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Alliance Bank's Market Insights Seminar

Malaysia: Turning around, looking for growth

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Agenda

- Global economy is gaining momentum
- A broadening base for domestic growth
- But, there are risks to our macro story
- Conclusion

Key messages

Global economy on upswing, but risks remain

- Global outlook remains favourable (Trumponomics)
- Confidence rising, sustained recovery in manufacturing and trade
- Policy reforms to raise the growth potential; declining productivity growth

Policy risks and financial vulnerabilities could temper the momentum

- Hopes fading if outcomes fall short of market expectations
- Potential disruptions: inward-looking policies, Brexit's negotiation & geo-politics
- Volatility induced by the withdrawal of monetary easing
- Unsustainable asset prices, credit growth and debt implosion

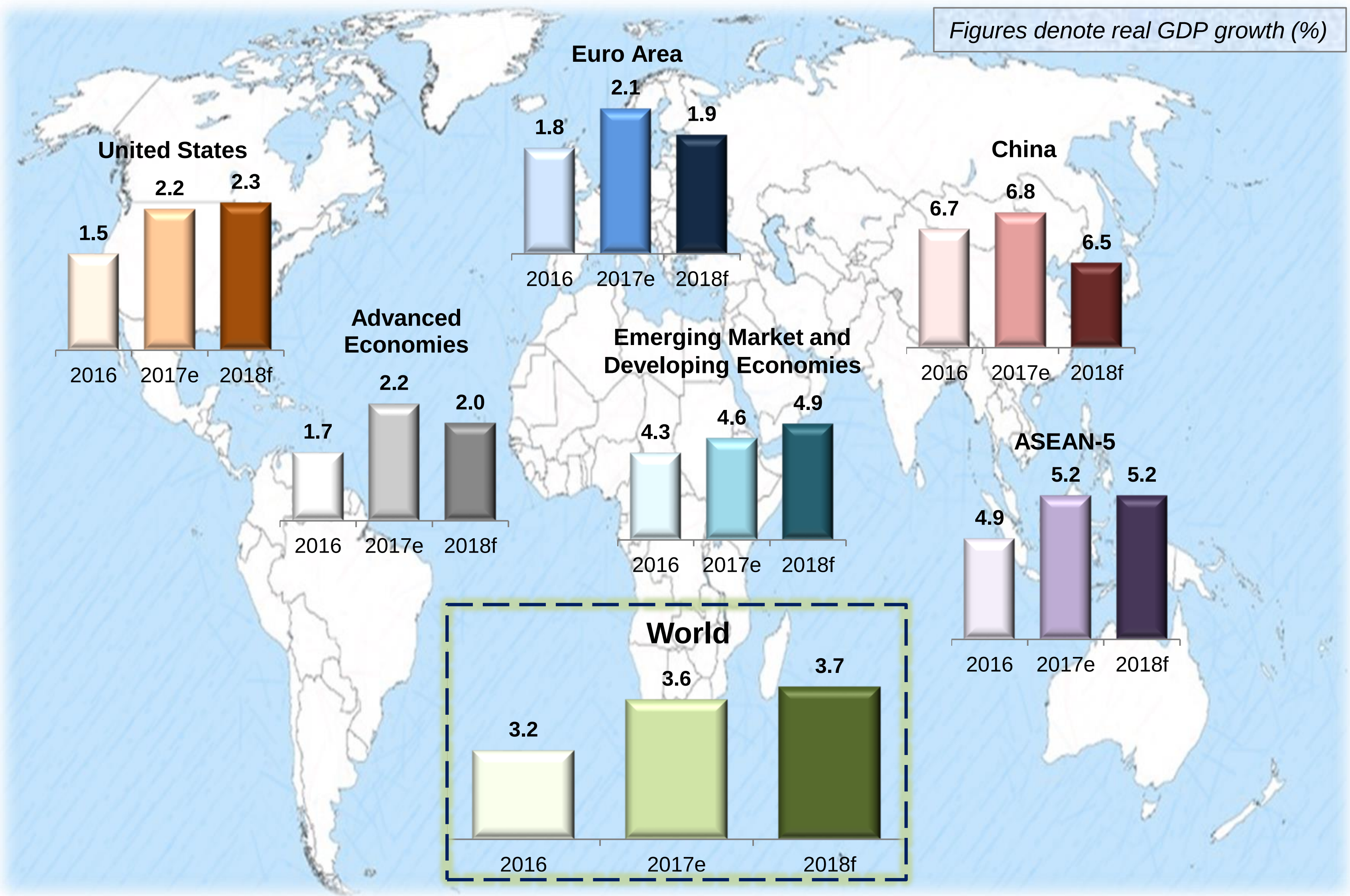
Malaysia faces challenges in a position of strength

- The Malaysian economy is gaining ground but growth remains vulnerable
- Step-up structural policy actions to boost growth potential and productivity
- Address as well as contain vulnerabilities to build economic resilience

Section 1:

The Big Picture in review…

Global economy is in a synchronised recovery



Source: IMF's WEO Report, October 2017

Global economic growth outlook at a glance

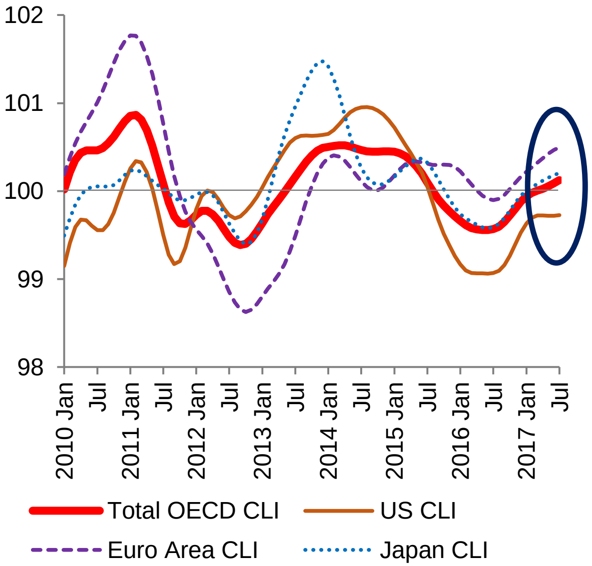
% Change (YoY)	2015	2016	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017 Q1	2017 Q2	2017f (IMF)	2017f (WB)	2018f (IMF)	2018f (WB)
United States	2.9	1.5	1.4	1.2	1.5	1.8	2.0	2.2	2.2	2.1	2.3	2.2
Euro Area	2.0	1.8	1.6	2.4	1.6	1.6	2.6	1.7	2.1	1.7	1.9	1.5
China	6.9	6.7	6.7	6.7	6.7	6.8	6.9	6.9	6.8	6.7	6.5	6.4
Japan	1.1	1.0	0.5	0.9	1.1	1.7	1.5	1.4	1.5	1.5	0.7	1.0
India	8.0	7.1	9.1	7.9	7.5	7.0	6.1	5.7	6.7	7.2	7.4	7.5
Malaysia	5.0	4.2	4.1	4.0	4.3	4.5	5.6	5.8	5.4	5.2	4.8	5.0
Singapore	1.9	2.0	1.9	1.9	1.2	2.9	2.5	2.9	2.5	-	2.6	-
Indonesia	4.9	5.0	4.9	5.2	5.0	4.9	5.0	5.0	5.2	5.1	5.3	5.3
Thailand	2.9	3.2	3.1	3.6	3.2	3.0	3.3	3.7	3.7	3.5	3.5	3.6
Philippines	6.1	6.9	6.9	7.1	7.1	6.6	6.4	6.5	6.6	6.6	6.7	6.7
Vietnam	6.7	6.2	5.5	5.8	6.6	6.7	5.2	6.3	6.3	6.3	6.3	6.4

Source: Officials; IMF (World Economic Outlook, October 2017); World Bank (Global Economic Prospects, June 2017)
Note: Annual GDP for India is on fiscal year basis, as per reporting practice of the country.

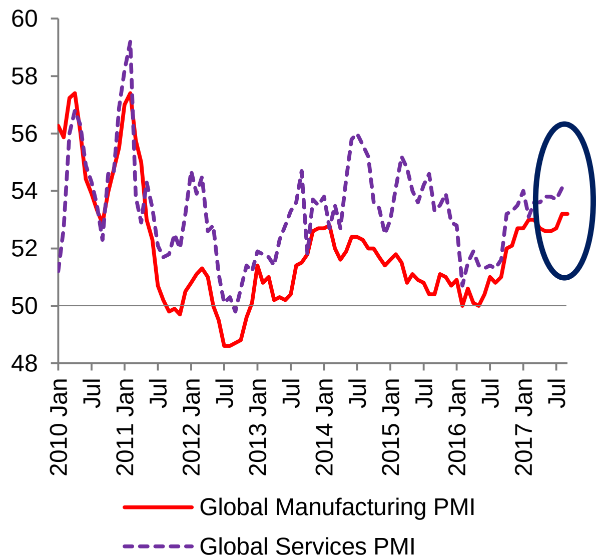
Global indicators point to steady global growth ahead

- Macro optimism comes from potential tax cuts, boost fiscal spending and loosen regulations.
- Markets are more focused on the prospects of the Trump's reflationary policies and less on the risk of policy shifts or other undesirable geo-politics outcomes.
- OECD Composite leading indicators and PMIs suggest upside risks to global growth.

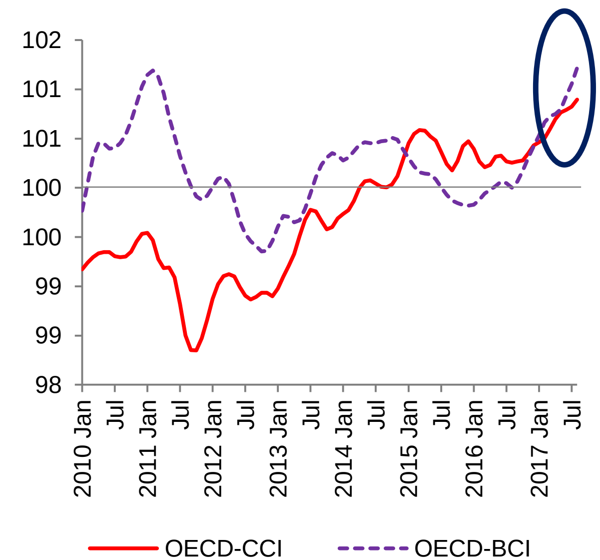
OECD composite leading indicators still steadying



Global PMI for manufacturing and services on uptrend



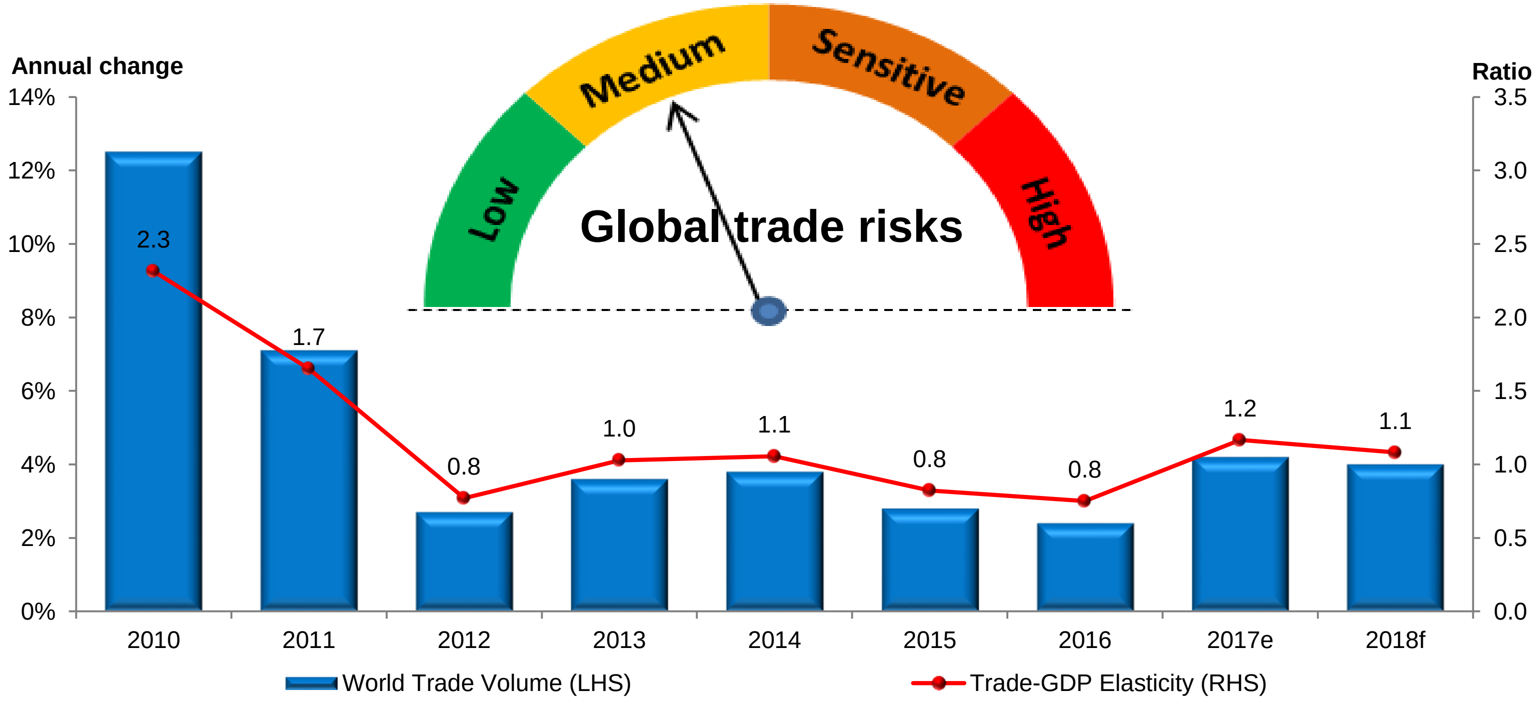
Business and consumer confidence trending higher



Source: OECD; Markit

Global trade rebounding but risks remain

- WTO revised upwards this year's global trade growth to 3.6% vs. IMF's 4.2% (1.3% in 2016) from 2.4% previously. For 2018, global trade growth is estimated at 3.2% vs. IMF's 4.0%.
- Rebounding trade growth is supported by accelerating economic growth and rising import demand in China and the United States, which spurred trade within Asia.
- Trade to GDP ratio, which had slumped to about 1.1x since the GFC from 2.0x, should rise to above 1.1x in 2017-18.

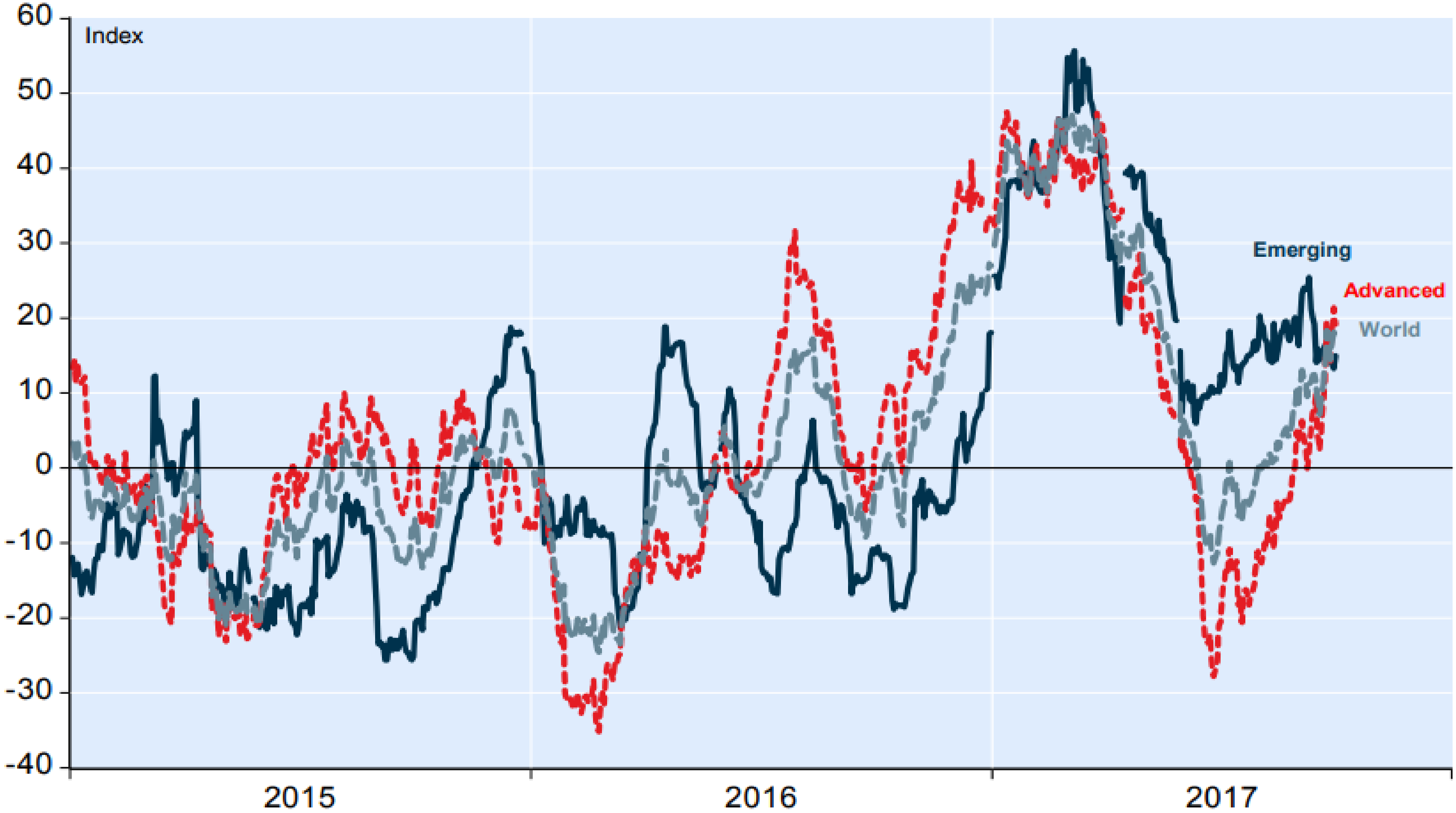


Source: IMF (WEO October 2017); SERC's computation

Economic surprise index shows widespread improvement

World: Positive economic surprises

Citi economic surprise index for World, Advanced and Emerging markets

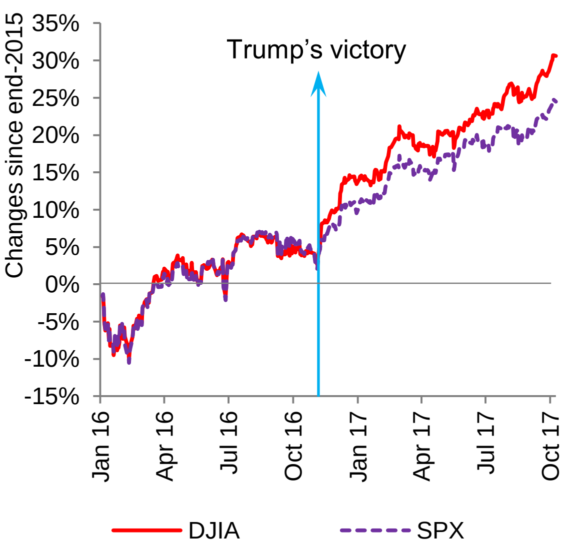


NBF Economics and Strategy (data via Bloomberg)

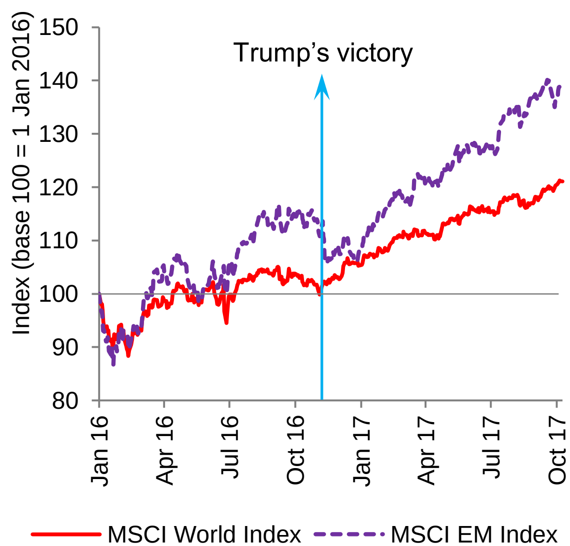
Global equity: Calm, confidence… and complacent?

