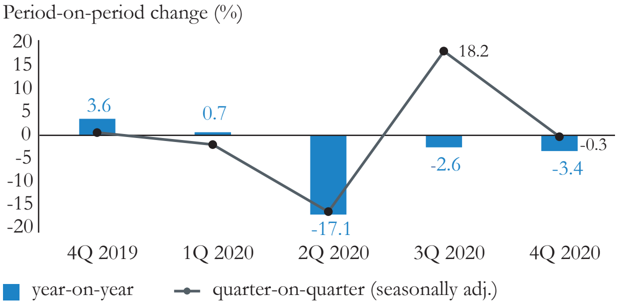
Developments in the Malaysian Economy

HIGHLIGHTS

- Domestic growth declined by 3.4%.
- Headline and core inflation moderated slightly during the quarter.
- Lower current account surplus of RM19.0 billion or 5.0% of GDP.

Growth declined in 4Q 2020

Chart 4: Real GDP Growth

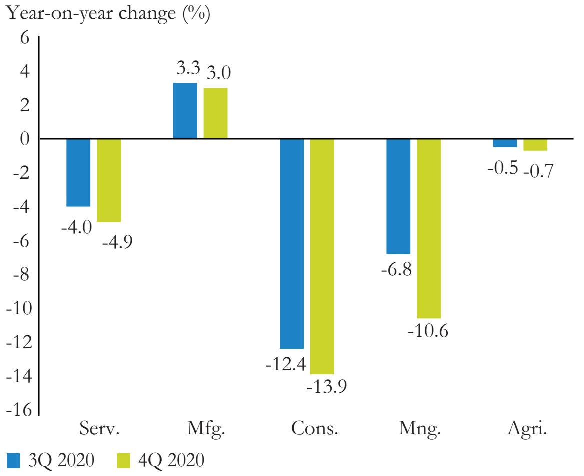


Source: Department of Statistics Malaysia

The Malaysian economy recorded a negative growth of 3.4% in the fourth quarter (3Q 2020: -2.6%), largely attributable to the imposition of the Conditional Movement Control Order (CMCO) on a number of states since mid-October. The restrictions on mobility, especially on inter-district and inter-state travel, weighed on economic activity. Nevertheless, the continued improvement in external demand provided support to growth. Consequently, except for manufacturing, all economic sectors continued to record negative growth. On the expenditure side, moderating private consumption and public investment activities weighed on domestic demand. On a quarter-on-quarter seasonally-adjusted basis, the economy registered a decline of 0.3% (3Q 2020: +18.2%).

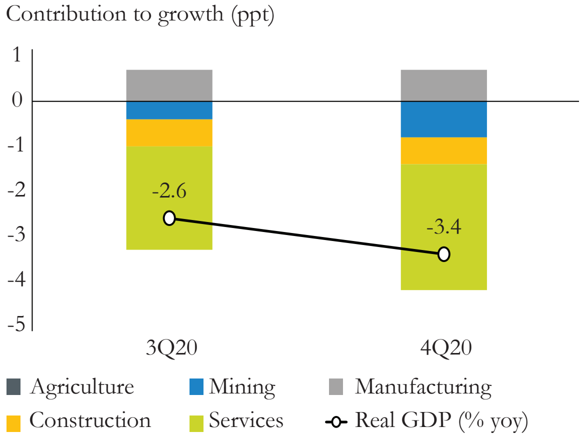
Continued negative growth in all economic sectors, except manufacturing

Chart 5: Growth by Economic Sectors



Source: Department of Statistics Malaysia

Chart 6: Contributions of Economic Sectors to Real GDP Growth



Source: Department of Statistics Malaysia

In terms of sectoral performance, all economic sectors, except manufacturing, registered negative growth in the fourth quarter.

The services sector registered a larger contraction of 4.9% in the fourth quarter of 2020 (3Q 2020: -4.0%), as tighter restrictions on mobility and stricter standard operating procedures (SOPs) affected domestic-oriented activities. The restrictions (e.g. shorter operating hours) and weak sentiments adversely impacted spending, particularly on recreational activity and non-essential retail goods, which in turn weighed on activity in the wholesale and retail trade subsector. This was partially offset by continued growth in the motor vehicle segment. In addition, the weakness in tourism activity amid continued closure of international borders weighed on key sub-sectors, such as food and beverage, accommodation as well as transport and storage. Meanwhile, finance and insurance continued to grow amid sustained loan and deposit growth. Growth in the information and communication sub-sector also improved, amid higher demand for data communication services, particularly broadband.

The agriculture sector contracted further by 0.7% (3Q 2020: -0.5%). This was due mainly to weak oil palm output as labour shortages continued to affect harvesting activities, while deteriorating weather conditions towards the end of the year led to operational constraints in production. Growth was also weighed by the continued weaknesses in the rubber, fisheries, forestry and logging subsectors, which partially offset the continued expansion in the livestock and other agriculture subsectors.

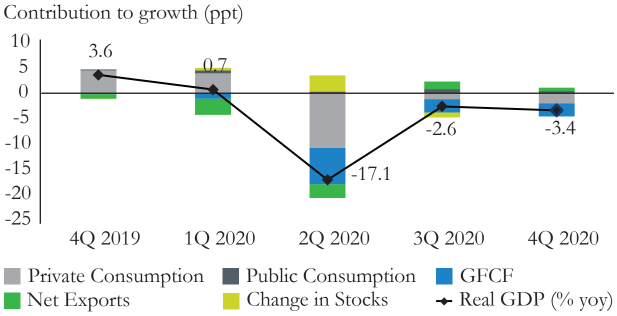
The construction sector registered a larger contraction (-13.9%; 3Q 2020: -12.4%). Labour shortages, site shutdowns due to COVID-19 outbreaks and interruptions in progress of selected work packages have affected growth, particularly in the civil engineering and residential sub sectors. The special trade sub sector, however, continued to register positive growth following support from small-scale projects under the PRIHATIN stimulus package.

The mining sector contracted further by 10.6% (3Q 2020: -6.8%). Both crude oil and natural gas production were lower during the quarter, attributed mainly to several facility closures for maintenance purposes.

The manufacturing sector expanded by 3.0% (3Q 20: 3.3%), as robust E&E production more than offset lower activity in the consumer cluster. The strong performance in the E&E sub-sector was supported by sustained global demand for semiconductors components, which has led to a global shortage. This has resulted in a build-up of order backlogs among Malaysian producers which are highly integrated in the global value chain. The positive growth in E&E was partially offset by the weakness in consumer-cluster. In particular, the refining and manufacture of palm-oil related products was affected by disruptions in the agriculture sector amid labour shortages. Several consumer-clusters, such as food and beverages, tobacco, and textiles subsectors, were affected by weaker demand due to the re-imposition of CMCO.

Decline in domestic demand

Chart 7: Contributions of Expenditure Components to Real GDP Growth



Source: Department of Statistics Malaysia

Domestic demand recorded a decline of 4.4% in the fourth quarter of 2020 (3Q 2020: -3.3%), mainly due to the subdued private consumption and public investment activities. Net exports grew by 12.4% (3Q 2020: 21.9%), with continued expansion in manufactured exports.

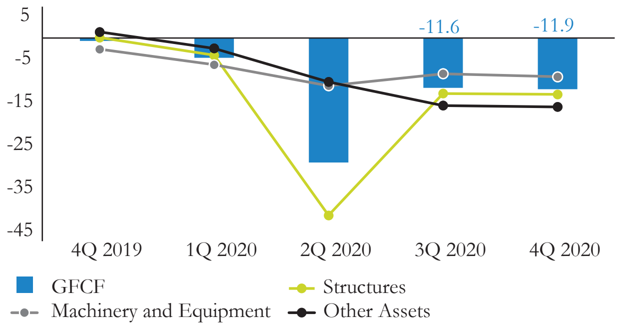
Private consumption contracted by 3.4% (3Q 2020: -2.1%). Household spending was subdued amid continued weaknesses in income and employment conditions during the quarter. Spending was also affected by tighter movement restrictions in selected states. Nevertheless, the decline in physical spending was partly mitigated by the continued acceleration in online spending. During the quarter, consumer expenditure also remained supported by various stimulus measures including the EPF *i-Lestari* withdrawals, the continued support to affected borrowers under the Targeted Repayment Assistance (TRA) and lower passenger car sales tax.

Meanwhile, public consumption continued to expand, albeit at a more moderate pace of 2.7% in the fourth quarter of 2020 (3Q 2020: 6.9%), supported by spending in emoluments.

Contraction in investment activity

Chart 8: GFCF Growth by Type of Asset

Year-on-year change (%)



Source: Department of Statistics Malaysia

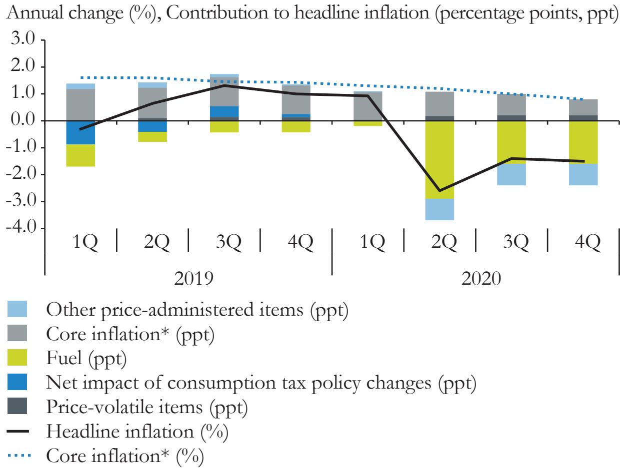
Gross fixed capital formation (GFCF) contracted further by 11.9% (3Q 2020: -11.6%), as capital spending from both private and public sectors remained relatively weak. By type of asset, investment in structures contracted by 13.1% (3Q 2020: -12.9) while investment in machinery & equipment (M&E) declined by 9.0% during the quarter (3Q 2020: -8.3%).

Private investment recorded a smaller decline of 7.0% (3Q 2020: -9.3%), mainly supported by continued capital spending in existing projects, particularly in the export-oriented industries.

Meanwhile, public investment registered a larger decline of 19.8% (3Q 2020: -18.6%). This reflects lower spending on fixed assets by the general government and weaker demand in most sectors which continued to weigh on capital spending by public corporations.

Headline inflation moderated slightly during the quarter

Chart 9: Contribution to Headline Inflation by Components



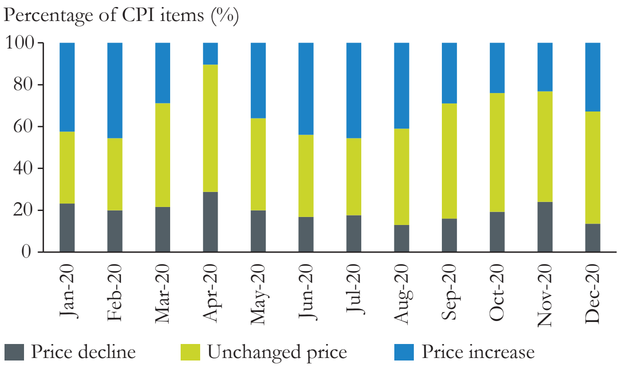
* Core inflation is computed by exluding price-volatile and price-administered items. It also excludes the estimated direct impact of consumption tax policy changes.

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

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), was slightly lower at -1.5% during the quarter (3Q 2020: -1.4%). This was mainly due to lower inflation for rental and communication services respectively as well as the larger annual decline in retail fuel prices. These were partly offset by higher inflation in other categories, in particular, transport services and food.

The lower inflation for communication services followed the lapse in the base effect of higher fixed telephone line call charges introduced in 2019. The lower rental inflation reflects weak demand for housing as income remained weak, as well as the new work arrangements and border closures. Retail fuel prices declined at an annual rate of 19.2% in the fourth quarter (-18.8% in 3Q 2020) although they were relatively stable on a quarterly basis. Following the lower inflation for communication services and rental, core inflation moderated to 0.8% during the quarter (3Q 2020: 1.0%).

Chart 10: Month-on-Month Price Changes of CPI Items*



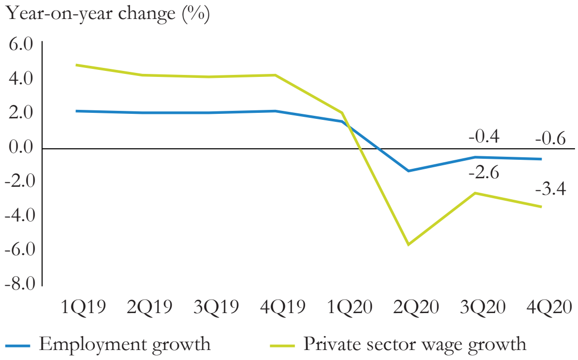
* Based on the month-on-month inflation for 125 CPI items at the 4-digit level.

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

Despite the slightly more negative headline inflation, broad-based downward pressures on prices were contained during the quarter, as reflected by the limited share of CPI items recording price declines (4Q 2020 average: 19%; 2010-2019 average: 21%).

Labour market conditions remained soft

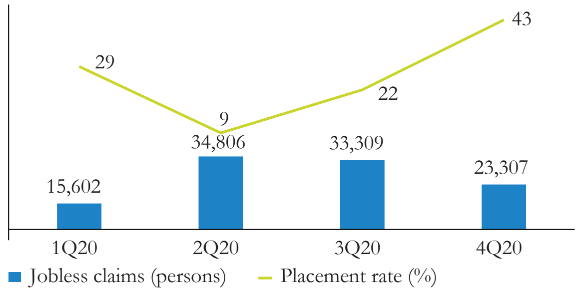
Chart 11: Employment and Wage Growth



Note: Private sector wage growth refers to wage growth of workers in the manufacturing and services sectors.

Source: Department of Statistics Malaysia

Chart 12: Jobless Claims and Placement Rate



Note: Jobless claims refers to the number of people who apply for the Employment Insurance System (EIS) benefits following loss of employment. The placement rate refers to the number of people placed in new jobs under the EIS for every 100 persons retrenched.

Source: Employment Insurance System, Social Security Organisation

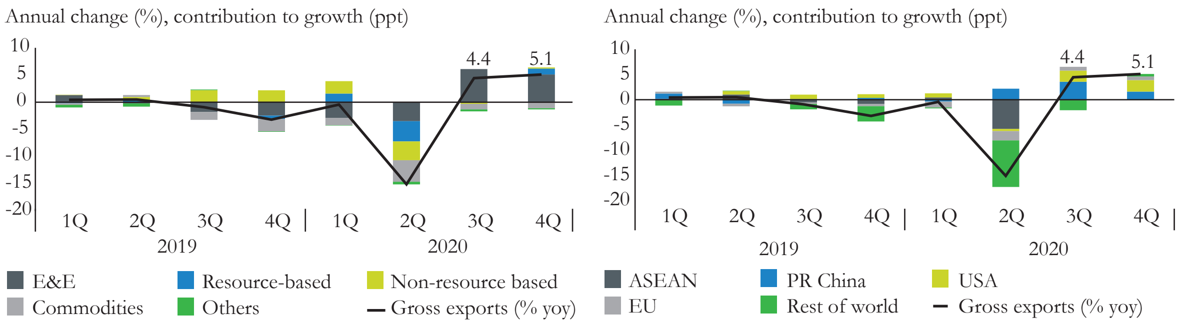
Labour market conditions remained soft amid the re-imposition of CMCO. The unemployment rate remained elevated at 4.8% (3Q 2020: 4.7%), mainly reflecting a larger decline in employment growth in the fourth quarter (-0.6%; 3Q 2020: -0.4%). Data from SOCSO reported lower jobless claims from the EIS (23,307 persons; 3Q 2020: 33,309) and higher placement rate of employees into new jobs (43 per 100 people retrenched; 3Q 2020: 22)[1]. This reflects improved labour market conditions particularly in October, before conditions deteriorated in November and December following the re-imposition of movement restrictions.

Private sector wages declined in the fourth quarter (-3.4%; 3Q 2020: -2.6%), mainly attributable to a larger contraction of wages in the services sector. Transportation & storage, accommodation and food & beverages subsectors continued to weigh on the services sector wage growth (-4.5%; 3Q 2020: -2.6%). Wage growth in the manufacturing sector also recorded a contraction, albeit smaller at 1.2% (3Q 2020: -2.7%) following weak growth in domestic-oriented manufacturing industries. These developments indicate employers remained cautious despite the recent positive manufacturing IPI performance, due to continued uncertainty surrounding the recovery trajectory.

[1] Job losses are proxied by the number of people who apply for the EIS benefits following loss of employment, while the placement rate refers to the number of people placed in new jobs under the EIS programme for every 100 persons retrenched. Thus, the placement rate is indicative of the pace of hiring, relative to retrenchment activity..

Improvement in trade activity amid higher external demand and domestic manufacturing activity

Chart 13: Gross Exports by Products and Markets



Source: Department of Statistics Malaysia

In the fourth quarter of 2020, gross exports grew by 5.1% (3Q 2020: 4.4%), driven primarily by the continued strength in manufactured exports. Gross imports registered a smaller decline of 4.5% (3Q20: -6.3%), due primarily to a more moderate contraction in intermediate imports. The trade surplus[2] amounted to RM59.9 billion (3Q 2020: RM60.3 billion).

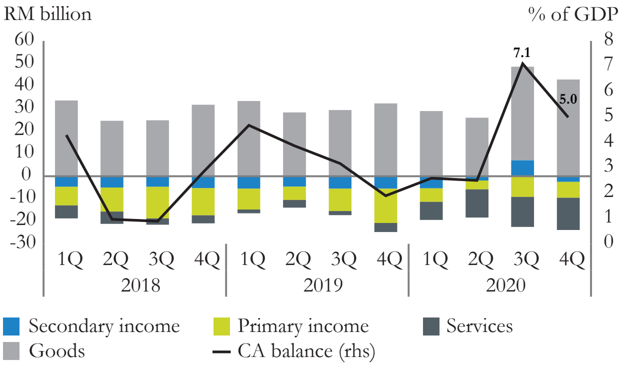
Manufactured exports continued to expand (7.6%; 3Q 2020: 6.8%), supported mainly by E&E exports (13.8%; 3Q 2020: 16.0%). This was driven by robust demand for semiconductors for work from home equipment and medical devices. Commodities exports contracted further (-7.8%; 3Q 2020: -7.2%) due to the sharp decline in crude oil export volume.

Capital imports remained in contraction during the quarter (-15.0%; 3Q 2020: -12.8%) amid the continued decline in domestic investment activity. Similarly, consumption imports declined by 0.3% (3Q 2020: 4.6%) due to lower household spending amid continued weak labour market conditions. Intermediate imports contracted at a slower pace (-7.2%; 3Q 2020: -13.5%), due to higher imports of industrial supplies, in line with the continued expansion in domestic manufacturing activity.

[2] The goods and trade surpluses differ because goods for processing, storage and distribution (with no change in ownership) are excluded from the goods account. This is as per the 6th Edition of the Balance of Payments and International Investment Position Manual by the IMF.

Lower current account surplus

Chart 14: Current Account Balance



Source: Department of Statistics Malaysia

The current account of the balance of payments registered a surplus of RM19.0 billion or 5.0% of GDP during the quarter (3Q 2020: RM26.1 billion or 7.1% of GDP). The lower surplus was due mainly to a deficit in the secondary income account and a larger deficit in the services account.

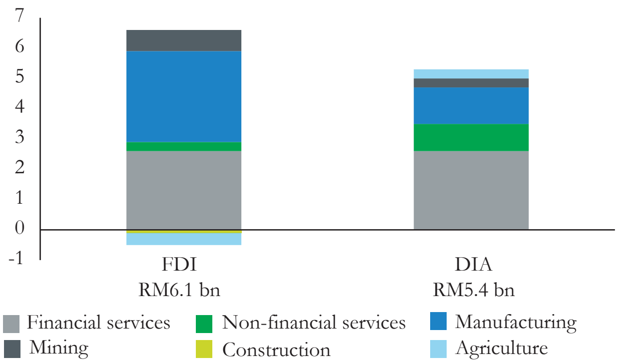
The goods surplus increased to RM42.9 billion (3Q 2020: RM41.5 billion), supported by strong exports of E&E, rubber gloves and Personal Protective Equipment (PPE). The services account recorded a larger deficit (-RM14.2 billion; 3Q 2020: -RM13.3 billion). This was due to higher payment for transportation services, as well as continued weakness in travel receipts as international travel restrictions remained.

The primary income account registered a lower deficit of RM7.1 billion (3Q 2020: -RM9.2 billion). This mainly reflected the higher income accrued to Malaysians investing abroad.

The secondary income account turned into a deficit of RM2.5 billion (3Q 2020: +RM7.1 billion) due to the absence of the transfers received last quarter as part of a settlement related to a wholly-owned subsidiary of the Minister of Finance (Incorporated).

Financial account registered a smaller net outflow supported by FDI inflows and lower outflows in portfolio and other investments

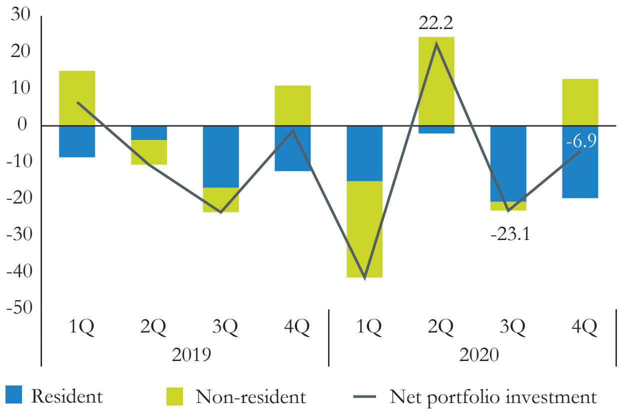
Chart 15: Direct Investment by Sector



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

Source: Department of Statistics Malaysia and Bank Negara Malaysia

Chart 16: Portfolio Investment



Source: Department of Statistics Malaysia and Bank Negara Malaysia

The financial account recorded a smaller net outflow of RM10.8 billion (3Q 2020: -RM35.2 billion), reflecting mainly lower outflows in the portfolio investment and other investment accounts.

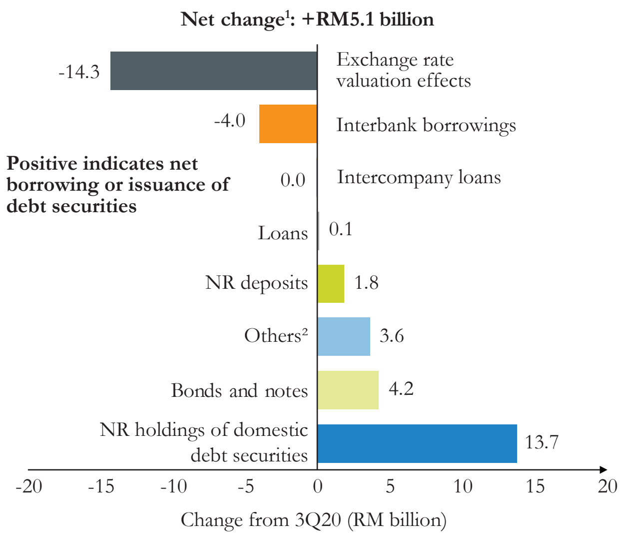
The direct investment account turned around to register a marginal net inflow of RM0.8 billion (3Q 2020: -RM3.1 billion) as foreign direct investment (FDI) registered a net inflow. Net FDI inflows, which amounted to RM6.1 billion (3Q 2020: -RM0.8 billion), were driven mainly by higher equity injections into Malaysia (RM4.4 billion; 3Q 2020: RM3.8 billion) as well as inflows from debt instruments (+RM3.5 billion; 3Q 2020: -RM9.4 billion). The inflows were primarily channelled into the services and manufacturing sectors. DIA recorded higher outflows of RM5.4 billion in the fourth quarter (3Q 2020: -RM2.2 billion). These investments abroad were channelled mainly into the services sector, notably the financial services and information and communication services sub-sectors.

The portfolio investment account recorded a smaller net outflow of RM6.9 billion (3Q 2020: -RM23.1 billion) driven by net inflows of non-resident (NR) portfolio investments of RM12.8 billion (3Q 2020: -RM2.4 billion) amid continued residents' portfolio investments abroad of RM19.7 billion (3Q 2020: -RM20.7 billion). Residents' portfolio investments abroad were driven by institutional investors' acquisitions of equity securities. Net NR portfolio investment inflows reflected inflows into debt securities (+RM14.1 billion; 3Q 2020: +RM4.5 billion) particularly Government bonds. This more than offset the continued, albeit smaller, liquidation of domestic equity securities (-RM1.3 billion; 3Q 2020: -RM6.9 billion).

The other investment account registered a smaller net outflow of RM3.7 billion (3Q 2020: -RM8.5 billion). This was due primarily to lower repayment of interbank borrowings. Net errors and omissions amounted to -RM10.8 billion during the quarter, or -2.2% of total trade.

External debt remained manageable

Chart 17: Changes in External Debt



[1] Changes in individual debt instruments exclude exchange rate valuation effects

[2] Comprises trade credits, IMF allocation of SDRs and other debt liabilities

Note: Figures may not add up due to rounding

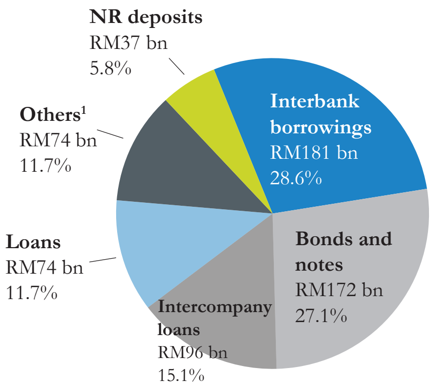
Source: Ministry of Finance Malaysia and Bank Negara Malaysia

Malaysia's external debt amounted to RM958.5 billion, or 67.7% of GDP as at end-December 2020 (end-September 2020: RM953.3 billion or 66.5% of GDP). The increase was due mainly to an increase in NR holdings of Government domestic debt securities, and a net issuance of international bonds and notes by corporates. This was partly offset by exchange rate valuation effects following the stronger ringgit against selected major and regional foreign currencies in the fourth quarter of 2020.

The country's external debt remained manageable, given its favourable currency and maturity profiles. Ringgit-denominated external debt amounted to RM325 billion and accounted for 33.9% of total external debt (end-September 2020: 33.1%). It was largely in the form of NR holdings of domestic debt securities (67.7% share of ringgit-denominated external debt) and ringgit deposits (17.7% share) in resident banking institutions. These liabilities were not affected by fluctuations in the ringgit exchange rate.

Foreign currency (FCY) external debt accounted for the remaining RM633.4 billion, or 66.1% of total external debt. 51.5% of FCY-denominated external debt were by the corporate sector, and are mainly subject to prudential and hedging requirements. 27.1% of total FCY-denominated external debt were long-term bonds and notes issued offshore, mainly by non-financial corporates and channelled primarily to finance asset acquisitions abroad. Intercompany loans, which accounted for 15.1% of FCY-denominated external debt, were generally on flexible and concessionary terms.

Chart 18: Breakdown of FCY-Denominated External Debt (RM billion, % share)



[1] Comprises trade credits, IMF allocation of SDRs, and other debt liabilities.

Source: Ministry of Finance Malaysia, Department of Statistics Malaysia, and Bank Negara Malaysia

Interbank borrowings and FCY deposits in the domestic banking system accounted for 34.4% of FCY-denominated external debt. The decline in interbank borrowings during the quarter was largely driven by maturing back-to-back intragroup transactions by banks in the Labuan International Business and Financial Centre. This was partially offset by the increase in interbank borrowings by some domestic banking groups as a pre-emptive measure to accumulate additional liquidity buffers in anticipation of a potential tightening in domestic US dollar liquidity conditions towards the year end. Nonetheless, three-quarters of interbank borrowings were in the form of intragroup borrowings, which are 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 below its long-term average at 5.3% of banks' total capital (end-September 2020: 4.6%; 5-year average: 5.7%).

From a maturity perspective, a larger share of total external debt during the quarter was skewed towards medium- to long-term tenure (61.7%; end-September 2020: 61.2%). Short-term external debt accounted for the remaining 38.3% of external debt, where 42.3% were intragroup borrowings, which were generally stable and on concessionary terms. About another 13.6% were accounted by trade credits, largely backed by export earnings and are self-liquidating. As at 29 January 2021, international reserves stood at USD108.6 billion, sufficient to finance 8.6 months of retained imports, and is 1.2 times the short-term external debt.

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