

Economic Developments in 2017

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Economic Developments in 2017

THE INTERNATIONAL ECONOMIC ENVIRONMENT

World economy recorded a broad-based and synchronised improvement

The year 2017 witnessed a strong rebound in economic activity, propelling the global economy to record its highest growth rate since 2011. World trade growth exceeded global GDP growth for the first time since 2014. The improvement in economic activity was broad-based across the advanced and emerging market economies, leading to a series of upward revisions in growth forecasts by international organisations and national authorities throughout the year. The renewed strength in GDP growth was driven mainly by robust investments in the advanced economies, which in turn fostered favourable external demand, particularly for Asia. Amid improving demand, several major central banks raised their key policy rates as part of their policy normalisation. While headline inflation edged higher, the core inflation remained low in many advanced economies, reflecting the softness in wage growth amid subdued productivity growth. Global financial markets recorded strong performance, in line with the upswing in global growth. Market volatility, surprisingly, remained low despite uncertainties due to geopolitical tensions. The rise in scepticism over globalisation in the previous year showed signs of diminishing as key election results in the EU suggested lower risk of upheaval from the populist movement. In this environment, policymakers continued to undertake various policy actions, including monetary, fiscal and structural reforms, to achieve country-specific objectives such as strengthening macroeconomic fundamentals and ensuring more sustainable growth in the medium term.

Stronger world growth

The global economy recorded its fastest growth since 2011. The International Monetary Fund (IMF)'s global

growth projection for 2017 was revised upwards from 3.4% to 3.7% between October 2016 and January 2018, reversing a long streak of eleven downward revisions since 2010.

Advanced economies experienced robust economic growth, supported by stronger domestic demand. In the US, rising GDP growth was driven by the pick up in consumer spending amid tighter labour market conditions and more positive consumer sentiments. The increased participation in the labour workforce was met with strong job creation and solid employment growth, driving the unemployment rate to the lowest level since 2001. In the euro area, GDP growth expanded at a faster pace. This was supported by improvements in business and consumer confidence, and favourable financing conditions, which in turn boosted income and spending. Of significance, uncertainties surrounding several key elections in the euro area and the outcome of the Brexit negotiations that persisted throughout the year had limited impact on the upward growth trajectory.

Amid stronger consumer demand, investment in the US and euro area also increased. This was supported by buoyant business sentiment, rising profits and the need to upgrade existing capital stock across major economies. The resumption of investment activity in the advanced economies was an important development given weakness in the previous year, particularly in machinery and equipment investments in the US. More importantly, the broad-based improvements in investment played a bigger role in driving global trade (Constantinescu et al., 2015). As such, global trade recorded its fastest growth since 2011 (2017: 4.2%; 2011: 7.1%). The remarkable trade resurgence in 2017 was broad-based across product categories and markets. The upswing in the technology sector also helped to support the strong rebound in trade volumes.

Such recovery in global trade provided further impetus to growth in many major Asian economies. Stronger demand for electronics & electrical (E&E) products, particularly semiconductors used in memory chips for smartphones and personal computers (PCs) was a key factor in driving the trade upswing in Asia, given the exposure of some countries to the global technology cycle. As a result, GDP growth in the Asian economies was predicated on strong double-digit export performance.

Besides the favourable external environment, domestic demand continued to be the main anchor for most countries in Asia. In PR China, growth was resilient despite ongoing structural reforms to rebalance the economy towards a consumption-led growth model. Rising household incomes, in particular in the rural areas, and high job creation raised consumption growth. Overall investment remained strong, supported by improvements in manufacturing and infrastructure spending. Capital expenditure by manufacturers was driven by better external demand. Residential investment moderated amid measures targeted at cooling the property market. In the ASEAN region, higher infrastructure spending by both the public and private sectors was a key growth driver as countries enhanced rural and urban mobility through transportation connectivity for further economic development. Coupled with sizeable government measures to support economic activity for lower income households, fiscal support also lent further impetus to domestic demand in Asia.

Higher global headline inflation but muted core inflation

Global inflation rates edged higher during the year as global demand conditions improved and commodity prices recovered in the second half of 2017. Core inflation remained modest in many of the countries.

In the first half of 2017, the IMF's commodity price indices trended downward, attributable mainly to higher-than-expected US shale production and rising agricultural food output which led to lower commodity prices. The indices returned to an upward trend in the second half of the year. The index for crude oil was lifted mainly by the announcement of Organization of the Petroleum Exporting Countries (OPEC) and some non-OPEC oil exporters to extend their oil output cuts until the end of 2018. Brent crude oil prices breached USD60 per

Table 1.1

World Economy: Key Economic Indicators

	Real GDP Growth (Annual change, %)		Inflation (Annual change, %)	
	2016	2017e	2016	2017e
World Growth	3.2	3.7	-	-
World Trade	2.5	4.7	-	-
Advanced Economies				
United States	1.5	2.3	1.3	2.1
Japan	0.9	1.7	-0.1	0.4
Euro area	1.8	2.3	0.2	1.5
United Kingdom	1.9	1.7	0.7	2.6
Other Advanced Asian Economies				
Korea	2.8	3.1	1.0	1.9
Chinese Taipei	1.4	2.9	1.4	0.6
Singapore	2.0	3.6	-0.5	0.6
Hong Kong SAR	2.1	3.8	2.4	1.5
The People's Republic of China	6.7	6.9	2.0	1.6
ASEAN-4				
Malaysia	4.2	5.9	2.1	3.7
Thailand	3.3	3.9	0.2	0.7
Indonesia	5.0	5.1	3.5	3.8
Philippines	6.9	6.7	1.8	3.0
India¹	7.1	6.6	5.0	3.3

¹ For India, GDP data is presented on a fiscal year basis
e Estimate

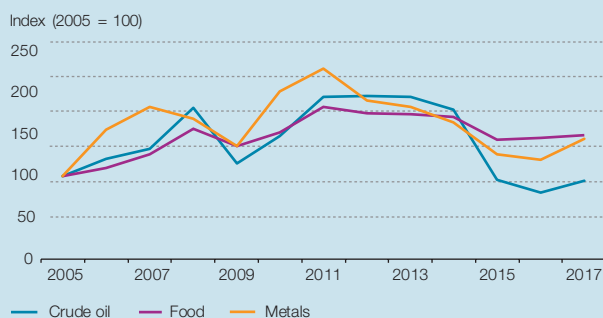
Source: International Monetary Fund (IMF) and National Authorities

barrel, the highest in two years. Similarly, metal prices such as copper, iron and zinc improved, supported by strong global demand and PR China's efforts to reduce surplus capacity by targeting inefficient and illegal production of minerals. Agricultural commodity prices, including food, also improved during the year reflecting stronger global demand amid supply shortages.

The recovery in commodity prices in 2017 contributed to higher headline inflation in the advanced economies, averaging 1.9% in 2017 (2016: 0.8%). Similar trends were observed in some Asian economies for example, the Philippines and Thailand experienced higher inflation due to rising costs of transportation and utilities.

Despite the uptick in headline inflation, underlying inflation remained subdued. Several explanations have been put

Chart 1.1: Indices of Primary Commodity Prices

Major commodity price indices resumed their upward trends in the second half of 2017

forth to describe the muted inflation environment. These include the rising influence of more integrated global product, labour and capital markets; subdued labour productivity growth weighing on wages; and the role of technology in increasing efficiencies while lowering the cost of goods. The disconnect between strong growth and muted inflationary pressure remained a conundrum for major central banks during the year. In the advanced economies, the UK was an exception to this trend. The sharp depreciation of the sterling pound was translated into higher prices.

Mixed policy actions

Despite the synchronised nature of the global growth recovery, monetary policy in the advanced and Asian economies diverged. Policy actions taken were tailored to factors specific to the individual economies. Broadly, the monetary policy stance among the advanced economies was skewed towards gradual normalisation. The US Federal Reserve continued to normalise its monetary policy by hiking the federal funds rate target three times in 2017 by a total of 75 basis points to end the year with a range of 1.25%-1.50%. The Bank of England raised its benchmark interest rate by 25 basis points for the first time in a decade as inflation began to accelerate. The European Central Bank announced a reduction of asset purchases by halving its monthly purchase rate to EUR30 billion until September 2018. The environment of robust economic growth allowed for monetary policy normalisation in the advanced economies to take place in an orderly manner. In contrast to the advanced economies, waning inflation in some Asian economies, such as Indonesia and India, had

prompted central banks to lower their benchmark interest rates. Similarly, the Bank of Japan (BoJ) maintained its massive stimulus programme in an effort to induce higher inflation which has fallen short of the BoJ's official target of 2% since the first quarter of 2015.

Besides monetary policy, several advanced economies also adopted fiscal and structural policies during the year to bolster macroeconomic fundamentals. In the US, the Tax Cuts and Jobs Act passed both chambers of Congress on 20 December 2017, ushering in major changes to personal and corporate tax rates, and international business taxation. In the euro area, efforts were aimed at maximising the impact of labour and product market reforms. For example, changes in legislation in France that decentralised collective bargaining led to faster labour market adjustment through greater flexibilities in hiring, wage-setting and labour mobility.

To strengthen macroeconomic fundamentals and enhance the sustainability of medium-term growth prospects, Asian policymakers undertook further structural reforms. In PR China, efforts were focused on policy reforms to reduce overcapacity and debt, while maintaining the gradual shift towards a more sustainable consumption-driven growth model. The Chinese government also intensified promotion of investment under the Belt and Road Initiative particularly for infrastructure networks. Further, ASEAN economies in particular announced measures to accelerate infrastructure investment, prioritising both physical and soft infrastructures. Measures included upgrading transportation networks, enhancing existing public-private partnership (PPP) frameworks, and increasing broadband penetration.

The cyclical upturn after seven years of muted growth following the Global Financial Crisis provided an avenue for many economies to remain steadfast in undertaking various policies to achieve more inclusive and sustainable growth. Despite the strong growth recorded during the year, policymakers continue to face various challenges including an aging population, increasing global leverage, technological disruption and growing income inequality. Active and consistent recalibration of policies are critical for the implementation of structural reforms, to strengthen economic fundamentals and to sustain the current growth momentum.

THE MALAYSIAN ECONOMY

Overview

The Malaysian economy performed strongly in 2017, registering a growth of 5.9% (2016: 4.2%). Growth was anchored by domestic demand, reflecting faster expansion in both private and public sector spending. Similar to the region, Malaysia benefited from the broad-based global recovery, with gross exports increasing at its fastest pace since 2004. The materialisation of positive spillovers from the external sector further reinforced domestic demand.

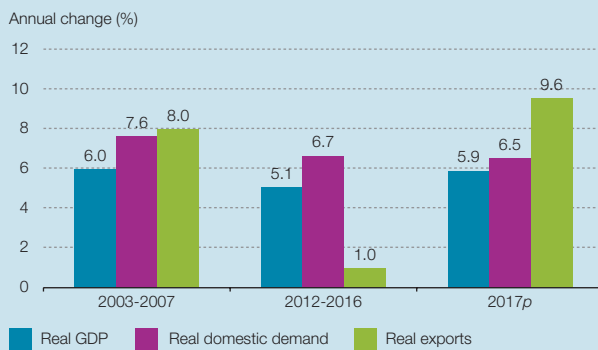
The Malaysian economy recorded a higher growth of 5.9% in 2017, as the strength in domestic demand was further boosted by a rebound in exports

A key highlight for the year was the rebound in gross exports, which advanced by 18.9% (2016: 1.2%). The stronger performance was due mainly to higher demand by major trading partners such as PR China, ASEAN, the EU, US and Japan, following the upswing in the global technology cycle, investment expansion in the advanced economies and the turnaround in commodity prices.

The global technology upswing was supported by a number of launches of popular flagship smart devices in 2017, which triggered a wave of new orders for firms along the supply chain of these products. In the case of Malaysia, which is the world's seventh largest semiconductor exporter with extensive linkages in

Chart 1.2: Real GDP Growth

Strong performance in real GDP in 2017



^p Preliminary

Note: Excluding real GDP growth during the period of the Global Financial Crisis

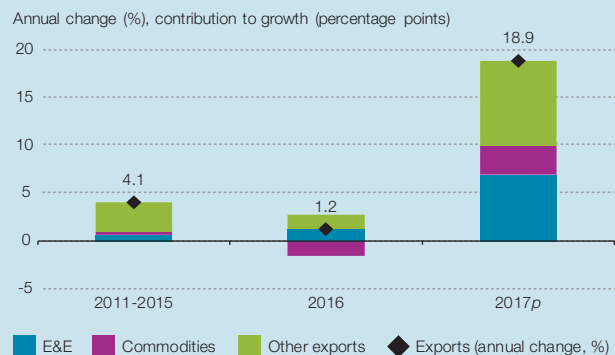
Source: Department of Statistics, Malaysia

the global value chain (GVC), the technology upcycle translated into robust demand for E&E products from regional and advanced economies. As a result, exports of semiconductor devices accelerated by 23.1% during the year (2016: 5.2%). The favourable environment of stronger demand, particularly from the regional economies, and a revival in investment activity in the advanced economies also lifted exports of non-E&E products (18.6%; 2016: 3.0%), such as petroleum, chemical, rubber and iron & steel products. After declining for two consecutive years, commodity exports turned around in 2017 to register a strong positive growth, supported largely by the recovery in major commodity prices, in particular for crude oil and liquefied natural gas (LNG).

Although real GDP growth was lifted by the external demand, domestic demand continued to anchor growth in 2017, underpinned by strong fundamentals, better labour market conditions and improving sentiments. Positive spillovers from the external sector to domestic demand began to materialise in the first half of 2017. The stronger external demand benefited private investment in particular, as firms in both export- and domestic-oriented industries embarked upon capacity expansions, including replacement and acquisitions of machinery and equipment to meet the higher demand. These developments directly benefited the labour market with faster employment and wage growth. These factors, together with Government measures to increase disposable income, further raised household spending. Public sector expenditure remained supportive of growth, as spending was prioritised towards critical infrastructure and essential public services.

Chart 1.3: Gross Export Performance by Products

Robust demand for E&E products boosted export performance

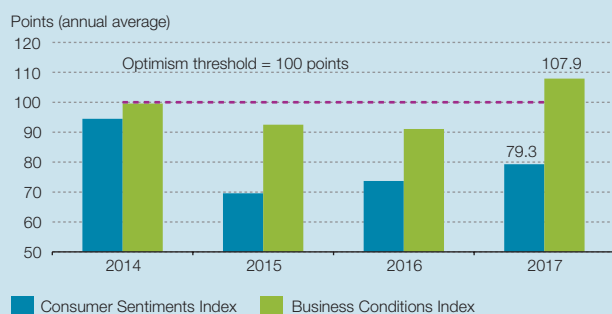


^p Preliminary

Source: Department of Statistics, Malaysia

Chart 1.4: MIER Consumer Sentiments and Business Conditions Index

Consumer and business sentiments improved during the year



Source: Malaysian Institute of Economic Research (MIER)

Following the expansion in both domestic and external demand, gross imports registered a double-digit growth of 19.9% (2016: 1.9%). Higher imports were attributable to intermediate and capital goods, in line with robust manufacturing exports and the more rapid investment activity in the manufacturing and services sectors, respectively. Overall, the trade surplus expanded to RM97.2 billion (2016: RM88.1 billion), supported by rapid export growth. The current account of the balance of payments registered a higher surplus, arising mainly from the larger goods surplus. Malaysia also continued to experience significant two-way movement of capital flows. In line with the improvement in international investor sentiments, non-resident portfolio inflows resumed in the second quarter of 2017, while foreign direct investment (FDI) inflows exceeded direct investment abroad (DIA) outflows over the year.

The strong performance of the external sector in 2017 reflects the outcome of structural policies undertaken over the decades that has resulted in the economy being highly open, diversified and served by multiple sources of growth. Malaysian producers, for instance, are deeply integrated in the GVC. Consequently, this enabled Malaysia to benefit from the broad-based upturn in the global economy. Critical investments undertaken in the manufacturing

sector, including in the E&E sub-sector, and the enabling infrastructure such as transport, logistics and communication services, also allowed firms to leverage swiftly on the uptick in global demand. Another critical factor is the presence of backward and forward linkages from exports to various industries in the manufacturing and services sectors. The close linkages within the Malaysian economy amplified the positive spillovers of the higher export orders, which together with improving business sentiments, gave rise to more business activity, investment spending, hiring in the labour market and income growth.

The positive economic environment of robust growth and vibrant trade has provided a valuable window of opportunity to pursue pre-emptive critical reforms and structural adjustments within the Malaysian economy. Fiscal consolidation efforts were on track, while monetary policy remained accommodative. Quality investments that ensure Malaysia's future-readiness, such as in the high-technology manufacturing and advanced services sectors, continued to be prioritised, leveraging on the established regional economic corridors and their respective focus areas.

Initiatives were also undertaken to raise productive capacity and remove constraints to growth, including encouraging the use of the sharing economy and ongoing investments in upskilling and training of the workforce. In 2017, employment gains kept pace with labour force expansion, with stronger employment driven by high- and mid-skilled workers. Productivity growth also picked up during the year, mainly driven by the manufacturing and services sectors. Going forward, the pursuit of productivity-driven growth highlights the importance of measuring and monitoring relevant metrics and indicators to aid policy making. To this end, the Malaysian Bureau of Labour Statistics¹ (MBLS) was established to integrate information collection on the labour market, including data on labour productivity and skills gaps. Collectively, these measures aim to maximise new sources of growth for the economy through lifting productivity and efficiency of existing assets.

Domestic Demand Anchored Growth in 2017

The Malaysian economy registered a robust growth of 5.9% in 2017 (2016: 4.2%). Domestic demand continued to anchor growth during the year, supported by faster expansion in both private and public sector spending. On the external front, real exports registered the strongest growth rate since 2010, underpinned by strong global expansion, particularly in the case of Malaysia's key trading partners, and higher global commodity prices.

¹ For further details, please refer to the White Box on 'The Malaysian Bureau of Labour Statistics'.

Table 1.2

Malaysia - Key Economic Indicators

	2015	2016	2017 ^p	2018 ^f
Population (million persons)	31.2	31.6	32.1	32.9
Labour force (million persons)	14.5	14.7	15.0	15.3
Employment (million persons)	14.1	14.2	14.5	14.8
Unemployment (as % of labour force)	3.1	3.4	3.4	3.2 ~ 3.5
Per Capita Income (RM)	36,093	37,792	41,072	42,834
(USD)	9,242	9,110	9,551	10,885 ³
NATIONAL PRODUCT (% change)				
Real GDP at 2010 prices	5.0	4.2	5.9	5.5 ~ 6.0
(RM billion)	1,063.4	1,108.2	1,173.6	1,240.1
Agriculture, forestry and fishery	1.3	-5.1	7.2	3.6
Mining and quarrying	5.3	2.2	1.1	1.8
Manufacturing	4.9	4.4	6.0	5.9
Construction	8.2	7.4	6.7	7.3
Services	5.1	5.6	6.2	6.1
Nominal GNI	5.2	6.2	10.1	6.9
(RM billion)	1,125.6	1,195.5	1,316.3	1,407.6
Real GNI	6.8	4.4	6.1	5.6
(RM billion)	1,039.0	1,084.9	1,150.8	1,215.0
Real aggregate domestic demand ¹	5.1	4.3	6.5	5.7
Private expenditure	6.1	5.6	7.5	7.6
Consumption	6.0	6.0	7.0	7.2
Investment	6.3	4.3	9.3	9.1
Public expenditure	2.1	0.4	3.3	-0.9
Consumption	4.4	0.9	5.4	0.6
Investment	-1.1	-0.5	0.1	-3.2
Gross national savings (as % of GNI)	29.0	29.1	29.2	28.8
BALANCE OF PAYMENTS (RM billion)				
Goods balance	109.2	101.4	118.1	120.5
Exports	681.3	686.1	808.9	865.9
Imports	572.1	584.7	690.8	745.3
Services balance	-20.6	-19.1	-23.1	-23.2
Primary income, net	-32.1	-34.6	-36.1	-39.1
Secondary income, net	-21.3	-18.6	-18.6	-19.3
Current account balance	35.2	29.0	40.3	38.9
(as % of GNI)	3.1	2.4	3.1	2.0 ~ 3.0
Bank Negara Malaysia international reserves, net ²	409.1	423.9	414.6	-
(in months of retained imports)	8.4	8.7	7.2	-
PRICES (% change)				
CPI (2010=100)	2.1	2.1	3.7	2.0 ~ 3.0
PPI (2010=100)	-7.4	-1.1	6.7	-
Real wage per employee in the manufacturing sector	3.7	4.1	2.2	-

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's account

³ Based on average USD exchange rate for the period of January-February 2018

^p Preliminary

^f Forecast

Note: Figures may not necessarily add up due to rounding

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

Table 1.3

Malaysia - Financial and Monetary Indicators

FEDERAL GOVERNMENT FINANCE (RM billion)	2015		2016		2017p	
Revenue	219.1		212.4		220.4	
Operating expenditure	217.0		210.2		217.7	
Net development expenditure	39.3		40.6		43.0	
Overall balance	-37.2		-38.4		-40.3	
Overall balance (% of GDP)	-3.2		-3.1		-3.0	
Public sector net development expenditure	140.4		158.1		146.7	
Public sector overall balance (% of GDP)	-7.7		-7.3		-4.7	
EXTERNAL DEBT						
Total debt (RM billion)	837.0		916.1		883.4	
Medium- and long-term debt	485.1		539.1		506.3	
Short-term debt	351.9		377.0		377.1	
Debt service ratio ¹ (% of exports of goods and services)						
Total debt	22.7		24.8		22.1	
Medium- and long-term debt	22.5		24.6		21.9	
MONEY AND BANKING						
	Change in 2015		Change in 2016		Change in 2017	
	RM billion	%	RM billion	%	RM billion	%
Money supply M1	14.0	4.1	20.4	5.7	41.9	11.0
M3	41.3	2.7	49.3	3.1	76.7	4.7
Banking system deposits	28.8	1.8	26.5	1.6	67.8	4.0
Banking system loans ²	105.4	7.9	76.4	5.3	62.9	4.1
Loan to fund ratio (% , end of year) ^{3&4}	83.0		84.3		84.0	
Loan to fund and equity ratio (% , end of year) ^{3,4&5}	74.6		75.3		73.7	
INTEREST RATES (% , AS AT END-YEAR)						
	2015		2016		2017	
Overnight Policy Rate (OPR)	3.25		3.00		3.00	
Interbank rates (1-month)	3.45		3.10		3.08	
Commercial banks						
Fixed deposit 3-month	3.13		2.92		2.94	
12-month	3.31		3.06		3.10	
Savings deposit	1.04		0.99		0.97	
Weighted average base rate (BR)	3.77		3.62		3.64	
Base lending rate (BLR)	6.79		6.65		6.68	
Treasury bill (3-month)	2.74		3.06		2.86	
Malaysian Government Securities (1-year) ⁶	2.59		3.26		2.89	
Malaysian Government Securities (5-year) ⁶	3.47		3.70		3.56	
EXCHANGE RATES (AS AT END-YEAR)						
	2015		2016		2017	
Movement of Ringgit (%)						
Change against SDR	-15.1		-0.8		5.2	
Change against USD	-18.6		-4.3		10.4	

¹ Includes prepayment of medium- and long-term debt

² Includes loans sold to Cagamas

³ Deposits exclude deposits accepted from banking institutions. 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 and all debt instruments (including subordinated debt, debt certificates/sukuk issued, commercial paper and structured notes)

⁵ Equities comprise ordinary and preferred shares, share premium and retained earnings

⁶ Refers to data from Fully Automated System for Issuing/Tender (FAST), Bank Negara Malaysia

p Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Table 1

Real GDP by Expenditure (2010=100)

	2017 ^p	2016	2017 ^p	2016	2017 ^p
	% of GDP	Annual change (%)		Contribution to growth (ppt)	
Domestic Demand¹	92.2	4.3	6.5	3.9	6.0
Private sector expenditure	71.2	5.6	7.5	3.8	5.3
<i>Consumption</i>	53.7	6.0	7.0	3.1	3.7
<i>Investment</i>	17.4	4.3	9.3	0.7	1.6
Public sector expenditure	21.0	0.4	3.3	0.1	0.7
<i>Consumption</i>	13.0	0.9	5.4	0.1	0.7
<i>Investment</i>	8.0	-0.5	0.1	0.0	0.0
<i>Gross Fixed Capital Formation</i>	25.4	2.7	6.2	0.7	1.6
Change in stocks	0.0			0.2	0.0
Net Exports of Goods and Services	7.8	1.5	-1.1	0.1	-0.1
Exports	72.9	1.1	9.6	0.8	6.7
Imports	65.1	1.1	11.0	0.7	6.8
Real Gross Domestic Product (GDP)	100.0	4.2	5.9	4.2	5.9

¹ Excluding stocks^p Preliminary

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Private consumption growth improved to 7.0% in 2017 (2016: 6.0%), supported mainly by continued wage and employment growth, with additional impetus from Government measures. Aggregate nominal wages¹ in the private and public sectors grew by 6.4% and 6.2%, respectively in 2017 (2016: 4.3% and 6.4%, respectively). Civil servants continued to benefit from the upward revision in their salaries that took place in July 2016. Consumer spending was further supported by Government measures to increase household disposable income, such as the reduction in employees' contribution to the Employees Provident Fund (EPF) by three percentage points (11% to 8%) and higher *Bantuan Rakyat 1Malaysia* (BR1M) payouts. Some of these measures were enacted to support the economy in March 2016 on account of the more challenging outlook. The recovery in consumer sentiments from its lowest level in 2015 also contributed to the stronger private consumption growth in 2017.

Public consumption growth expanded by 5.4% (2016: 0.9%) due to higher spending on supplies and services by the Federal Government amid sustained growth in the emoluments. The increased expenditure on supplies and services was mainly attributable to spending on maintenance and minor repair works.

Gross fixed capital formation (GFCF) grew at a faster pace of 6.2% in 2017 (2016: 2.7%), driven by improvements in both public and private investments.

Public investment recovered to register a marginal growth of 0.1% in 2017 (2016: -0.5%). This was supported by continued spending by both the General Government and public corporations, mainly in the downstream oil and gas (O&G) and transport & utilities sub-sectors. The continued capital outlays were also to accelerate urban and rural development.

Private investment growth accelerated to 9.3% (2016: 4.3%), as firms benefited from the conducive external and domestic operating environment. The strong growth in exports led to positive spillovers to the domestic economy, as firms embarked upon capacity expansion to cater to higher orders. Financing conditions, profitability and business sentiments also improved during the year. On a sectoral basis, private investment growth continued to be underpinned by the implementation of new and ongoing projects in the manufacturing and services sectors.

¹ For further details, please refer to the White Box on 'Improved Labour Market Conditions'.

In terms of assets, investment in machinery and equipment grew by 11.3% (2016: 1.1%), due in part to the production and capacity enhancements by firms in response to stronger demand. Growth of investment in structures, which accounts for 54.7% of total GFCF, remained moderate at 4.0% (2016: 4.9%), mainly reflecting a slowdown in residential investment. Growth of investment in other assets remained in contraction at -0.8% (2016: -4.3%) due to lower capital expenditure in the development of intellectual property products, particularly mineral exploration.

During the year, gross national savings (GNS) grew by 10.8% (2016: 6.6%), to increase slightly to 29.2% of gross national income (GNI, 2016: 29.1% of GNI) on account of more rapid growth in private savings (11.5%; 2016: -1.9%) and normalisation of growth in public savings (8.1%; 2016: 52.2%). Gross capital formation expanded by 8.2% (2016: 9.5%), resulting in a wider savings-investment gap of 3.1% of GNI (2016: 2.4% of GNI).

Improved Labour Market Conditions

The unemployment rate was steady at 3.4% in 2017 (2016: 3.4%, average 2011-2016: 3.1%) as stronger employment gains kept pace with labour force expansion. The labour force expanded by 303,000 people, while net employment gains amounted to 295,000 jobs. As a result, the labour force participation rate edged higher to 67.8% (2016: 67.7%) and employment growth tripled to 2.1% (2016: 0.7%). Industrial engagements¹ throughout the year corroborated the improving business sentiments. Employers were optimistic about the business outlook and thus continued to expand their workforce accordingly.

Table 1

Selected Labour Market Indicators

	2013	2014	2015	2016 ^r	2017 ^p
Employment ('000 persons)	13,545	13,853	14,068	14,164	14,459
Labour force ('000 persons)	13,981	14,264	14,518	14,668	14,971
Unemployment rate (% of labour force)	3.1	2.9	3.1	3.4	3.4
Layoffs ¹ (persons)	33,086	25,917	38,499	37,699	35,097
Foreign workers ('000 persons)	2,250	2,073	2,135	1,866	1,797

^p Preliminary

^r Figures have been revised to reflect latest population estimates

¹ Constitutes workers affected by retrenchments and voluntary separation scheme (VSS) offerings

Source: Department of Statistics, Malaysia, Ministry of Human Resources, Ministry of Home Affairs and Bank Negara Malaysia estimates

At the macro-level, employment gains were mostly driven by high- and mid-skilled workers, as both increased by 121,100 and 150,700 persons, respectively. High-skilled workers as a share of total employed persons increased marginally to 27.6% (2016: 27.3%), while mid-skilled workers still command the largest share of 59.5%. The share of low-skilled workers is unchanged at 13.0%. Latest data² suggest that high-skilled workers faced the lowest median wage growth at 3.1% to RM3,994 as compared to that of mid-skilled (5%, RM1,447) and low-skilled (10%, RM1,100) workers. The number of documented unskilled and semi-skilled foreign workers in Malaysia has declined to 1.8 million in 2017 (2016: 1.9 million). Correspondingly, its share to the labour force also declined to 12.0% from 12.7% at end-2016, below the 15% threshold set in the 11th Malaysia Plan.

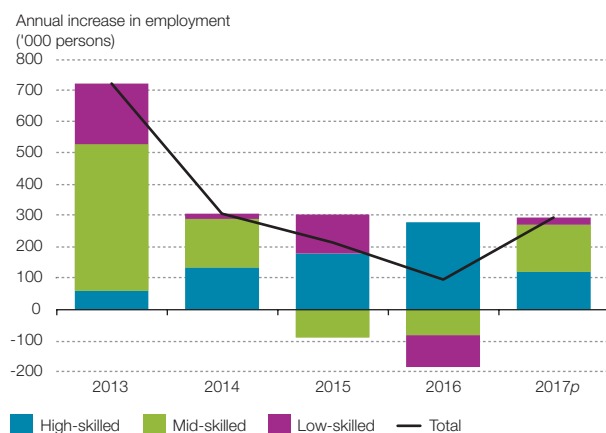
¹ As part of assessments of the Malaysian economy, the Bank undertakes regional economic and industry surveillance through its offices in Penang, Johor Bahru, Kota Kinabalu, Kuching and Kuala Terengganu. For more information, see Box Article on 'Broadening Economic Surveillance through Bank Negara Malaysia's Regional Offices' in Bank Negara Malaysia's Annual Report 2013.

² Based on the 2016 Salaries and Wages Survey by the Department of Statistics, Malaysia (DOSM).

Reported layoffs in 2017 continued on a decreasing trend (35,097 persons; 2016: 37,699 persons), approaching the long-run average³ of 30,000 persons per annum. These layoffs were concentrated within the manufacturing sector, reflecting industry-specific restructuring exercises, as multinational firms reconfigure their global value chains to reflect changing business needs. The stronger performance of the sector has, however, led to a net employment gain of 23,709 persons within the same period. Of significance, layoffs were highly context-specific, and partly reflects the flexibility of the labour market to adapt to changes in the operating environment, such as increases in efficiency and greater adoption of technology. As such, the implementation of the Employment Insurance System (EIS) on 1 January 2018 is crucial to mitigate the impact of involuntary separations to employees, by protecting workers' welfare and ensuring training and upskilling during periods of job transitions.

Chart 1: Net Employment Gains by Skill Level, 2013-2017

Net employment gains¹ driven by mid- and high-skilled job creation

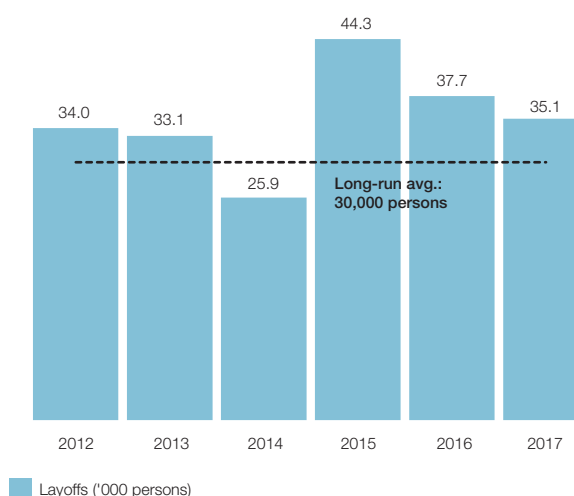


^p Preliminary
¹ Refers to the difference between employment level in a given year compared to the previous year

Source: Department of Statistics, Malaysia, Ministry of Human Resources and Bank Negara Malaysia estimates

Chart 2: Layoffs, 2012-2017

Reported layoffs continued its downward trend since 2015



Source: Department of Statistics, Malaysia, Ministry of Human Resources and Bank Negara Malaysia estimates

Aggregate nominal wages in the private⁴ and public sectors grew by 6.4% and 6.2% respectively in 2017 (2016: 4.3% and 6.4%, respectively). Wage growth in the private sector was driven mainly by the services sector. In particular, the stronger wage growth in major services sub-sectors⁵ (5.4%; 2016: 3.6%) was attributable to the *wholesale and retail trade* and *professional services* sub-sectors. In the manufacturing sector, higher wage growth (8.6%; 2016: 6.2%) was in line with the strong production in both export- and domestic-oriented sub-sectors. The continued positive impact of the salary increment for civil servants in July 2016 also contributed to overall wage growth.

Labour productivity, as measured by real value-added per worker, rose by 3.6% in 2017 (2016: 3.5%) driven mainly by productivity gains in the manufacturing and services sectors (4.7% and 4.2%, respectively; 2016: 4.1% and 3.6%, respectively). The better performance in these sectors was attributable to productivity gains in the retail trade, and manufacturing of transport equipment sub-sectors.

³ The long run average is the average annual layoffs from 2000-2016, excluding the crisis period of 2008-2009.
⁴ Private sector wages is 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% of total employment.
⁵ 'Major services sub-sectors' includes *wholesale and retail trade, accommodation and food and beverage, information and communication, transportation and storage, health, education, arts, entertainment and recreation, and professional and real estate services* sub-sectors.

The Malaysian Bureau of Labour Statistics

Post 2008-2009 financial crisis, there has been an increasing focus on issues surrounding the quality of economic growth and its impact on the people and communities. Discussions on jobs, inequality, social mobility and cost of living have all led to a growing demand from both policymakers and the research community for more high-frequency and granular set of labour statistics. The intent is that greater visibility on these issues will enrich public discourse and better inform policy deliberations and formulation.

Over the last decade, Malaysia has enhanced the labour statistics landscape. The publication of the annual GDP by income approach and wage conditions of key services industries has improved surveillance of both structural and cyclical policies. While progress has been made, there remain areas for improvement. The economic landscape has evolved rapidly with data flows increasing voluminously. Approaches to capture, manage and analyse data have also been revolutionised.

Recognising these challenges, the Government decided to establish the Malaysian Bureau of Labour Statistics (MBLS) as one of the major programmes within the Department of Statistics, Malaysia (DOSM). The MBLS is tasked with producing quality, timely and comprehensive labour market data. It is envisaged that highly-demanded information, such as wages, job creation and labour costs by industry will be accessible to policymakers and the public at a higher frequency (e.g. monthly, quarterly series) and with sufficient granularity (e.g. breakdown by key sectors and industries).

Among the critical gaps (Chart 1) in current official statistics that MBLS aims to address include the lack of available insights on “total hours worked” by key economic sectors. This will be an important enhancement to the existing labour productivity statistics, which is measured as the real value-added per employed persons. While the latter is quite useful, it runs the risk of overstating productivity gains, particularly if greater output is obtained from longer working hours. These nuances cannot be gleaned from the headline employment figures alone. Through the collection of data on total hours worked, MBLS will be able to measure labour productivity with greater accuracy. Also, greater insights into labour costs scaled to output by key industries would allow for more granular monitoring of wage pressures in the economy. This can help policymakers better discern if wage pressures are broad based or contained in specific industries. Such information is important to inform the choice of policy responses, if any, be it through monetary policy adjustments or targeted industry interventions.

Chart 1: Current Gaps in Selected Labour Market Statistics

MBLS is tasked to address current gaps in labour statistics landscape

Selected Labour Indicators by Key Economic Sectors	Monthly	Quarterly	Annually
Salary and wages	Some indicators available	Some indicators available	Available
Layoffs, vacancies, quits by occupations	Not available	Not available	Not available
Hours worked ¹	Not available	Not available	Some indicators available
Hiring sentiments	Not available	Available	Available
Long-term unemployment (total economy)	Not available	Not available	Available

■ Not available ■ Available ■ Some indicators available

¹ Available on an annual basis in the Labour Force Survey (breakdown by gender).
Industry breakdowns are unavailable.

Source: Bank Negara Malaysia's assessment

Incorporating the latest concepts and methodologies to account for employment developments in new growth areas such as the sharing economy (e.g. Airbnb, Uber) and the digital economy (e-commerce) would allow further customisation and recalibration of related policies such that they better deliver the intended outcomes. Indicators such as long-term employment by various durations and underemployment could offer much richer analysis on existing slack in the economy. In the period following the Global Financial Crisis (GFC), those indicators were heavily used by policymakers in the advanced economies to gauge the underlying health of the labour market and the risks of skills deterioration arising from being unemployed for long durations. In regards to the supply of labour, job retraining program design and its implementation could be adjusted for better delivery and results.

There is a clear need to further enhance labour market information through modernisation of data collection and management. Greater adoption of e-surveys and use of administrative data in various agencies are imperative. This could also be further advanced through the leveraging of Big Data analytics, in arriving at the needed

statistics. For example, data scraping on salary and wages from job postings and portals could provide deeper understanding on wage developments by location or by position. All things considered, this will require greater collaboration, data standardisation and sharing among various stakeholders.

Acknowledging the need for more data sharing and adoption of more modern statistical practices, the Labour Statistics Planning Group (LSPG) was established to oversee the inception and operationalisation of the MBLs. The LSPG, chaired by the Director General of the Economic Planning Unit (EPU), is a critical nucleus and platform for future inter-agency data collaboration through the leveraging of administrative data from the five core members¹ and ten satellite members². Readily-available administrative data (e.g. registration, transaction and record keeping) by various ministries and agencies, if integrated and utilised effectively with advanced statistical methods could potentially transform data analysis for policy formulation through more focused and evidence-based approaches. This includes contributors' records from the Employees Provident Fund (EPF) which can be used to better augment the monthly employment statistics. Similarly, information collected from the recently implemented Employment Insurance System (EIS) can offer high-frequency updates on unemployment conditions in the economy.

While it is still early days, the MBLs has already published data on labour productivity, employment, and salaries and wages based on the 2016 Economic Census, with longer-term goals that include statistics on the informal sector and labour costs. It is envisaged that it will also spur greater in-depth research by academia, think tanks and analysts, while contributing towards identifying better policy design and interventions (e.g., enhancing training and talent development programmes, reforming education).

The MBLs is building on the previous efforts made to strengthen the statistics landscape to meet the increasing demands for more varied, high-frequency, and granular data. It is important to note that this is by no means an isolated endeavor. It runs in tandem with a larger statistical review across the public sector to strengthen current governance and institutional arrangements. This is to ensure that Malaysia's overall statistical system remains relevant, progressive and effective in rapidly changing times.

¹ Economic Planning Unit (EPU), Ministry of Finance (MOF), Department of Statistics, Malaysia (DOSM), Bank Negara Malaysia (BNM), and Ministry of Human Resources (MOHR).

² Institute of Labour Market Information and Analysis (ILMIA), Employees Provident Fund (EPF), Public Service Department (JPA), Social Security Organisation (SOCSO), Inland Revenue Board of Malaysia (LHDN), Ministry of Home Affairs (MOHA), Ministry of Education (MOE), Ministry of Higher Education (MOHE) and Accountant General's Department of Malaysia (AGD).

Most Economic Sectors Recorded Higher Growth

On the supply side, most sectors registered higher growth in 2017. Malaysia's growth performance remained principally driven by the services and manufacturing sectors, which benefited from marked improvements in domestic and external conditions.

Growth in the services sector expanded at a faster pace of 6.2% (2016: 5.6%) amid broad-based improvements across most sub-sectors. On the consumer front, better labour market conditions and improving consumer sentiments lifted growth in the *retail, food and beverages and accommodation* and *motor vehicles* sub-sectors. The *finance and insurance* sub-sector registered higher growth, benefitting from the strong pick-up in capital market activity, particularly from initial public offerings. In the *transport and storage* sub-sector, growth was supported by stronger trade and air passenger traffic growth. Growth in the *information and communication* sub-sector was also higher, reflecting higher demand for data communication and computer services.

The manufacturing sector expanded further in 2017 (6.0%; 2016: 4.4%), driven by higher growth in the domestic-oriented industries, and continued expansion in the export-oriented industries. In the domestic-oriented industries, production of both commercial and consumer transport equipment turned around, reversing a

Table 1

Real GDP by Kind of Economic Activity (2010=100)

	2017p	2016	2017p	2016	2017p
	% of GDP	Annual change (%)		Contribution to growth (ppt) ¹	
Services	54.4	5.6	6.2	3.0	3.4
Manufacturing	23.0	4.4	6.0	1.0	1.4
Mining and quarrying	8.4	2.2	1.1	0.2	0.1
Agriculture	8.2	-5.1	7.2	-0.4	0.6
Construction	4.6	7.4	6.7	0.3	0.3
Real Gross Domestic Product (GDP)	100.0¹	4.2	5.9	4.2	5.9

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

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Source: Department of Statistics, Malaysia

decline in the output of motor vehicles in the previous year. Growth in the domestic-oriented industries was further supported by stable demand for food-related products and construction-related materials. Growth in the export-oriented industries was in tandem with the broad-based recovery in global demand, which supported the increased production of E&E and resource-based products such as palm oil-related and petroleum-related products.

The construction sector registered a moderate growth of 6.7% (2016: 7.4%). Growth was supported mainly by the *civil engineering* sub-sector, due to steady progress of large petrochemical, transportation, and utility projects. The *special trade* sub-sector benefited from increased activity from projects in the early stages of construction, such as land clearing, piling and land reclamation work. Growth in the *residential* sub-sector moderated, consistent with the record-high number of unsold residential properties. In the *non-residential* sub-sector, growth was sustained by higher activity from mixed developments, industrial and social projects such as theme parks and sports complexes, which was offset by the ongoing weakness in the commercial segment due to an oversupply of office space and shopping complexes.

Agriculture production growth rebounded to 7.2% (2016: -5.1%), driven mainly by a turnaround in crude palm oil (CPO) production, as yields recovered from the negative impact of El Niño in 2016.

In the mining sector, growth moderated to 1.1% (2016: 2.2%), reflecting the voluntary crude oil supply adjustments by PETRONAS, in line with the OPEC agreement to restrain oil production until end-2018. Growth remained supported by higher production in the natural gas sub-sector, reflecting the increased capacity of natural gas facilities.

EXTERNAL SECTOR

Strong external sector performance, supported by the significant upturn in global growth and trade activity, and improvement in international investor sentiments

Malaysia's external position improved significantly in 2017, amid broad-based improvement in the global economy and relatively lower volatility in the international financial markets. As an economy with a high degree of openness to trade and investment flows, Malaysia was well-positioned to benefit from these

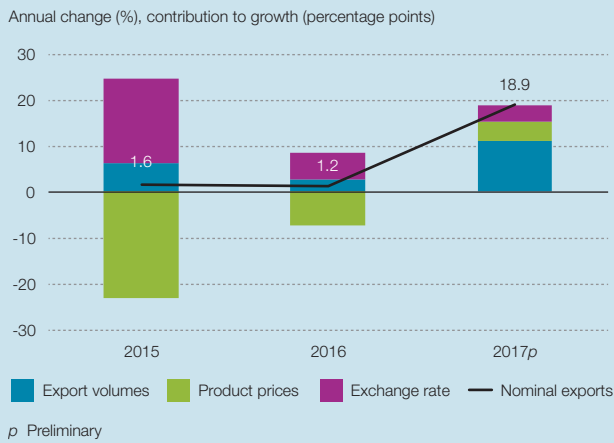
favourable conditions. This, in turn, contributed to a buoyant export performance, higher current account surplus, continued inflows of FDI and resumption of portfolio investment inflows by international investors. Malaysia's external debt declined, with risks mitigated by favourable currency and maturity profiles. Sufficient international reserves continued to serve as a buffer against potential external shocks and volatility.

Robust exports, driven by double-digit growth in export volumes and turnaround in export prices

Against the synchronous and more entrenched expansion in the advanced and emerging economies,

Chart 1.5: Contribution of Export Volumes, Product Prices and Exchange Rate to Gross Export Growth

Robust gross export growth driven by export volumes



Source: Department of Statistics, Malaysia

global trade activity rebounded, particularly in the Asian region. Malaysia benefited significantly from the resurgent external demand from trade partners, facilitated by the economy's deep integration into GVCs, and a highly-diversified composition of export products and markets.

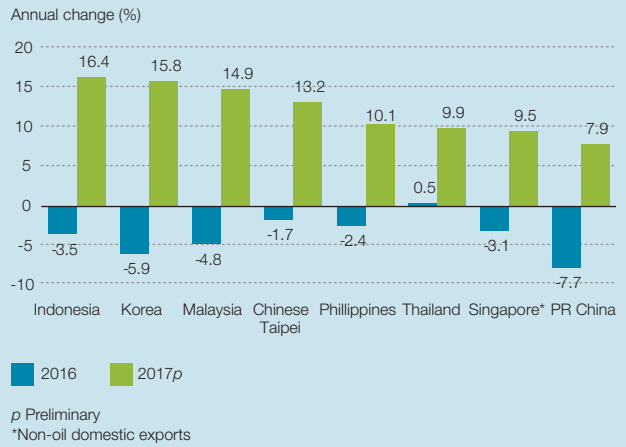
The acceleration in gross exports during the year was mainly driven by export volumes (Chart 1.5), which registered double-digit growth for the first time since 2004 (11.1%; 2016: 2.6%). The faster growth in export volumes was led by manufactured exports, in response to higher export-weighted global demand (3.6%; 2016: 3.1%). The revival in global consumer and business spending, in tandem with the launches of popular flagship smart devices, and investments in machinery and equipment, spurred an upswing in the global technology cycle. This induced stronger demand for E&E products, with E&E export volumes advancing by 16.8% during 2017 (2016: 3.4%), driven mainly by semiconductor exports. As a result, Malaysia's share of the global market for semiconductor exports increased to 5.9%² (2016: 5.7%).

Export volumes for non-E&E manufactured products also rebounded sharply (11.4%; 2016: -0.9%), driven by robust demand for petroleum, chemical, rubber and iron & steel products. For commodities however, export volumes moderated to 2.2% (2016: 9.5%) as higher LNG

² January-November 2017 figures, as published by Global Trade Atlas.

Chart 1.6: Regional Export Performance in US Dollar Terms

Stronger gross export growth (in US dollar terms) in line with regional countries



Source: Department of Statistics, Malaysia and Bloomberg

output from new production facilities in Sarawak was partially offset by lower crude petroleum exports amid the OPEC agreement to restrain oil production.

The turnaround in overall export product prices (4.3%; 2016: -7.4%) provided further impetus to gross export growth. This is particularly evident for commodity exports, which benefited from the recovery in prices for crude oil (+21.7%) and LNG (+13.6%) during the year (2016: -16.1% and -26.9%, respectively). Prices of manufactured exports was broadly sustained after declining for three consecutive years (2014-2016: -9.2%), partly supported by higher average selling prices for electronic components such as semiconductors and memory chips to fulfil rising global demand and tighter supply conditions. This was evidenced by very high capacity utilisation rates in the manufacturing sector, which rose to its highest post-GFC levels in many of the major economies such as the EU, US and PR China.

Removing the impact of exchange rate movements, in US dollar terms, Malaysia emerged as the third-best export performer in the region after Indonesia and Korea, with gross exports improving by 14.9% (2016: -4.8%, Chart 1.6). This shows that the exchange rate was not the main driver of the strong performance of gross export growth.

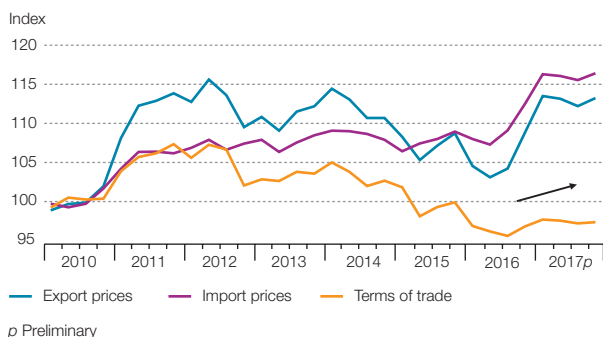
Gross imports registered double-digit growth of 19.9% (2016: 1.9%), mainly reflecting higher imports of intermediate goods, capital goods, and goods for re-exports. Stronger intermediate and capital goods imports (20.0% and 15.3%, respectively), was in line

Developments in Malaysia's Terms of Trade

Terms of trade refers to a country's export prices in relation to its import prices. It can be interpreted as the amount of imported goods a country can purchase per unit of exported goods. The terms of trade is represented by an index, which is calculated by dividing the price index of exports by the price index of imports and multiplying by 100. Improving terms of trade indicates that for every unit of exports sold, more units of imported goods could be purchased. In comparison, when the terms of trade worsens, the country needs to export more units for the same level of imports.

Chart 1: Malaysia's Terms of Trade

Improving terms of trade in 2017



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Source: Department of Statistics, Malaysia

Malaysia's terms of trade improved in 2017, but it had been on a declining trend since 2011. This was attributed mainly to:

- The slump in commodity prices; and
- Sluggish manufacturing export prices due to higher competition and industry consolidation, particularly in the E&E sector.

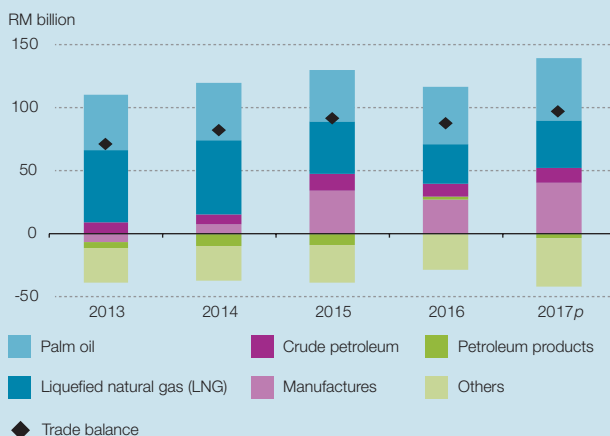
On a year-on-year basis, Malaysia's terms of trade strengthened in 2017. Since its trough in March 2016 of 96.0 points, the terms of trade improved amid a recovery in commodity prices and higher prices for manufactured exports. The terms of trade peaked at 98.0 points in February 2017 before moderating slightly to 97.7 points in December 2017.

The improvement in the terms of trade generated positive spillovers to the domestic economy. Firstly, higher demand for Malaysia's export products induced greater demand for labour and increased wages. This trend was particularly apparent in the manufacturing sector, which recorded robust employment and wage growth. Insights from surveillance conducted by the Bank's regional offices also indicated that firms in the export-oriented manufacturing sector reported a higher amount of overtime work to raise production and fulfil orders. The improvement in labour market conditions, in turn, resulted in higher household incomes and consumer spending. Secondly, the increased export orders and higher capacity utilisation rates¹ (82.6%; 2016: 77.5%) resulted in more firms embarking upon investment activity. Greater revenue and profits were also generated as firms benefited from both higher average selling prices and increased sales volume.

¹ Source: Malaysian Institute of Economic Research's capacity utilisation rates.

Chart 1.7: Trade Balance by Commodities

Higher trade balance supported by larger surplus in E&E and commodities



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Source: Department of Statistics, Malaysia

with the robust manufacturing exports and more rapid investment in the manufacturing and services sectors. Imports of high-value items, including a floating structure, oil & gas vessels and aircrafts provided further impetus to capital imports, particularly during the first quarter of the year. Better re-export activity was driven mainly by petroleum and E&E products, catering primarily to regional demand.

Overall, Malaysia's trade balance improved to RM97.2 billion (2016: RM88.1 billion), supported by higher surplus in E&E and commodities, that offset the continued deficit in non-E&E manufactured goods, such as machinery, equipment & parts, transport equipment and iron & steel products.

The current account balance improved to RM40.3 billion, or 3.1% of GNI, compared to the previous year (2016: RM29.0 billion or 2.4% of GNI).

The current account registered a higher surplus, largely due to a higher goods surplus³ following the strong export performance, which more than offset widening deficits in the services and primary income accounts.

In tandem with robust trade and higher domestic investment activity, the services account registered a wider deficit, due mainly to larger deficits in transportation and insurance services (-RM29.7 billion and -RM8.9 billion, respectively). The transportation deficit reflected heavy reliance on foreign service providers particularly in the sea and air freight segments. Air passenger and port segments nevertheless continued to register net surplus balances. In the travel account, a higher surplus was recorded (RM33.0 billion; 2016: RM31.5 billion), driven mainly by greater per capita spending by tourists in Malaysia. This offset the lower number of tourist arrivals (25.9 million tourists; 2016: 26.8 million tourists), reflecting mainly fewer tourists from ASEAN, India, the UK and Australia.

In the income account, the primary income deficit widened to RM36.1 billion (2016: -RM34.6 billion), due to larger investment income accrued to FDI in Malaysia, particularly in the manufacturing sector following the strong performance of export-oriented multinational companies. This was partially offset

by higher income from DIA by Malaysian companies mainly in the finance & insurance and manufacturing sectors, supported by a more favourable global economic climate. FDI returns continued to outpace DIA returns, registering 10.6% and 5.1%, respectively (2016: 9.3% and 3.7%, respectively). The secondary income account recorded a sustained sizeable deficit (-RM18.6 billion; 2016: -RM18.6 billion) driven by foreign workers' remittances.

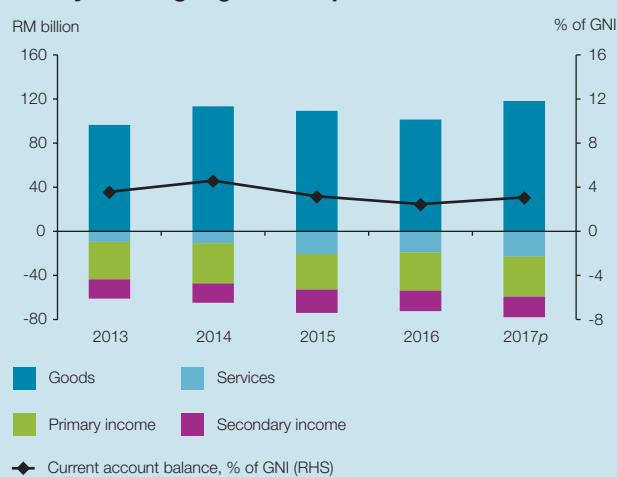
Significant cross-border capital flows

The financial account recorded a net inflow of RM2.3 billion (2016: net outflow of RM1.1 billion), attributable to continued long-term non-resident investment inflows in the form of FDI, and a resumption of portfolio investments by non-residents, driven by robust domestic growth, improvement in global growth prospects, and less volatile financial market conditions. These inflows were partially offset by DIA, albeit at a more moderate pace, and portfolio investments abroad by resident banks and institutional investors.

The *direct investment* account recorded a net inflow of RM12.4 billion (2016: net inflow of RM14.1 billion), as net FDI inflows exceeded net DIA outflows. The economy's growth performance and improved outlook provided support to Malaysia's attractiveness as an investment destination for international investors, leading to continued inward long-term direct investments by non-residents. FDI inflows amounted to RM39.2 billion, equivalent to 3.0% of GNI (2016: net inflow of RM47.2 billion or 3.9% of GNI), mainly in the form of equity capital injections from parent companies abroad and earnings retained for reinvestments in the domestic economy amid higher corporate profitability during the year. In terms of economic sectors, FDI remained broad-based. The largest recipient sector was non-financial services, particularly the real estate and information and communication services sub-sectors. FDI in the mining sector was also higher, increasing by 54% from the previous year to support ongoing upstream oil and gas exploration and extraction activities following the recovery in global oil prices. In terms of source countries, Europe and Asia were significant FDI contributors, particularly Hong Kong SAR, PR China, and the UK.

Chart 1.8: Current Account Balance

Higher current account surplus in 2017 attributable mainly to a larger goods surplus



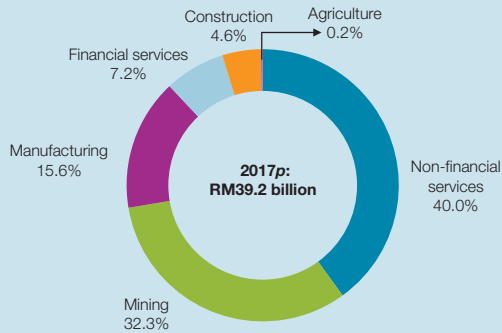
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Source: Department of Statistics, Malaysia

³ A difference between the goods surplus and trade surplus may arise 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.

Chart 1.9: Net Foreign Direct Investment by Sectors

Foreign direct investment¹ channelled mostly into the non-financial services sub-sector



¹ Foreign direct investment as defined according to the 5th Edition of the Balance of Payments Manual (BPM5) by the International Monetary Fund (IMF)

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Source: Department of Statistics, Malaysia

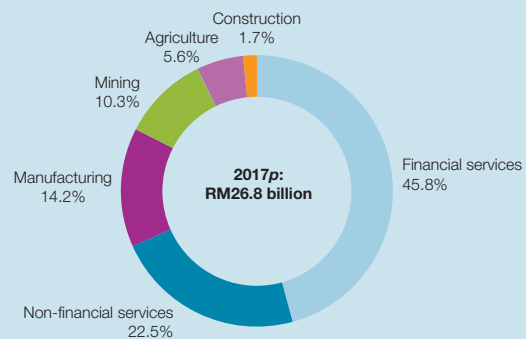
2.8% of GNI). The investments were mainly in the form of retained earnings and inter-company loan extensions to subsidiaries abroad. By sector, DIA was channelled mainly into the finance and insurance services sub-sector. DIA in the mining sector declined, reflecting the downscaling of upstream oil and gas investment activities abroad by the national oil company. ASEAN and Europe were major recipients of DIA by Malaysian companies, particularly Singapore, the UK and Indonesia.

Sufficient reserves and manageable external debt, while substantial capital flows were intermediated efficiently in the domestic financial markets

The *portfolio investment* account registered a lower net outflow of RM9.2 billion (2016: net outflow of RM15.4 billion), due mainly to a turnaround in non-resident portfolio investments, which recorded a net inflow of RM7.3 billion (2016: net outflow of RM0.4 billion), amid continued net acquisition of foreign financial assets by resident fund managers (net outflow of RM16.5 billion; 2016: net outflow of RM15.0 billion). Despite some volatility in the first quarter, non-resident portfolio investment flows saw a return to the domestic capital markets, reflecting purchases of domestic equity securities which were partially offset by a net liquidation of short-term domestic debt securities in the first quarter of 2017. In particular, foreign holdings of Malaysian Government Securities (MGS) declined during the quarter following a rebalancing of asset

Chart 1.10: Net Direct Investment Abroad by Sectors

Direct investment abroad¹ channelled mostly into the services sector



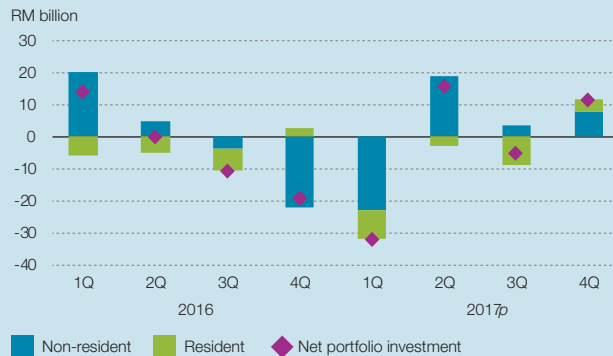
¹ Direct investment abroad as defined according to the 5th Edition of the Balance of Payments Manual (BPM5) by the International Monetary Fund (IMF)

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Source: Department of Statistics, Malaysia

Chart 1.11: Portfolio Investments

Resumption of portfolio investment inflows by non-residents



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Source: Department of Statistics, Malaysia

exposures to the emerging market economies by international asset managers. This was due to market expectations in March 2017 of monetary policy normalisation by the US Federal Reserve, renewed volatility in global oil prices, and the reduction of Malaysia's weightage in the JP Morgan GBI-EM Index following the inclusion of Argentina, Czech Republic and Uruguay in the index. As a result, non-resident holdings of public debt instruments declined to 16.4% as at end-March 2017 (end-December 2016: 20.8%). These large flows of funds were well-intermediated by Malaysia's deep and diversified financial market, and highly-capitalised and liquid banking system. The presence of domestic institutional investors supported demand during periods of financial market

stress and capital outflows. Despite net outflows from debt securities, foreign purchases of equity securities resumed in the first quarter of 2017 (end-March 2017: non-residents held 22.4% of total market capitalisation; end-December 2016: 22.3%), amid stronger corporate earnings, better ringgit performance and improved economic prospects.

Non-resident portfolio investment inflows into the domestic financial markets resumed amid lower financial market volatility for the rest of the year. The improvement in investor sentiments was supported by expectations of better corporate earnings, sustained strong exports growth, better-than-expected economic performance, and domestic growth prospects. These factors supported non-resident portfolio investment inflows into both the equity and debt markets, despite the maturing of a few tranches of MGS and Government Investment Issues (GII). Consequently, non-resident holdings of domestic equity securities and public debt instruments rose to 23.2% and 17.7%, respectively, as at end-December 2017.

The *other investment* account recorded a net outflow of RM1.3 billion (2016: net inflow of RM1.0 billion), due mainly to net outflows in the corporate sector. This reflected mainly the placements of currency and deposits abroad and a net repayment of loans owed to non-residents. These outflows were partially offset by net inflows in the banking sector, due mainly to the placements of currency and deposits in domestic financial institutions, extension of loans to Malaysian banks from financial institutions abroad and the repayment of loans previously extended by domestic banks. These interbank transactions, which vary in both magnitude and direction every quarter, underscored the treasury management strategies of individual banking institutions. The public sector registered a net outflow, attributable to the repayment of long-term loans by the general government. Errors and omissions (E&O) amounted to -RM51.9 billion, or -2.9% of total trade (2016: -RM13.2 billion or -0.9% of total trade), partly due to foreign exchange revaluation losses on international reserves arising from the appreciation of the ringgit over the year. Excluding revaluation losses, the E&O declined to -RM26.3 billion, or -1.5% of total trade.

Following these developments, the international reserves of Bank Negara Malaysia amounted to USD102.4 billion as at end-2017 compared to USD94.5 billion as at end-2016. Besides the support from a higher current account

surplus and continued inflows of FDI, the reserves level also reflected foreign exchange revaluation changes. The weakening of the US dollar against most of the currencies in the diversified foreign currency reserve assets during the year, except in the first quarter, contributed to the increase in reserves level. As at 15 March 2018, international reserves amounted to USD103.9 billion. The international reserves remain adequate to facilitate international transactions and sufficient to finance 7.3 months of retained imports and is 1.1 times the short-term external debt. Over the past 20 years, Malaysia has cultivated a wide range of monetary policy instruments and pursued greater exchange rate flexibility through deregulation and liberalisation. These have enabled the economy to reduce its reliance on the Bank's international reserves in managing external pressures.

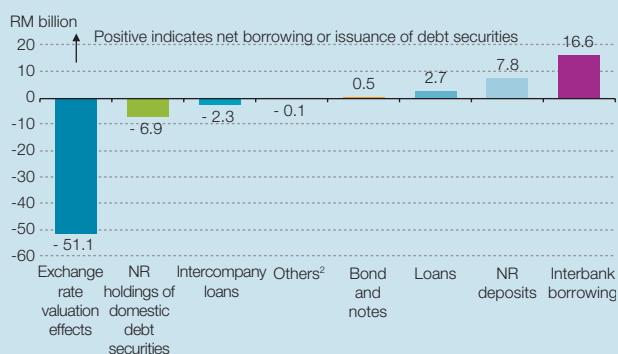
Of significance, the international reserves are not the only means for the country to meet its external obligations. Approximately 75% of external assets are held by domestic corporations, banks, and institutional investors. These external assets enable these entities to meet their external obligations without creating a claim on international reserves.

Manageable external debt

Malaysia's external debt declined to RM883.4 billion as at end-2017, equivalent to USD215.5 billion or 65.3% of GDP (2016: RM916.1 billion, equivalent to USD202.3 billion or 74.5% of GDP). The lower external

Chart 1.12: Changes in Total External Debt in 2017

Lower external debt in 2017 Net change¹: -RM32.8 billion



¹ Changes in individual debt instruments exclude exchange rate valuation effects

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

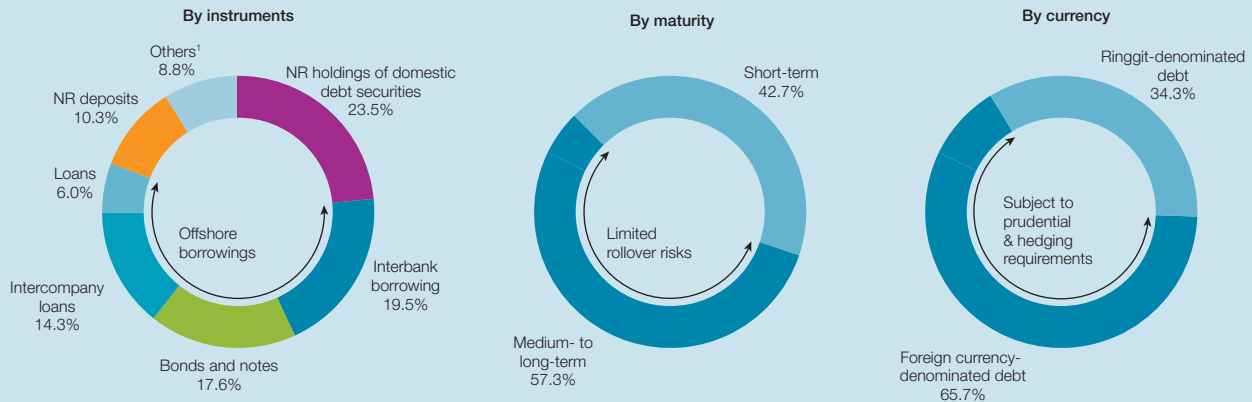
Note: NR refers to non-residents

Figures may not necessarily add up due to rounding

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Chart 1.13: Breakdown of Malaysia's Total External Debt (% share)

Favourable external debt profile



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

Source: Bank Negara Malaysia

debt was mainly attributed to valuation effects following the strengthening of the ringgit against most currencies during the year. Excluding valuation effects, Malaysia's external debt position increased by 1.4% of GDP, attributable mainly to increases in interbank borrowing and non-resident (NR) deposits.

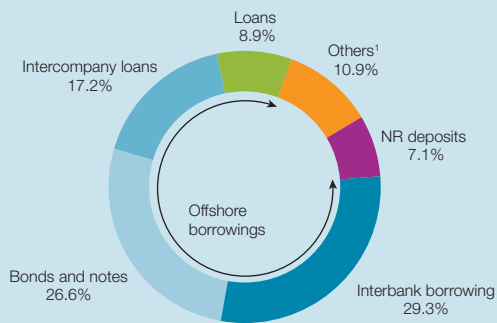
Risks from external debt remain manageable, mitigated by its currency and maturity profiles. More than a third of external debt is denominated in ringgit (34.3%), mainly in the form of NR holdings of domestic ringgit debt securities and ringgit deposits in domestic banking institutions. As such, these liabilities are not subject to

valuation changes from the fluctuations of the exchange rate. During the course of the year, the total NR holdings of domestic debt securities decreased by 3.2% to RM207.4 billion (end-2016: RM214.2 billion). This largely reflects the maturing MGS and GII, as well as Bank Negara Monetary Notes. In contrast, NR holdings of ringgit-denominated deposits in domestic banking institutions increased by RM0.8 billion or 1.6% to RM50.1 billion, equivalent to 55.0% of total NR deposits.

The remaining portion of total external debt of RM580.7 billion (65.7% share) is denominated in foreign currency (FC), which are subject to prudential and hedging requirements on banking institutions and corporations. The bulk of these obligations are offshore borrowings⁴, raised mainly to expand productive capacity and to better manage financial resources within corporate groups. As at end-2017, offshore borrowing was lower at 37.5% of GDP compared to 60.0% of GDP during the Asian Financial Crisis.

Chart 1.14: Breakdown of Foreign Currency-denominated External Debt (% share)

Foreign currency-denominated debt subjected to prudent liquidity management practices and hedging requirements



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

Source: Bank Negara Malaysia

Of the total FC-denominated external debt, around one third is accounted for by interbank borrowing and FC deposits in the domestic banking system, which increased by RM9.9 billion from end-2016. This reflects banks' intragroup liquidity management and placements of deposits by foreign parent entities, which are subject to prudent liquidity management practices, such as internal limits on funding and maturity mismatches. The next largest component is long-term bonds and notes

⁴ Comprised mainly of foreign currency loans raised, and bonds and notes issued offshore.

issued offshore (26.6% share or RM154.2 billion), primarily to finance asset acquisitions abroad that will generate future income. FC-denominated intercompany loans was lower by RM12.9 billion following net repayment during the year. These obligations are normally subject to flexible and concessionary terms, such as a flexible repayment schedule or lower interest rates.

From a maturity perspective, more than half of the total external debt is skewed towards medium- to long-term tenures (57.3% of total external debt), suggesting limited rollover risks. Additionally, not all short-term external debt pose a claim on reserves. In 2017, Malaysia recorded a higher

Chart 1.15: Net International Investment Position (IIP)

IIP registered a net liability in 2017

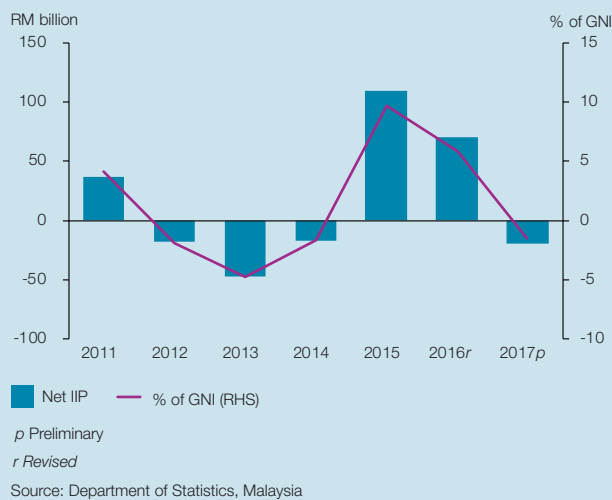
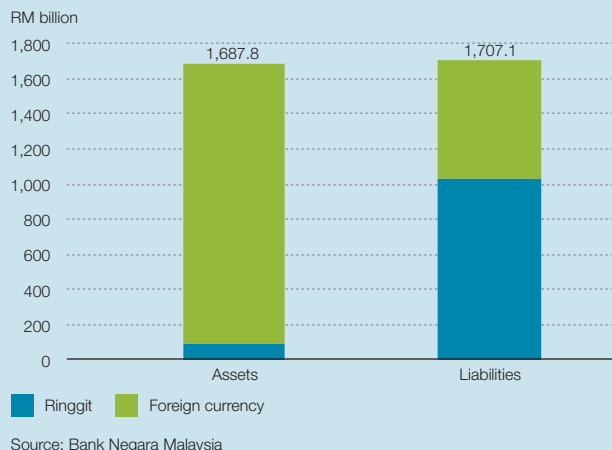


Chart 1.16: International Investment Position (IIP) by Currency

Foreign currency external assets exceed foreign currency external liabilities



current account surplus from the favourable external demand environment, and continues to experience a net short-term external asset position. This indicates that most borrowers are able to meet their external obligations given the steady stream of foreign currency earnings via trade activities and accumulation of external assets. As at end-2017, Malaysia has a net short-term asset position of RM268.1 billion. The sustained net short-term asset position reflects the economy's ability to service short-term external debt falling due. Furthermore, Malaysia has a net foreign currency asset position, as the bulk of liabilities are in ringgit and assets are mostly denominated in foreign currency. This means that Malaysia's external position is well-protected from a sharp exchange rate depreciation.

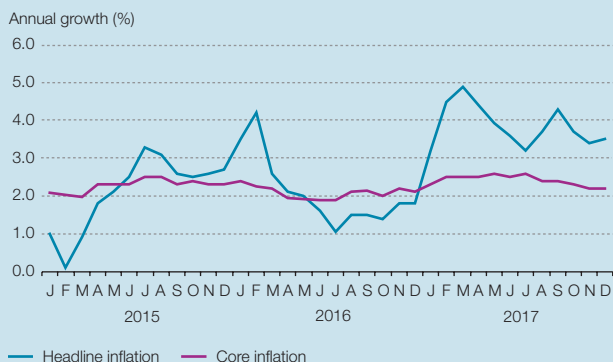
As at end-2017, Malaysia recorded a marginal net liability position of RM19.3 billion, equivalent to -1.5% of GNI, compared to a net asset position of RM70.1 billion, or 5.9% of GNI in 2016. The appreciation of the exchange rate (as at end-2017) was the key driver of the reversal in Malaysia's net international investment position (IIP). This underscores the role of the exchange rate as a shock absorber in influencing the IIP. The appreciation of the ringgit reduced the country's external assets, most of which are denominated in foreign currencies, when valued in ringgit terms. The impact of the stronger ringgit on external liabilities was relatively smaller given the high share of ringgit-denominated liabilities, namely in the form of non-resident holdings of domestic debt and equity securities as well as placement of deposits in the domestic banking system.

Headline inflation increased in 2017

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), increased to 3.7% in 2017 (2016: 2.1%). While the inflation numbers were within the Bank's expectations, inflation during the year remained volatile and was driven mainly by higher domestic fuel prices. Higher external and domestic costs from higher global commodity prices and disruptions in domestic food supplies respectively also contributed to inflation during the year. However, the stronger ringgit exchange rate since April 2017 helped to contain the increase in cost of production for domestic goods. Underlying inflation, as measured by core inflation, was also higher during the year, averaging at 2.3% in 2017 (2016: 2.1%).

Chart 1.17: Consumer Price Inflation

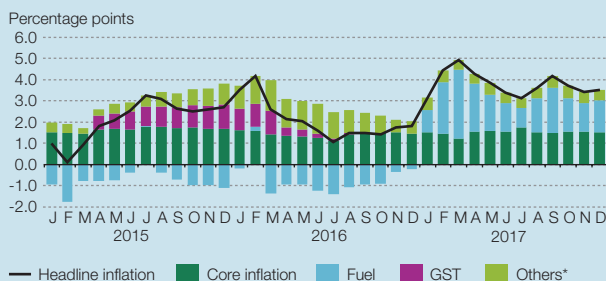
Headline inflation increased to 3.7% in 2017



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.18: Contributions to Headline Inflation by Components

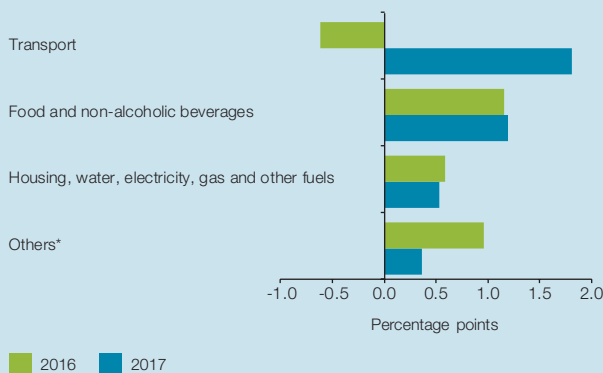
Headline inflation was driven mainly by higher domestic fuel prices



* Others include price-volatile items and other price-administered items
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.19: Contributions to Inflation by Categories

Contributions from the transport and food and non-alcoholic beverages categories were higher



* Others include clothing and footwear, alcoholic beverages and tobacco, health, education, communication, recreation services and culture, furnishings, household equipment and routine household maintenance, restaurants and hotels and miscellaneous goods and services categories

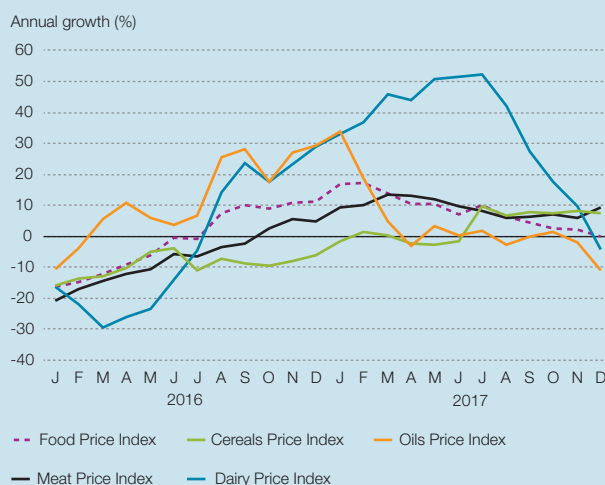
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Externally, global commodity prices were higher in 2017, driven by increases in the prices of oil and food. Global oil prices rose during the year following OPEC's agreement to cut production effective from 1 January 2017. The stronger-than-expected global oil demand since the second quarter of the year amid production cuts led to falling inventories, which also supported the increase in oil prices. The rise in global oil prices was further compounded by unexpected supply disruptions in the US Gulf Coast due to Hurricane Harvey at the end of August and geopolitical tensions in the Middle East towards the end of the year. Global food prices also increased during the year, driven mainly by stronger global demand amid supply shortages. The Food and Agriculture Organisation of the United Nations (FAO) Food Price Index, rose by 8% in 2017 (2016: -1.5%). With the exception of cereals, the annual rate of increases in prices for other food categories, notably meat, oils and dairy categories, accelerated during the third quarter of 2016, before slowing down in the second quarter of 2017. Specifically, palm oil prices also rose to a four-year high in the fourth quarter of 2016 as a result of tight supplies before declining in March 2017. Cereal prices only started to increase in the second half of 2017, driven partly by higher wheat prices following yield concerns from a worsening drought in the US and Canadian regions. The higher global commodity prices, coupled with a slight increase in import partners' inflation, resulted in higher cost for domestic producers.

Domestically, higher costs stemmed from supply disruptions and price adjustments that had been occurring since late 2016. In 2017, there were intermittent disruptions to the supply of fresh food caused by

Chart 1.20: FAO Food Price Index

Global food prices rose by 8%



Source: Food and Agriculture Organisation of the United Nations (FAO) Food Price Index

adverse weather conditions during the monsoon season in January, the outbreak of bird flu in February and adverse sea conditions in May. As a result, inflation for price-volatile items remained relatively high at 4.9% (2016: 5.6%, 2011-2015: 4.4%). The impact of several revisions to prices that took place in the second half of 2016 persisted into 2017. These revisions included an increase in satellite TV charges in August 2016 and the removal of the subsidy for cooking oil in November 2016. The impact of these revisions however, lapsed towards the end of 2017, leading to a moderation in inflation in the fourth quarter.

In terms of impact on CPI, the higher global oil prices during the year had a direct impact through domestic fuel prices. Prices of RON 97 petrol, RON 95 petrol and diesel were adjusted higher by 34 sen, 41 sen and 47 sen, respectively. The impact on inflation was compounded by the significantly lower global oil prices in the base period of 2016. As a result, *transport* inflation rose to 13.2% (2016: - 4.6%).

The higher external and domestic costs were also passed through indirectly to the prices of goods and services. Based on the Bank's industrial engagements⁵, firms took advantage of the relatively stronger demand during the year to increase their retail prices, easing the compression of their margins, especially for firms in the *food away from home* and *furnishings, household equipment and routine household maintenance* categories. For example, fast food and wheat-based food products experienced upward price revisions during the year. The higher global palm oil prices also led to higher prices for non-durable household goods, such as washing powders and

detergents. However, the adjustments were moderate as firms remained cautious. The impact was also partially contained by the stronger ringgit exchange rate since April 2017. These price revisions, coupled with slightly higher inflation of rental during the year, led to core inflation rising to 2.3% during the year.

Demand-driven inflationary pressures in the economy remained largely stable during the year, given the lack of persistent tightness in capital stock and absence of significant wage pressures. In 2017, firms in the manufacturing sector operated at a relatively high capacity utilisation rate of 82.6% (2016: 77.5%), supported by the increase in private sector spending and higher exports. While spare capacity has narrowed, it did not translate into broad-based price pressures. In terms of capital stock, the higher capacity utilisation was expected to lead to some tightness for firms. However, this tightness was not expected to persist and exert upward pressure on inflation as incoming investments, especially in machineries and equipment, would expand firms' productive capacity over time to cater to the stronger demand. In the labour market, there remained spare capacity even as the underutilisation of labour was declining. The unemployment rate during the year remained stable (3.4%; 2016: 3.4%) as the higher employment growth (2.1%; 2016: 0.7%) was matched by growth in the labour force (2.1%; 2016: 1.0%). While wages per worker grew in the manufacturing sector, it was offset by higher productivity, resulting in lower unit labour costs. In the services sector, unit labour costs were also lower given the stable growth in wages per worker amid increase in productivity.

Chart 1.21: Private Investment in Malaysia and Capacity Utilisation in the Manufacturing Sector

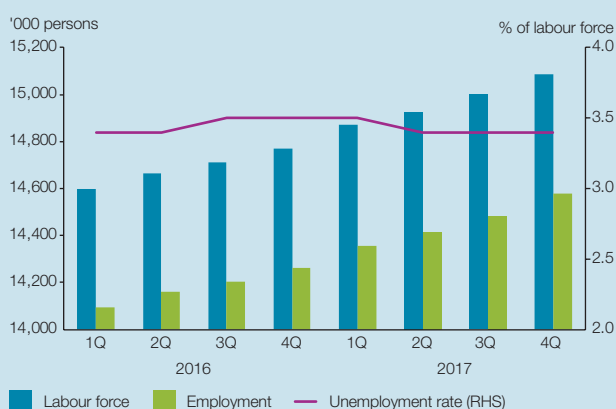
Higher growth in private investment would expand productive capacity in the manufacturing sector



Source: Department of Statistics, Malaysia and Malaysian Institute of Economic Research (MIEF)

Chart 1.22: Unemployment Rate, Employment and Labour Force

Unemployment rate remained stable as higher employment growth was matched by growth in the labour force



Source: Department of Statistics, Malaysia

⁵ The industrial engagements were undertaken by the Bank's Regional Economic Surveillance (RES) team.