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Bank Negara Malaysia Annual Report 2017

Still On Firm Ground, Risks Still Prevail

29 March 2018

Key Messages

- GLOBAL ECONOMY CONTINUES TO STRENGTHEN

- BALANCED RISKS TO GLOBAL OUTLOOK

- MALAYSIA: STRONG GROWTH OPTIMISM

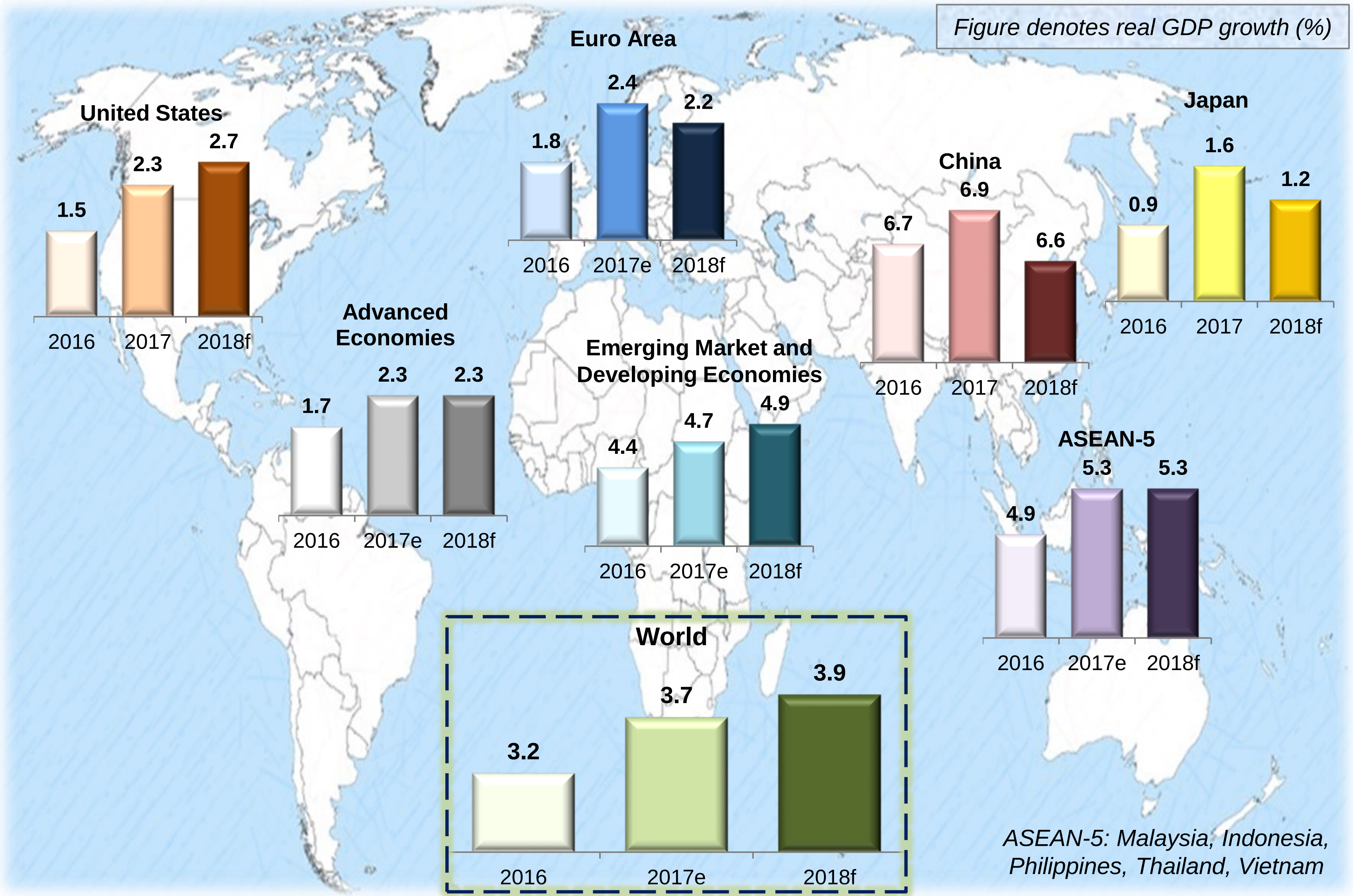
- ECONOMIC & FINANCIAL ISSUES

- CONCLUSION

Global UPSWING to continue in 2018

- **SYNCHRONOUS GLOBAL UPTREND IS BROADENING**. Global economic growth is **BROADLY BASED** and **SUSTAINED** in 2018, driven by private consumption and investment
- **GLOBAL TRADE** is showing strong growth momentum
- In **ADVANCED ECONOMIES**, **RISING WAGES** and **POLICY SUPPORT** will provide further impetus to growth
- In **ASIA**, growth will be driven by **SUSTAINED DOMESTIC ACTIVITY** and strong **EXTERNAL DEMAND**

GDP GROWTH estimates in advanced and emerging economies



Source: Officials; IMF (WEO Update, January 2018)

RISKS to the global growth outlook remain BALANCED

Upside Risks

- Potential higher growth in **INVESTMENTS AND RISING WAGES** to lift consumption and capital spending
- Upside risk to the US's growth outlook **THROUGH TAX REFORMS, FLOOD RELIEF PROGRAMS** and **INFRASTRUCTURE SPENDING** in 2018-19

Downside Risks

- Impact of a **SYNCHRONISED MONETARY POLICY NORMALISATION** across major economies
- **INWARD-LOOKING TRADE** policies remain a threat to global trade. Uncertainty in Europe amid pending new UK-EU trade agreements
- **GEOPOLITICAL RISKS** (domestic conflicts, terrorism attacks and territorial disputes)

SERC's comments	Despite the expected continuing global economic expansion, one should not remain complacency as there are potential risks and policy uncertainties that could temper market confidence as well as affect growth and investment activity. Rich market valuations raise the likelihood of a market correction should there is a policy misstep.

Malaysia's STRONG ECONOMIC OUTLOOK in 2018

- **STRONG GROWTH OPTIMISM IN 2018**. As expected, Bank Negara Malaysia (BNM) maintained strong positive optimism on the economy as real GDP growth is estimated to grow by **5.5-6.0% in 2018** (5.9% in 2017), marking higher from the Treasury's forecast of 5.0-5.5% made during the Budget in October 2017.
- **FIRES ON ALL CYLINDERS**. It is a more balanced growth. The strengthening global economic conditions would lift the prospect of gross exports (2018E: 8.4% vs. 18.9% in 2017). Supportive fiscal and monetary policy as well as accommodative financial conditions will sustain the strength of domestic demand (2018E: 5.7% vs. 6.5% in 2017).
- **PRIVATE CONSUMPTION** is estimated to maintain its resilient strength (7.2% in 2018 vs. SERC's 6.9%) as against 7.0% in 2017. Key underpinning factors are continued growth in **EMPLOYMENT AND INCOME, LOWER INFLATION, AND IMPROVING SENTIMENTS**. Cash handouts and personal income tax rate cut also helps consumption. Consumer spending has been proven resilience despite coping with high cost of living and inflation.
- **PRIVATE INVESTMENT** growth will expand at marginally lower rate of 9.1% in 2018 (9.3% in 2017) vs. SERC's 8.3%, supported by ongoing and new capital spending in both the manufacturing and services sectors amid continued positive business sentiments.
- **PUBLIC SECTOR EXPENDITURE** is estimated to decline by 0.9% in 2018 after an increase of 3.3% in 2017. This reflects more moderate growth in emoluments amid prudent spending on supplies and services while public investment will decline by 3.2% due to lower capital spending by public corporations.

UPSIDE and DOWNSIDE RISKS to economic growth outlook

POSITIVE FACTORS

i) **Stronger-than-expected global demand** will improve the prospects for export-oriented industries, and hence enhances profits for businesses and higher income for households;

ii) **Potential increase in minimum wage** helps to lift consumption**;** and

iii) **Higher pickup in existing and new production facilities** in various industries including oil & gas, resource-based manufacturing and electronics and electrical products will also support better growth outlook

NEGATIVE FACTORS

i) **Unfavourable monetary and regulatory policy shifts** in the advanced economies, rising trade tensions, and a sharper-than-expected growth moderation in China may dampen Malaysia's export growth;

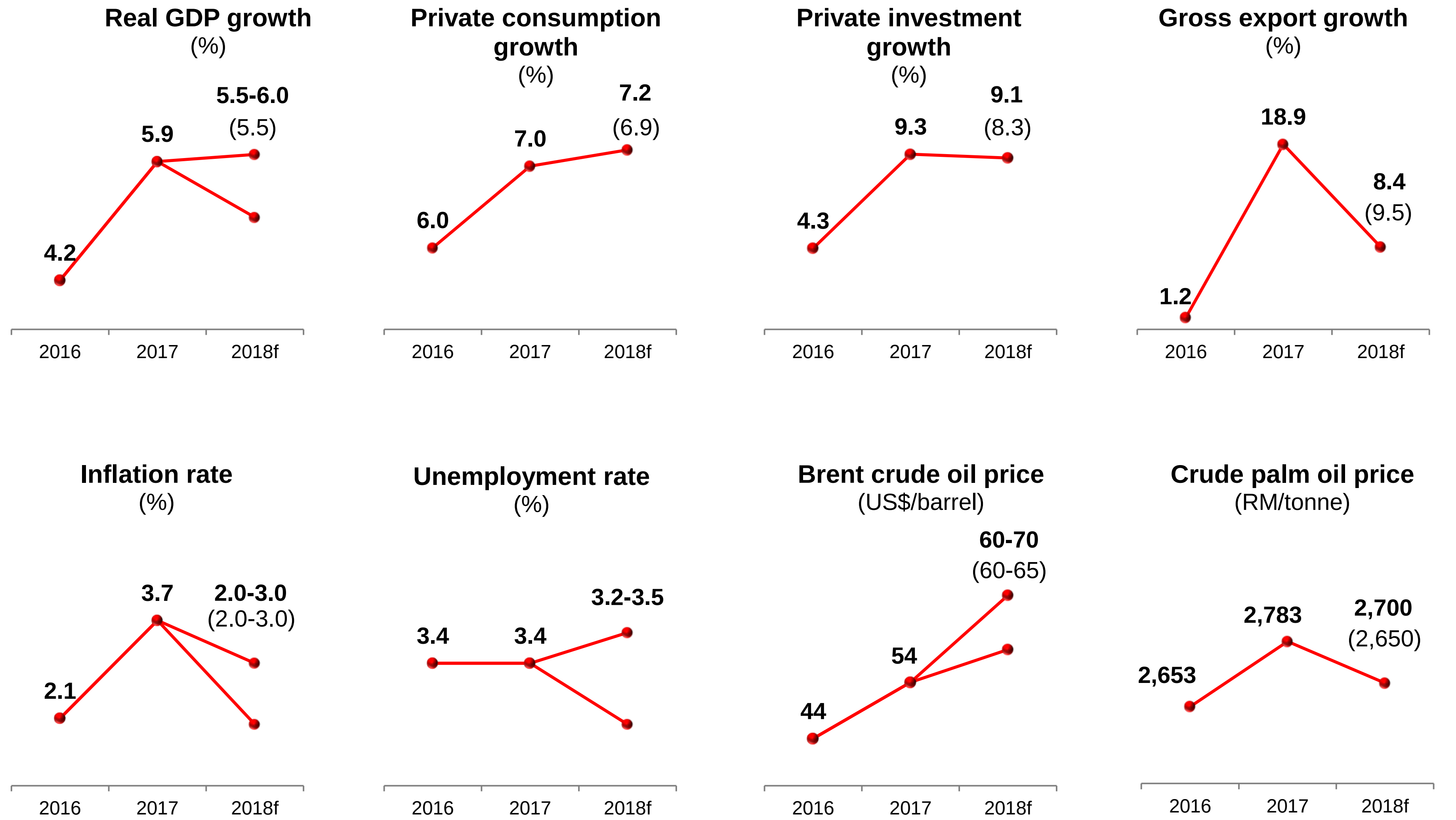
ii) Re-emergence of **volatile commodity prices**; and

iii) **Abrupt corrections in the international financial markets** could also weigh down sentiments, dampening the strength of domestic economic activity

SERC's COMMENTS

- Bank Negara Malaysia's point estimate GDP growth of 5.7% in 2018 (range between 5.5-6.0%) is higher than SERC's revised higher estimate of 5.5% (5.1% previously).
- While we are positive on the growth momentum, the **high base effect last year would weigh on this year's growth**. We concur with BNM's assessment of upside and downside risks underlying the projection of global and domestic economic growth.
- Externally, investors **should not become too complacent** after a long bull run in the stock market as unanticipated market surprises or event shocks would cause a risk repricing. External tail risks are **disruptive monetary policy shifts in the US, escalating trade tensions** between the US and its major trading partners could weigh down market confidence, dampen global trade and economic activity.
- Domestic risks are the **slowdown of structural reforms to increase productivity growth and the lack of quality investment** to raise the potential growth. **Structural unemployment** arising from the technology disruption could dampen consumer spending; increasing cost of doing business and compliance cost that weigh on businesses, especially SMEs.
- **Cost pressures remain a concern for businesses**. These include the implementation of the Employer Mandatory Commitment (EMC), which was postponed for implementation in 2017 (Under the EMC, the employers would be disallowed from deducting the levy from the wages of their workers); the Employment Insurance System (EIS); higher gas prices; probable review of new minimum wage in 2018 and new foreign workers' levy structure in 2019.

Malaysia's key ECONOMIC INDICATORS



Source: DOS, Malaysia; BNM; EIA; MPOB; SERC
Figure in parenthesis denotes SERC's estimate.

Sectoral outlook: Positive, BROAD-BASED EXPANSION

Services

2018F: 6.1% (SERC: 6.0%)

2017: 6.2%; % share of GDP: 54.4

- 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: 5.9% (SERC: 5.7%)

2017: 6.0%; % 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

Agriculture

2018F: 3.6% (SERC: 3.8%)

2017: 7.2%; % share of GDP: 8.2

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

Construction

2018F: 7.3% (SERC: 8.0%)

2017: 6.7%; % share of GDP: 4.6

- On-going large new and existing 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

Mining

2018F: 1.8% (SERC: 1.5%)

2017: 1.1%; % share of GDP: 8.4

- Higher natural gas output
- Malaysia agreed 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

BROADENING base of output expansion

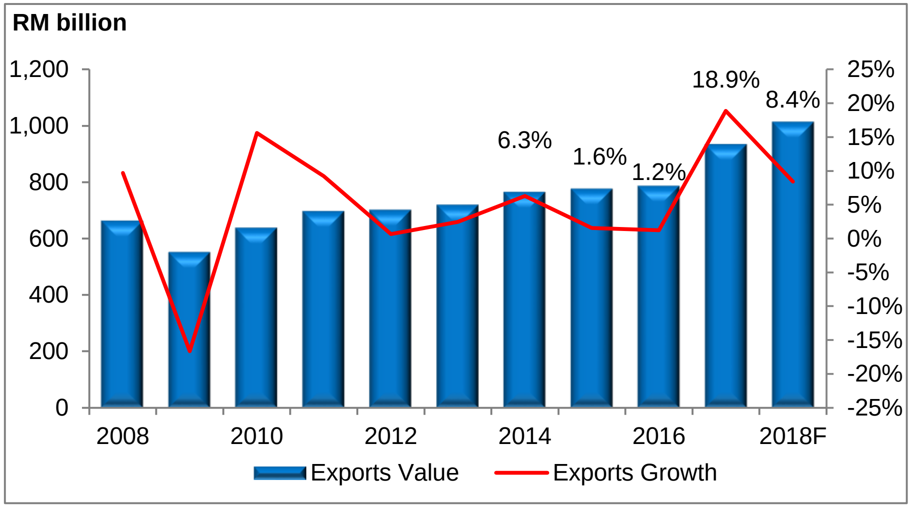
- Strong growth momentum; broad-based growth; resilient private sector activity

% change, 2010=100	**2015**	**2016**	**2017**	**2018*f* (BNM)**	**2018*f* (SERC)**
GDP by demand component					
Private consumption (53.7%)	6.0	6.0	7.0	7.2	6.9
Private investment (17.4%)	6.3	4.3	9.3	9.1	8.3
Public consumption (13.0%)	4.4	0.9	5.4	0.6	1.0
Public investment (8.0%)	-1.1	-0.5	0.1	-3.2	-1.5
Exports of goods and services (72.9%)	0.3	1.1	9.6	8.8	7.9
Imports of goods and services (65.1%)	0.8	1.1	11.0	9.1	8.8
GDP by economic sector					
Agriculture (8.2%)	1.3	-5.1	7.2	3.6	3.8
Mining & quarrying (8.4%)	5.3	2.2	1.1	1.8	1.5
Manufacturing (23.0%)	4.9	4.4	6.0	5.9	5.7
Construction (4.6%)	8.2	7.4	6.7	7.3	8.0
Services (54.4%)	5.1	5.6	6.2	6.1	6.0
Overall GDP	**5.0**	**4.2**	**5.9**	**5.5-6.0**	**5.5**

Figure in parenthesis indicates % share to GDP in 2017
Source: DOS, Malaysia; BNM; SERC

Firm EXPORTS and CURRENT ACCOUNT SURPLUS in 2018

Exports surged to fastest pace in 2017 …

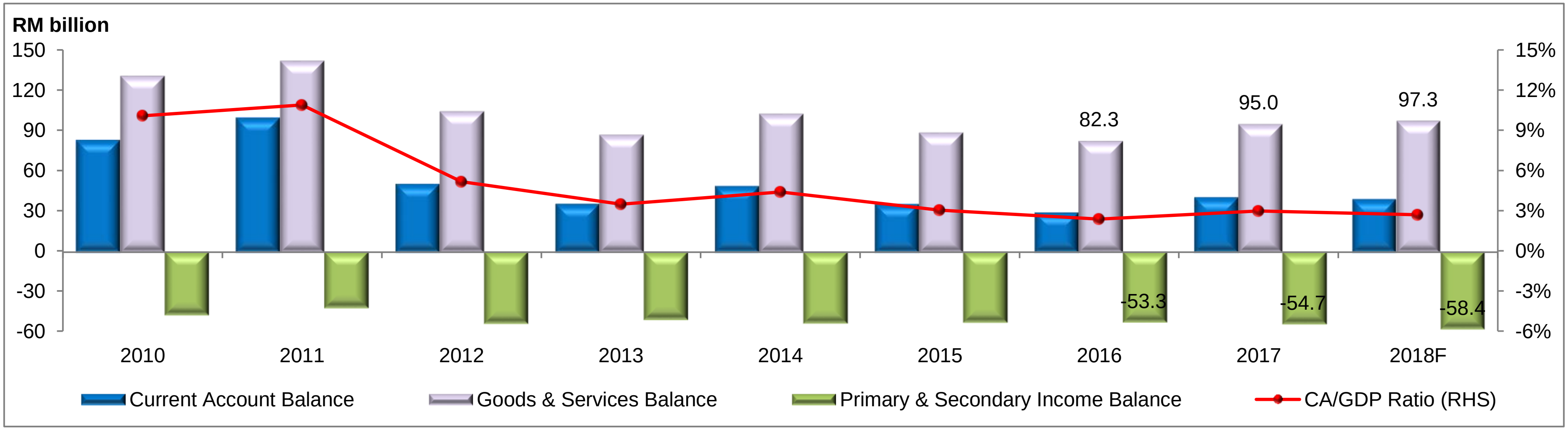


… reflecting broad-based expansion

Major export products [% Share]	RM billion	% Growth
E&E products [36.7%]	343.0	19.2
Petroleum product [7.7%]	72.0	31.7
Palm oil [4.9%]	46.1	11.3
LNG [4.3%]	40.5	23.7
Machinery & equipment [4.3%]	40.2	7.2
Metals [4.1%]	38.0	13.9
Optical & scientific equipment [3.5%]	32.4	12.8
Crude Petroleum [3.0%]	28.0	25.3

Figure in parenthesis indicates % share of gross exports in 2017

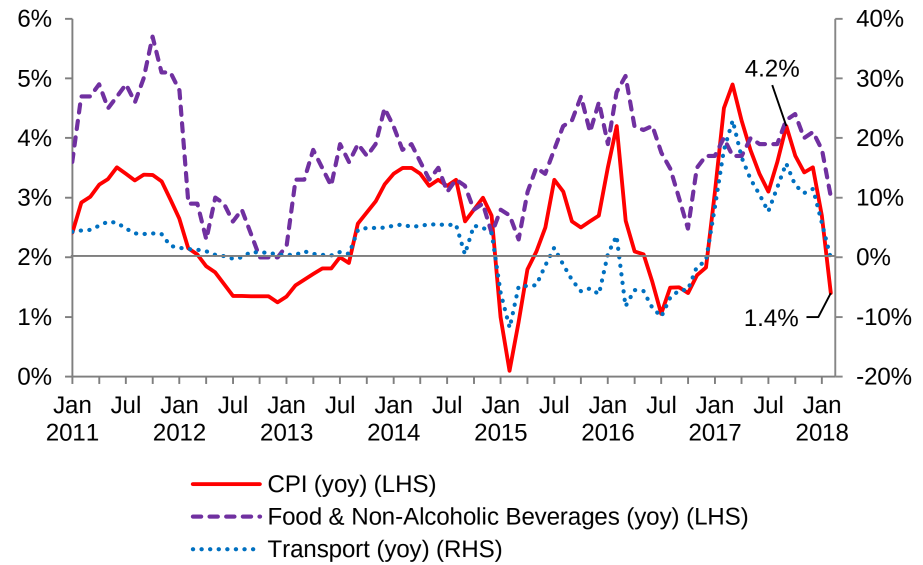
Current account surplus at 2.7% GDP in 2018



Source: DOS, Malaysia; BNM

PRICE PRESSURES seen easing …

- February's CPI (1.4% yoy) is the fifth consecutive month in which an easing of inflationary pressures has been recorded since September 2017 (4.2%), thanks to lower prices of transportation (fuel prices) and moderating food prices.
- BNM revised downward **2018'S INFLATION ESTIMATE to 2.0-3.0%** from the Treasury's estimate of 2.5-3.5% (3.7% in 2017).
- **TWO KEY RISKS TO INFLATION OUTLOOK**: i) Stronger-than-anticipated increase in global oil prices could lead to higher headline inflation; and ii) stronger-than-expected growth in demand could risk stronger demand-driven price pressures.
- We also **lower our 2018's CPI growth estimate to 2.0-3.0%** from 2.5-3.0% previously, mainly to reflect moderated food prices amid the variation of fuel prices, which remain a wild card. Other potential drivers of inflation are utility cost, wage growth and firm demand fuelling demand inflation. Higher technical base effects in 1H17 (4.2% in 1Q17; 3.8% in 2Q vs. 3.6% in 3Q and 3.5% in 4Q) also play a part.

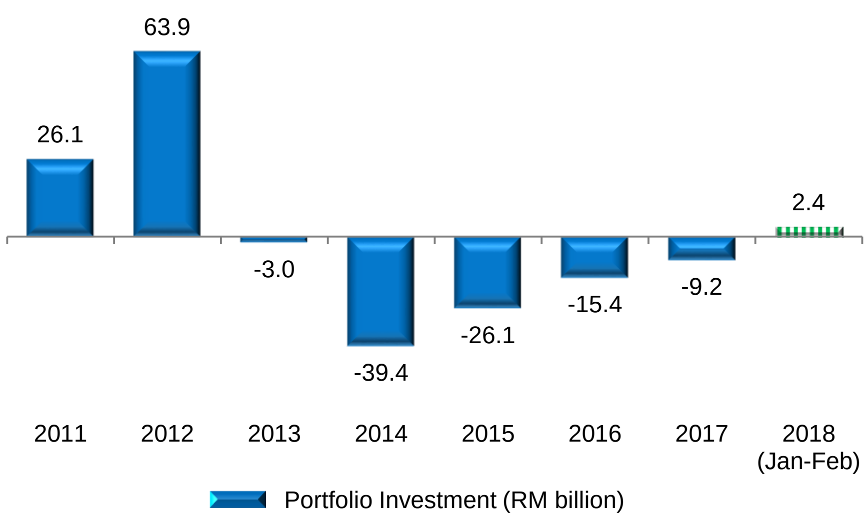


Source: DOS, Malaysia

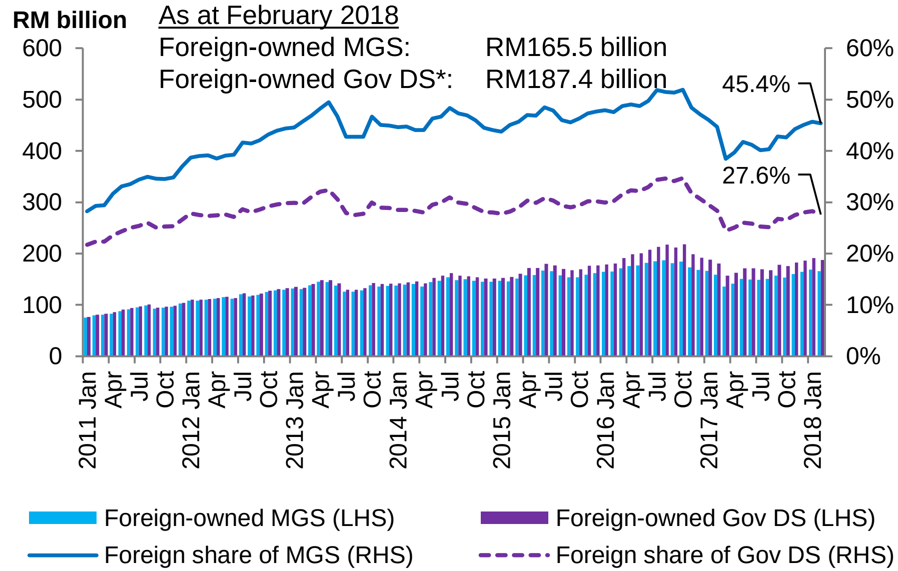
PORTFOLIO INVESTMENT – net inflows in early 2018

- **NET INFLOWS FOR THE FIRST TIME** in early 2018 after five successive years of net outflows since 2013.
- Better global and domestic economic prospects, stabilized and appreciating ringgit, and induced by the 14th General Election.

Portfolio investment outflows for five straight years during 2013-2017



Foreigners' interest in Malaysia's government debt securities*

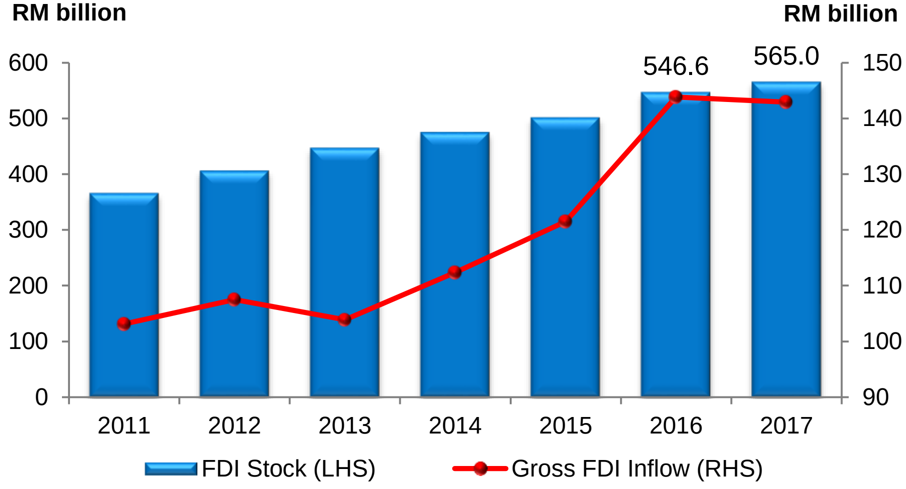


Source: BNM; Bursa Malaysia

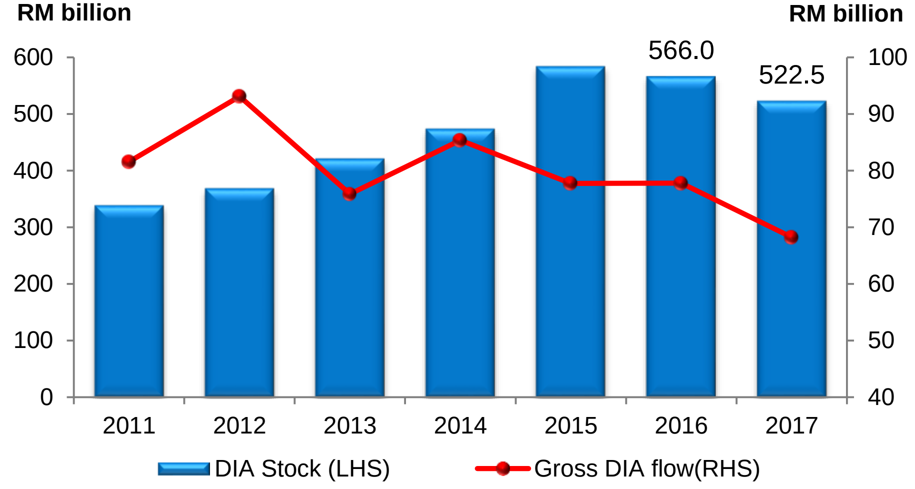
*Government debt securities (DS) include bonds, treasury bills and housing sukuk.

Foreign investment and outward investment SLOWED in 2017

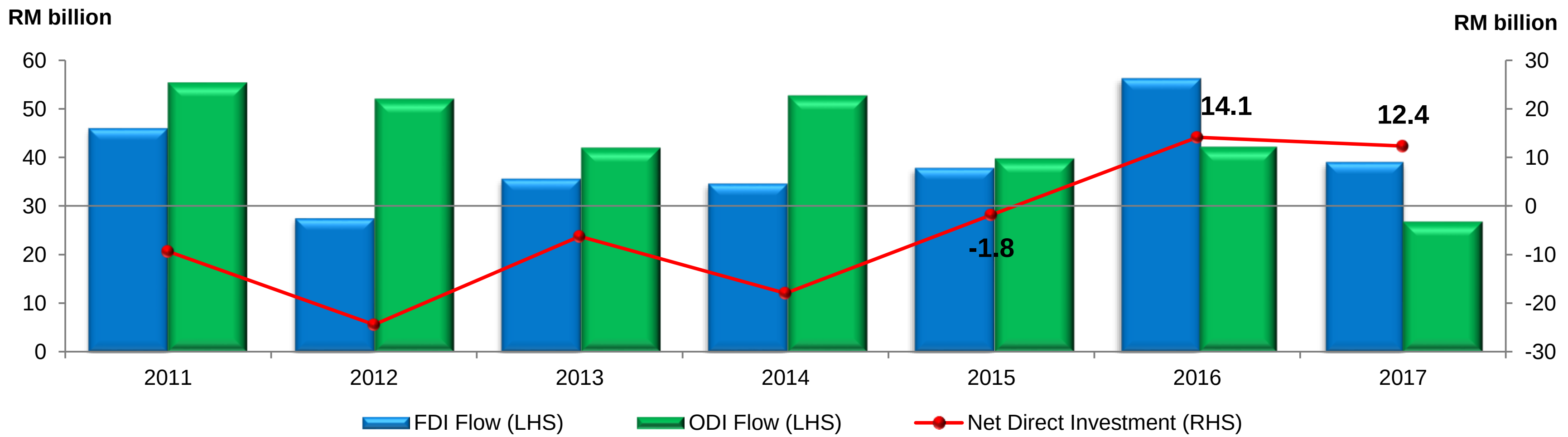
Malaysia still a preferred foreign investment (FDI) destination



Malaysian companies sustained their investment abroad (ODI)



Malaysia has been a net importer of capital for two years since 2015

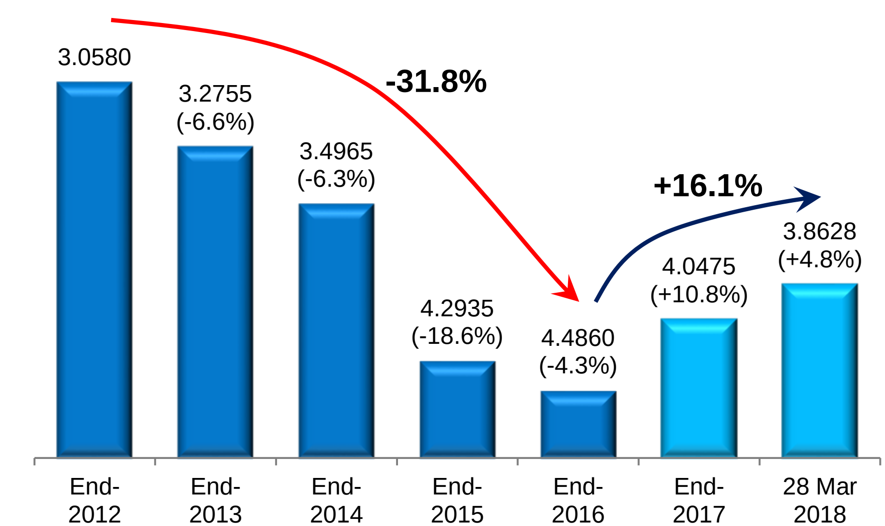


Source: BNM

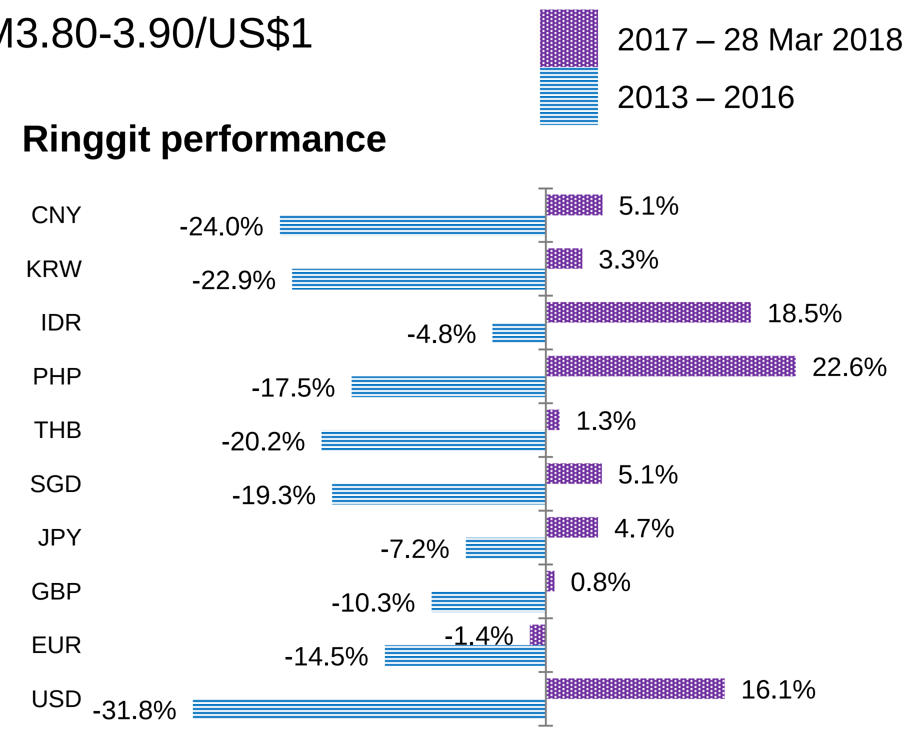
The ringgit does not reflect its FUNDAMENTAL value

- **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.
- SERC's estimate of RM/US$: End-2018F: RM3.80-3.90/US$1

Ringgit movement against USD



Ringgit performance



Source: BNM

More INTEREST RATE HIKES to come in 2018?

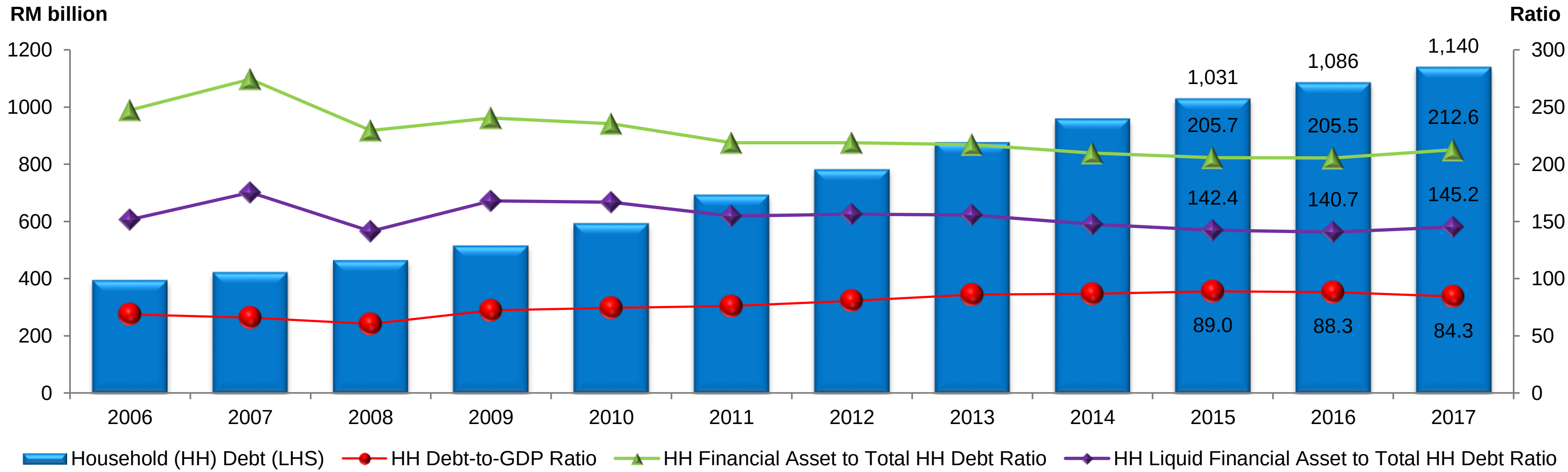
- **BNM raised OPR by 25 bps to 3.25%** in January this year after keeping it unchanged at 3.00% since July 2015. The market must prepare for further rise in rates if the following conditions are met throughout the year 2018:
  1) If the global growth and domestic economy continues to sustain at strong 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% ↓	5.9% ↑	**5.5% ↓**
Inflation	2.0% ↓	5.4% ↑	0.6% ↓	1.7% ↑	2.1% =	3.7% ↑	**2.0-3.0% ↓**
RM/US$1 *(end-period)*	3.3115 ↑	3.4675 ↓	3.4265 ↑	3.0855 ↑	4.4860 ↓	4.0475 ↑	**3.80-3.90 ↑**

Source: BNM; DOS, Malaysia

Preserving HOUSEHOLDS DEBT sustainability

- **HOUSEHOLD BORROWINGS GROWTH** moderated for the seventh consecutive year (+4.9% to RM1,139.9 billion in 2017; 2016: 5.4%; 2010: 14.2%), resulting in lower ratio of household debt-to-GDP to 84.3% (2016: 88.3%).
- **UNDERLYING TRENDS IN DEBT ACCUMULATION CONTINUED TO IMPROVE**. i) Growth of unsecured borrowings in the form of personal loans has been sharply lower (2017:2.5%; 2008: 25.2%); ii) debt servicing ratios of most households remained within prudent levels (median: 32.7%); and iii) growth in household financial assets (8.6%) outpaced that of debt for the first time since 2012.



Source: BNM

ISSUES for policy consideration and formulation

- **TO AVERT IMBALANCES IN THE PROPERTY MARKET**. Excess supply in the office space and shopping complex segments remains a concern. Incoming supply of new office space and shopping complexes are expected to significantly outstrip demand in the medium term, and will continue to exert downward pressure on occupancy and rental rates.
- **CONTINUED EVALUTION OF POLICIES FOR FUTURE**. The Bank has raised a number of current and forward looking mega trends and issues that would require immediate policy focus to get Malaysia ready and prepared in a new normal and complex environment.

UNLOCKING DIGITAL FUTURE

COMPLEXITY AND GROWTH

LOW SKILLED FOREIGN WORKERS' DISTORTION

COST OF LIVING ISSUES

Unlocking DIGITAL FUTURE

- Embracing fast evolving **technology, digitalization and innovation** to be a key catalyst of growth. The Digital Free Trade Zone (DFTZ) and e-Commerce are the game changers to boost businesses investment and opportunities.
- Digital transformation could boost US$100-136 billion in GDP by 2025.

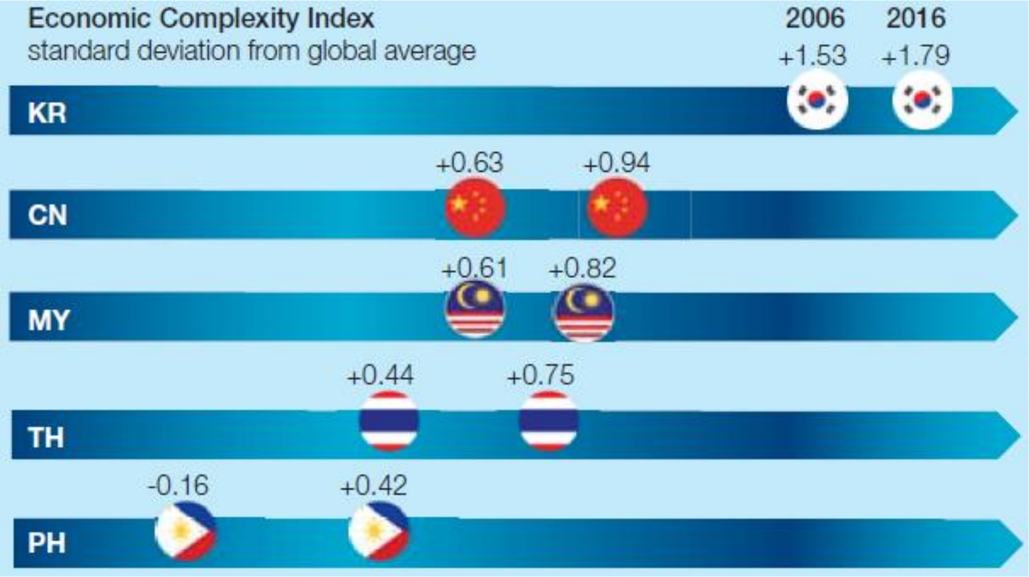
3 key fundamentals that must be addressed:

Fast affordable broadband	Talent tailored for digital progress	High digital adoption
Broadband speed is 3 times slower than frontrunners	Only 1 in 5 graduates are in STEM	< 40% of the population use internet banking and e-commerce

Modernising regulations, empowering talent and universal access to infrastructure will accelerate Malaysia's digitalisation

COMPLEXITY and GROWTH

- While Malaysia's **economic complexity** (a summary measure of the productive capabilities in terms of diversity and complexity of products it makes and exports) has improved, but its regional peers are fast catching up.
- It is imperative to accelerate efforts to **further diversify the product mix and deepen product complexity** through, among others, (i) extending the industry-academia element in research and training programmes beyond the E&E sector; (ii) promoting alternative finance via coordinated efforts among relevant institutions; (iii) elevating the digital National Data Ocean Platform; (iv) reviewing upstream tax to promote downstream activities in the palm oil industry; and (v) explicitly including complexity as an incentive criteria.



Source: The Atlas of Economic Complexity

Malaysia's economic complexity has improved, but others are fast catching up.

Sectoral diversification vital to deepen product mix and product complexity.

Low skilled FOREIGN WORKERS' DISTORTION

- The readily available pool of **cheaper low-skilled foreign workers distorts domestic factor prices**, and thus **discourages industrial upgrading** and **moving up the high value added chains**. The costs of unchecked dependence on low-skilled foreign workers would weigh on Malaysia's efforts to raise productivity and create higher-skilled and better-paying jobs.
- In this regard, the following approaches are needed to ensure that the **future foreign worker management system** in Malaysia is **clearly articulated**, **firmly implemented**, and **more aligned** to Malaysia's economic objectives of "high-productive and high-income" workforce: i) Clear stance on role of foreign workers; ii) gradual implementation and clear communication of policies; iii) market-driven demand management instruments; iv) fair treatment of foreign workers; and v) effective monitoring and enforcement.

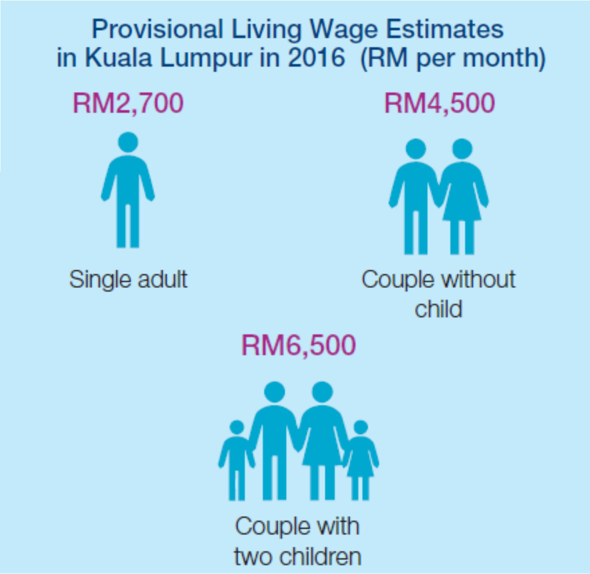
Indiscriminate reliance on low-skilled foreign workers imposes costs to the economy

COST OF LIVING issues

- Policies involving cost of living issues should **not only focus on cost-related solutions**, but also encompass more **income-enhancing measures**.
- The provision of a **LIVING WAGE** (the wage level that could afford the minimum acceptable living standard) that is commensurate with productivity to attain a higher and quality living standard. **Up to 27% of households** in Kuala Lumpur were **earning below the living wage**. Close to 70% consisted of just one employed household member.
- A coordinated response to issues of **affordable housing and escalating healthcare costs** would contribute to enhanced welfare.

The living wage enables households to afford a 'minimum acceptable' living standard, which include:

- Ability to meaningfully participate in society
- Opportunity for personal & family development
- Freedom from severe financial stress



CONCLUSION

- Supported by stronger global economic conditions, Bank Negara Malaysia expects the **MALAYSIAN ECONOMY to grow by 5.5% - 6.0%** (mid-point at 5.7%) in 2018 (5.9% in 2017). This is higher than our revised estimate of 5.5%.
- **DOMESTIC DEMAND** will continue to be the anchor of growth, underpinned by private sector activity. Both private consumption and investment are expected to grow at healthy clip in 2018, backed by supportive Budget measures, investment and growth-enhancing initiatives.
- **ALL ECONOMIC SECTORS** are forecasted to expand in 2018. The services and manufacturing sectors will continue to be the key drivers of overall growth.
- **HEADLINE INFLATION** is projected to moderate in 2018, averaging between 2.0% – 3.0% (3.7% in 2017), due mainly to an expected smaller price pressures from global energy and commodity prices. A stronger ringgit exchange rate would also mitigate import costs.
- **OVERALL ECONOMIC OUTLOOK** could see **UPSIDE RISKS** coming from stronger than expected global growth, which bodes well for exports, investment and income of export-oriented industries, including the expansion of production capacities of some industries. The **DOWNSIDE RISKS** are rising trade tensions among major trading nations; abrupt shifts in global monetary and regulatory policies; sharp corrections in financial markets would weigh on confidence and economic activity.

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谢 谢
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