Developments in the Malaysian Economy

HIGHLIGHTS

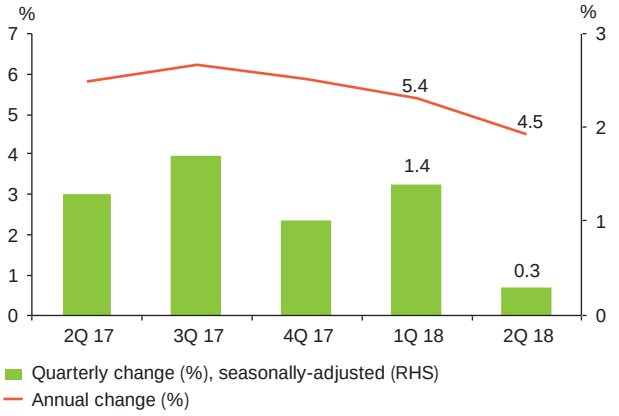
- The Malaysian economy expanded by 4.5% in the second quarter.
- Headline inflation declined to 1.3%.
- Current account surplus narrowed to 1.2% of GNI.

The Malaysian economy registered a growth of 4.5%

The Malaysian economy expanded at a slower pace of 4.5% in the second quarter of 2018 (1Q 2018: 5.4%). Growth was slower on account of supply disruptions in the mining sector and lower agriculture production. The latter is due to supply constraints and adverse weather conditions. On the demand side, growth was dampened by lower public investment and net export growth. Private sector spending remained resilient, expanding further by 7.5% (1Q 2018: 5.2%). In particular, private consumption increased strongly by 8.0% (1Q 2018: 6.9%). On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 0.3% (1Q 2018: 1.4%).

Continued growth in 2Q 2018, albeit at a slower pace

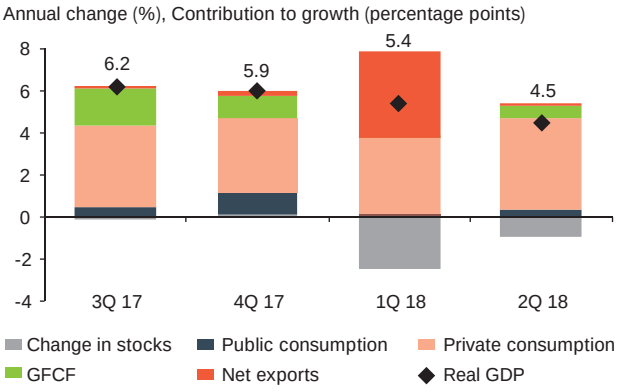
Chart 4: GDP Growth



Source: Department of Statistics, Malaysia

Private sector demand remained the key driver of growth

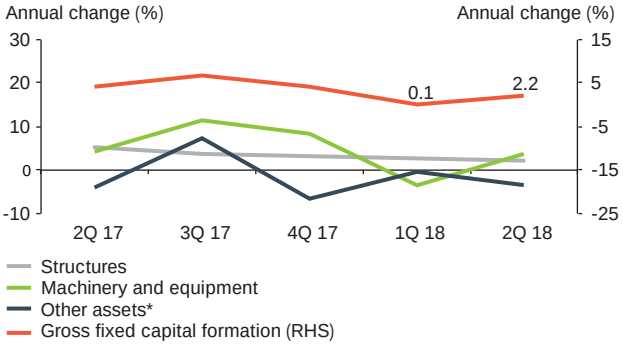
Chart 5: Contribution of Expenditure Components to GDP Growth



Source: Department of Statistics, Malaysia

Continued expansion in gross fixed capital formation

Chart 6: GFCF Growth by Type of Assets



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

Source: Department of Statistics, Malaysia

Domestic demand driven by the private sector

Domestic demand recorded a stronger growth of 5.6% (1Q 2018: 4.1%), as the higher private sector activity (7.5%; 1Q 2018: 5.2%) more than offset the decline in public sector spending (-1.4%; 1Q 2018: -0.1%).

Private consumption expanded at a stronger pace of 8.0% (1Q 2018: 6.9%), the highest since the first quarter of 2015. This was driven by continued strength in income and employment. Consumer spending was also boosted by the lower inflation during the quarter following the zerorisation of the Goods and Services Tax (GST) rate[1] and stronger consumer sentiments.

Private investment growth was higher at 6.1% (1Q 2018: 0.5%), driven mainly by capital spending in the manufacturing and services sectors. The better performance was supported by positive business sentiments, favourable demand conditions and continued high capacity utilisation during the quarter.

Public consumption registered a higher growth of 3.1% (1Q 2018: 0.4%), supported by improvement in supplies and services and sustained growth in emoluments.

Public investment continued to contract during the quarter (-9.8%; 1Q 2018: -1.0%). This was in part due to the near completion of ongoing projects and lower Federal Government development expenditure.

Growth in gross fixed capital formation (GFCF) improved to 2.2% (1Q 2018: 0.1%), attributed to higher private sector investment activity. By type of assets, capital spending on machinery and equipment rebounded to 3.6% (1Q 2018: -3.6%). Investment in structures expanded at a slower pace of 2.1% (1Q 2018: 2.8%), due mainly to a slower expansion in investments in non-residential property such as office and retail space. Investment in other types of assets contracted by 2.9% (1Q 2018: -0.2%).

[1] The reduction in the GST rate from 6% to 0% beginning 1 June 2018

Continued expansion in major economic sectors

On the supply side, growth was affected by commodity-specific shocks. Major economic sectors, notably the services and manufacturing sectors (77.5% of GDP), remained supportive of growth.

Growth in the mining sector contracted, due mainly to declining natural gas output following unplanned supply outages. The agriculture sector's growth declined as the oil palm sub-sector was affected by production constraints and adverse weather conditions.

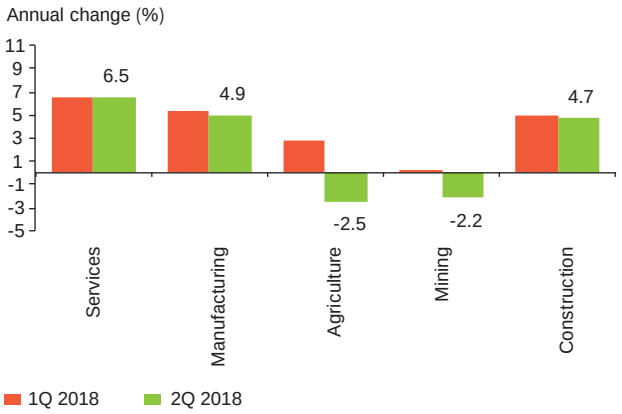
Growth in the services sector was sustained during the quarter, driven primarily by the wholesale and retail trade sub-sector arising from increased household spending following the zerorisation of the GST rate. Growth was further supported by the information and communication sub-sector, following continued strong demand for data communication services. Growth in the finance and insurance sub-sector was driven by continued strength in lending activity.

The manufacturing sector grew at a more moderate pace supported by continued strength in the electronics and electrical (E&E), consumer- and construction-related clusters. This can be attributed to the continued demand from fast growing semiconductor segments (e.g. automotive and Internet of Things (IoT)), and the zerorisation of the GST rate. These gains partly offset the slower performance in the primary-related cluster which was affected by the commodity-specific shocks upstream.

Growth in the construction sector continued to moderate in the second quarter. In the civil engineering sub-sector, growth was supported by the ongoing transportation, petrochemical and power plant projects. In the residential and non-residential sub-sectors, growth continued to decline. The development partly reflected the significant number of unsold residential properties and oversupply of office spaces and shopping complexes.

Other economic sectors continued to expand despite weak growth in the commodity sectors

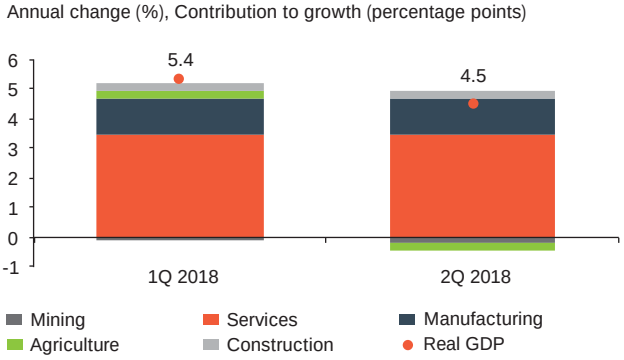
Chart 7: Growth by Sector



Source: Department of Statistics, Malaysia

Services and manufacturing sectors remained the key drivers of growth

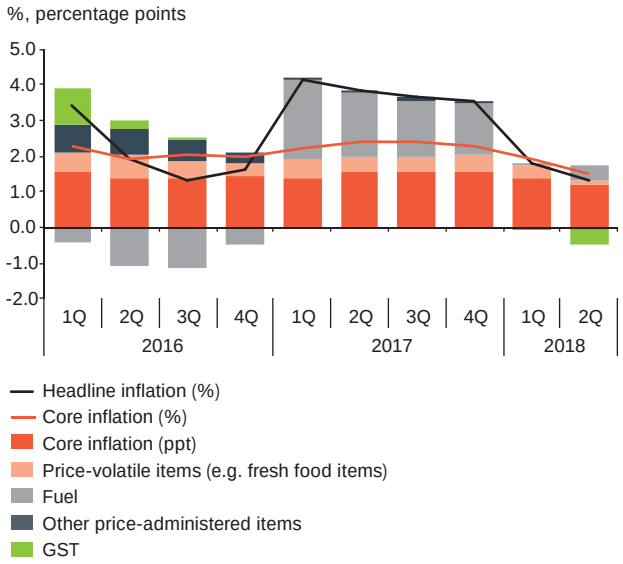
Chart 8: Contributions to Real GDP by Economic Sector



Source: Department of Statistics, Malaysia

The contribution from the zerorisation of the GST rate was offset by higher transport inflation

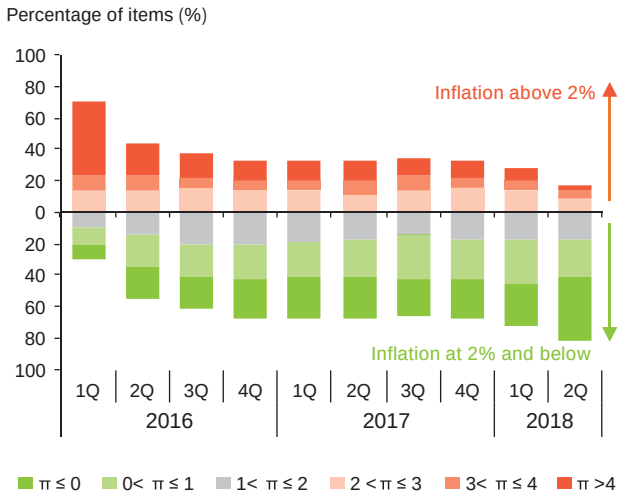
Chart 9: Contribution to Headline Inflation by Component



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

Inflation pervasiveness declined in 2Q 2018

Chart 10: Inflation Pervasiveness



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

Lower inflation during the quarter mainly reflected the zerorisation of the GST rate

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), declined to 1.3% in the second quarter of 2018 (1Q 2018: 1.8%).

The lower inflation outcome mainly reflected the zerorisation of the GST rate. As a result, inflation declined to 0.8% in June (May: 1.8%, April: 1.4%). The decline in prices was broad-based where more than 90% of the items that were previously taxed at the standard-rate under the GST were observed to register price declines ranging between 0.06% and 6.75%. As a result, the percentage of items in the CPI basket that registered inflation of more than 2% declined to 18% in the second quarter (1Q 2018: 28%). However, the extent of price decline in June was smaller than anticipated. Prices of standard-rated items in the CPI basket only declined by an average of 2.3%.

The impact from the GST zerorisation, however, was offset by higher transport inflation. While the domestic RON95 petrol price was maintained at RM2.20 per litre since 22 March 2018, the lower prices in the base period of the second quarter of 2017 resulted in higher inflation in the ***transport category***[2]. Nevertheless, the fixed RON95 petrol price has helped to contain further increases in fuel inflation during the quarter.

Core inflation, excluding the impact of the GST zerorisation, also moderated during the quarter to 1.5% (1Q 2018: 1.9%). This was mainly due to lower inflation in the ***food away from home*** sub-category, contributed by the stronger ringgit exchange rate in the first half of 2018 relative to the second half of 2017. Demand-driven inflation remained stable.

[2] RON95 petrol price averaged RM2.10 per litre in the second quarter of 2017.

Supportive labour market conditions

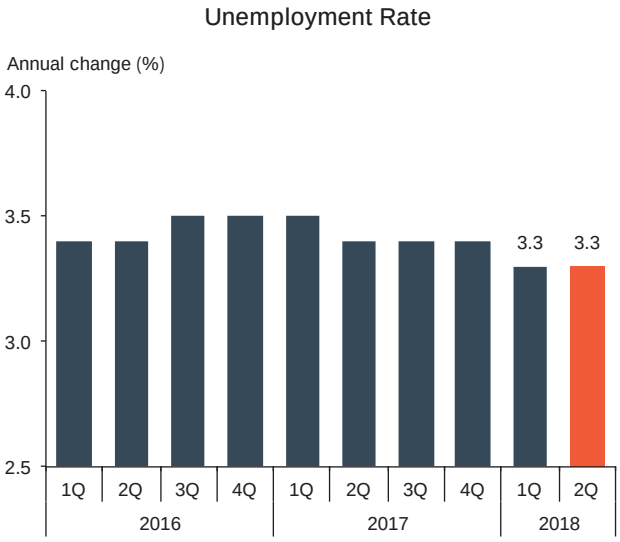
Labour market conditions in the second quarter of 2018 remained supportive of growth. Labour force expansion continued to match net employment gains, resulting in an unchanged unemployment rate at 3.3% (1Q 2018: 3.3%). Employment conditions in the quarter registered stronger growth of 2.4% (1Q 2018: 2.3%).

In the financial sector[4], there was a net employment gain of 1,412 jobs to 165,628 employed persons (1Q 2018: 164,216 persons). This mainly reflected the increase in high-skilled occupations (+ 1,762 persons).

Private sector wage growth moderated to 5.7% (1Q 2018: 6.6%). Manufacturing wage growth moderated to 10.1% from a strong growth of 13.9% in the first quarter of 2018. On the other hand, the services sector recorded an improvement of 3.7% (1Q 2018: 3.5%) in wage growth, supported by the wholesale and retail trade, and professional services sub-sectors.

Sustained unemployment rate

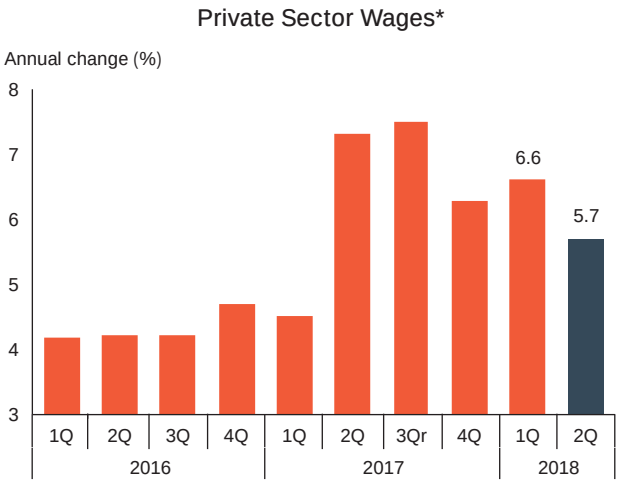
Chart 11: Unemployment rate



Source: Department of Statisitcs, Malaysia (DOSM)

Moderation in private sector wage growth

Chart 12: Private sector wages



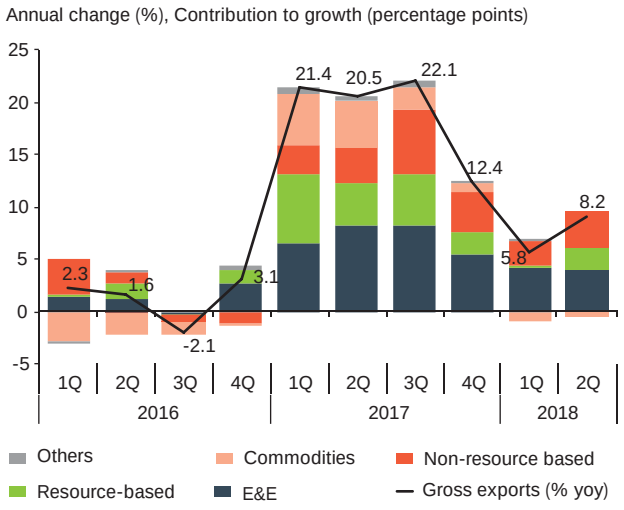
* Private sector wages is derived from the salaries and wages data published in the Monthly Manufacturing Statistics and Quarterly Services Statistics by the Department of Statistics, Malaysia (DOSM). It covers 64% of total employment.

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

[3] Covers only the banking institutions, development financial institutions, insurance companies and takaful operators. The information is obtained from an establishment survey conducted by Bank Negara Malaysia.

Manufactured goods remained the key driver of exports

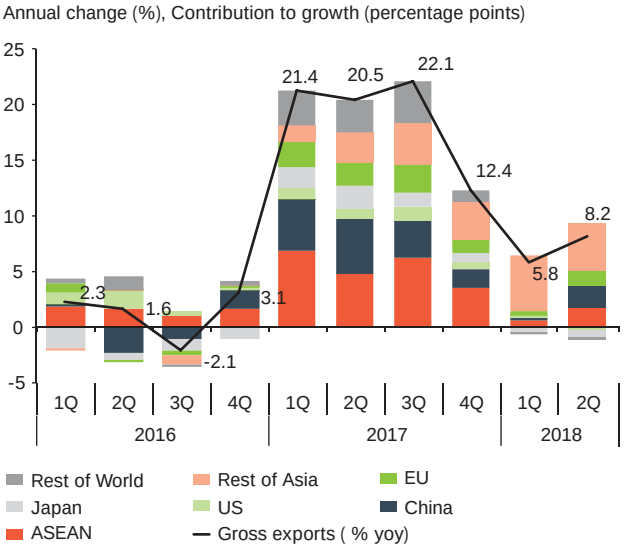
Chart 13: Gross Exports by Products



Source: Department of Statistics, Malaysia

Continued growth in exports to most major markets

Chart 14: Gross Exports by Markets



Source: Department of Statistics, Malaysia

Faster expansion in exports while imports rebounded

In the second quarter of 2018, gross exports expanded at a faster pace of 8.2% (1Q 2018: 5.8%), supported mainly by re-export activity which grew by 53.5% (1Q 2018: 42.3%). Domestic exports[5] turned around to register a positive growth of 0.2% (1Q 2018: -0.7%). The trade surplus remained healthy, albeit narrower at RM27.2 billion (1Q 2018: RM33.4 billion).

Gross exports was supported by continued demand from major trading partners, particularly the region. Manufactured exports registered a double-digit growth of 10.6% (1Q 2018: 8.2%). Semiconductor exports continued to record robust growth of 21.0% (1Q 2018: 29.6%), in tandem with continued expansion in the global technology cycle as reflected in the double-digit growth of global semiconductor sales. Both resource and non-resource based manufactured exports registered a faster pace of growth, driven mainly by chemicals and chemical products, petroleum products and manufactures of metal. Commodity exports recorded a smaller contraction, as the continued decline in crude palm oil, LNG and rubber exports were partially offset by higher crude petroleum export volumes and prices.

Gross imports rebounded to register a positive growth of 7.7% during the quarter (1Q 2018: -0.8%), underpinned by robust re-export activity and recovery in capital imports. Imports for re-exports was driven by the E&E segment. Capital imports turned around following stronger domestic investment activity and dissipation of high base effect in transport equipment segment in the first quarter of 2017. Intermediate imports, however, continued to decline, albeit at a slower pace in tandem with subdued exports of domestically-produced manufactured goods.

[4] Domestic exports is defined as gross exports excluding re-export activity. This is a newly published time series data by the Department of Statistics, Malaysia.

Lower current account surplus

The current account surplus narrowed to RM3.9 billion in the second quarter of 2018 (1Q 2018: RM15.0 billion), or 1.2% of GNI (1Q 2018: 4.5% of GNI), due to a lower goods surplus[2] and higher deficits in the services and primary income accounts.

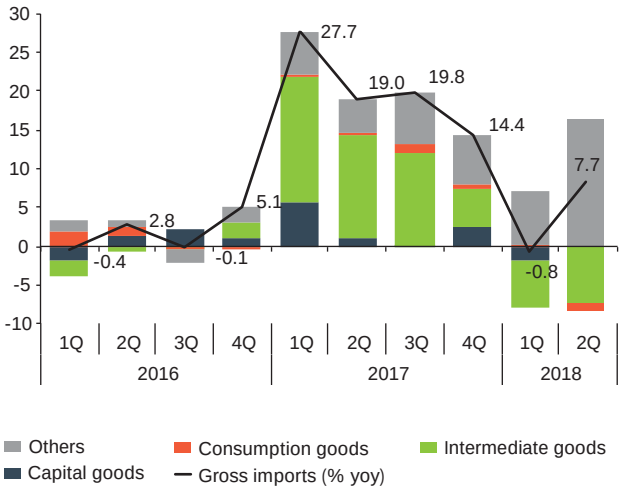
As the rebound in imports outpaced the increase in exports, the goods surplus narrowed to RM26.1 billion (1Q 2018: RM35.7 billion). In the services account, the deficit widened to RM6.2 billion (1Q 2018: -RM5.8 billion), owing mainly to higher net payments to foreign providers in the construction and transportation services segments.

The primary income account deficit widened to RM11.2 billion (1Q 2018: -RM10.2 billion), largely attributable to higher dividends earned by foreign portfolio investors in publicly-listed firms amid broadly sustained profits earned by MNCs investing in the domestic economy. The secondary income account recorded a sustained deficit of RM4.7 billion (1Q 2018: -RM4.7 billion), reflecting continued outward remittances by foreign workers.

Imports turned around, driven by robust re-export activity and recovery in capital goods

Chart 15: Gross Imports by Products

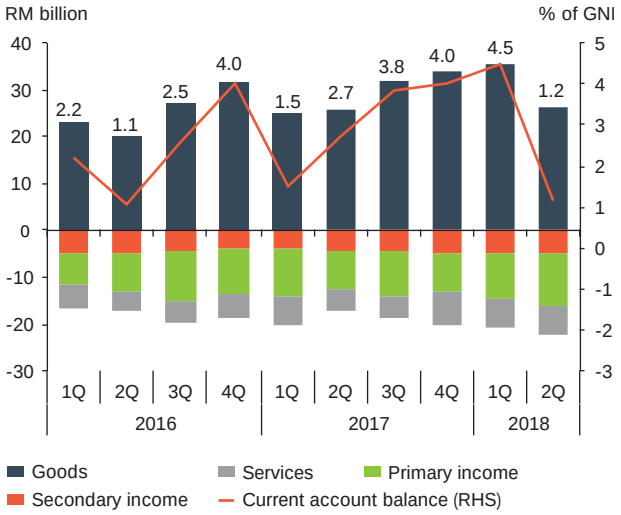
Annual change (%), Contribution to growth (percentage points)



Source: Department of Statistics, Malaysia

Current account surplus narrowed

Chart 16: Current account balance

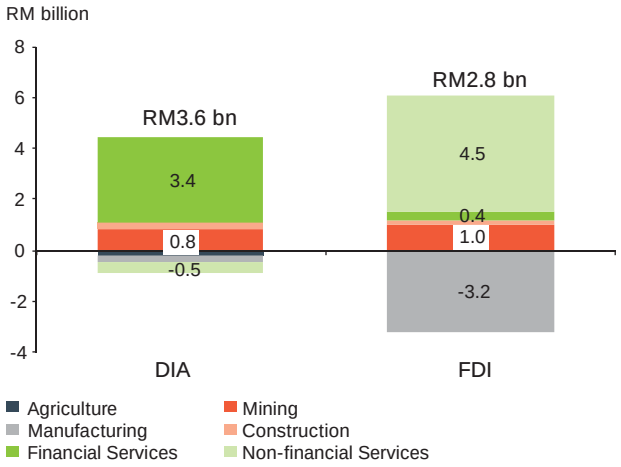


Source: Department of Statistics, Malaysia

[5] The difference between the goods surplus and trade surplus may arise from the exclusion of goods for processing, storage and distribution in the goods accounts as per the 6th Edition of the Balance of Payments and International Investment Position Manual (BPM6) by the IMF.

Net outflow in the direct investment account

Chart 17: Net Direct Investment Flows by Sector

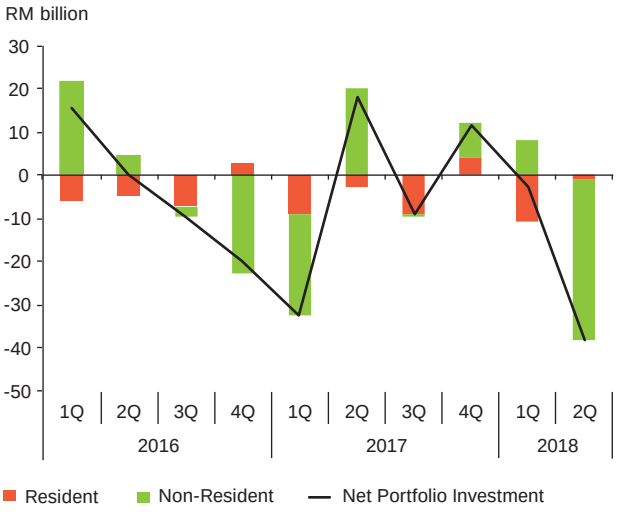


Note: For DIA, positive values refer to net outflows while negative values refer to net inflows

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Net outflow in portfolio investment account contributed mainly by non-residents

Chart 18: Portfolio Investments



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Financial account recorded net inflows

In the second quarter of 2018, the financial account registered a lower net inflow of RM9.2 billion (1Q 2018: net inflow of RM15.2 billion). Higher placements of currency and deposits with domestic financial institutions were partly offset by large outflows of non-resident portfolio investments.

The direct investment account registered a marginal net outflow of RM0.7 billion (1Q 2018: net inflow of RM10.7 billion). During the quarter, foreign direct investments (FDI) registered a lower net inflow of RM2.8 billion (1Q 2018: net inflow of RM12.0 billion), on account of lower retained earnings and some liquidation of foreign equity holdings in firms in the manufacturing sector, following acquisition by residents. FDI inflows were mainly channelled into the services sector, particularly the real estate and wholesale and retail trade sub-sectors, followed by the mining sector. Direct investments abroad (DIA) by Malaysian companies recorded a higher net outflow of RM3.6 billion (1Q 2018: net outflow of RM1.3 billion), mainly in the form of equity capital injection and reinvestment of earnings in subsidiaries abroad. DIA outflows were channelled mainly into the services sector, particularly the financial services sub-sector, followed by the mining sector.

The portfolio investment account registered a higher net outflow of RM38.3 billion (1Q 2018: net outflow of RM2.6 billion) attributed to non-resident outflows (2Q 2018: net outflow of RM37.2 billion; 1Q 2018: net inflow of RM7.9 billion) and continued net acquisition of foreign financial assets by resident domestic institutional investors, fund managers and banks (2Q 2018: net outflow of RM1.0 billion; 1Q 2018: net outflow of RM10.5 billion). Non-resident portfolio outflows were driven primarily by external factors, including expectations of a faster pace of US interest rate normalisation and further escalation of trade tensions and some concerns over domestic policy uncertainties.

The other investment account recorded a higher net inflow of RM48.4 billion (1Q 2018: net inflow of RM6.4 billion), due mainly to placements of currency and deposits with domestic financial institutions. Net errors and omissions amounted to -RM13.9 billion or -3.0% of total trade. The international reserves of Bank Negara Malaysia amounted to USD104.7 billion as at end-June 2018, compared to USD107.8 billion as at end-March 2018.

Manageable external debt

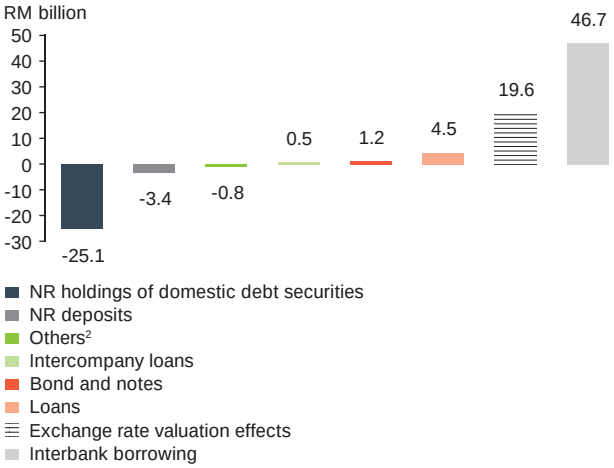
Malaysia's external debt amounted to RM936.5 billion, or 64.7% of GDP as at end-June 2018 (end-March: RM893.4 billion or 61.8% of GDP). The higher external debt reflects largely the increase in interbank borrowing and valuation effects of a weaker ringgit against selected major and regional currencies in the second quarter of 2018. These was partially offset by some liquidation of domestic debt securities by non-resident (NR) investors.

Malaysia's external debt remains manageable given its currency and maturity profiles, and the availability of large external assets. Close to one-third of total external debt is denominated in ringgit (31.2%; end-March: 34.8%), mainly in the form of NR holdings of domestic debt securities and in ringgit deposits in domestic banking institutions. As such, these liabilities are not subjected to valuation changes from the fluctuations in the ringgit exchange rate.

The remaining external debt of RM644.3 billion or 68.8% of total external debt (44.5% of GDP) is denominated in foreign currency (FC) and is subject to prudential liquidity management practices and hedging requirements on banking institutions and corporations. The bulk of these obligations are offshore borrowings, raised mainly to expand productive capacity and to better manage financial resources within corporate groups. As at end-June 2018, offshore borrowing stood at 40.5% of GDP (end-March: 35.8%), much lower compared to 60% of GDP during the Asian Financial Crisis in 1997-98.

Higher external debt in 2Q 2018

Chart 19: Changes in External Debt
Net change[1]: +RM43.1 billion

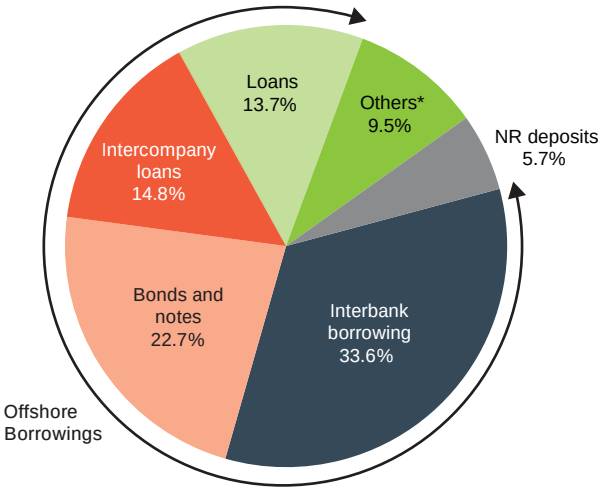


[1]Changes in individual debt instruments exclude exchange rate valuation effects
[2]Comprises trade credits, IMF allocation of SDRs and other debt liabilities
Note: NR refers to non-residents

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

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

Chart 20: Breakdown of Foreign Currency-denominated External Debt (% share)



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

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Of the total FC-denominated external debt (inclusive of valuation effects), 39.3% (or amounting to RM253.0 billion) is accounted for by interbank borrowing and FC deposits in the domestic banking system. This largely reflects banks' intragroup liquidity management and placements of deposits from foreign parent entities. In addition, during the quarter, several banks strengthened their FC liquidity buffers in anticipation of potential withdrawal and maturities of foreign currency deposits, as well as expectations of tighter and volatile conditions in the foreign exhange market. Banks' funding and liquidity risks continue to be proactively managed via robust internal controls and policies, including internal limits on (i) interbank borrowings, (ii) foreign currency funding and liquidity positions and (iii) foreign exchange market risk exposures. Foreign-currency risk, measured in net open position of foreign currency denominated exposures is stable at 5.2% of banks' total capital.

Long-term bonds and notes issued offshore amounted to RM144.8 billion as at end-June 2018, and is channeled primarily to finance asset acquisitions abroad that will generate future income. The intercompany loans are typically on flexible and concessionary terms, such as no fixed repayment schedule or low interest rate.

From a maturity perspective, more than half of the total external debt is skewed towards medium- to long-term tenure (52.0% of total external debt; end-March: 55.5%), suggesting limited rollover risks.

As at 31 July 2018, international reserves stood at USD104.5 billion. The reserves position is sufficient to finance 7.5 months of retained imports and is 0.9 times the short-term external debt. Malaysia's international reserves coverage of short-term external debt is adequate given the availability of external assets for borrowers to meet their external obligations.

Reserves is not the only means to meet external obligations. The progressive liberalisation of foreign exchange administration rules has resulted in greater decentralisation of reserves. This is reflected in the increasing acquisition of assets abroad by residents and corporations. In particular, banks and corporations hold three-quarters of Malaysia's external assets (as at end-2Q 2018: RM1.3 trillion), which can also be drawn down to meet their external debt obligations (RM740.9 billion), without creating a claim on international reserves. The adequate level of international reserves, together with the availability of substantial external assets by banks and corporations, and a flexible exchange rate, will continue to serve as important buffers against potential external shocks.