Developments in the Malaysian Economy

HIGHLIGHTS

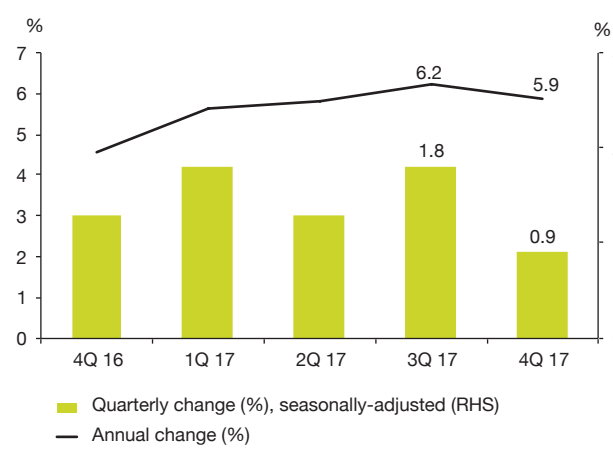
- The Malaysian economy expanded by 5.9% in the fourth quarter.
- Headline and core inflation moderated slightly to 3.5% and 2.3%, respectively.
- Current account surplus widened slightly to RM12.9 billion in the fourth quarter of 2017, accounting for 3.7% of GNI (3Q 2017: RM12.5 billion or 3.7% of GNI).

Growth of the Malaysian economy remained strong at 5.9% in the fourth quarter of 2017

For the fourth quarter of 2017, the Malaysian economy registered a growth of 5.9% (3Q 2017: 6.2%) as private sector spending continued to be the primary driver of growth (7.4%; 3Q 2017: 7.3%). The external sector performance improved further (5.4%; 3Q 2017: 1.7%), as real import growth moderated faster than real export growth. On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 0.9% (3Q 2017: 1.8%). For the year as a whole, the economy registered a robust growth of 5.9%.

Sustained growth in 4Q 2017

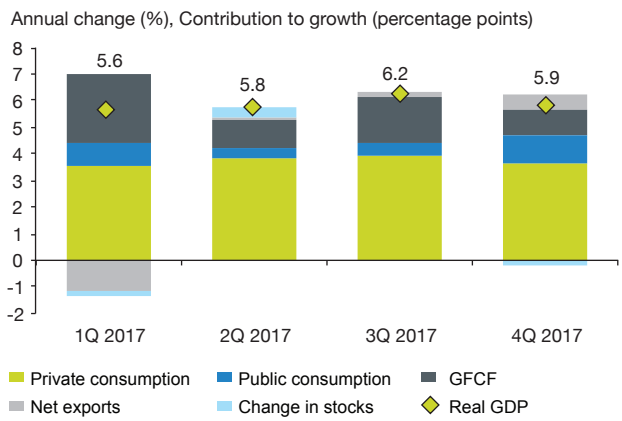
Chart 4: GDP Growth



Source: Department of Statistics, Malaysia

Private sector demand remained the key driver of growth

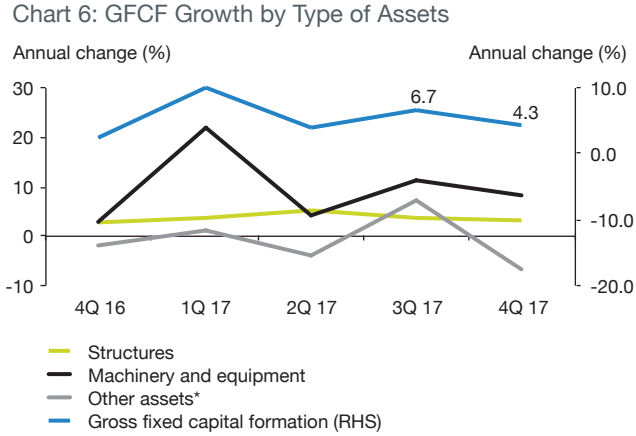
Chart 5: Contribution of Expenditure Components to GDP Growth



Source: Department of Statistics, Malaysia

Gross fixed capital formation expanded further

Chart 6: GFCF Growth by Type of Assets



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

Source: Department of Statistics, Malaysia

Domestic demand driven by the private sector

Domestic demand expanded by 6.2% (3Q 2017: 6.6%) supported by continued strength in private sector expenditure (7.4%; 3Q 2017: 7.3%), amid waning support from public sector spending (3.4%; 3Q 2017: 4.0%).

Private consumption expanded by 7.0% (3Q 2017: 7.2%), supported by continued wage and employment growth.

Private investment registered a higher growth of 9.2% (3Q 2017: 7.9%), driven mainly by the services and manufacturing sectors. Capital spending was supported by continued business optimism and favourable demand, which was evident across both export- and domestic-oriented industries.

Public consumption expanded by 6.9% (3Q 2017: 3.9%) mainly driven by higher spending on supplies and services by the Federal Government.

Public investment contracted during the quarter (-1.4%; 3Q 2017: 4.1%), due to lower capital spending by both the General Government and public corporations.

Gross fixed capital formation (GFCF) growth moderated to 4.3% (3Q 2017: 6.7%) mainly due to a contraction in public investment. By type of assets, capital spending on machinery and equipment continued to register a strong growth of 8.3% (3Q 2017: 11.5%). Investment in structures was broadly sustained at 3.3% (3Q 2017: 3.6%) while investment in other types of assets contracted by 6.7% (3Q 2017: 7.2%).

Moderate expansion across most economic sectors

On the supply side, most economic sectors recorded a moderate expansion, except for the agriculture sector, while growth in the mining sector declined.

The services sector registered slightly lower growth in the fourth quarter. This mainly reflected lower growth in the wholesale and retail trade sub-sector, in tandem with the moderation in private consumption. However, growth in the finance and insurance sub-sector improved, supported by lower insurance claims and sustained banking activity. Growth in the information and communication sub-sector continued to be underpinned by high demand for data communication and computer services.

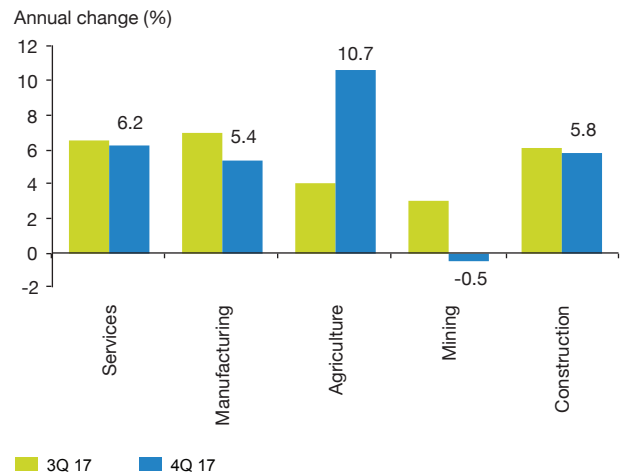
Growth in the manufacturing sector eased during the quarter, reflecting a broad-based moderation in both export- and domestic-oriented industries. Production in the export-oriented industries including electrical and electronics (E&E) and petroleum refinery activity continued to expand, albeit at a more moderate pace. Lower growth in the domestic-oriented industries was due mainly to a slower production of transport equipment and food-related products, as well as construction-related materials.

In the mining sector, growth declined as natural gas output was affected by pre-scheduled facilities' shutdown in Sarawak. However, the agriculture sector's growth performance improved, reflecting mainly higher CPO output as yields recovered from adverse weather conditions in the previous quarter.

Growth in the construction sector was sustained by civil engineering activity for rail, highway, petrochemical and power plant projects.

