1 Box Article

Profile of Malaysia’s External Debt

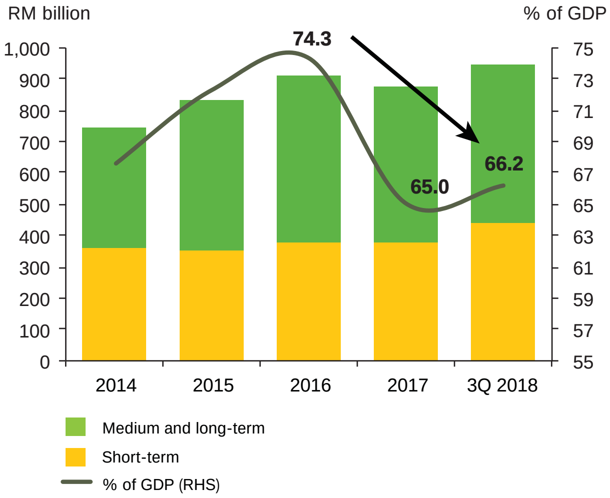
Author: Ahmad Faisal Rozimi, CFA

HIGHLIGHTS

- Malaysia’s total external debt has declined to 66.2% of GDP as at end-3Q 2018 from a peak of 74.3% of GDP as at end-2016. The bulk of the external debt is by corporations and banks.
- Foreign currency-denominated external debt stood at 46.0% of GDP as at end-3Q 2018, compared to the highest level of 60.0% of GDP during the 1997 Asian Financial Crisis. Of note, Government’s foreign-currency denominated external debt is very low (1.2% of GDP).
- While risks surrounding external financing conditions have increased, risks to Malaysia’s external debt, including short-term external debt, remain manageable. This is anchored by a favourable external debt profile and borrowers’ resilient repayment capacity.
- Reflecting the progressive liberalisation of Malaysia’s foreign exchange administration rules and the decentralisation of international reserves, Malaysian entities have accumulated significant external assets abroad.
  - Of significance, Malaysia’s non-reserve external assets have doubled from RM622 billion as at end-2010 to RM1.3 trillion as at end-3Q 2018. Domestic corporations and banks now hold about three-quarters of Malaysia’s RM1.7 trillion external assets.
  - This accumulation has contributed to Malaysia having a net foreign currency asset position. This provides a defence against sharp exchange rate depreciation.
  - Crucially, these assets can be drawn upon to meet borrowers’ external debt obligations without creating a claim on Bank Negara Malaysia’s international reserves.

External debt has declined after peaking at 74.3% of GDP at end-2016. More than half of external debt is skewed towards medium to long-term tenure, limiting rollover risk

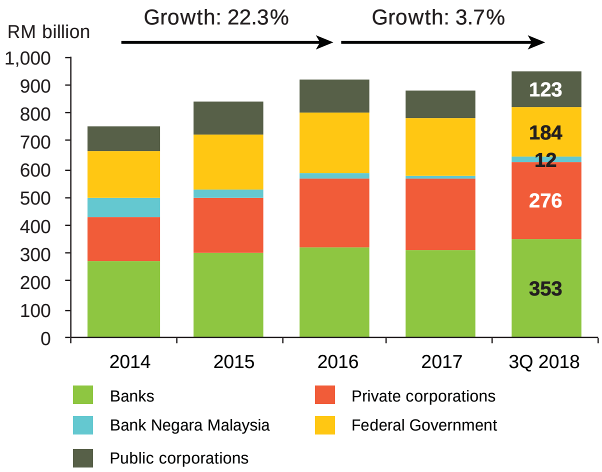
Chart 1: External Debt by Maturity (RM billion)



Source: Bank Negara Malaysia

External debt growth has slowed substantially since 2016

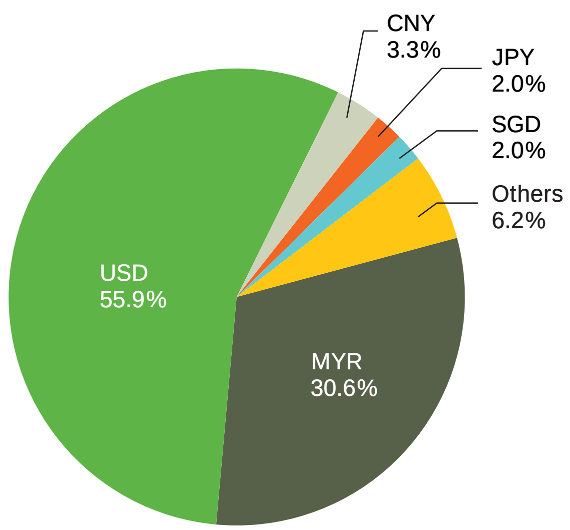
Chart 2: External Debt by Institution (RM billion)



Source: Bank Negara Malaysia

About a third of external debt is denominated in ringgit, lowering the exposure to currency fluctuations

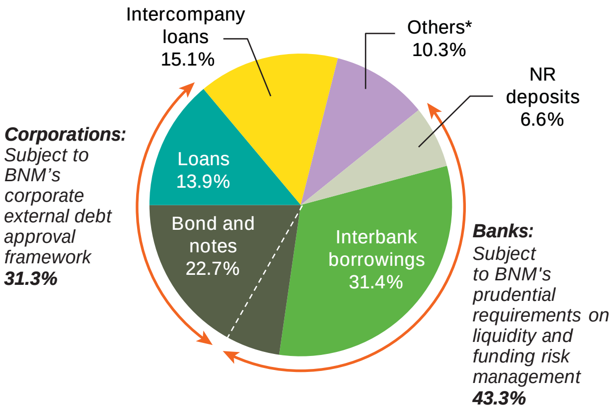
Chart 3: External Debt by Currency (% share)



Source: Bank Negara Malaysia

Foreign currency-denominated external debt stood at 46% of GDP, of which about three quarters are subject to BNM's prudential requirements and approval framework[1]

Chart 4: Breakdown of Foreign Currency-denominated External Debt (% share)



[1] Banks' exposure (43.3% share of foreign currency-denominated external debt) in the form of interbank borrowings, NR deposits and debt issuances are subject to prudential requirements on liquidity and funding risk management while corporations (31.3% share of foreign currency-denominated external debt) are subject to an approval framework to ascertain that external borrowings are utilised for productive purposes and that they are supported by foreign currency earnings or sufficiently hedged.

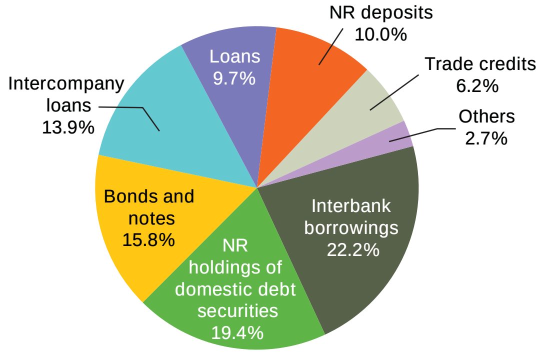
* Includes trade credits and miscellaneous, such as insurance claims yet to be disbursed and interest payables on bonds and notes.

Note: NR refers to non-residents

Source: Bank Negara Malaysia

Banks' external debt and corporates' foreign currency borrowings are subject to BNM's prudential and external debt approval framework, respectively while intercompany loans are typically on flexible and concessionary terms

Chart 5: External Debt by Instruments



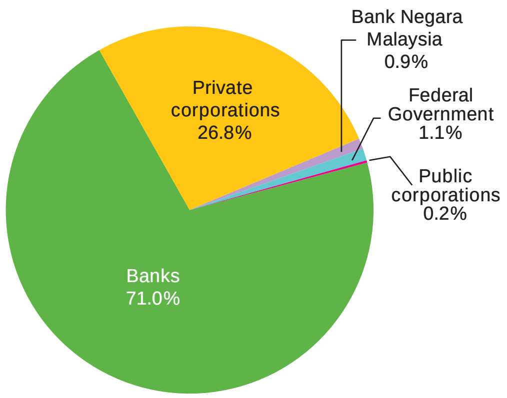
Key Characteristics of External Debt

1. **Interbank borrowings and NR deposits (32% share)**
   - ☑ Subject to prudent liquidity management including limits on funding and maturity mismatches
2. **Intercompany loans (14% share)**
   - ☑ Flexible and on concessionary terms
3. **Trade credits (6% share)**
   - ☑ Backed by export earnings which serve as a natural hedging tool against exchange rate shocks
4. **Bonds and notes and medium to long term loans (22% share)**
   - ☑ Mainly for investment abroad that will raise future foreign-currency income which enhances repayment capacity and hedges against exchange rate fluctuations

Source: Bank Negara Malaysia

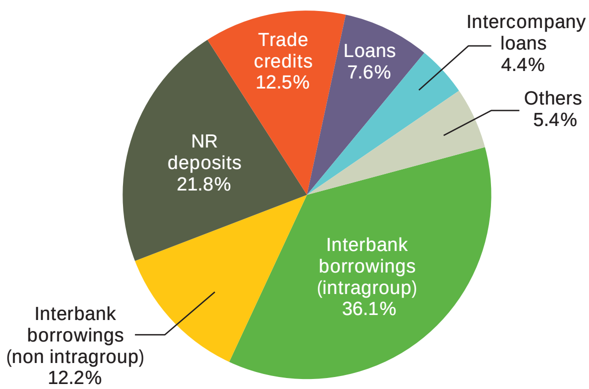
About 70% of short-term external debt is held by banking institutions, reflecting primarily sizeable presence of foreign banks in the domestic economy and strong regional footprint of Malaysian banks

Chart 6: Short-term External Debt by Institution (% share)



Source: Bank Negara Malaysia

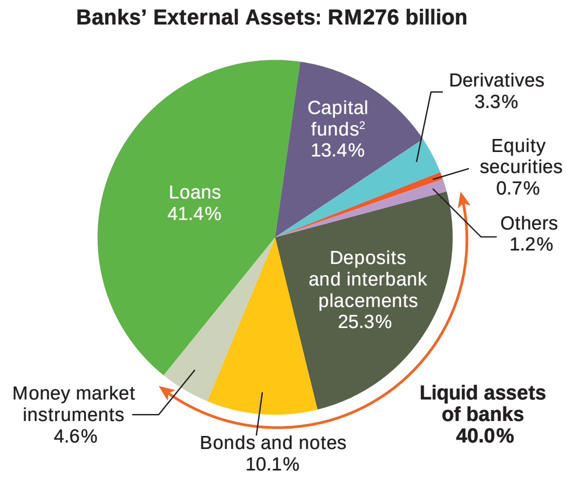
Chart 7: Short-term External Debt by Instrument (% share)



Source: Bank Negara Malaysia

Banking institutions hold substantial external assets, including liquid instruments which can be drawn upon to meet their external debt obligations

Chart 8: Banks' External Assets (% share)

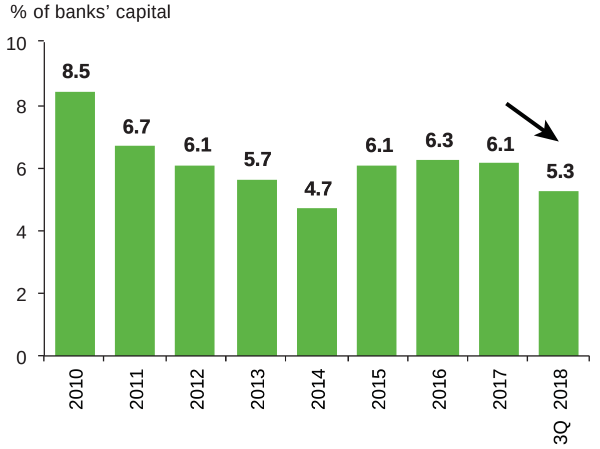


[2] Consist of equity investments and retained earnings held in subsidiaries and branches abroad. This is attributable to domestic banking groups which have a strong regional presence.

Source: Bank Negara Malaysia

Banks' net foreign currency open position remains small relative to banks' total capital

Chart 9: Banks' Net Foreign Currency Open Position[3] (% of banks' capital)

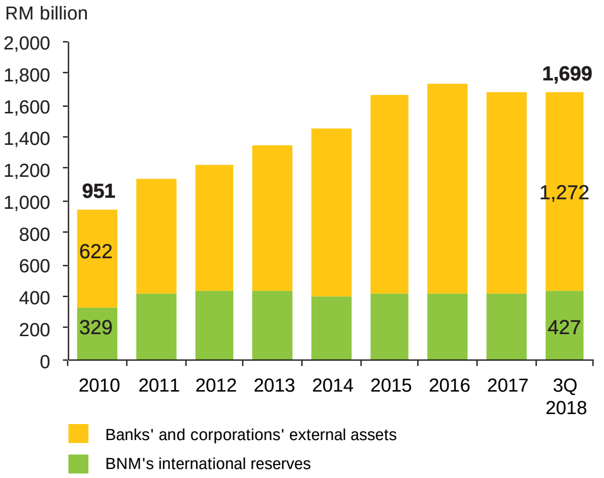


[3] Refers to the aggregated sum of the net short or long foreign currency positions accross all currencies for banks

Source: Bank Negara Malaysia

Malaysia's non-reserve external assets doubled from RM622 billion as at end-2010 to RM1.3 trillion as at end-3Q 2018

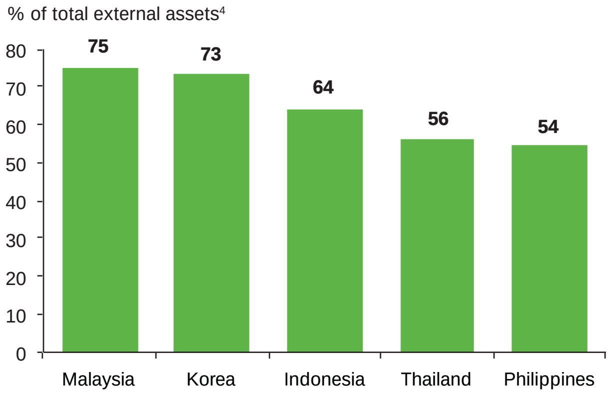
Chart 10: External Assets (RM billion)



Source: Bank Negara Malaysia and Department of Statistics Malaysia

Three quarters of Malaysia's RM1.7 trillion external assets are accounted for by domestic corporations and banks

Chart 11: Share of External Assets excluding Reserves to Total External Assets (% share)

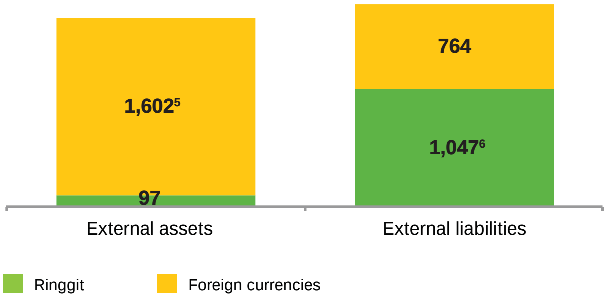


[4] External asset position as at end-3Q 2018 for Malaysia and as at end-2Q 2018 for other countries.

Source: Bank Negara Malaysia and Haver Analytics

Malaysia's foreign currency external assets far exceed its foreign currency external liabilities, thus mitigating the impact of ringgit depreciation i.e. bigger increase in external assets than external liabilities when ringgit depreciates

Chart 12: International Investment Position (IIP) by Currency as at end-3Q 2018 (RM bil)



[5] Includes mainly direct and portfolio investments abroad.
[6] Comprises non-resident holdings of domestic debt securities and placement of deposits in the domestic banking system, as well as holdings of equity securities in the form of foreign direct and portfolio investments.

Source: Bank Negara Malaysia and Department of Statistics Malaysia

Excluding international reserves, Malaysia has a small net foreign currency external debt liability position[7]. This further underscores that servicing the external debt obligations will not create a claim on the international reserves

Table 1: Malaysia's Net Foreign Currency External Debt Position (excluding international reserves)

	Foreign-Currency External Debt		
	Assets	Liabilities	Net
	(RM billion)		
Deposit placements	74.4	43.5	30.9
Bond and notes	91.3	149.3	-58.0
Interbank lending/borrowings	62.5	206.9	-144.4
Intercompany loans	214.5	99.0	115.5
Trade credits	77.9	53.8	24.1
Loans	107.1	91.5	15.6
NR holdings of domestic debt securities	0.0	0.0	0.0
Others	13.6	13.7	-0.1
Total	**641.4**	**657.9**	**-16.5**
% of GDP	***44.8***	***46.0***	***-1.2***

[7] The difference between Malaysia's foreign currency-denominated external debt liabilities (liability side, i.e. borrowings by Malaysian residents from non-residents) and foreign currency-denominated external debt assets (asset side, i.e. lending from Malaysian residents to non-residents).

Source: Bank Negara Malaysia