BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

STATUTORY REQUIREMENTS

In accordance with section 13 of the Central Bank of Malaysia Act 2009, Bank Negara Malaysia hereby publishes and has transmitted to the Minister of Finance a copy of this Annual Report together with a copy of its Financial Statements for the year ended 31 December 2010, 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 2010 is incorporated in Bank Negara Malaysia's Financial Stability and Payment Systems Report 2010 which forms an integral part of this Annual Report 2010.

Zeti Akhtar Aziz
Chairman
Board of Directors

23 March 2011

BOARD OF DIRECTORS

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz
D.K. (Johor), P.S.M., S.S.A.P., S.U.M.W., D.P.M.J.
Governor and Chairman

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

Dato' Muhammad bin Ibrahim
D.P.M.S.
Deputy Governor

Puan Nor Shamsiah binti Mohd Yunus
Deputy Governor

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

Datuk Oh Siew Nam
P.J.N.

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

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

Tan Sri Dato' Seri Dr. Sulaiman bin Mahbob
P.S.M., P.J.N., S.S.A.P., D.J.B.S., J.S.M., S.M.J., P.M.P., K.M.N., A.M.N.

Encik Chin Kwai Yoong

(Encik Chin Kwai Yoong was appointed as member of the Board of Directors effective 1 March 2010)
(Datuk Oh Siew Nam, Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor and Dato' N. Sadasivan were reappointed as members of the Board of Directors effective 1 March 2011)

Governor	Tan Sri Dr. Zeti Akhtar Aziz
Deputy Governor	Dato' Mohd Razif bin Abd. Kadir
Deputy Governor	Dato' Muhammad bin Ibrahim
Deputy Governor	Nor Shamsiah binti Mohd Yunus
Special Advisor	Dato' Ooi Sang Kuang
Project Advisor	Dato' Mohd Nor bin Mashor
Secretary to the Board	Abu Hassan Alshari bin Yahaya
Assistant Governor	Dr. Sukhdave Singh
Assistant Governor	Bakarudin bin Ishak
Assistant Governor	Norzila binti Abdul Aziz
Assistant Governor	Jessica Chew Cheng Lian
Assistant Governor	Donald Joshua Jaganathan
Assistant Governor	Abu Hassan Alshari bin Yahaya
Assistant Governor	Marzunisham bin Omar
Director	
Governor's Office	Suhaimi bin Ali
Strategic Communications	Abu Hassan Alshari bin Yahaya
Risk Management	Chung Chee Leong
Special Investigation	—
Financial Intelligence	Wan Mohd Nazri bin Wan Osman
Internal Audit	Tan Nyat Chuan
Economics	
Economics	Fraziali bin Ismail
Monetary Assessment and Strategy	Dr. Norhana binti Endut
International	Nazrul Hisyam bin Mohd Noh
Regulation	
Financial Sector Development	S. Abd. Rasheed bin S. Abd Ghafur
Islamic Banking and Takaful	Ahmad Hizzad bin Baharuddin
Financial Surveillance	Madelena binti Mohamed
Prudential Financial Policy	Mohd Zabidi bin Md Nor
Development Finance and Enterprise	Kamari Zaman bin Juhari
Consumer and Market Conduct	Koid Swee Lian
Money Business Services*	—
Supervision	
Financial Conglomerates Supervision	Che Zakiah binti Che Din
Insurance and Takaful Supervision	Yap Lai Kuen
Banking Supervision	Marina binti Abdul Kahar
Regulation and Supervision Administration Unit	Nor Aslaini binti Mohd Nasir
Payment Systems Policy	Cheah Kim Ling
Investment and Operations	
Investment Operations and Financial Markets	Adnan Zaylani bin Mohamad Zahid
Foreign Exchange Administration	Wan Hanisah binti Wan Ibrahim
Currency Management and Operations	Ramli bin Saad
Corporate Resources	
Strategic Human Capital	Mohd. Adhari bin Belal Din
Finance	—
Legal	Jeremy Lee Eng Huat
Strategic Management	Tunku Alizakri bin Raja Muhammad Alias
Human Capital Development Centre	Arlina binti Ariff
Corporate Services	Azmi bin Abd Hamid
IT Services	Alizah binti Ali
Statistical Services	Toh Hock Chai
Central Banking Services	—
LINK and Regional Offices	—
Security	Mior Mohd Zain bin Mior Mohd Tahir
Property Management Services	—
Sasana and Lanai Kijang Management Office	Lim Foo Thai
Bank Negara Malaysia Museum and Art Gallery	Muhammad Fawzy bin Ahmad
HR Services Unit	—
MIFC Promotion Unit	Shariffuddin bin Khalid
Chief Representative	
London Representative Office	Mohamad Ali Iqbal bin Abdul Khalid
New York Representative Office	Khairuzin bin Mohd Arif
Branch Manager	
Johor Bahru	Kamalullail bin Ramli
Kuching	Ishak bin Musa
Shah Alam	Mohd. Khir bin Hashim
Kuala Terengganu	Azizan bin Mohd Ali
Kota Kinabalu	Ahmad bin Abd Rahim
Pulau Pinang	Rosnani binti Mahamad Zain

* To be established later

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GOVERNOR'S STATEMENT

The world economy improved significantly in 2010. Particularly strong growth was recorded in the emerging economies with this trend being most pronounced in the Asian region. Generally this growth has been underpinned by strong domestic demand and the recovery in world trade. While the global growth momentum slowed in the second half of the year, economic growth in 2011 is expected to continue although at a more moderate pace. The slower world trade, and the implementation of policies to avoid risks to sustainable growth, have placed most emerging economies on a more steady growth path. The most pressing challenge for the world economy in 2010 has therefore been to promote a self-sustaining growth that is accompanied by job creation and macroeconomic stability.

In Malaysia, the economy expanded by 7.2% in 2010, with encouraging trends in private economic activity and continued improvements in employment conditions. Despite the more moderate global growth in 2011, Malaysia has the potential to sustain its underlying trend of steady economic growth. This will continue to be supported by sound macroeconomic fundamentals, continued access to financing in an environment of ample liquidity and a resilient financial sector. As a highly open economy, Malaysia will continue to be affected by the spillover effects of global developments. These will include the effects of developments and policies being pursued by the advanced economies, the geopolitical tensions in the Middle East and more recently, the tragic developments in Japan. Twelve years hence from the Asian financial crisis, Malaysia has built its capacity to cope with such challenges. The strengthening of our economic structure and the financial system, the enhancement of institutional arrangements and the improvement in our macroeconomic fundamentals have increased the resilience of our economy.

Two further global developments, the sharply higher global commodity and energy prices and the massive shifts in global liquidity, could also affect global growth prospects. These developments have been affected by supply disruptions due to geopolitical developments, weather conditions and the search for yield among investors in a low interest rate environment. The concern arising from these trends is that the higher commodity and energy prices could translate into higher inflation which in turn could unhinge inflationary expectations. In addition, the shifts in liquidity to emerging economies are also creating undue volatility in financial markets and excess liquidity conditions that could result in the formation of asset bubbles and other financial imbalances.

Despite the developments in the commodity markets, the consensus view at this stage is that economic activity would only be discernibly affected if the energy and commodity prices remained elevated for an extended period of time. The presence of stockpiles, better inventory management, the more efficient use of energy, and the better-anchored inflation expectations, all point to greater resilience to price shocks compared to the 1970s and 1980s. Nevertheless, different countries will be affected differently. Developing and emerging economies are likely to be more adversely affected given the greater weight of food and fuel in their consumption baskets. Commodity exporters will be less affected compared to commodity importers. The strength of the pass-through to domestic prices will also depend on factors such as domestic supply constraints, the efficiency of domestic distribution channels, the existence of subsidies and the fiscal capacity of governments to reduce the burden of higher prices.

In Malaysia, inflation was contained at 1.7% in 2010. The significant increases in global energy and commodity prices are expected however to translate into higher domestic food and fuel prices. In addressing this trend, Malaysia has adopted a more comprehensive approach that includes the implementation of a more gradual subsidy rationalisation, providing income support to the lower income groups, increasing food production and increasing efficiency in its distribution, and promoting greater energy efficiency by households and the industry. For monetary policy, this risk will need to be monitored and managed while taking into account that the consequent reduction in discretionary spending arising from the erosion of real income will also have a dampening effect on growth.

In early 2010, the Bank undertook steps to normalise the overnight policy rate, raising it in three steps to 2.75% as keeping interest rates too low for too long would result in its own risks that would undermine future growth. As we entered 2011, the risk of more modest growth remains, while the risk of higher inflation also needs to be managed. In this environment, monetary policy in 2011 has the flexibility to remain accommodative, although the degree of accommodation may need to be adjusted to ensure that economic growth in the medium term will not be damaged by higher inflation. Of importance is that the economy continues to remain on its current growth trajectory of a steady growth.

Managing the excess liquidity and its potential consequent effects on leverage, in particular by the household sector and also on the formation of bubbles in the asset markets has prompted a further strengthening of governance process to address these issues. A joint policy meeting of the Monetary Policy Committee and the Financial Stability Committee is periodically convened to deliberate on the appropriate policy responses in the event that these issues are raised in the respective committees. This is to ensure that policies will be consistent and coordinated. Also important is that there will not be over reliance on one set of measures that will result in over-adjustments.

A notable development in the current environment is the rising trend of household indebtedness and its potential to become an area of concern. While household indebtedness has increased, it has continued to be well-supported by strong financial buffers at the aggregate level. Income growth, the high rate of savings and the favourable employment conditions have supported the debt servicing capacity of households. Nevertheless, to avoid this becoming a risk, a comprehensive series of policies have been introduced during the course of the year. These include prudential policies applied in the residential property sector, new credit card measures and strengthened requirements for banks to adopt prudent and responsible lending practices. This was reinforced by increased financial education programmes including support arrangements to promote responsible borrowing by households. These pre-emptive measures, outcomes of the joint meetings, also aim to strengthen the resilience of the household sector.

A further policy challenge relates to the more volatile capital flows into the country. As with a number of other countries in the Asian region, Malaysia received large short-term capital flows since the second half of 2009. Overall, the capital flows have been manageable and have been well intermediated by the financial system. While the ringgit exchange rate has become more volatile against the major currencies, the foreign exchange market has remained orderly and the impact of these flows on domestic monetary conditions has not been destabilising. In addition, the substantial increase in liquidity in the banking system arising from these short-term flows has to a large extent been sterilised. The Bank also has at its disposal the instruments necessary to ensure that this excess liquidity does not lead to excessive risks in the financial system and the economy.

As part of the ongoing organisational development of the Bank, several advancements were achieved during the year. In particular, this included the operationalisation of the Central Bank of Malaysia Act 2009. In providing greater clarity of our mandate, the Act has significantly enhanced the role of the Board in providing its oversight on the operations of the Bank. In addition, the greater powers that the Act accords to the Bank is also accompanied by a more robust framework for governance and greater accountability. In addition to the existing Board Audit Committee, the Board Governance Committee and the Board Risk Committee were introduced during the year.

A further initiative in organisational development is the further strengthening of the performance-based culture at the Bank. This has continued to be a central pillar in the Bank's management of its staff and the remuneration and promotion framework. The Bank has also continued to build its human capital and strengthen its talent pipeline. In line with the demand for skills and specialised knowledge in this evolving economic and financial environment, the Bank has introduced specialist ladders and new job families for professionals that are supported by extensive tailored programmes to better equip our talent. Investment in technology was also a prime focus in 2010 with the further expansion and modernisation of the ICT infrastructure, including the operationalisation of the Bank's new Data Centre and the upgrading of our Recovery Centre.

The global financial and economic crisis and the challenges it has posed in the areas of the Bank's responsibilities have placed significant demands on our resources. On behalf of the Board I wish to express our appreciation and gratitude to all the staff of the Bank who have worked with great dedication and commitment to ensure that the Bank continues to serve the interest of the nation and to protect the longterm well-being of all citizens of this country. I am also grateful for the support and guidance of the Board of Directors, who are an integral part of the governance at the Bank. The Bank will continue to strive to achieve the highest standards of excellence in performing our responsibilities.

Zeti Akhtar Aziz
Governor
23 March 2011

2010

EXECUTIVE SUMMARY

The year 2010 saw a continuation in global economic recovery, which had begun in the second half of 2009. Nevertheless, the international environment remained highly uncertain, weighed down by continued structural weaknesses in the advanced economies and large swings in global financial markets. The emerging economies, however, experienced a rapid resumption of economic growth, but faced increasing challenges from volatile capital flows and rising inflationary pressures. Amidst this environment, the Malaysian economy resumed its growth path, underpinned by a strong expansion in domestic activity and greater integration with the region. The Annual Report provides detailed analyses of the developments in the Malaysian economy and policies pursued by the Bank during the year, as well as an assessment of the prospects for the economy against the backdrop of on-going developments in the global economic and financial landscapes and the key challenges going forward. The report also highlights the organizational changes in the Bank to strengthen its governance and capacity through enhancements in strategic management, risk management and talent development.

The Malaysian Economy in 2010

After the downturn in 2009, the Malaysian economy experienced a strong resumption of growth in 2010 with an expansion of 7.2%. Growth was driven mainly by robust domestic demand, with strong expansion in private sector activity. Meanwhile, the public sector continued to support the domestic economy through the implementation of programmes to further enhance the country's infrastructure and the public sector delivery system. External demand rebounded strongly in the first half of the year, underpinned by strong regional demand and to some extent, the low base effect. However, it subsequently moderated in the second half-year in tandem with the slowdown in global trade and the diminishing base effect.

Domestic demand conditions were robust. For the year as a whole, the overall aggregate domestic demand expanded strongly by 6.3% (2009: -0.5%). Private consumption expanded at a faster rate of 6.6% (2009: 0.7%), supported by better labour market conditions and the steady increase in incomes. Higher prices of crude palm oil and rubber supported increased spending by households in the rural areas. Continued access to credit amid an accommodative monetary environment also supported consumer spending. Robust consumer spending was reflected in the strong performance of major consumption indicators such as passenger car sales, retail sales and imports of consumption goods.

Private investment rebounded strongly to register a double-digit growth of 13.8% in 2010 (2009: -17.2%). Capital spending expanded across all sectors following favourable domestic economic conditions and improvements in external demand. The strong performance of investment activity was reflected in the improvement of major investment indicators. Import of capital goods increased by 16.2%, while sales of construction-related materials rose by 11% in 2010.

The public sector continued to provide support to growth during the year. Public investment increased by 5.5% (2009: 8%), partly reflecting the continuation of the second stimulus package amounting to RM5 billion in the first half of the year. Development expenditure was channelled mainly towards improving rural infrastructure and urban public transportion as well as enhancing the provision of public education and healthcare services. Meanwhile, growth in public consumption moderated to 0.1% (2009: 3.1%), attributable mainly to lower spending on supplies and services as the Government reprioritised spending programmes and reduced non-essential expenditure. Nevertheless, expenditure on emoluments was higher, in part because of the improved salary scheme for selected segments of the civil service.

On the supply side, all economic sectors registered a strong performance in 2010. The services sector expanded by 6.8% (2009: 2.6%) and was the largest contributor to growth, contributing 3.9 percentage points to the overall GDP growth. The sector expanded by 7.9% in the first half-year driven by higher growth in all sub-sectors. With the slowdown in external demand which affected the trade- and manufacturing-related services sub-sectors, growth moderated to 5.8% in the second half. The sustained expansion in domestic consumption activity, nevertheless, continued to benefit the services sub-sectors that are dependent on domestic demand, particularly the wholesale and retail trade; and communication sub-sectors.

The manufacturing sector rebounded strongly to register a growth of 11.4% (2009: -9.4%), driven largely by the strong growth in the first half-year, with expansion in both the export- and domestic-oriented industries. In the export-oriented industries, growth of the electronics and electrical products (E&E) cluster was underpinned by the revival of global corporate IT investments and higher consumer spending on electronics while growth of the primary-related cluster was in line with the recovery of the external environment. Robust growth in the domestic-oriented industries was supported mainly by strong domestic consumption activity. The pace of growth of the sector, however, moderated towards year-end due to slower external demand and the diminishing base effect.

The construction sector grew by 5.2% in 2010 (2009: 5.8%). Growth was supported mainly by the non-residential sub-sector, reflecting the construction of commercial properties and the upgrading and repair of public buildings. The civil engineering sub-sector continued to expand reflecting further progress in the implementation of infrastructure projects. Construction activity in the residential sub-sector declined, as fewer units of new residential properties were launched by developers, especially in the early part of 2010. Meanwhile, house prices increased by 6% on an annual basis during the first three quarters of 2010, almost twice the size of the average increase of 3.4% during 2000-09.

The agriculture sector (including forestry and fishing) expanded by 1.7% (2009: 0.4%). The production of food crops was sustained, while the production of industrial crops declined at a slower pace as rubber production picked up because of higher prices. Global agricultural commodity prices increased significantly during the year following stronger demand amid constrained supply due to adverse weather conditions. Prices of crude palm oil increased considerably during the year while rubber prices closed at record high on 30 December 2010.

The mining sector increased by 0.2% (2009: -3.8%) supported by higher production of natural gas to meet higher demand from major importers such as Japan and Taiwan, as well as the first full-year of exports to PR China. Crude oil output, however, continued to decline due mainly to lower production from the maturing oil fields and the shutdown of several oil fields for maintenance.

Conditions in the labour market improved in 2010 as reflected in lower retrenchments, higher number of vacancies and gains in employment. The unemployment rate declined to 3.2% of the labour force (2009: 3.7%), following stronger growth in employment (1.8%; 2009: 0.4%), compared to the growth in the labour force (1.3%; 2009: 0.8%).

Inflation increased during the year driven by supply factors arising from higher food and commodity prices and adjustments to administered prices. However, overall inflation remained low. Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), averaged 1.7% in 2010 (2009: 0.6%). Meanwhile, core inflation, an indicator of the demand-driven pressures on prices, moderated to 1.5% in 2010 (2009: 2.7%).

Malaysia's external position remained resilient in 2010, underpinned by a sizeable current account surplus and lower net outflows in the financial account. The acceleration of domestic demand provided impetus for the strong growth of gross imports which outpaced the growth of gross exports, leading to a slightly smaller trade surplus. The services account recorded a small surplus, supported by higher receipts from tourism as well as computer and IT services. Meanwhile, the lower net outflows in the financial account largely reflected the higher inflows of portfolio investment and foreign direct investment (FDI) given the improvement in both global and domestic economic conditions.

Gross exports expanded by 15.6% in 2010 (2009: -16.5%), with relatively stronger growth in the first half-year, supported by strong regional demand and to a certain extent, the low base effect of the previous year. The growth momentum, however, moderated in the second half, weighed down by the slower growth in manufactured exports, namely exports of electronics and electrical products (E&E). Commodity exports, on the other hand, remained resilient throughout the year and expanded by 26.9% (2009: -28.2%), supported by robust regional demand and high commodity prices. Gross imports grew by 21.7% (2009: -16.3%), with expansion across all major import categories, reflecting the pick-up in manufacturing activity and robust domestic demand.

The financial account recorded a smaller net outflow of RM21.9 billion (2009: -RM80.2 billion). Net portfolio inflows increased in line with regional trend given the prospects for strong growth as well as expectations for stronger regional currencies and higher interest rates. The improving global economic conditions and corporate profitability, as well as more favourable investment climate led to higher inflows of FDI. Direct investment abroad also rose as Malaysian companies continued to tap profitable opportunities overseas. However, other investment outflows, which largely reflected trade credits and placement of deposit abroad by residents, moderated during the year. As at 28 February 2011, the reserves level amounted to RM338.6 billion (equivalent to USD109.8 billion), which is adequate to finance 8.1 months of retained imports and is 4.3 times the short-term external debt. The international reserves held by the Bank remain usable and unencumbered.

Malaysia's external debt declined to RM226.3 billion or equivalent to 30.2% of GNI at the end of 2010. This reflected the decline in the medium- and long-term debt due to the net repayment of external loans by the private sector. Within the public sector, the NFPEs also registered a net repayment of external loans, including the maturity of several bonds. In contrast, the Federal Government recorded a net drawdown of external loans, primarily because of the issuance of the USD1.25 billion 5-year global sukuk in May 2010. The sukuk issuance was aimed at promoting Malaysia as a global Islamic financial hub as well as to establish a new US dollar benchmark for Malaysian corporates. During the year, the short-term external debt outstanding increased to RM79.4 billion, attributed primarily to higher non-bank private sector borrowings. The short-term external debt remained relatively small, accounting for only 10.6% of GNI, 24.2% of international reserves and 10.7% of goods and services exports.

Domestic Monetary and Financial Conditions in 2010

With the recovery becoming more entrenched, the focus of monetary policy during the early part of 2010 was on the need to normalise the extraordinary monetary stimulus undertaken in 2009. It was recognised that leaving the Overnight Policy Rate (OPR) at a low level for a sustained period could give rise to financial imbalances and create distorted incentives for economic agents, leading to the mispricing of risks, financial disintermediation and excessive credit growth. The OPR was, thus, gradually raised by 25 basis points each time in March, May and July 2010.

Monetary policy remained accommodative and supportive of growth. As the borrowing costs were still below the already low pre-crisis levels, financing conditions remained supportive of economic activity with growth in private sector financing remaining robust throughout 2010. Meanwhile, inflation remained low at 1.7% for the year as a whole. On the risk of a build-up of financial imbalances, assessments carried out throughout the year showed that growth in overall asset prices and credit were generally not excessive and continued to be in line with the improvements in the economy.

The larger and more volatile international financial flows to emerging economies also posed policy challenges in 2010. For Malaysia, these inflows have been manageable with no discernible signs of the inflows creating imbalances in the domestic economy and financial system. The ringgit exchange rate movements remained orderly, while sterilisation operations ensured that the impact of the excess liquidity on domestic monetary conditions was contained. The depth and resilience of the financial system allowed these funds to be better intermediated, while the healthy level of international reserves served to mitigate the risks arising from reversal of these flows.

The ringgit appreciated during the year, driven by the current account surplus and net portfolio inflows. Apart from common factors that attracted portfolio inflows to the region, there were also factors specific to Malaysia that provided impetus for such inflows and the further strengthening of the ringgit. The announcement of several key initiatives to transform the Malaysian economy and the further liberalization measures were among these factors. While the appreciation of the ringgit was generally orderly, it was punctuated by episodes of portfolio flow reversals, especially following the sovereign debt crisis in Europe in May and the developments in Ireland in November which induced heightened uncertainties. For the year as a whole, ringgit appreciated against the US dollar, euro and pound sterling, but depreciated against the Japanese yen.

The domestic equity market rose steadily in early 2010 but underwent a correction in May following developments in Europe. The market, however, rebounded in the second half of the year along with improved global market conditions, strong corporate performance and positive government measures. For the year as a whole, the FBM KLCI rose by 19.3% (2009 :45.2%).

Liquidity conditions in the banking system were ample throughout 2010. Private sector liquidity expanded at a measured pace, in line with real economic recovery and the resumption of foreign inflows. The sterilisation operations of the Central Bank were instrumental in ensuring that there was sufficient liquidity to support the economy, while not being excessive to result in misallocation of financial resources.

Financing conditions remained supportive of economic activity. The ready access to financing, relatively low cost of borrowing and ample liquidity in the financial system supported the demand for financing from both the private and public sectors. Net financing raised by the private sector through the banking system and the capital market expanded by 11.3% (2009: 8.4%) with strong demand from both the business and household sectors.

Outlook for the Malaysian Economy in 2011

The Malaysian economy is projected to grow by 5–6% in 2011. Growth is likely to improve during the course of the year with better growth performance in the second half of the year. The growth momentum will be underpinned by strong domestic demand, emanating primarily from private sector activity. Private consumption will be supported by favourable labour market conditions, higher disposable incomes, sustained consumer confidence and ready access to financing. Private investment is expected to remain strong, supported by capital spending by the domestic-oriented industries given the high levels of capacity utilisation and positive business confidence, as well as the implementation of key initiatives announced by the Government under the Economic Transformation Programme (ETP). Meanwhile, the public sector will remain supportive of growth, with higher capital spending projected in the second half of 2011. This is mainly resulting from the implementation of new projects and the acceleration of on-going projects to promote private sector activity.

On the supply side, all economic sectors are expected to expand in 2011, supported mainly by the continued growth of domestic demand. The services and manufacturing sectors are expected to grow at a more moderate pace given the high statistical base of 2010 with the expansion being driven by domestic demand dependent sub-sectors. Trade-related services and export-oriented manufacturing industries, however, will record slower growth, in line with the expected moderation in external demand. Meanwhile, growth in the agriculture and mining sectors is projected to strengthen, benefiting respectively from the expected turnaround in the production of industrial crops amid high commodity prices and the higher output of natural gas following the opening of two new gas fields. Further progress of on-going infrastructure projects and new projects due for implementation under the ETP will provide the impetus for the construction sector.

On the external front, the current account surplus is projected to amount to RM100.7 billion or 12.5% of GNI in 2011, reflecting a higher trade surplus and sustained services account surplus. The trade surplus is expected to emanate primarily from robust commodity exports supported by higher prices and sustained demand, particularly from the region. Meanwhile, the surplus in the services account will be driven by higher receipts from the travel account with the expected increase in tourist arrivals, especially from the region, amid active promotional campaigns and increased access to the country through the low-cost airline carriers. On the financial account, foreign direct investment inflows are expected to increase given the favourable economic outlook, better corporate earnings, rising business confidence, further improvements in global FDI flows and the Government's wide-ranging economic transformation projects. Direct investment abroad is expected to remain large as companies continue to seek new markets and business opportunities abroad.

The projected growth of the Malaysian economy is based on the expectation of moderate growth in advanced economies and a return to more normal growth rates by the Asian economies. Nevertheless, there remain risks to the growth projection which include sharper than expected deterioration in external conditions, significant volatility in capital flows given the continued uncertainty in international markets and higher than anticipated inflation emanating from supply-driven factors.

Labour market conditions are expected to remain positive in 2011, with the continued expansion in employment stemming primarily from growth in the domestic-oriented sectors. Job creation will be led by the services sector, particularly in the distributive trade, finance and insurance, and communication sub-sectors. In the manufacturing sector, despite a more moderate growth in the export-oriented industries, gains in employment will remain firm, supported by the expansion in the consumer-related and construction-related clusters. The unemployment rate is projected to remain at 3.2% of the labour force in 2011.

Headline inflation is expected to increase further in 2011 to average at 2.5 – 3.5%, driven primarily by the significant increases in global commodity and energy prices. There are also some incipient signs that domestic demand factors could result in possible upward pressure on prices in the latter part of the year in line with the sustained expansion in economic activity.

Economic and Monetary Management in 2011
Under this challenging global economic environment, the focus of policy is to support the sustainable growth of the economy while managing the risks to inflation. Fiscal policy will be geared towards preparing the nation towards becoming a developed and high-income economy. This will be achieved through measures to strengthen private investment and enhance infrastructure and the public sector delivery system. Among the measures announced in the 2011 Budget to facilitate private sector activity include the public-private partnership initiatives in the implementation of Government development projects, identification of high-impact projects for private sector investment and enhancing sources of private sector financing.

Monetary policy will continue to facilitate economic growth while managing the risks of inflation and the build-up of financial imbalances arising from high global liquidity, volatile capital flows and elevated commodity prices. Additional targeted instruments such as macro-prudential lending measures may be deployed if excessive risk-taking behaviour and asset price escalation were to occur within specific segments of the market. As a pre-emptive measure to manage the risk of an excess build-up of liquidity, the Statutory Reserve Requirement (SRR) ratio was raised from 1.00% to 2.00%, effective 1 April 2011.

Organisational Development and Governance
During 2010, the Bank continued with its effort in organisational development and promoting more effective governance. An important development was the operationalisation of Central Bank of Malaysia Act 2009 (CBA) which allows for development of a more robust governance framework. Under the CBA, two new Board committees, namely the Board Governance Committee and the Board Risk Committee were formed to undertake the oversight function of ensuring an effective governance and a more robust risk management process in the Bank. During the year, several initiatives were being implemented, aimed at promoting a strong risk management culture and pre-emptively managing risks that may affect the achievement of Bank's objectives. Efforts were also undertaken to strengthen Business Continuity Management (BCM). The Bank also undertook a strategic review of its 2009-2011 Business Plan to assess progress towards objectives and to realign resources where necessary to ensure more effective utilisation of resources.

The Bank continues to promote communication outreach and engagement with its stakeholders through various channels and initiatives. These include strategic engagements to enhance better understanding of developments in the economy and financial system and the Bank's monetary policy decisions, access to financing, financial literacy and financial inclusion. In an increasing challenging environment along with the high shareholders expectations, the Bank will continue to provide greater clarity on the Bank's role in the drive to achieve the economic transformation into a high income economy.

As part of the continuous effort to enhance regional and international cooperation, the Bank continues to be involved in technical collaboration with external agencies to other central banks from developing economies in the areas of institutional capacity building, Islamic finance and financial inclusion

Bank Negara Malaysia's Audited Financial Statements for 2010
The financial position of Bank Negara Malaysia, as audited and certified by the Auditor General, remained strong in 2010. Total assets of Bank Negara Malaysia amounted to RM390.2 billion with a net profit of RM6.2 billion for the financial year ended 31 December 2010. Bank Negara Malaysia declared a dividend of RM2 billion to the Government for the year 2010.

2010

ECONOMIC DEVELOPMENTS IN 2010

THE INTERNATIONAL ECONOMIC ENVIRONMENT

In 2010, the global economic recovery continued, albeit at an uneven pace, after exiting from the sharpest post-war economic contraction in the second half of 2009. The recovery accelerated in the first half of the year due to inventory restocking, continued policy support as well as the low base effect, but the momentum tapered off in the second half as these temporary factors waned. Global growth was led by strong economic activity in the emerging market economies, while the advanced economies continued to face crisis-induced and structural issues. Of significance, the emerging economies contributed more than two thirds of global growth in 2010.

The global economic recovery continued in 2010, led by the emerging market economies

In the advanced economies, recovery in the first half of the year was supported by factors such as the ongoing fiscal stimulus and inventory restocking. The pace of recovery, however, moderated towards the latter part of 2010. Domestic demand conditions in the advanced economies remained modest due to lingering effects of the financial crisis on private sector balance sheets. The escalation of sovereign debt crisis in the euro area and the announcements of impending fiscal austerity measures in several advanced economies weighed further on consumer and business sentiments in these countries. The emerging economies, notably in Asia, on the other hand, experienced a very strong recovery, particularly in the first half of the year. Growth in these economies was boosted by robust domestic demand activity, rapid expansion in intra-regional trade and to a certain extent, inventory restocking. After registering an exceptional growth performance in the first half of the year, most Asian economies continued to sustain a firm recovery in the second half, but at a more moderate pace, due to the slower improvement in external demand and the dissipating low base effect. The Asian economies also faced rising inflationary pressures towards the second half arising from increasing commodity prices, in particular food prices.

The divergence in the growth performance and the consequent differences in policy responses in the advanced and emerging economies had significant implications on global capital flows, asset prices and exchange rates during the year. In the advanced economies, authorities continued to pursue expansionary monetary policy by introducing further quantitative easing measures to stimulate economic growth. In contrast, many emerging economies have started to normalise their monetary policy in response to a better growth outlook and rising inflation. As a result of the widening interest rate and growth differentials, and the large injections of global liquidity from quantitative easing measures, capital flows into the emerging economies intensified. This exerted upward pressure on asset prices and exchange rates in these economies, prompting the monetary authorities to adopt wide-ranging measures to mitigate the impact of the capital flows on macroeconomic and financial stability.

International financial conditions were affected by periodic volatility associated with the sovereign debt crisis in the euro area, particularly in April, July and November. The escalation of government funding crisis in Greece in late April heightened the contagion risk to other euro area economies. In response, the EU-IMF extended a €110 billion bailout package to Greece on 2 May. To calm the financial markets, the EU-IMF also announced the creation of a €750 billion temporary financial safety net which included the €440 billion European Financial Stability Facility on 9 May to assist euro area countries that were in economic difficulties. On the same day, the European Central Bank (ECB) announced several measures to purchase euro government bonds through its Securities Market Programme and to provide emergency liquidity to euro area banks. However, persistent concerns on the health of the banking sector in the euro area over the following months triggered a stress test by the ECB in July. Global financial markets came under pressure again in November following uncertainty over Ireland's ability to raise funds. This eventually led to an EU-IMF €85 billion bailout package for Ireland on 28 November aimed at restructuring the Irish banking system and safeguarding its fiscal position. Notwithstanding the episodic stress in the euro area financial markets, global financial markets continued to register favourable performance during the year. Most major and regional equity markets recorded positive double-digit growth for the second consecutive year, with emerging markets being buoyed by large capital inflows. In the global bond market, large corporate issuers were able to raise funds cheaply given the low long-term yields.

Table 1.1

World Economy: Key Economic Indicators

	Real GDP Growth (%)		Inflation (%)	
	2009	2010e	2009	2010e
World Growth	**-0.6**	**5.0**	**-**	**-**
World Trade	**-10.7**	**12.0**	**-**	**-**
Advanced Economies				
United States	-2.6	2.8	-0.4	1.6
Japan	-6.3	3.9	-1.4	-0.7
Euro area	-4.1	1.7	0.3	1.6
United Kingdom	-4.9	1.3	2.2	3.3
East Asia	**5.4**	**9.2**	**0.3**	**3.2**
Asian NIEs[1]	**-0.8**	**8.3**	**1.3**	**2.3**
Korea	0.2	6.1	2.8	2.9
Chinese Taipei	-1.9	10.8	-0.9	1.0
Singapore	-0.8	14.5	0.6	2.8
Hong Kong SAR[2]	-2.7	6.8	0.5	2.4
The People's Republic of China	**9.2**	**10.3**	**-0.7**	**3.3**
ASEAN-4	**1.1**	**6.9**	**2.3**	**3.8**
Malaysia	-1.7	7.2	0.6	1.7
Thailand	-2.3	7.8	-0.9	3.3
Indonesia	4.5	6.1	4.8	5.1
Philippines	1.1	7.3	3.2	3.8
India[3]	**7.0**	**8.6**	**2.1**	**9.4**

[1] Newly industrialised economies
[2] Inflation refers to composite price index
[3] Inflation refers to wholesale price index
e Estimate

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

In the **United States (US)**, real GDP expanded by 2.8% in 2010 (2009: -2.6%), with about 50% of the growth coming from inventory restocking, following two years of inventory drawdown beginning in early 2008. Domestic demand remained modest, with private consumption growing at 1.8% (2009: -1.2%), supported by a drawdown in personal savings and a gain of USD3.2 trillion in net worth from the buoyant equity markets. However, households were constrained by a weak recovery in the job market with average monthly job creation of 78,000, a pace which could not meaningfully reduce the rate of unemployment. Thus, the unemployment rate remained elevated at 9.4% at end-year with the share of long-term unemployment rising further to 44.3% of total unemployment. The labour market conditions also exerted downward pressure on house prices, with residential investment remaining sluggish. In contrast, business investment in equipment and software expanded strongly by 15.1% (2009: -15.3%) as firms accelerated the replacement of obsolete machinery after postponing their investment plans during the financial crisis.

Against the backdrop of a gradual improvement in the economy in the first half of the year, and with the normalisation of conditions in the financial markets, the Federal Reserve (the Fed) allowed the automatic expiry of several quantitative easing programmes that were introduced during the crisis. While the federal funds rate was maintained at 0 - 0.25%, the Fed raised the discount rate by 25 bps to 0.75% on 18 February in an effort to normalise lending facilities. In addition, the Fed ended the purchase programmes for USD1.25 trillion agency mortgage-backed securities and USD175 billion agency debt at the end of the first quarter. However, as the economy showed signs of slowing in the second half of the year, the Fed announced on 10 August that it would keep its holdings of securities constant by reinvesting the proceeds from maturing securities in longer-term Treasury securities. Heightened risks arising from deflationary pressures and growing concerns over the possibility of a double-dip recession prompted the Fed to introduce a second round of quantitative easing amounting to USD600 billion on 3 November. The measure involves the purchase of US Treasuries by approximately USD75 billion a month, by the end of second quarter of 2011. This was aimed at easing financial conditions through the lowering of long-term yields and increase in equity prices in order to lower mortgage rates and increase the wealth effect in order to spur consumption and investment. In December, the US government also unveiled a USD858 billion tax relief package (5.9% of GDP), in which the bulk of the measures will be implemented in 2011-2012. The package includes the extension of the expiring tax cuts, unemployment benefits, and investment tax allowance incentives.

In the **euro area**, real GDP expanded modestly by 1.7% (2009: -4.1%) amid periodic episodes of sovereign debt problems in the peripheral economies. The recovery was uneven, largely due to the strong export-led growth in the core economies, in particular Germany, while the peripheral economies experienced weak domestic demand conditions. In Germany, real GDP expanded by 3.6% (2009: -4.7%) as the double-digit export growth had positive spillover effect on private consumption through a large expansion of jobs in the export-oriented industries. In contrast, domestic demand in the peripheral economies was weighed down by the imposition of fiscal austerity measures and the consequent deterioration in consumer confidence amid large layoffs in the public sector. Furthermore, high structural unemployment, fragile banking sectors and falling house prices continued to exert recessionary pressures on these economies. In view of the divergence in growth among the euro member countries and the persistent financial market uncertainty surrounding the ability of the peripheral economies to raise funding, the ECB decided to maintain an accommodative monetary policy stance throughout the year. The outbreak of the Greek crisis prompted further quantitative easing in May through the introduction of the Securities Market Programme to purchase both government and private sector bonds in the euro area. The ECB also reintroduced several of its liquidity facilities to extend unlimited short-term funds to the banking sector to ease funding strains given the banks' exposure through holdings of sovereign papers.

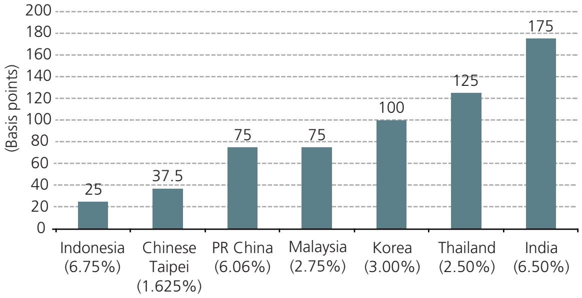
In the **United Kingdom (UK)**, real GDP expanded by 1.3% (2009: -4.9%), but growth was mainly contributed by inventory restocking while domestic demand continued to remain subdued. Private consumption growth was modest, in line with weak consumer sentiment following the announcement of planned fiscal austerity amounting to 5.6% of GDP over the next four years. Private investment was constrained by an overhang of spare capacity, low demand and tight credit conditions. In balancing between the fragility of economic recovery and markedly stronger headline inflation, the Bank of England (BOE) decided to keep the policy rate unchanged at 0.5% and maintained the size of its asset purchase programme at £200 billion.

The **Japanese** economy rebounded strongly by 3.9% in 2010 (2009: -6.3%), supported by double-digit growth in exports and industrial production. In the first half of the year, exports registered its fastest expansion in 30 years following strong demand for vehicles and semiconductors from Asia. Private consumption, posted a modest growth of 1.9% (2009: -1.9%), supported by fiscal stimulus in the form of subsidies for environment-friendly cars and electrical appliances. Notwithstanding the export-led recovery, the deflation threat in the domestic economy, coupled with a strong yen, prompted the Bank of Japan (BOJ) to expand its six-month lending facility to ¥20 trillion in March, in order to provide more loans to financial institutions at lower interest rates. The facility was first introduced in December 2009 with the initial amount of ¥10 trillion. As the recovery began to lose momentum in the second half of the year, the BOJ further expanded the lending facility to ¥30 trillion in August. As the strong yen and weakening of the US economy continued to weigh on the recovery, the BOJ reduced the overnight call rate in October to a range of 0 - 0.1% from 0.1% and established a ¥5 trillion asset purchase programme to purchase government and corporate bonds.

In the **Asian region**, growth was exceptionally strong in the first half of the year, driven by robust domestic demand, intra-regional trade, inventory restocking in the advanced economies as well as the low base effect. The strength in domestic demand was anchored by improving household and business sentiments, favourable labour market conditions and continued access to financing. The growth momentum was further reinforced by the double-digit expansion in exports for most regional economies, benefiting from strong intra-regional trade activity led by PR China, and demand associated with inventory restocking in the global economy. As a result, Singapore, Chinese

Chart 1.1

Cumulative Movements of Policy Rates since 2010

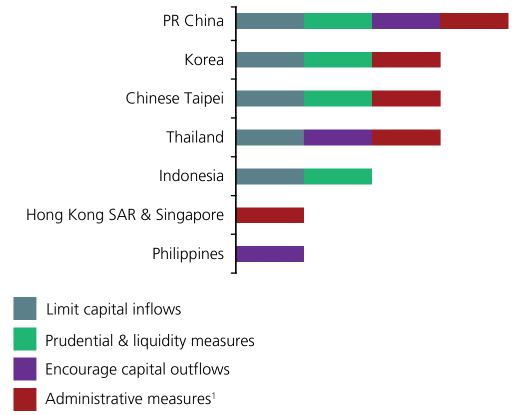


Note: Current policy rates in parentheses, as at mid-March 2011

Source: National authorities

Chart 1.2

Measures Introduced in the Region to Manage Capital Flows



[1] Real estate measures

Source: National authorities

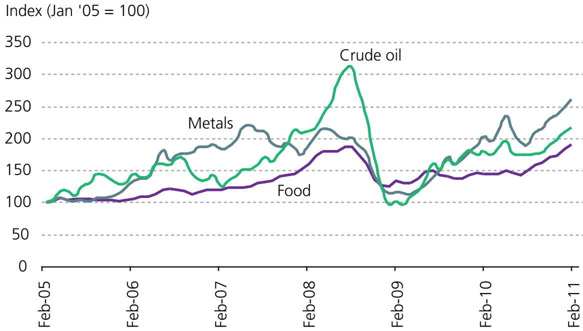
Taipei, PR China and Thailand recorded strong double-digit economic growth in the first half of the year. Growth in most regional economies, however, began to moderate towards the latter part of the year following the slower pace of improvement in external demand, reduced inventory restocking activity and waning low base effect. Nevertheless, domestic demand, particularly private consumption, continued to remain resilient, providing support to overall growth. Amid relatively favourable growth prospects, coupled with rising inflationary pressures associated with increasing commodity prices, several central banks in the region began to normalise their policy rates to levels consistent with the prevailing economic conditions. Malaysia, Chinese Taipei, Korea, Thailand, PR China and Indonesia increased their benchmark policy rates by cumulative hikes of between 25 and 125 basis points since 2010. In PR China, the People's Bank of China (PBOC) also raised the reserve requirement ratio eight times to 19.5% and imposed a quota on new bank lending to manage inflationary pressures and limit credit growth.

The pace of monetary policy normalisation in the region, however, was complicated by the large capital inflows experienced by several regional economies, exacerbated by further quantitative easing in the advanced economies. Several monetary authorities such as those in Thailand, Indonesia, Korea, Hong Kong SAR and PR China, used a number of instruments to mitigate the effects of capital inflows on domestic asset prices and exchange rates. These measures include the imposition of levies and taxes on the foreign holdings of domestic debt instruments and the income derived, and in some cases, limits on the holdings. Macroprudential measures were also adopted to limit the domestic banking institutions' exposure to foreign currency volatility. As large capital inflows also contributed to speculative activity in the domestic real estate sector, several authorities tightened the mortgage lending requirements and imposed stamp duties or levies to curb the speculative activity.

Global inflation was characterised by the apparent divergence in inflation trends between the advanced and regional economies. In the advanced economies, low resource utilisation rates and weak domestic demand resulted in a subdued inflationary environment as these economies treaded on a path of gradual and uneven recovery. Although headline inflation in the advanced economies picked up in the second half of the year due to rising energy prices, core inflation remained low in the US, euro area and Japan, generally reflecting the negative output gaps in these economies. There were also concerns on the risk of deflation in the US and euro area, with the former brought on by weaker-than-expected growth. The regional economies, however, experienced rising inflationary pressures arising mainly from higher commodity prices. Prices of metals, crude oil and food rose beyond peaks recorded in the second quarter. Global food prices, which remained subdued in the first half of the year, increased sharply in the latter part of the year attributable to stronger demand from

Chart 1.3

Indices of Primary Commodity Prices



Source: International Monetary Fund

the emerging markets and adverse weather conditions in different parts of the world. The impact of rising commodity prices was particularly a concern in the emerging market economies as their consumption baskets have a larger share of food and energy. The significant capital inflows into the Asian region have also raised concerns over the formation of asset bubbles, given that these flows were mainly channelled into domestic equity, bond and property markets.

In the **foreign exchange markets**, the US dollar depreciated during the year against most major currencies except the euro and the pound sterling. The broad dollar weakness was attributable to the nascent economic recovery in the US and the quantitative easing by the Fed. However, the dollar strengthened against the euro due mainly to periodic outbreaks of sovereign debt crisis in the euro area. Following concerns over the health of the banking sector in the euro area in June, the euro plunged below USD1.20, its lowest level against the dollar since March 2006. The US dollar also gained on the pound sterling due to expectations that the fiscal austerity in the UK will have a significant effect on its recovery process. The yen continued to strengthen against the US dollar to reach a 15-year high of ¥80 in October, benefiting from its role as a safe haven currency amid heightened investor risk aversion in the global financial markets. The yen remained firm in spite of interventions by the BOJ in September. Similarly, most regional currencies also appreciated against the US dollar supported by optimism over the relatively brighter growth prospects for the region vis-à-vis the advanced economies. The strengthening of regional currencies was also partly a result of the surge in short-term capital inflows, following the quantitative easing in the advanced economies and the increased investor appetite for higher-yielding financial assets in the emerging markets. The appreciating trend, however, was interrupted sporadically in the second and fourth quarters, as investors reduced their exposure in the emerging markets when there were renewed concerns over sovereign debt in the euro area. This resulted in a temporary weakening of regional currencies against the US dollar. Among regional currencies, the ringgit recorded the largest appreciation against the US dollar during the year while the yuan rose to a 17-year high as PR China moved to increase the flexibility of its exchange rate. The Singapore dollar and New Taiwan dollar also reached record highs following tightening measures by their respective monetary authorities.

THE MALAYSIAN ECONOMY

In 2010, the Malaysian economy experienced a strong resumption of growth, recording an expansion of 7.2% following the downturn in 2009. Growth was driven mainly by robust domestic demand; and primarily by private sector activity. In particular, private consumption expanded firmly during the year, underpinned by the improvement in labour market conditions, a steady increase in income, more optimistic consumers and continued access to credit. The improvement in labour market conditions was reflected in the stronger growth of employment, lower retrenchments and lower unemployment rate. Additionally, after a sharp contraction in 2009, private investment rebounded strongly to register a double-digit growth in 2010, reflecting the expansion of capital spending across all sectors, particularly the manufacturing, mining and services sectors, following favourable domestic economic conditions amidst an improvement in external demand. The public sector continued to play a crucial role in supporting the domestic economy during the year through the implementation of programmes to further enhance infrastructure and the public sector delivery system. External demand rebounded strongly in the first half of the year, underpinned by strong regional

Table 1.2

Malaysia - Key Economic Indicators

	2008	2009	2010*p*	2011*f*
Population (million persons)	27.5	27.9	28.3	28.6
Labour force (million persons)	12.0	12.1	12.2	12.5
Employment (million persons)	11.6	11.6	11.8	12.1
Unemployment (as % of labour force)	3.3	3.7	3.2	3.2
Per Capita Income (RM)	26,041	23,841	26,219	28,175
(USD)	7,812	6,764	8,140	9,204[6]
NATIONAL PRODUCT (% change)				
Real GDP at 2000 prices[1]	4.7	-1.7	7.2	5.0 ~ 6.0
(RM billion)	530.2	521.1	558.4	587.8
Agriculture, forestry and fishery	4.3	0.4	1.7	3.4
Mining and quarrying	-2.4	-3.8	0.2	2.0
Manufacturing	1.3	-9.4	11.4	5.7
Construction	4.2	5.8	5.2	5.4
Services	7.4	2.6	6.8	5.9
Nominal GNI	14.2	-7.3	11.4	8.8
(RM billion)	717.2	665.0	740.7	806.1
Real GNI	2.1	0.7	4.2	5.6
(RM billion)	493.2	496.5	517.2	546.0
Real aggregate demand[2]	6.8	-0.5	6.3	6.7
Private expenditure[2]	7.0	-2.7	7.8	7.4
Consumption	8.5	0.7	6.6	6.9
Investment	1.0	-17.2	13.8	9.7
Public expenditure[2]	6.1	5.2	2.5	5.1
Consumption	10.7	3.1	0.1	7.2
Investment	0.5	8.0	5.5	2.7
Gross national savings (as % of GNI)	38.0	31.7	34.2	34.1
BALANCE OF PAYMENTS (RM billion)				
Goods balance	170.6	141.7	136.6	144.3
Exports (f.o.b.)	664.3	554.1	639.8	674.8
Imports (f.o.b.)	493.8	412.3	503.3	530.5
Services balance	0.2	4.7	0.9	0.2
(as % of GNI)	…	0.7	0.1	…
Income, net	-23.7	-14.6	-25.2	-23.7
(as % of GNI)	-3.3	-2.3	-3.4	-2.9
Current transfers, net	-17.5	-19.6	-21.7	-20.2
Current account balance	129.5	112.1	90.5	100.7
(as % of GNI)	18.1	17.5	12.2	12.5
Bank Negara Malaysia international reserves, net[3]	317.4	331.3	328.6	-
(in months of retained imports)	7.6	9.7	8.6	-
PRICES (% change)				
CPI (2005=100)[4]	5.4	0.6	1.7	2.5 ~ 3.5
PPI (2005=100)[5]	10.3	-7.1	5.6	-
Real wage per employee in the manufacturing sector	-4.8	1.9	6.4	-

[1] Beginning 2007, real GDP has been rebased to 2000 prices, from 1987 prices previously
[2] Exclude stocks
[3] All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account
[4] Effective from 2011, the Consumer Price Index has been revised to the new base year 2010=100, from 2005=100 previously
[5] Effective from 2010, the Producer Price Index has been revised to the new base year 2005=100, from 2000=100 previously
[6] Based on average USD exchange rate for the period of January-February 2011
p Preliminary
f Forecast
... negligible

Note: Numbers may not necessarily add up due to rounding

Table 1.3

Malaysia - Financial and Monetary Indicators

FEDERAL GOVERNMENT FINANCE (RM billion)	2008		2009		2010*p*	
Revenue	159.8		158.6		159.7	
Operating expenditure	153.5		157.1		151.6	
Net development expenditure	41.9		49.0		51.3	
Overall balance	-35.6		-47.4		-43.3	
Overall balance (% of GDP)	-4.8		-7.0		-5.6	
Public sector net development expenditure	124.4		111.3		112.3	
Public sector overall balance (% of GDP)	-5.6		-6.8		-7.4	
EXTERNAL DEBT[1]						
Total debt (RM billion)	236.3		233.1		226.3	
Medium- and long-term debt	156.6		155.4		146.9	
Short-term debt[2]	79.7		77.8		79.4	
Debt service ratio (% of exports of goods and services)						
Total debt	2.6		6.5		7.6	
Medium- and long-term debt	2.5		6.4		7.5	
	Change in 2008		**Change in 2009**		**Change in 2010**	
MONEY AND BANKING	**RM billion**	**%**	**RM billion**	**%**	**RM billion**	**%**
Money Supply M1	14.0	8.3	17.9	9.8	23.5	11.7
M3	99.1	11.9	85.4	9.2	71.2	7.0
Banking system deposits	103.4	11.9	90.7	9.3	77.9	7.3
Banking system loans[3]	82.3	12.8	57.0	7.8	99.8	12.7
Loan-deposit ratio (end of year)[4]	77.7		77.9		81.3	
Financing-deposit ratio[4, 5]	85.8		84.6		87.7	
INTEREST RATES (AVERAGE RATES AS AT END-YEAR)	**2008**		**2009**		**2010**	
	%		%		%	
Overnight Policy Rate (OPR)	3.25		2.00		2.75	
Interbank rates						
1-month	3.30		2.00		2.73	
Commercial banks						
Fixed Deposit 3-month	3.04		2.03		2.74	
12-month	3.50		2.50		2.97	
Savings deposit	1.40		0.86		1.00	
Base lending rate (BLR)	6.48		5.51		6.27	
Treasury bill (3-month)	3.39		2.05		2.60	
Malaysian Government securities (1-year)*	2.89		2.12		2.85	
Malaysian Government securities (5-year)*	2.99		3.79		3.39	
EXCHANGE RATES	**2008**		**2009**		**2010**	
Movement of Ringgit (end-period)	%		%		%	
Change against SDR	-2.7		0.2		13.1	
Change against USD[6]	-4.5		1.2		11.1	

1 Effective from the first quarter of 2008, the external debt data of Malaysia has been redefined to treat entities in Labuan International Business and Financial Centre (Labuan IBFC) as residents
2 Excludes currency and deposits held by non-residents with resident banking institutions
3 Includes loans sold to Cagamas
4 Exclude financial institution transaction
5 Refers to the ratio of loans and holdings of PDS by the banking system to deposits of the banking system
6 Ringgit was pegged at RM3.80=USD1 on 2 September 1998 and shifted to a managed float against a basket of currencies on 21 July 2005
p Preliminary
* Refer to end-year

demand and to some extent, the low base effect. However, the growth momentum softened in the second half-year, in tandem with the moderation in global trade and a diminishing base effect.

In 2010, the Malaysian economy experienced a strong resumption in growth, recording an expansion of 7.2% following the downturn in 2009

On the supply side, all economic sectors registered strong performance in 2010, in line with the robust domestic demand and rebound in exports. The services sector in particular, benefited from the strengthening of both domestic and external demand, and remained as the largest contributor to growth. All services sub-sectors recorded higher growth in the first half-year but growth moderated in the second half following the slowdown in external demand, which affected the trade- and manufacturing-related services sub-sectors. Nevertheless, the sustained expansion in domestic consumption, continued to benefit the sub-sectors that are dependent on domestic demand. The manufacturing sector recovered firmly, with the electronics and electrical cluster and domestic-oriented industries registering double-digit growth rates. The pace of growth, however, moderated towards year-end due to slower external demand and the diminishing base effect. Similarly, the commodity sectors expanded at a stronger pace in 2010, supported by sustained high production of natural gas and food crops. The construction sector moderated due partly to the slower growth in the second half-year following the completion of projects financed by the second stimulus package.

Headline inflation averaged 1.7% in 2010 (2009: 0.6%), driven by supply factors arising from higher food and commodity prices and adjustments to administered prices. Domestic supply factors were relatively more dominant in driving inflation in 2010. During the year, there were a series of upward adjustments to the retail prices of RON95 petrol, diesel, LPG and sugar, as part of the Government's subsidy rationalisation programme announced in May. The impact of external factors on domestic prices were more modest in 2010, and confined to selected food items. This reflected the substantial increase in global prices of wheat and corn due to adverse weather conditions in key wheat and corn producing countries. Core inflation, which is an indicator of demand-driven pressures on prices rose at a more modest pace of 1.5% in 2010 (2009: 2.7%).

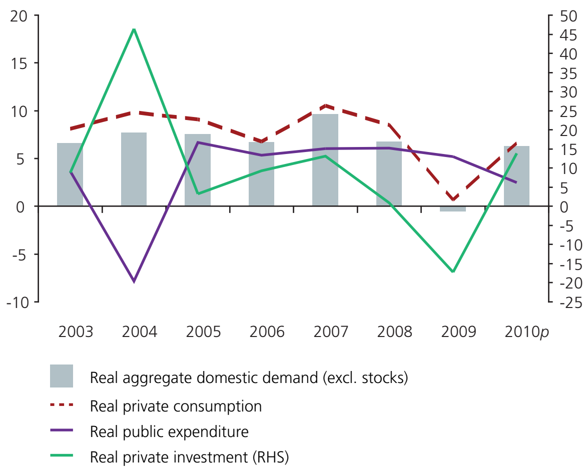
Malaysia's external position remained resilient in 2010. The current account surplus remained sizeable, but narrowed from 2009, while the financial account recorded a lower net outflow. The smaller current account surplus reflected the lower trade surplus as imports growth accelerated in response to the strong domestic demand during the year and outpaced the growth of exports. In addition, the income account deficit widened due to the higher profits accruing to foreign direct investors in Malaysia, while the services account remained in surplus, albeit by a smaller amount, supported by higher tourist arrivals. The financial account recorded a smaller net outflow in 2010, reflecting largely the higher inflow of portfolio investment and foreign direct investment following the improvement in both global and domestic economic conditions. These inflows partly offset the higher outflows of direct investment abroad as Malaysian companies continued to tap opportunities abroad. Other investment outflows, which reflected mostly trade credits and placements of deposits abroad by residents, moderated during the year. After adjusting for the errors and omissions, net international reserves declined by RM2.6 billion to RM328.6 billion, equivalent to USD106.5 billion, as at 31 December 2010.

DOMESTIC DEMAND CONDITIONS

Domestic demand recorded a strong growth of 6.3% in 2010 (2009: -0.5%). Despite the moderation in the global economy in the second half-year, domestic demand conditions remained robust throughout the year, driven by private sector activity. Private consumption increased at a faster pace, while private investment rebounded strongly to record a double-digit growth. The public sector continued to play a crucial role in supporting the domestic economy during the year through the implementation of programmes to further

Chart 1.4

Real Domestic Demand Aggregates



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

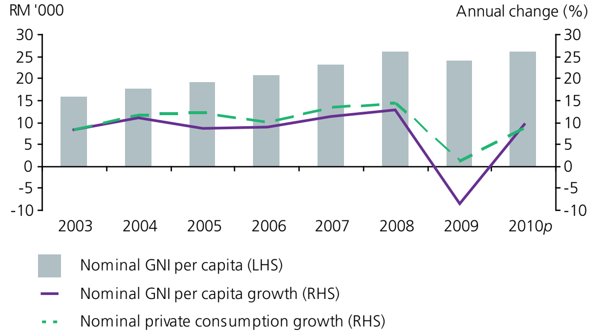
enhance infrastructure and the public sector delivery system.

Robust domestic demand, driven by strong expansion in private sector activity amid an improvement in external demand

Private consumption expanded firmly by 6.6% (2009: 0.7%). This was reflected in the strong performance of major consumption indicators, such as passenger car sales, retail sales and imports of consumption goods. Improved consumer confidence, as reflected in the higher MIER Consumer Sentiments Index during the year, had led to a significant increase in discretionary spending on items such as food away from home, communications and recreation. Consumer spending activity was supported by better labour market conditions and the steady increase in incomes. The more favourable labour market conditions were reflected in higher job vacancies, lower retrenchments and low unemployment. The average private sector salary increased by 4.5% in 2010 (2009: 4.3%), while stronger prices of crude palm oil and rubber supported higher expenditure by households in the rural areas. The average monthly gross income of FELDA households in

Chart 1.5

GNI per Capita



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

the palm oil scheme rose to RM3,236 per month (2009: RM2,457), while the rubber smallholders earned, on average, RM3,071 per month in 2010 (2009: RM1,812). Other developments such as the salary increments for bank employees and selected groups of civil servants, as well as the one-time special cash payment to civil servants, further provided additional impetus for consumption spending.

Consumer spending was also supported by continued access to credit as the monetary environment remained accommodative during the year. Household credit expanded further, with loans disbursed to households increasing by 11.1% in 2010. Nevertheless, the household debt remained stable at 75.9% of GDP as at end-2010 (2009: 76%). The household balance sheet remained sound, with a low household debt of 41.9% of total financial asset (2009: 42.1%), high individual deposits of RM407.8 billion and non-performing loans ratio for household loans declining to 2.3% as at end-2010 (2009: 3.1%).

Private investment rebounded strongly to register a double-digit growth of 13.8% in 2010 (2009: -17.2%). Capital spending expanded across all sectors, particularly in the manufacturing, mining and services sectors, following favourable domestic economic conditions and improvement in external demand. In addition, businesses also resumed investment activity that had been deferred due to the uncertainties arising from the global economic crisis.

The strong performance of investment activity was reflected in the improvement of major investment indicators. Imports of capital goods

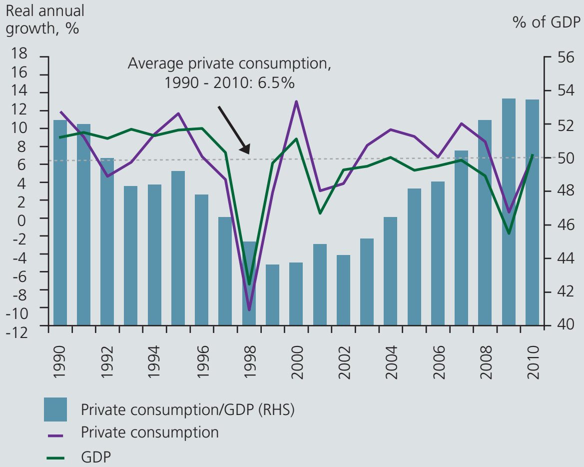
The Growth and Evolution of Consumer Spending in Malaysia

Introduction

Private consumption is increasingly becoming an important component of the Malaysian economy. It was the main driver of economic growth in this recent decade, increasing at an annual average of 7.4% during the period of 2000-2009[1], which exceeded the 4.8% average growth of real gross domestic product (GDP), and contributed more than two thirds of total GDP growth. As a result, the share of real private consumption in GDP increased steadily from 43.8% in 2000 to 53.5% in 2009.

Chart 1

Private Consumption and GDP



Source: Department of Statistics, Malaysia

In tandem with the robust growth of private consumption, there were clear shifts in the composition of private consumption over the last decade. This article analyses and explains the changing patterns of private consumption by main expenditure groups between 2000 and 2009, and concludes with insights on private consumption trends moving forward.

Changing Patterns of Consumption Expenditure

Based on the data of household consumption by purpose[2] during the period of 2000-2009, expenditure on food and non-alcoholic beverages formed the largest component, accounting for about 23% of total household expenditure. This was followed by expenditures on housing and utilities; transport; restaurants and hotels; and miscellaneous goods and services. These five largest components of consumption expenditure accounted for 75.6% of total household spending.

Table 1

Household Consumption by Purpose

	2000	2009	2000-09
	% of total household consumption		
Food and non-alcoholic beverages	24.1	21.8	23.0
Alcoholic, beverages and tobacco	2.2	2.3	2.1
Clothing and footwear	3.5	2.4	2.7
Housing, water, electricity, gas and fuels	21.7	16.7	18.9
Furnishings, household equipment and maintenance	5.9	5.2	5.4
Health	2.1	2.1	2.0
Transport	12.6	13.1	13.4
Communication	4.9	7.4	6.3
Recreation and culture	4.3	4.9	4.5
Education	1.5	1.6	1.5
Restaurants and hotels	5.8	9.7	7.5
Miscellaneous goods and services	11.6	12.7	12.8

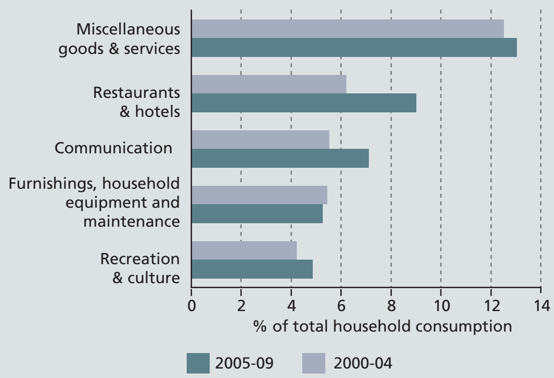
Source: Department of Statistics, Malaysia

1 Detailed information on private consumption for 2010 is not available at the time of publication of this article.
2 Follows the domestic concept of consumption expenditure where it measures purchases of goods and services by all households in Malaysia. The analysis on consumption patterns in this article refers to nominal household spending.

Two clear shifts in consumer spending patterns have emerged since 2000. First, the share of expenditure on discretionary[3] items has increased relative to spending on basic necessities[4]. Expenditure on discretionary items (such as restaurants and hotels, communication as well as recreation and culture) was particularly strong, followed by the expenditure on miscellaneous goods and services such as personal care, financial, insurance and other services. The share of these four components of income-sensitive spending rose from 26.5% of total household expenditure in 2000 to 34.7% in 2009 (Chart 2).

Chart 2

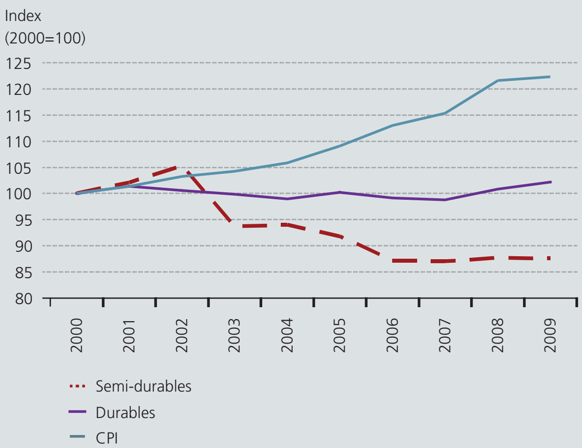
Household Consumption of Discretionary Items



Source: Department of Statistics, Malaysia

Chart 3

Prices of Consumption Expenditure



Source: Department of Statistics, Malaysia

In contrast, the proportion of household expenditure on basic necessities has declined gradually since 2002, attributable mostly to the decline in the shares of expenditure on food and non-alcoholic beverages, and housing and utilities. Spending on food items as a share of total household expenditure decreased from 24.1% in 2000 to 21.8% in 2009. Similarly, the average household spending on housing and utilities fell from 21.7% in 2000 to 16.7% in 2009.

Second, consumption of services has outpaced expenditure on goods[5]. Between 2000 and 2009, household consumption of services grew by about 10% annually, compared to the 8.4% growth of consumption of goods. Accordingly, the share of expenditure on services increased from 46.2% of total household spending in 2000 to almost 50% in 2009. Expenditure on services includes spending for services rendered by restaurants and hotels, financial and insurance intermediaries, education, healthcare and other intermediaries. As the ratio of spending on services rose, the share of household spending on goods declined gradually, accounted for mainly by the declines in expenditure on durable and semi-durable goods. Together, the share of expenditure on durable and semi-durable goods decreased[6] from 15.1% of total expenditure in 2000 to 12.5% in 2009, reflecting mainly the lower price levels of both durable and semi-durable goods in comparison with the overall consumer prices (Chart 3). For example, during the period of 2000-2009, price of clothing and footwear category declined by 1.6% annually. As a result, the share of expenditure on clothing and footwear decreased from 3.5% of total household spending in 2000 to 2.4% in 2009. Consumer spending on non-durables, which constituted 38.7% of total household spending in 2000, remained stable at 38% in 2009.

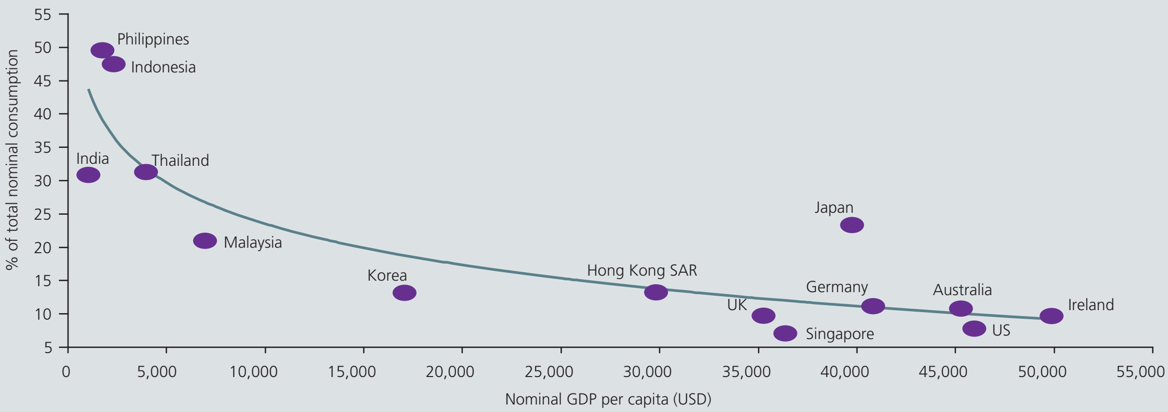
[3] Spending on non-essential goods and services, which typically can be postponed and often consists of luxury items.
[4] Comprises of essential categories, such as food consumption at home, clothing, rent and utilities.
[5] Consist of items which are tangible and can be divided into sub-groups such as durable, semi-durable and non-durable goods. Durable and semi-durable goods can be used repeatedly and have an expected lifetime of more than one year. Durable goods usually have longer lifespan and cost substantially more than semi-durable goods. Durable goods include furniture, household appliances and consumer electronics.
[6] The declining trend in the ratio is largely a nominal development. In real terms, the share of expenditure on durable and semi-durable goods has risen gradually since 2000, indicating an increase in the volume purchased under both categories.

These two changing patterns of household spending over this recent decade reflected several factors that influence consumers' preferences and decision-making. The main factor is the growing affluence of Malaysians, supported by the steady rise in disposable income and accumulation of wealth. Between 2004 and 2009, nominal per capita GDP increased by 6.8% annually, with mean monthly gross household income rising by 4.4% annually from RM3,249 in 2004 to RM4,025 in 2009. Similarly, household financial assets[7] grew at an annual rate of 14% during 2004-2009 to account for 180% of GDP in 2009 (2004: 167% of GDP).

These trends are consistent with consumer spending trends observed in other countries, which indicate that as income rises, the share of expenditure on basic necessities tends to decline while that on services tends to increase. Given the lower level of income in developing economies, the proportion of household expenditure on food is usually higher in developing economies and lower in high income economies (Chart 4). In contrast, advanced economies typically have a higher share of expenditure on services relative to developing economies (Chart 5).

Chart 4

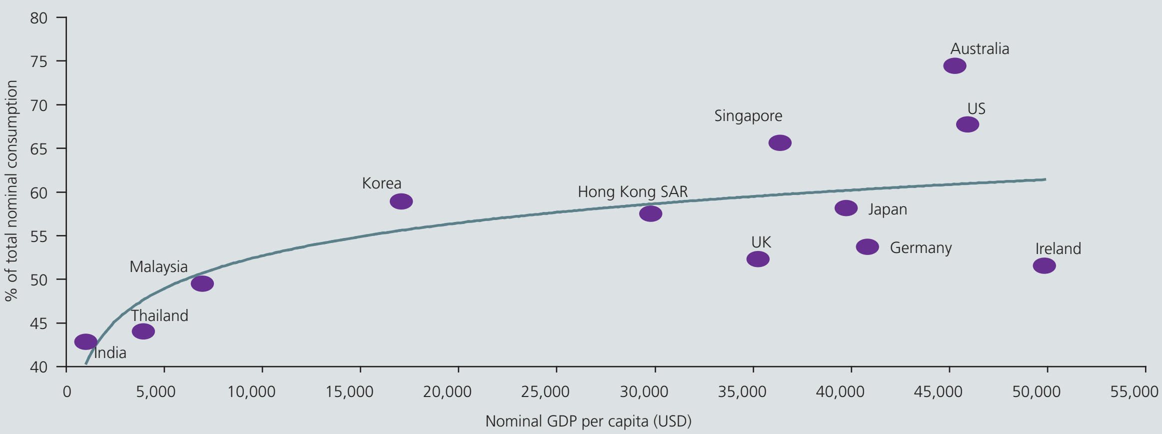
Consumer Spending on Food Items



Source: IMF, Eurostat and National Statistical Offices

Chart 5

Consumer Spending on Services



Source: IMF, Eurostat and National Statistical Offices

7 Consists of deposits held in the banking system, total assets of life insurance funds, household direct holdings of equity, Employees Provident Fund contributions and net asset value of unit trust funds for the period of 2003-2009.

Three other factors also contributed to the last decade's growth and evolution of consumer spending towards increased consumption of non-essentials. The demographic characteristics of Malaysians, given the relatively young and large working-age population[8] provide support for income growth. Younger people, who generally have a higher marginal propensity to consume, tend to spend more on non-essential goods and services. This is further supported by the increasing urbanisation[9] of the population. With higher income levels compared to rural households, households in the urban areas would normally have a higher proportion of spending[10] on discretionary items. This is especially true for services such as financial, recreation and entertainment, where the demand and the supply tend to be higher in urban areas.

Increased financial deepening and inclusion also influenced changes in consumer spending patterns. The financial sector plays an integral role in supporting private consumption by facilitating greater access to credit for households. In particular, greater access to credit allows individuals to fund discretionary expenditure, particularly that on durable goods, the purchase of which is generally financed more through borrowing as compared to other types of consumption. During the period 2000-2009, household debt grew at an annual rate of 13.5%. Household debt-to-GDP ratio increased from 46% in 2000 to 76% in 2009. Credit disbursed for consumption, which consists of loans for personal uses, credit card spending and the purchase of consumer durable goods, expanded by 20.5% annually between 2000 and 2009. Similarly, total loans disbursed to households for purchases of residential property and passenger car increased by 13.4% annually. The strong performance of these loans is indirectly translated into higher consumer spending as purchases of residential properties and passenger car are closely linked to spending on housing and transport-related items, which include furnishings and the maintenance of transport equipment. Although the ratio of household debt to GDP is relatively high, overall household balance sheet remained sound and debt repayment capacity continued to be intact. Household financial assets were more than two times of total household debt and the non-performing loans ratio of the household sector continued to trend downwards.

In addition, technological developments have affected trends in consumer spending, as evident from the increasing share of expenditure on communication and recreation. Technological innovations have encouraged consumer spending in technology-related goods and services, such as internet services, mobile communication equipment and data services, cable television services and audio visual equipment. Furthermore, the strong demand for technology-related goods and services was supported by the country's relatively young and educated population that expedited the adoption of newly available technological innovations.

Conclusion

The sustainability of private consumption growth is an important aspect of the transformation of the Malaysian economy moving forward. As the sources of growth shift towards domestic demand, private consumption will continue to play a significant role in contributing to economic growth. The pre-requisites to support sustainable growth in private consumption are already in place, namely rising income and wealth, favourable demographic, greater financial deepening and technological developments.

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8 68% of the total population fall in the 15 – 64 age group.
9 The urban population increased from 62% of total population in 2000 to 63.3% in 2009.
10 Based on the Household Expenditure Survey 2004/05, households living in urban areas spent 1.8 times more than households in rural areas.

Growth and Changing Trends of Private Investment in Malaysia

Introduction

Investment has an important role in the growth and development of the Malaysian economy. It ensures continuous enhancement and expansion of the country's productive capacity for the future development of the economy. While the public sector has an important overall supportive role, private sector capital spending is key to replenish and raise the capital stock to drive the performance of the various sectors in the economy. This article describes the growth and changing trends of private investment expenditure in Malaysia over the recent decade, and concludes with a brief outlook on the medium-term trends of private sector capital spending.

Developments over the Recent Decade

Private investment rebounded to register strong growth in 2010. The resumption of private capital spending is evident across all sectors, particularly in the manufacturing, mining and services sectors. Given the positive medium-term economic outlook and new government initiatives to promote investment, growth in private investment is expected to continue with contributions from both foreign and domestic investors. Of importance, strong investment activity will increasingly be driven by capital spending in new growth areas, such as renewable energy and financial services. This development not only contributes to economic growth in the short term, but more importantly, lays the foundation for future growth of the Malaysian economy.

Over the recent decade, private investment has recorded an average growth rate of 6.7% per annum in 2000-2010, with its performance closely tracking the overall performance of the economy (Chart 1). After the 1997/98 Asian Financial Crisis, investment activity began to recover in 2000 amid improving business confidence. Progress, however, was interrupted by the 2001 bursting of the Tech Bubble, and the negative impact on capital spending lasted for two years. Private investment subsequently recovered and peaked at a growth rate of 46.5% in 2004. However, towards the end of the decade, the global financial crisis led to a recession in the domestic economy in 2009. Private investment had weakened considerably during this period.

Chart 1

Private Investment and GDP (2000=100)

e Estimate

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

In terms of share, throughout the recent decade, private investment averaged 11% of real GDP, compared with the average share of 22.9% during 1990-1999. A key explanatory factor for the lower level of private investment is the emergence of less capital-intensive new growth areas in the services sector. Also, in the 1990s, especially in the period leading to the Asian Financial Crisis, there were periods of very high investment, predominantly in infrastructure. This trend is not sustainable in the long run.

Over the recent decade, Malaysia attracted net FDI inflow averaging 3% of GDP per annum, which is more moderate compared with the 1990s (average of 6.4% of GDP), due mainly to the changing nature of investment. A growing share of these investments have been channelled into less capital-intensive, higher value-added activity. Furthermore, higher competition for FDI from emerging economies, particularly low labour cost countries such as PR China and Vietnam have also contributed to the lower net inflows. Nonetheless, the average share of foreign investment to total private investment has remained stable (Table 1).

Table 1

Average Net FDI Inflow

	1990-1999	2000-2010
	% share	
Net FDI to GDP ratio	6.4	3.0
Net FDI to total private investment ratio	27.0	28.5

Source: Department of Statistics, Malaysia

Foreign investment has contributed significantly to the growth and transformation of the Malaysian economy. The large presence of multinational corporations (MNCs) has provided direct benefits in the form of employment creation and capital formation. It also provided opportunities for local firms to perform the role of vendors by supplying parts and services to the large MNCs, which has benefited the small and medium enterprises (SMEs). More importantly, FDI can also lead to the transfer of knowledge, technology and skills in developing local firms and human capital. Particularly, in the manufacturing sector, Malaysia has steadily climbed up the value chain with improved productivity levels. The real value-added per worker in the manufacturing sector has increased from RM49,013 in 2000 to RM78,707 in 2010 (equivalent to USD12,898 in 2000 to USD24,435 in 2010).

In terms of sectoral distribution, net FDI inflows during 2000-2010 were channelled mainly into the manufacturing, services, and oil and gas sectors. While the manufacturing sector remains the major recipient of the net inflows, the services sector has been a significant beneficiary of foreign investment. This is particularly evident in the financial services and wholesale and retail trade sub-sectors, following liberalisation efforts undertaken by the Government. In the oil and gas sector, capital spending for exploration, production and development activity remained high, driven mainly by PETRONAS and its foreign partners.

Despite the significance of foreign investors, domestic investment still constitute the larger share of total private capital spending, particularly in the services, agriculture and construction sectors. This is largely due to the capacity expansion activity of large domestic- and export-oriented enterprises to fulfil the growing demand for their products and services. Some of these companies have grown large enough and have developed the necessary expertise to expand into other regional economies to take advantage of more competitive supplies of land and labour, as well as to gain access into bigger markets. Moreover, capacity expansion by the SMEs that supply parts, components and related services have also contributed towards total investment, given the constant need to upgrade the equipment, technology and labour skills, to meet the higher quality standards and more advanced requirements by the larger corporations.

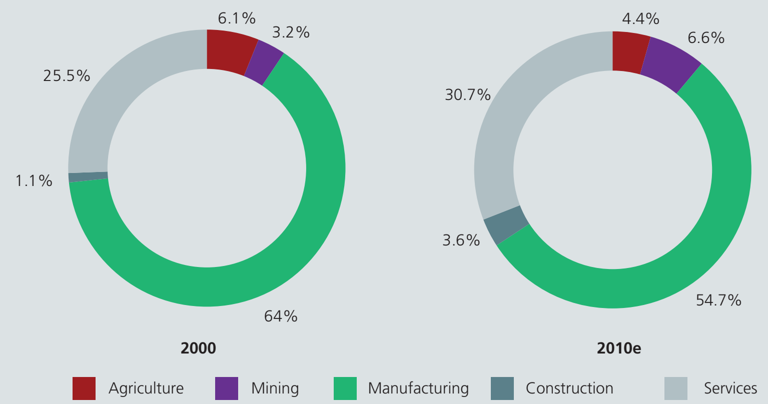
Changing Trends of Private Investment

Two distinct changes can be observed from the investment trends in the recent decade. First, there is increasing diversity in the investment spending across the various economic sectors. Second, more capital expenditure has been channelled into higher value-added, technologically-intensive projects across the different sectors of the economy.

The sectoral distribution of investment has become more diversified. In particular, the share of manufacturing sector investment has generally declined from 64% of total private investment in 2000 to 54.7% in 2010 (Chart 2). On the other hand, the share of services sector investment has increased from 25.5% of private investment in 2000 to 30.7% in 2010. This is also in tandem with the trends in FDI flows, as more foreign investment has been channelled into the services sector. These include the financial services, shared services and outsourcing (SSO), communication and wholesale and retail trade sub-sectors. Government policies promoting the growth and development of key services sub-sectors, especially through liberalisation and pro-competition policies, have contributed significantly towards higher capital spending in the services sector.

Chart 2

Private Investment by Sector



e Estimate

Source: Bank Negara Malaysia

In addition, the shares of investment in the mining and construction sectors have also increased. Investment in the mining sector was driven mainly by the exploration and production of oil and natural gas resources, as high and rising crude oil prices increased the viability of capital-intensive activity including the exploration and development of deepwater oilfields. Also, the share of investment in the construction sector has risen, but at levels well below those observed in the 1990s, when large infrastructure projects were under way. In the early 2000s, investment in the construction sector was lower, as selected construction and infrastructure projects were postponed and cancelled during and immediately after the 1997/98 Asian Financial Crisis. However, the subsequent revival of some of these projects, and the construction of new privatised roads and highways from the mid-2000s to enhance domestic transportation network connectivity had led to the rising share of capital spending in the construction sector.

Although the share of investment in the manufacturing sector is lower, it remains the largest contributor to overall investment. Capital spending in the sector continues to be underpinned by the large presence of foreign MNCs, particularly in the electrical and electronics (E&E) industries. The Government, as indicated in the medium- and long-term plans formulated for Malaysian economic development covering the recent decade[1], had underlined strategies to further deepen and widen the country's industrial base. This was to be achieved through attracting and promoting investment in new growth areas and targeted industrial clusters. Under this strategy, although the E&E sub-sector remains significant, shares of other sub-sectors have also risen. The average share of approved investment in the

[1] Second and Third Industrial Master Plans (1996-2020), as well as the Eighth and Ninth Malaysia Plans (2000-2010).

Table 2

Approved Manufacturing Investment by Selected Industries

	2000-2004	2005-2010
	% share of total	
Export-oriented industries	**69.3**	**60.9**
Primary-related cluster	36.9	32.2
Chemicals & chemical products	5.5	11.3
Petroleum products	12.9	11.8
Paper products	8.6	2.2
Textiles	2.0	1.4
Others (e.g. rubber products)	7.9	5.7
E&E cluster	32.3	28.7
Domestic-oriented industries	**30.7**	**39.1**
Consumer-related cluster	13.9	12.4
Transport equipment	7.8	4.4
Food	4.2	4.6
Others (e.g. medical supplies)	1.5	3.1
Construction-related cluster	16.8	26.7
Iron and steel	8.7	16.1
Non-metallic mineral products	4.0	6.0
Fabricated metal	4.2	4.5

Source: Malaysian Industrial Development Authority (MIDA) and Ministry of International Trade & Industry

E&E industries has dropped to 28.7% of the total amount, from 32.3% during 2000-2004 (Table 2). Other industries in the manufacturing sector that have attracted more capital spending towards the end of the decade were chemicals and chemical products, scientific and medical instruments, as well as domestic-oriented industries such as the construction-related cluster.

This development reflects the second key trend in private investment, namely rising investment into higher value-added and high technology activity. Capital-intensive projects in the manufacturing sector have expanded, as indicated by higher capital investment per employee (CIPE) of RM484,767 in 2010 compared with RM381,450 in 2000 among the approved manufacturing projects, an improvement of 27.1%. At the same time, labour-intensity has declined, as shown by lower average employment per project approved in the manufacturing sector during the past decade (95 persons per project in 2000-2010) compared with 1990-1999 (132 persons per project).

Following the Government's efforts to promote the development of selected new growth areas, capital spending in selected industries has increased, especially in the second half of the decade. The industries include the renewable energy, high-end electronic products, machinery and equipment as well as the medical devices industries.

In particular, the renewable energy industry, most notably in the solar industry cluster, has attracted major investment from several international firms. This contributed to higher capital spending in the sub-sectors involved in the production chain of photovoltaic solar cells, namely the E&E, chemicals and chemical products as well as non-metallic mineral products sub-sectors. When fully operational, Malaysia is set to become among the largest solar cell producers in the world, together with PR China, Japan, Chinese Taipei, and Germany. Moreover, the manufacture of higher value-added, specialised machinery and equipment, as well as medical instruments and devices has also attracted growing investment in Malaysia following rapid growth in demand and technological advancements.

Beyond the manufacturing sector, the Government has also aggressively promoted the development of the services sector, by offering attractive incentive packages and liberal policies on equity participation and employment requirement to encourage investment. Although less capital-intensive, these industries have higher value-added and hence provide high-skilled employment opportunities in comparison with the traditional manufacturing sector.

The SSO industry has attracted investment from global MNCs and large firms to establish international and regional offices in Malaysia. In the latest 2011 AT Kearney's Global Services Location Index (GSLI) report, Malaysia is ranked as one of the top three locations for outsourcing businesses in the world. The report also pointed out that the top three economies (India, PR China and Malaysia) have maintained their positions as the most attractive locations since the GSLI was introduced in 2003, due mainly to deep talent pools and cost advantages. In this regard, Malaysia has to keep developing and improving these factors, as well as other relevant infrastructure, in order to remain competitive and attractive among the international investor community.

In addition to the SSO industry, investment in the financial services industry has also expanded significantly in the last few years, partly due to the rapid development of Islamic finance. Further support to investment was provided through policies to further strengthen and liberalise the domestic financial sector, including the issuances of new licenses to financial institutions and service providers.

The Way Forward

The positive developments in private investment in the recent decade is expected to continue into the next decade. Improvements in the world economy will also lead to the resumption of higher FDI flows globally. Although competition for FDI flows will likely intensify further, particularly from the emerging regional economies, foreign investment to Malaysia is likely to remain given Malaysia's attractiveness and competitiveness. As outlined in the Economic Transformation Programme (ETP), more aggressive efforts to attract investment are being proposed and implemented. This includes revamping and expanding the role of the Malaysian Industrial Development Authority (MIDA) to include targeted outreach activity, which complements the broader marketing campaigns for identified key economic areas. Overall, foreign investment is still expected to account for about 30% of total private investment in the coming decade.

In addition, capital spending will likely continue to be channelled into diverse sectors of the economy. In particular, investment in the services sector are expected to be higher, indicating its growing importance as reflected by services sub-sectors being identified in seven out of the 12 National Key Economic Areas (NKEAs) in the ETP. These include higher value-added activity in the financial services, business services, wholesale and retail trade, education, healthcare, tourism-related industries and communication services. In the manufacturing sector, selected sub-sectors producing high technology equipment such as renewable energy, light emitting diodes (LEDs), as well as precision equipments and medical devices are also expected to attract higher investment. Furthermore, investment in the oil and gas sector is expected to increase, driven by continued exploration and extraction activity.

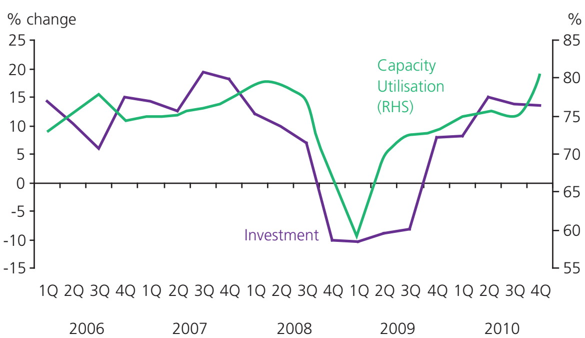
Going forward, given the appropriate combination of pro-growth policies, attractive incentive packages and liberalisation measures, as well as a vibrant external environment, private investment is expected to become an important catalyst for the growth and transformation of Malaysia towards a high-income, high value-added economy.

recorded a strong growth of 16.2% in 2010, while sales of construction-related materials increased by 11%. Moreover, accommodative financing conditions, as indicated by the higher loans disbursed to businesses (2010: 9.8%, 2009: -3.4%) and private debt securities issued for new activities (2010: 54.7%, 2009: -73.8%), provided further support for private investment activity. Gross FDI inflows rose to RM89.2 billion (2009: RM70.8 billion), reflecting the more favourable investment climate following improvements in the global economic environment as well as several key initiatives announced by the Government. Of significance, the MIER Business Conditions Index (BCI) remained above the 100-point confidence threshold for the most of 2010.

Investment in the manufacturing sector rose strongly in 2010 as demand for manufactured exports recovered. Higher production activity to meet the recovery in demand resulted in a higher capacity utilisation rate of 80% as at end-2010 (end-2009: 73%), leading to an increased need for firms to undertake capacity expansion activities. Capital spending in other sectors also grew in 2010. In the mining sector, capital spending was higher, mainly for oil and gas investment in upstream production facilities and exploration activity. Investment activity in the services sector also increased significantly, reflecting mainly the ongoing capacity expansion and upgrading of the broadband infrastructure in the communication industry, as well as the establishment of new retail outlets in the wholesale and retail trade sub-sector.

Chart 1.6

Total Nominal Investment and Manufacturing Sector Capacity Utilisation



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Public investment increased by 5.5% in 2010 (2009: 8%), supported partly by the continuation of the second stimulus package amounting to RM5 billion in the first half of the year. Development expenditure was channelled mainly towards improving rural infrastructure and urban public transport as well as enhancing the provision of public education and healthcare services.

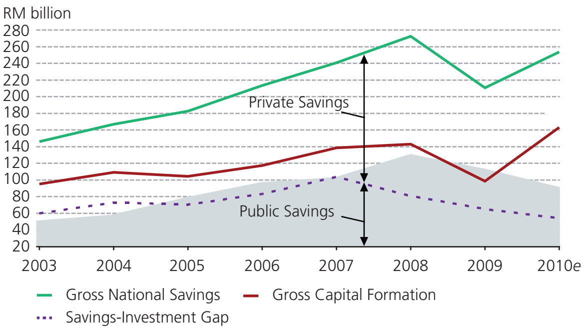
Investment by the non-financial public enterprises provided significant support to public investment in 2010, mainly in the mining, transportation, utilities and communication sectors. Capital spending in the mining sector reflected the ongoing upstream oil and gas exploration activity, while focus in the transportation sector was on upgrading and expanding the rail and air transport facilities. Additionally, investment in the utilities sector was channelled towards new power generation projects and the enhancement of the transmission and distribution network. Capital spending in the communication sector was also evident from the further development of the broadband infrastructure.

Public consumption moderated to 0.1% in 2010 (2009: 3.1%), attributable largely to lower spending on supplies and services. This is in line with the Government's initiative to reprioritise spending programmes and reduce non-essential expenditures. Nevertheless, expenditure on emoluments was higher following the improved salary scheme for selected segments of the civil service.

Private sector savings increased to RM199.4 billion (equivalent to 26.9% of GNI) in 2010 (2009: 21.9%), reflecting sound household and corporate sector balance sheets. Banking sector deposits held by households and businesses rose to RM821.8 billion in 2010 (2009: RM772.9 billion). In contrast, public sector savings declined to RM54.2 billion (equivalent to 7.3% of GNI, 2009: 9.8%), attributable mainly to the lower operating surpluses of the NFPEs during the year. Overall, **gross national savings (GNS)** increased markedly by 20.4% to RM253.6 billion (equivalent to 34.2% of GNI). However, the increase in GNS was offset by stronger investment spending by the private sector, resulting in a lower savings-investment surplus of RM90.5 billion (equivalent to 12.2% of GNI, 2009: RM112.1 billion or 16.9% of GNI).

Chart 1.7

Gross National Savings and Savings-Investment Gap



e Estimate

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

SECTORAL REVIEW

All economic sectors registered strong performance in 2010, in line with robust domestic demand and the rebound in exports. In particular, the manufacturing sector recovered firmly, with the electronics and electrical products cluster and domestic-oriented industries registering double-digit growth rates. Meanwhile, the services sector benefited from the strengthening of domestic demand over the year. Growth in all sectors, however, moderated in the second half of the year, reflecting the moderation in external demand and the diminishing statistical base effect. Nevertheless, overall growth was sustained by continued robust activity in the domestic-oriented sectors.

Robust growth in all services sub-sectors

The **services sector** registered a higher growth of 6.8% in 2010 (2009: 2.6%), with robust growth across all sub-sectors, amid the strengthening of both domestic and external demand. The services sector was the largest contributor to growth, contributing 3.9 percentage points to overall GDP growth. The sector expanded by 7.9% in the first half of the year, driven by higher growth in all sub-sectors, particularly the finance and insurance; wholesale and retail trade; communication; and transport and storage sub-sectors. In the second half, growth moderated to 5.8%, in response to the slowdown in external demand which affected the trade- and

Table 1.4

Services Sector Performance at Constant 2000 prices

	2009	2010*p*	2009	2010*p*
	Annual change (%)		Share to GDP (%)	
Services	**2.6**	**6.8**	**57.6**	**57.4**
Intermediate services	3.4	7.0	25.1	25.1
Finance and insurance	5.1	6.1	11.7	11.6
Real estate and business services	2.4	7.8	5.4	5.5
Transport and storage	-2.8	6.9	3.8	3.8
Communication	6.0	8.5	4.1	4.2
Final services	2.0	6.6	32.5	32.3
Wholesale and retail trade	1.2	7.9	13.3	13.4
Accommodation and restaurant	2.8	5.0	2.5	2.4
Utilities	0.4	8.2	3.0	3.0
Government services	2.0	6.5	7.6	7.6
Other services	4.4	4.0	6.1	5.9

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

manufacturing-related services sub-sectors. The expansion in domestic consumption activity, nevertheless, continued to benefit the services sub-sectors that are dependent on domestic demand, particularly the wholesale and retail trade; and communication sub-sectors.

The **finance and insurance** sub-sector grew by 6.1% (2009: 5.1%) as a result of increased net interest and fee-based incomes in the finance segment, which benefited from higher loan growth and the vibrant capital market during the year. In addition, the rise in premium income in the insurance segment lent further support to growth. The **wholesale and retail trade** sub-sector registered a stronger growth of 7.9% (2009: 1.2%), supported by higher household consumption spending, including for durable goods such as motor vehicles. The **transport and storage** sub-sector turned around to register a growth of 6.9% (2009: -2.8%), following improvements in trade activity and robust growth in passenger travel. However, growth in the sub-sector tapered off in the second half, as international trade slowed.

The robust performance of the **communication** sub-sector in 2010 is of notable significance.

Table 1.5

Selected Indicators for the Services Sector

	2009	2010*p*
	Annual change (%)	
Utilities		
Electricity production index	0.8	8.8
Wholesale & Retail Trade and Accommodation & Restaurant		
Consumption credit disbursed	13.2	12.6
Tourist arrivals	7.2	3.9
Total sales of motor vehicles	-2.1	12.8
Finance & Insurance and Real Estate & Business Services		
Loans outstanding in the banking system	7.8	12.7
Insurance premiums	9.1	10.6
Bursa Malaysia turnover (volume)	60.6	2.1
Transport & Storage and Communication		
Total container handled at Port Klang and PTP (TEUs)	-1.8	15.6
Airport passenger traffic	6.9	12.2
Air cargo handled	-13.7	14.2
SMS traffic	22.1	8.3
	%	
Penetration rate:		
- Broadband[1]	31.7	55.6
- Cellular phone[2]	106.2	117.6
- Fixed line[1]	44.0	42.5

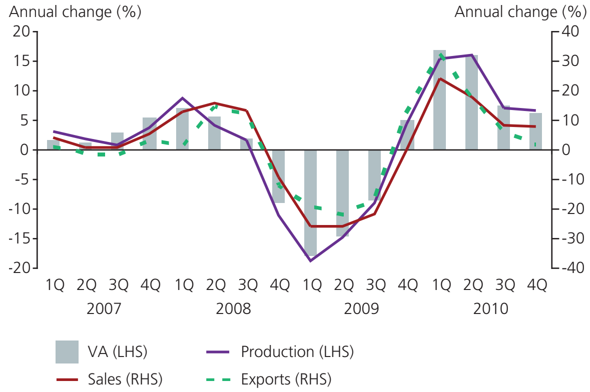
[1] of household
[2] of population
p Preliminary

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

The sub-sector grew by 8.5% (2009: 6%), registering consistently high growth in every quarter. Growth was spurred by the increased affordability of both mobile devices and data subscription packages. Furthermore, increased consumer preference for data services as well as the various initiatives to boost broadband connectivity, particularly in the rural areas and among low-income households, led to higher demand for broadband services. The broadband penetration rate stood at 55.6% of households as at end-2010 (end-2009: 31.7%), surpassing the Government's target of 50%.

Chart 1.8

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



Source: Department of Statistics, Malaysia

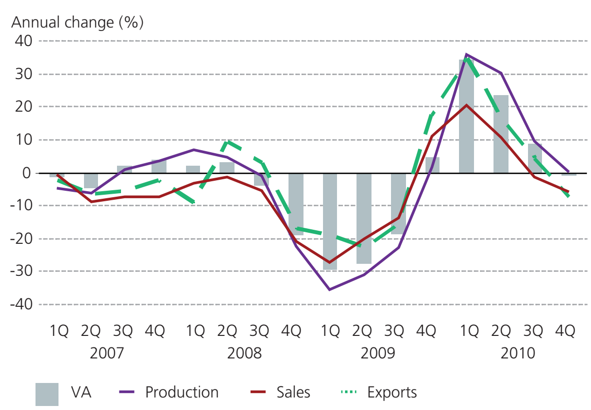
The **manufacturing sector** rebounded strongly in 2010, driven largely by the strong growth in the first half of the year with expansion in both the export- and domestic-oriented industries. The pace of growth, however, moderated towards year-end due to slower external demand and the diminishing base effect.

Strong recovery in the manufacturing sector

Growth in the export-oriented industry turned positive in 2010, driven by the strong rebound in the

Chart 1.9

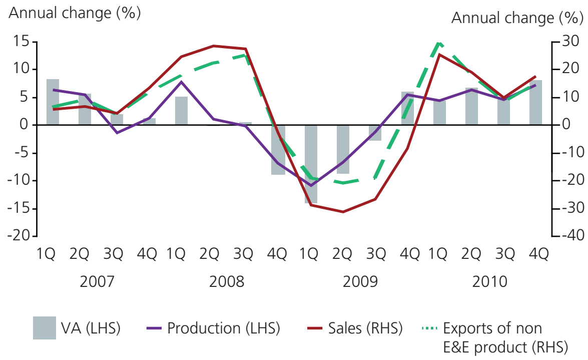
E&E Cluster: Value-added, Production, Sales and Exports



Source: Department of Statistics, Malaysia

Chart 1.10

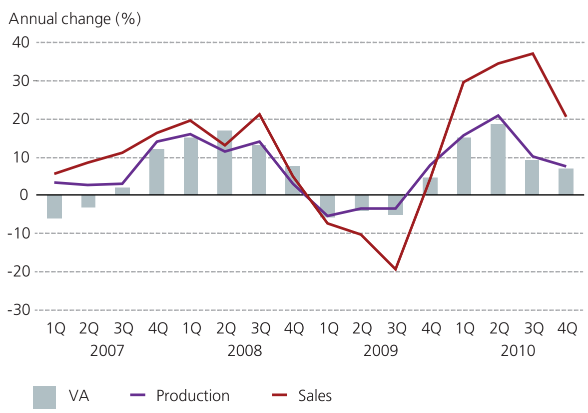
Primary-related Cluster: Value-added, Production, Sales and Exports



Source: Department of Statistics, Malaysia

Chart 1.11

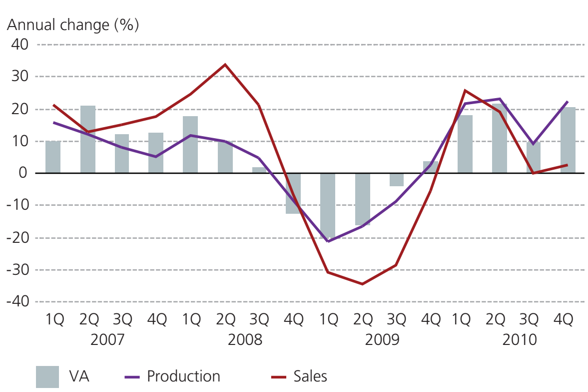
Consumer-related Cluster: Value-added, Production and Sales



Source: Department of Statistics, Malaysia

Chart 1.12

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



Source: Department of Statistics, Malaysia

electronics and electrical products (E&E) cluster. The E&E output growth was underpinned by the revival of global corporate IT investments and higher consumer spending on electronics, resulting in higher demand for semiconductors and audio-visual products, particularly in the first half of 2010. In the **primary-related cluster**, growth was in line with the recovery in the external environment, particularly from robust regional demand. Expansion in the cluster was driven primarily by the chemicals and rubber products industries.

The domestic-oriented industry grew by 15.6% (2009: -5.7%), supported mainly by strong domestic consumption activity. Output in the **consumer-related cluster** was driven by robust

Table 1.6

Performance of the Manufacturing Sector

	2009	2010
	Annual change (%)	
Value-added (RM million at 2000 prices)	**-9.4**	**11.4**
Overall Manufacturing Production[1]	**-10.0**	**11.1**
Export-oriented industries	**-11.1**	**9.7**
Electronics & electrical products cluster	**-22.8**	**17.4**
of which:		
Electronics	-24.6	3.2
Electrical products	-18.8	47.4
Primary-related cluster	**-3.5**	**5.7**
of which:		
Chemicals and chemical products	-1.7	11.5
Petroleum products	-0.8	-2.4
Rubber products	-3.0	20.8
Off-estate processing	-2.1	-2.3
Domestic-oriented industries	**-5.7**	**15.6**
Consumer-related cluster	**-1.2**	**13.4**
of which:		
Transport equipment	-12.4	29.7
Food, beverage & tobacco products	1.5	8.8
Construction-related cluster	**-11.4**	**18.9**
of which:		
Construction-related products	-18.1	21.9
Fabricated metal products	-1.1	15.0
Exports	**-12.3**	**13.0**

[1] Production data are based on the new Industrial Production Index (2005=100)
Source: Department of Statistics, Malaysia

growth in the transport equipment industry given the strong demand for vehicles throughout the year and the sustained performance in the food, beverage and tobacco industry. The **construction-related cluster** benefited from continued construction activity in the economy and implementation of the Government's stimulus measures. The major beneficiaries were the iron and steel and non-metallic mineral products industries. Nevertheless, growth in the second half moderated as the stimulus measures tapered off.

The agriculture, forestry and fishing **(agriculture) sector** expanded at a stronger pace of 1.7% in 2010, supported by sustained growth in the production of food crops such as livestock, fish and fruits. The industrial crops production registered a slower decline due to the rebound in **natural rubber** production, which increased by 9.6% to 939,241 tonnes as higher prices spurred tapping activity. The production of **crude palm oil**, however, declined further by 3.3% to 17 million tonnes amid unfavourable weather conditions. Palm oil stocks were lower by 28.1% to 1.61 million tonnes as at end-2010.

Table 1.7

Agriculture Sector: Value Added and Production

	2009	2010*p*
	Annual change (%)	
Value added	**0.4**	**1.7**
Industrial crops	**-4.6**	**-2.6**
Production of which:		
Crude palm oil	-1.0	-3.3
Rubber	-20.1	9.6
Saw logs	-8.7	-2.2[2]
Cocoa beans	-35.1	-13.8
Food crops	**7.2**	**7.0**
Production of which:		
Fish	12.2	2.7
Livestock[1]	7.6	2.4
Vegetables	3.1	-17.6
Fruits	0.6	8.3

[1] Refers to Peninsular Malaysia only
[2] Jan-Nov 2010
p Preliminary

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

Better performance in the agriculture sector due to high production of food crops

The agriculture sector benefited from higher prices in 2010. Global agricultural commodity prices increased significantly in the year following stronger demand, particularly from the emerging economies, while supply was constrained by adverse weather conditions. Rubber prices exceeded the historical high of RM10.71 per kg in April and recorded new highs since October 2010. On 30 December 2010, rubber prices closed at RM15.01 per kg (end-2009: RM9.58 per kg). Similarly, prices of crude palm oil also increased considerably during the year to reach RM3,770 per tonne by the end of 2010 (end-2009: RM2,571 per tonne).

The mining sector expanded marginally as higher natural gas production offset lower crude oil production

Value-added of the **mining sector** increased by 0.2% in 2010. Output of **natural gas** increased by 4.4% to 6,065 million standard cubic feet

Table 1.8

Mining Sector: Value Added and Production

	2009	2010*p*
	Annual change (%)	
Value added	**-3.8**	**0.2**
Production		
of which:		
Crude oil and condensates	-4.5	-3.5
Natural gas	-1.6	4.4

p Preliminary

Source: PETRONAS
Department of Statistics, Malaysia

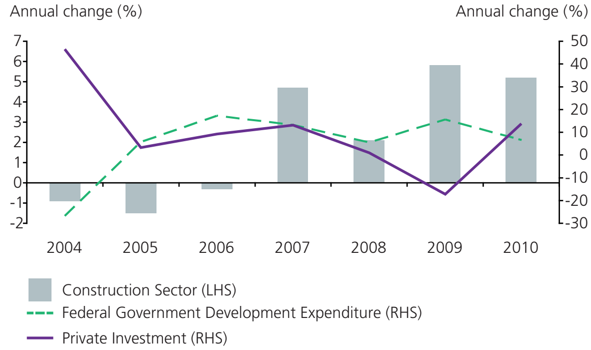
Table 1.9		
Malaysia: Crude Oil and Natural Gas Reserves[1]		
	As at 1 January	
	2009	2010*p*
Crude oil (including condensates)		
Reserves (billion barrels)	5.52	5.80
Reserve/Production (year)	22	24
Natural gas		
Reserves (billion barrels of oil equivalent)	14.66	14.76
Reserve/Production (year)	36	38

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

Source: PETRONAS

Chart 1.13

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



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

per day, as 2010 was the first full-year of exports to PR China and there was higher demand from the major importers such as Japan and Chinese Taipei. However, crude oil output continued to decline due mainly to lower production from the maturing oil fields and the shutdown of several oil fields for maintenance. The production of **crude oil (including condensates)** averaged 635,890 barrels per day in 2010, lower by 3.5% compared to 2009.

Moderate growth in the construction sector

The **construction sector** expanded by 5.2% in 2010 (2009: 5.8%), with some moderation in the second half, due partly to the completion of projects financed by the second stimulus package. Growth was supported mainly by the **non-residential** sub-sector, reflecting the construction of commercial properties, particularly purpose-built office and retail space, and the upgrading and repair of public buildings. The **civil engineering** sub-sector continued to grow amid continued progress in the implementation of infrastructure projects, such as the construction of the new Low Cost Carrier Terminal (LCCT), Second Penang Bridge, double-track rail project and several highways. However, construction activity in the **residential** sub-sector declined, with fewer units of new residential properties being launched by developers, particularly in the early part of 2010.

House prices, as measured by the Malaysian House Price Index (MHPI), increased by 6% on an annual basis during the first three quarters of 2010, almost doubling the average increase of 3.4% during

Table 1.10

Demand and Supply Indicators of the Residential Property Market

	1H '09	2H '09	1H '10	2H '10*p*
	Annual change (%)			
	Demand indicators			
Residential property transactions				
Value (RM million)	-14.3	17.1	30.7	13.6
Volume	-10.4	5.7	12.6	2.6
Finance for purchase of residential property				
Loan applications	11.1	54.9	40.6	18.0
Loan approvals	0.3	44.2	31.5	10.7
	Supply indicators			
New launches	**-21.1**	**55.6**	**8.8**	**-25.8**
New sales and advertising permits	**-16.8**	**57.8**	**22.1**	**10.9**
Housing approvals	**-23.7**	**66.7**	**11.1**	**36.5**
Loans for construction				
Loan applications	-31.4	36.5	63.9	76.5
Loan approvals	-38.2	4.2	42.2	61.9
	Price			
Malaysian House Price Index	1.6	3.5	5.9	6.2[1]

[1] Jul-Sep 2010
p Preliminary

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

2000-2009. The strong increase in prices was driven in large part by higher demand, due to continued growth in household incomes, improving consumer sentiments and the accommodative financing environment. By the middle of the year, prices of residential properties in specific locations, particularly in the Klang Valley, had increased by more than 10% on an annual basis but the pace of growth moderated towards end-year.

EXTERNAL SECTOR

Balance of Payments

Malaysia's external position remained resilient in 2010, underpinned by a sizeable current account surplus and a lower net outflow in the financial account. The trade surplus narrowed as import growth outpaced export growth, but nevertheless, remained large. The services account recorded a small surplus, supported by higher receipts from tourism as well as computer and IT services. However, the income account deficit widened due mainly to the higher profits of foreign direct investment in Malaysia. The lower net outflows in the financial account were largely attributable to the higher inflows of portfolio investments and FDI given the improvement in both global and domestic economic conditions. Outflows of direct investment abroad increased as Malaysian companies continued to tap opportunities in the regional and other markets. Other investment outflows, which mainly comprise trade credits and placements of deposits abroad by residents, moderated during the year.

Malaysia's external position remained resilient in 2010

During the year, errors and omissions excluding the cumulative foreign exchange revaluation loss amounted to RM38.4 billion. This represented 3.3% of Malaysia's total trade. After adjusting for

Table 1.11

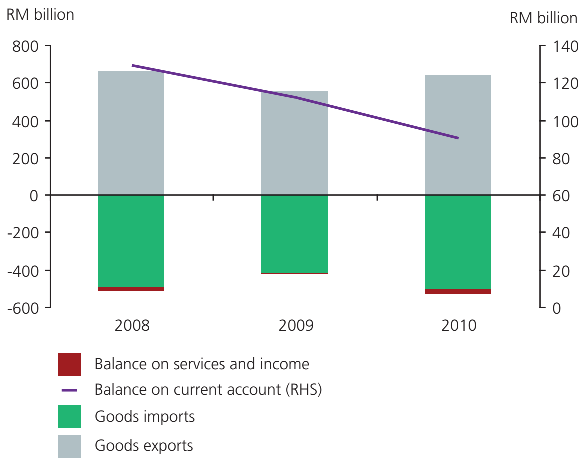
Balance of Payments

Item	2009			2010*p*		
	+	-	Net	+	-	Net
	RM billion					
Goods	554.1	412.3	141.7	639.8	503.3	136.6
Trade account	*553.3*	*434.9*	*118.4*	*639.4*	*529.2*	*110.2*
Services	101.3	96.6	4.7	104.7	103.8	0.9
Balance on goods and services	**655.3**	**508.9**	**146.4**	**744.5**	**607.1**	**137.4**
Income	39.3	54.0	-14.6	38.1	63.4	-25.2
Current transfers	3.7	23.3	-19.6	1.8	23.5	-21.7
Balance on current account	**698.4**	**586.3**	**112.1**	**784.5**	**694.0**	**90.5**
% of GNI			**17.5**			**12.2**
Capital account			-0.2			-0.2
Financial account			-80.2			-21.9
Direct investment			-22.9			-15.0
Portfolio investment			-1.7			44.9
Financial derivatives			2.5			-0.8
Other investment			-58.1			-51.1
Balance on capital and financial accounts			**-80.4**			**-22.1**
Errors and omissions			-17.9			-71.0
of which:						
Foreign exchange revaluation gain (+) or loss (-)			*10.7*			-32.6
Overall balance			**13.8**			**-2.6**
Bank Negara Malaysia international reserves, net			**331.3**			**328.6**
USD billion equivalent			**96.7**			**106.5**

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

Chart 1.14

Current Account



Source: Department of Statistics, Malaysia

the errors and omissions, the overall balance of payments recorded a small deficit of RM2.6 billion. Consequently, the net international reserves of Bank Negara Malaysia amounted to RM328.6 billion, equivalent to USD106.5 billion, as at 31 December 2010. As at 28 February 2011, the reserves remained at a comfortably high level of RM338.6 billion (equivalent to USD109.8 billion), adequate to finance 8.1 months of retained imports and cover 4.3 times of the short-term external debt. Malaysia's external reserves remain usable and unencumbered.

Current account surplus narrowed, reflecting the lower trade surplus as the growth of imports outpaced exports

Current Account

The **current account** surplus narrowed to RM90.5 billion or 12.2% of GNI in 2010 (2009: RM112.1 billion or 17.5% of GNI). Trade activity recovered during the year as global economic conditions improved, particularly among regional countries. Nonetheless, the acceleration of domestic demand also provided an impetus for the strong growth in gross imports which outpaced the growth in gross exports, leading to a smaller trade surplus. The services account recorded a surplus for the fourth consecutive year, albeit by a smaller amount. The surplus was supported by robust tourist arrivals and higher receipts from computer and IT services. The deficit in the income account widened as higher profits and dividends accruing to foreign direct investors operating in Malaysia more than offset the increase in profits and dividends accruing to Malaysian companies investing abroad.