Moderate growth across most economic sectors

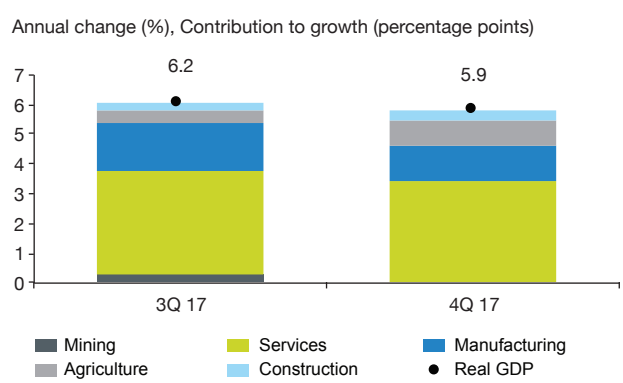
Chart 7: Growth by Sector



Source: Department of Statistics, Malaysia

Services and manufacturing sectors remained the key drivers of growth

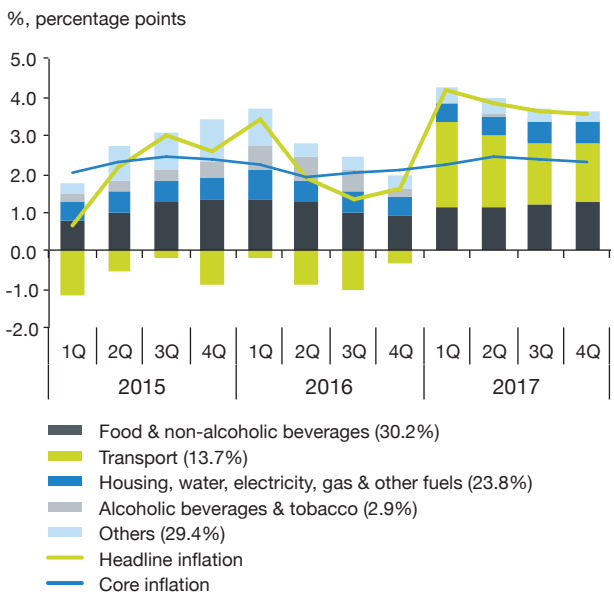
Chart 8: Real GDP by Economic Sector



Source: Department of Statistics, Malaysia

The more moderate headline inflation reflected lower inflation in the housing and transport categories

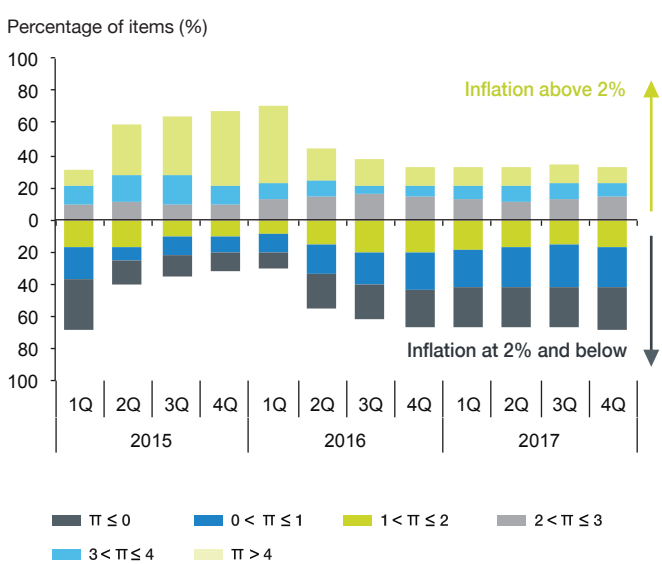
Chart 9: Headline Inflation



Note: Core inflation excludes the estimated direct impact of GST
Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Inflation pervasiveness was slightly lower in 4Q 2017

Chart 10: Inflation Pervasiveness



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

Both headline and core inflation moderated in 4Q 2017

Headline inflation[2] moderated slightly to 3.5% in 4Q 2017 (3Q 2017: 3.6%) due mainly to lower inflation in the *housing, water, electricity, gas and other fuels* and *transport* categories.

Inflation for the *housing, water, electricity, gas and other fuels* category averaged at 2.2% (3Q 2017: 2.3%). Rental inflation declined slightly to 2.8% during the quarter (3Q 2017: 2.9%), due mainly to the smaller increase in rental for terrace and bungalow houses.

While inflation in the *transport* category was slightly lower during the quarter, it remained elevated at 11.4% (3Q 2017: 11.7%) due to high domestic fuel prices.

Core inflation also declined during the quarter to 2.3% (3Q 2017: 2.4%). Inflation pervasiveness was lower, as the percentage of items in the CPI basket that registered inflation of more than 2% declined to 32% (3Q 2017: 34%).

[2] As measured by the annual change in the Consumer Price Index (CPI).

Stable labour market conditions

Labour market conditions remained stable in the fourth quarter of 2017. Private sector wage and employment growth moderated to 6.3% (3Q 2017: 7.5%) and 2.2% (3Q 2017: 2.3%) respectively. During the quarter, labour force expansion was relatively matched by net employment gains resulting in a stable unemployment rate of 3.4% (3Q 2017: 3.4%). The number of vacancies posted on a major job search website also moderated to 61,061 positions in the 4Q (3Q 2017: 68,794 positions).

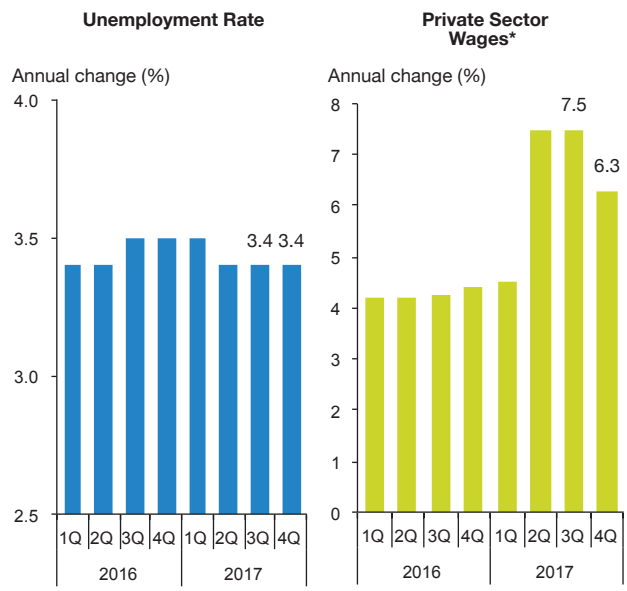
The moderation in private sector wages was due to slower wage growth in the services and manufacturing sectors. Services sector wage growth moderated to 5.0% (3Q 2017: 6.1%), amidst slowdown in the information and communication and professional services subsectors. Manufacturing wage growth moderated to 9.4% (3Q 2017: 10.6%) due to the slowdown in the electrical and electronics and chemicals subsectors.

Strong external sector performance

In 4Q 2017, gross export growth was comparatively lower than the previous quarter but continued to register double-digit performance of 12.4% (3Q 2017: 22.1%), driven mainly by manufactured exports (14.2%; 3Q 2017: 23.7%). The trade surplus widened to RM27.7 billion (3Q 2017: RM26.7 billion).

Stable unemployment rate and moderation in wage growth

Chart 11: Labour Market Indicators

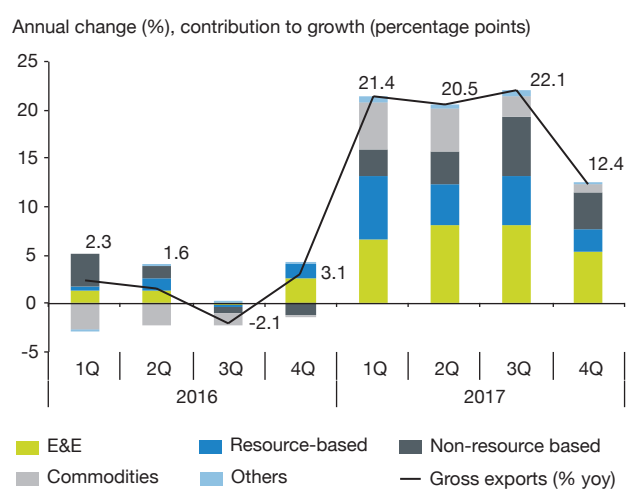


*Private sector wages is derived from the salaries and wages data published in the Monthly Manufacturing Statistics and Quarterly Services Statistics by the Department of Statistics, Malaysia (DOSM). It covers 62% of total employment.

Source: Department of Statistics, Malaysia

Export growth supported mainly by manufactured exports

Chart 12: Gross Exports by Products

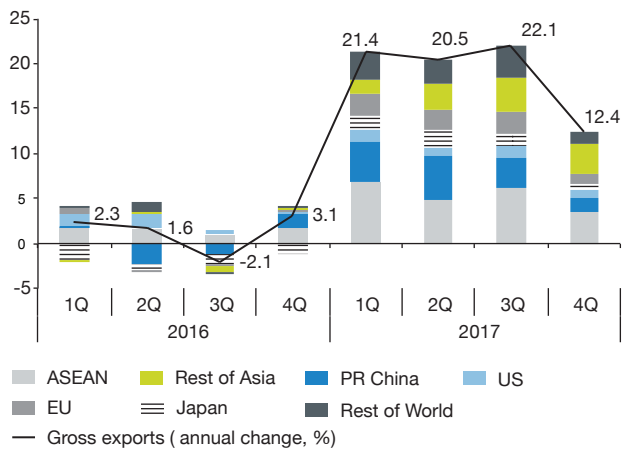


Source: Department of Statistics, Malaysia

Export growth was also broad-based across markets

Chart 13: Gross Exports by Markets

Annual change (%), contribution to growth (percentage points)

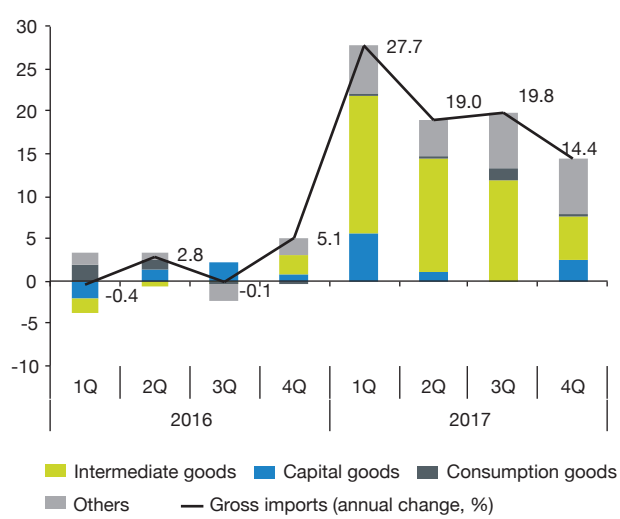


Source: Department of Statistics, Malaysia

Strong imports, supported mainly by intermediate and capital goods

Chart 14: Gross Imports by Products

Annual change (%), contribution to growth (percentage points)



Source: Department of Statistics, Malaysia

The strong manufactured export performance was supported by continued demand from Malaysia's major trading partners, particularly regional economies, the EU and US. Of significance, semiconductor exports accelerated to 24.4% (3Q 2017: 22.3%), benefitting from the upswing in the global technology cycle. Resource-based manufactured exports remained resilient, supported mainly by chemicals & chemical products, petroleum and rubber products. Commodity exports moderated due mainly to contractions in palm oil and natural rubber products and slower growth in LNG exports. This was however, partially offset by stronger crude petroleum exports, reflecting mainly higher crude oil prices.

Gross import growth remained strong in 4Q 2017 (14.4%; 3Q 2017: 19.8%), on account of continued strength in intermediate imports and higher capital imports. This was in line with strong manufacturing export performance and continued strength in domestic demand. Higher capital imports was in tandem with the strength in investment activity in the manufacturing and services sectors. This was further supported by a surge in aircraft deliveries during the quarter.

Higher current account surplus

The current account surplus widened slightly to RM12.9 billion in the fourth quarter of 2017 (3Q 2017: RM12.5 billion), accounting for 3.7% of GNI (3Q 2017: 3.7% of GNI). This was due to a larger goods surplus and lower deficit in the secondary income account which offset the higher deficits in the services and primary income accounts. For the full year, the current account surplus widened to RM40.3 billion or 3.1% of GNI (2016: 2.4% of GNI), the highest since 2015.

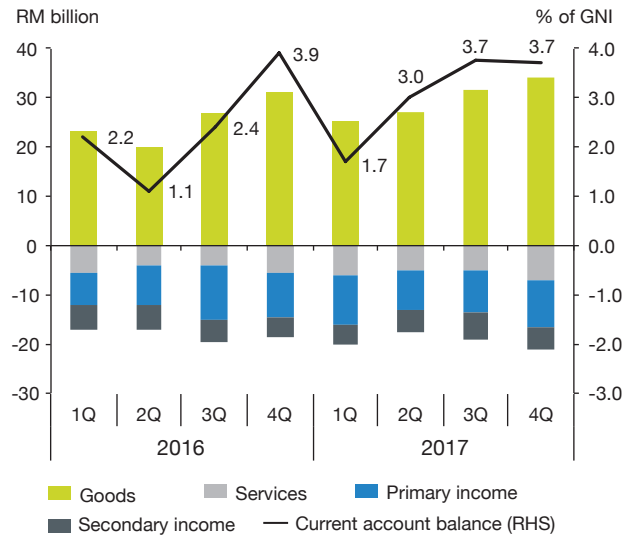
Reflecting the sustained strong export performance during the quarter, the goods surplus increased to RM34.1 billion[3] (3Q 2017: RM31.7 billion). The services account, however, registered a larger deficit of RM6.9 billion (3Q 2017: -RM4.9 billion). This was attributable mainly to the lower surplus in the travel account (RM7.9 billion; 3Q 2017: RM9.2 billion) as travel receipts declined due to lower tourist per capita expenditure. The construction services deficit was also higher (-RM4.3 billion; 3Q 2017: -RM3.3 billion), driven by higher construction services imports mainly in projects related to the oil & gas, utilities and transportation sectors.

The higher deficit in the primary income account (-RM9.5 billion; 3Q 2017: -RM8.6 billion) was largely attributable to higher profits accrued to foreign investors in Malaysia, particularly in the mining and wholesale & retail trade services sub-sectors. This was partially offset by higher profits earned by Malaysian firms investing abroad, particularly in the real estate services sub-sector.

The secondary income account registered a sizeable, albeit smaller deficit of RM4.8 billion (3Q 2017: -RM5.7 billion). Outward remittances amounted to RM8.6 billion (3Q 2017: -RM9.5 billion) driven by foreign worker remittances while inward remittances were sustained at RM3.8 billion (3Q 2017: RM3.8 billion).

Continued current account surplus

Chart 15: Current account balance

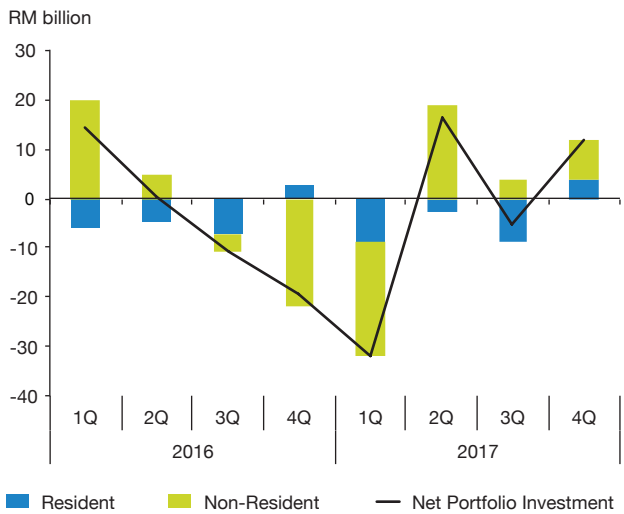


Source: Department of Statistics, Malaysia

[3] 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

Net inflows in portfolio investment account contributed by both residents and non-residents

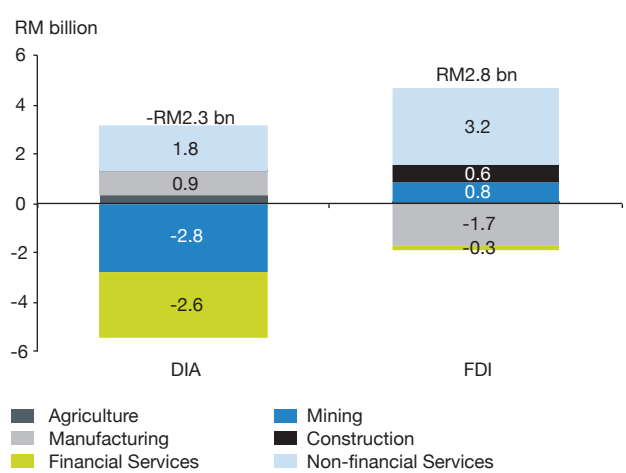
Chart 16: Portfolio Investments



Source: Department of Statistics, Malaysia

Net inflows in the direct investment account

Chart 17: 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

Financial account recorded net inflows

In the fourth quarter of 2017, the financial account registered a net inflow of RM5.0 billion (3Q 2017: net outflow of RM1.2 billion). This was supported by portfolio investment inflows by both residents and non-residents, foreign direct investments (FDI) and some liquidation of direct investments abroad (DIA) assets by Malaysian companies. These inflows were partially offset by outflows arising from banks' liquidity and treasury management operations.

The portfolio investment account registered a net inflow of RM11.7 billion (3Q 2017: net outflow of RM5.1 billion), attributed mainly to non-resident portfolio investments, which recorded a higher net inflow of RM7.7 billion (3Q 2017: net inflow of RM3.7 billion). Better-than-expected economic performance, higher corporate earnings and improvement in global oil prices provided support to investor sentiments in the domestic financial markets. Resident portfolio investments also registered a net inflow of RM4.0 billion (3Q 2017: net outflow of RM8.8 billion), as domestic institutional investors liquidated some of their bond holdings abroad.

The direct investment account registered a net inflow of RM5.1 billion (3Q 2017: net inflow of RM6.2 billion), on account of continued FDI inflows and a reversal of DIA flows during the quarter. FDI amounted to a smaller net inflow of RM2.8 billion (3Q 2017: net inflow of RM11.2 billion), due mainly to lower equity capital injections from parent companies and a moderation in retained earnings. FDI inflows were channeled mainly into the services sector, particularly the real estate and wholesale and retail trade sub-sectors, followed by the mining and construction sectors. DIA by Malaysian companies also recorded a net inflow of RM2.3 billion (3Q 2017: net outflow of RM5.0 billion), due to a net liquidation of equity capital and a net repayment of intercompany loans from subsidiaries and affiliates abroad. Sectors which recorded inflows were the mining and services sectors, particularly the financial services sub-sector.

The other investment account recorded a larger net outflow of RM10.9 billion (3Q 2017: net outflow of RM3.3 billion), due mainly to the placements of currency and deposits abroad by domestic financial institutions.

Following these developments, the overall balance of payments registered a deficit of RM13.1 billion in the fourth quarter (3Q 2017: a surplus of RM2.9 billion). Errors and omissions, which includes revaluation changes on BNM's international reserves, amounted to -RM31.0 billion or -6.7% of total trade.

Manageable external debt

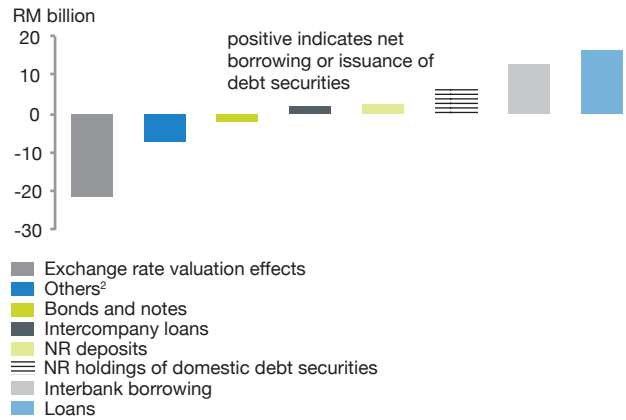
Malaysia's external debt amounted to RM883.4 billion, equivalent to USD215.5 billion or 65.3% of GDP as at end-December 2017 (end-September 2017: RM873.8 billion or USD204.7 billion or 64.6% of GDP). The higher external debt reflects the increase in loans, interbank borrowing and non-resident (NR) holdings of domestic debt securities. This was partially offset by valuation effects following the strengthening of the ringgit against selected major and regional currencies during the fourth quarter.

Malaysia's external debt remains manageable given its currency and maturity profiles, as well as the availability of large external assets. More than one-third of total external debt is denominated in ringgit (34.3%), mainly in the form of NR holdings of domestic debt securities and in ringgit deposits 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 RM580.7 billion (65.7%) is denominated in foreign currency (FC) and is subject to prudential liquidity management practices and hedging requirements on banking institutions and corporations. The bulk of these obligations are offshore borrowings, raised mainly to expand productive capacity and to better manage financial resources within corporate groups. As at end-December 2017, the offshore borrowing remained low at 37.5% of GDP compared to 60.0% of GDP during the Asian Financial Crisis.

Higher external debt in 4Q 2017

Chart 18: Changes in External Debt
Net Change[1]: +RM9.5 billion

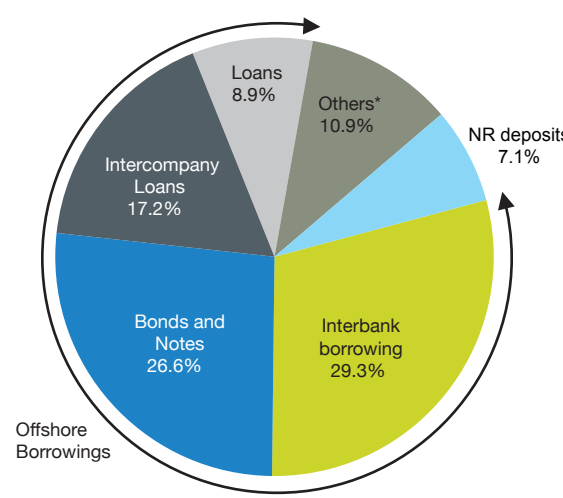


[1] Changes in individual debt instruments exclude exchange rate valuation effects
[2] Comprises trade credits, IMF allocation of SDRs and other debt liabilities
Note: NR refers to non-residents

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

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

Chart 19: Breakdown of Foreign Currency-Denominated External Debt (% of 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 (inclusive of valuation effects), more than one-third (or amounting to RM211.6 billion) is accounted by interbank borrowing and FC deposits in the domestic banking system. This largely reflects the banks' intragroup liquidity management and placements of deposits from foreign parent entities, which are subjected to prudent liquidity management practices. Among these are internal limits on funding and maturity mismatches. This is then followed by long-term bonds and notes issued offshore which amounted to RM154.2 billion as at end-December 2017, primarily to finance asset acquisitions abroad that will generate future income. The intercompany loans are typically on flexible and concessionary terms, such as no fixed repayment schedule or low interest rate.

From a maturity perspective, more than half of the total external debt is skewed towards medium- to long-term tenure (57.3% of total external debt), suggesting limited rollover risks. Given the export earnings of borrowers and external assets, it is important to note that international reserves is not the only means for banks and corporations to meet their short-term external obligations. International reserves account for about a quarter of total external assets, with the remaining external assets being held by banks and corporations. As at 30 January 2018, international reserves is 1.1 times the short-term external debt and is sufficient to finance 7.2 months of retained imports.