Understanding the Changing Dynamics of the Current Account of the Balance of Payments in Malaysia

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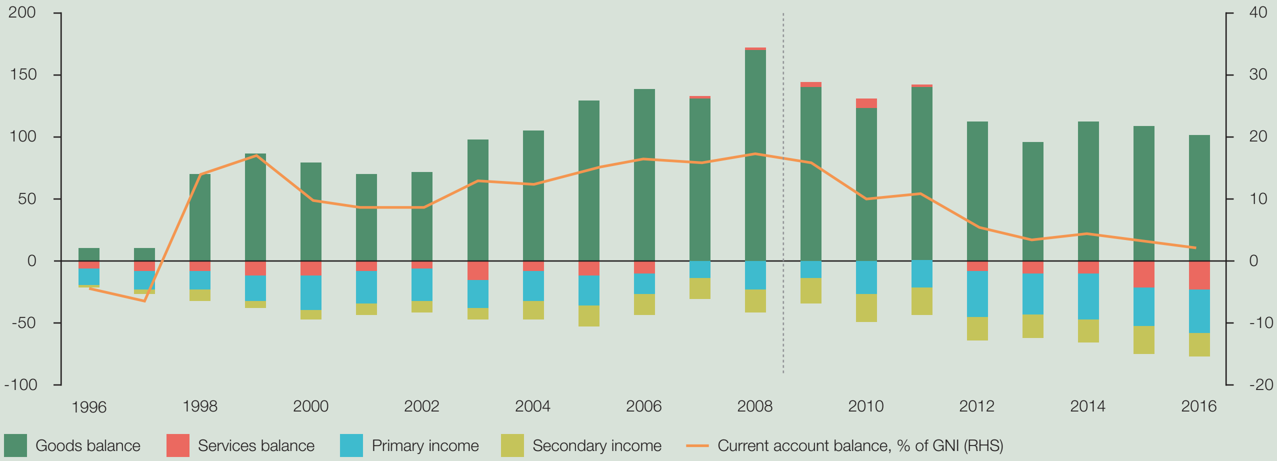
Introduction

Over the past two decades, Malaysia's current account performance can be broadly characterised by two distinct periods. The current account surplus rose following the Asian Financial Crisis (AFC) and peaked at 17.6% of GNI in 2008 (Chart 1). This was supported by the widening trade surplus amid sustained deficits in the services and income accounts. During this period, Malaysia's exports registered robust growth, supported by strong global demand and rising commodity prices. Conversely, import growth was more moderate, on account of subdued investment activity after the AFC. Following the Global Financial Crisis in 2008, the current account surplus began to narrow. Export growth slowed following the prolonged weakness in global demand and the steep decline in commodity prices. Demand for imported goods improved, underpinned by stronger domestic demand, that was partly driven by stimulative macroeconomic policy. Coupled with the widening deficits in the services and income accounts, the current account surplus settled at 2.1% of GNI in 2016.

Chart 1

Narrowing Current Account Balance Since 2008



Source: Department of Statistics, Malaysia

The current account balance is commonly assessed from the international trade perspective, focusing on factors determining exports and imports of goods and services, and payments and receipts of external incomes. Another perspective of the current account is the saving-investment gap (the excess of savings over investment), reflecting the intertemporal saving and investment decisions of the public and private sectors in the domestic economy. In a closed economy, domestic savings are essentially the only source of capital for investment activity. However, in an open economy, when investment in the economy exceeds the available domestic savings, there is a need to rely on foreign savings, and this causes the current account to go into deficit. In the case of Malaysia, the economy has in fact been saving more than it has been investing, thus resulting in a current account surplus. These excess savings have either been accumulated in the form of foreign assets held as part of Malaysia's international reserves, or they have been channelled abroad to finance economic activity in foreign countries.

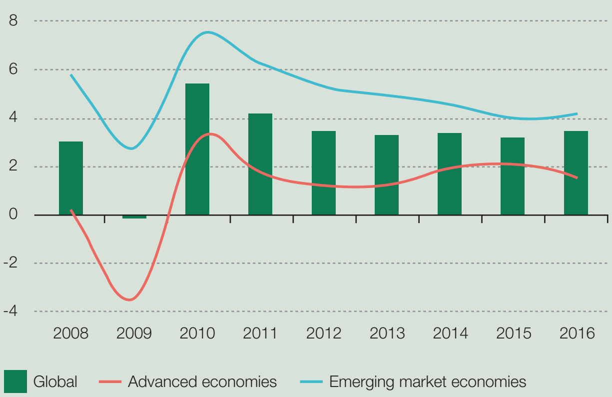
Given the narrowing current account surplus, it would be insightful to understand the factors which contribute to the changing dynamics of the current account over time. Building on a previous article on the current account position in 2012[1], this article provides a closer and more up-to-date examination of the drivers of the current account balance. We continue to evaluate the trends from the perspectives of international trade and the saving-investment gap, before concluding with a brief assessment on the outlook for the current account balance going forward.

Drivers of Malaysia's Current Account Balance

In recent years, Malaysia's current account movement has been influenced by three major global and domestic developments. First, the global economy has experienced a prolonged period of slow growth amid weak and uneven growth momentum across the advanced and emerging market economies (Chart 2). More recently, while advanced economies have begun to gradually recover, growth in the emerging market economies has moderated. Second, global commodity prices have declined sharply, with a low prospect for prices to return to their previous levels (Chart 3). Third, investment in the Malaysian economy, particularly by the private sector, has continued to expand.

Chart 2

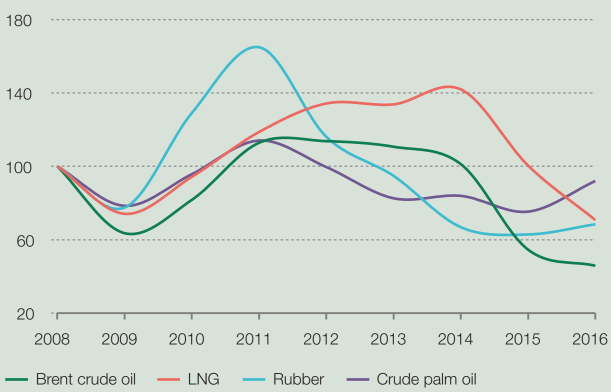
Slower Global Growth (Real GDP)



Source: International Monetary Fund

Chart 3

Sharp Decline in Commodity Prices



Source: Department of Statistics, Malaysia, Malaysian Palm Oil Board (MPOB), Malaysian Rubber Board, Bloomberg

From the international trade perspective, these factors have manifested in a lower goods surplus and higher services and income deficits (Chart 4). The goods surplus has declined as the subdued external environment weighed on Malaysia's export performance. At the same time, a period of strong domestic investment (2012 - 2016 average: 7.7%, 2003 - 2007 average: 5.6%) had contributed to the rise in imports[2]. Amid rapid capacity expansion and the implementation of large infrastructure projects, capital imports increased to an average of RM97 billion between 2012 and 2016 (2003 - 2007 average: RM57 billion).

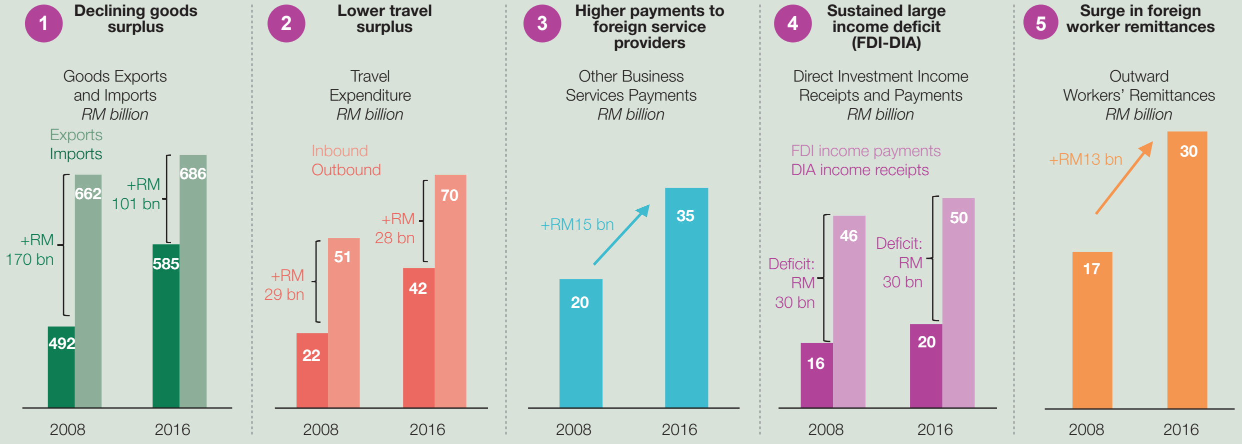
The travel surplus in the current account, while still high, has been gradually declining. Since 2010, the increase in outbound travel expenditure (i.e. Malaysian tourists travelling and spending abroad) has outpaced that of inbound travel expenditure. This has been supported by a growing middle income group and the increased affordability of overseas travel, following the rapid expansion of low-cost carriers in Malaysia. Modest income growth in foreign countries and rising tourism competition in the region contributed to a slower increase in inbound travellers in recent years.

Payments to foreign service providers, particularly for technical and engineering services, have also increased. Domestic technical expertise and consultancy management services have steadily been complemented by foreign

[1] Refer to the Box Article on 'Current Account Balance in Malaysia: Recent Developments and Outlook', Bank Negara Malaysia's Annual Report 2012.
[2] Refer to the Box Article on 'Private Investment in Malaysia: Drivers and Sustainability', Bank Negara Malaysia's Annual Report 2012.

Chart 4

Five Key Developments in Malaysia's Current Account Balance



Source: Department of Statistics, Malaysia

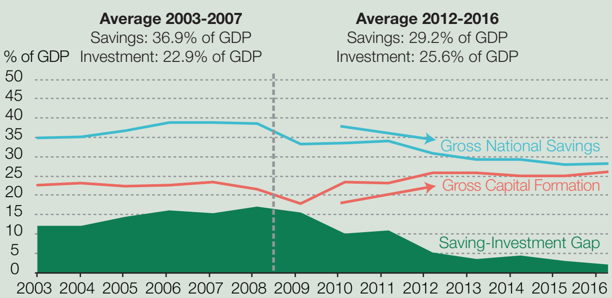
expertise and advisors, particularly for projects that use more complex technologies. Foreign services that require skilled and specialised knowledge have been used, mainly by the oil and gas, transportation and the utilities sectors.

The deficit in the investment income account has remained sizeable[3], as incomes accrued to Malaysian companies investing abroad, particularly in the mining and services sectors, were affected by the weaker global demand conditions. At the same time, foreign investors in Malaysia, particularly those in the manufacturing sector continue to earn sizeable profits from their investments in Malaysia. Foreign worker remittances also continued to grow, reflecting the increased reliance on foreign workers in the labour-intensive sectors of the economy.

From the saving-investment (S-I) perspective, the recent narrowing of the current account surplus has been driven by the rise in investment activity amid a moderation in gross national savings (Chart 5). Following a period of low investment after the AFC, the implementation of the Economic Transformation Programme (ETP) since 2010 has played a catalytic role in reviving investment activity in Malaysia. During this period, foreign firms continued to invest in Malaysia as reflected in the higher inflows of foreign direct investments (2012 - 2016 average: RM37.4 billion; 2003 - 2007 average: RM18.8 billion), particularly in the services and manufacturing sectors.

Chart 5

Narrowing Surplus Reflects Higher Investments Amid Moderating Savings in Malaysia



Source: Department of Statistics, Malaysia

[3] Refer to the Box Article on 'Payoffs from Going Global: Assessing the Returns from Malaysia's Direct Investment Abroad'.

The private sector continued to be the key driver of investments in Malaysia (Chart 6). On average, private investments advanced by 11.2% between 2012 and 2016 (2002 - 2007 average: 9%), underpinned by the implementation of large infrastructure projects and capacity expansion in high value-added services, manufacturing and mining sectors, which accounted for 92% of total private investment in 2015. Public investment remained broadly stable owing to sustained capital spending by public corporations, mainly in the oil and gas, transportation and utilities sub-sectors. These investments have also had a discernible impact on Malaysia's productive capacity, particularly in the oil and gas sector. Of note, the development of the new oil field in Gumusut-Kakap contributed to the increase in Malaysia's oil production capacity from 570,000 barrels per day (bpd) in 2013 to 661,000 bpd in 2016. Development expenditure by the Federal Government also supported public investment, focusing mainly on education, healthcare, housing, transport system and industrial infrastructure spending[4].

On the whole, investments by both the private and public sectors are necessary to boost Malaysia's productive capacity, enhance efficiency and connectivity, and to drive the growth of high value-added exports in the future (Table 1). Nonetheless, some risks of overinvestment in less productive sectors, as manifested by the oversupply of commercial properties, should be closely monitored and managed.

Chart 6

Higher Investments Driven by the Private Sector

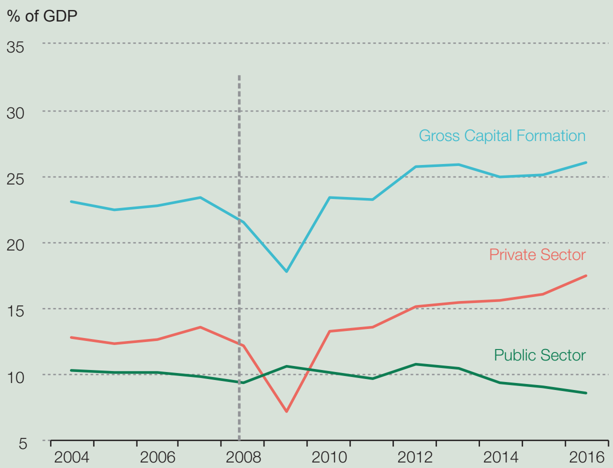
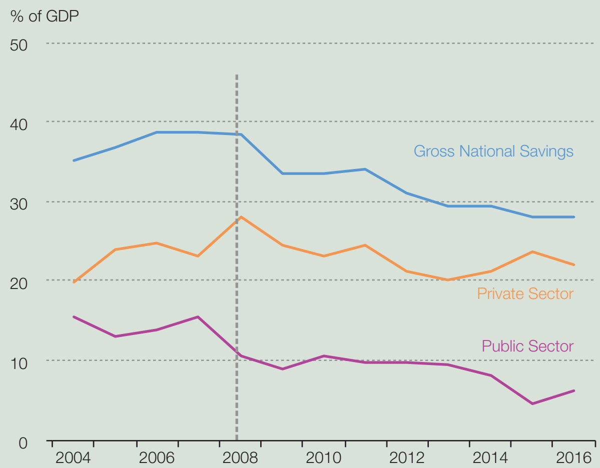


Chart 7

Moderating Savings Amid Lower Private Sector Savings



Source: Department of Statistics, Malaysia

Table 1

Productive Investments to Enhance Domestic Productive Capacity and Export Competitiveness

Sectors	Selected examples of major investments since 2008
Transportation & Storage	Mass Rapid Transit (MRT), Light Rail Transit (LRT) extensions
Manufacturing	New production lines by Hewlett-Packard, Intel and OSRAM (E&E)
Oil and gas & Utility	Pengerang Integrated Petroleum Complex (PIPC), Refinery and Petrochemical Integrated Complex (RAPID), Gumusut-Kakap and Malikai deepwater oil and gas projects (upstream and downstream), Sabah Oil and Gas Terminal, Tanjung Bin Power Plant, Janamanjung Power Plant
Aviation	Aircraft purchases by major airliners
Tourism & Retail	Genting 20th Century Fox Themepark, Meru Animation Studio, LEGOLAND, Johor and Mitsui Premium Outlets

Source: News flows

[4] Refer to the White Box on 'Debunking Malaysia's Investment Myths', in Bank Negara Malaysia's Annual Report 2014.

The moderation in gross national savings had also contributed to the narrowing S-I gap in Malaysia (Chart 7). The moderating trend was attributable mainly to lower private sector savings amid sustained savings by the public sector. Private savings were lower, stemming from the modest growth in the operating surplus of firms and continued strength in household consumption. As an indication, firms in the agriculture sector experienced a contraction in operating surplus (2012 - 2015 average: -2.4%; 2011: 28.2%), following the sharp decline in agriculture prices. Over this period, crude palm oil (CPO) and rubber prices had declined by 34% and 62% from their peak of RM3,279 per tonne and RM13.70 per kg in 2011, respectively. Significantly slower growth in the operating surplus of manufacturing firms (2012-2015 average: 3.3%; 2011: 16.0%) also weighed on private sector savings. Nevertheless, firms in the construction sector, wholesale and retail, as well as the finance and business services sub-sectors recorded sustained increases in profits (2012 - 2015 average: 7.3%; 2011: 7.4%), as domestic demand remained resilient. Household spending was underpinned by the continued growth in compensation of employees (2012 - 2015 average: 8.3%; 2011: 12.2%) and stable labour market conditions. The concurrent increase in costs of living also contributed to the lower household savings.

For the public sector, savings were broadly stable. Firms in the mining sector, which include public corporations, reported marginal growth in operating surpluses (2012 - 2015 average: 1.8%; 2011: 7.0%). Nevertheless, public corporations in the transportation, storage and communication services sub-sectors recorded relatively higher growth in profits, thus providing support to public savings (2012 - 2015 average: 5.9%; 2011: 12.3%). The smaller General Government[5] current deficit also alleviated pressure on public savings as efforts were taken to broaden the tax base and rationalise subsidies. Notable measures include the introduction of the Goods and Services Tax (GST) and the removal or reduction of subsidies on vehicle fuel, sugar and cooking gas. Despite these trends, Malaysia's gross national savings remained high at 28.1% of GDP in 2016 (2015: 28.1% of GDP), compared to the average savings rate of 22.9% of GDP in emerging market economies, excluding PR China[6]. This high rate of savings has enabled Malaysia to finance economic growth mainly from domestic sources.

Prospects for the Current Account

Going forward, Malaysia's current account balance is expected to remain in surplus, but will be narrower. In the near-term, global and domestic developments will continue to influence the performance of the current account. Malaysia's export performance is projected to improve, in line with higher global demand and commodity prices. This should also support higher incomes for export-oriented firms and Malaysia's outward FDI, particularly those in the commodity-related sectors. Investments are expected to continue to be channelled towards productive sectors. While large-scale and more complex investment activities will contribute to raising demand for foreign goods and services, these investments are expected to raise productive capacity and lift efficiency. These short-term trade-offs may be necessary to place Malaysia on a solid footing to tap on the opportunities in a fast-changing global environment.

Malaysia's external sector resilience was demonstrated during the recent sharp decline in commodity prices. Although it has narrowed, Malaysia's trade balance remained in surplus, underpinned by a diversified export structure – both in terms of products and markets. This underscores the importance of advancing structural reform measures to promote trade and investment diversification and competitiveness, and more importantly to move up the value chain. Under the broad strategies of the ETP, 11th Malaysia Plan, Services Sector Blueprint, Logistics and Trade Facilitation Masterplan, and the National Export Council, several measures have been introduced over the years. These include labour and product market reforms, the gradual removal of subsidies, allowing greater foreign participation in the services sector, enhancing efficiency of administrative processes, facilitating private investment in infrastructure, easing tourist visa regulations and deepening market access. The continued implementation of these reforms will be critical in strengthening Malaysia's external sector and shaping the path of Malaysia's current account balance moving forward.

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5 General Government comprise the Federal, State and Local Governments, as well as statutory bodies.
6 Gross national savings rate of emerging economies including PR China is 32.5% of GDP in 2015.