Total exports and imports amounted to RM1.17 trillion (157.8% of GNI), approaching the levels reached before the crisis (2008: RM1.18 trillion). In line with the robust growth in regional countries, **gross exports** expanded by 26.1% in the first half, underpinned by strong regional demand and to a certain extent, the low base effect of the previous year. However, the growth momentum moderated in the second half, weighed down by the slower growth of manufactured exports, which offset the strong growth in commodity exports. The performance

Table 1.12

Gross Exports

	2009	2010*p*
	Annual change (%)	
Gross exports	**-16.5**	**15.6**
Manufactures	**-12.3**	**13.0**
of which:		
Electronics	*-8.6*	*8.6*
Semiconductors	*3.4*	*5.3*
Electronic equipment and parts	*-18.8*	*12.2*
Electrical products	*-16.2*	*13.3*
Resource-based products[1]	*-17.1*	*20.0*
Commodities	**-28.2**	**26.9**
Agriculture	**-21.8**	**30.8**
of which:		
Palm oil	*-20.9*	*25.4*
Rubber	*-45.0*	*106.5*
Minerals	**-33.1**	**23.4**
of which:		
Crude oil and condensates	*-41.8*	*21.3*
LNG	*-24.8*	*22.1*

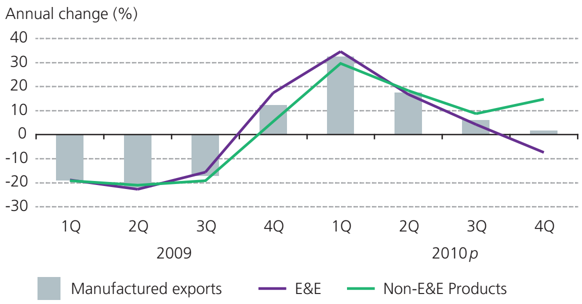
[1] Refers to food, beverages and tobacco products, wood products, furniture and parts, rubber products, petroleum products, chemicals and chemical products and non-metallic mineral products

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.15

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

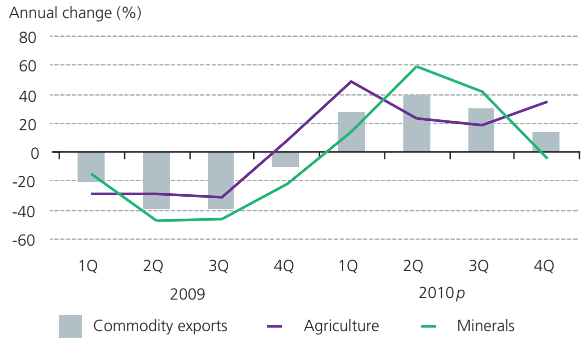


p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.16

Commodity Export Performance



p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

of manufactured exports mainly reflected the external demand for electronics and electrical products (E&E), which moderated towards the second half of the year. Commodity exports, on the other hand, remained resilient throughout the year, supported by robust regional demand and high commodity prices.

Manufactured exports expanded by 13% in 2010, with strong growth recorded across major products in the first half of the year. E&E exports, particularly semiconductors, rose significantly in the first half, benefiting from inventory restocking in the global electronics industry. Moving into the latter half of the year, the moderation in regional demand led to the softening of electronics exports. Similarly, the robust growth of non-E&E exports eased in the second half of the year, but continued to be supported by firm regional demand for resource-based products such as chemicals, petroleum and rubber products, and optical and scientific equipment.

Table 1.13

Direction of External Trade

	2010*p*				
	Exports		Imports		Trade balance
	RM billion	Annual change (%)	RM billion	Annual change (%)	RM billion
Total	**639.4**	**15.6**	**529.2**	**21.7**	**110.2**
of which:					
United States	**61.0**	**0.6**	**56.3**	**15.8**	**4.7**
European Union (EU)	**68.7**	**14.5**	**54.2**	**6.7**	**14.5**
Selected ASEAN countries[1]	**160.6**	**13.9**	**142.6**	**30.9**	**17.9**
Selected North East Asia countries	**157.5**	**19.7**	**131.6**	**19.6**	**25.9**
The People's Republic of China	*80.6*	*19.9*	*66.4*	*9.5*	*14.2*
Hong Kong SAR	*32.5*	*12.8*	*12.7*	*17.3*	*19.9*
Chinese Taipei	*20.2*	*39.9*	*23.8*	*29.0*	*-3.6*
Korea	*24.2*	*14.7*	*28.7*	*42.6*	*-4.5*
West Asia	**22.3**	**4.0**	**18.9**	**27.6**	**3.4**
Japan	**66.3**	**21.8**	**66.5**	**22.6**	**-0.3**
India	**21.0**	**23.3**	**8.0**	**1.4**	**13.0**

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

Source: Department of Statistics, Malaysia

Table 1.14

Imports by End-Use

	2009	2010*p*
	Annual change (%)	
Capital goods	**-5.9**	**16.2**
Capital goods (except transport equipment)	-8.2	16.1
Transport equipment	10.5	17.1
Intermediate goods	**-21.6**	**22.1**
Food and beverages, mainly for industry	-16.8	22.6
Industrial supplies, n.e.s.	-21.8	24.5
Fuel and lubricants	-36.0	34.1
Parts and accessories of capital goods (except transport equipment)	-19.0	19.6
Consumption goods	**-2.7**	**10.1**
Food and beverages, mainly for household consumption	7.8	9.1
Consumer goods, n.e.s.	-9.1	10.0
Re-exports	**35.1**	**32.2**
Gross Imports	**-16.3**	**21.7**

n.e.s. Not elsewhere specified
p Preliminary

Source: Department of Statistics, Malaysia

Commodity exports turned around to register a growth of 26.9%, buoyed by firm regional demand and stronger commodity prices. Of significance, agriculture exports sustained robust growth rates throughout the year, supported by rising prices of crude palm oil, natural rubber and continued demand from the region. While mineral exports also recorded strong expansion in the first half of the year, the pace of growth moderated in the second half as the decline in export volume of crude oil in the fourth quarter more than offset the gains from higher oil prices.

Gross imports grew by 21.7%, with expansion across all major import categories. Intermediate imports grew by 22.1%, led by imports of industrial supplies, fuel and lubricants, in tandem with the pick-up in manufacturing activity. Capital imports surged by 16.2%, as imports of machineries increased substantially in consonance with the revival of domestic investment activity. Likewise, imports of consumption goods expanded by 10.1%, driven mainly by imports of food and beverages, reflecting positive consumer spending. The pace of expansion in capital and consumption imports remained strong despite moderating slightly in the second half of the year.

The **services account** remained positive, albeit by a smaller amount, supported by strong tourism activity and higher receipts from computer and IT services. The surplus in the travel account was sustained as the improvement in global economic conditions continued to spur greater tourist arrivals. In 2010, tourist arrivals totalled 24.6 million visitors (2009: 23.6 million visitors), with Asian countries providing the largest number of visitors. The expansion of travel

Table 1.15

Services and Income Accounts

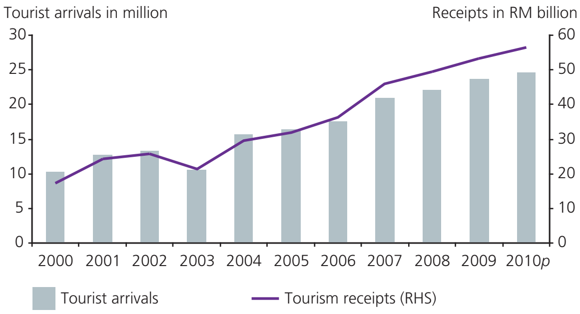
	2009	2010*p*		
	RM billion			
	Net	+	-	Net
Services Account	**4.7**	**104.7**	**103.8**	**0.9**
% of GNI	*0.7*			*0.1*
Transportation	-17.0	15.1	38.2	-23.0
Travel	32.7	57.4	25.4	32.0
Other services	-10.4	31.9	39.5	-7.6
Government transactions n.i.e.	-0.6	0.3	0.8	-0.5
Income Account	**-14.6**	**38.1**	**63.4**	**-25.2**
% of GNI	*-2.3*			*-3.4*
Compensation of employees	-1.5	3.6	5.6	-2.1
Investment income	-13.1	34.6	57.7	-23.2

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

Source: Department of Statistics, Malaysia

Chart 1.17

Tourist Arrivals and Tourism Receipts



p Preliminary

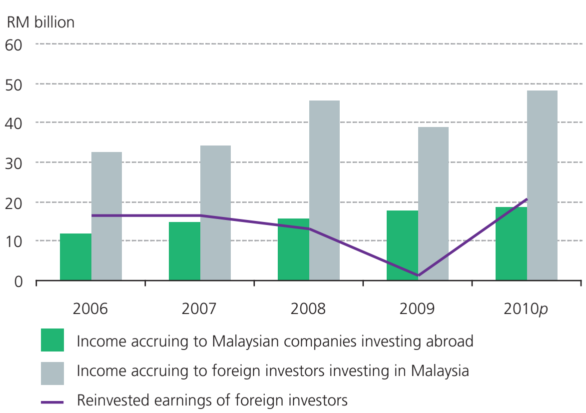
Source: Malaysia Tourism Promotion Board and Department of Statistics, Malaysia

routes and the increase of flight frequencies by low cost carriers were the main contributing factors. The deficit in other services account declined due mainly to higher receipts from computer and IT services. Meanwhile, the transportation account deficit widened as, in line with the acceleration of imports, higher freight payments exceeded the sustained receipts from passenger and cargo fares.

The **income account** deficit widened to RM25.2 billion or 3.4% of GNI. This largely reflected the higher profits and dividends accruing to portfolio and foreign direct investors in Malaysia, which more than offset the higher earnings from portfolio and direct investment abroad. In particular, foreign direct investments in the manufacturing and oil and gas sectors recorded significantly higher profits due to improved export performance in both manufactured products and crude minerals.

Chart 1.18

Direct Investment Income



p Preliminary

Source: Department of Statistics, Malaysia

Financial Account

In 2010, the financial account recorded a smaller net outflow of RM21.9 billion (2009: -RM80.2 billion). Of significance was the return of large scale portfolio inflows into Malaysia, a trend experienced across the region, given the prospects for strong growth of regional economies. There were also expectations for stronger regional currencies and higher interest rates, which in turn led to further inflows of foreign capital into the region. The improving global economic conditions and corporate profitability led to higher inflows of foreign direct investment (FDI). Similarly, direct investment abroad (DIA) rose as Malaysian companies continued to tap profitable opportunities in other regions. Other investment outflows, which largely reflected trade credits and placement of deposit abroad by residents, moderated during the year.

For the year as a whole, **portfolio investment** recorded a much larger net inflow of RM44.9 billion. The inflows of foreign portfolio funds were channelled into both the equity and debt securities markets, with the bulk of the funds flowing mainly into long-term debt securities. Despite the larger

Table 1.16

Balance of Payments: Financial Account

	2009	2010p
	RM billion	
Financial Account	**-80.2**	**-21.9**
Direct Investment	**-22.9**	**-15.0**
Abroad	-27.9	-42.6
In Malaysia	5.0	27.6
Portfolio Investment	**-1.7**	**44.9**
Financial Derivatives	**2.5**	**-0.8**
Other Investment	**-58.1**	**-51.1**
Official sector[1]	6.6	0.2
Federal Government	*-0.6*	*-0.4*
NFPEs	*0.5*	*0.6*
Bank Negara Malaysia	*6.6*	*0.0*
Private sector	-64.6	-51.4

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

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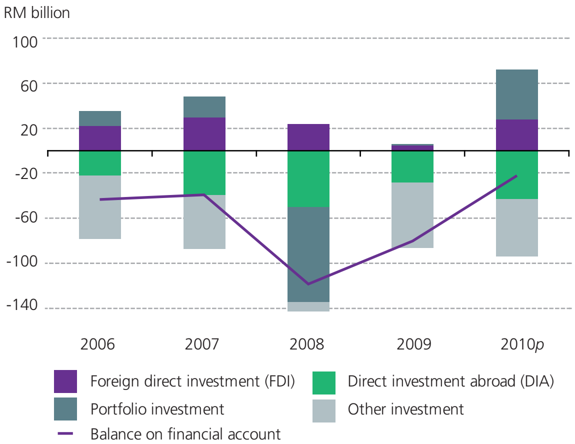
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.19

Financial Account



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Source: Department of Statistics, Malaysia and Bank Negara Malaysia

inflows, the level of foreign holdings in these asset markets remained below the pre-financial crisis levels of 2008/09.

The lower net outflows in the financial account largely reflected the higher inflows of portfolio investment and foreign direct investment

These inflows have not created economic and financial imbalances. Importantly, Malaysia has the policy capacity to manage these inflows. The presence of a robust monitoring and surveillance system has provided near real time information on the size and nature of these inflows and allows for early detection of any emerging risks inherent to these short-term flows. The more diversified financial sector, the stronger and resilient financial institutions as well as the deeper and broader financial markets have been able to absorb the volatility in capital flows such that orderly financial markets was preserved. The availability of a wide range of monetary instruments has allowed for effective sterilisation of excess liquidity in the system arising from these capital inflows.

Gross inflows of **FDI** increased further to RM89.2 billion, accounting for 12% of GNI in 2010 in tandem with the global economic recovery. Amid improvements in domestic economic conditions, higher corporate profitability contributed to the larger inflows of FDI into the country during the year. This was evident through the significantly higher amount of earnings retained for investments by existing multinational companies (MNCs) in Malaysia. In addition, several new Government initiatives, notably the Entry Point Projects (EPPs) under the Economic Transformation Programme (ETP) which provided business opportunities for the private sector to drive growth. The empowerment and corporatisation of MIDA to negotiate directly with investors and undertake real-time decision making on investments proposals is expected to contribute significantly in sustaining investors' confidence in the Malaysian economy.

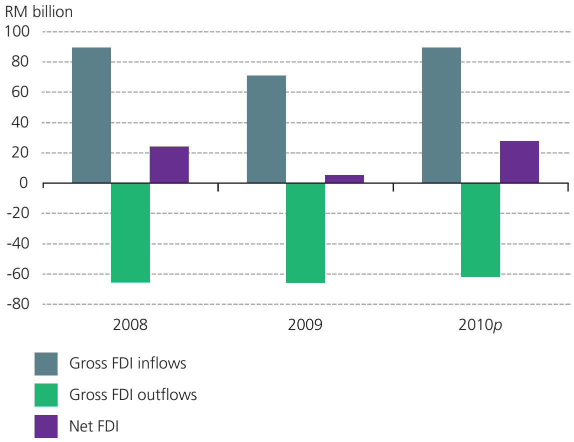
Positive investor sentiments to investing in Malaysia was further buoyed by improvements in the country's rankings for competitiveness and ease of doing business in the reports released by the International Institute for Management Development (IMD), UNCTAD and the World Bank, respectively. This, together with the continued efforts of the Government to further liberalise investment policies in the manufacturing and services sectors have helped to attract more FDI into Malaysia during the year. After taking into account the adjustments for outflows due largely to loan repayments to parent companies and to a certain extent, repatriation of working capital by some oil and gas companies, net inflows of FDI increased significantly to RM27.6 billion or 3.7% of GNI.

FDI in Malaysia continued to be broad-based. The manufacturing (60.2% share), services (30.2% share) and oil and gas (8.9% share) sectors were the main beneficiaries during the year. In the manufacturing sector, FDI was mainly into the E&E industries, largely by existing MNCs, for upgrading equipment and technology in a move towards higher value added activities and greater product sophistication. There were also investments undertaken by companies in the solar industry, which subsequently boosted the expansion of the solar value chain in Malaysia. Other investments in the manufacturing sector were in petroleum refining and petroleum-related products industry which continued to remain sizeable.

In the services sector, FDI inflows were channelled primarily into the finance and insurance sub-sector,

Chart 1.20

Foreign Direct Investment (FDI)



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Source: Department of Statistics, Malaysia

followed by the wholesale and retail sub-sector. Of significance, the bulk of investments in the finance and insurance sub-sector were undertaken by foreign financial institutions, mainly through reinvested earnings. The FDI in the wholesale and retail sub-sector was undertaken mainly by distributive companies related to telecommunication and electronic products. Investments in the oil and gas sector were mainly for extraction operations and production activities. Major contributors of FDI inflows in 2010 were mainly the advanced economies, particularly the United States, Japan and Netherlands.

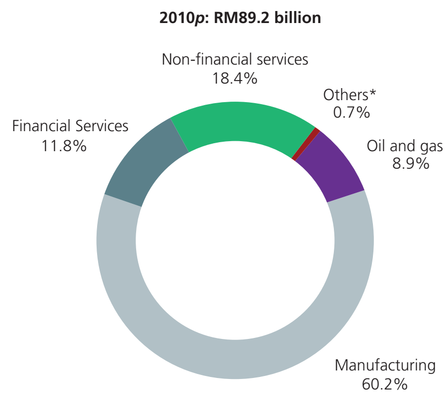
In 2010, gross outflows of **DIA** by Malaysian companies increased to RM67.9 billion, accounting for 9.2% of GNI. The larger DIA outflows reflected the continued investment by Malaysian companies in their existing operations and expansion into new businesses, as evidenced by higher outflows of equity capital, retained earnings, and larger extension of inter-company loans. After taking account the gross inflows, which was largely attributable to repayments of loans by subsidiaries abroad, net DIA amounted to RM42.6 billion or 5.8% of GNI.

The DIA by Malaysian companies was largely channelled into the services (67% share), oil and gas (19% share) and manufacturing (11% share) sectors. Investments in the services sector were led mainly by domestic financial institutions, utilities and telecommunications companies which were expanding their existing operations abroad in an effort to further tap high growth markets in the region, and to remain competitive on a regional scale. A significant part of investments in the services sector reflected strategic investments in healthcare, leisure and entertainment sub-sectors.

In the oil and gas sector, the DIA continued to be driven by Malaysian oil companies, primarily in the exploration and production (E&P) businesses as well as downstream processing activities. Investment abroad in the manufacturing sector reflected primarily reinvestments in the integrated agribusiness model, particularly

Chart 1.21

Gross FDI Inflows by Sector



Note: *Refers to agriculture and construction sectors

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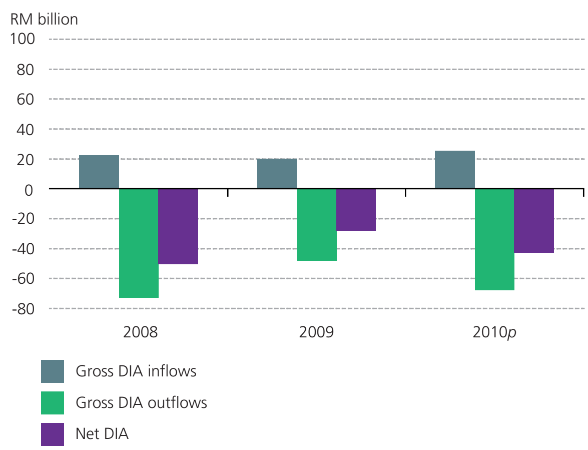
Source: Department of Statistics, Malaysia

Chart 1.22

Direct Investment Abroad (DIA)



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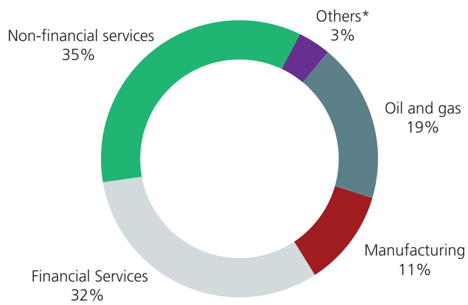
Source: Department of Statistics, Malaysia

Chart 1.23

Gross DIA Outflows by Sector



Note: *Refers to agriculture and construction sectors
p Preliminary

Source: Department of Statistics, Malaysia

relating to palm oil, which captures the entire value chain of the agricultural commodity processing. Most of DIA during the year were within the region, particularly in ASEAN, the Asian Newly Industrialised Economies (NIEs) and the West Asian economies. There were also sizeable investments abroad by Malaysian companies in the advanced economies, notably Australia and United Kingdom.

Other investment recorded a smaller net outflow of RM51.1 billion in 2010 due to a moderation in the private sector outflows and net inflows in the official sector. Despite higher net placements of deposits abroad by the banking sector, private sector outflows were lower on account of lower net trade credits. Unlike in 2009, Malaysian exporters extended less trade credit while Malaysian importers received more trade credit as foreign importers and exporters' access to trade financing improved as the global economic recovery gained traction. The higher outflows in the banking sector largely reflected the liquidity management strategy of the banks. Meanwhile, the official sector recorded a small inflow as external loan drawdown by the non-financial public enterprises (NFPEs) more than offset the external loan repayments by the Federal Government.

International Reserves

The **international reserves** held by Bank Negara Malaysia comprise holdings of gold and foreign exchange, the reserve position with the IMF and holdings of Special Drawing Rights (SDR). In 2010, net international reserves amounted to RM328.6 billion, equivalent to USD106.5 billion, as at 31 December 2010.

International reserves amounted to RM328.6 billion in 2010, supported mainly by continued surplus in the current account as well as inflows of FDI and portfolio investment

During the year, the international reserves were largely supported by the current account surplus following the surplus in the trade account arising from strong commodity and manufactured exports. The movement of the international reserves during the year was also to a large extent influenced by larger inflows of portfolio investment and FDI, reflecting improved economic prospects and strengthened investor sentiments. These inflows, however, were partly offset by direct investment abroad as well as net outflows of other investments.

Excluding the revaluation changes, reserves remained relatively stable in the first six months, with the net inflow of funds being reflected in the gradual appreciation of the ringgit. In the second half-year, reserves registered a modest increase following the intensification of portfolio inflows, particularly in the third quarter. For the year as a whole, the increase of reserves was however offset by the cumulative unrealised foreign exchange revaluation loss of RM32.6 billion arising from the strengthening of the ringgit against most major currencies.

Malaysia remains a participating member in the Financial Transactions Plan of the IMF. Under this plan, a member will provide resources to member countries that face short-term balance of payments difficulties. Notwithstanding a purchase of currency transaction by a member country under the Financial Transactions Plan, the **reserve position with the IMF** and the international reserves held in the form of **SDRs** declined in 2010 mainly due to the exchange

Table 1.17

Net International Reserves

	As at end		Change
	2009	2010	2010
	RM million		
SDR holdings	7,279.2	6,442.5	-836.7
IMF reserve position	1,515.8	1,453.5	-62.3
Gold and foreign exchange[1]	322,505.6	320,774.5	-1,731.1
Gross International Reserves	**331,300.6**	**328,670.5**	**-2,630.1**
Less Bank Negara Malaysia external liabilities	23.9	21.4	-2.5
Net International Reserves	**331,276.7**	**328,649.1**	**-2,627.6**
USD million equivalent	96,688.1	106,518.2	9,830.1
Months of retained imports	9.7	8.6	
Reserves/Short-term external debt (times)	4.2	4.1	

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

Note: Numbers may not necessarily add up due to rounding

Source: Bank Negara Malaysia

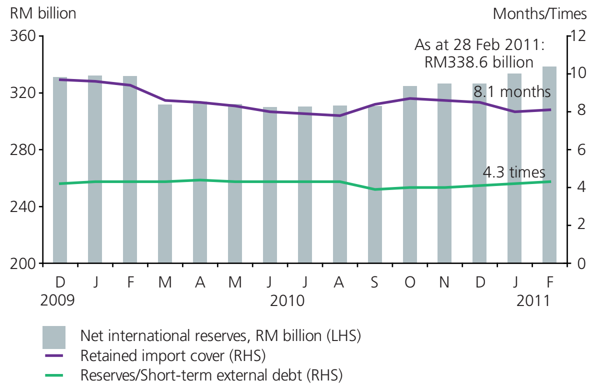
revaluation loss following the appreciation of ringgit against SDR.

Given the multifaceted challenge of shifting global liquidity flows, the reserves portfolio strategy and risk management practices were adapted accordingly. In particular, there was increased emphasis and caution on sovereign risk following heightened concerns about the funding capacity of some European sovereigns. Further diversification of currency holdings and assets to enhance the risk-adjusted returns of the portfolio remain a key investment strategy.

As at 28 February 2011, the reserves level amounted to RM338.6 billion (equivalent to USD109.8 billion), adequate to finance 8.1 months of retained imports and is 4.3 times the short-term external debt. The international reserves held by the Bank are usable and unencumbered. There are no foreign currency loans with embedded options and no undrawn, unconditional credit lines provided by or to other central banks, international organisations, banks and other financial institutions. Bank Negara Malaysia also does not engage in

Chart 1.24

Net International Reserves (end-month)



Source: Bank Negara Malaysia

ringgit-related options activity in the foreign currency markets.

External Debt

Malaysia's external debt management strategy had progressed amid the shifting global financial landscape and ongoing transformation of the Malaysian economy to a high-value added and high income economy. The strategy in essence, is geared towards creating a facilitative business environment to enhance competitiveness and flexibility of the economy. To facilitate greater mobility of capital to enhance management of financial resources, resident companies are free to source foreign currency borrowing within the same corporate group which includes foreign subsidiaries, branches, ultimate holding or parent companies, associate or sister companies. In safeguarding monetary and financial stability, the emphasis is to ensure that the management of the nation's external debt is continuously supported by a comprehensive, well-functioning and robust debt monitoring system that covers the overall debt level, the structure of the debt, and the debt-servicing obligations of the country.

Malaysia's external debt remained low at 30.2% of GNI

As at end-2010, Malaysia's total external debt declined to RM226.3 billion (or USD72.6 billion), or 30.2% of GNI (2009: RM233.1 billion). This reflected the decline in the medium- and long-

Table 1.18

Outstanding External Debt

	2009	2010*p*	2009	2010*p*
	RM billion	RM billion	USD billion	USD billion
Total debt	**233.1**	**226.3**	**67.4**	**72.6**
Medium- and long-term	155.4	146.9	44.9	47.1
Short-term[1]	77.8	79.4	22.5	25.5
As % of total debt	*33.4*	*35.1*		
As % of net international reserves	*23.5*	*24.2*		
As % of GNI				
Total debt	35.1	30.2		
Medium- and long-term debt	23.4	19.6		
As % of exports of goods and services				
Total debt	35.6	30.4		
Medium- and long-term debt	23.7	19.7		
Debt service ratio (%)	**6.5**	**7.6**		

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

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Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

term debt. The appreciation of the ringgit against major currencies during the year also contributed to the moderation in the overall external debt level. In the case of **medium- and long-term external debt**, the improvement was also due to the net repayment position of the private sector. As at end-year, Malaysia's external debt profile continued to be skewed towards a longer maturity structure with medium- and long-term debt accounting for 64.9% of total external debt.

In May 2010, the **Federal Government** issued a USD1.25 billion 5-year global *sukuk*, the first market loan raised in the international capital market since 2002. The *sukuk* issuance was aimed at promoting Malaysia as a global Islamic financial hub and to establish a new US dollar benchmark for Malaysian corporates. As at end-year, the outstanding external debt of the Federal Government rose to RM16.7 billion (2009: RM13.8 billion), as higher gross borrowings more than offset repayments and exchange revaluation gains during the year. External debt of the **NFPEs** declined to RM66.6 billion in 2010 (2009: RM71.6 billion). Although the NFPEs continued to drawdown long-term external loans, mainly to finance their capital investments, the amount was significantly lower. In addition, the repayment of external loans remained large, following the maturity of several bonds as well as continued loan repayments throughout the year.

Similarly, following significantly larger repayments during the year, the medium- and long-term debt of the **private sector** declined to RM63.6 billion (2009: RM70 billion). This largely reflected the larger repayments of debt by companies in the retail, communications and mining sectors.

During the year, the **short-term external debt** outstanding increased to RM79.4 billion (2009: RM77.8 billion), attributed primarily to higher non-bank private sector borrowings. The bulk of the short-term debt continued to be held by the banking sector (85.6% share) while short-term external debt of the non-bank private sector, comprising mainly revolving credits and overdraft facilities, remained low. As at end-2010, the short-term external debt remained relatively small, accounting for only 10.6% of GNI, 24.2% of international reserves and 10.7% of exports of goods and services.

LABOUR MARKET DEVELOPMENTS

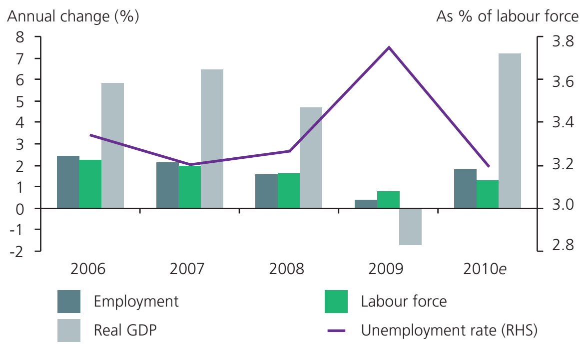
Labour market conditions improved in 2010, as reflected in lower retrenchments, higher number of vacancies and gains in employment. The unemployment rate declined to 3.2% of the labour force (2009: 3.7%), following stronger growth in employment (1.8%; 2009: 0.4%), compared to the growth in the labour force (1.3%; 2009: 0.8%).

Labour market conditions improved amid better economic performance

During the year, **employment** expanded by 1.8%, equivalent to a net addition of 204,400 jobs. The services sector remained the major source of employment, with net addition of 96,800 jobs, accounting for 47% of total job creation. Job creation in the services sector was driven mainly by new jobs in distributive trade and restaurants (47,600 jobs), finance and business services (15,900 jobs), and transport, storage and communication (8,000 jobs) sub-sectors. The manufacturing sector recorded gains in employment of 102,400 jobs, reversing the net job losses in 2009 following

Chart 1.25

Output and Employment



e Estimate

Source: Economic Planning Unit and Department of Statistics, Malaysia

Chart 1.26

Retrenchments in Selected Sectors

Source: Ministry of Human Resources

strong labour demand in the E&E and consumer-related industries. The E&E sector in particular, accounted for about two-thirds of total job creation in the manufacturing sector.

In terms of **skill levels**, the bulk of the jobs created were in the mid-skill (55% or 112,300) and the high-skill (51% or 104,600) category, while the low-skill category recorded job losses. Of significance, the number of high-skill jobs had been growing at a faster pace (3.2%) compared to the mid-skill (1.6%) category, while the number of low-skill jobs had declined (-1%). As at the end of 2010, 3.4 million or 28% of total employment was in high-skill jobs, 7.2 million or 61% in mid-skill jobs and 1.3 million or 11% in low-skill jobs.

Retrenchments declined by 72% to 7,085 persons (2009: 25,064 persons), due mainly to significantly fewer layoffs in the manufacturing sector. All sectors recorded improvement in retrenchments, except for the agriculture sector, which was affected by the closure and sale of a company in the first quarter. The E&E sub-sector in particular, remained resilient, as retrenchments were substantially lower (390 persons; 2009: 9,337 persons) reflecting the vast improvement in external demand. **Vacancies** posted on JobsMalaysia Portal increased to 1.8 million positions (2009: 1.5 million positions), attributable to higher number of job openings in the manufacturing (39% of total positions)

Table 1.19

Selected Labour Market Indicators

	2006	2007	2008	2009	2010e
Employment[1] ('000 persons)	11,159.0	11,398.0	11,576.5	11,620.5	11,824.9
Annual change (%)	2.4	2.1	1.6	0.4	1.8
Labour force[1] ('000 persons)	11,544.5	11,775.1	11,967.5	12,061.1	12,216.8
Annual change (%)	2.2	2.0	1.6	0.8	1.3
Retrenchments (persons)	15,360	14,035	24,033	25,064	7,085
Unemployment rate[1] (% of labour force)	3.3	3.2	3.3	3.7	3.2
Real labour productivity growth[2] (%)	3.3	4.2	3.1	-2.1	5.8

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

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

and services (29% of total positions) sectors. Hiring activity in the manufacturing sector was particularly strong in the first half year, supported by the expansion in both the export- and domestic-oriented industries.

In 2010, total registered foreign workers (including expatriates) in Malaysia declined by 5.6% to 1.8 million workers (2009: 1.9 million). The decline was in line with the Government's effort to further reduce the dependency on low-skilled foreign workers. Foreign workers accounted for 15.5% of employment in Malaysia in 2010 (2009: 16.5%) and were mainly employed in the manufacturing, construction and agriculture sectors.

Labour productivity, as measured by real value-added per worker, grew strongly by 5.8%, reversing the negative growth of 2.1% in 2009. Growth was underpinned by the strong productivity growth in the manufacturing (9.5%) and services (5%) sectors. Gains in productivity were supported by higher investment in capital, greater participation from high-skilled workers and from skills-upgrading through technical training schemes provided by the Government and the private sector. According to a survey conducted by Bank Negara Malaysia, the average **salary** increment in the private sector was 4.5% (2009: 4.3%), with an average increment of 3.8% and 5.5% in the manufacturing and non-manufacturing sectors respectively. In addition, both executives and non-executives received higher salary increments of 4.3% and 4.4%, respectively (2009: 4.1% and 3.5%).

PRICE DEVELOPMENTS

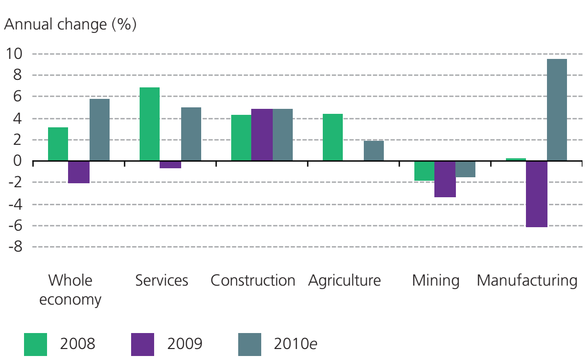
Consumer prices

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), averaged 1.7% in 2010 (2009: 0.6%). The increase in inflation during the year was driven by supply factors arising from higher food and commodity prices and adjustments to administered prices. The actual headline inflation was below the Bank's forecast range of 2.0 – 2.5% partly due to the difference between the actual and expected adjustments - both in terms of timing and magnitude of the Government's subsidy rationalisation programme. Core inflation, an indicator of the demand-driven pressures on prices, rose at a more modest pace of 1.5% in 2010 (2009: 2.7%).

The main contributors to inflation in 2010 were the *food and non-alcoholic beverages* and *transport* categories, which together comprised 59.2% of the overall increase in domestic prices during the year. Inflation in the *food and non-alcoholic beverages* category averaged 2.4% mainly on account of higher price increases in the *vegetables*, *meat* and *sugar, jam, honey, chocolate and confectionery* sub-categories. Inflation in the *transport* category registered a substantial turnaround from -9.4% in 2009 to 1.6% in 2010 due to higher fuel prices. The increase in inflation during the year was mitigated by further declines in the prices for the *clothing and footwear* and *communication* categories, which averaged -1.4% and -0.2% respectively (2009: -0.9% and -0.5% respectively). There was no broad based increase in inflation across all CPI sub-groups

Chart 1.27

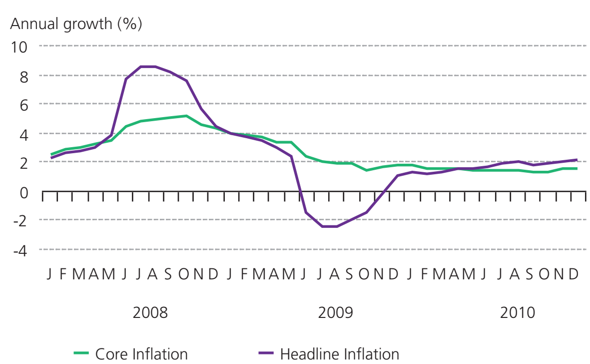
Labour Productivity Trends



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

Chart 1.28

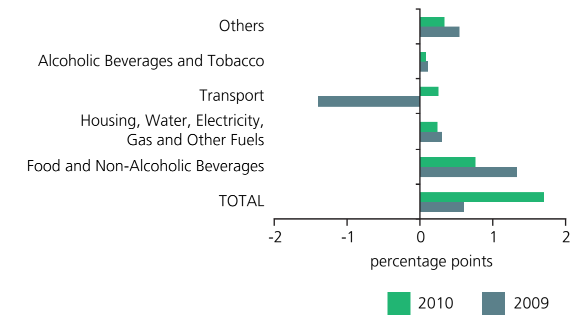
Consumer Price Inflation



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.29

Contribution to Inflation

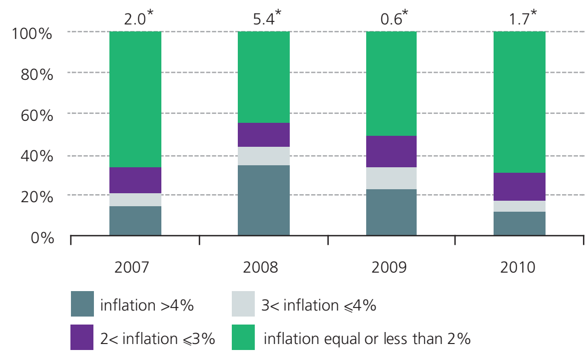


Note: Others refer to *communication; clothing and footwear; health; education; recreation services and culture; furnishings; household equipment and routine maintenance; restaurant and hotels;* and *miscellaneous goods and services*

Source: Bank Negara Malaysia

Chart 1.30

Percentage of CPI Components Above Specified Threshold



* Headline inflation

Source: Bank Negara Malaysia

during the year. Approximately 70% of CPI components recorded an inflation rate of less than 2% in 2010 compared to 45% in 2008. This suggests that the higher prices of food and fuel were not transmitted more broadly to other items in the CPI.

Domestic supply factors were relatively more dominant in driving inflation. During the year, there were a series of price adjustments as part of the subsidy rationalisation programme announced in May. Upward adjustments to the retail prices of RON95 petrol, diesel, LPG and sugar contributed approximately 0.18 percentage points to headline inflation in 2010. Other notable adjustments in retail prices in 2010 included the increase in prices of RON97 petrol and kerosene. In July, the Government announced that the price of RON97 petrol was to be determined by global market forces under a managed float mechanism. As a result, the price of RON97 petrol increased by a total of 25 sen/litre during the year. Prices for premium cigarettes have also risen as a result of an increase in excise duties. In addition to changes in administered prices, disruptions in supply due to adverse weather conditions and

Table 1.20

Price Adjustments in 2010

Item	Previous price (RM)	New price (RM)	Percentage change (%)	Impact on 2010 headline inflation (percentage points)
RON95 (per litre)	1.80	1.85	2.78	0.085
	1.85	1.90	2.70	0.015
RON97 (per litre)	2.05	2.10	2.44	0.007
	2.10	2.15	2.38	0.003
	2.15	2.30	6.98	0.004
Diesel (per litre)	1.70	1.75	2.94	0.001
	1.75	1.80	2.86	0.001
LPG (per kg)	1.75	1.85	5.71	0.013
	1.85	1.90	2.70	0.001
Sugar (per kg)	1.45	1.65	13.79	0.043
	1.65	1.90	15.15	0.022
	1.90	2.10	10.53	0.003
Cigarettes (premium 20-pack)	9.30	10.00	7.53	0.020

Source: Bank Negara Malaysia

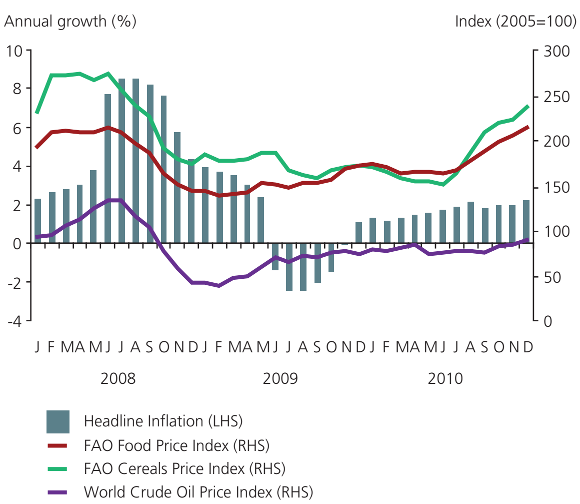
labour shortages also led to higher domestic prices, particularly for food. Prices in the *vegetables* sub-category increased on average by 7.8% in 2010 (2009: 1.0%).

Demand factors, on the other hand, were somewhat subdued in 2010. Consumer sentiments were stable during the year while economic output remained below its potential. Wages increased, albeit at a stable rate during the year. The increase in wages coincided with a stronger increase in productivity amidst rising employment and investment. This led to a narrowing of the wages-productivity gap, providing support to the view of a limited second round impact on inflation.

Compared to previous years, the impact of external factors on domestic prices were more modest in 2010 and confined to selected food items, specifically cereals and meat. This reflected the substantial increase in global prices of wheat and corn, particularly towards the second half of the year, due to adverse weather conditions in key wheat and corn producing countries. The higher global price of corn also led to an increase in prices of poultry feed, which in turn raised the price of poultry in Malaysia.

Chart 1.31

Headline Inflation and World Commodity Prices



Note: 1. FAO stands for Food and Agricultural Organisation of the United Nations.
2. The FAO Food Price Index consists of a weighted average of 55 food commodities considered by FAO specialists as representing the international prices of food

Source: FAO and Bloomberg

The movement in global crude oil prices also had a minimal impact on domestic inflation as it remained contained within the range of USD75 and USD85 per barrel between September 2009 and September 2010. This relative stability reflected the adequacy of oil supplies amidst rising oil demand following the economic recovery in emerging market economies. From November 2010, however, global crude oil prices began to increase sharply as investors rebalanced their portfolio into commodities due to the perception of further US dollar depreciation and higher global liquidity.

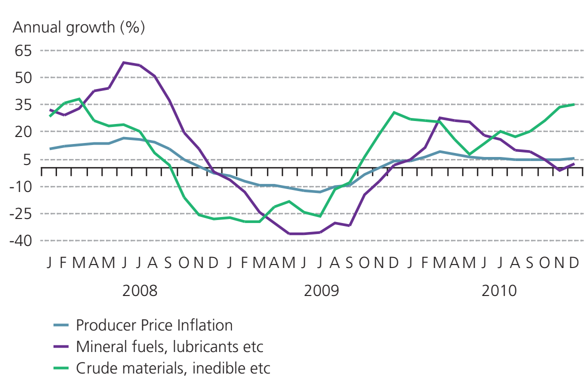
The higher inflation experienced by countries that are key sources of Malaysia's imports also contributed to the increase in domestic inflation during the year. Import partners from the emerging economies experienced higher inflation mainly on account of higher food and energy prices and stronger-than-expected recovery in domestic demand. The upward price pressures from the emerging economies, however, were partly offset by more muted inflationary pressures from the advanced economies. Most advanced economies experienced subdued demand conditions, slack capacity, sustained high unemployment and weak consumer and business confidence. External price pressures were also mitigated in part by the ringgit appreciation in 2010.

Producer prices

Producer price inflation, as measured by the Producer Price Index (PPI) rose in 2010 in line with the increase in global commodity prices. The annual change in the PPI averaged 5.6% during the year compared with a decline of

Chart 1.32

Producer Price Inflation



Source: Department of Statistics, Malaysia

-7.1% in 2009. Overall, the PPI for commodity-related components saw a significant increase of 15.4% in 2010 (2009: -20.0%). Meanwhile, non-commodity related producer prices increased at a much more moderate pace, averaging 1.6% in 2010 (2009: 0.1%).

In terms of composition, both the local and imported components of the PPI rose during the year. The annual growth of the PPI for local components increased to 7.7% in 2010 (2009: -10.4%), reflecting the effects of higher global commodity prices. Meanwhile, the PPI for imported products also registered an increase of 1.4% in 2010 compared to 0.5% in 2009.

The increase in global commodity prices during the year saw higher prices for commodity-related products of the PPI. In particular, prices for the *mineral fuels, lubricants etc*. and *crude materials, inedible* sub-categories rose by 12.8% and 22.4% respectively (2009: -22.0, -11.8) reflecting the rise in the prices of crude petroleum and crude palm oil during the year.

Determinants of Inflation in Malaysia

Introduction

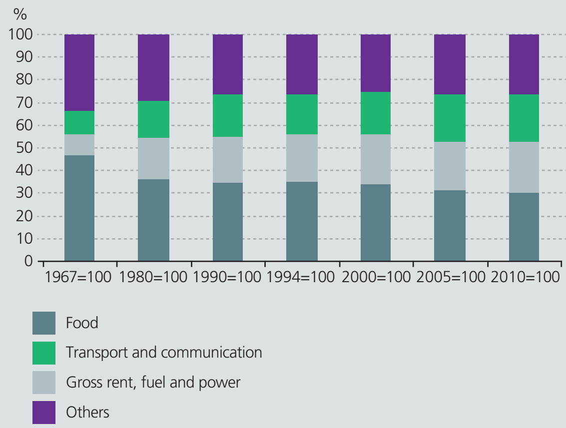
The drivers of inflation changes over time with the evolution of the structure of the economy, the behaviour of economic agents and economic cycles. This article looks at the structural determinants of inflation in Malaysia and how these determinants have evolved, the key supply and demand forces driving periods of high inflation, and concludes on the future challenges in managing domestic inflation.

Structural Determinants of Inflation

Since independence, the Malaysian economy has witnessed rapid evolution from being agriculture-based to manufacturing-driven and then to being service-based. As the economy developed and incomes grew, household expenditure patterns that underlie the Consumer Price Index (CPI[1]) have also evolved. In the early 1960s, a large portion of household expenditure was allocated to food and consequently, the item had a higher weight in the CPI basket. As the economy advanced and average income increased, the proportion of expenditure on food has decreased, while that on housing, transport and communication has risen.

Chart 1

CPI Weights



Source : Department of Statistics, Malaysia

A key feature affecting the transmission of inflation in Malaysia is the administered price mechanism. The prices of some essential goods are administered by the Government as changes in prices of these goods will have a significant impact on the cost of living for the low and middle-income group. Currently, price administered items constitute 29.3% of the CPI basket. In general, there are two types of price administered items. The first group comprises of items listed under the Price Control Act (1946), where the Government determines the retail prices for these goods. Examples of these items would be fuel and sugar. The second group are items which require Government approval for changes to be made on their prices, for example electricity tariff and public transport fares. With the administered price mechanism in place, the impact of supply shocks and external price developments on domestic prices is less direct and less immediate.

[1] The Consumer Price Index (CPI) measures the change across time in the cost of purchasing a basket of goods and services that represents the average pattern of purchases made by a particular population group across both urban and rural areas. The CPI is calculated according to 4 zones for Peninsular Malaysia (i.e. northern, middle, southern and eastern) and combined with Sabah and Sarawak to produce the Malaysia index. The Malaysia index is a composite index, weighted by regional expenditure weights of the three regional indices.

Being a small and highly open economy, domestic inflation has also been influenced by developments abroad. Global inflation moderated to historically low levels during the phase of "great moderation" whereby average inflation globally fell from 15.4% during the 1990 - 1999 period, to 3.9% during the 2000-2008 period. Changes in economic institutions, technology and business practices have improved the capacity of the economy to absorb shocks to output and inflation. For example, advances in computer technology and communications have improved the management of business inventories and allowed a reduction in costs. The shift of production to low cost centres in the emerging market economies (EMEs) also contributed to lower inflation globally. The lowering of global inflation in turn translated into lower imported inflation for Malaysia and coincided with a period of below average domestic inflation. Domestic inflation between 2000 and 2004 averaged 1.5% which was significantly below the long-term average of 2.9% (1960 – 2010).

Table 1

Price administered goods*

Price Control Act, retail price determined by the Government
Items
Food
Rice
Flour & other cereal grains
Bread & bakery products
Fresh meat
Evaporated/ condensed milk
Oils
Sugar
Non-food
Gas
Fuels & lubricants

Items where any changes in prices require Government approval
Items
Alcoholic beverages & tobacco
Beer
Wines
Spirits & liquors
Cigarettes, cigars etc
Tobacco
Housing, water, electricity, gas and other fuels
Water supply
Electricity
Communication
Telephone and telegraph services
Telephone and telegraph equipment
Postal services
Transport services
Passenger transport - rail
Passenger transport - road
Passenger transport - air
Passenger transport - sea
Other transport charges

*Classification is based on 4 digit level of the CPI

Inflation Determinants during Periods of High Inflation

Historically, at a long-term average of 2.9%, inflation in Malaysia has been one of the lowest in the region. The low inflation environment over the course of 50 years, however, was punctuated by four episodes of high inflation, that is in the mid-1970s, early 1980s, 1990s and late-2000s.

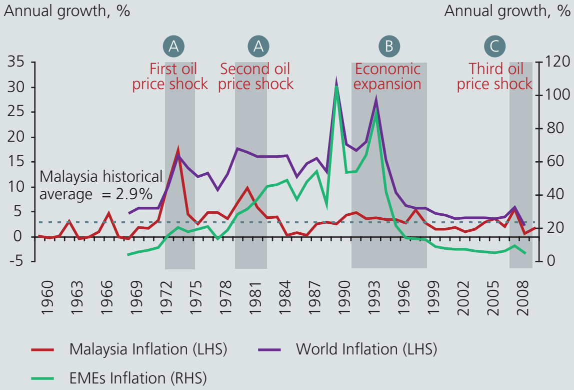
A. 1970s and 1980s : Global oil price shocks and surging food prices

The 1970s and 1980s saw significant increases in global energy and food prices due to disruptions in supply. Global oil prices rose sharply due to the Egypt-Israeli War and Iranian Revolution in 1973 and 1979 respectively. The global oil shocks resulted in domestic retail fuel[2] prices rising by 9.3%

[2] Fuel is reflected in the *transport and communication* category.

Chart 2

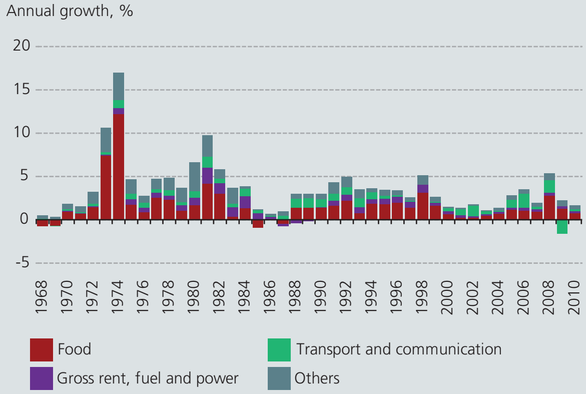
Episodes of High Inflation



Source: Department of Statistics, Malaysia and International Monetary Fund (IMF)

Chart 3

CPI by Category



Source: Bank Negara Malaysia

and 7.9% in 1974 and 1981, respectively. Global food prices rose strongly due to shortages of food supplies globally. This was a reflection of weak distribution linkages, a reduction in land for cultivation amidst urban development and industrialisation as well as adverse weather conditions. The impact was amplified by the high weight of food in the CPI basket, which was as high as 47% in the late 1960s. Food price inflation surged to double digit rates of 26.2% and 11.4% in both years mainly due to the significant increase in prices of *rice, bread and other cereals* and *fruits and vegetables* subcategories. As a result, there was a broad-based increase in domestic inflation to 17.3% and 9.7% in 1974 and 1981 respectively.

B. 1990s : Period of robust domestic demand and large capital inflows

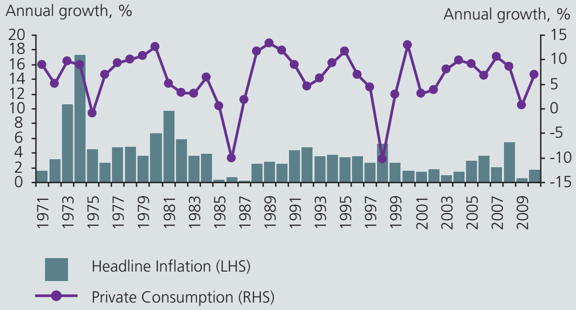
Inflation during the 1990s remained above 3%, with the exception of 1997 and 1999. Price increases were broad-based, driven by both demand and supply factors. During this period, domestic demand was particularly resilient, following robust income and employment growth. Substantial increases in the prices of property and equity, supported by strong growth in domestic liquidity and credit amid large capital inflows, led to increased net wealth and hence, supported domestic economic activity. The Kuala Lumpur Stock Exchange (KLSE) main index surged to a historical high of 1,314 points in early 1994 while the Malaysia House Price Index (MHPI) increased by an average of 7.6% per annum during the decade with a record high increase of 25.5% in 1991. As a result of the buoyant property market, average rental rates increased persistently, leading to the *gross rent, fuel and power* category of the CPI recording a 13-year record inflation rate of 4.4% in 1998.

Domestic supply factors also contributed to inflation, particularly in the *food* category. Food supply was constrained by adverse weather conditions, continued shortage of cultivated land, adjustments in administered prices by the Government, labour shortages and high capacity utilisation. Prices of the *fruits and vegetables, fish* and *meat* sub-categories increased throughout the 1990s. Inflation in the *transport and communication* category was also higher as bus and taxi fares as well as postal charges were increased.

Inflation peaked at 5.3% in 1998, reflecting rising cost pressures arising from higher import prices as the ringgit depreciated by 28.3% against the US dollar towards the end of 1997 and due to cyclical shortage of essential food items. Owing to the higher import cost, the Government increased the ceiling prices of five price administered items, namely cooking oil (5% increase), chicken (5% increase), flour (20% increase), sugar (21% increase) and milk (6% increase).

Chart 4

Inflation and Private Consumption



Source: Department of Statistics, Malaysia

C. 2000 – current : More persistent increases in global commodity prices

In the early 2000s, inflation moderated to very low levels as the demand and supply pressures that characterised the 1990s dissipated. Inflation in Malaysia, however, began rising in 2005, reaching a peak of 8.5% in July 2008. The higher inflation during this period was driven mainly by external factors, in particular, due to higher global commodity and food prices. In contrast to the supply shocks of the 1970s and 1980s, the increase in global commodity prices was underpinned by both supply and demand factors. Demand for commodities increased as emerging market economies such as the BRIC (Brazil, Russia, India and PR China) countries became more industrialised. Food prices rose on increasing use of biofuels in developed countries and increasing demand for a more varied diet across the expanding middle-class population of Asia. In addition to real demand, demand from increased speculative activity in the commodity markets also exerted upward pressures on global commodity prices as commodities became financialised amidst excess global liquidity.

At the same time, the global supply of commodities was strained. Limited land was allocated for agriculture as food producing countries shifted their focus to industrialisation. Global warming further exacerbated weather related food shortages. Geopolitical developments and concerns over disruptions to oil supply also played a role in the surge of global crude oil prices. All these events led to a broad-based increase in global commodity prices.

The sharp rise in global commodity prices and the consequent strain on Government finances due to the significant subsidy cost resulted in a series of upward adjustments in the prices of fuel products. In 2008, fuel prices increased by an average rate of 14.5% while food inflation rose to a 10-year high of 8.8%. Other than fuel and subsidised food items, the electricity tariff has also been revised upwards.

Future Challenges

Going forward, the drivers of inflation will continue to evolve in line with structural changes in the economy. As Malaysia transitions to a high value-add and higher income economy, the composition of household expenditure will also change. The inflation process could also change as a result of Government policies such as the introduction of Goods and Services Tax (GST), minimum wages and the reduction of subsidies. Domestic inflation may be more affected by external forces, especially global commodity prices, as the price mechanism gradually becomes more market driven. Supply shocks could become more persistent and may no longer be transitory as global demand for resources and food continue to rise as a result of population growth, rapid urbanisation and supply constraints. These factors suggest that the task of managing inflation would become more challenging as the same domestic and external shocks occurring today have increasingly different implications for inflation when they occur in the future.

Rise of Economic Integration in East Asia: The Malaysian Perspective

Introduction

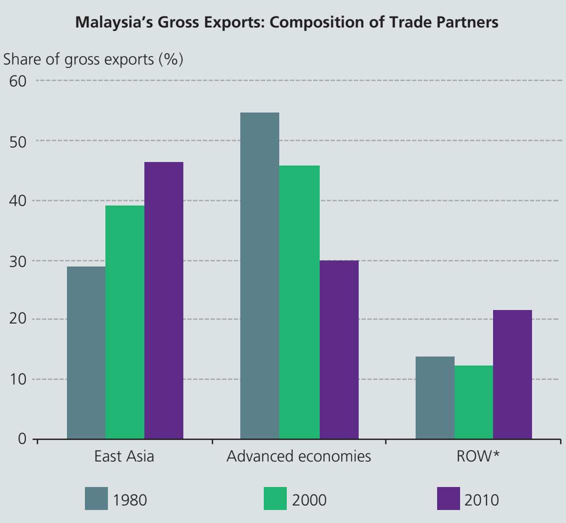
Over this recent decade, intra-regional linkages in East Asia[1] have strengthened significantly, and more recently during the global financial crisis, it has provided crucial support to the region's robust recovery. Economic integration in East Asia has been led by the vertical integration of production chains as multinational companies (MNC) seek lower-cost manufacturing facilities beyond national boundaries and capitalise on supportive local policy initiatives in foreign countries. In addition to the rising trend in shared production networks, the growing importance of domestic demand in East Asia has also spurred further economic integration in the region. This provides not only additional sources of demand for goods to economies within the region but also vast investment opportunities. As one of the most open economies in East Asia, Malaysia benefits significantly from the rising level of regional economic integration, through both the trade and investment channels.

Trade integration

In the 1980s, more than half of Malaysia's exports was channelled to the advanced economies[2] , while regional demand accounted for only 29.7% of gross exports. Following the intensification of trade integration, East Asia is currently the main export market for Malaysia, accounting for 47.7% of exports in 2010, while the market share of the advanced economies is lower at 30.1% of exports (Chart 1). Of importance, the emergence of East Asia as Malaysia's top export market illustrates the potential for the region to boost demand for Malaysia's exports as evidenced by the rebound from the recent global financial crisis. Malaysia's export growth recovered to 6.6% in the fourth quarter of 2009, supported by the strong export growth to East Asia of 25.1% (Chart 2).

Chart 1

Share of Exports to East Asia have Increased at the Expense of the Advanced Economies

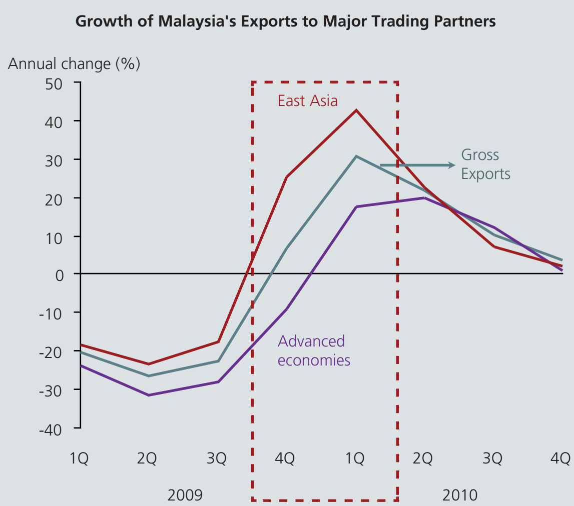


*ROW refers to Rest of the World

Source: Department of Statistics, Malaysia

Chart 2

Improvements in Export Performance Post Global Financial Crisis were Led by Exports to East Asia



Source : Department of Statistics, Malaysia

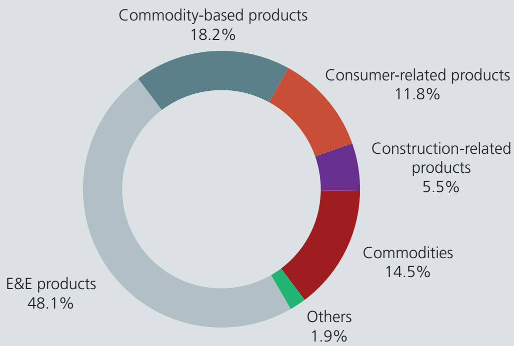
[1] East Asia refers to PR China, Hong Kong SAR, Chinese Taipei, Korea, Singapore, Thailand, Indonesia and the Philippines.

[2] Advanced economies refer to the US, euro area and Japan

Chart 3

Manufactured Exports Account for the Bulk of Malaysia's Exports to East Asia

Malaysia's Exports to East Asia by Products 2010 (RM281 billion)

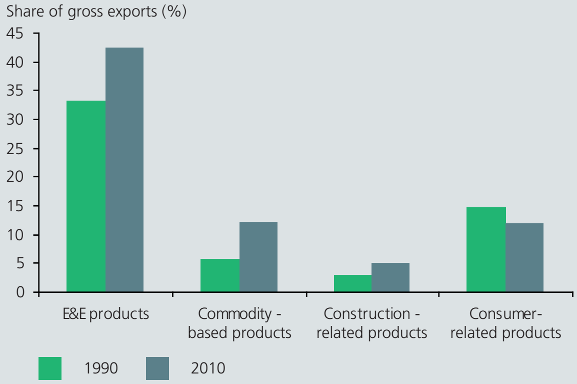


Source : Department of Statistics, Malaysia

Chart 4

Export Share Increased for All Major Manufactured Goods except Consumer-Related Products

Manufactured Exports as a Share of Malaysia's Gross Exports



Source : MATRADE and Department of Statistics, Malaysia

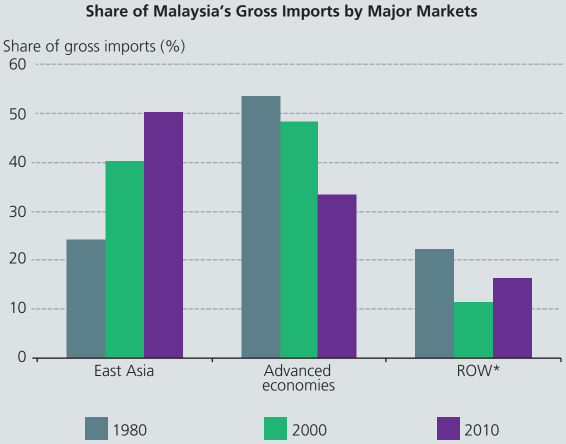
Within the regional production network, Malaysia is positioned as a producer and assembler of the parts and components of manufactured goods. This has provided impetus to the expansion in the exports of manufactured goods, which accounted for 72.1% of gross exports in 2010, compared to only 18.9% in 1980. In tandem with the region's role as the production and assembly hub for electronic and electrical (E&E) products, semiconductors as well as computer parts and components comprise the bulk of Malaysia's manufactured exports to the region, accounting for 48.1% of total exports to East Asia (Chart 3). In addition, Malaysia has also seen a significant increase in the exports of commodity-based manufactured goods, particularly chemicals and chemical products (Chart 4). This trend reflects the steady shift in Malaysia's economic activity from extracting crude commodities to manufacturing downstream products. Since 1990, the exports of commodity-based products have expanded at an annual average rate of 13.3%, supported mainly by firm regional demand. Thus, regional integration not only provides effective diversification of Malaysia's export destinations, it also creates higher demand for Malaysia's exports.

Malaysia's changing export structure has also been complemented by a diversification in import sources. The integration of production networks has led to a discernable trend, where more goods are sourced from the region instead of the traditional markets, particularly Japan. This is reflected by the rise in Malaysia's imports from the regional countries to 50.2% of total imports in 2010 from 24.3% in 1980 (Chart 5). In contrast, the market share for Japan almost halved to 12.6% over the same period (1980: 22.9%). In addition, 52.6% of Malaysia's imports of parts and components are from East Asia, compared to 44.8% a decade ago.

Although the bulk of imports continue to be intermediate goods, its share has diminished over the years (Chart 6). This has been matched by an increase in the imports of final goods. In 2010, imports of final goods accounted for 29.9% of gross imports (2000: 21.9%), consisting mainly of motor vehicles, optical and scientific instruments as well as jewellery. It is noteworthy that the imports of final goods are also increasingly being sourced from regional countries, such as PR China, Singapore and Thailand.

Chart 5

Imports are Increasingly Being Sourced from East Asia

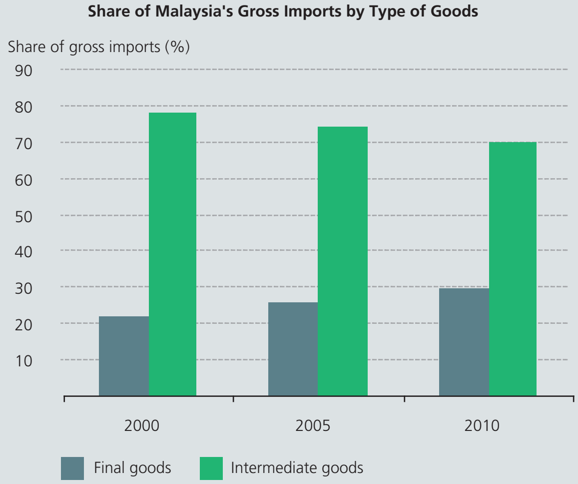


*ROW refers to Rest of the World

Source: Department of Statistics, Malaysia

Chart 6

Share of Final Goods Imports has been Increasing in Recent Years



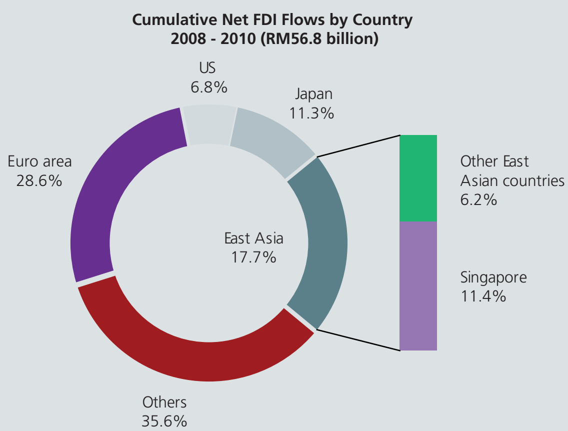
Source: Department of Statistics, Malaysia

Investment integration

Another key development in East Asia is the expansion of investment opportunities within the region. Benefiting from the vertical integration of Asia's production networks, Malaysia has also been receiving a steady rise in foreign direct investment (FDI) inflows. Following the temporary decline in 2009 given the global economic downturn, FDI flows into Malaysia resumed in 2010, amounting to RM27.6 billion. While FDI flows continue to be mainly sourced from the advanced economies, FDI flows from the regional countries have increased in recent years, accounting for almost 30% of total FDI flows to Malaysia in 2009 (2003: 10.1% of total FDI flows). Among the regional countries, Singapore is the main investor in Malaysia (Chart 7), with investments totalling RM46.2 billion as at end-2009 (51.4% of total FDI stock from the region). Similar to the trend of overall FDI flows, investments from the regional countries are also channelled mainly to the manufacturing and the finance and insurance sectors (Chart 8).

Chart 7

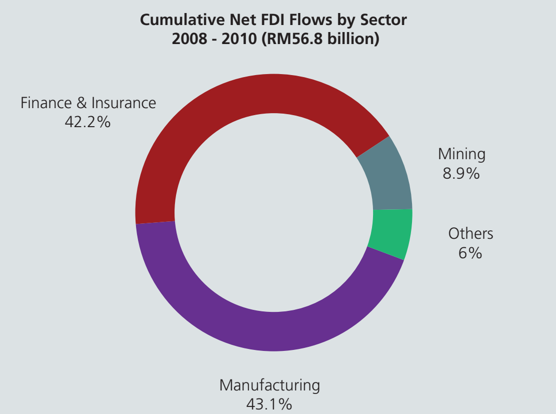
Among Regional Countries, Singapore is the Main Investor in Malaysia



Source: Department of Statistics, Malaysia

Chart 8

FDI Flows are Mainly Channelled into the Manufacturing and Services Sectors



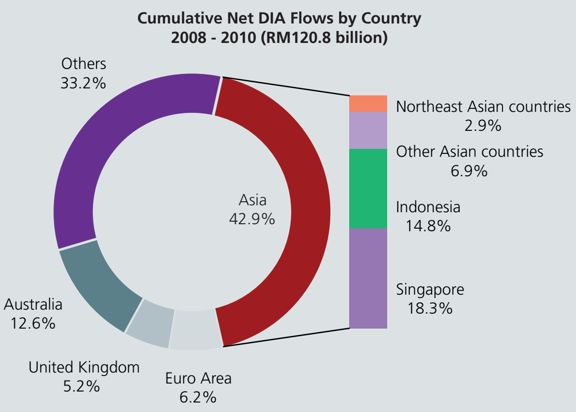
Source : Department of Statistics, Malaysia

Strong economic growth and regional integration in East Asia also intensifies competition in attracting FDIs. In particular, the emergence of lower-cost competitors in the region - notably PR China, Indonesia and Vietnam – has affected Malaysia's competitive advantage in labour-intensive industries. In this regard, foreign investments received in recent years have shifted towards higher value-added economic activities. Of significance, existing MNCs are spurred to reinvest in new production technology and high quality designs to move up the value chain. In addition, Malaysia has received a sizeable amount of new FDIs in new growth areas, such as renewable energy, aerospace, pharmaceutical and medical equipment. A large share of the new investments have also been channelled into the less capital intensive but high-skilled services sector, such as financial services and shared services operations. Although investments into the services sectors are of smaller value, they generally create a higher multiplier on the domestic economy, thereby contributing to a larger impact on domestic employment and income. In recent years, the Malaysian Government has also undertaken various initiatives to promote FDIs into high value-added sectors, in line with Malaysia's vision for private sector-driven economic growth. These measures include customising incentives for high-impact investments, introducing administrative reforms, and corporatising the Malaysian Investment Development Authority (MIDA) to facilitate foreign investors' access to the vast investment opportunities in Malaysia. Going forward, FDI inflows into Malaysia are expected to increase, given the more favourable investment climate as well as the improvement in global economic conditions.

Malaysian companies have also been actively capitalising on the opportunities arising from the deepening regional integration and the expansion in regional economic activity. Net direct investment abroad (DIA) by Malaysian companies has been increasing since 2005, and reached a high of RM50.2 billion in 2008. Of significance, a large share of DIA by Malaysian companies has been channelled to Asia, particularly the ASEAN countries (Chart 9).

Chart 9

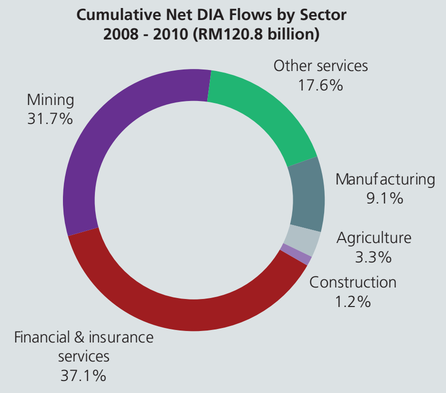
Asia Accounts for Almost Half of Malaysia's DIA Outflows



Source: Department of Statistics, Malaysia

Chart 10

A Large Share of Malaysia's Investment Abroad is in the Services Sector

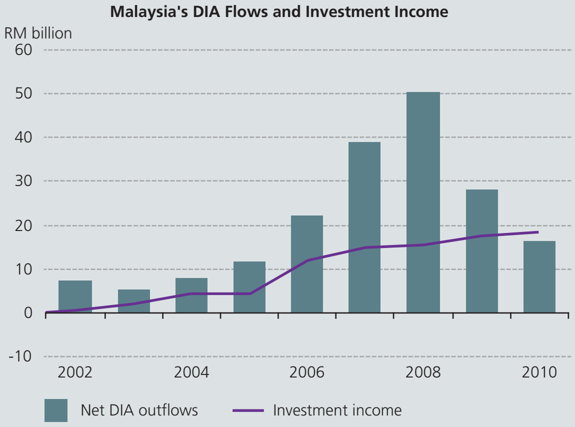


Source : Department of Statistics, Malaysia

The range of activities of DIA by Malaysian companies has also widened in recent years. In the early 1990s, DIA was undertaken mainly by Government-linked companies, particularly in the agriculture and the oil and gas sectors. However, in recent years, DIA has focused on gaining greater access to natural resources and tapping the vast opportunities in the fast growing regional economies. While the oil and gas sector continues to account for the largest share of Malaysia's investment abroad, there has been a significant rise in investments by the telecommunication and financial and insurance sectors, mainly through mergers

Chart 11

Higher Investment Income Arising from DIA



Source: Department of Statistics, Malaysia

and acquisitions (Chart 10). The direct investment by Malaysian companies contributes towards creating growth and employment opportunities in the regional economies while at the same time establishes stronger relationships between these economies and Malaysia. The expansion of DIA also benefits the Malaysian economy by developing more competitive and globalised Malaysian companies, as well as generating higher inflows of profits and dividends into Malaysia. Income accrued to Malaysian companies investing abroad doubled to RM11.9 billion in 2006, and has continued to increase since, rising to RM18.6 billion in 2010 (Chart 11).

Conclusion

The intensification of regional integration in East Asia has resulted in a broader trading base for Malaysia in terms of both markets and products. East Asia is currently Malaysia's main trading partner and a major consumer of both manufactured products and commodities. Although the advanced economies will remain an important source of final demand, the East Asian market has become an increasingly important source of external demand for Malaysia. From the investment perspective, Malaysia has strengthened its ties with regional countries through various investment ventures. In addition to receiving higher value-added FDIs that will spur Malaysia's transition into a high income economy, the increasing overseas investments by Malaysian firms will also benefit the domestic economy through the development of more competitive domestic firms. With increasing intra-regional trade and investment, the economic ties within the region will be further strengthened.

Liberalisation of Foreign Exchange Administration (FEA) to Strengthen Malaysia's Linkages with Regional and Global Economies

Over this recent five years, strong growth in intra-regional trade supported by resilient domestic demand and sustained recovery in investments have underpinned the region's performance. For Malaysia, economic flexibility has allowed the economy to adapt to the changing environment and sustained ventures into new areas of competitive advantage. Malaysia has continuously heightened its international linkages with the global and regional economies. The country has progressively liberalised its foreign exchange administration rules based on a balanced and sequenced approach that promote monetary and financial stability. Malaysia has always maintained the balanced need to ensure adequate prudential safeguards while creating a conducive business environment that enhances the competitiveness and flexibility of the economy. During this decade, a series of FEA liberalisation were implemented to enhance the competitiveness of the Malaysian economy in a rapidly globalised economic and financial environment.

Liberalisation of FEA rules to enhance competitiveness and promote cross border trade and investments

In 2010, Malaysia has further liberalised its FEA rules aimed towards achieving the following objectives:

(i) Promote international trade of goods and services using local currencies for settlement

Asia's diversification of the export markets towards increased intra-regional trade has been a critical factor to the region's rapid recovery from the recent global financial crisis. Today, intra-regional trade in Asia has increased to an average of 50% of the region's total trade as compared to 32% in 1995. Malaysia's inter-linkages with the global economy and the Asian region, in particular, has remained robust as reflected through the increase in total trade by 18.3% in 2010.

In further promoting intra-regional trade through minimising exchange rate risks and eliminating currency conversion costs, strategic initiatives have been undertaken by several countries in the region to promote the use of local currency for the settlement of trade in goods and services. Being Malaysia's largest trading partner at 12.6% of total trade, a cost effective bilateral arrangement was entered into between Malaysia and the People's Republic of China (PR China) to provide options for exporters and importers to settle international trade in the countries' respective local currencies.

Consistent with this development, flexibility was granted for the settlement of international trade for goods and services in ringgit in addition to foreign currency. With the liberalisation, resident exporters and importers were given additional choice to determine the currency of settlement for their trade in goods and services, thereby facilitating better management of currency mismatch and eliminating currency conversion costs. At the same time, PR China's decision to allow ringgit to be traded on the China Foreign Exchange Trade System will further enhance the use of local currency for settlement of international trade.

(ii) Enhance risk management

The expansion of intra-regional trade amidst challenging business environment also calls for flexible policies to support more effective risk management of trade transactions by residents. In facilitating residents to hedge their foreign currency risks in relation to trade, the remaining limit[1] applicable to anticipatory hedging on current account transactions was abolished.

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[1] Previously, residents were free to hedge on anticipatory basis for the import or export of goods and services only up to the total amount paid or received in the preceding 12 months.

The abolition is timely given the implementation of the Financial Reporting Standard 139 in January 2010 requiring companies to report financial assets and liabilities at fair value which would enhance the discipline of companies in assessing their financial exposures as it will have direct impact on their financial statements.

(iii) Facilitate accessibility to competitive financing

One of the necessary preconditions for the internationalisation and energising the private sector through the expansion of their productive frontiers is a flexible regulatory framework which promotes greater efficiency for companies to manage their financial resources through greater capital mobility.

In providing a competitive enabling environment, resident companies were accorded greater flexibility in sourcing of foreign currency financing within a corporate group which includes parent company, ultimate holding company, foreign subsidiary, branch as well as associate or sister company. This is a further extension of the liberalisation undertaken in 2008, whereby flexibility was granted for resident companies to access financing from companies within their corporate group, but only within the context of a parent–subsidiary relationship.

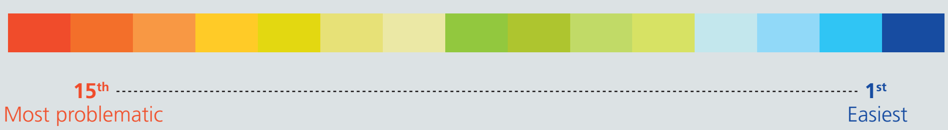
Impact of liberalisation

The continuous and progressive liberalisation of the FEA rules has contributed to a conducive environment for foreign direct investment. For 2010, foreign direct investments into Malaysia increased to RM27.6 billion from RM5 billion in 2009.

Given the progressive liberalisation of the FEA rules undertaken since 2005, FEA's ranking on ease of doing business in Malaysia has significantly improved by 11 notches from 13th place (considered as most problematic) in 2005/2006 to 2nd place (least problematic) in 2009/2010.

FEA's ranking on ease of doing business in Malaysia

	2005-06	2006-07	2007-08	2008-09	2009-10
Foreign exchange administration	13th	11th	7th	3rd	2nd



Source: Global Competitveness Report, World Economic Forum 2009/2010

2010 has also seen the upgrading of Malaysia into the Advanced Emerging market status from Secondary Emerging market status in the FTSE Global Equity Index arising from collaborative efforts amongst the relevant authorities to comply with FTSE's assessment criteria which includes flexible regulatory environment on cross border capital mobility. Malaysia's upgrading is a significant catalyst towards enlarging the market capitalisation of the FTSE Bursa Malaysia KLCI.

Policy approach in a dynamic global landscape

Amid greater global liquidity shifts and the increased potential effects of volatile capital flows which rapidly transmitted from one country to another, policy makers are faced with the challenge of developing a comprehensive and effective policy framework.

In Malaysia, the policy approach has been directed towards implementation of a flexible FEA framework that promotes real sector economic activities and enhancing the development of the domestic financial market. This approach has facilitated the economy to manage the impact of the volatile capital inflows through increased two-way flows and robust financial system to effectively intermediate the inflows and outflows through enhanced risk management and surveillance framework supported by strong corporate governance. With the current environment of heightened volatility and greater mobility of capital to this region, there is a need for greater vigilance and rigorous surveillance to avoid the build-up of excessive risks in the economy.

Regional cooperation continues to be accorded significant priority. The strengthening of regional cooperation is not only to preserve regional financial stability but also to enhance the prospects of the region as an investment destination whilst accelerating intra-regional trade. Asia is leveraging on existing intra-regional groupings and networks to forge greater cooperation and collaboration in areas of common interest, including the current platform for collaboration on capital account liberalisation for the region through the Working Group on Capital Account Liberalisation under the ambit of the Asean Economic Community.

Conclusion

Malaysia's regulatory framework will be continuously reviewed to support the country's transition into a high value-added, high income, sustainable and inclusive economy by 2020. Policy liberalisation of the FEA will provide an enabling environment in which high productivity, competitiveness and innovation will drive the country's economic transformation. The liberalisation will take into account the risks and global challenges and will be undertaken in a holistic approach, integral to the fundamental objective of achieving a financial sector which supports and drives the next phase of Malaysia's economic development. Progressive liberalisation with adequate safeguards and supported by a comprehensive and well functioning surveillance mechanism will continue to be the policy approach that will be pursued towards strategically enhancing Malaysia's linkages with global and regional economies.

Details of prudential FEA measures can be obtained from http://www.bnm.gov.my/fxadmin.

2010

MONETARY AND FINANCIAL CONDITIONS

INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

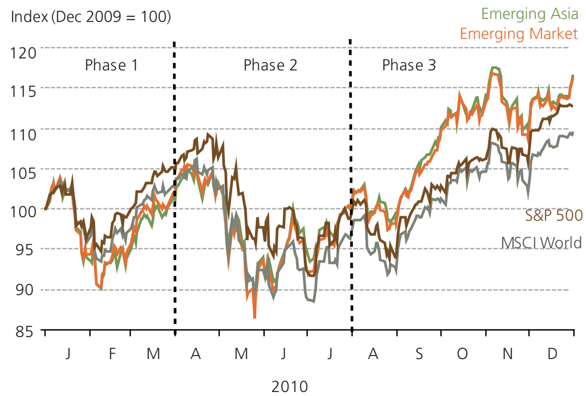
In 2010, developments in international monetary and financial conditions broadly followed three phases. In the first quarter, financial markets in both advanced and emerging economies continued the appreciating trend from 2009, building on the improvement in international economic conditions. In the second quarter, however, global financial markets entered a period of turbulence amid the escalating sovereign debt crisis in Europe and weaker growth prospects for both advanced and emerging economies. By August 2010, financial markets started to improve as policymakers in the advanced economies continued to maintain easy monetary conditions to strengthen the economic recovery. However, the sizeable injection of funds into the international monetary system, arising from this monetary easing, compounded the excess global liquidity situation, leading to a surge of capital flows into emerging economies. As a result, several emerging economies have implemented various measures to manage the risks that the large capital inflows posed for the domestic financial markets and the economy more generally.

Surge in global liquidity amplified the search for yield, leading to a sharp increase in capital flows into emerging economies

The year 2010 started on a positive note, building on the improvement in international economic and financial conditions towards the end of 2009. Global financial markets were on the uptrend, supported by accommodative monetary conditions and positive data on corporate earnings and economic activity. GDP growth in the US and several emerging economies during 4Q 2009 outperformed prior expectations. In February, the US Federal Reserve raised its discount rate by 25 basis points to 0.75%, a move seen by the markets as a first step towards unwinding the extraordinary liquidity measures implemented earlier during the global financial crisis.

Chart 2.1

Selected Equity Market Indices



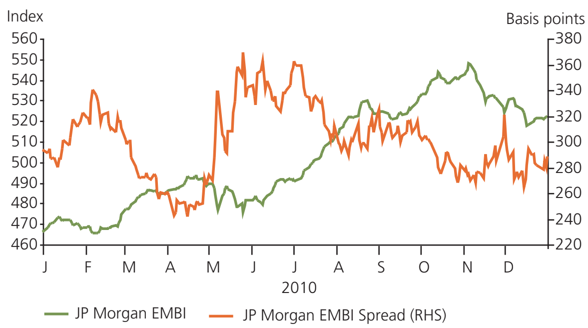
Source: Bloomberg

Despite tentative signs of recovery, it soon became clear that there were still unresolved issues in advanced economies. First, growth was far from entrenched, being driven mainly by temporary factors such as inventory restocking and policy support. Second, concerns over the fiscal positions of several peripheral European countries began to emerge, creating uncertainty in financial markets and dampening investor sentiment on growth prospects in the Eurozone.

In contrast, emerging economies showed firm signs of improvement in both the real and financial sectors. Output growth in several Asian countries outpaced pre-crisis levels. In addition to the strong rebound in equity markets, credit spreads in emerging markets narrowed, with the JP Morgan EMBI spread declining by 33 basis points in 1Q 2010. Some emerging economies started to exhibit incipient signs of overheating in the form of rapid and substantial price increases in certain asset markets, notably the property markets, as in the case of PR China, Hong Kong SAR and Singapore. The favourable outlook and the dissipation of the threat of an economic recession prompted several emerging

Chart 2.2

Emerging Market Bond Index (EMBI) and EMBI Bond Spreads



Source: Bloomberg

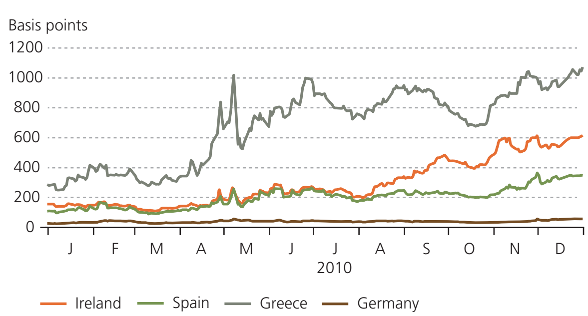
economies including PR China, India, Brazil, Malaysia and Vietnam to begin the process of normalising domestic monetary conditions.

By the second quarter of 2010, however, global financial markets began to encounter a period of turbulence. Financial conditions in the advanced economies deteriorated. The sovereign debt crisis in the euro area, which had surfaced earlier in the year, worsened considerably. Despite earlier measures to calm markets, concerns over the fiscal solvency of a number of peripheral European countries re-emerged, prompting downgrades on the sovereign debt ratings of these economies and further affecting investor confidence. Consequently, the credit default swap spreads of these peripheral countries widened significantly.

To stabilise the financial markets and improve liquidity, European policymakers embarked on a series of measures such as the creation of the €440 billion European Financial Stability Facility (EFSF) and the ECB's purchases of Eurozone government and private debt securities. Following the announcement of the EFSF, financial conditions started to stabilise. Yields on almost all euro sovereign bonds began to decline in April.

Chart 2.3

5-year Credit Default Swaps (CDS)



Source: Bloomberg

In the US, towards the end of the second quarter, there were signs that the recovery was losing traction, adding to the uncertainty and volatility of financial markets. Given the developments in the euro area and the unfavourable unemployment figures and the weaker growth prospects in the US, the threat of a double-dip recession in advanced economies became more pronounced. Additionally, the reregulation of the financial institutions after the crisis prompted a shift in investors' portfolio allocations to less risky assets. Consequently, while equity prices declined, bond yields in major developed markets fell.

Similarly, the recovery of the financial markets in emerging economies was punctuated by heightened investor risk aversion arising from developments in the advanced economies. The effects were compounded by the risk of weaker growth for emerging economies in 2H 2010 as exports were negatively affected by the slower growth prospects of the advanced economies. PR China's growth was also expected to moderate due to its policy tightening. Equity outflows from emerging markets, for example, totalled USD1.6 billion during May and June 2010[1]. The MSCI Emerging Asia and Emerging Market indices fell by 5.9% and 9.1%, respectively, during the period. This shift in funds was followed by a decline in the yield for the 10 year US Treasuries by 85 basis points while gold prices rose by 11.6%.

By August 2010, financial conditions in the advanced economies began to show signs of improvement. This improvement coincided with growing expectations that some central banks would ease monetary policy further to address concerns about the strength and sustainability of economic recovery. This expectation was later realised when the Bank of Japan and the Federal Reserve announced additional quantitative easing (QE) measures through financial asset

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

purchases of USD60 billion and USD600 billion respectively. There were also visible signs that economic conditions were starting to improve as evidenced by the increase in private consumption and better employment prospects. These factors improved investor confidence and revived financial market trading activity globally. With the global markets awash with liquidity, amid low levels of interest rates in the advanced economies, the search for yields led to a steady rise in financial and commodity markets. Between August and December 2010, the S&P 500 index rose by 19.9%. Volatility in the financial and commodity markets, as proxied by the VIX index[2], dropped significantly and returned to levels prior to the sovereign debt crisis fallout earlier in the year. The uptrend in commodity prices also accelerated, with oil prices reaching USD91 per barrel in December 2010.

The surge of global liquidity and the search for yield also led to a sharp increase in foreign portfolio investment flows into emerging economies. As a result, emerging market currencies, in particular the Chilean Peso, South African Rand and New Taiwanese Dollar, appreciated strongly against the USD by 10.6%, 10.0%, and 9.2% respectively between August and December 2010. Better growth prospects and expectations of further currency appreciations added to the interest in emerging markets. The build-up of liquidity in the domestic financial system from the surge in capital inflows, however, raised concerns over the possible formation of asset price

Chart 2.4

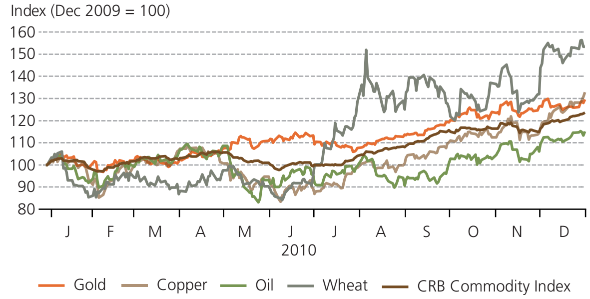
Measures of Volatility

Source: Bloomberg

[2] VIX is a measure of implied volatility of S&P 500 stock options. It represents the market expectation of stock market volatility over the next 30 day period.

Chart 2.5

Commodity Prices



Source: Bloomberg

bubbles in emerging economies. Some emerging economies, such as Indonesia, Chinese Taipei, South Korea and Brazil introduced policy measures to avoid undue risks related to the large capital flows into their domestic financial and property markets. These measures included taxing inflows, increasing the foreign exchange reserves that banks are required to hold, and liberalising outflows.

Towards year end, stronger signs of inflation began to emerge. The rapid rise in commodity prices and the increase in global food prices led to the intensification of supply driven inflation pressures. Together with the favourable outlook for growth in emerging economies, this prompted some central banks to resume the process of normalisation of monetary conditions. Bank Indonesia, the People's Bank of China, and the Reserve Bank of India began to raise policy interest rates, with several others indicating the intention to do so in the future. The pace, timing and magnitude of policy rate adjustments would, however, differ across countries and regions given the differences in the economic and financial conditions.

It is nevertheless evident that despite the recovery in economic and financial conditions towards the end of 2010, financial conditions were still very much dependent on policy support. In November 2010, Ireland sought a financial rescue package from the EU-IMF, highlighting the continued fragility of economic and financial conditions in the advanced economies. The uneven pace of economic recovery and the divergent monetary stances between the advanced and emerging economies is likely to persist. Rapid and sizeable shifts in capital flows will continue to pose a policy challenge to financial and monetary stability in emerging economies.

DOMESTIC MONETARY AND FINANCIAL CONDITIONS

Exchange Rate

The ringgit strengthened during the year. As in the previous years, the underlying trend of the ringgit continued to be driven by the positive net trade balance. Ringgit developments, however, were heavily influenced by significant two-way flows of portfolio investments arising from a combination of external and domestic factors. The large gross portfolio inflows during the year were partially offset by the large gross portfolio outflows, resulting in net inflows of RM44.9 billion. For 2010 as a whole, the ringgit appreciated by 11.1% against the US dollar, reaching to a peak of 3.0833 per US dollar on 4 November.

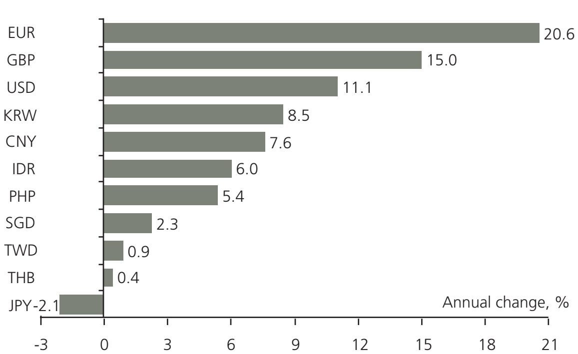
The ringgit appreciated during the year amidst volatile global financial conditions

The surge in portfolio inflows was driven by a combination of "pull" and "push" factors. The dominant "push" factor throughout the year was the expectation of a prolonged low interest rate environment in the advanced economies, which diverted the interest of investors towards higher yielding assets in emerging market economies. This was accentuated by the sizeable liquidity injection from unconventional asset purchases by monetary authorities in the advanced economies. There were also strong "pull" factors from the region due to the stronger recovery prospects and the expectations of further currency appreciation. These two factors were broadly common to all regional countries. For Malaysia, there were also specific factors. First, the Government's announcement of the New Economic Model (NEM), the Economic Transformation Program (ETP) and several other key initiatives to transform the Malaysian economy into a high income nation by 2020 has been received positively by investors. Second, strong GDP growth and the further liberalisation of foreign exchange administration rules during the year also provided the impetus for further strengthening of the ringgit.

The appreciating trend of the ringgit and other regional currencies was punctuated by a number of episodes of reversals arising mainly from global developments such as the sovereign debt and banking system concerns in Europe. Heightened uncertainties from such developments, coupled with the rapid and sizeable shifts in global liquidity from the advanced economies into emerging market economies resulted in volatility remaining elevated for ringgit and other regional currencies during the year. Two of the more significant episodes of reversals were the sovereign debt crisis in Europe in May, and the banking system concerns in Ireland in November. These events

Chart 2.6

Summary of Malaysian Ringgit Performance Against Major and Regional Currencies in 2010

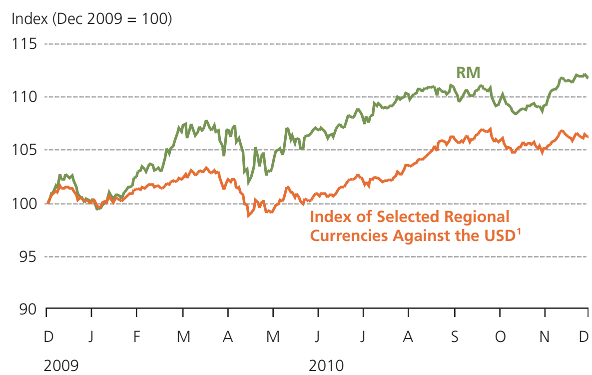


Note: (+) indicates an appreciation of the ringgit against foreign currency

Source: Bank Negara Malaysia

Chart 2.7

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



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

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

Source: Bank Negara Malaysia

coincided with net portfolio outflows from Malaysia of RM5.2 billion and RM5 billion in May and November respectively. Within the region, measures introduced by several countries to tighten monetary and credit conditions throughout the year and heightened geopolitical tensions in the Korean peninsula in November also raised concerns about possible disruptions in the regional financial markets and the overall pace of economic recovery.

Relying on the exchange rate as a tool for competitiveness is unsustainable and will harm the economy in the long run

Against other major currencies, the ringgit strengthened against the euro (20.6%) and pound sterling (15%), but weakened against the Japanese yen (-2.1%). The euro's weakness was apparent throughout 2010 amidst sovereign debt and banking system concerns in Europe. Against regional currencies, the ringgit broadly appreciated. Although the ringgit moved in line with other regional currencies, factors specific to each country led to variations in performance between regional currencies. The won was especially affected by the persistent tension in the Korean peninsula as investors withdrew funds amid concerns that a prolonged conflict could disrupt financial markets and derail economic recovery.

Chart 2.8

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

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

Source: Bank Negara Malaysia

There were some concerns that the strength of the ringgit and the volatility of exchange rates would have adverse implications on the exports sector and the economy. Given the diverse and highly open nature of the Malaysian economy, different economic agents are likely to be affected differently by changes in the ringgit exchange rate against any particular currency (*see white box 'The Impact of Exchange Rate Appreciation on Malaysia Trade'*). As global currency volatility is likely to remain elevated, firms may need to take this into consideration. Those adversely affected may need to re-strategise to become more efficient and competitive or even to venture into other opportunities. Those benefiting from the strengthened currency should seize the opportunity to further improve their competitiveness and build the necessary buffers to cope with times when the situation reverses. Using exchange rate as a tool for competitiveness is very risky and unsustainable and will harm the economy in the long-term as it might create distortions, causes imbalances and lead to trade protectionism. Therefore, orderly foreign exchange market conditions that avoids excessive volatility in the ringgit exchange rate is an important policy objective of the Bank.

Interest rates, bond yields and equity prices

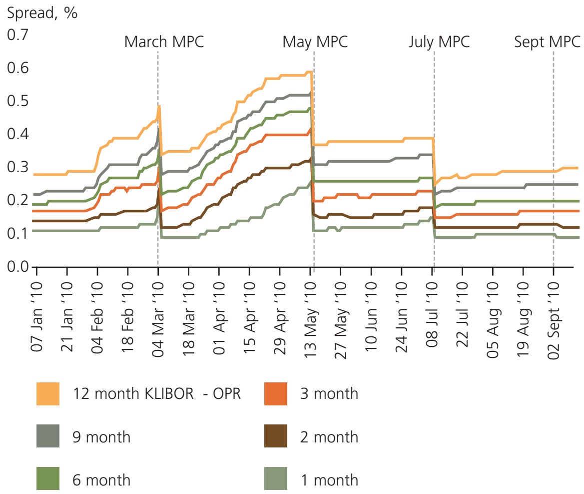
Interest rates rose in 2010 from historic lows due to the Bank's decision to normalise monetary conditions to prevent the risk of financial imbalances that could undermine the recovery process. The Overnight Policy Rate (OPR) was raised on 4 March, 13 May and 8 July, by 25 basis points each time, bringing the cumulative OPR adjustments for the year to 75 basis points. This was half of the 150 basis points cut in the OPR undertaken in 2008/09 to support domestic demand during the global financial crisis. As such, although retail lending rates rose following increases in the OPR, they are still at levels that support domestic demand and economic recovery.

Interest rates were normalised to prevent the risk of financial imbalances, but has remained below pre-crisis levels in 2010

Following the OPR increase, the overnight interbank rate in the money market rose from 2.00% on 1 March 2010 to 2.71% on 9 July 2010.

Chart 2.9

KLIBOR – OPR Spread



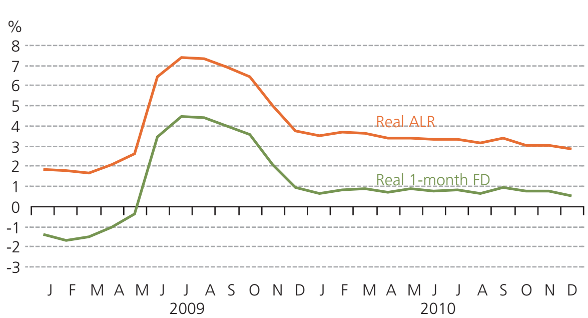
Source: Bloomberg

Interbank rates of other tenures also increased. KLIBOR rates rose in line with market expectations of higher interest rates. Notably, the spread between KLIBOR rates and the OPR increased in anticipation of interest rate increases at the March, May and July Monetary Policy Committee (MPC) meetings, and were relatively stable prior to the September MPC meeting when Bank Negara Malaysia paused raising the policy interest rate. This reflected the clear signal by the MPC that the prevailing level of the OPR was appropriate.

As intended by the MPC, the increase in the OPR resulted in retail deposit rates being revised upwards. Interest rates on fixed deposits increased by between 47-77 basis points. Given the modest inflation in 2010, depositors earned positive real returns on their savings throughout the year.

Chart 2.10

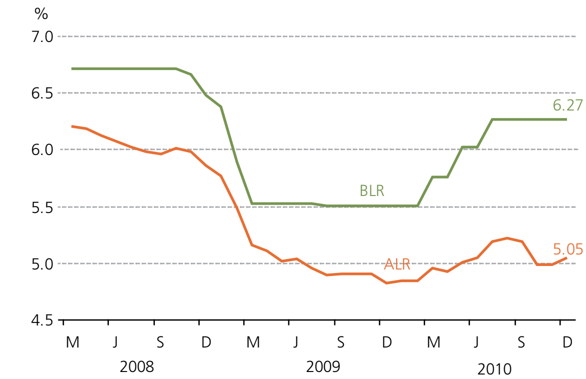
Real Deposit and Lending Rates



Source: Bank Negara Malaysia

Chart 2.11

Commercial Banks' Lending Rates (at end-period)



Source: Bank Negara Malaysia

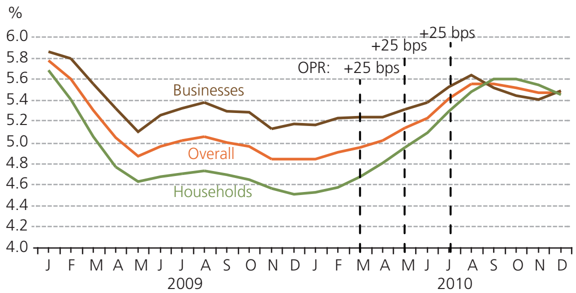
Reflecting the high pass-through of the OPR hikes to money market interest rates, banks responded by increasing retail lending rates to households and businesses. The benchmark lending rate, as measured by the average base lending rate (BLR) of commercial banks, increased by 76 basis points to 6.27%, as at end-July 2010. The adjustment in the BLR was prompt, with all banks increasing their respective BLRs within 6 days of the OPR adjustments.

Accordingly, lending rates on new loans were also revised. This was evidenced by the 78 basis points increase in average lending rates (ALR) on new loans approved, from 4.91% at end-February to 5.69% at end-August. The increase in lending rates on new loans was more pronounced in the household sector, which registered higher lending rates for all purposes, with the exception of credit cards, ranging between 63–95 basis points. Businesses also incurred higher cost of borrowing post normalisation. However, the magnitude of the increase was more modest as some businesses benefited from improved credit worthiness and lower risk premiums as economic conditions continued to improve in 2010.

Nevertheless, the cost of financing to businesses and households remained supportive of economic activity. Despite the increase in interest rates, retail lending rates remained below pre-crisis levels. Specifically, nominal retail lending rates to businesses remained on average 61 basis points below pre-crisis levels, as at end-December 2010. Similarly, lending rates to households were lower than pre-crisis levels by 38 basis points.

Chart 2.12

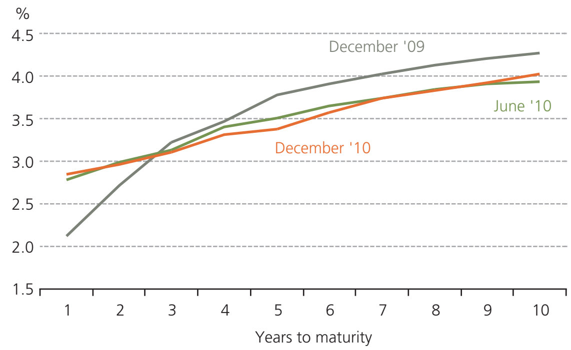
ALR on New Loans Approved (3-month moving average)



Source: Bank Negara Malaysia

Chart 2.14

MGS Benchmark Yield Curve



Source: Bank Negara Malaysia

The benchmark Malaysian Government Securities (MGS) yield curve flattened in 2010, as the short-term and long-term yields showed divergent trends. Yields on bonds of shorter maturities (1-year and below) increased in response to the normalisation of the OPR, similar to the money market and retail lending rates. The pass-through was almost one-for-one, with yields on the 1-year MGS increasing by 74 basis points from January to end-July 2010. By contrast, long-term yields declined in 2010 despite the increase in the OPR on strong demand for MGS, especially from non-residents. In addition to expectations for ringgit appreciation and the search for yield, demand was also supported by benign inflationary expectations.

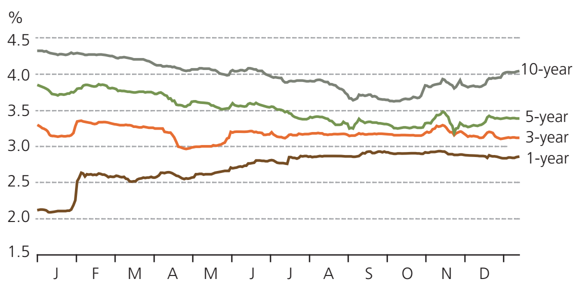
Non-resident holdings of domestic bonds in 2010 rose to RM121 billion from RM69 billion in 2009, accounting for 15.6% of total outstanding bonds at end-December 2010. Overall, yields on the 5-year and 10-year MGS for the year declined by 40 and 25 basis points respectively. This contributed to reducing the overall borrowing costs in the debt market, as corporate bond yields are benchmarked against MGS yields.

> The benchmark yield curve flattened in 2010 and helped reduced borrowing costs as corporate bonds were benchmarked against long-term MGS yields

Although yields were lower by the end of the year, there was a clear upward drift in long-term yields on expectations of higher Government borrowings

Chart 2.13

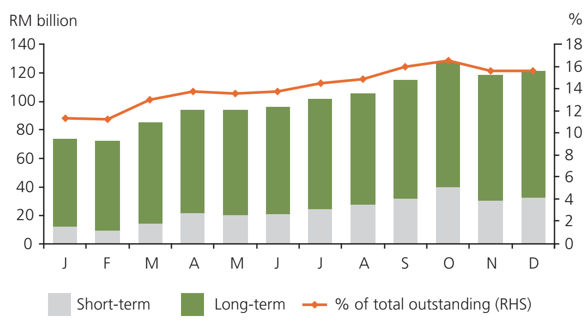
MGS Yields in 2010



Source: Bank Negara Malaysia

Chart 2.15

Outstanding Debt Securities Held by Non-residents in 2010



Source: RENTAS, Bank Negara Malaysia

in 2011 following the announcement of Budget 2011 in October. At the same time, rising global inflationary expectations due to higher commodity prices also contributed to the higher yields. From 15 October to end-December 2010, yields on the 10-year MGS recorded an increase of 37 basis points. On the other hand, short-term yields were largely unaffected by the Budget 2011 announcement, reflecting the lower maturity risk associated with short-term debt securities.

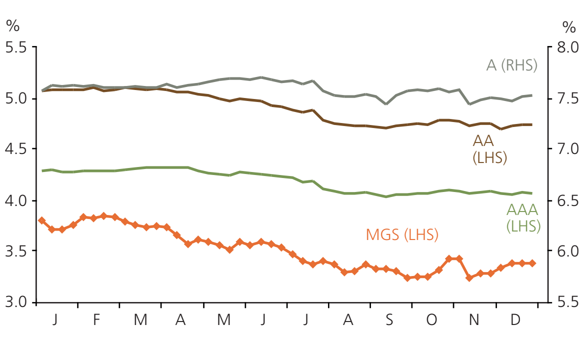
Cost of PDS financing remained low as yields declined following positive sentiment on the prospects for the economy

In the private debt securities (PDS) market, financing costs were kept low, as PDS yields are typically benchmarked against long-term MGS yields. While PDS yields were generally unchanged in the first half of 2010, yields declined in the second half of the year in line with the decrease in benchmark yields. The 5-year AAA and AA rated papers both declined by 17 basis points, while A rated papers declined by 14 basis points.

Sentiment in the PDS market continued to improve in line with the strength of the domestic economy, as evidenced by the improved liquidity conditions. Turnover in the PDS market increased to RM89.3 billion in 2010, from RM59.9 billion in 2009. In addition, the number of negative ratings actions declined substantially to 106 in 2010 from 170 in 2009. The improved conditions in the PDS market also helped ensure a conducive environment for debt financing in 2010.

Chart 2.16

5-year MGS and 5-year PDS Yields in 2010



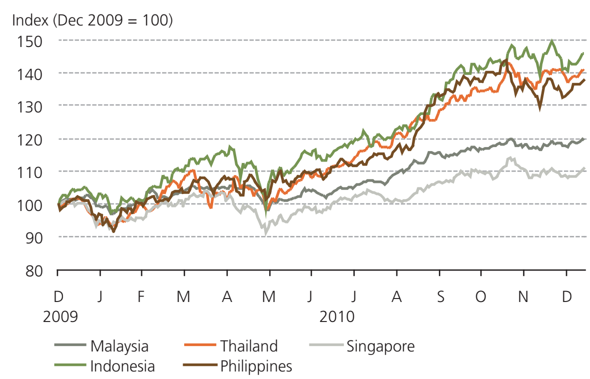
Source: Bank Negara Malaysia

The FBM KLCI recorded significant gains amidst stronger corporate earnings, robust economic growth and portfolio inflows

The domestic equity market rose steadily in early 2010, supported by stronger corporate earnings, robust economic growth and portfolio inflows. Similar to other regional markets, Malaysia experienced greater inflows given its more attractive growth trajectory. By May, however, global market sentiments were affected considerably by the developments in Europe. Subsequently, the benchmark FTSE

Chart 2.17

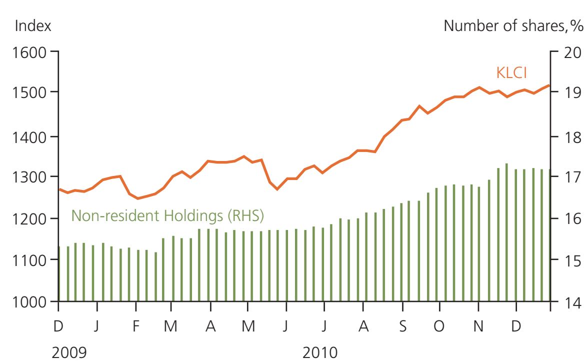
Regional Indices



Source: Bloomberg

Chart 2.18

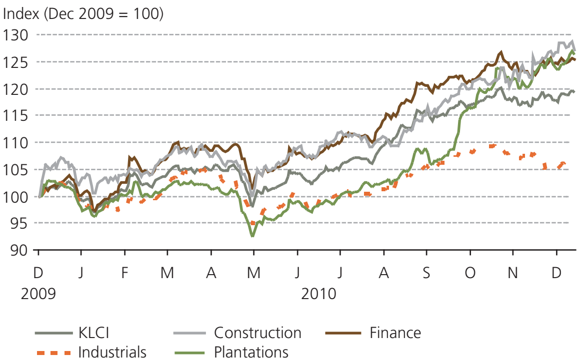
Shares Held by Non-residents in the KLCI



Source: Bursa Malaysia

Chart 2.19

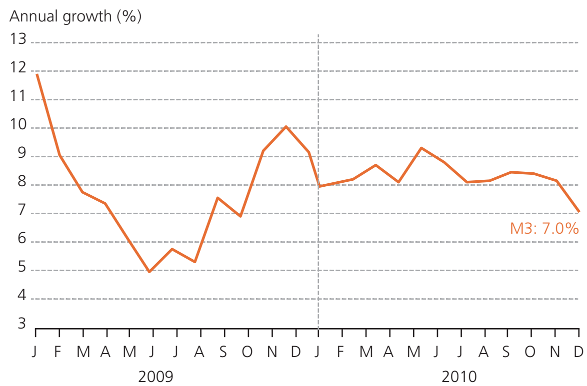
KLCI and Bursa Malaysia Sectoral Indices



Source: Bloomberg

Chart 2.20

Broad Money, M3



Source: Bank Negara Malaysia

Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) underwent a correction, as did other regional markets.

The FBM KLCI resumed its rise in the second half of the year as global market conditions stabilised, supported by increased non-resident purchases. This was driven mainly by expectations of a firmer ringgit, amidst a positive reception to the further liberalisation of the foreign exchange administration rules announced in August. Meanwhile, the search for higher returns in emerging economies, including Malaysia, was amplified by expectations and the eventual implementation of a second round of quantitative easing by the US Federal Reserve. Equity prices were further boosted by strong sectoral performances, with rising earnings of plantation companies due to higher commodity prices, while construction-related stocks benefited from the announcement of several major Economic Transformation Programme (ETP) projects. Several Government initiatives to increase the velocity and liquidity in the local index, such as the divestment of Khazanah Nasional Berhad shareholdings in major companies, also provided additional impetus to the market. In 2010, the FBM KLCI rose by 19.3% (2009: 45.2%).

Liquidity and Monetary Aggregates

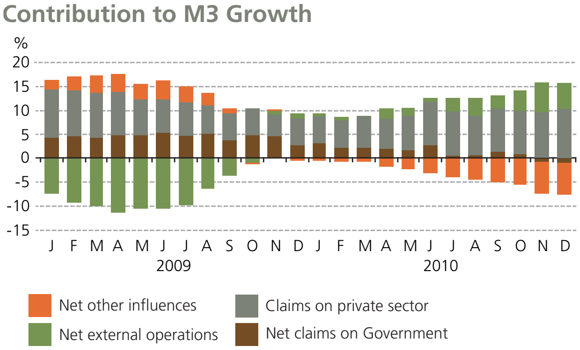
Liquidity conditions in the banking system were ample throughout 2010. The private sector liquidity expanded at a measured pace, in line with real economic recovery and resumption of foreign inflows. Notably, the normalisation of the OPR and consequent upward adjustments in retail lending rates did not dampen private sector liquidity expansion.

Private sector liquidity, as measured by broad money (M3), expanded at a measured pace of between 7.0% and 9.3% throughout the year. The main factor underpinning the expansion in broad money was higher credit extension by the banking system to businesses and households. Private sector liquidity also increased as a result of the higher foreign capital inflows. The expansion in M3, however, was partially mitigated by withdrawals of deposits by the private sector for the purchases of Bank Negara Monetary Notes (BNMNs). This was reflected in the moderation of "net other influences".

In the banking system, ample liquidity conditions prevailed at both the market and institution levels. All banks operated from a position of surplus liquidity with net placements of funds with Bank Negara Malaysia. The large number of banking institutions with surplus liquidity also implied that

Chart 2.21

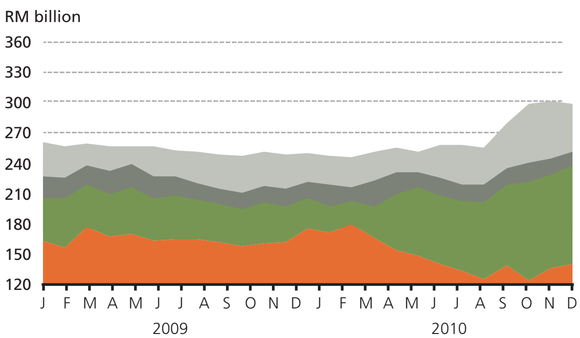
Contribution to M3 Growth



Source: Bank Negara Malaysia

Chart 2.22

Outstanding Liquidity Placed with BNM (at end-period)



Source: Bank Negara Malaysia

the Malaysian banking system had a low reliance on wholesale funding.

Bank Negara Malaysia conducted operations in the interbank money market to manage the surplus liquidity. Large foreign inflows of liquidity in the second half of the year were sterilised by the Bank to avoid overly expansionary liquidity conditions. This was achieved through the use of a wide range of monetary instruments in the Bank's sterilisation operations, including direct borrowing, repos and the issuance of BNMNs.

FINANCING OF THE ECONOMY

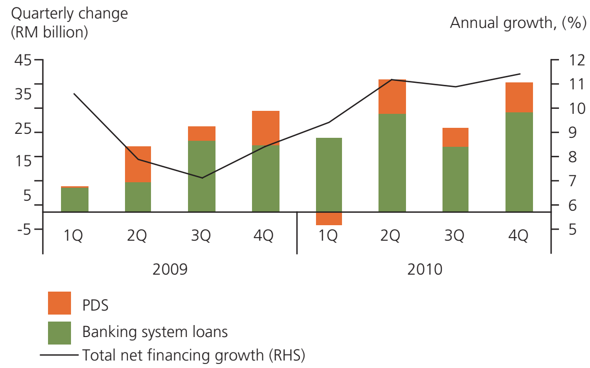
In 2010, financing conditions remained conducive and supportive of economic activity. The easy access to financing, relatively low cost of borrowing and ample liquidity in the financial system supported the demand for financing from both the private and public sectors.

Financing expanded by 11.3% in 2010 driven by the economic recovery and supported by accommodative financing conditions

Growth of private sector financing, which has been on an uptrend since the second half of 2009, picked up speed in the first half of 2010. The trend was in tandem with the strong economic recovery recorded during the period. Financing growth subsequently

Chart 2.23

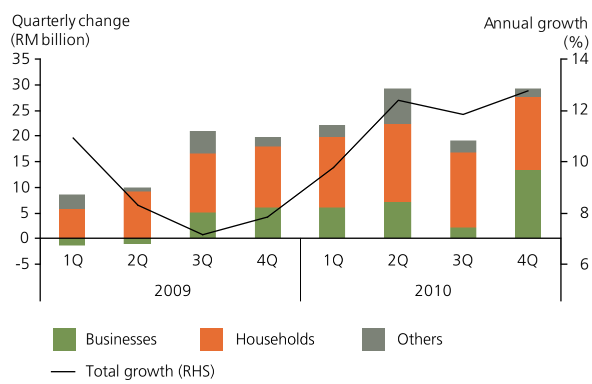
Total Net Financing to the Private Sector through Banking System Loans and PDS



Source: Bank Negara Malaysia

Chart 2.24

Loans Outstanding by Customers



Source: Bank Negara Malaysia

stabilised at 10% as economic activity moderated toward the second half of the year. For the year as a whole, net financing raised by the private sector through the banking system and the capital market expanded by 11.3% (2009: 8.4%). In terms of sectors, the expansion in financing during the year was broad-based with strong demand from both the business and household sectors.

Total financing to the business sector improved, growing by 8.4% in 2010 (2009: 6.3%), with financing extended mainly to the *finance, insurance and business services; manufacturing, real estate; wholesale, retail, restaurants and hotels (WRRH)* and *electricity, gas and water supply* sectors. Banking system loans to businesses expanded by 9.4% in 2010 (2009: 3%). The buoyant demand for financing by businesses was underpinned by improved sales and investment. The increased business activity resulting from higher domestic demand led to more loans being disbursed for the purpose of working capital, increasing at an annual rate of 11% (2009: -1.4%). Loans disbursed for investment purposes also expanded, in particular, for the *purchase of non-residential property* and *transport vehicles*, increasing by 50.5% and 48.8% respectively in 2010 (2009: -10.8% and -4.1%). Corporate expansion activity, especially merger and acquisitions in the *finance, insurance and business services* sector was a further catalyst to financing activity in the second half of 2010. The *manufacturing* sector, however, showed a moderation in its demand for loans, especially for working capital purposes, in the second half of the year. This reflected mainly slower production amidst weaker external demand.

Meanwhile, loans to the household sector increased further by 13.4% in 2010 (2009: 9.8%), with more loans being extended for the *purchase of residential and non-residential properties*; *purchase of securities, passenger cars, personal loans* and *credit cards*. The expansion in household loans reflected the strong growth in consumption expenditure, which in turn was driven by the steady increase in incomes of households, because of stable employment prospects and rising wages. For property loans, in addition to the attractive interest rates, the higher demand was supported by pent-up demand. In November, the Bank announced the implementation of a maximum loan-to-value (LTV) ratio applicable to the third and subsequent house financing facilities taken out by a borrower. The measure aimed at moderating the excessive investment and speculative activity in specific locations of the residential property market.

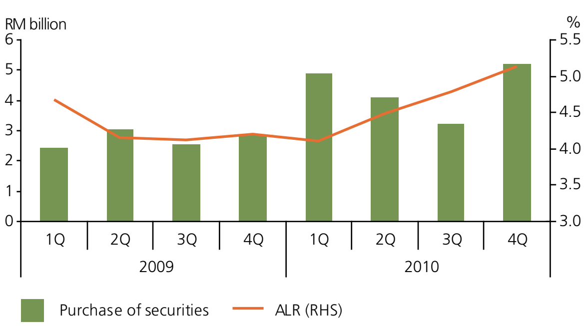
Loan applications for the purchase of passenger cars also continued to increase as households locked-in borrowings at relatively lower rates. This was further supported by the introduction of several new popular car models and other attractive offers for new car buyers.

Notwithstanding the strong financing growth in 2010, there was limited evidence of credit growth being excessive. The overall level of household indebtedness remained at a prudent level. This was supported by the improved capacity of households to absorb adverse shocks, despite the growth in debt levels. Household liquid financial asset to debt ratio increased from 150.9% at end-2009 to 153.9% at end-2010. The ratio of non-performing household loans (NPL) was also low at 2.3% (end-2009: 3.1%). While there was an initial increase in loans extended to individuals for the purchase of securities, mainly to finance the purchase of Amanah Saham Bumiputra (ASB), it moderated subsequently following the normalisation in interest rates. The demand for personal loans also moderated in the second half of the year given the higher lending rates.

In the private debt securities (PDS) market, although the total new issuances were lower in 2010 (2010: RM52.1 billion; 2009: RM58.6 billion), funds raised to finance new investments increased to RM13.5 billion (2009: RM8.7 billion). The PDS issuances were dominated largely by firms in the financial sector. The funds raised in the equity market amounted to RM32.1 billion (2009: RM26 billion). The larger funds raised reflected issuances of several large initial public offerings (IPOs) in line with improved market sentiments.

Chart 2.25

Loan Applications and ALR on New Loans Approved for the Purchase of Securities

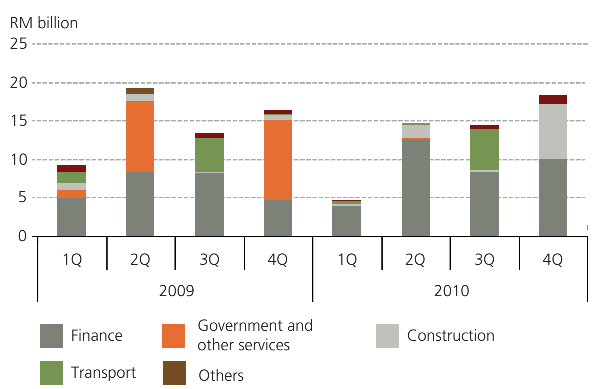


Note: The higher loans in 4Q reflected borrowing for the subscription of two new IPO listed in end-2010

Source: Bank Negara Malaysia

Chart 2.26

Gross PDS Issued by Sector



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

Source: Bank Negara Malaysia

The Impact of Exchange Rate Appreciation on Malaysian Trade

In 2010, the ringgit appreciated by 11.1% against the US dollar. Given that the US dollar is a key currency used globally to conduct trade and investment, this box article discusses how the appreciation would impact the Malaysian economy. The United States is Malaysia's fourth largest trade partner and accounts for 10%[1] of total trade. In this regard, the real effective exchange rate (REER)[2] is a better gauge of Malaysia's overall competitiveness as it takes into account changes in Malaysia's competitiveness vis-à-vis all of Malaysia's major trading partners and not just the United States. By this measure, the REER appreciated by a more moderate rate of 5.9% in 2010. The moderate REER appreciation has allowed the economy to better absorb and adjust to the stronger ringgit exchange rate.

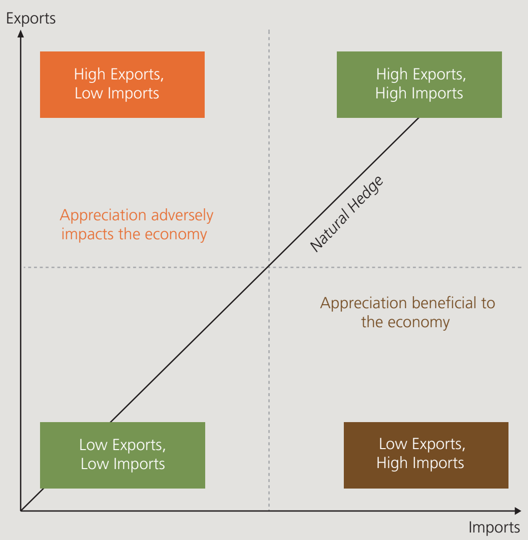
The sectoral impact of ringgit appreciation on trade

The very nature of international trade, which includes both importers and exporters, results in both those who are advantaged and disadvantaged when a currency appreciates or depreciates. Generally, export-dependent sectors in competitive international markets tend to be adversely affected by an exchange rate appreciation. The extent of the impact, however, depends on whether the decline in their exports proceeds can be offset by cheaper imported inputs. When the ringgit appreciates, firms that rely more on export revenue but source their inputs locally (i.e. pay in ringgit) will face a more significant impact on their profit margins. This is especially the case if these firms are price-takers in the international markets. In contrast, firms that source their inputs from abroad but supply the final product domestically will gain from a strong ringgit.

On a relative basis, given the manufacturing sector's large contribution to total output, the sector appears to be most affected as more than 50% of the sector is export-oriented. As Malaysia is part of the global manufacturing network, a majority of Malaysia's manufacturers import raw and processed materials and turn them into intermediate goods before exporting them to another destination for further processing or final consumption. Due to such production linkages, there is a strong co-movement between exports and

Chart 1

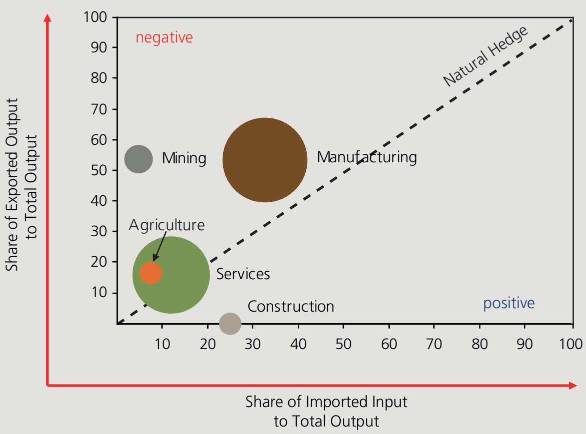
Gainers and losers of exchange rate appreciation



Source : Bank Negara Malaysia

Chart 2

Relative importance of exports and imports by sector



Notes : 1 Derived from the 2005 input-output table
2 Bubble represents sector's output relative to total output of the economy (RM1.6 trillion)

Source : Bank Negara Malaysia

[1] As at December 2010

[2] Refers to the weighted average of the ringgit against the currencies of Malaysia's major trading partners, adjusted for differences in inflation rates.

imports, which in turn makes trade more responsive to global demand rather than to ringgit performance alone. The close co-movement between exports and imports also broadly serves as a natural hedge for manufacturing firms, thereby limiting the overall impact of exchange rate movements.

The construction sector, on the other hand, stands to gain the most given that it is domestic-oriented. All of its output is priced and consumed domestically, with some of the inputs sourced from abroad. The lower cost of imported inputs, together with stronger demand for properties in domestic markets, has helped construction firms to register stronger operating surplus during the year.

The overall impact on the services sector is broadly balanced. The majority of industries in the services sector will benefit from an exchange rate appreciation given the high import content and limited reliance on exports. The positive impact, however, is partly offset by the adverse effects on the business services industry, as shared services and outsourcing mostly involve exports of services, driven mainly by the Multinational Corporations (MNCs) in Malaysia. These MNCs mostly source inputs domestically in ringgit and export their services internationally in foreign currency.

To assess the overall impact of ringgit appreciation on the economy, Bank Negara Malaysia conducts regular surveys to compile views from various industry players. In a survey conducted in 4Q 2010 that covered 177 companies[3], 38% of the respondents indicated that the appreciation did not have a significant impact on their profit margins. Another 34% of the respondents indicated that the ringgit appreciation would have some adverse impact on their profit margins, while 28% indicated a more favourable impact on their profit margins.

The survey also showed that should the ringgit appreciate further, the impact on industry players are expected to be broadly contained. The majority of respondents suggested that the impact would be either favourable or neutral. Nevertheless, about 35% of respondents indicated an adverse impact on their profit margins arising from further ringgit appreciation.

Implications for businesses

With challenges, come opportunities. While ringgit appreciation could result in some firms facing a decline in profitability, it does open up other growth opportunities. In particular, cheaper costs of imported inputs and capital would facilitate firms' transformation from labour to capital intensive production, which could

Chart 3

Quarterly sectoral survey 4Q 2010: Impact of ringgit appreciation on profit margins

Source: Bank Negara Malaysia

[3] Manufacturing (109), Non-financial services (43), Construction (25)

enhance firm productivity and ultimately profitability. Increased productivity would encourage firms to pay higher wages and promote a more vibrant labour market with a larger pool of highly skilled workers. Higher wages in turn, would empower domestic consumption and open up more opportunities for non-tradable sectors to flourish. This would eventually facilitate the reorientation of the Malaysian economy from being trade-dependent towards one that is driven mainly by domestic demand.

In the medium to long-term, businesses should evaluate whether the strategies being pursued are sustainable and robust to changing circumstances. In the short-term, those adversely affected should undertake steps to hedge their foreign currency exposure. They may also need to re-strategise or even venture into other opportunities. As exchange rate movements are transitory in nature, those benefiting should not be complacent and rely on either a stronger or weaker ringgit, but should instead improve their operations further to cope with the more challenging times when the situation reverses.

Conclusion

The recent ringgit appreciation impacted various sectors differently. While the impact on the broad economic sector was either neutral or positive, there were some sectors that were adversely affected. For a highly open economy like Malaysia, with trade in 2010 accounting for 157.8% of GNI, such an outcome is expected. In this regard, the uncertain external environment makes exchange rate volatility unavoidable. Subject to global conditions, the ringgit would continue to strengthen as the underlying economic fundamentals continue to improve. The Bank will focus on maintaining orderly market conditions and ensuring that the ringgit is aligned with economic fundamentals. Businesses, on their part, must be prepared to adapt to the changing environment, taking into account that such changes in relative prices, if sustained, are a signal for a shift in real resources out of sectors with declining comparative advantage into sectors offering new opportunities with strong comparative advantage.

2010

MONETARY POLICY IN 2010

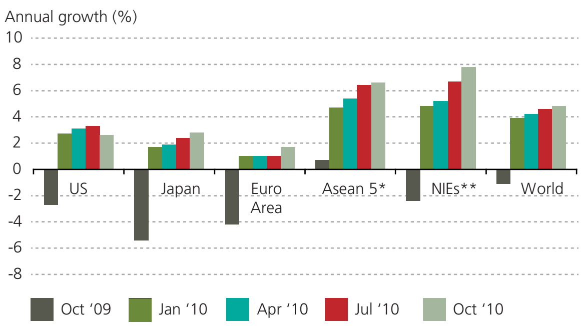
MONETARY POLICY

The Malaysian economy experienced a strong resumption of growth in 2010, driven by a robust expansion in private consumption and a rebound in private investment. In tandem with the improvement in the domestic economy, the focus of monetary policy in 2010 shifted away from the need to avert a fundamental economic downturn, and turned towards balancing the risks to inflation and growth, while ensuring that monetary conditions were appropriate to prevent the build-up of financial imbalances.

At the beginning of the year, economic indicators were signalling that the global recession was receding. Global growth was being led by a rebound in manufacturing and an upturn in the inventory cycle. Signs of improvement were evident from retail sales, consumer confidence, and the housing markets. World trade was also beginning to pick up. The change in outlook was reflected by the significant upward revision to the 2010 global growth forecast by the IMF in its January 2010 update of the World Economic Outlook (WEO). Meanwhile, economic performance of the emerging market economies, including Malaysia, was expected to improve more significantly than the advanced economies given the more resilient fundamentals relating to their economies and financial systems.

Chart 3.1

Outlook for Real GDP Growth in 2010



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

Source: IMF, WEO October 2009, January, April, July and October 2010

In the domestic economy, economic indicators suggested that the economy had started to grow again since the fourth quarter of 2009. Positive developments in manufacturing production, financing activity, external trade and labour market conditions reaffirmed the assessment that the economic recovery was gaining strength. The economy was expected to expand further during the course of 2010, with growth being supported by strengthening domestic demand, particularly private consumption, and further improvements in external demand.

With the improvement in economic outlook, the need to normalise the extraordinary monetary stimulus became the focus of the MPC during the early part of the year

Meanwhile, inflation was expected to rise gradually but remain low throughout the year. Measures of core inflation and demand indicators suggested the potential emergence of demand induced inflation later in the year, in line with the recovery in demand conditions. Demand related pressures on inflation, however, were expected to remain relatively modest. The risk to inflation was more likely to originate from supply-side factors, namely the increase in global commodity prices as global demand improved and the expected adjustments to administered prices that were undertaken under the subsidy rationalisation programme. These supply-side factors, however, would not warrant tighter monetary conditions unless they led to signs of persistent and wide spread second-round effects.

Against this backdrop, the need to normalise the extraordinary monetary stimulus undertaken in 2009 became the focus of the Monetary Policy Committee (MPC) during the early part of the year. Leaving the Overnight Policy Rate (OPR) at such a low level could give rise to financial imbalances and create distorted incentives for economic agents, leading to the mispricing of risks, financial disintermediation and excessive credit growth *(See white box on 'Financial Imbalances and the Role of Monetary Policy')*. Ignoring such risks could lead to undesirable effects on the broader economy when such financial imbalances unravel in a disorderly manner. The policy focus, hence, was to assess the appropriate timing and pace for the process of monetary policy normalisation. With the economy still at a nascent stage of recovery, the challenge was in ensuring that raising interest rates would not disrupt the sustainability of private sector demand in driving economic growth.

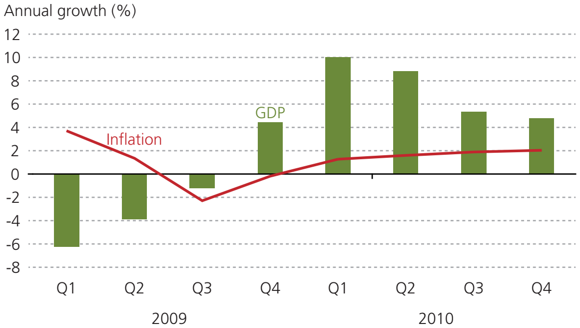
Incipient signs of the economic recovery being firmly entrenched allayed this concern. Compared to 2009, it was clear that the extraordinary conditions under which interest rates were reduced no longer prevailed. Forward looking indicators suggested stronger economic recovery ahead, while engagements with key industry players revealed more confident sentiments toward the economy. This assessment was affirmed in February 2010 when the numbers for 4Q 2009 showed a stronger growth performance of 4.4%.

The MPC was mindful that if interest rates continued to be held at very low levels for a sustained period, they could lead to financial imbalances. This was a key lesson from the experience of the industrial countries at the heart of the recent global financial crisis. A prolonged period of low interest rates discouraged savings, led to excessive borrowing, overinvestment in housing, and when combined with unchecked financial innovation, led to large investments in risky financial products. In essence, the following are the main considerations with regard to the normalisation of monetary policy. First, monetary policy must be adjusted pre-emptively to avoid the build-up of financial imbalances. Raising interest rates when financial imbalances have already permeated into the economy would not be effective. Second, the monetary policy stance needed to be recalibrated given that the threat of a fundamental recession was no longer present. The extraordinary amount of monetary stimulus provided in 2009 was no longer warranted as indicators showed growth becoming more entrenched led by the strong growth of private sector demand. Notwithstanding this need to normalise interest rates, it was recognised that monetary policy needed to remain accommodative to support the ongoing economic recovery. Policy adjustments would also be gradual to facilitate an orderly transition by financial institutions and market participants. Taking into account these considerations, the MPC normalised the OPR gradually by 25 basis points at each of the MPC meetings on 4 March, 13 May and 8 July 2010. The money market responded to the OPR increases in an orderly manner, with adjustments to money market rates, which were then transmitted to the retail lending rates.

Retail lending rates adjusted quickly, with all banks raising their base lending rates (BLR) within 6 days of the announcement of each OPR increase. Nevertheless, with borrowing

Chart 3.2

GDP and Inflation



Source: Bank Negara Malaysia

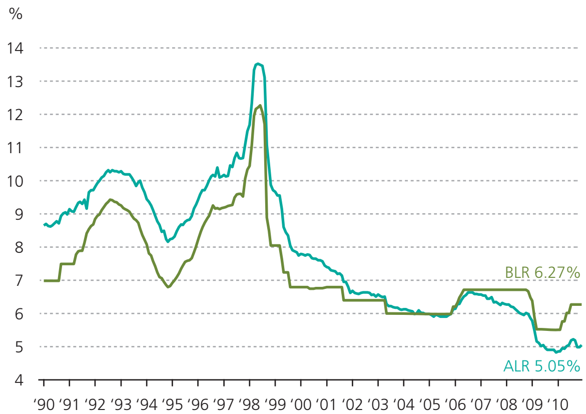
Table 3.1

MPC Meeting Dates and OPR Decisions

MPS Publication Dates	OPR
26 Jan 2010	2.00
4 Mar 2010	2.25 (+ 25 bps)
13 May 2010	2.50 (+ 25 bps)
8 Jul 2010	2.75 (+ 25 bps)
2 Sep 2010	2.75
12 Nov 2010	2.75

Chart 3.3

Base Lending Rate and Average Lending Rate of Commercial Banks

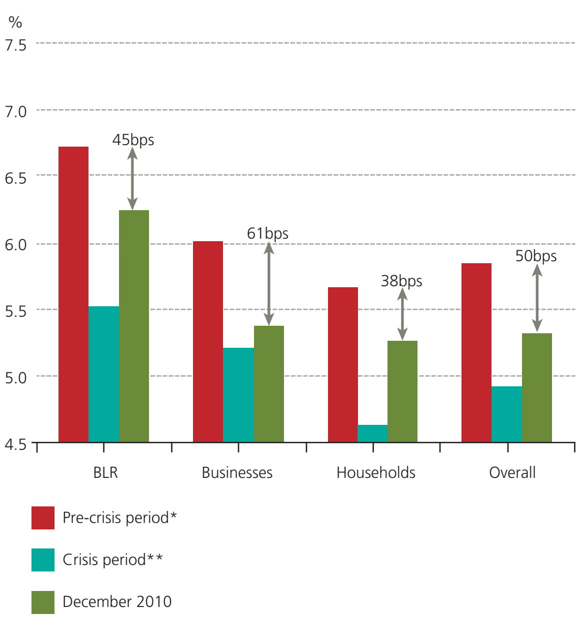


Source: Bank Negara Malaysia

costs still below pre-crisis levels, financing conditions remained supportive of economic activity. Specifically, as at end-December 2010, nominal retail lending rates on new loans to businesses remained on average 61 basis points below pre-crisis levels[1]. Lending rates to households were 38 basis points lower than pre-crisis levels over the same period.

Chart 3.4

Average Nominal Lending Rates on New Loans for Various Periods



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

Source: Bank Negara Malaysia

With the borrowing costs still below pre-crisis levels, financing conditions remained supportive of economic activity

Reflecting the reasonable borrowing cost and ample liquidity in the financial system, private sector financing remained robust throughout 2010. Loans extended to businesses during the year improved as retail sales and investment activity improved. Household loans also expanded in line with the strong growth in consumption expenditure following stable labour market conditions and positive sentiments. Notwithstanding the strong trends in financing, credit growth was judged to be in line with fundamentals and the overall level of household indebtedness remained at a prudent level.

Following the cumulative increase of 75 basis points, the MPC considered the OPR level of 2.75% to be appropriate and consistent with its assessment of the medium-term economic growth and inflation prospects. In the second half of the year, the Malaysian economy continued to expand in spite of the slower performance in the external sector. Domestic economic growth continued to be supported by domestic demand following favourable labour market conditions, positive sentiments, low inflation and conducive credit conditions. There were, nevertheless, downside risks to global growth arising from several factors. The escalation of the sovereign debt crisis in the euro area as well as the announcements of impending fiscal austerity measures in several advanced economies raised uncertainties on the sustainability of the global economic recovery. In addition, growth in the advanced economies slowed as the temporary boost to economic activity from the build-up of inventories and the earlier policy stimulus had begun to fade. Furthermore, the policy-induced slowdown in

[1] Over the period January 2008 to October 2008 when the OPR was still at 3.5%, the lending rates on new loans for businesses and households were on average 6.01% and 5.67% respectively.

PR China to achieve a more sustainable growth over the medium term could affect intra-regional trade.

With regard to inflation, the consumer price index (CPI) edged higher during the second half of the year. This increase was moderate despite the series of adjustments to administered prices, and was mainly on account of supply factors. At the same time, the lower imported inflation from more modest growth in the advanced economies and the stronger ringgit helped to mitigate some of the pressures on inflation. For the year as a whole, inflation remained low at an average of 1.7%.

The risk of a build-up of financial imbalances continued to be evaluated throughout the year. Assessments showed that growth in asset prices and credit were generally not excessive and continued to be in line with the improvements in the economy. First, there were limited evidence of overvaluation in the equity market. The magnitude of the KLCI increase did not deviate too far from its underlying trend. Moreover, even though equities posted healthy gains, equity purchases funded through borrowings were low. Second, evidence of excessive credit growth was also limited. The ratio of loan to GDP relative to its trend was neither excessive nor persistently above trend. Third, property price inflation at the national level remained modest with an annual increase of 1.5% in 2009, compared to the 2000-2008 average of 3.6%[2]. However, there were concerns of speculative activity in the property market in selected locations in the urban areas. The number of transactions and house prices in these locations experienced faster growth. There was also a rise in financing provided to individuals for multiple unit purchases. In this instance, targeted macro-prudential measures were judged to be more appropriate to address such concerns. The policy intent was to reduce speculative activity in the property market. To this end, the Bank in November 2010 announced the implementation of a maximum loan-to-value (LTV) ratio of 70% applicable to the third and subsequent house financing facilities taken out by a borrower.

Another development that posed challenges to the conduct of monetary policy during the year was the larger and more volatile international financial flows. Sustained divergence in growth prospects between developed and emerging economies led to continuous financial inflows into the emerging market economies and created upward pressure on their currencies. This was further compounded by further monetary easing in advanced economies. Differences on currency policy among the G20 nations also heightened tensions in the foreign exchange market. In response, several emerging market economies responded by imposing measures to better manage the significant increase in capital flows. Different countries, however, had different threshold levels to capital flows and exchange rate appreciation and varying capacity to manage them. The inflows into Malaysia have so far been manageable and with no discernible signs of the inflows creating imbalances in the domestic economy and financial system. Amidst the large capital inflows, the ringgit exchange rate movements remained orderly, while sterilisation operations ensured that the impact of the excess liquidity on domestic monetary conditions was contained. Having a broad range of instruments for monetary operations helped increase the efficiency of domestic liquidity management. The depth and resilience of the financial system together with the healthy level of international reserves also served to mitigate the risks arising from reversal of these flows.

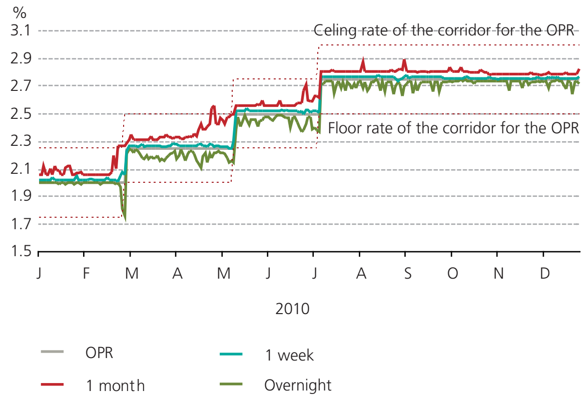
MONETARY OPERATIONS

Overall conditions in the domestic money market were stable in 2010. Focus was accorded to ensuring that the normalisation of monetary policy was being transmitted to the money market rates in an efficient and orderly manner. Money market conditions remained orderly as financial institutions adjusted their interest rates to the increases in the OPR in March, May and July 2010. The Bank maintained the average overnight interbank rate (AOIR) within the corridor of ± 25 basis points of the OPR. During the period 2 – 4 March 2010, the AOIR traded lower, close to the floor rate of the corridor. This reflected market participants' exceptional interest for overnight placements with the Bank ahead of the March MPC meeting. Subsequent to this episode, the AOIR traded within a wider range up until the third quarter in line with market expectations for further increases in the OPR.

[2] Source: National Property Information Centre (NAPIC)

Chart 3.5

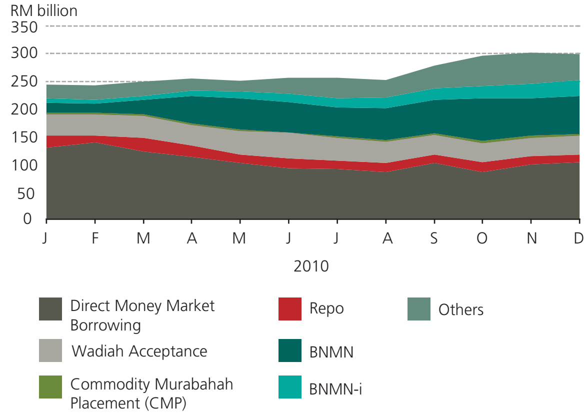
OPR and Interbank rates



Source: Bank Negara Malaysia

Chart 3.6

Outstanding Liquidity Placed with Bank Negara Malaysia



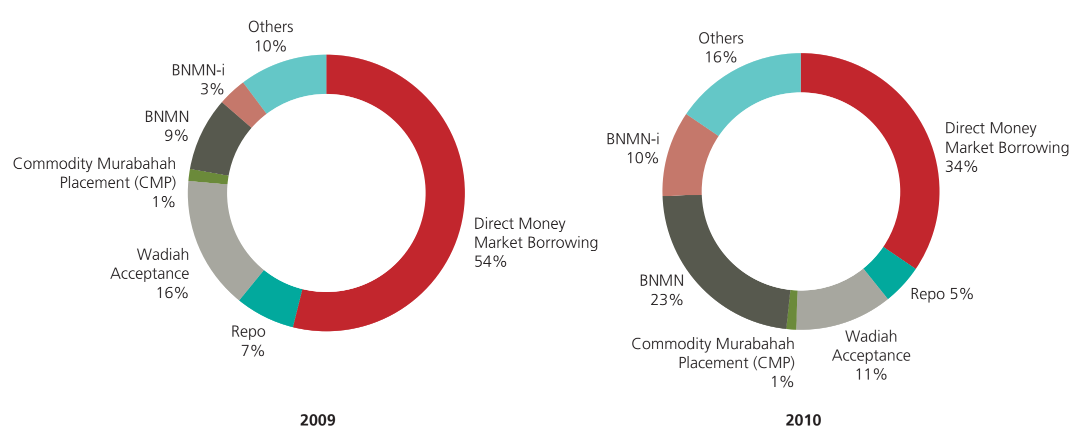
Source : Bank Negara Malaysia

With the resumption of portfolio inflows into the domestic financial markets, a key challenge for monetary operations was to manage the surplus liquidity in the interbank market. Malaysia, along with other emerging market economies, registered net portfolio inflows in 2010. For the year as a whole, aggregate surplus liquidity increased significantly to RM299.2 billion as at end-December 2010 (2009: RM251.8 billion).

The composition of monetary instruments became more diversified in 2010. Although uncollateralised borrowings remained the main instrument used (accounting for 62.7% of outstanding monetary policy instruments), there was a sizable increase towards securities-based monetary policy instruments (2010: 37.3%, 2009: 20.2%). Bank Negara Malaysia Monetary Notes (BNMN for conventional and BNMN-i for Islamic money markets) were increasingly used in 2010 as there had been strong demand for these securities by investors, particularly non-resident investors. Hence, the frequency of issuances for the BNMN and BNMN-i was increased from once a week in 2009 to twice a week in 2010. The share of Islamic monetary instruments was

Chart 3.7

Breakdown of Outstanding Monetary Policy Instruments



Source : Bank Negara Malaysia

23.9% of total monetary instruments as at end-2010. Liquidity absorbed through Islamic instruments increased in line with the growth of total liquidity in the system and stood at RM71.6 billion (2009: RM58.9 billion).

In terms of the maturity profile of monetary instruments, the average maturity was extended to 40 days in 2010 (2009: 27 days). This was a change in strategy compared to the last few years when the focus was on a shorter average maturity structure to ensure that liquidity can be swiftly unwound in the event of large and sudden outflows given the significantly more volatile environment in the financial markets. In a period of rising interest rates, extending the maturity of borrowings allows for more cost effective sterilisation operations as surplus liquidity is locked-in at a lower rate over a longer period.

During the year, the Bank introduced several changes to the features of monetary instruments to increase operational efficiency. One of the initiatives was the Range Maturity Auction (RMA), a variation to the money market term tender[3] which would allow flexibility in determining the maturity range for uncollateralised borrowings. The initiative made liquidity management more efficient by providing financial institutions the option to offer their excess ringgit funds according to their liabilities' profile. This would enhance the Bank's liquidity management by matching the Bank's liquidity forecast with the financial institution's liquidity requirements. Another enhancement of monetary operations was the automation of Commodity Murabahah Programme transactions in the Fully Automated System for Issuing/Tendering (FAST). This system caters for both auction/tender and bilateral transactions of the Commodity Murabahah. The system configuration of FAST enables the purchase and sale of commodities, auto generation of murabahah contracts and digital signature.

With respect to Islamic monetary instruments, the Bank will introduce new instruments that are structural variations of the BNMN-i issuances in 2011, namely the Bai Bithaman Ajil (deferred payment) and Istithmar (investment based on a combination of Murabahah and Ijarah). These new structures would appeal to a wider base of investors given the stricter compliance with Shariah requirements of different jurisdictions. In line with the vision of Malaysia being an Islamic Financial Centre, the Bank would continue to develop new and flexible Islamic monetary instruments that are widely acceptable amongst global investors.

[3] Money market term tender refers to uncollateralised borrowings with a predetermined maturity within 1 week to 2 months. Normal maturities for money market term tenders are 1 week, 2 weeks, 3 weeks and 1 month.

Financial Imbalances and the Role of Monetary Policy

In 2010, the OPR was raised by a total of 75 basis points. Although inflation remained benign and the economy was at an initial stage of recovery, the OPR was adjusted upwards to normalise monetary conditions to manage the risk of financial imbalances. In the Bank's assessment, if left unchecked, the subsequent unwinding of financial imbalances could undermine the sustainability of the economic recovery and have adverse consequences on price stability and economic growth.

Financial imbalances can manifest in the form of an unhealthy build-up of leverage, under-pricing of risks, excessive yield seeking activities, over investment in certain markets, asset prices that depart substantially from fundamentals and increased risks to the stability of the financial system. These distortions tend to surface when interest rates are expected to remain very low for a prolonged period. In this regard, the Bank is mindful of the need to ensure the stance of monetary policy is appropriately aligned to mitigate the risks to inflation and growth.

There has always been a close link between monetary policy and financial stability. First, extremely loose monetary policy for a prolonged period can be at the root of financial imbalances. Monetary policy affects the inter-temporal allocation of resources which underlie the incentives for economic agents to save and borrow. Interest rates that are kept too low for a prolonged period would create incentives for savers and borrowers that are detrimental to the economy over the medium term. For example, low or negative real returns on deposits could encourage shifts from low risk deposits towards speculative investments in riskier assets in a search of higher yields. Substantially low borrowing costs could also promote excessive leverage by households and businesses. Second, a well functioning and resilient financial system is necessary for the effective transmission of monetary policy. As the financial imbalances unravel, the balance sheets of financial institutions that are exposed to bad assets and delinquent borrowers would be impaired. In turn, these weak financial institutions will not be able to expand lending activity to support economic activity during downturns even under such an easy monetary policy environment. Third, financial imbalances have implications for macroeconomic stability, whereby a disorderly correction of imbalances may lead to a contraction in economic activity. For example, in the event that asset bubbles burst, asset values would deteriorate. Consumption and investment activities would be adversely affected as households and businesses face difficulties in securing financing due to deterioration in the value of collateral. Consequently, economic activity could slow or even contract.

The recent global financial crisis exemplifies clearly the close link between monetary policy and financial stability. The crisis was a culmination of financial imbalances accumulated over a prolonged period of very low interest rates. The unravelling of financial imbalances led to the collapse of financial institutions and market disruptions globally. Failures of the financial intermediation process and the contraction in private sector economic activity subsequently resulted in the worst global recession since the Great Depression. While monetary policies in the advanced economies at the centre of the crisis were substantially eased to support the economic activity, the dysfunctional financial institutions and markets were not able to transmit the unprecedentedly large monetary policy stimulus to the broader economy.

In formulating monetary policy, the Bank does not only focus narrowly on managing inflation and growth over the typical monetary policy horizon of 6 - 8 quarters. The Bank takes into consideration information on the developments in the credit and asset markets in its monetary policy decision making, with the view of ensuring macroeconomic stability over the medium term. Monetary policy takes into account the underlying cause of asset price inflation rather than the asset price inflation itself. This approach has resulted in policy action when monetary policy adjustment was made even in the absence of risks to inflation within the monetary policy horizon. The recent monetary policy normalisation is an example of this approach.

The use of interest rate policy to manage the risks of financial imbalances takes into account several important caveats. First, monetary policy must be pre-emptive in order to be effective. Raising interest rates when asset prices are already significantly overvalued would not be effective in deterring speculative activity as the expected gains from asset prices increases would have by then far exceeded the borrowing costs. Second, monetary policy on its own would not be effective in addressing such financial imbalances. To rely only on interest rates may in fact result in an over adjustment. Macroeconomic policies need to be considered in a holistic manner. There may be a need to complement monetary policy with more targeted macro-prudential measures[1] if risks emerge in specific sectors of the economy. Malaysia has a long history of relying on a broad array of policy instruments in managing the risks of financial imbalances. During the episode of asset price bubbles in the mid-1990s, in addition to monetary tightening, the Bank implemented prudential credit measures such as lowering the loan-to-value ratio for the purchase of selected non-owner occupied properties. These measures were also complemented by fiscal measures such as the upward revision of the graduated real property gains tax to between 15-20%. Third, monetary policy is a blunt tool. Merely raising interest rate aggressively to prevent financial imbalances could unnecessarily increase the cost of borrowing at the expense of broader economic growth.

In conclusion, monetary policy is relevant in addressing financial imbalances due to its influence on the behaviour of economic agents, and the need to obviate the consequences of financial imbalances on the efficacy of monetary policy itself. Hence, in addition to balancing the risks to inflation and growth, it is important to ensure that the stance of monetary policy is appropriate to prevent the build-up of financial imbalances.

[1] The Asian experience also suggests that macro-prudential tools are likely to be an integral part of the tightening in monetary and credit conditions as the economic recovery continues. For example, PR China, Hong Kong SAR, Korea and Singapore announced various measures to deflate housing prices in 2009 and 2010.

2010

OUTLOOK AND POLICY IN 2011

INTERNATIONAL ECONOMIC OUTLOOK

As in 2010, the global economy is expected to experience a two-speed and uneven economic recovery in 2011 with the overall economic growth likely to be more moderate. The continued divergence in growth performance between the advanced economies and emerging market economies, reflects the continuing impact of the global financial crisis on the potential growth path for the former. These effects include structural problems related to high unemployment, weak fiscal positions and constrained credit conditions. To some extent, growth prospects in the advanced economies will be supported by recent policy stimulus in the US and Japan, underscoring the governments' concerns that growth in private sector demand may not be sufficiently strong to sustain economic activity. After experiencing above-trend growth in the previous year, the Asian economies are expected to continue to lead global growth although the momentum will moderate to a pace closer to their long-term averages as the base effect dissipates. While external demand for the region will improve at a slower pace in line with the moderation in the global economy, domestic economic activity in these economies will remain robust, underpinned by positive consumer and business sentiments, improving labour markets and favourable financing conditions.

An emerging feature of the global economy in the post-crisis period is that the global growth is increasingly dependent on the emerging economies. While the emerging economies account for about a third of global GDP, they have contributed more than two thirds of global growth in recent years (1990s: one-third), highlighting the growing importance of emerging economies as the new growth centres. In the recent period, changing growth dynamics have brought about new challenges to the emerging economies following the shift in global short-term capital flows from the advanced economies to the emerging market economies. This trend has been further accentuated by the series of quantitative easing measures in the advanced economies that have contributed to a surge in global liquidity. As the monetary policy normalisation or tightening in the emerging economies is expected to continue, it will contribute to the widening of interest rate differential between the advanced and the emerging economies. These large and persistent short-term capital inflows into emerging economies often also exert significant upward pressure on exchange rates and asset prices in these economies. At the same time, the tendency of these flows to reverse in response to global developments is also likely to create greater volatility in financial prices in the emerging economies. For the regional monetary authorities, the challenges in 2011 will revolve around how best to manage the capital flows while concurrently addressing the emerging inflationary pressures arising from high global commodity prices.

In the **US**, the prospects are for a continued expansion in economic activity, underpinned by a new round of fiscal policy stimulus, easy monetary conditions, and a gradual revival in private consumption. Private sector demand, particularly consumption, will be boosted by the implementation of a USD858 billion tax relief package (5.9% of GDP) announced in December 2010, which include a two-year extension of tax relief for all income levels, a one-year extension of unemployment benefits, and a one-year tax payroll holiday and the continuation of investment incentives. The expansionary fiscal policy would also be reinforced by the second round of quantitative easing involving the Fed's purchase of USD600 billion worth of Treasury bonds during the first half of 2011. In addition to the anticipated positive impact of these measures on private sector demand, the underlying private consumption is also expected to be supported by a gradual improvement in the job market, rising personal incomes, longer working hours and the higher equity prices that will contribute towards increasing the net worth of households.

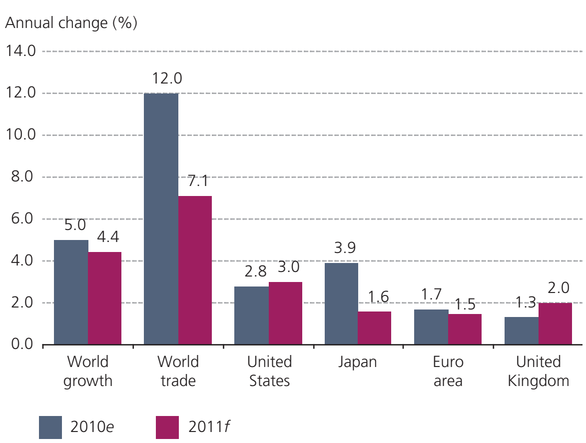
In the **euro area**, the economic growth is expected to continue albeit at an uneven and modest pace this year. While growth in the core economies such as Germany and France is projected to moderate amid a slower pace of improvement in external demand, robust private sector activity will likely sustain growth in these economies. In contrast, the growth prospects for the peripheral economies such as Greece and Ireland remain weak as domestic demand will be further impinged by fiscal austerity measures, high unemployment, fragile financial systems and tight credit conditions. Furthermore, the continued uncertainties surrounding the sovereign debt problems in the euro area will weigh on consumer and business sentiments, further restraining economic activity. In the **UK**, economic expansion is expected to remain modest as fiscal austerity measures weigh on domestic activity. The improvements in exports and industrial production are likely to continue, supported by a weak pound sterling. Amid an environment of rising inflationary pressures, private consumption is likely to be constrained by weak real income and job growth, tight credit conditions and low consumer confidence. For **Japan**, the export-dependent economy will continue to be supported by demand from the Asian region, particularly PR China. However, export growth is expected to slow during the year as the base effect dissipates and the impact of a strong yen takes effect. The fragile recovery in domestic demand will to some extent be supported by the ¥5 trillion stimulus package unveiled in November 2010, which includes job creation programmes, welfare spending and schemes to help small businesses and the construction sector. Nonetheless, domestic demand will be affected by continued deflation amid a strong yen.

The prospects of a gradual growth in the advanced economies coupled with a more moderate demand from the emerging economies are expected to slow the pace of expansion in **global trade** in 2011. Of significance, global trade will continue to be increasingly driven by the emerging economies, particularly Asia. In Asia, the changing global trade pattern will influence the global foreign investment pattern as multinational companies are likely to redirect resources to expand their operations rapidly in the fast growing economies. Intra-regional trade in Asia would remain strong, benefiting from the robust domestic demand in the region.

After an exceptionally strong recovery in the previous year, economic growth in the **Asian economies** is expected to return to a more normal pace in 2011. The expansion will be mainly driven by sustained strength of domestic demand while external demand is projected to register a slower pace of improvement in line with the moderation in the advanced economies. External demand may also be affected by the anticipated slower growth in the Chinese economy following a series of monetary and credit tightening measures introduced by the authorities to achieve a more sustainable overall growth momentum. Nevertheless, domestic demand will continue to be a key driver of growth in the region. Private consumption is expected to remain robust,

Chart 4.1

World Growth, World Trade and Growth in Major Advanced Economies (2010-2011)



e Estimate
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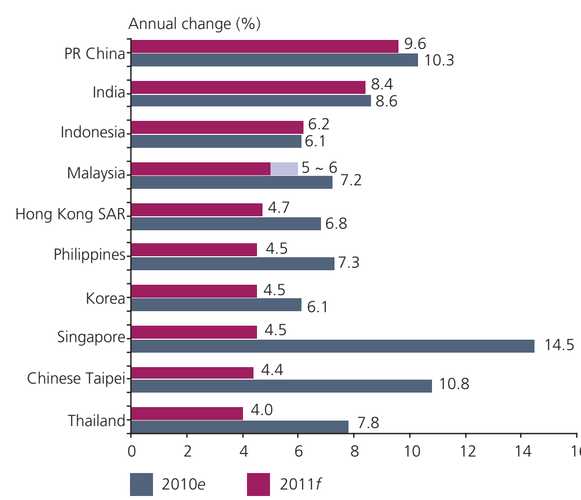
Source: International Monetary Fund and National Authorities

Chart 4.2

Regional Economies: Real GDP Growth



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Source: International Monetary Fund and National Authorities supported by buoyant consumer sentiments, better employment prospects, and favourable credit conditions. Large infrastructure development projects planned in several regional economies will also lend support to investment activities.

Global inflationary trends are expected to continue to diverge between the advanced and emerging economies. Underlying inflation is expected to remain subdued in the advanced economies, reflecting the economies' underutilised capacities and moderate demand conditions. Nevertheless, there is the risk that higher commodity prices will lead to higher headline inflation in these advanced economies. These inflationary pressures could be further exacerbated through the rising costs of imports resulting from higher inflation and appreciating currencies of key emerging market economies. For the emerging economies, inflationary pressures will remain a growing concern due to buoyant domestic demand, and the impact of rising global commodity prices. Commodity prices are expected to be on an upward trend, due to strong demand from emerging economies, adverse weather conditions and speculative activity in the commodity markets. In some economies, the appreciation of currencies has mitigated some of the inflationary pressures. Significant capital inflows into the emerging markets, however, may exert upward pressures on prices in the asset markets, thereby reinforcing the upside risk to the inflation outlook.

Despite improving global growth prospects, downside risks to growth remain. Growth in the advanced economies, particularly in the US and Japan, continue to be driven by policy stimulus amid heightened concerns over large fiscal deficits and increasing government debt of these economies. The lingering uncertainty regarding the sovereign debt problems in the euro area could have significant implications on the pace of fiscal expansion in the advanced economies, particularly in view of large refinancing needs of governments and the potential spikes in international borrowing costs. Notwithstanding the risk of early withdrawal of policy stimulus, the advanced economies continue to face persistent structural problems in the form of high unemployment, weak housing market and constrained credit conditions, highlighting the risk to the ability of private sector demand to drive overall growth.

Conversely, emerging economies are dealing with a different set of challenges to sustain their growth momentum. Given the continuing divergence in growth between the advanced and emerging economies amid ample global liquidity, significant capital inflows are expected to continue to flow to emerging economies. These large and volatile flows not only complicate the normalisation or tightening of monetary policy but also have the potential to create financial instability through the formation of price bubbles in the domestic asset markets. In addition, emerging economies are facing rising inflationary pressures associated with escalating commodity prices, resulting in the greater need to normalise monetary conditions, and in cases where domestic aggregate demand fuels inflationary pressures, to tighten their monetary stance. This could in turn attract more capital flows into these economies. Adding to the monetary policy uncertainty is the risk that rising food and fuel prices could erode the purchasing power of household incomes and cause a decline in discretionary spending, thereby affecting economic growth. The consequent monetary policy dilemma has encouraged a number of monetary authorities in emerging economies to rely on alternative policy tools such as macroprudential regulations, administrative measures and restrictions on capital inflows in order to manage the risks associated with these flows.

MALAYSIAN ECONOMY

Following the strong performance in 2010, the Malaysian economy is projected to grow at 5–6% in 2011, supported mainly by continued expansion in domestic demand. Whilst external demand is expected to moderate in 2011, the growth contribution of net exports would turn around to be positive amid a larger trade surplus on sustained commodity exports to the Asian region.

Domestic demand is expected to maintain a strong growth momentum, driven mainly by a robust expansion in private sector activity. Private consumption will be supported by favourable labour market conditions, higher disposable incomes and sustained consumer confidence. The employment situation is anticipated to improve, particularly with higher job creation in the domestic-oriented manufacturing and services sectors. The expectation for further increases in private sector salaries and continued high commodity prices will raise incomes of households. In addition, access to credit will also provide support to household spending in 2011. Private investment is expected to remain strong and contribute favourably to growth. This will be supported by capital spending by the domestic-oriented industries given the high levels of capacity utilisation and positive business confidence, as well as the implementation of key initiatives announced by the Government under the Economic Transformation Programme. Meanwhile, the public sector will remain supportive of growth, with higher capital spending projected in the second half of 2011. This is attributable mainly to the implementation of new projects and the acceleration of ongoing projects to promote private sector activity.

The Malaysian economy is projected to grow at 5 – 6% in 2011, supported mainly by continued expansion in domestic demand

All economic sectors are projected to expand firmly in 2011, supported mainly by the continued growth of domestic demand. The services and manufacturing sectors are expected to expand, albeit at a more moderate pace given the high statistical base of 2010. The services sector will remain the largest contributor to growth, driven by the domestic demand-oriented sub-sectors, particularly wholesale and retail trade, finance and insurance, and communication. The trade- and manufacturing-related sub-sectors, however, are expected to grow at a more moderate pace, in line with the expected moderation in external demand. A similar moderation in growth is also anticipated for the export-oriented industries in the manufacturing sector. In particular, the E&E cluster will experience a slower growth following the strong rebound in 2010. Nevertheless, growth in the domestic-oriented industries will continue to provide support to the manufacturing sector. In addition, growth in the primary sector is projected to strengthen, benefiting from the expected turnaround in industrial crop production amid high commodity prices, and higher natural gas output following the opening of two new gas fields. Further progress in on-going infrastructure projects and new projects due for implementation under the Economic Transformation Programme will provide the impetus for the construction sector.

Headline inflation is expected to average 2.5 – 3.5% in 2011, and will continue to be driven by supply factors. Global commodity prices is expected to rise on account of disruptions in supply due to adverse weather conditions, geopolitical developments, speculative activities and the strong demand from emerging economies. Domestically, while further adjustments to administered prices are expected in 2011, these adjustments are expected to be gradual. This will help to contain its overall impact on inflation. Meanwhile, the pressure on domestic prices from demand factors is expected to be modest.

On the external front, the larger trade surplus, together with the sustained services account surplus, is anticipated to contribute to a wider current account surplus (12.5% of GNI) in 2011. Gross exports are expected to expand at a more moderate pace, mainly on account of a high statistical base in 2010 and the slower growth in manufactured exports, in tandem with the projected moderation of global growth. Commodity exports, however, are expected to register robust growth, supported by higher prices and firm demand, particularly from the region. Meanwhile, growth in gross imports is projected to moderate significantly following a slowdown in the imports of intermediate goods, consistent with the more modest growth in manufactured exports. Consequently, a larger trade surplus will be recorded in 2011. The services account will continue to register a small surplus, driven by higher receipts from the travel account, while the income account deficit will be slightly smaller, due mainly to higher earnings by Malaysian companies investing abroad and lower repatriation of profits and dividends by foreign companies in Malaysia. For the financial account, gross inflows of foreign direct investment will likely increase further amid the favourable economic outlook, better corporate earnings and positive business confidence. Continued improvement in global FDI flows, together with the Government's

Potential Output of the Malaysian Economy

Potential output is the non-inflationary level of output that is consistent with the aggregate productive capacity of an economy. It provides an indication of the sustainable growth path of an economy based on available productive inputs, the level of technology and its overall efficiency. 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. TFP captures productivity increases arising from improvements in the utilisation of factor inputs.

Potential output of the Malaysian economy expanded by 4% in 2010, moderating from 5.3% and 4.2% in 2007 and 2008-2009 respectively. This is consistent with other country experiences[1], in which economic crises usually lead to lower potential output growth in the short term due to a slowdown in capital accumulation and the negative effects on labour. In most cases, TFP would also decline. In the case of the Malaysian economy, the initial slowdown in potential output growth was due mainly to slowing capital accumulation and TFP, while the subsequent moderation in potential output was primarily caused by slower growth in the labour force.

While potential output tends to be lower during recessions, actual output, however, usually witnesses a sharper decline, reflecting a relatively greater slowdown in overall demand vis-à-vis the productive capacity of the economy. This leads to the output gap[2] becoming negative, indicating spare capacity during a period of economic slowdown. As the economy recovers, the negative output gap gradually narrows. This was observed in 2010, in which the output gap of the Malaysian economy narrowed to -0.7% from -2.6% in 2009 as the economic recovery gathered strength.

Malaysia's output gap is projected to narrow further and turn slightly positive in 2011 given the sustained growth of the economy. Potential output growth is expected to return to its medium-term trend of about 5%, supported by a further expansion in the capital stock, the growing labour force and continued productivity improvements.

Table 1

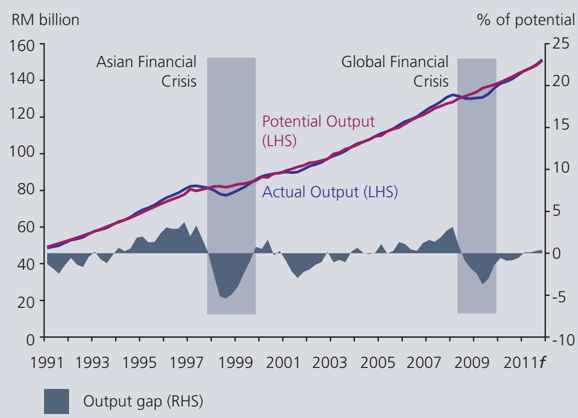
Actual Real GDP and Potential Output

Period	Actual Real GDP	Potential Output	Investment	Labour	Output Gap
	Annual change (%)				(% of potential output)
1993-1999	6.5	6.4	4.5	4.1	0.1
2000	8.9	4.8	25.7	4.4	0.5
2001	0.5	4.6	-2.1	1.5	-2.1
2002	5.4	4.1	0.6	1.9	-1.0
2003	5.8	5.9	2.8	3.6	-0.7
2004	6.8	5.4	3.6	1.0	0.2
2005	5.3	5.0	5.0	0.6	0.7
2006	5.8	5.7	7.5	2.1	0.8
2007	6.5	5.3	9.4	2.5	1.9
2008	4.7	4.2	0.7	1.3	0.3
2009	-1.7	4.2	-5.6	2.6	-2.6
2010*e*	7.2	4.0	9.4	2.5	-0.7

e Estimate

Chart 1

Actual and Potential GDP



f Forecast

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

[1] A good review of this can be found in Furceri, D. and A. Mourougane (2009), "The Effect of Financial Crises on Potential Output: New Empirical Evidence from OECD Countries", *OECD Economics Department Working Papers*, No. 699, OECD Publishing. doi: 10.1787/224126122024

[2] 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.

wide-ranging economic transformation projects, will support higher inflows of FDI into Malaysia. Direct investment abroad by Malaysian companies is anticipated to remain large as companies continue to seek new markets and business opportunities abroad.

