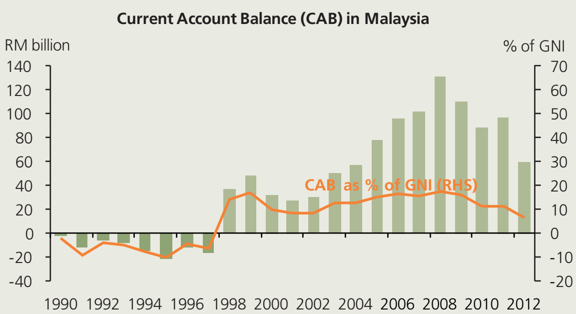
Current Account Balance in Malaysia: Recent Developments and Outlook

Introduction

Since the Asian financial crisis, Malaysia's current account balance has consistently recorded a surplus. Exports of goods have outpaced imports, and have more than offset the deficit in the services and income accounts. The strong performance of Malaysia's exports was due, in large part, to the broad diversification of products and the expansion of trade in new markets. In particular, commodity exports, which have low import content, played an important role in contributing to the increase in the current account surplus. In line with rising commodity prices in 2008, the current account surplus peaked at 17.6% of GNI in 2008. The Global Financial Crisis (GFC), however, marked the beginning of a moderating trend in the current account surplus (Chart 1). Weaker global demand and lower commodity prices have resulted in lower exports for Malaysia in recent years. Imports, on the other hand, increased significantly, driven by stronger domestic demand. The outcome of these trends has been the narrowing of the savings-investment surplus.

Chart 1

Current Account Balance Narrowing After More Than a Decade of Surplus



Source: Department of Statistics, Malaysia

Although the current account balance reflects the excess of exports over imports, it also mirrors the savings-investment surplus in an economy. In other words, the current account balance can be assessed in terms of both the international trade perspective and the savings-investment behaviour in an economy. In a closed economy, investment activity is funded solely from domestic savings. However, in an open economy such as Malaysia, investment activity may be funded by domestic or foreign savings. If an economy is saving more than it is investing, the economy would register a current account surplus. These excess savings can be used to accumulate reserves to provide a buffer against external vulnerabilities or channelled abroad to finance the consumption and investment activities of other economies, either in the form of extension of loans or investments abroad. In contrast, a current account deficit would indicate that an economy is investing more than it is saving. In this case, the economy would either borrow funds from abroad or receive inflows of foreign investment to finance its domestic consumption and investment requirements.

This box article explores the recent narrowing trend of the current account surplus from the two interrelated perspectives, namely the international trade and the savings-investment position.

I. International trade perspective

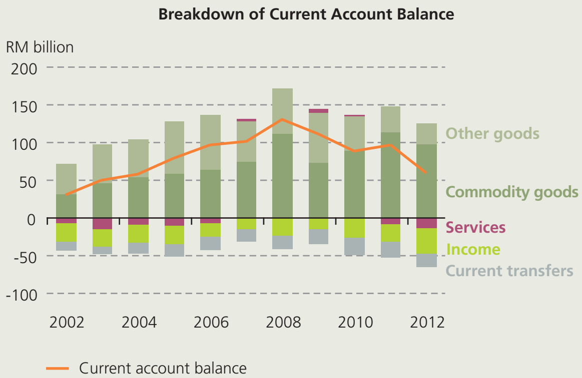
In the international trade perspective, developments in the current account balance can be viewed in terms of the changes in the exports and imports of goods and services, and the net balances of income and current transfers. In Malaysia, the current account surplus has been driven mainly by the surplus in the goods account, while the other components have remained in deficit[1] (Chart 2).

The goods surplus widened significantly after the Asian financial crisis as the growth of imports weakened following a substantial decline in domestic investment activity. At the same time, gross exports continued to expand[2], underpinned by the diversification in export products and markets. However, following the GFC, Malaysia's exports have expanded at a more modest pace. The weak

[1] In 2007-2010, the services account registered small surpluses.
[2] Gross exports expanded by an annual average rate of 8.7% in 2000-2008.

Chart 2

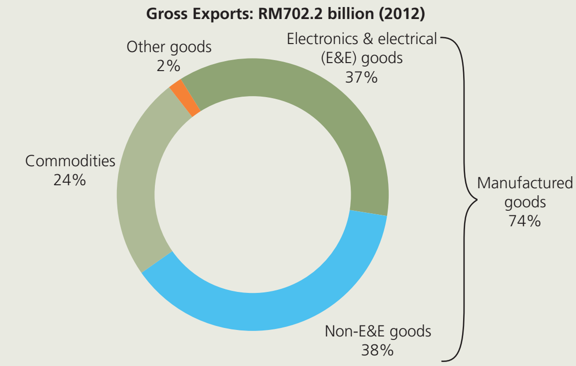
Current Account Surplus Narrowed Due Mainly to Lower Goods Surplus



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 3

Exports of Manufactured Goods Account for the Bulk of Gross Exports



Note: Numbers may not necessarily add up due to rounding
Source: Department of Statistics, Malaysia

global economy has reduced the demand for Malaysia's manufactured and commodity exports (74% and 24% share of gross exports respectively, Chart 3) and this has been further compounded by lower commodity prices.

Conversely, amid stronger domestic demand, imports have risen steadily since 2009 (Chart 4), due mainly to import of capital and consumption goods (16% and 8% share of gross imports respectively). Reflecting the increase in investment activity by both the public and private sectors, capital imports rose at an average annual rate of 13.8% during 2010-2012. Similarly, import of consumption goods increased by an average of 13.4% over the same period, supported by stronger domestic consumption, and to a smaller extent, the appreciation of the ringgit. Import of intermediate goods (61% of gross imports, Chart 5), on the other hand, recorded a moderation in growth, given that the bulk of these imports are used as inputs for the production of manufactured exports. This close relationship between manufactured exports and intermediate imports acts as an automatic stabiliser for the current account balance.

Chart 4

Growth of Imports Has Outpaced Exports in Recent Years

Source: Department of Statistics, Malaysia

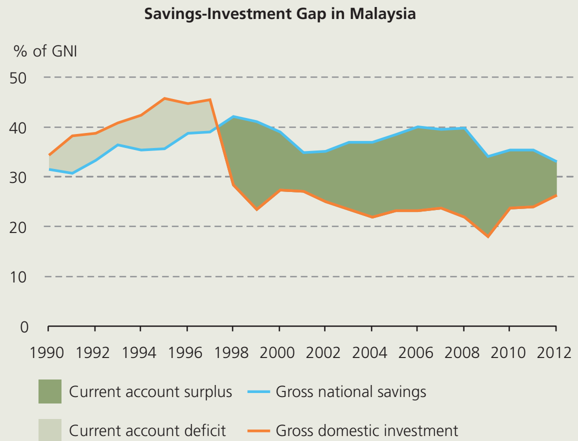
Chart 5

Intermediate Imports Account for 61% of Gross Imports

Source: Department of Statistics, Malaysia

Chart 6

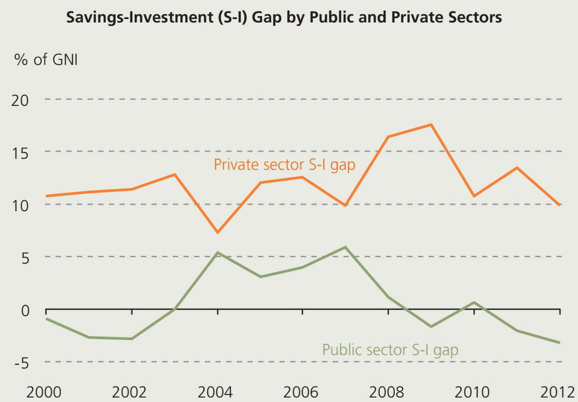
Current Account Surplus Narrowed as Investment Increased Amid Lower Savings



Source: Department of Statistics, Malaysia

Chart 7

Private Sector Remains a Net Saver while the Public Sector Has Turned into a Net Investor in Recent Years



Source: Department of Statistics, Malaysia

II. Savings-investment gap perspective

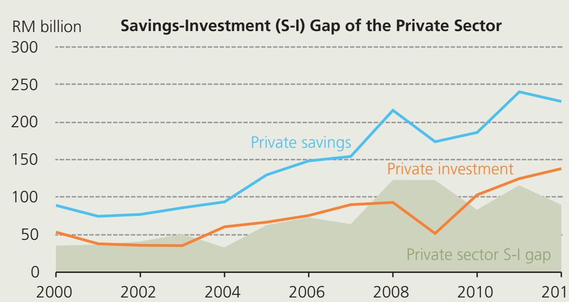
The current account balance is also an outcome of the inter-temporal investment and consumption decisions of both the public and private sectors in an economy. In the case of Malaysia, the sustained current account surplus since the Asian financial crisis reflected the sharp decline in investment amid a sustained high level of savings. In contrast, beginning 2010, gross fixed capital formation has been on the rise. This upturn in investment activity has resulted in a narrowing of the savings-investment gap (Chart 6).

As shown in Chart 7, Malaysia's savings-investment surplus has been driven mainly by the private sector, which has constantly registered an excess of savings over investment in the last decade. Prior to the GFC, the surplus of the private sector was attributable to both the elevated savings rate and low growth of investment (Chart 8). Nevertheless, in 2012, as investment strengthened while savings declined, the savings-investment surplus of the private sector narrowed.

Private investment has emerged as a major contributor to growth in recent years on account of strong corporate profits, high capacity utilisation, continued access to financing and the favourable investment climate[3]. In particular, major investments have been undertaken in the oil and gas, infrastructure, manufacturing and services sectors. Private investment has also been spurred by the implementation of the Economic Transformation Programme, which has catalysed investments in new growth areas, high value-added industries and infrastructure. Of significance, the rise of private investment is expected to enhance Malaysia's productive capacity, improve efficiency, and drive the

Chart 8

Private Savings Moderated while Private Investment Expanded



Source: Department of Statistics, Malaysia

[3] For a detailed discussion, please refer to the box article entitled 'Private Investment in Malaysia: Drivers and Sustainability".

growth of high value-added exports in the future. In the near term, it is expected that the expansion in investment activity will contribute to a further narrowing in the current account surplus.

The high level of savings by the corporate sector and households is attributable to two main factors. First, corporate profits have increased following sustained external demand for resource-based products, especially prior to the GFC. Second, mandatory contributions to the Employee Provident Fund, coupled with sustained wage growth, have supported household savings. Going forward, the savings rate is expected to remain elevated amid firm income growth.

As for the public sector[4], the savings-investment gap registered a small surplus, averaging 3.2% of GNI[5], in 2003-2008 (Chart 9). This surplus has turned into a deficit since 2009, when public expenditure increased significantly following the introduction of the two economic stimulus packages by the Federal Government to mitigate the impact of the global economic slowdown. The sustained capital spending by public enterprises have also contributed to the expansion in public investment. The public sector savings-investment gap widened in 2011 and 2012.

Going forward, given the Government's fiscal consolidation efforts through expenditure rationalisation and improvements in revenue collection, savings of the Federal Government are expected to remain firm. The operating surpluses of the public enterprises, however, would depend mainly on the strength of the recovery in the global economy and the resilience of domestic demand.

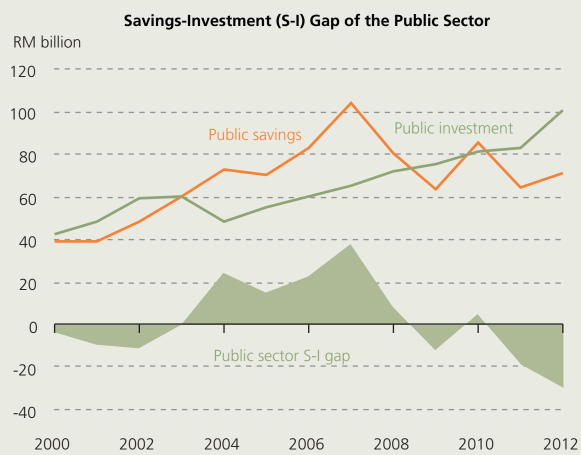
Conclusion

The recent narrowing of the current account surplus in Malaysia and several other Asian countries is consistent with the ongoing global rebalancing, underpinned by shifts in the sources of growth in the regional economies. For Malaysia, resilient domestic demand has supported the strong growth of imports, in turn outpacing exports which has been weighed down by weak external demand and lower commodity prices. Similarly, the stronger growth in investment activity and lower savings have resulted in a narrower current account surplus.

Going forward, amid a modest recovery in global growth and the continued expansion in domestic demand, Malaysia's current account surplus can be expected to narrow in the near term. As a highly open economy, changes in Malaysia's current account, particularly exports, will be highly dependent on factors that are exogenous to the economy. On the domestic front, the ongoing fiscal consolidation by the Government is expected to improve public savings, while private savings will be a function of the strength of private consumption. Over the longer term, the ongoing structural changes in the economy will be a key factor in determining the future path of Malaysia's current account balance. The continued investment in new growth areas and high value-added industries is expected to further diversify Malaysia's exports and enhance its areas of comparative advantage, thereby supporting export growth and the sustainability of the current account balance.

Chart 9

Public Savings Declined Amid Continued Rise in Public Investment



Source: Department of Statistics, Malaysia

[4] Public sector refers to the General Government and public enterprises.
[5] Public sector registered a deficit of 2.2% of GNI in 2000-2002.