



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

STATUTORY REQUIREMENTS

In accordance with section 13 of the Central Bank of Malaysia Act 2009, Bank Negara Malaysia hereby publishes and has transmitted to the Minister of Finance a copy of this Annual Report 2015 together with a copy of its Financial Statements for the year ended 31 December 2015, which have been examined and certified by the Auditor-General. The Financial Statements will also be published in the Gazette.

For the purposes of section 115 of the Development Financial Institutions Act 2002, the annual report on the administration of the Development Financial Institutions Act 2002 and other related matters for the year ended 31 December 2015 is incorporated in Bank Negara Malaysia's Financial Stability and Payment Systems Report 2015 which forms an integral part of this Annual Report 2015.

A handwritten signature in black ink, appearing to read 'Zeti Akhtar Aziz'.

Zeti Akhtar Aziz
Chairman
Board of Directors

23 March 2016

BOARD OF DIRECTORS

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz,
Governor and Chairman

Datuk Muhammad bin Ibrahim,
Deputy Governor

Datuk Nor Shamsiah binti Mohd Yunus,
Deputy Governor

Dr. Sukudhew Singh,
Deputy Governor

Tan Sri Dr. Mohd Irwan Serigar bin Abdullah,
Secretary-General to the Treasury

Dato' N. Sadasivan a/I N.N. Pillay,
Chairman of Board Risk Committee and Member of Board Audit Committee

Tan Sri Dato' Sri Dr. Sulaiman bin Mahbob,
Chairman of Board Governance Committee and Member of Board Risk Committee

Datuk Chin Kwai Yoong,
Chairman of Board Audit Committee and Member of Board Governance Committee

Tan Sri Datuk Dr. Yusof bin Basiran*,
Member of Board Audit Committee

Tan Sri Dato' Seri Siti Norma binti Yaakob*,
Member of Board Governance Committee

Dato Sri Lim Haw Kuang*,
Member of Board Risk Committee

Dato' Lee Yeow Chor*,
Member of Board Risk Committee

* Appointed to the Board in March 2015.

The Board of Directors wishes to extend its appreciation and gratitude to the two long-serving members, Tan Sri Datuk Oh Siew Nam and Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor who completed their terms in February 2015.

SHARIAH ADVISORY COUNCIL MEMBERS

Datuk Dr. Mohd Daud bin Bakar (Chairman)

P.J.N

Prof. Dr. Mohamad Akram bin Laldin (Deputy Chairman)

Tun Abdul Hamid bin Mohamad

S.S.M, D.U.P.N, S.P.C.M, D.M.P.N, D.P.C.M, K.M.N, P.J.K

Tan Sri Sheikh Ghazali bin Abdul Rahman

P.S.M, P.J.N, D.S.D.K, S.D.K, A.M.N

Dato' Seri Haji Hassan bin Ahmad

P.M.P, D.S.P.N, P.J.N, D.G.P.N

Prof. Dr. Engku Rabiah Adawiah binti Engku Ali

Prof. Dr. Ashraf bin Md. Hashim

Prof. Madya Dr. Rusni binti Hassan

Prof Madya Dr. Asmadi bin Mohamed Naim

Dr. Shamsiah binti Mohamad

En. Burhanuddin bin Lukman

Governor	Tan Sri Dr. Zeti Akhtar Aziz
Deputy Governor	Datuk Muhammad bin Ibrahim
Deputy Governor	Datuk Nor Shamsiah binti Mohd Yunus
Deputy Governor	Dr. Sukudhew Singh
Secretary to the Board	Abu Hassan Alshari bin Yahaya
Assistant Governor	Dato' Bakarudin bin Ishak
Assistant Governor	Norzila binti Abdul Aziz
Assistant Governor	Jessica Chew Cheng Lian
Assistant Governor	Donald Joshua Jaganathan
Assistant Governor	Abu Hassan Alshari bin Yahaya
Assistant Governor	Abdul Rasheed Ghaffour
Assistant Governor	Mohd. Adhari bin Belal Din
Director	
Governor's Office	Vivienne Leong Sook Leng
Strategic Communications	Shariffuddin bin Khalid
Internal Audit	Mohamad Muhsin bin Mohd Anas
Risk Management	Abdul Rahman bin Hussein
<i>Economics</i>	
Economics	Fraziali bin Ismail
Monetary Policy	Dr. Norhana binti Endut
International	Nazrul Hisyam bin Mohd Noh
Statistical Services	Toh Hock Chai
<i>Regulation</i>	
Financial Sector Development	Aznan bin Abdul Aziz
Islamic Banking and Takaful	Mohd Zabidi bin Md Nor
Financial Surveillance	Madelena binti Mohamed
Prudential Financial Policy	Qaiser Iskandar bin Anwarudin
Development Finance and Enterprise	Marina binti Abdul Kahar
Payment Systems Policy	Tan Nyat Chuan
Consumer and Market Conduct	Suhaimi bin Ali
Money Services Business Regulation	Shahariah binti Othman
<i>Supervision</i>	
Financial Conglomerates Supervision	Che Zakiah binti Che Din
Insurance and Takaful Supervision	Yap Lai Kuen
Banking Supervision	Cindy Siah Hooi Hoon
Specialist Risk Unit	Charles Sandanasamy*
Regulation and Supervision Administration	Nor Aslaini binti Mohd Nasir**
Financial Intelligence and Enforcement	Abd. Rahman bin Abu Bakar
<i>Investment and Operations</i>	
Investment Operations and Financial Markets	Adnan Zaylani bin Mohamad Zahid
Foreign Exchange Administration	Shamsuddin bin Mohd Mahayidin
Currency Management and Operations	Azman bin Mat Ali
<i>Organisational Development</i>	
Strategic Management	–
Strategic Human Capital	Mohd. Adhari bin Belal Din
Finance	Eugene Hon Kah Weng
Legal	Wan Mohd Nazri bin Wan Osman
Human Capital Development Centre	Thomas Tan Koon Peng
Central Banking Services	Ruziana binti Mohd Mokhtar**
LINK and Regional Offices	Arlina binti Ariff
IT Services	Ho Chai Huey
MIFC Promotion Unit	Nik Mohamed Din bin Nik Musa
<i>Centralised Shared Services (CSS)</i>	
General Manager	Dato' Mohd Nor bin Mashor
CSS Management Office	Lim Foo Thai
Facility Management Services	Myrzela binti Sabtu
Hospitality Services	Azmi bin Abd Hamid
Security Services	Dato' Badaruddin bin Mohd Isa
Museum, Art Gallery and KM Centre Services	–
Human Resource and General Services	Hairi bin Adam**
<i>Chief Representative</i>	
Beijing Representative Office	Albert See Choon Kwang**
London Representative Office	Raja Syamsul Anwar bin Raja Mohammed Affandi**
New York Representative Office	Harris bin Hassan***
<i>Regional Office Head</i>	
Johor Bahru	Raman A/L Krishnan**
Pulau Pinang	Mohd Daud bin Dahar**
Kuching	Rosnani binti Mahamad Zain**
Kota Kinabalu	Zambre bin Ismail**
<i>Branch Manager</i>	
Shah Alam	Syarinoor bin Sahimi***
Kuala Terengganu	Yusoff bin Yahaya***

* Administrative Head

** Deputy Director

*** Manager

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GOVERNOR'S STATEMENT

2015 was a year of significant developments with far-reaching implications. The recovery of the global economy has remained modest, amid slowing world trade, moderating growth in the emerging economies and the ongoing concerns on the durability of the economic recovery in the advanced economies. This was against a landscape of changing global policies, with monetary policy normalisation in the US and the continued policy easing in other major economies, and the collapse of energy prices arising from both short-term and structural changes in global supply and demand conditions. The confluence of these developments has generated large shifts in capital flows and heightened volatility in the international financial markets.

In the near term, these developments will continue to unfold and the expectation is for the global environment to remain highly uncertain. As we move further into the future, it is important to recognise that the global landscape has changed in fundamental ways and that these conditions will not revert to those experienced in the decades before. The challenge to secure more sustainable global growth will increasingly be dependent on the efforts across advanced and emerging economies to being better able to adapt to this changed landscape.

Given the high degree of openness of the Malaysian economy and the increased integration with the international financial system, our domestic economy is significantly affected by both the global and regional developments. Despite the challenges, however, the Malaysian economy has been able to weather the developments in 2015 and sustain a respectable growth. Importantly, the growth prospects for the economy remain. The resilience that underpins the Malaysian economy in facing the current difficult environment is derived from the continued strength of our economic fundamentals and a reflection of the structural adjustments and reforms that have been undertaken in the recent decades. A key aspect of this is the diversification of the structure of our economy from an over-dependence on exports to develop new domestic sources of growth. This has reduced the reliance of the overall economy on any single source of growth and thus the vulnerability to shocks in any particular industry.

Additionally, growth has become more balanced, anchored by sustained private sector-led domestic demand and reinforced in part by the series of measures implemented in the recent years to rein in excesses and imbalances. The financial system is also a key pillar of Malaysia's economic strength. While the domestic financial markets and the ringgit exchange rate were affected by the large shifts in capital flows, the more resilient and developed financial system, together with the continued high level of international reserves and the manageable level of external indebtedness, have strengthened the capacity of our economy to cope with the external shocks. It has ensured that financial intermediation has remained uninterrupted.

On the domestic front, the Malaysian economy continued to be in a period of adjustment, with the ongoing implementation of fiscal reforms. These reforms are crucial and have a vital role in supporting the sustainable growth of our economy. In the interim, however, these domestic adjustments, alongside the impact of the weaker ringgit exchange rate, have affected the cost of living for households, particularly for the lower-income segment. But as they are being introduced in an environment of lower global commodity prices and generally subdued global inflation, the expectation is for the overall inflation to remain manageable. In addition, to mitigate some of the adverse impact of these adjustments, various measures have been put in place to support the vulnerable segments of the economy. The progress made in advancing financial inclusion, and the mechanisms that have been put in place by the Bank to provide assistance to households and businesses that are experiencing financial difficulties have contributed to reducing the vulnerability of this broader segment of society during difficult economic times.

Confronted with this more challenging environment, the Bank remained focused on preserving monetary and financial system stability. The economic and financial resilience that was built over the recent decades has served as an anchor of stability in these testing times. It has removed the need to over rely on any single policy option, thus leaving room for pre-emptive and forward-looking economic management. At present, the Bank's policy priority has been on two fronts – to address immediate-term vulnerabilities, and to continue to provide an environment that supports sustainable growth. In ensuring ample liquidity conditions in the financial system amid the period of net external outflows, the Bank has continued to provide liquidity to the banking system through the use of a comprehensive set of measures. The monetary operations were strengthened and enhanced through the introduction of new instruments. This has been complemented more recently by the reduction in the Statutory Reserve Requirement. As external and domestic developments have continued to affect the ringgit exchange rate, efforts have also been directed at ensuring orderly conditions in the foreign exchange market. Consistent with price stability and the sustainability of the overall growth prospects, monetary policy has been kept steady and has remained accommodative and supportive of economic activity.

Over the medium term, the challenges that Malaysia will face are expected to remain significant. Beyond managing the risks to macroeconomic and financial stability arising from external uncertainties, focus must continue towards building future resilience. At the same time, there is increased urgency for the economy to accelerate its transition to a higher value-added, high-income economy and avoid a slide into a middle-income trap. To achieve this outcome, three vital shifts are necessary. The first is the intensification of a private sector-driven shift towards higher productivity and innovation, and to reduce reliance on factor accumulation and low-value production to drive economic growth. The second shift necessary is for the Malaysian economy to strengthen its integration with the global economy given the new and changing international landscape, by drawing on new areas of comparative advantage and harnessing new sources of opportunity. The third shift is the further strengthening of our existing institutional and physical infrastructures to create an enabling environment for a modern economy in this fast-changing environment. Despite the challenges, Malaysia has every potential to transition into a higher value-added, high-income economy going forward.

There were several important milestones during the year towards strengthening regional economic integration. The most notable of these was the establishment of the ASEAN Economic Community (AEC). For regional financial integration, the launch of the ASEAN Banking Integration Framework (ABIF) has provided the foundation for a more integrated banking system in the region. Within the ASEAN countries, financial integration is intended to be inclusive and benefit all segments of society. Consequently, financial inclusion has been elevated to be a policy priority in the region. As we move forward, the ASEAN integration process is expected to continue to gather momentum through the AEC Blueprint 2025. This has created the platform to further advance financial integration over the next decade while enhancing financial inclusion and safeguarding financial stability. In addition, regional central banks have also remained committed to ensuring regional macroeconomic and financial stability through various other collaborative platforms such as the ASEAN+3, the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) and the South East Asia Central Banks (SEACEN) Research and Training Centre.

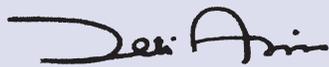
Beyond the progress made under ASEAN, Malaysia's participation in international free trade agreements such as the Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership will drive increases in productivity and the needs for structural changes in our economy, including supporting Malaysia's longer-term development. It will foster competition, create market access, incentivise transparency and good governance practices, while strengthening the trade and financial inter-linkages between Malaysia and the rest of the world.

The Bank has during the year continued with our own organisational transformation and modernisation to remain relevant and effective in our management of the new challenges confronting us. Following more than a decade of several series of organisational transformation, the Bank now stands on solid foundations. In particular, over the recent 15 years, more than ten major legislations governing the central bank and the financial industry have been introduced, including the Central Bank of Malaysia Act 2009. Commensurate with the new powers accorded to the Bank, the accountability frameworks and governance structures have been considerably enhanced and institutionalised. As part of this, the oversight role of the Board of Directors has been strengthened in the areas of risk management, internal controls and governance. The Central Bank of Malaysia Act 2009 also institutionalised the monetary policy independence that has prevailed since the establishment of the Bank in 1959. In 2015, new external members were appointed to our Monetary Policy Committee, adding to the collective diversity of experience, expertise and knowledge. The robust governance framework also ensures that the Bank's policy decisions are undertaken with the highest levels of professionalism and integrity, and are always in the interest of our nation.

Going forward, I believe that the Bank is in a position of prime strength. Of importance is that the Bank's institutional foundation is built on the strength of our talent. The Bank has placed a high priority on investing in the continuous development of our talent to ensure that we are always equipped with the best central banking skill-sets and calibre. These talent and leadership development efforts are underpinned by the Bank's robust talent strategies, succession planning and differentiated performance rewards. The Bank adopts a high-performance culture with a strong sense of accountability. Within our corporate culture,

there is a shared purpose to strive in the service of the nation, to be committed to duty, and to uphold our enduring tradition of integrity. The Bank has also transformed over the years from being vertically integrated towards horizontal collaboration so as to benefit from the diverse expertise that resides in the Bank. These have allowed for our resources and energies to be optimised and aligned towards the strategic outcomes, to ensure that the best results are achieved. Our work ethos also requires good risk management, considering the many implications and effects of our policies.

The Bank's dedication to maintaining high standards of excellence has provided a conducive environment for performance. It is the professionalism and expertise of the Bank's staff, together with the clarity of outcomes and roles, that have enabled the Bank to stay the course to deliver the mandates entrusted upon us, despite being confronted with domestic and external challenges. On behalf of the Board and the management, I wish to express great appreciation to all the staff of the Bank for their dedication and commitment in delivering the mandates of the Bank. I am also grateful to the Board of Directors for their ongoing support and guidance. As we continue to strive to excel as an organisation that serves in the best interests of the nation, I am highly confident that the institutional resilience and capacity built over the years have equipped the Bank to advance forward with every potential to deliver the best in the years to come.



Zeti Akhtar Aziz
Governor
23 March 2016

2015

EXECUTIVE SUMMARY



EXECUTIVE SUMMARY

In 2015, global growth moderated amid heightened international financial market volatility.

Throughout the year, the global economic and financial environment was shaped by three major developments. First, global commodity prices fell sharply to post-crisis lows, with significant repercussions for global growth and inflation. Second, international financial markets experienced heightened volatility amid policy shifts in the major economies and concerns over the slowing momentum of global growth, sovereign debt in the euro area, and the fall in commodity prices. The volatility in financial markets was exacerbated by speculative position-taking and the unwinding of those positions, as well as sudden shifts in investors' risk appetite, that led to volatile capital flows. Third, global growth moderated as the modest improvements in growth in the advanced economies were insufficient to offset the lower growth in emerging economies. Growth was also uneven across the advanced economies. While economic activity in the US gained traction, growth in the euro area improved at a modest pace during the year due to unresolved structural constraints. Given the highly challenging external environment, economic growth in Asia moderated during the year as weak export performance weighed on the pace of economic expansion. In particular, growth in PR China remained on a moderating trend, due to the slowing activity in sectors with excess capacity as well as weaknesses in the external sector. Global inflationary pressures also moderated during the year, reflecting mainly lower global commodity prices and the subdued global demand conditions.

