BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Statutory Requirements

In accordance with section 48 of the Central Bank of Malaysia Act 1958, 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 2006, 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 2006 is incorporated in Bank Negara Malaysia's Financial Stability and Payment Systems Report 2006 which forms an integral part of this Annual Report 2006.

Zeti Akhtar Aziz
Chairman
Board of Directors

21 March 2007

Board of Directors

Dr. Zeti Akhtar Aziz
D.K. (Johor), P.S.M., S.S.A.P., D.P.M.J.
Governor and Chairman

Dato' Ooi Sang Kuang
D.M.P.N.
Deputy Governor

Datuk Zamani bin Abdul Ghani
D.M.S.M., D.S.M., K.M.N.
Deputy Governor

Dato' Mohd Razif Abd Kadir
D.P.M.P., D.I.M.P.
Deputy Governor

Dato' Dr. Wan Abdul Aziz bin Wan Abdullah
D.P.S.K., A.M.N.

Datuk Oh Siew Nam
P.J.N.

Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor
P.S.M., D.A., P.N.B.S., J.S.M., J.B.S., A.M.N., P.B.J., P.P.D.(Emas)

Dato' N. Sadasivan
D.P.M.P., J.S.M., K.M.N.

Tan Sri Dato Sri Mohd. Hassan Marican
P.S.M., S.P.M.T., D.S.M.T., P.N.B.S., A.M.K.

Dato' Mohd Razif Abd Kadir was appointed as Deputy Governor with effect from 1 June 2006.

Datuk Oh Siew Nam, Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor and Dato' N. Sadasivan were reappointed as members of the Board effective 1 March 2007.

Dato' Dr. Wan Abdul Aziz bin Wan Abdullah was appointed as a member of the Board with effect from 28 February 2007. Tan Sri Dato' Sri Izzuddin bin Dali resigned from the Board with effect from 27 February 2007 on completion of his term as Secretary General to the Treasury.

Governor	Dr. Zeti Akhtar Aziz
Deputy Governor	Dato' Ooi Sang Kuang
Deputy Governor	Datuk Zamani bin Abdul Ghani
Deputy Governor	Dato' Mohd Razif bin Abd. Kadir
Assistant Governor	Dato' Mohamad Daud bin Hj. Dol Moin
Assistant Governor	Muhammad bin Ibrahim
Assistant Governor	Nor Shamsiah binti Mohd Yunus
Assistant Governor	Dato' Mohd Nor bin Mashor
Assistant Governor	Gopala Krishnan Sundaram
Assistant Governor	Lillian Leong Bee Lian
Secretary to the Board	Dato' Mohd Nor bin Mashor
Director	
Corporate Communications	Abu Hassan Alshari bin Yahaya
Internal Audit	Hor Weng Keng
Special Investigation	Johar bin Mokhtar
Financial Intelligence	Jeremy Lee Eng Huat
Economics	
Monetary Assessment and Strategy	Dr. Sukhdave Singh
Economics	V. Vijayaledchumy
International	Ismail bin Alowi
Regulation	
Financial Sector Development	Ahmad Hizzad bin Baharuddin
Financial Surveillance	Donald Joshua Jaganathan
Prudential Financial Policy	S. Abd. Rasheed bin S. Abd Ghafur
Consumer and Market Conduct	Koid Swee Lian
Islamic Banking and Takaful	Bakarudin bin Ishak
Development Finance and Enterprise	Marzunisham bin Omar
Supervision	
Financial Conglomerates Supervision	Che Zakiah binti Che Din
Banking Supervision	Chung Chee Leong
Insurance and Takaful Supervision	Yap Lai Kuen
IT and DFI Supervision	Mahdi bin Mohd. Ariffin
Payment Systems Policy	Cheah Kim Ling
Investment and Operations	
Investment Operations and Financial Market	Norzila binti Abdul Aziz
Foreign Exchange Administration	Wan Hanisah binti Wan Ibrahim
Currency Management and Operation	Ramli bin Saad
Organisation Support	
Human Resource Development Centre	Lim Lai Hong
Statistical Services	Chew Siew Kheam
Strategic Management	A. Kanagalingam
Risk Management	Santhini a/p Chandrapal
Human Resource Management	Kamari Zaman bin Juhari
Corporate Services	Dato' Mohd Nor bin Mashor
Property and Services	Zulkifli bin Abd Rahman
Security	Mior Mohd Zain bin Mior Mohd Tahir
Legal	Gopala Krishnan Sundaram
IT Services	Alizah binti Ali
Finance	Abdul Aziz bin Abdul Manaf
Financial Services Resource Centre	Lim Foo Thai
Head of Unit	
Regulation and Supervision Support	Siti Ramlah binti Ahmad
Chief Representative	
London Representative Office	Azman bin Mat Ali
New York Representative Office	Mahendran a/l Kanagaratnam
Branch Manager	
Pulau Pinang	Raman a/l Krishnan
Johor Bahru	Abdul Aziz bin Ahmad
Kota Kinabalu	Ahmad bin Abd Rahim
Kuching	Ishak bin Musa
Kuala Terengganu	Azizan bin Mohd Ali
Shah Alam	Mohd. Khir bin Hashim

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BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

The Malaysian economy achieved a steady growth in 2006 amidst an environment of moderating inflation. We entered the year with rising inflationary pressures, arising from record-high oil prices. While the policy rate was raised three times during the course of six months, monetary policy decisions carefully balanced the need to deal with the risks of inflation and the need to sustain a steady pace of economic growth.

With the increased flexibility of the economy, the more diversified economic structure, the improved macroeconomic fundamentals and the strengthened financial sector, the economy has emerged stronger and more resilient in 2006. While the external position remained strong, domestic private sector activity continued to drive the economic expansion. This trend was also reinforced by strong inflows of foreign direct investment. The manufacturing, services and the agriculture sectors continued to be the main engines of growth, while the mining and construction sectors experienced a recovery during the year.

Inflationary expectations were well anchored during the year. Despite rising inflation in the first half of the year, demand-induced inflation remained low and there was limited evidence of second-round effects from the supply-driven price shocks to headline consumer prices. Hence, following the increase in interest rates in late 2005 and early 2006, monetary policy remained unchanged for the remaining part of the year.

Malaysia continues to be a highly open economy in terms of the volume of trade and financial flows, and in terms of the foreign presence in our economy and financial system. In 2006, both exports and imports expanded at double-digit rates. Foreign direct investment in Malaysia also accounted for over one-quarter of investment. In addition, foreign financial institutions in the banking sector account for almost 30% of the market share while in the insurance, the foreign presence accounts for about 70%. Foreign participation in the capital market is also significant, with participation in the bond market now including non-residents who invest in papers as well as those issuing securities.

As a result of the high degree of integration with the global economy and the international financial system, global developments have significant effects on the domestic financial markets and economy. In addition, with the highly liberal exchange control policies, there have been large and volatile capital flows. Malaysia is therefore not insulated from external developments and contagion. Malaysia's ability to absorb this increased volatility has, however, been strengthened considerably. This increased resilience has been derived from the more diversified economic structure, the improved macroeconomic fundamentals, the strengthened financial system and the more developed financial markets.

While this growing resilience means that the country has the enhanced capacity to deal with shocks arising from unexpected external developments, the private sector will also need to actively manage their risks so as to be better positioned to benefit from the increased opportunities that the new environment accords. Strengthened corporate governance and risk management practices, reinforced by increased efficiency and greater innovation, will contribute to enhanced competitiveness and resilience. The accelerated development of the financial system has led to the emergence of new financial intermediaries, new financial instruments, more developed financial markets, and more liberalized exchange control rules. These progressive developments are aimed at meeting the changing requirements of the environment, facilitating flexibility in managing financial transactions and enhancing risk management by the private sector.

It has been almost two years since Malaysia transitioned to a more flexible exchange rate regime. The successful transition was the result of having in place a series of preconditions for its successful implementation. This includes a stronger and more dynamic banking sector; a deep and liquid bond market; strengthened macroeconomic fundamentals; sufficiently high level of reserves; and the liberalisation of the capital account commensurate with the capacity of the market to manage the risks. In addition, a surveillance mechanism has also been put in place to monitor capital flows given its increased influence in affecting exchange rate movements.

The developments in the ringgit foreign exchange market have generally been orderly, reflecting market conditions and the underlying fundamentals of the economy. The strength of the economy has essentially generated two-way flows that have contributed to the stability of the underlying trend in the exchange rate. The major part of the inflows is from export earnings, long-term investment activities and portfolio investments. The core of these flows is based firmly on sound fundamentals. The outflows have also generally reflected the strength of the economy that include the increased import demand, the repatriation of profits and dividends by foreign corporations and financial institutions, and the repayment and prepayment of external debt. In addition, an increasingly evident trend is the investment abroad by Malaysian companies. The outflows due to both the large foreign presence in Malaysia and the more internationally-oriented corporate sector have been substantial. In 2006, these outflows amounted to 5.3% of GDP and have, to some extent, offset the upward trend in the currency arising from the inflows.

The diversified financial structure and increasingly developed financial system have increased the potential for more effective intermediation by the financial sector. The ample liquidity situation, the strengthened capacity of the financial institutions and the greater depth and breadth of the capital market have supported the upward momentum in private investment activities. The household sector and the small- and medium-scale enterprises have also enjoyed substantial increase in access to financing. The investment banking institutions that commenced operations in 2006 are important capital market intermediaries that meet the new requirements of the corporate sector, while institutional arrangements for micro financing, which were introduced during the year, also enhanced access to financial services and financing for micro enterprises.

While the financial sector has been developed to become an important enabler of growth by facilitating the economic growth and transformation process, it is now emerging as a direct source of growth. The rapid development that has taken place in the financial services industry exemplifies this changing role. New areas of activity, including investment banking and Islamic finance, have experienced marked expansion. The finance, insurance, real estate and business sub-sector in the economy has become increasingly important to account for 15.5% of GDP, rising from 12.7% in 2000. This sub-sector also employs more than 770,000 persons compared to 500,200 in 2000. This significant growth has taken place despite the consolidation and rationalisation in the banking and insurance industries. The financial services industry has thus become an important engine of employment, income generation and thus growth of the economy.

With the increasing sophistication and dynamism of the financial services sector, the Bank has moved progressively to liberalise the financial services landscape. In particular, in new areas of growth including investment banking and Islamic banking and takaful, foreign equity limits have been raised. In the area of Islamic finance, three new Islamic banking licences were also issued to foreign players. This gradual but progressive liberalisation is not only aimed at promoting a competitive environment that ensures cost-effective pricing to benefit Malaysian consumers and businesses, but also to strengthen our trade and investment linkages with the rest of the world. The experience has also shown that the direct and indirect spillovers from the liberalisation would enhance growth, diversify activities and open new markets for Malaysia. For foreign investors, Malaysia has not only been a high profit centre, but has also provided a platform into the fast-growing East Asian region.

The Bank has also continued to review its foreign exchange administration rules and has progressively liberalised them with the aim of enhancing the efficiency of the delivery system, and providing greater potential for risk management by businesses, and thus enhancing Malaysia's overall competitiveness. In addition to reducing further the cost of doing business and facilitating a greater degree of risk management, the liberalisation announced in conjunction with this Report aims to contribute towards providing increased flexibility in undertaking foreign currency business, widening the investor base for ringgit assets and financial products, as well as enhancing business and capital market efficiency.

For the year 2007, the global economy is projected to expand by more than 4% despite some moderation in the US. This would be the fifth consecutive year the world economy has experienced strong growth. Despite some slowing in export growth, particularly in the first half of the year, the overall growth is expected to remain strong. The domestic economy is also expected to have an improved growth performance in the second half of the year. Domestic demand will be sustained as the improved consumer and business confidence translates into stronger private expenditure. Real GDP, in an environment of moderating inflation, is forecast to expand by 6%.

This stable macroeconomic and financial environment will be taken advantage of to shift resources to new areas of growth and also to shift to operating at higher levels of efficiency. A crucial component in achieving this is the accelerated shift to electronic means of payments. Studies conducted in countries where the migration to electronic payments has occurred show that the long-term savings from the adoption of these platforms more than offset the short-term costs of development and implementation. Transaction costs in an electronic payments system are between one-half to one-third of that of a paper-based system. In Malaysia's case, these costs are high, amounting to 1% of GDP per year. This level of savings would represent a significant stimulus to overall economic growth.

Malaysia's financial system, with the significant outreach by banks and adoption of basic electronic payments methods such as automated teller machine cards, is ready to adopt these more efficient systems widely. Indeed, it is possible for Malaysia to leapfrog to the latest electronic payments infrastructure, namely the more cost-effective and efficient internet- and mobile-based platforms. A precondition to successfully adopting these next-generation systems, however, is an expansion of the information infrastructure, in particular to have a significantly higher level of computer penetration and broadband coverage. While the cost of expanding the coverage may seem significant, the economic payoff from widespread broadband coverage will be great, far exceeding the cost savings arising from converting to electronic payments. The benefits that such access will also bring to the economy in terms of increased productivity, dissemination of information and capacity for more efficient communications will be tremendous. It will also allow business and financial transactions to take place more effectively and efficiently. This would subsequently lead to lower costs, higher quality and a higher standard of living.

While the global and economic outlook remains favourable, risks remain. In this context, continuous efforts will be directed to strengthen the resilience of the financial system and the economy to be able to absorb the shocks that might occur so as to minimize their implications on the domestic economy. This rapidly changing international environment has indeed altered the prospects and potential risks and challenges faced by the region. This has prompted a more coordinated approach to addressing common issues in the region. The aim for closer cooperation is not only to achieve greater regional macroeconomic and financial stability but also pave the way for achieving greater mutually-reinforcing growth. Regional cooperation is thus focused on strengthening the regional institutional arrangements and mechanisms in the areas of monitoring developments, enhancing capacity for risk management, financial market development and regional financial integration, crisis management and resolution and capacity building. The ultimate objective is to unleash the full potential of the region to achieve greater regional economic prosperity.

As part of the efforts to increase the internal ability of the Bank to manage a more challenging environment, the Bank has also continued to allocate significant attention to strengthening its organizational capacity so as to deliver the expected results. In 2006, the focus was on further improvements in the governance structure, talent management, learning and knowledge management as well as information and communication technology management. In particular, the realignment of the regulatory and supervisory functions under a more integrated approach was a major enhancement, to be better positioned to achieve financial stability and to drive the development of financial system. During the year, the Bank also made notable improvements to talent management. This included the establishment of new roles and competency requirements aligned to the Bank's strategic objectives. These initiatives mark a step in the continually evolving process to ensure that the Bank's talent management practices promote greater organizational clarity on roles and performance expectations across all levels. Leadership and knowledge management are also considered as critical components in internal capacity and capability development, and the Bank is increasingly collaborating with other central banks and other international learning providers to foster greater knowledge-sharing and understanding. The Bank will continue to accord utmost priority in its organizational development to enable it to carry out its mandate efficiently and effectively, in a sustainable manner.

Zeti Akhtar Aziz
Governor

21 March 2007

The Malaysian Economy in 2006

THE INTERNATIONAL ECONOMIC ENVIRONMENT IN 2006

The global economic environment was favourable in 2006, sustaining its fourth consecutive year of expansion of above 4%. While there was some moderation in the United States (US), especially towards the latter part of the year, global growth momentum remained firm. This resilience was attributed to several factors. First, the moderation of growth in the US economy was largely centred on the weak housing and automobile-related sectors. Second, although the contribution of the US economy to world growth was still significant, there was a broadening of growth across the major economic regions, specifically with growing economic impetus in Europe, continued recovery in Japan, and stronger expansion in the East Asian region[1] as well as other developing economies. Third, the strength of commodity markets throughout most of the year favoured resource-based producers, thus benefiting a large number of emerging economies through improved terms of trade and foreign exchange earnings.

Global growth broadened in 2006, with continued recovery in Europe and Japan and sustained expansion in Asia despite some moderation in the United States

The **US** economic slowdown thus far has been modest, reflecting a "soft landing" scenario with domestic demand remaining largely intact despite the downturn in the US housing market. Consumption activity remained steady with encouraging labour market conditions and favourable income positions. Since September 2003, the US labour market has continued to tighten amid steady job creation and rising real wages. In addition, the marked decline in gasoline prices towards the end of the year provided additional support to disposable incomes. Furthermore, despite the slower appreciation in house prices in 2006, household wealth was sustained by continued wealth-creation from the favourable equity market performance. More importantly, US non-residential property investment activity remained robust amidst favourable profit growth and healthy corporate balance sheets. The encouraging corporate performance mainly benefited from the sustained strength in external environment and the globalised operations of US firms, as well as favourable financing conditions. The US external position improved with a narrowing of the trade deficit since September 2006. The slowing US

[1] The East Asian region ex-Japan refers to PR China, Chinese Taipei, Hong Kong SAR, Indonesia, Korea, Malaysia, the Philippines, Singapore and Thailand.

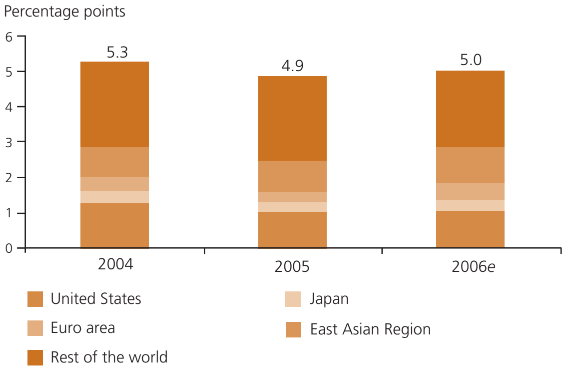
Table 1.1
World Economy: Key Economic Indicators

	Real GDP Growth (%)		Inflation (%)	
	2005	2006e	2005	2006e
World Growth	**4.9**	**5.0**	–	–
World Trade	**7.4**	**8.0**	–	–
Major Industrial Countries	**2.6**	**2.9**	**2.3**	**2.3**
United States	3.2	3.3	3.4	3.2
Japan	1.9	2.2	-0.3	0.2
Euro area	1.4	2.7	2.2	2.2
United Kingdom[1]	1.9	2.7	2.1	2.3
East Asia	**7.5**	**7.9**	**3.1**	**3.0**
Asian NIEs	**4.8**	**5.4**	**2.2**	**1.6**
Korea	4.0	5.0	2.7	2.2
Chinese Taipei	4.1	4.6	2.3	0.6
Singapore	6.6	7.9	0.5	1.0
Hong Kong SAR[2]	7.5	6.8	1.0	2.0
The People's Republic of China	**10.4**	**10.7**	**1.8**	**1.5**
ASEAN[3]	**5.4**	**5.8**	**5.9**	**6.8**
Malaysia	5.2	5.9	3.0	3.6
Thailand	4.5	5.0	4.5	4.7
Indonesia	5.6	5.5	10.4	13.3
Philippines	5.0	5.4	7.6	6.3

[1] Inflation based on Eurostat's harmonised index of consumer prices
[2] Inflation refers to composite prices
[3] Includes Singapore
e Estimates

Source : International Monetary Fund, national authorities and Bank Negara Malaysia estimates.

Chart 1.1
Contribution to World Growth



e Estimate
Source: Bank Negara Malaysia estimates based on World Bank and International Monetary Fund data

imports were mainly due to lower oil prices and a moderation in the demand for oil-related imports.

The year 2006 also witnessed clearer signs of a rebalancing of global growth among the major industrial economies. Up to November 2006, **Japan** had experienced its longest stretch of sustained economic expansion since the 57-month *"Izanagi"* boom of the late 1960s, although the strength of the recovery had remained modest and uneven. Strengthening business conditions as reflected in the *Tankan* surveys and improved corporate profits encouraged capital expenditure. Stronger external demand, especially for automobiles and machinery, also contributed significantly to growth, with exports to PR China recording double-digit growth. However, household spending was still restrained as wage growth was modest.

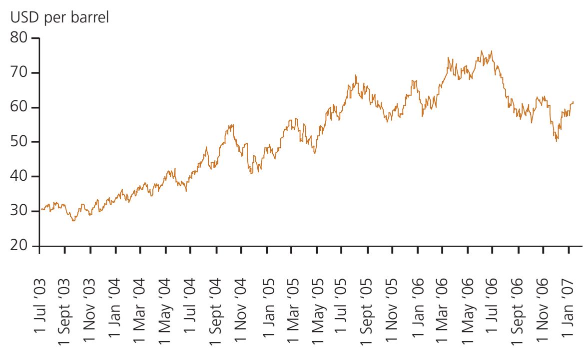
Meanwhile, economic recovery in the **euro area** had become more entrenched. The recovery was underpinned by stronger growth in Germany, which had positive reinforcing effects on the other member economies. The structural reforms undertaken in Germany over several years now had begun to benefit the domestic economy as seen in the improving competitiveness of German firms. For the euro area as a whole, while investment spending and export demand remained important for growth, there was a noticeable acceleration in private consumption.

Consumption activity benefited from rising consumer confidence and the significant improvement in labour market conditions, with the unemployment rate falling to its lowest level in five years. Elsewhere in Europe, the economy of the United Kingdom expanded at a robust pace, driven by the recovery in the housing market, expanding job creation and the strong performance of business and financial services.

Despite a softening global environment in the latter part of 2006, the **East Asian region** remained resilient. Growth was sustained at a strong pace, with continued support from both external and domestic demand. Growth also benefited from greater regional integration as reflected in the continued expansion in intra-regional trade. Higher commodity prices had also enhanced growth, particularly in resource-based countries, contributing to large current account surpluses. PR China remained the key contributor to regional expansion, with its economy growing at 10.7%, its fastest pace since 1995. Concerns over the sustainability of growth, however, led to measures by the Chinese authorities aimed at achieving more balanced growth, away from exports and investment, and more towards consumption activity.

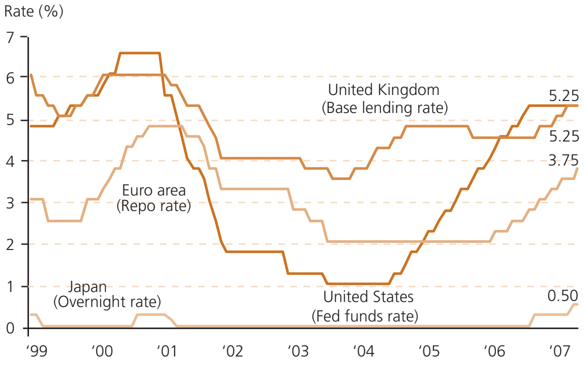
Globally, headline inflation remained elevated throughout most of 2006 due to the impact of oil prices. Oil prices rose, particularly in the first half-year, due to uncertainties over supply amid robust demand conditions and geopolitical

Chart 1.2
Crude Oil Prices: WTI 1-Month



Source: Reuters

Chart 1.3
Major Industrial Countries: Official Interest Rates



Source: National authorities

tensions affecting some of the key oil-producing countries. However, pressures on inflation eased when oil prices began to decline in August 2006, partly reflecting the diminishing risks to supply. Expectations of slowing US growth in the second half of the year together with a build-up in US inventories following warmer-than-expected weather played a role in easing short-term supply concerns. These developments, together with some reallocation of speculative funds to other markets, accentuated the downward trend in oil prices, despite production cuts by OPEC.

The need to mitigate the potential pass-through from oil prices to overall inflation and to manage inflationary expectations led most central banks to pursue a tightening bias in their **monetary policy** stance. In the US, the Federal Open Market Committee (FOMC) of the Federal Reserve Board gradually raised rates to 5.25% by June 2006. The FOMC maintained its monetary policy stance for the rest of the year despite indications of slowing growth amidst higher core inflation, tighter resource utilisation and rising unit labour cost. Meanwhile, signs that the Japanese economy had finally emerged from a prolonged deflationary period allowed the Bank of Japan (BOJ) to end its quantitative easing policy in March 2006, and subsequently, to remove its zero interest rate policy in July 2006. Thereafter, however, the lack of a clear upward trend in inflation limited the scope for the BOJ to undertake further rate increases. In Europe, both the European Central Bank and Bank of England raised interest rates, citing concerns that rapid money and credit growth would fuel inflationary pressures.

In the East Asian region, inflation trends varied across countries. In the ASEAN-4, inflationary pressures eased due to the waning effects of the removal of fuel subsidies, allowing the authorities in Indonesia, Thailand and the Philippines to adopt a more accommodative stance in their monetary policy. However, inflation in the NIEs[2] trended upwards, due to tight labour market conditions and strengthening conditions in the property markets. While oil price-induced inflationary pressures eased, several concerns remained. In particular, food prices remained high in most East Asian countries due to shortages caused by weather conditions.

OVERVIEW

The Malaysian economy strengthened in 2006, with real gross domestic product (GDP) expanding by 5.9%. The robust global growth during the year resulted in strong demand for electronics and primary commodities. This strong external environment was supported by strong domestic activity as private consumption rose in line with incomes and private investment increased to expand productive capacity to meet demand. As a result of the expansion in domestic and external

Chart 1.4
Real GDP, World Trade and Inflation Rate

[2] Newly Industrialised Economies (NIEs) refers to Chinese Taipei, Hong Kong SAR, Korea and Singapore.

Table 1.2 Malaysia - Key Economic Indicators

	2004	2005	2006*p*	2007*f*
Population (million persons)	25.6	26.1	26.6	27.2
Labour force (million persons)	10.8	11.3	11.5	11.8
Employment (million persons)	10.5	10.9	11.1	11.4
Unemployment (as % of labour force)	3.5	3.5	3.5	3.5
Per Capita Income (RM)	16,638	18,040	19,764	20,900
(USD)	4,378	4,763	5,388	5,806
NATIONAL PRODUCT (% change)				
Real GDP	7.2	5.2	5.9	6.0
(RM billion)	249.3	262.2	277.7	294.4
Agriculture, forestry and fishery	5.0	2.5	6.4	3.2
Mining and quarrying	3.9	0.8	-0.2	2.8
Manufacturing	9.8	5.1	7.0	6.6
Construction	-1.5	-1.6	-0.5	3.0
Services	7.0	6.5	6.5	6.3
Nominal GNP	14.2	10.7	11.7	7.9
(RM billion)	425.6	471.3	526.5	567.9
Real GNP	7.4	5.5	6.4	5.3
(RM billion)	233.4	246.2	261.9	275.7
Real aggregate demand[1]	7.5	7.3	7.4	7.4
Private expenditure[1]	13.9	9.1	7.6	7.2
Consumption	10.5	9.2	7.0	6.4
Investment	30.2	8.5	9.7	10.4
Public expenditure[1]	-3.3	3.6	7.2	7.7
Consumption	6.2	5.4	7.9	4.1
Investment	-11.0	1.9	6.5	11.4
Gross national savings (as % of GNP)	37.3	37.0	38.1	38.1
BALANCE OF PAYMENTS (RM billion)				
Goods balance	104.5	125.6	135.0	137.7
Exports (f.o.b.)	481.2	537.0	589.6	638.5
Imports (f.o.b.)	376.8	411.4	454.6	500.9
Services balance	-8.8	-9.0	-7.4	-6.7
(as % of GNP)	-2.1	-1.9	-1.4	-1.2
Income, net	-24.5	-23.9	-19.8	-22.1
(as % of GNP)	-5.8	-5.1	-3.8	-3.9
Current transfers, net	-14.6	-17.0	-16.6	-16.2
Current account balance[2]	56.5	75.7	91.2	92.7
(as % of GNP)	13.3	16.1	17.3	16.3
Bank Negara Malaysia international reserves, net[3]	251.6	265.1	290.4	-
(in months of retained imports)	7.9	7.7	7.8	-
PRICES (% change)				
CPI (2005=100)[4]	1.4	3.0	3.6	2.0 - 2.5
PPI (2000=100)[5]	8.9	6.8	6.7	-
Real wage per employee in the manufacturing sector (% change)	3.7	-0.02	-1.4	-

Note: Figures may not necessarily add up due to rounding
[1] Exclude stocks
[2] Figures for the year 2006 are estimates
[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 2006, the Consumer Price Index has been revised to the new base year 2005=100, from 2000=100 previously
[5] Effective from 2006, the Producer Price Index has been revised to the new base year 2000=100, from 1989=100 previously
p Preliminary
f Forecast

Table 1.3 Malaysia - Financial and Monetary Indicators

	2004		2005		2006*p*	
FEDERAL GOVERNMENT FINANCE (RM billion)						
Revenue	99.4		106.3		123.5	
Operating expenditure	91.3		97.7		107.7	
Net development expenditure	27.5		27.3		35.0	
Overall balance	-19.4		-18.7		-19.1	
Overall balance (% of GDP)	-4.3		-3.8		-3.5	
Public sector net development expenditure	56.7		64.5		84.4	
Public sector overall balance (% of GDP)	4.1		1.8		3.7	
EXTERNAL DEBT						
Total debt (RM billion)	200.6		197.7		179.4	
Medium- and long-term debt	156.8		150.7		138.1	
Short-term debt[1]	43.7		47.0		41.3	
Debt service ratio (% of exports of goods and services)						
Total debt	4.6		5.4		4.7	
Medium- and long-term debt	4.4		5.2		4.4	
	Change in 2004		**Change in 2005**		**Change in 2006**	
	RM billion	**%**	**RM billion**	**%**	**RM billion**	**%**
MONEY AND BANKING						
Money Supply M1	12.2	11.9	9.8	8.5	17.1	13.8
M3	68.0	12.4	49.7	8.0	82.4	12.3
Banking system deposits	70.1	12.7	68.6	11.0	116.1	16.8
Banking system loans[2]	40.1	8.5	44.2	8.6	34.9	6.3
Loan-deposit ratio (end of year)	78.4%		77.5%		70.8%	
Financing-deposit ratio[3]	87.7%		85.7%		79.1%	
	2004		**2005**		**2006**	
	%		**%**		**%**	
INTEREST RATES (AVERAGE RATES AS AT END-YEAR)						
Overnight Policy Rate (OPR)	2.70		3.00		3.50	
Interbank rates						
3-month	2.80		3.20		3.65	
Commercial banks						
Fixed Deposit 3-month	3.00		3.02		3.19	
12-month	3.70		3.70		3.73	
Savings deposit	1. 58		1.41		1.48	
Base lending rate (BLR)	5.98		6.20		6.72	
Treasury bill (3-month)	1.96		2.96		3.37	
Government securities (1-year)	2.24		3.30		3.55	
Government securities (5-year)	3.64		3.73		3.70	
	2004		**2005**		**2006**	
	%		**%**		**%**	
EXCHANGE RATES						
Movement of Ringgit (end-period)						
Change against SDR	-4.3		8.9		1.8	
Change against USD[4]	0.0		0.5		7.0	

1 Excludes currency and deposits held by non-residents with resident banking institutions
2 Includes loans sold to Cagamas
3 Adjusted to include holdings of private debt securities
4 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

demand, employment also strengthened as reflected in the decline in retrenchments and the acceleration in job creation. The unemployment rate remained unchanged at 3.5% while nominal wages increased.

Real GDP strengthened in 2006, underpinned by robust domestic demand and continued strong exports

In spite of the robust growth in output and wages, the economy remained on a balanced growth path in 2006. A number of indicators confirmed the sustainability of the growth momentum. The output gap was negligible in 2006 and productivity growth exceeded wage growth and hence helped contain inflationary pressures. The only significant source of inflation in 2006 was from supply factors, most notably, the adjustments to a number of administered prices as subsidies were partially removed. As the impact of these adjustments receded during the course of the year, the headline inflation rate also moderated.

DOMESTIC DEMAND CONDITIONS

Aggregate domestic demand recorded a stronger growth of 7.4% in 2006, driven mainly by the continued expansion in private sector activity. Consumer spending remained strong, benefiting from higher disposable incomes arising from strong export earnings, high commodity prices and favourable labour market conditions. Private investment continued to increase, with significant capital expenditure in the manufacturing, services and oil and gas sectors. Meanwhile, the public sector continued to support growth with the Government committed to improving the infrastructure and the provision of Government services mainly in education and health especially for the rural areas.

Private consumption expenditure remained resilient, increasing by 7% in 2006 (2005: 9.2%), in spite of concerns over rising prices, especially during the first half of the year. Major consumption indicators confirmed the strong trend in spending, with double-digit growth rates recorded for consumption imports, loans approved and disbursed for consumption credit, as well as credit card spending. The main factor that contributed to the strength in consumer spending was a steady income growth arising from firm commodity prices, strong export earnings, and stable employment conditions. Prices of major commodities such as rubber and crude palm oil (CPO) were sustained at high levels throughout 2006. Labour market conditions continued to be stable, with job vacancies rising and retrenchments declining. These developments benefited both the rural and urban households' disposable incomes, and supported consumers' optimistic outlook.

Chart 1.5
Real Domestic Demand Aggregates

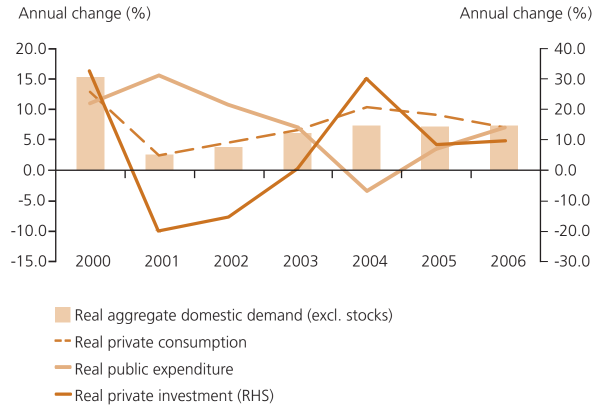
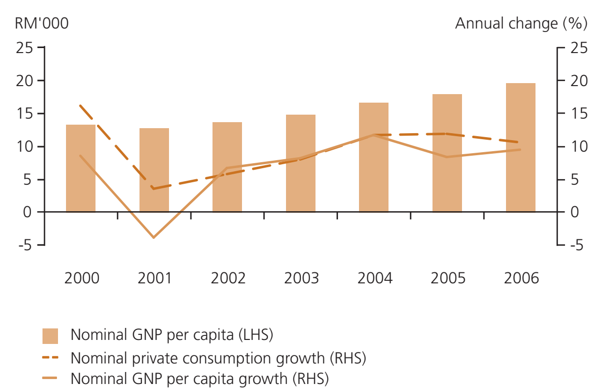


Chart 1.6
GNP per Capita

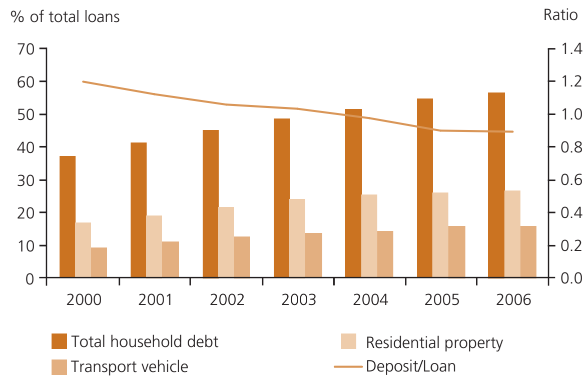


Robust domestic demand was driven mainly by continued expansion in private investment activity, particularly in the manufacturing and oil and gas sectors. Public sector continued to provide a supportive environment

As income and job prospects improved, consumer confidence and spending also strengthened. The Malaysian Institute of Economic Research (MIER)'s Consumer Sentiment Index (CSI), which measures consumers' assessment of their personal finances and the economy, reflected the improving sentiments during the year. The CSI dipped below the 100-point confidence threshold level in the first quarter of 2006, reflecting concern over higher prices, mainly from the impact of the 30-sen increase in the retail price of fuel in March and the adjustment made to electricity tariffs. To cushion the impact of these changes on consumers, the Government reduced the road tax and limited the number of consumers affected by the electricity tariff revision in the middle of the year. Further, the Government's assurance that the increase in retail petrol prices in March 2006 would be a one-off occurrence ensured that consumer confidence would not be significantly undermined. As a result, following a period of adjustment, consumption activity picked up again. Over the course of the second half of the year, stable labour market conditions, coupled with bonus payments to civil servants, provided a positive impetus to consumer confidence. As a result, the CSI rose to 110.9 points in the fourth quarter, the highest level for the year.

Although the Overnight Policy Rate (OPR) was increased twice in 2006 (February and April 2006), the rates remained at relatively low levels. In this environment, household credit continued to expand although the deposit-to-loan ratio for households has remained below parity for the third consecutive year. Moreover, despite the increase in loans to the household sector,

Chart 1.7
Household Debt and Deposit/Loan Ratio



household debt remained within prudential limits as their financial positions remained relatively sound. Their holdings of financial assets, including deposits with financial institutions, life insurance savings, unit trust funds, and EPF contributions, continued to exceed their liabilities, which, when coupled with the strong growth in incomes, led to the non-performing loan (NPL) ratios for both consumption credit and credit card debt to decline further to 6% and 3.7% respectively in 2006 (2005: 7.3% and 4.5% respectively).

In spite of some concern regarding business prospects early in the year due to higher crude oil prices, the sustained favourable economic conditions supported a 9.7% growth in **private investment**. MIER's Business Conditions Index, which has remained above the 100-point threshold level since the first quarter of 2005, underscored the positive business sentiments. The positive investment climate was also reflected in the higher gross FDI inflows in 2006, with the manufacturing and oil and gas sectors being the main beneficiaries. Favourable corporate earnings over several years now have left companies with stronger financial positions, enabling them to fund the bulk of their capital expenditure internally. In addition, the financial system continued to support private investment activity. In 2006, private debt securities (PDS) issued for new activities during the year increased to RM21 billion (2005: RM17.7 billion), and formed the bulk of the total PDS issued. The bulk of the

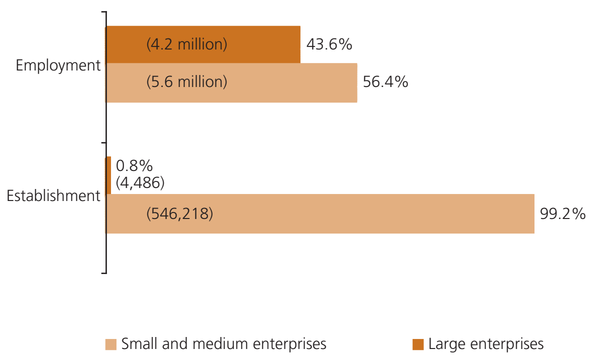
DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES

The development of a strong and dynamic SME sector is an important economic agenda of the Government. During the year, the National SME Development Council[1] (Council) had taken several key initiatives to promote the development of SMEs including strengthening the enabling infrastructure for SME development, building SMEs' capacity and capabilities, and improving the access to financing by SMEs.

Profile and Contribution of SMEs to the Economy

As the availability of data on the status and performance of SMEs is critical to facilitate the formulation of effective strategies and policies to support the development of SMEs, the Census of Establishment and Enterprise (Census) was conducted in 2005. Based on the response of 550,704 business enterprises in the agriculture, manufacturing and services sectors, the findings of the Census indicated that 99.2% or 546,218 of the business establishments are SMEs, of which 433,517 or about 80% are micro enterprises.

SME's Contribution to the Economy



The Census results also showed that SMEs are a major source of employment, providing jobs for over 5.6 million workers and accounting for 56% of total employment. While SMEs account for the bulk of business enterprises and employ the majority of workers, their contribution to the economy is relatively small. The SMEs contributed only about 19% to the total export value and 32% of gross domestic product. Similarly, productivity levels in the SMEs were found to be significantly lower than large enterprises as they generated an average value added per employee of just RM14,740, far lower than the RM47,830 generated by large enterprises.

Major Initiatives for SME Development

(i) National SME Development Blueprint 2007

The 2007 National SME Development Blueprint, which was endorsed by the Council in January 2007, provides an assessment of the major SME programmes implemented in 2006 as well as identifies programmes that will be implemented in 2007.

(a) Assessment of major SME development programmes in 2006

A total of 213 major programmes, involving a total expenditure of RM7.8 billion, were

1 The National SME Development Council is chaired by the Prime Minister and comprised Ministers and Heads of 18 key Ministries and Agencies involved in SME development. Bank Negara Malaysia is the Secretariat to the Council.

implemented in 2006. The focus of the programmes was on enhancing the capacity and capabilities of SMEs, particularly in the areas of entrepreneurship development, marketing and promotion, product development and technology enhancement. These programmes benefited more than 287,000 SMEs. The major outcomes from these programmes were:

- More than 128,000 SMEs, women entrepreneurs, graduates and students received entrepreneurship and technical training;
- Advisory services were provided to about 34,000 SMEs by various Government agencies;
- More than 5,100 SMEs were provided with industrial and business premises;
- About 780 SMEs benefited from business matching and expansion programmes such as the Industrial Linkage Programme and SMIDEX 2006; and
- A total of 272 SMEs received grants and financial assistance to improve and upgrade their technology and business processes through the Technology Acquisition Fund, Grant for Certification and Quality Management System, and Grant for Product and Process Improvement.

To enhance access to financing by SMEs, Bank Negara Malaysia increased the allocation for the Fund for Small and Medium Industries 2 and the New Entrepreneur Fund 2 by RM2.5 billion in 2006, established a RM1 billion Special Fund for Overseas Project Financing and introduced two new trade financing products. Additionally, a RM150 million venture capital fund for the agriculture sector was established by Bank Negara Malaysia with a banking group. SMEs also benefited from financial advisory services provided by Bank Negara Malaysia, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Export-Import Bank of Malaysia Berhad (EXIM Bank) and commercial banks.

(b) Major Programmes for SME Development in 2007

The Council approved the implementation of 189 major programmes for SME development in 2007 (213 in 2006), with RM3.7 billion committed. Of the 189 major programmes, 135 programmes are aimed at building the capacity and capabilities of SMEs. Another 27 programmes will be implemented to enhance SMEs' access to financing, while 27 programmes are to strengthen the enabling infrastructure to further support the growth of SMEs.

These programmes cover all sectors, including SMEs in agriculture and agro-based industries, and those involved in knowledge-based industries. Efforts would also be directed to promote Bumiputera participation in the SME sector. To provide infrastructure to support SMEs' growth, business premises, factories and workshops will be provided for SMEs in the rural areas. In addition, product packaging, distribution and marketing centres will be established to ensure efficient and effective distribution of agriculture and agro-based products of SMEs. On strengthening the capacity and capabilities of SMEs, programmes will focus on entrepreneur and human capital development, marketing and promotion, and the provision of advisory services to SMEs. Highlights include the implementation of the New Franchise Scheme, Biotechnology Entrepreneur Development and ICT SME Development programmes. Various training programmes will be implemented, including in the areas of financial management and accounting, as well as to develop SMEs in the retail and agriculture industries.

In the area of financing, banking and development financial institutions will continue to be the main provider of funds to the SME sectors. These financial institutions are expected to approve a total of RM51 billion in loans to about 110,000 SME accounts in 2007. This will be complemented by a target to approve 37,000 loans under the various Government schemes. Forty new companies in the ICT sector are expected to be financed under the ICT Fund, while the Biotechnology Commercialisation Grant aims to establish 35 projects.

(ii) Enhancing Awareness and Information Available to SMEs

(a) Launched of Inaugural SME Annual Report 2005

On 7 August 2006, the Council released the inaugural SME Annual Report 2005. The Report is an important initiative to enhance the dissemination of information on SMEs in Malaysia. It provides a comprehensive review on the status and performance of SMEs and highlights major programmes of the Government to promote SME development.

(b) Enhancements to SMEinfo Portal

The SMEinfo Portal (www.smeinfo.com.my), launched in January 2006, provides a wide array of information required by SMEs, including details on Government programmes, financial products, training programmes, and tips on how to start and manage a business. The Portal also contains the SME Business Directory, a platform for SMEs to advertise and showcase their products. The Portal is accessible in Bahasa Malaysia, English and Mandarin for greater outreach to the local and international business community. The SMEinfo Portal is used widely by domestic SMEs and foreign businesses, recording an average of about 205,000 hits a month, including visitors from over 70 countries. As at the end of February 2007, more than 14,000 SMEs have registered in the SME Business Directory Portal. In 2007, a number of new value-added services will be introduced, including the creation of an SME Bulletin Board to provide an avenue for public and private sector organisations to advertise SME related events and the SME Financial Product Directory, which will allow SMEs to search for suitable financial products to meet their business needs.

(iii) Establishment of the SME Business Adviser Network (SME-NET)

The SMEs have ranked the need for advisory services as high among the areas in which assistance is required. This includes advisory services in a wide range of areas including product development, technology adoption, business and financial management, marketing and promotion. In an effort to further strengthen the ability and quality of advisory services provided by the agencies and financial institutions, the Council approved the establishment of the SME-NET, a one-stop web-based directory in the SMEinfo Portal that contains the profiles and contact details of SME business advisers in the various Government agencies, commercial banks and development financial institutions. The SME-Net connects SME business advisers and experts across these organisations, and highlights specific areas of expertise, hence, enabling advisers to leverage on each other. The SMEs will benefit from the high quality and better delivery of advisory services in the areas of marketing, technology and operations management, human resource, financing, business development and product development.

(iv) Marketing and Promotion of SMEs' Products and Services

Following approval by the Council, the SME Marketing Committee, an inter-Ministry

Committee chaired by the Ministry of International Trade and Industry, has been established to develop a comprehensive marketing strategy and implementation approach to effectively market the SMEs' products and services overseas. The Malaysian External Trade Development Corporation (MATRADE) has been tasked to coordinate the implementation of international marketing programmes and activities. This two-pronged approach is aimed at enhancing the synchronisation of Government initiatives in planning and implementing overseas marketing strategies while optimising the utilisation of resources and expertise. The SME Marketing Committee has identified 14 strategies to further increase the penetration of the domestic SMEs' products and services in the global market. Comprehensive programmes will be implemented in 2007 by various Ministries and Agencies to assist in capacity building, promotion, information management and provision of financial support to facilitate our SMEs in marketing their products and services overseas.

Enhancing Access to Financing by SMEs

Lending by the financial institutions to SMEs has shown an increasing trend since 1998. In 2006, banking institutions, the main provider of funds to the SMEs, approved RM39.6 billion of financing to more than 84,000 SME accounts, an increase of 10.7% from 2005 (2005: RM35.8 billion). Loan disbursements increased by 19.9% to RM132.6 billion (2005: RM110.7 billion), while loans outstanding to SMEs expanded by 4.2% to RM104.6 billion as at end-2006 (end-2005: RM100.3 billion). Loans to SMEs accounted for 44.5% of total outstanding business loans as at end–2006 (end-2005: 44.5%). On a sectoral basis, lending to SMEs was diversified, with almost two-thirds being channelled to the wholesale and retail trade, hotels and restaurants, manufacturing and construction sectors.

In 2006, six development financial institutions (namely SME Bank, EXIM Bank, Bank Simpanan Nasional, Bank Kerjasama Rakyat Malaysia Berhad, Bank Pembangunan Malaysia Berhad and Bank Pertanian Malaysia) approved RM6.9 billion of financing to more than 18,000 SME accounts (2005: RM2.3 billion to 5,222 SME accounts) and disbursed RM3.7 billion to SMEs (2005: RM1.5 billion). The loans outstanding of development financial institutions to SMEs increased by 9.9% to RM13.2 billion as at end-2006 (end-2005: RM12 billion). Since its establishment in October 2005, the SME Bank approved and disbursed RM2.5 billion and RM1.6 billion in loans respectively. Its loans outstanding to SMEs stood at RM2 billion as at end-2006. Leasing and factoring companies, an alternative mode of financing equipment investment and working capital requirements, extended RM862.7 million of new financing in 2006 (2005: RM819 million). For newly established businesses, especially in the ICT sector, financing could also be obtained from venture capital companies. The total funds available for venture capital investments increased by 27.8% to RM3.3 billion as at end-2006 (end-2005: RM2.6 billion). These funds were invested in 460 companies compared with 380 companies as at end-2005.

Special Funds for SMEs

Currently, there are 94 Government funds and schemes with a total allocation of about RM25 billion to assist the SMEs. Five of these special funds were established by Bank Negara Malaysia with a total allocation of RM11.4 billion, to allow viable and eligible SMEs to have access to financing at reasonable costs (lending rates range from 3.75% to 6%). These funds are channelled through participating institutions comprising banking institutions, development financial institutions and ERF Sdn. Bhd. The five funds are:

- Fund for Small and Medium Industries 2 (fund size: RM6.75 billion);
- New Entrepreneurs Fund 2 (fund size: RM2.85 billion);

- Fund for Food (fund size: RM1.3 billion);
- Rehabilitation Fund for Small Businesses (fund size: RM200 million); and
- Bumiputera Entrepreneurs Project Fund (fund size: RM300 million).

Due to strong demand, allocations for the Fund for Small and Medium Industries 2 (FSMI2) and New Entrepreneurs Fund 2 (NEF2) was increased in 2006 by RM2 billion and RM500 million to RM6.75 billion and RM2.85 billion respectively. To ensure that these funds had a wider outreach, Bank Negara Malaysia revised the eligibility criteria of the FSMI2 and NEF2 in April 2006.

Initiatives to Improve Access to Financing by SMEs

The policy on enhancing access to financing by SMEs during the year continued to focus on strengthening the existing infrastructure to ensure a more effective channelling of funds to SMEs, provision of financial advisory support, as well as enhancing awareness on financial products and assistance programmes available to SMEs. Among notable initiatives introduced in 2006 were:

(i) Sustainable Microfinance Framework

The findings of the Census indicated that about 80% of SMEs are micro enterprises and most of them relied on their own sources of funding. Recognising this, the Council approved a comprehensive microfinance institutional framework to promote the development of a sustainable microfinance industry in Malaysia in order to ensure that micro enterprises have adequate and continuous access to financing. Within this framework, banking institutions, development financial institutions and credit cooperatives have been identified to provide microfinance products to complement the existing Government-sponsored microfinance programmes such as Amanah Ikhtiar Malaysia and Yayasan TEKUN Nasional.

With the introduction of the microfinance framework, several financial institutions have started to provide individuals and micro enterprises with fast, flexible and convenient access to financing for business purposes. Banking institutions have now launched microfinance products since December 2006. Microfinance products offered by the financial institutions have attractive features, with loans sizes ranging from RM500 to RM50,000. To provide the widest accessibility, flexible collateral requirements, fast loan approvals (ranging between 5 to 11 working days) and incentives to encourage good repayment practices by borrowers are incorporated into the microfinance products.

The Council also agreed that a common microfinance logo will be developed to create awareness on microfinance. Financial institutions that offer microfinancing will display this logo to enable and enhance public awareness on financial institutions that offer these services. Recipients or borrowers of microfinancing facilities will also be encouraged to display this logo at their business premises. Bank Negara Malaysia is also facilitating the development of a “Graduation Programme” to enable the larger micro enterprises to obtain the right amount and type of financing. Through this structured programme, micro enterprises that require larger amount of funds to finance business growth will be assisted in obtaining financing from the appropriate financial institutions.

(ii) Venture Capital Funds for the Agriculture Sector

To support the objective of developing the potential of the agriculture sector as the third engine of growth, two venture capital funds totaling RM350 million were jointly established in September 2006 by Bank Negara Malaysia, Khazanah Nasional Berhad and a banking group. The aim of these funds is to create and develop an integrated agricultural business, particularly in farming, fisheries and livestock as well as to finance new technology-intensive agriculture projects. Another agriculture venture capital fund will be launched with a banking group amounting to RM150 million in the first half of 2007.

(iii) Overseas Project Financing

Bank Negara Malaysia established a RM1 billion Overseas Project Fund at EXIM Bank in December 2006 to facilitate Malaysian companies with projects overseas in obtaining financing from the domestic banking institutions through the guarantee and co- financing facilities under the Fund. Under the guarantee facility, EXIM Bank will provide guarantees to loans obtained by eligible companies to finance overseas projects from the domestic banking institutions. With this credit guarantee facility, Malaysian companies, contractors and professional service providers will have an easier access to financing to support their business ventures abroad. Currently, four domestic banking groups are participating in the guarantee scheme.

(iv) SME Bank's Advisory Services

The SME Bank established the SME Bank Advisory Centre (SAC) to help SMEs grow, innovate and achieve excellence in their business activities as well as to overcome financial problems. The advisory services provided by the SAC include advice on marketing, business development, operations and customer service.

(v) New trade finance products

Two new trade finance products for SMEs were introduced in January 2006, namely the Multi Currency Trade Finance and Indirect Exporter Financing Scheme. These products are aimed at encouraging SMEs to export their goods and services, particularly to non-traditional markets such as members of the Organisation of Islamic Conference. Under the arrangement, SMEs can obtain financing without collateral from the banks, with the credit risk being shared between the bank and EXIM Bank. Financing approved to the SMEs under the two products amounted to RM26.1 million as at 31 December 2006. Islamic trade finance products are expected to be available to SMEs in 2007.

Financial Advisory Services

The LINK (Laman Informasi Nasihat dan Khidmat) in Bank Negara Malaysia provides financial advisory services to SMEs in the following areas:

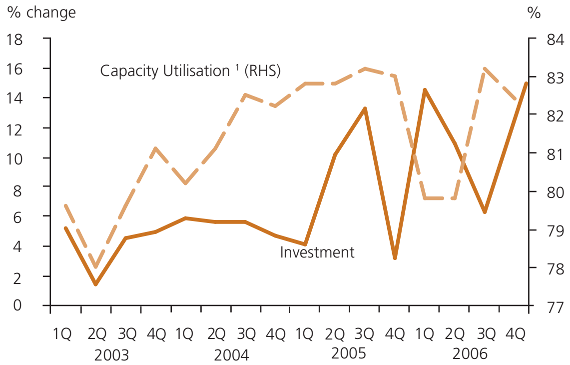
- information on various sources of financing;
- assistance in facilitation of the loan application process; and
- advice on financial requirements and problems of SMEs.

In 2006, the number of enquiries and assistance sought by SMEs totalled 4,186 (2005: 4,037) reflecting continued awareness among SMEs of availability of such services at the Bank. Of these, 77% were enquiries on special funds provided by the Government and advice on loan matters, while 23% were requests for assistance, mainly for loan restructuring and rejections.

Performance of the Small Debt Resolution Scheme

The Small Debt Resolution Scheme, established on 1 November 2003, continued to facilitate the restructuring of non-performing loans (NPLs) of SMEs with on-going businesses. As at end-2006, 562 applications for restructuring, with NPLs of RM405 million, were received under the scheme (end-2005: 394 applications with NPLs of RM278 million). Of these, 424 applications or 75.4% of the total applications, involving NPLs of RM267 million, have been approved for restructuring. In terms of applications for new financing, RM301 million in new funding was requested (end-2005: RM244 million), of which RM18 million was approved under the Rehabilitation Fund for Small Businesses. The performance of the scheme indicates that the restructuring of NPLs continues to be the mainstay in supporting the viability and sustainability of financially distressed SMEs, with new financing being selectively provided mainly to SMEs with new projects in hand.

Chart 1.8
Investment and Capacity Utilisation



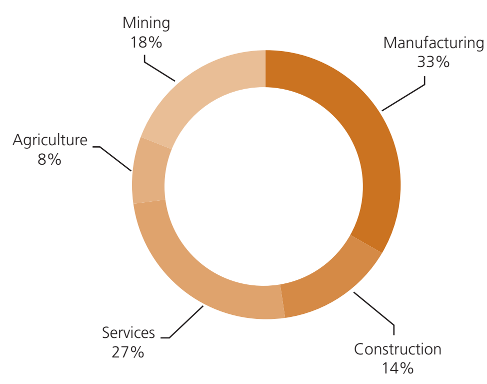
[1] Source: Malaysian Institute of Economic Research (MIER)

expansion in capital spending occurred in the manufacturing, services and upstream oil and gas sectors.

Manufacturers' expenditure on new machinery and equipment remained strong, as reflected in the higher imports of these items during the year. In view of the strong demand for resource-based products from abroad and sustained high capacity utilization levels, manufacturers undertook a significant expansion in capacity. The expansion of production capabilities in the off-estate processing industry also reflected a strong expansion in the commodities-related downstream sector in expectation of strong demand. In 2006, the Ministry of International Trade and Industry (MITI) approved 1,077 manufacturing projects worth RM46 billion (2005: RM31.1 billion), mainly for investment in the petroleum products, chemical products and electrical and electronics products industries. The bulk of the approved projects were new and mainly concentrated in biodiesel production, which is in line with Government's aspiration to promote the development of biofuels. At the same time, there was an increase in capital spending to expand current production lines, mainly in the electronics sector, where foreign participation is more prominent. For the projects approved during the year, capital investment per employee also rose, pointing to the shift towards more capital-intensive and higher value-added projects.

Capital spending in the oil and gas sector remained robust, driven by exploration and production projects as deepwater exploration intensified during the year. In the services sector, investment was most notable in the transportation

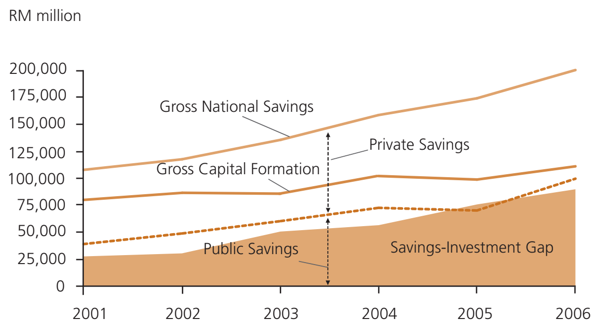
Chart 1.9
Private Investment by Sector (% share)



2006

and communications sub-sector. Higher capital spending was mainly attributed to the expansion of port facilities, investment in the air and sea transportation segments as well as on the enhancement of the telecommunications network. Meanwhile, in the agriculture sector, rising CPO prices and stronger demand for commodities have encouraged additional capital spending in crop expansion. Following the implementation of the Ninth Malaysian Plan, capital expenditure for road infrastructure picked up in 2006, where ongoing projects have been intensified while preliminary development works for some new highways have started.

Chart 1.10
Gross National Savings and Savings-Investment Gap



Public consumption grew at a stronger rate of 7.9% in 2006 (2005: 5.4%), due mainly to continued high expenditure on emoluments and supplies and services. The increase in emoluments expenditure reflected the Government's continued effort to enhance human capital development in order to strengthen the nation's productivity and competitiveness. Meanwhile, expenditure on supplies and services rose largely due to the Government's emphasis on improving the public sector's administrative machinery and delivery system.

In spite of higher public consumption, public sector savings rose significantly to RM101.7 billion or 19.3% of GNP (RM70.5 billion or 15% of GNP in 2005) due to the larger operating surpluses generated by the non-financial public enterprises (NFPEs). This contrasted with the more stable pattern in private sector savings. As a result, **gross national savings** (GNS) rose by 15.1% to RM200.7 billion or 38.1% of GNP. In the private sector, the high level of savings (RM99 billion or 18.8% of GNP) was due to higher disposable incomes and cash flows arising from strong export earnings, firm commodity prices and stable employment conditions during the year. Banking sector deposits held by individuals rose significantly by RM25.4 billion during the year (RM15.2 billion in 2005), underlining the strength of household balance sheets.

Public investment rose by 6.5% in 2006 (2005: 1.9%). During the year, the Federal Government remained committed to implementing development projects that improved socio-economic conditions, both in the rural and the urban areas. Of importance, capital spending for the provision of roads and utilities and the upgrading of educational facilities in rural areas has been accelerated. The bulk of the expenditure in the economic services sector were mainly channelled into improving the transportation and industrial infrastructure as well as broadening the agriculture base. Capital expenditure on the social services sector was mainly for improving essential services such as education and health, with a larger allocation for higher education, industrial training as well as medical facilities and equipment.

Capital expenditure by the NFPEs remained high, due mainly to allocations for capacity expansion and operational efficiency improvements by the three largest NFPEs: Petroliam Nasional Berhad (PETRONAS), Tenaga Nasional Berhad (TNB) and Telekom Malaysia (TM). PETRONAS' capital expenditure was mainly devoted to upstream oil exploration and production activities. TNB continued to spend on upgrading power generation and transmission systems in order to improve the distribution of power supply, and to cater for rising electricity demand during the year. Similarly, capital expenditure by TM was largely for the enhancement of the communication network. Despite the high mobile penetration rate, TM, through its mobile subsidiary unit, continued to spend on optimising the existing network and upgrading the broadband infrastructure to remain competitive. In addition, the company also concentrated on upgrading and expanding internet services, particularly broadband access.

Nevertheless, in spite of higher investment by both the private and public sectors, the more significant increase in the GNS led to a larger savings-investment balance in 2006. The balance, which is equivalent to the current account on the balance of payments, recorded a larger surplus of RM91.2 billion or 17.3% of GNP.

SECTORAL REVIEW

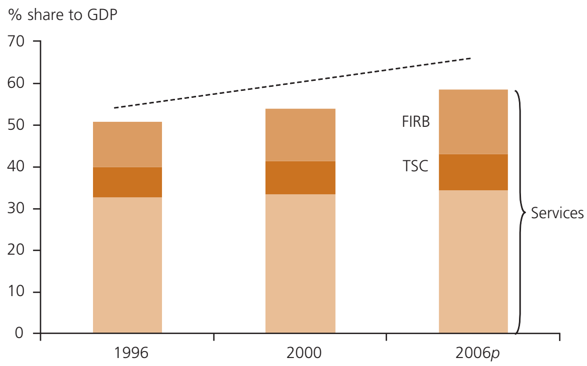
Services Sector

In addition to supporting the expansion in the economy, the **services sector** has evolved to become an important contributor to growth. The sector grew at a faster pace than the overall economy, which resulted in its share of GDP increasing to 59% (2000: 54%). The growth was mainly driven by two key sub-sectors that experienced rapid expansion during this period, namely the finance, insurance, real estate and business services; and the transport, storage and communication sub-sectors. These two sub-sectors now account for close to one-quarter of the overall GDP.

Services sector growth increasingly driven by financial services and other new activities

The shift in the profile was characterised by a major transformation in the financial services sector, and emergence of new activities such as Islamic banking, takaful, telecommunications, IT services, and shared services and outsourcing. The financial services sector has now become more diversified and competitive due to deregulation, liberalisation, industry consolidation and the entry of new players, particularly in Islamic finance. Improved financial inclusion and technological advancements amidst the increased competition also gave rise to a wider range of products and services, thus contributing to increased value-add during this period.

Chart 1.11
Services Sector Share to GDP



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FIRB refers finance, insurance, real estate & business services sub-sector
TSC refers transport, storage & communication sub-sector

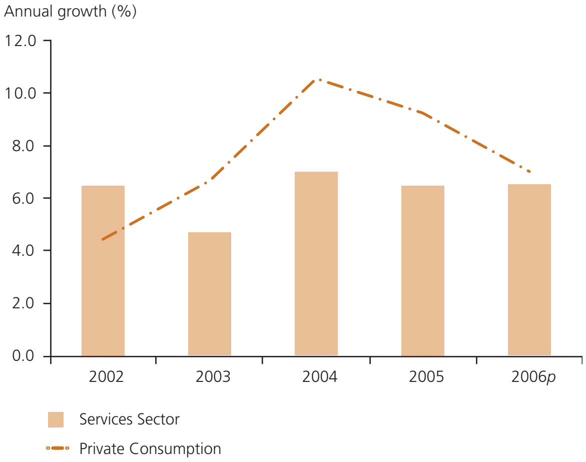
Source: Department of Statistics, Malaysia

Meanwhile, significant strides were also made in promoting other new areas of growth in the services sector. These are mainly knowledge-intensive activities which have high value-add. Telecommunications is one of the new areas that experienced rapid growth arising from rationalisation of cellular players as well as introduction of new applications and services, such as data services; on-line services related to e-commerce, entertainment and leisure industries; and the launching of third generation (3G) services.

In 2006, the services sector remained on a steady growth path and expanded by 6.5%. As growth in private consumption gradually returned to normal trends of close to GDP growth, the services sector was supported by higher trade-related activities, finance and tourism as well as increased contribution from new sources of growth.

Of significance, the **finance, insurance, real estate and business services** sub-sector recorded a favourable performance. The sector grew at a faster pace of 7.1% to contribute 1.1 percentage points to the overall GDP growth during the year. Increased financial intermediation activity, product innovation and emergence of new services such as financial advisory and fund

Chart 1.12
Annual Growth of Services Sector and Private Consumption



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Source: Department of Statistics, Malaysia

and wealth management, resulted in higher interest and fee-based income. Growth was also supported by higher insurance activity led mainly by medical and health insurance and investment-linked products from the life insurance segment. The sector was further reinforced by expansion in emerging areas. Islamic banking and takaful activities gathered momentum as eight new players commenced operations. During the year, the Malaysia International Islamic Financial Centre (MIFC) initiative was launched to promote Islamic financial products and services in international currencies for the global market. Over the period 2002 to 2006, the share of revenue from lending and fee-based activity from Islamic banks has tripled to account for 6.4% of revenue from the total banking system in 2006. Similarly, the takaful industry recorded an increase in revenue (contributions less claims) with the share rising to 8.2% of the total insurance industry revenue for the year (2002: 6.6%).

The other emerging area with strong growth is the business services segment, spurred by demand for IT services, outsourcing activities and professional services arising from the rapid expansion in the oil and gas and financial services segments. During the year, 307 new Multimedia Super Corridor (MSC) status companies were approved, of which 27 were in shared services and outsourcing activities. The extension of the MSC to specific areas in Melaka, Johor and Kuala Lumpur supported the growth in the IT-related activities.

Similarly, the **transport, storage and communication** sub-sector saw an improved performance during the year driven mainly by telecommunication activity, particularly in the cellular segment. A large subscriber base induced by declining prices of cellular phones as well as higher usage of both voice and data services due to the attractive promotions by the telecommunication players supported the expansion in the segment. The telecommunication sector was further supported by growth in the broadband and Internet segments due to the introduction of wireless broadband in residential areas and new wireless broadband products via 3G technology. The launching of the Malaysian Internet Exchange

Table 1.4
Growth in the Services Sector at Constant 1987 Prices

	2005	2006*p*
	Annual change (%)	
Services	**6.5**	**6.5**
Intermediate services	5.9	6.8
Transport, storage and communication	6.2	6.3
Finance, insurance, real estate and business services	5.7	7.1
Final services	6.9	6.3
Electricity, gas and water	5.6	4.9
Wholesale and retail trade, hotels and restaurants	8.0	5.9
Government services [1]	7.6	9.6
Other services [2]	4.9	4.5

[1] Include general public services (general public administration; external affairs; and public order and safety), defence, health, education and others.

[2] Include imputed rent from owner-occupied dwellings; community, social and personal services; products of private non-profit services to households and domestic services of households.

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Source: Department of Statistics, Malaysia

Table 1.5
Emerging Areas of Growth in the Services Sector

	End-2005	End-2006*p*
Islamic-based Financial Services		
Islamic Banks[1]	6	10
Takaful companies[1]	4	8
IT Service Industry		
No of MSC-status companies approved	1,421	1,728
Amount of approved private investment in MSC	18.2 billion	21.2 billion
Manufacturing-related services		
Operational Headquarters (OHQ)	106	131
International Procurement Centres (IPC)	177	191
Regional Distribution Centres (RDC)	10	17
Private Higher Education Services		
No. of private higher educational institutes (IPTS)	559	515
No. of students in IPTS (Year)	292,728	313,900
No. of foreign students in IPTS (Year)	33,903	38,900
Private Healthcare Services		
No of private hospitals participating in promoting health tourism	35	35

[1] Refers to institutions in operation
p Preliminary

Source: Multimedia Development Corporation, Malaysian Industrial Development Authority, Ministry of Higher Education, Association of Private Hospitals of Malaysia, Bank Negara Malaysia

by a consortium of 17 Malaysian internet service providers during the year created more activity locally.

Meanwhile, growth in the transportation segment was closely linked with the strengthening manufacturing and trade activity that resulted in increased usage of local haulage and port-related services. Revenue from transhipment activity, that is, the routing of cargo from regional countries via the major ports in the country, also saw rapid expansion during the year. Increased travel activity from both higher inbound tourists as well as more Malaysians travelling for leisure given the aggressive promotions by airlines, especially the low-cost carrier, supported the air transportation segment. During the year, the low-cost carrier recorded higher activity, as reflected by capacity expansion, increased flight frequency and the introduction of new destinations. Airport activity was further enhanced by the opening of the new low-cost carrier terminal in the first quarter of 2006.

After two consecutive years of strong expansion, the **wholesale and retail trade, hotels and restaurants** sub-sector reverted to a more moderate growth of 5.9%, influenced mainly by the normalisation in private consumption trends. Nevertheless, the impact was partially offset by higher tourism activity. Increased tourist arrivals, particularly from the high spending markets such as the Middle East, supported the hospitality segment and retail industry, especially the luxury goods segment. This was further enhanced by domestic tourism activity, encouraged by the aggressive promotions from the low-cost carrier and the five-day working week for the public sector.

During the year, the distributive trade industry was also affected by narrowing margins due to keen competition among the players. Hypermarkets and large retailers strategised on obtaining higher market shares. Discounts and the opening of new retail outlets in high-catchment areas and in new malls were among the efforts for a wider outreach to gain market share. In addition, retailers offered interest-free instalment plans and attractive payment schemes to entice purchases of consumer durables. To some extent, the narrowing margins affected the value-added growth in the sub-sector. Meanwhile, activity in the automotive trade industry, which accounts for about 11% of the total distributive trade industry, was subdued during the year, dampened by the low resale value of second-hand vehicles.

The **other services** sub-sector continued to expand steadily, supported by growth in other private services, namely entertainment, advertising, private education services and private healthcare services. The entertainment segment benefited from changing consumer behaviour and increased emphasis on leisure. Besides the entertainment segment, advertising and broadcasting services were supported by the

World Cup event and Visit Malaysia Year 2007 campaigns and aggressive promotions undertaken by the financial services, telecommunication and retail industries.

New areas of economic activity that have received greater policy attention in recent years are the private education and private healthcare services. These services continued to expand in 2006. The total number of students attending private higher education institutions increased by 7.2%, supported by foreign students from regional countries as well as Malaysians. During the year, there was an increase in the number of courses accredited by the Malaysian National Accreditation Board and higher number of institutions seeking the MSC status. As of end 2006, 35 private hospitals participated in health tourism, attracting foreign patients, mainly from Indonesia, Japan and the European countries. The foreigners sought treatment in Malaysia, attracted by the competitive rates, medical expertise and up-to-date facilities.

Table 1.6
Selected Indicators for the Services Sector

	2005	2006*p*
	Annual change (%)	
Utilities		
Electricity production index	5.8	5.1
Wholesale and Retail Trade, Hotels and Restaurants		
Consumption credit outstanding	18.7	14.9
Tourist arrivals	4.6	6.8
Total sales of motor vehicles	13.3	-11.2
Finance, Insurance, Real Estate and Business Services		
Loans outstanding in the banking system	8.6	6.3
Insurance premiums	7.7	5.5
Bursa Malaysia turnover (volume)	-4.7	93.3
Transport, Storage and Communication		
Total cargo handled at the six major ports (tonnes)[1]	7.6	5.8
Airport passenger traffic	4.8	2.2
Air cargo handled	4.3	5.7
SMS traffic	130.8	51.6
	%	
Penetration rate:		
- Internet dial-up	13.9	14.0
- Broadband	1.9	3.3
- Mobile phone	74.1	72.3
- Fixed line	16.6	16.1

[1] Both container and bulk cargo at Port Klang, Johor Port, Port of Tanjung Pelepas, Penang Port, Sabah Ports and Bintulu Port.
p Preliminary
Source: Department of Statistics, Malaysia; Malaysia Airports Holdings Berhad; Bursa Malaysia Berhad; Malaysian Communications and Multimedia Commission; relevant port authorities; Malaysian Automotive Association; Malaysia Tourism Promotion Board and Bank Negara Malaysia.

The **Government services** segment recorded stronger growth as a result of the introduction of the cost of living allowance and increases in salaries and bonuses paid to civil servants, while the **utilities** sub-sector was supported by the expansion in economic activity.

Manufacturing Sector

Growth in the **manufacturing sector** strengthened, underpinned by the continued upturn in the global electronics cycle which began in the second half of 2005. The performance was further enhanced by the strong external demand for resource-based industries such as petroleum, rubber and off-estate processing, which experienced better terms-of-trade due to higher export prices. The domestic-oriented industries also showed a marked improvement during the year. Overall, the manufacturing sector recorded a growth of 7%, resulting in its share to GDP remaining at 32%. Amidst the favourable performance, the capacity utilisation rate in the manufacturing sector remained stable during the year due to investments to expand and upgrade facilities in a number of industries.

Growth in the manufacturing sector strengthened, supported by the global electronics upcycle and improved performance in domestic-oriented industries

The domestic **electronics and electrical** sector was able to ride on the cyclical semiconductor

Table 1.7
Performance of the Manufacturing Sector

	2005	2006
	Annual change (%)	
Value-added (at constant 1987 prices)	**5.1**	**7.0**
Overall Production	**5.1**	**7.5**
Export-oriented industries	**5.7**	**7.5**
of which:		
Electronics and electrical products (E&E)	3.5	7.9
Chemicals and chemical products	11.0	3.2
Petroleum products	10.8	13.6
Rubber products	-0.4	7.2
Off-estate processing	8.1	5.7
Domestic-oriented industries	**2.8**	**7.2**
of which:		
Construction-related products	-0.5	3.2
Fabricated metal products	-4.9	26.5
Exports	**10.0**	**10.1**

Source: Department of Statistics, Malaysia

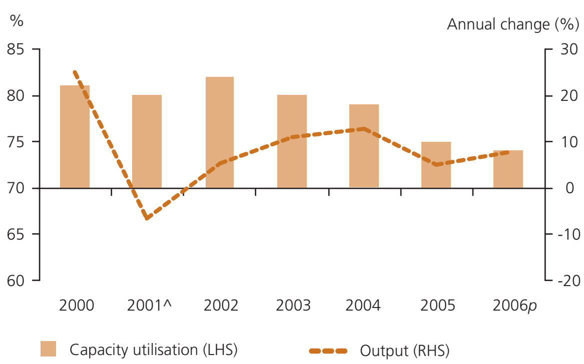
upturn resulting in strong growth, particularly in the first half-year. The global semiconductor recovery was broad based, supported by demand for all product segments, including computers, consumer electronics, telecommunications and automotives. Multinational companies located in Malaysia took the opportunity to produce newer products incorporating new technological advancements.

Increasing demand for laptops in the US market and the introduction of new microprocessors during the year supported the growth in computers and related products. Domestic manufacturers also increased production of telecommunication equipment and in the consumer electronics segment, some manufacturers moved up the value chain to produce flat screen televisions and DVD recorders.

After a favourable performance in the first three quarters of the year, the manufacturing sector expanded at a more moderate pace towards the year-end. Domestic data on exports and production as well as the indicators in the US showed some signs of weakness in the electronics and electrical sector. Nevertheless, the effects are expected to be transitory as the current global electronics upcycle is expected to continue into 2008.

In the **resource-based segment**, the rubber products industry turned around to record a positive growth of 7.2% (2005: -0.4%) led by the strong expansion in output of rubber gloves. For a number of years now, the major rubber glove manufacturers have been expanding aggressively through mergers and acquisitions, and investments in new production lines to meet increasing global demand induced by health-related factors. Despite the sharp increase in

Chart 1.13
Capacity Utilisation in the Manufacturing Sector



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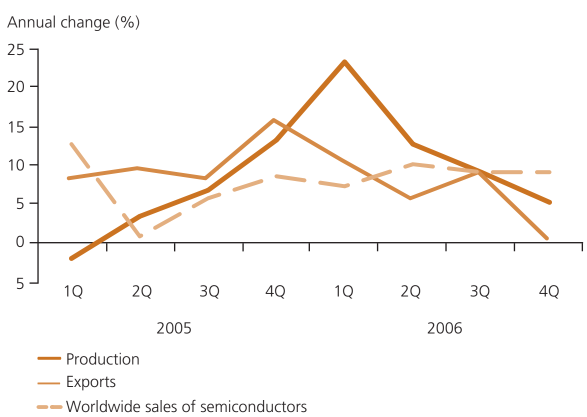
^ Output data from 2001 onwards were based on the new Industrial Production Index (2000=100)

Source: Department of Statistics, Malaysia
Bank Negara Malaysia

Chart 1.14
Production and Exports of Electronics



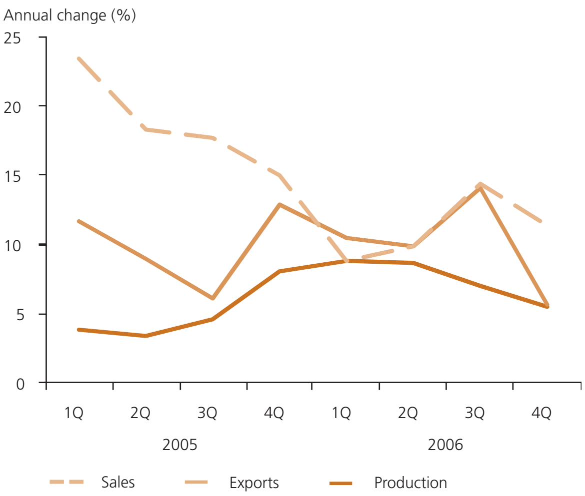
Source: Department of Statistic Malaysia
Semiconductor Industry Association (SIA)

the input prices of latex, the major players remained competitive and increased their market shares.

The petroleum products industry exhibited stronger growth due largely to increased refinery activity during the year. The growth was encouraged by strong external demand for petroleum products. Similarly, the performance of off-estate processing remained favourable arising from the strong growth in the output of crude palm oil and rubber.

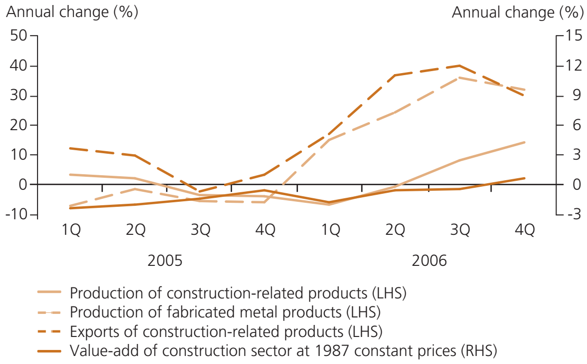
In the chemical and chemical products industry, growth was more subdued during the year due to lower production of industrial gases, in line with the lower output of natural gas. The industry was also partly affected by weaker demand for intermediate plastic products from China due to reduced reliance on imports as their domestic producers increased production. Nevertheless, the plastic products segment continued to expand due to growing demand from the electronics and electrical industry, as well as demand from the European Union. Malaysia, being one of the major producers of intermediate oleochemicals in the world, also benefited from the growing demand for beauty and household products.

Chart 1.15
Manufacturing Sector: Production, Exports and Sales



Source: Department of Statistics, Malaysia

Chart 1.16
Industries Related to the Construction Sector were Supported by Domestic and External Demand



Source: Department of Statistics, Malaysia

Over the years, the chemical industry has become more diversified, with its products ranging from industrial gases to plastic products to oleochemical products and more recently moving on to biofuels. The biofuel is mainly to cater to the European Union market, where there is growing demand for renewable sources of energy in light of the high oil prices and increasing environmental awareness.

The manufacturing sector in 2006 was also supported by the **domestic-oriented industries**, which grew at a faster pace of 7.2% (2005: 2.8%). This growth was mainly attributable to better performance by industries related to the construction sector, namely iron and steel, non-metallic products, and to some extent fabricated metal products, benefiting both from the gradual improvement in the construction sector as well as the strong external demand from regional countries. Meanwhile, the transport equipment industry recorded a mild decline, affected by the lacklustre demand for new motor vehicles.

Agriculture Sector

The agriculture, forestry and fishing **(agriculture) sector** recorded the highest growth rate since 1992 with an expansion of 6.4% in 2006. The growth was broad based across both the industrial and food crops. The former was supported by higher growth in palm oil, rubber and cocoa output, while food-related activity such as fisheries, livestock, paddy, fruits and vegetables recovered from the adverse weather conditions in the previous year. Growth was mainly supported by an increase in yields, amidst the high commodity prices and favourable weather conditions. The good agriculture practices adopted by the farming community with the application of agriculture inputs, fertilisers and usage of high yielding clones also contributed to the increased yields during the year.

The agriculture sector recorded a strong performance reflecting broad based expansion across both industrial crops and food-related activity, amidst the higher yields and favourable commodity prices

The Government's efforts to optimize the potential of the agriculture sector and to transform it into an important engine of growth continued to show results. The sector was the third largest contributor to economic activity, in terms of its share to GDP (8.3%), export revenue (7.1%) and employment (12.5%). Increased profits reaped by plantation companies influenced the upward trend in their stock prices. The Bursa Malaysia Plantation Index rose to 4,316 points at end-2006, an increase of 54% compared to end-2005 (2,799 points).

The agriculture sector also has strong spillover effects on the rural community. Incomes of farmers and smallholders increased strongly. Incomes of rubber smallholders increased by 45% to an average of RM2,900 per month (2005: RM2000; 1990s: RM600), leading to higher consumption activity among the rural population. In order to improve yields and maximise their incomes, smallholders intensified their tapping activity, adopted better exploitation technologies such as the low frequency tapping system (LITS) and used stimulants. Measures taken by the Government to provide replanting grants to encourage farmers to replant with high-yielding clones have also helped to raise the incomes of smallholders.

Crude palm oil production continued to expand by 6.1% to 15.9 million tonnes, representing the fourth consecutive year of strong growth. The increase in production was a result of expansion in matured areas (2% to 3.7 million hectares), and the rise in yields in terms of fresh fruit bunches (FFB) by 3.8% to 19.6 tonnes per hectare. Better harvesting management and the efficient application of agricultural inputs led to the higher yields. In terms of region, Peninsular Malaysia, which accounted for more than half of the total production, was responsible for the higher increase in output during the year, while output in Sabah grew at a more moderate pace.

Prices of palm oil remained supportive of the industry in 2006 with the crude palm oil local delivery price averaging RM1,521 per tonne, or an increase of 8.8%. The increase was fuelled by strong demand for new uses, namely in the

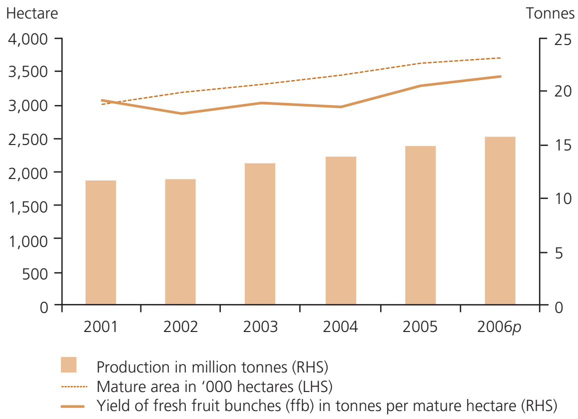
Table 1.8
Agriculture Sector:
Value Added, Production and Exports

	2005	2006*p*
	Annual change (%)	
Value added	**2.5**	**6.4**
Industrial crops	**4.0**	**6.2**
Production of which:		
Crude palm oil	7.0	6.1
Rubber	-3.7	11.9
Saw logs	1.6	-4.2
Cocoa beans	-16.3	14.2
Food crops	**0.2**	**6.7**
Production of which:		
Fish	-7.6	8.3
Livestock[1]	9.1	17.6
Vegetables	-2.8	3.8
Fruits	-18.7	5.3
Exports (value)	**0.6**	**12.5**

[1] Refers to Peninsular Malaysia only
p Preliminary

Source: Department of Statistics, Malaysia
Malaysian Palm Oil Board
Malaysian Rubber Board
Forestry Departments (Peninsular Malaysia, Sabah and Sarawak)
Malaysian Cocoa Board
Fisheries Department, Malaysia
Veterinary Services Department, Malaysia
Department of Agriculture, Malaysia

Chart 1.17
Oil Palm: Area, Production and Yield

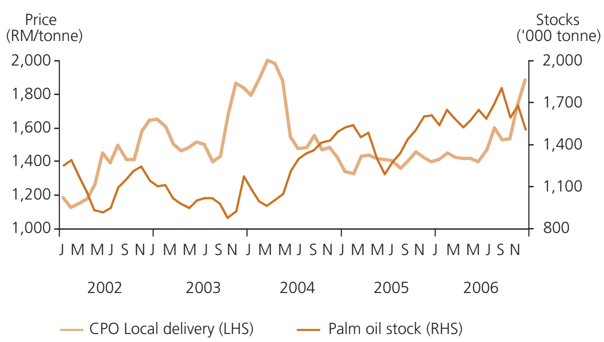


p Preliminary
Source: Malaysian Palm Oil Board (MPOB)

production of biodiesel as well as demand from food producers in the US to substitute palm oil for other edible oils containing *trans fatty* acids. While prices remained range-bound in the region of RM1,400 – RM1,550 per tonne in the first 10 months of the year amidst the strong increase in supply and higher stocks, prices subsequently trended higher to close at RM2,000 at end-2006. Nevertheless, crude palm oil remained competitive against the other major edible oils, with the price discount to soybean oil and rapeseed oil widening further during the year to USD121 per tonne and USD316 per tonne, respectively.

Growth in output was matched by a strong export performance during the year. Palm oil exports to PR China increased substantially due

Chart 1.18
Palm Oil Price and Stocks



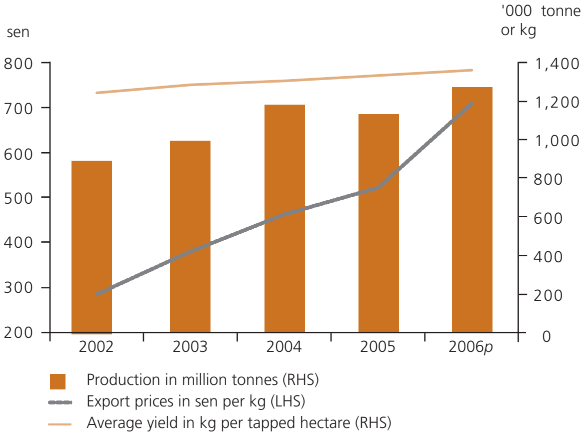
Source: Malaysian Palm Oil Board (MPOB)

primarily to the abolition of quotas on edible oils as well as the imposition of a flat tariff structure (9% rate) across imports of all edible oils effective 1 January 2006. This amendment to the tariff structure has enabled palm oil to compete on a level playing field with other edible oils in the market. Consequently, the share of exports to PR China increased to account for about one-quarter of total exports. Meanwhile, purchases by India declined further due to changes in the import tariff structure that favoured other oils such as soybean and rapeseed. Demand from the US continued to register strong growth for the third consecutive year, as US food manufacturers increasingly used palm oil in the food industry.

A major development in the palm oil industry during the year has been the strong interest in palm oil-based biodiesel, mainly for the export market. Among the renewable energy resources, palm oil has distinct advantages over other sources both in terms of price competitiveness as well as readily available supply. During the year, the industry had attracted significant investments given the strong external demand for biodiesel and attractive tax incentives provided. As of end-2006, the Government had approved 84 biodiesel plants with a total annual capacity of 9.45 million tonnes. By the end of 2007, annual biodiesel capacity is expected to reach approximately 1 million tonnes, all of which meets the international standard known as EN 14214. This would enable the palm oil industry to move up the value chain toward downstream processing, creating a new source of export earnings and stabilising palm oil price movements in future.

In recent years, **natural rubber** has regained its status as one of the key agriculture commodities. It recorded a strong performance, with output expanding at a double-digit rate to 1.26 million tonnes. Thus, for the third consecutive year, output breached the key threshold of 1 million tonnes. Of significance, Malaysia was the most responsive among all natural rubber producers in the world, as it recorded the highest increase in output (140,000 tonnes) during the year. The strong performance was driven mainly by increased output from smallholders, who account for almost 95% of the total rubber output in the

Chart 1.19
Natural Rubber: Production, Prices and Yield



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Source: Malaysian Rubber Board (MRB) and Department of Statistics, Malaysia

country. The high prices combined with increased yields due to favourable weather conditions led to the improved performance. The positive development took place despite the declining trend in the total acreage during the year (-2% to 1.23 million hectares). While Malaysia maintained its position as the third largest producer of natural rubber after Thailand and Indonesia, its share of world output rose further to 13.8% (2005: 13%).

Prices of SMR20, the Malaysian benchmark, rose significantly to record an historic high of above 700 sen per kilogramme in 2006 from around 285 sen in 2002. Prices peaked at 895 sen per kilogramme on 3 July 2006, around the period when international crude oil prices reached USD78 per barrel. Since then, prices have moderated in line with the downward trend in oil prices and rising rubber production. The sharp increase in prices was driven by several factors. Global stocks reached historically low levels amidst persistent demand, particularly from PR China. In addition, prices of synthetic rubber also reached new highs in line with the strong crude oil prices. Besides PR China, the other major buyers were the European Union (EU) countries (particularly Germany and France), accounting for 28.6% of total rubber exports.

Food-related activity, comprising fisheries, livestock, as well as other agriculture commodities (which include paddy, fruits and vegetables) performed well in 2006. The value added growth of 6.7% was driven by a combination of better weather conditions and stronger domestic demand. The livestock sub-sector continued to expand further, led by higher output of poultry, due to the utilisation of modern farming techniques and stronger demand from the food processing downstream industries.

In the **forestry** sector, logging activity declined in 2006 in line with the conservation efforts implemented as part of sustainable forest management. Correspondingly, exports of logs and sawn timber decreased substantially. These developments, coupled with the continued ban on exports of logs and sawn timber by Indonesia, resulted in the average Malaysian log price reaching a record high of RM474 per cubic metre, with sawn timber prices increasing by 18.8% during the year.

As part of the strategy on implementing sustainable forest management, as well as to ensure a continuous supply of raw materials for downstream activities, particularly furniture-making, the Government accelerated its efforts to promote forest plantations. Forest plantations are attractive value propositions as timber species in the forest plantation scheme require a shorter reforestation period of 10-15 years compared to that of tropical timber species which require 30-50 years. The Government established a special purpose vehicle with an initial fund of RM200 million in October 2006 to manage and fund forest plantation schemes undertaken by private entities, with the aim of harvesting 25,000 hectares of reforested timber to produce 5 million cubic metres of wood every year. Approximately 50% of the area under forest plantations would be planted with rubberwood, with the rest to be planted with other timber species, such as acacia, teak and *sentang.*

Output of **cocoa** turned around to register a strong performance. The double-digit growth was a result of measures taken in the past few years to address the declining production. Rehabilitation of cocoa fields, reduction in conversion of cocoa fields to other crops, as well as the active encouragement to replant cocoa through the

Cocoa Smallholders' Development Programme yielded positive results. At the same time, the assistance given to farmers in the form of high-yielding clones and disease-resistant planting materials also contributed towards reducing the incidence of black pod infection.

Mining Sector

The **mining sector** registered a mild contraction of 0.2% in 2006 due to lower production of crude oil and natural gas. The shutdown of a number of oil fields for maintenance, as well as the phased upgrading to expand capacity at the MLNG 2 plant, led to lower activity in the mining sector during the year. Nevertheless, the sector's contribution to the overall economy was significant in terms of foreign exchange earnings from exports, revenue to the Government and investments in exploration and downstream activities. Malaysia remained a net energy-exporting nation. Export earnings from minerals rose further due entirely to higher oil prices, as the export volume declined during the year. Over the years, the share of mineral exports to total gross exports has increased gradually from 7.2% in 2000 to 9.7% in 2006.

The shutdown of oil fields for maintenance as well as the phased upgrading to expand capacity at the MLNG 2 plant led to lower activity in the mining sector

In 2006, **crude oil** production (including condensates) averaged 699,796 barrels per day (bpd), representing a decline of 0.5%. The lower production of crude oil (excluding condensates: -3.5% to 548,487 bpd) was a result of the shutdown of several oil installations during the year for repairs and maintenance. This was mitigated to some extent by the rising contribution of condensates to overall oil production. Condensates, which in its natural state is in a gaseous form but is condensed into liquid during production, shares the same high quality properties as Malaysian light, sweet crude oil. During the year, output of condensates rose further at a double-digit rate (12%) to an increased share of 21.6% of total crude oil output (2001: 13%).

Table 1.9
Mining Sector:
Value Added, Production and Exports

	2005	2006*p*
	Annual change (%)	
Value added	**0.8**	**-0.2**
Production		
of which:		
Crude oil and condensates	-8.0	-0.5
Natural gas	11.3	-0.4
Exports	**26.4**	**8.6**

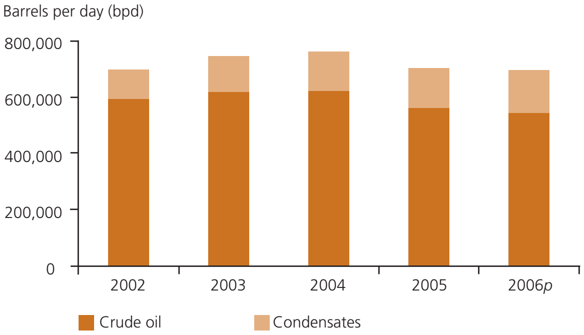
p Preliminary
Source: PETRONAS
Department of Statistics, Malaysia

Following six continuous years of growth in the sector, output of **natural gas** declined marginally by 0.4% in 2006. Activity was influenced by the sequenced shutdown of facilities at the MLNG 2 plant in Sarawak for upgrading to expand capacity. The increase in capacity is to meet future demand from Malaysia's traditional buyers as well as from the new market, PR China. Currently, Malaysia is a major supplier of LNG to Japan and Korea, capturing one-fifth of the domestic gas market in these two countries.

The oil and gas sector continued to benefit from the strong global oil prices that have prevailed since 2004. The price of the Malaysian benchmark oil grade, the Tapis Blend, rose by 20% to an average of USD68 per barrel in 2006. The price of the Tapis Blend strengthened steadily from USD64 per barrel at the beginning of the year to briefly breach USD80 per barrel in August before consolidating thereafter to around USD60 per barrel towards end-year.

The global oil market was characterised by strong demand from the US and emerging economies. Given the continued constraints on global supply as production in the major oil-producing countries reached close to full

Chart 1.20
Production of Crude Oil and Condensates



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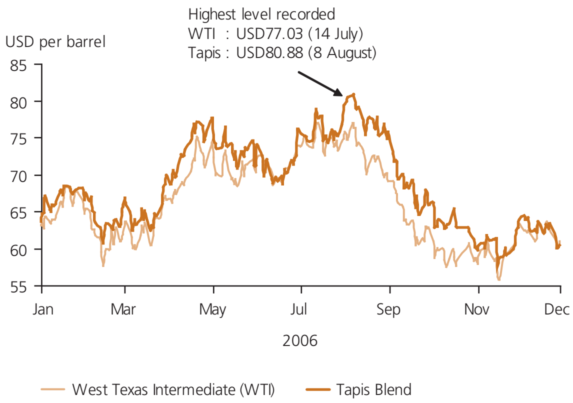
Source: PETRONAS

Chart 1.21
Crude Oil Prices (1-Month Futures) in 2006



capacity, and the inadequate refining capacity, especially in the US, demand factors had taken precedence over supply factors in influencing the direction of oil prices. Prices during the year were also influenced by the significant involvement of hedge funds in the global oil futures market. In addition, the market continued to be sensitive to geopolitical risks in the oil producing regions. Given these factors, oil prices have established a new 'persistence' level of USD50 per barrel, over and above the 'persistence' level of USD20 per barrel experienced throughout the 1990s. In line with developments in crude oil prices, the export price of LNG also increased further by 14.2% to RM1,081 per tonne during the year.

Table 1.10
Malaysia: Crude Oil and Natural Gas Reserves [1]

	As at end	
	2005	2006*p*
Crude oil (including condensates)		
Reserves (billion barrels)	5.25	5.25
Reserve/Production (year)	20	21
Natural gas		
Reserves (trillion standard cubic feet)	87.95	87.95
Reserve/Production (year)	34	34

[1] The National Depletion Policy was introduced in 1980 to safeguard the exploitation of the national oil reserves by postponing the development and control the production of major oil fields (with reserves of 400 million barrels or more).

p Preliminary

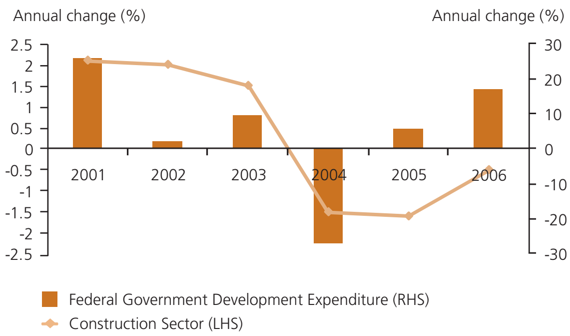
Source: PETRONAS

Overall, the production level of crude oil in 2006 was within the target set under the National Depletion Policy, which has been implemented since 1980 to ensure sustainable development of the country's oil resources. The depletion policy and the discovery of new oil and gas fields have contributed towards increasing the lifespan of the country's oil and gas reserves. Since 2002, 20 deepwater oil and gas fields in the offshore areas of Sabah have been discovered, in partnership with foreign oil companies through production sharing contracts (PSCs). Consequently, Malaysia's oil reserves have risen to 5.25 billion barrels with a longer lifespan of 21 years based on current production levels. These discoveries have also led to a significant increase in investments in the last two years, particularly in the form of foreign direct investment in the oil and gas sector and related services. In addition, the sector's strong inter-linkages with the manufacturing sector were evident from the rapid development of downstream activities such as the production of petrochemicals, gas processing and oil refining. This lent further support to growth in the resource-based industries.

Construction Sector

Construction activity improved further, registering only a mild contraction of 0.5% in 2006, led by a gradual recovery in civil engineering activity, as well as increased activity in the non-residential segment. Meanwhile, growth in the residential segment returned to a more moderate pace following several years of strong expansion.

Chart 1.22
Construction Sector Growth versus Federal Goverment Development Expenditure



Source: Department of Statistics, Malaysia and Accountant General Department

During the year, the Government announced several crucial policy decisions that would influence construction activity going forward. This includes the announcement of higher Federal Government spending on infrastructure projects under the Ninth Malaysia Plan (9MP). The 17.6% increase in spending is mainly for the construction of highways, bridges, schools and water-related projects. Emphasis would also be given for developmental projects outside the Klang Valley, including the Second Penang Bridge and the Penang Monorail, as well as the establishment of the Iskandar Development Region (IDR) to support economic growth in southern Johor. Towards the latter part of the year, key regulations were also liberalized. These included the relaxation of regulations pertaining to purchase of property by foreigners as well as amendments to the Strata Titles Act and Housing Development Act to facilitate more efficient regulatory approval in the construction sector.

Steady improvement in construction activity led by the civil engineering and non-residential segments

The **civil engineering** sub-sector began to show encouraging signs, as activity gradually recovered to register a positive growth by the final quarter of the year. In addition to the

Table 1.11
List of Major Ninth Malaysia Plan Projects

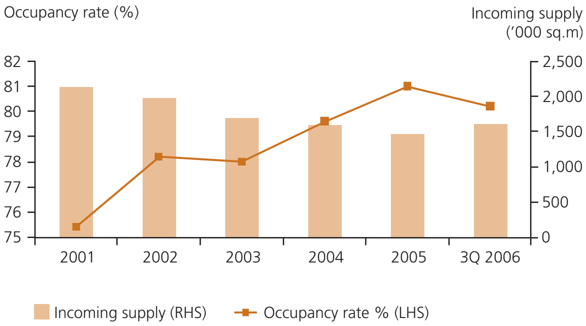
Third lane of the North South Expressway between Rawang-Tanjung Malim
Subang-Klang Link Project
Upgrading of KLIA to accommodate the new Airbus A380 aircraft
East Coast Highway Phase 2, Terengganu
Upgrading of Kota Kinabalu International Airport, Sabah
Development work at Jalan Tun Razak
Penang Prison Complex
Students' Quarters at Kolej Universiti Islam
Railway development at Batu Gajah, Perak
Vacuum Sewerage System I, Mukim Kelang
Industrial Training Institute (Miri, Sarawak)

High-Impact Projects
Second Penang Bridge
Penang Outer Ring Road
Penang Monorail
West Coast Expressway
Pahang Selangor Water Transfer Project
Langat 2 Water Treatment Plant
Sewerage and pipe replacement
Kajang-Seremban Highway

Iskandar Development Region (IDR), Johor
State Administrative Centre, Nusajaya
Tanjung Langsat Technopolis
Development of Free Access Zone
Cleaning of Sungai Segget, Sungai Skudai and Sungai Tebrau
Rail track to Port of Tanjung Pelepas
Johor Bahru Inner Ring Road Interchange
Upgrading of Jalan Ulu Tiram-Kota Tinggi to four lanes
Skudai Interchange
Upgrading of Johor Bahru-Kota Tinggi and Pasir Gudang Interchange
Upgrading of Jalan Tampoi to four lanes
Two elevated interchanges in Jalan Tampoi
Road linking Nusajaya and Malaysia-Singapore Second Link Bridge
Senai Interchange to Senai International Airport
Upgrading of drainage system
Senai-Skudai Highway
Second Permas Jaya Interchange
Upgrading of infrastructure at Senai International Airport
Upgrading of Perling Interchange
New security infrastructure and police station
Senai-Desaru Highway
Upgrading of traffic dispersal system

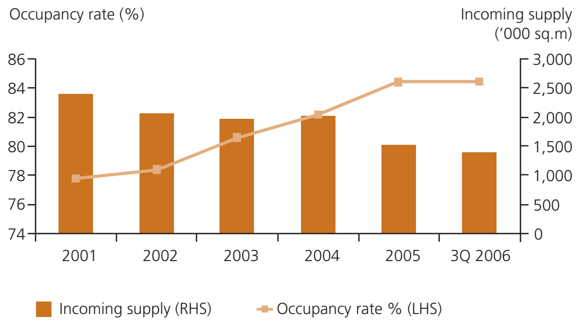
Source: Economic Planning Unit

Chart 1.23
Incoming Supply and Occupancy Rate of Retail Space in Malaysia (as at end period)



Source: National Property Information Centre (NAPIC), Valuation and Property Services Department

Chart 1.24
Incoming Supply and Occupancy rate of Purpose-Built Office Space in Malaysia (as at end period)



Source: National Property Information Centre (NAPIC), Valuation and Property Services Department

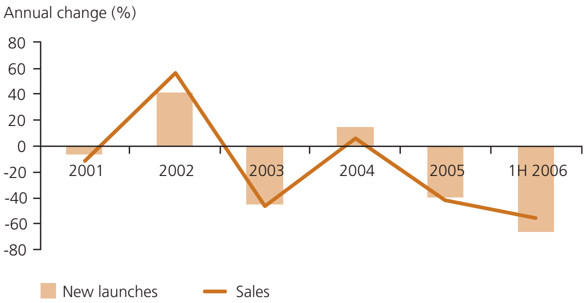
ongoing projects, the Government announced 880 new projects totalling RM15 billion, with 425 of these projects to be financed through the Private Finance Initiative. The civil engineering segment was also supported by construction activity in the oil and gas industry, mainly in the development and production of new facilities following discoveries of new offshore fields in Sabah. Meanwhile, several large civil engineering companies continued to secure projects abroad. They undertook highway, airport and hydropower plant projects in Asia, particularly in India and the Middle East.

Activity in the **non-residential** sub-sector trended higher during the year in line with robust business activity. Growth was backed by strong demand for both commercial and office space as reflected by the high occupancy rates and higher rentals during the year. In particular, incoming supply of shopping complexes during the year recorded a significant increase due to 10 large malls being constructed in the Klang Valley. These shopping complexes are expected to add 4 million square feet to the existing stock of 36 million square feet in 2007. Retailers have expanded their business activity in the key catchment areas while new malls have different concepts tailored towards the targeted consumer segments.

The office space segment was supported by new business activities, particularly in the city areas. The tenants comprise mainly multinational companies, financial institutions, outsourcing and IT-related companies as well as services companies related to the oil and gas business. Average rental rates in the Klang Valley rose by 20% to RM5.90 per square feet, amidst a high occupancy rate of 84%.

In line with the improving prospects in the non-residential sector, both in terms of yields and capital appreciation, the **Malaysian Real Estate Investment Trust (M-REIT)** sector continued to expand, with six new M-REITs listed on Bursa Malaysia. This brought the total number of M-REITs to nine as of end-February 2007. As a new asset class with defensive qualities, the M-REITs offer another opportunity for diversification of risk. While the market capitalisation of the REIT industry in Malaysia is relatively small when

Chart 1.25
Sales and New Launches in the Residential Sub-sector

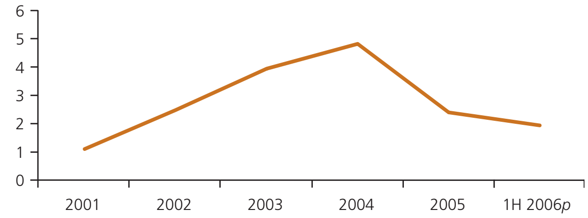


Source: National Property Information Centre (NAPIC), Valuation and Property Services Department compared to other regional countries (around USD850 million; Singapore: USD13.5 billion), the potential for further expansion is large.

Activity in the **residential** segment grew at a moderate pace as demand eased following the strong performance in previous years. This was reflected in the moderation in loan applications during the year. Housing developers also responded to changing market conditions by reducing launches of new properties and adapting to the changing requirements of consumers. Despite these efforts, the overhang of residential properties increased to 28,827 units by end-September 2006. In line with the overall market conditions, the Malaysia House Price Index rose at a more moderate pace of 2% in the first half of 2006. Despite the overall cautious attitude of consumers, demand for residential properties near the city area remained strong.

During the year, the Government undertook a number of important measures to facilitate the growth of the residential segment. The Strata Title Act and related bills were amended in December 2006, to enable a faster and more transparent approval process for strata titles, as well as to provide clearer oversight of property managers on the management of funds collected and disbursed. Amendments were also made to the Housing Development Act, whereby the Certificate of Fitness for Occupation (CFO), previously given by the local authorities, will be replaced with the Certificate of Completion and Compliance (CCC). The CCC will be issued by private architects and engineers, thus facilitating early occupation of buildings. The Government also liberalized rulings on foreign ownership of residential properties. Foreigners no longer need to obtain prior approval from the Foreign Investment Committee to purchase houses above RM250,000. Through these initiatives, property transactions are expected to increase.

Chart 1.26
Malaysian House Price Index



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Source: National Property Information Centre (NAPIC) , Valuation and Property Services Department

PRICES AND EMPLOYMENT

Consumer Prices

Globally, inflation remained a key macroeconomic issue in 2006. The robust performance of the global economy in recent years has driven up the demand and contributed to the upward pressure on the prices of commodities. At the same time, competition and the lower cost of production in China and India had helped to moderate the increase in goods and services prices worldwide. Malaysia, as a small open economy has not been

Table 1.12
Overhang of Residential Property in Malaysia by Price Range

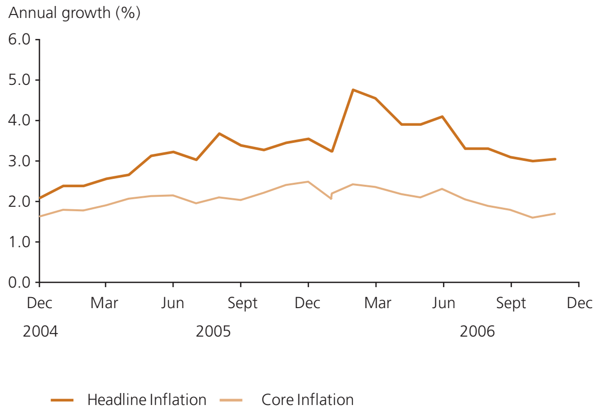
Residential Price Range	Units	Share (%)	Units	Share (%)
	As at end-2005		As at end-Sept 2006*p*	
RM50,000 or less	3,777	19.3	4,539	15.8
RM50,001 - RM100,000	5,806	29.7	7,554	26.2
RM100,001 - RM150,000	3,813	19.5	6,116	21.2
RM150,001 - RM200,000	2,666	13.6	4,327	15.0
RM200,001 - RM250,000	1,554	7.9	2,305	8.0
More than RM250,000	1,961	10.0	3,986	13.8
Total	**19,577**	**100**	**28,827**	**100**

p Preliminary
Source: National Property Information Centre (NAPIC), Valuation and Property Services Department

insulated from the factors that had influenced global prices.

The headline annual inflation rate, as measured by the Consumer Price Index (CPI), increased from 3% in 2005 to 3.6% in 2006. The level of headline inflation was within the Bank's forecast range of 3.5 – 4.0%. The core inflation rate rose at a more modest pace of 2.1% (2% in 2005) over the same period. The core inflation rate, a measure of CPI inflation which excludes transitory factors such as price-volatile items and price-administered items, reflects the underlying changes in prices induced by demand pressures. The divergence between headline inflation and the core inflation rate over the course of the year suggests that transitory factors were significant contributors to the buildup of price pressures. In particular, the adjustments to the administered prices of retail petroleum products and utilities during the year had a significant impact on the rate of inflation.

Chart 1.27
Consumer Price Index



The steeper increase in the headline inflation rate during the year was due largely to the increase in the prices of fuels and lubricants in the transport category. The sharp uptrend

Chart 1.28
Contribution to Headline Inflation

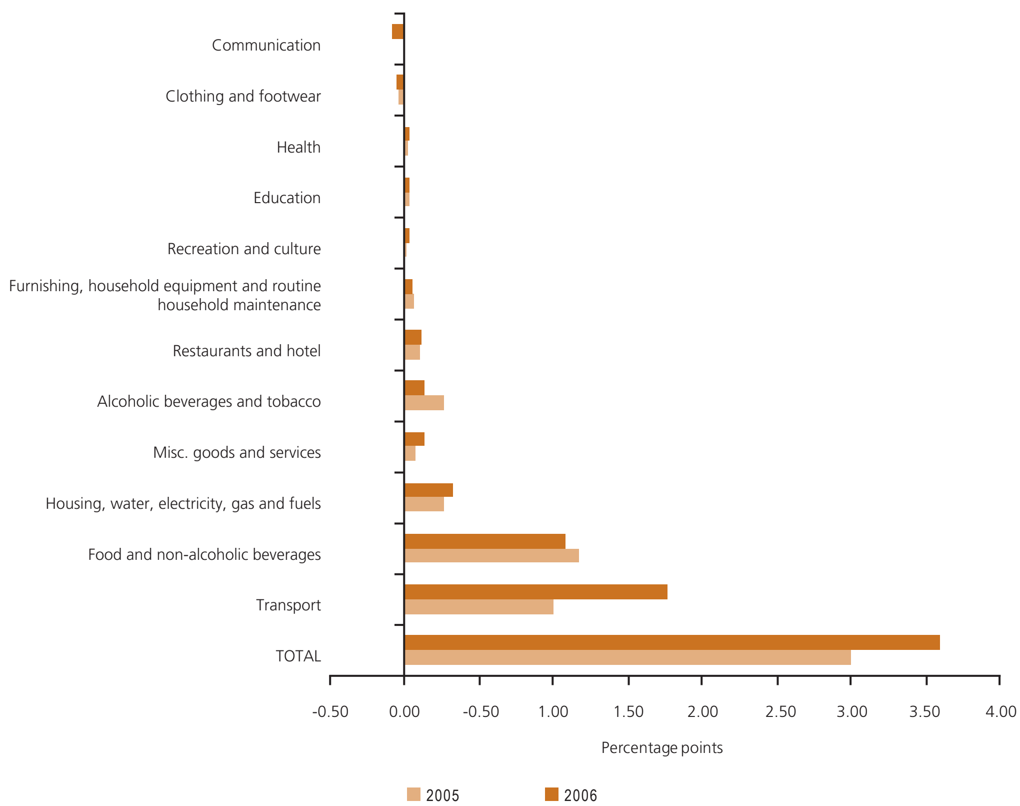


Table 1.13
Price Indicators

	Weight	2006 Annual growth (%)
Consumer Price Index (2005=100)	**100.0**	**3.6**
of which:		
Food and non-alcoholic beverages	31.4	3.4
Alcoholic beverages and tobacco	1.9	6.9
Clothing and footwear	3.1	-1.3
Housing, water, electricity, gas and other fuels	21.4	1.5
Furnishing, household equipment and routine household maintenance	4.3	1.1
Health	1.4	2.1
Transport	15.9	11.0
Communication	5.1	-1.4
Recreation services and culture	4.6	0.7
Education	1.9	1.6
Restaurants and hotels	3.0	3.7
Miscellaneous goods & services	6.0	2.2
Consumer Price Index		
Durable goods	8.0	-1.5
Semi-durable goods	4.3	-0.9
Non-durable goods	40.6	6.8
Services	47.1	2.1
Producer Price Index (2000=100)	**100.0**	**6.7**
of which:		
Local Production	65.7	9.0
Imports	34.3	2.2

Source: Department of Statistics, Malaysia

in international oil prices in early 2006 exerted a heavy burden on the Government's operating expenditure. As subsidies grew, the Government undertook a one-off increase in the prices of retail petroleum products in March 2006 by an average of 18.5%. Following this, the headline inflation rate rose sharply to 4.8% in March 2006 and remained elevated during the rest of the first half of 2006. The direct impact of the higher prices of retail petroleum products contributed 1.1 percentage points to the average headline inflation rate in 2006, compared with 0.31 percentage points in 2005.

Apart from the higher prices for retail petroleum products, the high oil prices had a notable impact on the cost of air travel through the increase in the fuel surcharges imposed by airlines. Other utility prices such as electricity tariffs and water charges in selected states were also adjusted upwards. Nevertheless, the cumulative impact of these adjustments was relatively small and thus, had only a minor impact on the headline inflation rate.

The key issue that arose following the adjustments of administered prices was the scale and pace of the pass-through to prices of other goods and services in the economy, as well as to wages. The broad evidence suggests that the indirect impact on the prices of other goods and services was limited. The underlying inflation rate that excludes the direct impact of retail petroleum products had begun to moderate since January 2006. Further, while a higher proportion of items in the CPI basket exhibited price increases in the wake of the rise in the prices of the retail petroleum products, this impact moderated in the second half-year, indicating that inflationary pressures were not wide-spread across the broad range of goods and services in the economy. Finally, there was no strong evidence of wage-price pressures in 2006 with measures of wage growth remaining relatively subdued. The annual growth rate of nominal private sector wages in 2006 was unchanged at 5.8%, according to the latest Salary and Fringe Benefits Survey undertaken by the Malaysian Employers Federation. This increase in wages was partly offset by improvements in labour productivity. The stronger annual increase in real labour productivity of 3.5% in 2006 (2005: 1.2%) kept overall cost pressure in the labour market relatively low throughout the year.

Despite the initial spike in the inflation rate in March 2006, inflation expectations of the public were broadly well-anchored throughout the year. The Government had indicated that the increase in retail petrol prices in March 2006 would be a one-off occurrence for the year, thus limiting the extent to which price pressures cascaded from production costs into the overall price level. This was supported by Government agencies undertaking active surveillance and ensuring that prices of controlled essential goods and services were transparent. The appreciation of the

Chart 1.29
Direct Impact of Retail Petroleum Product Inflation to Headline Inflation

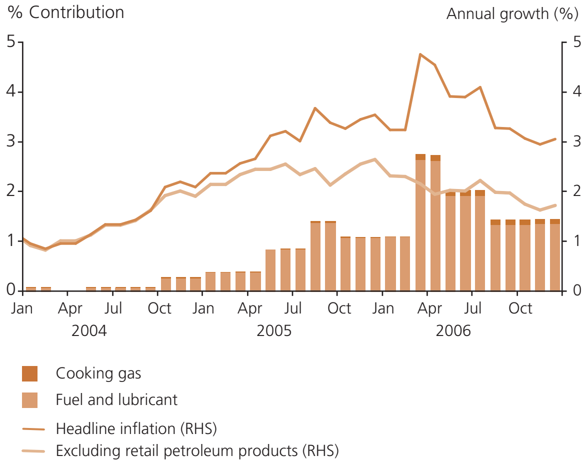


Chart 1.31
Food Inflation

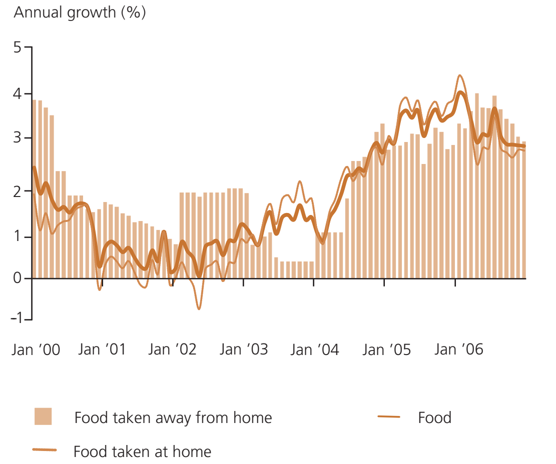
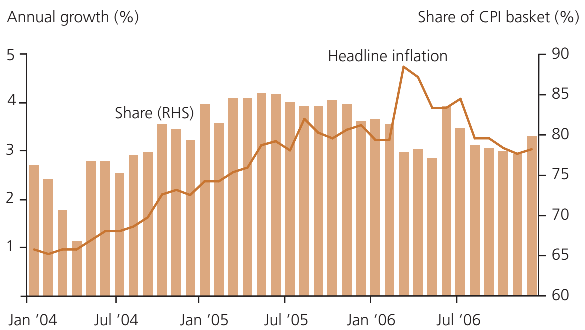


Chart 1.30
Share of Items in CPI Basket that Exhibited Annual Price Increases



ringgit exchange rate had also mitigated some inflationary pressure during the year by reducing the cost of imports.

Nevertheless, higher fuel prices had some impact on certain sectors of the economy. In particular, the higher utility costs have increased the operating expenditures of food retailers. Food prices tended to respond more quickly to changes in the costs of raw materials. However, the competitive environment had contained the pace of food price inflation, which eventually moderated in the second half of 2006. For the year as a whole, food inflation moderated to 3.4% from 3.6% in 2005.

The impact of the higher commodity prices was, however, significant from the producers' point of view, notably those in the resource-intensive industries. In the first half of the year, the increase in producers' prices was mainly driven by inflation in the commodity-related categories. However, this trend reversed in the second half-year when international spot crude oil prices declined. Overall, the average rate of producer price inflation moderated slightly to 6.7% in 2006 (2005: 6.8%).

Notwithstanding the fact that oil and other commodities are important inputs into the production process and significant movements in their prices had affected producers' overall costs and induced cost-push pressures, their importance for producer price inflation has diminished over time. In 2006, the Department of Statistics of Malaysia announced a rebasing of the Producer Price Index (PPI) to year 2000 (previously 1989=100) and a revision of the weights of items in the PPI basket in proportion to their contribution to the total value of output in the economy. Compared to the previous weights, the weights of non-commodity related items, such as machinery and transport equipment; and manufactured goods were significantly higher in the new Producer Price Index. The new weights are therefore more reflective of the current state of the Malaysian economy, which has evolved

Chart 1.32
Producer Price Index

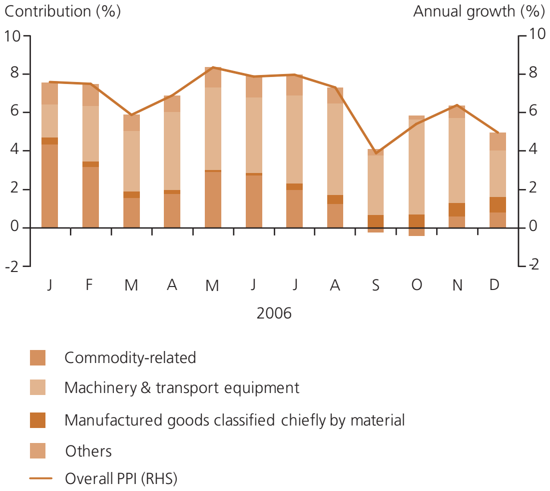
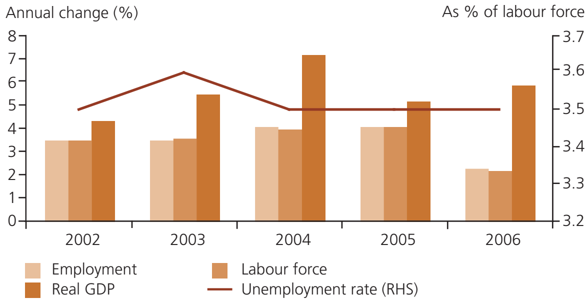


Chart 1.33
Output and Employment



Source: Department of Statistics, Malaysia
Economic Planning Unit

from one based on commodities, to one which is based on manufacturing.

All things considered, inflation was reasonably benign in light of the limited pass-through impact from high oil prices. To some extent, this reflects the broad global phenomenon in which improvements in product market efficiency and greater global competition have reduced the pricing power of producers and created greater flexibility in product and labour markets, driving global inflation rates to historically low levels. Consequently, the impact of shocks on inflation going forward is likely to be less persistent.

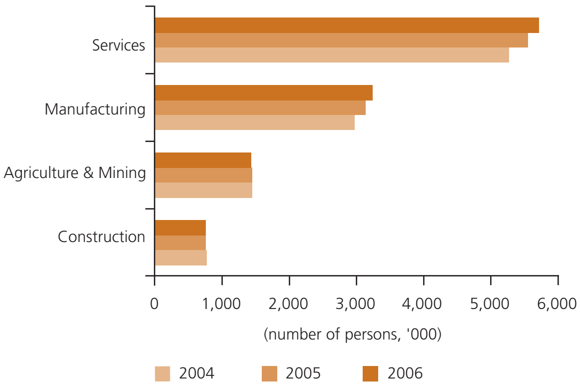
Labour Market Developments

The domestic labour market continued to strengthen in 2006 as demand for workers rose during the year amidst faster economic growth. The unemployment rate remained low at 3.5% of labour force, as job creation was robust. Labour force participation improved further and fewer retrenchments were recorded during the year.

Stronger labour market conditions

Total **employment** expanded by 2.3%, outpacing the 2.2% expansion in the labour force. As such, the labour force participation rate also increased during the year. The MIER Employment Index rose from 98.9 points in the first quarter to 114.8 points in the fourth quarter, reflecting the sustained improvements of the job market. Overall, the services sector continued to be the largest employer in the country (51% share), with the distributive trade, hotel and restaurants sub-sector (18% share) remaining the biggest employer in the sector. Compared to the other sectors, the manufacturing sector recorded the highest employment growth during the year (3.3%), in line with the strong expansion in manufacturing activity (7%). Nevertheless, the sector's share of employment remained stable at 29%. The construction sector recorded smaller job losses this year compared to the previous year (-0.6% and -1% respectively), as construction activity picked up towards end of the year and on

Chart 1.34
Total Employment by Sectors



Source: Economic Planning Unit

the expectations that more development projects were in the pipeline.

In 2006, the rate of increase of **foreign workers** in Malaysia moderated significantly. By end-year, the total number of foreign workers (including foreign expatriates) employed in Malaysia had risen by 3% in contrast with the 22% increase recorded in 2005. Nevertheless, the number of migrant workers remains significant, accounting for 17% of all persons employed. During the year, the Government approved the recruitment of 1,869,208 new migrant workers and another 33,567 foreign expatriates to work in Malaysia. The majority of the migrant workers were hired by employers in the manufacturing and agriculture sectors (35% and 26% respectively) to alleviate shortages for semi-skilled and unskilled labour. In the agriculture and domestic services sector, the workers mostly tended to originate from Indonesia, while those in the manufacturing sector were mainly from Indonesia, Nepal and Vietnam. Most foreign expatriates in Malaysia were engaged in the services (55% share) and manufacturing (37% share) sectors. Foreign expatriates from India, Japan, PR China, United Kingdom and Singapore, accounted for more than half of the total foreign skilled professionals in Malaysia.

Total **retrenchments** in 2006 declined for the fifth year to 15,360 persons, affecting mainly non-executives in areas such as plant and machine operators and assemblers, craft and related trade, and general workers. More than half of the retrenchments occurred in the manufacturing sector, following several retrenchments by companies in the E&E industry (27% share of the sector). The services sector as a whole retrenched more workers this year, accounting for 36% of the layoffs. The retrenchments occured in the transport, hotel and distributive trade industries. In general, most of the retrenchments were attributed to the sale and closure of companies as well as difficulties arising from high cost of production and reductions in demand.

Vacancy trends also pointed to more positive employment conditions. The number of new job vacancies reported via the Electronic Labour Exchange (ELX) rose significantly during the year. Stronger demand for labour was recorded in all key sectors, especially the manufacturing sector (42% share), amidst a backdrop of strong domestic and external sales, revival in construction activity and the opening of

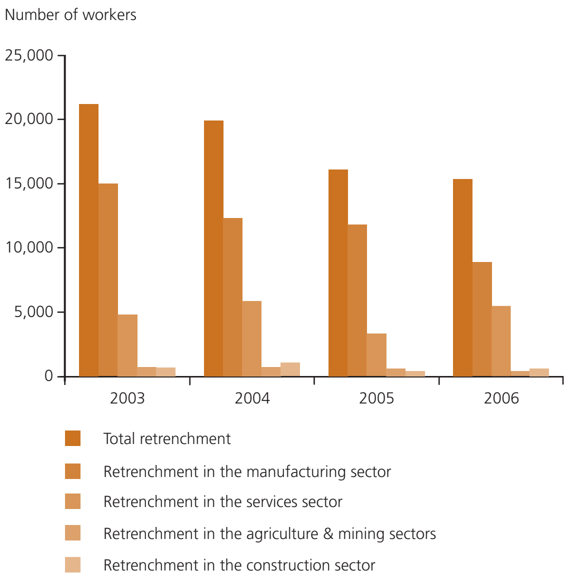
Table 1.14
Selected Labour Market Indicators

	2002	2003	2004	2005	2006*e*
Employment ('000 persons)[1]	9,709.0	10,047.2	10,463.7	10,892.8	11,144.1
Labour force ('000 persons)[1]	10,064.3	10,426.4	10,846.0	11,290.5	11,544.5
Retrenchments (persons)	26,452	21,206	19,956	16,109	15,360
Active jobseekers (persons)	32,305	28,404	27,227	72,573	84,046
New vacancies (positions)	162,787	96,918	49,975	304,500	834,675
Unemployment rate (%)[1]	3.5	3.6	3.5	3.5	3.5
Labour force participation rate (%)[1]	65.2	65.6	66.1	66.7	66.9
Real labour productivity growth (%)[2]	0.8	1.9	2.9	1.2	3.5

[1] Based on estimates by Economic Planning Unit
[2] Based on estimates by Bank Negara Malaysia
e Estimate

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

Chart 1.35
Retrenchment by Sectors



Source: Ministry of Human Resources

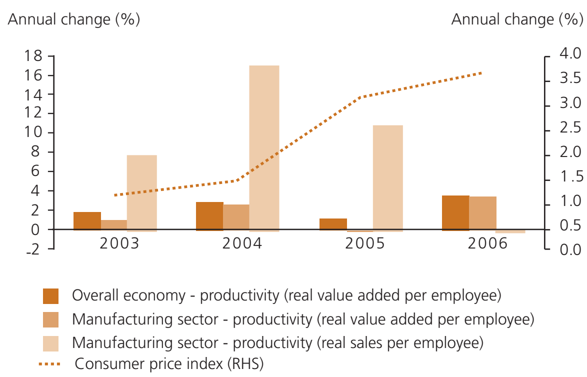
more retail and other services outlets. Most of the job positions advertised in the ELX were elementary occupations (60% share), which are more suitable for non-executives. For higher-skilled jobs, employers preferred to draw on the expertise and reach of private employment agencies and print media. Thus, total vacancies available in the economy were likely to be much higher than that reported by the ELX.

While demand for labour increased in 2006, the number of available workers also rose. **Active jobseekers** registered with the Manpower Department rose by 16% to 84,046 persons. A notable development was the significant presence of job seekers who were already employed but had reentered the job market in the expectation that they could find better jobs. This group accounted for 44% of registered jobseekers and signalled the more optimistic outlook of the job market. Meanwhile, graduates (diploma and degree holders) accounted for about 48% of the total active jobseekers, with 45% of this group possessing some work experience. These jobseekers were mainly graduates in ICT, Trade and Business Management, Electrical and Mechanical Engineering, and Accounting.

Despite the better economic outturn, **wage pressures** were relatively subdued due in part to the presence of a large number of unemployed graduates and availability of migrant workers. The Salary and Fringe Benefits Survey undertaken by the Malaysian Employers Federation showed that average private sector salary increment was 5.8%, the same as in the previous year. Generally, executives received a higher salary increase compared to the non-executives. On a sectoral basis, employees in the manufacturing sector benefited from the robust pace of manufacturing activity during the year. Salary increments in the manufacturing sector averaged 6%, higher than that of the non-manufacturing sector (5.5%). Similarly, the Salary, Benefits and Employment Conditions Survey in the manufacturing sector conducted by the Federation of Malaysian Manufacturers also revealed that average salary increase paid out to employees was 6% (2005: 6.3%).

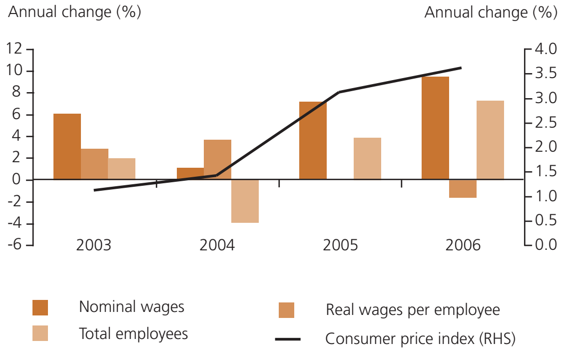
Labour productivity, as measured by the real value added per worker, improved significantly to 3.5% (2005: 1.2%), boosted by higher productivity growth in the agriculture, manufacturing and the services sectors. Increased use of capital and improvement in business processes, as well as higher values of products and services, resulted in the better productivity outturn. Estimates by Bank Negara Malaysia showed that

Chart 1.36
Productivity Trends



Source: Bank Negara Malaysia
Department of Statistics, Malaysia

Chart 1.37
Wage Costs in the Manufacturing Sector



Source: Bank Negara Malaysia
Department of Statistics, Malaysia

total factor productivity growth recorded an increase of 2.3% (2005: 2.1%), signifying better productivity gains arising from improvements in the utilisation of factor inputs through technological progress and overall efficiency improvement. The agriculture sector benefited from good weather conditions, which facilitated higher yields, as well as improved agricultural practices and increasing mechanisation. Data from the Monthly Manufacturing Survey published by the Department of Statistics revealed that manufacturing sales grew by 11.1% in nominal terms during the year. However, real sales value per worker recorded a marginal decline of 0.2% as total headcount and inflation increased at a faster pace (7.3% and 3.6% respectively) compared with the previous year (3.9% and 3% respectively).

Against a backdrop of favourable international economic conditions and an increasingly mobile workforce, the competition for talent and skilled workers has intensified. Workers who are equipped with the right technical and managerial expertise are now deemed critical and integral to any nation's bid to be competitive, to enhance productivity and increase value-add. The competition for talent is fiercest in the high-technology manufacturing industries, but has increasingly spread to the services industries too. Malaysia is not alone in facing the problem of **skills shortages** as even in developed countries, as well as the fast-growing economies of India and PR China[3], skill shortages are fast emerging as a critical business issue. In Malaysia, the recently announced Ninth Malaysia Plan, which is the blueprint for development spanning the period 2006-2010, has identified human capital development as the second of the five key thrusts that required urgent attention. Specifically, the second thrust of the Plan is to raise the country's capacity for knowledge and innovation. Programmes that will be undertaken include a comprehensive improvement of the education system, ranging from pre-school to tertiary and vocational institutions; improvement of access to the education system; creating more avenues for skills development, training and lifelong learning; and to promote innovation by nurturing high quality research and scientific capability. Generally, the Plan emphasised the need to enlarge the pool of suitably-skilled indigenous labour to drive the transformation towards a knowledge-based economy.

The skills shortage problem is most apparent from the large number of unemployed graduates in Malaysia. Latest available data from the Department of Statistics showed that there are 66,900 unemployed diploma and degree-level graduates as at end-September 2006, which is equivalent to about 4% of the graduate labour force or 20% of total unemployed workers. Among key factors cited as the main barriers to securing jobs include the lack of work experience (about 45% of the unemployed graduates are without working experience), the lack of communication and IT skills, and fields of study that is not in demand. In light of this, the Government has formed a Cabinet Committee to address this issue.

Immediate short-term measures include retraining the unemployed graduates, absorption of qualified graduates into vacant positions in

[3] In Britain, the shortage of applicants with the right skills has resulted in four of every 10 employers facing difficulties in filling graduate vacancies (Association of Graduate Recruiters, 2006). A survey conducted by Deloitte Consulting in 2005 revealed that more than 80% of American manufacturers experienced an overall shortage of qualified workers that cut across industry groups. Studies by the McKinsey Group revealed that Bangalore, India is already experiencing rising wages and high turnover among IT engineers, while in PR China, companies will have difficulties in finding enough suitable employees in key service and managerial occupations.

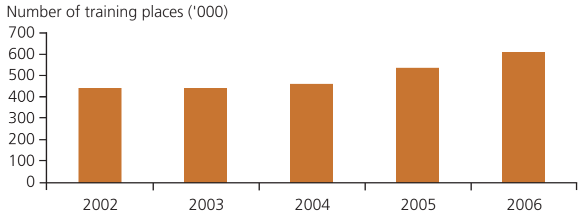
the civil service, and to facilitate the graduates' entry into entrepreneurship programmes. In 2006, 8,510 unemployed graduates underwent the Third Graduate Training Scheme or SLG III (2005: 7,992), taking up various courses such as English (45%), Executive Development Programme (22%), and web publishing and application development (9%). So far, the SLG programme has been quite successful in retraining the graduates and equipping them with the right skills as about 61% of them were gainfully employed upon completion of the course. In addition, there has been increased corporate involvement, especially from the government-linked companies (GLCs) and other corporations, to train unemployed graduates.

In the public sector, bottlenecks that are delaying the filling of more than 70,000 vacancies (30,000 of which are graduate-level positions) are being addressed. Latest data showed that about 24,378 unemployed graduates have been qualified to take on management and professional positions within the government sector.

At the same time, there are plans to increase and enhance collaboration between industries and universities as well as reforming parts of the academic curriculum to ensure that they are relevant to market needs. The recent Education Blueprint has put more emphasis on technology, science, mathematics, language proficiency and ICT to ensure a future pool of skilled and competent workforce. Meanwhile, the public universities have introduced a "soft-skills module" starting in 2007 and this module covers communication; critical thinking and problem solving; teamwork; leadership; entrepreneurship; lifelong learning and information management; and professional ethics and morality.

Employers have been quick in implementing measures to improve human capital strategies and to deal with the skills gap. Generally, the approaches undertaken can be grouped into three categories: focused recruitment; better in-house management of human capital assets; and collaborations with schools, colleges

Chart 1.38
HRDF: Number of Training Places Approved



Source: Pembangunan Sumber Manusia Berhad

and universities to enhance aspects of the curriculum. Focused recruitment ensures that the right talent and skills are identified and secured at an early stage. For skills that are difficult to locate in the domestic labour market, companies have ventured into the international labour market and recruited foreign professionals. This is reflected in the diverse group of expatriates who are currently engaged in various industries such as manufacturing, oil and gas, construction, transport and communications, IT, distributive trade and education.

In addition, companies are also putting more emphasis on training and career development to meet the changing attitudes regarding careers and job satisfaction in addition to financial benefits. Apart from "buying talent in the market", the philosophy of "building talent from within" is gaining emphasis, as reflected in the increased share of companies' investment in training and career development. In this respect, the Human Resource Development Fund continues to play an important role in encouraging training of staff by employers. In 2006, total financial assistance approved by the Pembangunan Sumber Manusia Berhad (PSMB) for training rose by 20% to RM289.2 million. With the exception of courses conducted abroad, reimbursements for all other promoted courses were increased to the full amount of the levy. During the year, popular training programmes that were approved by the PSMB include technical- and quality-related courses (30%), supervisory and management (16%), computer (13%) and safety and health (8%).

EXTERNAL SECTOR

Balance of Payments

Malaysia's external position remained strong in 2006. The **overall balance of payments** registered a higher surplus due to a larger current account surplus. The larger current account surplus reflected the strong trade surplus, attributable to continued expansion in both manufactured and commodity exports, as well as improvements in services and income accounts. The deficit recorded in the services account was lower due mainly to higher tourism receipts. Increased profits and dividends accruing to Malaysian companies investing abroad led to a lower income account deficit. In the financial account, there were significant inflows of both direct and portfolio investments into Malaysia. However, these net inflows were offset by higher direct investment abroad by Malaysian companies as well as outflows of other investment, reflecting the higher net repayment of external loans by the public sector and the higher placement of assets abroad by banks. After taking into account the errors and omissions, which include the foreign exchange loss arising from revaluation of Bank Negara Malaysia's international reserves as a result of the strengthening of the ringgit against major currencies, the net international reserves increased by RM25.3 billion to RM290.4 billion (or USD82.5 billion) as at 31 December 2006. As at 28 February 2007, reserves amounted to RM305.9 billion (or USD86.9 billion). This level of reserves is adequate to finance 8.2 months of retained imports and is nine times the short-term external debt.

Current Account

In 2006, the **current account** recorded a larger surplus of RM91.2 billion, equivalent to 17.3% of GNP (2005: RM75.7 billion or 16.1% of GNP), attributable to a large trade surplus and improvement in the services and income accounts. Expansion in gross exports reflected the continued growth in manufactured and commodity

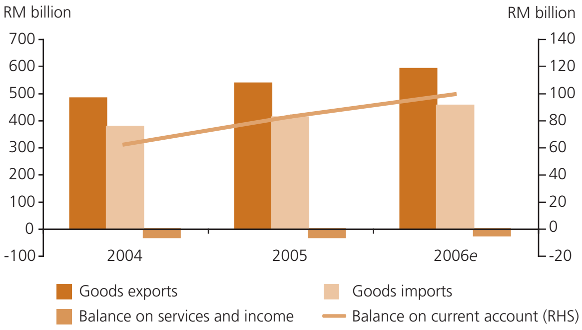
Table 1.15
Balance of Payments

Item	2005			2006e		
	+	-	Net	+	-	Net
	RM billion					
Goods	537.0	411.4	125.6	589.6	454.6	135.0
Trade account	*533.8*	*434.0*	*99.8*	*589.0*	*480.8*	*108.2*
Services	74.1	83.1	-9.0	78.0	85.3	-7.4
Balance on goods and services	**611.1**	**494.5**	**116.6**	**667.6**	**539.9**	**127.7**
Income	20.3	44.3	-23.9	30.5	50.3	-19.8
Current transfers	1.1	18.1	-17.0	1.1	17.7	-16.6
Balance on current account	**632.6**	**556.9**	**75.7**	**699.1**	**607.9**	**91.2**
% of GNP			**16.1**			**17.3**
Capital account			-			-
Financial account			-37.0			-39.9
Direct investment			3.8			4.3
Portfolio investment			-14.2			14.7
Other investment			-26.6			-59.0
Balance on capital and financial account			**-37.0**			**-39.9**
Errors and omissions			-25.1			-26.0
of which:						
Exchange revaluation gain (+) or loss (-)			*-15.5*			*-6.9*
Overall balance			**13.6**			**25.3**
Bank Negara Malaysia international reserves, net			**265.1**			**290.4**
USD billion equivalent			**70.2**			**82.5**

Note: Numbers may not necessarily add up due to rounding
e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.39
Current Account



e Estimate

exports. A larger inflow of tourism receipts and the improvement in commissions earned from procurement of goods for resale to non-residents, contributed to a lower services account deficit. The improvement in the income account reflected higher profits and dividends accruing to Malaysian companies from their overseas investments and higher returns from external reserves.

Malaysia's external position remained strong. The larger current account surplus was driven mainly by stronger trade surplus, reflecting expansion in both manufactured and commodity exports

In line with the improved external environment, growth in **gross exports** was sustained at a double-digit rate of 10.3% in 2006. The growth was supported by continued strong demand for primary commodities, as well as the sustained expansion in exports of manufactured goods.

The expansion in exports of **manufactured goods** was due to strong performance of selected resource-based industries, as well as continued growth in exports of **electronics and electrical (E&E) products**. The upturn in the global electronics cycle resulted in increased shipments of computers and parts and semiconductors

Table 1.16
Gross Exports

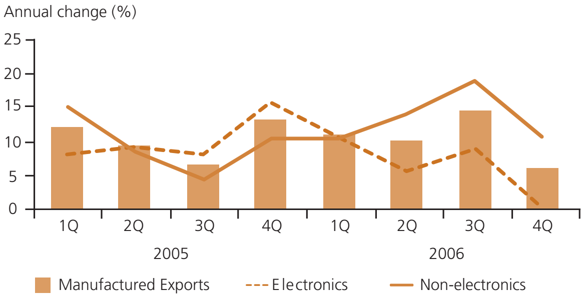
	2005	2006*p*
	Annual change (%)	
Gross exports	**10.9**	**10.3**
Manufacturing	**10.0**	**10.1**
of which:		
Electronics and electrical products	*9.9*	*6.4*
Chemicals & chemical products	*6.8*	*10.7*
Manufactures of metal	*7.4*	*33.0*
Petroleum products	*24.7*	*27.2*
Agriculture	**0.6**	**12.5**
of which:		
Palm oil	*-8.7*	*13.7*
Rubber	*11.2*	*42.3*
Minerals	**26.4**	**8.6**
of which:		
Crude oil and condensates	*32.6*	*8.1*
LNG	*21.0*	*12.0*

p Preliminary
Source: Department of Statistics, Malaysia

especially in the first half of the year. The demand for semiconductors was also induced by the introduction of new microprocessors during the year. Exports of telecommunications equipment also saw a discernable increase, due to capacity expansion by major producers in response to strong global demand. The positive impact from the increased export volume of electronics and electrical products was partly offset by falling export prices of selected products due to keen competition among major global producers.

Exports of **resource-based industries**, particularly wood, petroleum and rubber products as well as chemicals performed strongly during the year. The growth was supported by higher prices of these products as well as strong demand from the regional countries. Products that are related to the construction sector, namely metal and non-metallic mineral products, also saw a significant rise in exports during the year. The higher proceeds were due partly to the improvement in global steel prices, and in part due to the strong demand for pipes and glass as intermediate inputs

Chart 1.40
Export Performance of Electronics and Non-electronics Industries



Source: Department of Statistics, Malaysia

for industries in the regional countries. In addition, newer products such as the floating structures for the oil and gas industry continued to underpin the rapid increase in the transport equipment segment. Meanwhile, exports of furniture and parts were supported by the favourable demand from the United States, Japan and Australia.

Exports of **primary commodities** continued to expand at a double-digit rate due entirely to higher prices as the export volume declined by 2.4%. Primary commodity exports have over the years become an important source of foreign exchange earnings to the country, benefiting mainly from the strong commodity prices and demand from the emerging markets in the region. The value of commodity exports has doubled over the last six years to about RM99 billion and its share to total exports has increased to 16.8% (2000: 13.3%).

Export receipts from **agriculture** rose by 12.5% in 2006, led mainly by higher exports of palm oil and rubber. Palm oil exports turned around from a decline in 2005 to record a positive growth of 13.7%, due to both higher export prices and volume. The positive development was due to the diversification of the uses of palm oil from vegetable oil to non-edible uses, particularly for the production of biodiesel, which led the strong increase in exports to the European Union. Meanwhile, exports of palm oil to the US market continued to perform strongly as food manufacturers gradually substituted palm oil for other edible oils containing *trans fatty* acids. This was complemented by the continued rise in demand from traditional buyers, especially PR China. On the price front, the positive sentiment of potential demand for biofuel purposes, changes in domestic stock levels as well as the increase in soyabean oil prices, palm oil's closest substitute, had led to a gradual upward trend in prices during the year. Meanwhile, rubber exports also witnessed a sharp increase during the year led mainly by higher prices due to low global stocks amidst the supply constraints in the major producing region, rising demand from PR China as well as the increase in synthetic rubber prices in line with the prices of crude oil.

Mineral exports grew at a more moderate pace of 8.6% in 2006 after three consecutive years of strong performance. The growth was due to lower export volume of both crude oil and LNG in line with lower production during the year. The export performance was also influenced by the moderating energy prices towards the latter part of the year. Several key factors that influenced the price trends included the increase in inventories in the US as well as the weaker demand due to warmer-than-expected winter in the major industrial countries.

Gross imports expanded by 10.8% (2005: 8.6%). Imports of **intermediate goods**, which were the main component of import growth, expanded by 8.8%. Global demand for E&E products underpinned the demand for imported components, particularly parts and accessories for electronics and telecommunication products. These components were sourced mainly from PR China, Korea and Thailand. Imports of industrial supplies, such as chemicals used by the E&E industry increased. Sustained consumer spending led to higher imports of primary and processed materials used by the food and beverages industry. Meanwhile, higher imports of fuels and lubricants reflected mainly higher oil prices.

Consonant with strong business sentiment and the pick up in investment activity, imports of **capital goods** rose by 7.4%. Investment in machinery and equipment in areas such as

Table 1.17
Imports by End-Use

	2005 Annual change (%)	2006*p* Annual change (%)
Capital goods	**9.5**	**7.4**
Capital goods (except transport equipment)	11.5	5.4
Transport equipment	-4.5	23.5
Intermediate goods	**7.1**	**8.8**
Food and beverages, mainly for industry	-4.9	24.9
Industrial supplies, n.e.s.	7.4	11.1
Fuel and lubricants	42.6	25.7
Parts and accessories of capital goods (except transport equipment)	1.9	5.1
Consumption goods	**7.5**	**13.4**
Food and beverages, mainly for household consumption	4.1	4.8
Consumer goods, n.e.s.	10.0	18.8
Re-exports	**26.1**	**50.6**
Gross Imports	**8.6**	**10.8**

Note: Numbers may not necessarily add up due to rounding
n.e.s. Not elsewhere specified
p Preliminary

Source: Department of Statistics, Malaysia

bio-diesel, metals and high-end electrical and electronics industries lifted imports of machinery, metal tools as well as generators, turbines and electric motors for power generation. Increased exploration and development activity in the oil and gas industry led to higher imports of construction and mining equipment. Of significance, imports of ships, offshore support vessels, and aircraft were driven by strong external demand for commodity exports, oil and gas exploration as well as the expansion in intra-regional travel arising from high demand generated by the availability of low-cost air carrier services.

In tandem with sustained private consumer spending, and consumer confidence, imports of **consumption goods** increased by 13.4%. The growth in imports of consumption goods reflected mainly higher imports of semi-durables, particularly clothing and footwear as well as non-durables, such as medicines, soaps and cosmetics. Higher growth was also recorded for imports of food and beverages.

A notable development was the robust growth of 50.6% in **imports for re-export**, arising mainly from activities carried out in the free commercial zones at the ports and airports. These activities included trading, break bulking, grading, repacking, relabelling, transit and logistics. These imports were largely re-exported to Singapore, US, Thailand, PR China and Hong Kong SAR. Office machines and automatic data processing equipment, electrical machinery and parts and telecommunication equipment accounted for about half of the total imports for re-export. Exploration activity in the oil and gas industry also contributed to the growth as iron and steel pipes were imported, coated for anti-corrosion and re-exported.

Better economic linkages and measures taken to diversify into other non-traditional markets have brought about changes in the pattern of trade. Accordingly, the exports and imports diversification indices measured by the normalised Herfindahl-Hirschmann index improved to 0.14 and 0.13 respectively in 2006 (2000: 0.18 and 0.18, respectively). Malaysia's trade with the major trading partners, namely the United States (US), Singapore, Japan and the European Union (EU), declined to 52.6% (2000: 64.3%) of total trade. In contrast, trade with PR China, Korea, India and Australia recorded a rising trend and accounted for a larger market share.

Chart 1.41
Exports and Imports Diversification Indices

The exports and imports diversification indices are modified version of Herfindahl-Hirschmann index. It is normalised to obtain a numeric range from 0 to 1. A lower index signifies a higher degree of diversification.

The **US** continued to be Malaysia's largest trade partner. Nevertheless, the share of Malaysia's trade with US has declined to 16% of total trade in 2006 from 18.7% in 2000. **Singapore** remained as Malaysia's second largest trade partner with trade mainly in E&E products, petroleum related products, manufactures of metal and chemical products. Meanwhile, **Japan** maintained its position as the third largest trading partner as export growth strengthened, underpinned by liquefied natural gas (LNG) exports. The Japan-Malaysia Economic Partnership Agreement (JMEPA) has spurred the growth of palm oil exports which have preferential access under the Agreement. Japan remained as Malaysia's most important source of imports although its market share has declined, reflecting the growing diversification in the sources of imports.

Stronger economic activity in the **EU** together with improved business and consumer confidence resulted in trade with the EU strengthening and accounting for a higher market share. The major trading partners within the group were Germany, Netherlands and the United Kingdom (UK) which together accounted for more than half of Malaysia's trade with the EU. The trade surplus in Malaysia's favour increased substantially to RM20.3 billion, attributable to the trade surplus with Netherlands, the UK, Spain and Finland.

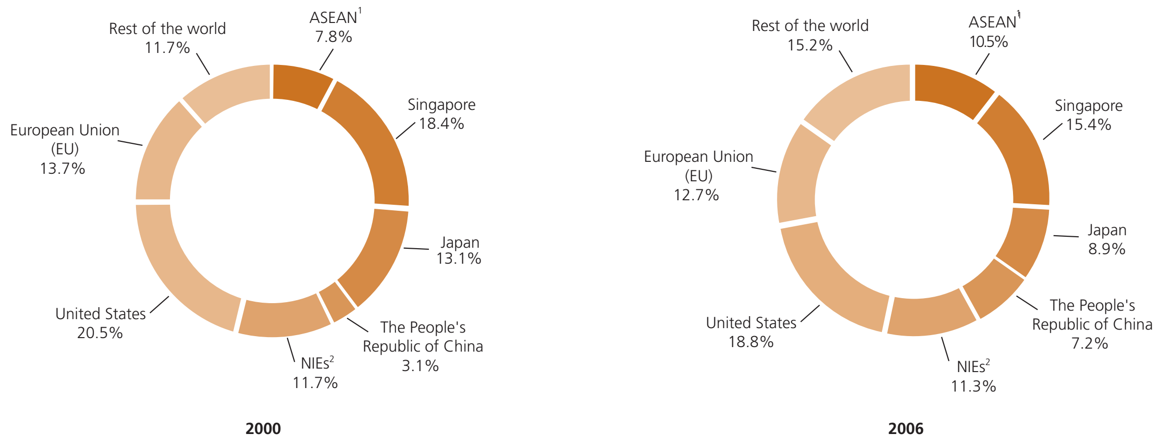
Table 1.18
Direction of External Trade

	2006*p*				
	Exports		Imports		Trade balance
	RM billion	Annual change (%)	RM billion	Annual change (%)	RM billion
Total	**589.0**	**10.3**	**480.8**	**10.8**	**108.2**
of which:					
United States	**110.6**	**5.3**	**60.2**	**7.7**	**50.4**
European Union (EU)	**74.9**	**19.7**	**54.6**	**8.2**	**20.3**
Selected ASEAN countries[1]	**152.5**	**10.7**	**116.7**	**9.7**	**35.8**
Selected North East Asia countries	**109.1**	**10.0**	**123.0**	**15.8**	**-13.9**
The People's Republic of China	*42.7*	*21.1*	*58.2*	*16.7*	*-15.6*
Hong Kong SAR	*29.1*	*-6.6*	*12.7*	*17.2*	*16.5*
Chinese Taipei	*16.0*	*8.3*	*26.2*	*9.4*	*-10.2*
Korea	*21.3*	*18.6*	*25.9*	*19.9*	*-4.6*
West Asia	**16.0**	**21.5**	**20.0**	**42.6**	**-3.9**
Japan	**52.2**	**4.6**	**63.6**	**0.9**	**-11.4**
India	**18.8**	**25.5**	**4.9**	**17.3**	**13.9**

Note: Numbers may not necessarily add up due to rounding
[1] Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam
p Preliminary

Source: Department of Statistics, Malaysia

Chart 1.42
Direction of Exports (% share)



[1] Selected ASEAN countries excluding Singapore
[2] Hong Kong SAR, Korea and Chinese Taipei

Trade with **North East Asia** (excluding Japan) expanded, supported largely by growth in imported components from PR China and Korea. Hence, PR China emerged as the third largest source of imports, consisting mainly imports of intermediate goods for the E&E sector. Exports to PR China strengthened by 21.1%, attributable to China's strong economic growth and higher demand for commodities. Higher imports from Korea were underpinned by imports of integrated circuits, office machine and parts, as well as ships. Exports to Korea grew by 18.6%, reflecting partly higher demand for LNG, which accounted for about a quarter of the exports.

Driven by strong investment performance, trade with **India** increased at a robust pace. Exports consisted of crude petroleum, E&E products and chemicals, while imports comprised chemicals, food and electrical machinery. The trade surplus, increased to RM13.9 billion. Trade with **West Asia** has been on a rising trend. Since 2005, the trade balance has shifted to favour West Asia as heavy crude oil is imported for the domestic market while about half of Malaysia's light crude oil, which commands a high premium on the international market, is exported. Exports to West Asia strengthened, reflecting mainly exports of electrical machinery, computers and components, palm oil as well as iron and steel. Promotional and marketing activities for Halal food have resulted in increased exports of processed foods, beverages, soaps and cosmetics to West Asia. The United Arab Emirates, Saudi Arabia and Iran were the major trading partners in this region.

The expansion in the services industry is mirrored in the progressive improvement in the services deficit in the balance of payments. In terms of GNP, the **services account** deficit declined to 2.3% of GNP during the period 2001-2006 from 3.9% of GNP in the period 1990-2000. This improvement was supported mainly by the significant increase in tourism receipts and, to a lesser extent, an improvement in commissions earned through international trading activities as well as exports of computers and information services. Policies to promote tourism and efforts to develop the sector led to a more than three-fold increase in tourism receipts since 2001 (2001-2006: average RM27.7 billion; 1990-2000: average RM8.6 billion) and resulted in a higher surplus in the travel account. In tandem with the expansion in trade and the active participation of Malaysian traders in the international market, commissions earned from the procurement of goods abroad for resale to non-residents have also increased. Policies to promote business process outsourcing, as well as the establishment of the Multimedia Super Corridor and the presence of large foreign-owned IT companies, led to growth in exports of computer and information services. Receipts from computer and information services were mainly from software system development and IT support services.

The services account deficit improved, supported by higher tourism receipts and commissions earned through international trading activities. Increased profits and dividends accruing to Malaysian companies from their overseas investment led to an improvement in the income account

In 2006, the services account deficit continued to improve and narrowed to RM7.4 billion or 1.4% of GNP (2005: -1.9% of GNP). The expansion of gross receipts was attributable mainly to higher tourist arrivals and sustained large number of day-trip border town travelers, which collectively contributed about RM34.7 billion (2005: RM33.1 billion) in foreign exchange earnings. The increase in tourism receipts reflected the expansion in regional travel following rising income levels in regional countries, greater air services connectivity and relaxation of visa requirements. The establishment of the low cost carrier terminal, cheap air fares as well as attractive holiday packages offered by low cost carriers had also facilitated greater regional travel.

Greater promotional efforts through joint collaboration between the public and private sectors in niche tourism sectors such as eco-tourism, sports and recreational tourism,

Table 1.19
Services and Income Accounts

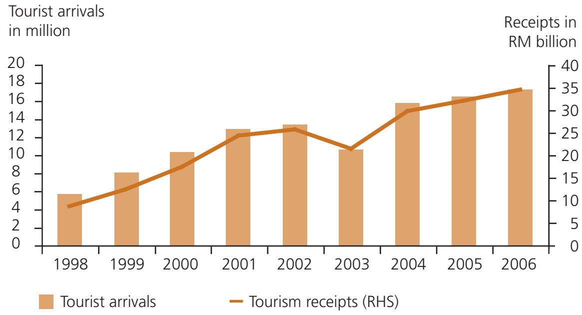
	2005	2006e		
	RM billion			
	Net	+	-	Net
Services Account	**-9.0**	**78.0**	**85.3**	**-7.4**
% of GNP	*-1.9*			*-1.4*
Transportation	-16.4	16.3	34.9	-18.6
Travel	19.4	35.3	13.7	21.6
Other services	-11.7	26.0	35.8	-9.9
Government transactions n.i.e.	-0.4	0.4	0.8	-0.4
Income Account	**-23.9**	**30.5**	**50.3**	**-19.8**
% of GNP	*-5.1*			*-3.8*
Compensation of employees	-0.5	4.8	5.2	-0.3
Investment income	-23.4	25.6	45.1	-19.5

Note: Numbers may not necessarily add up due to rounding
n.i.e. Not included elsewhere
e Estimate
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

as well as the hosting of meetings, incentives, conventions and exhibitions (MICE) led to higher tourism receipts. While tourist arrivals from Singapore, Thailand and Indonesia continued to account for the bulk of tourist arrivals, visitors from PR China, Korea, India and long-haul tourists from the US as well as West Asia were on a rising trend.

Of significance, the MICE tourism segment had attracted long-staying and high-spending travelers. The presence of many high-end hotels with comprehensive convention centre facilities has spurred the expansion of MICE activities. Continued strong focus on promoting Malaysia as

Chart 1.43
Tourist Arrivals and Tourism Receipts



Source: Malaysia Tourism Promotion Board and Department of Statistics, Malaysia an attractive MICE destination, under the brand name of "Meet and Experience Malaysia Truly Asia" was reflected in the country being ranked as one of the top ten MICE destinations in Asia.

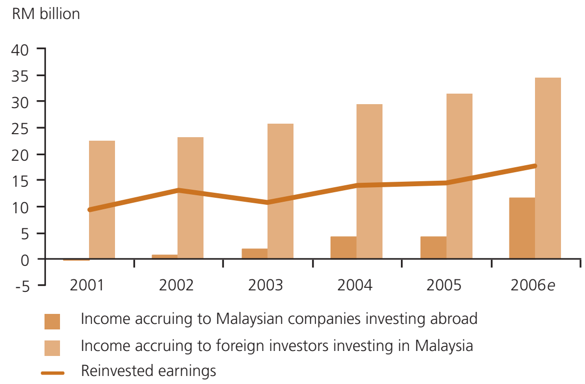
Another contributing factor to the improvement in the services account deficit was the lower net payments for other services, particularly for construction and communication services. Lower demand for imported construction services was in line with the moderation in the civil engineering sub-sector while continuing capacity expansion in networks and broadband facilities led to higher exports of communication services.

Meanwhile, commissions earned from the procurement of goods abroad for resale to non-residents grew strongly, attributable mainly to the trading of electronics and electrical goods, crude oil and petroleum related products. The bulk of these receipts were from Singapore, South Africa and the US. The expansion in business support outsourcing as well as network support services also contributed to higher export earnings in other services.

The expansion in the volume of trade, despite lower freight charges due to capacity expansion by shipping companies, resulted in higher payments for transportation services. Larger net outflows reflected the continued reliance on foreign carriers for transportation of goods. Gross receipts were higher, supported by earnings from passenger, cargo and charter services by domestic shipping and airline companies. The increase in transshipment cargo handled by Malaysian ports lent support to the growth in receipts. The transshipment cargo originated largely from Singapore, Hong Kong SAR, Japan and PR China.

The rising interest among Malaysian companies to invest abroad to diversify operations and provide synergy to domestic activities had yielded positive results. This was reflected in the improvement in the **income account** deficit, attributable mainly to the significantly higher profits and dividends accruing to Malaysian companies from their overseas investments, particularly in the mining, manufacturing and financial services sectors. Meanwhile, profits

Chart 1.44
Direct Investment Income



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

and dividends accruing to foreign direct investors increased in line with improved export performance by export-oriented industries, especially in the E&E segment and the oil and gas sector. The continuing high profits and dividends accruing to foreign direct investors reflected the successful operations of MNCs in Malaysia. Nevertheless, the actual outflows of investment income were lower since about half of these incomes were retained in the country for reinvestment. The improvement in the income account was also the outcome of higher returns on external reserves holdings.

Financial Account

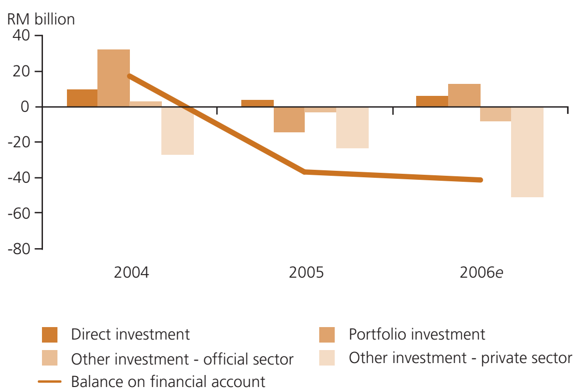
In 2006, the **financial account** recorded a larger net outflow of RM39.9 billion as higher overseas investment and net outflows of other investment more than offset the inflows of foreign direct investment and portfolio investment. The larger current account surplus was more than sufficient to finance the outflows in the financial account.

During the year, gross **foreign direct investment (FDI)** increased significantly to RM37.2 billion (2005: RM26.8 billion), equivalent to 7.1% of GNP, supported mainly by earnings retained by existing MNCs for reinvestment and the increased acquisition activity being driven by foreign investors. This trend reflects the sustained confidence and commitment of foreign investors operating in Malaysia, and is also an indication that the country remains a profit centre for global MNCs. After taking into account the adjustments for outflows due largely to loan repayments to parent companies abroad, net FDI inflows were higher at RM25.9 billion or 4.9% of GNP.

Higher inflows of FDI and portfolio investment reflected stronger confidence of investors in the Malaysian economy. Improved competitiveness and the rising interest of Malaysian companies to diversify their operations led to higher outflows for investment abroad

FDI into the *manufacturing sector* remained large, particularly for investments to increase capacity and diversify product lines, as well as for migration to the production of more capital intensive, higher valued-added and technology-oriented components, as observed from the higher capital investment per employee ratios of these investments. Higher investments in the petroleum refining and petroleum-related products industry were undertaken to support the buoyant upstream activity in the oil and gas sector in Malaysia.

Chart 1.45
Financial Account



e Estimate

Table 1.20
Balance of Payments: Financial Account

	2005	2006*e*
	RM billion	
Financial Account	**-37.0**	**-39.9**
Direct Investment	**3.8**	**4.3**
In Malaysia	15.0	25.9
Abroad	-11.3	-21.5
Portfolio Investment	**-14.2**	**14.7**
Other Investment	**-26.6**	**-59.0**
Official sector	-3.2	-8.0
Federal Government	*-0.6*	*-3.1*
NFPEs	*-2.6*	*-5.0*
Private sector	-23.5	-51.0

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

Meanwhile, FDI in the *services sector* was mainly in the finance, insurance, real estate and business services sub-sector, followed by the wholesale and retail trade, hotels and restaurants sub-sector as well as the transportation and communication sub-sector. The liberalisation of the financial sector, particularly the Islamic financial services sub-sector, attracted a significant inflow of FDI. The increased investments were reflected in the establishment of new branches and the expansion of financial services offered by foreign financial institutions in Malaysia, as well as the commencement of operations by another foreign bank which was awarded a licence for Islamic banking.

Malaysia remains an attractive destination for MNCs to locate their shared services and outsourcing (SSO) activities. During the year, 184 international and regional facilities, including those undertaking SSO activities, and 38 wholly foreign-owned Multimedia Super Corridor (MSC) status companies were given the approval to establish operations in Malaysia. The establishment of these operations would encourage higher value-added activity and reinforce linkages across the different segments in the services sector. Meanwhile, the opening of new retail outlets in emerging townships was supported by strong domestic consumption and tourism. Inflows of FDI into the *oil and gas sector* were for investment in both the upstream and downstream activities, supported by sustained high oil prices and the discovery of several offshore deepwater oil and gas fields in Sabah and Terengganu in recent years. These investments, ranging from exploration and extraction operations to development and production activities, were mostly undertaken by the national oil company in joint venture with its international partners through production sharing contracts.

While FDI remains crucial to Malaysia's long-term development in terms of capital, transfer of technology and access to global markets, the Government has also played an active role to support initiatives by Malaysian companies venturing abroad. In the 2007 Budget, the Government has approved an increase in the paid-up capital of EXIM Bank to enhance the financing available to domestic companies investing abroad, as well as the setting up of an *Overseas Investment Fund* (OIF) to finance start-up costs of domestic companies doing business overseas. In an effort to encourage Malaysian banks to expand overseas and establish a regional presence, the Government has announced that tax exemptions of up to five years will be granted on income received from new bank branches or remittances from bank subsidiaries overseas. Meanwhile, Bank Negara Malaysia has also set up an *Overseas Project Financing Fund* at the EXIM Bank to assist Malaysian companies that are bidding and securing contracts overseas by providing greater access to financing for their projects abroad.

In 2006, net **direct investment abroad** by Malaysian companies rose further to RM21.5 billion. Overseas investment in the *services sector* were led by companies in the finance, insurance, real estate and business services sub-sector. These investments included the acquisition of substantial interests in foreign financial institutions and real estate companies. In the transport, storage and communication sub-sector, investments were directed mainly to acquire interest in the telecommunication businesses and for expansion of existing operations to cater to the increasing needs of mobile telephone users in growing markets such as India, Indonesia and Thailand. Malaysian companies have also made inroads into the growing utilities sub-sector abroad particularly in large markets such as PR China via acquisition of power plants and the development of new plants. In the *oil and gas sector*, the national oil and gas company continued to conduct upstream oil and gas exploration and extraction and downstream processing activities, particularly in Africa and Central Asia. These activities are often carried out in partnerships with large foreign oil companies and the national oil companies in the host countries. In the *manufacturing sector*, overseas investments were led by companies in the electrical and electronics, automotive and shipping industries. There were also investments in palm oil processing and the manufacturing of fibre glass, furniture and rubber products. Although smaller in scale, these investments took advantage of the lower labour costs abroad and were intended to provide synergy through the establishment of an integrated supply chain with their existing Malaysian operations. In the *agriculture sector*, investments were directed primarily into oil palm plantations in Indonesia. Meanwhile, established Malaysian *construction* and engineering companies continued to invest abroad, leveraging on their expertise and experience in civil engineering and property development to secure various contracts for the construction of large infrastructure projects, residential housing and highways, particularly in the Middle East and South Asia. The successful operations of Malaysian companies investing abroad were evidenced by the significant increase in the profits and dividends accruing to Malaysian companies, from RM4.1 billion in 2005 to RM11.7 billion in 2006.

Portfolio investment turned around to record a net inflow of RM14.7 billion in 2006. In the first half of the year, inflows of portfolio funds were mainly for purchases of debt securities, particularly bonds and notes, including the long-term bond issued by an NFPE, and short-term money market instruments. These flows were encouraged by the high global liquidity situation and the relative attractiveness of Malaysian papers. Meanwhile, there were net outflows of equity funds as foreign investors liquidated their positions, particularly in the second quarter of 2006, following the global financial market correction in May. In the second half of the year, inflows of portfolio funds were mainly in the equity market. Foreign funds increased their exposure in the domestic equity market in line with the stronger performances of the regional bourses. A confluence of positive factors contributed to improved investor sentiments. These included the expectations of stronger earnings by Malaysian corporations, news of large mergers and acquisitions in the plantation, banking and construction sectors, an improved macroeconomic outlook and announcements on the implementation of Ninth Malaysia Plan (9MP) projects, as well as the appreciation of the ringgit, particularly in the fourth quarter of 2006. Meanwhile, there was some liquidation of investment in debt securities, as moderating inflationary pressures and lower inflation expectations influenced a downward trend on yields. This development, together with the maturity of a long term bond by an NFPE resulted in the net outflow of funds invested in debt securities.

The **other investment** account registered a significantly higher net outflow of RM59 billion in 2006, reflecting mainly larger net outflows by both the official and private sectors. The **official sector** registered a larger net loan repayment amounting to RM8 billion. Apart from the maturity of several large loans by both the Federal Government and NFPEs during the year, there were also prepayments of external loans by the NFPEs to reduce their overall debt exposure. Other investment by the **private sector,** which comprises mainly borrowing and lending as well as placements and withdrawals of deposits by the banking sector, and non-bank private sector transactions with unrelated counterparties, also recorded a higher net outflow. The outflow by the banking sector reflected mainly a higher placement of assets abroad as well as the unwinding of inter-bank borrowings by banks. Meanwhile, the higher outflows by the non-bank private sector reflected mainly higher trade credits extended by Malaysian exporters and the larger repayment of trade credits by Malaysian importers in line with the stronger trade performance.

External Debt

Malaysia continues to undertake a prudent debt management strategy. The prudential guidelines include efforts to minimise risk exposure against global interest rate shocks, adverse exchange rate movements and shifts in investor sentiments. The rationale for these guidelines is to allow the diversification of external borrowings by the public and private sectors in terms of currencies, maturity structure, debt instruments and creditors, in order to allow active management of risks. A comprehensive debt monitoring system

External debt position improved further, reflecting net repayments of debt by both the Federal Government and the NFPEs. Short-term external debt remained low and accounted for only 23% of total external debt

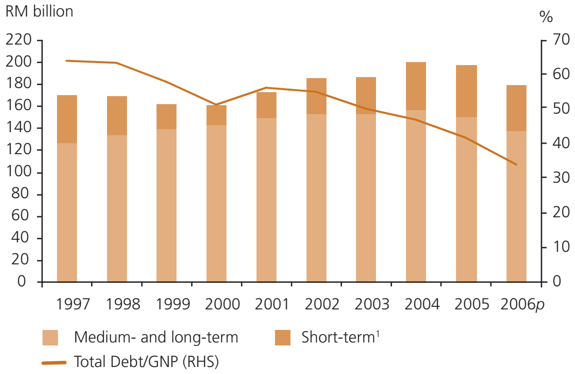
Table 1.21
Outstanding External Debt

	2005	2006*p*	2005	2006*p*
	RM billion	RM billion	USD billion	USD billion
Total debt	**197.7**	**179.4**	**51.8**	**50.3**
Medium- and long-term	150.7	138.1	39.5	38.7
Short-term[1]	47.0	41.3	12.3	11.6
As % of total debt	*23.7*	*23.0*		
As % of net international reserves	*17.7*	*14.2*		
As % of GNP				
Total debt	41.9	34.1		
Medium- and long-term debt	32.0	26.2		
As % of exports of goods and services				
Total debt	32.4	26.9		
Medium- and long-term debt	24.7	20.7		
Debt service ratio (%)	**5.4**	**4.7**		

[1] Excludes currency and deposits held by non-residents with resident banking institutions
p Preliminary

Source: Ministry of Finance and Bank Negara Malaysia

Chart 1.46
Outstanding External Debt



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

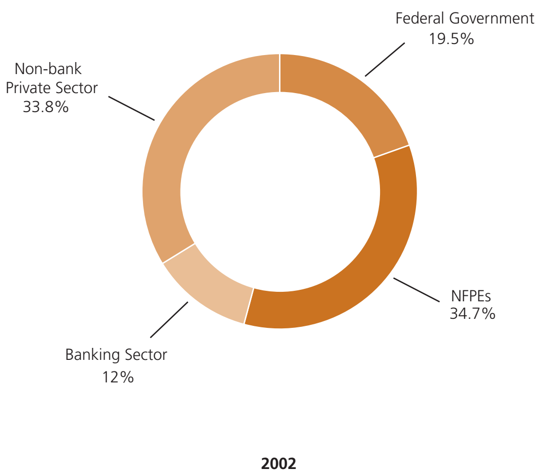
p Preliminary

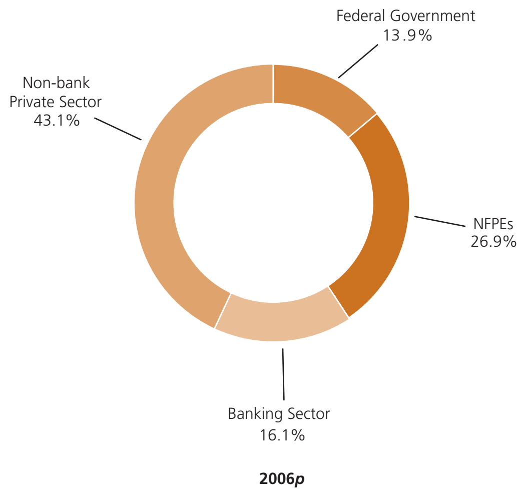
enables the authorities to monitor the overall debt level, the structure of the debt as well as debt-servicing obligations of both the public and private sectors.

In 2006, Malaysia's total external debt declined to RM179.4 billion (USD50.3 billion) as at end-2006 (end-2005: RM197.7 billion or USD51.8 billion), equivalent to 34.1% of GNP. The nation's capacity to service the external debt has also improved. As at end-2006, the total external debt accounted for only 61.8% of international reserves (end-2005: 74.6%) and 26.9% of the exports of goods and services (end-2005: 32.4%). Similarly, the nation's vulnerability to a reversal in short-term external debt has also declined as short-term debt now accounts for only 7.8% of GNP (end-2005: 10%), 14.2% of reserves (end-2005: 17.7%) and 6.2% of the exports of goods and services (end-2005: 7.7%). The short-term debt accounted for 23% of total external debt.

The improvement in the external debt position reflected declines in both the short-term and medium- and long-term debts. The **public sector** registered its fourth consecutive year of net repayments in 2006 (-RM7.7 billion; 2005: -RM11 billion). During the year, the **Federal Government** maintained its practice of sourcing its funding requirements mainly from non-inflationary domestic sources. For the third consecutive year, no market loan was raised from the international capital market. In contrast, large loan repayments were made following the maturity of two syndicated loans amounting to RM2.9 billion, contributing to a reduction in the Federal Government's debt for the third straight year in 2006. Despite marginally larger gross borrowing to finance capital expenditure, the **NFPEs** registered a fifth consecutive year of net

Chart 1.47
External Debt by Sector (% share)





p Preliminary

repayments in 2006. The repayments reflected largely the maturity of several large loans as well as the prepayment of some external loans, particularly by companies in the oil and gas sector, to reduce their external debt exposure. The net repayments by both the Federal Government and NFPEs contributed to a lower public sector external debt outstanding (RM73.3 billion; end-2005: RM86.2 billion) and reduced its share of total external debt (40.8%; end-2005: 43.6%).

The **private sector** registered a net drawdown of external loans, amounting to RM3.4 billion in 2006. Both gross borrowings and repayments were lower. The lower gross borrowing reflected partly improved corporate earnings and increased financing through domestic banking and capital markets amidst a competitive financial and interest rates environment. The bulk of the repayments were done by companies in the manufacturing, oil and gas and transportation sectors. While the private sector medium- and long-term debt accounted for about 47% of the total medium- and long-term debt, about two-thirds of these borrowings were inter-company loans that have flexible terms and concessionary interest rates.

The lower short-term external debt outstanding (RM41.3 billion; end-2005: RM47 billion), reflected primarily a marked decline in the short-term debt of the banking sector. The decline in the banking sector's debt was due mainly to the unwinding of inter-bank borrowings by banks. Meanwhile, there was an increase in the short-term external debt of the non-bank private sector, which comprises mainly of term loans, revolving credits and overdraft facilities. The increase is attributable to higher inter-company loans. The short-term borrowings of the non-bank private sector accounted for 30.2% of total short-term external debt.

The strengthening of the ringgit against major currencies has had a positive impact on Malaysia's external debt. The exchange revaluation gain amounting to RM8 billion arising from the appreciation of ringgit against major currencies during the year has contributed to a lower medium- and long-term debt. In addition, the stronger ringgit has also reduced the debt servicing payments in 2006.

International Reserves

The **international reserves** held by Bank Negara Malaysia comprise of holdings of foreign exchange and gold, its IMF reserve position and holdings of Special Drawing Rights (SDR). For the year 2006, net international reserves increased by RM25.3 billion to RM290.4 billion (USD82.5 billion) as at 31 December 2006. The increase in reserves occurred amidst significant two-way flows, reflecting the more robust economic activity and strong fundamentals of the Malaysian economy. As at 28 February 2007, reserves amounted to RM305.9 billion (USD86.9 billion). This level of reserves is adequate to finance 8.2 months of retained imports and is nine times the short-term external debt.

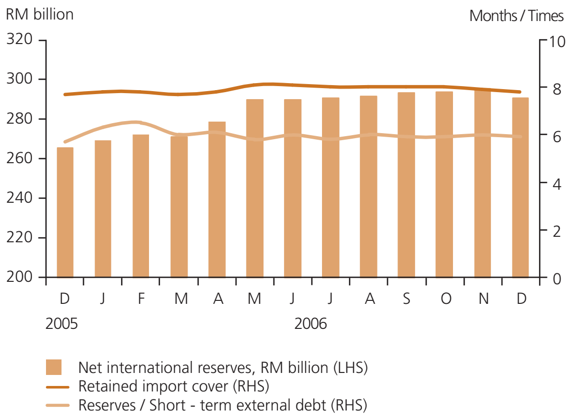
During 2006, the foreign exchange inflows were generated mainly from higher inflows of export earnings arising from a stronger trade performance. Inflows of foreign direct investment and portfolio funds also contributed to the accumulation of reserves. The steady inflow of foreign direct investment throughout the year reflected the sustained confidence of foreign

Table 1.22
Net International Reserves

	As at end			Change
	2004	2005	2006	2006
	RM million			
SDR holdings	765.3	748.3	756.9	8.6
IMF reserve position	3,068.4	1,186.3	793.4	-392.9
Gold and foreign exchange[1]	247,786.6	263,235.7	288,871.2	25,635.5
Gross International Reserves	**251,620.3**	**265,170.3**	**290,421.5**	**25,251.2**
Less Bank Negara Malaysia external liabilities	24.5	22.5	22.9	0.4
Net International Reserves	**251,595.8**	**265,147.8**	**290,398.6**	**25,250.8**
USD million equivalent	**66,209.4**	**70,169.3**	**82,450.8**	**12,281.5**
Months of retained imports	7.9	7.7	7.8	
Reserves/Short-term external debt (times)	5.8	5.6	7.0	

[1] 'Other Foreign Currency Claims on Residents' is reclassified from 'Gold and Foreign Exchange' to 'Other Assets' of Bank Negara Malaysia

Chart 1.48
Net International Reserves (end-month)



investors in the Malaysian economy. The improved corporate performance and economic prospects also attracted inflows of portfolio funds for investment, particularly in the equity market.

The increase in international reserves was mainly from higher inflows of export earnings and investment-related inflows. Increased economic activity and strong economic fundamentals created significant two-way flows during the year

Increased economic activity during the year led to higher outflows through import payments for goods and services as well as the repatriation of profits and dividends accruing to foreign companies operating in Malaysia. The large repayments and prepayments of external loans reduced Malaysia's external debt position and strengthened its resilience to external shocks. Overseas investment by Malaysian companies were also higher during the year, reflecting continued interests by Malaysian companies in diversifying and expanding their operations abroad.

During the year, the cumulative quarterly revaluation loss amounted to RM6.9 billion, following the strengthening of ringgit against major currencies, particularly in the first and fourth quarters.

With the growth in international reserves, Bank Negara Malaysia has progressively enhanced its reserve management strategy and practices. New asset classes and instruments are continuously assessed and reviewed for inclusion into the portfolio. At the same time, the risk management practices and infrastructure, as well as techniques of operations, have been upgraded to better manage the increasing complexity of both the portfolio and the operating environment. These initiatives are undertaken within Bank Negara Malaysia's overall investment strategy that focuses on ensuring capital preservation and the liquidity of reserves whilst optimising returns.

Malaysia, as a country with a strong balance of payments position, was included in the Financial Transactions Plan of the IMF that makes resources available to member countries facing short-term balance of payments difficulties. The **reserve position with the IMF** amounted to RM793.4 million as at end-2006. A lower reserve position was due mainly to the net repurchase of SDR69.9 million following repayment to the ringgit account by various member countries under the Financial Transactions Plan. As at end-2006, Malaysia's holdings of reserves in the form of **SDRs** increased to RM756.9 million, attributed mainly to the receipt of remuneration arising from Malaysia's net creditor position with the Fund.

The international reserves held by the Bank are usable and unencumbered. There are no foreign currency loans with embedded options; and no undrawn, unconditional credit lines provided by or to other central banks, international organisations, banks and other financial institutions. Bank Negara Malaysia also does not engage in options-related activity in the foreign currency markets.

Bank Negara Malaysia releases information on the international reserve position through a statement of the Bank's assets and liabilities on a fortnightly basis, with a one-week lag. In addition, the Bank also fulfils the IMF's Special Data Dissemination Standard (SDDS) requirements on detailed disclosure of international reserves and foreign currency liquidity information at the end of each month, with a one-month lag. The reserves data template also provides forward-looking information on the size, composition and usability of reserves and other foreign currency assets, and the future as well as potential (contingent) inflows and outflows of foreign exchange arising from the operations of the Federal Government and the Bank over the next 12-month period. On an annual basis, the Bank also discloses the currency composition of its reserves with a breakdown in terms of currencies that are in the SDR basket (comprising mainly the major currencies) and that of other currencies.

Monetary and Financial Conditions

For an economy with a high degree of economic and financial openness, developments in the global financial markets that drive capital flows have a profound influence on the domestic monetary and financial conditions. This is particularly the case for Malaysia given that its integration with the global economic and financial system is now greater than it has ever been (see Box on Openness). The cyclical movements and trends in global asset allocation and their impact on financial and real asset prices will have significant implications on domestic liquidity conditions, exchange rates, relative prices and the cost of financing.

OVERVIEW OF INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

In 2006, developments in the global financial markets were driven by the positive outlook for global economic growth and heightened inflation risks, and their implications on the direction of monetary policy, in an environment of continued excess liquidity. The strong outlook on growth and the possible inflationary implications of higher commodity prices had heavily influenced the monetary policies of the major world economies. Against the backdrop of high global liquidity, there was greater risk taking as investors searched for higher returns, resulting in significant capital flows into the emerging markets. As in other regional countries, monetary and financial conditions in Malaysia were sensitive to the variations in international capital flows.

Global economic developments were generally positive at the beginning of 2006. In Japan, there were early indications that the deflationary forces that were present in the economy for almost a decade had begun to reverse, resulting in the potential for rising interest rates. Economic growth in the US remained favourable despite the consecutive increases in the Fed Funds rate throughout 2005. The Euro area growth also showed improved resilience in the face of potentially higher inflation from the rising commodity prices.

In the emerging market economies, macroeconomic fundamentals also remained strong. The export sector for most emerging economies and thus, GDP growth, performed well, driven by the sustained external demand, stronger commodity prices and strengthened domestic private sector demand. Many emerging economies also exhibited improved fiscal positions as a result of progress in the fiscal consolidation process. These developments, which occurred against the background of increasing financial system deepening in the emerging economies, raised the attractiveness of the emerging markets as an investment destination at a time when the world financial system was awash with liquidity. As the year unfolded, the general optimism of global investors towards the strengthening of the macroeconomic fundamentals in the emerging markets continued to be firm despite occasional bouts of uncertainty and volatility.

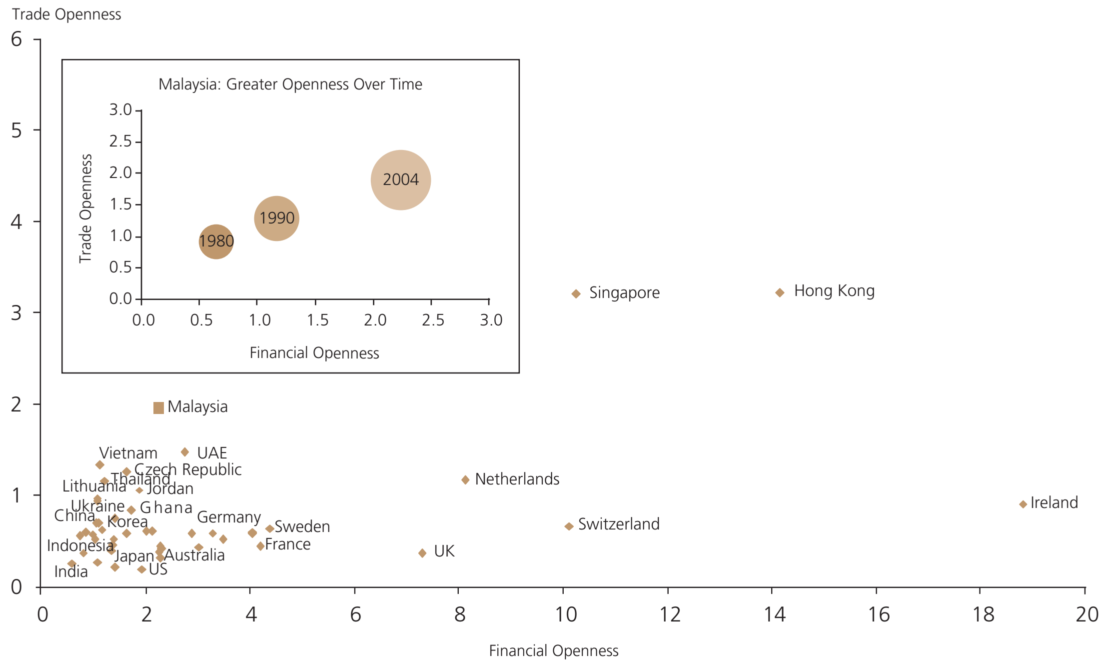
Developments in the global financial markets were driven by the outlook for global economic growth and inflation, as well as the direction of monetary policy, in an environment of continued excess liquidity

With the strong growth performance and high oil prices as the backdrop, the direction of monetary policy in the major industrialised economies throughout 2006 was determined by developments in the inflation outlook. The continued strong growth implied that demand would remain strong, which in turn suggested that oil and commodity prices would likely remain high. Both these developments factored prominently in the inflation outlook and hence monetary policy response during the year. Indeed, inflation expectations were closely influenced by the developments in the commodity prices, especially oil prices, which were generally on an upward trend during the first half of the year.

Consequently, the general view of markets at the turn of the year was that most central banks

Openness of the Malaysian Economy

Chart 2.1
Trade and Financial Openness in 2004



Notes:
1 Trade Openness is the sum of exports and imports relative to GDP
2 Financial Openness is the sum of external assets and liabilities relative to GDP
3 Based on Bank Negara Malaysia calculations; Data from Lane and Milessi-Ferreti (2006); IMF Direction of Trade Statistics (2006, August)
4 Excludes *outlier* Luxembourg

A distinguishing feature of the Malaysian economy is its high degree of openness to trade and cross-border financial flows. As a measure of economic openness, the volume of trade was about twice the size of the economy in 2004. The corresponding measure for financial openness, the stock of external assets and liabilities, was also more than two times the size of the economy.[1]

To obtain a better perspective of the magnitude, Chart 2.1 maps out the openness of the Malaysian economy relative to 58 economies representing the 30 developed economies that make up the Organisation for Economic Co-operation and Development (OECD), as well as 28 emerging economies from Asia, Eastern Europe and Latin America.[2] Malaysia ranks high in terms of trade openness, with only Hong Kong and Singapore having a higher degree of openness.

Malaysia also ranks reasonably high in terms of financial openness, exceeding the median score of 2.03. Of significance is that Malaysia appears to be more open financially relative to more developed economies such as the United States and Japan. Malaysia is also the most financially open country

1 External assets and liabilities refer to claims between a country's residents and non-residents. International holdings are classified into Portfolio Investment (which is subdivided into equity and debt securities), Foreign Direct Investment (which refers to equity participation above 10 percent), Other Investment (which includes debt instruments such as loans, deposits and trade credit), Financial Derivatives and Reserve Assets.
2 The emerging economies included in the sample are Argentina, Brazil, Brunei, Cambodia, Chile, China, Colombia, Croatia, Cyprus, Estonia, Hong Kong, India, Indonesia, Lao PDR, Latvia, Lithuania, Malta, Myanmar, Peru, Philippines, Russia, Singapore, Slovenia, Thailand, Ukraine, Uruguay, Venezuela and Vietnam.

in East Asia after Hong Kong, Singapore and Brunei. Hong Kong and Singapore are highly open by nature of their role as financial centres.

The inset-diagram in Chart 2.1 meanwhile indicates that the degree of openness of the Malaysian economy has increased significantly over time. It is highly likely that this evolution is an outcome of the structural changes occurring in the economy arising from Malaysia's trade orientation, open current account and the liberalisation of the capital account. Thus, the domestic economy and financial system may have, over time, become more sensitive to external developments as Malaysia became more integrated with the global economy.

Chart 2.2
Gross Domestic Product Annual Change (2000 - 2006) (Selected Industrialised Economies)

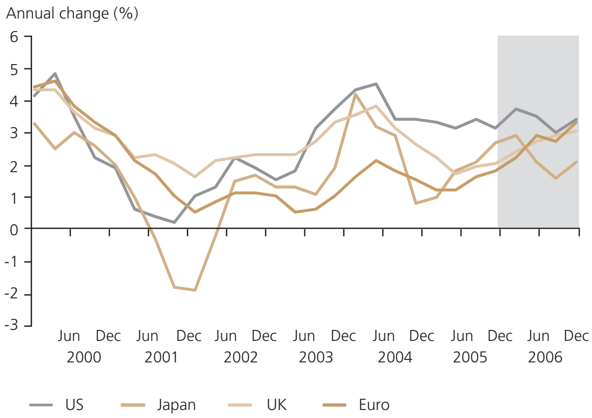


Chart 2.3
Consumer Price Index Annual Change (2000-2006) (Selected Industrialised Economies)

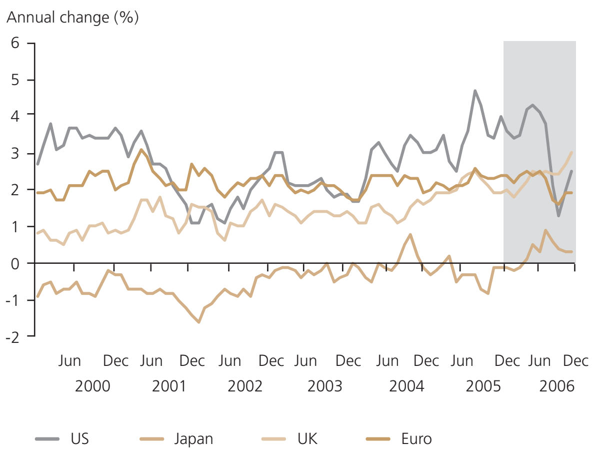
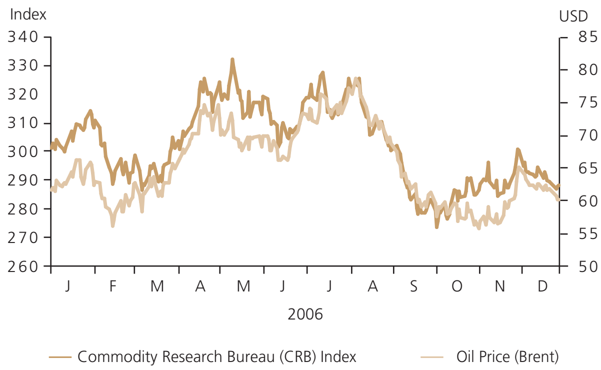


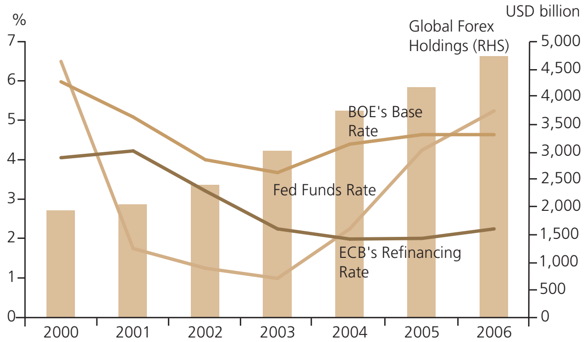
Chart 2.4
Commodities Index and Oil Price (2006)



would adopt a stance that is biased towards tighter monetary policy. Indeed, the major central banks maintained their tightening stance during the year. Since June 2004, the Federal Reserve Board raised rates on seventeen occasions to 5.25% by June 2006 and has now continued to maintain this rate while the Bank of Japan ended its zero interest rate policy in July. The European Central Bank and the Bank of England also raised interest rates to curb incipient inflationary pressures. Similarly, several Asian central banks tightened monetary policy during 2006.

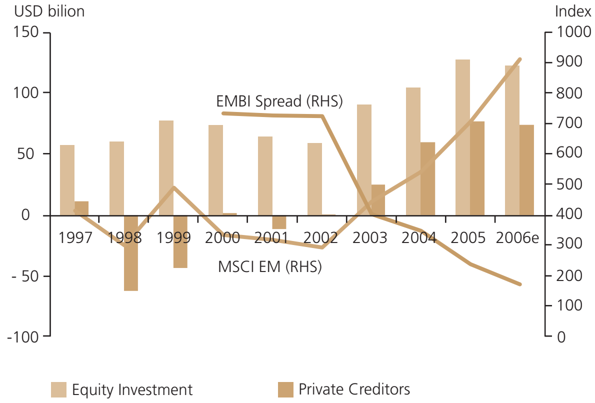
However, despite the tighter monetary conditions and higher global interest rates, easy global liquidity remained the central theme in explaining financial market conditions in 2006. The environment of high global liquidity resulted in the continued search for higher returns across different asset classes and risk profiles. Investors' heightened appetite for risk coupled with the strengthening macroeconomic fundamentals and

Chart 2.5
Global Interest Rates and Foreign Exchange Holdings (2000-2006)



* 2006 data refers to position up to 3Q 2006

Chart 2.6
Capital Inflows into Asia Pacific (1997-2006)



* MSCI EM: Morgan Stanley Capital International Index for Emerging Markets
* JP Morgan EMBI Spread: JP Morgan Emerging Market Bond Index Spread

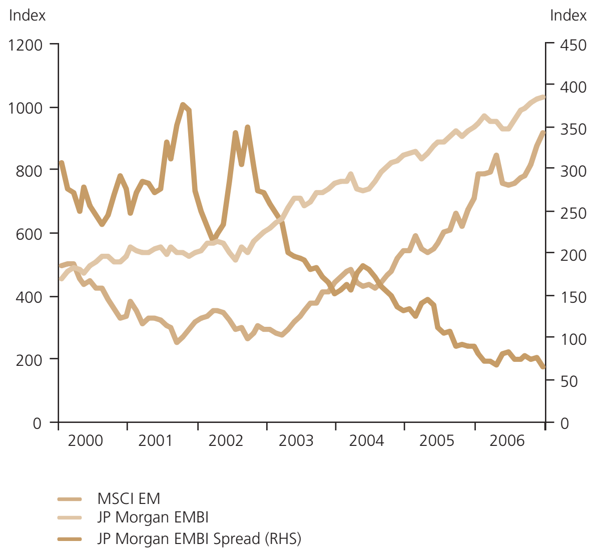
e Estimate
Source: International Institute of Finance (IIF)

the attractiveness of emerging economies as an investment destination saw significant inflows of capital into the emerging markets throughout the year. In 2006, emerging Asia received the bulk of these inflows which went mainly into equity investments. As a result, emerging market equities, as proxied by the Morgan Stanley Capital International (MSCI) Emerging Market index posted strong gains in 2006. The emerging market bond spreads underwent significant compression and risk aversion, as measured by the Chicago Board of Exchange (CBOE) implied volatility index, was at a historical low. As equity and bond prices in these markets were driven significantly higher, there were also some signs of speculative activity in the foreign exchange markets for some of the emerging market economies.

There were thus upward pressures on the currencies of a number of emerging economies as a result of these flows. While these pressures were decidedly the result of strong demand for the emerging market currencies as inflows into the equity and bond markets remained robust, there was evidence that the inflows were also for speculating on the exchange rate. Such short-term speculative flows tend to find their way into short-term instruments.

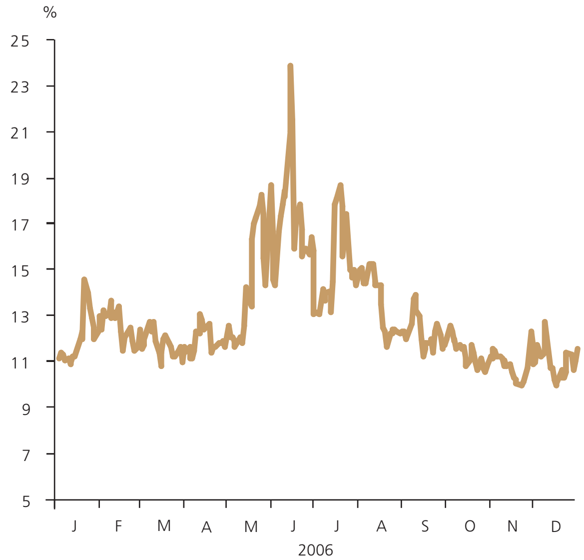
During the course of the year, there was a convergence of concerns over the strength of monetary tightening, especially in the US and Europe, due to a continued upward bias in the outlook for inflation, that was being driven by record high oil and commodity prices, as well as continued strong global growth. These concerns led to significant changes in the risk outlook,

Chart 2.7
Emerging Markets Bond and Equity Index (2000-2006)



* MSCI EM: Morgan Stanley Capital International Index for Emerging Markets
* JP Morgan EMBI: JP Morgan Emerging Market Bond Index
* JP Morgan EMBI Spread: JP Morgan Emerging Market Bond Index Spread

Chart 2.8
Chicago Board of Exchange (CBOE) Implied Volatility Index (2006)

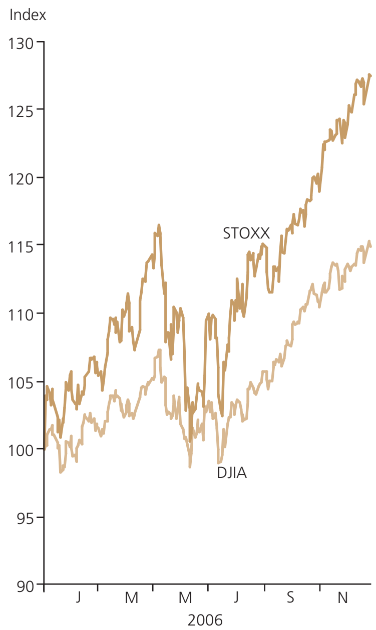


causing investors to reprice the risk premiums attached to riskier investments. Emerging equity and bond markets underwent a correction in May 2006 as a result of this re-evaluation of risks despite the absence of any significant changes in emerging market fundamentals.

The subsequent recovery however, has been strong, driven by the reversal in risk appetite following the positive reassessment of inflation and growth outlook. In particular, the inflation outlook had turned more benign as commodity prices declined while the Federal Reserve announced a pause in its interest rate hikes.

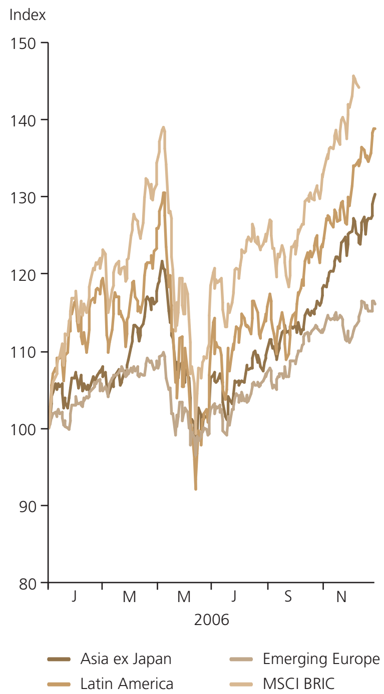
One feature of the financial market performance during the year has been the strong performances recorded across the different markets and asset classes. In the emerging markets, global capital flows returned as investors found that the risk-reward outlook had

Chart 2.9a
US and European Stock Indices (2006)



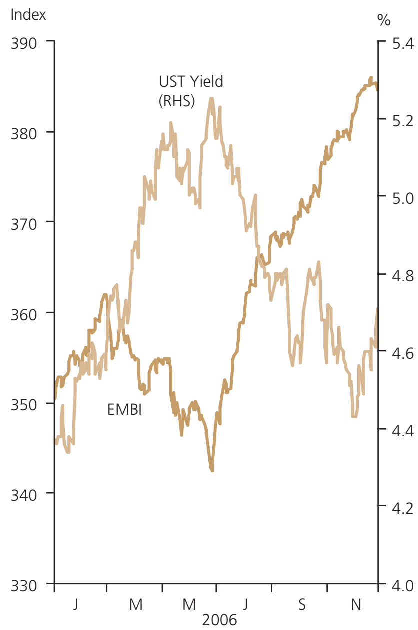
* DJIA: Dow Jones Industrial Average
* Euro Stoxx: Dow Jones Euro Stoxx Index

Chart 2.9b
Emerging Markets Stock Indices (2006)



* MSCI BRIC: Morgan Stanley Capital International Index for Brazil, Russia, India and China

Chart 2.9c
JP Morgan EMBI vs UST 10- year Yield (2006)

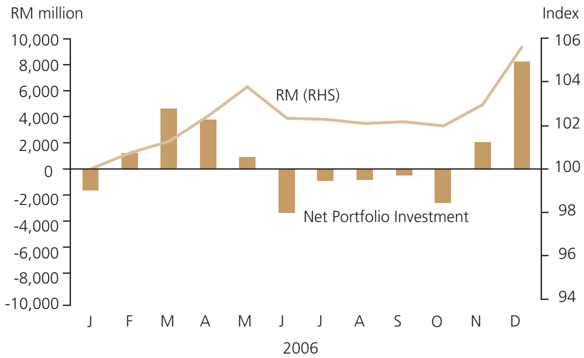


* JP Morgan EMBI: JP Morgan Emerging Market Bond Index
* UST: US Treasury

Source: Bloomberg and Datastream

become favourable. With the emerging markets' macroeconomic fundamentals improving, the inflows of funds lifted the emerging equity markets to much higher levels throughout the rest of the year and resulted in most equity markets surpassing their previous peaks. In the bond market, long-term yields declined significantly as funds flowed into the longer end of the market. As a result, the shape of the domestic yield curve became increasingly influenced by global interest rates. In some emerging economies, the decline in the long-term yields resulted in the yield curve inverting as short-term rates remained unchanged. These developments in the global financial markets had an important impact on monetary and financial market conditions in Malaysia in 2006.

Chart 2.11
Net Portfolio Investment and Exchange Rate of the Malaysian Ringgit (RM) against the US Dollar



Note: An increase in the index represents an appreciation of the ringgit against the US dollar

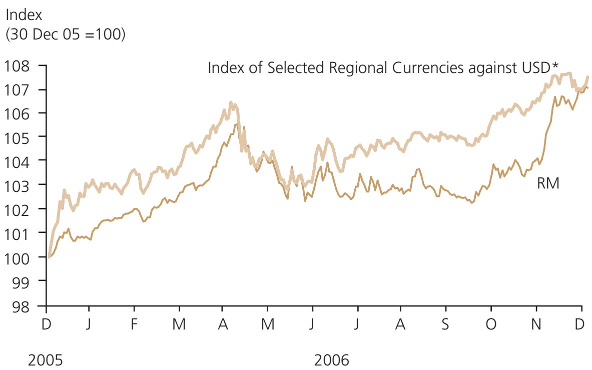
Source: Bank Negara Malaysia's Cash Balance of Payments Reporting System

RINGGIT EXCHANGE RATE DEVELOPMENTS

The ringgit exhibited greater two-way movements in 2006, driven broadly by the larger demand and supply of ringgit in the foreign exchange market. Key factors affecting the ringgit over the course of the year were the trade surplus, investment flows into the country arising from sound economic growth prospects, and market expectations of exchange rate appreciation. These factors were however counterbalanced by strong demand for foreign currencies for outward direct and portfolio investment, repayment and prepayment of external loans and the repatriation of significant amounts of profits and dividends.

The ringgit exhibited greater two-way movements in 2006, driven broadly by the larger demand and supply of ringgit in the foreign exchange market

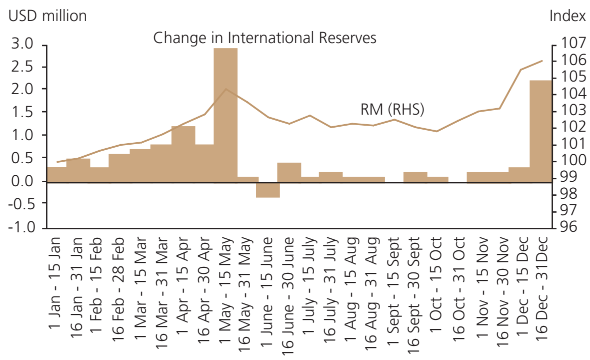
Chart 2.10
Exchange Rate of the Malaysian Ringgit (RM) and Selected Regional Currencies against the US Dollar



* Chinese renminbi, Indonesian rupiah, Korean won, Philippine peso, Singapore dollar, New Taiwanese dollar and Thai baht. Each currency is of equal weight

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

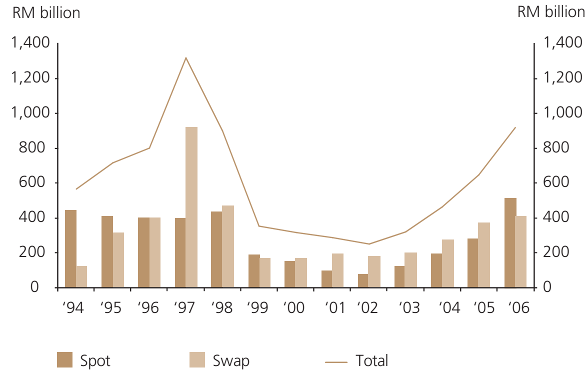
Chart 2.12
Change in International Reserves and Exchange Rate of the Malaysian Ringgit (RM) against the US Dollar



Note: An increase in the index represents an appreciation of the ringgit against the US dollar

Source: Bank Negara Malaysia

Chart 2.13
Volume of Interbank Transactions in the Kuala Lumpur Foreign Exchange Market



Note : Data from 2002 onwards is based on the new Ringgit Operations Monitoring System (ROMS), whereas observations for previous years are based on transactions of the eight Authorised Dealers

The ringgit's performance against the US dollar was broadly in line with the other regional currencies. The ringgit began the year appreciating against the US dollar as the surge of portfolio flows into the region augmented Malaysia's positive net trade receipts in the early part of the year.

In the latter half of May, the up-trend of the ringgit reversed as a result of the broad withdrawals of investments from emerging market equities and bonds. The retreat from emerging market financial assets was due to the re-assessment of risks by investors amid concerns that the pace of global economic growth would moderate following the tightening of interest rates, in particular, by the major economies, and the rise in commodity prices.

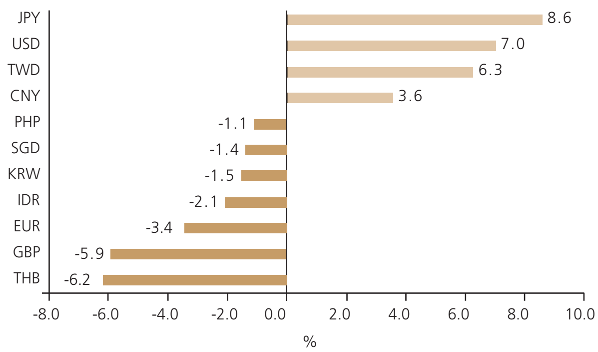
As the effects of the withdrawal from emerging market equities and bonds subsided in July, the ringgit remained relatively stable against the US dollar as net inflows from trade were offset by outflows for overseas direct investment, portfolio investment, repayment and prepayment of external loans and the repatriation of profit and dividends. Reflective of the growing opportunities in the region, there has been a growing trend for Malaysian companies to undertake investments abroad.

In December, the ringgit strengthened further as portfolio flows returned to emerging markets, amidst renewed positive investor sentiments towards regional economic fundamentals. The imposition of capital account measures by the Thai authorities in the latter half of December had only a marginal effect on investor sentiment towards Malaysian financial assets and the ringgit. With renewed inflows, the ringgit strengthened to RM 3.5305 against the US dollar on 28 December. For the year 2006 as a whole, the ringgit appreciated by 7% against the US dollar.

Intervention operations in the foreign exchange market were only to facilitate orderly market conditions, with the underlying trend being determined by the market and the supporting economic fundamentals. There is no predetermined level of the exchange rate. The unstable market conditions which occurred in the second half of May, when there was a significant reversal of capital flows, prompted the Bank to stabilise market conditions. When stability ensued in the foreign exchange markets in the aftermath of the sell-down of regional assets in July, the exchange rate continued to be determined by market conditions. The increased exchange rate movements of the ringgit against the US dollar arising from the two-way movements of the ringgit during the year coincided with a 42% expansion in the volume of foreign exchange transactions in the Kuala Lumpur interbank foreign exchange market, the greater part of which was driven by an 83% rise in spot transactions. In view of the greater depth and liquidity of the foreign exchange market, offsetting trade and capital flows can readily be matched, thereby potentially reducing the need for the Central Bank to be present in the market.

Against the other major currencies, the ringgit ended the year stronger against the Japanese yen but weaker against the euro. The Japanese yen weakened due to market expectations that interest rates in Japan would remain low and thus offer large opportunities for carry trades. The euro meanwhile appreciated on market expectations of policy rate increases by the European Central Bank and a positive assessment of economic data favouring the euro relative to the US dollar and

Chart 2.14
Summary of Ringgit Performance against Major and Regional Currencies
(Percent change, 1 Jan-29 Dec 2006)



Note: (+) represents an appreciation of the ringgit against the currency
(-) represents a depreciation

Japanese yen. Over the January – February 2007 period, the ringgit appreciated further against the major currencies, amidst continued net trade and investment flows.

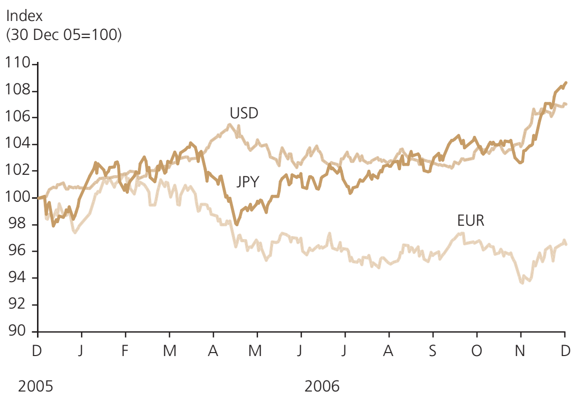
The performance of the ringgit compared to that of other regional currencies primarily reflected country-specific developments. In particular, the Thai baht and Indonesian rupiah attracted a sizeable amount of capital inflows due to positive investor sentiment towards these countries' high yielding assets, while the Philippine peso benefitted from inflows of overseas remittances and positive market sentiment arising from the improvements in government finances. Over the January – February 2007 period, the ringgit continued to record a mixed performance against regional currencies. The developments in the global, regional and domestic equity markets at end-February did not have a material impact on the ringgit.

Given the divergent trends of the ringgit against major and regional currencies, the ringgit nominal effective exchange rate (NEER) was stable in 2006, rising by only 0.7%. Between July 2005, when the current regime of a managed float against a basket of currencies was adopted, and the end of February 2007, the ringgit NEER has appreciated by about 4%.

LIQUIDITY AND MONEY SUPPLY

With high global liquidity and significant inflows during the year, surplus liquidity in the domestic financial system increased in 2006. Apart from the net inflow of direct investment and portfolio funds, the current account surplus and the drawdown of Government deposits with Bank Negara Malaysia also contributed to the increase in liquidity. BNM's sterilisation operations were aimed at offsetting the impact of the flows on domestic liquidity and maintaining relatively stable monetary conditions. Consequently, reserve

Chart 2.15
Exchange Rate of the Malaysian Ringgit against Major Currencies



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

Chart 2.16
Determinants of Reserve Money

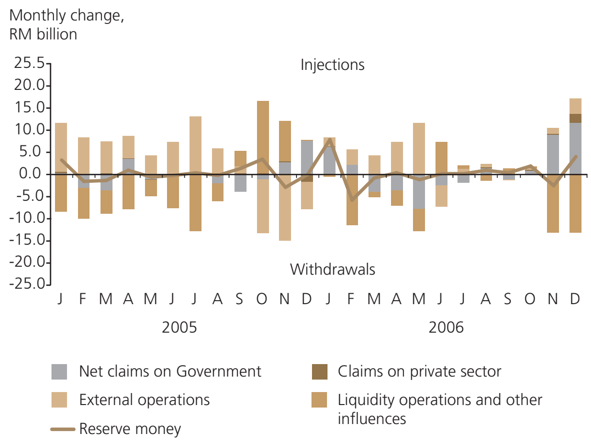
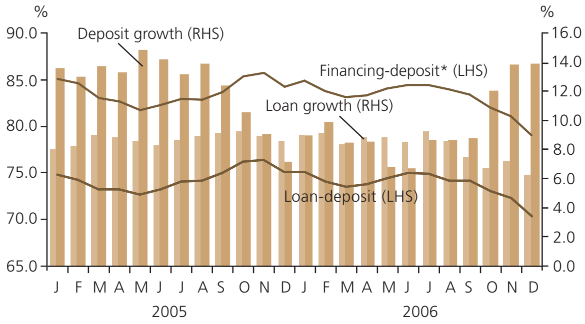


Chart 2.17
Financing-Deposit and Loan-Deposit Ratios



* Financing includes investment in PDS

money increased by RM5.6 billion or 10.6% during the year.

External flows and government operations were the main contributors to higher monetary growth

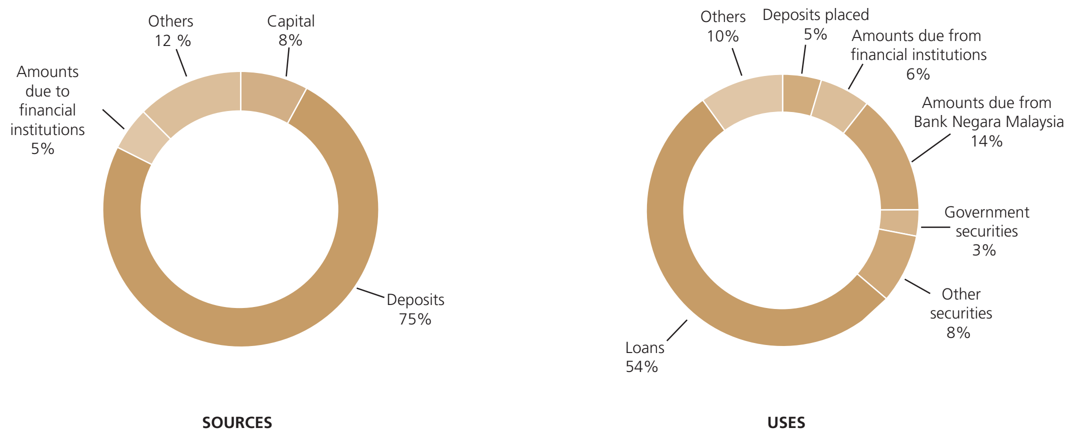
From the perspective of the banking system's balance sheet, deposits placed with the banking system (including discount houses) increased by 13.7%. On the other hand, the banking system's lending to the private sector, as reflected by loans outstanding and private debt securities holdings, expanded at a relatively slower pace compared with deposits. This resulted in the downward trend of the financing-deposit ratio. The additional liquidity was channelled into

Table 2.1
Broad Money, M3

	Change (RM billion)	
	2005	2006
M3	**49.7**	**82.4**
Currency in circulation	1.6	3.3
Demand Deposits	8.6	11.8
Broad Quasi-Money	39.4	67.3
Fixed deposits	*4.9*	*32.7*
Savings deposits	*1.9*	*5.2*
NIDs	*12.8*	*14.3*
Repos	*17.3*	*11.8*
FX deposits	*2.5*	*3.2*
Determinants of M3		
Net claims on Government	-5.4	9.2
Claims on the private sector	44.4	34.7
Loans	*44.8*	*36.8*
Securities	*-0.4*	*-2.1*
Net external operations*	18.5	58.6
*Bank Negara Malaysia**	*30.2*	*31.0*
Banking system	*-11.7*	*27.6*
Other influences	-7.9	-20.2

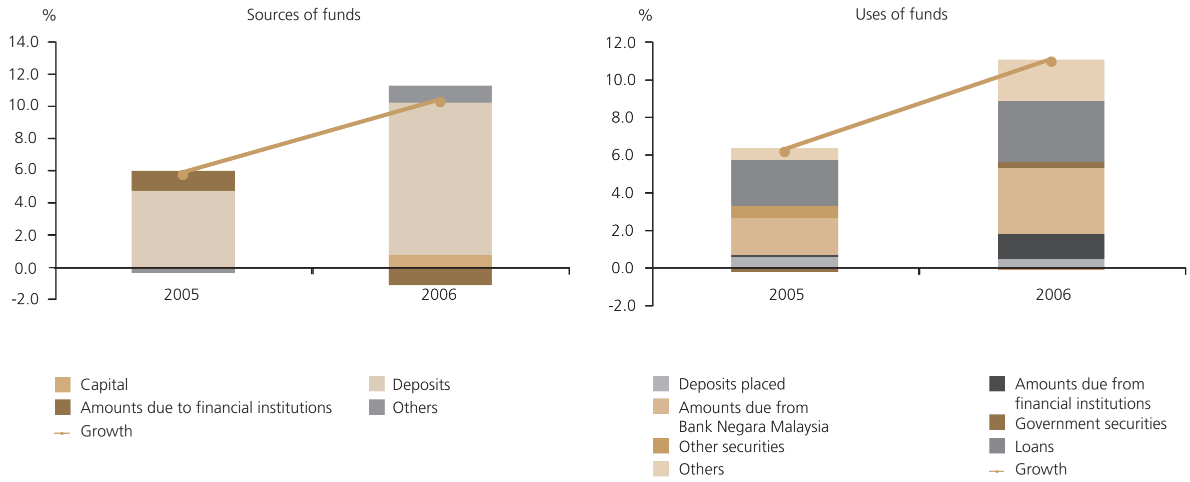
* Pre-revaluation of the international reserves

Chart 2.18
The Banking System's Sources and Uses of Funds[1] as at end-2006



[1] Adjusted to include discount houses

Chart 2.19
Changes in the Banking System's Sources and Uses of Funds[1]



[1] Adjusted to include discount houses

other assets, most notably in terms of lending to BNM. The banking system's net external assets also increased. To some extent, this reflected the increasing diversification of portfolios of the domestic banking institutions amid a more liberalised environment.

Broad money, M3, which is the currency and deposits of the non-bank private sector, continued to expand during the year. Growth in M3 trended downwards during the first half of the year, but picked up thereafter. At end-2006, M3 was growing at a higher annual growth rate of 12.3% (2005: 8%). The major contributor to the overall expansion and the general trend in M3 growth during the year was net foreign assets, which rose by RM58.6 billion, contributing 71% to the annual increase in M3. In contrast to 2005, Government operations also had an expansionary impact on M3 in 2006, particularly in the second half-year. Higher net claims on the Government were reflective of higher Government expenditures, with a large portion being financed through the drawdown of Government deposits placed with Bank Negara Malaysia. Growth in financing also contributed to M3 expansion, but by a smaller magnitude

Chart 2.20
Monetary Aggregates

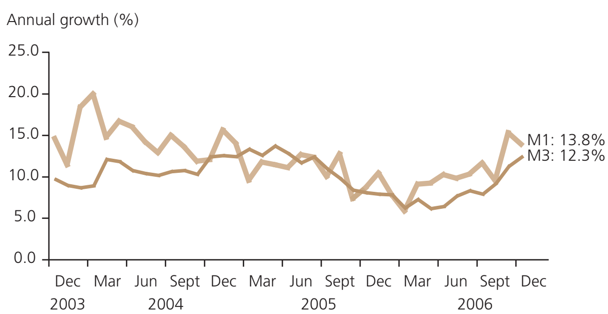
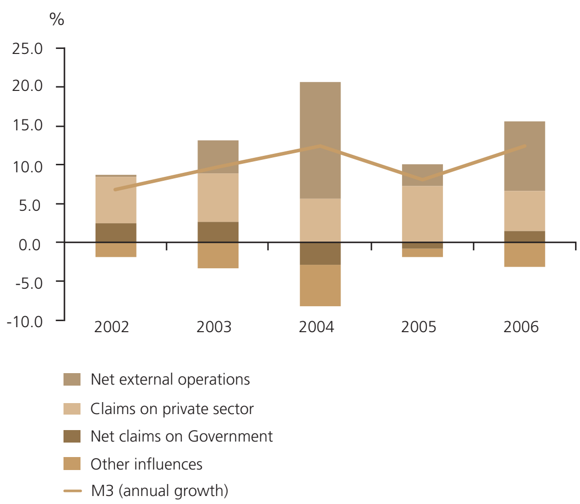


Chart 2.21
Contribution to M3 Growth



compared to 2005, as the growth in loans outstanding moderated towards the end of the year while the banking system's holdings of private debt securities (PDS) were also lower.

M1, a measure of transaction balances, increased by 13.8% in 2006 (2005: 8.5%). The increase mainly reflected higher placements of demand deposits by businesses and to a lesser extent, households. In addition, currency in circulation also increased.

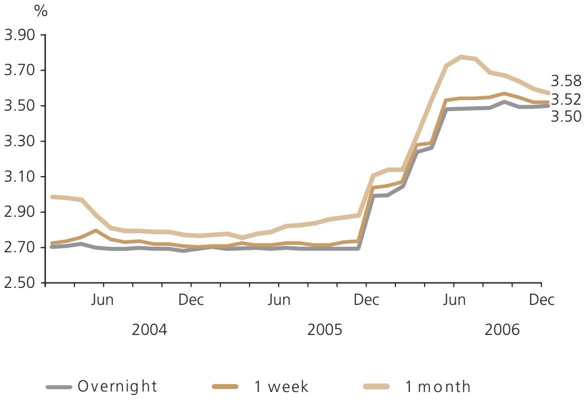
FINANCIAL MARKET CONDITIONS

Amidst the highly active global financial markets in 2006, domestic financial markets were similarly vibrant. Market expectations changed swiftly during the year, not just in response to external financial market developments, but also in response to domestic conditions. The money, bond and equity markets therefore reflected a myriad of inter-related factors, including the central bank's monetary policy decisions in 2006.

Interest Rate Developments

As the economy entered 2006, the strength of domestic economic growth coupled with higher commodity prices had a significant influence on the outlook for domestic inflation. Furthermore, global price developments were also expected to have an influence on domestic inflation. Indeed, with inflation on a rising trend early in the year, there were heightened concerns over the possible implications of a prolonged environment of negative real interest rates on the economy. Therefore, with the macroeconomic fundamentals remaining strong, the Bank took the opportunity to align monetary conditions to the prevailing environment of higher inflation. The Overnight Policy Rate (OPR) was increased twice, on 22 February and 26 April, by 25 basis points each time.

Chart 2.22
Interbank Rates



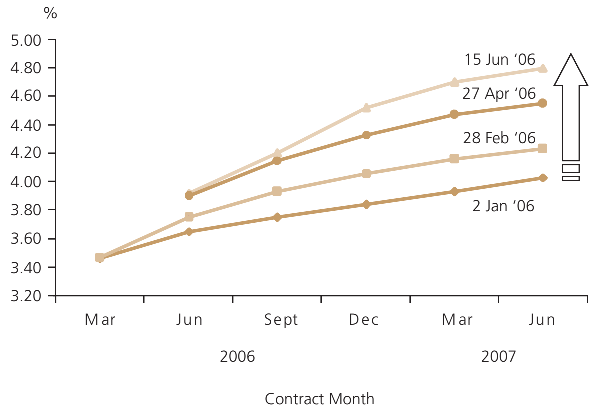
Although lending rates rose following the increase in the OPR, interest rates continue to be at historical lows

In the money market, the average overnight interbank rate stayed close to the OPR throughout the year. Prior to the rate increase in February, the daily weighted average overnight interbank rate moved within the range of 2.98% - 3.01%. After the first increase, it continued to move within a narrow band of 3.22% - 3.25%. For the remainder of the year, however, the range was slightly wider, with the overnight rate moving between 3.46% - 3.56%. Specifically, volatility increased temporarily in September when money market participants sourced funds in preparation for the larger-than-expected Malaysian Government Securities (MGS) auction.

The interbank rates for other tenures, namely the one-week and one-month maturities also rose over the course of the year, in line with market expectations of higher interest rates. The one month interbank rate peaked in June and moved downwards thereafter when market participants moderated their expectations of the pace of interest rate increases after inflation began trending downwards and when the OPR was left unchanged following the fourth Monetary Policy Committee (MPC) meeting of the year in May.

At the beginning of the year, market expectations were for more interest rate increases over the course of the year, following the rate increase in November 2005. This was reflected in developments in the interest rate derivatives market. The 3-month KLIBOR futures yield curve shifted upwards over the period January to June.

Chart 2.23
3-month KLIBOR Futures (First-Half 2006)



Similarly, interest rate swaps also trended upwards over the same period reflecting the market's expectation of rate increases in the first half of the year. Anticipation of increases in the OPR was driven by expectations that inflation would be higher amid robust growth prospects for the economy. The expectations were further reinforced by the increase in petrol pump prices by thirty cents on 28 February and inflation reaching the highs of 4.8% in March and 4.6% in April.

Nevertheless, the expectations for further rate increases began to subside in the second half-year. The 3-month KLIBOR futures for the December contract fell by 19 basis points as at 31 July from the highest rate on 15 June 2006. The KLIBOR futures curve continued to shift downwards and

Chart 2.24
3-month KLIBOR Futures (Second-Half 2006)

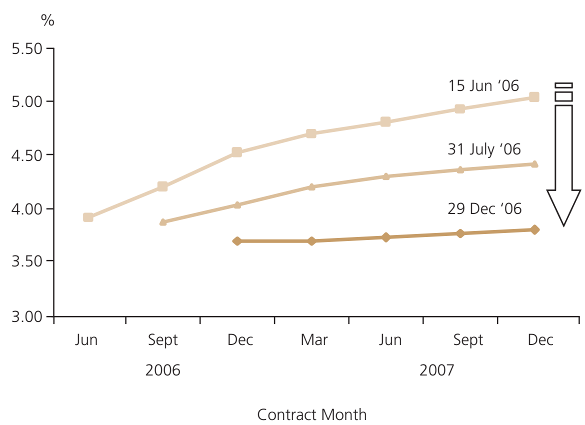
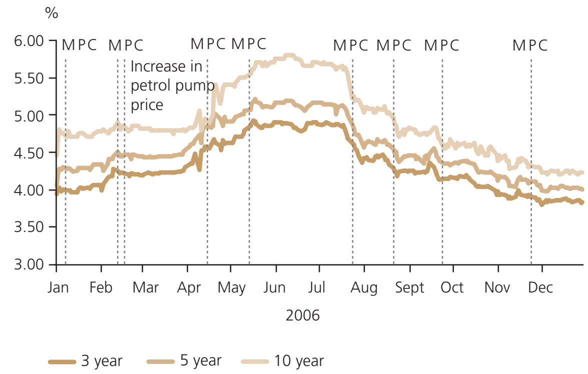


Chart 2.25
Interest Rate Swaps



flattened by December, indicating expectations were for the OPR to be relatively stable in the near term. Meanwhile, interest rate swaps remained stable after the fourth MPC meeting in May as market participants had already priced in a higher rate. When the OPR remained unchanged in May, interest rate swaps started trending downwards from about mid-July until December when they stabilised. Again, the moderating trend in interest rates during the second half reflected downward revisions in expectations of inflation as well as further increases in the policy rate.

In terms of retail interest rates, the average base lending rate (BLR) of the commercial banks adjusted quickly to changes in the OPR. The average BLR of all commercial banks had risen after the first OPR increase in November 2005 and continued to increase after the OPR changes

Chart 2.26
Commercial Banks' Lending Rates (at end-period)

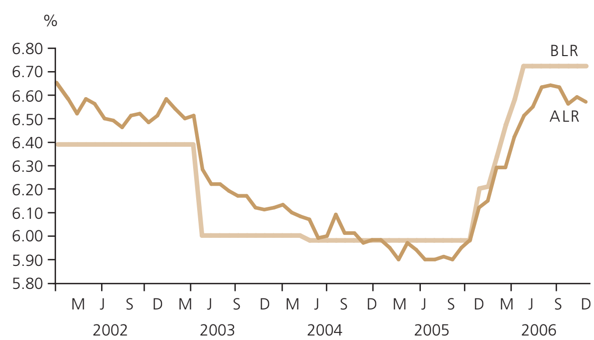
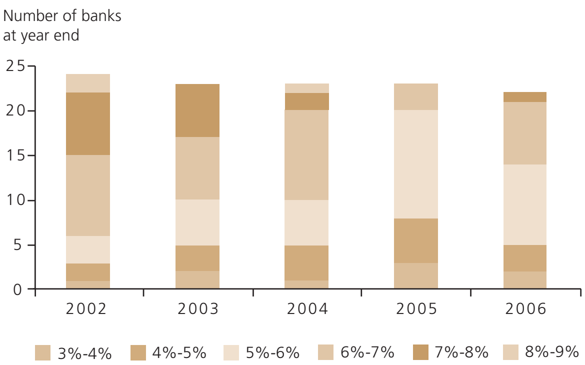


Chart 2.27
Range of Commercial Banks' ALR



in February and April and finally stabilised at 6.72% in mid-May until the end of the year. On the whole, the average BLR increased by 74 basis points, slightly lower than the total increase of 80 basis points in the OPR since November 2005. Most commercial banks had adjusted their BLRs upwards in the range of 50-100 basis points over the period January to May 2006.

The average lending rate (ALR) of the commercial banks increased in 2006 in line with the increase in the BLR. This reflected the re-pricing of existing BLR-pegged loans, the extension of new loans at the higher rates, as well as the maturing of older loans carrying lower interest rates. About 32% of banks had ALRs in the 7-8% range at end-2006, compared with only 13% at end-2005. Overall, the ALR peaked at 6.64% in August and declined slightly to 6.57%

Chart 2.28
1-month Interbank and Fixed Deposit (FD) Rates

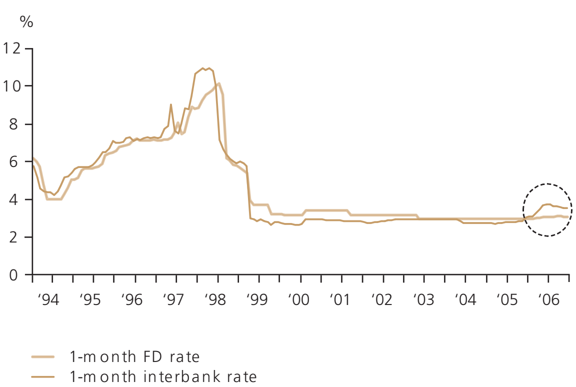
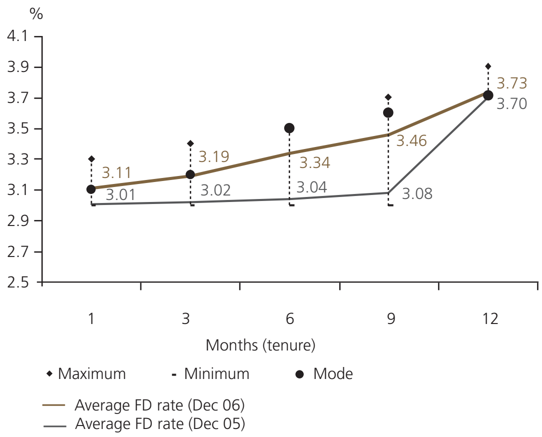


Chart 2.29
Commercial Banks' Fixed Deposit (FD) Rates



in December. Nevertheless, the increase of 59 basis points in the ALR was less than the increase in BLR due to competitive pressures as well as the fact that some loans carry fixed rates and are therefore not re-priced at the higher BLR. These fixed-rate loans, namely hire purchase loans and some housing loans, accounted for 17% and 5% of total loans outstanding respectively at end-2006. Some business loans were also priced on a cost-plus basis (10% of total loans) and have rates that are lower than the BLR.

For new loans approved, the weighted average lending rate was also 59 basis points higher than the average rate for 2005. The smaller increase in the weighted ALR for new loans approved relative to the BLR, reflected to a large extent the increased competition between the banking institutions.

The fixed deposit (FD) rates of the commercial banks were initially slow to adjust to the first increase in the OPR in November 2005. With the policy to ensure positive real rate of return to depositors, coupled with the situation of ample liquidity, FD rates were already higher than the interbank rates. In this environment, the banking institutions were able to source cheaper funds from the interbank market. This reduced their incentive to raise deposit rates. Most banks were also waiting for further increases in the OPR before making substantial changes in their FD rates. Consequently,

Movements of Islamic Rate of Returns and Conventional Interest Rates

An important feature of the Malaysian financial system is its dual banking system where the non-interest rate based Islamic banking system operates alongside the interest rate based conventional banking system. In view of the coexistence of these two systems, it is of interest to explore the extent to which prices differ between the two systems. Also, an understanding of the extent to which Islamic rate of returns change in response to changes in the central bank's policy rate will be crucial towards understanding how fast and effective the monetary transmission is via the Islamic financial system. Generally, the structure of Islamic financing requires the sharing of risks and profits in some pre-agreed ratios. Theoretically, given that the cost of a large proportion of existing Islamic financing is not directly linked to changes in the cost of funds, changes in monetary policy may only have a limited impact on the cost of existing loans.

In the interbank money market, Chart 2.30 shows that the profit rates in the Islamic money market have been generally lower than that in the conventional money market. However, movements in the Islamic profit rates follow closely changes in the conventional money market interest rates. In Chart 2.31, the base financing rate (BFR) of two major Islamic banks, are shown to move fairly closely with the BLRs of conventional banks. Therefore, monetary operations to manage liquidity in both the conventional and Islamic banking system do have a similar impact.

Chart 2.30
Overnight Conventional Rates and Islamic Rate of Returns

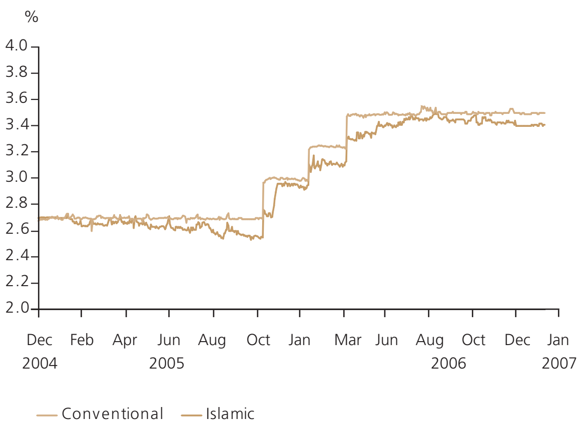
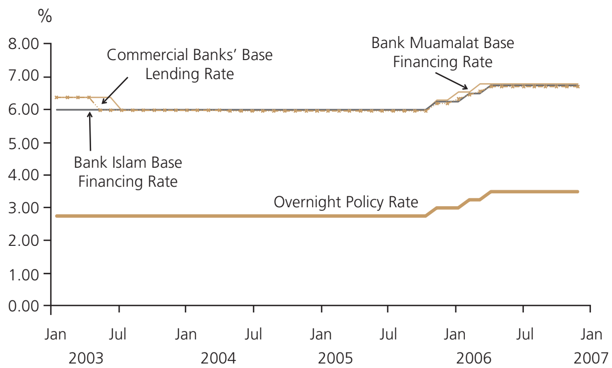


Chart 2.31
Islamic and Commercial Banks' Prime Lending Rates

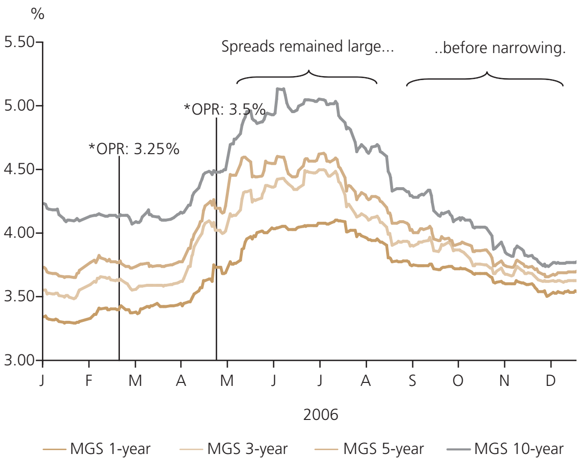


the pace of adjustment in FD rates picked up after the second OPR increase in February. The cost of interbank funds increased in line with the increase in the OPR. For example, the 1-month interbank rate moved convincingly above the corresponding FD rate in December 2005. From March onwards, a total of 13 banks adjusted their 1-month FD rate by 10–30 basis points. By December, the FD rates for tenures of between 1-month and 12-month maturities had increased by 2–46 basis points compared to November 2005. Chart 2.29 shows the change in average FD rates from December 2005 to December 2006, as well as the maximum, minimum and the mode of the FD rates offered by banks at end-December 2006. Real FD rates, which had been negative since May 2005 when inflation first began to rise above 3%, turned positive across all maturities in October 2006.

Bond Markets

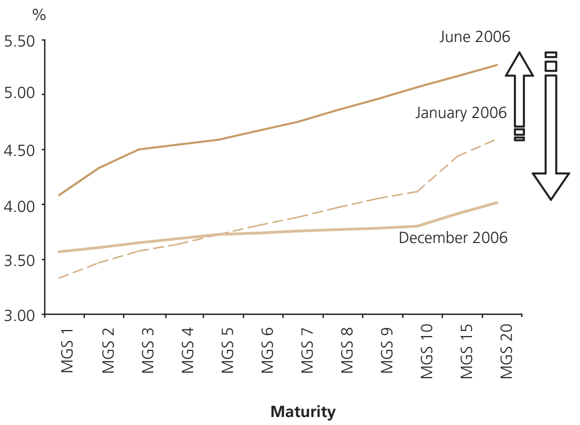
Both global and domestic developments explain the performance of the bond market in 2006. Global market developments amidst high excess liquidity played a major role in influencing the yield direction in 2006, particularly during the second half of the year. High global liquidity and the consequent search for yield channeled large amounts of capital flows into the emerging markets. These global developments, coupled with the strength in the macroeconomic and growth outlook in Malaysia, contributed to a vibrant and active bond market in 2006. On the domestic front, developments relating to the outlook for inflation heavily influenced investors' expectations of the central banks' monetary policy response, which subsequently affected the direction of yields. Expectations regarding the performance of the ringgit exchange rate also played a role in influencing yields during the year.

Chart 2.32
Malaysian Government Securities Yields (2006)



*OPR: Overnight Policy Rate

Chart 2.33
MGS Benchmark Yield Curve 2006



The inflation outlook, domestic interest rates and global liquidity conditions were among the factors determining the movement of yields in the ringgit bond market

The impact of these factors on the ringgit bond market performance in 2006 was manifested in the movements of the yields and the risk premium attached to the Malaysian market. The Malaysian Government Securities (MGS) yields trended upward, and by June, was about 80 basis points higher compared to the beginning of the year, before the market rallied and yields reversed during the second half of 2006. MGS yields reached their highest level in June with the yield on the 10-year MGS breaching the five percent mark, at 5.05%. The maturity spread between the 10-year and 1-year MGS was at its widest when the bond market yields reached its highest levels at mid-year. The correction in global financial markets in May had a modest impact on the bond market as compared to the equity market.

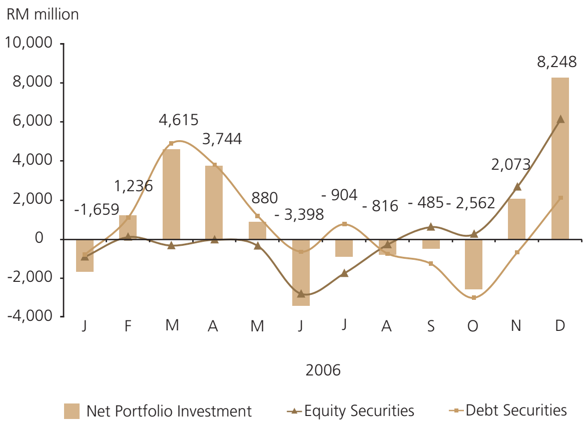
More importantly, there was a significant compression of the maturity spread by the end of 2006. As uncertainty over the global macroeconomic and inflation outlook dissipated, spreads between the 10-year and 1-year maturities, which were at around 80 basis points for much of the first half, narrowed significantly by year end. The MGS benchmark yield curve steepened in the period January to June before reverting to a flatter curve in the second half as more buying interest was concentrated at the longer end towards the end of the year.

In terms of domestic financial developments, expectations regarding the interest rate environment dominated investor interest in the bond market. Investors started the year on a cautious mood following the 25 basis points increase in the OPR in November 2005, as Bank Negara Malaysia began to gradually normalise the level of interest rates. With inflation continuing to show an upward bias in the early part of the year, investors began to price in the likelihood of a rate increase prior to the February and April MPC meetings. Moderating inflationary pressures and lower inflation expectations in the second half of the year influenced investors' perception that interest rates would not increase further. These expectations became more firmly entrenched when inflation began to moderate, increasing investors' confidence that the OPR will be kept unchanged at 3.5%.

Excess global liquidity and the consequent search for yield, especially following the May correction, was also significant in explaining the performance of the Malaysian bond market. The narrowing of the MGS yields after August was mainly the result of long-term rates being influenced by the increasing risk appetite among investors that led to bigger investment flows into the longer end of the yield curve. The Malaysian bond market was also seen as attractive compared to regional markets.

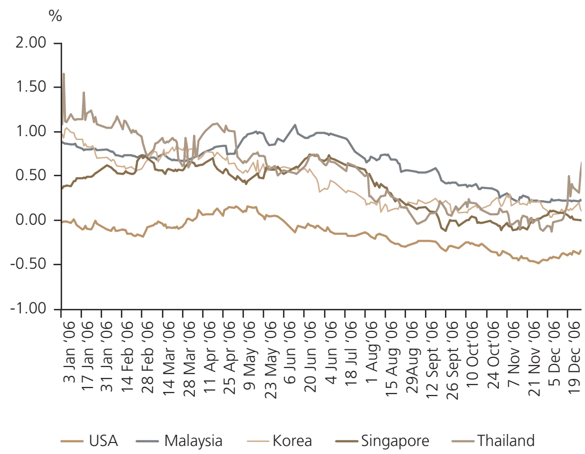
There were also other factors that contributed to cause Malaysian spreads to continue to

Chart 2.34
Net Portfolio Investment Flows into the Country (2006)



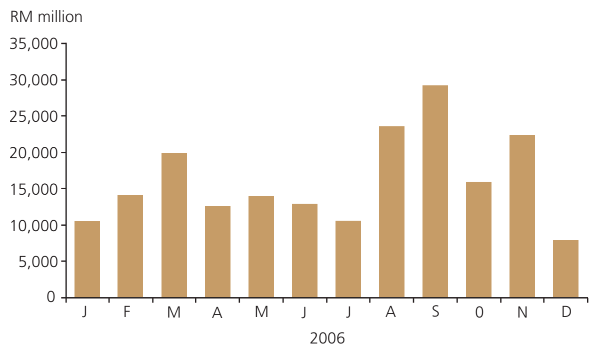
Source: Bank Negara Malaysia's Cash Balance of Payments System

Chart 2.35
Yield Spread (10 year - 1 year) for Selected Countries (2006)



narrow. Towards the year-end, yields were also influenced by the speculation that the ringgit could show further appreciation. This motivated investors to take positions in the ringgit bond market especially in the short-term securities, hence keeping yields on a downward trend. At the same time, the growing size and maturity of the Malaysian bond market led to it being considered for inclusion in the Citigroup World Government Bond index. This inclusion, to be effective in July 2007, resulted in some pre-emptive buying by global fund managers. Moreover, the inaugural issue of the callable MGS on 15 December 2006 also heightened interest in the domestic bond market. As a result, market turnover which had been

Chart 2.36
MGS Turnover 2006

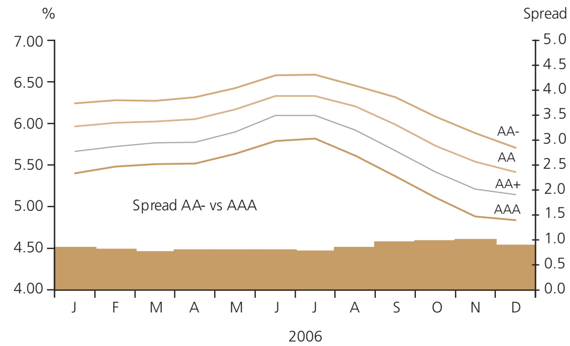


relatively low after the May correction, when foreign investors had pulled back capital from emerging markets, had rose to its highest levels during the second-half of the year.

In the corporate bond market, issuers were more aggressive in entering the market in anticipation of further OPR increases. The rally in the MGS market also sparked buying interests towards the high-grade segment of the corporate bond market.

Despite a higher number of downgrades being recorded in 2006 compared to 2005, the credit spread in the corporate bond market remained stable throughout the year. The higher downgrades were mainly within the investment

Chart 2.37
Corporate Bonds Indicative Yields (2006)



category and were isolated cases due to more stringent rating criterion being adopted. These

Increased Cooperation in the Development of the Regional Bond Market

Cooperative efforts to further develop the regional bond markets had advanced in 2006 with several developmental milestones achieved aimed at enhancing the depth and breadth of the regional bond markets.

Asian Bond Market Initiative (ABMI)
Under the auspices of the ABMI, the various working groups established in 2003 to promote the issuance and trading of bonds within the region have achieved several important milestones on a wide range of issues. These include a study on the possible creation of a "Regional Basket Currency Bonds" (RBCB). The study addresses issues on possible structures, impediments as well as effective regulatory framework to facilitate the creation of RBCB. The study on "Credit Guarantee and Investment Mechanism" had also progressed to Phase 2 towards development of a business model on credit guarantee and investment mechanism for the region.

Under the Working Group on Foreign Exchange Transactions and Settlement issues chaired by the Bank, the interim report on the study on "Minimising Foreign Exchange Settlement Risk in ASEAN+3 Region" has been completed and distributed to member countries. The study aimed to provide options to the region in minimising clearing and settlement risk for cross-border bond transactions including the possible establishment of a regional intermediary.

Other areas of collaboration and cooperation focused on identifying measures to promote rating harmonisation and further utilisation of local credit rating agencies in the ASEAN+3 region. Efforts were also undertaken to pool valuable experiences from member countries to identify an appropriate policy framework that could facilitate the funding of infrastructure development through the Asian bond markets. Phase 2 of the technical assistance programmes for 5 participating countries namely Cambodia, Indonesia, Philippines, Thailand and Vietnam has also been completed. To further improve comparability of information on the domestic bond markets in the region, the Asian Bond Online Website, which was developed in 2004, was also enhanced.

Asian Bond Fund

The Asian Bond Fund 2 (ABF2) that was launched in 2005 has experienced encouraging growth of 48% in the number of units and achieved a USD return of 6.9% per annum since its launch. The funds have also gained greater international recognition within the investment community. For the year ending 3 August 2006, Lipper ranked the Pan-Asian Investment Fund (PAIF) first in its survey of open-ended Asia bond funds.

The ABF Malaysia Bond Index fund, one of the funds under the ABF2, was listed in 2005 and has since helped to increase investor interest in the Malaysian bond market. Since listing, it has recorded a return of 3.9% per annum in ringgit terms (8.5% in US dollar[1] terms), placing it among the three best-performing single domestic market funds under the ABF2 umbrella while achieving unit growth of 13%. For 2006, the fund achieved a ringgit return of 4.6% (12.2% in US dollar terms). The number of ABF Malaysia units traded on Bursa Malaysia has been low mainly due to conservative buy-and-hold investors. However, the situation is expected to improve as the domestic market matures and becomes more liquid.

[1] These are total returns which include redistributed regular periodic income, capital gains from any rise in unit price and foreign exchange translation gains, if any, into US dollars.

downgrades thus did not affect the overall market sentiments.

Equity Markets

Despite a cautious start to the year, and notwithstanding some distinct periods of volatility, the Malaysian equity market ended 2006 on a significantly positive note. Among the factors that contributed to the better performance were renewed foreign inflows into the equity markets, strong corporate earnings, corporate mergers and acquisitions and expectation-driven sentiments following the announcement of the Ninth Malaysia Plan (9MP) infrastructure projects.

Driven by positive macroeconomic fundamentals and foreign investor interest, local equity markets performed well in 2006

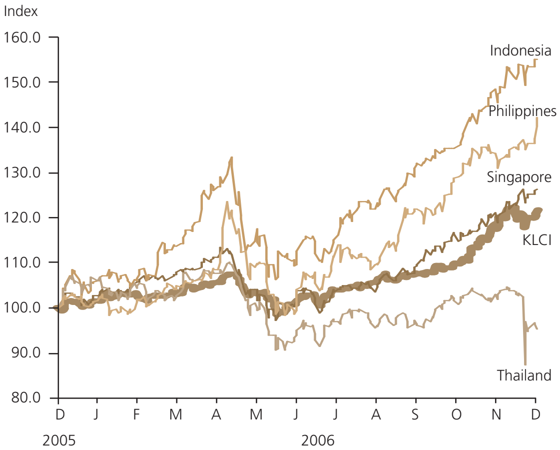
After the relatively weak performance in 2005, the KLCI ended 2006 at 1,096.24 points or 21.8% higher compared to end-2005. Although the benchmark index closed the year at its highest level since 1996, the Malaysian market lagged the other regional markets. The KLCI's performance was weak in the first half of the year but posted stronger gains in second half of the year as foreign investors' interests in the market increased.

There was also significant difference in the performance of the three major domestic indices, with the small-capitalisation MESDAQ recording a better performance relative to the Kuala Lumpur Main Board. On a sectoral basis, the construction and plantation sectors were the strongest performers, each posting gains of 57.5% and 54.2% respectively, for the year.

The KLCI started 2007 on a positive note, supported by inflows of non-resident funds driven by expectations of stronger domestic economic growth, favourable corporate earnings, and stable inflation outlook. The KLCI reached a high of 1,283.47 points on 23 February before the correction at the end of February and early March. As at 7 March 2007, the KLCI stood at 1,156.58 points or 5.50% higher compared to end-2006.

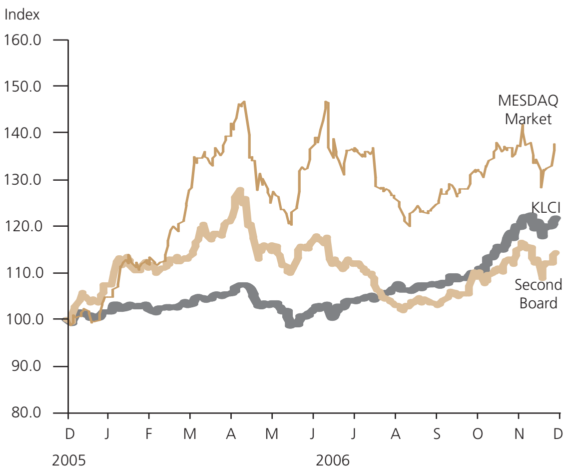
Capital flows into the equity market were important in explaining the KLCI's performance in 2006. The nature of capital flows into the equity market differed significantly between the two halves of the year. Despite the weak inflows

Chart 2.38
Regional Indices



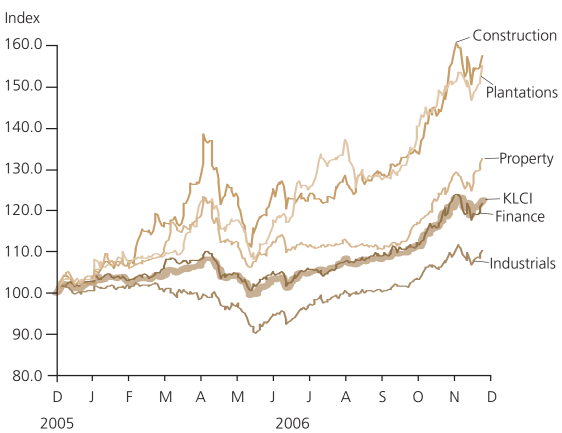
Source: Bursa Malaysia and Bloomberg

Chart 2.39
Bursa Malaysia Indices



Source: Bursa Malaysia and Bloomberg

Chart 2.40
Bursa Malaysia Sectoral Indices



Source: Bursa Malaysia and Bloomberg

Table 2.2
Bursa Malaysia : Selected Indicators

	2005	2006
Price Indices:		
FBM30	5,882.5	7,059.9
Composite	899.8	1,096.2
FBMEMAS	5,737.5	7,169.6
Second Board	80.4	92.0
MESDAQ Market	87.1	119.9
Total Turnover:		
Volume (billion units)	102.3	197.5
Value (RM billion)	177.3	250.6
Average Daily Turnover:		
Volume (million units)	414.3	802.9
Value (RM million)	716.9	1,018.9
Market Capitalisation (RM billion)	695.3	848.7
Market Capitalisation / GDP (%)	140.4	155.3
Total Number of Listed Companies:	1,021	1,027
Main Board	646	649
Second Board	268	250
MESDAQ Market	107	128
Number of Companies Delisted:		
Main Board	9	21
Second Board	5	8
MESDAQ Market	1	1
Market Liquidity:		
Turnover Value / Average Market Capitalisation (%)	25.1	35.9
Turnover Volume / Number of Listed Securities (%)	31.4	59.2
Market Concentration:		
*Market Capitalisation of 10 Most Highly Capitalised Stocks / Total Market Capitalisation (%)	36.1	35.4

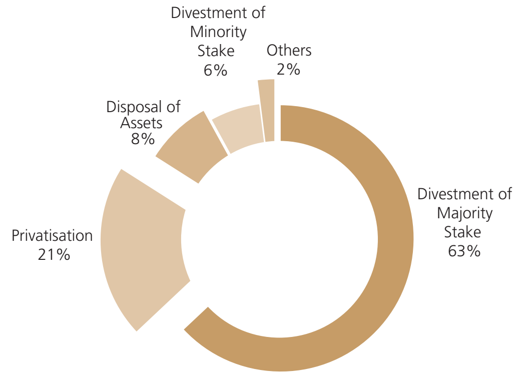
* Based on market transactions only
Source: Bursa Malaysia

of capital into the domestic equity market in the first half of the year, anecdotal evidence pointed towards the presence of offshore hedge funds in selected technology stocks, driven by expectations of stronger export performance in the electronics and electrical sector. Since a large proportion of the companies listed on the Second Board and the MESDAQ Market were technology-related companies, greater interest and trading in these markets resulted in significant market volatility. Following the market correction in May, there were large outflows. However, in the second half of the year, rising inflows into the equity market by foreign funds were focused on the bigger capitalisation stocks in the Main Board, which were more liquid and had greater research coverage.

Expectations of stronger corporate earnings as well as improved macroeconomic outlook also drove the equity market higher in the second half of the year. By the third quarter, commodity prices, especially oil prices, had begun to decline. With inflationary pressures receding, there were clear indications that global and domestic monetary policy tightening was being put on hold. Furthermore, it was evident that despite the three increases in the OPR since November 2005, corporate sector earnings had remained strong. Total revenue rose 7.6% in the third quarter of 2006 compared to the corresponding quarter in 2005. Over the same period, operating income rose by 18.4%. The corporate sector's interest coverage ratio at 5.3 remained high and their ability to continue servicing their debt was relatively unaffected by the higher interest rates.

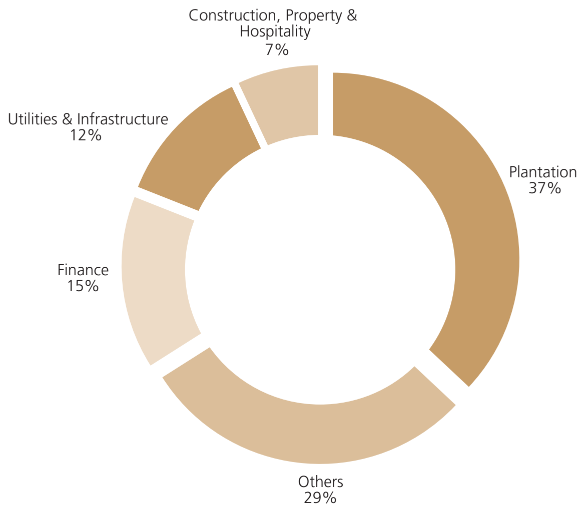
Further positive news on several sectors contributed to the momentum in the equity market. Robust demand for crude palm oil (CPO) throughout the year and continued upward re-ratings by market analysts provided the impetus for the solid performance of the plantation sector relative to other sectors of the KLCI. In addition, the announcement of infrastructure projects under the 9MP during the 2007 Budget release, raised market expectations for stronger earnings in the construction sector which was seen to be one of the main beneficiaries of the plan. The positive news regarding stocks in these two sectors rekindled foreign interest in these sectors and in the equity market in general.

Chart 2.41a
Mergers and Acquisitions (M&A) by Type, 2006



Source: Bursa Malaysia

Chart 2.41b
Mergers and Acquisitions (M&A) by Sector, 2006



Source: Bursa Malaysia

Mergers and acquisitions (M&A) activity also helped to spur the KLCI. A total of 84 successful M&As were recorded in 2006, with a total valuation of RM90 billion. Most of these were either divestment of majority stakes in entities listed in Bursa Malaysia or privatisation exercises. In terms of value, M&A activity was significantly boosted by the merger exercise in the plantation sector that would result in the creation of the world's largest plantation company, valued at RM31.4 billion. The finance sector also saw consolidation activity in the banking sector.

Market turnover for the KLCI in 2006 was the highest since 2000. Despite the higher volatility during the mid-year market correction, volatility

Chart 2.42a
Performance of KLCI in 1H2006

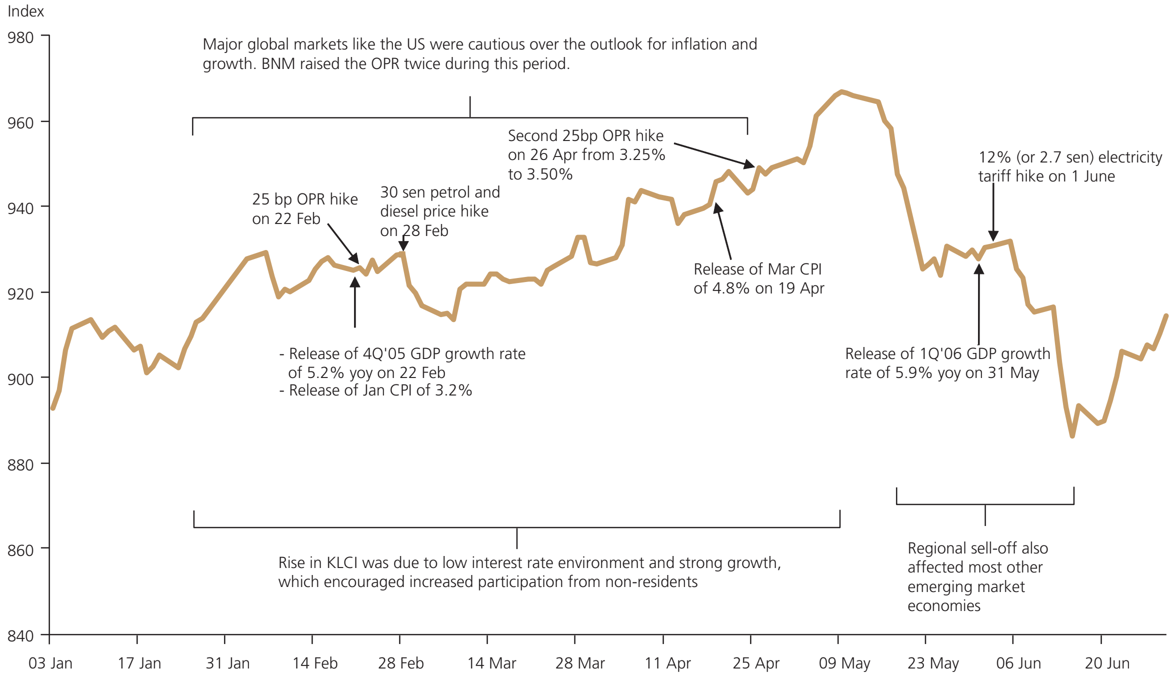


Chart 2.42b
Performance of KLCI in 2H2006

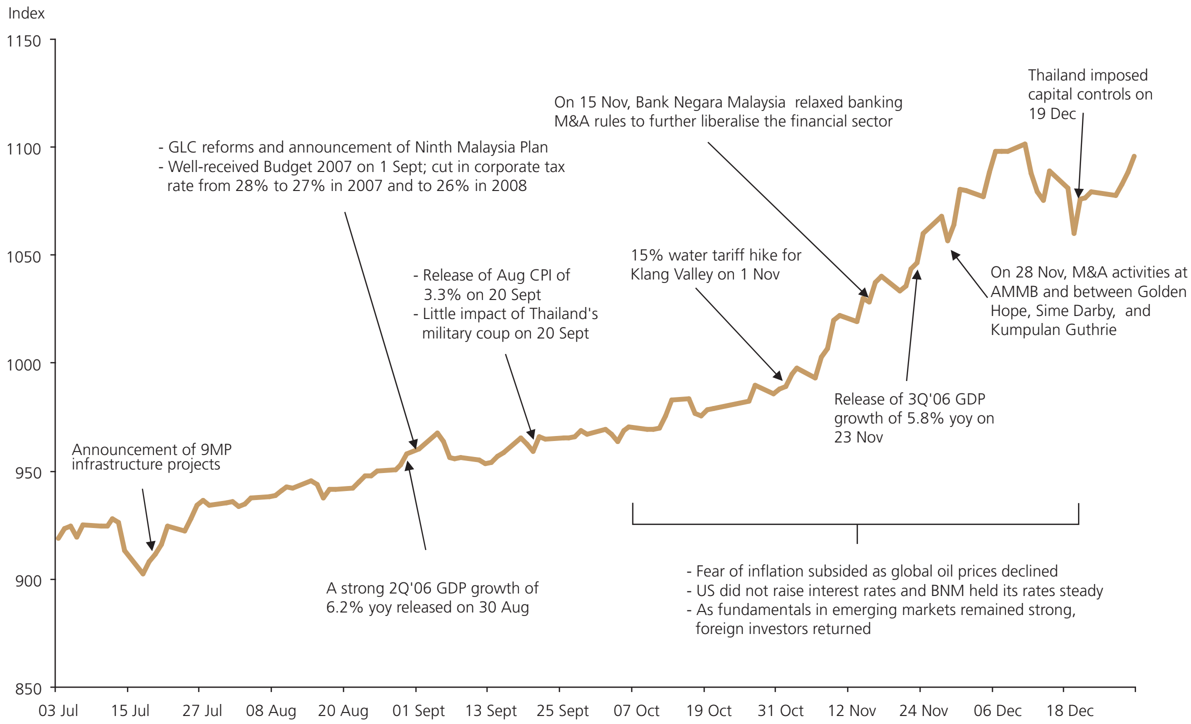
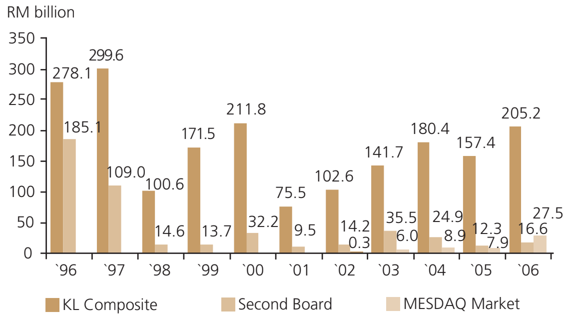
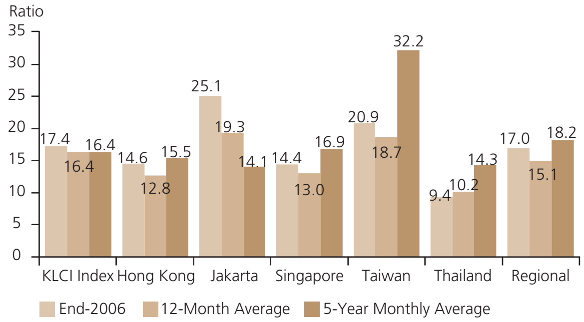


Chart 2.43
Market Turnover of Bursa Malaysia Markets



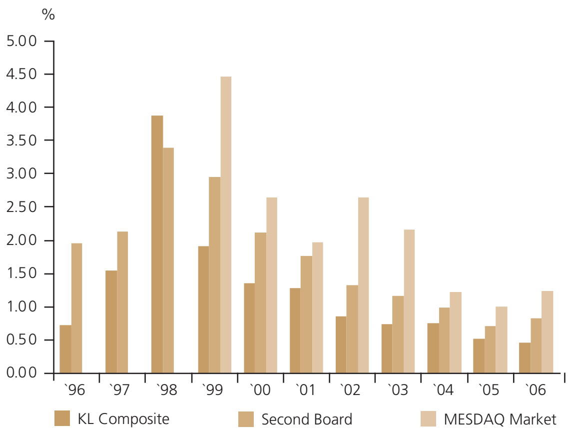
Source: Bursa Malaysia

Chart 2.45
Regional Comparison of Price-Earnings Ratios



Source: Bloomberg, Bank Negara Malaysia estimates

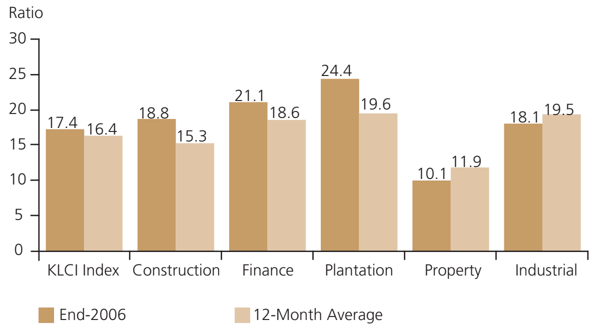
Chart 2.44
Volatility[1] in Bursa Malaysia Markets



[1] Refers to the annual average of the rolling 90-day standard deviation of daily returns

Source: Bank Negara Malaysia's calculations

Chart 2.46
Bursa Malaysia Comparison of Sectoral Price-Earnings Ratios



Source: Bloomberg, Bank Negara Malaysia estimates

levels remained well below historical levels. The Malaysian markets were also not significantly affected by the developments in neighbouring Thailand in the later half of the year, with the domestic indices rebounding very strongly.

Despite the stronger performance in 2006, the KLCI's valuation remained broadly in line with the historical trend. At the end of 2006, the price-earnings (P/E) ratio of the KLCI was slightly higher than its historical average. On a sectoral basis however, the significant gains in the construction and plantation sectors resulted in their P/E ratios being higher than those of the other sectors. All sectors showed higher P/E ratios except for the industrials and property sectors, which remained below their long-term averages.

FINANCING OF THE ECONOMY

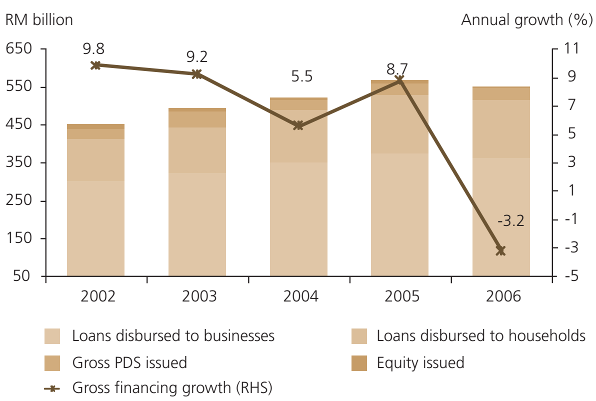
With domestic monetary and financial conditions strongly supportive of economic activity, the private sector was able to be more selective of the avenues and structures that were most suited to their financing needs. Expectations at the beginning of the year were for interest rates to increase. This encouraged borrowers to seek financing via the debt securities market to take advantage of the lower cost of borrowing. In addition, there was a notable shift towards financing avenues that provided borrowers with the necessary flexibility in meeting their longer term funding requirements. As such, while financing via the private debt securities market was sustained at a high level, financing via the banking system and the equity market was slower.

Overview

In 2006, total net financing channelled to the economy, encompassing both public and private financing, increased at a steady rate of 5.9% (7.4% in 2005), broadly in line with the sustained pace of economic growth.

Business operations and investment activity were supported by both internal funds and an increase in net financing of 5.9% (2005: 7%), with foreign sources of financing, namely foreign direct investment (FDI), augmenting domestic-based financing. The reliance on internal funds to some extent, accounted for the disconnect between the slower pace of growth in net financing to businesses vis-à-vis the sustained growth in private investment activity. The PDS market was the main source of domestic long-term financing. Large companies have increasingly sought to raise funds in the PDS market to finance their new activities. While the banking system continued to provide financing to businesses, accounting for the largest share of the disbursement of funds, these mostly comprised short-term revolving facilities with repayments broadly matching disbursements. Nevertheless, among SMEs, credit continued to be mainly sourced from the banking system, and the development financial institutions (DFIs). This includes financing under the Special Funds for SMEs administered by Bank Negara Malaysia and channelled through banking institutions and DFIs.

Chart 2.47
Gross Financing through Banking System and Capital Market



Financing of the households, which was concentrated mainly in the banking system, increased at a more moderate pace of 9.7% (2005: 15%), broadly in line with the growth in consumption expenditure.

Business operations and investment activity continued to be supported by diversified sources of financing and internally generated funds

Financing to the Business Sector

The business sector relied less on borrowed funds for working capital and investment in 2006 as evidenced by the lower amount of bank loan disbursements and steady level of gross PDS issuances. With strong cash surplus positions, many large corporates, particularly those in the manufacturing, services and commodities sectors, continued to rely on internal funds, augmented by FDI. At the same time, companies experiencing higher operating costs and more moderate demand for their goods and services took a more cautious stance in obtaining additional financing. The confluence of these factors led to a steady rather than a strong increase in net financing. Business loans and PDS outstanding expanded at a combined rate of 5% (2005: 6.5%).

Business Financing through the Banking System

The drawdown of bank loans by businesses, as indicated by loan disbursements, was lower by 3.3% in 2006 (6.9% in 2005), mainly reflecting lower working capital financing requirements in the manufacturing, and wholesale and retail trade sectors. In terms of loans outstanding to the manufacturing sector, approximately 26% were accounted for by industries related to the construction sector, namely iron and steel; non-metallic products and fabricated metals. Loan

Table 2.3
Financing of the Economy: Outstanding as at end-December 2006

By financing type/ institution \ By customer	Business[1] Total	Business[1] of which: SMEs	Households	Government	Total Financing
	RM million				
Financial Intermediaries	**346,668**	**120,222**	**386,409**	**1,755**	**734,833**
Banking Institutions	258,103	102,501	333,104	1,755	592,962
Development Financial Institutions (DFIs)[2]	23,542	13,221	27,596		51,138
Other Domestic Intermediaries[3]	65,024	4,500	25,709		90,733
Capital Market					
Bond Market[4]	**186,081**			**207,590**	**393,671**
Equity Market[5]	1,916				1,916
Venture Capital[5]	3,310				3,310
External Financing					
Foreign Direct Investment[5]	25,900				25,900
External Debt[6]	77,323			73,156	150,479
Net Change in Financing (2005)					
Financial Intermediaries	**19,852**	**8,540**	**45,902**	**(1,581)**	**64,174**
Banking Institutions	5,790	7,655	39,980	(1,581)	44,189
Development Financial Institutions (DFIs)[2]	4,324	203	5,578		9,902
Other Domestic Intermediaries[3]	9,738	682	344		10,082
Capital Market					
Bond Market[4]	17,969			13,700	31,669
Equity Market[5]	6,315				6,315
Venture Capital[5]	2,589				2,589
External Financing					
Foreign Direct Investment[5]	15,000				15,000
External Debt[6]	3,662			(10,780)	(7,118)
Total	**65,388**	**8,540**	**45,902**	**1,339**	**112,630**
Net Change in Financing (2006)					
Financial Intermediaries	**11,960**	**7,571**	**34,274**	**(1,669)**	**44,566**
Banking Institutions	7,824	6,545	28,741	(1,669)	34,896
Development Financial Institutions (DFIs)[2]	2,544	1,193	5,219		7,763
Other Domestic Intermediaries[3]	1,593	(167)	314		1,907
Capital Market					
Bond Market[4]	10,510			17,120	27,630
Equity Market[5]	1,916				1,916
Venture Capital[5]	3,310				3,310
External Financing					
Foreign Direct Investment[5]	25,900				25,900
External Debt[6]	6,006			(12,963)	(6,956)
Total	**59,602**	**7,571**	**34,274**	**2,488**	**96,365**

1 Business includes non-bank financial institutions, domestic non-business entities and foreign entities.

2 Refers to DFIs governed under the Development Financial Institutions Act, 2002.

3 Other domestic intermediaries include insurance companies, Employees Provident Fund (EPF), housing credit institutions, leasing and factoring companies and Treasury Housing Loan Division.

4 Bond Market refers to outstanding of private debt securities (PDS) and all Malaysian government securities.
PDS refers to corporate bonds issued including irredeemable convertible unsecured loan stocks (ICULS) and medium term notes (MTN).

5 Refers to flow during the year.

6 External financing of Government includes financing to non-financial public enterprises (NFPEs).

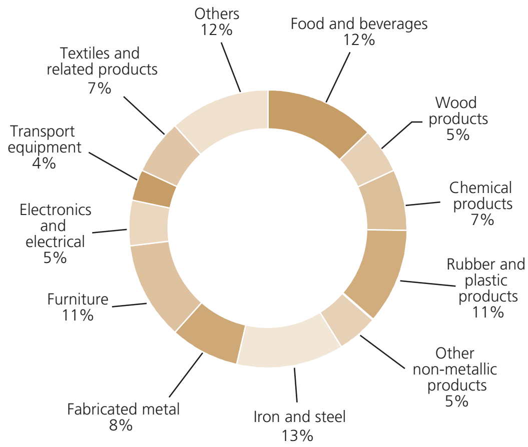
Table 2.4
Special Funds for SMEs administered by Bank Negara Malaysia

Type of Fund	RM million					%	
	Allocations	Approvals	Disbursements	Repayments	Loans Outstanding	Utilisation Rate[1]	Undrawn [2]
	As at end-2006						
Fund For Food	1,300.0	1,768.3	1,682.1	981.7	700.4	136.0	4.9
New Enterpreneurs Fund 2	2,850.0	3,206.7	2,864.1	547.8	2,316.3	112.5	10.7
Fund for Small and Medium Industries 2	6,750.0	7,820.2	7,059.0	2,259.7	4,799.2	115.9	9.7
Bumiputera Enterpreneurs Project Fund	300.0	599.9	516.8	454.0	62.8	200.0	13.9
Rehabilitation Fund for Small Businesses	200.0	18.3	15.7	5.6	10.1	9.1	14.1
Total	**11,400.0**	**13,413.4**	**12,137.7**	**4,248.8**	**7,888.9**	**117.7**	**9.5**
	Change during the year						
Fund For Food	-	144.1	147.6	153.2	-5.6		
New Enterpreneurs Fund 2	500.0	508.4	594.1	162.8	431.3		
Fund for Small and Medium Industries 2	2,000.0	1,471.6	1,655.7	1,233.4	422.2		
Bumiputera Enterpreneurs Project Fund	-	66.6	68.8	59.7	9.1		
Rehabilitation Fund for Small Businesses	-	1.8	7.1	4.9	2.2		
Total	**2,500.0**	**2,192.5**	**2,473.3**	**1,614.0**	**859.3**		

[1] Ratio of approvals over allocations.
[2] Ratio of approvals minus disbursements, over approvals

disbursements declined as growth in the industries related to the construction sector continued to contract in the first half of 2006. Moderate growth performances in the second half of 2006 in selected sub-segments of the rubber and plastic product industries may have also led to lower loan disbursements.

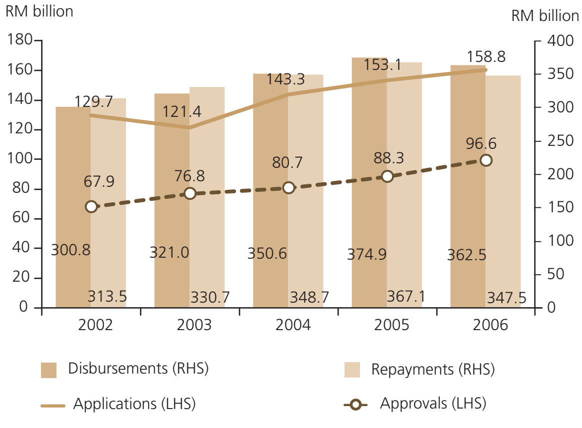
Chart 2.48
Loan Outstanding to the Manufacturing Sub-sectors as at end-2006



The lower loan disbursements in the manufacturing sector, to some extent, mirrored the performance of loan disbursements to the wholesale trade sector, which includes financing to facilitate the distribution of industrial products in addition to household products. Both the wholesale and retail trade sectors were also faced with increased competition amid resilient growth in private consumption.

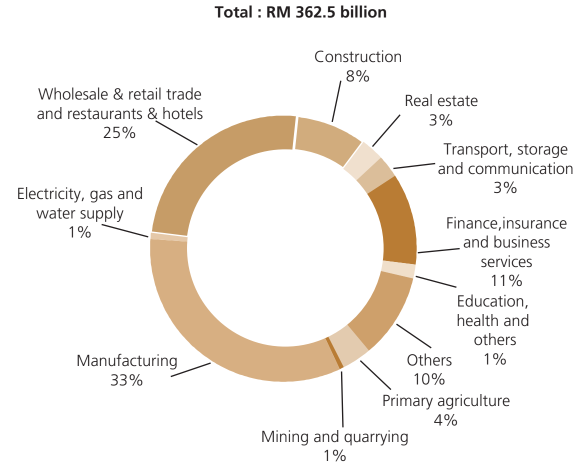
Throughout the year, the ratio of loan approvals to applications remained relatively stable for both large businesses and SMEs indicating that the lower loan disbursements were largely driven by demand rather than supply factors. Competition amidst surplus liquidity spurred banking institutions to provide attractive financing options. In some instances, viable emerging corporates and SMEs obtained financing at cost-plus rates that were lower than the BLR.

Chart 2.49
Business* Sector Loan Indicators



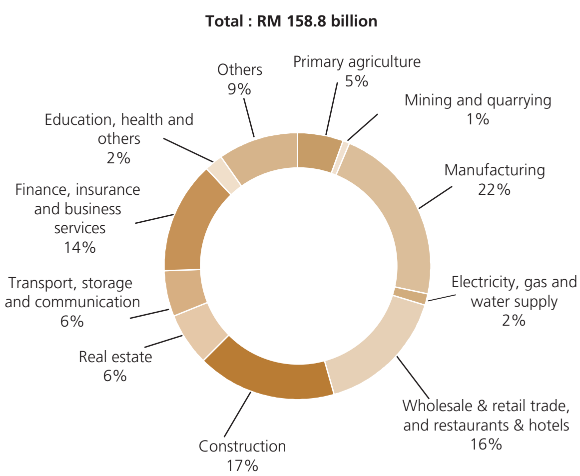
* Business sector includes non-bank financial institutions, domestic non-business entities and foreign entities

Chart 2.51
Business Loan Disbursements by Sector in 2006



While the growth performance of the construction sector and the manufacturing industries related to the construction sector improved in the second half of the year, this did not immediately translate into higher overall loan disbursements. Nevertheless, indicating some pick-up in financing needs, there was a strong recovery in new loan applications and approvals in the fourth quarter. For the year as whole, new loan applications and approvals rose by 4.1% and 12.5% respectively (2005: 6.8% and 9.4% respectively).

Chart 2.50
Business Loan Applications by Sector in 2006



Business Financing through the Bond Market

The bond market remained as one of the important sources of financing for the private sector. In the environment of rising inflation and interest rate during the first half of the year, corporations continued to tap the domestic bond market to meet their funding requirements as well as lock in prevailing interest rates in anticipation of further interest rate increases. Furthermore, as the market activity improved in the second half of the year, corporate interest in issuing debt securities to meet their financing needs remained high.

The bond market was an important source of financing for the private sector with total gross funds raised through the private debt securities market remaining substantial

In 2006, total gross funds raised through the PDS market (excluding Cagamas) remained substantial, amounting to RM31.7 billion (2005: RM35.7 billion). However, the PDS market recorded lower net funds raised of RM11.1 billion due to higher redemptions during the year.

Chart 2.52
Funds Raised through the PDS Market

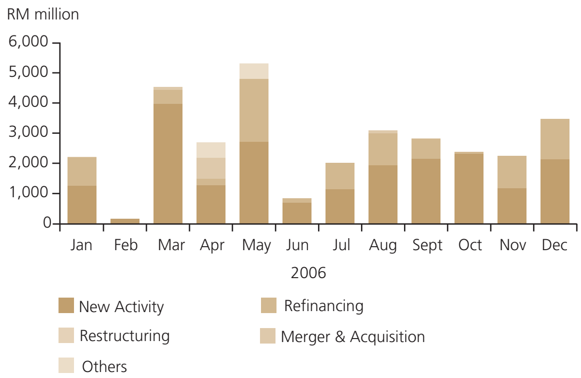


Table 2.5
Funds Raised in the Bond Market

	2005	2006
	RM million	
By Public Sector		
Government Securities (gross)	28,276	26,830
Less Redemptions	15,800	12,850
Equals Net Federal Receipts	12,476	13,980
Government Investment Issues (net)	1,000	9,500
Khazanah Bonds (net)	833	-630
Malaysia Savings Bond (net)	1,516	-1,931
Net Funds Raised	**15,825**	**20,919**
By Private Sector		
Private Debt Securities (gross)	38,196	38,887
Straight Bonds	3,869	8,667
Convertible Bonds	3,745	156
Islamic Bonds	9,537	4,781
Asset Backed Securities	6,210	1,546
Medium Term Notes	12,296	16,588
Cagamas Bonds	2,540	7,150
Less Redemptions	18,617	31,519
Private Debt Securities	13,432	20,617
Cagamas Bonds	5,185	10,902
Net Funds Raised	**19,579**	**7,368**
Net Funds Raised in the Bond Market	**35,404**	**28,287**

The PDS were issued by 95 corporations, mainly in the construction and property, finance and business services as well as utilities (electricity, gas and water) sectors. Major issuers within the construction and property sectors were companies involved in major infrastructure projects including projects under the 9MP. In the finance and business services sector, companies issued debt securities mainly to fund their working capital and financial activities. Meanwhile, independent power producers and companies involved in water related projects continued to resort to the debt securities market to meet long-term financing requirements that requires financing to be raised in small amounts over a long period of time.

Furthermore, the liberalisation of foreign exchange administration rules since April 2004 had encouraged two additional PDS issuances in the Malaysian capital market by foreign entities

Chart 2.53
Private Debt Securities by Sector in 2006: In Terms of Issuer and Amount Issued

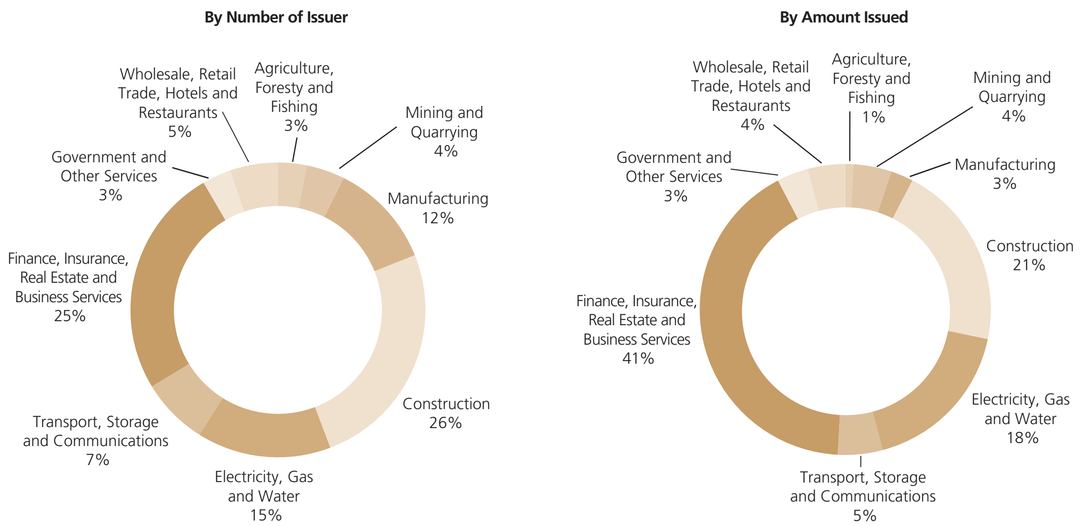


Chart 2.54
PDS Financing by Purpose

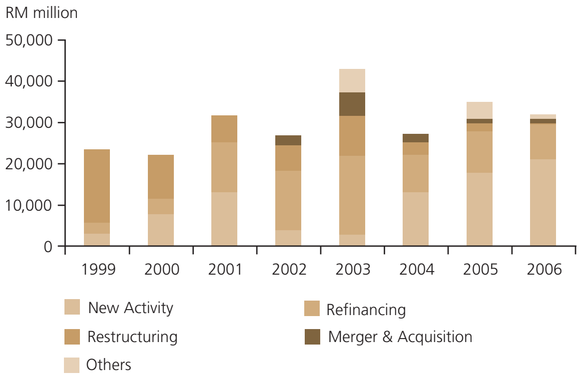
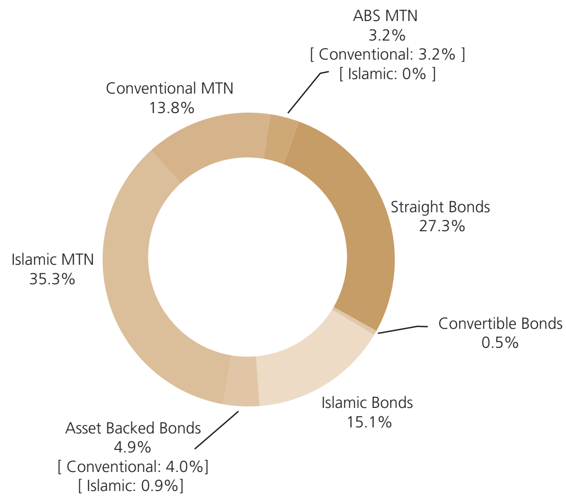


Chart 2.55
PDS Issues by Type of Instrument (Excluding Cagamas)

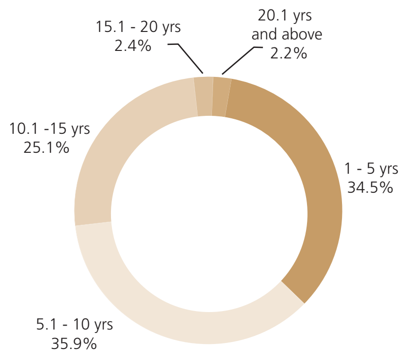


comprising a multilateral development bank and a multinational corporation. These issues were successful and have resulted in these entities opting to conduct further issuances in the Malaysian market. It is expected that going forward, more such entities will opt to issue their PDS in the Malaysian market.

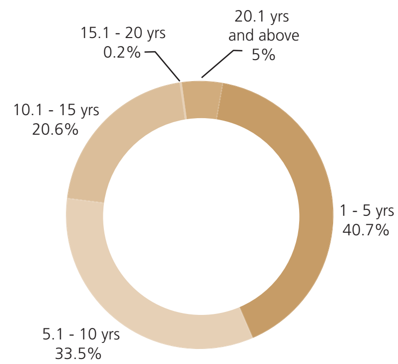
Most of the PDS issued during the year were channelled for new investment activity (66.1%) and the refinancing of existing debt (28%). The trend in corporate financing through the PDS market has evolved since the Crisis. In the more recent years, most companies have gone to the debt market to finance their new investment activities. The need for financing for restructuring purpose has tapered off since 2004 as the corporate sector has successfully undertaken their restructuring exercise.

The new PDS maturity profile during the year were concentrated on the tenures between one to ten years (74.2% of total new issues of PDS) reflecting the issuers' preference for the short to medium-term financing. Meanwhile, PDS with tenures of

Chart 2.56
PDS Issues by Tenure (Excluding Cagamas)

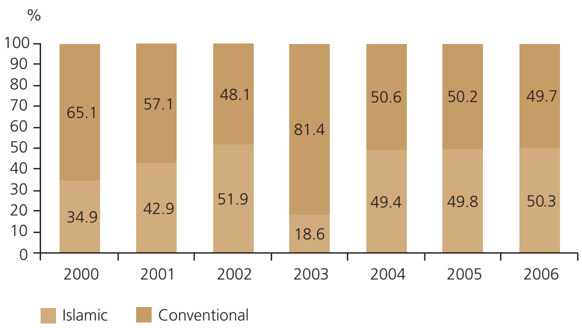


2005



2006

Chart 2.57
Funds Raised via Islamic and Conventional Private Debt Securities



more than 20 years (including the PDS with the longest tenure of 33 years) increased during the year and were mainly issued by companies involved in finance, power production and infrastructure projects that require long-term financing due to their extended gestation periods.

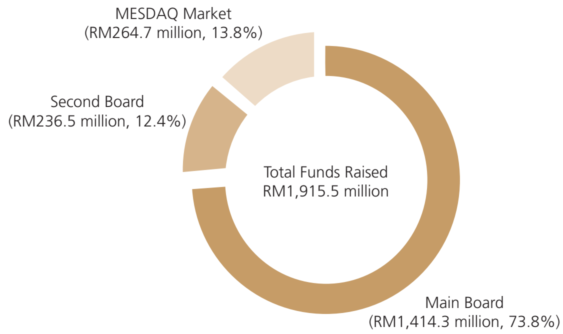
In line with the issuers' preferences for issuing short to medium-term securities, medium-term notes (MTN) programmes remained as the most favoured form of debt securities financing (52% of total new issuances) as the instruments provided issuers with the flexibility to obtain financing whenever they needed it. Also, the measures and initiatives taken to develop a more innovative and sophisticated Islamic capital market have resulted in greater issuance of Islamic products. Islamic securities issuances continued to grow and accounted for 50.3% of total PDS issued during the year.

Business Financing through the Equity Market

Total financing via the equity market in 2006 was RM1.92 billion, significantly below the amount raised in previous years. The reduced attractiveness of equity issues as an avenue to raise funds is attributable to the weak sentiments associated with the Malaysian equity market in the first half of the year. The low interest rate environment that prevailed throughout the year and the tightening of listing criteria on the MESDAQ Market by the Securities Commission were other factors contributing to the lower funds raised through the equity market.

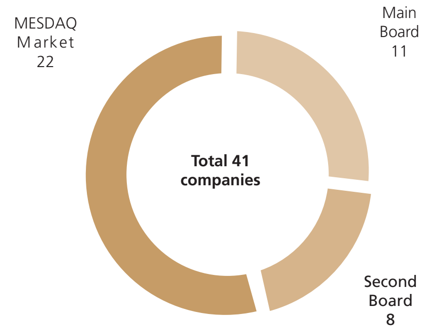
In the first half of 2006, given the uncertainty regarding the outlook on inflation and the possibility of a series of interest rate hikes, issues were delayed in anticipation of a better outcome for their public offerings at a later date. As the year unfolded, the low interest rate environment that prevailed also made other forms of financing more attractive. In particular, more companies sought financing through the PDS market. Listings on the MESDAQ Market were also heavily affected by the Securities Commission's decision to tighten the listing criteria. The policy move, mainly aimed at protecting investors, is however expected to assist in ensuring quality deal-flows into the market over the long-term.

Chart 2.58a
Funds Raised - By Board, (RM million, % share)



Source: Bursa Malaysia

Chart 2.58b
Number of Listings on Bursa Malaysia in 2006



Source: Bursa Malaysia

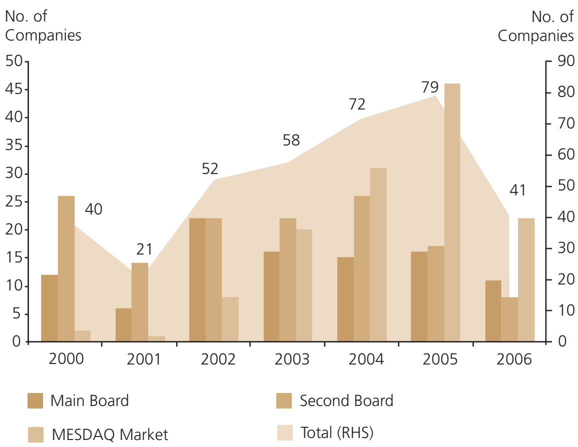
Table 2.6
Financing via the Equity Market (RM million)

	2005		2006	
	Amount (RM)	% Share	Amount (RM)	% Share
Initial Public Offers	5,305.1	84.0	1,518.7	79.3
Public	2,534.7	40.1	619.8	32.4
Offer for sale	2,167.7	34.3	313.4	16.4
Private Placement	602.8	9.5	585.6	30.6
Rights issues	967.7	15.3	367.4	19.2
Warrants	42.3	0.7	29.4	1.5
Total	**6,315.2**	**100.0**	**1,915.5**	**100.0**

Source: Bursa Malaysia

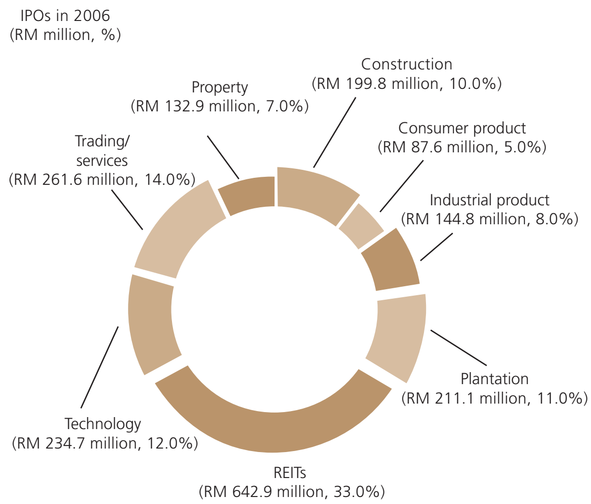
However, equity market sentiments turned more favourable towards the year-end. As a consequence, there were more listings in the Main, Second Board and the MESDAQ Market in the second half of the year. In the first five months of 2006, 18 companies sought listing on the stock market, but from June onwards, 23 companies listed on Bursa Malaysia. In terms of the amount raised, the Main Board remained the most significant avenue for listing on Bursa Malaysia. Significantly more funds were raised through the Main Board (73.8%), as compared to the Second Board (12.4%) and the MESDAQ Market (13.8%). Of significance is that despite the tighter

Chart 2.59
Number of Listings on Bursa Malaysia in 2006 - Breakdown by Boards



Source: Bursa Malaysia

Chart 2.60
Initial Public Offerings in 2006 - Breakdown by Sectors



listing requirements, the MESDAQ Market continued to register the highest number of listings among the three boards.

The sectors that received the most financing were the relatively new sector of Real Estate Investment Trusts (REITs), followed by the trading and services and technology sectors. In response to the Government's efforts to promote the development of REITs in the capital market through such incentives as the provision of favourable tax treatments, four new REITs were listed during the year. Funds raised by the REITs sector amounted to RM642.9 million and accounted for 33.6% of funds raised on Bursa Malaysia during the year (2005: 11.3%). The trading and services sector was the next largest issuer with a share of 13.7%, followed by the technology sector with 12.3%.

Financing to the Household Sector

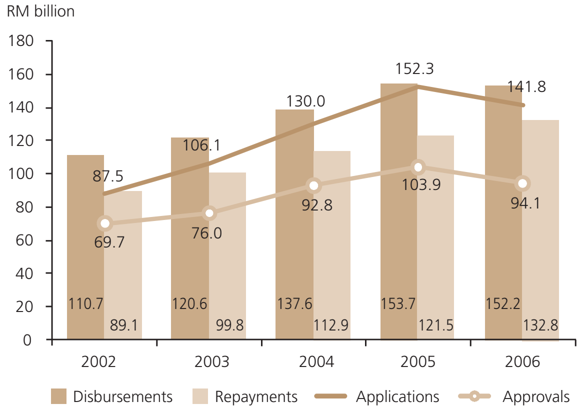
Demand for credit by the household sector mirrored the moderately slower growth in consumption expenditure. Loans outstanding of the household sector with the banking system, the primary source of household financing, increased at a more moderate rate of 9.4% in 2006 (2005: 15.1%). The slower pace of growth was primarily on account of lower financing channelled for the purchase of passenger cars, and to a lesser extent, for residential property. On balance, numerous factors, such as price adjustments and general uncertainty in the car market, influenced decisions regarding the purchasing of the bigger ticket items during the year.

Household financing increased at a more moderate pace mainly on account of lower passenger car loans

Loans outstanding for the purchase of passenger cars increased at a slower rate of 6.6%, broadly in line with the slowdown in demand for new cars. The ratio of loan approvals to applications remained relatively stable throughout the year, indicating that the moderating trends in the passenger car loan indicators were largely driven by demand and not supply factors. In the early part of 2006, car purchases were lower, as households adopted a "wait-and-see" stance with regard to the then yet to be released details of the National Automotive Policy (NAP). Subsequent to the announcement of the particulars of the NAP, demand moderated further, reflecting a confluence of factors. Households to a large degree held back on purchases on account of the lower trade-in values of used cars. This was particularly the case among the buyers replacing their existing cars, who account for a larger fraction of purchases in the car market. Some potential buyers also deferred their purchases on expectations of further price declines.

Loans outstanding for the purchase of residential property increased at a slightly more moderate pace of 8.5% (12.5% in 2005) with loan applications and disbursements lower by 1% and 3.6% respectively. Financing activity for residential property moderated as the pent-up demand for housing appears to have been satisfied over the past few years. In fact, some of the demand had probably been brought forward due to the incentives offered to encourage home ownership as well as the attractive financing packages available from the banks. In addition, households adopted a more cautious attitude during the year, particularly in terms of property

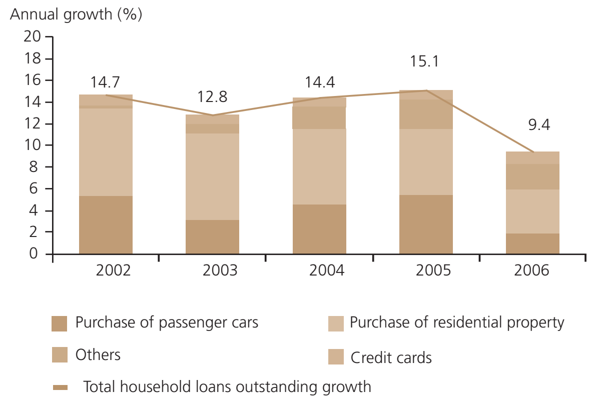
Chart 2.61
Household Sector Loan Indicators



purchases for investment. With overall moderation in demand and a situation of oversupply in some locations, certain households' decisions to defer purchases may have also reflected hopes of lower prices in the future.

Utilisation of credit cards increased during the year. Nevertheless, the repayment ratio[1] which indicates the average amount of debt that is paid in full, remained relatively stable at 60%, reflecting the continued use of credit cards as a means of payment rather than as a mode of obtaining credit. At the same time, the NPL ratio for outstanding credit card debt was lower at 3.7% (end 2005: 4.6%).

Chart 2.62
Banking System Loans Outstanding to Households: Total Growth and Contribution by Purpose



[1] Repayment ratio = [(Total spending + cash advance) - outstanding balance] / (Total spending + cash advance)]

Monetary Policy in 2006

OVERVIEW

Monetary policy in 2006 focused on attaining an appropriate balance between maintaining price stability and achieving the maximum sustainable level of economic growth. As with most countries in the global economy, inflation was one of the key macroeconomic issues in Malaysia during 2006. The robust performance of the global economy for a number of years has driven up demand for commodities and had contributed to significant upward pressures on the prices of resources worldwide. The intensification of cost pressures therefore warranted close vigilance against incipient signs of broader price increases. Although the upward price pressure had pushed inflation to levels not seen since the Asian Financial Crisis, the overall trend in inflation did not gain sufficient momentum to weaken the economy's medium term growth prospects or undermine price stability. The effects of supply-driven factors began to wane in the second half of the year, while core inflation remained relatively moderate. These developments mitigated the need for a strong response from monetary policy.

In the challenging environment of 2006, monetary policy sought to ensure that interest rates were at a level that would enable the central bank to respond to any risk of rising inflation, while at the same time remaining supportive of domestic demand

With the economy maintaining a steady growth path, the opportunity was taken to align monetary conditions to the environment of higher inflation. The Overnight Policy Rate (OPR) was raised twice, in February and April, by 25 basis points each time. The normalisation of interest rates placed the Bank in a better position to respond to any risks of rising inflation. Equally important was that interest rates remained supportive of growth whilst minimising the risks from a prolonged period of negative real interest rates.

THE POLICY ENVIRONMENT AND CHALLENGES

In fulfilling the monetary policy objective of preserving price stability and ensuring sustainable economic growth, monetary policy was confronted by a number of challenges during the year. After remaining low and stable for several years, price pressures emerged in the first half of the year amid rising energy and commodity prices in the global markets. The rise in inflation since May 2004 was particularly felt by the general populace and the economy, which had grown accustomed to a history of low inflation. Prior to the period of rising commodity prices, the rate of consumer price inflation had generally been on a declining trend from the levels seen in the aftermath of the Asian Financial Crisis of 1997-98 and the sharp depreciation of the ringgit. For the period end-1999 - July 2005, the inflation rate remained below the 1980 - 2005 average of 3.2%. Nevertheless, inflation began rising, with the gradual ascent punctuated by discrete jumps in the trend resulting from the removal of fuel subsidies and the upward adjustments to administered

Chart 3.1
Headline Inflation: 1980-2006

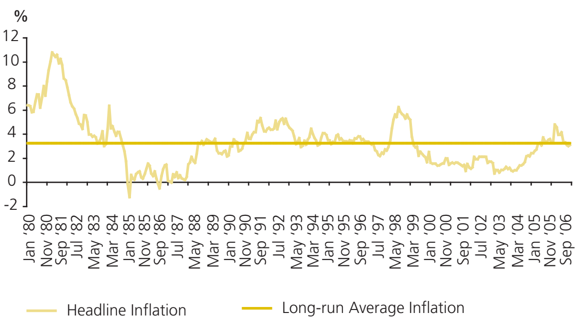
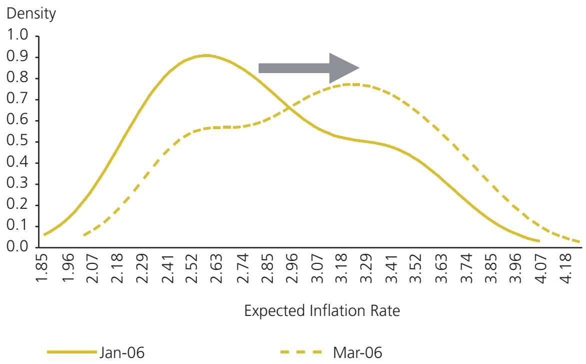


Chart 3.2
Market Inflation Forecast for 2006: Jan-06 vs Mar-06



Source: Consensus Economics

prices. With the building of momentum in commodity prices in the global markets at the beginning of the year, inflation was projected to be higher than Malaysia's long-term average.

The upward trend in inflation led to upward revisions of expectations of inflation in 2006. More specifically, following the fuel price revision in March 2006, financial markets adapted their expectations and revised upwards their inflation forecast for 2006. The concern was that such persistent expectations could create additional upward pressure on the prices of goods and services, and on wages.

A concomitant effect of the rise in inflation was the decline in real interest rates. Interest rates had been at historical lows since the Asian Financial Crisis of 1997-98. As domestic inflation began to rise, real interest rates declined and turned negative in the second quarter in 2005. Given that Malaysia is a high savings nation, a particular concern was the declining real rate of return on savings. A prolonged period of low and negative real interest rates could lead to distortions in the form and allocation of savings, as well as the use of capital.

The earlier accommodative monetary policy following the currency crisis in 1997-98 had contributed towards ensuring that domestic demand was on a sustainable growth path. Domestic growth prospects continued to be resilient throughout the year, underpinned by strong private consumption and investment. Uncertainties with respect to the growth outlook, however, began to emerge in the second half of the year. Although the indicators for domestic demand suggested continued resilience, there were indications that the external environment might become less favourable. Global and regional economic growth was expected to moderate in the second half of the year as the impact of rising interest rates abroad, particularly in the US, became more evident. Geopolitical risks and sustained high energy prices also increased uncertainties over the prospects for global economic growth. The risks of inflation therefore needed to be balanced against the risks of a more moderate economic outlook.

Chart 3.3
Interest Rate and Inflation

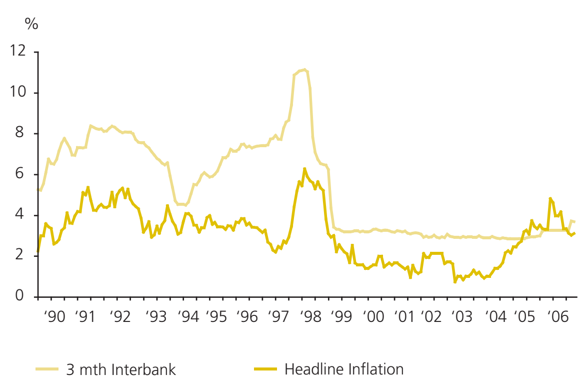
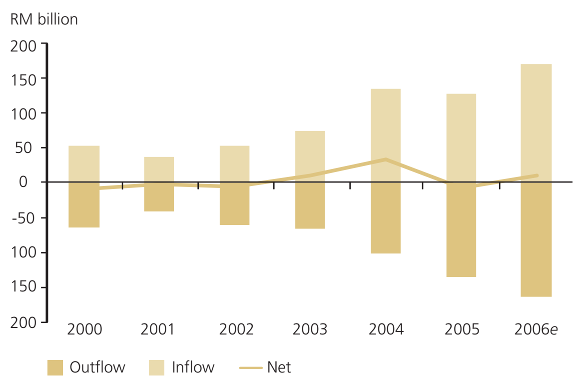


Chart 3.4
Portfolio Investment



Source: Cash BOP Reporting System, Bank Negara Malaysia

The increased volume of capital flows added another challenge to the policy environment. In line with the broad regional trend, private capital flows, particularly portfolio flows, were drawn to Malaysia by the favourable prospect for economic growth and expectations of currency appreciation. Although net portfolio flows in 2006 appeared modest compared to the high levels experienced in 2004, gross inflows and outflows of portfolio capital had risen significantly, and were considerably larger in relation to recent years.

MONETARY POLICY IN 2006

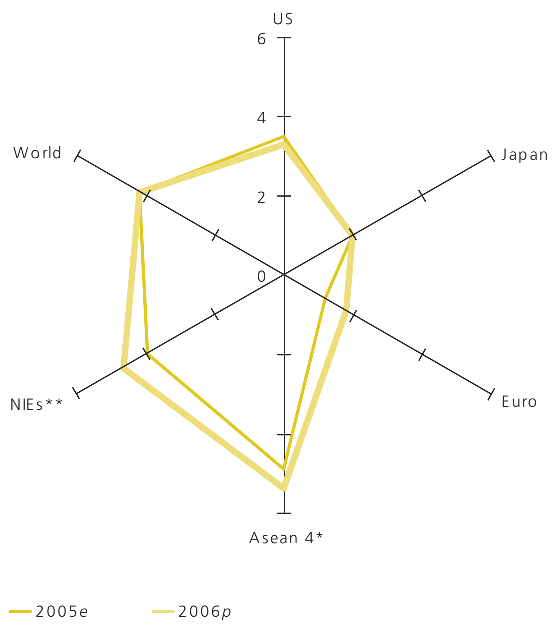
In the early part of the year, it was clear that sustained increases in energy and commodity prices in the global markets would exert upward pressures on prices. It was also clear that the higher cost of providing fuel subsidies would have an adverse effect on the Government's budgetary position. To ensure that resources were not diverted from the development needs of the country, the Government revised upwards domestic retail fuel prices in March 2006. Consequently, inflation rose markedly to 4.8% in March and was expected to remain at elevated levels for the rest of the year. What was not clear at that point in time was the extent of the second-round effects on inflation.

The OPR was raised to normalise monetary conditions to the prevailing environment of higher inflation

The rise in inflation prompted a normalisation of prevailing monetary conditions. While the OPR was raised by 30 basis points to 3% in November 2005, monetary conditions were not aligned to the elevated price conditions. The key consideration was whether the supply-driven price shocks would spur secondary rounds of price increases. The focus of monetary policy was not on responding to the initial supply-side shock, but rather on mitigating demand pressures and second-round effects to inflation. Based on the data that became available by the middle of the year, the assessment was that the impetus to inflation was mainly from the cost-driven factors and that there was little evidence of second-round effects. The pace of increase in core inflation was also relatively moderate. Furthermore, there were no signs of unusual wage pressures. Based on these trends, the forecast was that inflation would peak in the first half of the year and moderate thereafter.

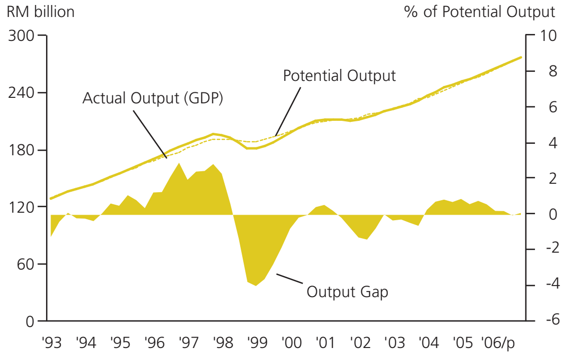
In terms of economic growth prospects, an assessment of coincident and forward looking indicators early in the year suggested that the economy was poised to sustain the economic growth momentum in 2006 on account of favourable external and domestic demand conditions. Firm economic growth in the US, supported by the recovery in Europe and Japan, were expected to spearhead an expansion in the major industrial countries and thus support the impetus for a continued uptrend in the global electronics cycle and commodity prices. Regional growth was also expected to remain strong as the region's electrical and electronics sector expanded

Chart 3.5
Outlook for Real GDP Growth as at end-2005 (annual percent change)



Source: IMF, WEO Sept 2005
* Indonesia, Malaysia, Philippines and Thailand
** Newly Industrialised Economies
e Estimate
p Projection

Chart 3.6
Actual and Potential Output as at early 2006*



* Estimate of potential output as at March 2006

in tandem with the global electronics up-cycle. Meanwhile, income growth was expected to support domestic demand through increased private consumption and investment.

Measures of potential output monitored by the Bank suggested that the Malaysian economy would grow close to its potential. Continued improvements in productivity and an expansion of the capital stock and the labour force were expected to further augment the productive capacity of the economy, thereby increasing the level of economic growth that could be sustained without generating price pressures.

In this environment, the Bank took the opportunity to normalise interest rates, which had been at historically low levels for an extended period of time. The normalisation of interest rates allowed monetary policy to be better placed to respond to risks of higher inflation. A prolonged period of negative real rates would also expose the economy to greater risks of distortions. The OPR was raised 25 basis points in February and again in April. Taking into account the increase by 30 basis points in November 2005, the OPR was increased by a cumulative 80 basis points to 3.5%, after remaining at 2.7% since the introduction of the New Interest Rate Framework in 2004[1].

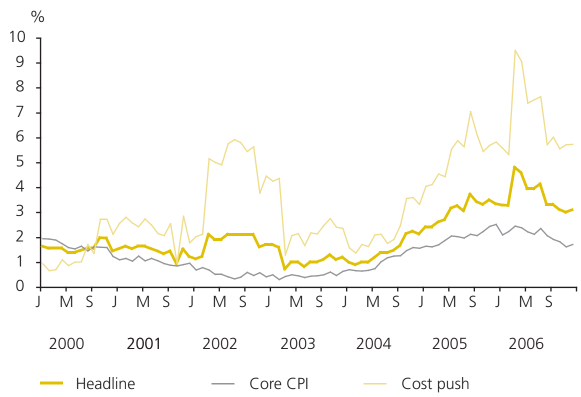
[1] Before the New Interest Rate Framework was introduced in April 2004, the benchmark policy rate was the Bank Negara Malaysia 3-month Intervention Rate. It was last adjusted in May 2003, when the Bank reduced the rate from 5% to 4.5%.

Table 3.1
Monetary Policy Decisions in 2006

MPS Release Date	Overnight Policy Rate (%)
20 January	3.00
22 February	3.25 ↑
26 April	3.50 ↑
22 May	3.50
28 July	3.50
25 August	3.50
26 September	3.50
24 November	3.50

Following these increases, the decision was made in May to leave rates unchanged. The overall assessment of the economic outlook was that the underlying trend had not changed. The Malaysian economy was expected to maintain its growth momentum on the basis of favourable domestic and external conditions. Strong private consumption and investment activity suggested that domestic demand would be sustained. Meanwhile, the continued growth in the US and China, the strengthening recovery in Japan and the Euro area, as well as the sustained momentum in global semiconductor sales indicated that external demand would remain strong. Although cost pressures remained, surveillance continued to indicate limited evidence of second-round price effects and

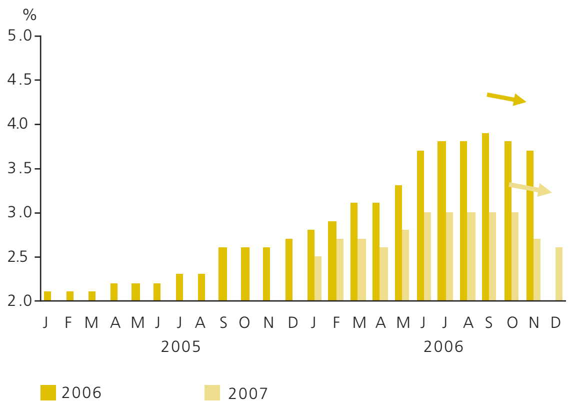
Chart 3.7
Headline, Core and Cost Push Inflation



demand-induced inflationary pressures. In line with the projections, headline inflation began moderating in May, while core inflation had stabilised. Given these trends, the OPR was kept unchanged at the May Monetary Policy Committee (MPC) meeting.

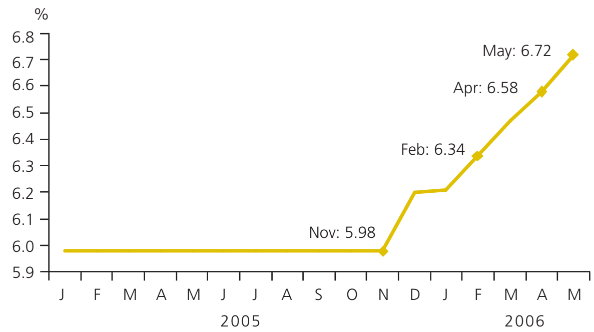
Headline inflation continued to moderate during the second half of the year following the lapse of the effects of price adjustments and in the absence of new price pressures. Weaker international oil and commodity prices and increased global competition, combined with a moderate environment of wage and price increases in the domestic economy, contributed towards sustaining the downward trend in inflation. Demand pressures also remained subdued as reflected in the moderation in core inflation. By the fourth quarter, financial market participants had revised downwards their forecasts for 2006 inflation in line with the outturn of lower inflation, while their average forecast for 2007 inflation was less than 3% as at December 2006. The lower inflation outcome was also the result of well-anchored inflation expectations that acknowledged the fact that the increase in inflation was transitory and was due mainly to supply factors. The track record of monetary policy response to address inflationary conditions has been a factor contributing to anchoring and stabilising expectations.

Chart 3.8
Average Market Forecasts for 2006 and 2007 Inflation



Source: Consensus Economics

Chart 3.9
Commercial Banks' BLR



Market adjustments to the OPR changes were efficient and predictable. This was a significant development given that the upward adjustments in the policy rate were the first since the introduction of the New Interest Rate Framework in 2004, whereby the setting of retail interest rates was deregulated. The adjustment in lending rates was generally more responsive relative to the adjustment in deposit rates. The slower response of the deposit rates was primarily due to the ample liquidity in the financial system. Despite the increase in the OPR, real deposit rates were negative due to the higher inflation. However, as inflation trended downwards in the later part of the year, real fixed deposit rates turned positive in October.

While lending rates adjusted upwards, the rates remained close to historical lows.

Chart 3.10
Commercial Banks' Fixed Deposit Rates

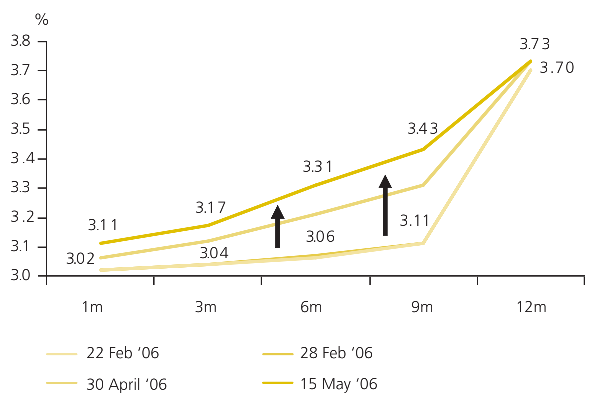
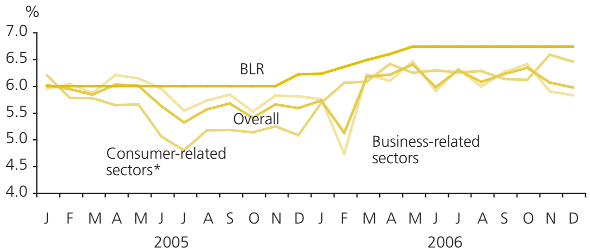
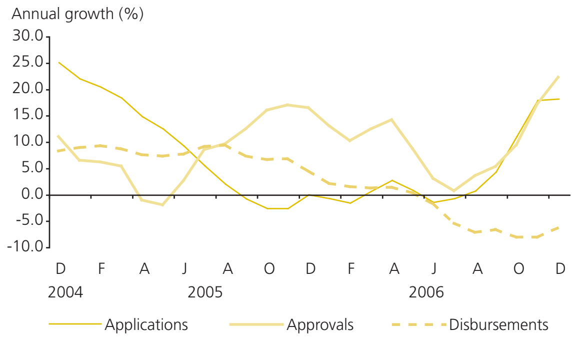


Chart 3.11
Weighted ALR on New Loans Approved by CBs



* Excludes loans for the purchase of residential properties and credit card

Chart 3.12
Trended Businesses Loan Indicators*



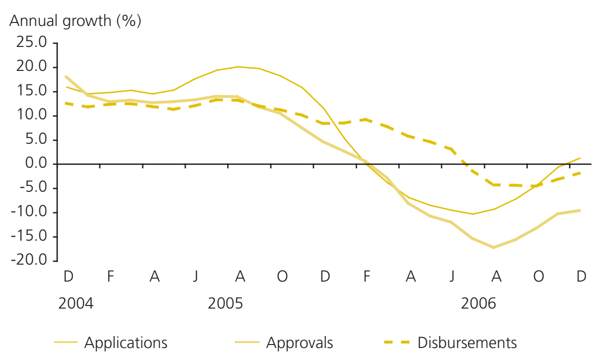
* Indicators are smoothened using a 6-month double centred moving average

Furthermore, despite the increase in the Base Lending Rate (BLR), the weighted average lending rates on new households and business loans continued to be below the average BLR of the banks. This reflected the continued competition in the loans market.

With the ample liquidity situation in an environment of low interest rates, domestic monetary and financial conditions remained supportive of the private sector. Alternative avenues and instruments for financing allowed for access to more diversified forms of financing. Increased competition amongst lenders also spurred banks to offer attractive financing options. The moderating trend in bank loans masked several key explanatory factors. First, business operations and investment activity were supported by greater reliance on financing from internal funds and the capital market. The reliance on internal funds to some extent accounted for the disconnect between the slower pace of growth in financing activity vis-à-vis the sustained growth in private investment activity. Second, household financing was gradually adjusting to more sustainable levels after increasing rapidly in recent years. Loans for the purchase of passenger cars, which were one of the main contributors to loan growth in 2004 and 2005, also moderated following general uncertainty in the car market. Third, despite the downward trend in credit growth, domestic demand remained resilient. Household consumption was supported by income growth and stable employment conditions. Meanwhile, investment by businesses remained strong, in part augmented by strong corporate cash flow and foreign direct investment (FDI). The subsequent upward trend in loan applications and approvals, especially to businesses, suggest some recovery in financing trends going forward.

In terms of the exchange rate, the ringgit has experienced greater two-way movement following the transition to a more flexible exchange rate regime. To date, the gradual strengthening of the ringgit exchange rate has been broadly in line with the currencies of Malaysia's major trading partners and is reflective of Malaysia's strong underlying macroeconomic fundamentals. After more than a year and a half, the economy has benefited

Chart 3.13
Trended Households Loan Indicators*



* Indicators are smoothened using a 6-month double centred moving average

from the more flexible exchange rate regime in a number of ways. In the face of structural changes in the regional and global environment, the two-way flexibility accorded by the exchange rate regime allows for greater policy flexibility to deal with potential external shocks. Early evidence suggests that the gradual appreciation of the real exchange rate has been another factor that has encouraged those in the tradable sector to undertake further adjustments to improve their efficiency and productivity. Such structural adjustments have moved Malaysia up the production value chain and thus improved the overall competitive position of the economy. Finally, the stronger currency had contributed to alleviate some of the price pressures emanating from imported inflation.

Nevertheless, as with any small open economy with liberal exchange control policies, global developments and capital flows can be a challenge for the management of the exchange rate. In Malaysia's case, the healthy two-way flow of capital enabled orderly foreign exchange market conditions throughout 2006. The upward pressure on the ringgit arising from inflows due to international trade, FDI and portfolio investment was counterbalanced by outflows arising from external debt repayments and prepayments, the large repatriation of profit and dividends by non-resident corporations, as well as overseas investments by residents. On the latter factor, there were increased investments overseas, as resident companies took advantage of their improved financial strength to venture into strategic investments abroad. The sum of outflows accounted for by the repatriation of profits and dividends and overseas investments amounted to RM29 billion or 5.3% of GDP in 2006.

With countries attaining a higher degree of economic and financial openness amid the growing sophistication of financial instruments and markets, developments in the global markets are having an increasingly more significant effect on domestic monetary and financial conditions. As the economy and the financial system become more integrated with the global system, the magnitude, channels and speed of risk transmission across countries are also becoming more challenging. This has prompted closer regional cooperation between central banks to pool their resources to enhance the surveillance networks and promote regional monetary and financial stability. The following box article highlights several ongoing initiatives that are being earnestly pursued by regional central banks, including Bank Negara Malaysia.

Selected Ongoing Central Bank Initiatives for Promoting Regional Cooperation

The EMEAP Task Force Initiative

- During the year, a significant development in regional cooperation was the establishment of the Task Force on Regional Financial Cooperation in Asia in February 2006. It represented the intensification of efforts to foster deeper financial cooperation among the regional central banks with the overriding objective of promoting macroeconomic and financial stability in the region and thus achieving mutually reinforcing regional growth and stability. The initiative focuses on the six mandates of cooperation: regional macro-monitoring and risk management; crisis management and resolution; financial market and infrastructure development and integration; capacity building; sharing of information, expertise and experience; and in communications.

Chiang Mai Initiative

- Significant effort has been devoted into regional crisis management and resolution, in particular the development and further enhancement of the regional self-help and support arrangement. The Chiang Mai Initiative (CMI) marks a particularly important step towards promoting such a regional self-help and support arrangement among the ASEAN+3 countries[1] with the objective of ensuring regional monetary and financial stability.

- The CMI was launched on 6 May 2000 by the ASEAN+3 Finance Ministers to supplement existing international financial facilities, and hence, make available, in a timely manner, financial resources to member countries facing temporary balance of payments and short-term liquidity needs. The CMI has two components, namely the ASEAN Swap Arrangement (ASA) and a network of bilateral swap arrangements (BSAs).

- To further strengthen the regional self-help financial support, the ASEAN+3 countries have agreed to work towards an advanced framework of regional liquidity support arrangement and as such achieve the long-term goal of multilateralising the CMI. In this regard, a task force was set up to study the possible options and progressive steps in multilateralising the CMI. The proposed framework is aimed at promoting a more effective and efficient pooling and utilisation of liquidity support among member countries.

- Under the CMI, Malaysia has entered into three BSA agreements, namely with Japan, Korea and PR China. The total amount of Malaysia's BSAs stands at USD4 billion. Collectively, as at end-2006, the BSA network, which comprised 16 agreements among eight ASEAN+3 countries, totalled USD77 billion, compared to USD58.5 billion at end-2005.

- Recent developments have also highlighted the need to enhance collaboration in the areas of macroeconomic and financial surveillance to provide early detection of risks within the region. As such, the region has embarked on a series of efforts to promote greater surveillance, particularly in complementing the BSAs under the CMI. In May 2006, the ASEAN+3 Finance Ministers agreed on measures to further strengthen regional surveillance capacity to assist the policy dialogue under the ASEAN+3 Economic Review and Policy Dialogue (ERPD) process. The ASEAN+3 Finance Ministers agreed to establish the Group of Experts (GoE). The GoE, which is made up of several regional professional experts, would serve as an independent economic assessment vehicle for this region. The experts are expected to identify and undertake in-depth studies on economic and financial vulnerabilities and concerns within the region, especially in the areas of macroeconomic policy, fiscal policy, external sector (trade and international finance), and monetary policy.

- In addition, the ASEAN+3 Finance Ministers also agreed to establish the Technical Working Group on Economic and Financial Monitoring (ETWG) to assist in further strengthening the surveillance process in the region. The ETWG would play an important role in developing the Early Warning System to facilitate early detection of emerging risks in the system. The ETWG is also expected to assist in enhancing and strengthening member countries' capacity building and surveillance capability.

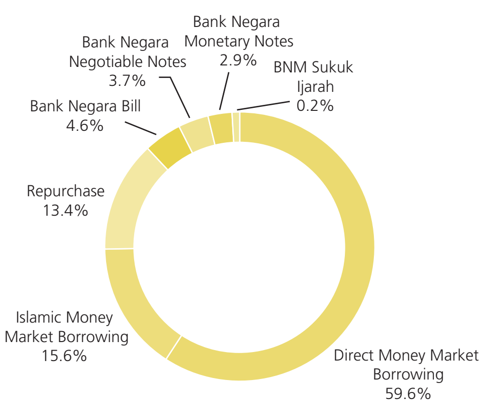
[1] ASEAN countries comprise Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Cambodia, Lao PDR, Myanmar and Vietnam. '+3' countries comprise Japan, Korea and PR China.

MONETARY OPERATIONS IN 2006

Monetary policy implementation throughout 2006 was focused on managing the liquidity situation in implementing the monetary policy decisions and maintaining orderly conditions in the money and foreign exchange markets. Policy operations were centred on managing the excess liquidity in the interbank system arising primarily from large inflows due to international trade and inward portfolio investments. Aggregate liquidity during the year increased, with the total amount of surplus liquidity sterilised by the Bank's various market-based monetary policy instruments increasing from RM163.7 billion on 31 December 2005 to RM207.5 billion as at 31 December 2006. Most of this surplus liquidity was sterilised through the conventional money market, which accounted for 79.6% of the total operations, with the remainder being accounted for by monetary operations in the Islamic money market.

Direct borrowing remains as the principal monetary policy instrument, accounting for 74.4% of the surplus liquidity sterilised. This type of borrowing is a highly flexible monetary policy instrument as new borrowings may be conducted with a short turnaround time via competitive multiple-price auctions through the Fully Automated System for Tendering platform (FAST). The maturity of these borrowings ranges from overnight to up to 6 months, with average maturities of total borrowings remaining short, ranging between 20 to 30 days. In the Islamic interbank money market, placements under the Al-Wadiah Yad-Dhamanah (custody and safekeeping) principle are generally undertaken with the same level of flexibility. The Bank also increased its use of repurchase transactions (repos) as a means to sterilise excess liquidity. The greater use of repos was made possible by the availability of collateral securities, primarily Malaysian Government Securities (MGS), from major institutional investors through the lending of securities via the Bank's Institutional Securities Custodian Program (ISCAP).

Chart 3.14
Monetary Instruments (As at end-2006)



A major development in the Islamic money market operations was the inaugural issuance of the Bank Negara Malaysia Sukuk Ijarah on 16 February 2006 with an issue size of RM400 million. This instrument is effectively a claim on a stream of lease payments from a sale and leaseback arrangement. A special purpose vehicle, the Bank Negara Malaysia Sukuk Berhad has been established to issue the Sukuk Ijarah. Proceeds from the issuance were used to purchase a pool of identified assets of the Bank, which were subsequently leased to the Bank and the rental payments are distributed to investors as a return on a semi-annual basis. Upon maturity of the Sukuk Ijarah, which coincides with the maturity of the lease tenure, Bank Negara Malaysia Sukuk Berhad would sell the assets back to Bank Negara Malaysia at a predetermined price. The Sukuk Ijarah adds to the diversity of money market instruments in Malaysia and contributes to the long-term development of a vibrant and comprehensive Islamic sukuk market in Malaysia.

A key enhancement to the breadth of the Bank's monetary policy instruments is the introduction of Bank Negara Monetary Notes (BNMNs). Pursuant to amendments to the Central Bank of Malaysia Act 1958, effective 19 October 2006, the Bank is able to issue this new instrument to manage liquidity in both the conventional and Islamic financial market. BNMNs are subject to a flexible limit expressed in terms of the prevailing level of international reserves held by the Bank and may be issued in either coupon-bearing or discount-to-face-value format with tenures of up to 3 years. Conventional Monetary Notes may also be issued by re-opening existing issues, and increasing the size of the re-opened issue. The first issuance of BNMNs was conducted in December 2006 with a total issue amount of RM1 billion. A total of RM6 billion of BNMNs were issued in 2006 on a discount-to-face-value format, all of which have a maturity of less than one year. Going forward, the BNMNs are likely to have a greater role as a monetary policy instrument given their flexibility, depth of the secondary market, and the larger issuance threshold accorded to the Bank by the amendments to the Act.

COMMUNICATING MONETARY POLICY

In 2006, the Bank undertook several initiatives to enhance the communication of monetary policy decisions and the transparency of the monetary policy decision-making process. The schedule of MPC meetings for the year has been announced to the public and released in advance since 2005. The schedule of MPC meetings for 2007 was released in November 2006. In addition, since April 2006, the Monetary Policy Statement (MPS) is released on the same day as the MPC meeting. The advanced release of the MPC meeting schedule, coupled with the timely release of the MPS, have contributed towards reducing uncertainty among market participants regarding the timing of monetary policy decisions and announcements. The more frequent issuance of the MPS has also enhanced market understanding of the issues and thus has been important in the formation of market and public expectations. Importantly, the content of the MPS serves to signal the MPC's assessment of the balance of risks to price stability and economic growth. Through the use of speeches, interviews and other communication channels, senior officials of the Bank have sought to expand and reiterate the MPC's views, which have enabled market participants to deepen their understanding of the considerations that affect decisions on the stance of monetary policy.

Outlook and Policy

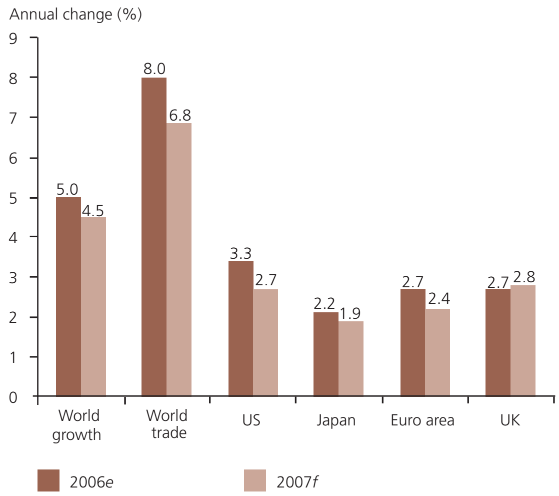
THE INTERNATIONAL ECONOMIC OUTLOOK

The outlook for global performance remains fairly optimistic. Global growth in 2007 is forecast to be sustained at above 4% for the fifth consecutive year. A growth of 4.5% is anticipated in 2007 (5.0% in 2006), with further easing of inflationary pressures and with some moderation in growth of world trade. The adjustment in the US housing market is expected to gradually have a broader impact on consumption. Recovery in Japan would continue, albeit at a more measured pace, while prospects for the euro area now look brighter following signs of a broad-based recovery in the major member countries. Notwithstanding the more moderate pace of expansion in external demand, growth in the Asian region is expected to remain encouraging, supported increasingly by domestic demand, particularly in PR China and India.

Global growth in 2007 is to be sustained at above 4% for the fifth consecutive year. While a moderation in growth is forecast for the US, the recovery in Europe and Japan is expected to be sustained. Growth in the Asian region will be supported by domestic demand. Strong capital flows to the region would continue to pose a challenge to monetary management

In the **US**, the prospect for further housing market weakness lingers as the ratio of residential property investment to GDP remains above its historical average while oversupply persists as evident from the high housing inventories and homeowner vacancy rates. There may be some spillover effects into consumption activity and other sectors of the economy in the early part of the year. Import demand may also be more broadly affected,

Chart 4.1
World Growth, World Trade and Growth in Major Industrial Countries (2006-2007)



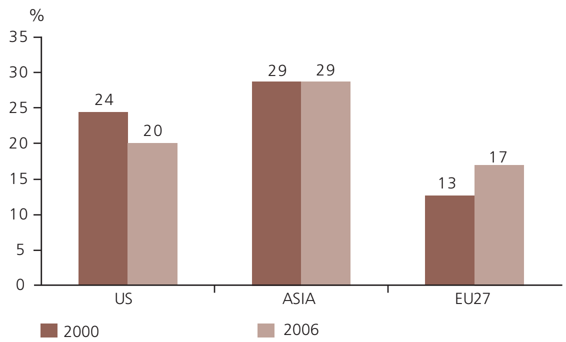
e Estimate
f Forecast

Source: International Monetary Fund and Bank Negara Malaysia

given the moderating domestic demand. This anticipated outcome would contribute to a further improvement in the US external imbalance, which has been a major area of concern associated with the adjustment of global imbalances.

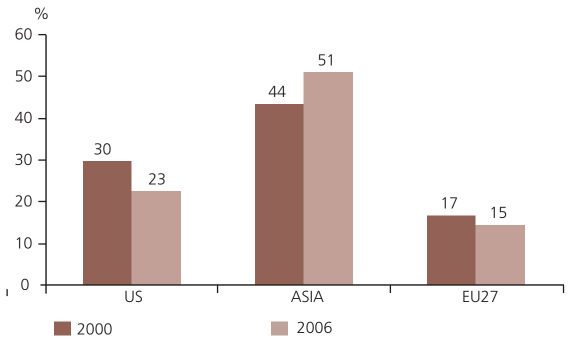
The impact of the moderation of growth in the US on global economic momentum in 2007 depends significantly on the sustainability of the recovery in Europe and Japan and the strength of domestic sources of growth in the rest of Asia. However, while these economies have relied on external demand to support growth and recovery, the share of European and Japanese exports to the US has declined noticeably (EU-15: 24% in 2000 to 20% of total exports in 2006; Japan: 30% in 2000 to 23% of total exports in 2006). With respect to domestic demand, the **euro area** economy appears to be better positioned to sustain its expansion. Labour market conditions are expected to continue improving in line with stronger economic activity and higher wage settlements supporting consumer spending. Germany's recovery is also seen to be contributing

Chart 4.2a
Export Shares of EU15 by Destination



Source: World Trade Atlas

Chart 4.2b
Export Shares of Japan by Destination



Source: World Trade Atlas

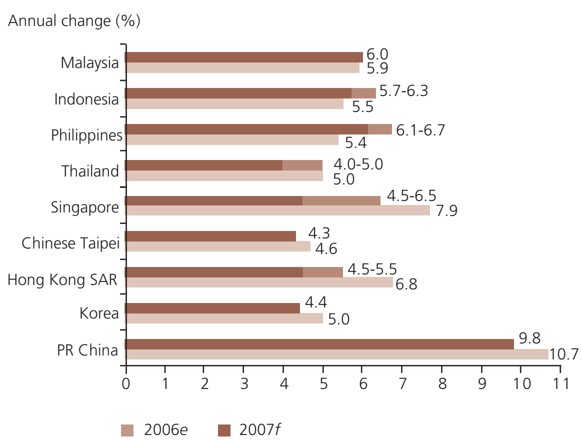
to global demand, as reflected in the trend of a stronger rise of German imports from economies outside the euro area.

In **Japan**, however, concerns persist on the prospects for a stronger recovery in private consumption. Enhanced consumption activity needs to be supported by a sustained uptrend in wage and income growth. Nonetheless, the strength in investment spending is expected to prevail as Japanese corporations are well-positioned to benefit from the continued expansion of global and regional demand.

With an anticipated moderate softening in external demand, especially in the first half of 2007, regional economies are projected to expand at a slightly less rapid pace in 2007. Domestic demand is expected to play a central role in cushioning the impact of the moderation in external demand. In addition, flexibility in monetary and fiscal policy following the easing of inflationary pressures and improving fiscal positions of regional economies, would provide further support to growth in domestic demand. This development is evident given the more accommodative monetary policy stance in Indonesia, Thailand and the Philippines. Higher consumption activity is also increasingly supported by rising income levels amid improving labour market conditions as seen in the lower levels of unemployment and rising real wages. Recent developments suggest a revival in investment trends. Several large infrastructure projects have been announced or have commenced operations. Such projects include the relocation of the administrative centre and the expansion of public housing supply in Korea, the building of the integrated resorts in Singapore, and public infrastructure projects in Thailand and the Philippines.

Trends also suggest that the global semiconductor industry, a key export sector of the region, is poised to record another favourable year with forecast growth of 9.5 - 10%. Demand for electronic products with advanced features has driven technology

Chart 4.3
Regional Countries: Real GDP Growth



e Estimate
f Forecast
Source: National authorities

enhancement in the semiconductor industry, leading to the production of high-performance microprocessors, graphics processors and memory chips. The new Microsoft operating system, Vista, is expected to lend support to sales in the PC segment in the second half of 2007 as demand increases. Meanwhile, in the broad commodity markets, despite some recent corrections, indications are that demand and prices would be generally sustained at elevated levels.

In **PR China**, rebalancing growth away from investment and export-related activities towards private consumption remains a key focus for policy makers. GDP growth in PR China is expected to ease moderately in 2007 due to slower exports and policy measures undertaken to restrain over-investment and promote economic rebalancing. Ongoing infrastructure projects related to rural development and several significant events like the Olympics 2008, Shanghai World Expo and Guangzhou Asian Games 2010 would continue to support strong investment growth.

Global inflation has started to stabilise amid easing oil prices. However, underlying demand conditions for commodities remain firm, especially in fast-growing regions, which suggests that prices would remain supported in the longer term. Going forward, while easing oil prices and slowing global growth may generally prompt some degree of monetary easing, monetary policy responses are expected to vary based on country-specific circumstances and conditions.

Global financial markets have grown significantly, driven by expanding capital flows and growth of new financial intermediaries. These developments have increased volatility and potential mis-pricing of risks across a number of asset classes and markets. Persistently strong capital inflows have also prompted policy responses by selected monetary authorities in the region. The large increase in carry trades and derivative trades and increased integration of global financial markets have raised the risks of sudden and large adjustments in financial markets and asset prices. Markets remain vulnerable to a sharp correction that could be triggered by a significant change in expectations. The recent developments at the end of February and early March in the global, regional and domestic equity markets reflect the potential for contagion. Nonetheless, the capacity to absorb the volatility from time to time would depend on the resilience and fundamentals of the underlying economies.

While global growth is expected to remain favourable in 2007, several key risks could affect this outlook. One risk is a sharper-than-expected US moderation. Although oil prices have declined from their recent peaks, geo-political developments could suddenly reverse this trend with implications for slower global growth and renewed inflationary pressures. Furthermore, while recent developments suggest that the US current account deficit is improving, the risk of a disorderly adjustment still remains. In addition, events that prompt the unwinding of carry trades could also contribute to destabilising developments in the international financial system.

MALAYSIAN ECONOMY IN 2007

Supported by sustained global growth and resilient domestic demand, the Malaysian economy is expected to register solid growth in 2007, with real GDP expanding by 6%. This pace is consistent with the expansion in productive capacity following the strengthening of the recovery in capital formation.

In 2007, investment, particularly private investment, is expected to play a major role in sustaining growth as strong domestic and external demand, coupled with high levels of capacity utilisation, induced firms to expand capacity. In addition, investment activity by the public sector is also expected to expand substantially with the commencement of work on infrastructure and other projects under the Ninth Malaysia Plan (9MP). Firm-level investment is also expected to benefit from the reduction in the corporate tax rate that was announced in the 2007 Budget, while ample liquidity in the financial system will ensure funding would be adequate.

Real GDP to expand by 6% in 2007, supported by sustained global growth and resilient domestic demand

The year will also see broad-based growth as the mining and construction sectors, which had contracted in 2006, are expected to register positive growth. The construction sector, in particular, will benefit from higher public expenditure as well as strong demand in the non-residential properties segment. In the mining sector, growth would be driven by a recovery in natural gas output after major upgrading work on the MLNG2 plant is completed. In addition, the Kikeh oil field in Sabah, which was discovered in 2004, is expected to start production in the fourth quarter of the year.

The growth momentum during the year will be influenced by both external and domestic factors. The global economy is expected to expand more moderately in the first half of the year, mirroring the slower growth expected in the US during this period. In addition, the global electronics industry is expected to see demand remain stable in the first half of the year before new products boost demand in the second-half year. On the domestic front, a number of major developments are expected to impact growth, mainly towards the latter part of the year. These include the more rapid implementation of public projects, the start of production at the Kikeh oil field and the significant increase in tourist arrivals for the Visit Malaysia Year 2007 during the peak summer travel season. Reflecting these factors, the Malaysian economy is expected to enjoy stronger growth in the second half-year.

Inflation is expected to remain benign during the year. After having increased in 2006 following the partial reduction of fuel and other subsidies, inflation is expected to trend downwards during the year. Price pressures from demand conditions are expected to remain subdued, given that the economy would be on a balanced growth path during the year. In addition, lower oil and energy prices would mitigate imported inflation. As a result of these factors, the average inflation rate for 2007 is expected to be in the range of 2 - 2.5%.

The current account is forecasted to record a surplus, driven by the trade surplus and improved services receipts arising from the tourism sector. Inflows of foreign direct investment are expected to remain substantial. Balancing these inflows, however, would be the strong outflows that are characteristic of a highly open economy. The nation's external indebtedness is expected to decline as the public sector will continue to register net repayment of its external obligations. Similarly, the strong performance of the trade, oil and gas and financial sectors would see significant repatriation of profits and dividends by foreign direct investors back to their home offices. In addition, Malaysian investors and firms are expected to intensify the diversification of their portfolios by investing abroad. These healthy two-way flows will combine to improve Malaysia's fundamentals while enhancing the economic integration with the regional and global economies.

Domestic Demand Conditions

Aggregate domestic demand is projected to remain resilient, with a growth rate of 7.4% in 2007. The private sector will remain as the main driver. However, the public sector is expected to play a more significant role as public investment projects under the 9MP are implemented.

Private investment, in particular, will be a major driver of growth and is expected to increase by 10.4%, due mainly to higher capital spending in the manufacturing, services and oil and gas sectors. The reduction of corporate income tax to 27% announced in the 2007 Budget would also stimulate private capital spending. Capital spending in the manufacturing sector would largely be driven by efforts to improve efficiency and expand capacity, especially in higher value-added projects that employ higher levels of technology and a more knowledge-based workforce. In the services sector, sustained high capital expenditure is expected in the utilities, telecommunications, and transportation sub-sectors. The expenditure would

Table 4.1
Real GDP by Expenditure (1987=100)

	2006*p*	2007*f*	2006*p*	2007*f*
	Annual change (%)		Contribution to real GDP growth (percentage point)	
Domestic demand [1]	**7.4**	**7.4**	**6.8**	**6.8**
Private sector expenditure	7.6	7.2	4.7	4.5
Consumption	*7.0*	*6.4*	*3.5*	*3.3*
Investment	*9.7*	*10.4*	*1.2*	*1.3*
Public sector expenditure	7.2	7.7	2.1	2.3
Consumption	*7.9*	*4.1*	*1.2*	*0.6*
Investment	*6.5*	*11.4*	*1.0*	*1.7*
Change in stocks			**-0.5**	**-0.1**
Net exports of goods and services	**-5.0**	**-9.6**	**-0.4**	**-0.8**
Exports	6.3	6.3	7.7	7.6
Imports	7.2	7.4	8.1	8.4
Real Gross Domestic Product	**5.9**	**6.0**	**5.9**	**6.0**

Note: Figures may not necessarily add up due to rounding
[1] Excluding stocks
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

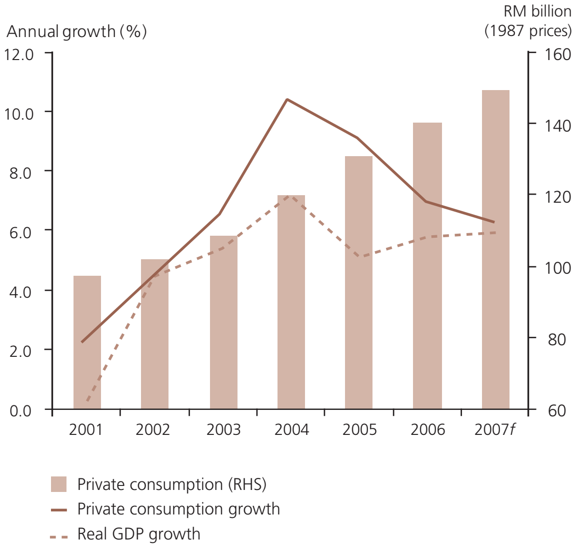
be for the development of power plants and water-related improvement projects, enhancement of network quality and providing additional broadband facilities. In the transportation sector, shipping and air services providers are expected to spend on fleet expansion. Meanwhile, higher capital spending is expected in the oil and gas sectors with the discovery of new oil and gas fields in recent years as well as continued exploration and survey activities in the deepwater areas.

Cognisant of the important role played by the public sector in encouraging investment by the private sector, the Government has introduced a number of investment initiatives to enhance the public service delivery system to attract both foreign and local investors. In particular, the introduction of the Private Financing Initiatives (PFIs), where the Government identifies projects for completion but the private sector would source the funds and implement them, would see greater private participation in public sector projects. A PFI Facilitation Fund of RM5 billion has been established to support 9MP projects being undertaken by the private sector. Projects implemented through this mechanism include the construction of government schools, quarters and office buildings. The implementation of the 9MP projects is also expected to boost capital expenditure in the construction sector. As a result of these new projects and the on-going road projects started in 2006; construction activity is expected to expand significantly in the second half of 2007.

The public sector's contribution to growth is expected to increase further in 2007 due mainly to higher public investment. **Public investment** is forecasted to grow significantly by 11.4%, driven by the higher development expenditure of the Federal Government on the 9MP projects. The Federal Government's allocation for development expenditure in the economic services sector is mainly for improving the agriculture sector, providing support for industrial growth and infrastructure development. In the social services sector, the bulk of expenditure is for the provision of essential services such as education and health and the development of housing projects. To promote more equitable development between regions, emphasis will be given to investment projects in the Northern Economic Corridor, East Coast Corridor and Southern Johor Economic Region.

In addition to investment undertaken directly by the Federal Government, public investment would gain further support from the strong planned capital outlays by the non-financial public enterprises (NFPEs). Tenaga Nasional Berhad is expected to continue investing in its electricity transmission and distribution infrastructure, as well as expanding its power generation capacity. Similarly, Telekom Malaysia Berhad will be upgrading the communications infrastructure. In the oil and gas sector, a large part of PETRONAS' capital spending will be in the upstream oil and gas segment, in collaboration with companies with whom it has entered into production sharing contracts.

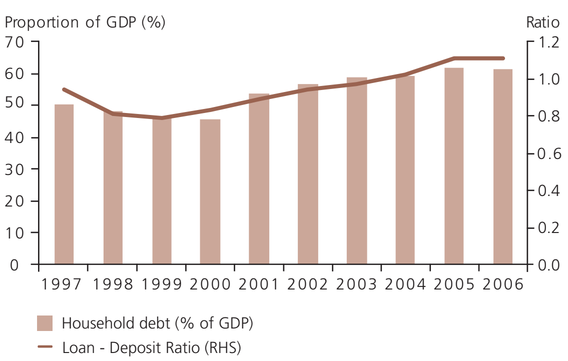
Chart 4.4
Real GDP and Private Consumption



f Forecast

Private consumption is expected to remain resilient, increasing by 6.4% in 2007. As a result of sustained growth in recent years, which has increased job creation, households are expected to enjoy income growth and better employment prospects. In addition, high commodity prices have significantly boosted rural incomes and spending. These same trends are expected to be sustained in 2007. Apart from sustained income growth, other factors that will provide support for sustained household consumption include the lower inflation rate, a conducive financing environment of low and stable interest rates, and the high rate of savings. In particular, the households' balance sheet remains relatively strong, as shown by the stable debt levels and the decreasing debt-service burden. As a result, consumption growth can be expected to remain robust, exceeding overall GDP growth for the eighth consecutive year.

Chart 4.5
Household Debt Indicators



The sustained improvement in the demand for labour would ensure that the economy operates near full employment, with the **unemployment rate** remaining at 3.5%. As a result, wages are expected to rise in 2007. The latest Malaysian Employers Federation Survey indicated that on average, salaries are expected to increase by 5.5% for executives and 5.4% for non-executives. Nevertheless, the increase in average salaries for executives in industries that are dependent on higher skilled workers such as insurance, banking and investment; business services and consultancy; education; F&B and chemical-related industries; and ICT, media and advertising, are likely to be higher than the industry average of 5.5%. For these industries, employers are expected to offer salary increments of up to 6.8%. Meanwhile, improvements in productivity, which have been significant in recent years, are expected to be even stronger as more companies implement performance- and productivity-linked wages and increase mechanization and automation to achieve higher efficiency. On the other hand, **public consumption** is expected to increase more moderately by 4.1% in 2007, particularly for expenditure on supplies and services. The increase is due, in part, to the Government's emphasis on improving the delivery system to support private sector activity.

Sectoral Outlook

On the production side, growth is expected to be broad based, reflecting expansion in all economic sectors. The services and manufacturing sectors would continue to drive growth, expanding at higher rate than overall GDP growth. The manufacturing sector would be led by resource-based industries and further supported by the electronics and electrical sector. The positive effects of the Visit Malaysia Year 2007 (VMY 2007) tourist promotion campaign and the increasing contribution from new activities are expected to benefit the services sector. Meanwhile, the agriculture sector is expected to continue to expand, reflecting increases in output of all major crops, albeit at a more moderate pace. The mining and construction sectors are expected to turn around and register positive growth, with the former supported by new capacity coming on-stream, while the latter would be underpinned by the positive effects from the implementation of development projects under the Ninth Malaysia Plan (9MP).

Growth in the **manufacturing sector** is expected to be sustained at 6.6% (2006: 7%). While the electronics and electrical (E&E) sector may experience some moderation in the first half of 2007 due to the expected moderation in the US economy, the growth would be supported by other industries. In particular, resource-based industries and industries related to the construction sector are expected to lend support during the year, led mainly by sustained regional demand and more broad-based domestic activities.

In the E&E sector, towards the closing months of 2006, there were some signs of softening demand for computers and related parts from the US market. As the US is a major export destination for Malaysian E&E products, the current moderation is expected to have some impact on Malaysian exports. Furthermore, there are also indications of a mild build-up in inventories of selected products, such as the 3G wireless handsets and high-end computers.

In view of the above, the assessment is that the Malaysian E&E sector is expected to record a moderately slower growth in the first half of 2007, in line with trends in the US economy, and to pick up strongly in the second half-year, supported by the growing global demand for the new operating system, Windows Vista. Since only a small percentage of existing global computers can support the new system (estimated 15%), most users will either have to upgrade the hardware on their existing computers or purchase new computers. The increased take-up of the new operating system is expected to fuel demand for computers and related semiconductor parts such as memory products and hard disk drives. The E&E sector is also expected to continue to benefit from other product segments due to the current global electronics up-cycle, which is expected to continue into 2008.

Firm demand for selected resource-based industries such as chemicals, rubber products and petroleum products should provide support for the manufacturing sector during the year. The chemical industry is expected to see an improved performance due to impetus from the new biodiesel plants that would come on-stream during the year. The growth in the rubber products industry is also expected to remain strong, supported by continued demand for rubber gloves and the transition of the tyre industry into higher value-added products amidst the more stable input prices. Output of petroleum products is expected to be driven by higher demand, while construction-related industries would be supported by the implementation of 9MP projects.

The **services sector** is expected to remain the key driver of growth, contributing 3.7 percentage points to overall GDP growth. The growth would be led mainly by intermediate services, while the final services segment is projected to expand at a moderate pace, in tandem with private consumption activity during the year. In the intermediate services segment, the finance, insurance, real estate and business services sub-

Table 4.2
Real GDP by Sector (1987=100)

	2006*p*	2007*f*
	Annual change (%)	
Agriculture	6.4	3.2
Mining	-0.2	2.8
Manufacturing	7.0	6.6
Construction	-0.5	3.0
Services	6.5	6.3
Real GDP	**5.9**	**6.0**

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia
Bank Negara Malaysia

sector will play a dominant role in generating growth, driven mainly by new areas of growth. Of significance, the entry of new players in Islamic finance and the newly-formed investment banks are expected to generate increased activity with the launching of new innovative products and services to attract a wider range of customers, including foreign clients. During the year, the initiative to promote Malaysia as an International Islamic Financial Centre is also expected to gain momentum.

The business services segment is expected to benefit from increased activity as new IT, and shared services and outsourcing companies, that have been granted Multimedia Super Corridor (MSC) status in 2006, begin operations. Consonant with the strategy outlined in the Malaysian Information, Communications and Multimedia Services 886 Strategy (MyICMS 886), the IT industry is expected to undertake high value-added content development over the next few years to ensure an adequate supply of product offerings for education, entertainment, games and e-services. In addition, demand for selected professional and skilled services such as draughting, surveying, architectural and engineering services are also expected to increase due to the pick-up in construction activity and the significant investments in the oil and gas sector.

Similarly, the transport, storage and communication sub-sector is expected to record stronger growth. In particular, growth in the telecommunications industry would be especially significant, driven by increased affordability and the availability of multimedia cellular phones with advanced features amidst the greater coverage of the high-speed data network. Meanwhile, the transport segment is expected to benefit from increased tourist arrivals during the VMY 2007, as well as the capacity expansion and promotional efforts by the domestic airline companies.

The final services segment is expected to expand at a moderate pace in line with the private consumption activity during the year. Part of the impact would be muted by higher tourism related activity as 240 events and activities have been lined up in conjunction with the VMY 2007. In addition, the spillover effects from the implementation of the 9MP projects are expected to translate into higher activity in the services sector.

The **agriculture sector** is expected to expand by 3.2%, reflecting increases in output of all major crops. While output growth in the first half-year, especially of crude palm oil and crops dependent heavily on irrigation, is expected to see some moderation due to the exceptional dry conditions brought by the *El Nino* weather phenomenon, the impact is likely to be temporary. The agriculture sector would see a stronger growth in the second half-year. Output of rubber is expected to expand further by 3.2% to 1.30 million tonnes in 2007, encouraged by the favourable prices. Improved breeding techniques and firm domestic demand are also expected to result in higher output of livestock during the year.

The **mining sector** is expected to expand by 2.8%, supported by higher output of crude oil and natural gas. Crude oil production (including condensates) is expected to average 722,500 barrels per day (bpd), supported by the commencement of operations at the new Kikeh oil field located offshore from Sabah in the final quarter of the year. The Kikeh plant is expected to produce 60,000 bpd initially before increasing to 120,000 bpd by the first quarter of 2008. Output of natural gas is also expected to increase by 2.2% as the MLNG 2 plant comes into full operation in the second half of the year following a capacity upgrade exercise. The increased production is to cater to long-term contracts with Japan and Korea.

After declining for three consecutive years, value added in the **construction sector** is expected to turn around, led mainly by the civil engineering segment. As the projects under the Ninth Malaysia Plan are tendered out and implemented, the effects are expected to translate into real activity to support the gradual recovery in the civil engineering segment. Growth is also expected to emanate from construction activities related to the oil and gas sector. The construction sector would be further enhanced by the higher growth in the non-residential segment, supported by rising demand for office space and increase in the supply of retail space. During the year, 10 new shopping complexes are expected to commence operation in the Klang Valley. Meanwhile, the residential segment is expected to continue to expand. Launches are likely to be in small numbers and mainly concentrated in prime locations and niche segments.

Balance of Payments

On the external front, the **current account** surplus is projected to remain large at 16.3% of GNP, reflecting the continued strong surplus in merchandise trade and an improvement in the services account. Both gross exports and imports are expected to expand by 8.2% and 9.8% respectively. Strong growth in exports of resourced-based manufactured products will partly mitigate the more moderate growth in E&E exports. The growth in commodity exports is expected to be sustained, supported by the higher prices for palm oil. The continued high levels of agriculture and mineral exports, which have low import content, will provide further support to the trade surplus. Higher tourism receipts in conjunction with the VMY 2007 campaign will contribute to the improvement in the services account. In the financial account, continued inflows of foreign direct investment (FDI) would also strengthen the overall balance of payments.

Table 4.3
Balance of Payments

	2006*e*	2007*f*
	RM billion	
Goods	135.0	137.7
Trade account	108.2	109.4
Exports (% annual change)	*10.3*	*8.2*
Imports (% annual change)	*10.8*	*9.8*
Services	-7.4	-6.7
Balance on goods and services	**127.7**	**131.0**
Income	-19.8	-22.1
Current transfers	-16.6	-16.2
Current account balance	**91.2**	**92.7**
% of GNP	***17.3***	***16.3***
Financial account	-39.9	-
Errors and omissions	-26.0	-
of which:		
Foreign exchange revaluation loss	-6.9	-
Overall balance	**25.3**	**-**

Note: Numbers may not necessarily add up due to rounding
e Estimate
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 4.4
External Trade

	2006*p*		2007*f*	
	RM billion	Annual change (%)	RM billion	Annual change (%)
Gross exports	**589.0**	**10.3**	**637.2**	**8.2**
of which:				
Manufacturing	473.2	10.1	511.7	8.1
Agriculture	42.1	12.5	53.1	26.0
Minerals	56.8	8.6	55.1	-3.0
Gross imports	**480.8**	**10.8**	**527.8**	**9.8**
of which:				
Capital goods	65.3	7.4	71.0	8.9
Intermediate goods	335.5	8.8	361.5	7.7
Consumption goods	27.9	13.4	30.6	9.7
Trade balance	**108.2**		**109.4**	

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia
Bank Negara Malaysia

Manufactured exports are expected to expand by 8.1% in line with trends in global trade. While the moderation in growth in the US economy is expected to somewhat dampen demand for electronic products in the first half-year, particularly computers and parts, the electrical and electronic products would continue to remain the largest contributor to export earnings. The moderate growth in export volume would be partly offset by more stable prices of semiconductors, after the declining trend in 2006. Growth would be further supported by exports of resource-based products, with exports of chemicals expected to be strong due to firm demand for biodiesel products from the EU.

Exports of **agricultural commodities** are expected to continue to record double-digit growth in 2007, driven mainly by higher receipts from palm oil. The expected strong increase would be due to the improved palm oil price, while export volume would be constrained to some extent by the increase in domestic demand from producers of palm oil-based biodiesel. The price of palm oil is expected to rise to RM2,200 per tonne, underpinned by strong demand from PR China and biodiesel producers amidst the limited global supply due to weather-related factors. Meanwhile, the export price of rubber is expected to consolidate from the very high level seen in 2006, influenced by the expected lower prices of synthetic rubber in line with trends in crude oil prices.

Exports of minerals would be influenced by lower receipts from crude oil, mainly arising from lower crude oil prices. The export price of Malaysian crude oil is projected to average USD58 per barrel in 2007 (2006: USD68 per barrel). Crude oil prices are expected to consolidate after four consecutive years of strong increase, due mainly to expected increase in global supply, particularly from the non-OPEC producers. The impact will be partially offset by higher exports of LNG, in tandem with the commencement of full operations at the MLNG 2 plant after the sequenced shutdown in 2006 for capacity upgrading purposes. LNG prices are also expected to be higher at RM1,150 per tonne due to expectations of higher demand in the global LNG market.

Growth in **imports** is expected to emanate from continued growth in imports of intermediate and capital goods. Intermediate import growth will stem from sustained demand for imported components, in line with the expansion in manufacturing production. Capital imports are expected to strengthen in line with higher investment activity. Growth in capital imports will be supported by capacity expansion in the manufacturing, services and oil and gas sectors. Higher capital imports in the services sector is expected to be led by deliveries of new ships and aircraft to meet strong demand arising from commodity exports and the expansion of intra-regional travel. Growth in capital imports will also stem from increased exploration and development activity in the oil and gas sector following the discovery of new deepwater wells.

The **services account** deficit is envisaged to improve further to 1.2% of GNP. Aggressive promotional activities targeted at medium- and long-haul tourists in conjunction with VMY 2007 are expected to enhance tourism earnings. The expansion in the shared services industry and the development of new products in the ICT sector will continue to underpin the growth in exports of computer and information services. Meanwhile, payments for transportation are expected to be higher in line with the higher volume of trade. Larger outflows in other services are expected with the increase in demand for professional services, particularly for the oil and gas sector as well as the upgrading of the transportation network.

The **income account** deficit is projected to be sustained at 3.9% of GNP, reflecting profits and dividends accruing to multinational companies (MNCs) from their investments in Malaysia. The projected investment income accruing to foreign investors is due to the export performance of the E&E and oil and gas industries. The rising trend in income accruing to foreign investors indicates that Malaysia is an attractive and profitable location for foreign direct investment. Meanwhile, sustained profits and dividends accruing to Malaysian companies from overseas investment will mitigate the deficit in the income account.

The **financial account** is expected to be supported by continued inflows of foreign funds for investment, particularly long-term capital. **Foreign direct investment (FDI)** is expected to remain high, largely from retained earnings by the existing MNCs operating in Malaysia, as well as from new FDI flows into the manufacturing, services and oil and gas sectors. More merger and acquisition activities as well as the implementation of development projects under the 9MP are also expected to attract inflows of FDI. FDI into the manufacturing sector is expected to remain significant following the higher level of FDI approved by the MITI in 2005 and 2006 (RM17.9 billion and RM20.2 billion, respectively). Most of these inflows would be channeled into the higher value-added electrical and electronics industry, as well as chemical and chemical products and basic metal products industries. Investment in the oil and gas sector is anticipated to remain sizeable given the expected increase in upstream exploration and production activities, led by foreign private oil companies operating in Malaysia through joint ventures with PETRONAS. The rapid development of the financial sector, particularly Islamic financial services sub-sector following liberalisation, and the growing interest of global MNCs to establish outsourcing and shared services operations would lead to higher inflows of FDI into the services sector. Meanwhile, **investment abroad** by Malaysian companies is projected to remain large, reflecting the sustained interest shown by Malaysian companies to expand and diversify their operations abroad. In addition to the greenfield investments, there would also be outflows of capital to acquire interest in existing businesses abroad. Most of these investments are likely to be channeled into the services sector, particularly the finance, telecommunications and utilities sub-sectors, as well as the oil and gas, manufacturing and construction sectors.

Inflation Outlook for 2007

Headline inflation, which was driven by higher energy prices in early 2006, has since eased and is likely to moderate further in 2007. The average inflation rate is expected to moderate to 2 – 2.5% for the year as a whole. Headline inflation is expected to be significantly lower in 2007 than in 2006, and price pressures are expected to be well-contained. In the short run, the main contributing factor to the lower inflation rate would be the lapse of the impact of the upward adjustment in the prices of retail petroleum products that took place in 2006. In addition, global energy prices have declined from their peak levels, and if sustained, would contribute towards alleviating cost pressures. Importantly, the moderating trend in inflation observed during the second half of 2006 has contained the public's inflation expectations for 2007.

Over the medium term, corporations are expected to continue to undertake new investments, which would expand the productive capacity of the economy, thereby ensuring continued growth without undue price pressures. Furthermore, price pressures would continue to be dampened by increased competitive pressures arising from increased international economic and financial integration. Barring any new upward adjustments to administered prices, it is likely that inflationary conditions will be relatively benign in 2007.

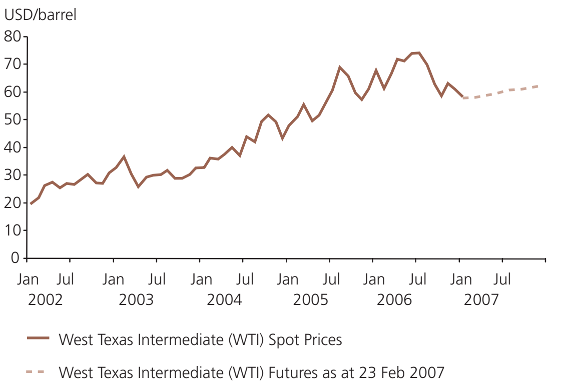
Notwithstanding the expectation for lower inflation in 2007, three key developments might generate upward pressure on consumer prices during the year. First, a favourable growth outcome coupled with increased factor utilisation could trigger stronger-than-expected wage pressures and pose an upward risk to general prices. Nevertheless, the expected improvements in labour productivity would help to contain unit labour costs. In this regard, the Bank will continue to monitor developments in the labour market closely.

Second, the inflation rate of price-volatile food items could also be affected should food supplies be disrupted due to adverse weather conditions during the year. For example, the severe flooding in Johor in late December 2006 and early 2007 had disrupted food supplies and led to an upturn in food prices. Nevertheless, the impact is likely to be transitory and should dissipate when food supplies normalise.

A third source of uncertainty for the inflation outlook is the evolution of global energy prices. Oil prices have been exceedingly volatile in recent years and renewed increases cannot be discounted based on the current pricing in the oil futures market. In February 2007, the International Energy Agency (IEA) cautioned that the high demand for oil, against the backdrop of tight supply conditions, could keep oil prices high over the medium term. As evident in previous years, shocks to energy prices would yield a direct impact on producers' input costs and transport costs.

These upside risks, however, are counterbalanced by the more robust capacity expansion and possible further increases

Chart 4.6
West Texas Intermediate (WTI) Spot and Future Prices



in productivity, which are expected to create downward pressure on inflation. Imported inflation would also be more subdued given that global inflation is expected to be broadly lower in 2007 compared to 2006. In particular, a sharper moderation in the inflation rates of Malaysia's trade partners could reinforce the decline in domestic consumer prices. Overall, at the point of writing, the risks to the inflation outlook relative to the central projection are judged to be reasonably well balanced.

MONETARY POLICY IN 2007

In line with the objectives of monetary policy, Bank Negara Malaysia will continue to promote price stability and sustainable economic growth in 2007. Decisions on monetary policy will remain conditional upon the evolution of the Bank's assessment of domestic and global macroeconomic conditions and the prospects for inflation and economic growth.

Despite the expected softening in global growth during the first half of 2007, growth of the global economy and world trade in 2007 as a whole are likely to be sustained at above 4% and 6% respectively. Domestic growth drivers are expected to remain strong, underpinned by the momentum in private investment, as well as resilient private consumption. Public demand will also remain supportive of economic growth. Employment prospects are expected to remain positive and supportive of income growth and consumer sentiment.

The outlook for inflation is relatively benign and is not expected to pose a significant policy challenge. Inflation is expected to be significantly lower than in 2006. The Malaysian economy is expected to operate close to its potential output (Box Article), with the

Potential Output of the Malaysian Economy

Potential output is the trend level of output that is consistent with the aggregate productive capacity of an economy. It traces the sustainable growth path of the economy based on its available productive inputs. Conceptually, the growth in potential output is primarily determined by the expansion and non-inflationary utilisation of physical capital and the labour force, as well as the rate of technological progress and improvement in overall economic efficiency and productivity. Therefore, the sustainability of long-term growth of an economy depends crucially on investment in physical capital and its efficient utilisation, increases in the size and productivity of the labour force, and the improvement in the general economic environment.

The latest estimates for Malaysia show that potential output grew at 6.3% in 2006, with the output gap[1] estimated at an average of positive 0.4% of potential output. With the continuous improvement in productivity and expansion of both capital stock and labour force during the year, the output gap narrowed and closed towards the second half of 2006, resulting in the Malaysian economy growing close to its potential level at the end of the year.

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

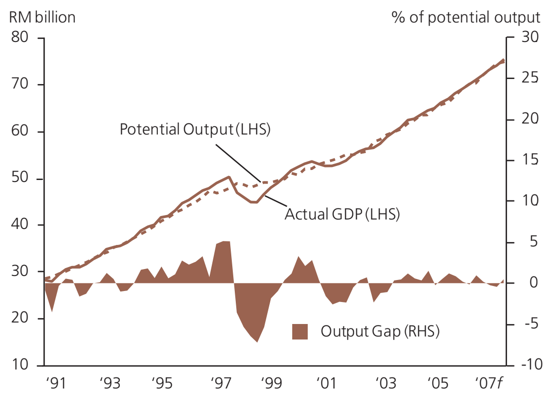
On the whole, the performance of the Malaysian economy since the year 2000 has been characterised by three clear developments. Firstly, the growth path of the Malaysian economy has been relatively balanced. Despite numerous external shocks to the region and the growing global imbalances, the economy did not experience any large deflationary or inflationary cycles, as indicated by the modest deviations between actual and potential output during the period. This provides a reflection of Malaysia's growing economic resilience. Secondly, this period also witnessed Malaysia's transition away from a factor-driven to more a productivity-driven economy. Compared to a decade before, productivity growth now accounts for a greater proportion of overall potential output expansion. This indicates that productivity levels have steadily improved.

Table 1
Actual GDP and Potential Output

Period	Actual GDP	Potential Output	Investment	Labour	Output Gap
	(Annual change in %)				(% of potential output)
1992-1999	6.7	6.7	4.5	3.1	0.1
2000	8.9	4.6	25.7	4.3	2.2
2001	0.3	3.9	-2.8	1.6	-1.3
2002	4.4	3.4	0.3	3.5	-0.4
2003	5.5	6.3	2.7	3.6	-1.1
2004	7.2	5.4	3.1	4.0	0.6
2005	5.2	4.9	4.7	4.1	0.8
2006e	5.9	6.3	7.9	2.2	0.4

e Estimate

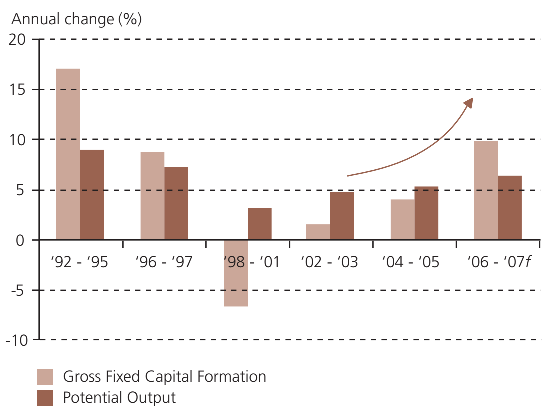
Chart 1
Actual and Potential GDP: Balanced Growth



f Forecast

Finally, the Malaysian economy also saw a recovery in investment activity from the second half of 2003 onwards, particularly in the private sector. This favourable development has contributed to the further growth of potential output in recent years (see Chart 2), thus expanding the productive

Chart 2
Investment Recovery Contributed to Continued Potential Output Expansion



f Forecast

capacity of the economy, which in turn will promote higher levels of economic activity over the near term.

Going forward, potential output of the economy is expected to grow above 6% in 2007 with the output gap remaining negligible during the year. The potential output growth would be driven by the continuous expansion of both the capital stock and labour force. This balanced expansion is expected to prevail going into the future, supported by further recovery of investment activity and the improvement in economic resilience and productivity.

output gap remaining negligible during the year. With continued investment by the private and public sector, the productive capacity of the economy would be further expanded. This implies that while demand will continue to grow, it is not expected to cause undue pressures on prices. Apart from these domestic factors, the global environment is also expected to remain relatively favourable given the lower oil and commodity prices. Importantly, inflation expectations are expected to remain well anchored.

Nevertheless, there are risks and uncertainties going forward that could have a material impact on the policy environment. The direction and volatility of oil prices in the global markets could become a source of concern. Although the current forecast is for the world economy to grow at a slightly slower pace, it is also possible that economic growth will turn out to be better than currently estimated, in which case demand pressures could emerge. Alternatively, there remain some downside risks emanating from the correction in the US housing market which could affect consumption in the US, with possible repercussions on world trade and growth of the world economy.

Capital flows could potentially pose a challenge to the management of monetary policy for most of the regional economies in 2007. As with any small open economy with liberal exchange control policies, capital flows need to be closely monitored. Such flows could result in excessive volatility in the financial markets and the economy. There would thus be continued intensive surveillance. The country is better positioned to absorb the volatility and the strategy of a gradual and sequential liberalisation of its capital account remains on course.

The conduct of monetary policy in 2007 will continue to balance between the need to ensure that interest rates remain at a level that would enable the central bank to respond to any risks of rising inflation, while remaining conducive to sustaining growth in domestic demand. At current interest rate levels, monetary policy remains accommodative. Bank Negara Malaysia will continue to assess developments in the domestic and international economies and will adjust its monetary policy stance as circumstances require.

Liberalisation of the Foreign Exchange Administration Policies

Malaysia has always undertaken a structured approach in reviewing the foreign exchange administration policies based on the readiness of the economy. Over the years, the foreign exchange administration policies have been progressively liberalised, aimed at enhancing Malaysia's competitiveness through reducing cost of doing business, increasing efficiency of the regulatory delivery system, providing a greater degree of risk management to businesses while safeguarding economic and financial stability.

In line with the country's strategic objectives and supported by progress achieved from previous liberalisations, Bank Negara Malaysia announces further liberalisation to the foreign exchange administration rules with effect from 1 April 2007 as follows:

(a) To provide greater flexibility to licensed onshore banks to undertake foreign currency business, the following foreign exchange administration rules are liberalised:

(i) Abolish net open position limit of licensed onshore banks which was previously capped at 20% of the banks' capital base.

(ii) Abolish the limit imposed on licensed onshore banks for foreign currency accounts maintained by residents.

(iii) Allow investment banks in Malaysia to undertake foreign currency business subject to a comprehensive supervisory review on the capacity and capability of the investment banks.

(b) To widen the investor base for ringgit assets and financial products, the following foreign exchange administration rules are liberalised:

(i) Grant further flexibility for non-resident stockbroking companies and custodian banks to obtain ringgit overdraft facility from licensed onshore banks to avoid settlement failure due to inadvertent delays by:

- Removing the previous overdraft limit of RM200 million; and
- Expanding the scope on utilisation of the overdraft facility to also include ringgit instruments settled through the Real Time Electronic Transfer of Funds and Securities (RENTAS) System and Bursa Malaysia. Previously, utilisation of the facility was confined only to shares traded on Bursa Malaysia.

(ii) Abolish the limit on the number of residential or commercial property loans obtained by non-residents. Under the previous policy, non-residents were allowed to obtain a maximum limit of three property loans from residents to finance the purchase or construction of residential or commercial properties in Malaysia.

(iii) Allow licensed onshore banks to appoint overseas branches of their banking group as a vehicle to facilitate the settlement of any ringgit assets of their non-resident clients.

(iv) Allow non-resident corporations to utilise proceeds arising from the listing of shares through Initial Public Offering on the Main Board of Bursa Malaysia, abroad.

(v) Remove the restriction on Labuan offshore banks to transact in ringgit financial products on behalf of non-resident clients.

(c) To reduce cost of doing business, enhance business efficiency as well as promote Malaysia as a centre of origination, the following foreign exchange administration rules are liberalised:

(i) Increase the limit of foreign currency borrowing that can be obtained by resident corporations from licensed onshore banks and non-residents as well as through issuance of onshore foreign currency bonds, to RM100 million equivalent in aggregate and on corporate group basis from the previous RM50 million equivalent. The proceeds may be used for domestic purposes or offshore investment.

(ii) Allow residents to hedge foreign currency loan repayment up to the full amount of underlying commitment.

(iii) Enhance flexibilities for resident individuals and corporations to invest in foreign currency assets as follows:
- Increase the limit for resident individuals with domestic ringgit borrowing to invest in foreign currency assets up to RM1 million per calendar year, from the previous limit of RM100,000;
- Increase the limit for resident corporations with domestic ringgit borrowing to invest in foreign currency assets up to RM50 million per calendar year, from the previous limit of RM10 million; and
- Allow resident corporations to utilise proceeds arising from listing of shares through Initial Public Offering on the Main Board of Bursa Malaysia for offshore investment purposes.

(iv) Increase the limit for resident institutional investors to invest in foreign currency assets as follows:
- Unit trust companies: up to 50% of net asset value (NAV) attributable to residents from the previous 30% of NAV;
- Fund management companies: up to 50% of funds of resident clients with domestic credit facilities from the previous 30% level; and
- Insurance companies and takaful operators: up to 50% of NAV of investment-linked funds marketed from the previous 30% of NAV.

(v) Allow resident corporations to lend in foreign currency, the proceeds arising from listing of shares on foreign stock exchanges to other resident corporations within the same corporate group in Malaysia.

(vi) Abolish restrictions on payments in foreign currency between residents for settlement of foreign currency financial products offered onshore.

(vii) Allow resident individuals to open and maintain joint foreign currency accounts for any purpose. Previously, resident individuals were allowed to maintain joint foreign currency accounts only for purposes of education and employment overseas.

Details of the liberalisation can be obtained from the Annex.

FISCAL POLICY IN 2007

The 2007 Budget is aimed at enhancing the macroeconomic fundamentals and promoting a more broadly balanced economic structure by placing emphasis on new areas of domestic economic activity. Fiscal policy in 2007 is therefore focused on facilitating the private sector in taking a greater role in economic development as well as in generating new sources of growth in the technology and knowledge-intensive sectors.

Expected higher revenue collection has allowed the Federal Government to plan increased expenditures, while reducing the budget deficit to

Table 4.5
Federal Government Finance

	RM billion		% change	
	2006*p*	2007*B*	2006*p*	2007*B*
Revenue	123.5	134.8	16.2	9.1
Total expenditure	143.5	157.5	11.9	9.7
Operating expenditure	*107.7*	*113.0*	*10.2*	*4.9*
Gross development expenditure	*35.8*	*44.5*	*17.3*	*24.3*
Loan recoveries	0.8	2.5		
Overall balance	**-19.1**	**-20.2**		
% of GDP	**-3.5**	**-3.4**		
Sources of financing:				
Net domestic borrowing	17.8	-		
Net external borrowing	-3.1	-		
Realisable assets[1] and adjustments	4.4	-		

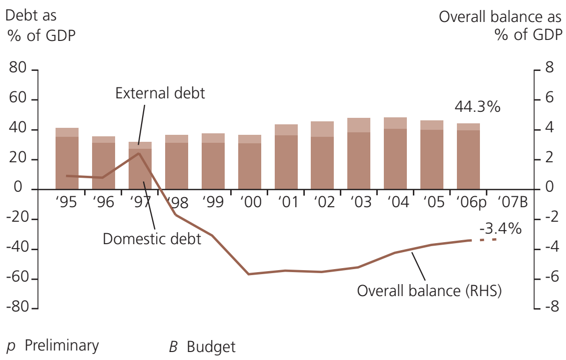
[1] A positive (+) sign indicates a drawdown in the accumulated realisable assets
[p] Preliminary
[B] Budget
Note: Numbers may not add up due to rounding
Source: Ministry of Finance

3.4% of GDP in 2007. Notably, the budgeted development expenditure was increased to support the Government's initiatives in generating higher value-added economic growth, developing skilled and knowledgeable manpower, as well as programmes to reduce socio-economic and regional disparities.

In addition to budgetary allocations, the Government has put in place various incentives for the development of industries with high growth potential including ICT, biotechnology, modern agriculture, the halal food industry, tourism and Islamic finance. The Government also enhanced the business-friendly environment to attract foreign direct investment and promote private investment by strengthening the public service delivery systems as well as improving existing incentives and taxes. In particular, corporate income tax was reduced by two percentage points in two stages, to 27% for the 2007 assessment year and 26% for 2008.

The Budget continues to embody the Government's underlying philosophy of fiscal prudence, balancing the need for fiscal flexibility within the context of sustaining long-term growth. The fiscal deficit is expected to decline gradually to achieve a sound fiscal position

Chart 4.7
Federal Government Fiscal Balance and Debt



that would provide the Government with the flexibility to respond to changing economic circumstances.

In terms of financing, the Government will continue to rely on domestic sources to finance the fiscal deficit, given the high domestic savings and ample liquidity situation. Recourse to external borrowing will be determined mainly by the need to establish international market presence and to provide benchmarks for private sector issues.

Governance and Organisational Development

OVERVIEW

During 2006, the Bank's governance and organisational development practices continued to be enhanced to ensure that the organisation evolves to meet the challenges posed by the dynamic external and domestic environment, as well as with the Bank continuing to progress towards the achievement of its desired outcomes. The Bank has continued to focus on the following priority areas:

- Continuously enhancing internal capacity and capability to achieve the Bank's mission of **promoting monetary and financial system stability and fostering a sound and progressive financial sector, that will support and sustain economic growth for the benefit of the nation**;
- Developing a more performance driven and strategy-focused organisation; and
- Sustaining a working environment that supports knowledge workers and promotes a performance-differentiated work culture.

The increased pace of change in the global economic and financial landscape, as well as the more rapid development of the Malaysian financial system continue to re-define the scope of central banking. Whilst the monetary, regulatory and supervisory functions remain central to the core mandate of maintaining monetary and financial stability, the Bank has expanded its developmental role to help shape the economic and financial landscape. To that end, the Bank has focused on specific strategic results critical to sustaining financial stability and economic growth in the prevailing and prospective environment of rapid change and increased uncertainty.

In order to ensure the success of the Bank's desired outcomes and strategic results, focused programs were initiated to enhance capacity and capability in the areas of governance, talent management, training and learning, knowledge management, as well as information and communications technology management.

Governance

The Bank's Corporate Governance framework has three (3) important pillars, namely, **independence** based on its given roles; **accountability** based on the need for optimum effectiveness and efficiency in performing the given roles through the use of its available resources, as well as monitoring performance and managing the associated risks; and **transparency** in ensuring clarity of its actions as they impact the Bank's multiple stakeholders.

Whilst the policy making function of the central bank is the mandate of the Management Committee chaired by the Governor and comprising three Deputy Governors and seven Assistant Governors, the responsibility for the general administration of the affairs and businesses of the Bank is vested in the Board of Directors. The Board of Directors comprises individuals of high integrity and eminence from industry and the public sector. The Board Audit Committee is chaired by an independent director. The Board had convened 12 monthly meetings during 2006. Four Board Audit Committee meetings were also held. Key issues pertaining to the corporate governance and organisational development of the Bank are deliberated at the Board meetings. The Board is also fully briefed on all policy matters pertaining to monetary and financial stability, as well as the management of the nation's payment systems. The Board approves the Bank's annual operating plan and budget.

The Management Committee, which is the highest executive body within the Bank, is chaired by the Governor, and meets once a week to deliberate on policy matters pertaining to the financial sector, the economy and the Bank's operations. The Management Committee is supported by several policy committees, which are also chaired by the Governor. These committees include the Reserve Management Committee, Monetary Policy Committee, Financial Stability Policy Committee and Risk Management Committee. The policy committees provide a forum for cross-functional deliberation, and hence the implementation of consistent policies. The collective skills, broad experience and knowledge of the Management Committee, combined with the legal framework under the Central Banking Act provides the Bank with the authority to remain autonomous in deliberating, setting and implementing its policy objectives.

In 2006, the Minister of Finance endorsed the establishment of an additional position for Deputy Governor, in line with the provisions of the Central Banking Act. Three new Assistant Governors were appointed in 2006, increasing the number to seven Assistant Governors. One specific enhancement is the placement of the regulatory and supervisory functions under separate Deputy Governors, as well as the re-structuring of the departments under the regulations and supervisory functions. The re-structuring aims for a more harmonised regulatory framework for the financial sector, improve functional specialisation within the Bank and provide more effective engagement with the financial sector and market. These changes in governance also amplify the Bank's continuous efforts to improve management agility and enhance its integrity as a regulatory and policy-making institution.

Another critical aspect of governance is sound financial management of the Bank's finances. The Bank conducts a bi-annual review of its operating plan and budget in order to ensure proper allocation of funds. The Bank's greater involvement in developmental projects has created new requirements in terms of financial information. A two-year project was initiated in 2006 to develop an enhanced Financial Management System, to replace the current system that was originally introduced in the 1980s. Further, as a means to enhance internal controls as well as be more prudent in expenditure management, the Bank has implemented a revised Procurement Policy and Procedures in August 2006. The new procurement guidelines will not only enhance checks and balances in procuring goods and services, but will also improve competitive sourcing and pricing.

In promoting greater transparency of its policy actions, the Bank continues to publish regular communication of economic data analysis through monthly and quarterly bulletins as well as increasingly through the Bank's website. The Bank's Annual Report includes comprehensive explanations of all key policy decisions taken during the year, in addition to the relevant economic and financial performance data.

The Bank conducted a briefing to the Prime Minister and the Minister of Finance, where the assessment of the economy and the financial sector were presented. In the same forum, other strategic financial and economic issues as well as challenges confronting the country were also presented with important policy recommendations. Additionally, to maintain transparency of its policy direction, the Bank had intensified efforts to ensure that the general public and other key stakeholders were kept abreast with developments in the financial system through targeted press statements and briefings.

Strategy and Performance Management

The objective of strategy and organisational performance management is to ensure that the Bank has focus and clarity in what it wants to achieve, the right strategies in place to achieve these objectives, and the resources aligned in the most efficient and effective manner for this purpose. The goals are guided by the core functions of ensuring monetary, financial system and payment system stability. A Strategy Forum supports this process by providing a platform to deliberate the Bank's effectiveness in delivering results, and how capacity and capability needs to be enhanced in order to improve organisational performance.

The internal strategy and performance management process plays a key role in:

- Enabling senior management to keep track of the wide range of organisational performance issues;
- Facilitating greater cross-functional dialogue on strategies;
- Ensuring that capacity and capability development efforts are aligned with the Bank's strategic focus; and
- Promoting greater sharing of critical talent and information across functions and roles in the Bank.

Talent Management
The translation of the Bank's strategic intents into measurable results is supported by a framework that together manages talent demand, talent supply and staff performance. These efforts have allowed the Bank to promote greater **organisational clarity on roles and performance expectations** across various levels within the Bank.

As a performance-oriented organisation, the Bank places emphasis on the need to differentiate its Compensation Aggregates (Annual Base Salary, Short Term Incentives and Benefits) based on merit of performance. The Bank implemented a new broad banded job grading and salary structure in line with the revised roles of staff. The revised scheme was affected from 1 May 2006, and included a performance-based salary adjustment to staff, as well as performance differentiated reward. The Bank also introduced specialist ladders for critical central banking functionalities, namely actuarial, risk management, econometrics and monetary policy, shariah and portfolio strategists. The objective of the specialist ladders is to ensure the Bank remained competitive in attracting, developing and retaining certain types of talents in these critical areas. The need for additional specialist or technical laddering will be reviewed from time to time.

The on-going review of talent requirements is complemented by a revised Behavioural Competency model for Senior Executives and above, meant to foster new types of skills and work practices in the Bank. The inculcation of appropriate behavioural, functional and technical competencies will provide greater clarity for staff in their respective functions, as well as provide a 'development compass' in steering an individual's progression within the Bank.

An increasingly important dimension of the Bank's talent management is the Bank's Scholarship Programme, which is one of the strategies for building a long-term talent pipeline to meet the Bank's requirements. The Bank has increased the number of scholarships offered by 85 percent (from 91 scholarships in 2005 to 168 scholarships in 2006) in order to better meet future talent needs. The Bank's scholarship focus areas are essentially in the core central banking disciplines and any newly identified emerging areas of competencies. The efforts to develop a more robust long-term talent pipeline is reinforced by a succession management system that takes into account the need for leadership and technical talent, vis-à-vis the anticipated attrition. The succession management is complemented with the Bank's rigorous leadership development programme. The Bank was recognised for these efforts with the Exemplary Practice Award under the leadership development category at the world-renowned Annual Corporate Xchange University Award For Excellence and Innovation in Corporate Learning, Orlando, Florida. The Bank is the first central bank to receive such an award.

The staff strength of 2,488 as at December 2006 has demonstrated an increase of six percent from December 2005 (staff strength of 2,345), with five percent attrition due to retirement and resignation. With a ratio of Executive to Non-Executive of 72:28, the Bank continues to emphasise the increase in professional talent, and a greater proportion of 'executive' level staff.

Knowledge Management
The emphasis accorded to Knowledge Management (KM) continues to deliver significant benefits to the Bank where embedded KM practices and greater engagement of external stakeholders have been enabled by the use of technology and systematic process improvements. Increasingly, KM practices are being institutionalised into the work culture of the Bank for improved productivity, enhanced learning for staff and closer collaboration with stakeholders.

Knowledge visibility, accessibility and reuse remained key KM value propositions for the Bank in improving performance. Towards this end, the Knowledge Hub, launched in February 2006, provided for the systematic identification, capture, sharing and storage of Strategic Knowledge Assets (SKA) across the Bank. By providing staff better access to the Bank's knowledge assets, the Knowledge Hub enables faster response times, reduces redundancies and provides more opportunities for new ideas to surface. Over time, the Knowledge Hub is envisaged to shift the Bank to a more collaborative culture and with its unified view, will enhance the value of the Bank's intellectual capital. The steady growth in content captured and re-used is seen as a positive measure of improving knowledge visibility in the Bank.

The Bank's efforts in promoting a Knowledge Based Organisation have enhanced horizontal collaboration through greater participation in cross-functional work teams, communities of practice and peer-assist groups. Various tools, such as after-action-reviews and storytelling were increasingly integrated into work processes to capture and share knowledge. In further enhancing horizontal collaboration, a Knowledge Fair was organised in November 2006. Various initiatives were showcased, through talks, multimedia presentations, games and interactive activities which provided a conducive learning environment for Bank staff.

In recognition of the synergies between KM and Learning, the Knowledge Management Centre and the Human Resource Development Centre (HRDC) were merged in August 2006. This is to enable more integrated KM and learning processes, and thus improve the services provided to staff of the Bank. Further, the work undertaken to enhance talent management also promoted the development of new competencies, and hence new types of knowledge assets.

The year 2006 also marked the beginning of a journey to develop the Bank's Enterprise Portal (EP). The EP enables real-time access to knowledge, anytime, anyplace as well as collaborative platforms to help staff stay connected to one another, as well as supporting more efficient collaboration with industry. To support the increasingly collaborative environment both internally and externally, a content management framework was also developed to govern the quality of content in terms of accuracy, timeliness and integrity, as well as efficiency of content flows in the Bank.

New work in progress includes intellectual capital measurement as a means to extract greater value from knowledge management tools and practices.

Training and Learning Management

The learning and development strategy focused on quality learning solutions, as well as the inculcation of self-directed learning through the development of personal learning roadmaps. This placed greater emphasis on the staff being responsible for their own self-development. The complementary development of the departmental learning roadmap had heightened the department's accountability to knowledge and skill acquisitions, and has facilitated the process of aligning the learning agenda with the Bank's objectives.

In addition, supervisors were also encouraged to be equipped with coaching skills to grow leaders in their units. In terms of enhancing technical skills, several modules on central banking knowledge were customised for on-line learning using the Bank's e-learning platform. Bank-wide functional learning solutions were also designed to meet the needs of line departments. 28 functional courses were organised in 2006 of which 18 were new. The new learning solutions covered areas on Risk Management, Forensic Accounting and Computing, International Accounting Standards and Islamic Finance.

In 2006, the Bank organised two sessions of the LDP (Leadership Development Programme) in collaboration with the Center for Creative Leadership (CCL) for selected managers with the potential to assume greater responsibilities. This programme included a 360-degree assessment on one's self-awareness of leadership effectiveness, strategic discourses with senior management of the Bank on leadership issues and challenges, and dialogues with proven industries leaders and highly recognised academics in the areas of leadership.

The Bank's financial commitment towards staff development for 2006 stood at 7.8% of total staff salary, (7.6% in 2005). On the average, each staff received eight training days in 2006 during the year with average cost of RM6,200 per employee compared to RM5,400 in 2005.

Technical Assistance and Collaboration Programmes with External Agencies

As part of the Bank's continued efforts to enhance regional and international cooperation, three learning programmes were organised under the Bank's International Learning programme flagship. This included the Basic Central Banking Course, Banking Supervision Foundation Course, and Insurance Regulation and Supervision Course. In total, 28 international participations from 15 countries benefited from these courses. All the foreign participants were sponsored under the Malaysian Technical Co-operation Programme (MTCP).

The Bank signed a technical co-operation arrangement with the Da Afghanistan Bank (DAB) in 2006 in the area of development and capacity building. Through the technical co-operation program, officers from DAB participated in the Bank Negara Malaysia's International Learning Programme and SEACEN's courses on banking supervision and leadership development.

The Bank also hosted the first "AITRI-Toronto Centre Leadership Programme" (AITRI ~ ASEAN Insurance Training and Research Institute) for the ASEAN insurance regulators and supervisors. The programme was aimed at providing specific focus in building and enhancing capacity for insurance regulators and supervisors with the skills and competencies to make difficult decisions quickly, implement change in their organisations effectively and deal with stakeholders in their jurisdiction using the Toronto Centre's ADAPT methodology and the OUI (Outward-Upward-Inward) model. The programme was facilitated by five programme leaders, four from the Toronto Centre and one from the Bank's Human Resource Development Centre. A total of 17 participants attended the programme which included five participants from Singapore, Cambodia and Thailand.

ICT Management

Information and Communications Technology (ICT) continues to be a key enabler in achieving the Bank's desired outcomes and the platform for collaborative workforce and leveraging on new knowledge and processes. In 2006, the Bank had put in place systems to monitor and deter illegal financial activities. Reporting Institutions can now perform their obligations under the Anti-Money Laundering Act 2001 (AMLA) by submitting Suspicious Transaction Reports or Cash Threshold Report through a secure online environment. The Bank had also extended the existing system capability to enable the insurance companies to submit their fraud cases online.

In order to facilitate information collection and sharing, the Bank had enhanced its enterprise architecture to cater for new developments in the financial landscape. This included amongst others the information on Small and Medium Enterprises (SMEs) now being submitted online, as well as the system to speed up the approval of new Islamic banking products requests by the financial institutions. This will help to promote greater innovation of products and services in a timely manner.

In 2007, the Bank will leverage on the Enterprise Portal (EP) platform to deploy Bank-to-Financial-Institutions (B2FI) collaborative channel between the Bank and the financial institutions under its supervision. The Bank is also continuing to enable greater horizontal collaboration within the organisation by enhancing internal processes and information accessibility via the Bank-to-Employee (B2E) facet of the EP platform. Upon deployment in 2007, the B2E will enable information to be delivered to individuals, groups and communities based on interests, job profiles and roles. Over time, the Bank envisaged further productivity enhancement through the leverage of these common capabilities by existing IT systems and likewise the exposure of their information and services on the EP platform.

ICT risk management plays a critical role in protecting information assets of the Bank. Throughout the year, the Bank has been able to enforce effective infrastructure security management. Security processes have been standardised, enforced and operationalised using the best of breed tools leading to improved security management, risk management and response-recovery. With these vital steps and measures implemented, the Bank's information and ICT infrastructure are safeguarded from external threats despite numerous attempts in cyber-attack and virus/ worm propagation.

RISK MANAGEMENT IN BANK NEGARA MALAYSIA

Embedding risk management practices in all operations, policy and strategic initiatives are integral to promoting a sound risk management culture. In order to provide assurance of the safety and soundness of the Bank's operations, the Risk Management Unit (RMU) continued to implement the 3-pronged risk assessment approach comprising the three steps of self-assessment by line departments, an independent assessment of line departments by RMU and a bank wide organisational risk assessment by RMU and Risk Management Committee (RMC) to instill sound enterprise risk management practices.

Risk Management Governance Structure

The risk management governance structure is an essential part of the efforts to ensure that risk management practices are effective, by providing sufficient check and balance as well as having clear accountability of risk. The Bank has accordingly put in place an institutional framework comprising establishment of management committees, design of roles and functions and work processes, with in-built internal controls, bearing these principles in mind.

At the apex of the Bank's risk management governance structure is the Risk Management Committee (RMC), which is the forum at the leadership level for focused and regular deliberation on risk issues. It also provides the risk management oversight and determines standards and requirements to ensure that appropriate strategic and operational risk control measures are implemented by all departments including all projects. The RMC is chaired by the Governor and meets four times a year to deliberate risk issues affecting the Bank, as well as individual departments. The RMU is responsible for providing the assessments on risk management and how the issues are being addressed as well as risk management policies, methodologies and adoption of risk management best practices.

Risk Management Practices

In 2006, the Committee continued assessing departments' risks, controls and emerging risk issues in their operations and business plans so as to maintain constant vigilance on the Bank's overall risk profiles.

The commitment shown by departments in carrying out the self-assessment review of the department's risk profiles marked the increased awareness and ownership of line departments in managing risks of core business processes, policy-making and strategic initiatives. This continued progress has been vital in creating a risk culture that involves employees at all levels and in providing a fertile ground for advocating enterprise risk management practices. The clear segregation in risk ownership is to inculcate proactive traits in managing risks while ensuring that the risk management process is continuous and self-sustaining. In addition, the Risk Management Unit provides technical support and performs a coordination and oversight role by assisting departments in their reporting to Management.

In 2006, RMU performed independent assessments of selected line departments and reported to RMC directly. As risks can no longer be managed in isolation, the RMU also assessed thematic or organisational risks such as capacity development and data management, which cut across functional lines to address interdependencies that may impinge on the achievement of the strategic goals and objectives of the Bank. These thematic risks are identified by RMU and assessed by consulting relevant departments as well as reviewing processes undertaken in carrying out the Bank's critical functions and responsibilities.

The combination of all three assessments mentioned is expected to provide a holistic view of risk profile and potential risks in the Bank. This approach will contribute towards greater risk awareness, organisational alignment and strengthen inter-linkages throughout the Bank. The RMU is also responsible for reviewing risk management policies by benchmarking against global best practices and providing technical support to line departments.

In 2006, the Bank also became a member of the International Operational Risk Working Group (IORWG), which was established to act as a centre of competence on Operational Risk Management (ORM) for central banks. The objectives of the Group are to share best practices, to innovate new framework and methodologies for the central bank community as well as to generate the value of managing operational risk.

Strategic and Policy Risk

Strategic risk is associated with the risk inherent in the formulation and execution of the Bank business plans and strategies. If not managed effectively, it can impede the achievement of the strategic aims and objectives of the Bank. As a result, significant emphasis has been placed in ensuring that all line departments identify the strategic risks in their core processes and bank-wide projects. The Management Committee and the various Steering Committees chaired by senior management play a vital role in ensuring that all existing and emerging risk issues in the business plans are being addressed. To complement this, the contents of the annual declaration, the self assessment tool, and the independent assessments by RMU are also designed to capture and address strategic level risks to enable management to proactively manage and contain the Bank's overall risk.

Policy risk is managed through a structured framework and process for policy making and implementation. Major components of the framework are the internal committees and working groups for cross-functional consultations and deliberations. The high level committees include the Management Committee, Monetary Policy Committee and the Financial Stability Committee; all chaired by the Governor. Policy working groups, chaired by Assistant Governors with membership comprising directors of relevant departments, form the working level forum for policy formulations. These working groups ensure that all information and expertise are tapped in the design and formulation of policies. In certain cases, the consultation process includes external stakeholders. This structure serves to ensure that the Bank's policy-making mechanism is effective in promoting monetary and financial stability.

Financial Risk

In managing the Bank's financial risks arising from its treasury operations, an independent Treasury Risk Management Section (TRMS) of the Investment Operations and Financial Market Department has been entrusted to specifically assess and enforce the Bank's treasury risk management policy with direct reporting to the Deputy Governor. In 2006, treasury risk management in the Bank continued to develop into a more specialised field employing the latest advancement in risk technology and risk methodology to effectively manage market, credit and operational risks associated with the Bank's investment operations. In the area of market risk, the Bank has embarked on a new investment framework with greater emphasis on managing market risk through risk budgeting, and enhanced focus on risk-adjusted return for its investment performance assessment. With the advent of more complex investment instruments, the Bank had also invested in new technology and systems to enhance market risk monitoring and assessment capability. In the area of credit risk, the Bank maintained its stringent credit policy to ensure credit exposures undertaken through the Bank's investment strategy remained within acceptable level, while the Bank continued to strengthen its treasury operational risk framework with on-line monitoring and early warning indicators.

Operational Risk

Department Heads continue to have direct responsibility in managing operational risk by ensuring that risk management practices are integral to daily operations and that all risks are appropriately addressed. In complementing the risk management process, the Risk Management Unit continued to play a proactive role and work in a collaborative manner with line departments to ensure that key risks are appropriately addressed.

Critical measures to address operational risk include budgetary controls, procurement framework and internal audit function. Budgetary controls are to promote planning and ensuring effective and efficient use of financial resources whereas the procurement framework sets the governance and best practices in acquisition or implementation of projects. The internal audit function is responsible for providing assurance to the Board on control and compliance, risk management and governing processes in the Bank.

Business Continuity Management

Within the Business Continuity framework, there are two high level components, the Crisis Management Committee and the Crisis Management Team. The Crisis Management Committee, which comprises Management Committee members, symbolises high level endorsement of the Business Continuity programme in the Bank. The Crisis Management Team has membership comprising directors from all identified critical departments and support teams.

As in previous years, periodic assessments of the Bank's capabilities to respond to crisis were done. This was achieved via the live-run exercises as well as the twice yearly Crisis Management Team meeting which discusses emerging business continuity issues.

During the year, a particular risk that was given much attention by the risk community was the potential outbreak of the Avian Influenza (AI). This external risk which triggered concern in early 2006 has the ability to interrupt business operations with significant and prolonged staff absenteeism as well as physical infrastructure disruptions. In response to this risk, the Bank drew up a Preparedness Plan for Pandemic Influenza to synchronise responses across the Bank. The Preparedness Plan had identified implications on both the financial and economics sectors as well as outlined measures to be taken in managing the economy, the financial sector and the insurance industry, and the payment and settlement system.

The RMU had also conducted Business Impact Analyses, which are used for analysing the potential impact of crisis to line departments and drive the priorities, strategies and solutions for managing business continuity and recovery for departments specifically and for the Bank as a whole. It also forms the underlying basis for reviewing existing crisis arrangements and for identifying new recovery strategies.

In addition, RMU participated in the Bank's annual Knowledge Management Fair to continue building up the awareness and understanding of Business Continuity Management (BCM). Although business continuity plans are already in place, opportunity for invocation is rare and almost non-existent for staff not involved with critical functions, hence there is a need to promote appreciation of its significance. Through various programmes such as talks, quizzes, puzzles and games, staff thinking towards business continuity arrangement is internalised by promoting the interest and sharing of knowledge concerning business continuity arrangements.

BANK NEGARA MALAYSIA
Organisation Structure

- **BOARD OF DIRECTORS**
  - **GOVERNOR** – Dr. Zeti Akhtar Aziz
    - Secretary to the Board – Dato' Mohd Nor bin Mashor
    - Governor's Office
    - Corporate Communications – Abu Hassan Alshari bin Yahaya
    - **DEPUTY GOVERNOR** – Dato' Ooi Sang Kuang
      - Internal Audit – Hor Weng Keng
      - **ASSISTANT GOVERNOR** – Vacant
        - Monetary Assessment and Strategy – Dr. Sukhdave Singh
        - Economics – V. Vijayaledchumy
        - International – Ismail bin Alowi
      - **ASSISTANT GOVERNOR** – Lillian Leong Bee Lian
        - Investment Operations and Financial Market – Norzila binti Abdul Aziz
        - Foreign Exchange Administration – Wan Hanisah binti Wan Ibrahim
        - Currency Management and Operation – Ramli bin Saad
      - **ASSISTANT GOVERNOR** – Gopala Krishnan Sundaram
        - Legal – Gopala Krishnan Sundaram
        - IT Services – Alizah binti Ali
        - Finance – Abdul Aziz bin Abdul Manaf
      - **ASSISTANT GOVERNOR** – Dato' Mohamad Daud bin Hj. Dol Moin
        - Human Resource Development Centre – Lim Lai Hong
        - Statistical Services – Chew Siew Kheam
        - Strategic Management – A. Kanagalingam
        - Risk Management – Santhini a/p Chandrapal
    - **DEPUTY GOVERNOR** – Datuk Zamani bin Abdul Ghani
      - Special Investigation – Johar bin Mokhtar
      - Financial Intelligence – Jeremy Lee Eng Huat
      - **ASSISTANT GOVERNOR** – Dato' Mohd Nor bin Mashor
        - Human Resource Management – Kamari Zaman bin Juhari
        - Corporate Services – Dato' Mohd Nor bin Mashor
        - Property and Services – Zulkifli bin Abd Rahman
        - Security – Mior Mohd Zain bin Mior Mohd Tahir
        - Financial Services Resource Centre – Lim Foo Thai
      - **ASSISTANT GOVERNOR** – Nor Shamsiah binti Mohd Yunus
        - Financial Conglomerates Supervision – Che Zakiah binti Che Din
        - Banking Supervision – Chung Chee Leong
        - Insurance and Takaful Supervision – Yap Lai Kuen
        - IT and DFI Supervision – Mahdi bin Mohd. Ariffin
        - Payment Systems Policy – Cheah Kim Ling
        - Regulation and Supervision Support Unit – Siti Ramlah binti Ahmad
    - **DEPUTY GOVERNOR** – Dato' Mohd Razif bin Abd. Kadir
      - **ASSISTANT GOVERNOR** – Muhammad bin Ibrahim
        - Financial Sector Development – Ahmad Hizzad bin Baharuddin
        - Financial Surveillance – Donald Joshua Jaganathan
        - Prudential Financial Policy – S. Abd. Rasheed bin S. Abd Ghafur
        - Consumer and Market Conduct – Koid Swee Lian
        - Islamic Banking and Takaful – Bakarudin bin Ishak
        - Development Finance and Enterprise – Marzunisham bin Omar

CERTIFICATE OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF BANK NEGARA MALAYSIA FOR THE YEAR ENDED 31 DECEMBER 2006

I have audited the financial statements of Bank Negara Malaysia for the year ended 31 December 2006. These financial statements are the responsibility of the management. My responsibility is to express an opinion on these financial statements based on my audit.

2. The audit has been conducted in accordance with the Audit Act 1957 and in accordance with approved auditing standards. Those standards require the audit be planned and performed to obtain reasonable assurance whether the financial statements are free of material misstatement. This audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Evaluation is also made on the accounting principles used and the overall financial statements presentation.

3. In my opinion, the financial statements give a true and fair view of the financial position of Bank Negara Malaysia as at 31 December 2006 and of the results of its operations for the year then ended in accordance with approved accounting standards.

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

PUTRAJAYA
9 MARCH 2007

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 2006 and of the results of operations for the year ended on that date.

On behalf of the Board,

ZETI AKHTAR AZIZ

CHAIRMAN

8 MARCH 2007
KUALA LUMPUR

On behalf of the Board,

OH SIEW NAM

DIRECTOR

8 MARCH 2007
KUALA LUMPUR

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

I, Abdul Aziz Abdul Manaf 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 8 March 2007.)

Before me,

PESURUHJAYA SUMPAH
No: W 027
Nama : NG LEONG HUAT
MALAYSIA

LEE HISHAMMUDDIN ALLEN & GLEDHILL
Level 16, Menara Asia Life
189, Jalan Tun Razak
50400 Kuala Lumpur.
Tel : 603-2161 2330
Fax : 603-2161 3933

Bank Negara Malaysia

Balance Sheet as at 31 December 2006

	Note	2006 RM	2005 RM
ASSETS			
Gold and Foreign Exchange	3	288,871,214,113	264,421,558,175
International Monetary Fund Reserve Position		793,377,077	1,186,337,566
Holdings of Special Drawing Rights		756,926,104	748,345,706
Malaysian Government Papers	4	1,504,154,121	961,013,021
Deposits with Financial Institutions		4,626,624,482	2,878,873,387
Loans and Advances	5	12,924,727,795	10,295,735,304
Other Assets	6	13,551,017,533	14,940,995,292
Total Assets		**323,028,041,225**	**295,432,858,451**
LIABILITIES AND CAPITAL			
Currency in Circulation		37,896,029,181	34,396,746,453
Deposits by: Financial Institutions		176,459,444,828	140,606,624,541
Federal Government		16,624,678,860	27,273,933,343
Others	7	2,199,409,354	4,297,159,874
Bank Negara Papers		24,793,933,282	20,347,587,398
Allocation of Special Drawing Rights	8	736,745,411	751,127,007
Other Liabilities	9	31,668,377,651	29,551,916,821
Total Liabilities		290,378,618,567	257,225,095,437
Authorised Capital RM200,000,000			
Paid-up Capital	10	100,000,000	100,000,000
General Reserve Fund	11	9,362,550,221	8,103,080,465
Other Reserves	12	23,186,872,437	30,004,682,549
Total Capital		32,649,422,658	38,207,763,014
Total Liabilities and Capital		**323,028,041,225**	**295,432,858,451**

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

Bank Negara Malaysia

Income Statement for the Year Ended 31 December 2006

	Note	2006 RM	2005 RM
Total Income	13	**4,843,406,554**	**4,989,023,000**
Less:			
Recurring Expenditure	14	773,866,381	809,055,659
Development Expenditure	15	610,070,417	619,004,191
Total Expenditure		**1,383,936,798**	**1,428,059,850**
Net Profit		**3,459,469,756**	**3,560,963,150**

Profit and Loss Appropriation Statement for the Year Ended 31 December 2006

	Note	2006 RM	2005 RM
Net Profit		**3,459,469,756**	**3,560,963,150**
Transfer to Other Reserves	16	1,000,000,000	1,000,000,000
Transfer to General Reserve Fund		1,259,469,756	1,360,963,150
Amount Payable to Federal Government		1,200,000,000	1,200,000,000
		3,459,469,756	**3,560,963,150**

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

Notes To The Financial Statements - 31 December 2006

1. **Principal Activities of the Bank**

   The Bank's principal roles and responsibilities are as follows:
   (a) to achieve monetary stability;
   (b) to promote a stable financial system;
   (c) to ensure an efficient payment system;
   (d) to issue currency in Malaysia; and
   (e) to act as a banker and a financial adviser to the Federal Government.

2. **Accounting Policies**

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

   2.1 **Basis of Preparation of Financial Statements**

   (a) These financial statements have been prepared in accordance with the Central Bank of Malaysia Act 1958 (Revised 1994) and applicable Malaysian Financial Reporting Standards (FRS) in as far as it is considered appropriate to the roles and responsibilities of the Bank. The Bank, having considered its responsibilities for the formulation and conducting effective monetary policy, is of the opinion that, it is appropriate to differ, in some aspects, from the Malaysian FRS.

   (b) The preparation of the financial statements in conformity with the requirements of the Malaysian FRS requires management to use certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the financial year. Although these estimates are based on the management's best knowledge of current events and actions, the actual results could differ from those estimates.

   2.2 **Measurement Base and Accrual Accounting**

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

   2.3 **Foreign Currency Translation**

   (a) The financial statements have been prepared using Ringgit Malaysia, the currency of the primary economic environment in which the Bank operates.

   (b) Assets and liabilities in foreign currencies have been revalued into Ringgit Malaysia at rates of exchange prevailing on the balance sheet date. Transactions in foreign currencies during the year have been translated into Ringgit Malaysia at rates of exchange prevailing on the value dates.

   (c) The International Reserves comprising Gold and Foreign Exchange, International Monetary Fund Reserve Position and Holdings of Special Drawing Rights as at 31 December 2006 was RM290,421.5 million equivalent to USD82,457.3 million.

   2.4 **Gold, Securities and Investments**

   Gold, securities and investments are stated at cost and provisions have been made for diminution in value as at 31 December 2006.

2.5 **Repurchase and Reverse-Repurchase Agreements**

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

3. **Gold and Foreign Exchange**

	2006 RM	2005 RM
Foreign Securities	222,484,196,755	214,223,340,658
Foreign Deposits	45,754,677,766	30,954,385,954
Balances with Other Central Banks, Bank for International Settlements (BIS) and International Monetary Fund (IMF)	7,689,540,079	5,043,988,892
Others	12,942,799,513	14,199,842,671
	288,871,214,113	264,421,558,175

With effect from May 2006, other foreign currency claims on residents are reclassified from 'Gold and Foreign Exchange' to 'Other Assets'.

4. **Malaysian Government Papers**

	2006 RM	2005 RM
Malaysian Government Securities	1,504,154,121	961,013,021

5. **Loans and Advances**

Loans and advances comprise mainly advances extended by the Bank to the participating institutions under section 30(1) of the Central Bank of Malaysia Act 1958.

6. **Other Assets**

Other assets include investments in shares and bonds of RM13,181,520,663 acquired under section 30(1)(j) and section 30(1)(oo)(i) of the Central Bank of Malaysia Act 1958.

7. **Deposits by Others**

A substantial part of these deposits comprises deposits from Federal Statutory Authorities.

8. **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 cumulation of the allocation was RM736,745,411 equivalent to SDR139,048,000.

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

10. **Paid-up Capital**
The entire issued and paid-up capital of RM100 million is owned by the Government of Malaysia.

11. **General Reserve Fund**

	2006	**2005**
	RM	**RM**
As at 1 January	8,103,080,465	6,742,117,315
Transfer from Net Profit	1,259,469,756	1,360,963,150
As at 31 December	9,362,550,221	8,103,080,465

12. **Other Reserves**
Other reserves comprise the Exchange Rate Fluctuation Reserve and the Contingency Reserve.

13. **Total Income**
Total income comprises revenue from foreign reserve management which includes interest and dividends, non-treasury income and is stated at net of amortisation/accretion of premiums/discounts and the monetary policy cost.

14. **Recurring Expenditure**
Recurring expenditure are expenses incurred in the management and administration of the day-to-day operations of the Bank.

15. **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 roles and responsibilities.

16. **Transfer to Other Reserves**
This transfer is made in accordance with section 7(2) of Central Bank of Malaysia Act 1958.

17. **Contingent Liabilities**
Total contingent liabilities as at 31 December 2006 amounted to RM7,487,719,316. These comprise:
(a) an amount of RM7,423,739,965 which represents the obligation of the Bank to pay in full, in SDR or other convertible currencies, the amount of Malaysia's quota in the IMF under the Articles of Agreement; and
(b) an amount of RM63,979,351 which represents the uncalled portion of the 3,220 units of shares held by the Bank in Bank for International Settlements. The amount is based on the nominal value (SDR5,000) of the uncalled portion and SDR rate as at the balance sheet date.

18. **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.

Foreign Exchange Administration Policies

Bank Negara Malaysia has undertaken further liberalisation of the foreign exchange administration policies to enhance the efficiency of the system and provide greater flexibility in the management of foreign exchange transactions. Bank Negara Malaysia has also amended the Exchange Control Act 1953 to strengthen the regulatory framework including the enforcement and surveillance provisions relating to foreign exchange transactions.

Liberalisation of Foreign Exchange Administration Policies

With effect from 1 April 2007, foreign exchange administration rules are liberalised to:

(a) Expand the scope of licensed onshore banks' foreign currency business;

(b) Facilitate investments in ringgit assets by non-residents;

(c) Enhance business efficiency and investment opportunities; and

(d) Facilitate development of the capital market.

Expanding Scope of Licensed Onshore Banks' Foreign Currency Business

To provide greater flexibility to licensed onshore banks to undertake foreign currency business, the following foreign exchange administration rules are liberalised:

(a) Abolish net open position limit of licensed onshore banks which was previously capped at 20% of the banks' capital base. The limit is abolished in view of the implementation of a more comprehensive regulatory capital framework for foreign currency risks.

(b) Abolish the limit imposed on licensed onshore banks for foreign currency accounts maintained by residents. The removal of the limit is to facilitate licensed onshore banks' readiness in enhancing capacity and capability to deal in foreign currency as well as to support the initiative to promote Malaysia as an Islamic Financial Centre.

(c) Allow investment banks in Malaysia to undertake foreign currency business subject to a comprehensive supervisory review on the capacity and capability of the investment banks.

Facilitating Investments in Ringgit Assets by Non-Residents in Promoting Malaysia as an Investment Destination

To widen the investor base for ringgit assets and financial products, the following foreign exchange administration rules are liberalised:

(a) Further flexibility for non-resident stockbroking companies and custodian banks to obtain ringgit overdraft facility from licensed onshore banks to avoid settlement failure due to inadvertent delays by:

    (i) Removing the previous overdraft limit of RM200 million; and

(ii) Expanding the scope on utilisation of the overdraft facility to include ringgit instruments settled through the Real Time Electronic Transfer of Funds and Securities (RENTAS) System and Bursa Malaysia. Previously, utilisation of the facility was confined only to shares traded on Bursa Malaysia.

The licensed onshore banks, in granting the overdraft facility, would continue to be required to observe the following conditions:

(i) The facility is not for funding purposes and granted strictly for settlement due to inadvertent or technical delays as well as time zone differences; and

(ii) The facility must not exceed two working days with no rollover options.

(b) Abolish the limit on the number of residential or commercial property loans obtained by non-residents. Under the previous policy, non-residents were allowed to obtain a maximum limit of three property loans from residents to finance the purchase or construction of residential or commercial properties in Malaysia.

(c) Allow licensed onshore banks to appoint overseas branches of their banking group as a vehicle to facilitate the settlement of any ringgit assets of their non-resident clients.

The ringgit transactions undertaken by the overseas branches would be subject to the following conditions:

(i) The overseas branches must conduct only straight pass-through transactions matched with a back-to-back arrangement on both amount and tenure with the licensed onshore banks. There will be no gapping of the ringgit positions in the books of the overseas branches;

(ii) This arrangement will be made available only to non-resident investors with firm underlying commitment to invest in ringgit assets; and

(iii) The licensed onshore banks will undertake full responsibility to ensure compliance on the conditions by establishing internal control and procedures as well as documentation of the overseas branches' transactions for audit purposes.

(d) Remove the restriction on Labuan offshore banks to transact in ringgit financial products on behalf of non-resident clients to enhance the role and scope of business of the Labuan offshore banks.

Enhancing Business Efficiency and Investment Opportunities for Residents

To reduce cost of doing business, enhance business efficiency as well as promote Malaysia as a centre of origination, the following foreign exchange administration rules are liberalised:

(a) Increase the limit of foreign currency borrowing that can be obtained by resident corporations from licensed onshore banks and non-residents as well as through issuance of onshore foreign currency bonds, to RM100 million equivalent in aggregate and on corporate group basis from the previous RM50 million equivalent. The proceeds may be used for domestic purposes or offshore investment.

(b) Allow residents to hedge foreign currency loan repayment up to the full amount of underlying commitment. Under the previous policy, hedging for foreign currency loan repayment was allowed only up to 24 months' commitment. The flexibility would provide greater degree of risk management facilities to businesses in Malaysia, thus reduce the country's vulnerability to external shocks.

(c) Enhance flexibilities for resident individuals and corporations to invest in foreign currency assets as follows:

(i) Increase the limit for resident individuals with domestic ringgit borrowing to invest in foreign currency assets up to RM1 million per calendar year from the previous limit of RM100,000; and

(ii) Increase the limit for resident corporations with domestic ringgit borrowing to invest in foreign currency assets up to RM50 million per calendar year from the previous limit of RM10 million.

(d) Increase the limit for resident institutional investors to invest in foreign currency assets as follows:

(i) Unit trust companies: up to 50% of net asset value (NAV) attributable to residents from the previous 30% of NAV;

(ii) Fund management companies: up to 50% of funds of resident clients with domestic credit facilities from the previous 30% level; and

(iii) Insurance companies and takaful operators: up to 50% of NAV of investment-linked funds marketed from the previous 30% of NAV.

(e) Allow resident corporations to lend in foreign currency, the proceeds arising from listing of shares on foreign stock exchanges to other resident corporations within the same corporate group in Malaysia.

(f) Abolish restrictions on payments in foreign currency between residents for settlement of foreign currency financial products offered onshore.

(g) Allow resident individuals to open and maintain joint foreign currency accounts for any purpose. Previously, resident individuals were allowed to maintain joint foreign currency accounts only for purposes of education and employment overseas.

Facilitating Development of the Capital Market

To support the intiatives to expand the pool of high quality stocks and to provide diversity of offerings and promote cross-border linkages with other markets, the following foreign exchange administration rules are liberalised:

(a) Allow non-resident corporations to utilise proceeds arising from the listing of shares through Initial Public Offering on the Main Board of Bursa Malaysia, abroad; and

(b) Allow resident corporations to utilise proceeds arising from the listing of shares through Initial Public Offering on the Main Board of Bursa Malaysia for offshore investment purposes.

Amendments to the Regulatory Framework

The Exchange Control Act 1953 (ECA) was amended to strengthen the enforcement and surveillance provisions to address illegal foreign exchange trading. In addition, a new provision was included in the ECA to regulate the issuance and obtaining of financial guarantees by residents. The amendments of the ECA, which were effective on 1 January 2007, include the following:

(a) Increased penalty amount for illegal dealings in foreign currency from RM10,000 to RM1 million and imprisonment term from three years to five years;

(b) Increased compound up to 50% of the penalty amount for all offences;

(c) Allowed investigating officers to obtain information and documents from advocates during investigation;

(d) Increased retention period of seized articles, including documents from three months to twelve months to facilitate investigation;

(e) Allowed search warrants to be issued to investigating officers of Bank Negara Malaysia to facilitate investigation process; and

(f) Required a resident to seek prior permission from the Controller of Foreign Exchange (Controller) to issue financial guarantee to or on behalf of a non-resident or obtain financial guarantee from a non-resident.

A blueprint for the money-changing industry was also developed to chart the direction of the industry aimed at enhancing the corporate governance of the licensees, strengthening Bank Negara Malaysia's surveillance and enforcement, improving regulatory delivery channel and ensuring customer protection.

Reporting Requirement

To reduce cost of doing business and enhance the efficiency of the regulatory delivery system, with effect from 1 January 2007, only resident companies which have registered or have been permitted to make investments abroad or obtain foreign currency credit facilities exceeding RM50 million equivalent, are required to submit a quarterly report on the external assets and liabilities of the companies to the Controller.

For further information on the foreign exchange administration policies, details can be obtained from Bank Negara Malaysia's website, http://www.bnm.gov.my/fxadmin

Key Economic and Financial Statistics

Table A.1
Gross Domestic Product by Kind of Economic Activity in Constant 1987 Prices

	2002	2003	2004	2005	2006*p*	2007*f*
	RM million					
Agriculture	19,064	20,109	21,107	21,626	23,009	23,746
Mining and quarrying	15,810	16,720	17,372	17,504	17,465	17,955
Manufacturing	66,019	71,691	78,742	82,724	88,542	94,427
Construction	7,251	7,359	7,248	7,133	7,097	7,310
Services	127,968	133,956	143,310	152,571	162,469	172,697
Less: Imputed bank service charges	21,073	22,622	23,461	24,296	25,215	26,122
Plus: Import duties	5,384	5,282	4,995	4,912	4,306	4,359
GDP at purchasers' prices[1]	**220,422**	**232,496**	**249,314**	**262,175**	**277,673**	**294,373**
	Annual change (%)					
Agriculture	2.8	5.5	5.0	2.5	6.4	3.2
Mining and quarrying	4.3	5.8	3.9	0.8	-0.2	2.8
Manufacturing	4.3	8.6	9.8	5.1	7.0	6.6
Construction	2.0	1.5	-1.5	-1.6	-0.5	3.0
Services	6.5	4.7	7.0	6.5	6.5	6.3
Less: Imputed bank service charges	19.2	7.3	3.7	3.6	3.8	3.6
Plus: Import duties	17.2	-1.9	-5.4	-1.7	-12.3	1.2
GDP at purchasers' prices	**4.4**	**5.5**	**7.2**	**5.2**	**5.9**	**6.0**

[1] Numbers may not necessarily add up due to rounding
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.2
Growth in Manufacturing Production (2000=100)

	2003	2004	2005	2006	2004	2005	2006
	Index				Annual change (%)		
Export-oriented industries	**107.9**	**123.8**	**130.8**	**140.7**	**14.8**	**5.7**	**7.5**
Electrical machinery, apparatus, appliances and supplies	104.4	124.5	128.9	139.1	19.3	3.5	7.9
Electronics	*108.3*	*136.0*	*143.0*	*160.0*	*25.6*	*5.2*	*11.8*
Electrical products	*96.8*	*102.1*	*101.3*	*98.3*	*5.5*	*-0.8*	*-2.9*
Chemicals and chemical products	117.2	134.9	149.7	154.5	15.1	11.0	3.2
Petroleum products[1]	116.0	127.4	141.2	160.4	9.8	10.8	13.6
Textiles, wearing apparel and footwear	85.5	81.4	84.1	89.3	-4.8	3.4	6.1
Wood and wood products	95.7	107.9	109.6	113.8	12.8	1.5	3.8
Rubber products	124.2	134.3	133.8	143.4	8.1	-0.4	7.2
Off-estate processing	118.0	121.2	131.0	138.5	2.7	8.1	5.7
Others	90.0	111.4	107.4	119.4	23.9	-3.7	11.3
Domestic-oriented industries	**114.0**	**119.9**	**123.2**	**132.1**	**5.2**	**2.8**	**7.2**
Construction-related products	109.8	111.2	110.7	114.2	1.3	-0.5	3.2
Non-metallic mineral products	*114.0*	*111.0*	*113.2*	*117.0*	*-2.6*	*2.0*	*3.3*
Basic iron & steel and non-ferrous metal	*101.8*	*111.7*	*105.8*	*109.0*	*9.7*	*-5.3*	*3.0*
Food products	118.1	120.5	129.7	138.3	2.0	7.6	6.7
Transport equipment	124.0	138.5	150.2	147.9	11.7	8.5	-1.5
Fabricated metal products	116.6	129.9	123.5	156.3	11.4	-4.9	26.5
Paper products	106.2	110.7	119.0	134.6	4.2	7.5	13.1
Beverages	110.9	112.4	119.3	112.9	1.4	6.1	-5.3
Tobacco products	87.9	90.5	87.8	83.6	2.9	-3.0	-4.7
Total	**109.1**	**123.0**	**129.3**	**139.0**	**12.8**	**5.1**	**7.5**

[1] Under the new Industrial Production Index (2000=100), LNG has been reclassified as petroleum products (previously classified as chemicals and chemical products). Consequently, petroleum products have been reclassified as export-oriented industries

Source: Department of Statistics, Malaysia

Table A.3
Production of Primary Commodities

		2002	2003	2004	2005	2006*p*	2003	2004	2005	2006*p*
		Volume					Annual Change (%)			
Crude palm oil	('000 tonnes)	11,909	13,355	13,976	14,961	15,881	12.1	4.7	7.0	6.1
Rubber[1]	('000 tonnes)	890	986	1,169	1,126	1,260	10.8	18.6	-3.7	11.9
Saw logs	('000 cu. metres)	20,649	21,532	21,781	22,119	21,180	4.3	1.2	1.6	-4.2
Cocoa	('000 tonnes)	48	36	33	28	32	-24.0	-7.8	-16.3	14.2
Crude oil (including condensates)	('000 bpd)	698	738	762	704	700	5.6	3.3	-7.7	-0.5
Natural gas	(mmscfd)	4,676	5,013	5,196	5,797	5,774	7.2	3.7	11.6	-0.4
Tin-in-concentrates	('000 tonnes)	4.2	3.4	2.7	2.9	2.4	-20.3	-18.3	4.1	-17.2

[1] Revised from 2000 onwards based on new data methodology
p Preliminary

Source: Malaysian Palm Oil Board
Department of Statistics, Malaysia
Forestry Departments (Peninsular Malaysia, Sabah & Sarawak)
Malaysian Cocoa Board
PETRONAS
Minerals and Geoscience Department, Malaysia

Table A.4
GNP by Demand Aggregates

	2002	2003	2004	2005	2006*p*	2007*f*
	at Current Prices (RM million)					
Consumption	209,022	227,277	252,088	279,957	309,197	335,494
Private consumption	*159,506*	*172,366*	*192,771*	*215,876*	*238,803*	*260,773*
Public consumption	*49,516*	*54,911*	*59,317*	*64,081*	*70,394*	*74,721*
Investment	83,764	87,089	91,818	98,930	110,396	126,016
Private investment	*29,376*	*29,856*	*39,736*	*44,360*	*50,287*	*57,150*
Public investment	*54,388*	*57,233*	*52,082*	*54,570*	*60,109*	*68,866*
Change in stocks[1]	3,105	-1,658	10,552	-200	-920	-2,470
Exports of goods and services	415,040	447,846	544,956	611,082	667,597	725,820
Imports of goods and services	348,919	365,383	449,262	494,529	539,928	594,839
GDP at purchasers' value	362,012	395,170	450,152	495,239	546,343	590,021
Net factor payments abroad	-25,061	-22,537	-24,549	-23,908	-19,825	-22,108
GNP at purchasers' value	336,951	372,633	425,603	471,331	526,518	567,913
	at Constant 1987 Prices (RM million)					
Consumption	132,872	143,162	156,739	169,792	182,068	192,796
Private consumption	*101,946*	*108,722*	*120,181*	*131,266*	*140,502*	*149,540*
Public consumption	*30,926*	*34,440*	*36,558*	*38,526*	*41,566*	*43,256*
Investment	63,249	64,960	66,996	70,175	75,745	84,025
Private investment	*22,181*	*22,270*	*28,994*	*31,466*	*34,523*	*38,107*
Public investment	*41,068*	*42,690*	*38,002*	*38,709*	*41,222*	*45,918*
Change in stocks[1]	3,200	-1,094	5,823	-838	-2,043	-2,246
Exports of goods and services	237,904	251,463	292,476	317,693	337,821	359,026
Imports of goods and services	216,802	225,996	272,721	294,647	315,918	339,227
GDP at purchasers' value	220,422	232,496	249,314	262,175	277,673	294,373
Net factor payments abroad	-17,253	-15,204	-15,870	-15,965	-15,743	-18,655
GNP at purchasers' value	203,169	217,292	233,443	246,210	261,930	275,719

[1] Includes statistical discrepancy
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5
Savings-Investment Gap

	2002	2003	2004	2005	2006*p*	2007*f*
	RM million					
Public gross domestic capital formation	54,388	57,233	52,082	54,570	60,109	68,866
Public savings	48,593	60,093	73,000	70,506	101,737	111,728
Deficit/surplus	-5,795	2,860	20,918	15,936	41,628	42,862
Private gross domestic capital formation	32,481	28,198	50,288	44,160	49,367	54,680
Private savings	68,770	75,963	85,881	103,905	68,953	104,471
Deficit/surplus	36,289	47,765	35,593	59,745	49,586	49,791
Gross domestic capital formation	86,869	85,431	102,370	98,730	109,476	123,546
(as % of GNP)	25.8	22.9	24.1	20.9	20.8	21.8
Gross national savings	117,363	136,056	158,881	174,411	200,690	216,199
(as % of GNP)	34.8	36.5	37.3	37.0	38.1	38.1
Balance on current account	30,494	50,625	56,511	75,681	91,214	92,653
(as % of GNP)	9.0	13.6	13.3	16.1	17.3	16.3

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.6
Labour Market: Selected Indicators

	2002	2003	2004	2005	2006e
	(number of position/persons)				
New Vacancies Reported by Industry[1]					
Agriculture, hunting, forestry & fishery	43,805	29,048	1,373	40,438	188,104
Mining & quarrying	321	121	41	150	861
Manufacturing	75,655	34,977	17,769	112,542	348,302
Construction	19,001	13,818	3,505	48,524	129,586
Services	24,005	18,954	18,624	63,441	154,902
Electricity, gas & water	*326*	*499*	*198*	*859*	*2,227*
Wholesale and retail trade, hotels & restaurants	*9,472*	*7,359*	*5,221*	*23,921*	*67,956*
Transport, storage & communication	*2,378*	*1,459*	*1,046*	*3,892*	*8,287*
Finance, insurance, real estate & business services	*4,874*	*4,079*	*6,162*	*13,874*	*26,642*
Public administration, defence & compulsory social security	*6,955*	*5,558*	*1,224*	*2,497*	*3,539*
Community, social and personal service activities			*4,773*	*18,398*	*46,251*
Others not elsewhere classified	-	-	8,663	39,405	12,920
Total vacancies	**162,787**	**96,918**	**49,975**	**304,500**	**834,675**
Retrenchment by Job Category					
Adminstration and management	2,239	1,755	2,072	1,712	1,245
Professional, technician and associate professional	3,511	3,661	2,542	2,689	2,471
Clerical workers	2,639	2,481	1,550	1,295	1,370
Service, shop, and market sales workers	2,263	1,818	3,201	1,792	2,501
Skilled agriculture and fishery workers	435	337	998	50	307
Production workers[2]	15,365	11,154	9,593	8,571	7,466
Total retrenchments	**26,452**	**21,206**	**19,956**	**16,109**	**15,360**
Employment by Industry[3] ('000 persons)					
Agriculture, forestry, livestock and fishery	1,418.0	1,413.2	1,406.9	1,401.3	1,392.4
Mining & quarrying	41.6	42.2	42.6	42.7	42.6
Manufacturing	2,596.1	2,776.4	2,972.4	3,133.2	3,236.8
Construction	767.3	774.6	767.3	759.6	755.2
Services	4,885.9	5,040.7	5,274.5	5,555.9	5,717.2
Electricity, gas & water	*81.7*	*85.5*	*89.9*	*93.0*	*95.0*
Transport, storage & communication	*519.5*	*548.7*	*594.3*	*630.6*	*646.4*
Wholesale and retail trade, hotels & restaurants	*1,672.6*	*1,698.1*	*1,786.4*	*1,927.0*	*1,986.1*
Finance, insurance, real estate & business services	*624.4*	*657.5*	*695.0*	*734.4*	*771.0*
Government services	*994.5*	*1,026.1*	*1,041.8*	*1,052.8*	*1,064.0*
Other services	*993.1*	*1,024.8*	*1,067.1*	*1,118.1*	*1,154.7*
Total employment	**9,709.0**	**10,047.2**	**10,463.7**	**10,892.8**	**11,144.1**
Unemployment rate (% of labour force)[3]	**3.5**	**3.6**	**3.5**	**3.5**	**3.5**

[1] Refers to new vacancies reported by employers through the Electronic Labour Exchange
[2] Comprise workers in craft and related trade; plant and machine operators and assemblers; and general workers
[3] Refers to estimates by Economic Planning Unit
e Estimates

Source: Economic Planning Unit and Ministry of Human Resources

Table A.7
Private Consumption Indicators

	2005	2006				
		1Q	2Q	3Q	4Q	Year
Sales of passenger cars ('000 units)	426.9	91.9	99.9	100.0	82.4	374.2
Annual change (%)	8.9	-9.5	-3.4	-9.7	-26.0	-12.3
Imports of consumption goods (RM billion)	24.6	6.4	6.8	7.4	7.4	27.9
Annual change (%)	7.4	14.0	12.8	14.7	12.1	13.4
Tax collection						
Sales tax (RM billion)	7.1	1.2	1.8	1.5	1.6	6.1
Service tax (RM billion)	2.6	0.5	0.7	0.6	0.8	2.6
Narrow Money (M1)						
Annual change (%)	8.5	5.7	10.1	11.5	13.8	13.8
Loans disbursed by banking system						
Consumption credit (excl. passenger cars)						
Annual change (%)	10.2	12.9	14.5	6.8	8.1	10.5
Retail trade, restaurants and hotels						
Annual change (%)	16.5	7.0	-1.6	-13.7	-16.7	-6.8
MRA retail sales (Annual change in %)	6.2	9.6	9.2	6.8	6.0	7.5
Credit card turnover spending (RM billion)	41.8	11.1	11.3	12.3	12.7	47.3
Annual change (%)	13.0	12.7	15.3	14.0	11.5	13.3
MIER Consumer Sentiment Index	-	90.1	104.2	107.5	110.9	-
KL Composite Index	899.8	926.6	914.7	967.6	1,096.2	1,096.2
Commodity prices						
CPO (RM/tonne)	1,398	1,427	1,411	1,529	1,716	1,521
Crude oil (USD/barrel)	57	67	74	73	62	69
Rubber (sen/kg)	523	689	778	760	608	709

Table A.8
Private Investment Indicators

	2005	2006				
		1Q	2Q	3Q	4Q	Year
Sales of commercial vehicles ('000 units)	125.4	32.0	27.5	31.1	26.0	116.6
Annual change (%)	31.4	25.2	-10.2	-15.0	-20.6	-7.1
Imports of capital goods (RM billion)	60.7	15.8	16.7	16.2	16.7	65.3
Annual change (%)	9.5	27.8	7.9	-4.6	4.6	7.6
Approvals by MITI (Manufacturing sector)						
No. of projects	1,027	217	285	269	306	1,077
Capital investment (RM billion)	31.1	5.2	9.9	20.0	10.9	46.0
Foreign	*17.9*	*3.9*	*2.9*	*7.0*	*6.5*	*20.2*
Local	*13.2*	*1.4*	*7.0*	*13.0*	*4.4*	*25.8*
New investment (% share)	44.6	29.7	55.1	83.9	51.2	63.8
Reinvestments (% share)	55.4	70.3	44.9	16.1	48.8	36.2
Loans disbursed by banking system						
Manufacturing sector						
Annual change (%)	4.2	-5.7	-7.8	-5.4	-3.4	-5.6
Construction sector						
Annual change (%)	0.3	0.7	6.1	-4.3	2.2	1.1
Private Debt Securities (excluding Cagamas)						
Total funds raised (RM billion)	35.7	6.9	8.8	7.9	8.1	31.7
New activities	17.7	5.4	4.7	5.2	5.6	21.0
Initial Public Offerings (Bursa Malaysia)						
Total funds raised (RM billion)	5.3	0.3	0.4	0.4	0.5	1.5
MIER Business Conditions Survey						
Business Conditions Index	-	102.5	102.4	107.8	107.2	-
Capacity Utilisation Rate	-	79.8	79.8	83.2	82.4	-
MSC-Status Companies						
No. of companies	258	48	60	67	132	307
Approved investment (RM billion)	1.8	0.5	0.7	0.6	1.1	2.9

Table A.9
Balance of Payments

Item	2003			2004		
	+	-	Net	+	-	Net
	RM million					
Goods[1]	**397,969**	**300,207**	**97,762**	**481,240**	**376,766**	**104,474**
Trade account	*397,884*	*316,538*	*81,347*	*481,253*	*399,632*	*81,621*
Services	**49,876**	**65,176**	**-15,300**	**63,717**	**72,496**	**-8,780**
Transportation	10,615	24,101	-13,486	12,018	29,801	-17,783
Travel	22,411	10,888	11,523	31,152	11,754	19,398
Other services	16,384	29,395	-13,011	20,120	29,795	-9,675
Government transactions n.i.e.[2]	466	793	-327	426	1,147	-721
Balance on goods and services	**447,846**	**365,383**	**82,462**	**544,956**	**449,262**	**95,694**
Income	**13,134**	**35,671**	**-22,537**	**16,023**	**40,572**	**-24,549**
Compensation of employees	2,201	3,161	-960	2,618	3,760	-1,142
Investment income[3]	10,933	32,510	-21,577	13,405	36,812	-23,408
Current transfers	**1,929**	**11,229**	**-9,300**	**1,700**	**16,333**	**-14,633**
Balance on current account	**462,910**	**412,283**	**50,625**	**562,681**	**506,169**	**56,511**
% of GNP			**13.6**			**13.3**
Capital account			-			-
Financial account			**-12,146**			**16,791**
Direct investment			4,194			9,739
Abroad			*-5,204*			***-7,833***
In Malaysia			*9,398*			***17,572***
Portfolio investment			4,168			31,965
Other investment			-20,508			-24,913
Official sector			*-11,201*			***2,427***
Private sector			*-9,307*			***-27,340***
Balance on capital and financial account			**-12,146**			**16,791**
Errors and omissions			**1,223**			**10,482**
of which:						
Foreign exchange revaluation gain (+)/ loss (-)			11,927			7,997
Overall balance (surplus + / deficit -)			**39,703**			**83,784**
Bank Negara Malaysia international reserves, net[4]						
RM million			167,812			251,596
USD million equivalent			44,161			66,209
Reserves as months of retained imports			6.5			7.9

[1] Adjusted for valuation and coverage to the balance of payments basis. Imports include military goods which are not included in trade data
[2] Include transactions of foreign military and diplomatic establishments
[3] Include undistributed earnings of foreign direct investment companies. The counterpart of these earnings is shown as reinvested earnings under "Direct Investment" in the Financial Account
[4] All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account
e Estimate
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

2005			2006*e*			2007*f*		
+	-	Net	+	-	Net	+	-	Net
				RM million				
536,955	**411,393**	**125,562**	**589,636**	**454,613**	**135,023**	**638,543**	**500,853**	**137,690**
533,788	*434,010*	*99,778*	*588,965*	*480,773*	*108,193*	*637,212*	*527,767*	*109,445*
74,127	**83,136**	**-9,010**	**77,960**	**85,314**	**-7,354**	**87,277**	**93,986**	**-6,710**
15,357	31,790	-16,433	16,271	34,919	-18,648	16,886	38,210	-21,324
33,500	14,051	19,449	35,324	13,717	21,607	43,368	16,980	26,388
24,842	36,518	-11,676	25,965	35,844	-9,879	26,604	37,912	-11,308
428	777	-350	401	834	-434	419	884	-465
611,082	**494,529**	**116,552**	**667,597**	**539,928**	**127,669**	**725,820**	**594,839**	**130,980**
20,346	**44,255**	**-23,908**	**30,451**	**50,276**	**-19,825**	**29,114**	**51,222**	**-22,108**
4,229	4,711	-482	4,844	5,166	-323	4,901	5,241	-340
16,117	39,543	-23,426	25,607	45,110	-19,503	24,213	45,981	-21,768
1,131	**18,095**	**-16,963**	**1,091**	**17,722**	**-16,630**	**1,046**	**17,266**	**-16,220**
632,559	**556,880**	**75,681**	**699,139**	**607,926**	**91,214**	**755,980**	**663,327**	**92,653**
		16.1			**17.3**			**16.3**
		-			-			
		-37,018			**-39,919**			
		3,771			4,343			
		-11,253			*-21,532*			
		15,024			*25,875*			
		-14,156			14,726			
		-26,633			-58,988			
		-3,150			*-8,018*			
		-23,484			*-50,970*			
		-37,018			**-39,919**			
		-25,111			**-26,045**			
		-15,496			-6,944			
		13,552			**25,251**			
		265,148			290,399			
		70,169			82,451			
		7.7			7.8			

Table A.10
Gross Exports

	2004	2005	2006*p*	2005	2006*p*	2006*p*
	RM million			Annual change (%)		% share
Manufactured goods	**390,938**	**429,873**	**473,213**	**10.0**	**10.1**	**80.3**
of which:						
Electronics, electrical machinery and appliances	257,221	282,779	300,861	9.9	6.4	51.1
Electronics	188,567	208,232	221,257	10.4	6.3	37.6
Semiconductor	*89,272*	*89,967*	*93,505*	*0.8*	*3.9*	*15.9*
Electronic equipment & parts	*99,295*	*118,265*	*127,752*	*19.1*	*8.0*	*21.7*
Electrical machinery & appliances	68,654	74,547	79,604	8.6	6.8	13.5
Consumer electrical products	*22,249*	*22,632*	*19,099*	*1.7*	*-15.6*	*3.2*
Industrial & commercial electrical products	*25,843*	*28,608*	*34,489*	*10.7*	*20.6*	*5.9*
Electrical industrial machinery and equipment	*17,841*	*20,476*	*22,844*	*14.8*	*11.6*	*3.9*
Household electrical appliances	*2,721*	*2,831*	*3,172*	*4.0*	*12.0*	*0.5*
Chemicals & chemical products	27,836	29,718	32,893	6.8	10.7	5.6
Manufactures of metal	15,969	17,157	22,817	7.4	33.0	3.9
Petroleum products	13,421	16,729	21,274	24.7	27.2	3.6
Optical and scientific equipment	11,615	12,318	13,558	6.1	10.1	2.3
Textiles, clothing and footwear	10,350	10,520	11,226	1.6	6.7	1.9
Wood products	8,680	8,860	10,343	2.1	16.7	1.8
Rubber products	6,073	6,777	9,101	11.6	34.3	1.5
Minerals	**41,391**	**52,321**	**56,844**	**26.4**	**8.6**	**9.7**
of which:						
Crude oil and condensates	21,494	28,508	30,814	32.6	8.1	5.2
LNG	17,189	20,790	23,285	21.0	12.0	4.0
Agricultural commodities	**37,183**	**37,421**	**42,106**	**0.6**	**12.5**	**7.1**
of which:						
Palm oil	20,842	19,036	21,643	-8.7	13.7	3.7
Rubber	5,205	5,787	8,235	11.2	42.3	1.4
Other exports	**11,741**	**14,173**	**16,802**	**20.7**	**18.6**	**2.9**
Total	**481,253**	**533,788**	**588,965**	**10.9**	**10.3**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.11
Exports of Primary Commodities

	2004	2005	2006*p*	2005	2006*p*
	Volume and value			Annual change (%)	
Commodity exports (RM million)	**78,574**	**89,742**	**98,950**	**14.2**	**10.3**
Agriculture exports (RM million)	**37,183**	**37,421**	**42,106**	**0.6**	**12.5**
of which:					
Palm oil					
('000 tonnes)	12,223	13,073	14,017	7.0	7.2
(RM/tonne)	1,705	1,456	1,544	-14.6	6.0
(RM million)	20,842	19,036	21,643	-8.7	13.7
Palm kernel oil					
('000 tonnes)	493	577	518	16.9	-10.1
(RM/tonne)	2,355	2,347	1,969	-0.3	-16.1
(RM million)	1,162	1,353	1,020	16.5	-24.6
Rubber					
('000 tonnes)	1,108	1,128	1,143	1.8	1.3
(sen/kilogramme)	470	513	721	9.2	40.5
(RM million)	5,205	5,787	8,235	11.2	42.3
Saw logs					
('000 cubic metres)	5,312	5,759	4,772	8.4	-17.1
(RM/cubic metre)	402	428	474	6.4	10.7
(RM million)	2,136	2,465	2,261	15.4	-8.3
Sawn timber					
('000 cubic metres)	3,163	3,685	3,318	16.5	-9.9
(RM/cubic metre)	1,119	1,099	1,306	-1.8	18.8
(RM million)	3,541	4,051	4,333	14.4	7.0
Cocoa beans					
('000 tonnes)	9.4	9.3	13.5	-1.4	45.8
(RM/tonne)	5,557	5,421	5,624	-2.4	3.7
(RM million)	52	50	76	-3.9	51.2
Mineral exports (RM million)	**41,391**	**52,321**	**56,844**	**26.4**	**8.6**
of which:					
Crude oil and condensates					
('000 tonnes)	18,047	17,719	16,304	-1.8	-8.0
(USD/barrel)	41.24	55.93	67.82	35.6	21.3
(RM million)	21,494	28,508	30,814	32.6	8.1
Liquefied natural gas (LNG)					
('000 tonnes)	20,525	21,948	21,534	6.9	-1.9
(RM/tonne)	837	947	1,081	13.1	14.2
(RM million)	17,189	20,790	23,285	21.0	12.0
Tin					
('000 tonnes)	30.1	33.6	19.4	11.7	-42.3
(RM/tonne)	31,700	27,827	30,093	-12.2	8.1
(RM million)	954	935	583	-2.0	-37.7

p Preliminary

Source: Department of Statistics, Malaysia

Table A.12
Principal Markets for Manufactured Exports

Country	2002	2003	2004	2005	2006*p*	2002	2003	2004	2005	2006*p*
	RM million					% share				
ASEAN	**78,981**	**82,481**	**99,086**	**110,946**	**121,973**	**26.2**	**25.3**	**25.3**	**25.8**	**25.8**
Singapore	55,917	57,367	65,516	73,872	80,201	18.5	17.6	16.8	17.2	17.0
Thailand	12,319	13,552	17,631	21,300	24,223	4.1	4.2	4.5	5.0	5.1
Indonesia	5,627	6,291	8,956	9,482	10,603	1.9	1.9	2.3	2.2	2.2
Philippines	4,249	4,346	6,037	5,287	6,005	1.4	1.3	1.5	1.2	1.3
Brunei Darussalam	869	925	946	1,005	941	0.3	0.3	0.2	0.2	0.2
United States	72,116	74,918	85,586	100,045	105,739	23.9	23.0	21.9	23.3	22.3
EU[1]	**38,505**	**41,077**	**51,584**	**53,457**	**63,583**	**12.7**	**12.6**	**13.2**	**12.4**	**13.4**
Netherlands	11,085	10,313	12,471	13,802	17,029	3.7	3.2	3.2	3.2	3.6
Germany	7,071	8,053	9,267	9,992	11,087	2.3	2.5	2.4	2.3	2.3
United Kingdom	7,836	8,131	9,679	8,652	9,985	2.6	2.5	2.5	2.0	2.1
Others	12,513	14,580	20,167	21,011	25,482	4.1	4.4	5.1	4.9	5.4
Japan	28,271	28,683	33,428	31,743	32,963	9.4	8.8	8.6	7.4	7.0
The People's Republic of China	14,041	17,376	22,226	25,728	31,962	4.6	5.3	5.7	6.0	6.8
Hong Kong SAR	19,147	24,717	27,528	30,127	28,055	6.3	7.6	7.0	7.0	5.9
Middle East[2]	5,992	7,485	10,570	12,901	15,608	2.0	2.3	2.7	3.0	3.3
Australia	5,951	7,116	9,555	10,591	11,108	2.0	2.2	2.4	2.5	2.3
Chinese Taipei	11,216	11,610	11,867	10,247	10,601	3.7	3.6	3.0	2.4	2.2
Korea	7,797	7,123	9,199	9,308	10,276	2.6	2.2	2.4	2.2	2.2
Latin American countries	3,031	2,939	4,157	4,641	5,959	1.0	0.9	1.1	1.1	1.3
Canada	1,992	2,132	2,758	2,555	3,509	0.7	0.7	0.7	0.6	0.7
Rest of the World	14,981	18,665	23,394	27,584	31,877	4.9	5.5	6.0	6.3	6.8
Total	**302,021**	**326,322**	**390,938**	**429,873**	**473,213**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

1 Includes the 10 new member states since 2004
2 Beginning 2004, Cyprus has been excluded from Middle East as it has been included under the EU countries
p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.13
Principal Export Markets for Electronics

Country	2002	2003	2004	2005	2006*p*	2002	2003	2004	2005	2006*p*
	RM million					% share				
United States	41,969	45,285	51,892	64,555	68,629	26.7	27.1	27.5	31.0	31.0
Singapore	33,000	32,042	33,412	35,049	34,830	21.0	19.1	17.7	16.8	15.7
Hong Kong SAR	12,641	18,005	19,607	21,649	18,657	8.0	10.8	10.4	10.4	8.4
The People's Republic of China	7,838	9,002	10,825	13,183	17,240	5.0	5.4	5.7	6.3	7.8
Netherlands	7,746	7,056	8,094	9,846	13,306	4.9	4.2	4.3	4.7	6.0
Japan	11,226	10,465	11,208	10,273	11,432	7.1	6.3	5.9	4.9	5.2
Thailand	6,921	7,147	8,291	9,343	9,692	4.4	4.3	4.4	4.5	4.4
Chinese Taipei	7,670	8,056	6,875	5,399	5,212	4.9	4.8	3.6	2.6	2.4
Germany	3,804	4,535	5,159	5,153	5,125	2.4	2.7	2.7	2.5	2.3
Korea	4,555	3,455	4,437	4,179	4,250	2.9	2.1	2.4	2.0	1.9
Others	20,031	22,333	28,767	29,603	32,884	12.7	13.2	15.4	14.3	14.9
Total	**157,401**	**167,381**	**188,567**	**208,232**	**221,257**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.14
Principal Export Markets for Electrical Products

Country	2002	2003	2004	2005	2006*p*	2002	2003	2004	2005	2006*p*
	RM million					% share				
United States	17,430	16,354	18,163	19,005	19,071	31.7	29.5	26.5	25.5	24.0
Singapore	7,443	8,340	10,573	13,091	14,922	13.6	15.0	15.4	17.6	18.7
Japan	7,584	6,758	7,659	7,542	6,190	13.8	12.2	11.2	10.1	7.8
Hong Kong SAR	2,483	2,398	2,551	2,987	3,423	4.5	4.3	3.7	4.0	4.3
The People's Republic of China	1,580	2,094	2,947	3,365	3,081	2.9	3.8	4.3	4.5	3.9
Germany	1,410	1,430	1,845	2,188	2,795	2.6	2.6	2.7	2.9	3.5
Thailand	1,558	1,643	2,305	2,544	2,647	2.8	3.0	3.4	3.4	3.3
United Kingdom	1,400	1,353	1,392	1,361	2,146	2.6	2.4	2.0	1.8	2.7
Others	14,009	15,100	21,219	22,464	25,329	25.5	27.2	30.8	30.2	31.8
Total	**54,897**	**55,470**	**68,654**	**74,547**	**79,604**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.15
Principal Export Markets for Chemicals and Chemical Products

Country	2002	2003	2004	2005	2006*p*	2002	2003	2004	2005	2006*p*
	RM million					% share				
The People's Republic of China	2,294	2,930	4,020	4,001	4,261	13.3	13.8	14.4	13.5	13.0
Thailand	1,387	1,771	2,350	2,715	3,144	8.0	8.4	8.4	9.1	9.6
Japan	1,750	2,105	3,016	3,005	3,017	10.2	9.9	10.8	10.1	9.2
Singapore	1,736	2,158	2,581	2,834	2,997	10.1	10.2	9.3	9.5	9.1
Indonesia	1,302	1,531	2,245	2,459	2,608	7.6	7.2	8.1	8.3	7.9
Hong Kong SAR	1,239	1,549	1,853	2,102	2,379	7.2	7.3	6.7	7.1	7.2
India	498	858	1,091	1,435	1,657	2.9	4.0	3.9	4.8	5.0
Korea	546	766	1,174	1,305	1,506	3.2	3.6	4.2	4.4	4.6
Chinese Taipei	882	960	1,336	1,143	1,348	5.1	4.5	4.8	3.8	4.1
United States	1,042	1,059	982	1,103	1,090	6.1	5.0	3.5	3.7	3.3
Others	4,552	5,513	7,188	7,616	8,886	26.3	26.1	25.9	25.7	27.0
Total	**17,228**	**21,200**	**27,836**	**29,718**	**32,893**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.16
Principal Export Markets for Palm Oil

Country	2002	2003	2004	2005	2006*p*	2002	2003	2004	2005	2006*p*
	'000 tonnes					% share				
The People's Republic of China	1,940	2,502	2,827	2,885	3,532	17.9	20.0	23.1	22.1	25.2
European Union[1]	1,478	1,647	1,862	2,135	2,582	13.6	13.2	15.2	16.3	18.4
Netherlands	*847*	*974*	*1,135*	*1,364*	*1,703*	*7.8*	*7.8*	*9.3*	*10.4*	*12.1*
Germany	*225*	*185*	*149*	*180*	*190*	*2.1*	*1.5*	*1.2*	*1.4*	*1.4*
Italy	*127*	*98*	*119*	*155*	*165*	*1.2*	*0.8*	*1.0*	*1.2*	*1.2*
Sweden	*102*	*106*	*114*	*103*	*220*	*0.9*	*0.8*	*0.9*	*0.8*	*1.6*
Others	*177*	*284*	*345*	*333*	*304*	*1.6*	*2.3*	*2.8*	*2.5*	*2.1*
Middle East[2]	1,449	1,749	1,647	1,548	1,231	13.3	14.0	13.5	11.8	8.8
Pakistan	1,059	1,098	838	928	855	9.8	8.9	6.9	7.1	6.1
United States	270	231	298	534	696	2.5	1.9	2.4	4.1	5.0
India	1,670	1,650	925	676	657	15.4	13.2	7.6	5.2	4.7
Japan	434	430	458	438	498	4.0	3.4	3.7	3.4	3.5
Bangladesh	230	272	353	485	413	2.1	2.2	2.9	3.7	2.9
Korea	218	208	228	223	207	2.0	1.7	1.9	1.7	1.5
Chinese Taipei	80	103	120	246	148	0.7	0.8	1.0	1.9	1.1
Australia	120	97	96	105	121	1.1	0.8	0.8	0.8	0.9
Others	1,909	2,500	2,571	2,870	3,077	17.6	19.9	21.0	21.9	21.9
Total	**10,857**	**12,487**	**12,223**	**13,073**	**14,017**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

[1] Includes 10 new member states since 2004
[2] Beginning 2004, Cyprus has been excluded from Middle East and included in the Europen Union
p Preliminary

Source: Department of Statistics, Malaysia

Table A.17
Principal Export Markets for Rubber

Country	2002	2003	2004	2005	2006*p*	2002	2003	2004	2005	2006*p*
	'000 tonnes					% share				
The People's Republic of China	129	207	289	386	406	13.9	21.9	26.1	34.2	35.5
European Union[1]	309	306	355	320	327	33.3	32.3	32.1	28.3	28.6
Germany	*119*	*129*	*149*	*132*	*144*	*12.8*	*13.6*	*13.4*	*11.7*	*12.6*
France	*41*	*40*	*53*	*46*	*41*	*4.4*	*4.2*	*4.8*	*4.1*	*3.6*
Netherlands	*15*	*12*	*20*	*28*	*21*	*1.6*	*1.3*	*1.8*	*2.5*	*1.9*
Italy	*28*	*29*	*29*	*24*	*22*	*3.1*	*3.0*	*2.6*	*2.1*	*1.9*
United Kingdom	*24*	*22*	*24*	*21*	*18*	*2.5*	*2.4*	*2.2*	*1.9*	*1.6*
Spain	*17*	*17*	*24*	*13*	*11*	*1.9*	*1.8*	*2.2*	*1.2*	*0.9*
Others	*65*	*57*	*56*	*56*	*70*	*7.0*	*6.0*	*5.1*	*4.8*	*6.1*
Middle East[2]	81	84	91	75	71	8.7	8.9	8.2	6.6	6.2
Iran	*45*	*48*	*55*	*40*	*45*	*4.8*	*5.1*	*4.9*	*3.6*	*3.9*
Turkey	*24*	*25*	*25*	*24*	*20*	*2.6*	*2.7*	*2.2*	*2.2*	*1.7*
Others	*12*	*11*	*11*	*11*	*6*	*1.3*	*1.1*	*1.1*	*0.8*	*0.6*
Korea	59	69	64	74	67	6.3	7.3	5.7	6.6	5.8
United States	81	77	74	67	64	8.7	8.1	6.7	6.0	5.6
Brazil	41	29	37	31	32	4.4	3.1	3.3	2.7	2.8
Canada	28	14	19	17	15	3.1	1.4	1.7	1.5	1.4
Singapore	9	9	22	10	3	1.0	0.9	2.0	0.9	0.3
Others	191	151	157	148	158	20.6	16.1	14.2	13.2	13.8
Total	**928**	**946**	**1,108**	**1,128**	**1,143**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

[1] Includes 10 new member states since 2004
[2] Beginning 2004, Cyprus has been excluded from Middle East and included in the European Union
p Preliminary

Source: Department of Statistics, Malaysia

Table A.18
Principal Export Markets for Crude Oil

Country	2002	2003	2004	2005	2006*p*	2002	2003	2004	2005	2006*p*
	'000 tonnes					% share				
India	2,462	3,396	3,081	3,496	4,463	15.2	19.0	17.1	19.7	27.3
Thailand	2,358	3,097	3,024	3,418	2,378	14.6	17.3	16.7	19.2	14.6
Australia	1,687	2,248	4,229	3,567	2,119	10.4	12.5	23.4	20.1	13.0
Indonesia	956	1,289	1,548	1,431	1,747	5.9	7.2	8.6	8.1	10.7
Singapore	203	468	890	1,638	1,478	1.3	2.6	4.9	9.2	9.1
Korea	1,838	1,271	1,316	1,389	1,433	11.4	7.1	7.3	7.9	8.8
Japan	2,131	1,440	1,051	734	926	13.1	8.1	5.8	4.2	5.7
Phillipines	511	610	406	743	471	3.2	3.4	2.3	4.1	2.9
New Zealand	604	402	205	299	424	3.7	2.2	1.1	1.7	2.6
Sri Lanka	485	425	420	358	357	3.0	2.4	2.3	2.0	2.2
United States	412	937	682	314	282	2.5	5.2	3.8	1.8	1.7
The People's Republic of China	1,723	2,013	1,036	240	79	10.6	11.2	5.8	1.4	0.5
Others	822	317	159	92	147	5.1	1.8	0.9	0.6	0.9
Total	**16,192**	**17,913**	**18,047**	**17,719**	**16,304**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.19
Principal Export Markets for LNG

Country	2002	2003	2004	2005	2006*p*	2002	2003	2004	2005	2006*p*
	'000 tonnes					% share				
Japan	10,782	12,477	12,284	13,884	12,360	71.8	72.1	59.8	63.3	57.4
Korea	2,303	2,679	4,599	4,820	5,748	15.4	15.5	22.4	22.0	26.7
Chinese Taipei	1,857	2,101	2,834	3,054	3,306	12.4	12.1	13.8	13.9	15.4
United States	-	54	299	-	-	-	0.3	1.5	-	-
Others	65	-	509	190	120	0.4	-	2.5	0.8	0.5
Total	**15,007**	**17,311**	**20,525**	**21,948**	**21,534**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.20
Imports by End-Use

	2004	2005	2006*p*	2005	2006*p*	2006*p*
	RM million			Annual change (%)		% share
Capital goods	**55,482**	**60,734**	**65,257**	**9.5**	**7.4**	**13.6**
Capital goods (except transport equipment)	48,367	53,939	56,868	11.5	5.4	11.8
Industrial machinery and equipment	*13,219*	*14,419*	*14,568*	*9.1*	*1.0*	*3.0*
Generators, turbines and electric motors	*4,435*	*5,198*	*5,793*	*17.2*	*11.5*	*1.2*
Construction and mining equipment	*1,117*	*982*	*1,080*	*-12.0*	*9.9*	*0.2*
Transport equipment	7,115	6,795	8,389	-4.5	23.5	1.7
Intermediate goods	**287,884**	**308,335**	**335,532**	**7.1**	**8.8**	**69.8**
Food and beverages, primary, mainly, for industry	3,709	3,747	4,977	1.0	32.8	1.0
Food and beverages, processed, mainly for industry	5,070	4,605	5,457	-9.2	18.5	1.1
Industrial supplies, n.e.s., primary	8,799	8,895	10,844	1.1	21.9	2.3
Industrial supplies, n.e.s., processed	81,176	87,704	96,471	8.0	10.0	20.1
Fuel and lubricants, primary	9,458	15,229	20,357	61.0	33.7	4.2
Fuel and lubricants, processed	9,823	12,263	14,209	24.8	15.9	3.0
Parts and accessories of capital goods (except transport equipment)	160,679	163,660	172,047	1.9	5.1	35.8
Parts and accessories of electronics and telecommunication equipment	*110,384*	*112,960*	*123,023*	*2.3*	*8.9*	*25.6*
Parts and accessories of transport equipment	9,170	12,232	11,170	33.4	-8.7	2.3
Consumption goods	**22,879**	**24,600**	**27,894**	**7.5**	**13.4**	**5.8**
Food and beverages, primary, mainly, for household consumption	3,354	3,403	3,629	1.5	6.6	0.8
Food and beverages, processed, mainly for household consumption	5,558	5,877	6,096	5.7	3.7	1.3
Transport equipment, non-industrial	329	318	347	-3.4	9.4	0.1
Consumer goods, n.e.s.	13,639	15,002	17,822	10.0	18.8	3.7
Durable	*3,023*	*3,514*	*3,858*	*16.3*	*9.8*	*0.8*
Semi-durables	*4,462*	*4,671*	*6,287*	*4.7*	*34.6*	*1.3*
Non-durables	*6,154*	*6,817*	*7,677*	*10.8*	*12.6*	*1.6*
Dual use goods	**9,107**	**11,308**	**12,196**	**24.2**	**7.8**	**2.5**
Fuel and lubricants, processed, motor spirit	4,740	6,424	7,292	35.5	13.5	1.5
Transport equipment, passenger motor cars	4,366	4,884	4,903	11.9	0.4	1.0
Goods n.e.s.	**408**	**563**	**-331**	**38.0**	**-158.8**	**-0.1**
Transaction below RM5,000	**6,531**	**6,608**	**7,305**	**1.2**	**10.6**	**1.5**
Retained imports	**382,290**	**412,148**	**447,852**	**7.8**	**8.7**	**93.2**
Re-exports	**17,342**	**21,862**	**32,920**	**26.1**	**50.6**	**6.8**
Gross imports	**399,632**	**434,010**	**480,773**	**8.6**	**10.8**	**100.0**

p Preliminary
n.e.s. Not elsewhere specified
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Table A.21
External Debt and Debt Servicing

	2002	2003	2004	2005	2006*p*
	RM million				
Medium- and long-term debt:					
Gross borrowing	**23,853**	**22,226**	**27,064**	**29,162**	**24,243**
Federal Government	*10,465*	*3,190*	*1,136*	*651*	*834*
NFPEs	*3,655*	*5,140*	*11,545*	*6,431*	*7,106*
Private sector	*9,732*	*13,896*	*14,383*	*22,080*	*16,304*
Repayment and prepayment	**23,104**	**29,309**	**25,172**	**34,958**	**28,544**
Federal Government	*2,445*	*6,854*	*1,015*	*4,154*	*3,887*
NFPEs	*6,942*	*12,437*	*12,645*	*13,911*	*11,741*
Private sector	*13,717*	*10,019*	*11,512*	*16,893*	*12,916*
Net borrowing	**749**	**-7,083**	**1,892**	**-5,796**	**-4,301**
Federal Government	*8,020*	*-3,664*	*120*	*-3,503*	*-3,053*
NFPEs	*-3,287*	*-7,297*	*-1,100*	*-7,480*	*-4,636*
Private sector	*-3,985*	*3,877*	*2,872*	*5,187*	*3,388*
Outstanding debt	**153,225**	**153,236**	**156,849**	**150,746**	**138,108**
Federal Government	*36,283*	*37,284*	*34,654*	*30,000*	*25,005*
NFPEs	*64,330*	*59,535*	*62,244*	*56,233*	*48,253*
Private sector	*52,612*	*56,417*	*59,951*	*64,513*	*64,850*
Currency composition (% share)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
US dollar	*77.3*	*76.6*	*76.8*	*79.6*	*78.7*
Japanese yen	*14.3*	*12.9*	*12.8*	*11.7*	*11.7*
Others	*8.4*	*10.5*	*10.4*	*8.7*	*9.6*
Short-term debt:					
Outstanding debt	**32,435**	**33,500**	**43,737**	**46,953**	**41,285**
Banking sector[1]	*21,894*	*23,321*	*35,333*	*38,871*	*28,812*
Non-bank private sector	*10,541*	*10,179*	*8,404*	*8,082*	*12,473*
Total external debt:	**185,660**	**186,736**	**200,586**	**197,698**	**179,393**
Total external debt (USD million)	**48,858**	**49,141**	**52,786**	**51,790**	**50,302**
% GNP	*55.1*	*50.1*	*47.1*	*41.9*	*34.1*
Annual change (%)	*7.1*	*0.6*	*7.4*	*-1.4*	*-9.3*
Total servicing (including short-term interest payment)	**27,832**	**28,627**	**24,866**	**32,800**	**31,438**
of which:					
Medium- and long-term debt					
Repayment (excluding prepayment)	**20,780**	**21,854**	**18,675**	**25,471**	**23,845**
Federal Government	*2,445*	*3,861*	*1,015*	*4,154*	*3,887*
NFPEs	*6,942*	*10,017*	*10,713*	*10,166*	*9,666*
Private sector	*11,393*	*7,976*	*6,947*	*11,152*	*10,292*
Interest payment	**6,297**	**6,150**	**5,442**	**6,101**	**5,707**
Federal Government	*1,692*	*1,883*	*1,758*	*1,729*	*1,678*
NFPEs	*3,430*	*3,287*	*2,684*	*3,182*	*2,722*
Private sector	*1,174*	*979*	*1,000*	*1,190*	*1,307*
Debt service ratio (% of exports of goods and services)					
Total debt	**6.7**	**6.4**	**4.6**	**5.4**	**4.7**
Medium- and long-term debt	6.5	6.3	4.4	5.2	4.4
Federal Government	*1.0*	*1.3*	*0.5*	*1.0*	*0.8*
NFPEs	*2.5*	*3.0*	*2.5*	*2.2*	*1.9*
Private sector	*3.0*	*2.0*	*1.5*	*2.0*	*1.7*

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

Source: Ministry of Finance and Bank Negara Malaysia

Table A.22
Consumer Price Index

	Weights (%) (2000=100)	2003	2004	2005		Weights (%) (2005=100)[1]	2006
		Annual Change (%)					Annual Change (%)
Total	100.0	1.2	1.4	3.0	Total	100.0	3.6
of which:					*of which:*		
Food	33.8	1.3	2.2	3.6	Food and non-alcoholic beverages	31.4	3.4
Beverages and tobacco	3.1	1.6	7.8	10.5	Alcoholic beverages & tobacco	1.9	6.9
Clothing and footwear	3.4	-2.0	-1.8	-1.0	Clothing & footwear	3.1	-1.3
Gross rent, fuel and power	22.4	0.9	1.0	1.2	Housing, water, electricity, gas and other fuels	21.4	1.5
Furniture, furnishings and household equipment and operation	5.3	-0.6	0.4	2.0	Furnishing, household equipment and routine	4.3	1.1
Medical care and health expenses	1.8	1.7	1.4	1.6	Health	1.4	2.1
Transport and communication	18.8	1.6	0.8	4.4	Transport	15.9	11.0
					Communication	5.1	-1.4
Recreation, entertainment, education and cultural services	5.9	0.6	-0.1	0.5	Recreation services and culture	4.6	0.7
					Education	1.9	1.6
					Restaurant and hotels	3.0	3.7
Miscellaneous goods and services	5.5	1.3	1.8	2.4	Miscellaneous goods & services	6.0	2.2

[1] Effective from 2006, the Consumer Price Index has been revised to the new base year 2005=100, from 2000=100 previously

Source: Department of Statistics, Malaysia

Table A.23
Producer Price Index

	Weights (%) (1989=100)	2003	2004	2005		Weights (%) (2000=100)[1]	2006
		Annual Change (%)					Annual Change (%)
Total	100.0	5.7	8.9	6.8	Total	100.0	6.7
of which:					*of which:*		
Food and live animals chiefly for food	14.9	-0.2	3.6	3.8	Food and live animal	5.3	3.2
Beverages and tobacco	2.1	0.9	1.6	1.9	Beverages and tobacco	1.0	3.0
Crude materials, inedible except fuels	18.0	7.5	6.6	3.0	Crude materials, inedible except fuels	4.4	14.0
Mineral fuels, lubricants & related materials	18.8	11.4	22.3	26.0	Mineral fuels, lubricants & related materials	11.9	7.8
Animal & vegetable oils & fats	8.5	15.7	13.2	-14.8	Animal & vegetable oils & fats	3.8	3.0
Chemicals & related products n.e.s.	4.4	1.4	4.3	2.2	Chemicals & related products n.e.s.	5.1	3.8
Manufactured goods classified chiefly by material	10.8	1.8	2.5	2.5	Manufactured goods classified chiefly by material	11.0	3.9
Machinery & transport equipment	18.4	0.1	0.1	0.6	Machinery & transport equipment	50.5	7.3
Miscellaneous manufactured articles	3.6	0.9	0.6	1.8	Miscellaneous manufactured articles	6.7	6.0
Commodities & transactions not classified elsewhere in the S.I.T.C.	0.6	0.5	0.2	0.0	Commodities & transactions not classified elsewhere in the S.I.T.C.	0.4	13.4
Local Production	79.3	6.8	10.3	7.9	Local Production	65.7	9.0
Import	20.7	0.8	2.0	1.5	Import	34.3	2.2

[1] Effective from 2006, the Producer Price Index has been revised to the new base year 2000=100, from 1989=100 previously
n.e.c: Not elsewhere classified
S.I.T.C: Standard International Trade Classification

Source: Department of Statistics, Malaysia

Table A.24
Broad Money (M3)

	Annual change					As at end
	2002	2003	2004	2005	2006	2006
	RM million					
Broad money (M3)[1]	31,607	48,524	67,990	49,688	82,365	749,691
Currency in circulation[2]	1,751	2,233	2,594	1,629	3,335	33,501
Demand deposits	6,718	11,210	10,086	8,650	11,776	107,892
Broad quasi-money	23,138	35,082	55,311	39,409	67,254	608,298
Fixed deposits	*12,648*	*17,065*	*24,668*	*4,949*	*32,722*	*389,647*
Savings deposits	*5,590*	*5,602*	*6,129*	*1,947*	*5,195*	*75,729*
NIDs	*3,575*	*1,965*	*8,179*	*12,785*	*14,321*	*46,262*
Repos	*2,507*	*8,016*	*13,337*	*17,260*	*11,799*	*75,571*
Foreign currency deposits	*-1,182*	*2,434*	*2,998*	*2,467*	*3,218*	*21,088*
Factors Affecting M3						
Net claims on Government	11,538	12,949	-15,921	-5,376	9,240	-3,492
Claims on Government	*-867*	*3,960*	*4,536*	*-2,152*	*1,614*	*36,905*
Less: Government deposits	*-12,405*	*-8,989*	*20,457*	*3,225*	*-7,626*	*40,396*
Claims on private sector	27,737	31,287	30,602	44,423	34,714	676,084
Loans	*19,288*	*21,468*	*39,753*	*44,840*	*36,779*	*596,722*
Securities	*8,449*	*9,819*	*-9,151*	*-417*	*-2,065*	*79,362*
Net external operations	8,197	33,319	90,681	2,999	51,652	312,620
Bank Negara Malaysia[3]	*14,524*	*39,703*	*83,784*	*14,738*	*24,065*	*290,399*
Banking system	*-6,327*	*-6,383*	*6,898*	*-11,739*	*27,587*	*22,221*
Other influences	-15,865	-29,031	-37,373	7,642	-13,241	-235,521

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

Table A.25
Money Supply: Annual Change and Growth Rates

	2002		2003		2004		2005		2006	
	RM million	%	RM million	%	RM million	%	RM million	%	RM million	%
Currency in circulation	1,749	7.9	2,205	9.2	2,516	9.6	1,561	5.5	3,342	11.1
Demand deposits with commercial banks and Islamic banks	6,595	11.3	10,827	16.6	9,649	12.7	8,194	9.6	13,759	14.7
M1[1]	8,344	10.3	13,032	14.6	12,164	11.9	9,755	8.5	17,101	13.8
Other deposits with commercial banks and Islamic banks[2]	12,686	4.5	29,487	10.0	95,937	29.6	72,261	17.2	84,938	17.3
Deposits with other banking institutions[3, 4]	10,576	9.9	6,005	5.1	-40,112	-32.5	-32,328	-38.7	-19,674	-38.5
M3[5]	31,607	6.7	48,524	9.7	67,990	12.4	49,688	8.0	82,365	12.3

[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 and discount houses. Also includes savings deposits with finance companies, negotiable instruments of deposits (NIDs) with finance companies and merchant banks, foreign currency deposits placed with merchant banks and call deposits with discount houses. Excludes interplacements among the banking institutions
[4] The large decline since 2004 reflected the absorption of finance companies by commercial banks
[5] Comprising M1 plus other deposits of the private sector placed with commercial banks and Islamic banks and deposits of the private sector placed with other banking institutions, namely the finance companies, merchant banks and discount houses

Table A.26
Interest Rates (%)

	Average rates at end-year					Average rates at end-month in 2006											
	2001	2002	2003	2004	2005	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
Overnight interbank	2.79	2.73	2.74	2.70	2.72	2.99	3.24	3.25	3.49	3.47	3.51	3.49	3.56	3.51	3.51	3.48	3.50
1-week interbank	2.82	2.76	2.80	2.74	2.75	3.05	3.23	3.28	3.51	3.54	3.55	3.51	3.57	3.57	3.60	3.54	3.53
1-month interbank	2.93	2.87	2.99	2.86	2.84	3.14	3.15	3.25	3.38	3.69	3.78	3.75	3.68	3.68	3.63	3.59	3.58
Commercial banks																	
Fixed deposit:																	
3 month	3.21	3.20	3.00	3.00	3.02	3.03	3.04	3.06	3.12	3.17	3.18	3.19	3.19	3.21	3.21	3.20	3.19
12 month	4.00	4.00	3.70	3.70	3.70	3.70	3.70	3.70	3.73	3.76	3.77	3.78	3.77	3.77	3.76	3.75	3.73
Savings deposit	2.28	2.12	1.86	1.58	1.41	1.42	1.43	1.44	1.46	1.47	1.47	1.46	1.46	1.46	1.46	1.48	1.48
Base lending rate (BLR)	6.39	6.39	6.00	5.98	6.20	6.21	6.34	6.47	6.58	6.72	6.72	6.72	6.72	6.72	6.72	6.72	6.72
Treasury bills (91 days)	2.73	2.82	2.77	1.96	2.96	2.88	2.86	3.10	2.87	2.95	3.49	3.46	3.38	3.39	3.50	3.49	3.37
Government securities (1 year)	2.93	2.94	2.93	2.24	3.30	3.31	3.40	3.43	3.73	4.01	4.06	4.02	3.78	3.73	3.66	3.56	3.55
Government securities (5 years)	3.18	3.15	4.28	3.64	3.73	3.71	3.74	3.76	4.20	4.49	4.57	4.33	4.09	3.96	3.81	3.72	3.70
Private debt securities																	
AAA																	
3-years	3.97	3.91	3.86	4.06	3.76	4.03	4.17	4.24	4.40	4.68	4.82	4.82	4.58	4.41	4.22	4.08	4.01
5-years	4.49	4.50	4.35	4.81	4.29	4.45	4.54	4.57	4.73	4.98	5.12	5.09	4.86	4.66	4.45	4.32	4.26
AA																	
3-years	4.97	4.80	4.43	4.67	4.22	4.43	4.56	4.60	4.82	5.09	5.20	5.21	5.03	4.85	4.62	4.45	4.38
5-years	5.57	5.38	4.99	5.50	4.78	4.86	4.94	4.95	5.16	5.42	5.52	5.52	5.35	5.15	4.91	4.77	4.71
A																	
3-years	6.33	6.31	5.79	6.03	5.84	6.00	6.11	6.19	6.32	6.47	6.67	6.70	6.56	6.45	6.24	6.09	5.91
5-years	6.98	7.07	6.51	6.90	6.56	6.73	6.82	6.89	7.01	7.12	7.26	7.25	7.11	7.01	6.80	6.68	6.53
BBB																	
3-years	9.07	9.33	9.45	9.92	9.47	9.54	9.65	9.73	9.78	9.68	9.89	9.92	9.83	9.85	9.86	9.83	9.62
5-years	9.99	10.36	10.48	10.99	10.41	10.45	10.53	10.63	10.62	10.56	10.82	10.84	10.67	10.67	10.68	10.67	10.48
BB & below																	
3-years	11.59	11.62	11.35	11.96	11.79	12.05	12.15	12.14	12.14	12.21	12.40	12.53	12.33	12.37	12.22	12.22	12.03
5-years	12.63	12.83	12.47	13.21	12.95	13.07	13.19	13.32	13.33	13.42	13.67	13.64	13.38	13.40	13.28	13.30	13.05

Table A.27
Movements of the Ringgit

	RM to one unit of foreign currency[1]			Annual change (%)		Change (%)
	2005	2005	2006	2005	2006	21 Jul.'05 -
	Jul. 21[2]	End-Dec.				Dec. 2006
SDR	5.5049	5.4020	5.3069	8.9	1.8	3.7
US dollar	3.8000	3.7800	3.5315	0.5	7.0	7.6
Singapore dollar	2.2570	2.2714	2.3028	2.4	-1.4	-2.0
100 Japanese yen	3.3745	3.2229	2.9675	14.9	8.6	13.7
Pound sterling	6.6270	6.5226	6.9315	12.2	-5.9	-4.4
Swiss franc	2.9588	2.8825	2.8915	16.3	-0.3	2.3
Euro	4.6212	4.4867	4.6460	15.3	-3.4	-0.5
100 Thai baht	9.0681	9.2049	9.8111	6.1	-6.2	-7.6
100 Indonesian rupiah	0.0386	0.0385	0.0393	6.2	-2.1	-1.6
100 Korean won	0.3665	0.3739	0.3797	-1.8	-1.5	-3.5
100 Philippine peso	6.8131	7.1254	7.2027	-5.0	-1.1	-5.4
Chinese renminbi	0.4591	0.4686	0.4523	-2.0	3.6	1.5

[1] US dollar rates are the average of buying and selling rates at noon in the Kuala Lumpur Interbank Foreign Exchange Market
Rates for foreign currencies other than US dollar are cross rates derived from rates of these currencies against the US dollar and the RM/USD rate
[2] Ringgit shifted from a fixed exchange rate against the US dollar to a managed float against a basket of currencies

Table A.28
Housing Credit Institutions

	Year of establishment	Objective	Lending rate for new housing loans (%)		No. of branches	
			2005	2006	2005	2006
Commercial banks[1]	-		2.9[2]	4.1[2]	2,225[3]	2,120[3]
Treasury Housing Loans Division	1970	To provide housing loans to Government employees	4.0	4.0	1	1
Bank Kerjasama Rakyat Malaysia Berhad	1954	A co-operative that mobilises savings and provides financing services to its members as well as non-members	7.2	7.3	106	110
Malaysia Building Society Berhad	1950	To be a consumer driven financial institution offering property lending and deposit taking activities leading to wealth management creation for its valued customers	2.0 ~ 9.25	1.0 ~ 9.25	22	22
Borneo Housing Mortgage Finance Berhad	1958	To provide housing loans mainly to Sabah and Sarawak State Government employees	3.0 ~ 8.75	3.0 ~ 8.75	2	2
Bank Simpanan Nasional	1974	To focus on retail banking and personal finance, especially for small savers	5.5[1]	6.9[1]	390	379
Sabah Credit Corporation	1955	To uplift the social economic development of Malaysians in Sabah through the provision of easy acces to financial credit	3.0 ~ 10.5	3.0 ~ 7.5	10	10

[1] 12-month average lending rate
[2] Excludes Islamic banks
[3] Includes Islamic banks

Source: Bank Negara Malaysia and various housing credit institutions

Table A.29
Outstanding Housing Loans

	2005	2006*p*	2005	2006*p*	2005	2006*p*
	RM million		Annual change (%)		% share	
Commercial banks[1]	148,329	162,291	17.9	9.4	82	83
Treasury Housing Loans Division	25,395	25,709	1.4	1.2	14	13
Bank Kerjasama Rakyat Malaysia Berhad	3,592	4,741	42.6	32.0	2	2
Malaysia Building Society Berhad	487	779	-74.0	60.0	...	...
Borneo Housing Mortgage Finance Berhad	713	721	1.0	1.2	...	...
Bank Simpanan Nasional	1,372	2,207	29.6	60.9	1	1
Sabah Credit Corporation	221	204	-7.8	-7.6	...	...
Total	**180,109**	**196,652**	**14.5**	**9.2**	**100**	**100**

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

Source: Bank Negara Malaysia and various housing credit institutions

Table A.30
Approved Housing Loans

	2005	2006*p*	2005	2006*p*	2005	2006*p*
	RM million		Annual change (%)		% share	
Commercial banks[1]	36,482	33,237	6.9	-8.9	84	82
Treasury Housing Loans Division	4,188	4,134	2.5	-1.3	10	10
Bank Kerjasama Rakyat Malaysia Berhad	1,111	812	6.8	-26.9	2	2
Malaysia Building Society Berhad	902	1,084	-33.6	20.2	2	3
Borneo Housing Mortgage Finance Berhad	62	70	-30.1	12.3	...	...
Bank Simpanan Nasional	848	1,408	240.8	66.0	2	3
Sabah Credit Corporation	8	11	35.5	33.9	...	...
Total	**43,601**	**40,756**	**6.4**	**-6.5**	**100**	**100**

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

Source: Bank Negara Malaysia and various housing credit institutions

Table A.31
Consolidated Public Sector Finance

	2003	2004	2005	2006*e*	2007*f*
	RM billion				
Revenue[1]	92.6	95.0	95.0	105.3	111.0
% growth	*11.7*	*2.6*	*-0.1*	*10.8*	*5.5*
Operating expenditure	83.6	101.0	106.6	117.4	124.1
% growth	*11.3*	*20.8*	*5.5*	*10.1*	*5.7*
Current surplus of NFPEs[2]	55.1	81.3	85.0	116.7	128.0
Current balance	**64.1**	**75.3**	**73.3**	**104.5**	**114.9**
% of GDP	***16.2***	***16.7***	***14.8***	***19.1***	***19.5***
Net development expenditure[3]	83.3	56.7	64.5	84.4	85.7
% growth	*20.5*	*-31.9*	*13.6*	*30.9*	*1.6*
General government[4]	43.2	32.1	30.1	38.4	45.1
NFPEs	40.2	24.6	34.4	46.0	40.6
Overall balance	**-19.2**	**18.5**	**8.8**	**20.2**	**29.2**
% of GDP	***-4.9***	***4.1***	***1.8***	***3.7***	***5.0***

[1] Excludes transfers within general government
[2] Refers to 34 NFPEs in 2003; 30 NFPEs in 2004 onwards
[3] Adjusted for transfers and net lendings within public sector
[4] Comprises Federal Government, state and local governments and statutory bodies
e Estimate
f Forecast
Note: Numbers may not add up due to rounding

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

Table A.32
Major Industrial Countries: Key Economic Indicators

	2002	2003	2004	2005	2006*e*	2007*f*
	Annual change (%)					
REAL GDP						
Major Industrial Countries	**1.5**	**1.9**	**3.2**	**2.6**	**2.9**	**2.5**
United States	1.6	2.5	3.9	3.2	3.3	2.7
Japan	0.3	1.5	2.7	1.9	2.2	1.9
Euro area	0.9	0.8	1.7	1.4	2.7	2.4
Germany	*0.0*	*-0.2*	*1.2*	*0.9*	*2.7*	*2.2*
United Kingdom	2.1	2.7	3.3	1.9	2.7	2.8
INFLATION						
Major Industrial Countries	**1.5**	**1.8**	**2.0**	**2.3**	**2.3**	**2.3**
United States	1.6	2.3	2.7	3.4	3.2	2.9
Japan	-0.9	-0.2	0.0	-0.3	0.2	0.7
Euro area	2.2	2.1	2.1	2.2	2.2	2.4
Germany	*1.4*	*1.0*	*1.8*	*1.9*	*1.8*	*2.6*
United Kingdom[1]	1.3	1.4	1.3	2.1	2.3	2.4
	% of labour force					
UNEMPLOYMENT						
Major Industrial Countries						
United States	5.8	6.0	5.5	5.1	4.6	4.9
Japan	5.4	5.2	4.7	4.4	4.1	4.0
Euro area	8.2	8.7	8.8	8.6	7.8	7.7
Germany	*8.7*	*9.1*	*9.5*	*9.5*	*8.1*	*7.8*
United Kingdom	5.2	5.0	4.8	4.7	5.4	5.1
	% of GDP					
CURRENT ACCOUNT BALANCE						
Major Industrial Countries						
United States	-4.5	-4.8	-5.7	-6.4	-6.4	-6.2
Japan	2.9	3.2	3.7	3.7	3.9	3.5
Euro area	0.6	0.4	0.9	-0.1	-0.1	-0.2
Germany	*2.0*	*1.9*	*3.7*	*4.0*	*4.2*	*4.0*
United Kingdom	-1.6	-1.3	-1.6	-2.4	-2.4	-2.3
FISCAL BALANCE[2]						
Major Industrial Countries						
United States	-2.6	-3.8	-3.7	-2.9	-2.5	-2.8
Japan	-6.7	-6.8	-5.8	-5.4	-5.2	-5.1
Euro area	-2.0	-2.3	-2.4	-2.0	-1.8	-1.7
Germany	*-1.7*	*-1.8*	*-2.3*	*-2.5*	*-1.9*	*-1.7*
United Kingdom	-1.8	-3.6	-3.2	-3.1	-3.1	-2.8

[1] Based on Eurostat's harmonized index of consumer prices
[2] Refers to central government fiscal balance
e Estimate
f Forecast

Source: IMF World Economic Outlook, September 2006
National authorities

Table A.33
East Asia: Key Economic Indicators

	2002	2003	2004	2005	2006*e*	2007*f*
REAL GDP	Annual change (%)					
Regional Countries						
The People's Republic of China	9.1	10.0	10.1	10.4	10.7	9.8
Korea	7.0	3.1	4.7	4.0	5.0	4.4
Chinese Taipei	4.2	3.4	6.1	4.1	4.6	4.3
Singapore	4.2	3.1	8.8	6.6	7.9	4.5 ~ 6.5
Hong Kong SAR	1.8	3.2	8.6	7.5	6.8	4.5 ~ 5.5
Malaysia	4.4	5.5	7.2	5.2	5.9	6.0
Thailand	5.3	7.1	6.3	4.5	5.0	4.0 ~ 5.0
Indonesia	4.4	4.9	5.1	5.6	5.5	5.7 ~ 6.3
Philippines	4.4	4.9	6.2	5.0	5.4	6.1 ~ 6.7
CONSUMER PRICES	Annual change (%)					
Regional Countries						
The People's Republic of China	-0.8	1.2	3.9	1.8	1.5	2.0
Korea	2.7	3.6	3.6	2.7	2.2	2.6
Chinese Taipei	-0.2	-0.3	1.6	2.3	0.6	1.8
Singapore	-0.4	0.5	1.7	0.5	1.0	0.5 ~ 1.5
Hong Kong SAR[1]	-3.0	-2.6	-0.4	1.0	2.0	1.5
Malaysia	1.8	1.2	1.4	3.0	3.6	2.0 ~ 2.5
Thailand	0.7	1.8	2.7	4.5	4.7	1.5 ~ 2.5
Indonesia	11.9	6.8	6.1	10.4	13.3	5.0 ~ 7.0
Philippines	3.0	3.5	6.0	7.6	6.3	4.0 ~ 5.0
CURRENT ACCOUNT BALANCE	% of GDP					
Regional Countries						
The People's Republic of China	2.4	2.8	3.6	7.2	7.2	7.2
Korea	1.0	2.0	4.1	2.1	0.4	0.3
Chinese Taipei	8.7	9.8	5.7	4.7	5.8	5.9
Singapore	13.4	24.1	24.5	28.5	28.5	27.3
Hong Kong SAR	7.6	10.4	9.5	11.4	8.7	7.8
Malaysia	8.4	12.8	12.6	15.3	16.7	15.7
Thailand	5.5	5.6	4.2	-2.1	-0.8	-1.3
Indonesia	4.0	3.5	0.6	0.3	0.2	0.6
Philippines	-0.5	0.4	1.9	2.4	2.4	1.7
FISCAL BALANCE[2]	% of GDP					
Regional Countries						
The People's Republic of China	-3.0	-2.4	-1.5	-1.3	-1.3	-1.1
Korea	3.9	1.8	0.7	0.6	n.a.	n.a.
Chinese Taipei	-3.0	-2.5	-2.1	-1.6	-2.4	-1.9
Singapore	0.1	-1.2	-0.1	0.7	-0.6	-0.3
Hong Kong SAR	-4.8	-3.3	-0.3	1.0	3.7	1.7
Malaysia	-5.6	-5.3	-4.3	-3.8	-3.5	-3.4
Thailand	-1.4	0.4	-1.5	2.4	2.1	n.a.
Indonesia	-1.7	-1.9	-1.4	-0.5	-1.3	-1.1
Philippines	-5.3	-4.6	-3.9	-2.7	-1.0	-0.9

[1] Refers to composite prices
[2] Refers to central government balance
e Estimates
f Forecast
n.a. Not available

Source: National Sources
IMF World Economic Outlook, September 2006