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 2007, 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 2007 is incorporated in Bank Negara Malaysia's Financial Stability and Payment Systems Report 2007 which forms an integral part of this Annual Report 2007.

Zeti Akhtar Aziz
Chairman
Board of Directors

26 March 2008

Board of Directors

Tan Sri 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

Dato' Zamani bin Abdul Ghani
D.P.S.K., 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' Sri Dr. Wan Abdul Aziz bin Wan Abdullah
S.S.A.P., 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.

Tan Sri Dato Sri Dr. Mohd Hassan Marican was reappointed as member of the Board of Directors effective 1 February 2008.

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

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BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

The Malaysian economy expanded by 6.3% in 2007, its fastest pace in three years. Growth was driven by robust domestic demand from both the private and public sectors. The stronger economic growth in a less favourable external environment has been on the account of the strength of domestic demand and the increasingly more diversified structure of our economy. With the structural transformation of the Malaysian economy during this recent decade, the services sector has now become the main driver of growth. As a result, new areas of growth have emerged. This diversification is also evident in the manufacturing sector and hence the export sector. This change in the pattern of trade has been reinforced by the further diversification of our export markets.

In 2008, the external environment is expected to deteriorate with the continued unfolding of the financial crisis that has erupted in the United States. With no signs of the crisis abating, there has been increased uncertainty and risk aversion in the financial markets. It is now expected that the economic slowdown in the crisis affected economies will be more pronounced and protracted than earlier anticipated. This is not only arising from the large scale liquidity strains and the consequent constraints on credit conditions, but also due to the impact of declining asset prices and higher inflation on consumer spending. While the extent of the impact of these developments on global growth is unclear, it has added to the existing uncertainty in the financial markets. It is likely for the significant volatility in the financial markets experienced in 2007 to extend into 2008.

The slower growth in some of the largest economies is likely to lead to a moderation in global trade. Trade among the Asian nations has, however, increased substantially. With the expansion in domestic demand in the Asian economies, the cumulative market in the region has increased significantly, thus increasing the prospects for mutually reinforcing intra-regional trade. Despite the region's strong inter-linkages to the global economy and to the international financial system, the dominance of domestic demand and the increasing regional economic integration have reduced the implications of external developments on the region. Thus, while the region is not being entirely insulated, there will occur some partial decoupling.

Malaysia enters this period of heightened global uncertainty from a strengthened position. The economy has been on a steady growth path averaging close to 6% in the past three years. The quality of the growth has also improved - becoming more balanced between domestic and external sources of growth, between private and public sector activity, and between the different economic sectors. There have also been significant payoffs from the development of the financial sector and the ongoing financial liberalisation. This has contributed to the more efficient functioning of the financial system and in supporting the growth process as well as its increased resilience in dealing with shocks. Against this background, the Malaysian economy is expected to sustain a growth of 5-6% in 2008.

Key in achieving this growth is sustained domestic demand. Rising incomes, strong labour market conditions and increased access to financing are expected to support continued consumption spending. Based on recent economic and financial indicators, strong domestic investment activity and foreign direct investment are expected to continue in 2008. With ample liquidity in the financial system, financing to support the increased activity is expected to continue. Public spending, including on projects under the Ninth Malaysia Plan and for the new economic corridors will reinforce the growth. Moreover, as a resource-based economy, the increase in commodity prices has generated high multiplier effects on the domestic economy. Strong employment and external balances, low indebtedness and a high rate of savings are additional macroeconomic fundamentals that have raised the level of resilience of the economy.

Even as the global economy shifts into slower growth, inflation is increasing in most countries due to the rising energy, commodity and food prices. In Malaysia, rising commodity prices have sharply increased the producer price index. These costs have not been passed on fully into consumer prices. The extent to which producer prices rise further and the extent to which these are passed on to consumers will determine the inflation trend in 2008 and into 2009. These inflationary pressures, however, are expected to be mitigated by a number of factors. The further slowing of global growth would to some extent ease the inflationary pressures and contain inflationary expectations. On the domestic front, capacity expansion and rising wages that are commensurate with productivity would also contain upward price pressures. Based on the assessment of these anticipated trends, the average headline inflation is expected to increase from 2% in 2007 to 2.5-3% in 2008.

Despite these inflation concerns in the global environment, most central banks have paused monetary tightening, while others have shifted to aggressive easing following the increased risk of a more pronounced economic slowdown. In Malaysia, the risks to inflation and to economic growth are assessed to be about in balance. Moreover, inflation has been largely due to rising costs rather than demand pressures. Given the nature of these inflationary pressures, significant efforts need to be directed by the private and public sectors to enhance efficiency levels and thus reduce costs. There remains tremendous potential within the system to further reduce the cost of doing business. Given the source of the inflationary pressures, when inflation is driven by global factors or supply shocks rather than domestic demand pressures, there are limits to what monetary policy can achieve. Over reliance on interest rates under these circumstances will result in an over adjustment of the economy. In this context, monetary policy will continue to carefully balance these considerations to ensure price stability in an environment of sustainable growth.

Monetary policy is also presented with the challenge of volatile capital flows. Heightened uncertainty has also resulted in an increase in the amplitude of the volatility of capital flows. For most of the period, there has been continued two way flows that have contributed to reducing the degree of the volatility. Inflows of export earnings, foreign direct investment and portfolio funds are offset by increases in payments for imports as well as repatriation of profits and dividends by multinationals and investments abroad by residents. There are however bouts of massive inflows as well as reversals triggered for the most part by profit taking or specific events. The financial instruments at the disposal of the Central Bank and the strong level of reserves have provided the Central Bank with the capacity to manage these extreme flows to ensure the orderly functioning of the foreign exchange market.

The recent volatility in the global and domestic financial markets has emphasized the importance of the efforts that have been undertaken to strengthen and deepen the domestic financial markets. In particular, significant efforts and resources were channeled for the development of the bond and foreign exchange markets. The Bank has continued in 2007, to undertake further sequenced and gradual liberalisation of the foreign exchange rules based on careful consideration of the preconditions and state of readiness of the financial system to manage the risks and benefits to the economy. This liberalisation has contributed to the development of the domestic financial markets including the foreign exchange market. The liberalisation has also had positive economic payoffs through the reduction in the cost of doing business and the creation of new business opportunities. Similarly, the pace of development of the bond market has also accelerated. As a percentage of GDP, the Malaysian bond market is now the largest in the ASEAN region and, excluding Japan, is the second largest in Asia after South Korea. Efforts to position Malaysia as an international Islamic financial hub has also yielded positive results. In 2007, the issuances of sukuk (Islamic securities) rose by 161% to account for 63% of total private debt securities issued. Malaysia accounts for 69% of the total global sukuk issuances. This trend has gained further momentum in early 2008 despite the uncertainties in the global financial markets.

In the region, the Bank continues to actively participate in efforts to strengthen regional cooperation among regional central banks. Priority is being given to the regional surveillance agenda and putting in place an integrated regional crisis management framework that may be activated in the event of an imminent crisis. As part of the implementation of the recommendations in the roadmap for cooperation among the EMEAP central banks, the Monetary and Financial Stability Committee has been established and will work towards a more structured surveillance and crisis management for the region. This is a tremendous step forward for the region's financial cooperation and integration. In 2007, the Bank has established a new Central Banking Services Unit to facilitate the efficient management of our interface with other Central Banks that involves two-way sharing of knowledge, experience and training.

During the year, the Bank's macro and micro surveillance capabilities were significantly strengthened. This includes enhancing the surveillance tools and the evaluations and assessments of the implications. With the greater uncertainties, stress-testing based on alternative scenario is increasingly being adopted to facilitate early preemptive action. From the experience of the Asian financial crisis, the resolution requires three important elements. Firstly, the approach adopted needs to be comprehensive, addressing both macro and micro developments. Secondly, it needs to be implemented at the early stage of the crisis, and thirdly, it needs to be accompanied by an extensive communication strategy to restore confidence and stability. Surveillance is key to supporting this process.

During the year, the Bank has intensified efforts to modernise and strengthen organisational capacity of the institution. Several departments were restructured during the year including that of the financial stability sector to achieve a more consistent regulatory and supervisory regime across all different components of the financial sector. It has also supported a more integrated approach to regulatory reforms and surveillance and has enabled a more efficient allocation of supervisory resources within the Bank.

A business plan for 2008 has also been drawn for the first time to set out the focus and priorities for the year, not only for achieving the core mandate of monetary and financial stability but also of the development of the financial sector. Finally, continued focus will be given to talent management and investment in human capital. Following the successful implementation of a performance-based highly-differentiated compensation system, the focus is on career management, succession planning and leadership development. The Bank will also continue to invest heavily in staff training in 2008 with the equivalent of 12% of total salaries being spent on learning.

In 2009, Bank Negara Malaysia will celebrate its 50th Anniversary. It is an important milestone in the nation's monetary and financial history. Since its establishment, the Bank has served the interest of the nation and sought to create a stable monetary environment while at the same time, promoting a modern and efficient financial system. Significant strides forward have been made in these 50 years, but the journey continues. With growing globalisation, the Malaysian economy and financial system will continue to evolve. This changing environment will undoubtedly bring new challenges. A major task this year will also be to amend our Central Banking Act to take into account the major changes that have occurred and transformed the environment we are operating in. This is to ensure that the Central Bank continues to effectively perform its responsibilities going forward over the next 50 years.

Finally, I would like to thank all staff and colleagues at Bank Negara Malaysia for the hard work and unwavering commitment during the year. I also thank our Board of Directors for their guidance and for their support to the Bank.

Zeti Akhtar Aziz
Governor

26 March 2008

The Malaysian Economy in 2007

The Malaysian Economy in 2007

THE INTERNATIONAL ECONOMIC ENVIRONMENT IN 2007

Global growth was strong in 2007, driven by above-trend growth in most industrial economies and buoyant growth in emerging market economies, despite moderation in the United States (US) economy, higher oil prices and the onset of financial market turbulence in the second half-year. The economies of the People's Republic of China (PR China), India and other large emerging economies such as Brazil and Russia increased their contribution to global growth, spurred by strong consumption and rising investment activity. Record-high commodity prices also buoyed growth in many resource-producing economies. Benefiting from these trends, the strong growth momentum in the Asian region was further supported by rising domestic demand, which more than compensated for some moderation in electronics exports. In contrast, downside pressures on the US economy increased towards end-year, affected by the emergence of the subprime mortgage problem and further downturn in the US housing sector, with its spillover to the global financial markets.

Global growth was strong in 2007, driven by above-trend growth in most industrial economies and buoyant growth in emerging market economies, despite moderation in the US economy, higher oil prices and the onset of financial market turbulence in the second half-year

The **US** economy displayed an uneven growth trend in 2007, but overall expanded at a more moderate pace than in 2006. After a below-trend first quarter due mainly to the weaker housing market, growth in the second and third quarters recovered to some extent, supported by non-housing investment activity and net exports that benefited from robust global growth and a weaker US dollar. Meanwhile, consumption spending remained supported throughout the year by favourable labour market conditions as reflected in positive job creation, low unemployment rates and favourable income growth. This was achieved despite the continued slowdown in the housing market, where house prices declined across the country amid elevated levels of inventory, falling home sales and rising foreclosures. However, by the fourth quarter, economic growth moderated significantly, reflecting in part the more significant implications from the ongoing correction in the housing market and the emerging impact from financial market turbulence.

Among the other major industrial countries, above-trend growth was sustained in 2007. Growth in **Japan** was supported by favourable export performance and investment activity linked

Table 1.1
World Economy: Key Economic Indicators

	Real GDP Growth (%)		Inflation (%)	
	2006	2007e	2006	2007e
World Growth	**4.9**	**4.7**	**-**	**-**
World Trade	**9.2**	**6.6**	**-**	**-**
Major Industrial Countries				
United States	2.9	2.2	3.2	2.9
Japan	2.2	2.0	0.3	0.1
Euro Area	2.8	2.6	2.2	2.0
United Kingdom[1]	2.8	3.1	2.3	2.4
East Asia	**8.1**	**8.4**	**2.6**	**3.7**
Asian NIEs	**5.4**	**5.5**	**1.6**	**2.2**
Korea	5.0	4.9	2.2	2.5
Chinese Taipei	4.9	5.7	0.6	1.8
Singapore	8.2	7.7	1.0	1.7
Hong Kong SAR[2]	7.0	6.3	2.0	2.0
People's Republic of China	**11.1**	**11.4**	**1.5**	**4.8**
ASEAN[3]	**5.9**	**6.3**	**6.7**	**3.4**
Malaysia	5.9	6.3	3.6	2.0
Thailand	5.1	4.8	4.6	2.0
Indonesia	5.5	6.3	13.1	6.3
Philippines	5.4	7.3	6.2	3.0
India[4, 5]	**9.6**	**8.7**	**4.8**	**4.8**

[1] Inflation based on Eurostat's harmonized index of consumer prices
[2] Inflation refers to composite price
[3] Includes Singapore
[4] Real GDP growth refers to fiscal year
[5] Inflation refers to wholesale price index
e Estimates

Source: International Monetary Fund, National Authorities, BNM estimates.

to growing demand from PR China, which has now surpassed the US as Japan's largest trading partner. These developments more than offset muted consumption growth, which was restrained due to flat nominal wage growth throughout the year. Growth momentum in the **euro area** also remained favourable in 2007, driven by growth in export demand to emerging regions and higher investment spending. Consumption also contributed to growth, supported by falling unemployment rates which reached the lowest levels since 1999. Elsewhere in Europe, the economy of the **United Kingdom** was sustained by strong performance of business and financial services, underpinned by rising employment and positive wage developments. However, some signs of weakening emerged in these economies in late 2007. Japan's housing investment was significantly affected by tighter building standards. In Europe including the UK, business and consumer confidence indices fell as the US subprime problems triggered tighter credit conditions and the housing markets in several of the economies began to soften.

In contrast to the trends in the developed economies, the strong growth momentum in the **Asian region** accelerated in 2007 as domestic demand and other growth drivers more than compensated for moderation in external demand due to the adjustment in the global electronics cycle and developments in the US. Domestic demand was buoyant, sustained by favourable labour market conditions, rising commodity prices and increased infrastructure spending. Growth also benefited from growing intra-regional trade, driven in part by strong performance of the PR China economy which expanded strongly by 11.4%. The Chinese economy was driven not only by sustained high investment growth and strong export performance but further lifted by higher private consumption which was encouraged by positive sentiments from rising equity markets in the first half-year and government measures including the development of rural areas. Elsewhere, **India** continued its robust expansion in 2007, led mainly by private consumption as strong economic growth contributed to rising income levels. Growth was also driven by investments as high retained corporate earnings boosted private investment. Meanwhile on the external front in Asia, sustained large current account surpluses and capital flows continued to contribute to higher foreign currency reserves in the regional economies. Notwithstanding this, the slowing US economy and a weaker US dollar had contributed to a narrowing of global imbalances, with US current account deficit reducing to about 5.7% of GDP. Other contributing factors include the increasing role of domestic demand in emerging economies, and sustained growth in euro area and Japan.

The high growth of the economies in **Latin America**, the **Middle East** and **emerging Europe** also provided a new source of demand for Asia, thus broadening growth away from the major industrial economies. Economic performance of economies within these regions continued at a vigorous pace in 2007, supported mainly by strongly positive economic developments including buoyant commodity prices, healthy domestic demand and robust export performance.

The prolonged period of high global growth since 2003 has created pressures on resource utilisation and resulted in the high prices of **commodities**. Oil prices have surged to record highs and also contributed to higher food prices due to increasing demand for substitutes to conventional fuels, including renewable energy such as biodiesel and ethanol. Adverse weather conditions have also contributed to rising food prices. Among the precious metals, gold prices rose sharply by 31% to USD 833.20 an ounce, reflecting the increasing popularity of gold as a hedge against inflation and as an alternative investment against a weakening US dollar. Recent trends suggest that underlying demand conditions for commodities remain firm,

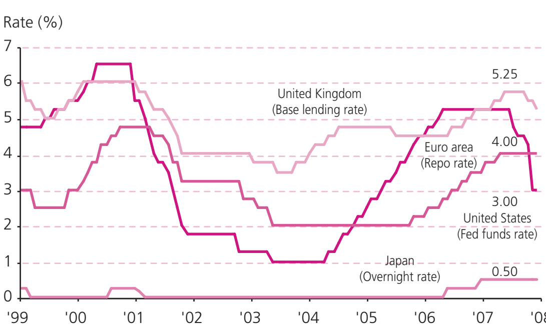
Chart 1.1
Crude Oil Prices: WTI 1-month

Source: Bloomberg

especially in fast-growing economic regions. Amid these developments, overall **global inflation** in 2007 began to rise. The US economy experienced increased pressure on price inflation, while the euro area continued to record rapid money and credit growth. Meanwhile, several countries in the Asian region faced price pressures from increases in food and fuel prices.

In the environment of rising inflationary pressures and generally favourable growth in the first half of 2007, **monetary authorities** in most major industrial and regional countries maintained a bias towards monetary tightening during this period. The US Federal Reserve Board (Fed) maintained policy interest rates at slightly above neutral levels throughout the early part of the year. However, the onset of financial market turmoil in August coupled with indications of a more significant deterioration in domestic demand amidst further weakness in the housing market prompted a marked shift towards easing, with the discount rate first being reduced in August followed by the easing of the federal funds rate beginning in September. In total, the Fed thus reduced the fed funds rate by 100 basis points during the last five months of 2007. Similarly, the Bank of England eased monetary policy in December 2007 to support growth as the impact of financial market turbulence intensified, after tightening in the first three quarters of the year. In the euro area, rising inflation prompted the European Central Bank (ECB) to also tighten in the first half-year to curb inflationary pressures but paused thereafter to assess the impact of volatile financial developments

Chart 1.2
Major Industrial Countries: Official Interest Rates



Source: National authorities

on growth. In the Asian region, PR China, Chinese Taipei, Korea and India also tightened monetary policy to contain inflation. However, the Philippines, Thailand and Indonesia reduced interest rates during the year to stimulate domestic demand as inflation moderated to within or below the governments' target ranges.

In the **financial markets**, equity markets especially in the emerging economies were generally buoyant in the first half of 2007. Thus many regional equity markets hit record highs, buoyed by strong capital inflows and optimism over the region's growth prospects. However, wider strains from the fallout of the US subprime mortgage sector began to intensify in the second half of 2007. Financial institutions, mainly in the US, undertook write-downs on subprime-related securities, and sought to repair their balance sheets by recapitalisation exercises. Financial institutions in the Asian region, on the other hand, were less affected due to the smaller direct exposure to the subprime-related markets. Nevertheless, rising uncertainty and concern over the problems in the global financial markets and the health of the global economy led to increased volatility in the regional equity markets, especially towards the end of the year.

In the **foreign exchange markets**, the US dollar broadly depreciated against all major and regional currencies in 2007. Dollar weakness was due mainly to the less favourable interest rate differentials and the relatively stronger performance of the other industrial and emerging market economies relative to the US. In addition to the more favourable growth in the euro area in 2007, the euro currency was also supported against the dollar as the ECB raised interest rates to the highest levels in six years. Pound sterling also advanced against the dollar especially in the first half-year due to the UK's stronger economic performance. Meanwhile, the yen appreciated significantly against the dollar in the second half of 2007 due to the unwinding of the yen carry trades in response to increased risk aversion following the subprime crisis. In the Asian region, most regional currencies also appreciated in 2007 against the dollar except for the Indonesian rupiah and Korean won. Regional currencies strengthened due to direct investments and portfolio inflows into the region and large trade surpluses amid sustained strong economic growth.

Table 1.2: Malaysia – Key Economic Indicators

	2005	2006	2007*p*	2008*f*
Population (million persons)	26.1	26.6	27.2	27.7
Labour force (million persons)	11.3	11.5	11.8	12.0
Employment (million persons)	10.9	11.2	11.4	11.6
Unemployment (as % of labour force)	3.5	3.3	3.3	3.2
Per Capita Income (RM)	18,966	20,841	23,103	24,651
(USD)	5,008	5,681	6,721	7,596[7]
NATIONAL PRODUCT (% change)				
Real GDP at 2000 prices[1]	5.0	5.9	6.3	5.0 - 6.0
(RM billion)	447.8	474.4	504.4	531.9
Agriculture, forestry and fishery	2.6	5.2	2.2	3.4
Mining and quarrying	-1.3	-0.4	3.2	6.0
Manufacturing	5.3	7.1	3.1	1.8
Construction	-1.8	-0.5	4.6	5.5
Services	6.7	7.2	9.7	7.7
Nominal GNI	10.2	12.0	13.1	8.9
(RM billion)	495.5	555.2	627.8	683.6
Real GNI	5.2	7.1	7.3	4.8
(RM billion)	423.7	453.8	486.7	510.0
Real aggregate demand[2]	7.3	7.0	10.5	5.6
Private expenditure[2]	7.6	7.0	11.8	6.5
Consumption	8.7	7.1	11.7	6.5
Investment	3.3	7.0	12.3	6.3
Public expenditure[2]	6.6	6.8	7.2	3.5
Consumption	6.4	5.0	6.4	6.0
Investment	6.8	8.9	8.0	0.5
Gross national savings (as % of GNI)	36.5	38.2	37.8	36.7
BALANCE OF PAYMENTS (RM billion)				
Goods balance	125.6	134.6	128.1	131.1
Exports (f.o.b.)	537.0	589.7	605.8	617.0
Imports (f.o.b.)	411.4	455.2	477.7	485.9
Services balance	-9.0	-6.9	1.0	1.0
(as % of GNI)	-1.8	-1.2	0.2	0.1
Income, net	-23.9	-17.4	-13.7	-16.1
(as % of GNI)	-4.8	-3.1	-2.2	-2.4
Current transfers, net	-17.0	-16.9	-16.1	-17.7
Current account balance[3]	75.7	93.4	99.3	98.3
(as % of GNI)	15.3	16.8	15.8	14.4
Bank Negara Malaysia international reserves, net[4]	265.2	290.4	335.7	-
(in months of retained imports)	7.7	7.8	8.4	-
PRICES (%change)				
CPI (2005=100)[5]	3.0	3.6	2.0	2.5 - 3.0
PPI (2000=100)[6]	5.9	5.1	6.7	-
Real wage per employee in the manufacturing sector	-0.02	-1.4	1.9	-

Note: Figures may not necessarily add up due to rounding.

1 Begining 2007, real GDP has been rebased to 2000 prices, from 1987 prices previously
2 Exclude stocks
3 Figures for the year 2007 are estimates
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
5 Effective from 2006, the Consumer Price Index has been revised to the new base year 2005=100, from 2000=100 previously
6 Effective from 2006, the Producer Price Index has been revised to the new base year 2000=100, from 1989=100 previously
7 Based on average USD exchange rate for the period of January-February 2008
p Preliminary
f Forecast

Table 1.3: Malaysia – Financial and Monetary Indicators

	2005	2006	2007*p*
FEDERAL GOVERNMENT FINANCE (RM billion)			
Revenue	106.3	123.6	139.9
Operating expenditure	97.7	107.7	123.1
Net development expenditure	27.3	35.0	37.5
Overall balance	-18.7	-19.1	-20.7
Overall balance (% of GDP)	-3.6	-3.3	-3.2
Public sector net development expenditure	66.1	86.5	103.2
Public sector overall balance (% of GDP)	1.4	-0.3	-2.6
EXTERNAL DEBT			
Total debt (RM billion)	197.7	184.5	187.4
Medium- and long-term debt	150.7	141.7	133.0
Short-term debt[1]	47.0	42.8	54.5
Debt service ratio (% of exports of goods and services)			
Total debt	5.4	4.8	3.8
Medium- and long-term debt	5.2	4.5	3.4

	Change in 2005		Change in 2006		Change in 2007	
	RM billion	%	RM billion	%	RM billion	%
MONEY AND BANKING						
Money supply M1	9.8	8.5	17.0	13.7	27.6	19.6
M3	51.6	8.3	87.5	13	72.5	9.5
Banking system deposits	69.0	11.1	119.3	17.2	56.5	7.0
Banking system loans[2]	44.2	8.6	34.9	6.3	51.2	8.6
Loan-deposit ratio (end of year)	77.5%		70.5%		72.2%	
Financing-deposit ratio[3]	85.7%		79.0%		80.8%	

	2005	2006	2007
INTEREST RATES (AVERAGE RATES AS AT END-YEAR)	%	%	%
Overnight Policy Rate (OPR)	3.00	3.50	3.50
Interbank rates			
1-month	2.84	3.54	3.56
Commercial banks			
Fixed deposit 3-month	3.02	3.19	3.15
12-month	3.70	3.73	3.70
Savings deposit	1.41	1.48	1.44
Base lending rate (BLR)	6.20	6.72	6.72
Treasury bill (3-month)	2.96	3.23	3.41
Government securities (1-year)	3.30	3.55	3.53
Government securities (5-year)	3.73	3.70	3.78

	2005	2006	2007
EXCHANGE RATES	%	%	%
Movement of Ringgit (end-period)			
Change against SDR	8.9	1.8	1.7
Change against USD[4]	0.5	7.0	6.8

[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
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OVERVIEW

The Malaysian economy continued its strong growth momentum, expanding by 6.3% in 2007. Growth was driven by robust domestic demand despite a weaker external environment which led to moderation in export growth. Private consumption and investment activities expanded strongly during the year. Private consumption recorded the highest growth rate since 2000, buoyed by rising disposable income following high commodity prices, salary increments in both the public and private sectors, as well as favourable labour market conditions. Strong investment in the manufacturing, services, construction, and oil and gas industries, combined with positive business sentiment, supported expansion in private investment. This was further reinforced by large inflows of foreign direct investment.

The Malaysian economy continued its strong growth momentum, expanding by 6.3% in 2007. Growth was driven by robust domestic demand despite a weaker external environment

The stronger growth achieved reflected the benefits of a more diversified economic base, which has strengthened the economy's resilience to the external environment. While the contribution of the manufacturing sector remains substantial, of significance is the shift in the economic structure in the recent few years towards the services sector, which has become the main driver of growth. The services sector led growth in 2007 was supported by domestic demand activities and new growth areas in finance, business services and communications. The turnaround of the construction sector to record positive growth after three consecutive years of contraction, as well as the recovery in the mining sector added further impetus to growth. In contrast, reflecting weaker external demand, the manufacturing sector registered a more moderate growth, affected by the slowdown in the production and exports of electronics and electrical products, especially in the first half of the year. However, reflecting the relatively broad-based structure of the manufacturing sector, the overall manufacturing sector remained supported by sustained growth in the domestic-oriented and resource-based industries.

Labour market conditions strengthened during the year as a result of the strong economic growth. The economy was effectively at full-employment, with the unemployment rate remaining low at 3.3%. During the year, demand for workers increased, while fewer retrenchments were recorded. The firm labour market conditions exerted some upward adjustments in wages, but as labour productivity improved, wage pressure on inflation was contained.

The strong economic performance was achieved in an environment of relatively low inflation. Overall, the headline inflation rate increased at a slower pace of 2% in 2007, due mainly to price increases in the food and beverages category. Domestic food prices were largely influenced by higher global food prices, which were underpinned by structural and cyclical factors. Nevertheless, the pass-through from global prices to domestic prices were to some extent mitigated by the various policy measures undertaken by the authorities, and domestic factors such as the more competitive environment for retailers. Inflation, however, edged higher in the second half of the year as private consumption gathered further momentum while pressures from food and commodity prices also increased.

The external position strengthened in 2007 supported mainly by the large trade surplus, which was underpinned by strong growth of commodity exports and continued growth in non-E&E manufactured exports. Also contributing to the improved external position was that net outflows in the financial account moderated. For the first time, the services account recorded a surplus due mainly to higher tourism and transportation receipts. Reflecting improved economic prospects and investor confidence, inflows of foreign direct investment and portfolio investment were larger.

The strong growth performance in 2007 has generated significant economic momentum and the ongoing structural transformation has further strengthened Malaysia's macroeconomic fundamentals during the year. Resilient household and corporate sectors, strong banking system, prudent fiscal management, large trade account surplus as well as high international reserves, place the economy in a better position to weather uncertainties in the event of a more pronounced slowdown in global growth and increased volatility in the financial markets.

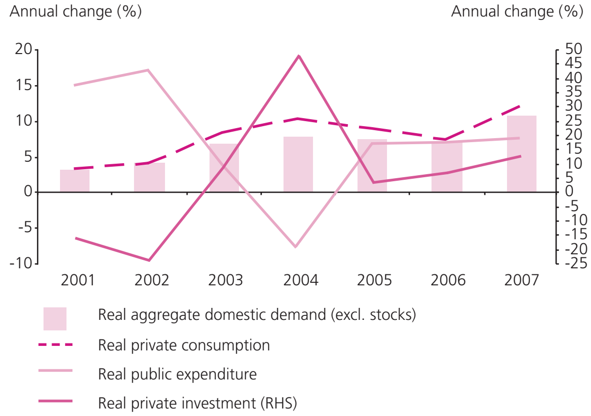
DOMESTIC DEMAND CONDITIONS

Domestic demand, especially private sector activities, led economic growth in 2007, in an environment of moderating external demand. **Domestic demand** grew strongly by 10.5% in 2007 (2006: 7%), driven mainly by the buoyant expansion in private consumption and investment. Consumer spending increased further, supported by the steady increase in disposable incomes, firm labour market and favourable financing conditions. Private investment activities remained strong, with higher levels of capital spending in the manufacturing, services and construction sectors as well as upstream oil and gas activities. The public sector, meanwhile, continued to be supportive of growth following implementation of projects and measures to enhance infrastructure and public sector delivery system.

Robust domestic demand was driven mainly by strong expansion in private sector activities

Private consumption increased at a faster pace of 11.7% in 2007 (2006: 7.1%). The robust consumer spending activities was reflected in favourable performance of major consumption indicators, such as imports of consumption goods, loans approved and disbursed for consumption, and credit card spending. Household spending was supported by the steady increase in disposable income and stable labour market conditions. Higher commodity prices, especially prices of crude palm oil and rubber, have led to rising disposable income of households in rural areas. The average monthly income of FELDA settlers in the palm oil scheme has doubled to RM2,800 per month (2006: RM1,386; 2001: RM700 per month), while rubber smallholders on average earned RM3,495 per month in 2007 (2006: RM3,486; 2001: RM650). In addition, the

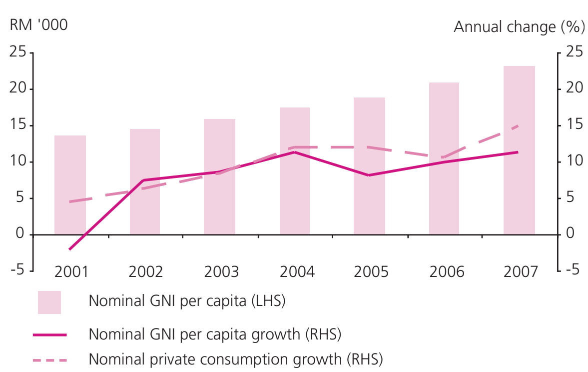
Chart 1.3
Real Domestic Demand Aggregates



upward salary adjustments for civil servants of between 7.5% to 35% further strengthened consumption in the second half of the year. Positive developments in the labour market such as rising job vacancies and declining retrenchment as well as the strong performance of the equity market further buoyed consumer sentiments.

During the year, the low interest rate environment and access to credit provided support for households' spending. Outstanding loans to households increased by 7.5% in 2007, driven mainly by loans for purchase of residential property and consumer durables. There was, however, no evidence of an increase in the vulnerability of household financial positions. The household debt to financial assets ratio was lower at 46.0% (2006: 49%), while the non-performing

Chart 1.4
GNI per Capita

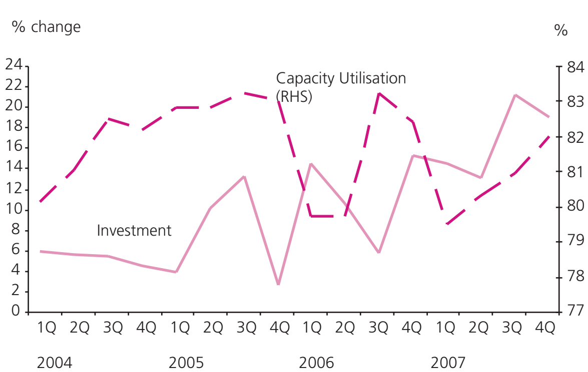


loan (NPL) ratio for household loans declined to 5.3% (2006: 7.1%). In addition, the NPL ratios for residential property, hire purchase and credit card loans were lower at 7.2%, 2.6% and 2.5% respectively (2006: 8.8%, 4.2% and 3.7% respectively).

Private investment expanded further in 2007, recording a higher growth rate of 12.3% (2006: 7%). Capital spending activities in most economic sectors, particularly manufacturing, services, construction and mining, accelerated further. The MIER's Business Conditions Index (BCI) which remained above the 100-point threshold level throughout the year, underscored positive business sentiment. In addition, the higher gross FDI inflows of RM46.1 billion in 2007 (2006: RM37.3 billion), mainly into the manufacturing, and oil and gas sectors, further reflected favourable investment climate. Healthy financial position of companies due to favourable corporate earnings over several years has also enabled them to fund the bulk of their capital expenditure from internal sources. Private investment activity also continued to be supported by favourable financing conditions. Loans approved and disbursed to businesses as well as private debt securities (PDS) issued for new activities continued to increase during the year. Loans disbursed to businesses increased by 9.5% while PDS issued for new activities rose to RM31.8 billion in 2007 (2006: RM21 billion).

Investment in the manufacturing sector was strong during the year, mainly supported by expenditure on new machineries and equipment.

Chart 1.5
Investment and Capacity Utilisation



Source: Malaysian Institute of Economic Research (MIER)

Sustained high level of capacity utilisation rate in the sector also underpinned additional capital spending activities. Major indicators such as imports of machineries and loans disbursed to the manufacturing sector indicated positive expansion in manufacturing investment. In 2007, the Ministry of International Trade and Industry approved a total of RM59.9 billion in 949 manufacturing projects (2006: RM46 billion), mainly for investment in electrical and electronics products, petroleum products and basic metal products industries. More than half of the approved investments were projects with foreign participation, indicating Malaysia's attractiveness as an investment destination. Foreign participation continued to be significant in the electronics sector, due largely to well established industry linkages and good infrastructure. In addition, capital investment per employee of the approved projects was higher, supporting a gradual shift towards higher capital-intensive projects.

Capital expenditure in the mining sector was driven mainly by robust activity in the upstream oil and gas sector, and reflected in the intensified exploration and production activities in deepwater oil fields. Investment in the services sector expanded mainly in the transportation sub-sector, attributable to expansion in air transport facilities. Capacity enhancement was also evident in the communications sub-sector due to ongoing network upgrading. Meanwhile, capital spending in the construction sector was supported by strong activities in high-end residential projects and the implementation of the 9MP projects.

The Government continued to play a prominent role in supporting and encouraging private sector activities. In Budget 2007, the Government reduced the corporate tax rate by two percentage points over two years, to 27% and 26% in 2007 and 2008 respectively. This helped reduce further the cost of doing business and accorded companies with greater capacity to expand capital spending.

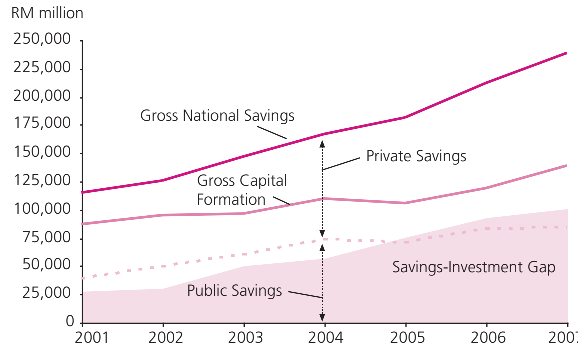
Public investment increased at a sustained rate of 8% in 2007 (2006: 8.9%). Public development expenditure continued to support growth, with large expenditure channelled into projects to further improve the economic and social services sectors of the economy as well as to reduce rural-urban and regional disparities. In the economic sector, expenditure was mainly for improving and upgrading both the industrial and public utilities infrastructure, enhancing the transportation system and increasing efficiency in agriculture production. In the social services sector, development expenditure continued to focus on the provision of essential services, namely education, healthcare and housing. Of importance, development expenditure on housing projects and healthcare facilities was accelerated during the year. In addition, the Government's commitment to develop human capital was evident in high disbursements to strengthen institutions of higher learning.

Capital expenditure by the non-financial public enterprises (NFPEs) continued to be high in 2007, attributed largely to exploration and production activities in the upstream oil and gas sector by PETRONAS. In addition, capacity expansion and upgrading programmes in the transportation, utilities and communication sectors also contributed to the growth in NFPEs' investment. Tenaga Nasional Berhad continued to spend on improving power generation and transmission systems to cater for rising demand for electricity. Capital spending in the communication sector focussed mainly on improving facilities in the area of broadband services. Meanwhile, investment in the transportation sector was largely for upgrading and capacity expansion exercise by both the port authorities and railway operator.

Public consumption increased steadily by 6.4% in 2007 (2006: 5%), largely on account of stronger growth in emoluments and higher expenditure on supplies and services and defence. The increase in emoluments expenditure was more pronounced in the second half-year as a result of the upward salary adjustment for civil servants of between 7.5% and 35%. Meanwhile, the increased expenditure for supplies and services was largely due to continued upgrading of public sector's administrative machinery and maintenance of buildings and fixtures.

In spite of higher public consumption, public sector savings remained high at RM83.8 billion in 2007 or 13.3% of GNI, with the main source of increase due to the large operating surpluses of the NFPEs. This increase was attributed to higher cash flows generated as a result of high commodity prices and strong export earnings.

Chart 1.6
Gross National Savings and Savings-Investment Gap



Meanwhile, private sector savings increased to RM153.4 billion or 24.4% of GNI in 2007 (23.2% of GNI in 2006), reflecting healthy household balance sheets. Banking sector deposits held by individuals rose to RM330.6 billion during the year (2006: RM299.1 billion). Overall, **gross national savings (GNS)** increased further by 11.9% to RM237.1 billion and the share of GNS remained high at 37.8% of GNI (2006: 38.2%). Despite higher investment by both public and private sector, the strong increase in the GNS led to a larger savings-investment surplus of RM99.3 billion or 15.8% of GNI in 2007.

SECTORAL REVIEW

Growth in 2007 was broad based, reflecting expansion across all key sectors of the economy. The growth was led by the strong performance in the services sector, and supported by the construction and mining sectors. Reflecting the increasing prominence of the services sector as a contributor to growth, the sector which grew by 9.7%, accounted for five percentage points of the total real GDP growth in 2007. After three years of decline, the construction sector turned around to register a positive growth of 4.6%, driven mainly by the civil engineering sub-sector which benefited from implementation of projects under the Ninth Malaysia Plan and in the oil and gas sector. The mining sector also recorded an improved performance led by higher production of crude oil following the coming on-stream of the Kikeh oil field. Meanwhile, the manufacturing and agriculture sectors recorded moderate expansion in 2007. The former was tempered by weak performance of export-oriented industries, especially electronics and electrical products, in an environment of subdued external demand, while the latter was weighed down by lower production of crude palm oil and rubber.

Services Sector

The **services sector** has, in recent years, emerged as a key driver of growth in the economy. The sector has been the most important contributor, expanding at an average annual growth rate of 6.8% between 2003-2007 and exceeding the average real GDP growth of 6%. In the recent two years, growth picked up substantially to above 7%, supported by robust domestic demand and tourism activities. Reflective of strong growth in the sector, total approved investments by MIDA in the services sector increased by 17.8% to RM65.4 billion in 2007 (2006: RM55.5 billion).

The services sector recorded the strongest growth in ten years reflecting broad-based expansion

Of importance, the strong performance of the services sector was broad based, with the key drivers being the real estate and business services; finance and insurance; communication; and wholesale and retail trade sub-sectors. These sub-sectors combined registered an average annual growth rate of 7.7% over the period 2003-2007. A notable development has been the prominence of new growth areas in the services sector which are mainly knowledge-intensive activities, such as telecommunications, Islamic finance, shared services and outsourcing (SSO) and IT services. The strong performance of these sub-sectors was due to rising demand and changes in consumer preference in line with improved income levels. The growth was also supported by policy initiatives to promote these areas. Given these developments, the services sector has developed its own endogenous strength and has become less reliant on the performance of other sectors.

The services sector continued on a strong growth momentum in 2007, expanding by 9.7%, the highest growth rate since 1997. It contributed five percentage points of the overall GDP growth of 6.3%, resulting in its share of total GDP rising to 53.4% in 2007 (2006: 51.8%). The growth was underpinned by strong domestic demand and further supported by tourism-related activities. Steady increases in incomes amidst the high commodity prices and revision to the civil service salary, as well as robust capital market activity and higher tourism activity as a result of the Visit Malaysia Year 2007 led to the strong demand for services during the year.

Table 1.4
Growth Performance of the Services Sector during 2003-2007 (at constant 2000 prices)

	2002	2007*p*	2003-2007
	RM million		CAGR[1] (%)
Total GDP	**377,559**	**504,408**	**6.0**
Services	**193,500**	**269,276**	**6.8**
Intermediate services	**82,833**	**117,564**	**7.3**
Finance and insurance	38,549	53,726	6.9
Real estate and business services	16,843	26,061	9.1
Transport and storage	14,637	18,942	5.3
Communication	12,805	18,834	8.0
Final services	**110,666**	**151,712**	**6.5**
Wholesale and retail trade	42,433	61,511	7.7
Accommodation and restaurant	8,553	11,515	6.1
Electricity, gas and water	11,759	15,137	5.2
Government services	24,816	34,890	7.1
Other services	23,105	28,659	4.4

p Preliminary
[1] Compound annual growth rate
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Table 1.5
Emerging Areas of Growth in the Services Sector

	As at end	
	2006	2007*p*
Islamic Finance		
Islamic Banks in operation	10	11
Takaful companies in operation	8	9*
IT Services and SSO[1]		
No. of MSC-status companies approved	1,728	1,994
Amount of approved private investment in MSC (RM billion)	21.2	24.9
No. of Operational Headquarters	133	150
No. of International Procurement Centres	191	203
No. of Regional Distribution Centres	17	18
Private Higher Education		
No. of private higher educational institutes (IPTS)	515	525
No. of students in IPTS (For the year)	323,787	308,978
No. of foreign students in IPTS (For the year)	36,449	33,604
Private Healthcare		
No. of private hospitals	210	195
No. of private hospitals participating in promoting health tourism	35	35

[1] Shared services and outsourcing
p Preliminary
* Including one new retakaful operator that commenced operation in 2007

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

The growth in the new services sub-sectors, such as Islamic finance and ICT services is also a result of initiatives taken by the authorities to promote these activities.

Strong domestic demand supported growth in the wholesale and retail trade; accommodation and restaurant; and other services sub-sectors. The **wholesale and retail trade** sub-sector, which grew strongly by 12.2%, benefited from the robust expansion in private consumption activity during the year. Meanwhile, the **accommodation and restaurant** sub-sector was supported by increased tourism activity, arising from a sharp rise in foreign tourist arrivals of 19.5% and robust domestic tourism. As a result, the average occupancy rate of hotels in the country rose to 70% from 65.5% in 2006. Encouraged by the strong consumer spending and tourist arrivals, about 31 new shopping malls were opened in 2007. Only the distributive trade activity in the automotive sector remained soft, especially in the first half of the year, due to the weak second-hand car market. Meanwhile, rising disposable incomes led to increased demand for private healthcare, beauty care, entertainment-related activity and private education, which contributed to the sustained expansion in the **other services** sub-sector during the year.

A significant development during the year was the robust growth in both the finance and insurance; and real estate and business services sub-sectors, which grew by 10.7% and 20.6% respectively. The combined share of the two sub-sectors to overall GDP rose to almost 16% by end-2007, with the **finance and insurance** sub-sector accounting for a higher share of 10.7%. The growth was driven by increased bank intermediation and fee-based activity. Fee-based revenue grew strongly by 33% during the year

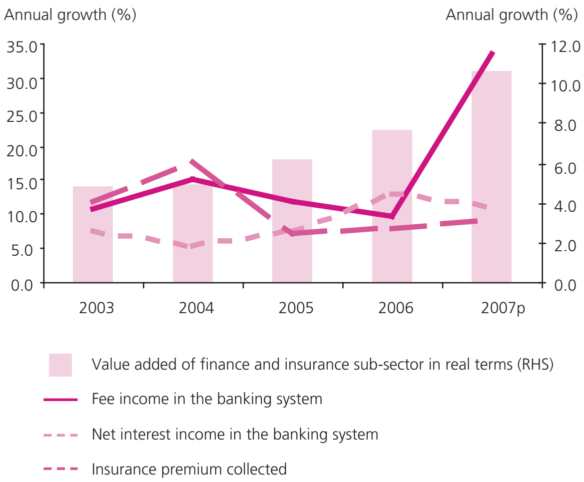
Table 1.6
Services Sector Performance at Constant 2000 Prices

	2006	2007*p*	2006	2007*p*
	Annual change (%)		Share to GDP (%)	
Services	**7.2**	**9.7**	**51.8**	**53.4**
Intermediate services	7.6	12.0	22.1	23.3
Finance and insurance	7.7	10.7	10.2	10.7
Real estate and business services	9.9	20.6	4.6	5.2
Transport and storage	5.2	10.2	3.6	3.8
Communication	6.8	6.9	3.7	3.7
Final services	7.0	7.9	29.6	30.1
Wholesale and retail trade	7.1	12.2	11.6	12.2
Accommodation and restaurant	6.0	10.9	2.2	2.3
Electricity, gas and water	5.2	4.0	3.1	3.0
Government services	9.8	4.2	7.1	6.9
Other services	4.7	5.0	5.8	5.7

p Preliminary

Source: Department of Statistics, Malaysia

Chart 1.7
Performance of the Finance and Insurance Sub-sector vis-à-vis Related Indicators



p Preliminary
Source: Department of Statistics, Malaysia
Bank Negara Malaysia

supported by underwriting and corporate advisory activity as well as innovation of products and services in wealth and portfolio management, remittances and trade finance services.

Growth in the finance segment was also supported by expansion in Islamic finance. Initiatives under the Malaysia International Islamic Financial Centre gathered momentum with approval given to Islamic banks to set up International Currency Business Units (ICBU). One foreign-owned Islamic bank and two takaful companies (including one retakaful operator) commenced operation in 2007, bringing the total to 11 Islamic banks and nine takaful companies in operation. In 2007, total Sukuk approved amounted to RM121 billion, an annual increase of 189%. Meanwhile, the introduction of new investment-linked as well as medical and health insurance products contributed to the growth in the insurance segment.

The **real estate and business services** sub-sector recorded a strong growth of 20.6% during the year. In particular, the business services segment was supported by strong brokerage activity in line with the increased turnover in the equity market. Growth was further supported by IT-related services, including SSO, as well as professional and consultancy services arising from robust construction, and oil and gas activity. During the year, 27 new SSO companies (including 19 wholly foreign-owned) started operations in the Multimedia Super Corridor (MSC) area, bringing the total SSO companies in the MSC to 123 (2006: 96 companies), while total spending on IT services grew by 24.9%. In addition, real estate activity also picked up momentum due to increased property transactions following several incentives announced by the Government, such as the exemption from the Real Property Gains Tax and liberalisation on property ownership by foreigners.

The **transport and storage** sub-sector registered a better performance due to improvements in air transportation and supporting services such as freight forwarding and warehousing. Higher travel among foreign and local tourists as well as aggressive expansion in the airline industry, especially in the low-cost carrier segment with the introduction of new destinations and competitive air

Table 1.7
Selected Indicators for the Services Sector

	2006	2007*p*
	Annual change (%)	
Utilities		
Electricity production index	5.1	3.9
Wholesale & Retail Trade and Accommodation & Restaurant		
Consumption credit disbursed	-0.5	9.2
Tourist arrivals	6.8	19.5
Total sales of motor vehicles	-11.1	-0.7
Finance & Insurance and Real Estate & Business Services		
Loans outstanding in the banking system	6.3	8.6
Insurance premiums	5.7	8.9
Bursa Malaysia turnover (volume)	93.3	82.2
Transport & Storage and Communication		
Total container handled at Port Klang and PTP (TEUs)	14.2	13.6
Airport passenger traffic	2.2	6.2
Air cargo handled	5.7	-5.5
SMS traffic	51.6	70.6
	%	
Penetration rate:		
- Internet dial-up	14.0	14.3
- Broadband	3.3	5.0
- Moblie phone	72.3	85.1
- Fixed line	16.1	16.3

p Preliminary

Source: Department of Statistics, Malaysia; Malaysia Airports Holdings Berhad; Senai Airport Terminal Sdn. Bhd; Malaysian Automotive Association; Bursa Malaysia Berhad; Malaysian Communications and Multimedia Commision; Ministry of Finance; PTP, Port Klang Authority, Syarikat Prasarana Negara Berhad; Malaysia Tourism Promotion Board and Bank Negara Malaysia.

fares further boosted the passenger-related air transport. Meanwhile, the water transportation segment benefited from expansion in carriage of LNG exports and higher freight rates.

The stronger domestic demand supported growth in the **communication** sub-sector reflecting higher usage of voice and data services as well as an increase in the number of subscribers, particularly in the cellular segment. The overall blended average revenue per user (from both post-paid and pre-paid subscribers) increased by 14.5% to RM63 in 2007 (2006: RM55). The rapid developments in the ICT industry and the continued expansion in Internet and broadband services coverage nationwide have also encouraged increased subscriber base in the Internet and broadband segments.

Manufacturing Sector

The **manufacturing sector** expanded by 3.1% in 2007 (2006: 7.1%) as the growth in domestic-oriented and selected resource-based industries cushioned the effects of the subdued external demand for electronics and electrical (E&E) products. Resource-based industries such as rubber, petroleum, and chemicals and chemical products expanded further, supported mainly by robust demand from the Asia-Pacific region. Similarly, the domestic-oriented industries benefited from the recovery in the construction sector and strong growth in private consumption. Against this backdrop, the overall capacity utilisation rate in the manufacturing sector remained stable at 76% amidst the expansion in investment and regular maintenance of plants in several industries. In terms of contribution to the overall GDP, the manufacturing sector's share declined slightly to 30.2% (2006: 31.1%).

The diversified manufacturing base cushioned the impact of the slowdown in the electronics and electrical industry

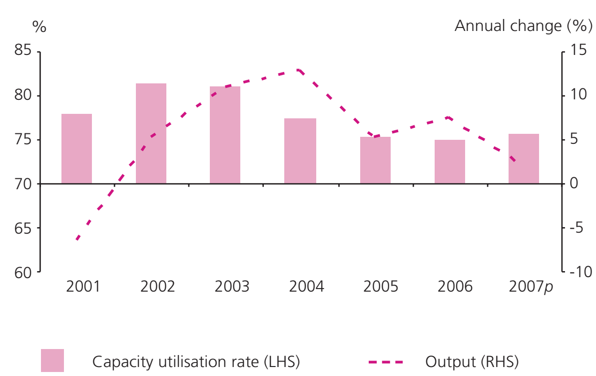
Despite the decline in output of E&E products, the **export-oriented industries** continued to expand, albeit marginally by 0.7%. The **E&E** performance was affected particularly in the first half of the year by the subdued external demand for computers and parts from the US, and lower production of semiconductors as a result of excess supply in the global semiconductor market. In the early part of the year, the slowing investment in equipment and software by the US corporate sector, which was due mainly to uncertain business environment as well as the delayed release of the service pack for the new operating system, affected the production of computers and parts segment as more than half of Malaysia's exports of these products are to the US. Nevertheless, production of computers and parts turned positive in the second half of the year in line with the improvement in US investment in equipment and software.

Table 1.8
Performance of the Manufacturing Sector

	2006	2007
	Annual change (%)	
Value-added (at constant 2000 prices)	**7.1**	**3.1**
Overall Production	**7.5**	**1.9**
- Export-oriented industries	**7.5**	**0.7**
of which:		
Electronics and electrical products (E&E)	7.9	-0.9
Chemicals and chemical products	3.2	1.8
Petroleum products	13.6	5.4
Rubber products	7.2	5.9
Off-estate processing	5.7	-0.5
- Domestic-oriented industries	**7.2**	**6.8**
of which:		
Construction-related products	3.2	5.0
Fabricated metal products	26.5	19.4
Exports	**10.1**	**0.3**

Source: Department of Statistics, Malaysia

Chart 1.8
Capacity Utilisation Rate in the Manufacturing Sector



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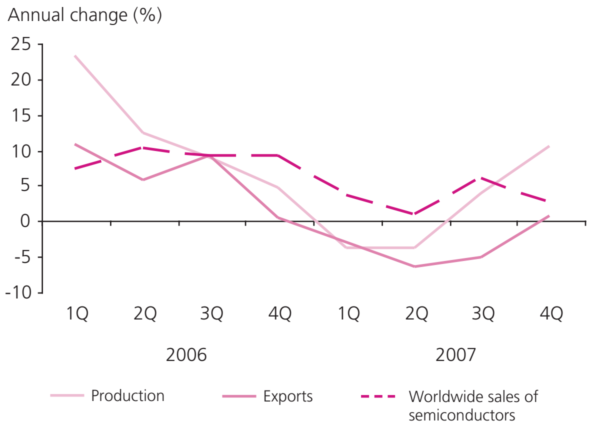
Source: Department of Statistics, Malaysia
Bank Negara Malaysia

Chart 1.9
Production and Exports of Electronics



Source: Department of Statistics, Malaysia
Semiconductor Industry Association (SIA)

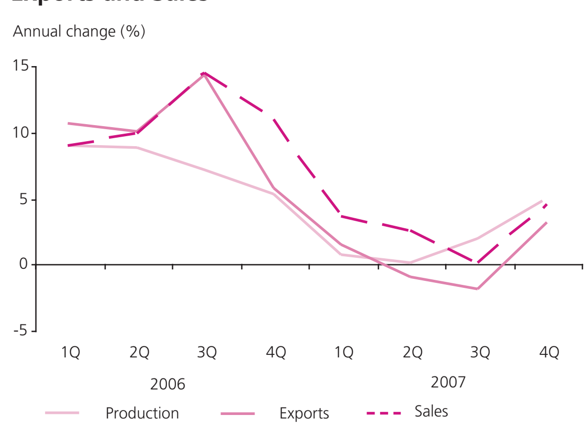
Meanwhile, production of semiconductors slowed down in the early part of the year as major manufacturers adjusted their excess inventories in some segments. Thereafter, production picked up gradually due to demand from the non-US market, particularly the euro area, Japan and PR China, driven by demand for end-products in the consumer and telecommunication segments. Meanwhile, the performance in the electrical products segment continued to be affected by the transition from old products like cathode-ray tube televisions and VCD players to higher value-added products like high definition LCD televisions, DVD recorders and Blu-ray players.

The E&E industry also faced declining average selling prices for both memory chips and microprocessors due to strong competition among major global producers. Amidst the more challenging environment, the E&E manufacturers in the country continuously moved up the value chain to produce higher value-added products to remain competitive. These included intensification of research and development efforts and in-sourcing activities for their related companies worldwide.

In the resource-based industries, output growth in the **rubber products** sector was sustained as the better performance in the tyre and tube segment offset the moderate growth in rubber gloves. The strong growth in the tyre and tube sub-sector was due to a major producer moving up the value chain to produce higher value added tyres. Meanwhile, output of rubber gloves moderated in the second half of the year after a strong performance in early 2007 due partly to rising input price. The **petroleum products** sector continued to benefit from increased production of liquefied natural gas amidst the strong domestic demand from the power generation sector and energy-intensive industries such as steel, cement and rubber industries.

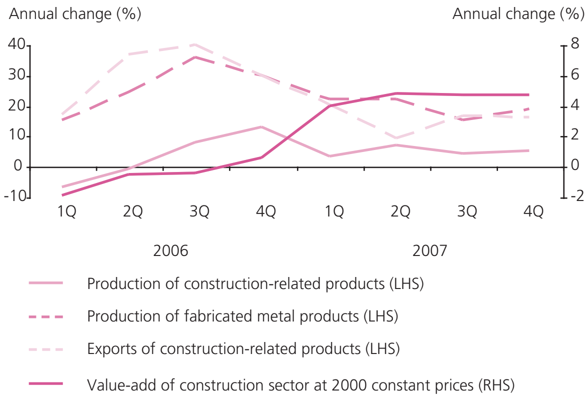
In the **chemicals and chemical products** industry, while the basic chemicals and other chemical products recorded stronger increases, the development was weighed down by weaker performance in the plastic products segment. The basic chemicals sector was driven by higher output of industrial gases owing to demand from related industries such as steel and petrochemicals which use gas as feedstock. In addition, the recovery in the construction sector had also contributed to the increased demand for industrial gases used for welding. The other chemical products segment, particularly pharmaceuticals, medicinal chemicals and botanical products were supported by increased external demand during the year. Meanwhile, output of plastic products was dampened by weaker demand from the E&E sector as well as the automotive industry. The increasing price of raw materials, especially resins which is a derivative of crude oil, also influenced the production of plastic products during the year. However, the recovery in the automotive sector in the second half of the year helped to cushion part of the impact.

Chart 1.10
Manufacturing Sector: Production, Exports and Sales



Source: Department of Statistics, Malaysia

Chart 1.11
Industries Related to the Construction Sector were Supported by Domestic and External Demand



Source: Department of Statistics, Malaysia

Output of **off-estate processing** contracted during the year, broadly in line with the performance of upstream activities of crude palm oil and rubber, while the **textiles and wearing apparel** industry was affected by weaker external demand.

Growth in the **domestic-oriented industries** was supported by strong domestic demand during the year. Production of **construction-related materials** picked up in tandem with the increased activity in the construction sector. Growth in these industries, particularly iron and steel, and cement was also reinforced by strong external demand from neighbouring countries such as Singapore, Indonesia and Vietnam, where construction activities have been robust. At the same time, local steel millers also increased exports to take advantage of higher international prices relative to domestic prices. The pick-up in construction activity had also led to higher demand for related fabricated metal products such as metal fixtures and furniture.

Consumer-related products, such as food, beverages and tobacco, showed an improvement underpinned by strong private consumption. Another notable development was that measures taken to promote the Halal food industry began to yield results as there was a discernable increase in exports of Halal food to the Middle East market. Meanwhile, the **transport segment** was affected by the continued sluggish second-hand car market in the first half year. Nevertheless, demand for new motor vehicles picked up in the second half of the year, supported by rising incomes, the launch of new models, and the continued access to financing at competitive rates.

Agriculture Sector

The agriculture, forestry and fishing **(agriculture) sector** expanded at a moderate pace of 2.2% in 2007, supported by food-related activity, particularly livestock, paddy, and vegetables. The strong performance in food-related activity more than offset the weaker performance in key industrial crops, namely crude palm oil and rubber, which account for about 36% of the total value-add in the agriculture sector. Biological yield down-cycle and inconsistent weather patterns were the main contributory factors for the less favourable performance of these industrial crops during the year.

The agriculture sector continued to expand mainly supported by food-related activity

Table 1.9
Agriculture Sector:
Value Added, Production and Exports

	2006	2007*p*
	Annual change (%)	
Value-added	**5.2**	**2.2**
Industrial crops	**4.1**	**0.4**
Production of which:		
Crude palm oil	6.1	-0.4
Rubber	14.0	-6.4
Saw logs	-4.7	-5.3
Cocoa beans	14.2	10.2
Food crops	**6.8**	**4.9**
Production of which:		
Fish	11.4	0.2
Livestock[1]	18.0	9.9
Vegetables	3.8	8.6
Fruits	5.3	-2.8
Exports (RM million)	**12.5**	**24.4**

[1] Refers to Peninsular Malaysia only
p Preliminary

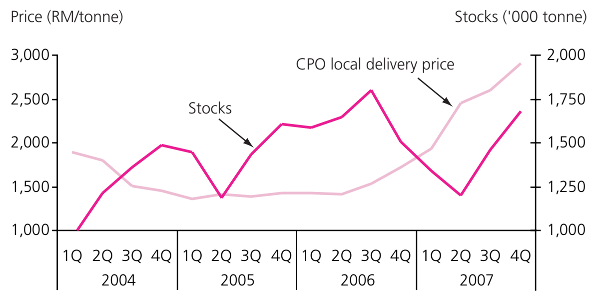
Source: Department of Statistics, Malaysia
Malaysian Palm Oil Board
Malaysian Rubber Board
Forestry Department (Peninsular Malaysia, Sabah and Sarawak)
Malaysian Cocoa Board
Fisheries Department, Malaysia
Veterinary Services Department, Malaysia
Department of Agriculture, Malaysia

Crude palm oil production declined, albeit marginally by 0.4%, to 15.8 million tonnes in 2007. This was the first decline in output since 1998 and was due to the biological yield down-cycle, which normally occurs every three to four years. Average national yields, as measured by fresh fruit bunches, declined by 2.9% to 19 tonnes per hectare in 2007. This was further exacerbated by damage in harvest in the southern region of Peninsular Malaysia due to floods in the early part of the year. Consequently, overall production in Peninsular Malaysia declined by 3.8%, which was partially mitigated by higher output in Sabah and Sarawak, which rose by 2.9% and 8.8% respectively.

A major development was the sharp increase in crude palm oil (CPO) prices of 62.6% to reach a historic average high of RM2,472 per tonne in 2007. This was driven by strong demand for palm oil, both for edible oil as well as for use as biofuel, which caused the CPO prices to be more closely correlated to crude oil prices. Prices increased sharply despite the increase in stocks, which rose by 11.6% to 1.68 million tonnes in 2007. Given this development, the price discount of palm oil to soybean oil and rapeseed oil narrowed to USD101 per tonne and USD189 per tonne respectively (2006: USD121 per tonne and USD316 per tonne respectively).

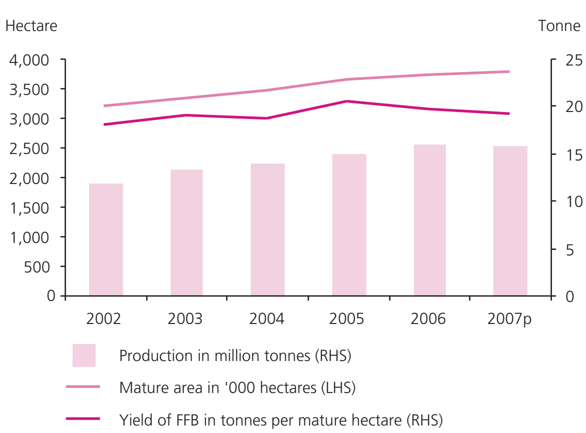
Production of **natural rubber** contracted by 6.4% to 1.2 million tonnes in 2007 due to weather-related factors. In the early part of the year, drier-than-usual weather conditions resulted in a severe wintering of rubber trees and subsequently by frequent instances of heavy rainfall which disrupted tapping activities, especially amongst the smallholders. The lower output was also influenced by the continued reduction in the total acreage of rubber areas. In 2007, total acreage of rubber land declined by 1.8% due to conversion to other crops, while about 98,300 hectares or 9% of total mature area was left idle. It is estimated that if the idle land was to be brought into production, the rubber output could have increased by about 9%. Despite these developments, Malaysia remained as the third largest producer of natural rubber in the world in 2007 after Thailand and Indonesia.

Chart 1.13
Palm Oil Price and Stocks



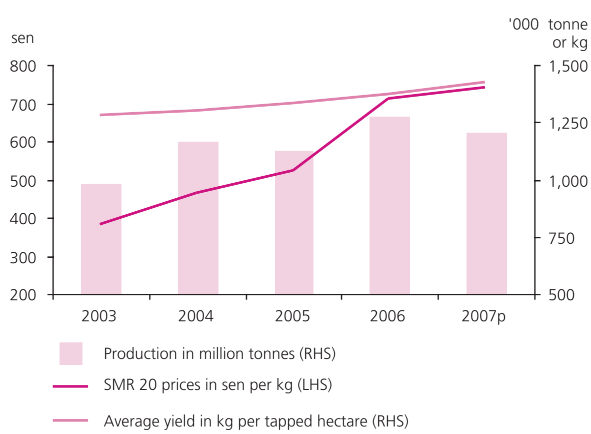
Source: Malaysian Palm Oil Board (MPOB)

Chart 1.12
Oil Palm: Area, Production and Yield



p Preliminary
Source: Malaysian Palm Oil Board (MPOB)

Chart 1.14
Natural Rubber: Production, Prices and Yield



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

The Malaysian benchmark rubber price, SMR20, rose further by 3.9% to average 737 sen per kilogramme in 2007. The movement in rubber prices during the year was strongly correlated with crude oil and synthetic rubber prices. In tandem with a strong upward trend in crude oil prices, rubber prices ended the year at 837 sen per kilogramme. Prices were also influenced by the surge in global demand, particularly in PR China.

The **food crops** sub-sector continued to perform favourably in 2007, with the value-added growth expanding by 4.9% (2006: 6.8%). The commencement of several large companies undertaking deep-sea tuna fishing, as well as the commercial livestock rearing activity helped enhance output in the food sub-sector.

In the **forestry** sub-sector, logging activities declined further in 2007, with output of logs contracting by 5.3%. The development is in tandem with the conservation efforts implemented as part of sustainable forest management. As a result of this and combined with lower demand for saw logs from Japan, export volume of saw logs and sawn timber declined during the year. The lower demand of logs from Japan was due to an abrupt change in the housing regulation which affected construction activity. As a result, export prices of logs fell by 4% to RM455 per cubic metre.

In ensuring sustainable forest management and continued supply of raw materials for wood-based downstream activities, the Government accelerated efforts to increase the size of forest plantation, with the aim of having 270,000 hectares planted. As at end-2007, 16 companies have been identified to take part in the scheme, which involved the development of 58,935 hectares of forest plantations, mainly rubberwood. These companies have received soft loans of RM267.6 million from the Government to undertake the forest plantation activities.

Cocoa output grew at a strong pace for the second consecutive year, rising by 10.2%, due mainly to favourable weather conditions. Output was further enhanced by the strong increase in productivity, especially in the rehabilitated areas under the Cocoa Rehabilitation Programme which came into maturity in 2007. Average national productivity increased by 18.3% during the year to an estimated 1,204 kilogrammes per hectare (2006: 1,018 kilogrammes per hectare).

Mining Sector

The **mining sector** rebounded to record a positive growth of 3.2% in 2007 due to higher output of both crude oil and natural gas, in an environment of stronger energy prices. Crude oil benefited from the coming on-stream of Malaysia's first deepwater oil field in Kikeh, Sabah, while natural gas output picked up following the recommencement of part of the MLNG2 plant after an upgrade exercise in the previous year. Following higher energy prices during the year, export revenue from minerals rose further to account for a larger share of 10.1% of total gross exports (2006: 9.7%).

The mining sector rebounded on increased production capacity amidst the higher prices

Production of **crude oil (including condensates)** averaged 695,276 barrels per day in 2007, representing an increase of 4.3%. The higher production was mainly driven by the 10.7% increase in crude oil output in Sabah to 90,394 barrels per day arising from the coming on-stream of the Kikeh oil field in August 2007. Production in Peninsular Malaysia, which contributes about 55% of total output of crude oil of the country, increased by 2.3% in 2007. Meanwhile, condensates continued to contribute significantly, accounting for about 19% of the total production of crude oil in the country.

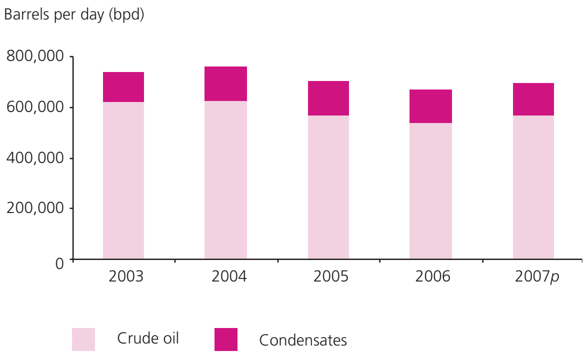
Table 1.10
Mining Sector:
Value Added, Production and Exports

	2006	2007*p*
	Annual change (%)	
Value-added	**-0.4**	**3.2**
Production		
of which:		
Crude oil and condensates	-5.2	4.3
Natural gas	-0.4	1.4
Exports	**8.6**	**7.5**

p Preliminary

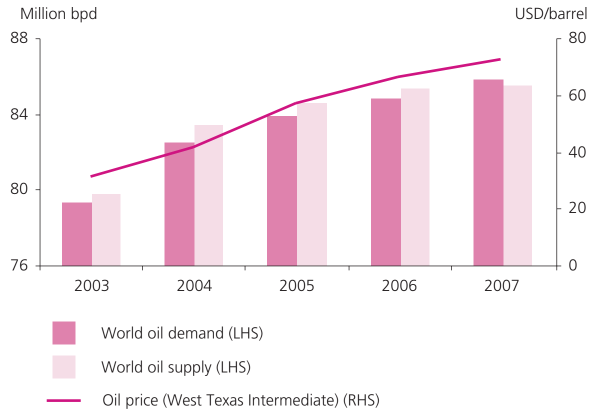
Source: PETRONAS
Department of Statistics, Malaysia

Chart 1.15
Production of Crude Oil and Condensates



p Preliminary
Source: PETRONAS

Graph 1.17
World Oil Supply and Demand

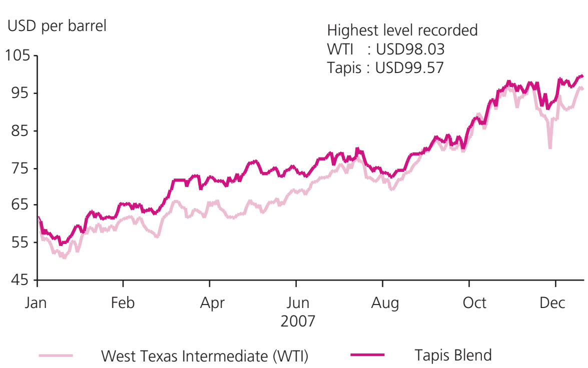


Source: International Energy Agency (IEA)

Output of **natural gas** expanded by 1.4% to 5,854 million standard cubic feet per day (2006: -0.4%). The increase was due to the recommencement of a gas liquefaction train at the MLNG2 plant in Sarawak after a capacity upgrade. As a result, natural gas production in Sarawak, which accounts for around 60% of total output in Malaysia, saw an increase of 4.7% (2006: -0.5%). The increase was mainly to cater for higher demand from Korea, one of the world's largest importers of LNG.

During the year, the global energy market continued to be characterised by strong upward pressure on prices. The price of the Malaysian benchmark oil grade, Tapis Blend, rose further by 11.5% to average USD76.46 per barrel, marking the sixth consecutive year of increase since 2001. The Tapis Blend, which opened the year at USD57.44 per barrel, increased continuously during the course of the year to reach its highest level of USD99.57 per barrel at end-year, before proceeding to breach the psychological threshold of USD100 per barrel on the first day of trading in 2008, at USD101.40 per barrel.

Chart 1.16
Crude Oil Prices (1-Month Futures) in 2007



The upward momentum in prices occurred against a backdrop of strong global demand amidst tight supply conditions. A significant development was that in 2007, world oil demand (85.8 million bpd) had exceeded world oil supply (85.5 million bpd), driven by robust global economic growth, especially in emerging market economies. Prices were also influenced by the involvement of speculative funds and asset managers in the global oil futures market, amidst continued geopolitical concerns in major oil-producing regions during the year. In line with developments in the global oil prices, the Malaysian natural gas prices also rose by 6.7% to RM1,154 per tonne.

Oil reserves in the country continued to increase in 2007, rising to 5.35 billion barrels or 22 years of lifespan, following the discovery of several deepwater oil fields off-shore Sabah, including Kikeh. The deepwater fields now account for about one-quarter of the oil reserves. These discoveries have led to higher investments in the sector, particularly from multinational oil companies and domestic service providers related to oil and gas.

Table 1.11
Malaysia: Crude Oil and Natural Gas Reserves[1]

	As at 1 January	
	2006	2007*p*
Crude oil (including condensates)		
Reserves (billion barrels)	5.25	5.35
Reserve/Production (year)	20	22
Natural gas		
Reserves (trillion standard cubic feet)	87.95	88.92
Reserve/Production (year)	35	38

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

Source: PETRONAS

Construction Sector

Following three consecutive years of decline, the **construction sector** turned around to record a positive growth of 4.6%. The expansion was driven mainly by the civil engineering sub-sector, and supported by expansion in the non-residential and residential sub-sectors.

Recovery in the construction sector led by civil engineering activity

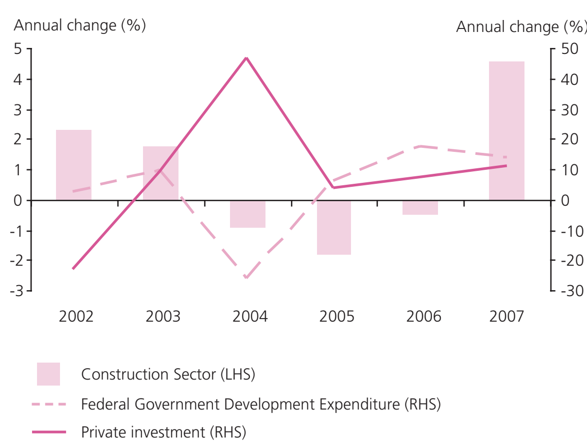
In the **civil engineering** sub-sector, the positive effects from the increased implementation of projects under the Ninth Malaysia Plan (9MP) gradually filtered through the economy during the course of the year. Federal Government development expenditure rose by 13.3% to RM40.6 billion in 2007 (2006: RM35.8 billion), to finance construction of new projects and upgrading of existing infrastructure facilities, such as roads, schools, hospitals and government quarters. The civil engineering sub-sector also benefited from increased construction activity in the oil and gas industry, comprising development and production of new oil facilities including rigs, platforms and storage terminals.

In addition, the order books of some domestic construction companies were also augmented by overseas projects, especially in the Middle East, India and Thailand. The projects include construction of highways, airport terminals and hydropower plants. The turnaround in the construction sector and increase in the order books of some construction companies led to the re-rating of construction companies listed on Bursa Malaysia. The Bursa Malaysia Construction Index increased significantly by 56.5% to 313.04 points at end-2007.

Growth in the **non-residential** segment picked up further during the year in tandem with robust business activity. Increased demand from new businesses as well as expansion by existing companies in the financial services, information technology, and oil and gas-related sectors caused a sharp increase in demand for office space, particularly in Kuala Lumpur. The strong demand was further reinforced by interests from foreign institutional investors. Meanwhile, new incoming supply of office space increased to 1.6 million square metres as at end-September 2007, of which almost half was recorded in Kuala Lumpur. Despite the increase in supply, the occupancy rate of office space increased further to 83% as at end-September 2007 (end-2006: 81.8%). The strong demand was also evidenced by increases in rentals.

The strong growth in private consumption had stimulated demand for retail properties. During the year, about 31 new shopping complexes were completed, of which nine were in the Klang Valley, resulting in the total number of lettable commercial space in the Klang Valley to increase to about 40 million square feet (2006: 36.4 million square feet). The new retail space was mainly towards high-end facilities. Given the rise in supply, rentals broadly remained unchanged,

Chart 1.18
Value-add Growth in Construction Sector versus Growth in Federal Government Development Expenditure and Private Investment



Source: Department of Statistics, Malaysia and Accountant General's Department

Development of a Vibrant and Sustainable Microfinance Industry

Importance of microfinance

The 2005 Census of Establishments and Enterprises (Census) showed that micro enterprises formed about 80% of the small and medium enterprises in Malaysia. Given its significance, the development of micro enterprises is critical to ensuring equitable and balanced economic growth that would lead to wealth and economic growth that are distributed and enjoyed by all segments of society, particularly the low income individuals who represent the largest constituents of micro entrepreneurs.

The Census also revealed that financial institutions contributed only 13% of the source of financing for micro enterprises. This indicated the enormous potential for the banking system to contribute to the development of micro enterprises to bring them into the economic mainstream. Access to microfinance[1] will enable more micro enterprises the opportunity to start and expand their businesses. This in turn will create more job opportunities, generate more income and thereby improve the overall standard of living. Micro enterprises that are brought into the formal financial and economic mainstream will also contribute towards achieving balanced and sustained economic development.

Roll out of microfinance

The development of a vibrant and sustainable microfinance industry is part of Bank Negara Malaysia's strategic objective of achieving greater financial inclusion, ensuring that all economic sectors, regions and communities have access to a full range of financial products and services. The development of a pool of microfinance providers amongst existing financial service providers was a strategy adopted to promote sustainable access to financing by micro enterprises.

In August 2006, the National SME Development Council (NSDC) approved a comprehensive microfinance institutional framework proposed by Bank Negara Malaysia, comprising banking institutions, development financial institutions (DFIs) and credit cooperatives to develop a sustainable microfinance industry. Bank Simpanan Nasional was mandated to provide microfinance, while Bank Kerjasama Rakyat Malaysia Berhad would provide microfinance to members of cooperatives and Bank Pertanian Malaysia would continue to provide microfinance to micro enterprises in the agriculture and agro-based sector. The banking institutions will be a further source of funding with its extensive nationwide network of branches to ensure widespread outreach of microfinance.

There has been considerable progress in the participation of financial institutions in providing microfinance. Currently, nine financial institutions (six banking institutions and three DFIs) have launched microfinance products. These financial institutions have adopted various business models to meet the diverse financial needs of the micro enterprises involved in various economic activities and sectors. The business models are:

- the **mass market model** where microfinance is provided through the financial institutions' nationwide branches;
- the **distributor network model** that involves financial institutions forming strategic partnerships with other institutions, and leveraging on the partner's customer base, key capabilities and infrastructure network;

[1] Defined by Bank Negara Malaysia as the provision of small loans/financing (up to RM50,000), to micro enterprises or self-employed individuals, for their business activities.

- the **community banking model**, where microfinance is provided to selected communities or target segments;
- the **cooperative model** that leverages on the infrastructure and capabilities of the cooperative movement; and
- the **monoline model** involving the formation of dedicated microfinance branches with branding, business model and processes separate from the parent financial institution to provide microfinance.

To strengthen the role of credit cooperatives in providing credit to micro enterprises, Bank Negara Malaysia proposed the establishment of the Cooperative Societies Commission to provide the supervisory oversight on the cooperatives to ensure prudential standards and best practices. The Act for its establishment was passed by Parliament in April 2007 and it commenced operations on 1 January 2008.

Practices from other countries with vibrant microfinance industries and research findings by Malaysian financial institutions have shown that micro enterprises value simple, easily accessible and timely provision of financing to cater to the needs of the small businesses. In this regard, microfinance products offered by the financial institutions have been made simple, fast and convenient. Microfinance is easy to obtain as there is no collateral required, documentation is minimal and the financing procedure is simple. The time taken by the financial institutions to approve and disburse microfinance is also kept short. Microfinance can also be obtained at branches and various distribution channels of financial institutions and their strategic partners to ensure extensive outreach and to provide convenience to the customers.

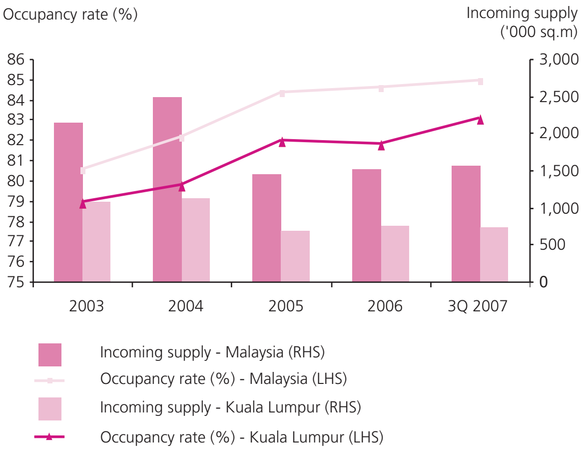
There are more than nine microfinance products, both conventional and Islamic, that are already available in the market. As at end-2007, total financing outstanding of RM224.7 million was provided to 22,788 microfinance customer accounts, with an average financing size of RM9,800.

Promoting awareness among the microfinance customers and the public

A national microfinance logo was launched by YAB Prime Minister at the 7th NSDC meeting held on 13 September 2007. Since the launch of the logo, financial institutions that offer microfinance have displayed the logo and a microfinance client charter to signify commitment in providing easy, fast and convenient microfinance services. Microfinance customers who have successfully obtained microfinance are encouraged to display the logo at their business premises.

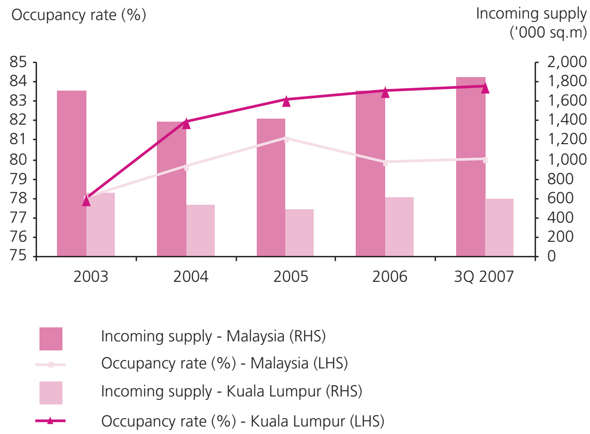
To further promote and create public awareness on the availability of microfinance, Bank Negara Malaysia has embarked on various promotion and awareness programmes such as the distribution of microfinance flyers at strategic locations, through various chambers of commerce, trade associations and local councils. The media have also been an important channel to inform and educate the public on the availability and benefits of microfinance. Financial institutions that provide microfinance are also encouraged to promote and advertise microfinance products and services to the general public.

Chart 1.19
Incoming Supply and Occupancy Rate of Purpose-Built Office Space in Malaysia and Kuala Lumpur (as at end period)



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

Chart 1.20
Incoming Supply and Occupancy Rate of Retail Space in Malaysia and Kuala Lumpur (as at end period)



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

except for choice properties. With the growing attraction of this sector, several shopping complexes were bought by foreign-based Real Estate Investment Trusts (REITs) in 2007.

Activity in the **residential** sub-sector remained positive during the year following several policy measures introduced by the Government since December 2006. These included the liberalisation of the Foreign Investment Committee (FIC) ruling on foreign purchases, the exemption from Real Property Gains Tax and relaxation on the number of residential or commercial property loans that foreigners could obtain. Findings from a survey by the Real Estate and Housing Developers Association showed that these liberalisations and the attractive valuation of high-end properties in the Klang Valley contributed to increased foreign interest in this segment. Residential property transactions by foreigners rose by about 30% in the first half of 2007 (2006: 13.9%). Demand was also supported by the availability of end-financing as reflected in higher housing loan applications, approvals and disbursements of 47.6%, 45.6% and 11.1% respectively during the year.

Developers were generally cautious in launching new projects in the past two years to prevent accumulation of unsold properties. Incoming supply declined by 8% to 580,883 units as at end-September 2007. However, given the renewed enthusiasm in 2007, future planned supply rose by 1.5% to 644,354 units. In line with the demand and supply trends, overhang of residential properties declined from a high of 28,827 as at end-September 2006 to 24,488 units at end-September 2007.

Table 1.12
Property Transactions in the Residential and Commercial Segment

	2005	2006	2007	2006	2007
				% Annual change	
Residential					
Value (RM million)	28,407.3	29,446.9	36,490.6	3.7	23.9
Volume	181,762	182,555	199,482	0.4	9.3
Commercial					
Value (RM million)	11,631.3	11,520.1	16,350.8	-1.0	41.9
Volume	24,151	25,687	27,900	6.4	8.6

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

Table 1.13
Overhang of Residential Property in Malaysia by Price Range

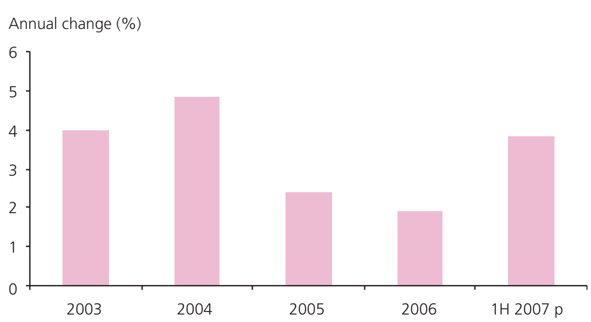
Residential Price Range	Units	Share (%)	Units	Share (%)
	As at end-2006		As at end-September 2007	
RM50,000 or less	3,419	13.5	3,353	13.7
RM50,001 - RM100,000	6,735	26.6	7,114	29.1
RM100,001 - RM150,000	5,473	21.6	4,349	17.8
RM150,001 - RM200,000	3,394	13.4	3,734	15.2
RM200,001 - RM250,000	1,870	7.4	1,994	8.1
More than RM250,000	4,440	17.5	3,944	16.1
Total	**25,331**	**100**	**24,488**	**100**

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

Overall, national house prices as measured by the Malaysian House Price Index increased by 3.8% in the first half of 2007 (2006: 1.9%). One of the factors that contributed to the increase is the rising cost of building materials. Prices of steel bars were revised upwards three times during the course of the year by a total of 45%, while the price of cement was revised at end-2006, and for the first time, was differentiated across the states based on transportation and other costs, with the quantum of increase varied between 10-78%.

During the year, the Government undertook several measures to enhance the public delivery system related to the construction sector. A One-Stop Centre was established to enable "fast-lane" approval for certain categories of projects such as those under the build-then-sell concept, Government projects, high-impact projects, and those that have potential to attract foreign investment. The framework enables simultaneous processing by the different local, state and federal departments, thus shortening the approval process substantially to four months. In addition, the Certificate of Fitness for Occupation was replaced with the Certificate of Completion and Compliance during the year, enabling faster occupation of completed projects.

Chart 1.21
Malaysian House Price Index



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

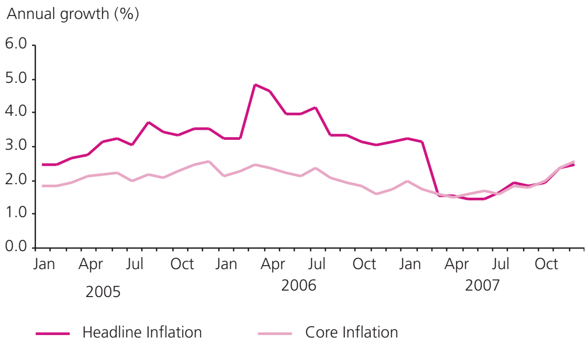
PRICES AND EMPLOYMENT

Consumer Prices

The headline inflation rate, as measured by the annual change in the Consumer Price Index (CPI), increased at a slower pace of 2% in 2007 (2006: 3.6%). The level of inflation was within the forecast range of 2-2.5%. While supply factors remained important, their contribution to overall inflation moderated, as the impact of earlier adjustments to administered prices waned in the first quarter of 2007. The absence of major adjustments to price-administered items during the year also mitigated the impact of supply factors on domestic prices. Meanwhile, core inflation, which proxies the demand-induced pressures on domestic prices, averaged 1.8% during the year (2006: 2.1%). Core inflation, however, edged higher in the second half of 2007.

Rising global prices of primary and food commodities posed a serious challenge to policymakers globally in 2007. These developments, in varying degrees, affected price inflation across the globe. Being a small and highly open economy, Malaysia was not spared from these developments. Nevertheless, the pass-through of global prices into domestic prices was somewhat

Chart 1.22
Consumer Price Inflation



mitigated by a number of factors including the various policy measures put in place by the authorities, as well as domestic factors such as strong competition among retailers and the substitution by consumers in response to the higher prices.

Of the CPI components, price increases in the food and non-alcoholic beverages category were the main contributors, accounting for 47.1% of the headline inflation rate compared to 29.7% in the previous year. Domestic food prices were largely influenced by the higher world prices for food commodities, including household essentials such as rice, wheat flour and palm oil-based cooking oil. The higher global food prices were underpinned by both structural and cyclical factors. These included the stronger demand for food commodities from emerging market economies such as India and China, the use of food crops for the production of alternative fuels such as bio-diesel and ethanol, speculative demand, and adverse weather conditions in major producing countries such as Australia. As a result, in many countries, the contribution of food prices to headline inflation was higher than in the previous year. Domestic food prices were also affected by seasonal purchases during the festive seasons and transitory adverse weather conditions which affected farming activities and disrupted supplies.

Although the global price of crude oil advanced towards the USD100/barrel mark in 2007, domestic fuel and gas prices remained unchanged because of the fuel subsidy provided by the Government. Consequently, the

Table 1.14
Price Indicators

Consumer Price Index (2005=100)	Weight	2007 Annual change (%)	% of Total Inflation
Total	**100.0**	**2.0**	
Food and Non-Alcoholic Beverages	31.4	3.0	47.1
Transport	15.9	2.3	18.3
Housing, Water, Electricity, Gas and Other Fuels	21.4	1.3	13.9
Alcoholic Beverages and Tobacco	1.9	7.8	7.4
Restaurants and Hotels	3.0	3.7	5.6
Recreation Services and Culture	4.6	1.4	3.2
Miscellanous Goods and Services	6.0	1.0	3.0
Furnishings, Household Equipment and Routine	4.3	1.1	2.4
Education	1.9	1.8	1.7
Health	1.4	1.6	1.1
Clothing and Footwear	3.1	-1.4	-2.2
Communication	5.1	-1.2	-3.1
Non-durables goods	40.6	2.7	54.8
Services	47.1	2.1	49.5
Semi-durables goods	4.3	-0.8	-1.7
Durables goods	8.0	-1.4	-5.6
Producer Price Index (2000=100)	**100.0**	**6.7**	
Local Production	65.6	7.5	73.4
Import	34.4	4.7	24.1

Source: Department of Statistics, Malaysia

contribution of the transport sector to the overall headline inflation, at 18.3%, was lower compared to the 48.6% in the previous year when there was a fuel price adjustment. The restaurants and hotels; and recreation services and culture categories registered a higher contribution to the headline inflation rate, as prices of hotel accommodation and tour packages rose due to higher demand following the very high number of tourist arrivals in response to the Visit Malaysia Year 2007 campaign (2007: 21.0 million, 2006: 17.5 million). The contribution of the alcoholic beverages and tobacco category to the CPI was also higher following the Government's decision to impose additional excise duties on tobacco products in July.

Nevertheless, as with the preceding year, the increase in the headline inflation rate was partly mitigated by the decline in the prices of items in the communication, and clothing and footwear categories as a result of strong global and domestic competitive pressures. In the case of communication equipment, the lower prices also reflected the benefits of technological

Chart 1.23
World Prices for Selected Food Commodities

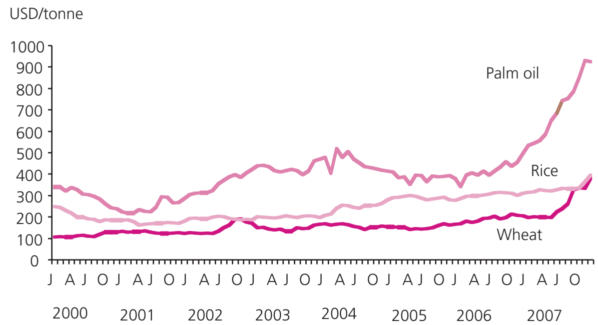
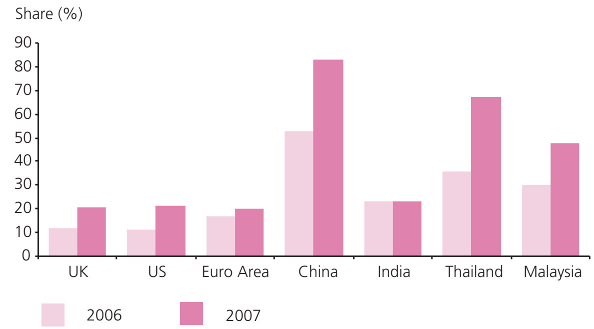


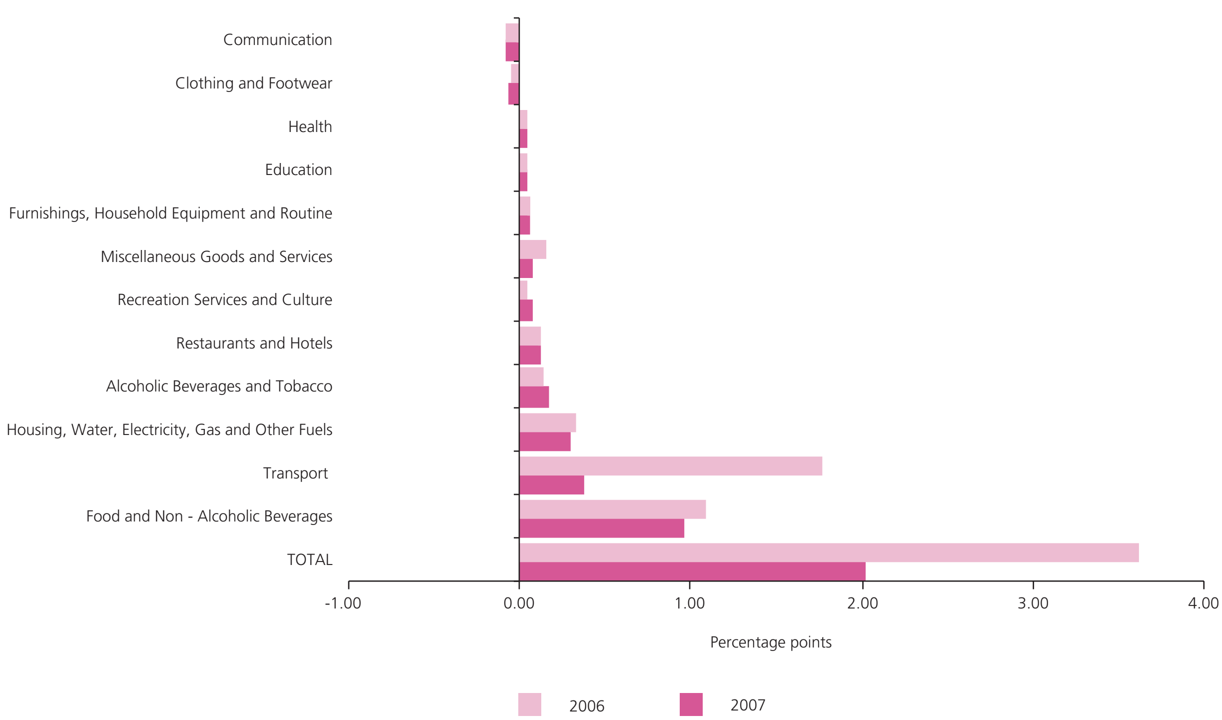
Chart 1.25
Share of Contribution of Food Prices to Headline Inflation



advancement. The appreciation of the ringgit exchange rate had also, to some extent, mitigated some of the higher prices of imports.

There is also a growing perception that the actual inflation may be higher. There could be a number of explanations to this divergence from the statistics that are compiled by the Department of Statistics. As a statistical construct, the CPI comprises a basket of goods that is typically consumed by Malaysian households based on surveys done by the Department of Statistics every five years. The compilation of the statistics averages out the changes in the prices of different types of goods and services, as well as regional differences in the prices of goods and services. Based on the prices of selected food items that are monitored weekly by the Ministry of Domestic Trade and Consumer Affairs, and which are published by the local newspapers, the variances across regions, and over time, tend to be quite substantial. The CPI, thus is an average

Chart 1.24
Contribution of CPI Components to Headline Inflation



change of movements in prices for the country as a whole, and will not be reflective of the cost of living in a specific locality or the income category of a specific group. Moreover, while the CPI basket comprises more than 400 goods, different brands of the same item often have different price behaviour.

Finally, it is important to note that there is a certain degree of asymmetry in the way price changes are perceived. Prices that are increasing tend to receive more attention than prices that are declining. Since 2005, prices for the clothing and footwear, and communication categories of the CPI, on the average, have fallen annually by 1.2% and 0.9% respectively. These declining prices helped to offset the impact of price increases in other categories on the overall CPI.

Producer Prices

The impact of higher global commodity prices was more evident in the Producer Price Index (PPI), which increased by an annual rate of 6.7% in 2007 (2006: 5.1%). The commodities component of the PPI rose by 12.4% (2006: 9.6%) following higher global prices of commodities such as rubber, crude palm oil and crude oil. Excluding commodities, the PPI rose at an annual rate of 4.5% compared to 3.6% in the previous year.

Both the domestic and external components of the PPI registered increases. The prices of local component of the PPI increased at an annual rate of 7.5% (2006: 6.7%). The increase reflected higher prices for machinery and transport equipment; mineral fuels, lubricants and related material; food and live animals; and animal and vegetable oils and fats. Meanwhile, the annual growth rate of the imported component of the PPI was also higher at 4.7% (2006: 2.2%) and was attributed to increases in prices of items such as machinery and transport equipment; manufactured goods classified chiefly by material; chemical and related products; animal and vegetable oils and fats; and food and live animals.

Labour Market Developments

The domestic labour market continued to improve in 2007, in line with the stronger economic performance. The unemployment rate remained low at 3.3% as demand for workers increased and fewer retrenchments was recorded during the year. Total employment grew at a rate of 2.1% to 11.4 million workers compared to the labour force growth of 2.0% to 11.8 million persons. Accordingly, the labour force participation also increased to 67%. The average MIER Employment Index was 13.5 points higher in 2007 or 120.8 points (2006: 107.3 points).

Stronger labour market in 2007

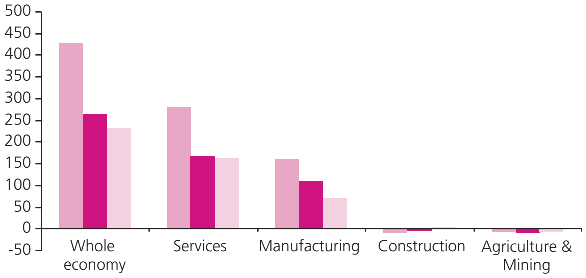
There were positive job creations for all key sectors, except agriculture which recorded a marginal decline. Overall, **employment** continued to be highest in the services sector, with the distributive trade, hotel and restaurant sub-sector continuing to be the largest employer in the sector. Recruitment activities were active in the retail segment and financial sector in view of the launch of several large retail outlets and the opening of several foreign bank branches and Islamic banks during the year. Of significance, the construction sector, after recording job losses for three consecutive years, expanded its workforce by 2,066 persons in tandem with the recovery in the construction sector. Meanwhile, the moderation in manufacturing activities led to slower hiring and smaller job gains.

In 2007, total **retrenchments** continued its downward trend seen since 2001. Retrenchments totaled 14,035 persons or 8.6% lower (2006: 15,360 persons). The bulk of the retrenched workers was mainly involved in the lower-skilled jobs. Layoffs in the manufacturing sector (71% share of total

Chart 1.26
Output and Employment

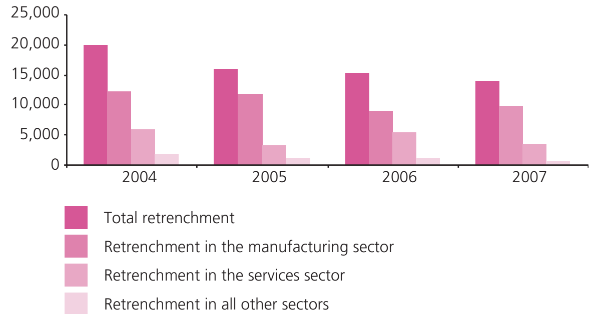
Source: Economic Planning Unit
Department of Statistics, Malaysia

Chart 1.27
Additions to Employment by Sector



Source: Economic Planning Unit

Chart 1.28
Retrenchment in Selected Sectors



Source: Ministry of Human Resources

retrenchments) were higher, but retrenchments in all other sectors were noticeably lower, resulting in a lower overall total. Given its weak performance, retrenchments in the E&E industries more than doubled that of 2006. Meanwhile, the services sector accounted for another 25% of those retrenched, occurring mainly in the distributive trade, hotel and restaurant sub-sector.

Total **active vacancies** reported via the Electronic Labour Exchange (ELX) remained high at 825,182 positions (2006: 834,675 positions). Labour demand from the manufacturing sector was the highest (33% share), followed by the agriculture and services sectors (27% and 25% share respectively). The bulk of job openings was for elementary occupations suitable for lower skilled workers. Of significance, vacancies for jobs requiring higher education and technical qualifications such as managers, professionals and technicians rose significantly, reflecting more demand for skilled labour.

Active jobseekers registered via ELX increased by 10% to 92,508 persons (2006: 84,046 persons). The strong growth environment coupled with high employment led to a positive outlook on job prospects. About 41% of these jobseekers were already employed but had re-entered the job market for career and salary progression. Corresponding to the increased demand for workers with higher education level and technical skills, the number of graduate jobseekers (diploma and degree holders) rose by 3.2%, accounting for about 45% of the total active jobseekers. Meanwhile, there were fewer jobseekers that registered for jobs requiring lower-end skills. As a result, more migrant workers were hired during the year.

Table 1.15
Selected Labour Market Indicators

	2003	2004	2005	2006	2007*e*
Employment[1] ('000 persons)	10,047.2	10,463.7	10,892.8	11,159.0	11,392.4
Labour force[1] ('000 persons)	10,426.4	10,846.0	11,290.5	11,544.5	11,775.1
Retrenchments (persons)	21,206	19,956	16,109	15,360	14,035
Active jobseekers (persons)	28,404	27,227	72,573	84,046	92,508
Active vacancies (positions)	96,918	49,975	304,500	834,675	825,182
Unemployment rate[1] (%)	3.6	3.5	3.5	3.3	3.3
Labour force participation rate[1] (%)	65.6	66.1	66.7	66.9	67.0
Real labour productivity growth[2] (%)	2.2	2.5	0.9	3.4	4.1

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

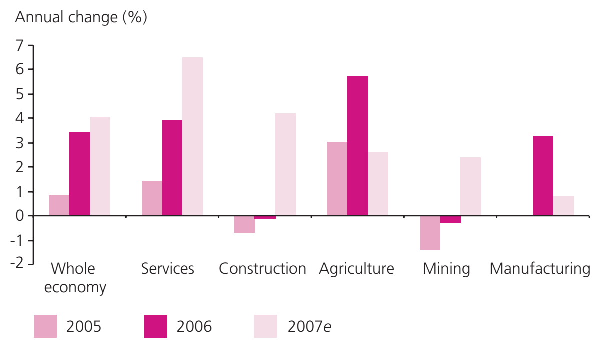
Source: Bank Negara Malaysia
Economic Planning Unit
Ministry of Human Resources

In 2007, total **foreign workers** (including foreign expatriates) in Malaysia rose by 9.3% to 2.08 million persons. As at year-end, there were 2.04 million migrant workers and 34,822 foreign expatriates. The majority of the ***migrant workers*** were in the manufacturing, agriculture and construction sectors (36% share, 25% and 14% respectively), as these sectors continued to face labour shortages, while domestic maids accounted for another 15% share. While most manufacturing companies indicated plans to reduce foreign workers by moving towards greater automation and the adoption of new technologies, they cited high cost of automation and the lack of skilled workers to operate and maintain the more complex equipment as key constraints in scaling up their operations. Meanwhile, ***foreign expatriates*** rose by 5.7% to 34,822 persons, reversing the downward trend since 2000. Most of the expatriates were engaged in the services and manufacturing sectors (60% share and 33% respectively). Recognising that employment of expatriates could facilitate companies to strengthen their operations, the Government reduced the time taken to approve expatriates' employment passes to within a week, as well as extended the work permits to 5-10 years (previously 2 years).

Labour productivity, as measured by the real value added per worker, recorded a higher growth of 4.1% (2006: 3.4%), with all key sectors recording a positive growth in labour productivity. Labour productivity growth was the highest in the services sector (6.5%), supported by higher productivity growth in the finance, insurance, real estate and business services segment (9.2%), and distributive trade, hotel and restaurant sub-sector (8.3%). Of significance, labour productivity in mining and construction sectors recovered in 2007, as output for oil and gas, and construction-related activities were stepped-up. In the manufacturing sector, despite lower additions to the workforce, labour productivity growth moderated (0.8%) on weaker sales and output performance.

The stronger expansion of economic activities and labour demand resulted in some **wage** pressures, with executives in the private sector receiving a higher salary increase (5.9%) compared to the non-executives (5.6%) (2006: 5.9% and 5.7% respectively). The higher average salary increase reflected in part companies' policy

Chart 1.29
Labour Productivity Trends



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

in rewarding performance, and use of salary to attract and retain talents.

The **supply of talents**, however, has not matched the pace of its demand, resulting in skill shortages. Skilled shortages are felt more acutely in the area of experienced and professional workers. Some of the skills that are in high demand include engineers, machinists, geologists, architects, accountants, Islamic bankers, IT specialists as well as mid- and senior-level managers. Demand for these skilled workers has increased and is expected to remain high in the medium term. In Malaysia, although the shortage has not yet reached critical levels, efforts are being made to alleviate this problem.

One issue that the Government is actively addressing is the unemployment among graduates. According to the Ministry of Human Resources, total unemployed graduates has declined to 49,406 as at end-2007, equivalent to about 13% of total unemployed persons in Malaysia (2006: 65,700 unemployed graduates or 17% share). The Ministry of Higher Education has instituted several measures to ***improve the employability of local graduates***. One of the measures was the full introduction of soft-skills (including mastering the English language and presentation techniques) and entrepreneurship modules for the 2007/2008 academic session in all public universities. Secondly, the Curriculum Committee (with industry representatives) was given the flexibility to fine-tune the content of courses to keep them current and in sync with market needs. In addition, plans are also underway for a compulsory six months industrial training for critical courses (three months for other courses) to better expose undergraduates to the working environment and help develop their competency.

More companies are now more willing to send their staff for ***training and skills upgrading courses***. Total financial assistance and training places approved by Pembangunan Sumber Manusia Berhad increased by 14.4% and 13.4% respectively. More manufacturing workers were sent for training (61% share), especially from the E&E and transport-equipment industries (21% and 4% of total), while in the services sector, workers from supermarkets and hypermarkets as well as hotels accounted for another 6% and 5% of total training places. Overall, quality-control courses were more popular (22%), followed by safety and health (14%), management and technical courses (9% each).

In the ***financial services sector***, Bank Negara Malaysia has embarked on several initiatives to develop the talent pool to further support and enhance the dynamism of the sector. Firstly, the International Centre for Education in Islamic Finance (INCEIF) was set up in March 2006, to develop and enhance human capital in Islamic finance. As at 12 March 2008, a total of 721 students from 44 countries have enrolled for INCEIF's professional certification in Chartered Islamic Finance Professional, which is the world's first certification on Islamic finance, while another 29 students have signed up for the PhD in Islamic Finance. In addition, the Financial Sector Talent Enrichment Programme (FSTEP) was launched in January 2008. The programme, developed by the financial services industry together with the Central Bank, is designed to develop new entrants into the industry. Participants of the programme will receive training and gain exposure in commercial banking, investment banking, Islamic banking as well as insurance and takaful through rigorous classroom and on-the-job training. The first batch of participants for the one-year programme involved 297 candidates selected from a total of 2,900 applicants from a diverse academic background and with excellent academic credentials.

EXTERNAL SECTOR

Balance of Payments

Malaysia's external position strengthened in 2007. The **overall balance of payments** was larger, due to a larger current account surplus, while net outflows in the financial account moderated. The sustained large trade surplus, underpinned by strong growth in commodity exports, and an improvement in the services and income accounts contributed to the larger current account surplus. In particular, the services account recorded its first surplus due mainly to higher tourism and transportation receipts. Higher profits and dividends accruing to Malaysian companies investing abroad as well as higher returns from external reserves led to a lower income account deficit.

Malaysia's external position remained strong, supported by a large current account surplus underpinned by strong commodity exports. Of significance, the services account recorded its first surplus

In the financial account, improved economic prospects and investor sentiment contributed to higher net inflows of both foreign direct investment (FDI) and portfolio investment. However, these inflows were offset by higher direct investment abroad by Malaysian companies, and net outflows of other investment. After adjusting for errors and omissions, which include the foreign exchange revaluation loss arising from the revaluation of Bank Negara Malaysia's international reserves due to the strengthening of the ringgit against major currencies, the net international reserves increased by RM45.3 billion to RM335.7 billion or equivalent to USD101.3 billion as at 31 December 2007. The reserves increased further to RM384.1 billion or equivalent to USD116.3 billion as at 29 February 2008. This reserves position is adequate to finance 9.6 months of retained imports and covers 7.1 times the short-term external debt. Malaysia's reserves remained usable and unencumbered.

Table 1.16
Balance of Payments

Item	2006 +	2006 -	2006 Net	2007e +	2007e -	2007e Net
	RM billion					
Goods	589.7	455.2	134.6	605.8	477.7	128.1
Trade account	*589.0*	*480.8*	*108.2*	*605.2*	*504.8*	*100.3*
Services	80.0	87.0	-6.9	97.1	96.1	1.0
Balance on goods and services	**669.8**	**542.2**	**127.6**	**702.9**	**573.8**	**129.1**
Income	31.0	48.3	-17.4	38.8	52.5	-13.7
Current transfers	1.1	18.0	-16.9	1.2	17.3	-16.1
Balance on current account	**701.9**	**608.5**	**93.4**	**742.9**	**643.5**	**99.3**
% of GNI			**16.8**			**15.8**
Capital account			–			-0.1
Financial account			-43.5			-37.0
Direct investment			…			-8.8
Portfolio investment			12.9			18.4
Other investment			-56.4			-46.6
Balance on capital and financial accounts			**-43.5**			**-37.1**
Errors and omissions			-24.8			-16.9
of which:						
Foreign exchange revaluation gain (+) or loss (-)			*-6.9*			*-5.6*
Overall balance			**25.2**			**45.3**
Bank Negara Malaysia international reserves, net			**290.4**			**335.7**
USD billion equivalent			**82.5**			**101.3**

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

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

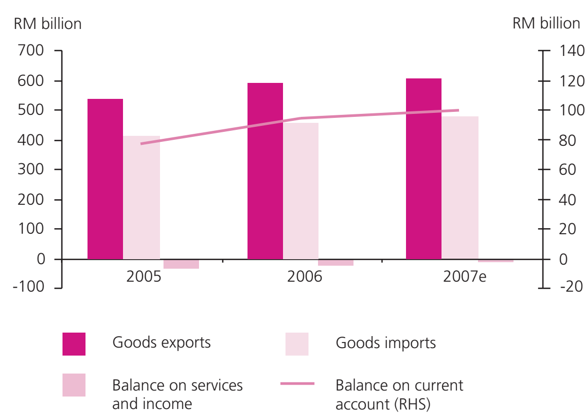
Current Account

The **current account** recorded a larger surplus of RM99.3 billion or 15.8% of GNI (2006: RM93.4 billion or 16.8% of GNI), supported by a large trade surplus and improvement in the services and income accounts. The trade surplus was underpinned by strong commodity exports as a result of high prices of palm oil and minerals. During the year, commodity exports, which have low import content, contributed to 73% of the trade surplus.

Gross exports grew at a moderate pace of 2.7% in 2007 (2006: 10.3%) as weak demand for manufactured exports was partially mitigated by strong growth in exports of primary commodities.

Growth in **exports of manufactured goods** moderated to 0.3% in 2007 (2006: 10.1%), as a result of the decline in E&E exports (-4.2%; 2006: 6.4%) and moderation in non-E&E exports (8.1%; 2006: 17.2%). The weak performance in E&E exports was mainly attributable to the slowdown in demand for computers and parts from the US market following weaker investment in equipment and software by the corporate sector, especially in the early part of the year. The E&E exports were also affected by lower prices during the year arising

Chart 1.30
Current Account



e Estimate

Table 1.17
Gross Exports

	2006	2007*p*
	Annual change (%)	
Gross exports	**10.3**	**2.7**
Manufactures	**10.1**	**0.3**
of which:		
Electronics and electrical products	*6.4*	*-4.2*
Chemicals and chemical products	*10.7*	*13.8*
Manufactures of metal	*33.0*	*15.7*
Petroleum products	*27.2*	*3.8*
Agriculture	**12.5**	**24.4**
of which:		
Palm oil	*13.7*	*47.8*
Rubber	*42.3*	*-10.9*
Minerals	**8.6**	**7.5**
of which:		
Crude oil and condensates	*8.1*	*3.5*
LNG	*12.0*	*12.3*

p Preliminary
Source: Department of Statistics, Malaysia

from the excess inventories of certain segments of semiconductor chips and strong competition among major global producers. Exports of electrical products continued to remain weak due to the transition from lower-end products such as the cathode-ray tube televisions and VCD players to higher value-added products like high definition LCD televisions, DVD recorders and Blu-ray players. Nevertheless, there were signs of improvement in exports of E&E products towards year-end led by the computer and parts segment.

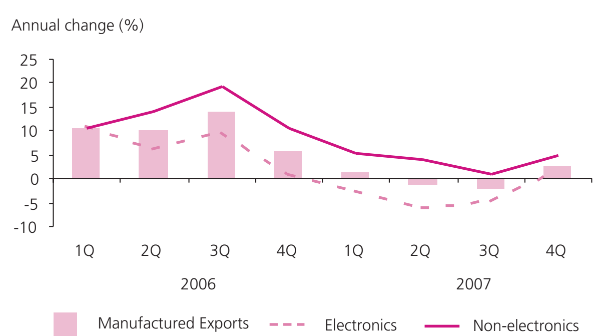
In the **non-E&E segment**, exports of chemicals and chemical products expanded by 13.8% in 2007 (2006: 10.7%). The better export performance was supported by demand from the US, EU and the Asian region as well higher prices in line with the increase in input prices of commodities. Meanwhile, exports of food products showed a strong growth of 23.6% due partly to the increase in demand for Halal food from the Middle East countries. Exports of textiles and wearing apparel and petroleum products declined due to weaker demand from Malaysia's major buyers.

Exports of **primary commodities** continued to expand by double-digit rate for the fifth consecutive year, rising by 14.7%. Total commodity exports surpassed the RM100 billion mark in 2007, thus resulting in its share of gross exports to rise to 18.8% (2001: 13%). The favourable performance was due to the effect of higher commodity prices which rose on average by 18.5% in 2007.

Agriculture exports grew by 24.4% in 2007, led mainly by the significant increase in exports of palm oil. Palm oil exports strengthened further by 47.8%, due wholly to higher prices, which averaged RM2,368 per tonne (2006: RM1,544 per tonne). Strong demand, especially for biofuel uses resulted in palm oil prices to be closely correlated with movements in crude oil prices. Meanwhile, export volume declined by 3.7% due to lower offtake by India and the EU as a result of shifting to other cheaper oils such as rapeseed. Nevertheless, exports to PR China continued to expand, accounting for 28% of Malaysia's total palm oil exports. In addition, demand from the US remained strong as US food manufacturers continue to switch to using palm oil in their food products. Similarly, exports of other agriculture commodities such as rubber, saw logs and sawn timber experienced declines in 2007. In line with the decline in output of rubber in Malaysia, export volume saw a decline of 10.9%. PR China remained Malaysia's largest importer of rubber, accounting for 36.4% of total rubber exports in 2007, followed closely by the European Union, with a total share of 28.9%.

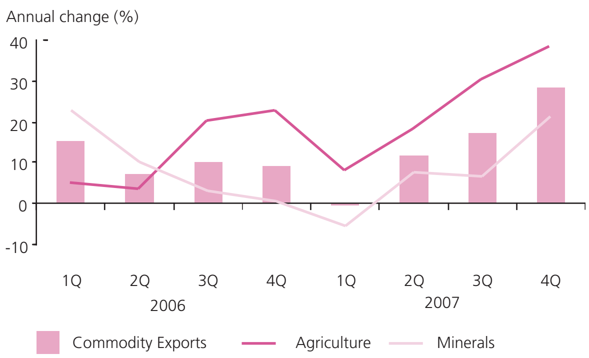
Growth in **mineral exports** was relatively sustained at 7.5% in 2007, driven mainly by higher prices and, to a lesser extent, by increases in export volume. The increase in crude oil exports was supported by the increase in prices (2.9%) as well as turnaround in export volume (0.5%) after

Chart 1.31
Export Performance of Electronics and Non-electronics Industries



Source: Department of Statistics, Malaysia

Chart 1.32
Commodity Export Performance



Source: Department of Statistics, Malaysia

a decline of 8% in the previous year. The latter was supported by the strong global oil demand, as well as the increase in production from the Kikeh field which began operations during the year. This was further supported by sustained growth in LNG exports, which expanded by 12.3% amidst the higher prices and increased offtake from Korea, a major LNG importer.

Gross imports increased by 5%, reflecting mainly imports of inputs for manufactured exports as well as higher demand for consumer and capital goods. Imports of **intermediate goods**, the main component of imports, expanded by 6.9%. This reflected the growth in imports of processed industrial supplies, particularly metals, chemicals and chemical products, and semi-manufactured gold. Increased demand for materials used by the construction industry underpinned imports of metals while demand for plastics from the EU spurred the imports of chemicals. Consistent with strong domestic demand, intermediate imports relating to the manufacture of goods for the domestic market also expanded. Strong domestic consumption supported the growth of imports of primary and processed materials for the food and beverages industry.

Of significance, further expansion in investment activity resulted in higher imports of **capital goods** (7.2%). Capital imports were channelled mainly into the manufacturing, services and mining sectors, primarily for capacity expansion and upgrading for new technologies. Investments to expand capacity in the manufacturing sector, particularly in metals and higher-end electronics, and the drive for fuel efficiency led to higher imports of machinery as well as generators and turbines. Increased exploration and development activities in the oil and gas sector, and implementation of projects under the 9MP lifted imports of construction and mining equipment as well as imports of offshore support vessels.

Table 1.18
Imports by End-Use

	2006	2007*p*
	Annual change (%)	Annual change (%)
Capital goods	**7.4**	**7.2**
Capital goods (except transport equipment)	5.4	5.6
Transport equipment	23.5	17.8
Intermediate goods	**8.8**	**6.9**
Food and beverages, mainly for industry	24.9	21.0
Industrial supplies, n.e.s.	11.1	17.0
Fuel and lubricants	25.7	2.0
Parts and accessories of capital goods (except transport equipment)	5.1	0.4
Consumption goods	**13.4**	**3.6**
Food and beverages, mainly for household consumption	4.8	6.8
Consumer goods, n.e.s.	18.8	1.8
Re-exports	**50.6**	**-22.4**
Gross Imports	**10.8**	**5.0**

n.e.s. Not elsewhere specified
p Preliminary

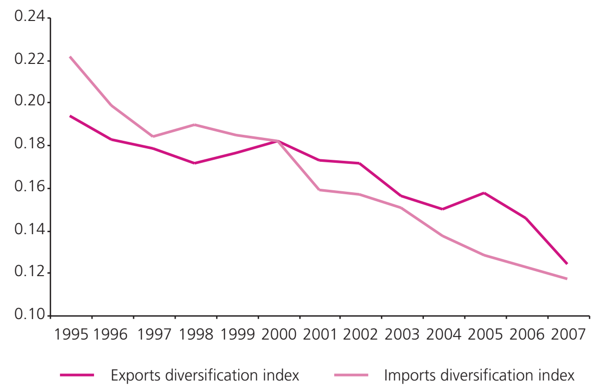
Source: Department of Statistics, Malaysia

Following continued growth in private consumption, **consumption imports** expanded by 3.6%. The growth in consumption imports reflected higher imports of food and beverages for household consumption. Nevertheless, imports of semi-durables, such as leather goods, tapes and records, declined.

Malaysia's export markets continued to be diversified. Reflecting this, the export and import diversification indices, as measured by the normalized Herfindahl-Hirschmann indices declined further to 0.124 and 0.116 respectively in 2007 (2006: 0.145 and 0.122 respectively). The improvement in trade diversification was reflected in the further strengthening of trade links to India, West Asia and Australia. Exports to Australia and India were driven by demand for petroleum-related and E&E products while exports to West Asia were more varied, comprising E&E products, jewellery and palm oil. The enlarged trade share with the EU reflected increasing trade links with Southern Europe. Diversification within the traditional ASEAN markets has also shown improvement with increased trade penetration into emerging new markets such as Vietnam.

The **US** continued to be Malaysia's largest trading partner despite a decline in share to 15.6% of Malaysia's total exports (2000: 20.5%). While exports of computer and parts as well as office machine components declined, exports of palm oil has increased. The increase in palm oil exports by 13.4% was underpinned by higher prices as well as increased usage of palm oil by US food manufacturers. **Singapore** remained as Malaysia's second largest trading partner.

Chart 1.33
Exports and Imports Diversification Indicies



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.

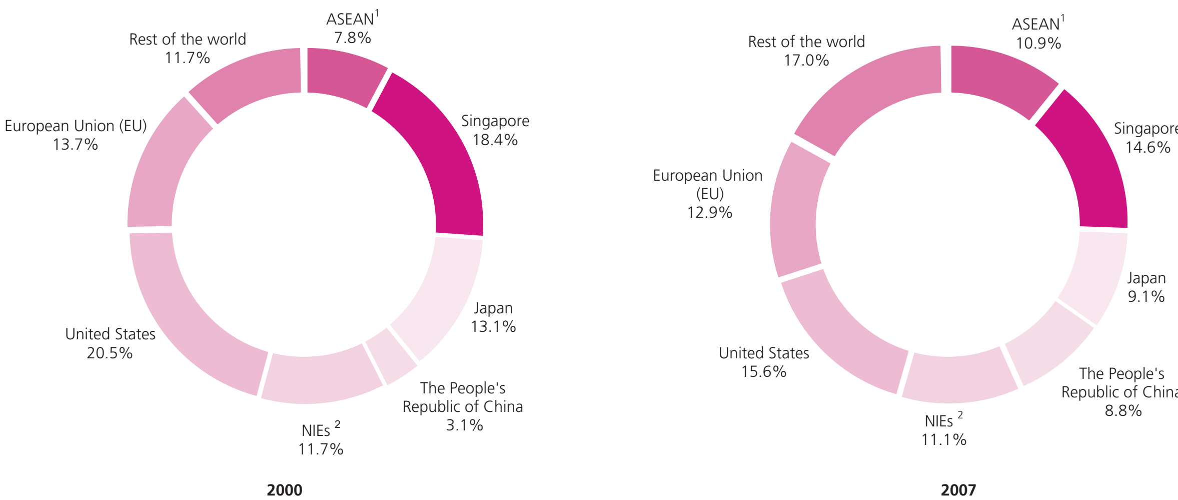
Table 1.19
Direction of External Trade

	2007*p*				
	Exports		Imports		Trade balance
	RM billion	Annual change (%)	RM billion	Annual change (%)	RM billion
Total	**605.2**	**2.7**	**504.8**	**5.0**	**100.3**
of which:					
United States	**94.5**	**-14.5**	**54.7**	**-9.2**	**39.8**
European Union (EU)	**77.8**	**3.6**	**59.9**	**9.5**	**17.9**
Selected ASEAN countries[1]	**154.3**	**1.2**	**122.7**	**5.2**	**31.6**
Selected North East Asia countries	**120.5**	**10.4**	**133.2**	**8.3**	**-12.7**
The People's Republic of China	*53.0*	*24.3*	*64.9*	*11.5*	*-11.9*
Hong Kong SAR	*28.0*	*-4.0*	*14.7*	*16.0*	*13.3*
Chinese Taipei	*16.5*	*2.6*	*28.7*	*9.5*	*-12.3*
South Korea	*23.0*	*8.2*	*24.9*	*-3.8*	*-1.9*
West Asia	**18.9**	**18.1**	**17.4**	**-13.0**	**1.6**
Japan	**55.2**	**5.8**	**65.5**	**3.1**	**-10.3**
India	**20.2**	**7.6**	**7.1**	**44.7**	**13.1**

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 1.34
Direction of Exports (% share)



[1] Thailand, Indonesia, Philippines, Brunei Darussalam and Vietnam

[2] Hong Kong SAR, South Korea and Chinese Taipei

Higher exports of chemicals and crude petroleum following growing demand by Singapore's petrochemical industry mitigated the decline in the E&E exports. Meanwhile, exports to **Japan** continued to strengthen, underpinned by demand for LNG and palm oil. Japan remained as Malaysia's most important source of imports, comprising mainly substrates for integrated circuits, semiconductor devices, transport equipment and ships.

Increased trade with markets in Southern Europe led to an increase in the share of Malaysia's trade with the **EU**. Exports to the growing market in Italy was largely air conditioners, radio and TV parts. Trade with Belgium also strengthened, with exports comprising mainly automatic data processing machines and cameras while imports were mainly chemicals and medicine. Nevertheless, the United Kingdom, Germany, the Netherlands and France remained as Malaysia's major trading partners in the EU.

Exports to North East Asia (excluding Japan) expanded by 10.4%, underpinned by the growth in exports to PR China and South Korea. Strong economic activity in PR China and expansion of intra-regional trade through production networks induced demand for exports of integrated circuits, office machine parts, chemicals and palm oil from Malaysia. PR China emerged as the largest market for Malaysia's palm oil, accounting for 28% of total palm oil exports. Meanwhile, PR China became Malaysia's second major source of imports, with imports comprising mainly E&E components and chemicals. Exports to South Korea were underpinned by strong growth in LNG and crude petroleum, attributable to increasing energy consumption and demand by South Korea's petrochemical industry.

Trade with **ASEAN** (excluding Singapore) remained resilient, with exports expanding by 6.6% in 2007. Notably, trade with Vietnam and Indonesia recorded robust growth of 23.8% and 19% respectively. Vietnam's increased openness to trade after its accession to the World Trade Organisation in November 2006 contributed towards an increase in Malaysia's export share to Vietnam. Higher exports reflected exports of iron and steel products for the construction industry and E&E products. Meanwhile, exports to Indonesia were supported by demand for petroleum and chemical products.

The strong performance of the services industry in 2007 was reflected in the turnaround in the **services account** deficit to a surplus position (RM1 billion or 0.2% of GNI). The improvement in the services account was

Table 1.20
Services and Income Accounts

	2006	2007e		
	RM billion			
	Net	+	–	Net
Services Account	**-6.9**	**97.1**	**96.1**	**1.0**
% of GNI	*-1.2*			*0.2*
Transportation	-19.6	24.2	37.7	-13.5
Travel	23.5	44.3	18.0	26.3
Other services	-10.4	28.3	39.7	-11.4
Government transactions n.i.e.	-0.4	0.3	0.7	-0.4
Income Account	**-17.4**	**38.8**	**52.5**	**-13.7**
% of GNI	*-3.1*			*-2.2*
Compensation of employees	-0.3	5.4	5.9	-0.5
Investment income	-17.1	33.4	46.6	-13.2

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

attributed mainly to the rise in exports of travel and transportation services, which together accounted for more than two-thirds of total gross services receipts. Of significance, the travel account recorded a larger surplus of RM26.3 billion, reflecting mainly higher foreign exchange earnings as a result of significant increase in tourist arrivals in conjunction with the Visit Malaysia Year (VMY) 2007.

The surplus in services account was attributable to higher tourism and transportation receipts

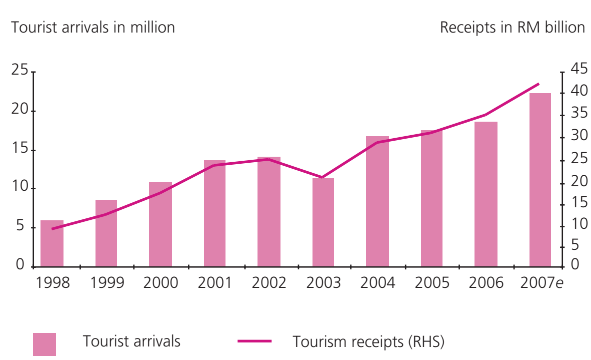
Tourist arrivals expanded strongly by 19.5% to 21 million visitors attributable to the VMY 2007 campaign. Tourists were mainly from ASEAN, PR China, India and the Middle East. Greater air services connectivity and rising income levels spurred the growth of tourists from regional countries, while the simplified processes and relaxation of visa requirements continued to support growth of tourists from PR China and India. Similarly, mid- to long-haul tourists from the Americas, Europe and Oceania also increased during the year.

The other contributing factor to the improvement in the services account was the lower deficit in the transportation account (RM13.5 billion), due to higher earnings from passenger, cargo and charter services. Of significance, earnings from passenger fares doubled, supported mainly by greater travel demand in the region. Higher volume of transshipment cargo originating largely from Hong Kong SAR, PR China, Chinese Taipei, Japan and Singapore led to increased earnings from transshipment activities. On the payments side, outflows for freight charges, the bulk of which was for sea transportation, grew at a slower pace following the moderate growth in trade.

The other services account recorded a marginally higher deficit of RM11.4 billion, reflecting mainly continued net outflows for royalties and licence fees as well as payments for professional and financial services, while demand for imported communication and construction services increased. Outflows for royalties and licence fees reflected the continuing acquisition and usage of intellectual property rights. The net outflows for financial and insurance services were attributable mainly to the payment of custodian charges, loan commitment fees, as well as the reinsurance of high and specialised risks. Higher demand for roaming, images transmission and teleconferencing services led to a higher net outflow in communication services. Meanwhile, larger payments for construction services reflected increased imports of services for power and petrochemical plants as well as development of deepsea wells for the oil and gas industry.

The outflows in the other services account were mitigated by inflows attributable to commissions earned from the procurement of goods abroad for re-sale to non-residents as well

Chart 1.35
Tourist Arrivals and Tourism Receipts

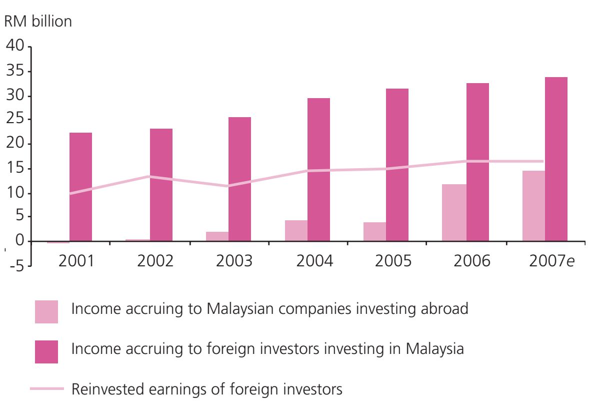


e Estimate
Source: Malaysia Tourism Promotion Board and Department of Statistics, Malaysia

as exports of computer and IT services. Reflecting the continuous participation of Malaysian traders in the international market, the commissions earned from international trading activities were sustained. Trading was mainly in electrical and electronics, palm oil as well as petroleum-related products, with the bulk of the receipts from the US and Singapore. In line with the expansion in SSO industry and the development of new software application products for the ICT sector, receipts from exports of computer and IT services improved. The growth was supported by the SSO centres of financial institutions, as well as the regional IT centres of the oil and gas companies providing technical support, engineering, research and development solutions to their affiliates. Regional countries, in their efforts to upgrade IT services, have emerged as major export markets for Malaysia's software and IT support services.

The **income account** improved further in 2007, with the deficit narrowing to RM13.7 billion or 2.2% of GNI. Reflecting the successful operations of Malaysian companies investing abroad, profits and dividends accruing to Malaysian companies, particularly in the manufacturing, mining and financial sectors, increased to RM14.7 billion. The improvement in the income account was also attributable to returns on higher external reserves holdings. Meanwhile, profits and dividends accruing to foreign investors in Malaysia remained large as Malaysia continued to be a profitable center for global MNCs. About half of these profits and dividends were retained in Malaysia for reinvestment.

Chart 1.36
Direct Investment Income



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

Financial Account

In 2007, the **financial account** recorded a smaller net outflow of RM37 billion, as net outflows of other investment moderated, while the larger net direct investment abroad by Malaysian companies was partially offset by higher net inflows of FDI and portfolio investment. The strong current account surplus was more than sufficient to finance the outflows in the financial account.

Higher inflows of FDI and portfolio investment reflected increased opportunities and strengthened confidence in the Malaysian economy. Increased capacity and rising interest by Malaysian companies to expand and diversify operations abroad led to larger outflows of overseas investment

During the year, gross inflows of **FDI** increased further to RM46.1 billion or equivalent to 7.4% of GNI. The gross inflows of FDI were broad-based and channelled mainly into the manufacturing (38%), services (24%), agriculture (20%) and oil and gas (18%) sectors. The larger gross FDI during the year was attributed mainly to higher inflow of equity capital, emanated largely from increased acquisition of local interests by foreign

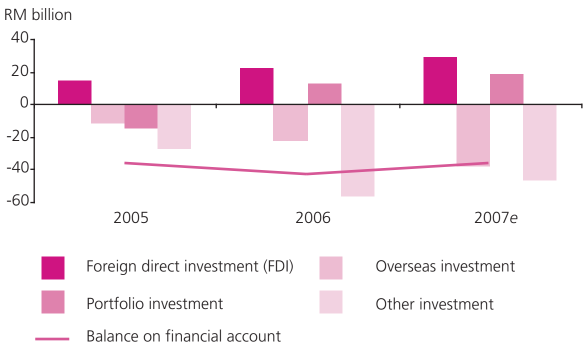
Table 1.21
Balance of Payments: Financial Account

	2006	2007*e*
	RM billion	
Financial Account	**-43.5**	**-37.0**
Direct Investment	**…**	**-8.8**
In Malaysia	22.2	29.1
Abroad	-22.2	-37.9
Portfolio Investment	**12.9**	**18.4**
Other Investment	**-56.4**	**-46.6**
Official sector[1]	-8.0	-5.8
Federal Government	*-3.1*	*-2.3*
NFPEs	*-5.0*	*-3.5*
Private sector	-48.4	-40.8

Note: Numbers may not necessarily add up due to rounding
[1] Excludes bonds and notes raised abroad by the Federal Government and NFPEs
e Estimate
… Negligible

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.37
Financial Account



e Estimate

companies. Meanwhile, earnings of existing MNCs retained for reinvestment and inflows arising from drawdown of inter-company loans were sustained. This development reflected confidence of foreign investors in the Malaysian economy, and that the country remained as an attractive investment destination. After taking into account the adjustments for outflows due largely to loan repayments to parent companies abroad, net FDI inflow increased to RM29.1 billion or 4.6% of GNI.

The *manufacturing sector* continued to attract a sizeable inflow of FDI despite a slowdown in exports of E&E products. The FDI in the E&E industry was funded mainly by retained earnings, and largely for upgrading of equipment and technology as well as establishing new product lines and capacity. The buoyant upstream activity in the oil and gas sector provided further impetus to growth of investment in the petroleum refining and petroleum-related product industry. New inflows of equity capital were attributed mainly to acquisitions of substantial interest in Malaysian companies in the paper and paper-related industry by the Indian- and Australian-based investors.

FDI in the *services sector* remained strong and channelled mainly into the finance and insurance; real estate and business services as well as wholesale and retail trade sub-sectors. The Malaysia International Islamic Financial Centre (MIFC) initiative, including liberalisation of the foreign ownership in the Islamic finance, have yielded positive results as manifested in the increased foreign interest and investment in both Islamic banking and takaful during the year. Of significance, new banking and takaful licenses were awarded to an international Islamic bank and a foreign takaful company respectively to operate in Malaysia. Meanwhile, there were also acquisitions of significant interests in two local banking institutions by foreign banks from Hong Kong SAR and Australia. Increased foreign interest to establish shared services and outsourcing (SSO) operations in Malaysia was reflected in the commencement of operations by 19 new wholly foreign-owned SSO companies under Multimedia Super Corridor (MSC) status in 2007. Foreign investment in the wholesale and retail trade sub-sector is reflected in the expansion of existing retail outlets and establishment of new outlets in the cities and emerging townships in tandem with strong domestic consumption and tourism activities.

The strong crude oil prices and firm global demand as well as the discovery of several offshore deepwater oil and gas fields in Sabah and Terengganu in recent years led to a significant inflow of FDI into the *oil and gas sector*. The investments, ranging from exploration and extraction operations to production and development activities, were undertaken mostly by PETRONAS in joint venture with its international partners through production sharing contracts. Meanwhile, the inflows of FDI into the *agriculture sector* were attributed mainly to the merger and restructuring of a Malaysian oil palm plantation company with its Singapore-based counterpart.

During the year, the Government continued to undertake policy measures and implement initiatives to enhance the business and investment climate in Malaysia and thus, further attracted FDI. The Special Taskforce to Facilitate Business (PEMUDAH) was established to review and improve the services delivery system of the public sector to enhance its efficiency and reduce cost of doing business. Several key areas of the delivery system pertaining to investment and business operations were streamlined and improved during the course of the year. These included the processing of work passes for expatriates, registration of business, environmental impact assessment as well as tax refunds to businesses.

Meanwhile, the Government has also announced generous tax incentive and flexibilities for foreign investors to invest and operate in the three economic corridors, namely the Iskandar Development Region (IDR), the Northern Corridor Economic Region (NCER) and East Coast Economic Region (ECER). The supportive business and investment environment was in tandem with the objective to boost investment in new services sub-sectors such as healthcare and education, high value-added manufacturing and agriculture activities, tourism as well as oil and gas industry. In the Budget 2008, the Government announced further liberalisation of foreign ownership in Islamic fund management business and simplification of issuance of visa and permits for expatriates to facilitate the hiring of highly-skilled and professional workers to meet industries' need.

While FDI continues to be important for Malaysia's long-term development plan, the Government has also played an active role to support initiatives by Malaysian companies to diversify and expand their operations abroad. In this respect, Bank Negara Malaysia had, in April 2007, further liberalised the foreign exchange administration measures in relation to overseas investment.

During the year, net **direct investment abroad** by Malaysian companies increased significantly to RM37.9 billion, reflecting increased capacity and rising interest of Malaysian companies to seize opportunities abroad. These investments were effected mainly through acquisition of large interests in existing operations or businesses abroad. In the *services sector,* a local gaming and resort company has increased its presence in the region as well as in the more developed market via acquisition of existing operations and participation in the development of new operation. Domestic shipping and telecommunication companies have also increased their investments in emerging markets such as Indonesia, Bangladesh and Brazil. The expansions and new investments reflected the growing competitiveness and sophistication of Malaysian companies to become regional or global players. Meanwhile, in the *oil and gas sector,* PETRONAS continued to forge partnerships with several foreign oil companies for exploration and extraction activities. Investment abroad in the *construction sector* remained significant following the success of Malaysian companies in bidding and on-going work of several large infrastructure, roads and highway projects abroad, especially in the Middle East, South Asia and ASEAN.

In 2007, there were substantial two-way flows of portfolio funds, with episodes of reversals largely due to external developments. For the year as a whole, **portfolio investment** recorded a larger net inflow of RM18.4 billion. Large net inflows in the first half of the year, driven mainly by strong positive investor sentiment, more than offset net outflows in the second half of the year due largely to concerns related to the US sub-prime problems. In the first quarter of the year, strong inflows of foreign portfolio funds were for purchases of both equity and debt securities, supported by improved investor sentiment due to stronger economic fundamentals and a confluence of positive pull factors, including announcements of special incentives to promote investment in the IDR, removal of real property gains tax as well as expectations of appreciation of the ringgit. In the second quarter, foreign investors liquidated some holdings of equities and shifted their asset allocation to highly rated debt securities. The heightened uncertainty in the global financial markets arising from the US sub-prime problems led to net liquidation of both equity and debt securities by foreign investors in the third quarter. Nevertheless, inflows of foreign funds for investment in the debt market resumed in the fourth quarter as foreign investors remained cautious with investments in the equity market.

The **other investment** recorded a lower net outflow of RM46.6 billion in 2007, reflecting lower net outflows by both the official and private sectors. The **official sector** registered another net repayment of external loan, reflecting net repayments of loans by both the Federal Government and the non-financial public enterprises (NFPEs). Meanwhile, the other investment by the **private sector**, which comprises mainly borrowing and lending and placement and withdrawal of deposits by the banking sector as well as the non-bank private sector transactions with unrelated counterparties, recorded a lower net outflow. The outflows by the banking sector, albeit lower, reflected mainly placement of assets abroad amidst increased portfolio diversification by banks and ease of sourcing foreign exchange from domestic market. Meanwhile, outflows by the non-bank private sector was attributed mainly to trade credits extended by Malaysian exporters, repayment of trade credits by importers and placement of deposit with financial institutions abroad.

External Debt

Malaysia continues to adopt prudent external debt management strategies while facilitating business operations. In this regard, the rules on foreign currency borrowing by residents have been progressively liberalised to enable residents to source foreign currency financing at competitive costs. Given the dynamic and rapidly evolving global business environment, greater emphasis is placed by the Central Bank on enhancing risk management capabilities to minimise risk exposures against global interest rate and exchange rate movements and shift in investors' sentiment. The management of the nation's external debt is supported by a comprehensive debt monitoring system which enables the authorities to monitor the overall debt level, the structure of debt as well as debt-servicing obligations of both the public and private sectors.

The external debt position remains at prudential levels, with the debt profile biased towards a longer maturity structure. The public sector continued to record net repayments

As at end-2007, Malaysia's total external debt amounted to RM187.4 billion (or USD56 billion), or equivalent to 29.9% of GNI. Notwithstanding a moderate increase in the total external debt, the nation's debt servicing capacity continued to improve. This was reflected in the decline in the ratios of total external debt to the international reserves and the exports of goods and services to 55.8% and 26.7% respectively (end-2006: 63.5% and 27.5%, respectively). The overall debt service ratio (excluding prepayment) improved (3.8%; 2006: 4.8%). In addition, the external debt profile continued to be skewed towards a longer maturity structure, with medium- and long-term debt accounting for 70.9% of the total debt. The short-term external debt remained low, accounting for only 8.7% of GNI, 16.2% of international reserves and 7.7% of exports of goods and services.

Table 1.22
Outstanding External Debt

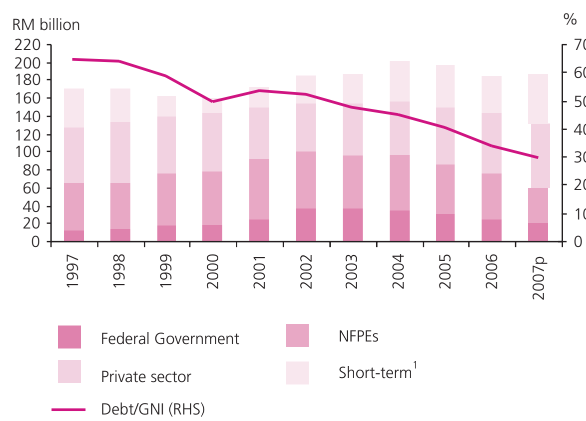
	2006	2007*p*	2006	2007*p*
	RM billion	RM billion	USD billion	USD billion
Total debt	**184.5**	**187.4**	**51.7**	**56.0**
Medium- and long-term	141.7	133.0	39.7	39.7
Short-term[1]	42.8	54.5	12.0	16.3
As % of total debt	*23.2*	*29.1*		
As % of net international reserves	*14.7*	*16.2*		
As % of GNI				
Total debt	33.2	29.9		
Medium- and long-term debt	25.5	21.2		
As % of exports of goods and services				
Total debt	27.5	26.7		
Medium- and long-term debt	21.2	18.9		
Debt service ratio (%)	**4.8**	**3.8**		

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

Source: Ministry of Finance and Bank Negara Malaysia

During the year, the **medium- and long-term external debt** declined, due mainly to lower external debt of the public sector. The public sector, comprising both the Federal Government and non-financial public enterprises (NFPEs), registered its fifth consecutive year of net repayment of external debt (-RM10.4 billion). During the year, the **Federal Government**

Chart 1.38
Outstanding External Debt



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

maintained its practice of sourcing funding requirements mainly from non-inflationary domestic sources. For the fourth consecutive year, no market loan was raised from the international capital market. The drawdown of external loans was attributed entirely to project loans committed earlier from official bilateral sources and multilateral development banks. Meanwhile, external loan repayment increased, attributable mainly to the maturity of the sovereign Global Sukuk of USD600 million and prepayments of project loans. The **NFPEs** recorded its sixth consecutive year of net repayment in 2007. The larger net loan repayments reflected mainly the maturity of bonds issued by companies in the electricity, gas and water sub-sector, oil and gas sector as well as finance and insurance sub-sector, and higher prepayments of loans. Conscious efforts to reduce exposure to external debt through prepayments were effected mainly by companies in the manufacturing sector and communication sub-sector.

Meanwhile, the **private sector** registered a net drawdown of external debt amounting to RM8.6 billion in 2007, reflecting mainly higher loan drawdown particularly by companies in the transport and storage; and communication sub-sectors. The larger drawdown was largely to finance capital expenditure in line with higher private investment activity during the year. The repayment during the year was primarily by companies in the finance and insurance; and real estate and business services sub-sectors as well as the manufacturing sector. While the private sector medium- and long-term debt accounted for 53.8% of the total medium- and long-term debt, about two-third of these loans were inter-company loans that have flexible terms and concessionary interest rates.

In 2007, the **short-term external debt** outstanding increased to RM54.5 billion (end-2006: RM42.8 billion), attributed primarily to the inter-bank borrowings arising from treasury operations. Meanwhile, the short-term external debt of the non-bank private sector, comprising mainly revolving credits and overdraft facilities, was lower, accounting for a smaller share of the total short-term external debt (22.6%; end-2006: 32.7%).

Malaysia's external debt continued to benefit from the appreciation of the ringgit against the major currencies during the year. The exchange revaluation gain amounting to RM6.7 billion has contributed to a lower medium- and long-term debt outstanding. In addition, the stronger ringgit had also reduced the debt servicing payments in 2007.

International Reserves

The international reserves held by Bank Negara Malaysia comprise the holdings of foreign exchange and gold, reserve position with the IMF and holdings of Special Drawing Rights (SDR). For the year of 2007, the net international reserves increased by RM45.3 billion to RM335.7 billion (equivalent to USD101.3 billion) as at 31 December 2007. The increase in reserves was due to large trade surplus underpinned by strong commodity exports as well as larger inflows of both FDI and portfolio investment, reflecting improved economic prospects and strengthened investor confidence. The reserves increased further to RM384.1 billion (equivalent to USD116.3 billion) as at 29 February 2008, adequate to finance 9.6 months of retained imports and is 7.1 times the short-term external debt.

The increase in reserves was due to large trade surplus underpinned by strong commodity exports as well as larger inflows of both FDI and portfolio investment, reflecting improved economic prospects and strengthened investor confidence

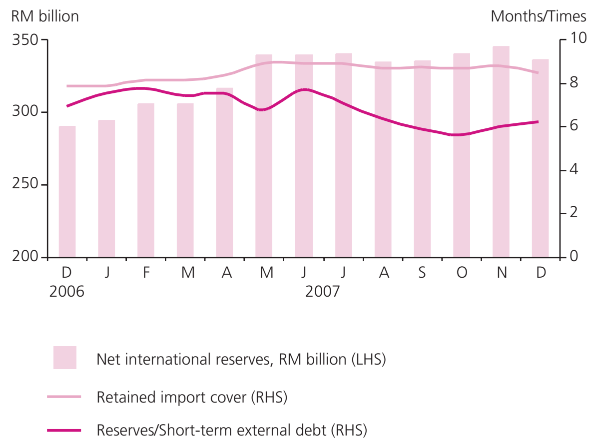
During 2007, foreign exchange inflows were generated from the higher repatriation of export earnings, supported by strong commodity exports, and the larger inflows of FDI and portfolio investment following the improved economic prospects and investor confidence. Meanwhile, stronger economic activity and better corporate performance led to higher outflows through increased payments for imports of goods and services, as well as repatriation of profits and dividends accruing to foreign companies operating in Malaysia. The higher overseas investments by Malaysian companies during the year also contributed to the outflows.

Table 1.23
Net International Reserves

	As at end			Change
	2005	2006	2007	2007
	RM million			
SDR holdings	748.3	756.9	760.9	4.0
IMF reserve position	1,186.3	793.4	617.5	-175.9
Gold and foreign exchange[1]	263,328.0	288,871.2	334,338.6	45,467.4
Gross International Reserves	**265,262.7**	**290,421.5**	**335,717.0**	**45,295.5**
Less Bank Negara Malaysia external liabilities	22.5	22.9	22.2	-0.7
Net International Reserves	**265,240.2**	**290,398.6**	**335,694.8**	**45,296.2**
USD million equivalent	**70,193.4**	**82,450.8**	**101,338.1**	**18,887.3**
Months of retained imports	7.7	7.8	8.4	
Reserves/Short-term external debt (times)	5.6	6.9	6.2	

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

Chart 1.39
Net International Reserves (end-month)



During the year, the cumulative foreign exchange revaluation loss amounted to RM5.6 billion, following the strengthening of ringgit against the major currencies, particularly in the first and fourth quarters of 2007.

Malaysia, as a country with a strong balance of payments position, remains a participating member in the Financial Transactions Plan of the IMF, which makes resources available to member countries facing short-term balance of payments difficulties. The decline in **reserve position with the IMF** in 2007 was due mainly to the repayment to the ringgit account by various member countries under the Financial Transactions Plan. Meanwhile, the increase in international reserves held in the form of **SDRs** was attributed mainly to the receipt of remuneration arising from Malaysia's net creditor position with the IMF.

The Bank has continued to maintain diversified portfolio in the management of the international reserves. This is in addition to the traditional objectives of capital and liquidity preservation. The Bank continued to review and assess new asset classes, instruments and currencies for inclusion into the investment portfolio in order to improve the risk adjusted returns on the reserves. The Bank also introduced a new investment benchmark in early 2007 that included some of the additional new asset classes and currencies, incorporating a more strategic and longer-term approach in reserve management. Complementary to this, new risk management techniques, utilising more quantitative tools such as value-at-risk and tracking error were adopted to enhance the market risk management of reserves, while the governance framework was further strengthened to enable a more efficient and effective investment management structure. In addition to these, as part of an overall diversification strategy, the Bank also awarded new investment mandates to selected global fund managers for more specialised asset classes.

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.

Development of Small and Medium Enterprises

The development of a strong and dynamic SME sector is an important national agenda towards creating sustainable and balanced economic growth. During the year, the National SME Development Council[1] (Council) had taken further steps to spur the development of SMEs to the next level by strengthening the enabling infrastructure for SME development, building SMEs' capacity and capabilities, and improving access to financing by SMEs.

Profile and Contribution of SMEs to the Economy

The Baseline Census of Establishments and Enterprises was conducted in 2005 (Census 2005) and provided important data on the profile and performance of SMEs to facilitate the formulation of effective policies and strategies to support SME development. Based on the responses of 552,804 business enterprises, SMEs formed 99.2% or 548,267 of the business establishments in Malaysia, of which almost 80% or about 435,300 are micro enterprises. The findings revealed that 87% of SMEs are in the services sector, followed by 7.2% of SMEs in the manufacturing sector and 6.2% in the agriculture sector.

Achievements of SME Development Initiatives

Since the establishment of the Council in 2004, the foundations for SME development have been strengthened considerably. Various initiatives have been implemented by the Council and have benefited policymakers by improving policy formulation, monitoring and assessment of SME development programmes. This in turn has strengthened the capacity and capability, enhanced access to financing and provided comprehensive dissemination of relevant and important information to SMEs.

Key Initiatives and Achievements in 2007

The Council has implemented several key initiatives towards SME development in 2007:

(i) Establishment of SME Central Coordinating Agency

During the 7th Council meeting held in September, it was agreed that an SME Central Coordinating Agency (SME CCA), a dedicated Government agency would be established to spearhead SME development in Malaysia. A key role of the SME CCA is to coordinate the policy formulation and SME development programmes to ensure that comprehensive and effective programmes are implemented across all sectors. The SME CCA will also act as a one-stop information centre for SMEs to obtain comprehensive information and advisory services in the areas of development of business plans, marketing, technology adoption, information services, and financial advisory. In addition, the SME CCA will disseminate information on SME performance and statistics, and conduct research on SME-related issues and development. With the establishment of the SME CCA, Bank Negara Malaysia will hand over the role of the Secretariat of the Council to the Agency.

(ii) SME Annual Report 2006

On 13 September 2007, the Council released the SME Annual Report 2006. The Report is an important initiative to disseminate information on the strategies and programmes that have been implemented by the Government to support the development and growth of the SME sector. The report also showcased success stories of the SMEs.

(iii) SME Business Adviser Network

The establishment of the SME Business Adviser Network, a one-stop web-based directory in the SMEinfo Portal (www.smeinfo.com.my) provides a platform for SME business advisers in the various Government agencies and financial institutions to connect and leverage on

[1] The National SME Development Council is chaired by the Prime Minister and comprised Ministers and Heads of 15 key Ministries and Agencies involved in SME development. Bank Negara Malaysia is the Secretariat to the Council.

each other in their respective areas of expertise. The network enables SMEs to put forward enquiries and issues online, directed to the SME business advisers. This enables a timely and comprehensive range of high-quality advisory services in the areas of marketing, technology and operations management, human resource, financing, and business and product development to be made available to SMEs. Currently, there are more than 200 business advisers from financial institutions and SME-related Government agencies connected through the network to provide comprehensive, online advisory services to SMEs.

(iv) Brand-SME Development Programme

The Brand-SME Development Programme, spearheaded by the Ministry of International Trade and Industry, aims to promote, reinforce and sustain the value of individual SME brands through a National Mark. The acceptability of SMEs' products and services in the domestic and foreign markets will be enhanced through this programme which targets to promote the recognition of the National Mark. The aim of the programme is to establish 100 SME brands overseas within four years. Under the programme, selected SMEs from targeted sectors will be assisted in developing the branding of their products. SMEs will be certified and granted the use of the National Mark upon successfully undergoing the auditing process to ascertain the adequacy, readiness and commitment in the branding.

(v) Establishment of the National SME Innovation Focal Point

The National SME Innovation Focal Point was established in March 2007. This focal point is a collaboration between industry associations, entrepreneurs, research institutions, financiers (including venture capitalists) and relevant Government agencies to formulate initiatives and programmes for the development of innovation-driven SMEs. Since inception, the focal point has established a database which stores technology related research findings and through the Technology Foresight Programme, SMEs are kept abreast with the latest information on best practice technologies. A Technology and Innovation Showcase was organised in June 2007 whereby a total of 53 ready-to-commercialise research projects were showcased and 22 of these projects were adopted by SMEs. Under the Global Supplier Programme, SMEs are encouraged to develop and commercialise new and innovative products and services for international markets.

Enhancing Access to Financing by SMEs

Comprehensive SME Financing Landscape

The financing landscape has been continuously evolving to meet the needs of SMEs for the three key stages of a business life-cycle, namely start-up, business expansion and rehabilitation. There are various sources of financing for SMEs from the financial institutions which includes the banking institutions, development financial institutions, leasing and factoring companies, as well as venture capital companies which provide equity financing. In addition, various special funds and schemes for the SMEs have been set up by the Government.

Financial institutions remain as the largest source of funding for SMEs. As at end-2007, total financing outstanding from banking institutions and development financial institutions amounted to RM128 billion and was provided to 625,167 SME accounts. Banking institutions are the main providers of financing to SMEs, accounting for over 89% or RM114.2 billion of total financing outstanding provided by banking institutions and development financial institutions.

A Comprehensive SME Financing Landscape

625,167 SME accounts[1] have RM128b worth of financing as at end 2007

Banking Institutions
- **47** banks with **3,359** branches
- **RM114.2b** financing outstanding to **518,446** SME accounts at end-2007
- 2007: **RM55.1b** financing approved to **109,497** SME accounts

Development Financial Institutions (DFIs)
- **6** DFIs with **677** branches
- **RM13.8b** financing outstanding to **106,721** SME accounts at end-2007
- 2007: **RM8.1b** financing approved to **23,477** SME accounts

Financing by Banking Institutions and Development Financial Institutions include:

5 Bank Negara Malaysia Special Funds
- Approved **RM16.1b** financing to **33,717** SME accounts
- **RM7.6b** outstanding at end-2007
- 2007: **RM2.7b** approved to **4,859** SME accounts

100 Government Funds and Schemes[2]
- Approved **RM85.5b** to **1.3m** SME accounts at end-2007
- **RM7.0b** financing outstanding at end-2007
- 2007: **RM13.7b** approved to **243,203** SME accounts

Small Debt Resolution Scheme
- Since establishment, restructured NPLs of **565** SMEs amounting to **RM324m**
- 2007: Restructured NPLs of **141** SMEs amounting to **RM56.9m**

Credit Guarantee Corporation Malaysia Berhad
- Guaranteed **RM39.1b** financing to **373,665** SME accounts since 1972
- Outstanding guarantee of **RM14.68b** financing to **90,437** SME accounts at end-2007
- 2007: Guaranteed **RM4.0b** financing to **13,008** SME accounts

Venture Capital (VC)
- **52** VC companies
- Outstanding **RM1.8b** investment in **433** companies at end-2006
- 2007: **RM479m** invested

Leasing and Factoring
- **RM2.0b** loans outstanding at end-2007
- 2007: **RM792.3m** approved

Note 1: Consist of accounts maintained with banking institutions and development financial institutions

Note 2: Only part of the Government funds and schemes are disbursed through development financial institutions.

Significant Expansion of Financing to SMEs

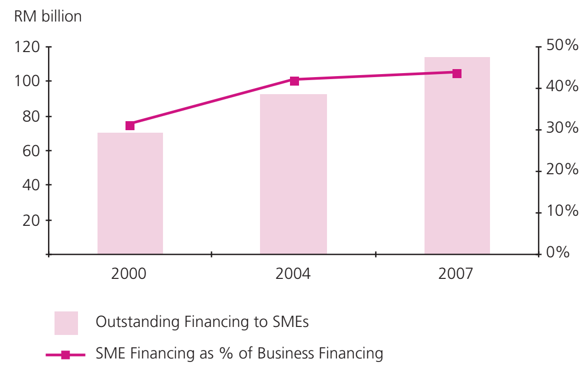
Financing to SMEs continued to expand significantly in 2007. The banking institutions and development financial institutions had approved RM63.2 billion to more than 132,000 SME accounts in 2007. This significant achievement had exceeded the 2007 projected financing approval target of RM51 billion to 110,000 SME accounts.

Banking Institutions: Main SME Financing Indicators

	During		
	2007	**2006**	**2007 (% annual growth)**
Applications (RM billion)	99.1	71.4	38.8
Number of Accounts ('000)	*158.2*	*106.0*	*49.2*
Approvals (RM billion)	55.1	40.2	37.1
Number of Accounts ('000)	*109.5*	*83.7*	*30.8*
Disbursements (RM billion)	141.5	134.1	5.5
Repayments (RM billion)	126.6	122.5	3.4
	As at end		
	2007	**2007 (% annual growth)**	**2006 (% annual growth)**
Financing Outstanding (RM billion)	114.2	9.1	5.1

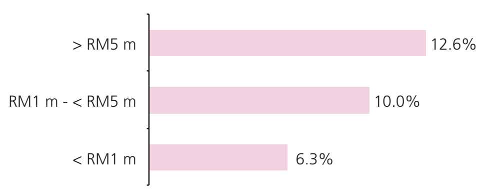
Banking institutions continued to expand financing to the SME sector. Financing applications from SMEs and approvals by banking institutions grew strongly in 2007. Applications and approvals increased by 38.8% year-on-year (yoy) to RM99.1 billion and 37.1% yoy to RM55.1 billion respectively. Disbursements grew by 5.5% yoy to RM141.5 billion, primarily reflecting disbursements to the construction and manufacturing sectors. The moderate disbursements as compared to strong approvals could be due to lower take-up of financing approved to SMEs. SMEs could have submitted multiple financing applications to a number of banks while only accepting financing offers from the bank that offers the most competitive financing rate, despite obtaining multiple approvals from banks on their applications. Alternatively, another possible reason could be the lower utilisation of approved financing lines by SMEs.

Increase in Financing to SMEs

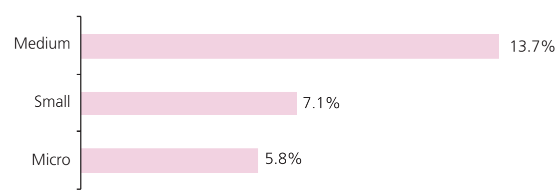


The total SME financing outstanding of RM114.2 billion accounted for 17.7% of the total banking institutions financing and 43.6% of the total business financing as at end-2007. Meanwhile, the number of outstanding SME accounts increased by 10,805 accounts to 518,446 accounts at end-2007. In 2007, larger sized financing were granted to larger sized SMEs. The growth of financing sizes larger than RM5 million (+12.6% yoy), was higher than that of those smaller than RM1 million (+6.3% yoy). Similarly, the growth of financing to medium-sized SMEs (+13.7% yoy) was higher than that of financing to small-sized SMEs (+7.1% yoy) and microenterprises (+5.8% yoy).

Financing Outstanding (By Financing Size, 2007, % yoy)

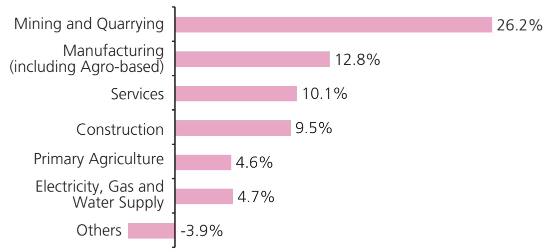


Financing Outstanding (By SME Size, 2007, % yoy)

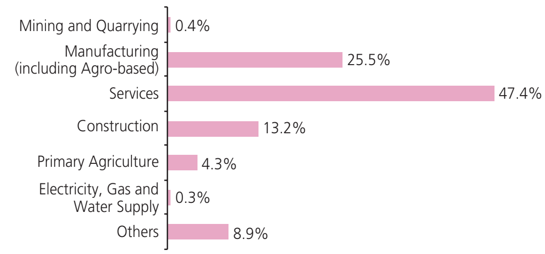


Financing outstanding grew by 9.1% yoy at end-2007, as compared to end-2006 of 5.1% yoy growth. This was mainly driven by higher growth in the construction (9.5%), primary agriculture (4.6%) and mining sectors (26.2%) and continued high growth in the services (10.1%) and manufacturing sectors (12.8%). Of the total financing outstanding at end-2007, almost 73% was

Financing Outstanding (By Sector, 2007, % yoy)



Financing Outstanding (By Sector, 2007, % Share)



extended to the services (47.4%) and manufacturing (25.5%) sectors, while the balance was extended to other sectors including construction (13.2%) and primary agriculture (4.3%).

Non-performing loans (NPLs) by SMEs continued to improve due to full or partial settlements and higher reclassification of NPLs to performing status, as well as efforts by banking institutions to achieve healthier balance sheets through loan write-offs and sale of NPLs. This has resulted in the decline of NPLs by 3.1% to RM10.4 billion as at end-2007 from RM10.7 billion as at end-2006. Similarly, gross SME NPL ratio has improved to 9.1% from 10.2% as at end-2006. On a sectoral basis, the decline in SME NPLs was mainly recorded in agriculture (-30% yoy), construction (-15% yoy) and services (-7.1% yoy) sectors.

The development financial institutions continued to complement the banking institutions in expanding the provision of financing to SMEs. In 2007, financing approvals and disbursement of the six development financial institutions[2] under the purview of Bank Negara Malaysia increased by 17.9% yoy to RM8.1 billion and 15.5% yoy to RM4.3 billion respectively, indicating consistent take-up and utilisation of the approved financing lines by SMEs. As at end-December 2007, development financial institution's financing outstanding grew by 6.8% yoy to RM13.8 billion, accounting for about 11% of total financing outstanding of the banking institutions and development financial institutions. 72% of the development financial institution's financing outstanding as at end-December 2007 were extended to the services (42.7%) and construction (29.3%) sectors. The balance was extended to other sectors including agriculture (11.7%) and manufacturing (8.3%).

Special Government Funds for SMEs

There are 105 Special Government Funds for SMEs with a total allocation of RM31.8 billion as at end-2007. The funds, mainly for nurturing and developmental purposes, are channelled to SMEs through the appointed financial institutions as well as various ministries and government agencies. Five of the Special Government Funds with a total allocation of RM11.4 billion, are administered by Bank Negara Malaysia. These 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).

Following a recommendation by Bank Negara Malaysia, a comprehensive study is currently being conducted by the Government to enhance the effectiveness of the Government funds, including where appropriate, to rationalise the number of existing funds to be more focused in meeting the financing needs of the SMEs.

[2] Comprise of Bank Pembangunan Malaysia Berhad, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Bank Kerjasama Rakyat Malaysia Berhad and Bank Simpanan Nasional.

Progress of Major Initiatives to Improve Access to Financing by SMEs in 2007

Although the SME financing trend has continued to grow, initiatives continued to be taken to strengthen finance providers, widen the avenues of financing and address specific issues faced by SMEs in accessing adequate financing, to ensure that SMEs at various stages of their business life-cycle are able to have access to the necessary amount and type of financing. The specific issues that are being addressed currently include insufficient collateral, insufficient financial track record, and insufficient financing sizes. The focus of the initiatives continues to be in four broad areas, that is, (i) strengthening financial service providers, (ii) strengthening the financial infrastructure, (iii) developing new financial products for SMEs, and (iv) strengthening the provision of advisory services:

(i) Strengthening Financial Service Providers

(a) Development of a Vibrant and Sustainable Microfinance Industry

Please refer to the box article on 'Development of a Vibrant and Sustainable Microfinance Industry'.

(b) Transformation of Credit Guarantee Corporation Malaysia Berhad (CGC)

CGC has embarked on a transformation exercise in 2005 to enhance its role in supporting the growth and development of competitive SMEs. The following are some key initiatives undertaken by CGC in 2007:

- Broadened the scope of guarantee beneficiaries to include selected Islamic banks and development financial institutions to allow wider outreach to SMEs;
- Established an equity financing arm, Aureos-CGC Advisers Sdn. Bhd. to provide equity financing for SMEs;
- Introduced new products and services for SMEs (see section on 'Developing new financial products for SMEs' below); and
- Embarked on an initiative to establish a SME Credit Bureau (see section on 'Strengthening the financial infrastructure' below).

(c) Transformation of Bank Pertanian Malaysia

The intiative to restructure and strengthen Bank Pertanian Malaysia (Bank Pertanian) in a comprehensive manner has achieved significant progress, with the approval of the Bill to corporatise Bank Pertanian in Parliament in December 2007. Following this, the corporatised Bank Pertanian, with a paid-up capital of RM1 billion, is expected to be operationalised in the first half of 2008.

With strengthened institutional and financial capacities, Bank Pertanian is envisaged to be more effective and instrumental in supporting and promoting the development of the agriculture and agro-based sector, by providing a broader range and more innovative financial and non-financial products and services to meet the financing and developmental needs of the sector. In addition, Bank Pertanian is currently embarking on a series of enhancement measures to strengthen its capacity and capability, particularly in the areas of product development, risk management and information technology systems enhancement.

