

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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Key Highlights on

Economic and Financial Developments in 4Q 2018

Higher economic growth of 4.7% despite global headwinds

Continued expansion in domestic demand amid receding supply disruptions

Real GDP Growth



Income and employment growth continued to drive robust household spending

Continued expansion in the manufacturing sector supported by electronics

Improvement in mining and agriculture sectors

Headline inflation declined in the fourth quarter of 2018

Headline inflation declined during the quarter as transport inflation turned negative

Headline and Core Inflation[1]



[1]Core inflation excludes the estimated direct impact of consumption tax policy changes

The combined outcome of the changes in consumption tax policy continued to exert an overall downward impact to headline inflation

Contribution to Headline Inflation by Components



Source: Department of Statistics Malaysia, Bank Negara Malaysia unless stated otherwise
For more information, visit www.bnm.gov.my

International Economic Environment

HIGHLIGHTS

- Continued expansion of the global economy, albeit at a more moderate pace.
- Weaker export growth in regional economies, amid lower external demand and impact from ongoing global trade tensions.
- Financial market volatility reignited at the start of the quarter, but eased towards the end of 2018.

Global growth grew at a more moderate pace

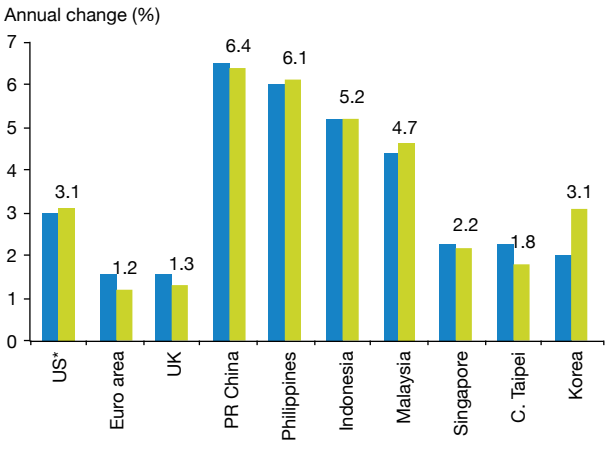
The global economic expansion continued, albeit at a more moderate pace in the fourth quarter of 2018. With the exception of the US, major advanced and emerging market economies recorded more moderate growth.

In the advanced economies, improvements in labour markets supported private consumption, as unemployment rates and wage growth remained steady. Consumer Price Indices recorded a more moderate increase during the quarter, as fuel prices moderated. Investment activity registered a slower expansion across most economies. The fiscal impetus from the 2017 tax reforms in the US began to wane in the fourth quarter of 2018.

Growth in the Asian region showed signs of a synchronised moderation. PR China recorded slower growth, as the economy faced external and domestic headwinds. Nevertheless, infrastructure investment in PR China improved marginally towards the end of the quarter, reflecting policy support from the government. Domestic demand in other Asian economies moderated, due mainly to waning support from investments and lower external demand. Private consumption growth remained sustained.

Global economic activity moderated in 4Q 2018

Chart 1: GDP Growth

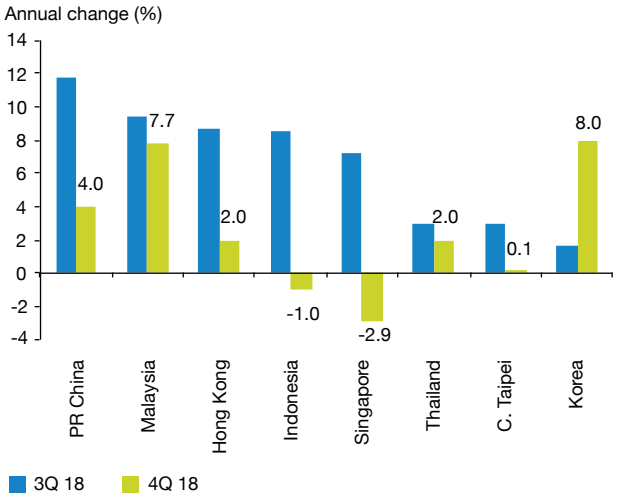


*Refers to implied 4Q18 GDP growth based on IMF's 2018 annual projection, as the recent government shutdown had delayed the actual GDP data release.

Source: National authorities

Weaker export performance in 4Q 2018

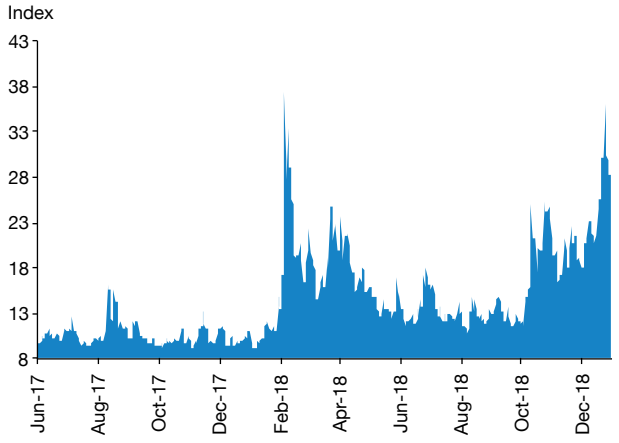
Chart 2: Export Growth of Selected Economies (in USD terms)



Source: Bloomberg

Higher volatility in the financial markets

Chart 3: Chicago Board Options Exchange (CBOE) Volatility Index (VIX)



Source: Bloomberg

Lower export growth

Weaker external demand and uncertainties from the ongoing trade actions affected external demand for regional economies. Most regional economies recorded lower export growth in the fourth quarter of 2018, reflecting lower export shipments to the US, Euro Area and PR China. By products, the lower regional export growth was due mainly to electrical and electronic products, while lower commodity prices also weighed on overall export performance.

Higher volatility in the financial markets

Financial market volatility continued to rise in October, amid equity selloffs in the US and emerging market economies (EMEs). This was attributable partly to the ongoing monetary policy tightening in the US, amid weaker reported corporate profits.

Of note, financial conditions in emerging markets tightened further, amid sustained capital outflows in Asian and Latin American countries. Trade disruptions from US tariff hikes and speculation over non-tariff retaliatory measures by PR China further reignited financial market volatility in the fourth quarter of 2018, albeit with some easing in December as the planned tariffs were suspended.

Brent crude oil price averaged lower at USD69 per barrel in the fourth quarter of 2018 (3Q 2018: USD76). The decline in crude oil prices was driven by expectations for global oil oversupply as the US reported record oil production and granted sanction waivers for Iran's oil trade partners. Prices were also weighed by concerns over the impact of global growth moderation on oil demand.

Developments in the Malaysian Economy

HIGHLIGHTS

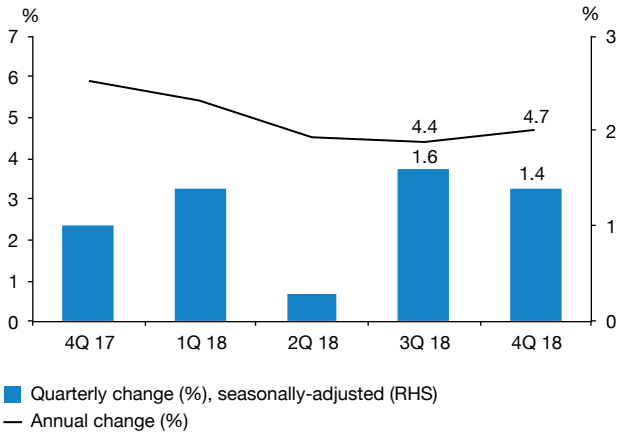
- The Malaysian economy expanded by 4.7% in the fourth quarter.
- Headline inflation declined slightly to 0.3%, while core inflation edged up to 1.6%.
- Current account surplus widened to RM10.8bn (or 3.0% of GNI) in the fourth quarter.

The Malaysian economy registered a higher growth of 4.7%

The Malaysian economy grew by 4.7% in the fourth quarter of 2018 (3Q 2018: 4.4%), supported by continued expansion in domestic demand and a positive growth in net exports. Private sector expenditure remained the main driver of domestic demand, while a rebound in real exports of goods and services (+1.3%; 3Q 2018: -0.8%) contributed towards the positive growth of net exports. On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 1.4% (3Q 2018: 1.6%). For 2018 as a whole, the economy expanded by 4.7% (2017: 5.9%).

Higher growth in 4Q 2018

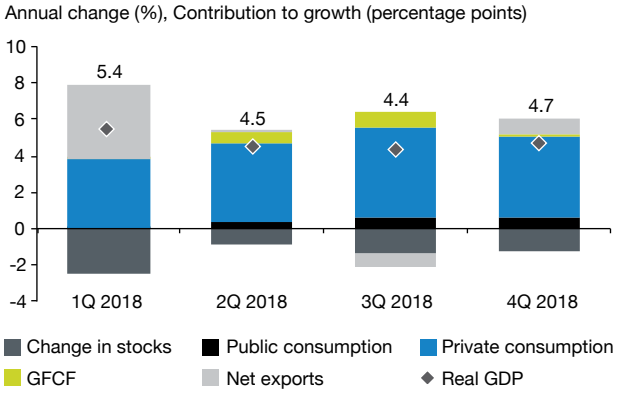
Chart 4: Real GDP Growth



Source: Department of Statistics Malaysia

Private activity supported growth

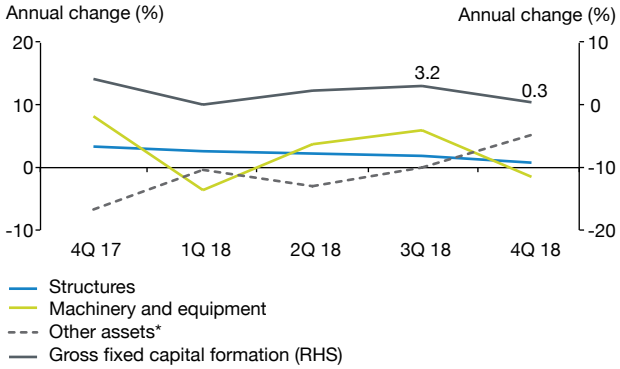
Chart 5: Contribution of Expenditure Components to Real GDP Growth



Source: Department of Statistics Malaysia

Moderation in gross fixed capital formation

Chart 6: GFCF Growth by Type of Assets



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

Source: Department of Statistics Malaysia

Slower expansion in domestic demand

Domestic demand expanded at a more moderate pace of 5.6% (3Q 2018: 6.9%) during the quarter. Growth was weighed down by a moderation in gross fixed capital formation.

Private consumption growth remained robust at 8.5% (3Q 2018: 9.0%), despite the frontloading of purchases during the tax holiday period in the previous quarter. Income and employment growth continued to drive household spending. Government measures to alleviate cost of living, such as special payments to civil servants and pensioners, also provided some support to consumer spending.

Private investment growth moderated to 4.4% (3Q 2018: 6.9%), attributed to slower capital spending across major economic sectors. However, ongoing multi-year projects particularly in the manufacturing sector continued to provide support to overall growth.

Public consumption expanded at a slower pace of 4.0% (3Q 2018: 5.2%), attributable to a more moderate growth in supplies and services.

Public investment remained in contraction during the quarter (-4.9%; 3Q 2018: -5.5%), due mainly to a decline in capital spending by public corporations.

Gross fixed capital formation (GFCF) expanded marginally by 0.3% (3Q 2018: 3.2%), as private sector capital expenditure moderated amid a contraction in public sector investment. By type of assets, capital spending on structures expanded by 0.8% (3Q 2018: 1.8%), while investment in machinery and equipment declined (-1.5%; 3Q 2018: 5.9%).

Continued expansion in most sectors

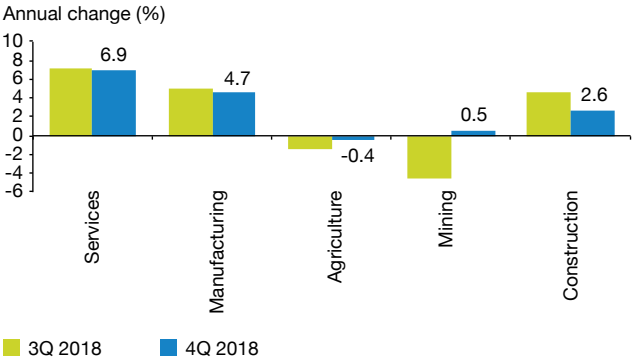
On the supply side, major sectors continued to expand, while growth in the commodity-related sectors improved.

In the services sector, the wholesale and retail trade subsector remained supported by continued strength in consumer spending. The information and communications subsector benefitted from continued demand for data communication services and the positive impact on fixed broadband demand following the implementation of the Mandatory Standard Access Pricing (MSAP) mechanism. Growth in the transport and storage subsector improved marginally in line with better trade activity. Activity in the finance and insurance subsector expanded at a moderate pace as higher growth in insurance claims and lower fee-based income weighed on the performance of the subsector.

Growth in the manufacturing sector remained driven by continued strength in the electronics and electrical (E&E) and transport-related production. Relatively strong growth in the E&E cluster was attributed to the front loading of exports globally in anticipation of higher trade tariffs between the US and PR China. Growth in the transport-related production was supported by the manufacture of passenger cars and auto parts, as a result of aggressive promotional campaigns by car dealers as well as the replenishment of vehicle stocks after the end of the tax holiday. These improvements were offset by the slower performance in the primary- and construction-related clusters amidst slowing regional demand for resource-based manufactures such as chemicals, refined palm oil products and basic iron and steel products.

Continued expansion across most sectors, with the exception of commodity-related sectors

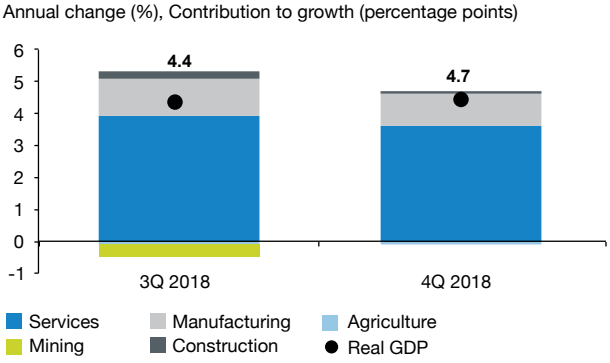
Chart 7: Growth by Sector



Source: Department of Statistics Malaysia

Services and manufacturing sectors remained the key drivers of growth

Chart 8: Contributions to Real GDP by Economic Sector



Source: Department of Statistics Malaysia

Performance of the mining sector rebounded, supported by higher oil and natural gas production following the maintenance shutdown in the previous quarter. Despite weak palm oil harvesting and rubber tapping activities due to adverse weather conditions, the agriculture sector recorded a smaller decline.

The construction sector registered lower growth due to a moderation in the civil engineering and special trade subsectors. The civil engineering subsector was impacted by near completion of large petrochemical projects and delays in highway construction. Support from early works activity on the special trade[1] subsector waned, as projects transitioned to mid-phase. Growth in the non-residential sub-sector improved slightly, while growth in the residential subsector remained weak amid the high number of unsold residential properties.

[1] Includes works such as land reclamation, site preparation, electrical installation, and works for specialised projects such as solar panels.

Inflation declined during the quarter as transport inflation turned negative

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), declined to 0.3% in the fourth quarter of 2018 (3Q 2018: 0.5%). For 2018 as a whole, headline inflation averaged at 1.0% (2017: 3.7%), its lowest level since 2009.

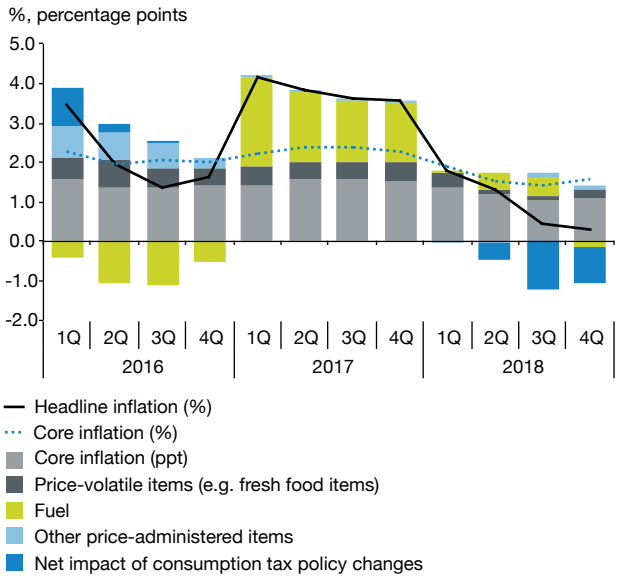
The decline in headline inflation was due mainly to transport inflation turning negative (4Q 2018: -1.2%; 3Q 2018: 3.0%), reflecting the fixed domestic RON95 petrol and diesel prices during the quarter compared to the higher fuel prices in the base period of 4Q 2017.

The combined outcome of the zerorisation of the Goods and Services Tax (GST) and the implementation of the Sales and Services Tax (SST) continued to exert an overall downward impact to headline inflation during the quarter. The percentage of items in the CPI basket that had inflation of more than 2% remained low at around 9% in 4Q 2018 (3Q 2018: 9%).

Core inflation, excluding the impact of consumption tax policy changes, edged up to 1.6% (3Q 2018: 1.4%). Demand-driven inflationary pressures in the economy remained contained in the absence of excessive wage pressure and some degree of spare capacity in the capital stock.

The decline in headline inflation reflected the deflation in the transport category

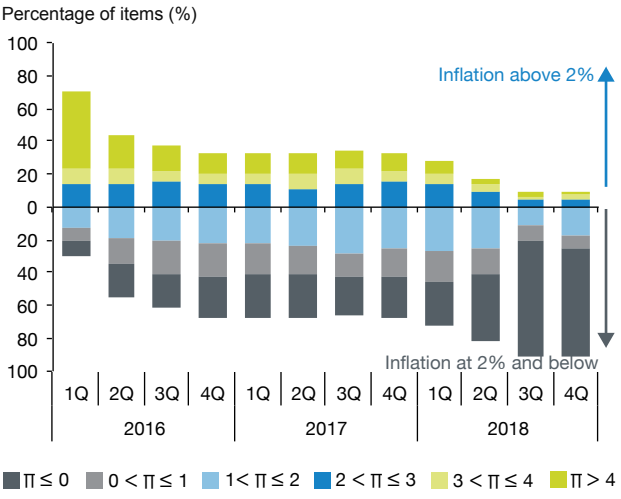
Chart 9: Contribution to Headline Inflation by Components



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

Inflation pervasiveness remained stable in 4Q 2018

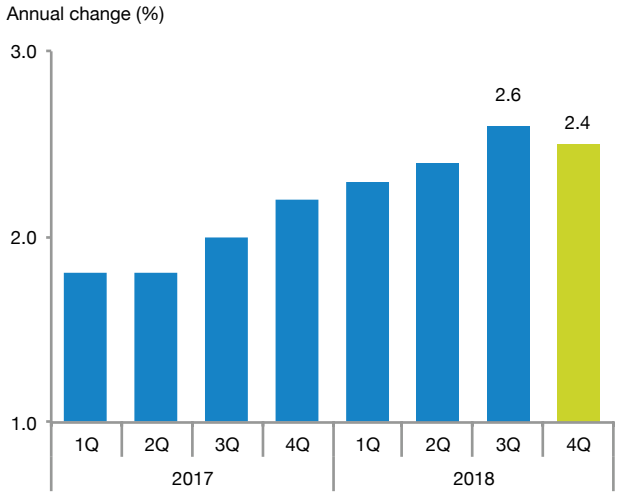
Chart 10: Inflation Pervasiveness



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

Employment continued to grow albeit more moderately

Chart 11: Employment Growth



Source: Department of Statistics Malaysia

Sustained manufacturing sector wage growth

Chart 12: Manufacturing sector wages*



* Manufacturing sector wages were derived from the salaries and wages data published in the Monthly Manufacturing Statistics by the Department of Statistics Malaysia (DOSM). Services sector wages were not featured as the data were not available when the draft was being finalised.

Source: Department of Statistics Malaysia and BNM estimates

Stable labour market conditions

During the fourth quarter, labour market conditions remained supportive of economic activity. Employment continued to expand albeit at a more moderate pace (2.4%, 3Q 2018: 2.6%), amid stable unemployment rate (3.3%; 3Q 2018: 3.4%). Stronger net employment gains were recorded in the services sector.

Manufacturing sector wage growth remained firm at 9.8% (3Q 2018: 9.6%). Wage growth in export-oriented industries (10.8%; 3Q 2018: 10.9%) continued to outpace that of domestic-oriented industries (6.6%; 3Q 2018: 6.1%).

Higher current account surplus

The current account surplus widened to RM10.8 billion (3Q 2018: RM3.8 billion) in the fourth quarter. This was due to a larger goods surplus[2] and a smaller income deficit, which more than offset the higher services deficit.

The goods surplus increased to RM33.0 billion (3Q 2018: RM26.6 billion) due to stronger manufactured exports in both the E&E and non-E&E segments, amid a smaller contraction in commodity exports. The services account, however, registered a larger deficit of RM4.3 billion (3Q 2018: -3.3 billion), owing mainly to a smaller surplus in the travel account (RM7.4 billion; 3Q 2018: RM8.0 billion) and higher net payments to foreign providers for architectural and engineering services, as well as use of intellectual property.

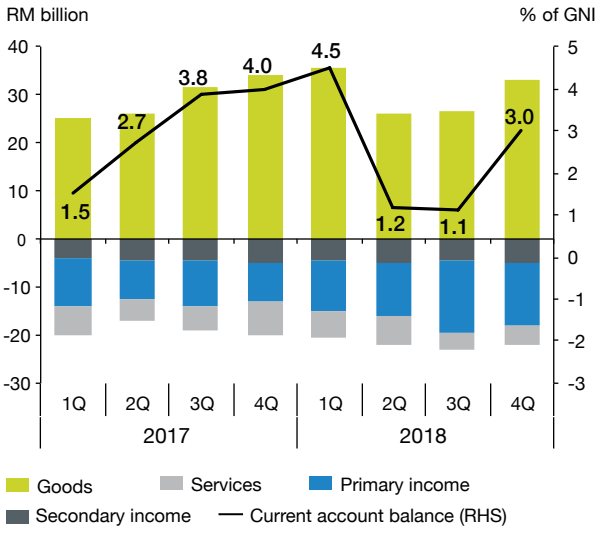
In the income accounts, a smaller deficit in the primary income account (-RM12.9 billion; 3Q 2018: -RM15.0 billion) was attributable to the higher income generated by Malaysian firms investing abroad and lower profits accrued to foreign investors in Malaysia. The secondary income deficit remained sizeable at RM4.9 billion (3Q 2018: -RM4.5 billion), on account of continued outward remittances by foreign workers.

Financial account registered a net outflow

The financial account registered a net outflow of RM6.1 billion (3Q 2018: Net inflow of RM2.3 billion). This was due to higher net outflows in the portfolio and other investment accounts, which more than offset the net inflows of direct investment during the quarter.

Current account surplus widened

Chart 13: Current account balance

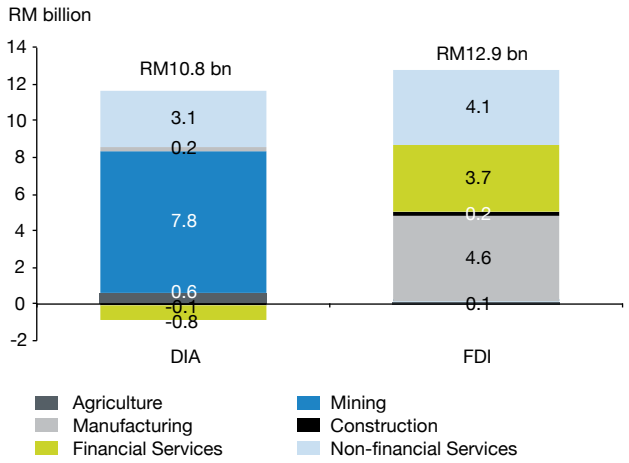


Source: Department of Statistics Malaysia

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

Higher net inflow in the direct investment account

Chart 14: Net Direct Investment Flows by Sector

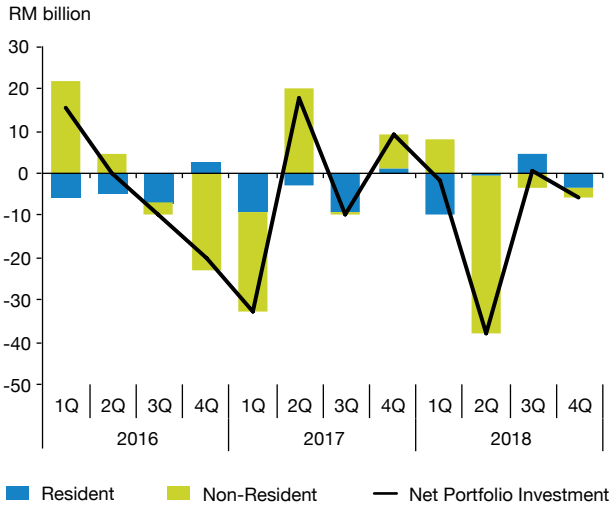


Note: For DIA, positive values refer to net outflows while negative values refer to net inflows

