# ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FOURTH QUARTER OF 2014

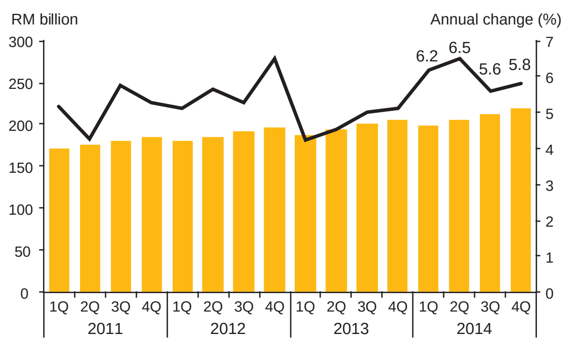
## OVERVIEW

### The Malaysian economy registered higher growth in the fourth quarter of 2014

Global economic activity continued to expand at a moderate pace in the fourth quarter of 2014. Nevertheless, the growth has remained uneven across economies. While the US economy continued to show broader signs of improvement, economic activity in the euro area and Japan remained subdued. In Asia, growth has been driven by domestic demand and exports. Lower inflation was recorded in most economies with the decline in energy prices reinforcing this trend.

The Malaysian economy registered a higher growth of 5.8% in the fourth quarter of 2014 (3Q 2014: 5.6%), driven mainly by stronger private sector spending. On the supply side, growth was sustained by the major economic sectors, supported by trade and domestic activities. On a quarter-on-quarter seasonally-adjusted basis, growth momentum increased to 2.0% (3Q 2014: 0.9%). For the year 2014, the Malaysian economy grew by 6.0%.

**The economy registered higher growth in the fourth quarter**
(at constant 2005 prices)




Source: Department of Statistics, Malaysia

Domestic demand remained the anchor of growth in the fourth quarter, mainly on account of the improvement in private sector activity. Private investment expanded at a faster pace of 11.2% (3Q 2014: 6.8%), driven by capital spending in the manufacturing and services sectors. Private consumption registered a stronger growth of 7.8% (3Q 2014: 6.7%), supported by stable labour market conditions and continued wage growth. Public consumption expanded at a more moderate pace of 2.7% in the fourth quarter (3Q 2014: 5.3%), due to slower growth in both emoluments and supplies and services. Public investment, however, continued to decline, albeit at a slower pace of 2.1% (3Q 2014: -8.9%), following a smaller contraction in spending on fixed assets by the Federal Government.

On the supply side, growth in the fourth quarter was supported by major economic sectors. Growth in the services sector was underpinned by expansion across all sub-sectors. The construction sector remained strong, driven mainly by non-residential and residential sub-sectors, while the mining sector registered a stronger growth due to higher crude oil production. The manufacturing sector continued to expand, supported mainly by the export-oriented industries. However, the agriculture sector recorded a contraction due to lower palm oil production caused by the floods in the eastern states of Peninsular Malaysia.

The inflation rate, as measured by the annual change in the Consumer Price Index (CPI), averaged lower at 2.8% in the fourth quarter (3Q 2014: 3.0%). This decline was mainly attributed to the lower inflation in the *food and non-alcoholic beverages* category (2.7%; 3Q 2014: 3.2%), reflecting the decline in the prices of fresh meat and fresh seafood during the quarter. For the year as a whole, inflation averaged 3.2% (2013: 2.1%).

The trade surplus was higher at RM21.5 billion (3Q 2014: RM16.8 billion). Gross exports moderated to 0.5% (3Q 2014: 1.5%), due mainly to a decline in commodity exports amid a more moderate expansion of manufactured exports. Gross imports grew at a faster pace of 4.6% in the fourth quarter (3Q 2014: 2.6%).

The international reserves of BNM amounted to RM405.5 billion (equivalent to USD116.0 billion) as at 31 December 2014. This reserve level has taken into account the quarterly adjustment for foreign exchange revaluation changes. As at 30 January 2015, the reserves position amounted to RM386.5 billion (equivalent to USD110.6 billion), sufficient to finance 7.9 months of retained imports and is 1.1 times the short-term external debt.

## Interest rates remained stable

On 6 November 2014, the Monetary Policy Committee (MPC) decided to maintain the Overnight Policy Rate (OPR) at 3.25%. Reflecting the unchanged OPR since the September meeting, the average overnight interbank rate was relatively stable during the quarter, moving within a range of 3.04% to 3.27% between 1 October and 31 December 2014. Interbank rates of other short-term maturities (less than 1 month) were also relatively stable. Interbank rates of longer maturities, however, continued to trend higher during the quarter. This reflects the bidding up of interbank rates by banks amid intense competition for stable funding. The competition for stable funding is to comply with the phasing in of the new Basel III regulatory liquidity requirements, amid overall slower growth in deposits due to net external outflows. The average quoted fixed deposit (FD) rates of commercial banks for the tenures 1 to 12 months, remained relatively stable, ranging from 3.08% to 3.31%. The average base lending rate (BLR) of commercial banks remained unchanged at 6.79%, while the average lending rate (ALR) on outstanding loans was stable (5.51%; 3Q 2014: 5.52%). Overall lending rates continue to be below their long-run averages and remain supportive of economic activity.

The monetary aggregates continued to expand in the fourth quarter. M1, or narrow money, increased by RM16 billion during the quarter. On an annual basis, M1 expanded by 5.7% as at end-December (end-September 2014: 6.7%). M3, or broad money, increased by RM49.9 billion on a quarter-on-quarter basis to record an annual growth rate of 7.0% as at end-December (end-September 2014: 5.2%), driven mainly by the continued expansion in credit extended to the private sector by the banking system and higher net claims on the Government. The expansion in broad money, however, was moderated somewhat by the decline in net foreign assets. In the banking system, ample liquidity conditions prevailed at both the institutional and system-wide levels. The level of surplus liquidity placed with BNM remained high at RM270 billion as at end-December despite a reduction during the quarter following the release of liquidity to meet the greater demand for funds amidst external sector outflows.

Total gross financing raised by the private sector through the banking system and the capital market amounted to RM309.8 billion (3Q 2014: RM302.1 billion). On a net basis, outstanding banking system loans and PDS expanded by 8.8% as at end-December (end-September 2014: 8.9%). The growth in outstanding banking system loans to businesses continued to remain healthy with outstanding loans to SMEs increasing further by 13.4% as at end-December (end-September 2014: 12.5%). Household outstanding loans growth continued to moderate to 9.9% as at end-December (end-September 2014: 10.7%) reflecting policy effectiveness, following earlier measures to ensure prudent levels of household debt. Net funds raised in the capital market were higher at RM26.4 billion in the fourth quarter (3Q 2014: RM17.1 billion).

Movements of the ringgit and other regional currencies in the fourth quarter were mainly driven by external developments. Besides growing concerns on the prospects of global growth, regional currencies also faced depreciation pressure due to the strengthening of the US dollar, which was driven by the expectations of interest rate normalisation by the Fed amid the recovery in the US economy. The ringgit, however, depreciated more than other regional currencies, especially in December, following heightened market concerns on the impact of the sharp fall in oil prices on the Malaysian economy, particularly on the Government's fiscal position.

Overall, the ringgit depreciated by 6.4% against the US dollar during the quarter. The ringgit also depreciated against the Australian dollar (-0.1%), the pound sterling (-2.2%), the euro (-2.3%), and all regional currencies. The ringgit, however, appreciated by 2.3% against the Japanese yen.

Between 1 Jan and 10 February 2015, the ringgit depreciated against the US dollar by 2.4%. The ringgit also depreciated against the pound sterling (-0.3%) and Japanese yen (-3.2%), but appreciated against the euro (4.7%) and Australian dollar (2.2%). Against regional currencies, the ringgit broadly depreciated by between 0.1% and 3.3%.

## Domestic financial stability continued to be preserved

The Malaysian financial system remained resilient throughout the quarter against the backdrop of significant decline in oil prices which had impacted the financial market and exchange rate movements. Financial intermediation remained well-supported by sound financial institutions, orderly financial market conditions and sustained confidence in the financial system. The outlook for domestic financial stability is expected to remain positive, albeit in the face of a more challenging operating environment.

The banking system remained well-capitalised with the common equity tier 1 (CET1) capital ratio, tier 1 capital ratio and total capital ratio well above the minimum regulatory levels at 12.6%, 13.3% and 15.2% respectively. The total capital buffer for banks which are in excess of the minimum regulatory capital requirement stood at more than RM90 billion. More than 80% of banks' total capital consists of high quality capital in the form of paid-up capital, retained earnings and reserves. Similarly, the capital adequacy ratio of the insurance sector remained strong at 253% (3Q 2014: 246.9%), with an excess capital buffer of RM30.2 billion.

## Domestic demand will remain as the key driver of growth

Moving forward, the global economy is expected to remain on a moderate growth path, but with increasing divergence in the growth momentum among the major economies. The decline in energy prices is expected to provide some additional support to overall global growth, as higher disposable income and lower inflation will support consumer spending. Nevertheless, there remain considerable downside risks to global economic activity. This includes a prolonged weakness in demand and low inflation or the possibility of deflation in several major economies, uncertainty over monetary policy adjustments in key advanced economies, and rising concerns on the growth prospects of several net commodity-exporting emerging economies amid declining energy prices.

The Malaysian economy is expected to remain on a steady growth path. The gradual recovery in global growth will lend support to manufactured export performance, although overall export growth would likely remain modest amid lower commodity prices. Domestic demand is expected to remain favourable amidst the lower oil prices. Investment activity is projected to remain resilient, with broad-based capital spending by both the private and public sectors cushioning the lower oil and gas-related investment activity. While private consumption is expected to moderate, the steady rise in income and employment, and the additional disposable income from the lower oil prices would support household spending.