In response to the slowing growth momentum in an increasingly uncertain economic and financial environment, the overall global monetary policy stance became more accommodative in most regions. Among advanced economies, there was a divergence in the monetary policy stance of the major central banks. While the US took the first step to normalise interest rates, the euro area and Japan increased monetary stimulus through their respective asset purchase programmes and by introducing negative interest rates. In Asia, several economies reduced key policy rates and introduced fiscal measures to support growth.

Despite the challenging economic environment in 2015, the Malaysian economy registered a growth of 5.0%, supported by continued expansion in domestic demand. The Annual Report provides an analysis of the developments in the Malaysian economy and outlines the challenges ahead. The report also highlights the Bank's efforts to enhance its governance, organisational development and communications.

The Malaysian economy in 2015

The Malaysian economy grew by 5.0% in 2015 (2014: 6.0%), supported by the continued expansion of domestic demand (2015: 5.1%, 2014: 5.9%). Domestic demand was primarily driven by the private sector. Modest improvements in external demand in the second half of the year also provided additional impetus to economic growth.

Private consumption continued to expand, albeit at a more moderate pace as households adjusted their spending to the higher cost of living arising from the implementation of Goods and Services Tax (GST), adjustments in administrative prices, and the depreciation in the ringgit. Nevertheless, households received some support from the higher cash transfers under the Bantuan Rakyat 1Malaysia (BR1M) scheme, the reduction in individual income tax rates for the 2015 assessment year and savings derived from lower domestic fuel prices during the year. Household spending was also supported by continued income growth and stable labour market conditions. Public consumption recorded a sustained growth of 4.3% in 2015 (2014: 4.4%), reflecting the continued efforts by the Government to provide support to growth, while remaining committed to the steady reduction in the fiscal deficit.

Gross fixed capital formation (GFCF) grew by 3.7% in 2015 (2014: 4.8%) mainly due to slower growth in private sector investment. During the year, the expansion in private investment was lower at 6.4% (2014: 11.0%), reflecting the moderation in domestic demand and cautious business sentiments. While investment in new oil and gas explorations moderated, overall private investment continued to be supported

by downstream oil and gas activities, and new and on-going projects in the manufacturing and services sectors. Public investment improved to register a smaller contraction of -1.0% (2014: -4.7%) as the Federal Government and public corporations continued to undertake capital spending, thus providing support to the economy.

On the supply side, all major economic sectors registered more moderate growth, with the exception of the mining sector. The moderation reflected the slower expansion of activity in industries catering to domestic demand. However, export-oriented manufacturing and trade-related services benefited from the modest improvement in external demand.

Labour market conditions remained broadly stable in 2015 as demand for labour was sustained by the continued expansion across all economic sectors. While the labour force participation rate was stable at 67.6% (2014: 67.5%), the unemployment rate edged higher to 3.2% (2014: 2.9%) as more cautious business sentiments led to softer employment prospects towards the second half of the year.

Headline inflation declined to 2.1% in 2015 (2014: 3.2%) as the impact of lower global energy and commodity prices more than offset the effects from a weaker ringgit exchange rate, the implementation of GST and several upward adjustments in administered prices. Despite the lower level of inflation during the year, price increases were more pervasive due to the implementation of GST, the weakening of the ringgit and the higher prices for fresh food. Headline inflation was also relatively more volatile in 2015 reflecting a series of adjustments in domestic fuel prices. Nevertheless, core inflation excluding GST remained stable at 2.3% during the year (2014: 2.3%). The stability of core inflation was a reflection of the more moderate domestic demand conditions, the absence of excessive wage growth and the benign inflation globally.

Malaysia's external position remained resilient in 2015 despite the greater uncertainties in the global economy. While the current account surplus narrowed during the year, it remained supported by a sizeable trade surplus of RM94.6 billion (2014: RM82.5 billion). For the year as a whole, growth in exports and imports moderated to 1.9% and 0.4%, respectively (2014: 6.3% and 5.3%). There were two divergent trends in external trade

during the year. In the first half of the year, the external trade performance was largely weighed down by the decline in commodity prices and the sluggish demand for commodities and commodity-related manufactured products. In the second half of the year, external trade improved due to a rebound in export growth arising from higher demand for manufactured products and commodities, and the positive valuation effects from the ringgit depreciation. For the whole year, the trade surplus was higher, supported by both manufactured and commodity products.

Against the backdrop of continued uncertainties in global financial markets, the external sector experienced significant two-way cross-border capital flows for most of 2015. The financial account recorded a net outflow of RM53.3 billion (2014: net outflow of RM81.6 billion). During the year, considerable volatility was observed in foreign portfolio funds, in part due to the building up and unwinding of speculative positions in the domestic and offshore markets. Net portfolio outflows of non-resident funds amounted to RM19.0 billion (2014: net outflows of RM10.4 billion). Notwithstanding the developments in short-term portfolio flows, it is noteworthy that Malaysia remained a competitive destination for long-term capital, as evidenced by the steady inflow of foreign direct investments (FDI). The bulk of the FDI flows went into the manufacturing sector, primarily in the electronics and electrical (E&E) and petrochemical-related industries.

The international reserves of Bank Negara Malaysia amounted to RM409.1 billion (equivalent to USD95.3 billion) as at 31 December 2015. As at 29 February 2016, the reserves were at RM410.5 billion (equivalent to USD95.6 billion). The international reserves remained ample to facilitate international transactions and were sufficient to finance 8.3 months of retained imports and is 1.2 times of the short-term external debt. The progressive liberalisation of foreign exchange administration rules has resulted in a greater decentralisation of international reserves, which has enabled the economy to reduce its reliance on the Bank's international reserves. This is evident from the increasing acquisition of assets abroad by Malaysian entities. The availability of these external assets enables these entities to meet their external debt obligations without creating a claim on the international reserves. The greater exchange rate flexibility also reduces

reliance on international reserves in managing external pressures.

Malaysia's external debt remained manageable throughout 2015. The external debt stood at RM833.7 billion, equivalent to USD192.2 billion or 72.1% of GDP as at end-2015 (end-2014: RM747.5 billion, equivalent to USD211.8 billion or 67.5% of GDP). The rise in the external debt was mainly due to valuation effects from the depreciation of the ringgit against most currencies during the year. Excluding the foreign exchange revaluation changes, offshore borrowing increased at a more moderate pace of 4.0% in 2015, contributing two percentage points to the overall increase in the external debt. These borrowings were mainly a reflection of the net drawdown of intercompany borrowings by several private corporations in the oil and gas sector, and new issuances of international debt securities. Nevertheless, the profile of Malaysia's external debt remained healthy with more than half being of medium to long-term tenures. Risks from foreign exchange fluctuations were largely contained as about 36% of the external debt is ringgit-denominated, while most of the foreign currency-denominated debt was hedged, either naturally through foreign currency earnings or through the use of financial instruments.

Being a highly open economy, Malaysia is not insulated from the heightened uncertainties and risks from external developments. However, Malaysia has demonstrated its ability to withstand external shocks through economic flexibility and the safeguards provided by the financial buffers and robust policy frameworks that have been built over the course of many years. Malaysia's deep and diversified domestic financial market were able to accommodate the large volume of capital flows, while domestic institutional investors provided sustained demand for domestic financial assets as foreign investors rebalanced their exposures. The Bank's monetary operations and the use of several policy instruments also ensured the availability of sufficient liquidity to support the orderly functioning of the money and exchange rate markets. The flexibility of the exchange rate has also allowed the ringgit to adjust to the changes in external conditions. At the same time, the international reserves has acted as a buffer to prevent excessive volatility in the ringgit exchange rate. As such, despite considerable volatility in capital flows, the impact on domestic

financial markets was not significant, allowing for uninterrupted financial intermediation to support the economy.

Economic and Monetary Management in 2015

The Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.25% in 2015, with the focus of ensuring that monetary conditions supported the sustainable growth of the Malaysian economy while maintaining price stability. Against the backdrop of a challenging external environment that affected the outlook for the Malaysian economy, the monetary policy stance remained accommodative and supportive of economic activity. The MPC also maintained its vigilance against risks related to financial imbalances.