- Markets shrug off headwinds: Fed's rate hikes and the shrinking of balance sheet; geopolitical risks; uncertainty over the Trump administration's policies.
- While market volatility remains remarkably low, investors should be prepared for bouts of volatility and pullbacks along the way.

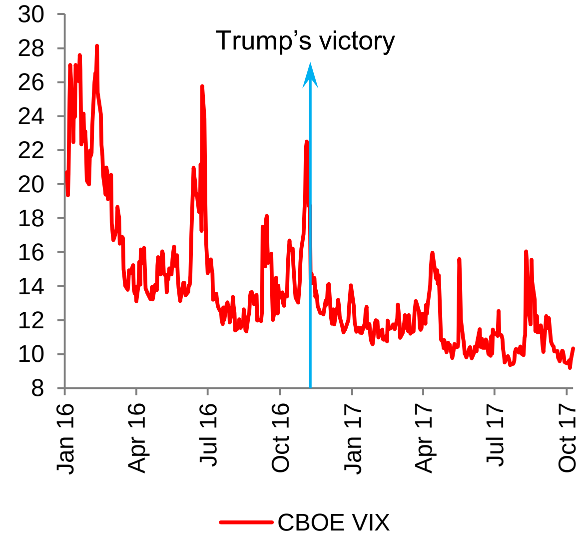
US stocks rally post Trump's thumping victory…



…spillovers to emerging markets



Volatility hangs lower amid geo-politics risk

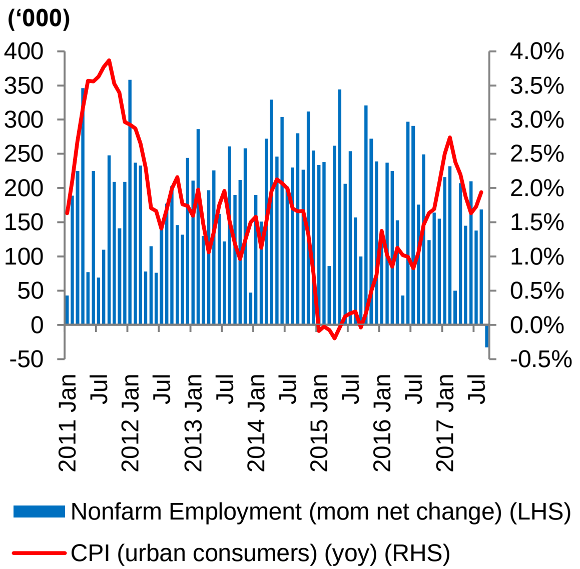


Source: WSJ; MSCI; CBOE

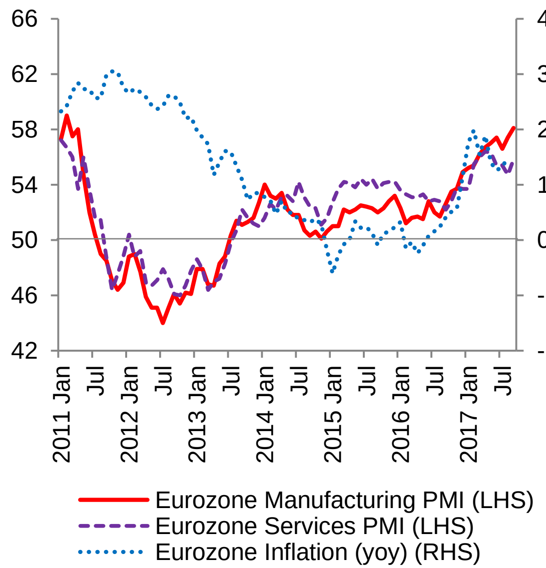
Here's are how the US, Euro Area and Japan doing

- **US**: Growth is steadying (3.1% annualised qoq in 2Q vs. 1.2 % in 1Q), supported by on going strength in the job market, pick-up in investment and exports. The impact off hurricanes will hold down growth but the growth will rebound when the reconstruction work gets under.
- **Euro area**: Recovery is broadening (0.6% qoq in 2Q vs. 0.5% in 1Q) but gaps remain.
- **Japan**: Resilient domestic spending and exports bolstered the strongest economic growth in two years (0.6% qoq in 2Q vs. 0.3% in 1Q).

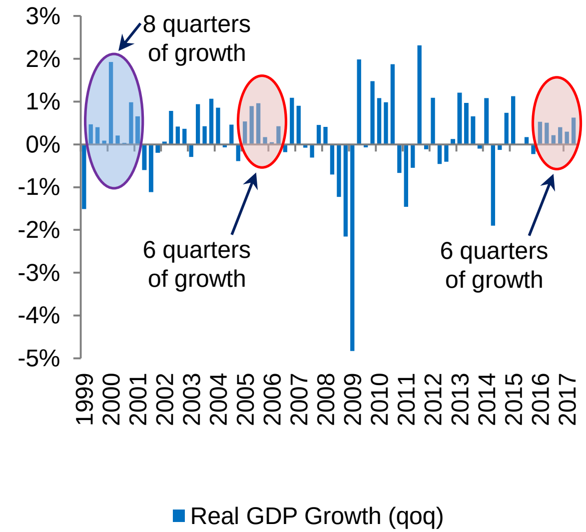
US: Lost of employment due to Hurricanes Harvey and Irma



Euro Area: Gaining momentum



Japan: Sustained recovery

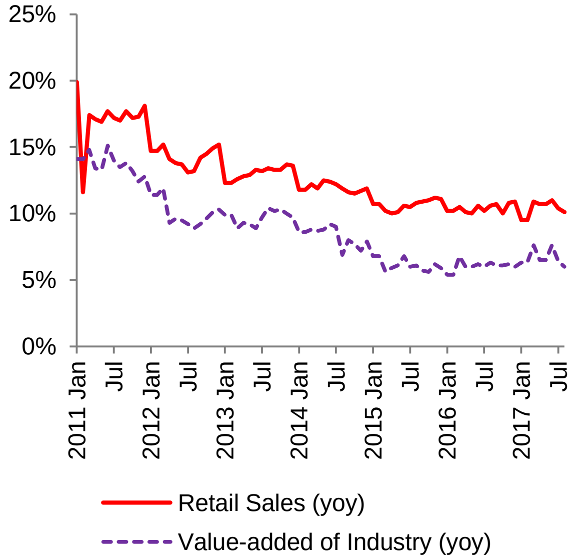


Source: US BLS; Markit; Eurostat; Cabinet Office, Japan

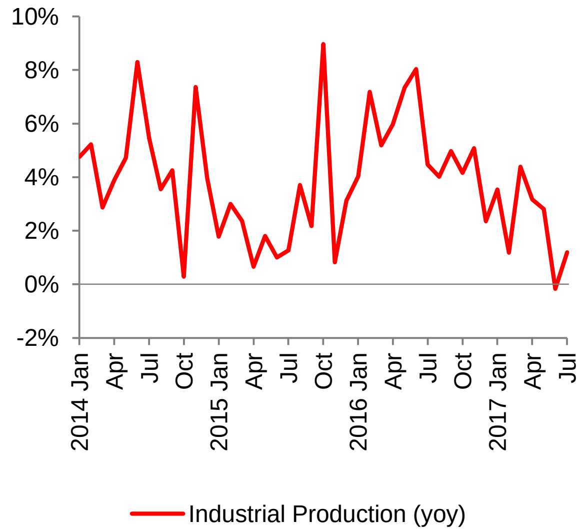
Here's are how China, India and ASEAN-4 doing

- **China**: Defied expectations to show resilient GDP growth amid lingering debt concerns.
- **India**: Still lingering disruptions associated with the demonetization shock as well as transition costs related to the GST in July 2017
- **ASEAN-4**: Exports have shown greater strength.

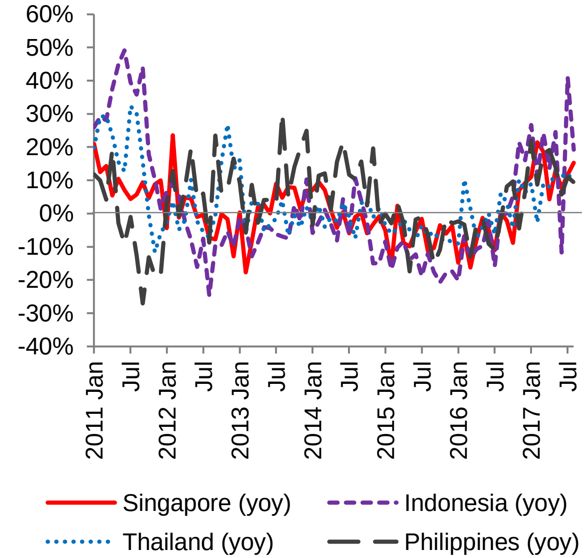
China: Sustained economic activities



India: Industrial output slips below zero for the first time after Jun 2013



ASEAN-4: Exports generally on upswing

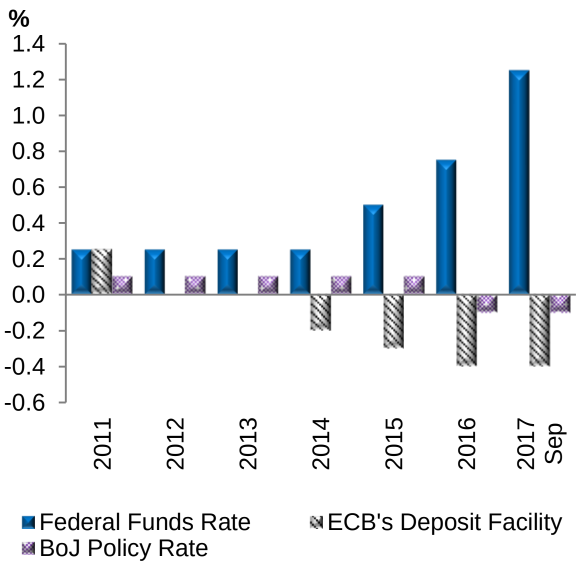


Source: NBS, China; MOSPI, India; DOS, Malaysia; DOS, Singapore; Statistics Indonesia; BOT; PSA

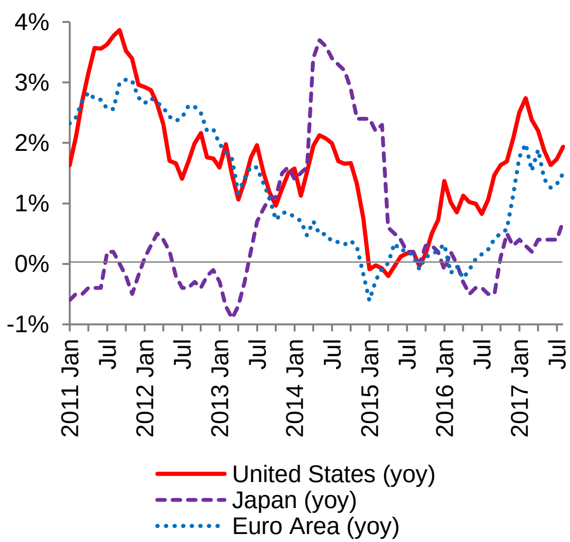
The era of global cheap money is coming to an end

- The Fed is clearly at the vanguard and setting a vital lead for others to follow. Fed funds rate expectation: end-2017: 1.50%; end-2018: 2.25%; end-2019: 3.00%.
- Rolling back of US$4.5 trillion balance sheet in October.
- Subdued headline inflation means a gradual normalization of interest rate.
- The ECB is ready to tweak interest rate after the expiry of its QE in December 2017.

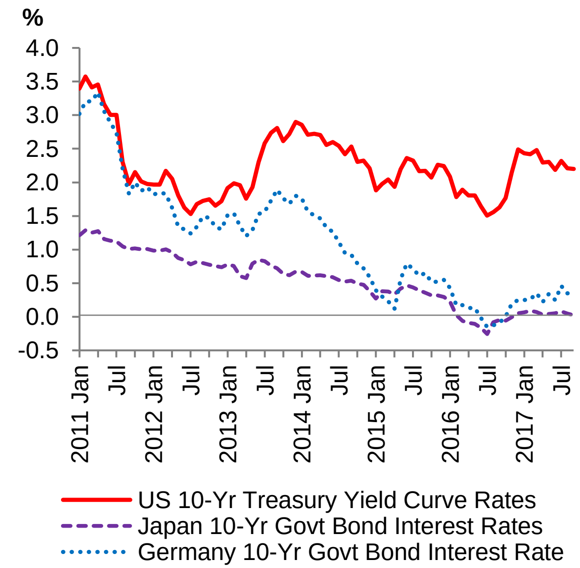
The Fed's rate hike cycle continues; while BoJ and ECB remained unchanged



Headline inflation in the West is slowing down



Bond yields seem to be stabilised



Source: Federal Reserve; ECB; BoJ; U.S. Department of the Treasury; MOF, Japan; Eurostat

The Fed embarks on the "Great Unwind"

- Potentially, this policy change would impact on the US dollar, US bond yields, and capital flows as well as periods of volatility. But, it is expected that this "Great unwinding" transition will not be as eventful as some fear.
- **First**, the scale of reduction in the Fed's balance sheet in the next few years will be nowhere near as large as the increase during the expansion phase.
- **Second**, some of the effects of balance sheet normalisation may already be factored in the market. The FOMC is very unlikely to shock the market by announcing a more hawkish path than this expectation implies, the impact of the event itself may be rather muted.
- **Third**, the effect of balance sheet tightening may be offset by the Fed adopting an easier path for short term interest rates than it otherwise would have chosen.
- The key point is that the Fed's future stance of monetary policy will be determined by the combination of balance sheet normalisation and the path for the Fed funds rate.

The Fed is determined to avoid a repeat of the 2013 "taper tantrum"

What to expect from the Fed's shrinking balance sheet?

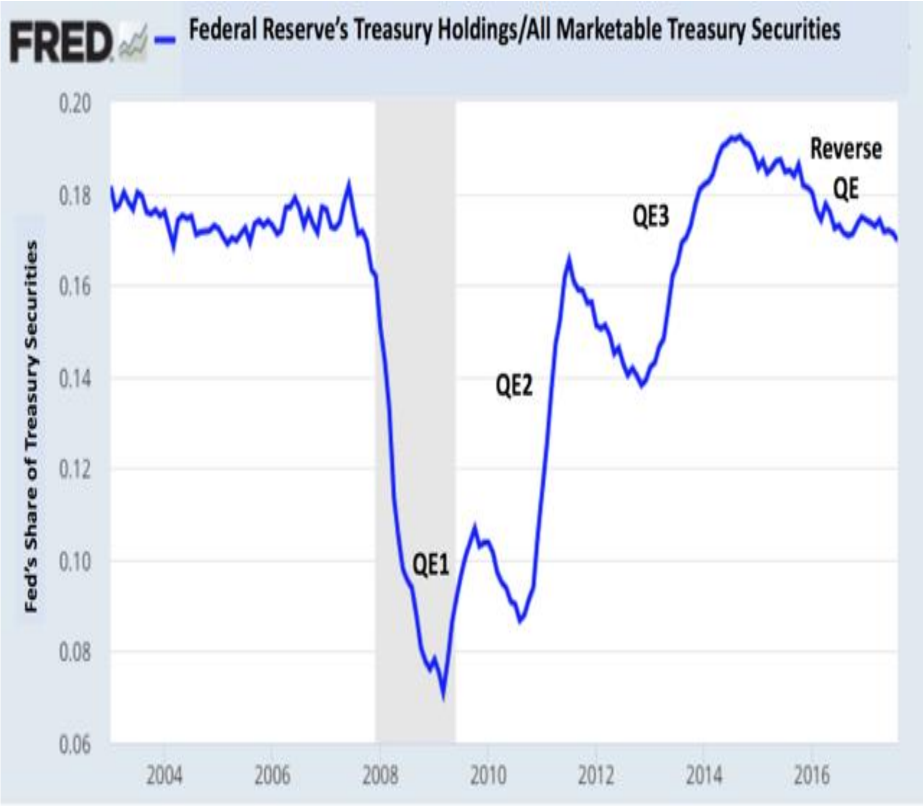
- Less than US$900 billion before the GFC to about US$4.5 trillion today—including about US$2.5 trillion in Treasuries and US$1.8 trillion in mortgage-related securities.
- The Fed will allow US$10 billion to roll off initially, increasing quarterly in US$10 billion increments until the total hits US$50 billion starting in October 2017.
- Potentially, this policy change would impact on the **US dollar**, **US bond yields, and capital flows**.

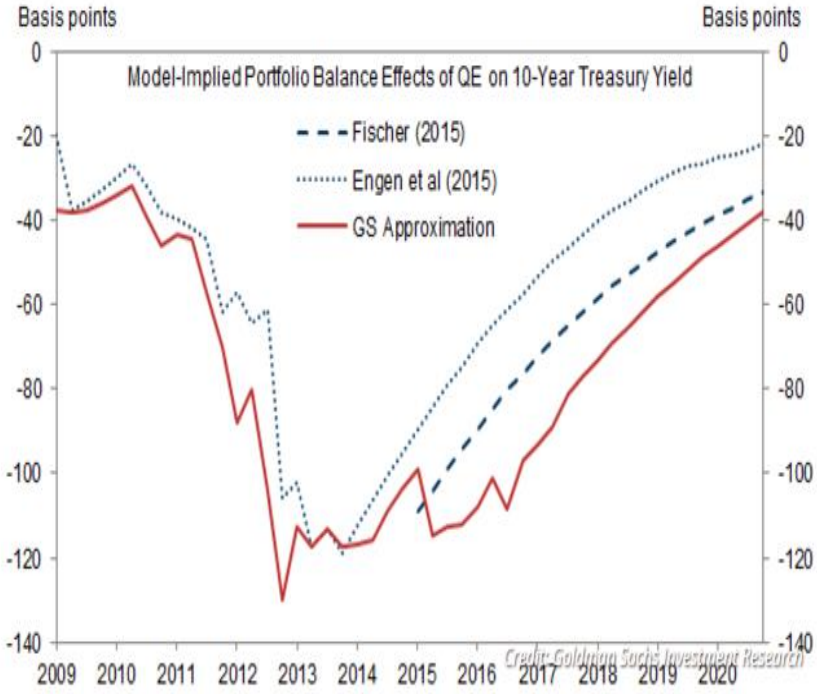
Scale	Market	Interest rate
• US$6bn per month for Treasuries at 3-mth intervals over 12 mths until it reaches US$30bn per month • Mortgage-backed securities, tapering US$4bn per month initially at 3-mth intervals over 12mths until it reaches US$20bn per month	• Some effects of the reduction may be already factored in the market • Unlikely to shock the market by announcing a hawkish path	• Future monetary policy stance will be decided by the normalization of interest rates and unwinding of balance sheet • Balance sheet shrinking will be offset by the adoption of easier short-term interest rate path

To avoid a repeat of the 2013 "Taper tantrum"

The Great Unwinding: What happens to Treasury Yields?

