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SERC

CIMB-Sin Chew Business Forum

Malaysia: Preparing for the future

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15 January 2018

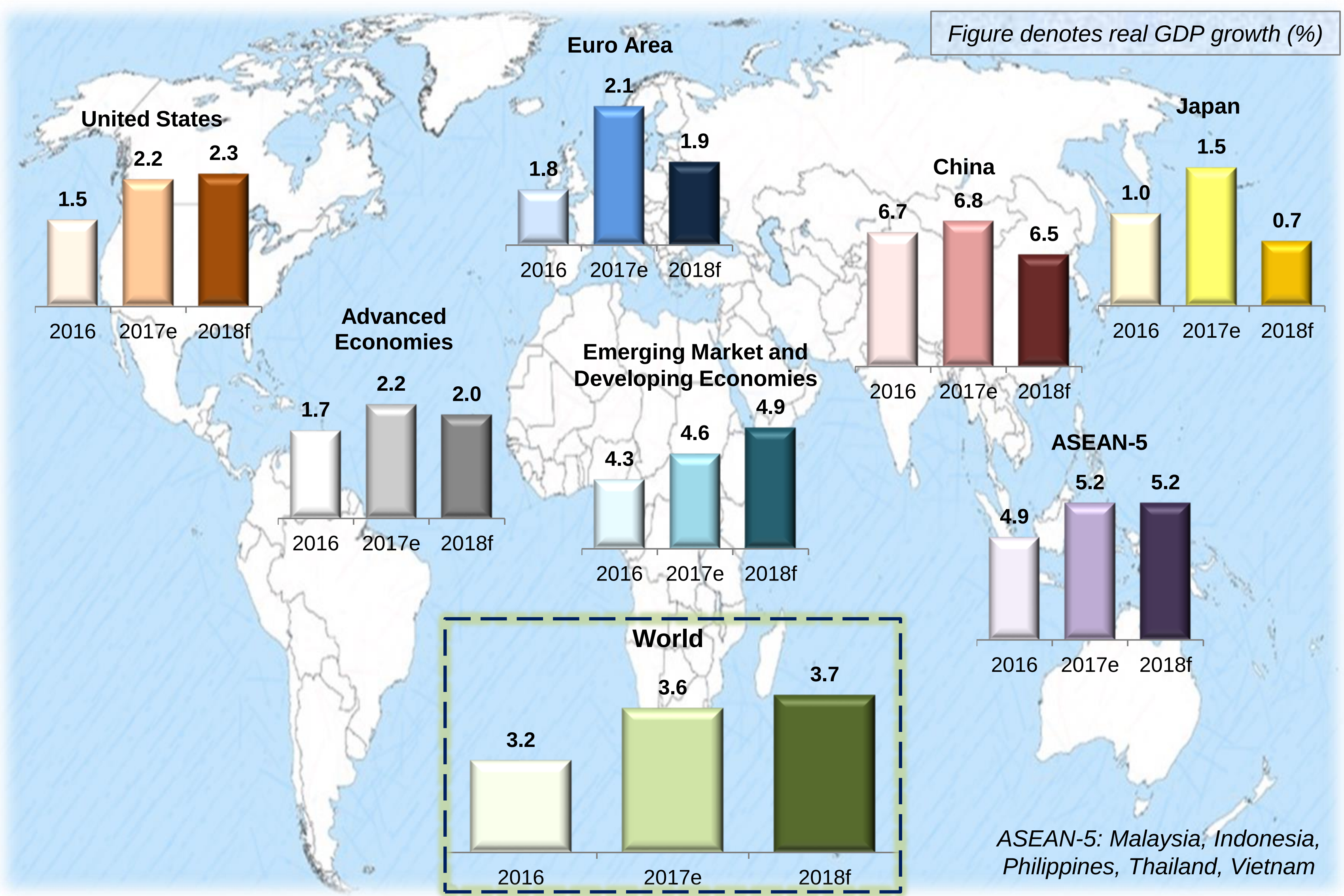
Agenda

- GLOBAL ECONOMY TO CONTINUE MOMENTUM
- GLOBAL ECONOMIC RISKS TO WATCH
- MALAYSIA: WHAT TO EXPECT IN 2018?
- HOW RESILIENCE IS MALAYSIA TO SHOCKS?
- MEDIUM- AND LONG-TERM POLICY CHALLENGES

PROBING questions

- How **SUSTAINABLE** is the current global economic upswing?
- What are key **CHALLENGES** to boost potential output while building resilience against downside risks?
- Will there be a **SYNCHRONISED TIGHTENING** in global monetary policy in 2018?
- Can Malaysia stay **RESILIENT** in challenging times?
- Step up **POLICY REFORMS** to address and contain **VULNERABILITIES** to build economic resilience

Global ECONOMIC UPSWING, is the recovery COMPLETE?



Source: IMF

Mapping global prospects, CHALLENGES and RISKS

Global economy on upswing, but risks remain

- Recovery is **INCOMPLETE**; some still weak
- Short-term growth supported by improved confidence and pent-up demand
- Potential for much faster growth - **WEAK PRODUCTIVITY; AGING POPULATION**
- Improve **GOVERNANCE** and the **INVESTMENT CLIMATE**

Policy risks

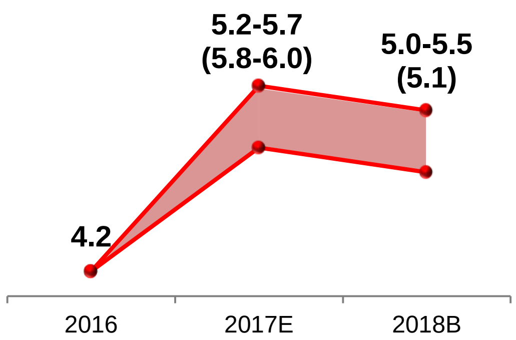
- Hopes fading if policy outcomes fall short of market expectations
- **POTENTIAL DISRUPTIONS**: inward-looking policies, Brexit's negotiation & geo-politics
- Volatility induced by the withdrawal of monetary easing and shrinking balance sheet
- Monetary policy – From **DIVERGENCE TO CONVERGENCE?**

Contain financial vulnerabilities

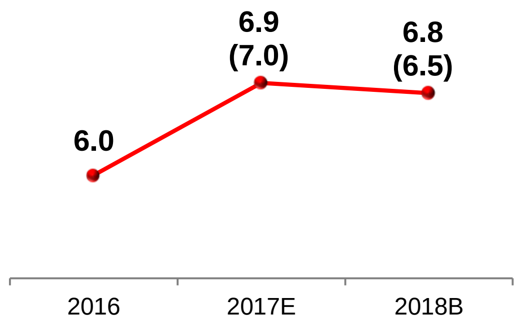
- Stretched asset valuations and increasing **LEVERAGE** (Global debt to GDP: 318% at 3Q17)
- **UNSUSTAINABLE** asset prices, credit growth and debt implosion
- Chinese to rein in **CREDIT EXPANSION AND CONTROL DEBT** (2017: 257% of GDP)

Malaysian economy: What to EXPECT in 2018? UPSIDE RISK!

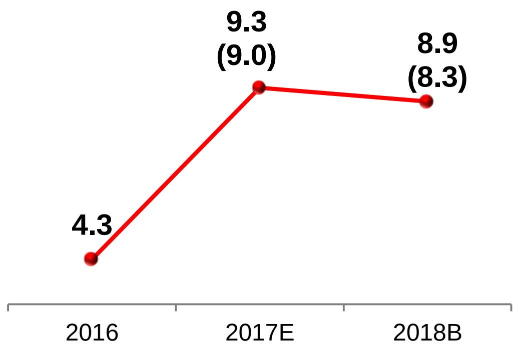
GDP growth
(%)



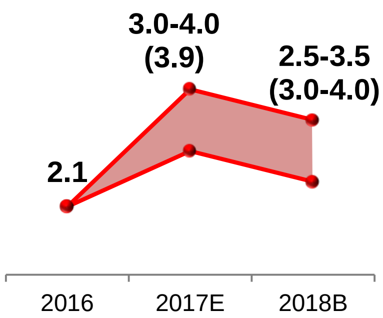
Private consumption growth
(%)



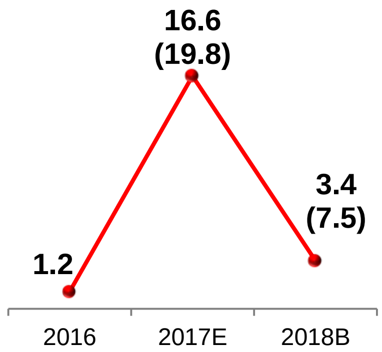
Private investment growth
(%)



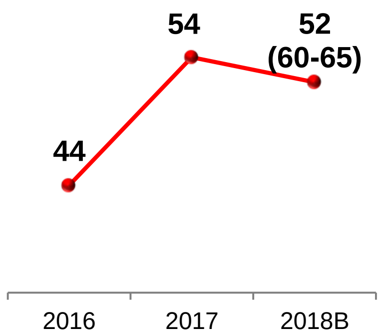
Inflation rate
(%)



Export growth
(%)



Brent crude oil price
(US$/barrel)



Crude palm oil price
(RM/tonne)

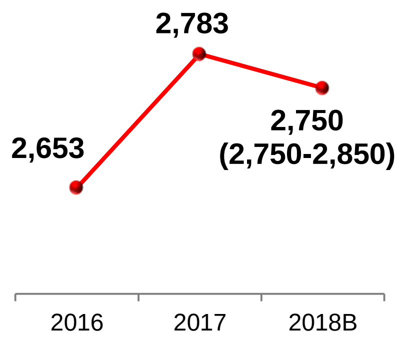


Figure in parenthesis denotes SERC's estimation and forecast
Source: MOF (Economic Report 2017-18); EIA; MPOB; SERC

Sectoral outlook: Positive, BROAD-BASED EXPANSION

Services

2018F: 5.6% (2017E: 6.1%)

% share of GDP: 54.5

- Sustained domestic spending, higher tourist arrivals, logistic services and financial services
- Higher growth in wholesale and retail trade, F&B, information and communication, transport and storage as well as finance and insurance subsectors

Manufacturing

2018F: 5.5% (2017E: 6.3%)

% share of GDP: 23.0

- Export-oriented industries: sustained demand for electronics and electrical products, refined petroleum and wood products
- Domestic-market oriented: construction-related building materials, food products and transport equipment

Mining

2018F: 1.5% (2017E: 1.7%)

% share of GDP: 8.4

- Higher natural gas output
- Malaysia agrees to extend oil output cuts until end-2018
- Brent price to average US$60-65 per barrel in 2018 vs 2018 Budget's US$52

Agriculture

2018F: 3.8% (2017E: 5.5%)

% share of GDP: 8.1

- Slower rise in CPO production and rubber output
- Livestock, fruits and vegetables

Construction

2018F: 8.0% (2017E: 7.2%)

% share of GDP: 4.6

- On-going civil engineering infrastructure projects such ECRL, MRT SSP line, Electrified Double Track Gemas-Johore Bahru, SPE, Pan Borneo Highway and Bokor Central Processing Platform
- Property overhang glut Slow growth in commercial development due to property overhang

Getting ready to INTEREST RATE HIKES in 2018

- **OUR BASELINE CALL IS 25 BASIS POINTS HIKE FOR A START**. The market must prepare for further rise in rates if the following conditions are met throughout the year 2018:
  1) If the global growth and domestic economy continues to sustain at strong levels, supported by domestic demand;
  2) To anchor inflation expectations should headline and core inflation continue to remain at elevated levels as oil prices remain a wild card. BNM needs to stay ahead of the inflation curve; and
  3) To balance the yield gaps should the Fed hike rates aggressively.

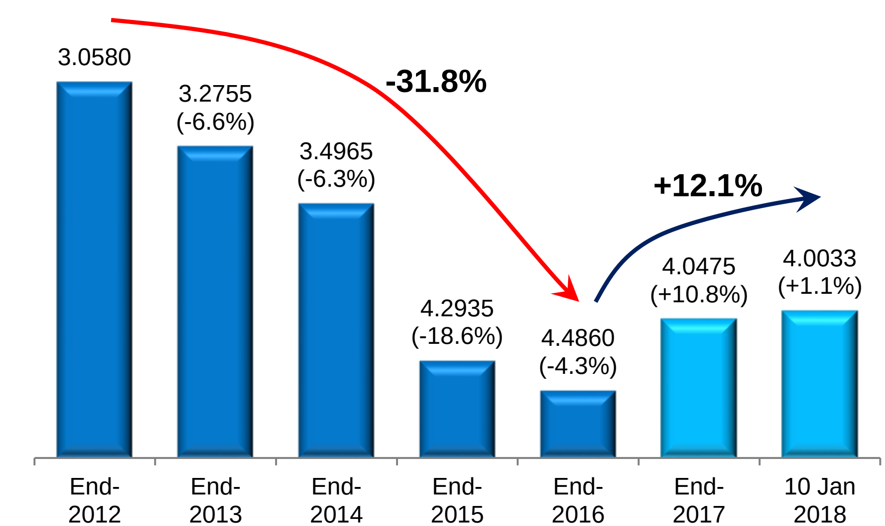
	2007	2008	2009	2010	2016	2017	2018*F*
OPR	3.50% =	3.25% ↓	2.00% ↓	2.75% ↑	3.00% ↓	3.00 =	**3.25-3.50% ↑**
GDP	6.3% ↑	4.8% ↓	-1.5% ↓	7.4% ↑	4.2% ↓	5.8%[1] ↑	**5.1% ↓**
Inflation	2.0% ↓	5.4% ↑	0.6% ↓	1.7% ↑	2.1% =	3.9%[1] ↑	**3.0-3.5% ↓**
RM/US$1 *(end-period)*	3.3115 ↑	3.4675 ↓	3.4265 ↑	3.0855 ↑	4.4860 ↓	4.0475 ↑	**3.80-3.90 ↑**

[1] *Estimated*
Source: Bank Negara Malaysia

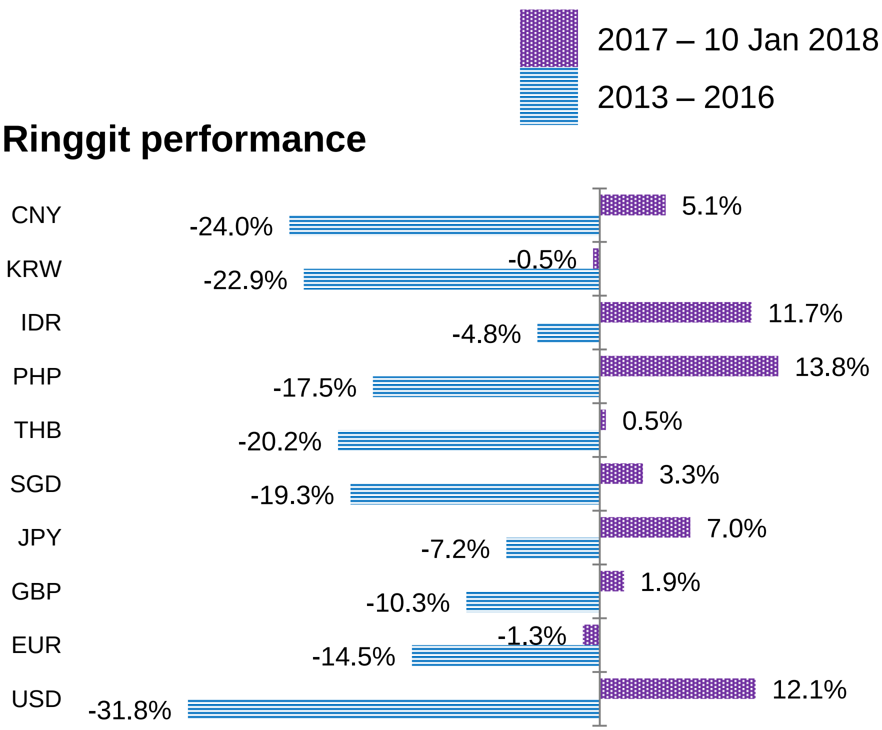
The ringgit does not reflect its FUNDAMENTAL value

- **POSITIVE FUNDAMENTALS**: Brightening economic growth prospects, firming commodity prices, the onshore ringgit stabilization measures, prospect of domestic interest rate normalization, continued current account surplus, accumulation of foreign reserves.
- **COUNTERACT DAMPENING FACTORS**: Strong US dollar, higher US interest rates and yields, flows into the US dollar assets, geopolitical risks and developments in global financial markets.
- End-2018F: RM3.80-3.90/US$1

Ringgit movement against USD



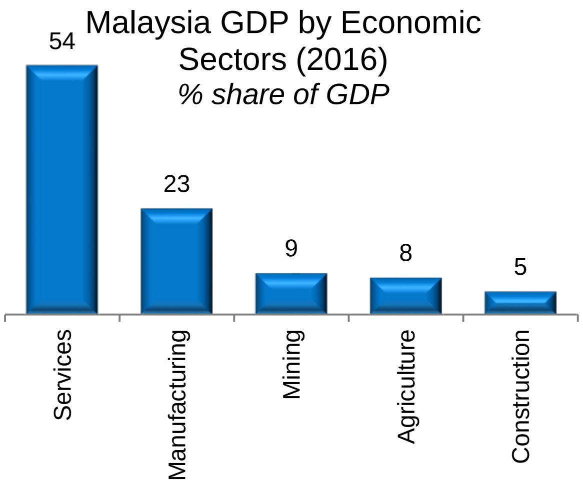
Ringgit performance



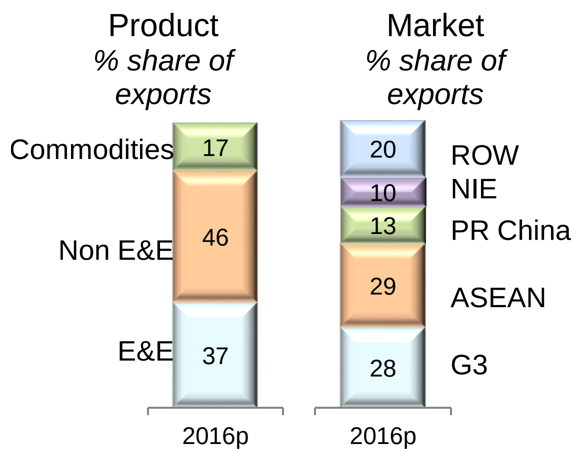
Source: Bank Negara Malaysia

Macroeconomic FUNDAMENTALS supportive of growth

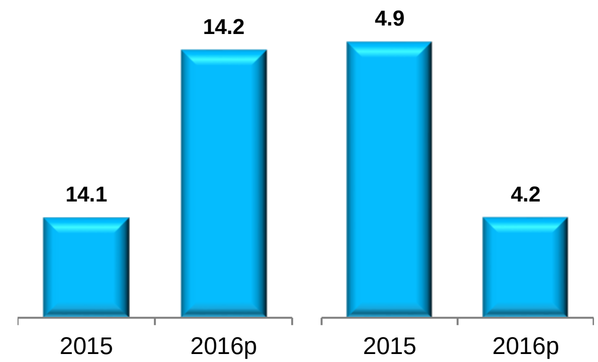
Diversified sources of growth



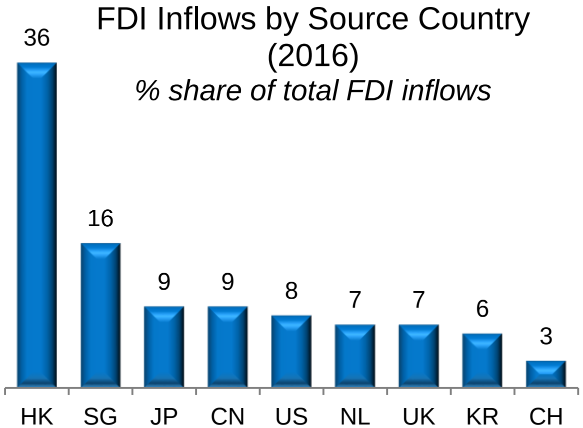
Diversified export markets and products



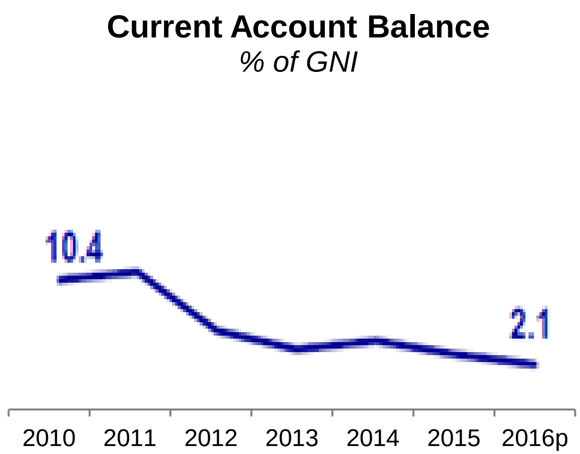
Stable labour market conditions



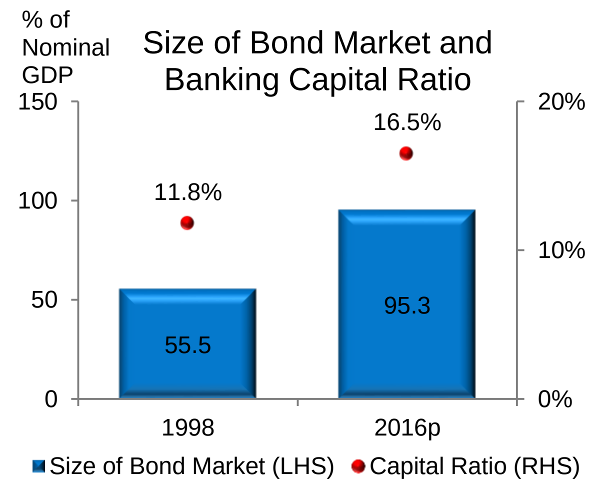
Conducive investment destination for foreign investors



Current account balance reflects strong investment



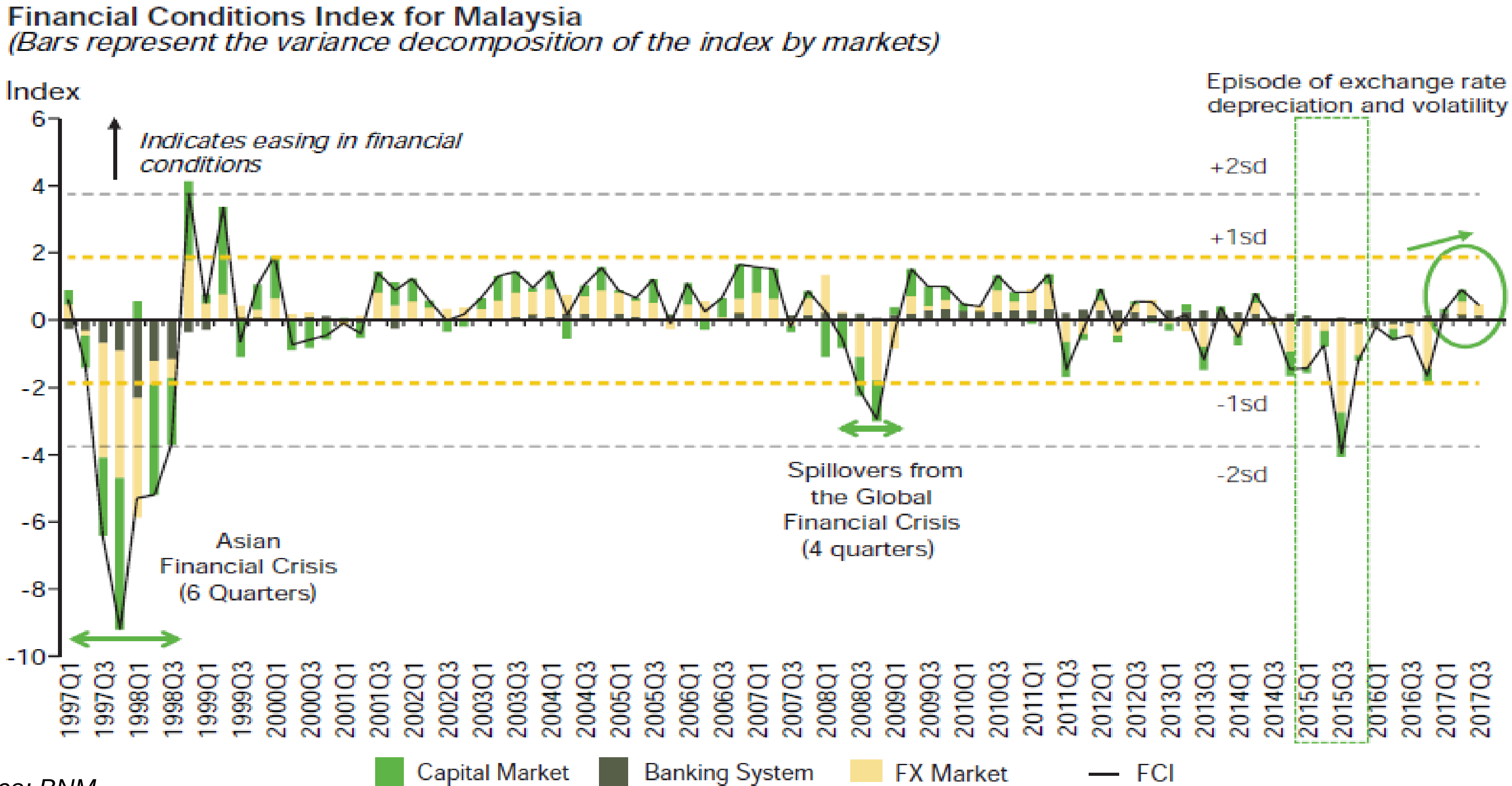
Deeper markets and strong financial buffers



Source: BNM (Annual Report 2016)

FCI indicates IMPROVING financial conditions since 2016

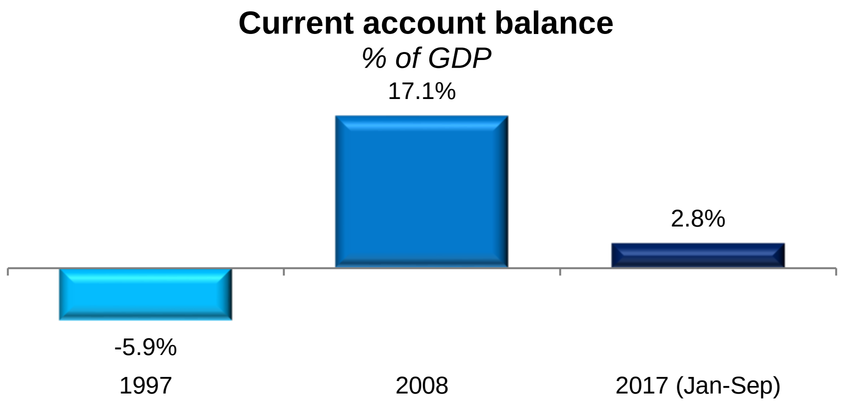
- Decreased **VOLATILITY** in the foreign exchange and equity markets.



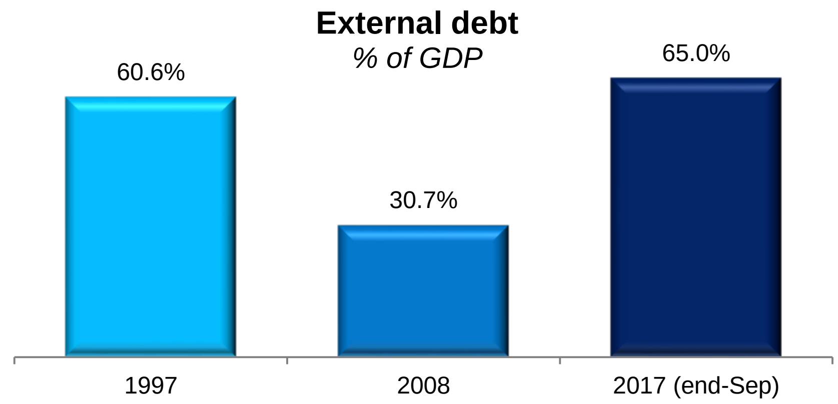
Source: BNM

Malaysia's SUSTAINABILITY heatmap

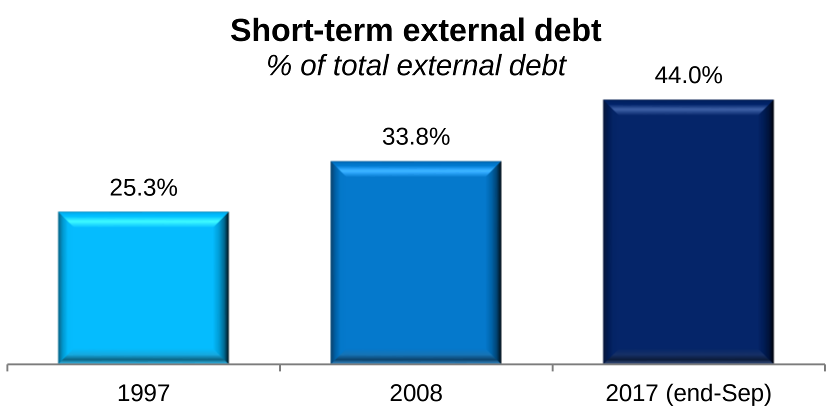
Shrinking current account surplus



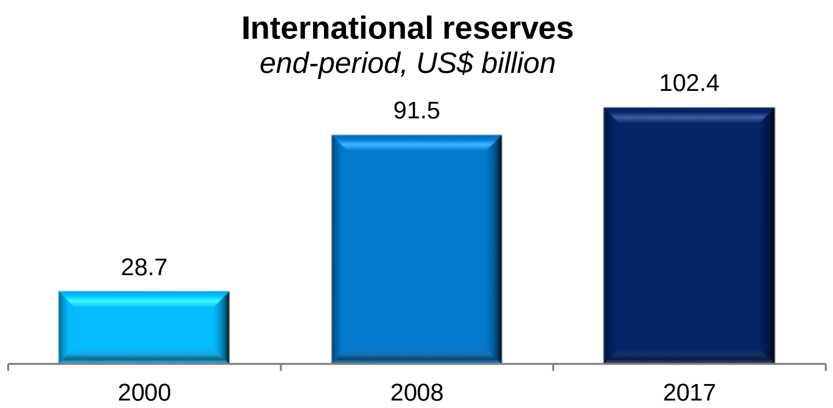
Higher external debt (reclassification & exchange rate revaluation)



Rising short-term external debt



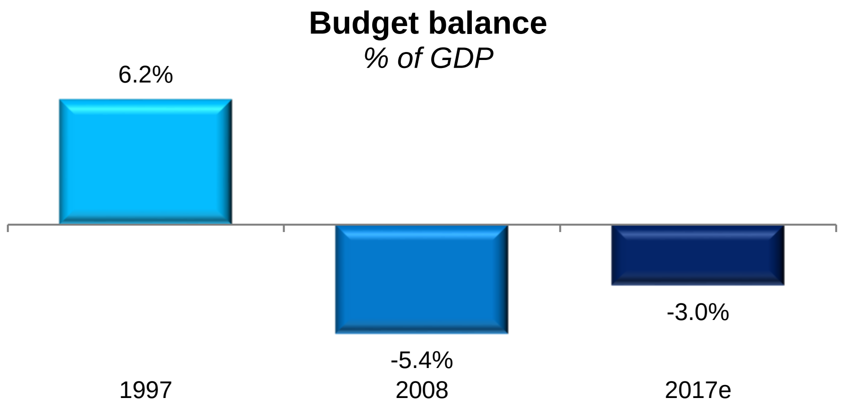
Reserves adequacy (7.2 months of retained imports; 1.1 times short-term external debt)



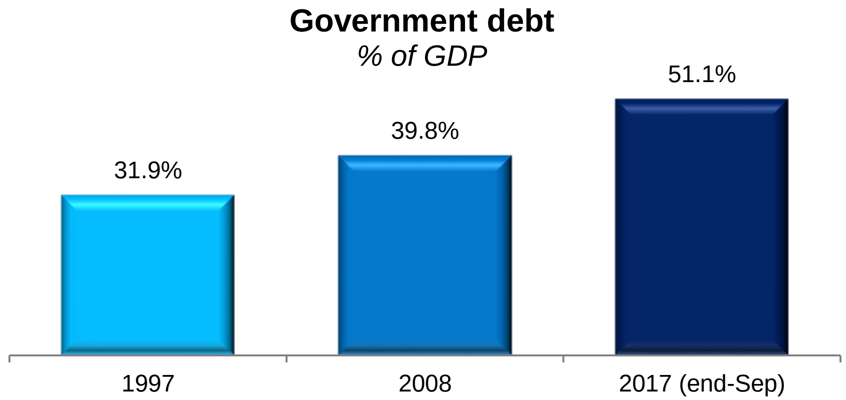
Source: BNM; CIMB Research

Malaysia's SUSTAINABILITY heatmap

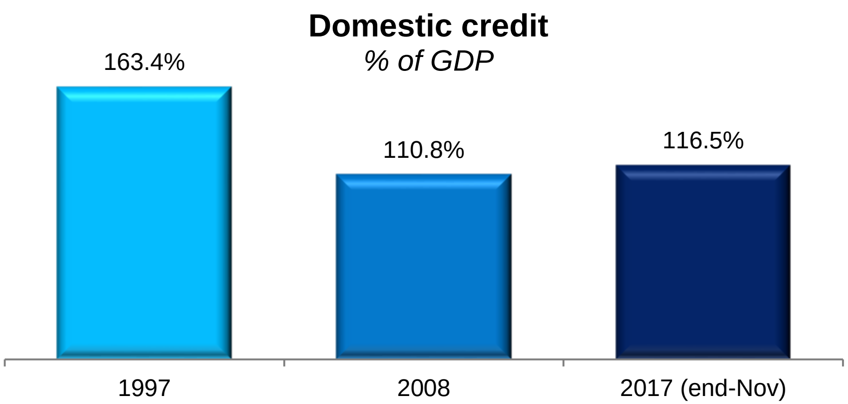
Fiscal consolidation remains on track



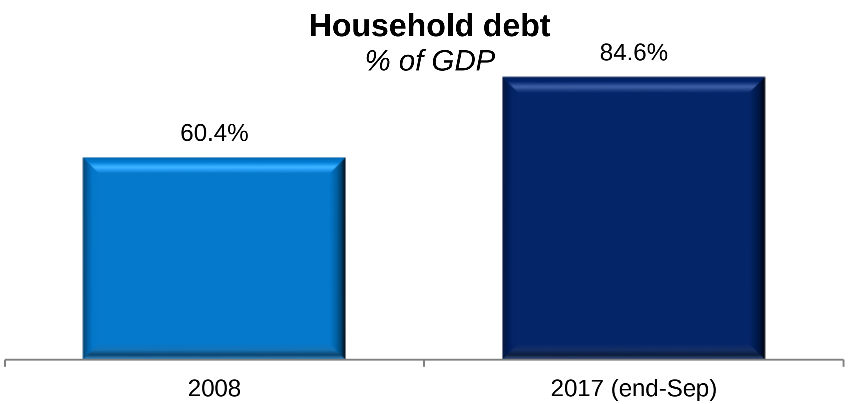
Government debt is contained below the self-imposed target of 55% of GDP



High domestic credit vulnerable to economic shock



Household debt ratio remains high amid moderate household credit



Source: BNM; CIMB Research

Four SHIFTING TRENDS cast challenging future for Malaysia

DRIVING COMPETITIVENESS AND PRODUCTIVITY

- Qualitative and quality growth factors – labour force skills, digitalisation
- Competitive framework – tax structure and business regulations
- Unlocking productivity is critical

DIGITAL TECHNOLOGIES AND TRANSFORMATION

- Building a connected ecosystem
- Technology disruption, sharing of economy
- Driving e-commerce

RISING GLOBAL COMPLEXITY

- Unpredictable policy shift in advanced economies
- Shifting hotspot of dominant economic power
- China's factor

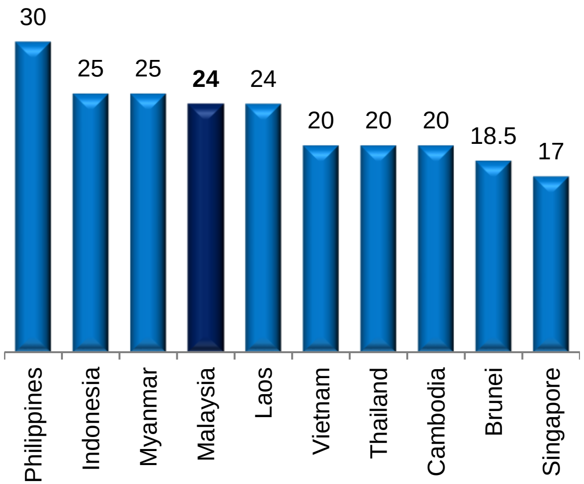
AGEING POPULATION

- Widening retirement savings gap
- Rapidly escalating healthcare expenditure

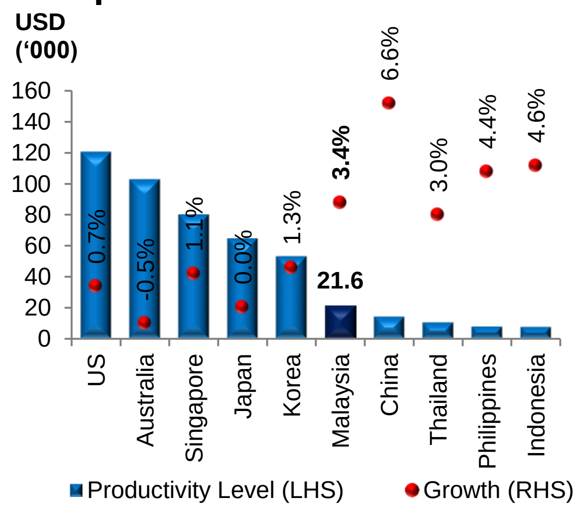
#1 Driving COMPETITIVENESS and productivity

- Global competition to cut **CORPORATE TAX** heats up
- Malaysia’s **PRODUCTIVITY** growth is lagging behind
- Strategies and initiatives
  - ❑ Push for a **COMPETITIVE TAX STRUCTURE**
  - ❑ Restructure and improve the management of **FOREIGN WORKERS**
  - ❑ Actively encourage the adoption of **4TH INDUSTRY REVOLUTION**
  - ❑ Create dedicated pool of investment funds or align existing fund to drive 4th Industry Revolution agenda nationally

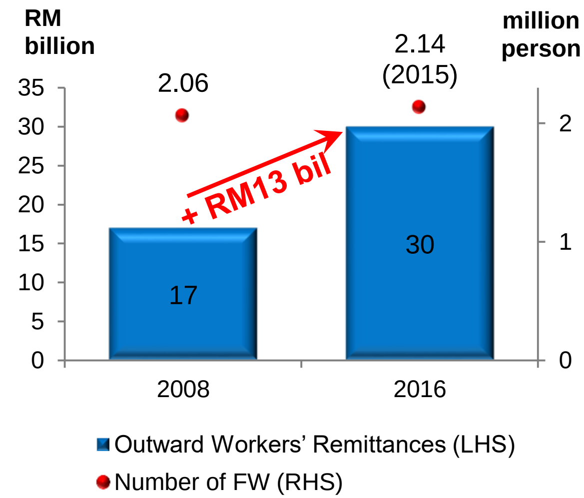
Regional corporate tax rate comparison



Regional labour productivity comparison in 2015



Higher FW remittances

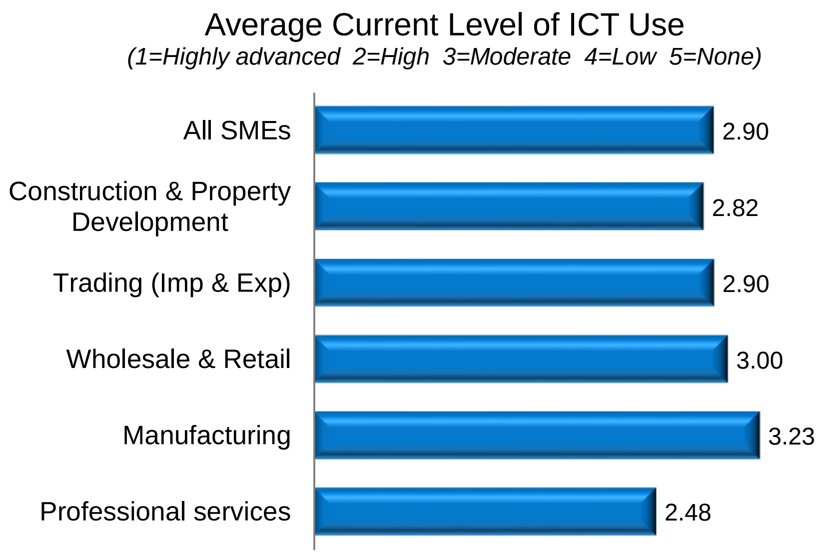


Source: EY; MPC; BNM; EPU

#2 DIGITAL TECHNOLOGIES and transformation

- **TRANSPORT** – seamless connectivity, safety, reliability and speed
- **CONNECTIVITY/COMMUNICATION** – investment in ICT to scale benefits of digitalization, broadband speed and reliability of coverage
- **SPACE/HOUSING** – sharing of economy
- **MANUFACTURING FOR THE FUTURE**
- **CONSUMER CULTURE** (taste, fashion and lifestyle)

Moderately usage of ICT



Malaysia National E-Commerce Strategic Roadmap to double the e-commerce growth

	2015	2020 *business as usual*	2020 *with intervention*
e-Commerce contribution *(RM billion)*	68	114	170+
e-Commerce growth *(% CAGR)*	12.8 *2012-2015*	10.8 *2015-2020*	20.8 *2015-2020*

Source: National E-Commerce Strategic Roadmap; SERC

#3 Rising GLOBAL COMPLEXITY

- According to PwC, emerging markets will continue to be the growth engine of the global economy. By 2050, **CHINA** could be the **LARGEST ECONOMY** in the world, with India in second place and Indonesia in fourth place. **MALAYSIA** will improve to 24th placing from 27th in 2016.

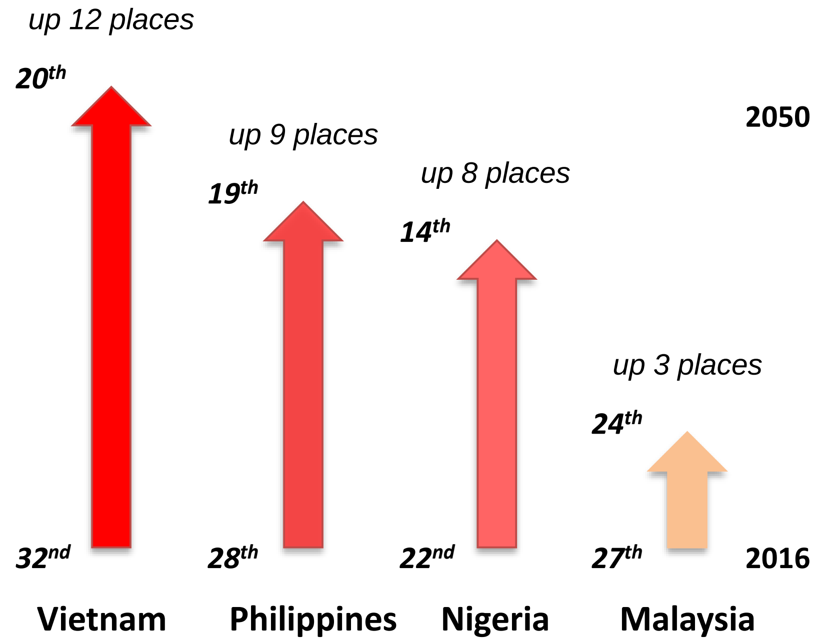
Emerging market will dominate the world's top 10 economies in 2050 (GDP at PPPs)

2016		*2030*		*2050*	
China	1	China	1	China	1
US	2	US	2	India	2
India	3	India	3	US	3
Japan	4	Japan	4	Indonesia	4
Germany	5	Indonesia	5	Brazil	5
Russia	6	Russia	6	Russia	6
Brazil	7	Germany	7	Mexico	7
Indonesia	8	Brazil	8	Japan	8
UK	9	Mexico	9	Germany	9
France	10	UK	10	UK	10
Malaysia	27	Malaysia	25	Malaysia	24

E7 economics

G7 economies

Vietnam, the Philippines and Nigeria could make the greatest moves up the rankings by 2050



Average annual GDP growth rate, 2016-2050

Vietnam	Philippines	Nigeria	Malaysia
5.1%	4.3%	4.2%	3.5%

Sources: IMF for 2016 estimates, PwC analysis for projection 2030 & 2050

The CHINA'S FACTOR in Malaysia's growth

Malaysia is China's
- #11 - export destination
- #7 - source of imports
- #7 - top preferred tourism destination in 2016

China is Malaysia's
- #1 - source of imports (*19.6% share in Jan-Nov)*
- #2 - export destination (*13.4% share in Jan-Nov*)
- #6 - gross FDI flow *(RM8.5bn@7.6% in Jan-Sep)*
- #10 - FDI stock *(RM15.5bn@2.8% at end-Sep)*
- #3 - tourist arrivals (+8.1% yoy to 1.9m in Jan-Oct)

Some of China's companies in Malaysia

Some of China's projects in Malaysia

East Coast Rail Line
(est. RM55bn)

Malaysia-China Kuantan Industrial Park
(secured RM30bn foreign investment)

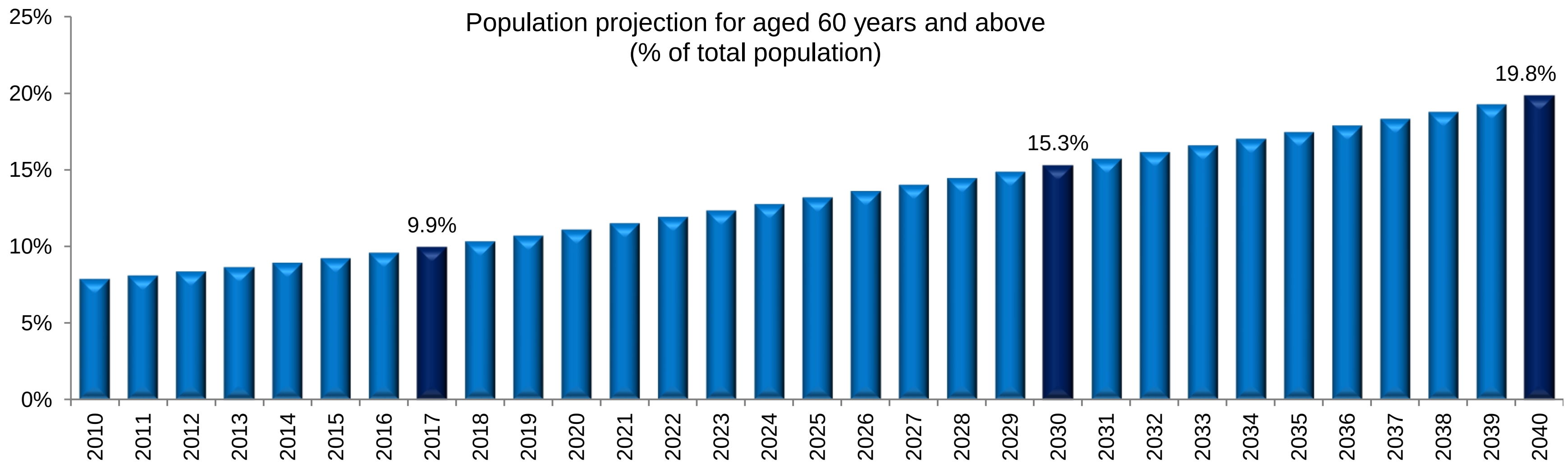
Melaka Gateway Deep Sea Port
(est. US$7.2bn)

Penang Second Bridge
(around RM4.5bn)

Sources: DOS, Malaysia; BNM; Tourism Malaysia; China Customs; China Tourism Academy

#4 AGEING population

- Malaysia will become an ageing population by 2030 when **15% OF OUR POPULATION** will be aged 60 and above (9.9% or 3.2 million in 2017).
- The ageing population and lifestyle illnesses are drivers of growing healthcare expenditure; dampening productivity, deter investment and elderly people spend differently.
- **FISCAL COST ON HEALTHCARE, SOCIAL PROTECTION AND HOUSING** will be substantial for elderly population.
- The combined pressures of ageing and the retirement savings gap might redefine the concept of retirement into the future (tapered retirement).



Sources: DOS, Malaysia

Strengthening the QUALITATIVE sources of growth

Sustaining QUALITY investment

- Unfavourable corporate tax rate
- Improve ease of doing business and business regulations
- Increased Total Factor Productivity (TFP) and capita intensity
- Contain overinvestment in property sector

DIGITALISATION, labour skills and productivity

- Building a connected ecosystem
- Digital technology investments on business operation and productivity
- Uneven distribution of technological change benefits
- Investing in workforce skills – anticipating future skills needs

Uplift the potential of SMEs

- Facilitate SMEs in e-commerce via digitalization technology investment
- High value creation in manufacturing and services
- Manufacturing for the future requires reinventing through a strong pipeline of innovations in materials, ICT, automation of production processes, robotics and digitalisation to deliver goods and services

Supportive FISCAL, MONETARY & financial policies

- Setting right fiscal priorities;
- Structural reforms
- Prioritize social and economic expenditure and transfer to foster a balance and inclusive growth
- Prudent monetary policy; safeguard financial stability; contain excessive leveraging

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谢 谢
THANK YOU

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