BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

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3Q

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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Contents

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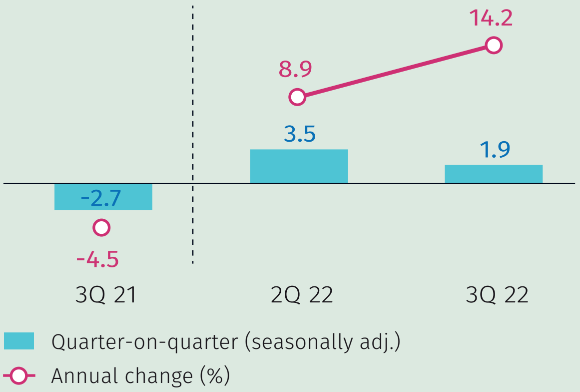
Highlights: 3Q 2022

Strong expansion of 14.2% in 3Q22

Domestic and external demand remained forthcoming

Real GDP



Source: Department of Statistics, Malaysia

Factors affecting GDP in 3Q22...

Strong household spending
Private Consumption:
+15.1%

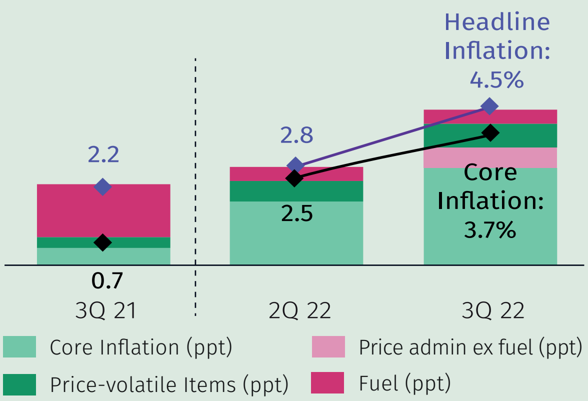
Higher capital expenditure
Gross Fixed Capital Formation:
+13.1%

Robust demand for exports
Exports of Goods & Services:
+23.9%

...and partly lifted by base effects

Headline inflation has likely peaked for the year in 3Q22

Inflation
Annual change (%),
Contribution to headline inflation (ppt)



* Core inflation is computed by excluding price-volatile and price-administered items.
Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Factors affecting inflation in 3Q22:

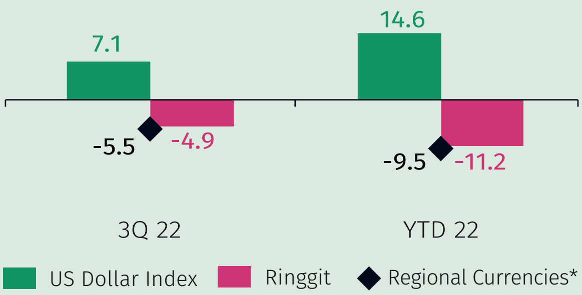
Higher core inflation*
Driven by continued improvement in demand amid the high cost environment.

Low base in 3Q21
Discount in electricity prices last year contributed 0.5 ppt to headline inflation.

USD strength drove major & regional currencies lower

Ringgit depreciation in line with regional currencies

Movement of US Dollar Index, Ringgit & Regional Currencies against the USD (%)



* Regionals comprise Indonesia, Philippines, Korea, Singapore and Thailand.
YTD as at 9 November 2022.
Source: Bank Negara Malaysia

Malaysia's external resilience will continue to mitigate adverse spillovers to the economy

Large foreign currency (FCY) external assets outweigh FCY external liabilities

Well-capitalised banking system
No undue reliance on external financing to support financial intermediation.

Risk from FCY debt largely contained
More than half are subject to prudential safeguards & on flexible terms.

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International Economic Environment

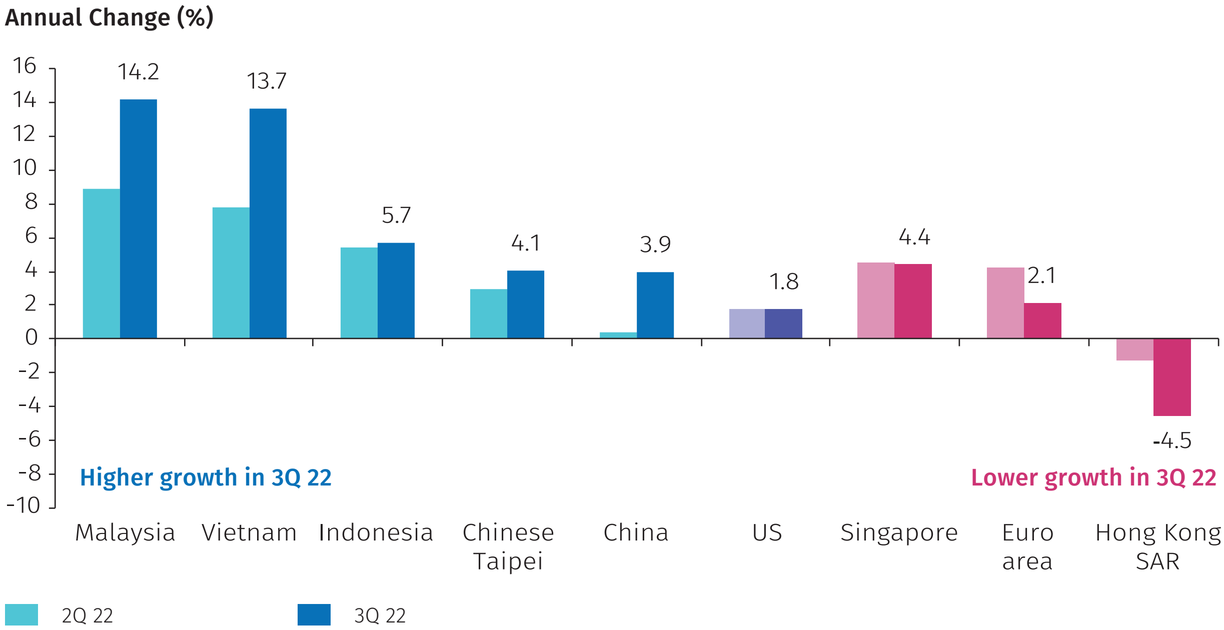
Highlights

- Global growth moderated in the third quarter of 2022.
- Regional exports expanded rather modestly.
- Global financial markets remained volatile.

Global economy continued to expand, albeit at a slower pace

Global growth continued to moderate in the third quarter of 2022. Inflationary pressures remained high amid elevated commodity prices and tight labour markets, despite improvements in global supply chain conditions. Consequently, central banks made further adjustments to monetary policy settings to reduce inflationary pressures. High inflation and energy prices weighed on economic activity. Manufacturing and services activities slowed further, particularly in advanced economies. However, these factors were partly offset by positive COVID-related developments in Asia. China and Chinese Taipei gradually recovered from disruptions due to COVID experienced in the previous quarter. In addition, growth in several ASEAN economies was lifted by base effects from lockdowns imposed in the same period last year.

C1 GDP Growth of Selected Economies

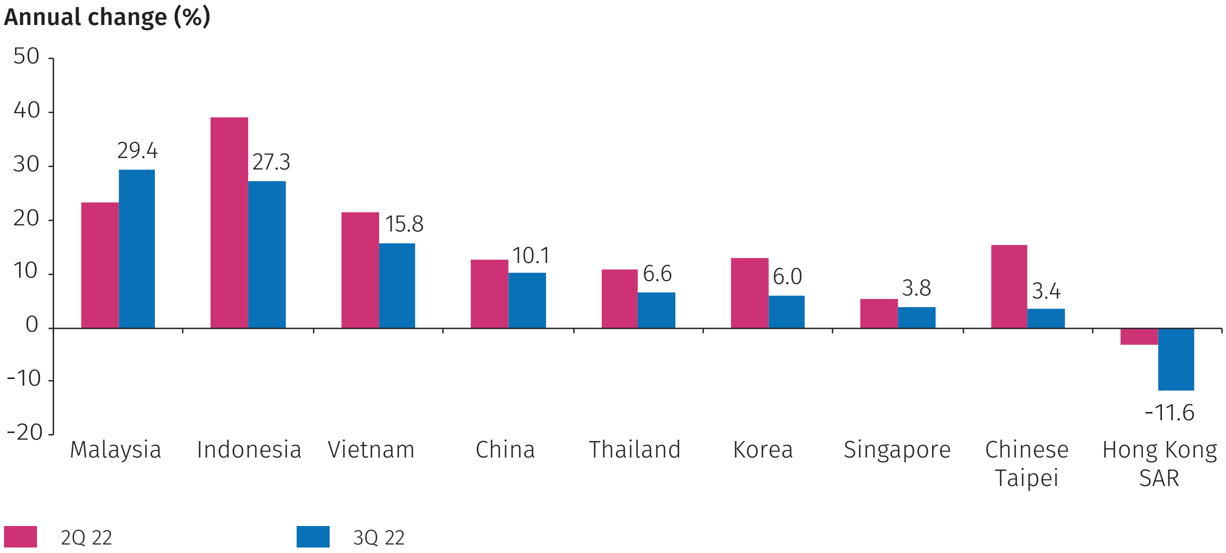


Source: National authorities

Regional exports expanded modestly

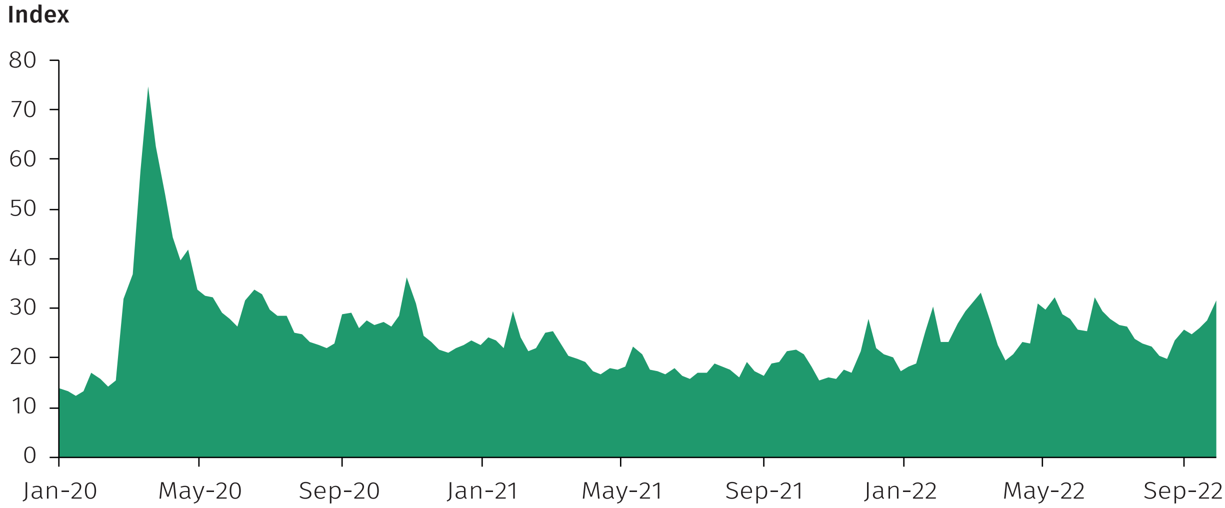
Amid slower global demand, regional exports recorded modest growth throughout the quarter. The shift in demand from goods to services further weighed on export growth. The moderation in demand was most pronounced in the electrical and electronics (E&E) sector. Nonetheless, high commodity prices lent support to commodity exports.

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



Source: National authorities

C3 **CBOE Volatility Index (VIX)**



Source: Bloomberg

Global financial markets remained volatile

On average, global financial market volatility remained elevated during the quarter (CBOE VIX, 3Q 2022: 24.8; 2Q 2022: 27.4; Average 2011-19: 16.2). In July and early August, global financial market volatility moderated in response to lower-than-expected inflation in the US. However, in the second half of the quarter, volatility began to rise again following increased uncertainty over the pace of tightening by the US Federal Reserve (Fed). The index peaked at a 3-month high after the Fed announced the third 75 basis points hike and signalled a much higher terminal rate. Financial markets were also weighed down by volatile commodity prices and concerns over weaker global growth prospects.

Brent crude oil prices declined to an average of USD98 per barrel during the quarter (2Q 2022 average: USD112 per barrel), on concerns over lower oil demand as global growth moderated.

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Developments in the Malaysian Economy

Highlights

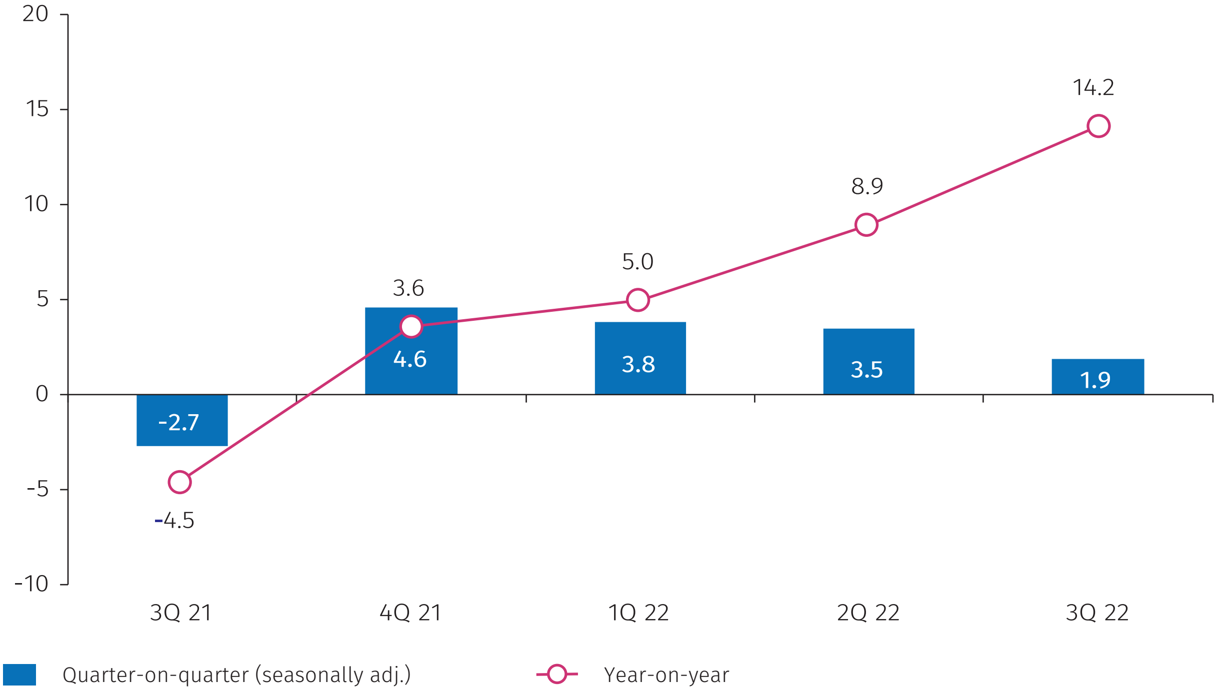
- The Malaysian economy recorded a strong growth of 14.2% in the third quarter of 2022.
- Headline inflation increased during the quarter.
- Higher current account surplus of RM14.1 billion, or 3.1% of GDP.

GDP registered strong growth in the third quarter of 2022

The Malaysian economy registered a strong growth of 14.2% in the third quarter of 2022 (2Q 2022: 8.9%). Apart from the sizeable base effects from negative growth in the third quarter of 2021,[1] the high growth was underpinned by continued expansion in domestic demand. On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 1.9% (2Q 2022: 3.5%). Overall, the Malaysian economy expanded by 9.3% in the first three quarters of 2022.

C4 Real GDP Growth

Annual and quarterly change (%)



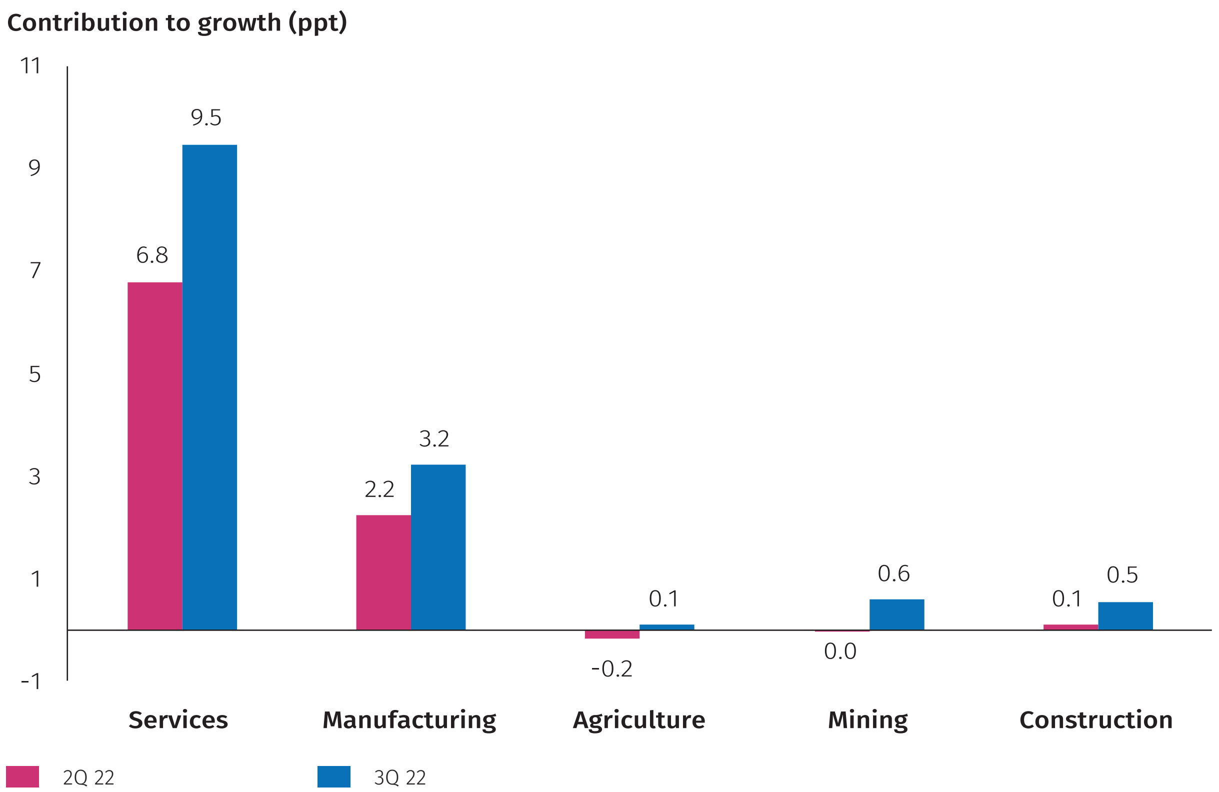
Source: Department of Statistics, Malaysia

[1] The Malaysian economy was adversely affected by the re-imposition of strict containment measures during the third quarter of 2021, which entailed, among others, limits to operating capacities for selected economic activities and inter-state travel restrictions. Against this, the economy recorded a contraction of 4.5%.

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

Expansion across all economic sectors

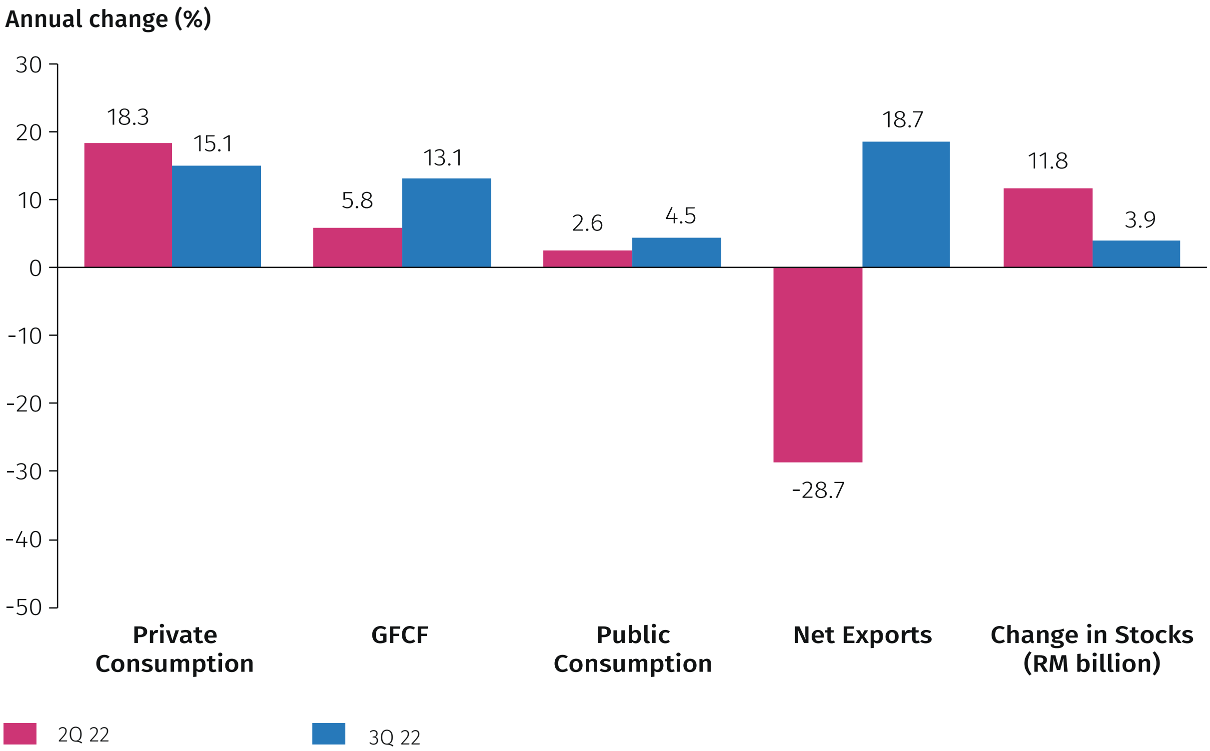
All economic sectors expanded in the third quarter of 2022. The services sector strengthened further by 16.7% (2Q 2022: 12.0%), primarily supported by consumer-related subsectors. Better labour market conditions and the continued recovery in tourism provided strong impetus to retail and leisure-related activities. Policy measures such as the increase in minimum wage further supported domestic spending.

The manufacturing sector grew by 13.2% (2Q 2022: 9.2%). The E&E cluster continued to record strong growth (17.3%; 2Q 2022: 15.5%), while the primary sector expanded at a faster pace (6.0%; 2Q 2022: 1.3%) due to the resumption of operations at an existing oil refinery that was previously under maintenance. The consumer cluster registered double-digit growth, lifted by the ramp up of production in the motor vehicle and transport equipment segment to meet the high backlog in orders.

The construction sector recorded a higher growth of 15.3% (2Q 2022: 2.4%) as all subsectors recorded improvements in activities. Commercial real estate, mixed-development and small-scale projects continued to support activities in the non-residential and special trade subsectors.

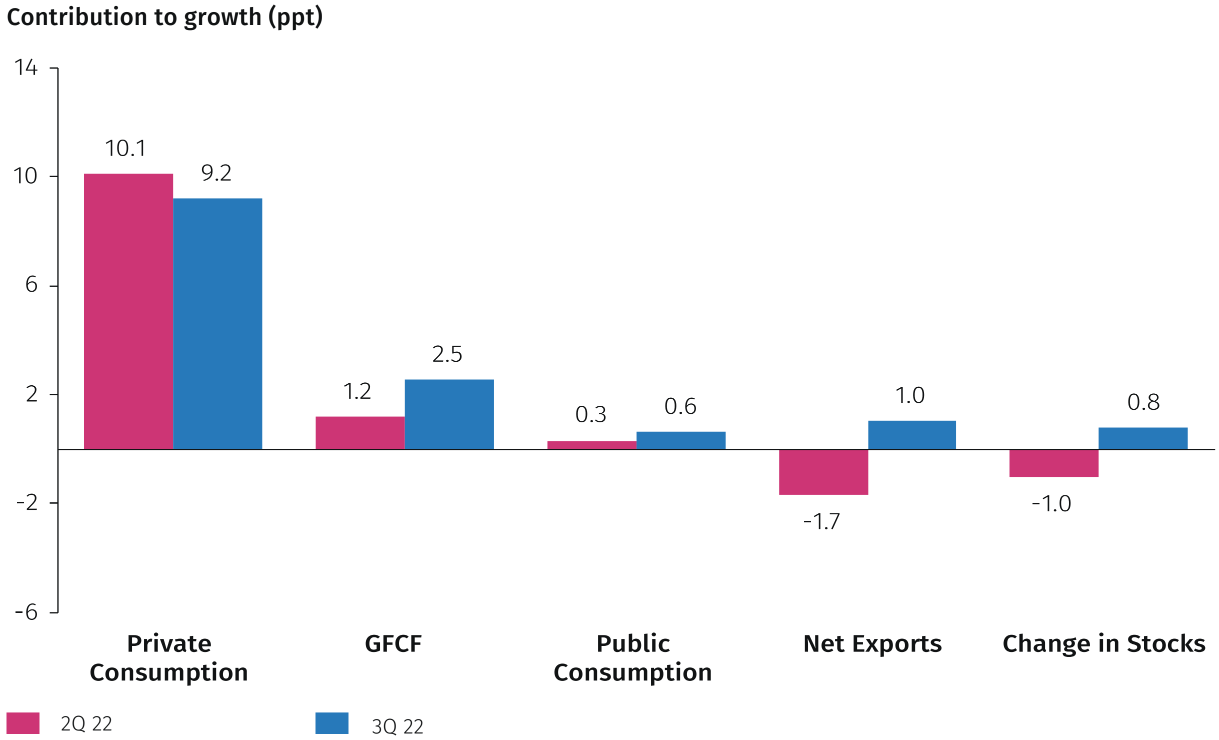
Commodities-related sectors rebounded. Growth in the mining sector rose to 9.2% (2Q 2022: -0.5%), attributed mainly to higher oil and gas output, including from the Pegaga gas field in Block SK320, Sarawak, as well as Block PM302, Terengganu. Growth was also partly contributed by base effects arising from maintenance-related closures in the same period last year. The agriculture sector grew by 1.2% (2Q 2022: -2.4%), driven mainly by higher oil palm output amid gradual receding of labour shortages and improved yields following higher rainfall earlier in the year.

C7 Annual Growth of Real GDP by Expenditure Components



Source: Department of Statistics, Malaysia

C8 Contributions of Expenditure Components to Real GDP Growth



Source: Department of Statistics, Malaysia

Continued expansion in domestic demand

During the quarter, domestic demand expanded by 13.1% (2Q 2022: 13.0%), driven by firm private sector expenditure.

Private consumption growth remained robust at 15.1% (2Q 2022: 18.3%). This was attributed to the continued recovery in labour market conditions with higher employment and income growth. The strong performance was driven by spending across both necessities and discretionary items. Policy support, including the increase in minimum wage and Bantuan Keluarga Malaysia also spurred consumer spending.

Public consumption expanded at a faster pace of 4.5% (2Q 2022: 2.6%), attributable to higher growth in spending on supplies and services.

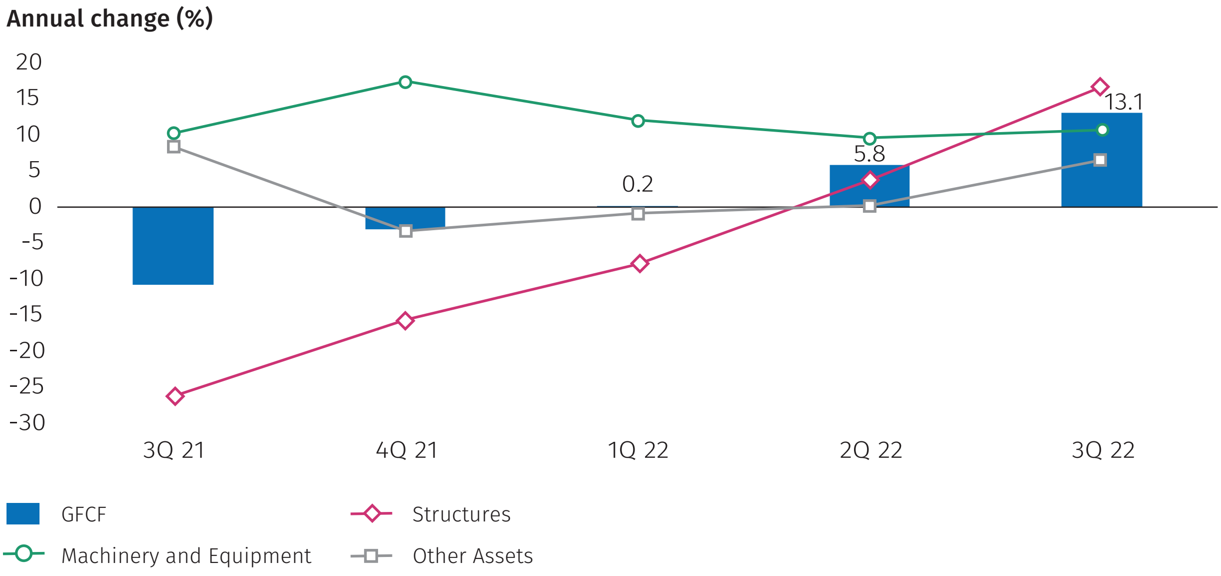
Further improvement in investment activity

Gross fixed capital formation (GFCF) registered a higher growth of 13.1% (2Q 2022: 5.8%) as capital spending by both private and public sectors improved further. Investment in structures increased by 16.7% (2Q 2022: 3.8%), while investment in machinery and equipment (M&E) and other assets rose by 10.7% (2Q 2022: 9.6%) and 6.6% (2Q 2022: 0.2%), respectively.

Private investment grew by 13.2% (2Q 2022: 6.3%), with higher capital expenditure driven mainly by services and manufacturing firms. Structures investment improved as projects across all property segments progressed further. The higher capital spending in M&E benefitted from capacity expansions amid favourable demand conditions.

Public investment expanded by 13.1% (2Q 2022: 3.2%), on account of higher capital spending by both general government and public corporations particularly in the oil and gas, and telecommunication sectors.

C9 **GFCF Growth by Type of Asset**



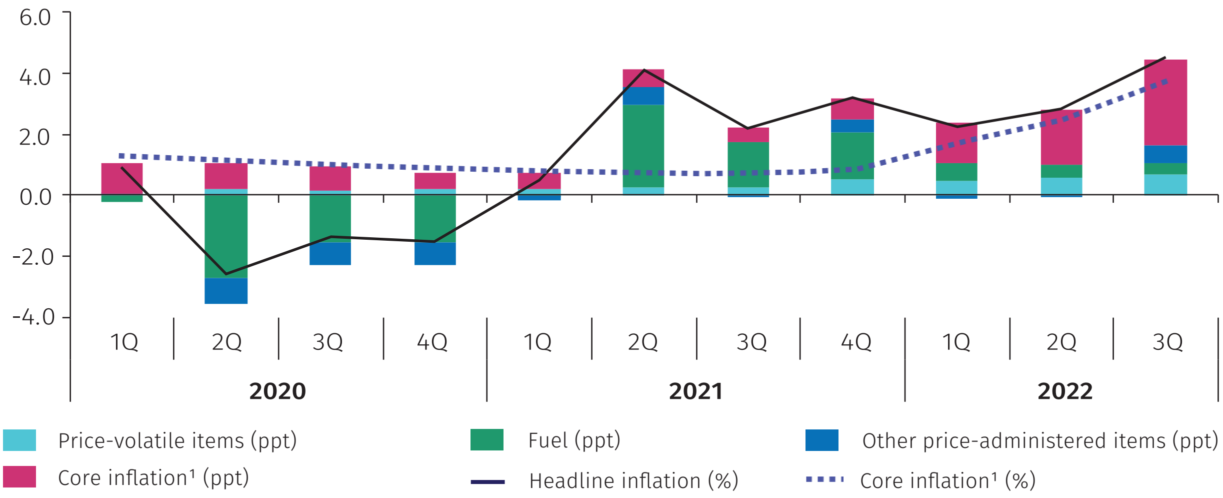
Source: Department of Statistics, Malaysia

Headline inflation increased during the quarter

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), rose to 4.5% during the quarter (2Q 2022: 2.8%). As expected, the increase was largely driven by the base effect from the discount on electricity bills implemented in the third quarter of 2021, as well as sustained increases in core and price-volatile inflation. The inflationary pressures reflected the confluence of stronger demand conditions and elevated cost pressures, particularly for food-related items.

C10 Contribution to Headline Inflation by Components

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

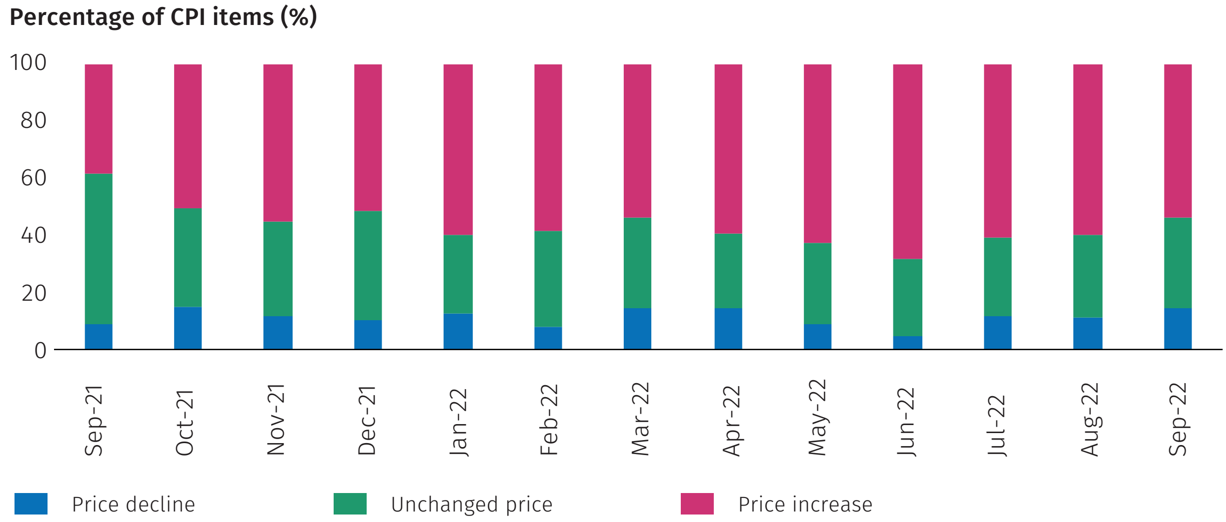


[1] Core inflation is computed by excluding price-volatile and price-administered items.

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

Core inflation rose to 3.7% (2Q 2022: 2.5%) attributable to continued strengthening in demand in a high-cost environment. The increase was predominantly driven by food away from home (3Q 2022: 8.2%; 2Q 2022: 5.3%) and higher rental inflation (3Q 2022: 1.4%; 2Q 2022: 0.9%). Prices for other discretionary services, such as cultural services and restaurants and hotels, also rose. Price pressures remained pervasive throughout the quarter. The share of CPI items recording monthly price increases trended lower but remained high at 58.1% (2Q 2022: 63.2%; 2011-2019 average: 45.6%).

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

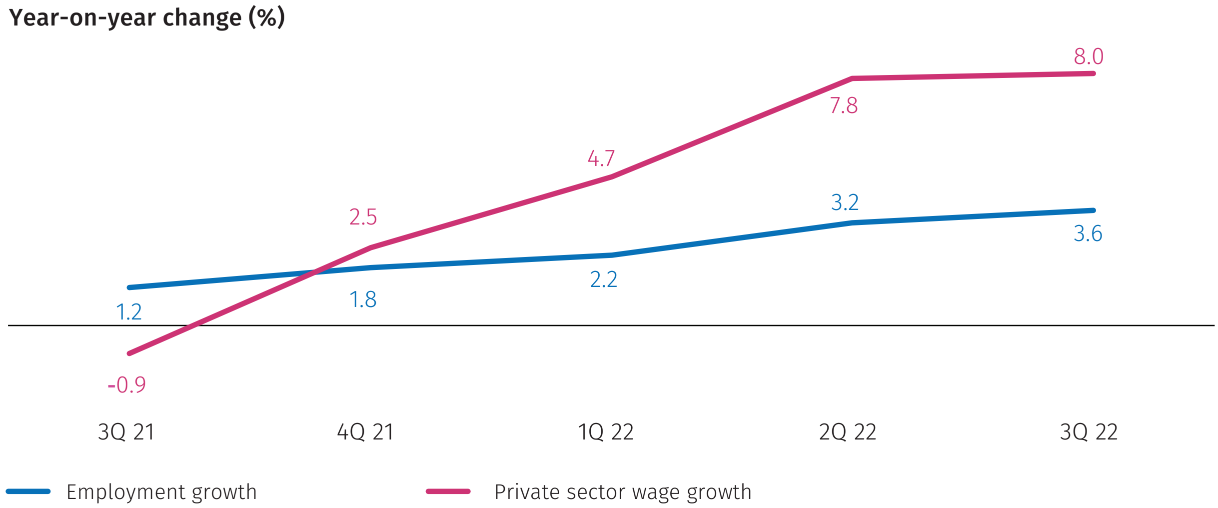
Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Further recovery in labour market

Labour market conditions improved further in the third quarter of 2022, with the unemployment and underemployment rates declining to 3.7% and 1.1% of the labour force, respectively (2Q 2022: 3.9% and 1.3%, respectively). This was supported by strong employment gains, amid an increasing number of workers entering the labour force. The labour force participation rate continued to improve, increasing to 69.4% of the working-age population, above the pre-pandemic level (2Q 2022 69.2%; 4Q 2019: 68.5%). Data on jobless claims and new job placements from the Employment Insurance System (EIS) also showed hiring was sustained amid lower retrenchments during the quarter.

Private sector wages also continued to improve in the third quarter of 2022, supported by the strong pace of economic expansion. In terms of momentum, on a quarter-on-quarter seasonally adjusted basis, wage growth moderated closer to pre-crisis averages (1.1%; 2Q 2022: 2.1%; 2015-2019 avg.: 1.4%). Wage growth was driven by broad-based improvements across both the services and manufacturing sectors.

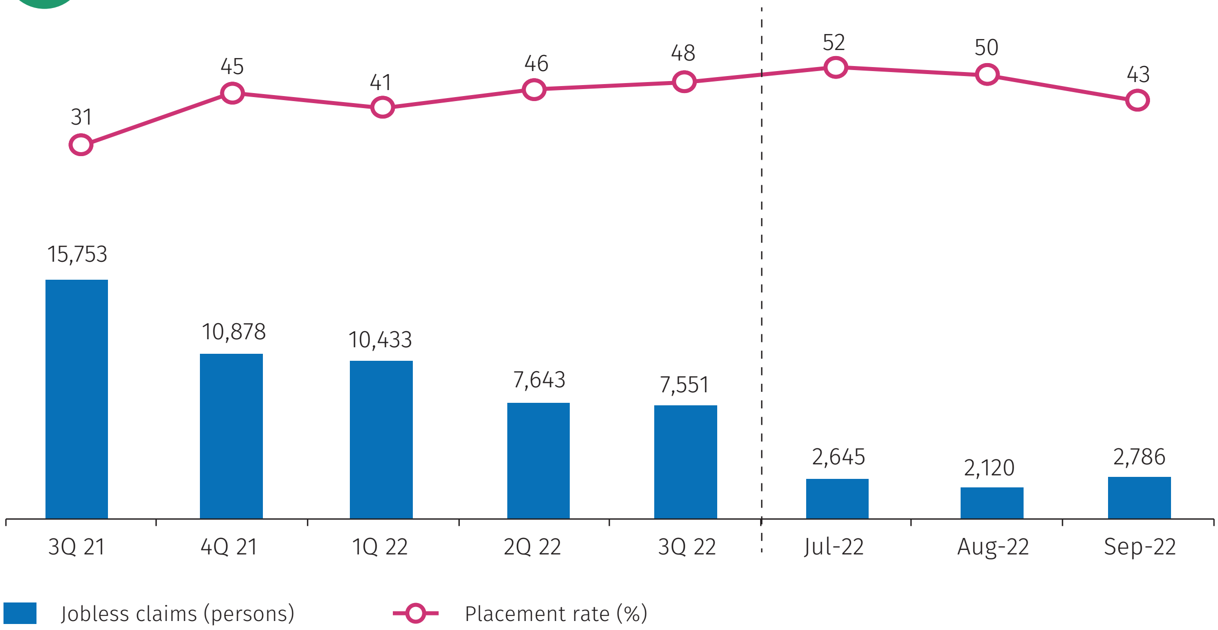
C12 **Employment and Wage Growth**



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

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

C13 Jobless Claims and Placement Rate

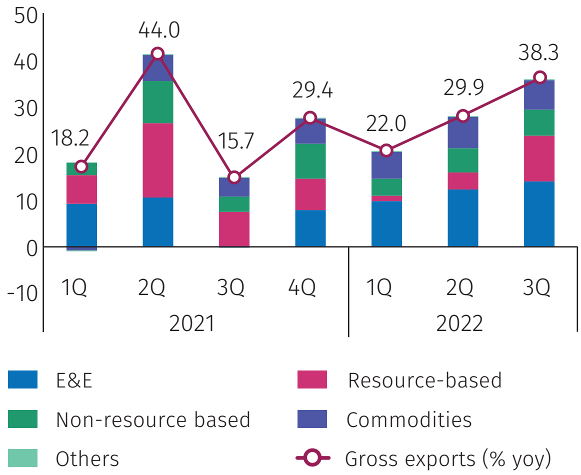


Note: Jobless claims refers to the number of people who apply for the Employment Insurance System (EIS) benefits following loss of employment. The placement rate refers to the number of people placed in new jobs under the EIS for every 100 persons retrenched.

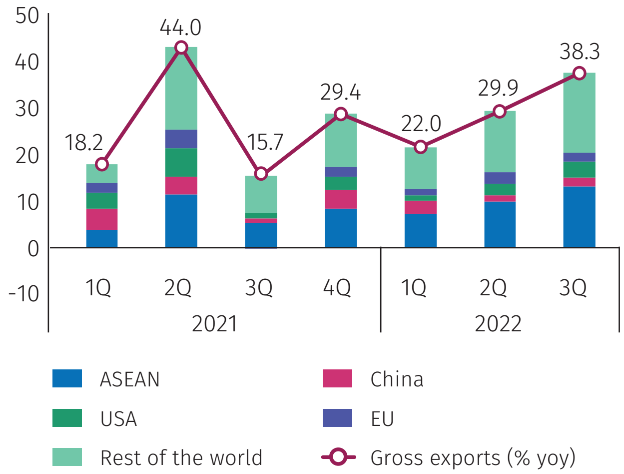
Source: Employment Insurance System, Social Security Organisation

C14 Gross Exports by Product and Market

Annual change (%), contribution to growth (ppt)



Annual change (%), contribution to growth (ppt)



Source: Department of Statistics, Malaysia

Export and import performance remained robust

Gross exports advanced by 38.3% (2Q 2022: 29.9%), reflecting a broad-based expansion across products, supported by external demand and high commodity prices. Manufactured exports expanded by 36.8% (2Q 2022: 26.0%), driven by both E&E (41.4%, 2Q 2022: 37.6%) and non-E&E exports (33.4%, 2Q 2022: 18.1%).

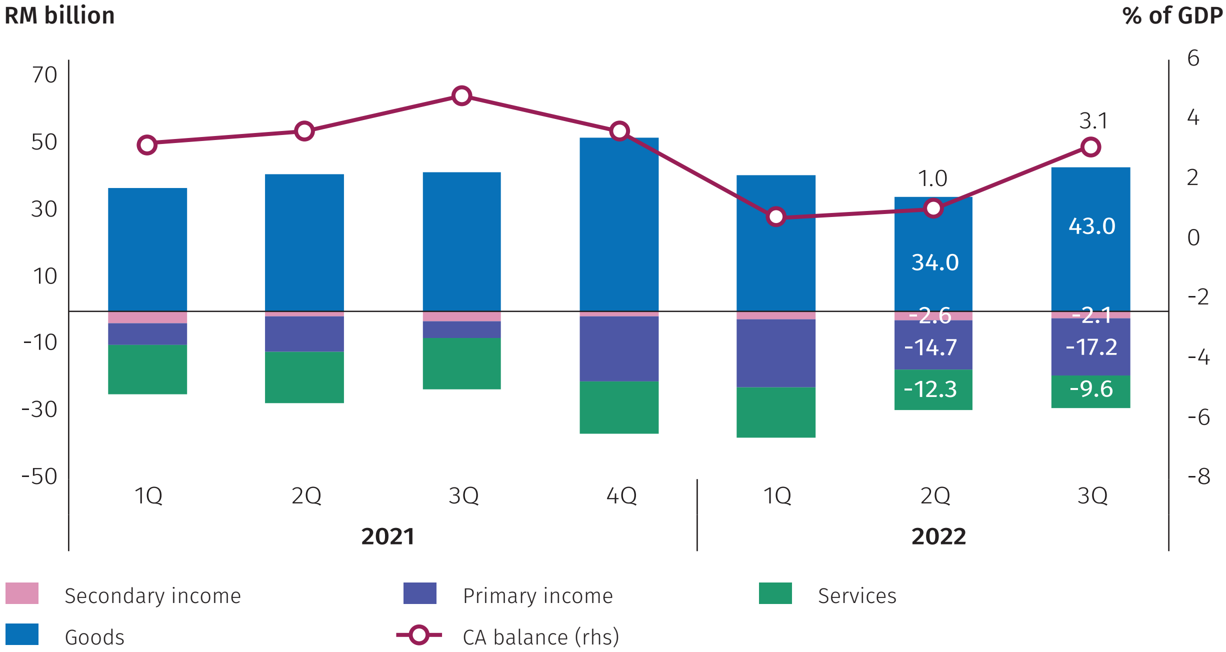
Meanwhile, gross imports grew by 46.5% (2Q 2022: 36.0%), driven by higher intermediate imports (40.8%, 2Q 2022: 36.1%). This was amid firms' continued effort to build up inventory buffers to mitigate the impact of supply chain disruption and strong expansion in domestic demand. The trade surplus widened to RM64.3 billion (2Q 2022: RM58.0 billion).

Higher current account surplus

The current account of the balance of payments recorded a higher surplus of RM14.1 billion, or 3.1% of GDP during the quarter (2Q 2022: RM4.4 billion or 1.0% of GDP).

The goods account[2] registered a higher surplus of RM43.0 billion (2Q 2022: RM34.0 billion). The services deficit narrowed to RM9.6 billion (2Q 2022: -RM12.3 billion) mainly on account of higher travel and transport receipts amid improvement in inbound tourist arrivals. Meanwhile, the income account registered a higher deficit due mainly to lower investment income generated by Malaysian firms investing abroad.

C15 Current Account Balance



Source: Department of Statistics, Malaysia

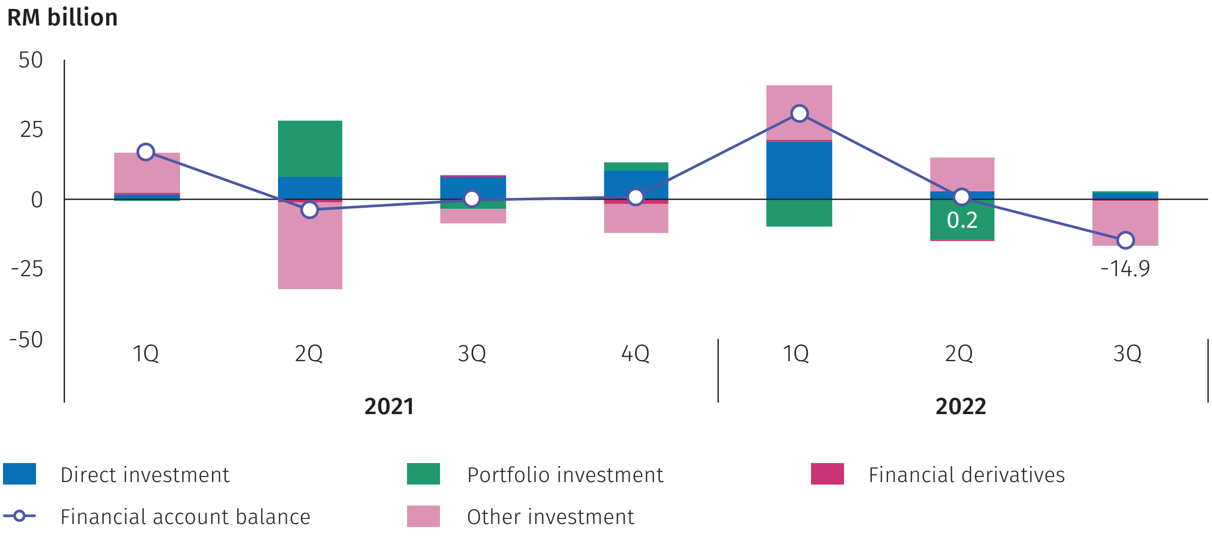
[2] The goods and trade surpluses differ because goods for processing, storage and distribution (with no change in ownership) are excluded from the goods account. This is as per the 6th Edition of the Balance of Payments and International Investment Position Manual by the International Monetary Fund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

Financial account registered a net outflow

The financial account registered a net outflow of RM14.9 billion (2Q 2022: RM0.2 billion). This reflects an outflow in other investments, owing to interbank borrowing primarily for liquidity management practices as well as placement of funds abroad by corporates.

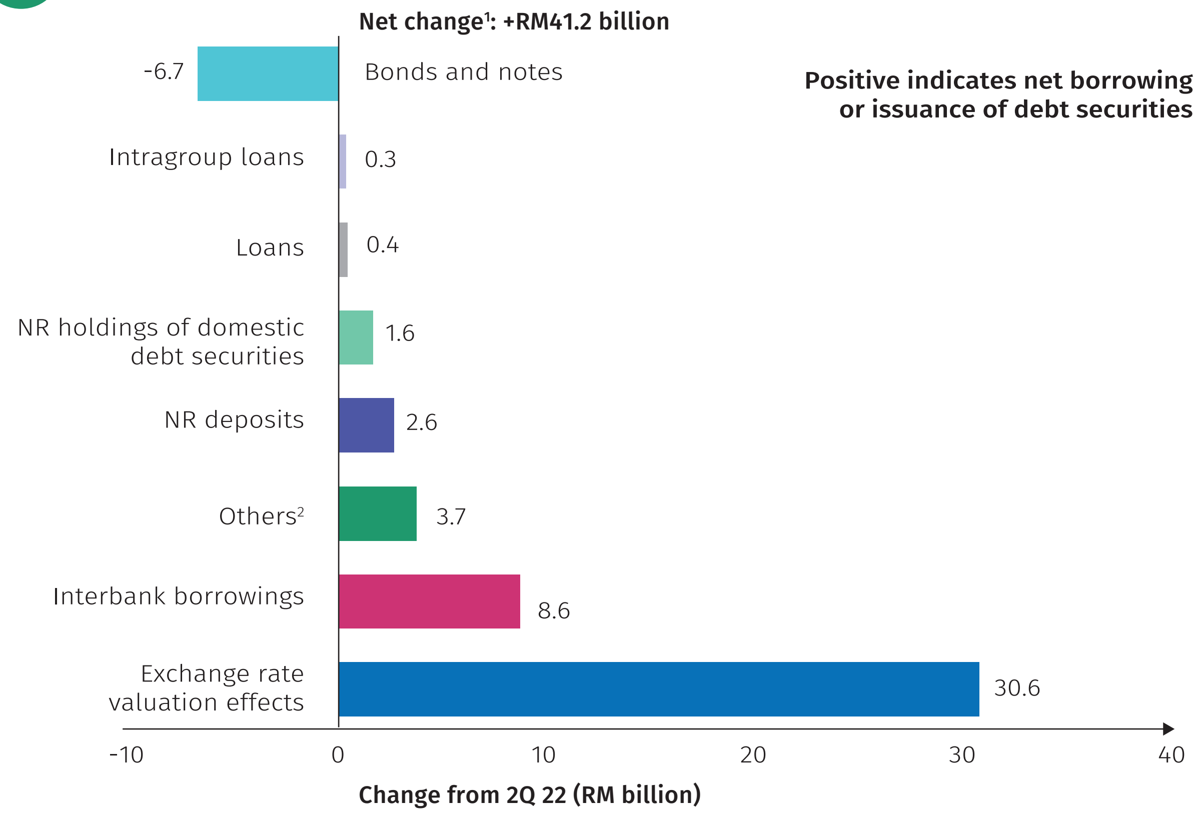
Foreign direct investment (FDI) inflows (RM12.3 billion; 2Q: RM17.3 billion) benefitted mainly the manufacturing sector and financial services subsector while direct investment abroad (DIA) outflows (-RM10.3 billion; 2Q: -RM14.7 billion) were channeled primarily into the financial services subsector and mining sector. Portfolio investments turned around to register a small net inflow (RM0.1 billion; 2Q 2022: -RM14.7 billion) due to net inflows from residents' liquidation of investments in equities and debt securities abroad (RM2.6 billion; 2Q 2022: -RM4.4 billion). Net errors and omissions stood at RM14.1 billion during the quarter, or +1.8% of total trade.

C16 Financial Account Flows by Key Components



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

C17 **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

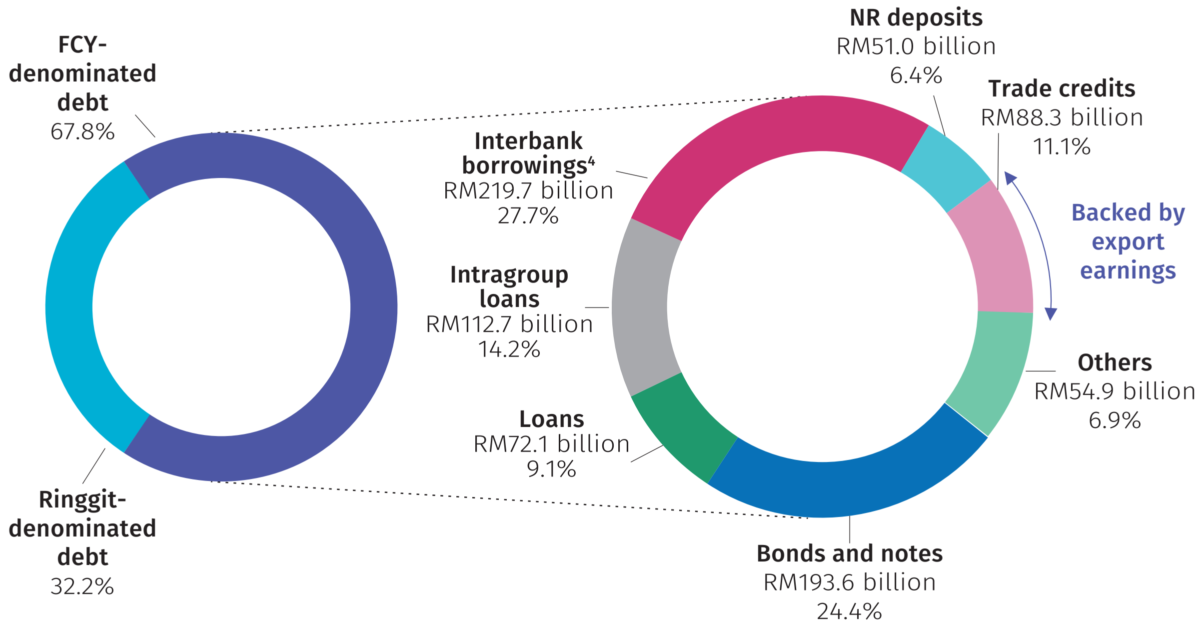
External debt remained manageable

Malaysia's external debt edged higher to RM1,169.4 billion, or 67.0% of GDP as at end-September 2022 (end-June 2022: RM1,128.3 billion or 67.7% of GDP). The increase was mainly attributable to the exchange rate valuation effects following the weaker ringgit against the US dollar. Other contributing factors were higher intragroup interbank borrowings, mainly to shore up foreign exchange liquidity buffers and to finance domestic lending activities, and trade credits.

Malaysia's external debt remained manageable, given its favourable currency and maturity profiles. Ringgit-denominated debt accounted for 32.2% of total external debt and these liabilities were not affected by fluctuations in ringgit exchange rate. About 67.8% of total external debt are denominated in foreign currency (FCY), with 67.6% of these FCY liabilities subject to BNM's prudential and hedging requirements.[3]

[3] Bonds and notes issued offshore stood at RM193.6 billion, accounting for 24.4% of total FCY-denominated external debt, issued largely by non-financial corporates. These, together with loans, that amounted to RM72.1 billion or 9.1% of total FCY-denominated external debt, are subject to BNM's hedging requirements. Intragroup loans, which are issued between related foreign entities and accounted for 14.2% of FCY-denominated external debt, were generally on flexible and concessionary terms. Meanwhile, banks' management of FCY liquidity risk arising from interbank borrowings and non-resident deposits (accounting for 34.2% of FCY-denominated external debt) are also subject to prudential standards issued by the Bank.

C18 **Breakdown of FCY-Denominated External Debt (RM billion, % share)**



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

From a maturity perspective, 58.5% of total external debt comprised of medium- to long-term tenure, thereby limiting rollover risks, while the remaining 41.5% were of short-term maturity. As at 31 October 2022, international reserves stood at USD105.2 billion, sufficient to finance 5.1 months of imports of goods and services[5] and is 1.0 time the short-term external debt.

[4] For more information on the risk assessment of banks' external debt, please refer to BNM's Financial Stability Review First Half 2022, page 34, which can be accessed at https://www.bnm.gov.my/documents/20124/8440087/fsr22h1_en_book.pdf

[5] 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 https://www.bnm.gov.my/documents/20124/6118085/qb2021q4_en_box_imports.pdf

Box Article

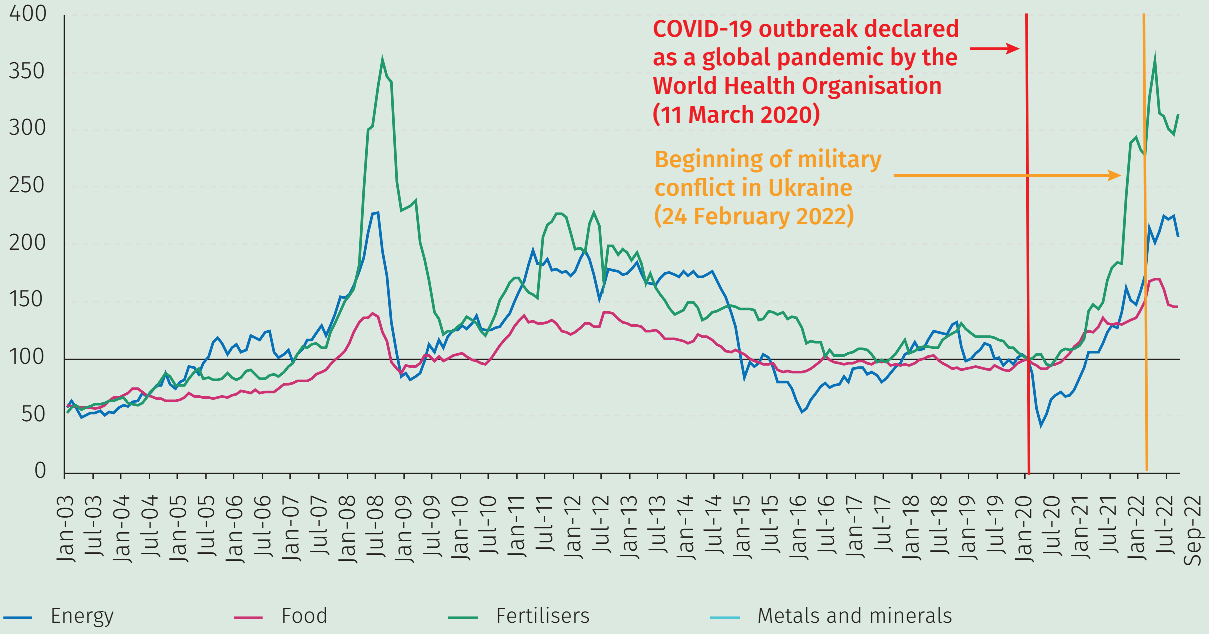
Global Commodity Price Trends, Inflation Dynamics, and Policy Responses: The Case of Malaysia

Introduction

Global energy and non-energy commodity prices surged to historical highs early this year with the unfolding of the military conflict in Ukraine (Chart 1). This came on the heels of a broad-based uptrend, apparent since the middle of 2020, which reflected the confluence of a rebound in global demand, production shortfalls, and supply-chain disruptions.

C1 Key Global Commodity Prices

Index based on nominal US dollars (January 2020=100)



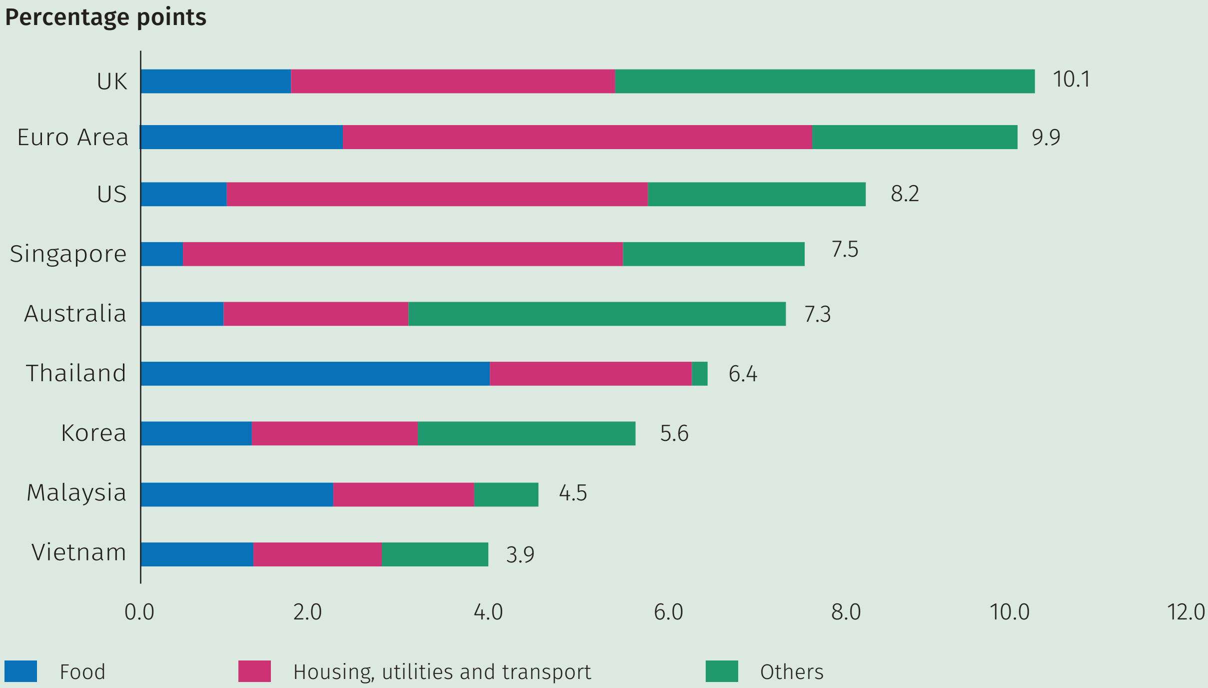
Note: Energy comprises coal, crude oil, and natural gas. Food comprises cereals, vegetable oils and meals, and other foods (sugar, bananas, oranges, beef and chicken meat).

Source: World Bank Commodiy Price Data (The Pink Sheet). Updated on 4 October 2022.

Most countries have experienced higher headline inflation this year, driven mainly by increases in energy and food inflation (Chart 2), with pass-through to core inflation. However, the exposure to and impact from elevated global commodity prices vary across countries. Supply-demand imbalances were also a key factor at play in the evolution of overall domestic inflationary pressures, and thus core inflation. Given this, policy responses to manage inflationary pressures have somewhat differed across countries as they transitioned to normalcy in the aftermath of COVID-19 and dealt with novel reopening effects.

This article presents the channels through which global commodity prices affect inflation in Malaysia. It then discusses current domestic inflation dynamics, and the factors that continue to set our country apart from others. This article also examines the risk of runaway inflation in Malaysia.[1] Finally, it provides an insight into the monetary policy recalibration by the Bank's Monetary Policy Committee (MPC) in 2022, and its interaction with other macroeconomic policies.

C2 **Drivers of Headline Inflation in Selected Countries**



Note: Inflation rates are for September 2022, except 3Q 2022 for Australia.

Source: IMF Consumer Price Index Database, Eurostat Harmonised Index of Consumer Prices Database and Bank Negara Malaysia estimates.

Propagation channels of global commodity prices to domestic inflation[2]

The transmission of global commodity prices to Consumer Price Index (CPI) inflation can be explained in terms of stages and channels – direct and indirect (Chart 3). **Stage 1** relates to the proportion of import content in the CPI basket, and therefore the global to domestic pass-through of commodity prices. If the import content exposure is high, consumer prices would more likely be impacted by a more significant increase in commodity prices. Both direct and indirect channels are at work here -- how global commodity input prices propagate directly through imported finished goods and indirectly through imported raw and intermediate inputs that affect production cost of domestically produced items in the CPI basket.

Prices of consumption goods that are largely commodity-based or heavily reliant on imported commodities would naturally track the trends in global commodity prices quite closely. Examples of such goods are energy and non-cooked food items.[3] However, some of these commodity-based essential consumer goods are also subject to price controls and subsidies in the domestic market, which dampen the pass-through of commodity price increases. Goods which are subject to price controls and subsidies currently include RON95 petrol, diesel, electricity, gas, and selected categories of chicken, eggs, sugar, palm-oil based cooking oil, and wheat flour (estimated to affect slightly less than 13% of the CPI basket).

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[1] Runaway inflation is defined here as persistently high inflation. For example, 1970s style inflation (Poole, 2005).

[2] Higher commodity prices may affect the macroeconomy through three channels – inflation, changed production patterns, and terms of trade effects (Igan et al., 2022). This article focuses on the first of these though the latter two may indirectly affect inflation through growth and income effects. For example, as a net commodity exporter, Malaysia's terms of trade has experienced a positive shock amid elevated commodity prices.

[3] Examples of non-cooked food items include (but not limited to) fresh and frozen meat, grains, and fruits.

Aside from global prices, the impact of commodity prices, either through the direct or indirect channels, may be dampened or amplified by exchange rate movements and international freight costs.

Generally, the relatively limited dependency on imports partly mitigates the impact of global commodity prices on firms' costs and domestic prices. Imported finished goods make up about 16% of the CPI basket of the average household.[4] Half of this is fuel, which is subject to price administration. From the supply side, based on the Input-Output Tables 2020 for Malaysia, intermediate imported inputs account for about 12% of total gross output. Meanwhile, the Import Producer Price Index (PPI) accounts for 29% of the total PPI basket.[5]

Stage 2 relates to the perpetuation of the indirect channel, that is the domestic pass-through of the higher production costs induced by increases in commodity prices. The more commodity price changes pass through downstream to a broad range of goods and services used in production and operations (for instance, across various intermediate and finished materials, transportation, logistics, and utilities) the more likely will spillovers be observed in consumer goods and services. Subsequently, a more broad-based increase in prices may become evident.

Besides the cost structure factor from Stage 1 (import content exposure and magnitude of commodity price increase), other factors that influence this pass-through to producer and consumer prices[6] include firms' profit margins and the overall cost environment, market structure, and underlying demand conditions – all of which could be inter-related. The extent of pass-through may be partly mitigated when firms absorb the higher costs to retain market share; to follow international business strategies (pricing to market); or while weighing demand conditions. Firms may also seek to improve their margins (see Bank Negara Malaysia (2011, 2015) for further details).

Taken together, these factors have affected Malaysia's inflation dynamics over the past two years. Price increases were generally subdued in 2021, despite rising costs (that is, Stage 1 saw price increases, but the transmission to Stage 2 was relatively muted).[7] The pass-through of prolonged elevated costs (in Stage 2), however, became more apparent in 2022, amid recovering demand conditions and competition influencing pricing decisions. The nuances to this are explored further in the box below, "From broiler farm to "nasi campur"".

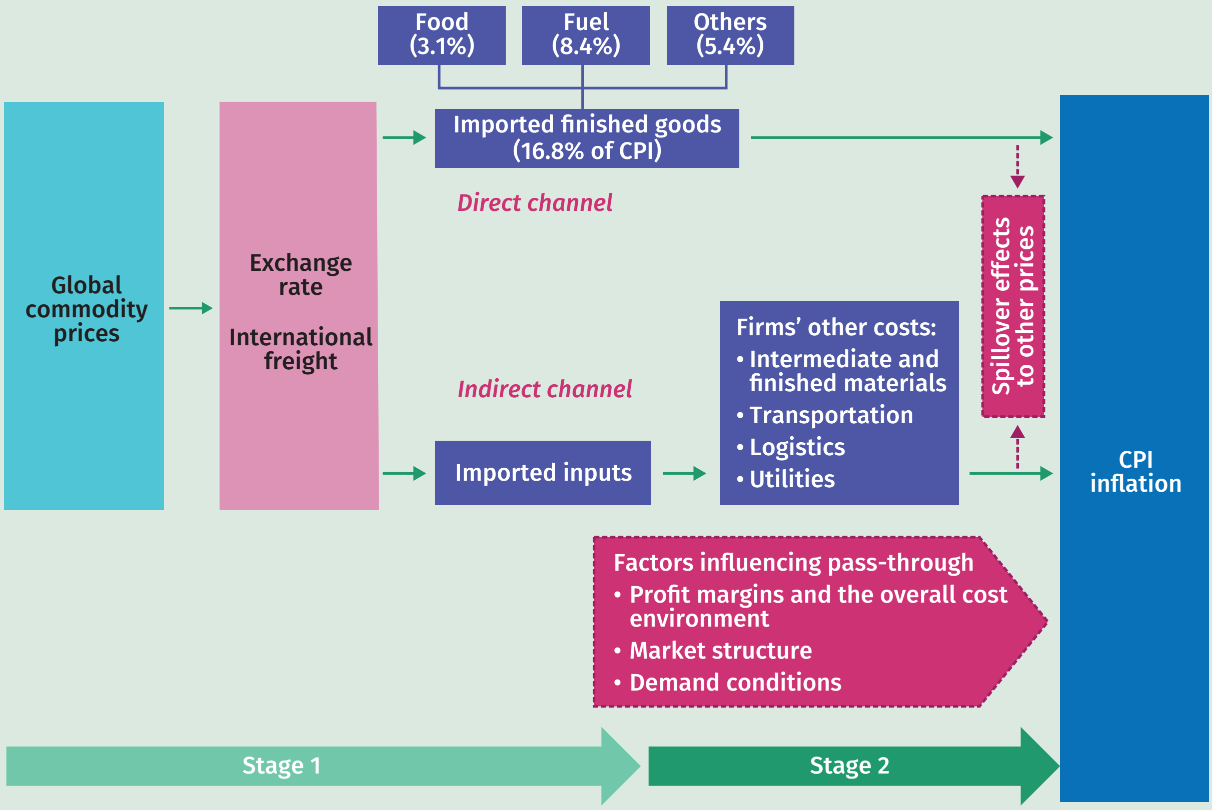
[4] While imported content in the CPI basket is what matters most for gauging the impact of commodity prices on inflation, it is also useful to note that other indicators also point to a relatively low share of imports in consumption namely: imported finished consumption goods constitute around 8% of total imports, and 10% of private consumption respectively (Source: Department of Statistics, Malaysia (2022a, 2022b) and Bank Negara Malaysia estimates).

[5] The Producer Price Index (PPI) for the *domestic economy* encompasses 70.89% of local production and 29.11% of imports based on 2015 Economic Census and import value data (Department of Statistics, Malaysia, 2021). Given the larger share of local production, the overall exposure to global commodity price and exchange rate shocks is relatively manageable.

[6] Other than administered prices.

[7] During the imposition of full lockdown in 3Q 2021, the share of CPI items recording unchanged prices averaged at 62.9% compared to the 2011-2019 average of 33.2%.

C3 Overview of the Transmission Channels from Global Commodity Prices



Note: Adapted from Bank Negara Malaysia (2011, 2015).

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

From broiler farm to "nasi campur"

To better illustrate the channels and interlinkages associated with the transmission of global commodity prices to domestic consumer prices, this section focuses on domestic chicken meat production. It highlights that the higher inflation in "nasi campur" cannot be traced directly or solely to imported commodity costs. Instead, this higher inflation rate broadly reflects the aggregated effects of the cost environment (including the pass-through of commodity prices along the supply chain) and demand conditions.

The cost of poultry feed, mostly made from imported grains and soybean meal, constitutes the largest proportion of the total variable cost of broiler production (see Chart 4).[8] These costs have risen steadily, reflecting global grains inflation which averaged 21.9% from January to September 2022 (2011-19 average: 0.5%),[9] exchange rate movements and international freight costs. The increase in feed prices reflects the **Stage 1** pass-through described earlier. To a lesser extent, the impact of commodity prices on the total variable cost of broiler production is also transmitted through utility cost. Electricity cost rose following the imposition of a surcharge on electricity consumption by commercial and industrial sectors this year.[10] The surcharge reflected the increase in global coal prices that has increased the cost of electricity production (Tenaga Nasional Berhad, 2022).

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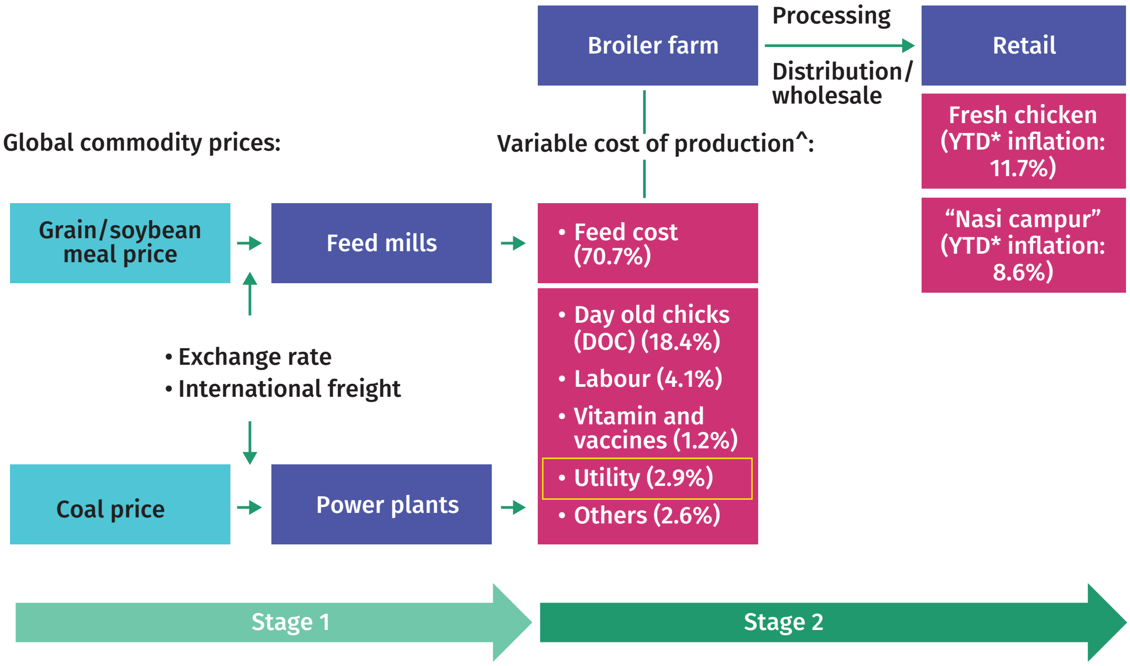
[8] Based on Abdurofi et al. (2017). The data referenced is the feed cost share of total variable cost for centre, Peninsular Malaysia.
[9] Source: World Bank Commodity Price Data (The Pink Sheet).
[10] 3.70 sen per kWh under the Imbalance Cost Pass-Through (ICPT) mechanism beginning 1 February 2022 till 31 December 2022.

Considering all these cost factors, fresh chicken prices have increased. To contain chicken prices from escalating beyond control, the Government imposed price ceilings on standard chicken and rolled out producer subsidies since February 2022. Export restrictions were put into effect since June 2022.[11]

Despite the Government's efforts, fresh chicken inflation averaged 11.7% from January to September 2022 (2011-19 average: 2.1%). The rise in fresh chicken inflation has caused higher food away from home inflation, for example, for chicken rice, cooked chicken, and "nasi campur" (mixed rice) dishes.[12] This illustrates the **Stage 2** pass-through (see also Chart 3) with the spillover of the price of a finished good (fresh chicken), which has an essential input that is commodity-based, to non-commodity related consumer services (food away from home).

C4 Global Commodity Prices to Local Chicken and "Nasi Campur" Prices



^Source: Abdurofi et al. (2017).
*Source: Department of Statistics, Malaysia. YTD refers to average inflation from January to September 2022.

[11] Export restrictions have been gradually lifted since October.
[12] Average inflation rates from January to September 2022 for chicken/duck rice, cooked chicken, and mixed rice were 5.8%, 5.8% and 8.6%, while their 2011-19 averages were 3.3%, 3.6% and 4.1% respectively. See also monthly publications by the Department of Statistics, Malaysia on the CPI (Department of Statistics, Malaysia, 2022c).

Current inflation dynamics: Cost and demand drive higher inflation in some segments; upside partly contained by country-specific factors

"Overshooting" in some CPI categories reflects sensitivity to a high-cost environment and the release of pent-up demand

Recent inflation dynamics largely reflect the pass-through of relative price changes[13] to aggregate inflation (first-round effects). These relative price changes are associated with spillovers from salient[14] price increases (in particular, higher prices associated with energy and food-related inputs).

[13] Relative price changes reflect adjustments in prices that arise from fluctuations in the supply and demand of specific goods and services. These adjustments can be fairly broad-based when related to products like oil and food that enter the production chain for a wide range of other goods and services (Humpage, 2008).
[14] Price changes which are more important for consumers, and could potentially have a larger bearing on the overall price trend (Bank for International Settlements, 2022). This could be due to their pervasive role in production chains (for example, energy prices) or their weight in consumption baskets (for example, food).

About half (47%) of the CPI basket currently have experienced overshooting inflation rates (Chart 5). *Food and non-alcoholic beverages,* with a weight of 29.5%, contributed around 50% on average to higher inflation this year, and reflects both higher *food at home* and *food away from home* inflation. In the context of propagation channels, the higher *food at home* inflation mainly reflects the Stage 1 transmission amid elevated global commodity prices. Meanwhile, cost pressures reflected in the *food at home* inflation had seeped into the *food away from home* inflation, in turn more reflective of Stage 2 transmission, where input costs in food services are indirectly affected by higher commodity prices. Essentially, the propagation via Stage 2 is more likely to dominate when inflation becomes more broad-based in the economy, given the factors affecting pass-through. Of great significance here, the most important factor here is the strength in underlying demand conditions, namely, the reopening of the economy, better employment and income conditions, and improvements in tourism activities. The recovery in demand allows producers and firms to pass on the higher costs.[15] Our earlier box article has shown that, *food away from home; restaurants and hotels;* and *recreation services and culture* were "sensitive and negative" during the pandemic (Bank Negara Malaysia, 2021). This implies that prices were generally subdued during the lockdown but would subsequently rebound when economic activity resumed post lockdown and were found to be, therefore, relatively more susceptible to pent-up demand.

C5 Difference Between Actual and Trend Inflation Rates for Broad CPI Categories

[1] Based on the difference between actual inflation rates in September 2022 versus the implied growth from linear extrapolation of the pre-pandemic (2019) trend of CPI categories at the two-digit level.

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

[15] When demand is relatively inelastic (insensitive to price changes), firms may choose to pass on higher costs to consumers, for example, for food at home, which comprises necessity items.

Going forward, the risk of lingering cost shocks has risen in light of the stronger US dollar environment.[16] This would impact the cost of imported goods, particularly internationally traded commodities, though this may be partially offset by the possible moderation in global commodity prices.[17, 18]

All in all, the high-cost environment and recovering demand suggest that inflationary pressures could continue– where relative price changes associated with intermittent cost shocks continue to have an impact on aggregate inflation. There are, however, offsetting factors. These are discussed further in the next section.

Administered prices, manageable supply-demand imbalances, and a limited impetus for wage-price spiral dynamics will continue to restrain runaway inflation

A key factor that has kept inflation relatively manageable is that despite the sharp increase in global energy commodity prices, inflation in domestic energy prices (retail fuel, electricity, and gas) has been relatively subdued due to subsidies. The food-related price controls which target key necessities, and a reasonable level of self-sufficiency across food items, have also helped to partly shield Malaysia from elevated imported input prices amid the environment of a stronger US dollar. This has, however, impacted the Government's budget. In 2022, cost of subsidies and social assistance is estimated to be RM 58.9 billion, compared to RM 23.0 billion in 2021 (Ministry of Finance Malaysia, 2022).

Second, the extent of supply-demand imbalances is relatively manageable. Differences with other economies include the timing, pace, and magnitude of the recovery due in part to the degree of policy support during the height of the COVID-19 pandemic, and labour market tightness (Bank Negara Malaysia, 2021). While conditions have been improving post economic reopening, there remains some slack in the overall labour market. The unemployment rate stood at 3.7% in August 2022, still higher than the rate of 3.3% in February 2020, just before the imposition of the nationwide lockdown. This is largely due to the continued expansion of the labour force, in contrast to labour supply constraints observed in advanced economies. Nonetheless, latest indicators show that economic activity strengthened further in the third quarter, suggesting the presence of demand pressures that warrant a close monitoring.

Third, there is limited impetus for second round effects (that is, feedback between price and wage increases) to cause persistently higher inflation. Key triggers of this are inflation expectations and wage-setting behaviour. This is reflected in long-run inflation expectations not deviating much from its historical average (in the absence of an inflation target) (Bonatti et al., 2022). If inflation expectations are well-anchored, households would "look through" temporary jumps in inflation as they trust that the central bank can rein in high inflation (Goel and Tsatsaronis, 2022). As of 3Q 2022, Malaysian households' long-run inflation expectations were edging lower towards the 2017-2019 average (Chart 6).[19]

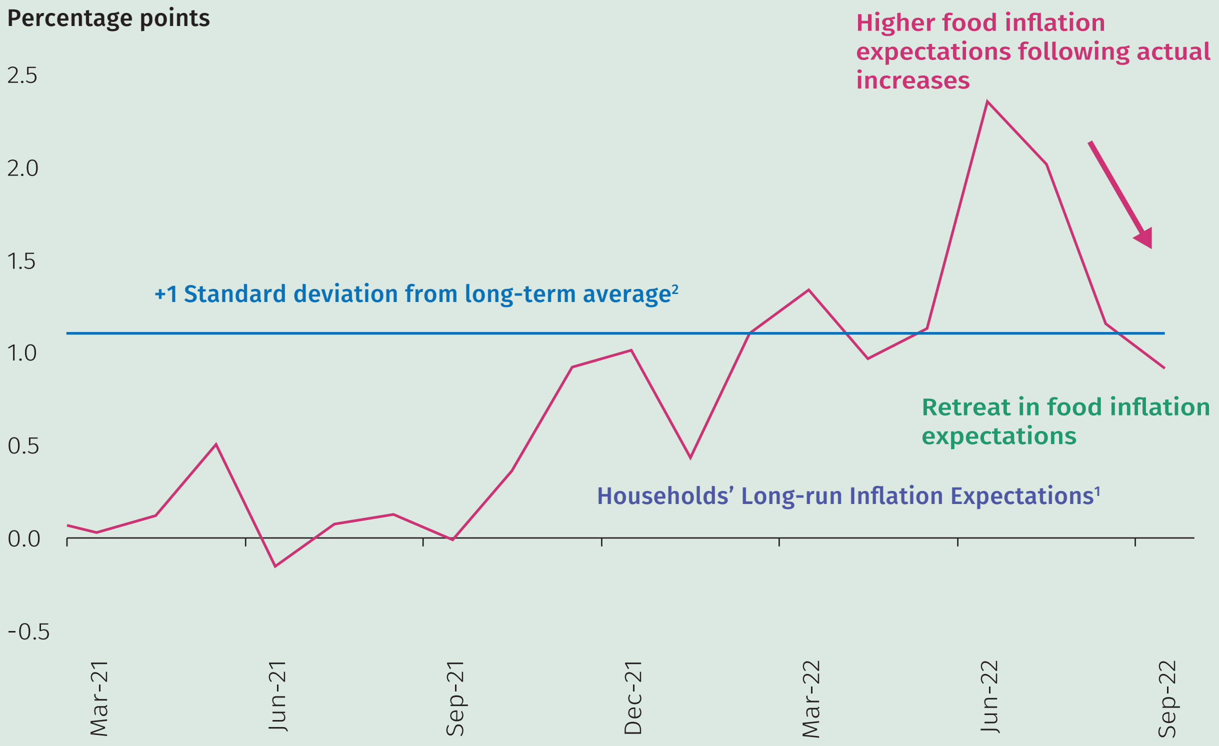
[16] Another factor potentially affecting inflation are changes to domestic policy measures, for example, in relation to subsidies.

[17] World Bank Group (2022).

[18] For example, global maize price declined by 10.1% to USD342.9 per metric ton on average in 3Q 2022 (USD 308.4 per metric ton in 2Q 2022) (World Bank Commodity Price Data (The Pink Sheet)) However, the equivalent Ringgit value declined by only 5.4% (from RM1511.6 to RM1430.3 per metric ton), given the MYR/USD depreciation of 4.9%.

[19] Source: Bank Negara Malaysia Consumer Sentiment Survey.

C6 Deviation of Households' Long-run Inflation Expectations from Long-term Average



[1] Households' inflation expectations for 2-3 years ahead.
[2] Long-term average refers to the average of 2017-2019 households' long-run inflation expectations.

Source: Bank Negara Malaysia Consumer Sentiment Survey.

At this juncture, risks from wage-push inflation remain broadly contained for two key reasons. First, real wage per worker growth[20] is improving (2022 YTD.: -0.3%; 2021: -1.9%) and has not outpaced productivity growth[21] (2022 YTD: 6.1%; 2021: 2.3%).[22] This, together with continued slack in the labour market have set us apart in terms of labour market-driven inflationary pressures experienced in some other countries, where there is relatively more negative real wage growth and a tight labour market.

Second, structurally, the Malaysian labour market has been characterised by limited wage bargaining power on the part of workers. Wage-price feedback via wage indexation and strong labour unions is largely absent. Thus, the risk of excessive catch-up wage demands remains limited, notwithstanding the implementation of minimum wage hike in May 2022.

[20] Real wage per worker growth is calculated as growth in nominal wages per worker less inflation. The year-to-date growth for 2022 is the average for the first three quarters. Wage refers to private sector wages which comprise workers in the manufacturing and services sectors. Similarly for employment.
[21] Productivity growth is calculated as GDP growth less employment growth. The year-to-date growth in 2022 is the average for the first three quarters.
[22] While wage growth has not been excessive, a reversal in globalisation post pandemic could make inflation more responsive to labour market structure (Boissay et al., 2021).

Policy responses

Monetary policy is key but not the only policy lever to tackle the current inflation challenges; coordination with fiscal measures is vital

Monetary policy influences the whole economy with a lag;[23] while fiscal measures can be more targeted and used to address immediate challenges. With intermittent cost and supply shocks potentially on the horizon, coordination between monetary and fiscal policy is critical in tackling inflation – recognising the strength of each; and also so that neither is over-burdened or worse, cancels out the other.

With the recovery in domestic demand, signs of demand-driven inflation are closely monitored. The recent OPR adjustments help to pre-emptively manage the risk of excessive demand on price pressures. Further, the gradual adjustments in the OPR are necessary to avoid the need for stronger measures in the future, such as faster and steeper increases.

Similar to some other countries,[24] domestic price controls and subsidies have helped in alleviating cost-of-living pressures. These fiscal measures have afforded the Bank to be more measured in recalibrating monetary policy. These measures have alleviated some of the price pressures in necessity items, especially important for the vulnerable groups. In the absence or the reduction of these subsidies, there might have been more notable negative growth effects alongside higher inflation, posing a greater challenge for monetary policy.

The Bank recognises that prolonged reliance on untargeted fiscal support and subsidies would not be sustainable. These policies need to be managed judiciously so that: (i) supply shortages are mitigated, (ii) it does not fuel excess demand, (iii) fiscal space is preserved for future shocks, and (iv) rationalisation is designed in a manner that minimises disruptions to the economy. Over the long-term, structural reforms are needed to, among others, improve food security. This includes diversifying food import sources and improving agricultural productivity through greater use of technology.

Conclusion

Propagation of global commodity prices to inflation occurs through multiple stages and channels. It depends on the strength of the direct and indirect channels to domestic costs as well as other factors affecting price-setting behaviour such as demand conditions in the economy. In Malaysia, while administered price measures and signs of moderating global commodity prices help mitigate inflationary pressures, upside risks to inflation remain. Risk of higher inflation could materialise should demand continue to strengthen, and external shocks persist, such as the strong US dollar environment.

Monetary policy has been pre-emptively adjusted in part to avoid the need to be more aggressive down the road, in the case where upside risks to inflation materialise. Effective coordination between monetary policy and other policies is critical to continue to support sustainable growth in an environment of price stability.

Going forward, as part of the comprehensive analysis of inflation dynamics, areas that warrant ongoing and deeper research and surveillance include the role of business balance sheets and profit margins in determining cost pass through; adjustments to production and supply, including alternative sources of inputs and new investments by businesses to expand capacity; and pricing power amid changing demand conditions. These elements are crucial to enable a deeper understanding of price-setting behaviour and the mapping of the inflation trajectory.

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[23] According to some estimates, it usually takes about one year for monetary policy to have the most effect on the economy This is because it takes time for households and businesses to change their behaviours. Source: Bank Negara Malaysia (2022).

[24] Several countries in East Asia and the Pacific have some form of price controls or subsidies relating to energy and food items including Japan (which introduced fuel subsidies for the first time this year), the Philippines, Thailand, and Vietnam. See for instance, Batmunkh and Pfutze (2022), and Gencer and Akcura (2022).

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Monetary and Financial Developments

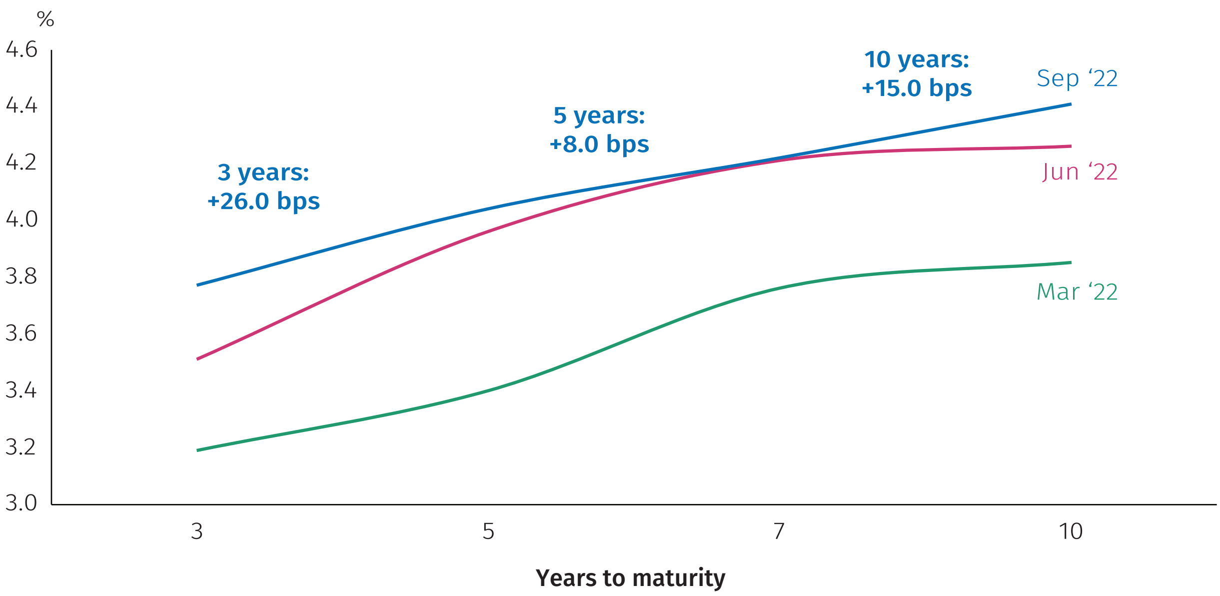
Highlights

- In 3Q 2022, domestic financial market conditions tightened amid higher bond yields.
- Given the persistent strengthening of the US dollar, the ringgit continued to depreciate, in line with other regional currencies.
- Interest rates rose during the quarter following the increase in the OPR.
- Continued expansion in net financing amid higher outstanding loan growth.

Bond yields trended upwards

In the third quarter of 2022, global financial conditions tightened further as major central banks continued to tighten their monetary policy stance to manage the risks from elevated and prolonged inflationary pressures. Consequently, global bond yields trended higher during the quarter, while global equities continued to decline. Concerns over a weakening global growth outlook and geopolitical tensions also led to investors' preference for relatively safer forms of financial assets, which further contributed towards a

C19 Trend in MGS Yields



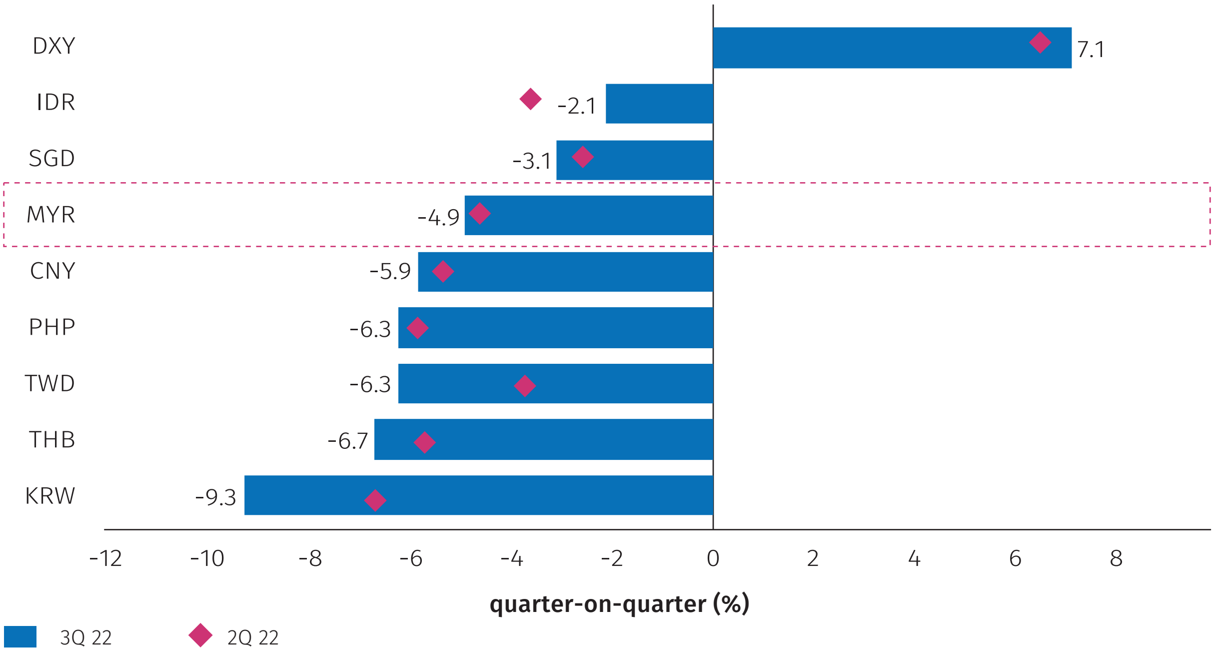
Source: Bank Negara Malaysia and Bursa Malaysia stronger US dollar. In terms of non-resident capital flows for Malaysia, there continued to be differentiation across the bond and equity markets, with non-resident portfolio outflows from the bond market and non-resident portfolio inflows into the equity markets. This suggests the more dominant role of external factors in driving bond market developments while domestic equity markets were supported by domestic factors such as the positive economic outlook.

For Malaysia, domestic bond yields increased during the quarter. The 3-year, 5-year and 10-year MGS yields increased by 26.0, 8.0, and 15.0 basis points, respectively. To some extent, the rise in yields also reflected the impact from the increase in the Overnight Policy Rate (OPR) in July and September. However, the upward adjustments in bond yields were of a smaller magnitude compared to the previous quarter due to lower non-resident bond outflows.

Ringgit depreciation driven by continued strengthening of the US dollar

Amid persistent strengthening in the US dollar, the ringgit depreciated by 4.9% (2Q 2022: -4.6%), in line with movements of regional currencies during the quarter (3Q 2022 regional average: -5.5%). Furthermore, the weakening of the yuan also weighed on the ringgit, given the close trade linkages between Malaysia and China.

C20 Performance of the US Dollar Index and Regional Currencies Against the US Dollar



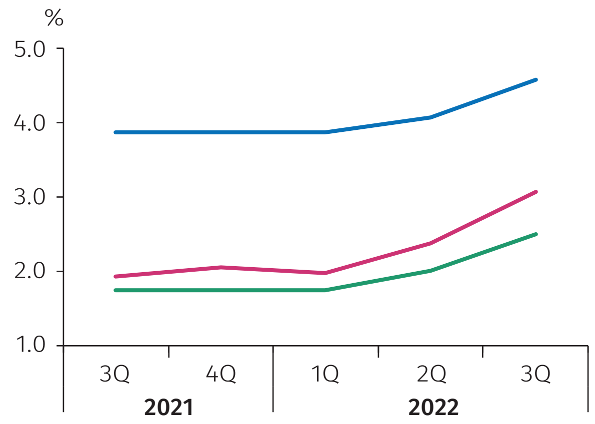
Source: Bank Negara Malaysia

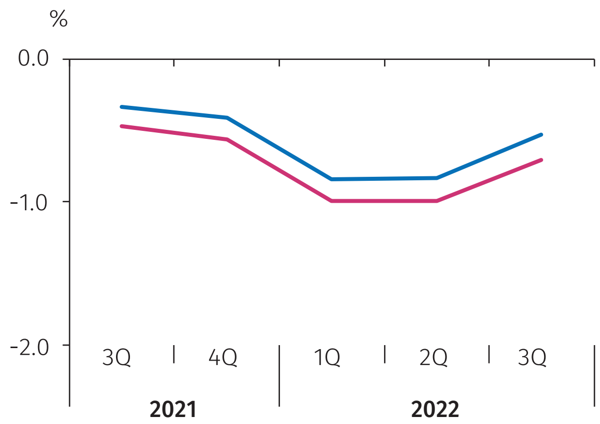
Interest rates rose during the quarter following the increase in the OPR

Interest rates in the wholesale and retail markets continued to trend higher in the third quarter following the two rounds of increases in the OPR by 25 basis points each on 6 July 2022 and 8 September 2022. The magnitude of adjustments in the interbank market immediately after the July MPC meeting was less than the actual quantum of the OPR hike as market participants had partially priced in the adjustment. Since the OPR adjustments, however, the KLIBOR continued to increase, particularly at the longer tenures amid market expectations of further increase in the OPR. For the quarter, the 1-month and 3-month KLIBOR increased by 46 and 68 basis points respectively to end the period at 2.67% and 3.06% (2Q 2022: 2.21% and 2.38%).

In the retail market, lending and deposit rates also responded to the OPR increase. The weighted average lending rate (ALR) on outstanding loans increased by 50 basis points while nominal fixed deposit (FD) rates increased by between 44 and 49 basis points across tenures of 1 to 12 months. Real FD rates[6] also increased, but to a lesser degree, given expectations for higher inflation.

C21 Interest Rates (at end-period)





- Weighted average lending rate (ALR)
- Overnight Policy Rate (OPR)
- 3M KLIBOR

- 3M real fixed deposit rate
- 12M real fixed deposit rate

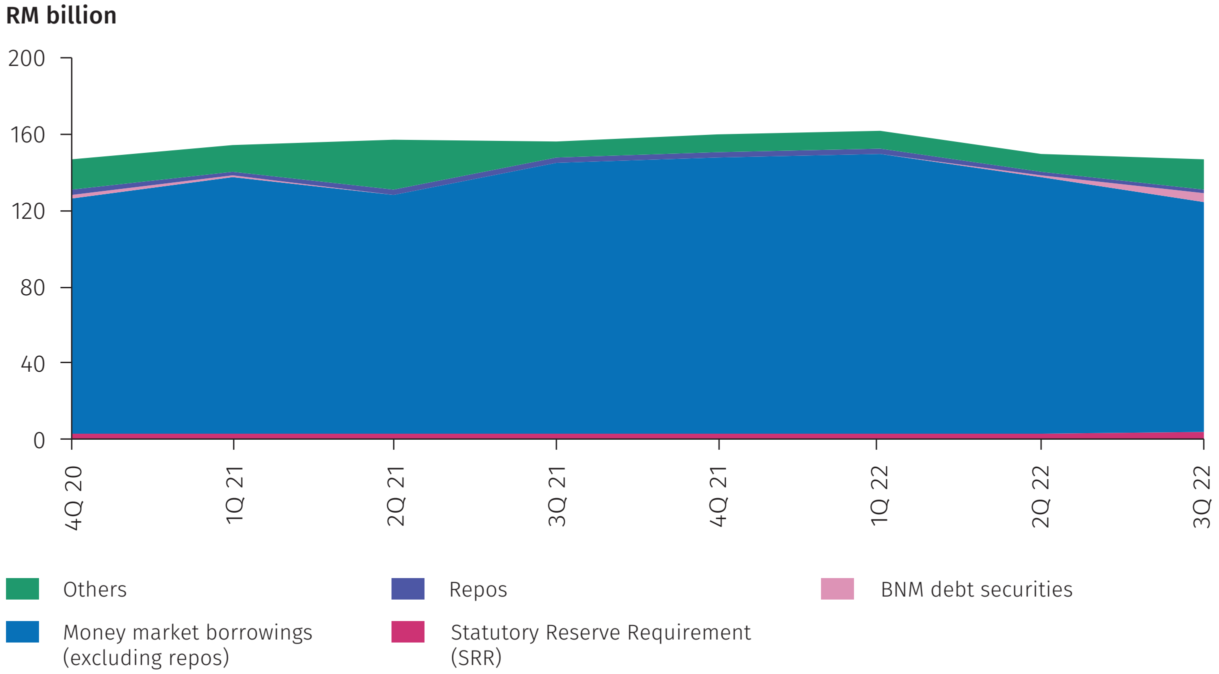
Source: Bank Negara Malaysia, Bloomberg and Consensus Economics

[6] 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).

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 Bank Negara Malaysia declined marginally amid portfolio outflows during the quarter. At the institutional level, almost all banks maintained surplus liquidity positions with the Bank as at end-September 2022.

C22 **Outstanding Ringgit Liquidity Placed with Bank Negara Malaysia (at end-period)**



Source: Bank Negara Malaysia

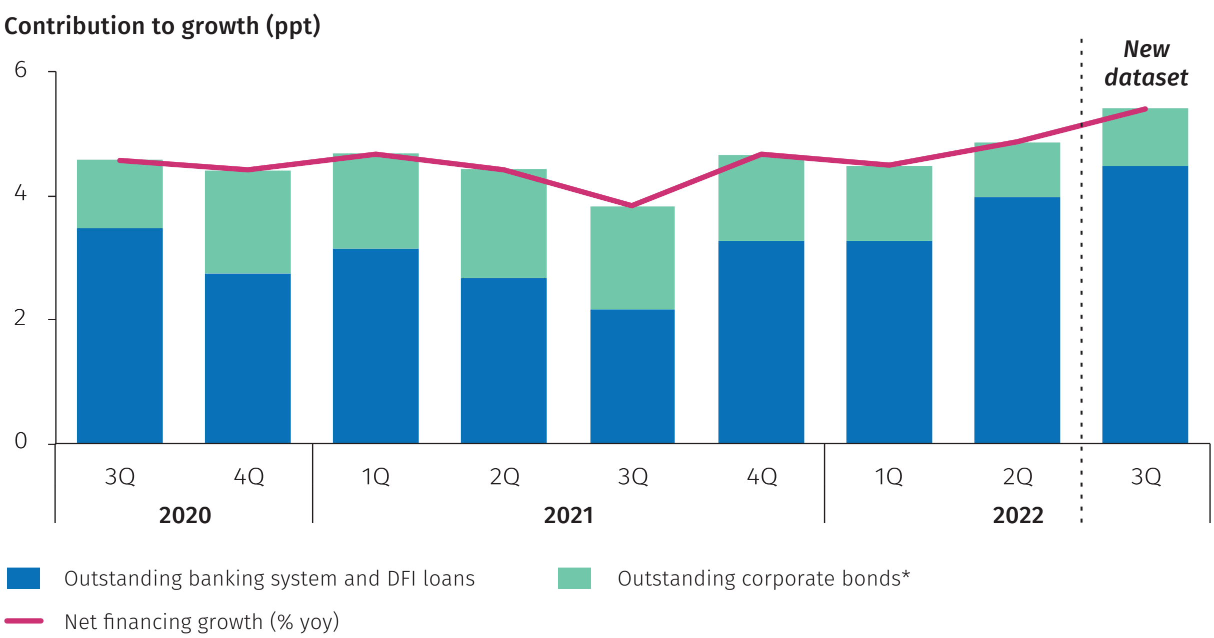
Continued expansion in net financing amid higher outstanding loan growth

As at end-3Q 2022, net financing grew by 5.4% (2Q 2022: 4.9%) supported mainly by higher outstanding loan[7] growth (6.1%; 2Q 2022: 5.4%), driven by the household segment. Meanwhile, growth in outstanding corporate bonds[8] was sustained at 3.5% (2Q 2022: 3.4%).

Outstanding business loan growth stood at 5.0%, as the growth in loan repayments outpaced that of loan disbursements,[9] particularly in the non-SME segment. By purpose, working capital financing continued to be the key driver of credit growth. There was high repayments growth across most sectors. Loan applications remained forthcoming across most loan purposes and business segments, reflecting continued demand for financing to support business activity.

For households, outstanding loans grew by 6.2% on account of high growth in loan disbursements to households for the purchase of houses and cars. This reflected continued loan demand, despite the lapse of certain measures such as the sales tax relief on new vehicles. In addition, the ability of households to repay loans remained sustained, as observed from the high growth in loan repayments, especially as most repayments have fully resumed during the quarter following the gradual lapse in repayment assistance programmes.

C23 Contribution to Net Financing Growth



* Excludes issuances by Cagamas and non-residents

Note: Data on outstanding loans for 3Q 2022 onwards are based on the new set of loans/financing data reflecting the latest requirements.

Source: Bank Negara Malaysia

Note: Financing data from 3Q 2022 onwards are based on the new set of loan/financing data reflecting the latest requirements and cannot be directly compared to previous quarters' data.

7 Loans from the banking system and development financial institutions (DFIs).

8 Excludes issuances by Cagamas and non-residents.

9 Except for the commodity-related sectors, most sectors generally recorded high double-digit growth in loan disbursements and repayments during the quarter.

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The Bank's Policy Considerations

Highlights

- At the September and November 2022 meetings, the Monetary Policy Committee (MPC) decided to further reduce the degree of monetary accommodation by raising the OPR to 2.75%.
- The MPC is not on any pre-set course and will continue to consider the 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 further adjusted the degree of monetary accommodation by increasing the OPR by 25 basis points at both the September and November 2022 meetings to 2.75%.

At the November MPC meeting, the MPC assessed that the global economy continues to be weighed down by rising cost pressures, tighter global financial conditions, and strict containment measures in China. These factors more than offset the support from positive labour market conditions, and the full reopening of most economies and international borders. Inflationary pressures were more persistent than expected due to strong demand, tight labour markets, and elevated commodity prices, despite improvements in global supply chain conditions. Consequently, many central banks are expected to continue raising interest rates to manage inflationary pressures. In particular, continued aggressive adjustments in US interest rates and expectations of a higher terminal rate in the US have contributed to a persistently strong US dollar environment. This has resulted in higher volatility in financial markets, affecting other major and emerging market currencies, including the ringgit. Going forward, the global growth outlook will continue to face headwinds from tighter financial conditions amid elevated inflation in major economies and the domestic challenges in China. The growth outlook remains subject to downside risks, including escalation of geopolitical tensions, worsening of domestic headwinds in China and potential energy rationing in Europe.

For the Malaysian economy, latest available indicators show that economic activity strengthened further in the third quarter, driven primarily by robust domestic demand. Going forward, despite the challenging global environment, domestic demand will remain the key driver of growth. Household spending will continue to be underpinned by improvements in labour market conditions and income prospects. Tourist arrivals have increased following the reopening of international borders and will further lift tourism-related sectors. Investment activity and prospects will be supported by the realisation of multi-year projects. Nevertheless, external demand is expected to moderate following softening global growth. Despite bouts of heightened volatility in the global financial and foreign exchange markets, these developments are not expected to derail Malaysia's growth. Domestic liquidity remains sufficient, with continued orderly functioning of the financial and foreign exchange markets. Financial institutions also continue to operate with strong capital and liquidity buffers. These will ensure financial intermediation remains supportive of the economy. Downside risks to the domestic economy continue to stem from a weaker-than-expected global growth, higher risk aversion in global financial markets amid more aggressive monetary policy tightening in major economies, further escalation of geopolitical conflicts, and worsening supply chain disruptions.

As at the November MPC meeting, it was assessed that headline inflation is likely to have peaked in 3Q 2022 and is expected to moderate thereafter, albeit remaining elevated. Underlying inflation, as measured by core inflation, is projected to average closer to the upper end of the 2.0% - 3.0% forecast range in 2022, having averaged 2.7% year-to-date, given some demand-driven price pressures amid the high-cost environment. Moving into 2023, headline and core inflation are expected to remain elevated amid both demand and cost pressures. Changes to domestic policy measures, such as subsidies and price controls, could also affect the level of inflation. The extent of upward pressures to inflation will remain partly contained by existing price controls, subsidies, and the remaining spare capacity in the economy. The balance of risk to the inflation outlook in 2023 is tilted to the upside. Domestic policy measures on subsidies, global commodity price developments arising mainly from the ongoing military conflict in Ukraine and prolonged supply-related disruptions are key risk factors.

Against the backdrop of continued positive growth prospects for the Malaysian economy, the MPC decided to further adjust the degree of monetary accommodation. The adjustment would also pre-emptively manage the risk of excessive demand on price pressures, consistent with the recalibration of monetary policy settings that balances the risks to domestic inflation and sustainable growth. At the current OPR level, the stance of monetary policy remains accommodative and supportive of economic growth. The MPC is not on any pre-set course, which means that monetary policy decisions will continue to depend on evolving conditions and their implications on the overall outlook to domestic inflation and growth. Any adjustments to the monetary policy settings going forward would continue to be done in a measured and gradual manner, ensuring that monetary policy remains accommodative to support sustainable economic growth in an environment of price stability.

Macroeconomic Outlook

Highlights

- Global growth expected to slow going into 2023.
- The Malaysian economy will continue to expand, driven mainly by domestic demand.
- Headline inflation has likely peaked in 3Q 2022 and is expected to moderate in 4Q 2022.

Slower global growth for 2023, amid various headwinds

Global growth is expected to slow going into 2023. The rebound from the reopening of the economies will wane, and growth would likely be weighed down by tighter global financial conditions and high inflation. Central banks, especially in advanced economies, have quickened the pace of monetary policy adjustments to contain inflation. This has led to significant spillovers to emerging market economies, through weaker currencies, tighter financial conditions and slower exports. While inflation is expected to ease in 2023, it would likely remain above average amid elevated commodity prices and tight labour markets. The inflationary pressure in Europe may be exacerbated by gas shortages and higher energy prices. This would dampen consumer spending and industrial production. These headwinds are likely to outweigh the lift from easing supply chain conditions and higher growth in China following the relaxation of its city-wide lockdowns.

The balance of risks to global growth remains tilted to the downside. Risks stem from further escalations of geopolitical tensions or more aggressive monetary tightening to manage persistent inflation. In addition, country-specific risks in China and Europe remain. They include risks of severe lockdowns and a deeper property market downturn in China, and energy rationing in Europe. In contrast, upside risks to global growth could arise from earlier-than-expected easing of China's zero-COVID policy and faster-than-expected moderation in inflation, as supply-side pressures ease.

The Malaysian economy will be driven mainly by continued expansion in domestic demand

Going forward, Malaysia's economic growth will be supported by continued expansion in domestic demand. The economy would benefit from the improvement in labour market conditions, realisation of multi-year projects and higher inbound tourism activity. While external demand is expected to moderate, this will be partly cushioned by Malaysia's diversified export base.

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

Headline inflation is projected to moderate but remain elevated in the fourth quarter of 2022

After trending upward to an average of 4.5% in the third quarter of 2022, headline inflation is expected to moderate in the fourth quarter of 2022, albeit remaining elevated. The base effect from the discount on electricity bill which have contributed to higher inflation in third quarter of 2022 will dissipate in the fourth quarter of 2022.[10] Overall, headline inflation is expected to average at 3.3% in 2022.[11] Underlying inflation, as measured by core inflation, is expected to stay elevated for the remainder of 2022 amid firm demand and the high-cost environment.

Moving into 2023, headline and core inflation are expected to remain elevated amid both demand and cost pressures, as well as any changes to domestic policy measures. The extent of upward pressures to inflation will remain partly contained by existing price controls, subsidies, and the remaining spare capacity in the economy. The balance of risk to the inflation outlook in 2023 is tilted to the upside and continues to be subject to domestic policy measures on subsidies, as well as global commodity price developments arising mainly from the ongoing military conflict in Ukraine and prolonged supply-related disruptions.

[10] The discount on electricity bill was implemented in 3Q 2021 under the PEMULIH Electricity Discount scheme.
[11] Source: Economic Outlook 2023, Ministry of Finance Malaysia.

Annex

T1 GDP by Expenditure Components (at constant 2015 prices)

	Share 2021 (%)	2021		2022		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	92.7	-4.2	1.9	4.4	13.0	13.1
Private sector	74.4	-4.4	2.5	4.4	15.4	14.7
Consumption	*58.8*	*-4.2*	*3.7*	*5.5*	*18.3*	*15.1*
Investment	*15.6*	*-4.9*	*-2.8*	*0.4*	*6.3*	*13.2*
Public sector	18.3	-3.5	0.1	4.8	2.8	6.3
Consumption	*13.8*	*7.1*	*1.6*	*6.7*	*2.6*	*4.5*
Investment	*4.5*	*-28.9*	*-3.4*	*-0.9*	*3.2*	*13.1*
Net Exports	6.0	-39.9	0.8	-26.5	-28.7	18.7
Exports of Goods and Services	*69.1*	*4.2*	*13.0*	*8.0*	*10.4*	*23.9*
Imports of Goods and Services	*63.1*	*11.4*	*14.5*	*11.1*	*14.0*	*24.4*
Real GDP	**100.0**	**-4.5**	**3.6**	**5.0**	**8.9**	**14.2**
GDP (q-o-q growth, seasonally adjusted)	**-**	**-2.7**	**4.6**	**3.8**	**3.5**	**1.9**

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		
		3Q	4Q	1Q	2Q	3Q
		Annual change (%)				
Services	57.0	-4.9	3.2	6.5	12.0	16.7
Manufacturing	24.3	-0.8	9.1	6.6	9.2	13.2
Agriculture	7.1	-2.0	2.8	0.1	-2.4	1.2
Mining	6.7	-3.2	-0.6	-1.1	-0.5	9.2
Construction	3.7	-20.6	-12.3	-6.2	2.4	15.3
Real GDP	**100.0**	**-4.5**	**3.6**	**5.0**	**8.9**	**14.2**

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		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
Current Account	**18.2**	**15.3**	**3.0**	**4.4**	**14.1**
(% of GDP)	*4.8*	*3.6*	*0.7*	*1.0*	*3.1*
Goods	41.5	51.8	40.5	34.0	43.0
Services	-15.3	-15.4	-15.0	-12.3	-9.6
Primary income	-4.8	-19.6	-20.1	-14.7	-17.2
Secondary income	-3.1	-1.4	-2.5	-2.6	-2.1
Financial Account	**-0.2**	**0.7**	**30.4**	**0.2**	**-14.9**
Direct investment	8.0	10.5	20.8	2.6	2.0
Assets	-15.3	-17.2	9.1	-17.0	-17.9
Liabilities	23.3	27.7	11.7	19.6	19.9
Portfolio investment	-3.7	2.6	-10.1	-14.7	0.1
Assets	-4.9	-6.1	-13.9	-4.4	2.6
Liabilities	1.2	8.7	3.8	-10.3	-2.5
Financial derivatives	0.7	-1.8	0.2	-0.2	-0.4
Other investment	-5.2	-10.6	19.6	12.5	-16.6
Net errors & omissions[2]	**3.4**	**-13.1**	**-20.6**	**0.3**	**14.1**
Overall Balance	**21.3**	**2.6**	**12.8**	**4.9**	**13.1**

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-Sep	end-Jun	end-Sep
	RM billion		
Total External Debt	**1,062.7**	**1,128.3**	**1,169.4**
USD billion equivalent	*253.7*	*256.2*	*252.2*
By instrument			
Bonds and notes[1]	200.3	191.9	194.7
Interbank borrowings[1]	176.1	204.6	221.3
Intragroup loans[1]	140.5	150.9	155.7
Loans[1]	75.4	73.0	75.0
Non-resident holdings of domestic debt securities	248.9	252.7	254.3
Non-resident deposits	96.4	106.9	111.4
IMF allocation of Special Drawing Rights (SDRs)	28.6	28.3	28.6
Others[2]	96.5	119.8	128.4
Maturity profile			
Medium- and long-term	666.2	677.5	684.2
Short-term	396.5	450.8	485.2
Currency denomination			
Ringgit	367.2	377.7	377.0
Foreign	695.5	750.6	792.4
Total debt / GDP (%)	68.8	67.7	67.0
Short-term debt / Total debt (%)	37.3	40.0	41.5
Reserves / Short-term debt (times)	1.2	1.1	1.0[3]

[1] These debt instruments constitute the offshore borrowings.
[2] Comprise trade credits and miscellaneous.
[3] Based on international reserves as at 31 October 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		
	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q
	Change during the period (RM billion)				Annual change (%)			
Total net financing	**48.4**	**30.0**	**26.6**	**44.6**	**4.7**	**4.5**	**4.9**	**5.4**
Outstanding:								
Loans[1,2]	38.3	25.8	26.7	33.6	4.4	4.4	5.4	6.1
Business enterprises	11.2	12.1	11.5	-0.4	4.8	4.3	5.5	5.0
SMEs	9.6	3.7	4.1	4.7	4.9	6.0	7.5	6.5
Non-SMEs	1.7	8.5	7.6	-5.0	4.7	2.9	3.9	3.7
Households	27.3	14.6	14.7	19.2	4.2	4.8	5.7	6.2
Corporate bonds[3]	10.1	4.2	-0.1	11.0	5.4	4.6	3.4	3.5

[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: Annual change data before 3Q 2022 are based on the previous set of loan/financing data, and cannot be directly compared to data for 3Q 2022 onwards. Numbers may not add up due to rounding.

Source: Bank Negara Malaysia

T6 Loan Indicators

	2021	2022			2022
	4Q	1Q	2Q	3Q	3Q
	During the period (RM billion)				Annual change (%)
Total					
Loan applications[1]	350.3	325.4	369.7	409.1	52.3
Loan approvals[1]	167.7	145.9	192.6	224.0	63.4
Loan disbursements[1]	571.2	557.1	601.0	602.6	24.4
Loan repayments[1]	550.3	555.0	605.3	603.8	25.6
Of which:					
Business enterprises[2]					
Loan applications	123.7	119.2	143.7	180.8	47.5
Loan approvals	73.8	59.3	92.4	119.6	49.0
Loan disbursements	460.6	448.4	491.1	484.9	19.8
Loan repayments	454.9	448.1	496.3	490.8	23.2
SMEs					
Loan applications	66.8	61.8	75.8	84.8	47.4
Loan approvals	31.4	30.0	38.8	48.6	44.9
Loan disbursements	114.6	119.6	126.5	127.4	34.6
Loan repayments	109.1	116.2	124.9	126.6	35.1
Non-SMEs					
Loan applications	44.0	41.8	56.2	85.3	51.6
Loan approvals	32.6	23.5	36.9	62.7	56.3
Loan disbursements	257.9	245.8	278.9	255.4	14.2
Loan repayments	256.3	250.0	284.0	272.8	23.0
Households					
Loan applications	226.6	206.2	226.0	228.3	56.3
Loan approvals	93.9	86.6	100.2	104.4	83.9
Loan disbursements	110.7	108.7	109.9	117.7	48.1
Loan repayments	95.4	106.9	109.0	113.0	37.6

[1] Loans for all segments include data from the banking system and development financial institutions (DFIs).
[2] Numbers for SMEs and Non-SMEs may not add up to business enterprises. This is due to the inclusion of domestic non-bank FIs, domestic FIs, government, domestic other entities, foreign entities and firms of unknown size under business enterprises.

Note: Numbers may not add up due to rounding.

Source: Bank Negara Malaysia

T7 Banking System Profitability Indicators

	2021		2022		
	3Q	4Q	1Q	2Q	3Q[p]
Return on equity (%)[1]	9.4	9.5	10.9	11.8	12.4
Return on assets (%)[1]	1.1	1.1	1.2	1.3	1.4
	RM million				
Net interest income	13,711	14,681	14,794	15,482	16,280
Add: Fee-based income	2,861	3,119	2,922	2,832	2,922
Less: Operating cost[2]	8,776	9,393	8,907	9,229	9,945
Gross operating profit	7,796	8,407	8,809	9,085	9,257
Less: Impairment[3] and other provisions	2,689	2,064	1,196	905	1,512
Gross operating profit after provision	5,107	6,344	7,613	8,179	7,745
Add: Other income[1]	2,677	2,394	2,008	3,088	4,554
Pre-tax profit[1]	**7,784**	**8,737**	**9,621**	**11,267**	**12,299**
	Annual change (%)				
Return on equity (percentage points)[1]	0.3	1.1	2.6	2.2	3.0
Return on assets (percentage points)[1]	0.02	0.11	0.27	0.20	0.30
Net interest income	0.5	5.6	4.4	5.8	18.7
Add: Fee-based income	0.3	-1.1	-8.4	-1.7	2.1
Less: Operating cost[2]	3.7	6.4	-22.2	2.6	13.3
Gross operating profit	-2.9	2.2	48.8	6.7	18.7
Less: Impairment[3] and other provisions	-17.9	-65.2	-22.5	-58.0	-43.8
Gross operating profit after provision	7.4	175.9	73.9	28.7	51.6
Add: Other income[1]	-25.5	-23.9	-26.2	-4.4	70.1
Pre-tax profit[1]	**-6.8**	**60.5**	**35.5**	**17.5**	**58.0**

[1] Banking system profits are aggregated at the entity level. The aggregated results for 2019 onwards have been 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		
	3Q	4Q	1Q	2Q	3Q[p]
	RM million				
Life Insurance & Family Takaful					
Excess income over outgo[1]	2,157	1,048	1,866	-4,139	497
General Insurance & General Takaful					
Operating profit	928	354	258	754	953
Claims ratio (%)	52	61	63	65	52
	Annual change (%)				
Life Insurance & Family Takaful					
Excess income over outgo[1]	-46.2	-75.9	184.3	-223.2	-77.0
General Insurance & General Takaful					
Operating profit	21.5	-61.3	-63.6	-30.0	2.8
Claims ratio (percentage points)	-3.8	8.3	8.6	13.8	0.0

[1] Excess income over outgo excludes investment-linked unit funds to reflect the core performance of ITOs' profitability more accurately and thus, may not be directly comparable to the data reported in previous publications.

p Preliminary

Source: Bank Negara Malaysia

T9 Federal Government Finance[1]

	2021		2022p		
	3Q	4Q	1Q	2Q	3Q
	RM billion				
Revenue	51.5	75.9	62.7	61.6	83.3
Annual growth (%)	*11.0*	*-1.4*	*26.6*	*8.3*	*61.7*
Operating expenditure	50.7	63.4	64.6	65.2	69.2
Annual growth (%)	*-11.0*	*18.1*	*3.8*	*18.2*	*36.5*
Current balance	**0.8**	**12.5**	**-1.9**	**-3.6**	**14.1**
Net development expenditure	22.1	13.3	16.6	13.4	14.7
Annual growth (%)	*82.6*	*-34.3*	*8.7*	*6.3*	*-33.5*
COVID-19 Fund[2]	5.0	14.3	5.4	4.1	5.6
Overall balance	**-26.3**	**-15.1**	**-23.9**	**-21.1**	**-6.2**
Memo:					
Total net expenditure	77.8	91.0	86.6	82.7	89.5
Annual growth (%)	*5.1*	*8.0*	*0.0*	*7.2*	*15.0*
Total Federal Government debt (as at end-period)	969.3	979.8	1005.8	1045.0	1074.8
Domestic Debt	708.5	714.0	736.6	780.7	808.3
External Debt	260.8	265.9	269.2	264.3	266.5
Non-resident holdings of RM-denominated debt	*234.9*	*240.4*	*244.4*	*239.5*	*241.0*
Offshore borrowing	*26.0*	*25.5*	*24.9*	*24.8*	*25.4*

p Preliminary
[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