(ii) Strengthening the Financial Infrastructure

(a) CGC's SME Credit Bureau

To enhance access to financing by SMEs, CGC has embarked on an initiative in 2007 to establish the SME Credit Bureau, through a strategic partnership with a premier global provider of credit information on SMEs. The Bureau is a credit databank that would facilitate financing to SMEs by providing financial institutions and trade creditors with convenient, timely and efficient access to credit information on SMEs. Through its operations, the Bureau will assist SMEs build a track record, which financing institutions can use in evaluating financing applications. In addition, SMEs could also enjoy more favourable terms from trade creditors and suppliers, with the access to third party information on the SMEs' businesses. The Bureau is also expected to play a significant role in inculcating prudent and sound financial management practices among the SMEs, whereby SMEs could initiate adequate remedial actions to address weaknesses highlighted through the rating provided. The Bureau is expected to be in operation in the second half of 2008. SMEs can register as members of the Bureau at www.smecreditbureau.com.my.

(b) The Small Debt Resolution Scheme

The Small Debt Resolution Scheme, established in 2003, continued to facilitate the restructuring of NPLs of SMEs with on-going businesses. As at end-2007, 726 applications with total NPLs of RM486 million have been received. Of these, 565 applications involving NPLs of RM324 million were approved for restructuring, while RM18 million new financing was approved for 38 applications. To enhance the outreach of the Scheme, Bank Negara Malaysia included Bank Kerjasama Rakyat Malaysia Berhad (Bank Rakyat), Bank Pertanian and Export-Import Bank of Malaysia Berhad (EXIM Bank) as participating financial institutions in the Scheme in January 2008, whereby their customers with NPLs of less then RM3 million will also be eligible to be considered under this Scheme.

(iii) Developing New Financial Products for SMEs

(a) New Products and Services by CGC

To enhance access to financing by SMEs, the following new products and services were introduced by CGC in 2007:

- A guarantee scheme for start-ups (DAGS Start-up) to assist new SMEs which have difficulties in obtaining bank financing, due to insufficient collateral and insufficient financial track record. Under the Scheme, eligible SMEs which have been in operation for less than one year may obtain 100% guarantee for financing of up to RM2 million.
- A Syariah-based guarantee scheme, the Credit Enhancer Islamic (Enhancer-*i*) was launched in January 2008.

(b) Synthetic Securitisation of SME Loans

In May 2007, Cagamas Bhd. introduced Malaysia's first securitisation of SME loans amounting to RM600 million through its wholly-owned subsidiary, Cagamas SME Bhd, with loans originating from a Malaysian banking institution. The transaction is the first synthetic securitisation transaction in the country. Through such securitisation, banking institutions will have greater flexibility in managing their SME loans portfolio and will have enhanced capacity to provide financing to SMEs.

(c) The Special Relief Guarantee Facility for Flood Affected Businesses

In 2007, Bank Negara Malaysia established a Special Relief Guarantee Facility of RM500 million to alleviate the problems faced by businesses affected by the floods which hit the country in December 2006 and January 2007. Under the facility, flood-affected businesses were able to obtain financing at subsidised rates from all commercial banks, Islamic banks, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Bank Rakyat and Bank Pertanian. CGC provided 80% guarantee for the financing obtained. As at end-2007, 4,640 applications were approved with total financing amounting to RM471.9 million.

(d) Venture Capital Funds for the Agriculture Sector

Two venture capital funds totalling RM300 million were established in 2006 by Bank Negara Malaysia and two banking groups. The funds are aimed at creating and developing an integrated agriculture business, particularly in farming, fisheries and livestock, as well as to finance new technology-intensive agriculture projects, including biotechnology. As at end-2007, investments totalling RM72.9 million were made in seven companies.

(e) New Trade Financing Arrangements and Overseas Project Financing by EXIM Bank
The Multi Currency Trade Finance (MCTF) and Indirect Exporter Financing Scheme (IEFS) were established in January 2006, aimed at encouraging SMEs to export their goods and services, particularly to the non-traditional markets such as members of the Organisation of Islamic Conference. As at end-2007, RM106.9 million was approved under MCTF and RM1.8 million was approved under IEFS.

To facilitate funding for Malaysian companies with overseas projects, a RM1 billion Overseas Project Fund was established by Bank Negara Malaysia at EXIM Bank in December 2006. A total of RM190.9 million financing were approved with guarantee coverage of RM143 million as at end-2007.

(iv) Strengthening the Provision of Financial Advisory Services
To complement the financial infrastructure, initiatives have also been taken to ensure that a comprehensive financial advisory services infrastructure is in place. SMEs have utilised the various avenues made available to channel queries and complaints and take the opportunity to improve understanding of financial issues and seek assistance to rehabilitate problematic businesses. On this front, Bank Negara Malaysia has continued to provide relevant services through the following:

(a) BNMLINK
Bank Negara Malaysia's *Laman Informasi Nasihat dan Khidmat* (BNMLINK) continues to provide financial advisory services to the SMEs in the following areas:
- Information on various sources of financing available to SMEs;
- Assistance in facilitation of the financing application process; and
- Advice on SME financial requirements and problems.

At end-2007, more than 16,600 enquiries and assistance were sought by the SME sector, reflecting continued awareness among SMEs of the availability of such services at Bank Negara Malaysia. Of these, 79% were enquiries on special funds provided by the Government and advice on financing matters, while the remaining were for assistance, mainly on loan restructuring and loan rejections.

(b) BNMTELELINK
To complement the walk-in counter services offered by BNMLINK, the BNMTELELINK, Bank Negara Malaysia's dedicated Contact Centre, was launched in 2007. BNMTELELINK facilitates members of the public including SMEs, to bring their queries and complaints to the Bank via telephone, or in writing via fax, email or post. As at end-2007 (within seven months of operation), BNMTELELINK has attended to 677 enquiries by SMEs. BNMTELELINK can be contacted at:

Tel. : 1300 88 5465 (Toll-Free Line)
Fax : 03 – 2174 1515 / 03 – 2174 1616
Email : bnmtelelink@bnm.gov.my

In addition to the above services, financial advisory services are also being provided to SMEs by all commercial banks through the SME Units at the respective financial institutions; the SME Bank through its Advisory Centre (SAC); and the CGC through its Business Advisory Services Entity (BASE) panel consultants.

Monetary and Financial Conditions

Monetary and Financial Conditions

Monetary and financial conditions remained favourable in 2007. Despite being subjected to bouts of volatility due to global financial markets developments, domestic financial markets demonstrated resilience and were supported by the robust macroeconomic fundamentals. Globalisation and financial integration has led to financial markets adjusting more rapidly to external events and has resulted in a stronger international co-movement of asset prices across countries. Thus, the increased volatility in financial markets due to external developments and their consequent impact on the economy creates a more challenging environment for macroeconomic management.

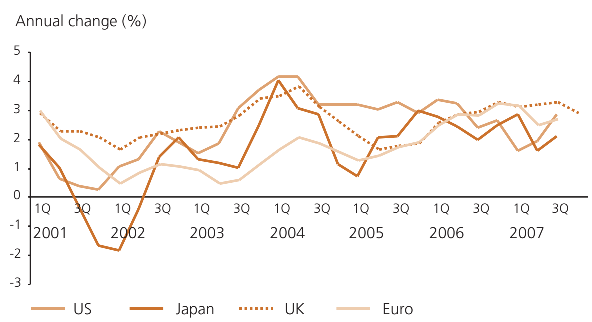
OVERVIEW OF INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

After several years of robust growth, 2007 signified a pivotal turning point in the global economic and financial environment. Financial market conditions turned disorderly as the unfolding sub-prime and credit crisis in the US spread across the major financial markets. This has been accompanied by the sustained depreciation of the US dollar vis-à-vis other major currencies, as well as the persistence of large global imbalances and surging food and commodity prices.

Global financial market conditions were mainly influenced by the unfolding US sub-prime crisis, sustained depreciation of the US dollar, as well as the persistence of large global imbalances and rising food and commodity prices

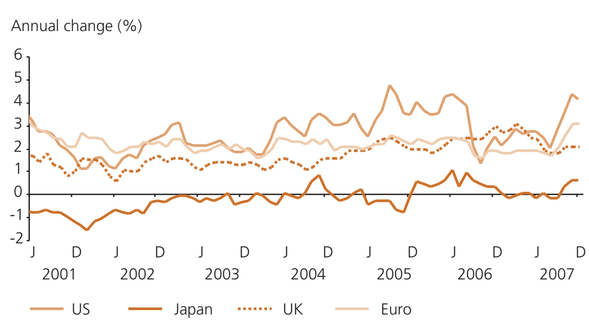
The year 2007 began favourably with global financial market conditions supported by a broadly positive global outlook. Major economies were expected to sustain their expansion, albeit at a slower growth rate, while growth in emerging market economies was expected to continue unabated. Despite rising inflationary pressures from high food prices, early signs of a slowing US housing market and geopolitical tensions in the Middle East, investor optimism was sustained in the early part of the year by the continued expansion of the global economy, the ample global liquidity conditions and orderly conditions in financial markets. As a result, equity markets turned in a robust performance in early 2007, with emerging market equities achieving new records. Sovereign yields rose in major bond markets, as expectations were for tighter future monetary policy, in light of favourable growth prospects amidst rising food and commodity prices. The positive outlook was also evident in the emerging markets, with risk premiums remaining low, as reflected by the continuous narrowing of spreads in the early months of 2007.

Chart 2.1
Gross Domestic Product Annual Change (Selected Industrialised Economies)



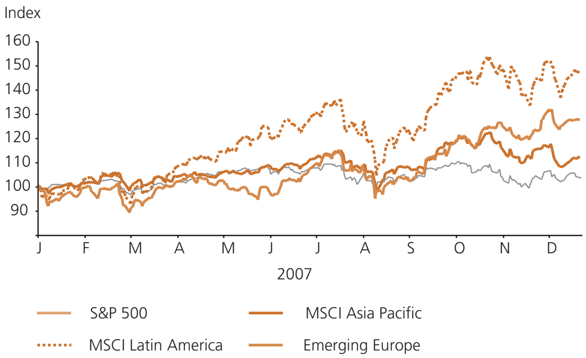
Source: Bloomberg

Chart 2.2
Consumer Price Index Annual Change (Selected Industrialised Economies)



Source: Bloomberg

Chart 2.3
Performance of Global Equity Markets



Source: Bloomberg

Chart 2.4
Emerging Market Bond Index and Bond Spreads (EMBI)

Source: Bloomberg

Against the background of expectations for steady expansion of the global economy supporting growth in employment and incomes amid diminishing spare capacity in most major economies, the balance-of-risks to price stability in the major economies in early 2007 was on the upside. While the US Federal Reserve kept its policy rate unchanged in the first-half of 2007, the FOMC statements during this period underscored its predominant monetary policy concern that inflation would persist for a longer period of time. Similar tightening biases were also expressed by both the Bank of England and the European Central Bank, which increased their key policy rates by 75 basis points and 50 basis points respectively, between January and July 2007.

Among the regional economies, the situation was somewhat more mixed. High capital inflows leading to a build-up of liquidity and faster money and credit expansion, contributed further to rising domestic inflationary pressures in several economies. In view of the high liquidity growth and its impact on the asset markets, the Bank of Korea took further tightening steps in 2007 by raising its policy rate and introducing other quantitative measures to curb the steady rise in asset prices. In addition to increasing the key policy rate, the People's Bank of China adopted supplementary measures, such as increases in reserve requirements, to contain inflation and rapid credit expansion. In Thailand and Indonesia, however, concerns on the downside risk to growth dominated monetary policy decisions. Inflationary pressures were deemed to be under control following previous monetary tightening that had been successful in mitigating the impact of high commodity prices on domestic prices. Therefore, monetary policy was eased in these countries in 2007 to stimulate domestic demand.

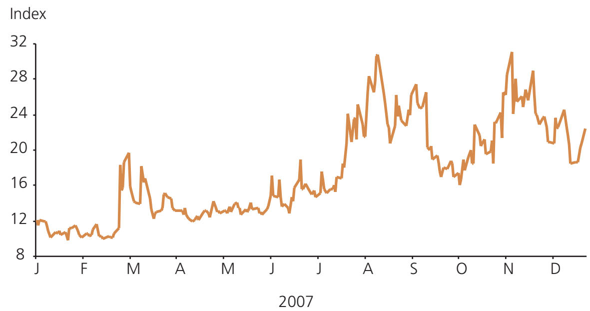
Concerns on the prospects of a protracted decline in US house prices and the implications on the US economy began to surface at the end of the first quarter of 2007. The outlook for the US mortgage market took a turn for the worst by mid-year, when risk premiums on the sub-prime mortgage market rose significantly and triggered widespread sharp downward ratings of financial assets amongst global investors and caused disruptions in the interbank markets. The loss of confidence in the valuation of structured credit products heightened uncertainty surrounding the extent and distribution of these losses across the financial system. As a result, liquidity demand increased dramatically, but was met with more risk averse lenders, leading to the surge in the cost of borrowing. Spreads rose sharply across the credit universe in tandem with the rise in interbank money market rates. Market volatility increased sharply and disorderly conditions prevailed, which at times, led to malfunctioning interbank markets in the major financial centres of the industrial world.

At the initial stage, the impact of the sub-prime turmoil was deemed to be confined within the financial markets. Against an

Chart 2.5
3-month LIBOR less 3-month Treasury Bill Yield

Source: Bloomberg

Chart 2.6
Chicago Board of Exchange (CBOE) Implied Volatility Index (VIX)



Source: Bloomberg

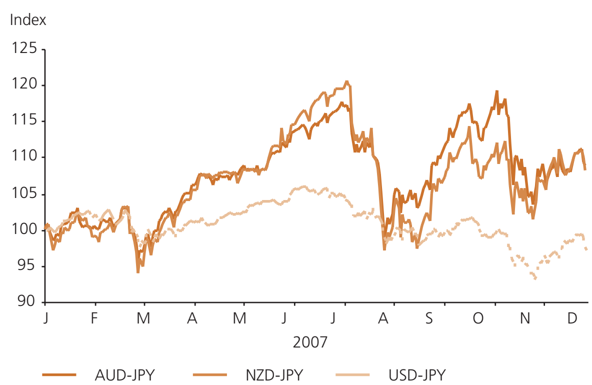
uncertain background of financial turbulence and potential systemic implications, major central banks responded with injections of liquidity into the tight interbank markets, as well as broadening the range of assets that were allowed to be discounted with the central banks. In addition, the US Federal Reserve undertook an immediate cut in its discount rate by 50 basis points on 17 August 2007 to promote the restoration of orderly conditions in financial markets.

While liquidity conditions in most emerging markets remained favourable given their limited exposure to the US sub-prime assets and asset- backed securities markets, the integration across financial markets and the ongoing repricing of risks, did lead to a sharp sell-off in equities and selected currencies in the region. Emerging markets equities, however, proved to be resilient, as the MSCI for emerging market recorded gains of about 36.5% for the year as a whole.

Nonetheless, on a broader scale, the sub-prime crisis initiated a holistic reassessment of risks globally. First, the low risk premiums environment that had prevailed for the recent three years came to an end. Concerns and uncertainty about the location and size of potential losses in the credit derivative markets led to the elevation of risk aversion, with investors returning to safe-haven assets, thus leading to the fall in yields of US Treasuries from 5.02% at end-June 2007 to 4.02% at end-December 2007. Volatility in the US equity market as measured by the VIX index, increased to 30.8 index points on 16 August 2007 from 16.2 index points on 1 July 2007.

Second, the sub-prime crisis also increased the volatility in the currency markets, due partly to the unwinding of carry trade positions. Carry trades or leveraged cross-currency positions were profitable as long as investors benefited from borrowing in a cheap funding currency to invest in higher earning foreign currency assets; with gains from interest rate differentials not expected to be overwhelmed by near-term exchange rate movements. With the sustained period of low policy interest rates and low perceived exchange rate risks in Japan and Switzerland, the yen and the Swiss franc have

Chart 2.7
Carry Trade Index (Cumulative Excess Return)



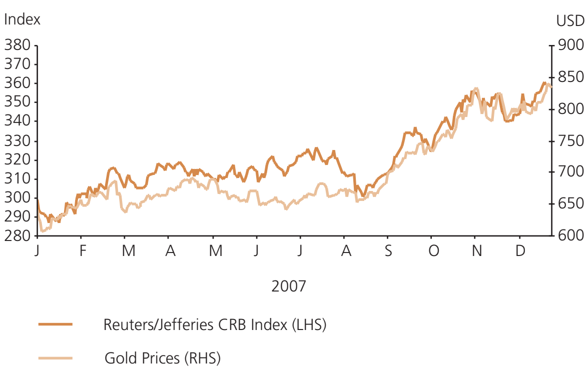
Source: Bloomberg

been used to fund carry trade activities into high yielding currencies and other financial instruments. However, these carry trade positions had retreated somewhat, given the heightened risk aversion following the greater uncertainty in the financial markets in the period after the sub-prime crisis.

Third, the overriding concern arising from the sub-prime crisis was the extent to which the contraction and higher pricing of credit had repercussions on the real sector. As economic data continued to show deteriorating conditions in the US housing and job markets, the key policy challenge was to ascertain the extent of its spillover effects on the real economy. Given the greater trade and financial linkages between the major developed economies and the rest of the world, any protracted slowdown would inevitably have an impact on the external demand in these economies and thus on the global economic outlook.

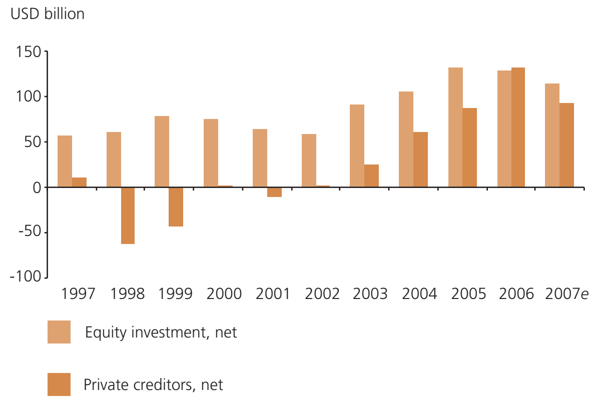
Fourth, global commodity prices continued to scale new highs in 2007, driven by strong demand and a shift in asset allocation away from financial assets, and thereby contributing to the build-up of global inflationary pressures. As a result, the prospect of significantly slower global growth amidst a sustained increase in global commodity prices, has led to some concerns of possible stagflation in the developed economies. Nevertheless, the slowdown in the US and other developed economies would contain global demand, thus limiting the probability of such a scenario.

Chart 2.8
Commodities Index (CRB) and Gold Prices



Source: Bloomberg

Chart 2.9
Capital Flows to Emerging Asia



e Estimate
Source: Institute of International Finance

Overall, emerging markets have remained broadly resilient, but face critical challenges ahead. Sustained periods of strong private capital inflows to emerging markets and developing economies have supported growth and the positive developments in the domestic financial markets. Nonetheless, some economies have also experienced inflationary pressures, due to the rapid expansion of credit and liquidity. In addition, the risk of greater financial market volatility due to the impact of the unfolding sub-prime crisis, the prospect of slower global growth and reduced trade flows, as well as elevated inflationary pressures, would pose challenges to macroeconomic management.

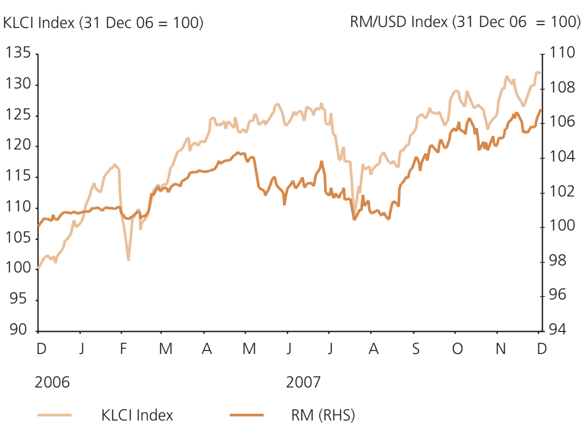
RINGGIT EXCHANGE RATE DEVELOPMENTS

Strong two-way trade and investment flows continued to influence ringgit performance against major and regional currencies during the year. Underlying demand for the ringgit was derived from the positive net trade balance, sustained inward foreign direct investment and substantial repatriation of profits and dividends by Malaysian companies with investments abroad. Ringgit demand was also augmented by significant portfolio inflows, as expectations of strong earnings growth and further currency appreciation contributed to the re-rating of Malaysian equities. This was reinforced by the generally optimistic investor sentiments towards the region and the broad weakness of the US dollar. The upward ringgit pressure was to a certain extent balanced by the demand for foreign currencies to fund larger outward direct and portfolio investments, repayment and prepayment of external loans by both the public and private sectors and the repatriation of profits and dividends by non-residents. The strengthening of the ringgit was also punctuated by several external events during the year, such as the global equity correction in the first quarter and the global financial disruptions following the developments in the US housing market in the third quarter, which had a restraining effect on regional currencies, including the ringgit.

Strong two-way trade and investment flows continued to influence ringgit performance against major and regional currencies during the year

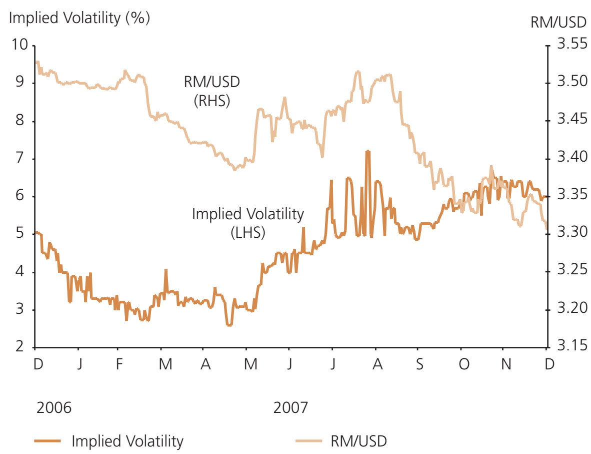
The strong demand for ringgit resulted in the continued appreciation against the US dollar in 2007. The upward trend in the ringgit was however disrupted by the withdrawals of funds from the region following the correction in the Shanghai equity market in February, and developments related to the US sub-prime mortgage market, particularly in the period June through September. The weakness of the ringgit in the June to September period was especially noteworthy because it corresponded with a marked increase in ringgit exchange rate volatility. These disruptions proved to be temporary as the ringgit resumed its appreciating trend, arising from the positive investor sentiment towards the Malaysian economy. The ringgit also reflected the general

Chart 2.10
Performance of the Kuala Lumpur Composite Index (KLCI) and the Malaysian Ringgit (RM) against the US Dollar



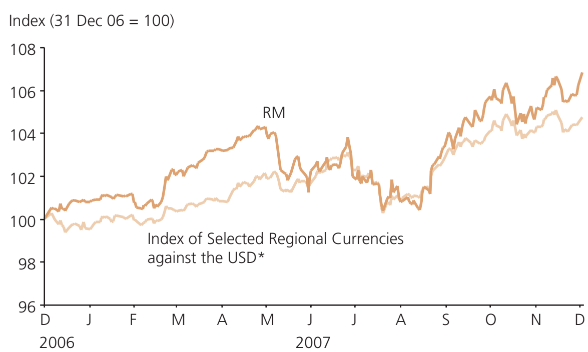
Source : Bursa Malaysia

Chart 2.11
Exchange Rate and Implied Volatility of the Malaysian Ringgit (RM) against the US Dollar



Source : Bloomberg

Chart 2.12
Exchange Rate of the Malaysian Ringgit (RM) and Selected Regional Currencies against the US Dollar



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

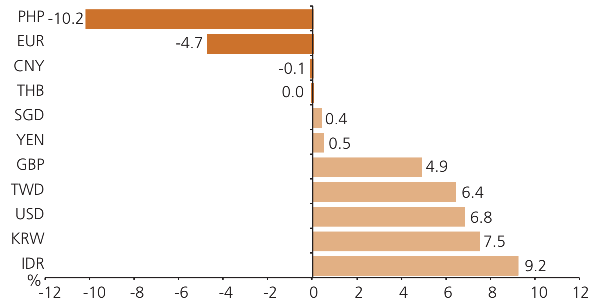
Note: An increase in the index represents an appreciation of the ringgit or of selected regional currencies against the US dollar.

improvement in investor sentiment following the monetary policy action by the US Federal Reserve to normalize market conditions and address the emerging risk of a broader US economic slowdown, as well as the efforts by the other major central banks to ease the tight liquidity conditions in financial markets. For the year as a whole, the ringgit appreciated by 6.8% against the US dollar to end the year at the dollar exchange rate of RM3.3065 (noon rate).

The ringgit also ended the year marginally higher by 0.5% against the Japanese yen. The ringgit was generally stronger against the yen in the first half of the year as the yen was the favoured short currency for carry trade activities. The substantial unwinding of these positions following the rise in global financial market volatility in the second half of the year, however, led to a significant appreciation of the yen relative to the ringgit. Nevertheless, the ringgit ended the year firmer versus the yen on renewed carry trades and concerns about the strength of growth of the Japanese economy. Conversely, the ringgit depreciated against the euro by 4.7%, following the marked strengthening of the euro against the major currencies. Key factors supporting the euro were market expectations for continued monetary policy tightening by the European Central Bank, the positive economic growth outlook for the euro zone, and the greater role of euro as a reserve currency.

Chart 2.14
Summary of Malaysian Ringgit (RM) Performance against Major and Regional Currencies

Percent change, 1 Jan - 31 Dec 2007



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

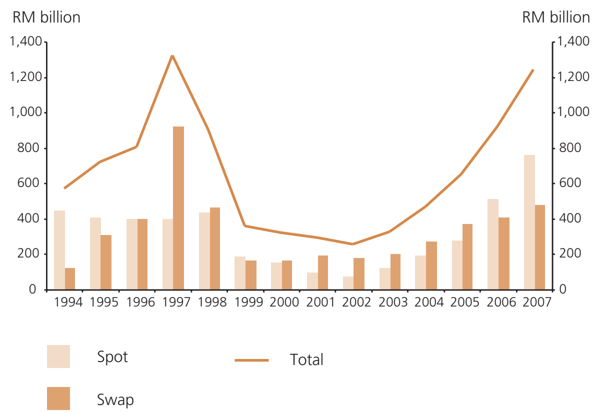
The performance of the ringgit against the regional currencies was mixed. Although the underlying trend of the ringgit was broadly consistent with that of other currencies in the region, country-specific factors resulted in variations in performance between the regional currencies. In particular, the Philippine peso strengthened due to strong remittances and export receipts, and the relatively high interest rates of peso instruments. The Indonesian rupiah weakened as demand for foreign currency rose in line with import growth following stronger economic activity and the increase in world oil prices.

Chart 2.13
Exchange Rate of the Malaysian Ringgit (RM) against Major Currencies

Index (31 Dec 06 = 100)

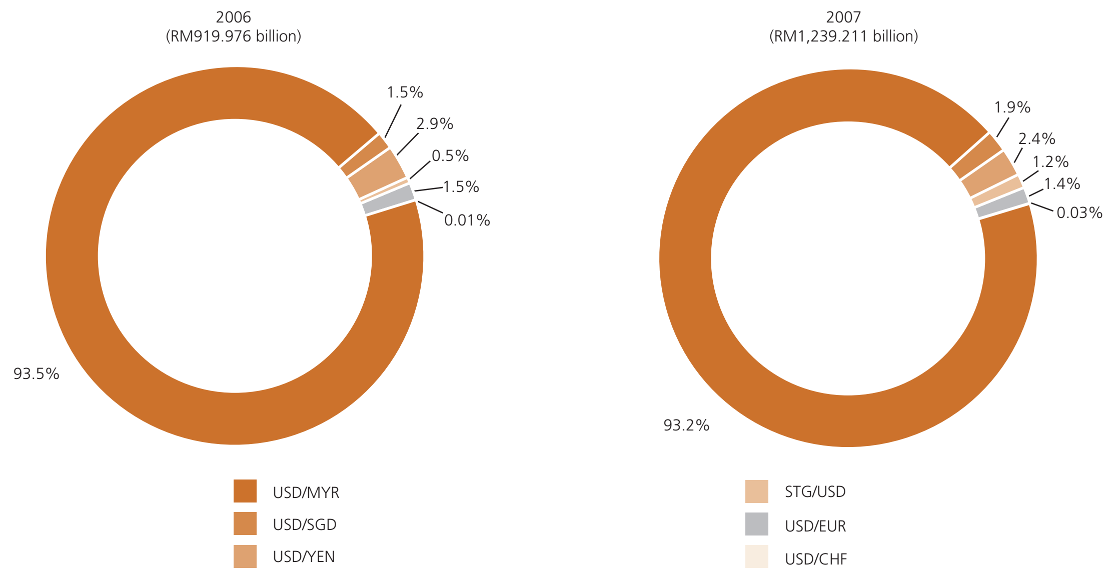
Note: (+) indicates an appreciation of ringgit against the currency

Chart 2.15
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.

Chart 2.16
Transactions in the Kuala Lumpur Foreign Exchange Market by Currency



The rapid expansion in the volume of interbank transactions in the Kuala Lumpur foreign exchange market continued in 2007. At current exchange rates, total volume increased by 34.7% (at constant 2006 exchange rates: 41.1%). The increase in turnover was driven mainly by the rise in spot transactions, which grew by 49.2% at current exchange rates (at constant 2006 exchange rates: 60.6%). For the recent two years, spot transactions had overtaken swap transactions as the dominant contributor to the overall volume, a reversal of the trend since 2000. This may in part be attributed to the increase in short-term financial flows into the region. It is noteworthy that the 34.7% increase in the average daily volume of spot and swap transactions in the Kuala Lumpur foreign exchange market is higher than the annualized global average growth of 20.2% over the 2005 – 2007 period covered by the Bank for International Settlements Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in 2007. This development reflects the larger two-way flows and the growing vibrancy of the Kuala Lumpur foreign exchange market.

LIQUIDITY AND MONEY SUPPLY

In 2007, monetary aggregates expanded as a consequence of both external and domestic factors. Broad money, or M3, exhibited a relatively stable growth trend in the first half of 2007, which subsequently moderated towards the second half of the year, and ended the year growing at an annual rate of 9.5% (end-2006: 13.0%).

Large external flows and higher lending activity contributed to sustained growth in monetary aggregates

Inflows from the current account surpluses, foreign direct investments and portfolio funds were the main drivers in the expansion of liquidity, albeit at a lesser extent compared to 2006. In particular, during the third quarter, net foreign assets exerted a contractionary impact on M3, reflecting to a large extent, the outflows from the heightened risk aversion amongst

Chart 2.17
Monetary Aggregates

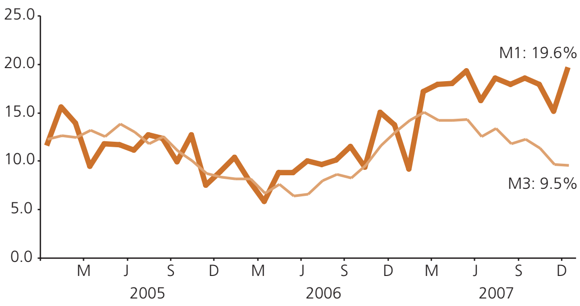
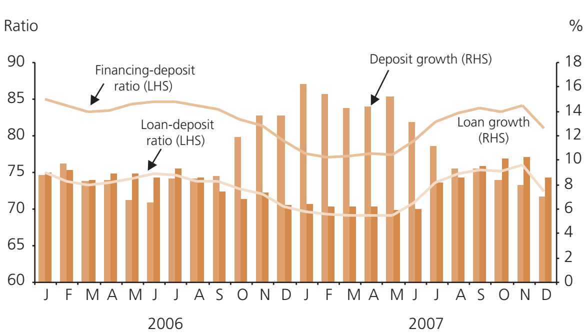


Table 2.1
Broad Money, M3

	Change (RM billion)	
	2006	2007
M3	87.5	72.5
Currency in circulation	3.4	2.8
Demand deposits	11.7	24.2
Broad Quasi-Money	72.4	45.5
Fixed deposits	*31.9*	*10.7*
Savings deposits	*5.2*	*8.7*
NIDs	*14.3*	*-15.3*
Repos	*11.8*	*-72.4*
FX deposits	*3.2*	*1.5*
Other deposits	*5.9*	*112.2*
Determinants of M3		
Net claims on Government	8.3	0.3
Claims on private sector	34.7	51.6
Loans	*36.8*	*48.5*
Securities	*-2.1*	*3.1*
Net external operations*	59.7	76.4
*Bank Negara Malaysia**	*32.1*	*50.9*
Banking system	*27.6*	*25.4*
Other influences	-15.3	-55.8

* Pre-revaluation of the international reserves

Chart 2.18
Financing-Deposit and Loan-Deposit Ratios



investors due to the US sub-prime crisis. Higher bank lending contributed significantly to M3 growth in the second half of the year, in tandem with the increased pace of economic activity.

Narrow money or M1, continued to record stronger growth throughout the year, evidenced by the annual growth of 19.6% at end-December (end-2006: 13.7%), as the private sector opted for higher transaction balances to undertake trading activities.

Meanwhile, banking system liquidity continued to remain ample, as evidenced by the financing-deposit and loan-deposit ratios. During the year, the banking system's lending to the private sector, as reflected by loans outstanding and holdings of private debt securities, expanded at a faster pace of 9.4%, compared with deposits growth of 7.0%. While this resulted in a higher financing-deposit and loan-deposit ratio to 80.8% and 72.2% respectively, liquidity remained ample to enable the banking institutions to undertake their lending activities.

FINANCIAL MARKET CONDITIONS

Apart from brief periods of corrections, the domestic financial markets proved resilient in the face of global financial market turbulence. In part, the resilience reflected strong macroeconomic performance, with sustained private sector-led growth. Nevertheless, given that global financial markets have become increasingly integrated, the domestic financial markets experienced larger and more volatile episodes of capital flows which coincided with the swings in risk appetite of the global investors.

In addition to the strong domestic fundamentals, domestic sentiments strengthened during the year following the announcements of several projects under the Ninth Malaysia Plan and the economic corridors. Sentiments were further lifted by other initiatives including the transformation program for the Government-linked companies (GLCs) and the Government's incentive package for the property market. The incentive package for the property sector included the relaxation of rules on foreign property purchases, the exemption of the real property gains tax and increased commitment for a more efficient public delivery system such as a faster approval process. These measures were complemented by the further liberalisation of the capital account transactions.

Interest Rate Developments

With the Overnight Policy Rate (OPR) held at 3.50% throughout the year, changes in the domestic money market and retail interest rates were driven primarily by market factors.

Money market and deposit rates were generally stable. Lending rates, however, softened due to strong competition between banks

In the money market, the average overnight interest rate remained close to the OPR throughout the year, trading in a tight range between 3.48% and 3.51%. The interbank rates of the one-week and one-month maturities were also relatively stable, with spreads against the overnight rate narrowing as the year progressed. The narrowing spread between the various tenures may be attributed to market participants paring down their expectations of adjustment to the OPR.

The lending rates of commercial banks on the other hand, moderated in 2007. While the base lending rate was unchanged at 6.72%, the average lending rate (ALR) on outstanding loans trended lower by 28 basis points to 6.29% as at end-December 2007. Compared to 2006, more banks had their ALRs in the 6-7% range, down from the 7-9% range, providing further evidence of the downward trend in lending rates. The average lending rates on new loans approved also trended lower. The declining trend in lending rates reflected the ample supply of

Chart 2.19
Interbank Rates

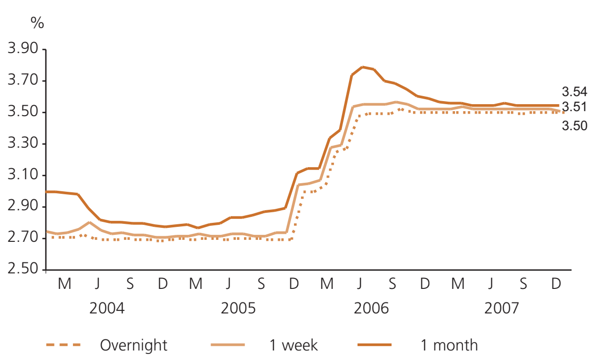


Chart 2.20
Commercial Banks' Lending Rates (at end-period)

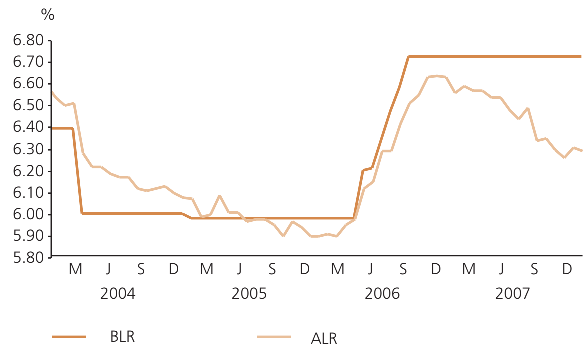


Chart 2.21
Range of Commercial Banks' ALR

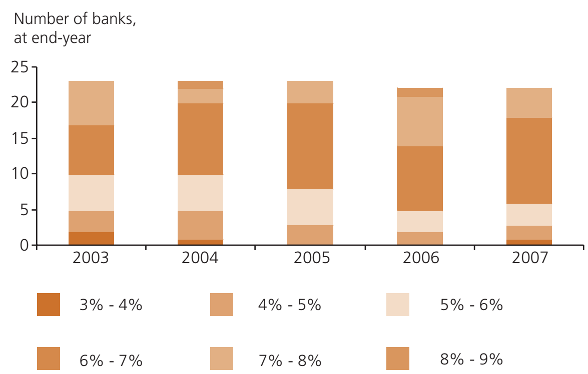
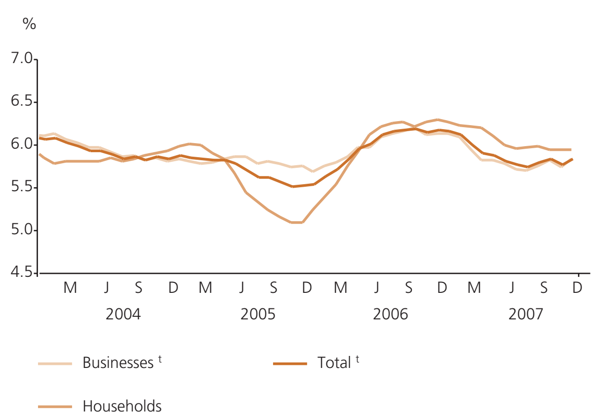


Chart 2.22:
Commercial Banks' ALR on New Loans Approved (6 months moving average)



t Trend in the ALR on new loans was adjusted to remove the one-off effect of a large loan approved in the transport, storage and communication sector

Chart 2.23
Commercial Banks' Fixed Deposit Rates

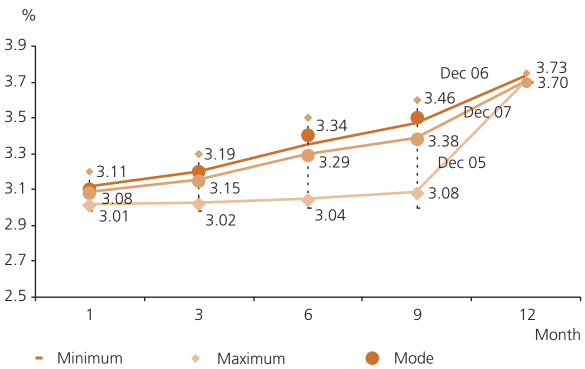


Chart 2.24
Real Fixed Deposit Rates

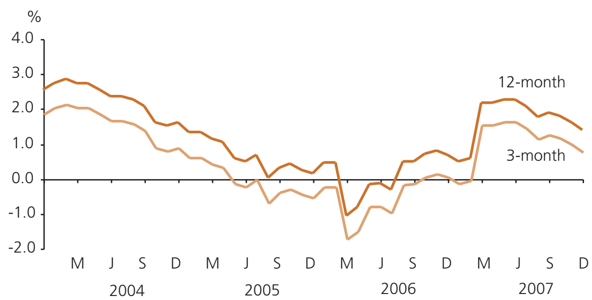
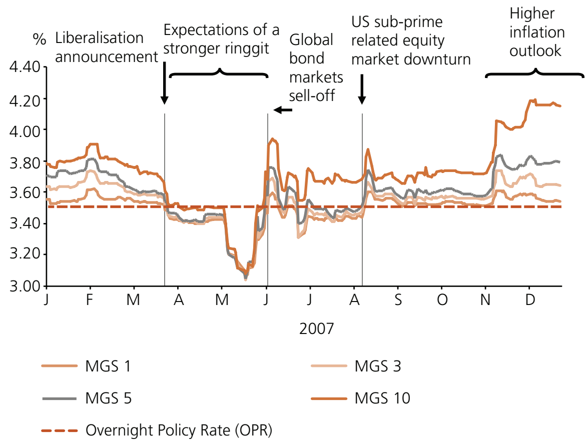


Chart 2.25
Malaysian Government Securities Yields



Source: Bank Negara Malaysia

loanable funds, leading to more aggressive competition amongst the banks.

Fixed Deposit (FD) rates softened slightly in 2007. The adjustments in FD rates, however, were modest in comparison to the downtrend in lending rates. The FD rates of the 1 and 12 month tenures are supported by the floor rates imposed by Bank Negara Malaysia on retail fixed deposits. As at end-December, FD rates between the 1 and 12 months tenures were between 3.08% and 3.70% respectively.

Bond Markets

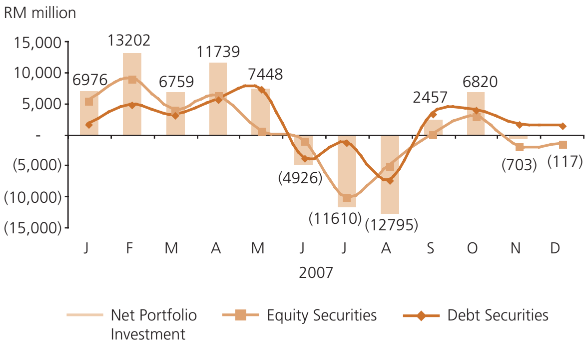
The performance of the bond market in 2007 was driven by both global and domestic factors. Expectations regarding the movement of the ringgit exchange rate and the anticipation of changes in monetary policy stance, together with global financial market developments influenced the movements in yields. Consequently, the year saw large two-way capital flows in the bond market, leading to greater volatility in bond yields, especially in the MGS market.

Yields in the ringgit bond market were relatively more volatile, affected by the disorderly conditions in the global financial markets including in the foreign exchange markets, and changes in inflationary expectations

The expectation of a stronger ringgit resulted in larger foreign accumulation of ringgit-denominated assets, including bonds. Large inflows into the bond market pushed yields downwards and caused the MGS yields up to the 10-year maturity to dip below the OPR level in April. The large inflows also resulted in the narrowing of the spreads between the 10-year MGS and the shorter term securities. Similarly in regional economies, the yield curve in Korea, Singapore and Thailand also flattened.

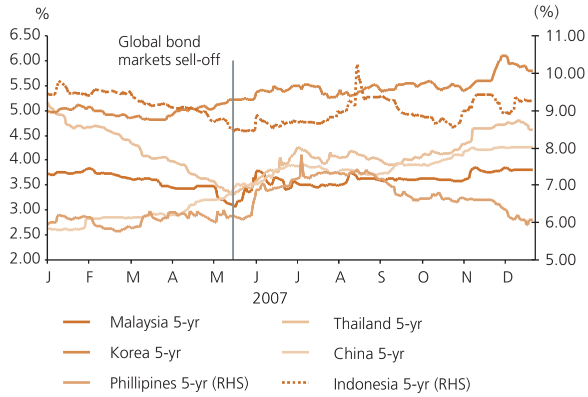
While the MGS bond market enjoyed a positive rally in the first half of 2007 and correspondingly a significant decline in yields,

Chart 2.26
Net Portfolio Investment Flows into the Country



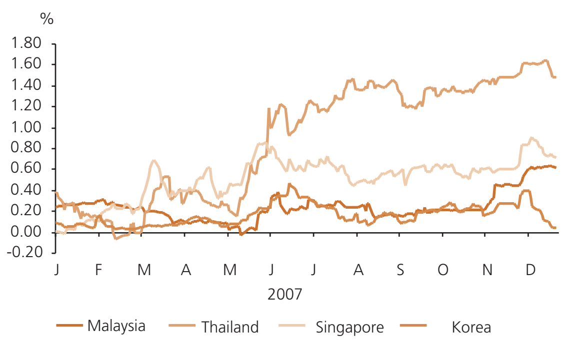
Source: Bank Negara Malaysia's Cash of Balance of Payments System

Chart 2.28
Regional 5-year Government Securities Yield



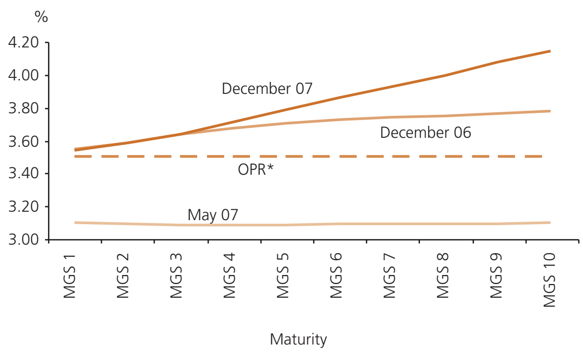
Source: Bloomberg

Chart 2.27
Yield Spread (10-yr against 1-yr) for Selected Countries



Source: Bloomberg

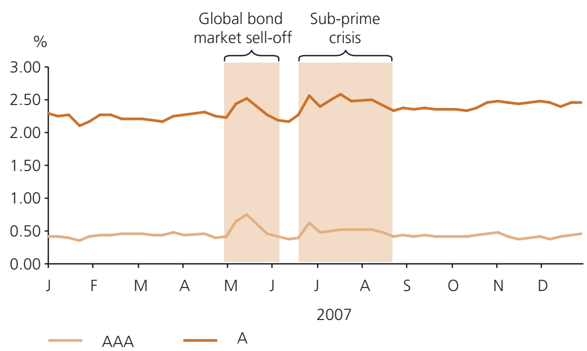
Chart 2.29
MGS Benchmark Yield Curve 2007



*OPR: Overnight Policy Rate
Source: Bank Negara Malaysia

the dramatic change in global financial markets led to reversals in the direction of the yields in the second half of 2007. The sub-prime and credit crisis caused a sell-off in the Malaysian and regional bond markets, pushing yields sharply upwards. However, market sentiments improved in August 2007 following the aggressive response from the US Federal Reserve. Expectations of higher inflation pushed the bond yields to rise towards year-end as investors priced in the possibility of a monetary policy response. The spreads between the 10-year MGS and the shorter and medium-term MGS widened and eventually led to the steepening of the MGS benchmark yield curve in December. Nevertheless, as inflows continued to enter the bond market, the rise in yields moderated.

Chart 2.30
Corporate Yield Spread Against MGS (3-year)



Source: Bank Negara Malaysia

In the corporate bond market, yields generally moved in tandem with the movement of Government bond yields, especially for the higher rated credits. However, during periods of uncertainty, the lower-rated issues were subjected to a slight widening in the spreads.

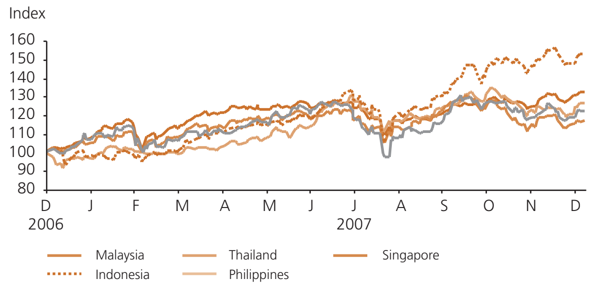
Equity Markets

The benchmark Kuala Lumpur Composite Index (KLCI) started the year on a bullish note and crossed the 1,300 level in April for the first time in 13 years. The KLCI continued its upward momentum and achieved several new highs to reach 1,445.03 at year-end, recording a gain of 31.8% in 2007. Nonetheless, the rise in the equity market was punctuated by a number of market corrections and temporary withdrawals by foreigners due to the repricing of risks arising from global and regional developments such as the Shanghai market correction in February, the global bond markets sell-off in June and the heightened global market uncertainty in August following the US sub-prime loans fallout. The KLCI, however, rebounded quickly, buoyed by the strong fundamentals of the domestic economy, robust corporate earnings and rising commodity prices. Positive sentiments arising from the Government's pro-growth policies and an increase in mergers and acquisitions activity also provided added impetus to the local equity market.

Despite bouts of volatility due to global financial developments, the KLCI was resilient in 2007, gaining support from strong macroeconomic fundamentals and favourable corporate earnings

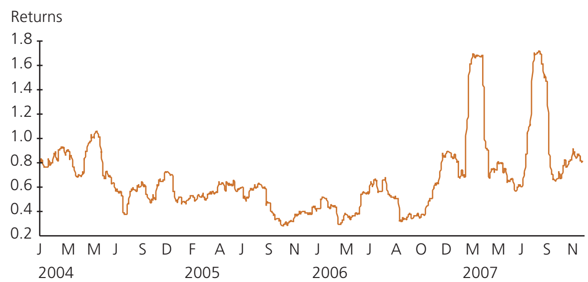
During the year, the Second Board and the MESDAQ Market underperformed the Main Board which is more liquid with higher quality stocks. A confluence of positive factors pushed the plantation sector to emerge as the best performing sector in the market, followed by the property and construction sectors. The plantation sector gained 87.4%, while the construction and property sectors recorded increases of 56.5% and 49.3% respectively in 2007. Market turnover rose significantly during the year with the average daily volume of shares traded rising by 93% to 1,548 million units, while the value of turnover more than doubled to RM2,346 million.

Chart 2.31
Regional Indices



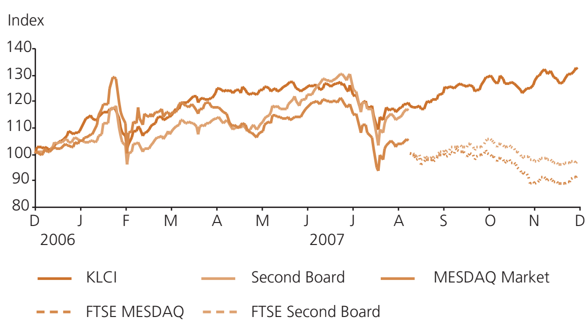
Source: Bloomberg

Chart 2.32
Volatility of Returns on the KLCI[1]



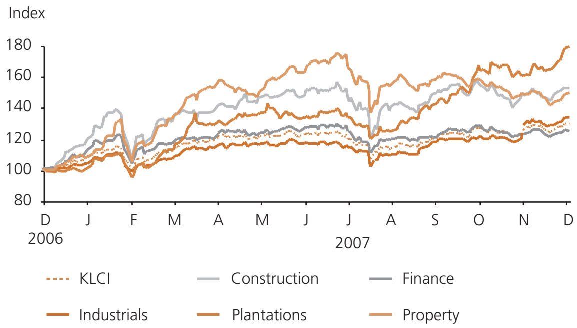
1 Refers to the 30-day rolling standard deviation of daily returns
Source: Bank Negara Malaysia estimates

Chart 2.33
Bursa Malaysia Indices**



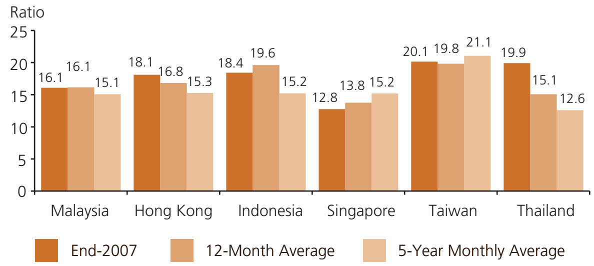
** From September 10, 2007, the Second Board and MESDAQ was replaced with Second Board and FTSE MESDAQ
Source: Bloomberg

Chart 2.34
Bursa Malaysia Sectoral Indices



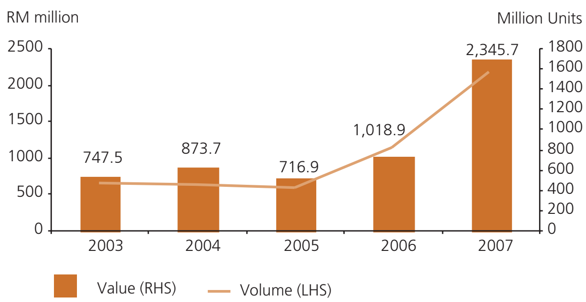
Source: Bloomberg

Chart 2.37
Regional Comparison of Price-Earnings Ratios



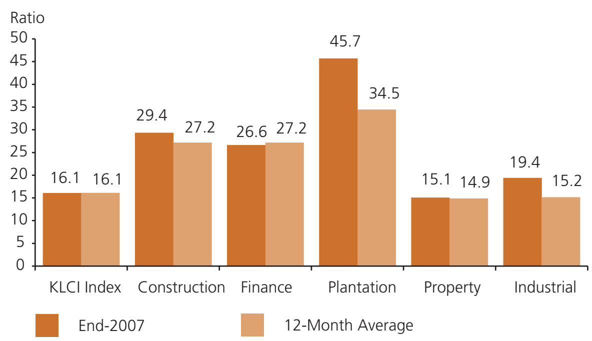
Source: Bloomberg, Bank Negara Malaysia estimates

Chart 2.35
Average Daily Turnover of Bursa Malaysia



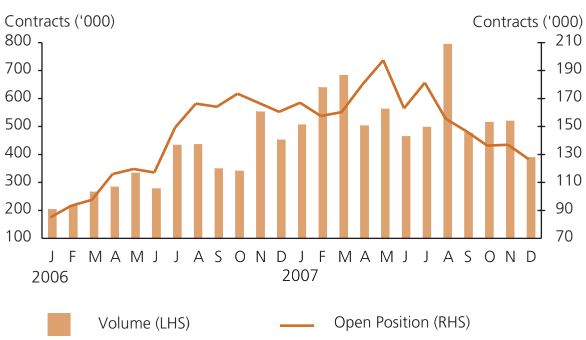
Source: Bursa Malaysia

Chart 2.38
Bursa Malaysia Comparison of Sectoral Price-Earnings Ratios



Source: Bloomberg, Bank Negara Malaysia estimates

Chart 2.36
Bursa Malaysia Derivatives: Total Monthly Volume and Month-end Open Interest



Source: Bursa Malaysia

Active trading in the KLCI and the crude palm oil (CPO) futures led to the stronger performance of the derivatives market in 2007. Strong gains in the underlying stocks and the high CPO prices were key factors in driving the interest in the derivatives market. Total annual trading volume for derivatives (comprising KLCI futures, crude palm oil futures, 3-month KLIBOR futures and MGS futures) in 2007 was 6.6 million contracts or an increase of 57.8% (2006: 4.2 million contracts).

The KLCI's valuation at current price-earnings (P/E) multiple of 16.1 times as at end-2007 was slightly higher than the historical 5-year monthly average multiple P/E of 15.1 times. Meanwhile, the plantation and construction sectors outperformed the overall market on improved earnings outlook and reratings by investors.

The KLCI began on a positive note in 2008, with stronger interest in the plantation stocks helping the market to reach an all-time high of 1,516.2 on 11 January 2008. However,

Table 2.2
Bursa Malaysia: Selected Indicators

	2006	2007
Price Indices (Index):		
FBM30	7,059.9	9,343.7
Composite	1,096.2	1,445.0
FBMEMAS	7,169.6	-
Second Board	92.0	-
MESDAQ Market	119.9	-
FTSE Second Board	-	6,732.4
FTSE MESDAQ	-	6,109.2
Total Turnover:		
Volume (billion units)	197.5	360.4
Value (RM billion)	250.6	540.2
Average Daily Turnover:		
Volume (million units)	802.9	1,584.4
Value (RM million)	1,018.9	2,345.7
Market Capitalisation (RM billion)	848.7	1,106.2
Market Capitalisation / GDP (%)	148.2	172.4
Total Number of Listed Companies:	1,027	987
Main Board	649	636
Second Board	250	227
MESDAQ Market	128	124
Number of Companies Delisted:		
Main Board	21	48
Second Board	8	13
MESDAQ Market	1	2
Market Liquidity:		
Turnover Value / Average Market Capitalisation (%)	33.3	52.2
Turnover Volume / Number of Listed Securities (%)	59.2	98.9
Market Concentration:		
*Market Capitalisation of 10 most Highly Capitalised Stocks / Total Market Capitalisation (%)	35.4	38.3

* Based on market transactions only

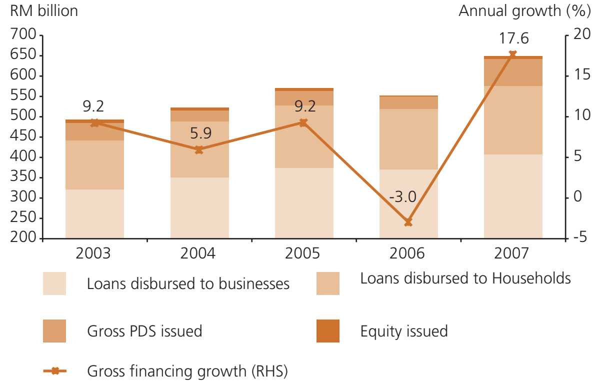
Source: Bursa Malaysia

following the corrections in global equity markets arising from concerns about the severity of the US economic slowdown, the KLCI closed lower at 1,357.4 at end-February 2008. The losses were, however, cushioned by the continuing rise in plantation stocks as crude palm oil prices hit new peaks.

FINANCING OF THE ECONOMY

Financing activity expanded in 2007 providing strong support to the domestic economy. Amid ample liquidity and low borrowing costs, total net financing channeled to the economy, encompassing both the public and private sectors, increased at a higher rate of 9.3% (2006: 6.1%). In terms of financing to the private sector, there was higher demand for financing

Chart 2.39
Gross Financing through Banking System and Capital Market

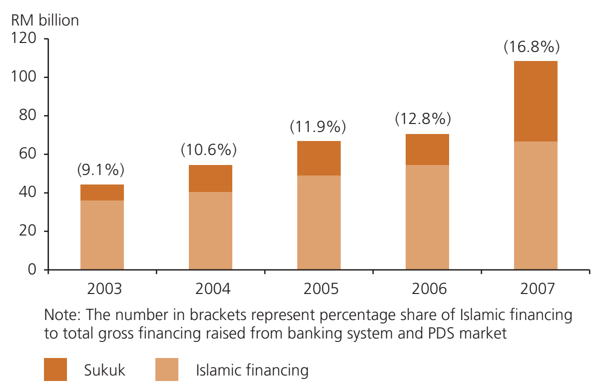


from both the business and household sectors, to support investment and consumption activities. Increased corporate expansion activity, including mergers and acquisitions and privatisations, and progress on projects under the Ninth Malaysian Plan provided additional impetus to the growth of financing during the year.

The robust growth of the economy was well supported by ample financing from the financial system

Of importance, the turmoil in the global financial markets in the second half of 2007 had a limited impact on domestic financing activity. Bank financing activity continued to record a

Chart 2.40
Financing raised via Islamic Instruments



Note: The number in brackets represent percentage share of Islamic financing to total gross financing raised from banking system and PDS market

Table 2.3
Financing of the Economy

By financing type/institutions \ By customer	Business[1] Total	Business[1] of which: SMEs	Households	Government	Total Financing
	RM million				
Net Change in Financing (2006)					
Financial Intermediaries					
Banking Institutions	10,011	8,705	26,605	(1,669)	34,948
Development Financial Institutions (DFIs)[2]	2,404	942	5,172	-	7,576
Other Domestic Intermediaries[3]	2,302	(167)	314	-	2,616
Capital Market					
Bond Market[4]	13,485	-	-	15,120	28,605
Equity Market	1,916	-	-	-	1,916
Venture Capital	721	-	-	-	721
External Financing					
Foreign Direct Investment	22,183	-	-	-	22,183
External Loan[5]	8,387	-	-	(10,850)	(2,463)
Total	**61,409**	**9,481**	**32,091**	**2,601**	**96,100**
Net Change in Financing (2007)					
Financial Intermediaries					
Banking Institutions	24,376	9,491	27,169	(328)	51,217
Development Financial Institutions (DFIs)[2]	3,326	877	6,126	-	9,452
Other Domestic Intermediaries[3]	13,421	(218)	1,112	-	14,534
Capital Market					
Bond Market[4]	32,849	-	-	24,780	57,629
Equity Market	7,126	-	-	-	7,126
Venture Capital	-	-	-	-	-
External Financing					
Foreign Direct Investment	27,939	-	-	-	27,939
External Loan[5]	2,178	-	-	(13,926)	(11,749)
Total	**111,215**	**10,150**	**34,407**	**10,526**	**156,148**

[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 the Treasury Housing Loan Division.
[4] Bond Market refers to outstanding private debt securities (PDS) and all Malaysian government securities.
PDS includes irredeemable convertible unsecured loan stocks (ICULS) and medium term notes (MTN) issued by the corporate sector.
[5] External financing of Government includes financing to non-financial public enterprises (NFPEs).

strong growth of 8.6% (2006: 6.3%) during the year. While there was greater risk aversion for securities below the AA-rating, the bond market remained vibrant, with several large issuances contributing to the highest annual amount of funds raised to date, amounting to RM66.5 billion (2006: RM30.7 billion).

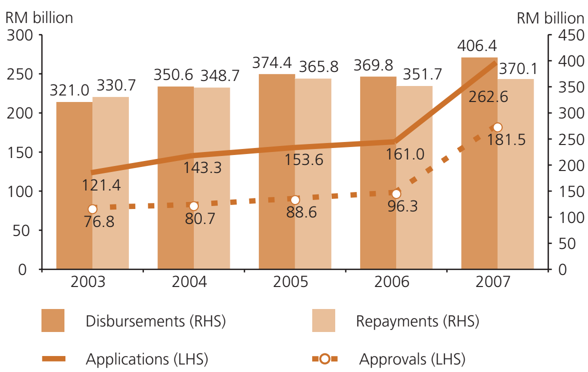
The concerted efforts undertaken by Bank Negara Malaysia in positioning Malaysia as the leading Islamic financial hub have yielded positive results. In 2007, issuances of Islamic securities rose by 161.2% to account for 62.7% of total PDS issued. Two of the largest issuances in the corporate bond market, amounting to RM22.4 billion, were sukuk. Meanwhile, the disbursements of Islamic financing increased at a rapid pace of 22% in 2007 (+11% in 2006) to account for 11.6% of total loans disbursed by the banking system.

Financing to the Business Sector

In 2007, the demand for financing by businesses was underpinned by the sustained growth in business and investment activity. Businesses supported their activities by acquiring a larger amount of financing from bank loans and the capital market, as well as from internal funds. Although bank loans continued to account for a significant share in the total financing to businesses (25.9%), the types and mechanisms of financing have gradually changed over the years, amid the evolving nature of the economy and the financial system (see Box Article). In essence, businesses are relying more on the banks for short-term financing to fund their working capital, whilst using the bond market to secure longer term financing for capital investments.

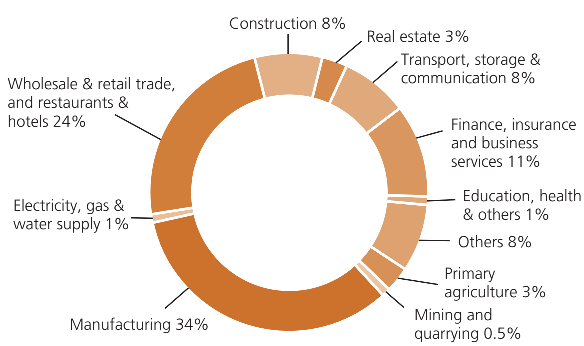
New loan applications and approvals to the businesses registered strong growth rates of 63.1% and 88.4% respectively (2006: 4.8% and 8.7% respectively). Compared to 2006, loan disbursements turned around to register a stronger growth of 9.9% (2006: -1.2%). The bulk of the loans disbursed to businesses were for the purpose of working capital (75.6% of total loans disbursed), with larger amount of funds channeled to the manufacturing (mainly domestic-oriented industries), wholesale trade, and construction sectors – economic sectors that experienced stronger activity during the year. Mergers and acquisitions activity in the finance, insurance and business services sector spurred higher loans to this sector, which was also reflected in loans extended for the purchase of securities. A significant development during the year was the disbursement of a large syndicated bridging loan by several banks to finance the privatisation activity of a company. The loan, however was refinanced in December 2007 via the private debt securities market.

Chart 2.41
Business* Sector Loan Indicators



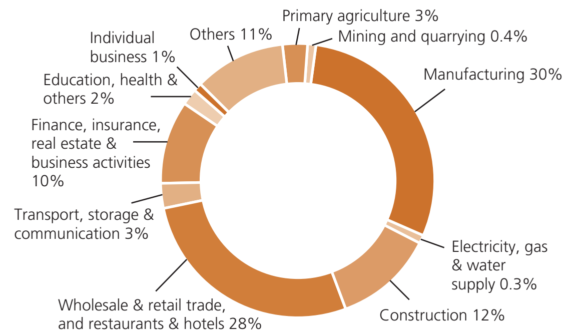
* Businesses includes non-bank financial institutions, domestic non-business entities and foreign entities

Chart 2.42
Business Loan Disbursements by Sector in 2007



Total : RM 406.4 billion

Chart 2.43
Loan Disbursements to SMEs by Sector in 2007



Total : RM 141.5 billion

The SMEs, meanwhile, continued to enjoy greater access to financing from the banking system and the development financial institutions (DFIs), including financing under the Special Funds administered by Bank Negara Malaysia. Outstanding SME loans of the banking system rose at a higher growth rate of 9.1% in 2007 (2006: 5.1%) to account for 17.7% of total outstanding banking system loans. While the distribution of funds remained broad-based, the manufacturing, wholesale and retail trade, and construction sectors accounted for the biggest shares of 30%, 28% and 12% of total loans disbursed to SMEs respectively. The year 2007 also marked the introduction of a new avenue of financing for the SMEs. In May, Cagamas SME Berhad issued an inaugural synthetic collateralised loan obligation amounting to RM600 million, which was backed by a SME loan portfolio residing at a banking institution.

Financing via the bond market (excluding Cagamas and issuance by non-residents) was buoyant in 2007, with gross funds raised rising

Table 2.4
Special Funds for SMEs administered by Bank Negara Malaysia

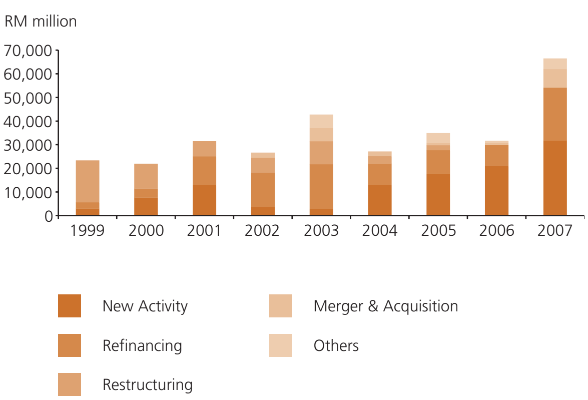
Type of fund	RM million					%	
	Allocations	Approvals	Disbursements	Repayments	Loans Outstanding	Utilisation Rate[1]	Undrawn[2]
	As at end-2007						
Fund For Food	1,300.0	1,730.4	1,706.5	1,366.3	340.2	133.1	1.4
New Enterpreneurs Fund 2	2,850.0	3,436.6	3,203.1	807.1	2,396.0	120.6	6.8
Fund for Small and Medium Industries 2	6,750.0	10,117.9	8,776.3	3,981.5	4,794.8	149.9	13.3
Bumiputera Enterpreneurs Project Fund	300.0	760.3	656.2	584.9	71.3	253.4	13.7
Rehabilitation Fund for Small Businesses	200.0	17.7	19.9	10.5	9.4	8.9	12.4
Special Relief Guarantee Facility	500.0	471.9	-	-	-	94.4	100.0
Total	**11,900.0**	**16,534.9**	**14,362.0**	**6,750.3**	**7,611.7**	**138.9**	**13.1**
	Change during the year						
Fund For Food	-	37.9	24.3	384.5	360.2		
New Enterpreneurs Fund 2	-	229.9	338.9	259.3	79.6		
Fund for Small and Medium Industries 2	-	2,297.7	1,717.3	1,721.7	4.4		
Bumiputera Enterpreneurs Project Fund	-	160.4	139.5	130.9	8.5		
Rehabilitation Fund for Small Businesses	-	0.5	4.2	4.9	0.7		
Special Relief Guarantee Facility	500.0	471.9	-	-	-		
Total	**500.0**	**3,121.5**	**2,224.3**	**2,501.4**	**277.2**		

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

significantly to RM66.5 billion (RM30.7 billion in 2006). Despite large redemptions during the year, the net issuance of debt securities (excluding Cagamas and issuance by non-residents) was still higher at RM19 billion (2006: RM10.1 billion). The bulk of the PDS issued during the year were used for new investment activity (48%), the refinancing of existing debt (34%) and for mergers and acquisitions activity (12%).

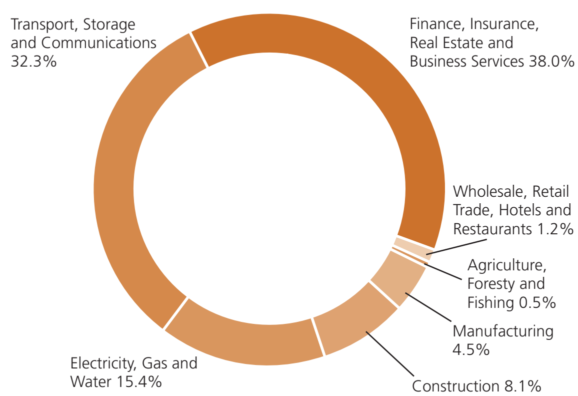
During the year, there were several large PDS issuances with the longer maturity profiles being used to fund the privatisation of a major telecommunications firm as well as the acquisition of an energy provider. The share of PDS with tenures of more than 10 years rose to 30% of total PDS issued (2006: 27%). In addition, the year also witnessed considerable progress in asset securitisation, as reflected by the higher issuance of asset-backed securities (ABS). A total of RM7.4 billion was raised in

Chart 2.44
PDS Financing by Purpose
(Excluding Cagamas and Issuance by Non-Resident)



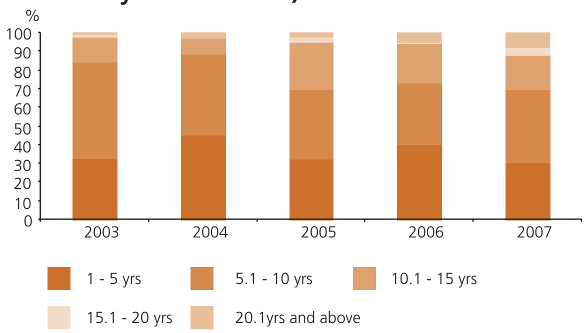
Source: Bank Negara Malaysia

Chart 2.45
PDS by Sector in 2007:
In Terms of Amount Issued
(Excluding Cagamas and Issuance by Non-Resident)



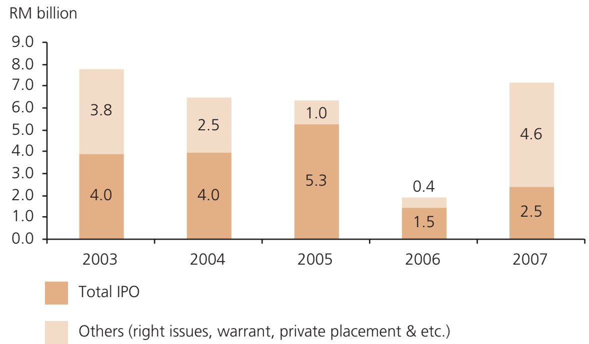
Source: Bank Negara Malaysia

Chart 2.46
PDS Issues by Tenure (Excluding Cagamas and Issuance by Non-Resident)



Source: Bank Negara Malaysia

Chart 2.48
Total Financing Raised via the Equity Market

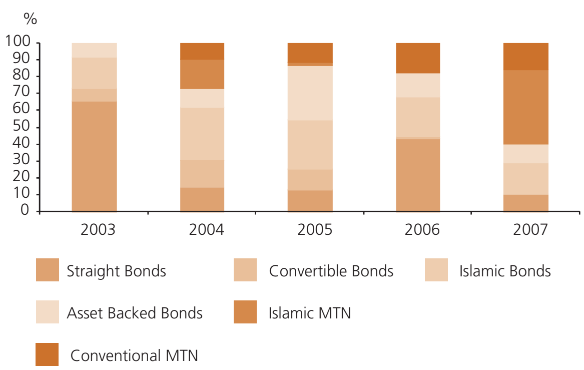


Source: Bursa Malaysia, Bank Negara Malaysia estimates

the capital market through the issuance of ABS (including residential mortgage-backed securities or RMBS). This accounted for 11.1% of funds raised in the capital market.

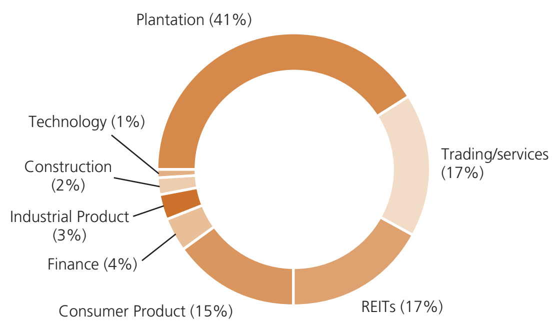
Financing via the equity market, was also significantly higher in 2007. Total funds raised from the market increased to RM7.1 billion from RM1.9 billion in 2006. New funds were mostly raised through rights issues (61%), followed by initial public offerings or IPOs (35%). The plantation, trading and services and Real Estate Investment Trusts (REITs) sectors raised the most funds through IPOs.

Chart 2.47
PDS Issues by Type of Instruments (Excluding Cagamas and issuance by Non-Resident)



Source: Bank Negara Malaysia

Chart 2.49
Initial Public Offerings by Sectors in 2007



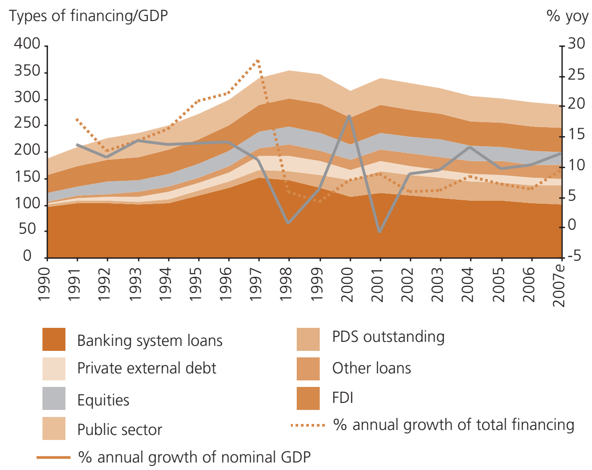
Source: Bursa Malaysia and Bank Negara Malaysia estimates

The Evolution of Financing Sources for the Malaysian Economy

Since the early 1990s, amidst relatively strong and sustained growth, the Malaysian economy has undergone significant structural change and has become more diversified. The financial system, which plays a pivotal role in facilitating and supporting economic growth, has also undergone significant transformation. Financial deepening, coupled with the changing sources of growth of the economy, has contributed to the changing structure of the sources, types and level of financing.

The financing ratio (total financing[1] as a percentage to GDP) has steadily moderated since 2001, with financing growing at a slower pace compared with nominal GDP (see chart 2.50). This is a clear divergence from the trend for most of the 1990s, when financing growth exceeded the growth of GDP. The moderating trend in the ratio can be largely attributed to structural changes in the economy, with private consumption gaining prominence over private investment as the key growth driver. Such a marked shift in growth patterns was evident when comparing the periods before and after the Asian crisis. During the pre-crisis period (1990-1997), the economy was driven mainly by investment, with a higher volume of financing for capital-intensive industries and large infrastructure projects. Loans extended to the business sector experienced a strong average annual growth of 30% over the period. With the sources of growth of the economy shifting from investment to consumption, especially since 2001, the financing needs of the economy became less intense. In the post-crisis period (2001-2007), the corporate sector focused on de-leveraging and following the period of over investment, private investment began to decelerate. Consequently, the financing profile of businesses also changed, with businesses mainly borrowing short term to meet working capital needs, reducing their long–term loans for investment and relying more on the bond market, thus causing loans outstanding of the business sector to advance at a slower pace. At the same time, the shift in bank financing to the household sector resulted in a significant reduction in the average size of loans disbursed, mainly because financing to households for the purchase of fixed assets and consumption durables were smaller compared to the amount required for investment outlays by businesses. The combination of these factors led to a decline in the financing intensity by the banking institutions.

Chart 2.50
Financing Ratio of the Malaysian Economy, 1990-2007



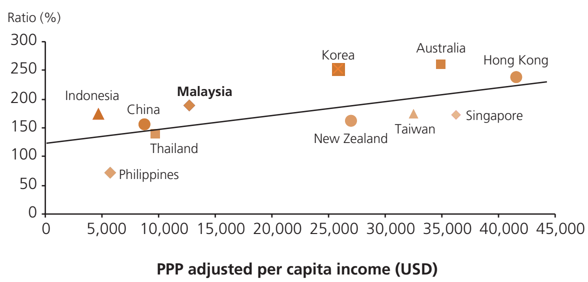
e Estimate
Source: Bank Negara Malaysia calculations

[1] Total financing comprises of two main components: (1) Domestic sources which consist of loans from the banking institutions, PDS, equities and loans from other domestic non-bank financial institutions (development financial institutions, Employee Provident Fund, insurance companies, leasing and factoring companies, the Treasury Housing Loan Division and Malaysia Building Society Berhad). (2) External sources which consist of foreign direct investments as well as short and long-term borrowings from abroad.

The different sectors of the economy also exhibited varying degrees of financing intensity, which is defined as the ratio of financing to sectoral output. The construction sector, which was one of the primary drivers of economic growth during the pre-crisis period, was characterised by a high financing intensity, as more capital was needed for construction and large infrastructure projects. The manufacturing and services sector, which became the biggest contributors to economic growth after the crisis, have lower financing requirements. The lower financing intensity in the manufacturing sector could be attributable to the large presence of MNCs, which rely more on internally generated funds for their operations. The services sector requires less financing for their investments given that the nature of their operations are less capital intensive. The shift in the sectors that drive economic growth thus is also a key factor accounting for the moderation in the financing to GDP ratio.

Although the financing to GDP ratio has moderated over the past several years, it has remained at a relatively high level. A cross-country comparison indicated that at 189%, the ratio of outstanding banking system loans and private debt securities to GDP for Malaysia was relatively high given its level of development, compared to some other regional countries (see chart 2.51). This was due to several factors. With regards to bank financing, Malaysia has a successful policy of promoting financial inclusion across regions and sectors. Households, for example, faced minimal constraints in accessing bank financing. Even as early as the first half of the 1990s, lending for the purchase of properties and cars had already accounted 20.4% of the total outstanding loans of the banking system (2007: 41.8% of total outstanding loans). An added impetus to the growth in household loans was that in the aftermath of the Asian crisis, the banking institutions shifted their focus from the business sector to the financing of the household sector as part of their business diversification strategies. Combined with the Government's policy of raising home ownership, which was manifested through various measures, household borrowing experienced marked growth in 2001-2005.

Chart 2.51
Financing[1] to GDP Ratio and PPP Adjusted per Capita Income: Country Comparison in 2007



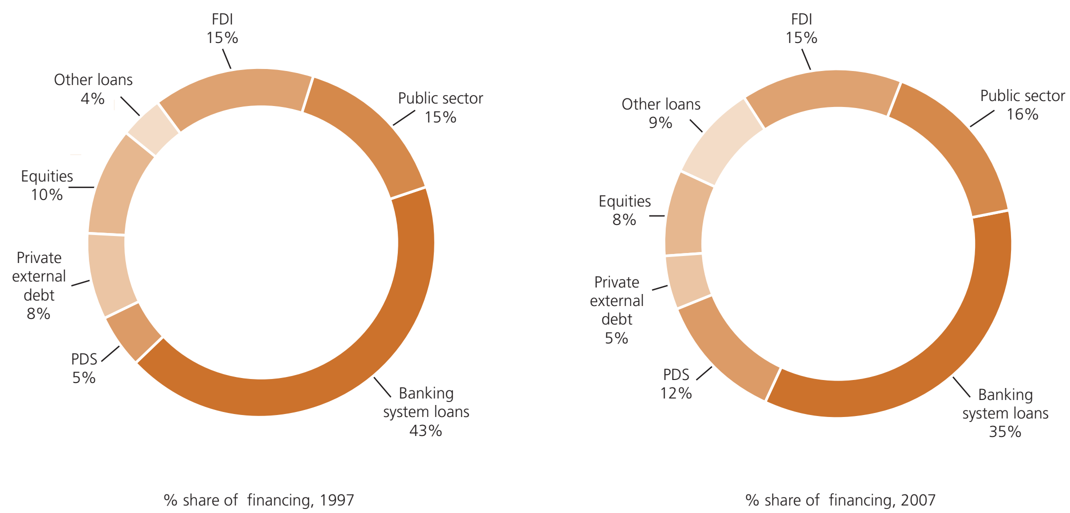
[1] Financing comprises of only banking system loans as well as private and public bonds outstanding

Source: Based on Bank Negara Malaysia calculations; data from Asian Bonds Online, CEIC and World Economic Outlook databases.

There were also significant changes in the sources of financing for the economy. In the last decade, the financial system in Malaysia has strengthened significantly and undergone significant transformation thus creating a more diversified and deeper financial system. Of significance has been the growing importance of the capital market in providing medium to long-term funding for corporates. Bank Negara Malaysia, together with other agencies undertook various measures to develop a strong market infrastructure and a comprehensive legal and regulatory framework to support the growth of the bond market. The Asian Development Bank, in June 2006, ranked the Malaysian debt securities market as the second largest in Asia after Japan. The share of financing through the issuance of PDS grew substantially from 5% of total financing in 1997 to 12% in

2007 (see chart 2.52). Although the share of loans extended by the banking system relative to overall financing declined from 43% to 35%, the banking system, nevertheless, remains an important source of financing for the working capital of businesses as well as for funding household investment and consumption. Over the same period, the share of household loans to total banking system loans increased from 33% to 56%. The role of other domestic intermediaries, namely the development financial institutions (DFIs), insurance companies and housing credit institutions as alternative providers of financing has also become more important. These institutions complemented the banking institutions by providing financing to selected sectors of the economy. More specialised institutions such as the DFIs have been increasing their financing, especially to the SMEs. As a result, financing from DFIs has expanded strongly at an average annual growth rate of 33% over the last seven years, to account for a larger share of 5.1% of total financing as at end-2007 (1.0% as at end-1997).

Chart 2.52
Sources of Financing



A distinctive development in the financing of the economy has been the growing importance of Islamic financing. Bank Negara Malaysia has implemented a range of measures to develop the Islamic finance industry, which have yielded significant results. Over the period of 2001-2007, financing via Islamic instruments expanded significantly at an average annual growth of 23% to support funding for new growth areas and to serve as an alternative source of financing for the economy.

In recent years, new measures have been introduced to deepen and enhance the efficiency of the financial system. Among others, key measures include the liberalisation of foreign exchange administration rules to allow multilateral financial institutions and multinational corporations to issue both ringgit and non-ringgit denominated instruments in the capital market; the launch of Malaysia International Islamic Financial Centre (MIFC) initiative; allowing locally incorporated foreign banks to establish Islamic subsidiaries; and the introduction of web-based Fully Automated System for Issuing/ Tendering (FAST). With these measures, the financial system will continue to evolve and become more effective in intermediating financial resources and risks, and supporting the continued transformation of the Malaysian economy.

Financing to the Household Sector

Financing of the household sector has been a major focus of growth by the banking institutions. Of the total increase in banking system loans outstanding in 2007, 55.6% was to the household sector. During the year, bank loans disbursed to the household sector advanced by 12.6% (2006: -1%). The strong performance was largely attributed to strong income growth of households, underpinned by stable employment prospects and rising wages. Wealth effects from the robust performance of the stock market, coupled by Government incentives as well as attractive and competitively priced loan products offered by banks were among the contributing factors to household loans reaching their highest level since 2005.

Loan disbursements for the purchase of residential property rebounded strongly to grow by 12.5% in 2007 (2006: -5.6%). Positive outlook for income and employment prospects underscored the strong increase in the demand for residential property. This was further augmented by various measures and initiatives introduced by the Government and other regulatory agencies to boost the residential property sector. Following the announcement of the exemption of real property gains tax in March 2007, financing for the purchase of residential property rose steadily to register firmer growth in the second half of 2007. The trend is expected to continue with the introduction of additional measures such as the 50% exemption of stamp duty on purchases of houses below RM250,000 as well as the monthly withdrawal from EPF Account II for the repayment of housing loans effective January 2008. This contributed to the strong growth in housing loan applications and

Chart 2.53
Household Sector Loan Indicators

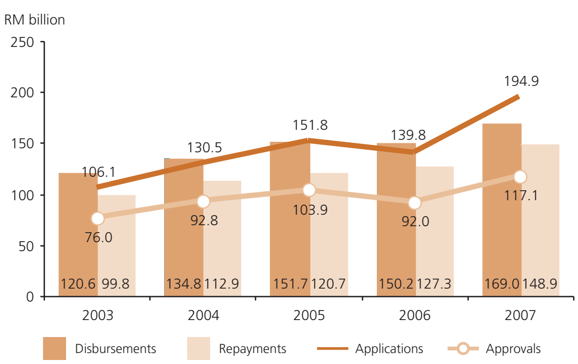
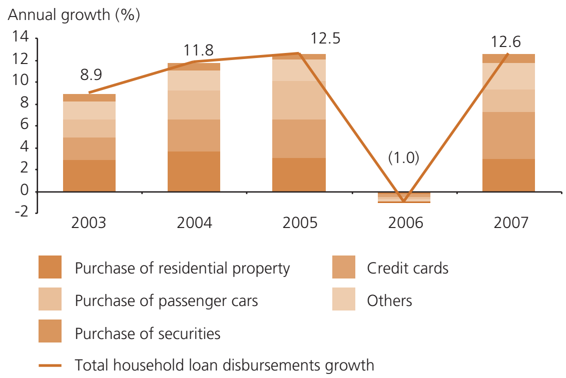


Chart 2.54
Banking System Loan Disbursements to Households: Total Growth and Contribution by Purpose



approvals at 43.8% and 27.3%, respectively, in 2007 (2006: -7.2% and -11.5% respectively).

During the year, consumption credit expanded amid higher utilisation of credit cards and the drawdown of personal loans. Nonetheless, the repayment ratio[2] for credit cards remained high at 58.4% (2006: 58.2%) reflecting the continued use of credit cards as a means of payment rather than as a mode of financing.

Financing for the purchase of passenger cars turned around to register positive growth in second half of the year. For the year as a whole, car loans declined at a slower pace of -0.2% (2006: -27.2%). The rebound in growth was consistent with the revival of the car market following the launches of new mass-market and fuel-efficient models. More importantly, the used car market has also begun to see more stable prices, which facilitated consumer decisions to sell and replace their cars.

Despite the robust growth in financing, the overall level of household indebtedness remained at prudent levels. This was evident from the substantial improvement in the non-performing loans (NPL) ratio of households from 7.1% in 2006 to 5.3% in 2007. In addition, the NPL ratios for outstanding loans for residential property, passenger cars and credit cards were lower at 7.2%, 2.6% and 2.5% respectively (2006: 8.8%, 4.2% and 3.7% respectively).

[2] Repayment ratio = [(Total spending + cash advance) – outstanding balance] / (Total spending + cash advance).

Monetary Policy in 2007

Monetary Policy in 2007

OVERVIEW

In fulfilling the objective of maintaining price stability and promoting sustainable economic growth, monetary policy in 2007 was complicated by the dual challenge of inflationary pressures emanating from escalating global commodity and food prices, and heightened downside risks to growth arising from unstable global financial markets. Although domestic demand had accorded considerable resilience to the economy, as a small and highly open economy, Malaysia is not insulated from external developments. Consequently, the growth momentum of the economy and the threat to inflation were clouded by considerable uncertainty. Developments in 2007 heightened the uncertainties given the wide range of possible outcomes surrounding growth and inflation, on account of the complexity of the issues facing the global financial markets and their potential impact on the US and global economy.

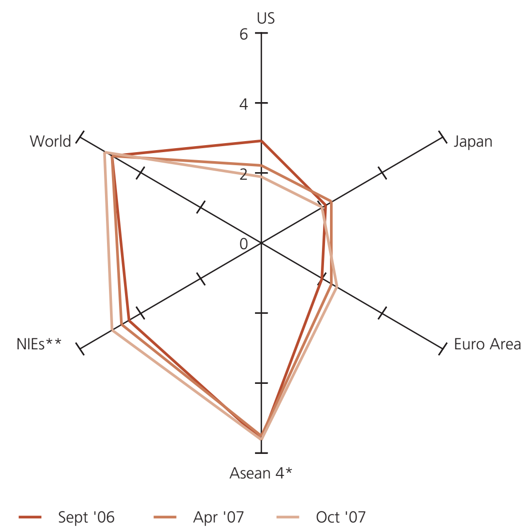
In 2007, monetary policy was confronted with the dual challenge of inflationary pressures emanating from escalating global commodity and food prices, and heightened downside risks to growth arising from unstable global financial markets

While the risks of slower global growth and higher inflation became more elevated as the year progressed, there was, however, no clear indication that one risk exceeded the other. The overall assessment was that the risks to growth and inflation were about balanced. The Monetary Policy Committee (MPC), therefore, judged that the prevailing monetary conditions were consistent with the medium term growth and inflation outlook, and the Overnight Policy Rate (OPR) was left unchanged at all of the eight policy meetings during the year.

MONETARY POLICY IN 2007

At the outset of 2007, conditions appeared to be favourable to the Malaysian economy achieving a growth rate that was projected to be close to the potential of the economy and for inflation to moderate from the levels in 2006. The prospect of moderating growth of the US economy and the consequent implications for global and regional growth were incorporated into the Bank's forward-looking assessment. The baseline scenario was that some softening in Malaysia's external sector was anticipated but it was not expected to be severe. The momentum of growth in domestic demand in the economies in the euro area and Asia was strong. The Asian economies were benefiting from rising final demand within Asia and hence, greater intra-regional trade. Two-thirds of Malaysia's trade is now with Asia, and therefore, the robust performance of the Asian economies would, to a certain extent, reduce some of the impact of the US slowdown.

Chart 3.1
Outlook for Real GDP Growth in 2007
(Annual change, %)



Source: IMF, WEO September 2006, April and October 2007
*Indonesia, Malaysia, Philippines and Thailand
**Newly Industrialised Economies

Of crucial significance for the Malaysian economy, domestic demand was expected to provide strong support to economic growth. Robust domestic demand was supported by the strengthening of private consumption and private investment activities, while the public sector was set to play an important supportive role. The economy was expected to expand at a stronger pace in the second half of 2007 underpinned by key growth-supporting developments, namely the implementation of projects under the Ninth Malaysia Plan, the commencement of production at a key oil field and gas plant, as well as the expected significant increase in tourist arrivals during the peak summer travel season.

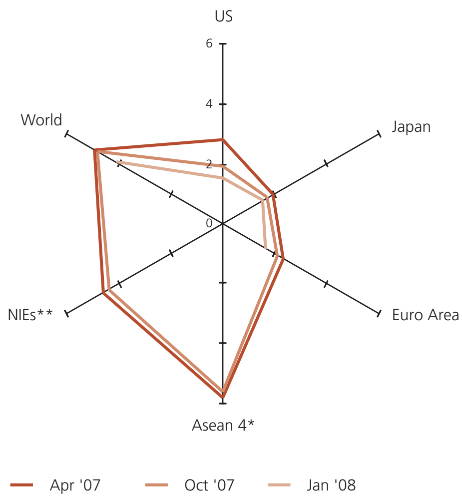
In May, there were, however, some market expectations for a reduction in the OPR following the release of weak data for the growth of exports and the industrial production index (IPI). Market expectations subsequently adjusted to an unchanged policy rate outlook for 2007 following the availability of a more complete set of indicators with the release of the first quarter GDP growth. The Bank's assessment at the time was that although exports, especially manufactured exports, had shown signs of softening, a broad range of forward-looking indicators pointed to sustained economic activity going forward. These included the uptrend in the Department of Statistics Leading Index, the double-digit increase in loan applications and approvals, as well as the relatively upbeat consumption and investment sentiments.

As the year progressed into the second half, the uncertainties surrounding US financial stress and global growth prospects increased. The global financial markets, which had been experiencing bouts of volatility arising from growing and mixed concerns about global imbalances, equity and property market overvaluations and exchange rate adjustments, experienced significant turbulence in August and September amid mounting concerns over the deterioration in the US subprime mortgage market. The rapid and significant reassessment of risks associated with US subprime-related securities created turmoil in the credit markets and led to the evaporation of liquidity from the interbank markets in the US, UK and Europe. This necessitated major central banks injecting large amounts of funds into the interbank markets to alleviate liquidity shortages and to bring interbank interest rates back down to their normal levels. In the Malaysian bond and equity markets, the reassessment of risks and increased caution by international investors led to episodes of outflows, causing considerable market volatility. Nevertheless, given the surplus liquidity condition, the demand for funds amidst the outflows was met comfortably through the non-rollover of short-term lending by banks to Bank Negara Malaysia. The possible adverse consequences for financial stability were also mitigated by the absence of direct exposure of domestic banks and the non-bank private sector to US asset-backed subprime-related securities.

Though the impact of market contagion on the Malaysian economy was largely contained, of greater concern was the spillover effect of the financial turbulence on global growth prospects. Downside risks became more pronounced towards year-end, as financial market strains and the US housing downturn appeared to be more widespread and deeper than previously anticipated. With these developments causing financial market meltdowns and weighing down heavily on US growth prospects, the Federal Reserve aggressively reduced its policy rate by large magnitudes in successive moves in September and in the last quarter of the year. Uncertainty over the degree and duration of the impact on global growth prospects also affected the policy bias for several economies, with a greater tendency for easing in several major economies towards the end of the year, in contrast to the tightening stance that was more prominent in the early part of the year. While central banks in regional economies were on a tightening stance in the early part of the year, there was a shift towards a more cautious stance towards the end of the year. Although the International Monetary Fund (IMF) made a marginal downward revision to its world growth forecast for 2008, from 4.9% in April 2007 to 4.8% in October 2007, by December 2007, however, it acknowledged that downside risks had increased markedly[1] . Thus, while global economic activity continued to remain resilient in the second half of 2007 with relatively robust growth in the Asian economies, global growth prospects were clearly subject to increased downside risks.

[1] In January 2008, the IMF further revised its world growth forecast for 2008 to 4.1%.

Chart 3.2
Outlook for Real GDP Growth in 2008
(Annual change, %)



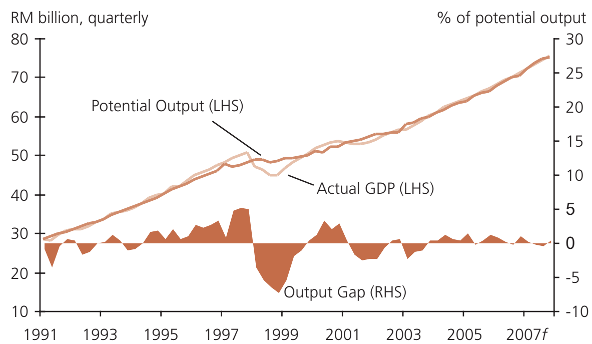
Source: IMF, WEO April 2007, October 2007 and January 2008
*Indonesia, Malaysia, Philippines and Thailand
**Newly Industrialised Economies

The domestic economy performed strongly in the third quarter of 2007, registering a growth rate of 6.6%, with faster growth in private consumption, and in both private and public investment. Near-term forward-looking domestic demand indicators pointed to sustained activity, and the economy was very much on track to achieve the 6% growth projection for 2007. With the economy operating from a position of strength, underpinned by a more diversified economic structure and a healthy financial system, the likelihood of a baseline scenario of relatively steady growth in 2008 increased. Nevertheless, the heightened downside risks to global growth had generated greater downside risks to this baseline scenario. The degree to which these downside risks to global growth could take place would determine the actual outcome on domestic growth.

The evolving global growth prospects and its implications for the domestic economy also needed to be balanced against the inflation outlook. The Bank's forecast early in the year was for domestic headline inflation to moderate, averaging 2.0 - 2.5% in 2007, following the lapse of the effects of the increase in retail petrol prices in March 2006. It was, however, recognised that a key upside risk to inflation emanated from increasing global commodity and food prices.
The pass-through of these prices to domestic prices, nevertheless, was expected to be somewhat mitigated in 2007 by several factors, including capacity expansion and strong competition among producers and retailers. The economy was projected to operate close to its potential with a small negative output gap, suggesting limited demand-driven inflationary pressures. Additionally, the existence of administered and controlled prices for selected food items, and petrol and petroleum-related products, to some extent, reduced the impact of the global price pressures on domestic prices.

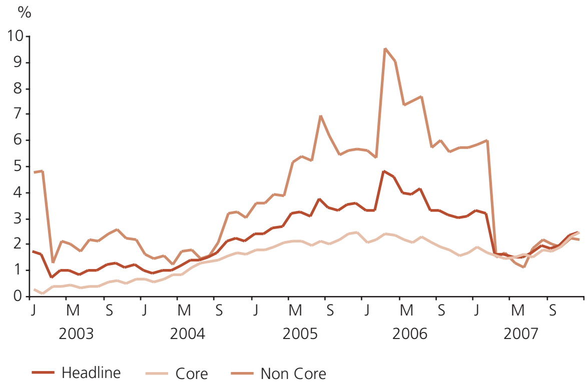
With the lapse of the effect of the fuel price adjustment and in the absence of new impetus to price increases, headline inflation trended downwards in the first half of 2007, averaging only 1.4% in the second quarter. In the second half of 2007, however, headline and core inflation edged up gradually, both averaging 2%. The rise was primarily a cost-driven phenomenon and was most discernible in food prices. Global oil and food prices had continued to escalate because of cyclical and structural factors. Higher global oil prices, however, did not translate into higher domestic fuel prices as the subsidies provided by the Government were unchanged during the year. Higher global prices of food commodities, however, had a more direct impact on domestic prices. A notable manifestation of this was the increase in wheat-based food product prices following the increase in the administered price of general-purpose wheat flour in May 2007.

Chart 3.3
Actual and Potential GDP as at March 2007



f Forecast

Chart 3.4
Headline, Core and Non Core Inflation



Stronger demand, arising from higher domestic purchasing power, also played an ancillary role in the price increases, allowing producers to pass on increases in their costs into final consumer prices. Important catalysts for the firm trend in private consumption were increases in public and private sector wages, the increase in incomes arising from higher commodity prices, the wealth effects from the stock market, and the steady employment prospects. In addition, consumer sentiments remained strongly positive during the year.

As the year drew to a close, the elevated levels of global prices continued to pose upside risks to domestic inflation going forward. Analysts' forecast of average inflation for 2008 edged up from August 2007 onwards after a stepwise decline in the first seven months. Nevertheless, the expected average inflation rate of 2.7% for 2008 in December 2007 was not significantly different compared to the forecasts made at the beginning of 2007. The factors that had mitigated some of the inflationary pressures in 2007, namely capacity expansion, competition, and Government surveillance on prices and the monitoring activities on supply and distribution were expected to continue in 2008. It should be noted that slower global growth could also have a moderating impact on global commodity price trends. Thus, going into 2008, the inflation risks from cost-driven pressures were expected to remain elevated, but these were expected to be contained by the higher downside risks to global growth.

Given the assessment on the growth and inflation prospects, the OPR remained unchanged at 3.50% during 2007. In essence, the risks to growth and inflation were viewed to be broadly in balance at the eight MPC meetings during the year. Conditions became gradually more challenging as the year progressed, as the Bank had to confront opposing forces in the form of greater downside risks to growth and potentially higher upside risks to inflation. Monetary policy was thus aimed at achieving a balance between supporting economic activity and not generating undue demand-driven inflationary pressures. Of crucial importance was that the upside risks to inflation emanated mainly from cost-driven and global factors. Changing interest rates and monetary conditions was not considered the appropriate strategy to alleviate the impact of these developments. It was recognised that considerable price pressures originated from structural factors, which in turn, would require structural adjustments and policies to increase efficiency or flexibility of the economy.

With the OPR unchanged at 3.50% during the year, monetary conditions were assessed as being supportive of economic activity. Average nominal lending rates on new loans approved trended downwards in 2007, amidst ample liquidity and intense competition among banks. The supportive monetary conditions were reflected in the continued steady and broad-based growth in financing. Banking system loans outstanding expanded by 8.6% in 2007

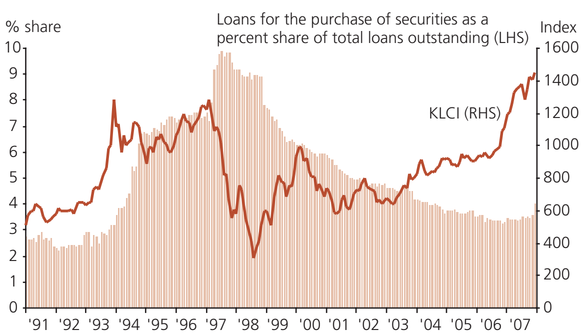
Chart 3.5
Average of Analysts' Forecast for 2008 Inflation

Source: Consensus Economics

(6.3% in 2006). In particular, this reflected stronger business loan growth as businesses across the various sectors sought financing for working capital and to expand production capacity. In the bond market, funds raised to finance new activity amounted to RM31.8 billion compared with RM21 billion in 2006. Notwithstanding the prevailing environment of surplus liquidity in the banking system, there was no evidence of excessive lending or over-concentration in specific sectors that could be fuelling inflationary pressures and excessive asset price increases. Although the growth in bank financing for share purchases picked up during the year amidst the uptrend in the KLCI, the increase remained relatively modest, especially when compared to the experience a decade ago. Overall, financing developments were assessed to be consistent with the objective of monetary policy of obtaining a balance between sustainable growth and price stability.

The trend in the ringgit exchange rate also affected monetary conditions. Strong two-way international trade and investment flows continued to determine the ringgit performance against the major and regional currencies during the year. In particular, volatility of portfolio flows in response to global developments created some volatility in the exchange rate of the ringgit. The Bank smoothened the impact of these flows on the exchange rate of the ringgit, while also sterilising the increase in liquidity to contain the impact of these flows on domestic monetary conditions.

Chart 3.6
Banking System Loans Outstanding for the Purchase of Securities



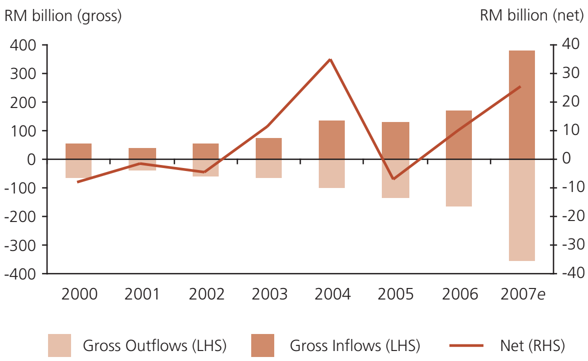
MONETARY OPERATIONS IN 2007

Bank Negara Malaysia conducted monetary operations to stabilise the average overnight interbank rate around the OPR and to ensure that there was sufficient liquidity in the interbank market. Through a combination of market operations and providing collateralised lending and deposit standing facilities at the upper and lower limit of the corridor respectively, the Bank ensured that the overnight rates traded within a corridor of ± 25 basis points of the OPR. Throughout the year, the ringgit overnight interbank rate was relatively stable and closely tracked the OPR with an average deviation (average interbank rate minus OPR) of less than one basis point.

The presence of excess liquidity posed a key challenge to monetary management during the year. The Asian region as a whole continued to receive substantial inflows during the year. For several countries in the region, liquidity management was a challenge on several fronts in terms of avoiding sudden and disruptive movement of the currencies, addressing the potential adverse impact on central bank balance sheets and limiting the inflationary effects on the economy and the financial system of the continued inflows. Central banks had turned to a broader range of monetary instruments, using both direct measures such as reserve requirements, and indirect instruments such as repos and the issuance of central bank papers to manage liquidity. Malaysia remained a net recipient of trade and capital flows, which contributed to an increase of RM58.6 billion or 24.4% in aggregate domestic liquidity during 2007. Net portfolio investments were higher during the year compared to 2006. The net position, however, masked the significant size of gross inflows and outflows, particularly during the key market events that occurred during the year, namely the global equity market correction in February, the global bonds sell-off in June and the subprime mortgage fallout in August and September.

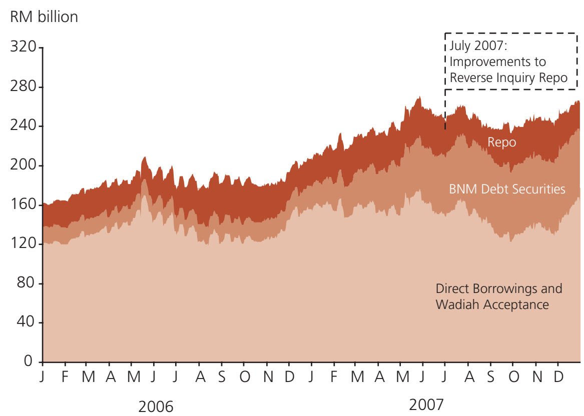
Several major overseas money markets experienced a severe liquidity crunch amidst the subprime mortgage turmoil in August and September. Though much calmer, the domestic money market was affected by the temporary

Chart 3.7
Portfolio Investment



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

Chart 3.8
Outstanding Monetary Instruments



reversal of capital flows arising from the pullback of portfolio funds during these periods. The liquidity impact from capital flow reversals was offset by the unwinding of existing outstanding sterilisation operations, thus ensuring an orderly adjustment in the money and financial markets.

The swift and flexible monetary response in dealing with such heavy outflows experienced in the August-September period was possible due to the short-term average maturity structure of the various monetary instruments utilised by the Bank in its operations. By the end of the year, the total amount of surplus liquidity sterilised by the Bank using various market-based monetary instruments amounted to RM309.7 billion. The weighted average maturity of these total borrowings was 39 days, which provided the Bank with significant operational flexibility. Furthermore, the Bank has at its discretion the ability to provide additional liquidity if necessary via reverse repo or its collateralised lending standing facility against the estimated RM160 billion of Class-1 liquefiable assets held by financial institutions as at the year-end.

In terms of the types of instruments used for monetary operations, uncollateralised direct borrowings and acceptance of Shariah-compliant deposit placements under the Al-Wadiah (custody and safekeeping) concept remained as the principal instruments, accounting for 51% of the surplus liquidity sterilised as at end-2007. The use of direct borrowings has been de-emphasised (74% of total sterilised liquidity as at end-2006) in favour of greater issuance of Bank Negara Monetary Notes (BNMNs) to further develop the short-term ringgit debt securities market. Operationally, the Bank increased the frequency of issuances to twice per week (from once a week in 2006) and raised the total outstanding amount from RM15.1 billion as at end-2006 to RM69.5 billion by end-2007.

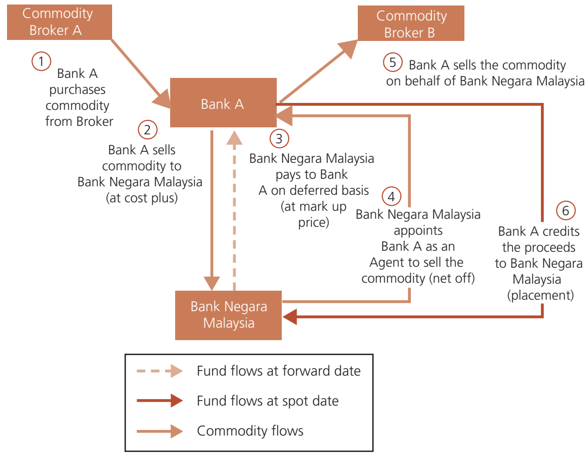
The importance of BNMNs as a monetary instrument has also grown, accounting for 26.4% of the total instruments utilised versus 11.2% in 2006. BNMNs are a preferred investment asset class compared to direct borrowings, as these securities are typically a short-duration low-risk asset class tradable in the secondary market and they qualify for Class-1 liquefiable asset status under the Liquidity Framework for banking institutions.

The Bank has also been fine-tuning its reverse inquiry repo facility for interbank market participants since 2 July 2007 to enhance its operational transparency and flexibility. The Fully Automated System for Issuing/Tendering (FAST) website provides a daily list of Malaysian Government Securities (MGS) available for loan via repo. The securities on this list are drawn from securities in the Bank's own inventory, as well as those that have been lent to the Bank by major institutional investors through the Institutional Securities Custodian Program (ISCAP). Through ISCAP, participating institutional investors transfer their MGS holdings to the Bank, and receive a fee. The Bank uses MGS borrowed through this arrangement as collateral in the Bank's repo operations. These measures have facilitated the greater use of repos in the interbank market, while also contributing towards the development of a market reflective benchmark yield curve for MGS.

A floating rate version of BNMNs was also introduced on 19 July 2007 to expand the spectrum of debt instruments used for managing liquidity in the financial market. This instrument allows the Bank to issue, and for investors to purchase, debt securities at longer maturity terms without undertaking correspondingly longer-term interest rate risks. The instrument also added a high quality issuer, for the first time, to the floating-rate debt securities market space. The inaugural issue pays a floating-rate coupon of the 6-Month Kuala Lumpur Interbank Offered Rate (KLIBOR) minus a pre-determined fixed spread. Price discovery of the fixed spread element is facilitated by way of a competitive variable-rate uniform price auction (also known as a Dutch auction) via the Principal Dealer network. The issue size of RM500 million was over-subscribed by 2.09 times and issued at par value to all successful bidders at the coupon rate of 6-Month KLIBOR minus 10 basis points that resets semi-annually. Future issuance of this instrument may also be pegged to alternative reference rates like the 3-Month KLIBOR and may have different coupon reset periods.

The use of Islamic monetary instruments increased to 23.2% of total instruments as at end-2007. The expansion of liquidity in the Islamic money market was contributed by the growth of Islamic financial assets in tandem with the increased number of full-fledged Islamic banks. A key development to enhance the efficiency of liquidity management in the Islamic money market was the introduction of the Commodity Murabahah Programme (CMP) on 8 February 2007. CMP is a cash deposit product that is based on a globally accepted Islamic concept. As depicted in Chart 3.9, CMP utilises over-the-counter crude palm oil contracts as well as

Chart 3.9
Commodity Murabahah Programme



selected metal contracts like palladium and platinum on the London Metal Exchange as the underlying commodity transactions to facilitate liquidity management.

Going forward, the Bank will continue to be confronted by the challenges posed by continued volatility in global financial markets, including volatility in global exchange rates. Such volatility would likely have significant influence on the direction of capital flows, which in turn, would have an impact on the domestic financial markets and the overall financial system. Thus, operational flexibility, through a diverse and effective set of monetary instruments, remains crucial for the Bank to continue to manage liquidity effectively. Continued strengthening and deepening of the domestic financial markets will further enhance both the capacity of the economy to absorb the large and volatile capital flows and the effectiveness of the Bank's market operations in dealing with them. In addition, in its catalyst role towards realising the vision of Malaysia as an International Islamic Financial Centre, the Bank will develop new and flexible Islamic monetary instruments that are widely acceptable among global investors.

Outlook and Policy

Outlook and Policy

INTERNATIONAL ECONOMIC OUTLOOK IN 2008

While moderation is expected in the developed economies in 2008, the growth momentum is expected to be sustained in Asia and the other emerging economies. The growth outlook would be dependent on the length and depth of the US slowdown, and the extent of the impact from financial market turbulence. Inflation is expected to remain elevated following sustained high oil and food prices. While these developments will have an impact on the Asian regional economies, the growth in the region will continue to be supported by strong domestic demand and the high growth momentum in the large economies in the region. Overall, the expectation is for global growth to moderate, reflecting a less favourable environment in the major industrial economies and continued uncertainty in the global financial markets.

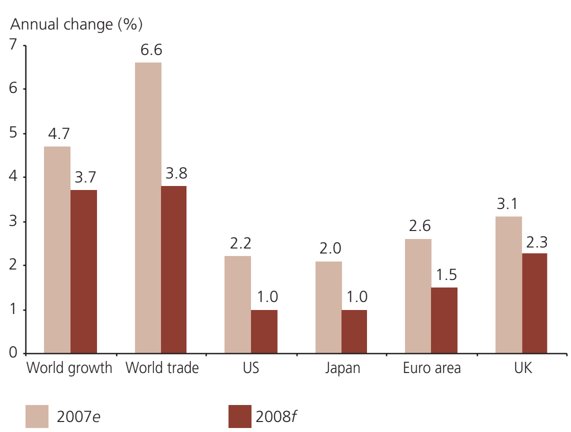
While moderation in growth is expected in the developed economies in 2008, growth is expected to remain strong in Asia and other emerging economies. However, the global growth outlook would be dependent on the length and depth of the US slowdown and the extent of the impact of the financial market turbulence

In the **US**, the prospects are for further weakening in the economy, with several indicators showing moderation across industrial activities, employment and consumption. The housing market correction is expected to continue as housing supply outstrips demand, while at the same time, household spending is likely to be affected by weakening labour market conditions. However, net exports are expected to lend some support with the weakness in the US dollar and the continued demand arising from the relatively stronger growth in the rest of the world. The risk to the outlook of growth of the US economy has increased significantly arising from uncertainties on the extent of the impact of the problems in the credit market and on the ability of the financial system to intermediate credit and its spillover effects on the broader economy. Constrained balance sheets and increasing risk aversion have already led to higher risk premiums and significant tightening of credit standards beyond housing loans, which would adversely impact the economy.

Nevertheless, policy responses that have been put in place are, however, expected to provide some support to the economy. These include aggressive easing by the Fed and the fiscal stimulus package announced. Possible resolution mechanisms are also being discussed to address the strains in the financial system.

Reflecting a further slowing of the US economy as well as some domestic developments in the euro economies, growth in the **euro area** is expected to expand at a slower pace. Slower export demand especially from the US and softer investment activity in construction amidst a broader slowdown in housing markets in several European economies are the major factors behind the more moderate prospects for growth in the

Chart 4.1
World Growth, World Trade and Growth in Major Industrial Countries (2007-2008)



e Estimate
f Forecast
Source: International Monetary Fund and Bank Negara Malaysia

euro area. However, consumption activity in the region will be supported by rising wages and lower unemployment rates. Furthermore, increasing integration of Central and Eastern Europe economies into the European Union would support growth amidst expansion of intra-EU trade. In addition to strong domestic demand and the presence of skilled labour amidst relatively low wages, ongoing economic restructuring and reform in the emerging European economies have attracted Western European companies to set up businesses and expand production chains in these economies.

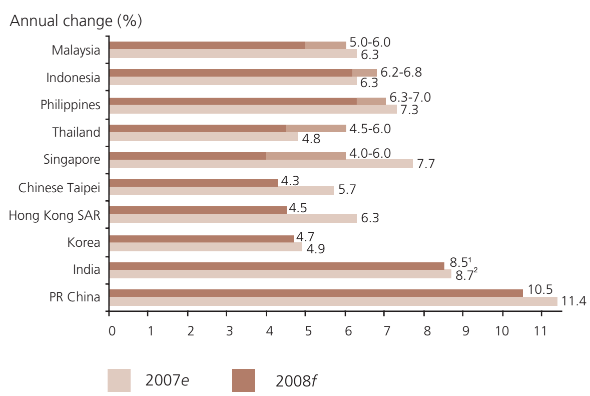
In contrast to the developments in the major developed economies, the growth momentum within the **Asian region** is expected to be relatively sustained in 2008. The slowdown in the US is likely to be mitigated by strong growth in PR China and India along with a vibrant economic expansion in commodity-exporting countries.

Prospects for **PR China**'s economy remains positive with continued high growth expected, despite a slight moderation in external demand and the effect of monetary tightening. Investment spending is likely to remain the main driver of growth for China, given the large need for infrastructure development and industrial upgrading. Private consumption is also expected to contribute more to economic activity as growth is gradually rebalanced from being investment-driven to being consumption-driven. Rising household income growth and living standards would support higher consumer activity as government efforts to redistribute growth to less developed regions take broader effect. However, export growth is likely to moderate in 2008 amidst slowing external demand and government efforts to reduce its current account surplus. There is, however, a rising concern on domestic inflation, attributed mainly to rising food prices and strong demand pressures.

India, which is increasingly becoming a driver of growth in the region, is also expected to register robust economic performance in 2008 supported mainly by investment and industrial expansion. Growth is also likely to be underpinned by strong consumer demand. Growth in the **Latin America** and the **Middle East** regions is also expected to remain strong, supported by strong domestic consumption benefiting from the high commodity and energy prices.

Meanwhile, the other **Asian regional economies** can be expected to experience some moderation in growth, reflecting the slowdown in external demand. However, the overall growth momentum is projected to be supported by strong domestic demand. Commodity prices are expected to remain relatively high, adding to the impetus for growth in several of the commodity-producing economies. Trends in the global semiconductor industry also suggest that a sustained albeit modest recovery can be expected as consumer electronics demand typically strengthens in a year coinciding with the Olympics. This would support electronics exports in several regional economies which are involved in this segment. Meanwhile, domestic demand is expected to play a central role in cushioning the impact of the moderation in external demand. Higher consumption activity is expected to remain supported by rising income levels and firm labour market conditions as seen in the generally low unemployment rates across the region. Implementation of infrastructure projects across the region is adding support to investment activity. In addition, flexibility in fiscal policy is expected as several regional economies have improved their fiscal positions over a number of years, while monetary policy remains accommodative for several of the regional economies. The substantial monetary easing undertaken in the Philippines, Thailand and Indonesia in 2007 would further stimulate growth in 2008.

Chart 4.2
Regional Countries: Real GDP Growth



e Estimate
f Forecast
1 Fiscal year 2007/2008
2 Fiscal year 2006/2007
Source: National authorities

In 2008, global and regional **inflation** is expected to remain elevated based on pass-through effects from higher commodity prices in the second half of 2007 and the expectation of continued high oil and food prices. Oil prices are expected to continue to be subject to pressures from sustained demand growth, supply constraints and potential supply-side shocks. While a significant softening of global growth may lead to some correction in commodity prices from the recent peak levels, underlying trends suggest that prices would remain elevated. Prices could also remain supported in the longer term with the emergence of commodities as a growing asset class for diversification and enhancing returns by fund managers. Therefore, inflationary pressures may persist while the risks to growth have increased. Against this backdrop, monetary policy actions are thus expected to vary based on country-specific conditions and the balance of risks to inflation and growth.

Notwithstanding these trends, several **risks** have increased the uncertainty on the global and regional outlook. In the event of a more protracted period of significantly below-trend growth of the US economy, accompanied by a sharper slowdown in other industrialised economies, there would be a larger impact on growth across the region as trade linkages to the developed economies remain strong. A further risk is the more severe impact from disruptions in the functioning of the financial markets and the financial intermediation process. Further adverse credit-constraining developments in the financial sector in several of the major economies could precipitate more widespread financial market volatility and damage business and consumer sentiment, while potentially prolonging the downturn in economic activity as more segments of financing activity are affected. However, in the event that there are larger than expected corrections in commodity prices, commodity-producing economies would be affected.

MALAYSIAN ECONOMY IN 2008

The outlook for the Malaysian economy in 2008 remains favourable. As a small and highly open economy, the outlook will be influenced by the current high degree of uncertainties in the global economic and financial environment, including the problems associated with the international credit markets and financial institutions. These uncertainties will have some impact on Malaysia, mainly through the trade and financial markets linkages.

The Malaysian economy is expected to remain on a steady growth path, expanding by 5 - 6% in 2008, supported by resilient domestic demand

The resilience of the Malaysian economy to weather a slowdown in the global economy has, however, strengthened over the years, due to a number of factors. First is the emergence of domestic demand as a key driver of growth. The strong economic growth of 6.3% in 2007 was achieved due to the robust expansion in domestic activities despite a moderation in external demand. Second, Malaysia's export markets are increasingly diversified, with almost 54% of total exports to the Asian (exclude Japan) economies (2001: 46.2%). Meanwhile, the share of Malaysia's exports to US has declined to 15.6% in 2007 from 20.2% in 2001. Thus, while global growth is expected to moderate in 2008 due mainly to slower growth in the US, and to a lesser extent, in Europe and Japan, the outlook for strong economic growth in the Asian region and other emerging economies would support the export sector. Third, as a commodity producer, Malaysia will continue to benefit from high prices of crude oil, palm oil and rubber. In addition, the strong base in the commodity sector would further strengthen the linkages with down-stream activities, including the resource-based industries which will continue to benefit from the robust domestic demand as well as demand from the regional economies.

Against this backdrop, the Malaysian economy is projected to expand by 5 – 6% in 2008. Domestic demand is expected to remain resilient, providing strong support to the economy. While consumer and business sentiments could be affected by the prospects of a sharper than expected global economic slowdown and uncertainties in the international financial markets, the major underlying factors supporting domestic private sector activities are expected to remain generally intact in 2008. Private consumption will be supported by the steady growth in income, firm labour market conditions, high commodity prices as well as a conducive financing environment. The diversified and high level of approved domestic and foreign direct investments for a number of years now, particularly in the manufacturing, services, and oil and gas sectors, indicate that private investment activity will remain robust in 2008. In addition, private investment will also benefit from measures implemented to further improve business environment, including the reduction in corporate tax rate, as well as intensification of implementation of projects under the Ninth Malaysia Plan (9MP) and the economic corridors. The public sector will continue to remain supportive of growth in facilitating the efficient implementation of these projects.

All sectors are projected to record strong growth in 2008, with the exception of the manufacturing sector for which growth is projected to moderate further to 1.8% (2007: 3.1%) in tandem with the weakness in external demand. The services sector will be supported by the resilient private consumption and a robust tourism sector, while the implementation of the 9MP projects as well as investment in the oil and gas sector would underpin the growth momentum in the construction sector. The agriculture and mining sectors will register stronger growth following expected higher production of palm oil and rubber, as well as crude oil respectively.

Global inflation, which is to remain elevated based on the expectation of continued high commodity and non-commodity prices, is expected to exert upward pressure on the domestic inflation. In particular, these developments are expected to have an impact on domestic food prices. However, the ability of producers to pass on cost increases into consumer prices would depend on the strength of consumption demand and to what extent consumers substitute from the more expensive goods into cheaper ones. In addition, softer global growth in 2008 could also contain the rise in global commodity prices. On balance, the average headline inflation rate for 2008 is expected to be in the range of 2.5 – 3%.

On the external front, the weaker demand for manufactured exports, particularly for the E&E products, will be partly offset by the relatively strong growth in exports of commodities and non-E&E manufactured products. The services account will continue to record a surplus supported by the higher tourism receipts expected in conjunction with the extension of Visit Malaysia Year campaign to August 2008. The surplus in the current account, therefore, is projected to remain high, albeit lower at 14.4% of GNI. The financial account is expected to remain favourable, supported mainly by the continued inflows of foreign direct investment. In addition, continued retention by the multinational corporations (MNCs) of a significant amount of their profits in Malaysia and new inflows of equity capital for acquisition of domestic businesses by foreign investors are also expected for 2008.

There is great uncertainty on the depth and length of the slowdown in the US economy, and its spillover effects on other developed economies as well as emerging market economies. The projection of economic growth of 5 – 6% for Malaysia in 2008 has, therefore, taken this into account and is based on the assumption that the US economy moderates to significantly below-trend growth during the year, based on the most recent available data. The projection also assumes that the policy measures undertaken by the US authorities would result in a less protracted slowdown in the US and thus, in the other major economies.

The downside risks remain, however, particularly on the possibilities of a more protracted and sharper slowdown in the US, accompanied by a substantial moderation of growth in other developed economies that would result in a more widespread spillover of heightened risk aversion by the international financial markets on the global economy. In this scenario, the domestic economy may be impacted to grow at a slower pace, nearer the lower end of the forecast range. Malaysia's strong underlying fundamentals, however, places the economy in a position of strength to meet any unexpected global developments. The authorities also have a range of policy options to respond in a timely manner as required to counter the downside risks should they emerge and thereby, promote domestic economic growth.

Domestic Demand Conditions

The major underlying factors that supported robust domestic demand in 2007 are expected to remain intact in 2008. The private sector will continue to drive domestic demand, particularly from consumption spending, while the public sector remains supportive of growth with the on-going

Table 4.1
Real GDP by Expenditure (2000=100)

	2007*p*	2008*f*	2007*p*	2008*f*
	Annual change (%)		Contribution to real GDP growth (percentage point)	
Domestic demand[1]	**10.5**	**5.6**	**8.8**	**4.9**
Private sector expenditure	11.8	6.5	7.1	4.1
Consumption	*11.7*	*6.5*	*5.7*	*3.3*
Investment	*12.3*	*6.3*	*1.4*	*0.8*
Public sector expenditure	7.2	3.5	1.7	0.8
Consumption	*6.4*	*6.0*	*0.8*	*0.8*
Investment	*8.0*	*0.5*	*0.9*	*0.1*
Change in stocks			**-2.6**	**1.8**
Net exports of goods and services	**0.9**	**-8.4**	**0.1**	**-1.3**
Exports	3.7	0.9	4.6	1.1
Imports	4.1	2.3	4.5	2.4
Real Gross Domestic Product (GDP)	**6.3**	**5 - 6**	**6.3**	**5 - 6**

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

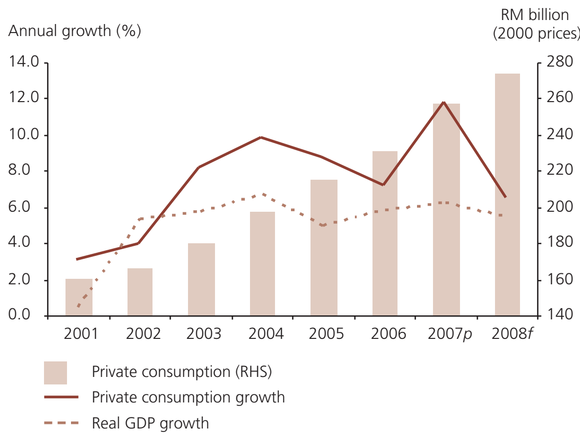
implementation of the 9MP projects. However, a sharper than expected slowdown in the US, moderating growth in the other developed economies and heightened uncertainties, could have an impact on domestic demand. Against this scenario, aggregate domestic demand would moderate to 5.6% in 2008.

Factors supporting robust domestic demand to remain intact in 2008, despite the less conducive external environment

Growth in **private consumption** expenditure is expected to moderate but remain high at 6.5% in 2008. Household spending will continue to be supported by the steady increase in disposable income and favourable employment prospects as the domestic labour market conditions are expected to remain firm during the year. Labour demand from most economic sectors would continue to be strong, especially from the services sectors which are typically labour-intensive. The manufacturing sector, however, is expected to record more moderate recruitment activities. Meanwhile, the implementation of the 9MP projects and various corridor projects would lead to higher new job creations across various job levels and industries, especially in construction; construction-related industries; and professional services. Consequently, the unemployment rate would remain low at 3.2% of labour force. In view of the firm labour market conditions, the overall private sector salary growth is projected to be sustained at 5.8%.

The positive impact of the upward salary adjustments for civil servants in July 2007 will continue into 2008, particularly in the first half-year. In addition, households in the rural area would continue to enjoy favourable income growth as commodity prices are expected to remain high in 2008. Other factors supporting private consumption growth include the relaxation of policy allowing for monthly withdrawal to cover mortgage repayments from the EPF Account 2 as well as the conducive financing environment with low and stable interest rates. Households' balance sheet is also expected to remain strong as reflected by stable debt levels and low non-performing loans for consumption credit and credit cards. In addition, the promotional events related to the Visit Malaysia Year 2007, which has been extended to August 2008, would continue to support domestic tourism and consumption activities.

Chart 4.3
Real GDP and Private Consumption



p Preliminary
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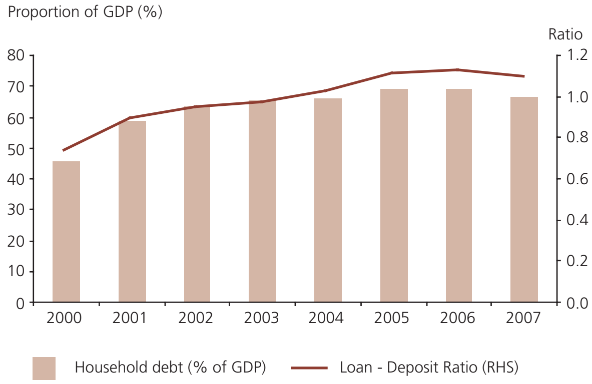
Chart 4.4
Household Debt Indicators



Private investment is expected to be sustained in 2008, albeit at a slower rate of expansion. The increased investment activity will be supported by the generally favourable business climate and pro-business initiatives implemented by the Government. In particular, the phased reduction in corporate income tax to 26% in 2008 and 25% in 2009 is expected to provide stimulus for private sector capital spending activities. In addition, implementation of projects under the 9MP and in the various economic corridor development plans are expected to be accelerated during the year, and would reinforce the private sector investment activities, especially in the construction sector. Capital spending in the manufacturing sector is expected to remain resilient, based on the high level of approved investment recorded in the recent two years. In 2006 – 2007, total investment approved by the Ministry of International Trade and Industry in the manufacturing sector amounted to RM105.9 billion. Meanwhile, continued fleet expansion programmes by the shipping and air services providers would be the main driver of capital spending in the services sector. In the mining sector, investment in the upstream oil and gas sector is expected to accelerate due to strong upstream exploration activities, particularly in the deepwater areas.

In terms of public sector expenditure, **public consumption** is expected to increase by 6% in 2008, mainly on account of higher expenditures on emoluments and supplies and services. Expenditure on supplies and services is expected to contribute to improve support facilities and public sector delivery system.

For **public investment** in 2008, Federal Government spending will remain high and mainly channelled towards improving the economic and social services sectors of the economy. The allocation for development expenditure in the economic sector is mainly for the implementation of infrastructure projects under the 9MP and the various economic corridors as well as to improve the agriculture sector. In the social services sector, the bulk of expenditure will be utilised for the provision of essential services such as education and health and development of affordable houses, emphasising improvements in human resource development and basic amenities. Capital outlays from the non-financial public enterprises will be higher in 2008, mainly in the oil and gas, and services sectors. Capital spending by PETRONAS in the upstream oil and gas sector is expected to increase due to intensification of exploration and production activities. Meanwhile, higher investment is expected for the enhancement of the communications network and provision of utility services.

Sectoral Outlook

On the production side, all economic sectors, except manufacturing, are projected to record high growth rates. Growth will continue to be driven by the services sector, with further impetus emanating from the construction, mining and agriculture sectors. The growth in the services sector will be underpinned by resilient private consumption and robust tourism activity, while public and private sector-driven investments would support the growth momentum in the construction sector. The manufacturing sector is, however, expected to record a more moderate expansion in an environment of weak external demand, especially from the United States. The robust domestic demand and growth of regional economies will, however, support growth in the domestic-oriented and selected resource-based industries and thus, partly mitigate the downside risks from the projected slowdown in the electronics and electrical (E&E) industry. In addition, higher production of crude oil as well as positive supply factors, such as recovery in the palm oil's yield cycle and improved weather conditions for rubber, will support growth in the mining and agriculture sectors respectively.

Table 4.2
Real GDP by Sector (2000=100)

	2007*p*	2008*f*
	Annual change (%)	
Agriculture	2.2	3.4
Mining & quarrying	3.2	6.0
Manufacturing	3.1	1.8
Construction	4.6	5.5
Services	9.7	7.7
Real Gross Domestic Product (GDP)	**6.3**	**5 - 6**

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia
Bank Negara Malaysia

The **services sector** is expected to sustain its strong growth momentum, expanding by 7.7%, contributing 4.1 percentage points to the overall GDP growth. As a result, the share of the services sector to GDP is expected to increase to 54.5% (2007: 53.4%).The strong growth in the sector will be supported by private consumption and tourism activity during the year, as well as the impetus from new growth areas. Activities in the new growth areas, such as Islamic finance, telecommunications, IT services, shared services and outsourcing (SSO) and professional services, are expected to gain further momentum during the year.

The services sector will remain the key driver of growth in 2008, and reinforced by higher growth in the construction and commodities sectors

The finance and insurance sub-sector would benefit from the anticipated sustained growth in bank lending and fee-based activity, in line with the expansion in domestic economic activity. Demand for financing is expected to be supported by healthy financial positions of households and businesses as well as the low interest rate environment. Growth would be further enhanced by the development in Islamic finance, with the entry of new Islamic banks and expected strong activity in the Islamic capital markets following the further implementation of initiatives to promote Malaysia as an International Islamic Financial Centre. The insurance segment, meanwhile, is expected to be supported by the expected recovery in motor insurance in tandem with higher car sales as well as demand for investment-linked and other savings-related insurance products for education and medical purposes.

The real estate and business services sub-sector is projected to continue its strong growth momentum. Increased property transactions in response to incentives announced in 2007, as well as new incentives that came into effect in 2008, including the withdrawal of EPF funds to repay monthly housing loan installments and the 50% stamp duty waiver for residential properties below RM250,000, should support real estate activity. The business services segment is projected to be enhanced by growth in IT services, as well as professional services following higher activities in the construction, and oil and gas sectors, as well as increased SSO activity.

The outlook for the transport and storage sub-sector remains favourable, led by the passenger transport segment. Liberalisation of the Kuala Lumpur-Singapore air route and commencement of new rail services in the Ipoh-Rawang route following the completion of the double-tracking project are positive factors that would attract more people to travel. The communication sub-sector is likely to be supported by the roll-out of new technologies such as the WiMax technology and mobile network portability, and innovations by new market entrants such as the mobile virtual network operators.

The final services segment is expected to continue on a firm expansion path in line with trends in private consumption. Of significance, the automotive segment is likely to see an improvement following the stabilisation in the second-hand car market, launching of new models and the upward salary adjustments for civil service. In addition, tourism activity is expected to intensify, with the Government aiming to achieve 22.5 million tourist arrivals during the year. As a result, this would support the wholesale and retail trade as well as the accommodation and restaurant sub-sectors.

The **manufacturing sector** is expected to record a modest growth of 1.8% (2007: 3.1%) due to the expected weak performance of the export oriented-industries in an environment of projected moderation of global economic growth. In particular, the E&E industry is expected to weaken further in view of the more sluggish US growth. Weaknesses in the US household and corporate sectors could adversely affect the computers and parts segment of the E&E industry, given that a large share of these products is exported to the US. Nevertheless, the impact is expected to be softened by sustained growth in the semiconductor segment led by demand emanating from the Asia-Pacific region. The Beijing Olympics 2008 as well as the expansion in mobile penetration in emerging markets are anticipated to generate strong demand for semiconductors.

In addition, the non-E&E industries, particularly domestic-oriented and selected resource-based industries that export mainly to the region, are expected to perform favourably during the year. Industries related to the construction sector, including fabricated metal are likely to see an improved performance supported by higher construction activity, while the transport equipment industry is expected to turn around to register a positive growth in tandem with the pick-up in sales of new motor vehicles during the year. Off-estate processing activity should strengthen following the recovery in production of palm oil and rubber. Meanwhile, growth in the chemicals and chemical products sector may be constrained by the rising raw material prices.

In the **agriculture sector**, growth is expected to strengthen to 3.4%, supported by the recovery in output of major industrial crops, namely palm oil and rubber. Amidst the biological yield up-cycle of palm trees, palm oil output is projected to trend higher to 16.25 million tonnes supported by the recovery in yields. Similarly, output of rubber is expected to record a positive growth assuming normal weather conditions would support both yields and tapping activities. The projected high prices are also expected to stimulate tapping activity during the year, especially among the smallholders. Growth in the agriculture sector is also likely to emanate from activity related to food crops, such as livestock and fisheries, due to improved rearing methods and expansion in deep-sea fishing.

The **mining sector** would continue to lend further support to economic growth, expanding by 6%. Production of crude oil (including condensates) is expected to increase by 7.2% to an average of 743,000 barrels per day, supported by the acceleration in output from the Kikeh deepwater oil field in Sabah. Output of natural gas is also expected to rise to fulfill demand from Korea and Japan, Malaysia's major LNG importers.

Prospects are for the **construction sector** to expand by 5.5%, led mainly by higher activity in the civil engineering sub-sector. The sub-sector is expected to benefit from activity related to implementation of projects under the 9MP as well as in the oil and gas sector. Growth would also be supported by the increased activity in the non-residential and residential sub-sectors. The former would be supported by demand for office space, particularly in the Klang Valley, while the latter is expected to benefit from the measures taken by the Government in 2007 to spur the residential sub-sector.

Balance of Payments

On the external front, in tandem with the slowdown in the global economy, both exports and imports are expected to record slower growth of 1.8% and 1.4% respectively in 2008. Nevertheless, the current account surplus is expected to remain high, at 14.4% of GNI. The large surplus in the **current account** will be supported mainly by a sustained high trade balance underpinned by strong exports of commodities and non-E&E products, and further reinforced by a continued surplus in the services account due to higher tourism receipts. Similarly, the financial account is expected to remain favourable, supported mainly by continued inflows of foreign direct investment (FDI).

The current account surplus is expected to be supported by a large trade balance and a surplus in the services account. The financial account will be underpinned by continued inflows of foreign direct investment

In tandem with the weaker external conditions, gross exports are expected to record a modest growth of 1.8%, due mainly to lower demand for manufactured exports, particularly E&E products. However, the relatively strong growth in exports of commodities, supported by higher prices of palm oil and crude oil, and the high demand for non-E&E products particularly from the Asian region, are expected to partly offset the impact.

Table 4.3
Balance of Payments

	2007*e*	2008*f*
	RM billion	
Goods	128.1	131.1
Trade account	100.3	104.2
Exports (% annual change)	*2.7*	*1.8*
Imports (% annual change)	*5.0*	*1.4*
Services	1.0	1.0
Balance on goods and services	**129.1**	**132.1**
Income	-13.7	-16.1
Current transfers	-16.1	-17.7
Balance on current account	**99.3**	**98.3**
% of GNI	**15.8**	**14.4**
Capital account	-0.1	
Financial account	-37.0	
Balance on capital and financial accounts	**-37.1**	
Errors and omissions	-16.9	
of which:		
Foreign exchange revaluation loss	*-5.6*	
Overall balance	**45.3**	

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

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Manufactured exports are expected to decline by 1.6%, reflecting further softening in demand for E&E products, which is affected by the weakness in the US economy. The impact would be felt mainly in exports of computer and parts. However, sustained growth in semiconductor exports, led by demand from the Asia-Pacific region, is expected to partially offset the impact. Manufacturing exports will also be supported by growth in non-E&E exports including selected resource-based and metal products which are mainly to the region. Halal products are also expected to gain further momentum into the Middle-East market during the year.

Exports of **agricultural commodities** are expected to remain favourable, expanding by 23.7% in 2008, led mainly by higher receipts of palm oil and rubber. The growth in palm oil earnings is expected to be supported by higher prices, as well as a recovery in export volume. Similarly, rubber exports are expected to be lifted by higher prices and increase in export volume in line with the rise in rubber production and continued demand from the major importing countries.

Growth in **mineral exports** is expected to be higher at 10.3% (2007: 7.5%), reflecting expansion in both crude oil and LNG. The increase in crude oil exports would be driven by higher export volume in line with the increased production from the Kikeh field as well as high prices. LNG exports would be supported by continued demand from the major importing countries.

Growth in **gross imports** is expected to emanate from continued expansion in imports of capital and consumption goods. Capital imports are expected to strengthen (8.5%) in line with capacity expansion in the services, oil and gas and manufacturing sectors. Deliveries of new ships and aircraft to meet the firm demand for commodity exports and expansion in intra-regional travel respectively will lead to higher capital imports in the services industry. Continued development of new oil and gas fields and related infrastructure will also result in higher capital imports. Imports of consumption goods will be supported by growth in private consumption. In line with weaker performance of E&E sector, imports of intermediate goods (which constitute 69% of total imports) are expected to decline.

In 2008, the **services account** is expected to record another year of surplus, supported mainly by increased tourism receipts due to higher tourist arrivals following the extension of the Visit Malaysia Year campaign until end-August 2008. Tourist arrivals are expected to increase to 22.5 million visitors (2007: 21 million) thereby contributing towards a larger travel surplus. In addition to tourists from ASEAN countries,

Table 4.4
External Trade

	2007*p*		2008*f*	
	RM billion	Annual change (%)	RM billion	Annual change (%)
Gross exports	**605.2**	**2.7**	**616.2**	**1.8**
of which:				
Manufacturing	474.7	0.3	467.2	-1.6
Agriculture	52.4	24.4	64.8	23.7
Minerals	61.1	7.5	67.4	10.3
Gross imports	**504.8**	**5.0**	**512.0**	**1.4**
of which:				
Capital goods	69.9	7.2	75.9	8.5
Intermediate goods	358.8	6.9	355.5	-0.9
Consumption goods	28.9	3.6	29.9	3.3
Trade balance	**100.3**		**104.2**	

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

visitors from India, PR China and the Middle East markets are envisaged to increase further. The continued expansion in the SSO and ICT industries is expected to contribute to higher earnings from exports of computer and information services. Meanwhile, implementation of 9MP projects and the economic corridor developments as well as increased activities in the oil and gas sector would lead to increase in the demand for imported services, particularly the construction and professional services. Payments to foreign service providers in the areas related to communication and multimedia services are also expected to increase following rising demand for transmission services.

The **income account** deficit is projected to be at 2.4% of GNI. The deficit is attributable mainly to sustained large profits and dividends accruing to foreign multinationals (MNCs) from their investment in Malaysia, particularly in the oil and gas, services and manufacturing sectors. Meanwhile, profits and dividends accruing to Malaysian companies investing abroad are expected to remain high, mainly from the oil and gas, services, agriculture and utilities sectors.

The **financial account** is expected to be supported mainly by continued inflows of foreign funds for long-term investment. **Foreign direct investment** (FDI) is expected to emanate mainly from retained earnings of existing MNCs operating in Malaysia and new inflows of equity capital for acquisition of domestic businesses by foreign investors. The implementation of the new economic corridors is also expected to attract new inflows of FDI. FDI in the *manufacturing sector* is projected to remain sizeable, following the higher levels of foreign manufacturing projects approved by the Ministry of International Trade and Industry (MITI) in 2006 and 2007 (RM20.2 billion and RM33.4 billion respectively). The bulk of the approved projects is in high value-added E&E; petroleum products including petrolchemicals; basic metal products; paper and printing as well as chemicals and chemical products industries.

Foreign direct investment in the *services sector* will reflect mainly foreign investment in the finance and insurance; and real estate and business services sub-sectors following the progressive liberalisation and rapid development in the financial sector, particularly Islamic finance, as well as establishment of the SSO operations and MSC-status information technology companies in Malaysia by MNCs. Foreign participation in the wholesale and retail trade; and accommodation and restaurant sub-sectors will be in line with the continued expansion in the tourism sector. The focus on key development areas such as education, healthcare, logistics and tourism-related activity in the economic corridors are also likely to spur new inflows of FDI into the services sector. Given the sustained high energy prices and continued upstream production activities, FDI in the *oil and gas sector* is anticipated to remain large.

Meanwhile, **direct investment abroad** by established Malaysian companies is expected to be mainly via acquisition of substantial interest in businesses abroad, aimed at broadening market base and tapping into new opportunities as well as positioning themselves as regional and global players. These investments are projected to be broad based, with the bulk of the outflows channelled into the *services sector*, specifically the finance and insurance; real estate and business services; wholesale and retail trade; accommodation and restaurant; as well as utilities sub-sectors. Meanwhile, investment in the *oil and gas* and *construction sectors*, are expected to continue in view of the projected strong global demand for energy as well as fast paced infrastructure development in the region and Middle East.

Notwithstanding this, the expected global economic slowdown and increased uncertainty in the global financial markets may have some impact on the outlook for FDI flows and direct investment abroad by Malaysian companies.

Inflation Outlook for 2008

Headline inflation is expected to average 2.5 – 3% in 2008 (2007: 2%) reflecting the passthrough effects of global inflation, as well as continued strength of domestic demand. Despite the expected deceleration in global economic growth, favourable domestic demand conditions are expected to sustain overall economic activity at reasonably high levels, albeit below potential productive capacity. Consumption demand for goods and services by households is expected to be supported by expectations of stable employment conditions and positive growth in private sector wages. The salary adjustment in the public sector, higher income for rural communities due to the continued high commodity prices and the implementation of a withdrawal scheme from the Employees Provident Fund (EPF) for housing loan repayment, would all lend support to domestic consumption. The expected growth in private investment activity, the implementation of the Ninth Malaysia Plan and the new economic growth corridors will further augment domestic demand in 2008.

The period of high uncertainty surrounding global growth and inflation prospects that was evident from the second half of 2007 is expected to continue in 2008. As a small and highly open economy, Malaysia is not insulated from external price pressures or macroeconomic shocks. There are incipient signs that global price developments, especially the strong rise in the prices of commodities and higher inflation in Malaysia's major trading partners, have begun to exert upward pressure on domestic prices. The imported price component of the CPI recorded an upward trend, from increasing at 0.3% per annum in June 2007 to 1.5% per annum in December 2007. External price pressures are expected to continue to have a significant influence on domestic price developments in 2008.

There also remains considerable uncertainty with regard to global commodity prices, particularly for crude oil and food commodities. Global crude oil prices have remained elevated, staying within the USD90 - 100 per barrel range in the January - February 2008 period. Such developments are expected, as in the past, to have repercussion on global prices, both at the producer and the consumer level. Increased fuel costs have already contributed to higher freight charges and fares in the shipping and airline industries. Although domestic fuel prices are partly subsidised by the Government, the extent of high global crude oil prices feeding through the supply chain of other imported inputs and ultimately into consumer prices needs to be closely monitored.

Meanwhile, world food prices are also subject to both cyclical and structural developments. Data from the February 2008 edition of The Food and Agriculture Organisation of the United Nation's (FAO) Crop Prospect and Food Situation indicated that the ratio of global supply (existing stock and new production) of cereal, comprising of wheat, rice and coarse grains, relative to global utilization is on the decline, falling from 1.24 in the year 2005/06 to 1.20 in 2006/07, and to 1.19 in 2007/08. These developments reflect, in part, global supply constraints amidst strong demand from rising consumption, as well as new sources of demand, such as for the production of bio-fuels. This could have implications on feedstock costs, leading to higher meat, poultry and milk prices for consumers. Amid tight supply conditions, production disruptions arising from adverse weather conditions could also prolong the elevated and volatile food prices.

To some extent, the presence of administered prices and Government subsidies on imported food items could mitigate or delay the pass-through into domestic food prices. For food items that are not under any type of price controls, the non-food items, or intermediate goods such as animal feed, the pass-through would depend on the prevailing demand conditions, the elasticity of demand for that particular product, as well as the business strategies of the producers or distributors. The ability of the producers to pass on cost increases to consumer prices would depend greatly on the strength of consumption demand. It will also depend on the extent to which consumers substitute from more expensive goods into cheaper goods. Competition and fear of losing market share could act as a strong deterrent to indiscriminate price increases.

There is also further added uncertainty to the inflation outlook in terms of the potential for stronger wage demand by the private sector to affect a broader rise in the general price level. Private sector wages are expected to increase as demand for labor remains strong. At this stage, however, there is little evidence that labour costs will rise at a faster pace in 2008 than previously. As in the past, the steady stream of foreign skilled and unskilled workers is expected to augment the domestic work force to balance the demand for labor and hence attenuate wage pressures. In 2007, the number of migrant workers and expatriates employed in Malaysia increased significantly by 9.4% and 5.7% respectively (2006: 3% and -1.3%). Furthermore, the wage increases have generally been commensurate with improvements in labor productivity, in which case, the increase in unit labour cost could be relatively small and would not add substantially to inflation.

A factor counterbalancing the upside risks to price pressures is the weaker global economic outlook, which could lead to lower global commodity prices and hence, lower global inflation. The projections are for growth

Table 4.5
Average growth of salary increases for executives in the private sector

	2007	2008*f*
Hay Group	6.5	6.4
Tower Perrins	5.6	5.8
FMM	5.6	5.9
MEF	6.2	5.7
Watson Wyatt	5.6	5.6
Average	**5.9**	**5.9**

f Forecast

of the global economy to moderate to 3.7% this year (2007: 4.7%), with the less favourable environment in the advanced economies and continued uncertainty in the global financial markets. This may contain further increases in global commodity prices.

MONETARY POLICY IN 2008

In 2008, the external environment is expected to be more challenging as growth in the industrial economies is forecast to moderate, whilst price pressures could potentially stay elevated. Nevertheless, domestic demand is expected to support Malaysia's economic growth momentum. Malaysia's real GDP is expected to grow by 5 - 6% in 2008.

Price pressures in 2008 are expected to be stronger following the relatively benign domestic inflation environment of 2007. Headline inflation is expected to average between 2.5 - 3% driven by the pass-through of prices of inputs, as well as higher global prices of food, commodities and other raw materials. As at end-2007, the weighted inflation for the countries that are a major source of imports for Malaysia had risen to 3.6% per annum and it is trending upwards.

There are a number of factors that could help contain inflationary pressures in 2008. Competitive pressures and substitution by consumers from more expensive into less expensive goods could mitigate the ability of producers to pass on their costs into final consumer prices. Slower global growth could ease pressures on global food and commodity prices, as well as reduce inflation in Malaysia's import partner countries. Government policies to ensure the availability of essential goods would also contribute to reducing the cost of these goods. With the economy expected to operate below its potential, the presence of excess capacity should also have a dampening effect on prices. Slower demand may also ease labour cost pressures and wage increases are more likely to be reflective of improvements in productivity.

The conduct of monetary policy in 2008 will face a number of challenges. The balance of risks to inflation and growth would be more difficult to gauge given the high degree of uncertainty regarding the global macroeconomic and financial environment. The problems in global financial markets and the extent of their eventual impact on real economic activity in the US and to the global economy remains a source of great risk. The longer these problems persist, the more extended is the likely duration of their negative impact on the global economy. Risk aversion, credit constraints and negative wealth effects are likely to depress consumer and investor sentiment, resulting in a deeper and more protracted weakening of global demand. Although Malaysia's domestic economic fundamentals remain sound, Malaysia's highly open economy means that international developments will impact the domestic economy. With respect to inflation, uncertainties regarding the depth and length of slower global growth and the degree to which it will dampen commodity prices will influence the inflation outlook.

A second challenge is managing the more frequent, large and volatile capital flows and their impact on the exchange rate, domestic liquidity and asset prices. Rapidly changing market sentiments, the search for higher yields, and sudden shifts in risk premiums are factors driving such volatile flows. Large short-term inflows and outflows have at times contributed to highly volatile exchange rate movements which creates significant uncertainties for businesses and consumers in undertaking economic decisions thereby having a negative impact on the real economy. Also, the resulting increase in liquidity arising from large inflows could be inflationary and distort both financial and real asset prices in the domestic economy. Recognising that such flows will result in greater challenges in the conduct of monetary policy, Bank Negara Malaysia has increasingly broadened its range of instruments to manage the flows and enhanced the surveillance mechanisms to ensure that such flows do not disrupt the smooth functioning of the financial system and the economy.

In this uncertain environment, the focus of monetary policy in 2008 will be on sustaining the economic growth momentum while maintaining price stability in the medium to long term. In the formulation of monetary policy, the Bank will continue to be forward looking and will weigh the impact of new developments on growth and inflation. The Bank stands ready for a monetary policy response in the event the outlook for growth or inflation changes and the nature of the problem prompts a change in monetary policy. Concerning price stability, it is also important to note that not all sources of inflationary pressures warrant a monetary policy response. Monetary policy is foremost a demand management tool. As such, it has limited influence in terms of mitigating cost-push price pressures emanating from rising global prices of food and commodities. Moreover, other policies would also be more appropriate if the problem is structural or underpinned by supply driven factors.

Potential Output of the Malaysian Economy

Potential output is the trend level of output that is consistent with the aggregate productive capacity of the economy. It provides a clear determinant for the pace of sustainable growth based on its available productive inputs. 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 total factor productivity (TFP) growth, which captures productivity gains from improvements in factor inputs as well as overall economic efficiency.

The latest estimate for Malaysia shows that potential output grew at 6.4% in 2007, with the output gap[1] estimated at an average of -0.1% of potential output. The Malaysian economy was, therefore, characterised by balanced growth, with the small negative output gap suggesting that the economy was performing close to its potential with minimal demand-driven inflationary pressure. Growth was supported by continuous improvement in productivity and expansion of both capital stock and labour force during the year.

Table 1
Actual GDP and Potential Output

Period	Actual GDP	Potential Output	Investment	Labour	Output Gap
	(Annual change in %)				(% of potential output)
1993-1999	6.4	6.5	3.5	3.2	0.0
2000	8.9	4.0	25.6	4.3	2.2
2001	0.3	4.6	-2.1	1.6	-1.8
2002	4.4	3.9	0.6	3.5	-0.4
2003	5.5	6.0	2.8	3.6	-0.5
2004	7.2	5.5	3.6	4.0	0.7
2005	5.2	5.2	5.0	4.1	0.5
2006	5.9	6.3	7.9	2.2	0.1
2007*e*	6.3	6.4	9.2	2.0	-0.1

e Estimates

Overall, since the year 2000, Malaysia's economy has exhibited relatively balanced growth as shown by the output gap which was on average less than ±1% of potential output. The period corresponding to the Eighth Malaysia Plan (2001-2005) witnessed Malaysia's evolvement from capital-led growth in the 1990s to a productivity-driven growth (see chart 2). In line with the

[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.

Chart 1
Actual and Potential GDP

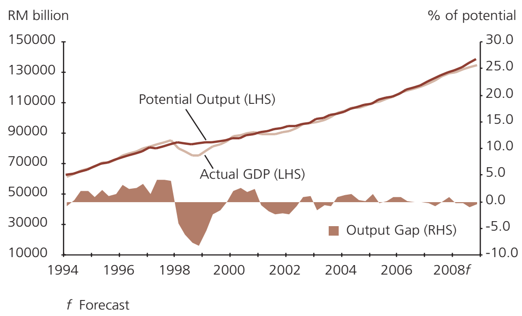
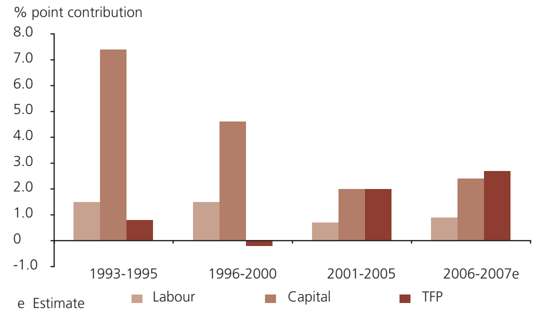


Chart 2
Factor contributions and TFP growth



strategies to increase productivity and competitiveness under the Ninth Malaysia Plan (2006-2010), it is expected that improving productivity levels through greater knowledge intensity of labour force as well as efficiency in the use of capital and technological progress will continue to enhance the contribution of TFP. Having suffered from a period of lacklustre investment climate since the Asian crisis, the pick-up in private investment activities since 2003 has contributed favourably to the growth of potential output. This trend for private investment activity is expected to be sustained in the future, given the strong domestic demand and the implementation of the Ninth Malaysia Plan projects.

Going forward, potential output of the economy is expected to grow above 6% in 2008 supported by the expansion of capital stock and the labour force. However, the output gap is expected to widen marginally following a modest moderation in actual output projected during the year.

Liberalisation of the Foreign Exchange Administration Rules

As a highly open economy, Malaysia has taken advantage of globalisation to sustain its growth momentum and diversify its economic structure. Efforts to strengthen its economic and financial relationships with the rest of the world has contributed to the high level of external trade, sustained level of foreign direct investment and an increase in overseas ventures by Malaysian corporations and financial institutions. Malaysia is committed to progressively liberalise the foreign exchange administration rules to continuously promote the competitiveness of the economy and taking into consideration that economic benefits of the liberalisation outweigh the risks and costs. The sequenced and gradual liberalisation approach that has been adopted has led to positive economic payoffs for the country through the reduction of the cost of doing business, enhancing the regulatory delivery system and facilitating the sound and healthy development of the domestic financial system.

In the early part of 2007, fifteen foreign exchange administration rules were liberalised and the details were reported in the Bank's Annual Report 2006. Subsequently, further liberalisation of the foreign exchange administration rules were announced to strengthen further the overall macroeconomic objective of enhancing Malaysia's competitiveness and promoting economic flexibility. The liberalised rules are as follows:

Objective	Rules liberalised
1. To reduce transaction cost, cost of doing business and enhancing business efficiency	• Effective 28 November 2007, a resident corporation with export earnings is free to pay another resident corporation in foreign currency for settlement of goods and services. • Effective 1 October 2007, (i) The individual reporting threshold for payment and receipts between residents and non-residents is increased to RM200,001 or its equivalent in foreign currency from the previous threshold of RM50,001 per transaction. (ii) The registration requirements on the following were abolished: ➢ Forward foreign exchange contracts entered by residents; ➢ Ringgit-denominated loans extended by a resident to a non-resident for purchase or construction of immovable properties in Malaysia; ➢ Investment in foreign currency assets by residents; ➢ Foreign currency borrowing by resident corporations from: – licensed onshore banks; – non-residents; and – another resident company within the same corporate group using proceeds from an Initial Public Offering on foreign stock exchanges; and ➢ Repayment of permitted foreign currency borrowing (without fixed schedule of repayments) or prepayment. • Effective 1 January 2008, the requirement for submission of the following reports was also abolished: (i) Overseas Account Statement (Statement OA) for accounts maintained by resident corporations with offshore banks; and (ii) Inter-Company Account Statement (Statement IA) for accounts maintained by resident corporations with non-resident corporations.
2. To facilitate the development of Malaysia as an Islamic Financial Centre	• Effective 1 October 2007, unit trust and fund management companies are free to invest the total amount of Islamic funds under their management in foreign currency assets. (Previously the limit for investment in foreign currency assets was up to 50% of the Net Asset Value or of total funds of residents with domestic ringgit borrowing).
3. To facilitate hedging and development of commodities futures market in Malaysia	• Effective 15 January 2008, the following flexibilities were granted to facilitate the transaction of the US dollar denominated crude palm oil futures contracts (USD FUPO) on Bursa Malaysia:

Objective	Rules liberalised
	(i) Exclude investments by residents in USD FUPO on Bursa Malaysia from the investment in foreign currency assets rule, if the contracts are settled in ringgit; and (ii) Allow commodity futures brokers licensed by Securities Commission to act as agents to licensed onshore banks to quote exchange rates to facilitate settlement of USD FUPO with Bursa Malaysia.
4. To support the development of new areas of economic growth	• Effective 24 September 2007, resident corporations approved under the Iskandar Development Region framework and biotechnology companies approved under the National Biotechnology Policy, are free to undertake the following: (i) To pay and receive payments in foreign currency, other than the currency of Israel, with residents; (ii) To borrow any amount of foreign currency from licensed onshore banks and non-residents; (iii) To invest any amount in foreign currency assets onshore and offshore; and (iv) To retain export proceeds offshore.
5. To enhance risk management flexibility for investment in ringgit assets by non-residents	• Effective 1 October 2007, the requirement for a non-resident to reinvest within 7 working days, the proceeds arising from the sale of ringgit assets prior to the maturity of the forward foreign exchange contract was abolished.

The remaining foreign exchange administration rules currently applicable to non-residents and residents are mainly for prudential purposes and will be progressively reviewed to continuously promote the competitiveness of the Malaysian economy. The rules can be broadly categorised into the following 6 main areas:

The explanatory notes are in the Annex.

FISCAL POLICY IN 2008

The 2008 Budget outlined wide-ranging tax and non-tax measures to enhance the nation's competitiveness, strengthen human capital development and ensure the well-being of all Malaysians. Fiscal policy in 2008 also focused on expediting the implementation of projects and programmes that had been identified under the Ninth Malaysia Plan.

In enhancing the nation's competitiveness, a more competitive tax regime coupled with initiatives to strengthen the efficiency of the public service delivery systems were among the key measures introduced. In the 2008 Budget, the Government reduced corporate income tax by two percentage points in two stages, to 26% for the 2008 assessment year and then to 25% in 2009, and introduced a single-tier tax system under which profits are only taxed at the company level and dividends received are exempted from tax. To promote the Islamic financial sector and Malaysia as an international Islamic financial centre, the Government introduced a number of measures, including tax incentives for existing stockbroking companies to set up Islamic stockbroking subsidiaries, exempt income tax on all fees related to Islamic fund management activities and including fees earned by non-resident consultants with expertise in Islamic finance, and tax deductions on the share of distributed profits for the takaful industry. As part of the Government commitment towards improving the public delivery system, the Special Taskforce to Facilitate Business (PEMUDAH) was established to formulate measures to improve public service by reviewing procedures and recommending alternative processes to reduce the administrative and regulatory cost of doing business in Malaysia.

The Federal Government's overall financial position is expected to strengthen further in 2008. The increase in the overall revenue from increased efficiency in revenue collection and the higher oil-related income, will accommodate the increased Federal Government expenditures, while reducing the budget deficit to 3.1% of GDP in 2008 (3.2% in 2007). The rise in emoluments after the increase in civil servant salaries in July 2007 accounts for part of the increase. In terms of development expenditure, special attention was given to both the economic and the social sectors in an effort to generate higher value-added economic growth, strengthen human capital development, and address socio-economic inequalities. The bulk of the development expenditure will, therefore, be channeled to the economic sectors (agriculture and infrastructure) and social sectors (education, training, health and housing). In terms of financing, the Government continues to finance the fiscal deficit from domestic sources, facilitated by the high domestic savings and ample domestic liquidity.

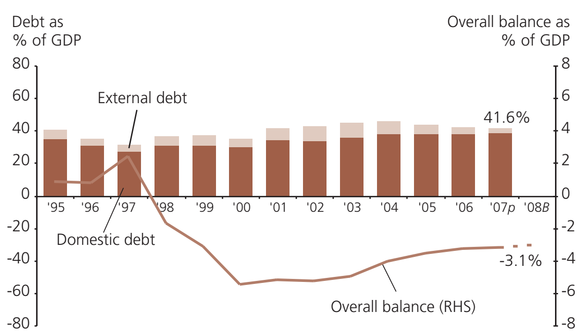
Table 4.6
Federal Government Finance

	RM billion		% change	
	2007*p*	2008*B*	2007*p*	2008*B*
Revenue	139.9	146.4*	13.2	4.7
Total expenditure	163.6	168.8	14.0	3.1
Operating expenditure	*123.1*	*128.8*	*14.3*	*4.6*
Gross development expenditure	*40.6*	*40.0*	*13.3*	*-1.4*
Loan recoveries	3.1	0.8		
Overall balance	**-20.7**	**-21.6**		
% of GDP	**-3.2**	**-3.1**		
Sources of financing:				
Net domestic borrowing	25.8	-		
Net external borrowing	-4.3	-		
Realisable assets[1] and adjustments	-0.8	-		

[1] A positive (+) sign indicates a drawdown in the accumulated realisable assets
p Preliminary
B Budget
* Revenue used are inclusive of potential tax losses arising from implementation of 2008 Budget measures
Note: Numbers may not add up due to rounding

Source: Ministry of Finance

Chart 4.5
Federal Government Fiscal Balance and Debt



p Preliminary
B Budget

Governance and Organisational Development

Governance and Organisational Development

OVERVIEW

During 2007, the Bank's governance and organisational development practices continued to focus on building a performance-driven culture to ensure that the Bank is able to deliver its core mandates of ensuring monetary and financial system stability, as well as supporting sustained medium and long-term growth. The Bank increased investments in human capital, learning and knowledge, work space and physical facilities, and technology. Attention was also given to changes in governance structure. New policies, practices, processes and systems were also introduced to enhance the potential for the Bank to strengthen performance. These improvements were reinforced by the promotion of new sets of role-based behavioural competencies and value-based corporate codes designed to ensure the organisation continues to effectively contribute to the nation's economic and financial agenda.

The organisational development strategies and practices to support the Bank's role have yielded demonstrable results. Performance improvement was visible across the organisation, reflected by greater capacity to respond to the higher performance expectations, and achievements of goals set for the operating units and the institution during the year. The Bank made a conscious effort during the year to reprioritise organisational development initiatives and programmes, and importantly to enhance the focus on areas directly related to the Bank's strategic results. Project-based collaborative work among line departments, which had become a norm within the Bank, contributed towards optimising the utilisation and sharing of resources, leading to higher level of performance in these priority areas. Roles of leadership at all levels were given greater emphasis, with augmented commitment and efforts to enhance talent management practices, in particular, mobilisation of talent, talent development, succession management and reward management. The Bank's planned programmes under its "knowledge-based and learning organisation" initiatives were continued, with positive results on the staff, in particular, with respect to self-directed learning. Given the growing importance of regional integration, the Bank addressed its capabilities to build more effective regional and international networks.

Governance

The Board of Directors, which functions as an oversight board, comprises of the Governor as the Chairman, three Deputy Governors and five other non-executive members from the industry and public sector. The Board is responsible for policy and the general administration of the affairs and business of the Bank. In performing these roles, the Board is guided by three key pillars of governance, namely **independence** based on its given roles; **accountability** based on the need for operational effectiveness and efficiency in performing the given roles through optimising the use of 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. In furthering its roles, the Board is assisted by the Board Audit Committee to supervise the Bank's financial and non-financial compliance to the internal controls. The Board Audit Committee is chaired by an independent director. The Board convened 12 monthly meetings and four Board Audit Committee meetings in 2007.

The Management Committee, which is the highest executive entity within the Bank and chaired by the Governor, meets weekly to deliberate on policy matters pertaining to the Bank's core functions as well as the general operations of the Bank. The practice of cross-functional committees which over time had become increasingly effective in the Bank's decision making process had been institutionalised to become a critical component in the Bank's decision management framework. The Management Committee is complemented by several other policy committees, which are also chaired by the Governor. These committees include, the Monetary Policy Committee, Financial Sector Policy Committee, Reserve Management Committee, Financial Liberalisation Committee and Risk Management Committee. These policy committees provide for balanced participation of staff across the line departments, as well as depth and breadth in inputs and more effective implementation of decisions, in addition to enhancing ownership and accountability. Collectively the Management Committee and the policy committees provide the executive leadership, to steer the Bank in fulfilling its statutory mandates.

Various measures to enhance governance were introduced during 2007. The orientation of enhancing time-to-market required focus on efficiency of decision making processes as well as effectiveness of execution of decision at the operating level. In particular, there was a re-alignment of the supervisory and regulatory functions which was initiated in 2006 and implemented in 2007. The realignment was to provide sector-wide functional focus and foster a holistic approach to the management of the challenges of the sector. The new structures put in place enabled effective sharing of knowledge, experience, information and data and promoted greater cross-functional consultations and in-depth deliberations across business units for a more timely detection and resolution of emerging issues.

Department reviews were also undertaken to enhance the governance of three departments of the Bank. A review of the Economics Department was undertaken to ensure that the Bank continues to have in place capability to identify, assess and respond to emerging macroeconomic developments. The review aimed at further strengthening macro economic surveillance and assessment as well as research capability to support the Bank's core mandates of monetary and financial stability, as well as the Bank's role as an economic adviser to the government. The Bank, in 2007, established a new unit known as Central Banking Services to share knowledge and best practices with other central banks and regulatory authorities. The primary role is to foster mutual learning and to strengthen relations and interlinkages with the central banking fraternity.

During the year, the Bank also initiated a strategic review of the Internal Audit and Currency Management and Operations departments which is due to be completed in 2008. Further changes were also made in the area of sound management of the Bank's finances. The Bank actively focused on the issue of more effective cost management taking into account the risks, costs and benefits in the conduct of central banking business. In 2007, the Bank's Procurement Management Policies and Procedures were further enhanced with respect to risk management and cost effectiveness in procurement. As part of the on-going Cost Conscious Culture initiative, various measures were implemented by the departments in 2007 ranging from more efficient office administration, handling of external meetings and events, training, travelling, currency operations, e-payment and improved work processes to enhance effective resource management in the conduct of routine operations.

Corporate Social Responsibility

The Bank established a BNM Volunteers team for community service in 2007 to provide another channel for staff to contribute to society. The establishment of the BNM Volunteers team enables the Bank and the staff to fulfill corporate social responsibility and contribute towards the advancement of disadvantaged and under-served communities. This is done through hands-on voluntary community service projects and financial contributions.

The Bank had also initiated a project to create greater awareness and formulate initiatives to implement and monitor strategies to address global warming. An Engine Group has been established to drive this project including creating awareness among staff to actively recycle, reuse and reduce the utilisation of depletable resources. Efforts have also been undertaken to embed and implement environmentally friendly initiatives within the Bank's systems and work processes. As the staff voluntary movement gathers momentum, nation-wide initiatives partnering with other agencies championing this cause will also be undertaken by volunteers from the Bank.

The Bank continued with its programme of early engagement with deserving and talented students from the lower income groups in particular those from the rural areas. The programme is part of the Bank's initiative to develop human capital to broaden the talent supply for the Bank and the nation and involves the identification of young Malaysian talent in upper secondary classes. Their academic, physical and social developments are facilitated with financial support for learning materials as well as equipment for extra curricular activities.

Talent Management

During 2007, various new human capital management practices were introduced to further enhance the Bank's ability to meet the challenges in the area of talent management. The Bank adopted a Workforce Planning Framework which focuses on the overall talent requirements of the Bank over the medium and long term, addressing issues such as the number of employees, the required skill sets and competencies for the respective functional areas of the Bank. The framework forms a guideline in the determination of jobs, manpower levels and structures within the Bank that would deliver the Bank's desired outcomes in the most efficient, effective and sustainable manner.

In terms of Talent Demand, the Bank redefined the job families and its structure to improve alignment with the Bank's business strategy. This process led to a re-assessment of manpower for certain critical functions. The Talent Supply processes which were also introduced in 2007, have led to more effective and efficient assessment of the availability and readiness of talents to assume jobs across all levels. The talent supply process ensures that greater job-person fit is maintained, while enabling greater flexibility in moving talent within the Bank. This framework is also used for succession planning for mission critical positions in the Bank.

Performance differentiated practices continued to be an integral part of the Bank's talent management strategy, underpinning major human capital policies and processes. Despite raising the performance standards and more stringent evaluations and assessments in 2007, the average performance of the Bank's staff has continued to improve. The Bank reviewed the reward system, focusing on variable components of the remuneration in order to ensure that it remains relevant and competitive.

Talent management has also involved the strengthening of staff values and commitment to improve their level of attachment and engagement with the organisation. By understanding positive values that are intrinsic to the Bank and common to its members, the staff will be better able to internalise these values and have greater appreciation of their roles within the Bank. In 2007, the Bank revised the core shared values introduced in the mid-90s to be more reflective of its current roles and environment. The core shared values are represented by the acronym "i-ACTED" which stands for Integrity, Authoritative, Collaborative, Trust, Excellence and Diversity.

In terms of capacity, the total staff strength of the Bank increased by four percent to 2,597 as at end-2007. The attrition rate due to retirement and resignations reduced to four percent. With a ratio of Executive and Non-Executive of 3:2, the Bank continues to emphasise the increase in its professional talent pool.

As part of the Bank's efforts to build its talent pipeline, as well as contribute to the nation's human capital development, 165 scholarships were awarded to candidates pursuing pre-university programmes at local colleges and first degree programmes at local and overseas universities in 2007. To provide opportunities for the Bank's staff to enhance their knowledge and expertise, 47 of them were offered scholarships to pursue first degree programmes at local universities and post graduate studies at local and overseas universities. The distribution of the scholarship awards focused on disciplines relating to central banking areas such as Economics, Actuarial Science, Law, Accountancy, Financial Engineering and Mathematics. Other areas included Islamic Banking and Economics, Corporate Finance and Shariah.

As part of the Bank's contribution towards nation building, the Bank started the Special Scholarship Award for top Sijil Pelajaran Malaysia achievers in 2005. In line with the Bank's aspiration to develop top potentials in the country, the awards have given young Malaysians opportunities to acquire the best learning experience at world class learning institutions. A total of 12 students have been awarded this special scholarship since it was introduced in 2005. For the year 2005 and 2006, the Bank awarded three Special Scholarships for each year. However, the number was increased to six in 2007.

Knowledge Management

In 2007, the focus with respect to knowledge management related to improving content management, including visibility and leveraging on accumulated corporate information and research, as well as improving knowledge acquisition, knowledge sharing and collaboration with both internal and external stakeholders.

In terms of content management, the Bank introduced a new Enterprise Content Management policy, setting out guiding principles and broad policies that supports the entire lifecycle of content in the Bank. The Enterprise Content Management policy introduces a uniform set of best practices to preserve the Bank's intellectual capital. As part of this on-going agenda, there were concerted efforts to identify knowledge gaps so that the Bank's knowledge management systems will be able to ensure that the gaps are addressed, and thus, ensure greater alignment of knowledge management processes with the Bank's business requirements.

Work on the Bank's Enterprise Portal progressed further in 2007 with the deployment of two key functions, namely the Knowledge-Hub (which provides a means for seeking and sharing of information as well as collaboration among members of communities) and e-Collaboration (which is a system for on-line collaboration), through the Enterprise Portal's platform. The FI@KijangNet portal was launched to the financial industry in February 2007 to provide a one-stop communication and collaboration channel with the Bank. Essentially, the portal supports the entire life-cycle of the policy development process across various industry sectors. Under the current release, financial institutions are able to access cross-sector policy guidelines, manage user rights as well as post and access enquiries and responses online. The FI@KijangNet has significantly improved accessibility of information to the financial industry, while enabling the Bank to reduce the time taken to communicate new policy directives to the industry as a whole. In particular, all branches of all financial institutions can access the information, rather than depending on their respective headquarters to forward the information to them.

Training and Learning Management

In 2007, the Bank continued to put greater emphasis on delivering quality learning solutions to meet the needs for new knowledge and competencies. The orientation towards performance-based and self-directed learning has led to an increase in demand for job specific learning.

In order to ensure greater relevance of content, 80% of the learning solutions offered to the staff throughout 2007 underwent significant customisation, using the data obtained through a comprehensive learning needs analysis conducted by the Bank. A comprehensive learning needs analysis was also conducted for very technical courses, such as the Banking Supervision Foundation Course, the Insurance Regulation and Supervision Course, the Central Banking Series, the Financial Regulators Forum in Islamic Finance (part of the Global Islamic Finance Forum) and the Islamic Finance Course for Financial Regulators (IFCFR). This was to ascertain that the learning solutions offered provided the latest knowledge and expertise in the specific knowledge areas as required by the participants.

The Bank had also successfully organised an inaugural Advanced Central Banking Course in June 2007. The Advanced Central Banking Course is the final series of a three part series in the Central Banking curriculum which includes the Basic Central Banking Course and the Intermediate Central Banking Course. This three part series provides a comprehensive and integrated curriculum for central bankers.

The progress made by the Bank's leadership development processes implemented since 2004 were acknowledged with the Bank being awarded the Exemplary Practice Award in the 8th Corporate University Xchange Awards For Excellence and Innovation In Corporate Learning under the Leadership Development category in February 2007 in the United States of America. In 2007, the Leadership Development Programme (LDP) for Directors and Deputy Directors was extended to the next level for Managers to ensure a robust talent pipeline.

The year 2007 also saw the Bank putting greater emphasis on assessing the impact and effectiveness of the learning solutions offered. With regard to increased knowledge due to learning, 90% of the functional courses were successfully assessed through participants' feedback and reflection. The average knowledge gained for learning sessions offered in 2007 was recorded at 70%. The result on the learning effectiveness for the LDP showed that a high percentage of knowledge was gained, with 58% of the new knowledge being currently applied at the workplace.

For 2007, the average learning investment per-employee was RM8,700, which amounted to 11% of staff salary. With respect to the training man-days, each employee registered an average of 10 training days.

Technical Assistance and Collaboration Programmes with External Agencies

As part of the Bank's efforts to enhance regional and international cooperation, the Bank collaborated with central banks of emerging economies in the following areas :

- Sponsorship of participants from countries identified under the Malaysian Technical Cooperation Program (MTCP) to attend various training programmes conducted at the Bank. These programmes included the Basic Central Banking Course, Banking Supervision Foundation Course, Insurance Regulation and Supervision Course, and the Global Islamic Finance Forum.
- Study visits from central banks of emerging economies of Asia, Central Asia, the African continent and the Middle-East.
- Advisory services provided by the senior staff of the Bank at the request of other central banks.

The areas cover a wide range of central banking issues as well as organisational development work to build internal capacity in a central bank. The Bank has also benefited from the exchange of knowledge and experience, and has enhanced the network for collaboration amongst other fellow central bankers.

ICT Management

Information and Communications Technology (ICT) has proved a key enabler in enhancing business process efficiency, and supporting the achievement of the Bank's desired outcomes. During 2007, the Bank strengthened the ICT infrastructure by implementing a high performance and cost effective new wide area network infrastructure that connects the Bank with all the financial institutions. The infrastructure provides the performance for high volume and large size of transactions, in line with the current and future business needs. In order to further optimise the use of ICT infrastructure and time to deployment of ICT applications, an exercise was undertaken to consolidate the servers and storage capacity by leveraging on virtualisation technology – a foundation for the implementation of on-demand services.

The Bank also put in place a direct link-up with the Malaysia Deposit Insurance Corporation to support the administering of the deposit insurance system and assessing the risks to ensure sound risk management in the domestic financial system.

In supporting Malaysia's endeavours as an International Islamic Financial Centre, the Bank has implemented a cost-effective system for secure settlement and depository of non-RM bonds, thereby putting in place the necessary infrastructure that minimises settlement risks. In relation to the country's burgeoning bond market, the Bond Info Hub initiative was completed. The new infrastructure provides the capability for content aggregation of bond information from primary and secondary market players for access by the public and foreign investors.

ICT was also strategically used to improve the regulatory process through the implementation of the FI@KijangNet communication and collaborative platform, which is deployed using the Bank's Enterprise Portal. This functionality enables financial institutions to access, collaborate and make enquiries on the policies online. In enhancing the performance of the reporting institutions and the Bank's obligations under the Anti-Money Laundering Act 2001 (AMLA), the system has been expanded in year 2007 to enable collaboration, analysis and surveillance on AMLA-related information. The Bank also enhanced its delivery system for managing enquiries and complaints lodged by the public through the new BNM TELELINK contact centre.

Finally, to strengthen security management, the Bank has embarked on an Enterprise Public Key Infrastructure initiative [ePKI] to enhance authenticity, confidentiality and integrity in the implementation of payments system. This would promote public confidence in the safety of the systemically important payments system in Malaysia that includes the Cheque Truncation System and the Real-Time Gross Settlement System.

RISK MANAGEMENT IN BANK NEGARA MALAYSIA

Risk management is regarded as a key element of governance at the Bank with the underlying objectives of safeguarding the Bank's reputation and ensuring the safety and soundness of the Bank's operations. As a principle, the risk management framework is periodically reviewed to ensure that it remains effective in surfacing key risks of the Bank and that appropriate processes and systems are implemented to manage these risks. In 2007, the Risk Management Committee approved a new framework and approach in managing organisational risk to further strengthen the existing risk management infrastructure.

Risk Management Governance Structure

The risk management governance structure headed by the Risk Management Committee (RMC) chaired by the Governor, is the main driver for risk management in the Bank. Through this dedicated forum for risk management discussion, RMC members carry out focused deliberations on organisation-wide risk issues faced by the Bank. Two sub-committees have been established under the new framework to support the RMC, namely the Financial Risk Management Committee and Operational Risk Management Committee. These two committees are responsible for overseeing the financial and operational risks respectively and to ensure adequacy of its management. It is envisaged that this new structure would allow for greater focus and more in-depth analysis on the two critical risk areas of the Bank, through the involvement of key heads of departments in the two committees to spur better rationalization of issues. It is also aimed at addressing risk interlinkages in the Bank. The new structure would allow the RMC to be focused on high level organizational risk issues, including strategic, policy, reputation and capability risks as well as to formulate appropriate risk mitigation measures at a macro level.

The Risk Management Unit (RMU) is responsible for developing and maintaining the risk management framework of the Bank which encapsulates the development of policy and processes, tools and methodology as well as promoting effective best practices. It oversees the implementation of the framework, and ensures that risk management processes are appropriately carried out.

Key Initiatives for 2007

Over the years, the focus of risk management in the Bank gradually moves away from department centric to a more integrated approach by adopting an Enterprise Risk Management (ERM) framework. A sound ERM framework has allowed the Bank to manage risks in a multi-dimensional perspective by linking risks to the achievement of multiple objectives (which include strategic goals, optimal resource allocation, reliable information and compliance with laws and regulations) and how they are associated with various functions and levels of accountability in the Bank. In this respect, the main challenge is to aggregate risks across different risk types and also across business units to obtain an overall bank-wide risk situation and subsequently to manage the key risks at the organisational level. In 2007, considerable effort was focused on developing the bank-wide risk profile, which would ultimately evolve to a corporate risk dashboard. To do so, the self-assessment was seen as the main building block to form this profile.

Accordingly, improvements were made to the self-assessment tool to attain better consistency of approach across departments as well as to ensure common language, through improving the Bank's risk taxonomy. This is to facilitate bank-wide consolidation and enable better risk categorisation and treatment in the organisation. Greater engagement with line departments is done to both validate the risk management process in departments and to increase awareness and responsibility, thereby improving the Bank's overall risk culture.

Based on the self-assessment process which is a bottom-up approach, a preliminary corporate dashboard is formulated. This bank-wide risk profile was the foundation for triggering discussion with the management team to link the business area or process perspective to management's perspective and to establish better linkages with the Bank's strategy, key business objectives, and organisation and resource requirements. The ultimate aim is to bring together a top-down and bottom-up approach to complement each other and thus arrive at a holistic picture of risks in the Bank.

Bearing in mind the continuous evolution of risk management practices, benchmarking global best-practices is an ongoing process. Nevertheless, maintaining simplicity whilst ensuring the robustness of the Bank's risk management process remained a pressing challenge. Further work is required in education to enable departments to draw out key risks in their functions for upward reporting, without compromising detailed risk assessments at departmental level.

Overall, risk awareness across the organisation progressed in the year, evident from the growing reference to risk management in all strategic dialogues and the various levels of decision-making forums across the Bank. Encouraging was the increased commitment to risk management by the line departments. This is reflected by the better usage and more timely submission of self-assessment using RMU's self-assessment tool to respective Assistant Governors and the RMU, the increased quality (in coverage and depth) of the risk issues identified, greater peer-engagement within individual departments to determine the departments' risk profiles, as well as greater requests for the RMU to provide views and technical assistance in managing risk in various projects and initiatives. To raise the level of sound risk management culture and nurture an environment which is conducive for addressing risk issues, more workshops and discussions were conducted in the year.

The Bank also continued its participation in the International Operational Risk Working Group (IORWG), which was established to act as a centre of competence on operational risk management for central banks. The Bank was involved in discussions, forums and sharing of ideas which were facilitated by IORWG's dedicated website and annual conference. Annually, expert groups are established to do research on specific topics to further enhance frameworks and methodologies for the central bank community. The Bank is involved in a group which is looking at best ways to integrate risk management with strategic planning.

Strategic and Policy Risk

Strategic risk, or possible impediments to the achievement of the Bank's objectives and strategic aims by its very nature, is inherent in core processes and Bank-wide projects. Thus, in order to allow for active management of strategic risk within the Bank, institutional structures such as Management Committees and Steering Committees chaired by Senior Management are in place to oversee risk in strategic priority areas and key decision making processes.

To complement this, the design of RMU's self-assessment tool (the Annual Declaration) as well as the independent assessments by the RMU, are added measures to ensure the holistic capturing of strategic level risks for timely and proactive management.

In executing its role of promoting sound monetary and financial stability, as well as the role of the Central Bank in shaping the domestic financial landscape, another risk of concern to the Bank is policy risk. To ensure the effectiveness of the Bank's policy making mechanism, structures such as the policy risk and implementation framework are in place within the Bank. 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

An independent Treasury Risk Management Section (TRMS) of the Investment Operations and Financial Market Department is responsible to assess the treasury risk of the Bank and to enforce the Bank's treasury risk management policy with direct reporting to the Deputy Governor. The treasury risk management policy defines the risk parameters and TRMS is responsible to measure and monitor the treasury risk exposure and also reports the performance of the treasury operations. The risk assessment and performance provides value added input in the investment decision making process. In line with market best practices and advancement in IT, the Bank continued to upgrade and update its risk methodology and framework to ensure robust risk coverage on the investment of the foreign reserves. In 2007, a more quantitative market risk framework was adopted by the Bank which provides more detailed risk evaluations across different asset types under increasingly challenging market environment. In addition, the credit risk framework has also been strengthened to meet new challenges in the credit market. A ratings-based framework ensures strong credit risk management and maintains high credit quality of reserves despite the negative development in the credit market globally.

Operational Risk

The management of operational risk, commonly expressed as the risk of loss that arises from inadequate systems, controls or human error or other management failure continues to be a critical role and responsibility of heads of departments. In this respect, the respective directors are accountable for ensuring that risk management is integrated in all daily operations and departmental processes, as well as for attesting the appropriateness of risk treatments in place.

In addition to department specific operational risk mitigation such as detailed procedure manuals, clear roles and responsibilities, dual control/separation of duties and embedded process controls, organisation level controls that encompass an effective budgetary control, a sound procurement framework and the internal audit function are also present as additional check and balance measures.

In an effort to continuously enhance internal controls, a review of the payment policy and procedures was carried out in 2007. The enhanced controls and approving authorities for the procurement and payment processes have been incorporated in the Procurement Management Policy and Procedures.

Business Continuity Management (BCM)

The Bank's detailed BCM programme has two main objectives, which are to provide continuous critical central banking operations in order to pre-empt any systemic risk in the financial sector, as well as to provide for the safety of Bank staff and the protection of the Bank's assets.

A significant development in the year is the refinement of the Bank's BCM planning scope which covers among others, the expansion of the Bank's planning time-line to prepare the organisation for more prolonged interruptions. This would involve reviewing the Business Impact Analysis, Business Continuity Plan and requirements for the Recovery Centre. For greater recovery preparedness, the introduction of additional scenarios for test and live-runs, and deliberate inclusion of more departments in BCM exercises was also done in 2007.

Structurally, the RMC remains at the apex of the organisation's BCM structure and is responsible for endorsing the Bank's BCM policies and practices. Another important group in the BCM structure is the Crisis Management Team (CMT), chaired by a designated Deputy Governor with an Assistant Governor as the deputy. Tasked with the responsibility of managing events with negative repercussions to the Bank's services and physical infrastructure comprising building, people and systems, the CMT also met in the year to scrutinise results of bank-wide BCM exercises, and approved a new internal incident level-indicator to enhance clarity in roles and responsibilities and streamline incident responses in the Bank.

In 2007, the Bank's numerous designated critical teams also continued to be involved in various types of centralised and decentralised programmes and exercises. Some examples include the regular backup IT systems checks, live-runs and group table-top simulation exercises. These are all designed to provide continual training to the Bank's pre-identified key staff to enable appropriate recovery responses whenever required. Finally, an inaugural bank-wide notification exercise involving the entire Bank was also successfully organised during the year.

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 — Suhaimi bin Ali
  - Corporate Communications — Abu Hassan Alshari bin Yahaya
  - **DEPUTY GOVERNOR** — Dato' Ooi Sang Kuang
    - Internal Audit — Hor Weng Keng
    - Statistical Services — Chew Siew Kheam
    - **ASSISTANT GOVERNOR** — Vacant
      - Monetary Assessment and Strategy — Dr. Sukhdave Singh
      - Economics — Marzunisham bin Omar
      - 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 — Arlina binti Ariff
      - Strategic Management — Donald Joshua Jaganathan
      - Risk Management — Santhini a/p Chandrapal
  - **DEPUTY GOVERNOR** — Dato' 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
      - Sasana Kijang PMO — Lim Foo Thai
      - Central Banking Services — V. Vijayaledchumy
    - **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
  - **DEPUTY GOVERNOR** — Dato' Mohd Razif bin Abd. Kadir
    - **ASSISTANT GOVERNOR** — Dato' Muhammad bin Ibrahim
      - Financial Sector Development — Ahmad Hizzad bin Baharuddin
      - Financial Surveillance — S. Abd. Rasheed bin S. Abd Ghafur
      - Prudential Financial Policy — Jessica Chew Cheng Lian
      - Consumer and Market Conduct — Koid Swee Lian
      - Islamic Banking and Takaful — Bakarudin bin Ishak
      - Development Finance and Enterprise — Vacant
      - MIFC Promotion Unit — Shariffuddin bin Khalid
  - Regulation and Supervision Administration — Siti Ramlah binti Ahmad

Annual Financial Statements

CERTIFICATE OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF BANK NEGARA MALAYSIA FOR THE YEAR ENDED 31 DECEMBER 2007

I have audited the financial statements of Bank Negara Malaysia for the year ended 31 December 2007. 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 2007 and of the results of its operations for the year then ended in accordance with approved accounting standards.

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

PUTRAJAYA
12 MARCH 2008

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 2007 and of the results of operations for the year ended on that date.

On behalf of the Board,

ZETI AKHTAR AZIZ
CHAIRMAN

12 MARCH 2008
KUALA LUMPUR

On behalf of the Board,

OH SIEW NAM
DIRECTOR

12 MARCH 2008
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 12 March 2008.)

Before me,

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

LEE HISHAMMUDDIN ALLEN & GLEDHILL
Level 16, Menara TM 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 2007

	Note	2007 RM	2006 RM
ASSETS			
Gold and Foreign Exchange	3	334,338,606,394	288,871,214,113
International Monetary Fund Reserve Position		617,472,897	793,377,077
Holdings of Special Drawing Rights		760,950,672	756,926,104
Malaysian Government Papers	4	2,468,203,632	1,504,154,121
Deposits with Financial Institutions		62,470,044,391	4,626,624,482
Loans and Advances	5	12,288,159,901	12,924,727,795
Other Assets	6	11,937,972,319	13,551,017,533
Total Assets		**424,881,410,206**	**323,028,041,225**
LIABILITIES AND CAPITAL			
Currency in Circulation		42,192,729,256	37,896,029,181
Deposits by: Financial Institutions		231,591,665,147	176,459,444,828
Federal Government		14,274,462,010	16,624,678,860
Others	7	2,819,726,945	2,199,409,354
Bank Negara Papers		69,009,960,464	24,793,933,282
Allocation of Special Drawing Rights	8	726,822,946	736,745,411
Other Liabilities	9	34,518,924,334	31,668,377,651
Total Liabilities		395,134,291,102	290,378,618,567
Authorised Capital RM200,000,000			
Paid-up Capital	10	100,000,000	100,000,000
General Reserve Fund	11	10,799,678,929	9,362,550,221
Other Reserves	12	18,847,440,175	23,186,872,437
Total Capital		29,747,119,104	32,649,422,658
Total Liabilities and Capital		**424,881,410,206**	**323,028,041,225**

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

Bank Negara Malaysia

Income Statement for the Year Ended 31 December 2007

	Note	2007 RM	2006 RM
Total Income	13	**8,489,814,550**	**4,843,406,554**
Less:			
Recurring Expenditure	14	834,185,691	773,866,381
Development Expenditure	15	994,993,036	610,070,417
Total Expenditure		**1,829,178,727**	**1,383,936,798**
Net Profit		**6,660,635,823**	**3,459,469,756**

Profit and Loss Appropriation Statement for the Year Ended 31 December 2007

		2007 RM	2006 RM
Net Profit		**6,660,635,823**	**3,459,469,756**
Transfer to Other Reserves	16	3,723,507,115	1,000,000,000
Transfer to General Reserve Fund		1,437,128,708	1,259,469,756
Amount Payable to Federal Government		1,500,000,000	1,200,000,000
		6,660,635,823	**3,459,469,756**

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

Notes to the Financial Statements - 31 December 2007

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, with the revaluation of financial instruments that are held at fair value through profit and loss 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 2007 was RM335,717 million equivalent to USD101,344.8 million.

2.4 Gold, Securities and Investments

Gold, securities and investments are stated mainly at cost and provisions have been made for diminution in value as at 31 December 2007.

2.5 Repurchase and Reverse-Repurchase Agreements

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

2.6 **Net Profit**

The net profit of the Bank has been appropriated in accordance with section 7 of the Central Bank of Malaysia Act 1958 and only realised gains are made available for dividend distribution.

3. **Gold and Foreign Exchange**

	2007 **RM**	**2006** **RM**
Foreign Securities	239,672,351,872	222,484,196,755
Foreign Deposits	68,159,741,976	45,754,677,766
Balances with Other Central Banks, Bank for International Settlements (BIS) and International Monetary Fund (IMF)	6,603,359,274	7,689,540,079
Others	19,903,153,272	12,942,799,513
	334,338,606,394	288,871,214,113

4. **Malaysian Government Papers**

	2007 **RM**	**2006** **RM**
Malaysian Government Securities	2,468,203,632	1,504,154,121

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 RM11,233,737,492 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 subscriptions 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 RM726,822,946 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**

	2007 RM	2006 RM
As at 1 January	9,362,550,221	8,103,080,465
Transfer from Net Profit	1,437,128,708	1,259,469,756
As at 31 December	10,799,678,929	9,362,550,221

12. **Other Reserves**
Other reserves comprise the Exchange Rate Fluctuation Reserve, Revaluation Reserve and the Contingency Reserve. The Revaluation Reserve is created to deal with the movements in the market values of the Bank's investment portfolios which are designated at fair value through profit and loss.

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 the Central Bank of Malaysia Act 1958 and note 2.6.

17. **Contingent Liabilities**
Total contingent liabilities as at 31 December 2007 amounted to RM7,345,905,721. These comprise:
(a) an amount of RM7,282,788,042 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 RM63,117,679 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.

Annex

Contents

Foreign Exchange Administration Policies

Malaysia continues to maintain a liberal foreign exchange administration policy. The current foreign exchange administration rules are mainly prudential measures to support the overall macroeconomic objective of maintaining financial and economic stability.

I. DEFINITIONS

Non-residents:
- Overseas branches, subsidiaries, regional offices, sales offices and representative offices of resident corporations;
- Embassies, Consulates, High Commissions, supranational or international organisations recognised by the Government of Malaysia; or
- Malaysian citizens who have obtained permanent status of a territory outside Malaysia and are residing outside Malaysia.

Residents:
- Citizens of Malaysia (excluding persons who have obtained permanent resident status of a territory outside Malaysia and are residing abroad);
- Non-citizens who have obtained permanent resident status in Malaysia and are residing permanently in Malaysia; or
- Persons, whether body corporate or unincorporated, registered or approved by any authority in Malaysia.

Ringgit assets include:
- Ringgit-denominated securities including bills of exchange, private debt securities, Cagamas bonds or notes, Malaysian Government Securities, Treasury Bills, shares and warrants;
- Derivatives traded on Bursa Malaysia and OTC derivatives (excluding OTC derivatives and structured products which tantamount to lending or borrowing of ringgit between residents and non-residents);
- Fixed deposits and negotiable instruments of deposits denominated in ringgit;
- Immovable properties in Malaysia; and
- Other fixed assets in Malaysia.

Foreign currency assets include:
- Equity/portfolio investment abroad;
- Loans to non-residents;
- Foreign currency deposits onshore and offshore; and
- Investment in approved foreign currency products marketed by licensed onshore banks and any residents permitted by the Controller of Foreign Exchange (the Controller).

Domestic ringgit borrowing refers to any ringgit advance, loan, trade financing, hire purchase, factoring, leasing facilities, redeemable preference shares or similar facility in whatever name or form, except:
- Trade credit terms extended by a supplier for all types of goods and services;
- Forward exchange contracts entered into with licensed onshore banks;
- One personal housing loan and one vehicle loan obtained from residents;
- Credit card and charge card facilities; and
- Inter-company borrowing within a corporate group in Malaysia.

II. Foreign Exchange Administration Rules Applicable to NON-RESIDENTS

FOREIGN DIRECT AND PORTFOLIO INVESTMENTS BY NON-RESIDENTS	
The foreign exchange administration rules support and facilitate non-resident's investments into Malaysia.	
• Purchase of ringgit assets	• Free to purchase any ringgit assets including ringgit-denominated bonds issued by non-residents in Malaysia.
• Sourcing ringgit for settlement of ringgit assets	• Ringgit for settlement of the investment can be sourced from: ✓ Non-resident's own External Accounts[1]; ✓ Sale of foreign currency on spot or forward basis, with licensed onshore banks or overseas branches appointed by licensed onshore banks; or ✓ Onshore borrowing.
• Onshore borrowing	• Free to borrow any amount in foreign currency from licensed onshore banks. • Allowed to borrow in ringgit up to RM10 million in aggregate from licensed onshore banks for any purpose in Malaysia, including financing the purchase of ringgit assets. • Allowed to borrow any amount for margin financing from resident stockbroking companies.
• Divestment/income from investment	• Free to repatriate funds from divestment of ringgit assets or profits/dividends arising from the investments. • Repatriation, however, must be made in foreign currency other than the currency of Israel.
• Hedging	• Free to hedge the exposure arising from investment in ringgit assets made on or after 1 April 2005 with the licensed onshore banks or overseas branches appointed by licensed onshore banks.
INVESTMENT IN IMMOVABLE PROPERTIES BY NON-RESIDENTS	
• Purchase of immovable property	• Free to purchase residential and commercial properties in Malaysia. • Such purchase need only to comply with guidelines[2] issued by the Foreign Investment Committee of Malaysia. The details can be obtained at http://www.epu.jpm.my.
• Onshore borrowing	• Free to borrow any amount to finance or refinance the purchase of residential and commercial properties in Malaysia, except for purchase of land only.

[1] External Accounts are ringgit accounts maintained with licensed onshore banks by or for non-residents.
[2] (a) FIC approval is not required for non-residents purchasing residential property exceeding RM250,000; and
(b) Non-residents under the "Malaysia My Second Home" Programme are exempted from any approval requirement.

LENDING IN RINGGIT AND FOREIGN CURRENCY BY NON-RESIDENTS TO RESIDENTS

- Ringgit lending
  - Lending in ringgit to a resident by a non-resident requires prior permission of the Controller.
- Foreign currency lending
  - Free to lend in foreign currency to a resident provided the resident borrower's total foreign currency borrowing does not exceed the following limits:

Resident individual	RM10 million equivalent in aggregate
Resident corporation	RM100 million equivalent in aggregate on a corporate group basis

  - The onus is on the resident borrower to obtain the prior permission of the Controller for borrowing exceeding the limits.

BORROWING BY NON-RESIDENTS FROM RESIDENTS

- Foreign currency borrowing from licensed onshore banks
  - Free to borrow any amount of foreign currency from licensed onshore banks.
- Foreign currency borrowing from non-bank residents
  - Free to obtain foreign currency borrowing from a non-bank resident as follows:

Resident lender	Amount
A resident with no domestic ringgit borrowing	No limit
A resident, with or without domestic ringgit borrowing, using own foreign currency funds maintained onshore or offshore	No limit
A resident with domestic ringgit borrowing*: ✓ Individual ✓ Corporation	Through conversion of ringgit up to: ✓ RM1 million in aggregate per calendar year ✓ RM50 million in aggregate per calendar year on a corporate group basis

* Provided the resident lender's total investment in foreign currency assets, including lending in foreign currency, does not exceed the limit.

<table>
<tr><td>• Ringgit borrowing from licensed onshore banks and non-bank residents</td><td>• Free to obtain ringgit borrowing from licensed onshore banks and non-bank residents as follows:
<table>
<tr><td>Borrowing by non-residents (other than stockbroking companies and correspondent banks) from licensed onshore banks for any purpose in Malaysia</td><td>Up to RM10 million in aggregate</td></tr>
<tr><td>Borrowing by non-resident stockbroking companies and custodian banks from licensed onshore banks for settlement of ringgit securities on Bursa Malaysia and RENTAS due to inadvertent delays on the receipt of funds</td><td>No limit</td></tr>
<tr><td>Borrowing by non-residents (other than stockbroking companies and correspondent banks) from licensed onshore banks and resident stockbroking companies for margin financing</td><td>No limit</td></tr>
<tr><td>Borrowing from licensed onshore banks or non-bank residents to finance or refinance the purchase of residential and commercial properties in Malaysia</td><td>No limit</td></tr>
<tr><td>Borrowing from non-bank residents</td><td>Up to RM10,000 in aggregate</td></tr>
<tr><td>Borrowing from resident insurance companies</td><td>Up to the cash surrender value of the insurance policies purchased by the non-residents</td></tr>
</table>
</td></tr>
<tr><td colspan="2">ISSUANCE OF RINGGIT AND FOREIGN CURRENCY DENOMINATED BONDS/SUKUK IN MALAYSIA BY NON-RESIDENTS</td></tr>
<tr><td>• Issuance of ringgit or foreign currency denominated bonds/sukuk</td><td>• Multilateral Development Banks, Multilateral Financial Institutions, foreign sovereign, foreign quasi-sovereign agencies and foreign multinational companies may issue ringgit or foreign currency denominated bonds/sukuk in Malaysia.</td></tr>
<tr><td>• Utilisation of bond/sukuk proceeds</td><td>• Proceeds from the issuance of bonds/sukuk are allowed to be used onshore or offshore.
• Ringgit-denominated bond/sukuk proceeds to be used offshore have to be converted into foreign currency with the licensed onshore banks.</td></tr>
<tr><td>• Hedging</td><td>• Issuers are free to hedge exchange rate and interest/profit rate exposure arising from the issuance of ringgit-denominated bonds/sukuk and any subsequent interest/profit and coupon payments with the licensed onshore banks.
• Non-resident investors of the bonds/sukuk are also free to hedge exchange rate and interest/profit rate exposure with licensed onshore banks.</td></tr>
</table>

• Guidelines for issuance	• Specific details on guidelines as well as incentives for issuance of ringgit and foreign currency denominated bonds/sukuk in Malaysia can be obtained at any of the following web-site addresses: ✓ http://www.mifc.com ✓ http://www.bnm.gov.my/fxadmin ✓ http://www.sc.com.my
HEDGING BY NON-RESIDENTS	
• Hedging of ringgit assets	• Free to hedge with licensed onshore banks, exchange rate and interest rate exposures arising from investments in ringgit assets purchased on or after 1 April 2005 as well as ringgit-denominated bonds/sukuk issued in Malaysia by non-residents.
OPENING OF RINGGIT AND FOREIGN CURRENCY ACCOUNTS IN MALAYSIA BY NON-RESIDENTS	
• Opening of ringgit and foreign currency accounts	• Free to open foreign currency and ringgit accounts with licensed onshore banks. • The ringgit accounts maintained by non-residents with licensed onshore bank in Malaysia are termed as "External Accounts".
• Repatriation/utilisation of funds from the ringgit or foreign currency accounts	• **External Accounts** ✓ Free to convert with licensed onshore bank for repatriation abroad. ✓ Free to pay a resident for any purpose, except for the following:- ➢ Payment for the import of goods and services; ➢ Lending in ringgit to residents other than as permitted by the Controller; and ➢ Payment on behalf of a third party. ✓ Free to pay to another non-resident's External Account for settlement of purchase of ringgit assets from the non-resident. • **Foreign currency accounts** ✓ Free to repatriate. ✓ Free to pay a resident for any purpose including for settlement of goods and services.
IMPORT AND EXPORT OF RINGGIT AND FOREIGN CURRENCY BY NON-RESIDENT TRAVELLERS	
• Import and export of ringgit notes	• Allowed to import or export ringgit notes up to RM1,000.
• Import of foreign currency notes and traveller's cheques	• No limit.
• Export of foreign currency notes and traveller's cheques	• Up to the amount brought into Malaysia or USD10,000, whichever is higher.
• Declaration for import and export of foreign currency	• To declare in the Arrival/Departure Card (IMM.26) issued by the Immigration Department for foreign currency notes and travellers' cheques exceeding USD10,000.

• Import and export of ringgit and foreign currency exceeding permitted limits	• Application can be made online, using Form 13 which can be obtained at http://www.bnm.gov.my/fxadmin, or submitted via written application to Foreign Exchange Administration Department, Bank Negara Malaysia. • Response is given within one day from receipt of application with complete information.

III. Foreign Exchange Administration Rules Applicable to RESIDENTS

INVESTMENTS IN FOREIGN CURRENCY ASSETS BY RESIDENTS	
The current limits for investment in foreign currency assets are applicable only to residents that have domestic ringgit borrowing and convert ringgit into foreign currency to invest in foreign currency assets.	
• Investment in foreign currency assets	• No limits for residents without domestic ringgit borrowing, using own ringgit or foreign currency funds. • Residents with domestic ringgit borrowing are allowed to invest as follows: ✓ Resident individual: ➢ No limit if funded with own foreign currency funds; ➢ Up to RM1 million equivalent in aggregate per calendar year if from conversion of ringgit; and ➢ Up to RM10 million equivalent in aggregate if funded using foreign currency borrowing. ✓ Resident corporation: ➢ No limit if funded with own foreign currency funds; ➢ No limit if funded from proceeds of listing through initial public offering on: - the Main Board of Bursa Malaysia; or - foreign stock exchanges ➢ Up to RM50 million equivalent in aggregate and on corporate group basis per calendar year if from conversion of ringgit; and ➢ Up to RM100 million equivalent in aggregate and on a corporate group basis if funded using foreign currency borrowing.

• Investment in foreign currency assets by resident institutional investors ✓Unit trust management company ✓Fund management company ✓Insurers and takaful operators	✓ Unit trust management company: ➢ Investment of Islamic funds - No limit ➢ Investment of conventional funds **Foreign currency-denominated funds** - 100% of the net asset value (NAV) **Ringgit-denominated funds** - 100% of NAV attributed to non-residents; - 100% of NAV attributed to residents without domestic ringgit borrowing; and - 50% of NAV attributed to residents with domestic ringgit borrowing. ✓ Fund management companies: ➢ Fund mandated to be invested in Shariah-compliant assets - No limit ➢ Fund mandated to be invested in non Shariah-compliant assets **Foreign currency funds** - No limit **Ringgit funds** - 100% of total funds managed for non-residents; - 100% of total funds managed for residents without domestic ringgit borrowing; and - 50% of total funds managed for residents with domestic ringgit borrowing. ✓ Insurers and takaful operators, including international currency business unit of takaful operators and international takaful operators: **Foreign currency-denominated funds** - 100% of NAV of foreign currency investment-linked funds marketed to residents and non-residents **Ringgit-denominated funds** - 100% of NAV of investment-linked funds marketed to non-residents; - 100% of NAV of investment-linked funds marketed to residents without domestic ringgit borrowing; - 50% of NAV of investment-linked funds marketed to residents with domestic ringgit borrowing; - 10% of margin of solvency for insurer; and - 5% of total assets for takaful operator.

• Payment for purchase of foreign currency assets	• Offshore foreign currency assets: ✓ Payment must be made in foreign currency other than the currency of Israel. ✓ The foreign currency may be sourced from conversion of ringgit with licensed onshore banks or own foreign currency funds. • Onshore foreign currency assets offered by licensed onshore banks or entities[3] approved by the Controller: ✓ Payment may be in foreign currency or ringgit.
• Divestment/income from investment in foreign currency assets	• Free to repatriate and convert divestment proceeds or income from investment in foreign currency assets into ringgit. • Free to retain the proceeds in foreign currency accounts.
• Hedging	• Free to hedge with licensed onshore banks for investment in foreign currency assets based on firm underlying commitment.
BORROWING IN FOREIGN CURRENCY AND RINGGIT BY RESIDENTS	
• Foreign currency borrowing ✓ By resident individuals	• Free to borrow in foreign currency up to the equivalent of RM10 million in aggregate from: ✓ Licensed onshore banks; and ✓ Non-residents.
✓ By resident corporations	• Free to borrow in foreign currency up to the equivalent of RM100 million in aggregate on a corporate group basis: ✓ From licensed onshore banks; ✓ From non-residents; and ✓ Through issuance of foreign currency denominated bonds onshore and offshore.
✓ Proceeds from offshore listing	• Free to borrow from another resident company within the same corporate group, the foreign currency proceeds from the listing on foreign stock exchanges.
✓ Foreign currency trade financing facilities	• Free to obtain foreign currency trade financing facilities from licensed onshore banks. • Foreign currency trade financing facilities (other than for financing of export of goods) from offshore up to the equivalent of RM5 million in aggregate. • Trade financing facilities for export of goods are to be obtained from licensed onshore banks only.
✓ Repayment and prepayment	• Free to repay and prepay approved foreign currency borrowing.
✓ Hedging	• Free to hedge drawdown and repayment of foreign currency borrowing with licensed onshore banks.
• Ringgit borrowing from non-residents	• Prior permission is required for residents to obtain any amount of ringgit borrowing from non-residents.

[3] Example: (a) Unit trust companies offering foreign currency unit trust funds.
(b) Bursa Malaysia for trading of foreign currency derivative products such as CPO futures.

ISSUANCE OF RINGGIT AND FOREIGN CURRENCY DENOMINATED SECURITIES BY RESIDENTS	
• Issuance of securities to non-residents	• Free to issue the following ringgit securities registered in Malaysia to non-residents: ✓ Ordinary shares, including bonus and rights issues; ✓ Irredeemable preference shares; and ✓ Private debt securities. • Prior permission is required for issuance of securities to non-residents other than as stated above.
• Issuance of bonds/sukuk: ✓ Ringgit-denominated bonds/sukuk	• Free to issue in Malaysia.
✓ Foreign currency-denominated bonds/sukuk	• Allowed as long as total foreign currency borrowing, including the bonds/sukuk does not exceed RM100 million equivalent.
• Utilisation of bond proceeds: ✓ Ringgit-denominated bonds/sukuk	• Free to use onshore. • Free to use for investment in foreign currency assets provided issuer's total investment does not exceed RM50 million equivalent in aggregate per calendar year.
✓ Foreign currency-denominated bonds/sukuk	• Free to use onshore and offshore.
• Guidelines for issuance	• Guidelines for issuance can be obtained at: ✓ http://www.mifc.com ✓ http://www.bnm.gov.my/fxadmin ✓ http://www.sc.com.my
EXPORT AND IMPORT OF GOODS AND SERVICES BY RESIDENTS	
• Currency for payment of import and export	• Payment must be made in foreign currency other than the currency of Israel.
• Repatriation of export proceeds	• Must be repatriated to Malaysia in full as per the sales contract and not exceeding six months from the date of export. • Prior permission is required for residents to: ✓ Offset export proceeds against other payables to non-residents; or ✓ Receive the export proceeds exceeding six months from date of export.
• Retention of export proceeds	• Free to retain in foreign currency accounts and ringgit accounts with licensed onshore banks. • Prior permission is required to retain export proceeds in foreign currency accounts maintained with offshore banks.
• Hedging	• Free to hedge with licensed onshore banks, payments or receipt for the import or export of goods and services: ✓ Based on firm underlying commitment; or ✓ On anticipatory basis up to the actual total amount paid or received in the preceding 12 months.

OPENING OF FOREIGN CURRENCY ACCOUNTS (FCA) BY RESIDENTS	
• Opening of FCA	• Free to open FCA with licensed onshore banks and offshore banks.
• Sources of funds	• The account can be credited with foreign currency funds sourced: ✓ From conversion of ringgit with licensed onshore banks: ➢ No limit for residents without domestic ringgit borrowing; ➢ For residents with domestic ringgit borrowing up to permitted limits for investment in foreign currency assets. Additional limits for overseas education and employment purposes: - Up to USD150,000 each with licensed onshore banks or licensed offshore banks in Labuan; and - Up to USD50,000 with overseas banks. ✓ From other residents for permitted purposes; and ✓ From non-residents. Export proceeds, however, may be retained with licensed onshore banks only.
• Opening of joint FCA	• Resident individuals are free to open joint foreign currency accounts for any purpose. • Resident corporations, however, require prior permission to open joint foreign currency accounts.
PAYMENT BETWEEN RESIDENTS	
• Payment in ringgit	• No restriction.
• Payment in foreign currency	• Resident corporations with export earnings are free to pay another resident corporation in foreign currency for settlement of goods and services.
HEDGING BY RESIDENTS	
• Hedging of current account transactions	• Free to hedge with licensed onshore banks for payments and receipts for import and export of goods and services: ✓ Based on firm underlying commitment; or ✓ On anticipatory basis provided the amount entered does not exceed the total amount paid or received in the preceding 12 months.
• Hedging of capital account transactions	• Free to hedge with licensed onshore banks based on committed capital inflows or outflows. • Residents are also allowed to hedge their existing holdings of foreign currency assets.

IMPORT AND EXPORT OF RINGGIT AND FOREIGN CURRENCY BY RESIDENT TRAVELLERS	
• Import and export of ringgit notes	• Allowed to import or export ringgit notes up to RM1,000.
• Import of foreign currency notes and traveller's cheques	• No limit.
• Export of foreign currency notes and traveller's cheques	• Allowed to export foreign currency notes and traveller's cheques up to an equivalent of USD10,000.
• Import and export of ringgit and foreign currency exceeding permitted limits	• Application can be made online, using Form 13 which can be obtained at http://www.bnm.gov.my/fxadmin, or submitted via written application to Foreign Exchange Administration Department, Bank Negara Malaysia. • Response is given within one day from receipt of application with complete information.

Key Economic and Financial Statistics

Table A.1
Gross Domestic Product by Kind of Economic Activity at Constant 2000 Prices

	2003	2004	2005	2006	2007*p*	2008*f*
	RM million					
Agriculture	33,369	34,929	35,822	37,672	38,501	39,817
Mining and quarrying	40,959	42,627	42,076	41,914	43,245	45,840
Manufacturing	119,687	131,127	138,014	147,756	152,367	155,150
Construction	15,031	14,903	14,637	14,559	15,223	16,063
Services	201,568	214,528	228,994	245,550	269,276	289,982
Less: Undistributed FISIM[1]	17,654	17,705	17,742	18,347	19,720	20,862
Plus: Import duties	6,453	6,099	6,017	5,287	5,517	5,959
GDP at puchasers' prices[2]	**399,414**	**426,508**	**447,818**	**474,392**	**504,408**	**531,949**
	Annual change (%)					
Agriculture	6.0	4.7	2.6	5.2	2.2	3.4
Mining and quarrying	6.1	4.1	-1.3	-0.4	3.2	6.0
Manufacturing	9.2	9.6	5.3	7.1	3.1	1.8
Construction	1.8	-0.9	-1.8	-0.5	4.6	5.5
Services	4.2	6.4	6.7	7.2	9.7	7.7
Less: Undistributed FISIM[1]	3.7	0.3	0.2	3.4	7.5	5.8
Plus: Import duties	-2.1	-5.5	-1.3	-12.1	4.3	8.0
GDP at purchasers' prices	**5.8**	**6.8**	**5.0**	**5.9**	**6.3**	**5.0 ~ 6.0**

[1] Financial intermediation services indirectly measured
[2] Numbers may not necessarily add up due to rounding
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.2
Growth in Manufacturing Production (2000=100)

	2004	2005	2006	2007	2005	2006	2007
	Index				Annual change (%)		
Export-oriented industries	**123.8**	**130.8**	**140.7**	**141.8**	**5.7**	**7.5**	**0.7**
Electrical machinery, apparatus, appliances and supplies	124.5	128.9	139.1	137.8	3.5	7.9	-0.9
Electronics	*136.0*	*143.0*	*160.0*	*162.4*	*5.2*	*11.8*	*1.5*
Electrical products	*102.1*	*101.3*	*98.3*	*89.7*	*-0.8*	*-2.9*	*-8.7*
Chemicals and chemical products	134.9	149.7	154.5	157.2	11.0	3.2	1.8
Petroleum products[1]	127.4	141.2	160.4	169.0	10.8	13.6	5.4
Textiles, wearing apparel and footwear	81.4	84.1	89.3	81.0	3.4	6.1	-9.3
Wood and wood products	107.9	109.6	113.8	115.4	1.5	3.8	1.4
Rubber products	134.3	133.8	143.4	151.8	-0.4	7.2	5.9
Off-estate processing	121.2	131.0	138.5	137.7	8.1	5.7	-0.5
Others	111.4	107.4	119.4	126.0	-3.7	11.3	5.5
Domestic-oriented industries	**119.9**	**123.2**	**132.1**	**141.1**	**2.8**	**7.2**	**6.8**
Construction-related products	111.2	110.7	114.2	120.0	-0.5	3.2	5.0
Non-metallic mineral products	*111.0*	*113.2*	*117.0*	*117.4*	*2.0*	*3.3*	*0.4*
Basic iron & steel and non-ferrous metal	*111.7*	*105.8*	*109.0*	*124.8*	*-5.3*	*3.0*	*14.5*
Food products	120.5	129.7	138.3	148.8	7.6	6.7	7.6
Transport equipment	138.5	150.2	147.9	139.0	8.5	-1.5	-6.0
Fabricated metal products	129.9	123.5	156.3	186.5	-4.9	26.5	19.4
Paper products	110.7	119.0	134.6	149.5	7.5	13.1	11.0
Beverages	112.4	119.3	112.9	122.3	6.1	-5.3	8.3
Tobacco products	90.5	87.8	83.6	85.9	-3.0	-4.7	2.8
Total	**123.0**	**129.3**	**139.0**	**141.6**	**5.1**	**7.5**	**1.9**

[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

	2003	2004	2005	2006	2007*p*	2004	2005	2006	2007*p*
	Volume					Annual change (%)			
Crude palm oil ('000 tonnes)	13,355	13,976	14,961	15,881	15,823	4.7	7.0	6.1	-0.4
Rubber ('000 tonnes)	986	1,169	1,126	1,284	1,201	18.6	-3.7	14.0	-6.4
Saw logs ('000 cu. metres)	21,532	21,782	22,398	21,344	20,214	1.2	2.8	-4.7	-5.3
Cocoa ('000 tonnes)	36	33	28	32	35	-7.8	-16.3	14.2	10.2
Crude oil (including condensates) ('000 bpd)	738	762	704	667	695	3.3	-7.7	-5.2	4.3
Natural gas (mmscfd)	5,013	5,196	5,797	5,774	5,854	3.7	11.6	-0.4	1.4
Tin-in-concentrates ('000 tonnes)	3.4	2.7	2.9	2.4	n.a.	-18.3	4.1	-16.1	-

p Preliminary
n.a. Not available

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
Gross National Income by Demand Aggregrates

	2003	2004	2005	2006	2007*p*	2008*f*
	at Current Prices (RM million)					
Consumption	240,980	268,206	297,583	326,393	374,563	414,679
Private consumption	*186,674*	*208,571*	*233,305*	*257,868*	*295,685*	*324,352*
Public consumption	*54,306*	*59,635*	*64,278*	*68,525*	*78,878*	*90,327*
Investment	93,864	99,336	107,185	119,596	139,972	153,600
Private investment	*33,798*	*50,592*	*53,705*	*60,835*	*72,471*	*81,650*
Public investment	*60,066*	*48,744*	*53,480*	*58,761*	*67,501*	*71,950*
Change in stocks[1]	1,462	9,930	-1,868	-1,061	-2,179	-707
Exports of goods and services	447,846	546,925	611,081	669,776	702,905	723,717
Imports of goods and services	365,383	450,350	494,530	542,150	573,763	591,583
GDP at purchasers' value	418,769	474,048	519,451	572,555	641,499	699,706
Net factor payments abroad	-22,537	-24,402	-23,908	-17,356	-13,704	-16,144
GNI at purchasers' value	396,232	449,646	495,543	555,199	627,795	683,562
	at Constant 2000 prices (RM million)					
Consumption	231,362	253,025	273,764	291,899	322,807	343,485
Private consumption	*180,423*	*198,193*	*215,435*	*230,641*	*257,625*	*274,371*
Public consumption	*50,939*	*54,832*	*58,329*	*61,258*	*65,182*	*69,114*
Investment	91,317	94,562	99,266	107,116	118,075	122,237
Private investment	*33,614*	*49,239*	*50,841*	*54,392*	*61,107*	*64,978*
Public investment	*57,703*	*45,322*	*48,425*	*52,724*	*56,968*	*57,259*
Change in stock[1]	966	4,052	-1,651	-1,108	-13,626	-4,417
Exports of goods and services	440,963	511,774	552,094	592,898	614,914	620,707
Imports of goods and services	365,195	436,906	475,655	516,412	537,761	550,062
GDP at purchasers' value	399,414	426,508	447,818	474,392	504,408	531,949
Net factor payments abroad	-22,605	-23,760	-24,139	-20,567	-17,671	-21,998
GNI at purchasers' value	376,809	402,838	423,679	453,825	486,737	509,951

[1] Includes statistical discrepancy

p Preliminary

f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5
Savings-Investment Gap

	2003	2004	2005	2006	2007*p*	2008*f*
	RM million					
Public gross domestic capital formation	60,066	48,744	53,480	58,761	67,501	71,950
Public savings	60,093	73,000	70,506	83,234	83,757	85,893
Deficit/surplus	27	24,256	17,026	24,473	16,256	13,943
Private gross domestic capital formation	35,260	60,522	51,837	59,774	70,292	80,943
Private savings	85,859	93,807	110,491	128,720	153,372	165,253
Deficit/surplus	50,599	33,285	58,654	68,946	83,080	84,310
Gross domestic capital formation	95,326	109,266	105,317	118,535	137,793	152,893
(as % of GNI)	24.1	24.3	21.3	21.4	21.9	22.4
Gross national savings	145,952	166,807	180,997	211,954	237,129	251,146
(as % of GNI)	36.8	37.1	36.5	38.2	37.8	36.7
Balance on current account	50,626	57,541	75,680	93,419	99,336	98,253
(as % of GNI)	12.8	12.8	15.3	16.8	15.8	14.4

p Preliminary
f Forecast
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.6
Labour Market: Selected Indicators

