ECONOMIC AND FINANCIAL DEVELOPMENTS IN MALAYSIA IN THE FOURTH QUARTER OF 2015

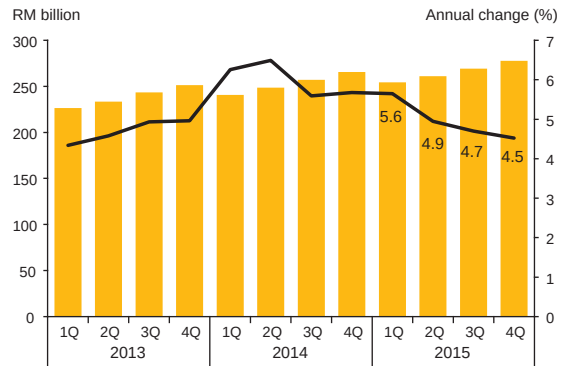
OVERVIEW

Global economic activity continued to expand at a moderate pace in the fourth quarter of 2015. The advanced economies registered modest improvements, but with the pace of growth remaining constrained by crisis-related legacies, including high indebtedness and labour market weaknesses. In Asia, economic activity continued to be supported by domestic demand amid weak export performance. Monetary policy stances experienced a more pronounced divergence given the differing country-specific domestic challenges.

The Malaysian economy expanded by 4.5% in the fourth quarter of 2015

The Malaysian economy registered a growth of 4.5% in the fourth quarter of 2015 (3Q 2015: 4.7%), supported mainly by the private sector demand. On the supply side, growth was underpinned by the major economic sectors. On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 1.5% (3Q 2015: 0.7%). For the year 2015, the Malaysian economy expanded by 5.0%.

The economy expanded in the fourth quarter
(at constant 2010 prices)



Source: Department of Statistics, Malaysia

Despite the challenging economic environment during the quarter, the private sector continued to be the key driver of growth. Private consumption grew by 4.9% (3Q 2015: 4.1%), supported by stable wage growth and labour market conditions. Private investment expanded by 5.0% (3Q 2015: 5.5%), driven by capital spending in the manufacturing and services sectors. Public investment growth moderated in the fourth quarter (0.4%; 3Q 2015: 1.8%), following lower growth in fixed assets spending by the Federal Government. Meanwhile, public consumption growth registered sustained growth of 3.3% (3Q 2015: 3.5%) as the stronger growth in emoluments was offset by slower growth in supplies and services expenditure.

On the supply side, growth in the fourth quarter was supported by the major economic sectors. Growth in the services sector was underpinned by the consumption- and trade-related activities. The manufacturing sector recorded a marginally higher growth, supported mainly by domestic-oriented industries. In the construction sector, growth was supported by the civil engineering and residential sub-sectors. Meanwhile, growth in the agriculture sector moderated, reflecting lower production of palm oil. The mining sector, however, registered a contraction arising from the lower production of both crude oil and natural gas.

Inflation, as measured by the annual change in the Consumer Price Index (CPI), was lower at 2.6% in the fourth quarter of 2015 due to the lower domestic fuel prices. However, this was partly offset by the higher inflation for food and cigarettes.

The trade surplus increased to RM30.4 billion in the fourth quarter of 2015 (3Q 2015: RM22.2 billion). Gross exports registered a stronger growth of 8.1% (3Q 2015: 5.5%), supported mainly by the non-resource based manufactured products, particularly machinery, appliances and parts, as well as metal products. Meanwhile, gross imports expanded further by 3.7% (3Q 2015: 2.9%), reflecting higher imports across major categories.

The international reserves of BNM amounted to RM409.1 billion (equivalent to USD95.3 billion) as at 31 December 2015. This reserves level has taken into account the quarterly adjustment for foreign exchange revaluation changes.

As at 29 January 2016, the reserves position amounted to RM410.1 billion (equivalent to USD95.5 billion). The level of international reserves remains ample to facilitate international transactions, being sufficient to finance 8.4 months of retained imports, significantly higher than the 3-month international threshold. The reserves level is also adequate to meet external obligations with a reserves to short-term external debt coverage of 1.2 times. It is important to note that not all short-term external debt creates a claim on reserves given the high level of external assets and export earnings of borrowers.

Interest rates remained stable

The Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.25% during the fourth quarter of 2015. At the prevailing level of the OPR, monetary conditions remained supportive of economic activity. While interbank rates below the 1-month tenure were steady, rates beyond the 1-month tenure continued to trend higher during the quarter due to greater demand by banks for stable funding. This led to competition among banks to attract deposits by offering higher deposit rates. The resultant increase in funding cost was transmitted to lending rates in the interbank market. In terms of retail rates, deposit rates were steady throughout the quarter. The average base rate (BR) of banks at the end of the quarter increased slightly, reflecting the upward revision to the BR following the higher KLIBOR.

M3, or broad money, increased by RM12.8 billion on a quarter-on-quarter basis to grow at an annual rate of 2.7% as at end-December 2015 (end-September 2015: 5.2%); driven mainly by the continued expansion in credit extended to the private sector by the banking system. The level of surplus liquidity placed with BNM remained ample at over RM200 billion as at end-December 2015. As part of a comprehensive effort by Bank Negara Malaysia to ensure sufficient liquidity in the domestic financial system, BNM reduced the statutory reserve requirement (SRR) ratio from 4.00% to 3.50%, effective from 1 February 2016.

Total gross financing raised by the private sector through the banking system and the capital market amounted to RM331.4 billion (3Q 2015: RM287.9 billion) in the fourth quarter. On a net basis, outstanding banking system loans and Private Debt Securities (PDS) expanded at a relatively stable growth rate of 8.6% as at end-December 2015 (end-September 2015: 8.8%). While growth in outstanding business loans was at a slower annual pace of 8.0% as at end-December 2015 (end-September 2015: 11.0%), the amount of loans disbursed to businesses increased during the quarter. Financing provided to SMEs remained high, with outstanding SME loans recording an annual growth rate of 15.0% as at end-December 2015 (end-September 2015: 17.6%). Outstanding household loans growth however, moderated to 7.7% as at end-December 2015 (end-September 2015: 8.1%), reflecting mainly the moderation in loans for the purchase of non-residential property and for the purchase of securities. Net funds raised in the capital market increased to RM51.4 billion in the fourth quarter (3Q 2015: -RM2.6 billion), driven mainly by funds raised through private sector issuances in December.

The ringgit, along with other regional currencies, did not face significant volatility during the quarter despite uncertainties over global growth prospects and declining global energy prices. Overall, the ringgit appreciated by 3.6% against

the US dollar during the quarter. The ringgit also appreciated against the euro (6.7%), the pound sterling (6.0%), and the Japanese yen (4.0%), but depreciated against the Australian dollar (-0.5%). The ringgit also appreciated against all regional currencies, by between 2.4% and 5.8%, with the exception of the Indonesian rupiah (-2.4%).

Between 1 January and 16 February 2016, the ringgit appreciated against the US dollar (3.5%). The ringgit also appreciated against the pound sterling (6.3%), the Australian dollar (5.4%), and the euro (1.4%), but depreciated against the Japanese yen (-1.3%). The ringgit appreciated against most regional currencies.

Domestic financial stability remains preserved

The Malaysian financial system remained resilient throughout the quarter despite the environment of heightened market volatility amid uncertainties in global growth and energy prices. Domestic financial intermediation continued to be well-supported by sound and well-capitalised financial institutions. Liquidity in the banking system remained ample despite occasional tight funding conditions. While investors' take a cautious approach in the period ahead, domestic financial system stability is expected to be maintained. The deep and well-developed domestic financial markets have continued to support orderly market conditions and sustained confidence in the financial system.

The Malaysian financial institutions remained well-capitalised. The common equity tier-1 capital, tier-1 capital and total capital ratios of banks were sustained well above the minimum regulatory levels at 12.8%, 13.8% and 16.1%, respectively. More than 80% of the banks' total capital is of high quality, comprising retained earnings, paid-up capital and reserves. The capital adequacy ratio for the insurance sector was similarly healthy at 245.5% (3Q 2015: 243.8%). In aggregate, banks, insurers and takaful operators have capital buffers totalling RM147.4 billion (banks: RM117.3 billion; insurers / takaful operators: RM30.1 billion), that would be able to absorb any potential losses from adverse credit and market events.

Domestic demand will remain the key driver of growth

Downside risks to the global outlook remain elevated. This is reflected in the re-emergence of heightened volatility in the financial markets in the early weeks of 2016, following concerns over the growth prospects of the major economies, the fall in energy prices and the global policy shifts. Going forward, although the global economy is projected to expand further, growth is expected to be moderate and uneven. The pace of recovery will remain modest in the major advanced economies. Meanwhile, in Asia, while growth is expected to slow, domestic demand is projected to continue supporting growth.

The Malaysian economy is expected to face a challenging operating environment in the immediate future. Growth will continue to be driven by domestic demand, with some support from net exports. Nevertheless, the pace of domestic demand expansion is projected to moderate. While the growth in income and employment continues to support private consumption, it is expected to moderate as households continue to adjust to the higher cost of living. Meanwhile, private investment is projected to moderate to below its long term trend but will nevertheless be supported by the capital expenditure in the manufacturing and services sectors, as well as the implementation of infrastructure projects. The downside risks to growth will however remain, given the continued uncertainty in the external environment and the on-going reforms in the domestic economy.