

Economic, Monetary and Financial Developments in 2019

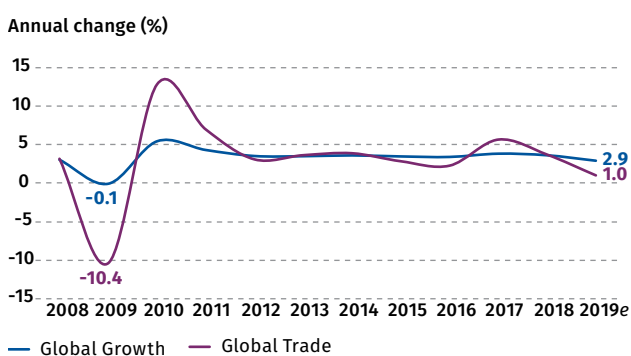
MODERATE GROWTH PERFORMANCE AMID HEADWINDS

Challenging global environment

The global economy and global trade expanded by 2.9% and 1.0%, respectively in 2019 (2018: 3.6% and 3.7%, respectively), which were the lowest since 2009 (Chart 1.1). The sharp moderation in growth of both economic and trade activities was due mainly to the protracted and unresolved global trade tensions which exacerbated the cyclical downturn in global manufacturing and investment activities. Firm consumer demand and timely policy actions, however, provided some support to global growth.

The cycles of intensification and de-escalation of trade tensions in 2019 generated significant uncertainties, which affected business sentiments and resulted in intermittent spikes in financial market volatility (Chart 1.2). Throughout the year, the trade dispute between the US and PR China broadened to encompass more products and moved

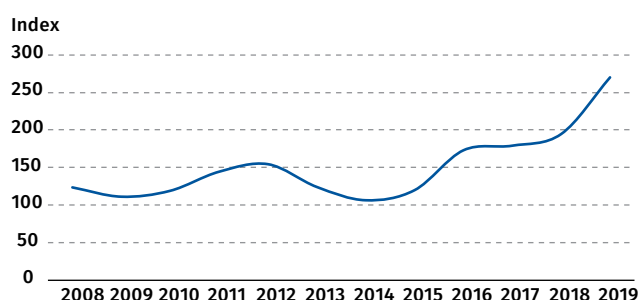
Chart 1.1: Global Growth and Trade



^e Estimate

Source: International Monetary Fund (IMF)

Chart 1.2: Global Economic Policy Uncertainty (PPP-adjusted GDP weights)



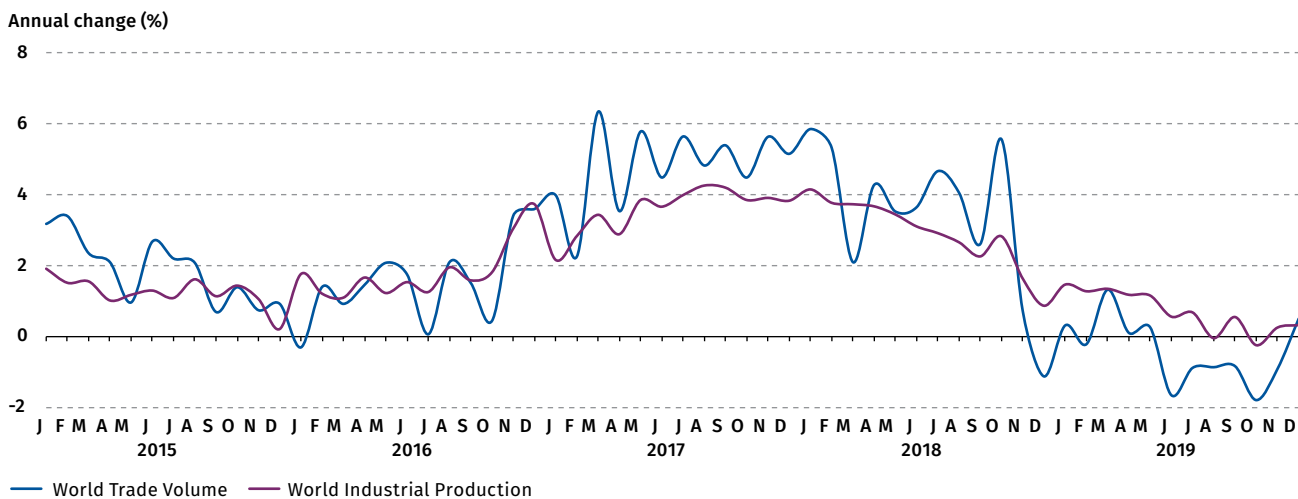
Source: www.policyuncertainty.com

beyond tariffs on goods to include company-specific sanctions, particularly in the technology industry. Increasingly, the trade dispute has led multinational corporations to reassess their global production strategies, prompting a reconfiguration of global value chains.

The trade dispute compounded the ongoing cyclical downturn in global trade and dampened investment activity (Chart 1.3). Amidst weak demand conditions, the automotive industry was severely affected by supply disruptions, while the tech cycle was on a downturn. Investment activity in many major economies was thus weakened by the concurrent effects of a poor near-term business outlook and uncertainties surrounding the trade dispute.

Despite weaker trade and investment activities, steady consumption demand provided some support to global growth. Domestic demand in major economies was supported by resilient private consumption, underpinned by favourable labour market conditions with stable wage growth and lower unemployment rates. Expansionary fiscal policies in the US and most emerging market economies (e.g. PR China and developing Asia) also helped to cushion growth.

Chart 1.3: World Trade Volume and Industrial Production



Source: Netherlands Bureau for Economic Policy Analysis

Global growth was also supported by broad-based monetary policy easing in an environment of low inflation. Major central banks turned more accommodative towards mid-2019 amid broad-based weakness in growth and the materialisation of idiosyncratic risks. After raising its Federal Funds Rate (FFR) nine times from 2015 to 2018, the US Federal Reserve reduced the FFR three times in 2019.¹ Similarly, the European Central Bank reduced its deposit rate, and announced the resumption of quantitative easing. The prospect of weaker domestic growth conditions was also prevalent in emerging market economies, where policy rate reductions followed suit.

Financial markets dominated by global risk aversion

Against this uncertain global environment, global capital flows were volatile, primarily dominated by risk aversion during the year. Moreover, country-specific risks such as the prolonged state of Brexit negotiations and political unrest in Hong Kong SAR and Latin America, resulted in episodes of sharp capital flows and exchange rate movements, as uncertainty levels were elevated and investor sentiments were subdued. These amplified global risk aversion, which led to a sustained demand for safe haven assets such as the US dollar and gold, and safer financial asset classes, such as sovereign bonds, as well as capital flow reversals from emerging market economies.

Reflective of global drivers, and to some extent domestic factors, Malaysia's financial markets experienced significant two-way portfolio flows throughout the year. Apart from trade tensions, shifts in non-resident portfolio flows were also triggered by idiosyncratic events such as the FTSE Russell's review on Malaysia's potential exclusion from the World Government Bond Index (WGBI). Notwithstanding the two-way capital flow movements throughout the year, Malaysia registered net non-resident portfolio inflows amounting to RM11.0 billion (equivalent to USD2.7 billion) in 2019. The international reserves position in US dollar terms increased by USD2.2 billion to USD103.6 billion as at end-2019 (end-2018: USD101.4 billion) and was largely attributed to positive investment returns on the Bank's reserves assets amounting to USD5.4 billion in 2019, as well as the Government's 10-year Samurai Bond issuance amounting to JPY200 billion (equivalent to USD1.8 billion).

Despite financial market volatility, the ringgit ended the year with an appreciation against the US dollar and the trade-weighted basket of currencies of Malaysia's major trading partners (NEER). The ringgit appreciated by 1.1% to close at RM4.0925 against the US dollar, while the NEER appreciated by 0.8% (Chart 1.4).

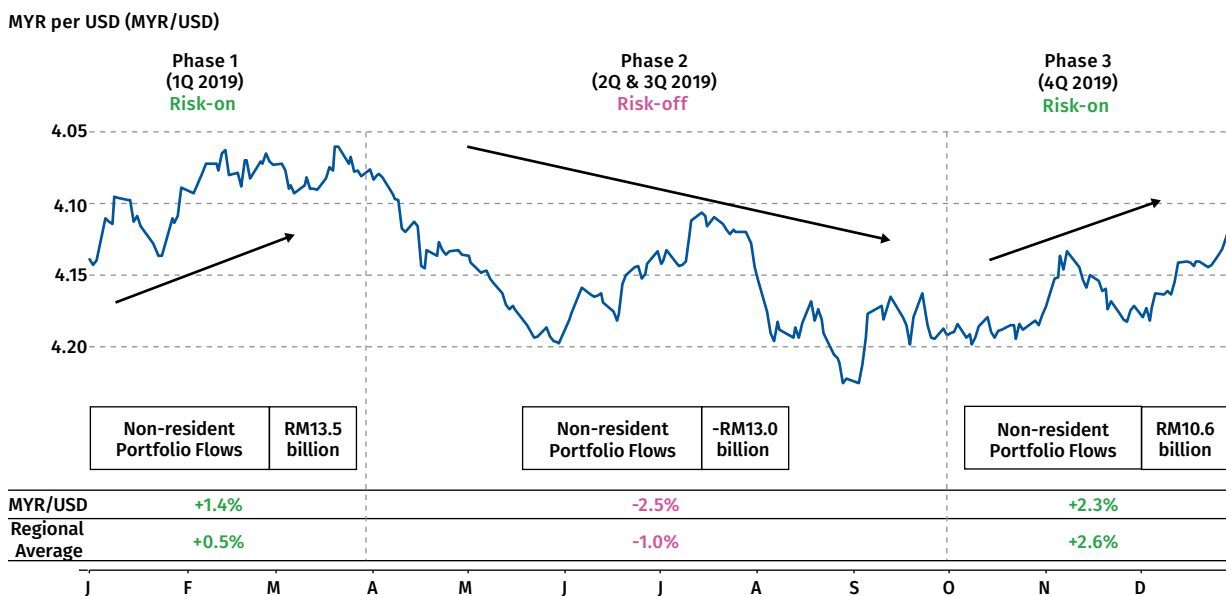
¹ The target range for the FFR was raised from 0.25-0.50% in December 2015 to 2.25-2.50% in December 2018. By the end of 2019, the target range was reduced to 1.50-1.75%.

Two-way portfolio flows and periods of exchange rate volatility in 2019

In 2019, Malaysia experienced significant shifts in portfolio flows amid intermittent periods of heightened exchange rate volatility. This was due mainly to shifting investor risk sentiments driven by global developments. Domestic factors to some extent, also played a role in affecting investor sentiments.

Non-resident portfolio flows and ringgit developments in 2019 can be characterised into three distinct phases (Chart 1). In the first phase (1Q 2019), the global risk-on investment cycle took place amid expectations of the US Federal Reserve’s more accommodative monetary policy stance. Higher investor appetite for riskier assets drove portfolio inflows to the region, resulting in an appreciation of the ringgit against the US dollar, in line with most regional currencies. However, this trend reversed during the second phase (2Q – 3Q 2019), due mainly to higher global risk aversion amid the escalation of trade disputes between the US and PR China. The FTSE Russell’s review on Malaysia’s potential exclusion from the WGBI in April also weighed on investor sentiments. In the final phase (4Q 2019), there was a resumption in non-resident portfolio inflows as investor sentiments improved amid some progress in the trade talks between the US and PR China. This subsequently led to the ringgit appreciating by 1.1% in 2019 to close at RM4.0925 against the US dollar.

Chart 1: Movement of Ringgit against the US dollar and Non-resident Portfolio Flows in 2019



Note: Regional average reflects the movements of selected regional currencies against the US dollar, which includes Chinese renminbi, Indonesian rupiah, Korean won, Philippine peso, Singapore dollar, New Taiwan dollar and Thai baht

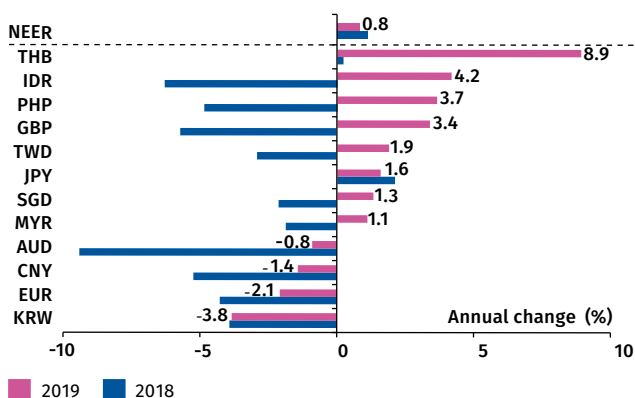
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Amid a challenging global environment, the flexibility in the ringgit exchange rate plays an important role as a shock absorber to the changing external conditions thus helping to preserve macroeconomic stability and growth. At the same time, the Bank remains cognisant that an excessively volatile ringgit could lead to heightened uncertainties, financial instability and may disrupt economic activity. As such, the Bank conducted two-way foreign exchange intervention operations to manage excessive exchange rate volatility and ensure orderly foreign exchange market conditions. Ongoing financial market liberalisation efforts by the Bank had also increased accessibility and flexibility for market participants to better manage foreign exchange risks.

As Malaysia is an open economy, bilateral currency movements alone, such as the ringgit against the US dollar or Thai baht, is neither a good measure of overall ringgit performance nor does it fully reflect Malaysia’s

underlying fundamentals. In the short-term, bilateral exchange rate movements can be largely driven by sentiments surrounding specific factors regarding the currency pair in question, such as the economic, monetary policy or political situation of the country. For example, movements in the ringgit against the US dollar in 2019 was due partially to developments in the US and the US dollar being a safe haven currency during periods of risk aversion. Instead, the overall performance of the ringgit is better reflected through the ringgit's performance against a trade-weighted basket of currencies of Malaysia's major trading partners (i.e. Nominal Effective Exchange Rate (NEER)). In 2019, the ringgit NEER appreciated by 0.8% (2018: 1.1%). In the medium- to longer-term, the performance of the ringgit will reflect Malaysia's economic fundamentals.

Chart 1.4 : Performance of Major and Regional Currencies against the US Dollar and Ringgit Nominal Effective Exchange Rate (NEER)



Note: (+) indicates an appreciation of currencies against the US dollar
NEER shows the value of the ringgit against a trade-weighted basket of Malaysia's major trading partners' currencies

Source: Bank Negara Malaysia

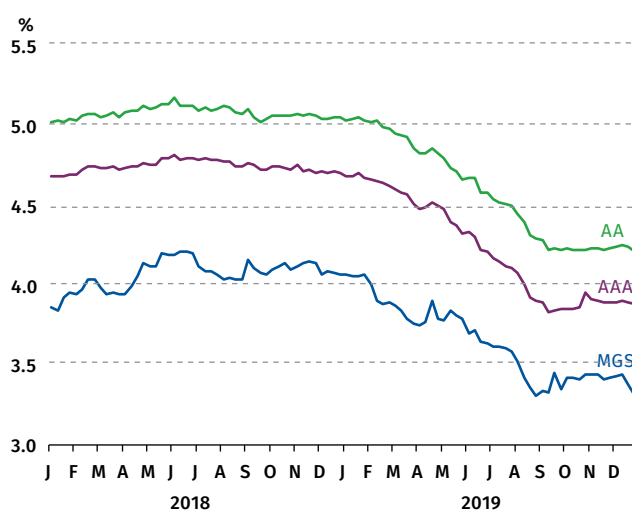
Meanwhile, performance of the domestic bond and equity markets diverged, with non-resident inflows into the bond market and outflows from the equity market. In the bond market, the decision by FTSE Russell to retain Malaysia in the WGBI in September 2019 reinforced positive sentiments in the bond market. As a result of the inflows and the reduction in the Overnight Policy Rate (OPR) in May 2019, Government bond yields² trended lower over the course of the year by 49 – 77 basis points across the tenures (Chart 1.5). Correspondingly, yields on the higher-rated corporate bonds³ also declined by 71 – 85 basis points. The equity market,⁴ in contrast, trended lower by 6.0% (2018: -5.9%) to end at 1,588.8 points (2018: 1,690.6 points) amid a net sell-off by non-resident investors (-RM6.7 billion). Domestic equities were further weighed down by moderate corporate earnings outlook, particularly in the financial services, and industrial products and services sectors, which saw sizeable stock price decrease during the year (Chart 1.6).

² Refers to yields on benchmark Malaysian Government Securities (MGS) across the 1 - 10 year tenures.

³ Refers to AAA- and AA-rated papers across the 3 – 10 year tenures.

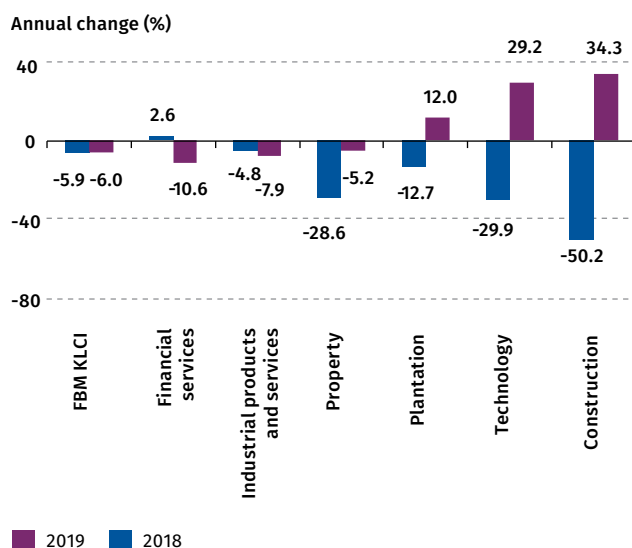
⁴ Refers to the benchmark FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI).

Chart 1.5: 10-year MGS and 10-year Corporate Bond Yields



Source: Bank Negara Malaysia

Chart 1.6: Performance of Sectoral Equity Indices

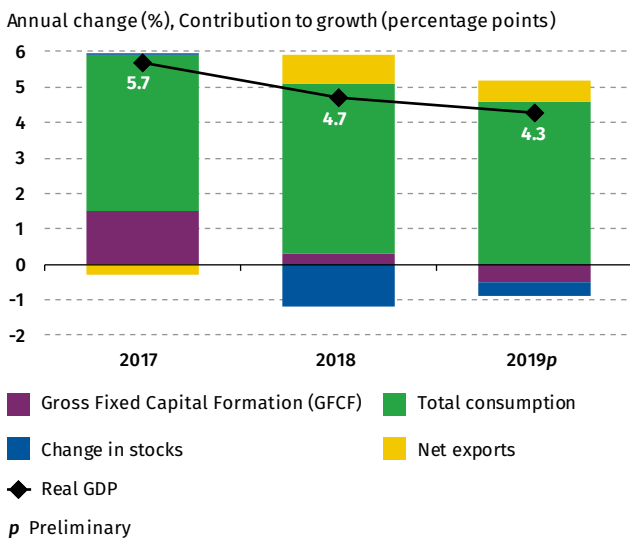


Source: Bloomberg

The Malaysian economy expanded by 4.3% in 2019

Growth of the Malaysian economy was supported by resilient private sector spending, which grew by 6.2% amid a challenging external environment. In particular, household spending remained firm and provided support to overall growth. In line with most emerging market economies, however, weaker external demand weighed on Malaysia's exports and investment activity (Chart 1.7). In the second half of the year, the economy was affected by supply disruptions in the commodities sector.

Chart 1.7: Real GDP by Expenditure

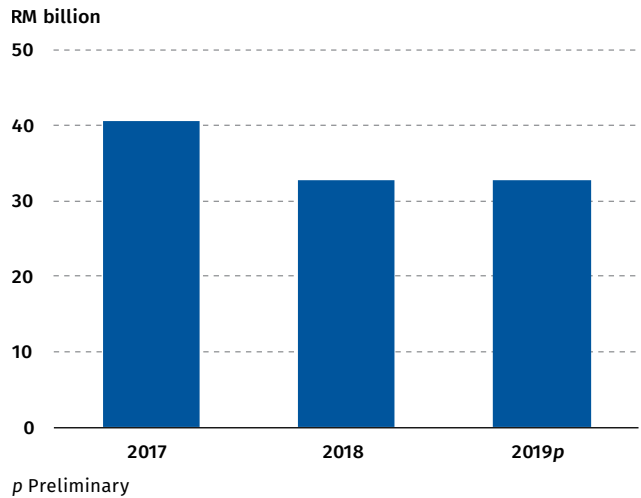


Source: Department of Statistics, Malaysia

Private consumption remained firm in 2019 (7.6%, 2018: 8.0%). In 2018, consumer spending was lifted by the 3-month tax holiday prior to the transition to the Sales and Services Tax (SST) and the dissipation of this one-off factor resulted in a more moderate expansion in private consumption in 2019. Notwithstanding, household spending was supported by continued income and employment growth. Lower income households also benefitted from key Government measures such as the increase in minimum wage and cash transfers (e.g. *Bantuan Sara Hidup*).

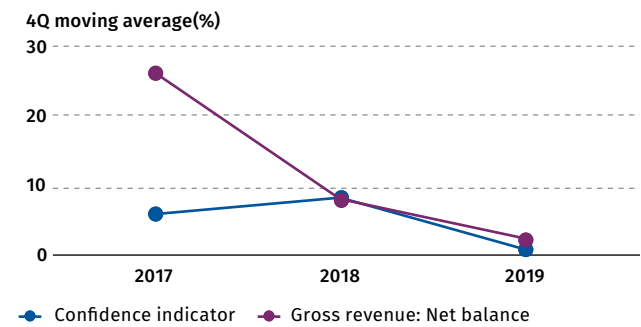
In addition to lower global demand, investment activity in Malaysia was weighed down by weak investor sentiments. While foreign direct investment (FDI) remain sustained, investments by the private sector were affected by the

Chart 1.8: Foreign Direct Investment



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.9: Business Tendency Survey



Source: Department of Statistics, Malaysia

highly uncertain global outlook, a broad-based decline in corporate profitability and continued weakness in the domestic property market (Charts 1.8 and 1.9). Meanwhile, investments by the public sector were particularly weak due mainly to lower capital spending by public corporations and the review of some large projects.

However, weakness in investment activity was mitigated by several factors. First, large multi-year investment projects in the resource-based and electrical and electronic (E&E) manufacturing subsectors continued to make steady progress. Second, the resumption of several rail transport projects, mainly in the second half of the year, provided some lift to investment growth. Third, broadly stable global oil prices in 2019 also supported further capital outlay by companies in the mining sector.

Table 1.1

Malaysia - Key Economic Indicators

	2017	2018	2019 ^p
Population (million persons)	32.0	32.4	32.6
Employment (million persons)	14.5	14.8	15.1
Unemployment (as % of labour force)	3.4	3.3	3.3
Per Capita Income (RM)	41,627	43,086	45,034
(USD)	9,680	10,678	10,871
NATIONAL PRODUCT (% change)			
Real GDP at 2015 prices	5.7	4.7	4.3
(RM billion)	1,299.9	1,361.5	1,420.5
Agriculture, forestry and fishery	5.7	0.1	1.8
Mining and quarrying	0.4	-2.6	-1.5
Manufacturing	6.0	5.0	3.8
Construction	6.7	4.2	0.1
Services	6.2	6.8	6.1
Nominal GNI	9.7	4.7	5.2
(RM billion)	1,333.0	1,395.3	1,467.3
Real GNI	5.7	3.6	5.1
(RM billion)	1,280.8	1,327.1	1,394.9
Real aggregate domestic demand ¹	6.5	5.5	4.3
Private expenditure	7.4	7.1	6.2
Consumption	6.9	8.0	7.6
Investment	9.0	4.3	1.5
Public expenditure	3.4	0.1	-2.7
Consumption	5.5	3.3	2.0
Investment	0.3	-5.0	-10.8
Gross national savings (as % of GNI)	29.2	26.7	24.9
BALANCE OF PAYMENTS (RM billion)			
Goods balance	117.1	119.2	125.5
Exports	801.4	832.8	817.8
Imports	684.3	713.6	692.2
Services balance	-22.9	-17.7	-10.9
Primary income, net	-38.7	-51.6	-43.5
Secondary income, net	-17.3	-19.3	-21.4
Current account balance	38.3	30.6	49.7
(as % of GDP)	2.8	2.1	3.3
Bank Negara Malaysia international reserves, net ²	414.6	419.5	424.0
(in months of retained imports)	7.2	7.4	7.5
PRICES (% change)			
Consumer Price Index (2010=100)	3.7	1.0	0.7 ³
Producer Price Index (2010=100)	6.7	-1.1	-1.4 ³

¹ Exclude stocks

² All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank Negara Malaysia's audited accounts

³ Actual figures for 2019

^p Preliminary

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 1.2

Malaysia - Financial and Monetary Indicators

FEDERAL GOVERNMENT FINANCE (RM BILLION)	2017	2018	2019p			
Revenue	220.4	232.9	264.4			
Operating expenditure	217.7	231.0	263.3			
Net development expenditure	43.0	55.3	52.6			
Overall balance	-40.3	-53.4	-51.5			
Overall balance (% of GDP)	-2.9	-3.7	-3.4			
Public sector net development expenditure	131.8	142.0	139.1			
Public sector overall balance (% of GDP)	-3.6	-4.6	-6.5			
EXTERNAL DEBT						
Total debt (RM billion)	885.2	924.9	946.3			
Medium- and long-term debt	533.4	519.6	554.5			
Short-term debt	351.8	405.3	391.8			
Debt service ratio ¹ (% of exports of goods and services)						
Total debt	15.3	11.8	12.8			
Medium- and long-term debt	15.0	11.3	12.2			
MONEY AND BANKING	Change in 2017		Change in 2018		Change in 2019	
	RM billion	%	RM billion	%	RM billion	%
Money supply M1	42.0	11.0	4.9	1.2	24.8	5.8
M3	81.2	4.9	158.1	9.1	67.0	3.5
Banking system deposits	70.6	4.1	163.2	9.2	55.5	2.9
Banking system loans ²	62.9	4.1	121.4	7.7	65.8	3.9
Loan to fund ratio (% , end of year) ^{3,4}	83.9		83.1		83.2	
Loan to fund and equity ratio (% , end of year) ^{3,4,5}	73.5		72.6		72.9	
INTEREST RATES (% , AS AT END-YEAR)					2019	
Overnight Policy Rate (OPR)	3.00		3.25		3.00	
1-month interbank	3.08		3.45		3.08	
Commercial banks						
Fixed deposit 3-month	2.94		3.15		2.90	
12-month	3.10		3.33		3.09	
Savings deposit	0.97		1.07		0.97	
Weighted average base rate (BR)	3.64		3.91		3.68	
Base lending rate (BLR)	6.68		6.91		6.71	
Treasury bill (3-month)	2.86		3.29		2.98	
Malaysian Government Securities (1-year) ⁶	2.89		3.45		2.96	
Malaysian Government Securities (5-year) ⁶	3.56		3.78		3.18	
EXCHANGE RATES (AS AT END-YEAR)					2019	
Movement of Ringgit (%)						
Change against SDR	5.2		-0.2		1.9	
Change against USD	10.4		-1.8		1.1	

¹ Includes prepayment of medium- and long-term debt² Includes loans sold to Cagamas³ Loans exclude loans sold to Cagamas and loans extended to banking institutions. Beginning July 2015, loans exclude financing funded by Islamic Investment accounts.⁴ Funds comprise deposits (excluding deposits accepted from banking institutions and Bank Negara Malaysia) and all debt instruments (including subordinated debt, debt certificates/sukuk issued, commercial papers and structured notes)⁵ Equities comprise ordinary and preferred shares, share premium and retained earnings⁶ Refers to data from Fully Automated System for Issuing/Tendering (FAST), Bank Negara Malaysia

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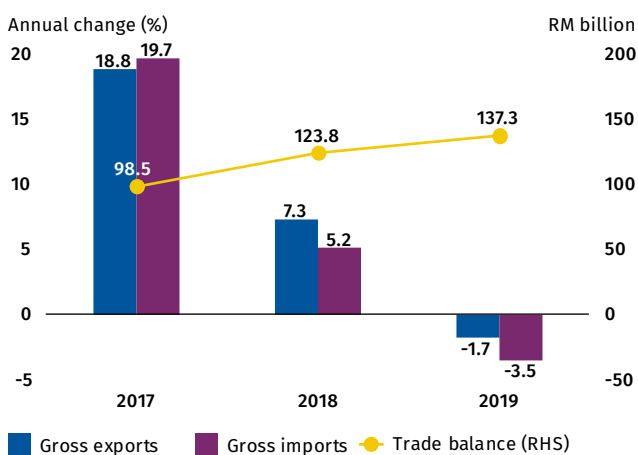
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

The domestic economy continued to be affected by supply disruptions in the production of key commodities in 2019. Following the severe supply disruptions in 2018, growth in the agriculture and mining sectors rebounded in the first half of 2019 driven mainly by the recovery in oil palm and natural gas production. In the second half of the year, however, growth in the agriculture sector contracted as the lagged impact of dry weather conditions and a cutback in fertiliser application in the early part of the year affected oil palm yields. Similarly, growth in the mining sector also declined as facility closures and maintenance work had affected both crude oil and natural gas output.

The lower commodity production compounded the subdued external demand and ongoing trade tensions, resulting in a decline of 1.7% in Malaysia's gross exports in 2019 (2018: 7.3%) (Chart 1.10). Nevertheless, the adverse impact of lower demand from any single market or product was partially mitigated by Malaysia's diversified exports market and product base (Chart 1.11). In addition, Malaysia also benefitted from some trade diversion which partially offset the negative impact of trade tensions on exports during the year.

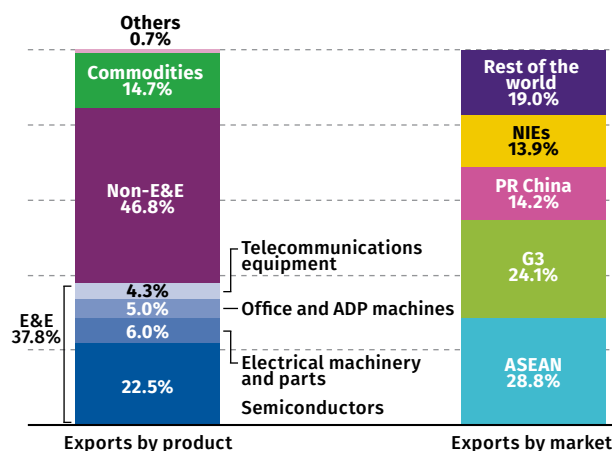
Collectively, the decline in external demand and investment activity resulted in lower demand for imports, which declined by 3.5% in 2019 (2018: 5.2%). In tandem with the decline in exports, imports for further processing as well as imports for re-export activity were subdued in 2019. The lower investment activity also reduced demand for capital imports, particularly machinery and transport equipment.

Chart 1.10: Gross Exports, Gross Imports and Trade Balance



Source: Department of Statistics, Malaysia

Chart 1.11: Share of Exports by Product and Market in 2019



Note: 1) G3 includes the US, the euro area and Japan
2) Newly Industrialised Economies (NIEs) refers to Hong Kong SAR, Korea and Chinese Taipei

Source: Department of Statistics, Malaysia

The larger contraction in goods imports vis-à-vis weak export growth contributed towards a higher current account surplus of RM49.7 billion or 3.3% of GDP (2018: RM30.6 billion or 2.1% of GDP). The higher current account surplus was also attributable to an increase in tourism receipts. This was further supported by a lower primary income deficit, in line with more moderate FDI income during the year.

Domestic demand continued to support growth in 2019

In 2019, domestic demand remained the key driver of growth in the Malaysian economy, mainly supported by an expansion in private sector spending amid weaker public sector expenditure (Table 1). On the external front, net exports lent some support to growth, despite a decline in real exports and imports against a backdrop of subdued global trade performance.

Table 1

Real GDP by Expenditure (2015=100)

	2019p	2018	2019p	2018	2019p
	% of GDP	Annual change (%)		Contribution to growth (percentage point)	
Domestic Demand¹	94.1	5.5	4.3	5.2	4.1
Private sector expenditure	75.6	7.1	6.2	5.1	4.6
Consumption	58.8	8.0	7.6	4.4	4.3
Investment	16.8	4.3	1.5	0.7	0.3
Public sector expenditure	18.5	0.1	-2.7	0.0	-0.5
Consumption	12.2	3.3	2.0	0.4	0.3
Investment	6.3	-5.0	-10.8	-0.4	-0.8
Gross Fixed Capital Formation	23.1	1.4	-2.1	0.3	-0.5
Change in stocks	-1.4			-1.2	-0.4
Net Exports of Goods and Services	7.3	11.4	8.9	0.8	0.6
Exports	64.0	2.2	-1.1	1.5	-0.8
Imports	56.7	1.3	-2.3	0.8	-1.4
Real Gross Domestic Product (GDP)	100.0	4.7	4.3	4.7	4.3

¹ Excluding stocks
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Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Private consumption continued to record a strong growth of 7.6% in 2019, which was well above its long-term average (2011-2018: 7.0%). This was driven by supportive labour market conditions and selected Government measures amid a modest inflation environment. Households also continued to sustain spending, particularly on necessities.

Gross fixed capital formation (GFCF) registered a contraction of 2.1% in 2019, reflecting slower capital spending by the private sector and a decline in public investment. By type of asset, lower capital spending in both structures (2019: -0.6%; 2018: 1.9%) and machinery and equipment (2019: -5.4%; 2018: 0.7%) weighed on the overall growth performance.

Private investment expanded at a slower pace of 1.5%. The heightened uncertainty surrounding global trade tensions affected business sentiments of both domestic and export-oriented firms. Similarly, domestic policy uncertainty arising from the review of infrastructure projects also dampened overall sentiments. The continued weakness in the domestic residential and non-residential property market had also contributed towards the modest investment performance.

However, investment was supported by the implementation of new and ongoing projects in both the manufacturing and services sectors. In particular, capacity expansions in the manufacturing sector were evident in the resource-based and E&E industries, while in the services sector, investments benefitted from sustained capital spending in the transport and healthcare services subsectors. Investment intentions also remained positive as reflected by the encouraging investment approvals during the year.

Public investment declined by 10.8%, due mainly to the completion of large-scale projects by public corporations. The continued rationalisation efforts by the Government, as reflected by the ongoing review of several large-scale infrastructure projects had also contributed to lower spending by public corporations. Nevertheless, capital expenditure remained supported by Federal Government spending, particularly in the education and housing sectors.

Public consumption expanded at a moderate pace of 2.0%, as continued growth in emoluments was weighed down by lower Government spending on supplies and services. This is in line with the Government's commitment to optimise expenditure without affecting the delivery of public services.

Moderate growth in major economic sectors

The services and manufacturing sectors remained as key contributors to growth (Table 1). However, these sectors expanded at a more moderate pace mainly on account of weaker external demand and a normalisation in the growth of household spending. The agriculture and mining sectors benefitted from an improvement in oil palm yields, and a recovery in natural gas production from pipeline disruptions in 2018, respectively. These sectors, which had improved in the first half of the year, subsequently contracted in the second half amid a recurrence in supply disruptions which had affected the production of oil palm, natural gas and crude oil. Growth in the construction sector moderated, following the completion of large projects, smaller scale and fewer number of new projects and an oversupply of properties.

The services sector expanded by 6.1% (2018: 6.8%), as growth normalised following a robust performance in 2018, when the tax holiday period encouraged greater consumer spending. Growth in the wholesale and retail trade as well as food, beverages and accommodation subsectors remained firm, lifted by firm household spending amid supportive labour market conditions. The transport and storage subsector benefitted from higher transshipment activity, despite being partially offset by slower global trade activity. Growth in the finance and insurance subsector moderated amid slower loan and deposit growth. However, this was partially mitigated by the rebound in the fee-based income as a result of more IPO offerings during the year. Growth in the information and communication subsector moderated, following the one-off price reduction in fixed broadband prices under the Mandatory Standard Access Pricing regulation in 2018.

The manufacturing sector recorded a slower growth of 3.8% in 2019 (2018: 5.0%). Within the export-oriented clusters, weak external demand affected manufacturing activity in the electrical and electronics (E&E) cluster, while the supply disruptions in key commodities led to lower production in primary-related clusters. Growth in both clusters, however, remained positive, supported by the presence of Malaysian E&E firms in diversified, fast-growing product segments such as automotive electronics, medical devices and cloud computing, as well as the recovery in natural gas output. Domestically, the frontloading of demand for passenger cars during the tax holiday period in 2018 had weighed on the production of transport equipment in 2019.

Growth in the agriculture sector improved to 1.8% during the year (2018: 0.1%), due mainly to a turnaround in oil palm yields from production constraints and adverse weather conditions in 2018. Nevertheless, the recovery was interrupted by the impact of exceptionally dry weather and a cutback in fertiliser application in the early part of the year, which negatively affected oil palm yields in the latter part of 2019. Natural rubber production also rebounded, as higher rubber prices induced more rubber tapping activity.

The mining sector continued to register a contraction (-1.5%; 2018: -2.6%), as crude oil output was weighed down mainly by maintenance works and voluntary supply adjustments by PETRONAS. Nevertheless, the pace of the contraction in the sector eased, following the recovery in natural gas production from the pipeline disruptions in 2018.

Table 1

Real GDP by Kind of Economic Activity (2015=100)

	2019p	2018	2019p	2018	2019p
	% of GDP	Annual change (%)		Contribution to growth (ppt) ¹	
Services	57.7	6.8	6.1	3.8	3.5
Manufacturing	22.3	5.0	3.8	1.1	0.8
Mining and quarrying	7.1	-2.6	-1.5	-0.2	-0.1
Agriculture	7.1	0.1	1.8	0.0	0.1
Construction	4.7	4.2	0.1	0.2	0.0
Real Gross Domestic Product (GDP)	100¹	4.7	4.3	4.7	4.3

¹ Figures may not necessarily add up due to rounding and exclusion of import duties component

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Source: Department of Statistics, Malaysia

Growth in the construction sector moderated to 0.1% (2018: 4.2%), reflecting mainly the completion and near-completion of large infrastructure and mixed development projects. In the non-residential and residential subsectors, fewer and smaller new projects amid the commercial property glut and elevated level of unsold residential properties also contributed to the lower growth. While the civil engineering subsector remained the key contributor to growth, the delay in construction work for major highways, in addition to the completion of large petrochemical projects, led to a moderation in construction growth during the year.

Supportive labour market conditions in 2019

Labour market conditions remained supportive of growth in 2019, despite being softer. Employment grew by 2.1% (2018: 2.5%), amounting to an additional employment gain of 316,000 persons, while unemployment rate remained stable at 3.3% (Table 1). The labour force participation rate also rose to 68.9% (2018: 68.3%).

Table 1

Selected Labour Market Indicators

	2015	2016	2017	2018	2019p
Employment ('000 persons)	13,992	14,177	14,451	14,810	15,126
(% change)		1.3	1.9	2.5	2.1
Unemployment rate (% of labour force)	3.1	3.4	3.4	3.3	3.3
Labour force participation rate (% of working age population)	67.9	67.7	68.0	68.3	68.9
Retrenchments (persons)	38,499	37,699	35,097	23,168	29,605
Foreign workers ('000 persons)	2,135	1,866	1,797	2,016	2,000

p Preliminary

Note: The 2019 unemployment and labour force participation rates were estimated based on the quarterly averages of 2019 figures from the Labour Force Survey, while the 2019 employment growth was sourced from the Labour Productivity Statistics.

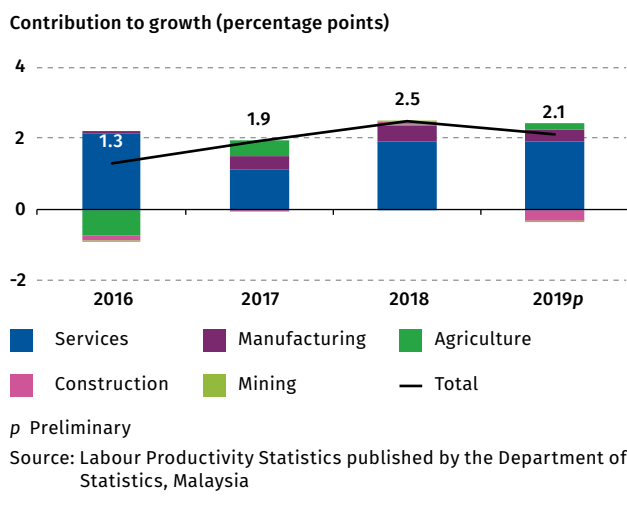
Source: Department of Statistics, Malaysia and Ministry of Human Resources

In 2019, employment growth was mainly driven by high- and low-skilled workers, which grew by 3.9% and 6.5% respectively. Mid-skilled workers continued to account for the largest share of total employed persons at 59.5% (2018: 60.4%), followed by high-skilled workers at 27.6% (2018: 27.2%).

From a sectoral perspective, employment growth was driven mainly by the services sector (3.2%), followed by the manufacturing (2.1%) and agriculture (1.6%) sectors (Chart 1). In particular, the food, beverages and

accommodation subsector; and wholesale and retail trade subsector recorded strong employment growth of 7.7% and 3.3% respectively (2018: 8.1% and 3.2% respectively). Meanwhile, retrenchments rose to 29,605 persons per annum (2018: 23,168 persons; long-run average¹: 34,530 persons).

Chart 1: Employment Growth by Sector, 2016 - 2019^p



Aggregate nominal wages in the private² and public sectors grew at a slower rate of 4.2% and 3.7% respectively in 2019 (2018: 6.0% and 4.5%, respectively). The services sector registered a higher wage growth (4.1%, 2018: 3.8%), supported by food and beverages subsector; as well as information and communication subsector. The manufacturing sector registered a lower wage growth of 4.3% (2018: 10.8%). The moderation was broad-based across most manufacturing industries, but particularly evident in export-oriented industries, which included the E&E subsector (2019: 5.7%, 2018: 13.9%) and petroleum, chemical, rubber and plastic products subsector (2019: 3.6%, 2018: 11.6%). In 2019, wage per worker growth in the manufacturing sector moderated (2.9%, 2018: 8.6%), but still remained higher than that of the services sector (1.5%, 2018: 1.2%).

Labour productivity³ growth slowed to 2.2% in 2019 (2018: 3.4%), with broad-based moderation across all sectors. Services sector productivity growth moderated to 2.7% (2018: 5.0%), given the normalisation in production growth post-tax holiday and longer working hours. Productivity growth in the manufacturing sector also moderated (2.5%; 2018: 3.3%) due largely to slower production in the E&E subsector.

¹ The long-run average is the average annual retrenchments from 1997 - 2018. Data is sourced from Ministry of Human Resources.

² 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. It covers 62.9% of total employment.

³ Measured by real value-added per hour worked.

Resilient external sector amid challenging global developments

Malaysia maintained a healthy current account surplus while the financial account continued to register FDI inflows. Residents increasingly diversified their portfolios abroad and the domestic bond market saw non-resident inflows during the year.

The current account surplus widened to RM49.7 billion or 3.3% of GDP in 2019 (2018: RM30.6 billion or 2.1% of GDP) (Table 1). From a savings-investment perspective, the higher current account surplus reflected a sharper decline in investments. By components, the improvement in the current account balance was driven by lower deficits in the primary income and services accounts amid a higher goods surplus (Chart 1). The goods surplus increased as a result of a sharper decline in imports relative to exports.

The services account recorded a smaller deficit of RM10.9 billion (2018: -RM17.7 billion), due mainly to an increase in travel receipts and lower net payments for transportation and construction services. The travel account surplus widened to RM30.9 billion (2018: RM30.0 billion) following higher tourist arrivals and per capita spending, particularly by tourists from regional economies. Meanwhile, the deficits in the transportation and construction services accounts narrowed following more moderate trade and investment activity, respectively.

In the income account, the primary income deficit narrowed significantly to RM43.5 billion (2018: -RM51.6 billion). This reflected higher income earned by resident investors and lower income accrued to non-resident investors. Of note, the lower deficit in the direct investment income account, which moderated to RM33.3 billion (2018: -RM35.9 billion), was due to lower income accrued to foreign companies in Malaysia, particularly in the mining and manufacturing sectors. At the same time, Malaysian firms investing abroad in the information and communication services and agriculture sectors reported higher income. Portfolio investment income receipts increased following higher returns for resident investors from their investments in equity securities abroad.

The secondary income account recorded a larger deficit of RM21.4 billion (2018: -RM19.3 billion), reflecting an increase in outward remittances by foreign workers.

In 2019, the financial account recorded a net outflow of RM34.3 billion (2018: +RM18.6 billion). This was mainly on account of higher investments by residents in portfolio assets abroad and sustained direct investment abroad (DIA) which were partially offset by long-term FDI inflows.

The direct investment account registered a net inflow of RM9.4 billion (2018: +RM11.3 billion). In 2019, FDI inflows amounted to RM32.8 billion, equivalent to +2.2% of GDP (2018: +RM32.6 billion; +2.3% of GDP) (Chart 2). Of note, during the first quarter of the year, FDI recorded its highest-ever quarterly inflows to date, contributed mainly by the acquisition of a private healthcare group by a Japanese investor and the formation of a joint venture in the oil and gas sector. For the rest of the year, however, FDI was affected by subdued global investor sentiments. Advanced economies such as Japan (29.9% of net FDI flows for the year), Hong Kong SAR (25.7%) and the Netherlands (15.9%) were major contributors of FDI.

Table 1
Balance of Payments¹

Item (Net)	2017	2018	2019 ^p
	RM billion		
Current account	38.3	30.6	49.7
Goods ²	117.1	119.2	125.5
Services	-22.9	-17.7	-10.9
Primary income	-38.7	-51.6	-43.5
Secondary income	-17.3	-19.3	-21.4
Capital account	0.0	-0.1	0.3
Financial account	-4.7	18.6	-34.3
Direct investment	16.2	11.3	9.4
Portfolio investment	-15.4	-44.4	-37.7
Financial derivatives	-0.2	1.0	-0.4
Other investment	-5.3	50.7	-5.7
Net errors and omissions³	-17.1	-41.3	-7.3
Overall balance	16.4	7.8	8.4

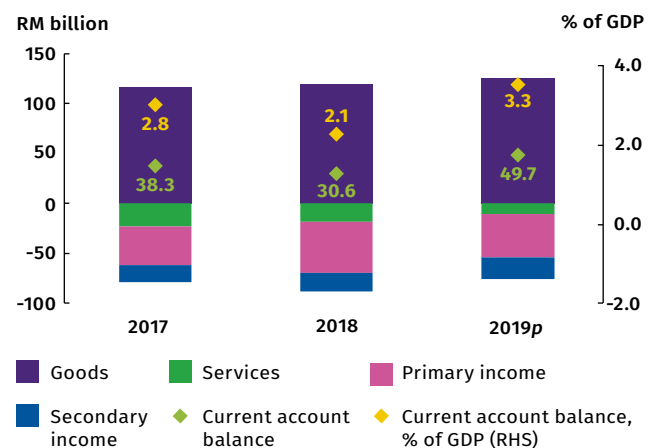
¹ In accordance with the Balance of Payments and International Investment Position Manual, Sixth Edition (BPM6) by the International Monetary Fund (IMF)

² Adjusted for valuation and coverage of goods for processing, storage and distribution

³ As at 1Q 2018, the net E&O excludes reserves revaluation changes. This practice is backdated to 1Q 2010

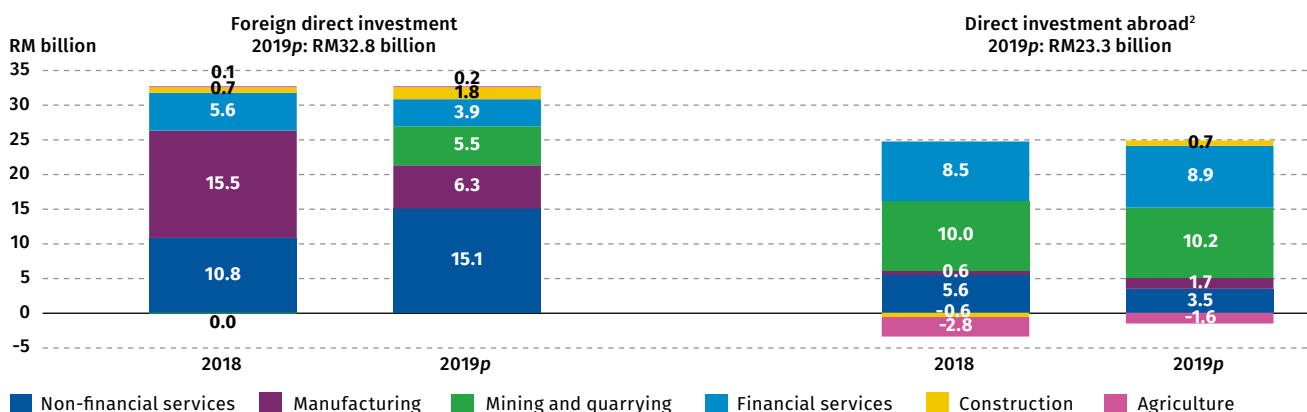
^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1: Current Account Balance


Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 2: Net Foreign Direct Investment and Direct Investment Abroad¹ by Sector



¹ Foreign direct investment and direct investment abroad as defined according to the Balance of Payments and International Investment Position Manual, Fifth Edition (BPM5) by the International Monetary Fund (IMF)

² Negative values refer to net inflows

p Preliminary

Note: Figures may not necessarily add up due to rounding

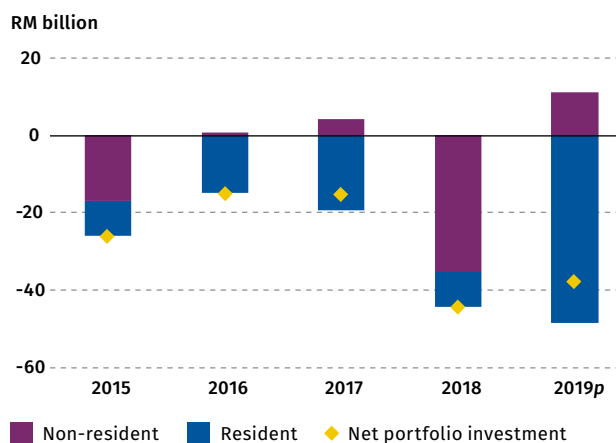
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

DIA outflows were slightly higher at RM23.3 billion; -1.5% of GDP (2018: -RM21.3 billion; -1.5% of GDP). Notable investments during the year included the acquisition of two offshore fields in Brazil and additional investments in existing projects abroad by a domestic oil and gas company. Brazil (25.2% of net DIA flows for the year), Australia (12.9%) and the Netherlands (11.9%) were the major recipients of DIA in 2019.

The portfolio investment account registered a net outflow of RM37.7 billion (2018: -RM44.4 billion), attributed mainly to higher resident investments abroad (-RM48.7 billion; 2018: -RM9.1 billion) (Chart 3). These investments were led by domestic institutional investors into both equity instruments and debt securities for the purposes of diversifying risk exposures and investment incomes. Meanwhile, non-resident portfolio investment flows remained volatile. For 2019 as a whole, non-resident portfolio flows registered a net inflow of RM11.0 billion (2018: -RM35.3 billion).

The other investment account recorded a net outflow of RM5.7 billion (2018: +RM50.7 billion), reflecting interbank placements abroad by resident banks, amid a net drawdown of external loans by the private sector. Net errors and omissions (E&O) amounted to -RM7.3 billion or -0.4% of total trade (2018: -RM41.3 billion, or -2.2% of total trade) during the year.

Chart 3: Portfolio Investments



p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Improvement in Net International Investment Position

Malaysia's net international investment position (IIP) registered a lower net liability position of RM47.3 billion as at end-2019 (2018: -RM77.7 billion) (Chart 1). This improvement mainly reflected an increase in external assets by RM91.7 billion, primarily in portfolio investments, which more than offset the increase in external liabilities of RM61.3 billion.

Malaysia's external position was also strengthened by more favourable composition of external liabilities. In particular, the increase in external liabilities were due mainly to higher inflows of long-term FDI, mainly composed of equity holdings and retained earnings, which are less susceptible to capital reversals.

Overall, Malaysia's external debt increased to RM946.3 billion as at end-2019, or 62.6% of GDP (end-2018: RM924.9 billion or 63.9% of GDP). Higher external debt was mainly accounted by increases in non-resident (NR) holdings of domestic debt securities and deposits, and external loans by corporations (Chart 2). These were partially offset by the decrease in intercompany loans and interbank borrowings.

Risks surrounding external debt were well contained given its favourable maturity and currency profiles, coupled with the Bank's prudential and hedging requirements.¹ As at end-2019, the external debt-at-risk for corporations² and banks³ amounted to RM59.7 billion and RM67.7 billion, respectively. Cumulatively, these amounted to 13.5% of Malaysia's total external debt and 30.0% of international reserves.

More than half of the outstanding external debt was of medium- and long-term tenures, with low rollover risk (Chart 3). Meanwhile, almost one-third of the external debt was denominated in ringgit (32.8%; end-2018: 30.2%), and not affected by valuation changes arising from fluctuations in the exchange rate. The remainder of external debt that was denominated in foreign currencies (FCY) was largely supported by FCY earnings and subject to prudential requirements on liquidity and funding risk management.⁴ Moreover, intercompany loans, which accounted for 14.1% of FCY external debt were generally available on flexible and concessionary terms. In addition, banks and corporations held sizeable FCY external assets amounting to RM1.3

Chart 1: Net International Investment Position (IIP)

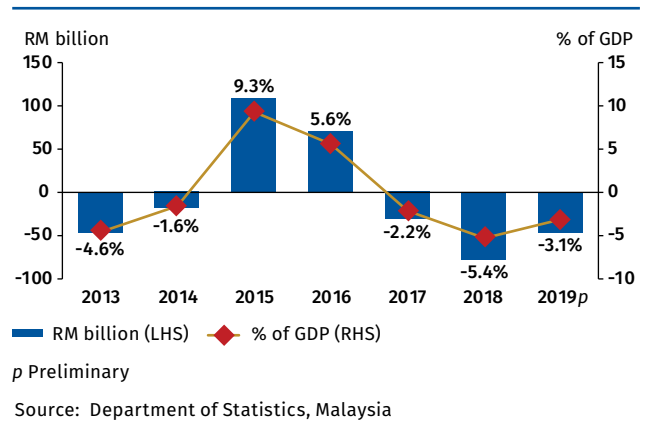
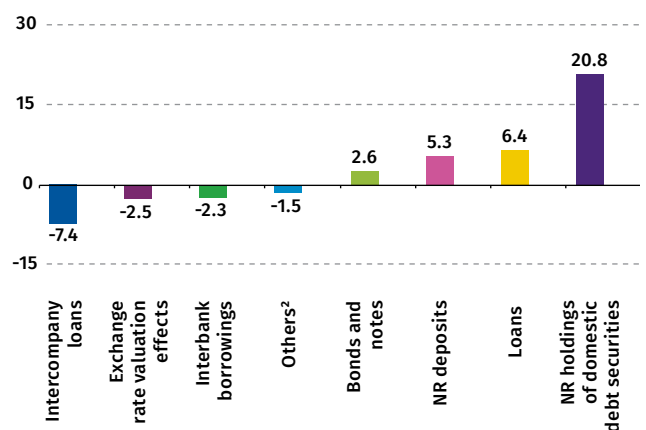


Chart 2: Change in External Debt

Net change¹: +RM21.4 billion



¹ Changes in individual debt instruments exclude exchange rate valuation effects

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

Note: NR refers to non-residents

Figures may not necessarily add up due to rounding

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

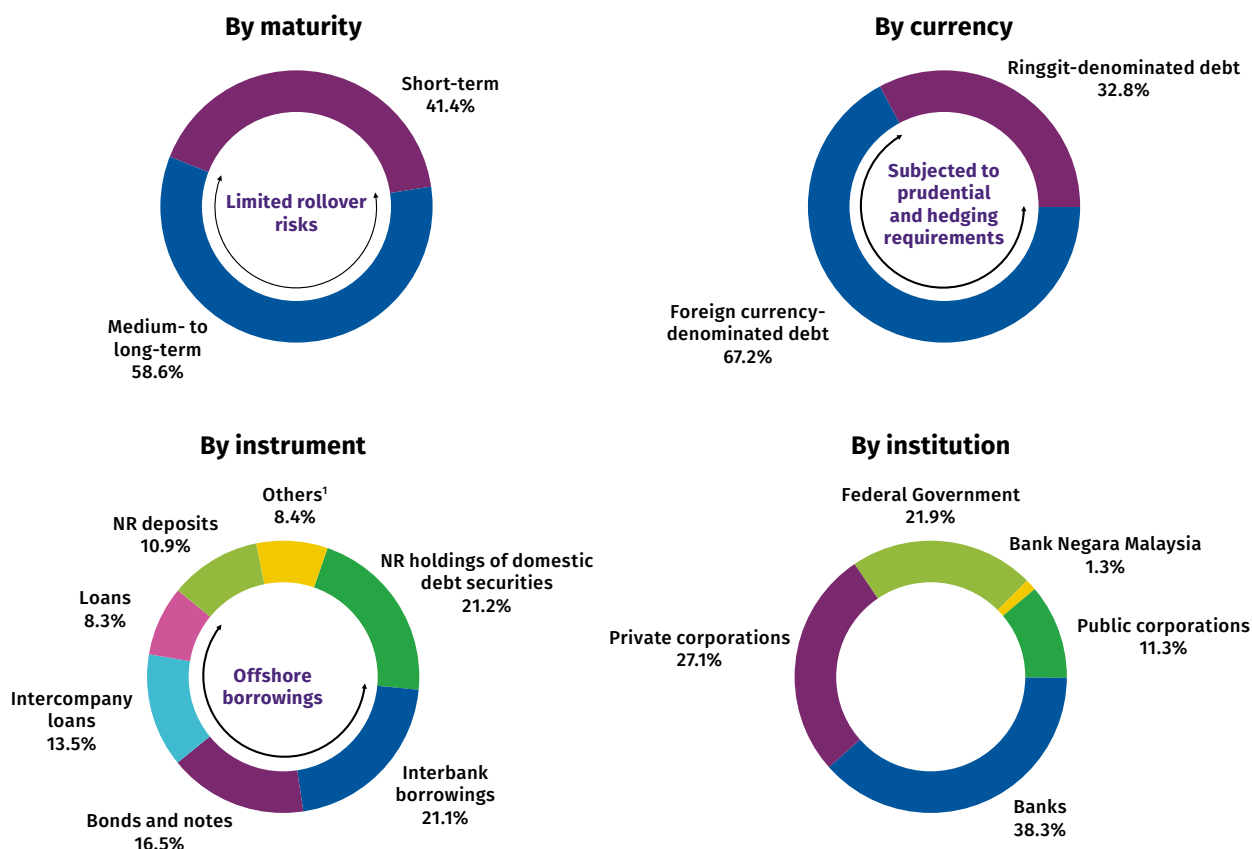
¹ For more details on Malaysia's external debt management, please refer to BNM Annual Report 2018 Box Article titled 'Malaysia's Resilience in Managing External Debt Obligations and the Adequacy of International Reserves'.

² Based on the assessment on about 70% of offshore loans raised and bonds issued by corporations, in which interest coverage ratio is less than the prudent threshold of two times.

³ Refers to the portion of banks' external debt that were more susceptible to sudden withdrawal shocks. These include interbank borrowings (RM46.9 billion), deposits accepted (RM16.6 billion) and other short-term debt (RM4.3 billion) from unrelated counterparties. For further details on banks' external debt trend, refer to BNM Financial Stability Review – Second Half 2019.

⁴ Including requirements imposed on banks under local banking regulations.

Chart 3: Breakdown of Malaysia's Total External Debt (% share)



¹ Includes trade credits, IMF allocation of SDRs and miscellaneous, such as insurance claims yet to be disbursed and interest payables on bonds and notes

Note: Figures may not necessarily add up due to rounding

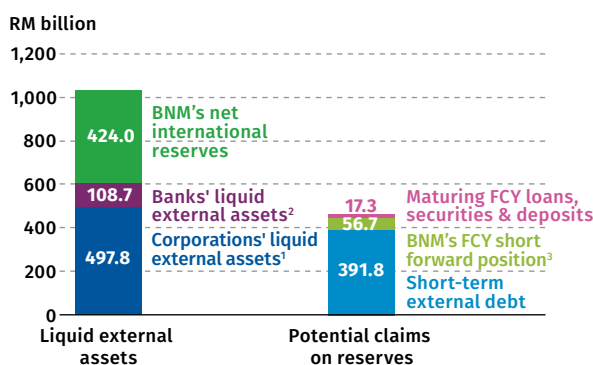
Source: Bank Negara Malaysia

trillion. This further reinforces the repayment capacity of these entities to meet their external obligations.

BNM's international reserves, which accounted for 23.9% of the country's external assets, remained an important policy buffer against external shocks. The international reserves amounted to USD103.6 billion as at end-2019 (end-2018: USD101.4 billion), sufficient to finance 7.5 months of retained imports and is 1.1 times the short-term external debt.

In 2019, Malaysia maintained a sizeable net foreign currency asset position. About 94.5% of external assets were denominated in foreign currency compared to 41.4% of total external liabilities. This demonstrated Malaysia's ability in responding to external shocks. In particular, a bout of depreciation in the ringgit will result in a larger increase in external assets compared to external liabilities, thus enhancing Malaysia's external position. This stabilising mechanism, coupled with the favourable nature and composition of Malaysia's IIP, accords the economy with resilience against potential external shocks.

Chart 4: Liquid External Assets and Potential Claims on International Reserves



¹ Consist of portfolio investments and currency and deposits

² Consist of deposits and interbank placements, bonds and notes and money market instruments

³ Including the forward leg of currency swaps

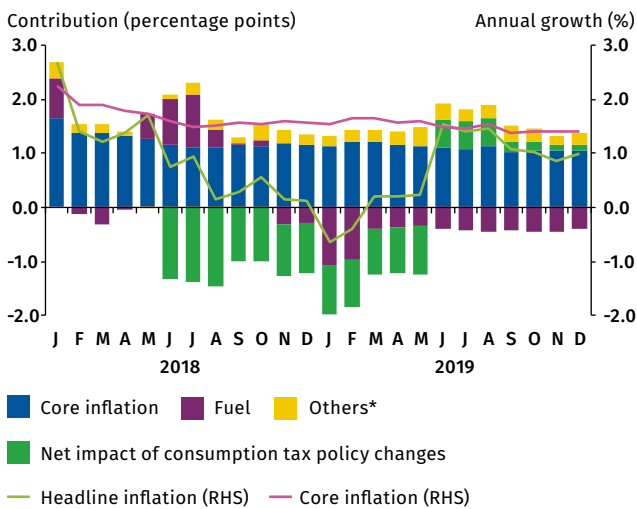
Source: Bank Negara Malaysia

Lower headline inflation

Average headline inflation⁵ was lower at 0.7% (2018: 1.0%) (Chart 1.12). The extension of fuel price ceilings and festive price control scheme on food items contained fuel and food inflation, while changes in consumption tax policy in 2018⁶ continued to exert an overall downward pressure on prices. Apart from these factors, relatively lower global oil prices and improved food supply conditions also contributed to the lower fuel and food prices, respectively. The decline in inflation in import partners' economies further helped contain domestic inflationary pressures.

Underlying inflation as indicated by core inflation,⁷ on the other hand, remained relatively stable (2019: 1.5%; 2018: 1.6%). This indicates that demand-driven inflationary pressures were relatively subdued amid the lack of impetus from the labour market. Along with the stable real wage growth per worker in the private sector, the presence of spare capacity in domestic industries supported the stability of the underlying inflation.

Chart 1.12: Contribution to Headline Inflation by Components



* Others include price-volatile items and other price-administered items

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

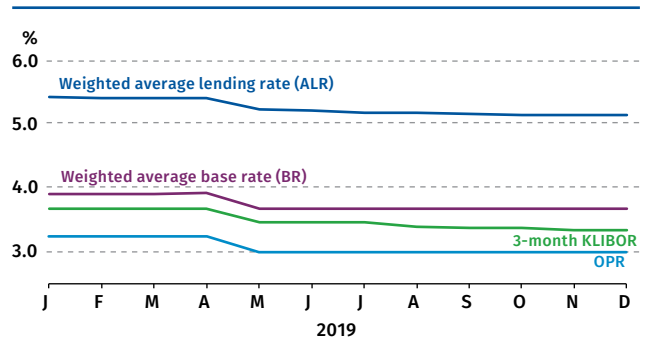
⁵ Measured by the annual percentage change in the Consumer Price Index (CPI).
⁶ Refers to the combined impact of the zeroisation of the Goods and Services Tax (GST) rate and the implementation of the Sales and Services Tax (SST).
⁷ Core inflation is computed by excluding price-volatile and price-administered items. It also excludes the estimated direct impact of tax policy changes.

Monetary policy remained conducive for continued growth amid price stability

The OPR was reduced by 25 basis points to 3.00% at the May 2019 meeting, to ensure a conducive monetary environment for a steady growth path amid low inflation. In the Monetary Policy Committee's (MPC) assessment, downside risks to Malaysia's growth prospects had increased, mainly stemming from external factors. At the same time, heightened uncertainties in the domestic environment, the risk of extended weakness in commodity-related sectors and some signs of tightening in financial conditions factored into the MPC's considerations. Therefore, the OPR reduction was intended to preserve the degree of monetary accommodativeness, thus ensuring that monetary policy remained conducive for continued growth and price stability. The MPC was also mindful that measures beyond monetary policy such as structural reforms would be pertinent to raise potential growth.

The policy rate reduction had the intended impact on lending rates in the economy, as the wholesale and retail interest rates subsequently declined (Chart 1.13). The pass-through to the interbank market was strong and immediate, as the Kuala Lumpur Interbank Offered Rate (KLIBOR) declined by 23 – 25 basis points across tenures within a day of the OPR reduction. In the retail segment, all banks also revised downward their respective base rates by 25 basis points, resulting in a lower weighted average base rate of 3.68% as at end-2019 (2018: 3.91%). Lending rates as indicated by the weighted average lending rate (ALR) on outstanding loans gradually trended downwards to end the year at 5.16% (2018: 5.43%). The overall transmission to

Chart 1.13: Policy, Interbank and Lending Rates (at end-period)



Source: Bank Negara Malaysia and Bloomberg

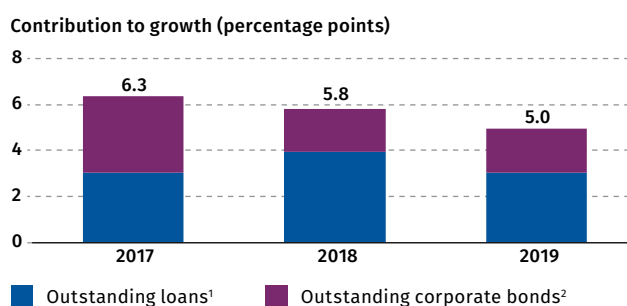
lending rates was strong given the high share of floating-rate loans in the banking system (about 75%), strong market competition, and the decline in banks' cost of funds.

Nevertheless, financing to the private sector moderated in line with economic activity, mainly weighed down by cautious borrowing sentiments during the year. This was reflected in net financing growth, which expanded by 5.0% (2018: 5.8%), where outstanding loans grew by 4.0% (2018: 5.2%)⁸ while growth in outstanding corporate bonds was sustained at 8.0% (2018: 8.0%) (Charts 1.14 and 1.15). The demand-driven moderation in loan growth was more pronounced in the business segment, further compounded by high loan repayment trends and cautious lending by banks to selected sectors experiencing weakness. The bond market also lacked impetus amid the review in large infrastructure projects, despite a lower yield environment.⁹ However, following the OPR reduction in May, demand for loans improved, with applications increasing for both business and household loans. This, in turn, translated into some improvement in loan growth, particularly in the business segment, towards the end of the year.

Financing supply conditions were continuously monitored by the Bank to ensure lending remained supportive of economic activity, supplemented by ongoing and new measures to enhance the financing ecosystem.¹⁰ Relatively stable funding and liquidity conditions for banks continued to facilitate credit intermediation, with no significant changes in overall loan granting criteria reported by banks. Stable loan approval rates and loan disbursements at levels comparable to recent averages¹¹ indicated there had not been a general reduction in credit available to borrowers, including small and medium enterprises (SMEs). For instance, about three out of four housing and SME loans continued to be approved in 2019. Supportive home ownership initiatives such as the Home Ownership Campaign which was launched in 2019, and financing schemes for first-time home buyers

including BNM's Affordable Home Fund, also provided further impetus to housing loans. More broadly, a variety of direct funds, financing guarantee, debt restructuring, financial advisory and capacity building programmes for homebuyers and SMEs have been put in place over the years to improve access to financing for the underserved segments and to promote a more holistic financing ecosystem.

Chart 1.14 : Total Net Financing Through Banks, Non-Bank Financial Institutions and Corporate Bonds

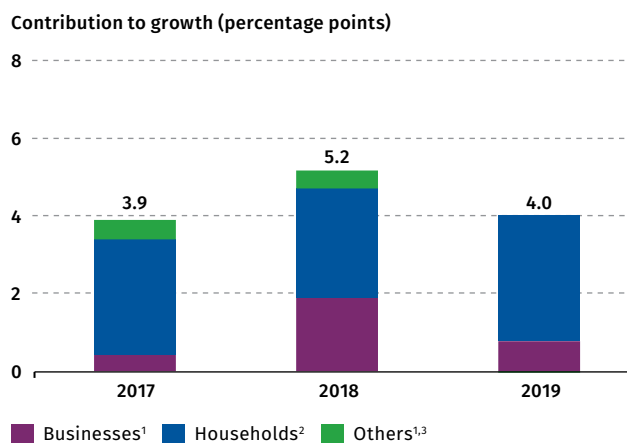


¹ Loans from the banking system, development financial institutions (DFIs) and major non-bank financial institutions (NBFIs)
² Excludes issuances by Cagamas and non-residents

Note: Effective June 2019, banking system loans data for April 2018 onwards were revised to include data from a newly licensed commercial bank. It was previously classified as a non-bank financial institution.

Source: Bank Negara Malaysia

Chart 1.15: Outstanding Loans by Borrowers



¹ Loans from the banking system and development financial institutions (DFIs) only

² Loans from the banking system, DFIs and major non-bank financial institutions (NBFIs)

³ Includes loans of financial institutions, NBFIs, Government, domestic other entities, and foreign entities

Note: Effective June 2019, banking system loans data for April 2018 onwards were revised to include data from a newly licensed commercial bank. It was previously classified as a non-bank financial institution.

Source: Bank Negara Malaysia

⁸ Nonetheless, slower loan growth in 2019 as observed in the data reflected, in part, a statistical revision to include loans from a newly licensed commercial bank for April 2018 onwards. Excluding this factor which inflated loan growth slightly in 2018, the moderation in loan growth in 2019 would be less severe.

⁹ Excluding a single large issuance in the finance, insurance, real estate and business services sector in May 2019, total corporate bond issuances amounted to RM96.3 billion (2018: RM92.8 billion) (Note: Excluding issuances by Cagamas and non-residents).

¹⁰ For related analysis on lending trends, banks' risk appetite and an examination of loan rejections, refer to the BNM Quarterly Bulletin Third Quarter 2019 Box Article titled 'Banking on Banks: Are They Lending Enough?'

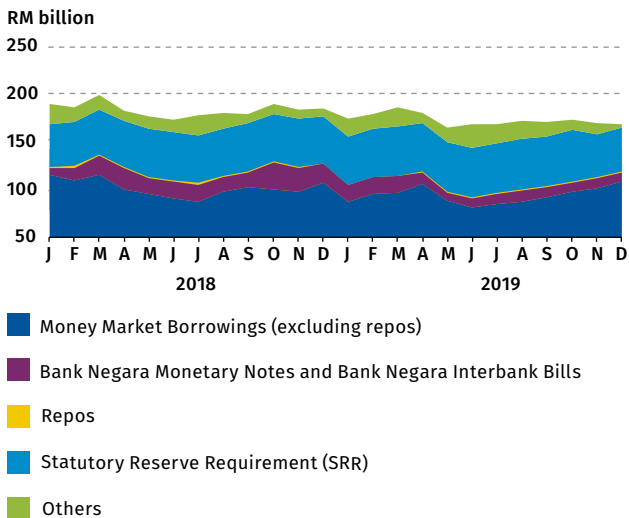
¹¹ Total loans disbursed by the banking system and development financial institutions (DFIs) in 2019 amounted to RM1,275.7 billion, comparable to the three-year average (2016-2018) of RM1,182.4 billion.

Monetary operations ensured sufficient liquidity

The Bank conducted monetary operations to ensure sufficient liquidity to support the orderly functioning of the interbank and foreign exchange markets, amid capital flow volatility during the year. In particular, the Bank’s liquidity injection operations through reverse repos and foreign exchange swaps mitigated the contractionary impact on banking system liquidity arising from intermittent periods of large portfolio outflows.

Accordingly, as spillovers to banking system liquidity remained contained, this ensured continued financial intermediation to support economic activity. At the system level, aggregate outstanding liquidity placed with the Bank amounted to RM168.9 billion (2018: RM185.0 billion)

Chart 1.16: Outstanding Ringgit Liquidity Placed with Bank Negara Malaysia (at end-period)



Source: Bank Negara Malaysia

(Chart 1.16). At the institutional level, most banking institutions continued to maintain surplus liquidity positions with the Bank. Overall, the price discovery process in the domestic money market remained uninterrupted, as evidenced by broadly stable interbank rates.

The reduction in the Statutory Reserve Requirement (SRR) ratio from 3.50% to 3.00% in November 2019 resulted in a broad-based release of liquidity into the domestic banking system. The SRR ratio was reduced to provide additional liquidity to the banking system on a more permanent basis. This was in view of the need to absorb less excess liquidity from the banking system, as the previous build-up in excess liquidity over the years of strong inflows has partially reversed. The release of liquidity amounting to RM7.4 billion would continue to support the efficient functioning of the domestic financial markets and facilitate effective liquidity management by the banking institutions.