The Malaysian economy was projected to grow at a steady pace of between 4.5% and 5.5% in 2015, on the premise that domestic demand would be the anchor to growth amid weak external demand. Headline inflation was forecasted to range between 2.0% to 3.0% as lower global commodity prices and the lower global inflation were expected to offset the increase in domestic cost factors and the effects from a weaker ringgit exchange rate. Underlying inflation was assessed to remain relatively moderate amid slower growth of domestic demand. This outlook, however, was subject to risks arising from a series of developments during the year. These included the impact of the uncertain outlook for commodity prices on the domestic oil and gas sector and the potential negative spillover to investment activity, exports, the overall balance of payments and the Government's fiscal position. Another risk was related to the outcome of the GST introduction in April 2015, especially in terms of the pricing behaviour of firms and possible profiteering. Heightened uncertainties in the global economy and financial markets, and to a certain extent, domestic factors during the second half of the year had also significantly affected domestic financial markets and the ringgit exchange rate.

Notwithstanding these developments, the Malaysian economy proved to be resilient and was sustained by a well-diversified economy. The deep financial markets and well-capitalised financial institutions were able to withstand the large and volatile capital flows and this enabled financial intermediation to continue uninterrupted. Overall domestic liquidity remained sufficient and financial

institutions continued to operate with strong capital and liquidity buffers. Against this backdrop, the MPC assessed that the stance of monetary policy was appropriate and consistent with the achievement of sustainable economic growth and price stability. Monetary policy, together with earlier macro- and micro-prudential measures also continued to play a role in ensuring that the growth of household debt was sustainable and that the risks of financial imbalances emerging was minimised.

Ringgit developments in 2015 were heavily influenced by portfolio investment flows arising primarily from external factors. For the year as a whole, the ringgit depreciated by 18.6% against the US dollar. The broad depreciating trend in the ringgit was an outcome of several key factors. The anticipation and eventual normalisation of US interest rates had resulted in a rebalancing of portfolio investments towards US financial assets and led to a significant appreciation of the US dollar. Furthermore, there were significant portfolio outflows from many emerging market economies, including Malaysia. Concerns over the impact of lower prices of crude oil and commodities on the domestic economy and negative domestic sentiments also led to a larger depreciation in the ringgit against other currencies. For an open economy like Malaysia, the depreciation of the ringgit was a necessary adjustment to the external headwinds facing the economy. A weaker ringgit helped to mitigate potential losses to exporters from lower commodity prices by increasing ringgit earnings from currency conversions. Nevertheless, the massive shifts in cross-border capital flows during the year caused the ringgit to become undervalued and misaligned.

In 2015, the Bank's monetary operations were focused on managing the reduction in liquidity within the banking system caused by the large external outflows. Contractionary pressures on liquidity were offset by the net release of funds placed with the Bank. In addition, the issuance of Bank Negara Monetary Notes (BNMNs) was replaced with other instruments of shorter maturities to enable banks to readily meet any sudden withdrawals of funds caused by the outflows. The Bank also used its monetary operations, including the reverse repo facility, to provide liquidity to the banking system when needed. To further ensure sufficient liquidity in the domestic financial system, the Bank reduced the Statutory Reserve Requirement (SRR) ratio from 4.00% to 3.50%, effective from 1 February 2016. With the continued ample

liquidity conditions and orderly financial market conditions, the financial intermediation process continued to function smoothly, with financing activity remaining at a healthy level.

Net financing to the private sector expanded at an annual rate of 8.2% in 2015 (2014: 8.6%). The more moderate pace of growth during the year was driven by lower growth of loans to the household sector. The lower growth in household debt was partly an outcome of the pre-emptive measures by the Bank and the Government since 2010 to ensure the sustainability of household debt. Financing to businesses, however, remained robust and in line with economic activity, with higher growth in outstanding loans and net issuances of private debt securities (PDS) by businesses. Financing to the small and medium enterprises (SMEs), in particular, continued to record strong growth in 2015 driven mainly by loans to the services sector.

Outlook for the Malaysian Economy in 2016

The international economic and financial landscape is likely to remain challenging in 2016 and will be a key factor that will influence the prospects of the Malaysian economy. Depending on their nature, global developments can pose both upside and downside risks to the Malaysian economic growth. The Malaysian economy is expected to grow by 4.0 - 4.5% in 2016. Domestic demand will continue to be the principal driver of growth, sustained primarily by private sector spending. Private consumption growth is expected to trend below its long-term average, reflecting largely the continued household adjustments to an environment of higher prices and greater uncertainties. These moderating effects, however, will be partially offset by continued growth in income and employment, as well as some support from Government measures targeted at enhancing households' disposable income.

In an environment of prolonged uncertainties and cautious business sentiments, private sector investment growth is projected to be slower compared to its performance in the past five years. Capital expenditure in the upstream mining sector will continue to be affected by the environment of low energy and commodity prices. Support to private sector capital spending will mainly stem from the implementation of on-going and new investment projects, particularly in the manufacturing and services sectors.

Reflecting the Government's commitment to more prudent spending, growth of public sector expenditure is also expected to be more moderate but would continue to be supportive of overall growth. Public investment is, however, projected to turn around to register a positive growth, reflecting higher spending by the Federal Government on fixed assets and the continued implementation of key infrastructure projects by public corporations.

The external sector is expected to remain resilient in 2016. Despite subdued commodity prices, Malaysia's export performance is projected to remain positive, in line with the modest improvement in external demand. The well-diversified nature of Malaysia's exports will continue to support the overall growth in exports. Gross imports are projected to expand further amid an increase in intermediate imports to support the sustained performance of manufactured exports and the higher growth in capital imports due to continued expansion domestic private investment. The overall trade balance in 2016 is expected to continue to record a surplus, albeit one that is smaller. The services account is projected to record a narrower deficit on account of an expected improvement in tourism activity. Overall, the current account surplus is projected to narrow further to 1.0 - 2.0% of gross national income (GNI).

On the supply side, all economic sectors are projected to expand, albeit at a more moderate pace in 2016. The services and manufacturing sectors will remain the key drivers of overall growth. Despite the lower oil and gas prices, growth in the mining sector will be supported by new gas production capacity. Growth momentum in the construction sector is projected to moderate slightly in 2016 amid a modest expansion in both the residential and non-residential sub-sectors.

Headline inflation is projected to be higher at 2.5 - 3.5% in 2016 (2015: 2.1%), due mainly to increases in the prices of several price-administered items and the weak ringgit exchange rate. However, the impact of these cost factors on inflation will be mitigated by the low global energy and commodity prices, generally subdued global inflation and more moderate domestic demand. The trajectory of inflation during the year, however, could be more volatile given the uncertainties relating to global oil and commodity prices as well as the pace of global growth.

Economic and Monetary Management in 2016

Monetary policy in 2016 will focus on ensuring that monetary conditions remain supportive of sustainable domestic growth with price stability, taking into consideration the evolving risks in the external and domestic environments. In particular, global economic and financial developments will need to be closely monitored and assessed in terms of their implications for the domestic growth and inflation outlook. Monetary policy will also continue to take into account the risk of financial imbalances. In addition, given the expectation of continued volatility in external flows, the Bank's monetary operations will be directed towards ensuring that domestic liquidity in the financial system will remain sufficient to support the orderly functioning of the domestic financial markets.

Fiscal policy in 2016 will continue to focus on fiscal consolidation. The 2016 Budget was recalibrated in January 2016 to incorporate the expected decline in global oil prices. Government spending was reprioritised and measures were introduced to broaden revenue sources. Fiscal spending will be prioritised towards high impact infrastructure projects that could have large multiplier effects by increasing the productive capacity of the economy. In addition, emphasis will continue to be accorded towards ensuring inclusive and sustainable growth through welfare enhancements, particularly in the form of socio-economic support to the lower- and middle-income segments to help them cope with the rising cost of living.

Given the expectation of a challenging global financial environment, Malaysia will likely be confronted by volatile movements in capital flows. However, Malaysia's deep and developed financial markets are well-positioned to intermediate these flows, thus ensuring that the functioning of the domestic financial markets will continue to be orderly and supportive of the real economy. Malaysia's ability to withstand external shocks will also be augmented by its ample buffers and robust policy frameworks that have been steadily built over time.

Governance, Organisational Development and Communications

As an institution that serves in the best interest of the nation, the Bank has always placed great emphasis on strengthening its governance standards, accountability and internal capabilities. The Bank's Board of Directors oversees the institution's general policies, administration,

performance in delivering its mandates, management of risks, financial management, and reserves and currency management. In 2015, two Board members completed their terms and four new Board members were appointed. Two new external members were also appointed to the MPC, which marks the first time that the MPC has included members from outside the Bank. The new appointments add to the diversity, collective experience, expertise and knowledge of the Board and the MPC, further strengthening the Board's oversight of the Bank and the MPC.

In 2015, initiatives were implemented to ensure continued strategic focus and a robust risk management culture in all aspects of the Bank's operations. The Bank's Business Plan for 2015 - 2017 provides organisational focus and clarity of the Bank's key outcomes and strategies over the medium-term. During the year, the Bank refined its risk appetite and tolerance statements based on more granular data. This is to ensure that decisions are made with careful consideration of the risks involved and with appropriate mitigating measures. The risk management function is complemented by a risk-based internal audit function for all critical operations of the Bank.

The Bank practices prudent financial management, and vigorously pursues organisational efficiency. Attracting and retaining talent of the right calibre is a key policy. The Bank maintains its heavy investment in building the technical and leadership skills of its staff. To keep abreast with the rapid pace of technological change, the Bank undertook an independent review of its Information and Communications Technology (ICT) architecture in 2015.

Given increased uncertainty in the economic and financial environment, both domestically and internationally, the Bank intensified its communications throughout 2015 to promote better understanding of developments affecting the Malaysian economy and financial system. This was done through more frequent press conferences, interviews and engagement sessions with key stakeholders, which complemented other

communication channels such as the Monetary Policy Statement (MPS).

The Bank also continued to play a role in shaping central banking issues globally through increased engagements and collaborations with the international financial and economic communities. The Bank's thought leadership and advocacy roles have been recognised through the appointment of the Governor as Chair for Responsible Finance Institutes' Council of Advisors, and the Bank's role as observer, one out of three emerging countries appointed, for the Basel Committee on Banking Supervision, and Chair of the BIS Central Bank Governance Group. Global recognition for the Bank's senior leadership has also included the Alliance for Financial Inclusion leadership award and Maya declaration award for global leadership in financial inclusion; "Lifetime Achievement Award for the global development of Islamic finance" awarded by His Highness Sheikh Mohammed bin Rashid Al Maktoum, Ruler of Dubai; the prestigious Wharton Dean's Medal to recognise outstanding leaders of private enterprise, public services and academia; and the "Lifetime Achievement Award" by Central Banking Publications.

A notable outcome in 2015 was the establishment of the Asia School of Business (ASB), a collaboration between the Bank and the Massachusetts Institute of Technology (MIT) Sloan School of Management. The ASB supports the growth of talent by meeting the increasing demand for leadership and management capabilities, especially given Asia's rapid transformation and expanding growth potential.

Bank Negara Malaysia's Audited Financial Statements for 2015

The financial position of Bank Negara Malaysia, as audited and certified by the Auditor General, remained strong in 2015. The total assets of Bank Negara Malaysia amounted to RM440.6 billion, with a net profit of RM7.8 billion for the financial year ending 31 December 2015. Bank Negara Malaysia declared a dividend of RM3.0 billion to the Government for the year 2015.

2015

ECONOMIC DEVELOPMENTS IN 2015

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THE INTERNATIONAL ECONOMIC ENVIRONMENT

In 2015, the global economic and financial environment was shaped by three major developments. First, global commodity prices fell sharply to post-crisis lows. This had significant repercussions for the growth prospects of both the commodity-exporting and commodity-importing economies, as well as the inflation outcomes in these economies. Second, international financial markets experienced heightened volatility driven by policy shifts in major economies, speculative activity, heightened risk aversion, and the drastic fall in the prices of oil and other key commodities. Third, global growth moderated. The modest improvements in the advanced economies were insufficient to offset the moderation in growth in emerging economies. Emerging economies, nevertheless, remained the key contributor to global growth with a share of 73%. Against a backdrop of diverse uncertainties arising from elevated concerns over growth, inflation and external spillovers, the policy outlook became more challenging during the year. Policymakers in many economies also faced fiscal constraints, resulting in continued overdependence on monetary policy to support growth. This was particularly the case in some of the advanced economies, where the policy rates have become negative. As a consequence, monetary policy decisions and measures became a huge driving factor in the financial markets.

Global growth moderated amid heightened international financial market volatility

Global growth moderated

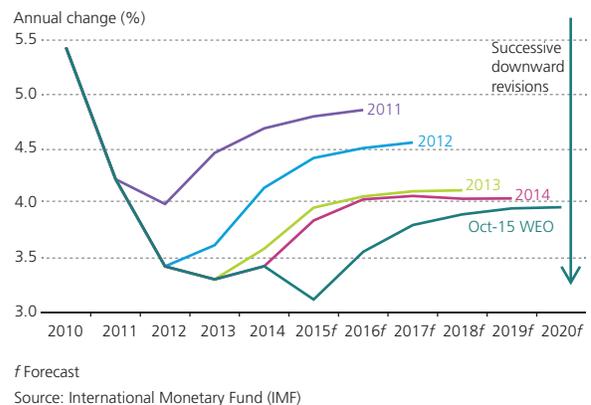
The global economy entered 2015 with expectations for a better recovery in growth, supported partly by optimism over the positive impact of lower oil prices on demand in the oil-importing countries. Of note, the International Monetary Fund (IMF) began the year with a forecast of 3.5% for global

growth and 3.8% for global trade. As the year progressed, however, it became apparent that the global economy continued to underperform. In some large emerging economies, underlying domestic constraints, including high indebtedness, outweighed the benefits to domestic demand from low commodity prices. This was compounded by heightened volatility in the financial markets, which dampened consumer, business and investor sentiments. The improvement in major advanced economies remained modest, weighed down by the lingering legacies of the financial crisis, which included the high private sector indebtedness, strained fiscal positions and slack in the labour markets. As a result, the global growth outlook was successively revised downwards throughout the year. In addition, the growth of global trade saw a particularly large downward revision, registering its slowest pace of expansion in the post-crisis period.

In the US, economic activity gained further traction, driven mainly by an improvement in the labour and housing markets. Of significance, the economy produced more than 200,000 new jobs on average each month. The unemployment rate fell to 5%, the lowest rate since 2008. In the housing market, sales, new construction and prices also trended higher. These developments supported the improvement in household balance sheets. The decline in gasoline prices to an average of

Chart 1.1

IMF's Global Economic Outlook



USD2.42 per gallon (2014: USD3.36 per gallon) also provided additional impetus to consumption. Notwithstanding the weakness in the commodity-related sectors, investment activity was sustained by spending in the services sector which accounts for almost three-quarters of total investment. Given the gradual strengthening of economic fundamentals, the Federal Reserve (Fed) signalled the imminent start of interest rate normalisation throughout the year. Finally in December, the Fed raised its Federal Funds Rate (FFR) for the first time since 2006, temporarily removing some uncertainty from global financial markets.

In PR China, growth remained on a moderating trend in 2015 as the continued rebalancing

Table 1.1

World Economy: Key Economic Indicators

	Real GDP Growth (Annual change, %)		Inflation (Annual change, %)	
	2014	2015e	2014	2015e
World Growth	3.4	3.1	-	-
World Trade	3.4	2.6	-	-
Advanced Economies				
United States	2.4	2.4	1.6	0.1
Japan	0.0	0.5	2.8	0.8
Euro area	0.9	1.6	0.4	0.0
United Kingdom	2.9	2.2	1.5	0.0
Emerging Asia¹	6.2	5.8	2.5	1.8
Other Advanced Asian Economies	3.4	2.0	1.6	0.5
Korea	3.3	2.6	1.3	0.7
Chinese Taipei	3.9	0.7	1.2	-0.3
Singapore	3.3	2.0	1.0	-0.5
Hong Kong SAR	2.6	2.4	4.4	3.0
The People's Republic of China	7.3	6.9	2.0	1.4
ASEAN-4	4.5	4.6	4.7	3.6
Malaysia	6.0	5.0	3.2	2.1
Thailand	0.8	2.8	1.9	-0.9
Indonesia	5.0	4.8	6.4	6.4
Philippines	6.1	5.8	4.2	1.4
India²	7.2	7.6	6.6	4.9

¹ Emerging Asia refers to Chinese Taipei, Hong Kong SAR, Indonesia, Korea, Malaysia, Philippines, PR China, Singapore and Thailand

² For India, GDP data is presented on a fiscal year basis
e Estimate

Source: International Monetary Fund, National Authorities and Bank Negara Malaysia estimates

of the economy and the implementation of structural reforms resulted in slowing activity in sectors with excess capacity. The economy faced stronger headwinds arising from weak external demand and higher financial market uncertainty, particularly in the second half of the year. Notably, periodic episodes of sharp corrections in the Chinese equity markets, with unexpected spillovers from policy measures and adjustments, combined with heightened concerns over the global growth prospects, triggered a sharp increase in global risk aversion that pushed the CBOE Volatility Index (VIX) to a four-year high in August. Nevertheless, the impact of economic rebalancing efforts and weaker sentiments on PR China's overall growth were partly offset by the announcement of pro-growth measures during the year, amid sustained consumer spending and a continued expansion of the services sector.

In Europe, growth improved at a modest pace during the year due to unresolved structural constraints. Growth in the UK economy was supported mainly by a steady improvement in private consumption. Nonetheless, while unemployment fell to its lowest level in almost ten years, wage growth remained subdued. On the other hand, investment activity moderated. In particular, the recovery in the housing market slowed following robust growth in the previous two years. The euro area experienced a more pronounced economic recovery in 2015, supported by both domestic demand and exports. Notably, private consumption rose in all the core euro area economies, supported by a gradual improvement in labour market conditions, low oil prices and favourable credit conditions. Nevertheless, the pace of growth remained uneven and some smaller euro area economies experienced negative growth. Furthermore, the region continued to suffer from bouts of heightened volatility arising from unresolved sovereign debt concerns in Greece. In the second quarter of the year, investor concerns were reignited by a disagreement between international creditors and the ruling Greek government over structural reforms, raising the prospect of a Greek debt default. The situation escalated in late June when the Greek government introduced capital controls and announced a referendum over the bailout conditions. Investor sentiments improved subsequently following the announcement of a third bailout programme in mid-July. Nevertheless, most of the volatility experienced during this period was concentrated in the financial markets.

In contrast, the Japanese economy registered only a modest rebound in 2015, following stagnation in growth the preceding year. Despite the continued implementation of monetary easing measures, both private consumption and investment activity remained subdued. Export growth was also weighed down by slower demand from Asian economies, amid moderating economic activity in the region.

Economic activity in the emerging economies moderated for the fifth consecutive year, reflecting both external and domestic headwinds. The slowdown in global trade amid weakening external demand and sentiments affected the emerging economies, especially those with high trade openness. This was compounded by stronger headwinds arising from the increased volatility of capital flows and the consequent pressure of local currencies against the US dollar. For the commodity exporters, the significant decline in global commodity prices resulted in a deterioration of the trade and fiscal positions of these economies. Country-specific developments, including political uncertainty in several economies in Latin America and the escalation of conflicts in the Middle East and Russia weighed on growth in these economies. For several large emerging economies, growth was affected by structural reforms, including energy, tax and price reforms, intended to improve fiscal positions and enhance economic competitiveness.

Amid the highly challenging external environment, growth in the rest of Asia also moderated during the year. While domestic demand remained the key driver of growth in the region, weak export performance weighed on the pace of economic expansion. To address the slowing growth momentum, policymakers in several economies in the region lowered policy rates and introduced fiscal stimulus measures, which provided some support to economic activity.

More subdued global inflation

Global inflationary pressures moderated in 2015, reflecting the lower global commodity prices and subdued global demand conditions.

Crude oil prices declined sharply to an average of USD54¹ per barrel in 2015 (2014: USD99 per barrel). Higher production by major oil-producing economies and shale oil producers in the US, amid moderating global demand, contributed

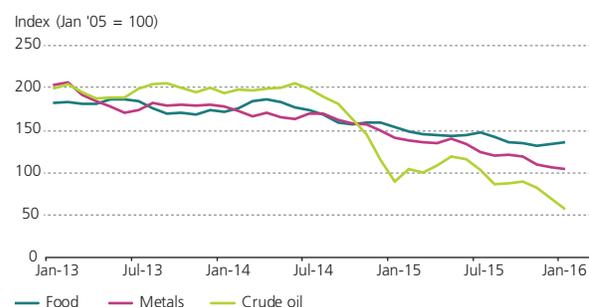
to persistent oversupply concerns in the global markets. These concerns intensified further in the second half of the year following the successful conclusion of the Iranian nuclear deal, the commitment of the Organisation of the Petroleum Exporting Countries (OPEC) to not cut the existing production levels, and the worsening sentiments over global growth prospects of several large emerging economies. Consequently, crude oil prices fell to a twelve-year low of USD36 per barrel towards the end of the year.

Prices of non-oil commodities also moderated during the year. In particular, the prices of base metals, such as iron ore, copper and zinc, declined significantly, weighed down mainly by slowing demand from PR China and an increase in supply from new mines. In addition, food prices also moderated as favourable weather conditions supported the production of several agricultural products, including sugar, coffee and soybeans in Latin and North America. The decline in food prices was exacerbated by rising inventory due to softer global demand.

In the advanced economies, inflationary pressures weakened in 2015, weighed down mainly by lower energy prices. Of significance, several major economies experienced episodes of near-zero or negative headline inflation during the year. Core inflation rates, which exclude food and energy prices, remained relatively subdued, amid moderate demand and wage growth. Similarly, inflation in most Asian economies also weakened alongside the decline in commodity prices and moderating economic growth. However, headline inflation rose in Indonesia, reflecting mainly an increase in fuel pump prices, following the implementation of measures to rationalise fuel subsidies.

Chart 1.2

Indices of Primary Commodity Prices



Source: International Monetary Fund (IMF)

¹ Based on global Brent crude oil 1-month futures price.

More accommodative global policy stance

In response to the increasingly challenging external environment and moderating domestic economic activity, the overall global policy stance became more accommodative in most regions. In the advanced economies, the uneven growth momentum between economies resulted in a divergence in the direction of monetary policy. While the US raised interest rates for the first time in nine years, the euro area and Japan increased monetary stimulus through their respective asset purchase programmes and negative interest rates. In Asia, several economies reduced key policy rates and introduced targeted fiscal measures to support growth. Additionally, policymakers in the region continued to advance structural reforms to strengthen macroeconomic fundamentals and enhance medium-term growth sustainability.

The divergence in monetary policy stance between the advanced economies became more apparent in 2015. In the US, supported by growing indications of improving labour market conditions, the Fed began to communicate its intention to begin normalising monetary policy during the year. Nevertheless, the Federal Open Market Committee (FOMC) maintained its FFR in the first three quarters, highlighting concerns over the impact of global economic and financial developments on growth and inflation. However, with lower financial market volatility and improvements in US economic activity in the fourth quarter, the FOMC increased the FFR target range by 25 basis points to 0.25 – 0.50% in December. In contrast, amid subdued inflation, the European Central Bank (ECB) continued to implement an asset purchase programme of EUR60 billion per month, which is forecasted to remain until March 2017. In addition, the interest rate on the deposit facility was lowered by 10 basis points to -0.3% towards the end of the year. In Japan, the Bank of Japan (BoJ) continued with its annual asset purchases of JPY80 trillion amid disinflation concerns. To encourage a decline in long-term interest rates, the BoJ supplemented these purchases by extending the maturity of current Japanese government bond purchases to 7–12 years (previous: 7–10 years) from January 2016 onwards and increased the purchases of exchange-traded funds and real estate investment trusts. Across other advanced economies, central banks in Australia, Canada, Denmark, New Zealand, Norway and Sweden also reduced key policy rates following higher downside risks to inflation and growth.

In PR China, the People's Bank of China (PBoC) lowered the benchmark lending rate and reserve requirement ratio by 125 and 250 basis points to 4.35% and 17.50%, respectively, to help reduce the funding costs for financial institutions, and thereby the financing costs of the corporate sector. Concurrently, the PBoC also continued to undertake financial reforms, including the implementation of deposit insurance, the removal of ceiling rates on deposits and the introduction of a more market-oriented exchange rate framework. To support economic growth, Chinese policymakers announced targeted fiscal measures during the year. These included tax reductions on consumer goods and automobiles, preferential tax policies for SMEs, lower restrictions on the property market and additional funding for infrastructure investments.

Policies in Asia were shaped by domestic concerns amid a more challenging external environment, with several central banks in the region lowering key policy rates. Given more subdued inflationary pressures, Bank Indonesia, the Bank of Thailand and the Reserve Bank of India reduced their key policy rates by 50, 50 and 125 basis points, respectively. Similarly, in Singapore, the Monetary Authority of Singapore reduced the slope of the S\$ nominal effective exchange rate policy band in January and October. Amid moderating domestic demand and weak exports, central banks in Korea and Chinese Taipei also lowered their key policy rates by 50 and 25 basis points, respectively. In contrast, following the Fed's decision to increase the FFR, the Hong Kong Monetary Authority increased the Base Rate by 25 basis points in December.

In addition to monetary easing, a number of Asian economies, including Chinese Taipei, Thailand, Indonesia and Korea, announced fiscal measures to support domestic economic activity. These measures were in the areas of providing financing support for small businesses, higher public investment and rebates to encourage purchases of durable consumer goods. To further strengthen macroeconomic fundamentals and enhance medium-term growth prospects, Asian policymakers also continued with the implementation of structural reforms. In particular, policymakers in the region introduced measures to accelerate infrastructure investment, deregulate labour markets, improve the ease of doing business and promote entrepreneurship.

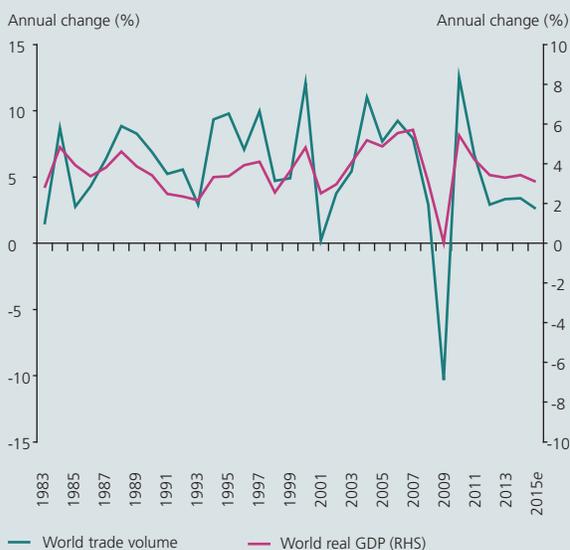
Recent Slowdown in Global Trade: Cyclical Bane or Structural Shift?

Introduction

Global trade growth experienced a sharp deceleration in 2015, registering its slowest pace of expansion since the 2008 Global Financial Crisis (GFC) (Chart 1). The underperformance of global trade compared to global economic activity is, however, not a recent phenomenon. Global trade elasticity, calculated as the ratio of world trade growth to GDP growth, has been on a declining trend even prior to the GFC (Chart 2), suggesting that the recent trend of subdued growth in global demand only partly explains the modest trade performance in recent years. Several structural shifts could be contributing to a change in the dynamics between global trade and global growth. This article aims to provide possible explanations regarding the cyclical and structural factors that may be weighing on global trade growth and the potential impact of these trends on Asia.

Chart 1

Global Trade in 2015 Expanded at its Slowest Pace Since the Crisis

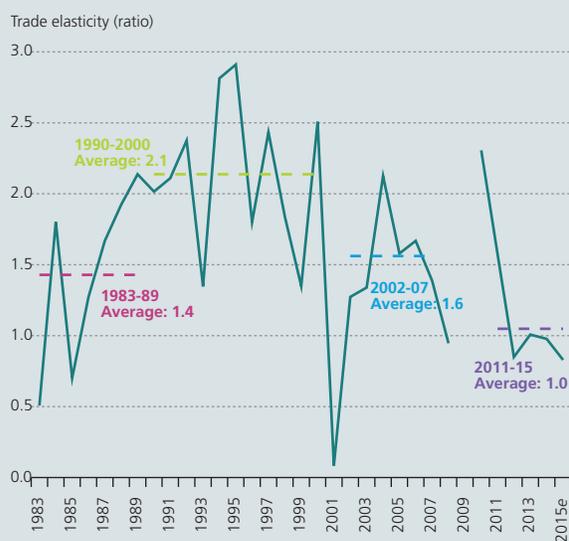


e Estimates

Source: International Monetary Fund (IMF)

Chart 2

Trade Elasticity Has Been on a Declining Trend in the Recent Decade



e Estimates

Source: International Monetary Fund (IMF)

Cyclical and Structural Factors

Persistent economic weakness, particularly in several of the major advanced economies is likely to be the key factor in explaining the modest performance of world trade after the GFC.

In the pre-GFC period, the advanced economies collectively accounted for almost two-thirds of total global imports (Chart 3) and almost 60% of global import growth. However, the sharp growth contraction and the impairment of the financial systems experienced by these economies during the crisis resulted in a protracted compression in demand, which constrained the pace of expansion in global trade (Chart 4).

In particular, the weak recovery in investment growth has major implications for global trade activity given that investment goods typically have higher import content relative to consumption goods (Constantinescu et al., 2015). In the advanced economies, while consumer spending has been on a recovering trend, investment growth has remained weak. In Europe, domestic demand has been further weakened by the implementation of fiscal austerity measures and weak investor sentiments amid prolonged concerns surrounding the European sovereign debt crisis.

Chart 3

Pre-GFC, Advanced Regions Had a Higher Share of Global Trade



Chart 4

Post-GFC Import Demand From the Advanced Economies Has Remained Weak



It should be highlighted that despite persistent demand weakness in the advanced economies, global trade activity in the post-GFC period did not experience a collapse. A key supporting factor of global trade growth was the recovery in trade in the emerging economies (Marinov and Marinova, 2013), amid a strong growth rebound in these economies in the period immediately after the crisis. Between 2010 - 2011, the emerging economies accounted for almost four-fifths of global GDP growth. More recently, however, global trade is facing stronger headwinds. In 2015, several large emerging economies experienced a moderation in growth due to a confluence of factors. This included the significant decline in commodity prices, on-going structural reform measures and country-specific factors, which weighed on both the domestic and external demand of these economies. Heightened uncertainty during the year, arising from policy shifts and financial market adjustments in several major economies also adversely affected global sentiments, contributing to a further weakness in global trade, which continued to grow but only at a modest pace.

Beyond these cyclical weaknesses, there are also structural factors at play, in particular the diminishing impact of major catalytic factors that were important drivers of the high global trade growth observed in the 1990s and early 2000s. First, the proliferation of global value chains (GVCs) catalysed a rapid increase in global trade of intermediate goods (WTO, 2011). This was in part spurred by the information and communication technology (ICT) revolution, which greatly reduced the cost of managing, transacting and coordinating production across borders (WTO, 2011). As a result, firms were better able to leverage on the comparative advantages of different countries through outsourcing and dispersing the different stages of production internationally.

Second, major trade liberalisation breakthroughs, including the formation of the European Union (EU)¹ and the World Trade Organisation (WTO) resulted in the lowering of tariffs and regulatory barriers. This provided further impetus to the expansion of GVCs. For Europe, the more liberalised trade environment between the EU members has contributed to a tripling of intra-European trade from EUR800 billion in 1992 to EUR2.9 trillion in 2014.

Third, the accession of PR China into the WTO in 2001 marked a major shift in the global trade landscape. The opening up of the Chinese economy facilitated a rapid expansion of its manufacturing

¹ The European Union (EU) was formed in 1992 upon the signing of the Maastricht Treaty. To date, the EU has 28 member states with Croatia being the latest addition to the union in 2013.

sector amid large inflows of foreign direct investment. The offshoring phenomenon accelerated as firms became better at maximising the economies of scale offered by the GVCs. This was further supported by low production costs in the host country as they became increasingly adept in manufacturing processes. Subsequently, PR China's share of world merchandise exports to global trade more than doubled, from 5.8% in 2003 to 12.7% in 2014.

It is hypothesised that the catalytic effects of these factors may have peaked, resulting in a lower elasticity of global trade with respect to global growth. Of late, there are signs of an emerging trend towards more onshoring or re-shoring of manufacturing activity. Anecdotal evidence suggests that multi-national corporations are increasingly relocating production back to the US and Europe².

Asia's Experience

In the past few decades, given its long history of global orientation and trade openness, Asia has benefitted tremendously from the rapid expansion of international trade activity. The diversity of resources in the region enabled each economy to specialise at different stages of both regional and global production networks³. This inherent strength of the region was further reinforced by the close geographical proximity of Asian economies to fast-growing PR China amid continued deepening of trade linkages with the Chinese economy (Chart 5). Intra-regional trade rose from 32% of total trade in 1990 to 43% in 2007, while Asia's merchandise trade grew at an annual average rate of 8.9% in 1990 - 2000 and 16.3% in 2002 - 2007.

As with the advanced economies, trade activity in Asia was adversely affected during the GFC. Nevertheless, the Asian economies experienced a swift rebound in demand in the few years following the GFC. The strong economic recovery could be attributed in part to increasing trade within the Asian region and between Asia and the other emerging economies that also registered favourable growth following the crisis. For example, Asia's trade with Latin America, the Middle East and Africa increased from 12% in 2007 to 15% of its total trade in 2014. Nevertheless, most recently, a confluence of headwinds, including the persistent demand weakness in the advanced economies, as well as structural factors, such as maturing GVCs, have contributed to a continued moderation in trade growth in the region.

