012 to 43% of total monetary operations. At the same time, the use of securities-based transactions had gradually declined, partly reflecting reduced demand for securities during the period of outflows.

Chart 3.9

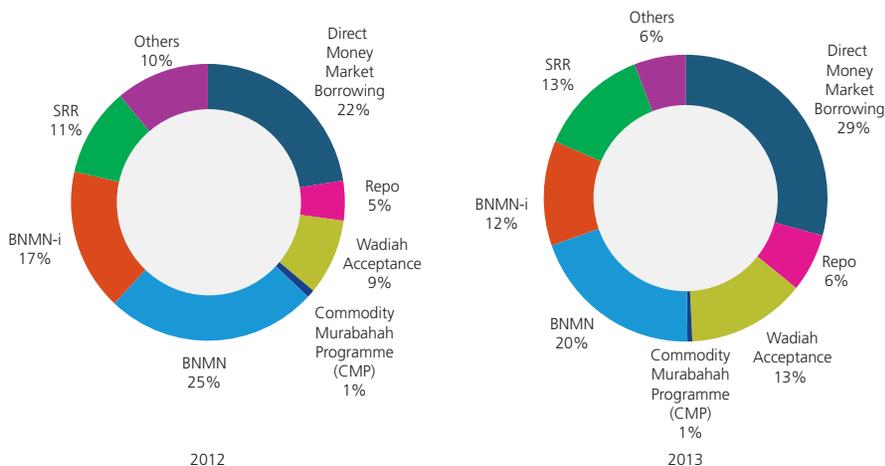
Outstanding Amount of BNMNs



Source: Bank Negara Malaysia

Chart 3.10

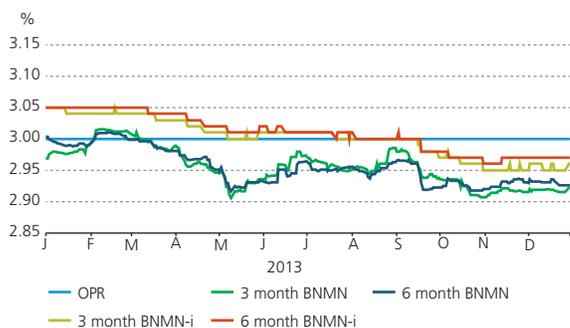
Breakdown of Outstanding Monetary Policy Instruments



Source: Bank Negara Malaysia

Chart 3.11

BNMN Yields and OPR



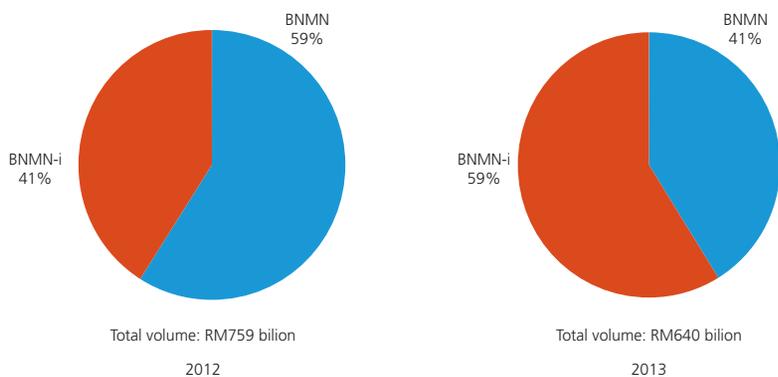
Source: Bank Negara Malaysia

The average duration for overall borrowing declined to 45.3 days in 2013 from 56.1 days in 2012.

The fluctuations in liquidity in the banking system led to the active management of the issuances of Bank Negara Monetary Notes (BNMNs). The Bank began reducing issuances of BNMNs from the first quarter of the year, having observed declining demand from non-resident investors. This strategy continued throughout the year following the global market volatility and outflows. As a result, total outstanding BNMNs declined from RM154.3 billion in early January 2013 to RM106.7 billion at the end of the year. Yields remained stable and averaged 6 basis points

Chart 3.12

Trading of Conventional and Islamic BNMNs



Source: Bank Negara Malaysia

below the OPR in 2013. This was despite higher yields observed from early February to March during a transition period after the Bank prescribed the use of onshore USD/MYR fixing for all domestic foreign exchange orders executed at the 11.00 am fixing. As for the trading of BNMNs, comprising conventional and Islamic BNMNs, the total volume amounted to RM640.0 billion in 2013, a decline of 15.7% compared to 2012. However, the share of Islamic BNMNs traded increased from 41% to 59%. The total trading of Islamic BNMNs increased by 21.0% to RM377.6 billion, catering to the demands of both conventional and Islamic investors for these securities and reflecting the growing acceptance of Islamic instruments by global investors.

The Bank continued with a number of initiatives to strengthen regional cooperation and facilitate

more effective liquidity management by financial institutions in the domestic and regional markets. In 2013, the Bank established a cross-border collateral arrangement (CBCA) with the People's Bank of China, the third CBCA established after arrangements with the Monetary Authority of Singapore and Bank of Thailand in previous years. With this latest arrangement, financial institutions in Malaysia can now pledge Chinese government and central bank securities with the Bank to obtain ringgit liquidity. For the Islamic money market, the Bank introduced Islamic Range Maturity Auction (iRMA), an auction similar to the conventional RMA launched in 2011, to increase the operational efficiency of Islamic monetary operations. The iRMA provides flexibility for Islamic banks to choose the maturity tenure of placements with the Bank in the form of Wadiah Acceptance or Commodity Murabahah Programme.

2013

OUTLOOK AND POLICY IN 2014

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THE INTERNATIONAL ECONOMIC OUTLOOK

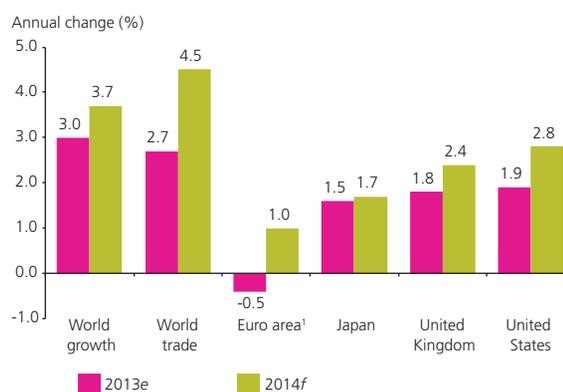
The gradual improvement in the global economy experienced in 2013 is expected to continue in 2014. Global growth will be supported by a broader economic recovery in the advanced economies and sustained growth in the emerging economies. Continued improvements in the advanced economies will have positive spillovers on the rest of the world, in particular on economies with extensive trade linkages. Nevertheless, the pace of recovery is expected to remain moderate, with global economic activity expanding below the average growth rate observed over 2000-2007.

Global growth to improve in 2014, supported by a broader economic recovery in the advanced economies and sustained growth in the emerging economies

A contributing factor underlying this trend is the remaining structural issues in the advanced economies, in particular the high structural unemployment and weak financing activity amid ongoing fiscal consolidation and deleveraging activity. In this environment, emerging economies are transitioning towards a more moderate pace of growth due in part to the policy stance that has been adopted to address domestic risks such as strong credit growth and rising property prices. The emerging economies also face the challenge of managing external risks. In particular, the policy normalisation in the major advanced economies will have spillovers on the international financial markets given the significant inter-linkages in the international financial system. The primary concern is on the pace and magnitude of capital flow reversals and the risks of contagion for the small open economies, and the attendant impact of these developments on the momentum of the global recovery.

Chart 4.1

World Growth, World Trade and Growth in Major Advanced Economies (2013-2014)



¹ Refers to EU-17
 e Estimate
 f Forecast
 Source: International Monetary Fund and National Authorities

The **US** economic recovery is expected to be sustained by continued improvement in the private sector, and further supported by lower fiscal constraints. The pace of fiscal consolidation is anticipated to slow in the near term, as the recent US budget agreement has increased the discretionary government spending limits and removed the risk of a government shutdown over the next two years. This is expected to lead to improved sentiments, with positive spillovers on the private sector. Of significance, capital spending could gain momentum, supported by rising business confidence and more accommodative lending conditions. The average age of equipment and software is also at a record high, indicating that the long-overdue replacement cycle could materialise this year. Similarly, investment in the housing market is expected to improve, driven by higher demand and low inventory. On the housing sector, increasing prices will further reduce the number of the so-called underwater mortgages¹, contributing to better household balance sheets and increase households' labour mobility.

¹ Underwater mortgages refers to mortgages of homeowners that have come to exceed the value of their homes as a result of the significant decline in house prices during the 2007-2009 recession

The recovery of household wealth through higher equity and real estate values has already translated into improving consumer confidence, and lifting consumer spending. Private consumption will also be supported by improvements in the labour market and lower debt. After four years of deleveraging from about 122% of disposable income in the first quarter of 2009, household debt has declined to 100.3% in the fourth quarter of 2013, below the 2000-2005 average of 100.7%. Notwithstanding these positive trends, the strength of the recovery will be weighed down by post-crisis structural weaknesses. The labour market continues to experience declining labour participation rates and elevated long-term unemployment levels. High income inequality and subdued wage growth will also weigh on the pace of expansion.

In the **euro area**, while the gradual improvement in economic activity is expected to continue, the pace of recovery is likely to be subdued and uneven across the region. The strength of domestic demand, particularly in the crisis-affected economies, remains suppressed by weak labour market conditions, financial fragmentation and the ongoing adjustments in private and public sector balance sheets. While the unemployment rate is stabilising, the rate remains elevated at historical highs, with significant divergences across countries, ranging from 5.3% in Germany to more than 25% in Greece and Spain. Nevertheless, government consumption is expected to register a smaller contraction amid a slower pace of fiscal consolidation. The euro area external sector is, however, gaining further momentum in line with the improving global economic environment. Amid a still-fragile growth outlook, policy decisions to undertake further structural and financial sector reforms, including deregulation of the labour markets, reduction of public debt and the creation of a banking union, will continue to be critical elements in promoting confidence and supporting a sustained economic recovery.

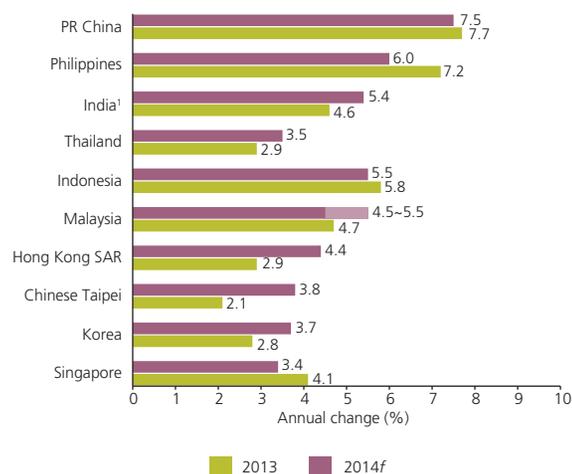
Economic activity in **Japan** is expected to be underpinned by the continuation of the stimulative policies of 2013, thus sustaining positive sentiments in the economy. The introduction of the ¥18.6 trillion fiscal stimulus package in December 2013 will mitigate some of the adverse impact from the scheduled increase in consumption tax in April 2014. On the external front, export performance will benefit from the global economic recovery. Prospects for a stronger

and sustained recovery depend, however, upon the progress of structural reforms, positive wage growth and increased capital expenditure.

The overall growth momentum in **Asia** is expected to be sustained, supported by the gradual improvement in external demand. However, the degree of improvement in exports could vary across the region. In some of the advanced Asian economies, export growth is projected to strengthen, benefitting from improved demand for consumer electronic products and industrial machineries, in line with the recovery in the advanced economies. Commodity exporters are, however, likely to experience more muted export performance as improvements in export volume may be offset by lower commodity prices. While domestic demand remains a key driver of growth in most of the ASEAN economies, the strength of economic activity is contingent on several country-specific factors. In a number of these economies, private consumption and private investment activities could be affected by rising costs and inflation. Growth in PR China will expand at a more moderate pace amid efforts to rebalance the economy towards a more sustainable, consumption-driven growth model. The pursuit of reforms in key areas such as financial liberalisation, fiscal and social reforms remains a top policy priority for the government in 2014.

Chart 4.2

Regional Economies: Real GDP Growth



^f Forecast
¹ Refers to fiscal year

Source: International Monetary Fund and National Authorities

Global inflation is expected to be moderate, in line with lower price pressures in the commodity markets following improved supply conditions. The increase of energy production in the US and the expected easing of geopolitical risks in the Middle East would reduce supply constraints of crude oil, thus exerting downward pressure on prices. Similarly, food prices are expected to fall on account of increased crop production. The inflation outlook is, however, expected to vary between the advanced and emerging economies. In most of the advanced economies, persistent negative output gaps and slow wage growth will limit price increases. In contrast, some Asian economies are projected to experience higher cost-push inflation in an environment of tightening labour market conditions.

Notwithstanding the improved outlook, the global economy continues to face **downside risks**. A key concern is the continued economic slack in the advanced economies despite the recent improvement in growth. Unemployment rates remain elevated relative to pre-crisis levels in many advanced economies while spare capacity continues to be sizeable in several economies, reducing the prospect of higher investment growth. Amid low inflation, prolonged weak growth may expose some economies to the risk of deflation. Fiscal uncertainties also continued to linger, particularly in the advanced economies. In the US, there still remain fiscal challenges, such as a more permanent solution to the debt-ceiling limit and structural deficits arising from higher mandatory expenditures. In the euro area, while fiscal austerity has resulted in a narrowing of budget deficits, these measures have adversely affected private sector activity and hence, overall growth. Furthermore, public debt remains high, limiting the room for policy support to the economy.

Amid these global developments, the emerging economies face a relatively different set of domestic risks. Financial imbalances have been a key concern following the strong increase in credit and asset prices. This has led to high household debt levels in many emerging economies, including those in Asia. In PR China, financial risks arise from the rapid growth in shadow banking activity, a growing source of financing for property and infrastructure investments. A few emerging economies are

also experiencing twin deficits. In particular, current account positions turned into deficits in some countries as a weak recovery in external demand was accompanied by strong domestic growth that boosted imports. A rising trend in public debt levels, coupled with fiscal deficits, was observed in several of these economies in large part due to the result of fiscal stimulus implemented during the global recession in 2008-2009. Furthermore, some emerging economies also face structural challenges such as supply bottlenecks, rising income inequality and over-reliance on the traditional sources of growth.

Given the improving growth outlook in the advanced economies, the gradual normalisation of monetary policy will be inevitable, as evidenced by the recent scale-back of quantitative easing (QE) in the US. The unprecedented scale of QE undertaken since 2009 suggests that the reversal is likely to reverberate across the global financial markets and pose a significant challenge to policymakers. Against the backdrop of heightened volatility in global portfolio flows, concerns over domestic factors in the emerging economies could exacerbate negative investor sentiments and lead to a disorderly reversal of capital flows. This, in turn, raises the risk of disruptions to credit intermediation and disproportionate corrections in asset prices. While there appears to be increasing country differentiation based on the assessment of strengths and weaknesses of each economy, contagion risks have risen. The increasing inter-linkages in the global financial system have led to a swift transmission of financial shocks across markets, regions and asset classes, in particular during the period of a simultaneous rise in risk aversion which could trigger herd behaviour. However, it is noteworthy that while global policy spillovers will pose significant challenges to the region, many Asian economies continue to exhibit resilience, underpinned by strong fundamentals following the decade of reforms after the Asian Financial Crisis. The more flexible exchange rates, higher foreign exchange reserves and more developed financial systems have significantly improved Asia's resilience to withstand external shocks and preserve macroeconomic and financial stability (More discussion on this can be found in the box article 'Spillovers of Quantitative Easing on Asia' in Chapter 2).

THE MALAYSIAN ECONOMY

Overview

The Malaysian economy is expected to remain on a steady growth path in 2014, expanding by 4.5%-5.5% (2013: 4.7%). The growth momentum will be supported by better performance in the external sector amid some moderation in domestic demand.

The Malaysian economy is expected to remain on a steady growth trajectory of 4.5%-5.5% in 2014

Domestic demand will remain the key driver of growth, albeit at a more moderate pace, reflecting the continued public sector consolidation. Private investment is forecast to register robust growth for the fifth consecutive year, driven by the ongoing implementation of multi-year projects and the improvement in external demand. Private consumption will be underpinned by healthy labour market conditions and sustained income growth. Nonetheless, household spending is expected to moderate towards its long-term trend growth, reflecting in part the impact of the higher inflation. Public consumption is anticipated to record lower growth, following the ongoing consolidation of the Government's fiscal position, while public investment is projected to register a higher growth, supported by both Government and public enterprise capital spending.

In line with the improvement in external demand, Malaysia's export performance across most product categories is expected to pick up in 2014. Electronics and electrical (E&E) exports will benefit from higher demand from the advanced economies while exports of non-E&E will be sustained by regional demand for resource-based products. Gross export performance is expected to be further supported by a small positive growth in commodity exports following two consecutive years of contraction. Services exports is expected to be higher due to the stronger travel account, which will be supported by Visit Malaysia Year 2014. At the same time, gross imports is projected to increase at a faster pace, driven mainly by higher intermediate imports. With import growth remaining robust, the current account surplus of

the balance of payments is projected to narrow in 2014. Nevertheless, as exports improve, net exports of goods and services is expected to exert a lower negative contribution to real growth in 2014.

Headline inflation is expected to average 3%-4% in 2014 (2013: 2.1%) due mainly to domestic cost factors. These include the recent price adjustments arising from subsidy rationalisation and the spillover effects of these adjustments on the prices of other goods and services. The higher cost pressures, however, will be partly contained by subdued external price pressures, given the expectations of lower global food and energy prices. Continued expansion in domestic capacity and a moderation in domestic demand would also contribute towards attenuating the cost pressures.

Notwithstanding the moderation in domestic demand, the underlying fundamentals of the Malaysian economy remain strong. Growth will be driven by the private sector across a diversified range of economic activities. Of importance, employment remains strong and incomes are rising. The financial system is resilient, with financial intermediation expected to provide continued support to investment and consumption activity. In addition, the strength of Malaysia's external position remains intact, with international reserves at healthy levels and external debt within prudent limits.

While the central outlook for the Malaysian economy assumes a gradual improvement in external demand, downside risks to global growth remain. These downside risks could affect the performance of the Malaysian economy in 2014. In the advanced economies, excess capacity in the labour and product markets remains, while fiscal uncertainties may affect the pace of recovery. Emerging economies may also experience slower-than-expected domestic demand amid policy measures to address domestic risks arising from high growth in credit and asset prices. As in 2013, volatility in global financial markets could contribute to the potential re-emergence of large and volatile capital flows. It should be noted that past experience has demonstrated Malaysia's ability to withstand volatile capital flows. For example, following intense deleveraging at the height of the crisis in the advanced economies, Malaysia experienced capital reversals by non-residents amounting to RM113.4 billion between second quarter 2008 and second quarter 2009, without disruptions

Higher Growth amid Expansion in All Economic Sectors

On the supply side, all economic sectors are expected to register positive growth in 2014. Key drivers to overall growth will be the services and manufacturing sectors, which will benefit from the improvement in the global economic environment despite more moderate growth in domestic demand.

Table 1
Real GDP by Sector (2005=100)

	2013p	2013p	2014f	2013p	2014f
	% of GDP ¹	Annual change (%)		Contribution to growth (percentage point) ¹	
Services	55.2	5.9	6.2	3.2	3.4
Manufacturing	24.5	3.4	3.5	0.8	0.9
Mining and quarrying	8.1	0.5	1.6	0.0	0.1
Agriculture	7.1	2.1	3.8	0.2	0.3
Construction	3.7	10.9	10.0	0.4	0.4
Real GDP	100.0	4.7	4.5 ~ 5.5	4.7	4.5 ~ 5.5

¹ Figures may not necessarily 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 services sector is projected to continue on a firm expansion path in 2014. Growth will be mainly supported by production-related activities such as wholesale, transport and storage amid a pick-up in external trade activity. Consumption-related activities including retail trade, and accommodation and restaurants will be supported by household spending, albeit at a more moderate rate. Nonetheless, higher tourist arrivals, in conjunction with Visit Malaysia Year 2014, will provide support to growth. In the finance and insurance sub-sector, growth is projected to improve due mainly to higher growth in the insurance segment. The finance segment will be supported by continued demand for financing, particularly from businesses.

The outlook for the manufacturing sector is also favourable, led by the export-oriented industries, which are expected to record higher growth, in line with the improvement in external demand (see 'Performance of the Manufacturing Sector to Improve, Driven by the E&E and Primary-related Clusters').

However, growth in the domestic-oriented industries, in particular the consumer-related cluster such as transport equipment and food and beverage, is expected to be lower than in 2013 in line with the more moderate domestic demand. The construction-related cluster will remain supported by the continued implementation of various construction projects.

The construction sector is expected to continue recording high growth, albeit at a more moderate pace in 2014, as the completion of several large civil engineering projects will more than offset the progress in existing projects in the transport, utility, and oil and gas sectors. Although several highway and power plant projects are expected to commence in 2014, these projects are not expected to provide significant support to overall growth in the construction sector in 2014.

In the commodity sector, growth in agriculture is expected to improve on account of higher production of palm oil as both yields and the number of matured palm trees increase. Growth will also be supported by food commodities, especially livestock and fisheries. Better performance is projected in the mining sector due to higher crude oil and natural gas production from deepwater and marginal fields; and enhanced oil recovery.

to the financial intermediation process. Malaysia's well-developed capital markets, resilient external position and strong banking system will continue to provide the country with the capacity and policy flexibility to absorb the volatility in capital flows. The economy could, however, also register stronger growth performance if the pace of global recovery exceeds expectations.

Domestic demand continues to anchor growth

Domestic demand is expected to grow at a more moderate pace of 6.9% in 2014 (2013: 7.6%), reflecting the ongoing public sector consolidation. Domestic demand will be supported by investment and private consumption.

Private domestic demand to anchor growth amid lower public expenditure

Private investment growth is expected to remain robust at 12.6% in 2014, the fifth consecutive year of double-digit growth. The projected growth rate is higher than the 2000-2012 average growth of 8.8%. Insights gained from the Bank's survey with businesses suggest that investments will be broad-based and geographically diverse, supported by the improvement in external demand and continued expansion in domestic consumption. Sustained improvements in the investment climate will also attract new investments and support the ongoing implementation of projects with long gestation periods. These include projects under the Economic Transformation Programme (ETP) and the development of regional economic corridors.

In the services sector, private investment is expected to be driven by investments in the domestic-oriented sectors. Capital spending in the healthcare and education sectors is expected to be lifted by increasing demand, in line with the development of Malaysia as a medical and education hub. Investments in the telecommunication and aviation segments will be supported by infrastructure upgrading and capacity expansion, while hotels and retail investments will expand, underpinned by domestic spending and tourism activities.

Table 4.1

Real GDP by Expenditure (2005=100)

	2013p	2014f	2013p	2014f
	Annual change (%)		Contribution to growth (percentage point)	
Domestic Demand¹	7.6	6.9	6.9	6.4
Private sector expenditure	9.0	8.3	5.9	5.7
<i>Consumption</i>	7.6	6.9	3.8	3.6
<i>Investment</i>	13.6	12.6	2.1	2.1
Public sector expenditure	3.7	2.9	0.9	0.7
<i>Consumption</i>	6.3	3.0	0.8	0.4
<i>Investment</i>	0.7	2.9	0.1	0.3
Change in Stocks			-0.2	-0.5
Net Exports of Goods and Services	-22.9	-10.3	-2.0	-0.6
Exports	-0.3	2.1		
Imports	1.9	3.1		
Real Gross Domestic Product (GDP)	4.7	4.5 ~ 5.5	4.7	4.5 ~ 5.5

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

Investment in the residential property segment is also expected to remain firm, supported by the construction of mid-range residential properties. This is in line with private developers' and Government measures taken to meet rising demand for affordable housing by low- and middle-income earners.

Capital spending in the manufacturing sector is also projected to increase in 2014, driven by higher investments in the E&E sector and sustained investments in the domestic-oriented manufacturing clusters. The recovery in external demand is expected to support investments in new technology in the E&E sector, while continued diversification into new growth areas, such as medical equipment, optics and solar will further contribute to the recovery in manufacturing investments. In addition, investments in the construction-related cluster, especially in steel and cement will continue to be channelled towards meeting the demand from the implementation of existing construction projects. Furthermore, as announced under

Budget 2014, the RM120 million integrated package allocated by the Government to SMEs will allow firms to upgrade capacity and invest in mechanisation and new technology in the face of higher costs. This is expected to facilitate improvements in productivity and the shift of SMEs towards higher value-added activity.

Investment in the mining sector will be sustained by the ongoing construction of production facilities under existing deepwater projects and investments in marginal fields. In addition, firm energy prices will continue to underpin exploration and discoveries of new fields.

Private consumption is expected to grow by 6.9% in 2014 (2013: 7.6%). This moderation towards its long-run average of 6.6% (1990-2013) is after two consecutive years of strong growth. The more moderate growth in household spending follows a period of higher prices and greater uncertainty. Nevertheless, favourable income prospects are expected to provide support to private consumption going forward. Wage growth in the export-oriented sectors is expected to improve as the sector benefits from the better performance in the external sector. Wages in the domestic-oriented sectors are expected to remain stable. The implementation of the minimum wage policy by some companies will also support wages, albeit to a lesser extent compared to 2013. In addition, targeted Government transfers to low- and middle-income households are expected to partially mitigate the impact of higher prices on household spending.

The labour market is expected to remain supportive of private consumption, with the unemployment rate projected to remain stable at 3.1% (2013: 3.1%). Employment growth is expected to remain above the post-Global Financial Crisis (GFC) average of 3%, but to moderate from a strong growth of 4.8% in 2013. The demand for labour will be supported by the improvement in global economic conditions, particularly benefitting the export-oriented industries, and the sustained expansion in domestic economic activity.

Growth in household credit is expected to be slower in 2014, in part due to the series of measures implemented by the Bank in 2013. Nonetheless, the impact of these measures on private consumption growth is expected to be marginal as creditworthy households will continue to have access to credit.

Public sector spending is expected to moderate in 2014, in line with the Government's continued commitment to fiscal consolidation.

Public consumption is expected to record a slower growth of 3%, reflecting more moderate expenditure on supplies and services; and emoluments.

Public investment will register higher growth of 2.9%, underpinned by public enterprises' (PEs) investment and Federal Government development expenditure. Investments by PEs reflect the continued implementation of key infrastructure projects, particularly in the oil and gas, utility and transportation sub-sectors. The Federal Government development expenditure will be channelled mainly towards improving access and connectivity in urban and rural transportation infrastructure. In the social services sector, expenditure will be channelled primarily to the education, training and healthcare sub-sectors.

Improvement in external demand

In line with the improvement in external demand, Malaysia's export performance is expected to pick up in 2014. Gross exports is forecast to expand by 5.8% in 2014 amid an improvement in demand from the advanced economies and sustained growth in the regional economies.

External demand to improve as global economic activity continues to expand

The growth in manufactured exports is expected to improve in 2014, driven by both E&E exports and non-E&E exports. E&E exports is expected to expand at a modest pace in 2014, supported by the improvement in investment activity in the US, in particular corporate spending on IT-related equipment. In addition, while the personal computers sub-segment remains important, manufacturers are increasingly diversifying their product mix to cater to the fast-growing mobile devices and automotive sub-segments. Non-E&E exports is expected to continue to expand, supported by sustained regional demand for resource-based products and re-exports of petroleum products following the continued expansion in petroleum

Evolving Household Balance Sheets and Implications for Private Consumption

Introduction

The household balance sheet in Malaysia has evolved significantly over the recent decade. The size of the balance sheet has grown substantially over the years, as reflected in rising household assets and debt. The composition of the balance sheet has also changed, with higher holdings of financial and property assets. This article explores the changing structure of the household balance sheet and discusses the key drivers behind it. It also examines the effects of these changes on private consumption and outlines the policy implications going forward.

The Evolving Nature of the Household Balance Sheet¹

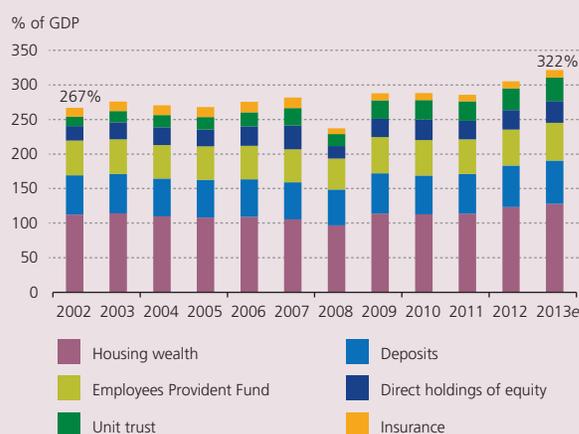
The household balance sheet provides a snapshot of assets and liabilities, and reflects households' financial health. Assets reflect resources for future spending, and can be both liquid² (for example deposits, unit trust funds and direct investments in the stock market) and relatively illiquid (for example housing wealth³ and mandatory contributions to the Employees Provident Fund). Household debt represents liabilities that need to be repaid in the future, comprising of loans to purchase property and securities, and to finance consumption⁴.

Two key trends in Malaysia's household balance sheet can be observed. First, the size of the balance sheet has grown since 2002. Total household assets grew at an average annual rate of 10.4% from 2003-2013 to 321.6% of GDP at end-2013, while household debt grew annually by 12.7% to 86.8% of GDP at end-2013 (Chart 1 and 2). In level terms, household assets continue to exceed debt by 3.7 times. This trend is mainly attributable to rising household income, which facilitates asset accumulation through an increase in savings and borrowings.

Second, the composition of household assets has become more diversified. While the level of deposits continues to grow, its share of total assets has been on a moderating trend. At the same time, the accumulation of assets in unit trust funds and equities has been on the rise (Chart 3). This trend

Chart 1

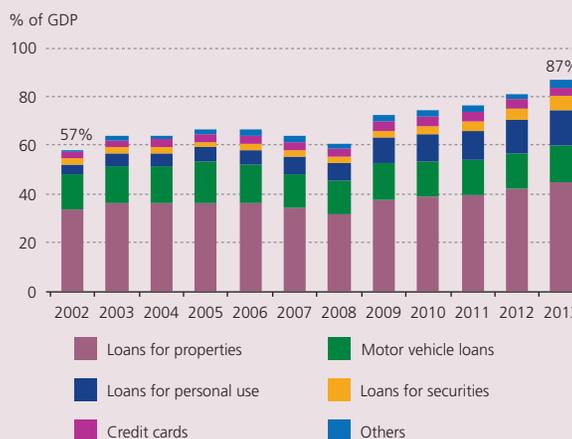
Composition of Household Assets



e Estimate, housing wealth data is only available up to 3Q 2013
Source: Bank Negara Malaysia estimates

Chart 2

Composition of Household Debt



Source: Bank Negara Malaysia

¹ Only domestic assets and liabilities are included in the analysis. This is due to the unavailability of a breakdown by economic agents in the International Investment Position statistics on holdings of assets abroad and external liabilities.
² Liquid assets are assets that can be converted into cash quickly and with minimal loss of value.
³ Housing wealth is estimated by multiplying the average national house price with the total number of residential properties excluding unsold units.
⁴ Loans for consumption comprise of motor vehicle loans, personal loans and credit card facilities.

not only reflects more developed domestic financial markets offering a wider range of products and services, but is also attributable to households' growing financial sophistication and improving awareness of alternative savings instruments. Housing wealth, meanwhile, continues to be the largest component of household assets⁵.

From a distributional perspective, much of this wealth accumulation can be accounted for by higher-income households who are able to save a larger proportion of their income. Chart 4 illustrates the distribution of households by income groups and proxies of asset ownership based on flow data across income brackets⁶. Relative to lower-income households, those with monthly income above RM5,000 (accounts for a share of 33.7% of total households) assume a larger share of spending that is channelled to the accumulation of financial assets (65.8%) and earnings from rental income⁷ (60.1%).

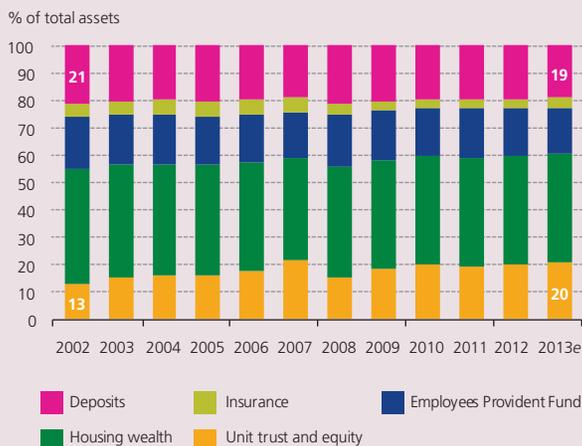
The Implications for Private Consumption

The changing size and structure of the household balance sheet has important implications for private consumption. On the assets side, the accumulation of property and financial assets has enabled Malaysian households to benefit from the recent asset price increases, supporting private consumption. Conceptually, asset prices affect spending by asset-owning households through three main channels (Skudelny, 2009). First, households are able to sell their assets to finance spending. This channel is stronger for more liquid financial assets, in which capital gains can be realised more quickly. Second, when assets serve as retirement savings, an appreciation in the value of these assets reduces the perceived need to save at present to finance future spending. Finally, assets can serve as collateral, enabling households to borrow against the value of the asset. While the three channels benefit asset owners, higher asset prices, particularly for property, increases the need for debt accumulation among house buyers. This reduces the disposable income of these households going forward, which may partially offset the positive wealth effect on private consumption.

On the liabilities side, borrowings to finance consumption have allowed households to adjust their spending patterns. Households with access to credit can borrow to facilitate purchases of durable goods as well as

Chart 3

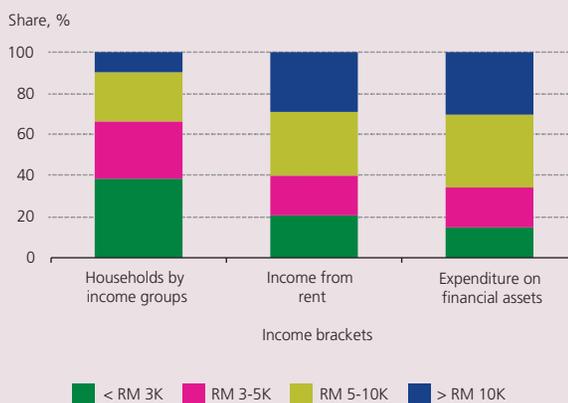
Total Household Assets by Components



e Estimate, housing wealth data is only available up to 3Q 2013
Source: Bank Negara Malaysia estimates

Chart 4

Income from Rent and Expenditure on the Accumulation of Financial Assets Across Income Brackets



Source: Household Expenditure Survey 2009/10 and Household Income Survey 2012, Department of Statistics, Malaysia

⁵ For household liabilities, loans for the purchase of properties remain the largest component. Personal loans accounted for an increasing share since 2002, although its growth moderated in 2013. Refer to the Financial Stability and Payment Systems Report 2013 for a detailed analysis of household liabilities.

⁶ Statistics on stocks of household assets by income groups are not available.

⁷ Rental income, however, constitutes only a small fraction of total income for all income brackets.

to support consumption during times of lower income. Nonetheless, a portion of income must be devoted to the repayment of debt going forward. Consumption is not increased permanently but rather brought forward, hence limiting future increases in consumption. The sustainability of private consumption thus requires that households' future repayment capacities are in line with their debt obligations.

To understand the role of these channels for private consumption, an aggregate consumption function for the Malaysian economy was estimated⁸. The determinants considered are income, housing wealth, financial wealth⁹, consumption credit disbursements and repayments. The contribution of each determinant to private consumption is quantified and illustrated in Chart 5.

The findings show that income is the most important driver of private consumption, accounting for an average of 67.4% of private consumption growth during the period. This result reflects the fact that private consumption has been consistently supported by stable labour market conditions and sustained income growth. Since 2005, housing and financial wealth have been supportive of private consumption, accounting for 14.5% and 13.7% of private consumption growth, respectively. The contributions have increased in the post-global financial crisis period. Consumption credit disbursements, while on average playing a small role, contributed significantly to private consumption during certain periods¹⁰. This reflects the fact that consumption credit cannot permanently increase spending, but rather helps households redistribute consumption over time or purchase durable goods¹¹.

The econometric findings relate to aggregate private consumption. Across income groups, the determinants of private consumption are likely to differ. Income likely contributes a larger share to private consumption growth for lower-income households, given that they have higher marginal propensities to consume

Table 1

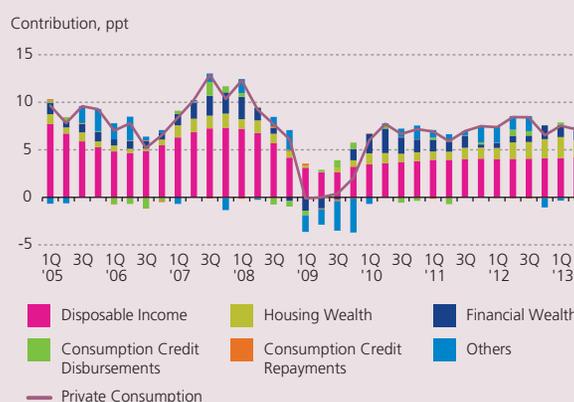
Average Contribution of the Determinants of Private Consumption Growth (2005-2Q 2013)

Determinant	Contribution (%)
Disposable income	67.4
Housing wealth	14.5
Financial wealth	13.7
Consumption credit disbursements	0.3
Consumption credit repayments	-0.2
Others	4.3

Source: Bank Negara Malaysia estimates

Chart 5

Drivers of Private Consumption Growth



Source: Bank Negara Malaysia estimates

⁸ An error correction model (ECM) was used. Housing and financial wealth are estimated as the value of wealth net of the outstanding value of loans used to purchase them (e.g. financial wealth minus loans outstanding for the purchase of securities).

⁹ Financial wealth refers to household holdings of unit trust funds. Direct holdings of equities are excluded due to the unavailability of reliable quarterly data.

¹⁰ For example, between 2Q and 4Q 2009, consumption credit disbursements contributed an average of 0.6ppt. to overall private consumption growth of 1.0%. This coincided with the reductions in the Overnight Policy Rate by the Bank to support the economic recovery during this period.

¹¹ Loan repayments do not have a significant impact on private consumption in this model. This likely reflects the fact that there have been no episodes of widespread deleveraging on household balance sheets in the sample period. Repayments are expected to adversely affect consumption during such a deleveraging episode. For example, Dynan (2012) found that highly-leveraged homeowners in the United States experienced larger falls in consumption between 2007 and 2009, after accounting for the wealth effects of lower house prices.

(Murugasu, Ang and Tng, 2013). Improving the distribution of household income is thus likely to support overall private consumption. Meanwhile, wealth effects are probably larger for high-income households as they tend to hold more housing and financial assets.

Policy Implications

The findings suggest that balance sheet developments have become an increasingly important consideration for policy analysis for two key reasons. First, asset price movements have an important effect on household spending. For example, a reversal of the asset price gains in recent years is likely to reduce wealth, which may cause households to scale back on their spending. Thus, policy would need to focus on the sustainability of asset prices and the spillovers to the economy. This effect is, however, partially mitigated by the fact that a larger proportion of housing and financial wealth is held by higher-income households with larger savings buffers. Households with monthly income above RM5,000 save approximately a fifth of their income and are better able to support their consumption amid adverse asset price movements. Nonetheless, ensuring that asset prices are reflective of economic fundamentals remains a policy priority, given the potentially significant adverse implications of sharp corrections in asset prices for macroeconomic and financial stability.

Second, changes in household income may now pose significant implications for the real economy and financial stability. It not only affects households' ability to consume in a given period, but also to service their debt obligations. For example, if an income earner of an indebted household becomes unemployed, the household may be forced to further cut back on spending to manage debt repayments or face default. These concerns are, however, partially alleviated by holdings of assets. Liquid financial assets of households are 1.6 times outstanding debt, sufficient to cover their liabilities in the event of income shocks. In addition, 52% of the household debt is utilised for property purchases, and hence, is backed by physical assets. From a distributional perspective, however, the Bank continues to closely monitor lending to lower-income households. Households earning below RM3,000 a month have higher leverage positions than those in other income groups and hence are more susceptible to income shocks. The policy imperative, therefore, is to continue to ensure that households only borrow within their means.

Taking all these into consideration, the Government and the Bank have undertaken pre-emptive policies to prevent household balance sheets from becoming a source of systemic risk. In the 2014 Budget, the Government raised the real property gains tax (RPGT) and the minimum price of properties that can be purchased by foreigners. These measures are aimed at curbing speculation and ensuring that property prices grow in line with fundamentals. The Bank has also introduced macroprudential measures in stages since 2010, to prevent excessive household indebtedness and to ensure responsible lending practices. These measures are part of a broader trend of more active use of macroprudential policies to manage risks related to financial imbalances and excessive leverage. PR China, Chinese Taipei, Hong Kong SAR, Singapore and Indonesia have introduced macroprudential measures to manage either property prices or mitigate unsustainable increases in household indebtedness.

Conclusion

The household balance sheet has evolved over the recent decade. It has grown in size, both in terms of assets and debt, and has become more diversified. These developments have helped to support private consumption in recent years. Going forward, the household balance sheet will continue to evolve and have implications on household welfare, private consumption and economic growth. Nonetheless, it is recognised that over-leveraging which is not commensurate with income will make households more vulnerable to adverse shocks, and subsequently, pose a risk to household spending and sustainable growth. Therefore, there is a need to continuously evaluate financial developments and undertake pre-emptive action to mitigate the build-up of imbalances when appropriate.

References

Dynan, K. (2012), 'Is a Household Debt Overhang Holding Back Consumption?' *Brookings Papers on Economic Activity*, (Spring 2012), pp. 299-362.

Murugasu, D., Ang, J.W. & Tng, B.H. (2013), 'The Marginal Propensity to Consume Across Household Income Groups', *Bank Negara Malaysia Working Paper Series, WP2/2013*.

Performance of the Manufacturing Sector to Improve, Driven by the E&E and Primary-related Clusters

The improvement in external demand amid the recovery in global growth is expected to benefit the manufacturing sector. This is particularly relevant to the export-oriented industries, consisting of the E&E and primary-related clusters, which together account for 80% of the manufacturing output in Malaysia. In the E&E cluster, growth will be driven mainly by higher demand for semiconductors, especially for final use in mobile devices, tablets and automobiles. Amid the positive growth performance of semiconductors in recent years and underperformance of the personal computers and parts segment following the GFC, semiconductors have now become the largest contributor to Malaysia's E&E exports, accounting for a 39.7% share of total E&E exports (2006: 31.1% share). Growth is further supported by the primary-related cluster, underpinned by sustained regional demand for chemicals, refined petroleum and rubber products.

storage capacity (see 'Re-export Activity Providing Growing Support to Malaysia's Trade').

Export performance will also be supported by a small positive growth in commodity exports following two consecutive years of contraction. The better performance of commodity exports will be underpinned by the improvement in global demand for commodities and a smaller decline in commodity prices. The smaller decline in prices is attributed to higher crude palm oil (CPO) price that will partially offset the lower prices of liquefied natural gas (LNG), crude oil and rubber.

Gross imports is projected to increase at a stronger pace of 8.9% in 2014. Intermediate imports, which form the bulk of Malaysia's imports, is expected to rise in 2014 as manufacturers increase production to meet higher export orders. In addition, the continued expansion of domestic investment and consumption activity will continue to support the imports of capital and consumption goods, respectively.

In the services account, the projected smaller deficit will be supported by the increase in tourist arrivals and higher tourist spending in conjunction with Visit Malaysia Year 2014. Growth in imports, nonetheless, will be driven by continued payments for transportation and other services, in line with the expansion in trade and investment activity during the year.

In the income account, income from Malaysian companies abroad is expected to increase given the improving global economic outlook. Nevertheless, it is likely to be surpassed by

profits and dividends accrued to multinational corporations operating in Malaysia following the recovery in manufactured exports. Net outflows in the income account, therefore, is likely to be sustained in 2014.

Overall, with the gradual recovery in exports, net exports of goods and services will exert a lower negative contribution to real growth in 2014. Nevertheless, with import growth remaining robust, and exports registering a modest recovery, the current account surplus of the balance of payments in 2014 is projected to narrow to RM30.8 billion or 3% of GNI.

Table 4.2

External Trade

	2013 ^p	2014 ^f
	Annual change (%)	
Gross exports		
<i>of which:</i>	2.4	5.8
Manufactures	5.7	7.2
Agriculture	-17.0	8.5
Minerals	3.8	-4.1
Gross imports		
<i>of which:</i>	7.0	8.9
Capital goods	2.8	7.2
Intermediate goods	4.3	6.0
Consumption goods	8.7	8.5
Trade balance	-26.4	-22.7

^p Preliminary
^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Re-export Activity Providing Growing Support to Malaysia's Trade

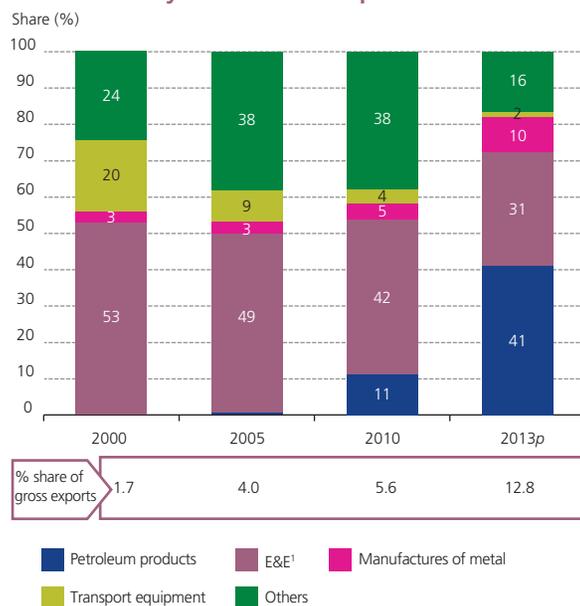
A notable development in Malaysia's trade structure in recent years is the increase in re-export activity. In essence, goods are considered as re-exports if the goods are exported out of the country in the same form as when they were originally imported, without undergoing any major transformation. Goods for re-export are recorded in the Customs merchandise trade figures for both exports and imports. However, some of these items are excluded from the goods account compilation in the Balance of Payments (BoP) statistics. These include goods that are imported and then exported without involving a change in ownership.

Re-export activity has been a feature of Malaysia's trade for several decades, but it used to account for only a small share of total exports. The strong growth of Malaysia's re-export activity in the more recent period has been largely attributable to the rapid increase in re-export of petroleum products. This reflects the ongoing expansion of petroleum storage capacity, as Malaysia positions itself as a regional oil storage and trading hub, as planned under the Economic Transformation Programme (ETP). Subsequently, the share of re-exports to total gross exports has more than doubled, increasing to 12.8% in 2013 from 5.6% in 2010.

By composition, the share of re-exports of petroleum products has grown significantly in recent years given the expansion in storage capacity. Currently, it constitutes the largest share of Malaysia's total re-exports, surpassing E&E re-exports. In addition, increasing warehousing activity for metal in Johor has also resulted in the rising share of re-exports of manufactures of metal.

Chart 1

Share of Malaysia's Total Re-export



¹Includes machinery and equipment

p Preliminary

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Re-export activity has positive spillover effects on the economy. First, it increases the value-add of other related industries, including the transportation and storage services sub-sectors, manufacturing and construction sectors. Second, it contributes to the creation of mid-to high-skilled jobs, such as engineers and operators in the respective fields, resulting in higher employment and hence consumption activity. Third, the growth of re-export activity has a direct positive impact on net exports of services and investment in storage terminals and port infrastructure. For Malaysia, the positive spillovers of re-export activity to the economy is still small but is expected to increase rapidly going forward. At this point, most of the activity remains centred around warehousing services and other supporting or add-on services based on customers' requirements, such as heating and blending.

The strong growth of re-export of petroleum products is expected to continue, supported by further capacity expansion in petroleum storage terminals. This will further increase the contribution of re-exports to Malaysia's growth in the years ahead.

Table 4.3

Balance of Payments

	2013 ^p	2014 ^f
	RM billion	
Goods	102.7	93.7
Services	-15.0	-11.9
Balance on goods and services	87.6	81.8
Primary income	-35.2	-34.9
Secondary income	-15.2	-16.0
Balance on current account	37.3	30.8
% of GNI	3.9	3.0
Capital account	-0.0	
Financial account	-15.0	
Balance on capital and financial accounts	-15.1	
Errors and omissions	-7.5	
<i>of which:</i>		
Foreign exchange revaluation gains	18.6	
Overall balance	14.6	

Note: Figures may not necessarily add up due to rounding

^p Preliminary

^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Inflation Outlook

Headline inflation is projected to average 3%-4% in 2014 (2013: 2.1%) due mainly to domestic cost factors. These include the recent price adjustments arising from subsidy rationalisation and the spillover effects of these adjustments on the prices of other goods and services. The higher cost pressures, however, will be partly contained by subdued external price pressures, given the expectations of lower global food and energy prices. Continued expansion in domestic capacity and a moderation in domestic demand would also help to attenuate the cost pressures. Upside risks to inflation include stronger domestic demand arising from better-than-expected external demand, a significant rise in global commodity prices and excessive wage increases leading to second-round effects. These risks, however, are assessed to be relatively low.

Externally, global inflation will remain subdued due to the prevalence of excess productive capacity and adequate supply of commodities to meet the expected increase in global demand. The Food and Agriculture Organisation of the

United Nations (FAO)² projected lower global food prices in 2014, as the production of major food items, such as corn and wheat, is expected to increase significantly. Global crude oil prices are expected to remain stable, to average at USD103.70 per barrel in 2014³ (2013: USD104 per barrel). The unprecedented supply of shale oil and the increase in its production in the US, as well as stable production of crude oil by other major oil producers will be sufficient to accommodate the expansion in demand for oil. In addition, the easing of geopolitical risks in the Middle East will also reduce the risk of crude oil supply disruptions. In line with the subdued global commodity prices, inflationary pressures originating from Malaysia's key import partners are also expected to be modest. The more moderate external price pressures would help to alleviate the pressure on domestic production costs.

Headline inflation to be driven by domestic cost factors

Domestically, the upward adjustments to the prices of petroleum products and sugar, as well as higher excise duties on tobacco products, in the later part of 2013, together with the recent increase in electricity tariffs in January, will contribute to higher inflation in 2014. While these adjustments may also have some spillover effects on the prices of other goods and services, the magnitude of the spillovers is expected to be contained given that these adjustments were implemented during a period of low inflation and moderate demand conditions. The pressure on prices from domestic demand factors is also expected to be modest due to a slower increase in household spending and the slower real wage growth. Thus, while the economy is expected to grow at close to its potential (see box article on 'Estimating Malaysia's Potential Output'), it is not expected to result in significant domestic price pressures.

However, the upside risks to inflation remain. A better-than-expected recovery in the external demand would lead to stronger domestic demand. This could lead to higher demand-driven

² November 2013 Food Outlook

³ Average price of Brent, Dubai and West Texas Intermediate (WTI) crude oil, equally weighted, as projected by the International Monetary Fund (IMF) in the January 2014 World Economic Outlook.

Estimating Malaysia's Potential Output

Potential output reflects the productive capacity of the economy. It is the maximum amount of goods and services an economy can produce over the long term without exerting downward or upward pressure on prices. The output gap is a measure of the difference between the actual output of the economy and its potential output. Policymakers closely monitor the potential output and output gap for two main reasons. First, the estimates of potential growth not only inform policymakers of the long-term sustainable growth rate of the economy but also the underlying drivers of growth. Second, the output gap reflects the extent to which economic resources are being overutilised or underutilised, and therefore, provides insights into demand-driven inflationary trends. For example, a negative output gap suggests that there is slack in the economy and price pressures will be weak on account of the weak demand conditions. Conversely, with a positive output gap, the economy is operating above its potential. If this condition persists, the prevailing excessive demand will exert upward price pressure on factors of production and subsequently cause an increase in the general price level.

This article highlights three different approaches of assessing Malaysia's potential output and output gap¹ (Table 1). These approaches comprise of statistically-based filtering methods, macroeconomic model-based multivariate filter methods and structural methods. The approaches complement the existing estimation method using the production function approach, and have further improved the understanding of the relationships between potential output, output gap and economic activity.

Table 1

Various Methods in Estimating the Output Gap

Estimation Methods	
Univariate	Linear Trend
	Univariate State Space
	Hodrick-Prescott
Multivariate	Multivariate Kalman Filter (MVKF)
	Multivariate Filter (MV)
Structural	Structural Vector Autoregression (SVAR)
	Cobb-Douglas production function (CDPF)

In the past, potential output was estimated through mechanistic linear trends which assume that the potential output grows at a constant rate through time. Increasingly, estimation techniques have advanced to use more sophisticated approaches which incorporate economic relationships, and thus are able to capture the dynamics and drivers of potential output. The macroeconomic model-based multivariate filter establishes more robust linkages between the estimated potential output and output gap with other key macroeconomic variables, including inflation and the non-accelerated inflation rate of unemployment (NAIRU). The structural vector autoregression (SVAR) approach allows price shocks to be decomposed into demand- and supply-side shocks which would have important policy implications. Meanwhile, the Cobb-Douglas production function (CDPF) approach allows growth to be decomposed into contributions from the various factors of production. Notwithstanding the progress that has been made, estimating the potential output and the output gap remains challenging as it cannot be directly observed and it can change significantly when an economy experiences structural changes.

Each competing model is different conceptually and will therefore produce different results. Nonetheless, the various estimation results can be used for cross-checking and therefore, contribute to more rigorous understanding of the economy's potential output and output gap.

Estimates of the Malaysian Economy's Potential Output

Based on the three different approaches, the potential output growth is estimated to be in the range of 4.7% to 5.1% in 2013 (a simple average of 4.9%) and to range between 4.6% to 5% in 2014 (a simple average of 4.8%) (Chart 1). Based on the projected economic growth, the output gap is estimated to be a small positive of 0.3% and 0.5% in 2013 and 2014, respectively.

¹ An in-depth discussion of the various estimation techniques can be found in the forthcoming BNM Working Paper on Estimating Malaysia's Potential Output.

In terms of the quarterly time profile, both the univariate (Chart 2) and multivariate filters² (Chart 3) indicate that the economy registered a small negative output gap in the first two quarters of 2013, which turned marginally positive in the third quarter of the year. This small positive output gap is likely to persist in 2014. The estimates produced by filtered-based methods appear to give a plausible representation of Malaysia's historical business cycle and remain close to the range of the structural model estimates³. In particular, both filters estimated large positive output gaps during the periods leading up to the Asian Financial Crisis (AFC) and the Global Financial Crisis (GFC) and negative output gaps during the crises. These trends are further supported by the comparable output gap profiles from the structural models, namely the production function approach and the SVAR model (Chart 4).

Chart 1

GDP and Potential Output Growth, 1996-2014f



e Estimates
f Forecast

Source: Bank Negara Malaysia estimates

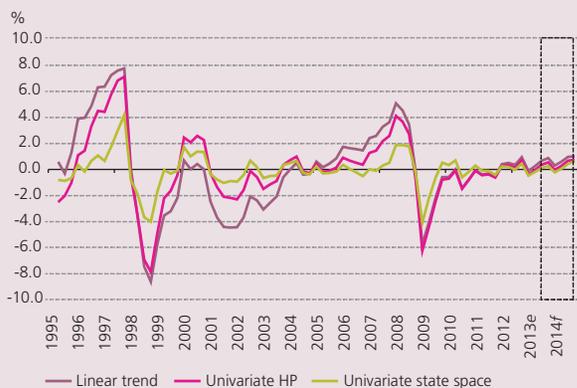
The estimates produced by filtered-based methods appear to give a plausible representation of Malaysia's historical business cycle and remain close to the range of the structural model estimates³. In particular, both filters estimated large positive output gaps during the periods leading up to the Asian Financial Crisis (AFC) and the Global Financial Crisis (GFC) and negative output gaps during the crises. These trends are further supported by the comparable output gap profiles from the structural models, namely the production function approach and the SVAR model (Chart 4).

In terms of the drivers of growth, the production function approach suggests that potential output in 2014 will continue to be supported by firm private investment and favourable labour market conditions.

While output gap profiles for the filter-based and the structural models remain broadly similar, the

Chart 2

Univariate Filter Output Gap Estimates, 1995-2014f

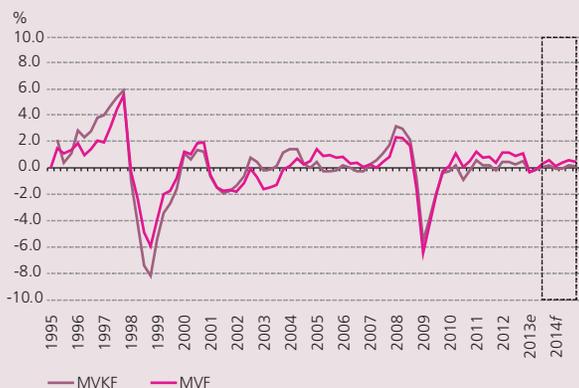


e Estimate
f Forecast

Source: Bank Negara Malaysia estimates

Chart 3

Multivariate Filter Output Gap Estimates, 1995-2014f



e Estimate
f Forecast

Source: Bank Negara Malaysia estimates

² Multivariate Kalman filter exploits the information on the excess demand in the labour market which is used as a proxy for demand in the product market. On the other hand, the multivariate filter, which takes into account the interaction between price, output, unemployment and capacity utilisation, improves further the estimation of the potential output.

³ When the sample is truncated in 2008, the out-of sample forecast produced by the model-based multivariate filter for Malaysia show that the profile of the gap estimates remained consistent with the full-sample estimates. Benes et al conducted ex-post forecasting exercises for numerous countries and they found that the multivariate filter performs well relative to a random walk (see Benes, J. et al. (2010). *Estimating Potential Output with a Multivariate Filter*, IMF Working Paper, WP/10/285).

size of the output gap estimated by the two classes of models differs⁴. The univariate and multivariate filtered-based models estimate the output gap to be in smaller range compared with the structural models (0.04%-0.7% and 0.4%-1.3%, respectively) (Table 2). This is attributable to the key differences in how the two classes of models are specified. By construction, estimates from the structural models are governed by the theoretical relationship between the level of labour, capital and technology advancement in the economy. Of importance, in generating the estimates, the magnitude of the inter-linkages between these variables is assumed to be unchanged across time. The structural model hence, provides a good estimate of the economy's potential output over a longer run horizon. However, it may overestimate the output gap in the short-run as it does not explicitly account for the recent changes occurring in the economy. In contrast, the filter-based models combine the information from the latest underlying trend and the theoretical relationship among the macroeconomic variables. For example, the multivariate filter-based models generate the output gap estimates by capturing the latest trends from macroeconomic variables such as inflation, capacity utilisation and unemployment. To ensure consistency, information about the trend trajectory from these variables is linked together with a set of conditional relationship backed by economic theory such as Phillips curve that relates the output gap to inflation; a dynamic version of the Okun's law that relates unemployment and output gap; and a capacity utilisation equation that links capacity utilisation rates to the output gap. In other words, by construction, the filter-based models are more adept at picking up the recent short-run dynamics that are taking place in the economy. In this instance, it is likely that the potential output has been lifted by the robust growth of investment in recent years.

Table 2

Output Gap Estimates, 2014^f

Estimation Methods	Range (%)
Univariate	0.2 - 0.7
Multivariate	0.04 - 0.4
Structural	0.4 - 1.3

^f Forecast

Source: Bank Negara Malaysia estimates

Chart 4

Structural Models' Estimates of Output Gap, 2000-2014^f



^e Estimate

^f Forecast

Source: Bank Negara Malaysia estimates

Conclusion

Although the estimated size of the output gap differs across models, the output gap profiles remain broadly similar and all point towards the economy operating close to its potential level in 2013 and into 2014. Going forward, the evolution of the potential output will be determined both by the structural features of the economy and the economic environment in which the economy operates. While the increases in the quantity of capital and labour may raise potential output, sustainable long-term growth critically depends on the quality of capital and labour as well as how efficiently these factors are used. Total factor productivity, which is associated with technological innovations and knowledge, will also be important in determining the country's long-term potential growth. Thus the successful creation of an ecosystem that promotes competition, skills, knowledge and innovation will play a key role in ensuring that productivity gains are reaped.

⁴ For example, in the case of New Zealand, Claus et al. indicate a greater amplitude of output gaps from structural VARs and the Kalman filter than of those from the HP and HP multivariate filter (see Claus, I. et al, (2000). *The Output Gap: Measurement, Comparisons and Assessment*, Reserve Bank of New Zealand Research Paper, no. 44). In contrast Mc Morrow and Röger find that the HP filter generates larger output gaps than the Kalman filter in the EU countries (see Mc Morrow K, and Röger, W. (2001). *Potential Output: Measurement Methods, "New" Economy Influences and Scenarios for 2001-2010*, ECFIN Economic Paper, no. 150).

inflationary pressures that in turn could translate into higher spillovers across the economy. Global food and energy prices could also rise significantly should there be disruptions to the global supply of commodities, contributing to higher input costs and imported inflationary pressures. There is also the risk of second-round effects on inflation should inflation expectations increase disproportionately, accompanied by excessive wage increases that are not reflective of the improvements in productivity. However, based on available information, the current assessment is that the probability of these risks manifesting themselves is relatively low.

MONETARY POLICY OUTLOOK

Monetary policy in 2014 will aim to support the sustainable growth of the Malaysian economy while mitigating any potential vulnerabilities arising from inflation and financial imbalances. The Malaysian economy is expected to continue on a steady growth path, supported by better performance in the external sector amid some moderation in domestic demand. Compared to 2013, inflation is projected to be higher. Nevertheless, the higher inflation will largely be due to cost factors, with the underlying inflation expected to remain contained. The continued low global and domestic interest rate environment would also make it important to be vigilant to the build-up of financial imbalances.

The global economy is expected to continue to improve in 2014, underpinned by a broader recovery in the advanced economies amid sustained growth in the emerging economies. The improvements in the advanced economies will have positive spillover effects on the rest of the world and provide support to the emerging economies as they transition towards a more moderate pace of growth in domestic demand. Nevertheless, there remains uncertainty surrounding the global macroeconomic and financial environment. In the advanced economies, key concerns are the significant economic slack and the impact of fiscal consolidation on the pace of recovery. Emerging economies face the challenge of managing external risks. The monetary policy transition in the advanced economies could heighten volatility in exchange rates, financial markets and capital flows, that may in turn, become destabilising to the growth prospects in these economies. Emerging economies may also experience a moderation in

domestic demand as policy measures are taken to address domestic risks.

The Malaysian economy is projected to grow between 4.5%-5.5% in 2014. Domestic demand will continue to be the anchor for growth, but it will grow at a more moderate pace. Private investment is projected to continue to register robust growth, while private consumption is expected to moderate to its long-term trend growth. Public sector spending is also projected to expand at a slower pace. Nevertheless, the economy is expected to benefit from the gradual recovery in the advanced economies. Employment prospects are expected to remain favourable. Key risks to the growth outlook over the near- to medium-term emanate mainly from the external sector, arising from the downside risks to global growth. The economy could also experience stronger growth should the pace of global recovery exceed expectations.

Price pressures are expected to be stronger in 2014, following the relatively benign inflation environment throughout most of 2013. Headline inflation is expected to average between 3%-4% in 2014, due mainly to domestic cost factors. The higher cost pressures will be partly contained by the subdued external price pressures, continued expansion in domestic capacity and the more moderate rate of expansion in domestic demand. There is, however, a risk that higher global commodity prices and stronger-than-expected demand conditions could put an upward pressure on inflation. Rising inflationary expectations and excessive wage increases, if they occur, would also pose upside risks to inflation. However, these risks are assessed to be contained at this juncture.

Given the nature of the factors behind the increase in inflation, monetary policy is not the best policy tool to manage the situation. Being a demand management tool, there is less reliance on monetary policy to deal with cost-push inflationary pressures. There is greater reliance on other policies, such as measures to expand domestic capacity, improve the distribution channels and promote market efficiency and competitiveness. Nevertheless, higher cost-push inflation could lead to inflation expectations becoming unanchored and could, in turn, lead to wage growth that is not consistent with productivity growth. This could create conditions for a more significant increase in inflation. Recognising these risks, monetary surveillance will remain focused on identifying

signs that inflation is becoming more pervasive and persistent, where a monetary policy response would become more appropriate.

Given the prolonged period of relatively low international and domestic interest rates, such a situation could encourage excessive risk-taking. The consequent build-up of excessive leverage and asset price misalignment could undermine macroeconomic and financial stability should these imbalances unwind in a disorderly manner. To the extent that such excessive risk-taking behaviour or asset price escalations occur within specific segments of the economy, other targeted policy instruments such as macroprudential measures would be deployed to address the risks. Such measures are, however, complementary in nature and not a substitute for interest rate policy.

Large shifts in global liquidity and capital flows are expected as central banks in some of the advanced economies continue to reduce their degree of monetary accommodation. This could heighten currency and financial market volatility in emerging economies, including in this region, and influence domestic monetary and financial conditions. The building of buffers and the continuous strengthening of fundamentals over the years has improved the resilience of the Malaysian economy and financial system to external shocks. This resilience is vital in ensuring that episodes of capital outflows do not lead to unintended excessive tightening of monetary conditions. Importantly is that the monetary and financing conditions do not become destabilising and continue to be supportive of the economy.

FISCAL POLICY OUTLOOK

Fiscal policy in 2014 is aimed towards strengthening the fiscal position, while ensuring continued support for domestic growth and the protection of the well-being of the society. Given the challenging domestic and external environment, fiscal reforms are being pursued gradually without undermining economic growth. At the same time, fiscal resources will be directed towards key economic sectors to accelerate the shift towards a high value-added, high-income economy.

The Federal Government fiscal deficit is expected to be rationalised further to 3.5% of GDP in 2014 from 3.9% of GDP in 2013, underpinned by sustained revenue expansion and more efficient spending. Given the path of fiscal consolidation,

Table 4.4

Federal Government Finance

	RM billion		% change	
	2013 ^p	2014 ^B	2013 ^p	2014 ^B
Revenue	213.4	224.1	2.6	5.0
Total expenditure	253.5	262.2	0.4	3.4
<i>Operating expenditure</i>	211.3	217.7	2.8	3.0
<i>Gross development expenditure</i>	42.2	44.5	-10.1	5.4
Loan recoveries	1.5	0.9		
Overall balance	-38.6	-37.1		
% of GDP	-3.9	-3.5		
<i>Sources of financing:</i>				
Net domestic borrowing	39.5	-		
Net external borrowing	-0.2	-		
Realisable assets ¹ and adjustments	-0.7	-		

¹ A negative (-) sign indicates a build-up in assets

^p Preliminary

^B Budget

Note: Numbers may not add up due to rounding

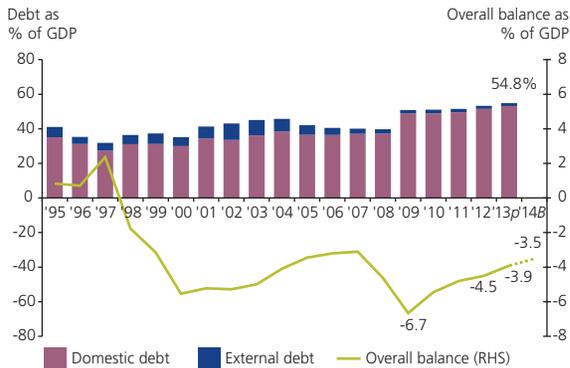
Source: Ministry of Finance, Malaysia

the Government is expected to remain on track in meeting its fiscal deficit target of 3% of GDP by 2015 and a balanced budget by 2020. The implementation of expenditure reforms would be key to reducing the fiscal deficit moving forward. Of importance is the restructuring of subsidies towards achieving fiscal sustainability. Such transition would lead to a more efficient allocation of resources in the economy.

Fiscal resources in 2014 are being prioritised towards high-impact investment projects undertaken in collaboration with the private sector. These include, among others, the ongoing MRT project, expansion of broadband infrastructure and acceleration of the development of regional economic corridors. The investment in public infrastructure will enhance mobility, connectivity and promote development nationwide, which would also further enhance productivity in the economy. Higher value-added activities, particularly in the agricultural and logistics sectors, will be encouraged to promote greater participation in the global supply chain. Incentives to improve productivity of small and medium enterprises are aimed at enhancing business competitiveness. Efforts to develop human capital will be strengthened through high quality training programmes and the implementation of the Malaysia Education Blueprint 2013-2025. The enhancement of the quality of talent is critical

Chart 4.3

Federal Government Fiscal Balance and Debt



^p Preliminary
^B Budget

Source: Ministry of Finance, Malaysia

to accelerating Malaysia’s progress towards being a high-income nation. Measures to promote affordable housing, quality healthcare services, security and public order, and environmental conservation will help to improve the quality of life and well-being of society.

In June 2013, the Fiscal Policy Committee (FPC) was established to serve as the central policy-making committee for the formulation and implementation of fiscal strategies and giving due consideration to their impact on overall macroeconomy. The objective is to have in place a holistic fiscal framework and the institutional mechanism for the successful implementation of reforms, including shifting towards a more broad-based tax system through the introduction of the Goods and Services Tax in April 2015 to ensure fiscal sustainability into the future.

2013

GOVERNANCE, ORGANISATIONAL
DEVELOPMENT AND COMMUNICATIONS

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In 2013, the Bank completed most of the targeted initiatives for the year and sustained the progress of its three year Business Plan amid increased challenges posed by the global economic and financial environment. The Bank's research, surveillance, policy and advisory functions were focused on managing the risks emanating from the external environment, volatile capital flows, rising asset prices, and high level of household debt. Several pre-emptive policy actions were undertaken to preserve macroeconomic and financial stability. The Bank continued to engage and advise the Government on relevant macroeconomic issues towards sustaining a conducive environment for the country's economic growth and development. In addition, the Bank made further progress in expanding opportunities for higher value activities within the Malaysian financial ecosystem, notably further solidifying Malaysia's position as the World's Islamic Finance Marketplace, the adoption of the Sasana Accord for financial inclusion and promoting green financing. In the area of insurance, initiatives included promoting efficiency of the motor insurance business and a more comprehensive life insurance and takaful framework to support a higher level of insurance and takaful penetration. Other areas included the liberalisation of the foreign exchange administration rules to further enhance the business environment, enhancing the platform to cater for multi-currency funds and securities settlement including issuance and raising Malaysia's profile as an international education hub in financial services. These achievements were facilitated by the Bank's continued emphasis on governance, organisational development and communications as strategic imperatives in delivering the Bank's mandates.

GOVERNANCE

The Board of Directors (Board) has responsibility for the general policy, administration and business of the Bank. The Board comprises the Governor, three Deputy Governors and the Secretary-General of the Treasury as ex-officio members of the Board and five independent directors who are non-executive members. The third Deputy Governor was appointed in April 2013. The Board exercises oversight of

the management and operations of the Bank and reviews the performance of the Bank in delivering its mandates of promoting monetary and financial stability in an environment that is conducive to the sustainable growth of the Malaysian economy. The Board reviews the Bank's strategic planning and risk management practices, human capital management, the Bank's financial position and also oversees other administrative matters that impact the efficiency and effectiveness of the Bank's operations.

In 2013, the Board met monthly during the year to deliberate on the Bank's operations and discussed new developments in the regional and global environment. The official opening of the Bank's Beijing Representative Office witnessed the first occasion where a Board meeting was conducted abroad, in Beijing, in conjunction with other activities to further strengthen bilateral ties with PR China.

At its meetings, the Board deliberated on key economic and financial conditions, and how domestic and external developments may impact the economy, the consequences for financial stability and the Bank's operations, along with the Bank's policy responses to these developments. The meetings also discussed the Bank's financial condition, reserves and currency management, and talent management issues.

During the year, the Board continued to focus its oversight role on governance and internal controls, particularly in relation to project management, information technology architecture and the enhancement of statistical systems, all of which aim to develop the Bank's capabilities to undertake its operations in a more complex and challenging environment. The Board was briefed monthly on the Bank's treasury operations and investment strategies given the uncertainties in the global financial markets. The Board also oversaw the Bank's adoption of accounting practices and reporting in compliance with generally accepted principles and practices of accounting standards, taking into consideration the Bank's unique position as a Central Bank. The Board approved a new framework to ensure the availability of

sufficient financial buffers to strengthen the financial and operational sustainability of the Bank. During 2013, the Board also approved a number of regional and international cooperation agreements with foreign regulators in the area of economic and financial sector development, and financial stability.

In performing its oversight function, the Board is supported by three Board Committees, namely the Board Governance Committee (BGC), the Board Audit Committee (BAC) and the Board Risk Committee (BRC). The members of these committees consist solely of non-executive directors and this is intended to strengthen independent oversight of the Bank's operations. The BGC is responsible for overseeing the principles and practices of governance for the Bank. The BGC convened four meetings in 2013, and made several recommendations to the Board on issues relating to the budget and operating plan and matters relating to the appointment and reappointment of Deputy Governors, members of the Shariah Advisory Committee and Financial Stability Executive Committee.

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. The BAC convened five meetings in 2013 to review and approve the audit plan, review audit activities and the performance of the Internal Audit function, review the accounts and financial statements, review the audit charter and deliberate on audit findings and the rectification actions taken to strengthen internal controls of the Bank.

The Board Risk Committee assists the Board in providing oversight on the management of risks that could lead to the Bank experiencing financial loss, disruption of operations, failure to meet its mandates or damage to the Bank's reputation. In 2013, the BRC met three times to deliberate on the Bank's management of enterprise-wide risks. The BRC discussed the Bank's transversal risks, namely people, physical security, information security and legal risks, and the associated risk mitigation strategies. 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 continued to strengthen its risk management framework to increase its agility in addressing new risks posed by the rapidly evolving landscape. The measures were focused on the Bank's ability to respond effectively in adverse situations, and included recovery facilities, roles and responsibilities, as well as business processes that reduce the time to response, improve the predictability of response and the range of possible response options. Robust risk management is a critical element that supports the sustainability of operations in the event of any adverse development in the environment.

Risk Management governance structure

The Bank's risk management governance provides clear accountabilities and responsibilities that ensure risk management strategies are effectively implemented and significant risks are adequately managed. The management of risks in the Bank is overseen by several risk committees, with roles that complement each other.

As noted earlier, the Board and the Board Risk Committee have the broad oversight function of the governance structure for the risk management framework. The Board, with the support of the BRC, provides strategic direction on risk management at the Bank to ensure that it has the necessary processes, systems and resources for effective risk management. 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 those 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 chaired by a designated Deputy Governor. The Reserves Management Committee (ReMC), chaired by the Governor, with members comprising the Deputy Governors and Assistant Governors, oversees strategies for the investment of the international reserves, the management of the associated risks and the monitoring of their impact on the Bank's financial position. The ReMC discusses global economic and financial market trends as well as the different types of risks, such as market risks, credit risks, and operational risks, that are likely to

arise in implementing the investment strategies. Financial returns are reviewed from a risk-adjusted basis and investment decisions seek to achieve a balance between returns and the risks undertaken.

Risk Management framework

The Bank has adopted Enterprise Risk Management (ERM) to have a holistic view of risks. The ERM incorporates elements from the Operational Risk Management (ORM) and Financial Risk Management (FRM) frameworks. The ORM framework promotes sound operational risk management processes and practices to manage events that may adversely affect the achievement of the Bank's mandates and objectives. The FRM framework addresses facets of financial risk management to ensure financial sustainability and places importance on the timely identification and effective management of financial risks.

The Bank adopted a three lines of defence approach that has proven to be an effective risk management tool. The first line of defence involves the line departments that are responsible for identifying, mitigating and managing risks at the operational level. The second line of defence comprises the Risk Policy Owners (RPO) and the Strategic and Risk Management Department. RPO functions were designed to assist line departments in managing transversal risks that cut across the organisation, namely legal, information security, physical security, business continuity, reputation, information technology and people risks. The third line of defence is the internal audit, which provides an independent assessment and verification of the effectiveness of the risk management policies and measures.

Key initiatives in 2013

In 2013, the ERM principles and framework were revised to establish greater integration between corporate planning and risk management by firstly, identifying the risk events that may obstruct the achievement of the desired outcomes identified in the Bank's Business Plan; and secondly, embedding the corresponding risk mitigation strategies within the Bank's Business and Operating Plan process.

The efforts in strengthening its risk management framework received international recognition when the Bank was selected to spearhead the working group on ERM Reporting at the 2013 International Operational Risk Working Group (IORWG) meeting of central banks in Rabat, Morocco. A new ERM report

was developed which captured the elements of top-down risk assessment, Risk Control Self-Assessment (RCSA) and transversal risks assessments.

Strengthening Risk Management framework, tools and practices

In terms of operational risk management practices, the three lines of defence and heightened risk awareness were strengthened by implementing an incident reporting mechanism as a tool to capture the occurrence of any risk events that could have led, or did lead, to an undesirable outcome. The policy requires incidences to be reported in order to mitigate losses, enhance monitoring of risk and ensure compliance with legislation and policies. An incident can be reported via the *IReport* application system and it will be automatically escalated to the responsible party for immediate remedial actions, where appropriate.

In addition, *IComply* serves as a repository for all internal policies and guidelines to enhance staff awareness and enhance the risk management culture within the Bank.

Heightening Risk Management awareness

Various socialisation and awareness programmes were conducted to strengthen the effectiveness of risk management practices and thus, improved the Bank's capacity to respond to business disruptions promptly. In addition to workshops conducted to enhance understanding on transversal risks and business continuity management, a Risk Awareness Day (RAD) was held to share knowledge on the latest policies, guidelines, systems and processes of risk management. The Bank stressed the roles and accountabilities of the RPO through periodic RPO forums and promoted prudent management of transversal risks with an RPO Guide.

Enhancing the Bank's readiness and resilience

The Bank revised its organisation level Business Continuity Plan (BCP) through an integrated assessment of the various business impact analysis and recovery strategies. The scope and objectives of Business Continuity Management (BCM) exercises such as Bank-wide combined live runs, call tree exercises and systems connectivity tests were further improved to test operational agility and stretch recovery capabilities. Business continuity awareness was instilled among line departments through mini desktop simulation exercises to rectify gaps in the department level BCP.

In 2013, the Bank enhanced its role as the lead for the financial industry with respect to business continuity management and participated in the annual national level cyber drill exercise. Majlis Keselamatan Negara (National Security Council) was engaged to ensure greater integration of the Bank's crisis management with the national level BCM infrastructure. Improvements to the BCM infrastructure included the development of a BCM Portal to facilitate internal and external communication and collaboration.

Internal Controls and Assurance

The Internal Audit Department (IAD) supports the BAC by providing an independent and objective assessment of the adequacy and effectiveness of the governance processes, risk management measures and internal controls of the Bank's key functions and significant activities. In addition, IAD also provides an assessment on the adequacy and effectiveness of internal controls in the identified significant activities of related entities that may affect the achievement of the Bank's mandates and objectives.

The year 2013 marked the completion of IAD's three-year audit plan which saw the department successfully complete its assessment on all core processes and major risks in the significant activities of line departments, branches and regional offices and the Bank's related entities. Annual audits were conducted on key risk areas such as reserves management, currency management (including branch operations), finance operations and procurement management to assess the adequacy of internal controls, risk management, policies and procedures, reliability and accuracy of data, and the integrity of the IT systems. IAD also evaluated the human resource function in terms of human capital planning and management and in the adherence to the Bank's code of ethics. Quality assurance was performed on the controls and governance processes of regulatory, supervisory and surveillance functions for the financial industry, including market conduct and payment system operations, to ensure the effectiveness of these roles and functions. During the three year audit cycle, an independent assessment was conducted to gauge the effectiveness of the overall policies, processes and risk methodologies adopted by the risk management function in the identification, control and monitoring of the credit, market, operational and reputational risks that may impact the Bank.

IAD had also engaged the senior management and the Boards of the related entities in assessing the adequacy of the risk control environments. Through the audit activities, IAD had increased the management's focus in strengthening the internal controls, enhancing policies and procedures and improving risk management at the Bank and its related entities. To ensure that the recommendations are implemented effectively by the departments and related entities, IAD closely monitored the remedial actions taken to resolve the audit issues raised by the auditors. This was reported quarterly to the BAC and monthly to the senior management.

IAD also continued to provide input to the various management committees and project committees as part of its advisory role to ensure the effectiveness of controls, governance processes and risk management measures within the Bank. IAD serves as an independent member in two of the Bank's large projects, at the working committee and the Project Steering Committee level, within clearly defined accountability structures to ensure the function remains independent from management, and any major concerns are to be reported to the BAC.

During the year, IAD had undertaken initiatives to further improve the effectiveness of the audit function. IAD intensified its engagements with other regulators to promote opportunities for peer learning on the latest developments in audit practices including the 2013 revised Committee of Sponsoring Organizations of the Treadway Commission (COSO) principles framework. Technical practice groups were established within the department to further deepen the collective knowledge base of the Bank's auditors in order to reflect the growing complexity and scope of the Bank's operations. IAD also continued its collaboration with the Strategic and Risk Management Department to effectively identify changes in the risk profiling of the significant activities to facilitate audit scoping and assess the adequacy and effectiveness of the controls highlighted in the respective department's Risk Control Self-Assessment.

A new three-year audit plan for 2014-2016 has been developed and approved by the BAC on 18 December 2013. The plan will be reviewed annually to reflect changes in the Bank's activities, risk profiles and operating environment. The plan continues to ensure that all departments and

related entities are audited within the three-year period. Greater focus and scope will be given to risk management and governance for the purpose of identifying and assessing the risk profile of activities undertaken by the departments and related entities, and integrating the 2013 COSO principles within the audit framework. Departments and related entities with higher risk profiles will be prioritised and audited more frequently to ensure adequate internal controls and strong risk management practices were established to mitigate the risks associated with their respective operations. The rapid changes in information technology risks will also necessitate periodic reviews of the Bank's IT systems' security controls and IT project management.

ORGANISATIONAL DEVELOPMENT

Organisational Sustainability and Preparedness

The Bank emphasised organisational development strategies aimed at sustainability and preparedness as it continues to deliver its core mandates amid the challenging global financial and economic environment. This was achieved through organisation-wide clarity and focus on key outcomes and deliverables anchored to a robust three-year Business Plan, which sets the medium term strategic direction and aligns the required resources towards achieving the Bank's objectives. Strategies and action plans are aligned to seven focus areas, namely ensuring monetary stability, preserving financial system stability, developing a more inclusive financial system, ensuring effective financial intermediation, ensuring smooth migration to e-payments, promoting greater integration of Malaysia into the regional and global economic and financial systems, as well as sustaining the high performance of the Bank.

The Business Plan 2012-14 helps different functions within the Bank to build a common understanding of outcomes and to plan on how to effectively collaborate on cross-functional initiatives or activities. The business planning process also identifies the resources required in the medium term to implement new policies. The different perspectives from various functions contribute towards more effective resource planning, clarity of inter-dependent roles and better risk management.

During the year, steps were taken to further integrate elements of business strategy, risk, human capital and financial resources for a more holistic view of organisation performance

management and more informed decision-making. Firstly, organisational and individual performance data was streamlined to ensure that performance is more rigorously measured against targets aligned with the Bank's outcomes and mandates. Secondly, new risk indicators were developed to assess risks to the achievement of desired outcomes, and highlight business strategies that require review. Thirdly, the Bank's financial discipline was strengthened with controls that require the alignment of new project budgets against the Bank's business priorities, resulting in better cost management and prioritisation of Bank-wide projects. This was augmented with revisions to internal policies to facilitate pooling of financial resources that enable more cost effective and flexible allocation and utilisation of financial resources to achieve the Bank's mandates. In addition, a project management guide is being developed to address project management risk, and ensure timely delivery and completion of projects.

In terms of continuous enhancements to the organisation's roles and functions, the Consumer and Market Conduct (CMC) Department and the Strategic Communications Department were among the functions that underwent a restructuring exercise in 2013. In the case of CMC, the exercise strengthens the surveillance and supervisory functions to more effectively address issues relating to financial scams, inappropriate selling of financial products and services and inculcate greater financial awareness amongst the public through financial education. The changes at the communications function anticipate the increased complexity of communications in terms of specialised knowledge and the importance of managing public expectations and enabling key stakeholders, including the public, to better understand the Bank's policies and actions.

Human Capital Management and Development

During the year, the Bank continued to build on the Job Family framework introduced in 2012, with emphasis on the longer term assessment, development, progression and retention of staff. Greater focus was given towards strengthening initiatives to build a healthy talent pipeline, especially for the mission critical positions that have a greater impact on the performance of the Bank. Interventions towards talent development and organisational effectiveness were also intensified through implementation of various aspects of human capital management while

addressing time to competence for staff in important functions.

The integrated profiling framework continued to be strengthened to ensure the efficiency and robustness of the assessment process for all levels of staff from the point of recruitment to mission critical talent within the Bank. The work included the up-skilling of internal assessors to enable the profiling and feedback processes to be conducted internally. The succession planning framework was implemented to support a healthy talent pipeline in the mid to long term, where talent for all mission critical positions were methodically assessed, monitored and developed for more challenging roles. The roll out of this strategic initiative will chart future plans for more rigorous leadership development interventions tailored to individual successors. Accordingly, the new career progression framework for the respective job families and refinements of the Bank's Leadership Competencies were introduced to better determine the role expectations and facilitate individual career growth and development. This approach will allow staff adequate time and resources to acquire and equip themselves with the required technical and leadership competencies to progressively grow into more demanding roles.

Developing the Bank's Workforce: Learning and Knowledge Management

In line with the Bank's strategic objectives, human capital development efforts continued to focus on the learning priorities for staff to improve competency, productivity and performance by working closely with subject matter experts to co-create a variety of structured and unstructured learning interventions.

Growing the required leadership capabilities for mission critical functions was done through structured leadership development programmes and more intensive engagements between staff selected for leadership roles and the line departments. These efforts included personalised coaching and feedback sessions to address specific leadership development gaps. The approach also enabled line departments to progressively take greater ownership for talent development, thus creating a more conducive environment for staff to demonstrate leadership potential.

Technical competency development was also intensified in 2013 through the implementation

of structured curriculum oriented around the core competencies of the different job families. Through the co-creation model, the learning interventions were not only more relevant to business needs; they were also timelier in terms of developing competencies to address emerging issues and challenges. In 2013, the Bank inaugurated a series of structured curriculum, namely the Supervision Leadership Essential Series and Advanced Supervision Series for the Supervision job family. Both programmes were aimed at providing Bank supervisors with the knowledge and skills required to perform their role effectively.

The Bank also focused on improving staff productivity through personal development and effectiveness programmes in the areas of integrated and creative thinking, problem solving, communication, coaching, time management, office management, speech and report writing and impactful presentation. These programmes were targeted to the middle management level as well as non-executives across all job families.

In addition to structured programmes, staff undertook learning through multiple informal channels in the form of leadership series, e-learning, case studies, toastmasters club and the annual book sale event. Sharing of knowledge in the form of multimedia content was also made pervasive through an intranet platform. The Bank's Knowledge Management Centre continued to expand the collection of physical and online resources for the staff in the areas of central banking, Islamic finance and financial services.

Managing the talent pool

The Bank has for many years invested in building its talent pool and in contributing to nation building. In 2013, the inaugural Kijang Academy was launched which featured an enhanced profiling methodology and feedback sessions for scholars' personal development. A total of 54 scholarships were awarded to exceptional students to pursue pre-university, first degree and post-graduate programmes in selected universities. The Bank also invested in staff to pursue relevant fields of study as part of the overall talent management strategy. A structured engagement and intervention programme was introduced for scholars aimed at enhancing English language proficiency and building self-confidence. As a result, in 2013, 39% (2012: 9%) of the Bank scholars were accepted into top universities,

while continuous engagements heightened their level of readiness for future entry into the Bank. In 2013, 76 returning scholars were successfully placed in various departments based on their specialisation, interest and best fit.

The prestigious Kijang Emas Scholarship, established in 2005 to support nation building, was awarded to three top students in the *Sijil Pelajaran Malaysia* examinations in 2012 to pursue their preferred fields of study supported by full scholarships at selected top universities in the world. As this scholarship is for nation building, recipients are required to return and serve the country upon graduation. To-date, a total of 43 Kijang Emas scholarships have been awarded.

The Bank also put in place measures to address the occasional instances of staff misconduct to ensure overall integrity and discipline as well as to maintain public confidence and reputation. Towards this end, the Bank Negara Malaysia Code of Ethics (CoE) is continuously reviewed to enable staff to fully comprehend and adhere to the expected behaviours required. The CoE was expanded and tightened to ensure that appropriate disciplinary action would be taken where necessary.

Staff strength

In 2013, the staff strength increased by 0.5% to 2,834 from 2,820 in 2012. This includes staff who are seconded or attached to extend technical assistance to or acquire knowledge from other organisations. Attrition declined marginally to 4.6% (2012: 4.8%). The ratio of executive to non-executive staff remained constant at 3.5:2. This manpower continues to be at the relevant level in order for the Bank to deliver its current mandates.

International Technical Cooperation Programmes

The Bank continues to play a role in capacity building for the global central banking community. Through its international technical cooperation programmes, the Bank also strengthened its regional and international linkages. In 2013, the programmes covered areas such as Islamic finance, financial inclusion, financial stability and organisational development, benefiting 841 officials of central banking institutions from 78 countries representing Asia, Africa, Middle East and Latin-America.

Focus was also directed towards strengthening alliances with both international and domestic

partners to improve the delivery and effectiveness of the technical cooperation programmes and to facilitate the sharing of experiences and pooling of technical expertise. International partners during the year included the Alliance for Financial Inclusion (AFI), the World Bank and the Consultative Group to Assist the Poor, SEACEN Centre, Asian Development Bank (ADB), Islamic Development Bank (IDB) and Islamic Research and Training Institute (IRTI).

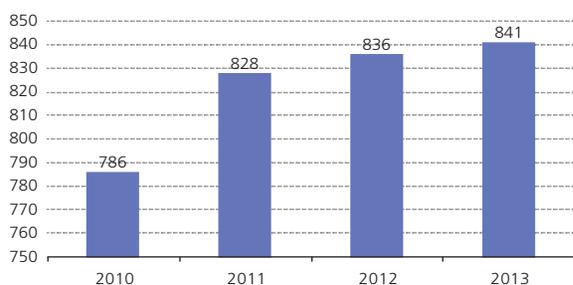
To enhance the knowledge and skills of policymakers and regulators globally in their pursuit of greater financial inclusion, the Bank and AFI signed a Letter of Cooperation for capacity building in August 2013. This collaborative framework with AFI is an important milestone towards establishing the Bank as a capacity building centre for the AFI network. In 2013, the Bank jointly organised with AFI three capacity building programmes which benefited 124 officials from 40 countries, and will be organising six capacity building programmes on relevant financial inclusion policy areas with AFI over the next two years.

The Bank also intensified its capacity building efforts to support the Association of South-East Asian Nations (ASEAN) financial integration agenda through the conduct of technical cooperation programmes, participated by 319 officials from ASEAN member countries. Of the total, 93 officials were from four of the newer ASEAN countries, namely Cambodia, Laos, Myanmar and Vietnam, participating in programmes that were supported by ADB. On a bilateral level, a Memorandum of Understanding (MoU) was signed with the Central Bank of Myanmar to establish a framework of cooperation for capacity building and human capital development with the support of the Malaysian Technical Cooperation Programme of the Malaysian Government.

Capacity building programmes in the development of an effective and well-regulated Islamic financial system continued to be a major focus area in 2013, as evidenced by the 179 participants from 28 countries in the various Islamic finance programmes organised during the year, including an Islamic Finance Workshop held in Muscat, Oman, co-organised by the Bank and IDB; and the inaugural Islamic Liquidity Management Workshop in collaboration with IRTI.

Chart 5.1

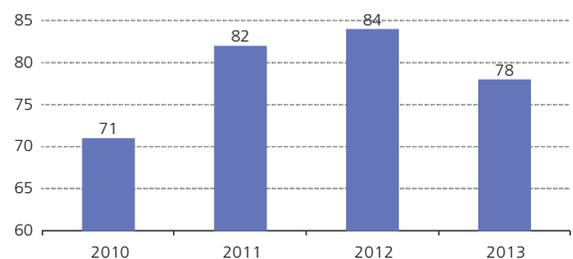
Technical Cooperation Programmes: No. of Participants



Source: Bank Negara Malaysia

Chart 5.2

Technical Cooperation Programmes: No. of Participating Countries



Source: Bank Negara Malaysia

Moving forward, the Bank is committed in its efforts to provide international technical cooperation particularly in the areas of financial inclusion, financial stability and Islamic finance to support the ASEAN financial integration agenda and foster greater regional and international ties.

Driving Service Excellence

The Bank's Centralised Shared Services (CSS) division comprises the CSS Management Office and five service units, namely Facility Management, Security, Hospitality Services, Museum, Art Gallery and KMC Services, and Human Resource and General Services.

Refinements to the CSS operating structure as a one-stop multi-service provider in April 2013 represent the management's continued effort to strengthen the value chain and create greater synergy from the rationalisation of professional support functions. The refined structure now provides the management with an improved oversight in the areas of governance, performance management, risk management, compliance,

financial management and stakeholder engagement with respect to common support functions and resources.

In 2013, CSS had developed a set of strategies aimed at developing a more integrated service delivery system, with greater standardisation to increase efficiency and value creation. Some of the early signs of improvements in the delivery of services include fast decision-making afforded by its operational autonomy and synergies created through greater alignment of internal business processes.

CSS' professional services provide an efficient support system which is vital for the success of the Bank's objectives in terms of being a center of excellence for learning in central banking and financial services, and in increasing the level of financial awareness amongst the public, the business community and school children. In 2013, CSS successfully managed an increase of 32% and 41% respectively in the number of corporate events and in the number of external events organised at Sasana Kijang and Lanai Kijang compared to 2012. The Museum and Art Gallery's exhibitions contributed to increasing awareness of the Bank's mandate and activities with a higher number of visitors totaling 40,000 in 2013 (2012: 27,701). The exhibits included the new Economics Gallery, which is the sixth gallery in operation, the organisation of creative and interesting exhibitions, as well as various educational programmes for different segments of society. In addition, the more integrated end-to-end process of facility management and more proactive preventive maintenance resulted in a reduction of 7% in facility management cost.

In developing a high-performing workforce with a user-centric mindset, CSS introduced a comprehensive Service Level Agreement (SLA) in April 2013. The clarification of the scope for service standards ensured that proper controls and commitments are in place for the service providers to consistently deliver a reliable and professional level of service to the stakeholders. The measures included the implementation of a new financial management framework in 2013 to enable more effective use of financial resources and for more robust monitoring of expenditures, hence enforcing better financial discipline amongst the service units.

CSS implemented the Third Party Administration (TPA) of the Bank's medical services with effect

1 January 2013, which resulted in substantial cost savings and improved the Bank's capability to more rigorously monitor its medical spending and the health profile of its employees. Another value-added service introduced in 2013 was the launch of the CSS Service Portal. The Portal will be developed in phases, and will serve as the single point of reference for stakeholders, and eventually serve as a common work-bench and business analytics platform to enable more informed decisions pertaining to the Bank's operations.

Sustaining Information and Communications Technology (ICT) Operations Effectiveness and Resilience

The focal point for the delivery of technology services in 2013 was operations effectiveness and efficiency through business process automation and process enhancements. These facilitated the achievement of the Bank's strategic outcomes.

Financial market infrastructure improvement and innovation

Improvements were made to the ICT infrastructure to cater for increased foreign participation in the financial system and to encourage investments by foreign players. This included system enhancements for the Fully Automated System for Tendering (FAST) to facilitate the inaugural issuance of the International Islamic Liquidity Management Corporation (IILM) USD Sukuk. In addition, a secured RENTAS Information Link (iLINK) infrastructure was made available over the Internet, thus providing local participants with an additional secured channel for access and also cater to the increased participation of foreign investors in the near future. Internally, end-to-end process flow and automation for the Bank's Financial Management System and Special Funds Integrated System via RENTAS Straight-Through Processing had ensured greater certainty of transaction integrity and better information management.

ICT facilities for a high performance workplace

The coverage of Wi-Fi Internet was further expanded, aimed towards providing 'on-premise' work mobility. An on-demand-bandwidth Wi-Fi Internet infrastructure was made available to guests attending key events hosted in the Bank, enabling the efficient provision of higher bandwidth, when required, in a cost-effective manner.

A private-cloud web conferencing service for regional communications and collaboration

between staff based at the Bank's Headquarters and at the Branches and Regional Offices was also piloted in 2013. These services-enabled capabilities such as virtual meeting and real-time online discussions empowered greater collaboration and quicker decision-making, while reducing traveling time and cost.

Continuing the thrust towards the mobile space, an iPad application leveraging on private-cloud was introduced for an international meeting participated by delegates from 11 central banks from the East-Asia Pacific region. The application was made accessible to delegates prior to the event thus allowing real-time online access to information and presentation materials.

Infrastructure with enhanced resiliency, scalability and security

The continued expansion and vibrancy of the Malaysian financial system requires a periodic technology refresh in order to ensure the performance, resiliency and robustness of the critical ICT infrastructure supporting the financial market and payment operations. Notable initiatives included the replacement of the server platform for FAST with a higher capacity and scalable infrastructure to cater for expanded business requirements. In line with such infrastructure improvements, the Bank's Enterprise Backup, Recovery and Archival platform was also revamped with more efficient, scalable and expandable infrastructure to support enhanced business continuity objectives and response time requirements.

The increased cyber security threat has led to a global trend towards the adoption of stronger encryption methodology. Given the more pervasive use of e-payments in Malaysia, the Bank has acted to improve its Enterprise Public Key Infrastructure to support the use of longer cryptographic keys in line with international standards for financial market systems such as RENTAS and Sistem Penjelasan Informasi Cek Kebangsaan secara Elektronik (eSPICK). The full deployment for adoption in the financial market systems is scheduled in first quarter 2014.

COMMUNICATIONS

The Bank's communications role was intensified in 2013 in view of heightened challenges and uncertainties, especially in the global environment. More intensive engagements were carried

out with various stakeholders, explaining the soundness of the Malaysian economy and the financial sector's resilience amidst the global and domestic headwinds which included market concerns over quantitative easing (QE) tapering and rising household indebtedness. Communication efforts were also focused in driving the Bank's strategic initiatives, including financial inclusion, expanding regional ties and extending the public outreach.

Enhancing confidence in the Malaysian economy and financial system

Throughout 2013, the Bank communicated on the resiliency of the domestic economy and financial sector using various platforms, such as the Bank's annual report and financial stability report briefings, quarterly GDP press conferences, roundtable discussions with analysts and economists, meetings with large fund managers, and senior management interviews with local and international media. The key messages conveyed were sustainable economic growth driven by domestic demand amidst a low and stable inflation environment, supported by a strong financial sector. The Bank also highlighted the increasing role of Islamic finance as an alternative to conventional financial services.

In fostering financial stability, the Bank communicated the rationale for the series of pre-emptive macro-prudential policies to address elevated household indebtedness and rising property prices. The exercise included engagements with different stakeholders, including non-banking financial intermediaries, to ensure clarity around the Bank's objectives and to facilitate more effective implementation of the measures.

During the year, various meetings and workshops were held to explain the new Financial Services Act 2013 and the Islamic Financial Services Act 2013 and its significance in placing the financial industry in a state of readiness to respond to future challenges. Similarly, to further develop the life insurance and family takaful industry in Malaysia, there were extensive engagements with industry and consumer associations on the concept paper of the revised Life Insurance and Family Takaful Framework.

In its continued efforts to enhance data resources for economic analysis, the Bank collaborated with the Department of Statistics Malaysia (DOSM)

in introducing the seasonally adjusted data for the Malaysian economy to the economics community. This was supplemented by other statistics workshops and conferences highlighting the importance of good statistics for proper analysis, better surveillance and making informed policy decisions.

Monetary policy communications

Monetary policy communications are undertaken through the Monetary Policy Statements (MPS) issued by the Monetary Policy Committee (MPC) of the Bank after each MPC meeting. These are supplemented by commentary on the monetary policy stance by senior officials at media interviews, conferences and workshops. Each MPS includes the rationale for decisions on the Overnight Policy Rate, taking into account the global and regional economic and financial developments and their impact on the domestic economy and inflation. The advance release of the scheduled dates of MPC meetings for the subsequent year provides certainty on policy making and promotes orderly market conditions.

Regional and International communication initiatives

Communications on regional and international matters covered a broader spectrum of issues, ranging from the strengthening of Malaysia's economic ties with regional economies, the launch of the new iconic brand identity 'Malaysia: World's Islamic Finance Marketplace' and the hosting of the Alliance for Financial Inclusion Global Policy Forum by the Bank. The Global Policy Forum was graced by Her Majesty Queen Maxima of the Netherlands, and culminated with the announcement of the Sasana Accord which aims to drive financial inclusion policies across the world.

As Malaysia's trade and investment with PR China continues to grow rapidly, there were increased efforts to enhance public awareness on the usage of Renminbi (RMB) for trade settlement. This resulted in greater RMB trade transactions for 2013 and increased interest amongst companies on using RMB. In anticipation of much greater financial linkages between the two countries, the Bank officially opened its Representative Office in Beijing, the third such office after London and New York.

Expediting migration to e-payments

In expediting the e-payments agenda, a nationwide campaign, 'Experience IBG', or

Interbank GIRO, was launched in collaboration with the industry to encourage businesses and the general public to switch from cheques to IBG services. The campaign covered roadshows, TV interviews, media editorials and advertisements and collaborating with participating financial institutions to engage with the public in promoting IBG services across the country. The promotions extended to the Northern and Southern regions, targeting heavy cheque users to use e-payments such as through mobile Point-of-Sale and online transactions via the Financial Processing Exchange (FPX).

Financial inclusion and empowerment

The Bank continued its outreach activities to the public to facilitate greater financial inclusion and awareness and management of financial matters. The Bank leveraged on its MobileLINK coach, counter services and strategic collaboration with various consumer associations to educate and enable rural communities to understand and use financial services, especially on the availability of agent banking services. During the year, a total of 91 sub-districts were covered with more than 15,000 people from rural communities benefiting from the engagements.

Taking cognizance of the increasing role of small and medium enterprises (SMEs) in the economy, the Bank worked together with other bodies, including the SME Bank, in engaging with the SMEs nation-wide on the availability of various financing schemes. More than 95% of the participating bankers and SMEs were satisfied with the communication programmes and more than 85% were of the view that the programmes should be continued.

A more inclusive and empowered financial system will result in a more discerning consumer with higher expectations. An important mechanism in managing these expectations is the Bank's BNMLINK services that assist the public on financial matters by providing information and resolving issues with financial institutions. The cumulative number of financial consumer enquiries from individuals and businesses increased by 7.7% to 441,712 (2012: 410,163), with 88% of the cases being resolved.

While BNMLINK addresses concerns raised by consumers at the individual level, another more structured programme launched by the Bank is the Financial Management Awareness and

Education Campaign. This programme is being implemented in collaboration with the Bank's subsidiary, the Credit Counselling and Debt Management Agency (AKPK), via prime-time radio segments, media articles and social media competitions. The areas of focus included living within means and seeking help early when experiencing signs of financial distress.

As a means to assist young and new borrowers to better manage their financial affairs, AKPK's POWER! Programme had attracted 171,485 participants since the launch of the Programme in 2011. In addition, AKPK had handled a total of 248,491 counselling cases as at end-2013 with 41% of the participants requesting further assistance under its Debt Management Programme. It had also promoted public financial literacy through participation in PEMANDU's 1 AZAM (Akhiri Zaman Misikin) programme. Through these initiatives, AKPK succeeded in reaching out to a total of 1.4 million consumers in 2013.

In terms of dispute resolution services, the Financial Mediation Bureau (FMB) continued to highlight its services through various events, exhibitions and briefings jointly with other agencies, including PIDM and AKPK. The total number of complaints received by FMB in 2013 declined to 1,881 (2012: 1,919). FMB's intervention to resolve disputes were more effective, with 2,592 complaints closed in 2013, reducing the number of outstanding cases to 1,030 (2012: 1,741). The improved performance was due to better collaboration between FMB and the Financial Service Providers and more streamlined processes in complaint management.

Enhancing public awareness on financial scams

During the year, the Bank stepped up its public awareness initiatives on financial scams. These included media advertisements and updating the Financial Consumer Alerts by an additional 52 entities to a total of 143 entities (2012: total of 91 entities) that were neither authorised nor approved under the Bank's laws and regulations. These were reinforced by continuous surveillance and intelligence sharing Bank-wide and with other law enforcement agencies. Financial scams cases reported to BNMLINK have declined by 2,511 cases (23%) to 8,402 (2012: 10,913).

Supporting national agenda of 'Going Green'

In support of the national agenda of 'Going Green', the Bank engaged with the public on the need to use recycled-fit banknotes during festive seasons to help in conserving the environment. This joint initiative with the Ministry of Energy, Green Technology and Water included the active participation of the financial industry associations.

Growing importance of online communications

The Bank's website continued to play a major role as a communication and engagement medium. Apart from explaining the Bank's mandate and roles, and providing a wide range of economic and financial data and analysis, as well as regulatory developments and policies, the website also informs consumers on financial matters, such as banking and insurance needs, and alerting them on illegal financial schemes. The website received six million visits for 2013 and was awarded the 5-star rating in the Malaysian Government Portals and Websites' annual rating exercise for the third consecutive year.

In view of the popularity of social media, the Bank has undertaken communication initiatives to engage stakeholders through this medium. These efforts saw an increase in the Bank's Facebook fans to 28,965 (2012: 18,839) and in its Twitter followers to 34,936 (2012: 14,603). To engage with the younger community, the Bank is now actively using videos in educating them on financial matters. In collaboration with the Royal Malaysian Police, the Bank is leveraging on channels such as YouTube to disseminate information on financial crimes.

Greater knowledge sharing to improve staff productivity

The Bank continues to support knowledge sharing and collaboration amongst staff with a wide range of online content, ranging from highly technical briefs to purely social events. This is complemented by various social and formal face-to-face interactions in the Bank, often with the participation of industry and international members of the financial community. All these efforts have contributed towards creating a more conducive and enriching work environment.

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REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF BANK NEGARA MALAYSIA FOR THE YEAR ENDED 31 DECEMBER 2013

Report on the Financial Statements

I have audited the financial statements of Bank Negara Malaysia which comprise the Statement of Financial Position as at 31 December 2013 and Income Statement for the year then ended, a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation and fair presentation of the financial statements in accordance with the Central Bank of Malaysia Act 2009 and applicable financial reporting standards approved in Malaysia to the extent that it is, in the opinion of the directors, appropriate to do so, having regard to the objects and functions of the Bank. The directors are also responsible for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatement or omission, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on the financial statements based on the audit. The audit has been carried out in accordance with the Audit Act 1957 and in conformity with the auditing standards approved in Malaysia. Those standards require that I comply with ethical requirements as well as to plan and perform the audit in order to obtain reasonable assurance that the financial statements are free from material misstatement or omission.

The audit involves performing procedures to obtain audit evidence on the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment including the assessment of the risks of material misstatement or omission of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers the internal control relevant to the preparation and presentation of the financial statements of Bank Negara Malaysia in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control of Bank Negara Malaysia. The audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

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 2013 and of the financial performance and the results of its operations for the year ended, in all material respects, in accordance with the Central Bank of Malaysia Act 2009 and the financial reporting standards approved in Malaysia to the extent that it is, in the opinion of the directors, appropriate to do so, having regard to the objects and functions of the Bank. The preparation of the financial statements differ, in some aspects, from the approved accounting standards in Malaysia. In accordance with the requirements of Section 9 of the Act, I also report that in my opinion, the accounting records and other records required by the Act have been properly kept by Bank Negara Malaysia.



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

PUTRAJAYA
14 MARCH 2014



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 2013 and of the results of operations for the year ended on that date.

On behalf of the Board,



ZETI AKHTAR AZIZ
CHAIRMAN

12 MARCH 2014
KUALA LUMPUR

On behalf of the Board,



OH SIEW NAM
DIRECTOR

12 MARCH 2014
KUALA LUMPUR

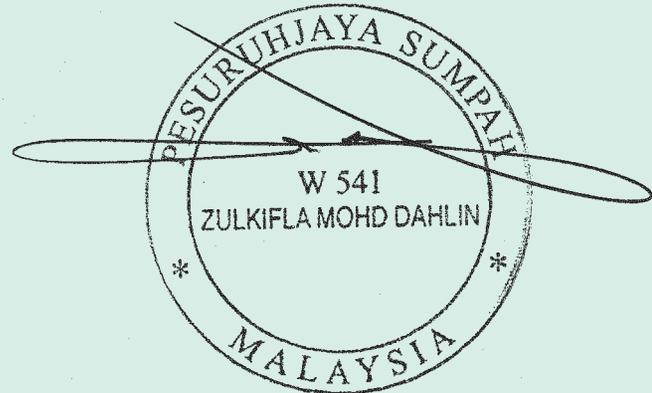
DECLARATION BY THE OFFICER PRIMARILY RESPONSIBLE FOR THE FINANCIAL MANAGEMENT OF BANK NEGARA MALAYSIA

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

Subscribed and solemnly declared)
by the abovenamed at Kuala Lumpur)
this 12 March 2014.)



Before me,



NO. 17, JALAN PETALING
50000 KUALA LUMPUR

Bank Negara Malaysia

Statement of Financial Position as at 31 December 2013

		2013 RM	2012 RM
ASSETS			
Gold and Foreign Exchange	3	432,209,463,509	418,534,966,977
International Monetary Fund Reserve Position		3,183,163,738	2,652,752,648
Holdings of Special Drawing Rights		6,488,214,835	6,043,522,017
Malaysian Government Papers	4	1,852,122,439	2,182,809,238
Deposits with Financial Institutions	5	16,444,346,374	28,235,130,500
Loans and Advances	6	6,681,648,479	9,550,114,161
Other Assets	7	7,296,923,894	6,951,916,824
Total Assets		474,155,883,268	474,151,212,365
LIABILITIES AND CAPITAL			
Currency in Circulation		73,030,918,741	67,124,370,608
Deposits from: Financial Institutions		198,707,476,320	180,812,181,557
Federal Government		7,106,526,875	14,708,467,629
Others	8	2,892,230,514	4,083,301,315
Bank Negara Papers		105,897,166,260	153,129,553,960
Allocation of Special Drawing Rights	9	6,790,312,388	6,326,742,220
Other Liabilities	10	25,259,228,604	19,531,802,167
Total Liabilities		419,683,859,702	445,716,419,456
Paid-up Capital	11	100,000,000	100,000,000
General Reserve Fund	12	14,424,959,189	14,368,713,485
Risk Reserve	13	39,947,064,377	13,966,079,424
Total Capital		54,472,023,566	28,434,792,909
Total Liabilities and Capital		474,155,883,268	474,151,212,365

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

Bank Negara Malaysia

Income Statement for the Year Ended 31 December 2013

		2013 RM	2012 RM
Total Income	Note 14	6,747,594,782	6,912,371,963
Less:			
Recurring Expenditure	15	1,120,455,560	1,151,187,009
Development Expenditure	16	170,893,518	160,857,975
Total Expenditure		1,291,349,078	1,312,044,984
Net Profit		5,456,245,704	5,600,326,979
Appropriation of Net Profit:			
Transfer to Risk Reserve	17	3,900,000,000	4,100,000,000
Transfer to General Reserve Fund		56,245,704	326,979
Amount Payable to Federal Government		1,500,000,000	1,500,000,000
Net Profit		5,456,245,704	5,600,326,979

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

Notes to the Financial Statements for the Year Ended 31 December 2013

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 11 March 2014.

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

- The financial statements have been prepared using ringgit Malaysia, the currency of the primary economic environment in which the Bank operates.
- 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.
- 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 2013. 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

	2013 RM	2012 RM
Foreign Securities	370,973,012,213	369,087,355,757
Foreign Deposits	13,753,641,155	10,382,364,133
Balances with Other Central Banks, Bank for International Settlements (BIS) and International Monetary Fund (IMF)	14,656,338,583	7,123,144,900
Others	32,826,471,558	31,942,102,187
	<u>432,209,463,509</u>	<u>418,534,966,977</u>

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.

	2013 RM	2012 RM
Malaysian Government Securities	1,852,122,439	2,176,401,438
Sukuk 1Malaysia 2010	-	6,407,800
	<u>1,852,122,439</u>	<u>2,182,809,238</u>

5. **Deposits with Financial Institutions**

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

6. **Loans and Advances**

Loans and advances comprise mainly advances extended by the Bank to the participating institutions under various schemes such as Fund for Small and Medium Industries and New Entrepreneur Fund aimed at promoting growth and development of small and medium business establishments. The extensions of these advances are mainly provided under section 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 RM4,662,873,384 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 RM6,790,312,388.

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**

	2013 RM	2012 RM
As at 1 January	14,368,713,485	14,368,386,506
Transfer from Net Profit	56,245,704	326,979
As at 31 December	<u>14,424,959,189</u>	<u>14,368,713,485</u>

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.

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 2013 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 2013 comprise the following:

(a) Membership with IMF

- (i) The Bank has an obligation to pay to IMF an equivalent amount of RM5,794,633,148 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 2013, 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 RM18,329,868,326).
- (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 2013, the amount that can be called for under the NAB credit arrangement is SDR295,881,875 (equivalent to RM1,492,508,066).
- (iv) On 23 July 2012, the Bank has pledged a USD1,000,000,000 (equivalent to RM3,275,500,000) 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 RM60,909,560. 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 2013, the Bank's total commitment amounted to USD300 million (equivalent to RM982.7 million) and there was no request for liquidity support under ASA from any member country during the financial year.

(ii) **Bilateral Currency Swap Arrangement**

(a) 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 2013, 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.

(b) On 20 October 2013, the Bank signed BCSA agreement with the Bank of Korea with the objective of promoting bilateral trade and facilitating trade settlement in local currency between the two countries. As at 31 December 2013, the Bank's total commitment under the BCSA is RM15 billion and there has been no request to activate the BCSA during the financial year.

(iii) **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 2013, the Bank's total commitment is USD9.1 billion (equivalent to RM29.8 billion). For the financial year ended 31 December 2013, there was no request for liquidity support from any member country.

19. **Financial Risk Management**

The Reserve Management Committee oversees the assessment, measurement and the control of the 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, 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 assessed and monitored on a daily basis and all of the investments and instruments are valued marked-to-market. A benchmark policy approved by the Board of Directors reflects the long-term objectives and acceptable risk-return profile of the investments. Investments may be made in instruments that are different than the benchmark. This deviation in investment is controlled through a set of risk management limits and investment guidelines that is also approved by the Board of Directors. Sensitivity analysis and stress testing are undertaken to assess emerging risk and potential marked-to-market losses from adverse movements and volatility in the market, as well as liquidity conditions.

(b) Credit Risk

Credit risk is the risk of investments not paying its principal and/or 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 credit risk framework governs the permissible investments and degree of credit exposure of the Bank. This ensures investments are with issuers and counterparties of high credit standing and the probability of losses from this risk is low. The framework, which is approved by the Board, also incorporates market-based credit indicators such as ratings implied from financial market prices, and internal credit assessment. This enhances the credit framework by providing a more dynamic and forward-looking credit assessment.

(c) Operational Risk

Operational risk 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 surveillance mechanism is in place to support the identification of emerging risk in the Bank's operations for action to be taken in managing gaps and in 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.

21. Comparatives

Certain comparative figures have been restated to conform with the current year's presentation. With effect from 2013, the accounts of the subsidiaries and the associated companies shall not be consolidated into the accounts of the Bank as such investments are immaterial compared with the total assets of the Bank. The effects of this change on the comparative figures are as follows:

	As restated	As previously stated
	RM	RM
Other Assets	6,951,916,824	9,131,723,239
Other Liabilities	19,531,802,167	21,711,608,582

2013

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Table A.1

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

	2009	2010	2011	2012	2013 ^p	2014 ^f
	RM million					
Agriculture	50,063	51,263	54,253	54,782	55,913	58,048
Mining and quarrying	66,386	66,182	62,565	63,432	63,767	64,773
Manufacturing	152,150	170,261	178,237	186,748	193,006	199,806
Construction	19,270	21,459	22,464	26,531	29,422	32,369
Services	335,027	359,829	385,179	409,976	433,998	460,742
Plus: Import duties	6,989	7,660	8,653	10,001	10,589	12,338
GDP at purchasers' prices¹	629,885	676,653	711,351	751,471	786,696	828,074
	Annual change (%)					
Agriculture	0.1	2.4	5.8	1.0	2.1	3.8
Mining and quarrying	-6.5	-0.3	-5.5	1.4	0.5	1.6
Manufacturing	-9.0	11.9	4.7	4.8	3.4	3.5
Construction	6.2	11.4	4.7	18.1	10.9	10.0
Services	2.9	7.4	7.0	6.4	5.9	6.2
Plus: Import duties	-7.1	9.6	13.0	15.6	5.9	16.5
GDP at purchasers' prices	-1.5	7.4	5.1	5.6	4.7	4.5 ~ 5.5

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

Services Sector Performance at Constant 2005 prices

	2009	2010	2011	2012	2013 ^p	2009	2010	2011	2012	2013 ^p
	Annual change (%)					Share to GDP (%)				
Services	2.9	7.4	7.0	6.4	5.9	53.2	53.2	54.1	54.6	55.2
Intermediate services	3.2	8.1	6.3	7.4	5.0	21.6	21.8	22.0	22.4	22.5
<i>Finance and insurance</i>	4.4	8.2	6.8	7.8	1.8	9.0	9.1	9.2	9.4	9.1
<i>Real estate and business services</i>	3.6	7.6	5.3	7.2	7.4	5.4	5.4	5.4	5.5	5.6
<i>Transport and storage</i>	-3.0	7.1	5.4	4.9	4.6	3.7	3.7	3.7	3.6	3.6
<i>Communication</i>	6.2	9.7	7.6	9.2	10.0	3.6	3.6	3.7	3.8	4.0
Final services	2.6	6.9	7.5	5.8	6.4	31.6	31.4	32.1	32.2	32.7
<i>Wholesale and retail trade</i>	1.7	8.3	7.1	4.8	6.4	14.0	14.1	14.3	14.2	14.5
<i>Accommodation and restaurant</i>	4.5	7.0	6.0	5.4	5.7	2.4	2.4	2.5	2.5	2.5
<i>Utilities</i>	2.0	7.7	3.4	4.3	4.1	2.6	2.6	2.5	2.5	2.5
<i>Government services</i>	3.4	5.9	12.3	9.5	8.2	7.3	7.2	7.7	8.0	8.3
<i>Other services</i>	3.8	4.4	4.9	3.9	5.1	5.2	5.1	5.1	5.0	5.0

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Table A.3

Growth in Manufacturing Production (2005=100)

	2010	2011	2012	2013	2011	2012	2013
	Index				Annual change (%)		
Export-oriented industries	107.1	110.8	115.2	118.1	3.4	3.9	2.5
Electronics and electrical products cluster	97.7	94.2	96.3	100.2	-3.6	2.2	4.0
<i>Electronics</i>	88.1	77.8	81.1	89.3	-11.7	4.2	10.2
<i>Electrical products</i>	116.5	126.3	126.1	121.4	8.4	-0.2	-3.7
Primary-related cluster	113.5	121.9	127.9	130.1	7.4	4.9	1.8
Chemicals and chemical products	117.9	128.3	139.0	146.8	8.8	8.4	5.6
Petroleum products	113.7	120.7	125.9	121.3	6.2	4.3	-3.7
Textiles, wearing apparel and footwear	83.8	92.5	85.7	88.1	10.4	-7.4	2.8
Wood and wood products	84.9	79.9	85.7	84.9	-5.9	7.2	-1.0
Rubber products	150.2	171.0	176.2	196.9	13.9	3.0	11.7
Off-estate processing	110.0	119.6	119.6	121.6	8.7	0.0	1.7
Paper products	125.8	140.4	135.8	130.0	11.6	-3.3	-4.2
Domestic-oriented industries	132.5	143.3	155.2	163.6	8.2	8.3	5.4
Construction-related cluster	133.7	157.1	170.5	175.7	17.6	8.5	3.0
Construction-related products	116.8	132.0	133.1	128.5	13.0	0.9	-3.4
<i>Non-metallic mineral products</i>	121.7	148.0	155.4	142.7	21.6	5.0	-8.2
<i>Basic iron & steel and non-ferrous metals</i>	110.9	112.4	105.9	111.2	1.4	-5.8	5.0
Fabricated metal products	166.3	205.9	242.8	266.9	23.8	18.0	9.9
Consumer-related cluster	131.6	133.4	144.1	154.8	1.3	8.1	7.4
Food products	133.8	140.1	152.3	156.7	4.7	8.7	2.9
Transport equipment	132.3	126.7	144.3	167.0	-4.3	13.9	15.8
Beverages	150.4	163.0	158.0	156.1	8.4	-3.0	-1.3
Tobacco products	88.2	98.6	109.0	89.4	11.8	10.6	-18.0
Others	115.4	114.0	112.7	124.8	-1.2	-1.1	10.7
Total	112.2	117.2	123.1	127.1	4.5	5.0	3.2

Source: Department of Statistics, Malaysia

Table A.4

GNI by Demand Aggregates

	2009	2010	2011	2012	2013 ^p	2014 ^f
	at Current Prices (RM million)					
Consumption	441,185	476,273	533,325	587,065	637,856	696,780
<i>Private consumption</i>	348,168	378,791	418,258	459,862	504,468	557,687
<i>Public consumption</i>	93,017	97,482	115,067	127,203	133,388	139,093
Investment	156,660	179,793	197,181	241,733	264,579	294,006
<i>Private investment</i>	81,028	98,555	112,786	140,180	161,119	185,196
<i>Public investment</i>	75,633	81,238	84,395	101,553	103,460	108,810
Change in stocks ¹	-29,517	5,955	8,656	828	-5,613	1,200
Exports of goods and services	651,671	744,034	810,221	820,159	816,338	851,360
Imports of goods and services	507,142	608,728	664,928	708,548	728,706	769,571
GDP at purchasers' value	712,857	797,327	884,456	941,237	984,453	1,073,775
Net factor payments abroad	-14,215	-26,333	-21,806	-36,024	-35,189	-34,940
GNI	698,642	770,994	862,650	905,213	949,264	1,038,835
	at Constant 2005 Prices (RM million)					
Consumption	387,844	411,768	447,108	479,051	514,026	545,342
<i>Private consumption</i>	309,169	330,385	352,872	379,990	408,725	436,927
<i>Public consumption</i>	78,675	81,383	94,236	99,061	105,301	108,415
Investment	141,584	158,397	168,281	201,717	218,230	237,436
<i>Private investment</i>	73,231	86,699	95,836	116,850	132,782	149,553
<i>Public investment</i>	68,353	71,697	72,445	84,867	85,448	87,883
Change in stocks ¹	-8,682	8,129	2,124	6,639	5,036	1,000
Exports of goods and services	615,024	683,391	714,793	714,070	711,983	727,120
Imports of goods and services	505,886	585,031	620,955	650,007	662,579	682,824
GDP at purchasers' prices	629,885	676,653	711,351	751,471	786,696	828,074
Net factor payments abroad	-21,941	-40,910	-44,457	-58,355	-58,401	-57,833
GNI	607,944	635,743	666,894	693,116	728,295	770,241

¹ Includes statistical discrepancy

^p Preliminary

^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5

Savings-Investment Gap

	2009	2010	2011	2012	2013 ^p
	RM million				
Public gross domestic capital formation	75,633	81,238	84,395	101,553	103,460
Public savings	63,905	85,898	87,998	95,923	49,184
Deficit/surplus	-11,728	4,660	3,603	-5,630	-54,276
Private gross domestic capital formation	51,511	104,510	121,442	141,008	155,506
Private savings	173,964	187,032	220,265	203,986	247,055
Deficit/surplus	122,453	82,522	98,823	62,978	91,549
Gross domestic capital formation	127,143	185,748	205,837	242,561	258,966
(as % of GNI)	18.2	24.1	23.9	26.8	27.3
Gross national savings	237,869	272,930	308,263	299,909	296,239
(as % of GNI)	34.0	35.4	35.7	33.1	31.2
Balance on current account	110,726	87,183	102,426	57,348	37,273
(as % of GNI)	15.8	11.3	11.9	6.3	3.9

^p Preliminary

Source: Department of Statistics, Malaysia and Ministry of Finance

Table A.6

Labour Market: Selected Indicators

	2009	2010	2011	2012	2013 ^p
	(number of positions/persons)				
Vacancies by Industry¹					
Agriculture, forestry & fishing	230,303	327,670	399,522	337,466	306,542
Mining & quarrying	1,377	2,517	3,369	2,180	1,880
Manufacturing	695,418	693,711	689,422	598,890	456,478
Construction	111,622	250,820	388,241	310,954	308,783
Services	507,627	512,503	778,994	369,983	329,007
<i>Electricity, gas & water supply²</i>	4,367	8,269	15,091	6,521	7,043
<i>Wholesale & retail trade; accommodation & food services</i>	162,270	147,303	185,577	109,117	95,966
<i>Transport & storage; information & communication</i>	15,090	17,888	20,100	17,921	14,864
<i>Finance & insurance; real estate & business services³</i>	148,001	168,067	372,346	114,099	96,399
<i>Public administration & defence; compulsory social security</i>	16,128	20,414	6,897	5,115	4,020
<i>Community, social & other service activities</i>	161,771	150,562	178,983	117,210	110,715
Total vacancies	1,546,347	1,787,221	2,259,548	1,619,473	1,402,690
Retrenchments by Industry					
Agriculture, forestry & fishing	278	866	172	156	180
Mining & quarrying	78	30	24	81	117
Manufacturing	17,850	3,854	5,635	7,616	7,940
Construction	503	262	290	1,002	353
Services	6,355	2,073	3,329	2,639	2,605
<i>Electricity, gas & water supply²</i>	156	-	66	46	-
<i>Wholesale & retail trade; accommodation & food services</i>	1,429	662	1,322	743	742
<i>Transport & storage; information & communication</i>	643	208	293	292	362
<i>Finance & insurance; real estate & business services³</i>	1,923	934	672	827	628
<i>Public administration & defence; compulsory social security</i>	137	22	545	511	548
<i>Community, social & other service activities</i>	2,067	247	431	220	325
Total retrenchments	25,064	7,085	9,450	11,494	11,195
Employment by Industry ('000 persons)					
Agriculture, forestry & fishing	1,471.1	1,614.9	1,410.0	1,601.7	1,713.8
Mining & quarrying	64.7	57.2	76.0	80.6	87.9
Manufacturing	1,807.1	2,108.5	2,222.3	2,227.9	2,230.3
Construction	1,015.9	1,082.7	1,133.6	1,163.7	1,258.8
Services	6,540.2	7,036.4	7,442.6	7,649.2	8,045.4
<i>Electricity, gas & water supply²</i>	58.1	122.2	122.4	142.5	145.2
<i>Wholesale & retail trade; accommodation & food services</i>	2,632.3	2,744.5	2,941.7	3,073.0	3,266.1
<i>Transport & storage; information & communication</i>	592.0	733.6	812.8	833.2	812.9
<i>Finance & insurance; real estate & business services³</i>	873.4	1,026.7	1,156.7	1,230.6	1,265.1
<i>Public administration & defence; compulsory social security</i>	813.8	787.7	749.0	697.6	771.5
<i>Community, social & other service activities</i>	1,570.6	1,621.7	1,660.0	1,672.3	1,784.8
Total employment	10,899.0	11,899.5	12,284.4	12,723.2	13,336.2
Unemployment rate (% of labour force)	3.7	3.3	3.1	3.0	3.1

¹ Refers to vacancies reported by employers through the JobsMalaysia portal. Data from 2012 onwards is not comparable to previous years due to a reclassification exercise

² Refers to electricity, gas, steam, air conditioning; water supply, sewerage, waste management and remediation activities

³ Refers to finance and insurance, real estate, professional, scientific, technical, administrative and support services

^p Preliminary

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, Ministry of Human Resources and Bank Negara Malaysia

Table A.7

Private Consumption Indicators

	2008	2009	2010	2011	2012	2013
Sales of passenger cars ('000 units)	497.5	486.1	543.6	520.5	552.2	576.7
Annual change (%)	12.3	-2.3	11.8	-4.3	6.1	4.4
Imports of consumption goods (RM billion)	32.3	31.4	34.5	39.5	43.7	47.5
Annual change (%)	11.8	-2.7	9.7	14.7	10.7	8.7
Tax collection						
Sales tax (RM billion)	8.4	8.6	8.2	8.6	9.5	10.1
Service tax (RM billion)	3.3	3.3	3.9	5.0	5.6	5.9
Narrow Money (M1)						
Annual change (%)	8.3	9.8	11.7	15.4	11.9	13.0
Loans disbursed by banking system						
Consumption credit (excl. passenger cars)						
Annual change (%)	2.2	19.7	12.5	13.3	-3.4	7.9
Wholesale and retail trade, restaurants and hotels						
Annual change (%)	24.5	-7.4	16.3	13.8	27.4	4.2
MRA retail sales (Annual change in %)	5.0	0.8	8.4	8.1	5.5	4.5 ^e
Credit card turnover spending ¹ (RM billion)	63.4	68.1	78.0	86.8	91.9	98.1
Annual change (%)	14.4	7.5	14.5	11.2	5.9	6.8
MIER Consumer Sentiment Index ²	71.4	109.6	117.2	106.3	118.7	82.4
FBM KLCI	876.8	1,272.8	1,518.9	1,530.7	1,689.0	1,867.0
Commodity prices						
CPO (RM/tonne)	2,875	2,257	2,752	3,279	2,864	2,375
Crude oil (USD/barrel)	102.1	64.3	79.7	113.8	118.6	115.1
Rubber (sen/kg)	828.8	642.8	1,069.6	1,366.5	962.4	785.9

¹ Resident spending only² Refers to 4th quarter^e Estimates

Table A.8

Private Investment Indicators

	2008	2009	2010	2011	2012	2013
Sales of commercial vehicles ('000 units)	50.7	50.6	61.6	65.0	75.6	79.1
Annual change (%)	14.4	-0.2	21.8	5.6	16.2	4.7
Imports of capital goods (RM billion)	69.9	65.8	73.8	80.3	96.1	98.7
Annual change (%)	0.0	-5.9	12.2	8.9	19.6	2.8
Approvals by MIDA (Manufacturing sector)						
No. of projects	919	766	910	846	804	787
Capital investment (RM billion)	62.8	32.6	47.2	56.1	41.1	52.1
<i>Local</i>	16.7	10.5	18.1	21.9	20.2	21.6
<i>Foreign</i>	46.1	22.1	29.1	34.1	20.9	30.5
New investment (% share)	66.9	67.6	50.6	59.0	65.4	73.1
Reinvestments (% share)	33.1	32.4	49.4	41.0	34.6	26.9
Loans disbursed by banking system						
Manufacturing sector						
Annual change (%)	12.4	-15.2	12.0	21.9	16.1	-1.6
Construction sector						
Annual change (%)	6.8	16.6	5.5	5.4	20.5	14.4
Private Debt Securities (excluding Cagamas)						
Total funds raised (RM billion)	49.7	58.6	52.1	69.6	121.1	83.9
New activities	33.3	8.7	13.5	8.4	19.5	7.5
Initial Public Offerings (Bursa Malaysia)						
Total funds raised (RM billion)	1.3	12.2	19.8	7.4	22.9	8.2
MIER Business Conditions Survey						
Business Conditions Index ¹	53.8	118.8	99.5	96.6	94.1	92.0
Capacity Utilisation Rate ¹	74.4	81.4	82.9	81.2	80.9	80.0
MSC-Status Companies						
No. of companies	242	284	218	215	213	236
Approved investment (RM billion)	1.8	2.2	1.5	2.5	2.9	3.0

¹ Refers to 4th quarter

Table A.9

Balance of Payments

	2010			2011		
	+	-	Net	+	-	Net
	RM million					
Goods¹	641,135	504,384	136,751	699,591	548,026	151,565
Services	102,900	104,344	-1,444	110,630	116,902	-6,272
Transportation	15,696	38,087	-22,391	15,482	40,546	-25,064
Travel	58,350	26,733	31,617	60,146	31,187	28,959
Other services	28,572	38,741	-10,168	34,723	44,367	-9,644
Government transactions n.i.e.	281	783	-502	279	803	-524
Balance on goods and services	744,034	608,728	135,306	810,221	664,928	145,293
Primary income	38,322	64,655	-26,333	52,491	74,297	-21,806
Compensation of employees	3,550	5,632	-2,082	3,707	6,038	-2,331
Investment income	34,772	59,023	-24,251	48,785	68,260	-19,475
Secondary income	1,920	23,711	-21,790	4,683	25,744	-21,061
Balance on current account	784,276	697,094	87,183	867,395	764,969	102,426
% of GNI			11.3			11.9
Capital account			-111			-133
Financial account			-19,946			23,265
Direct investment			-13,977			-9,337
Assets			-49,163			-55,324
Liabilities			35,186			45,987
Portfolio investment			48,467			26,139
Assets			-23,176			-18,522
Liabilities			71,643			44,661
Financial derivatives			-698			-76
Other investment			-53,738			6,539
Official sector			119			-1,337
Private sector			-53,856			7,876
Balance on capital and financial accounts			-20,057			23,132
Errors and omissions			-69,754			-30,876
of which:						
Foreign exchange revaluation gain (+) / loss (-)			-32,641			7,566
Overall balance (surplus + / deficit -)			-2,628			94,682
Bank Negara Malaysia international reserves, net ²						
RM million			328,649			423,331
USD million			106,518			133,610
Reserves as months of retained imports			8.6			9.6

¹ Adjusted for valuation and coverage to the balance of payments basis

² 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

2012			2013 _p			2014 _f		
+	-	Net	+	-	Net	+	-	Net
RM million								
703,152	577,538	125,614	690,867	588,191	102,677	714,593	620,894	93,700
117,007	131,010	-14,003	125,471	140,516	-15,045	136,766	148,677	-11,911
13,665	41,677	-28,012	14,373	44,727	-30,354	15,677	47,810	-32,133
62,548	35,654	26,893	66,225	37,648	28,576	73,970	40,249	33,721
40,536	53,006	-12,470	44,620	57,648	-13,028	46,746	60,171	-13,425
257	672	-415	253	492	-239	373	447	-74
820,159	708,548	111,611	816,338	728,706	87,632	851,360	769,571	81,789
42,323	78,348	-36,024	47,453	82,643	-35,189	51,826	86,767	-34,940
4,076	7,116	-3,040	4,400	8,259	-3,859	4,086	8,920	-4,833
38,247	71,232	-32,985	43,053	74,384	-31,331	47,740	77,847	-30,107
6,848	25,087	-18,239	7,337	22,506	-15,169	7,000	23,000	-16,000
869,330	811,982	57,348	871,128	833,855	37,273	910,186	879,337	30,849
		6.3			3.9			3.0
		159			-48			
		-23,037			-15,048			
		-21,748			-4,080			
		-51,910			-40,622			
		30,162			36,542			
		58,388			-2,766			
		-21,455			-31,901			
		79,843			29,135			
		954			-101			
		-60,632			-8,101			
		-1,702			-3,933			
		-58,930			-4,169			
		-22,878			-15,096			
		-30,597			-7,528			
		-7,686			18,611			
		3,873			14,649			
		427,204			441,853			
		139,715			134,902			
		9.5			9.5			

Table A.10

Gross Exports

	2011	2012	2013 ^p	2012	2013 ^p	2013 ^p
	RM million			Annual change (%)		% share
Manufactures	504,127	519,897	549,606	3.1	5.7	76.4
<i>of which:</i>						
Electronics, electrical machinery and appliances	261,006	256,471	264,004	-1.7	2.9	36.7
Electronics	182,159	178,789	186,594	-1.8	4.4	25.9
<i>Semiconductors</i>	107,090	101,789	111,194	-4.9	9.2	15.4
<i>Electronic equipment & parts</i>	75,069	77,000	75,399	2.6	-2.1	10.5
Electrical machinery & appliances	78,847	77,682	77,411	-1.5	-0.3	10.8
<i>Electrical industrial machinery and equipment</i>	27,659	29,204	31,067	5.6	6.4	4.3
<i>Industrial & commercial electrical products</i>	24,508	25,480	24,117	4.0	-5.3	3.4
<i>Consumer electrical products</i>	22,866	18,714	18,230	-18.2	-2.6	2.5
<i>Household electrical appliances</i>	3,814	4,285	3,997	12.3	-6.7	0.6
Chemicals & chemical products	47,767	47,318	52,152	-0.9	10.2	7.2
Petroleum products	36,654	52,785	66,827	44.0	26.6	9.3
Manufactures of metal	31,011	29,475	34,928	-5.0	18.5	4.9
Optical and scientific equipment	18,760	22,928	20,814	22.2	-9.2	2.9
Rubber products	17,516	19,466	18,222	11.1	-6.4	2.5
Textiles, clothing and footwear	10,939	9,488	10,216	-13.3	7.7	1.4
Wood products	8,563	8,456	8,455	-1.2	...	1.2
Agriculture	91,426	77,343	64,230	-15.4	-17.0	8.9
<i>of which:</i>						
Palm oil	60,310	53,067	41,774	-12.0	-21.3	5.8
Rubber	13,481	7,864	7,027	-41.7	-10.6	1.0
Minerals	90,604	92,974	96,488	2.6	3.8	13.4
<i>of which:</i>						
Liquefied natural gas (LNG)	52,049	56,129	59,193	7.8	5.5	8.2
Crude oil and condensates	32,452	31,951	31,639	-1.5	-1.0	4.4
Others	11,705	12,428	9,491	6.2	-23.6	1.3
Total	697,862	702,641	719,815	0.7	2.4	100.0

Table A.11

Exports of Primary Commodities

	2011	2012	2013 ^p	2011	2012	2013 ^p
	Volume and value			Annual change (%)		
Commodity exports (RM million)	182,031	170,317	160,718	28.2	-6.4	-5.6
Agriculture exports (RM million)	91,426	77,343	64,230	33.0	-15.4	-17.0
<i>of which:</i>						
Palm oil						
('000 tonnes)	18,448	17,890	17,819	8.9	-3.0	-0.4
(RM/tonne)	3,269	2,966	2,344	23.8	-9.3	-21.0
(RM million)	60,310	53,067	41,774	34.8	-12.0	-21.3
Palm kernel oil						
('000 tonnes)	1,083	1,294	1,124	6.1	19.5	-13.1
(RM/tonne)	3,557	1,901	1,926	42.6	-46.6	1.3
(RM million)	3,853	2,460	2,165	51.2	-36.2	-12.0
Rubber						
('000 tonnes)	946	771	846	5.0	-18.5	9.7
(sen/kilogramme)	1,425	1,020	831	39.4	-28.4	-18.5
(RM million)	13,481	7,864	7,027	46.4	-41.7	-10.6
Saw logs						
('000 cubic metres)	3,315	3,013	3,142	-23.4	-9.1	4.3
(RM/cubic metre)	589	561	595	19.0	-4.7	6.0
(RM million)	1,952	1,691	1,870	-8.9	-13.3	10.6
Sawn timber						
('000 cubic metres)	2,085	2,043	1,964	-3.1	-2.0	-3.9
(RM/cubic metre)	1,560	1,558	1,613	3.5	-0.1	3.5
(RM million)	3,252	3,183	3,168	0.3	-2.1	-0.5
Cocoa beans						
('000 tonnes)	25.4	47.7	42.9	7.3	87.5	-10.0
(RM/tonne)	10,038	8,364	8,368	-13.0	-16.7	0.1
(RM million)	255	399	359	-6.6	56.3	-10.0
Mineral exports (RM million)	90,604	92,974	96,488	23.8	2.6	3.8
<i>of which:</i>						
Crude oil and condensates						
('000 tonnes)	12,506	11,863	11,816	-23.6	-5.1	-0.4
(USD/barrel)	111.67	114.98	111.68	45.9	3.0	-2.9
(RM million)	32,452	31,951	31,639	5.5	-1.5	-1.0
Liquefied natural gas (LNG)						
('000 tonnes)	24,848	23,769	25,252	8.3	-4.3	6.2
(RM/tonne)	2,095	2,361	2,344	24.1	12.7	-0.7
(RM million)	52,049	56,129	59,193	34.3	7.8	5.5
Tin						
('000 tonnes)	42.3	37.2	36.4	25.5	-12.1	-2.2
(RM/tonne)	76,460	64,794	69,453	23.7	-15.3	7.2
(RM million)	3,234	2,410	2,526	55.2	-25.5	4.8

^p Preliminary

Source: Department of Statistics, Malaysia

Table A.12

Principal Markets for Manufactured Exports

	2009	2010	2011	2012	2013 ^p	2009	2010	2011	2012	2013 ^p
	RM million					% share				
ASEAN	114,026	130,666	138,797	155,027	169,277	26.4	26.8	27.5	29.8	30.8
Singapore	70,183	78,370	81,856	88,719	94,650	16.2	16.1	16.2	17.1	17.2
Thailand	24,148	28,285	28,521	30,679	32,876	5.6	5.8	5.7	5.9	6.0
Indonesia	13,016	15,675	18,925	25,473	31,356	3.0	3.2	3.8	4.9	5.7
Philippines	5,218	6,992	7,959	8,171	7,966	1.2	1.4	1.6	1.6	1.4
Brunei Darussalam	1,462	1,344	1,536	1,985	2,429	0.3	0.3	0.3	0.4	0.4
European Union	52,830	58,527	58,707	50,402	56,545	12.2	12.0	11.6	9.7	10.3
Netherlands	15,301	16,389	13,564	12,939	16,266	3.5	3.4	2.7	2.5	3.0
Germany	13,739	15,408	16,128	14,216	15,183	3.2	3.2	3.2	2.7	2.8
United Kingdom	6,657	6,801	6,587	6,351	6,531	1.5	1.4	1.3	1.2	1.2
Others	17,133	19,929	22,428	16,896	18,564	4.0	4.1	4.4	3.2	3.4
The People's Republic of China	51,254	61,027	63,749	67,332	76,781	11.9	12.5	12.6	13.0	14.0
United States	56,897	55,604	51,027	54,962	53,595	13.2	11.4	10.1	10.6	9.8
Japan	30,204	35,596	37,987	35,733	33,270	7.0	7.3	7.5	6.9	6.1
Hong Kong SAR	28,293	31,548	30,262	29,166	30,533	6.5	6.5	6.0	5.6	5.6
Middle East	20,659	21,273	22,646	22,978	23,343	4.8	4.4	4.5	4.4	4.2
Australia	13,927	13,154	14,037	15,160	16,237	3.2	2.7	2.8	2.9	3.0
Korea	9,895	12,313	12,996	14,150	14,014	2.3	2.5	2.6	2.7	2.5
India	8,319	11,508	14,220	14,734	12,516	1.9	2.4	2.8	2.8	2.3
Chinese Taipei	10,216	13,357	13,506	12,949	12,469	2.4	2.7	2.7	2.5	2.3
Latin American countries	7,362	9,063	9,849	9,727	9,583	1.7	1.9	2.0	1.9	1.7
Canada	2,630	2,977	2,589	2,788	2,388	0.6	0.6	0.5	0.5	0.4
Rest of the World	25,668	30,237	33,756	34,788	39,055	5.9	6.2	6.7	6.7	7.1
Total	432,179	486,849	504,127	519,897	549,606	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.13

Principal Export Markets for Electronics

	2009	2010	2011	2012	2013 ^p	2009	2010	2011	2012	2013 ^p
	RM million					% share				
The People's Republic of China	34,862	38,326	38,644	38,101	38,461	19.3	19.7	21.2	21.3	20.6
Singapore	28,049	32,027	28,304	27,913	31,688	15.5	16.5	15.5	15.6	17.0
Hong Kong SAR	20,283	22,500	21,464	21,307	23,562	11.2	11.6	11.8	11.9	12.6
United States	28,170	24,605	20,384	21,651	21,007	15.6	12.7	11.2	12.1	11.3
Thailand	9,352	9,344	8,782	10,635	11,779	5.2	4.8	4.8	5.9	6.3
Japan	9,565	9,936	9,469	10,118	9,880	5.3	5.1	5.2	5.7	5.3
Netherlands	9,493	10,264	6,086	6,687	8,927	5.3	5.3	3.3	3.7	4.8
Germany	7,658	8,413	8,019	5,544	6,634	4.2	4.3	4.4	3.1	3.6
Chinese Taipei	5,851	6,242	5,696	6,080	5,706	3.2	3.2	3.1	3.4	3.1
Korea	3,547	4,369	5,281	3,940	3,596	2.0	2.2	2.9	2.2	1.9
Others	23,912	28,386	30,029	26,812	25,354	13.2	14.6	16.5	15.0	13.6
Total	180,743	194,412	182,159	178,789	186,594	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 Electrical Products¹

	2009	2010	2011	2012	2013 ^p	2009	2010	2011	2012	2013 ^p
	RM million					% share				
United States	12,979	12,484	11,666	12,679	13,391	19.0	16.3	14.8	16.3	17.3
European Union	9,454	9,281	10,882	9,485	9,626	13.9	12.1	13.8	12.2	12.4
Singapore	8,190	8,470	8,419	8,890	9,061	12.0	11.0	10.7	11.4	11.7
Japan	6,961	9,251	9,507	7,115	6,885	10.2	12.1	12.1	9.2	8.9
Middle East	5,089	6,479	6,762	6,843	5,946	7.5	8.4	8.6	8.8	7.7
Indonesia	2,471	2,491	3,316	3,677	4,078	3.6	3.2	4.2	4.7	5.3
Thailand	2,601	3,427	3,530	4,077	3,910	3.8	4.5	4.5	5.2	5.1
The People's Republic of China	3,201	3,972	4,238	4,222	3,741	4.7	5.2	5.4	5.4	4.8
Australia	4,122	4,285	3,365	3,164	3,113	6.0	5.6	4.3	4.1	4.0
Others	13,138	16,595	17,162	17,529	17,659	19.3	21.6	21.8	22.6	22.8
Total	68,205	76,734	78,847	77,682	77,411	100.0	100.0	100.0	100.0	100.0

¹ Including machinery and equipment

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.15

Principal Export Markets for Chemicals and Chemical Products

	2009	2010	2011	2012	2013 ^p	2009	2010	2011	2012	2013 ^p
	RM million					% share				
The People's Republic of China	5,348	6,772	8,051	8,815	10,781	15.7	16.3	16.9	18.6	20.7
Indonesia	3,070	4,012	4,610	5,233	5,391	9.0	9.7	9.7	11.1	10.3
Thailand	2,764	3,295	4,185	4,236	4,519	8.1	7.9	8.8	9.0	8.7
Singapore	3,299	3,756	3,906	3,873	4,271	9.7	9.0	8.2	8.2	8.2
Japan	2,286	3,093	4,015	3,611	3,477	6.7	7.4	8.4	7.6	6.7
India	2,011	2,490	2,831	2,922	2,926	5.9	6.0	5.9	6.2	5.6
Korea	1,230	1,420	1,710	1,852	2,100	3.6	3.4	3.6	3.9	4.0
United States	1,166	1,339	1,543	1,383	1,835	3.4	3.2	3.2	2.9	3.5
Netherlands	1,083	1,324	1,755	1,349	1,646	3.2	3.2	3.7	2.9	3.2
Philippines	1,117	1,331	1,572	1,482	1,564	3.3	3.2	3.3	3.1	3.0
Others	10,704	12,725	13,589	12,562	13,643	31.4	30.6	28.4	26.5	26.2
Total	34,079	41,557	47,767	47,318	52,152	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.16

Principal Export Markets for Palm Oil

	2009	2010	2011	2012	2013 ^p	2009	2010	2011	2012	2013 ^p
	'000 tonnes					% share				
The People's Republic of China	4,059	3,463	4,034	3,484	3,651	25.0	20.4	21.9	19.5	20.5
India	1,263	1,184	1,723	2,628	2,281	7.8	7.0	9.3	14.7	12.8
European Union	1,979	2,104	2,187	2,419	2,323	12.2	12.4	11.9	13.5	13.0
<i>Netherlands</i>	1,117	1,133	1,293	1,511	1,549	6.9	6.7	7.0	8.4	8.7
<i>Italy</i>	151	188	212	291	251	0.9	1.1	1.1	1.6	1.4
<i>Sweden</i>	54	119	158	99	125	0.3	0.7	0.9	0.6	0.7
<i>Spain</i>	120	107	156	183	125	0.7	0.6	0.8	1.0	0.7
<i>Others</i>	537	557	369	335	273	3.3	3.3	2.0	1.9	1.5
Middle East	1,364	1,864	1,775	1,505	1,481	8.4	11.0	9.6	8.4	8.3
Pakistan	1,764	2,134	1,851	1,359	1,408	10.9	12.6	10.0	7.6	7.9
United States	866	1,032	1,045	1,022	1,013	5.3	6.1	5.7	5.7	5.7
Japan	528	542	551	557	499	3.2	3.2	3.0	3.1	2.8
Singapore	438	468	467	599	472	2.7	2.8	2.5	3.3	2.7
Bangladesh	113	171	149	249	374	0.7	1.0	0.8	1.4	2.1
Korea	299	322	365	371	355	1.8	1.9	2.0	2.1	2.0
Philippines	114	210	521	291	190	0.7	1.2	2.8	1.6	1.1
Others	3,469	3,451	3,778	3,406	3,771	21.3	20.4	20.5	19.0	21.2
Total	16,256	16,945	18,448	17,890	17,819	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.17

Principal Export Markets for Rubber

	2009	2010	2011	2012	2013 ^p	2009	2010	2011	2012	2013 ^p
	'000 tonnes					% share				
The People's Republic of China	272	348	409	307	391	38.7	38.6	43.2	39.7	46.3
European Union	184	270	275	232	199	26.2	30.0	29.1	30.0	23.5
<i>Germany</i>	82	118	114	112	104	11.6	13.1	12.0	14.5	12.2
<i>Finland</i>	4	11	17	15	18	0.5	1.2	1.8	2.0	2.1
<i>Portugal</i>	17	23	21	18	14	2.4	2.5	2.3	2.4	1.7
<i>France</i>	18	22	16	12	12	2.6	2.4	1.7	1.6	1.4
<i>Belgium</i>	5	6	14	12	10	0.7	0.7	1.4	1.6	1.1
<i>United Kingdom</i>	8	12	18	12	9	1.1	1.3	1.9	1.5	1.0
<i>Others</i>	59	91	93	61	42	8.4	10.1	9.8	7.9	5.0
Middle East	54	64	55	55	75	7.7	7.1	5.8	7.1	8.9
<i>Iran</i>	32	39	28	33	55	4.5	4.3	2.9	4.2	6.5
<i>Turkey</i>	17	20	21	16	14	2.4	2.2	2.3	2.0	1.7
<i>Others</i>	6	5	6	6	6	0.8	0.6	0.6	0.8	0.7
United States	28	40	34	33	36	4.0	4.4	3.6	4.3	4.2
Brazil	23	27	21	23	29	3.3	3.0	2.3	2.9	3.4
Korea	47	49	44	32	25	6.7	5.4	4.6	4.1	3.0
Chinese Taipei	13	14	11	10	11	1.9	1.5	1.2	1.4	1.3
Others	80	89	97	80	79	11.4	9.9	10.3	10.4	9.4
Total	703	901	946	771	846	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.18

Principal Export Markets for Crude Oil

	2009	2010	2011	2012	2013 ^p	2009	2010	2011	2012	2013 ^p
	'000 tonnes					% share				
Australia	3,321	5,166	3,729	4,521	4,297	20.2	31.5	29.8	38.1	36.4
India	2,872	2,320	2,454	1,952	2,251	17.5	14.2	19.6	16.5	19.0
Thailand	2,767	2,262	2,042	1,901	1,906	16.9	13.8	16.3	16.0	16.1
Japan	469	616	922	1,115	922	2.9	3.8	7.4	9.4	7.8
New Zealand	214	539	409	544	776	1.3	3.3	3.3	4.6	6.6
Korea	877	950	865	498	477	5.3	5.8	6.9	4.2	4.0
The People's Republic of China	1,429	1,382	944	581	357	8.7	8.4	7.5	4.9	3.0
Singapore	1,428	896	169	170	283	8.7	5.5	1.4	1.4	2.4
Philippines	561	946	297	305	146	3.4	5.8	2.4	2.6	1.2
Others	2,475	1,296	677	276	400	15.1	7.9	5.4	2.3	3.4
Total	16,412	16,373	12,506	11,863	11,816	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 LNG

	2009	2010	2011	2012	2013 ^p	2009	2010	2011	2012	2013 ^p
	'000 tonnes					% share				
Japan	12,877	13,990	15,416	14,808	15,528	58.3	60.9	62.0	62.3	61.5
Korea	5,659	4,839	3,972	4,152	4,317	25.6	21.1	16.0	17.5	17.1
Chinese Taipei	2,455	2,828	3,362	2,764	2,660	11.1	12.3	13.5	11.6	10.5
Others	1,104	1,296	2,097	2,045	2,748	5.0	5.6	8.4	8.6	10.9
Total	22,095	22,953	24,848	23,769	25,252	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.20

External Debt and Debt Servicing

	2009	2010	2011	2012	2013p
	RM million				
Medium- and long-term debt:					
Gross borrowing	35,839	53,373	76,887	86,071	97,989
<i>Federal Government</i>	459	4,493	6,561	678	453
<i>Public enterprises</i>	17,900	4,076	3,043	8,612	12,482
<i>Private sector</i>	17,480	44,805	67,283	76,781	85,054
Repayment and prepayment	36,095	50,700	78,886	77,694	79,277
<i>Federal Government</i>	6,767	823	5,978	694	783
<i>Public enterprises</i>	9,478	3,574	7,313	9,665	5,550
<i>Private sector</i>	19,850	46,303	65,595	67,335	72,944
Net borrowing	-256	1,874	-1,017	7,859	20,246
<i>Federal Government</i>	-6,308	3,670	583	-16	-330
<i>Public enterprises</i>	8,422	502	-4,269	-1,053	6,931
<i>Private sector</i>	-2,371	-2,297	2,669	8,928	13,645
Outstanding debt	155,312	147,653	153,611	159,788	189,967
<i>Federal Government</i>	13,787	16,745	18,105	16,848	16,763
<i>Public enterprises</i>	75,933	70,383	69,647	66,034	76,330
<i>Private sector</i>	65,591	60,524	65,859	76,906	96,875
Short-term debt:					
Outstanding debt	77,434	79,420	103,753	92,964	128,114
<i>Banking sector¹</i>	68,572	67,982	92,302	80,488	113,529
<i>Non-bank private sector</i>	8,863	11,438	11,451	12,475	14,584
Total external debt:	232,746	227,072	257,364	252,752	318,081
Total external debt (USD million)	67,332	72,817	80,404	81,715	95,796
<i>% GNI</i>	33.3	29.5	29.8	27.9	33.5
<i>Annual change (%)</i>	-1.5	-2.4	13.3	-1.8	25.8
Currency composition (% share)	100.0	100.0	100.0	100.0	100.0
<i>US dollar</i>	72.7	65.8	68.4	68.1	71.3
<i>Japanese yen</i>	8.4	8.8	8.2	6.7	4.9
<i>Others</i>	18.9	25.4	23.4	25.2	23.8
Total servicing (including short-term interest payment)	42,284	56,153	84,123	82,976	84,061
<i>of which:</i>					
Medium- and long-term debt					
Repayment²	36,095	50,700	78,886	77,694	79,277
<i>Federal Government</i>	6,767	823	5,978	694	783
<i>Public enterprises</i>	9,478	3,574	7,313	9,665	5,550
<i>Private sector</i>	19,850	46,303	65,595	67,335	72,944
Interest payment	5,718	4,974	4,737	4,830	4,419
<i>Federal Government</i>	931	558	492	840	673
<i>Public enterprises</i>	3,295	3,342	3,326	2,943	2,487
<i>Private sector</i>	1,492	1,074	919	1,047	1,259
Debt service ratio (% of exports of goods and services)					
Total debt	6.5	7.5	10.4	10.1	10.3
Medium- and long-term debt	6.4	7.5	10.3	10.1	10.3
<i>Federal Government</i>	1.2	0.2	0.8	0.2	0.2
<i>Public enterprises</i>	2.0	0.9	1.3	1.5	1.0
<i>Private sector</i>	3.3	6.4	8.2	8.3	9.1

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.21

Consumer Price Index

	Weights (%) (2010=100)	2010	2011	2012	2013
		Annual change (%)			
Total	100.0	1.7	3.2	1.6	2.1
<i>of which:</i>					
Food and non-alcoholic beverages	30.3	2.4	4.8	2.7	3.6
Alcoholic beverages and tobacco	2.2	4.0	4.6	0.4	6.0
Clothing and footwear	3.4	-1.4	-0.2	-0.6	-0.6
Housing, water, electricity, gas and other fuels	22.6	1.1	1.8	1.6	1.7
Furnishings, household equipment and routine household maintenance	4.1	0.7	1.8	2.0	1.5
Health	1.3	1.6	2.7	2.0	1.9
Transport	14.9	1.6	4.4	0.7	2.0
Communication	5.7	-0.2	-0.3	-0.6	-0.7
Recreation services and culture	4.6	1.6	2.0	1.2	0.1
Education	1.4	1.7	2.2	2.4	2.4
Restaurants and hotels	3.2	2.0	5.9	2.9	2.5
Miscellaneous goods and services	6.3	2.7	2.4	2.0	0.3

Source: Department of Statistics, Malaysia

Table A.22

Producer Price Index

	Weights (%) (2005=100)	2010	2011	2012	2013
		Annual change (%)			
Total	100.0	5.6	9.0	0.1	-1.9
<i>of which:</i>					
Food	5.4	2.6	8.6	1.0	2.4
Beverages and tobacco	0.9	-0.5	3.7	0.3	2.1
Crude materials, inedible	5.4	22.4	23.2	-10.3	-11.1
Mineral fuels, lubricants, etc.	17.4	12.8	24.2	7.0	-0.6
Animal and vegetable oils and fats	4.2	17.9	24.4	-11.7	-14.1
Chemicals	7.0	3.0	9.4	-0.5	0.4
Manufactured goods	10.9	1.8	3.2	-0.5	-0.3
Machinery and transport equipment	42.9	1.2	-0.6	0.8	-0.5
Miscellaneous manufactured articles	5.4	0.6	2.5	0.6	0.1
Miscellaneous transactions and commodities	0.5	12.2	6.2	1.3	-2.3
Local production	65.6	7.7	12.0	-0.2	-2.3
Import	34.4	1.4	2.3	0.7	-0.9

Source: Department of Statistics, Malaysia

Table A.23

Broad Money (M3)

	Annual change					As at end
	2009	2010	2011	2012	2013	2013
	RM million					
Broad money (M3) ¹	85,439	68,791	155,581	111,211	109,504	1,462,390
Currency in circulation ²	3,015	4,246	5,142	3,971	5,819	62,617
Demand deposits	14,707	18,449	28,854	26,998	32,053	264,537
Broad quasi-money	67,717	46,096	121,585	80,242	71,633	1,135,237
<i>Fixed deposits</i>	23,347	27,038	72,789	60,894	66,957	681,006
<i>Savings deposits</i>	10,050	2,675	10,728	8,070	8,025	131,765
<i>NIDs</i>	-8,583	-4,115	-1,239	-1,392	18	15,816
<i>Repos</i>	898	655	-1,701	2,150	100	2,260
<i>Foreign currency deposits</i>	15,283	1,432	13,125	14,090	4,877	88,114
<i>Other deposits</i>	26,721	18,412	27,883	-3,570	-8,345	216,276
Factors Affecting M3						
Net claims on Government	25,808	-8,119	2,803	-3,311	21,394	69,984
<i>Claims on Government</i>	35,919	-3,116	4,839	896	16,025	124,629
<i>Less: Government deposits</i>	10,110	5,003	2,035	4,207	-5,370	54,645
Claims on private sector	50,957	84,847	116,431	128,389	119,534	1,323,876
<i>Loans</i>	46,481	91,981	111,787	105,512	109,445	1,189,755
<i>Securities</i>	4,476	-7,134	4,644	22,877	10,089	134,121
Net foreign assets	22,462	31,785	103,372	19,419	14,865	523,704
<i>Bank Negara Malaysia³</i>	7,343	-1,793	94,530	4,095	14,185	435,063
<i>Banking system</i>	15,119	33,578	8,842	15,325	680	88,642
Other influences	-13,789	-39,722	-67,025	-33,287	-46,289	-455,174

¹ Excludes interplacements among banking institutions

² Excludes holdings by banking system

³ Includes exchange rate revaluation loss/gain

Note: Numbers may not add up due to rounding

Table A.24

Money Supply: Annual Change and Growth Rates

	2009		2010		2011		2012		2013	
	RM million	%	RM million	%						
Currency in circulation	3,015	7.5	4,246	9.8	5,803	12.2	3,907	7.3	5,449	9.5
Demand deposits with commercial banks and Islamic banks	14,855	10.4	19,221	12.2	28,769	16.3	26,872	13.1	32,318	13.9
M1 ¹	17,869	9.8	23,467	11.7	34,572	15.4	30,779	11.9	37,768	13.0
Other deposits with commercial banks and Islamic banks ²	68,044	9.4	47,343	6.0	120,878	14.5	87,005	9.1	73,696	7.1
Deposits with other banking institutions ³	-475	-1.7	-2,020	-7.2	131	0.5	-6,574	-25.2	-1,959	-10.0
M3 ⁴	85,439	9.2	68,791	6.8	155,581	14.3	111,211	9.0	109,504	8.1

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

Note: Numbers may not add up due to rounding

Table A.25

Interest Rates (%)

	As at end-year							As at end-month in 2013											
	2007	2008	2009	2010	2011	2012		Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
Overnight interbank	3.49	3.25	1.99	2.72	2.99	3.00		2.99	2.99	3.00	3.00	3.00	3.00	3.00	3.00	2.93	2.98	3.00	2.99
1-week interbank	3.52	3.27	2.02	2.77	3.01	3.01		3.01	3.01	3.01	3.01	3.01	3.01	3.01	3.02	3.01	3.01	3.02	3.02
1-month interbank	3.56	3.30	2.07	2.83	3.05	3.06		3.07	3.07	3.10	3.06	3.08	3.06	3.06	3.10	3.07	3.06	3.07	3.20
Commercial banks																			
Fixed deposit																			
3-month	3.15	3.04	2.03	2.74	2.99	2.97		2.97	2.97	2.97	2.97	2.97	2.97	2.97	2.97	2.97	2.97	2.97	2.97
12-month	3.70	3.50	2.50	2.97	3.22	3.15		3.15	3.15	3.15	3.15	3.15	3.15	3.15	3.15	3.15	3.15	3.15	3.15
Savings deposit	1.44	1.40	0.86	1.00	1.15	1.03		1.00	1.01	1.01	1.02	1.02	1.01	1.01	1.02	1.01	1.01	1.01	0.99
Base lending rate (BLR)	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	6.53
Treasury bills (91 days) ¹	3.39	2.94	1.98	2.82	2.99	3.04		3.04	3.04	3.04	3.02	3.01	3.01	3.00	3.01	3.00	3.00	3.00	3.00
Government Securities																			
1-year	3.53	2.89	2.12	2.85	2.82	3.01		3.00	3.00	2.97	2.95	2.98	3.10	3.11	3.11	3.06	2.95	2.98	3.03
5-year	3.78	3.00	3.79	3.39	3.23	3.24		3.23	3.25	3.22	3.15	3.28	3.41	3.68	3.68	3.56	3.37	3.60	3.66
Private debt securities																			
AAA																			
3-year	4.07	4.17	3.72	3.63	3.65	3.53		3.54	3.55	3.56	3.54	3.51	3.57	3.66	3.71	3.67	3.65	3.69	3.71
5-year	4.28	4.48	4.32	4.07	3.99	3.80		3.81	3.81	3.81	3.80	3.75	3.79	3.88	3.94	3.97	3.86	3.91	3.96
AA																			
3-year	4.39	4.95	4.50	4.34	4.29	4.04		4.04	4.05	4.04	4.01	3.96	3.99	4.10	4.09	4.11	4.09	4.12	4.16
5-year	4.64	5.31	5.07	4.75	4.65	4.30		4.30	4.31	4.30	4.27	4.21	4.22	4.33	4.33	4.34	4.31	4.38	4.41
A																			
3-year	6.06	6.90	6.80	6.90	6.57	6.34		6.32	6.33	6.32	6.34	6.34	6.37	6.39	6.34	6.33	6.34	6.34	6.32
5-year	6.51	7.43	7.57	7.53	7.11	6.98		6.97	6.96	6.93	6.98	7.02	7.04	7.03	7.03	7.00	7.02	7.01	7.02
BBB																			
3-year	9.71	10.32	10.18	10.40	10.21	10.06		10.06	10.08	10.06	10.06	10.01	10.02	10.02	10.03	9.94	10.02	10.01	10.02
5-year	10.72	11.36	11.32	11.43	11.24	11.14		11.15	11.16	11.15	11.17	11.14	11.14	11.14	11.18	11.05	11.13	11.12	11.17
BB & below																			
3-year	11.92	12.68	12.58	12.78	12.62	12.53		12.48	12.57	12.56	12.57	12.53	12.55	12.54	12.55	12.43	12.52	12.50	12.52
5-year	13.16	13.86	14.02	14.51	14.13	13.76		13.69	13.79	13.76	13.82	13.80	13.82	13.77	13.78	13.64	13.71	13.71	13.70

¹ Refers to data from FAST, Bank Negara Malaysia

Table A.26

Movements of the Ringgit

	RM to one unit of foreign currency ¹			Annual change (%)		Change (%)
	2005	2012	2013	2012	2013	21 Jul. '05 - Dec. '13
	21 Jul. ²	End-Dec.				
SDR	5.5049	4.6791	5.0481	3.9	-7.3	9.0
US dollar	3.8000	3.0583	3.2815	3.9	-6.8	15.8
Singapore dollar	2.2570	2.5030	2.5943	-2.4	-3.5	-13.0
100 Japanese yen	3.3745	3.5576	3.1281	15.2	13.7	7.9
Pound sterling	6.6270	4.9420	5.4076	-0.9	-8.6	22.6
Australian dollar	2.8823	3.1804	2.9299	1.3	8.6	-1.6
Euro	4.6212	4.0412	4.5263	1.7	-10.7	2.1
100 Thai baht	9.0681	9.9910	9.9757	0.2	0.2	-9.1
100 Indonesian rupiah	0.0386	0.0317	0.0269	9.2	17.8	43.4
100 Korean won	0.3665	0.2865	0.3108	-4.2	-7.8	17.9
100 Philippine peso	6.8131	7.4446	7.3908	-2.7	0.7	-7.8
100 New Taiwan dollar	11.890	10.533	11.009	-0.5	-4.3	8.0
Chinese renminbi	0.4591	0.4909	0.5422	2.5	-9.5	-15.3

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.27

Housing Credit Institutions

	Year of establishment	Objective	Lending rate for new housing loans (%)		No. of branches	
			2012	2013	2012	2013
Commercial banks	-		4.30 ^{1,2}	4.27 ^{1,2}	4228 ³	4341 ³
Treasury Housing Loans Division	1970	To provide housing loans to Government employees	4.00 ¹	4.00 ¹	1	1
Bank Kerjasama Rakyat Malaysia Berhad	1954	A co-operative society which collects deposits and provides banking facilities according to Syariah principles	6.30 ¹	4.50 ¹	140	144
Malaysia Building Society Berhad	1950	To be a consumer driven financial institution offering property lending and deposit taking activities leading to wealth creation for its valued customers	7.35 ~ 7.41	7.09 ~ 7.33	38	43
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	4.64 ¹	4.81 ¹	396	400
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.28

Housing Loans Outstanding

	2012	2013 ^p	2012	2013 ^p	2012	2013 ^p
	RM million		Annual change (%)		% share	
Commercial banks ¹	288,501	325,047	12.8	12.7	86.3	87.5
Treasury Housing Loans Division	32,982	32,464	5.7	-1.6	9.9	8.7
Bank Kerjasama Rakyat Malaysia Berhad	2,978	2,569	-11.9	-13.7	0.9	0.7
Malaysia Building Society Berhad	5,409	5,394	4.8	-0.3	1.6	1.5
Borneo Housing Mortgage Finance Berhad	641	660	-1.7	2.8	0.2	0.2
Bank Simpanan Nasional	3,806	5,074	15.4	33.3	1.1	1.4
Sabah Credit Corporation	96	81	-17.9	-15.8
Total	334,413	371,289	11.6	11.0	100.0	100.0

¹ Includes Islamic banks^p Preliminary

... Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.29

Housing Loans Approved

	2012	2013 ^p	2012	2013 ^p	2012	2013 ^p
	RM million		Annual change (%)		% share	
Commercial banks ¹	87,807	111,406	-1.1	26.9	88.4	90.2
Treasury Housing Loans Division	8,316	9,042	22.4	8.7	8.4	7.3
Bank Kerjasama Rakyat Malaysia Berhad	39	566	-29.1	1351.3	0.0	0.5
Malaysia Building Society Berhad	800	435	56.3	-45.6	0.8	0.4
Borneo Housing Mortgage Finance Berhad	91	171	74.7	86.7	0.1	0.1
Bank Simpanan Nasional	2,237	1,829	114.6	-18.2	2.3	1.5
Sabah Credit Corporation	0	0
Total	99,290	123,449	2.1	24.3	100.0	100.0

¹ Includes Islamic banks^p Preliminary

... Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.30

Financing of the Economy

By customer By financing type/institution	Businesses ¹		Households	Government	Total Financing
	Total	of which: SMEs ²			
RM million					
Net Change in Financing (2012)					
Financial Intermediaries					
Banking Institutions	38,861	23,782	63,949	1,656	104,465
Development Financial Institutions (DFIs) ³	2,915	(91)	7,291	-	10,205
Other Domestic Intermediaries ⁴	(12,480)	(36)	2,689	-	(9,792)
Capital Market					
Bond Market ⁵	60,374	-	-	47,937	108,310
Equity Market	27,405	-	-	-	27,405
External Financing					
Foreign Direct Investment	31,117				31,117
External Loan ^{6,7}	12,072			(4,870)	7,201
Total	160,261	23,655	73,928	44,723	278,911
Net Change in Financing (2013p)					
Financial Intermediaries					
Banking Institutions	47,165	22,639	74,130	(3,609)	117,687
Development Financial Institutions (DFIs) ³	3,422	1,295	5,491	-	8,913
Other Domestic Intermediaries ⁴	(928)	145	(81)	-	(1,010)
Capital Market					
Bond Market ⁵	29,012	-	-	41,925	70,937
Equity Market	16,027	-	-	-	16,027
External Financing					
Foreign Direct Investment	38,774				38,774
External Loan ^{6,7}	22,078			10,211	32,288
Total	155,550	24,079	79,540	48,527	283,617

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

Note: Numbers may not add up due to rounding

Table A.31

Consolidated Public Sector Finance

	2010	2011	2012	2013 ^p	2014 ^f
	RM billion				
Revenue ¹	127.2	160.7	189.0	195.1	205.4
% growth	-4.3	26.3	17.7	3.2	5.3
Operating expenditure	167.1	196.1	226.0	234.1	239.7
% growth	-2.0	17.3	15.2	3.6	2.4
Current surplus of NFPEs ²	123.2	107.0	129.7	85.2	99.5
Current balance	83.2	71.5	92.7	46.2	65.2
% of GDP	10.4	8.1	9.9	4.7	6.2
Net development expenditure ³	103.0	101.3	135.2	180.2	164.3
% growth	-8.2	-1.7	33.5	33.3	-8.9
General Government ⁴	53.7	51.8	50.8	50.3	53.0
NFPEs	49.3	49.5	84.4	130.0	111.3
Overall balance	-19.8	-29.8	-42.5	-134.1	-99.0
% of GDP	-2.5	-3.4	-4.5	-13.6	-9.4

¹ Excludes transfers within General Government

² Refers to 30 NFPEs from 2004 onwards

³ Adjusted for transfers and net lendings within public sector

⁴ Comprises Federal Government, state governments, local governments and statutory bodies

^p Preliminary

^f Forecast

Note: Numbers may not add up due to rounding

Source: Ministry of Finance, Malaysia and non-financial public enterprises (NFPEs)

Table A.32

Major Advanced Economies: Key Economic Indicators

	2009	2010	2011	2012	2013e	2014f
	Annual change (%)					
REAL GDP						
United States	-2.8	2.5	1.9	2.8	1.9	2.8
Japan	-5.5	4.7	-0.5	1.4	1.5	1.7
Euro area	-4.4	2.0	1.6	-0.7	-0.5	1.0
<i>Germany</i>	-5.1	4.0	3.3	0.7	0.4	1.6
United Kingdom	-5.2	1.7	1.1	0.2	1.8	2.4
INFLATION						
United States	-0.4	1.6	3.2	2.1	1.5	1.5
Japan	-1.4	-0.7	-0.3	0.0	0.4	2.9
Euro area	0.3	1.6	2.7	2.5	1.4	1.5
<i>Germany</i>	0.2	1.2	2.5	2.1	1.6	1.8
United Kingdom	2.2	3.3	4.5	2.8	2.6	2.3
	% of labour force					
UNEMPLOYMENT						
United States	9.3	9.6	8.9	8.1	7.4	6.3 - 6.6
Japan	5.1	5.1	4.6	4.3	4.0	4.3
Euro area	9.6	10.1	10.1	11.4	12.1	12.2
<i>Germany</i>	7.8	7.1	5.9	5.5	5.3	5.5
United Kingdom	7.6	7.8	8.0	7.9	7.6	7.5
	% of GDP					
CURRENT ACCOUNT BALANCE						
United States	-2.6	-3.0	-3.0	-2.7	-2.7	-2.8
Japan	2.9	3.7	2.0	1.0	1.2	1.7
Euro area	-0.2	0.1	0.1	1.3	2.3	2.5
<i>Germany</i>	6.0	6.3	6.2	7.0	6.0	5.7
United Kingdom	-1.4	-2.7	-1.5	-3.7	-2.8	-2.3
FISCAL BALANCE¹						
United States	-12.9	-10.8	-9.7	-8.3	-5.8	-4.7
Japan	-10.4	-9.3	-9.9	-10.1	-9.5	-6.8
Euro area	-6.4	-6.2	-4.2	-3.7	-3.1	-2.5
<i>Germany</i>	-3.1	-4.2	-0.8	0.1	-0.4	-0.1
United Kingdom	-11.4	-10.1	-7.7	-6.1	-6.1	-5.8

¹ Refers to general government fiscal balance

e Estimate

f Forecast

Source: International Monetary Fund, Federal Reserve (Dec 2013 Projections) and National Authorities

Table A.33

Emerging Asia: Key Economic Indicators

	2009	2010	2011	2012	2013e	2014f
REAL GDP	Annual change (%)					
Regional Countries						
The People's Republic of China	9.2	10.4	9.3	7.7	7.7	7.5
Korea	0.3	6.3	3.7	2.0	2.8	3.7
Chinese Taipei	-1.8	10.8	4.2	1.5	2.1	3.8
Singapore	-0.6	15.1	6.0	1.9	4.1	3.4
Hong Kong SAR	-2.5	6.8	4.8	1.5	2.9	4.4
Malaysia	-1.5	7.4	5.1	5.6	4.7	4.5 ~ 5.5
Thailand	-2.3	7.8	0.1	6.5	2.9	3.5
Indonesia	4.6	6.2	6.5	6.3	5.8	5.5
Philippines	1.1	7.6	3.6	6.8	7.2	6.0
INFLATION	Annual change (%)					
Regional Countries						
The People's Republic of China	-0.7	3.3	5.4	2.6	2.6	3.0
Korea	2.8	2.9	4.0	2.2	1.3	2.3
Chinese Taipei	-0.9	1.0	1.4	1.9	0.8	2.0
Singapore	0.6	2.8	5.2	4.6	2.4	2.7
Hong Kong SAR ¹	0.5	2.4	5.3	4.1	4.3	3.5
Malaysia	0.6	1.7	3.2	1.6	2.1	3 ~ 4
Thailand	-0.9	3.3	3.8	3.0	2.2	2.1
Indonesia	4.8	5.1	5.4	4.3	7.0	7.5
Philippines	4.2	3.8	4.6	3.2	3.0	3.5
CURRENT ACCOUNT BALANCE	% of GDP					
Regional Countries						
The People's Republic of China	4.8	4.0	1.9	2.3	2.0	2.7
Korea	3.9	2.9	2.3	3.8	4.6	3.9
Chinese Taipei	11.4	9.3	8.9	10.5	10.0	9.6
Singapore	17.7	26.8	24.6	18.6	18.5	17.6
Hong Kong SAR	9.9	7.0	5.6	1.6	2.3	2.5
Malaysia	15.5	10.9	11.6	6.1	3.8	2.9
Thailand	8.3	3.1	1.7	0.0	0.1	-0.2
Indonesia	2.0	0.7	0.2	-2.8	-3.2	-3.1
Philippines	5.6	4.5	3.1	2.8	2.5	2.2
FISCAL BALANCE²	% of GDP					
Regional Countries						
The People's Republic of China	-2.3	-1.7	-1.1	-1.7	-1.9	-2.1
Korea ³	0.0	1.7	1.8	1.9	1.4	1.7
Chinese Taipei ³	-6.2	-5.0	-4.0	-4.3	-3.2	-3.0
Singapore ³	-0.5	7.4	9.6	7.4	5.3	4.8
Hong Kong SAR ³	1.5	4.2	3.9	3.2	2.6	3.3
Malaysia	-6.7	-5.4	-4.8	-4.5	-3.9	-3.5
Thailand	-4.4	-1.5	-1.6	-4.4	-2.7	-3.2
Indonesia	-1.6	-0.7	-1.1	-0.8	-2.2	-2.5
Philippines	-3.7	-3.5	-2.0	-2.3	-0.8	-0.8

¹ Refers to composite price index

² Refers to central government fiscal balance

³ Refers to general government fiscal balance

e Estimates

f Forecast

Source: International Monetary Fund, National Authorities, Economist Intelligence Unit (EIU) and Bank Negara Malaysia estimates

