BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

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2Q

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

The BNM Quarterly Bulletin presents a quarterly review of Malaysia's economic, monetary and financial developments. It includes the Bank's latest assessments on the direction of the economy going forward. The Bulletin also provides insights on current economic and financial issues, including highlights of policy initiatives undertaken by Bank Negara Malaysia in pursuit of its mandates.

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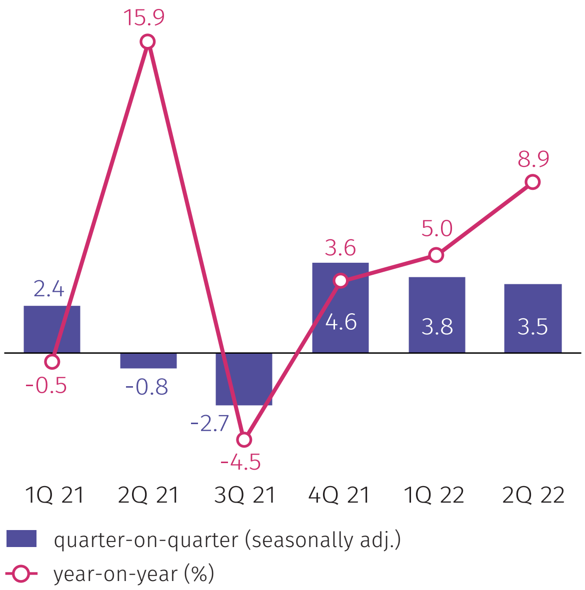
Highlights: 2Q 2022

GDP expanded by 8.9% in 2Q 2022 amid improving domestic demand

Growth lifted by labour market improvements, border reopening and policy assistance

Real Gross Domestic Product



Source: Department of Statistics Malaysia

Selected GDP Components
(Annual change (%)

Demand

+18.3% Private consumption

+6.3% Private investment

+10.4% Exports of Goods and Services

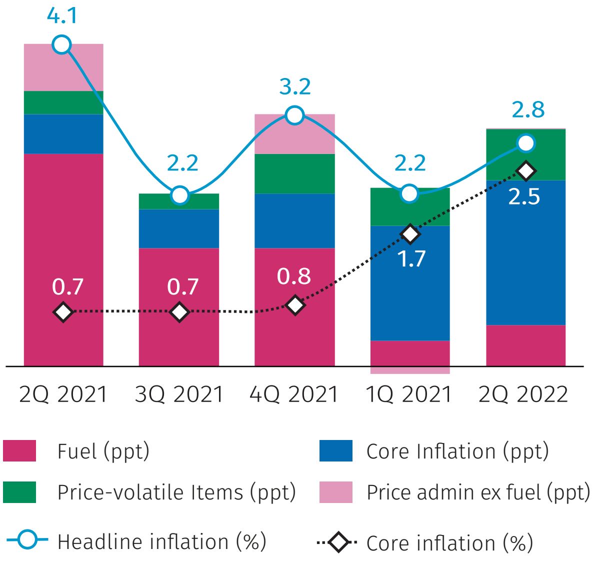
Supply

+12.0% Services

+9.2% Manufacturing

Headline and core inflation increased in 2Q 2022

Annual change (%),
contribution to headline inflation (ppt)



Factors affecting inflation in 2Q 2022

***Core inflation*[1]**
Increase in core inflation *(2Q 22: 2.5%; 1Q 22: 1.7%)* amid the high cost environment and improving demand, with increases predominantly driven by food away from home and other food items

Global factors
High global commodity prices amid ongoing military conflict in Ukraine, adverse weather conditions in key food-exporting countries and the stronger US dollar

[1] Core inflation is computed by excluding price-volatile and price-administered items.

Source: Department of Statistics Malaysia and Bank Negara Malaysia estimates

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International Economic Environment

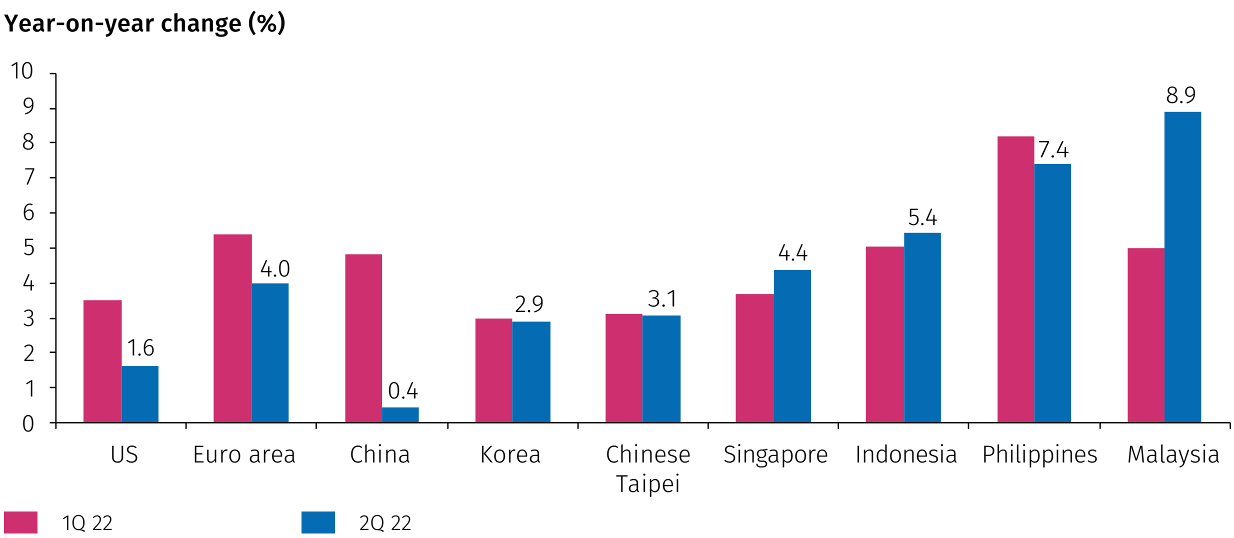
Highlights

- Global growth moderated during the second quarter of 2022.
- Regional exports also moderated but remained fairly strong.
- Global financial market volatility increased.

Moderation in global growth led by major economies

Global growth continued to moderate in the second quarter of 2022 as a result of a slowdown in growth in major economies. However, in several regional economies, the year-on-year growth for the quarter was lifted by base effects from COVID-19 lockdowns during the corresponding period last year. The ongoing military conflict in Ukraine contributed to elevated commodity prices, which led to higher inflation globally. This has weighed on household incomes and consumption. In addition, lockdowns were re-imposed in China, which caused a brief re-escalation in global supply chain disruptions, and moderation in China's economic activity. Beyond China, manufacturing and services activity held up better but continued to moderate further, as high inflation and cost pressures weighed on economic activity. An ongoing shift of demand from goods to services also affected manufacturing activity, while services activity moderated as the effects from pent-up demand following the reopening of the economy begun to fade.

C1 GDP Growth of Selected Economies



Source: National authorities

Growth of the US economy moderated to 1.6% (1Q 2022: 3.5%) during the quarter, as consumption activity continued to slow amid high inflation, which suppressed real wage growth and sentiments. Private investment activity also recorded a moderation during the quarter. The labour market, however, remained tight. Low unemployment and high number of job openings continued to prevail. There were signs though that the tightness may have peaked, amid some recovery in labour supply.

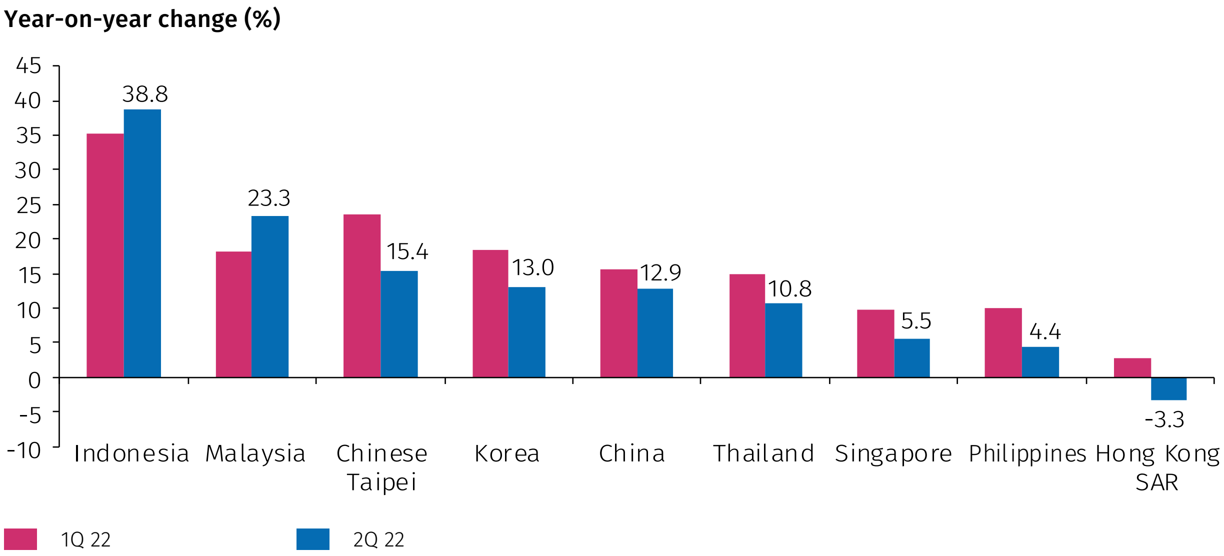
In the euro area, the economy grew at a slower pace of 4.0% (1Q 2022: 5.4%). Services activity partly supported growth, amid a continued rebound stemming from the reopening of the economy. Overall, economic activity continued to slow across the quarter, as high inflation weighed on demand and sentiments.

In China, the economy grew by 0.4% (1Q 2022: 4.8%). The re-imposition of lockdowns amidst COVID-19 outbreaks led to a contraction in economic activity and an increase in unemployment rate early in the quarter. The reopening of the economy later in the quarter and policy support from the government, however, led to a pickup in growth.

Regional export growth moderated from a high level

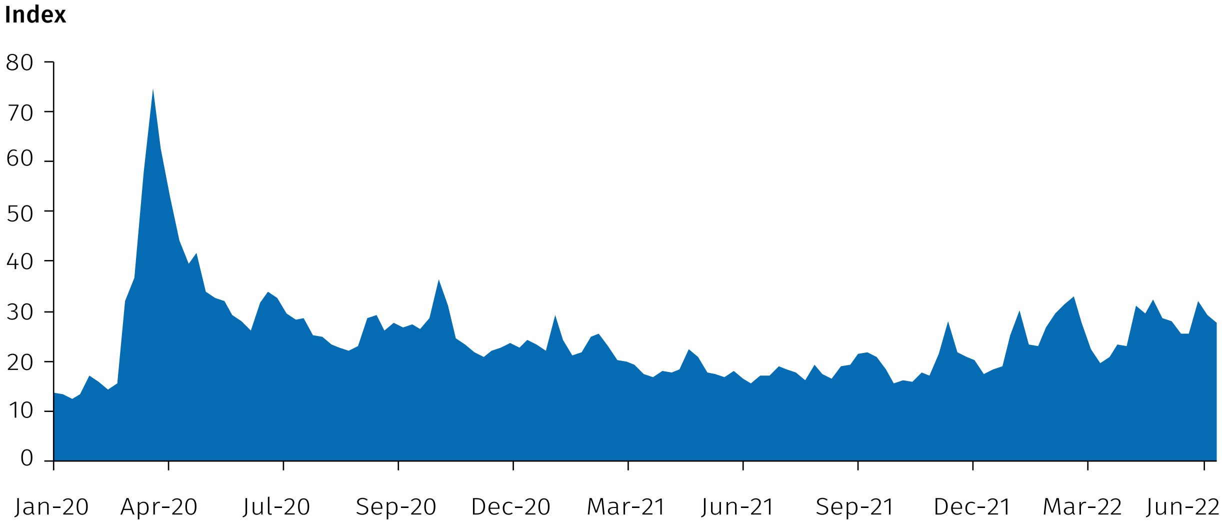
With global demand slowing, regional exports moderated during the quarter. Nevertheless, in most economies, export growth remained strong, owing to the region's focus on electrical and electronics (E&E) products, which continue to experience resilient global demand. Commodity exporters, such as Indonesia and Malaysia, also benefitted from rising commodity prices. On the other hand, lockdowns in China and Hong Kong SAR have weighed on export growth in these economies.

C2 **Export Growth of Selected Economies (in USD terms)**



Source: National authorities

C3 CBOE Volatility Index (VIX)



Source: Bloomberg

Global financial market volatility increased

Global financial market conditions experienced increased volatility during the quarter (CBOE VIX, 2Q 2022: 27.3; 1Q 2022: 25.3). The increased volatility throughout the quarter reflected the uncertainty among investors regarding the pace of US monetary policy tightening. Volatility was particularly high in the run up to the meetings of the US Federal Open Market Committee (FOMC), as well as around the release of US inflation data. In addition, volatility in commodity prices amid elevated geopolitical tensions and continued concerns over the impact of China's COVID-19 policy, further weighed on financial markets globally.

Brent crude oil prices rose sharply to an average of USD112 per barrel during the quarter (1Q 2022 average: USD98 per barrel). Global oil demand continued to recover. Oil prices were also supported by tight global oil supply conditions amid the ongoing military conflict in Ukraine and continued underproduction by some OPEC+ members in meeting their oil output quotas.

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Developments in the Malaysian Economy

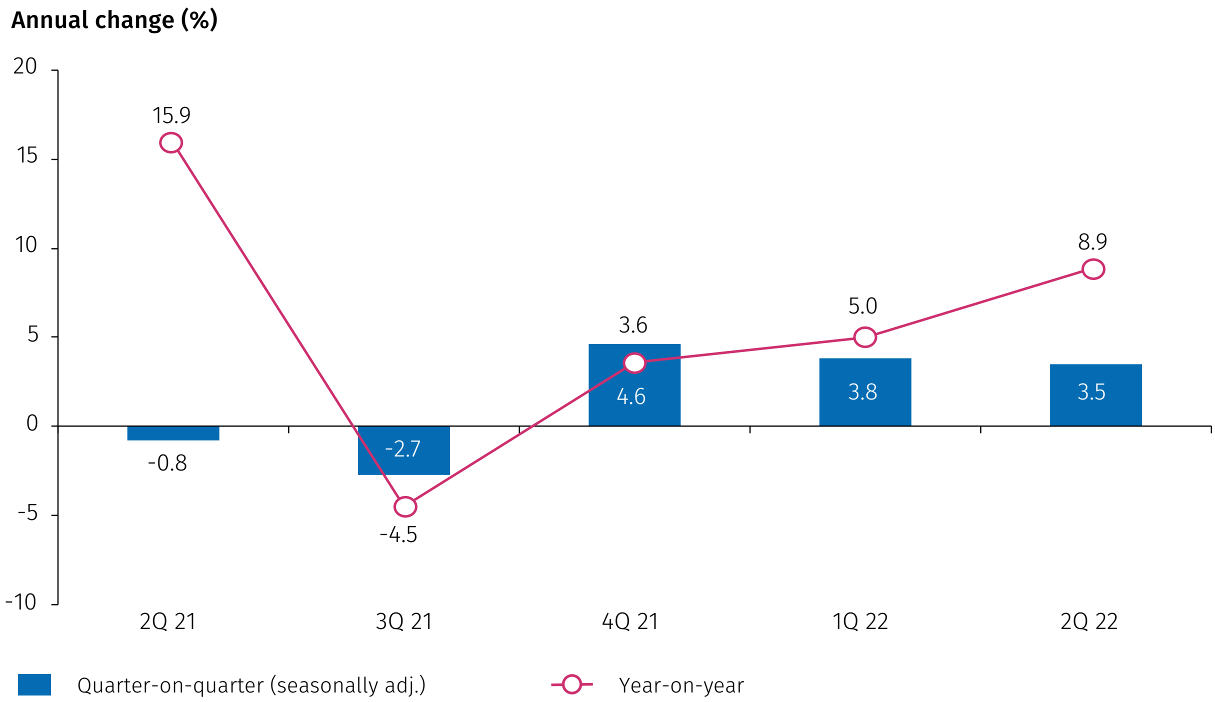
Highlights

- The Malaysian economy recorded an accelerated growth of 8.9% in the second quarter of 2022.
- Headline inflation increased during the quarter.
- Higher current account surplus of RM4.4 billion, or 1.0% of GDP.

GDP continued to expand in the second quarter of 2022

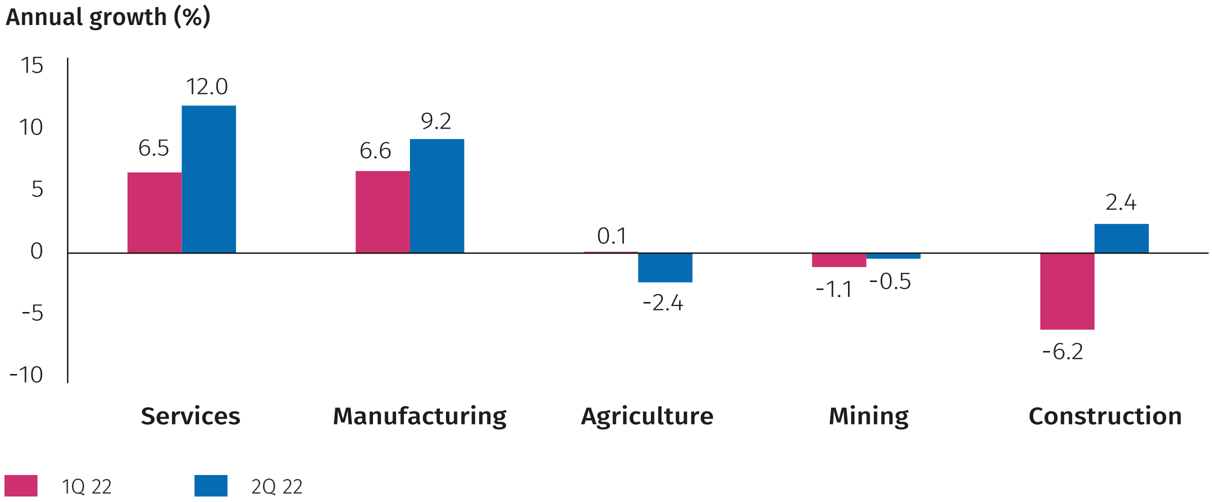
The Malaysian economy registered a strong growth of 8.9% in the second quarter of 2022 (1Q 2022: 5.0%). While growth was lifted to some extent by the low base from the Full Movement Control Order (FMCO) in June 2021, growth in April and May 2022 was particularly robust, underpinned by the continued recovery in labour market conditions and policy support. The improvement also reflected normalising economic activity as the country moved towards endemicity and reopened international borders. Exports remain supported by strong demand for E&E products. In terms of economic activity, the services and manufacturing sectors continued to drive growth. On a quarter-on-quarter seasonally-adjusted basis, the economy increased by 3.5% (1Q 2022: 3.8%).

C4 **Real GDP Growth**



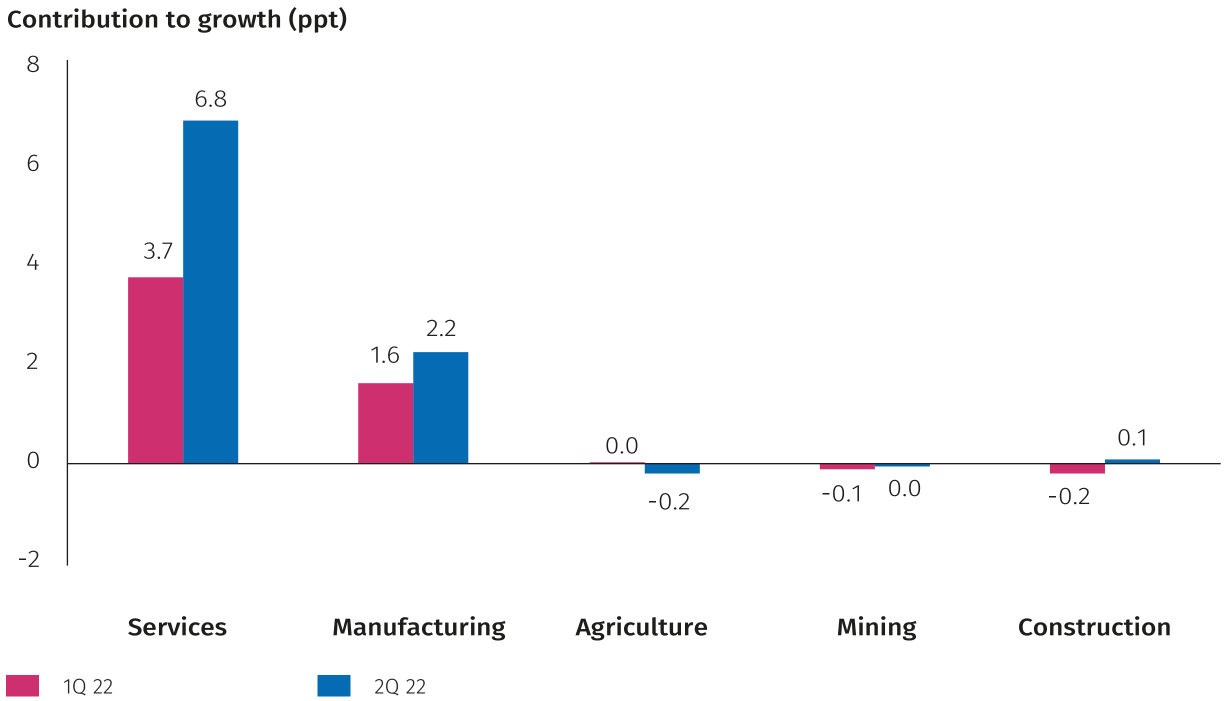
Source: Department of Statistics, Malaysia

C5 Annual Growth of Economic Sectors



Source: Department of Statistics, Malaysia

C6 Contributions of Economic Sectors to Real GDP Growth



Source: Department of Statistics, Malaysia

Continued expansion in key economic sectors

Key economic sectors continued to expand in the second quarter of 2022. The services sector grew by 12.0% (1Q 2022: 6.5%). Consumer-related subsectors such as retail and leisure-related activities continued to recover amid the transition to endemicity, reopening of the international borders, improving labour market conditions and the additional support from policy assistance. The strong expansion was also seen in business-related activities including transport and storage, due in part to higher growth in air passenger traffic and tourist arrivals. Furthermore, growth of the real estate subsector continued to improve as property transactions recovered. Additionally, the information and communication subsector provided further support to growth following greater usage of e-commerce services.

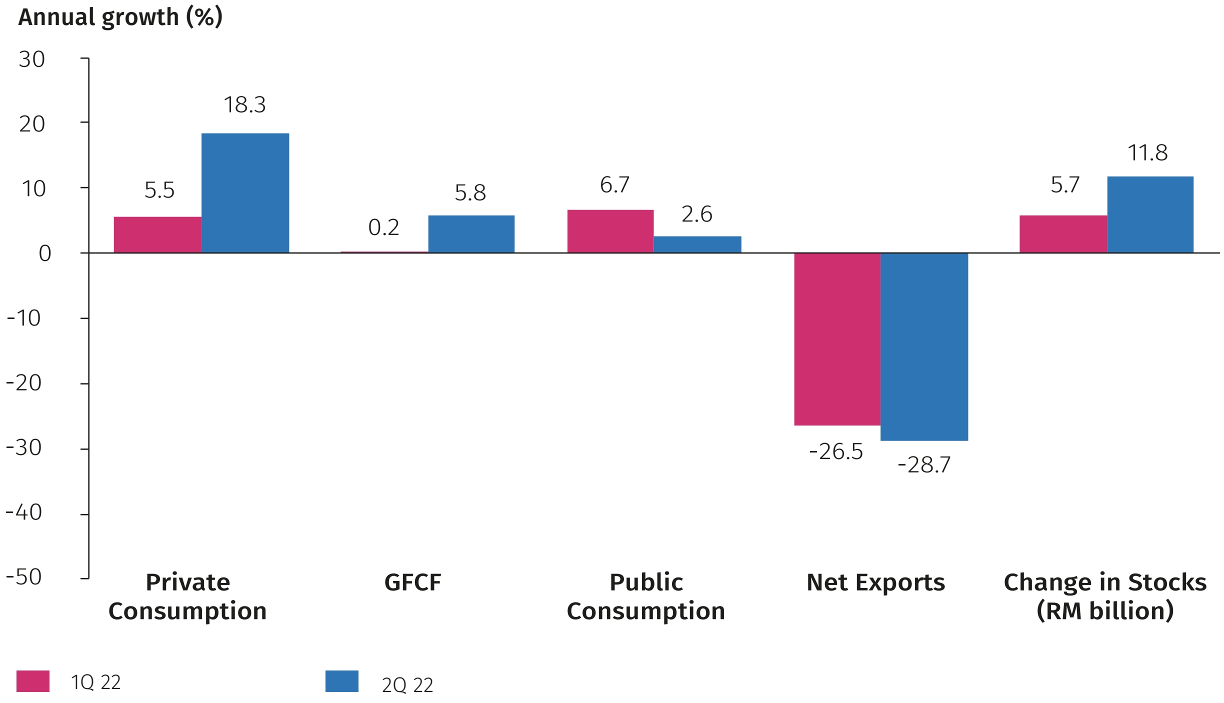
The manufacturing sector expanded by 9.2% (1Q 2022: 6.6%), supported by both the export- and domestic-oriented industries. The effect of global supply disruptions was partly mitigated, as manufacturers were able to implement proactive measures to cushion the impact such as building inventory buffers through advance bookings and using alternative modes of transportation. The E&E cluster continued to record double-digit growth driven by global demand for semiconductors. The consumer cluster grew at a faster pace, supported by strong domestic spending activities. In particular, the motor vehicle and transport equipment segment ramped up production to meet order backlogs and fulfil demand as orders accelerated ahead of the expiration of Sales and Services Tax (SST) exemption on 30 June 2022. However, growth in the primary-related cluster moderated as the production of selected pandemic-induced products such as rubber gloves continued to normalise.

The construction sector grew by 2.4% (1Q 2022: -6.2%), its first positive growth since 2Q 2021. Large commercial and industrial projects as well as small-scale projects continued to support activity in the non-residential and special trade subsectors. Meanwhile, the slower progress in infrastructure projects led to subdued growth in the civil engineering subsector.

The mining sector recorded a smaller contraction of 0.5% (1Q 2022: -1.1%) amid closures of several oil and gas facilities for maintenance during the quarter. Nevertheless, higher production from oil and gas fields such as the Pegaga gas field in Block SK320 located in offshore East Malaysia provided some support to growth.

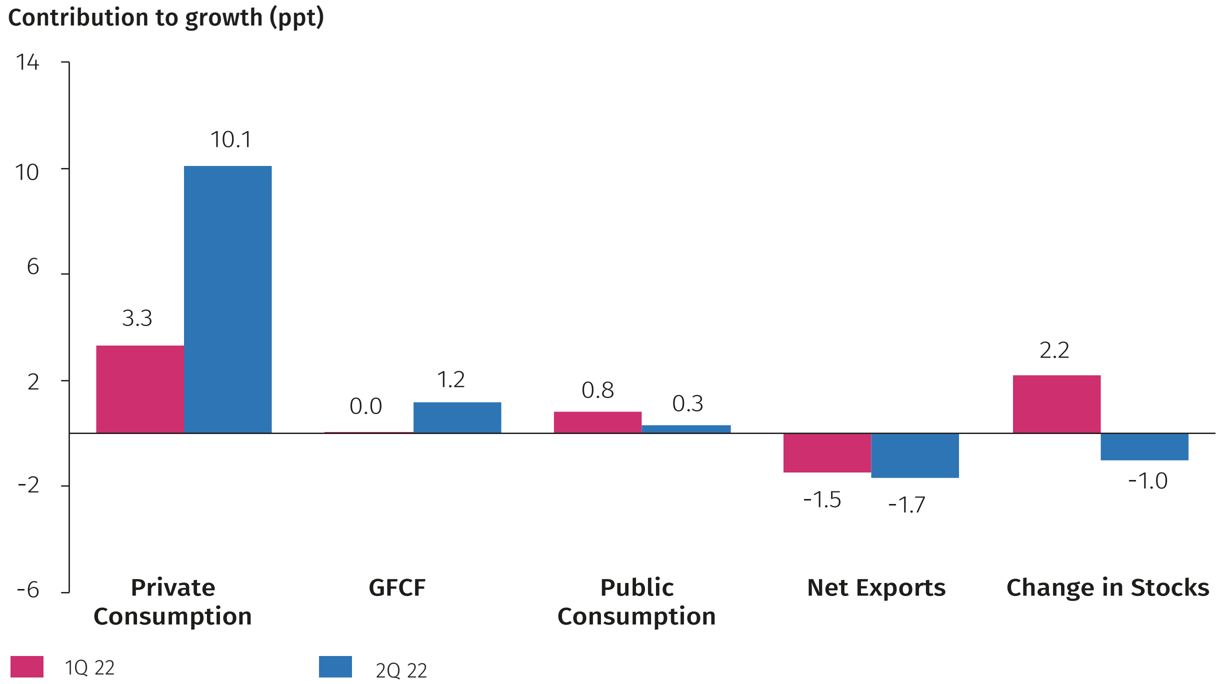
The agriculture sector declined by 2.4% (1Q 2022: 0.1%). During the quarter, production in livestock and other agriculture subsectors were affected by rising input costs particularly for animal feed and fertiliser. Growth was also weighed down by weak oil palm output as harvesting activity was hampered by prevailing labour shortages.

C7 Annual Growth of GDP by Expenditure Components



Source: Department of Statistics, Malaysia

C8 Contributions of Expenditure Components to Real GDP Growth



Source: Department of Statistics, Malaysia

Higher growth in domestic demand

During the quarter, domestic demand registered a higher growth of 13.0% (1Q 2022: 4.4%). This was mainly supported by a robust growth in private expenditure amid further normalisation of economic activity, as well as improving labour market conditions. On the external front, demand for Malaysia's exports, particularly for E&E products, remained strong.

Private consumption grew at a faster pace of 18.3% (1Q 2022: 5.5%), driven by higher spending on necessities and selected discretionary items such as restaurants and hotels, recreational services and household furnishings. The strength in consumer expenditure was primarily driven by the recovery in the labour market. Policy support, including the implementation of minimum wage hike,[1] Bantuan Keluarga Malaysia and an Employees Provident Fund (EPF)-related measure also provided additional lift to consumer spending.

Public consumption expanded at a moderate pace of 2.6% (1Q 2022: 6.7%), weighed down by lower supplies and services spending, reflecting smaller COVID-19 related expenditure.

[1] Increased to RM1,500 and applies to companies with five or more employees effective 1 May 2022.

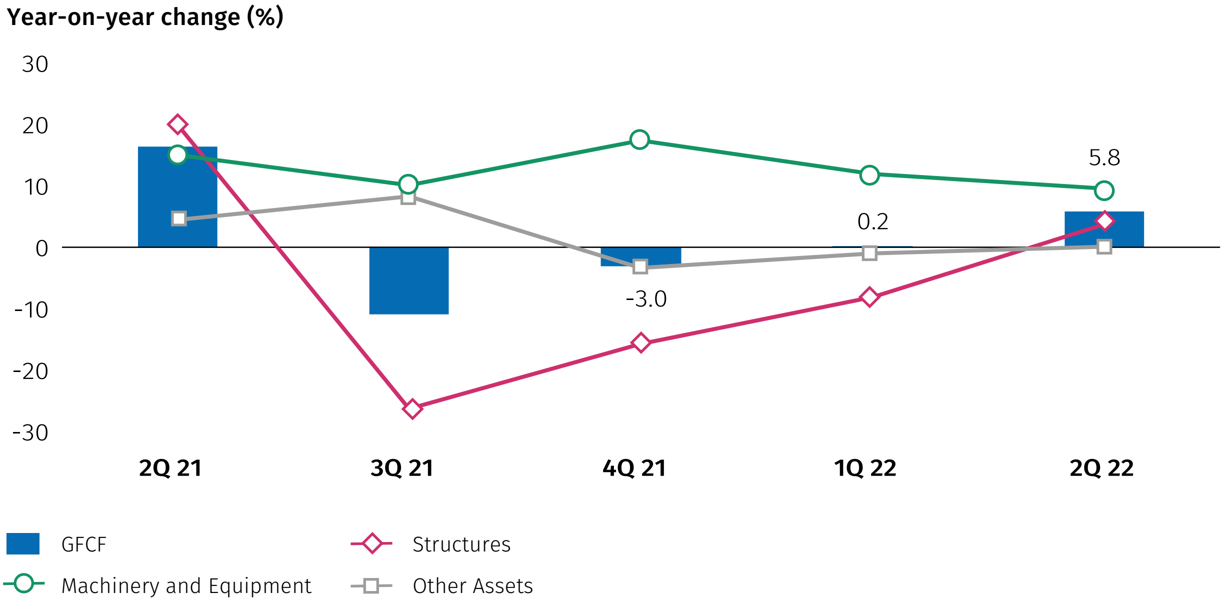
Improvement in investment activity

Gross fixed capital formation (GFCF) registered a higher growth of 5.8% (1Q 2022: 0.2%) as capital spending by both private and public sectors improved. By type of asset, investments in structures and other assets expanded by 3.8% (1Q 2022: -7.9%) and 0.2% (1Q 2022: -0.9%) respectively. Meanwhile, machinery and equipment (M&E) investments grew by 9.6% (1Q 2022: 12.0%).

Private investment expanded by 6.3% (1Q 2022: 0.4%), supported by increased capital spending in the services and manufacturing sectors. Structures investments improved, as businesses across the key sectors resumed investment projects, particularly in the non-residential segment. Furthermore, capital spending in manufacturing and ICT-related machinery and equipment continued to lift investment growth. This is in line with firms' efforts to expand capacity amid continued demand and further adoption of automation and digitalisation.

Public investment registered a growth of 3.2% (1Q 2022: -0.9%), driven mainly by improvement in capital expenditure by public corporations in the oil and gas, and telecommunication sectors.

C9 GFCF Growth by Type of Asset



Source: Department of Statistics, Malaysia

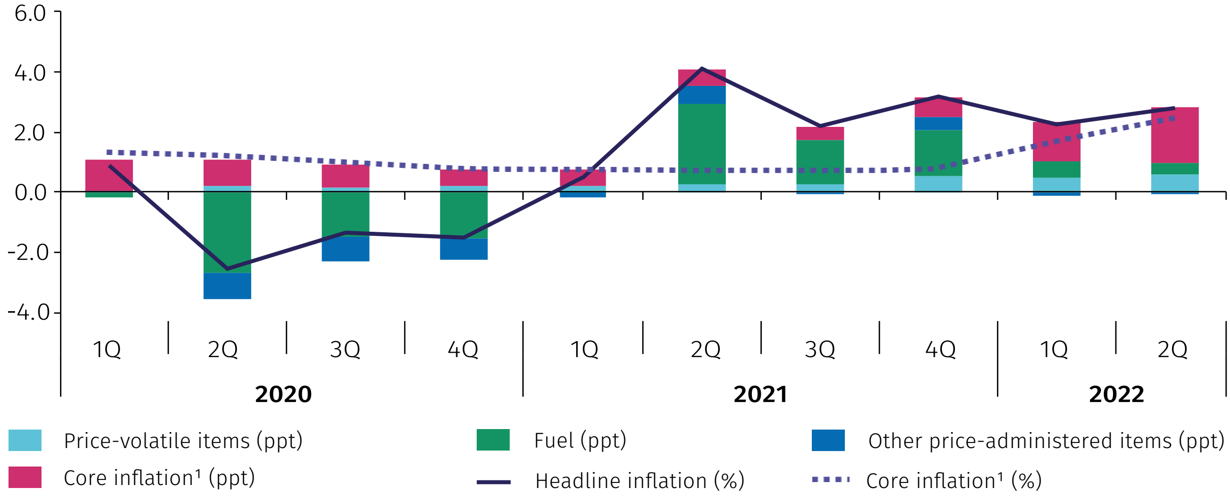
Headline inflation increased during the quarter

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), increased to 2.8% during the quarter (1Q 2022: 2.2%). The increase reflected higher core inflation and higher fuel and price-volatile inflation. Elevated cost pressures amid the ongoing military conflict in Ukraine, adverse weather conditions in key food-exporting countries and the stronger US dollar were all key contributing factors to this.

Core inflation rose to 2.5% (1Q 2022: 1.7%) given the improvement in demand conditions amid the high-cost environment. The increase was predominantly driven by food away from home (2Q 2022: 5.3%; 1Q 2022: 3.6%) and other food items. Some discretionary items (e.g. accommodation services) have also recorded higher inflation. Correspondingly, price pressures continued to be pervasive throughout the quarter. The share of CPI items recording monthly price increases averaged higher at 63.2% (1Q 2022: 57%; 2011-2019 average: 45%).

C10 Contribution to Headline Inflation by Components

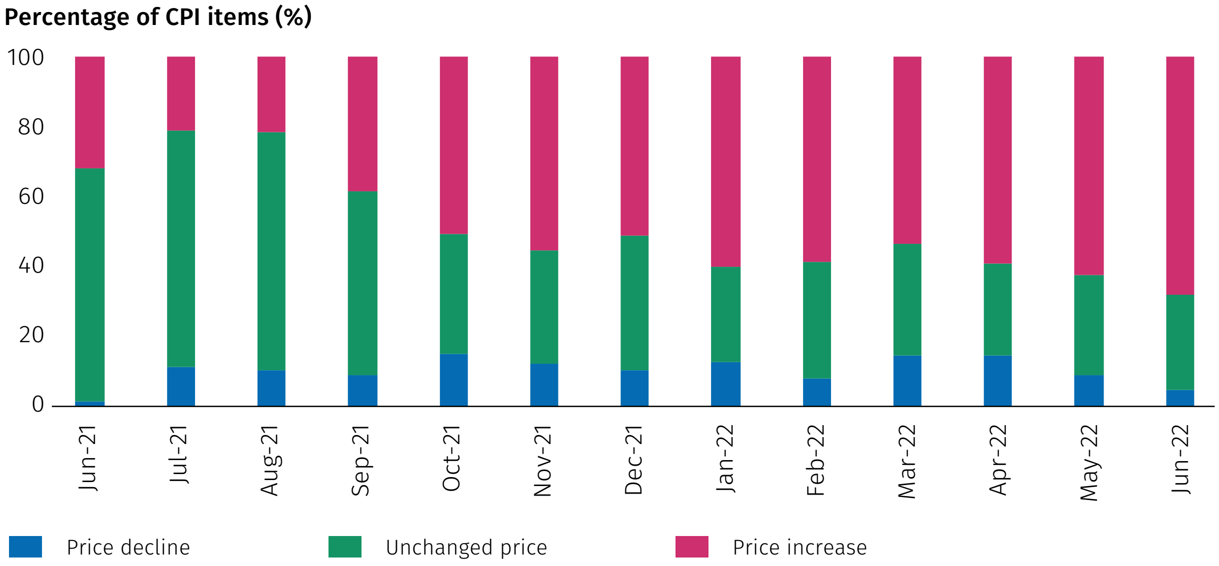
Annual change (%), Contribution to headline inflation (percentage points)



[1] Core inflation is computed by excluding price-volatile and price-administered items.

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

C11 Month-on-Month Price Changes of CPI Items*



* Based on the month-on-month inflation for 125 CPI items at the 4-digit level

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

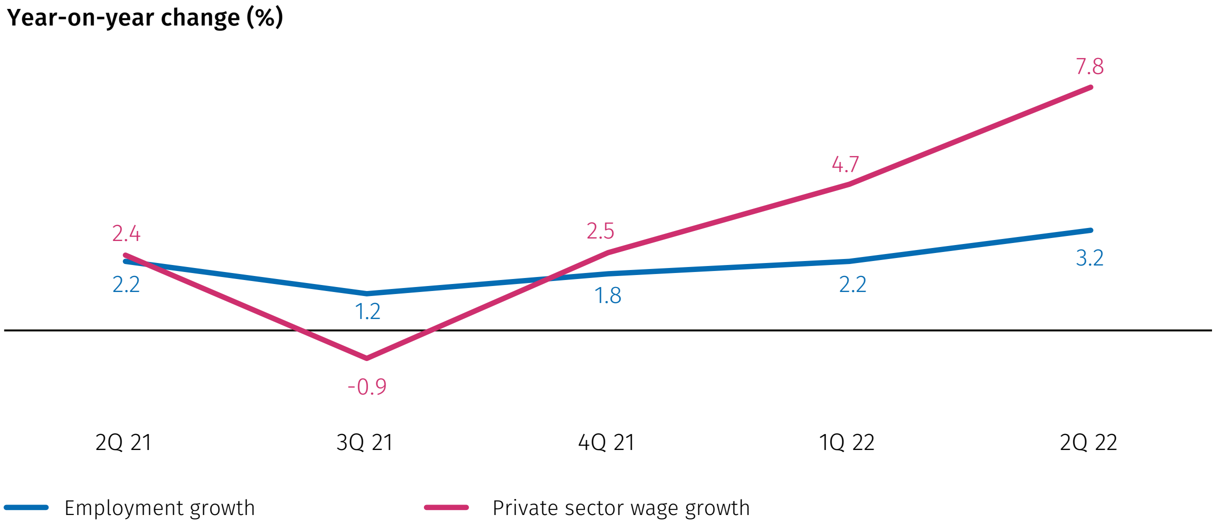
Labour market conditions steadily improved

Labour market conditions continued to improve in the second quarter of 2022. The unemployment rate declined further to 3.9% (1Q 2022: 4.1%). This was driven by a robust increase in employment (+126 thousand persons, 1Q 2022: +134 thousand persons), alongside a continued strong expansion of the labour force (+97 thousand persons, 1Q 2022: +111 thousand persons). As a result, the labour force participation rate increased to 69.2% of the working-age population, above the pre-pandemic level (1Q 2022: 69.0%; 4Q 2019: 69.1%). Meanwhile, the population outside the labour force declined further, to 7.26 million persons (1Q 2022: 7.29 million persons), indicating continued entries of workers into the labour force amid stronger economic activity. The underemployment rate further declined to 1.3% of the labour force (1Q 2022: 1.5%).

Data from the Employment Insurance System (EIS) showed jobless claims also declined during the quarter (7,643 persons; 1Q 2022: 10,433 persons), while the placement rate of employees into new jobs remained strong (46 per 100 people retrenched; 1Q 2022: 41). This suggests a relatively strong pace of hiring amid lower retrenchments in the economy.

Private sector wages improved further in the second quarter of 2022, growing by 7.8% on a year-on-year basis (1Q 2022: 4.7%), and supported in part by the increase in the minimum wage. Wages in the manufacturing sector increased by 5.2% (1Q 2022: 4.1%), driven by broad-based improvements across manufacturing industries, particularly the E&E, non-metallic mineral products, basic metal and fabricated metal products and F&B and tobacco subsectors. Meanwhile, wages in the services sector registered strong growth (9.3%; 1Q 2022: 5.0%), supported by the wholesale and retail, transportation and storage, and information and communication subsectors. On a quarter-on-quarter seasonally-adjusted basis, the momentum in private sector wage growth was sustained at 2.4% (1Q 2.6%).

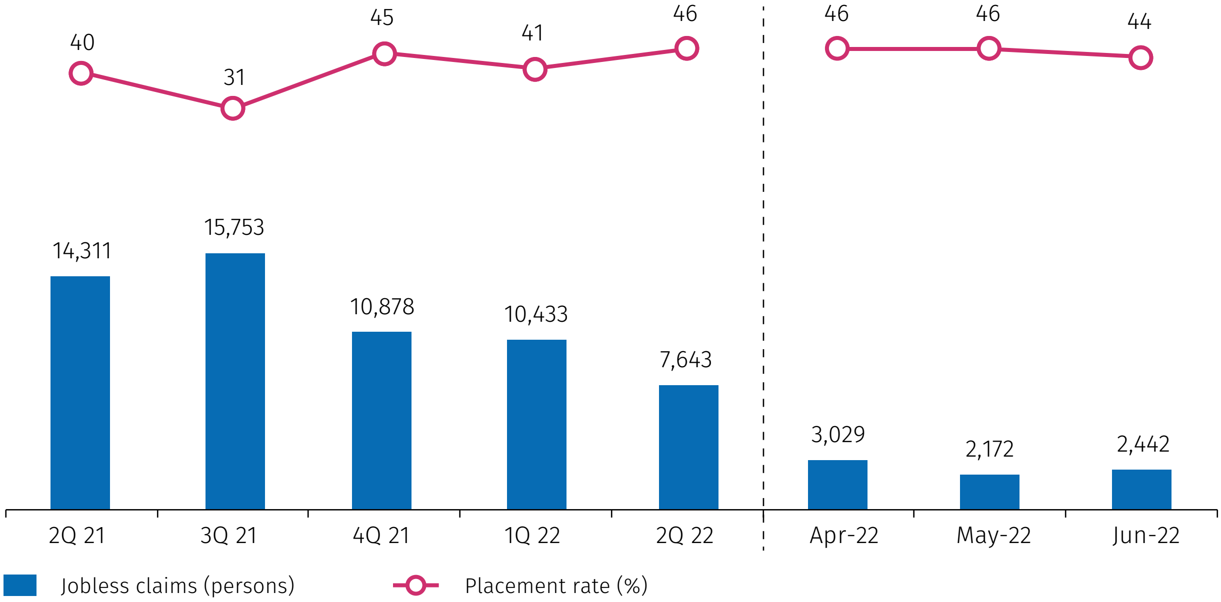
C12 Employment and Wage Growth



Note: Private sector wage growth refers to wage growth of workers in the manufacturing and services sectors

Source: Department of Statistics, Malaysia

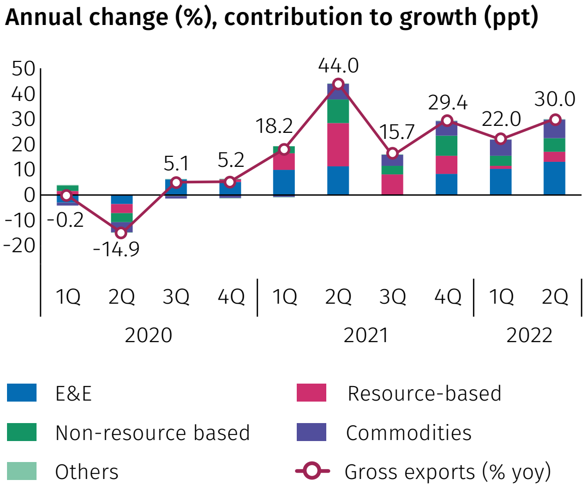
C13 Jobless Claims and Placement Rate

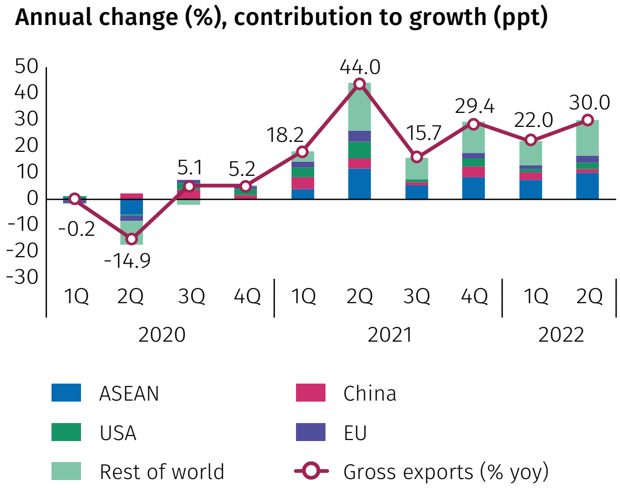


Note: Jobless claims refers to the number of people who apply for the Employment Insurance System (EIS) benefits following loss of employment. The placement rate refers to the number of people placed in new jobs under the EIS for every 100 persons retrenched.

Source: Employment Insurance System, Social Security Organisation

C14 Gross Exports by Product and Market





Source: Department of Statistics, Malaysia

Export performance remained strong

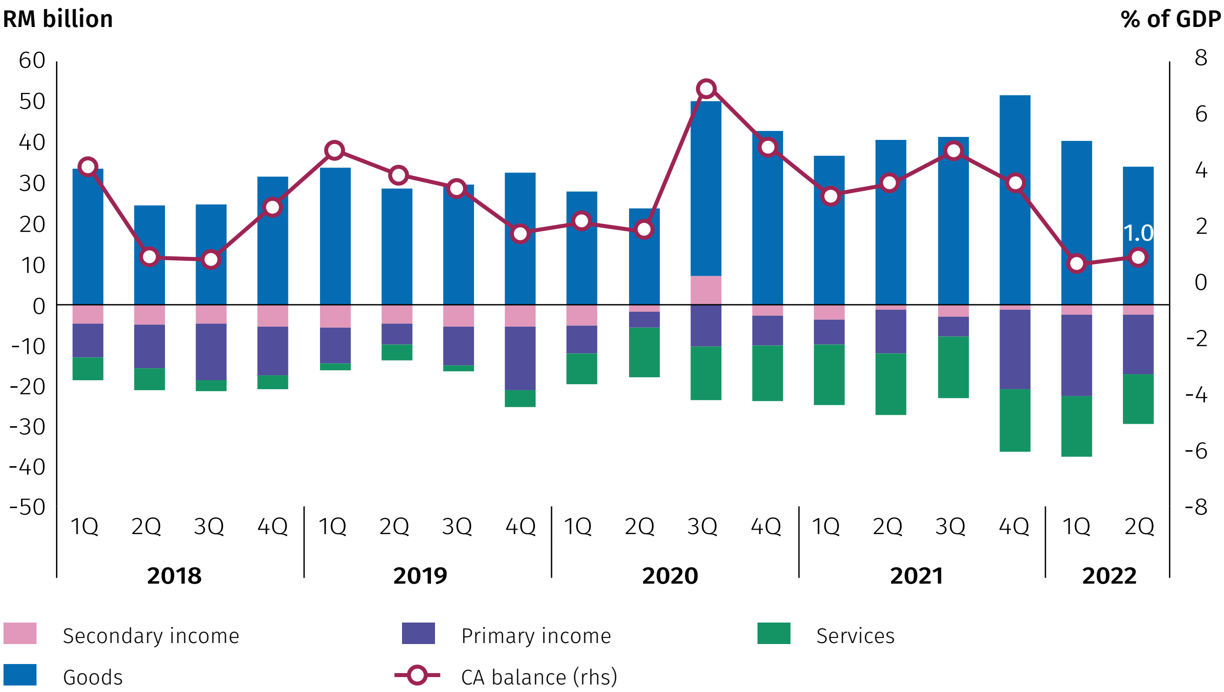
Gross exports increased by 30.0% (1Q 2022: 22.0%), reflecting a broad-based expansion across products, supported by external demand and higher commodity prices. Meanwhile, gross imports grew by 36.1% (1Q 2022: 25.2%), driven by the growth in intermediate imports. The trade surplus[2] narrowed to RM58.1 billion (1Q 2022: RM65.0 billion).

Manufactured exports expanded by 26.0% (1Q 2022: 17.8%), underpinned by stronger E&E exports (37.6%, 1Q 2022: 27.2%). Non-E&E exports registered a growth of 18.2% (1Q 2022: 10.4%), largely attributable to the exports of petroleum products, palm-oil based manufactured products as well as metal manufactures. The growth of commodity exports remained robust at 55.3% (1Q 2022: 51.9%), supported mainly by CPO, LNG and crude oil exports amid higher commodity prices.

Intermediate imports recorded a strong growth of 36.2% (1Q 2022: 29.0%) in tandem with the expansion in manufactured exports. Consumption imports grew by 18.1% (1Q 2022: 24.4%), supported by the strong growth in private consumption. Growth in capital imports, however, moderated to 8.2% (1Q 2022: 17.5%).

[2] The goods and trade surpluses differ because goods for processing, storage and distribution (with no change in ownership) are excluded from the goods account. This is as per the 6th Edition of the Balance of Payments and International Investment Position Manual by the International Monetary Fund (IMF).

C15 Current Account Balance



Source: Department of Statistics, Malaysia

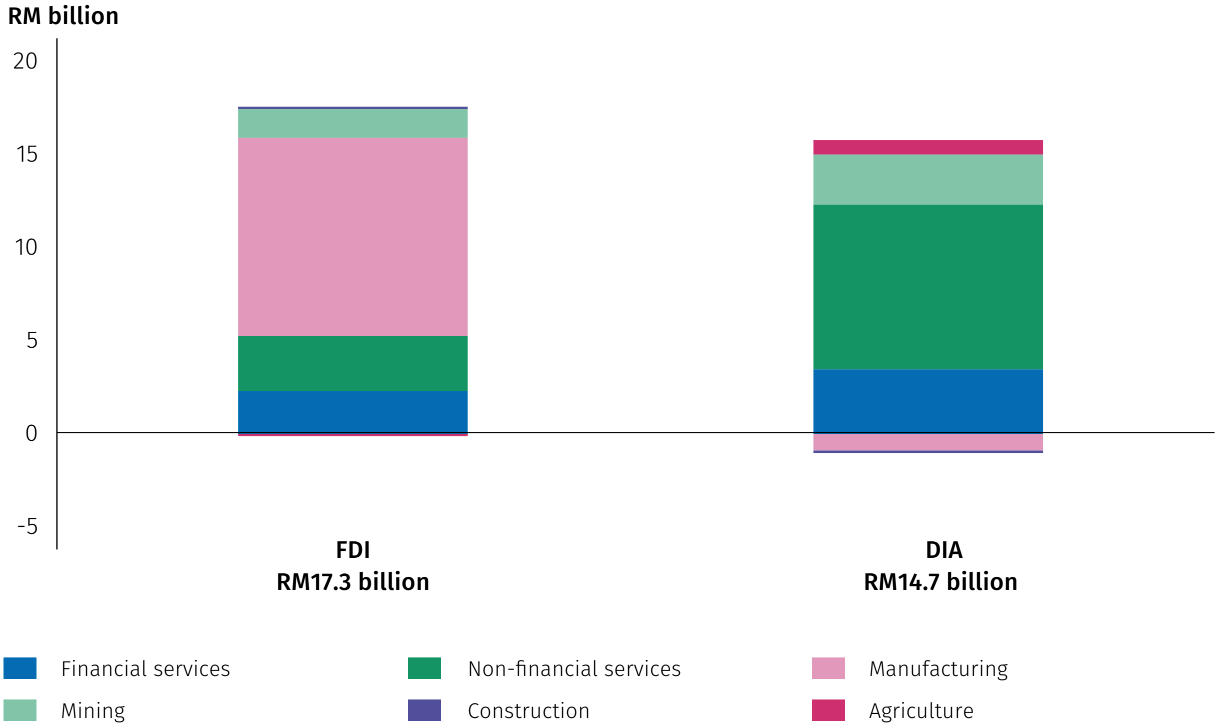
Higher current account surplus

The current account of the balance of payments recorded a higher surplus of RM4.4 billion, or 1.0% of GDP during the quarter (1Q 2022: RM3.0 billion or 0.7% of GDP), supported mainly by smaller primary income and services deficits.

The goods account registered a surplus of RM34.0 billion (1Q 2022: RM40.5 billion) as the increase in imports outpaced that of exports amid firms' mitigation measures to build up inventory buffers. The services deficit narrowed to RM12.3 billion (1Q 2022: -RM15.0 billion) supported mainly by higher travel receipts amid reopening of international borders.

The primary income account recorded a smaller deficit of RM14.7 billion (1Q 2022: -RM20.1 billion), due mainly to higher income generated by Malaysian firms investing abroad. The deficit in the secondary income remained broadly sustained at RM2.6 billion (1Q 2022: -RM2.5 billion) amid continued outward remittances by foreign workers.

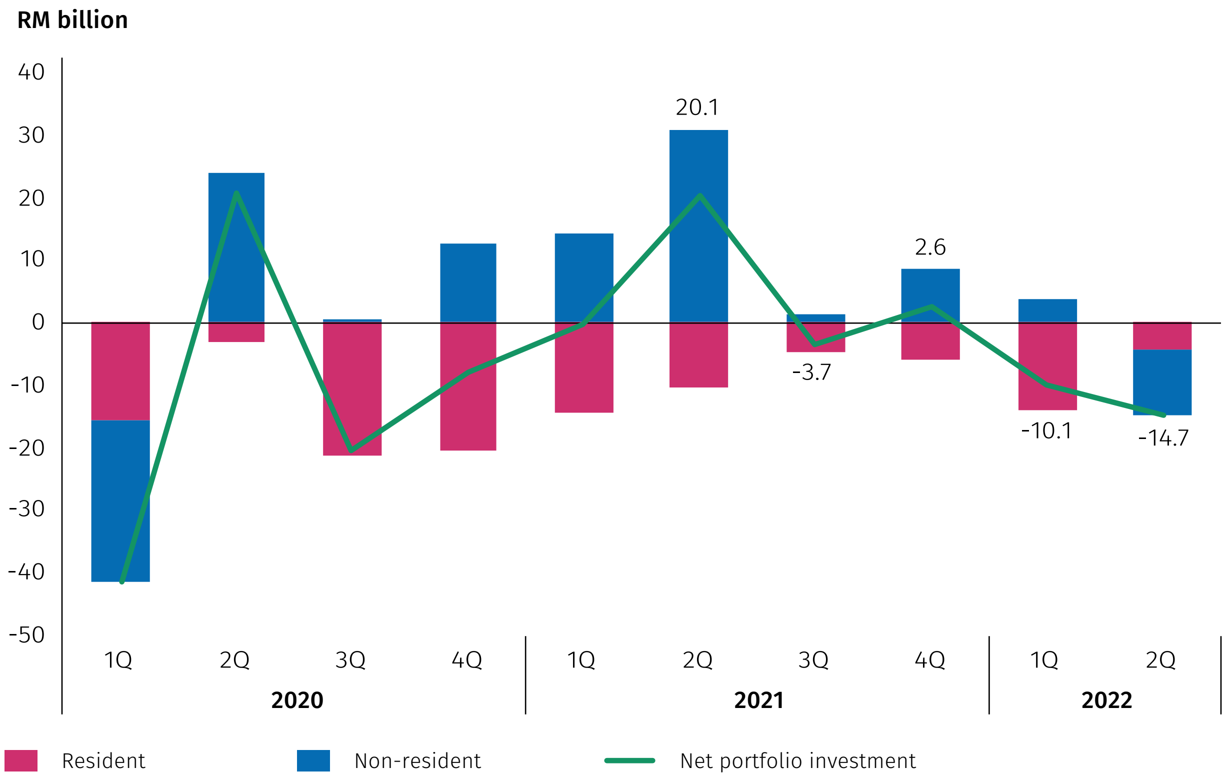
C16 Direct Investment by Sector



Note: For DIA, positive values refer to net outfows, while negative values refer to net inflows.
Figures may not sum due to rounding.

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

C17 Portfolio Investment



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Financial account recorded lower net inflows

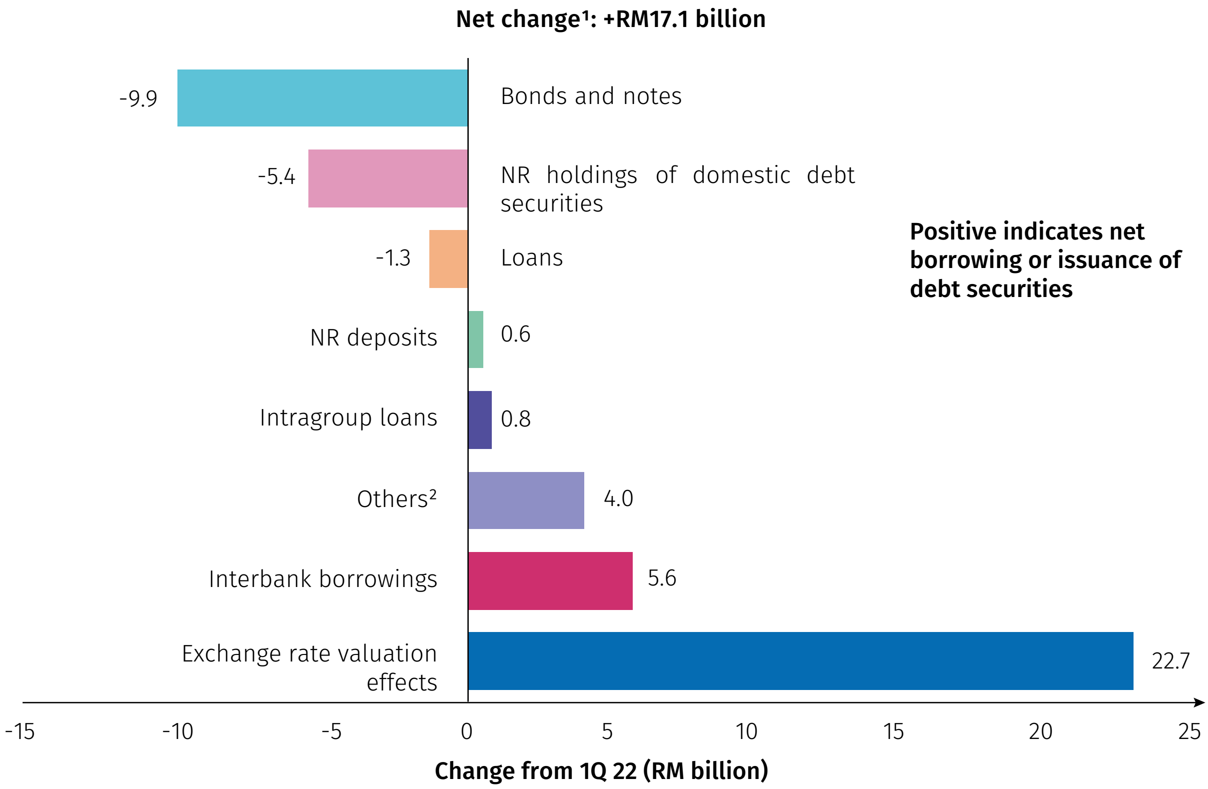
The financial account recorded a lower net inflow of RM0.2 billion (1Q 2022: +RM30.4 billion). This reflects a moderation in direct and other investment net inflows, which was largely offset by portfolio investment net outflows.

The direct investment account registered net inflows of RM2.6 billion (1Q 2022: +RM20.8 billion), underpinned by net inflows in foreign direct investment (FDI) (+RM17.3 billion; 1Q 2022: +RM24.4 billion). This was driven by larger reinvestment of earnings (+RM15.3 billion; 1Q 2022: +RM8.9 billion) and continued equity injections into Malaysia (+RM5.2 billion; 1Q 2022: +RM5.4 billion). These were partially offset by outflows in debt instruments (-RM3.2 billion; 1Q 2022: +RM10.0 billion) due to loan repayments and lower other payables. The FDI was mainly channeled into the manufacturing sector and financial services subsector. Meanwhile, direct investment abroad (DIA) increased during the quarter (-RM14.7 billion; 1Q 2022: -RM3.6 billion). These investments were primarily channeled into the services and mining sectors.

The portfolio investment account recorded a net outflow of RM14.7 billion (1Q 2022: -RM10.1 billion). This was mainly on account of net outflows of non-resident (NR) portfolio investments (-RM10.3 billion; 1Q 2022: +RM3.8 billion) due to higher outflows in NR debt securities (-RM13.2 billion; 1Q 2022: -RM4.7 billion). These more than offset the NR securities net inflows (+RM2.9 billion; 1Q 2022: +RM8.5 billion). Additionally, outflows continued to be driven by institutional investors' equity investments abroad, albeit at a more moderate level (-RM4.7 billion; 1Q 2022: -RM10.2 billion).

The other investment account registered a net inflow of RM12.5 billion (1Q 2022: +RM19.6 billion). This was due primarily to interbank borrowing and the maturing loans placed abroad by the domestic banking system. Net errors and omissions amounted to +RM0.3 billion during the quarter, or +0.05% of total trade.

C18 Changes in External Debt



[1] Changes in individual debt instruments exclude exchange rate valuation effects
[2] Comprises trade credits, IMF allocation of SDRs and other debt liabilities

Note: Figures may not add up due to rounding

Source: Ministry of Finance Malaysia, Department of Statistics, Malaysia and Bank Negara Malaysia

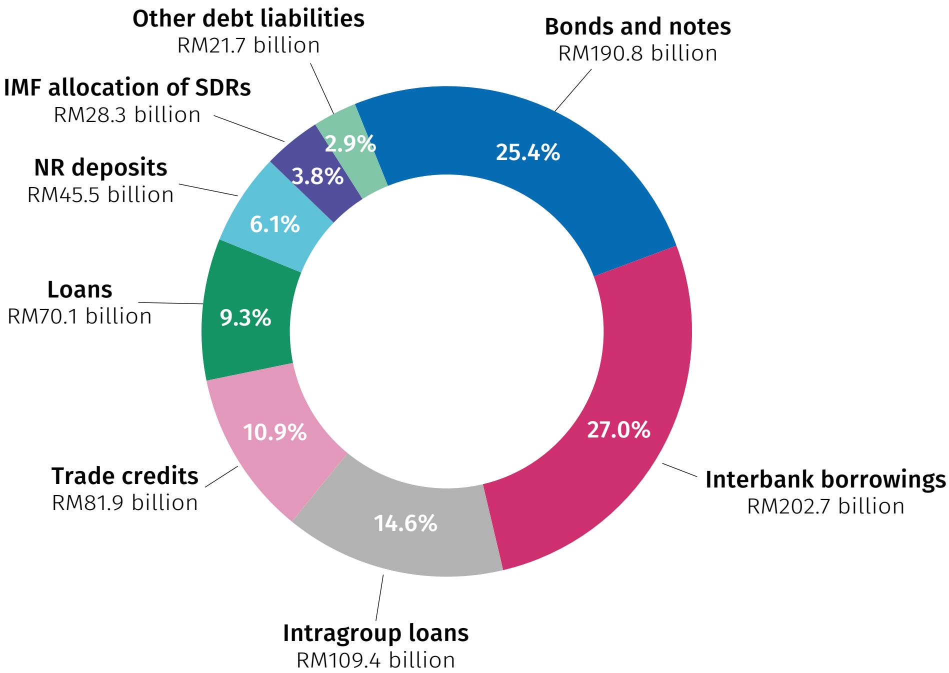
External debt remained manageable

Malaysia's external debt amounted to RM1,128.3 billion, or 67.7% of GDP as at end-June 2022 (end-March 2022: RM1,111.2 billion or 69.6% of GDP). The increase was mainly attributable to the exchange rate valuation effects following the weaker ringgit against selected major and regional currencies, especially the US dollar during the quarter. The other major contributory factors were higher interbank borrowings and trade credits. These were partially offset by the net repayment of bonds and notes and some liquidation of NR holdings of domestic debt securities.

Overall, Malaysia's external debt remained manageable, given its favourable currency and maturity profiles. Ringgit-denominated external debt amounted to RM377.7 billion and accounted for 33.5% of total external debt (end-March 2022: RM381.3 billion and 34.3% respectively). This was largely in the form of NR holdings of domestic debt securities (66.9% share of ringgit-denominated external debt) and ringgit deposits (16.3% share) in resident banking institutions. These liabilities were not affected by fluctuations in the ringgit exchange rate.

Foreign currency (FCY) external debt accounted for the remaining RM750.6 billion, or 66.5% of total external debt (end-March 2022: RM729.9 billion and 65.7%). Long-term bonds and notes issued offshore stood at RM190.8 billion, accounting for 25.4% of total FCY-denominated external debt, issued largely by non-financial corporates. These are subject to BNM's prudential and hedging requirements. Intragroup loans, which are issued between related foreign entities and accounted for 14.6% of FCY-denominated external debt, were generally on flexible and concessionary terms.

C19 Breakdown of FCY-Denominated External Debt (RM billion, % share)



Source: Ministry of Finance Malaysia, Department of Statistics, Malaysia, and Bank Negara Malaysia

Interbank borrowings and FCY deposits in the domestic banking system accounted for 33.1% of FCY-denominated external debt. The increase in FCY interbank borrowings was primarily driven by domestic banking groups (DBGs) sourcing FCY abroad to shore up existing FCY liquidity buffers. This was in anticipation of maturing domestic FCY deposits and potential tightening of FCY liquidity conditions. Part of these funds was channelled into lending activities while certain DBGs subsequently placed FCY sourced abroad with overseas affiliates, a reflection of their centralised liquidity management practices. DBGs' higher interbank borrowings were partially offset by repayments of back-to-back intragroup funding by some banks in the Labuan International Business and Financial Centre (LIBFC) to their respective head offices. Overall, intragroup borrowings from related parties located abroad continue to make up the bulk of total banking system interbank borrowings, accounting for about 70% of the total, and are generally more stable, thereby limiting rollover risks faced by banks. Despite the higher external debt amount due to the currency depreciation, banks continue to actively manage FCY mismatches, as evidenced by the net open position of their FCY-denominated exposures,[3] which remained low at 4.6% of banks' total capital (end-March 2022: 4.3%).

From a maturity perspective, 60.0% of total external debt has medium- to long-term tenure (end-March 2022: 61.5%), thereby limiting rollover risks. Short-term external debt accounted for the remaining 40.0% of external debt (end-March 2022: 38.5%). Of note, 40.5% of short-term external debt were in the form of intragroup borrowings from parent banks or related multi-national corporates located abroad. About another 17.6% were accounted by trade credits, largely backed by export earnings and are self-liquidating. As at 29 July 2022, international reserves stood at USD109.2 billion, sufficient to finance 5.4 months of imports of goods and services[4] and is 1.1 times the short-term external debt.

[3] Refers to the aggregated sum of the net short or long foreign currency positions for all currencies across banks.
[4] For more information on this indicator, please refer to the article on "Expansion of the Measure on Reserve Coverage of Imports – from Retained Imports to Imports of Goods and Services" in BNM's Quarterly Bulletin for the Fourth Quarter of 2021 publication, page 27, which can be accessed at bnm.gov.my/documents/20124/6118085/qb2021q4_en_box_imports.pdf

Box Article

Malaysia's Trade Resilience in the Post-Pandemic Era

Introduction

Covid-19 was a watershed moment for the global community. Many lost their lives while many livelihoods were severely affected. It caused unprecedented disruptions to most economies around the globe. Remarkably, following measures to manage the spread of the pandemic and support incomes and jobs, the global economy returned to the path of recovery, with advanced economies (AEs) leading the way. Global trade rebounded sharply on strong demand especially for durable goods. This benefited emerging market economies (EMEs), including Malaysia.

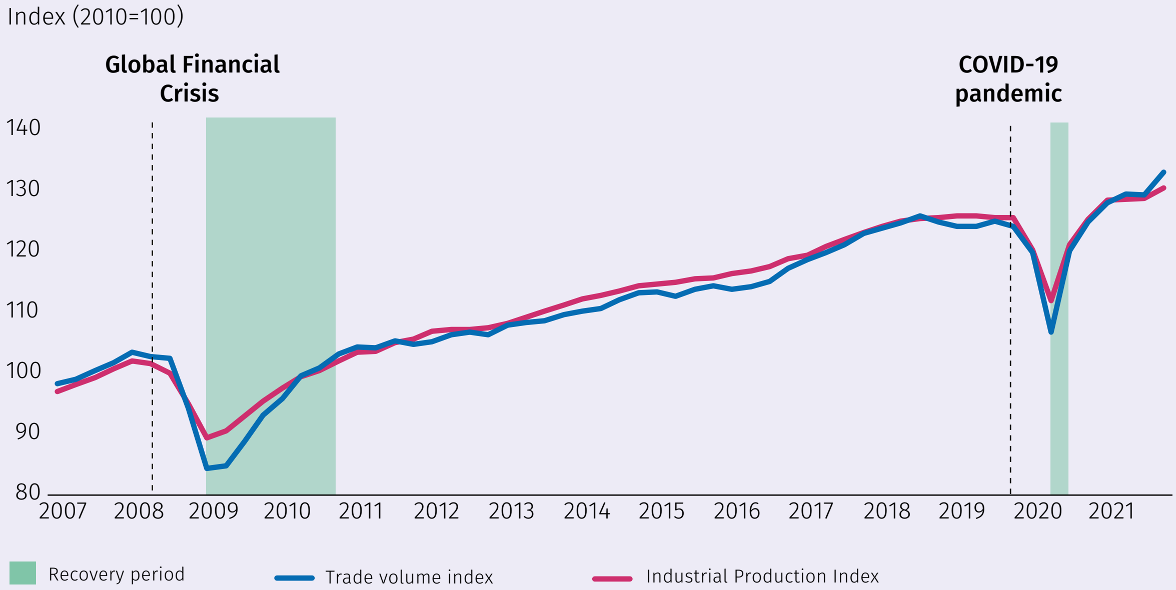
This article seeks to address three main questions: First, what are the factors that influenced Malaysia's trade resilience during and post-pandemic? Second, what are the post-pandemic trends that could influence Malaysia's trade over the medium term? Third, what policy lessons could we infer from the crisis to enhance the country's trade resilience?

Spillover impact of Covid-19 on Malaysia's trade: From breaking point to rebound

The Covid-19 pandemic was a sizeable shock to the global trade and economy. In the World Economic Outlook in April 2020, the IMF projected that the global economy would contract by 3%. This was the worst downturn since the Great Depression in 1930s. Back in 2009 when the world output contracted by 0.1%, trade volumes collapsed by 13%. During the pandemic, global trade volume plummeted by 14% in 2Q 2020 (Chart 1).

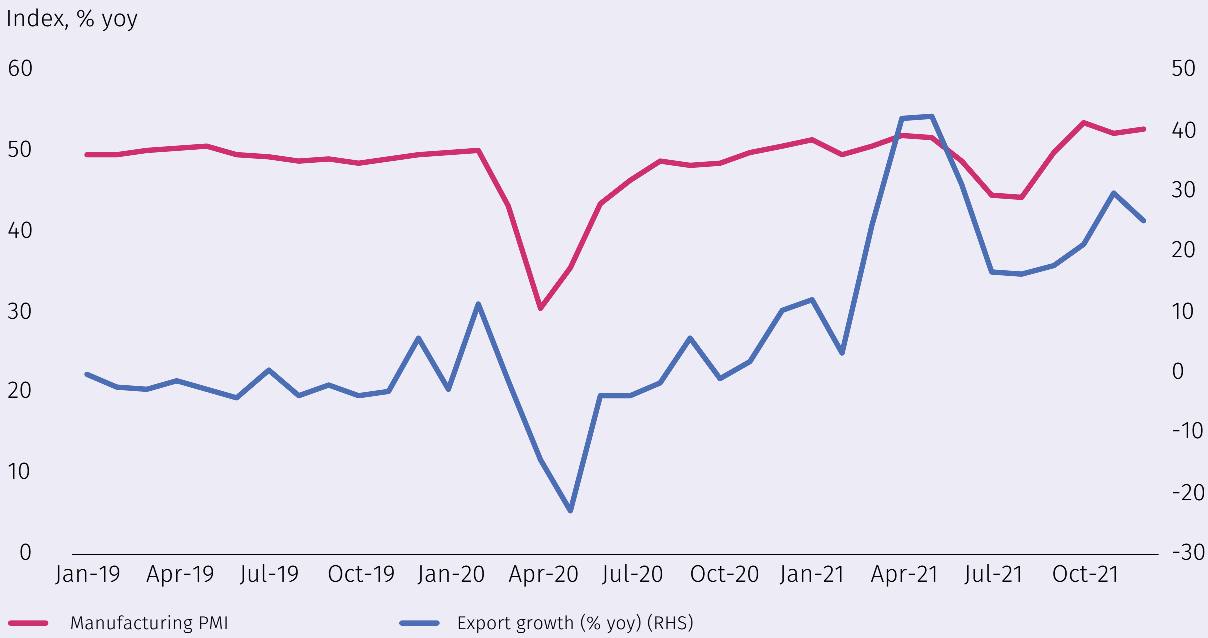
Rather unexpectedly, such concerns about global trade rapidly subsided when trade flows rebounded in 2H 2020 onwards. Although the decline in trade volume were about similar in depth compared to the Global Financial Crisis (GFC), the rebound was much quicker and sharper. At the core of this turnaround was the success of the early containment measures in China. Moreover, the rapid development and roll-out of vaccines especially in AEs allowed gradual resumption of economic activities. The recovery in global economic activity was also characterised by the shift in consumption pattern away from contact-intensive service industries towards durable goods. This led to robust demand for manufactured goods, with exporters that are deeply integrated in the GVCs, such as ASEAN, were amongst the main beneficiaries (Chart 2). The resilience in global trade reflected the agility of manufacturers to adapt their supply chain networks against the pandemic-induced disruptions. Policymakers also played a pivotal role as monetary, financial and fiscal policies were deployed at an unprecedented scale and speed. For instance, the exceptionally accommodative monetary policy and liquidity measures by major central banks helped to keep trade finance flowing, better than during the GFC.

C1 World Merchandise Trade Volume Index and Industrial Production Index



Note: Recovery period refers to quarters for the trade volume to return to the pre-crisis level
Source: CPB Netherlands Bureau for Economic Policy Analysis

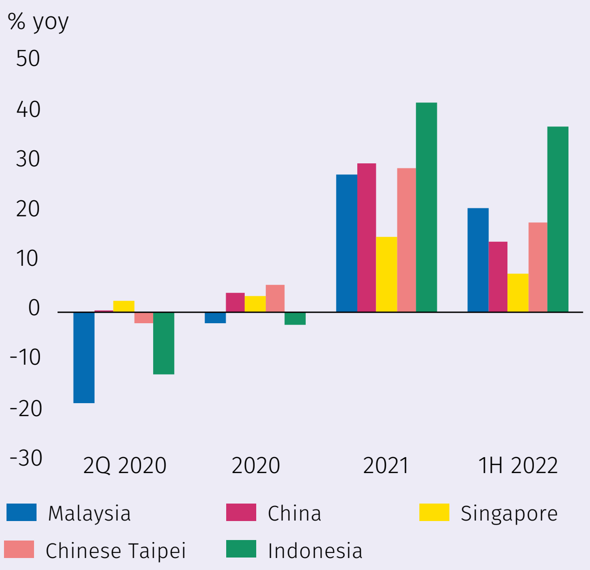
C2 ASEAN Manufacturing PMI and Export Growth



Source: S&P Global, CEIC

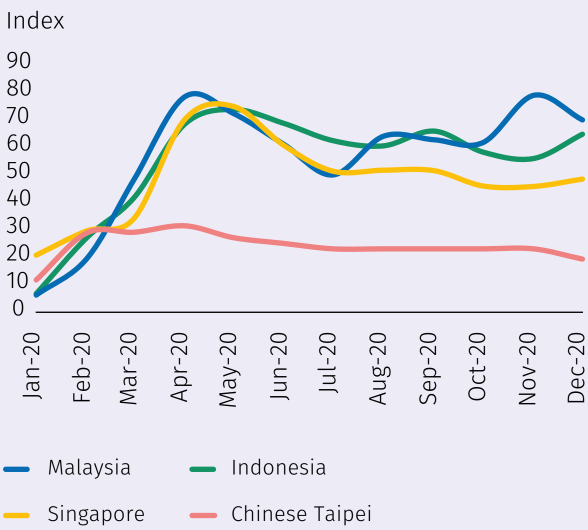
As a small and open economy, Malaysia was not spared from this global shock. Merchandise exports collapsed by -14.9% in 2Q 2020. This was the sharpest decline since 3Q 2009 (-21.9%). Despite this, exports of rubber products surged given the robust demand due to the pandemic. Compared to many other regional economies, Malaysia's exports declined by a larger magnitude in 2Q 2020 and remained relatively more sluggish for the rest of the year (Chart 3). This could be partially traced to the somewhat stricter and longer lockdowns in Malaysia than some other regional economies (Chart 4). As a result, there were higher frictions and impediments in restarting production activity. As these restrictions were gradually eased, export growth rebounded strongly and was broadly in line with regional economies, surpassing pre-pandemic levels.[1] The recovery in trade was rather broad-based across products. Some products recorded exceptional growth due to robust external demand (Chart 5). E&E products, which account for more than a third of Malaysia's exports, grew particularly strong due to robust demand for work-from-home equipment as well as cloud computing.[2] Recovery in commodity prices also supported commodity-related exports.

C3 Export Growth of Selected Regional Economies (in USD terms)



Source: National authorities

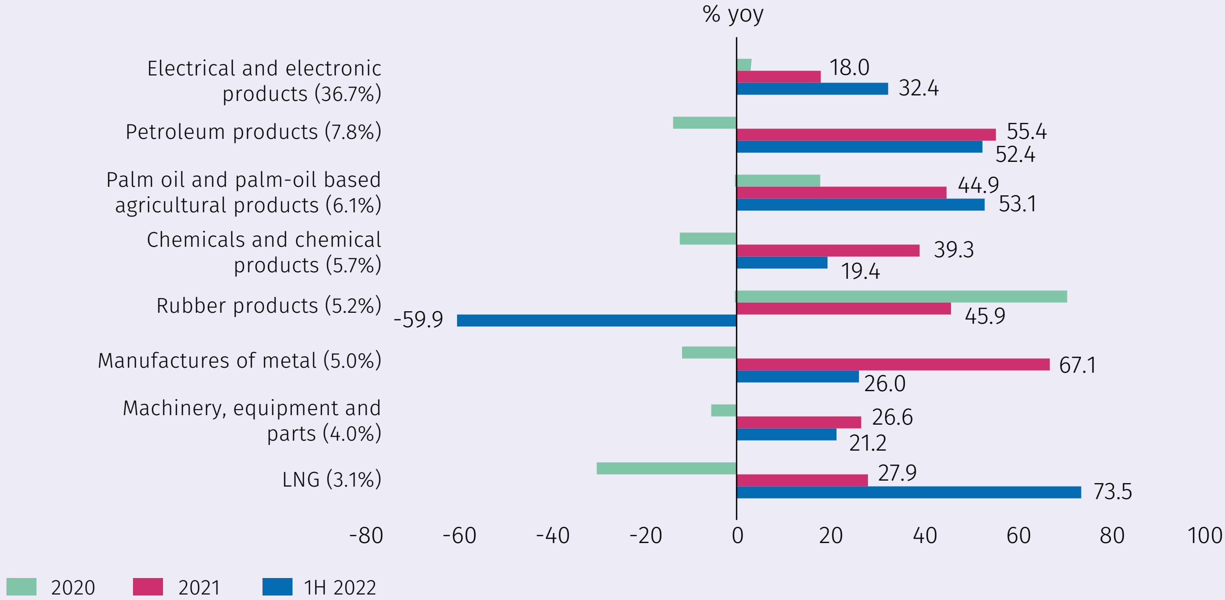
C4 Stringency Index of Selected Regional Economies



Note: Higher index indicates stricter containment measures
Source: Oxford Government Response Tracker

[1] The 2021 export level surpassed the 2019 level for Malaysia and most regional countries.
[2] For more detailed analysis on impact of global chip shortages to Malaysia's E&E sector, please refer to the box article titled 'The Global Chip Shortage: Implications and Opportunities for Malaysia' in the BNM Quarterly Bulletin in 2Q 2021.

C5 Growth of Malaysia's Top Export Products



Note: Values in parentheses refer to share of exports in 2021
Source: Department of Statistics, Malaysia

Malaysia's deep integration into GVCs and rapid adaptability enhanced Malaysia's trade resilience

Malaysia's diversified export structure across products and markets has been the main source of export strength and resilience. In addition, Malaysia's integration in the GVCs helped to support trade recovery in tandem with strong external demand for durable goods. While trade recovery was driven by external demand, the impact was reinforced by firms' rapid adaptability to various production constraints and challenges arising from the pandemic shock.

(1) Malaysia's role in GVCs was supported by strong manufacturing ecosystem that has advanced steadily over the decades

Malaysia's position in the GVCs[3] has improved over the years with higher contribution of domestic value-added in our exports as seen in the rising forward linkage (Chart 6). In addition, reliance on foreign inputs for exports has also been declining as reflected in the lower backward linkage. Given Malaysia's higher domestic value-added contributions in GVCs, stronger demand in other parts of the world was quickly transmitted to our economy. In particular, the investment and development of E&E ecosystem enabled Malaysia to be deeply integrated into the global semiconductor value chain. The E&E industry in Malaysia has become more sophisticated over the years, evolving from mainly assembly-related work to expand towards R&D activities (Chart 7). A well-developed infrastructure and proficient talent pool provided the impetus for a rich and diversified ecosystem for production and exports. This turned Malaysia into a key player in the global E&E manufacturing hub including in high value-added sectors such as medical, aerospace and automotive. Malaysia is currently the 12th largest exporter of E&E and the 6th largest semiconductor exporter in the world.[4]

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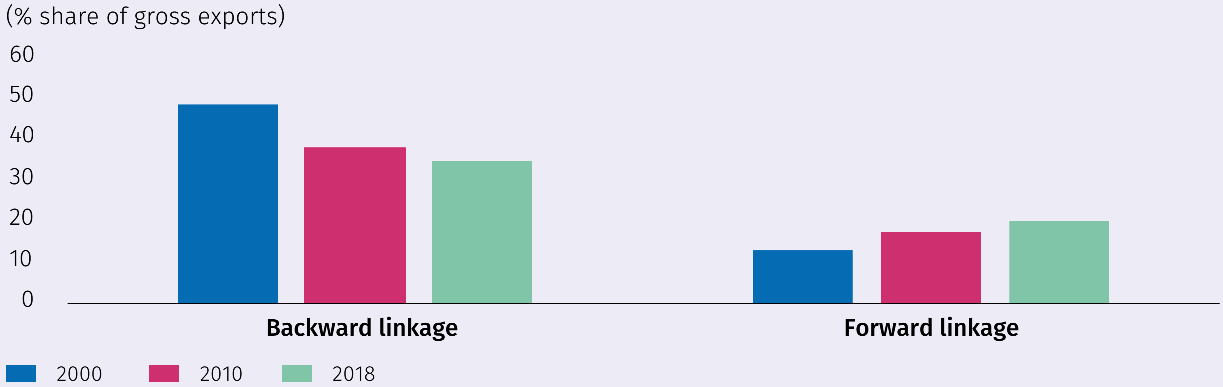
[3] Backward and forward linkages can be used to characterise the position of a country's GVC participation. World Trade Organization defines backward GVC participation as the ratio of the foreign value-added content of exports to the economy's total gross exports. Meanwhile, forward GVC participation captures the domestic value added contained in inputs sent to third economies for further processing and export through supply chains.

[4] Source: IHS Markit.

C6 Malaysia's Backward and Forward GVC Participation

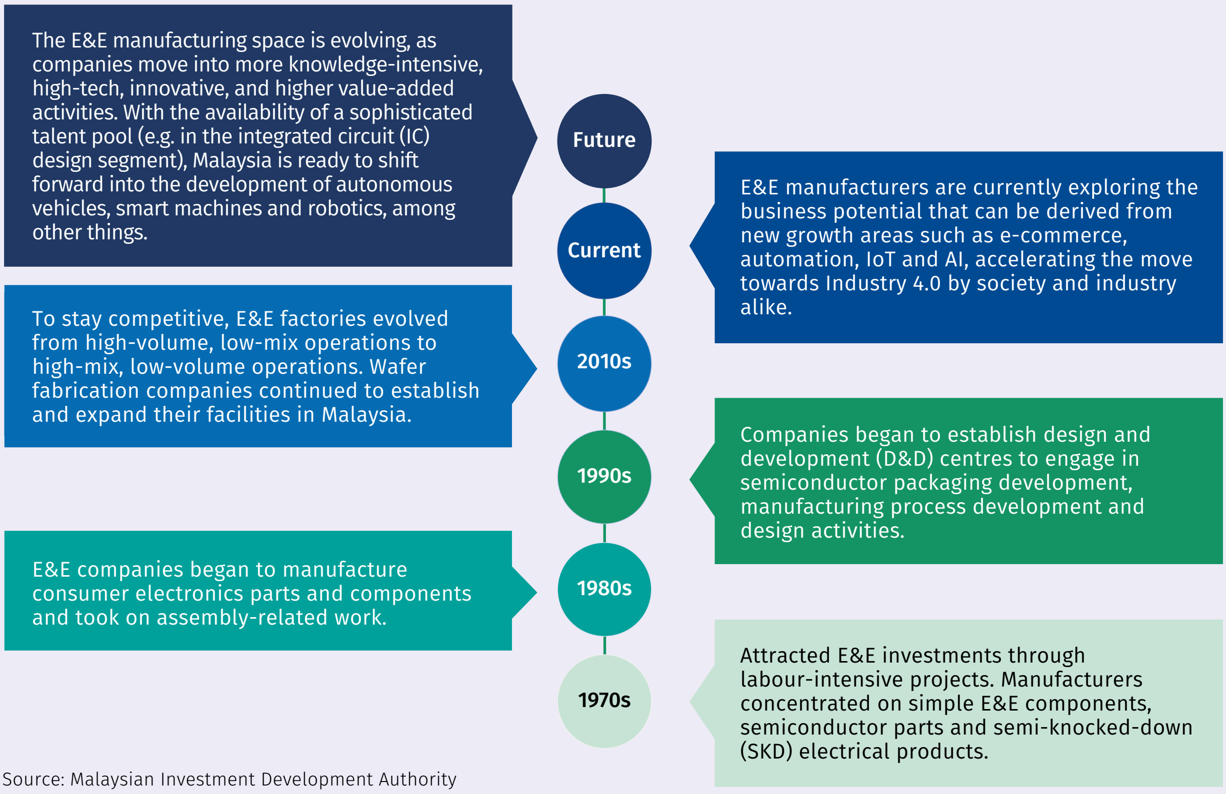


Source: Trade in Value Added, Organisation for Economic Co-operation and Development

(2) Rapid adaptability by firms allowed them to ride on strong external demand

Firms' adaptability and agility to mitigate the disruptions and to capture high global demand have also contributed to the resilience of Malaysia's trade. Local garment-makers quickly transformed themselves into manufacturers of protective gowns and face masks to respond to high global and domestic demand. Airline companies mobilised its passenger aircraft as a cargo-only fleet to transport in-demand medical supplies and e-commerce goods. Firms, including smaller businesses also quickly adapted to switching their business operations to online platforms (Chart 8).

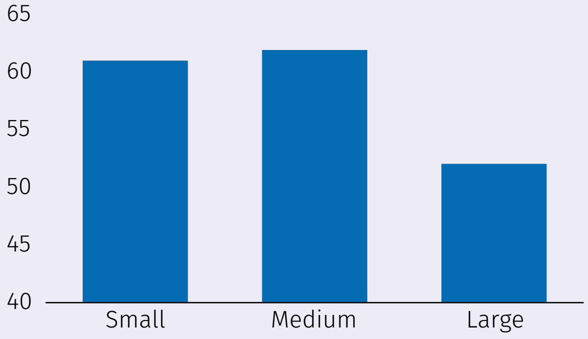
C7 Evolution of Malaysia's E&E Industry



Source: Malaysian Investment Development Authority

C8a Increased Use of Digital Platforms in Malaysia

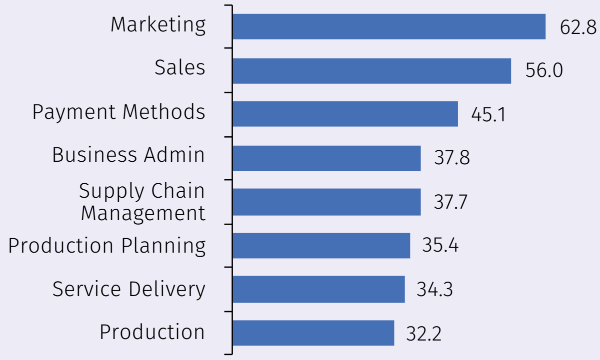
(% share of firms)



Source: World Bank's COVID-19 Business Pulse Survey Round 1, December 2020

C8b Use of Digital Platforms by Business Function in Malaysia

(% share among firms that increased use in digital platforms)



Source: World Bank's COVID-19 Business Pulse Survey Round 1, December 2020

Firms' adaptability to COVID-19 disruptions continued to pay significant dividends as global supply chain disruptions persisted beyond 2021. Malaysian firms employed several strategies to mitigate the impact of supply chain disruptions. This include building inventories by placing advanced bookings to secure supplies as well as expanding production capacity by investing in new plants and machinery. In addition, some firms opted to use alternative modes of transport, such as air cargo or land trucking to avoid shipment delays. Firms have also taken proactive steps to negotiate with their clients to spread out orders, while others have diversified their supplier base.

Government policies were also crucial in ensuring firms could quickly and successfully adapt in the fast-changing operating environment. Throughout the various phases of the movement control order (MCO) in 2020 and 2021, manufacturing firms integral to the global supply chains were allowed to operate[5] amid strict but practical standard operating procedures. On this front, ground-level insights gained from the Bank's continuous engagement with firms provided vital information for policy design and interventions. This included early identification of potential risks to the economic outlook, which enabled policies to be more nimble, timely and ultimately, effective.[6]

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5 Thirteen industries including electronics, chemical and pharmaceutical companies could operate at 60% workforce capacity during the strictest phases of the lockdowns, while five other industries including automotive, iron and steel could still operate at 10% capacity.

6 For more detailed analysis on the importance of ground-level insights during the pandemic, please refer to the box article titled 'Taking the Pulse of the Economy During the Pandemic' in the BNM Annual Report 2021.

What to look out for? Key drivers that will shape Malaysia's trade over the medium term and policy imperatives

The COVID-19 shock is yet another example of the country's agility to capitalise on the surge in global demand. Exporters of selected products have benefited immensely from their investments in retooling and rolling out new product lines as well as leveraging on their deep integration in the GVCs. Moving forward, Malaysia could benefit from riding on emerging megatrends to ensure our continued competitiveness.

(1) Reshoring of GVCs by major economies

The pandemic revealed that over-reliance on GVCs can increase the economy's exposure to systemic risks from geopolitical, environment, economic and health disruptions. A clear example of this is the shortage of microchips creating knock-on effects globally across many durable goods sectors such as automotive and consumer electronics. In response, major economies have considered and even embarked on protectionist measures. This includes reshoring of production for key manufacturing inputs such as microchips, medical supplies and food. The move towards self-sufficiency was part of a new strategy to strengthen economic resiliency against global supply disruptions (Table 1).

T1 Notable reshoring policies by governments

Country/Region	Actions
United States	• Planned USD52 billion in federal investments for the domestic semiconductor research, design and manufacturing provisions (2021). • Introduced legislation to establish a tax credit for investments in constructing, expanding and upgrading semiconductor manufacturing facilities and equipment in the U.S. (2021).
European Union	• Approved USD3.5 billion European Battery Innovation project to subsidize Tesla, BMW and other companies to produce lithium-ion batteries in Europe (2021).
India	• Government offered USD2.5 billion in subsidies for battery production to support a "Make-In-India" strategy (2021).
Japan	• Allocated a fund of 248.6 billion yen (USD2.33 billion) in its economic emergency plan to support the relocation of manufacturing activities to Japan.

Source: News flows, country authorities

The reshoring of manufacturing production, however, could pose even higher and new risks to production and economic activity. According to an IMF study,[7] there is already over-concentration of intermediate inputs in home countries. As a result, reshoring could increase vulnerability to disruptions through higher concentration risk. Another study by the World Bank (Chepeliev et al, 2022) shows that in a world where countries re-shore their production, global trade would decline by as much as 17 percent by 2030, with adverse effects on incomes and welfare.

[7] World Economic Outlook April 2022, Chapter 4: Global Trade and Value Chains during the Pandemic.

It is also difficult to disentangle or reconfigure the GVCs due to their positive externalities and efficiency gains to participating countries. Firms have made significant investments in infrastructure, relationships and networks spanning suppliers, producers, consumers and local communities. As benefits of GVCs continue to outweigh potential costs,[8] firms will find it very hard and costly to abandon these investments or shift to alternative modes. Studies have shown that during the Covid-19 crisis, strong trade relationship along the value chain helped to cushion the impact of economic shocks. Espitia et al. (2021) shows that the export performance of sectors that are integrated in the GVCs are less negatively impacted than sectors that primarily rely on domestic inputs. Through involvement in GVCs, firms benefit from greater diversifications and are less susceptible to domestic shocks.

Diversification remains a key strategy in mitigating risks. Rather than advancing protectionist measures, the global community would be better served by focusing on stronger risk management in global trade to enhance trade resilience. Greater GVCs diversification for example, could increase inputs substitutability, lift production and logistical efficiency and reduce dependency on the demand from a specific economy. To enhance logistical and production efficiency, firms could also transform their production processes to make it easier to substitute inputs provided by different suppliers across geographical locations. Tesla reconfigured its software so they can use chips that were less affected by the semiconductor shortage. IMF (2022) estimates that greater product substitutability can reduce economic impact by around four-fifths in the receiving countries following a supply disruption in a large supplier country.

Venturing into new trade agreements with selected strategic partners[9] is one way to enhance diversification. This will open up new opportunities for Malaysian firms as outlined in the National Trade Blueprint 2022-2025. One of the global trends identified in the Blueprint is the rapid population growth in the African continent, which currently accounts for only 2.5% of Malaysian exports.

Ultimately, given the intense competition among GVC players, efforts to strengthen Malaysia's position should be a key priority. Malaysia needs to move away from reliance on low-cost production models to higher value-added activities. Resiliency factors like logistics, inventory management and access to substitutable inputs, flexibility and skills of workforce will be key in driving the country's competitive edge. Quality investments that are aligned with the National Investment Aspirations (NIAs) can deepen Malaysia's contribution that will also increase economic complexity, expand domestic-linkages, develop new economic clusters, create high-value jobs and improve inclusivity. Also, by aiming for sectors that are knowledge-driven, tech-intensive and low carbon, these investments would encourage R&D and innovation, which would incentivise horizontal and downstream diversification into more complex export products. This is particularly relevant for the palm oil sector, which has a high potential to advance into higher value-added downstream segments such as agrochemicals and food products.[10]

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[8] In 'Global value chains: Efficiency and risks in the context of COVID-19', OECD (2021) uses computable general equilibrium (CGE) trade model and found that most economies are better off interconnected via GVCs than in localised regime in terms of efficiency and vulnerability against shocks.

[9] Malaysia has entered into several bilateral and multilateral Free Trade Agreements. The most recent ratification was the Regional Comprehensive Economic Partnership (RCEP) on 18 March 2022.

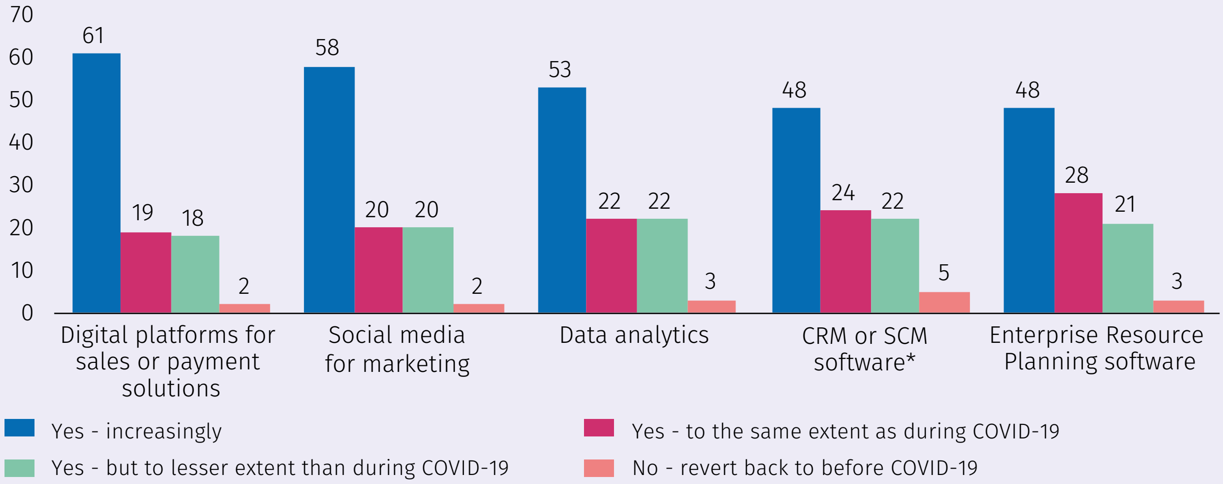
[10] In BNM's Economic and Monetary Review 2020 Box Article "Innovation Malaysia: towards higher Quality growth in a Post-Pandemic Future", it highlights that accelerating downstream palm oil activities is one of the key imperatives for Malaysia to emerge stronger post-pandemic.

(2) Technology and digital services present significant opportunities for future sources of growth and exports

Firms' adoption of digitalisation and e-commerce accelerated during the pandemic, even among smaller enterprises. The use of online platforms is likely to be a persistent trend (Chart 9). The automation of industrial processes allowed firms to meet low-touch and social distancing requirements while ensuring production continuity. For example, through remote monitoring capability, engineers in Malaysia were able to guide the staff in Beaumont, Texas for an orderly shutdown of its facility before being impacted by Hurricane Laura in August 2020 (Greenfield, 2021). Additionally, usage of digital technology such as Internet of Things (IoT) and cloud computing has effectively become the new norm. Other than production, technology was also deployed in sales and marketing, payment methods, supply chain management and production planning. This also means bigger opportunities for small and medium-sized enterprises (SMEs) to participate in the GVCs.[11]

C9 Expected Use of Digital Technologies Post-Pandemic in Malaysia

(% share of firms who started or increased use)



* CRM = customer relationship management; SCM = supply chain management

Source: World Bank's COVID-19 Business Pulse Survey Round 4, March 2022

Adoption of new technologies into GVCs can improve efficiency while providing new growth opportunities. For instance, blockchain technology is increasingly being employed to record transactions in shipping logistics, thus improving bureaucratic efficiency. By automating forms and bills of lading,[12] this would expedite the administrative processes and customs procedures and clearance. Importantly, it will minimise errors and delays as well as reduce revenue leakages for the Government. Recently, it was reported that the Royal Malaysian Customs Department has begun using the blockchain-enabled 'TradeLens' platform in Malaysia to modernise the shipping processes. This should create the pathway towards greater transparency, more efficient trade activities and higher customer satisfaction.[13]

[11] Companies adopting digitalisation using high-speed internet and website adoption are 6–10 percent more likely to participate in GVCs (Gopalan, Reddy and Sasidharan, 2022).

[12] A bill of lading is a document issued by a carrier to acknowledge receipt of cargo for shipment.

[13] News Straits Times (2020).

Policies that encourage digitalisation as outlined under the 'MyDigital' initiative will enable more local players, particularly MSMEs to participate in GVCs. To complement this, a highly-skilled and digital-ready workforce is required to supply firms with the talents needed for them to digitalise their operations and increase productivity. Hence, there needs to be collaboration between firms, educational institutions and the Government to supply a market-ready, high-skilled employment base.[14] In Norway, social partners participate as external members in the governing boards of domestic higher educational institutions (OECD, 2019). This allows social partners with close links to the labour market to contribute to the institutions' strategy for education and research activities. Malaysia's own industry-led Penang Skills Development Centre (PSDC) has demonstrated commendable achievements in training and developing high-skilled workforce especially for the E&E industry. This tripartite initiative which brings the industry, Government and academia including polytechnic institutions should be emulated in other industries to develop digital-savvy and future-ready talent that will enable Malaysia to undertake more complex and higher value-added activities.

(3) Making trade greener and sustainable into the future

The post-pandemic era also presents opportunities to accelerate the shift towards the green and sustainability agenda. As the pandemic exposed fragilities in the global economy, there has been greater focus to 'build back better' by paving the way towards a greener and sustainable recovery. In the automotive sector, more countries are shifting towards energy efficient vehicles (EEV) such as hybrid cars and electric vehicles (EVs). Global sales of EVs doubled in 2021 from the previous year to a new record of 6.6 million (International Energy Agency, 2022). In addition, demand for green technology such as solar panels, electric vehicles and lithium batteries has seen a strong increase. In 2021, renewable electricity capacity additions increased by 6% globally, reaching a record-high of 295 gigawatts (GW) and is expected to increase by over 8% in 2022. Solar photovoltaic is forecast to account for 60% of the increase in global renewable capacity this year, a 25% gain from last year (International Energy Agency, 2022). Increasing demand for cleaner energy sources also implies new market opportunities for biofuel exports. This provides opportunities for Malaysia to shift towards exporting more renewable energy.

Therefore, there should be greater emphasis towards green and sustainability compliance across export industries with clear environmental, social and governance (ESG) targets and measurable outcomes moving forward. To encourage the transition to low carbon practices for SMEs, the Bank has established the Low Carbon Transition Facility (LCTF). The implementation of the Government Green Procurement policy and the provision of alternative financing such as green sukuk are also encouraging developments. Beyond this, there should be increased coordination between agencies to attract investments in low carbon industries. Measures to enhance export capacity and branding and promotion strategies for green products are also paramount. For example, palm oil products in the downstream segments that promote RSPO-certified crude palm oil could expand opportunities to tap into the global markets for sustainable products. Furthermore, effective policies including targeted incentives could also encourage businesses and exporters to adopt green practices. On that note, the policy implementation should be well-calibrated to align ESG ambitions with different ESG risk levels for different export sectors. Overall, these efforts should enhance Malaysia's trade competitiveness.

[14] For more information, please refer to BNM's Economic and Monetary Review 2020 Box Article titled "Getting the Great Reset Right: Structural Labour Market Issues in the Post-COVID-19 World".

Conclusion

Since its trough in the second quarter of 2020, Malaysia's trade has rebounded swiftly in 2021 supported by strong external demand for goods. Malaysia has been able to withstand the impact of global supply chain disruptions considerably well, given our diversified export structure and firms' adaptability as well as supportive policy measures. However, the global post-pandemic trade climate presents new challenges and growth opportunities for Malaysia. A prioritisation towards the implementation of policies that strengthen trade resilience would be critical for Malaysia, given the importance of exports to the Malaysian economy. Policies focusing on sustainability, technology, innovation and inclusivity will be the key underpinnings of a more sustainable growth. The role of the Government is paramount, particularly on strategic direction and administrative capacities to implement key structural reforms. This includes revitalising quality investments through NIAs, digitalisation of the economy, creating highly-skilled and future-ready workforce as well as enhancing trade competitiveness and market access (Chart 10).

C10 Existing Policies that can Enhance Malaysia's Trade Resilience

Source: EPU, MITI, MATRADE, Bank Negara Malaysia

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Monetary and Financial Developments

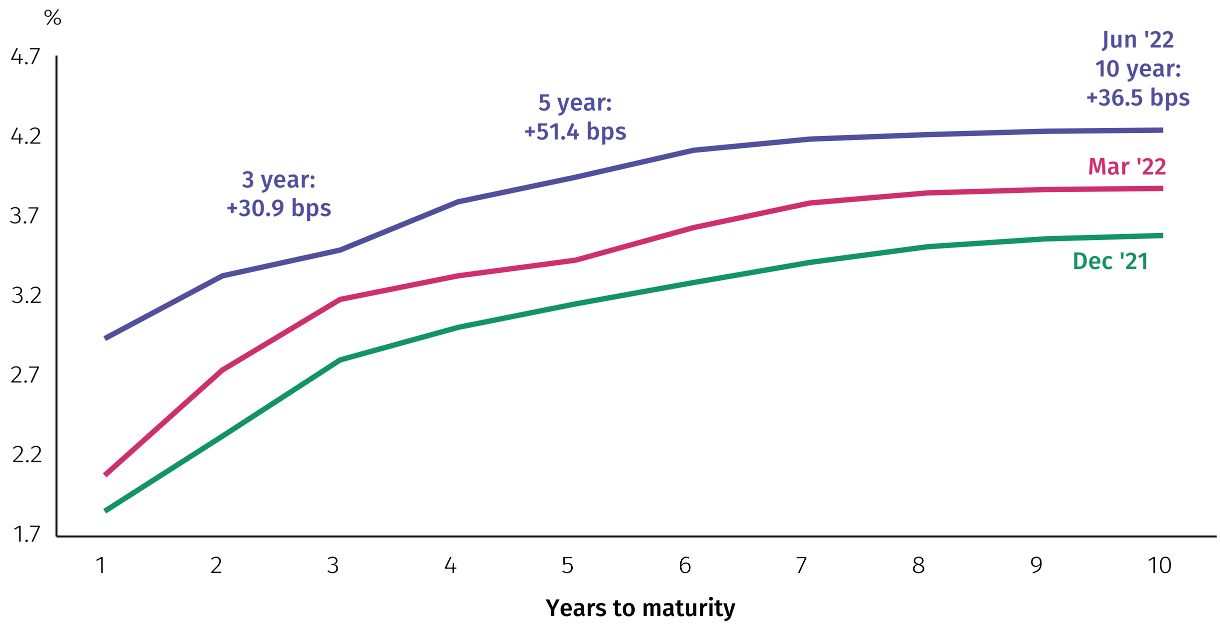
Highlights

- Domestic financial market conditions tightened, amid higher bond yields and decline in equity markets.
- Alongside broad US dollar strength, the ringgit depreciated against the US dollar, in line with regional currencies.
- Nominal interest rates increased during the quarter following the increase in the OPR.
- Growth in net financing underpinned by continued bank lending.

Bond yields rose

In the second quarter of 2022, global financial conditions tightened due to higher policy rates by global central banks amid more elevated and prolonged inflationary pressures. Investor sentiments were dampened by growth concerns, and the military conflict in Ukraine. The US Federal Open Market Committee (FOMC) has cumulatively raised its federal funds rate by 225 basis points (bps) through hikes of 25 bps, 50 bps, 75 bps and 75 bps at its March, May, June and July meetings respectively. The FOMC also indicated that further monetary policy tightening would be appropriate moving forward to reduce inflationary pressures by achieving a more sustainable balance between demand and supply. These factors contributed to a strong US dollar environment, with the US Dollar index (DXY) rising to a 20-year high (end-Q2 2022: 104.66).

C20 Trend in MGS Yields



Source: Bank Negara Malaysia

For Malaysia, domestic financial conditions also tightened with the 3-year, 5-year and 10-year MGS yields increasing by 30.9, 51.4 and 36.5 basis points, respectively. Of significance however, these adjustments were relatively smaller compared to the increase[5] in regional economies[6] following lower bond outflows registered in the quarter.

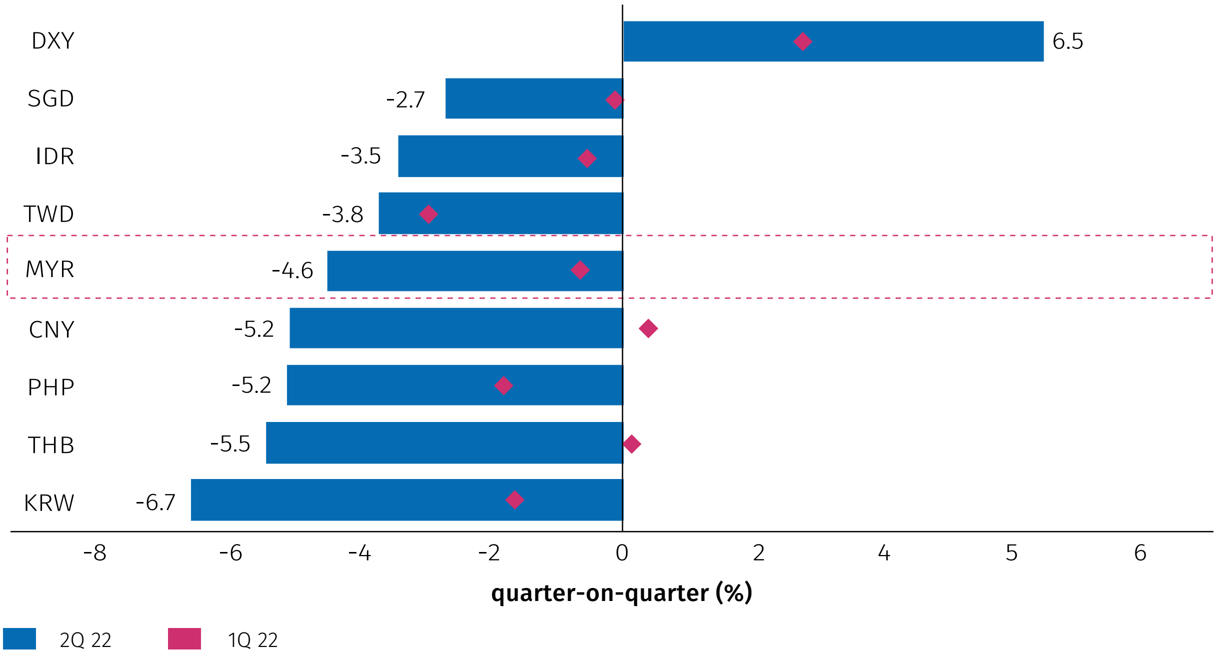
Ringgit depreciated amid continued US dollar strength

The ringgit depreciated by 4.6% against the US dollar (1Q 2022: -0.7%), in line with the movement of regional currencies. The downward pressure on the ringgit and regional currencies was driven mainly by a broad US dollar strength. The region also recorded foreign portfolio outflows amid growth concerns and worsening global trade outlook. The military conflict in Ukraine also resulted in an increase in global investor risk aversion, which subsequently contributed to higher demand for 'safe haven' assets in countries like the US. Between April and May, the ringgit was relatively more affected compared to other regional currencies given the outlook of some of Malaysia's major trade partners. However, the ringgit's performance subsequently improved towards the end of the quarter as sentiments improved following the release of data underscoring strong domestic economic recovery.

Equity market declined, reflecting weak investor sentiment and expectations of lower global growth

The FBM KLCI declined along with most regional equities amid global risk-off sentiment and higher interest rates. The negative performance was driven mainly by sectors in technology (-19.2%), plantation (-13.2%), and industrial products (-11.6%).

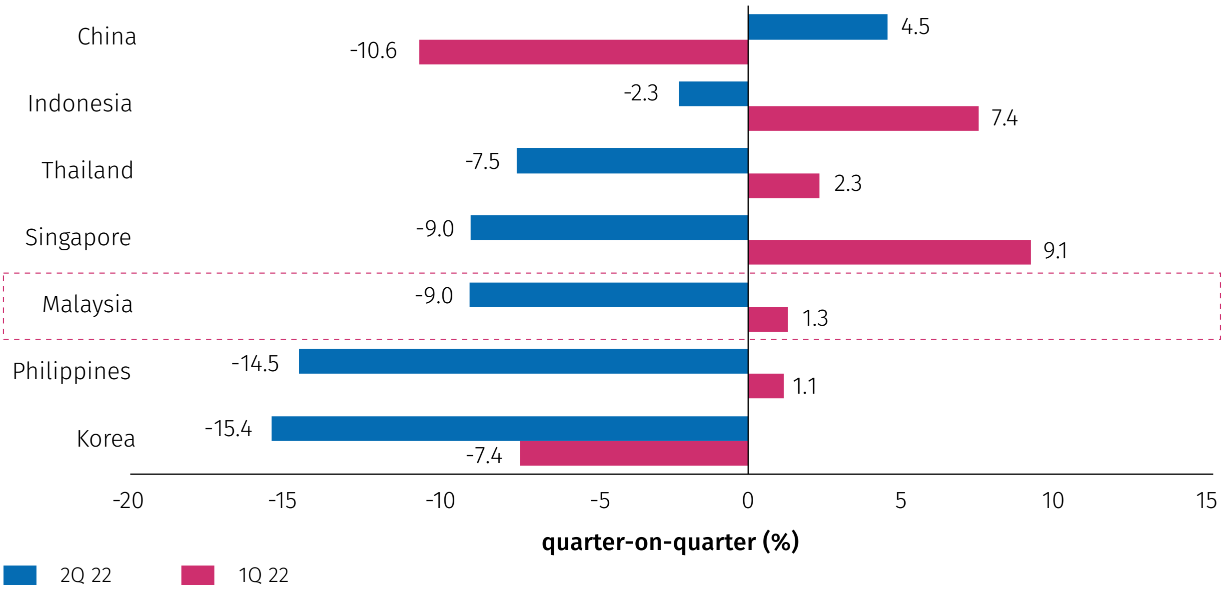
C21 Performance of Regional Currencies Against the US Dollar



Source: Bank Negara Malaysia and Reuters

5 Average increase of 10-year bond yields in regional countries is 69.8 basis points
6 Regional economies include Singapore, Indonesia, Thailand, Philippines and Korea

C22 Performance of Regional Equity Markets

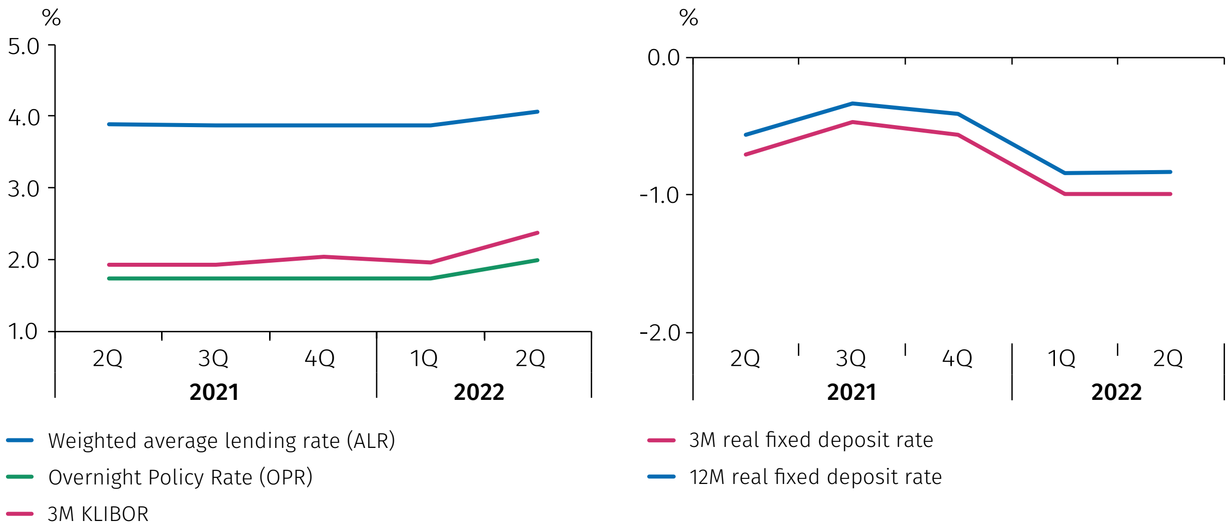


Source: Bloomberg

Nominal interest rates increased during the quarter following the increase in the OPR

Following the increase in the Overnight Policy Rate (OPR) by 25 basis points on 11 May 2022, interest rates in the wholesale and retail markets trended higher. In the interbank market, the KLIBOR increased by 25 to 26 basis points across all tenures within one day of the OPR adjustment, and continued to increase after the initial adjustment amid market expectations of further increase in the OPR.[7] For the quarter, the 1-month and 3-month KLIBOR rose by 33 and 41 basis points respectively to end the period at 2.21% and 2.38% (1Q 2022: 1.88% and 1.97%).

C23 Interest Rates (at end-period)



Source: Bank Negara Malaysia, Bloomberg and Consensus Economics

[7] The OPR was raised by another 25 basis points on 6 July 2022.

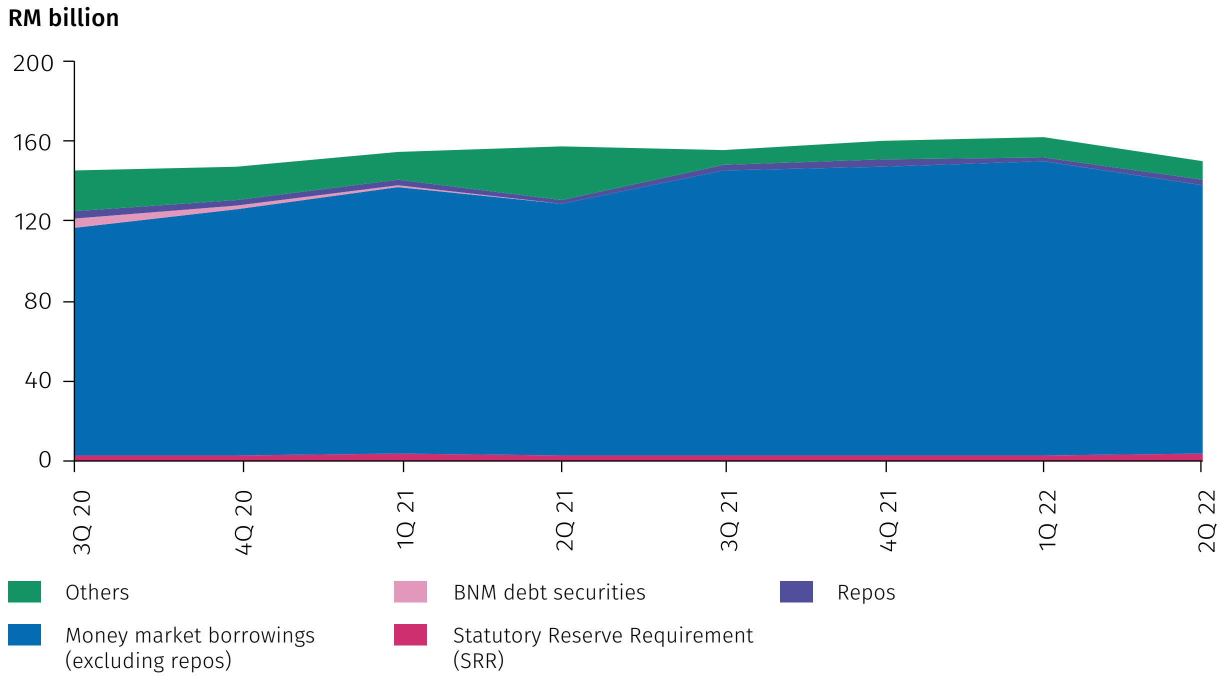
Lending rates also responded to the OPR increase. The weighted average base rate (BR) and the weighted average lending rate (ALR) on outstanding loans increased by 25 and 20 basis points respectively to 2.68% and 4.07% by end-quarter (1Q 2022: 2.43% and 3.87%).

Returns to depositors also rose. Nominal fixed deposit (FD) rates increased by between 22 to 25 basis points across tenures of 1 to 12 months. Real FD rates[8] remained broadly stable during the quarter despite the increase in nominal rates given expectations for higher inflation.

Banking system liquidity remained sufficient to facilitate financial intermediation

Banking system liquidity remained sufficient at both the institutional and system-wide levels to facilitate financial intermediation activity. The level of outstanding liquidity placed with the Bank declined, reflecting higher currency in circulation as demand for cash increased during the festive season,[9] as well as the net outflows during the quarter. At the institutional level, almost all banks maintained surplus liquidity positions with the Bank as at end-June 2022.

C24 Outstanding Ringgit Liquidity Placed with Bank Negara Malaysia (at end-period)



Source: Bank Negara Malaysia

[8] Real fixed deposit rates are computed as the difference between nominal fixed deposit rates and inflation expectations. Inflation expectations is measured as the average expected rate of inflation over the next 12 months (based on data from Consensus Economics), approximated by an average of the forecasts for the current and next calendar year weighted by their share in the forecasting horizon of 12 months ahead. This is comparable to the use of fixed-horizon forecasts in the literature, including Dovern et al. (2012) and Siklos (2013).

[9] The demand for cash during the festive season this year was particularly high amid the reopening of the economy and the availability of the Employees Provident Fund (EPF) special withdrawal scheme.

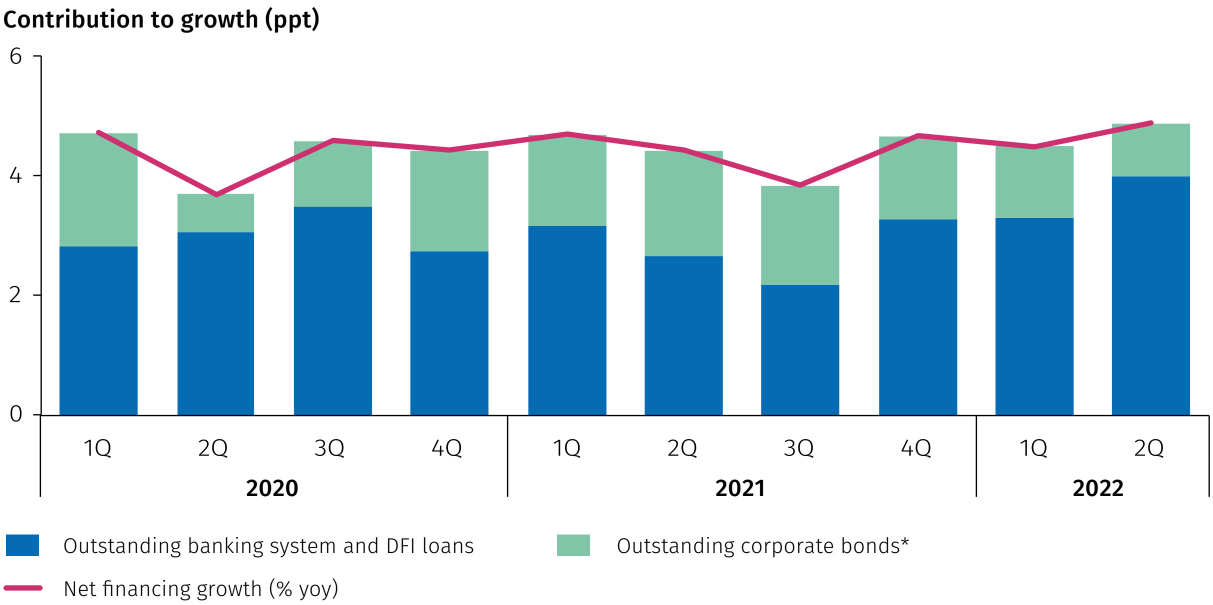
Growth in net financing underpinned by bank lending

As at end-2Q 2022, net financing recorded higher growth (4.9%; 1Q 2022: 4.5%), on account of higher outstanding loan[10] growth (5.4%; 1Q 2022: 4.4%) in both the business and household segments. Outstanding corporate bond[11] growth moderated (3.4%; 1Q 2022: 4.6%) as growth in bond redemptions continued to outpace that of issuances.

Outstanding business loan growth increased to 5.5% (1Q 2022: 4.3%), as working capital[12] loan disbursements to both the SME and non-SME segments continued to record strong growth (23.4%; 1Q 2022: 21.2%). The higher disbursements reflected higher growth in working capital loan applications and continued drawdowns on existing credit lines. Correspondingly, businesses continued to record strong growth in working capital loan repayments (20.3%; 1Q 2022: 22.2%; 2017-19 quarterly average: 5.2%). Notably, growth in outstanding investment-related[12] loans also improved, as loan disbursements recorded strong positive growth across business segments (50.5%; 1Q 2022: 11.6%).

For households, outstanding loan growth continued to increase (5.7%; 1Q 2022: 4.8%), with higher growth recorded across all loan purposes. Loan disbursement growth also increased (29.0%; 1Q 2022: 12.7%; 2017-19 quarterly average: 5.8%) amid higher growth in loan demand,[13] particularly for the purchase of passenger cars and residential properties. In addition, growth in loan repayments increased further (13.3%; 1Q 2022: 3.3%), as repayment assistance programmes lapsed.

C25 **Contribution to Net Financing Growth**



* Excludes issuances by Cagamas and non-residents

Source: Bank Negara Malaysia

[10] Loans from the banking system and development financial institutions (DFIs).

[11] Excludes issuances by Cagamas and non-residents.

[12] Classification of business loans by purpose is only available for the banking system.

[13] Indicated by loan applications to the banking system.

Standardised Base Rate

Box Article

Introduction

As announced by Bank Negara Malaysia (BNM) on 11 August 2021, the Standardised Base Rate (SBR) replaced the Base Rate (BR) as the main reference rate for new retail floating-rate loans and financing facilities with effect from 1 August 2022. For the purpose of this box article, 'loans' include Shariah-compliant financing facilities. Prior to this, banks adopted different methodologies to set their respective BRs. The SBR will serve as the common reference rate for all banks and is linked solely to BNM's Overnight Policy Rate (OPR). This article discusses the background and motivation behind the introduction of the SBR, the key features and benefits of the SBR, the transition from the BR to the SBR, and the way forward.

A) Background and motivation behind the introduction of the Standardised Base Rate

Reference rates are publicly accessible interest rates used by banks as a basis for the pricing of loans. This is particularly relevant for floating-rate loans, as changes in the reference rates lead to changes in the lending rates over the tenure of the loans. The way in which reference rates are determined and used, therefore, have implications on consumers' repayments of their loans, banks' practices in the pricing of loans and the effectiveness of monetary policy transmission.

The Reference Rate Framework was introduced in January 2015. It introduced the BR, which replaced the Base Lending Rate (BLR) as the reference rate for retail floating-rate loans in Malaysia.[1] The introduction of this framework served to improve transparency and discipline in the pricing of retail loans, while enhancing the transmission of monetary policy. Unlike the BLR, which could change due to factors such as banks' operating costs and profit margins, the BR would vary only in response to changes in banks' funding costs. The framework allowed banks to adopt bank-specific BR methodologies that were reflective of their funding strategies, while encouraging greater discipline in banks' pricing practices as banks could not change the lending rates during the tenure of a loan except where there were changes in the credit risk of the borrower or funding costs of the bank (and not for example, to recoup additional operating costs). Over time, banks' BR methodologies became increasingly complex. Initially, the 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR), which was a market-determined external benchmark, was a popular choice for the benchmark rate among banks due to its simplicity. It was also easily comparable across banks. Since then, advancements in banks' BR methodologies had led to the wider adoption of internal benchmarks that were individually determined by the respective banks. This included BRs that were based on a composite of the 3-month KLIBOR and internal funding components, or solely based on banks' internally-determined benchmarks. These developments were also reflective of broader types of funding instruments used by banks to fund loans. The evolution of BR methodologies in turn had reduced the transparency and comparability of BRs across different banks, making it more difficult for consumers to compare the retail loan products and understand the reasons behind changes in their loan repayments. In addition, the variability of BR methodologies across banks also had the effect of dampening monetary policy transmission, due to uneven responses by banks to changes in the OPR.

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[1] For more information, please refer to the box article titled 'The New Reference Rate Framework' in the BNM Annual Report 2014, as well as the box article titled 'Outcomes of the Reference Rate Framework: Moving Towards More Efficient and Transparent Practices' in the Quarterly Bulletin on Economic and Financial Developments in the Malaysian Economy in the Second Quarter of 2017.

As part of BNM's periodic review of its policies, further revisions, which came into effect on 1 August 2022, were therefore made to the Reference Rate Framework to ensure that the requirements remain relevant and fit-for-purpose in achieving its intended outcomes, which are to-

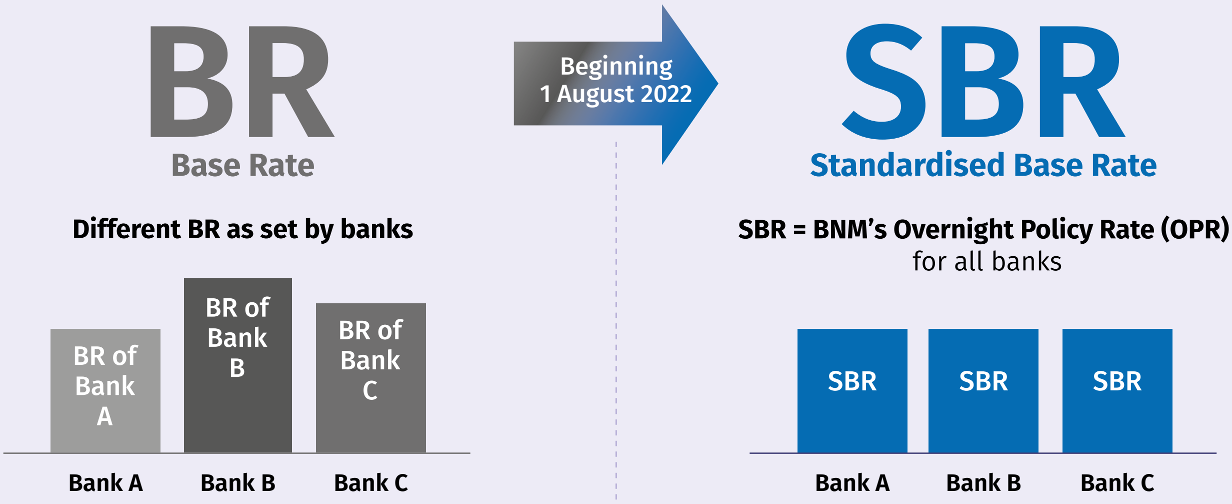
a) promote a transparent reference rate that facilitates meaningful comparisons of loans across banks to allow consumers to make informed decisions;
b) reinforce sound practices in the pricing of retail floating-rate loans by banks; and
c) preserve the effective transmission of monetary policy decisions.

These revisions are encapsulated in the introduction of the SBR to replace the BR for all banks.

B) Key features and benefits of the Standardised Base Rate

The main feature of the SBR is in its standardisation as the common reference rate for all banks. Unlike the BR, which differs for each bank, the SBR is the same across banks.[2]

C1 What is new in the revised Reference Rate Framework?



Another key aspect of the SBR is that it is linked solely to the OPR. This is a further simplification compared to the BR, which was previously determined by both the banks' individual benchmark cost of funds, as well as the cost of holding non-interest bearing statutory reserves with BNM.[3] All other components of loan pricing, such as borrowers' credit risk, liquidity risk premiums, Statutory Reserve Requirement (SRR) cost, operating costs and profit margins, are reflected in the spread above the SBR, which will remain fixed throughout the life of the loan, except in cases where there is a change in the credit risk profiles of borrowers (Chart 2).[4]

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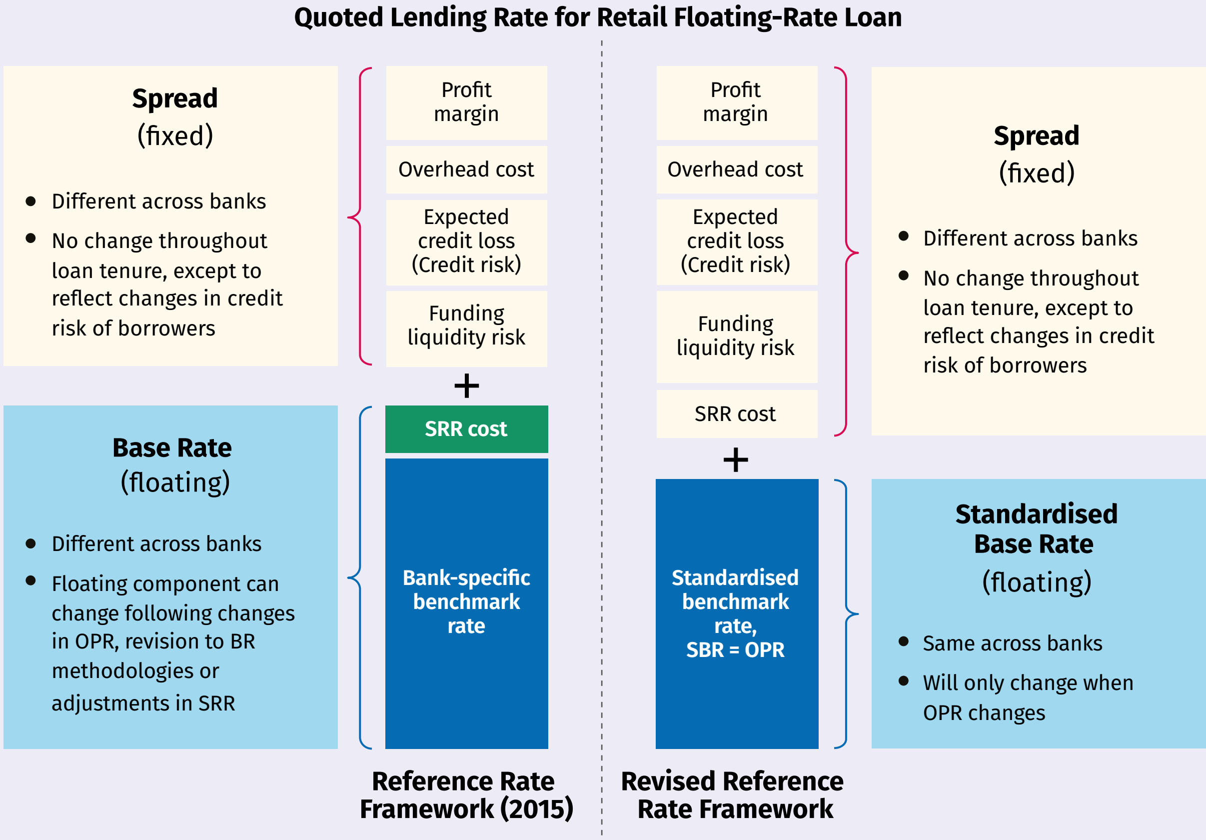
[2] For more details on the revised Reference Rate Framework guidelines, please refer to the Reference Rate Framework policy document published on 11 August 2021.

[3] Statutory reserves are held by all banks pursuant to the Statutory Reserve Requirement (SRR) set by BNM. The SRR cost component has been excluded from the SBR for simplicity and ease of understanding for consumers. The exclusion also avoids the complexities and additional compliance costs for banks that are associated with operationalising the changes to the SBR arising from changes in the SRR. In addition, this was in consideration of the relatively small quantum of the change in the SRR cost component compared to changes in banks' overall cost of funds. The SRR component is incorporated in the overall pricing of the loans, as part of the spread that is fixed over the SBR.

[4] The pricing of the spread can only be adjusted to reflect changes in the credit risk profile of the customer throughout the tenure of the loan, and cannot be increased to reflect changes in banks' operating costs, funding management strategies or the overall portfolio default experience. Such repricing or revision to the lending rates would be subject to BNM's Responsible Financing policy document issued in 2019, as well as the Credit Risk policy document issued in 2019. The guidelines protect customers' interest by ensuring that lending rates would not be repriced in cases of one or two missed repayments, unless such missed repayment has resulted in a change in the credit risk profile or creditworthiness of the customer. The quantum of repricing should also be reasonable, such that it is not excessive and does not exceed the reasonable estimated costs incurred by the banks in connection with the defaulted financing facility.

C2 Comparison of the Reference Rate Framework (2015) and the Revised Reference Rate Framework

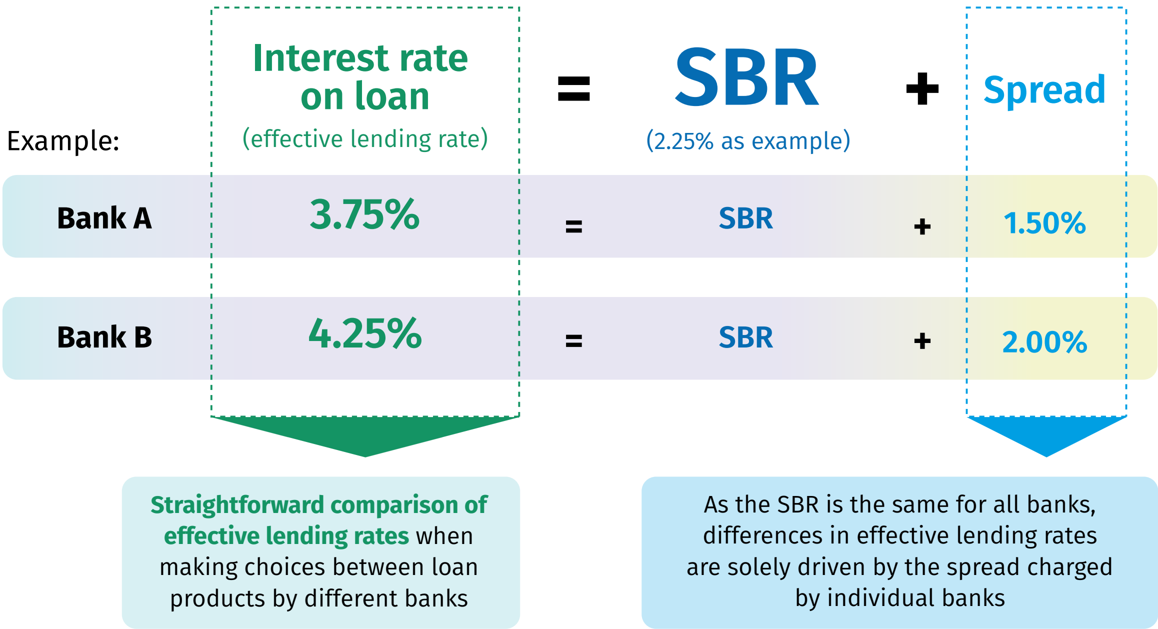


With this revision, changes to the SBR would therefore only occur following changes in the OPR, which is determined by the Monetary Policy Committee (MPC) of BNM. The OPR was selected as the benchmark rate as it is best suited in achieving the intended outcomes of the Reference Rate Framework. The OPR is simple and transparent to consumers. Compared to other external benchmark rates such as KLIBOR, the OPR as the benchmark rate would also ensure greater robustness, integrity and resilience of the benchmark during both normal and stressed market conditions.

The standardisation of the reference rate will make it easier for consumers to compare floating-rate loan products across banks by focusing on the spread above the SBR. It also helps consumers better understand the factors causing changes in their loan repayments during the life of a loan. This is important given the relatively high refinancing costs including legal costs, which increase barriers for borrowers to refinance their existing loans. The SBR therefore will also contribute towards preserving a competitive retail loan market by encouraging more informed borrowing decisions by consumers.

The SBR applies to retail floating-rate loan applications from 1 August 2022. This includes new loans, refinancing of existing loans, and renewal of existing revolving facilities after 31 July 2022. For consumers, this would be applicable to floating-rate loans, such as housing loans and personal loans. Given that the main feature of the SBR is in its standardisation of reference rate, consumers can more easily compare the all-in, effective lending rate across banks, which captures the different spread charged by individual banks.[5]

C3 How should you compare lending rates across banks?



Consumers may also find more information to help with their borrowing decisions from the Consumer Guide on the Revised Reference Rate Framework, which is available on the BNM website*.

* https://www.bnm.gov.my/documents/20124/938039/Consumer+Guide_RRF_EN.pdf

The introduction of the SBR itself would have no impact on the effective lending rates of existing retail loans at the point of transition. Existing BR- and BLR-based loans which were granted prior to 1 August 2022 will continue to remain priced against the BR and BLR until the maturity of these loans.[6] With the revised Reference Rate Framework, changes to the reference rate for existing loans earlier priced against the BR and BLR would also move exclusively in tandem with the OPR, changing by the same quantum as changes in the OPR. Changes in borrowers' loan repayments would therefore be more predictable and transparent to borrowers, as future movements in the loan repayment amounts for borrowers who service their loans on time will only happen due to changes in the OPR.[7] Previously, changes in the BR and BLR could vary due to individual bank-specific factors, which were not completely visible to borrowers.

[5] The effective lending rate refers to the all-in annual interest rate charged on the outstanding loan amount. Differences in the effective lending rates would affect the monthly loan repayment amount.

[6] Banks will continue to display their BRs and BLRs, in addition to the SBR, at all branches and websites after the effective date, for customers' reference.

[7] With the revised Reference Rate Framework, beyond OPR movements, changes in borrowers' loan repayment amount after the initiation of loans would only occur following changes in the credit risk profiles of borrowers. The potential for lending rates on existing loans to be repriced to reflect changes in the credit risk profiles of borrowers is similar to the practice under the previous regimes.

The revised Reference Rate Framework also reinforces sound pricing practices by banks. While the reference rate will be standardised, banks will retain the flexibility to determine the lending rates on new loans based on various factors, including a borrower's credit risk, liquidity risk premiums, operating costs, profit margin and other costs, which would continue to be reflected in the spread above the SBR. As the spread remains generally fixed throughout the lifetime of a loan, the revised framework further strengthens incentives for banks to appropriately price and manage these risks and costs. Improved comparability in the spread above the SBR between banks would also drive greater efficiency in banks, ultimately benefitting consumers. Existing regulations, such as the Risk-Informed Pricing standards issued by BNM would also mitigate against the competitive underpricing of risks that may impact financial stability.

As movements in the SBR, BR and BLR will exactly mirror changes in the OPR, the revised Reference Rate Framework further facilitates an effective and even transmission of monetary policy, given the more direct and equivalent pass-through of OPR adjustments to retail interest rates. Accordingly, changes in lending rates for retail floating-rate loans would better reflect changes in OPR, both in cases of OPR increases and reductions. The enhanced transmission of monetary policy following the revised framework is crucial, as the financing of the economy remains predominantly bank-based even as market-based financing has been increasing over the years,[8] and the majority of banking system financing consists of floating-rate loans.[9]

C) The way forward

Going forward, BNM will continue to closely monitor the implementation of the revised Reference Rate Framework to ensure that it achieves its intended outcomes. At the same time, efforts will continue to further develop a more mature loan market, supported by appropriate market infrastructure and increased financial literacy among consumers.

Some of the desirable features of such a market include the availability of a broader range of loan products, including hybrid loans[10] or convertible loans[11] that can better cater to the different needs of consumers. This would entail a more needs-based and personalised approach for consumers, underpinned by minimal regulatory friction and costs, greater transparency, and healthy market competition. The further development of market infrastructure, including more active securitisation and derivatives markets, would also provide a more conducive environment for banks to enhance their risk management and offer differentiated loan products. Measures to reduce the refinancing and legal costs of loans, alongside ongoing initiatives to increase the financial capability of consumers are equally important to improve the dynamism of the loan market.

Given continued developments in the loan market, the Reference Rate Framework will continue to be periodically reviewed to ensure that the framework remains effective in supporting financial intermediation activities.

References:

Bank Negara Malaysia. 2021. "Reference Rate Framework" Bank Negara Malaysia's 11 August 2021 Policy Document.

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Bank Negara Malaysia. 2015. Box Article on "The New Reference Rate Framework." Bank Negara Malaysia's 2014 Annual Report.

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8 Private sector financing by the banking system and in the corporate bond market accounted for 72% and 28% of total net financing, respectively, as at end-2021 (2010: 77% and 23%, respectively).

9 Around 78% of total banking system loans are floating-rate loans, as at May 2022.

10 A typical feature of this type of loan involves the pricing of the loan against a fixed interest rate during the initial periods, which then changes into floating-rate pricing at the later periods.

11 A form of a hybrid loan where borrowers hold the option to convert from fixed to floating-rate pricing during the tenure of the loan.

The Bank's Policy Considerations

Highlights

- At the May and July 2022 meetings, the Monetary Policy Committee (MPC) decided to reduce the degree of monetary accommodation, by raising the Overnight Policy Rate (OPR) to 2.25%.
- The MPC will continue to assess evolving conditions and their implications on the overall outlook to domestic inflation and growth

Monetary policy remains accommodative and supportive of economic growth

Following the MPC's decision to begin adjusting the degree of monetary accommodation at the May 2022 meeting, the MPC decided to further adjust the degree of monetary accommodation by increasing the OPR by 25 basis points to 2.25% at the July 2022 meeting.

At the July MPC meeting, the MPC assessed that the reopening of the global economy and the improvement in labour market conditions in major economies continued to support the recovery of global economic activity. However, these have been partly offset by the impact from rising cost pressures, the military conflict in Ukraine and strict containment measures in China. Inflationary pressures have continued to increase mainly due to elevated commodity prices and strong demand conditions, despite some easing in global supply chain conditions. Consequently, central banks are expected to continue adjusting their monetary policy settings, some at a faster pace, to reduce inflationary pressures. Going forward, the pace of global growth is expected to moderate, and will continue to be affected by the elevated cost pressures, conflict in Ukraine, global supply chain conditions, and financial market volatility.

For the Malaysian economy, the MPC viewed that economic activity continued to strengthen in recent months. Exports and retail spending indicators affirmed the positive growth momentum, supported by the transition to endemicity. In the labour market, the unemployment rate declined further, with higher labour participation and improving income prospects. Looking ahead, while external demand is expected to moderate, weighed by headwinds to global growth, the MPC assessed that economic growth will be supported by firm domestic demand. Additionally, the reopening of international borders since 1 April 2022 is expected to lift the recovery in tourism-related sectors. Investment activity and prospects continue to be supported by the realisation of multi-year projects. However, downside risks to growth continue to prevail, stemming from a weaker-than-expected global growth, further escalation of geopolitical conflicts, and worsening supply chain disruptions.

As at the July MPC meeting, headline inflation to date had averaged 2.4%. While it is projected to remain within the 2.2% - 3.2% forecast range for the year, headline inflation may be higher in some months due mainly to the base effect from electricity prices. Underlying inflation, as measured by core inflation, is expected to average between 2.0% - 3.0% in 2022 as demand continues to improve amid the high-cost environment. Nevertheless, the extent of upward pressures on inflation will remain partly contained by existing price controls, fuel subsidies and the continued spare capacity in the economy. The inflation outlook continues to be subject to global commodity price developments, arising mainly from the ongoing military conflict in Ukraine and prolonged supply-related disruptions, as well as domestic policy measures.

Amid the positive growth prospects for the Malaysian economy, the MPC decided to further adjust the degree of monetary accommodation. This is consistent with the MPC's view that the unprecedented conditions that necessitated a historically low OPR have continued to recede. At the current OPR level, the stance of monetary policy remains accommodative and supportive of economic growth. The MPC will continue to assess evolving conditions and their implications on the overall outlook to domestic inflation and growth. Any adjustments to the monetary policy settings going forward would be done in a measured and gradual manner, ensuring that monetary policy remains accommodative to support a sustainable economic growth in an environment of price stability.

Other policy highlights in the second quarter of 2022

<table>
<tr><th>Policy highlights</th><th>Salient details</th></tr>
<tr><td>Discussion Paper (DP) 2024 Climate Risk Stress Testing Exercise (CRST)</td><td>• Issued on 30 June 2022, the DP sets out the Bank's proposed framework and elements for the industry-wide CRST exercise in 2024. It discusses the applicability and format of the exercise, and technical elements such as scenarios selection, portfolio scope and granularity, and other considerations.</td></tr>
<tr><td>Policy Document (PD) on Bancassurance/Bancatakaful</td><td>• Issued on 30 June 2022, the PD aims to: -
o ensure bancassurance/bancatakaful remains a viable channel that is widely accessible for consumers to purchase insurance and takaful products;
o promote sound market conduct practices that safeguard consumers' interest through needs-based sales, disclosure and enhanced transparency; and
o promote market competitiveness and preserve consumer choice.
• Amongst others, the PD addresses safeguards to mitigate mis-selling risks and strengthened expectations on sales of bancassurance/bancatakaful products to vulnerable consumers.</td></tr>
<tr><td>PD on Governance, Risk Management, and Operations for Money Services Business (MSB)</td><td>• Issued on 30 June 2022, the PD sets out the minimum standards that MSB licensees must observe in implementing sound governance practices, appropriate risk management and robust internal control systems for their business. This is particularly important given that the MSB industry has continued to evolve to meet the needs of the economy with greater digitalisation in the provision of services.
• The enhanced requirements, amongst others, will contribute towards supporting sound business practices among industry players, strengthening consumer protection and safeguarding the MSB industry from being used as a conduit for illegal activities, money laundering and terrorism financing.</td></tr>
<tr><td>PD on Financial Reporting for Takaful Operators</td><td>• Issued on 29 April 2022, the PD has been revised to ensure compliance with Shariah requirements and the latest Malaysian Financial Reporting Standards (MFRS) requirements applicable to takaful business, namely MFRS 17 Insurance Contracts and MFRS 9 Financial Instruments. The PD is consistent with the latest ruling by the Shariah Advisory Council of the Bank (SAC) and recommendations by the Malaysian Accounting Standards Board relating to application of the MFRS 17 and the MFRS 9 to takaful businesses.
• Key highlights of the PD include: -
o specific requirements on the presentation of financial statements to improve comparability;
o new requirements for measurement and disclosure of qard (interest-free loan) provided by the shareholders' fund to the takaful fund; and
o additional disclosure requirements to reflect takaful specificities, including compliance with the latest SAC rulings on the application of time value of money for qard transaction between the shareholders' fund and takaful fund.</td></tr>
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Macroeconomic Outlook

Highlights

- Global growth is expected to moderate in 2022.
- The Malaysian economy is projected to improve further in the second half of 2022.
- Headline inflation projected to be higher in some months in the second half of 2022 due in part to base effects.

Slower global growth for 2022, amid various headwinds

In 2022, global growth is projected to continue on its recovery path, supported by the sustained reopening of the economy and stronger labour markets. Nevertheless, the military conflict in Ukraine is expected to dampen the pace of the global recovery. Commodity prices have risen higher, reflecting the disruption in commodity production and trade due to the war and associated sanctions by Western countries on Russia. This has led to higher global inflation, which would exacerbate cost pressures on firms while negatively impacting consumer sentiments and spending.

Most major economies are expected to experience strong and persistent inflationary pressures, in an environment of elevated commodity prices and tight labour markets. Central banks in major economies have stepped up the pace of monetary policy tightening to tackle inflation and ensure inflation expectations remain anchored. Financial conditions are expected to tighten. All these factors could weigh on growth.

In China, city-wide lockdowns have been lifted as the number of COVID-19 cases fell. Policy support and a rebound in activity as the economy reopens are expected to support growth. Nevertheless, the continued implementation of containment measures to keep COVID-19 cases low would still constrain economic activity amid high transmissibility of the Omicron variant. The ongoing property market slowdown is also expected to dampen sentiments and weigh on overall economic growth.

Overall, the balance of risks to world growth remains tilted to the downside. A further escalation of geopolitical tensions, especially between Russia and the West, could lead to deeper economic disruptions and higher prices, especially for euro area economies. There is also a risk that high inflation remains more persistent than expected or that inflation expectations become un-anchored. This could lead to faster-than-expected monetary policy tightening in AEs. In addition, there could be a reimposition of a severe and widespread lockdown in China if COVID-19 cases increased sharply. In contrast, upside risks to growth could come from a stronger-than-expected recovery in China from additional policy support and improving sentiments, faster-than-expected improvement in supply chain conditions, as well as stronger-than-expected recovery from reopening of economies.

The Malaysian economy will be supported by firm domestic demand

The Malaysian economy is projected to expand further for the remainder of the year. Economic growth will be underpinned by firm domestic demand as external demand is expected to moderate, weighed by headwinds to global growth. Going forward, growth would continue to benefit from improving labour market conditions and recovery in tourism-related sectors, following the reopening of international borders. Furthermore, investment activities are also projected to improve, supported by the realisation of multi-year projects.

However, the balance of risks to Malaysia's growth remains tilted to the downside. This stems mainly from weaker-than-expected global growth, further escalation of geopolitical conflicts and worsening supply chain disruptions.

Headline inflation projected to be higher in some months in the second half of 2022 due in part to base effects

Headline inflation is expected to trend higher in some months during the remainder of the year, due in part to the base effect from the discount on electricity tariffs implemented in 3Q 2021. As projected earlier, underlying inflation, as measured by core inflation, is expected to average higher in 2022, as demand continues to improve amid the high-cost environment.

Overall, the outlook remains subject to upside risks, contingent on the strength of domestic demand which could contribute to further broad-based price pressures, as well as global commodity price developments and domestic policy measures. Nevertheless, the extent of upside pressure on inflation is expected to remain partly contained by the existing price control measures, fuel subsidies and the continued spare capacity in the economy.

Annex

T1 GDP by Expenditure Components (at constant 2015 prices)

	Share 2021 (%)	2021		2022		
		2Q	1H	1Q	2Q	1H
		Annual growth (%)				
Aggregate Domestic Demand (excluding stocks)	92.7	12.3	4.9	4.4	13.0	8.6
Private sector	74.4	13.0	5.3	4.4	15.4	9.6
Consumption	*58.8*	*11.7*	*4.3*	*5.5*	*18.3*	*11.5*
Investment	*15.6*	*17.3*	*8.7*	*0.4*	*6.3*	*3.4*
Public sector	18.3	9.0	3.3	4.8	2.8	3.8
Consumption	*13.8*	*8.2*	*6.9*	*6.7*	*2.6*	*4.7*
Investment	*4.5*	*12.0*	*-6.9*	*-0.9*	*3.2*	*1.0*
Net Exports	6.0	57.6	27.7	-26.5	-28.7	-27.6
Exports of Goods and Services	*69.1*	*37.1*	*23.3*	*8.0*	*10.4*	*9.2*
Imports of Goods and Services	*63.1*	*35.5*	*22.9*	*11.1*	*14.0*	*12.6*
Real GDP	**100.0**	**15.9**	**7.0**	**5.0**	**8.9**	**6.9**
GDP (q-o-q growth, seasonally adjusted)	**-**	**-0.8**	**-**	**3.8**	**3.5**	**-**

Note: Figures may not add up due to rounding and exclusion of stocks.

Source: Department of Statistics, Malaysia

T2 GDP by Economic Activity (at constant 2015 prices)

	Share 2021 (%)	2021		2022		
		2Q	1H	1Q	2Q	1H
		Annual growth (%)				
Services	57.0	13.4	4.9	6.5	12.0	9.2
Manufacturing	24.3	26.7	15.8	6.6	9.2	7.9
Agriculture	7.1	-1.5	-0.7	0.1	-2.4	-1.2
Mining	6.7	10.6	2.4	-1.1	-0.5	-0.8
Construction	3.7	40.3	8.3	-6.2	2.4	-2.1
Real GDP	**100.0**	**15.9**	**7.0**	**5.0**	**8.9**	**6.9**

Note: Numbers do not add up due to rounding and exclusion of import duties component.

Source: Department of Statistics, Malaysia

T3 Balance of Payments[1]

	2021					2022	
	1Q	2Q	3Q	4Q	Year	1Q	2Q
	RM billion						
Current Account	**11.9**	**13.2**	**18.2**	**15.3**	**58.7**	**3.0**	**4.4**
(% of GDP)	*3.2*	*3.6*	*4.8*	*3.6*	*3.8*	*0.7*	*1.0*
Goods	36.7	40.7	41.5	51.8	170.6	40.5	34.0
Services	-14.8	-15.2	-15.3	-15.4	-60.7	-15.0	-12.3
Primary income	-6.3	-10.8	-4.8	-19.6	-41.6	-20.1	-14.7
Secondary income	-3.7	-1.4	-3.1	-1.4	-9.6	-2.5	-2.6
Financial Account	**16.6**	**-4.1**	**-0.2**	**0.7**	**13.0**	**30.4**	**0.2**
Direct investment	1.8	8.2	8.0	10.5	28.5	20.8	2.6
Assets	-8.0	-8.4	-15.3	-17.2	-48.9	9.1	-17.0
Liabilities	9.8	16.6	23.3	27.7	77.4	11.7	19.6
Portfolio investment	-0.2	20.1	-3.7	2.6	18.8	-10.1	-14.7
Assets	-14.3	-10.5	-4.9	-6.1	-35.8	-13.9	-4.4
Liabilities	14.2	30.6	1.2	8.7	54.6	3.8	-10.3
Financial derivatives	0.3	-1.5	0.7	-1.8	-2.3	0.2	-0.2
Other investment	14.7	-30.9	-5.2	-10.6	-32.0	19.6	12.5
Net errors & omissions[2]	**-11.3**	**-4.4**	**3.4**	**-13.1**	**-25.5**	**-20.6**	**0.3**
Overall Balance	**17.1**	**4.7**	**21.3**	**2.6**	**45.7**	**12.8**	**4.9**

Assets: (-) denotes outflows due to the acquisition of assets abroad by residents.
Liabilities: (+) denotes inflows due to the incurrence of foreign liabilities.
[1] In accordance with the Sixth Edition of the Balance of Payments and International Investment Position Manual (BPM6) by the International Monetary Fund (IMF).
[2] As at 1Q 2018, quarterly net E&O excludes reserves revaluation changes. This practice is backdated up to 1Q 2010.
Note: Numbers may not add up due to rounding
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

T4 Outstanding External Debt

	2021	2022	
	end-Jun	end-Mar	end-Jun
	RM billion		
Total External Debt	**1,021.4**	**1,111.2**	**1,128.3**
USD billion equivalent	*245.9*	*264.4*	*256.2*
By instrument			
Bonds and notes[1]	196.8	194.8	191.9
Interbank borrowings[1]	187.6	192.9	204.6
Intragroup loans[1]	132.7	146.5	150.9
Loans[1]	75.2	74.1	73.0
Non-resident holdings of domestic debt securities	244.8	258.1	252.7
Non-resident deposits	93.5	104.9	106.9
IMF allocation of Special Drawing Rights (SDRs)	8.0	28.1	28.3
Others[2]	82.7	111.9	119.8
Maturity profile			
Medium- and long-term	635.8	683.6	677.5
Short-term	385.6	427.6	450.8
Currency denomination			
Ringgit	358.4	381.3	377.7
Foreign	663.0	729.9	750.6
Total debt / GDP (%)	68.5	69.6	67.7
Short-term debt / Total debt (%)	37.8	38.5	40.0
Reserves / Short-term debt (times)	1.2	1.1	1.1[3]

[1] These debt instruments constitute the offshore borrowings.
[2] Comprise trade credits and miscellaneous.
[3] Based on international reserves as at 29 July 2022.

Note: Figures may not add up due to rounding

Source: Ministry of Finance Malaysia and Bank Negara Malaysia

T5 Financing of the Private Sector through the Banking System, DFIs and Capital Market

	2021		2022			2021		2022		
	2Q	1H	1Q	2Q	1H	2Q	1H	1Q	2Q	1H
	Change during the period (RM billion)					Annual growth (%)				
Total net financing	**15.9**	**49.5**	**30.4**	**26.9**	**57.3**	**4.4**	**4.4**	**4.5**	**4.9**	**4.9**
Outstanding:										
Loans[1,2]	7.4	31.8	26.2	27.0	53.1	3.6	3.6	4.4	5.4	5.4
Business enterprises	3.5	16.6	10.3	12.0	22.3	1.3	1.3	4.3	5.5	5.5
SMEs	0.0	3.9	7.6	4.5	12.1	6.0	6.0	6.0	7.5	7.5
Non-SMEs	3.4	12.7	2.7	7.5	10.1	-2.2	-2.2	2.9	3.9	3.9
Households	4.3	12.1	15.0	15.1	30.1	5.3	5.3	4.8	5.7	5.7
Outstanding corporate bonds[3]	8.5	17.7	4.2	-0.1	4.1	6.9	6.9	4.6	3.4	3.4

[1] Loans from the banking system and development financial institutions (DFIs).
[2] Includes loans sold to Cagamas.
[3] Excludes issuances by Cagamas and non-residents.
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

T6 Loan Indicators

	2021		2022			2021		2022		
	2Q	1H	1Q	2Q	1H	2Q	1H	1Q	2Q	1H
	During the period (RM billion)					Annual growth (%)				
Total										
Loan applications[1]	243.2	463.8	239.8	276.0	515.8	44.7	27.0	8.7	13.5	11.2
Loan approvals[1]	98.7	188.6	106.3	130.4	236.7	48.1	22.9	18.2	32.2	25.5
Loan disbursements[2]	357.2	718.4	415.3	441.1	856.3	36.0	24.3	15.0	23.5	19.2
Loan repayments[2]	366.4	722.3	403.3	432.4	835.7	43.5	25.6	13.3	18.0	15.7
Of which:										
Business enterprises[3]										
Loan applications	91.3	172.1	89.2	104.6	193.8	-5.4	-8.9	10.4	14.6	12.6
Loan approvals	38.8	74.4	42.7	58.4	101.1	-7.2	-10.6	20.2	50.4	35.9
Loan disbursements	274.3	541.7	309.6	334.2	643.8	33.6	25.7	15.8	21.8	18.8
Loan repayments	276.6	535.4	303.0	330.7	633.7	37.7	27.2	17.1	19.6	18.4
SMEs										
Loan applications	47.0	86.4	45.1	53.6	98.7	-1.6	-9.2	14.4	14.0	14.2
Loan approvals	17.7	32.9	21.2	25.9	47.1	18.5	13.0	39.9	46.3	43.4
Loan disbursements	76.3	153.9	87.9	93.2	181.1	35.5	28.5	13.3	22.1	17.6
Loan repayments	77.4	151.1	84.8	90.6	175.4	51.4	29.2	15.1	17.1	16.1
Non-SMEs[3]										
Loan applications	44.4	85.7	44.1	51.1	95.1	-9.0	-8.6	6.7	15.2	11.1
Loan approvals	21.1	41.5	21.5	32.5	54.0	-21.5	-23.3	5.5	53.9	30.1
Loan disbursements	198.0	387.8	221.7	241.0	462.7	32.9	24.6	16.8	21.7	19.3
Loan repayments	199.2	384.3	218.2	240.1	458.3	33.1	26.4	17.9	20.5	19.3
Households										
Loan applications	151.8	291.7	150.7	171.3	322.0	112.2	65.6	7.7	12.8	10.4
Loan approvals	59.8	114.2	63.5	72.0	135.6	141.4	62.5	16.8	20.4	18.7
Loan disbursements	82.8	176.7	105.7	106.9	212.6	44.5	20.2	12.7	29.0	20.3
Loan repayments	89.8	186.9	100.3	101.7	202.0	64.7	21.2	3.3	13.3	8.1

[1] Loan applications and approvals for all segments include data from the banking system only.
[2] Loan disbursements and repayments for all segments include data from the banking system and development financial institutions (DFIs). With effect from 1 April 2020, an automatic moratorium was implemented on loan/financing repayments/payments by household and SME borrowers for a period of 6 months.
[3] Includes domestic non-bank financial institutions, domestic financial institutions, government, domestic other entities and foreign entities.
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

T7 Banking System Profitability Indicators

	2021				2022	
	1Q	2Q	3Q	4Q	1Q	2Q[p]
Return on equity (%)[1]	8.3	9.7	9.4	9.5	10.9	11.8
Return on assets (%)[1]	0.9	1.1	1.1	1.1	1.2	1.3
	RM million					
Net interest income	14,175	14,630	13,711	14,682	14,794	15,482
Add: Fee-based income	3,189	2,880	2,861	3,122	2,922	2,832
Less: Operating cost[2]	11,442	8,998	8,776	9,393	8,907	9,301
Gross operating profit	5,922	8,511	7,796	8,412	8,809	9,012
Less: Impairment[3] and other provisions	1,543	2,155	2,689	2,064	1,196	867
Gross operating profit after provision	4,379	6,357	5,107	6,348	7,613	8,145
Add: Other income[1]	2,719	3,231	2,677	2,393	2,008	3,088
Pre-tax profit[1]	**7,098**	**9,587**	**7,784**	**8,741**	**9,621**	**11,233**
	Annual growth (%)					
Return on equity (percentage points)[1]	-1.8	0.8	0.3	1.1	2.6	2.1
Return on assets (percentage points)[1]	-0.21	0.09	0.02	0.11	0.27	0.20
Net interest income	11.6	47.2	0.5	5.6	4.4	5.8
Add: Fee-based income	23.5	24.8	0.3	-1.0	-8.4	-1.7
Less: Operating cost[2]	32.9	9.9	3.7	6.4	-22.2	3.4
Gross operating profit	-11.2	109.9	-2.9	2.2	48.8	5.9
Less: Impairment[3] and other provisions	-44.1	-10.3	-17.9	-65.2	-22.5	-59.8
Gross operating profit after provision	12.0	284.5	7.4	176.1	73.9	28.1
Add: Other income[1]	-37.9	-31.8	-25.5	-23.9	-26.2	-4.4
Pre-tax profit[1]	**-14.4**	**50.0**	**-6.8**	**60.6**	**35.5**	**17.2**

[1] Banking system profits are aggregated at the entity level. The aggregated results for 2019 onwards are subsequently adjusted for dividend income received from domestic banking subsidiaries (previously added at both the parent and subsidiary levels). The adjustment is reflected under 'Other income'. Differences in comparative pre-tax figures reported in previous Quarterly Bulletins are estimated to range between 5.5% and 10.7%.

[2] Refers to staff costs and overheads.

[3] Refers to 12 Months Expected Credit Losses (ECL), Lifetime ECL Not Credit Impaired and Lifetime ECL Credit Impaired based on the Malaysian Financial Reporting Standard 9 (MFRS 9).

p Preliminary

Source: Bank Negara Malaysia

T8 Insurance and Takaful Sector Profitability Indicators

	2021				2022	
	1Q	2Q	3Q	4Q	1Q	2Q[p]
	RM million					
Life Insurance & Family Takaful						
Excess income over outgo[1]	-2,212	3,361	2,157	1,048	1,866	-4,137
General Insurance & General Takaful						
Operating profit	710	1,074	916	354	262	771
Claims ratio (%)	55	51	52	61	63	65
	Annual growth (%)					
Life Insurance & Family Takaful						
Excess income over outgo[1]	68.0	-66.4	-46.2	-75.9	184.3	-223.1
General Insurance & General Takaful						
Operating profit	30.2	-6.9	20	-61.1	-63.1	-28.2
Claims ratio (percentage points)	-4.7	-1.6	-3.8	8.3	8.6	13.8

[1] Data excludes investment-linked unit fund
p Preliminary
Source: Bank Negara Malaysia

T9 Federal Government Finance[1]

	2021		2022p		
	2Q	1H	1Q	2Q	1H
	RM billion				
Revenue	56.9	106.4	62.7	61.6	124.3
Annual growth (%)	*0.8*	*4.5*	*26.6*	*8.3*	*16.8*
Operating expenditure	55.2	117.4	64.6	65.2	129.8
Annual growth (%)	*6.2*	*2.9*	*3.8*	*18.2*	*10.6*
Current account	**1.7**	**-11.0**	**-1.9**	**-3.6**	**-5.5**
Net development expenditure	12.6	27.9	16.6	13.4	30.0
Annual growth (%)	*80.0*	*57.0*	*8.7*	*6.3*	*7.4*
COVID-19 Fund[2]	9.3	18.4	5.4	4.1	9.5
Overall balance	**-20.2**	**-57.3**	**-23.9**	**-21.1**	**-45.0**
Memo:					
Total net expenditure	77.1	163.7	86.6	82.7	169.3
Annual growth (%)	*-4.9*	*6.0*	*0.0*	*7.2*	*3.4*
Total Federal Government debt (as at end-period)	958.4	958.4	1005.8	1045.0	1045.0
Domestic Debt	698.5	698.5	736.6	780.7	780.7
External Debt	259.9	259.9	269.2	264.3	264.3
Non-resident holdings of RM-denominated debt	*231.5*	*231.5*	*244.4*	*239.5*	*239.5*
Offshore borrowing	*28.4*	*28.4*	*24.9*	*24.8*	*24.8*

p Preliminary
Note:
[1] Numbers may not add up due to rounding.
[2] A specific trust fund established under Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020 to finance economic stimulus packages and recovery plan.

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia