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 3Q 2019

GDP expanded by 4.4% (2Q: 4.9%)

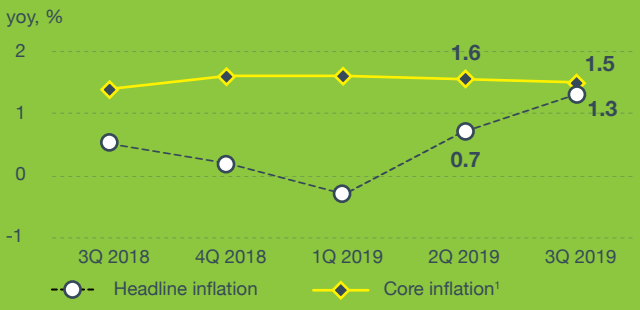
Slower growth in domestic demand and key economic sectors

- Slower growth momentum across most domestic demand components and net exports
- Contraction in the mining and construction sectors
- Services and manufacturing sectors continued to support growth

Headline inflation rose but remained modest

Higher headline inflation due mainly to the lapse in the impact of the GST zerorisation

Headline and Core Inflation[1]



[1] Core inflation is computed by excluding price-volatile and price-administered items. It also excludes the estimated direct impact of consumption tax policy changes.

Box Article - Banking on Banks: Are They Lending Enough?

Bank financing remains forthcoming to eligible borrowers

New loans approved by banks[2]

Housing loans

RM119 bn benefitting > 272,000 borrowers

Small and Medium Enterprises

RM50 bn benefitting > 76,000 SMEs

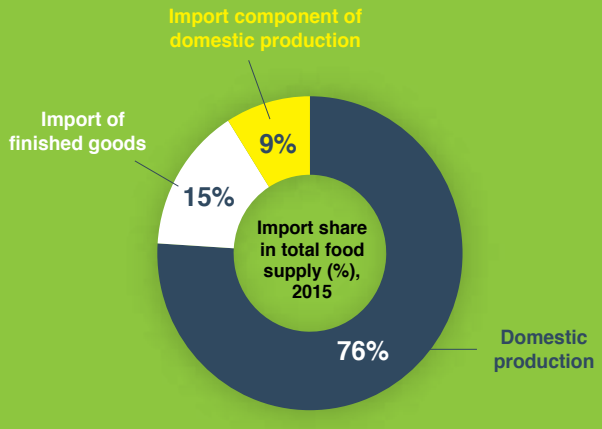
[2] Refers to January - September 2019

Main reasons for loan rejections for SMEs and households

- Applicants already highly indebted / over-leveraged
- Insufficient income / cash-flow issues
- Poor financial track record

Box Article - Food Imports and the Exchange Rate: More than Meets the Eye

Imports form 24% of Malaysia's total food supply



Exchange rate impact to food prices is limited and varying

- Exchange rates explain a fraction of food price changes
- Exchange rate impact varies across food items
- Impact varies depending on households' consumption patterns

Source: Bank Negara Malaysia estimates based on Input-Output Tables 2010-2015, Department of Statistics, Malaysia

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

International Economic Environment

HIGHLIGHTS

- The global economy moderated in the third quarter of 2019.
- Weaker export performance in regional economies amid softer external demand.
- Financial market volatility increased due to trade, geopolitical and market developments.

Global growth continued to moderate

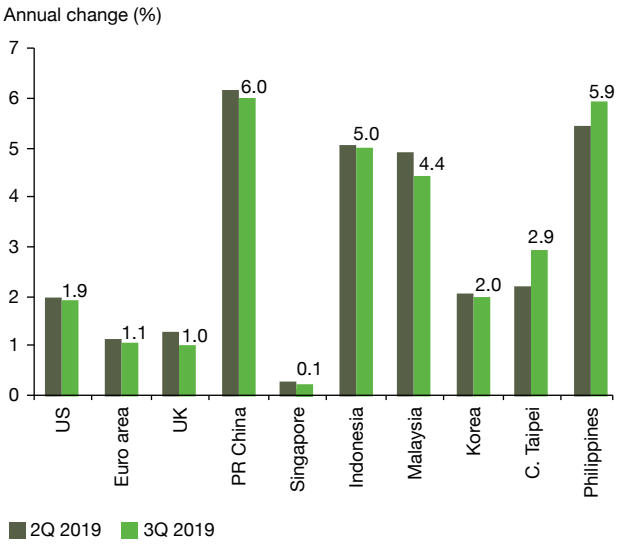
The global economy expanded at a more moderate pace in the third quarter of 2019.

In the US, growth moderated as investment weakened on the back of waning fiscal support, moderating industrial production and increased business uncertainty from its trade dispute with PR China. Whilst private consumption remained resilient, labour market conditions showed signs of softness, with wage and employment growth beginning to slow. Economic activity in the euro area continued to moderate, as investment and external demand indicators remained weak. Private consumption also moderated, driven by softer labour conditions and spillovers from Germany's manufacturing slowdown to other euro area countries.

The regional economies continue to be confronted by headwinds from the global trade slowdown, which further weighed on external demand. The growth moderation in PR China was due to softer private expenditure, driven partly by spillovers from persistent weakness in exports. Meanwhile, policy stimulus provided support to public investments. Growth in Singapore moderated to its slowest level since the Global Financial Crisis (GFC), due to weaker exports, which also affected private consumption.

Growth in most economies moderated in 3Q 2019

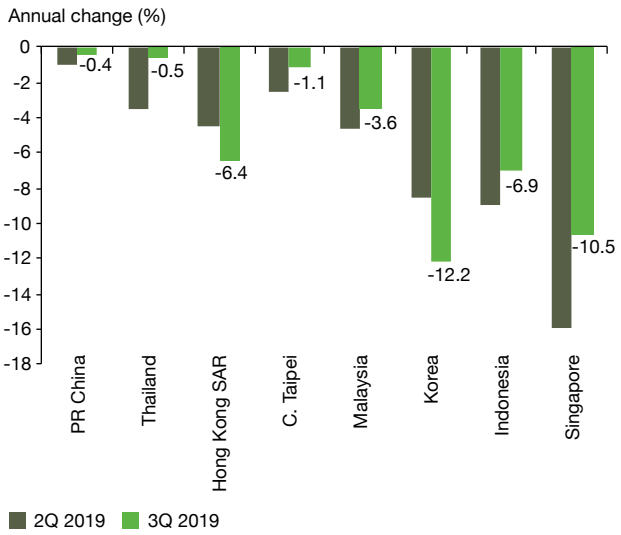
Chart 1: GDP Growth of Selected Economies



Source: National authorities

Lower regional export growth in 3Q 2019

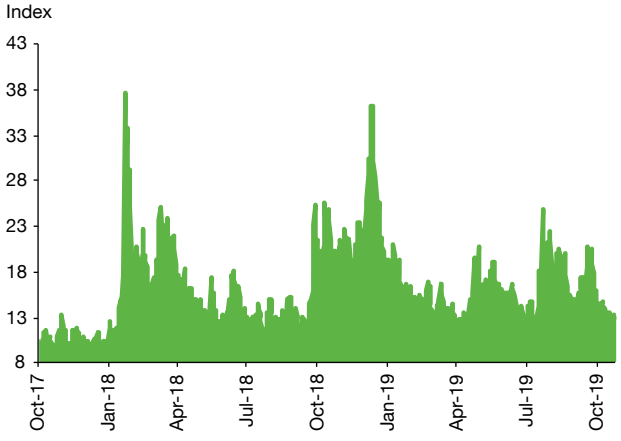
Chart 2: Export Growth of Selected Economies (in USD terms)



Source: National authorities

Heightened global financial market volatility

Chart 3: Chicago Board Options Exchange (CBOE) Volatility Index (VIX)



Source: Bloomberg

Contraction in regional exports

In the third quarter, regional exports continued to contract, reflecting the adverse effects from trade tensions and increasingly weak demand conditions from major economies.

Exports of goods from PR China contracted by a smaller 0.4% in the third quarter of 2019, led by subdued performance in the machinery and electrical equipment segment. However, Korea's exports registered a larger contraction, as the deterioration in electronic equipment and parts more than offset the sustained momentum in automobiles.

Heightened financial market volatility

Markets experienced bouts of heightened volatility in the third quarter, driven by a culmination of trade, financial market and geopolitical developments.

Primarily, trade tensions between the US and PR China escalated markedly in August, which led to substantial spikes in financial market volatility. The US announced tariffs of 30% and 15% on USD250 billion and USD300 billion, respectively, on goods imported from PR China. A retaliatory tariff of 10% on USD45 billion worth of imports from the US was also announced.

Moreover, aberrations in the bond markets of major advanced economies, as well as the concurrent release of weaker-than-expected real economic data in the US, triggered bouts of volatility in financial markets. Geopolitical developments in Asia and the Middle East further increased economic uncertainty.

The Brent crude oil price averaged lower at USD62 per barrel in the third quarter of 2019 (2Q 2019: USD68), as concerns over weak global demand conditions more than offset the upward price pressure from the ongoing voluntary output cuts by OPEC+ and the oil supply disruptions in the Middle East.

Developments in the Malaysian Economy

HIGHLIGHTS

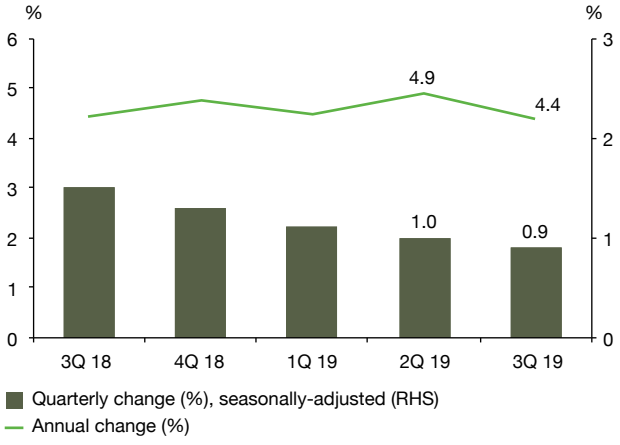
- The Malaysian economy expanded by 4.4% in the third quarter of 2019.
- Headline inflation increased, mainly reflecting the lapse in the impact of the Goods and Services Tax (GST) zerorisation, while core inflation remained steady.
- Current account surplus amounted to RM11.5 billion (3.1% of GNI).

The Malaysian economy grew by 4.4% in the third quarter of 2019

Growth in the Malaysian economy moderated to 4.4% in the third quarter of 2019 (2Q 2019: 4.9%), primarily attributed to lower growth in key sectors and a decline in the mining and construction activities. On the demand side, most domestic demand components and net exports registered slower growth momentum. On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 0.9% (2Q 2019: 1.0%).

Continued growth in 3Q 2019

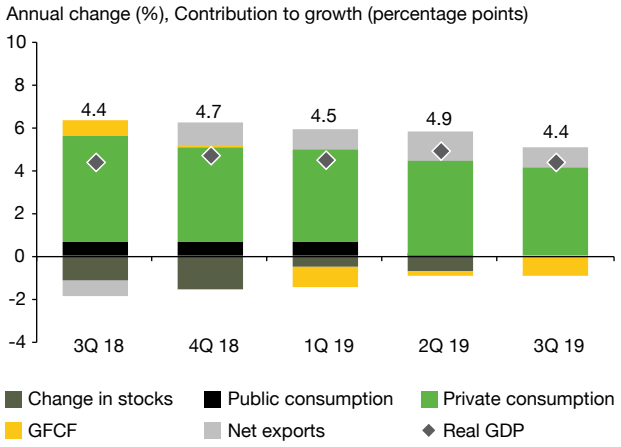
Chart 4: Real GDP Growth



Source: Department of Statistics, Malaysia

Private sector activity remained the key driver of growth

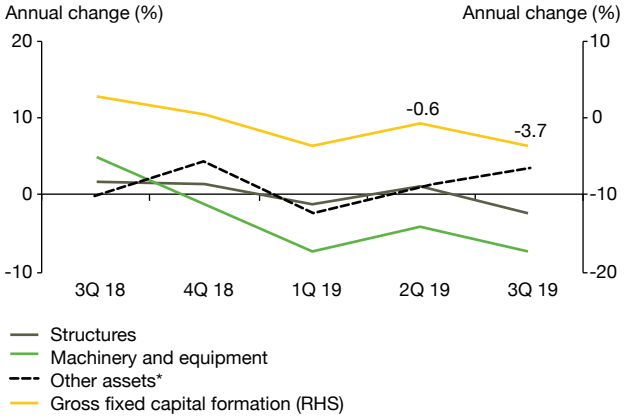
Chart 5: Contribution of Expenditure Components to Real GDP Growth



Source: Department of Statistics, Malaysia

Contraction 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 continued to anchor growth, albeit at a slower momentum

Domestic demand growth moderated to 3.5% (2Q 2019: 4.6%), with private sector expenditure remaining the key contributor to growth.

Private consumption grew by 7.0% (2Q 2019: 7.8%), as household spending normalised towards its long-term trend. This partly reflected strong base effects from the tax holiday spending last year. Nevertheless, spending remained supported by continued income and employment growth, as well as selected Government measures.

Public consumption spending increased by 1.0% (2Q 2019: 0.3%). While emolument growth remained positive, expenditure on supplies and services continued to decline, albeit at a slower pace. This is in line with the Government's commitment to expenditure optimisation.

Gross fixed capital formation (GFCF) contracted by 3.7% (2Q 2019: -0.6%), on account of slower growth in private sector capital expenditure and a larger contraction in public sector investment. By type of assets, investment in structures contracted by 2.4% (2Q 2019: +1.2%), while investment in machinery and equipment declined further to -7.4% (2Q 2019: -4.2%). However, investment in other types of assets improved to 3.6% (2Q 2019: 1.0%) due mainly to higher research and development (R&D) spending.

Private investment growth expanded marginally by 0.3% (2Q 2019: 1.8%), weighed down by lower capital spending across major economic sectors. Investment continued to be affected by heightened uncertainty surrounding external conditions and continued weakness in the broad property segment.

Public investment remained in contraction (-14.1%; 2Q 2019: -9.0%), reflecting lower capital spending by both Federal Government and public corporations.

Services and manufacturing sectors continued to support growth

The services sector grew by 5.9% in the third quarter of 2019 (2Q 2019: 6.1%). Most key subsectors moderated. In the wholesale and retail subsector, the stronger expansion in wholesale was offset by lower growth in the retail and motor vehicles segments. Growth in the transport and storage subsector was also lower amid weaker trade activity, while the finance and insurance subsector was weighed down by slower financing activity despite higher fee-based income. Meanwhile, the information and communication subsector grew at a moderate pace, reflecting slower demand for data communication services.

Growth in the manufacturing sector moderated to 3.6% (2Q 2019: 4.3%) due to the slower growth in the E&E and consumer-related industries. In the E&E cluster, the production of electronics-related products was affected by the ongoing weakness in global demand. The slower growth in the consumer-related industries[1] was attributable to the lower growth in crude and refined palm oil production. Transport equipment category registered lower growth due to the high base during the tax holiday period last year.

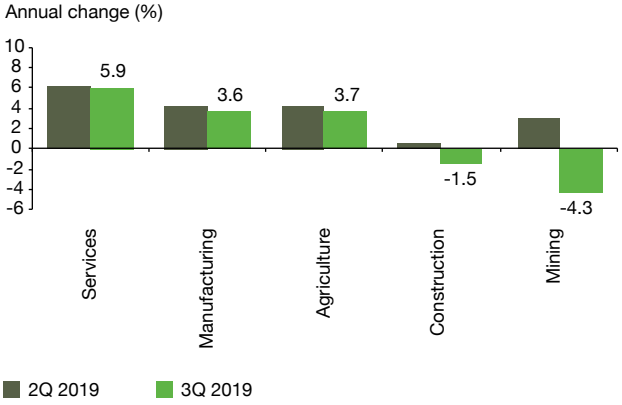
The agriculture sector grew by 3.7% (2Q 2019: 4.2%), as the pace of recovery in oil palm output slowed while forestry and logging activities contracted further. These factors outweighed the improvement in rubber and livestock production.

Meanwhile, the mining sector contracted by 4.3% (2Q 2019: +2.9%), due mainly to maintenance works that affected oil production. This partially offset the ongoing output recovery in natural gas.

The construction sector contracted by 1.5% (2Q 2019: +0.5%). The main contributor was the larger contraction in the non-residential subsector amid the continued oversupply of commercial properties. In the residential subsector, activities declined further amid high number of unsold residential properties. The civil engineering subsector's growth moderated following the near-completion of large petrochemical and highway projects. Growth in the special trade subsector was also lower reflecting fewer early works activities from large projects that were already at mid-stages of completion.

Most sectors expanded, with the exception of mining and construction

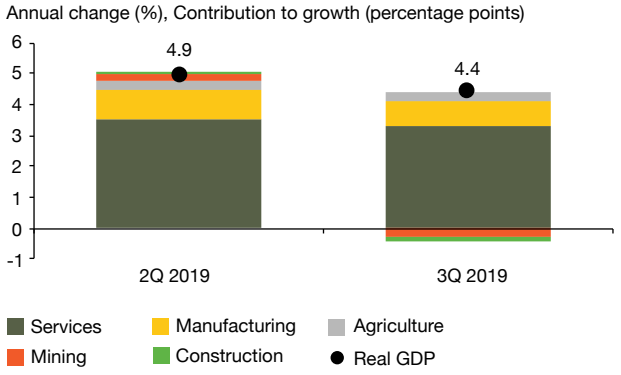
Chart 7: Growth by Sector



Source: Department of Statistics, Malaysia

Growth was mainly contributed by the services and manufacturing sectors

Chart 8: Contributions to Real GDP by Economic Sector

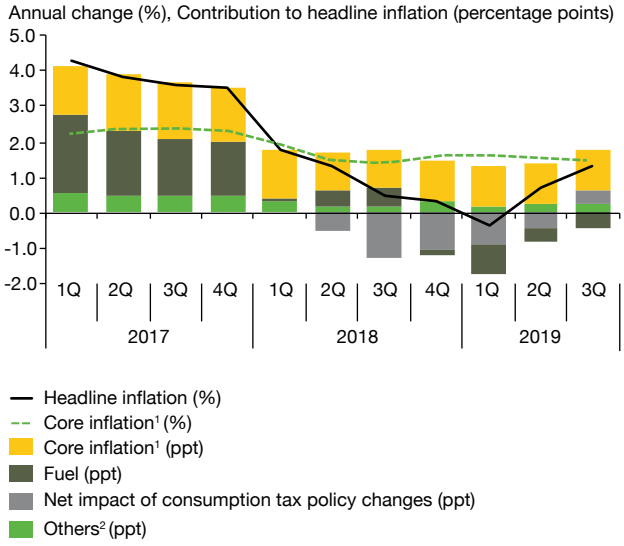


Source: Department of Statistics, Malaysia

[1] Both crude and refined palm oil production are reflected in the consumer-related cluster as they are categorised under the manufacture of food products in the MSIC 2008 classification.

Higher headline inflation mainly reflected the lapse in the impact of the GST zerorisation

Chart 9: Contribution to Headline Inflation by Components



[1] Core inflation is computed by excluding price-volatile and price-administered items. It also excludes the estimated direct impact of consumption tax policy changes.

[2] Others include price-volatile items and other price-administered items

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

Headline inflation increased mainly reflecting the lapse in the impact of the GST zerorisation

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), increased to 1.3% in 3Q 2019 (2Q 2019: 0.7%).

The higher inflation outcome mainly reflected the lapse in the impact from the GST zerorisation between June and August 2018. This was despite the lapse in the impact of the Sales and Services Tax (SST) implementation in September, which contributed to lower headline inflation that month (September: 1.1%; August: 1.5%; July: 1.4%).

There was a slightly larger negative contribution to headline inflation from fuel products during the quarter. This reflected a decline in the RON97 petrol price amid lower average global oil prices (average RON97 petrol price per litre 3Q 2019: RM2.56; 2Q 2019: RM2.65).

Core inflation, excluding the impact of consumption tax policy changes, was steady at 1.5% (2Q 2019: 1.6%). Demand-driven inflationary pressures remained broadly stable and contained, amid the absence of excessive wage pressure and some degree of spare capacity in the capital stock.

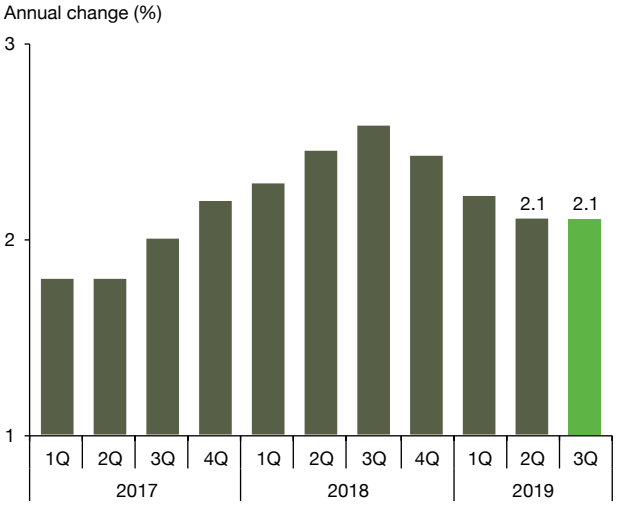
Supportive labour market conditions

Labour market conditions remained supportive of growth during the quarter. The unemployment rate was stable at 3.3% (2Q 2019: 3.3%), as employment gains matched the expansion of the labour force. Employment growth was also sustained at 2.1% (2Q 2019: 2.1%).

Private sector wage growth moderated to 3.8% (2Q 2019: 4.2%). This was supported mainly by services wage growth, which was relatively sustained (4.1%; 2Q 2019: 4.4%), particularly in the food and beverages (6.0%, 2Q 2019: 5.8%); and information and communication sub-sectors (3.5%, 2Q 2019: 3.6%). Growth of manufacturing wages was more moderate (3.2%, 2Q 2019: 3.9%). Lower wage growth was observed largely in export-oriented industries, particularly in the E&E (4.1%; 2Q 2019: 5.1%) and petrochemical clusters (2.2%; 2Q 2019: 3.1%).

Sustained employment growth

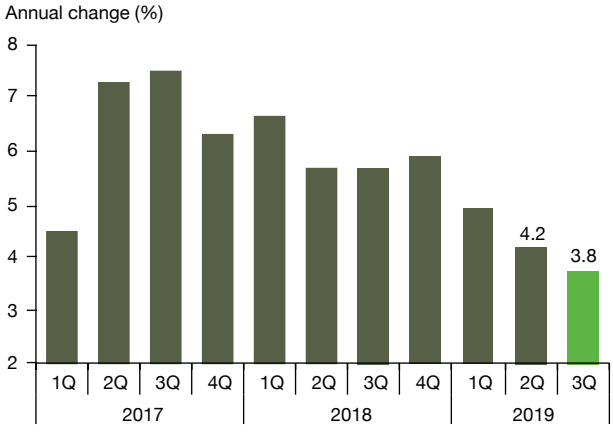
Chart 10: Employment Growth



Source: Department of Statistics, Malaysia

Private sector wage growth moderated

Chart 11: Private Sector Wages*



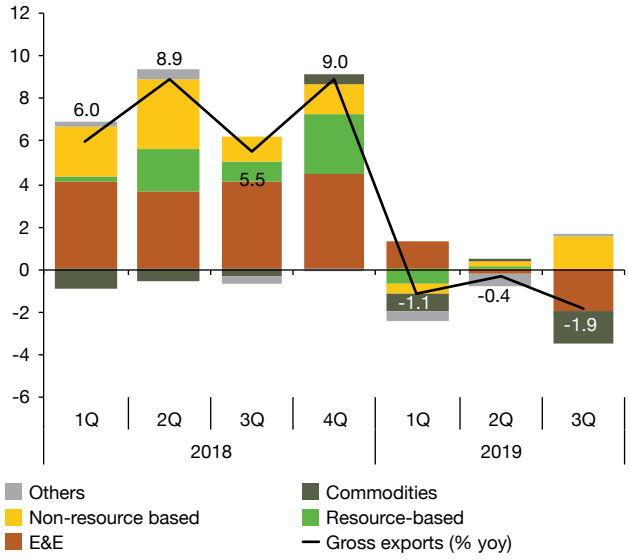
* Private sector wages are derived from the salaries and wages data published in the Monthly Manufacturing Statistics and Quarterly Services Statistics by the Department of Statistics, Malaysia. They cover 62.9% of total employment.

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

Contraction in E&E and commodities exports offset higher growth in non-resource based exports

Chart 12: Gross Exports by Products

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

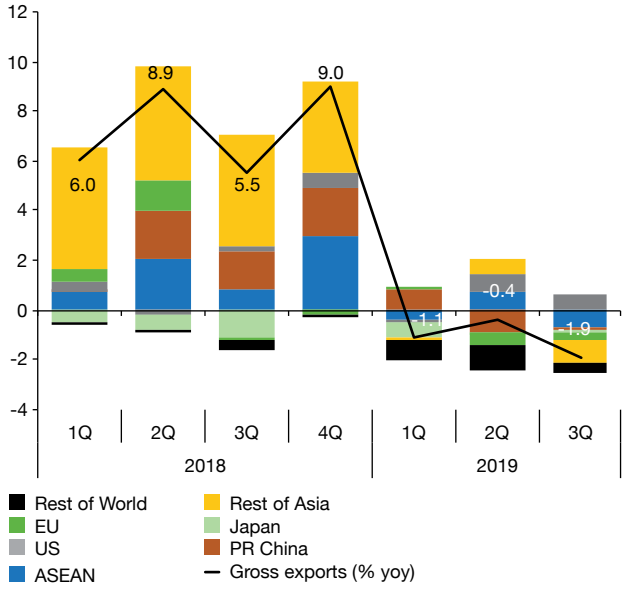


Source: Department of Statistics, Malaysia

Slowing demand from regional economies

Chart 13: Gross Exports by Markets

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



Source: Department of Statistics, Malaysia

Continued decline in exports and a sharper contraction in imports

In the third quarter of 2019, gross exports contracted by 1.9% (2Q 2019: -0.4%). This reflected a decline in commodities and E&E exports, which more than offset the improvement in non-resource based exports. Gross imports declined to -5.8% (2Q 2019: -1.4%) and was broad-based. The trade surplus[2] increased to RM33.5 billion (2Q 2019: RM30.4 billion).

Commodities exports turned negative (-10.0%; 2Q 2019: 0.2%) due primarily to a sharp decline in crude petroleum exports (-43.9%; 2Q 2019: -10.4%). This was attributable to the temporary closure for maintenance works at selected oil fields and lower global oil prices. Manufactured exports contracted by 0.6% (2Q 2019: 0.2%) following lower E&E and resource-based exports. E&E exports recorded a larger decline (-4.9%; 2Q 2019: -0.6%) amid lower demand from PR China and regional economies, due in part to the slowdown in global semiconductor sales and the ongoing trade tensions. By contrast, non-resource based products grew at a faster pace (6.9%; 2Q 2019: 1.2%), supported by higher demand for transport equipment, machinery equipment and parts, iron and steel products.

Intermediate imports contracted (-3.0%; 2Q 2019: 6.8%) during the quarter due to lower imports of electronics and telecommunications equipment, and processed industrial supplies, such as chemicals and metals. Capital imports recorded a steeper decline (-15.4%; 2Q 2019: -8.9%), affected by a larger drag from machineries and transport equipment investments.

[2] The difference between the goods surplus and trade surplus arises 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.

Current account surplus driven by higher goods surplus

The current account surplus of the balance of payments amounted to RM11.5 billion or 3.1% of GNI in the third quarter of 2019 (2Q 2019: RM14.3 billion or 3.9% of GNI). The higher goods surplus and lower services deficit was offset by a larger primary income deficit.

As the decline in import growth outpaced export growth, the goods surplus widened to RM30.8 billion (2Q 2019: RM28.1 billion).

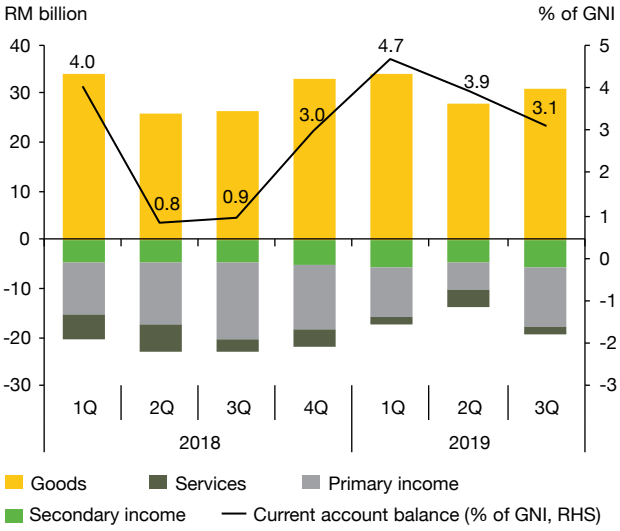
In the services account, the deficit narrowed to RM1.6 billion (2Q 2019: -RM3.4 billion) during the quarter. This was due primarily to an increase in the travel account surplus (RM9.5 billion; 2Q 2019: RM7.1 billion) following higher tourist arrivals and per capita spending.

The primary income account registered a larger deficit of RM12.2 billion (2Q 2019: -RM5.5 billion). This was on account of lower investment income earned by Malaysian firms investing abroad amid higher profits earned by foreign investors in Malaysia.

The deficit in the secondary income account amounted to RM5.5 billion (2Q 2019: -RM4.9 billion), reflecting continued outward remittances by foreign workers.

Higher goods surplus

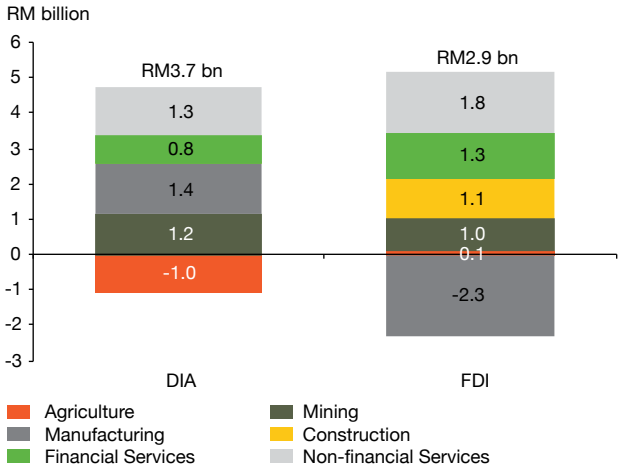
Chart 14: Current Account Balance



Source: Department of Statistics, Malaysia

More moderate DIA and FDI

Chart 15: Net Direct Investment Flows by Sector

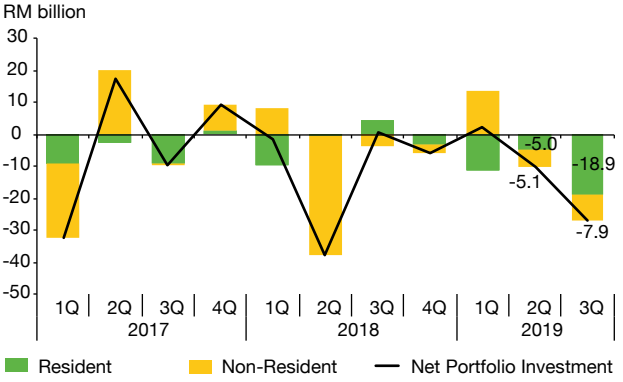


Note: For DIA, positive values refer to net outflows while negative values refer to net inflows. Figures may not add up due to rounding.

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Net outflow in portfolio investment account attributable to residents and non-residents

Chart 16: Portfolio Investments



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Financial account registered a smaller net outflow

The financial account registered a smaller net outflow of RM1.3 billion (2Q 2019: -RM18.6 billion). During the quarter, outflows in the direct investment and portfolio investment accounts were partly offset by inflows in the other investment account. Of note, long term investment flows slowed during the quarter.

The direct investment account registered a smaller net outflow of RM0.8 billion (2Q 2019: net outflow of RM8.2 billion), due largely to smaller outflows of direct investment abroad (DIA). During the quarter, DIA by Malaysian companies registered a smaller net outflow of RM3.7 billion (2Q 2019: -RM12.6 billion). The outflows were mainly channelled into the manufacturing and non-financial services sectors, particularly the arts, entertainment and recreation subsector. FDI also registered a smaller net inflow of RM2.9 billion (2Q 2019: +RM4.4 billion). While equity capital injections increased, this was offset by higher dividend payments to direct investors, and a net repayment of intercompany loans to parent companies and affiliates. FDI was channelled mainly into the non-financial services, particularly wholesale and retail trade subsector, and the financial services sector.

The portfolio investment account registered a larger net outflow of RM26.8 billion (2Q 2019: -RM10.2 billion), following outflows from both resident and non-resident investors. Residents' portfolio investments abroad recorded a substantially larger net outflow (RM18.9 billion; 2Q 2019: -RM5.0 billion) as institutional investors purchased equity and debt securities abroad. For non-residents, despite inflows into the domestic bond market (please refer to developments in the domestic financial markets on page 27), repayments due to maturing international debt securities led to a net outflow of RM7.9 billion during the quarter (2Q 2019: -RM5.1 billion).

The other investment account recorded a larger net inflow of RM25.3 billion (2Q 2019: RM0.3 billion), due to the reversal of previous interbank placements abroad by resident banks that have matured. Net errors and omissions amounted to -RM3.7 billion, or -0.8% of total trade.

Lower external debt

Malaysia's external debt amounted to RM916.4 billion, or 60.4% of GDP as at end-September 2019 (end-June 2019: RM931.1 billion or 61.4% of GDP). The lower external debt reflected mainly the decline in intercompany loans. This was attributed largely to the consolidation of the net debt obligations of a foreign multinational corporation in the mining sector. There was also a net repayment of bonds and notes during the quarter.

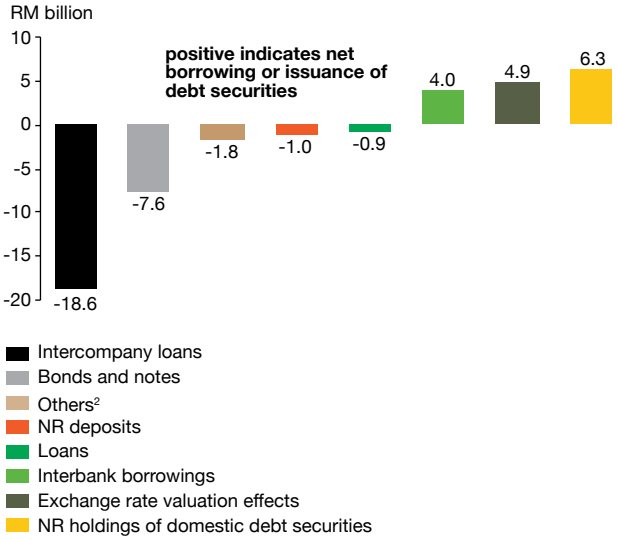
These were partly offset by acquisitions of domestic debt securities by non-residents and higher interbank borrowings. In addition, there was also higher revaluation from the weaker ringgit against regional and major currencies during the period.

The country's external debt remains manageable, given its currency and maturity profiles. Close to one-third of external debt was denominated in ringgit (32.9%; end-June 2019: 31.7%), mainly in non-resident holdings of domestic debt securities (62.5% share of ringgit-denominated external debt) and ringgit deposits (17.8% share) in domestic banking institutions. As such, these liabilities are not subject to valuation changes from fluctuations in the ringgit exchange rate.

The remaining external debt of RM615.3 billion or 67.1% of total external debt was denominated in foreign currency (FCY). The corporate sector accounted for close to half of FCY-denominated external debt and are largely subject to prudential and hedging requirements.

Lower external debt in 3Q 2019

Chart 17: Changes in External Debt
Net change[1]: -RM14.6 billion

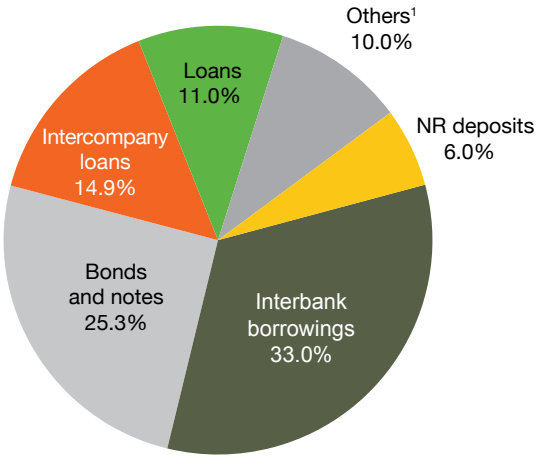


[1] Changes in individual debt instruments exclude exchange rate valuation effects
[2] Comprises trade credits, IMF allocation of SDRs and other debt liabilities
Note: NR refers to non-residents
Figures may not add up due to rounding

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

FCY-denominated debt subject to prudent liquidity management practices and hedging requirements

Chart 18: Breakdown of Foreign Currency-denominated External Debt (% share)



[1] 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

By instrument, 39.0% (or RM239.6 billion) of FCY-denominated external debt were accounted for by interbank borrowings and FCY deposits in the domestic banking system. 74.0% of interbank borrowings were in the form of largely stable intragroup borrowings from related offices abroad, including parent banks, regional offices and subsidiaries. This reflected banks' centralised liquidity and funding management practices. Foreign-currency risk, measured in terms of the net open position of FCY-denominated exposures[3], remained low at 4.1% of banks' total capital.

Long-term bonds and notes issued offshore, accounting for 25.3% of total FCY-denominated external debt, stood at RM155.7 billion as at end-September 2019. These were mainly by non-financial corporations and channelled primarily to finance asset acquisitions abroad. The intercompany loans, amounting to RM91.4 billion and accounting for 14.9% of FCY-denominated external debt, are typically on flexible and concessionary terms.

From a maturity perspective, 57.0% of the total external debt was skewed to medium- to long-term tenure (end-June 2019: 58.3%), suggesting low rollover risks. Short-term external debt accounted for the remaining 43.0% of external debt. Close to half of the short-term external debt were intragroup borrowings among banks and corporations, which are generally stable and on concessionary terms, while another 12% were accounted by trade credits, which are largely backed by export earnings. As at 31 October 2019, international reserves stood at USD103.2 billion, sufficient to finance 7.6 months of retained imports, and is 1.1 times the short-term external debt.

[3] Refers to the aggregated sum of the net short or long foreign currency positions for all currencies across banks.

Box 1 Article

Food Imports and the Exchange Rate: More Than Meets the Eye

Authors: Mohamad Ikmal Ahmad Nordin, Nur Aimi Abdul Ghani, Eilyn Chong and Zul-Fadzli Abu Bakar

HIGHLIGHTS

- **Malaysia is a net food importer, with imports forming about a quarter of total food supply.**
- **Imports are only one component of total production costs; others include labour, utilities and logistics. Prices are also determined by industry margins, policies and regulation, among others.**
- **The exchange rate impact on imported inflation is limited, and varies across items and households.**

If a recent trip to the supermarket left you feeling like your groceries have become slightly more expensive, this may not just be a misperception. Food prices in the country have in fact been increasing, with price increases appearing more evident for certain imported food items. As this development is taking place at a time when the exchange rate is depreciating, it has led to debate that the cause of higher food prices is the exchange rate depreciation. Stemming from this, the solutions often quoted are controlling the ringgit and boosting local production to reduce reliance on imported food and thus, limiting any price pressures emanating from exchange rate changes.

The situation, however, is certainly more nuanced. While the exchange rate has an impact on food prices, there are more salient factors in price determination, and therefore other ways in which this situation can be managed. This article discusses Malaysia's food imports and the relationship between their prices and exchange rates, while taking into account the globalised nature of food supply and complexities in the domestic supply chain.

Back to basics: Why do countries import?

As the global economy became more open and interconnected, the dynamics of imports and exports have also become more complex. Theoretically, countries would benefit from specialising in goods that they can produce at a lower opportunity cost than other countries. In practice, however, opportunity cost is but one of the many considerations for producing food domestically. For example, nations frequently subsidise agricultural practices and enact protectionist barriers to safeguard important agricultural constituencies. They may also engage in domestic food production for food security reasons and to hedge against disruptions in the supply chain.

In the same vein, countries import food for a host of reasons: to source food products that do not exist within a country's borders, to meet consumers' changing demands, to acquire products that are of higher quality, to source inputs for local production (e.g. corn for chicken feed), and to obtain similar goods that are relatively cheaper. These considerations come together to enmesh most countries in a global network of food trade.

Notably, most countries import food products, even economies that are net food exporters. The literature on global food trade posits two alternative methods to ensure the availability and affordability of food: the first method, more prevalent in public discussion, is self-production to hedge against dependency on imports and disturbances in the global food supply chain. The second approach is to improve purchasing power of a

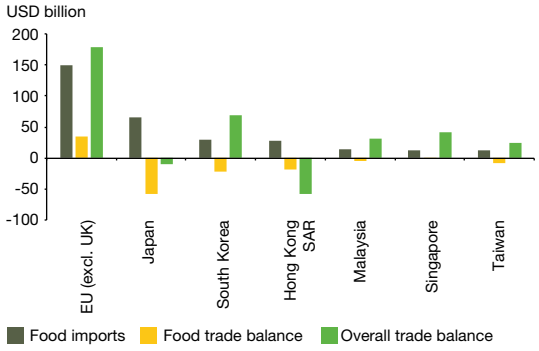
country by focusing on export productivity, and using proceeds from exports to purchase food on the world market. This approach argues for countries to stick to their comparative advantage and produce goods that cost relatively lower in their respective domains.

In practice, countries pursue a mix of both approaches. An economy like the European Union (EU) is a net food exporter, yet it still has sizeable gross food imports (see Figure 1). This is attributable to the fact that modern food production is industrial, and like most industrial goods, involve extensive supply chains and multiple inputs. Any of those inputs could be sourced from regions with the lowest costs. Therefore, import dependency for certain food items could be an inherent feature of an open and globalised economy.

Other economies seemingly opt for the strategy of overall export productivity to purchase food, as they have a positive trade balance while being net importers for food. This strategy has been identified as 'ensuring food availability', which takes into account all sources of supply in addition to domestic production, including imports, food aid and food stocks[1]. In short, countries are dependent on imports for parts of their food supply chain, although the level varies from one country to another. A negative trade balance for food is also not inherently problematic as some countries deprioritise domestic food production while pursuing their comparative advantage to gain export proceeds from other goods and services and acquire food on the global market.

Most countries have sizeable gross food imports, even net food exporters

Figure 1: Food Imports and Trade Balance for 2018



Source: Global Trade Atlas, https://www.gtis.com/gta, Department of Statistics, Malaysia

Food imports in Malaysia: How much do we import?

Over the past five years, the food and beverages trade deficit has increased moderately (2018: RM18.8 billion; 2013: RM16.9 billion). While the imports have been increasing from RM43 billion in 2013 to RM54 billion in 2018 (CAGR, 2013-18: 4.7%), exports have risen at a faster pace, from RM26 billion in 2013 to RM35 billion in 2018 (CAGR 2013-18: 6.2%)[2].

In reality, Malaysia produces enough to meet domestic consumption for many basic food items. Out of 33 most commonly consumed agricultural products, 16 have a self-sufficiency ratio (SSR) of more than 100%[3], implying that for these food items, domestic production is adequate to cater to local consumption. Upon closer inspection, Malaysia is also a net exporter for half of these foods (see Figure 2), belying the notion of a widespread 'import dependency'[4].

[1] Ministry of Foreign Affairs of the Netherlands (2011), p. 15.

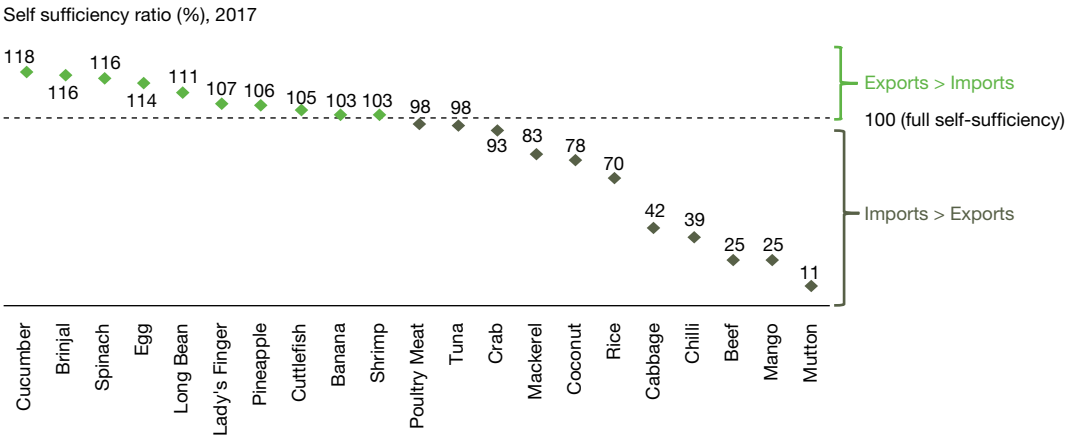
[2] Compound annual growth rate (CAGR) for real import growth 2013-2018: 2.2% and real export growth 2013-2018: 3.7%. Source: Department of Statistics, Malaysia.

[3] The SSR is a measure to indicate how reliant a country's food production is on imports. More technically, it refers to the ratio of domestically produced food to total available supply in the country. The higher the ratio, the higher the percentage of domestic production. Source: Supply and Utilisation Accounts Selected Agricultural Commodities Malaysia 2013-2017, Department of Statistics, Malaysia.

[4] Import dependency connotes the idea of an economy that heavily relies upon imports in order to meet its domestic needs.

Many basic food items are close to self-sufficiency

Figure 2: SSR and Net Exports/Imports, Selected Food Items



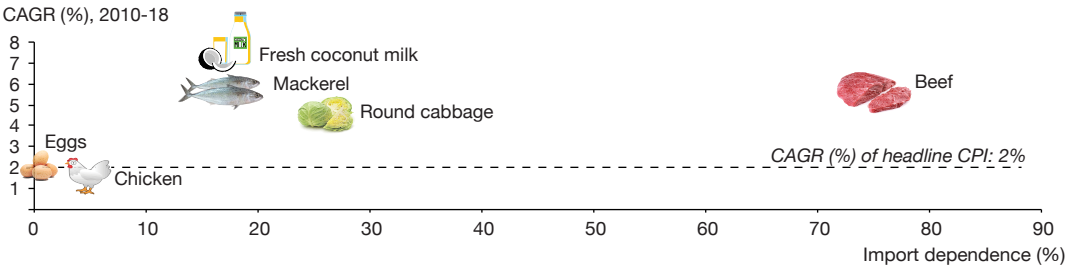
* Note: Import and SSR for rice are based on 2016 figures

Source: Supply and Utilisation Accounts Selected Agricultural Commodities Malaysia 2013-2017, DOSM

From the perspective of imports, the share of imported content in total food supply amounts to 24%[5]. These include both import component of domestic production (9%) and imports of finished goods (15%). Indeed, the supply for certain food items, such as beef and round cabbage, is met largely by imports. Incidentally, these import-dependent items are the ones experiencing above-average inflation rates over the past decade (see Figure 3). Conversely, items such as poultry meat and eggs, which have high self-sufficiency ratios, exhibit price increases that are largely in line with headline inflation. Nonetheless, there is a non-linear relationship between import dependency and price increases. To illustrate, while import dependency for beef is higher than for coconuts, its price increase over the period 2010-2018 is lower than that of fresh coconut milk. Thus, factors other than exchange rate movements also influence the final price to consumers.

The relationship between import dependency and price increase is non-linear

Figure 3: Compound Annual Growth Rates (CAGR) of CPI for Selected Food Items, 2010-2018



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

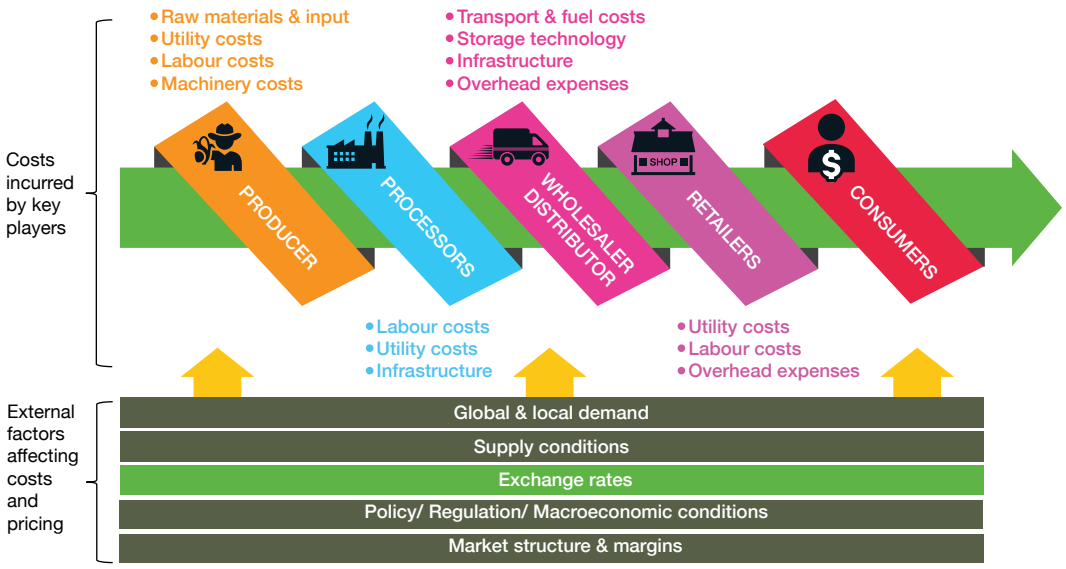
[5] The total import share is calculated based on a weighted average of 17 food-related industries excluding oils & fats. Source: Input-Output Tables 2010-2015, Department of Statistics, Malaysia.

Determinants of food prices: What factors are at play?

Taking into consideration the entire production chain, imports are only one component of total production costs. Agricultural production consists of several main factors, including raw materials and inputs, labour, utilities and logistics (see Figure 4). For instance, the production of round cabbages incurs costs in the form of seeds and fertiliser (inputs), farm labour, water and electricity bills, and finally, logistical costs associated with transportation of vegetables from the farm to retail outlets.

There are many layers involved in food production, all of which affect costs and final prices

Figure 4: Stylised illustration of price determination factors along the agricultural food supply chain



Source: Based on findings from the European Commission (2009), Malaysia Competition Commission (2019)

Imports typically enter the equation by way of raw materials or inputs, some of which are not available domestically. Production of some food items require intermediate inputs such as seeds for fruits and vegetables, or live cattle for the beef industry. In the latter example, domestic players merely play the role of processors and distributors, while actual cultivation and breeding are conducted overseas. As described above, the extent of imported inputs vary by food items; for some food items they might be a critical component, while for other domestically-produced items, labour-intensiveness or logistical complexities may be more significant.

Since food items are globally traded commodities, global demand and supply are also important determinants of import prices. These fundamental factors serve to drive fluctuations in world food prices beyond the control of any given country. Thus, prices might increase even if exchange rates were constant. For example, prices of imported beef from India have been on an uptrend in recent years, contributed by increased demand from countries such as PR China and Indonesia, when previously Malaysia was the sole importer of Indian beef[6]. Global prices for fish and seafood have also risen in recent years, as supply tightened and demand consistently grew[7].

[6] Malaysia Competition Commission (2019), p. 102.
[7] Food and Agricultural Organization of the United Nations (2019), Globefish Highlights.

Margins form the final building block in the determination of consumer prices. While theory posits that margins could reflect the level of market power, determining market power in practice is challenging as some pockets of concentration may exist even if the industry as a whole comprises a large number of players. However, a recent study by the Malaysia Competition Commission (MyCC) identified cattle and beef importation, infant formula production, as well as fish and vegetable distribution as industries with high concentration, which may give their players disproportionate market power.

In the beef industry, where more than 70% of supply is imported, five beef importers collectively account for more than 50% of import volume over the period 2014-2018. This high concentration persists even though the market comprises more than 80 companies. Similarly for live cattle, two importers account for more than 50% of import volume[8]. MyCC raised concerns that this concentration potentially gives players influence over the market supply and pricing, consequently reducing the bargaining power of their buyers. Notably, the report found that wholesale and retail prices for imported beef did not decline even as the exchange rate appreciated from January 2017 to mid-2018, illustrating that the relationship between imports, exchange rates and prices is not as straightforward as commonly assumed. To add to the complexity, final prices would also be affected by public policy and regulation (e.g. health and safety standards), which would also directly impact price developments.

Exchange rates: How big of a role do they play?

An estimation of the exchange rate pass-through to imported food prices in Malaysia[9] suggests that, as expected, a depreciation of the nominal effective exchange rate (NEER) is associated with higher inflation rates for imported food items. However, this pass-through is partial, as exchange rate movements explain only a fraction of these price changes.

Notably, the pass through to individual imported items varies. To illustrate, it is estimated that the average exchange rate pass-through to imported inflation over a 12-month period is around 26% for Indian mackerel (*ikan kembung*), compared to around 8% for apples[10].The actual impact of exchange rate movements on household expenditure would thus be dissimilar and dependent on the composition of each individual household's food consumption basket. On average, a quarter of households' monthly food consumption consists of items with high import content and exchange rate movements would directly affect the prices of these items the most (see Figure 5). On the whole, it is estimated that a 10% depreciation of the NEER would result in a 0.3-0.4% increase in food expenditures.

Nevertheless, it is important to note that this estimation does not include any indirect impact, such as from fuel products or knock-on effects from higher transport costs on food consumed away from home. Households may also deviate from this average due to preferences – as they purchase more imported foods out of preference (e.g. imported rice, premium vegetables, etc.), or consume more food items with high import content, their exposure to import costs would consequently increase.

Conversely, households could also begin to alter consumption patterns and substitute for more economical options, which would then temper the impact of an exchange rate depreciation to household expenditure. Ultimately, exchange rates have a limited contribution to food price changes and the extent to which a household feels the effects of an exchange rate depreciation would hinge upon the composition of its consumption basket.

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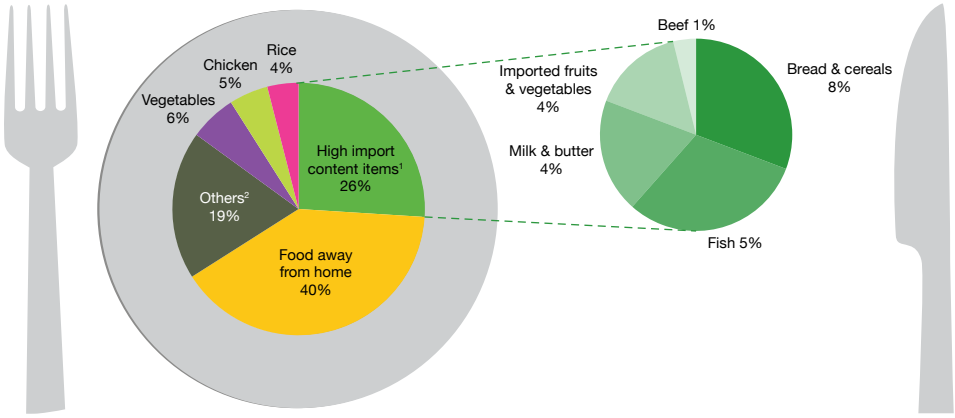
[8] Malaysia Competition Commission (2019), pp. 97-98.

[9] The empirical specification controls for the lag of imported food prices and inflation in import partner countries. Imported food prices are estimated using a weighted index of CPI items with SSR below 95%.

[10] These figures are based on estimations using quarterly inflation data from 1Q 2010 to 3Q 2019 on changes in the NEER, controlling for seasonality, output gap, wage-productivity gap, inflation in import partner economies, and relevant commodity prices where possible.

On average, items with high import content constitute 26% of households' food consumption basket

Figure 5: Household Food Consumption Composition in the CPI (%)



[1] High import content items are classified as selected net imported food items based on trade balance statistics, excluding price-administered items. Breakdown figures may not add up due to rounding adjustments.
[2] Others include beverages, seafood, oils, sugar and confectionaries, and other food preparations.

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

Holding a tiger by the tail

When all factors are considered, Malaysia, similar to other small open economies, is in a dilemma when it comes to imported food. The situation could be summed by the Latin phrase *auribus teneo lupum;* 'holding a tiger by the tail', where both doing nothing and doing something to resolve a problem may result in unintended consequences.

On the one hand, it is undeniable that certain foods with high import dependence are subject to exchange rate fluctuations. Prices for items such as beef, fish, seafood and certain vegetables, all of which are mostly imported, have risen in recent years and these are the items that consumers typically consume.

However, this article cautions against two misconceptions. First is the fixation on the 'net importer' status and exchange rates as the sole driver of food prices. Malaysia is, on the whole, self-sufficient for a considerable number of food items although its total import content for food (24%) is not insignificant. Transforming into a net food exporter may still not wean the country off the need for imports and being under the influence of exchange rates. As explained earlier, exchange rate movements explain only a fraction of food price changes and other factors may be equally, if not more important.

Secondly, caution should also be exercised when suggesting an appreciation of the exchange rate as the main solution for rising food prices. The exchange rate is a crucial macroeconomic variable which is determined by various fundamental factors such as interest rate and inflation differentials, current account and public sector surpluses and deficits, as well as overall economic performance. Arbitrary movements in currency levels would affect exports and import prices, and have far-reaching consequences for the balance sheets of Malaysian firms.

On the other hand, not doing anything is equally risky as higher food prices pose a burden on consumers' cost of living. The problem of rising food prices has to be addressed comprehensively; reducing imports alone will not necessarily result in lower prices, especially when imported inputs are a significant component in the costs of producing food items domestically. In addition, the lack of economies of scale compared to other food-producing countries might prove an obstacle in achieving self-sufficiency in food production; in which case a more practical approach would be to import food items at cheaper cost.

In light of the multifaceted layers involved in food production, the relevant domestic policies currently proposed are timely and warranted, which include diversifying import sources, streamlining regulations and modernising production and distribution technology. These measures, while requiring time to materialise, would address the structural issues that have been at the core of Malaysia's food supply for decades.

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Monetary and Financial Developments

HIGHLIGHTS

- The ringgit depreciated in the third quarter driven by global risk aversion.
- The performance of domestic bond and equity markets diverged amid a confluence of global monetary easing and escalating trade tensions.

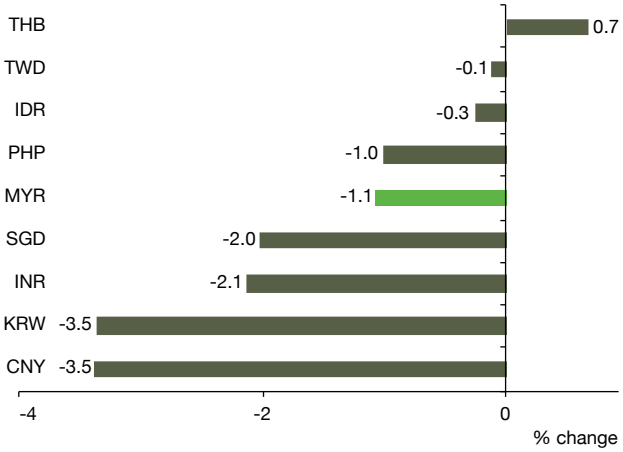
The performance of domestic financial markets were mixed during the third quarter

Performance of domestic financial markets during the quarter was mixed, largely reflecting shifts in investor sentiments and risk appetites amid a confluence of external factors. Despite global monetary easing, worsening trade tensions and concerns on the global growth outlook led to continued heightened risk aversion among financial market investors.

As a result, the US dollar continued to broadly strengthen against other currencies, partly driven by investors' sustained demand for safe haven assets. Consequently, the ringgit depreciated by 1.1% against the US dollar in the third quarter, in line with regional currencies.

Ringgit depreciated against the US dollar in line with most regional currencies

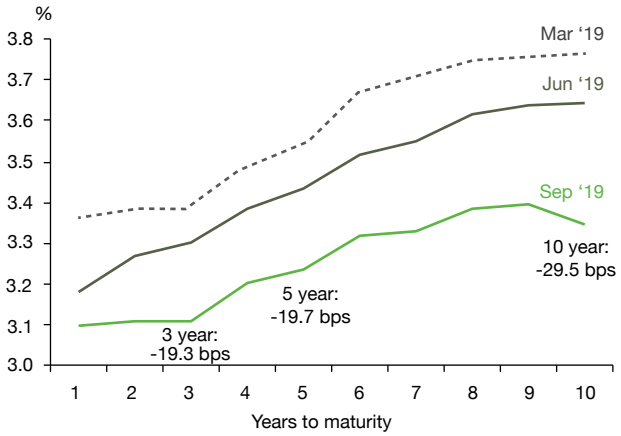
Chart 19: Performance of Regional Currencies Against the US Dollar (1 July - 30 September 2019)



Source: Bank Negara Malaysia

MGS yield curve shifted downwards amid global monetary easing

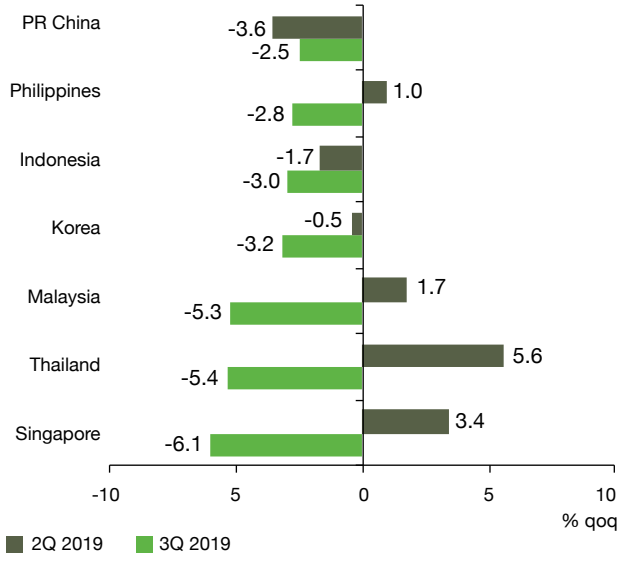
Chart 20: Trend in MGS Yields



Source: Bank Negara Malaysia

Domestic equity market performance declined in line with regional trend

Chart 21: Performance of Regional Equity Markets



Source: Bloomberg

The domestic equity and bond markets experienced diverging performances arising from these global developments. In particular, the FBM KLCI declined by 5.3% to close at 1,584 points at end-September (end-June: 1,672 points), while the 3-year, 5-year, and 10-year MGS yields declined by 19.3, 19.7 and 29.5 basis points, respectively. The weaker domestic equity market performance was in line with the regional trend, as the heightened global risk aversion weighed down on most emerging market equity indices. However, domestic bond yields trended downwards driven by non-resident inflows into the domestic bond market as heightened global risk aversion led to a shift in preference towards the holding of safer financial assets, such as sovereign bonds. The lower yields were also driven by expectations of synchronised global monetary policy easing. In addition to this, the decision to retain Malaysia in the FTSE Russell World Government Bond Index (WGBI) bolstered bond market sentiments at the end of the quarter.

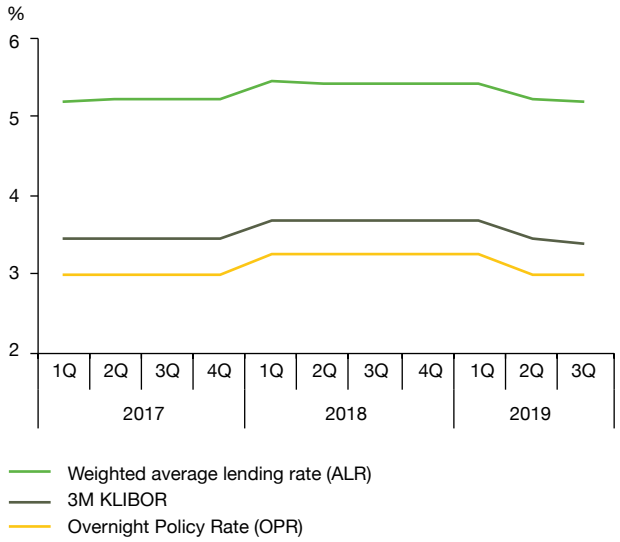
Retail lending rates continued to decline during the quarter, reflecting further OPR pass-through

Nominal interest rates in the wholesale market saw some downward pressure in the third quarter, reflecting market expectations of a potential reduction in the Overnight Policy Rate (OPR). In particular, the 3-month KLIBOR declined by 8 basis points to 3.38% (2Q 2019: 3.46%). In the retail market, while the weighted average base rate (BR) remained stable at 3.68% (2Q 2019: 3.68%), the weighted average lending rate (ALR) on outstanding loans declined to 5.18% (2Q 2019: 5.23%), which reflected the further pass-through from the reduction in the OPR in May 2019.

Real fixed deposit (FD) rates increased in September 2019 due to the relatively lower headline inflation during the month. In particular, the real 3-month and 12-month FD rates increased to 1.75% (June 2019: 1.40%) and 1.99% (June 2019: 1.59%) respectively.

Decline in selected interest rates during the quarter

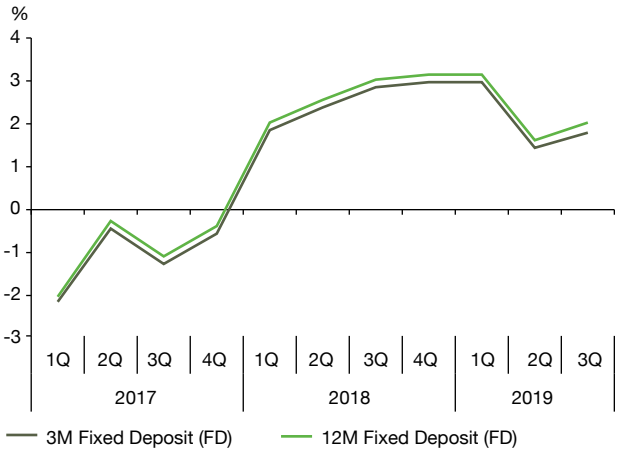
Chart 22: Policy, Interbank and Lending Rates (at end-period)



Source: Bank Negara Malaysia and Bloomberg

Real deposit rates increased, reflecting lower inflation in September

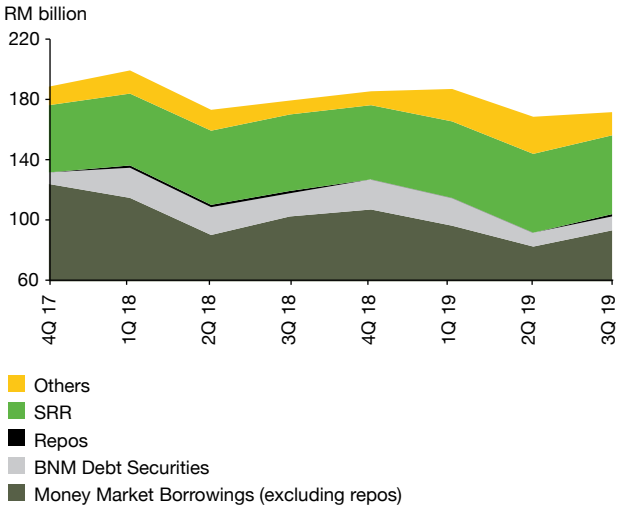
Chart 23: Real Fixed Deposit Rates by Maturity (at end-period)



Source: Bank Negara Malaysia

Outstanding surplus ringgit liquidity placed with the Bank remained stable

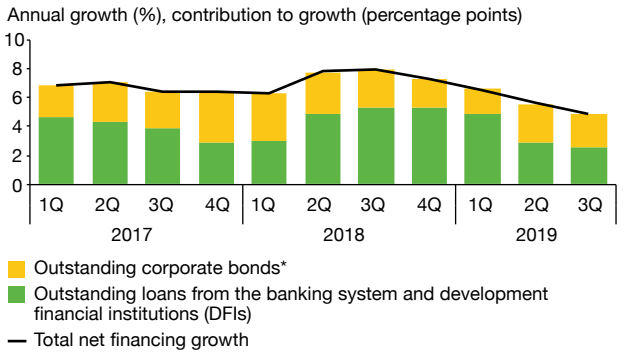
Chart 24: Outstanding Ringgit Liquidity Placed with Bank Negara Malaysia as at end-period



Source: Bank Negara Malaysia

Continued expansion of net financing

Chart 25: Contribution to Net Financing Growth



* Excludes issuances by Cagamas and non-residents

Source: Bank Negara Malaysia

Banking system liquidity remained sufficient to facilitate financial intermediation

The level of surplus liquidity placed with the Bank remained relatively stable, reflecting the marginal net inflows during the quarter. At the institutional level, most banks continued to maintain surplus liquidity positions with the Bank.

The reduction in the Statutory Reserve Requirement (SRR) Ratio from 3.50% to 3.00% effective 16 November 2019 will result in a broad-based release of liquidity into the banking system. This will continue to support the efficient functioning of the domestic financial markets and facilitate effective liquidity management by the banking institutions.

Continued expansion of net financing during the quarter

In the third quarter, net financing expanded by 4.8% on an annual basis (2Q 2019: 5.6%), amid continued moderate growth in loans.[4] Growth of outstanding corporate bonds[5] increased by 9.0% during the quarter (2Q 2019: 10.6%), with most issuances in the finance, insurance, real estate and business services sector. Outstanding business loans recorded a 1.6% growth on an annual basis (2Q 2019: 2.7%). Steady loan disbursements to the manufacturing, wholesale and retail trade, restaurants and hotels, and construction sectors supported loan growth in these sectors. However, loan growth in the real estate sector contracted amid continued weakness in the property segment. Demand for business financing continued to improve with higher growth in loan applications[6] during the quarter (11.9%, 2Q 2019: 3.9%). For the household segment, outstanding loans expanded by 4.6% (2Q 2019: 4.8%) with higher loans disbursed for the purchase of residential property and personal use.

[4] Loans from the banking system and development financial institutions (DFIs).
[5] Corporate bonds exclude issuances by Cagamas and non-residents.
[6] Loan applications to the banking system only.

Box Article 2

Banking on Banks: Are They Lending Enough?

Authors: Syairah Hanin Shaharuddin, Lim Sheng Ling, Nurjannah Ahmat, 'Aliya' Yasmin Hanafi, Junaidah Yusof and Kiesha Ooi

HIGHLIGHTS

- Overall lending has moderated from a period of credit exuberance
- Banks remain willing to lend to bankable segments
- Loan rejections are symptomatic of broader issues on home affordability and creditworthiness

Introduction

The moderating trend in credit growth in more recent periods has raised questions on whether banks are lending enough to support the Malaysian economy, and the extent to which banks may have turned overly cautious on lending standards. This article attempts to contextualise these issues from various perspectives, including lending[1] trends, banks' risk appetite, and the profile of loan rejections.

Overall lending has moderated from a period of credit exuberance[2]

Outstanding loans from the banking system have registered a more moderate expansion. As at end-September 2019, the annual growth in outstanding loans from the banking system moderated to 3.8% (2017: 4.1%, 2018: 5.6%) (Chart 1).

The moderation in credit growth reflects both structural and cyclical trends. Structurally, growth in bank lending has stabilised to more moderate levels as compared to the strong credit growth during 2010-14, a period of exuberant consumption credit and property-related lending (Chart 1). The gradual moderation in credit expansion partly reflects the outcome of a deliberate and measured policy strategy to manage risks from high household indebtedness and to curb excessive speculative activity in the Malaysian housing market[3] (Chart 2). Since 2016, household personal financing and housing loans have been growing more in line with income at a pace of 3-5% and 7-9%, respectively, below their previous peaks of 20.5% and 13.4% (Charts 3 and 4). Meanwhile, a moderation in property investments[4] by businesses also contributed to more moderate business loan growth (Chart 5). Cyclically, credit growth is also a function of the demand for credit, corresponding with the economic cycle. Demand for credit has moderated in recent years, in line with more moderate domestic economic activity amid weaker sentiments, prevailing uncertainties and heightened risks from the global environment (Chart 6).

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[1] The terms "loans", "credit", "lending" and "financing" are used interchangeably throughout this article to refer to loans extended by banks, and includes financing extended by Islamic banks.

[2] Unless otherwise stated, the data used in this section have been adjusted to exclude a newly licensed commercial bank. The adjustment allows for comparable and meaningful analysis of the loan indicators across time.

[3] Refers to a series of pre-emptive macro- and micro-prudential measures deployed by the Government and BNM from the year 2010. These include the implementation of maximum loan-to-value (LTV) ratio for housing loans, maximum loan tenures, Guidelines on Responsible Financing, and increase in the Real Property Gains Tax for property disposal. For a summary of the measures, refer to the BNM Financial Stability and Payment Systems Report 2017 box article titled "Indebted to Debt: An Assessment of Debt Levels and Financial Buffers of Households".

[4] Refers to both purchase of residential and non-residential properties. The growth of business loans for property end-financing peaked at 23.8% during the 2010-14 period.

From a supply perspective, loans disbursed to the private sector remain at levels comparable to the recent three-year average (2016-18) (Chart 7). This shows that there has not been a general reduction in credit available to the economy. After normalising for economic activity during each period, loans disbursed to all segments in recent periods have fallen slightly below historical averages[5], reflecting the lagged effect of dampened credit demand given slower loan applications in the preceding quarters (Chart 8). Prevailing softer property market conditions have also weighed on bank lending. However, recent improvements in loan applications since the second quarter of 2019 could translate to higher disbursements in future periods.

Banks remain willing to lend to bankable segments[6]

Fundamentally, banks have a natural incentive to lend in order to generate revenue. In the case of Malaysian banks, net interest income comprises the bulk (64.8%) of their gross income. Over the years, this incentive to lend has grown stronger as banks' profit margins have come under greater pressure due to strong competition among banks for market share. Faced with narrowing margins, the ability of banks to grow lending volume has become more important to maintain profitability.

This is also borne out by trends in loan approvals. On average, banks approve roughly three out of four housing loan applications they receive. In 2019[7] alone, this meant banks approved housing loans worth RM119 billion for about 273,000 borrowers, which is higher than the level of approvals seen in the past three years for the same period. Nearly half of the loans approved (42%) were granted to first-time homeowners. The distribution of loan rejections corresponded broadly to the distribution of loan applications across income groups (Chart 9). This suggests that the availability of access to credit has not been disproportionately withdrawn for any particular income segment. BNM's review of bank lending practices affirms that in carrying out affordability assessments on loan applications, banks are taking into account borrowers' specific financial circumstances.

In the small and medium enterprise (SME) segment, banks have been approving about seven to eight out of every ten loan applications received. In 2019, this equated to RM50 billion in loans approved, which is higher than the 3-year average of RM48 billion for the same period, benefitting about 76,000 SMEs. Banks have also been easing collateral requirements and financing rates for SMEs in the past year based on more holistic assessments of an SME's income and cash flow conditions. Banks' increasing experimentation with innovative credit assessment tools, such as psychometric assessments, coupled with their strong financial buffers further reinforce the willingness and capacity of banks to sustain credit flows to the economy.

Notably, the share of SME credit to SME GDP for Malaysia is 63%, well above other major economies (Chart 10). SMEs also represent a strategic growth driver for most banks, as reflected in the steady uptrend in the share of SME financing over total business financing since 2010 (Chart 11). Banks also continue to be the main source of external financing for SMEs, accounting for more than 92% of total SME financing.

Loan rejections are symptomatic of broader issues on home affordability and creditworthiness

While banks are willing to lend and are adopting better risk assessment tools to identify creditworthy borrowers, studies have found poor repayment track record, cash flow concerns and over-leveraging to be the primary factors for loan rejections among households and SMEs[8].

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[5] Refers to the 2006-18 period, excluding the period of strong credit growth during 2010-14. Recent deviations to below the long-term average remains within one standard deviation for businesses and SMEs but is somewhat more pronounced in the household segment at slightly more than one standard deviation beginning the second quarter of 2019.

[6] Lending data used from here onwards includes a newly licensed commercial bank.

[7] Refers to January-September.

[8] Source: Surveys conducted by Bank Negara Malaysia, imSME and SME Corp

For housing loans, this stems from a broader issue of home affordability, which becomes readily apparent when 72% of rejected applications were for the purchase of homes that are either seriously or severely unaffordable relative to the applicant's income level[9] (Chart 12).

For SMEs, loan rejections were found to be most commonly associated with younger businesses with incomplete financial statements and negative net worth[10]. A review[11] of rejected applications affirms this, with weak financial positions and concerns on business viability topping reasons for banks' rejections of SME loan applications (Chart 13). Certain businesses, particularly start-ups and high-risk ventures, are ill-suited to financing by deposit-taking institutions like banks. The high level of uncertainty in these businesses' performance is incompatible with the nature of deposits that should be payable on demand, which entails banks to safeguard the security of deposits at all times. As a result, SMEs involved in such segments also face relatively higher rejection rates.

Recognising these natural limitations on the part of banks, BNM, in collaboration with Credit Guarantee Corporation (CGC) and Agensi Pengurusan dan Kaunseling Kewangan (AKPK), have set up the Khidmat Nasihat Pembiayaan (MyKNP) to assist those with unsuccessful financing applications. Unsuccessful SME financing and home financing applicants will be referred to MyKNP@CGC and MyKNP@AKPK, respectively, where they may obtain advisory services on the possible reasons for the rejected application, ways to improve future financing eligibility, as well as alternative funding sources and solutions.

Concluding thoughts

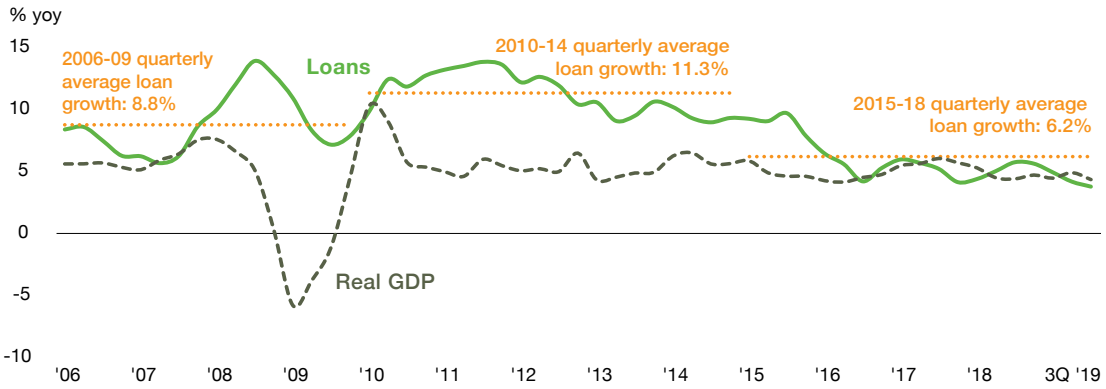
Despite the more moderate expansion in outstanding loans and the perception that bank lending standards are overly stringent, data on loan disbursements and approvals continue to show that banks remain willing to lend to bankable households and businesses, with the amount of credit being extended sustained at levels largely aligned with prevailing economic conditions. The recent moderation in loan growth has followed from a period of credit exuberance, and is an expected outcome of a deliberate and measured policy strategy to manage risks from high household indebtedness and speculative activities in the residential property segment. Further, when examining rejected loan applications more closely, it also becomes apparent that rejections are largely symptomatic of broader issues on housing affordability and creditworthiness rather than banks being overly cautious. At the same time, ensuring responsible lending standards remains important to avoid increasing economic and financial vulnerabilities, and to promote the resilience of banks, households and businesses. This is critical to provide support for the economy through financial and business cycles and ultimately the welfare of Malaysians.

[9] For a discussion on the different methodologies on assessing housing affordability, refer to the Bank Negara Malaysia Annual Report 2016 box article titled "Demystifying the Affordable Housing Issue in Malaysia".

[10] For an in-depth discussion on the financing needs and challenges faced by SMEs, refer to the Bank Negara Malaysia Financial Stability and Payment Systems Report 2018 box article titled "Understanding Financing through the Lens of Small and Medium Enterprises (SMEs)".

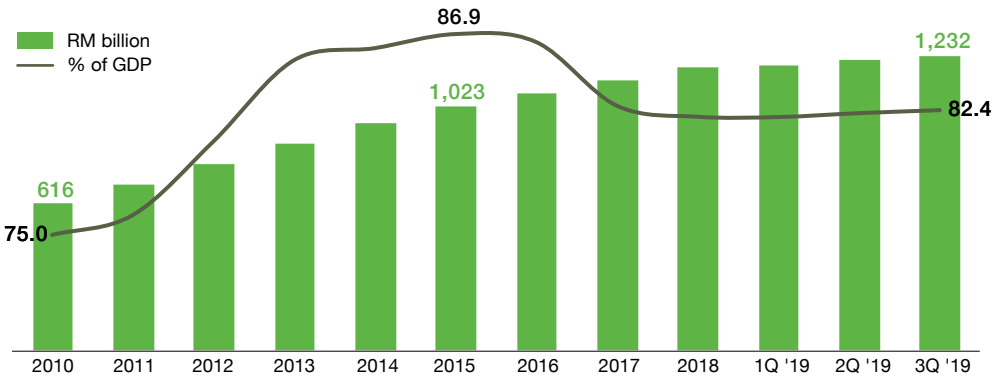
[11] A supervisory review was conducted to establish whether banks are overly conservative when assessing loan applications by SMEs. A random sample of 691 SME rejection cases was taken for the exercise, spanning several banking groups.

Chart 1: Outstanding Banking System Loans and Real GDP



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

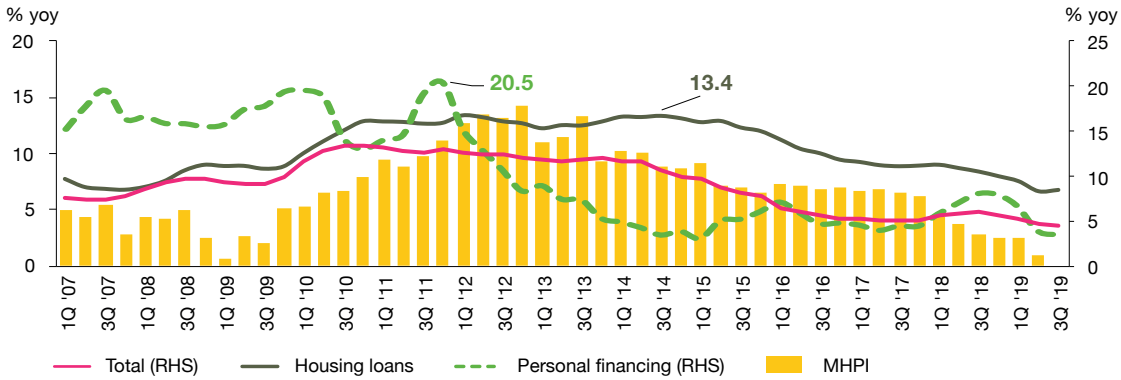
Chart 2: Outstanding Household Debt



Note: Extended by banks, development financial institutions (DFIs) and major non-bank financial institutions (NBFIs)

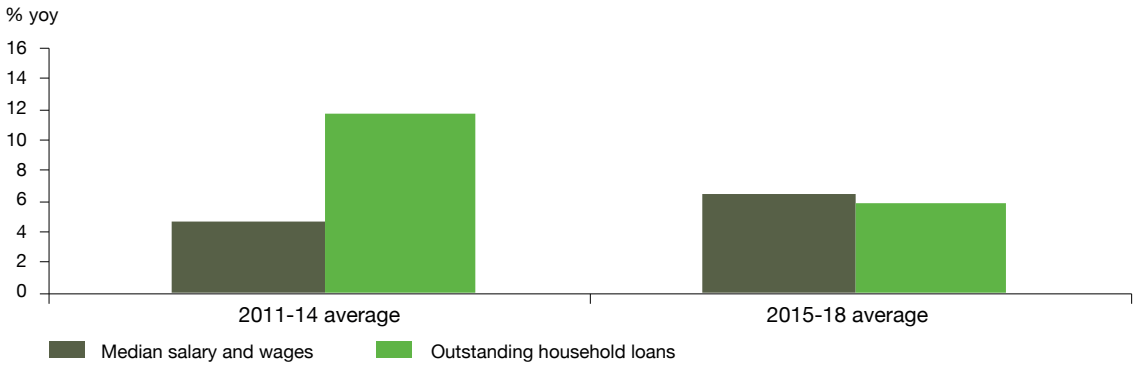
Source: Bank Negara Malaysia

Chart 3: Outstanding Household Loans



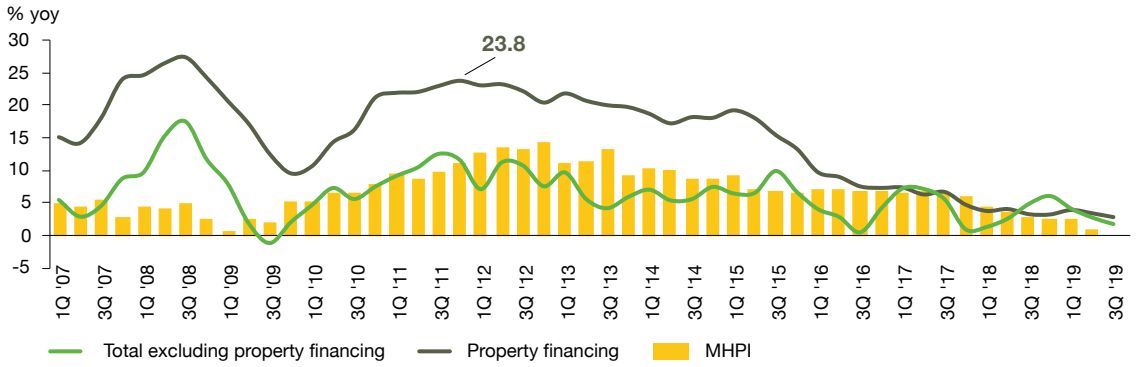
Note: Latest Malaysian House Price Index (MHPI) data for 2Q 2019 is preliminary
Source: Haver Analytics, National Property Information Centre (NAPIC) and Bank Negara Malaysia

Chart 4: Growth in Household Loans and Income



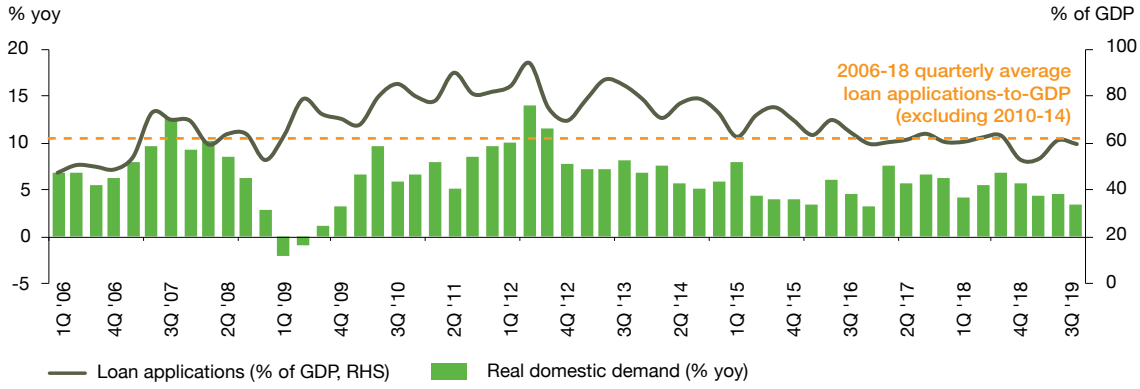
Note: Salary and wages data is only available in annual frequency, and for 2010 onwards
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 5: Outstanding Business Loans



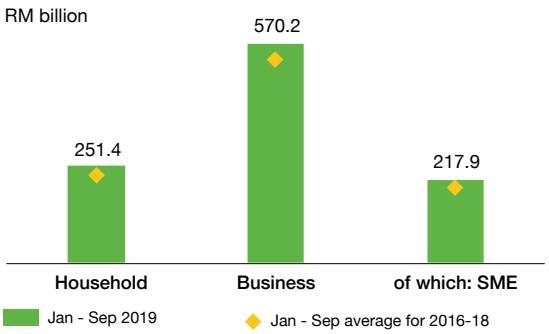
Note: Latest Malaysian House Price Index (MHPI) data for 2Q 2019 is preliminary
Source: Haver Analytics, National Property Information Centre (NAPIC) and Bank Negara Malaysia

Chart 6: Loan Applications and Domestic Demand



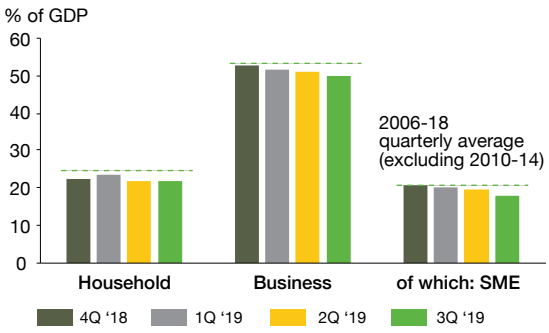
Source: Bank Negara Malaysia

Chart 7: Loan Disbursements



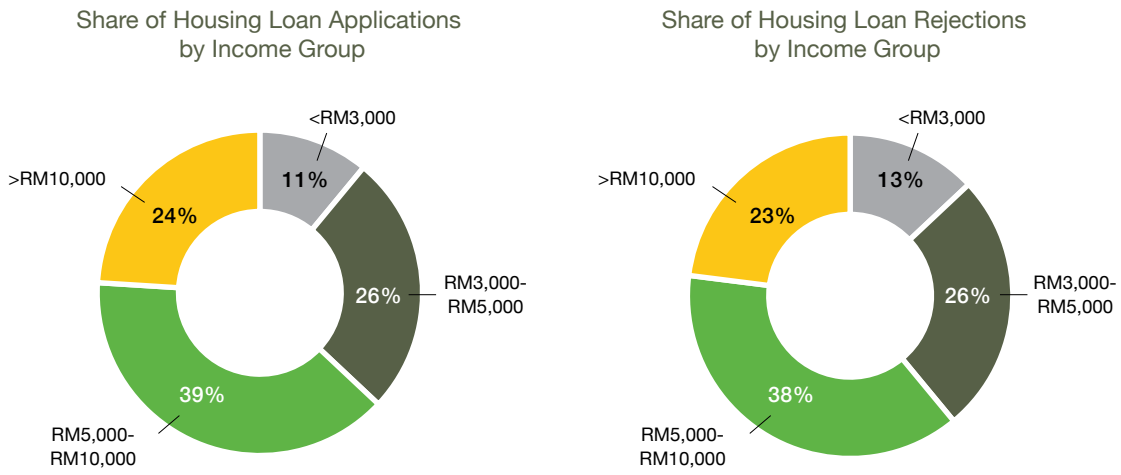
Source: Bank Negara Malaysia

Chart 8: Loan Disbursements-to-GDP



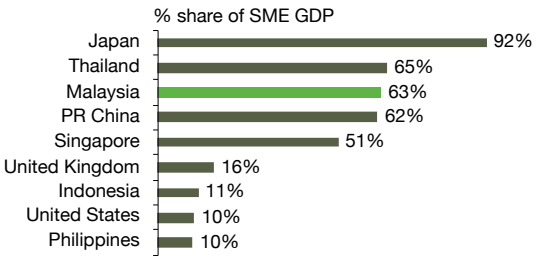
Source: Bank Negara Malaysia

Chart 9: Composition of Housing Loan Applications and Rejections by Income Group



Source: Bank Negara Malaysia

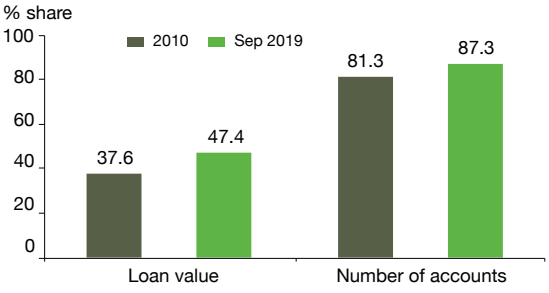
Chart 10: SME Credit-to-SME GDP*



*Refers to latest SME GDP data available from 2012 - 2018

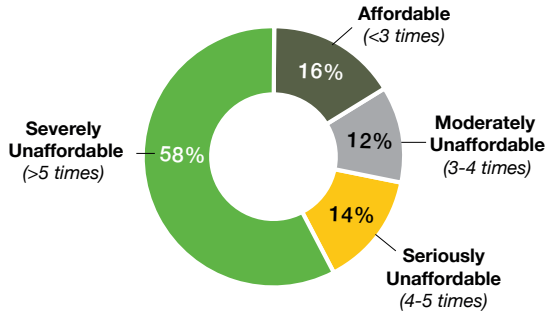
Source: Bank Negara Malaysia estimates using data from Financing SMEs and Entrepreneurs: An OECD Scoreboard (2019), World Bank, DOSM, China MSME Finance Report 2018 and Deloitte Southeast Asia (2015) Digital banking for SMEs

Chart 11: Share of Outstanding SME Loans to Outstanding Business Loans



Source: Bank Negara Malaysia

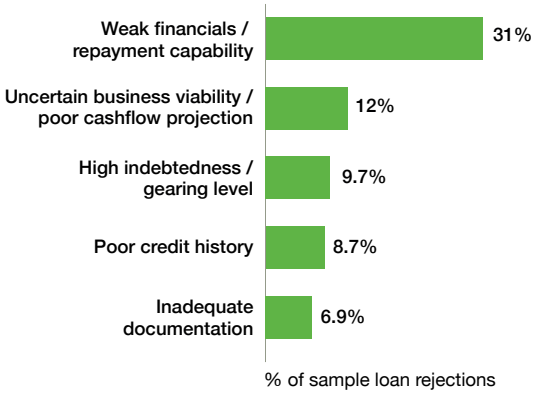
Chart 12: Rejected Housing Loan Applications by Affordability[1]



[1] Using the Median Multiple approach, this refers to the ratio of house price to households' annual income

Source: Department of Statistics, Malaysia, National Property Information Centre (NAPIC) and Bank Negara Malaysia

Chart 13: Top 5 Reasons for SME Loan Rejections



Source: Bank Negara Malaysia

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The Bank's Policy Considerations

HIGHLIGHTS

- **The MPC maintained the Overnight Policy Rate at 3.00% in July, September and November, assessing that the current monetary policy stance remains accommodative and supportive of economic activity.**

The OPR remained accommodative

The Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.00% at the July, September and November 2019 meetings. At this level of the OPR, the stance of monetary policy remains accommodative and supportive of economic activity.

The global economy is expanding at a more moderate pace, with the slowdown becoming more synchronised across both the advanced and emerging economies. Going forward, geopolitical tensions, policy uncertainty and unresolved trade disputes could exacerbate financial market volatility and further weigh on the global growth outlook. Monetary easing and other policy measures are expected to provide some support to growth.

Growth of the Malaysian economy is expected to be within projections in 2019 and the pace sustained going into 2020. Growth is expected to remain anchored by firm private sector expenditure. This projection remains subject to downside risks, mainly stemming from uncertainties in global economic and financial conditions as well as weakness in commodity-related sectors.

Headline inflation in 2020 is expected to average higher but remain modest. The trajectory will, however, be dependent on global oil and commodity price developments. Underlying inflation is expected to remain stable, supported by the continued expansion in economic activity and in the absence of strong demand pressures.

The MPC will continue to assess the balance of risks to domestic growth and inflation, to ensure that the monetary policy stance remains conducive to sustainable growth amid price stability.

Other policy highlights in the third quarter of 2019

Policy highlights	Salient requirements
Net Stable Funding Ratio (NSFR) – Policy Document (PD)	• The NSFR ensures that banks can support asset growth in a sustainable manner, by funding their activities with stable sources of funding. • The policy will come into force on 1 July 2020.
Shariah Governance – Policy Document (PD)	• The PD aims to strengthen the effectiveness of Shariah governance within Islamic financial institutions by enhancing expectations on– o the roles and responsibilities of the board, Shariah committee and key organs involved in ensuring end-to-end Shariah compliance; o professionalism and independence of Shariah committees; and o quality of internal control functions for effective management of Shariah non-compliance risks. • This PD will come into force on 1 April 2020, with a 3-year transition for the tenure limit of Shariah committee members.
Corporate Governance for DFIs – Exposure Draft (ED)	• The ED was issued for public consultation on 23 August 2019, setting out the strengthened requirements for strong and effective boards, with greater emphasis on a sound risk culture and a requirement to disclose DFIs' mandates and performance measurement frameworks. • Key proposals include requirements to: o strengthen the management structure to promote accountability and transparency; o an expectation for DFIs to foster a corporate culture that promotes ethical, prudent and professional behaviour; and o enhanced disclosure of mandates and performance measurement frameworks. • The PD is expected to be issued in November 2019.
Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) – Money Services Business (Sector 3) (Supplementary Document No. 2) – Policy Document (PD)	• The PD sets out the minimum requirements for licensed money changers which carry on money changing business through online channel or mobile channel using e-KYC for customer on-boarding. • This policy aims to ensure that effective and robust AML/CFT control measures and systems are in place where licensed money changers establish business relationships with customers by way of electronic means without face-to-face verifications. • The PD came into force on 19 September 2019.
Risk Management in Technology (RMiT) – Policy Document (PD)	• The PD will come into force on 1 January 2020, setting out the Bank's requirements for financial institutions' management of technology risk. • The 4 key thrusts of the requirements are– o Effective board oversight on IT and cyber risks; o A strong second line of defence for effective technology risk management; o Adequate arrangements to ensure continued service availability and resilient IT infrastructures; and o Greater cyber resilience to emerging risks associated with new technologies.

Macroeconomic Outlook

HIGHLIGHTS

- Global economic activity to moderate in 2019, with fragile recovery expected in 2020.
- Growth of the Malaysian economy to remain broadly sustained in 2019 and 2020.
- Headline inflation in 2020 is projected to average higher but remain modest.

Global growth to moderate in 2019, with fragile recovery expected in 2020

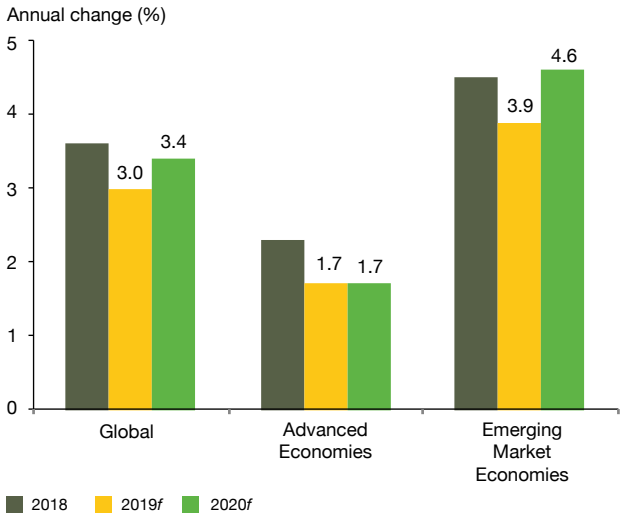
Global growth is expected to moderate in 2019 and marginally improve in 2020, amid continued headwinds from weak global trade and softer domestic demand in major economies. However, the outlook for 2020 is fragile and predicated upon faster growth in vulnerable emerging market economies, which is subject to uncertainty.

The US economy is projected to moderate, due mainly to waning investment activity. Private consumption growth is expected to weaken, as labour market conditions soften. In the euro area, sustained weaknesses in Germany's manufacturing sector could exert adverse spillovers to the rest of the euro area, amplified by moderating global demand. In PR China and the regional economies, although growth prospects are weighed by weak external demand, supportive domestic policies are expected to buffer the growth moderation.

The balance of risk to the global outlook remains tilted to the downside, emanating mainly from a continued escalation in trade tensions and intensification of geopolitical developments.

Global economic activity to moderate in 2019, and marginally improve in 2020

Chart 26: GDP Growth



f Forecast

Source: IMF World Economic Outlook (October 2019)

Growth of the Malaysian economy to remain sustained in 2019 and 2020

The Malaysian economy continued to expand in the third quarter, bringing the overall performance of the first three quarters to 4.6%. The pace of growth is expected to be sustained for the remainder of the year and going into 2020. Household spending will remain the key driver of growth, supported by continued employment and income growth. Private investment growth is projected to remain modest, supported partly by realisation of approved projects. Public investment will be a smaller drag to growth, following planned higher capital spending mainly in the transportation segment. On the external front, support from net exports will likely moderate, as imports are expected to grow faster than exports, in line with the projected improvement in the investment activity.

The balance of risks to growth remains tilted to the downside, arising from protracted trade tensions, uncertainties in the global economic and financial conditions, as well as weakness in commodity-related sectors.

Headline inflation in 2020 is projected to average higher but remain modest

The annual average headline inflation is expected to be low in 2019. For the remainder of the year, headline inflation will reflect the downward contribution from the lapse in the SST impact and domestic fuel prices as fuel price ceilings remain in place until the end of 2019.

Moving into 2020, headline inflation is projected to average higher but remain modest. This reflects the lapse in the impact of consumption tax policy changes, the lifting of the fuel price ceilings amid the relatively subdued outlook on global oil prices, and policy measures in place to contain food prices. The trajectory of headline inflation will, however, be dependent on global oil and commodity price developments. Underlying inflation is expected to remain stable, supported by the continued expansion in economic activity and the absence of strong demand pressures.