Section 1

Economic Assessment

Chapter

ONE

The Malaysian Economy

“ENTREPRENEURSHIP DRIVING SMEs”

Chapter
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The Malaysian Economy

The Malaysian economy continued to demonstrate considerable resilience in the face of multiple headwinds by registering a moderate growth of 4.7% in 2018 (2017: 5.7%). Several external and domestic challenges arising partly from global trade tensions and the historic change of Government have weighed on the overall GDP growth. Apart from that, supply disruptions have adversely affected activity in the mining and agriculture sectors, as well as commodity exports, consequently resulted in a larger-than-expected moderation in growth.

Amid uncertainties in the economic landscape, the growth prospect of the Malaysian economy remains robust for the year 2019, with the overall GDP is projected to expand by 4.7%. Resilient domestic demand will continue to anchor growth, particularly household spending following stable labour market and low inflation. The resilience in the economy will be backed up by the diversified economic structure, sound macroeconomic fundamentals and developed financial system.

PERFORMANCE IN 2018

The Malaysian economy grew at a more moderate pace of 4.7% in 2018 (2017: 5.7%). The growth continued to be anchored by domestic demand, supported mainly by private sector expenditure. Meanwhile, net exports rebounded during the year as the growth in real exports outpaced real imports.

Private consumption expanded at its fastest pace since 2012 at 8.0% (2017: 6.9%). Favourable income and labour market conditions continued to drive household spending with additional support from the three-month tax holiday (1 June - 31 August 2018) following the zerorisation of the Goods and Services Tax (GST) rate, as well as other Government measures, such as the stable retail fuel price of RON95 petrol and special payments to civil servants and pensioners.

Private investment grew at a slower pace of 4.3% (2017: 9.0%) amid heightened uncertainty arising from both external and domestic developments. However, firms, particularly in the export-oriented sectors, continued to increase production capacity and improve efficiency to meet demand.

Public consumption growth moderated to 3.3% (2017: 5.5%) due to slower growth in spending on both emoluments and supplies & services, which is in line with the Government's commitment to reprioritise expenditures.

Public investment declined by 5.0% in 2018 (2017: 0.3%), mainly attributed to lower spending by public corporations following the near completion of large projects in the downstream oil & gas and utilities industries. Capital expenditure by the Federal Government was higher in 2018, supported by continued spending in transportation infrastructure, public utilities and agricultural & rural development.

Table 1.1: Real GDP by Expenditure (constant 2015 prices)

	2017	2018p	1H 2019p	2019e
	Annual growth (%)			
Domestic Demand[1]	6.5	5.5	4.5	4.0
Private Sector Expenditure	7.4	7.1	6.1	5.6
Consumption	6.9	8.0	7.7	6.8
Investment	9.0	4.3	1.2	1.5
Public Sector Expenditure	3.4	0.1	-2.1	-1.8
Consumption	5.5	3.3	3.2	2.0
Investment	0.3	-5.0	-11.3	-8.1
Net Exports of Goods and Services	-3.9	11.4	16.0	14.5
Exports	8.7	2.2	0.1	-0.4
Imports	10.2	1.3	-1.8	-2.1
Real GDP	**5.7**	**4.7**	**4.7**	**4.7**

[1]Excluding stocks
p: preliminary e: estimate based on Budget 2020 by Ministry of Finance
Source: Department of Statistics, Malaysia and BNM Quarterly Bulletin for 2Q 2019

On the **supply side**, most economic sectors recorded an expansion, with the exception of commodity-related sectors. The principal drivers of growth remained to be from the services and manufacturing sectors. Nevertheless, the agriculture sector recorded a marginal growth following adverse weather conditions, while supply disruptions in natural gas production led to a contraction in the growth of mining sector.

With labour market conditions generally stable and remained favourable in 2018, the unemployment rate sustained at 3.3% (2017: 3.4%) as stronger employment gains kept pace with labour force expansion.

Table 1.2: Real GDP by Economic Sector (constant 2015 prices)

	2017	2018[p]	1H 2019[p]	2019[e]
	Annual growth (%)			
Agriculture	5.7	0.1	4.9	4.3
Mining & Quarrying	0.4	-2.6	0.3	0.6
Manufacturing	6.0	5.0	4.2	4.0
Construction	6.7	4.2	0.4	1.7
Services	6.2	6.8	6.3	6.1
Real GDP	**5.7**	**4.7**	**4.7**	**4.7**

p: preliminary e: estimate based on Budget 2020 by Ministry of Finance
Source: Department of Statistics, Malaysia and BNM Quarterly Bulletin for 2Q 2019

Headline inflation moderated to 1.0% (2017: 3.7%), mainly reflecting the impact of the stable retail fuel prices and the zerorisation of the GST rate which have more than offset upward cost pressures that remained present for some parts of 2018.

Table 1.3: Inflation and Unemployment Rate

	2017	2018[p]	2019[e]
	Annual growth (%)		
Inflation Rate			
Consumer Price Index (2010 = 100)	3.7	1.0	0.9
Producer Price Index (2010 = 100)	6.7	-1.1	-
Unemployment Rate	3.4	3.3	3.3

p: preliminary e: estimate
Source: Department of Statistics, Malaysia and Budget 2020 by Ministry of Finance

Table 1.4: Balance of Payments

	2017	2018p	1H 2019e	2019e
	RM billion			
Current Account	38.3	30.6	30.6	43.4
% of GNI	2.9	2.2	4.3	2.9
Goods	117.1	119.2	62.0	131.0
Services	-22.9	-17.7	-5.3	-21.1
Primary Income	-38.7	-51.6	-15.7	-45.3
Secondary Income	-17.3	-19.3	-10.4	-21.2
Financial Account	-4.7	18.6	-32.4	-
Direct Investment	16.2	11.3	8.0	-
Assets	-24.2	-23.3	-18.4	-
Liabilities	40.4	34.6	26.4	-
Portfolio Investment	-15.4	-44.4	-8.1	-
Financial Derivatives	-0.2	1.0	-0.7	-
Other Investment	-5.3	50.7	-31.6	-
Net Errors and Omissions	-17.1	-41.3	5.9	-
Overall Balance (surplus + / deficit -)	16.4	7.8	4.1	-
Net International Reserves of BNM (RM billion)	414.6	419.5	-	-
Net International Reserves of BNM (USD billion)	102.4	101.4	-	-
Reserves as Months of Retained Imports	7.2	7.4	-	-

p: preliminary e: estimate
Source: Department of Statistics, Malaysia, BNM Annual Report 2018 and Budget 2020 by Ministry of Finance

In the face of multiple headwinds in the global economic environment, the Malaysian **external sector** performance was resilient in 2018. The current account of the balance of payments remained in surplus as the income deficit was more than offset by a sizeable goods surplus and smaller services deficit. The level of international reserves continued to serve as a key buffer against potential external shocks.

OUTLOOK FOR 2019

The year 2019 was rather tense given the dynamism in the global economy is being weighed down by slowdown in manufacturing sector and global trade following rising trade and geopolitical tensions. In addition, prolonged uncertainty on Brexit, additional US tariffs on China's import as well as disruptions to technology supply chain added to the volatile market sentiment. Against the backdrop of these constraints, the latest World Economic Outlook (WEO) released by International Monetary Fund (IMF) on 15 October 2019 has revised downward its growth outlook for 2019 for the sixth time since July 2018. The growth for the year 2019 was further downgraded to 3.0% (WEO July'19: 3.2%), which is the slowest pace since the global financial crisis took place in 2008 - 2009. With global activity generally remaining subdued and the outlook remains precarious, the balance of risks continues to remain on the downside, emanating from potential escalation of trade and geopolitical tensions, buildup in financial vulnerabilities and unmitigated climate change.

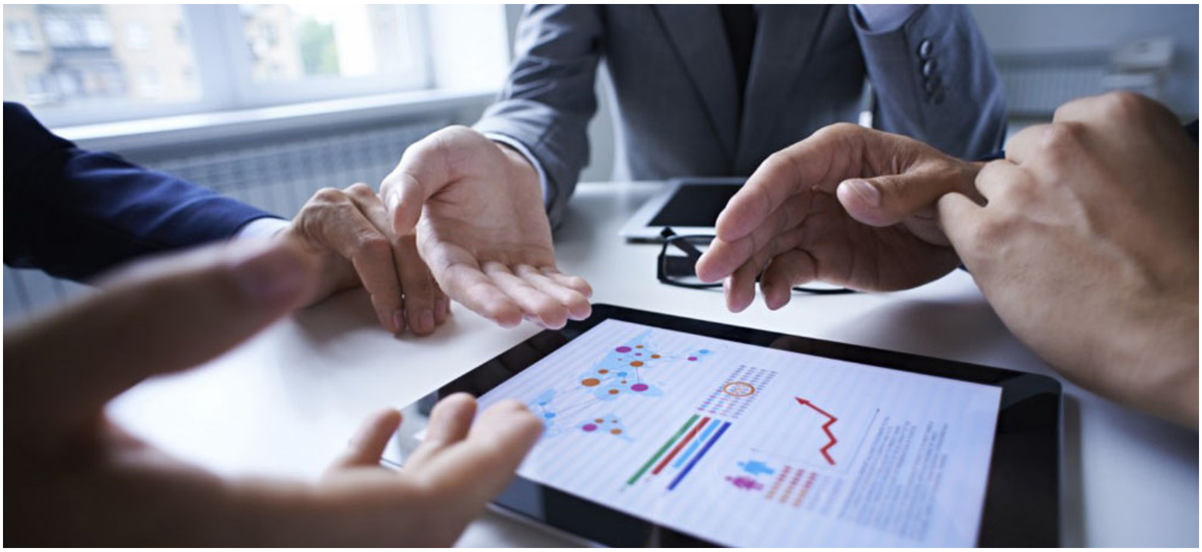
Table 1.5: IMF World Economic Outlook (WEO) in October 2019

	2018^{p}	2019^{e}	2020^{f}
World Output	**3.6**	**3.0**	**3.4**
Advanced Economies	**2.3**	**1.7**	**1.7**
United States	2.9	2.4	2.1
Euro Area	1.9	1.2	1.4
Japan	0.8	0.9	0.5
United Kingdom	1.4	1.2	1.4
Emerging and Developing Economies	**4.5**	**3.9**	**4.6**
Emerging and Developing Asia*	6.4	5.9	6.0
China	6.6	6.1	5.8
India	6.8	6.1	7.0
ASEAN-5**	5.2	4.8	4.9
Emerging and Developing Europe	3.1	1.8	2.5
Latin America and the Caribbean	1.0	0.2	1.8
Middle East and Central Asia	1.9	0.9	2.9
World Trade Volume (goods and services)	**3.6**	**1.1**	**3.2**

p: preliminary e: estimate f: forecast
**China, India, Indonesia, Malaysia, Philippines, Thailand & Vietnam*
***Indonesia, Malaysia, Philippines, Thailand & Vietnam*
Source: IMF World Economic Outlook, October 2019

Amidst the challenging global environment, the **Malaysian economy** is projected to sustain its growth momentum, expanding by **4.7% in 2019**. **Domestic demand** will remain to be the principal driver of growth, expecting to grow by 4.0% in 2019. Private consumption is also estimated to grow by 6.8%, supported by continued wage growth and favourable employment prospects. Household spending will be further boosted by an upward revision of the minimum wage rate, cash transfers, income tax refund and lower cost of borrowings.

Private investment activity is expected to register a much slower growth of 1.5% in 2019, reflecting lower external demand and capacity utilisation rate, particularly in the export-oriented industries. While some investors remained cautious in the first half of 2019, investment is anticipated to pick up in the second half of the year, in line with the Business Tendency Statistics which expected a more favourable business performance during the mentioned period. In addition, investment in high value-added areas, such as advanced materials, optics & photonics, petrochemicals and pharmaceuticals are projected to attract more investors.

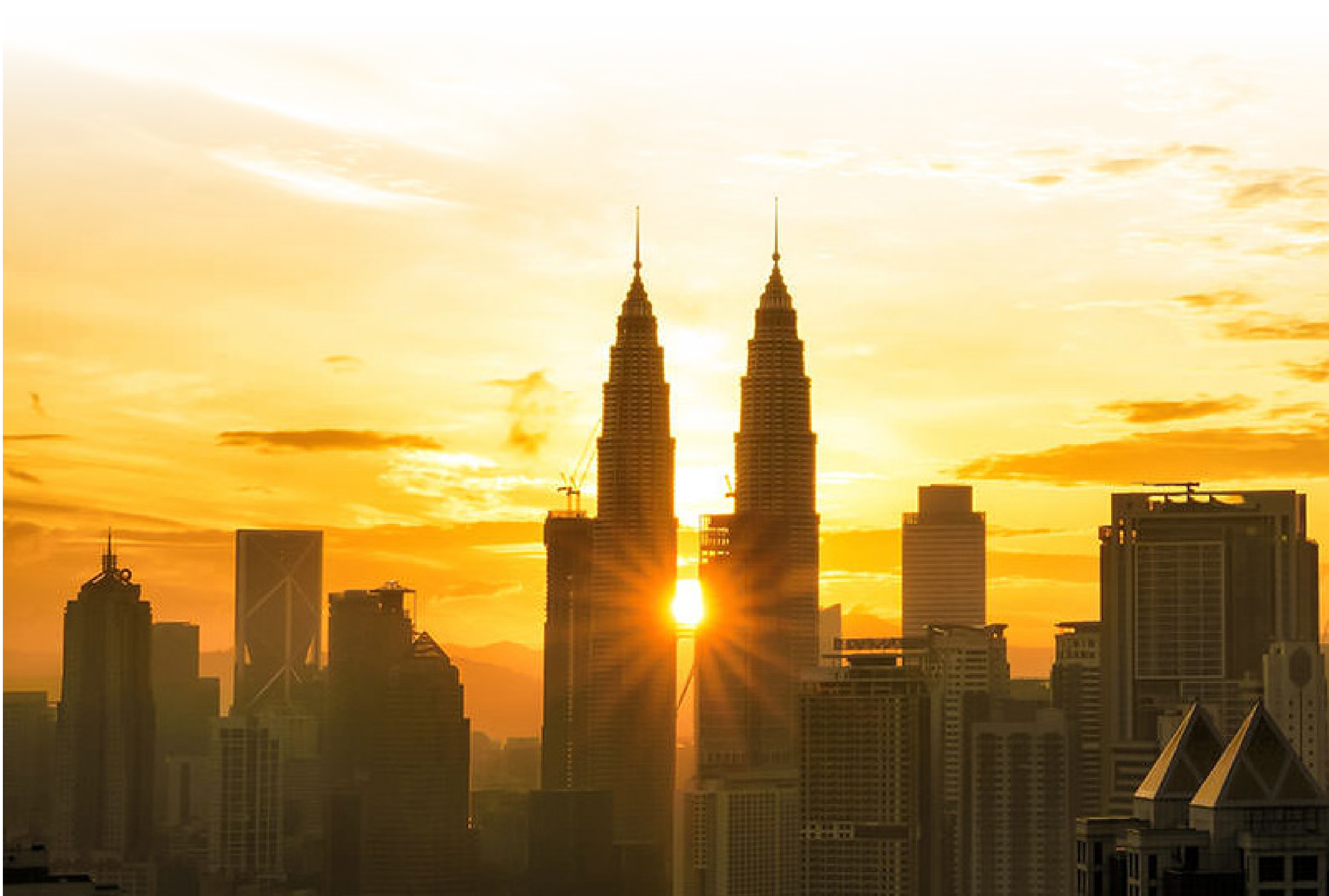


Public consumption is projected to remain moderate at 2.0% in 2019 in line with the fiscal consolidation path. The Government will continue to undertake expenditure optimisation practises, emphasising on the reduction of wastage and leakages without affecting public service delivery. Meanwhile, **public investment** is estimated to decline by 8.1% in 2019 following lower capital outlays by public corporations, especially in oil & gas related industries. Development expenditure by the Government will mostly focused on the economic and social sectors, mainly channelled into transportation system, energy & public utilities as well as into education and healthcare.

On the **supply side**, all economic sectors would continue to expand with the services and manufacturing sectors being the main contributors to growth. Growth in agriculture sector is projected to register an expansion in 2019 amid higher production of crude palm oil and natural rubber. Meanwhile, there will be a turnaround in the growth of mining sector in 2019, supported by higher natural gas production. The construction sector is estimated to record a moderate growth, mainly supported by the civil engineering segment.

Despite slowdown in global economic growth and trade performance, Malaysia's **external sector** is expected to remain resilient. Overall in 2019, the current account of the balance of payments is projected to widen and remain in surplus at RM43.4 billion or 2.9% of Gross National Income (GNI), following the increase in net exports of goods and services. In addition, gross exports are estimated to expand marginally while gross imports to decline in 2019 as it being weighed down by capital goods due to lower investment activities.

Headline inflation in 2019 is anticipated to grow by 0.9%, partly due to the imposition of departure levy which took effect in September 2019. Nevertheless, minimal impact on the overall inflation is expected following the introduction of sugar tax in July 2019 though it has a relatively smaller weightage in the Consumer Price Index (CPI) basket. Going forward, the trajectory of inflation outlook will rely on foreign exchange rate movements and uncertainties in the global oil prices as a result of trade and geopolitical tensions.



Monetary policy in 2019 will continue to focus on supporting economic growth against the backdrop of low inflation and stable financial conditions. Furthermore, money and foreign exchange markets as well as intermediation activities are anticipated to remain vibrant to anchor monetary operations. Supported by sufficient liquidity and strong capital buffers, the banking sector is expected to remain robust and orderly. The capital market will also be resilient, driven by well-developed infrastructure and instruments. Despite the positive expectations, external uncertainties which include the global growth pace, US-China trade tensions as well as global financial market volatility may affect the banking and capital market performance.

Fiscal policy in 2019 will focus on strengthening the Government's fiscal position by pursuing gradual fiscal consolidation while lending continued support for growth, paring down debt and liabilities, as well as promoting economic inclusiveness. Correspondingly, the path towards consolidation is outlined with fiscal balances targeted at -3.4% and -3.2% of GDP in 2019 and 2020 respectively, being anchored by several key reform initiatives which include enhancing expenditure effectiveness, diversify and broaden the revenue base and encourage holistic and transparent debt management.