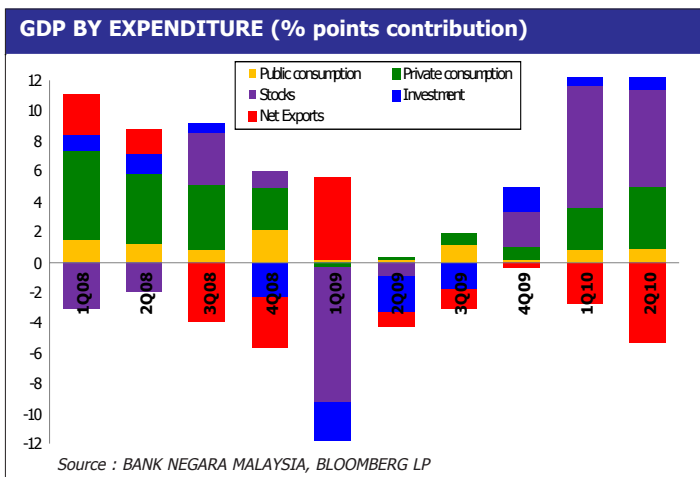


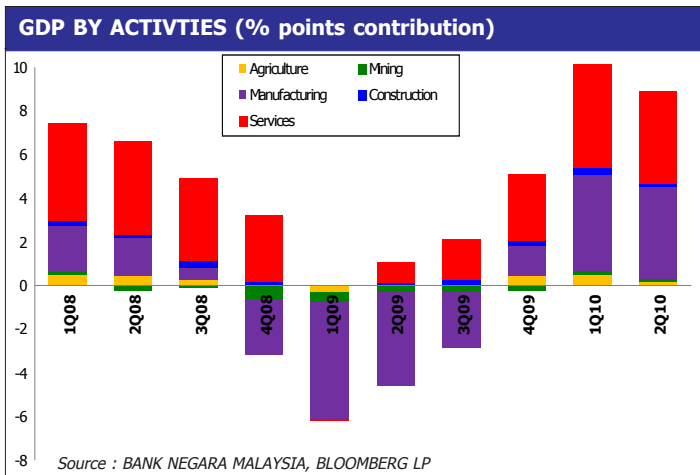
### 2Q10 MALAYSIA GDP REVIEW

- The Malaysian economy continued to expand robustly at 8.9% yoy in 2Q10. However, it was slower compared with the 10.1% pace charted in 1Q10. We had estimated the growth rate for the quarter at 8.8% while the market's consensus was lower at 8.4%. On qoq, the country's GDP in 2Q10 had expanded by 3.5%, slower compared with 4.6% in 2Q09, which had contributed to the slower annual growth in 2Q10 compared with the preceding quarter. Nonetheless, the 8.9% increase is still the highest on record since 1Q00, excluding the 10.1% pace in 1Q10. On average, the domestic economy grew by 9.5% in 1H10 following an increase of 1.6% in 2H09 and a contraction of 5.1% in 1H09. A stronger growth in domestic demand had helped cushion the impact of slower exports during the quarter, while on the supply side, manufacturing and services sectors continued to propel the overall growth.
- The 3.5% qoq expansion in 2Q10 was consistent with the average rate achieved in the preceding ten years for the 2Q, reflecting the normalization of the expansion pace of the domestic economy. Consequently, the value of GDP in 2Q10 has surpassed the pre-crisis peak level in 3Q08 by 1.6%, suggesting a full recovery from the global financial crisis.
- The continuing buoyant performance of the economy to a large extent was driven by the domestic demand which rose by 9.0% yoy in 2Q10 from 5.3% in 1Q10. Improved job market, firmer recovery of the stock market, continuing accommodative monetary policy and low interest rate and inflation had lifted consumer sentiment and encouraged spending. Private consumption as a result recorded a faster increase of 7.9% in 2Q10 after expanding by 5.1% in 1Q10. Total domestic consumption in 2Q10 was further supported by slightly higher government operating expenditure which grew by 6.8% from 6.3% in 1Q10. Overall, domestic consumption expanded by 7.7% in 2Q10 from 5.3% in the preceding quarter.
- It is encouraging to note that fixed capital formation, or investment, had expanded sharply during the second quarter, a mirror of the improved industrial and business activity following demand recovery. The Government continued spending on projects under the stimulus programs would have also helped boost the overall investment growth to 12.9% in 2Q10 from 5.4% in the previous quarter.
- Given the faster expansion of domestic consumption and investment expenditure, the domestic demand excluding inventory change had made a significant contribution of 7.9 percentage points to the overall GDP growth in 2Q10 from 4.7 percentage points in 1Q10. We view this as an encouraging development for the local economy as the recovery has shifted



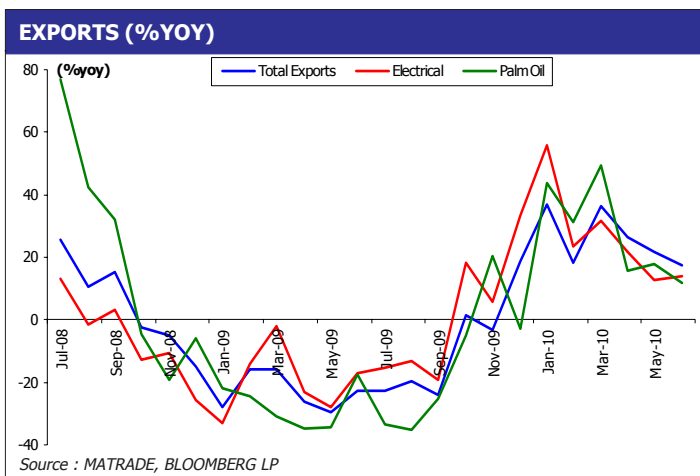
back to domestic demand which helped remove volatility in inventory.

- Exports had continued to contribute positively to the overall GDP growth in 2Q10, but its net contribution had declined further due its slower growth which was exceeded by imports. Export growth moderated sharply to 13.8% in 2Q10 from 19.3% in 1Q10 stemming from the weaker demand from major economies and higher base. Imports on the other hand were buffered by the robust domestic demand in 2Q10 and recorded a 21.9% increase, though slowing from 27.5% in 1Q10. As imports continued to outpace exports, the contraction of net exports widened to 38.4% from 12.9% in 1Q10 and caused a 5.7% percentage pts negative contribution to the overall GDP growth.



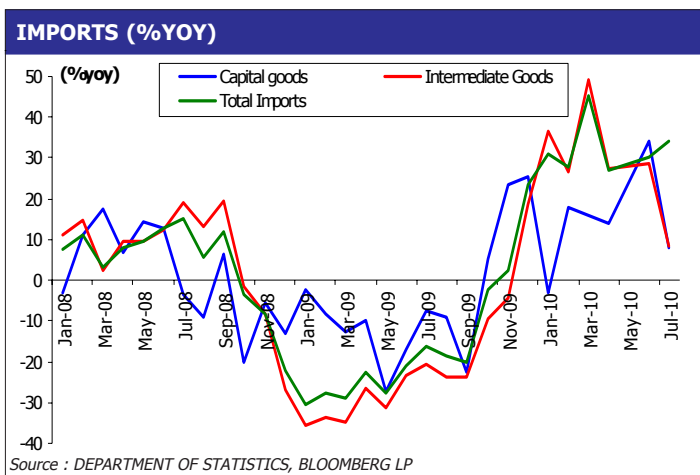
- Inventories charted its first net increase during the quarter following 11 straight quarters of drawdown. Increased production in the manufacturing sector in particular in response to expanding demand had led to higher inventories by RM6.4 billion in 2Q10 from a net decline of RM2.3 billion in 1Q10. However, given the smaller annual change, the contribution of inventories to the overall GDP growth decreased from 8.0 percentage points in 1Q10 to 6.3 percentage points in 2Q10.

- On the supply side, manufacturing continued to lead other sectors in 2Q10 with a slightly smaller double-digit growth of 15.9% from 17.0% in 1Q10 as manufacturers resumed to replenish inventories. The slower annual growth to some extent reflected the high base effect and the slowing export demand for the E&E items. However, on q-o-q the manufacturing sector had expanded faster at 5.0% in 2Q10 from 0.8% in the preceding quarter. Despite the strong growth, manufacturing output remained lower compared with the pre-crisis level by 2.3%, reflecting the severity of the impact of global economic crisis on the sector.

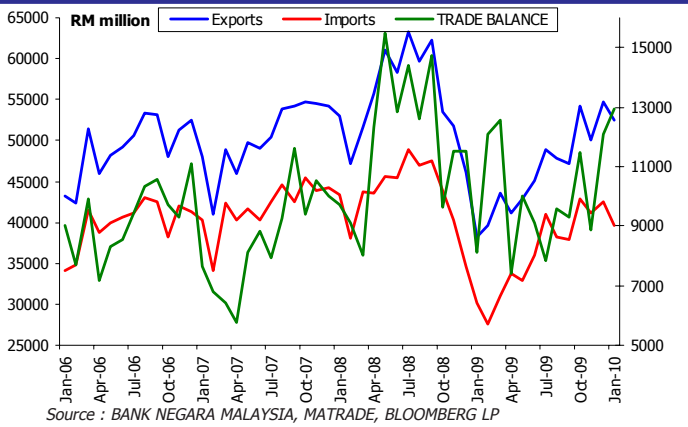


- Similarly, the services sector sustained a strong increase of 7.3% in 2Q10 but slowing from the 8.5% gain in the previous quarter mainly caused by high base effect. The sector was largely supported by stronger growth in private expenditure and sustained trade activities. The services sector had contributed 4.2 percentage points to the overall GDP growth in 2Q10, similar to the contribution of manufacturing sector.

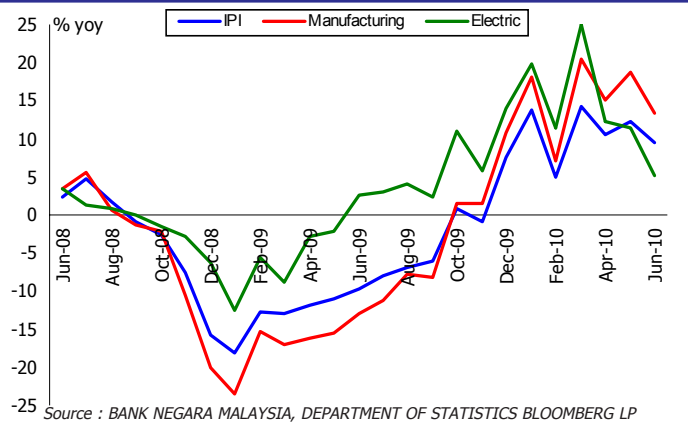
- Both the agriculture and construction sectors recorded the sharpest slowdown among the supply side components in 2Q10. The agriculture sector rose by 2.4% in 2Q10 from 6.8% in the preceding quarter mainly caused by the decline in crude palm oil and rubber production due to weather conditions, as reported by respective domestic institutions. Construction activities on the other hand were dragged by the high base effect as the sector continued to expand at 4.2% in 2Q10. Mining sector also recorded expansion but the pace moderated slightly to 1.9% from 2.1% in 1Q10.



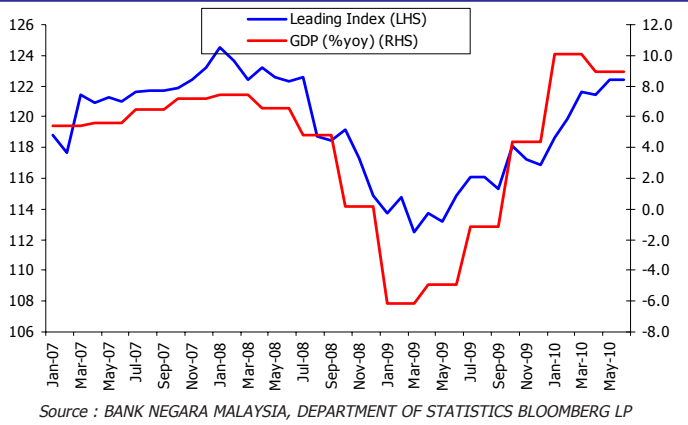
## EXTERNAL TRADE (RM BILLION)



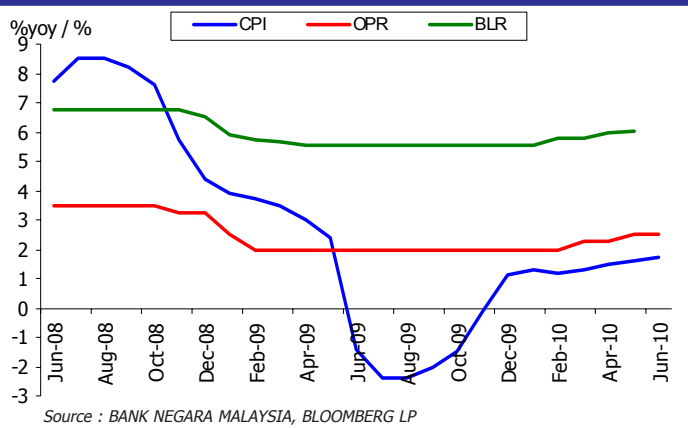
## IPI (% YOY)



## COMPOSITE LEADING INDEX vs GDP (%YOY)

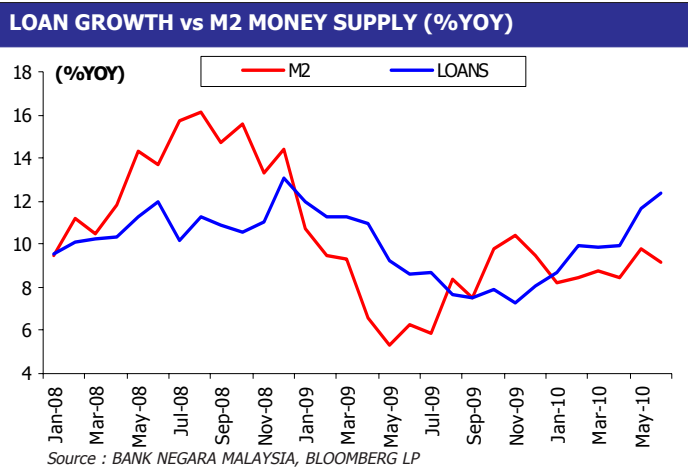


## CPI vs OPR vs BLR (%)



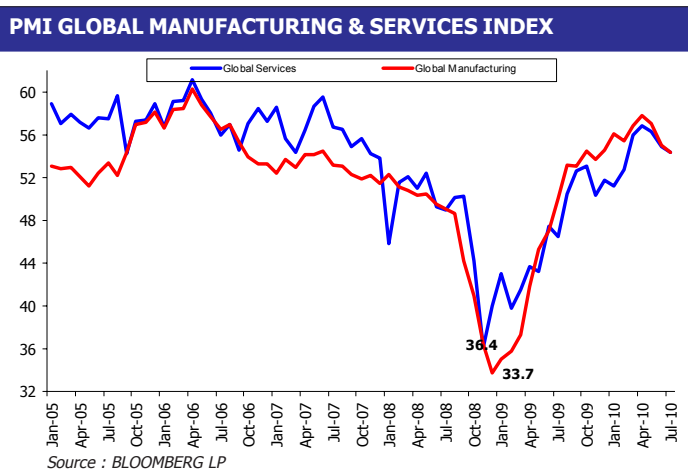
## PROSPECT & CHALLENGES

- Malaysia's growth momentum is likely to slow down in 2H10, mainly as a result of slowing global economic recovery. While the impact of global stimulus packages is waning, there are persistent weakness in the major economies that would dampen global demand and capital flows. The major worries of major economies include governments' high fiscal imbalance, rising debts and high unemployment rates. There are concerns on the impact of moderating global inventory cycle and rising inflation expectation in the developing countries which could trigger a sharper deceleration of global growth.
- The expectation of a slower global economic expansion is supported by the latest global key economic indicators, which broadly continued to show declines from their recent peaks. The OECD Global Composite Leading Index, an important gauge of the health of developed economies, recorded a slower pace of annual growth of 6.7% in June after reaching a peak of 10.3% in February. At the same time, the ISM Global Manufacturing Index declined to 54.3 points in July, the lowest level since November 2009 which signals the weakening of the global inventory cycle. Additionally, the sharp deterioration of the Baltic Dry Index to 1967 points in July, the lowest level since May last year, indicates a further slowdown in international trade activities.
- Despite the increasing risks of a major slowdown, we are not expecting another recession or a double-dip position, given the pro-active policy responses and firm commitment of policy makers globally to ensure a more entrenched and sustainable economic recovery. A more likely scenario is a prolonged sub-par growth in the developed economies as fiscal and monetary policy tools become exhaustive to help support their economic activities. On the other hand, the developing economies are likely to experience some moderation in the growth pace following softening demand from major economies.
- Domestically, the impact of export slowdown would be to decelerate the overall economic expansion in 2H10. We are forecasting exports to chart a significantly slower growth of 6.5%-7.0% in 2H10 from 16.5% in 1H10. Consequently, exports may remain below the pre-crisis level by 3.9%, but improving from the current 9.6%.
- However, domestic demand may expand further by 8.0%-8.5% in 2H10 from 7.2% in 1H10 to help sustain the impact of slowing exports. This would be led by higher private consumption as consumer sentiment continues to be lifted by the improvement in the job market, low interest rate and stable commodity prices. Consumption spending would also be supported by festive activities in 2H10.
- Similarly, investment could also see a sustained growth in 2H10 as the private sector is expected to take advantage of the continuing low interest rates and easy access to credit. Furthermore, works are expected to start on the high valued projects such as the new LCCT worth RM2.1bn, the Semantan Pumping Station worth RM2.5bn and the LRT extension line worth RM7bn which had already been awarded earlier this year.
- On the supply side, the performance of manufacturing sector would be most impacted by the export deceleration and slower

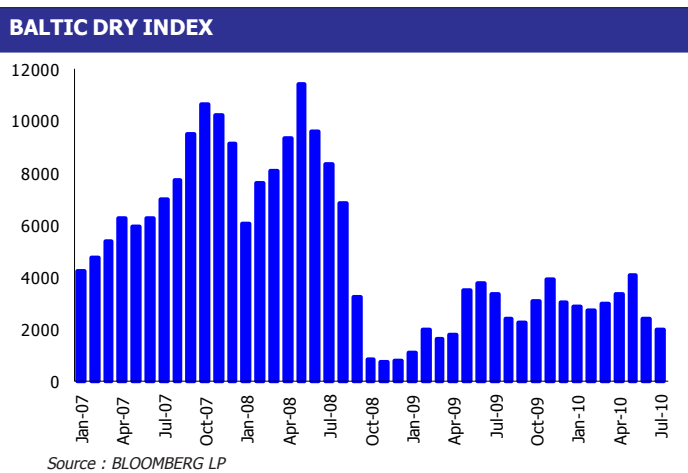
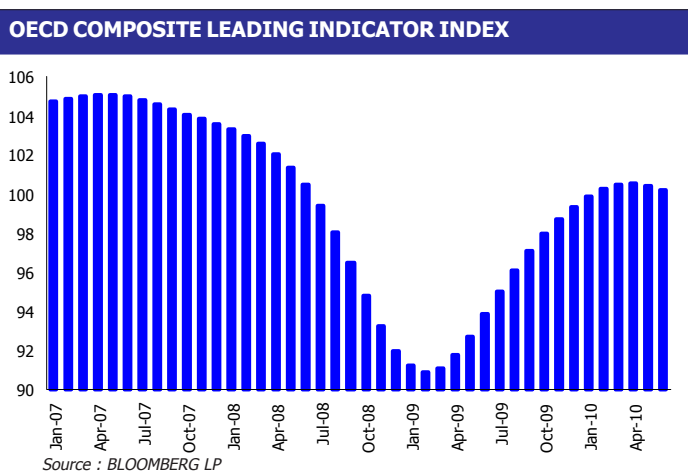


global inventory cycle in 2H10. Consequently, it will also erode the level of inventory and dampen the overall GDP growth. In contrast, the services sector is expected to see a sustained growth in 2H10 supported by the strong increase in domestic demand. The construction sector similarly may continue to record sustained performance given the concentration of high value infrastructure projects in 2H10.

- **Overall, the rate of GDP expansion in 2H10 is projected to decelerate to 5.5%-6.0% from 9.5% in 1H10. However, supported by sharply higher growth in 1H10, we are revising our 2010 GDP growth forecast to 7.5%-8.0% from 7.0%-7.5%, after declining by 1.7% in 2009.**
- **On the monetary policy front, we continue to expect the OPR to be held at the current rate of 2.75% until the end of the year.** Despite the robust growth pace in 2Q10, the local economy remains highly susceptible to any significant changes on the global front. Given the moderate inflationary expectation for the year and the non-existence of imbalances in the financial system, BNM could pause on its interest rate normalizing path in the final two meetings of the year while accessing the impact of the global slowdown on the domestic economy. Furthermore, the 75bps hike made since March this year has narrowed the gap between CPI and OPR compared with the pre-crisis level. BNM has also viewed the current level of interest rate as consistent and appropriate with the country's inflation and growth prospects.



- For 2011, we expect growth to slow further during 1H before accelerating in the 2H due to the high base effect and the reversal in inventory cycle. Furthermore, with the gradual unwinding of the fiscal and monetary policy support, domestic demand may moderate to affect the overall GDP. The planned subsidies' reform and GST implementation could also slow domestic demand. Hence, we project the GDP growth to moderate to 5.0-5.5% in 2011.



**MALAYSIA GROSS DOMESTIC PRODUCT**

%yoy	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10f	4Q10f	2008	2009	2010F
<b>Real GDP</b>	<b>-3.9</b>	<b>-1.2</b>	<b>4.4</b>	<b>10.1</b>	<b>8.9</b>	<b>6.9</b>	<b>5.6</b>	<b>5.0</b>	<b>-1.7</b>	<b>7.8</b>
Agriculture	0.3	-0.4	5.9	6.8	2.4	2.1	-0.6	4.0	0.6	2.5
Mining	-3.5	-3.6	-2.8	2.1	1.9	2.8	6.2	-2.5	-3.8	3.3
Manufacturing	-14.5	-8.6	5.0	17.0	15.9	11.3	7.1	1.3	-9.7	12.6
Construction	4.4	7.9	9.3	8.7	4.2	-3.9	-0.3	6.7	5.8	1.8
Services	1.7	3.4	5.2	8.5	7.3	6.3	6.0	7.2	3.3	7.0
Consumption	0.6	2.9	1.4	5.3	7.7	5.4	10.6	9.1	1.2	7.4
Public consumption	1.5	9.4	0.7	6.3	6.8	5.0	5.9	10.9	3.1	6.0
Private consumption	0.3	1.3	1.6	5.1	7.9	5.5	12.2	8.6	0.7	7.7
Investment (excl. stocks)	-9.6	-7.9	8.2	5.4	12.9	7.4	7.0	0.6	-5.6	8.3
Net Exports	-6.7	-10.3	-4.7	-12.9	-38.4	-16.2	-10.0	-5.9	5.0	-19.5
Exports	-24.0	-30.0	6.0	19.3	13.8	8.9	4.3	1.2	-10.4	11.2
Imports	-20.0	-32.0	7.0	27.5	21.9	11.8	5.5	2.1	-12.3	15.6

