

Developments in the Malaysian Economy

Highlights

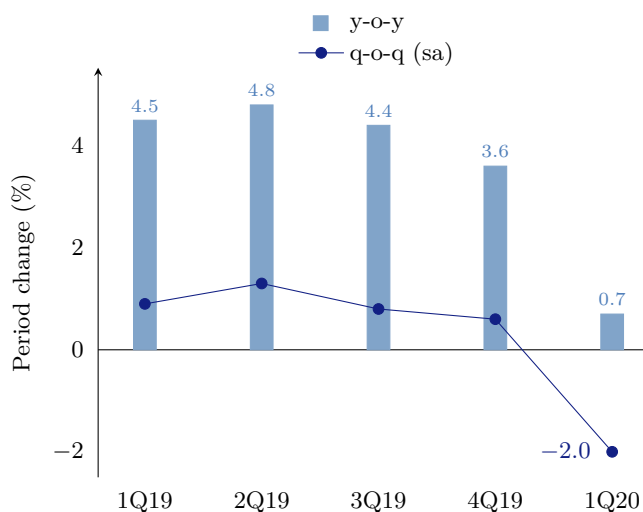
- The Malaysian economy moderated sharply to 0.7% in the first quarter.
- Headline and core inflation remained modest at 0.9% and 1.3%.
- Current account surplus amounted to RM9.5 billion (2.6% of GDP).

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

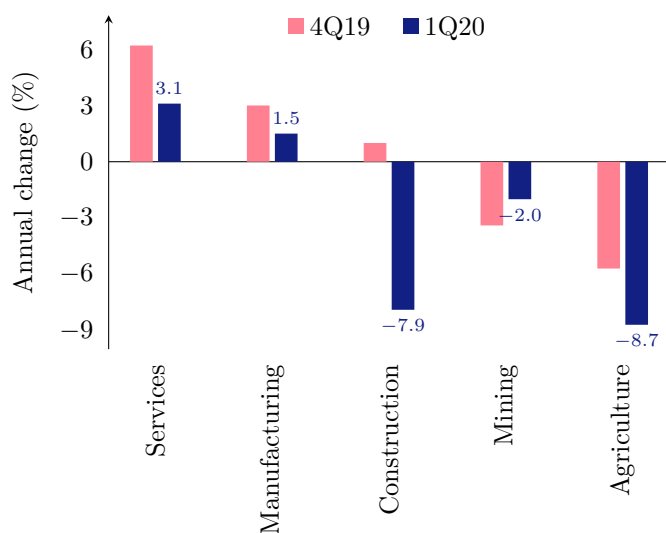
and non-essential services, border closures and restrictions on public movement, work and operating hours, as well as mandatory social distancing and personal protection measures. Essential services include telecommunications, finance, production and the provision of food supplies, healthcare, utilities, 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.

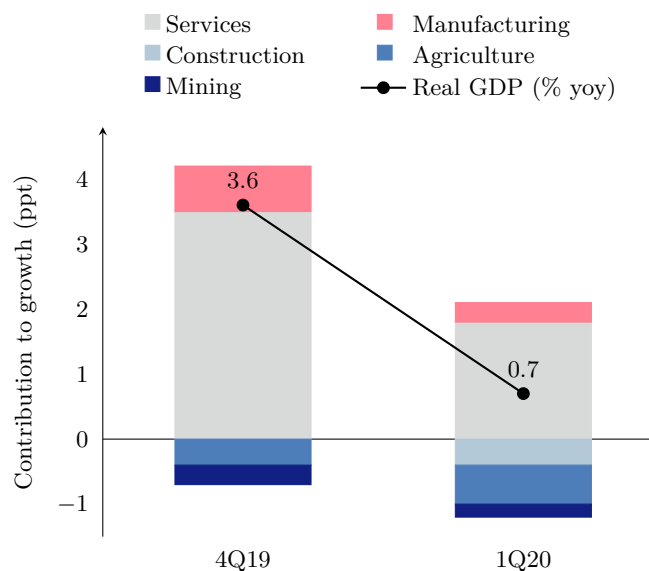
Growth in the mining sector remained in contraction (-2.0%; 4Q 2019: -3.4%), as crude oil and natural gas production was weighed by ongoing maintenance works and the gas pipeline incident in East Malaysia.

