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

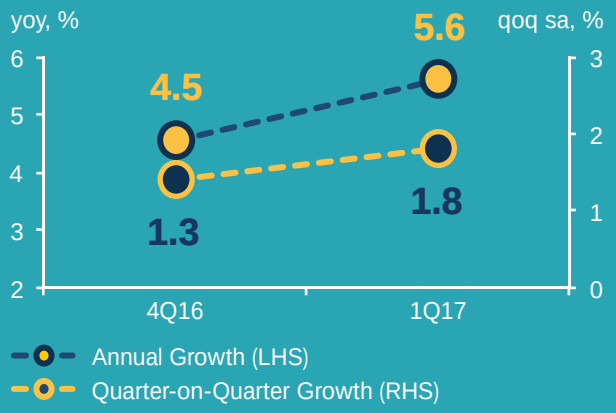
Economic and Financial Developments in 1Q2017

Higher GDP growth at 5.6%

Private sector spending grew by 8.2% (4Q16: 5.9%)

On the supply side, the agriculture sector turned around to register positive growth of 8.3% (4Q16: -2.5%)

Real GDP Growth



Rise in inflation mainly reflected the increase in global oil prices

Inflation in the transport category was higher

Crude Oil Prices

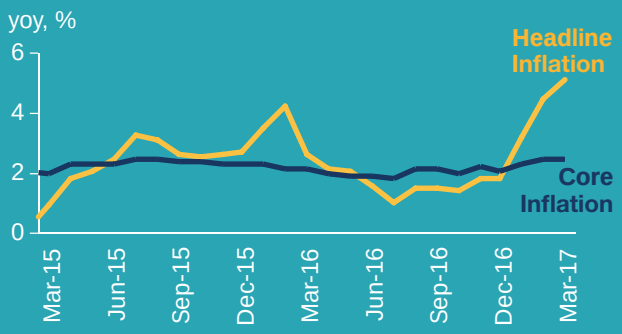
1Q17: USD55/barrel
1Q16: USD35/barrel

RON95 Petrol

1Q17: RM2.23/litre
1Q16: RM1.73/litre

However, the increase in core inflation remained modest

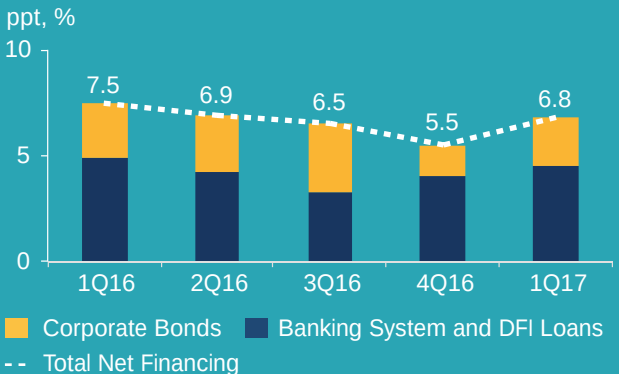
Headline and Core Inflation



Financing conditions remained supportive of economy

Financing to the private sector improved during the quarter

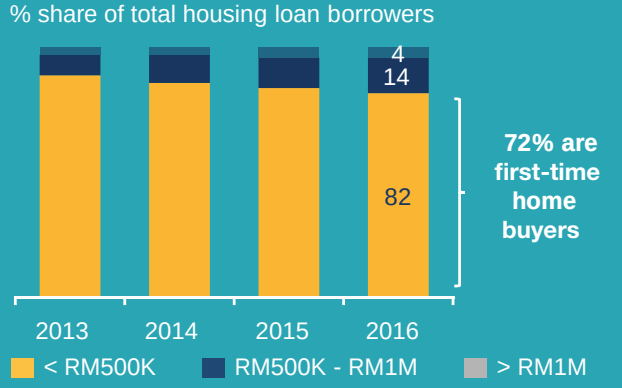
Contribution to Net Financing Growth*



*Net financing is comprised of outstanding banking system and DFIs loans and outstanding corporate bonds

Eligible borrowers continued to have access to financing

Debunking the Myth: Property Measures Have Led to Higher Loan Rejection Rates



72% are first-time home buyers

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

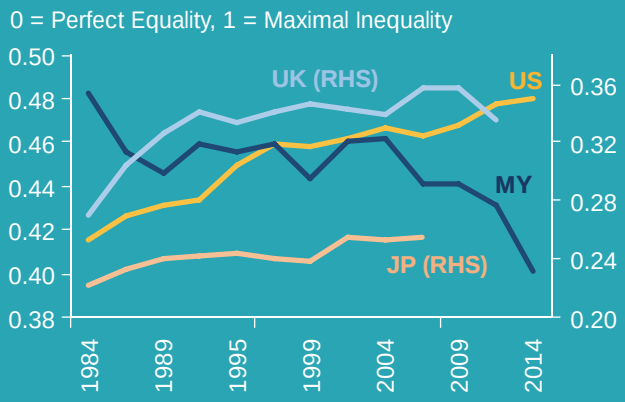
Key Highlights on

Feature Articles

Central Banking and Inequality: The Current State of the Conversation

Globally, both wealth and income inequality have risen

GINI Coefficient



Source: Chartbook of Economic Inequality, EPU, Census Bureau

Incorporating inequality into policy deliberations may help achieve a more effective monetary policy

Issue of inequality matters as distributions of income and wealth affect policy outcomes

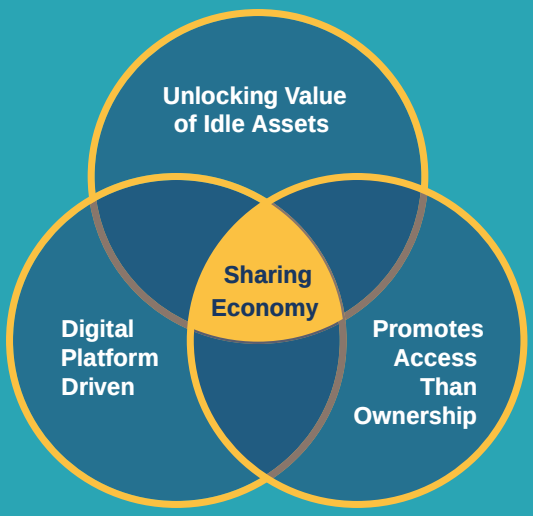
Initiatives to lessen income inequality:

- ✓ Advancing financial inclusion
- ✓ Enhancing financial education and financial empowerment
- ✓ Increasing affordable housing supply
- ✓ Mitigating rising cost of living

The Sharing Economy – Harnessing the Value of Idle Assets

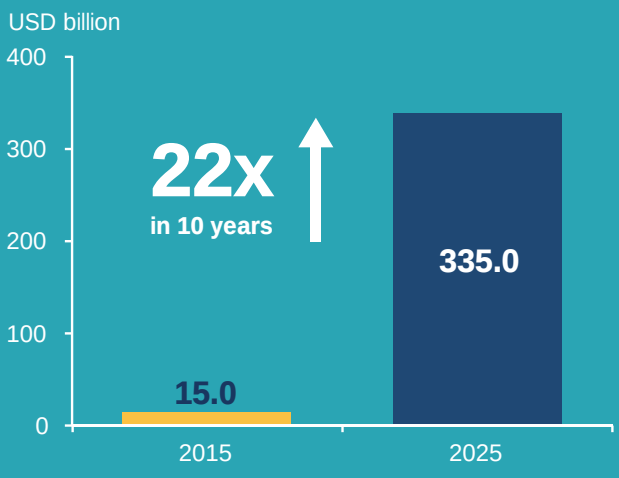
The 'sharing economy' reduces resource underutilisation

Characteristics of the Sharing Economy



Clear and coherent policy stance is important for the sharing economy industry to thrive

Global Revenue of the Sharing Economy



Note: Projections by PricewaterhouseCoopers, "The Sharing Economy" published in 2015

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

International Economic Environment

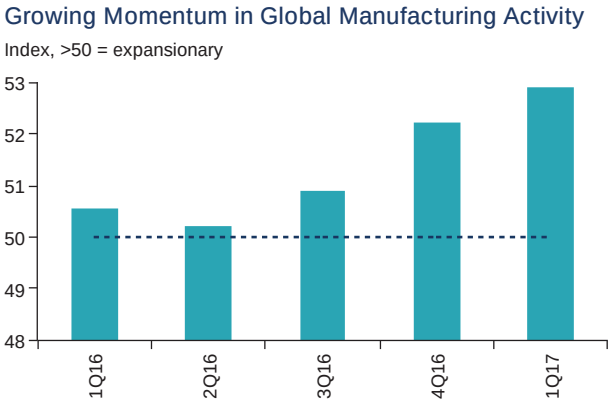
HIGHLIGHTS

- **Broad-based improvements in global growth, supported by stronger investment activity in major advanced economies.**
- **Rise in headline inflation following increase in crude oil prices.**
- **Less volatile financial markets, despite several major developments.**

Global growth expanded further

In the first quarter of 2017, global economic activity expanded further with growth becoming more synchronised across countries. Indicators such as the manufacturing purchasing managers' index (PMI) and trade growth showed a significant pick-up in economic activity. In particular, the manufacturing PMI recorded the fastest rate of expansion in six years. Manufacturing activity was supported by better performance across the consumer, intermediate and investment goods sectors, suggesting a broad-based expansion in demand from consumers and businesses. Trade for the Asian economies, including Korea, Chinese Taipei and Singapore, recorded double-digit growth for the first time since 2011, supported mainly by the electrical & electronics (E&E) and commodities sectors.

Chart 1 Global Manufacturing PMI

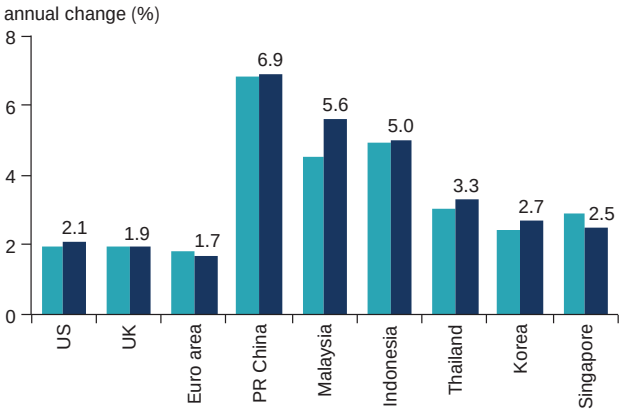


Source: J.P. Morgan, IHS Markit, Bloomberg

The improvement in growth was observed across both the advanced and emerging market economies. First quarter GDP releases showed higher growth in several economies in Asia and sustained performance in the advanced economies. Looking at the growth components, while the expansion in consumption was sustained, investment activity rose in the advanced economies. This was an important development given the weakness seen in investment particularly in the US since 2Q 2016. More importantly, improvements in investment play a bigger role in driving global trade (Constantinescu et al., 2015). Continued strength in domestic demand in PR China lent further support to global demand, as shown by the double-digit growth in PR China's imports during the quarter. The rise in demand was generated by both the demand for intermediate goods meant for re-exports and domestic consumption. Asia benefitted from the recovery in global demand amid sustained strength in domestic demand, supported by favourable labour market conditions and infrastructure spending.

Chart 2: GDP Growth of Selected Economies

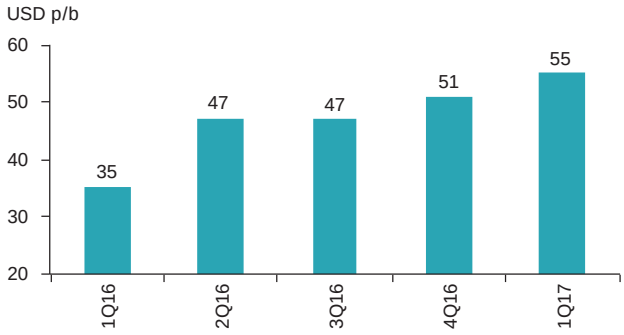
Further Global Economic Expansion in 1Q 2017



Source: National authorities

Chart 3: Brent Crude Oil Price

Higher Crude Oil Prices in 1Q 2017



Source: Bloomberg

Chart 4: Inflation Rates of Selected Economies

Headline Inflation Rose Across Major Advanced and Asian Economies



*Data refers to personal consumption expenditures price index

Source: National authorities

Higher headline inflation following increase in oil prices

Headline inflation in many economies rose during the quarter arising mainly from increased oil prices. Brent crude oil price averaged USD55 per barrel (4Q 2016: USD51 per barrel), supported by investors' optimism following strong compliance by OPEC members for the oil output cut initiative.

This price increase drove up transportation costs across the major advanced and emerging economies. The UK's headline inflation rose to 2.1%, above the Bank of England's inflation target of 2%, the highest since 4Q 2013. Similarly, in the euro area, headline inflation recorded its fastest reading since 1Q 2013. However, the pace of inflation differed across euro member states. Germany and Spain recorded inflation rates of 2.0% and 2.8%, respectively, while Finland and Greece registered inflation rates of 0.9% and 1.3%, respectively. Rising inflation was also observed across Asian economies, including Indonesia, the Philippines, Korea, Thailand and Singapore where the transportation subcomponent constituted between 8% (Philippines) to 19% (Thailand) of the consumer price index (CPI) basket. Nonetheless, underlying price pressures remained modest, as reflected by the low growth in core inflation. The only major exception was the US, where core inflation (as measured by the personal consumption expenditures price index) rose due to a sustained expansion of private consumption, particularly of services.

Less volatile financial markets

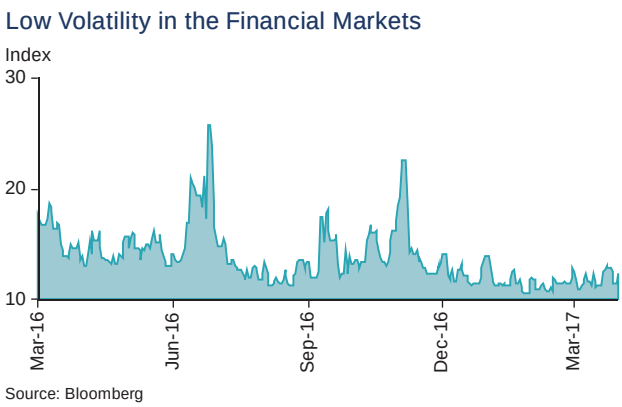
Volatility in the global financial markets declined, as major developments and events were largely anticipated by market participants.

A key policy event was Federal Reserve's decision to raise the federal funds rate for the second time since December 2015. The normalisation was a widely anticipated move. The Federal Reserve had earlier indicated that an interest rate hike would be appropriate amid continued improvements in employment and inflation data. Most other major central banks remained committed to maintaining an accommodative monetary policy stance until stronger signs of rising inflation emerged while allowing the current phase of economic expansion to be more entrenched. Beyond monetary policy, the much awaited triggering of the Article 50[1] by the UK government also had limited impact on volatility in the financial markets.

[1] Article 50 of the Treaty on European Union is the part of European Union law that sets out the process by which member states may withdraw from the European Union.

Markets were nevertheless affected, albeit marginally, by the attempt by the Trump administration to repeal the Affordable Care Act, as evidenced by an increase in the VIX reading on 23 March. Concerns surrounding the Trump administration's ability to execute the pro-growth policies rose, resulting in a depreciation of the US dollar against major and regional currencies, towards the end of the quarter.

Chart 5: Chicago Board Options Exchange (CBOE) Volatility Index (VIX)



Source: Bloomberg

Developments in the Malaysian Economy

HIGHLIGHTS

- **Growth rose to 5.6%, lifted by stronger domestic demand activity.**
- **Headline inflation rose and was driven mainly by higher transport prices.**
- **Current account balance narrowed to 1.7% of GNI amid lower goods surplus, as import growth outpaced export growth during the quarter.**

The Malaysian economy advanced by 5.6% in the first quarter of 2017

The Malaysian economy recorded a higher growth of 5.6% in the first quarter of 2017 (4Q 2016: 4.5%). Private sector activity was higher and remained as the main driver of growth. Growth was further lifted by higher exports, as increased demand for manufactured products led to a strong growth in real exports (9.8%; 4Q 2016: 2.2%). Real imports also increased at a faster rate of 12.9% (4Q 2016: 1.6%) on account of higher growth of capital and intermediate goods. On a quarter-on-quarter seasonally-adjusted basis, the economy recorded a growth of 1.8% (4Q 2016: 1.3%).

Domestic demand driven by private activity

Domestic demand growth increased to 7.7% in the first quarter of the year (4Q 2016: 3.2%), supported by continued expansion in private sector expenditure (8.2%; 4Q 2016: 5.9%) and the turnaround in public sector expenditure.

Private consumption grew by 6.6% (4Q 2016: 6.1%). Household spending remained supported by continued expansion in employment and wage growth. The implementation of selected Government measures, including the higher amount of Bantuan Rakyat 1Malaysia cash transfers, also provided additional impetus to household spending.

Chart 6: GDP Growth



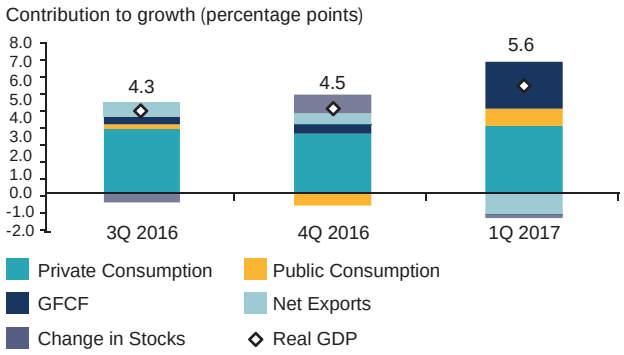
Source: Department of Statistics, Malaysia

Public consumption recorded a stronger growth of 7.5% (4Q 2016: -4.2%) attributed to higher spending on both emoluments and supplies and services.

Private investment grew at a robust pace of 12.9% (4Q 2016: 4.9%), following continued capital spending in the services and manufacturing sectors. Investments in machinery and equipment were higher during the quarter, supported by the implementation of several large-scale projects in the manufacturing sector.

Chart 7: Contribution of Expenditure Components to GDP Growth

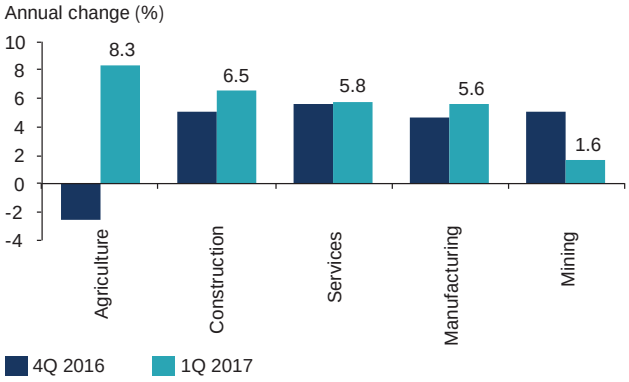
Private Sector Demand Remained the Principal Driver of Growth



Source: Department of Statistics, Malaysia

Chart 8: Growth by Sector

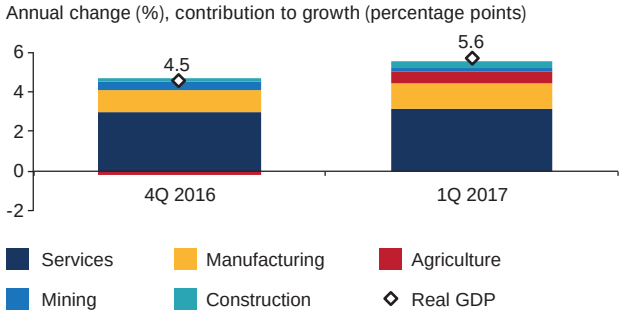
Strong Rebound in Agriculture Sector Growth



Source: Department of Statistics, Malaysia

Chart 9: Real GDP by Economic Sector

Contribution to Growth from Agriculture Sector Turned Positive post-El Niño



Source: Department of Statistics, Malaysia

Business sentiments improved during the quarter amid the better international economic environment and more stable financial markets.

Public investment registered a higher growth of 3.2% (4Q 2016: -0.4%), driven mainly by higher spending on fixed assets by public corporations.

Gross fixed capital formation (GFCF) rose by 10.0% (4Q 2016: 2.4%), due to a turnaround in public investment and higher private investment growth. The stronger growth in total investment was due to broad-based increases in capital spending in machinery and equipment (21.8%; 4Q 2016: 2.9%), structures (3.8%; 4Q 2016: 2.8%) and other types of assets (1.4%; 4Q 2016: -2.0%).

Higher growth across major economic sectors

On the supply side, most economic sectors expanded at a faster pace. The improvement in the overall growth was contributed primarily by the turnaround in the agriculture sector and higher growth in the manufacturing and services sectors.

Growth in the agriculture sector rebounded as crude palm oil yields recovered from the negative impact of El Niño. The performance of the sector was also supported by a double-digit expansion in rubber production. In the manufacturing sector, growth was driven mainly by the electronics and electrical segment, in line with the continued favourable global demand for semiconductors. The domestic-oriented industries were supported by the continued demand for food-related products and a rebound in the motor vehicle production.

The services sector expanded at a faster pace in the first quarter. Growth in the wholesale and retail sub-sector improved in line with higher household spending. The finance and insurance sub-sector also registered higher growth, supported by improvements in loan growth and capital market activity amid higher issuance of IPOs. Growth in the construction sector was stronger, supported by civil engineering activity in the petrochemical, power plant and transportation segments.

In the mining sector, growth moderated on lower crude oil production, particularly in Sarawak and Peninsular Malaysia, as part of the global initiative to reduce oil production.

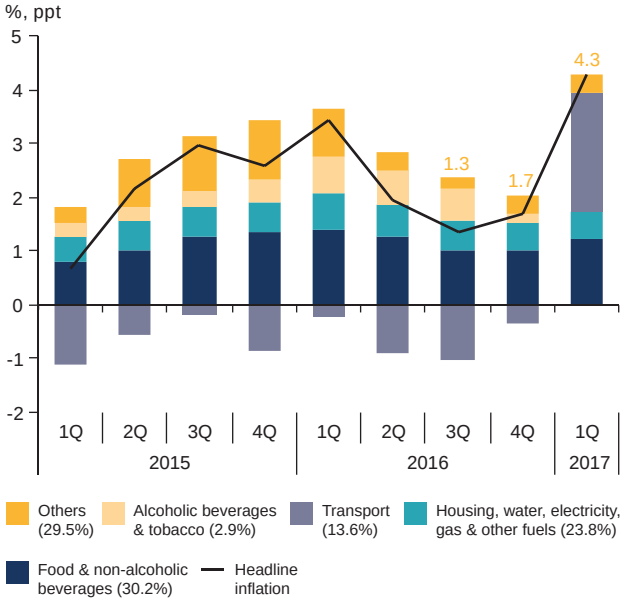
Headline inflation increased due to higher transport prices

Headline inflation[2] was higher at 4.3% in the first quarter of 2017 (4Q 2016: 1.7%) driven mainly by cost factors. During the quarter, prices of RON95 petrol averaged higher at RM2.23 per litre compared to an average of RM1.73 per litre during its base period in the 1Q 2016. This resulted in significantly higher inflation in the ***transport*** category at 16.2% (4Q 2016: -2.6%). Higher domestic fuel prices were primarily an outcome of the increase in global oil prices following OPEC's agreement to cut production effective 1 January 2017. Inflation in the ***food and non-alcoholic beverages*** category was higher at 4.2% (4Q 2016: 3.3%) with the ***food away from home*** sub-category registering a growth of 4.0% (4Q 2016: 3.4%). The increase in food inflation was due to shortages in fresh food supplies amid adverse weather conditions, which were also transmitted into the higher prices for ***food away from home***. However, in March 2017, food inflation started to moderate as supply conditions improved.

The higher prices for ***food away from home*** amidst an increase in rental inflation led to higher core inflation of 2.4% in 1Q 2017 (4Q 2016: 2.1%). However, the transmission of higher prices remained contained. This was reflected in the inflation pervasiveness[3] which remained broadly stable. The limited transmission was attributed partly to the small share of ***transportation, energy*** and ***basic chemicals*** (10.4%)[4] in the production cost of most items in the CPI basket. Domestic production and consumption also have relatively modest import content (about 20% and 6.7%, respectively), containing the pass-through of the weaker ringgit exchange rate to domestic inflation.

Chart 10: Headline Inflation

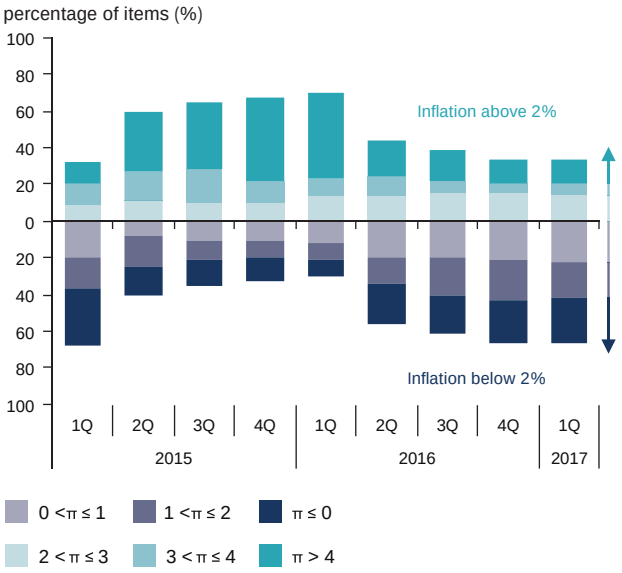
Higher Inflation Reflected Primarily the Pass-Through of Higher Global Oil Prices



Source: Department of Statistics, Malaysia and BNM estimates

Chart 11: Inflation Pervasiveness

However, Inflation Pervasiveness Remained Broadly Stable

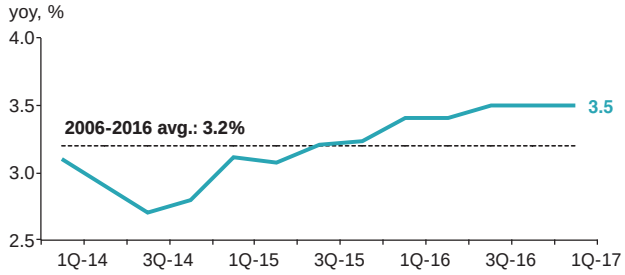


Source: Department of Statistics, Malaysia and BNM estimates

[2] As measured by the annual change in the Consumer Price Index (CPI).
[3] Inflation pervasiveness captures the share of items in the CPI basket which is rising at a given pace. Inflation is more pervasive if a larger number of items are registering a faster rate of price increase. It is useful in distinguishing increases in headline inflation which is driven by relative price changes from general price ones.
[4] This share is derived from an analysis of the Input-Output table.

Chart 12: Unemployment Rate

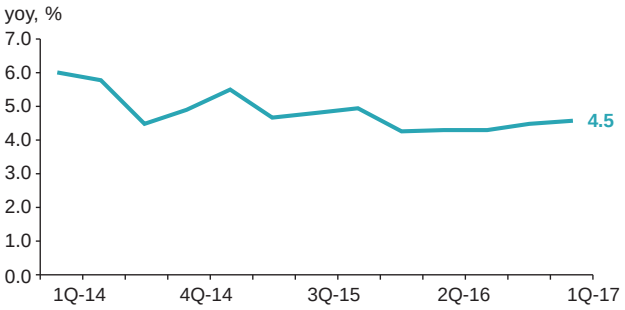
Unemployment Rate Held Steady



Source: Department of Statistics, Malaysia

Chart 13: Private Sector Wages

Sustained Wage Growth



Source: Department of Statistics, Malaysia

Stable labour market conditions

Labour market conditions remained stable in the first quarter, with slightly higher labour force participation, at 67.7% of the working age population (4Q 2016: 67.6%). During the quarter, the labour force expansion of 98,700 people was met with a corresponding net employment gain of 95,300 people. As such, the unemployment rate remained unchanged at 3.5% of the labour force (4Q 2016: 3.5%). Higher vacancies posted on a major job search website at 61,760 positions suggest increasing demand for new hires (4Q 2016: 53,214).

Private sector wages continued to expand at a sustained pace of 4.5% in 1Q 2017 (4Q 2016: 4.4%), as the stronger wage growth in the major services sub-sectors (5.1%; 4Q 2016: 3.7%) offset the moderating wage growth in the manufacturing sector during the quarter (3.2%; 4Q 2016: 5.9%). Wage expansion during the quarter was supported by both domestic- and export-oriented manufacturing and services industries.

Box Article 1

Inflation: Perception vs. Reality

Authors: Loke Po Ling and Farina Adam Khong

HIGHLIGHTS

- **Public scepticism on the CPI has increased as their personal experiences suggest larger increase in cost of living. However, cost of living and inflation are two different concepts, and public perceptions of inflation are subject to biases.**
- **Due to the biases, measures of perceived inflation were higher than CPI inflation, especially at times of rising inflationary pressures. This could influence public's expectations of future inflation, and in turn might change their consumption and investment decisions.**

"Perception is real, even when it is not reality" ~ Edward de Bono

In economics, there is always a fine line between perception and reality. Whether the official CPI inflation is a reflection of the actual change in cost of living is one of those pertinent issues. Despite the relatively low CPI inflation in the past two years (2016: 2.1%; 2015: 2.1%), the experiences of the general public suggest that the cost of living has risen more significantly. Hence, the ability of the CPI as a good indicator of changes in cost of living in the country is subject to scepticism.

The disconnect between the cost of living and the reported CPI inflation arises due to three factors. First, cost of living and inflation are two different concepts as highlighted in the Box Article: Inflation and Cost of Living in the Annual Report 2015. CPI inflation is computed based on a single basket of goods and services which reflects average consumption patterns of the Malaysian households, and average prices in the economy. To the extent there are differences in spending patterns and variations in prices at various locations, the overall CPI inflation would not reflect the individual cost of living. Based on staffs' estimates, the inflation rates across income groups and states were indeed different from the national average.

- Comparing across states, households in Kuala Lumpur experienced the highest inflation rate of 2.8% in 2016, which is higher than the national average of 2.1%.
- Comparing across income groups, households in the bottom 20% of the income group experienced inflation rates that were 0.12 to 1.12 percentage points higher than households in the top 20% of the income group. This is due to their higher share of expenditure on food, which generally experienced a higher rate of inflation compared to other goods and services[1].

As the CPI provides a good measure of the changes in the overall consumer price level in the economy, it is a relevant indicator for the conduct of macroeconomic policies, such as monetary policy, that aim to affect the broader economy.

Second, while CPI only considers the annual rate of change in prices of goods and services, the discussions on the issue of cost of living also take into account the income perspective. Households feel the pressure of rising cost of living not solely when costs increase, but when incomes do not rise in tandem, leading to an erosion of purchasing power.

[1] This is not unique to Malaysia and has been observed in other countries

Third, the public perceptions on price increases are also subject to several natural biases. This is because consumers have different information sets than the ones used to compute the CPI when forming perceptions. These information sets comprise initial beliefs, social interaction with other economic agents and life-time experiences. The biased perceptions could influence consumer's expectations of future inflation, and in turn would change consumption and investment decisions. In this regard, understanding public inflation perceptions is important so that central banks are able to develop effective strategies to anchor inflation expectations.

This article lists some of the factors driving the public's perception of inflation and subsequently provides quantitative measures of the perceived inflation. It also explains factors that led to divergence between the perceived and CPI inflation in the recent period.

Public perception of inflation is subject to biases

Public's perception of inflation is shaped by their personal experiences and is subject to two biases, namely, frequency and memory bias.

- Frequency bias: Consumers' views on inflation are predominantly driven by the price changes in items that are more frequently purchased. The frequently purchased items are non-durable items such as food and personal care items that typically experience higher rate of inflation.
- Memory bias: Consumers tend to remember price increases and disregard price declines.

To quantitatively gauge the level of inflation perceived by the public, two measures of perceived inflation are constructed, namely the Everyday Price Index (EPI)[2] and Perceived Price Index (PePI)[3]. These indices incorporate the frequency and memory biases.

i. **Everyday Price Index (EPI)** is an index that comprises frequently purchased goods and services (at least once a month) that incorporate the frequency bias. The index accounts for 60% of the CPI basket. It excludes infrequently purchased and big tickets items such as clothing, household appliances and holiday expenses. Items, for which prices are contractually fixed, such as rentals, are also excluded due to the less frequent variations in prices.

   In the reweighted EPI basket, the food and non-alcoholic beverages category accounts for more than half (50.2%). Together with the transport category, these goods and services collectively account for 66% of the EPI basket. As a result, changes in prices of food and fuel products will greatly affect the EPI inflation.

Table 1: Weights in the CPI and the EPI baskets

Categories	CPI Weights	EPI Weights
Food & non-alcoholic beverages	30.2	50.2
Transport	13.7	15.8
Communication	5.2	7.8
Housing & utility	23.8	7.0
Recreation	4.9	5.9
Alcoholic beverages & tobacco	2.9	4.1
Restaurant & hotel	2.9	4.1
Miscellaneous	6.5	2.0
Education	1.1	1.6
Furnishing	3.8	1.5
Clothing & footwear	3.3	0.0
Health	1.7	0.0
Total	**100.0**	**100.0**

Source: Department of Statistics, Malaysia and staff calculation

[2] Vlasenko and Cunningham (2015).
[3] By employing similar concept highlighted by Brachinger (2006).

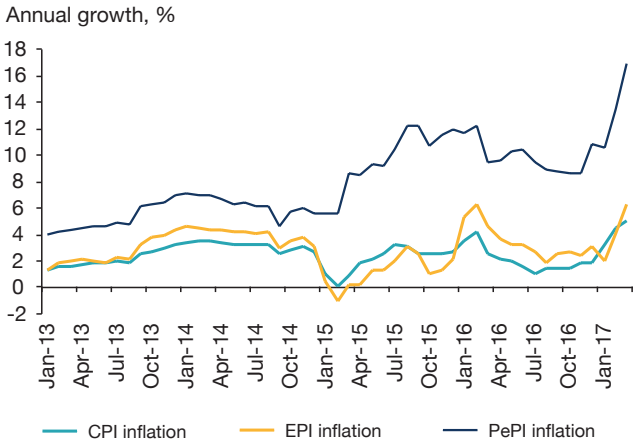
ii. Perceived Price Index (PePI) is a further refinement to the EPI, where it attempts to incorporate the memory bias in addition to the frequency bias. Items in PePI are exactly the same as EPI. However, the index will only capture price increases, as consumers tend to disregard price declines. Price indices that are registering declines are assumed to be unchanged.

Even in a low inflation environment, public perception of inflation has remained high given the perception bias

Comparing the measures of perceived inflation and the CPI inflation, EPI inflation was generally higher than the CPI inflation, indicating that prices of frequently purchased items were rising at a faster rate than the infrequently purchased items.

- Between July 2013 and December 2014, there were series of upward adjustments to administered prices such as prices of cigarettes, sugar and domestic fuel.
- In 2016, food inflation was exceptionally higher following the El-Nino phenomenon.
- The exception was in 2015 where the larger weight for the transport category exacerbated the negative impact from lower fuel prices, driving EPI inflation lower than CPI inflation.

Chart 1: Headline Inflation, EPI Inflation and Perceived Inflation



Source: Department of Statistics, Malaysia and staff calculation

PePI, inarguably, registers the highest rate of inflation.

- PePI was significantly higher than CPI inflation and EPI inflation. In 2015, the PePI inflation increased at a much faster pace due to the implementation of GST that led to broad-based price increases.
- In contrast, while CPI inflation and EPI inflation also increased during this period, the increase was relatively more modest as fuel prices were lower. The lower fuel prices, however, were not captured in PePI inflation.

Table 2: CPI, EPI and Perceived Inflation

Average annual growth, %	CPI	EPI	PePI
5-year average: 2012-2016	2.2	2.6	7.0
Increase in admin prices: July 2013 – December 2014	3.0	3.8	6.1
GST implementation: April 2015 – March 2016 November 2016 – March 2017	2.8 3.3	2.6 3.6	10.8 12.1

Source: Department of Statistics, Malaysia and staff calculation

Educating the public on inflation and clear communication on inflation outlook is important to anchor inflation expectations

By incorporating frequency and memory bias, the perceived inflation measures provides support to why the general public views actual inflation to be higher than the official CPI inflation. While this perception may not necessarily be the reality, the impact can be real as economic agents act upon their beliefs and make decisions on consumption and investment, which in turn would affect the economy. For example, expecting a significant increase in inflation, households may demand for higher wages beyond their productivity growth. This will lead to a second-round increase in prices and the consequent wage-price spiral. Alternatively, households could also cut down current consumption markedly in view of higher cost of living in the future. This, in turn, will lead to a slowdown in the overall economic activity.

Thus, correcting the perception biases is important to anchor inflation expectations. In this regard, efforts would be focused towards educating the public on inflation, how it is different from the cost of living, its computation as well as the importance of validating information used in making consumption and investment decisions. Information on the outlook and future trends of inflation would also be communicated to reassure the public that inflation will be kept low over the medium-term horizon.

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External position remained resilient

Gross exports accelerated by 21.4% in the first quarter of 2017 (4Q 2016: 2.8%). The growth performance was broad-based, driven by manufactured and commodities exports, both of which recorded double-digit growth.

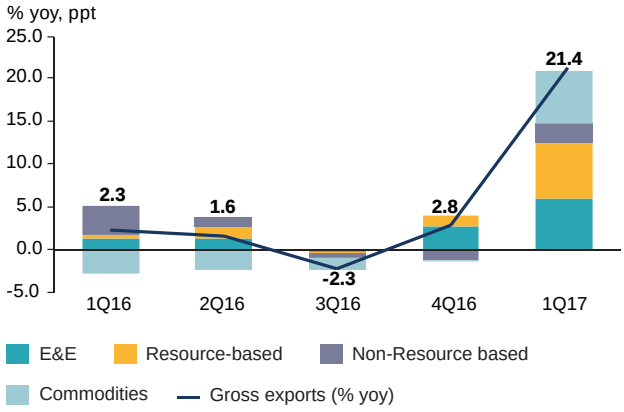
Strong growth in manufactured exports was attributable to higher demand from all major trading partners particularly the US, PR China and regional economies. Demand for E&E products increased, particularly for semiconductors. In terms of destination, E&E exports were supported primarily by the higher demand from PR China and the US.

Resource-based manufactured exports were also higher in the first quarter of 2017 due mainly to petroleum products, and chemicals and chemical products. Exports of these products were mainly concentrated to PR China and the region. Commodity exports were supported by the improvement in commodity prices and higher export volumes of crude oil, CPO and LNG.

Gross imports grew robustly by 27.7% in the first quarter of 2017 (4Q 2016: 5%), underpinned by higher intermediate goods and imports of capital and transport equipment. Of significance, capital imports were driven mainly by high-value items, including a floating structure, oil and gas vessels and several aircrafts. Intermediate imports registered higher growth, in line with strong manufacturing export performance. As import growth outpaced export growth during the quarter, the trade surplus was lower at RM18.9 billion (4Q 2016: RM27.5 billion).

Chart 14: Gross Exports by Products

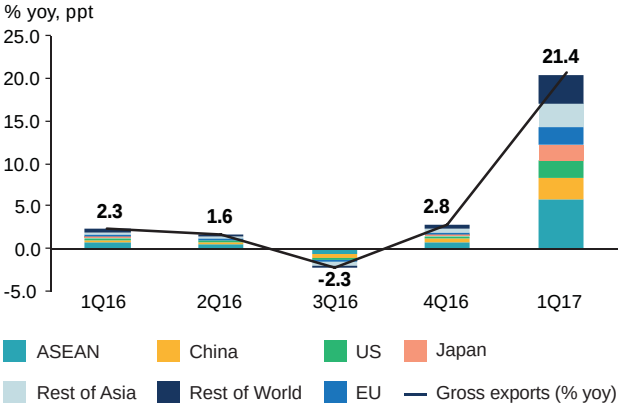
Higher Exports Growth Across Major Products



Source: Department of Statistics, Malaysia

Chart 15: Gross Exports by Markets

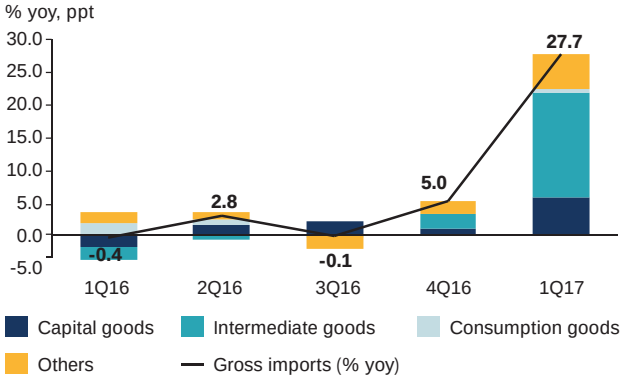
Exports was Also Broad-based Across Markets



Source: Department of Statistics, Malaysia

Chart 16: Gross Imports by Products

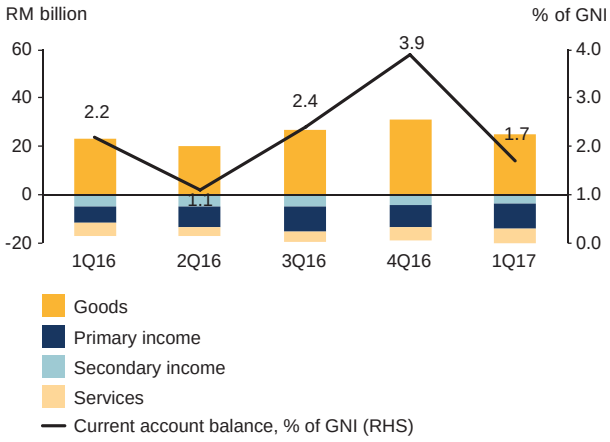
Higher Gross Imports, Particularly in Intermediate and Capital Goods



Source: Department of Statistics, Malaysia

Chart 17: Current Account Balance

Lower Current Account Surplus due to Smaller Goods Balance



Source: Department of Statistics, Malaysia

Current account surplus narrowed

In the first quarter of 2017, the current account surplus narrowed due to a lower goods surplus and higher deficit in the services account. The goods surplus narrowed to RM25.3 billion in the first quarter of 2017 (4Q 2016: RM31.2 billion), as robust import growth outpaced export growth.

The deficit in the services account widened to RM6.2 billion in the first quarter of 2017 (4Q 2016: deficit of RM5.4 billion), attributable mainly to higher payments for transportation services. This is in tandem with the increase in trade. In addition, net payment for construction services was higher in the first quarter of 2017 as reflected in the pick-up in investments. The deficit in those categories was partly offset by a sustained net travel surplus of RM7.6 billion (4Q 2016: RM7.6 billion).

The deficit in the primary income account was higher at RM9.9 billion in the first quarter of 2017 (4Q 2016: deficit of RM9.2 billion). Profits accrued to foreign investors in Malaysia (RM20.0 billion; 4Q 2016: RM19.4 billion) continued to outpace the profits generated by Malaysian investments abroad (RM11.4 billion; 4Q 2016: RM11.5 billion).

The net payment in the secondary income account was lower at RM3.9 billion in the first quarter of 2017 (4Q 2016: net payment of RM4.1 billion). This was due mainly to the moderation in outward remittances (RM8.5 billion; 4Q 2016: RM8.6 billion).

Financial account recorded lower net outflows

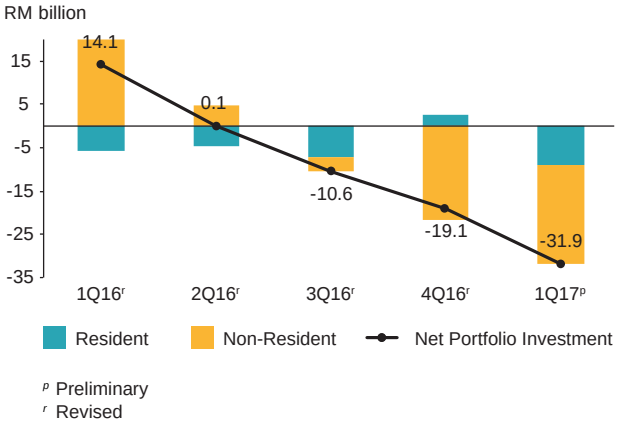
In the first quarter of 2017, the financial account recorded a lower net outflow of RM8.8 billion (4Q 2016: net outflow of RM14.2 billion), attributed mainly to net outflows in the portfolio investment account.

Portfolio investment by non-residents recorded a net outflow of RM22.9 billion (4Q 2016: net outflow of RM21.8 billion). Non-resident holdings of debt securities were lower, primarily concentrated in short-term papers with maturities of less than 3 years. This mainly reflected the maturity of Malaysian Government Securities (MGS) during the quarter and a rebalancing of exposures by international asset managers. Contributing factors were the Federal Reserve's decision to raise the federal funds rate in March 2017, renewed volatility in global oil prices and the reduction of Malaysia's weightage in the JP Morgan GBI-EM Index. The sale of non-residents' portfolios were smoothly intermediated by domestic institutions. As a result, the bond market remained relatively stable. In contrast to the net outflows from debt securities, foreign purchases of equity securities resumed amid stronger corporate earnings and the better ringgit performance. Resident portfolio investment registered a net outflow of RM9 billion (4Q 2016: net inflow of RM2.7 billion), attributed to a net acquisition of foreign financial assets by domestic fund managers and institutional investors.

The direct investment account registered a net inflow of RM8.3 billion (4Q 2016: net inflow of RM1 billion), as the incurrence of direct investment liabilities more than offset the accumulation of direct investment assets during the quarter. Direct investment abroad (DIA) by Malaysian companies declined to RM8.7 billion (4Q 2016: net outflow of RM12 billion), due mainly to lower injection of equity capital to subsidiaries abroad. Most of DIA was undertaken by companies in the services sector, particularly the financial services and utilities sub-sectors, followed by the mining sector. Foreign direct investment (FDI) rose to RM17 billion (4Q 2016: net inflow of RM13 billion), on account of higher earnings retained for reinvestment and the drawdown of intercompany loans. FDI inflows were mainly channeled into the services sector, primarily the real estate and information and telecommunication sub-sectors, followed by the mining sector.

Chart 18: Portfolio Investments

Higher Net Portfolio Outflows, Mainly by Non-Residents

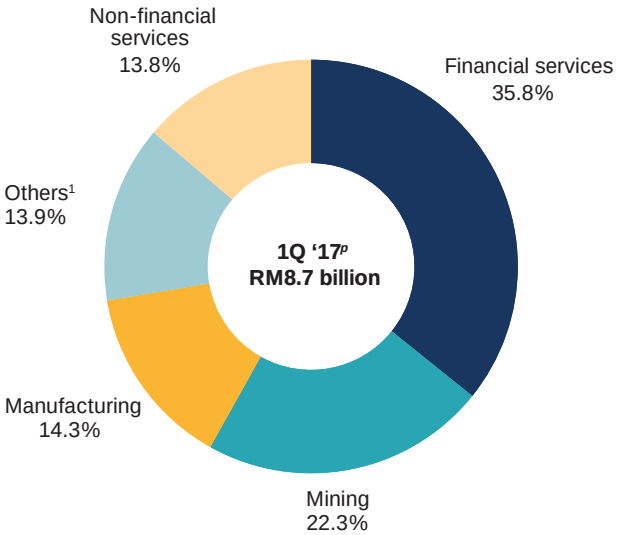


p Preliminary
r Revised

Source: Department of Statistics, Malaysia

Chart 19: Net DIA by Sector

DIA Channeled Mostly into the Services Sector



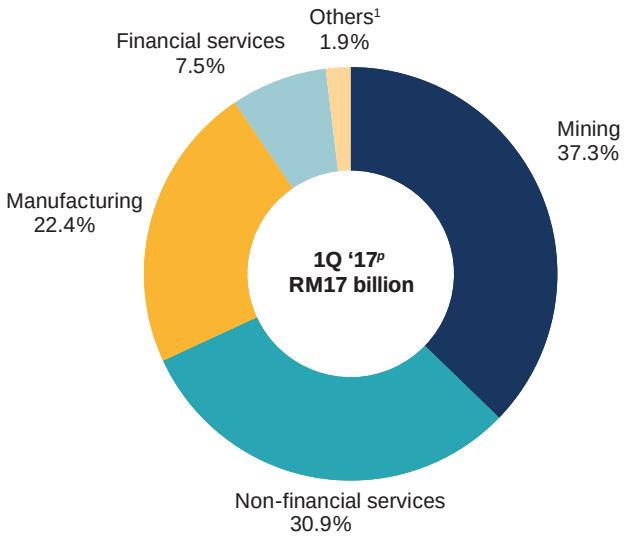
1 Refers to agriculture and construction sectors
p Preliminary

Note: Figures may not necessarily add to 100% due to rounding

Source: Department of Statistics, Malaysia

Chart 20: Net FDI by Sector

FDI Channeled Mostly into the Services and Mining Sectors



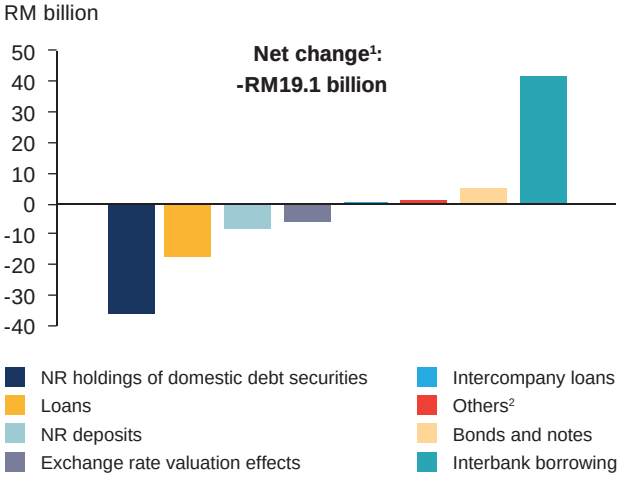
[1] Refers to agriculture and construction sectors
[p] Preliminary

Note: Figures may not necessarily add to 100% due to rounding

Source: Department of Statistics, Malaysia

Chart 21: Changes in External Debt

Lower External Debt in 1Q 2017



[1] Changes in individual debt instrument 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

The other investments account recorded a higher net inflow of RM14.2 billion (4Q 2016: net inflow of RM5 billion), due mainly to both the larger placements of currency and deposits by foreign financial institutions in Malaysian banks and the repayment of trade credits which were previously extended by Malaysian exporters.

Following these developments, the overall balance of payments registered a deficit of RM1.8 billion in the first quarter (4Q 2016: a surplus of RM19 billion). Errors and omissions amounted to RM1.7 billion or 0.4% of total trade.

Manageable external debt

Malaysia's external debt amounted to RM897.0 billion, equivalent to USD200.8 billion or 68.4% of GDP as at end-March 2017 (end-December 2016: RM916.1 billion or USD202.3 billion). The lower external debt largely reflects the decline in holdings of domestic debt securities and deposits in domestic banking institutions by non-residents (NR), and a net repayment of loans. There were also valuation effects following the strengthening of the ringgit against selected major and regional currencies during the quarter. These were partly offset, in particular, by a significant increase in interbank borrowing during the quarter for liquidity management within related entities, investment and financing purposes.

Malaysia's external debt remains manageable given its currency and maturity profiles, and the availability of larger external assets. Close to one-third of total external debt is denominated in ringgit (30.3%), mainly in the form of NR holdings of domestic debt securities and ringgit deposits in domestic banking institutions. As such, these liabilities are not subjected to valuation changes from the fluctuations in the ringgit exchange rate.

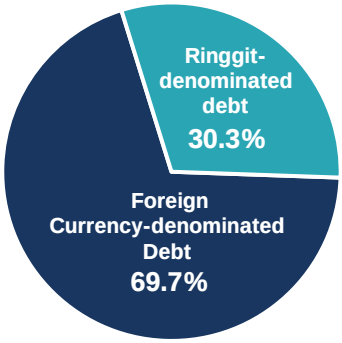
The remaining external debt of RM624.9 billion (69.7%) is denominated in foreign currency (FC) and is mostly hedged, either naturally through foreign currency earnings or through the use of financial instruments. The bulk of these obligations are offshore borrowings, raised mainly to expand productive capacity and to better manage financial resources within corporate groups. As at end-March 2017, offshore borrowing remained low at 42.5% of GDP compared to 60.0% of GDP during the Asian Financial Crisis.

Of the total FC-denominated external debt (inclusive of valuation effects), more than one-third is in the form of interbank borrowing and FC deposits with the domestic banking system, which amounted to RM237.9 billion. This largely reflects 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 RM172.2 billion as at end-March 2017, primarily to finance asset acquisitions abroad that will generate future income. The intercompany loans are normally subject to 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 (54.9%) of total external debt), suggesting limited roll over risks. It is important to note that international reserves are not the only means in which the banks and corporations rely on to meet their short-term external obligations, given the export earnings of borrowers and external assets. The latest reserves position of USD96.1 billion as at 28 April 2017 is only about a quarter of total external assets, with the remaining being held by banks and corporations. International reserves are 1.1 times the short-term external debt and are sufficient to finance 7.9 months of retained imports.

Chart 22: Breakdown by Currency (% share)

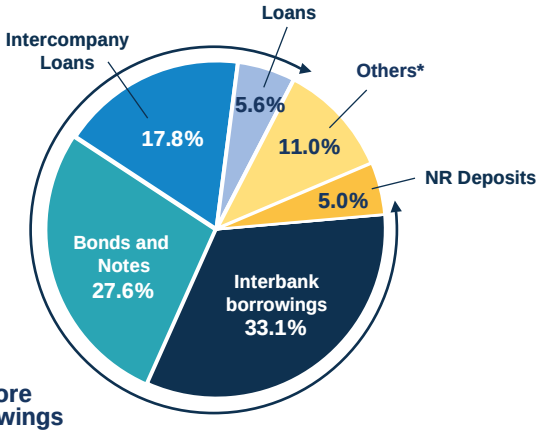
FC-Denominated Debt Largely Hedged



Source: Bank Negara Malaysia

Chart 23: Breakdown of Foreign Currency-denominated External Debt (% of Share)

About Half of FC-Denominated Debt are Subjected to Prudent Liquidity Management Practices and Flexible Terms

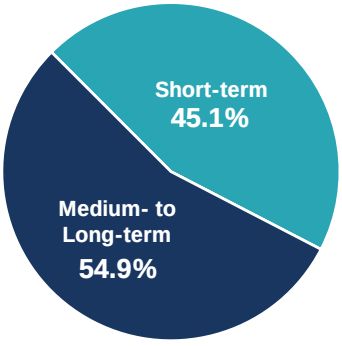


* Includes trade credits and miscellaneous, such as insurance claims yet to be disbursed and interest payables on bonds and notes

Source: Bank Negara Malaysia

Chart 24: Breakdown by Maturity (% share)

Limited Roll Over Risks



Source: Bank Negara Malaysia

Monetary and Financial Developments

HIGHLIGHTS

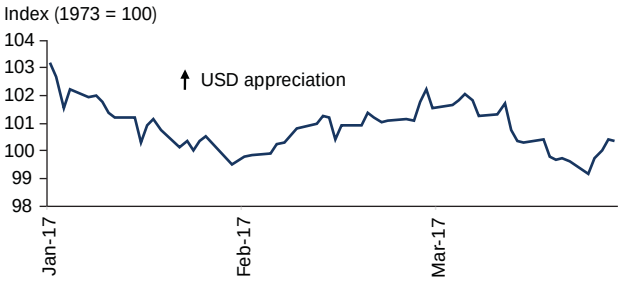
- **Ringgit performed better against the US dollar during the quarter.**
- **Despite non-resident outflows from the bond market, MGS yields remained stable due to strong demand by domestic institutional investors.**
- **Real interest rates turned negative but this is likely to be transitory.**

Ringgit recovery driven primarily by external factors

The ringgit and most regional currencies appreciated against the US dollar during the quarter amid the broad weakening of the US dollar. Despite reaching the highest level in 14 years in early January, the dollar index went on a downward trend during the quarter. The weaker US dollar sentiments were driven mainly by market uncertainties on the direction and implication of policies in the US. Regional currencies were also supported by renewed investor interest in financial assets of regional countries following the Federal Reserve's decision to maintain the path of interest rate normalisation in March. In addition, the ringgit showed more stability during the quarter compared to the previous quarter following the measures announced by the Financial Market Committee of Bank Negara Malaysia in December 2016.

Chart 25: USD Index

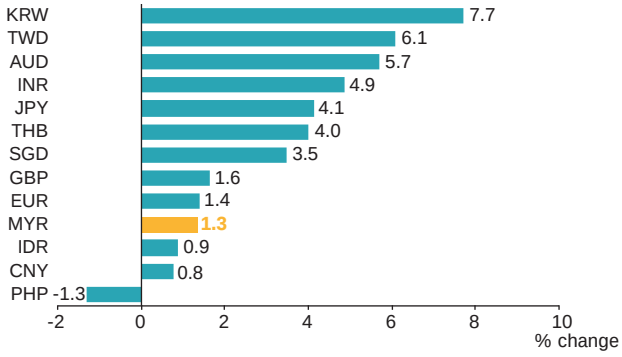
Weaker US Dollar during the Quarter



Source: Bloomberg

Chart 26: Summary of Performance of Regional and Major Currencies Against USD (1 Jan - 31 March 2017)

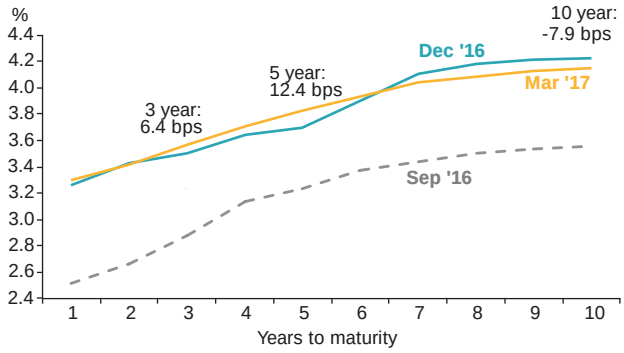
Most Major and Regional Currencies Appreciated Against the US Dollar



Source: Bank Negara Malaysia

Chart 27: Trend in MGS Yields

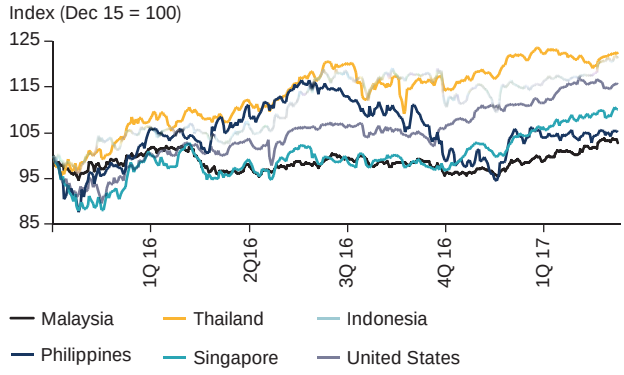
Bond Yields Remained Stable Amid Sustained Demand from Domestic Investors



Source: Bank Negara Malaysia

Chart 28: Selected Equity Indices

Gains in Domestic Equity Market in Line with Regional Trend



Source: Bloomberg

Domestic monetary and financial conditions remained supportive of economic activity

Overall domestic monetary and financial conditions remained supportive of economic activity during the period. Bond yields remained stable due to the support from domestic institutional investors that contained the impact of non-resident outflows. Liquidity conditions continued to remain sufficient while stable retail funding costs continued to provide support to private sector financing.

The cost of fund raising in the bond market remained stable despite non-resident outflows

During the quarter, non-resident holdings of government bonds fell by RM34.3 billion (4Q 2016: -RM18.3 billion). The bulk of these outflows was from the Malaysian Government Securities (MGS) and occurred at the end of the quarter, partly due to MGS redemptions in March. In addition, outflows were largely from shorter-term papers attributed to the unwinding of NDF positions by non-resident financial institutions, coinciding with higher 3-year and 5-year MGS yields during the quarter. Despite the large non-resident outflows, strong demand from domestic institutional investors led to the decline of 7.9 basis points in the 10-year MGS yield.

Positive sentiments drove equity market returns

The domestic equity market experienced strong buying from non-resident investors during the period driven mainly by positive sentiments in global stock markets arising from external developments.

The KLCI index was also supported by buying of selected blue-chip stocks following the announcement of better-than-expected economic growth of 4.5%, stronger corporate earnings in 4Q 2016 and news of potential mergers and acquisitions. Subsequently, the FBM KLCI increased by 6.0% to close at 1,740.1 points at end-March (end-December 2016: 1,641.7 points).

Due to higher inflation, real fixed deposit rates have turned negative

Both retail and wholesale borrowing costs remained stable throughout the quarter. The 3M KLIBOR was steady, ranging between 3.42% and 3.43%. In the retail market, the weighted average base rate (BR) was also steady at 3.62% and correspondingly, the weighted average lending rates (ALR) on outstanding loans remained stable throughout the quarter (end-March: 5.20%).

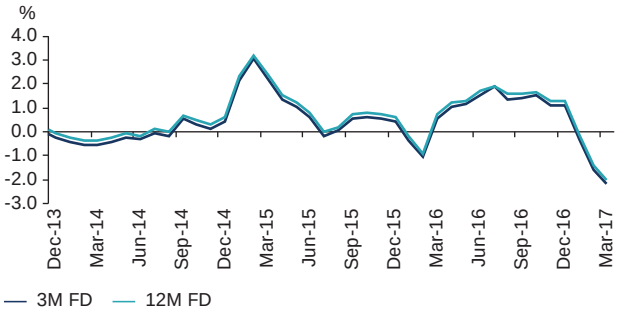
Reflecting the higher inflation, real fixed deposit (FD) rates turned negative in January and remained so throughout the quarter (end-March: real 12M FD: -2.0%; real 3M FD: -2.2%). Real weighted average lending rates (ALR) on outstanding loans have also declined (end-March: 0.1%). Nevertheless, with the currently high level of inflation expected to be transitory, the real deposit rates are estimated to turn positive towards the end of the year.

Overall liquidity conditions remained sufficient for 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 BNM moderated, reflecting continued portfolio outflows during the quarter, which did not lead to pressures in the interbank market. At the institutional level, most banks continued to maintain surplus liquidity positions.

Chart 29: Real FD Rates (by Maturity), as at End-period

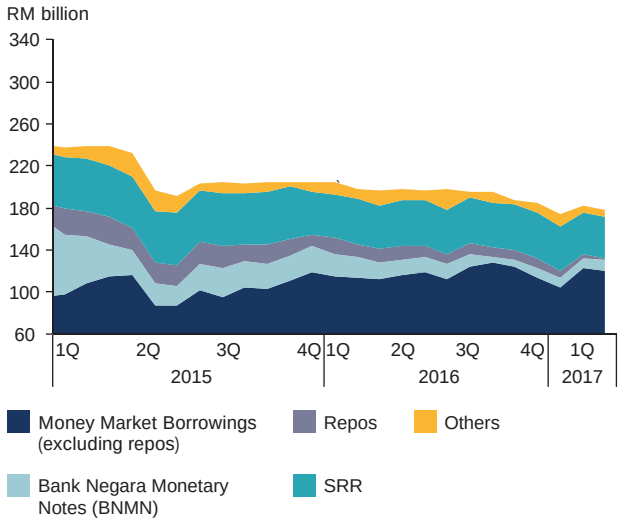
Real Deposit Rates have Turned Negative due to High Inflation



Source: Bank Negara Malaysia

Chart 30: Outstanding Ringgit Liquidity Placed with BNM, as at End-period

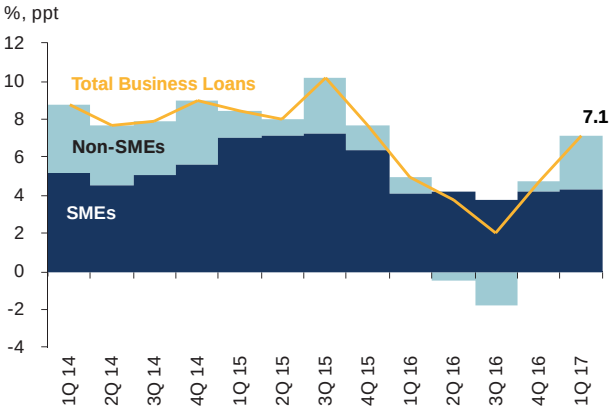
Outstanding Liquidity Placed with BNM Moderated in the First Quarter



Source: Bank Negara Malaysia

Chart 31: Contribution to Annual Growth of Outstanding Business Loans

Business Loan Growth Increased, Driven by Both SMEs and Non-SMEs



Source: Bank Negara Malaysia

Growth of business loans increased significantly from the last quarter

The growth of net financing increased to 6.8% in 1Q 2017 (4Q 2016: 5.5%) driven by both the growth in loans extended by the banking system and development financial institutions (DFIs) (1Q 2017: 6.0%; 4Q 2016: 5.3%), and the growth of net outstanding issuances of corporate bonds (1Q 2017: 9.3%; 4Q 2016: 6.1%).

Given healthy supply conditions with continued loan disbursements to all segments of borrowers, higher financing activity reflected the improved demand conditions during the quarter. In particular, growth of outstanding business loans increased to 7.1% (4Q 2016: 4.8%), reflecting improvement in both SMEs and other businesses during the quarter. The growth of SME loans increased (1Q 2017: 9.2%; 4Q 2016: 9.0%), with continued expansion in loans extended to the *transport, storage and communication; manufacturing; wholesale and retail trade, and restaurants and hotels;* and *construction* sectors. The growth of outstanding household loans continued to moderate to 5.3% (4Q 2016: 5.5%) with broad-based moderation across most loan types.

Managing Risks to Financial Stability

HIGHLIGHTS

- **Growth in household debt continued to moderate, while access to financing remains available to eligible house buyers.**
- **Domestic financial market conditions remained orderly, with the support of domestic institutional investors including financial institutions.**
- **Sustained profitability of financial institutions, supported by sound asset quality and liquidity position.**

Domestic financial system remains resilient

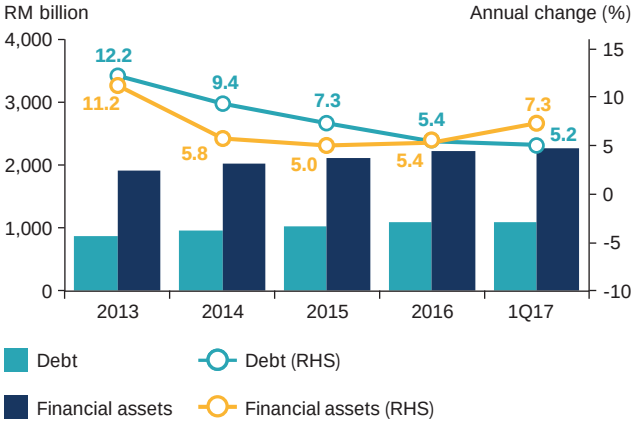
Financial stability was sustained despite global uncertainties associated with policy adjustments in some major economies. Credit conditions in the domestic banking system continue to remain conducive for businesses and households amid an economic environment that remains challenging and the higher cost of living. The asset quality and earnings of financial institutions are expected to remain intact as domestic financial intermediation activities continue to be supported by the liquidity buffers of financial institutions. In addition, domestic financial markets demonstrated sound capacity to weather challenges from the more volatile investor sentiments and global developments.

Credit risk exposures remain supported by sustained debt servicing capacity of borrowers

In the first quarter of 2017, the annual growth of household debt extended its moderating trend to 5.2% (4Q 2016: +5.4%). Demand for affordable house financing remains the main driver of the increase in household debt, with outstanding housing loans expanding annually by 8.5% (4Q 2016: +9.1%). Overall household debt repayment capacity remains sound, supported by stable labour market conditions and adequate financial buffers. Both household financial assets and liquid financial assets remained high on aggregate, accounting for 2.1 and 1.5 times of debt, respectively.

Chart 32: Household Sector Debt and Financial Assets

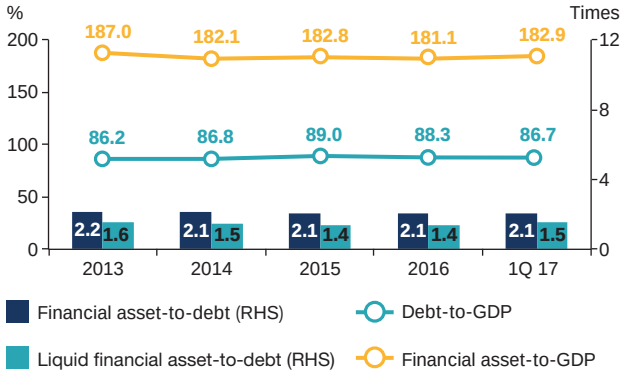
Growth in Household Financial Assets Outpaced that of Household Debt



Source: Bank Negara Malaysia, Bloomberg, Department of Statistics, Malaysia, Securities Commission Malaysia and internal computation

Chart 33: Household Sector Key Ratios

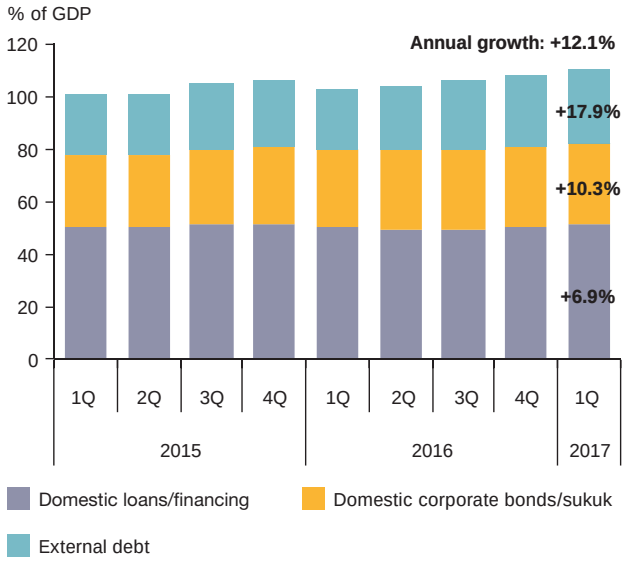
Households Maintained Aggregate Financial Assets at Two Times of Debt



Source: Bank Negara Malaysia, Bloomberg, Department of Statistics, Malaysia, Securities Commission Malaysia and internal computation

Chart 34: Business Sector NFC Debt-to-GDP

Total Business Borrowings in the Quarter was Driven by New Corporate Bond/Sukuk Issuances



Source: Bank Negara Malaysia

The quality of the household debt portfolio has remained intact with signs of further strengthening. First, affordability assessments by lenders continued to improve as about 42% of borrowers with newly approved loans have debt service ratios (computed based on income net of statutory deductions) of less than 40%. Second, the share of borrowings by vulnerable borrowers (those earning less than RM3,000 per month) reduced further to account for 21.9% (4Q 2016: 22.2%) of total bank and non-bank lending to households. Third, the sensitivity of this group to changes in interest rates is to a certain degree buffered as close to half of their total borrowings are in the form of fixed-rate financing. These developments contributed towards sustaining the low and stable levels of delinquent and impaired loans ratios of 1.3% and1.6%, respectively (4Q 2016: 1.5% and 1.6%, respectively).

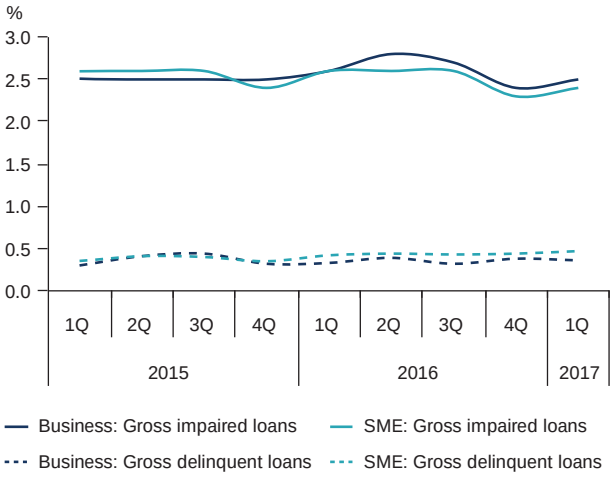
Credit conditions remained conducive with limited evidence of broad-based tightening in the supply of financing to businesses. In the first quarter, total business borrowings grew annually by 12.1% (4Q 2016: +8.6%). This was driven by new fund raising in the corporate bond and sukuk markets, which expanded by 10.3% (4Q 2016: +7.3%), mainly in the oil and gas (O&G) and real estate activities sectors. External borrowings were also higher due to new borrowings and exchange rate valuation effects. Outstanding bank financing to businesses was driven by higher disbursements to the manufacturing, retail and transportation sectors. Total financing by banks and development financial institutions to SMEs also maintained a robust annual growth of 9.2% (4Q 2016: +9.0%).

Financial health of firms remained intact. The aggregate leverage of Malaysian non-financial corporations[5], as measured by the median debt-to-equity ratio, remained stable at 43.5% at the end of the fourth quarter of 2016. This was supported by satisfactory debt servicing capacity and liquidity positions. On aggregate, the median interest coverage ratio (ICR) remained significantly above the prudent threshold of two times, at 11.8 times (3Q 2016: 10.5 times). The strengthened debt servicing capacity was driven by the export-oriented sectors on the back of a recovery in commodity prices. The aggregate median cash-to-short-term debt (CASTD) ratio also remained stable at 1.2 times. These factors contributed to support the low and stable levels of delinquent and impaired business loans, although higher delinquencies continued to be observed among players in the civil engineering, post and telecommunications sectors.

O&G companies are expected to record better earnings from the second half of 2017 onwards. This will largely stem from anticipated higher average prices and improvements in rig utilisation. These developments have contributed to improvements in the median ICR of the sector to 28.2 times (3Q 2016: 12.4 times), while the median CASTD ratio remained satisfactory at 2.4 times (3Q 2016: 2.9 times). The impaired and delinquent loan ratios were at 4.3% (4Q 2016: 4.1%) and 0.1% (4Q 2016: 0.3%), respectively. Risks to the banking system remain limited as exposures to the sector only account for about 5% of total exposures to businesses.

Chart 35: Business Sector Gross Impaired Loans and Gross Delinquent Loans

Overall Banking System Business Loans Portfolio Remains Sound

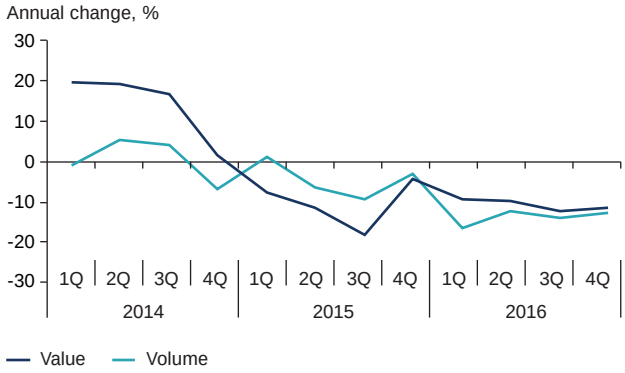


Source: Bank Negara Malaysia

[5] Based on 120 listed firms on Bursa Malaysia FBM KLCI with 85% market capitalisation (excluding financial institutions).

Chart 36: Property Sector Annual Change of Transaction Volume and Value

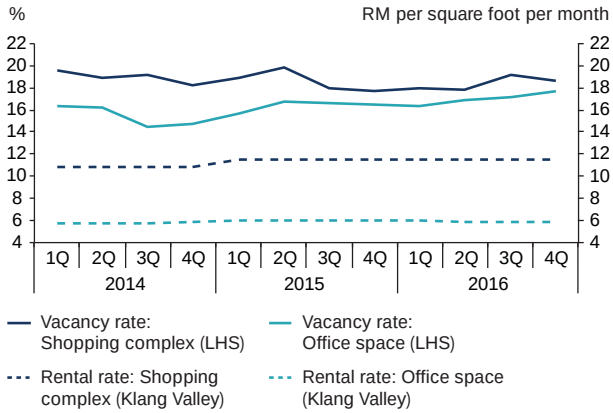
Housing Transactions Declined Further Both in Terms of Volume and Value



Source: National Property Information Centre

Chart 37: Property Sector Vacancy and Rental Rates

Vacancy and Rental Rates of Office Space and Shopping Complex Remained Depressed



Source: National Property Information Centre, Knight Frank, Jones Lang Wootton and internal computation

House prices in Malaysia continued to grow at a more moderate pace of about 7% during third quarter of 2016, while the preliminary growth figure for the Malaysian House Price Index was 5.5% for the final quarter. This was driven by gradual price adjustments in the higher-end segments. Correspondingly, total primary and secondary housing transactions declined further both in terms of volume and value. Demand for affordable housing remains strong, with about 60% of new housing loan approvals for the purchase of houses priced below RM500,000. Housing loan approval rates remain high at 74.2% (4Q 2016: 75.2%). The ongoing rebalancing of supply is expected to improve overall housing affordability, particularly for first-time buyers.

Risks of slower house price growth on bank exposures to the housing segment are assessed to be limited. About 72% of housing loan borrowers constituted first-time buyers of houses priced below RM500,000. Overall, about 84% of housing loan borrowers only have one outstanding housing loan. Such borrowers have strong incentives to maintain loan repayments in the event of financial stress or negative equity on their homes, compared to investment buyers. Speculative activity in the housing market remained subdued. The annual growth in the number of borrowers with three or more outstanding housing loans (a proxy for speculative buyers) remained stable at 1.4% (4Q 2016: +1.4%). The number of housing loans settled within three years (the typical duration required to complete construction after a property is acquired) - another indication of speculative purchases - eased to 9.2% (4Q 2016: 11.9%) of total settled housing loans.

Oversupply remains a concern in the office space and shopping complex segments. Vacancy and rental rates of these segments remained depressed in the final quarter of 2016, partly reflecting softer tenant demand and consolidation of some retailers. The glut in the commercial property segment may lead to deeper imbalances in the property market with spillovers to the other parts of the economy. Direct risks to banks from end-financing exposures to the office space and shopping complex segments remained small at 3.4% of total bank loans, supported by sound lending and valuation practices. The delinquency and impairment ratios for these exposures remained low at 0.8% and 1.1%, respectively (4Q 2016: 0.7% and 1%, respectively).

Box Article 2

Debunking the Myth: Property Measures Have Led to Higher Loan Rejection Rates

Author: Lim Le Sze

HIGHLIGHTS

- **The overall housing loan approval rate remains high at 74.2% in 1Q 2017.**
- **First-time house buyers continue to have access to financing.**
- **Rental as an alternative option to house-ownership.**

Myth 1: Housing loan rejection rates are as high as 60%

The overall housing loan approval rate remains high at 74.2%[1] (average 2012-2016: 74.1%). The approval rate is the ratio of the number of housing loan applications approved[2] by all banks in Malaysia to the number of housing loan applications received by the banks during the same period. In 1Q 2017, banks approved a total of RM22.3 billion of house financing to 90,137 borrowers. Of these, more than half was for buyers of affordable housing units priced below RM500,000.

Generally, housing loan applications were rejected if the borrower was already highly leveraged with weak credit history and had insufficient documentation to support ability to repay loan obligation.

Myth 2: First-time buyers are unable to obtain housing loans because of the impositions of macroprudential measures

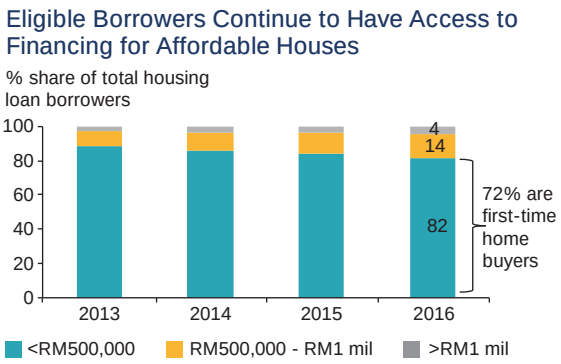
The measures introduced by the Bank since 2010 were for two specific purposes: (i) curb excessive speculative activity in the housing market; and (ii) deter over-borrowing. The maximum loan-to-value ratio (LTV) of 70% introduced in 2010 is imposed only on borrowers with three or more outstanding housing loans. Therefore, this measure does not affect eligible first-time house buyers, who typically qualify for an LTV of up to 95% (including Mortgage Reducing/Decreasing Term Assurance). In fact, it improves the chances of first-time buyers getting a loan as it shifts financial institutions' focus away from the speculators. In 2016, about 72% of housing loan borrowers are first-time buyers of homes priced below RM500,000 (Chart 1).

The maximum housing loan tenure of 35 years is more than sufficient for borrowers to settle their loans by retirement. Increasing the housing loan tenure will further add to the total cost of financing and also would not significantly improve one's debt service ratio. To illustrate this point, assuming the tenure for a housing loan of RM500,000 is increased from 35 to 40 years, the total cost of financing will increase by 17.4% or RM97,428 while the monthly instalment will only reduce by 4.4% or RM112 (Chart 2).

[1] This ratio is derived based on monthly data submissions from banks to Bank Negara Malaysia. The Bank notes that other sources have quoted different estimates based on broad surveys extended to a limited sample of developers.
[2] Regardless of whether it is accepted or subsequently cancelled by the applicant.

Developer interest bearing schemes (DIBS) are similar to adjustable rate mortgages, one of the key causes of the subprime mortgage crisis. These schemes should not be allowed as they encourage excessive speculative activity in the property market and cause artificial increases in house prices. Property valuers indicated that the price difference between houses with DIBS and without DIBS can be as high as 30%. Homebuyers generally were unaware of this fact due to lack of transparency and non-disclosure of material information.

Chart 1: Housing Loan Borrowers by House Price Range



Source: Bank Negara Malaysia and internal computation

Table 1: Comparison Table for Different Loan Tenures

Increasing Loan Tenure Will Further Add to the Total Financing Cost

	Loan tenure of 35 years	Loan tenure of 40 years	Difference
Loan amount (RM)	500,000	500,000	
Financing rate (%)	5	5	
Monthly instalment (RM)	2,523	2,411	112
Total cost of financing (RM)	559,844	657,272	**97,428**
Difference in total cost			17.40%

Source: Internal computation

Myth 3: Roof over one's head = Need to own a house

Buying and owning a house is a long-term commitment and represents a significant financial obligation for an individual. Rigorous financial planning and the availability of sound financial buffers against unexpected events are critical. To illustrate this point, the table below shows the monthly obligation associated with the purchase of a house priced at RM300,000. For a household earning RM5,000 a month, there is very little amount of money left for savings or emergencies after deducting the monthly instalment for the housing loan and monthly household expenditures.

Table 2: Illustration on Residual Income

Owning a Home is a Significant Commitment

	RM
Assumed household monthly income	**5,000**
Net monthly income after statutory deductions	**4,272**
Housing loan (RM300, 000) monthly instalment*	1,283
Household monthly expenditures**	2,946
Residual monthly income for savings and emergencies	**43**

*Based on 35-year loan tenure, loan-to-value ratio of 90% and lending rate of 5%
**Based on Household Expenditure Survey 2014 (Department of Statistics Malaysia)

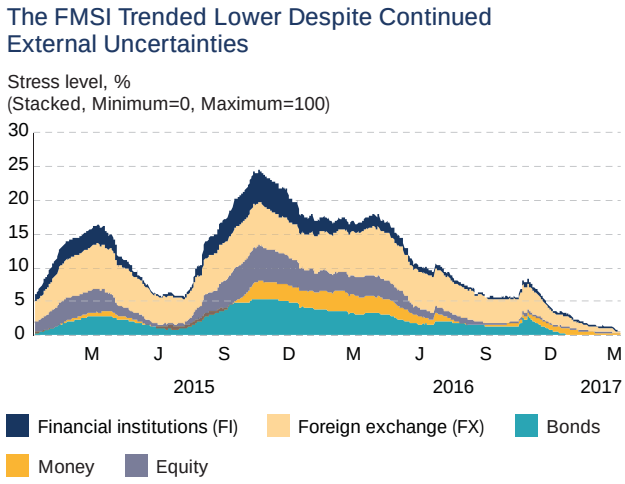
Measures to promote responsible lending and borrowing are intended to deter borrowers from incurring debts that could lead to financial hardship. It minimises the risk of borrowers having to carry an excessive debt burden, and losing their homes to foreclosure if they are unable to service the debt.

Domestic financial market conditions remained orderly

Investor sentiment continues to be affected by policy developments in the US, uncertainty surrounding the pace and timing of the US Federal Reserve interest rate normalisation, on-going volatility in the commodities market and heightened geopolitical risks. Despite these external developments, overall stress in the domestic financial markets trended downwards during the quarter, as seen in the Financial Market Stress Index (FMSI)[6].

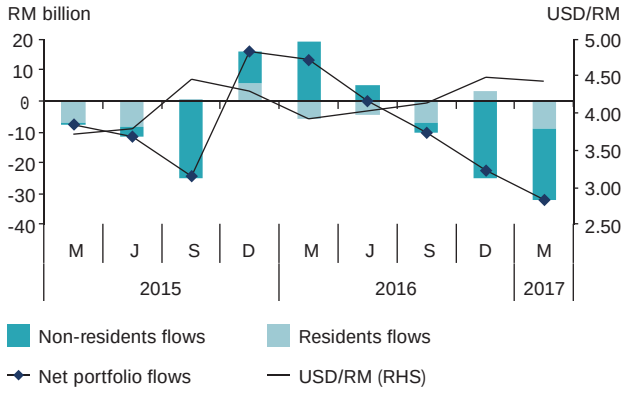
Domestic financial market conditions remained orderly despite larger net portfolio investment outflows of RM31.9 billion (4Q 2016: net outflows of RM22.3 billion). This was partly attributable to non-resident outflows from shorter term bonds (with maturity of less than three years) following external developments and the unwinding of non-deliverable forward position by non-resident financial institutions. The quarter also saw the maturity of two Malaysian Government Securities (MGS) in February and March, of which RM11.5 billion was held by foreign investors as at end-2016. Non-resident holdings in the equities market were sustained at 22.4% (4Q 2016: 22.3%) of total market capitalisation. The FBM KLCI rallied with global equity markets to end higher at 1740.09 points (4Q 2016: 1641.73 points).

Chart 38: Financial Market Stress Index (FMSI)



Source: Bloomberg and internal computation

Chart 39: Financial Market Net and Gross Portfolio Flows and Ringgit Exchange Rate Movement

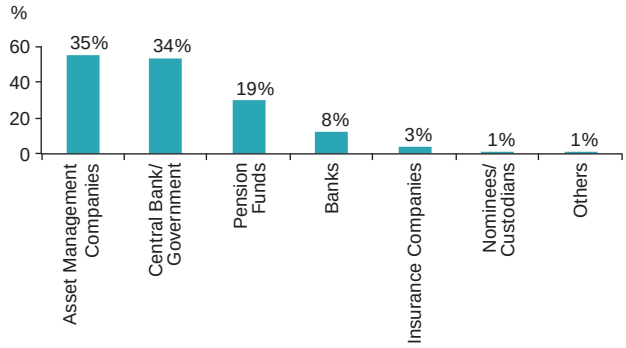


Source: Department of Statistics, Malaysia

[6] The FMSI is a risk monitoring tool for the financial market that is developed based on the European Central Bank's (ECB) Composite Indicators of Stress Index (CISS). It is constructed from indicators of volatility in five components of the domestic financial markets - the foreign exchange (FX), equity, bond, money markets and financial institutions (FIs). The stress level at a specific date is expressed as a value between 0 and 100, which signifies the lowest to highest stress level.

Chart 40: Distribution of Non-resident Holdings of Government Bonds as at end-March 2017

Diversified Non-resident Investor Base with Majority Held by Long-term Investors



Source: Bank Negara Malaysia

As at end of the quarter, non-resident investor holdings amounted to 24.7% (4Q 2016: 30.6%) of total outstanding public debt securities, decreasing from its peak of 34.7% recorded in November 2016. Long-term investors, such as pension funds, insurance companies, governments and central banks, and asset managers, accounted for more than 90% of these holdings. However, on an aggregate basis, risk exposure to a single non-resident investor is well diversified as none of the non-resident investors accounted for more than 0.75%, while the top 50 non-resident investors only hold 10.6% of the total outstanding bonds. A more diversified investor base would provide more balanced two-way flow given their varied investment needs.

In addition, domestic institutional investors continue to have the capacity to absorb selling by non-residents. Trading liquidity in the capital markets were sustained with the monthly turnover ratio for MGS increasing to 14.1% (4Q 2016: 11.8%), while the turnover ratio for FBM KLCI edged higher to 2.1% (4Q 2016: 1.9%). The bid-ask spreads were unchanged at 0.4% and 0.2% of mid-price for FBM KLCI and MGS, respectively.

In the currency market, the ringgit appreciated by 1.3% against the US dollar to end the quarter at RM4.4265 per US dollar (4Q 2016: RM4.4860). As at end of the quarter, the 5-year cross-currency basis swap spread and the 5-year sovereign credit default swap spread had narrowed to 50 basis points (bps) and 107.6 bps, respectively (4Q 2016: 68 bps and 137.8 bps, respectively).

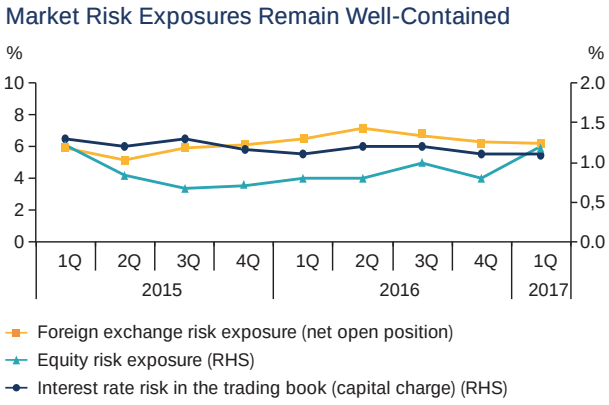
Market risk exposures supported by risk management and hedging strategies

Banks' exposures to market risks remain largely in the form of foreign exchange (FX) risk. At end-March 2017, FX net open position of banks stood at 6.2% (4Q 2016: 6.3%) of total capital, as banks continued to actively manage FX exposures amid ringgit volatility. Exposures to interest rate risk in the trading book remained low at 1.1% while equity risk rose to 1.2% of total capital, respectively (4Q 2016: 1.1% and 0.8%, respectively). For the insurance and takaful industry, market risk exposures were higher at 14.4% (4Q 2016: 13.3%) of total capital available, driven by increase in equity risk amidst new purchases by a few large insurers. Equity risk, which forms the bulk of insurers' market risk exposures, rose to 8.7% (4Q 2016: 7.8%) of total capital available.

Sound profitability and sustained liquidity position of financial institutions

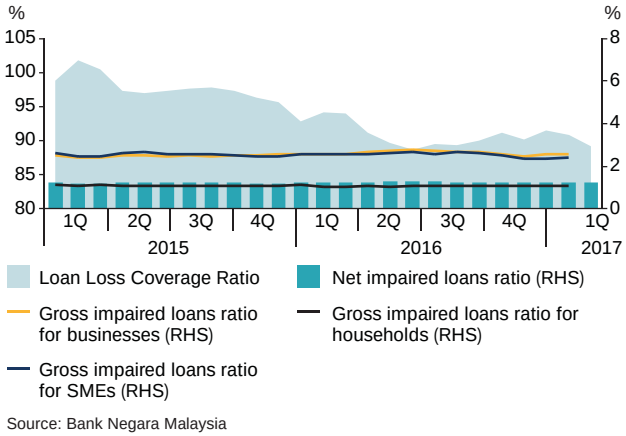
Pre-tax profit of the banking system amounted to RM8 billion (4Q 2016: RM7.7 billion) in the first quarter, driven by higher net interest income from lending/financing activities and stronger fee-based income. Lower loan loss provisions were recorded, supported by sound asset quality. Notwithstanding this, financing (including interest) margin net of operating costs and loss provisions remained stable at 0.60 percentage points (ppts) (4Q 2016: 0.62 ppts). In the insurance and takaful sector, general insurers and takaful operators recorded lower operating profit of RM491.1 million in the first quarter of 2017 (4Q 2016: RM890.8 million), on account of higher claims particularly in the motor and marine, aviation and transit (MAT) businesses. On the contrary, life insurers and family takaful operators recorded a significant increase in profitability with excess income over outgo rising to RM6.1 billion (4Q 2016: RM0.7 billion). This was largely attributed to improved net capital gains from both bond and equity holdings, in line with the improved valuations in the financial markets.

Chart 41: Banking System Equity, Foreign Exchange and Interest Rate Risks (% of Total Capital)



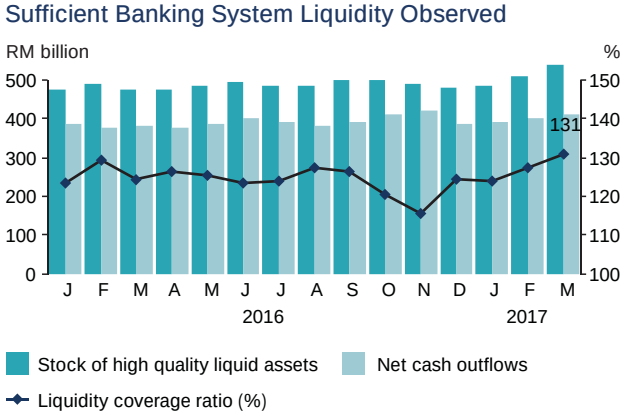
Source: Bank Negara Malaysia

Chart 42: Banking System Loan Quality



Source: Bank Negara Malaysia

Chart 43: Banking System Basel III Liquidity Coverage Ratio



Source: Bank Negara Malaysia

Liquidity in the banking system remains sufficient to support intermediation activities. Total banking system placements, reverse repos and statutory reserves with Bank Negara Malaysia which can be unwound to meet liquidity needs, stood at RM166.8 billion. The banking system Basel III Liquidity Coverage Ratio (LCR)[7] stood at 131% as at end-March 2017, well above the current transitional minimum regulatory requirement of 80% (4Q 2016: 124%). More than 90% of banks recorded LCR levels above 100%.

Domestic funding conditions remained stable during the quarter. Average cost of deposits for banks declined marginally by 4 bps to 2.55% while the 3-month KLIBOR was stable at 3.43%, respectively (4Q 2016: 2.60% and 3.41%, respectively). Banks' funding structure remained stable and predominantly deposit-based (69% of total funding) and in local currency. On aggregate, banking system deposits recorded a higher growth of 3.3% (4Q 2016: +1.5%). Household and business sector deposits continued to grow at a rate of 5.7% and 2.8%, respectively (4Q 2016: +5.1% and -2.3%, respectively).

While the bulk of banks' funding remained in the form of deposits, banks continued to diversify their funding structure through the issuance of medium-term ringgit and foreign currency denominated funding instruments. The total net issuance of debt securities for 1Q 2017 amounted to RM12.6 billion (4Q 2016: RM4.8 billion). This contributed towards further reducing maturity and currency mismatches in the banks' funding structures. Taking into account the broadened funding structure, the loan-to-funds ratio[8] (LTF) stood at 82.8% (4Q 2016: 84.3%) at the end of the quarter.

[7] The Basel III LCR has been phased in since June 2015, with initial compliance set at 60% and progressive increments of 10% each year until 100% with effect from 2019. As of 1 January 2017, the minimum requirement is set at 80%.

[8] Funds comprise deposits and all debt instruments issued (including subordinated debt, debt certificates/sukuk, commercial papers and structured notes).

Improved accessibility to financial services

The Bank actively pursues the financial inclusion agenda along four key dimensions, namely convenient access, high take-up, responsible usage and high satisfaction. In recent years, financial inclusion in Malaysia has advanced significantly, driven by an expansion in financial access points nationwide. All 144 districts and 97% (2011: 46%) of the 886 sub-districts now have at least one financial access point, enabling 99% of Malaysians to conveniently tap safe, reliable and affordable financial services. This achievement can be mainly attributed to the agent banking initiative (Table 11).

Moving forward, the Bank is leveraging on geo-spatial mapping analytics to better visualise and monitor the distribution of financial access points. The geo-spatial mapping tool generates maps via satellite imaging and includes relevant information on financial access points, population density, economic activity, road network and surface conditions. The analytics are expected to unlock significant benefits including:

- More granular assessment on the effectiveness of financial access points, by taking into account relevant geographical and socioeconomic information. This supports the development of sound branching and product delivery strategies.
- More robust assessment on the impact of disasters on SMEs operations, which will improve the responsiveness of operational and policy interventions (e.g. delivery of assistance funds).
- Ability to provide better information to consumers on the nearest financial access points.

The Bank's Policy Consideration

HIGHLIGHTS

- **At the current level of the OPR, the stance of monetary policy is accommodative and supportive of economic activity.**
- **Current macroprudential and other measures to manage financial imbalances in the household sector and property market remain adequate, as associated risks are largely contained.**

The MPC maintained the OPR at 3.00%

At the January and March Monetary Policy Committee (MPC) meetings, the MPC maintained the Overnight Policy Rate (OPR) at 3.00%. At the most recent meeting in May, the MPC also maintained the OPR at 3.00%. At this level of the OPR, the stance of monetary policy is accommodative and supportive of economic activity.

The Malaysian economy is expected to perform better in 2017 compared to the 4.2% growth in 2016, driven by domestic demand growth and positive contribution from the external sector. The growth in exports is expected to continue to provide support to overall growth, due in part to expectations for faster global growth. Headline inflation is also projected to be higher in 2017, reflecting primarily the pass-through impact of the increase in global oil prices on domestic retail fuel prices. The decision by the MPC to maintain the OPR was based on the assessment that the recent increase in inflation would be transitory. Monetary policy is not the appropriate tool to address cost-push inflation. Going forward, the MPC will monitor closely the degree of spillover of the higher costs to the broader price trends and overall demand conditions.

Bank's Financial Stability Committee (FSC) assessed that domestic financial stability remains preserved

During the quarter, the FSC observed that key sources of risks to domestic financial stability continue to stem from high levels of domestic debt, elevated property prices in some segments of residential property and an oversupply of commercial property, and persistent volatility in financial markets. The FSC assessed that risks associated with household debt and corporate sector leverage are largely contained and current macroprudential and other measures are adequate. Credit conditions and supply remain conducive to economic needs. The FSC opines that increased vigilance is required over commercial property developments, loan performance in some business segments and lending activities of non-bank financial institutions.

Given the anticipated persistent volatility in global financial markets and investor sentiments, the Bank will further assess the impact of foreign participation in the local bond markets on domestic financial stability. In April 2017, the Financial Markets Committee, together with the Bank, also announced a number of initiatives to promote a fair and effective financial market, improve bond market liquidity, ease hedging activities and enhance market transparency. In the coming quarters, the Bank will continue to monitor the progress and assess the potential effects of the removal of tariffs for all existing motor products (except motor third party products), and the transition towards mandatory PIN verification for payment cards, both of which come into effect from 1 July 2017.

Macroeconomic Outlook

HIGHLIGHTS

- **Global growth to expand at a faster pace in 2017, supported by improvements in both advanced and emerging market economies.**
- **The Malaysian economy on track to register higher growth in 2017.**
- **Inflation may have peaked in the first quarter, outlook remains contingent upon movements in oil prices.**

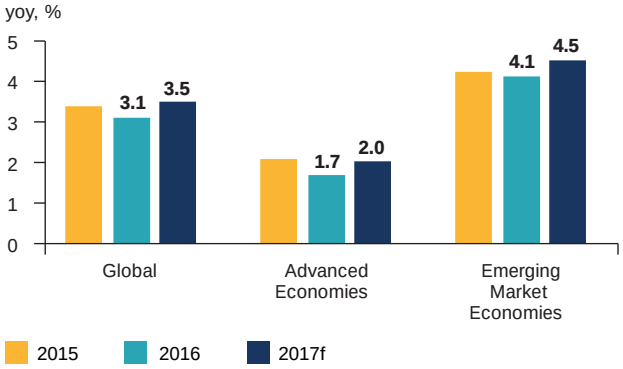
Global growth to expand at a faster pace, supported by improvements across regions

Global growth enters the year 2017 on a stronger footing with positive economic data releases across regions. In the advanced economies, private consumption continues to support domestic activity amid improvement in the labour market conditions and recovery in household wealth. Recent data suggests a more favourable outlook for investment compared to 2016, which will translate into stronger global trade. Growth in the emerging market economies is benefiting from the recovery in commodity prices as external demand improves. This outlook is reinforced by sustained domestic demand against a supportive policy environment. Against this backdrop, global growth is expected to expand at a faster pace in 2017.

Despite these developments, the balance of risks to global growth remain tilted to the downside. Of immediate concern are the developments in Europe which are generating policy uncertainties, as indicated by the higher reading in the economic policy uncertainty index in the first quarter. The short-term impact is likely to be felt more in the financial markets. However, over a longer term, changes in financing conditions will affect real economic activity. The threat of protectionism and negative developments in the prices of key commodities are also risk factors that the Bank is monitoring.

Chart 44: Real GDP Growth

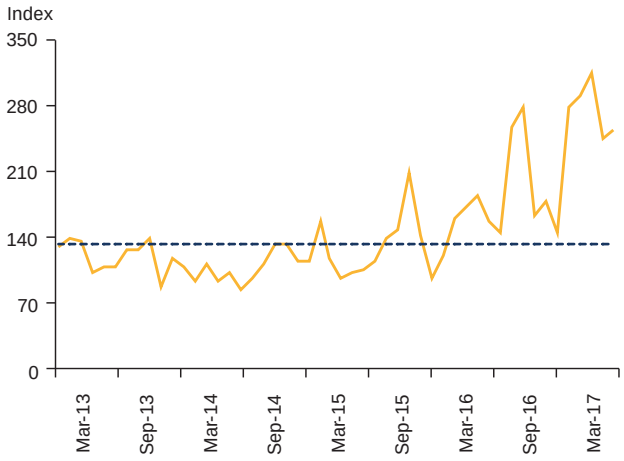
Growth Improvements Projected Across Regions in 2017



Source: International Monetary Fund

Chart 45: Global Economic Policy Uncertainty Index

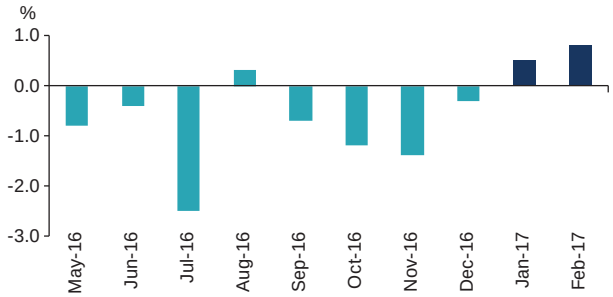
Heightened Global Economic Policy Uncertainty



Source: Baker, Bloom and Davis

Chart 46: Composite Leading Index

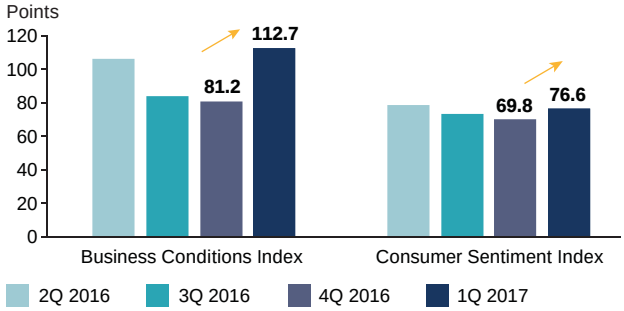
Leading Indicator Points to Continued Expansion in the Domestic Economy



Source: Department of Statistics, Malaysia

Chart 47: MIER Business Conditions and Consumer Sentiment Indices

Sentiment Indicators Improved in 1Q 2017



Source: Malaysian Institute of Economic Research

The Malaysian economy on track to register higher growth in 2017

The Malaysian economy continued to expand in the first quarter of 2017, driven mainly by domestic demand activity. Looking ahead, leading indicators such as the Department of Statistics Malaysia's composite leading index, MIER Business Conditions Index and MIER Consumer Sentiments Index, point to continued expansion of the domestic economy. Private consumption will be sustained by continued wage and employment growth, with additional lift coming from various policy measures to raise disposable income. Investment activity is projected to expand, driven mainly by the implementation of new and ongoing projects in the manufacturing and services sectors. The stabilisation of commodity prices is also expected to lend support to investment activity in the mining sector. On the external front, exports are expected to benefit from the improvement in global growth, especially among Malaysia's key trading partners. Overall, the economy remains on track to expand as projected in 2017.

On the supply side, the improvement in external trade will benefit the export-oriented industries in the manufacturing and services sectors, particularly the E&E industry and trade-related services. The agriculture sector will continue to recover as CPO yields improve post-El Niño. Growth in the mining sector is projected to be supported by output from the ramping up of production in new oil and gas facilities. In the construction sector, new and existing civil engineering projects will drive the sector going forward.

Inflation expected to moderate from second quarter onwards

Inflation increased to 4.3% in the 1Q 2017 driven by higher costs, but is expected to moderate in the second quarter onwards. However, compared to the forecast at the beginning of the year, the upside risks to global oil prices have increased given the rising geopolitical tensions in the Middle East and the possibilities of an extension to OPEC's output cut agreement. While the impact of these developments on global oil prices remain limited at this juncture, if they persist, inflation could average higher than forecasted.

1 Feature Article

Central Banking and Inequality: The Current State of the Conversation

Authors: Zul-Fadzli Abu Bakar and Ho Sui-Jade

HIGHLIGHTS

- **Monetary policy has a short-run and possibly medium-run impact on inequality. In the long run, the distributional impact is not clear.**
- **Incorporating inequality into policy deliberations may help achieve a more effective monetary policy.**

Introduction

For a long period, "benign neglect" characterised the attitude that central bankers displayed towards inequality (Monnin, 2014). Traditionally, the mandates of central banks and inequality are considered to be independent of each other.

However, since 2011, frequent statements have been made that seem to suggest that a rethinking of monetary stance on inequality may be needed (Monnin, 2014)[1]. For example, in October 2014, Yves Mersch, a member of the European Central Bank (ECB) Executive Board, asserted that "all economic policy-makers have some distributional impact as a result of the measures they introduce – yet until recently, such consequences have been largely ignored in the theory and practice of monetary policy." Figure 1 provides a timeline of milestones that may explain the recent popularity of inequality among central bankers.

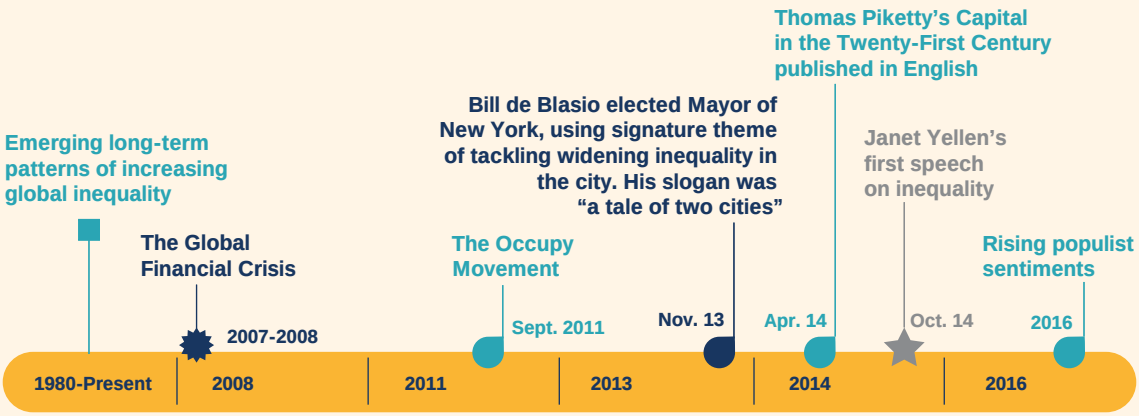
Building on the work by Monnin (2014), this article reviews selected studies and statements by officials of three major central banks – the Fed, the Bank of England (BOE) and the ECB – on the interaction between central banks and inequality. The findings can be summarised into the following three questions[2]:

- Does monetary policy influence inequality?
- Should central bankers consider inequality in their monetary policy deliberations?
- How can a central bank address inequality?

[1] Ibid. Note: Among major central banks, statements about inequality are especially more frequent after Janet Yellen, at a conference organised by the Boston Fed in October 2014, spoke about inequality. It marked her first speech as chairwoman focused exclusively on inequality. Nevertheless, she did not make any links between this issue and monetary policy.

[2] These questions are adapted from ones discussed in Monnin (2014).

Figure 1: Factors contributing to the rising popularity of inequality



1) Most central bankers acknowledge that monetary policy has a short-run and possibly medium-run impact on inequality. The long-run effect, however, is subject to debate.

The mechanism in which monetary policy affects inequality depends on several factors; namely the current distribution of assets between the rich and the poor; and the responsiveness of households and firms towards changes in the monetary policy stance.

In an environment of loose monetary policy and rising inflation, a low interest rate environment will benefit net borrowers while reducing the rate of returns on savings. As such, the short term impact could be to widen the income gap if the rich are net borrowers while the poor are net savers. Furthermore, if loose monetary policy fuels asset prices, the rich who tend to own more assets than the poor and middle classes, would also disproportionately gain from higher asset prices. Over the medium-term, however, an accommodative stance will lead to a reduction in unemployment. If labour market outcomes (wages and employment prospects) become relatively more favourable for the poor, then income inequality may narrow.

In the long run, things are less clear. Would the above distributional effects cancel each other out, such that there is no long-run distributional impact of monetary policy? Or, would they reinforce each other, in which case, monetary policy is responsible for the rising long-term trend in inequality. Below are selected statements made by representatives of major central banks and the IMF on this issue:

Bank of England (2014 and 2016)

- Over the shorter term, central bank policies can affect inequality; for example through extraordinary monetary accommodation which has boosted asset prices and exacerbated inequality.
- However, the tools at the disposal of central banks; i.e. interest rates, money supply, regulations cannot reshape the long-term structural trends in the economy.

ECB (2016)

- Over the medium-term, monetary policy reduces unemployment, which benefits poorer households the most. A faster return to full employment should, in turn, contribute to lower future inequality.

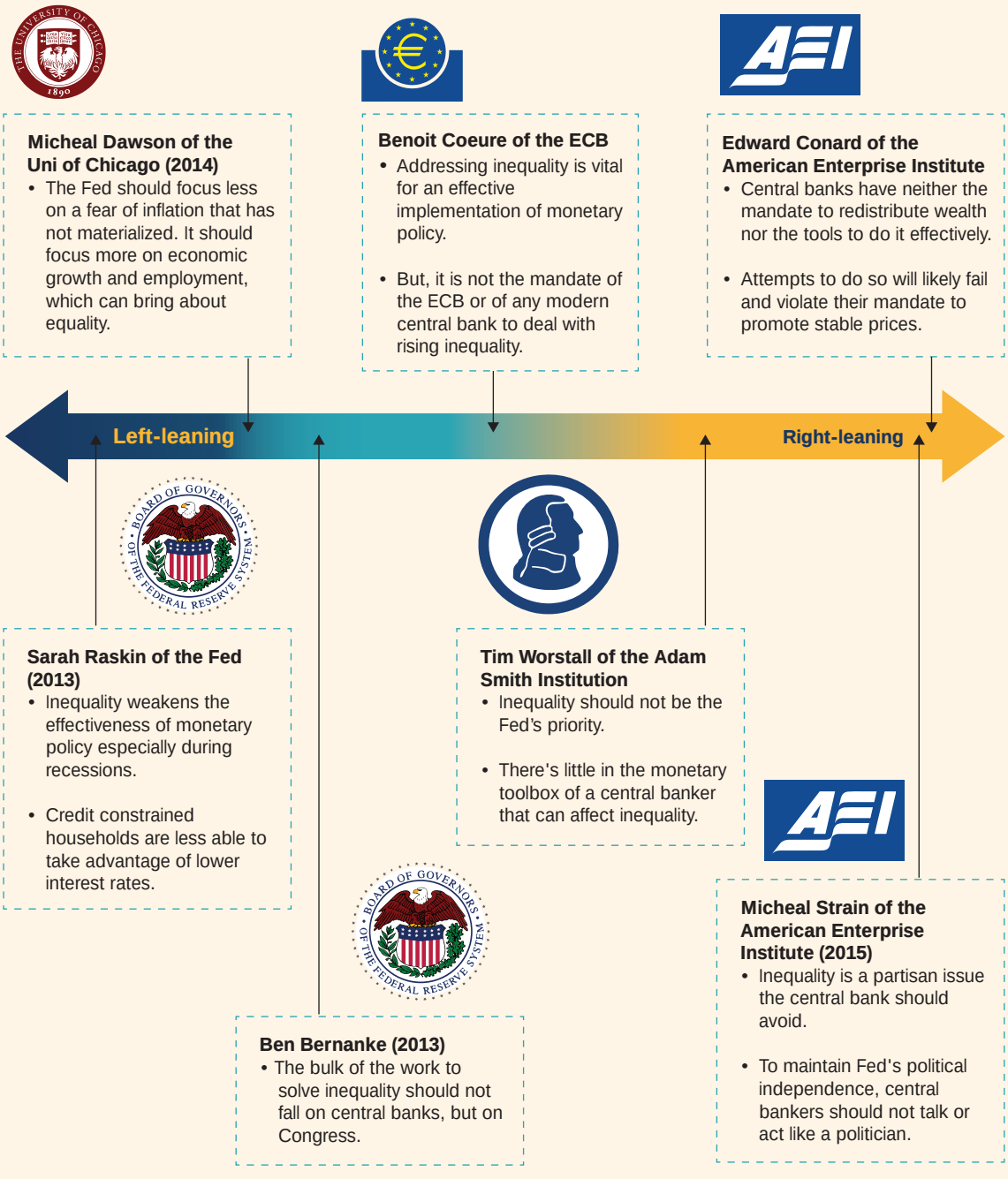
The IMF (2012)

- Monetary policy shocks play a significant role in cyclical fluctuations in inequality, but cannot account for the increasing trend in income inequality.

2) Incorporating inequality into policy deliberations is generally agreed to help achieve a more effective monetary policy. Incorporating inequality into a central bank's mandate however, is perceived as radical.

Figure 2 shows the views of select policy-makers and scholars along their partisan lines. Left-leaning policy-makers and scholars have advocated for greater scrutiny of inequality in monetary policy deliberations. Those on the right have preferred for central banks to focus on its traditional mandates. There is a general agreement that inequality dampens the transmission of monetary policy. Despite this, there is a broad sense of reluctance for the existing mandates of central banks to be revised to include an additional goal of curbing inequality.

Figure 2: Statements on whether inequality should be considered in monetary policy deliberations across political spectrum



3) Central banks have limited tools (e.g. regulatory policies) which are at best indirect, incidental and transient in redistributing wealth. But, as long as achieving their traditional mandates is not compromised, they could consider the distributive effects of their policies.



Janet Yellen (2017)

- Monetary policy cannot boost real GDP growth over the longer run or address the root causes of income inequality.
- But, the Fed still has a vital role to play in addressing issues around economic opportunity and inclusive growth.

BROOKINGS

Brookings Institution (2015)

- Monetary policy is blunt and its distributive effects are not clear. But this should not prevent the Fed from pursuing its mandate to achieve maximum employment and price stability, thereby providing broad benefits to the economy.



Joseph Stiglitz (2014)

- Central banks should be bolder in their regulatory role to help tackle inequality. For example, they can work towards preventing abusive credit card practices, usurious interest rates, and predatory and discriminatory lending, which are especially costly to the poor.



Fontan et al (2016)

- Central banks could address inequality in two ways:
  - o Using distributive concerns as tie-breakers. If a central bank can choose between two policies that perform equally well with respect to its mandates, it should choose the more equitable policy.
  - o Revising the existing mandates of central banks to include a permanent objective of curbing inequality.

Bank Negara Malaysia has been mindful of the implications of policy on inequality and its distributional consequences on various segments of the economy. In this regard, the Bank has ensured that the mandate on financial inclusion remains on track. In addition, the Bank has carried out specific research on affordable housing and the impact of debt on inequality to get a better grasp of the issues faced by the households. Granular data analysis, for example on the distribution of wealth by age groups and income groups, is used extensively to deepen understanding on the distributional impact of monetary policy.

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2 Feature Article

The Sharing Economy – Harnessing the Value of Idle Assets

Author: Ang Jian Wei

HIGHLIGHTS

- The 'sharing economy' is a system that reduces asset or resource underutilisation for monetary or non-monetary benefits.
- Malaysia ought to embrace the sharing economy but with appropriate safeguards.
- Clear and coherent policy stance is important for a vibrant sharing economy industry.

Introduction

The sharing economy has disrupted many traditional means of doing business and will grow further in prominence. Its rapid development has drawn both sharp critics and strong supporters alike. By 2015, there were already 17 sharing economy firms globally with valuations of more than USD1 billion. This is impressive since many of these companies were only formed during the Global Financial Crisis[1]. The sharing economy's global revenue is projected to grow from USD15 billion in 2015 to USD335 billion in 2025[2]. If harnessed correctly, the use of technology to better unlock the value of idle assets can improve economic efficiency and provide other means for households to increase their income.

What is the sharing economy?

The 'sharing economy' is a system that reduces asset or resource underutilisation for monetary or non-monetary benefits with three major characteristics. Firstly, it is usually driven by digital platforms that match both demand and suppliers of goods and services. Secondly, it promotes access rather than a change in ownership. Thirdly, it provides other means for households and businesses to monetise their underutilised assets and resources (Figure 1). The sharing economy typically spans the transportation (e.g. ride-sharing), space (e.g. accommodation), goods and the intangibles (e.g. skills, time) industries (Figure 2).

New Frontier with Benefits to the Economy

Technology has helped reduce transaction costs, thus making the sharing of assets much easier, cheaper and larger in scale. This has led to new job opportunities, more efficient ways of using resources and more innovative means of doing business.

Jobs in the sharing economy can be appealing to households as some may have lower barriers to entry and flexible hours that allow them to work around their commitments. This flexibility is well suited for groups like students, working professionals or seniors that have resources that can be monetised. For example, seniors can use property assets to earn additional income. Airbnb reported that seniors are its fastest-growing host demographic, with 10% of its hosts being over the age of 60[3]. These jobs can also provide crucial support especially in tough times. Around 26% to 42% of those surveyed in the US and five European countries are engaged in independent work out of necessity[3].

[1] Owyang & VB Profiles (2015), "The Sharing Economy has Created 17 billion-dollar Companies (and 10 unicorns)"
[2] PWC, 2016, "The Sharing Economy"
[3] McKinsey Global Institute (2016), "Independent Work: Choice, Necessity, and the Gig Economy"

Figure 1: Characteristics of the Sharing Economy

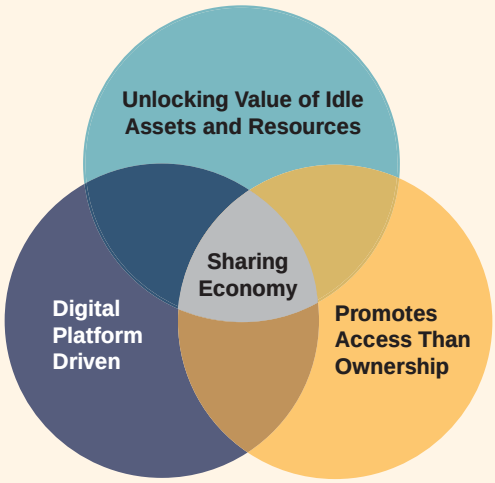
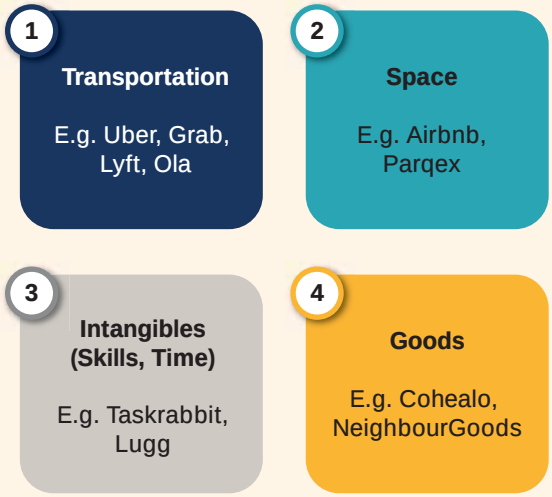


Figure 2: Main Industries Under Sharing Economy



The sharing economy can also help unlock the value of idle assets and improve economic efficiency. One example is the inefficiencies in mass private car ownership. Estimates suggest that cars, on average, are parked 95% of the time[4]. Increasing the usage of these private vehicles by integrating it with the current public transportation system (e.g. to address the last-mile challenge) can help households reduce their transportation-related spending. This concept can be further extended to other industries, be it underutilised space, time or skills.

Another positive spillover is the dynamism that sharing economy players bring to the economy through greater competition. Increasing competition from sharing economy firms has prompted many incumbents to relook into their existing business models and find more ways to bring value to their customers. Consumers also benefit from more options and lower prices. For example, Airbnb's rates are between 30 and 60 per cent cheaper than hotel rates around the world[5]. This helps drive tourism activity by appealing to budget travellers. Competition also leads to better quality services and more efficient allocation of resources.

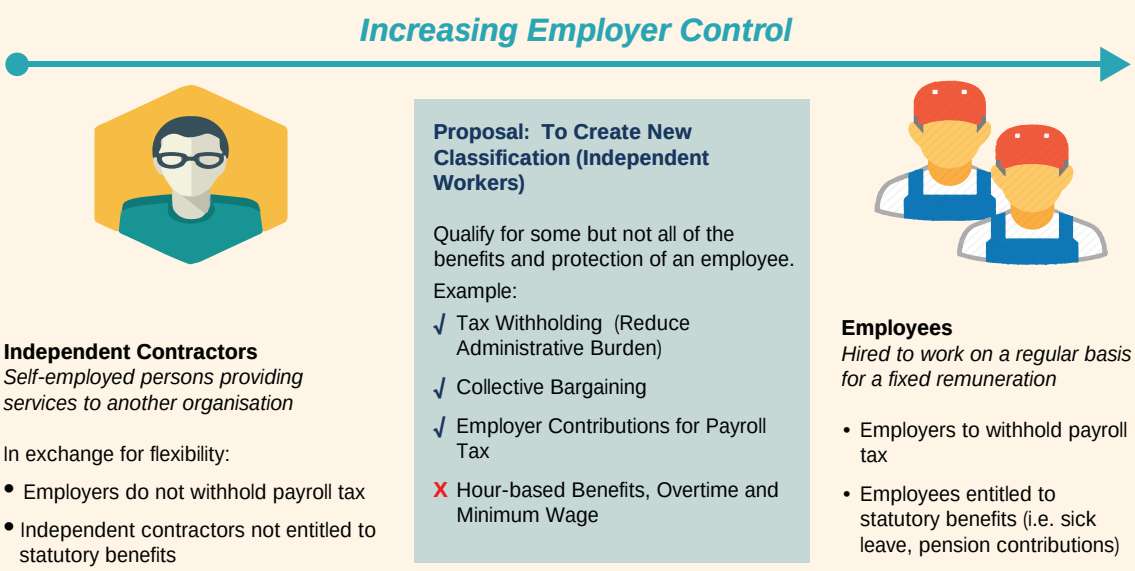
Embrace But With Appropriate Safeguards

Malaysia should embrace the sharing economy, but should be mindful of the risks that it poses.

The first risk is the dispute on the legal classification of service providers who participate in these platforms. Currently, a majority of sharing economy players are platforms matching supply and demand, with its service providers being classified as 'independent contractors' as opposed to 'employees'. Some platforms can use this as a means to shift liability responsibilities onto the providers and avoid the payment of statutory benefits[6] (e.g. paid sick leave, retirement contributions), while expecting a commitment no different than that of an employee. This has resulted in various litigations in the US and the UK. As a response, there are proposals for a new middle classification: 'independent workers'[7], where service providers will qualify for some, but not all of the benefits that employees receive (Figure 3).

[4] Barter, Paul (2013), "Cars Are Parked 95% of the Time. Let's Check!" This number originally refers to the United States, but the author did some cross country comparison and found that the numbers are also in that ballpark: Singapore (95%), UK (96.5%), Seoul (92.3%).
[5] Yaragi & Ravi (2016), "The Current and Future State of the Sharing Economy."
[6] Honor, Michelle (2016), "The Uncertainty of Worker Misclassification in the Sharing Economy"
[7] Harris & Krueger (2015), "A Proposal for Modernizing Labor Laws for Twenty-First-Century Work: The Independent Worker"

Figure 3: Classification of Workers



Another risk pertains to the welfare of both the consumers and providers of goods and services. Consumers need to have some confidence that the goods and services bought over these platforms are of a reasonable standard, and that safety will not be compromised. Likewise, providers should have some assurances that any assets shared will not be mishandled and that the payment is as agreed. In the event where expectations are not met, there should be well-established procedures for fair compensation. Timely reputational ratings will help reduce information asymmetry and have been used as a case for fewer regulations. However, they are also exposed to risks of collusion and reciprocity.

There is also a concern that there might be an erosion to the tax base and an unfair advantage against the incumbents should sharing economy players avoid paying their fair share of taxes. As a start, a clear taxation threshold should be set such that casual earners are not unduly penalised. This can then be complemented by raising awareness among the sharing economy participants on their tax obligations. The tax authorities in the US and Australia have taken the lead by launching a dedicated website to engage them. The sharing economy platforms should play a part in collecting tax on the Government's behalf, such as the arrangement between Amsterdam and Airbnb[8].

Policy Considerations

For the sharing economy to thrive in Malaysia, there will first need to be a clear and coherent policy stance. Positive signalling across the various industries, be it transportation or home sharing, will encourage both investments and participation by investors and the public, respectively. Given the wide-ranging issues, the Government will likely need to adopt a consolidated approach to work through the various concerns. The Government can also take this opportunity to engage sharing economy players in further enhancing the efficiency of public sector operations (e.g. running errands, survey collection). It can also explore other means to better utilise its idle assets (e.g. underutilised meeting rooms and car fleets) as adopted in the UK and Seoul.

[8] Airbnb (2014), "Airbnb to Collect Tourist Taxes in Amsterdam"

While the reaction of other policymakers towards the sharing economy remains mixed, there is a trend towards greater acceptance over time. It is a growing recognition that it is worthwhile to strike a balance such that the gains from the sharing economy are maximised, while the risks are managed accordingly. Malaysia too, should not shy away from the frontiers in the digital space. Rather, it should work towards building an edge in these new growth areas.

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Annex

Table 1:

GDP by Expenditure Components (at constant 2010 prices)

	Share 2016 (%)	2016			2017
		1Q	4Q	Year	1Q
		Annual growth (%)			
Aggregate Domestic Demand (excluding stocks)	91.6	3.4	3.2	4.3	7.7
Private sector		4.4	5.9	5.6	8.2
Consumption	*53.2*	*5.2*	*6.1*	*6.0*	*6.6*
Investment	*16.9*	*2.1*	*4.9*	*4.3*	*12.9*
Public sector		-0.2	-2.6	0.4	5.8
Consumption	*13.1*	*2.7*	*-4.2*	*0.9*	*7.5*
Investment	*8.5*	*-4.4*	*-0.4*	*-0.5*	*3.2*
Net Exports	8.4	-7.9	6.4	1.5	-14.5
Exports of Goods and Services	*70.4*	*1.0*	*2.2*	*1.1*	*9.8*
Imports of Goods and Services	*62.1*	*2.3*	*1.6*	*1.1*	*12.9*
GDP	**100.0**	**4.1**	**4.5**	**4.2**	**5.6**
GDP (q-o-q growth, seasonally adjusted)	**-**	**0.8**	**1.3**	**-**	**1.8**

Source: Department of Statistics, Malaysia

Table 2:

GDP by Economic Activity (at constant 2010 prices)

Annual growth (%)	Share 2016 (%)	2016			2017
		1Q	4Q	Year	1Q
Services	54.3	5.1	5.5	5.6	5.8
Manufacturing	23.0	4.6	4.7	4.4	5.6
Mining	8.8	-1.2	5.0	2.2	1.6
Agriculture	8.1	-3.8	-2.5	-5.1	8.3
Construction	4.5	8.0	5.1	7.4	6.5
Real GDP	**100.0**[1]	**4.1**	**4.5**	**4.2**	**5.6**

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

Source: Department of Statistics, Malaysia

Table 3:

Trade Account

	Share 2016 (%)	2016			2017
		1Q	4Q	Year	1Q
		Annual growth (%)			
Gross Exports	**100.0**	**2.3**	**2.8**	**1.1**	**21.4**
Manufactured	82.2	6.5	3.4	3.2	19.5
E&E	*36.6*	*3.6*	*7.7*	*3.5*	*18.4*
Non-E&E	*45.5*	*8.8*	*0.1*	*3.0*	*20.3*
Resource based	*22.9*	*1.7*	*5.6*	*3.3*	*30.1*
Non-resource based	*22.7*	*16.2*	*-5.2*	*2.7*	*11.3*
Commodities	17.1	-13.4	-0.9	-8.6	27.5
Agriculture	*9.0*	*6.6*	*14.1*	*4.7*	*29.6*
Minerals	*8.2*	*-25.9*	*-12.8*	*-19.8*	*25.5*
Gross Imports	**100.0**	**-0.4**	**5.0**	**1.9**	**27.7**
Intermediate goods	57.1	-3.2	3.8	-0.1	27.8
Capital goods	14.4	-12.7	6.7	4.9	42.0
Consumption goods	9.6	24.6	-0.2	7.3	4.0
Re-exports and dual-use goods	18.9	8.8	10.4	3.2	29.5
Trade balance (RM billion)	**-**	**23.9**	**27.5**	**87.3**	**18.9**

Source: MATRADE and Department of Statistics, Malaysia

Table 4:

Malaysia's Direction of Exports

	Share 2016 (%)	2016			2017
		1Q	4Q	Year	1Q
		Annual change (%)			
European Union (EU)	**10.2**	**7.9**	**1.0**	**1.2**	**22.2**
Japan	**8.1**	**-16.1**	**-13.2**	**-12.9**	**18.1**
United States	**10.2**	**13.1**	**2.3**	**8.9**	**11.9**
ASEAN[1]	**29.4**	**6.5**	**6.1**	**5.4**	**23.9**
North East Asia	**22.9**	**-1.8**	**5.6**	**-3.2**	**23.9**
People's Republic of China	*12.5*	*1.3*	*12.3*	*-2.9*	*39.9*
Hong Kong SAR	*4.8*	*-3.2*	*10.4*	*2.1*	*10.0*
Korea	*2.9*	*-6.5*	*-7.8*	*-7.6*	*-1.4*
Chinese Taipei	*2.7*	*5.2*	*-13.5*	*-8.0*	*12.3*
West Asia[2]	**2.9**	**3.0**	**11.4**	**3.0**	**6.9**
India	**4.1**	**3.0**	**1.1**	**1.1**	**13.8**
Total exports	**100.0**	**2.3**	**2.8**	**1.1**	**21.4**

[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

Table 5:

Balance of Payments[1]

	2016[r]			2017[p]
	1Q	4Q	Year	1Q
	RM billion			
Current Account	6.2	12.5	29.0	5.3
(% of GNI)	2.2	3.9	2.4	1.7
Goods	23.3	31.2	101.4	25.3
Services	-5.7	-5.4	-19.1	-6.2
Primary income	-6.4	-9.2	-34.6	-9.9
Secondary income	-4.9	-4.1	-18.6	-3.9
Financial Account	**7.8**	**-14.2**	**-1.1**	**-8.8**
Direct investment	3.8	1.0	14.1	8.3
Assets	*-11.4*	*-15.1*	*-42.1*	-2.7
Liabilities	*15.2*	*16.1*	*56.2*	10.9
Portfolio investment	14.1	-19.1	-15.4	-31.9
Assets	*-5.9*	*2.7*	*-15.0*	-9.0
Liabilities	*20.0*	*-21.8*	*-0.4*	-22.9
Financial derivatives	0.5	-1.2	-0.8	0.6
Other investment	-10.7	5.0	1.0	14.2
Errors & omissions[2]	-41.6	20.7	-13.2	1.7
Overall Balance	**-27.6**	**19.0**	**14.8**	**-1.8**

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 on gains/losses made on international reserves
[r] Revised
[p] Preliminary

Source: Department of Statistics, Malaysia

Table 6:

Outstanding External Debt

	2016		2017
	end-Mar	end-Dec	end-Mar
	RM billion		
Total External Debt	**814.1**	**916.1**	**897.0**
USD billion equivalent	*204.9*	*202.3*	*200.8*
By instrument			
Bond and notes[1]	146.9	169.1	172.4
Interbank borrowing[1]	150.7	171.0	211.6
Intercompany loans[1]	97.3	137.5	136.8
Loans[1]	49.2	53.8	35.9
NR holdings of domestic debt securities	223.9	214.2	178.0
NR deposits	78.8	86.2	77.8
Others[2]	67.3	84.3	84.6
Maturity profile			
Medium and long-term	486.0	539.1	492.4
Short-term	328.1	377.0	404.6
Currency denomination			
Ringgit	319.8	311.4	272.2
Foreign	494.3	604.7	624.9
Total debt/GDP (%)	66.2	74.5	68.4
Short-term debt/Total debt (%)	40.3	41.2	45.1
Reserves/Short-term debt (times)	1.2	1.1	1.1[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 28 April 2017.
Note: NR refers to non-residents

Source: Ministry of Finance and Bank Negara Malaysia

Table 7:

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

	2016			2017	2016			2017
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q
	During the period (RM billion)				Annual growth (%)			
Net total financing	**11.5**	**37.7**	**114.0**	**38.7**	**7.5**	**5.5**	**5.5**	**6.8**
Outstanding loans*[1]	4.6	40.4	84.1	15.4	6.3	5.3	5.3	6.0
Of which:								
Business enterprises	-4.9	21.8	28.0	8.9	4.9	4.8	4.8	7.1
SMEs	*2.9*	*8.6*	*24.6*	*3.8*	*9.0*	*9.0*	*9.0*	*9.2*
Non-SMEs	*-7.8*	*13.2*	*3.4*	*5.0*	*1.4*	*1.1*	*1.1*	*5.3*
Households	8.5	16.1	49.2	7.9	6.5	5.5	5.5	5.3
Outstanding Corporate Bond	7.0	-2.7	29.9	23.3	11.4	6.1	6.1	9.3

* Include loans sold to Cagamas
[1] Banking system and Development Financial Institution (DFIs)
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Table 8:

Loan Indicators

	2016			2017	2016			2017
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q
	During the period (RM billion)				Annual growth (%)			
Total								
Loan applications[1]	187.6	198.6	802.8	197.4	5.1	-7.9	-3.0	5.2
Loan approvals[1]	76.8	93.1	346.9	87.3	-18.3	-7.1	-11.8	13.8
Loan disbursements[2]	271.8	296.2	1,102.3	291.7	-1.2	0.8	-1.9	7.3
Loan repayments[2]	275.8	279.2	1,078.4	289.6	3.4	0.9	1.7	5.0
Of which:								
Business enterprises[3]								
Loan applications	87.7	92.4	376.8	86.4	11.8	-14.1	-5.0	-1.6
Loan approvals	35.8	46.4	165.9	40.9	-10.2	-5.3	-7.8	14.2
Loan disbursements	195.9	217.8	796.0	213.3	1.4	2.7	-1.1	8.9
Loan repayments	201.0	206.7	786.2	210.6	3.2	0.4	1.1	4.8
SMEs								
Loan applications	41.0	46.4	182.7	41.2	-3.3	11.5	-1.9	0.5
Loan approvals	14.2	19.1	66.9	13.9	-10.9	28.0	3.1	-1.9
Loan disbursements	62.4	72.1	267.6	71.7	-8.1	3.2	-2.1	14.9
Loan repayments	61.8	69.2	265.9	70.9	0.9	2.5	3.0	14.8
Non-SMEs[3]								
Loan applications	46.8	46.1	194.1	45.2	29.7	-30.2	-7.8	-3.4
Loan approvals	21.7	27.3	99.1	27.0	-9.7	-19.8	-13.9	24.8
Loan disbursements	133.5	145.7	528.4	141.5	6.6	2.4	-0.6	6.0
Loan repayments	139.2	137.4	520.3	139.7	4.3	-0.5	0.1	0.3
Households								
Loan applications	99.9	106.2	426.0	111.1	-0.2	-1.7	-1.0	11.2
Loan approvals	41.0	46.7	181.0	46.4	-24.3	-8.9	-15.2	13.3
Loan disbursements	75.9	78.3	306.4	78.4	-7.4	-4.2	-3.8	3.3
Loan repayments	74.8	72.5	292.2	78.9	3.7	2.4	3.5	5.6

* The annual growth is for end-period
[1] Loan applications and approvals for all segments include only banking system loans
[2] Loan disbursements and repayments for all segments includes banking system and development financial institutions (DFIs)
[3] Includes domestic non-bank financial institutions, domestic financial institutions, government, domestic other entities and foreign entities
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Table 9:

Banking System Profitability Indicators

	2016				2017
	1Q	2Q	3Q	4Q	1Q
Return on equity (%)	12.4	13.1	12.8	12.5	11.8
Return on assets (%)	1.3	1.4	1.4	1.3	1.3
	RM million				
Net interest income	10,625	10,601	10,658	11,591	11,330
Add: Fee-based income	2,433	2,237	2,181	2,588	2,540
Less: Operating cost[24]	7,278	7,335	7,290	7,706	7,625
Gross operating profit	5,780	5,502	5,550	6,473	6,246
Less: Impairment[25] and other provisions	817	740	450	743	304
Gross operating profit after provision	4,963	4,762	5,100	5,730	5,943
Add: Other income	2,740	4,133	2,849	1,961	2,022
Pre-tax profit	**7,704**	**8,895**	**7,949**	**7,691**	**7,965**
	Annual growth (%)				
Return on equity *(percentage points)*	-0.7	3.4	1.2	1.1	-4.3
Return on assets *(percentage points)*	4.2	8.6	9.0	5.7	-1.6
Net interest income	3.6	2.3	-0.2	6.6	6.6
Add: Fee-based income	-5.0	-11.4	1.2	6.0	4.4
Less: Operating cost	0.4	-2.5	0.0	-8.0	4.8
Gross operating profit	3.8	2.6	0.1	30.9	8.1
Less: Impairment and other provisions	23.2	96.2	-69.0	89.7	-62.8
Gross operating profit after provision	1.1	-4.5	24.7	25.8	19.7
Add: Other income	28.0	66.6	-11.3	-25.3	-26.2
Pre-tax profit	**9.3**	**19.1**	**8.9**	**7.1**	**3.4**

[24] Refers to staff cost and overheads
[25] Refers to individual and collective impairment provisions in accordance with the Policy Document on Classification and Impairment Provisions for Loans / Financing

Source: Bank Negara Malaysia

Table 10:

Insurance and Takaful Sector Indicators

	2016				2017
	1Q	2Q	3Q	4Q	1Q
	RM million				
Life Insurance & Family Takaful					
Excess of Income Over Outgo	4,624	2,629	5,348	658	6,132
General Insurance & General Takaful					
Operating profit	*777*	*852*	*885*	*891*	*491*
Claims ratio (%)	*54*	*56*	*56*	*57*	*63*
	Annual growth (%)				
Life Insurance & Family Takaful					
Excess of Income Over Outgo	*-13.3*	*42.5*	*1382.0*	*-87.5*	32.6
General Insurance & General Takaful					
Operating profit	*-0.6*	*24.9*	*59.6*	*31.3*	*-36.8*
Claims ratio (percentage points)	*3.7*	*-8.4*	*-9.1*	*-4.0*	*9.0*

Source: Bank Negara Malaysia

Table 11:

Summary Statistics on Agent Banking

	End-2011	End-2016
Sub-districts served (mukim)	46.4%	97.4%
No. of agents	460	7,984
Agent banking transactions (value)	RM0.4 billion	RM8.5 billion
Agent banking transactions (volume)	3.1 million transactions	100.3 million transactions

Source: Bank Negara Malaysia

Table 12:

Federal Government Finance[p]

	2016			2017
	1Q	4Q	Year	1Q
	RM billion			
Revenue	48.8	59.8	212.4	46.6
% annual growth	*-5.3*	*6.8*	*-3.0*	*-4.4*
Operating expenditure	57.4	50.0	210.2	57.6
% annual growth	*3.5*	*-13.0*	*-3.1*	*0.3*
Current account	**-8.6**	**9.8**	**2.2**	**-10.9**
% of GDP	**-3.0**	**3.0**	**0.2**	**-3.4**
Net development expenditure	*9.2*	*13.7*	*40.6*	*9.3*
% annual growth	*16.1*	*-11.5*	*3.5*	*1.7*
Overall balance	***-17.7***	***-3.8***	***-38.4***	***-20.2***
% of GDP	***-6.1***	***-1.2***	***-3.1***	***-6.2***
Memo:				
Total net expenditure	66.5	63.7	250.8	66.9
% annual growth	*5.1*	*-12.7*	*-2.1*	*0.5*
Total Federal Government debt[1] (as at end-period)	626.9	648.5	648.5	664.5
% of GDP	*51.0*	*52.7*	*52.7*	*50.2*
Domestic Debt	416.7	435.6	435.6	486.9
% of GDP	33.9	35.4	35.4	36.8
External Debt	210.2	212.9	212.9	177.6
% of GDP	*17.1*	*17.3*	*17.3*	*13.4*
Non-resident holdings of RM-denominated Federal Government debt	*190.2*	*191.8*	*191.8*	*156.7*
% of GDP	*15.5*	*15.6*	*15.6*	*11.8*
Offshore borrowing	*19.9*	*21.1*	*21.1*	*20.9*
% of GDP	*1.6*	*1.7*	*1.7*	*1.6*

[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 2010.

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia