DEVELOPMENTS IN THE MALAYSIAN ECONOMY

The Malaysian economy grew by 4.0% in the second quarter

The Malaysian economy expanded by 4.0% in the second quarter of 2016 (1Q 2016: 4.2%). Private sector expenditure remained the key driver of growth (6.1%; 1Q 2016: 4.5%), and contributed towards the continued expansion in domestic demand. However, growth was affected by the continued decline in net exports and a significant drawdown in stocks. While real exports registered a better performance (1.0%; 1Q 2016: -0.5%) due to higher demand for manufactured products, real imports increased at a faster rate of 2.0% (1Q 2016: 1.3%) on account of improvement in growth of capital and intermediate goods. As a result, net exports continued to register a negative growth during the quarter, albeit at a slower pace of -7.0% (1Q 2016: -12.4%). The drawdown in stocks was attributed to lower production in agriculture and manufactured products. On a quarter-on-quarter seasonally-adjusted basis, the economy recorded a growth of 0.7% (1Q 2016: 1.0%).

Continued expansion in domestic demand

Domestic demand grew by 6.3% in the second quarter of the year (1Q 2016: 3.6%), with private sector expenditure expanding at a stronger pace of 6.1% (1Q 2016: 4.5%). **Private consumption** growth expanded by 6.3% (1Q 2016: 5.3%), supported by continued wage and employment growth, as well as the additional disposable income from Government measures. **Private investment** registered a higher growth of 5.6% in the second quarter (1Q 2016: 2.2%), underpinned mainly by continued capital spending in the services and manufacturing sectors, amid some improvements in business confidence.

Public consumption recorded a stronger growth of 6.5% (1Q 2016: 3.8%), as a result of higher spending on supplies and services. **Public investment** turned around to register a positive growth of 7.5% (1Q 2016: -4.5%), driven by higher spending on fixed assets by both the Federal Government and public corporations.

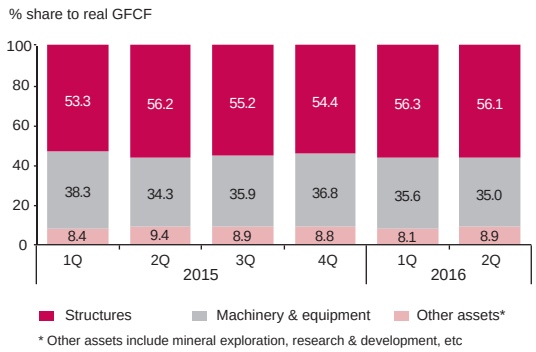
GDP by Expenditure Components
(at constant 2010 prices)

	Share 2015 (%)	2015		2016		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Aggregate Domestic Demand (excluding stocks)	91.6	4.6	6.3	3.6	6.3	5.0
Private Sector	69.2	5.7	7.6	4.5	6.1	5.4
Consumption	*52.4*	*6.4*	*7.7*	*5.3*	*6.3*	*5.8*
Investment	*16.9*	*3.9*	*7.4*	*2.2*	*5.6*	*4.0*
Public Sector	22.4	0.9	1.8	0.4	6.9	3.6
Consumption	*13.5*	*6.9*	*5.6*	*3.8*	*6.5*	*5.2*
Investment	*8.9*	*-8.1*	*-3.7*	*-4.5*	*7.5*	*1.1*
Net Exports	8.6	-11.1	-10.5	-12.4	-7.0	-9.8
Exports of Goods and Services	*72.9*	*-4.0*	*-2.4*	*-0.5*	*1.0*	*0.2*
Imports of Goods and Services	*64.3*	*-3.1*	*-1.1*	*1.3*	*2.0*	*1.6*
GDP[1]	**100.0[1]**	**4.9**	**5.3**	**4.2**	**4.0**	**4.1**
GDP (q-o-q growth, seasonally adjusted)	**-**	**0.9**	**-**	**1.0**	**0.7**	**-**

[1] Numbers do not add up due to rounding and exclusion of stocks
Source: Department of Statistics, Malaysia

In terms of total investment, **gross fixed capital formation (GFCF)** registered a faster expansion of 6.1% (1Q 2016: 0.1%), supported by both public and private investment. By type of assets, the higher capital spending was due to the turnaround in machinery and equipment investment (8.1%; 1Q 2016: -7.1%) and the continued growth in structures investment (5.9%; 1Q 2016: 5.7%).

GFCF by Type of Assets



* Other assets include mineral exploration, research & development, etc
Source: Department of Statistics, Malaysia

Major economic sectors continued to expand

On the supply side, all sectors continued to expand, with the exception of the agriculture sector. The higher growth in the services sector was underpinned primarily by stronger household spending while growth in the manufacturing sector was supported by the electronics and electrical cluster. Growth in the construction sector was stronger, dominated by the civil engineering sub-sector. The performance of the mining sector improved, due mainly to higher crude oil and natural gas production during the quarter. Growth in the agriculture sector declined, due to the lagged impact of El Niño on crude palm oil production.