Source: Department of Statistics Malaysia and Bank Negara Malaysia

Net outflow in portfolio investment account attributable to both residents and non-residents

Chart 15: Portfolio Investments



Source: Department of Statistics Malaysia and Bank Negara Malaysia

The direct investment account registered a higher net inflow of RM2.1 billion (3Q 2018: net inflow of RM0.5 billion). During the quarter, foreign direct investments (FDI) improved, registering a larger net inflow of RM12.9 billion (3Q 2018: net inflow of RM4.3 billion). FDI inflows were channeled mainly into the manufacturing sector, and the non-financial services sectors. Meanwhile, direct investments abroad (DIA) by Malaysian companies also recorded a higher net outflow of RM10.8 billion (3Q 2018: net outflow of RM3.8 billion). DIA outflows were channeled primarily into the mining and non-financial services sectors.

The portfolio investment account registered a net outflow of RM5.8 billion (3Q 2018: marginal net inflow of RM1.0 billion). This reflected a turnaround in residents' portfolio asset transactions, following higher purchases of equity securities abroad (4Q 2018: net outflow RM3.3 billion; 3Q 2018: net inflow RM4.4 billion.) Non-residents recorded a smaller outflow of portfolio investments, amounting to RM2.5 billion (3Q 2018: net outflow RM3.6 billion). This was due to a net liquidation of equity securities, amid heightened global financial market volatility.

The other investment account recorded a net outflow of RM1.8 billion (3Q 2018: net inflow of RM1.0 billion). This was attributable to outflows following the maturity of interbank deposits within the domestic banking sector and trade credits, which were partly offset by the inflows from the maturity of currency & deposits and the repayment of trade credits to the private sector. Net errors and omissions amounted to -RM10.8 billion, or -2.2% of total trade. The international reserves of Bank Negara Malaysia amounted to USD101.4 billion as at end-December 2018, compared to USD103.0 billion as at end-September 2018.

Manageable external debt

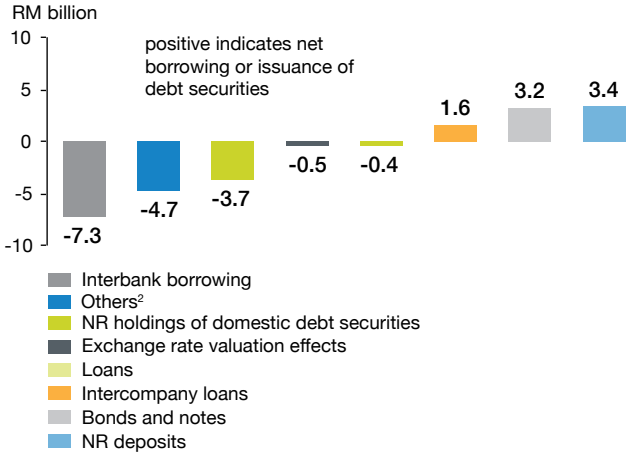
Malaysia's external debt stood lower at RM924.9 billion, or 64.7% of GDP as at end-December 2018 (end-September 2018: RM933.3 billion or 65.3% of GDP). The lower external debt reflects net repayment of interbank borrowing and trade credits, as well as some liquidation of domestic debt securities by non-resident investors. There was also the refinancing of several loans with equity capitalisation by related companies during the quarter. These were partially offset by the increase in non-resident deposits as well as a net issuance of bonds and notes offshore.

The country's external debt remains manageable, given its currency and maturity profiles, and the presence of large external assets. Close to one-third of external debt is denominated in ringgit (31.1%; end-September: 31.3%), mainly in the form of non-resident holdings of domestic debt securities (62.7% share) and in ringgit deposits (17.9% share) in domestic banking institutions. As such, these liabilities are not subjected to valuation changes from the fluctuations in the ringgit exchange rate.

The remaining external debt of RM637.4 billion or 68.9% of total external debt is denominated in foreign currency (FC) and comprised offshore borrowing predominantly. As at end-December 2018, offshore borrowing declined to RM566.9 billion or 39.7% of GDP (end-September: RM570.3 billion or 39.9% of GDP). The corporate sector accounted for slightly more than half of FC-denominated external debt. Of which, about three-quarters were hedged, either by FC-denominated revenue streams or financial instruments.

Lower external debt in 4Q 2018

Chart 16: Changes in External Debt
Net change[1]: -RM8.4 billion

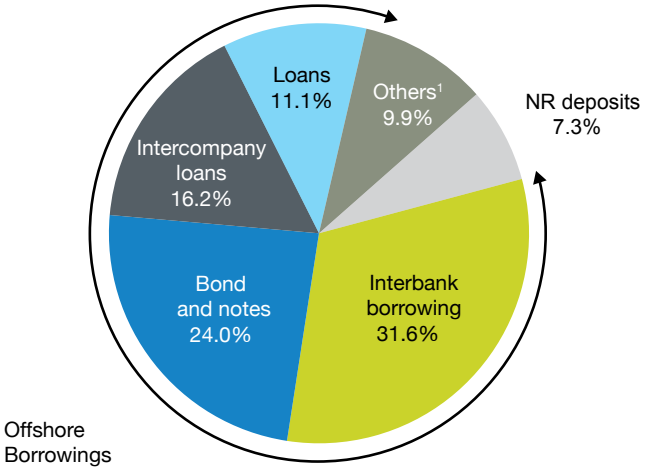


[1]Changes in individual debt instruments exclude exchange rate valuation effects
[2]Comprises trade credits, IMF allocation of SDRs and other debt liabilities
Note: NR refers to non-residents

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

FC-denominated debt subjected to prudent liquidity management practices and hedging requirements

Chart 17: Breakdown of Foreign Currency-Denominated External Debt (% Share)



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

Of the total FC-denominated external debt, 38.9% (or RM248.2 billion) represents interbank borrowing and FC deposits in the domestic banking system. 75.5% of interbank borrowing was intragroup borrowing, largely reflecting banks' centralised liquidity and funding management practices. During the quarter, banks' FC-denominated short-term external debt declined following net repayment of interbank borrowing, amid sustained growth in stable FC funding sources. Foreign exchange risk, measured in net open position of FC-denominated exposures[3] remained low at 5.8% of banks' total capital, reflecting banks' continued vigilance in managing foreign exchange risks.

Long-term bonds and notes issued offshore stood at RM152.7 billion as at end-December 2018, accounting for 24.0% of total FC-denominated external debt. These were mainly by non-financial corporations and channeled primarily to finance asset acquisitions abroad. Intercompany loans, which amount to RM103.2 billion and account for 16.2% of FC-denominated external debt, are typically on flexible and concessionary terms. About 80% of these intercompany loans were obtained by multinational corporations (MNCs) from parent or affiliate companies abroad.

From a maturity perspective, 56.2% of the total external debt is skewed towards medium- to long-term tenure (end-September: 56.1%), suggesting limited rollover risks. Short-term external debt accounted for the remaining 43.8% of external debt. As at 31 January 2019, international reserves stood at USD102.1 billion, sufficient to finance 7.4 months of retained imports, and is 1.0 time the short-term external debt (For detailed description of the composition of external debt, please refer to the Box Article entitled 'Profile of Malaysia's External Debt' in Bank Negara Malaysia's Quarterly Bulletin 3Q 2018).

Of importance, reserves are not the only means for banks and corporations to meet their external obligations. The progressive liberalisation of foreign exchange administration rules has resulted in greater decentralisation of reserves. In particular, banks and corporations held roughly three-quarters of Malaysia's RM1.7 trillion external assets, which can be drawn down to meet their RM733.3 billion external debt obligations, without creating a claim on international reserves. While the flexible exchange rate remains the first line of defense, adequate international reserves and availability of substantial foreign currency external assets by banks and corporations continues to serve as important policy buffers against potential external shocks.

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

Monetary and Financial Developments

HIGHLIGHTS

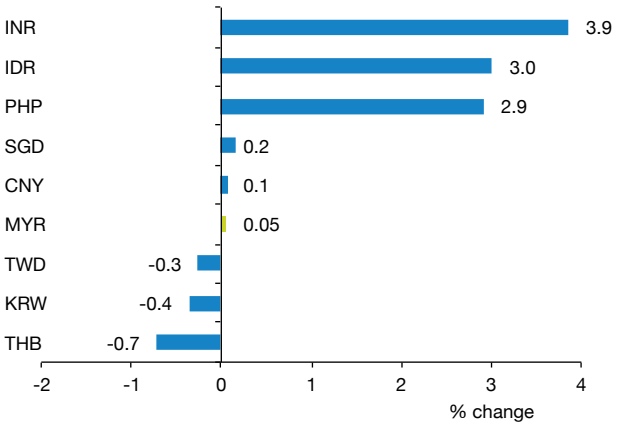
- The ringgit appreciated marginally in the fourth quarter despite non-resident portfolio outflows.

The ringgit appreciated marginally against the US dollar in the fourth quarter

The ringgit appreciated marginally against the US dollar during the fourth quarter of 2018, despite cautious investor sentiments in global financial markets and non-resident portfolio outflows from the domestic bond and equity markets. These outflows were driven mainly by expectations for a faster pace of US monetary policy normalisation, prior to the US Federal Reserve's (Fed) downward revision of its policy rate projection for 2019 in December 2018. In addition, uncertainties surrounding the moderating momentum of global growth and global trade also led to the unwinding of non-resident investments from regional financial markets, including Malaysia. However, these outflows were offset by resident inflows, mainly from goods and services, leading to the marginal appreciation of the ringgit. Going forward, lingering uncertainties on global trade and the trajectory of monetary policy normalisation in the US will continue to influence the performance of regional currencies, including the ringgit.

Ringgit appreciated marginally against the US dollar

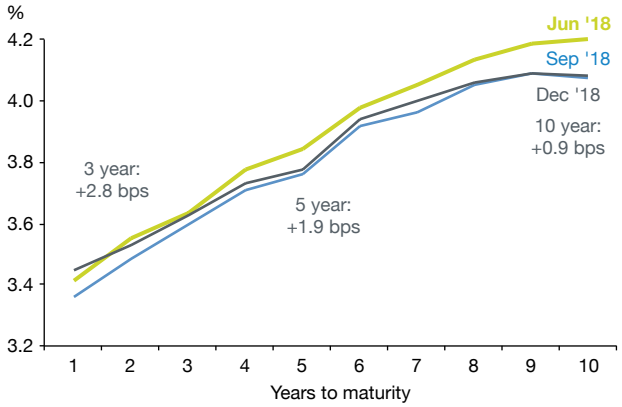
Chart 18: Summary of Performance of Regional Currencies Against the US Dollar (1 October - 31 December 2018)



Source: Bank Negara Malaysia

MGS yield curve remained broadly stable

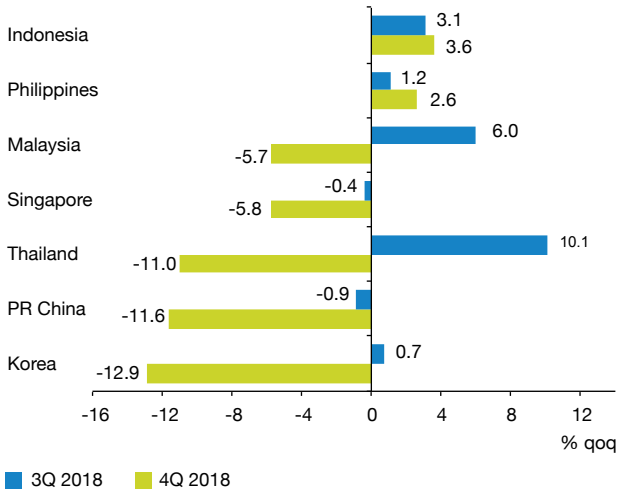
Chart 19: Trend in MGS Yields



Source: Bank Negara Malaysia

Decline in the domestic equity market was in line with the performance of most regional equities

Chart 20: Performance of Regional Equity Markets



Source: Bloomberg

Government bond yields were broadly stable despite non-resident outflows during the fourth quarter

Domestic bond yields increased only marginally during the quarter despite non-resident outflows due to continued support from domestic institutional investors. Non-resident outflows from the MGS market were driven mainly by expectations for a faster pace of US monetary policy normalisation. This led to international investors rebalancing their portfolio investments in EMEs towards US financial assets. During the period, the 3-year, 5-year and 10-year MGS yields increased by 2.8, 1.9 and 0.9 basis points, respectively.

FBM KLCI declined in the fourth quarter due to external uncertainties

The FBM KLCI reversed its gain in the third quarter, declining by 5.7% in the fourth quarter to close at 1,690.6 points as at end-December (end-September 2018: 1793.2 points). During the period, heightened risk-off sentiments in global financial markets were driven by concerns on the pace of monetary policy normalisation in the US, expectations of moderating global growth and lower corporate earnings. This led to the unwinding of non-resident holdings from global equity markets, including Malaysia.

Real interest rates edged upwards amid lower inflation in the fourth quarter

Nominal interest rates in the wholesale and retail markets were stable throughout the fourth quarter of 2018. The benchmark 3-month KLIBOR remained unchanged at 3.69%, while interbank rates across other maturities also remained unchanged. In the retail market, both the weighted average base rate (BR) and the weighted average lending rate (ALR) on outstanding loans were stable at 3.91% (3Q 2018: 3.90%) and 5.42% (3Q 2018: 5.43%) respectively.

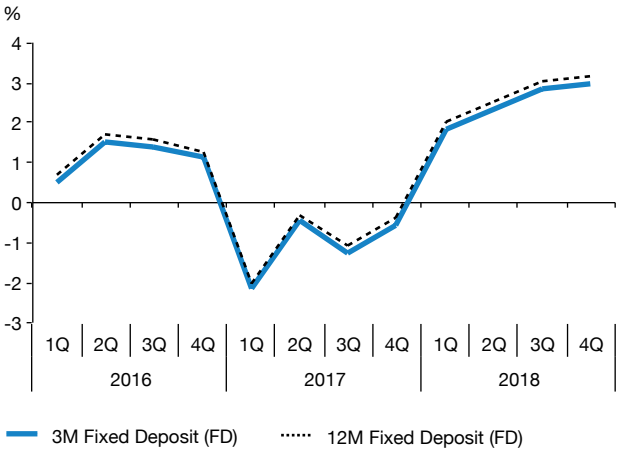
Real fixed deposit (FD) rates continued to increase in the fourth quarter of 2018, albeit at a moderating pace due to the marginally lower headline inflation. In particular, the real 3-month and 12-month FD rate increased by 10 basis points to 2.95% (3Q 2018: 2.85%) and 3.13% (3Q 2018: 3.03%), respectively.

Liquidity conditions remained sufficient to facilitate financial intermediation

In the banking system, liquidity conditions remained sufficient at both the institutional and system-wide levels. The level of surplus liquidity placed with the Bank remained relatively stable during the quarter, reflecting a moderation of net outflows. At the institutional level, most banks continued to maintain surplus liquidity positions.

Real deposit rates increased at a moderating pace

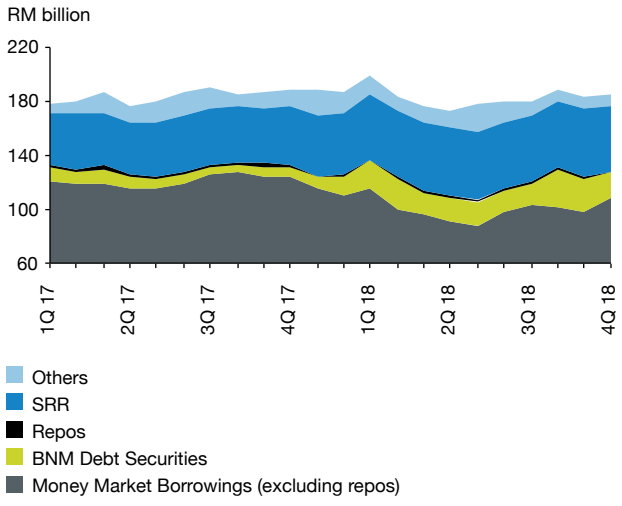
Chart 21: Real Fixed Deposit Rates (by Maturity) as at end-period



Source: Bank Negara Malaysia

Outstanding surplus ringgit liquidity placed with the Bank remained stable

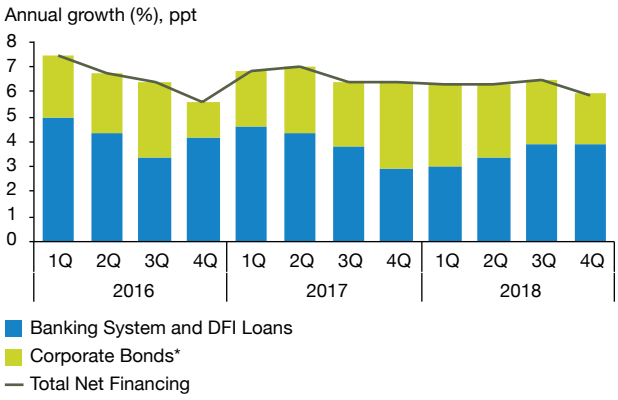
Chart 22: Outstanding Ringgit Liquidity Placed with Bank Negara Malaysia as at end-period



Source: Bank Negara Malaysia

Moderation in net financing growth due mainly to lower growth in outstanding corporate bonds

Chart 23: Contribution to Net Financing Growth



Note: Net financing comprises outstanding banking system and DFI loans, and outstanding corporate bonds
*Excludes issuances by Cagamas and non-residents

Source: Bank Negara Malaysia

Net financing moderated during the quarter

In the fourth quarter, net financing expanded by 5.8% on an annual basis (3Q 2018: 6.5%). The moderation mainly reflected the lower growth in outstanding corporate bonds[4] of 8.0% (3Q 2018: 10.8%), in part due to the high base effect during the same period in 2017. Outstanding loan[5] growth was stable during the quarter at 5.1% (3Q 2018: 5.1%). Outstanding business loans continued increasing steadily to 4.6% (3Q 2018: 3.6%), driven mainly by the higher loan growth for the *wholesale and retail trade, restaurants and hotels; manufacturing;* and *finance, insurance and business services* sectors. Despite a lower growth in outstanding loans for SMEs[6] (4Q 2018: 0.6%; 3Q 2018: 2.4%), the amount of loans disbursed was higher during the quarter (4Q 2018: RM80.8 billion; 3Q 2018: RM77.2 billion). Outstanding household loans during the period grew by 5.2% (3Q 2018: 5.5%), supported mainly by loans for the *purchase of residential properties; purchase of securities;* and *personal use*.

[4] Corporate bonds exclude issuances by Cagamas and non-residents.
[5] Loans extended by the banking system and development financial institutions (DFIs).
[6] Partly reflects an ongoing reclassification exercise of SMEs to non-SMEs by financial institutions.

The Bank's Policy Considerations

HIGHLIGHTS

- **The MPC maintained the Overnight Policy Rate at 3.25% in January 2019, as the degree of monetary accommodativeness is consistent with the intended policy stance and supportive of economic activity.**

The OPR remained accommodative

At the November 2018 and January 2019 Monetary Policy Committee (MPC) meetings, the Overnight Policy Rate (OPR) was maintained at 3.25%. The Malaysian economy is expected to remain on a steady growth path with domestic demand as the key driver of growth. Headline inflation is expected to average moderately higher in 2019.

The MPC assessed that risks to both global and domestic growth were tilted to the downside and will be dominated by several challenges. These include slower growth in the major economies, escalation of trade tensions, tighter global financial conditions amid an uncertain pace and timing of monetary policy normalisation in the US, heightened political and policy uncertainty, and commodity-related shocks. Going forward, the MPC will continue to monitor and assess these challenges for the potential adverse impact to domestic growth and inflation.

Domestic financial markets have remained resilient despite bouts of global financial market volatility. Domestic monetary and financial conditions remain orderly and supportive of economic growth. Monetary operations will continue to ensure sufficient liquidity to support the orderly functioning of money and foreign exchange markets and intermediation activity.

Other policy highlights in the fourth quarter of 2018

The Bank issued the finalised policy document on Outsourcing in December 2018. The policy aims to strengthen safeguards to ensure that outsourcing risk does not impair the safety and soundness of financial institutions and supervisability by the Bank. In particular, the requirements accord added emphasis on the institutions' governance and risk management, due diligence of service providers, data confidentiality protection and business continuity planning, and are complemented by an approval requirement for material outsourcing arrangements. The standard came into effect on 1 January 2019, with transitioning arrangements until 1 July 2022 for financial institutions to bring existing outsourcing arrangements into compliance with the new requirements.

Given the growing demand of end-users for immediate payments and the increasing net debit exposures in real-time retail payment systems. Supervisory expectations on intraday liquidity management would be incorporated in the Liquidity Risk Management exposure draft, which is planned for issuance in 2019.

In view of the increasing sophistication and complexity of cyberattacks relating to payments, financial institutions have been encouraged to deploy control measures that would be effective in an 'assumed breached' environment, including the means to detect out-of-policy or suspicious payments and to stop fraudulent in-flight transactions. Such measures should complement existing defences to counter cyberattacks.

Macroeconomic Outlook

HIGHLIGHTS

- In 2019, global growth is expected to moderate.
- The Malaysian economy will continue to remain on a steady growth path in 2019.
- Headline inflation is projected to average moderately higher in 2019.

More moderate global growth in 2019, with substantial downside risks

The global economy is expected to expand at a more moderate pace across advanced economies and emerging market economies (EMEs) in 2019.

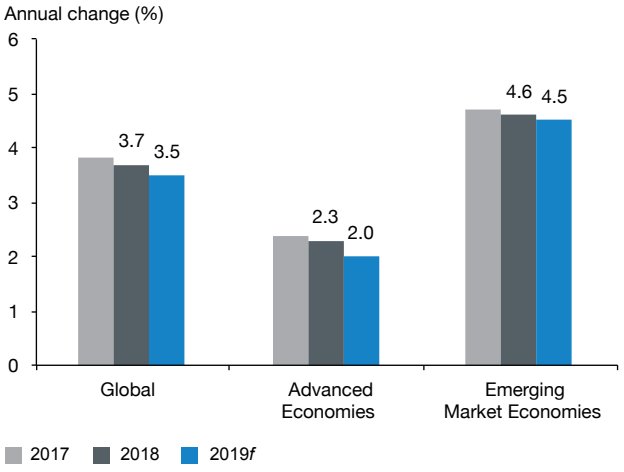
In advanced economies, growth prospects will continue to be driven by strong labour market conditions, lending sustained support to private consumption, amid more moderate investment activity. In the US, however, growth is expected to moderate as the stimulative effects of fiscal policies wane, and the impact of higher interest rates begins to affect the economy.

Growth in the Asian region is expected to moderate. Of significance, growth in PR China is expected to expand at a slower rate, reflecting ongoing structural reforms in the country, amid existing and potential trade actions. This will likely weigh on regional exports. However, domestic demand is expected to support growth in the region.

Overall, there is a higher downside risk to global growth in 2019. Any further deterioration or widening of trade tensions will drag down both global trade and growth. Tightening financial conditions and heightened volatility in financial markets, coupled with country-specific factors ranging from heightened political and policy uncertainty, and elevated debt levels, could also weigh on growth prospects.

Moderating global growth in 2019

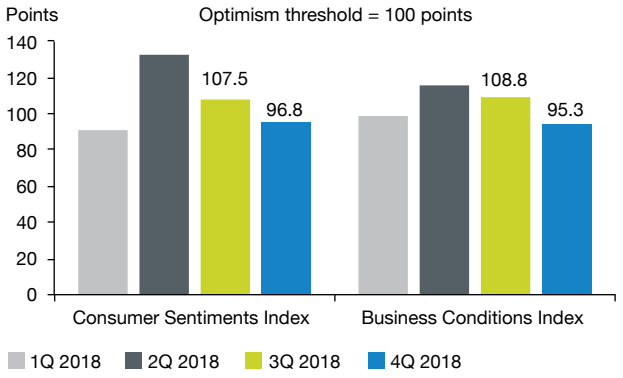
Chart 24: GDP Growth



Source: IMF World Economic Outlook (January 2019)

Moderation in sentiment indicators

Chart 25: MIER Consumer Sentiments and Business Conditions Index



Source: Malaysian Institute of Economic Research (MIER)

The Malaysian economy to remain on a steady growth path in 2019

Amid escalating trade tensions and tighter global financial conditions, the Malaysian economy recorded a respectable growth of 4.7% in 2018. Growth in 2018 was further affected by unanticipated supply disruptions in the commodity-related sectors.

For 2019, as the supply disruptions recede and new production facilities commence, the Malaysian economy is expected to continue to expand at a steady pace. Private sector demand is expected to remain the main driver of growth amid fiscal rationalisation while the external sector would be weighed down by weaker global demand. Although sentiments have moderated from recent highs, private sector expenditure will continue to be supported by fundamental factors such as continued income and employment growth.

Risks to growth remain tilted to the downside. These stem mainly from further escalation of trade tensions and tightening of global financial conditions.

Moderately higher headline inflation in 2019

In 2019, headline inflation is expected to average moderately higher. The consumption tax policy will exert a temporary impact on headline inflation in 2019, and will start to lapse towards the end of the year.

Recent developments in the global oil market have led to lower projected global oil prices. With the floating of domestic fuel prices in January 2019, the lower global oil prices would have a more direct impact on and help contain the increase in headline inflation. However, the trajectory of global oil prices remains uncertain, thereby presenting a risk to the inflation outlook.

Underlying inflation, which excludes the impact of the changes in consumption tax policy, is expected to be broadly stable in 2019 in the absence of strong demand pressure.

Annex

Table 1

GDP by Expenditure Components (at constant 2010 prices)

	Share 2018 (%)	2017		2018		
		4Q	Year	3Q	4Q	Year
		Annual growth (%)				
Aggregate Domestic Demand (excluding stocks)	92.9	6.2	6.5	6.9	5.6	5.6
Private sector	*72.8*	7.4	7.5	8.5	7.7	7.2
Consumption	*55.5*	*7.0*	*7.0*	*9.0*	*8.5*	*8.1*
Investment	*17.4*	*9.2*	*9.3*	*6.9*	*4.4*	*4.5*
Public sector	20.1	3.4	3.3	1.1	0.4	0.1
Consumption	*12.8*	*6.8*	*5.4*	*5.2*	*4.0*	*3.3*
Investment	*7.3*	*-1.4*	*0.1*	*-5.5*	*-4.9*	*-5.2*
Net Exports	8.4	2.3	-1.9	-7.5	9.9	13.4
Exports of Goods and Services	*70.6*	*6.7*	*9.4*	*-0.8*	*1.3*	*1.5*
Imports of Goods and Services	*62.2*	*7.3*	*10.9*	*0.1*	*0.2*	*0.1*
GDP	**100.0**	**5.9**	**5.9**	**4.4**	**4.7**	**4.7**
GDP (q-o-q growth, seasonally adjusted)	**-**	**1.0**	**-**	**1.6**	**1.4**	**-**

Source: Department of Statistics, Malaysia

Table 2

GDP by Economic Activity (at constant 2010 prices)

Annual growth (%)	Share 2018 (%)	2017	2018			
		4Q	1Q	2Q	3Q	4Q
		Annual change (%)				
Services	55.5	6.2	6.5	6.5	7.2	6.9
Manufacturing	23.0	5.4	5.3	4.9	5.0	4.7
Mining	7.9	-0.3	0.1	-2.2	-4.6	0.5
Agriculture	7.8	10.7	2.8	-2.5	-1.4	-0.4
Construction	4.5	5.9	4.9	4.7	4.6	2.6
Real GDP	**100.0**[1]	**5.9**	**5.4**	**4.5**	**4.4**	**4.7**

[1] Numbers do not add up due to rounding and exclusion of import duties component

Source: Department of Statistics, Malaysia

Table 3

Balance of Payments[1]

	2017		2018		
	4Q	Year	3Q	4Q	Year
	RM billion				
Current Account	**13.9**	**40.3**	**3.8**	**10.8**	**33.5**
(% of GNI)	*4.0*	*3.1*	*1.1*	*3.0*	*2.4*
Goods	34.1	116.8	26.6	33.0	121.4
Services	-7.0	-22.8	-3.3	-4.3	-19.7
Primary income	-8.4	-36.4	-15.0	-12.9	-49.4
Secondary income	-4.8	-17.3	-4.5	-4.9	-18.8
Financial Account	**0.9**	**-4.7**	**2.3**	**-6.1**	**18.6**
Direct investment	5.0	16.2	0.5	2.1	11.3
Assets	*-0.3*	*-24.2*	*-5.6*	*-10.0*	*-23.3*
Liabilities	*5.2*	*40.4*	*6.1*	*12.1*	*34.6*
Portfolio investment	9.4	-15.4	0.8	-5.8	-44.4
Assets	*1.3*	*-19.4*	*4.4*	*-3.3*	*-9.1*
Liabilities	*8.1*	*4.1*	*-3.6*	*-2.5*	*-35.3*
Financial derivatives	-1.1	-0.2	0.0	-0.7	1.0
Other investment	-12.3	-5.3	1.0	-1.8	50.7
Errors & omissions[2]	-12.6	-19.1	-9.5	-10.8	-44.3
Overall Balance	**2.1**	**16.4**	**-3.4**	**-6.2**	**7.7**

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 et E&O excludes reserves revaluation changes. This practice is backdated up to 2Q 2010.
Note: Numbers may not add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 4

Outstanding External Debt

	2017	2018	
	end-Dec	end-Sept	end-Dec
	RM billion		
Total External Debt	**885.2**	**933.3**	**924.9**
USD billion equivalent	*215.9*	*223.0*	*221.0*
By instrument			
Bond and notes[1]	151.4	150.0	153.2
Interbank borrowing[1]	172.2	211.9	204.1
Intercompany loans[1]	131.3	135.0	136.5
Loans[1]	53.7	73.4	73.2
NR holdings of domestic debt securities	207.4	183.9	180.2
NR deposits	92.0	94.9	98.2
Others[2]	77.2	84.2	79.5
Maturity profile			
Medium and long-term	533.4	523.6	519.6
Short-term	351.8	409.7	405.3
Currency denomination			
Ringgit	307.6	292.5	287.5
Foreign	577.7	640.8	637.4
Total debt/GDP (%)	65.4	65.3	64.7
Short-term debt/Total debt (%)	39.7	43.9	43.8
Reserves/Short-term debt (times)	1.2	1.0	1.0[3]

[1] These debt instruments constitute the offshore borrowing.
[2] Comprise trade credits, IMF allocation of SDRs and miscellaneous.
[3] Based on international reserves as at 31 January 2019.
Note: NR refers to non-residents

Source: Ministry of Finance and Bank Negara Malaysia

Table 5

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

	2017		2018			2017		2018		
	4Q	Year	3Q	4Q	Year	4Q	Year	3Q	4Q	Year
	Change during the period (RM billion)					Annual growth (%)				
Net total financing	**42.5**	**138.2**	**34.3**	**30.5**	**133.9**	**6.4**	**6.4**	**6.5**	**5.8**	**5.8**
Outstanding loans[1,2]	22.2	63.1	25.6	23.6	88.7	3.8	3.8	5.1	5.1	5.1
Of which:										
Business enterprises	-2.3	8.1	9.5	3.9	28.8	1.3	1.3	3.6	4.6	4.6
SMEs[3]	*5.1*	*15.9*	*-1.3*	*-0.4*	*2.0*	*5.3*	*5.3*	*2.4*	*0.6*	*0.6*
Non-SMEs	*-7.5*	*-7.8*	*10.8*	*4.3*	*26.8*	*-2.5*	*-2.5*	*4.8*	*8.7*	*8.7*
Households	16.7	46.6	14.5	14.5	52.0	4.9	4.9	5.5	5.2	5.2
Outstanding corporate bonds	20.3	75.1	8.7	6.9	45.2	15.4	15.4	10.8	8.0	8.0

[1] Banking system and development financial institutions (DFIs)
[2] Includes loans sold to Cagamas
[3] Partly reflects an ongoing reclassification exercise of SMEs to non-SMEs by financial institutions
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Table 6

Loan Indicators

	2017		2018			2017		2018		
	4Q	Year	3Q	4Q	Year	4Q	Year	3Q	4Q	Year
	During the period (RM billion)					Annual growth (%)				
Total										
Loan applications[1]	217.6	841.2	230.9	200.0	859.4	9.5	5.1	4.3	-8.1	2.2
Loan approvals[1]	104.1	380.1	104.4	103.1	397.5	11.9	10.2	7.8	-0.9	4.6
Loan disbursements[2]	310.0	1,171.3	314.1	340.7	1,256.6	3.6	5.0	8.8	9.9	7.3
Loan repayments[2]	300.3	1,159.1	307.9	332.7	1,236.8	7.0	6.8	6.5	10.8	6.7
Of which:										
Business enterprises[3]										
Loan applications	100.0	370.1	100.3	86.5	380.0	8.1	-1.1	3.3	-13.4	2.7
Loan approvals	51.6	177.8	48.4	50.9	186.1	11.2	8.4	9.0	-1.3	4.7
Loan disbursements	219.7	835.9	224.4	248.3	898.7	0.9	4.8	9.2	13.0	7.5
Loan repayments	216.4	834.4	222.3	244.9	889.6	5.4	6.6	6.6	13.2	6.6
SMEs[4]										
Loan applications	47.7	177.2	47.1	43.3	181.9	3.4	-2.5	1.6	-9.3	2.6
Loan approvals	18.5	64.6	17.8	16.3	65.5	-4.3	-2.6	5.0	-11.6	1.4
Loan disbursements	78.4	296.3	77.2	80.8	307.3	8.6	10.8	0.5	3.1	3.7
Loan repayments	73.4	286.1	76.3	79.3	304.3	7.9	9.8	2.7	8.1	6.4
Non-SMEs[3]										
Loan applications	52.3	192.9	53.3	43.2	198.1	12.8	0.3	4.8	-17.2	2.7
Loan approvals	33.1	113.2	30.5	34.5	120.6	22.2	15.9	11.4	4.4	6.6
Loan disbursements	141.3	539.6	147.2	167.5	591.4	-3.0	1.7	14.4	18.6	9.6
Loan repayments	143.1	548.3	146.0	165.6	585.3	4.1	5.0	8.8	15.8	6.7
Households										
Loan applications	117.6	471.1	130.6	113.5	479.3	10.7	10.5	5.1	-3.5	1.7
Loan approvals	52.5	202.4	56.1	52.3	211.3	12.6	11.8	6.8	-0.5	4.4
Loan disbursements	90.3	335.4	89.7	92.4	357.9	10.8	5.6	7.9	2.4	6.7
Loan repayments	83.8	324.7	85.6	87.7	347.2	11.3	7.3	6.2	4.7	6.9

[1] Loan applications and approvals for all segments include only banking system loans
[2] Loan disbursements and repayments for all segments include banking system and development financial institutions (DFIs)
[3] Includes domestic non-bank financial institutions, domestic financial institutions, government, domestic other entities and foreign entities
[4] Partly reflects an ongoing reclassification exercise of SMEs to non-SMEs by financial institutions
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Table 7

Banking System Profitability Indicators

	2017	2018			
	4Q	1Q	2Q	3Q	4Q
Return on equity (%)	13.1	12.4	13.3	12.7	12.6
Return on assets (%)	1.5	1.4	1.5	1.4	1.4
	RM million				
Net interest income	11,662	12,045	12,046	12,253	12,493
Add: Fee-based income	3,036	2,606	2,515	2,479	2,475
Less: Operating cost[1]	8,180	8,101	7,838	7,725	8,289
Gross operating profit	6,517	6,550	6,723	7,007	6,679
Less: Impairment[2] and other provisions	415	682	429	630	652
Gross operating profit after provision	6,103	5,868	6,294	6,377	6,027
Add: Other income	3,838	3,048	4,063	2,228	3,370
Pre-tax profit	**9,941**	**8,916**	**10,356**	**8,605**	**9,397**
	Annual change (%)				
Return on equity *(percentage points)*	0.5	0.6	0.6	-0.1	-0.4
Return on assets *(percentage points)*	0.1	0.1	0.1	0.01	-0.03
Net interest income	5.0	6.7	3.7	4.3	7.1
Add: Fee-based income	18.2	4.3	-0.5	-3.0	-18.5
Less: Operating cost[1]	7.7	7.1	2.2	0.5	1.3
Gross operating profit	7.2	5.2	3.8	5.9	2.5
Less: Impairment[2] and other provisions	-40.2	126.9	-47.8	19.3	57.1
Gross operating profit after provision	13.3	-0.9	11.3	4.7	-1.2
Add: Other income	67.6	52.0	13.6	-26.7	-12.2
Pre-tax profit	**29.5**	**12.4**	**12.2**	**-5.8**	**-5.5**

[1] Refers to staff costs and overheads
[2] Refers to individual and collective impairment provisions in accordance with the Policy Document on Classification and Impairment Provisions for Loans / Financing for banks that have yet to adopt Malaysia Financial Reporting Standard 9 (MFRS 9), and 12 Months Expected Credit Losses (ECL), Lifetime ECL Not Credit Impaired and Lifetime ECL Credit Impaired for banks that have adopted MFRS 9

Source: Bank Negara Malaysia

Table 8

Insurance and Takaful Sector Profitability Indicators

	2017	2018			
	4Q	1Q	2Q	3Q	4Q
	RM million				
Life Insurance & Family Takaful					
Excess income over outgo	4,918	4,095	-1,222	8,414	-998
General Insurance & General Takaful					
Operating profit	783	561	759	1,207	466
Claims ratio (%)	55	57	59	53	57
	Annual change (%)				
Life Insurance & Family Takaful					
Excess income over outgo	647.7	-33.1	-127.7	139.2	-120.3
General Insurance & General Takaful					
Operating profit	-12.1	13.4	-0.4	84.7	-40.5
Claims ratio (percentage points)	-1.7	-6.0	3.7	-7.9	2.3

Source: Bank Negara Malaysia

Table 9

Federal Government Finance

	2017		2018[p]		
	4Q	Year	3Q	4Q	Year
	RM billion				
Revenue	64.6	220.4	58.9	67.4	233.1
% annual growth	*8.0*	*3.8*	*0.3*	*4.3*	*5.8*
Operating expenditure	58.3	217.7	55.1	57.5	230.4
% annual growth	*16.7*	*3.6*	*14.1*	*-1.4*	*5.8*
Current account	**6.3**	**2.7**	**3.9**	**9.9**	**2.7**
% of GDP	***1.8***	***0.2***	***1.1***	***2.6***	***0.2***
Net development expenditure	13.4	43.0	7.5	28.0	55.3
% annual growth	*-1.9*	*5.9*	*-22.4*	*108.5*	*28.5*
Overall balance	**-7.2**	**-40.3**	**-3.6**	**-18.1**	**-52.5**
% of GDP	***-2.0***	***-3.0***	***-1.0***	***-4.8***	***-3.7***
Memo:					
Total net expenditure	71.8	260.7	62.5	85.5	285.7
% annual growth	*12.7*	*3.9*	*8.0*	*19.1*	*9.6*
Total Federal Government debt (as at end-period)	686.8	686.8	731.1	741.0	741.0
% of GDP	*50.7*	*50.7*	*51.1*	*51.8*	*51.8*
Domestic Debt	484.1	484.1	547.3	562.2	562.2
% of GDP	*35.8*	*35.8*	*38.3*	*39.3*	*39.3*
External Debt	202.8	202.8	183.8	178.8	178.8
% of GDP	*15.0*	*15.0*	*12.9*	*12.5*	*12.5*
Non-resident holdings of RM-denominated Federal Government debt	*186.2*	*186.2*	*167.2*	*162.1*	*162.1*
% of GDP	*13.8*	*13.8*	*11.7*	*11.3*	*11.3*
Offshore borrowing	*16.6*	*16.6*	*16.6*	*16.7*	*16.7*
% of GDP	*1.2*	*1.2*	*1.2*	*1.2*	*1.2*

[p] Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia