Section I : Economic Assessment

Chapter 1

The Malaysian Economy

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Against a backdrop of improving global economic conditions, the Malaysian economy recorded a growth of 5.9% in 2017 (2016: 4.2%). The higher growth was driven primarily by domestic demand and further lifted by outstanding performance of gross exports. The growth of gross exports increased at its fastest pace since 2004 which led to positive spillover to the domestic economy. In 2018, after taking into consideration the actual Malaysia's Gross Domestic Product (GDP) growth in the first half of 2018 at 4.9%, Bank Negara Malaysia (BNM) has revised its 2018 GDP growth projection to 5.0%, lower than the earlier official growth projection of between 5.5 - 6.0%, due partly to a prolonged disruptions of oil and gas production and weak crude palm oil production in the first half of 2018. Despite the lower revised GDP growth projection, domestic economy in 2018 is expected to be supported by sustained global growth and trade momentum, private sector activity and higher consumer spending, particularly during the zerorisation of Goods and Services Tax (GST) from June to August 2018.

PERFORMANCE IN 2017

The Malaysian economy registered a robust growth of 5.9% in 2017 (2016: 4.2%). Growth continued to be anchored by domestic demand, reflecting faster expansion in both private and public sector spending. The rebound in gross exports growth following strong global demand was the key highlight for the year.

Private consumption growth further improved to 7.0% in 2017 (2016: 6.0%), supported by sustained growth in wage, employment and various measures from the Government. Consumer spending was supported by the Government measures targeted to increase household disposable income. These measures include reduction in employees' contribution to the Employees Provident Fund (EPF) by three percentage points (11% to 8%), higher Bantuan Rakyat 1Malaysia (BR1M) cash transfers and upward revision in civil servants' salaries in July 2016.

Private investment growth accelerated to 9.3% (2016: 4.3%) as firms benefited from the conducive external and domestic operating environment. There were positive spillover to the domestic economy due to strong growth in exports, as firms ramp-up capacity expansion to cater to higher orders. Financing conditions, profitability and business sentiments also improved during the year.

Public consumption growth expanded by 5.4% (2016: 0.9%) following higher spending on supplies and services, mainly on maintenance and minor repair works, by the Government amid sustained growth in the emoluments.

Public investment recovered to grow at 0.1% (2016: -0.5%), supported by continued spending by the Government and public corporations, mainly in the downstream oil & gas and transport & utilities sub-sectors.

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

	2016	2017[p]	1H 2018[p]	2018[e]
	Annual growth (%)			
Domestic Demand[1]	4.3	6.5	4.9	5.7
Private Sector Expenditure				
Consumption	6.0	7.0	7.4	7.2
Investment	4.3	9.3	3.4	9.1
Public Sector Expenditure				
Consumption	0.9	5.4	1.8	0.6
Investment	-0.5	0.1	-5.2	-3.2
Net exports of goods and services	1.7	-1.9	29.9	5.5
Exports	1.3	9.4	2.9	8.8
Imports	1.3	10.9	0.0	9.1
Real GDP	**4.2**	**5.9**	**4.9**	**5.5 ~ 6.0**

[1]*Excluding stocks*

p: preliminary *e: estimate based on BNM Annual Report 2017*

Source: Department of Statistics, Malaysia

On the **supply side**, most economic sectors registered higher growth in 2017, driven mainly by the two main sectors, namely services and manufacturing sectors, which benefited from marked improvement in domestic and external conditions.

Meanwhile, labour market conditions have improved as stronger employment gains kept pace with labour force expansion. The unemployment rate remained stable at 3.4% (2016: 3.4%) as employers continued to expand their workforce following better business outlook.

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

	2016	2017[p]	1H 2018[p]	2018[e]
	Annual growth (%)			
Agriculture	-5.2	7.2	0.1	3.6
Mining & Quarrying	2.1	1.0	-1.0	1.8
Manufacturing	4.4	6.0	5.1	5.9
Construction	7.4	6.7	4.8	7.3
Services	5.7	6.2	6.5	6.1
Real GDP	**4.2**	**5.9**	**4.9**	**5.5 ~ 6.0**

p: preliminary *e: estimate based on BNM Annual Report 2017*

Source: Department of Statistics, Malaysia

Inflation remained volatile during the year, with **headline inflation** edged higher to 3.7% in 2017 (2016: 2.1%). Higher external and domestic costs from higher global commodity prices and disruptions in domestic food supplies had contributed to the higher inflation. The rise in inflation was however mitigated by the stronger ringgit exchange rate since April 2017, which helped to offset the increase in cost of production for domestic goods.

Table 1.3: Inflation and Unemployment Rate

	2016	2017[p]	2018[e]
	Annual growth (%)		
Inflation Rate			
Consumer Price Index (2010 = 100)	2.1	3.7	2.0 ~ 3.0
Producer Price Index (2010 = 100)	-1.1	6.7	-
Unemployment Rate	3.4	3.4	3.2 ~ 3.5

p: preliminary *e: estimate based on BNM Annual Report 2017*

Source: Department of Statistics, Malaysia

Table 1.4: Balance of Payments

	2016	2017[p]	2018[e]
	RM billion		
Current Account	29.0	40.3	38.9
% of GNI	2.4	3.1	2.0 ~ 3.0
Goods	101.4	118.1	120.5
Export of Goods	686.1	808.9	865.9
Gross Exports (annual growth, %)	1.2	18.9	8.4
Import of Goods	584.7	690.8	745.3
Gross Imports (annual growth, %)	1.9	19.9	8.6
Services	-19.1	-23.1	-23.2
Primary Income	-34.6	-36.1	-39.1
Secondary Income	-18.6	-18.6	-19.3
Financial Account	-1.1	2.3	-
Direct Investment	14.1	12.4	-
Assets	-42.1	-26.7	-
Liabilities	56.2	39.1	-
Portfolio Investment	-15.4	-9.2	-
Assets	-15.0	-16.5	-
Liabilities	-0.4	7.3	-
Financial Derivatives	-0.8	0.5	-
Other Investment	1.0	-1.3	-
Net Errors and Omissions	-13.2	-51.9	-
Overall Balance (surplus + / deficit -)	14.8	-9.3	-
Net International Reserves of BNM (RM billion)	423.9	414.6	-
Net International Reserves of BNM (USD billion)	94.5	102.4	-
Reserves as Months of Retained Imports	8.7	7.2	-

p: preliminary e: estimate based on BNM Annual Report 2017

Source: Department of Statistics, Malaysia

Malaysia's **external sector** position improved significantly in 2017, benefiting from the favourable global economic landscape and relatively lower volatility in the international financial markets. Malaysia registered a higher current account surplus, mainly due to a higher goods surplus following the strong export performance, which has contained the widening deficits in the services and primary income accounts. The level of international reserves was sufficient to provide a buffer against potential external shocks and volatility.

OUTLOOK FOR 2018

The latest **World Economic Outlook (WEO) Update** released by the International Monetary Fund (IMF) on 16 July 2018 has maintained the projection of **global growth** to expand by **3.9%** in **2018** (2017: 3.7%). Among advanced economies, growth divergences between the United States (US), Europe and Japan are widening, reflecting greater-than-expected growth moderations in the Euro Area and Japan. Meanwhile, emerging and developing economies are expected to maintain its robust performance in 2018 - 2019. Nevertheless, **risk** to the outlook remain skewed to the **downside**. These include a potential retreat from globalisation and free trade in the advanced economies, uncertainty over the United Kingdom (UK) and European Union (EU) negotiations and geopolitical concerns. In addition, greater volatility in the international financial markets and monetary policy normalisation in the advanced economies could lead to further capital outflows and financial market adjustments in emerging economies.

Table 1.5: IMF World Economic Outlook (WEO) Update in July 2018

	2017[p]	2018[e]	2019[f]
World Output	**3.7**	**3.9**	**3.9**
Advanced Economies	**2.4**	**2.4**	**2.2**
United States	2.3	2.9	2.7
Euro Area	2.4	2.2	1.9
Japan	1.7	1.0	0.9
United Kingdom	1.7	1.4	1.5
Emerging and Developing Economies	**4.7**	**4.9**	**5.1**
Emerging and Developing Asia *	6.5	6.5	6.5
China	6.9	6.6	6.4
India	6.7	7.3	7.5
ASEAN-5 **	5.3	5.3	5.3
Emerging and Developing Europe	5.9	4.3	3.6
Latin America and the Caribbean	1.3	1.6	2.6
Middle East, North Africa, Afghanistan and Pakistan	2.2	3.5	3.9
World Trade Volume (goods and services)	**5.1**	**4.8**	**4.5**

p: preliminary e: estimate f: forecast

**China, India, Indonesia, Malaysia, Philippines, Thailand & Vietnam*
*** Indonesia, Malaysia, Philippines, Thailand & Vietnam*

Source: IMF World Economic Outlook Update, July 2018

For **Malaysia**, the economy is estimated to record a growth of **5.0%**, lower than the earlier official growth projection of between 5.5 - 6.0% in 2018, after taking into account the actual GDP growth performance in the first half of 2018 at 4.9%. A prolonged disruption of oil and gas production due to supply outages in Sabah and Sarawak and weak crude palm oil production are some of the main factors that have been constraining the economic growth.

On the demand side, **domestic demand** will continue to be the principal driver of growth in 2018, underpinned by private sector activities. **Private consumption** growth is expected to remain stable at 7.2% in 2018, supported by continued growth in employment and income, lower inflation and improving sentiments. Exports performance is expected to support income growth in the export-oriented industries amid continued growth in domestic economic activity. Meanwhile, measures to boost disposable income such as continuation of cash transfers, individual income tax reduction, zero-rated GST which takes effect on 1 June 2018 and continued for three months and the introduction of the new Sales and Services Tax (SST) effective 1 September 2018 are expected to give a positive impact to consumer spending.

In the early part of the year, **private investment** was estimated to grow at 9.1% in 2018, underpinned by ongoing and new capital spending in both the manufacturing and services sectors, and further strengthened by continued positive business sentiment. Growth is estimated to be less affected by the moderate mining investment activity following the improvement in commodity prices. Investments in the export-oriented industries such as the electrical & electronics and resource-based industries would continue to benefit from the anticipated expansion in global growth. However, actual data in the first half of 2018 indicated that private investment only recorded a growth of 3.4%. Thus, growth of private investment for the whole year would be expected to record a moderate growth from the earlier projection.

On the supply side, all economic sectors are projected to expand in 2018, with services and manufacturing sectors remain the key contributors to overall growth

Following the Government's commitment to reprioritise and rationalise non-critical expenditure, **public consumption** is expected to record a marginal growth of 0.6% in 2018 due to more moderate growth in emoluments amid prudent spending on supplies and services. Meanwhile, **public investment** growth is expected to decline by 3.2% due to lower capital spending by public corporations following the near completion of large-scale projects.

On the **supply side**, all economic sectors are projected to expand in 2018, with services and manufacturing sectors remain the key contributors to overall growth. Growth in the construction sector is expected to moderate than the earlier projection of 7.3%, supported by the ongoing transportation, petrochemical and powerplant projects. The agriculture sector is expected to register a more moderate pace following the exceptional post-El Niño rebound in 2017, supply and production constraints as well as adverse weather conditions in 2018. Meanwhile, in the early part of the year, mining & quarrying sector was projected to register higher growth, reflecting the continued pickup in natural gas production. However, in the second quarter of 2018, the sector declined due mainly to declining natural gas output following unplanned supply outages in Sabah and Sarawak.

Based on the official projection made in the early part of 2018, the **external sector** will remain resilient amid further strengthening in the global economy. Both gross exports and imports are projected to grow at above-average trends, albeit at a more sustainable pace of 8.4% and 8.6%, respectively. Overall, Malaysia's current account balance is expected to record a surplus of between 2.0 - 3.0% of Gross National Income (GNI) in 2018.

In the month of August 2018, during the release of second quarter 2018 GDP by BNM, **headline inflation** in 2018 was projected to be lower compared to the forecast earlier in the year. This revised forecast has taken into account the anticipated impact of recent policy measures, including the zerorisation of the GST and the fixing of retail fuel prices, on domestic cost factors. However, going forward and continuing into 2019, based on the latest Monetary Policy Statement released in September 2018, headline inflation is expected to edge upwards taking into consideration the impact of policy measures on domestic cost factors. The impact of the changes in the consumption tax policy on headline inflation will be transitory and lapse towards the end of 2019. Underlying inflation is nevertheless expected to remain relatively stable.

The **monetary policy** in 2018 will be focusing on ensuring the sustainable growth of Malaysian economy while maintaining price stability. At the Monetary Policy Committee (MPC) meeting held in January 2018, the Overnight Policy Rate (OPR) was raised by 25 basis points to 3.25%. This was done in ensuring that the monetary policy stance remains accommodative and sufficient for sustainable growth prospects while mitigating risks that could arise from a prolonged period of low interest rates. At the subsequent meetings in March, May, July and September 2018, the MPC decided to maintain the OPR at 3.25%. At the current level of the OPR, the degree of monetary accommodativeness is consistent with the intended policy stance. The MPC will continue to monitor and assess the balance of risks surrounding the outlook for domestic growth and inflation.

Fiscal policy in 2018 is aimed towards strengthening the fiscal position by lowering the fiscal deficit to 2.8% of GDP without undermining the economic growth and prosperity of the people. To achieve the goal, two committees will be established by the new Government namely the Public Finance Committee to provide a medium-term fiscal plan including fiscal consolidation and Tax Reform Committee that will assess the overall tax system to make it more efficient, neutral and progressive.