Developments in the Malaysian Economy

HIGHLIGHTS

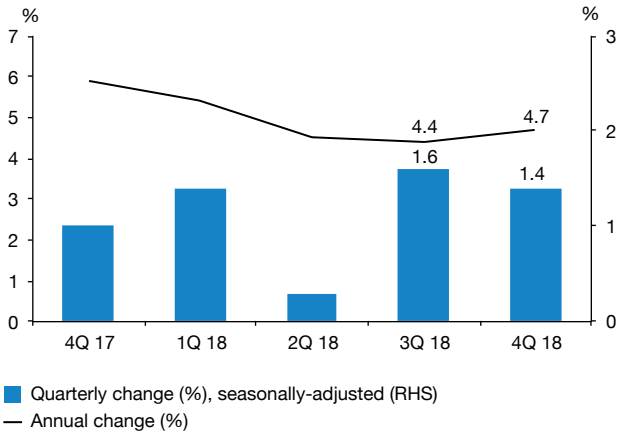
- The Malaysian economy expanded by 4.7% in the fourth quarter.
- Headline inflation declined slightly to 0.3%, while core inflation edged up to 1.6%.
- Current account surplus widened to RM10.8bn (or 3.0% of GNI) in the fourth quarter.

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

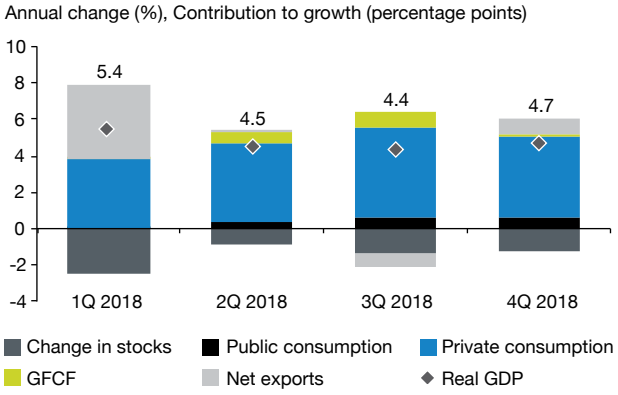
Chart 4: Real GDP Growth



Source: Department of Statistics Malaysia

Private activity supported growth

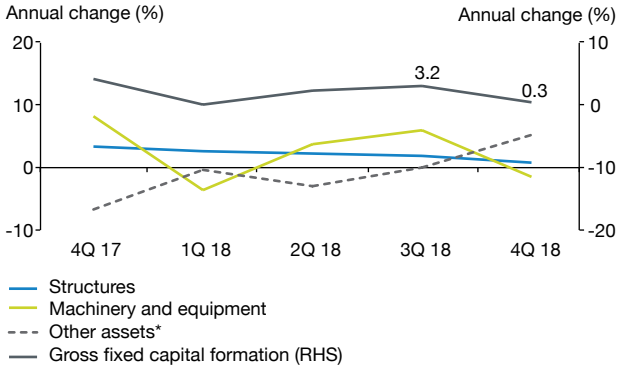
Chart 5: Contribution of Expenditure Components to Real GDP Growth



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

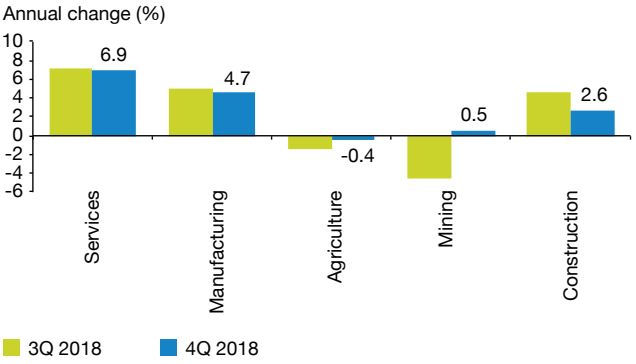
On the supply side, major sectors continued to expand, while growth in the commodity-related sectors improved.

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

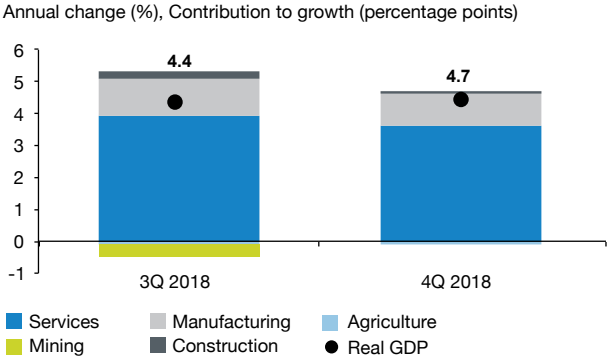
Chart 7: Growth by Sector



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.

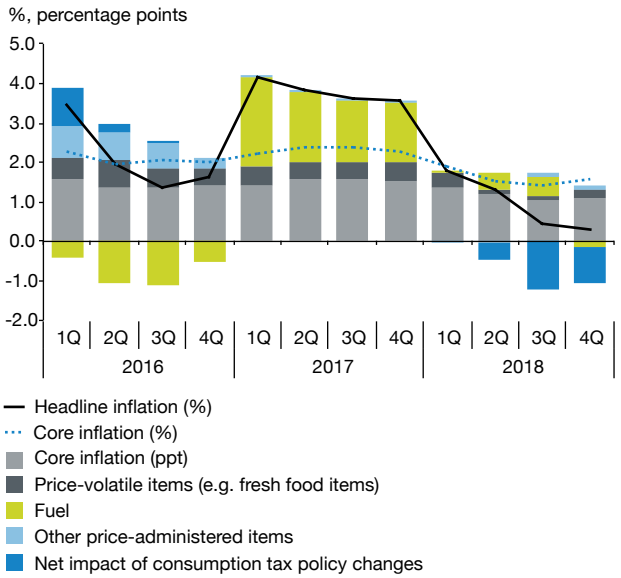
The decline in headline inflation was due mainly to transport inflation turning negative (4Q 2018: -1.2%; 3Q 2018: 3.0%), reflecting the fixed domestic RON95 petrol and diesel prices during the quarter compared to the higher fuel prices in the base period of 4Q 2017.

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

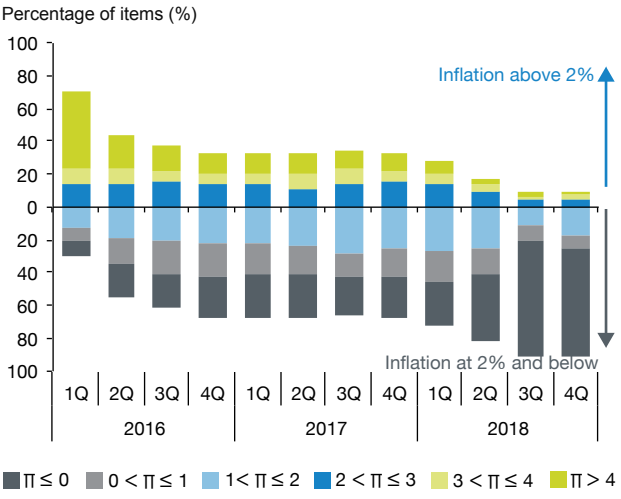
Chart 9: Contribution to Headline Inflation by Components



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

Inflation pervasiveness remained stable in 4Q 2018

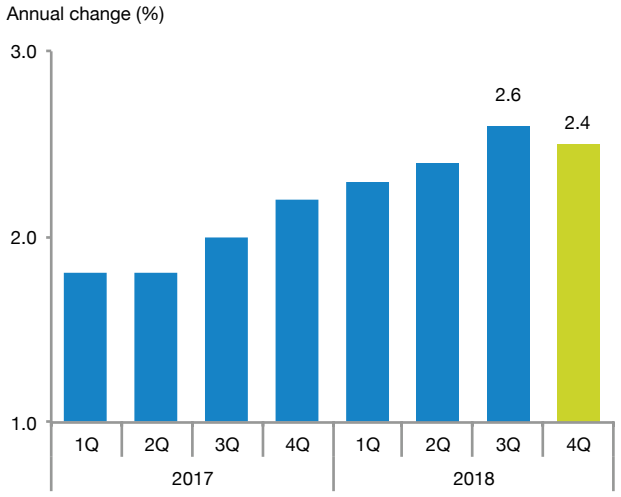
Chart 10: Inflation Pervasiveness



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.

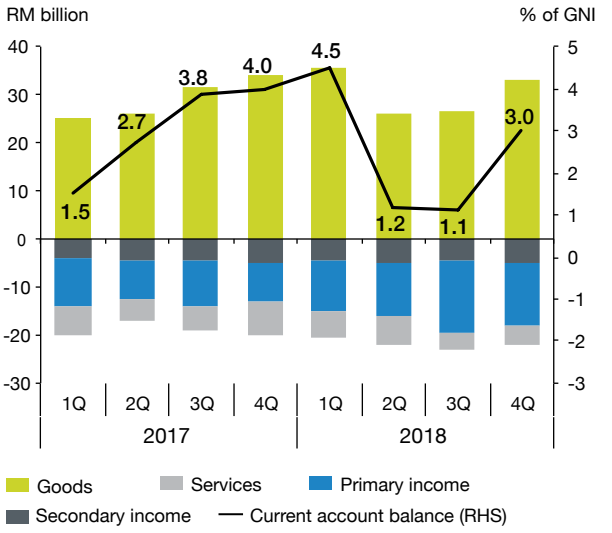
In the income accounts, a smaller deficit in the primary income account (-RM12.9 billion; 3Q 2018: -RM15.0 billion) was attributable to the higher income generated by Malaysian firms investing abroad and lower profits accrued to foreign investors in Malaysia. The secondary income deficit remained sizeable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

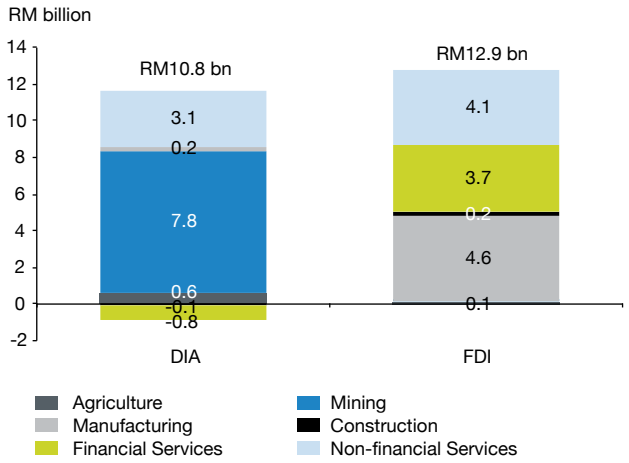


Source: Department of Statistics Malaysia

[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

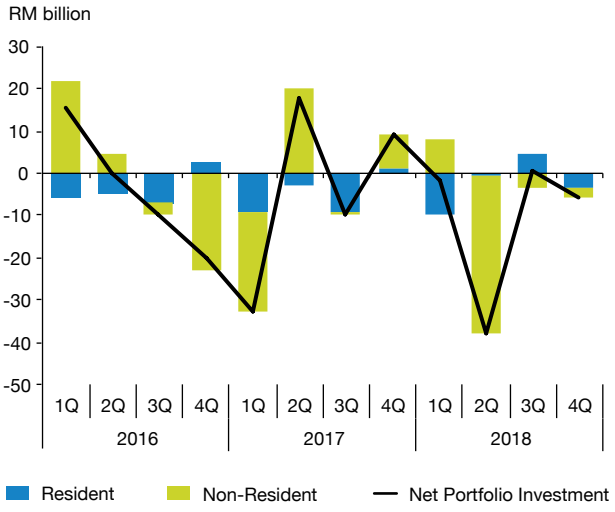


Note: For DIA, positive values refer to net outflows while negative values refer to net inflows

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

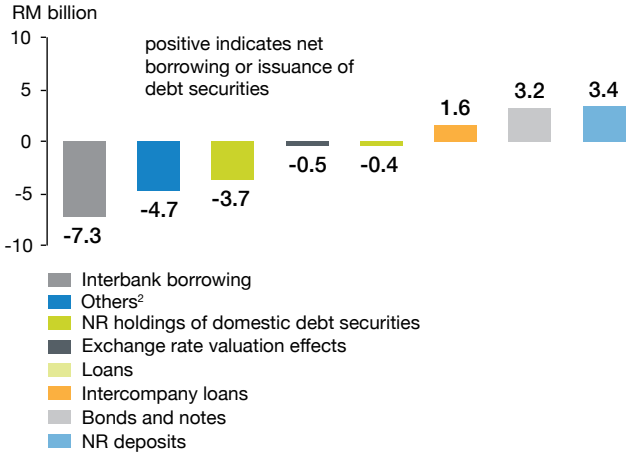
Malaysia's external debt stood lower at RM924.9 billion, or 64.7% of GDP as at end-December 2018 (end-September 2018: RM933.3 billion or 65.3% of GDP). The lower external debt reflects net repayment of interbank borrowing and trade credits, as well as some liquidation of domestic debt securities by non-resident 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

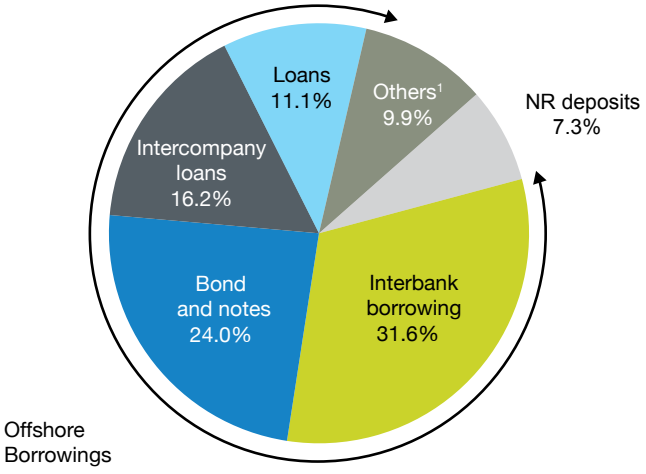


[1]Changes in individual debt instruments exclude exchange rate valuation effects
[2]Comprises trade credits, IMF allocation of SDRs and other debt liabilities
Note: NR refers to non-residents

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.