Developments in the Malaysian Economy

HIGHLIGHTS

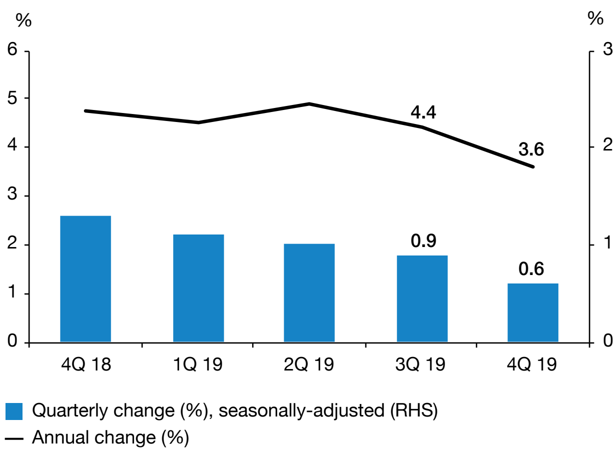
- The Malaysian economy expanded by 3.6% in the fourth quarter of 2019.
- Headline inflation declined in the fourth quarter while core inflation remained stable.
- Current account surplus narrowed to RM7.6 billion (2.0% of GNI).

The Malaysian economy grew by 3.6% in the fourth quarter of 2019

The Malaysian economy expanded by 3.6% in the fourth quarter of 2019 (3Q 2019: 4.4%), supported by higher private sector spending (7.4%; 3Q 2019: 5.4%). However, growth was affected by a decline in net exports. On the supply side, higher growth in the services and construction sectors was weighed down by supply disruptions in the commodities sector. On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 0.6% (3Q 2019: 0.9%). For 2019 as a whole, the economy expanded by 4.3% (2018: 4.7%).

Continued growth in 4Q 2019

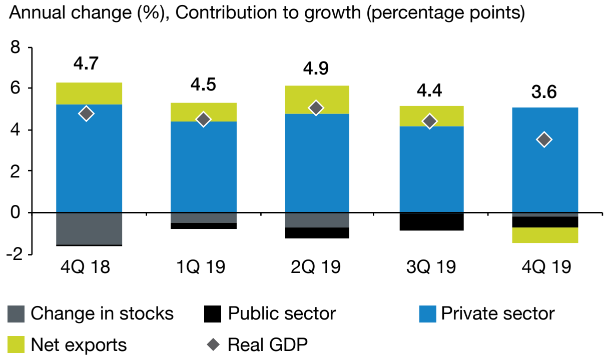
Chart 4: Real GDP Growth



Source: Department of Statistics, Malaysia

Private sector activity remained the key driver of growth

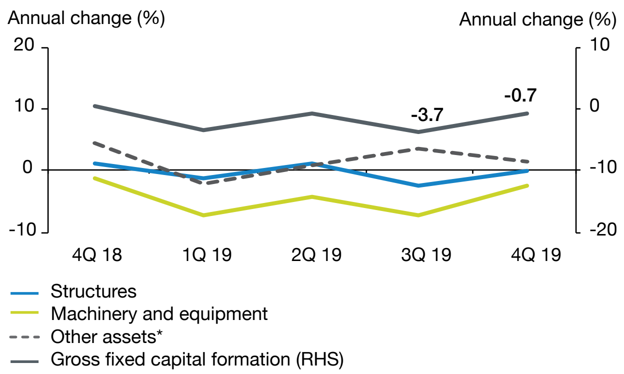
Chart 5: Contribution of Expenditure Components to Real GDP Growth



Source: Department of Statistics, Malaysia

Smaller contraction in gross fixed capital formation

Chart 6: GFCF Growth by Type of Assets



*Other assets include mineral exploration, research & development and capitalised planting.

Source: Department of Statistics, Malaysia

Growth underpinned by domestic demand

Growth was anchored by domestic demand, amid weak net exports. Domestic demand expanded by 4.9% (3Q 2019: 3.5%), driven by higher private sector activity.

Private consumption growth increased to 8.1% (3Q 2019: 7.0%), anchored by positive income and employment growth. This was supported by sustained spending on necessities, such as food and transportation, and leisure-related expenditure, such as restaurants and hotels, and recreational services.

Public consumption expanded by 1.3% (3Q 2019: 1.0%), supported by higher growth in emoluments. Government spending on supplies and services continued to decline, albeit at a smaller pace.

Gross fixed capital formation (GFCF) registered a smaller contraction of 0.7% (3Q 2019: -3.7%). This was mainly underpinned by higher capital spending by the private sector. By type of assets, investment in structures as well as machinery and equipment (M&E) improved, with growth of 0.1% (3Q 2019: -2.4%) and -2.6% (3Q 2019: -7.4%), respectively. Structures investment was supported by implementation of civil engineering projects and the turnaround in the residential segment.

Private investment registered a higher growth of 4.2% (3Q 2019: 0.3%), mainly driven by continued investments in the services and manufacturing sectors. In particular, higher capital expenditure in transport services and construction-related manufacturing had contributed to the growth performance.

Public investment recorded a smaller decline of 7.7% (3Q 2019: -14.1%). This was due to a smaller contraction in capital spending by public corporations amid weak investment by the General Government.

Higher growth in the services and construction sectors, weighed down by supply disruptions in the commodities sector

The services sector grew at a faster rate (6.1%; 3Q 2019: 5.9%). Growth was mainly driven by firm consumer-related spending, particularly in the food and beverages and accommodation sub-sector, as well as motor vehicles. The finance and insurance sub-sector registered higher growth mainly due to higher fee-based income. Continued demand for data communication services contributed to growth in the information and communication sub-sector, while sustained growth in the transport and storage sub-sector was largely supported by air passenger traffic and port-related activities.

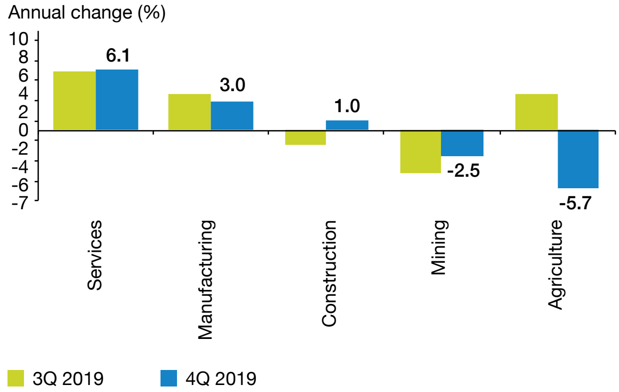
Growth in the manufacturing sector moderated (3.0%; 3Q 2019: 3.6%). E&E production was affected by continued weakness in the global demand for semiconductors. Production disruptions in the commodities sector also had a negative impact on downstream manufacturing activities. Growth in the consumer-related cluster was weaker mainly due to a contraction in oil palm production. In the primary-related cluster, growth moderated following closures of major downstream oil refineries and lower gas liquefaction activities. However, the pace of moderation was cushioned by the operationalisation of large oil refinery and petrochemical facilities in Johor.

Having registered positive growth in the first three quarters of the year, the agriculture sector contracted during the quarter (-5.7%, 3Q 2019: 3.7%). This was due to the decline in oil palm output, which was affected by severe dry weather conditions and cutbacks in fertilizer application during the early part of 2019.

Mining sector growth declined at a slower pace (-2.5%; 3Q 2019: -4.3%), reflecting a smaller decline in oil production as output gradually recovered from major maintenance work that was done in the previous quarter. Growth in natural gas output contracted, as production was affected by temporary facility closures.

Most sectors expanded, while mining and agriculture sectors contracted

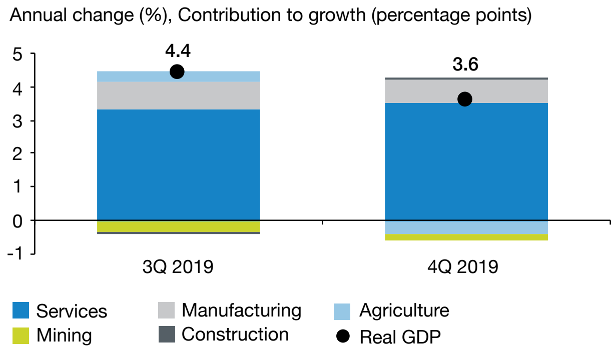
Chart 7: Growth by Sector



Source: Department of Statistics, Malaysia

Services and manufacturing sectors remained the key drivers of growth

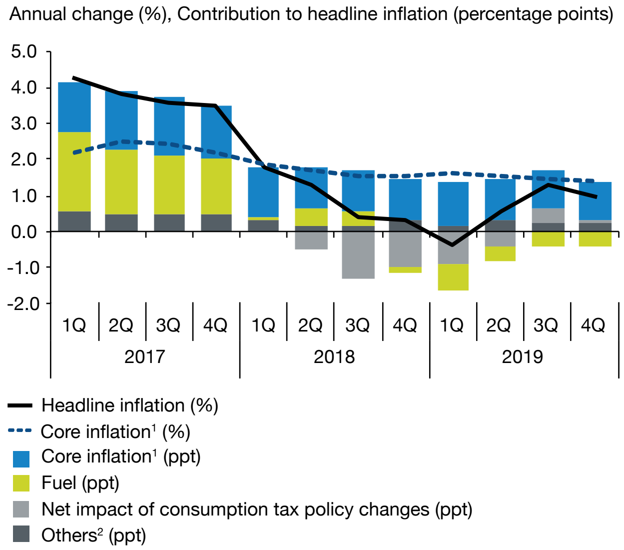
Chart 8: Contributions to Real GDP by Economic Sector



Source: Department of Statistic, Malaysia

Lower headline inflation as the impact of the SST implementation lapsed

Chart 9: Contribution to Headline Inflation by Components



[1] Core inflation is computed by excluding price-volatile and price-administered items. It also excludes the estimated direct impact of consumption tax policy changes.

[2] Others include price-volatile items and other price-administered items

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

Growth in the construction sector recovered (1.0%; 3Q 2019: -1.5%) during the quarter. The recovery was mainly attributable to the turnaround in the residential sub-sector, supported by affordable housing activities. Civil engineering activities were also higher, supported by large transportation projects. In addition, higher growth in special trade sub-sector was due mainly to the ongoing solar projects and higher installation and finishing works from the completion of petrochemical and mixed development projects. The non-residential sub-sector however remained in contraction, amid ongoing oversupply of commercial properties.

Headline inflation declined as the impact of the SST implementation lapsed

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), decreased to 1.0% in 4Q 2019 (3Q 2019: 1.3%). The lower inflation outcome mainly reflected the lapse in the impact of the SST implementation. Fuel inflation continued to have a negative contribution to inflation, as domestic retail fuel price ceilings were maintained.

Core inflation was stable at 1.4%, reflecting the absence of strong demand pressures in the economy, amid moderate expansion in private sector wages.

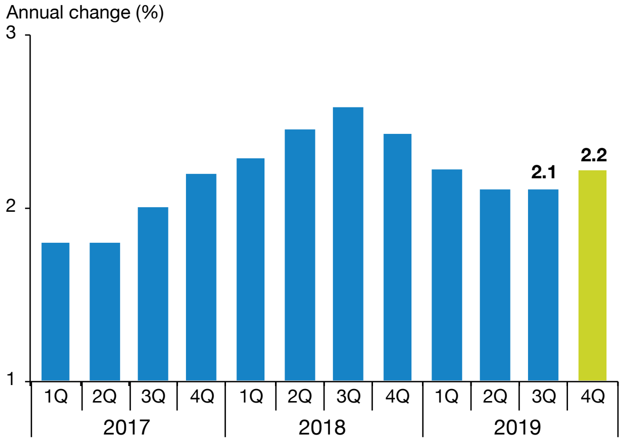
Improved labour market conditions

During the fourth quarter, labour market conditions improved. Employment growth was higher (2.2%; 3Q 2019: 2.1%), while the unemployment rate was lower at 3.2% (3Q 2019: 3.3%) as employment growth outpaced labour force growth during the quarter.

Private sector wage growth was marginally higher at 3.9% (3Q 2019: 3.8%), driven by firm wage growth in both the services and manufacturing sectors. Private services wages grew by 4.2% (3Q 2019: 4.1%), supported by wage growth in the wholesale and retail trade (3.7%; 3Q 2019: 3.6%) and transportation and storage (2.8%; 3Q 2019: 2.6%) sub-sectors. In the manufacturing sector, wages expanded by 3.3% (3Q 2019: 3.2%). This was due mainly to higher wages in the domestic-oriented industries, particularly in the food, beverages and tobacco (3.9%; 3Q 2019: 2.4%) as well as the non-metallic mineral and metal products (3.0%; 3Q 2019: 1.9%). Wages in the electrical and electronics industry, however, moderated (3.8%; 3Q 2019: 4.1%) due to continued weakness in demand for E&E products.

Higher employment growth

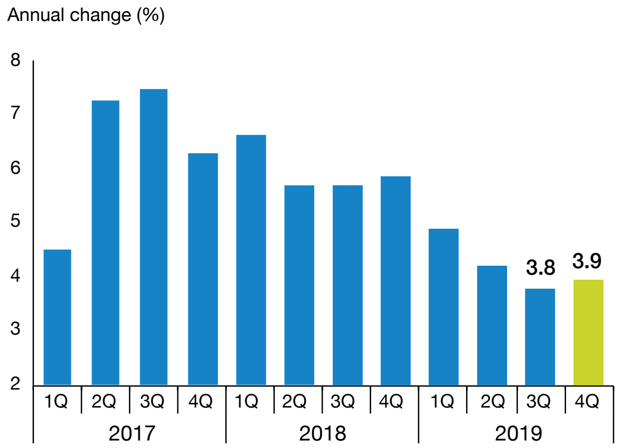
Chart 10: Employment Growth



Source: Department of Statistics, Malaysia

Marginally higher private sector wages

Chart 11: Private Sector Wages*



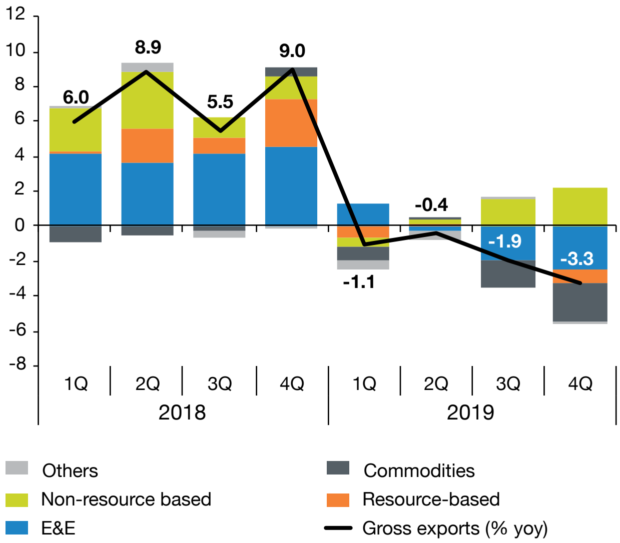
* Private sector wages are derived from the salaries and wages data published in the Monthly Manufacturing Statistics and Quarterly Services Statistics by the Department of Statistics, Malaysia. They cover 62.9% of total employment.

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

Sharper decline in manufactured and commodities exports

Chart 12: Gross Exports by Products

Annual change (%), Contribution to growth (percentage points)

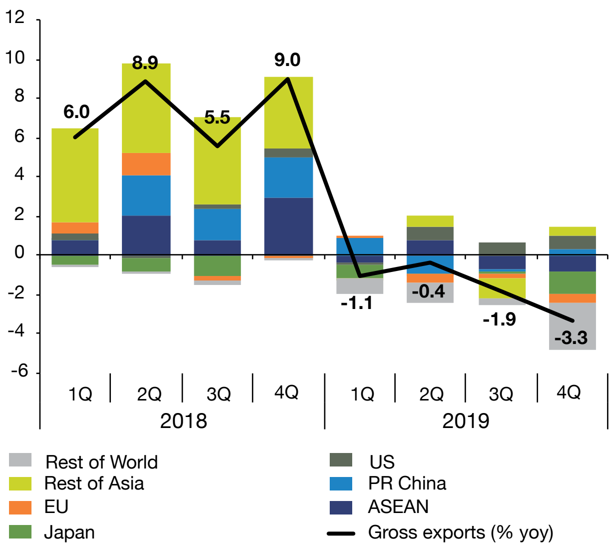


Source: Department of Statistics, Malaysia

Slowing demand from regional economies

Chart 13: Gross Exports by Markets

Annual change (%), Contribution to growth (percentage points)



Source: Department of Statistics, Malaysia

Sharper decline in exports while imports registered a smaller contraction

In the fourth quarter of 2019, gross exports contracted by 3.3% (3Q 2019: -1.9%), weighed by declines in both manufactured and commodities exports. Gross imports declined at a slower pace of 4.0% (3Q 2019: -5.8%), due mainly to a positive turnaround in intermediate imports and a smaller contraction in capital imports. The trade surplus[1] increased to RM36.5 billion (3Q 2019: RM33.5 billion).

Manufactured exports contracted by 1.2% (3Q 2019: -0.6%), due mainly to the decline in E&E exports (-6.5%; 3Q 2019: -4.9%) amid lower exports to the US, PR China and regional economies. This partly reflected the slowdown in global semiconductor sales. By contrast, non-E&E exports continued to expand at a sustained pace. Exports of commodities recorded a larger decline (-14.3%; 3Q 2019: -10.0%) due to a sharp contraction in liquefied natural gas exports (-25.2%; 3Q 2019: 4.1%), following temporary facility closures and lower prices.

Intermediate import growth turned positive during the quarter (0.9%; 3Q 2019: -3.0%), due to higher imports of industrial supplies, such as metals and metal products, and parts and accessories of capital goods. Capital imports recorded a smaller decline (-8.9%; 3Q 2019: -15.5%), supported by higher demand for maritime ships, aircrafts and office equipment.

[1] The difference between the goods surplus and trade surplus arises from the exclusion of goods for processing, storage and distribution in the goods accounts as per the 6th Edition of the Balance of Payments and International Investment Position Manual (BPM6) by the IMF.

Narrower current account surplus

The current account surplus of the balance of payments amounted to RM7.6 billion or 2.0% of GNI in the fourth quarter of 2019 (3Q 2019: RM11.5 billion or 3.1% of GNI). The higher goods surplus was offset by larger income and services deficits.

As the decline in imports outpaced exports, the goods surplus widened to RM32.8 billion (3Q 2019: RM30.8 billion).

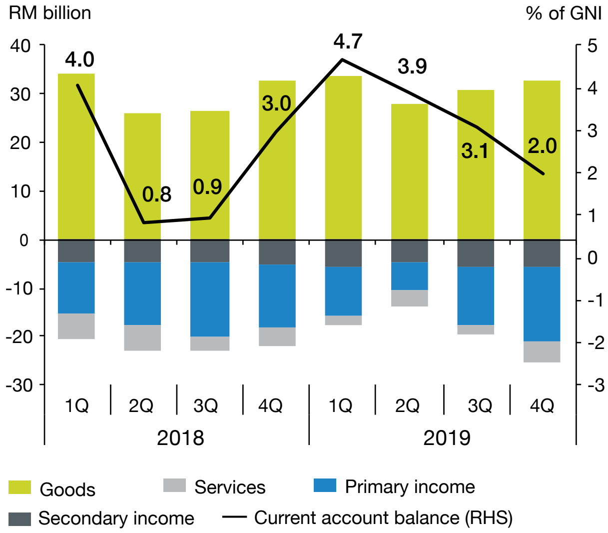
In the services account, the deficit widened to RM4.0 billion (3Q 2019: -RM1.6 billion) during the quarter. This was due primarily to a decline in the travel account surplus (RM6.4 billion; 3Q 2019: RM9.5 billion) following lower tourist arrivals.

The primary income account registered a larger deficit of RM15.7 billion (3Q 2019: -RM12.2 billion). This mainly reflected higher investment income accrued to foreign investors in Malaysia.

The deficit in the secondary income account amounted to RM5.5 billion (3Q 2019: -RM5.5 billion), reflecting continued outward remittances by foreign workers.

Larger income and services deficit

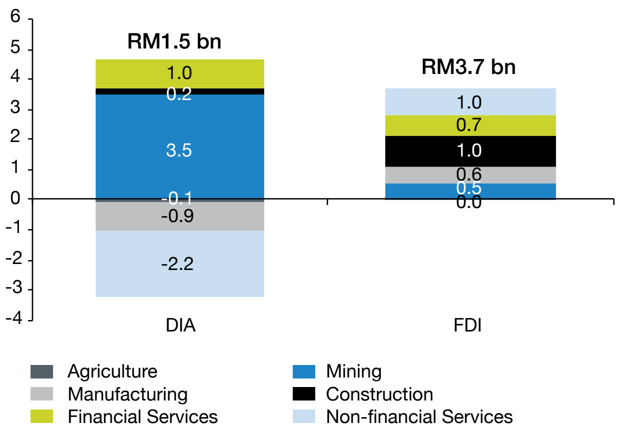
Chart 14: Current account balance



Source: Department of Statistics, Malaysia

Net inflow in the direct investment account

Chart 15: Net Direct Investment Flows by Sector

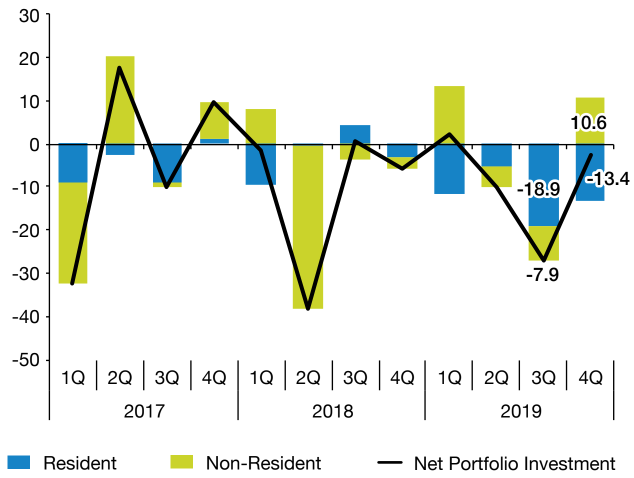


Note: For DIA, positive values refer to net outflows while negative values refer to net inflows. Figures may not add up due to rounding.

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Net outflow in portfolio investment account attributable to resident investors

Chart 16: Portfolio Investments



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Financial account registered a smaller net outflow

The financial account registered a smaller net outflow of RM0.6 billion (3Q 2019: -RM1.3 billion), due to lower net outflow of portfolio investments amid net inflow in the direct investment account.

The direct investment account turned around to register a net inflow of RM2.2 billion (3Q 2019: net outflow of RM0.8 billion), reflecting higher foreign direct investment (FDI) and a smaller outflow of direct investment abroad (DIA). During the quarter, FDI registered a higher net inflow of RM3.7 billion (3Q 2019: +RM2.9 billion) and was channelled mainly into the construction and non-financial services sectors, particularly the wholesale and retail trade sub-sector. DIA by Malaysian companies registered a smaller net outflow of RM1.5 billion (3Q 2019: -RM3.7 billion). The outflows were mainly channelled into the mining and financial services sectors.

The portfolio investment account registered a smaller net outflow of RM2.8 billion (3Q 2019: -RM26.8 billion), following more moderate outflows from resident investors and a return of non-resident portfolio investments. Residents' portfolio investments abroad recorded a smaller net outflow (RM13.4 billion; 3Q 2019: -RM18.9 billion). Domestic institutional investors continued to purchase equity securities abroad, while liquidating some holdings of foreign debt securities. For non-residents, improved investor sentiments amid positive developments in trade negotiations led to a net inflow of RM10.6 billion into domestic debt securities (3Q 2019: -RM7.9 billion).

The other investment account recorded a marginal net inflow of RM0.6 billion (3Q 2019: RM25.3 billion). This reflected a drawdown of loans to the private sector, which were almost entirely offset by net interbank placements abroad by resident banks. Net errors and omissions amounted to -RM9.4 billion during the quarter, or -2.0% of total trade.

Manageable external debt

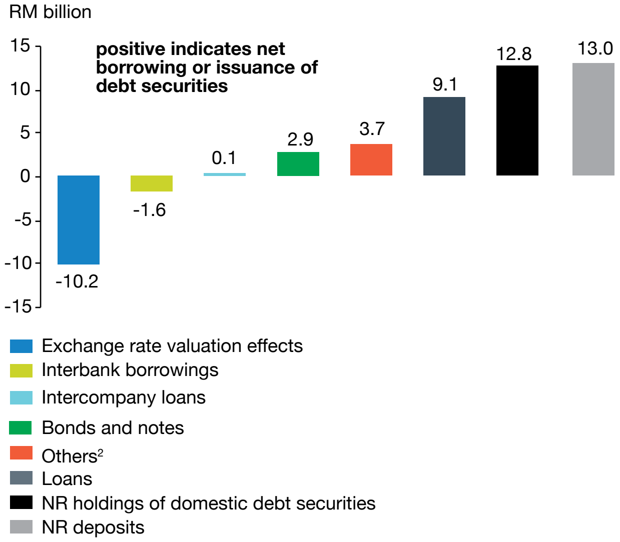
Malaysia's external debt increased to RM946.3 billion, or 62.6% of GDP as at end-December 2019 (end-September 2019: RM916.4 billion or 60.7% of GDP). The higher external debt reflects mainly the increase in non-resident (NR) deposits and purchases of Malaysian Government Securities, and higher external borrowings by resident corporations. This was partially offset by valuation effects following the stronger ringgit against selected major and regional foreign currencies during the period.

The country's external debt remains manageable, given its currency and maturity profiles. Close to one-third of external debt was denominated in ringgit (32.8%; end-September 2019: 32.0%), mainly in NR holdings of domestic debt securities (64.8% share of ringgit-denominated external debt) and NR ringgit deposits (17.9% share) in domestic banking institutions. These liabilities are not subject to valuation changes that may arise from fluctuations in the ringgit exchange rate.

The remaining external debt (RM635.9 billion or 67.2% of total external debt) was denominated in foreign currency (FCY). The corporate sector accounted for close to half of FCY-denominated external debt and are largely subject to prudential and hedging requirements so that such borrowings do not pose a material macroeconomic risk. Long-term bonds and notes issued offshore, accounting for 24.5% of total FCY-denominated external debt, stood at RM155.5 billion as at end-December 2019. These were mainly by non-financial corporations and channelled primarily to finance asset acquisitions abroad. Intercompany loans, amounting to RM89.8 billion or 14.1% of FCY-denominated external debt, are typically on flexible and concessionary terms.

Higher external debt in 4Q 2019

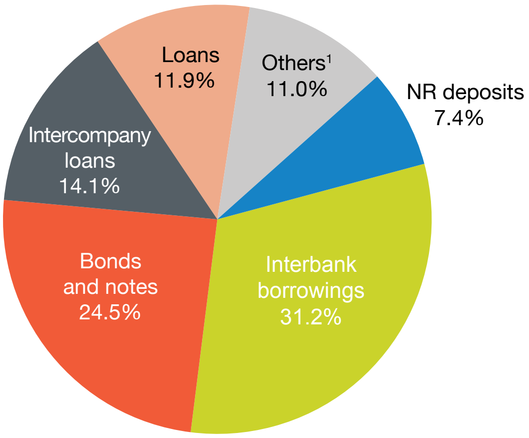
Chart 17: Changes in External Debt
Net change[1]: +RM29.9 billion



[1] Changes in individual debt instruments exclude exchange rate valuation effects
[2] Comprises trade credits, IMF allocation of SDRs and other debt liabilities
Note: NR refers to non-residents
Figures may not add up due to rounding
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

FCY-denominated debt subject to prudent liquidity management practices and hedging requirements

Chart 18: Breakdown of Foreign Currency-Denominated External Debt (% share)



[1]Includes trade credits and miscellaneous, such as insurance claims yet to be disbursed and interest payables on bonds and notes

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Interbank borrowings and FCY deposits in the domestic banking system accounted for 38.6% (or RM245.3 billion) of FCY-denominated external debt. About three quarters of the interbank borrowings were in the form of largely stable intragroup borrowings, including from parent banks, regional offices and subsidiaries. This reflects banks' centralised liquidity and funding management practices. Foreign-currency risk, measured in terms of the net open position of FCY-denominated exposures[2], remained low at 4.4% of banks' total capital.

From a maturity perspective, 58.6% of the total external debt was skewed to medium- to long-term tenure (end-September 2019: 57.0%), suggesting limited rollover risks. Short-term external debt accounted for the remaining 41.4% of external debt. Close to half of the short-term external debt were intragroup borrowings among banks and corporations, which are generally stable and on concessionary terms, while another 12.2% were accounted by trade credits, largely backed by export earnings. As at 31 January 2020, international reserves stood at USD104.2 billion, sufficient to finance 7.5 months of retained imports, and is 1.1 times the short-term external debt.

[2] Refers to the aggregated sum of the net short or long foreign currency positions for all currencies across banks.