

The Malaysian Economy

Despite the challenging economic environment in 2015, the Malaysian economy remained resilient, to expand by 5.0% (2014: 6.0%), supported by the continued expansion in private sector-led domestic demand. The growth was also underpinned by modest improvement in external demand in the second half year. For 2016, the Malaysian economy is expected to continue to expand, albeit at a more moderate pace of 4.0 – 4.5%. Domestic demand will remain the key driver of growth, sustained primarily by private sector spending. The resilience in the economy is supported by the diversified economic structure, sound macroeconomic fundamentals, developed financial system and continued ability in policy flexibility.



PERFORMANCE IN 2015

The Malaysian economy registered a moderate growth of 5.0% in 2015 (2014: 6.0%). The growth was supported by strong domestic demand, driven by the private sector.

Private consumption continued to record a moderate growth as households adjusted their expenditure to the higher cost of living from the implementation of Goods and Services Tax (GST), administrative price adjustments, subsidy rationalisation and depreciation in the ringgit. Nevertheless, a higher disposable income through targeted Government measures to low- and middle-income households and the stable labour market conditions supported higher spending. In addition, there was front loading of consumption activities in the early part of the year ahead of the implementation of the GST in April 2015.

Private investment moderated due to lower investments in new oil and gas explorations during the year. Nevertheless, the impact was partially mitigated by continued investments in downstream oil and gas activities, and investments in new and on-going projects in the manufacturing and services sectors.

Table 1.1 : Real Gross Domestic Product (GDP) by Expenditure (constant 2010 prices)

	2014	2015 ^p	1H 2016 ^p	2016 ^e
	Annual growth (%)			
Domestic Demand ¹	5.9	5.1	5.0	4.3
Private Sector Expenditure				
Consumption	7.0	6.0	5.8	5.1
Investment	11.1	6.4	4.0	5.5
Public Sector Expenditure				
Consumption	4.3	4.4	5.2	2.0
Investment	-4.7	-1.0	1.1	1.1
Net exports of goods and services	13.2	-3.8	-9.8	1.1
Exports	5.0	0.6	0.2	3.2
Imports	4.0	1.2	1.6	3.4
Real GDP	6.0	5.0	4.1	4.0~4.5

¹Excluding stocks, p : preliminary; e : estimate based on BNM Annual Report 2015

Source: Department of Statistics, Malaysia

On the **supply side**, all major economic sectors except mining and quarrying recorded moderate growth in 2015, weighed down by slower domestic demand. However, export-oriented manufacturing industries and trade-related services benefited from the modest improvement in external demand from both the advanced and developing economies. Growth in the mining sector was supported by higher production of crude oil, while the construction sector grew at a moderate pace amidst the slowdown in residential activity. Although the labour market remained broadly stable, the unemployment rate edged higher to 3.1% (2014: 2.9%) as more cautious business sentiments led to softer employment prospects towards the later part of the year.

Table 1.2 : Real GDP by Key Economic Activity (constant 2010 prices)

	2014	2015 _p	1H 2016 _p	2016 _e
	Annual growth (%)			
Agriculture	2.1	1.2	-6.0	-0.3
Mining & quarrying	3.5	4.7	1.4	3.5
Manufacturing	6.2	4.9	4.3	4.1
Construction	11.7	8.2	8.4	7.9
Services	6.6	5.1	5.4	4.4
Real GDP	6.0	5.0	4.1	4.0~4.5

p : preliminary; *e* : estimate based on BNM Annual Report 2015
Source: Department of Statistics, Malaysia

Headline inflation declined to 2.1% in 2015 (2014: 3.2%), reflecting lower global energy and commodity prices which more than offset the effects from the ringgit depreciation, the implementation of GST and Government rationalisation of subsidy prices. Headline inflation was also more volatile throughout the year due to a series of adjustments in domestic fuel prices.

Table 1.3 : Inflation and Unemployment Rate

	2014	2015 ^p	2016 ^e
	Annual growth (%)		
Inflation			
Consumer Price Index (2010 = 100)	3.2	2.1	2.0 ~ 3.0
Producer Price Index (2010 = 100)	1.4	-4.8	-
Unemployment	2.9	3.1	3.3 ~ 3.5

p : preliminary; *e* : estimate based on BNM Annual Report 2015
Source: Department of Statistics, Malaysia



Table 1.4 : Balance of Payments

	2014	2015 ^p	2016 ^e
	RM billion		
Current Account	48.6	34.7	19.1
% of GNI	4.5	3.1	1.0 ~ 2.0
Goods	113.3	109.6	99.5
Export of Goods	678.9	685.4	707.6
Gross Export (% annual change)	6.5	1.0	3.2
Import of Goods	565.5	575.8	608.1
Gross Import (% annual change)	4.5	1.8	5.6
Services	-10.7	-21.0	-19.2
Primary Income	-36.6	-32.0	-38.0
Secondary Income	-17.4	-21.9	-23.1
Financial Account	-80.0	-50.9	-
Direct Investment	-18.0	4.8	-
Assets	-52.6	-37.2	-
Liabilities	34.6	41.9	-
Portfolio Investment	-39.4	-28.2	-
Assets	-28.1	-9.1	-
Liabilities	-11.2	-19.1	-
Financial Derivatives	-1.0	-0.7	-
Other Investment	-21.7	-26.8	-
Net Errors and Omissions	-5.5	21.1	-
Overall Balance (surplus +/- deficit -)	-36.5	3.8	-
Net International Reserves BNM	405.3	409.1	-
Net International Reserves of BNM (USD billion)	115.9	95.3	-
Reserves as Months of Retained Imports	8.3	8.4	-

p : preliminary; *e* : estimate based on BNM Annual Report 2015
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Against the backdrop of continued uncertainties in the global markets, Malaysia's **external sector** remained resilient. Despite the sizeable trade surplus, the current account surplus narrowed amidst larger deficits in the services and secondary income accounts. The level of international reserves remained sufficient to meet short-term external obligations, thus providing ample buffers against external vulnerabilities.



OUTLOOK FOR 2016

While the **global economy** entered 2016 with expectations of a modest recovery, however the uncertainties and events that unfolded during the course of the year led to downward revisions in growth prospects. The International Monetary Fund (IMF) has revised downward its growth outlook for 2016 for the fourth time since October 2015 to 3.1% (Apr '16: 3.2%), as it foresees weaker-than-earlier expected growth in both the advanced economies and emerging markets. Global growth thus remains the same as in 2015.

The downside risks remained elevated due to the economic and political uncertainty from BREXIT and a sharper-than-expected growth moderation in the Chinese economy that could have a potentially significant spillover effects on global trade activity, investor sentiment and commodity prices. In addition, uncertainty surrounding global oil prices as well as high volatility in capital flows and in the financial markets will also affect growth prospects of several larger economies. Geopolitical and climate related factors tensions could also weigh down on the outlook for several economies.

Table 1.5 : IMF World Economic Outlook (WEO) in July 2016

	2015	2016 ^e	2017 ^f
World Output	3.1	3.1	3.4
Advanced Economies	1.9	1.8	1.8
United States of America	2.4	2.2	2.5
Euro Area	1.7	1.6	1.4
Japan	0.5	0.3	0.1
United Kingdom	2.2	1.7	1.3
Emerging and Developing Economies	4.0	4.1	4.6
Emerging and Developing Asia *	6.6	6.4	6.3
People's Republic of China	6.9	6.6	6.2
India	7.6	7.4	7.4
ASEAN-5 **	4.8	4.8	5.1
Emerging and Developing Europe	3.6	3.5	3.2
Latin America and the Caribbean	0.0	-0.4	1.6
Middle East, North Africa, Afghanistan and Pakistan	2.3	3.4	3.3
World Trade Volume (goods and services)	2.6	2.7	3.9

Note: e : estimate, f : forecast

* PR China, India, Indonesia, Malaysia, Philippines, Thailand & Viet Nam

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Source: IMF World Economic Outlook Update, July 2016

IMPACT OF BREXIT TO MALAYSIA

Given the high degree of openness of the Malaysian economy, the heightened risks from the external environment including BREXIT will certainly have implications to the domestic economy. Nonetheless, the diversified economic structure continue to lend support for the economy to withstand the external shocks. The impact is likely to be seen in two fold, one the direct impact and the other the knock-on effects on other economies, thus dampening world growth and affecting Malaysia's growth prospects. The direct impact through trade is minimal as United Kingdom (UK) only contributed about 1.2% of Malaysia's total

exports, while Malaysia imports only 1% of total imports from UK in 2015. The amount is small compared with People's Republic of China (PR China), Singapore or United States of America (USA) which make up to 36.4% of Malaysia's total trade.

Meanwhile, investments in the UK could be affected to some extent due to exposure of large firms and Malaysian public-listed companies (PLCs) in regulated assets, casino operations and property developments. The weaker British pound arising from the BREXIT could result in lower translated profits and investments to these companies, but would have a positive impact on the services related to education in the UK. Financial markets are likely to remain volatile as "flight to safety" resulting in capital flows from emerging markets to safe haven countries, such as United States. However, the Malaysian economy could be affected in 2016 through the knock-on-effects of lower demand for Malaysian products and services arising from weaker global demand.

Amidst the challenging external economy, the Malaysian economy is expected to grow at a more moderate pace of 4.0 - 4.5% in 2016. The forecast is premised on continued domestic demand anchoring growth, sustained mainly by private sector spending



Amidst the challenging external economy, the Malaysian economy is expected to grow at a more moderate pace of **4.0 - 4.5% in 2016**. The forecast is premised on continued **domestic demand** anchoring growth, sustained mainly by private sector spending. However, the pace of expansion in domestic demand is expected to be more moderate due to uncertainties on both the global and domestic fronts.

Private consumption is projected to moderate further to 5.1% (2015: 6.0%) as households adjust to higher cost of living and market uncertainties. Consumer spending is likely taken into account the continued impact from the GST implementation and rolling back of fuel subsidy. Uncertainty in labour market conditions and the ringgit depreciation is expected to affect household spending with weaker consumer sentiments. Realising the adverse effects, the Government took proactive measures such as to increase the disposable income by reducing the employee's contribution of the Employees Provident Fund (EPF) from 11% to 8% in the period March 2016 - December 2017, raise *Bantuan Rakyat 1Malaysia* (BR1M) cash transfers and provide additional tax relief of RM2,000 for individual taxpayers. On the tourism activity, the easing of travel requirement for tourists from the PR China, introduction of the e-Visa for tourists in several countries and ongoing promotional efforts for targeted tourism, is expected to recover tourist arrivals and raise tourist spending locally.

Chart 1.1 : Growth of Tourist Arrivals and Private Consumption, %

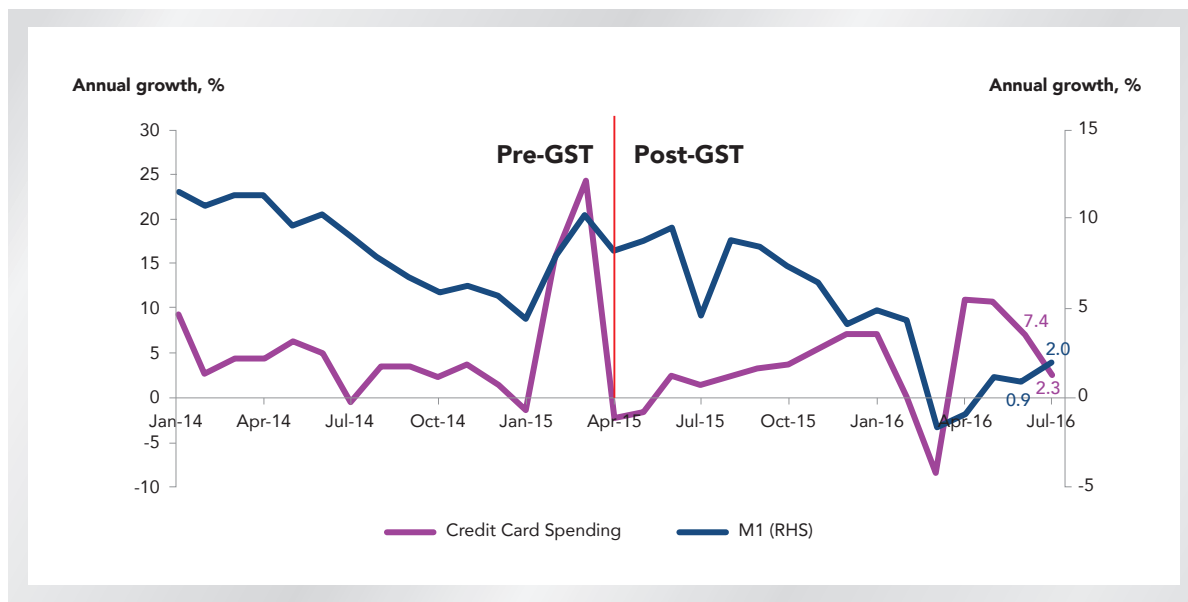


Source: Department of Statistics, Malaysia, Tourism Malaysia and CEIC

In terms of household spending, consumer spending indicators, such as growth of credit card spending and narrow money (M1) have shown a declining trend and then a spike just before the implementation of GST. Meanwhile, post-GST implementation, there has been a gradual downward trend in growth, although in recent months, there have seen a gradual pick-up in growth of credit card spending and M1.



Chart 1.2 : Growth of Credit Card Spending and Narrow Money (M1), %



Source: Bank Negara Malaysia

Private investment growth is expected to trend below its long-term average to expand by 5.5% (2015: 6.4%). Investment activity in the upstream mining sector such as oil fields is projected to be weaker due to the low commodity prices. Nonetheless, the implementation of ongoing and new investment projects especially in the manufacturing and services sectors are expected to support private sector capital spending.

Reflecting the Government's commitment to more prudent spending, growth in **public consumption** is expected to be more moderate but would continue to be supportive of overall growth. **Public investment** meanwhile is projected to turn around to register a positive growth, reflecting higher spending by the Federal Government on fixed assets and the continued implementation of key infrastructure projects by public corporations.

On the **supply side**, key economic sectors are projected to expand at a more moderate pace in 2016. The services and manufacturing sectors would remain to be the key economic contributors to GDP growth. Growth in the mining sector is likely to be supported by new gas production capacity despite the lower oil and gas prices, while the construction sector growth is projected to moderate slightly. The agriculture sector is expected to contract marginally due to lower palm oil yields following the hot and dry weather conditions.

The **external sector** is expected to remain resilient with continued current account surplus despite the narrowing of the surplus due to the global weakness. Exports will be weighed down by subdued commodity prices and weaker demand, while gross imports to expand amidst the rise in demand for intermediate imports to support the continued performance of manufactured exports. In addition, capital imports is expected to be higher due to continued expansion in domestic private investment. The overall trade balance is projected to remain in a marginal surplus. The **services account** deficit is projected to narrow due to improvement in tourism activities. Hence, the **current account** surplus is expected to be lowered further to 1.0 – 2.0% of gross national income (GNI).

Headline inflation is projected to be at 2.0 – 3.0% in 2016, due mainly to price adjustments in several price-administered items such as intra-city highway toll charges, railway charges, reduction in electricity tariff rebates as well as weaker ringgit exchange rate. However, these inflationary pressures are expected to be mitigated by tapering first-round GST effects, low global energy and commodity prices, subdued global inflation, moderate domestic demand and accommodative monetary policy.

The Malaysian economy entered 2016 from a position of strength supported by a strong financial system. A significant aspect of this is the diversification in economic activities. Thus, **monetary policy** in 2016 focuses on ensuring monetary conditions remain supportive of sustainable domestic growth, taking into consideration the downside risks from the domestic and external environments. Given the uncertain global economic and financial developments outlooks, the Malaysian Government and Bank Negara Malaysia (BNM) will closely monitor and assess their implications to the domestic growth and inflation outlook. In the recent Monetary Policy Committee (MPC) meeting on 13 July 2016, the Overnight Policy Rate (OPR) was reduced to 3.00% from 3.25%, due to the uncertainties in the global environment which could potentially impact Malaysia's growth prospects. In ensuring that the domestic economy continues on a steady growth path amid stable inflation, the new adjustment to the OPR is intended for the degree of monetary accommodativeness to remain consistent with the policy stance. This is against an environment of increased downside risks to global growth.

Fiscal policy in 2016 will continue to focus on fiscal consolidation amidst the challenging external and domestic environment. The 2016 Budget, tabled in October 2015, was recalibrated in January 2016 to incorporate the expected decline in global oil price. The budget restructuring is to ensure that the economy and financial position remain on the right trajectory. Aside from that, the Government introduced measures to broaden the revenue sources with redistribution of the telecommunications spectrum, stricter duty enforcement on sales of cigarettes, liquors and imported vehicles in duty-free islands as

well as streamlining the foreign worker levy system. The implementation of GST had also led to broadening of the sources of income for the Government. Hence, the fiscal deficit target for 2016 is at 3.1% of GDP (2015: 3.2%).

With the Eleventh Malaysia Plan being the most crucial plan in the nation's progress towards Vision 2020, fiscal resources in 2016 will be prioritised towards high impact projects with large multiplier effects to reduce cost. Emphasis will continue to be accorded towards ensuring inclusive and sustainable growth through welfare enhancements especially in the form of socio-economic support to cope with the rising cost of living and encourage private consumption. Going forward, in facing the uncertain environment, **sustaining fiscal reform** and **prudent macroeconomic measures** would remain crucial components of the Government's economic transformation agenda.