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

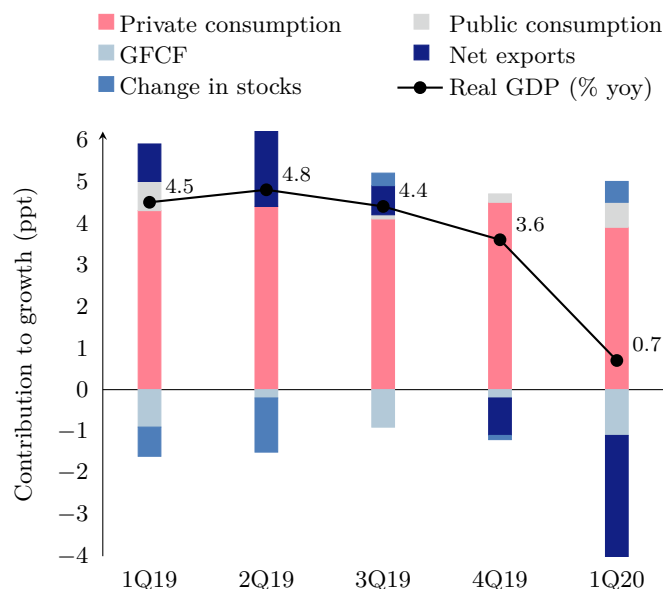
Domestic demand registered a modest growth of 3.7% in the first quarter (4Q 2019: 4.8%), due mainly to weaker capital spending by both the private and public sectors. The subdued investment activity was mainly attributable to the containment measures undertaken by authorities both globally and domestically. 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

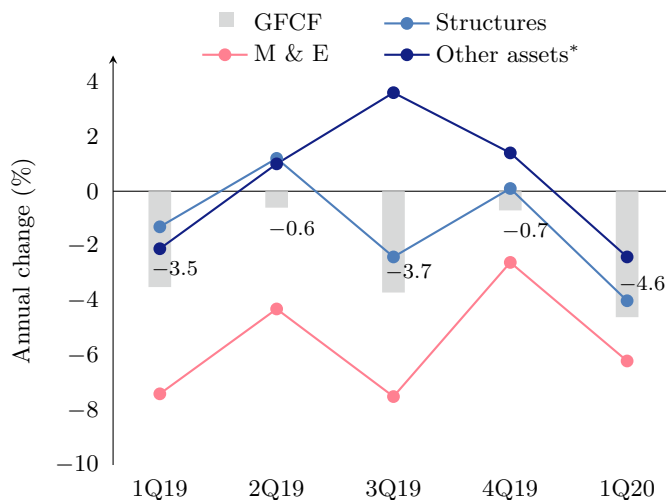
Gross fixed capital formation (GFCF) registered a larger contraction of 4.6% (4Q 2019: -0.7%), weighed by lower capital spending from both the private and public sectors. This reflected weaker global demand conditions and disruptions to supply chains, which led to slower progress in capital spending. 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

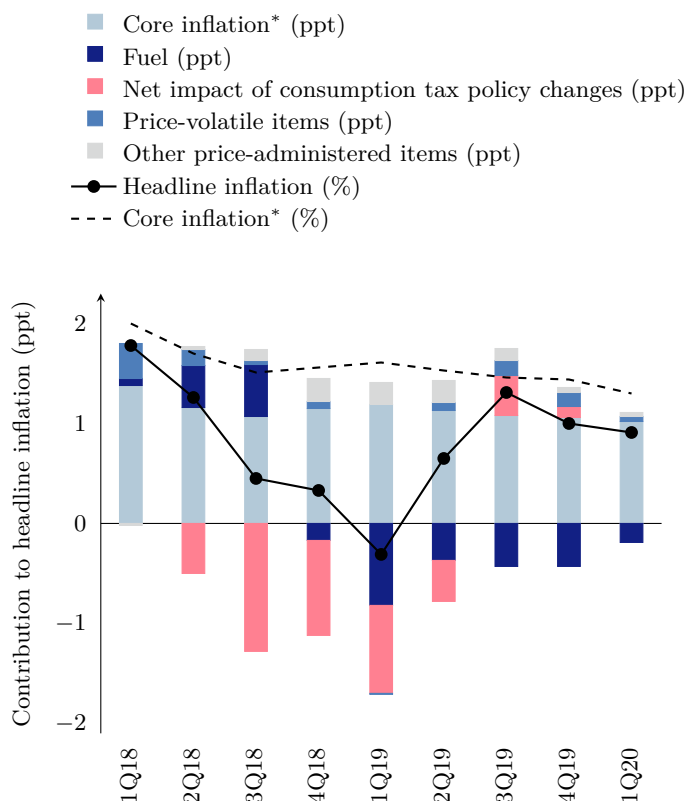
Headline inflation remained modest during the quarter

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

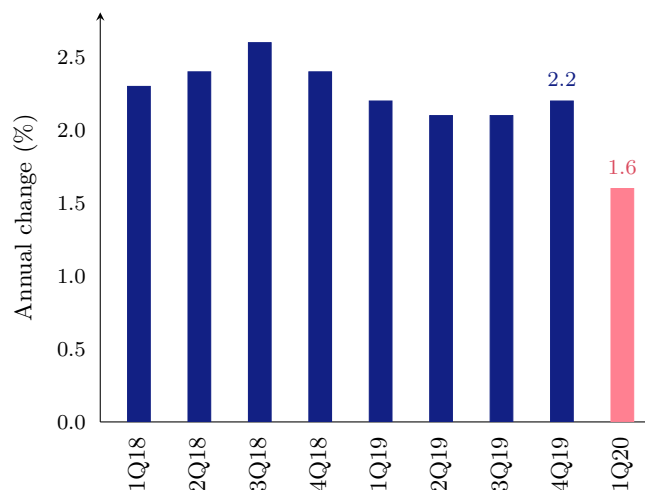
Soft labour market conditions

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

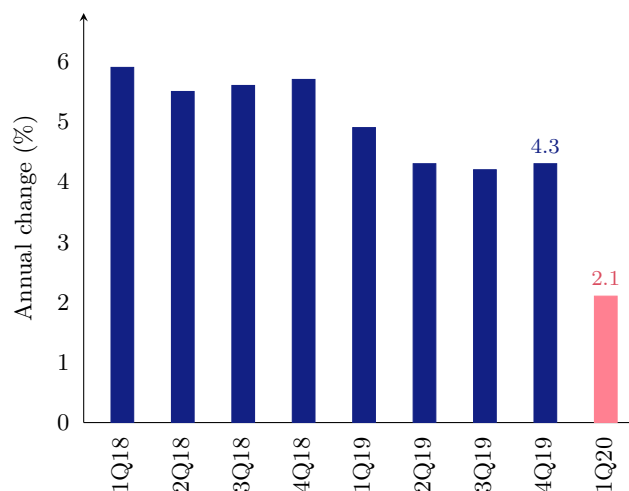
Chart 10: Employment Growth



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

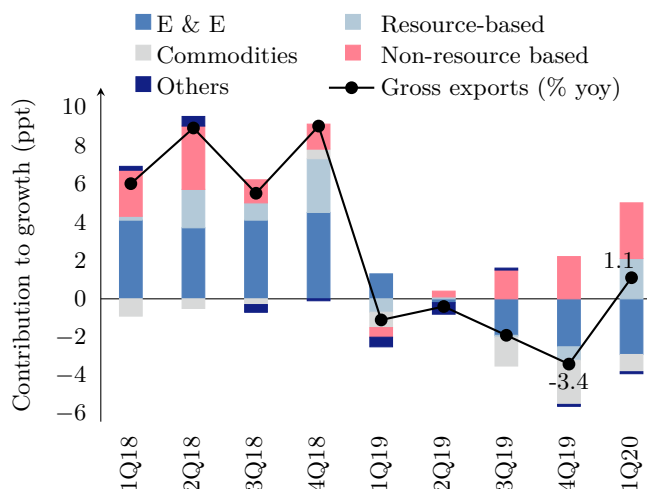
In the first quarter of 2020, gross exports registered positive growth of 1.1% (4Q 2019: -3.4%) supported by higher manufactured exports. Gross imports recorded a positive turnaround of 1.3% (4Q 2019: -3.9%), due to higher intermediate goods imports. The trade surplus² widened to RM37.0 billion (4Q 2019: 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

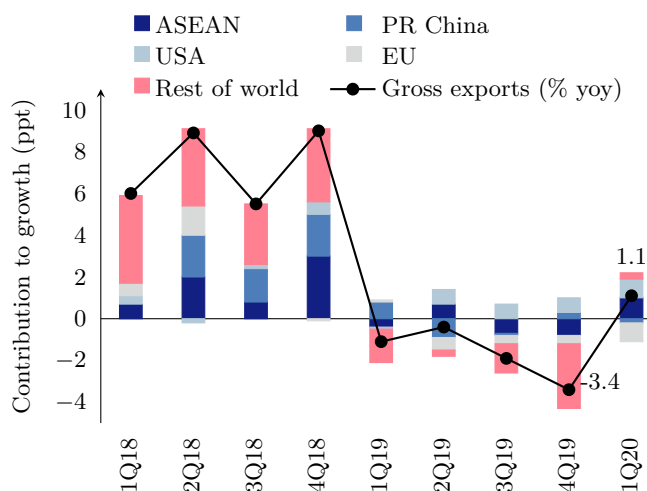
Chart 12: Gross Exports by Products



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).

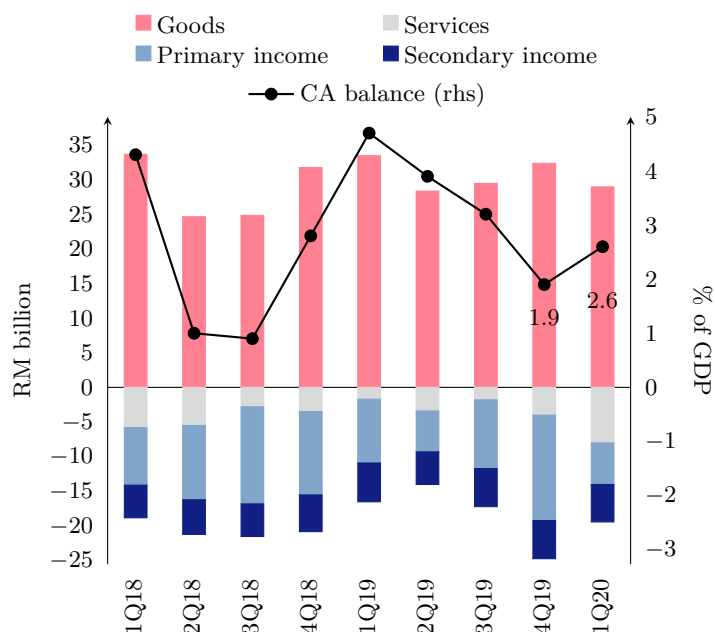
In the services account, the deficit widened to RM8.0 billion (4Q 2019: -RM4.0 billion). This was due primarily to the decline in the travel surplus to RM2.1 billion (4Q 2019: RM6.4 billion) following lower tourist arrivals amid travel restrictions and aversion arising from the COVID-19 pandemic, coupled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

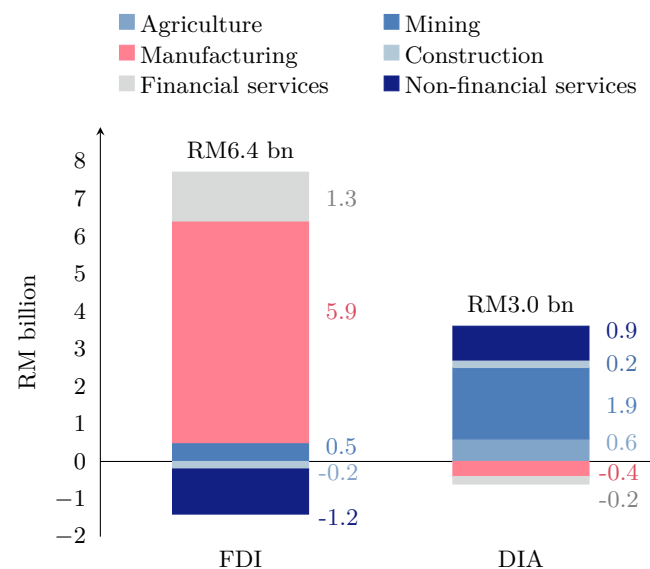
Financial account registered a net outflow

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

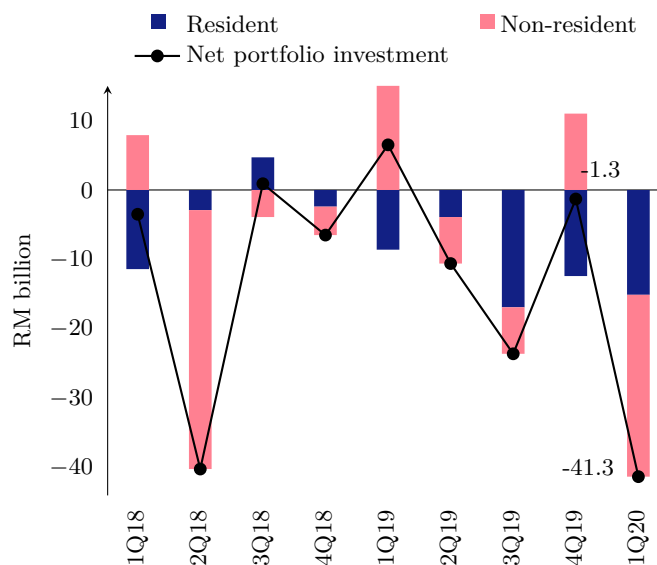
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

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

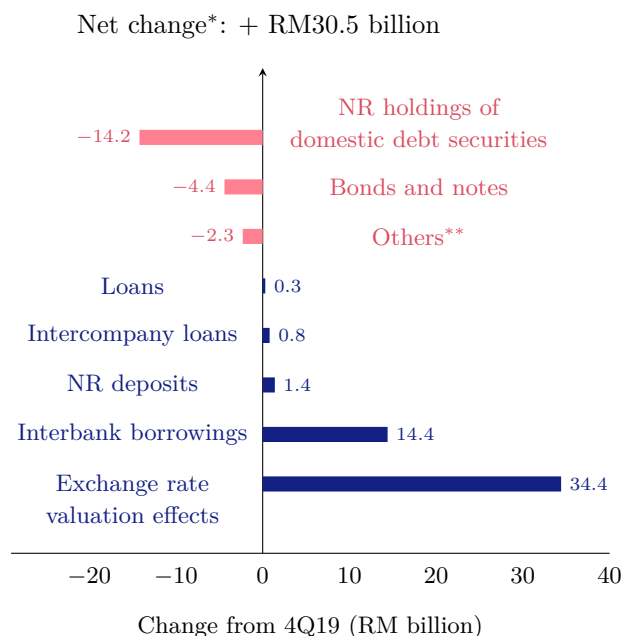
Malaysia's external debt stood at RM975.9 billion, or 64.4% of GDP as at end-March 2020 (end-December 2019: RM945.4 billion or 62.6% of GDP). The increase largely reflected valuation effects following the weaker ringgit against selected major and regional foreign currencies in the first quarter of 2020 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



*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

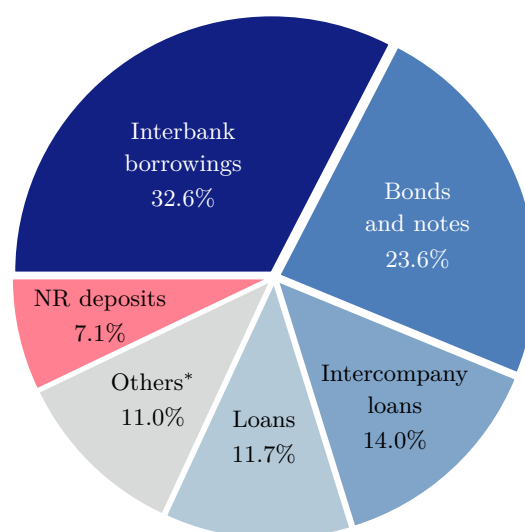
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

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 exposures³, 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.