	2003	2004	2005	2006	2007e
	(number of positions/persons)				
Active Vacancies Reported by Industry[1]					
Agriculture, hunting, forestry and fishery	29,048	1,373	40,438	188,104	226,759
Mining and quarrying	121	41	150	861	1,163
Manufacturing	34,977	17,769	112,542	348,302	275,155
Construction	13,818	3,505	48,524	129,586	117,217
Services	18,954	18,624	63,441	154,902	204,599
Electricity, gas and water supply	*499*	*198*	*859*	*2,227*	*1,477*
Wholesale and retail trade, hotels and restaurants	*7,359*	*5,221*	*23,921*	*67,956*	*66,600*
Transport, storage and communication	*1,459*	*1,046*	*3,892*	*8,287*	*12,578*
Finance, insurance, real estate and business services	*4,079*	*6,162*	*13,874*	*26,642*	*50,235*
Public administration, defence and compulsory social security	*5,558*	*1,224*	*2,497*	*3,539*	*11,287*
Community, social and personal service activities		*4,773*	*18,398*	*46,251*	*62,422*
Others not elsewhere classified	–	8,663	39,405	12,920	289
Total vacancies	**96,918**	**49,975**	**304,500**	**834,675**	**825,182**
Retrenchment by Category of Occupation					
Administration and management	1,755	2,072	1,712	1,245	1,120
Professional, technician and associate professional	3,661	2,542	2,689	2,471	2,367
Clerical workers	2,481	1,550	1,295	1,370	1,060
Service, shop and market sales workers	1,818	3,201	1,792	2,501	1,690
Skilled agriculture and fishery workers	337	998	50	307	193
Production workers[2]	11,154	9,593	8,571	7,466	7,599
Others not elsewhere classified	–	–	–	–	6
Total retrenchments	**21,206**	**19,956**	**16,109**	**15,360**	**14,035**
Employment by Industry[3] ('000 persons)					
Agriculture, forestry, livestock and fishery	1,413.2	1,406.9	1,401.3	1,392.4	1,386.3
Mining and quarrying	42.2	42.6	42.7	42.6	42.9
Manufacturing	2,776.4	2,972.4	3,133.2	3,244.3	3,317.1
Construction	774.6	767.3	759.6	755.2	757.3
Services	5,040.7	5,274.5	5,555.9	5,724.6	5,888.8
Electricity, gas and water supply	*85.5*	*89.9*	*93.0*	*95.0*	*96.5*
Transport, storage and communication	*548.7*	*594.3*	*630.6*	*646.4*	*661.8*
Wholesale and retail trade, hotels and restaurants	*1,698.1*	*1,786.4*	*1,927.0*	*1,993.6*	*2,060.4*
Finance, insurance, real estate and business services	*657.5*	*695.0*	*734.4*	*771.0*	*802.7*
Government services	*1,026.1*	*1,041.8*	*1,052.8*	*1,064.0*	*1,075.3*
Other services	*1,024.8*	*1,067.1*	*1,118.1*	*1,154.7*	*1,192.2*
Total employment	**10,047.2**	**10,463.7**	**10,892.8**	**11,159.0**	**11,392.4**
Unemployment rate[3] (% of labour force)	**3.6**	**3.5**	**3.5**	**3.3**	**3.3**

[1] Refers to active 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

	2006	2007				
		1Q	2Q	3Q	4Q	Year
Sales of passenger cars ('000 units)	374.2	95.6	104.8	125.1	117.3	442.9
Annual change (%)	-12.3	4.1	4.9	25.1	42.4	18.4
Imports of consumption goods (RM billion)	27.9	7.0	6.8	7.5	7.6	28.9
Annual change (%)	13.4	8.9	1.1	1.2	3.8	3.6
Tax collection						
Sales tax (RM billion)	6.5	1.4	1.6	1.5	2.1	6.6
Service tax (RM billion)	2.7	0.5	0.8	0.7	1.0	3.0
Narrow Money (M1)						
Annual change (%)	13.7	17.8	16.2	18.5	19.5	19.5
Loans disbursed by banking system						
Consumption credit (excl. passenger cars)						
Annual change (%)	9.5	15.7	3.5	20.7	17.9	14.5
Retail trade, restaurants and hotels						
Annual change (%)	-6.7	-5.2	-13.1	5.0	19.3	1.0
Credit card turnover spending (RM billion)	47.3	13.1	13.2	14.1	15.2	55.6
Annual change (%)	13.3	18.3	16.4	15.1	19.9	17.5
MIER Consumer Sentiment Index	-	124.1	115.9	117.5	110.7	-
KL Composite Index	1,096.2	1,246.9	1,354.4	1,336.3	1,445.0	1,445.0
Commodity prices						
CPO (RM/tonne)	1,521	1,940	2,451	2,596	2,902	2,472
Crude oil (USD/barrel)	69	65	76	77	96	78
Rubber (sen/kg)	709	707	741	715	783	736

Table A.8
Private Investment Indicators

	2006	2007				
		1Q	2Q	3Q	4Q	Year
Sales of commercial vehicles ('000 units)	116.6	9.3	11.0	12.4	11.6	44.3
Annual change (%)	-7.1	-70.9	-60.1	-60.1	-55.3	-62.0
Imports of capital goods (RM billion)	65.3	14.9	16.5	19.1	19.5	70.0
Annual change (%)	7.4	-5.3	-1.1	17.5	17.3	7.2
Approvals by MITI (Manufacturing sector)						
No. of projects	1,077	207	281	216	245	949
Capital investment (RM billion)	46.0	6.5	25.1	7.9	20.4	59.9
Foreign	*20.2*	*4.0*	*12.4*	*5.4*	*11.7*	*33.4*
Local	*25.8*	*2.5*	*12.7*	*2.5*	*8.7*	*26.5*
New investment (% share)	63.8	80.7	29.1	48.2	72.4	52.0
Reinvestments (% share)	36.2	19.3	70.9	51.8	27.6	48.0
Loans disbursed by banking system						
Manufacturing sector						
Annual change (%)	-6.2	19.6	9.4	11.1	13.8	13.3
Construction sector						
Annual change (%)	0.1	9.6	5.8	7.4	5.0	6.9
Private Debt Securities (excluding Cagamas)						
Total funds raised (RM billion)	31.7	6.2	20.6	12.1	28.7	67.6
New activities	21.0	4.5	6.5	8.3	12.5	31.8
Initial Public Offerings (Bursa Malaysia)						
Total funds raised (RM billion)	1.5	0.6	0.5	0.4	1.0	2.5
MIER Business Conditions Survey						
Business Conditions Index	-	105.5	122.1	117.5	105.5	-
Capacity Utilisation Rate	-	79.6	80.4	81.0	82.0	-
MSC-Status Companies						
No. of companies	307	45	78	71	72	266
Approved investment (RM billion)	2.9	0.4	1.0	1.2	1.1	3.7

Table A.9
Balance of Payments

Item	2004			2005		
	+	-	Net	+	-	Net
	RM million					
Goods[1]	**481,903**	**377,129**	**104,774**	**536,955**	**411,393**	**125,562**
Trade account	*481,253*	*399,632*	*81,621*	*533,788*	*434,010*	*99,778*
Services	**65,022**	**73,221**	**-8,199**	**74,127**	**83,136**	**-9,010**
Transportation	12,147	29,692	-17,545	15,357	31,790	-16,433
Travel	31,171	12,075	19,096	33,500	14,051	19,449
Other services	21,279	30,308	-9,029	24,842	36,518	-11,676
Government transactions n.i.e.[2]	426	1,147	-721	428	777	-350
Balance on goods and services	**546,925**	**450,350**	**96,575**	**611,081**	**494,530**	**116,552**
Income	**16,452**	**40,854**	**-24,402**	**20,346**	**44,255**	**-23,908**
Compensation of employees	3,047	4,042	-995	4,229	4,711	-482
Investment income[3]	13,405	36,812	-23,408	16,117	39,543	-23,426
Current transfers	**1,603**	**16,474**	**-14,871**	**1,131**	**18,095**	**-16,963**
Balance on current account	**564,980**	**507,678**	**57,302**	**632,559**	**556,879**	**75,681**
% of GNI			**12.7**			**15.3**
Capital account			–			–
Financial account			**19,347**			**-37,019**
Direct investment			9,739			3,771
Abroad			*-7,833*			*-11,253*
In Malaysia			*17,572*			*15,024*
Portfolio investment			32,994			-14,156
Other investment			-23,386			-26,634
Official sector			*2,400*			*-3,150*
Private sector			*-25,786*			*-23,484*
Balance on capital and financial accounts			**19,347**			**-37,019**
Errors and omissions			**7,079**			**-25,111**
of which:						
Foreign exchange revaluation gain (+) / loss (-)			7,997			-15,496
Overall balance (surplus + / deficit -)			**83,728**			**13,550**
Bank Negara Malaysia international reserves, net[4]						
RM million			251,690			265,240
USD million			66,235			70,193
Reserves as months of retained imports			7.9			7.7

1 Adjusted for valuation and coverage to the balance of payments basis. Imports include military goods which are not included in trade data
2 Include transactions of foreign military and diplomatic establishments
3 Include undistributed earnings of foreign direct investment companies. The counterpart of these earnings is shown as reinvested earnings under "Direct Investment" in the Financial Account
4 All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account
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

2006			2007*e*			2008*f*		
+	-	Net	+	-	Net	+	-	Net
RM million								
589,743	**455,185**	**134,558**	**605,814**	**477,669**	**128,145**	**616,993**	**485,870**	**131,123**
588,965	*480,773*	*108,193*	*605,153*	*504,814*	*100,339*	*616,169*	*511,974*	*104,195*
80,034	**86,964**	**-6,931**	**97,091**	**96,094**	**997**	**106,724**	**105,713**	**1,011**
15,491	35,111	-19,620	24,174	37,689	-13,516	24,841	38,618	-13,777
38,237	14,736	23,501	44,322	18,017	26,305	50,900	22,494	28,406
25,905	36,283	-10,378	28,294	39,696	-11,402	30,582	43,912	-13,330
401	834	-433	301	691	-390	401	689	-288
669,776	**542,150**	**127,627**	**702,905**	**573,763**	**129,142**	**723,717**	**591,583**	**132,134**
30,993	**48,349**	**-17,356**	**38,794**	**52,498**	**-13,704**	**38,133**	**54,277**	**-16,144**
5,004	5,287	-283	5,350	5,877	-527	6,239	6,783	-544
25,989	43,062	-17,073	33,444	46,621	-13,177	31,894	47,494	-15,600
1,147	**17,999**	**-16,852**	**1,179**	**17,281**	**-16,102**	**1,253**	**18,990**	**-17,737**
701,917	**608,498**	**93,419**	**742,878**	**643,542**	**99,336**	**763,103**	**664,850**	**98,253**
		16.8			**15.8**			**14.4**
		–			**-95**			
		-43,488			**-37,035**			
		22			-8,791			
		-22,161			*-37,874*			
		22,183			*29,082*			
		12,911			18,356			
		-56,422			-46,600			
		-8,019			*-5,787*			
		-48,403			*-40,813*			
		-43,488			**-37,130**			
		-24,772			**-16,910**			
		-6,945			-5,597			
		25,158			**45,296**			
		290,399			335,695			
		82,451			101,338			
		7.8			8.4			

Table A.10
Gross Exports

	2005	2006	2007*p*	2006	2007*p*	2007*p*
	RM million			Annual change (%)		% share
Manufactures	**429,873**	**473,213**	**474,714**	**10.1**	**0.3**	**78.4**
of which:						
Electronics, electrical machinery and appliances	282,779	300,861	288,326	6.4	-4.2	47.6
Electronics	208,232	221,257	213,450	6.3	-3.5	35.2
Semiconductor	*89,967*	*93,505*	*96,471*	*3.9*	*3.2*	*15.9*
Electronic equipment & parts	*118,265*	*127,752*	*116,979*	*8.0*	*-8.4*	*19.3*
Electrical machinery & appliances	74,547	79,604	74,876	6.8	-5.9	12.4
Consumer electrical products	*22,632*	*19,099*	*16,469*	*-15.6*	*-13.8*	*2.7*
Industrial & commercial electrical products	*28,608*	*34,489*	*29,690*	*20.6*	*-13.9*	*4.9*
Electrical industrial machinery and equipment	*20,476*	*22,844*	*25,183*	*11.6*	*10.2*	*4.2*
Household electrical appliances	*2,831*	*3,172*	*3,534*	*12.0*	*11.4*	*0.6*
Chemicals & chemical products	29,718	32,893	37,421	10.7	13.8	6.2
Manufactures of metal	17,157	22,817	26,410	33.0	15.7	4.4
Petroleum products	16,729	21,274	22,093	27.2	3.8	3.7
Optical and scientic equipment	12,318	13,558	13,612	10.1	0.4	2.2
Textiles, clothing and footwear	10,520	11,226	10,632	6.7	-5.3	1.8
Wood products	8,860	10,343	9,689	16.7	-6.3	1.6
Rubber products	6,777	9,101	10,323	34.3	13.4	1.7
Minerals	**52,321**	**56,844**	**61,117**	**8.6**	**7.5**	**10.1**
of which:						
Crude oil and condensates	28,508	30,814	31,880	8.1	3.5	5.3
LNG	20,790	23,285	26,157	12.0	12.3	4.3
Agriculture	**37,421**	**42,106**	**52,366**	**12.5**	**24.4**	**8.7**
of which:						
Palm oil	19,036	21,643	31,983	13.7	47.8	5.3
Rubber	5,787	8,235	7,335	42.3	-10.9	1.2
Others	**14,173**	**16,802**	**16,956**	**18.6**	**0.9**	**2.8**
Total	**533,788**	**588,965**	**605,153**	**10.3**	**2.7**	**100.0**

p Preliminary
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.11
Exports of Primary Commodities

	2005	2006	2007*p*	2006	2007*p*
	Volume and value			Annual change (%)	
Commodity exports (RM million)	**89,742**	**98,950**	**113,483**	**10.3**	**14.7**
Agriculture exports (RM million)	**37,421**	**42,106**	**52,366**	**12.5**	**24.4**
of which:					
Palm oil					
('000 tonnes)	13,073	14,017	13,505	7.2	-3.7
(RM/tonne)	1,456	1,544	2,368	6.0	53.4
(RM million)	19,036	21,643	31,983	13.7	47.8
Palm kernel oil					
('000 tonnes)	577	518	588	-10.1	13.4
(RM/tonne)	2,347	1,969	2,747	-16.1	39.6
(RM million)	1,353	1,020	1,615	-24.6	58.3
Rubber					
('000 tonnes)	1,128	1,143	1,018	1.3	-10.9
(sen/kilogramme)	513	721	720	40.5	0.0
(RM million)	5,787	8,235	7,335	42.3	-10.9
Saw logs					
('000 cubic metres)	5,759	4,772	4,644	-17.1	-2.7
(RM/cubic metre)	428	474	455	10.7	-4.0
(RM million)	2,465	2,261	2,112	-8.3	-6.6
Sawn timber					
('000 cubic metres)	3,685	3,318	2,985	-9.9	-10.1
(RM/cubic metre)	1,099	1,306	1,373	18.8	5.1
(RM million)	4,051	4,333	4,096	7.0	-5.4
Cocoa beans					
('000 tonnes)	9.3	13.5	17.8	45.8	31.9
(RM/tonne)	5,421	5,624	6,522	3.7	16.0
(RM million)	50	76	116	51.2	53.0
Mineral exports (RM million)	**52,321**	**56,844**	**61,117**	**8.6**	**7.5**
of which:					
Crude oil and condensates					
('000 tonnes)	17,719	16,304	16,390	-8.0	0.5
(USD/barrel)	55.93	67.82	74.63	21.3	10.0
(RM million)	28,508	30,814	31,880	8.1	3.5
Liquefied natural gas (LNG)					
('000 tonnes)	21,948	21,534	22,668	-1.9	5.3
(RM/tonne)	947	1,081	1,154	14.2	6.7
(RM million)	20,790	23,285	26,157	12.0	12.3
Tin					
('000 tonnes)	33.6	19.4	15.8	-42.3	-18.7
(RM/tonne)	27,827	30,093	49,522	8.1	64.6
(RM million)	935	583	780	-37.7	33.8

p Preliminary
Source: Department of Statistics, Malaysia

Table A.12
Principal Markets for Manufactured Exports

Country	2003	2004	2005	2006	2007*p*	2003	2004	2005	2006	2007*p*
	RM million					% share				
ASEAN	**82,751**	**99,201**	**111,048**	**122,140**	**122,368**	**25.4**	**25.4**	**25.8**	**25.8**	**25.8**
Singapore	57,665	65,514	73,896	80,233	77,141	17.7	16.8	17.2	17.0	16.3
Thailand	13,526	17,721	21,330	24,301	25,002	4.2	4.5	5.0	5.1	5.3
Indonesia	6,290	8,931	9,491	10,617	12,568	1.9	2.3	2.2	2.2	2.6
Philippines	4,337	6,073	5,316	6,039	6,475	1.3	1.6	1.2	1.3	1.4
Brunei Darussalam	933	962	1,015	950	1,182	0.3	0.2	0.2	0.2	0.2
United States	76,574	87,385	101,887	107,829	91,436	23.5	22.4	23.7	22.8	19.3
EU[1]	**43,906**	**52,950**	**54,883**	**65,332**	**67,470**	**13.4**	**13.5**	**12.8**	**13.8**	**14.2**
Netherlands	10,418	12,584	13,920	17,159	18,520	3.2	3.2	3.2	3.6	3.9
Germany	8,237	9,499	10,229	11,430	13,807	2.5	2.4	2.4	2.4	2.9
United Kingdom	8,361	9,953	8,945	10,322	9,467	2.5	2.5	2.1	2.2	2.0
Others	16,890	20,914	21,789	26,421	25,676	5.2	5.4	5.1	5.6	5.4
The People's Republic of China	17,458	22,335	25,774	32,048	37,846	5.3	5.7	6.0	6.8	8.0
Japan	28,971	33,648	31,900	33,142	32,574	8.9	8.6	7.4	7.0	6.9
Hong Kong SAR	24,736	27,534	30,093	28,020	26,645	7.6	7.0	7.0	5.9	5.6
Middle East[2]	7,685	10,752	13,059	15,832	18,653	2.4	2.8	3.0	3.3	3.9
Australia	7,209	9,669	10,706	11,232	12,177	2.2	2.5	2.5	2.4	2.6
Chinese Taipei	11,587	11,930	10,272	10,626	11,661	3.5	3.0	2.4	2.3	2.4
Korea	7,159	9,237	9,333	10,325	10,698	2.2	2.4	2.2	2.2	2.3
India	3,151	5,044	6,249	7,089	9,116	0.9	1.3	1.5	1.5	1.9
Latin American countries	3,136	4,419	4,993	6,310	7,398	1.0	1.1	1.2	1.3	1.6
Canada	2,229	2,848	2,655	3,645	3,009	0.7	0.7	0.6	0.8	0.6
Rest of the World	9,770	13,986	17,021	19,643	23,663	3.0	3.6	3.9	4.1	4.9
Total	**326,322**	**390,938**	**429,873**	**473,213**	**474,714**	**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 European Union
p Preliminary
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.13
Principal Export Markets for Electronics

Country	2003	2004	2005	2006	2007*p*	2003	2004	2005	2006	2007*p*
	RM million					% share				
United States	45,352	51,900	64,555	68,628	56,405	27.1	27.5	31.0	31.0	26.4
Singapore	32,067	33,398	35,049	34,829	34,241	19.2	17.7	16.8	15.7	16.0
The People's Republic of China	9,028	10,881	13,183	17,240	22,634	5.4	5.8	6.3	7.8	10.6
Hong Kong SAR	18,041	19,623	21,650	18,657	17,513	10.8	10.4	10.4	8.4	8.2
Netherlands	7,060	8,104	9,846	13,306	13,416	4.2	4.3	4.7	6.0	6.3
Japan	10,479	11,209	10,273	11,432	11,211	6.3	6.0	5.0	5.2	5.3
Thailand	7,127	8,286	9,344	9,692	9,952	4.2	4.4	4.5	4.4	4.7
Chinese Taipei	8,061	6,877	5,399	5,212	5,348	4.8	3.6	2.6	2.4	2.5
Germany	4,537	5,159	5,153	5,126	6,620	2.7	2.7	2.5	2.3	3.1
Korea	3,453	4,438	4,179	4,251	4,091	2.1	2.4	2.0	1.9	1.9
Others	22,176	28,692	29,601	32,884	32,019	13.2	15.2	14.2	14.9	15.0
Total	**167,381**	**188,567**	**208,232**	**221,257**	**213,450**	**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	2003	2004	2005	2006	2007*p*	2003	2004	2005	2006	2007*p*
	RM million					% share				
United States	16,379	18,175	19,005	19,070	15,783	29.5	26.5	25.5	24.0	21.1
Singapore	8,539	10,584	13,091	14,922	11,367	15.4	15.4	17.6	18.7	15.2
Japan	6,848	7,667	7,542	6,191	6,080	12.4	11.2	10.1	7.8	8.1
The People's Republic of China	2,137	2,949	3,365	3,082	3,560	3.9	4.3	4.5	3.9	4.8
Hong Kong SAR	2,403	2,556	2,988	3,423	3,331	4.3	3.7	4.0	4.3	4.4
Thailand	1,665	2,310	2,545	2,647	2,849	3.0	3.4	3.4	3.3	3.8
Germany	1,438	1,849	2,188	2,795	2,602	2.6	2.7	3.0	3.5	3.5
United Kingdom	1,352	1,394	1,360	2,146	1,904	2.4	2.0	1.8	2.7	2.5
Others	14,709	21,170	22,463	25,328	27,400	26.5	30.8	30.1	31.8	36.6
Total	**55,470**	**68,654**	**74,547**	**79,604**	**74,876**	**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	2003	2004	2005	2006	2007*p*	2003	2004	2005	2006	2007*p*
	RM million					% share				
The People's Republic of China	2,929	4,020	4,002	4,262	4,947	13.8	14.4	13.5	13.0	13.2
Thailand	1,771	2,360	2,716	3,145	3,394	8.4	8.5	9.1	9.6	9.1
Singapore	2,165	2,582	2,834	2,997	3,367	10.2	9.3	9.5	9.1	9.0
Indonesia	1,532	2,249	2,459	2,608	2,934	7.2	8.1	8.3	7.9	7.9
Japan	2,125	3,028	3,006	3,018	2,887	10.0	10.9	10.1	9.2	7.7
Hong Kong SAR	1,550	1,857	2,103	2,379	2,005	7.3	6.7	7.1	7.2	5.4
India	858	1,104	1,435	1,656	1,829	4.1	4.0	4.8	5.0	4.9
Chinese Taipei	961	1,336	1,143	1,349	1,776	4.5	4.8	3.9	4.1	4.7
Korea	766	1,175	1,304	1,507	1,552	3.6	4.2	4.4	4.6	4.1
United States	1,060	983	1,103	1,089	1,300	5.0	3.5	3.7	3.3	3.5
Others	5,483	7,142	7,613	8,883	11,430	25.9	25.6	25.6	27.0	30.5
Total	**21,200**	**27,836**	**29,718**	**32,893**	**37,421**	**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	2003	2004	2005	2006	2007*p*	2003	2004	2005	2006	2007*p*
	'000 tonnes					% share				
The People's Republic of China	2,502	2,827	2,885	3,532	3,786	20.0	23.1	22.1	25.2	28.0
European Union[1]	1,647	1,862	2,135	2,586	2,097	13.2	15.2	16.3	18.4	15.5
Netherlands	*974*	*1,135*	*1,364*	*1,703*	*1,527*	*7.8*	*9.3*	*10.4*	*12.1*	*11.3*
Germany	*185*	*149*	*180*	*190*	*30*	*1.5*	*1.2*	*1.4*	*1.4*	*0.2*
Italy	*98*	*119*	*155*	*165*	*126*	*0.8*	*1.0*	*1.2*	*1.2*	*0.9*
Sweden	*106*	*114*	*103*	*220*	*134*	*0.8*	*0.9*	*0.8*	*1.6*	*1.0*
Others	*284*	*345*	*333*	*308*	*280*	*2.3*	*2.8*	*2.5*	*2.1*	*2.1*
Middle East[2]	1,683	1,143	1,496	1,177	1,212	13.5	9.3	11.4	8.4	9.0
Pakistan	1,098	838	928	855	1,062	8.8	6.9	7.1	6.1	7.9
United States	231	298	534	696	516	1.9	2.4	4.1	5.0	3.8
Japan	430	458	438	498	516	3.4	3.7	3.4	3.6	3.8
India	1,650	925	676	657	515	13.2	7.6	5.2	4.7	3.8
Korea	208	228	223	207	225	1.7	1.9	1.7	1.5	1.7
Bangladesh	272	353	485	413	170	2.2	2.9	3.7	2.9	1.3
Chinese Taipei	103	120	246	148	129	0.8	1.0	1.9	1.1	1.0
Australia	97	96	105	121	121	0.8	0.8	0.8	0.9	0.9
Others	2,566	3,075	2,922	3,127	3,156	20.5	25.2	22.3	22.2	23.3
Total	**12,487**	**12,223**	**13,073**	**14,017**	**13,505**	**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.17
Principal Export Markets for Rubber

Country	2003	2004	2005	2006	2007*p*	2003	2004	2005	2006	2007*p*
	'000 tonnes					% share				
The People's Republic of China	207	289	386	406	371	21.9	26.1	34.2	35.5	36.4
European Union[1]	295	346	313	316	294	31.2	31.2	27.7	27.6	28.9
Germany	*129*	*149*	*132*	*144*	*136*	*13.6*	*13.4*	*11.7*	*12.6*	*13.3*
France	*40*	*53*	*46*	*41*	*43*	*4.2*	*4.8*	*4.1*	*3.6*	*4.3*
Netherlands	*12*	*20*	*28*	*21*	*17*	*1.3*	*1.8*	*2.5*	*1.9*	*1.6*
Italy	*29*	*29*	*24*	*22*	*20*	*3.0*	*2.6*	*2.1*	*1.9*	*1.9*
United Kingdom	*22*	*24*	*21*	*18*	*16*	*2.4*	*2.2*	*1.9*	*1.6*	*1.5*
Spain	*17*	*24*	*13*	*11*	*9*	*1.8*	*2.2*	*1.2*	*0.9*	*0.9*
Others	*46*	*47*	*49*	*59*	*53*	*4.9*	*4.2*	*4.2*	*5.1*	*5.4*
Korea	69	64	74	67	61	7.3	5.7	6.6	5.8	6.0
Middle East[2]	83	89	74	71	54	8.8	8.1	6.6	6.2	5.3
Iran	*48*	*55*	*40*	*45*	*27*	*5.1*	*4.9*	*3.6*	*3.9*	*2.7*
Turkey	*25*	*25*	*24*	*20*	*21*	*2.7*	*2.2*	*2.2*	*1.7*	*2.1*
Others	*10*	*9*	*10*	*6*	*6*	*1.0*	*1.0*	*0.8*	*0.6*	*0.5*
United States	77	74	67	64	53	8.1	6.7	6.0	5.6	5.2
Brazil	29	37	31	32	38	3.1	3.3	2.7	2.8	3.8
Canada	14	19	17	15	19	1.4	1.7	1.5	1.4	1.9
Singapore	9	22	10	3	2	0.9	2.0	0.9	0.3	0.2
Others	163	168	156	169	126	17.3	15.2	13.8	14.8	12.3
Total	**946**	**1,108**	**1,128**	**1,143**	**1,018**	**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	2003	2004	2005	2006	2007*p*	2003	2004	2005	2006	2007*p*
	'000 tonnes					% share				
India	3,396	3,081	3,496	4,417	3,908	19.0	17.1	19.7	27.1	23.8
Australia	2,248	4,229	3,567	2,269	3,331	12.5	23.4	20.1	13.9	20.3
Indonesia	1,289	1,548	1,431	1,547	2,038	7.2	8.6	8.1	9.5	12.4
Singapore	468	890	1,638	1,285	1,607	2.6	4.9	9.2	7.9	9.8
Korea	1,271	1,316	1,389	1,433	1,545	7.1	7.3	7.8	8.8	9.4
Thailand	3,097	3,024	3,418	2,528	1,435	17.3	16.8	19.3	15.5	8.8
Japan	1,440	1,051	734	926	987	8.0	5.8	4.1	5.7	6.0
Phillipines	610	406	743	471	872	3.4	2.3	4.2	2.9	5.3
New Zealand	402	205	299	424	381	2.2	1.1	1.7	2.6	2.3
The People's Republic of China	2,013	1,036	240	79	240	11.2	5.7	1.4	0.5	1.6
United States	937	682	314	282	46	5.2	3.8	1.8	1.7	0.3
Sri Lanka	425	420	358	357	-	2.4	2.3	2.0	2.2	-
Others	317	159	92	286	-	1.9	0.9	0.6	1.7	-
Total	**17,913**	**18,047**	**17,719**	**16,304**	**16,390**	**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	2003	2004	2005	2006	2007*p*	2003	2004	2005	2006	2007*p*
	'000 tonnes					% share				
Japan	12,477	12,284	13,884	12,360	13,426	72.1	59.8	63.3	57.4	59.2
Korea	2,679	4,599	4,820	5,748	6,135	15.5	22.4	22.0	26.7	27.1
Chinese Taipei	2,101	2,834	3,054	3,306	3,035	12.1	13.8	13.9	15.4	13.4
United States	54	299	-	-	-	0.3	1.5	-	-	-
Others	-	509	190	120	72	-	2.5	0.8	0.5	0.3
Total	**17,311**	**20,525**	**21,948**	**21,534**	**22,668**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary
Source: Department of Statistics, Malaysia

Table A.20
External Debt and Debt Servicing

	2003	2004	2005	2006	2007*p*
			RM million		
Medium- and long-term debt:					
Gross borrowing	**22,226**	**27,064**	**29,162**	**28,620**	**23,844**
Federal Government	*3,190*	*1,136*	*651*	*834*	*489*
NFPEs	*5,140*	*11,545*	*6,431*	*10,909*	*1,706*
Private sector	*13,896*	*14,383*	*22,080*	*16,877*	*21,650*
Repayment and prepayment	**29,309**	**25,172**	**34,959**	**28,538**	**25,699**
Federal Government	*6,854*	*1,015*	*4,154*	*3,887*	*4,803*
NFPEs	*12,437*	*12,645*	*13,911*	*13,197*	*7,840*
Private sector	*10,019*	*11,512*	*16,893*	*11,453*	*13,055*
Net borrowing	**-7,083**	**1,892**	**-5,796**	**82**	**-1,855**
Federal Government	*-3,664*	*120*	*-3,503*	*-3,053*	*-4,314*
NFPEs	*-7,297*	*-1,100*	*-7,480*	*-2,288*	*-6,134*
Private sector	*3,877*	*2,872*	*5,187*	*5,424*	*8,594*
Outstanding debt	**153,236**	**156,849**	**150,746**	**141,704**	**132,978**
Federal Government	*37,284*	*34,654*	*30,000*	*25,005*	*19,602*
NFPEs	*59,535*	*62,244*	*56,233*	*50,378*	*41,854*
Private sector	*56,417*	*59,951*	*64,513*	*66,322*	*71,521*
Currency composition (% share)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
US dollar	*76.6*	*76.8*	*79.6*	*80.5*	*80.7*
Japanese yen	*12.9*	*12.8*	*11.7*	*11.4*	*11.2*
Others	*10.4*	*10.4*	*8.6*	*8.0*	*8.1*
Short-term debt:					
Outstanding debt	**33,500**	**43,737**	**46,953**	**42,800**	**54,468**
Banking sector[1]	*23,321*	*35,333*	*38,871*	*28,812*	*42,134*
Non-bank private sector	*10,179*	*8,404*	*8,082*	*13,988*	*12,334*
Total external debt:	**186,736**	**200,586**	**197,698**	**184,505**	**187,445**
Total external debt (USD million)	**49,141**	**52,786**	**51,790**	**51,736**	**56,027**
% GNI	*47.1*	*44.6*	*39.9*	*33.2*	*29.9*
Annual change (%)	*0.6*	*7.4*	*-1.4*	*-6.7*	*1.6*
Total servicing (including short-term interest payment)	**28,627**	**24,866**	**32,800**	**32,141**	**26,463**
of which:					
Medium- and long-term debt					
Repayment (excluding prepayment)	**21,854**	**18,675**	**25,471**	**23,759**	**19,105**
Federal Government	*3,861*	*1,015*	*4,154*	*3,887*	*4,803*
NFPEs	*10,017*	*10,713*	*10,166*	*11,311*	*5,035*
Private sector	*7,976*	*6,947*	*11,152*	*8,561*	*9,267*
Interest payment	**6,150**	**5,442**	**6,101**	**6,561**	**5,028**
Federal Government	*1,883*	*1,758*	*1,729*	*1,678*	*1,328*
NFPEs	*3,287*	*2,684*	*3,182*	*3,511*	*2,282*
Private sector	*979*	*1,000*	*1,190*	*1,372*	*1,418*
Debt service ratio (% of exports of goods and services)					
Total debt	**6.4**	**4.5**	**5.4**	**4.8**	**3.8**
Medium- and long-term debt	6.3	4.4	5.2	4.5	3.4
Federal Government	*1.3*	*0.5*	*1.0*	*0.8*	*0.9*
NFPEs	*3.0*	*2.4*	*2.2*	*2.2*	*1.0*
Private sector	*2.0*	*1.5*	*2.0*	*1.5*	*1.5*

[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.21
Consumer Price Index

	Weights (%) (2000=100)	2003	2004	2005		Weights (%) (2005=100)[1]	2006	2007
		Annual Change (%)					Annual Change (%)	
Total	100.0	1.2	1.4	3.0	Total	100.0	3.6	2.0
of which:					*of which:*			
Food	33.8	1.3	2.2	3.6	Food and non-alcoholic	31.4	3.4	3.0
Beverages and tobacco	3.1	1.6	7.8	10.5	Alcoholic, beverages & tobacco	1.9	6.9	7.8
Clothing and footwear	3.4	-2.0	-1.8	-1.0	Clothing & footwear	3.1	-1.3	-1.4
Gross rent, fuel and power	22.4	0.9	1.0	1.2	Housing, water, electricity, gas and other fuels	21.4	1.5	1.3
Furniture, furnishings and household equipment and operation	5.3	-0.6	0.4	2.0	Furnishing, household equipment and routine	4.3	1.1	1.1
Medical care and health expenses	1.8	1.7	1.4	1.6	Health	1.4	2.1	1.6
Transport and communication	18.8	1.6	0.8	4.4	Transport	15.9	11.0	2.3
					Communication	5.1	-1.4	-1.2
Recreation, entertainment, education and cultural services	5.9	0.6	-0.1	0.5	Recreation services and culture	4.6	0.7	1.4
					Education	1.9	1.6	1.8
					Restaurants and hotels	3.0	3.7	3.7
Miscellaneous goods and services	5.5	1.3	1.8	2.4	Miscellaneous goods & services	6.0	2.2	1.0

[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.22
Producer Price Index

	Weights (%) (1989=100)	2003	2004	2005		Weights (%) (2000=100)[1]	2006	2007
		Annual Change (%)					Annual Change (%)	
Total	100.0	5.7	8.9	6.8	Total	100.0	5.1	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	3.1	8.5
Beverages and tobacco	2.1	0.9	1.6	1.9	Beverages and tobacco	1.0	5.8	-0.4
Crude materials inedible except fuels	18.0	7.5	6.6	3.0	Crude materials, inedible except fuels	4.4	14.5	14.1
Mineral fuels, lubricants & related materials	18.8	11.4	22.3	26.0	Mineral fuels, lubricants & related materials	11.9	11.0	3.0
Animal & vegetable oils & fats	8.5	15.7	13.2	-14.8	Animal & vegetable oils & fats	3.8	-0.3	46.7
Chemicals & related products n.e.c	4.4	1.4	4.3	2.2	Chemicals & related products n.e.c	5.1	3.4	3.6
Manufactured goods classified chiefly by material	10.8	1.8	2.5	2.5	Manufactured goods classified chiefly by materials	11.0	3.7	4.7
Machinery & transport equipment	18.4	0.1	0.1	0.6	Machinery & transport equipment	50.5	3.5	4.6
Miscellaneous manufactured articles	3.6	0.9	0.6	1.9	Miscellaneous manufactured articles	6.7	3.5	1.5
Commodities & transactions not classified elsewhere in the SITC	0.6	0.5	0.2	0.0	Commodities & transactions not classified elsewhere in the S.I.T.C.	0.4	13.4	12.3
Local Production	79.3	6.8	10.3	7.9	Local Production	65.6	6.7	7.5
Import	20.7	0.8	2.0	1.6	Import	34.4	2.2	4.7

[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.23
Broad Money (M3)

	Annual change					As at end
	2003	2004	2005	2006	2007	2007
	RM million					
Broad money (M3)[1]	48,908	68,167	51,609	87,467	72,486	832,788
Currency in circulation[2]	2,233	2,593	1,629	3,335	2,746	36,247
Demand deposits	11,107	10,031	8,683	11,705	24,247	132,382
Broad quasi-money	35,569	55,543	41,297	72,427	45,494	664,159
Fixed deposits	*17,018*	*25,192*	*4,940*	*31,940*	*10,705*	*402,017*
Savings deposits	*5,602*	*6,129*	*1,947*	*5,195*	*8,703*	*84,432*
NIDs	*1,965*	*8,179*	*12,785*	*14,321*	*-15,279*	*30,983*
Repos	*8,016*	*13,337*	*17,260*	*11,799*	*-72,366*	*3,205*
Foreign currency deposits	*2,434*	*2,998*	*2,467*	*3,218*	*1,512*	*22,600*
Other deposits	*533*	*-291*	*1,898*	*5,956*	*112,219*	*120,922*
Factors Affecting M3						
Net claims on Government	12,954	-16,599	-5,204	8,317	265	-1,335
Claims on Government	*3,960*	*4,536*	*-2,152*	*1,614*	*416*	*37,321*
Less: Government deposits	*-8,993*	*21,135*	*3,052*	*-6,703*	*151*	*38,656*
Claims on private sector	31,287	30,524	44,501	34,714	51,634	727,717
Loans	*21,468*	*39,753*	*44,840*	*36,779*	*48,498*	*645,220*
Securities	*9,819*	*-9,229*	*-339*	*-2,065*	*3,135*	*82,497*
Net external operations	33,398	90,626	1,832	52,745	70,743	383,363
Bank Negara Malaysia[3]	*39,781*	*83,728*	*13,550*	*25,158*	*45,319*	*335,718*
Banking system	*-6,383*	*6,898*	*-11,719*	*27,587*	*25,423*	*47,645*
Other influences	-28,730	-36,383	10,480	-8,309	-50,155	-276,957

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

Table A.24
Money Supply: Annual Change and Growth Rates

	2003		2004		2005		2006		2007	
	RM million	%	RM million	%	RM million	%	RM million	%	RM million	%
Currency in circulation	2,205	9.2	2,516	9.6	1,561	5.5	3,342	11.1	2,728	8.1
Demand deposits with commercial banks and Islamic banks	10,724	16.3	9,594	12.6	8,227	9.6	13,688	14.5	24,913	23.1
M1[1]	12,929	14.4	12,110	11.8	9,788	8.5	17,029	13.7	27,640	19.6
Other deposits with commercial banks and Islamic banks[2]	29,996	10.1	96,089	29.4	73,923	17.5	89,308	18.0	41,602	7.1
Deposits with other banking institutions[3,4]	5,984	5.1	-40,032	-32.4	-32,102	-38.4	-18,871	-36.7	3,244	9.9
M3[5]	48,908	9.7	68,167	12.3	51,609	8.3	87,467	13.0	72,486	9.5

[1] Comprising currency in circulation and demand deposits of the private sector
[2] Comprising savings and fixed deposits, negotiable instruments of deposits (NIDs), repos and foreign currency deposits of the private sector placed with commercial banks and Islamic banks
[3] Comprising fixed deposits and repos of the private sector placed with finance companies, merchant banks/investment banks and discount houses. Also include savings deposits with finance companies, negotiable instruments of deposits (NIDs) with finance companies and merchant banks/investment banks, foreign currency deposits placed with merchant banks/investment banks and call deposits with discount houses. Excludes interplacements among the banking institutions
[4] The large decline since 2004 reflected the absorption of finance companies by commercial banks
[5] Comprising M1 plus other deposits of the private sector placed with commercial banks and Islamic banks and deposits of the private sector placed with other banking institutions, namely the finance companies, merchant banks/investment banks and discount houses

Table A.25
Interest Rates (%)

	Average rates at end-year					Average rates at end-month in 2007											
	2002	2003	2004	2005	2006	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
Overnight interbank	2.73	2.74	2.70	2.72	3.38	3.50	3.49	3.50	3.50	3.49	3.50	3.49	3.49	3.50	3.50	3.50	3.49
1-week interbank	2.76	2.80	2.74	2.75	3.42	3.52	3.51	3.52	3.52	3.52	3.53	3.52	3.51	3.53	3.52	3.52	3.52
1-month interbank	2.87	2.99	2.86	2.84	3.54	3.56	3.55	3.56	3.54	3.54	3.55	3.57	3.55	3.54	3.54	3.54	3.56
Commercial banks																	
Fixed deposit:																	
3-month	3.20	3.00	3.00	3.02	3.19	3.19	3.19	3.18	3.18	3.18	3.17	3.15	3.15	3.15	3.15	3.15	3.15
12-month	4.00	3.70	3.70	3.70	3.73	3.72	3.71	3.71	3.71	3.71	3.71	3.70	3.70	3.70	3.70	3.70	3.70
Savings deposit	2.12	1.86	1.58	1.41	1.48	1.49	1.44	1.43	1.44	1.44	1.44	1.44	1.44	1.43	1.43	1.44	1.44
Base lending rate (BLR)	6.39	6.00	5.98	6.20	6.72	6.72	6.72	6.72	6.72	6.72	6.72	6.72	6.72	6.72	6.72	6.72	6.72
Treasury bills (91-day)	2.82	2.77	1.96	2.96	3.23	3.38	3.41	3.46	3.37	3.30	3.50	3.47	3.53	3.47	3.49	3.42	3.41
Government securities (1-year)	2.94	2.93	2.24	3.30	3.55	3.61	3.55	3.42	3.42	3.35	3.30	3.43	3.55	3.52	3.52	3.57	3.53
Government securities (5-year)	3.15	4.28	3.64	3.73	3.70	3.80	3.63	3.46	3.45	3.44	3.39	3.48	3.62	3.58	3.57	3.74	3.78
Private Debt securities																	
AAA																	
3-year	3.91	3.86	4.06	3.76	4.01	4.05	4.03	3.90	3.81	3.83	3.90	3.96	3.99	3.95	3.99	4.05	4.07
5-year	4.50	4.35	4.81	4.29	4.26	4.26	4.22	4.09	3.96	4.02	4.06	4.10	4.16	4.12	4.17	4.26	4.28
AA																	
3-year	4.80	4.43	4.67	4.22	4.38	4.40	4.36	4.25	4.16	4.18	4.21	4.26	4.30	4.25	4.27	4.34	4.39
5-year	5.38	4.99	5.50	4.78	4.71	4.65	4.62	4.48	4.38	4.37	4.42	4.45	4.53	4.48	4.50	4.60	4.64
A																	
3-year	6.31	5.79	6.03	5.84	5.91	5.81	5.79	5.67	5.67	5.65	5.85	5.92	5.93	5.89	5.98	6.10	6.06
5-year	7.07	6.51	6.90	6.56	6.53	6.39	6.32	6.15	6.13	6.09	6.26	6.41	6.50	6.48	6.51	6.55	6.51
BBB																	
3-year	9.33	9.45	9.92	9.47	9.62	9.46	9.33	9.28	9.29	9.20	9.63	9.63	9.68	9.65	9.71	9.71	9.71
5-year	10.36	10.48	10.99	10.41	10.48	10.27	10.15	10.13	10.19	10.13	10.54	10.52	10.57	10.53	10.66	10.71	10.72
BB & below																	
3-year	11.62	11.35	11.96	11.79	12.03	11.82	11.67	11.65	11.59	11.49	11.83	11.91	11.97	11.80	11.97	11.93	11.92
5-year	12.83	12.47	13.21	12.95	13.05	13.02	12.85	12.75	12.63	12.58	12.90	13.07	13.07	12.89	13.11	13.09	13.16

Table A.26
Movements of the Ringgit

	RM to one unit of foreign currency[1]			Annual change (%)		Change (%)
	2005	2006	2007	2006	2007	21 Jul.'05 - Dec. 2007
	Jul. 21[2]	End-Dec.				
SDR	5.5049	5.3069	5.2190	1.8	1.7	5.5
US dollar	3.8000	3.5315	3.3065	7.0	6.8	14.9
Singapore dollar	2.2570	2.3028	2.2938	-1.4	0.4	-1.6
100 Japanese yen	3.3745	2.9675	2.9534	8.6	0.5	14.3
Pound sterling	6.6270	6.9315	6.6070	-5.9	4.9	0.3
Swiss franc	2.9588	2.8915	2.9445	-0.3	-1.8	0.5
Euro	4.6212	4.6460	4.8756	-3.4	-4.7	-5.2
100 Thai baht	9.0681	9.8111	9.8159	-6.2	0.0	-7.6
100 Indonesian rupiah	0.0386	0.0393	0.0352	-1.9	11.5	9.8
100 Korean won	0.3665	0.3797	0.3532	-1.5	7.5	3.8
100 Philippine peso	6.8131	7.2027	8.0158	-1.1	-10.1	-15.0
Chinese renminbi	0.4591	0.4523	0.4527	3.5	-0.1	1.4

[1] US dollar rates are the average of buying and selling rates at noon in the Kuala Lumpur Interbank Foreign Exchange Market
Rates for foreign currencies other than US dollar are cross rates derived from rates of these currencies against the US dollar and the RM/US dollar rate
[2] Ringgit shifted from a fixed exchange rate against the US dollar to a managed float against a basket of currencies

Table A.27
Housing Credit Institutions

	Year of establishment	Objective	Lending rate for new housing loans (%)		No. of branches	
			2006	2007	2006	2007
Commercial banks[1]	–		4.1[2]	4.4[2]	2,120[3]	2,125[3]
Treasury Housing Loans Division	1970	To provide housing loans to Government employees	4.0	4.0	2	2
Bank Kerjasama Rakyat Malaysia Berhad	1954	A co-operative that mobilises savings and provides financing services to its members as well as non-members	7.3	7.3	110	112
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	1.0 ~ 12.0	1.0 ~ 12.0	22	26
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	6.9[1]	7.13[1]	379	375
Sabah Credit Corporation	1955	To uplift the social economic development of Malaysians in Sabah through the provision of easy access to financial credit	3.0 ~ 7.5	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.28
Outstanding Housing Loans

	2006	2007*p*	2006	2007*p*	2006	2007*p*
	RM million		Annual change (%)		% share	
Commercial banks[1]	162,290	174,268	9.6	7.4	82	82
Treasury Housing Loans Division	25,352	26,822	-0.2	5.8	13	13
Bank Kerjasama Rakyat Malaysia Berhad	4,310	4,475	15.1	3.8	2	2
Malaysia Building Society Berhad	3,513	4,413	39.8	25.6	2	2
Borneo Housing Mortgage Finance Berhad	721	716	1.2	-0.7	...	...
Bank Simpanan Nasional	2,273	2,645	56.6	16.4	1	1
Sabah Credit Corporation	204	190	-7.6	-6.9	...	...
Total	**198,663**	**213,529**	**9.1**	**7.5**	**100**	**100**

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

Source: Bank Negara Malaysia and various housing credit institutions

Table A.29
Approved Housing Loans

	2006	2007*p*	2006	2007*p*	2006	2007*p*
	RM million		Annual change (%)		% share	
Commercial banks[1]	32,838	48,142	-9.9	46.6	82	86
Treasury Housing Loans Division	4,134	5,830	-1.3	41.0	10	10
Bank Kerjasama Rakyat Malaysia Berhad	633	266	-31.4	-58.1	2	...
Malaysia Building Society Berhad	1,180	1,055	179.2	-10.6	3	2
Borneo Housing Mortgage Finance Berhad	70	63	12.3	-10.4	...	...
Bank Simpanan Nasional	1,380	808	64.2	-41.4	3	1
Sabah Credit Corporation	11	15	33.9	33.0	...	...
Total	**40,246**	**56,179**	**-6.2**	**39.6**	**100**	**100**

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

Source: Bank Negara Malaysia and various housing credit institutions

Table A.30
Consolidated Public Sector Finance

	2004	2005	2006	2007*p*	2008*f*
	RM billion				
Revenue[1]	95.0	95.0	102.0	115.5	122.8
% growth	*2.6*	*-0.1*	*7.4*	*13.3*	*6.4*
Operating expenditure	101.0	106.6	117.7	134.5	140.6
% growth	*20.8*	*5.5*	*10.4*	*14.3*	*4.5*
Current surplus of NFPEs[2]	81.3	85.0	100.7	105.4	105.7
Current balance	**75.3**	**73.3**	**84.9**	**86.4**	**88.0**
% of GDP	***15.9***	***14.1***	***14.8***	***13.5***	***12.6***
Net development expenditure[3]	56.7	66.1	86.5	103.2	90.1
% growth	*-31.9*	*16.5*	*31.0*	*19.3*	*-12.7*
General Government[4]	32.1	31.7	40.8	47.0	47.6
NFPEs	24.6	34.4	45.7	56.2	42.5
Overall balance	**18.5**	**7.3**	**-1.6**	**-16.8**	**-2.1**
% of GDP	***3.9***	***1.4***	***-0.3***	***-2.6***	***-0.3***

[1] Excludes transfers within general Government
[2] Refers to 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
p Preliminary
f Forecast
Note: Numbers may not add up due to rounding
Source: Ministry of Finance and non-financial public enterprises (NFPEs)

Table A.31
Major Industrial Countries: Key Economic Indicators

	2003	2004	2005	2006	2007*e*	2008*f*
	Annual change (%)					
REAL GDP						
Major Industrial Countries						
United States	2.5	3.6	3.1	2.9	2.2	1.0
Japan	1.4	2.7	1.9	2.2	2.0	1.0
Euro Area	0.8	2.0	1.5	2.8	2.6	1.5
Germany	*-0.3*	*1.1*	*0.8*	*2.9*	*2.7*	*2.0*
United Kingdom	2.8	3.3	1.8	2.8	3.1	2.3
INFLATION						
Major Industrial Countries						
United States	2.3	2.7	3.4	3.2	2.9	2.3
Japan	-0.3	0.0	-0.3	0.3	0.1	0.5
Euro Area	2.1	2.1	2.2	2.2	2.0	2.0
Germany	*1.0*	*1.8*	*1.9*	*1.8*	*2.1*	*1.8*
United Kingdom[1]	1.4	1.3	2.0	2.3	2.4	2.0
	% of labour force					
UNEMPLOYMENT						
Major Industrial Countries						
United States	6.0	5.5	5.1	4.6	4.6	5.7
Japan	5.3	4.7	4.4	4.1	4.0	4.0
Euro Area	8.7	8.8	8.6	7.8	6.9	6.8
Germany	*8.8*	*9.2*	*9.1*	*8.1*	*6.5*	*6.3*
United Kingdom	5.0	4.8	4.8	5.4	5.4	5.4
	% of GDP					
CURRENT ACCOUNT BALANCE						
Major Industrial Countries						
United States	-4.8	-5.5	-6.1	-6.2	-5.7	-5.5
Japan	3.2	3.7	3.6	3.9	4.5	4.3
Euro Area	0.5	1.1	0.3	0.0	-0.2	-0.4
Germany	*1.9*	*4.3*	*4.6*	*5.0*	*5.4*	*5.1*
United Kingdom	-1.3	-1.6	-2.5	-3.2	-3.5	-3.6
FISCAL BALANCE[2]						
Major Industrial Countries						
United States	-4.8	-4.4	-3.6	-2.6	-2.6	-2.9
Japan	-8.0	-6.2	-4.8	-4.1	-3.9	-3.8
Euro Area	-3.1	-2.9	-2.6	-1.6	-0.9	-1.1
Germany	*-4.0*	*-3.8*	*-3.4*	*-1.6*	*-0.2*	*-0.5*
United Kingdom	-3.5	-3.4	-3.3	-2.7	-2.5	-2.3

[1] Based on Eurostat's harmonised index of consumer prices
[2] Refers to general government fiscal balance
e Estimate
f Forecast

Source: IMF World Economic Outlook, October 2007
National authorities and Bank Negara Malaysia estimates

Table A.32
East Asia: Key Economic Indicators

	2003	2004	2005	2006	2007*e*	2008*f*
REAL GDP	Annual change (%)					
Regional Countries						
The People's Republic of China	10.0	10.1	10.4	11.1	11.4	10.5
Korea	3.1	4.7	4.2	5.0	4.9	4.7
Chinese Taipei	3.5	6.2	4.2	4.9	5.7	4.3
Singapore	3.1	9.0	7.3	8.2	7.7	4.0 ~ 6.0
Hong Kong SAR	3.0	8.5	7.1	7.0	6.3	4.5
Malaysia	5.8	6.8	5.0	5.9	6.3	5.0 ~ 6.0
Thailand	7.1	6.3	4.5	5.1	4.8	4.5 ~ 6.0
Indonesia	4.9	5.1	5.6	5.5	6.3	6.2 ~ 6.8
Philippines	4.9	6.2	5.0	5.4	7.3	6.3 ~ 7.0
CONSUMER PRICES	Annual change (%)					
Regional Countries						
The People's Republic of China	1.2	3.9	1.8	1.5	4.8	5.0
Korea	3.5	3.6	2.8	2.2	2.5	3.3
Chinese Taipei	-0.3	1.6	2.3	0.6	1.8	2.0
Singapore	0.5	1.7	0.5	1.0	1.7	4.5 ~ 5.5
Hong Kong SAR[1]	-2.6	-0.4	0.9	2.0	2.0	3.4
Malaysia	1.2	1.4	3.0	3.6	2.0	2.5 ~ 3.0
Thailand	1.8	2.8	4.5	4.6	2.0	2.8 ~ 4.0
Indonesia	6.8	6.1	10.5	13.1	6.3	4.0 ~ 6.0
Philippines	3.5	6.0	7.6	6.2	3.0	3.0 ~ 4.0
CURRENT ACCOUNT BALANCE	% of GDP					
Regional Countries						
The People's Republic of China	2.8	3.6	7.2	9.4	11.7	12.2
Korea	2.0	4.1	1.9	0.7	0.1	-0.4
Chinese Taipei	9.6	5.6	4.5	6.8	6.8	7.1
Singapore	24.2	20.1	24.5	27.5	27.0	25.4
Hong Kong SAR	10.4	9.5	11.4	10.8	11.2	9.5
Malaysia	12.1	12.1	14.6	16.3	15.5	14.0
Thailand	3.4	1.7	-4.5	1.6	3.7	2.2
Indonesia	3.5	0.6	0.1	2.7	1.6	1.2
Philippines	0.4	1.9	2.0	4.3	3.8	2.6
FISCAL BALANCE[2]	% of GDP					
Regional Countries						
The People's Republic of China	-2.4	-1.5	-1.3	-1.3	-1.0	-0.6
Korea	1.8	0.7	0.6	0.4	n.a.	n.a.
Chinese Taipei	-2.9	-2.3	-2.5	-0.3	-0.2	n.a.
Singapore[3]	-1.2	-0.1	0.7	0.0	2.6	-0.3
Hong Kong SAR[3]	-3.3	-0.3	1.0	4.0	7.2	-0.4
Malaysia	-5.0	-4.1	-3.6	-3.3	-3.2	-3.1
Thailand	1.2	0.6	-0.3	0.7	-0.2	n.a.
Indonesia	-1.9	-1.4	-0.5	1.0	1.1	1.7
Philippines	-4.6	-3.9	-2.7	-1.1	-0.8[4]	0.0

[1] Refers to composite prices
[2] Refers to central government balance
[3] Refers to fiscal-year starting April to March of the following year
[4] For January-September 2007
e Estimates
f Forecast
n.a. Not available

Source: National Sources
IMF World Economic Outlook, October 2007