The **services sector** grew at a higher rate of 5.7% in the second quarter (1Q 2016: 5.1%), underpinned primarily by stronger household spending. The wholesale and retail trade sub-sector recorded a higher growth of 6.7% (1Q 2016: 5.2%), in line with the improvement in private consumption. In the information and communication sub-sector, growth remained robust (8.8%; 1Q 2016: 8.5%), driven by continued strong demand for data communication services. Growth in the finance and insurance sub-sector sector improved to 1.6% (1Q 2016: 0.1%), on account of higher premiums in the insurance segment. The expansion in the real estate and business services sub-sector was due mainly to professional services in the business services segment, while growth of the transportation and storage sub-sector was supported by passenger traffic and trade activity.

GDP by Economic Activity (at constant 2010 prices)

	Share 2015 (%)	2015		2016		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Services	53.5	5.0	5.7	5.1	5.7	5.4
Manufacturing	23.0	4.2	4.9	4.5	4.1	4.3
Mining	9.0	6.0	7.8	0.3	2.6	1.4
Agriculture	8.9	4.6	0.3	-3.8	-7.9	-6.0
Construction	4.4	5.6	7.6	7.9	8.8	8.4
Real GDP	**100.0[1]**	**4.9**	**5.3**	**4.2**	**4.0**	**4.1**
Real GDP (q-o-q seasonally adjusted)	**-**	**0.9**	**-**	**1.0**	**0.7**	**-**

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

Source: Department of Statistics, Malaysia

Performance of the Services Sector (value added at constant 2010 prices)

	Share 2015 (%)	2015		2016		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Intermediate Services	**38.1**	**4.8**	**5.2**	**4.7**	**5.5**	**5.1**
Finance & insurance	12.9	0.2	1.0	0.1	1.6	0.8
Real estate & business services	8.0	6.2	6.8	6.4	6.8	6.6
Transport & storage	6.6	5.4	5.5	5.8	5.9	5.8
Information & communication	10.6	9.3	9.4	8.5	8.8	8.7
Final Services	**61.9**	**5.1**	**5.9**	**5.4**	**5.8**	**5.6**
Wholesale & retail trade	27.4	5.8	7.8	5.2	6.6	5.9
Food & beverages and accommodation	5.2	6.6	6.9	6.2	6.9	6.6
Utilities	4.8	3.9	3.8	6.7	5.4	6.1
Government services	16.3	4.0	3.9	5.3	4.9	5.1
Other services	8.2	4.7	4.7	4.6	4.4	4.5
Total Services	**100.0[1]**	**5.0**	**5.7**	**5.1**	**5.7**	**5.4**

[1] Numbers do not add up due to rounding

Source: Department of Statistics, Malaysia

Selected Quarterly Indicators in the Services Sector

	2015		2016		
	2Q	1H	1Q	2Q	1H
	Index				
MIER Consumer Sentiments Index	71.7	72.2	72.9	78.5	75.7
MIER Retail Trade Index	76.8	81.1	65.9	105.0	85.5
MIER Tourism Market Index	84.7	92.7	93.0	99.5	96.3
	Annual change (%)				
Total passenger traffic at all airports	1.6	0.4	3.8	2.8[1]	3.4[2]
Total consumption credit outstanding	2.7	2.7	1.9	1.8	1.8
Total loans outstanding	9.1	9.1	6.4	5.6	5.6
Loans outstanding to the wholesale & retail trade, hotels & restaurants	8.2	8.2	7.0	5.2	5.2
Imports of consumption goods	25.4	15.2	24.6	9.9	16.4
Total sales of motor vehicles	-11.2	-3.3	-22.0	-6.3	-14.5
Container cargo handled (Port Klang and PTP)	6.0	9.3	6.3	5.1	5.7

[1] Apr-May 2016
[2] Jan-May 2016

Source: Various sources

The **manufacturing sector** expanded by 4.1% in the second quarter (1Q 2016: 4.5%). Growth in the export-oriented industries benefited mainly from the higher production of semiconductors and petrochemical-related products. The domestic-oriented industries were supported by sustained production of food and beverages and construction-related materials. Motor vehicle output, on the other hand, remained weak.

Performance of the Manufacturing Sector

	Share in 2015 (%)	2015		2016		
		2Q	1H	1Q	2Q	1H
		Annual Change (%)				
Overall Value Added (at constant 2010 prices)	**100.0**	**4.2**	**4.9**	**4.5**	**4.1**	**4.3**
Export-oriented industries	63.6	4.1	5.5	4.5	7.0	5.8
Domestic-oriented industries	36.4	4.5	3.8	4.6	-0.4	1.8
Overall Manufacturing Production[1]	**100.0**	**4.1**	**4.8**	**4.3**	**3.9**	**4.1**
Export-oriented industries	**77.6**	**4.3**	**4.7**	**4.2**	**4.2**	**4.2**
Electronics and electrical products cluster	**25.0**	**4.8**	**7.6**	**5.9**	**8.5**	**7.3**
Of which:						
Electronics	15.3	-6.1	-3.3	6.0	9.8	7.9
Electrical products	7.6	37.7	39.0	6.4	7.8	7.1
Primary-related cluster	**52.6**	**4.0**	**3.1**	**3.2**	**1.8**	**2.5**
Of which:						
Chemicals and chemical products	14.3	5.5	7.6	3.3	4.9	4.1
Petroleum products	21.0	0.9	1.5	1.2	5.0	3.0
Rubber products	2.5	7.6	3.1	6.9	4.7	5.7
Off-estate processing	6.4	7.3	-5.9	2.7	-21.5	-11.6
Domestic-oriented industries	**22.4**	**3.5**	**5.4**	**4.6**	**2.8**	**3.7**
Construction-related cluster	**11.3**	**2.8**	**4.8**	**4.9**	**5.0**	**5.0**
Of which:						
Construction-related products	8.2	2.9	5.4	4.7	4.5	4.6
Fabricated metal products	3.1	2.8	3.7	5.4	5.9	5.6
Consumer-related cluster	**11.1**	**4.1**	**6.1**	**4.2**	**0.9**	**2.5**
Of which:						
Transport equipment	5.5	6.0	7.4	2.0	-7.4	-3.1
Food, beverage & tobacco products	5.4	1.7	4.5	7.3	13.0	10.1

[1] Industrial Production Index (2010=100)

Source: Department of Statistics, Malaysia

The **construction sector** grew by 8.8% in the second quarter (1Q 2016: 7.9%), driven by the civil engineering sub-sector. Growth in the civil engineering sub-sector was stronger, underpinned by petrochemical, transport and utility-related projects. In the special trade sub-sector, growth was sustained, supported by early-work activity such as site clearance and piling activity. The residential sub-sector expanded at a faster pace during the quarter, reflecting higher construction activity of both high-end and affordable housing projects. In the non-residential sub-sector, growth weakened further following slower construction activity in the commercial property, especially in the office space segment.

Growth in the **agriculture sector** contracted by 7.9% (1Q 2016: -3.8%), due mainly to a double-digit decline in the production of palm oil amid the lagged impact of El Niño on yields. The performance of the **mining sector** improved (2.6%, 1Q 2016: 0.3%), on account of higher crude oil and natural gas production, particularly in Sabah.

Performance of the Agriculture Sector

	Share in 2015 (%)	2015		2016		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Value Added (at constant 2010 prices)	**100**	**4.6**	**0.3**	**-3.8**	**-7.9**	**-6.0**
Industrial Crops	**61.0**	**6.0**	**-1.6**	**-9.2**	**-16.3**	**-13.1**
Of which:						
Oil palm	46.9	10.5	-0.4	-10.0	-19.3	-15.2
Rubber	7.2	-4.7	1.0	-13.0	-4.5	-9.7
Food Crops	**39.0**	**2.5**	**3.2**	**3.5**	**5.3**	**4.4**
Of which:						
Fishing	10.7	-0.2	2.2	-2.1	6.6	2.0
Livestock	10.7	3.1	3.7	5.0	4.9	4.9

Source: Department of Statistics, Malaysia

Performance of the Mining Sector

	2015		2016		
	2Q	1H	1Q	2Q	1H
	Annual change (%)				
Value Added (at constant 2010 prices)	**6.0**	**7.8**	**0.3**	**2.6**	**1.4**
Production					
Of which:					
Crude oil and condensates	13.7	17.0	-0.3	0.6	0.2
Natural gas	-2.3	-1.8	0.0	3.9	1.9
Other mining and support services	10.7	12.5	6.5	8.6	7.6

Source: Department of Statistics, Malaysia

Indicators for the Construction Sector

	Share 2015 (%)	2015		2016		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Value of construction work done	100.0	8.2	11.6	11.1	11.7	11.4
Non-residential	34.0	15.5	19.8	3.8	2.1	3.0
Residential	29.4	7.8	13.5	8.4	12.5	10.4
Civil engineering	31.8	1.5	2.9	21.3	21.6	21.4
Special Trade[1]	4.7	7.4	5.7	17.3	13.5	15.4
Housing approvals		-16.0	-19.5	-22.1	-36.6	-30.8
Production[2] of construction-related materials		2.8	4.8	4.9	5.0	5.0
Hydraulic cement		12.8	16.3	-7.9	-8.1	-8.0
Other porcelain and ceramic products		21.6	26.1	0.7	7.1	4.0
Other articles of concrete, cement and plaster n.e.c		4.9	12.6	-8.9	9.1	-0.2
Prefabricated structural components for building or civil engineering of cement, concrete or artificial stone		-6.4	-9.9	21.7	21.1	21.4
Capital imports (excluding lumpy items)		-2.8	3.9	-8.1	2.9	-2.7
Loans for the construction sector						
Approval		46.0	35.4	0.4	-14.1	-8.5
Disbursement		5.7	4.4	-2.8	5.4	1.1

[1] Works such as site preparation, electrical installation and painting
[2] Industrial Production Index (2010=100)

Source: Department of Statistics, Malaysia, Ministry of Urban Wellbeing, Housing and Local Government and Bank Negara Malaysia

Headline inflation declined in the second quarter 2016

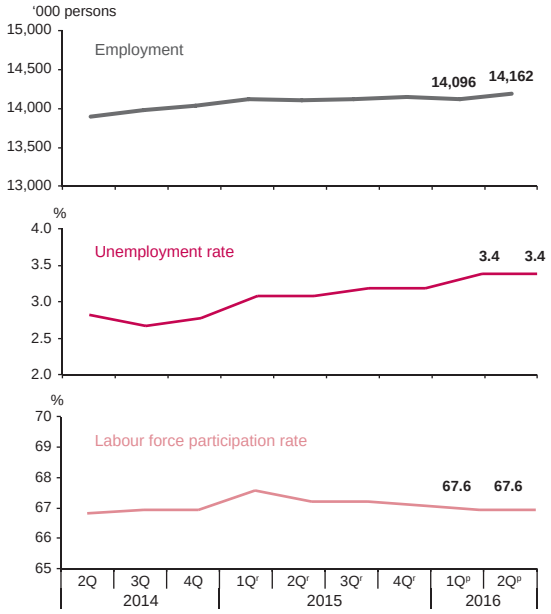
Inflation, as measured by the annual change in the Consumer Price Index (CPI), declined to 1.9% in the second quarter of 2016 (1Q 2016: 3.4%) due mainly to the lapse of the impact of the Goods and Services Tax (GST), which was implemented in April 2015. The decline in inflation was observed in all twelve CPI categories. The *transport* category recorded the largest decline in inflation to -6.6% in the second quarter (1Q 2016: -1.6%) due mainly to the base effect from higher domestic fuel prices in the corresponding period last year. The price of RON95 petrol averaged RM1.70 per litre in 2Q 2016, which was lower than the average price of RM1.98 per litre recorded in 2Q 2015.

The Producer Price Index (PPI) declined in the second quarter of 2016 by 2.1% (1Q 2016: -4.4%). The decline was driven mainly by lower prices of intermediate materials, particularly in the *processed fuel and lubricants* category, reflecting the continued environment of low global energy and commodity prices during the quarter.

Stable labour market

Labour market conditions remained stable in the second quarter. Employment increased during the quarter, registering a moderate net gain of 66,000 jobs[1]. This was almost equal to the expansion of the labour force during the period. As a result, the unemployment rate was unchanged at 3.4% of the total labour force (1Q 2016: 3.4%). Labour force participation was sustained, at 67.6% of the total labour force (1Q 2016: 67.6%). New positions posted on JobStreet.com at 66,088 positions suggest sustained demand for new hires (1Q 2016: 61,378).

Labour Market Indicators*



* The Labour Force Survey (LFS) figures for 1Q 2015 onwards reflect new current population estimates by DOSM

[p] Preliminary
[r] Revision

Source: Department of Statistics, Malaysia

Consumer Price Index

Category	Weights (%) (2010=100)	1Q 2016	2Q 2016
		Annual change, %	
Total	**100**	**3.4**	**1.9**
Food and non-alcoholic beverages	30.2	4.6	4.2
Housing, water, electricity, gas and other fuels	23.8	3.0	2.5
Transport	13.7	-1.6	-6.6
Others	32.3	4.8	2.8

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

[1] Preliminary estimates

Wage indicators suggest continued wage growth in key economic sectors. In the distributive trade services sub-sector[2], wage growth was stronger at 5.3% (1Q 2016: 4.6%), while employment growth was slightly higher at 3% (1Q 2016: 2.5%). Aggregate wages in the manufacturing sector also continued to grow favourably by 5% (1Q 2016: 6.9%), supported by high wage growth in the export-oriented sectors, particularly in the E&E, petrochemicals and textiles clusters. Employment growth in the sector, however, declined marginally (-0.1%; 1Q 2016: -0.5%), as manufacturers remained cautious on the outlook for demand.

External position remains sound in the second quarter, despite narrowing current account surplus

In the second quarter of 2016, the **current account** surplus narrowed to RM1.9 billion, equivalent to 0.6% of GNI (1Q 2016: RM5.0 billion or 1.8% of GNI). The smaller current account surplus was due mainly to lower trade surplus, higher investment income received by foreign investors in Malaysia and continued outward remittances by foreign workers in Malaysia.

Balance of Payments[1]

	2015		2016		
	2Q	1H	1Q	2Q	1H
	RM billion				
Current Account	**8.1**	**19.5**	**5.0**	**1.9**	**6.9**
(% of GNI)	*2.9*	*3.5*	*1.8*	*0.6*	*1.2*
Goods	23.6	51.3	23.5	19.8	43.3
Services	-5.0	-8.5	-6.8	-4.6	-11.5
Primary income	-4.6	-12.3	-6.7	-8.2	-14.9
Secondary income	-5.9	-11.0	-4.9	-5.1	-10.0
Financial Account	**5.7**	**-24.1**	**5.8**	**9.5**	**15.3**
Direct investment	0.7	-0.8	3.7	5.3	9.0
Assets	*-17.6*	*-27.5*	*-11.2*	*-3.8*	*-15.0*
Liabilities	*18.2*	*26.8*	*14.9*	*9.1*	*24.1*
Portfolio investment	-11.8	-19.7	13.1	0.1	13.2
Assets	*-8.1*	*-15.4*	*-5.9*	*-4.7*	*-10.6*
Liabilities	*-3.7*	*-4.3*	*19.0*	*4.8*	*23.8*
Financial derivatives	-0.4	-0.4	0.5	0.0	0.5
Other investment	17.3	-3.2	-11.5	4.1	-7.4
Errors & omissions[2]	-4.3	-1.5	-38.4	-2.7	-41.1
Overall Balance	**8.5**	**-7.2**	**-27.6**	**8.8**	**-18.8**

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] Includes unrealised foreign exchange revaluation gains/losses on international reserves

Source: Department of Statistics, Malaysia

Trade Account

	Share 2015 (%)	2015		2016		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
Gross Exports	**100.0**	**-3.7**	**-3.1**	**1.0**	**1.4**	**1.2**
Manufactured	80.2	2.3	1.2	6.4	4.8	5.6
E&E	*35.6*	*3.1*	*4.9*	*3.6*	*3.5*	*3.5*
Non-E&E	*44.6*	*1.6*	*-1.5*	*8.7*	*5.7*	*7.2*
Resource based	*22.3*	*-5.5*	*-8.9*	*1.6*	*6.4*	*4.1*
Non-resource based	*22.3*	*9.8*	*7.3*	*16.2*	*5.1*	*10.3*
Commodities	19.2	-23.0	-16.8	-18.3	-13.7	-16.2
Minerals	*10.6*	*-36.0*	*-21.6*	*-32.5*	*-24.4*	*-29.2*
Agriculture	*8.6*	*-2.7*	*-9.3*	*6.5*	*-2.9*	*1.5*
Gross Imports	**100.0**	**-5.2**	**-2.6**	**-0.4**	**3.1**	**1.4**
Intermediate goods	58.2	-4.6	-1.0	-3.1	-0.3	-1.7
Capital goods	14.0	-12.5	-2.5	-12.9	10.2	-1.9
Consumption goods	9.1	25.4	15.2	24.6	9.9	16.4
Others (including re-exports and dual-use goods	18.7	-12.9	-13.9	8.7	5.3	7.0
Trade balance (RM billion)	**–**	**20.4**	**41.7**	**23.9**	**17.9**	**41.8**

Source: MATRADE and Department of Statistics, Malaysia

In the second quarter of 2016, gross export recorded a higher growth of 1.4%, (1Q 2016: 1.0%), driven mainly by a smaller contraction in the growth of commodity exports which offset the slower manufactured export growth. Gross imports registered a positive growth of 3.1% (1Q 2016: -0.4%), reflecting mainly higher imports of capital goods, smaller decline in intermediate imports amid more modest expansion in consumption imports. As a result, the trade surplus was lower at RM17.9 billion (1Q 2016: RM23.9 billion).

During the quarter, contraction in commodity exports was smaller, attributable mainly to higher demand for LNG and rubber and an improvement in the prices of these commodities. The slower growth in manufactured exports was due mainly to a more moderate expansion in exports of non-resource-based manufactured products amid a sustained growth in E&E exports. After several quarters of strong growth, growth of non-resource-based manufactured exports such as machinery, appliances and parts, as well as metal products slowed down in the second quarter of 2016. Nonetheless, exports of semiconductors improved in tandem with higher productions, underpinning E&E export growth.

[2] The distributive trade services sub-sector consist of wholesale and retail trade, and motor vehicles sub-sectors.

In terms of destination, exports to key trading partners, particularly PR China and the EU, recorded a contraction during the quarter. Exports to PR China slowed down following lower demand for metal and petroleum products. Exports to the EU also declined due mainly to slower exports of E&E products, as well as machinery, appliances and parts. These weaknesses, however, were offset by the stronger export performance to the US amid continued demand for E&E products, particularly semiconductors. Higher LNG demand also provided some support to the improvement in exports to Japan.

Gross imports registered a positive growth of 3.1% during the quarter (1Q 2016: -0.4%), supported mainly by higher imports of capital and transport equipment in line with the improvement in investment activity. The strong growth in consumption imports also contributed to gross import growth following continued demand for imported semi-durable and non-durable consumer goods. Intermediate imports registered a smaller contraction, in line with the more moderate manufacturing export performance.

Malaysia: Direction of Exports

	Share 2015 (%)	2015		2016		
		2Q	1H	1Q	2Q	1H
		Annual change (%)				
European Union (EU)	**10.1**	**4.4**	**3.1**	**7.9**	**-0.1**	**3.8**
Japan	**9.5**	**-26.6**	**-14.1**	**-20.6**	**-8.4**	**-15.7**
United States	**9.4**	**4.0**	**9.1**	**13.1**	**17.4**	**15.3**
ASEAN[1]	**28.1**	**-0.8**	**-1.6**	**6.5**	**5.4**	**6.0**
North East Asia	**24.0**	**2.1**	**-2.5**	**-4.3**	**-9.6**	**-7.1**
People's Republic of China	*13.0*	*17.1*	*1.9*	*1.3*	*-16.6*	*-8.7*
Hong Kong SAR	*4.7*	*-8.0*	*-1.0*	*-3.2*	*2.8*	*-0.2*
Korea	*3.2*	*-14.9*	*-11.8*	*-13.7*	*0.4*	*-7.9*
Chinese Taipei	*3.0*	*-16.2*	*-10.6*	*-15.1*	*-7.1*	*-10.9*
West Asia[2]	**2.8**	**-10.1**	**-9.0**	**5.2**	**5.6**	**5.4**
India	**4.1**	**-2.9**	**3.9**	**3.0**	**-1.1**	**0.9**
Total exports	**100.0**	**-3.7**	**-3.1**	**1.0**	**1.4**	**1.2**

[1] Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam, Vietnam, Cambodia, Myanmar and Laos
[2] United Arab Emirates, Saudi Arabia, Oman, Iraq, Qatar, Kuwait, Jordan, Lebanon, Bahrain, Syria, Palestine, Yemen and Iran

Source: Department of Statistics, Malaysia

The deficit in the services account was smaller at RM4.6 billion (1Q 2016: deficit of RM6.8 billion), attributable largely to lower net payment for *construction services* following the completion of an oil and gas facility, *telecommunication, computer and information services,* as well as *personal, cultural and recreational services* for acquiring less foreign media and entertainment content. Higher net travel surplus was recorded in 2Q 2016 due mainly to lower payments for outbound tourism amid improvement in receipts from inbound tourism.

The deficit in the primary income account widened to RM8.2 billion (1Q 2016: a deficit of RM6.7 billion), due mainly to higher investment income accrued to foreign investors in Malaysia as larger profits were registered during the quarter (RM18.1 billion; 1Q 2016: RM14.1 billion). This more than offset the increase in income generated by Malaysian firms investing abroad (RM11.3 billion; 1Q 2016: RM9.0 billion). During the quarter, FDI firms in manufacturing, services and mining sectors have declared large profits following higher demand and better commodity prices compared to the first quarter of 2016. Of importance, the FDI companies continued to retain a portion of the investment incomes for reinvestment in Malaysia

The net payment for secondary income account was broadly sustained at RM5.1 billion in 2Q 2016 (1Q 2016: a net payment of RM4.9 billion), primarily on account of larger remittances by foreign workers for Hari Raya festivity.

In the second quarter of 2016, the **financial account** recorded a net inflow of RM9.5 billion (1Q 2016: net inflow of RM5.8 billion), due mainly to net inflows in the direct investment and in the other investment account.

Direct investment account registered a net inflow of RM5.3 billion (1Q 2016: net inflow of RM3.7 billion), as the incurrence of direct investment liabilities continued to outpace the accumulation of direct investment assets.

On the assets side, outward direct investment amounted to RM3.8 billion (1Q 2016: net outflow of RM11.2 billion). Of these, Direct Investment Abroad (DIA) by Malaysian companies declined to RM3.5 billion (1Q 2016: net outflow of RM11.3 billion), due mainly to lower injection of equity capital and extension of loans to subsidiaries abroad. The bulk of DIA was undertaken by companies in the services sector, namely the finance and insurance, recreation and utilities sub-sectors. This is followed by investments in the mining sector.

On the liabilities side, inward direct investment amounted to RM9.1 billion (1Q 2016: net inflow of RM14.9 billion). Of these, Foreign Direct Investment (FDI) moderated to RM8.8 billion (1Q 2016: net inflow of RM15.0 billion), mainly on account of lower injection of equity capital by multinational companies into their Malaysian operations. FDI inflows were largely channelled into the manufacturing sector, particularly the electrical and electronics industry, and to a lesser extent the petrochemicals industry. There was also FDI into the services sector, mainly the real estate and information and telecommunication sub-sectors.

Portfolio investment by non-residents recorded a lower net inflow of RM4.8 billion (1Q 2016: net inflow of RM19.0 billion). During the quarter, there was a net liquidation of equities as investor sentiments were affected by the uncertainty over the stance of US monetary policy, volatility in global crude oil prices and the reduction of Malaysia's weightage in the MSCI Emerging Markets Index. Nevertheless, the liquidation in equities were more than offset by higher purchases of debt securities, as the continued search for yield by non-resident fixed income investors led to strong demand for Malaysian Government Securities (MGS) and Government Investment Issues (GII) as well as for the issuance of the foreign currency denominated Wakala Global Sukuk by the Federal Government. Portfolio investment by residents registered a net outflow of RM4.7 billion (1Q 2016: net outflow of RM5.9 billion), due mainly to the continued acquisition of foreign financial assets by domestic banks and institutional investors. Collectively, resident and non-resident portfolio investment recorded a marginal net inflow of RM77 million (1Q 2016: net inflow of RM13.1 billion).

Other investment account turned around to record a net inflow of RM4.1 billion (1Q 2016: net outflow of RM11.5 billion). The inflows were mainly attributed to the repatriation of interbank placements abroad by Malaysian banks following their maturity as well as a net placement of interbank deposits by non-resident financial institutions in the domestic banking system. The public sector recorded a net outflow, due mainly to a net repayment of external loans by the public corporations.

Following these developments, the overall balance of payments registered a surplus of RM8.8 billion in the first quarter (1Q 2016: deficit of RM27.6 billion). Errors and omissions amounted to –RM2.7 billion or -0.8% of total trade, mostly reflecting the foreign exchange revaluation changes in international reserves arising from the strengthening of most currencies against the ringgit during the quarter.

Manageable external debt

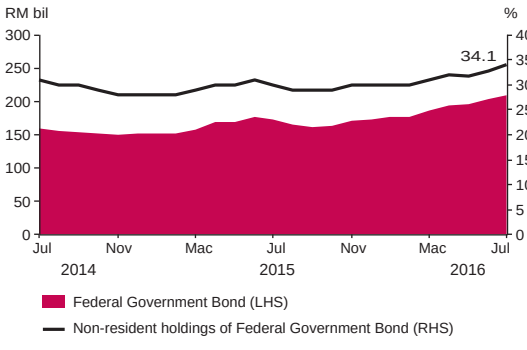
Malaysia's external debt stood at RM848.2 billion, equivalent to USD209.0 billion or 69.0% of GDP as at end-June 2016 (end-March 2016: RM809.1 billion or USD 203.7 billion, equivalent to 65.8% of GDP). The higher external debt was attributed to the drawdown of external borrowing and higher non-resident holdings of domestic debt securities during the quarter. There were also valuation effects following the strengthening of most currencies against the ringgit.

The weakening of the ringgit mainly affected the outstanding amount of offshore borrowing, which increased by 6.3% to RM466.7 billion as at end-June 2016 (end-March 2016: RM439.0 billion). The impact of exchange rate valuation changes on offshore borrowing was, nevertheless, manageable as borrowings by corporations, namely public and non-bank private corporations are largely hedged, either naturally through foreign currency earnings, or through the use of financial instruments. As at end-June, the offshore borrowing remained low at 38.0% of GDP compared to 60% of GDP during the Asian Financial Crisis (AFC) in 1997-98.

Excluding the foreign exchange valuation changes, offshore borrowing increased by 4.1% during the quarter. This partly reflects a Federal Government issuance of USD1.5 billion Wakala Global Sukuk, with the proceeds to be used to redeem an earlier USD1.2 billion Wakala Global Sukuk maturing in July 2016 and to finance development expenditure. There was a net drawdown of interbank borrowing, mainly for financing, liquidity management and investment purposes. In addition, there were net issuances of foreign-currency bond and drawdown of long-term offshore loans by banks partly to diversify the maturity structure of their funding. Non-bank private corporations also recorded a net drawdown of intercompany loans during the quarter.

The non-resident holdings of ringgit-denominated domestic debt securities increased by RM8.4 billion to RM232.3 billion (end-March 2016: RM223.9 billion). Most acquisitions were in Federal Government domestic debt securities, namely MGS and Government Investment Issues. More specifically, non-resident holdings of Federal Government bond increased to 34.1% of the outstanding value or RM209.7 billion as at end-July 2016 (end-March 2016: RM186.7 billion). The majority of these investors are long-term investors, mainly asset managers, central banks and pension funds, which reflects the improving sentiments on Malaysia's economy. On the other hand, the non-resident holdings of Bank Negara Monetary notes further declined to RM12.9 billion as at end-June 2016 (end-March 2016: RM21.1 billion).

Non-Resident Holdings of Federal Government Bond



Source: Bank Negara Malaysia

Overall, Malaysia's external debt remains manageable, with medium- to long-term external debt accounting for more than half of the outstanding position (60.7%). The short-term external debt was slightly lower during the quarter and accounted for only 39.3% of the total external debt (end-March 2016: 40.6%). The international reserves were adequate to cover the short-term external debt by 1.2 times. About two-thirds of the short-term external debt is held by the banking sector, which not all pose a claim on international reserves since the debt is partly covered by the banks' corresponding external assets. The bulk of the remaining short-term external debt was accounted for by trade credits and intercompany loans. Trade credits are largely backed by export earnings, while intercompany loans are generally on flexible and concessionary terms, such as no fixed repayment schedule and zero or low interest rate.

Outstanding External Debt

	2015	2016	
	end-June	end-Mar	end-June
	RM billion		
Offshore borrowing[1]	429.0	439.0	466.7
USD billion equivalent	*112.5*	*110.5*	*115.0*
Medium- and long-term	*251.7*	*271.8*	*288.4*
Public sector	119.4	117.0	121.7
Private sector	132.3	154.8	166.7
Short-term	*177.3*	*167.1*	*178.4*
NR holdings of dom. debt securities	209.2	223.9	232.3
Medium- and long-term	*186.4*	*197.8*	*215.8*
Short-term	*22.8*	*26.1*	*16.5*
NR deposits	84.2	78.8	77.3
Others[2]	69.6	67.5	71.9
Medium- and long-term	*58.6*	*11.4*	*11.0*
Short-term	*11.0*	*56.1*	*60.9*
Total external debt	**791.9**	**809.1**	**848.2**
USD billion equivalent	*207.7*	*203.7*	*209.0*
External debt (Redefined)			
Total debt/GDP (%)	68.4	65.8	69.0
Short-term debt[3]/Total debt (%)	43.3	40.6	39.3
Reserves/Short-term debt[3] (times)	1.2	1.2	1.2[5]
External debt (Previous definition)			
Total debt/GDP (%)	37.1	35.7	38.0
Short-term debt[4]/Total debt (%)	41.3	38.1	38.2
Reserves/Short-term debt[4] (times)	2.2	2.3	2.2[5]

[1] Equivalent to the external debt as previously defined, comprised mainly foreign currency loans raised, and bonds and notes issued offshore.
[2] Comprise trade credits, IMF allocation of SDRs and miscellaneous.
[3] Short-term offshore borrowing, NR holdings of short-term domestic debt securities, NR deposits, short-term trade credits and miscellaneous.
[4] Equivalent to short-term offshore borrowing.
[5] Based on international reserves as at 29 July 2016.

Note: NR refers to non-resident

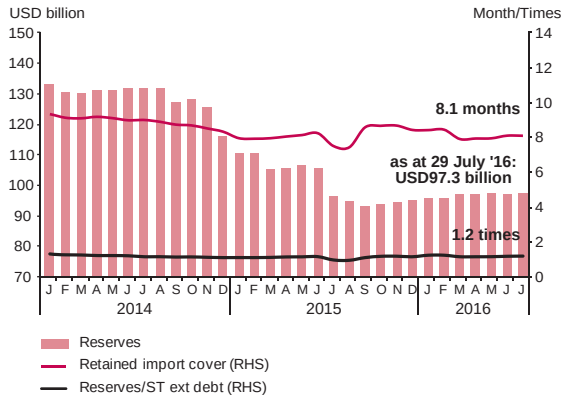
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

International reserves remain ample to facilitate international transactions

The international reserves of BNM amounted to RM390.4 billion (equivalent to USD97.2 billion) as at 30 June 2016 (end-March: RM381.5 billion; USD97.0 billion). This reserves level has taken into account the quarterly adjustment for foreign exchange revaluation changes.

As at 29 July 2016, the reserves position amounted to RM391.1 billion (equivalent to USD97.3 billion). The international reserves remain ample to facilitate international transactions. They are sufficient to finance 8.1 months of retained imports, significantly higher than the 3-month international threshold. The reserves level is also adequate to meet external obligations given the reserves to short-term external debt coverage of 1.2 times. It is important to note that not all short-term external debt creates claim on reserves given the external assets and export earnings of borrowers.

Net International Reserves (as at end period)

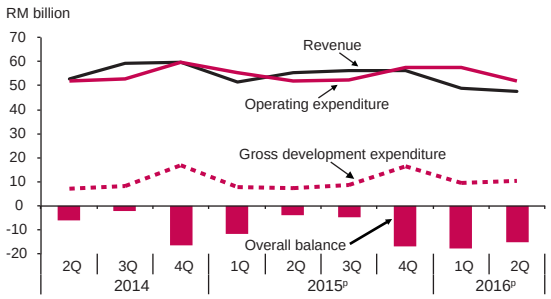


Source: Bank Negara Malaysia

Government spending increased

During the second quarter of 2016, Federal Government expenditure increased by 5.8%, due primarily to higher development expenditure. Development expenditure increased by 43.9% on an annual basis (1Q 2016: 16.1%) and was mainly channelled towards the *transportation* and *trade and industry* sectors. Operating expenditure registered a slower annual growth rate of 0.5% (1Q 2016: 3.5%), reflecting the Government's expenditure rationalisation measures, as reflected by a marked decline in *subsidies* and *grants and transfers.* Revenue declined by 14.0% (1Q 2016: -5.3%), due mainly to lower individual income tax collection. Overall, the Federal Government recorded a lower deficit of 5.0% of GDP (1Q 2016: -6.1% of GDP) during the quarter. As at end-June 2016, total outstanding debt of the Federal Government amounted to RM655.7 billion or 53.4% of the estimated 2016 GDP.

Federal Government Finance



p Preliminary
Source: Ministry of Finance, Malaysia

Federal Government Finance[p]

	2015		2016		
	2Q	1H	1Q	2Q	1H
	RM billion				
Revenue	55.3	106.8	48.8	47.5	96.3
% annual growth	*4.9*	*4.9*	*-5.3*	*-14.0*	*-9.8*
Operating expenditure	51.8	107.3	57.4	52.1	109.5
% annual growth	*0.2*	*0.3*	*3.5*	*0.5*	*2.1*
Current account	**3.4**	**-0.5**	**-8.6**	**-4.6**	**-13.2**
% of GDP	***1.2***	***-0.1***	***-2.9***	***-1.5***	***-2.2***
Net development expenditure	7.3	15.1	9.2	10.4	19.6
% annual growth	*3.5*	*8.3*	*16.1*	*43.9*	*29.4*
Overall balance	**-3.8**	**-15.6**	**-17.7**	**-15.0**	**-32.8**
% of GDP	***-1.4***	***-2.8***	***-6.1***	***-5.0***	***-5.6***
Memo item:					
Total net expenditure	59.1	122.4	66.5	62.5	129.0
% annual growth	*0.6*	*1.2*	*5.1*	*5.8*	*5.4*
Total Federal Government debt[1]					
(as at end-period)	627.5	627.5	626.9	655.7	655.7
% of GDP	*54.2*	*54.2*	*51.0*	*53.4*	*53.4*
Domestic debt	429.2	429.2	416.7	424.9	424.9
% of GDP	*37.1*	*37.1*	*33.9*	*34.6*	*34.6*
External debt	198.3	198.3	201.2	230.8	230.8
% of GDP	*17.1*	*17.1*	*17.1*	*18.8*	*18.8*
Non-resident holdings of RM-denominated Federal Government debt	*179.5*	*179.5*	*190.2*	*206.2*	*206.2*
% of GDP	*15.5*	*15.5*	*15.5*	*16.8*	*16.8*
Offshore borrowing	*18.8*	*18.8*	*19.9*	*24.7*	*24.7*
% of GDP	*1.6*	*1.6*	*1.6*	*2.0*	*2.0*

[p] Preliminary
[1] A portion of the Housing Loan Fund debt amounting to RM21.9 billion (1.8% of estimated 2016 GDP) has been transferred to the new statutory body for civil servant housing loans (Public Sector Home Financing Board, LPPSA) beginning 2016

Note: Beginning first quarter of 2015, GDP has been rebased from base year 2005 to base year 2010

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia