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Bank Negara Malaysia Annual Report 2018

The Challenge to Sustaining Momentum

27 March 2019

Key Messages

MODERATING GLOBAL ECONOMIC GROWTH

GLOBAL RISKS REMAIN

MALAYSIA: THE CHALLENGE TO SUSTAINING MOMENTUM

ECONOMIC & FINANCIAL ISSUES

CONCLUSION

Global growth is MODERATING in 2019

- The International Monetary Fund (IMF) estimates a **3.5% GLOBAL GROWTH** for **2019** and **3.6% for 2020**
- Signs of slowing momentum in most major **ADVANCED and EMERGING ECONOMIES** such as China

US – Fading fiscal stimulus, trade friction and the lagged impact of monetary tightening

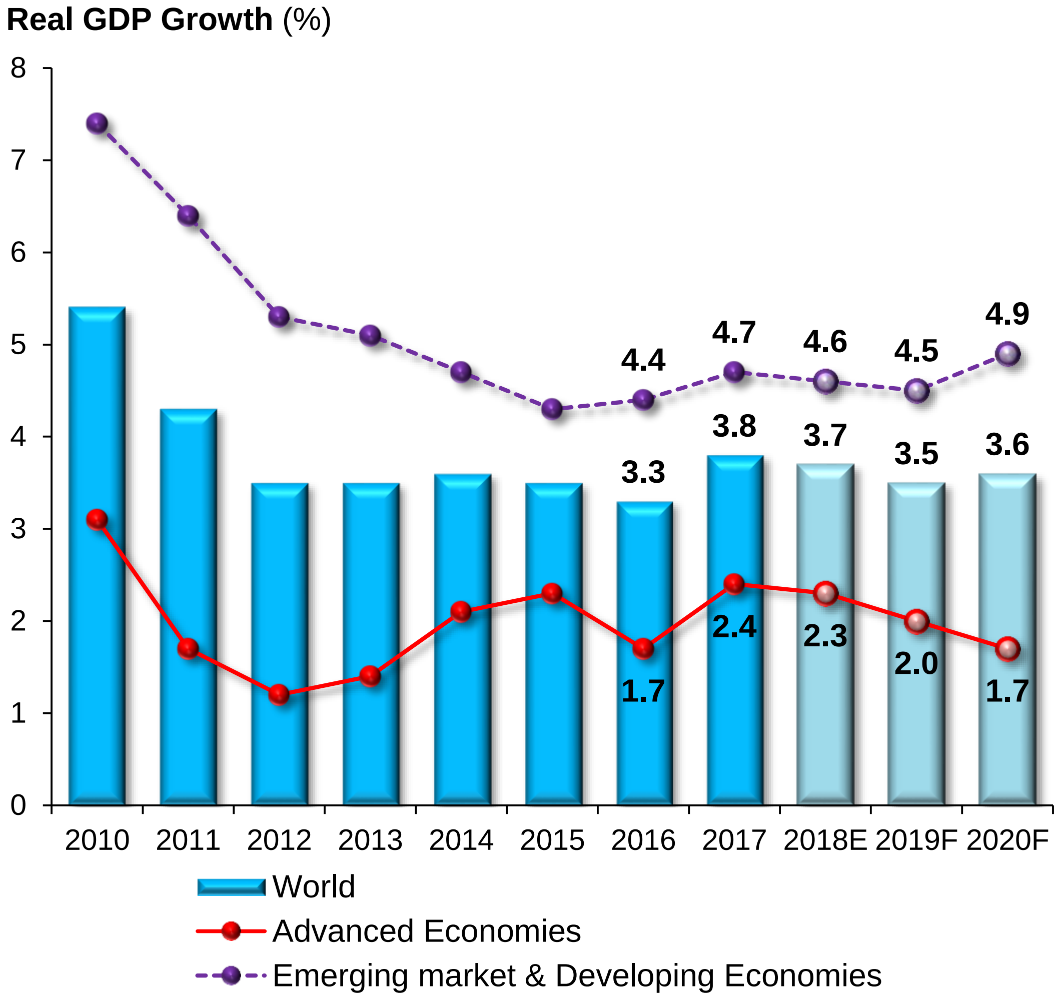
EURO AREA – Sluggish global trade and geopolitical uncertainty are seen dragging on growth

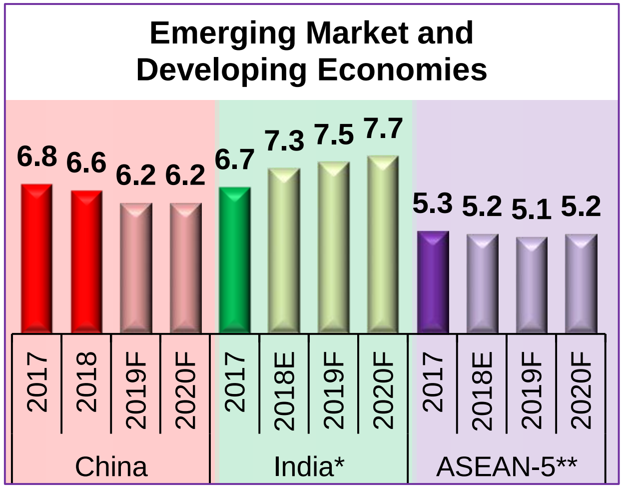
JAPAN – Global trade uncertainty, slowing China demand and a downturn in the global tech cycle

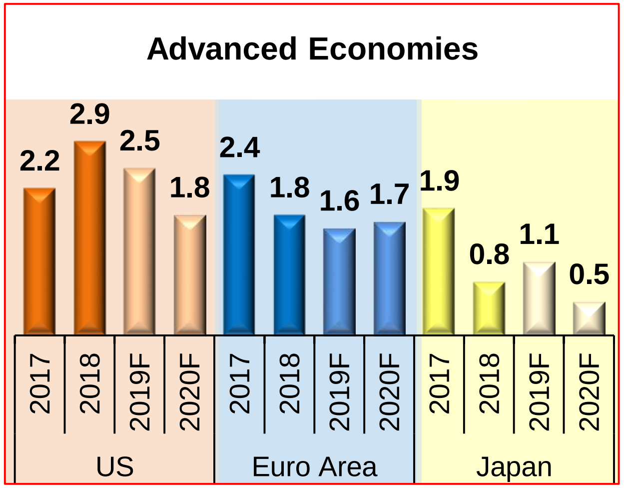
CHINA – Ongoing structural reforms, trade disputes amid monetary easing and fiscal support

ASIAN ECONOMIES – moderate growth as exports react to slowing advanced economies and China

GDP GROWTH estimates in advanced and emerging economies







Source: Officials; IMF (WEO Update, January 2019)

* *Annual GDP for India is on fiscal year basis*

** *ASEAN-5: Malaysia, Indonesia, Philippines, Thailand, Vietnam*

Key RISK FACTORS to prospects for the global growth

UNRESOLVED TRADE TENSIONS remain a key source of risk, affecting global trade and investment activities

The **BREXIT IMPASSE** (or hard Brexit) could stir global financial volatility

ELEVATED POLITICAL AND POLICY uncertainty could lead to investor uncertainty and bouts of volatility in financial markets

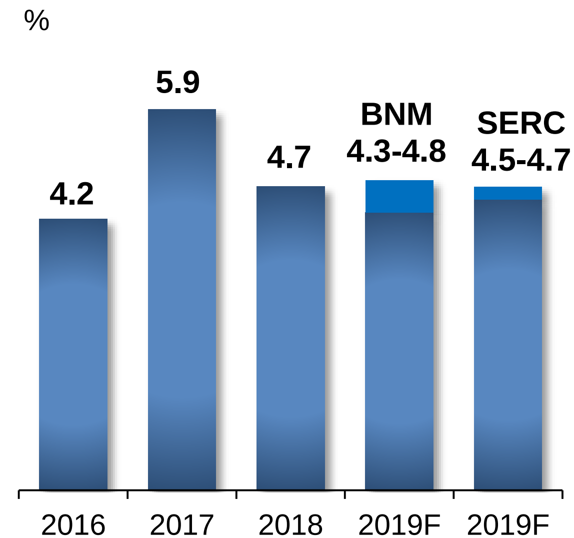
GREATER VOLATILITY IN CAPITAL FLOWS to emerging market economies

SERC's comments	*Moderating economic activities and heightened policy risks are clouding global economic prospects. Global trade and investment have softened. It is critical for policymakers to rebuild policy buffers while removing barriers to investments and promoting trade integration.*

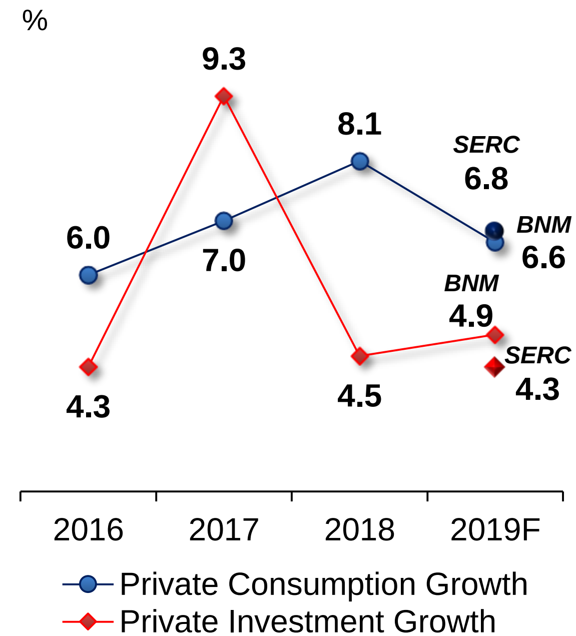
Malaysia's GDP growth is SUSTAINED albeit slower in 2019

- **BNM** estimates **real GDP growth to increase by 4.3-4.8% in 2019** (4.7% in 2018), underpinned by domestic demand amid a more moderate expansion in exports. This marks a revision from Ministry of Finance's forecast of 4.9%.
- **SERC's GDP growth estimate is between 4.5-4.7%** for this year, keeping a close watch on the state of global economy, the outcome of the US-China trade talks and the strength of domestic demand.

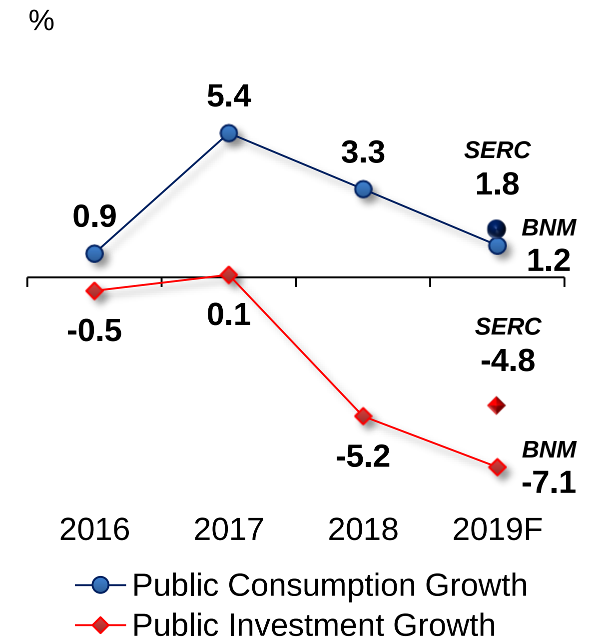
Real GDP growth driven by domestic demand expansion



Private sector remains the growth anchor



Public sector spending remains a drag



Source: DOSM; BNM; SERC

DOMESTIC DEMAND continues to be the anchor of growth

BNM expects **PRIVATE CONSUMPTION** to grow at **a slower rate of 6.6% in 2019** (8.1% in 2018) as it normalizes closer to its long-term average of 6.7%. The fundamental drivers are stable labour market conditions (3.3-3.5% vs. 3.4% in 2018) and continued wage growth (salary increments between 4.9% and 5.2%). Other supportive measures are stable fuel prices, higher minimum wage and cost of living aid.

PRIVATE INVESTMENT is projected to **improve moderately** (**4.9% in 2019** vs. 4.5% in 2018), supported by the ongoing multi-year projects, particularly in the manufacturing and services sectors. Nonetheless, the moderating global economic conditions and softening business sentiments could affect investment activity.

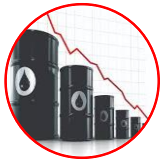
PUBLIC CONSUMPTION is expected to **expand at a moderate pace of 1.2% in 2019** from 3.3% in 2018 on a decline in spending on supplies and services, which is in line with the Government's continued commitment to rationalise non-critical spending through cost reduction in the public sector.

PUBLIC INVESTMENT is projected to **contract by a larger magnitude of 7.1% in 2019** (-5.2% in 2018), dragged mainly by lower investment by public corporations following the completion of large-scale projects.

DOWNSIDE RISKS to 2019's economic growth projection

UNRESOLVED TRADE TENSIONS between the US and China and a slower-than-expected global growth will affect Malaysia via the trade and investment channel.

The **UNCERTAIN PACE OF THE MONETARY POLICY NORMALISATION IN THE US** could heighten financial market volatility across emerging market economies, leading to volatile two-way capital flows and currency fluctuations.



VOLATILITY IN THE GLOBAL OIL PRICE could also affect export performance and mining sector investment.

On the domestic front, a **RE-OCCURRENCE OF THE COMMODITY SUPPLY DISRUPTION**, partly from unanticipated weather patterns, could affect the recovery in the mining and agriculture sectors.

OVERSUPPLY SITUATION in the PROPERTY MARKET could dampen activity in the construction sector.

SERC's COMMENTS

- ***Bank Negara Malaysia's point estimate GDP growth of 4.7% in 2019*** *(range between 4.3-4.8%) is quite in line with SERC's estimates of between 4.5-4.7%. BNM's revised GDP estimates from the Ministry of Finance's forecast of 4.9% underscores the risks to prospects of economic growth given the considerable external uncertainties.*

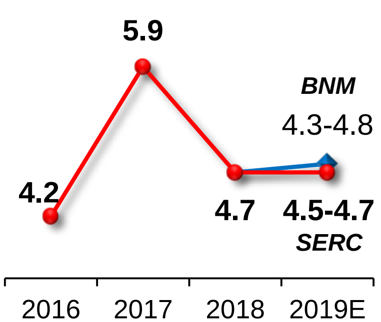
- *We **concur with BNM's assessment of downside risk factor**s influencing the outcome of global and domestic economic projections. It is clearly that the risks are largely **external driven, with the unresolved US-China trade dispute topping the list,** followed by **the monetary policy uncertainty in advanced economies,** which would induce wide swings in financial and foreign exchange markets and also **global oil price volatility.***

- *Besides the **potential drags from the disruption in mining and agriculture sectors** due to weather-induced shocks as well as further consolidation in the property sector due to massive overhang, the timely implementation of projects and programs as approved in the 2019 Budget as well as the removal of policy uncertainties are crucial to support economic growth and investment.*

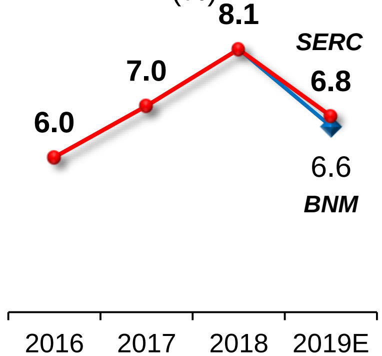
- *While the policymakers build policy buffers to sustain economic growth in the short term, they must work on s**tructural reforms to increase productivity growth, to drive high technology-driven quality investment** to raise the potential growth. **Structural unemployment** arising from the technology disruption could dampen consumer spending; increasing cost of doing business and compliance cost that weigh on businesses, especially SMEs.*

Malaysia's key ECONOMIC INDICATORS

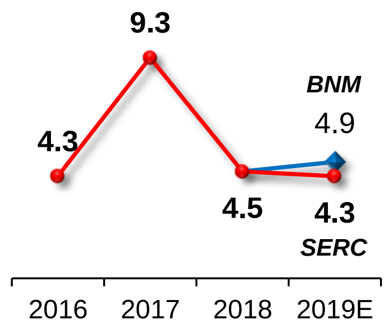
Real GDP Growth
(%)



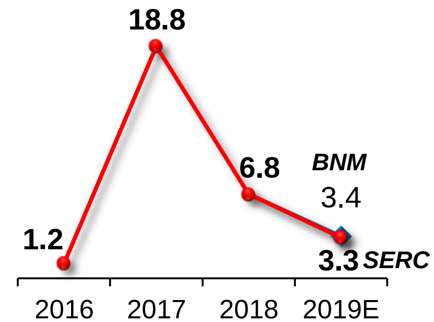
Private Consumption Growth
(%)



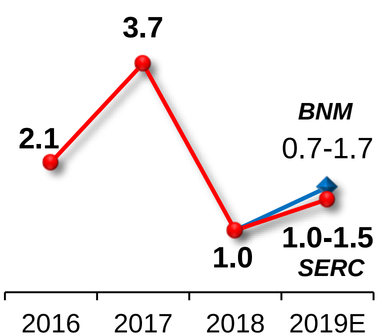
Private Investment Growth
(%)



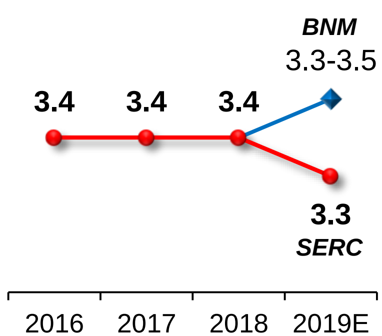
Gross Export Growth
(%)



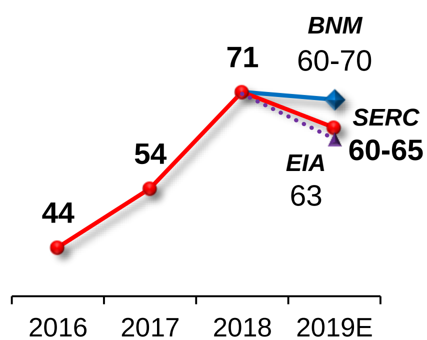
Inflation Rate
(%)



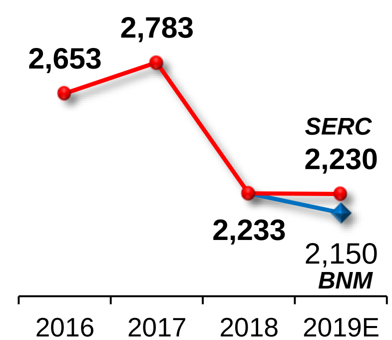
Unemployment Rate
(%)



Brent Crude Oil Prices
(US$/barrel)



Crude Palm Oil Prices
(RM/metric tonne)



Source: DOSM; EIA; MPOB; BNM; SERC

Sectoral outlook: Positive, BROAD-BASED EXPANSION

Services

2019F: 5.7% (SERC: 5.8%)

2018: 6.8%; % share of GDP: 55.5

- Sustained demand supports the wholesale and retail trade, food and beverages and accommodation
- Other growth sub-sectors are information and communication, finance and insurance

Manufacturing

2019F: 4.8% (SERC: 5.7%)

2018: 5.0%; % share of GDP: 23.0

- Moderate growth in electronics and electrical output due to slower demand
- The operationalisation of RAPID will boost the production of refined petroleum and petrochemical products

Agriculture

2019F: 2.8% (SERC: 1.8%)

2018: -0.4; % share of GDP: 7.8

- Higher palm oil output amid recovery in yield

Construction

2019F: 3.0% (SERC: 4.4%)

2018: 4.2%; % share of GDP: 4.5

- Slower growth due to the completion of large petrochemical projects
- Continued progress of large transportation and utility projects will provide support
- Residential and non-residential sectors will remain subdue amid the oversupply of residential and commercial properties

Mining

2019F: 0.8% (SERC: 0.5%)

2018: -1.5; % share of GDP: 7.9

- Recovery in natural gas production in East Malaysia
- Decline in crude oil due to supply constraints and in support of OPEC's output cut

Sources of GDP growth: DEMAND and SUPPLY side

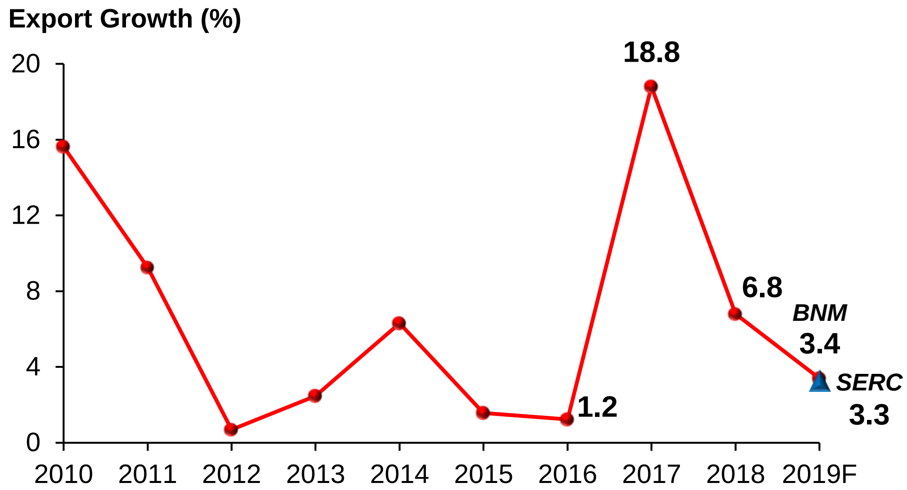
- Private sector expenditure will cushion the effects of lower public spending
- All economic sectors are expected to register positive growth in 2019. Both the mining and agriculture will rebound from contractions.

% growth, 2010=100	**2016**	**2017**	**2018**	**2019F (BNM)**	**2019F (SERC)**
GDP by demand component					
Private consumption (55.0%)	6.0	7.0	8.1	6.6	6.8
Private investment (17.4%)	4.3	9.3	4.5	4.9	4.3
Public consumption (12.8%)	0.9	5.4	3.3	1.2	1.8
Public investment (7.3%)	-0.5	0.1	-5.2	-7.1	-4.8
Exports of goods and services (70.6%)	1.3	9.4	1.5	0.1	1.5
Imports of goods and services (62.2%)	1.3	10.9	0.1	0.0	1.3
GDP by economic sector					
Agriculture (7.8%)	-5.2	7.2	-0.4	2.8	1.8
Mining & quarrying (7.9%)	2.1	1.0	-1.5	0.8	0.5
Manufacturing (23.0%)	4.4	6.0	5.0	4.8	5.7
Construction (4.5%)	7.4	6.7	4.2	3.0	4.4
Services (55.5%)	5.7	6.2	6.8	5.7	5.8
Overall GDP	**4.2**	**5.9**	**4.7**	**4.3-4.8**	**4.5-4.7**

Source: DOSM; BNM; SERC
Figure in parenthesis indicates % share to GDP in 2018

Lower EXPORTS and CURRENT ACCOUNT SURPLUS in 2019

Exports are expected to slow to 3.4% in 2019 due to slower manufactured goods

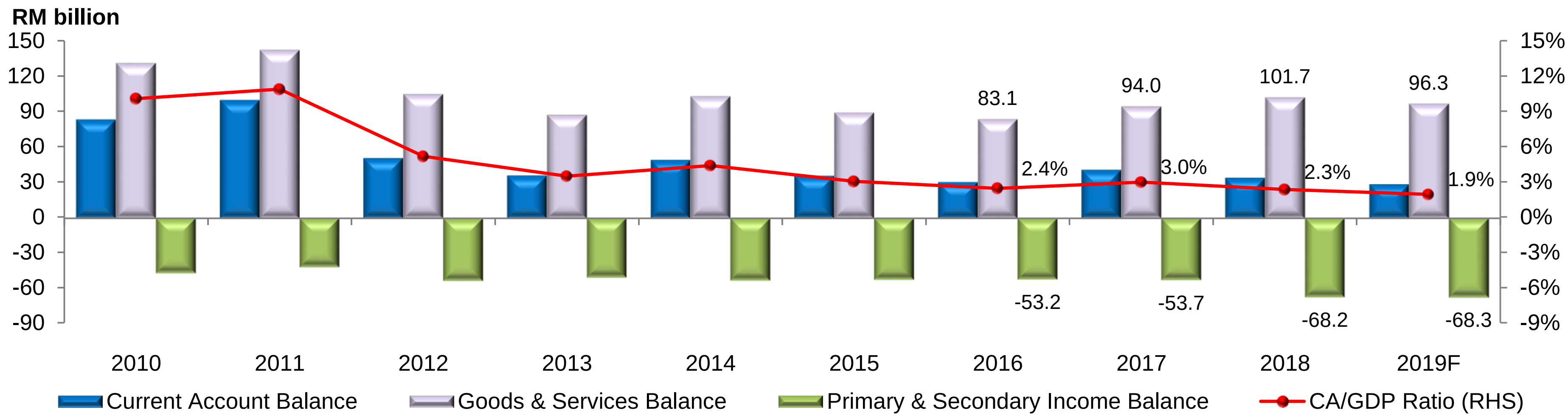


Export performance in 2018 by major products

Major export products	RM billion	% Growth
E&E products [38.2%]	380.8	11.0
Petroleum product [7.7%]	76.4	6.4
Chemical and related products [5.8%]	57.7	22.5
Manufactures of metal [4.5%]	44.7	17.8
Machinery & equipment [4.1%]	40.6	1.2
LNG [4.0%]	40.1	-3.1
Palm oil [3.9%]	38.6	-16.2
Crude Petroleum [3.7%]	36.6	29.4

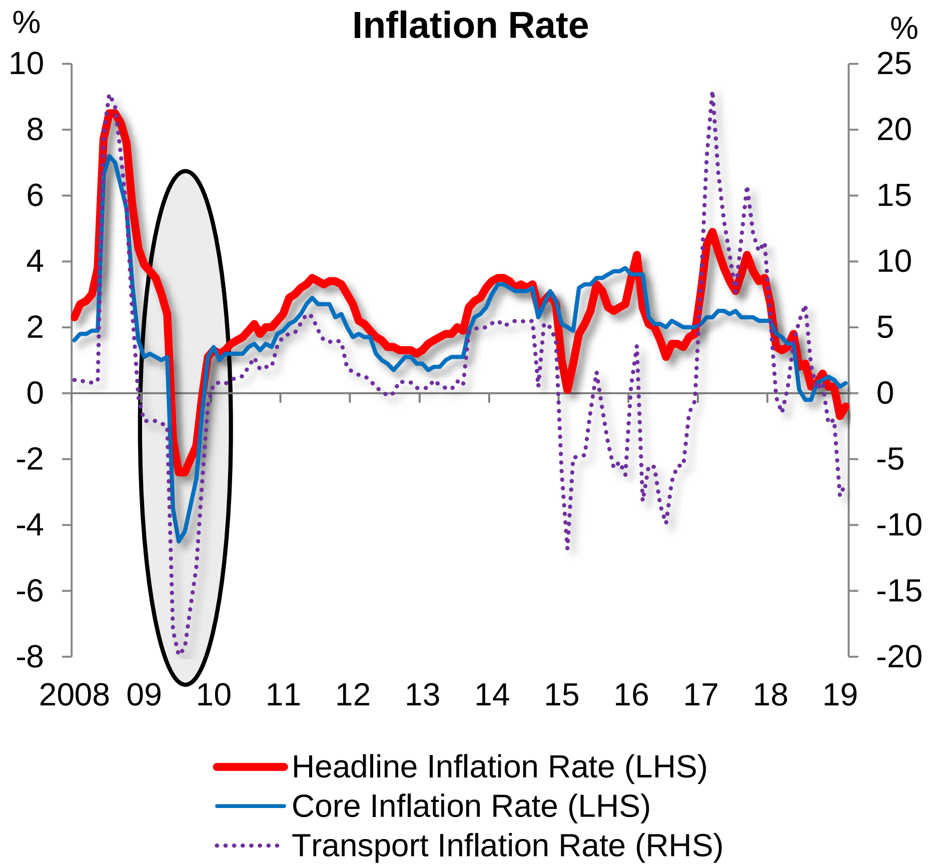
Figure in parenthesis indicates % share of gross exports in 2018

Current account surplus at 1.9% of GDP in 2019



Source: DOSM; BNM; SERC

"Technical" base-induced DEFLATION is transitory



- BNM expects **HEADLINE INFLATION** to **average between 0.7-1.7% in 2019 (SERC: 1.0-1.5%)** (1.0% in 2018) due to some cost pass-through from domestic cost factors.
- **DOMESTIC COST FACTORS**: the lapse in consumption tax policy (the ending of 3-month zerorised GST tax holidays and reintroduction of SST); increase in minimum wage and higher electricity surcharges for businesses; potential increase in food prices. However, the expected lower global oil prices will feed into stable and lower fuel prices.
- First deflation (Jan 2019: -0.7% yoy) since end-2009. It is merely a technical deflation due to the decline in fuel prices and the replacement of GST with SST.

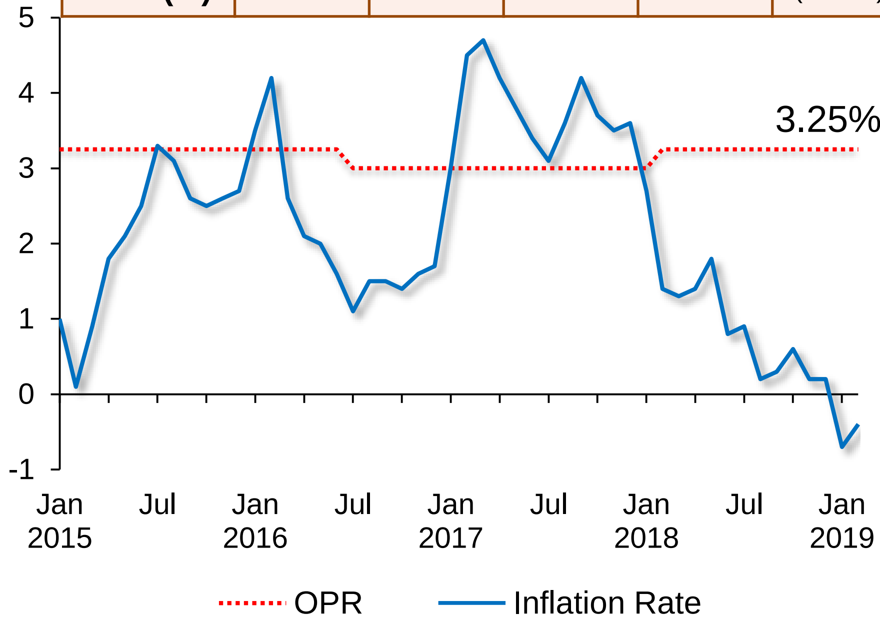
Source: BNM; DOSM
Note: Core inflation in 2008-2014 excludes food and non-alcoholic beverages only.

An INTEREST RATE CUT might be coming …

- Bank Negara Malaysia says that **MONETARY POLICY IN 2019** will focus on **PROMOTING STEADY GROWTH**. The policy toolkit includes interest rate, micro-and macro-prudential measures.

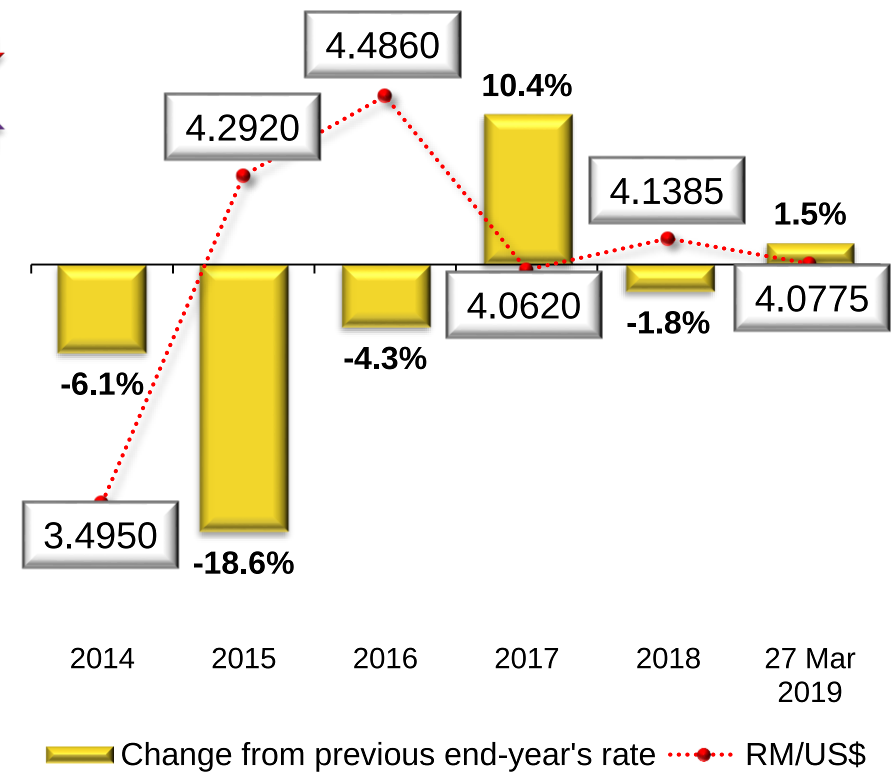
Inflation will rise moderately in 2019

Year	2015	2016	2017	2018	2019E
OPR (%)*	3.25	3.00	3.00	3.25	3.00
Inflation Rate (%)	2.1	2.1	3.7	1.0	1.0-1.5 (SERC)



* OPR as at end-year

Ringgit outlook at RM3.95-4.00 per US dollar

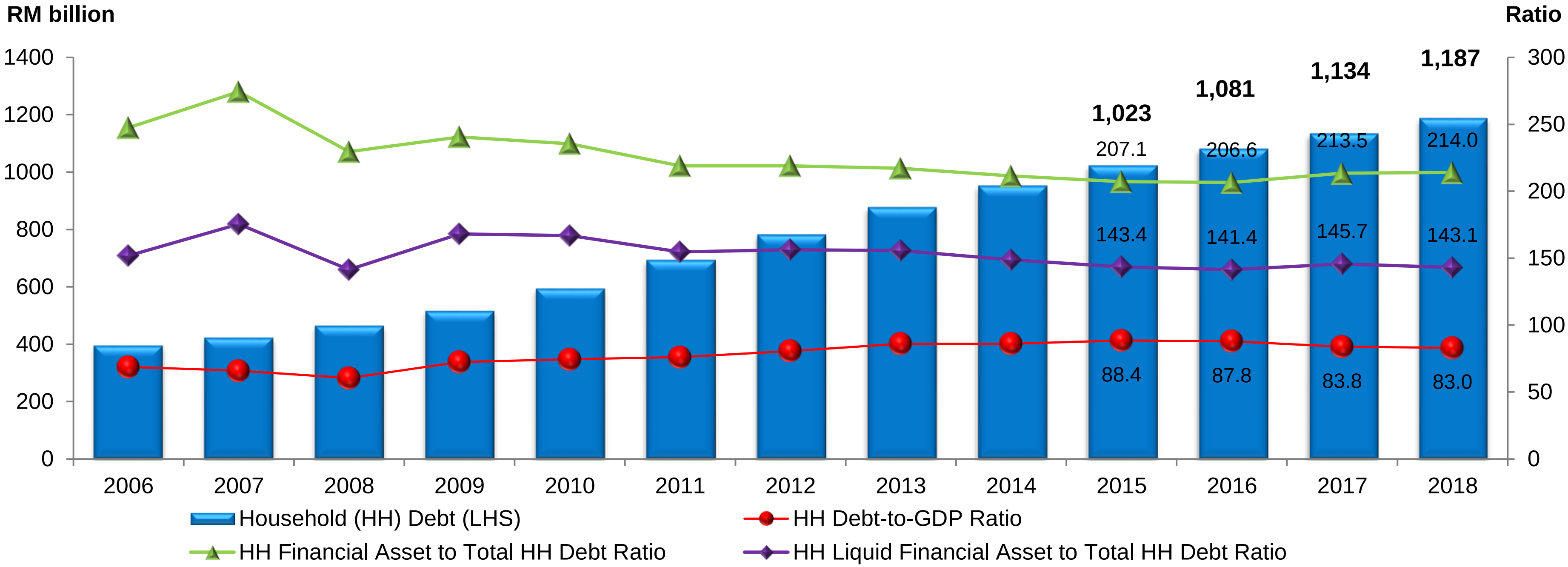


Note: Exchange rate (12:00 rate) as at end-period

Source: DOSM; BNM; SERC

HOUSEHOLDS DEBT continued to expand at a slower pace

- **HOUSEHOLD DEBT growth** moderated for the eighth consecutive year (**+4.7% to RM1,187.3 billion in 2018**; 2017: 4.9%; 2010: 14.2%), resulting in lower ratio of household debt-to-GDP to 83.0% (2017: 83.8%).
- **QUALITY OF HOUSEHOLD DEBT REMAINED INTACT**. i) The ratio of household assets to debt remained high at 4.0 times; ii) households maintained comfortable levels of financial assets and liquid financial assets at 2.1 times and 1.4 times respectively; and iii) debt service ratio (DSR) for the bulk (70%) of newly approved loans have remained below 60%.

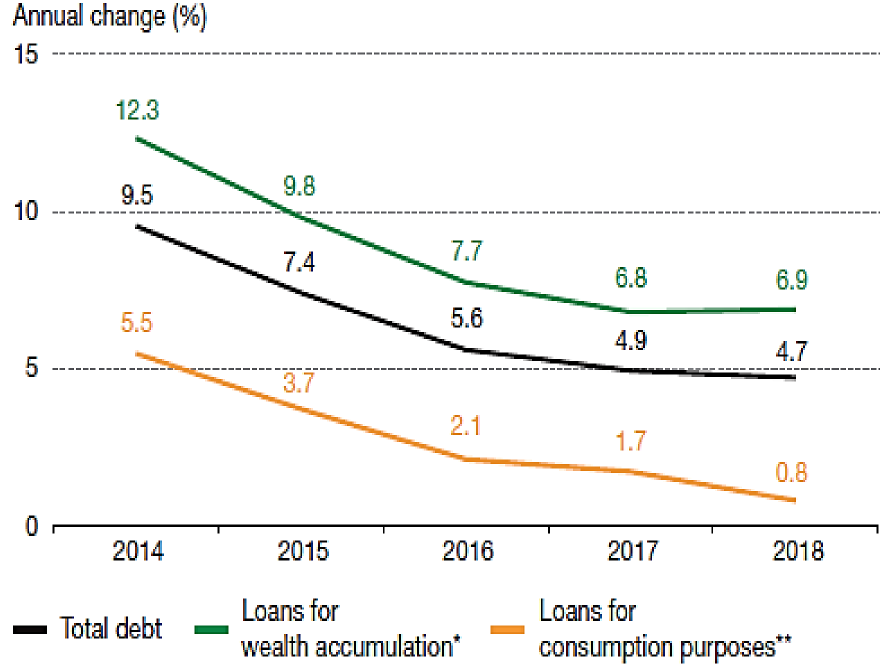


Source: BNM

Household sector debt conditions

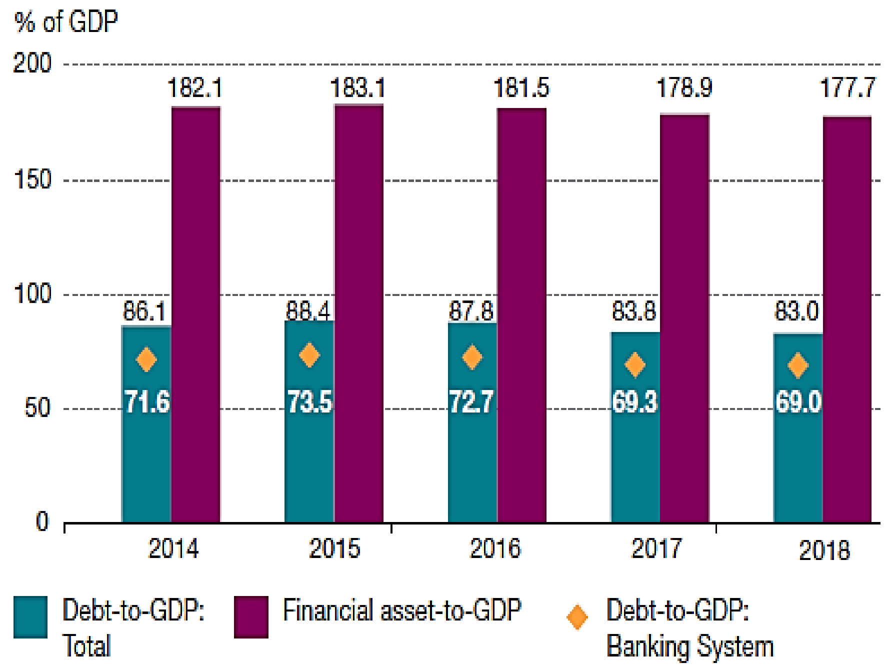
Growth of household debt continued to moderate …

Household Sector – Annual Growth of Debt



… with debt-to-GDP ratio declining further

Household Sector – Key Ratios

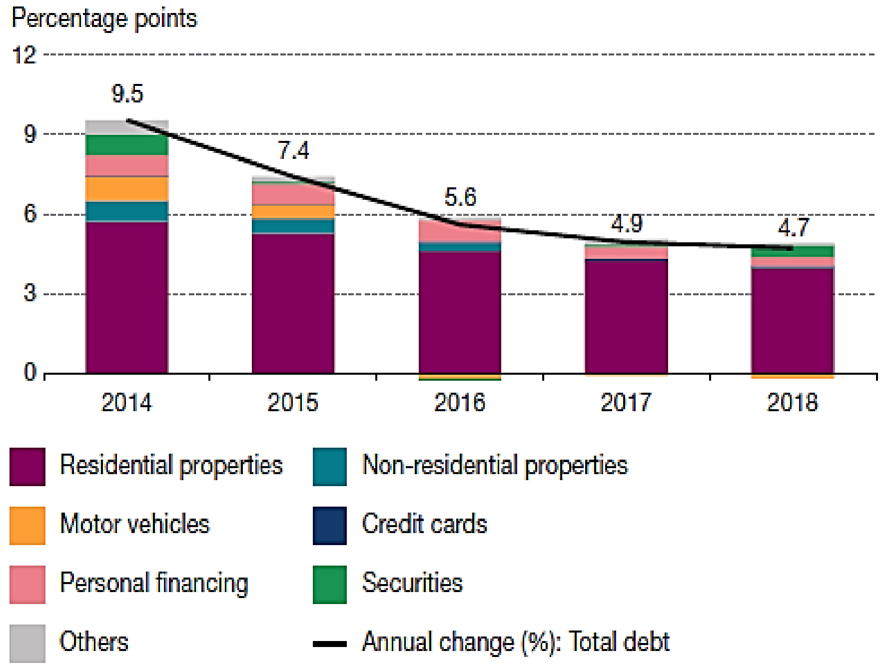


Source: BNM

Household sector debt conditions (cont.)

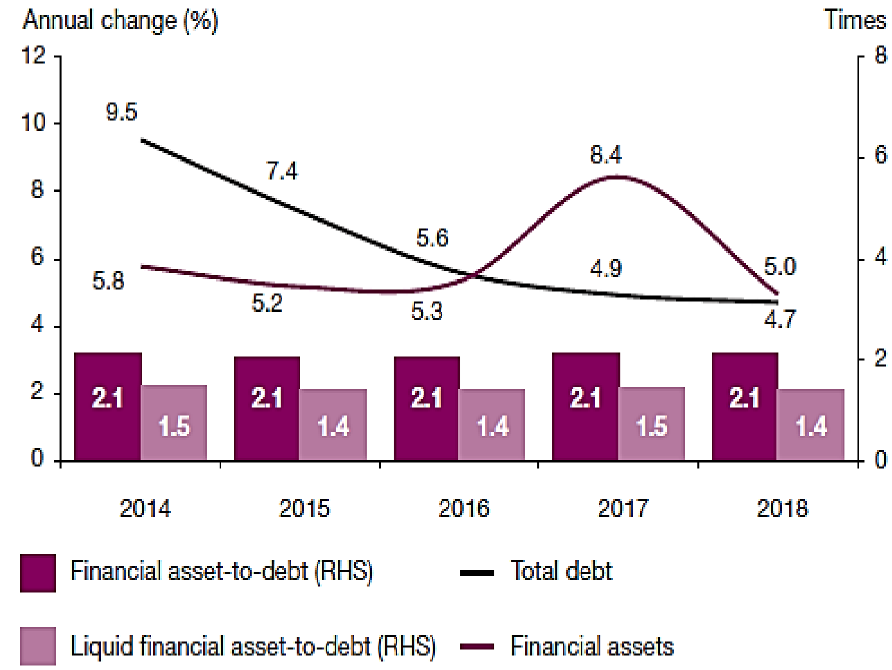
Slower debt growth was driven mainly by moderation in residential property and motor vehicle loans

Household Sector – Contribution to Growth in Debt



Growth of financial assets continued to outpace that of debt

Household Sector – Debt and Financial Assets

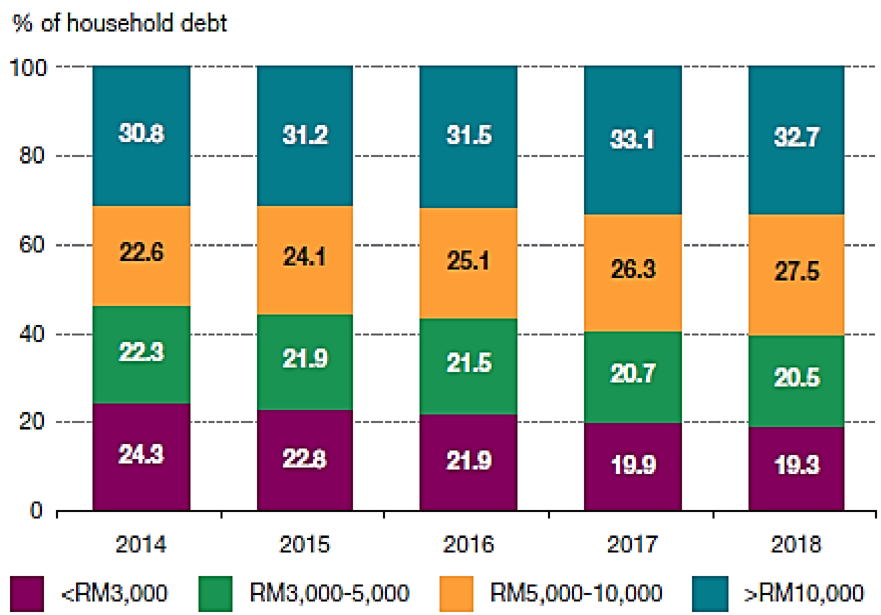


Source: BNM

Household sector debt conditions (cont.)

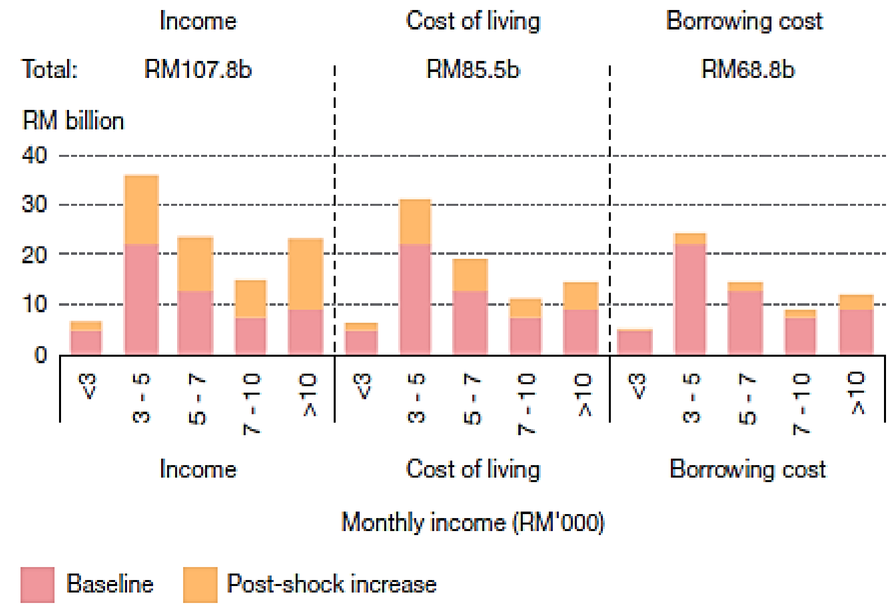
Share of borrowings by vulnerable borrowers declined further

Household Sector – Debt by Monthly Income Group



Potential losses remain within banks' total excess capital buffer

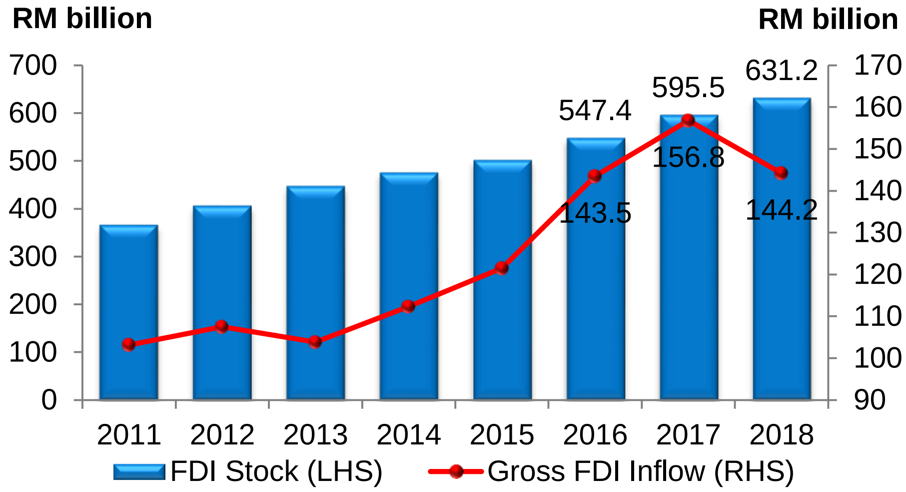
Household Sector – Potential Losses to Banks Under Pre- and Post-Shock Scenarios



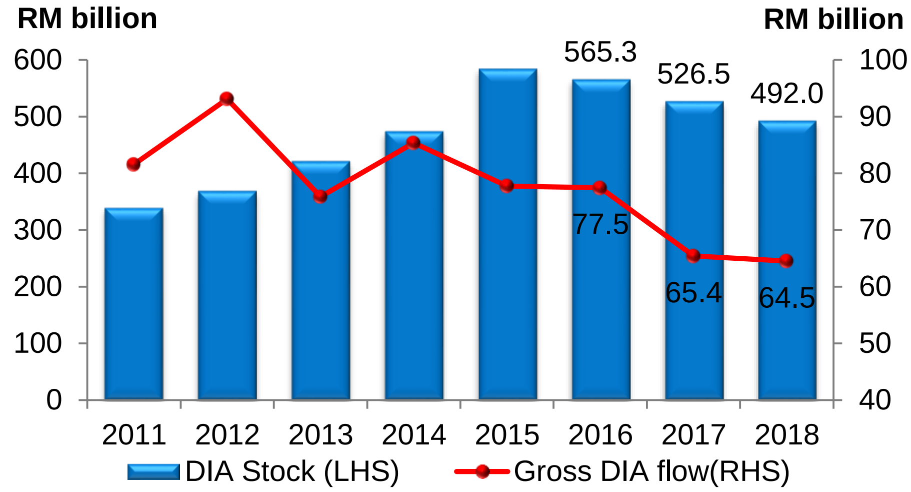
Source: BNM

LOWER FDI and Outward investment in 2018

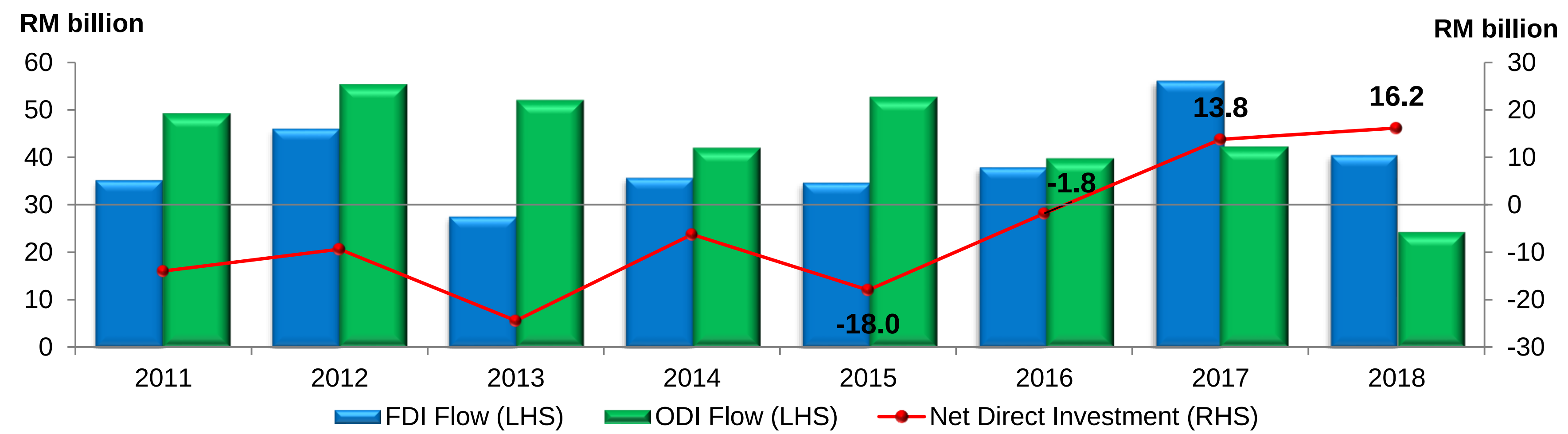
First decline in gross FDI inflows since 2013



Outward direct investment stock remains on declining trend



Lower FDI and outward investment in 2018

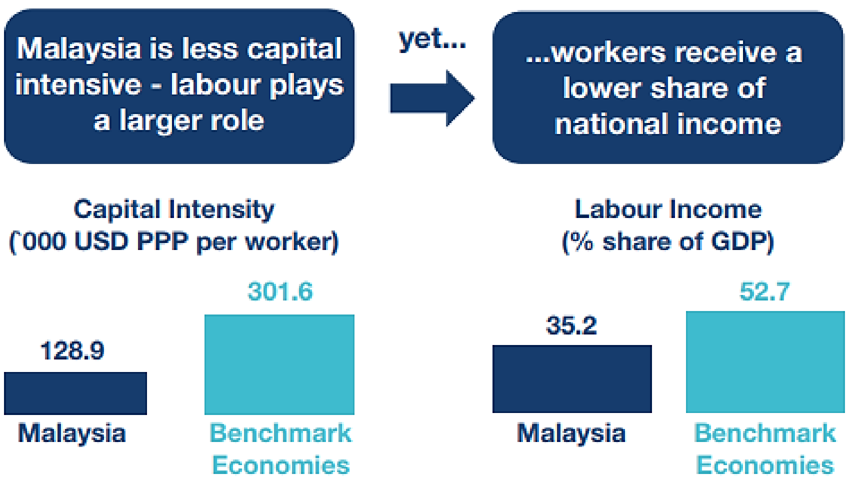


Source: BNM

Malaysian WAGES do not commensurate with PRODUCTIVITY

- Generally, employees' wages do not commensurate with the value of output they produced, they only be paid by US$340 for every US$1,000 worth of output, much lower than the benchmarking economies (US$510 for every US$1,000 worth of output) across most economic activities.
- Despite Malaysia is less capital intensive economy and the labour share of income has risen over the years, the share of labour income share still lagging behind many advanced countries.

Insufficient creation of high-skilled and high-paying jobs → (1) Low-skilled jobs are created faster than mid- and high-skilled jobs, due to expansion in labour intensive and low wage industries | (2) Real starting salaries for graduates have declined



Comprehensive LABOUR MARKET REFORMS necessary to raise income

Source: BNM

Malaysia's RESILIENCE in managing EXTERNAL DEBT OBLIGATION and ADEQUACY of international reserves

Potential shocks

1. Exchange rate depreciation
2. Global financial conditions tightening
3. Domestic and global growth slowdowns

External debt driven by country-specific factors

- External debt development is driven by the country-centric factors, including the **high presence of foreign banks and MNCs**, **extensive regional network of domestic banks** and a **highly developed domestic debt market**.
- Although Malaysia's external debt is **relatively higher** (**64.7% of GDP as at end-2018**) in comparison to the EMEs median peer countries, but **it is manageable** over the medium term as it has proven to be resilient to adverse shocks and is likely to remain so even when the shocks are magnified.
- **International reserves position** (US$102.6 billion as at 15 March 2019) provides another layer of strength to the external sector position.
- Moreover, **resident banks and corporations' liquid external assets** are **more than sufficient to cover the short-term external debt**.
- Altogether, the **liquid external assets are 1.7 times higher than potential claims on reserves**.

SMEs FINANCING

Difficulty in accessing financing NOT a key constraint to SME growth

- A survey conducted by BNM revealed that about **22% of the respondents had applied for financing** in six months time, with the majority **(94%) of their applications being approved**.
- On average, the majority of the **applications (89%) was approved within one month** and the **funds were disbursed within the subsequent month (87%)**.

22%	94%	87%
of respondents applied for financing	financing applications approved	financing disbursed within a month

Source: BNM

Common Financing Barriers Among Pockets of SMEs

- Insufficient documentation
- Insufficient cash flow for repayments
- Non-viable business plans
- Low awareness

Policy Implications:

- Establishment of a secured transaction framework
- Formalisation to enhance access to finance
- Promote alternative finance

Existing policy priorities remain relevant to support SME growth

Encourage greater innovation by FIs	Enhance efficiency in financing processes
Strengthen SMEs' financial capabilities	Increase credit enhancement products

FOREIGN EXCHANGE ADMINISTRATION liberalisation to enhance businesses' hedging flexibilities …

1

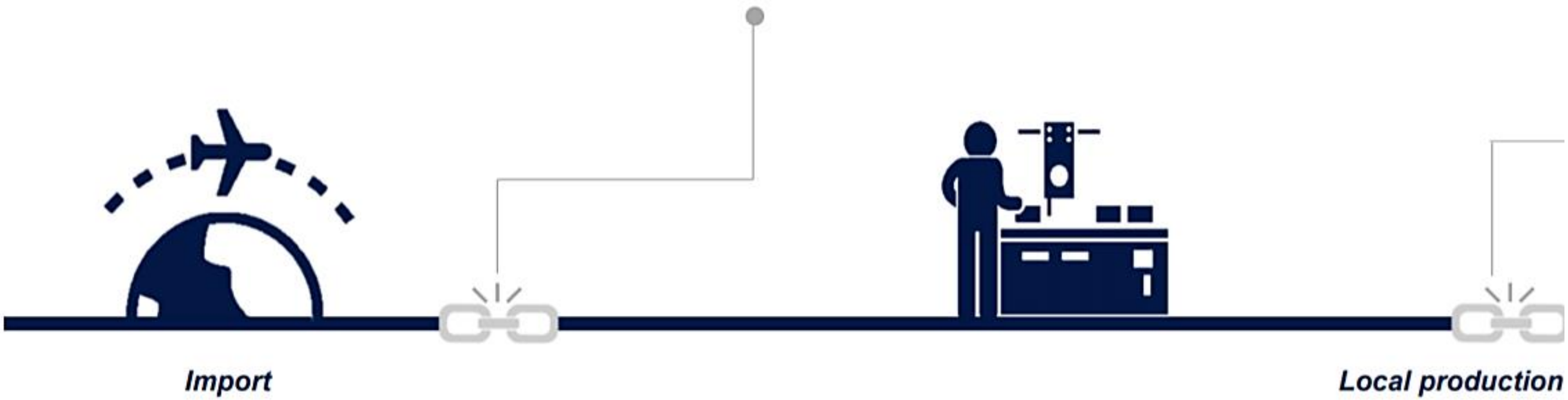
Flexibility to hedge longer term obligations

(Effective immediately)

Residents can extend hedging of foreign currency exposures on current account obligations[1] and loan repayment up to 12 months

Benefit

Allow residents to better manage their foreign currency exposure for longer tenure



1/ Current account obligations include imports of goods and services as well as profits, dividends and interests

SME: Small and Medium Enterprise

Source: BNM

... for better foreign exchange risk management

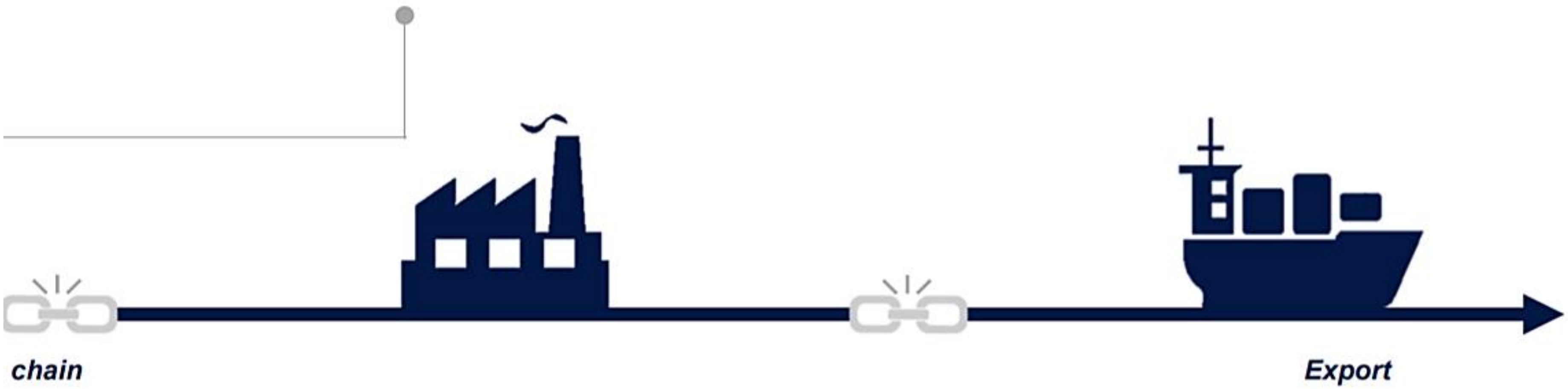
2

Flexibility for SMEs with import obligations to receive payment in foreign currency
(Effective 2 May 2019)

Resident exporters can make payment in foreign currency to resident SMEs (net importers) for settlement of domestic trade in goods and services upon one-off registration with respective banks

Benefit

Allow SMEs which are net importers to achieve 'natural hedge', thus minimising foreign exchange risks



Source: BNM

CONCLUSION

- **Bank Negara Malaysia** expects the **MALAYSIAN ECONOMY to grow by 4.3-4.8%** (mid-point at 4.7%) in 2019 (4.7% in 2018). This is in line with our estimate of 4.5-4.7%.
- **DOMESTIC DEMAND** will continue to be the anchor of growth, underpinned by private sector activity as public sector continues to consolidate spending. Both private consumption and investment are expected to grow decently in 2019 while public investment will contract sharply due mainly to the completion of major projects and continued rationalization of spending.
- **ALL ECONOMIC SECTORS** are forecasted to expand, albeit mixed growth in 2019. The services and manufacturing sectors will continue to be the key drivers of overall growth. Both the mining and agriculture sectors are expected to rebound on recovery in production as the supply-induced shocks and disruptions receded.
- **HEADLINE INFLATION** is projected to average between 0.7-1.7% in 2019 (1.0% in 2018), due mainly to some pass-through of domestic cost factors (the lapsing of consumption tax, increase in minimum wage, electricity surcharge on businesses) amid the moderating effect from stable fuel prices.
- **DOWNSIDE RISKS TO ECONOMIC GROWTH projection** would come from external side (the unresolved trade disputes, uncertainty in monetary policy in advanced economies, volatile capital flows and oil prices**. DOMESTIC RISKS** could emanate from the commodity supply disruption, and the overhang in residential and commercial properties.

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