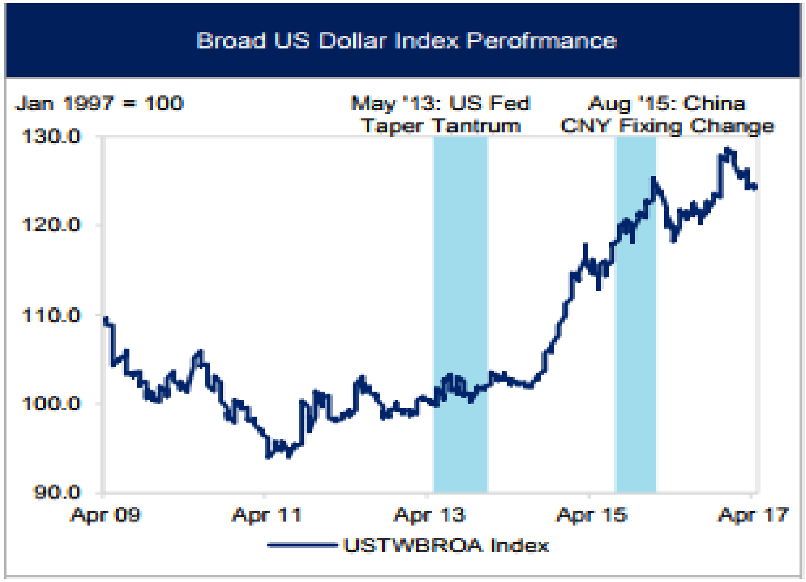
- Fed's QE program effect: Reduced 10-year term premium (bond yield) by 120 basis points in 2013; and reduced the dollar effective exchange rate by 4.5-5.0%.
- It is estimated that the gradual runoff of the Fed's US$4.5 trillion portfolio could drive the 10-year Treasury yield up 15-20 basis points every year.
- End-2017E: 10-year Treasury notes at 2.40%; End-2018F: 10-year Treasury notes at 2.60-80%

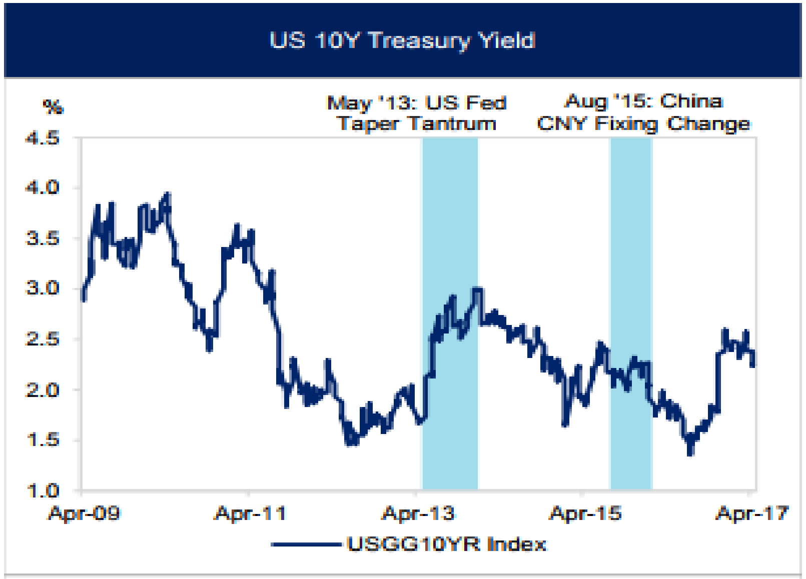


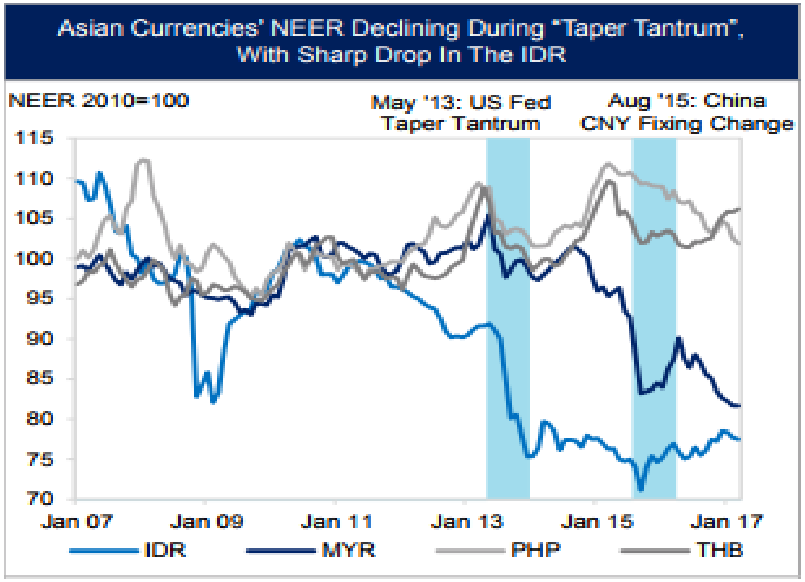


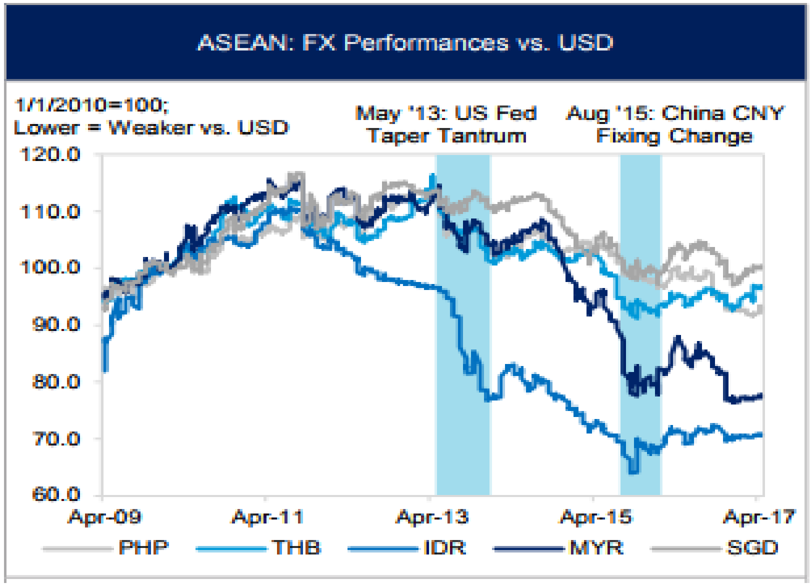
By Goldman Sachs' estimates the balance sheet reduction should hurt stocks and bonds. The red line shows the steady decline of the term premium as the central bank cuts its holdings of government paper.

ASEAN currencies to cope with mild corrections









Source: UOB

Policy rates outlook

End-period of	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 Sep/Oct	2017e	2018f
US, Federal Funds Rate	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.25-0.50	0.50-0.75	1.00-1.25	1.25-1.50	2.00-2.25
Euro Area, ECB (Deposit Facility)	2.00	0.25	0.25	0.25	0.00	0.00	-0.20	-0.30	-0.40	-0.40	-0.40	0.00
Japan, BOJ Policy Rate	0.10	0.10	0.00-0.10	0.00-0.10	0.00-0.10	0.00-0.10	0.00-0.10	0.00-0.10	-0.10	-0.10	-0.10	0.00-0.10
China, PBOC 1-year Benchmark Loan Interest Rate	5.31	5.31	5.81	6.56	6.00	6.00	5.60	4.35	4.35	4.35	4.35	4.89
India, RBI Policy Repo Rate	6.50	4.75	6.25	8.50	8.00	7.75	8.00	6.75	6.25	6.00	5.75	6.00
South Korea, BOK Base Rate	3.00	2.00	2.50	3.25	2.75	2.50	2.00	1.50	1.25	1.25	1.25	1.50
Malaysia, BNM Overnight Policy Rate	3.25	2.00	2.75	3.00	3.00	3.00	3.25	3.25	3.00	3.00	3.00	3.25
Indonesia, BI 7-Day Reverse Repo Rate	9.25	6.50	6.50	6.50	5.75	7.50	7.75	7.50	4.75	4.25	4.25	4.25
Thailand, BOT 1-Day Repurchase Rate	2.75	1.25	2.00	3.25	2.75	2.25	2.00	1.50	1.50	1.50	1.50	1.75
Philippines, BSP Overnight Reverse Repurchase Facility	5.50	4.00	4.00	4.50	3.50	3.50	4.00	4.00	3.00	3.00	3.00	3.25

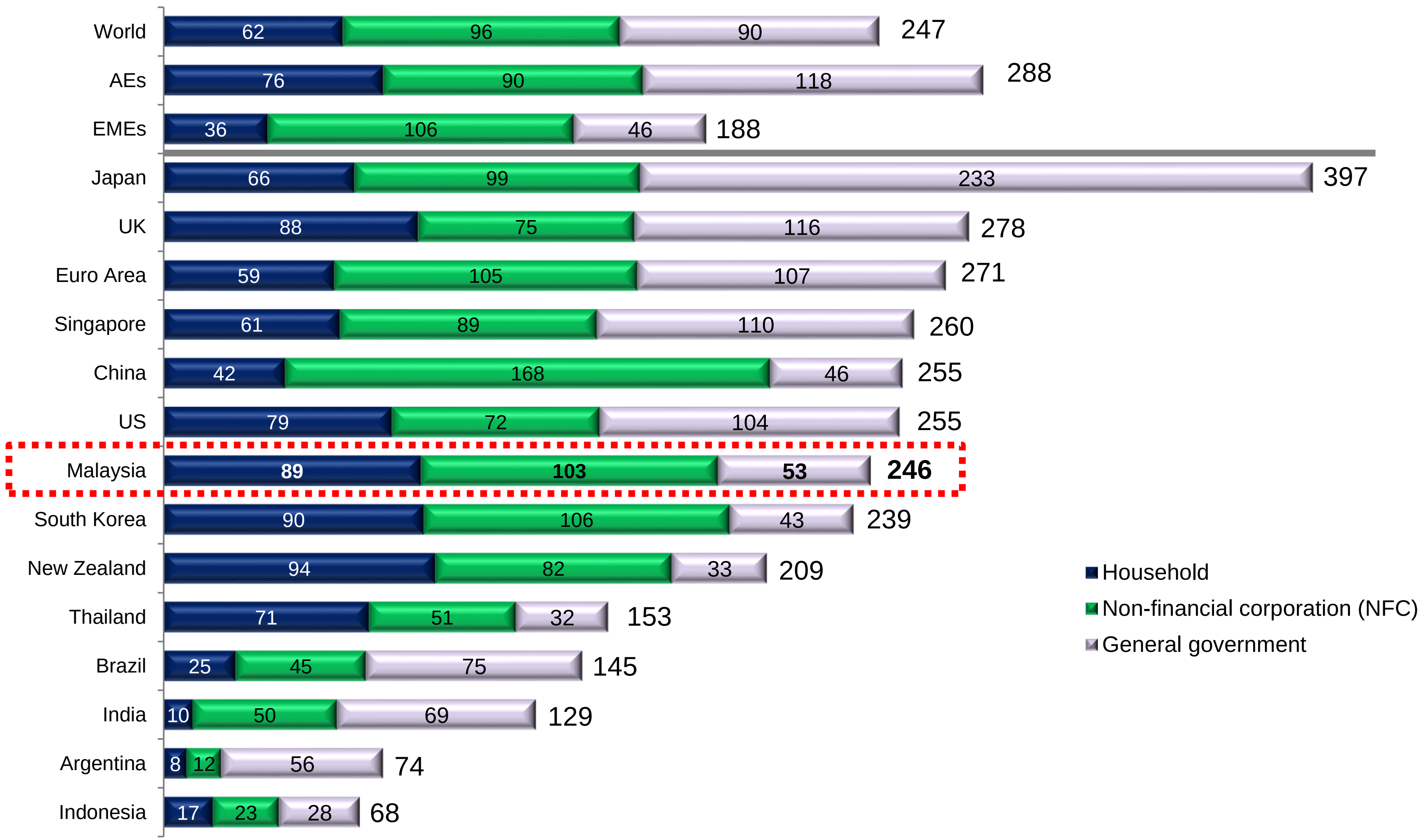
Source: Various officials; SERC estimates and forecast
Note: Indonesia employed BI 7-Day Reverse Repo Rate (BI 7-Day RR Rate) as new policy rate from 19 Aug 2016

Risks and financial vulnerabilities in perspective

Fading	• Disconnect between financial markets vs. real economy • Fading hopes on the delivery of promised policy reforms
Disruptions	• Trade protectionist mindset • Unresolved issues related to Brexit's negotiation • A plethora of policy and political uncertainties
Volatility	• Faster pace of the Fed's rate hikes and its balance sheet's reduction • Strong US dollar-induced exchange rate volatility • Financial distress on high foreign borrowing and currency mismatch
Unsustainable	• Unsustainable asset prices, excessive credit growth • Bloated debt in some emerging economies

Global debt burden as interest rates head higher is a source of concern

- At almost 250% of GDP, Malaysia's level of indebtedness warrants attention



Source: BNM

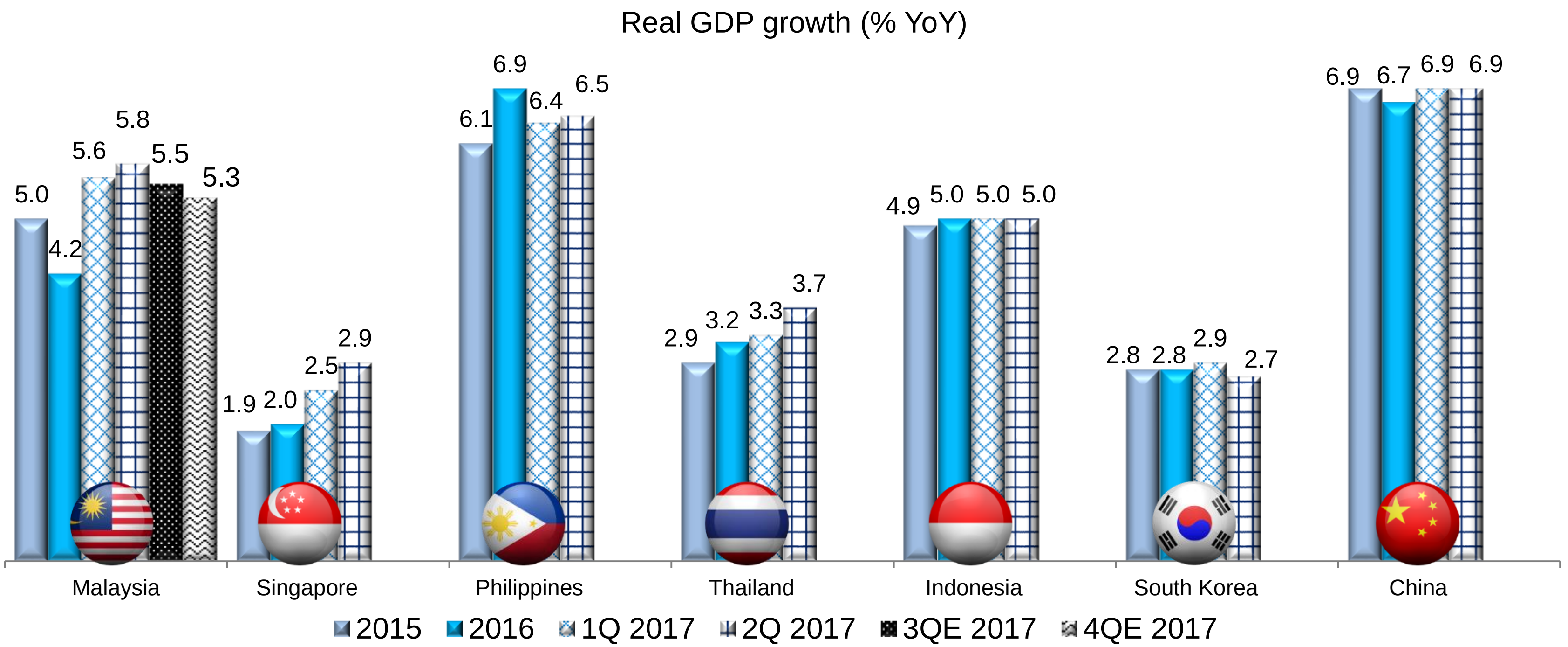
Section 2:

Malaysia: Turning around; looking for growth

The Malaysian economy is gaining ground

- The economy is looking up as the headwinds of past two years dissipate.
- The economy held up strongly (5.7% yoy in 1H17 vs. 4.1% in 1H16), the highest in more than two years. 2017's economic growth will hit 5.5% and estimated 5.1% in 2018.
- Resilient domestic demand, improving prospects for exports and corrective policy steps.

Malaysia was among the fastest-growing economies

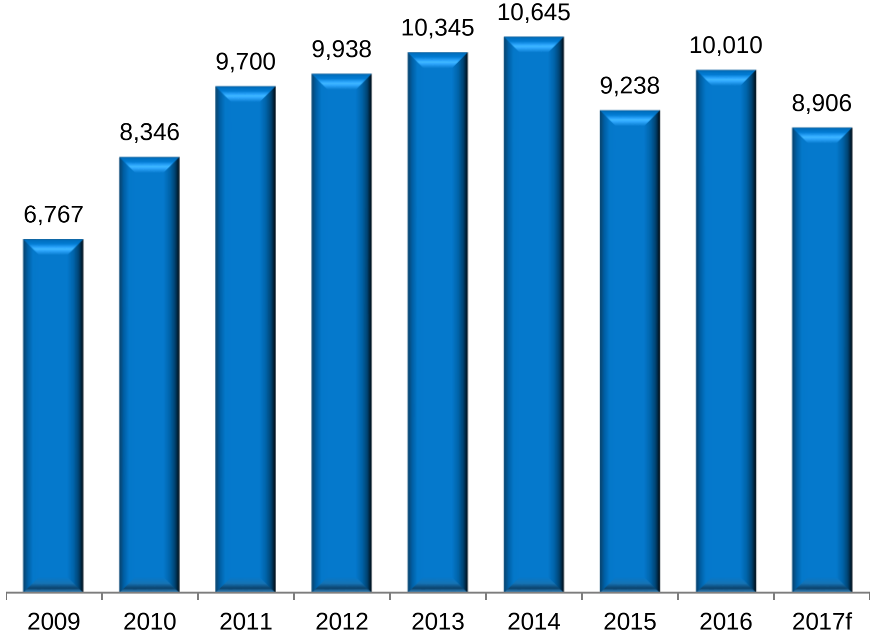


Source: Various officials

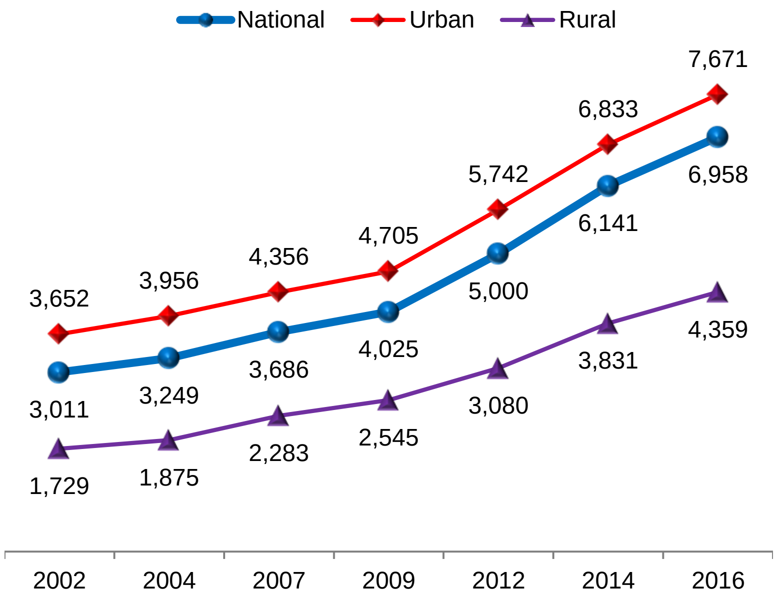
Malaysia has moved out of the "middle-income trap"

- Six years into the implementation of the National Transformation Program, Malaysia has escaped the middle-income trap, with GNI per capita hitting US$10,010 in 2016 (US$6,767 in 2009).
- Mean household income increased by 8.1% pa to RM6,958 in 2016 from RM4,025 in 2009. In real terms, it grew by 7.7% pa for the same period.

Malaysia's GNI per capita (US dollar)



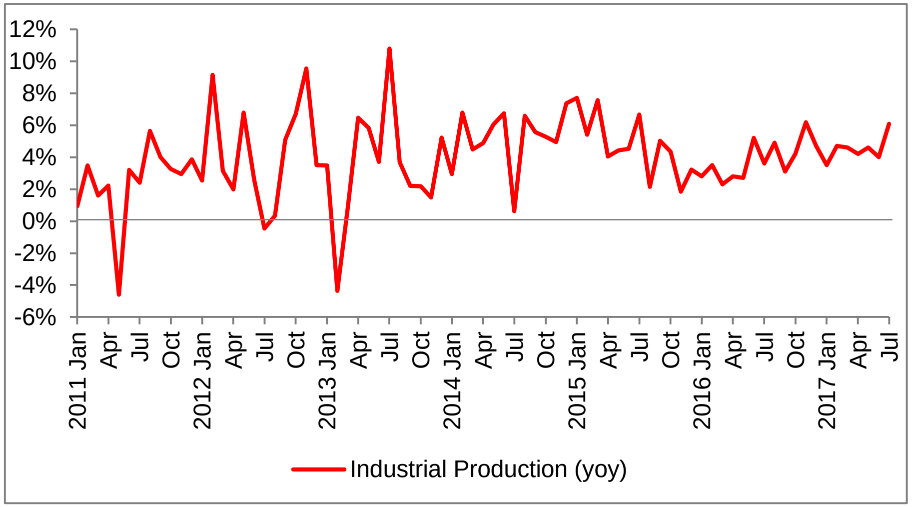
Mean monthly gross household income (RM)



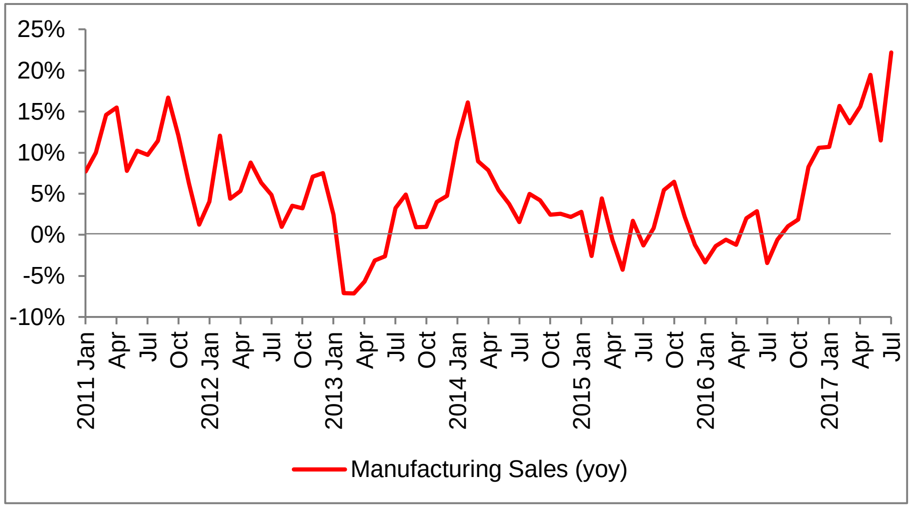
Source: BNM; PEMANDU; EPU

Snapshot of real economic and sentiment indicators

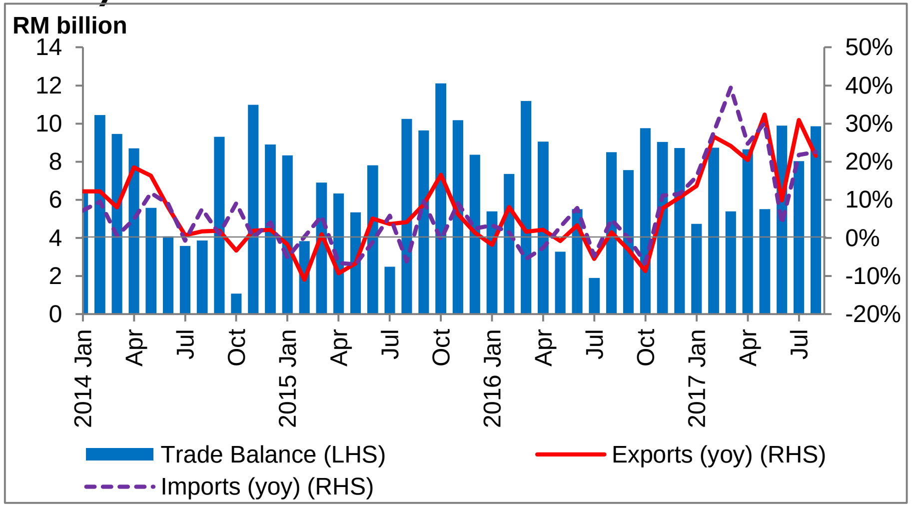
Industrial production grew steadily



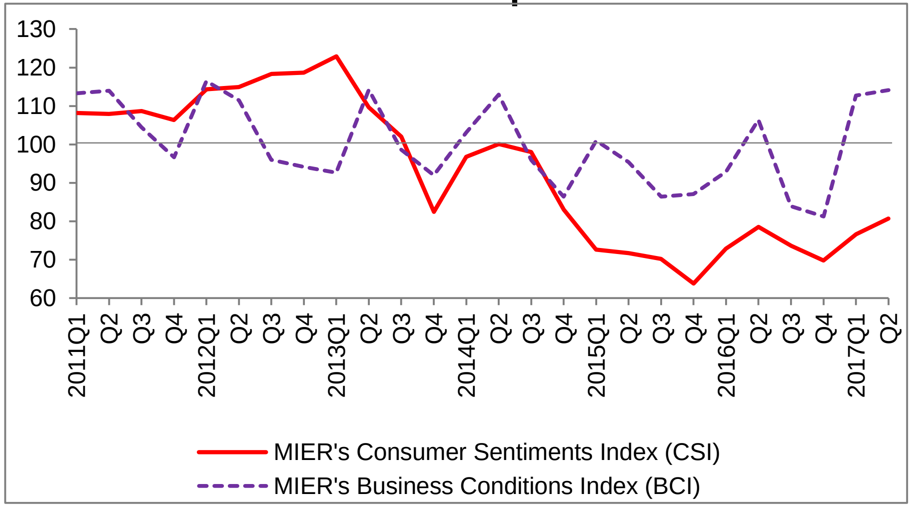
Manufacturing sales recorded highest growth since March 2010



Exports still growing at a robust pace (22.2% in 8M17)



Business condition improves while consumer sentiment still below the 100pt threshold

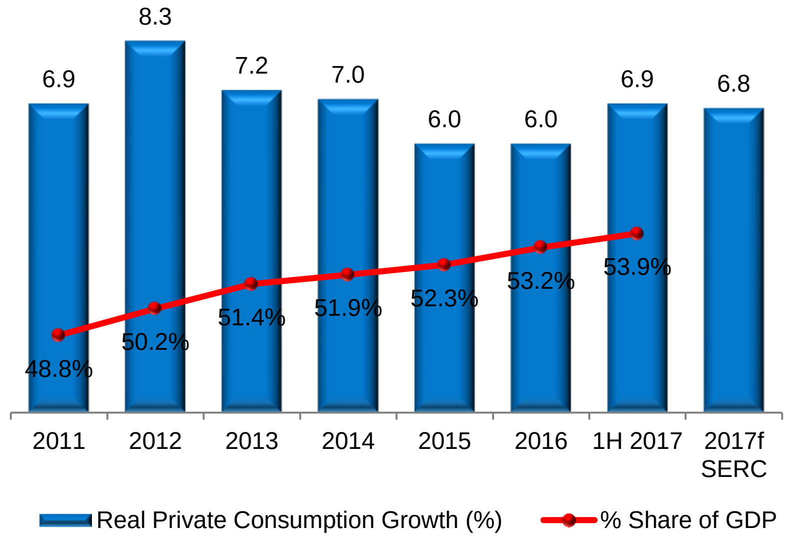


Source: DOS, Malaysia; MIER

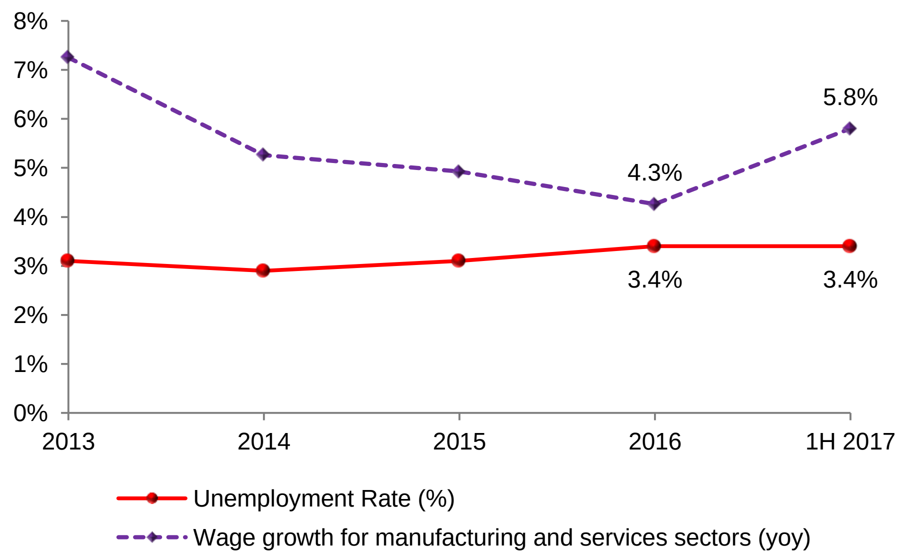
Private consumption still powering the economy

- Resilient consumer spending (6.9% yoy in 1H17; 2017E: 6.8%).
- Factors underpinning consumer spending: employment, wage growth, commodity income and income-support measures.
- Private consumption will remain the dominant driver of growth (2016-2020F: 6.4% pa vs. 7.1% pa in 2011-15).

Real private consumption growth trend (% YoY)



Stable labour market conditions

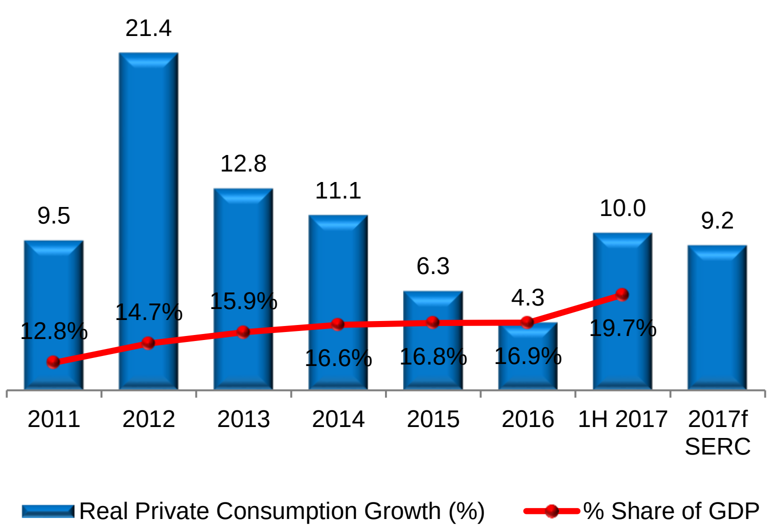


Source: DOS, Malaysia; SERC

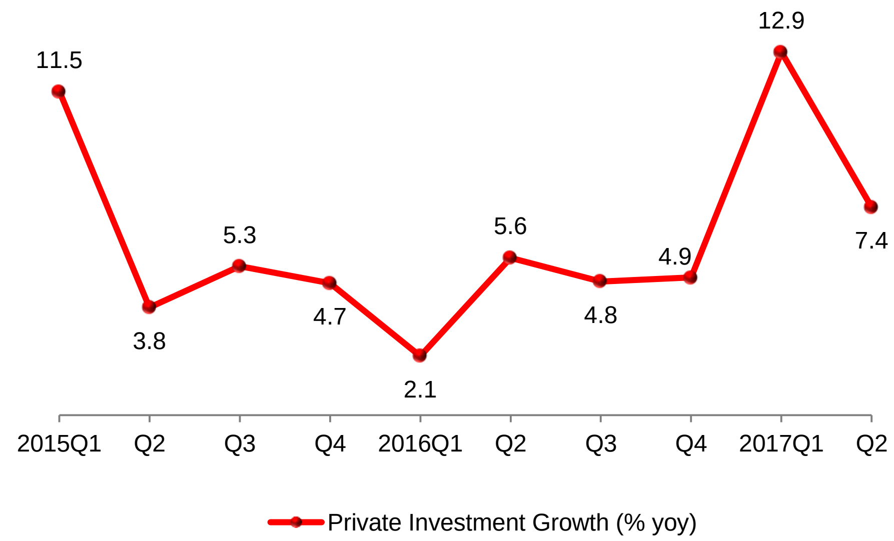
Private investment makes a strong comeback

- Private investment staged a strong expansion of 10.0% yoy in 1H2017 after trapped in lower growth trajectory since 2Q 2015.
- High capital spending in the services and manufacturing sectors.
- Uncertainty ahead of GE14 may temper private investment (2017E:9.2%, 2016-2020F: 8.2% pa vs. 12.2% pa in 2011-15).

Real private investment growth trend (% YoY)



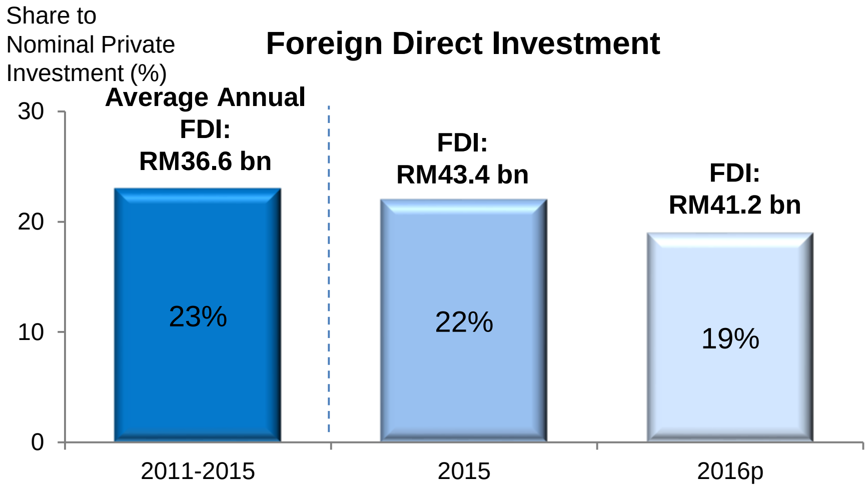
Quarterly real private investment growth (% YoY)



Source: DOS, Malaysia; SERC

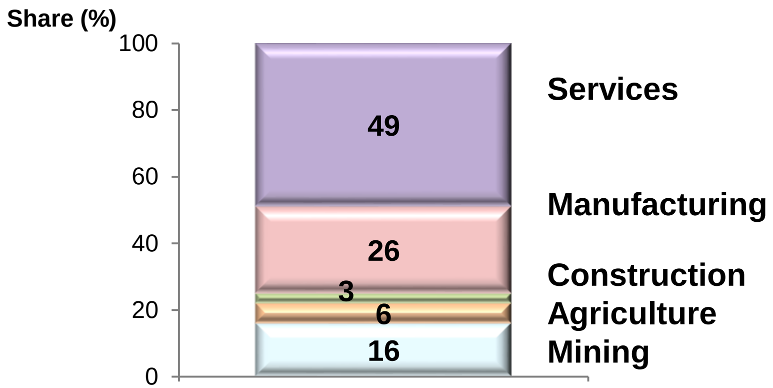
Private investment trend touchpoints

Malaysia continues to attract FDI, but in lower amounts



Services and manufacturing sectors account for 75% of private investment activity

Private Investment by Sector (2010-2015)



Key quality projects to increase efficiency, productive capacity and employment

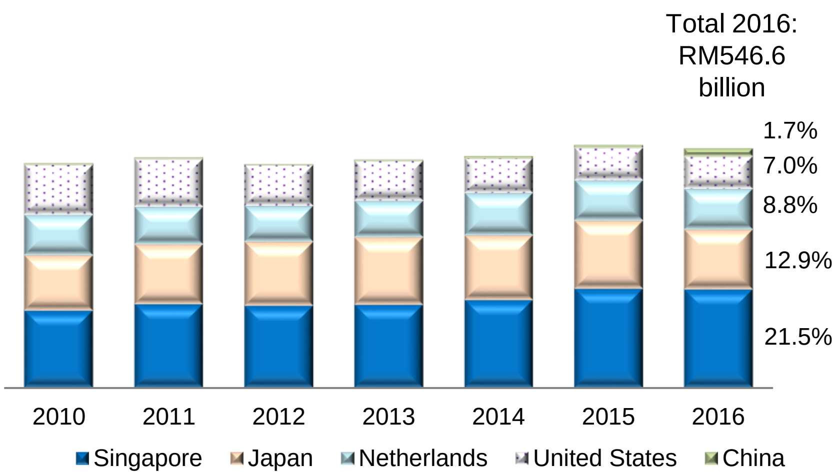
Services

- **Transport and storage** Oil and gas storage terminals, seaports and aircrafts
- **Telecommunication** 4G/LTE network expansion

Manufacturing

- **Electrical and electronics (E&E)**
- **Resource-based industries**

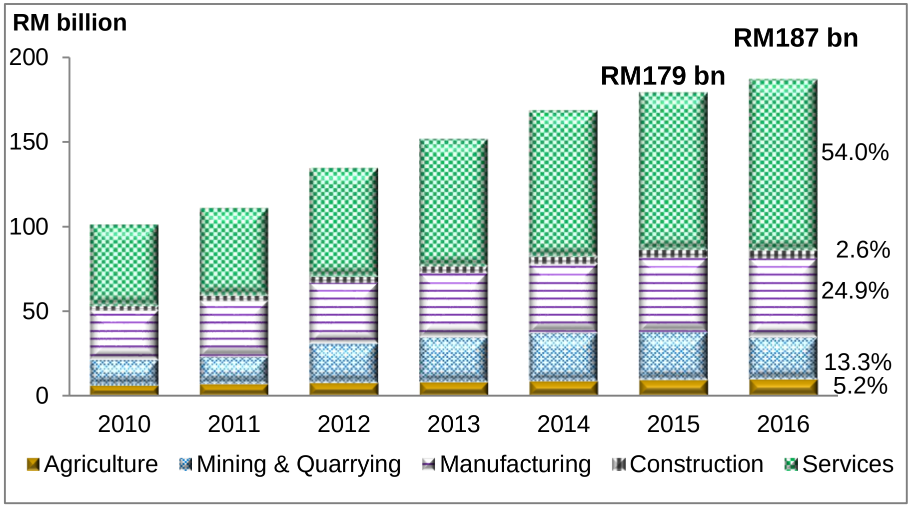
FDI stocks in Malaysia are well diversified



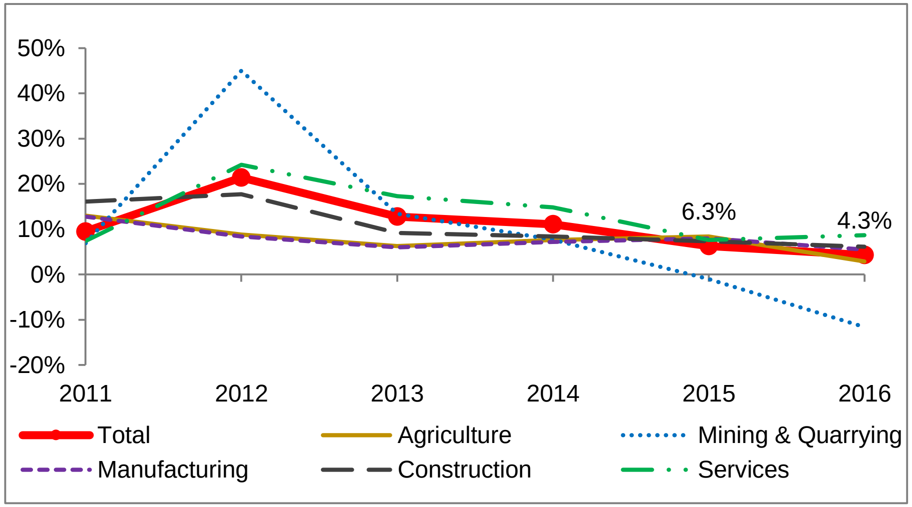
Source: Bank Negara Malaysia

Snapshot of private investment

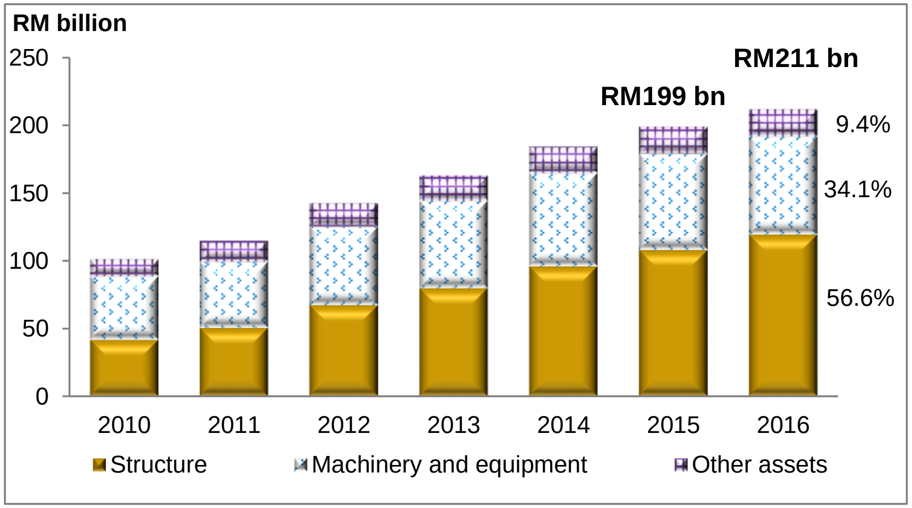
Real private investment by sector



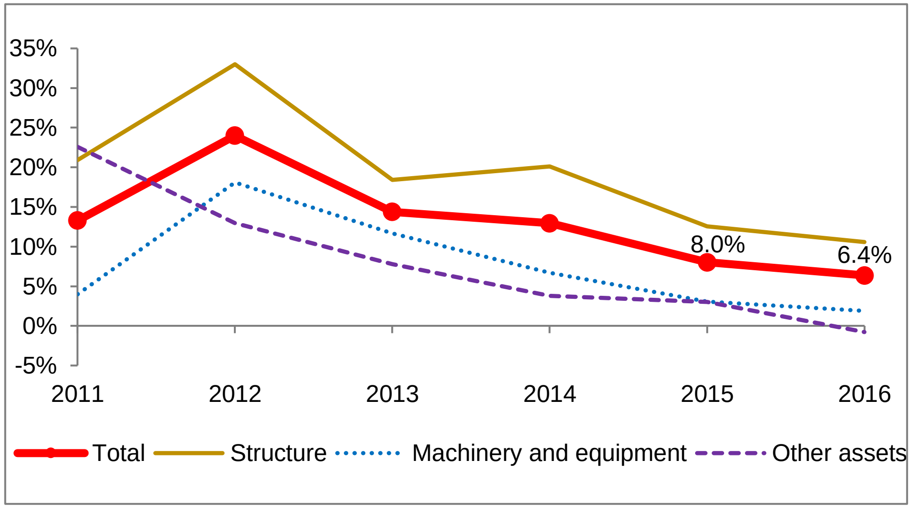
Real private investment growth by sector



Nominal private investment by type



Nominal private investment growth by type

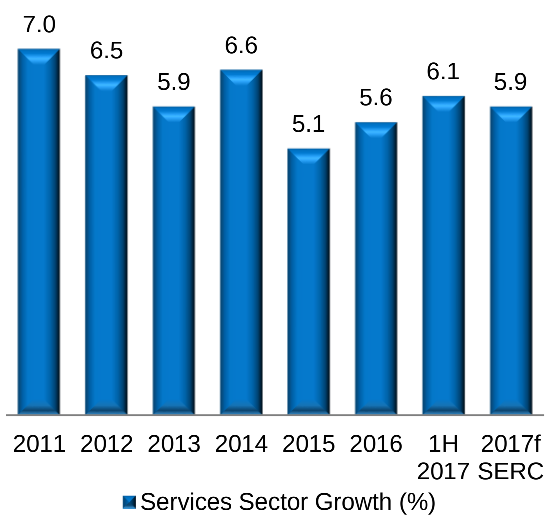


Source: DOS, Malaysia

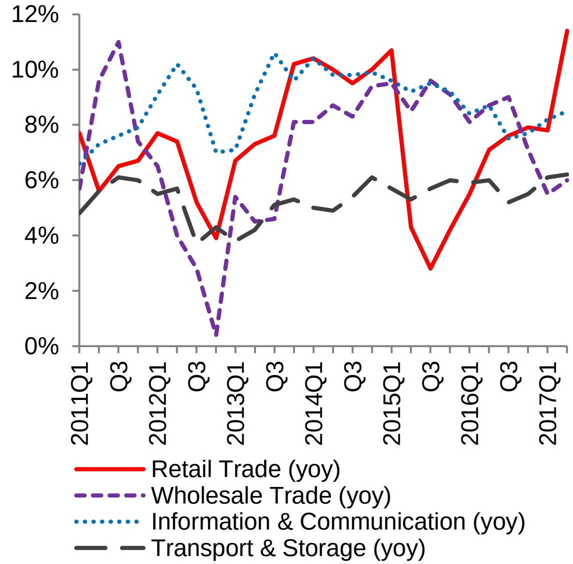
Services: Dominant driver of GDP growth

- The services sector grew by 6.1% yoy in 1H17 (2017E:5.9%, 2016-2020F:5.8% pa vs. 6.2% pa in 2011-15).
- At 54.4% of GDP in 2016, there is still some way to achieve the Government's target of 58.0% by 2020.
- Broad-based expansion: trade-related, consumption-based and financial services.
- E-commerce and Digital Free Trade Zone will boost the services growth.

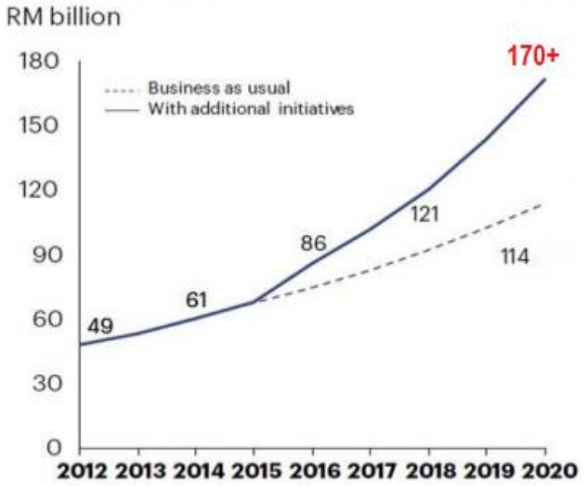
Output growth of services sector



Performance of services subsectors



E-commerce growth will double to 20.8% pa in 2015-2020

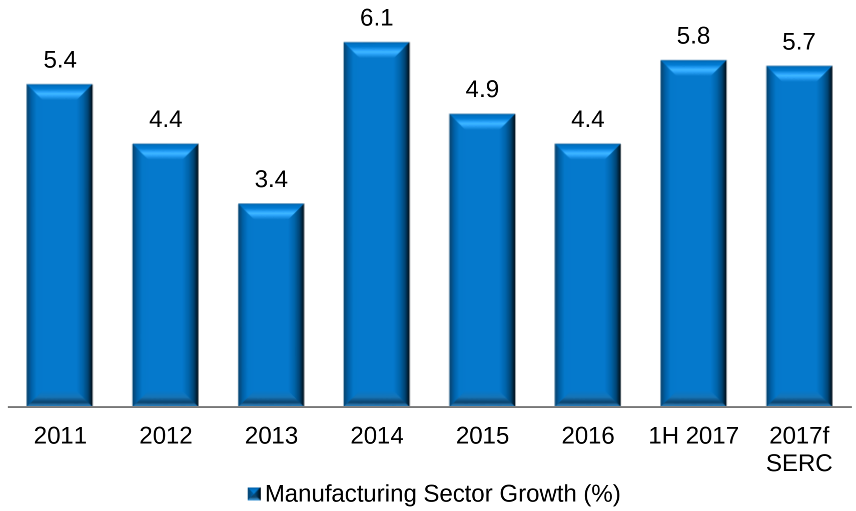


Source: DOS, Malaysia; National E-Commerce Strategic Roadmap; SERC

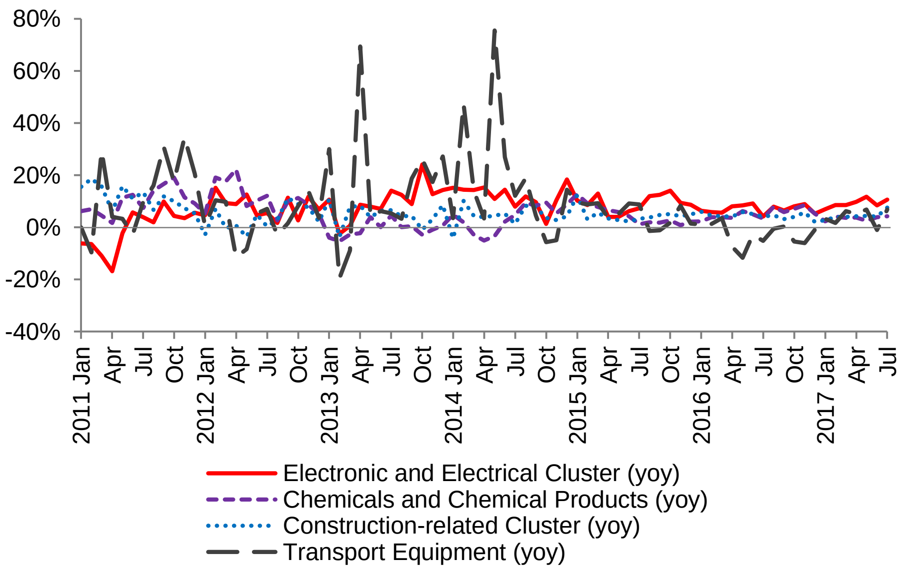
Manufacturing: Still growing decently

- The manufacturing sector sustained higher growth of 5.8% yoy in 1H17 (2017E: 5.7%, 2016-2020F: 5.3% pa vs. 4.8% pa in 2011-15).
- Export-oriented industries (electronics, technology products and chemical-based products). Growth in the domestic-oriented industries -- production of food and construction-related materials (ECRL, MRT, HSR, Pan Borneo Highway, ports, and real estate development).
- Complex business landscape, high cost of doing business, lingering issues about foreign workers and the weak ringgit could dampen the sector's growth in the near-term.

Output growth of manufacturing sector



Performance of key industries



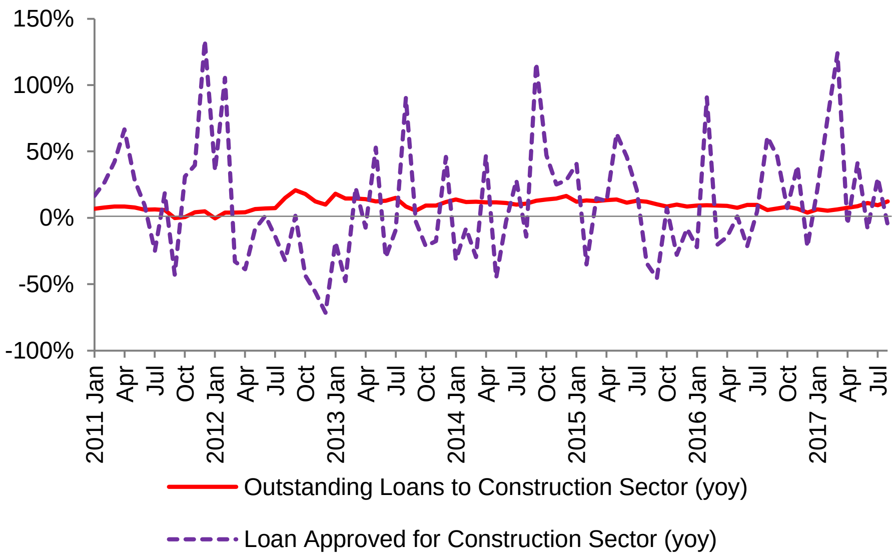
Source: DOS, Malaysia; BNM; SERC

Construction: Promising outlook

- Growth in the construction sector is projected to expand at a faster pace in 2017 (estimated 8.0% vs. 7.4% in 2016) and 8.7% pa in 2016-2020 (10.6% pa in 2011-15).
- Public spending on transportation projects (MRT, LRT, rail, HSR), highways (Pan Borneo Highway), ports and the public-driven affordable housing development.
- An estimated RM212 billion value of construction jobs covering on-going and new ones over the next five years. Positive spillovers and multiplier effects on more than 140 sub-sectors.

Output growth of construction sector

Indicators of construction sector

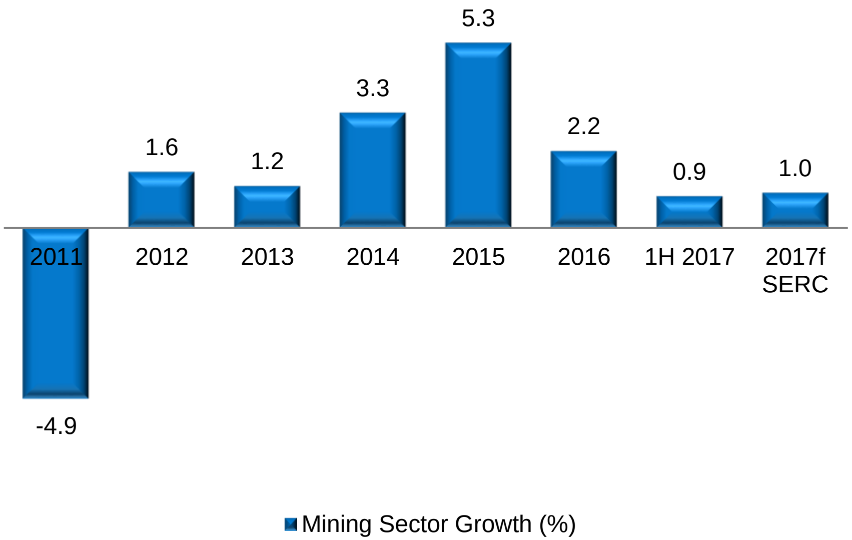


Source: DOS, Malaysia; BNM; SERC

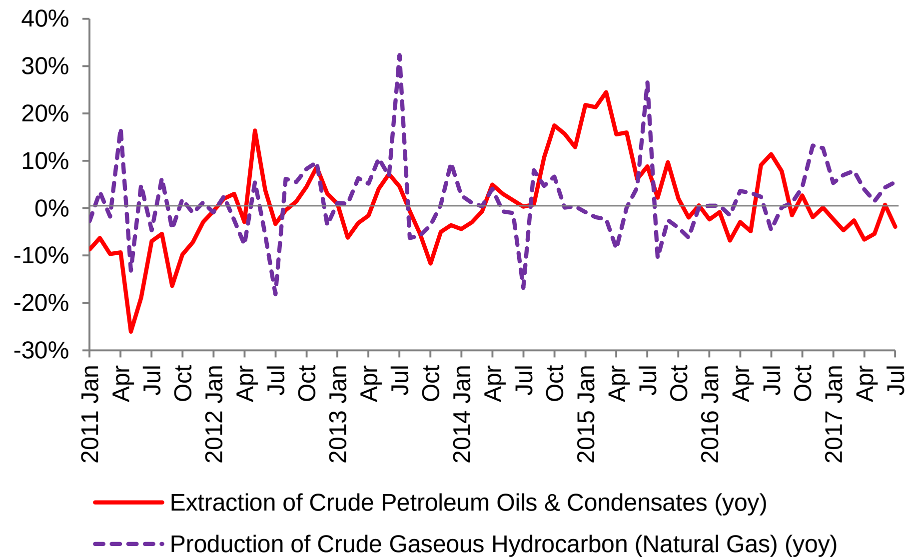
Mining: Sustained recovery is well underway

- The mining sector growth is estimated to pace slower at 1.0% in 2017 (2.7% in 2016), supported by natural gas production as well as new oil field. Output growth is estimated to increase by 1.8 pa in 2016-2020 (1.3% pa in 2011-15).
- PETRONAS's voluntary 20,000 barrels per day crude oil supply cut to dampen the sector's performance in 1H2017.
- SERC estimates crude oil price of US$55-60 per barrel in 2017-18 (US$43.67 in 2016).

Output growth of mining sector



Crude oil and natural gas output

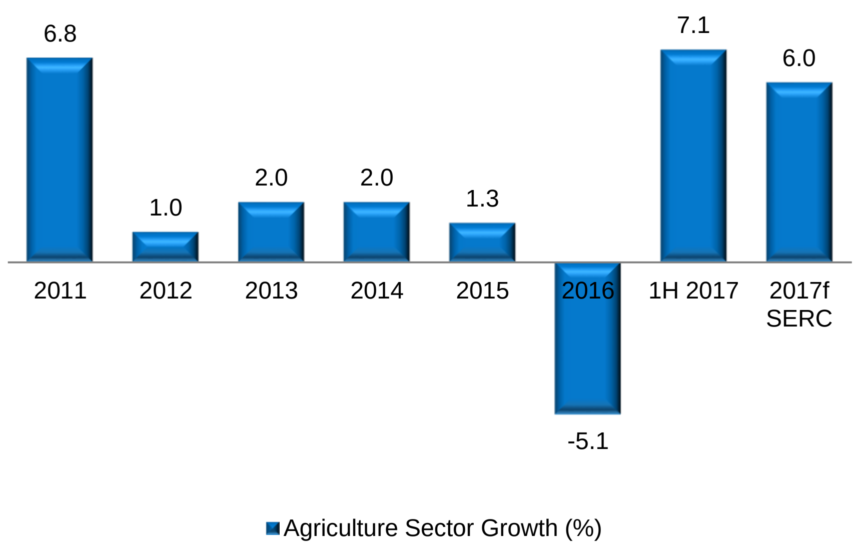


Source: DOS, Malaysia; SERC

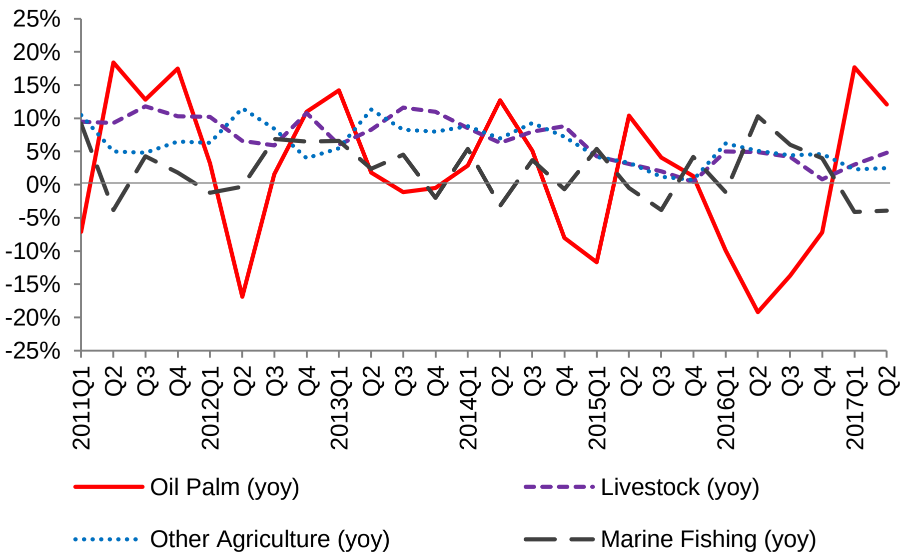
Agriculture: From contraction to expansion

- The agriculture sector rebounded strongly to expand by 7.1% yoy in 1H17 and estimated 6.0% in 2017 from a decline of 5.1% in 2016 as the adverse impact of El Niño dissipated.
- Agriculture output is projected to grow by 2.0% pa in 2016-2020 vs. 2.6% pa in 2011-15.
- Palm oil price forecast: RM2,700 per tonne for 2017, RM2,750-2,850 in 2018-2020 (RM2,647 in 2016).

Output growth of agriculture sector



Subsectors of agriculture

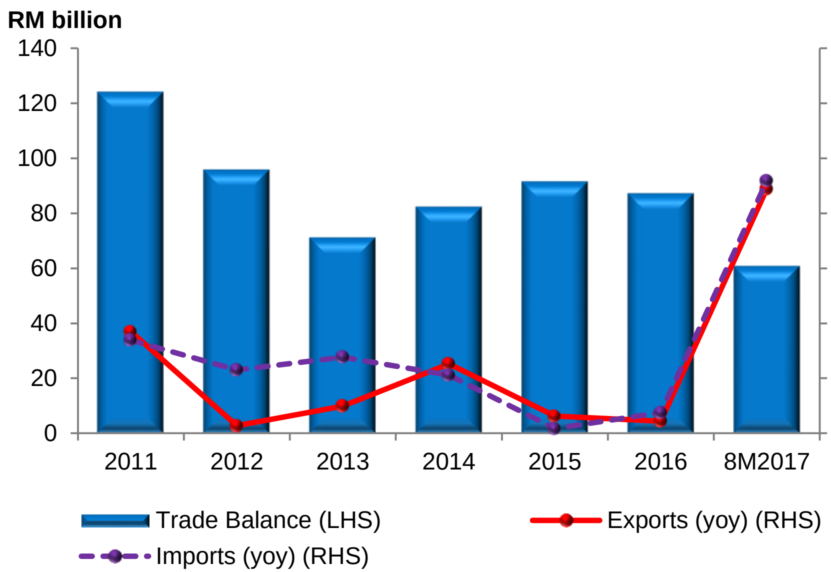


Source: DOS, Malaysia; SERC

Exports swing from a drag to a driver of growth

- Exports have staged a strong recovery since Nov 2016 (estimated 17.5% in 2017 vs. 1.2% in 2016). Exports are projected to rise by 7.5-9.5% pa in 2018-2020.
- Three fundamental drivers: improved global demand, tech demand and higher commodity prices. Base and weak exchange rate effects have inevitably played some part.
- Risks to trade could come from trade protectionism and disruptive policies in advanced economies.

Exports bounced back strongly



Source: DOS, Malaysia

Higher exports across the board

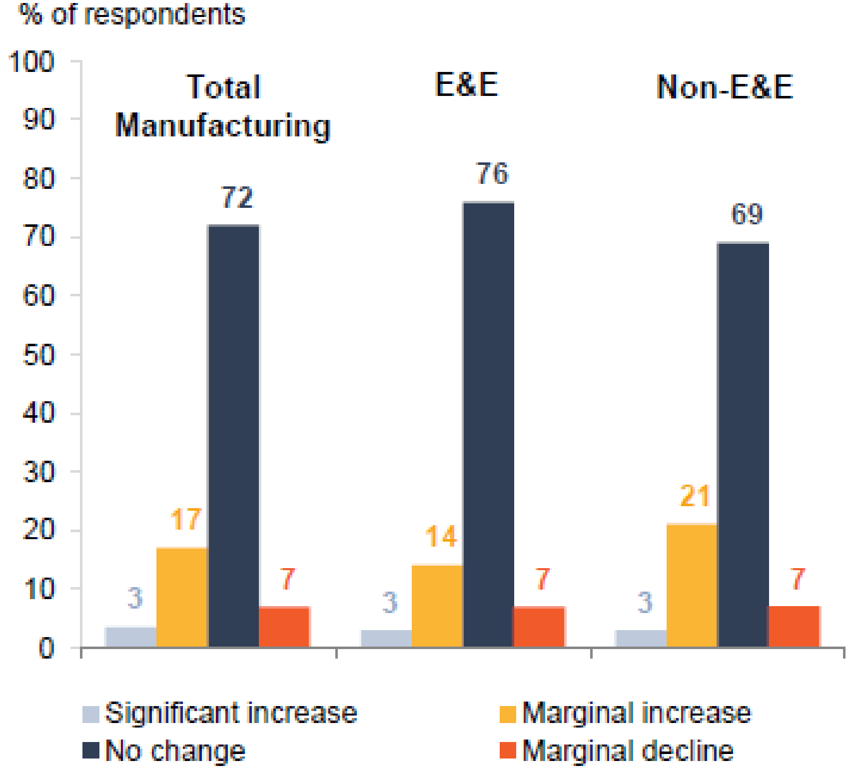
Major export products	**2016**	**8M2017**
Electrical & electronics (36.6%)	3.5%	21.4%
Chemical, with products (7.5%)	7.0%	18.3%
Petroleum products (6.9%)	-0.1%	43.6%
Palm oil (5.3%)	3.3%	18.8%
Machinery equipments (4.8%)	4.2%	6.9%
Manufacturers of metal (4.2%)	-4.3%	8.6%
Liquefied natural gas (4.1%)	-28.2%	34.6%
Optical & scientific equip. (3.7%)	10.2%	12.2%
Crude oil (2.8%)	-14.6%	33.2%
Overall gross exports	**1.2%**	**22.2%**

Parenthesis indicates share of overall gross exports in 2016

Exports swing from a drag to driver of growth

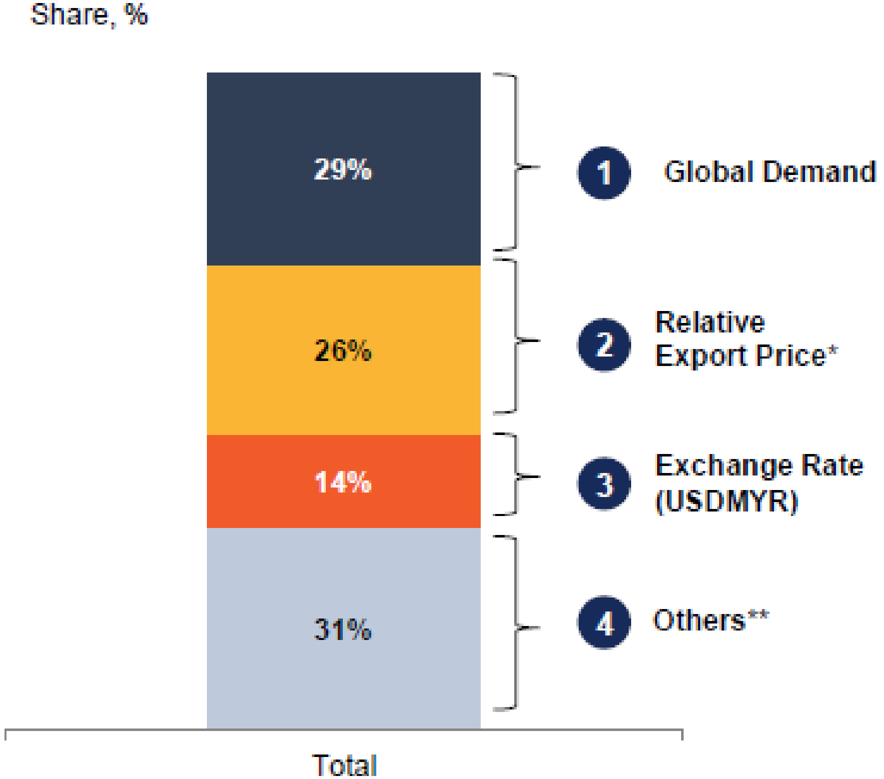
Majority of companies surveyed reported marginal or no benefit from ringgit depreciation

Firm Survey: Impact of Exchange Rate Depreciation on Export Order Volumes



Improving global conditions to underpin export volume growth going forward

Empirical Findings: Contribution to Export Volume Growth, 2005-2016



* Ratio of domestic export prices to global export prices

** Other temporary factors affecting exports that are not included in the model (i.e. the shortage of trade credit in 2008-2009 and the introduction of storage facilities that enabled higher re-exports of petroleum)

Source: Industrial engagements; RES Annual Report Survey (March 2017) – 63 manufacturing exporters, Bank Negara Malaysia estimates

Where is our growth coming from?

- Broad-based output expansion. Domestic demand still calling the shots.
- All economic sectors registered positive growth in 1H 2017.
- Services and manufacturing sectors are the dominant growth drivers.

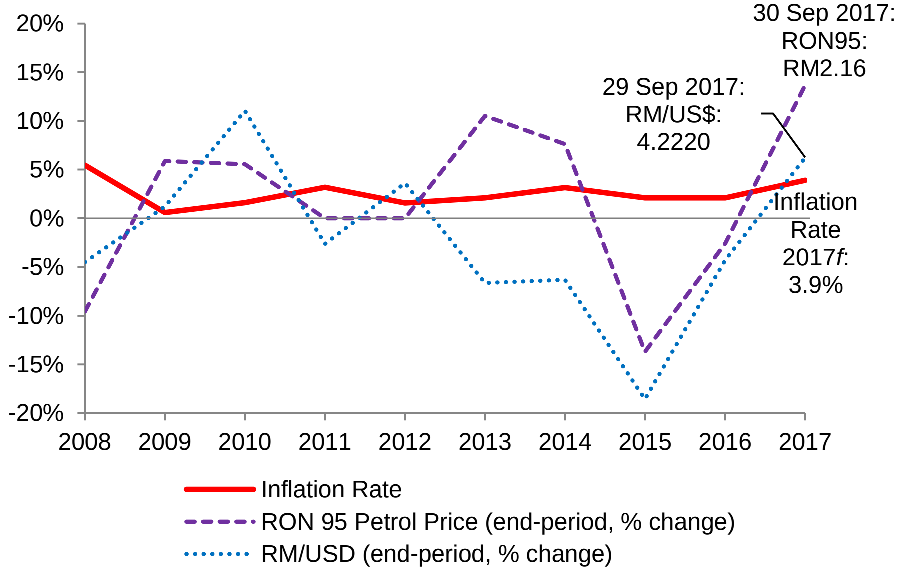
% change, 2010=100	**2015**	**2016**	**2017 1Q**	**2017 2Q**	**2017 1H**	**2017*e* (SERC)**	**2018*f* (SERC)**
GDP by demand component							
Private consumption (53.2%)	6.0	6.0	6.6	7.1	6.9	6.8	6.2
Private investment (16.9%)	6.3	4.3	12.9	10.7	10.0	9.2	8.3
Public consumption (13.1%)	4.4	0.9	7.5	3.3	5.3	5.1	4.0
Public investment (8.5%)	-1.1	-0.5	3.2	-5.0	-0.9	1.2	2.0
Exports of goods and services (70.4%)	0.3	1.1	9.8	9.6	9.7	9.9	6.7
Imports of goods and services (62.1%)	0.8	1.1	12.9	10.7	11.8	11.7	7.8
GDP by economic sector							
Agriculture (8.1%)	1.3	-5.1	8.3	5.9	7.1	6.0	4.0
Mining & quarrying (8.8%)	5.3	2.2	1.6	0.2	0.9	1.0	1.5
Manufacturing (23.0%)	4.9	4.4	5.6	6.0	5.8	5.7	5.5
Construction (4.5%)	8.2	7.4	6.5	8.3	7.4	8.0	9.0
Services (54.3%)	5.1	5.6	5.8	6.3	6.1	5.9	5.6
Overall GDP	**5.0**	**4.2**	**5.6**	**5.8**	**5.7**	**5.5**	**5.1**

Source: DOS, Malaysia; BNM; SERC
Parenthesis indicates % share to GDP in 2016

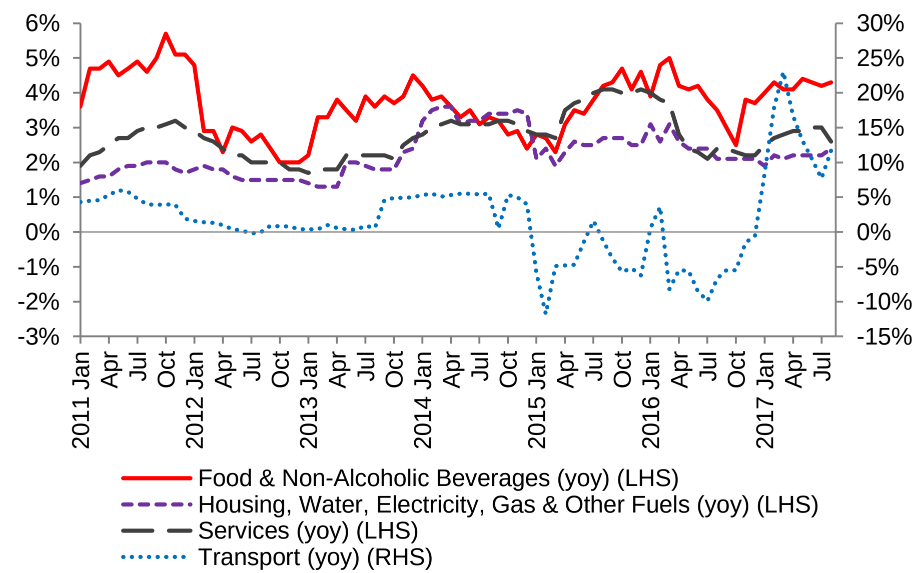
Inflation trends - Fuel price remains a big wild card...

- High fuel prices-inflicted cost price pressures along with other indirect costs such as the spillover effect of the weakening ringgit pushed inflation higher to 5.1% yoy in March.
- But, it had moderated from 4.3% in 1Q to 4.0% in 2Q and 3.2% in July before moving higher to 3.7% in August. CPI growth up 3.9% in 8M17.
- Inflation is expected to increase by 3.9% in 2017 and 2.5-3.0% in 2018.

Fuel price and exchange rate changes on inflation



Inflation is largely driven by food prices and volatile fuel prices

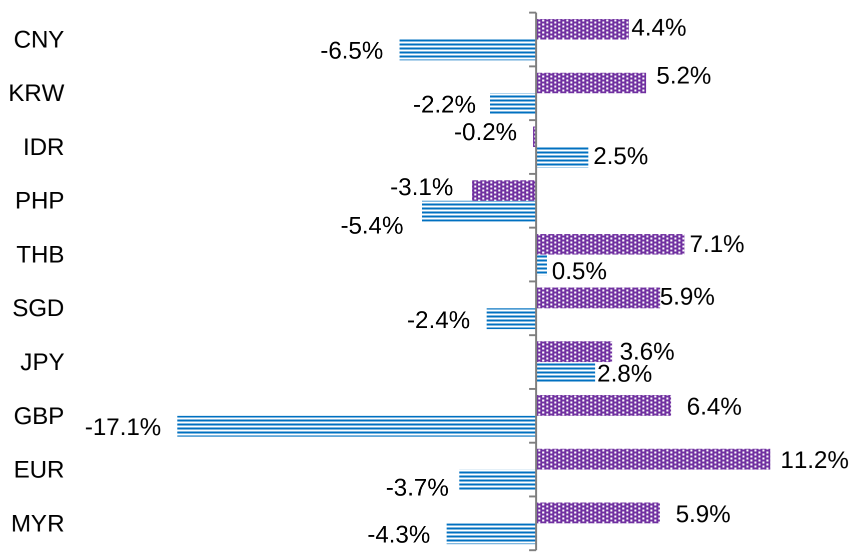


Source: BNM; DOS, Malaysia; SERC

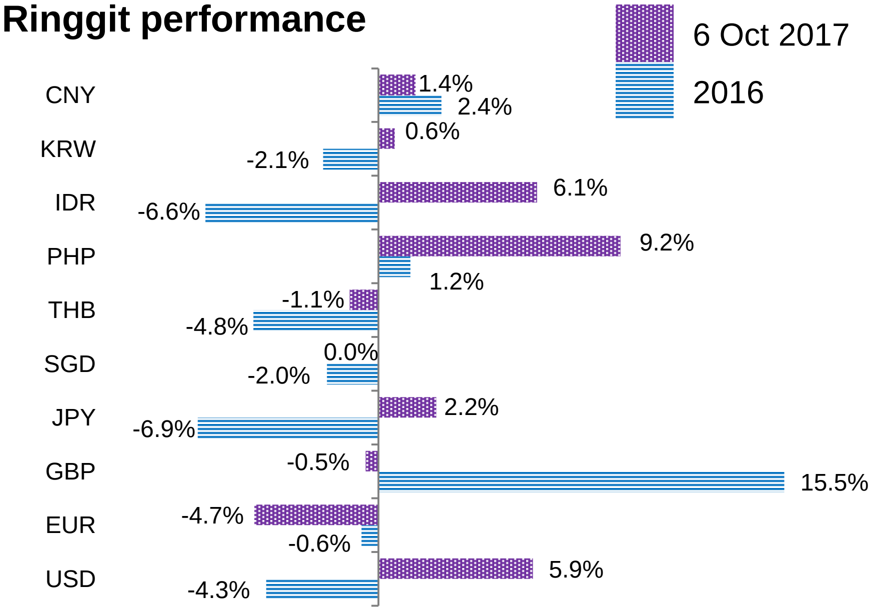
The ringgit does not reflect its fundamental value

- In REER terms, the ringgit has appreciated by 0.5% as of August this year (-15.0% in 2013-16).
- **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-2017E: RM4.20/US$1; End-2018F: RM4.10-4.20/US$1

Regional currencies against USD

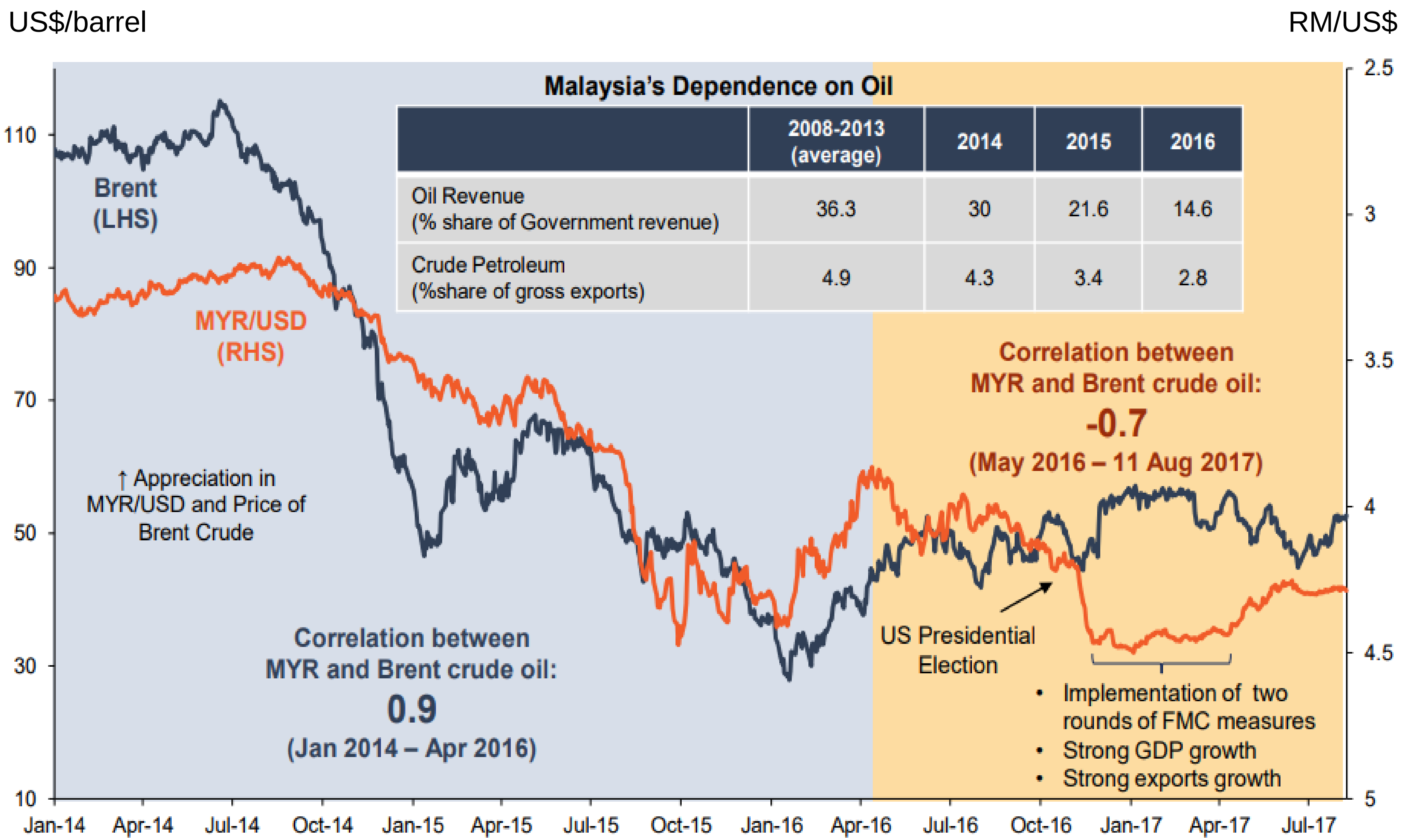


Ringgit performance



Source: Bank Negara Malaysia

The ringgit decouples from crude oil price



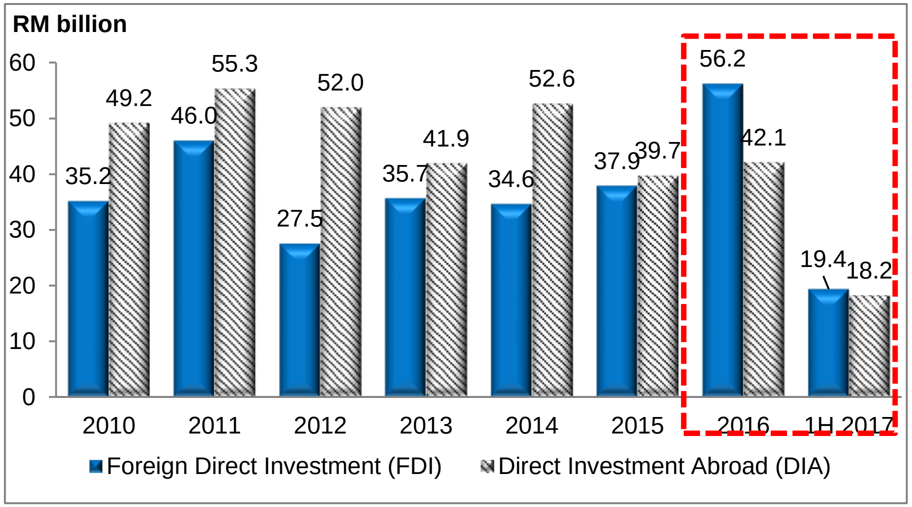
Malaysia's Dependence on Oil

	2008-2013 (average)	2014	2015	2016
Oil Revenue (% share of Government revenue)	36.3	30	21.6	14.6
Crude Petroleum (%share of gross exports)	4.9	4.3	3.4	2.8

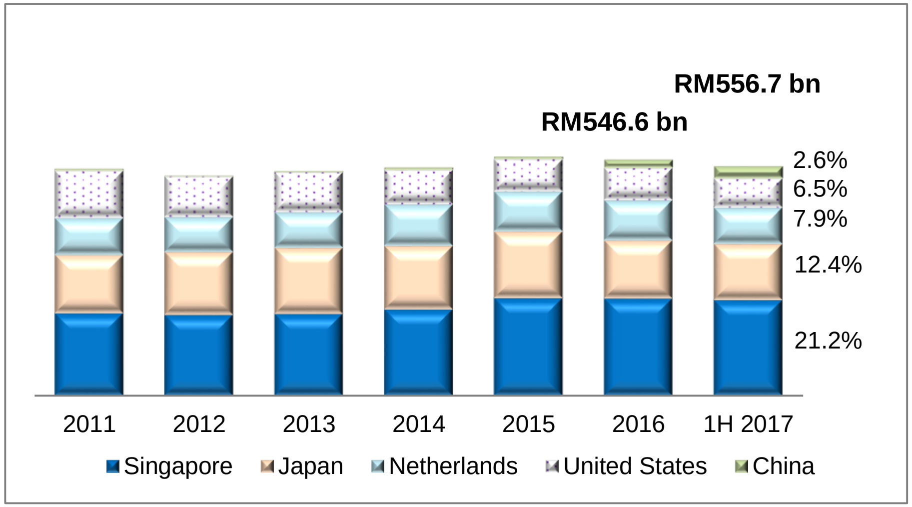
Source: BNM

Does FDI still favor Malaysia?

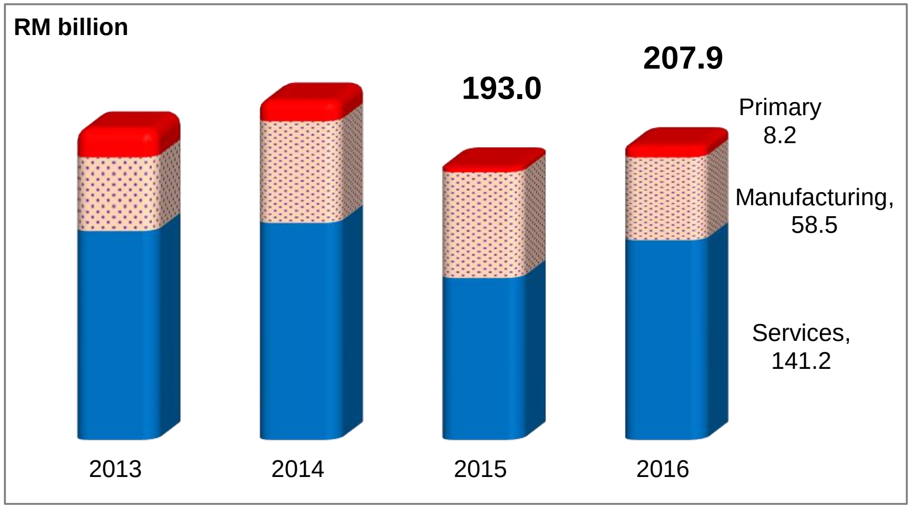
FDI exceeded Malaysia's direct investment abroad



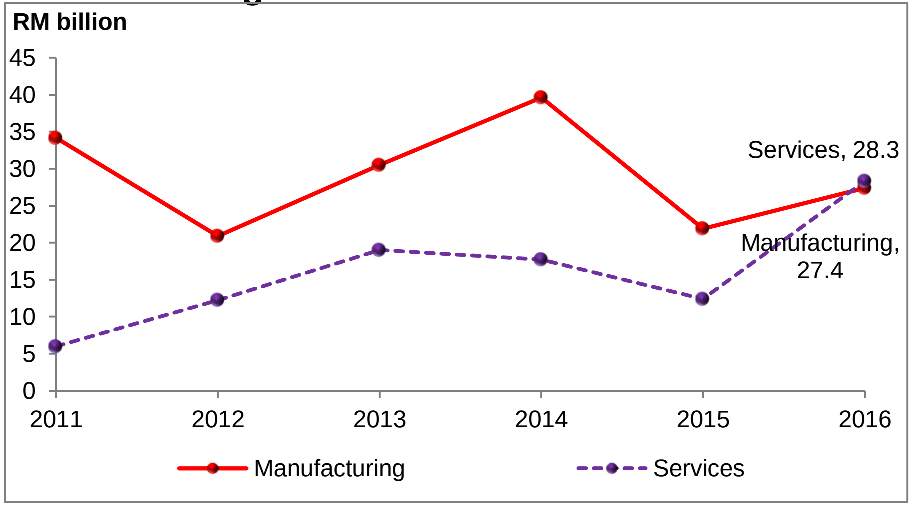
FDI stock in Malaysia: Diversified investors



Higher approved total investment in 2016



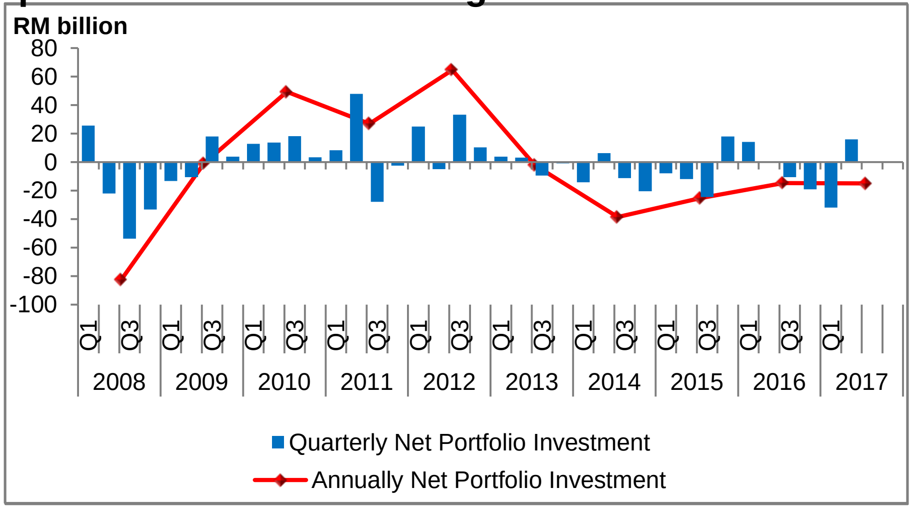
Higher approved foreign investment in manufacturing and services



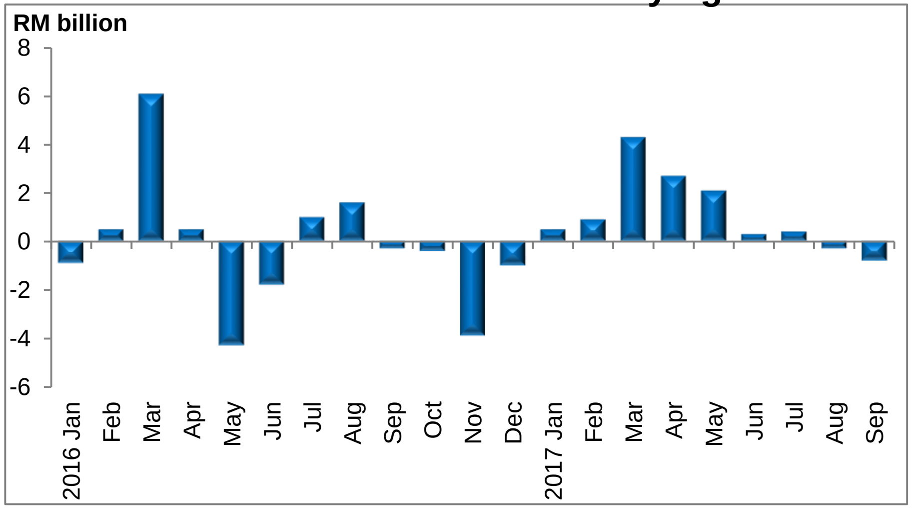
Source: BNM; MIDA

Capital reverses into inflows from outflows

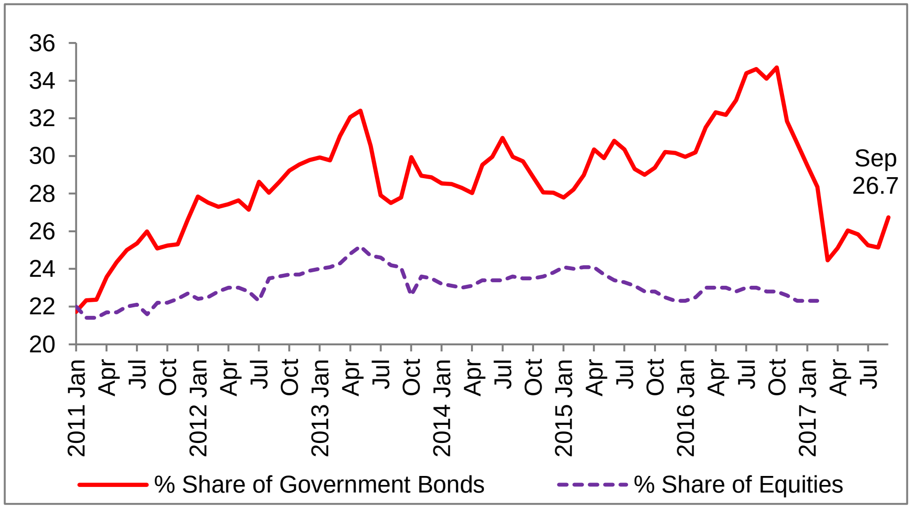
Capital inflows in 2Q after three consecutive quarters of outflow totaling RM61.5 billion



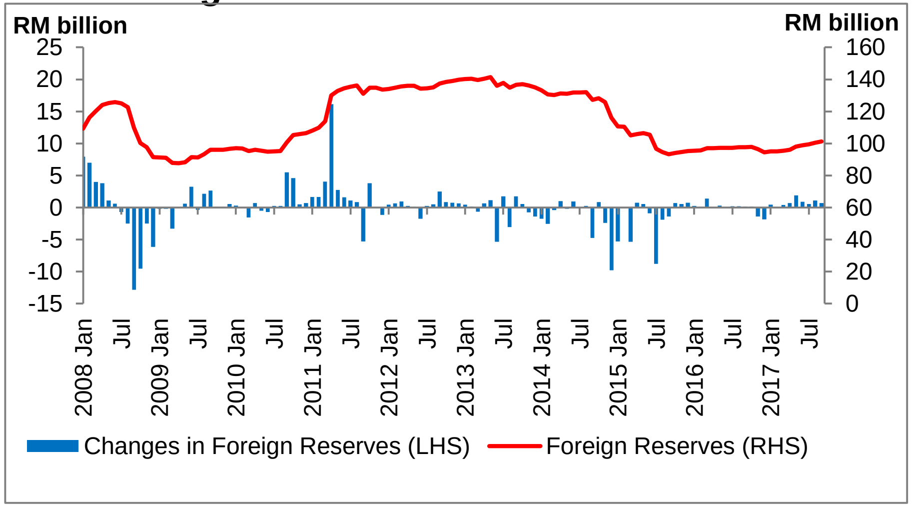
Net foreign selling started since August after seven consecutive months of net buying



Foreign share of equities and government bonds



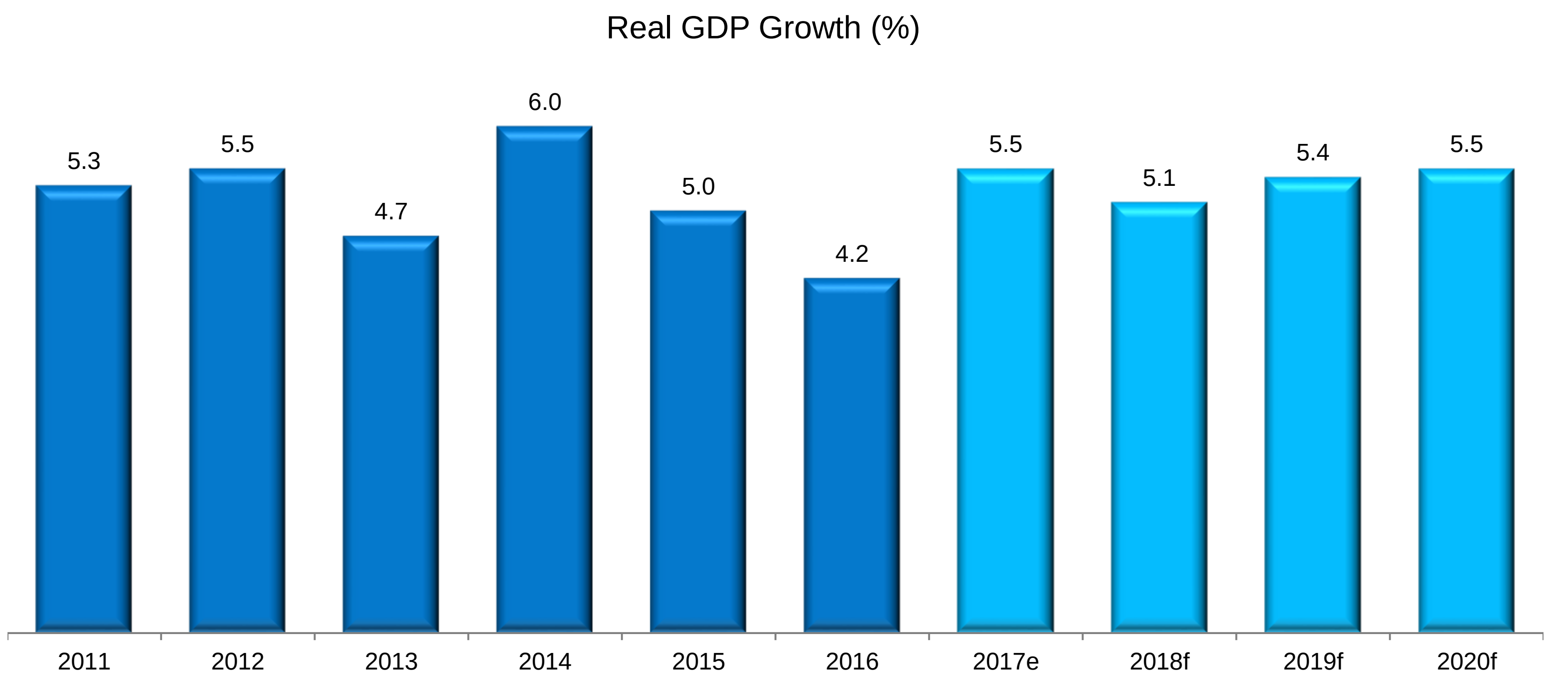
Foreign reserves surpassed US$100 billion mark as at 15 August



Source: BNM; Bursa Malaysia

Malaysia's medium-term economic outlook

- Medium-term growth prospects are positive (5.1% pa in 2016-20 vs. 5.3% pa in 2011-15).
- Domestic demand still dominant.
- Services, manufacturing and construction sectors remain key drivers of growth.
- Public infrastructure and transportation projects (rail, ports, highways) and investment in major economic sectors (manufacturing, services, mining and real estate).



Source: DOS, Malaysia; SERC

Can BNM afford to increase interest rates?

Policy environment

- Lingering uncertainties in global economic and financial environment
- Higher US interest rates and unwinding of the Fed's balance sheet
- Volatile capital flows and exchange rate

Growth, inflation and financial imbalances

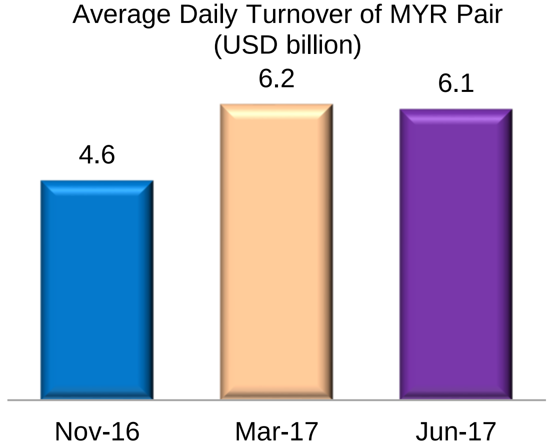
- Is domestic economic growth strong enough?
- Domestic demand faces headwinds (high cost of living and weak consumer sentiment)
- Cost-induced inflation outweighs demand pressure
- Household debt to GDP eased to 85.6% at end-June 2017 (88.4% at end-2016; 89.1% at end-2015)
- Continue to monitor the risk of financial imbalances

	2007	2008	2009	2010	2016	2017*e*	2018*f*
OPR	3.50%	3.25% ↓	2.00% ↓	2.75% ↑	3.00% ↓	3.00% =	3.00-3.25% ↑
GDP	6.5%	4.7% ↓	-1.7% ↓	7.4% ↑	4.2% ↓	5.5% ↑	5.1% ↓
Inflation	2.0%	5.4% ↑	0.6% ↓	1.6% ↑	2.1% =	3.9% ↑	2.5-3.0% ↓

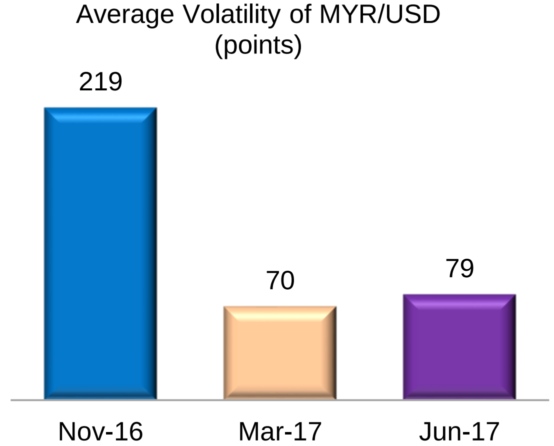
BNM will face a tough yet decisive balancing act if the Fed takes more aggressive run of rate increases ahead

BNM's measures show some positive outcome

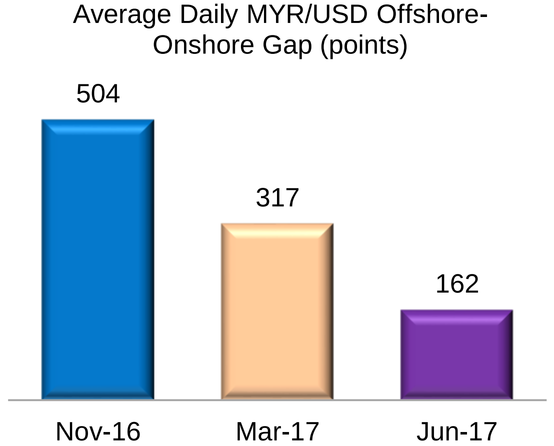
Greater FX intermediation by the market



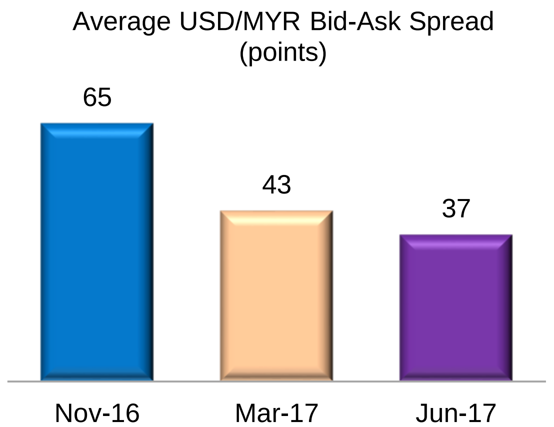
More stable ringgit reduces business uncertainty



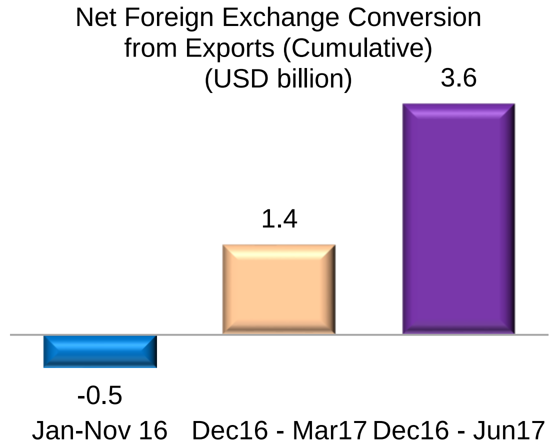
Impact of offshore rates to onshore has further reduced



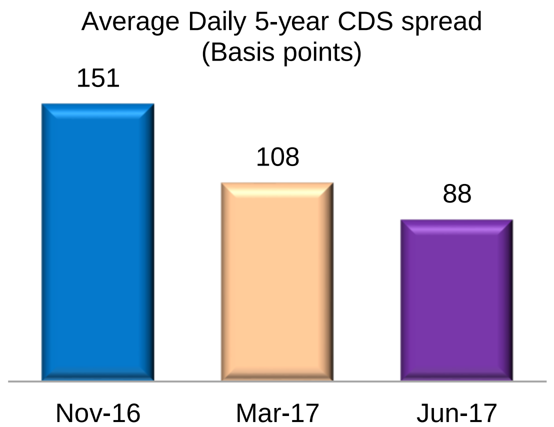
FX transaction cost has reduced for market participants



Greater balance of foreign currency demand and supply



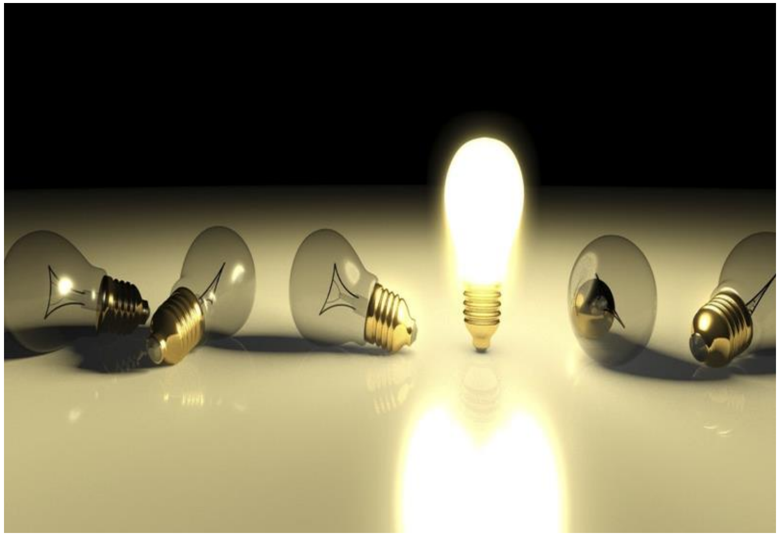
Further reduction in credit spread lowered cost of borrowing for corporates



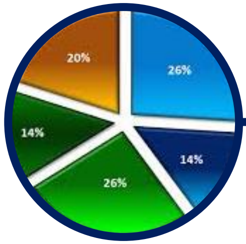
Source: BNM (2Q 2017 BNM Quarterly Bulletin)

Section 3:

A critical look at Malaysia economy – Challenges, pitfalls and opportunities



Malaysia is in a position of strength to withstand negative shocks



Diversified economic and trade structure

Structural transition towards high-value added sectors with varied export products and markets

Well-developed and resilient financial system

Strong capital and liquidity buffers with continued access to financing

Adequate reserves and manageable external debt

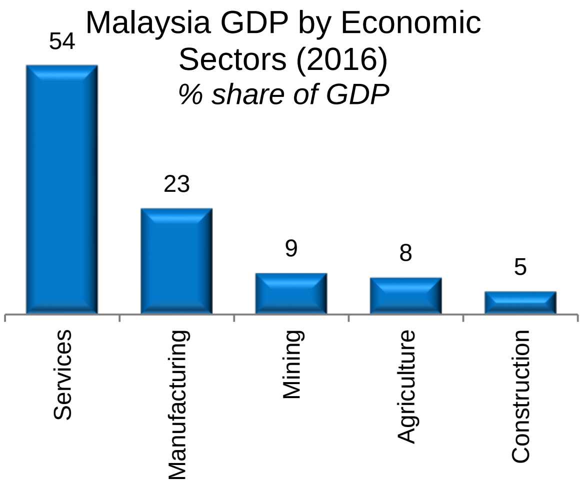
Ample international reserves and increased foreign asset holdings act as buffer against external shocks

Policy space and flexibility

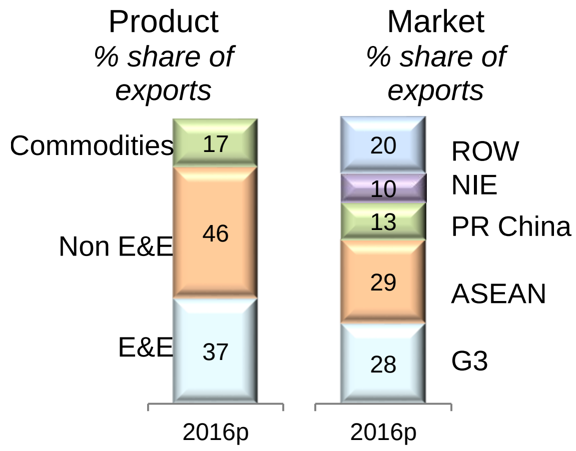
Flexible exchange rate and monetary policy space

Macroeconomic fundamentals remain supportive of growth

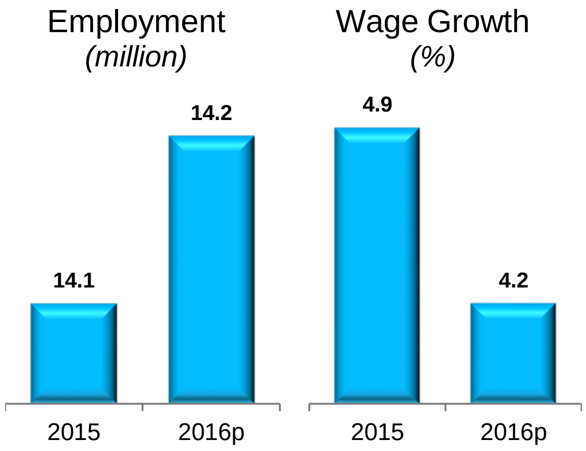
Diversified sources of growth



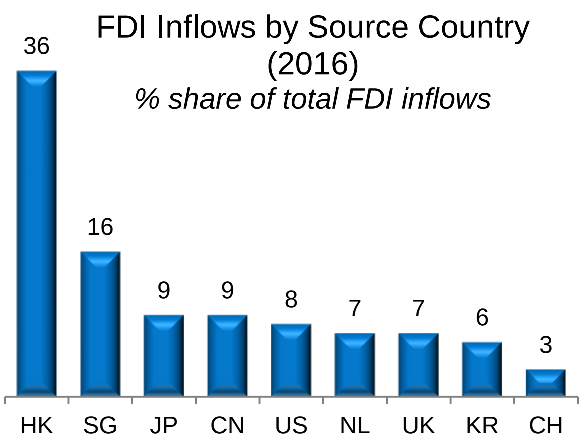
Diversified export market and product



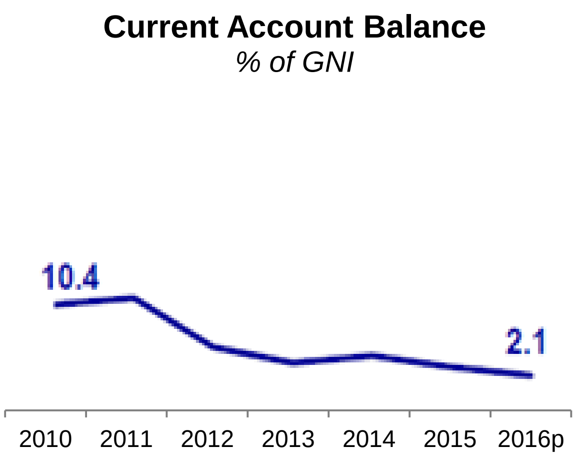
Stable labour market conditions



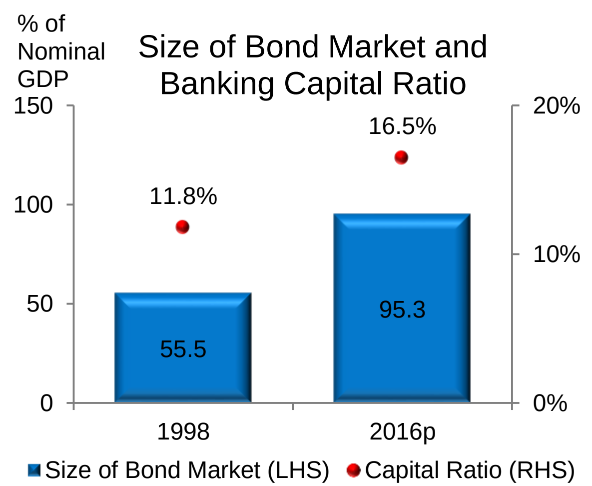
Conducive investment destination for foreign investors



Current account balance reflects strong investment



Deeper markets and strong financial buffers



Source: BNM (Annual Report 2016)

Malaysia's sustainability heatmap

	Stock of portfolio inflows since 2009 as a share of reserves	Short-term external debt as % of reserves	FX reserves to M2	Import coverage ratio
Indonesia	100	36	32	8
Malaysia	15	110	25	6
Philippines	7	21	44	8
Singapore	137	71	64	7
Thailand	-14	32	38	11
Vietnam	16	42	13	3
	Short term external debt as % of GDP	External debt as % of GDP	Household debt as % of GDP	Loan-to-Deposit Ratio
Indonesia	4	34	16	92
Malaysia	29	67	86	85
Philippines	5	25	9	69
Singapore	58	443	75	97
Thailand	13	32	80	108
Vietnam	6	40	n/a	91

Source: Various sources

Here are four shifting trends casting a challenging future for Malaysia

Driving competitiveness and productivity

- Competitive framework – tax structure and regulatory environment
- Unlocking productivity is critical

Digital technologies and transformation

- Building a connected ecosystem
- Technology disruption, sharing of economy

Rising global complexity

- Unpredictable policy shift in advanced economies
- Shifting hotspot of dominant economic power

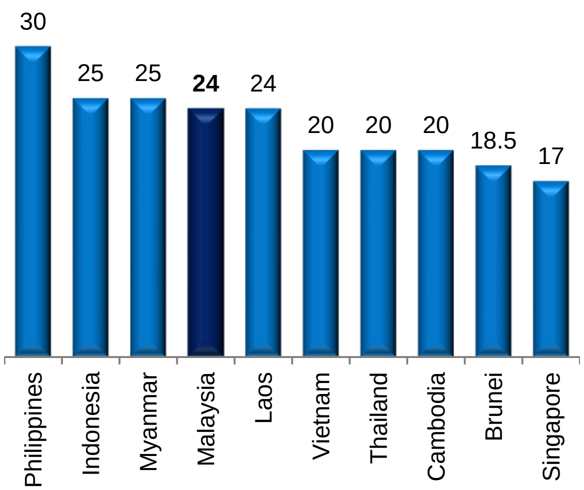
Ageing population

- Widening retirement savings gap
- Rapidly escalating healthcare expenditure

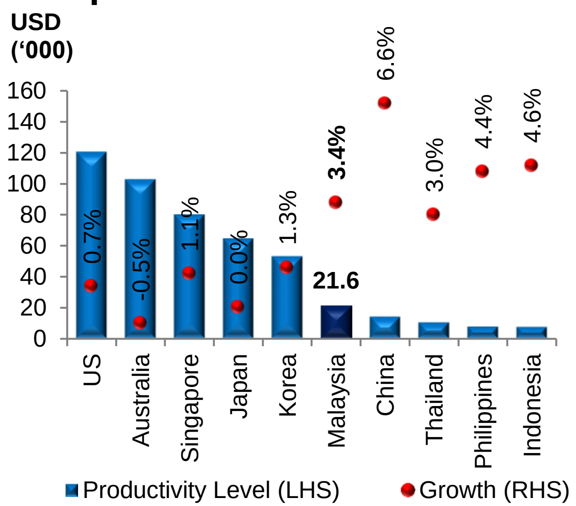
#1 Driving competitiveness and productivity

- 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

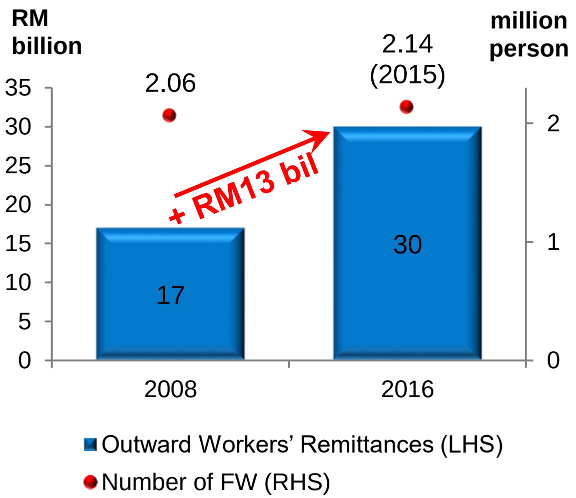
Regional corporate tax rate comparison



Regional labour productivity comparison in 2015



Higher FW remittances

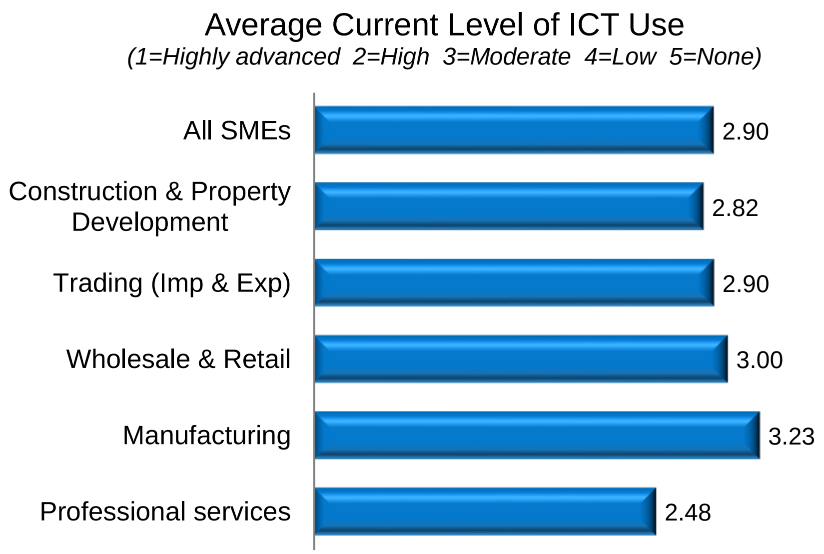


Source: EY; MPC; BNM; EPU

#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**
- **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

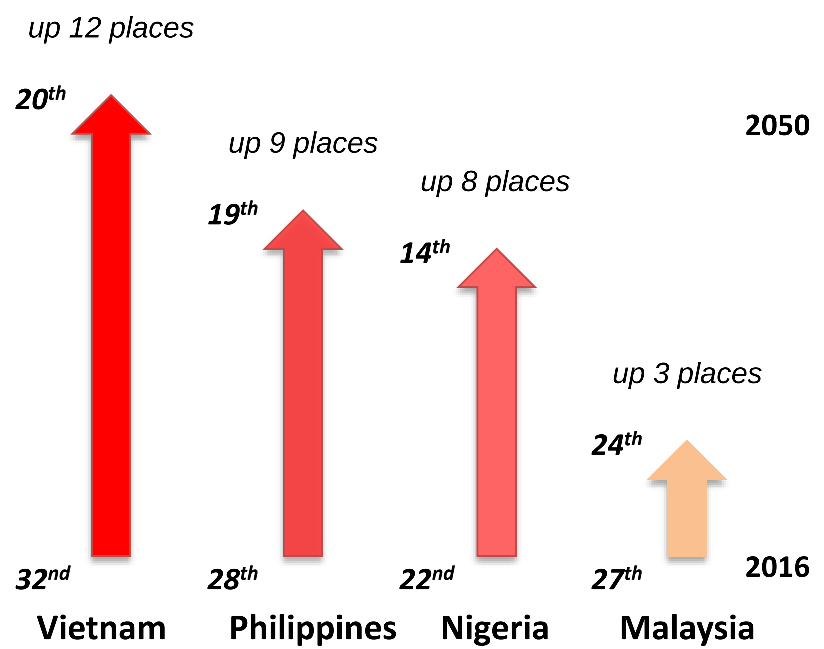
- According to PwC, emerging markets will continue to be the growth engine of the global economy. By 2050, China could be the largest economy in the world, with India in second place and Indonesia in fourth place. Malaysia will improve to 24th placing from 27th in 2016.

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% in 8M17*)
- #2 - export destination (*13.2% in 8M17*)
- #4 - gross FDI flow *(RM6.2bn@9.2% in 1H17)*
- #10 - FDI stock *(RM14.5bn@2.6% at end-June)*
- #3 - tourist arrivals (+7.8% to 905K)

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)

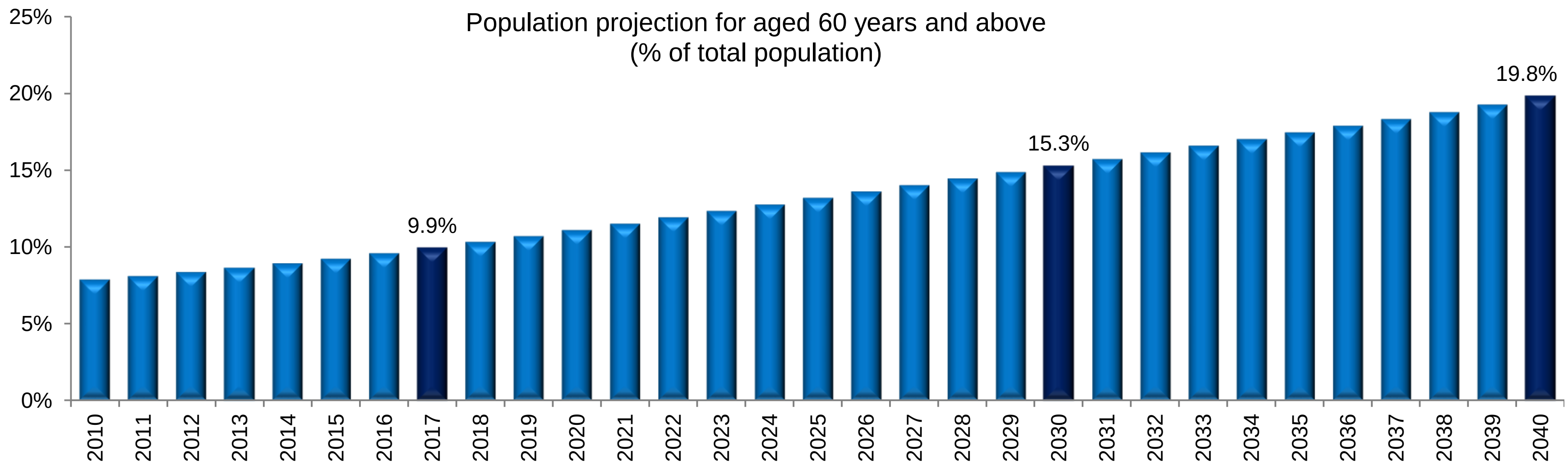
Melaka Gateway Deep Sea Port
(est. US$7.2bn)

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 (9.6% or 3.0 million in 2016).
- 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

Reduce vulnerabilities; build future resilience

Structural policy actions to boost growth & productivity

- **Mitigate increasing cost of doing business**, ease regulatory burden
- Create a **conducive ecosystem** to harness a **digital and connected economy** as well as **e-Commerce**
- **Leverage on technology and innovation** to increase knowledge-based capital investment and raise productivity
- **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

Address as well as contain vulnerabilities to build economic resilience

- **Priorities for growing exports**. Maintain a conducive export ecosystem, facilitated by the provision of techno-driven logistic and ports system, easing of regulatory burden, streamlining and simplifying procedures to enhance trade
- Improve **labour market, skills, competition, trade policies**
- **Sequencing of mixed development projects** to contain the oversupply of commercial, office and retail space
- Increase the **supply of affordable housing**

Reduce vulnerabilities; build future resilience

Continued vigilance in lending practices to contain household debt

- **Total household debt moderated further** by 5.1% to US$1.1 trillion at end-June 2017 or **85.6% of GDP** at end-June 2017 (88.4% at end-2016; 89.1% at end-2015).
- High households' debt make them more vulnerable to negative income and interest rates shocks, making household balance sheets more precarious.
- Borrowers in the **more vulnerable income segments in the bottom 40 income group**, accounted for only 11.4% of total debt.
- More than half (53%) of borrowings remain sensitive to changes in interest rates.

Continued strengthening of fiscal buffers

- **Fiscal consolidation continues. Fiscal deficit will reduce to -2.8% of GDP in 2018** (estimated -3.0% in 2017), marking the ninth straight year of narrowing deficit since 2010.
- **Re-orientate operating expenditure** to free up limited fiscal space for productive public investment.
- **Responsible and optimal** budget spending through minimizing wastage and reducing leakages.
- So, it is **not about how much money is allocated and spent**, but **how well the allocated money is spent**.

Conclusion

1) The global economy is in a synchronized expansion of economic activities. It is a mutual reinforced economic upswing in both advanced and emerging economies.

2) Policy uncertainty will remain in 2018, and the risks include unexpected changes in monetary policies and the shrinking of the Fed's balance sheet, the financial-sector uncertainty in major economies, as well as geopolitical tensions. Pressures for protectionism are building up.

3) The Malaysian economy remains on track for expansion, firing on twin engines (2017E: 5.5%; 2018F:5.1%).

4) Strengthening policy space, addressing vulnerabilities, and enhancing international competitiveness by promoting investment, services, high-end manufacturing and FDI would also boost economic resilience and improve growth prospects.

5) Reaping digital technologies dividend requires the right policy mix and investments such as software and hardware investment, soft skills and the right ecosystem to harness information, communications and technology (ICT) and e-commerce to deliver increased productivity and growth.

社会经济研究中心

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谢 谢
THANK YOU

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