BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

The BNM Quarterly Bulletin presents a quarterly review of Malaysia's economic, monetary and financial developments. It includes the Bank's latest assessments on the direction of the economy going forward. The Bulletin also provides insights on current economic and financial issues, including highlights of policy initiatives undertaken by Bank Negara Malaysia in pursuit of its mandates.

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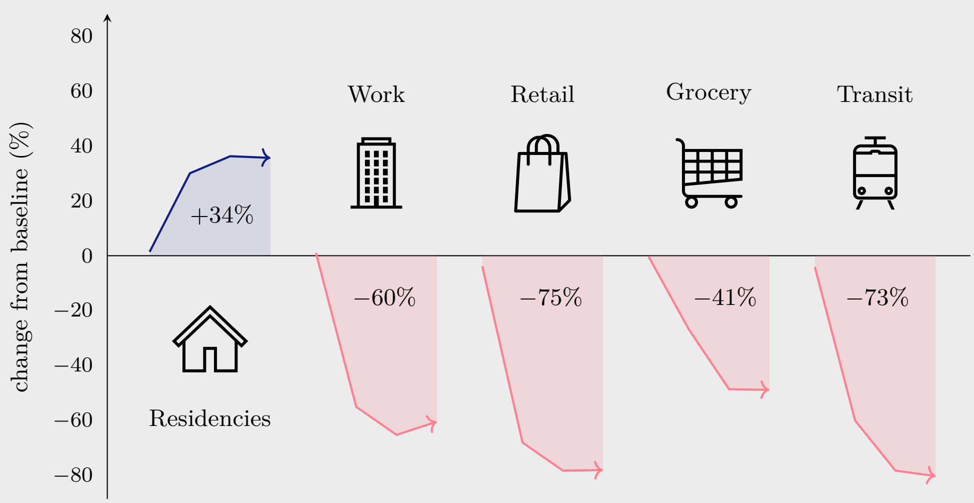
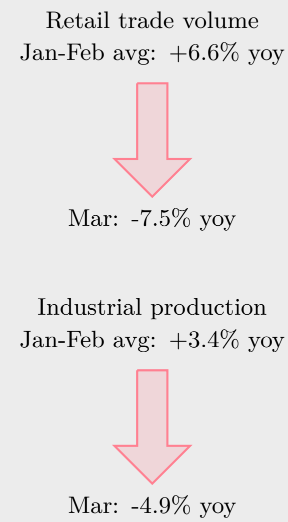
Highlights: 1Q 2020

Malaysians began staying home to fight the COVID-19 pandemic

This was a necessary near-term sacrifice to avert a health crisis

Mobility by Location Type between 15-Feb and 31-Mar (baseline: 3-Jan to 6-Feb)

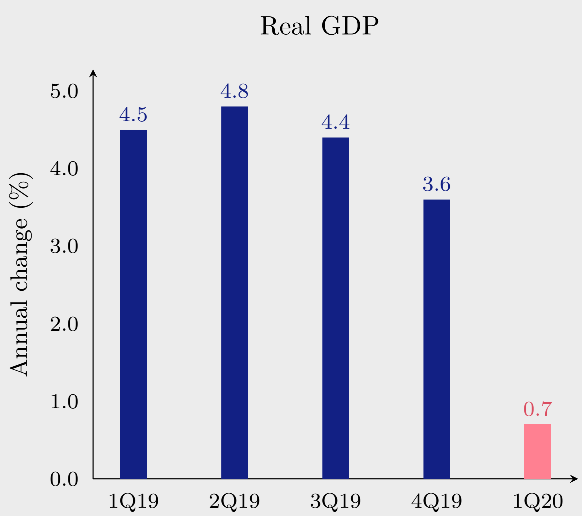


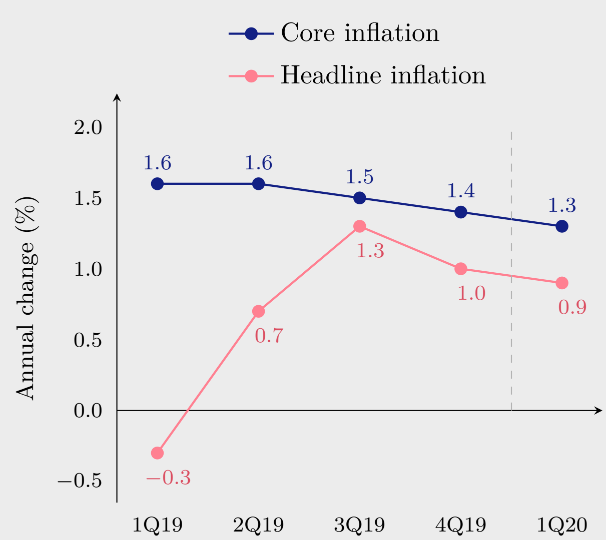


Source: Google COVID-19 Community Mobility Report and Department of Statistics, Malaysia

The sudden downshift in economic activity caused growth to moderate

Headline and core inflation also moderated during the quarter





Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

International Economic Environment

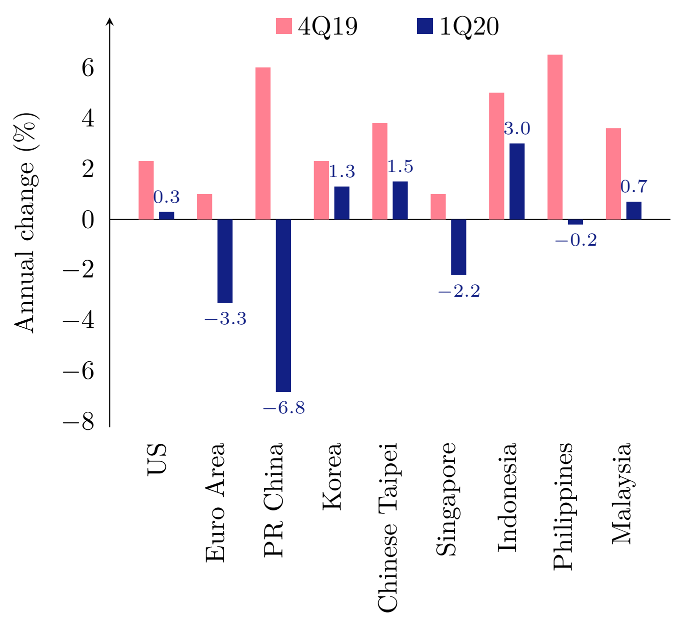
Highlights

- Global growth experienced a sharp slowdown in the first quarter of 2020.
- Exports in the regional economies showed mixed performance.
- Financial market volatility rose as the COVID-19 pandemic spread further globally.

The global economy contracted in 1Q 2020

The global economy experienced a sharp moderation in the first quarter of 2020. The rapid spread of the COVID-19 virus resulted in the introduction of lockdown and social distancing measures in many major economies. This also resulted in elevated volatility in global financial markets.

Chart 1: GDP Growth of Selected Economies



Source: National authorities

Growth in PR China contracted by 6.8%, as aggressive containment measures were introduced from 23 January to 8 April to slow the spread of COVID-19. These measures resulted in a significant decline in economic activity, as reflected by the broad-based contraction in fixed asset investments, consumption and production activities.

By the end of the quarter, most major economies globally had introduced containment measures of varying stringency, most of which remain in place. As a result, labour market conditions across major economies deteriorated sharply in 1Q 2020. Jobless claims and short-time work claims in the US and Germany, respectively, rose in March beyond levels experienced during the 2008-09

Global Financial Crisis. In the US, growth moderated sharply to 0.3% from 2.3% in 4Q 2019. Private sector expenditure and imports moderated significantly, reflecting the sudden turnaround in labour market conditions, rising risk aversion, and weaker growth prospects. Nevertheless, government consumption was sustained, providing an anchor to US growth. In the euro area, where lockdown measures were introduced earlier and more widely, restrictions in operating capacity and business activities led to contractions in economic activity.

In the regional economies, growth was influenced by two factors. Firstly, containment measures, which were introduced from end-March onwards, affected both domestic supply and demand conditions in these economies. This is with the exception of Korea, which did not impose any lockdown measures[1]. Secondly, the introduction of aggressive social distancing and lockdown measures in both PR China and the major advanced economies disrupted global value chain activity and dampened external demand conditions.

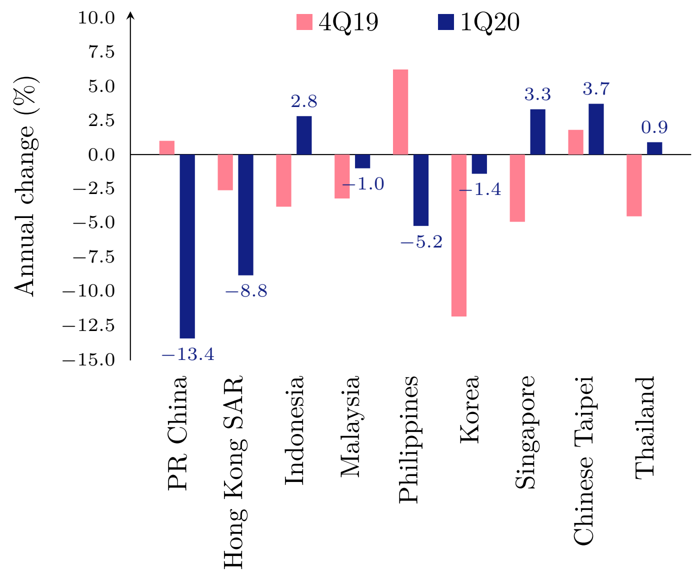
[1] Korea avoided the use of lockdown measures, despite escalating cases in Feb-20. A variety of factors enabled Korea to rely on contact tracing and targeted quarantines, including high test capacity (up to ~15,000/day), real-time surveillance technology and risk communication, easily accessible tests, as well as an adequately equipped healthcare service.

Mixed regional exports performance in the quarter

Following incipient signs of recovery in several regional economies in 4Q 2019, exports registered a mixed performance in the first quarter of 2020, with some regional economies registering marginal improvements.

Exports from Indonesia and Chinese Taipei expanded at a modest rate of 2.8% and 3.7%, respectively. In PR China, exports growth registered a sharp contraction of 13.4% in 1Q 2020, driven by both transitory production disruptions during the nationwide quarantine and the subsequent demand slowdown in major trading partners.

Chart 2: Export Growth of Selected Economies (in USD terms)



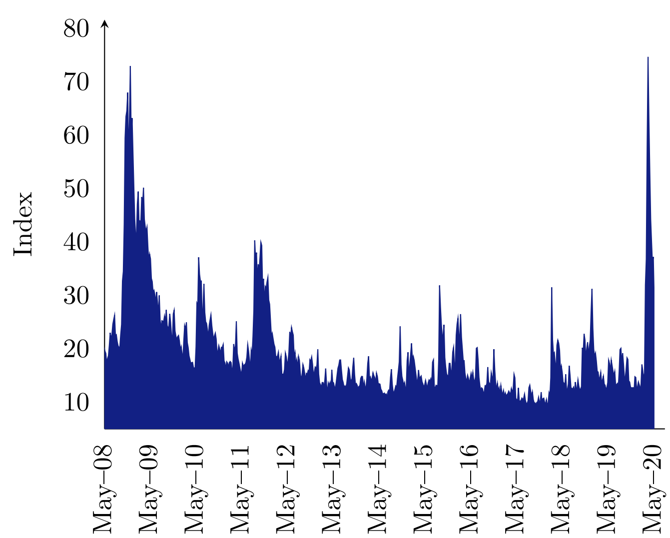
Source: National authorities

Global financial market volatility increased significantly

The escalation of the pandemic and lockdown measures resulted in weak growth prospects. Financial market volatility subsequently increased to the highest level since the 2008-09 Global Financial Crisis, weighing further on the global demand momentum. Emerging market economies (EMEs) experienced capital outflows as risk aversion rose, leading to tighter financial conditions. Global flight-to-safety behaviour led to sharp selloffs in equity markets and increased demand for sovereign bonds in major advanced economies. This was driven mainly by fears of earnings shortfalls and credit rating downgrades of some corporates.

Brent crude oil price weakened to an average of USD51 per barrel during 1Q 2020 (4Q 2019 average: USD62 per barrel), weighed by the decline in global oil demand amid the COVID-19 pandemic and concerns over the expiry of OPEC+ output cuts agreement by end-March.

Chart 3: CBOE Volatility Index (VIX)



Source: Bloomberg

Box Article

Crises and Policy: COVID-19 Truly is Different

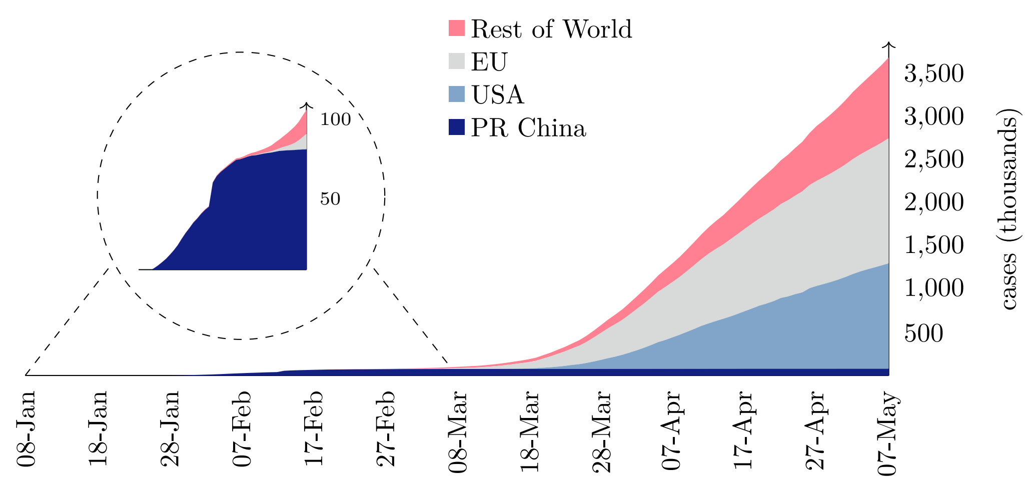
by Suah Jing Lian

Highlights

- **COVID-19 is unprecedented - a supply shock which induced a demand shock.**
- **Policy during a pandemic must prioritise incomes and ensure liquidity without compromising public health prioritised.**
- **Policies should meet three criteria - directness, timeliness, and adequacy.**

When news of the first COVID-19 outbreak in PR China broke in early January, the initial expectation was that it was temporary and most of the global economy would be insulated. Many of the initial downward revisions to global growth projections were largely well under 1 percentage point. The situation has since changed dramatically. COVID-19 is now a pandemic of unprecedented scale in this generation, infecting well over 3.6 million people as at 7 May (figure 1). Governments have mobilised resources for the healthcare sector and deployed strict containment measures such as restrictions in travel, movement and business activities to contain the pandemic. Amidst the lives lost to COVID-19, livelihoods have been significantly affected. This is a necessary, but heavy, price to pay, with the global economy now expected to enter a severe recession in 2020.

Figure 1: Cumulative confirmed COVID-19 cases by location



Source: World Health Organisation

This article addresses two main questions: Firstly, how different is the economic crisis caused by the COVID-19 pandemic? Secondly, how should economic policy respond to the ongoing crisis?

How should we view economic downturns and crises?

To address the ongoing crisis, we should first understand the cause of the downturn. Key guiding questions are: (i) what is the nature of these shocks, and (ii) what is the predicted response of output, employment, and prices? Broadly, macroeconomic shocks fall into three categories – supply, demand and financial.

1) **Supply-side shocks**

   These are driven by constraints on production, total factor productivity (TFP), input prices and the labour force. The depth and duration of the resultant economic downturn depend on whether the shock is transitory or permanent. Notable episodes include the 1973 OPEC Crisis and the recent 2014-16 Oil Price Shock. Shapiro (1987) notes that the magnitude of output, employment and price responses depends on the persistence of the shock. Growth will moderate if production or price constraints remain and will normalise when they dissipate or are relieved by policy intervention. Production and prices tend to move in opposite directions.

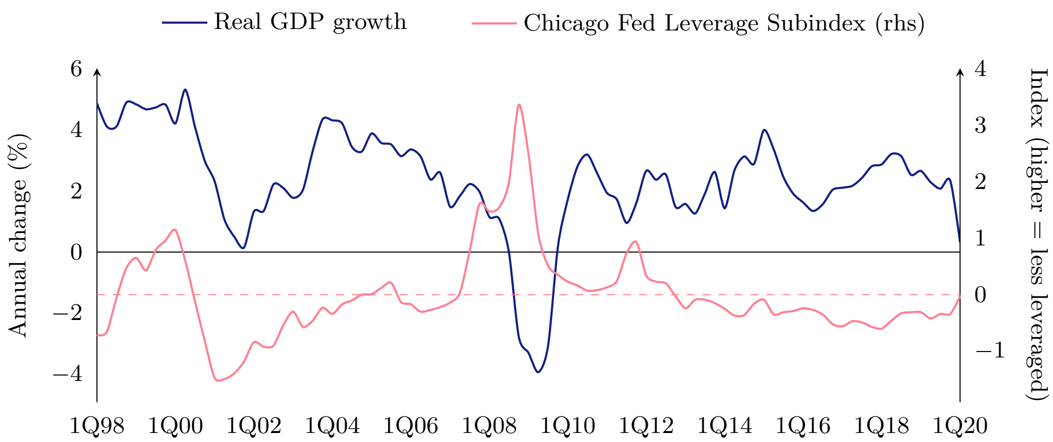
2) **Demand-driven shocks**

   These are due to changes in demand-side factors, such as economic uncertainty, risk aversion, monetary shocks, or a shift in the strength of domestic expenditure or exports. For instance, the US-PR China trade war in 2018-2019 constitutes an external demand shock for small open economies. Inflation and growth often move in the same direction in crises originating from demand shocks.

3) **Financial crises**

   Financial crises behave akin to a demand-driven crisis, except that the depth and duration of the downturn is usually larger due to the procyclical behaviour of the financial sector. Figure 2 illustrates this procyclical tendency with an indicator of leverage in the US financial sector and US real GDP growth. Leading to the 2008-09 Global Financial Crisis (GFC), rising leverage assisted the economic expansion. Loose credit conditions boosted asset prices, especially in the US housing and mortgage securities markets, which was sustained by widespread over-optimism and speculative risk-taking behaviour that became increasingly detached from economic fundamentals. As mortgage delinquencies rose amid slower household income growth, deteriorating sentiments and risk appetite led to the re-evaluation of risk asset prices. This led to the unwinding of financial imbalances that built-up prior to 2007. Growth weakened substantially and was accompanied by steep deleveraging, especially amongst banks, resulting in a credit crunch. This amplified the degree of financial tightness, loss of wealth and income and, subsequently, even weaker economic growth. Here, procyclical financial sector frictions amplified the economic downturn on a global scale. While the source of financial crises is the financial sector, its procyclicality with economic activity exerted large adverse demand effects.

Figure 2: US Leverage Index and Real GDP Growth



Source: Federal Reserve Economic Database (FRED)

Despite the separate classifications, crises can morph into one another, eventually exhibiting cross-crises features. For example, the 1980s Latin American debt crisis originated from a supply-side shock in the global oil market, which led to slower demand as monetary policy tightened to address accelerating inflation in the US, a key source of external demand for the region. Consequently, scepticisms on reserve adequacy also triggered currency runs, such as in Mexico. Therefore, it is key to monitor signs that a crisis is broadening in nature.

Why is the ongoing COVID-19 pandemic causing an economic crisis?

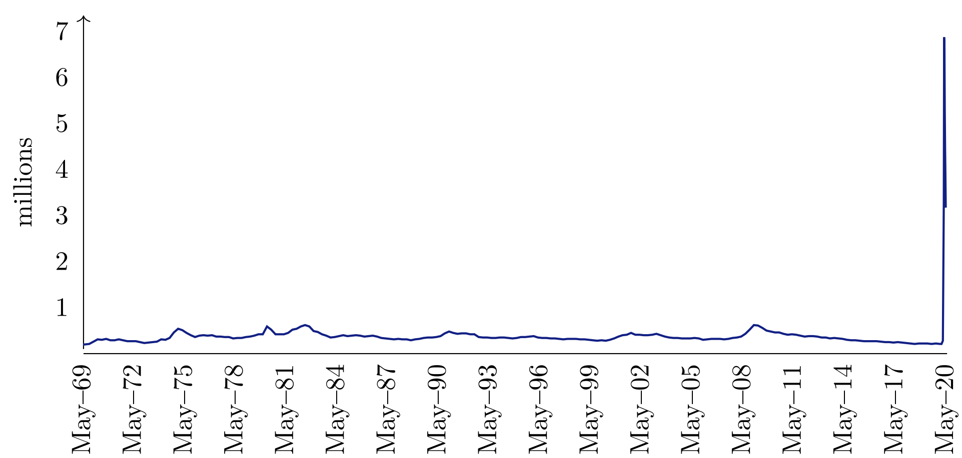
The economic crisis certainly originated as a *supply shock*; stay-at-home orders, lockdown measures and social distancing, both enforced and voluntary, have brought economic activity to a sudden stop, with production disruptions also affecting global supply chains. The supply shock subsequently triggered a large adverse *demand response*, as the decline in production caused businesses and households to sustain large income losses. In the early stages, for trade-dependent economies such as Malaysia, the pandemic constituted an adverse *external demand shock* originating from PR China. This has since broadened amid steep output contractions globally.

Figure 3: How the COVID-19 Supply Shock Induced Amplified Demand Shocks

Lockdowns & production shutdowns → Job & income losses in affected sectors → Weaker domestic demand → Job & income losses in initially unaffected sectors → Even weaker demand

In the emerging pandemic-macro literature, Guerrieri et al. (2020) describes the ongoing COVID-19 pandemic as a Keynesian Supply Shock, which is a supply-side shock that produces an amplified demand shock. Guerrieri et al. (2020) explains that while income losses initially occurred only in directly affected sectors, such as non-essential services and food and beverages segments, other sectors subsequently experienced weaker demand, such as in essential services and manufacturing, causing labour demand to weaken further (figure 3). Restrictions on business operations and movements, a typical feature of lockdown measures globally, lead to a sudden shortfall of revenue, resulting in significant cash flow deficiencies. To stay afloat, businesses inevitably retrench or furlough workers. In the US, this caused the unprecedented rise in job losses since mid-March (figure 4). Overall, a vicious cycle is created where more income is lost, further depressing overall consumer demand, and amplifying output losses.

Figure 4: Weekly Initial Jobless Claims in the US

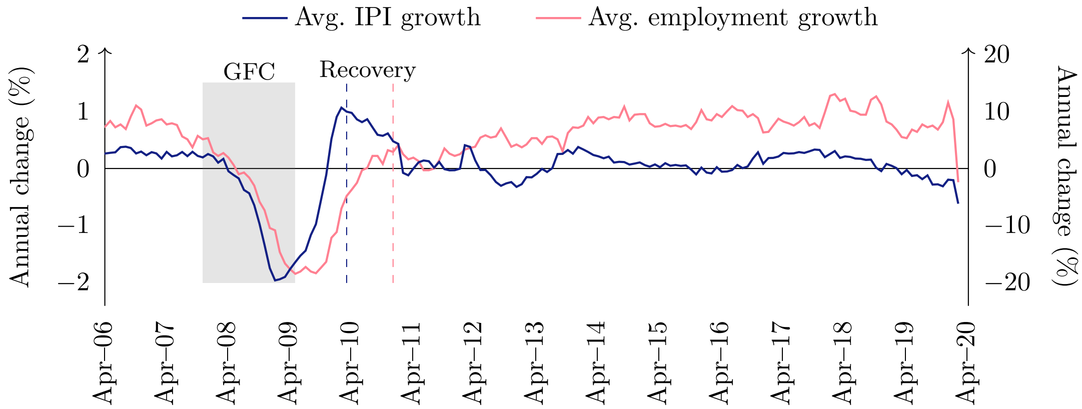


Source: Federal Reserve Economic Database

The dislocation of labour markets poses a concern for two reasons. Firstly, labour market strength anchor private sector expenditure, and subsequently overall economic growth. Weak labour markets limit the strength and pace of economic recovery. Secondly, this may lead to unemployment hysteresis, especially if people leave the labour force entirely, or if the loss of work experience result in skills mismatches. This explains Ball's (2014) finding that the OECD advanced economies affected by the GFC experienced severe potential output losses. While labour market hysteresis may stem from a transitory shock, the output losses may be permanent. This stresses the importance of appropriate and adequate policy responses in addressing labour market weaknesses during the downturn.

Additionally, labour markets recover slowly. Search and matching frictions limit the pace at which employment recovers, constraining the pace of any normalisation, a view from the literature underpinned by Mortensen and Pissarides (1994). Amongst the G4 economies, the first post-recession peak in employment growth was observed two years after the trough of the GFC, while the rebound in output growth was observed a year earlier (figure 5).

Figure 5: Average Employment and Industrial Production Growth in G4 Economies

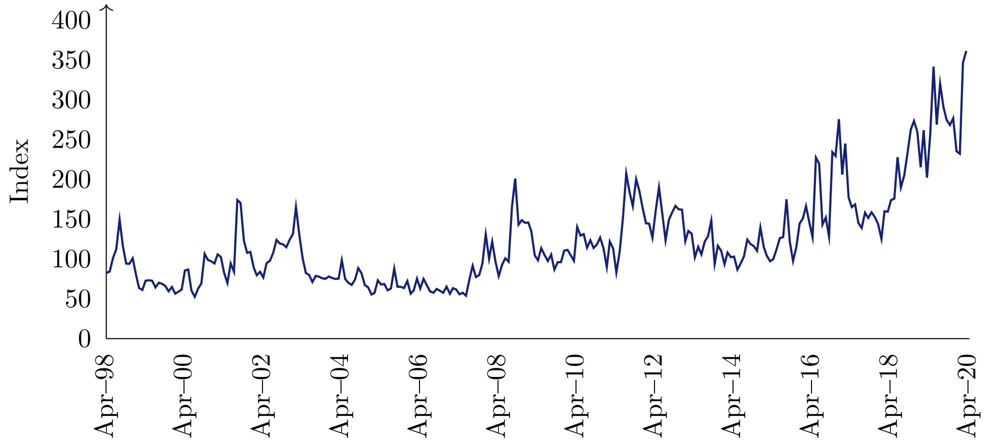


Source: CEIC, national authorities

Abstracting from labour markets, output hysteresis may also arise from business closures, driven by three factors. Firstly, firms face difficulties in immediately filling job vacancies as lockdown measures are lifted. Secondly, firms affected by cash flow mismatches and supply chain disruptions due to insolvencies or repurposing exercises may struggle to re-establish operations. Thirdly, with social distancing expected to continue even as lockdown measures are lifted, demand will be subdued. These frictions faced by firms will interact with those in the labour market, amplifying the initial shocks if left unaddressed.

The prevailing elevated levels of economic uncertainty could worsen the magnitude and pace of the recovery. Despite easing trade tensions in early January, economic policy uncertainty has returned to historical highs due to the unpredictability of the ongoing pandemic (figure 6). Baker et al. (2016) point out that repeated episodes of elevated economic uncertainty weigh on demand, further affecting prospects for an economic recovery. Additionally, Fajgelbaum et al. (2017) suggest that lower economic activity, in turn, generates an 'uncertainty trap' that persistently weighs on demand.

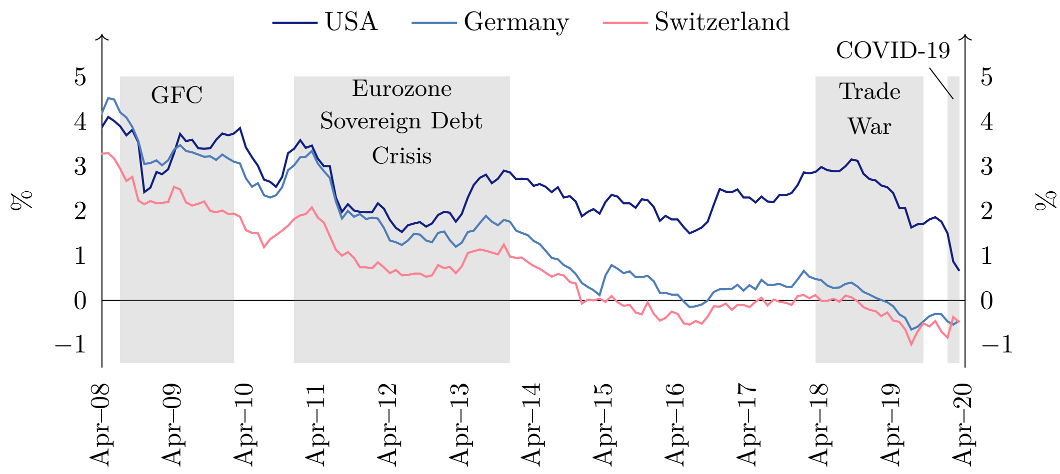
Figure 6: Global Economic Policy Uncertainty Index



Source: Baker, Bloom and David (2016), policyuncertainty.com

Sentiments also play a role as an amplifier of adverse shocks, as they tend to weaken as growth prospects become less favourable. Consumers and firms subsequently build up precautionary savings and defer consumption and investment, respectively. Where wealth losses are incurred through volatile asset price movements, expenditure may be reduced. For portfolio investors, risk aversion prompts flight-to-safety behaviour, tightening financing conditions and further amplifying the downturn. To corroborate, demand for safe-haven assets, such as long-term sovereign bonds of reserve currency economies, rises during economic crises, as reflected in dips in yields (figure 7).

Figure 7: 10-Year Government Bond Yields

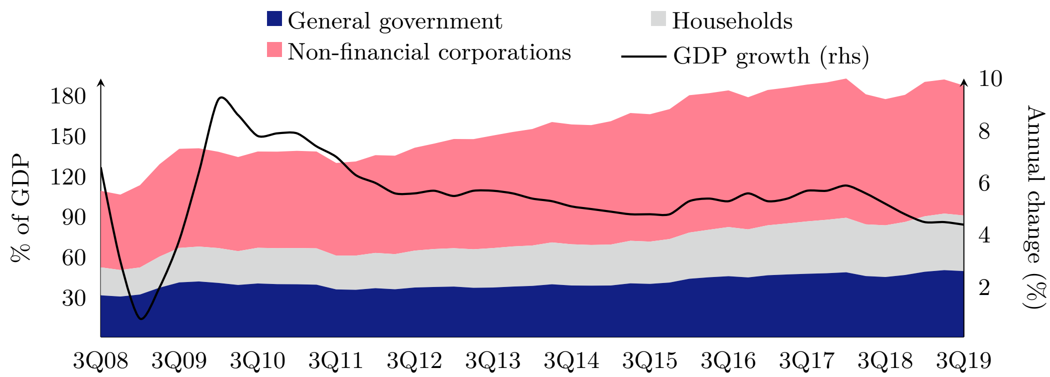


Source: CEIC, national authorities

COVID-19 is thus a temporary supply-side shock that has generated a large shortfall in demand. With significant effects on labour markets, business activity and sentiments, the recovery is likely to be weak.

Can the crisis deteriorate further?

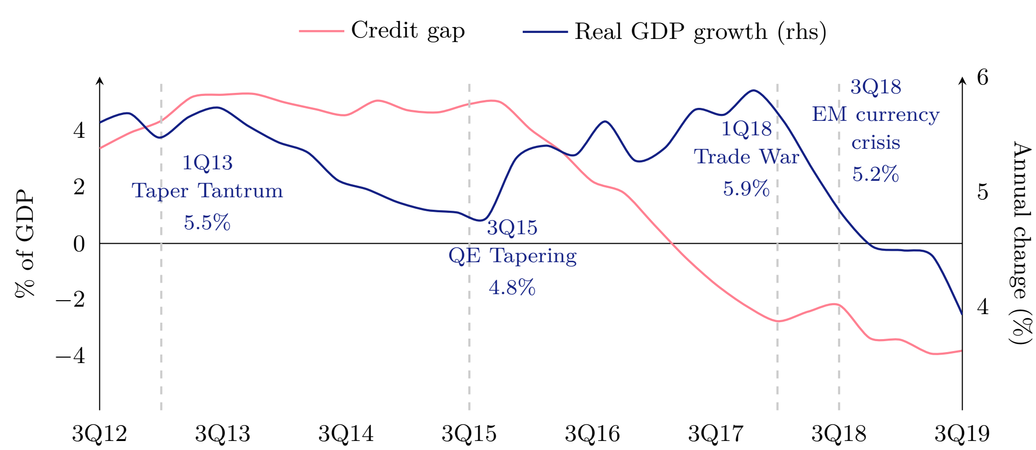
Figure 8: Credit to the Non-Financial Sector in Emerging Economies



Source: BIS

The potential unwinding of debt globally, especially in emerging economies, where there has been a steep build-up amid subdued growth since the GFC (figure 8), can worsen the ongoing crisis into becoming a financial crisis.

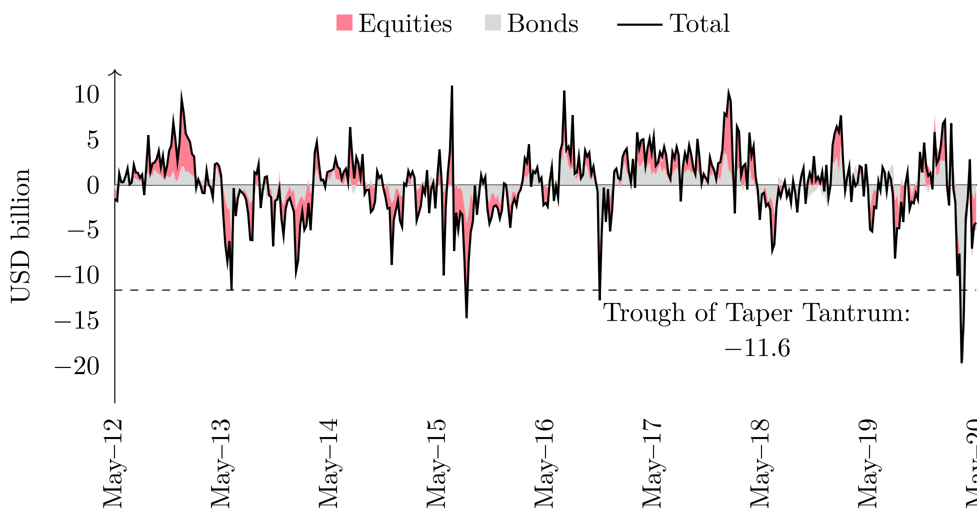
Figure 9: Real GDP Growth and Credit Gap in Emerging Economies



Source: BIS, IMF, CEIC, Haver, national authorities, BNM estimates

From a cyclical point of view, both credit and business cycles are at less favourable positions (figure 9), relative to previous episodes of downturns since the GFC. This limits the scope of some vulnerable emerging economies to withstand the shock from COVID-19. Regulatory improvements, such as the Basel III framework, partly mitigates this risk by increasing financial sector resilience since the GFC, especially amongst banking institutions. In Malaysia, this has enabled the financial sector to confront the ongoing crisis from a position of strength, with ample capital and liquidity buffers. Nevertheless, flight-to-safety behaviour can trigger sharp capital outflows and exacerbates external sector vulnerabilities in emerging economies (figure 10), thus increasing financial stability risks.

Figure 10: Net Capital Flows in Emerging Economies



Source: EPFR Global

Downturns can be limited without compromising public health priorities

Against the backdrop of the health crisis, economic policy has two roles. Firstly, it is to ensure that the pandemic is contained. Secondly, it is to support income levels without compromising on health priorities.

Achieving the first role is straightforward. Policy should lift resource constraints faced by the healthcare sector. This is broadly attained through the generous and swift provision of funding, equipment, infrastructure and human capital for healthcare services, including in Malaysia. The article will focus on the second role, which is more contentious, as it requires addressing deteriorating livelihoods without trading off health goals. To achieve this, measures must meet three criteria – **(i) directness**, **(ii) timeliness**, and **(iii) adequacy**.

1) **Directness**

Measures should address directly the immediate and binding constraint faced by households and firms – large cash flow shortages amid prevailing financial vulnerabilities. Policy responses introduced by many economies thus far have attempted to address this issue both directly, such as cash handouts and wage subsidies, and indirectly, via tax credits/deferments and loan guarantees. These measures attempt to minimise income losses and preserve cost conditions for firms and households, in the absence of work and production. Importantly, direct cash transfers to individuals or businesses alleviate immediate liquidity constraints. They decouple production and business activities from income flows, hence avoiding conflict with public health efforts to flatten the epidemic curve.

To prevent escalating into a financial crisis, policy also directly addressed balance sheet strains in the financial sector. Supervisory authorities and central banks have broadly encouraged the use of countercyclical capital and conservation buffers, beyond interest rate cuts and liquidity injections. The relaxation of macroprudential policies have also been pursued to support the economy. Additionally, central banks and governments have extended broad and targeted loan guarantees, and credit lines, to prevent credit crunches at the firm-level, which could generate adverse spillovers into financial institutions.

2) **Timeliness**

There is a limited duration before people are overwhelmed by financing and expenditure needs amid a loss of income. Policy must quickly ease liquidity constraints faced by households and businesses to avert insolvencies and, consequently, job losses. Timely policy requires data and some automaticity. One way to ascertain this is through fast-moving coincident indicators that unambiguously indicates if the economy is in a recession. The Federal Reserve's Sahm Rule is one such indicator. Sahm (2019) suggest the direct linking of the indicator to the release of large-scale direct stimulus, while Chodorow-Reich and Coglianese (2019) suggests the automatic extension of unemployment insurance by liberalising eligibility and financing during times of economic distress. Haughwout (2019) further recommends the automatic kickstart of public infrastructure projects, as and when the economy is believed to have entered a recession. While recessions are often defined in terms of GDP, such measurables carry considerable lag, hence resulting in delayed diagnosis of economic conditions.

Early detection of the recession allows for more effective measures, and hence limiting more significantly the economic fallout, in the form of elevated bankruptcies, sharp rise in job losses and the likelihood of a permanent increase in unemployment.

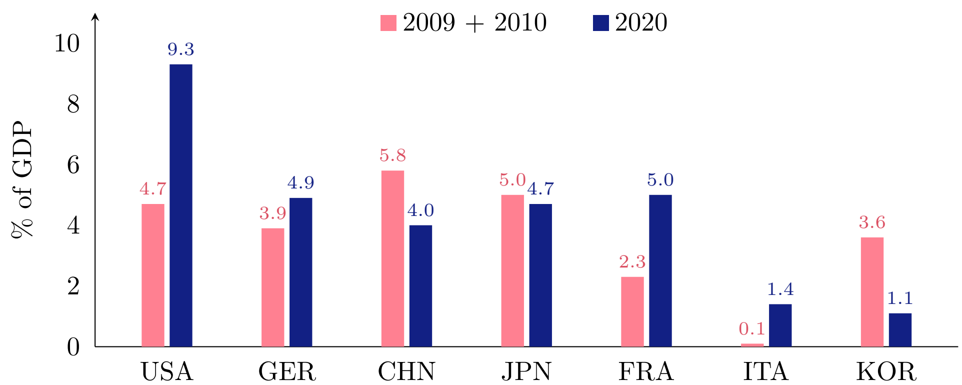
This highlights the importance of timely interventions. Coordinated and swift monetary policy actions eased financial market conditions, especially in emerging markets. US Dollar swap lines were offered by the Federal Reserve to central banks of major emerging markets, including Brazil and Mexico, and selected regional economies. This partially offsets the shortage of US dollar and limited the degree of sharp and sudden tightening of financial conditions, thus preventing the ongoing crisis from becoming a financial crisis.

3) **Adequacy**

The magnitude of the policy response must be adequate, corresponding to the unprecedented nature of the economic crisis caused by the COVID-19 pandemic.

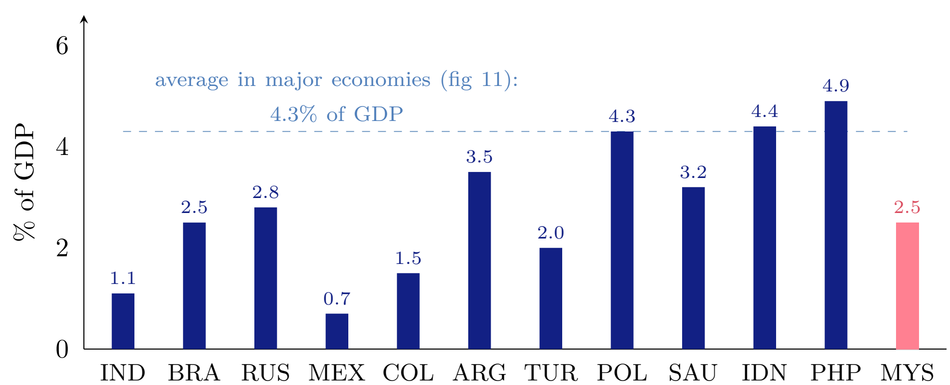
Abstracting from economics, as we view COVID-19 from a humanitarian standpoint, stimulus is about maintaining livelihoods and keeping people dignified during a challenging period. Guerrieri et al. (2020) suggests that even though policy stimulus has rightfully a reduced impact on growth, as continued social distancing and containment restricts economic activity, it is still the appropriate response. By providing ample assistance to vulnerable groups in the economy, the core aim of sustaining well-being in a humane manner can be achieved.

Figure 11: Crisis-Related Fiscal Stimuli in Major Economies (as of 6 May 2020)



Source: National authorities

Figure 12: Crisis-Related Fiscal Stimuli in Emerging Economies (as of 6 May 2020)



Source: National authorities, IMF, and BNM estimates

In response to the significant shortfall in economic activity, major economies have introduced large fiscal and monetary policy responses. Figure 11 summarises the magnitude of the fiscal measures, benchmarked against the 2008-09 GFC. Table 1 shows the monetary policy measures, both policy rate cuts and quantitative easing as at 6 May 2020. Within the first months of the pandemic, fiscal and monetary policy responses have exceeded levels in the GFC, especially in the US and Japan. Additionally, figure 12 shows the fiscal stimulus sizes of select emerging economies, benchmarked against the average of several major and regional advanced economies.

Table 1: Monetary Policy Responses of Selected Economies (as of 6 May 2020)

	Cut to Policy Rate (basis pts)		**Quantitative Easing** (LCY bil)	
	GFC	2020	GFC	2020
USA	425	150	1,750	unlimited
EUR	325	0	60	870
GBR	475	65	200	200
JPN	45	0	6,000	25,180
KOR	325	50	-	10,000
IND	525	75	-	2,000
ZAF	650	100	-	unspecified
CHL	775	125	-	6,600
MYS	150	100	-	-

From a financial sector perspective, maintaining ample access to liquidity is vital during crises, where deleveraging and risk aversion are elevated, to prevent self-fulfilling banking sector, debt and currency crises. Central banks and supervisory authorities have enabled banks to draw on prudential buffers to provide countercyclical response to the ongoing crisis. Securing financial sector stability not only limits the economic fallout, but also enables a sustained recovery by ensuring strong financial intermediation during and after the crisis.

Malaysia's policy responses have met these criteria

Policies have been centred on alleviating cash flow challenges faced by firms and households since the onset of the COVID-19 pandemic, fulfilling the directness criterion. In end-February, prior to the global escalation, direct transfers and credit guarantees were introduced for affected sectors, mainly the tourism-related industries. In March and April, widespread direct transfers, the loan moratorium and special credit lines, such as the BNM Special Relief Facility, recognised that directness in addressing liquidity needs of households and firms was critical.

Additionally, the swift operationalisation of measures was responsive to global and domestic economic developments, which had deteriorated significantly since mid-March. Notably, with extensions of the Movement Control Order (MCO), sizeable relief for SMEs and households were announced incrementally, commensurate with the degree of disruption in economic activity. From the monetary and financial policy fronts, the Overnight Policy Rate (OPR) and Statutory Reserve Requirements (SRR) were lowered, while allowing banks to draw on prudential buffers, in advance of the full escalation of COVID-19.

To limit the economic fallout without compromising public health goals, sizeable economic assistance was provided. Recognising the severity of the economic fallout if left insufficiently addressed, Malaysia's stimulus package ranks as one of the largest across emerging economies and the region, totalling 17% of GDP accounting for both direct and indirect measures. Broad-based monetary easing further bolstered financial stability, enabling a smooth recovery as the pandemic dissipates. Indeed, during a truly different crisis without historical precedence, the economic response has been equally unprecedented, in line with the urgency exemplified by these criteria.

Conclusion

This article contextualises the economic nature of the public health crisis caused by the COVID-19 pandemic. It is an unprecedented supply-side shock that prompted an amplified demand response. We analysed the global fiscal, monetary and financial policy responses. We noted that the policy priority during COVID-19 is to view the economy from a humanitarian standpoint – to sustain livelihoods and keeping liquidity needs met without compromising public health priorities. For this aim, the article identified three characteristics in which policy considerations should meet – directness, timeliness, and adequacy.

COVID-19 truly is different – an unprecedented health crisis, that has generated a paradigm-shifting economic crisis. As such, the economic front, reflective of the downturn, requires policy responses of a similarly unprecedented nature.

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Developments in the Malaysian Economy

Highlights

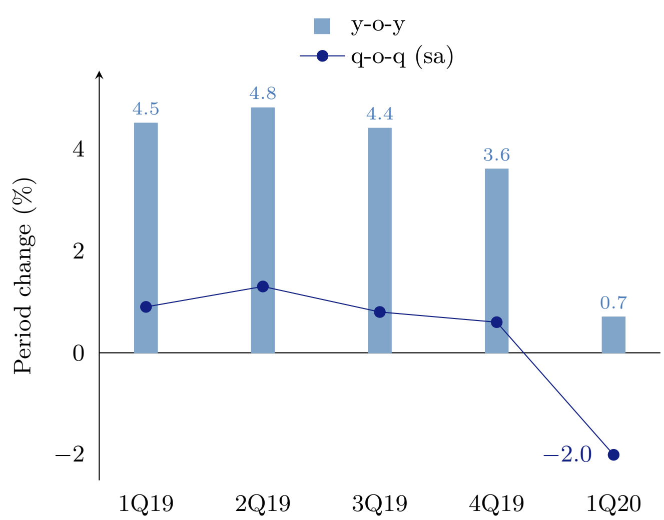
- **The Malaysian economy moderated sharply to 0.7% in the first quarter.**
- **Headline and core inflation remained modest at 0.9% and 1.3%.**
- **Current account surplus amounted to RM9.5 billion (2.6% of GDP).**

The Malaysian economy registered a lower growth of 0.7% in the first quarter of 2020

At 0.7%, this was the lowest growth since 3Q 2009 (-1.1%), reflecting the early impact of measures taken both globally and domestically to contain the spread of the COVID-19 pandemic, including the introduction of the Movement Control Order (MCO) in Malaysia. On the supply side, the services and manufacturing sectors moderated, while the other sectors contracted. From the expenditure side, domestic demand moderated, while exports of goods and services recorded a sharper decline. On a quarter-on-quarter seasonally-adjusted basis, the economy declined by 2.0% (4Q 2019: 0.6%).

Following two months of steady expansion, economic activity experienced a sharp downshift in March as a result of MCO (18 – 31 March). This was evidenced by the decline in the Industrial Production Index and Index of Wholesale and Retail Trade which recorded an average growth of 3.4% and 5.5%, respectively, in January-February before contracting to -4.9% and -6.1% in March (1Q 2020: 0.4% and 1.5% respectively). The MCO comprised government closure of schools, universities

Chart 4: Real GDP Growth



Source: Department of Statistics, Malaysia

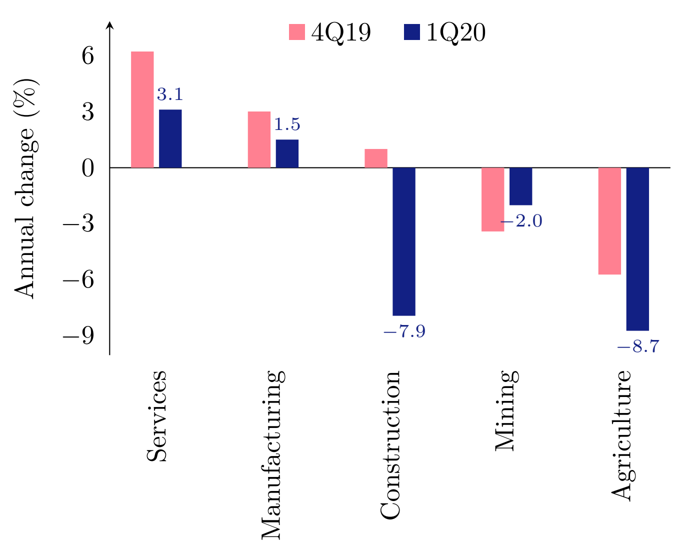
and non-essential services, border closures and restrictions on public movement, work and operating hours, as well as mandatory social distancing and personal protection measures. Essential services include telecommunications, finance, production and the provision of food supplies, healthcare, utilities, E&E, as well as selected industries in the primary and consumer clusters in the manufacturing sector. Sectors which were more labour intensive and require face-to-face interaction were more impacted by the MCO. In particular, construction activity was completely prohibited during the MCO phase. In contrast, the production capacity in industries which were more capital intensive, such as mining and the E&E manufacturing sub-sector, were affected to a lesser extent. The MCO also led to weaker private sector activity given mobility restrictions, closures of non-essential services, such as retail sub-sectors, and a temporary halt in ongoing investments.

Growth moderated sharply across major economic sectors weighed by the MCO in March and prevailing commodity supply disruptions

The services sector moderated to 3.1% in 1Q 2020 (4Q 2019: 6.2%), the slowest growth since 2Q 2009. The sector was affected by the COVID-19 pandemic, particularly the tourism-related and non-food retail subsectors. The implementation of the MCO substantially affected business activity, tourism and consumer spending. This led to a sharp slowdown in the wholesale and retail trade, as well as food and beverages and accommodation sub-sectors. International and domestic travel restrictions significantly impacted the transport and storage sub-sector, with passenger air travel in particular, grinding almost to a complete halt during the MCO. Growth in the finance and insurance subsector was supported by sustained financing and higher net insurance premium. Meanwhile, continued demand for data communication services during the

Slower growth in the services and manufacturing sectors, while other sectors contracted

Chart 5: Growth by Economic Sectors



Source: Department of Statistics, Malaysia

MCO period contributed to the growth in the information and communication sub-sector.

The manufacturing sector moderated further to 1.5% (4Q 2019: 3.0%). The lockdown in PR China to contain the pandemic disrupted the global supply chain for a broad range of products including electrical and electronics (E&E) and transport equipment. This resulted in a shortage of intermediate input for some domestic industries. Nevertheless, the impact was mitigated through a drawdown of inventory, which largely sustained domestic production activities. Manufacturing activity was however impacted by the imposition of the MCO. While the production of essential items and its supply chain were allowed to operate, it did so at significantly reduced capacity due to the 50% cap on labour utilisation to ensure sufficient social distancing at workplaces.

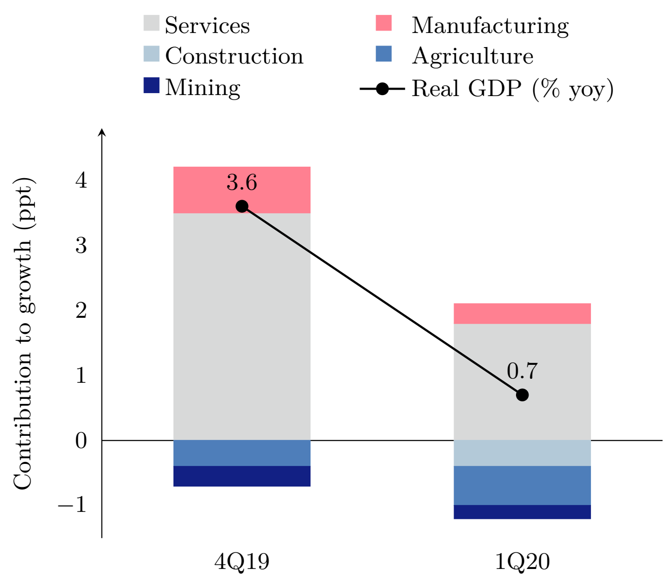
Growth in the mining sector remained in contraction (-2.0%; 4Q 2019: -3.4%), as crude oil and natural gas production was weighed by ongoing maintenance works and the gas pipeline incident in East Malaysia.

The agriculture sector contracted further (−8.7%; 4Q 2019: −5.7%). Oil palm production continued to be weighed by the lingering effects of the severe dry weather conditions and cutbacks in fertiliser applications experienced in the early part of 2019. This was further affected by the MCO, which led to lower production across most agriculture sub-sectors.

The construction sector declined by 7.9% during the quarter (4Q 2019: +1.0%), reflecting mainly the halt in activities during the MCO. This had more than offset the progress in the large transportation projects and activities in the affordable housing segments during the early part of the quarter.

Services and manufacturing sectors remained key drivers of growth

Chart 6: Contributions to Real GDP by Economic Sector



Source: Department of Statistics, Malaysia

Domestic demand was affected by lower investment activity

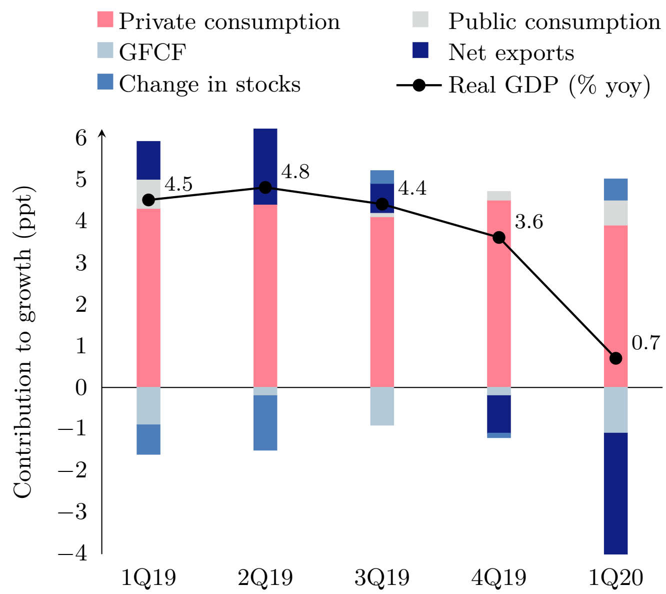
Domestic demand registered a modest growth of 3.7% in the first quarter (4Q 2019: 4.8%), due mainly to weaker capital spending by both the private and public sectors. The subdued investment activity was mainly attributable to the containment measures undertaken by authorities both globally and domestically. Domestic demand was also affected by weaker consumer sentiments and business confidence, given the heightened uncertainty surrounding COVID-19. In addition, net exports performance was also a large drag to growth during the quarter. Nonetheless, growth was supported by continued expansion in private and public consumption.

During the quarter, private consumption growth moderated to 6.7% (4Q 2019: 8.1%). In January and February, retail and financing data indicated continued strength in consumption spending growth. The MCO in the second half of March affected spending to some extent, but mainly for big-ticket and leisure-related items such as car purchases and recreational services. Amid soft labour market conditions, stimulus measures such as bringing forward the Bantuan Sara Hidup disbursement from the second quarter to March, and the cut in the Overnight Policy Rate (OPR) particularly in January provided important support to spending. The availability of online delivery platforms also cushioned the impact of movement restrictions.

Public consumption expanded at a faster pace of 5.0% (4Q 2019: 1.3%), supported by higher spending on both emoluments and supplies and services.

Moderate growth due to subdued domestic demand and decline in external sector

Chart 7: Contribution of Expenditure Components to Real GDP Growth



Source: Department of Statistics, Malaysia

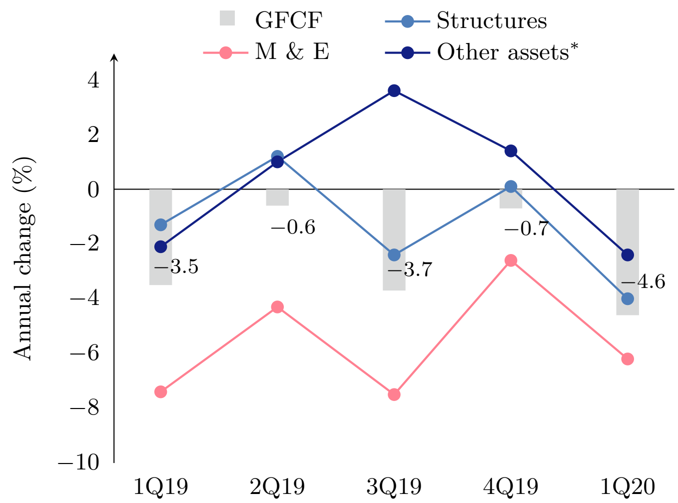
Gross fixed capital formation (GFCF) registered a larger contraction of 4.6% (4Q 2019: -0.7%), weighed by lower capital spending from both the private and public sectors. This reflected weaker global demand conditions and disruptions to supply chains, which led to slower progress in capital spending. Furthermore, ongoing investment projects were temporarily halted during the MCO. By type of assets, the weakness was broad-based, as investment in structures as well as machinery and equipment (M&E) declined by 4.0% (4Q 2019: 0.1%) and 6.2% (4Q 2019: -2.6%), respectively.

Private investment growth registered its first contraction since the fourth quarter of 2010 (1Q 2020: -2.3%; 4Q 2019: 4.3%), as subdued external conditions and heightened uncertainty affected business sentiments and investment intentions. In addition, the MCO had resulted in some disruption to ongoing construction projects and delivery of M&E.

Public investment recorded a larger decline of 11.3% (4Q 2019: -8.0%). This was due to a larger contraction in capital spending by both general government and public corporations during the quarter.

Larger contraction in gross fixed capital formation

Chart 8: GFCF Growth by Type of Assets



*Other assets include mineral exploration, research & development and capitalised planting

Source: Department of Statistics, Malaysia

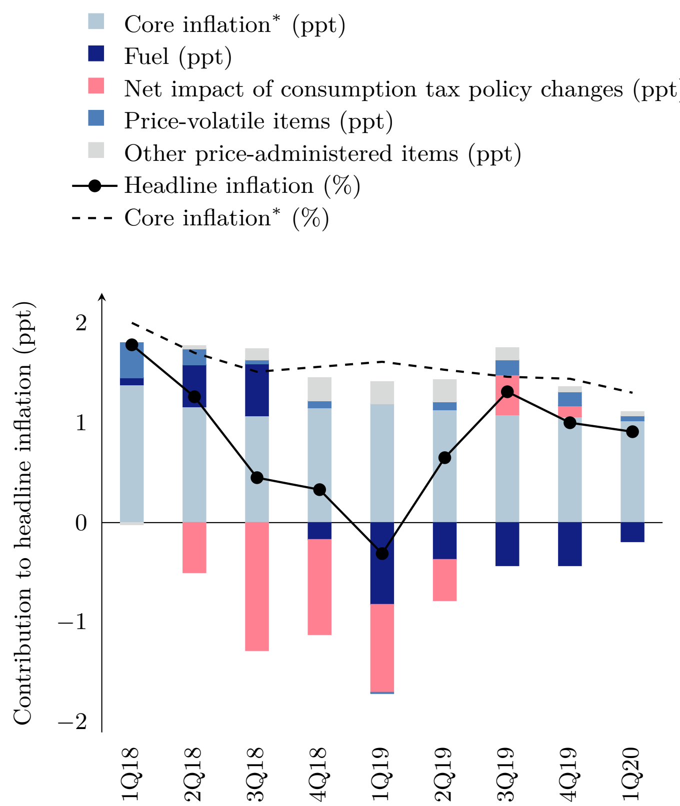
Headline inflation remained modest during the quarter

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), remained modest at 0.9% in 1Q 2020 (4Q 2019: 1.0%). The lapse in the remaining impact from the Sales and Services Tax (SST) implementation and lower price-volatile inflation (e.g. fresh food items) during the quarter was mostly offset by the smaller negative contribution from fuel inflation.

In terms of the monthly trajectory, headline inflation increased to 1.6% in January 2020 reflecting the low base effect from fuel prices last year. By March, however, headline inflation turned negative at -0.2% as fuel inflation declined significantly amid lower global oil prices. Nevertheless, the decline in inflation was not broad-based as the percentage of CPI items displaying month-on-month price declines remained broadly stable during the month (March: 22%, February: 20%, January: 23%).

Core inflation moderated slightly to 1.3% (4Q 2019: 1.4%), remaining below its historical average amid incipient signs of moderating demand pressure and soft labour market conditions.

Chart 9: Contribution to Headline Inflation by Components



*Core inflation is computed by excluding price-volatile and price-administered items. It also excludes the estimated direct impact of consumption tax policy changes

Source: Department of Statistics Malaysia and Bank Negara Malaysia estimates

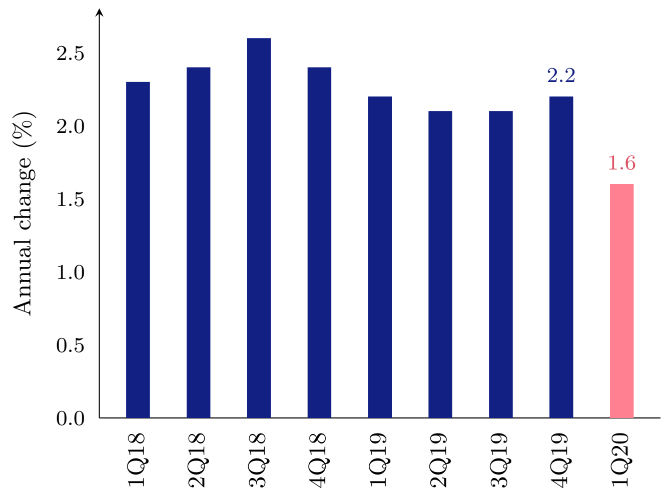
Soft labour market conditions

Labour market conditions softened in the first quarter of the year. During the first two months of the quarter, employment growth was sustained at 2.1%, while the unemployment rate remained stable at 3.3%. However, labour market conditions worsened in March mainly due to the weakness in tourism-related industries. The introduction of MCO affected employment growth in the last two weeks of March. For the quarter, employment growth moderated to 1.6% (4Q 2019: 2.2%). The unemployment rate rose to 3.5% in the first quarter (4Q 2019: 3.2%).

Private sector wage growth moderated to 2.1% (4Q 2019: 4.3%), due to slower wage growth in both the services and manufacturing sectors. Private services wage growth slowed to 1.4% (4Q 2019: 4.2%), driven mainly by tourism-related services, such as wholesale and retail trade, food and beverage, and accommodation (1.9%; 4Q 2019: 3.9%) as well as transportation and storage (-3.5%; 4Q 2019: +2.8%) sub-sectors. In the manufacturing sector, wages grew by 3.4% (4Q 2019: 4.4%). This was mainly due to lower wage growth in the E&E sub-sector (4.1%; 4Q 2019: +5.1%) amid more moderate growth in the E&E segment. Wage growth in the transport equipment and other manufacturing sub-sector also slowed (1.3%; 4Q 2019: +5.1%), mainly arising from a decline in wages in the motor vehicles, trailers and semi-trailers sub-category.

Employment growth slowed

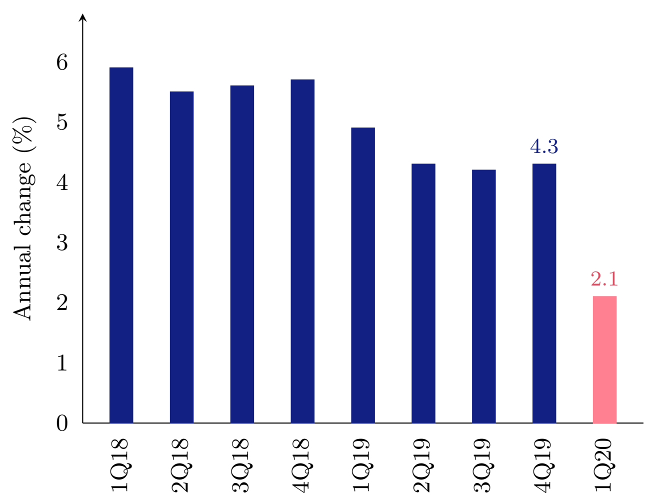
Chart 10: Employment Growth



Source: Department of Statistics, Malaysia

Moderation in private sector wages

Chart 11: Private Sector Wage Growth*



*Private sector wages are derived from the salaries and wages data published in the Monthly Manufacturing Statistics and Quarterly Services Statistics by the Department of Statistics, Malaysia. They cover 62.9% of total employment.

Source: Department of Statistics, Malaysia

Positive growth in trade activity

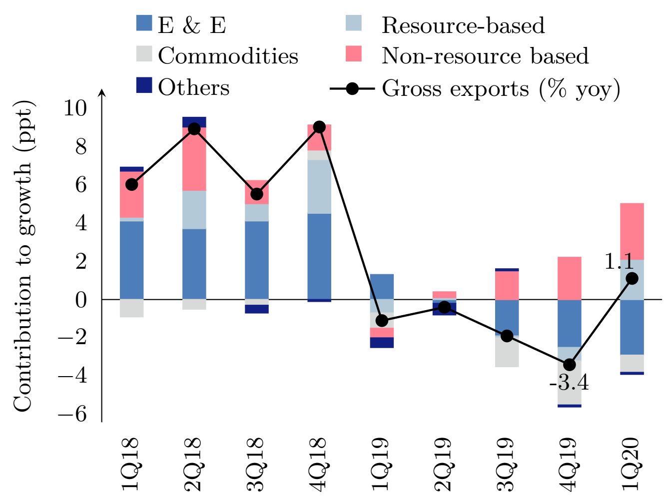
In the first quarter of 2020, gross exports registered positive growth of 1.1% (4Q 2019: -3.4%) supported by higher manufactured exports. Gross imports recorded a positive turnaround of 1.3% (4Q 2019: -3.9%), due to higher intermediate goods imports. The trade surplus[2] widened to RM37.0 billion (4Q 2019: RM36.4 billion).

The supply chain disruptions arising from PR China's nationwide factory closures in February 2020 was partially mitigated by firms' inventory buffers. Nonetheless, the imposition of MCO (18 March – 31 March 2020) adversely affected export performance in March. Manufactured exports grew by 2.5% (4Q 2019: -1.2%) supported by higher growth in resource-based and non-resource based exports, which more than offset the larger contraction in E&E exports. Non-E&E exports rose by 11.2% (4Q 2019: 3.4%) supported by higher exports of petroleum products, iron & steel and rubber products. E&E exports recorded a larger contraction (-7.6%; 4Q 2019: -6.5%) amid lower exports to regional trade partners, including PR China, Thailand and Hong Kong SAR. Commodities exports declined at a slower pace (-5.6%; 4Q 2019: -14.3%) following higher palm oil exports and smaller contraction in mining products.

Intermediate imports grew by 8.1% (4Q 2019: 1.0%) due to higher imports of food & beverages and fuel & lubricants. Capital imports declined further (-26.8%; 4Q 2019: -8.9%) amid weak investment activity. This was reflected in a larger contraction in imports of machinery and transport equipment.

Higher manufactured exports supported growth

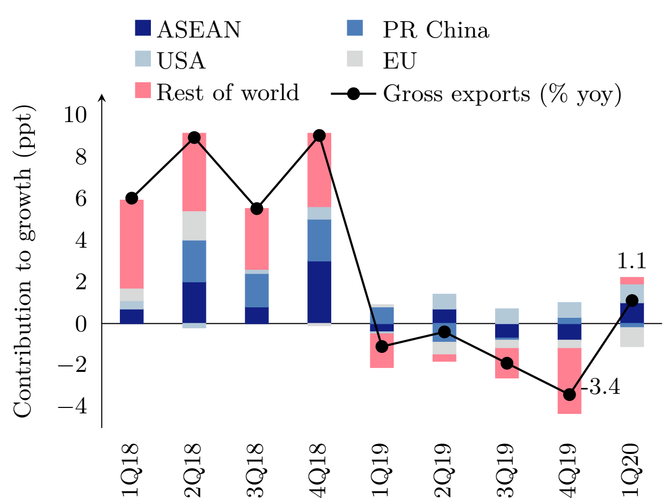
Chart 12: Gross Exports by Products



Source: Department of Statistics, Malaysia

Higher demand from the US and ASEAN economies

Chart 13: Gross Exports by Market



Source: Department of Statistics, Malaysia

[2] The difference between the goods and trade surpluses arises from the exclusion of goods for processing, storage and distribution in the goods accounts as per the 6th Edition of the Balance of Payments and International Investment Position Manual (BPM6) by the IMF.

Higher current account surplus

The current account surplus of the balance of payments widened to RM9.5 billion or 2.6% of GDP in the first quarter of 2020 (4Q 2019: RM7.5 billion or 1.9% of GDP), as the smaller primary income deficit more than offset the smaller goods surplus and larger services deficit.

As the decline in the level of exports outpaced that of imports, the goods surplus decreased to RM28.9 billion (4Q 2019: RM32.3 billion).

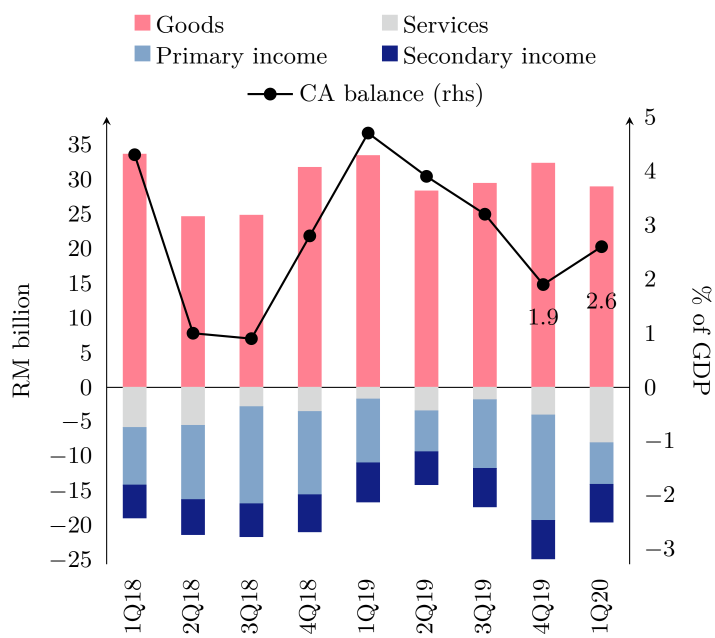
In the services account, the deficit widened to RM8.0 billion (4Q 2019: -RM4.0 billion). This was due primarily to the decline in the travel surplus to RM2.1 billion (4Q 2019: RM6.4 billion) following lower tourist arrivals amid travel restrictions and aversion arising from the COVID-19 pandemic, coupled with lower average spending per tourist.

The primary income account deficit declined sharply to RM6.0 billion (4Q 2019: -RM15.2 billion). This mainly reflected lower income accrued to foreign investors in Malaysia, particularly in the finance & insurance, and manufacturing sectors.

The deficit in the secondary income account was sustained at RM5.4 billion (4Q 2019: −RM5.5 billion), reflecting continued outward remittances by foreign workers.

Lower primary income deficit contributed to larger current account surplus

Chart 14: Current Account Balance



Source: Department of Statistics, Malaysia

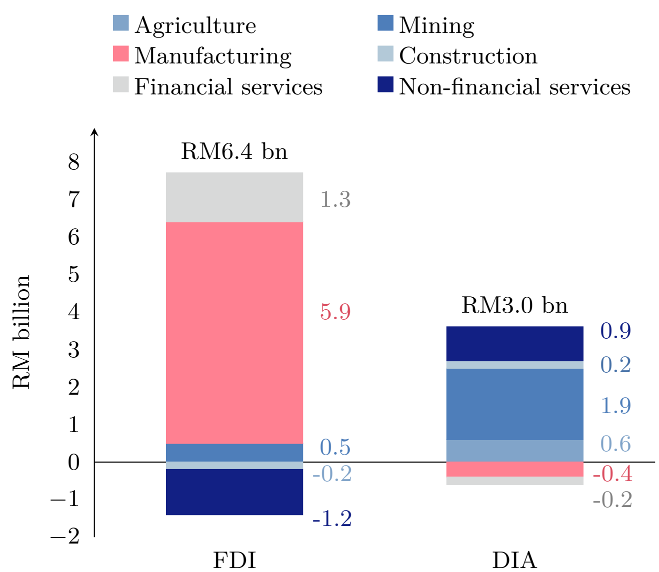
Financial account registered a net outflow

The financial account registered a net outflow of RM13.3 billion (4Q 2019: -RM0.1 billion), due to higher net portfolio investment outflows amid net inflows in other investment and direct investment accounts.

The direct investment account registered a net inflow of RM3.4 billion (4Q 2019: +RM4.4 billion). During the quarter, foreign direct investment (FDI) registered a higher net inflow of RM6.4 billion (4Q 2019: +RM5.4 billion) and benefitted mainly the manufacturing and financial services sectors. Direct investment abroad (DIA) by Malaysian companies registered a higher net outflow of RM3.0 billion (4Q 2019: -RM1.1 billion). The outflows were mainly channelled into the mining sector, followed by the non-financial services sector, particularly the information and communication subsector.

Net inflow in the direct investment account

Chart 15: Net Direct Investment Flows by Sector



Note: For DIA, positive values refer to net outflows while negative values refer to net inflows.
Figures may not add up due to rounding

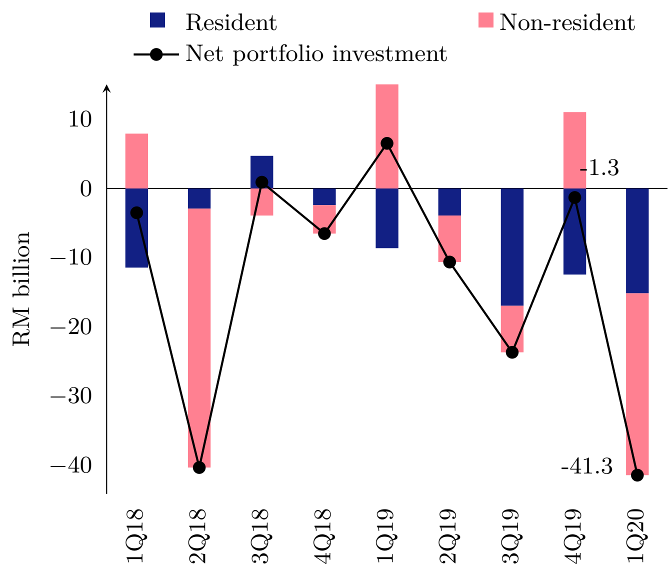
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The portfolio investment account registered a significant net outflow of RM41.3 billion (4Q 2019: -RM1.3 billion), following higher outflows from both non-resident and resident investors. Non-residents' portfolio investments recorded a net outflow of RM26.2 billion (4Q 2019: +RM11.0 billion), of which, RM6.9 billion and RM19.3 billion were from equity and debt securities, respectively. This reflected significant global uncertainties surrounding the impact of the COVID-19 pandemic as well as outflows following the maturity of a tranche of Malaysian Government Securities (MGS). Portfolio investment by residents recorded a net outflow of RM15.1 billion (4Q 2019: -RM12.4 billion).

Other investment account recorded a higher net inflow of RM22.1 billion (4Q 2019: -RM2.5 billion). This reflected mainly placements of interbank deposits in the domestic banking sector, and some net liquidation of interbank deposits previously placed abroad by domestic banks. Net errors and omissions amounted to -RM4.7 billion during the quarter, or -1.1% of total trade.

Net outflow in portfolio investment account attributable to both resident and non-resident investors

Chart 16: Portfolio Investments



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Manageable external debt

Malaysia's external debt stood at RM975.9 billion, or 64.4% of GDP as at end-March 2020 (end-December 2019: RM945.4 billion or 62.6% of GDP). The increase largely reflected valuation effects following the weaker ringgit against selected major and regional foreign currencies in the first quarter of 2020 and higher interbank borrowings. This was partly offset by lower non-resident (NR) holdings of domestic debt securities and net repayment of bonds and notes.

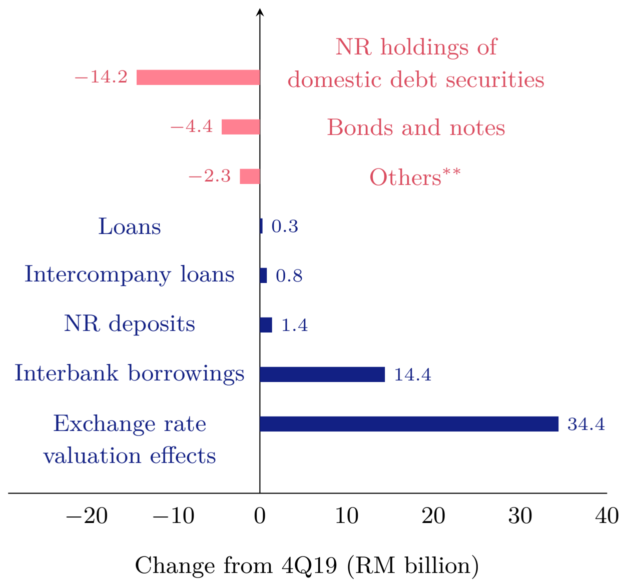
Malaysia's external debt remains manageable, given its currency and maturity profiles. Close to one-third of external debt was denominated in ringgit (30.4%; end-December 2019: 32.8%), mainly in the form of NR holdings of domestic debt securities (62.9% share of ringgit-denominated external debt) and NR ringgit deposits (19.4% share) in domestic banking institutions. These liabilities were not subject to valuation changes that may arise from fluctuations in the ringgit exchange rate.

The remaining external debt of RM679.1 billion, or 69.6% of total external debt was denominated in foreign currency (FCY). The corporate sector accounted for close to half of FCY-denominated external debt and were largely subject to prudential and hedging requirements. Long-term bonds and notes issued offshore, accounting for 23.6% of total FCY-denominated external debt, stood at RM160.0 billion as at end-March 2020. These were mainly by non-financial corporations and channelled primarily to finance asset acquisitions abroad. Intercompany loans, amounting to RM95.2 billion or 14.0% of FCY denominated external debt, were typically on flexible and concessionary terms.

Higher external debt in 1Q 2020

Chart 17: Changes in External Debt

Net change*: + RM30.5 billion



*Changes in individual debt instruments exclude exchange rate valuation effects

**Comprises trade credits, IMF allocations of SDRs and other debt liabilities

Note: NR refers to non-residents
Figures may not add up due to rounding

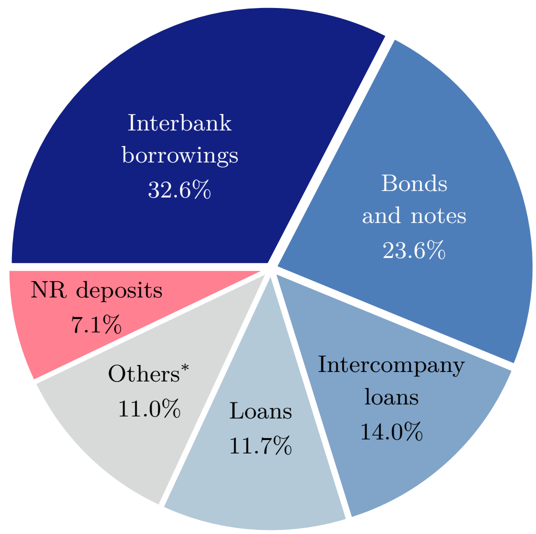
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Interbank borrowings and FCY deposits in the domestic banking system accounted for 39.8% (or RM270.1 billion) of FCY-denominated external debt. The higher interbank borrowings during the first quarter was largely driven by domestic banking groups managing their group-wide liquidity needs. Higher placements from the parent banks of locally-incorporated foreign banks to fund domestic FCY loans and short-term investment activities were also observed. About three quarters of these transactions continued to be in the form of intragroup borrowings, which were generally more stable, thereby limiting rollover risks faced by banks. Meanwhile, foreign-currency risk, measured in terms of the net open position of FCY-denominated exposures[3], remained low at 4.0% of banks' total capital.

From a maturity perspective, 56.8% of the total external debt was skewed towards medium- to long-term tenure (end-December 2019: 58.6%), suggesting limited rollover risk. Short-term external debt accounted for the remaining 43.2% of external debt. Of these, 43.6% were intragroup borrowings among banks and corporations, which were generally stable and on concessionary terms. About another 11.4% were accounted by trade credits, largely backed by export earnings. As at 30 April 2020, international reserves stood at USD102.5 billion, sufficient to finance 7.9 months of retained imports, and is 1.1 times the short-term external debt.

FCY-denominated debt subject to prudent liquidity management practices and hedging requirements

Chart 18: Breakdown of Foreign Currency-Denominated External Debt (% share)



*Includes trade credits and miscellaneous, such as insurance claims yet to be disbursed and interest payables on bonds and notes

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

[3] Refers to the aggregated sum of the net short or long foreign currency positions for all currencies across banks.

Monetary and Financial Developments

Highlights

- **Substantial non-resident portfolio outflows amid heightened risk aversion, reflecting uncertainties surrounding the impact of the COVID-19 pandemic.**
- **Weak investor sentiments and increased demand for safe haven assets caused non-resident portfolio outflows from the domestic equity and bond markets, and depreciation of ringgit.**

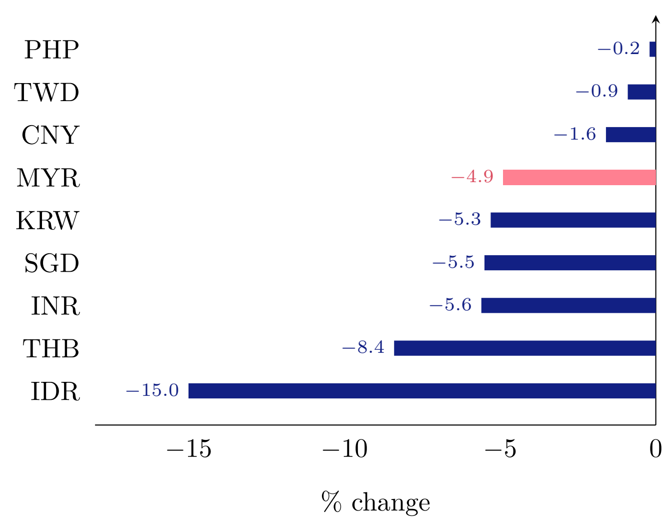
Performance of domestic financial markets was affected by significant global risk aversion

Performance of domestic financial markets trended downwards during the quarter following substantial non-resident portfolio outflows amid heightened global risk aversion. The global risk aversion was driven mainly by uncertainties surrounding the duration and severity of COVID-19 pandemic, and its impact on the global economy.

While investor sentiments were supported by the Phase One trade deal between the US and PR China in early January, it deteriorated rapidly as concerns over the potential economic impact of COVID-19 pandemic intensified, particularly towards the end of January. Additionally, the substantial decline in global oil prices also exacerbated the already weak investor sentiment.

Ringgit depreciated against the US dollar in line with regional currencies

Chart 19: Performance of Regional Currencies against the US Dollar (1 January - 31 March 2020)



Source: Bank Negara Malaysia

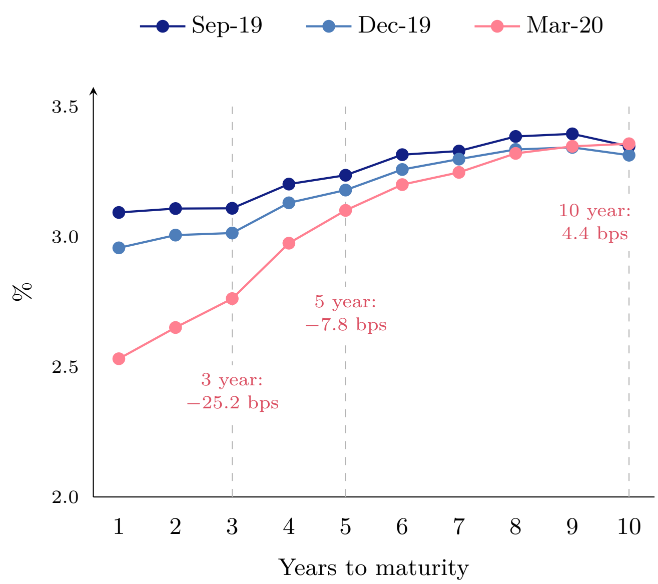
These factors amplified risk aversion in global financial markets, leading to increased demand for highly liquid assets such as cash, and safe haven assets such as US Treasury securities.

As a result, the domestic equity and bond market registered non-resident outflows for the quarter, in line with regional economies. The FBM KLCI declined by 15% to close at 1,350.9 points as at end-March (end-December: 1,588.8 points). While domestic bond yields at the longer-end of the yield curve increased marginally, shorter-term bond yields declined amid sustained demand from domestic institutional investors and expectations for a reduction in the overnight policy rate. During the quarter, the 3-year and 5-year MGS yields declined by 25.2 and 7.8 basis points respectively, while the 10-year MGS yield increased marginally by 4.4 basis points.

Consequently, the ringgit depreciated by 4.9% against the US dollar during the quarter, in line with regional currencies. The depreciation of ringgit against the US dollar was also driven by the strengthening US dollar amid increased demand for US dollar-denominated assets.

MGS yields declined across shorter tenures during the quarter

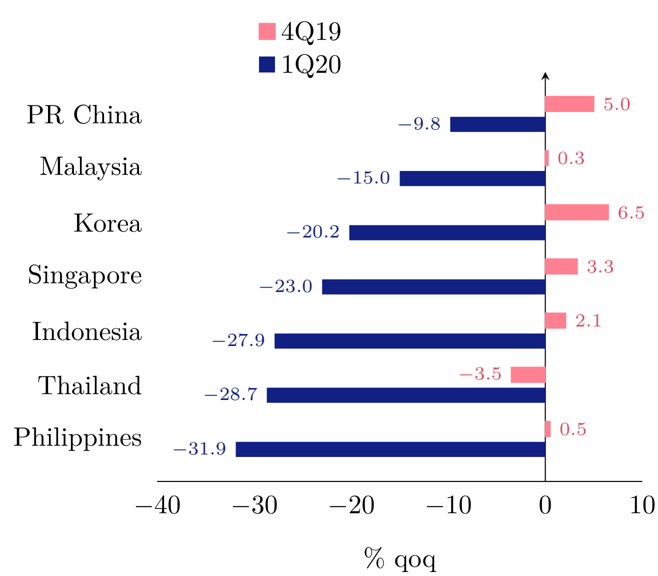
Chart 20: Trend in MGS Yields



Source: Bank Negara Malaysia

Domestic equity market performance declined in line with regional trend

Chart 21: Performance of Regional Equity Markets



Source: Bloomberg

Interest rates declined during the quarter following the reductions in the Overnight Policy Rate (OPR) in January and March 2020

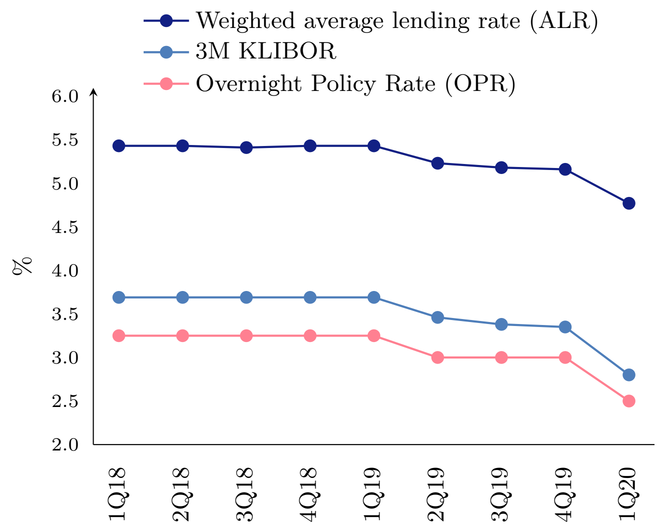
Following the reductions in the OPR by 25 bps in January and March 2020 respectively, interest rates in the wholesale and retail markets trended lower. In the interbank market, strong and immediate pass-through to rates was observed across all tenures after both reductions, with the KLIBOR decreasing by 23 to 25 bps across tenures within one day of the respective OPR adjustments. The longer-maturity KLIBOR continued to decline after the March OPR reduction amid market expectations of further monetary easing. The 3-month and 12-month KLIBOR ended the quarter at 2.80% and 3.05% respectively (4Q 2019: 3.35% and 3.64%).

Similarly, nominal fixed deposit (FD) rates also decreased following the OPR adjustments. The decline during the quarter ranged from 49 to 53 basis points across tenures of 1 to 12 months. Real FD rates increased despite the decline in nominal rates given the lower inflation in March.

The transmission of OPR to base rate (BR) was also strong, with all banks revising their BRs downwards by 50 basis points to the current weighted average of 3.18% (4Q 2019: 3.68%). Correspondingly, the weighted average lending rate (ALR) on outstanding loans declined by 39 basis points to 4.77% in March (4Q 2019: 5.16%).

Lower interest rates in the retail and interbank market

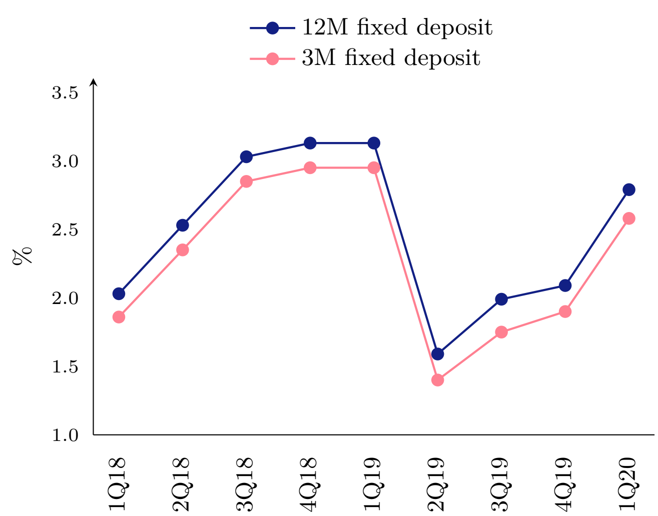
Chart 22: Policy, Interbank and Lending Rates (at end-period)



Source: Bank Negara Malaysia and Bloomberg

Real deposit rates increased, driven by the lower inflation in March

Chart 23: Real Fixed Deposit Rates by Maturity (at end-period)



Source: Bank Negara Malaysia

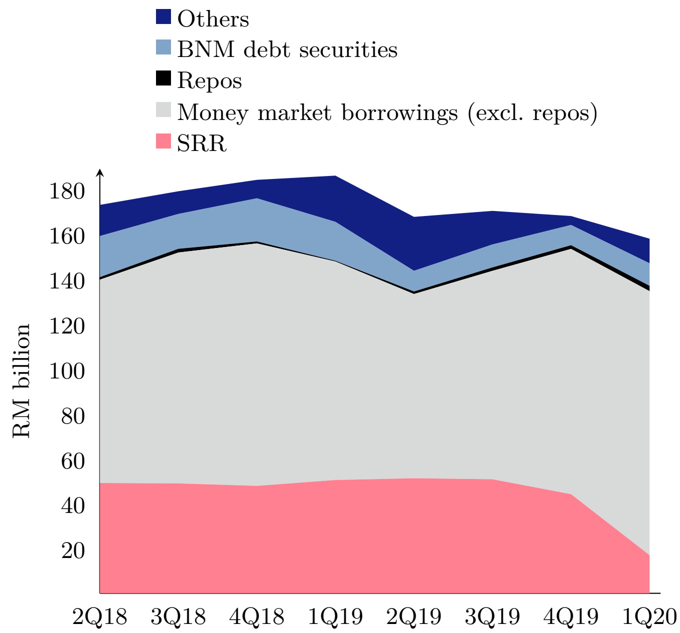
Banking system liquidity remained sufficient to facilitate financial intermediation

The level of surplus liquidity placed with the Bank declined, reflecting the net outflows during the quarter. Nevertheless, banking system liquidity remained sufficient to facilitate financial intermediation and this would continue to be supported by the Bank's liquidity-injecting operations. At the institutional level, most banks continued to maintain surplus liquidity positions with the Bank.

The Statutory Reserve Requirement (SRR) ratio was reduced from 3.00% to 2.00% in March, with additional flexibility provided to Principal Dealers (PDs) to recognise MGS and MGII as part of the SRR compliance. These combined SRR measures have released approximately RM30 billion worth of liquidity into the banking system. The higher liquidity available to banks has provided greater flexibility for banks in their liquidity management, and was reflected in the higher level of money market placements with the Bank by the end of the first quarter. In addition, the flexibility provided to the PDs has also supported the continued smooth functioning of the domestic bond market.

Outstanding surplus ringgit liquidity placed with the Bank declined during the quarter

Chart 24: Outstanding Ringgit Liquidity Placed with Bank Negara Malaysia (at end-period)



Source: Bank Negara Malaysia

Sustained net financing expansion

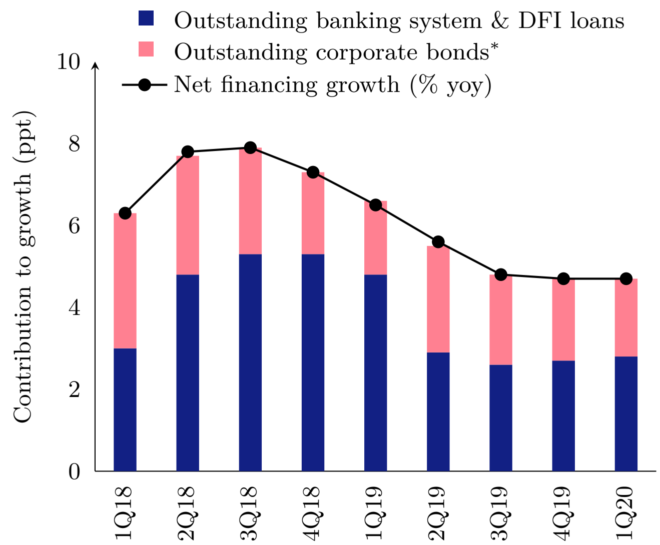
In the first quarter, net financing expanded at a sustained pace of 4.7% on an annual basis (4Q 2019: 4.7%), supported by higher growth in outstanding loans[4] of 3.8% (4Q 2019: 3.5%). Growth in outstanding corporate bonds[5] moderated to 7.6% during the quarter (4Q 2019: 8.0%). Corporate bond issuances were lower, amid seasonally slow issuance in January and a sharp increase in yields in March following the escalation of COVID-19.

Growth in outstanding business loans increased (3.4%; 4Q 2019: 2.4%), contributed mainly by the electricity, gas and water, and education, health and others sectors. Disbursements significantly outpaced repayments in these sectors. For the household segment, growth in outstanding loans moderated (3.8%; 4Q 2019: 4.7%), mainly due to high repayments on loans for the purchase of securities.

Demand for business financing, as indicated by loan applications[6], slowed during the quarter, mainly in the primary agriculture and manufacturing sectors. However, loan applications for working capital increased to levels significantly higher than recent average. Demand for household loans was also lower, particularly for housing loans, amid the expiration of the Home Ownership Campaign in 2019, and the MCO in mid-March.

Expansion supported by higher loan growth amid lower growth in corporate bonds

Chart 25: Contribution to Net Financing Growth



*Excludes issuances by Cagamas and non-residents

Source: Bank Negara Malaysia

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[4] Loans from the banking system and development financial institutions (DFIs).

[5] Excludes issuances by Cagamas and non-residents.

[6] Loan applications in the banking system only.

The Bank's Policy Considerations

Highlights

- **The MPC reduced the Overnight Policy Rate by 50 basis points to 2.00% at the May 2020 MPC meeting, to cushion the economic impact from COVID-19 and to support the improvement in economic activity.**
- **The Bank adjusted the Statutory Reserve Requirement to support financial intermediation activity.**

The MPC reduced the OPR to provide support to the economic environment

At each of the January and March 2020 Monetary Policy Committee (MPC) meetings, the Overnight Policy Rate (OPR) was reduced by 25 basis points. More recently, at the May 2020 MPC meeting, the OPR was further reduced by 50 basis points to 2.00%. The ceiling and floor rates of the corridor for the OPR were correspondingly reduced to 2.25% and 1.75%, respectively. In total, the OPR has been reduced by 100 basis points this year.

Global economic conditions have weakened significantly. Measures to contain the COVID-19 pandemic have disrupted economic activity across most economies. Financial conditions have also tightened amid elevated risk aversion and uncertainty. Substantial policy stimuli introduced by many economies, coupled with the gradual easing of containment measures globally, would partially mitigate the economic impact of COVID-19. Growth prospects should improve in 2021 with the expected containment of the pandemic.

For Malaysia, domestic economic conditions have similarly been affected by the pandemic. The weak external demand environment will exert a larger drag on domestic economic activity. The MCO, while necessary, has also constrained production capacity and spending. Labour market conditions are expected to weaken considerably. Economic conditions would be particularly challenging in the first half of the year. The fiscal stimulus measures, alongside monetary and financial measures will, however, offer some support to the economy. With more businesses allowed to operate under the Conditional MCO, economic activity is projected to gradually improve.

Average headline inflation in 2020 is likely to be negative, due mainly to projections for substantially lower global oil prices. Underlying inflation is expected to be subdued given the projections of weaker domestic growth prospects and labour market conditions.

The financial sector is sound, with financial institutions operating with strong capital and liquidity buffers. Liquidity remains ample, augmented by liquidity injections by the Bank via various tools including outright purchases of government securities, reverse repos and the reduction in the Statutory Reserve Requirement (SRR). The Bank stands ready to provide liquidity in the interbank market to ensure orderly market conditions, conducive to support financial intermediation activity.

Together, the total OPR reduction of 100 basis points, other monetary and financial measures undertaken by the Bank, as well as fiscal measures implemented this year will partly cushion the economic impact on businesses and households and support the improvement in domestic economic activity. The MPC will continue to monitor the outlook for domestic growth and inflation. The Bank will utilise its policy levers as appropriate to create enabling conditions for a sustainable economic recovery.

The Bank adjusted the SRR to support financial intermediation activity

The Bank adjusted the SRR as part of the Bank's continuous efforts to ensure sufficient liquidity to support financial intermediation activity.

On 19 March 2020, the Bank announced that the SRR ratio will be lowered by 100 basis points from 3.00% to 2.00% effective 20 March 2020. In addition to the SRR ratio reduction, each Principal Dealer is also able to recognise Malaysian Government Securities (MGS) and Malaysian Government Investment Issues (MGII) of up to RM1 billion as part of the SRR compliance. This flexibility to the Principal Dealers is available until 31 March 2021. These combined measures will release approximately RM30 billion worth of liquidity into the banking system.

On 5 May 2020, the Bank announced that MGS and MGII can be used by all banking institutions to fully meet the SRR compliance effective 16 May 2020. This flexibility to the banking institutions is available until 31 May 2021. This measure will release approximately another RM16 billion worth of liquidity into the banking system.

The SRR is an instrument to manage liquidity and is not a signal on the stance of monetary policy. The OPR is the sole indicator used to signal the stance of monetary policy.

Other policy highlights in the first quarter of 2020

Policy highlight	Salient details
Policy Document (PD) on Anti-Money Laundering, Countering Financing of Terrorism and Targeted Financial Sanctions for Financial Institutions (AML/CFT and TFS for FIs)	• The PD came into effect on 1 January 2020 setting out the obligations of reporting institutions with respect to requirements imposed under the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001, requirements on reporting institutions in implementing a comprehensive risk-based approach in managing ML/TF risks, and targeted financial sanctions requirements on financial institutions regulated or supervised by the Bank. • The PD is a revision and consolidation of the AML/CFT Sector 1 to Sector 4 policy documents.
Exposure Draft (ED) on Corporate Strategic Plan (CSP)	• The ED was issued on 16 January 2020 on expectations of development financial institutions (DFIs) in developing business plans and funding strategies. • The ED sets out (1) governance requirements to ensure effective implementation of the CSP; (2) key features of the CSP such as the Statement of Corporate Intent and Annual Funding Requirement; and (3) guidance on the implementation of the Performance Measurement Framework for DFIs.
Exposure Draft (ED) on Recovery Planning	• The ED was issued on 17 January 2020, setting out key principles, requirements and supervisory expectations on the development and maintenance of recovery plans by financial institutions. Robust recovery plans are expected to enhance supervisability, recovery and resolvability of financial institutions.
Policy Document (PD) on Domestic Systematically Important Banks (D-SIBs) Framework	• The PD was issued on 5 February 2020 to facilitate the identification of systemically important banks (D-SIBs) whose distress or disorderly failure may cause significant disruption and result in adverse spillovers to the financial system and the economy. • The PD addresses the following elements on D-SIBs: (1) Regulatory requirements and policy measures that are applicable to D-SIBs, such as the capital surcharge above the minimum regulatory requirement to increase the bank's loss-absorbance capacity; (2) intensity of supervisory oversight by the Bank; and (3) macroprudential surveillance activities of the Bank. • The PD on Capital Adequacy Framework (Capital Components) was updated on 5 February 2020 to incorporate the Higher Loss Absorbency requirement that is applicable to a D-SIB.
Exposure Draft (ED) on Licensing Framework for Digital Banks	• The ED was updated on 3 March 2020 to incorporate further details on the simplified regulatory framework applicable to digital banks during the foundational phase. • This includes, among others, the simplified requirements on capital adequacy and liquidity risk.

<table>
<tr><th>Policy highlight</th><th>Salient details</th></tr>
<tr><td>Measures to Assist Individuals, SMEs and Corporates Affected by COVID-19</td><td>
A number of measures were announced on 25 and 27 March 2020 to assist individuals, SMEs and corporates affected by COVID-19. These include financial relief measures, regulatory and supervisory measures, and lending assistance. Among them were:
Financial Relief Measures

A 6-month deferment offered by banking institutions on all loan/financing repayments (except credit card balances) of individuals and SMEs on 1 April 2020.
An option provided to credit cardholders to convert their outstanding balances into a 3-year term loan at a lower interest/profit rate.
An option for affected life policyholders and family takaful participants to defer premiums/contribution payments due for three months without affecting policy coverage, with effect from 1 April 2020.
Flexibility provided by general insurers and takaful operators for policyholders and takaful participants to meet premiums/contributions due, including by restructuring of policies/certificates.
Expedited insurance and takaful claims processes related to COVID-19.

Regulatory and Supervisory Measures

Flexibility for banking institutions to draw down on the capital conservation buffer of 2.5%, operate below minimum liquidity coverage ratio of 100% and utilise the regulatory reserves that were set aside during periods of strong loan growth. These buffers are expected to be restored within a reasonable period after 31 December 2020.
Minimum Net Stable Funding Ratio requirement of 80%, effective on 1 July 2020. Banking institutions will be required to comply with the minimum requirements of 100% from 30 September 2021.
Lowered interest rate (IRCC) and profit rate (PRCC) stress factor caps for insurers and takaful operators from 40% to 30% starting 31 March 2020, to better reflect the prevailing market conditions.

</td></tr>
<tr><td>Lending facilities for SMEs</td><td>
BNM's Fund for SMEs (the Fund) was mobilised and bolstered to provide immediate relief for Malaysian SMEs to withstand the economic fallout from the pandemic. The Fund, totalling RM13.1 billion, includes three new facilities which are:

Special Relief Facility (SRF) to help alleviate the short-term cash flow problems faced by affected SMEs;
Agrofood Facility (AF) to increase food production for both domestic consumption and exports; and
Automation and Digitalisation Facility (ADF) to incentivise SMEs to automate processes and digitalise operations to increase productivity.

The Bank also reduced the maximum financing rates charged to SMEs.
</td></tr>
</table>

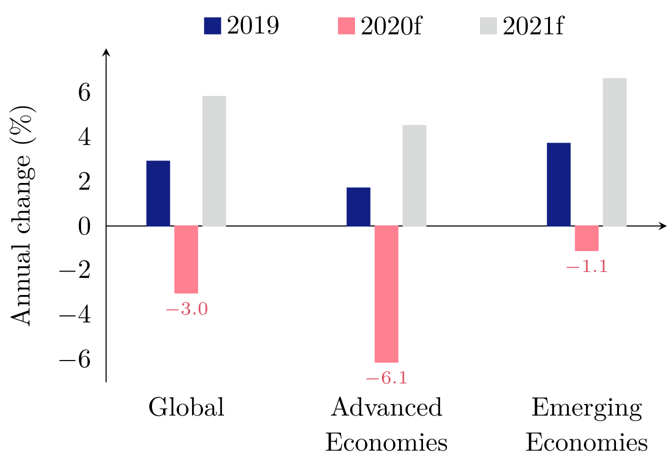
Macroeconomic Outlook

Highlights

- A global recession is expected in 2020 due to the measures taken to contain the COVID-19 pandemic.
- Malaysian economy to be affected by weak global demand and containment measures particularly in 1H 2020 before a gradual recovery in 2H 2020.
- Muted inflationary pressures in 2020.

The global economy to enter a severe recession in 2020

Chart 26: GDP Growth of Selected Economies



Source: IMF World Economic Outlook (April 2020)

The IMF projects global growth in 2020 to be -3.0%, the weakest since the Great Depression. A recovery in 2021 is expected, conditional on the gradual dissipation of the COVID-19 pandemic in the second half of 2020, as well as its successful containment by end-2020.

In PR China, with containment measures in Hubei Province lifted since April, domestic demand is expected to recover gradually, weighed partly by continued social distancing behaviour as COVID-19 continues to spread at a slower rate. High frequency activity indicators such as the Purchasing Managers' Index, as well as exports have bottomed out in the first quarter, pointing further towards a recovery in growth. Nevertheless, as containment measures are introduced globally amid a broad escalation in COVID-19 cases, external demand is expected to weaken in the near-term.

The recovery in PR China will anchor growth in regional economies, whose domestic demand conditions are expected to experience a transitory slowdown. Nevertheless, policy responses have been timely and forthcoming, such as in Singapore where fiscal measures totalled 13.0% of GDP, allowing a sustained recovery to be secured as the pandemic begin to dissipate.

Major advanced economies have introduced unprecedented policy responses to limit the economic fallout from the COVID-19 pandemic. Policy rates were broadly reduced to the zero lower bound, while the magnitude of quantitative easing exceeded that of the Global Financial Crisis within the first months of the pandemic, including the US, euro area and Japan. Large fiscal stimulus packages were additionally introduced, especially in the US and Japan. These measures were primarily aimed at preventing hysteresis in labour market and output, as well as limiting the deterioration in private sector balance sheet conditions, by sustaining income flows amid low economic activity.

Downside risks to the growth outlook remain, arising from a more severe impact from the COVID-19 pandemic and the resurgence of COVID-19 cases. In vulnerable emerging economies, sharp and volatile two-way capital flows could lead to the unwinding of external sector imbalances. In the US, the downgrades in corporate credit ratings and earnings weakness in severely affected sectors, may lead to a continued tightening of financial conditions. The materialisation of these financial sector vulnerabilities may further exacerbate the downturn in the global economy.

The Malaysian economy to be significantly impacted by COVID-19

Malaysia's economic prospects for 2020 is being severely affected by the COVID-19 pandemic. Strict measures to contain the spread of the pandemic, both globally and domestically, will weigh considerably on both external demand and domestic growth.

Domestically, the economic impact of the MCO is expected to be broad-based, with the largest impact likely felt by the consumer-oriented and labour-intensive industries. This includes the services sector, particularly consumer services and construction sectors. Capital-intensive sectors such as mining and E&E are expected to be the least impacted. In terms of employment, the impact from the slowdown would be larger on the self-employed and those working in small and medium enterprises. However, under the Conditional MCO that was effective 4 May 2020, most sectors of the economy were allowed to operate, albeit in a controlled and prudent setting and by observing stringent Standard Operating Procedures (SOPs). Notwithstanding the lifting of movement restrictions, international travel restrictions and social distancing measures are expected to continue for the remainder of the year.

Reflecting the longer duration of the MCO, followed by the Conditional MCO from 4 May to 9 June 2020, the Malaysian economy is expected to contract in the second quarter. However, economic activity is expected to gradually pick up in 2H 2020, following the lifting of the MCO, support from fiscal, monetary and financial measures and progress in transport-related projects by the public sector. The Malaysian economy is expected to register a positive recovery in 2021, in line with the projected improvement in global growth.

The economic stimulus measures announced will provide sizeable assistance to households and businesses. This is further augmented by the Bank's broad array of measures, including reductions in the OPR and SRR, deferment of loan and financing repayments for a period of six months for individual and SME borrowers, daily market operations to ensure ample liquidity and enhancements to existing financing facilities under BNM's Fund for SMEs. The Bank has also allowed banks to utilise their regulatory buffers to further ensure continued financial intermediation.

The growth outlook is subject to significant downside risks. This arises mainly from the uncertainties surrounding the spread of COVID-19 and the duration of containment measures globally. This uncertainty may also result in delays in household spending and business investments. In addition, the risks of commodity supply shocks remain.

Inflationary pressures to be muted in 2020

Average headline inflation is likely to turn negative this year, mainly due to the projections of significantly lower global oil prices. In terms of food inflation, the outlook is uncertain and depends on the interplay between global and domestic supply and demand factors. Nevertheless, the ceiling prices implemented on select essential food items, in addition to the upcoming festive season price control scheme, are expected to contain food prices in the near term. Going forward, the outlook of headline inflation remains significantly affected by global oil and other commodity prices including food, as well as evolving demand conditions.

Underlying inflation, as measured by core inflation, is expected to be subdued amid the projections of weaker domestic growth prospects and labour market conditions.

Annex

Table 1: GDP by Expenditure Components (at constant 2015 prices)

	2019 share %	2019			2020
		1Q	4Q	Year	1Q
		Annual growth, %			
Aggregate domestic demand (excl. stocks)	94.0	4.5	4.8	4.3	3.7
Private sector	75.6	6.0	7.4	6.2	4.7
Consumption	58.7	7.7	8.1	7.6	6.7
Investment	16.8	0.6	4.3	1.6	−2.3
Public sector	18.5	−1.6	−2.3	−2.8	−0.7
Consumption	12.2	6.3	1.3	2.0	5.0
Investment	6.3	−13.7	−8.0	−10.8	−11.3
Net exports	7.0	13.0	−12.4	9.7	−37.0
Exports of goods and services	63.7	0.1	−3.4	−1.3	−7.1
Imports of goods and services	56.7	−1.6	−2.4	−2.5	−2.5
GDP	100.0	4.5	3.6	4.3	0.7
GDP (qoq growth, seasonally adjusted)	-	0.9	0.6	-	−2.0

Source: Department of Statistics, Malaysia

Table 2: GDP by Economic Activity (at constant 2015 prices)

	2019 share %	2019			2020
		1Q	4Q	Year	1Q
		Annual growth, %			
Services	57.7	6.4	6.2	6.1	3.1
Manufacturing	22.3	4.1	3.0	3.8	1.5
Mining	7.1	−1.5	−3.4	−2.0	−2.0
Agriculture	7.1	5.8	−5.7	2.0	−8.7
Construction	4.7	0.4	1.0	0.1	−7.9
Real GDP	100.0[1]	4.5	3.6	4.3	0.7

[1] Figures may not add up due to rounding and exclusion of import duties

Source: Department of Statistics, Malaysia

Table 3: Balance of Payments[1]

	2019			2020
	1Q	4Q	Year	1Q
	RM billion			
Current account	16.9	7.5	50.9	9.5
(% of GDP)	4.7	1.9	3.4	2.6
Goods	33.4	32.3	123.3	28.9
Services	−1.7	−4.0	−10.9	−8.0
Primary income	−9.2	−15.2	−40.3	−6.0
Secondary income	−5.6	−5.5	−21.3	−5.4
Financial account	−13.3	−0.1	−33.8	−13.3
Direct investment	13.9	4.4	5.6	3.4
Assets	−8.5	−5.6	−31.9	−1.8
Liabilities	22.4	10.0	37.5	5.2
Portfolio investment	6.5	−1.3	−29.0	−41.3
Assets	−8.6	−12.4	−41.7	−15.1
Liabilities	15.0	11.0	12.6	−26.2
Financial derivatives	−0.2	−0.6	−0.5	2.5
Other investment	−33.4	−2.5	−9.9	22.1
Net errors and omissions[2]	1.9	−9.9	−9.0	−4.7
Overall balance	5.5	−2.2	8.4	−8.7

Assets: (−) denotes outflows due to the acquisition of assets abroad by residents
Liabilities: (+) denotes inflows due to the incurrence of foreign liabilities

[1] In accordance with the 6th Edition of the Balance of Payments and International Investment Position Manual (BPM6) by the International Monetary Fund (IMF)
[2] As at 1Q 2018, quarterly net E&O excludes reserves revaluation changes. This practice is backdated up to 1Q 2010.

Note: Figures may not add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 4: Outstanding External Debt

	2019		2020
	end-Mar	end-Dec	end-Mar
	RM billion		
Total external debt	904.6	945.4	975.9
USD billion equivalent	219.6	228.3	223.3
By instrument			
Bonds and notes[1]	159.3	155.9	160.5
Interbank borrowings[1]	176.3	199.5	223.8
Intercompany loans[1]	140.3	126.9	132.3
Loans[1]	71.2	78.4	82.4
Non-resident holdings of domestic debt securities	186.9	201.0	186.8
Non-resident deposits	93.6	102.9	106.1
Others[2]	76.9	80.8	84.0
Maturity profile			
Medium- and long-term	535.6	554.2	554.3
Short-term	369.0	391.2	421.6
Currency denomination			
Ringgit	289.2	310.4	296.8
Foreign	615.5	635.1	679.1
Total debt / GDP (%)	59.9	62.6	64.4
Short-term debt / Total debt (%)	40.8	41.4	43.2
Reserves / Short-term debt (times)	1.1	1.1	1.1[3]

[1] These debt instruments constitute the offshore borrowings.
[2] Comprise trade credits, IMF allocation of SDRs and miscellaneous.
[3] Based on international reserves as at 30 April 2020.

Note: NR refers to non-residents
Figures may not add up due to rounding

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Table 5: Financing of the Private Sector through the Banking System, DFIs and Capital Markets

	2019			2020	2019			2020
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q
	Change during the period (RM billion)				Annual growth (%)			
Total net financing	23.0	27.0	114.4	25.5	6.5	4.7	4.7	4.7
Outstanding:								
Loans[1,2]	8.8	25.4	65.5	13.1	6.4	3.5	3.5	3.8
Business enterprises	1.3	9.4	15.5	8.3	4.4	2.4	2.4	3.4
SMEs[3]	−1.6	−36.7	−41.4	2.0	0.2	−12.9	−12.9	−11.9
Non-SMEs	2.9	46.1	56.9	6.3	8.7	16.8	16.8	17.7
Households	10.3	15.9	50.5	0.5	7.5	4.7	4.7	3.8
Corporate bonds[4]	14.2	1.6	48.9	12.5	7.1	8.0	8.0	7.6

[1] Loans from the banking system and development financial institutions (DFIs). Effective June 2019, data for April 2018 onwards were revised to include data from a newly licensed commercial bank (MBSB Bank Berhad). It was previously classified as a non-bank financial institution. The inclusion of the outstanding loan figures resulted in higher financing annual growth rates for a transitory period from 2Q 2018 to 1Q 2019 due to the lower base in preceding years.

[2] Includes loans sold to Cagamas.

[3] Partly reflects the reclassification exercise of SMEs to non-SMEs by financial institutions.
Between January 2018 to December 2019, a net amount of RM60.4 billion of outstanding SME loans was reclassified as outstanding non-SME loans. RM38.3 billion was reclassified during the fourth quarter of 2019.

[4] Excludes issuances by Cagamas and non-residents.

Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Table 6: Loan Indicators

	2019			2020	2019			2020
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q
	During the period (RM billion)				Annual growth (%)			
Total								
Loan applications[1]	194.4	225.6	877.8	197.1	−7.1	11.1	1.0	1.4
Loan approvals[1]	90.8	103.3	410.1	86.9	0.5	−1.5	2.0	−4.3
Loan disbursements[2]	313.9	334.8	1,275.7	317.4	4.4	−2.1	1.2	1.1
Loan repayments[2]	319.3	324.0	1,270.1	319.8	7.8	−3.1	2.3	0.2
Business enterprises[3]								
Loan applications	84.4	106.4	400.9	92.4	−10.4	20.1	3.6	9.6
Loan approvals	41.1	49.7	191.5	41.4	3.4	−4.4	1.6	0.9
Loan disbursements	221.4	236.6	900.0	227.8	5.4	−5.0	−0.1	2.9
Loan repayments	226.6	231.1	902.9	220.2	10.0	−6.0	1.3	−2.8
SMEs[4]								
Loan applications	43.9	51.0	195.4	47.5	−0.2	16.7	6.1	8.1
Loan approvals	15.4	17.9	67.4	14.1	2.2	9.2	1.9	−8.4
Loan disbursements	75.7	71.0	295.8	63.5	−0.2	−12.4	−4.0	−16.2
Loan repayments	76.8	74.5	302.6	65.8	2.8	−6.3	−0.8	−14.3
Non-SMEs[3]								
Loan applications	40.5	55.4	205.4	45.0	−19.4	23.4	1.3	11.2
Loan approvals	25.6	31.8	124.1	27.3	4.2	−10.6	1.4	6.5
Loan disbursements	145.7	165.6	604.2	164.3	8.5	−1.5	1.9	12.8
Loan repayments	149.7	156.6	600.3	154.3	14.1	−5.9	2.3	3.1
Households								
Loan applications	110.0	119.2	476.9	104.6	−4.3	4.2	−1.1	−4.9
Loan approvals	49.8	53.6	218.5	45.5	−1.7	1.3	2.4	−8.6
Loan disbursements	92.4	98.2	375.7	89.6	2.3	5.7	4.6	−3.0
Loan repayments	92.7	92.9	367.2	99.6	2.8	4.9	5.1	7.4

[1] Loan applications and approvals for all segments include data from the banking system only
[2] Loan disbursements and repayments for all segments include data from the banking system and development financial institutions (DFIs)
[3] Includes domestic non-bank FIs, domestic FIs, government, domestic other entities and foreign entities
[4] Partly reflects the reclassification exercise of SMEs to non-SMEs by financial institutions

Note: Effective June 2019, data from April 2018 were revised to include data from a newly licensed commercial bank (MBSB Bank Berhad), previously classified as a non-bank FI.
Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Table 7: Banking System Profitability Indicators

	2019				2020
	1Q	2Q	3Q	4Q	1Q*p*
Return on equity (%)	11.5	13.0	12.9	13.0	11.1
Return on assets (%)	1.3	1.5	1.5	1.5	1.3
	RM million				
Net interest income	12,438	12,009	12,701	13,159	12,696
Add: Fee-based income	2,548	2,619	2,670	3,227	2,583
Less: Operating cost[1]	8,385	8,421	8,626	9,130	8,614
Gross operating profit	6,601	6,206	6,745	7,256	6,665
Less: Impairment[2] and other provisions	164	322	820	0	2,174
Gross operating profit after provision	6,437	5,884	5,925	7,257	4,491
Add: Other income	2,548	5,506	4,302	3,648	4,644
Pre-tax profit	8,985	11,390	10,227	10,905	9,135
	Annual growth (%)				
Return on equity (percentage points)	−0.8	−0.3	0.2	0.3	−0.4
Return on assets (percentage points)	−0.08	−0.01	0.04	0.06	−0.04
Net interest income	3.3	−2.3	1.7	2.9	2.1
Add: Fee-based income	−2.2	4.0	7.9	29.1	1.3
Less: Operating cost[1]	3.5	6.3	10.3	9.6	2.7
Gross operating profit	0.8	−9.9	−5.5	4.3	1.0
Less: Impairment[2] and other provisions	−75.9	−30.9	18.5	−100.0	1,224.4
Gross operating profit after provision	9.7	−8.3	−8.1	16.7	−30.2
Add: Other income	−16.4	35.2	92.0	8.3	82.3
Pre-tax profit	0.8	8.6	17.7	13.8	1.7

[1] Refers to staff costs and overheads
[2] Refers to 12 Months Expected Credit Losses (ECL), Lifetime ECL Not Credit Impaired and Lifetime ECL Credit Impaired based on the Malaysian Financial Reporting Standard 9 (MFRS 9)

p Preliminary

Source: Bank Negara Malaysia

Table 8: Insurance and Takaful Sector Profitability Indicators

	2019				2020
	1Q	2Q	3Q	4Q	1Qp[1]
	RM million				
Life Insurance & Family Takaful					
Excess income over outgo	8,561	7,947	3,795	3,907	−11,605
General Insurance and General Takaful					
Operating profit	716	677	785	758	435
Claims ratio (%)	57	59	59	59	59
	Annual growth (%)				
Life Insurance & Family Takaful					
Excess income over outgo	109.0	750.6	−50.1	486.6	−235.6
General Insurance and General Takaful					
Operating profit	27.5	−10.8	−35.0	59.1	−39.3
Claims ratio (percentage points)	−0.1	0.4	6.0	1.9	2.6

[1] Excludes reinsurance due to unavailability of data

p Preliminary

Source: Bank Negara Malaysia

Table 9: Federal Government Finance^p

	2019p			2020p
	1Q	4Q	Year	1Q
	RM billion			
Revenue	63.7	69.9	264.4	45.3
Annual growth (%)	17.2	4.0	13.5	−28.8
Operating expenditure	59.5	69.8	263.3	62.5
Annual growth (%)	8.3	20.1	14.0	5.2
Current account	4.2	0.1	1.1	−17.2
Net development expenditure	11.3	19.6	52.6	10.9
Annual growth (%)	5.5	−30.1	−4.9	−3.6
Overall balance	−7.1	−19.5	−51.5	−28.2
Memo:				
Total net expenditure	70.8	89.4	315.9	73.5
Annual growth (%)	7.8	3.8	10.4	3.8
Total Federal Government debt (as at end-period)	776.8	793.0	793.0	823.8
Domestic debt	584.3	585.3	585.3	631.3
External debt	192.5	207.7	207.7	192.5
Non-resident holdings of RM-denominated debt	168.7	183.7	183.7	167.2
Offshore borrowing	23.7	24.0	24.0	25.2

p Preliminary
Note: Numbers may not add up due to rounding

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia