Outlook and Policy in 2017

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Outlook and Policy in 2017

THE INTERNATIONAL ECONOMIC OUTLOOK

Global economic activity is projected to expand at a faster pace in 2017, supported by an expansion in domestic demand in the advanced and emerging market economies, and expectations of a recovery in trade activity in the emerging regions. The outlook would be supported by expansionary fiscal plans in selected major economies and recovery in commodity prices. Despite these positive signs, the overall outlook for the global economy still has signs of fragility given its high susceptibility to adverse shocks.

Global economy to improve in 2017 despite the presence of new and prevailing risks

Domestic demand in the advanced and emerging market economies is expected to be boosted by fiscal measures in selected major economies, namely the US, the UK and PR China. In the US, expectations are for the new administration to lower taxation rates and increase infrastructure spending which may provide impetus to global trade. The UK government has also unveiled a plan that includes higher expenditure on infrastructure and housing as well as increased funding for innovation, research and development. These pro-growth policy measures could spur renewed vigour in demand from the advanced economies, consequently lending support to global demand. Furthermore, PR China’s continued efforts at rebalancing its growth are likely to be accompanied by policy fine-tuning to achieve a gradual moderation in its growth.

In addition, the recovery in the prices of key commodities such as coal, steel and crude oil will benefit commodity exporters. In the coal and steel markets, PR China has pledged to reduce excess capacity as part of its ongoing structural reforms. Similarly, members of the Organisation of Petroleum Exporting Countries (OPEC) have lowered their output of crude oil. This is expected to contribute towards a gradual drawdown of inventories and reduce the oversupply of global crude oil.

While positive spillover of expansionary policies by major economies poses an upside risk, the presence of new and prevailing downside risks continue to dominate the global economy. Firstly, the potential retreat of globalisation in the advanced economies and the potential introduction of protectionist trade policies in the US could hamper the recovery in global trade, which is crucial for maintaining a dynamic global economic environment. Secondly, the uncertainty over the length and outcome of the UK and EU negotiations may negatively affect business sentiments, thus impacting international trade activity and investments. Thirdly, monetary policy divergence between the US and the other major economies will intensify in 2017. This anticipation will lead to changes in investor behaviour. In particular, it could result in overadjustments in the currency markets and destabilised capital flows. While interest rates are not expected to rise significantly, governments and corporations with highly leveraged balance sheets may find their debt-servicing capacity being stretched, and this could have consequential implications for financial stability. Finally, geopolitical risks in relation to domestic conflicts, terrorism attacks and territorial disputes remain, which could affect sentiments in the global financial markets and dampen economic activity.

THE MALAYSIAN ECONOMY

Positive prospects for the Malaysian economy in 2017 are premised upon expectations of an improving global economy and the continued growth in domestic demand. The Malaysian economy is projected to register growth of 4.3% - 4.8% in 2017 (2016: 4.2%).
The improvement in global growth is expected to generate positive spillovers to the domestic economy through the trade, investment and income channels. Malaysia’s export performance will benefit from higher growth among key trading partners and the projected recovery in commodity prices. On the domestic front, investment activity is expected to be underpinned by capital expenditure in the export-oriented industries, particularly in the manufacturing sector. This, together with the continued roll-out of large-scale infrastructure projects will support investment activity going forward. Meanwhile, private consumption will be sustained by continued wage growth and recent pro-growth Government measures. For the public sector, the Government remains committed to fiscal consolidation, which will be achieved through the reprioritisation of public spending and lower expenditure on non-critical items. Despite this, the public sector is still projected to contribute positively to growth through continued public investment in selected sectors.

The Malaysian economy is projected to expand by 4.3% - 4.8% in 2017

It has become more evident that the global landscape is set to experience concurrent shifts in policy stance, reflecting changes arising from the new US administration and policy shifts after the UK’s EU referendum. In this environment, there could be a diverse range of outcomes, with varying implications for the Malaysian economy. In particular, increased protectionism among the major economies would impact and dampen global trade performance. The prospect of increasing monetary policy divergence between the US and other major economies could lead to tighter and more uncertain financial market conditions, with higher volatility in capital flows and exchange rates. The materialisation of these external risks would be a source of heightened uncertainty for the Malaysian economy and financial system, adversely affecting sentiments and labour market conditions. In addition, the persistence of earlier domestic headwinds, such as the higher cost of living and weak sentiments, could also moderate the growth of domestic demand.

Malaysia will face these challenges from a position of strength. The Malaysian economy’s strengths are derived from its highly diversified economic structure, resilient external position and policy flexibility. Financial intermediation will remain supportive of growth, underpinned by strong bank balance sheets and a well-developed financial market. Looking ahead, the challenging global environment necessitates continued emphasis on enhancing the nation’s economic resilience and broadening growth sources. Efforts are being intensified to rebuild policy space, proactively address potential vulnerabilities and unlock the potential of new growth areas. These structural reforms and pre-emptive policy measures are envisaged to provide greater support to Malaysia's future growth prospects.

Domestic demand continues to be the principal driver of growth

In 2017, the Malaysian economy is projected to grow by 4.3% - 4.8%. Domestic demand will continue to be the main driver of growth, underpinned primarily by private sector activity. Reflecting the Government’s commitment to fiscal consolidation, the contribution of public sector to growth is expected to remain moderate going forward. Nevertheless, public sector expenditure will remain supportive of growth. On the external front, export growth is expected to recover gradually, in line with the improvement in global growth.

Private consumption is projected to expand by 6.0% in 2017. While households are likely to make further expenditure adjustments in response to rising inflationary pressure, consumption spending is expected to remain sustained, supported by a stable labour market and continued wage growth. The implementation of selected Government measures are also expected to increase household disposable income. These measures include the higher amount of Bantuan Rakyat 1Malaysia cash transfers, reduction in employees’ contribution to EPF by 3 percentage points until December 2017 as well as the special assistance to all civil servants (RM500) and retirees (RM250). The higher commodity prices are also expected to support incomes, particularly for rural households.

In an environment of moderate growth and cautious business sentiments, labour market conditions are expected to remain soft in 2017. While employment is expected to remain expansionary, job growth will not be sufficiently robust to absorb new entrants to the labour force, causing the unemployment rate to edge higher (3.6% – 3.8%);
2016: 3.5%). Nevertheless, domestic demand and a gradually improving external sector is expected to lend support to the labour market, and wages are expected to continue growing at a moderate pace. The Malaysian Employers Federation (MEF) annual survey reports that employers expect salary increments to average at approximately 5.4% in 2017 (2016: 5.5%). Wage growth is likely to be supported by the export-oriented manufacturing sector, while wages in the domestic-oriented services sector are expected to expand moderately.

Private investment is projected to register a modest growth of 4.1% in 2017, as firms are expected to remain cautious amidst continued uncertainty in the economic environment. Nevertheless, private investment will remain supported by implementation of on-going and new projects, particularly in the services and manufacturing sectors. In the services sector, investment activity will be mainly supported by continued capacity expansion in the domestic-oriented industries, particularly in the telecommunications and real estate sub-sectors. Investments in storage facilities will also contribute to investment growth in the services sector. In tandem with the gradual improvement in global growth, investment in the manufacturing sector is expected to be driven primarily by export-oriented industries, especially the E&E and resource-based sub-sectors. Specifically, capital spending in the E&E sector will be supported by the manufacturing of products in the higher-value added segments. Following the improvement in global crude oil prices, mining investment is expected to register a smaller contraction in 2017.

Public consumption growth is expected to register a marginal contraction of 0.2% in 2017, as the Government continues to reprioritise spending and reduce non-critical expenditure. The more prudent spending on supplies and services is expected to weigh on overall growth despite the continued expansion in emoluments.

Public investment is projected to expand by 1.5%, driven by higher capital expenditure by both the Government and public corporations. This reflects the continued implementation of key infrastructure projects in diversified sectors, including in the utilities and transportation sub-sectors, as well as the downstream oil and gas sector.

Table 1

<table>
<thead>
<tr>
<th>Real GDP by Expenditure (2010=100)</th>
<th>2016p</th>
<th>2017f</th>
<th>2016p</th>
<th>2017f</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Annual change (%)</td>
<td>Contribution to growth (percentage point)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic Demand(^1)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private sector expenditure</td>
<td>4.4</td>
<td>4.4</td>
<td>4.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Consumption</td>
<td>5.7</td>
<td>5.6</td>
<td>3.9</td>
<td>3.9</td>
</tr>
<tr>
<td>Investment</td>
<td>6.1</td>
<td>6.0</td>
<td>3.2</td>
<td>3.2</td>
</tr>
<tr>
<td>Public sector expenditure</td>
<td>4.4</td>
<td>4.1</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td>Consumption</td>
<td>0.4</td>
<td>0.5</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Investment</td>
<td>1.0</td>
<td>-0.2</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Change in Stocks</td>
<td></td>
<td></td>
<td>0.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Net Exports of Goods and Services</td>
<td>-1.8</td>
<td>5.3</td>
<td>-0.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Exports</td>
<td>0.1</td>
<td>2.2</td>
<td>0.1</td>
<td>1.5</td>
</tr>
<tr>
<td>Imports</td>
<td>0.4</td>
<td>1.8</td>
<td>0.2</td>
<td>1.1</td>
</tr>
<tr>
<td>Real Gross Domestic Product (GDP)</td>
<td>4.2</td>
<td>4.3 - 4.8</td>
<td>4.2</td>
<td>4.3 - 4.8</td>
</tr>
</tbody>
</table>

\(^1\) 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
Broad-based Expansion across All Economic Sectors

All economic sectors are projected to register positive growth in 2017. The services and manufacturing sectors will be the key contributors to overall growth, while the construction sector will expand at a faster pace. The agriculture sector is expected to rebound as yields recover from the El Niño weather phenomenon. Growth in the mining sector is expected to remain steady as higher natural gas output and the start of the new Malikai oil field offset the crude oil supply reduction by PETRONAS in the first half of 2017. The adjustment is part of the global agreement reached in end-2016 to reduce inventory levels and boost oil prices, involving OPEC and several non-OPEC countries, including Malaysia.

Table 1

Real GDP by Kind of Economic Activity (2010=100)

<table>
<thead>
<tr>
<th></th>
<th>2016p</th>
<th>2016p</th>
<th>2017f</th>
<th>2016p</th>
<th>2017f</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% of GDP</td>
<td>Annual change (%)</td>
<td>Contribution to growth (percentage point)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Services</td>
<td>54.2</td>
<td>5.6</td>
<td>4.9</td>
<td>3.0</td>
<td>2.6</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>23.0</td>
<td>4.4</td>
<td>4.3</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>8.8</td>
<td>2.7</td>
<td>2.7</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Agriculture</td>
<td>8.1</td>
<td>-5.1</td>
<td>4.0</td>
<td>-0.5</td>
<td>0.3</td>
</tr>
<tr>
<td>Construction</td>
<td>4.5</td>
<td>7.4</td>
<td>8.0</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td><strong>Real Gross Domestic Product (GDP)</strong></td>
<td><strong>100.0</strong></td>
<td><strong>4.2</strong></td>
<td><strong>4.3 – 4.8</strong></td>
<td><strong>4.2</strong></td>
<td><strong>4.3 – 4.8</strong></td>
</tr>
</tbody>
</table>

1 Figures may not necessarily add up due to rounding and exclusion of import duties component
p Preliminary
f Forecast
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The services sector is projected to expand, albeit at a more moderate pace. In particular, the performance of consumption-related services such as retail trade, food & beverages and accommodation will be underpinned by stable labour market conditions and continued wage growth. The transport and storage sub-sector will benefit from higher air passenger traffic, commencement of the Mass Rapid Transit (MRT) services and the improvement in trade activity. In the information and communication sub-sector, growth will be supported by strong demand for internet and digital services. Growth in the finance and insurance sub-sector is, however, anticipated to remain subdued in tandem with the moderate loan growth.

The manufacturing sector is expected to record sustained expansion. Growth will be driven largely by the export-oriented industries, particularly in the electronics segment, reflecting a recovery in the global demand for semiconductors. Sustained regional demand for chemical-related products will continue to provide support to the primary-related cluster despite a fall in crude oil refinery activity. On the domestic front, growth will be supported by resilient consumer spending on food products and firm growth in the construction-related cluster, while demand for motor vehicles is projected to remain subdued.

Growth in the construction sector is projected to expand at a faster pace in 2017, driven mainly by new and existing civil engineering projects in the utilities, transportation and petrochemical segments.

In the commodities sector, agricultural production is expected to rebound as crude palm oil yields recover from the adverse impact of El Niño. Mining sector growth is projected to remain sustained, supported mainly by the acceleration of natural gas production from the LNG Train 9 and PETRONAS’ FLNG Satu facilities, as well as production from the new Malikai oil field. Nonetheless, the voluntary 20,000 barrels per day crude oil supply adjustment by PETRONAS is expected to dampen the sector’s performance in the first half of the year.
Potential Output and the Output Gap of the Malaysian Economy

Potential output is the level of output that an economy can sustainably produce with its available resources, which include capital, labour and technology, without creating excessive pressure on prices. The difference between actual and potential output, otherwise known as the output gap, indicates the economy’s position in the business cycle and the possible presence of inflationary pressures in the case of a positive output gap, or disinflationary pressures in the case of a negative output gap. For instance, a larger positive output gap is normally associated with higher employment, higher wages and, hence, stronger inflationary pressures. Potential output and the output gap are therefore closely monitored by the Bank due to their relevance to its principal objective of promoting “monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy”.

In 2016, Malaysia’s potential output is estimated to have expanded by 4.8%, a marginal moderation from 5% in 2015 (2010 - 2014 average potential output growth: 4.9%). This trend is attributable mainly to the slower expansion of the labour force, which was partially offset by sustained increases in productivity and growth of the capital stock. In level terms, actual output was close to potential output in 2016, as reflected in a negligible output gap (2015: 0.5%). The narrowing output gap reflects the moderation in real output growth (2016: 4.2%; 2015: 5%). Indeed, the moderation in the growth of actual and potential output partly reflects the challenging external environment, with modest global growth and periods of heightened financial market volatility during the year.

Despite experiencing low commodity prices and weak business sentiments, total investment activity continued to expand in 2016. The expansion was mainly attributable to continued capital expenditures by the private sector. Labour market conditions in Malaysia were softer in 2016. Although layoffs were confined to specific industries, aggregate job creation was insufficient to fully absorb new entrants to the labour force. This led to a rise in the unemployment rate to 3.5% in 2016 (2015: 3.1%; 2010 - 2014 average: 3.1%).

The negligible output gap in 2016 indicates that the economy did not experience substantial price pressures and is consistent with the stable inflation rate of 2.1% registered during the year.

Going forward, the actual output of the Malaysian economy is projected to remain close to its potential. The narrow output gap indicates that the pressure on prices from demand is expected to remain benign. Growth in potential output is expected to be driven by growth in the labour force and sustained growth in private and public investment, leading to expansion of the capital stock. Efforts to increase productivity will be crucial in increasing the growth of potential output and ensuring the sustainability of that growth.

\[\text{Chart 1}\]

**Actual and Potential Output**

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual Growth in Potential Output (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>5.0</td>
</tr>
<tr>
<td>2016f</td>
<td>4.8</td>
</tr>
<tr>
<td>2017f</td>
<td>4.5-5.0</td>
</tr>
</tbody>
</table>

- Estimate
- Forecast

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

2. Potential output was estimated using the production function approach.
EXTERNAL SECTOR

Malaysia’s external sector is expected to remain resilient despite continued uncertainties in the global environment. Overall, following the gradual improvement in exports, the net export of goods and services is projected to provide some support to real GDP growth in 2017. The current account is expected to register a surplus of 1% - 2% of GNI in 2017. Both exports and imports are expected to strengthen in 2017, underpinned by the projected improvements in global growth, commodity prices and sustained domestic demand. Given the firm domestic demand, import growth is expected to continue to outpace export growth. This would result in a lower trade surplus. As the largest component of the current account, developments in trade will significantly influence the current account position. Moving forward, the prospects for trade and the current account will be shaped by three key factors, namely the state of global demand, commodity prices and the strength of domestic demand1.

The current account of the balance of payments will remain in surplus in 2017

Table 4.1

<table>
<thead>
<tr>
<th>External Trade</th>
<th>2016p</th>
<th>2017f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross exports</td>
<td>1.1</td>
<td>5.5</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufactures</td>
<td>3.2</td>
<td>3.7</td>
</tr>
<tr>
<td>Agriculture</td>
<td>4.7</td>
<td>8.9</td>
</tr>
<tr>
<td>Minerals</td>
<td>-19.8</td>
<td>21.1</td>
</tr>
<tr>
<td>Gross imports</td>
<td>1.9</td>
<td>6.4</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital goods</td>
<td>4.9</td>
<td>7.9</td>
</tr>
<tr>
<td>Intermediate goods</td>
<td>-0.1</td>
<td>5.4</td>
</tr>
<tr>
<td>Consumption goods</td>
<td>7.3</td>
<td>9.9</td>
</tr>
<tr>
<td>Trade balance (RM billion)</td>
<td>87.3</td>
<td>86.4</td>
</tr>
</tbody>
</table>

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

1 For a more detailed account, refer to Box Article on ‘Understanding the Changing Dynamics of the Current Account of the Balance of Payments’.

Gradual improvement in global demand

Global growth is projected to improve in 2017. This is supported by the expansion of domestic demand in the advanced and emerging economies. As a highly open economy with well-diversified export products and markets, Malaysia stands to benefit from the better global growth prospects. Gross exports are expected to increase by 5.5% in 2017 (2016: 1.1%), while gross imports are expected to increase by 6.4% (2016: 1.9%).

Manufactured exports are expected to strengthen, supported by broad-based expansion in both E&E and non-E&E exports. E&E exports will be bolstered by a recovery in demand for semiconductors in 2017, particularly in new segments such as the automotive, industrial and storage markets, in addition to the steady demand for traditional devices such as smartphones. Non-E&E exports will continue to grow, supported by demand for resource-based products such as oleo-chemicals and petrochemicals from the region. In tandem with higher manufacturing exports, intermediate imports, which form the bulk of Malaysia’s imports, are projected to rise further.

Despite the improvements in global growth, downside risks remain. The projected pick-up in exports could be undermined by weaker-than-expected growth performance of Malaysia’s major trading partners. Moreover, the materialisation of more protectionist trade policies in the major advanced economies, and political and policy uncertainties, could have spillovers on the strength of global growth and global trade.

Table 4.2

<table>
<thead>
<tr>
<th>Current Account of Balance of Payments1</th>
<th>2016p</th>
<th>2017f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item (Net)</td>
<td>RM billion</td>
<td></td>
</tr>
<tr>
<td>Goods</td>
<td>101.2</td>
<td>98.4</td>
</tr>
<tr>
<td>Services</td>
<td>-22.6</td>
<td>-24.0</td>
</tr>
<tr>
<td>Primary income</td>
<td>-34.7</td>
<td>-36.3</td>
</tr>
<tr>
<td>Secondary income</td>
<td>-18.7</td>
<td>-20.7</td>
</tr>
<tr>
<td>Current account balance</td>
<td>25.2</td>
<td>17.4</td>
</tr>
<tr>
<td>% of GNI</td>
<td>2.1</td>
<td>1~2</td>
</tr>
</tbody>
</table>

p Preliminary
f Forecast

1 The data are compiled in accordance with the Sixth Edition of the International Monetary Fund (IMF)’s Balance of Payments and International Investment Position Manual (BPM6)

Note: Figures may not necessarily add up due to rounding
Source: Department of Statistics, Malaysia and Bank Negara Malaysia
Higher commodity prices

Commodity prices have recovered steadily from the lows in early 2016. Crude oil prices have improved following the agreement among OPEC members and several other non-OPEC producers, including Malaysia, to limit supply. In tandem with these production cuts, Malaysia’s exports of crude oil are also expected to be lower in volume terms, particularly in the first half of the year despite the support from the ramp up in production from the new Malikai oil field. Nonetheless, gross exports of crude oil are likely to improve, as higher crude oil prices are expected to more than offset the slower growth in export volumes. Exports of liquefied natural gas (LNG) are projected to turn around to record positive growth on account of accelerated production aided by a new floating gas vessel. Similarly, crude palm oil (CPO) exports are expected to rise, following the increase in CPO prices and production volumes, reflecting the recovery from the effects of the El Niño weather conditions.

Sustained domestic demand

Reflecting the sustained growth in domestic investment activity, capital imports are projected to register stronger growth, particularly for the manufacturing and services sectors. In addition, the higher crude oil prices will also increase intermediate imports such as fuel and lubricants. Imports of consumption goods are also expected to increase due mainly to higher imports of food and beverages.

The services account is projected to register a larger deficit, in line with higher trade and improvement in investment activities. Services imports will continue to be supported by imports of transportation and other services including business and professional services. However, services exports are also expected to improve, supported by a larger travel account surplus amidst the expected increase in tourist arrivals and tourist spending. The increased coverage of countries from which Chinese and Indian tourists are eligible to apply for e-Visa and the intensified promotional endeavours to target specific tourism industries such as medical and sports tourism are expected to attract more tourists to Malaysia.

In the income account, profits from Malaysian companies investing abroad are expected to improve, mostly on account of the higher income of oil and gas companies, which account for more than a third of Malaysia’s investment income abroad. Nevertheless, this is likely to be partially offset by the higher profits of foreign direct investors in Malaysia. Reflecting the sustained growth in manufactured exports, investment income for multinational corporations operating in Malaysia is expected to be higher. Taken together, this will result in a higher deficit in the primary income account in 2017. The secondary income account is expected to continue to register a deficit, mainly attributable to higher expected outward remittances, which will more than offset the expected increase in inward remittances.

INFLATION OUTLOOK

Higher inflation will be mainly cost-driven and is not expected to significantly change the medium-term inflation outlook

Headline inflation is projected to increase in 2017 averaging between 3.0% - 4.0% (2016: 2.1%), reflecting primarily the pass-through impact of the increase in global oil prices on domestic retail fuel prices. This cost-driven inflation, however, is not expected to cause significant spillovers into the broader price trends, given the stable domestic demand conditions. Underlying inflation is, therefore, expected to only increase modestly.

Global oil prices are expected to be higher in 2017 following the decision by members of OPEC and several other oil producing countries to reduce crude production to ease the glut in global oil supply. The higher global oil prices, along with the depreciated ringgit exchange rate, will translate into higher domestic retail fuel prices. As of first quarter of 2017, the pump price of RON95 petrol has been higher, averaging RM2.23 per litre, significantly above the average price of RM1.76 per litre recorded in 2016. The increase in fuel prices from their low base, coupled with a notable share of expenditure on fuel in the consumption basket of Malaysian households, will have a noticeable effect on headline inflation for the year.

Beyond oil, other global costs factors are also expected to put some upward pressure on domestic inflation.

2 The IMF projected global oil prices to average USD55 per barrel in 2017 in the IMF Primary Commodity Price Forecast in January 2017. The price is the average price of Dated Brent, West Texas Intermediate (WTI) and Dubai Fateh crude oil, equally weighted.
While global food prices are expected to remain low\(^3\) amid improved weather and supply conditions, the outlook is for overall commodity prices to register a modest rate of increase in 2017, underpinned by higher prices for agriculture and metal-based products. The inflation rates of Malaysia’s major trading partners are also projected to register small positive increases. However, the pass-through of these external price factors to domestic prices would be somewhat mitigated by the fact that domestic production and consumption contain relatively modest imported content. The spillovers into domestic prices are also not expected to be significant, especially given that domestic demand is projected to remain stable. With the absence of strong enabling demand conditions, firms’ willingness and ability to pass-on increases in costs to consumers are expected to be more limited. Domestic sources of inflationary pressure are also expected to be contained. Underlying inflation is, therefore, expected to only increase modestly in 2017.

The inflation outlook is, however, subject to three key risks. First, headline inflation could average higher if global oil prices were to increase more than anticipated. The projected trajectory of domestic headline inflation will be dependent on the future trend in global oil prices which remains highly uncertain. Second, the depreciation in ringgit exchange rate could also have a larger pass-through effect on domestic prices, causing the headline inflation to be higher than projected. A third factor would be the strength of growth in both Malaysia and its trading partners, which could create upward or downward pressures on domestic inflation.

**MONETARY POLICY**

**Monetary policy in 2017 will focus on supporting the sustainable growth of the Malaysian economy while maintaining price stability**

Monetary policy in 2017 will continue to ensure the monetary policy stance is consistent with sustaining a steady economic growth path amid price stability. The policy environment is expected to remain challenging. Although growth is expected to improve due to better performance of the external sector, the economy will be challenged by higher inflation, volatile capital flows and lingering constraints in the global economic and financial environment.

The global economy is anticipated to improve gradually in 2017. Nevertheless, it will continue to be confronted with significant downside risks. Global growth remains susceptible to adverse shocks to international trade, arising from the threat of trade protectionism, geopolitical developments and other unfavourable developments in the major economies. Moreover, the expected shifts in global liquidity and capital flows given the anticipation of monetary policy normalisation in the US would have spillover effects on the domestic financial markets and the ringgit exchange rate. The implications of these developments on the balance of risks to the domestic growth and inflation outlooks will be assessed closely during the year.

Given the uncertainties in the global economic and financial environment, the Malaysian economy is projected to expand at a moderate pace of 4.3% - 4.8% in 2017, driven primarily by domestic demand from the private sector. While the projected improvement in external demand and recovery in commodity prices would lend support to the anticipated stronger economic expansion compared to 2016, domestic headwinds such as continued adjustments to higher cost of living and cautious economic sentiments could weigh on Malaysia’s growth prospects.

Headline inflation is expected to average higher, within the range of 3.0% - 4.0% in 2017. Nevertheless, the higher inflation compared to 2016 will be mainly cost-driven, and the spillovers to the broader price trends are expected to remain contained. Underlying inflation is expected to increase only moderately in the absence of strong demand conditions. The inflation outlook, however, is subject to key uncertainties surrounding global oil prices and the path of the ringgit exchange rate and the pass-through to domestic prices.

The continuing uncertainty surrounding the outlook for both domestic growth and inflation poses a greater challenge in assessing the likely path of baseline growth and inflation. Monetary policy will also continue to consider the risk of destabilising financial imbalances, although these have largely remained contained. Given the expectation of periods of volatility in capital flows, the Bank’s

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\(^3\) Based on Food and Agriculture Organization of the United Nations (FAO)' Food Outlook report in October 2016.
monetary operations will continue to ensure that domestic liquidity in the financial system will remain sufficient to support the orderly functioning of the domestic financial markets. The focus of the Monetary Policy Committee would therefore be on ensuring that the stance of monetary policy remains consistent with the achievement of steady growth and stable inflation, supported by healthy financial intermediation in the economy.

**FISCAL POLICY**

**Fiscal deficit to reduce further**

Fiscal policy in 2017 is aimed towards further strengthening of the Government’s fiscal position, while ensuring continued support for domestic growth and promoting economic inclusiveness. The Federal Government’s fiscal deficit is expected to narrow further to 3.0% of GDP in 2017 (2016: -3.1%), underpinned by sustained growth in revenue and a marginal expansion in operating expenditure. Continued fiscal consolidation despite the challenging domestic and external economic environment is a reflection of the Government’s commitment to fiscal reforms while recognising the need to ensure a pro-growth environment in the economy.

Following fiscal reforms, the Government has managed to rein in the growth of operating expenditure. The share of operating expenditure as a percentage of GDP has declined to 17.1% in 2016 compared to 18.8% in 2015. This is expected to decline further to 16.2% following efforts to reduce non-critical spending on grants and transfers to statutory bodies, and the further rationalisation of subsidies. The Government also continues to diversify its revenue sources to ensure resilience amidst uncertainties in global commodity markets. As a result, despite expectation of higher oil prices, the contribution of oil-related revenue is expected to decline to 13.8% in 2017 compared to 14.6% in 2016. In addition, the establishment of a special tax unit,
Outlook and Policy in 2017

Affordable housing schemes include MyBeautiful New Home, Projek Perumahan Rakyat and SPNB People Friendly Home while fiscal transfers include, among others, Bantuan Rakyat 1Malaysia and social safety net programmes such as assistance to poor families, senior citizens and disabled groups.

The Collection Intelligence Arrangement (CIA), reflects the Government’s effort to enhance tax compliance.

In the 2017 Budget, fiscal resources have been strategically prioritised towards high impact infrastructure projects and programmes for capacity building. These include public infrastructure4 such as highways and railways that expand connectivity between urban and rural areas. Development of human capital5 will be strengthened through enhancement of up-skilling programmes and industrial training. The improvement of the quality of talent to meet the needs of industry is critical to accelerate Malaysia’s progress towards becoming a high-income nation.

The budget was also consistent with the efforts to ensure inclusive and sustainable growth. Through welfare enhancement programmes, the Government will continue to focus on sustaining the capacity of the lower- and middle-income segments to cope with the rising cost of living. Socio-economic support to these groups is dispersed through various forms of assistance6, including affordable housing schemes and fiscal transfers. These measures would also provide support to private consumption.

In May 2016, the Fiscal Policy Committee (FPC) tasked a newly established Technical Committee on Fiscal Risks and Contingent Liabilities to evaluate and enhance measures to contain the Federal Government’s fiscal risks and contingent liabilities. This committee is expected to further strengthen public finances while ensuring fiscal flexibility and sustainability into the future.

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<table>
<thead>
<tr>
<th>Federal Government Finance</th>
<th>RM billion</th>
<th>Annual change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2016p</td>
<td>2017B</td>
</tr>
<tr>
<td>Oil price</td>
<td>44</td>
<td>45</td>
</tr>
<tr>
<td>Revenue</td>
<td>212.4</td>
<td>219.7</td>
</tr>
<tr>
<td>Total expenditure</td>
<td>252.2</td>
<td>260.8</td>
</tr>
<tr>
<td>Operating expenditure</td>
<td>210.2</td>
<td>214.8</td>
</tr>
<tr>
<td>Gross development expenditure</td>
<td>42.0</td>
<td>46.0</td>
</tr>
<tr>
<td>Loan recoveries</td>
<td>1.3</td>
<td>0.7</td>
</tr>
<tr>
<td>Overall balance</td>
<td>-38.4</td>
<td>-40.3</td>
</tr>
<tr>
<td>% of GDP</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources of financing:

<table>
<thead>
<tr>
<th></th>
<th>2016p</th>
<th>2017B</th>
<th>2016p</th>
<th>2017B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net domestic borrowing</td>
<td>37.9</td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net external borrowing</td>
<td>0.8</td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Realisable assets1 and adjustments</td>
<td>-0.3</td>
<td>-</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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1 A negative (-) sign indicates a build-up in assets
p preliminary
B Budget
Note: Numbers may not add up due to rounding
Source: Ministry of Finance, Malaysia

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4 These include implementation of the new East Coast Rail Line and acceleration of the Pan Borneo Highway.

5 Examples include enhancement in the Technical Vocational Education Training (TVET) programme and extension of the 1Malaysia Training Scheme (SL1M) for 20,000 graduates.

6 Affordable housing schemes include MyBeautiful New Home, Projek Perumahan Rakyat and SPNB People Friendly Home while fiscal transfers include, among others, Bantuan Rakyat 1Malaysia and social safety net programmes such as assistance to poor families, senior citizens and disabled groups.
Structural Reforms in ASEAN-5 Economies: Past Successes and Future Challenges

By Gloria Tsan Ern Hui and Ooi Kiesha

Introduction

The Asian Financial Crisis (AFC) in 1997 - 1998 marked a significant turning point for several Asian economies. From the viewpoint of the ASEAN-5 economies, the experiences from the AFC brought to light the importance of comprehensive reforms to address the underlying weaknesses and structural deficiencies of an economy (Park et. al., 2013). These structural reforms include an array of policies to support the banking systems, address spillovers into the real economy and strengthen the dynamism and resilience of the crisis-affected economies. While the macroeconomic resilience of the regional economies have been sustained for about two decades, the current global economic and financial environment, especially in the aftermath of the Global Financial Crisis (GFC), increasingly poses significant challenges and downside risks to the sustainability of growth in the ASEAN-5 economies going forward. Furthermore, the rise of Industry 4.0, rapid urbanisation and the growing importance of climate change also call for proactive structural reforms that help to keep pace with global issues and trends. This article serves to highlight the importance of structural reforms in Malaysia and its ASEAN neighbours against this backdrop.

Critical reforms in the post-AFC period

The AFC brought into view the region’s vulnerability associated mainly with financial and economic fragility. On the financial side, an over-reliance on the banking sector, under-supervised and under-regulated financial systems and a deep mismatch between foreign liabilities and foreign assets were key vulnerabilities. The crisis also revealed several structural challenges such as debt-driven investment booms, rigid exchange rate regimes and current account deficits in the 1990s. In the aftermath of the crisis, the crisis-affected economies underwent deep transformation, recovered and thrived by embracing pertinent structural reforms. In the financial sector, policy measures successfully strengthened the supervision and regulation of the banking system, diversified sources of financing and enhanced domestic financial infrastructure. Measures in the real sector focused largely on improving macroeconomic management, strengthening public institutions and building up buffers to manage external shocks. As a result, ASEAN-5 economies today have diversified sources of growth, developed financial sectors, flexible exchange rates and healthier external positions (Chart 1).

Chart 1

Current Account Balance and Foreign Reserves in ASEAN-5*

% of GDP

Current Account Balance

USD tn

Foreign Reserves

-4

-2

0

2

4

6

Pre-AFC (1990-96)

AFC (1998)

Pre-GFC (2007)

GFC (2009)

Post-GFC (2015)

Pre-AFC (1996)

AFC (1998)

Pre-GFC (2007)

GFC (2009)

Post-GFC (2015)

* Refers to Indonesia, Philippines, Malaysia, Thailand and Singapore

Source: IMF October 2016 WEO, Haver, Bloomberg

Notes:

1 ASEAN-5 refers to Indonesia, Malaysia, Philippines, Singapore and Thailand.

2 Refer to policies that improve the productive capacity of an economy by removing impediments to the efficient functioning of markets.

3 Refers to the combination of several major innovations in digital technology, including the Internet of Things, cloud computing, digital fabrication, advanced robotics and artificial intelligence.
ASEAN-5 demonstrated considerable resilience in 2009 during the GFC, much of which could be attributable to the strength in the region’s economic fundamentals. While GDP and export growth declined significantly in 2009, the region’s financial systems were largely unaffected with continued functioning of financial intermediation. Households and corporates also entered the crisis with generally stronger balance sheets. Of great significance, the more flexible exchange rates and more institutionalised and transparent monetary policy making have allowed the region to pursue more effective monetary policies, thereby cushioning the severity of the crisis. Central banks across ASEAN-5 reduced their key policy rates by an average of 290 basis points from peak to trough between 2007 and 2009. Additionally, fiscal support took place with stimulus packages, including tax cuts and subsidies in several economies. As a result, growth rebounded swiftly, from 2.6% in 2009 to 8.9% in 2010.

**Chart 2**

**Real GDP, Policy Interest Rates and General Government Expenditure in ASEAN-5**

Real GDP and Policy Interest Rates

<table>
<thead>
<tr>
<th>Year</th>
<th>ID</th>
<th>MY</th>
<th>TH</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2007</td>
<td>15</td>
<td>20</td>
<td>30</td>
</tr>
<tr>
<td>2008</td>
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<td>2009</td>
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<td>2010</td>
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<td>2011</td>
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<tr>
<td>2015</td>
<td>55</td>
<td>60</td>
<td>70</td>
</tr>
<tr>
<td>2016</td>
<td>60</td>
<td>65</td>
<td>75</td>
</tr>
</tbody>
</table>

Source: IMF October 2016 WEO, Haver

**Structural reforms continue to be relevant for ASEAN-5 in the post-GFC period**

While the ASEAN-5 economies have experienced success in executing structural reforms post-AFC, the GFC has unleashed new challenges for the region that render further structural reforms critical in the current period. These challenges include, but are not limited to:

a) **Prolonged weakness in global trade**

Against the backdrop of persistent weakness in several of the major advanced economies, global trade has remained sluggish post-GFC. Of significance, the weak recovery in investment growth, which generally has higher import content, contributed to slower growth of trade relative to overall GDP growth. Beyond this cyclical weakness, other structural forces have also weighed on trade activity, including the diminishing impact from past impetuses on trade such as the proliferation of global value chains in the 1990s and early 2000s and PR China’s ongoing transformation towards a more consumption-based growth model⁴. Therefore, the external

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⁴ For more details, please refer to Box Article on “Recent Slowdown in Global Trade: Cyclical Bane or Structural Shift?” in Bank Negara Malaysia’s Annual Report 2015.
demand that has been a key source of growth for the regional economies prior to the GFC has now become a source of decelerating momentum for ASEAN-5 given the region’s trade openness. The trend of lower global trade growth is expected to persist given the lack of new impetus to growth in the major economies amid rising anti-globalisation sentiments. The IMF forecasted that world trade will average 4.1% in the next five years compared to 8.4% from 2003 to 2007. Therefore, the region needs to focus on its competitiveness in this more challenging global environment, if it is to continue experiencing relatively healthy growth rates going forward.

b) Limitations of fiscal space
While the ASEAN-5 economies generally have more macroeconomic policy space to manoeuvre domestically compared to most major advanced economies, headline fiscal balances in a few economies have yet to return to pre-crisis (2003 - 2007) levels. General government gross debt has also risen in several economies amid an environment of low and accommodative interest rates. This highlights the concerns over the need to restore fiscal space to allow for counter-cyclical responses to future shocks. Additionally, fiscal space needs to be generated to address developmental challenges, including greater investments in infrastructure to reduce supply bottlenecks and human capital development. In this respect, encouraging greater private sector participation in the development of physical infrastructure and the provision of financial, education and healthcare services could help to lower the fiscal burden of the government, while also increasing productivity gains and improving the quality of services.

c) A new global financial landscape
Following the GFC, the global financial landscape has been shaped by new regulatory standards such as the Basel III, which has been introduced to strengthen prudential and regulatory standards for the banking sector. In this regard, policy makers in the region have maintained prudent financial positions by building capital and liquidity buffers of regional financial institutions after the AFC (Yao, 2016). This has allowed the region to be well-positioned to meet the requirements of this new global standard. Nonetheless, the financial landscape continues to evolve, providing both opportunities and challenges for the region. Technological advancements have spurred growth in Financial Technology, otherwise known as FinTech, which has the potential to reshape the way financial services are provided. New ways of financing, new products and new participants have emerged, challenging the role and relevance of traditional business models. These include FinTech developments that have expanded the frontiers of banking in areas such as peer-to-peer lending, merchant and e-commerce finance and online trade finance. It is therefore critical for policymakers in the region to provide a supportive legal and regulatory environment that would support innovation, but at the same time ensure consumer protection and the orderly functioning of financial markets.

ASEAN-5’s policy focus on structural reforms
Recognising the increasing urgency of implementing comprehensive reforms in this challenging environment, policy makers in the region continue to undertake proactive measures, not only to address potential risks and spillovers from the external environment in the short term, but also to further strengthen the region’s growth prospects and competitiveness over the medium term. While the specific mix of reforms to address the challenges unleashed following the GFC may differ across countries, the general reform priorities for ASEAN-5 encompass the following:

a) Enhancing economic productivity
Growth in the region has been achieved through the vibrant external and domestic sectors. Amid prolonged weakness in global trade, it is highly important for the region to undertake reforms to ensure continued balanced growth going forward. This can be done through raising the productive capacity of an economy by improving connectivity, competitiveness and human capital competency. In light of this, the ASEAN-5 economies have been forward-looking reformers that have prioritised investments in both hard infrastructure such as upgrading transportation networks and increasing broadband penetration, and soft infrastructure like improving governance

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5 Source: IMF October 2016 World Economic Outlook.
mechanisms and developing human capital. Recognising the need for greater private sector involvement in financing the scaling-up of infrastructure development, regional economies have also taken proactive measures to enhance existing public-private partnership (PPP) frameworks, thus reducing the reliance on government fiscal resources. Efforts to foster productivity through infrastructure development have been complemented by the development of a competent workforce, not only in promoting sustainable growth over the longer term, but also in ensuring an equitable distribution of economic gains. For example, several countries in the region, particularly Malaysia and Singapore, have been steadfast in undertaking instituted labour market reforms such as the implementation of minimum wage, improving accessibility to higher education, and deepening labour skills to enhance competitiveness.

b) Maintaining macroeconomic stability
To further strengthen underlying fundamentals, policy makers in the ASEAN-5 countries, particularly the Philippines, Indonesia and Malaysia have been embarking on reforms to improve fiscal space and public institutional frameworks. In particular, the introduction of tax reforms and subsidy rationalisation, and the diversification and expansion of public income sources have played a vital role in re-building policy space since the GFC period. Economies such as Singapore and Malaysia have also undertaken pre-emptive policies such as macro-prudential measures to manage imbalances in the property market and curb concerns over elevated household indebtedness. A prudent fiscal position and forward-looking policies to reduce vulnerabilities can therefore lay the foundation for better macroeconomic stability.

c) Enhancing flexibility and efficiency of financial systems
With the rapidly evolving global financial landscape, authorities in the region recognise that regulations should not stifle innovation and new approaches to financial development (Amer and Park, 2010). Instead, in keeping abreast with the development of FinTech, continuous efforts have been undertaken to encourage greater experimentation. ASEAN-5 economies such as Singapore and Malaysia, for example, have begun to embrace the emergence of FinTech by introducing regulatory sandboxes. This has enabled financial institutions and FinTech participants to test their innovations in the market within a well-defined environment, with appropriate financial safeguards in place, thereby stimulating competition and promoting innovation while preserving financial stability.

Keeping pace with global trends
Beyond addressing the challenges that have emerged following the GFC, it is equally important for the region to be proactive in carrying out reform efforts to both harness the benefits and minimise the risks from shifting global trends. Policy imperatives include keeping in stride with the rise of Industry 4.0 and promoting an inclusive and green economy. Industry 4.0 has created new growth areas, such as sharing economy and e-commerce. While much has been done in ASEAN-5 to ride on the wave of Industry 4.0, the e-commerce adoption remains fairly nascent, suggesting that there is still considerable room for improvement.

Amid rapid development and urbanisation, the urgency to safeguard against negative social cost has risen. In light of this, regional economies have been implementing reforms to promote inclusive growth by enhancing the access to opportunities for all segments of society. This includes introducing a more comprehensive social protection mechanism such as providing financial services to the unserved and underserved at the individual and business levels. In Malaysia, myriad efforts have been undertaken to improve the access and usage of quality and affordable financial services through innovative channels, products and infrastructure.

In creating an environmentally sustainable growth, efforts to expand and scale up the usage of energy-efficient technologies have also been gradually gaining traction in the region. For example, in 2015, investment in solar projects within the South East Asian region, particularly Thailand, Indonesia and the Philippines, rose to a record high of USD1.7 billion (2010-2014 average: USD0.9 billion). A few regional economies have also increasingly supported green building adoption,

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8 Source: Clean Energy Pipeline (2016).
by using ecologically-friendly construction materials and conserving energy and space. Singapore, in particular, has taken
the lead in Asia by ranking first on the Economist Intelligence Unit’s Asian Green City Index9.

Regional cooperation beyond national initiatives

The regional economies recognise that policy strategies need to be two-fold, because the deepening of structural reforms
at the national level needs to be complemented by initiatives to increase regional cooperation. Of importance, the ASEAN
Economic Community (AEC) Blueprint 2025 draws attention to the fact that greater integration allows regional economies
to harness the benefits arising from the diversity and complementarities that exist across the economies10. As such,
ASEAN’s information sharing and capacity building initiatives play an important role in enhancing the technical capacity of
policy makers in undertaking reforms. Taking into account the different development levels and needs of its member states,
ASEAN also continues to make progressive efforts in intensifying regional financial integration, promoting financial inclusion
and ensuring financial stability. Of note, the ASEAN Banking Integration Framework (ABIF) highlights ASEAN’s commitment
to strengthen intra-regional trade and investments while preserving regional financial stability.

Conclusion

ASEAN-5’s transformation through economic and financial reforms have accorded the region with stronger fundamentals
and policy flexibility to withstand external shocks, as illustrated in the region’s swift rebound during the GFC. Today,
headwinds in the global economic environment, including persistent weakness in international trade activity, prolonged
macroeconomic and policy uncertainties, and increased volatility in exchange rates and capital flows necessitate these
economies to continue prioritising reforms. Additionally, shifting megatrends such as technological disruptions, rapid
urbanisation and climate change offer both challenges and opportunities for the region. By promoting sustainable growth
and economic dynamism, the region can raise resilience amid these cyclical and structural shocks. Advancing collaboration
amongst economies in the ASEAN region also allows countries to leverage on each other’s strengths to reap greater
economic and social benefits of reforms.

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9 Source: Economist Intelligence Unit (2011).
10 Source: ASEAN Secretariat (2015).
Demystifying the Affordable Housing Issue in Malaysia

By Cheah Su Ling and Stefanie Joan Almeida

Introduction

Since 2012, the increase in house prices in Malaysia has outstripped the rise in income levels. Consequently, prevailing median house prices are beyond the reach of most Malaysians. This is primarily attributable to a gross mismatch between housing supply and demand amid diverging expectations between households and developers. The issue has been compounded by the fact that the distribution of new housing supply has been concentrated in the higher-priced categories. The undersupply of housing is particularly acute in the affordable housing segment. The provision of affordable homes has become a challenge for policymakers worldwide, with Malaysia being no exception. It is a similar problem in the United States (US), United Kingdom (UK), Australia and New Zealand (Demographia International, 2015). This article aims to define what affordable housing means in the Malaysian context, given income levels and demographic factors. With this, the level of affordable housing supply needed at present and in the future is estimated. The article then identifies some of the policies used by other countries in addressing the shortage of affordable housing which provide important policy lessons for dealing with the situation in Malaysia.

Defining Housing Affordability

Affordable housing is broadly defined as housing which is adequate in quality and location, and is not so costly that it prevents its occupants from meeting other basic living needs. Given the broad scope of what constitutes affordable housing, this article focuses on the financial affordability of housing to gauge the extent to which house prices in the market are beyond the financial means of households in Malaysia.

According to UN-HABITAT, the financial affordability of housing is affected by two key components: (i) cost of purchasing the house, and (ii) cost of keeping the house (Diagram 1), which are in turn influenced by property prices, the amount of down payment required and size of financing obtained, as well as the ability to finance the maintenance of the property and

Diagram 1

Basic Components of Financial Affordability of Housing

1. House purchase price
   - House price determined by cost of land, infrastructure, building materials, labour and profit
2. Ability to finance down payment
   - Affected by down payment requirements, available savings, existing debt and loan amount
3. Interest rates and loan tenure, income and non-housing expenditure
4. House occupation cost
   - Land lease, home insurance, property assessment tax, quit rent and building maintenance costs

Housing affordability

Source: Adapted from UN-HABITAT (2011)

1 This article is an extension to the Box Article on ‘Assessing Demand-Supply Conditions in the Malaysian Property Market’, in Bank Negara Malaysia’s Annual Report 2015.
3 A broader definition of affordable housing refers not only to affordability in terms of prices, but extends to housing which meets minimum decent standards of living (basic amenities, floor-space, sanitation, without structural building defects) and that is located not too far away from centres of employment, usually one hour away (McKinsey Global Institute, 2014).
monthly mortgage repayments. Given the broad dimensions of affordable housing, several housing affordability metrics have emerged. While there is no universal standard in defining housing affordability, there are however, three approaches that are commonly used, namely the Median Multiple, the Housing Cost Burden and the Residual Income.

According to the Median Multiple (MM)\(^4\) methodology developed by Demographia International to evaluate urban housing markets, a house is considered affordable if it can be financed by less than three times a household’s median annual income. The median multiple of 3.0 is based on the historical trend in six nations\(^5\) where housing affordability ranged between 2.0 to 3.0 until the 1980s or 1990s. While the accuracy of which the MM indicates an affordable housing market may vary between countries, it is nevertheless a useful broad measure for comparing housing affordability. Secondly, going a step further and taking into account the availability of credit, housing affordability can be thought of as a percentage of household income that is spent on housing. This is the Housing Cost Burden (HCB) approach, commonly used in the US, Australia and the OECD countries. The approach\(^6\) is based on the rule of thumb by which housing expenditures\(^7\) of less than 30 percent of household income\(^8\) are deemed affordable. Households that pay more than 30% are considered housing cost-overburdened, as they risk not having sufficient income for other necessities such as food, transportation and healthcare. The third measure is the Residual Income (RI), which is a more granular approach. The RI considers first, the basic necessities of household costs, and subtracts these costs from the income of a household. What is left is the “residual” income. This would reflect the household’s capacity to spend on housing (e.g. mortgage repayments). The RI approach is used by some commercial banks to evaluate mortgage applications. Table 1 depicts a comparison of the three metrics.

**Table 1**

<table>
<thead>
<tr>
<th>Macro-level method</th>
<th>Approach</th>
<th>Definition of housing affordability</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Median Multiple (MM)</td>
<td>Median house price that is three times or less than the annual income of the median household (e.g. house price-to-income ratio of 3.0 and below).</td>
<td>Easy to calculate.</td>
<td>Ignores the role of credit.</td>
</tr>
<tr>
<td></td>
<td>Housing Cost Burden (HCB)</td>
<td>Housing expenditure (e.g. mortgage repayment) that is less than 30% of household income.</td>
<td>Considers the effect of leverage and non-housing expenditures of household.</td>
<td>Rigid threshold of 30%.</td>
</tr>
<tr>
<td></td>
<td>Residual Income (RI)</td>
<td>Residual income (after deducting non-housing costs) that is sufficient to service monthly mortgage obligations.</td>
<td>Considers the effect of leverage and the household’s spending patterns.</td>
<td>Limited cross-country comparability.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>More reflective of a household’s ability to purchase a house.</td>
<td>Requires detailed data on household income and attributes, cost of living and housing costs.</td>
</tr>
</tbody>
</table>


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\(^4\) Recommended by the World Bank as well as the United Nations (UN). It is also used by the Joint Centre for Housing Studies, Harvard University, US.

\(^5\) Australia, Canada, Ireland, New Zealand, UK and US.

\(^6\) Developed by the US Department of Housing and Urban Development.

\(^7\) Total housing costs include mortgage principal payments and interest payments or rent, house insurance, mandatory services and charges (sewage and refuse removal), regular maintenance and repairs, taxes and the cost of utilities (e.g. water, electricity, gas and heating). For renters, these costs are counted if paid by the tenant.

\(^8\) Household income includes income from work, social benefits, investments and other household income. Disposable income (household income, after taxes and deductions) is sometimes used, as in OECD (2016).
Assessing the Affordability of Houses in Malaysia

Using the MM approach, the ratio of median house price to the median household income has consistently exceeded 3.0 since 2004. By 2014, the housing affordability ratio was 4.4\(^9\), indicating that houses in Malaysia as a whole, were ‘seriously unaffordable’ (Chart 1). Within Malaysia, house prices range from ‘affordable’ in Melaka (affordability ratio of 2.98 in 2014) to ‘seriously unaffordable’ in Terengganu\(^8\), Kuala Lumpur, Penang and Sabah (ratio above 5, Chart 2).

Estimates using the HCB and the RI methodologies broadly concur with the above findings. Both the HCB and RI approaches consider housing loans as supporting the ability of households to purchase homes. The price of an affordable house under these two approaches is equivalent to the maximum amount of housing loan\(^11\) that the household is able to obtain. This enables the household to afford a house at a higher price than that under the MM approach, which is an indication of the number of times median house prices exceed annual household income without the aid of a housing loan. The price of an affordable house under the RI approach is in turn higher than in the HCB approach. This is because the RI approach releases the 30% housing-cost expenditure constraint imposed by the HCB, acknowledging that households of different income brackets may spend different proportions of their income on housing and non-housing expenditures.

\(^9\) Latest median household income data available was in 2014 (DOSM, 2014). Using the MM approach, houses in Malaysia were less affordable compared to US (house price-to-income ratio of 3.6), Canada and Ireland (4.3), but more affordable than in UK (4.7), Singapore (5.0), Australia (6.4), New Zealand (8.2) and Hong Kong (17.0) (Demographia International, 2015).

\(^8\) In Terengganu, growth in house prices (2012-2014: 14.1%) outstripped that of household income (11.6%).

\(^11\) Other factors considered include prevailing interest rates, 90% loan-to-value and loan tenure of 35 years. Calculations consider the disposable income of households (gross income minus EPF, SOCSO and income tax).
The shaded area in Chart 3 illustrates this point, where the ideal price of an affordable house for a median household in 2014 (monthly income of RM4,585) is up to RM165,060 using the MM approach, but is higher at RM248,000 with the HCB and RM261,000 with the RI approach. In 2014, the actual median price for a house in Malaysia was RM242,000. This suggests that houses were affordable under the HCB and RI approaches. The same conclusion holds for Selangor and Johor. However, houses in the major urban centres were unaffordable according to all three methods (Chart 4). Across all four major urban centres, the prevailing median market house prices were significantly above the ideal affordable house prices. The situation was particularly acute in Georgetown which suffered the highest median house prices and lowest median household income. Given that house prices increased further in 2016, housing affordability continues to be a current issue for households.

Factors Contributing to Housing Affordability Issues in Malaysia

The issue of affordable housing reflects mainly the supply-demand imbalances in Malaysia, which worsened during the 2012 - 2014 period. During these years, new housing supply fell short of the increase in demand (average supply of 85,000 new units versus the formation of 118,000 new households). This is in contrast to the period 2007 - 2009, when the new supply exceeded the demand for housing (Chart 5).

Secondly, the effect of the supply shortfall on housing affordability was exacerbated by the slower increase in household incomes (12.4%) relative to house prices (17.6%) (Chart 6). Both of these trends were more acute in key states (Charts 5a and 6a).
Insufficient Supply of New Houses Compared to the Increase in Households During 2012-2014

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Increase in Number of Households</th>
<th>Completion of New Houses</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-2009</td>
<td>123</td>
<td>140</td>
</tr>
<tr>
<td>2012-2014</td>
<td>118</td>
<td>85</td>
</tr>
</tbody>
</table>

Source: National Property Information Centre and Department of Statistics, Malaysia

During 2012-2014, the Growth in Median House Prices Has Outpaced the Growth in Median Household Income

<table>
<thead>
<tr>
<th>Year</th>
<th>Median House Prices</th>
<th>Median Household Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-2009</td>
<td>5.1</td>
<td>5.5</td>
</tr>
<tr>
<td>2012-2014</td>
<td>17.6</td>
<td>12.4</td>
</tr>
</tbody>
</table>

*Note: CAGR refers to Compound Annual Growth Rate

The Undersupply is Evident Across Most Key States in 2012-2014

<table>
<thead>
<tr>
<th>State</th>
<th>Net Increase in Number of Households</th>
<th>Completion of New Houses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kuala Lumpur</td>
<td>12.4</td>
<td>5.0</td>
</tr>
<tr>
<td>Selangor</td>
<td>48.1</td>
<td>19.7</td>
</tr>
<tr>
<td>Penang</td>
<td>19.1</td>
<td>11.9</td>
</tr>
<tr>
<td>Johor</td>
<td>17.4</td>
<td>12.2</td>
</tr>
</tbody>
</table>

Source: National Property Information Centre and Department of Statistics, Malaysia

Faster Growth in Median House Prices Compared to Income Levels Across All Key States During 2012-2014

<table>
<thead>
<tr>
<th>State</th>
<th>Median House Prices</th>
<th>Median Household Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kuala Lumpur</td>
<td>19.2</td>
<td>14.2</td>
</tr>
<tr>
<td>Selangor</td>
<td>14.2</td>
<td>7.7</td>
</tr>
<tr>
<td>Penang</td>
<td>7.9</td>
<td>7.9</td>
</tr>
<tr>
<td>Johor</td>
<td>21.4</td>
<td>19.3</td>
</tr>
</tbody>
</table>

Majority of Unsold Houses in Malaysia were Those in the Non-affordable Price Category

Note: Affordable house price estimated with HCB. Total unsold properties include unsold properties that were completed and under construction as at 1Q 2016

Source: National Property Information Centre and Bank Negara Malaysia estimates
A third factor which worsened the housing affordability issue was the trend of higher property launches in the price categories above RM250,000\textsuperscript{12} (Chart 7). While there were more launches during 2012 - 2014, the number of new affordable housing units for households earning the median income (below RM250,000\textsuperscript{13}) was fewer by 16,200 units per year since the period 2008 - 2009. The oversupply of higher-end properties beyond what households can afford resulted in a significant portion of these non-affordable properties remaining unsold (Chart 8).

**Access to Financing for Home Buyers and Industry Players**

For home buyers, bank financing for the purchase of residential properties for qualified borrowers continued to be available. Growth in loans outstanding for home purchase averaged at 13.2\% during 2012 - 2014 (2008 - 2009: 9.8\%). While this moderated to 9.2\% in 2016, this moderation was due to the softer housing market. The demand for affordable housing had supported the expansion in end-financing by banks for residential property purchases. As at end-2016, about 56\% of loans outstanding were for houses priced below RM250,000, while loans for houses priced between RM250,000 to RM500,000 accounted for another 25\%. Rejection rates for housing loan applications also fell further to 23.6\% in 2016 (2012 - 2015: 26.1\%). These trends are evidence that financing remains ample for eligible home buyers.

Similarly, house builders continued to have access to bank financing. Loans for real estate activities and residential property construction increased at a healthy rate of 11.7\% in 2016 (2012 - 2014: 18.5\%), reflecting the fewer property launches and incoming supply.

**The Level of Affordable Housing That is Needed**

On the supply side, it is evident that the housing market has not provided an adequate supply of affordable housing for the lower- and middle-income households. In 2014, the shortage\textsuperscript{14} of affordable houses was estimated to be 960,000\textsuperscript{15} units. This gap is evident across most states, with Sabah and Sarawak having the highest deficit, accounting for 50\% of the total shortage in Malaysia. Among the four states with the highest concentration of urban population, the shortage of affordable housing was largest in Kuala Lumpur, followed by Penang and Johor. On the other hand, Selangor was found to have a surplus of affordable houses. However, this could be an over-estimation given that there is a significant number of low-cost housing in the state that may fail to meet the quality and location requirements of households\textsuperscript{16}.

While there are multiple programmes by the private sector, and the Federal and State Governments to supply affordable housing, the current level of house-building is not sufficient to meet the demand. If the current trends in population growth, urbanisation and income growth persist, the demand for affordable housing is likely to increase going forward. By 2020, the shortage of affordable housing could very well be more than one million\textsuperscript{18} units.

\textsuperscript{12} Developers have cited higher land costs, construction materials, labour and compliance costs as some of the reasons for higher property prices.

\textsuperscript{13} The price of an affordable house in 2014 is RM248,000 and RM261,000 using the HCB and RI approaches respectively.

\textsuperscript{14} Due to data limitations, the affordable housing gap in this article is estimated based on financial affordability of houses. Ideally, more accurate estimates of the demand of affordable housing should also take into account the requirement of households in terms of quality and location standards of houses, in addition to house prices.

\textsuperscript{15} Given that the stock of houses in the affordable price range is not readily available, the estimation is based on the assumption that households can only buy properties they can afford. Hence, the share of affordable housing transactions (i.e transactions occurring up to the price of an affordable house) is used as a proxy for the share of affordable houses in the market. The difference between the stock of affordable houses (supply) and the number of low- and middle-income households (who are likely to demand affordable homes) would then determine the shortage of affordable houses. These steps are repeated individually for each state, and summed up to arrive at an estimated shortage of 960,000 units nationwide in 2014.

\textsuperscript{16} Shortcomings of low-cost public housing in Selangor include its location away from institutions of learning and healthcare facilities, as well as building defects such as waterproofing and pipe leakages (Hashim et al, 2012).

\textsuperscript{17} From 2000 - 2010, the average annual population growth rate was 1.9\%, while the average annual growth rate for the number of households over the same period was 3.2\%. Additionally, the average size of households decreased from 4.6 persons per household in 2000 to 4.2 persons per household in 2010 (DOSM, 2010).

\textsuperscript{18} Projections are guided by population forecasts in the Eleventh Malaysian Plan and incorporate the trend of affordable housing completions during the period 2014 to 1H 2016.
Policy Lessons in Addressing the Affordable Housing Issue

A shortage in affordable housing is not unique to Malaysia. Other countries have identified both supply and demand-side policies to narrow the affordable housing gap. This challenge requires a multi-pronged approach focusing on four key areas: i) increasing supply and reducing the cost of affordable housing; ii) establishing a central repository as a systematic way of monitoring and managing the demand and supply of affordable housing; iii) developing a thriving rental housing market; and iv) diversifying the sources of financing for affordable homes.

i) Increasing the Supply and Reducing the Cost of Affordable Housing

Addressing the under-provision of affordable houses calls for a more organised approach. The empowerment of a single authority to spearhead the planning and delivery of affordable housing nationwide could unlock scale efficiencies, facilitate the management of a database, as well as to undertake research on policy options to address the affordable housing challenge.

An industrial approach can be used to deliver housing quickly, on a large scale and at a lower cost. Industrial construction techniques to improve labour productivity have shortened the delivery time by 40% - 50% and reduced costs by 30% (McKinsey Global Institute, 2014). Additionally, smarter procurement processes such as the establishment of a buying consortia have enabled cost savings (via discounts on bulk orders), which can be passed on to the buyers through lower house prices.

ii) Establishing a Central Repository as a Systematic Way of Monitoring and Managing the Demand and Supply of Affordable Housing

In countries which have made significant progress in addressing the housing affordability issue, an integrated database which captures the demand and supply of housing has been useful in helping the provision of affordable housing by the public and private sectors. This central repository, which should ideally be managed and monitored by the single authority mandated to oversee the nation’s affordable housing needs, should be updated frequently to reflect the changes in household income as well as the evolving needs and preferences of the households. Regular surveys can be carried out to keep up with the requirements of households in terms of prices, build-up size, design and location so that future supply can be tailored to reflect their needs.

iii) Developing a Thriving Rental Market

The private rental sector can help reduce the supply-demand gap for affordable housing. In Malaysia, only 24% of households live in rented accommodation. To manage the demand for affordable housing, rental needs to be a viable option of choice, and not a last resort for households. Policy initiatives in other countries have focused on strengthening the legal and institutional frameworks underlying the rental market.

Globally, governments have safeguarded the rights of tenants and landlords by enacting specific legislations such as Tenancies Act (Australia and New Zealand) or have incorporated these qualities into their Federal Law (Germany). Tenancy protection includes having an enforceable tenancy agreement and a tenancy deposit mechanism involving a neutral third party to protect a tenant’s rights to deposit recovery while allowing the landlord to use the money in case the tenant breaches the tenancy agreement.

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19 Singapore’s Housing Development Board (HDB) builds and manages affordable homes. About 80% of its population lives in HDB flats. In Korea, the Land and Housing Corporation constructs affordable housing units for the vulnerable, including for rental.

20 The UK Procurement Effi ciency Initiative for social housing achieved 15% - 30% savings on material costs (McKinsey Global Institute, 2014).

21 Sample Household Surveys (SHS) are carried out by the HDB in Singapore on a large scale every five years. The latest survey in 2013 covered 7,800 households living in all 23 HDB towns and estates.

22 This is low when compared to Hong Kong (49%), Japan (38%), New Zealand (35%) and Australia (31%). For more details, please refer to Box Article on ‘Assessing Demand-Supply Conditions in the Malaysian Property Market’ in Bank Negara Malaysia’s Annual Report 2015.

23 Rental deposits are kept with a third party such as a dedicated government agency (New Zealand Tenancy Services, Residential Tenancies Bond Authority of Victoria, Australia), approved tenancy deposit schemes (UK Tenancy Deposit Scheme, UK Deposit Protection Services) or joint-bank savings account (Germany).
iv) Diversifying Sources of Financing for the Delivery and Purchase of Affordable Homes

Affordable housing development, especially in key economic centres can be cost-prohibitive to developers. Leveraging on private sources is helpful in moving towards a more sustainable market-based approach in the long run. In India, public-private partnerships in a joint-venture model have complemented public channels of financing the supply of public housing (UN-HABITAT, 2011).

For households, home financing methods significantly impact affordability. One option is bank financing of housing loans. Following the Global Financial Crisis, innovations in housing finance need to strike a balance between improving access to housing finance for households and avoiding the loose lending standards that could trigger excessive speculation or overburden households that do not have the ability to repay their housing loans. Alternatively, home financing can be supported by creative mechanisms leveraging on multiple sources of funding and innovative financing schemes such as shared-ownership which allow buyers to acquire partial interest in a home rather than buying one outright.

Conclusion

The housing market in Malaysia has not been able to provide an adequate supply of affordable housing for the masses. This undersupply of affordable homes is likely to worsen going forward given current trends in income and demographic factors.

Going forward, a carefully-designed strategy of policy interventions is required for the housing market to ensure that it is able to accommodate households of all income groups. Meeting the demand of affordable housing units going forward will require the commitment of both the Government and the private sector. The establishment of a central agency to consolidate the provision of affordable housing as well as a central repository is key. Additionally, reducing costs associated with the development of affordable housing through the implementation of cost-saving and productivity-enhancing technologies would increase the speed and scale of delivery of affordable housing projects going forward. On the demand side, the development of the rental market to bridge the affordability gap could relieve some of the pressure on the Government to build all of the affordable housing needed. This should be complemented by more innovative schemes to fund the delivery of affordable houses. As for end-financing, as in other countries, the Central Bank has introduced macroprudential measures to deter speculative activity in the housing market and to avoid over-borrowing beyond one’s means. It is important to note that these measures do not in any way hamper access to financing for eligible borrowers including those who are first-time buyers.

To conclude, while the challenge of bridging the affordability gap is significant, the experiences of other countries show that using a creative mix of innovative and targeted policies, it is not unsurmountable.

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24 Mexico has a dedicated housing provident fund (UN-HABITAT, 2011).
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Youth Unemployment in Malaysia: Developments and Policy Considerations

By Dian Hikmah Mohd Ibrahim and Mohd Zaidi Mahyuddin

Introduction

In the aftermath of the Global Financial Crisis (GFC), the global youth population has been negatively affected by the deep recession, the ensuing environment of prolonged and shallow economic recovery and lacklustre job growth1. The global youth unemployment rate2 rose from a pre-crisis rate of 11.7% in 2007 to 13.1% in 2009, reaching a historic peak of 13.2% in 2013, and is estimated to remain high at 13.1% in 2016. The global youth unemployment rate is approximately three times the unemployment rate of adults, and more than two times the overall global unemployment rate. These figures amount to more than 70 million young people around the world who are experiencing difficulty finding meaningful employment. The International Labour Organisation (ILO) reported that youth unemployment is on the rise again in 2017, particularly in emerging market economies, after improving slightly between 2012 and 2015. The ILO also cited studies which find that early youth unemployment has serious long-term negative effects on future incomes and future risk of unemployment, particularly for youth who were immediately afflicted by unemployment upon graduation from universities3.

This article seeks to shed light on the state of youth unemployment in Malaysia, and provide an overview of immediate and long-term measures to address these issues. Part I of this article discusses developments surrounding youth unemployment in Malaysia, particularly with regard to graduate unemployment. Part II attempts to offer an explanation of these trends, and Part III offers some policy recommendations, drawing lessons from success stories in other countries.

Part I: The State of Youth Unemployment and Increasing Concerns over Graduate Unemployment in Malaysia

Youth in Malaysia have not been spared from these global trends

The youth unemployment rate in Malaysia was estimated to have reached 10.7% in 2015, more than three times higher than the national unemployment rate of 3.1%. Malaysia is among regional economies4 with an incidence of youth unemployment in the double-digits, despite a low overall unemployment rate (Charts 1 and 2).


Source: International Labour Organisation and Bank Negara Malaysia estimates

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1 Scarpetta et.al 2010. Rising Youth Unemployment during the Crisis: How to Prevent Negative Long-term Consequences on a Generation?
2 In this article, ‘youth’ refers to the population, labour force, and employed and unemployed workers between the ages of 15 to 24.
3 ILO 2016. World Employment and Social Outlook: Youth.
4 For ASEAN economies, youth unemployment rates hover at around 12.8% in 2013, roughly similar to the global average.
Youth represents more than half of total unemployed workers, despite only making up a third of the labour force (Chart 3). In 2015, the youth unemployment rate increased by 1.2 percentage points from an estimated 9.5% to 10.7%, while the national unemployment rate increased by only 0.2 percentage points (2.9% to 3.1%) during the same period (Chart 4). Youth unemployment has been on the rise in the recent period, as the growth in hiring has slowed since late 2014. Cautious business sentiments and moderating economic performance have restrained businesses from expanding their workforce. The youth are the most vulnerable to these trends; they are likely to be the last to be hired and the first to be made redundant, due to their lack of experience, higher information asymmetry on the labour market, and poor ability to communicate their skills effectively to employers. While a lot of media attention has been focused on the plight of retrenched workers, slower hiring has had a wider impact on the economy, affecting particularly youth and new jobseekers.

Graduate employability is a rising concern for Malaysia and a few countries in the region

The youth labour force tends to be more skewed towards youth with lower educational attainment. Among 15 - 24 year-olds, only 16% have tertiary educational attainment, while the highest level of schooling attained by the remaining 84% is secondary education (Profile for overall labour force: Tertiary education: 28%; Primary, Secondary, and No formal education: 72%). Notably, youth with tertiary education make up a relatively larger share of unemployed youth (23% of total unemployed youth, Chart 5). Of concern, among those with tertiary educational attainment, the unemployment rate is higher at 15.3% (Youth without tertiary education: 9.8%) (Chart 6; See Information Box on ‘Key Findings from the 2015 Graduate Tracer Study Report’).

Interestingly, this trend does not appear to be unique to Malaysia. Among regional economies, unemployment rates for young graduates also tend to be higher than non-graduates (Chart 7). This observation appears to be counter-intuitive to the economic wisdom of increasing returns to educational attainment, and seems to be the opposite of the experience in the advanced economies. These trends are likely to be related to the nature of global supply chains and ensuing patterns of job creation in the emerging economies, vis-à-vis the advanced economies. Thus far, research on factors driving comparative trends on graduate vs. non-graduate youth unemployment in advanced and emerging economies have been scant. These developments in graduate unemployment has raised several key policy questions for emerging economies, regarding enhancing the quality and relevance of education systems to prepare for rapidly evolving industries, the types of jobs being created and the readiness of the human capital base, and measures to enhance matching in the labour market and alleviate information asymmetry on industry skill needs.

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6 The labour force is divided into four main categories of educational attainment: Primary educational attainment, secondary educational attainment, tertiary educational attainment, and no formal education. In this article, tertiary-educated workers are also called graduates.
Chart 5

Profile of Youth Labour Force and Unemployed Youth by Educational Attainment, 2015

Source: The International Labour Organisation, Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Chart 6

Unemployment Rates by Educational Attainment, 2015

Source: The International Labour Organisation, Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Chart 7

Country Comparison of Youth Unemployment Rates by Educational Attainment

Source: The International Labour Organisation and Bank Negara Malaysia estimates

Part II: Factors Underlying High Youth and Graduate Unemployment

Labour market mismatches arising from both limited high-skilled job creation and inadequate supply of industry-ready graduates

Despite the workforce increasingly becoming more educated, job creation in the Malaysian economy has remained concentrated in the low and mid-skilled jobs7 (Chart 8), as domestic industries stay in low-value added activities that emphasise cost efficiency and dependence on cheap labour, rather than pursuing innovation as a source of growth. The Malaysian economy also continues to face the challenge of attracting high-quality investments that would create more high-paying, high skilled jobs for the local workforce8. In the meantime, firms point to skills shortage as a key factor which prevents them from making investments to move up the value chain9. This mismatch between the changes in educational

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8 Nixon et. al 2017. Fostering inclusive growth in Malaysia.
Key Findings from the 2015 Graduate Tracer Study Report

The Ministry of Education’s Graduate Tracer Study tracks the status of graduates of higher learning institutions six months after graduation to ascertain whether they have started working, are continuing their studies, or are still looking for employment. Observations are gathered from graduates of public and private universities, university colleges, polytechnics, and community colleges. Of the 273,373 graduates in 2015, a large number hold Bachelor’s Degree and Diploma, 45% and 43% of all graduates, respectively. Among all graduates, 53% were reported to have started working, 18% chose to pursue further studies, and 24% of graduates were still unemployed (Chart 1). Bachelor’s degree-holders recorded the highest unemployment rate amongst graduates of all qualifications at 27.9% (Chart 2). By fields of study, graduates from the Sciences, and Literature and Social Sciences tend to have higher rates of unemployment (Chart 3). By household income brackets, graduates from lower-income households also tend to have higher unemployment rates. This observation holds true across qualifications (Chart 4). Empirical evidence elsewhere point to a multitude of reasons, including the readiness of graduates for the world of work, insufficient job creation for some fields, and the lasting implications of socioeconomic backgrounds on learning and social progression. In terms of earnings, 54% of graduates earn less than RM2,000 a month. Starting salaries for graduates have remained largely stagnant since 2007 (Charts 5 and 6), despite certain sectors, namely the financial services and oil and gas industries, offering higher salaries at the entry level. These observations invite further questions for academics and policymakers, and more research is warranted to uncover the root causes of these observations, and to design appropriate policy responses.

Chart 1
Distribution of Graduates by Employment Status

*Note: Includes graduates waiting for placement and undergoing upskilling
Source: Ministry of Higher Education and Bank Negara Malaysia estimates

Chart 2
Unemployment Rates of Graduates, and by Qualification*

*Note: Unemployment rates are expressed as a percentage of respective group categories
Source: Ministry of Higher Education and Bank Negara Malaysia estimates

Chart 3
Unemployment Rate by Field of Study*

*Note: Unemployment rates are expressed as a percentage of respective group categories
Source: Ministry of Higher Education and Bank Negara Malaysia estimates

Chart 4
Unemployment Rate of Graduates by Monthly Family Income Brackets*

*Note: Unemployment rates are expressed as a percentage of respective group categories
Source: Ministry of Higher Education dan Bank Negara Malaysia estimates
attainment of the workforce and the types of jobs created is also manifested to some extent in anaemic demand for fresh graduates, as online job postings for entry-level positions for graduates have remained largely stagnant since 2012 (Chart 9).

Employers continue to cite significant skill gaps among new recruits. A survey conducted by the World Bank and Talent Corporation\(^{10}\) found that 90% of companies believe that university graduates should have more industrial training by the time they graduate, and 81% of companies surveyed rated communication skills as a major deficit among graduates. Concerns on the marketability and adaptability of graduates to the labour market are frequently attributed to the state of

the national education and technical and vocational education and training (TVET) systems\textsuperscript{11}. However, lack of industry involvement in human capital development has also contributed to the dearth of truly effective training programmes for workers. The same TalentCorp survey found that 53\% of firms have never engaged career centres in their recruitment efforts. Thus, even though youth may lack requisite skills, effective, meaningful training programmes which would prepare them for work have also not been forthcoming (Chart 10).

\begin{center}
\begin{tabular}{|c|c|}
\hline
\textbf{Firms think that graduates are not ready for workplace...} & \textbf{...but firms' collaboration with universities are limited} \\
\hline
90\% Companies feel more practical training should be provided for graduates & 50\% Companies have no structured internship programmes \\
\hline
80\% Companies think the university curricula is not reflective of the current realities & 53\% Firms have never worked with career centres \\
\hline
81\% Companies rate communication skills as the major skill deficit in graduates & \textless; 10\% Companies had experience in developing curricula or programmes with universities \\
\hline
\end{tabular}
\end{center}

\textbf{Source: The World Bank-TalentCorp Survey on Graduate Employability}

Part III: Policy must be attuned to equip the younger generation to meet future challenges

Globally, the problem of youth unemployment is not new. However, socioeconomic developments in the past few years have dramatically exacerbated the situation. Going forward, the twin developments of persistent high youth unemployment and rising income inequality may constrain social mobility, and lead to increasing dissatisfaction among the populace\textsuperscript{12}. In Malaysia, this has already contributed, in part, to brain drain – the flight of high-skilled talent to advanced economies and neighbouring countries, in search of better jobs and pay\textsuperscript{13}. Left unattended, a generation of economically disenfranchised youth could have negative and far-reaching ramifications on the economic and social landscape. In the near future, the youth will have to contend with more self-reliant economic arrangements and even more job displacements, with the advent of the wider interconnectedness, alongside rapid technological advancement. Thus, policy must be orientated towards preparing the younger generation to meet these challenges head-on.

Firstly, addressing the root cause of the problem must be a permanent national agenda. Quality education, including an effective TVET sector is important towards building human capital. These goals are highlighted in the Malaysian Education Blueprint (2015 - 2025), which outlines meaningful strategies to transform the national education system, empower institutions of higher learning with greater autonomy and accountability, develop technologically savvy, well-rounded graduates, and improve the quality of the national TVET sector. For youth in particular, research has shown that more access to effective vocational training is linked to lower rates of youth unemployment\textsuperscript{14}. In Germany, the Dual Vocational Technical Training System pairs “apprentices” from vocational schools with companies to incorporate work-based learning experiences to prepare them for employment. It has been widely credited with keeping youth unemployment low in the country.

Secondly, promoting meaningful industry collaboration in education and training is key in community-building and nurturing a vibrant workforce, which serves the immediate and future needs of industry. A well-funded and effective platform is

\textsuperscript{11} OECD 2013. Structural Policy Country Notes on Malaysia.
\textsuperscript{12} OECD 2011. Social Cohesion in Southeast Asia.
\textsuperscript{14} Banerji et. al 2014. Youth Unemployment in Europe: Searching for Solutions.
needed towards offering high-quality training and promoting workforce development. Such a platform would serve as an avenue in which the Government, industry, and education and training sectors could i) consult and develop curriculum and training to fulfill industry skill needs, and ii) actively support implementation and continuous enhancement efforts. In Australia, the Industry and Skills Committee serves as a formal platform for industry leaders to play an active role in policy direction and decision-making for the TVET sector, including development of “training packages” which are informed by both labour market skill gaps and industry requirements.

Third, a comprehensive social security infrastructure needs to be built, including designing active labour market policies (ALMP) which are specifically targeted towards youth, as well as displaced workers. The objective of ALMPs is two-pronged, i) to increase employment opportunities, and ii) to improve the matching of workers to jobs. While still in its infancy, Malaysia is making positive gains in this respect, with the Employment Insurance Scheme (EIS), which was announced in Budget 2015. The EIS is envisioned to be a holistic programme, with ALMP measures as a main feature, including career counselling services and training schemes. Globally, ALMPs specifically targeted towards improving employability of youth are lacking, despite this group’s vulnerability to economic downturns and crisis. Nevertheless, a few countries, notably Sweden and Finland, have widened the social safety infrastructure by experimenting with policy measures such as Youth Guarantee Schemes. In these schemes, Public Employment Services provide personalised needs assessment and employment plans, and guarantee placements for youth by matching them to employment, academic or vocational study, or training to enhance employability and entrepreneurship. The job-matching process may be further facilitated by leveraging on technology, as evidenced by popular smartphone-based career applications and websites such as Switch and LinkedIn, which have become one of the primary avenues for jobseekers to signal their skills to potential employers, and for employers to search for talent15.

Fourth, conscientious implementation of various blueprints and programmes is key, along with a functional governance structure, effective monitoring and active enhancements to initiatives. A critical piece of the puzzle is reliable information and statistics on the progress of specific programmes, training schemes and grants, and performance of education and training institutions. Currently, gaps in labour market statistics, particularly on job creation, labour turnover, and hiring trends, present a significant challenge for policymakers. Towards this end, the Government’s recognition of the need to establish the Malaysian Bureau of Labour Statistics16 will go a long way towards ensuring development of high-frequency, reliable indicators on labour market and macroeconomic trends. This is key to planning and monitoring the progress of human capital development and labour market policies and facilitate responsive, evidence-based, and timely policy-making.

Finally, and over the longer-term horizon, policies to tackle youth unemployment need to be reviewed from time to time. Policy-making needs to be flexible and agile, responsive to the rapidly evolving job market of the future. This will include policies and programmes to specifically inculcate a culture of entrepreneurship and innovation, promote lifelong learning and improve workforce adaptability to changing industrial tides. The newly-announced National Transformation plan (TN50) maps the direction of the country in the next 30 years after 2020 and sets a new vision for the nation, with an eye on the aspirations of the youth.

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References