Source : Bank Negara Malaysia, Department of Statistics Malaysia, Bloomberg LP, Research Division PNB

**MALAYSIA KEY STATISTICS**

	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10
<b>FINANCIAL SYSTEM</b>								
OPR (%)	2.00	2.00	2.00	2.25	2.25	2.50	2.50	2.75
M1 (%yoy)	9.8	10.7	15.3	20	8.9	12.1	12.6	-
M2 (%yoy)	9.5	8.2	8.4	8.8	8.5	9.8	9.2	-
M3 (%yoy)	9.2	8	8.2	8.7	8.1	9.5	8.8	-
Loan Growth (%yoy)	7.8	8.6	10	9.8	10.0	11.6	12.4	-
Deposit Growth (%yoy)	9.3	8.4	7.4	8.4	8.1	9.0	9.0	-
<b>CONSUMER PRICE INDEX</b>	1.1	1.3	1.2	1.3	1.5	1.6	1.7	1.9
<b>PRODUCER PRICE INDEX</b>	3.6	4.2	5.9	9.0	7.4	5.9	5.2	-
<b>EXTERNAL TRADE</b>								
Exports (%yoy)	18.7	37.0	18.4	36.4	26.6	21.8	17.2	-
Electrical	33.4	55.5	23.5	31.2	21.6	12.8	14.1	-
Crude Oil	77.3	35.4	125.2	55.7	93.0	71.9	18.4	-
Chemical	30.8	49.5	32.9	60.2	26.2	23.0	20.8	-
LNG	-36.1	-18.7	-31.5	11.5	33.2	92.0	67.6	-
Palm Oil	-3.1	44	31	49.3	15.7	17.9	11.6	-
Imports (%yoy)	23.3	31	27.9	45.3	27.0	34.2	30.1	-
Intermediate Goods	18.8	36.7	26.4	49.4	27.4	8.5	28.7	-
Capital Goods	25.3	-2.9	18.1	16.1	14.0	7.8	34.3	-
Consumer Goods	6.7	19.4	17.1	18.7	9.3	-6.5	15.9	-
<b>INDUSTRIAL</b>								
Industrial Production (%yoy)	7.5	13.8	4.9	14.1	10.6	12.3	9.4	-
Manufacturing	10.8	18.1	6.8	20.3	15.1	18.7	13.3	-
Electric	14.1	19.8	11.4	24.9	12.2	11.5	5.2	-
Mining	-0.2	4	-1.5	-0.6	0.8	-0.2	1.3	-
<b>BNM RESERVES</b>								
USD	96.7	97.0	96.9	95.3	96.0	95.5	94.8	95.0
MYR	332.6	330.8	329.8	310.8	313.9	312.2	309.8	310.6
<b>MAJOR COMMODITIES</b>								
Crude Oil (USD per barrel)	79.36	72.89	79.66	83.76	86.15	73.97	75.63	78.95
Palm Oil (MYR per tonne)	2590	2436	2600	2580	2535	2430	2587	
Rubber (MYR per kg)	953.75	992.50	1047.75	1053.25	996.00	949.25	929.75	922.5