While growth will be driven mainly by domestic demand in 2011, external demand will remain important given that the total trade in goods and services accounted for 176% of GDP in 2010. The growth projection of 5 – 6% is based on the expectation of moderate growth in the advanced economies and a return to more normal growth rates by the Asian economies. Nonetheless, there remains downside risks to global growth. Notwithstanding robust domestic demand, a rapid deterioration in external conditions could have significant adverse spill over effects on the overall economy through the investment and employment channels, whilst also affecting overall sentiments. Second, volatility in capital flows will continue to remain a policy challenge for the region, including Malaysia. In line with the regional economies, Malaysia has been receiving large inflows of portfolio investments since the second half of 2009. Malaysia has managed to effectively intermediate these flows given the strength and depth of the financial system and the wide range of monetary instruments available to the Central Bank. While this is currently the case, there needs to be vigilance on the potential risk of massive shifts in global liquidity flows that could overwhelm the financial markets in the emerging economies, including Malaysia. Going forward, significant volatility in two-way flows can be expected given the continued uncertainties in the international financial markets and the shifting global financial landscape. Third, higher-than-anticipated inflation would also present downside risks to the growth projection. Given the expectation for private consumption to contribute significantly to growth, sharper-than expected increases in food and fuel prices in particular, would pose a risk to the GDP growth momentum in 2011.

Domestic Demand Conditions

Domestic demand is projected to register a strong expansion of 6.7% in 2011, driven by robust private sector activity. In particular, private consumption is expected to continue to be a main contributor to growth supported mainly by the favourable labour market conditions, rising disposable income and sustained consumer confidence. Private investment will continue to be strong, especially in the second half of 2011, spurred by the favourable outlook for domestic-oriented industries and the overall positive business conditions. The public sector will remain supportive of growth. Of importance, public investment will be underpinned by the implementation of projects outlined in the Tenth Malaysia Plan (10MP) as well as higher capital spending by the NFPEs.

Strong expansion of domestic demand in 2011, driven by robust private sector activity

Private consumption will be the main contributor to domestic demand growth in 2011, with an expansion of 6.9%. The strong expansion in consumer spending is attributable to the favourable labour market conditions, higher disposable income and sustained consumer confidence. Amid a more moderate growth in external demand, gains in employment will be mainly supported by the continued strong expansion in domestic-oriented manufacturing and services sectors. The unemployment rate is projected to remain stable at 3.2% of the labour force in 2011. In addition to the improved employment situation, higher household incomes will also be underpinned by the expectation of further increases in private sector salaries by an average of 4.8% in 2011 and the continued high commodity prices, with the latter having a significant positive impact on the incomes of rural households.

Household spending will also be supported by continued access to credit. While the ratio of household debt to GDP was relatively high at 75.9% as at end-2010, the overall household balance sheet has remained sound. In particular, the ratio of debt to financial assets remained relatively unchanged at a level of 41.9% as at end-2010. Loan repayments across all types of household borrowings remained high, with the ratio of repayments to disbursements of household loans averaging at 85% in 2010

Table 4.1

Real GDP by Expenditure (2000=100)

	2010*p*	2011*f*	2010*p*	2011*f*
	Annual change (%)		Contribution to real GDP growth (percentage point)	
Domestic Demand[1]	**6.3**	**6.7**	**5.6**	**6.0**
Private sector expenditure	7.8	7.4	4.9	4.7
Consumption	6.6	6.9	3.6	3.7
Investment	13.8	9.7	1.4	1.0
Public sector expenditure	2.5	5.1	0.6	1.3
Consumption	0.1	7.2	0.0	1.0
Investment	5.5	2.7	0.6	0.3
Change in stocks			**4.9**	**-0.9**
Net exports of goods and services	**-24.2**	**2.3**	**-3.3**	**0.2**
Exports	9.8	2.7	10.5	3.0
Imports	14.7	2.8	13.8	2.8
Real Gross Domestic Product (GDP)	**7.2**	**5.0~6.0**	**7.2**	**5.0~6.0**

[1] Excluding stocks
p Preliminary
f Forecast
Note: Figures may not necessarily add up due to rounding
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

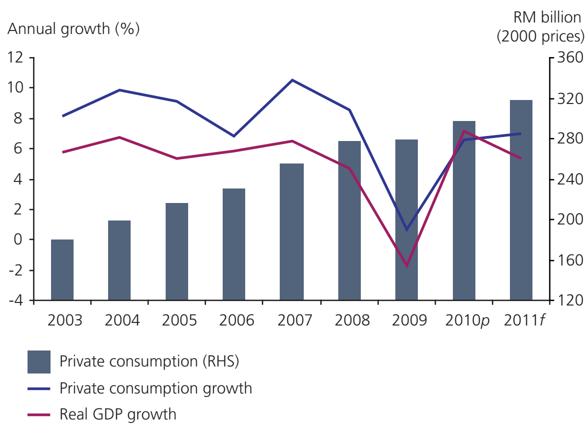
(2006-09: 87%). The non-performing loans ratio of the household sector continued to trend downwards, from 7.1% as at end-2006 to 2.3% as at end-2010. With the overall household balance sheet remaining sound and debt repayment capacity continuing to be intact at the aggregate level, financing conditions will continue to be supportive of household consumption in the near term.

Private investment is expected to register a growth of 9.7% in 2011, supported by capital spending in all economic sectors, particularly in the services, manufacturing and mining sectors. High investment activity will be sustained by positive business confidence, in line with the strengthening of domestic demand. Important initiatives announced by the Government in 2010 are also expected to weigh favourably on business confidence and outlook. In addition, the overall improvement in global FDI and consequently, higher FDI into Malaysia, will also contribute positively towards private investment growth.

In the services sector, capital spending is projected to increase further, especially among domestic-oriented firms, in tandem with higher domestic consumption as well as ongoing initiatives to improve the provision of existing services. Communication service providers are expected to enhance and expand the present broadband infrastructure and networks, driven by the anticipation of higher demand for broadband services. In the wholesale and retail trade industry, firms have indicated expansion plans through the establishment of new outlets. The financial services industry is also expected to undertake higher

Chart 4.3

Real GDP and Private Consumption



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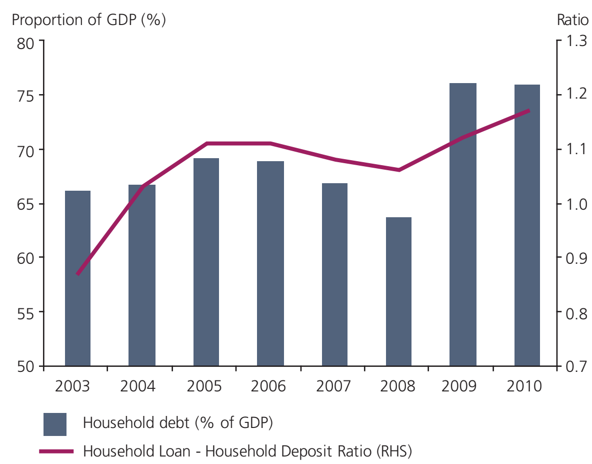
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 4.4

Household Debt Indicators



Source: Bank Negara Malaysia

capital expenditure, following the establishment of new operations by foreign licensees and business expansion by current institutions.

In addition, investment activities in the transportation and storage sector will be supported by the development of oil and gas-related storage and terminal facilities, as well as expansion in port infrastructure and air transportation, given the expectation of higher passenger demand and additional air routes.

Capital spending in the manufacturing sector is expected to remain resilient, as reflected by the higher level of approved investment projects in the sector in 2010. Higher investments were approved for the E&E, petroleum products and basic metal products segments. In particular, investment spending in the E&E segment is attributable to foreign manufacturers in the new growth area of renewable energy as well as hard disk drive components. Furthermore, high capacity utilisation rates will continue to promote capacity expansion activity by manufacturing firms in general, especially in the domestic-oriented industries.

Investment in other sectors is expected to register further improvements. In the mining sector, investment is anticipated to increase, supported by the expansion and upgrading of existing production facilities, development expenditure for new discoveries in the past few years, as well as exploration activities in the deepwater and marginal oil fields. In addition, new tax incentives that have improved project viability in the oil and gas industry will provide further impetus to exploration activity in the mining sector. In the construction sector, capital spending is also expected to increase on account of the implementation of new and ongoing infrastructure projects.

Public sector expenditure will reinforce the expansion of domestic demand in 2011, particularly, with higher public capital spending projected in the second half of the year. This is attributable mainly to the implementation of new projects and acceleration of ongoing projects to promote private sector activity.

Public consumption is projected to increase by 7.2% in 2011, due to higher expenditure on emoluments and supplies and services. Of importance, the expansion in supplies and services is in line with Government's new commitment under the 10MP to ensure the effective delivery of quality public services and proper maintenance of public assets.

Public investment is expected to remain supportive of growth in 2011 with an expansion of 2.7%. This is on account of higher Government capital spending driven by new projects planned under the ETP and 10MP as well as ongoing 9MP programmes. In the economics sector, a large proportion of development expenditure will be utilised to provide basic rural infrastructure, improve connectivity in urban public transport as well as to fund water supply and electrification projects. Substantial provision is also made to trade and industry sub-sector to promote higher domestic private investment activity. Education and healthcare sub-sectors are given priority in the social services sector to support the development of a skilled workforce and to enhance provision of affordable healthcare.

Investment by the non-financial public enterprises (NFPE) is also expected to rise, providing further support to public investment in 2011. Capital expenditure in the oil and gas sector will be the main contributor, largely on account of upstream activities for the development of marginal fields and deepwater explorations. Additionally, capital expenditure in the transport and utility sub-sectors will be focused on rail and airport expansion and the construction of new power plants respectively. Expenditure on the high speed broadband project is expected to make up the bulk of the investment in the communication sub-sector.

Sectoral Outlook

All economic sectors are projected to expand in 2011, to be supported mainly by the continued growth of domestic economic activity. From the high base of 2010, the services and manufacturing sectors are expected to expand at a more moderate pace in 2011, underpinned by the favourable growth in the domestic-dependent sub-sectors. Trade-related services and export-oriented manufacturing industries, however, will record slower growth, in line with the expected moderation in external demand. Growth in the primary sector is projected to strengthen, benefiting from the expected turnaround in the production of industrial crops amid high commodity prices, as well as higher output of natural gas. Further progress of on-going infrastructure projects and new projects due for implementation under the Economic Transformation Programme (ETP) will provide the impetus for the construction sector.

Steady expansion across all economic sectors in 2011, to be supported mainly by domestic demand

The **services** sector will remain the largest contributor to growth in 2011, with a projected growth rate of 5.9% (2010: 6.8%). All sub-sectors are expected to expand further, to be driven by sub-sectors that are dependent on domestic demand such as wholesale and retail trade, finance and insurance, and communication. Reflecting the slower external demand, the trade- and manufacturing-related sub-sectors are expected to grow at a more moderate pace.

The wholesale and retail trade sub-sector is expected to continue to register a robust performance, supported by higher private consumption amid favourable labour market conditions as well as the expansion of new retail stores and hypermarkets. The sub-sector is also expected to benefit from higher tourist arrivals, particularly from the high-income countries.

Table 4.2

Real GDP by Sector (2000=100)

	2010*p*	2011*f*
	Annual change (%)	
Agriculture	1.7	3.4
Mining & quarrying	0.2	2.0
Manufacturing	11.4	5.7
Construction	5.2	5.4
Services	6.8	5.9
Real Gross Domestic Product (GDP)	**7.2**	**5.0 ~ 6.0**

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia
Bank Negara Malaysia

Growth in the finance and insurance sub-sector is expected to remain strong, driven mainly by the finance segment, as bank lending would continue to grow in tandem with higher consumer spending and business expansion activity. The anticipated increase in capital market activity would contribute favourably to the fee-based income of banking institutions. In the insurance segment, growth is expected to emanate mainly from the life segment, in line with rising disposable income and improved public awareness on financial planning.

Similarly, outlook for the communication sub-sector is expected to remain robust. The telecommunication industry would be driven by the non-voice segment, as demand for mobile data is expected to benefit from the rising popularity and affordability of smartphones amid a proliferation of new devices and intensified competition among service providers. Growth will be further supported by wider roll-out of high-speed broadband (HSBB), wireless broadband services and continuous initiatives by the Government to promote the adoption of broadband services in the rural areas.

Growth in the trade-related sub-sectors is projected to be more moderate, reflective of the slower growth outlook of external demand. In the transport and storage sub-sector, the expected moderation in cargo-related services would be partly offset by the resilience in the passenger-related segment, in line with projected higher tourist arrivals and increased domestic tourism activities. Competitive airfares in the low-cost segment and aggressive expansion by domestic airlines would provide further support to growth.

The **manufacturing** sector is projected to grow at a more modest pace in 2011 given the high base in 2010. Slower expansion is expected in the export-oriented industries, in tandem with an environment of more moderate external demand. In particular, the E&E cluster will experience a slower growth after the sharp rebound in 2010. The anticipated slower growth will be in line with the trend in world semiconductor sales, but the cluster will continue to be supported by demand for products in the consumer and communications segments, particularly from within the region. In addition, implementation of investments in new areas, such as solar cell and light-emitting diodes (LED) manufacturing, is expected to benefit the cluster. Growth in the primary-related cluster will continue to be driven by global demand for chemical and off-estate products, particularly from within the region. In addition, the rubber products industry is expected to perform favourably, supported by the demand for gloves as well as automotive-related rubber products.

Growth in the domestic-oriented industries will continue to provide support to the manufacturing sector. The consumer-related cluster is expected to move in tandem with the continued growth of private consumption, particularly in the food- and transport-related industries. The construction-related cluster will be supported by the expected improvement in construction activity during the year. In addition, infrastructure projects in the region will continue to benefit the production of steel products.

The **agriculture** sector is expected to record a higher growth of 3.4% in 2011 due to a turnaround in the production of industrial crops. Palm oil output is projected to recover in the second half of the year in line with an expected normalisation of weather conditions during the period. Similarly, high rubber prices amid low global stocks and strong global demand will continue to encourage tapping activity during the year. Growth of the agriculture sector will also be supported by the sustained high production of food crops in line with the Government's efforts to invigorate the sector, including measures to promote high value-added agriculture activities.

The **mining** sector is projected to expand by 2% reflecting higher natural gas output with the opening of two new gas fields in offshore Terengganu and Sarawak. However, crude oil production is expected to decline further due to scheduled maintenance and the implementation of the Reservoir Management Plan to sustain long-term production.

Growth in the **construction** sector is expected to improve to 5.4% in 2011 (2010: 5.2%), supported by expansion across all sub-sectors. In particular, the civil engineering sub-sector is expected to benefit from the implementation of projects under various Government initiatives. Apart from further progress on on-going projects such as the construction of the Second Penang Bridge, double-track rail networks, LCCT, and oil and gas terminal in Sabah, the civil engineering sub-sector will also be supported by the implementation of new major projects such as the construction of power plants in Terengganu and Sabah as well as the Klang Valley LRT extension. The non-residential sub-sector will be driven by the on-going construction of purpose-built office and retail space and the public sector expenditure on the building and upgrading of schools, hospitals and clinics, while the continued growth in housing demand and favourable financing environment will support growth in the residential sub-sector.

Balance of Payments

On the external front, the current account surplus is expected to increase to RM100.7 billion or 12.5% of GNI in 2011. Higher commodity prices and firm domestic demand will continue to drive growth in gross exports and imports respectively, contributing to a bigger trade surplus. The services account is expected to register a small surplus on account of higher receipts from the travel account. On the financial account, foreign direct investment inflows are likely to increase further while direct investment abroad by Malaysian companies is projected to remain large as the economic outlook, particularly in the region, remains favourable.

Gross exports are expected to expand by 5.4%, a moderation from the high base in the previous year. Manufactured exports are projected to register more modest growth as E&E exports are expected to expand at a moderate pace in tandem with the slower growth of the global electronics industry. Given their relative strength in the computer segment, Malaysian producers are likely to reap limited benefits from the upgrade in the global electronics, driven by smartphones, tablets and other consumer electronic gadgets. Nonetheless, continued regional demand for audio-visuals, such as flat panel televisions and Blu-ray disc players/recorders will continue to support the sustained growth in exports of electrical products. In the non-E&E product segment, the increase in exports is expected to be driven by sustained regional demand for resource-based products, particularly chemicals, petroleum and rubber and higher commodity prices. Commodity exports are expected to continue to register robust growth, supported by higher prices and firm demand for commodities, particularly from the region.

Growth in gross imports is projected to moderate to 5.7% as imports of intermediate goods slow down in line with the more modest growth in manufactured exports. Nonetheless, both consumption and capital imports are expected to grow at sustained rates, supported by the resilient expansion of domestic private consumption and the strengthening of private investment.

The services account is expected to continue registering a small surplus of RM0.2 billion, driven by higher receipts from the travel account as tourist arrivals, particularly from the region are projected to increase amidst active promotional campaigns and increased access through the low-cost airline carriers. In the income account, the deficit is likely to be slightly smaller due mainly to higher earnings by Malaysian companies investing abroad and lower repatriation of profits and dividends by MNCs operating in Malaysia. The former is expected to be supported by stronger commodity prices and favourable economic outlook in the region, while the latter will be affected by the expected moderation in exports.

On the financial account, gross inflows of foreign direct investment (FDI) are expected to increase further in 2011 given the favourable economic outlook, better corporate earnings and rising business confidence. Further improvements in global FDI flows and the Government's wide-ranging economic transformation projects will lend additional support to inflows of FDI into Malaysia. The higher FDI is expected to remain broad based with flows being channelled mainly into the manufacturing, services as well as the oil and gas sectors. In the manufacturing sector, FDI will be in the form of both reinvestment by MNCs for capacity expansion and new investments in new growth areas and emerging technologies. Data from MIDA on approved foreign investment in the manufacturing sector shows that the bulk of the investments will be in industries such as E&E, petroleum products including petrochemicals, basic metal products as well as non-metallic mineral products that are likely to generate high value-added, utilise high technology and create higher skills. FDI in the

Table 4.3

Balance of Payments

	2010*p*	2011*f*
	RM billion	
Goods	136.6	144.3
Trade account	110.2	114.6
Exports (% annual change)	*15.6*	*5.4*
Imports (% annual change)	*21.7*	*5.7*
Services	0.9	0.2
Balance on goods and services	**137.4**	**144.6**
Income	-25.2	-23.7
Current transfers	-21.7	-20.2
Balance on current account	**90.5**	**100.7**
% of GNI	***12.2***	***12.5***
Capital account	-0.2	
Financial account	-21.9	
Balance on capital and financial accounts	**-22.1**	
Errors and omissions	-71.0	
of which:		
Foreign exchange revaluation loss	*-32.6*	
Overall balance	**-2.6**	

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

Table 4.4

External Trade

	2010*p*		2011*f*	
	RM billion	Annual change (%)	RM billion	Annual change (%)
Gross exports	**639.4**	**15.6**	**674.2**	**5.4**
of which:				
Manufactured	486.7	13.0	507.9	4.4
Agriculture	69.9	30.8	78.5	12.4
Minerals	72.8	23.4	78.6	8.0
Gross imports	**529.2**	**21.7**	**559.6**	**5.7**
of which:				
Capital goods	76.4	16.2	84.3	10.3
Intermediate goods	363.2	22.1	382.4	5.3
Consumption goods	34.6	10.1	37.5	8.4
Trade balance	**110.2**	**-6.9**	**114.6**	**4.0**

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

oil and gas sector will continue to be supported by rising prices and increasing demand as well as increased government incentives to the sector. Following further liberalisation of the services sector in 2009, FDI in the services sector is likely to flow into both the financial and non-financial services sub-sectors. Although the amount of foreign investments in the service sector could be relatively small when compared to the investments in the manufacturing sector, these investments are expected to generate higher employment opportunities in the managerial, professional and technical levels, in line with Government's objective of creating a quality workforce and higher income economy.

Direct investment abroad (DIA) by Malaysian companies is anticipated to remain large in 2011 as companies continue to seek new markets and business opportunities abroad. The large DIA is expected to be channelled mainly into the services, oil and gas as well as manufacturing sectors, focusing on regional and other emerging economies. While most of the DIA continues to be led by Government-linked companies, the private sector is also expected to continue to invest abroad by venturing into areas of their expertise and seeking opportunities in existing and new regions and markets. This will continue to benefit Malaysian companies through greater competitiveness arising from having better market access and greater economies of scale, thus, leading to a greater potential for higher repatriation of profits and dividends from investments abroad over the medium term.

Labour Market Outlook

Labour market conditions are expected to remain positive in 2011, with the continued expansion in employment stemming primarily from growth in the domestic-oriented sectors. Job creation will be led by the services sector, particularly in the distributive trade, finance and insurance, and communication sub-sectors. In the manufacturing sector, despite a more moderate growth in the export-oriented industries, gains in employment will be sustained, supported by the expansion in the consumer-related and construction-related clusters. The unemployment rate is projected to remain at 3.2% of the labour force in 2011. The positive employment outlook will underpin expectations of higher wages and income growth of households, supporting sentiments and private consumption activity during the year. Based on a survey conducted by Bank Negara Malaysia, most firms in the manufacturing, non-financial services and construction sectors are optimistic on the outlook for employment and expect further increases in salaries. The overall average salary increment in the private sector is expected to be 4.8% (2010: 4.5%), with an average increment of 3.1% and 5.5% in the manufacturing and non-manufacturing sectors, respectively.

Inflation Outlook

Headline inflation is expected to average 2.5 – 3.5% in 2011. Inflation will continue to be driven by supply factors, especially from higher global commodity prices and further adjustments to domestic administered prices. Demand pressures will be modest in line with the gradual improvements in domestic demand. The wider forecast range reflects greater uncertainty in the external and domestic environment, particularly on global food and energy prices, and the timing and magnitude of adjustments to administered prices by the Government.

Headline inflation is expected to increase, driven mainly by supply factors

On the supply side, global commodity prices are expected to increase on account of disruptions in supply due to adverse weather conditions, geopolitical developments, speculative activities and strong demand from emerging economies. For crude oil, the IMF WEO update in January 2011 projected prices to increase to an average of USD90 per barrel in 2011 (USD79.5 per barrel in 2010). The IMF projection was similar to the survey of analysts' forecasts by Bloomberg in early February 2011, which showed a median projection of close to USD90 per barrel. As demand from advanced economies is expected to remain low throughout 2011, the underlying demand for crude oil is mainly from emerging economies. Supply of crude oil, on the other hand, is expected to remain adequate for the year. In February 2011, the International Energy Agency (IEA) estimated the spare production capacity of the Organisation of the Petroleum Exporting Countries (OPEC) to amount to 4.7 million barrels per day, compared to only 2.3 million barrels per day during the peak of the oil price shock in 2008.

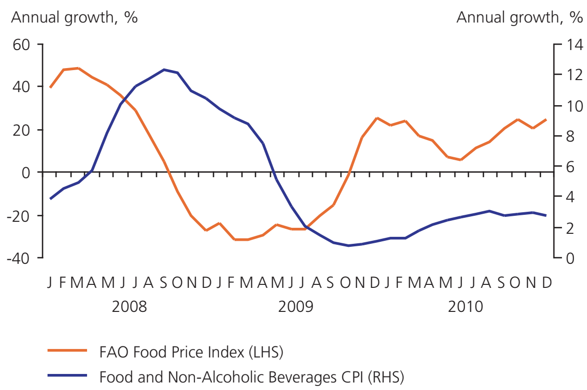
Global food prices in 2011 are expected to remain high as demand pressures remain elevated amidst robust economic growth and rising incomes, especially in emerging market economies such as China, India and Indonesia. Continued disruptions in supply from seasonal factors and adverse weather conditions would exert further upward pressure on prices. The November 2010 edition of the Food and Agriculture Organisation of the United Nation's (FAO[1]) Food Outlook anticipated that the recent rapid pace of increase in food prices will be temporary given that supplies of major food crops are expected to be more than adequate when reserves increase by the second half of 2011. For Malaysia, the impact of higher global food prices in 2010 would also be felt in 2011 as movements in global food prices are transmitted to domestic prices with a lag given that many of the food items in the CPI basket are administered by the Government.

Speculative demand for commodities could also intensify, as investors continue to search for higher returns amidst excess liquidity and low interest rates globally. This could drive up global commodities prices and increase their volatility. Better than expected growth in the advanced economies could also contribute to drive up prices further. Another source of uncertainty is the evolution of geopolitical developments in the Middle East and North Africa region, which could exert further upward pressures on global prices of commodities, especially crude oil.

On the whole, average inflation among Malaysia's key import source countries is expected to be higher in 2011. Prevailing slack capacity and subdued demand pressures from low consumption spending in advanced economies would, to some extent, soften inflationary pressures from these countries. However, strong domestic demand will likely see sustained price pressures in emerging market economies. This in turn would result in higher costs for imported inputs and consumer

Chart 4.5

Food and Non-Alcoholic Beverages CPI and FAO Food Price Index



Source: Department of Statistics Malaysia and FAO

goods from these economies, and exert additional pressure on domestic inflation.

Domestically, as part of the Government subsidy rationalisation programme, a series of adjustments to the prices of administered items is expected for 2011. The impact on overall inflation will depend on the timing and magnitude of these adjustments. However, the price adjustments are expected to be gradual, and this will help to contain the overall impact on inflation.

The pressure on domestic prices from demand factors is expected to be moderate and in line with the steady increase in domestic demand. Increases in wages, improvements in consumer and business sentiments, steady increase in private consumption, and the favourable monetary conditions will continue to support the consumption and investment activities of households and businesses. Consequently, the output gap will be narrowing, albeit at a measured pace, and could turn slightly positive in 2011 (*See white box on Potential Output of the Malaysian Economy*). While this could create upward pressure on prices, the extent of such price pressures are expected to be modest. Moreover, the overall price increases will also be balanced by the potential negative developments in the external sector.

A factor that has attenuated the upside pressure on prices is the appreciation of the ringgit's nominal effective exchange rate since 2010. Thus far, the appreciation has helped to soften the transmission of external price pressures to domestic inflation. However, excessive

[1] The FAO Food Price Index consists of a weighted average of 55 food commodities considered by FAO specialists as representing the international prices of food.

strengthening of the exchange rate can also lead to a misalignment of the exchange rate against economic fundamentals which would in turn have negative implications on the overall economy. Gradual and orderly adjustments in the exchange rate is important to allow for the corresponding adjustments to take place in the real economy.

MONETARY POLICY

Monetary policy in 2011 is expected to operate in an increasingly complex environment characterised by continued uneven global economic growth, high global liquidity, volatile capital flows, and elevated commodity prices. Compared to 2010, when monetary policy focused on preventing the risk of financial imbalances and sustaining economic growth, the upside risks to inflation have become increasingly visible in 2011. Monetary policy will thus continue to support the sustainable growth of the economy while managing the risks to inflation. Emphasis will also be placed on ensuring that monetary policy remains appropriate to avoid the build-up of financial imbalances.

Monetary policy will support sustainable growth of the economy while managing the risks to inflation

The Malaysian economy is expected to grow at 5 – 6% in 2011. The projected growth rates are consistent with the fundamentals of the Malaysian economy. Given the weaker external demand, domestic private demand will have an important role in driving economic growth. Both private consumption and investment are expected to maintain their growth momentum supported by an accommodative policy environment. However, a risk to this outlook is the increase in the inflation rate.

Inflation is expected to trend higher in 2011, driven mainly by commodity and energy prices which have increased sharply due to multiple external factors such as changes in global demand, adverse weather conditions, geopolitical developments, and, to a certain extent, speculative activity driven by ample global liquidity and the financialisation of the commodity markets. This will lead to higher domestic prices. While there is little that monetary policy can do about these “first-round” effects, vigilance needs to be accorded to assess whether such price pressures become entrenched and are reinforced by domestic factors. Under these circumstances, the degree of monetary accommodation may need to be adjusted to ensure that inflation does not increase to levels that will undermine economic activity and erode economic welfare.

Rising inflation may also result in real interest rates becoming negative. Apart from the importance of providing positive real returns on savings to depositors, low real interest rates could encourage excessive risk taking behaviour, the disintermediation of funds from safe assets, like deposits, into more risky investments in a search for higher yields, and potentially spur the build-up of excessive leverage. Such developments create imbalances that could undermine the long-term growth potential of the economy when they unwind, usually in a disorderly manner. In this regard, the stance of monetary policy should remain appropriate to avoid the build-up of financial imbalances. To the extent that such excessive risk taking behaviour or asset price escalations occur within specific segments of the market, other targeted instruments such as macro-prudential measures can be deployed to address such concerns.

Capital flows would pose another challenge to the management of monetary policy in 2011. Large shifts in global liquidity have resulted in significant capital flows into emerging economies, and in particular, into the Asian region. Due to their large size, these inflows have the potential to create sharp movements in the exchange rate. Such sharp movements within a short period of time would be detrimental to economic activity. Decision making by businesses in an environment of such uncertainty about the future pricing of goods and services as well as investments becomes highly challenging. Excessive flows can also lead to a sharp escalation in domestic asset prices, which, when these flows reverse, can then collapse, which will in turn create negative wealth effects. Such flows need careful monitoring and management.

Compared to previous episodes, Malaysia now has greater latitude in managing capital flows. First, the more diversified and developed financial system has helped to intermediate the capital flows. Second, the managed float regime has accorded the necessary flexibility for the exchange rate to adjust to changing conditions. Third, the Bank's ability to manage domestic liquidity has also improved significantly, supported by a wider range of instruments for its monetary operations and augmented by better surveillance and information systems. Fourth, the stronger fundamentals and a healthy level of international reserves also mean that the Bank has the buffers to preserve macroeconomic and financial stability if capital flows were to reverse. Fifth, closer cooperation among central banks in the region also enhances the Bank's ability to be pre-emptive in managing the risks emanating from capital flows.

FISCAL POLICY

Fiscal policy in 2011 is geared towards transforming the nation into a developed and high-income economy by continuing to focus on measures that facilitate and enable a higher level of private sector activity. These measures are guided by the strategies outlined in the 10th Malaysia Plan (10MP), 6 National Key Result Areas (NKRAs) and the 12 National Key Economic Areas (NKEAs). In particular, the 2011 Budget focuses on measures to reinvigorate private investment and boost domestic demand.

In facilitating private sector activities, the 2011 Budget outlined, among others, three key initiatives. First, the establishment of public-private partnership initiatives as a key mechanism to implement Government development projects through private sector funding. Second, the identification of several high-impact development projects to further attract private sector investment, such as Kuala Lumpur International Financial District (KLIFD) and Mass Rapid Transit (MRT). Third, the implementation of measures to enhance the sources of private sector financing, including measures to revitalise the capital market and venture capital industry. There are also measures to enhance efficient public delivery system in order to facilitate transactions between the private sector and Government agencies.

Acknowledging that human capital development is key to transforming Malaysia into a high-income economy, the Government is committed to developing and effectively managing human capital. This is achieved through measures to attract, motivate and retain talent, intensifying training programs and strengthening the quality of education at all levels. Among the announced measures were the introduction of the Industrial

Table 4.5

Federal Government Finance

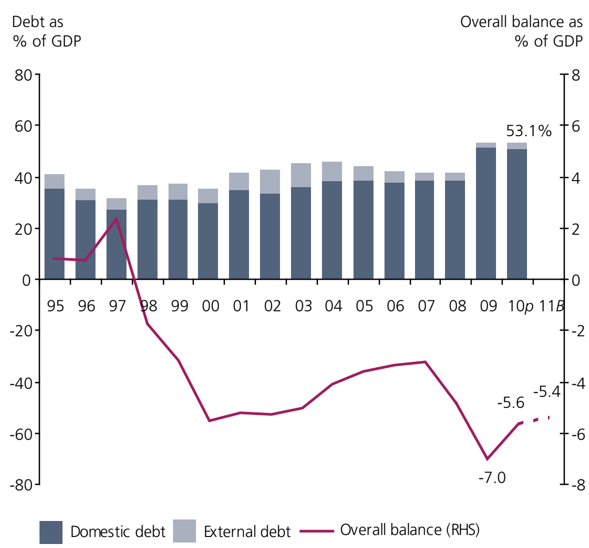
	RM billion		% change	
	2010*p*	2011*B*	2010*p*	2011*B*
Revenue	159.7	165.8	0.6	3.9
Total expenditure	204.4	212.0	-1.0	3.7
Operating expenditure	*151.6*	*162.8*	*-3.5*	*7.4*
Gross development expenditure	*52.8*	*49.2*	*6.6*	*-6.8*
Loan recoveries	1.5	0.7		
Overall balance	**-43.3**	**-45.5**		
% of GDP	**-5.6**	**-5.4**		
Sources of financing:				
Net domestic borrowing	36.5	-		
Net external borrowing	3.7	-		
Realisable assets[1] and adjustments	3.1	-		

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

Source: Ministry of Finance

Chart 4.6

Federal Government Fiscal Balance and Debt



p Preliminary
B Budget

Source: Ministry of Finance

Skills Enhancement Programme and 1Malaysia Training Programme. The Government will also establish a National Wage Consultation Council as the main platform for wage determination to ensure fair wages that commensurate with productivity. In promoting inclusive and equitable economic growth, the Government has also accorded importance to efforts in enhancing the welfare of Malaysians, particularly those from the disadvantaged groups. Hence, budgetary allocations continue to be directed towards providing resources to eradicate hardcore and urban poverty, assist the poor and vulnerable groups by increasing home ownership, enhancing the social safety net and expanding public health facilities.

For 2011, the Federal Government is expected to record a lower fiscal deficit of 5.4% of GDP (2010: 5.6% of GDP). Fiscal expenditure during the year is projected to be higher by 3.7% at RM212 billion (2010: RM204.4 billion) due to the Government reform initiatives and projects under the 9th and 10th Malaysia Plan. Nevertheless, the rising expenditure will be contained as the Government gradually reduces its direct role in the economy while encouraging the private sector to be the main driver of growth. Meanwhile, revenue collection is expected to be higher in 2011 on account of sustained economic performance and higher commodity prices. An increase in the service tax rate from 5% to 6%, as well as other measures related to the enhancement of the tax system, will also increase revenue collection. In terms of financing, the Government will continue to tap the domestic market,taking advantage of the low borrowing cost and ample liquidity.

In the medium term, the Federal Government fiscal deficit is expected to narrow further, consistent with the Government's commitment to a phased consolidation over the next five years, as outlined in the 10MP. Measures to transform the nation into a developed and high-income economy are expected to enhance future growth of the economy, thus providing support for the Government to strengthen its finances. Going forward, the challenge for fiscal policy centres on further consolidation of the fiscal deficit and maintaining a sustainable debt path, while playing a prudent facilitative role in the economy.

2010

GOVERNANCE, COMMUNICATIONS AND ORGANISATIONAL DEVELOPMENT

The year 2010 was the first year of the operationalisation of Central Bank of Malaysia Act 2009 (Act), which came into force on 25 November 2009. With the necessary powers and autonomy accorded to the Bank, the Act also further strengthened the governance framework by enhancing accountability and transparency. To ensure the Bank effectively discharges its roles and responsibilities according to its mandates, focus continued to be on strengthening organisational capacity and capability, including in the areas of strategic management, risk management, communications and talent development.

GOVERNANCE

A key aspect of the Act is the institutionalisation of a more robust governance framework, with a further strengthening of the Board's oversight function. As provided for in the Act, two new Board committees, the Board Governance Committee and the Board Risk Committee, were established in 2010. Similar to the existing Board Audit Committee, the members of these new Board Committees are non-executive Directors. See white box `Operationalisation of Central Bank of Malaysia Act 2009´.

The Board Governance Committee, which had convened five meetings in 2010, made several recommendations to the Board on various issues relating to the budget and operating plan of the Bank, as well as the appointment of members of the Monetary Policy Committee, Shariah Advisory Committee and Financial Stability Executive Committee. The governance process was further enhanced by incorporating an appraisal mechanism to evaluate the performance of the Board, the Board Committees and the individual board members in effectively discharging their roles and responsibilities.

The Board Risk Committee convened three meetings during the year to deliberate on overall risk management at the Bank and approved the new Enterprise Risk Management Framework, including the Operational and Financial Risk frameworks. The Board Audit Committee, which had four meetings in 2010, reviewed and deliberated on matters pertaining to the functions and activities of the Internal Audit Department, to ensure an independent and objective assessment on the Bank's internal controls, governance process and risk management measures. During the year, the Board Audit Committee had deliberated on the internal audit findings and remedial actions to be taken, and provided oversight in ensuring that the Bank's internal control system is continuously enhanced to remain effective in mitigating key risks. In this regard, all material audit recommendations were implemented satisfactorily.

Risk Management

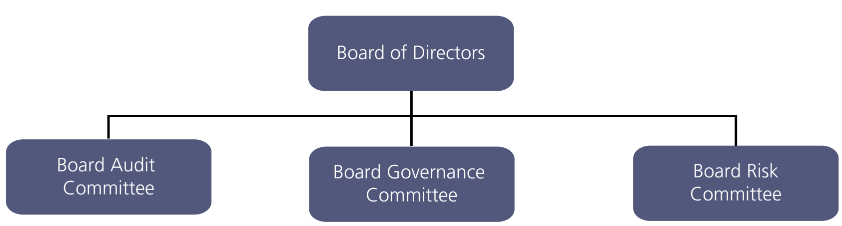
Risk Management Governance

The risk governance structure within the Bank aims to ensure effective management of the different types of risks while meeting the strategic objectives of the organisation. The management of risks is overseen by several committees and their complementary roles are linked through a robust risk management governance framework.

The Board and Board Risk Committee

The Board and the Board Risk Committee (BRC) have the overall oversight function in the governance structure of the risk management framework. The Board provides strategic direction

BNM Governance Framework



on the risk management of the Bank and ensures that the Bank identifies its key risks and has in place the appropriate systems and resources to manage these risks. The BRC, comprised of non-executive directors of the Bank, supports the Board in providing independent oversight in the management of risks. In addition, the Risk Management Department reports directly to BRC.

Risk Management Committee, Operational Risk Management Committee and Financial Risk Management Committee

The objectives of the Risk Management Committee (RMC) are to address strategic risk issues, to oversee the management of risks and to drive the risk management culture in the Bank. RMC ensures that all significant risks are adequately managed and mitigated and that appropriate risk management practices are embedded in the Bank's operations. The RMC is supported by two sub-committees, namely the Operational Risk Management Committee (ORMC) and Financial Risk Management Committee (FRMC), which assist the RMC in identifying the operational and financial risks to the Bank and ensuring that the risks are adequately managed.

Enhancing the Risk Management framework

To address the rapidly evolving landscape, the Bank in 2010 enhanced the current Enterprise Risk Management framework by putting in place a proactive, practical and robust risk management framework, comprising of the new Operational Risk Management (ORM) and Financial Risk Management (FRM) frameworks. The respective frameworks leverage on the existing efforts to nurture a strong risk management culture within the Bank by further promoting practical and robust risk management practices. The ORM framework outlines the overall management of operational risks in the Bank, by promoting sound and effective operational risk management procedures and practices to manage the possible occurrence of events which may adversely affect, among others, the achievement of the Bank's mandates and objectives. The FRM framework outlines the multiple aspects of financial risk management within the context of the Bank and places emphasis on timely identification and effective management of the financial risks.

The three lines of defence

The **three lines of defence** concept is strongly emphasised in the new frameworks to institutionalise effective risk management practices within all areas in the Bank where clarity is given to the role, responsibility and accountabilities in decision-making, as well as control mechanisms in the risk management governance practices.

The first line of defence refers to the line departments which are responsible for identifying, assessing, mitigating and reporting risks within their own areas of business. This essentially means the line departments need to have the strategic understanding and are fully conversant with the risks undertaken and are accountable for ensuring that the appropriate mitigating controls are in place.

The second line of defence is the Risk Management Department function which has both the oversight and advisory roles to the line departments. This second line actively challenges the assessments and initiatives done by line departments by engaging with risk owners and consolidating Bank-wide risks into various risk types.

The risk management function also includes `Risk Policy Owners´, who manage specific transversal risks shared across the Bank, for example people risk, information security risk and legal risk. Risk management for international reserves, in key areas of market, credit and operations is also monitored by the Treasury Risk Management section of the Investment Operations and Financial Market Department. The third line of defence refers to the internal audit function which provides independent assurance and verification of efficacy in implementing the risk management frameworks.

Enhancing Risk Management practices, tools and methodologies

In line with the three lines of defence concept and to strengthen the risk management culture, the Bank adopts both the top-down and bottom-up approaches in classifying the different classes of risks, identifying those accountable for those risks across the organisation and enabling mitigation actions to be effectively communicated. The top-down approach emphasises the strategic risks and the Bank's overall performance and allows assessment of organisational risks that have significant impact on the reputation of the Bank. The bottom-up approach provides a platform for risk issues at the departmental level to be identified and managed accordingly and

Operationalisation of the Central Bank of Malaysia Act 2009

Introduction

The Bank underwent a smooth transition from the legislative framework under the Central Bank of Malaysia Act 1958 to the new Central Bank of Malaysia Act 2009 (Act) when the new Act came into force on 25 November 2009. The new Act provides the Bank with the necessary powers and autonomy to effectively fulfill its mandates of promoting monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy. In line with the requirements of the new Act, the Bank's institutional capability has been further reinforced through the introduction of a more robust governance framework and practices.

Mandates of the Bank

The *raison d'être* for the Bank is expressly provided in its principal objectives of promoting monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy. The Act has also provided for the following primary functions of the Bank:
(i) formulate and conduct monetary policy in Malaysia;
(ii) issue currency in Malaysia;
(iii) regulate and supervise financial institutions which are subject to the laws enforced by the Bank;
(iv) provide oversight over the money and foreign exchange markets;
(v) exercise oversight over payments systems;
(vi) promote a sound, progressive and inclusive financial system;
(vii) hold and manage the foreign reserves of Malaysia;
(viii) promote an exchange rate regime consistent with the fundamentals of the economy; and
(ix) act as financial adviser, banker and financial agent of the Government.

In giving effect to its objects and in carrying out its functions, the Bank shall have due regard to the national interest.

Monetary Stability

The Monetary Policy Committee (MPC) was introduced in 2002 to formulate monetary policy and policies for the conduct of monetary policy operations. The new Act institutionalises this Committee and accords it autonomy in the formulation of monetary policy. The MPC has met six times during the year in accordance with the schedule published by the Bank. To ensure efficient and robust monetary policy deliberation and decision making process, the procedures for the MPC have been enhanced. Each MPC meeting is held over a period of two days and comprises two sessions to ensure sufficient time for presentations, discussions and deliberations and decision making. In the first session, MPC members are apprised of the latest economic, monetary and financial developments and relevant, accurate and timely analysis on monetary policy issues. This is followed by a second session where there is deliberation of issues and decision making by the MPC as well as preparation of the Monetary Policy Statement. MPC members may also request for specific research or analysis to be undertaken with the results being presented at the MPC meetings.

Establishment of New Committees

Pursuant to the provisions of the Act, the Bank has enhanced its governance framework and practices through the establishment and operationalisation of several committees. Members of these committees are drawn from among individuals with the relevant expertise and experience and have been appointed taking into account the need for mixed competencies. Members of the committees are as follows:

Financial Stability Executive Committee	Key Responsibilities
Tan Sri Dr. Zeti Akhtar Aziz (Governor) Dato' Muhammad bin Ibrahim (Deputy Governor) Tan Sri Dato' Sri Dr. Wan Abdul Aziz bin Wan Abdullah Encik Jean Pierre Sabourin Dato' Johan Raslan Encik Philip Koh Tong Ngee	▪ Decide on proposed actions by the Bank to: • issue orders to entities not regulated by the Bank or other supervisory authority; • extend liquidity assistance to: (i) entities not regulated by the Bank; (ii)subsidiaries or branches of Malaysian financial institutions abroad; • provide capital support to a financial institution for the purpose of averting or reducing risks to financial stability.
Shariah Advisory Council	**Key Responsibilities**
Dr. Mohd Daud Bakar (Chairman) Dato' Dr. Abdul Halim Ismail (Deputy Chairman) Tun Abdul Hamid Haji Mohamad Tan Sri Datuk Sheikh Ghazali Abdul Rahman Sahibus Samahah Dato' Haji Hassan Haji Ahmad Dr. M. Anwar Ibrahim Prof. Dr. Ashraf Md. Hashim Prof. Madya Dr. Engku Rabiah Adawiah Engku Ali Prof. Madya Dr. Mohamad Akram Laldin Dr. Aznan Hassan Dr. Rusni Hassan	▪ Ascertain the Islamic law for Islamic financial business and issue rulings; ▪ Advise the Bank on Shariah issues relating to the activities or transactions of the Bank; ▪ Advise any Islamic financial institutions or any other person on Islamic financial business pursuant to any written law; ▪ Issue rulings pursuant to a request from the courts or arbitrator.

In carrying out its functions under the Act, the aforementioned committees are guided by their respective terms of reference or by-laws which set out the practices, functions, roles and responsibilities and accountability of the committee members in decision making.

Financial Stability
Apart from the constitution of the Financial Stability Executive Committee (Executive Committee), the Bank had undertaken several initiatives to put in place an operational framework pursuant to its financial stability mandate under the Act. These include:

Strengthened internal financial stability arrangements and decision making process
The Bank has reinforced its internal institutional and governance arrangements to ensure effective execution of its financial stability functions. The Financial Stability Policy Committee (FSPC) continues to serve as the Bank's internal high-level forum responsible for monitoring and averting risks to systemic stability. In doing so, the FSPC may implement macro prudential measures or impose specific actions to resolve problems within individual institutions as required to address identified risks to financial stability. The FSPC is also responsible for (i) making specific recommendations to the Executive Committee on the appropriate intervention and resolution actions in accordance with Section 38 of the Act; and (ii) monitoring the implementation of approved actions as commissioned

by the Executive Committee. The FSPC is also accountable for decisions to invoke Section 98 of the Malaysia Deposit Insurance Corporation Act 2011 and may issue a notification of non-viability of a member institution to Malaysia Deposit Insurance Corporation (MDIC) for resolution.

In addition, the Bank is also developing a systemic stability framework that will further enhance existing policy structures and analyses to capture the interlinkages, trade-offs and necessary coordination between key policy areas within the Bank for financial stability. The systemic stability framework aims in particular, to promote greater focus, coverage and coherence between macro prudential, micro prudential and crisis management policies to support the effective performance of the Bank's mandate for financial stability.

This framework will also contribute towards strengthening the Bank's internal governance and processes and serve as a performance management tool to monitor the Bank's overall effectiveness in achieving its financial stability mandate.

While the effective conduct of monetary policy presupposes a stable and healthy financial system as an effective transmission mechanism, continued financial stability requires effective and sound monetary policy and macroeconomic conditions. Given that monetary and financial stability are highly interdependent, efficient implementation of policies in both areas are critical towards sustainable economic growth. In this regard, the Bank has introduced an internal organisational process that ensures effective coordination of financial stability policies that may have wider impact on macroeconomic and monetary conditions. For this purpose, the Bank has established a joint MPC-FSPC forum to deliberate macro prudential policies that have broader implications for the economy. This joint forum provides for the Bank to effectively manage complex interactions and policy trade-offs between these mutually reinforcing mandates. In 2010, the joint forum met once to deliberate and decide on the policy responses to the developments in the household sector and property market.

Co-operation with other supervisory authorities

In cognisance of the importance of timely information flows and coordinated policy responses, Section 40 of the Act empowers the Bank as the authority for financial stability to enter into arrangements with other supervisory authorities and co-ordinate financial stability measures with the same. Further, the provision also empowers the Bank, where necessary, to obtain or share any information or document with the supervisory authorities. The Bank engages with other regulatory authorities such as the Securities Commission (SC) and MDIC on a regular basis and is currently reviewing its memorandums of understanding with these agencies particularly in the areas of surveillance and supervision to facilitate the timely identification of pre-emptive responses to systemic risk within clear accountability structures and frameworks that are consistent with current legislation. Work is also underway to establish new memorandums of understanding with other regulatory agencies such as the Suruhanjaya Koperasi Malaysia (SKM) in view of the growing significance of the cooperative industry in the domestic financial landscape as well as with supervisory authorities in the region to support the effective monitoring and supervision of regionally active financial institutions.

Oversight of money and foreign exchange market

The orderly functioning of and confidence in the money and foreign exchange market is critical for monetary policy functions and financial stability. Accordingly, Section 43(1) of the Act empowers the Bank to issue rules, codes, standards, principles or guidelines for the purposes of regulating, developing, or maintaining orderly conditions or the integrity of, the money market, the foreign exchange market or the market for the derivatives related to the currencies, securities and other financial instruments traded in these markets. The oversight responsibility of the Bank would include regulation, supervision and market conduct surveillance in these markets.

The Bank is currently finalising the regulatory scope for the money market, the foreign exchange market and the market for the derivatives related to the currencies, securities and other financial instruments traded in these markets. This will include a comprehensive review of current arrangements for participation in these markets, the administration and enforcement of relevant regulations and codes of conduct applicable to market participants and the role of self-regulating organisations in promoting confidence, orderly and transparent dealings in the markets.

The Bank and SC are also in the process of reviewing the existing Memorandum of Understanding to incorporate, among others, joint-regulation arrangements to provide clear responsibilities and collaborative mechanisms for the regulation of derivatives or financial instruments in the money market which are within the supervision and oversight of the supervisory authorities.

Enhanced framework for provision of liquidity assistance

To support the enhanced powers and flexibility accorded to the Bank under the Act to provide emergency liquidity assistance, for the purpose of preventing institutional or market liquidity shocks from threatening systemic stability, the Bank's existing Emergency Liquidity Assistance (ELA) framework is being strengthened and aligned with the new requirements under the Act. This enhanced framework for the provision of ELA is aimed at ensuring continued efficacy of the lender of last resort function of the Bank (including strengthened internal arrangements for the coordination of viability assessments of institutions requiring liquidity support) and ensures commensurate operational, governance and accountability mechanisms.

Board of Directors and the Board Committees

Under the new legislative framework, the Board of Directors of the Bank remains responsible for the oversight over the management of the Bank and keeps under constant review the performance of the Bank in giving effect to its mandated roles. Throughout 2010, the Board convened twelve meetings to deliberate on various aspects of the Bank's business and affairs including approving the Bank's budget and operating plan, the by-laws for the MPC and the Board Committees of the Bank.

In carrying out its oversight function, the Board of Directors is assisted by three Board Committees. Each Board Committee is composed of three independent and non-executive Board members and is governed by its respective by-laws as approved by the Board. The Chairman of the Board Committees is appointed from a member of the respective Board Committees. The Board Committees are as follows:

Board Governance Committee	Key Responsibilities
Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor (Chairman); Tan Sri Dato' Seri Dr. Sulaiman bin Mahbob; Encik Chin Kwai Yoong	▪ Review the effectiveness of and recommend the principles and practices of governance of the Bank; ▪ Periodic review of the mandates of the Bank and make recommendations to the Board; ▪ Recommend members to various important committees such as the MPC, the Executive Committee and the Shariah Advisory Council (SAC); ▪ Examine and recommend the budget and operating plan of the Bank.
Board Audit Committee	**Key Responsibilities**
Datuk Oh Siew Nam (Chairman); Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor; Dato' N. Sadasivan	▪ Assist the Board in its oversight of the integrity of the accounts and financial statements of the Bank, the effectiveness of the internal control systems, the performance of the internal audit function as well as compliance with legal and regulatory requirements.
Board Risk Committee	**Key Responsibilities**
Dato' N. Sadasivan (Chairman); Datuk Oh Siew Nam; Tan Sri Dato' Seri Dr. Sulaiman bin Mahbob	▪ Assist the Board in the oversight on the review and management of the enterprise risks of the Bank.

Since its establishment, the Board Governance Committee (BGC) met five times to deliberate on various issues concerning governance practices within the Bank. The BGC had made recommendations for the appointment of the MPC members as well as members of the Executive Committee and the SAC. The BGC had also made recommendations on issues relating to the Bank's budget and operating plan as well as an appraisal mechanism to evaluate the performance of the Board, the Board Committees and individual board members in discharging their respective roles and functions.

The Board Audit Committee (BAC) convened four meetings throughout the year to assist the Board in providing oversight on the Bank's financial reporting, internal control environment and compliance with legal and regulatory requirements. The BAC oversees the Internal Audit Department of the Bank and approves its audit plans, scope of work and resource requirements. The BAC also reviews the internal audit findings and recommends actions to be taken by the Management to ensure their timely rectification. In addition, the BAC reviews the National Audit Department's audit reports, including their findings and any remedial action to be taken by the Bank.

The Board Risk Committee (BRC) convened three meetings in 2010 to review the management of the enterprise risks faced by the Bank including risks of financial loss, disruption to operations, failure to attain the Bank's objectives or other residual risks that could give a negative perception to the Bank's reputation. In this regard, the BRC had reviewed and recommended the new Operational Risk Management (ORM) and Financial Risk Management (FRM) frameworks for the Board of Directors' approval. The ORM and FRM frameworks were approved by the Board of Directors in November 2010 and January 2011 respectively. The development of both frameworks is part of the overall enhancement to the Bank's Enterprise Risk Management framework which is aimed to further strengthen the Bank's approach in the management of risks facing the Bank, taking into account new challenges in central banking.

Conclusion

Moving forward, the powers vested with the Bank under the Act together with the strengthened governance framework ensures that the Bank is well positioned to discharge the roles and responsibilities of preserving monetary stability and financial stability to best serve the Malaysian economy in the years ahead.

to ensure that Senior Management is kept aware of the day-to-day operational risks in the Bank.

The Bank also applies effective risk management tools to facilitate the management of risks, such as the Risk Control Self Assessment (RCSA) methodology. RCSA is a comprehensive technique for managing risks, particularly operational risks within departments, and is based on the premise that departments are responsible for managing their own risks. It is an ongoing effort of facilitated profiling of risks to ensure systematic identification and management of risks in the Bank. Enhancements to the RCSA were introduced in 2010 via the adoption of eRCSA, a system built to enable the maintenance of a Bank-wide risk repository, to clarify risk accountability lines, as well as to embed the risk management culture at all levels of the Bank. The system facilitates risk analysis and ensures better and up-to-date data quality. Data consistency is also improved with the enhanced risk taxonomy in place to build a common understanding of risk terminologies. As part of the continuous improvement in the current controls, clear escalation procedures on risk events have also been formulated to strengthen the governance process.

Strengthening Business Continuity Management readiness

The Bank continues its efforts to strengthen its readiness and response capabilities to address business disruptions. One of the key initiatives for Business Continuity Management (BCM) in 2010 is the establishment of the BCM Working Group which is responsible for developing an integrated BCM framework which includes implementing proper governance and processes. It also aims to enhance industry-wide coordination and collaboration, and develop industry-wide BCM testing for the Bank and financial sector. In addition, the Crisis Management Team has approved a shorter timeframe for notification of Combined Live Runs as part of the efforts to enhance the Bank's readiness in handling crisis situations.

Risk Management outlook

Risk management practices ensure that the Bank is well prepared for both the foreseen and unforeseen challenges given the unpredictable and rapidly changing operating landscape. The Bank remains committed to continually strengthening its risk management capabilities to ensure that risks are adequately managed during the course of performing its functions.

In line with this, several planned initiatives are currently underway to further enhance the risk management approach, which includes strengthening the assessment of reputational risks faced by the Bank, collaborative efforts to link risk assessment outcomes with strategic planning and resource planning in ensuring strategic goals are met, further enhancement of risk management tools through the development of Key Risk Indicators and Incident Reporting, as well as enhancements to the risk management culture through efforts like workshops conducted for all departments, participation in Bank-wide knowledge fairs and other engagements.

Moving forward, the Bank will also continue to evolve its risk management practices, internal controls and BCM planning. This will ensure the Bank is well equipped with the right capacity and capability to face risks and withstand any future challenges. A strong and robust risk management framework will not only support the Bank's stability during the good times but also safeguard its credibility during times of trials.

Internal Controls

The Internal Audit Department (IAD) assists the Board Audit Committee (BAC) in meeting its objectives by providing an independent and objective assessment of the state of the Bank's internal control systems. IAD reports directly to the BAC and is independent from the Bank's business activities and does not assume any business or operational responsibilities. To ensure comprehensive and robust audit planning exercise for each audit assignment, IAD collaborates with the Risk and Strategic Management departments in identifying and evaluating inherent risks, reviewing key issues and concerns, and assessing the risk control functions in the significant activities and core processes of the Bank.

The Bank's risk based internal auditing framework incorporates a holistic review of significant activities and core processes of the Bank as well as the risk control functions in determining the frequency and coverage of audits to be conducted. An overall audit rating is assigned based on the assessment of the control environment of the areas reviewed. Audit priority ratings are also provided for specific audit issues raised based on their significance and risk, which are escalated to the appropriate level of Senior Management and the Risk Management Department. Reviews are concurrently conducted on clusters of line departments that are involved in a specific core process of the Bank as well as on clusters of line departments that undertake a common significant activity, to ensure that risks, spanning between relevant line departments in core processes and major risks that are inherent in significant activities across line departments, are adequately assessed. IAD provides regular updates of its findings and assessments to the BAC and the Senior Management. In addition, Jabatan Audit Negara (National Audit Department) provides its periodic oversight on the conduct and audit coverage of IAD.

COMMUNICATIONS

The Bank's communications initiatives in 2010 focused on several key areas including the economic outlook, monetary stability and financial sector soundness and resilience. Strategic engagements were initiated with the Government, the media, financial industry, analysts and economists, representatives of industries from the real sectors of the economy and the public. These engagements were carried out through various channels, including media conferences, meetings, dialogues and roadshows. It has increased the understanding of the Bank's role in promoting macro economic stability that is important for sustainable growth, ensuring the soundness and resilience of the financial system while developing an effective and efficient financial sector.

Annual Report – key platform for providing assessment on the economic outlook and facilitating better understanding of the developments and policies that affect the economy and financial sector

Engagement sessions were carried out during the presentation of the 2009 Annual Report and the Financial Stability and Payment Systems Report, held in the early part of the year. Throughout the year, the Bank had continuous engagements with representatives from the manufacturing, services, construction and mining industries, to gain insights into the issues facing these industries, and to obtain their views on their industries' performance and outlook. These engagements provided the Bank with valuable insights on issues affecting key sectors of the economy and the overall prospects for the Malaysian economy.

Monetary policy communications

The Monetary Policy Statement was the main medium of conveying the decisions taken on monetary policy. The Bank's decision to normalise the policy rate in the early part of the year to mitigate potential risks of financial imbalances and ensuring sustainable growth was communicated and explained mainly through the Monetary Policy Statements that is issued after each of the Monetary Policy Committee meeting. This is reinforced with engagements with the industry, analysts and economists. The communication efforts focused on ensuring understanding that during this period of normalisation, monetary policy remained accommodative and that the thrust of policy was to avoid financial imbalances and the potential emergence and destabilising effects on the economy. These communication activities have resulted in orderly adjustments in the money market, lending rates in the economy as well as greater understanding by the stakeholders of the rationale behind the Bank's monetary policies.

Strength and role of the financial sector

During the year, communications initiatives continued to focus on the measures that were taken to ensure continued resilience of the financial sector, and to ensure that the sector continues its effective and efficient intermediation function in the economy. Communications on the various measures to address concerns about household indebtedness were also undertaken.

With regard to Islamic finance, wide coverage was given to developments in the sector. Further communications and promotional activities were carried out under the Malaysia International Islamic Financial Centre (MIFC) initiative to solidify Malaysia's position as the leading International Islamic Financial Centre. Other areas of focus included the value propositions of Islamic finance in contributing to financial stability and its growing relevance in the global financial system. These efforts helped to strengthen the MIFC brand.

The Malaysian financial sector achieved a higher ranking when the World Economic Forum ranked the sector five notches higher to 17th position in its financial development index, the highest ranking among emerging economies.

As part of the continuous efforts in building confidence in the financial system, deposit insurance limits for banks were increased to RM250,000 effective 31 December 2010. The protection system was also extended to insurance and takaful policy holders, thereby strengthening consumer protection further. Of importance was that the blanket deposit guarantee scheme expired without it being recoursed to even once.

Continuously extending the Bank's communication outreach with stakeholders

During the year, continuous engagement efforts with the various stakeholders were undertaken as part of the Bank's initiative in increasing awareness on financing as well as promoting financial literacy.

Arising from the Bank's broader developmental role, increased communication efforts were undertaken to improve access to SME financing, given this sector's importance in supporting economic growth and employment. The Bank, in collaboration with the Association of Banks in Malaysia (ABM), Credit Guarantee Corporation and SME Corporation Malaysia (SME Corp) engaged with SME associations and business chambers nationwide in training personnel to manage the SME Financing Help Desks at their respective offices, and provide advisory services to their members. It is envisaged that approximately 60 trainers from 15 SME associations and business chambers would be trained in 2011. Efforts were also undertaken in promoting micro financing nationwide through strategic tie-ups with the Department of Housing and Local Government, SME Corp and Bank Simpanan Nasional. These were supported by about 100 roadshows, with exhibitions, seminars and workshops, promoting banking services for SMEs and micro enterprises, as well as educating the general public, teachers and students, on how to practise prudent financial management and its importance in their daily lives.

In addition, the Bank held dialogues with various business associations and chambers, providing latest developments on SME access to financing, and also participated in engagement sessions organised by ABM with business organisations in various states. Continuous efforts were also undertaken by the Bank in facilitating engagements between banking institutions and specific industries.

With the outreach of financial education and advisory services to the public continuing to be an important agenda for the Bank, delivery channels were expanded through the introduction of mobile counter services in smaller towns, beginning with the state of Selangor. For the first time, the Bank formed strategic collaborations with consumer associations in disseminating information and educating the public on financial matters. Other efforts by the Bank in enhancing financial literacy were enabled through working with Members of Parliament and business chambers and associations by publicising and disseminating useful financial information to their constituencies and members. During the year, the Bank also communicated alerts through media and mobile phones on matters of public concern and interest such as financial scams and illegal deposits taking schemes.

In promoting financial literacy and sound financial management for young individuals and new borrowers, the `Pengurusan Wang Ringgit Anda´ (POWER!) Programme was launched in January 2011, driven by Credit Counselling and Debt Management Agency (AKPK). The objective is to empower this group to effectively manage their finances, contributing towards promoting better protection for financial consumers and a more resilient household sector.

As a result of the greater awareness on the Bank's Integrated Contact Center (comprising BNMLINK, BNMTELELINK and the Complaints Management and Advisory Unit), the number of cases seeking its services reached 293,388 in 2010, an increase of 15.6% over 2009.

The Bank also regularly engaged with the banking and insurance sectors on ways to provide a higher standard of service to the public. Various dialogues were held with individual financial institutions on complaint handlings and consumer related issues to ensure customers are fairly treated and provided with improved services.

The Bank's efforts in engaging with the public were complemented by AKPK and the Financial Mediation Bureau (FMB) services. During the year, AKPK counseled a total of more than 30,000 customers nationwide, with more than half of them being further assisted via its debt management program. The programme provided personalised debt repayment plans to be put in place to assist distressed borrowers repay their outstanding loans to financial institutions. The FMB, in turn, assisted more than 2,100 customers, free of charge, in resolving their banking and insurance matters with their financial service providers. The services provided by these agencies have continued to facilitate the public to be more informed and have better control of their financial situation.

As part of the policy formulation process of the proposed third party bodily injury and death cover, the Bank conducted a series of engagement sessions with the relevant stakeholders. Arising from this, there was constructive feedback and buy-in towards the Bank's efforts to formulate a more holistic new motor cover framework including measures to improve the overall claims settlement process.

Increased accessibility to online communications

With technology revolutionising the communications channels such as through the growing importance of online media, the Bank continued its efforts in providing greater outreach to the public through its website. Following the revamp in 2009 and the introduction of new content segments, the website now provides better information on the Bank's regulatory, supervisory and developmental functions. Reflecting this, there were increased number of unique visitors, website visits and page views; with over 2 million visitors (+31%), 5.4 million website visits (+26%) and about 13.8 million page views (+7%).

The Monthly Statistical Bulletin was revised to a new format on the Bank's website, providing its readers with updates on the monetary and financial conditions in a more concise manner.

The Bank has also ventured into social media channels, such as Facebook and Twitter, for greater stakeholder interactivity. These new channels, have helped increase the Bank's website visits and paved the way for greater outreach to stakeholders.

Continued engagement with staff in enhancing performance

Fostering team work and collaboration among staff has assumed major significance in the Bank's internal communication programmes, to engage and motivate them in driving productivity and excellence. The Bank places strong emphasis on its value system as it is fundamental to the smooth operations of the Bank, the professional conduct of its staff and their interaction with stakeholders. During the year, the Bank reinforced its core shared values by embarking on a series of engagement programmes. The shared value theme was incorporated in the Bank's Knowledge Fair, Annual Dinner and events organised at the Bank in conjunction with 2010 FIFA World Cup, providing participants the experience and a common understanding of the Bank's shared values.

Communications challenges for the Year 2011

Moving ahead, the operating environment is expected to remain challenging, leading to higher expectations of stakeholders on the Bank's role in the economy and financial system.

Against the background of uncertainty, it will be necessary for the Bank to continue to provide in a timely manner its views and perspectives on the outlook of the economy, inflation and other important monetary and financial developments. Communication initiatives will also be undertaken in providing further clarity on the new Financial Sector Blueprint, particularly in highlighting the facilitative and driver roles of the financial sector in supporting Malaysia's economic transformation into a high income, high value-added economy.

In line with the need to extend the outreach of LINK services to people in rural and remote areas, Mobile LINK services will be introduced in June 2011. Strategic tie-ups with consumer associations will also be further strengthened to facilitate efforts in enhancing financial capability of consumers, promoting financial inclusion and strengthening the public confidence in the financial services industry. Efforts will continue to be directed at organising more roadshows to enhance public understanding on financial matters and thereby improving their financial capability.

With the online communication landscape changing radically and with society imposing greater demands for online content, the Bank will also broaden its delivery channels such as including access through mobile devices and leveraging on the advances in communication technology.

ORGANISATIONAL DEVELOPMENT

Strategy Focus and Orientation

The Bank continued to deliver its mandates in a more challenging environment in 2010. Through a robust strategic management process, the

Bank's strategic objectives and outcomes were communicated across the organisation, enabling effective capacity and capability building in addressing current and future challenges.

Achieving Bank's strategic outcomes

The Bank completed a full cycle of the strategic management process in 2010 which encompassed strategic planning, implementation and review of the Bank's Business Plan 2009-2011. Specifically, the review process has provided an important and instrumental platform to facilitate focused discussion by management in evaluating the achievement of the Bank's outcomes, to prioritise key activities, as well as to identify and address risks and challenges faced by the Bank. Senior Management was provided with a comprehensive half-yearly assessment report on the progress of the Bank's strategic outcomes, action plans and key issues affecting the achievement of these outcomes. The robustness of the strategic management process will be further enhanced with the integration of risk assessment processes.

During the year, greater alignment and prioritisation of activities were achieved in the key planning and budgeting processes of the Bank, via greater collaboration among the risk, strategic and financial management functions, as well as, audit, technology and human resource planning.

In line with the development of the new Financial Sector Blueprint, the Senior Management Conference (SMC) for 2010 was anchored upon understanding the future financial system that will support Malaysia's transition to a high value-added economy. The SMC also provided a platform for in-depth discussion and engagement on issues affecting the successful implementation of the Financial Sector Blueprint to ensure that the financial system will continue to support growth as well as act as a catalyst for Malaysia's aspirations to become a high income, high value-added nation.

Building a High Performance Workforce

Talent management, anchored on an integrated human capital management framework, continued to remain one of the top priorities for the Bank. The human capital strategy of creating a healthy talent pipeline is focused on strengthening the Bank's internal capacity and capability. The Bank continued its long term investment in building the leadership pipeline by ensuring a robust process of reviewing and matching of roles and functions of existing talents through its Leadership Profiling Centre as well as attracting high caliber talent with the potential for greater responsibility.

A major milestone in 2010 was the operationalisation of the Risk and Actuarial Specialist Ladders initiative. The group of professionals in these key knowledge areas is an important foundation to support the thought leadership of the entire Bank as well as the financial sector at large. To ensure that healthy pool of these professionals are readily available, the Bank undertook a dynamic rewards strategy which was both market driven and innovative.

Empowering fresh talent with the knowledge, skills and the right attitude for success gained momentum through the New Executives Programme for Central Bankers with the successful completion of four batches of new executives in 2010. Through this programme, the talent was able to have a greater understanding of the functions within the Bank as well as foster tight working relationships with peers and colleagues from across the Bank. This programme sets a solid foundation that will serve the participants well in future years and foster high engagement in the Bank.

Fortifying the organisational structure

The Bank initiated the streamlining of roles that require certification of technical skills and knowledge at the diploma level with the introduction of the Non-Executive Job Bands and Career Progression Framework. In addition, a new Behavioural Competency Model was also developed for these roles to imbue behaviours and attitudes that reflect the Bank's values.

Continuous building of talent pipeline

In ensuring that the Bank's leadership succession pool remains healthy and ready, the Bank continues to invest in the profiling and development of its talent. A structured and robust profiling process followed by feedback and focused leadership development, will enhance job-fit for mission critical positions, strengthen leadership capabilities and create a healthy organisational climate. While ensuring that succession management ultimately serves the Bank's needs, individual aspirations are also accorded recognition to promote continued motivation and retention.

While the Bank places importance in the development of its existing staff, a significant feeder pool to the Bank's future talent are the Bank's scholars. In 2010, 84 high caliber students received scholarships to pursue pre-university and first degree programmes in various fields of studies which are relevant to central banking functions.

The Bank's conviction to contribute positively to nation-building continued to be realised through the Kijang Emas Scholarship Award, granted only to students with exemplary results in the Sijil Pelajaran Malaysia (Malaysian Certificate of Education) examination. For 2010, five top students in the nation were granted the award and given the liberty to embark on any field of studies with top notch higher learning institutions anywhere in the world. In the spirit of service to the country, these students are required to return to Malaysia upon completion of their studies to serve the nation. Since its inauguration in 2005, this prestigious scholarship has been awarded to 32 top students who had taken a range of learning disciplines such as medicine, engineering, economics, law, actuarial science, genetics, biochemistry, architecture, psychology and accounting.

To assist talented students that were facing financial difficulties, the Bank awarded 20 scholarships under its `Scholarship Award for Secondary Schools´ programme, to such students who had exemplary results in the Penilaian Menengah Rendah (Lower Secondary Assessment) examination. The scholarships enable these students to continue pursuing their secondary education and also create a potential source of future talents for the Bank.

Managing the performance curve

Being a performance-driven organisation, the Bank continuously raises performance standards in its drive for excellence. While top performing talent is incentivised through differentiated rewards, the Bank also took steps to effectively manage staff who have difficulty in work performance through a Performance Improvement Programme with collective accountability from line departments.

Staff strength

While departments in the Bank took steps to rationalise and re-align their functions and roles, every effort was made to optimise the combined impact of technology, improved processes and a more competent workforce. At the end of 2010, the total staff strength increased marginally by 0.9% to 2,734 compared with 2,709 as at end 2009. Attrition, mainly due to retirement and resignation continued to remain stable at four percent. The ratio of executive to non-executive staff was also stable and remained close to 3:2.

Future orientation

To remain ahead of the curve for human capital imperatives and strategies, the Bank has begun the process of streamlining human capital management practices with the proposed merger of its Knowledge and Learning Committee into the Human Capital Management Committee. This would provide impetus for more concerted effort focused on providing business-centric responses on the Bank's most valued asset, its people.

The Bank's future plans also include empowering staff to take ownership of their personal development and growth by providing them with a comprehensive document, known as a Development Advisor Manual (DA), which will contain a wealth of developmental options. The DA is the cornerstone that will enrich individual development efforts of Bank staff as self directed learners and will also enhance and elevate the learning and development interventions for all staff based on their target levels in the Behavioural Competency Model. The Bank will also be introducing comprehensive information on career opportunities on the Bank's HR portal. Being better informed on the various career paths, Bank staff would be in a position to be more proactive in their career choices within the Bank. This feature would create further opportunities for on-line learning, as the Bank leverages on the IT platform to enable `anytime, anywhere´ learning solutions.

Attracting, retaining and motivating staff through a dynamic rewards strategy would be another focus in 2011. This is to make certain that the Bank's rewards practices remain relevant and competitive. While the Bank keeps abreast annually with the general market salary trends and remuneration practices, periodic adjustments and salary revisions are undertaken to ensure appropriate financial compensation for the value of jobs which will change over time in response to changes in the Bank's business requirements.

Developing the Bank's Workforce through Learning and Knowledge Management

In ensuring the Bank remains well positioned to face challenges, emphasis is given to nurturing the right talent with the necessary competencies to perform effectively. In 2010, concerted efforts were undertaken to further enhance the development of the Bank's workforce. This involved two main strategic thrusts, namely, enhancing the alignment of learning and knowledge management to the business needs and building an enabling environment to nurture greater learning and growth.

Greater alignment to achieve business results

In ensuring greater alignment to the business results, further refinements were made to enhance the comprehensiveness of the Bank's learning and knowledge needs analyses (LKNA). A more structured LKNA exercise was carried out in 2010 and this formed the basis for developmental interventions in accelerating the time to competence of the Bank's workforce. The Bank remains supportive of developing its workforce and this was reflected by the increase of learning investment for 2010, which stood at 12% of the total staff salary (10% in 2009).

In complementing the Bank's efforts to ensure a more healthy talent pipeline, the Bank focused its efforts towards improving the Leadership Development Blueprint. The quality and capacity of leadership talent within the Bank was further augmented through greater self awareness of leadership strengths and developmental needs while emphasising coaching and mentoring at the workplace as well as organising programmes to further enhance staff engagement. In addition, attention was also given to the design of the Bank's new hires programme to reduce the time to competence and to produce `ready-now´ central bankers who can achieve seamless transition to the workplace.

To meet the demands for solutions that satisfy the developmental needs of knowledge workers, with focus on positive impact on performance of business units, efforts continued to be directed towards increasing the availability of customised learning solutions. As a result, the overall number of `on-demand´ customised solutions to address developmental needs increased more than 100% in 2010.

Building an enabling environment for learning and knowledge sharing and seeking

As part of the Bank's strategy to create a knowledge rich and an enabling environment for learning and growth, further initiatives to strengthen the Bank's learning and knowledge management environment were implemented through multiple channels, such as the annual knowledge fair (K-Fair) and engagement with Senior Management via events like Conversations with Senior Management (CoSM) and Central Banking Tea Talks series, which continued to receive strong participation rates. The annual K-Fair continued to be one of the main platforms to promote knowledge seeking and self-directed learning culture amongst the Bank staff.

The Bank was recognised as a Centre of Excellence in its role to catapult the learning and growth in 2010. Apart from being benchmarked for leadership in the area of learning and knowledge management by both international and domestic organisations, higher demand for BNM's Flagship Learning Programmes was evident in 2010. This positive trend provided the impetus for more enhanced collaboration with strategic partners both within as well as outside the country such as the Toronto Leadership Centre, International Monetary Fund (IMF) and Committee on Payment and Settlement Systems (CPSS).

The leadership of the Bank continued to champion and sponsor human capital development initiatives by their active participation as teachers as well as subject matter experts in various learning and knowledge initiatives and flagship programmes. The Bank also received recognition by the International Islamic University Malaysia (IIUM) for its Certificate in Islamic Law (CIL) programme organised jointly with IIUM. As of end-2010, the programme has produced 60 graduates since its commencement in 2008.

Moving forward, the Bank will remain steadfast in its commitment to providing an enabling environment for talent development. Much of the focus for the next year will be centred on real-time learning through the concept of bringing the classroom to the workplace.

Technical Cooperation Programmes with External Agencies

In 2010, the Bank received a total of 112 requests from other central banks and international agencies to study the strategies and systems that have contributed to the successful development of the Malaysian financial system. The significant increase in such knowledge sharing activities created opportunities for the Bank to engage with central bankers from Asia, Central Asia, the African continent

Corporate Social Responsibility

Corporate Social Responsibility (CSR) has always been an integral part of the Bank's mandates. Over the years, the Bank has carried out various CSR initiatives, including the Bank Negara Malaysia special scholarship programme, initiatives in support of young artist and the Graduates Programme aimed at enhancing employability of unemployed graduates. In 2008, the Bank Negara Malaysia Volunteers Association or `BNM Volunteers´ was established to provide an avenue for the Bank's staff to undertake outreach initiatives for targeted segments of the community.

1. BNM Volunteers

Establishment of the BNM Volunteers was to enable staff to pursue meaningful social activities, indirectly striking the delicate balance of work and life and in the process, develop leadership skills, boost morale and build character. With the motto `Make A Difference´, the volunteers set about in their efforts to contribute towards the advancement of disadvantaged communities, such as the hard-core poor, underprivileged women and children, the disabled, senior citizens, and those who have suffered misfortune due to health or environmental calamities, through hands-on volunteer community service projects and monetary contributions.

A wide range of activities were planned and executed in 2010 to benefit the underprivileged and less fortunate, as well as to increase general awareness on financial literacy and healthcare. The spirit of volunteerism at the Bank is not limited to staff, but also to family members and friends. The Bank's branches nationwide also actively participated in the programme by identifying and assisting the underprivileged in areas otherwise unknown and inaccessible from the Bank's headquarters in Kuala Lumpur. Some of the programmes embarked by the BNM Volunteers group are:

Financial Literacy Programme

Financial Literacy Programme (FLP) is designed to educate small groups of the community on basic financial knowledge such as savings, expenses, investments, debt management, budgeting and microfinancing. It is conducted monthly in collaboration with the Non-Governmental Organisation (NGO) Generasi Gemilang, targeting poor households mainly consisting of single mothers. BNM Volunteers is planning to further spread financial awareness to the communities in Sri Pantai and Prima Selayang in 2011.

As part of an extension of the FLP programme during the month of Ramadan in 2010, BNM Volunteers accompanied participating families of Sri Pantai for a shopping trip at a local hypermarket. Each family was given RM150 to purchase food, clothing and household items. As participants have had four briefing sessions on Personal Financial Management prior to the shopping session, an evaluation was made by the BNM Volunteers to gauge participants' understanding of financial management after the trip.

LET'S BRING 'EM FOOD!

BNM Volunteers collaborated with Pertubuhan Tindakan Wanita Islam (PERTIWI) to provide free healthy meals and clean drinking water to various destitute inner city communities on a regular basis. In addition to donating money to provide food, groups of six to eight BNM Volunteers helped to distribute food prepared by PERTIWI every Friday evening for a period of 12 weeks. The food was delivered via the `food van´ to designated areas in Chow Kit, near Dayabumi and Masjid India.

Contribution and Donation for Victims of Natural Disasters

BNM Volunteers have also assisted in channeling donations to help victims of natural disasters during the year. One of the initiatives involved collaboration with BNM's Museum and Art Gallery to reproduce Ahmad Zakii Anwar's `Huruf´ series to be sold as limited edition prints. Proceeds from the sale were contributed to the Haiti Earthquake Fund. BNM Volunteers collected and distributed donations for the people of Pakistan affected by floods and landslides in 2010. The BNM Volunteers also worked with the Malaysian Red Crescent during the year to contribute aid to victims of natural disasters in South East Asian countries such as Indonesia (volcano eruptions and tsunami), Myanmar and Philippines (typhoons and cyclones) and Thailand and Vietnam (flooding).

Tuition Programme at Rumah Opah
A group of BNM Volunteers provided fortnightly tuition on Mathematics and English to orphans at Ruman Opah in Klang. In addition, donations were raised to buy reading materials and learning kits for these children. The objective of this programme is to provide extra classes to the children in a fun and interactive way. This successful tuition programme is currently being expanded to another orphanage in Puchong.

Fun Visit to the 'Lost World of Tambun' with Underprivileged Children
36 BNM Volunteers organised an outing with 50 underprivileged children from Pertubuhan Kebajikan Ehsan AshShakur in Rawang, to The Lost World of Tambun in April 2010. Each volunteer provided individual attention to the children assigned to them and this bonding experience made the visit very meaningful for all those involved. The special experience continued beyond the visit as the volunteers kept in touch with the children via letters and notes to build upon the relationships created.

HIV/AIDS Awareness
In conjunction with the Bank's Knowledge Fair 2010, the BNM Volunteers in collaboration with the Bank's Human Capital Development Centre and The Malaysian AIDS Council, set up an exhibition for the Bank's staff to learn about the HIV+ community in Malaysia and how they can be supported. A talk by the President of Malaysian AIDS Council, Datuk Mohd. Zaman Khan was organised to provide the staff with awareness of HIV/AIDS and to help reduce the stigma and discrimination faced by people living with HIV.

2. Graduates Programme
The Graduates Programme 500 or better known as `GP500´ is a programme conducted by the Bank to enhance the employability of 500 unemployed graduates from underprivileged families. Enhancement of the employability of graduates is done through skills improvement and on-the-job-training with reputable employers in various industries for a duration of one to two years. Companies nationwide, through their respective associations, have collaborated with the Bank to provide development opportunities to the graduates through attachment programmes. Throughout the programme and in an effort to strengthen their skills, the Bank organised, structured and customised development programmes focused on enhancing analytical skills, communication skills, and entrepreneurship. In addition, interventions related to self-enhancement, counseling and motivation were also provided.

After more than a year into the programme, 432 out of the 500 graduates were absorbed by the companies they were attached with or were able to secure permanent positions with other employers. The success of GP500 led the Bank to continue with this programme in 2011 for an additional 200 unemployed graduates.

3. Bank Negara Malaysia Special Scholarship Programmes
In addition to the Bank's annual scholarships awarded to outstanding students that meet the Bank's requirements, Bank Negara Malaysia also awards special Kijang Emas scholarships at the tertiary level to nurture critical talents of the nation, and at secondary level, in aid of students from low income families who have excelled in their Peperiksaan Menengah Rendah (PMR), (Lower Secondary Assessment) examination.

Kijang Emas Scholarship
The Bank offers five prestigious awards annually to top Sijil Pelajaran Malaysia (Malaysian Certificate of Education) achievers to pursue studies in fields of their choice as part of the effort to nurture critical talent for the nation. Since its inauguration in 2005, this prestigious scholarship has been awarded to 32 top students, pursuing various fields of studies such as medicine, engineering and economics, from A-Levels to PhD programmes.

Secondary School Awards

A total of 20 awards are offered annually to selected Form 4 students who have excelled in the PMR examinations. This award is given to those from lower income groups as a way to encourage them to excel in their academic pursuits. One student from this scheme became a recipient of the Kijang Emas Scholarship in 2010 while four others have successfully secured the Bank scholarships to pursue A-Level programmes since 2010.

4. Initiatives in Support of Young Malaysian Artists

Since 1962, the Bank has had a major role in the development of Malaysian art. In the early days of the Bank's collection, the works of art were offered to the Bank by individual artists. Now, the Bank systematically procures works directly from artists, galleries and auction houses, thereby supporting the entire industry through its active participation in every sector of the art market.

The Bank's support is crucial as the Malaysian art market is still very small and requires dedicated investments by organisations able to make such contributions. The opening of a world class art gallery by the Bank in 2011, housing a major part of the Bank's collections, will further support this nascent sector and provide a new venue for exhibitions of upcoming works. The new art gallery covers a total area of 2,010 square metres with the flexibility of creating large or intimate spaces to suit any exhibition. To promote high standards in artistic production, the Bank through the Kijang Awards in 2004, held an open art competition to encourage artists in Malaysia to gear themselves to create superior works to be included in the Bank's growing permanent collection. Since 2006, the Bank's Money Museum has also organised the `Art Invitation´ that introduces young and upcoming artists to the financial industry.

and the Middle-East. A broad range of topics were covered, with areas of greatest interest being Islamic finance, financial stability, SME development and microfinance, as well as organisational development.

The Bank also continued to offer a wide range of international learning programmes under the auspices of the Government sponsored Malaysian Technical Cooperation Programme (MTCP) which included Banking Supervision Foundation Course, Intermediate Islamic Finance Course for Financial Regulators and Central Banking Courses.

In the area of Islamic finance, the Bank provided capacity building programmes to financial regulators (114 participants from 36 countries) such as the on-going collaboration with the Islamic Development Bank where capacity building programmes on Islamic finance were organised in Kuala Lumpur and Jordan. A workshop on Regulatory and Supervisory Framework for Islamic Financial Institutions was also conducted in Bishkek for officials of the National Bank of Kyrgyz Republic under the auspices of the MTCP, as part of a Government to Government technical assistance initiative. The programme focused on various aspects of the Islamic financial services industry, the challenges pertinent to Islamic finance globally and the range of emerging solutions. The seminars and dialogues held during the year aimed to contribute to the enhancement of the quality and quantity of competent regulators and professionals required by the rapidly growing Islamic finance industry.

The other emphasis of international capacity building is in the area of financial inclusion. The objective of supporting capacity building for policymakers and practitioners of microfinance is to contribute to the global agenda of building more inclusive financial systems to enable those who are underserved to be able to use financial services to improve their livelihood. The Bank conducted its Financial Inclusion Advisers (FIA) programmes in Kuala Lumpur, in collaboration with Japan International Cooperation Agency, as well as in Uganda, in collaboration with the Bank of Uganda and the Alliance for Financial Inclusion (AFI). More than 100 participants from eight African countries took part in dialogues where country experiences and new models of microfinance were shared. The dialogues focused on topical issues, including new forms of micro financial institutions, products and services that cater for the underserved communities, financial education, market conduct as well as the need for greater coordination between Government agencies, regulators and market players in shaping the development of more inclusive financial systems. In relation to this, the Bank also hosted a workshop on the important subject of financial inclusion data, an initiative led by the AFI.

Apart from Islamic finance and financial inclusion, the Bank also conducted programmes in organisational development and capacity building, focusing on governance, talent management, risk management and central bank modernisation. The Bank also continued to expand its technical cooperation on a bilateral basis by entering into Memorandum of Understanding with several central banks and agencies during 2010. Moving forward, the Bank's international technical cooperation will continue to stress the importance of sharing knowledge on central banking practices and building collaborative relationships with other central banks from developing economies in the face of globalisation and regional integration.

Technology Infrastructure Expansion in Supporting Business Productivity and Performance

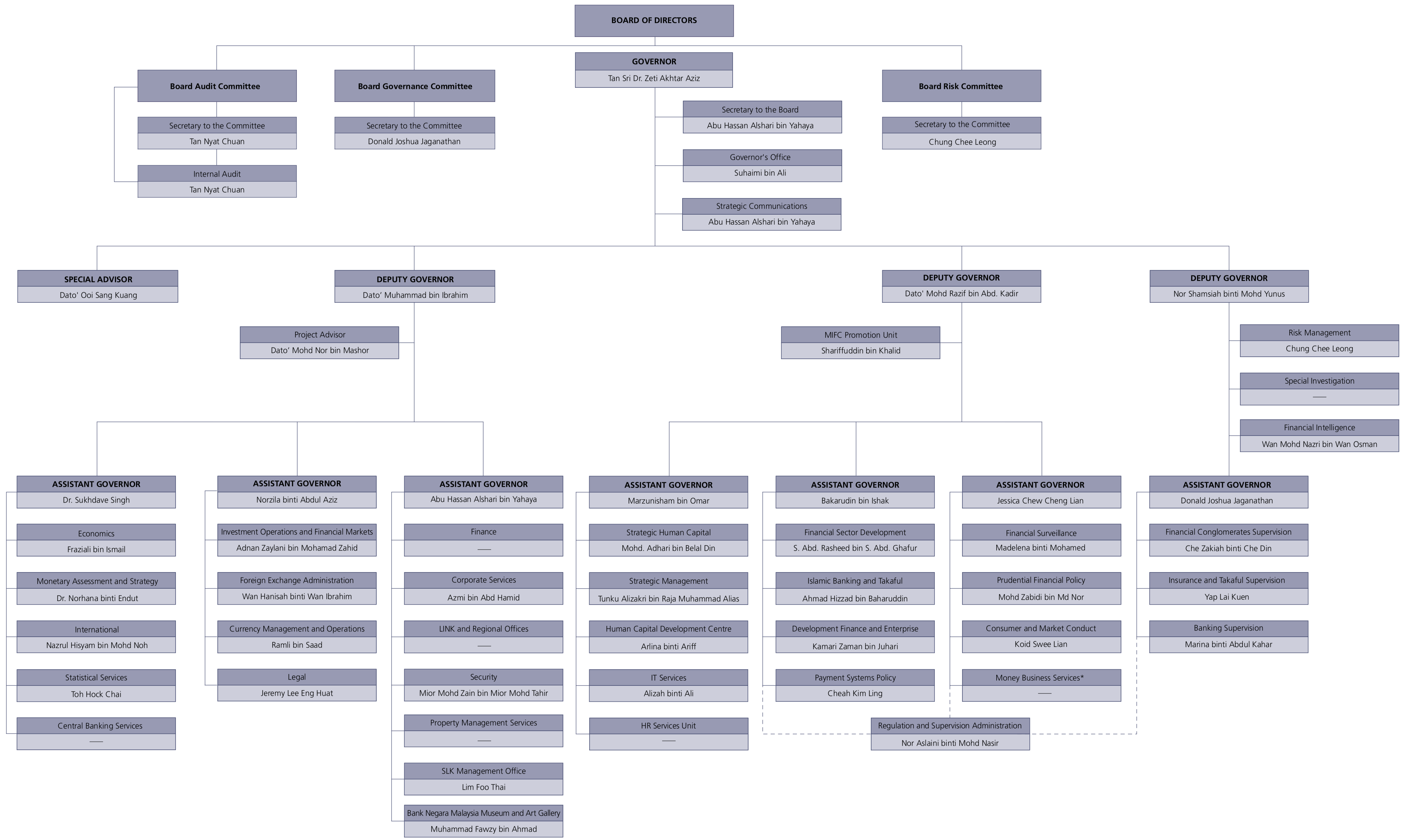
The year 2010 witnessed the further expansion and modernisation of the Bank's Information and Communications Technology (ICT) infrastructure and facilities to support and sustain its operations. The implementation of efficient and resilient infrastructure and technology solutions was recognised as a strategic initiative supporting the achievement of the Bank's desired outcomes. Acknowledging the dependence of key business operations on ICT, the Bank continued to embark on initiatives to optimise the use of technology and secure its critical information assets, while ensuring strong business continuity practices, in order to deliver optimum value to both internal and external stakeholders. Spearheading the infrastructure expansion effort is the operationalisation of the new Data Centre, a leading-edge and highly secure facility equipped with high-performance network links that seamlessly connect the Bank's systems residing in the HQ, Data Centre, as well as the Recovery Centre. The implementation of this triangular network infrastructure is the first in Malaysia, and is designed for high-performance, reliable and secured network infrastructure services.

The completion of the relocation of ICT services and critical operations had laid the foundation for the Bank to continue the transformation of its technology infrastructure towards `on-demand´ capabilities that can effectively address business requirements, particularly the dynamic and time-critical implementations crucial in the achievement of specific business outcomes. The establishment of a `virtualised´ ICT environment to better support business needs for additional and optimised space, computing power and networking requirements, is one example of an ongoing initiative to support and align ICT with the business.

The existing infrastructure of the Bank's Recovery Centre was further upgraded to support high-availability and enhanced system resiliency, to maintain the capacity of the ICT infrastructure at the centre to be on par with the Data Centre. These are for critical applications supporting business operations in the area of cheque-clearing, payments and settlement, and treasury. Towards supporting the Bank's agenda in financial market development and reserve management operations, two major enabling solutions were also developed and completed in the year 2010. The issuance of Sukuk 1Malaysia and the establishment of retail bond market trading were facilitated via system enhancements on the Scripless Securities Depository System. The Treasury Operations System (TERAS) was enhanced to support the expanding reserve management operations and to improve operational efficiency.

Moving forward, the Bank is continuously exploring the use of emerging technologies in encouraging the increased usage of ICT, especially in facilitating the dissemination of information. With the adoption of new technologies, it is imperative that adequate security measures, surveillance and controls be put in place to address new security concerns. In this regard, frequent reviews and strengthening of ICT security controls and risk mitigation are being conducted as part of the process to safeguard the Bank's ICT and information assets. These efforts, together with the modernisation of the ICT infrastructure in the Bank, are geared towards meeting the objective of ensuring a heightened state of ICT-readiness as well as being in alignment with the overall business continuity management at the Bank.

BANK NEGARA MALAYSIA
Organisation Structure



As at 1 March 2011
* To be established later

2010

ANNUAL FINANCIAL STATEMENTS

CERTIFICATE OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF BANK NEGARA MALAYSIA FOR THE YEAR ENDED 31 DECEMBER 2010

I have audited the financial statements of Bank Negara Malaysia for the year ended 31 December 2010. These financial statements are the responsibility of the management. My responsibility is to audit and to express an opinion on these financial statements.

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

In my opinion, the financial statements give a true and fair view of the financial position of Bank Negara Malaysia as at 31 December 2010 and of the results of its operations for the year ended in accordance with the approved accounting standards.

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

PUTRAJAYA
9 MARCH 2011

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 2010 and of the results of operations for the year ended on that date.

On behalf of the Board,	On behalf of the Board,
ZETI AKHTAR AZIZ	**OH SIEW NAM**
CHAIRMAN	DIRECTOR
8 MARCH 2011	8 MARCH 2011
KUALA LUMPUR	KUALA LUMPUR

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

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

Subscribed and solemnly declared)
by the abovenamed at Kuala Lumpur)
this 8 March 2011.)

Before me,

PESURUHJAYA SUMPAH
No: W027
Nama : NG LEONG HUAT
MALAYSIA

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

Bank Negara Malaysia

Statement of Financial Position as at 31 December 2010

	Note	2010 RM	2009 RM
ASSETS			
Gold and Foreign Exchange	3	320,774,448,194	322,505,629,648
International Monetary Fund Reserve Position		1,453,521,555	1,515,842,594
Holdings of Special Drawing Rights		6,442,516,703	7,279,175,067
Malaysian Government Papers	4	2,285,433,098	2,683,093,250
Deposits with Financial Institutions	5	40,583,035,000	9,373,175,000
Loans and Advances	6	11,837,444,956	12,407,481,804
Other Assets	7	6,795,391,854	7,213,305,329
Total Assets		**390,171,791,360**	**362,977,702,692**
LIABILITIES AND CAPITAL			
Currency in Circulation		55,787,812,628	51,138,567,538
Deposits by: Financial Institutions		170,732,428,628	181,535,107,206
Federal Government		14,226,350,050	18,641,169,858
Others	8	3,663,691,712	1,270,868,081
Bank Negara Papers		100,376,801,291	33,357,434,443
Allocation of Special Drawing Rights	9	6,396,555,926	7,231,066,765
Other Liabilities	10	19,273,907,766	21,710,810,087
Total Liabilities		370,457,548,001	314,885,023,978
Paid-up Capital	11	100,000,000	100,000,000
General Reserve Fund	12	13,643,961,478	13,478,068,329
Other Reserves	13	5,970,281,881	34,514,610,385
Total Capital		19,714,243,359	48,092,678,714
Total Liabilities and Capital		**390,171,791,360**	**362,977,702,692**

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

Bank Negara Malaysia

Income Statement for the Year Ended 31 December 2010

	Note	2010 RM	2009 RM
Total Income	14	**7,478,425,194**	**9,826,516,615**
Less:			
Recurring Expenditure	15	873,712,705	1,071,025,015
Development Expenditure	16	438,819,340	1,085,627,775
Total Expenditure		**1,312,532,045**	**2,156,652,790**
Net Profit		**6,165,893,149**	**7,669,863,825**
Appropriation of Net Profit:			
Transfer to Other Reserves	17	4,000,000,000	4,168,449,182
Transfer to General Reserve Fund		165,893,149	1,501,414,643
Amount Payable to Federal Government		2,000,000,000	2,000,000,000
Net Profit		**6,165,893,149**	**7,669,863,825**

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

Notes to the Financial Statements - 31 December 2010

1. **Principal Activities of the Bank**

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

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

2. **Accounting Policies**

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

   2.1 **Basis of Preparation of Financial Statements**

   (a) These financial statements have been prepared in accordance with the Central Bank of Malaysia Act 2009 and applicable Malaysian Financial Reporting Standards (FRS). Section 10 of the Central Bank of Malaysia Act 2009 provides that the Bank, in preparing its financial statements, shall comply with accounting standards to the extent that it is, in the opinion of the Bank, appropriate to do so, having regard to the objects and functions of the Bank. The Bank, having considered its responsibilities for the formulation and conduct of effective monetary policy, is of the opinion that, it is appropriate to differ, in some aspects, from the Malaysian FRS.

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

   2.2 **Measurement Base and Accrual Accounting**

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

   2.3 **Foreign Currency Translation**

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

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

   (c) The unrealised revaluation gains or losses arising from changes in the exchange rates are recognised in Other Reserves.

(d) The International Reserves comprising Gold and Foreign Exchange, International Monetary Fund Reserve Position and Holdings of Special Drawing Rights at 31 December 2010 was RM328,670.5 million equivalent to USD106,525.1 million.

2.4 **Securities and Investments**

Securities and investments are stated mainly at cost and provisions have been made for diminution in value as at 31 December 2010. Designated financial instruments which have been identified as Available For Sale are stated at fair value and the unrealised revaluation gains or losses arising from changes in market prices are recognised in Other Reserves.

2.5 **Repurchase and Reverse-Repurchase Agreements**

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

2.6 **Fixed Assets**

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

2.7 **Net Profit**

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

3. **Gold and Foreign Exchange**

	2010 RM	**2009 RM**
Foreign Securities	275,379,932,314	277,872,235,367
Foreign Deposits	13,631,359,440	14,655,589,658
Balances with Other Central Banks, Bank for International Settlements (BIS) and International Monetary Fund (IMF)	6,767,913,697	3,765,861,668
Others	24,995,242,743	26,211,942,955
	320,774,448,194	322,505,629,648

4. **Malaysian Government Papers**

Malaysian government papers refer to holdings of Government debt instruments.

	2010 RM	**2009 RM**
Malaysian Government Securities	2,285,423,098	2,683,093,250
Sukuk 1Malaysia 2010	10,000	-
	2,285,433,098	2,683,093,250

5. **Deposits with Financial Institutions**
Deposits with financial institutions comprise deposits placed by the Bank with financial institutions under section 75(i) and section 100 of the Central Bank of Malaysia Act 2009[1].

6. **Loans and Advances**
Loans and advances comprise mainly advances extended by the Bank to the participating institutions under various schemes such as Fund for Small and Medium Industries and New Entrepreneur Fund aimed at promoting growth and development of small and medium business establishments. The extensions of these advances are mainly provided under section 49 and section 100 of the Central Bank of Malaysia Act 2009[1].

7. **Other Assets**
Other assets include investments in shares and bonds of RM6,270,261,038 acquired under section 48(1) and section 100 of the Central Bank of Malaysia Act 2009[1].

8. **Deposits by Others**
A substantial part of these deposits comprises deposits from public authorities.

9. **Allocation of Special Drawing Rights**
IMF member countries are allocated Special Drawing Rights (SDR) in proportion to their subscription to the IMF. The allocation represents a dormant liability of the Bank to the IMF, against which assets are received in SDR from the IMF. The net cumulative allocation of SDR was RM6,396,555,926 equivalent to SDR1,346,143,721.

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

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

12. **General Reserve Fund**

	2010	**2009**
	RM	**RM**
As at 1 January	13,478,068,329	11,976,653,686
Transfer from Net Profit	165,893,149	1,501,414,643
As at 31 December	13,643,961,478	13,478,068,329

13. **Other Reserves**
Other reserves comprise:

(a) **Exchange Rate Fluctuation Reserve**
A reserve established to meet unrealised exchange revaluation gains or losses arising from the fluctuations of exchange rates against ringgit Malaysia.

(b) **Revaluation Reserve**
A reserve established to deal with the movements in the market values of the Bank's investment portfolios which have been designated as Available For Sale portfolios and measured at fair value.

[1] Pursuant to section 100 of the Central Bank of Malaysia Act 2009, transactions or arrangements made under the Central Bank of Malaysia Act 1958 are deemed to have been made under the Central Bank of Malaysia Act 2009.

(c) **Contingency Reserve**
A reserve established to provide for future losses resulting from unfavorable external circumstances which are not within the reasonable control of the Bank.

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

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

16. **Development Expenditure**
Development expenditure are expenses incurred mainly to finance developmental and long term projects undertaken by the Bank that are in line with its principal objects and functions.

17. **Transfer to Other Reserves**
This transfer is made in accordance with section 7 of the Central Bank of Malaysia Act 2009.

18. **Contingencies and Commitments**

18.1 **Contingent Assets**
Total contingent assets as at 31 December 2010 amounted to RM1,300,000,000. These comprise the Bank's total contributions to International Centre for Leadership in Finance (ICLIF) Trust Fund and International Centre for Education in Islamic Finance (INCEIF) Trust Fund to finance activities related to training, research and development of human resource on banking and financial services managed by ICLIF and INCEIF. It is provided in the Trust Deeds that the total contributions will be returned to the Bank when the Centres become self-sufficient in the future.

18.2 **Commitments**
Total commitments as at 31 December 2010 comprise the following:

(a) **Membership with IMF**
An amount of RM5,620,898,121 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.

(b) **Shareholding in BIS**
An amount of RM57,377,538 which represents the uncalled portion of the 3,220 units of shares held by the Bank in the BIS. The amount is based on the nominal value (SDR5,000) of the uncalled portion and SDR rate as at the balance sheet date.

(c) **New Arrangements to Borrow by IMF**
The Bank has participated in the New Arrangements to Borrow (NAB), a set of credit arrangements between the IMF and its member countries to provide supplementary source of financing to the IMF for the purpose of safeguarding the stability of the international monetary system. As at 31 December 2010, the Bank's total commitment under the NAB credit arrangement amounted to SDR340,000,000 (equivalent to RM1,615,599,420). However, for the financial year ended 31 December 2010, there was no call on the NAB by the IMF.

(d) **ASEAN Swap Arrangement**

The Bank has participated in the multilateral ASEAN Swap Arrangement (ASA) together with other ASEAN central banks and monetary authorities to provide short-term foreign currency liquidity support to member countries with balance of payments difficulties. As at 31 December 2010, the Bank's total commitment and eligible maximum drawdown amounted to USD300 million (equivalent to RM925.7 million) and USD600 million (equivalent to RM1.9 billion) respectively. However, for the financial year ended 31 December 2010, there was no request for liquidity support under ASA from any member country.

(e) **Bilateral Swap Arrangement**

On 7 January 2009 and 2 April 2010, the Bank renewed the Bilateral Swap Arrangement (BSA) agreements with the Bank of Korea and the People's Bank of China respectively under the Chiang Mai Initiative. As at 31 December 2010, the Bank's commitment and eligible maximum drawdown under each BSA is USD1.5 billion respectively (equivalent to RM4.6 billion). For the financial year ended 31 December 2010, there was no request to activate the BSAs.

(f) **Chiang Mai Initiative Multilateralisation Arrangement**

The Bank has participated in the Chiang Mai Initiative Multilateralisation (CMIM) arrangement to provide financial support to ASEAN+3 member countries facing balance of payments and short-term liquidity difficulties. The effective date of the CMIM Agreement is 24 March 2010. Under the CMIM arrangement, member countries facing balance of payments and short-term liquidity constraints can obtain financial support in United States dollars through swap arrangements against their respective local currencies. As at 31 December 2010, the Bank's total commitment and eligible drawdown are USD4.6 billion (equivalent to RM14 billion) and USD11.4 billion (equivalent to RM35.1 billion) respectively. For the financial year ended 31 December 2010, there was no request for liquidity support from any member country.

19. **Financial Risk Management**

The Reserve Management Committee oversees treasury and investment risks in the management of reserves and to ensure that the following risks are contained within acceptable levels:

(a) **Market Risk**

Market risk is the exposure of the Bank's financial position to adverse movements in market prices such as interest rates and foreign exchange rates. The management of market risk is governed by the benchmark policy approved by the Board of Directors which reflects the long-term investment objectives and acceptable risk-return profile. Within the benchmark policy, the Board of Directors allows `active risk´ to be taken through investments that deviate from the benchmark. This `active risk´ is controlled through a `tracking error´ limit. Sensitivity analysis and stress testing is also undertaken to assess potential mark-to-market losses on the reserves due to unexpected fluctuations and volatility in the market.

(b) **Credit Risk**

The credit risk on reserves is the risk that a counter party, either financial institutions or issuers, fails to perform its contractual obligation to the Bank. A comprehensive rating-based credit risk framework approved by the Board of Directors governs the permissible investment universe of the Bank. The implementation of this framework includes rating implied from the credit default swap market that adds a forward looking credit assessment on issuers. Having such a framework in place also strengthens the Bank's operational efficiency in this area and ensures the reserves are invested only with high credit quality counterparties or issuers. The policies and continuous assessment of credit exposures ensures the objective of capital preservation is met.

(c) **Operational Risk**

Operational risk in treasury operations is the risk of financial loss due to failed internal process, inadequate controls and procedures, gaps in skill-sets and adverse external events that impede operations. Operational risk is mitigated through a strong and robust governance framework and effective implementation of risk controls and limits.

20. **Income Tax**

The Bank is exempted from payment of income tax and supplementary income tax as set out in the Income Tax (Exemption) (No. 7) Order 1989.

2010

ANNEX

CONTENTS

Key Economic and Financial Statistics

Table A.1

Gross Domestic Product by Kind of Economic Activity at Constant 2000 Prices

	2006	2007	2008	2009	2010*p*	2011*f*
	RM million					
Agriculture	37,701	38,177	39,828	39,992	40,680	42,066
Mining and quarrying	42,030	42,881	41,831	40,246	40,338	41,161
Manufacturing	147,154	151,257	153,171	138,809	154,621	163,493
Construction	14,639	15,707	16,366	17,321	18,220	19,195
Services	247,099	272,406	292,555	300,153	320,559	339,319
Less: Undistributed FISIM[1]	18,385	19,607	20,410	21,872	23,099	24,629
Plus: Import duties	5,287	5,521	6,839	6,445	7,064	7,217
GDP at purchasers' prices[2]	**475,526**	**506,341**	**530,181**	**521,095**	**558,382**	**587,822**
	Annual change (%)					
Agriculture	5.2	1.3	4.3	0.4	1.7	3.4
Mining and quarrying	-1.0	2.0	-2.4	-3.8	0.2	2.0
Manufacturing	6.7	2.8	1.3	-9.4	11.4	5.7
Construction	-0.3	7.3	4.2	5.8	5.2	5.4
Services	7.4	10.2	7.4	2.6	6.8	5.9
Less: Undistributed FISIM[1]	3.6	6.7	4.1	7.2	5.6	6.6
Plus: Import duties	-12.1	4.4	23.9	-5.8	9.6	2.2
GDP at purchasers' prices	**5.8**	**6.5**	**4.7**	**-1.7**	**7.2**	**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 (2005=100)

	2007	2008	2009	2010	2008	2009	2010
	Index				Annual change (%)		
Export-oriented industries	**111.2**	**109.9**	**97.7**	**107.2**	**-1.2**	**-11.1**	**9.7**
Electronics and electrical products cluster	**111.8**	**107.8**	**83.2**	**97.7**	**-3.6**	**-22.8**	**17.4**
Electronics	*119.9*	*113.4*	*85.5*	*88.2*	*-5.4*	*-24.6*	*3.2*
Electrical products	*96.2*	*97.1*	*78.9*	*116.3*	*0.9*	*-18.8*	*47.4*
Primary-related cluster	**110.7**	**111.2**	**107.4**	**113.5**	**0.4**	**-3.5**	**5.7**
Chemicals and chemical products	111.4	107.6	105.8	117.9	-3.5	-1.7	11.5
Petroleum products	110.8	117.4	116.5	113.7	5.9	-0.8	-2.4
Textiles, wearing apparel and footwear	100.3	100.3	80.4	83.8	0.0	-19.8	4.2
Wood and wood products	95.7	91.2	76.0	84.9	-4.7	-16.6	11.7
Rubber products	122.5	128.2	124.3	150.2	4.7	-3.0	20.8
Off-estate processing	105.1	115.0	112.6	110.0	9.4	-2.1	-2.3
Paper products	140.8	120.6	114.0	125.8	-14.4	-5.5	10.4
Domestic-oriented industries	**112.5**	**121.5**	**114.6**	**132.5**	**8.0**	**-5.7**	**15.6**
Construction-related cluster	**121.6**	**126.9**	**112.4**	**133.7**	**4.3**	**-11.4**	**18.9**
Construction-related products	113.2	116.9	95.8	116.8	3.2	-18.1	21.9
Non-metallic mineral products	*105.3*	*114.9*	*99.3*	*121.7*	*9.1*	*-13.6*	*22.6*
Basic iron & steel and non-ferrous metal	*122.9*	*119.3*	*91.5*	*110.9*	*-2.9*	*-23.3*	*21.1*
Fabricated metal products	137.8	146.2	144.6	166.3	6.1	-1.1	15.0
Consumer-related cluster	**105.9**	**117.6**	**116.1**	**131.6**	**11.0**	**-1.2**	**13.4**
Food products	114.5	125.8	129.8	133.8	9.9	3.2	3.1
Transport equipment	94.3	116.4	102.0	132.3	23.4	-12.4	29.7
Beverages	114.2	117.2	114.5	150.4	2.6	-2.3	31.4
Tobacco products	99.0	93.5	87.5	88.2	-5.6	-6.4	0.9
Others	110.4	101.7	129.1	115.4	-7.9	27.0	-10.6
Total	**111.4**	**112.2**	**101.0**	**112.2**	**0.7**	**-10.0**	**11.1**

Source: Department of Statistics, Malaysia

Table A.3

GNI by Demand Aggregates

	2006	2007	2008	2009	2010*p*	2011*f*
	at Current Prices (RM million)					
Consumption	326,889	371,436	427,243	434,812	465,406	510,952
Private consumption	*258,280*	*293,040*	*334,712*	*338,894*	*368,275*	*405,471*
Public consumption	*68,609*	*78,396*	*92,531*	*95,918*	*97,131*	*105,481*
Investment	119,213	138,393	144,634	136,824	154,237	167,699
Private investment	*62,139*	*76,577*	*79,801*	*65,155*	*76,912*	*86,889*
Public investment	*57,074*	*61,816*	*64,834*	*71,670*	*77,325*	*80,810*
Change in stocks[1]	-1,722	10	-1,685	-38,358	8,887	6,592
Exports of goods and services	669,505	706,382	765,370	655,336	744,497	783,751
Imports of goods and services	539,443	574,172	594,655	508,927	607,061	639,201
GDP at purchasers' prices	574,441	642,049	740,907	679,687	765,966	829,793
Net factor payments abroad	-17,295	-13,984	-23,707	-14,640	-25,249	-23,653
GNI	557,146	628,065	717,200	665,047	740,717	806,140
	at Constant 2000 Prices (RM million)					
Consumption	292,280	320,644	349,404	353,541	372,105	397,986
Private consumption	*230,948*	*255,263*	*276,998*	*278,872*	*297,390*	*317,890*
Public consumption	*61,332*	*65,381*	*72,406*	*74,669*	*74,715*	*80,097*
Investment	106,750	116,751	117,610	110,997	121,467	128,890
Private investment	*55,538*	*62,813*	*63,413*	*52,492*	*59,715*	*65,496*
Public investment	*51,212*	*53,938*	*54,197*	*58,506*	*61,752*	*63,394*
Change in stocks[1]	257	-770	-4,324	-14,289	11,102	5,993
Exports of goods and services	590,784	614,815	624,605	559,537	614,358	631,222
Imports of goods and services	514,544	545,099	557,114	488,691	560,648	576,270
GDP at purchasers' prices	475,526	506,341	530,181	521,095	558,382	587,822
Net factor payments abroad	-19,742	-23,522	-36,988	-24,565	-41,136	-41,850
GNI	455,784	482,819	493,192	496,531	517,246	545,973

[1] Includes statistical discrepancy
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.4

Savings-Investment Gap

	2006	2007	2008	2009	2010*p*
	RM million				
Public gross domestic capital formation	57,074	61,816	64,834	71,669	77,325
Public savings	83,226	103,841	80,879	65,161	54,204
Deficit/surplus	26,152	42,025	16,045	-6,508	-23,121
Private gross domestic capital formation	60,417	76,587	78,116	26,797	85,799
Private savings	130,293	136,752	191,583	145,445	199,431
Deficit/surplus	69,876	60,165	113,467	118,648	113,632
Gross domestic capital formation	117,491	138,403	142,949	98,466	163,124
(as % of GNI)	21.1	22.0	19.9	14.8	22.0
Gross national savings	213,519	240,593	272,462	210,606	253,635
(as % of GNI)	38.3	38.3	38.0	31.7	34.2
Balance on current account	96,028	102,190	129,513	112,139	90,511
(as % of GNI)	17.2	16.3	18.1	16.9	12.2

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5

Labour Market: Selected Indicators

	2006	2007	2008	2009	2010e
	(number of positions/persons)				
Vacancies Reported by Industry[1]					
Agriculture, hunting, forestry and fishery	188,104	226,759	275,548	230,303	327,670
Mining and quarrying	861	1,163	1,450	1,377	2,517
Manufacturing	348,302	275,155	327,798	695,418	693,711
Construction	129,586	117,217	107,421	111,622	250,820
Services	154,902	204,599	346,763	507,627	512,503
Electricity, gas and water supply[(I)]	*2,227*	*1,477*	*2,047*	*4,367*	*8,269*
Wholesale and retail trade, hotels and restaurants[(II)]	*67,956*	*66,600*	*99,317*	*162,270*	*147,303*
Transport, storage and communication[(III)]	*8,287*	*12,578*	*15,264*	*15,090*	*17,888*
Financial intermediation, real estate, renting and business services[(IV)]	*26,642*	*50,235*	*125,821*	*148,001*	*168,067*
Public administration, defence and compulsory social security	*3,539*	*11,287*	*11,132*	*16,128*	*20,414*
Community, social and personal service activities	*46,251*	*62,422*	*93,182*	*161,771*	*150,562*
Others not elsewhere classified	12,920	289	0	0	0
Total vacancies	**834,675**	**825,182**	**1,058,980**	**1,546,347**	**1,787,221**
Retrenchments by Industry					
Agriculture, hunting, forestry and fishery	312	255	398	278	866
Mining and quarrying	78	61	89	78	30
Manufacturing	8,890	9,970	11,014	17,850	3,854
Construction	603	291	199	503	262
Services	5,477	3,458	4,769	6,355	2,073
Electricity, gas and water supply	*65*	*5*	*77*	*156*	*0*
Wholesale and retail trade, hotels and restaurants	*2,327*	*1,929*	*2,052*	*1,429*	*662*
Transport, storage and communication	*1,521*	*322*	*773*	*643*	*208*
Financial intermediation, real estate, renting and business services	*983*	*761*	*1,008*	*1,923*	*934*
Community, social and personal service activities	*581*	*441*	*859*	*2,204*	*269*
Total retrenchments	**15,360**	**14,035**	**16,469**	**25,064**	**7,085**
Employment by Industry[2] ('000 persons)					
Agriculture, forestry, livestock and fishery	1,392.4	1,389.8	1,390.9	1,391.5	1,390.3
Mining and quarrying	42.6	42.9	42.8	42.6	42.2
Manufacturing	3,227.2	3,296.6	3,338.2	3,302.0	3,312.3
Construction	755.2	757.3	758.4	760.8	768.4
Services	5,741.7	5,911.4	6,046.1	6,112.2	6,311.7
Electricity, gas and water supply[(I)]	*95.0*	*96.8*	*97.6*	*97.4*	*100.1*
Wholesale and retail trade, hotels and restaurants[(II)]	*1,930.4*	*1,957.7*	*1,984.3*	*1,996.4*	*2,184.8*
Transport, storage and communication[(III)]	*646.4*	*660.0*	*673.2*	*675.0*	*683.5*
Finance, insurance, real estate and business services [(IV)]	*767.5*	*789.7*	*811.9*	*814.7*	*832.5*
Government services	*1,152.5*	*1,225.6*	*1,263.5*	*1,286.2*	*1,249.5*
Other services	*1,150.0*	*1,181.6*	*1,215.6*	*1,242.5*	*1,260.9*
Total employment	**11,159.0**	**11,398.0**	**11,576.5**	**11,609.1**	**11,824.9**
Unemployment rate[2] (% of labour force)	**3.3**	**3.2**	**3.3**	**3.7**	**3.2**

e Estimates
[1] Refers to vacancies reported by employers through the JobsMalaysia portal (formerly known as Electronic Labour Exchange, ELX).
[2] Refers to estimates by Economic Planning Unit
[(I)] From 2010 onwards, refers to electricity, gas, water, steam and air conditioning supply
[(II)] From 2010 onwards, refers to wholesale and retail trade, accommodation and food services
[(III)] From 2010 onwards, refers to transport, storage, information and communication
[(IV)] From 2010 onwards, refers to financial intermediation, real estate, professional, scientific, technical, administrative and support services

Source: Economic Planning Unit and Ministry of Human Resources

Table A.6

Private Consumption Indicators

	2009	2010				
		1Q	2Q	3Q	4Q	Year
Sales of passenger cars ('000 units)	486.1	133.1	138.8	136.5	135.1	543.6
Annual change (%)	-2.3	22.0	16.6	2.4	8.5	11.8
Imports of consumption goods (RM billion)	31.4	8.3	8.6	8.5	9.1	34.6
Annual change (%)	-2.7	18.5	13.3	3.2	6.9	10.1
Tax collection						
Sales tax (RM billion)	7.0	1.7	2.1	2.0	2.3	8.0
Service tax (RM billion)	3.3	0.8	1.0	1.0	1.1	3.9
Narrow Money (M1)						
Annual change (%)	9.8	12.0	12.6	11.5	11.7	11.7
Loans disbursed by banking system						
Consumption credit (excl. passenger cars)						
Annual change (%)	19.7	11.4	19.9	9.2	10.2	12.5
Retail trade, restaurants and hotels						
Annual change (%)	-7.4	14.5	30.1	12.7	9.0	16.3
MRA retail sales (Annual change in %)	0.8	7.9	5.8	9.8	8.5	8.4
Credit card turnover spending[1] (RM billion)	68.1	18.6	18.8	19.5	21.1	78.0
Annual change (%)	6.2	16.4	14.8	12.9	14.0	14.0
MIER Consumer Sentiment Index	-	114.2	110.4	115.8	117.2	-
FBM KLCI	1,272.8	1,320.6	1,314.0	1,463.5	1,518.9	1,518.9
Commodity prices						
CPO (RM/tonne)	2,257	2,562	2,529	2,642	3,276	2,752
Crude oil (USD/barrel)	62.0	79.0	78.0	76.3	85.2	79.6
Rubber (sen/kg)	643.0	1,025.0	975.0	979.0	1,300.1	1,070.0

[1] Resident spending only

Table A.7

Private Investment Indicators

	2009	2010				
		1Q	2Q	3Q	4Q	Year
Sales of commercial vehicles ('000 units)	50.6	14.4	14.9	15.6	16.8	61.6
Annual change (%)	-0.2	29.5	25.9	17.4	16.4	21.8
Imports of capital goods (RM billion)	65.8	16.3	18.9	19.6	21.6	76.4
Annual change (%)	-5.9	9.7	26.5	21.1	9.4	16.2
Approvals by MITI (Manufacturing sector)						
No. of projects	766	173	284	231	223	911
Capital investment (RM billion)	32.6	5.8	7.5	7.9	23.3	44.4
Foreign	*22.1*	*3.3*	*4.2*	*5.5*	*16.4*	*29.5*
Local	*10.5*	*2.5*	*3.2*	*2.4*	*6.8*	*14.9*
New investment (% share)	67.6	39.5	76.3	38.8	47.4	50.6
Reinvestments (% share)	32.4	60.5	23.7	61.2	52.6	49.4
Loans disbursed by banking system						
Manufacturing sector						
Annual change (%)	-15.2	10.4	21.3	11.8	5.4	12.0
Construction sector						
Annual change (%)	16.6	5.8	14.1	7.0	-2.4	5.5
Private Debt Securities (excluding Cagamas)						
Total funds raised (RM billion)	58.6	4.7	14.7	14.4	18.3	52.1
New activities	8.7	2.4	2.2	7.1	1.8	13.5
Initial Public Offerings (Bursa Malaysia)						
Total funds raised (RM billion)	12.2	1.2	2.9	1.1	14.5	19.8
MIER Business Conditions Survey						
Business Conditions Index	-	124.0	119.6	104.9	99.5	-
Capacity Utilisation Rate	-	81.7	82.0	82.2	82.9	-
MSC-Status Companies						
No. of companies	284	30	54	56	78	218
Approved investment (RM billion)	2.2	0.4	0.3	0.6	0.3	1.5

Table A.8

Balance of Payments

Item	2007 +	2007 -	2007 Net	2008 +	2008 -	2008 Net
	RM million					
Goods[1]	**605,175**	**475,687**	**129,488**	**664,325**	**493,773**	**170,552**
Trade account	*604,300*	*502,045*	*102,255*	*663,014*	*519,804*	*143,209*
Services	**101,207**	**98,485**	**2,722**	**101,045**	**100,882**	**163**
Transportation	24,548	37,581	-13,032	22,495	37,895	-15,401
Travel	48,278	19,226	29,052	50,961	22,446	28,515
Other services	28,079	41,018	-12,939	27,463	39,839	-12,376
Government transactions n.i.e.[2]	301	660	-359	126	702	-576
Balance on goods and services	**706,382**	**574,173**	**132,209**	**765,370**	**594,655**	**170,715**
Income	**39,068**	**53,052**	**-13,984**	**39,930**	**63,638**	**-23,707**
Compensation of employees	5,350	5,973	-622	4,421	5,152	-731
Investment income[3]	33,717	47,079	-13,362	35,509	58,486	-22,977
Current transfers	**1,348**	**17,383**	**-16,035**	**1,410**	**18,905**	**-17,495**
Balance on current account	**746,798**	**644,607**	**102,190**	**806,710**	**677,197**	**129,513**
% of GNI			**16.3**			**18.1**
Capital account			**-186**			**4,159**
Financial account			**-38,954**			**-118,501**
Direct investment			-9,348			-26,058
Abroad			*-38,892*			*-50,192*
In Malaysia			*29,545*			*24,134*
Portfolio investment			18,548			-82,171
Financial derivatives			-164			-2,206
Other investment			-47,991			-8,066
Official sector			*-5,787*			*852*
Private sector			*-42,203*			*-8,918*
Balance on capital and financial accounts			**-39,140**			**-114,342**
Errors and omissions			**-17,754**			**-33,421**
of which:						
Foreign exchange revaluation gain (+) / loss (-)			-5,597			-5,824
Overall balance (surplus + / deficit -)			**45,296**			**-18,250**
Bank Negara Malaysia international reserves, net[4]						
RM million			335,695			317,445
USD million			101,338			91,530
Reserves as months of retained imports			8.4			7.6

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

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

2009			2010*p*			2011*f*		
+	-	Net	+	-	Net	+	-	Net
RM million								
554,067	**412,322**	**141,745**	**639,844**	**503,270**	**136,575**	**674,774**	**530,452**	**144,321**
553,295	*434,940*	*118,355*	*639,428*	*529,195*	*110,234*	*674,234*	*559,585*	*114,649*
101,270	**96,606**	**4,664**	**104,653**	**103,791**	**863**	**108,978**	**108,748**	**230**
15,518	32,551	-17,034	15,117	38,150	-23,034	17,530	40,850	-23,320
55,589	22,886	32,704	57,398	25,361	32,037	59,409	25,888	33,521
30,015	40,414	-10,399	31,879	39,515	-7,636	31,858	41,265	-9,407
148	755	-607	260	765	-506	181	746	-566
655,336	**508,927**	**146,409**	**744,498**	**607,061**	**137,437**	**783,751**	**639,201**	**144,551**
39,347	**53,986**	**-14,639**	**38,123**	**63,373**	**-25,249**	**37,782**	**61,435**	**-23,653**
3,984	5,475	-1,491	3,552	5,631	-2,078	4,010	5,700	-1,690
35,363	48,511	-13,148	34,571	57,742	-23,171	33,772	55,735	-21,963
3,714	**23,345**	**-19,631**	**1,848**	**23,524**	**-21,677**	**1,400**	**21,600**	**-20,200**
698,398	**586,258**	**112,139**	**784,469**	**693,958**	**90,511**	**822,933**	**722,236**	**100,697**
		17.5			**12.2**			**12.5**
		-161			**-185**			
		-80,208			**-21,918**			
		-22,908			-14,983			
		-27,948			*-42,632*			
		5,040			*27,649*			
		-1,689			44,942			
		2,453			-755			
		-58,064			-51,122			
		6,556			*237*			
		-64,620			*-51,359*			
		-80,370			**-22,103**			
		-17,938			**-71,035**			
		10,697			-32,641			
		13,831			**-2,628**			
		331,277			328,649			
		96,688			106,518			
		9.7			8.6			

Table A.9

Gross Exports

	2008	2009	2010*p*	2009	2010*p*	2010*p*
	RM million			Annual change (%)		% share
Manufactures	**490,908**	**430,575**	**486,675**	**-12.3**	**13.0**	**76.1**
of which:						
Electronics, electrical machinery and appliances	276,923	246,897	271,251	-10.8	9.9	42.4
Electronics	196,023	179,087	194,443	-8.6	8.6	30.4
Semiconductors	*89,938*	*92,972*	*97,856*	*3.4*	*5.3*	*15.3*
Electronic equipment & parts	*106,085*	*86,115*	*96,587*	*-18.8*	*12.2*	*15.1*
Electrical machinery & appliances	80,899	67,809	76,808	-16.2	13.3	12.0
Consumer electrical products	*19,873*	*18,794*	*25,807*	*-5.4*	*37.3*	*4.0*
Industrial & commercial electrical products	*32,807*	*23,986*	*22,513*	*-26.9*	*-6.1*	*3.5*
Electrical industrial machinery and equipment	*24,729*	*21,905*	*24,942*	*-11.4*	*13.9*	*3.9*
Household electrical appliances	*3,490*	*3,125*	*3,546*	*-10.5*	*13.5*	*0.6*
Chemicals & chemical products	40,723	34,161	41,674	-16.1	22.0	6.5
Manufactures of metal	29,066	22,644	26,199	-22.1	15.7	4.1
Petroleum products	31,111	21,939	29,217	-29.5	33.2	4.6
Optical and scientific equipment	15,032	13,095	18,332	-12.9	40.0	2.9
Textiles, clothing and footwear	10,911	9,375	9,654	-14.1	3.0	1.5
Wood products	9,751	7,978	8,385	-18.2	5.1	1.3
Rubber products	12,426	12,125	15,455	-2.4	27.5	2.4
Minerals	**88,164**	**58,984**	**72,787**	**-33.1**	**23.4**	**11.4**
of which:						
Crude oil and condensates	43,582	25,360	30,765	-41.8	21.3	4.8
Liquefied natural gas (LNG)	41,475	31,195	38,099	-24.8	22.1	6.0
Agriculture	**68,301**	**53,429**	**69,905**	**-21.8**	**30.8**	**10.9**
of which:						
Palm oil	45,951	36,345	45,571	-20.9	25.4	7.1
Rubber	8,112	4,460	9,210	-45.0	106.5	1.4
Others	**15,640**	**10,307**	**10,061**	**-34.1**	**-2.4**	**1.6**
Total	**663,014**	**553,295**	**639,428**	**-16.5**	**15.6**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.10

Exports of Primary Commodities

	2008	2009	2010*p*	2009	2010*p*
	Volume and value			Annual change (%)	
Commodity exports (RM million)	**156,466**	**112,413**	**142,692**	**-28.2**	**26.9**
Agriculture exports (RM million)	**68,301**	**53,429**	**69,905**	**-21.8**	**30.8**
of which:					
Palm oil					
('000 tonnes)	14,894	16,256	17,201	9.1	5.8
(RM/tonne)	3,085	2,236	2,649	-27.5	18.5
(RM million)	45,951	36,345	45,571	-20.9	25.4
Palm kernel oil					
('000 tonnes)	653	1,028	1,030	57.4	0.3
(RM/tonne)	3,758	1,639	2,689	-56.4	64.0
(RM million)	2,454	1,684	2,771	-31.4	64.5
Rubber					
('000 tonnes)	916	703	901	-23.2	28.1
(sen/kilogramme)	886	634	1,022	-28.4	61.2
(RM million)	8,112	4,460	9,210	-45.0	106.5
Saw logs					
('000 cubic metres)	4,131	4,211	4,392	1.9	4.3
(RM/cubic metre)	500	482	488	-3.6	1.1
(RM million)	2,066	2,031	2,142	-1.7	5.5
Sawn timber					
('000 cubic metres)	2,809	1,688	1,904	-39.9	12.8
(RM/cubic metre)	1,360	1,842	1,650	35.5	-10.4
(RM million)	3,819	3,110	3,141	-18.6	1.0
Cocoa beans					
('000 tonnes)	7.6	14.4	23.7	88.4	64.8
(RM/tonne)	7,879	9,063	11,534	15.0	27.3
(RM million)	60	130	273	116.7	109.7
Mineral exports (RM million)	**88,164**	**58,984**	**72,787**	**-33.1**	**23.4**
of which:					
Crude oil and condensates					
('000 tonnes)	16,763	16,412	16,382	-2.1	-0.2
(USD/barrel)	103.27	58.00	76.51	-43.8	31.9
(RM million)	43,582	25,360	30,765	-41.8	21.3
Liquefied natural gas (LNG)					
('000 tonnes)	23,164	22,185	23,309	-4.2	5.1
(RM/tonne)	1,791	1,406	1,635	-21.5	16.2
(RM million)	41,475	31,195	38,099	-24.8	22.1
Tin					
('000 tonnes)	27.6	22.9	33.7	-17.0	47.3
(RM/tonne)	61,598	45,771	61,831	-25.7	35.1
(RM million)	1,698	1,047	2,084	-38.3	98.9

p Preliminary

Source: Department of Statistics, Malaysia

Table A.11

Principal Markets for Manufactured Exports

Country	2006	2007	2008	2009	2010*p*	2006	2007	2008	2009	2010*p*
	RM million					% share				
Selected ASEAN countries	**123,766**	**123,809**	**134,424**	**114,180**	**130,613**	**26.1**	**26.1**	**27.4**	**26.5**	**26.8**
Singapore	81,359	78,490	84,904	70,359	78,493	17.2	16.6	17.3	16.3	16.1
Thailand	24,624	24,991	25,643	24,073	28,148	5.2	5.3	5.2	5.6	5.8
Indonesia	10,677	12,574	16,319	13,074	15,653	2.3	2.7	3.3	3.0	3.2
Philippines	6,135	6,564	6,202	5,211	6,975	1.3	1.4	1.3	1.2	1.4
Brunei Darussalam	971	1,190	1,356	1,463	1,345	0.2	0.3	0.3	0.3	0.3
The People's Republic of China	32,015	38,009	44,396	51,169	60,993	6.8	8.0	9.0	11.9	12.5
European Union	**65,155**	**66,971**	**63,061**	**52,465**	**58,168**	**13.8**	**14.1**	**12.8**	**12.2**	**12.0**
Netherlands	17,787	19,060	18,605	15,178	16,335	3.8	4.0	3.8	3.5	3.4
Germany	11,158	13,393	13,574	13,716	15,409	2.4	2.8	2.8	3.2	3.2
United Kingdom	10,117	9,219	8,587	6,657	6,803	2.1	1.9	1.7	1.5	1.4
Others	26,093	25,299	22,295	16,914	19,621	5.5	5.3	4.5	3.9	4.0
United States	106,009	90,102	76,633	56,653	55,586	22.4	19.0	15.6	13.2	11.4
Japan	33,294	32,574	35,944	30,177	35,560	7.0	6.9	7.3	7.0	7.3
Hong Kong SAR	28,147	26,690	26,942	28,026	31,479	5.9	5.6	5.5	6.5	6.5
Middle East	16,008	18,815	23,342	20,688	21,298	3.4	4.0	4.8	4.8	4.4
Australia	11,287	12,081	14,794	13,736	13,155	2.4	2.6	3.0	3.2	2.7
Chinese Taipei	10,838	11,724	10,529	10,074	13,330	2.3	2.5	2.1	2.3	2.7
Korea	10,381	10,732	10,294	9,592	12,316	2.2	2.3	2.1	2.2	2.5
India	7,258	9,172	10,119	8,050	11,512	1.5	1.9	2.1	1.9	2.4
Latin American countries	6,072	7,156	9,172	7,358	9,064	1.3	1.5	1.9	1.7	1.9
Canada	3,535	2,971	2,964	2,620	2,978	0.7	0.6	0.6	0.6	0.6
Rest of the World	19,666	22,888	28,296	25,787	30,624	4.2	4.8	5.8	6.0	6.3
Total	**473,432**	**473,695**	**490,908**	**430,575**	**486,675**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.12

Principal Export Markets for Electronics

Country	2006	2007	2008	2009	2010*p*	2006	2007	2008	2009	2010*p*
	RM million					% share				
The People's Republic of China	17,297	22,640	27,298	34,833	38,265	7.8	10.6	13.9	19.5	19.7
Singapore	35,115	34,326	33,859	28,045	32,027	15.9	16.1	17.3	15.7	16.5
United States	68,237	56,406	43,365	28,060	24,605	30.8	26.4	22.1	15.7	12.7
Hong Kong SAR	18,729	17,524	17,434	20,106	22,624	8.5	8.2	8.9	11.2	11.6
Netherlands	13,386	13,535	11,225	9,462	10,264	6.0	6.3	5.7	5.3	5.3
Japan	11,462	11,244	10,211	9,561	9,923	5.2	5.3	5.2	5.3	5.1
Thailand	9,681	9,954	9,356	9,248	9,339	4.4	4.7	4.8	5.2	4.8
Germany	5,136	6,618	6,588	7,657	8,421	2.3	3.1	3.4	4.3	4.3
Chinese Taipei	5,268	5,357	4,517	5,697	6,242	2.4	2.5	2.3	3.2	3.2
Korea	4,283	4,110	3,621	3,299	4,357	1.9	1.9	1.8	1.8	2.2
Others	32,914	31,991	28,551	23,118	28,376	14.9	15.0	14.6	12.9	14.6
Total	**221,508**	**213,704**	**196,023**	**179,087**	**194,443**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.13

Principal Export Markets for Electrical Products

Country	2006	2007	2008	2009	2010*p*	2006	2007	2008	2009	2010*p*
	RM million					% share				
United States	19,025	15,759	14,825	12,970	12,506	24.0	21.3	18.3	19.1	16.3
European Union	13,235	12,214	13,364	9,344	9,283	16.7	16.5	16.5	13.8	12.1
Japan	6,090	5,936	7,269	6,946	9,252	7.7	8.0	9.0	10.2	12.0
Singapore	14,701	10,983	10,838	8,169	8,476	18.5	14.8	13.4	12.0	11.0
Middle East	3,355	4,393	5,634	5,090	6,481	4.2	5.9	7.0	7.5	8.4
Australia	1,797	2,522	3,600	4,117	4,288	2.3	3.4	4.5	6.1	5.6
The People's Republic of China	3,092	3,555	3,824	3,146	3,973	3.9	4.8	4.7	4.6	5.2
Thailand	2,670	2,784	2,693	2,600	3,427	3.4	3.8	3.3	3.8	4.5
Hong Kong SAR	3,420	3,287	3,410	2,976	3,279	4.3	4.4	4.2	4.4	4.3
Others	11,892	12,561	15,443	12,452	15,842	15.0	17.0	19.1	18.4	20.6
Total	**79,277**	**73,993**	**80,899**	**67,809**	**76,808**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.14

Principal Export Markets for Chemicals and Chemical Products

Country	2006	2007	2008	2009	2010*p*	2006	2007	2008	2009	2010*p*
	RM million					% share				
The People's Republic of China	4,432	5,009	5,076	5,359	6,833	13.1	13.5	12.5	15.7	16.4
Indonesia	2,646	2,902	3,969	3,074	4,014	7.8	7.8	9.7	9.0	9.6
Singapore	3,084	3,329	3,714	3,299	3,757	9.1	9.0	9.1	9.7	9.0
Thailand	3,168	3,389	3,658	2,774	3,301	9.4	9.1	9.0	8.1	7.9
Japan	3,132	2,866	3,104	2,290	3,106	9.3	7.7	7.6	6.7	7.5
India	1,797	1,874	2,194	2,011	2,490	5.3	5.0	5.4	5.9	6.0
Hong Kong SAR	2,388	2,004	1,965	1,528	1,603	7.1	5.4	4.8	4.5	3.8
Chinese Taipei	1,416	1,723	1,607	1,158	1,483	4.2	4.6	3.9	3.4	3.6
Korea	1,555	1,550	1,293	1,237	1,433	4.6	4.2	3.2	3.6	3.4
United States	1,274	1,512	1,567	1,181	1,339	3.8	4.1	3.8	3.5	3.2
Others	8,834	11,001	12,576	10,250	12,317	26.2	29.6	30.9	30.0	29.6
Total	**33,725**	**37,159**	**40,723**	**34,161**	**41,674**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.15

Principal Export Markets for Palm Oil

Country	2006	2007	2008	2009	2010*p*	2006	2007	2008	2009	2010*p*
	'000 tonnes					% share				
The People's Republic of China	3,532	3,786	3,808	4,059	3,759	25.0	28.2	25.6	25.0	21.9
Pakistan	855	1,062	1,291	1,764	2,165	6.0	7.9	8.7	10.9	12.6
Middle East	1,324	1,212	1,257	1,364	1,868	9.4	9.0	8.4	8.4	10.9
European Union	2,586	2,097	2,010	1,694	1,819	18.3	15.6	13.5	10.4	10.6
Netherlands	*1,703*	*1,527*	*1,333*	*1,117*	*1,153*	*12.0*	*11.4*	*8.9*	*6.9*	*6.7*
Italy	*165*	*126*	*165*	*151*	*181*	*1.2*	*0.9*	*1.1*	*0.9*	*1.1*
Germany	*190*	*30*	*105*	*154*	*165*	*1.3*	*0.2*	*0.7*	*0.9*	*1.0*
Sweden	*220*	*134*	*85*	*54*	*116*	*1.6*	*1.0*	*0.6*	*0.3*	*0.7*
Others	*308*	*280*	*323*	*219*	*204*	*2.2*	*2.1*	*2.2*	*1.3*	*1.2*
India	657	515	925	1,263	1,157	4.6	3.8	6.2	7.8	6.7
United States	696	516	1,078	866	982	4.9	3.8	7.2	5.3	5.7
Japan	498	516	530	528	542	3.5	3.8	3.6	3.2	3.2
Korea	207	225	199	299	354	1.5	1.7	1.3	1.8	2.1
Bangladesh	413	170	254	113	183	2.9	1.3	1.7	0.7	1.1
Chinese Taipei	148	129	128	155	151	1.0	1.0	0.9	1.0	0.9
Australia	121	121	113	126	129	0.9	0.9	0.8	0.8	0.7
Others	3,105	3,064	3,304	4,025	4,092	22.0	22.8	22.2	24.8	23.8
Total	**14,142**	**13,412**	**14,894**	**16,256**	**17,201**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.16

Principal Export Markets for Rubber

Country	2006	2007	2008	2009	2010*p*	2006	2007	2008	2009	2010*p*
	'000 tonnes					% share				
The People's Republic of China	406	371	301	272	346	34.1	36.4	32.9	38.7	38.4
European Union	316	294	279	166	234	26.6	28.9	30.5	23.6	26.0
Germany	*144*	*136*	*123*	*82*	*117*	*12.1*	*13.3*	*13.5*	*11.6*	*13.0*
France	*41*	*43*	*32*	*18*	*22*	*3.4*	*4.3*	*3.5*	*2.6*	*2.4*
Netherlands	*21*	*17*	*21*	*19*	*27*	*1.8*	*1.6*	*2.3*	*2.7*	*3.0*
Italy	*22*	*20*	*17*	*9*	*13*	*1.9*	*1.9*	*1.9*	*1.3*	*1.4*
United Kingdom	*18*	*16*	*17*	*8*	*11*	*1.5*	*1.5*	*1.8*	*1.1*	*1.3*
Spain	*11*	*9*	*8*	*4*	*6*	*0.9*	*0.9*	*0.8*	*0.6*	*0.7*
Others	*59*	*54*	*61*	*26*	*39*	*5.0*	*5.3*	*6.7*	*3.7*	*4.3*
Middle East	71	54	69	54	64	6.0	5.3	7.5	7.7	7.1
Iran	*45*	*27*	*40*	*32*	*38*	*3.8*	*2.7*	*4.4*	*4.5*	*4.3*
Turkey	*20*	*21*	*21*	*17*	*20*	*1.7*	*2.1*	*2.3*	*2.4*	*2.2*
Others	*6*	*5*	*7*	*6*	*5*	*0.5*	*0.5*	*0.8*	*0.8*	*0.6*
Korea	67	61	52	47	49	5.6	6.0	5.6	6.7	5.4
United States	64	53	53	28	40	5.4	5.2	5.8	4.0	4.4
Brazil	32	38	35	23	27	2.7	3.8	3.8	3.3	3.0
Canada	15	19	12	9	9	1.3	1.9	1.4	1.3	1.0
Others	218	129	114	103	132	18.3	12.7	12.5	14.6	14.6
Total	**1,188**	**1,020**	**916**	**703**	**901**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.17

Principal Export Markets for Crude Oil

Country	2006	2007	2008	2009	2010*p*	2006	2007	2008	2009	2010*p*
	'000 tonnes					% share				
Australia	2,269	3,331	3,272	3,321	5,464	13.4	19.7	19.5	20.2	33.4
India	4,417	3,908	3,890	2,872	2,292	26.2	23.2	23.2	17.5	14.0
Thailand	2,528	1,435	1,579	2,767	2,256	15.0	8.5	9.4	16.9	13.8
The People's Republic of China	79	240	837	1,429	1,387	0.5	1.4	5.0	8.7	8.5
Singapore	1,285	1,607	2,497	1,428	943	7.6	9.5	14.9	8.7	5.8
Korea	1,433	1,545	1,356	877	929	8.5	9.2	8.1	5.3	5.7
Philippines	471	872	759	561	894	2.8	5.2	4.5	3.4	5.5
Indonesia	1,547	2,038	1,289	2,098	744	9.2	12.1	7.7	12.8	4.5
Japan	926	987	751	469	609	5.5	5.8	4.5	2.9	3.7
New Zealand	424	381	356	214	544	2.5	2.3	2.1	1.3	3.3
United States	282	46	165	371	160	1.7	0.3	1.0	2.3	1.0
Others	1,214	491	13	5	160	7.2	2.9	0.1	0.0	1.0
Total	**16,875**	**16,880**	**16,763**	**16,412**	**16,382**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.18

Principal Export Markets for LNG

Country	2006	2007	2008	2009	2010*p*	2006	2007	2008	2009	2010*p*
	'000 tonnes					% share				
Japan	12,170	13,238	13,350	12,877	14,041	57.3	57.8	57.6	58.0	60.2
Korea	5,626	6,069	6,541	5,659	4,917	26.5	26.5	28.2	25.5	21.1
Chinese Taipei	3,319	3,524	3,242	2,455	2,862	15.6	15.4	14.0	11.1	12.3
Others	119	72	31	1,194	1,488	0.6	0.3	0.1	5.4	6.4
Total	**21,234**	**22,904**	**23,164**	**22,185**	**23,309**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.19

External Debt and Debt Servicing

	2006	2007	2008[2]	2009	2010*p*
	RM million				
Medium- and long-term debt:					
Gross borrowing	**28,620**	**23,844**	**26,428**	**36,198**	**52,982**
Federal Government	834	489	472	451	4,495
NFPEs	10,909	1,706	5,952	17,900	4,076
Private sector	16,877	21,650	20,004	17,846	44,411
Repayment and prepayment	**28,539**	**25,699**	**13,279**	**36,380**	**50,898**
Federal Government	3,888	4,803	946	6,737	831
NFPEs	13,197	7,840	2,069	8,128	3,455
Private sector	11,453	13,055	10,265	21,515	46,612
Net borrowing	**81**	**-1,855**	**13,149**	**-183**	**2,084**
Federal Government	-3,054	-4,314	-474	-6,286	3,664
NFPEs	-2,288	-6,134	3,884	9,772	620
Private sector	5,424	8,594	9,740	-3,669	-2,201
Outstanding debt	**141,704**	**132,978**	**156,622**	**155,375**	**146,901**
Federal Government	25,005	19,602	20,316	13,786	16,745
NFPEs	50,378	41,854	63,146	71,600	66,591
Private sector	66,322	71,521	73,160	69,990	63,565
Short-term debt:					
Outstanding debt	**42,800**	**54,468**	**79,689**	**77,760**	**79,396**
Banking sector[1]	28,812	42,134	72,042	69,029	67,968
Non-bank private sector	13,988	12,334	7,647	8,730	11,428
Total external debt:	**184,505**	**187,445**	**236,311**	**233,136**	**226,297**
Total external debt (USD million)	**51,736**	**56,027**	**67,417**	**67,445**	**72,568**
% GNI	33.1	29.8	32.9	35.1	30.2
Annual change (%)	-6.7	1.6	26.1	-1.3	-3.0
Currency composition (% share)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
US dollar	81.9	81.2	76.6	72.7	65.9
Japanese yen	10.7	10.6	9.3	8.4	8.8
Others	7.4	8.3	14.2	18.9	25.4
Total servicing (including short-term interest payment)	**32,086**	**26,562**	**19,968**	**42,546**	**56,430**
of which:					
Medium- and long-term debt					
Repayment (excluding prepayment)	**23,760**	**19,105**	**13,279**	**36,380**	**50,898**
Federal Government	3,888	4,803	946	6,737	831
NFPEs	11,311	5,035	2,069	8,128	3,455
Private sector	8,561	9,267	10,265	21,515	46,612
Interest payment	**6,389**	**5,126**	**5,532**	**5,696**	**5,069**
Federal Government	1,506	1,426	1,155	909	658
NFPEs	3,511	2,282	2,493	3,025	3,161
Private sector	1,372	1,418	1,884	1,762	1,250
Debt service ratio (% of exports of goods and services)					
Total debt	**4.8**	**3.8**	**2.6**	**6.5**	**7.6**
Medium- and long-term debt	4.5	3.4	2.5	6.4	7.5
Federal Government	0.8	0.9	0.3	1.2	0.2
NFPEs	2.2	1.0	0.6	1.7	0.9
Private sector	1.5	1.5	1.6	3.6	6.4

[1] Excludes currency and deposits held by non-residents with resident banking institutions
[2] Effective from the first quarter of 2008, the external debt data of Malaysia has been redefined to treat entities in Labuan International Business and Financial Centre (Labuan IBFC) as residents
p Preliminary
Note: Numbers may not necessarily add up due to rounding

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Table A.20

Consumer Price Index

	Weights (%) (2005=100)	2007 Annual change (%)	2008 Annual change (%)	2009 Annual change (%)	2010 Annual change (%)
Total	**100.0**	**2.0**	**5.4**	**0.6**	**1.7**
of which:					
Food and non-alcoholic beverages	31.4	3.0	8.8	4.1	2.4
Alcoholic beverages and tobacco	1.9	7.8	7.3	6.1	4.0
Clothing and footwear	3.1	-1.4	-0.5	-0.9	-1.4
Housing, water, electricity, gas and other fuels	21.4	1.3	1.6	1.4	1.1
Furnishing, household equipment and routine household maintenance	4.3	1.1	3.0	2.9	0.7
Health	1.4	1.6	2.2	2.3	1.6
Transport	15.9	2.3	8.8	-9.4	1.6
Communication	5.1	-1.2	-0.6	-0.5	-0.2
Recreation services and culture	4.6	1.4	1.8	1.5	1.6
Education	1.9	1.8	2.3	2.4	1.7
Restaurants and hotels	3.0	3.7	6.6	2.9	2.0
Miscellaneous goods and services	6.0	1.0	3.3	3.8	2.7

Source: Department of Statistics, Malaysia

Table A.21

Producer Price Index

	Weights (%) (2005=100)	2007 Annual change (%)	2008 Annual change (%)	2009 Annual change (%)	2010 Annual change (%)
Total	**100.0**	**5.5**	**10.3**	**-7.1**	**5.6**
of which:					
Food	5.4	8.5	12.3	0.3	2.6
Beverages and tobacco	0.9	0.8	1.4	1.7	-0.5
Crude materials, inedible	5.4	21.9	11.5	-11.8	22.4
Mineral fuels, lubricants etc.	17.4	4.0	34.5	-22.0	12.8
Animal and vegetable oils and fats	4.2	43.0	24.5	-19.5	17.9
Chemicals	7.0	3.1	7.3	-7.5	3.0
Manufactured goods	10.9	2.7	6.7	-0.5	1.8
Machinery and transport equipment	42.9	1.8	0.7	1.5	1.2
Miscellaneous manufactured articles	5.4	1.4	1.7	1.5	0.6
Miscellaneous transactions and commodities	0.5	6.2	12.4	-6.2	12.2
Local Production	65.6	7.1	13.3	-10.4	7.7
Import	34.4	2.4	4.0	0.5	1.4

Source: Department of Statistics, Malaysia

Table A.22

Broad Money (M3)

	Annual change					As at end
	2006	2007	2008	2009	2010	2010
	RM million					
Broad money (M3)[1]	87,467	72,436	99,127	85,439	71,666	1,088,969
Currency in circulation[2]	3,335	2,746	4,178	3,015	4,246	47,685
Demand deposits	11,705	24,247	11,093	14,707	18,616	176,798
Broad quasi-money	72,427	45,444	83,856	67,717	48,805	864,487
Fixed deposits	*31,940*	*10,701*	*27,969*	*23,347*	*28,493*	*481,822*
Savings deposits	*5,195*	*8,703*	*7,786*	*10,050*	*2,675*	*104,943*
NIDs	*14,321*	*-15,279*	*144*	*-8,583*	*-2,862*	*19,682*
Repos	*11,799*	*-72,366*	*-3,046*	*898*	*655*	*1,711*
Foreign currency deposits	*3,218*	*1,570*	*16,649*	*15,283*	*1,432*	*56,021*
Other deposits	*5,956*	*112,116*	*34,356*	*26,721*	*18,412*	*200,308*
Factors Affecting M3						
Net claims on Government	8,317	-641	33,649	25,808	-8,119	49,097
Claims on Government	*1,614*	*-490*	*33,652*	*35,919*	*-3,116*	*102,870*
Less: Government deposits	*-6,703*	*151*	*3*	*10,110*	*5,003*	*53,773*
Claims on private sector	34,714	53,407	94,229	50,957	96,215	970,892
Loans	*36,779*	*50,926*	*76,903*	*46,481*	*92,000*	*863,031*
Securities	*-2,065*	*2,481*	*17,326*	*4,476*	*4,215*	*107,861*
Net foreign assets	52,745	71,166	-51,985	22,462	17,620	371,883
Bank Negara Malaysia[3]	*25,158*	*44,569*	*-18,265*	*7,343*	*-1,793*	*322,253*
Banking system	*27,587*	*26,597*	*-33,720*	*15,119*	*19,413*	*49,630*
Other influences	-8,309	-51,496	23,235	-13,789	-34,050	-302,902

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

Table A.23

Money Supply: Annual Change and Growth Rates

	2006		2007		2008		2009		2010	
	RM million	%	RM million	%	RM million	%	RM million	%	RM million	%
Currency in circulation	3,342	11.1	2,728	8.1	4,178	11.5	3,015	7.5	4,246	9.8
Demand deposits with commercial banks and Islamic banks	13,688	14.5	24,913	23.1	9,863	7.4	14,855	10.4	19,221	12.2
M1[1]	17,029	13.7	27,640	19.6	14,040	8.3	17,869	9.8	23,467	11.7
Other deposits with commercial banks and Islamic banks[2]	89,308	18.0	41,552	7.1	92,514	14.7	68,044	9.4	47,357	6.0
Deposits with other banking institutions[3,4]	-18,871	-36.7	3,244	9.9	-7,427	-20.7	-475	-1.7	842	3.0
M3[5]	87,467	13.0	72,436	9.5	99,127	11.9	85,439	9.2	71,666	7.0

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

Table A.24

Interest Rates (%)

	As at end-year						As at end-month in 2010											
	2004	2005	2006	2007	2008	2009	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
Overnight interbank	2.70	2.72	3.38	3.50	3.48	2.12	2.00	2.00	2.14	2.20	2.33	2.46	2.63	2.71	2.71	2.74	2.73	2.73
1-week interbank	2.74	2.75	3.42	3.52	3.50	2.14	2.02	2.02	2.23	2.27	2.41	2.52	2.71	2.77	2.77	2.76	2.76	2.76
1-month interbank	2.86	2.84	3.54	3.54	3.53	2.18	2.08	2.07	2.32	2.37	2.52	2.58	2.76	2.82	2.81	2.81	2.79	2.79
Commercial banks																		
Fixed deposit:																		
3 month	3.00	3.02	3.19	3.15	3.04	2.03	2.03	2.03	2.28	2.28	2.50	2.51	2.73	2.73	2.73	2.73	2.74	2.74
12 month	3.70	3.70	3.73	3.70	3.50	2.50	2.50	2.50	2.67	2.67	2.81	2.82	2.95	2.95	2.95	2.96	2.96	2.97
Savings deposit	1.58	1.41	1.48	1.44	1.40	0.86	0.86	0.80	0.86	0.86	0.93	0.95	0.99	1.02	1.02	1.02	1.00	1.00
Base lending rate (BLR)	5.98	6.20	6.72	6.72	6.48	5.51	5.51	5.51	5.76	5.76	6.02	6.02	6.27	6.27	6.27	6.27	6.27	6.27
Treasury bills (91 days)	2.40	2.50	3.23	3.43	3.39	2.05	1.95	2.26	2.14	2.47	2.63	2.66	2.77	2.88	2.86	2.86	2.87	2.83
Government securities (1 year)	2.24	3.30	3.55	3.53	2.89	2.12	2.26	2.59	2.58	2.58	2.70	2.79	2.86	2.87	2.90	2.93	2.87	2.85
Government securities (5 years)	3.64	3.73	3.70	3.78	3.00	3.79	3.76	3.84	3.75	3.62	3.59	3.53	3.41	3.38	3.25	3.43	3.28	3.39
Private Debt Securities																		
AAA																		
3-years	3.72	3.95	4.01	4.07	4.17	3.72	3.72	3.76	3.77	3.80	3.81	3.76	3.65	3.60	3.61	3.64	3.63	3.63
5-years	4.39	4.38	4.24	4.28	4.48	4.32	4.28	4.29	4.33	4.30	4.28	4.24	4.12	4.09	4.07	4.11	4.09	4.07
AA																		
3-years	4.27	4.36	4.38	4.39	4.95	4.50	4.53	4.57	4.59	4.55	4.54	4.43	4.34	4.29	4.31	4.36	4.35	4.34
5-years	5.00	4.81	4.71	4.64	5.31	5.07	5.09	5.09	5.10	5.05	5.00	4.92	4.79	4.74	4.75	4.79	4.76	4.75
A																		
3-years	5.82	5.94	5.91	6.06	6.90	6.80	6.94	6.95	6.95	7.02	7.09	7.06	6.96	6.91	6.93	6.96	6.87	6.90
5-years	6.66	6.70	6.53	6.51	7.43	7.57	7.63	7.62	7.62	7.65	7.70	7.67	7.58	7.54	7.58	7.57	7.52	7.53
BBB																		
3-years	9.77	9.44	9.57	9.71	10.32	10.18	10.32	10.28	10.30	10.33	10.41	10.34	10.30	10.26	10.28	10.36	10.40	10.40
5-years	10.81	10.41	10.51	10.72	11.36	11.32	11.47	11.39	11.47	11.48	11.50	11.46	11.42	11.36	11.43	11.48	11.44	11.43
BB & below																		
3-years	11.91	11.97	12.06	11.92	12.68	12.58	12.77	12.78	12.73	12.73	12.77	12.77	12.76	12.69	12.74	12.87	12.76	12.78
5-years	13.10	13.04	13.13	13.16	13.86	14.02	14.23	14.23	14.33	14.35	14.44	14.44	14.42	14.25	14.38	14.45	14.46	14.51

Table A.25

Movements of the Ringgit

	RM to one unit of foreign currency[1]			Annual change (%)		Change (%)
	2005	2009	2010	2009	2010	21 Jul.'05 -
	21 Jul.[2]	End-Dec.				Dec. 2010
SDR	5.5049	5.3487	4.7273	0.2	13.1	16.4
US dollar	3.8000	3.4245	3.0835	1.2	11.1	23.2
Singapore dollar	2.2570	2.4401	2.3859	-1.4	2.3	-5.4
100 Japanese yen	3.3745	3.7076	3.7869	3.4	-2.1	-10.9
Pound sterling	6.6270	5.5001	4.7817	-9.1	15.0	38.6
Swiss franc	2.9588	3.3084	3.2720	-1.1	1.1	-9.6
Euro	4.6212	4.9191	4.0804	-0.9	20.6	13.3
100 Thai baht	9.0681	10.271	10.227	-3.2	0.4	-11.3
100 Indonesian rupiah	0.0386	0.0364	0.0344	-13.1	6.0	12.4
100 Korean won	0.3665	0.2937	0.2707	-6.4	8.5	35.4
100 Philippine peso	6.8131	7.4196	7.0400	-1.9	5.4	-3.2
Chinese renminbi	0.4591	0.5016	0.4662	1.2	7.6	-1.5

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

Table A.26

Housing Credit Institutions

	Year of establishment	Objective	Lending rate for new housing loans (%)		No. of branches	
			2009	2010	2009	2010
Commercial banks	-		3.6[1,2]	4.0[1,2]	4,086[3]	4,108[3]
Treasury Housing Loans Division	1970	To provide housing loans to Government employees	4.0[1]	4.0[1]	2	2
Bank Kerjasama Rakyat Malaysia Berhad	1954	A co-operative society which collects deposits and provides banking facilities according to Syariah principles	6.5[1]	6.9[1]	122	127
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	6.37~6.41	7.04~7.08	32	33
Borneo Housing Mortgage Finance Berhad	1958	To provide housing loans mainly to Sabah and Sarawak State Government employees	6.75~8.25	6.75 ~ 8.25	1	1
Bank Simpanan Nasional	1974	To promote and mobilise savings particularly from small savers and to inculcate the habit of thrift and savings	3.8[1]	5.9[1]	375	384
Sabah Credit Corporation	1955	To uplift the social economic development of Malaysians in Sabah through the provision of easy acces to financial credit	3.0 ~ 7.5	3.0 ~ 7.5	11	11

[1] 12-month average lending rate
[2] Excludes Islamic banks
[3] Includes Islamic banks

Source: Bank Negara Malaysia and various housing credit institutions

Table A.27

Housing Loans Outstanding

	2009	2010*p*	2009	2010*p*	2009	2010*p*
	RM million		Annual change (%)		% share	
Commercial banks[1]	210,017	226,930	9.3	8.1	84.0	85.0
Treasury Housing Loans Division	26,716	27,042	-2.5	1.2	10.7	10.1
Bank Kerjasama Rakyat Malaysia Berhad	4,189	3,837	-5.2	-8.4	1.7	1.4
Malaysia Building Society Berhad	5,274	5,331	2.6	1.1	2.1	2.0
Borneo Housing Mortgage Finance Berhad	717	682	-3.4	-4.8	0.3	0.3
Bank Simpanan Nasional	3,034	3,128	2.7	3.1	1.2	1.2
Sabah Credit Corporation	163	141	-9.0	-13.1	0.1	0.1
Total	**250,111**	**267,091**	**7.4**	**6.8**	**100.0**	**100.0**

[1] Includes Islamic banks
p Preliminary

Source: Bank Negara Malaysia and various housing credit institutions

Table A.28

Housing Loans Approved

	2009	2010*p*	2009	2010*p*	2009	2010*p*
	RM million		Annual change (%)		% share	
Commercial banks[1]	60,707	80,327	4.8	32.3	85.0	87.7
Treasury Housing Loans Division	5,920	6,254	-21.9	5.7	11.1	8.5
Bank Kerjasama Rakyat Malaysia Berhad	115	59	-61.4	-48.5	0.4	0.2
Malaysia Building Society Berhad	1,650	396	5.4	-76.0	2.3	2.4
Borneo Housing Mortgage Finance Berhad	60	37	-11.7	-37.3	0.1	0.1
Bank Simpanan Nasional	798	900	11.7	12.8	1.0	1.2
Sabah Credit Corporation	4	3	-67.2	-37.0	…	…
Total	**69,253**	**87,977**	**1.6**	**27.0**	**100.0**	**100.0**

[1] Includes Islamic banks
p Preliminary
… Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.29

Financing of the Economy

By customer / By financing type/institution	Businesses[1] Total	Businesses[1] of which: SMEs[2]	Households	Government	Total Financing
	RM million				
Net Change in Financing (2009)					
Financial Intermediaries					
Banking Institutions	20,371	570	38,559	9,085	68,015
Development Financial Institutions (DFIs)[3]	5,897	2,179	7,039	-	12,936
Other Domestic Intermediaries[4]	6,266	-744	-676	-	5,590
Capital Market					
Bond Market[5]	25,458	-	-	51,969	77,427
Equity Market	26,045	-	-	-	26,045
External Financing					
Foreign Direct Investment	5,040	-	-	-	5,040
External Loan[6,7]	-2,087	-	-	1,926	-161
Total	**86,990**	**2,005**	**44,922**	**62,980**	**194,892**
Net Change in Financing (2010)					
Financial Intermediaries					
Banking Institutions	33,774	2,971	57,965	8,058	99,797
Development Financial Institutions (DFIs)[3]	3,698	-3,480	7,373	-	11,071
Other Domestic Intermediaries[4]	1,591	-11	326	-	1,917
Capital Market					
Bond Market[5]	20,748			34,222	54,970
Equity Market	32,139	-	-	-	32,139
External Financing					
Foreign Direct Investment	10,511	-	-		10,511
External Loan[6,7]	-3,727			-2,091	-5,818
Total	**98,735**	**-520**	**65,664**	**40,189**	**204,587**

1 Businesses include non-bank financial institutions, domestic non-business entities and foreign entities
2 Adjusted to include reclassification of SMEs to large corporation
3 Refers to DFIs governed under the Development Financial Institutions Act, 2002
4 Other domestic intermediaries include insurance companies, Employees Provident Fund (EPF), housing credit institutions, leasing and factoring companies and the Treasury Housing Loan Division
5 Refers to changes in outstanding of private debt securities (PDS) and all Malaysian Government securities. Data excludes Cagamas bonds and issuances by non-residents. PDS includes irredeemable convertible unsecured loan stocks (ICULS) and medium term notes (MTN) issued by the corporate sector
6 Based on the new classification of external debt, which has been redefined to treat entities in Labuan International Business and Financial Centre (Labuan IBFC) as residents, effective from first quarter of 2008
7 External financing of Government includes financing to non-financial public enterprises (NFPEs)

Table A.30

Consolidated Public Sector Finance

	2007	2008	2009	2010*p*	2011*f*
	RM billion				
Revenue[1]	110.7	128.3	134.0	131.1	138.5
% growth	*8.6*	*15.9*	*4.4*	*-2.1*	*5.7*
Operating expenditure	135.0	165.0	170.3	167.7	176.8
% growth	*14.7*	*22.2*	*3.2*	*-1.5*	*5.5*
Current surplus of NFPEs[2]	130.1	119.4	101.2	92.1	90.6
Current balance	**105.8**	**82.7**	**64.9**	**55.5**	**52.4**
% of GDP	***16.5***	***11.2***	***9.5***	***7.2***	***6.2***
Net development expenditure[3]	96.3	124.4	111.3	112.3	121.1
% growth	*11.3*	*29.1*	*-10.5*	*0.9*	*7.9*
General Government[4]	44.7	50.5	54.5	55.2	54.8
NFPEs	51.6	73.8	56.8	57.1	66.4
Overall balance	**9.4**	**-41.7**	**-46.4**	**-56.7**	**-68.8**
% of GDP	***1.5***	***-5.6***	***-6.8***	***-7.4***	***-8.2***

1 Excludes transfers within general Government
2 Refers to 30 NFPEs from 2004 onwards
3 Adjusted for transfers and net lendings within public sector
4 Comprises Federal Government, state and local governments and statutory bodies
p Preliminary
f Forecast
Note: Numbers may not add up due to rounding

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

Table A.31

Major Advanced Economies: Key Economic Indicators

	2006	2007	2008	2009	2010*e*	2011*f*
	Annual change (%)					
REAL GDP						
United States	2.7	2.0	0.0	-2.6	2.8	3.0
Japan	2.0	2.4	-1.2	-6.3	3.9	1.6
Euro area	3.1	2.9	0.4	-4.1	1.7	1.5
Germany	*3.4*	*2.7*	*1.0*	*-4.7*	*3.6*	*2.2*
United Kingdom	2.8	2.7	-0.1	-4.9	1.3	2.0
INFLATION						
United States	3.2	2.9	3.8	-0.4	1.6	1.0
Japan	0.3	0.0	1.4	-1.4	-0.7	-0.3
Euro area	2.2	2.1	3.3	0.3	1.6	1.5
Germany	*1.8*	*2.3*	*2.8*	*0.2*	*1.2*	*1.4*
United Kingdom	2.3	2.3	3.6	2.2	3.3	2.5
	% of labour force					
UNEMPLOYMENT						
United States	4.6	4.6	5.8	9.3	9.6	9.6
Japan	4.1	3.8	4.0	5.1	5.1	5.0
Euro area	8.4	7.5	7.5	9.4	10.0	10.0
Germany	*9.8*	*8.4*	*7.3*	*7.5*	*6.8*	*7.1*
United Kingdom	5.5	5.3	5.7	7.6	7.8	7.4
	% of GDP					
CURRENT ACCOUNT BALANCE						
United States	-6.0	-5.1	-4.7	-2.7	-3.2	-2.6
Japan	3.9	4.8	3.2	2.8	3.1	2.3
Euro area	0.4	0.4	-0.7	-0.4	0.2	0.5
Germany	*6.5*	*7.6*	*6.7*	*4.9*	*6.1*	*5.8*
United Kingdom	-3.4	-2.6	-1.6	-1.1	-2.2	-2.0
FISCAL BALANCE[1]						
United States	-2.0	-2.7	-6.7	-12.9	-11.1	-9.7
Japan	-4.0	-2.4	-4.1	-10.2	-9.6	-8.9
Euro area	-1.3	-0.6	-1.9	-6.3	-6.5	-5.1
Germany	*-1.6*	*0.2*	*0.0*	*-3.1*	*-4.5*	*-3.7*
United Kingdom	-2.6	-2.7	-4.9	-10.3	-10.2	-8.1

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

Source: International Monetary Fund and National Authorities

Table A.32

East Asia: Key Economic Indicators

	2006	2007	2008	2009	2010*e*	2011*f*
REAL GDP	Annual change (%)					
Regional Countries						
The People's Republic of China	12.7	14.2	9.6	9.2	10.3	9.6
Korea	5.2	5.1	2.3	0.2	6.1	4.5
Chinese Taipei	5.4	6.0	0.7	-1.9	10.8	4.4
Singapore	8.7	8.8	1.5	-0.8	14.5	4.5
Hong Kong SAR	7.0	6.4	2.3	-2.7	6.8	4.7
Malaysia	5.8	6.5	4.7	-1.7	7.2	5~6
Thailand	5.1	5.0	2.5	-2.3	7.8	4.0
Indonesia	5.5	6.3	6.0	4.5	6.1	6.2
Philippines	5.3	7.1	3.7	1.1	7.3	4.5
INFLATION	Annual change (%)					
Regional Countries						
The People's Republic of China	1.5	4.8	5.9	-0.7	3.3	2.7
Korea	2.2	2.5	4.7	2.8	2.9	3.4
Chinese Taipei	0.6	1.8	3.5	-0.9	1.0	1.5
Singapore	1.0	2.1	6.6	0.6	2.8	2.4
Hong Kong SAR[1]	2.0	2.0	4.3	0.5	2.4	3.0
Malaysia	3.6	2.0	5.4	0.6	1.7	2.5~3.5
Thailand	4.6	2.2	5.5	-0.9	3.3	2.8
Indonesia	13.1	6.3	9.8	4.8	5.1	5.5
Philippines	6.2	2.8	9.3	3.2	3.8	4
CURRENT ACCOUNT BALANCE	% of GDP					
Regional Countries						
The People's Republic of China	9.3	10.6	9.6	6.0	4.7	5.1
Korea	0.6	0.6	-0.6	5.1	2.6	2.9
Chinese Taipei	7.0	8.9	6.8	11.3	10.0	9.5
Singapore	24.2	26.7	18.5	17.8	20.5	18.4
Hong Kong SAR	12.1	12.3	13.6	8.7	8.3	8.3
Malaysia	16.7	16.0	17.5	17.1	11.8	12.2
Thailand	1.1	6.3	0.6	7.7	3.5	2.5
Indonesia	3.0	2.5	0.1	1.9	0.9	0.1
Philippines	4.5	4.9	2.2	5.3	4.1	3.4
FISCAL BALANCE[2]	% of GDP					
Regional Countries						
The People's Republic of China	-0.7	0.9	-0.4	-3.0	-2.9	-1.9
Korea	2.4	4.2	1.7	0.04	1.4	2.0
Chinese Taipei	-1.6	-1.4	-2.4	-5.8	-3.8	-2.5
Singapore	5.3	10.0	5.3	-0.8	2.4	1.5
Hong Kong SAR	4.3	8.1	0.1	1.6	1.6	1.8
Malaysia[3]	-3.3	-3.2	-4.8	-7.0	-5.6	-5.4
Thailand	2.2	0.2	0.1	-3.2	-2.7	-2.3
Indonesia	0.3	-1.2	-0.1	-1.6	-1.5	-1.7
Philippines	-1.4	-1.5	-1.3	-3.9	-3.9	-3.5

[1] Refers to composite price index
[2] Refers to general government fiscal balance
[3] Refers to central government fiscal balance
e Estimates
f Forecast

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