Furthermore, PR China's economic transition is posing an additional challenge for Asian economies, in particular for the exporters of raw materials and intermediate goods. The slowdown in PR China's final demand will affect the export performance of its trade partners. Additionally, PR China's structural transformation process amid increasingly competitive domestic firms have led to import substitution of some of the parts and components that are usually sourced from other economies, including from those in Asia (Kee and Tang, 2015). This is evidenced by the moderation in PR China's imports of intermediate goods from a pre-crisis average growth of 26.5% to just 3.5% from 2012 to 2014 (Chart 6).

Asia's Prospects

With the effect of past trends diminishing, the future direction of global trade will depend on the interplay between the various ongoing and emerging structural shifts in the global economy and trade landscape. These include PR China's economic transition towards a more consumption-based growth, a rising middle income population in the emerging economies and new multilateral trade agreements. To successfully adapt to this fast evolving environment requires agility. This in turns necessitates economies to have strong institutions, sufficient policy flexibility as well as diversified sources of trade and growth.

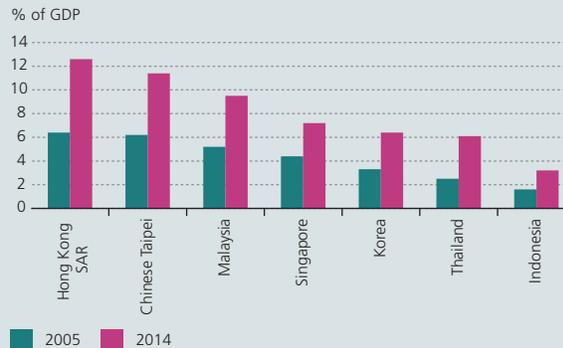
Following the Asian Financial Crisis, policymakers in Asia undertook wide-ranging structural reforms to strengthen economic resilience and improve their growth prospects. In particular, policymakers

² A BCG survey of senior US-based manufacturing executives showed that more manufacturers are planning to add production capacity in the US, compared to any other country. The share of manufacturers that are in the process of reshoring production back to the US is also increasing (Boston Consulting Group, 2015).

³ The varying stages of development among the Asian nations enable each of them to take advantage of its distinctiveness to develop a supportive ecosystem, as explained by the "flying geese model" (Kojima, 2000).

Chart 5

PR China's Importance as a Source of Final Demand for Asia Has Increased



Note: 2014 final demand for the region estimated based on 2011 figures available on OECD TIVA

Source: OECD Trade in Value Added (TIVA) - October 2015 database and Bank Negara Malaysia estimates

Chart 6

PR China's Imports of Intermediate Goods Have Declined



Source: UN COMTRADE

embarked on efforts to develop a vibrant manufacturing base, to move up the value chain and to improve efficiency and competitiveness. At the same time, measures were also implemented to strengthen domestic demand in the region, including increasing labour market flexibility and enhancing social safety nets.

Conclusion

This article puts forth cyclical and structural factors that have caused the global trade growth and the intensity of trade to decline in recent years. At this point, with the global economy still undergoing some critical transitions, it is difficult to conclude whether these trends in global trade will continue. Nevertheless, it is imperative for economies to continuously embark on policy initiatives geared towards enhancing their competitiveness, in order to benefit from the more globalised world and to position the economy to confront the increasingly challenging global environment.

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Chart 1.3

Cumulative Movements of Policy Rates (January 2015 - January 2016)



Note: Current policy rates as at end January 2016 in parentheses

Source: National Authorities

The range of policy measures employed during the year underscored the challenge faced by policymakers in striking a balance between addressing short-term risks and long-term growth challenges. Policy formulation and implementation were further complicated by volatile capital flows and pressures in the foreign exchange markets. The fact that policy space in many countries was more constrained following the strong measures rolled out in the immediate aftermath of the global financial crisis in 2008-2009 also added to some uncertainty in the financial markets. Combined with the on-going imbalances in many major economies, the operating environment in 2015 remained challenging, and this is likely to weigh on prospects for 2016.

THE MALAYSIAN ECONOMY

Overview

Despite the challenging economic environment in 2015, the Malaysian economy grew by 5.0% (2014: 6.0%), supported by the continued expansion of domestic demand. Growth of domestic demand was stronger during the early part of the year, partly reflecting the frontloading of consumption spending prior to the implementation of the Goods and Services Tax (GST) in April 2015. In the second half of the year, as growth in domestic demand moderated, a modest improvement in external demand provided additional impetus to economic growth.

Domestic demand was primarily driven by the private sector. Private consumption continued to expand, albeit at a more moderate pace. Despite

concerns about the rising cost of living and weak sentiments, household spending was supported by continued income growth and stable labour market conditions. This was further supported by an increase in targeted Government transfers to low- and middle-income households, as well as the boost to disposable incomes from the lower fuel prices during the year.

Despite the challenging economic environment, the Malaysian economy registered a growth of 5.0% in 2015

Private investment growth was slower as capital expenditure was affected by the moderation in domestic and global growth, and cautious business sentiments. While the low oil prices affected upstream mining investment, the continued progress of ongoing and new investment projects in the services and manufacturing sectors, especially in the export-oriented industries, provided support to the overall investment performance.

Despite the challenging conditions, the public sector continued to provide support to growth while remaining committed to the steady reduction in fiscal deficit. Measures by the Government to freeze new hiring and cut costs to reduce discretionary spending contributed to the sustained growth in public consumption in 2015. Public investment improved to register a smaller contraction because of higher capital spending by both the public corporations and the Federal Government. Growth was underpinned by ongoing as well as new projects.

On the supply side, all major economic sectors registered more moderate growth, with the exception of the mining sector. The moderation reflected the slower expansion in industries related to domestic demand. However, export-oriented manufacturing and trade-related services industries benefited from the modest improvement in external trade, especially with the major advanced economies.

The external sector remained resilient in 2015. In the first half of the year, the external trade performance was largely weighed down by the decline in commodity prices and the sluggish demand for commodities and commodity-related

Table 1.2

Malaysia - Key Economic Indicators

	2013	2014	2015 ^p	2016 ^f
Population (million persons)	30.2	30.6	31.0	31.4
Labour force (million persons)	13.6	14.0	14.2	14.6
Employment (million persons)	13.2	13.5	13.8	14.1
Unemployment (as % of labour force)	3.1	2.9	3.2	3.3 ~ 3.5
Per Capita Income (RM)	32,596	34,945	36,285	37,930
(USD)	10,345	10,677	9,291	8,821
NATIONAL PRODUCT (% change)				
Real GDP at 2010 prices ¹	4.7	6.0	5.0	4.0 ~ 4.5
(RM billion)	955.3	1,012.5	1,062.6	1,106.1
Agriculture, forestry and fishery	1.9	2.1	1.0	-0.3
Mining and quarrying	1.2	3.3	4.7	3.5
Manufacturing	3.4	6.2	4.9	4.1
Construction	10.8	11.8	8.2	7.9
Services	6.0	6.5	5.1	4.4
Nominal GNI	5.3	8.6	5.2	5.9
(RM billion)	984.8	1,069.3	1,124.7	1,191.0
Real GNI	5.2	6.0	6.8	3.8
(RM billion)	916.9	971.9	1,038.1	1,077.7
Real aggregate domestic demand ²	7.3	5.9	5.1	4.3
Private expenditure	8.5	7.9	6.1	5.2
Consumption	7.2	7.0	6.0	5.1
Investment	12.8	11.0	6.4	5.5
Public expenditure	4.1	0.4	2.1	1.6
Consumption	5.9	4.4	4.3	2.0
Investment	1.9	-4.7	-1.0	1.1
Gross national savings (as % of GNI)	30.4	30.3	28.8	28.3
BALANCE OF PAYMENTS (RM billion)				
Goods balance	96.6	113.4	108.9	99.5
Exports	637.7	679.9	685.8	707.6
Imports	541.1	566.5	576.9	608.1
Services balance	-9.6	-11.2	-20.5	-19.2
Primary income, net	-34.0	-37.3	-32.2	-38.0
Secondary income, net	-17.5	-17.6	-22.2	-23.1
Current account balance	35.5	47.3	34.0	19.1
(as % of GNI)	3.6	4.4	3.0	1.0 ~ 2.0
Bank Negara Malaysia international reserves, net ³	441.9	405.3	409.1	-
(in months of retained imports)	9.5	8.3	8.4	-
PRICES (% change)				
CPI (2010=100) ⁴	2.1	3.2	2.1	2.5 ~ 3.5
PPI (2010=100) ⁵	-1.7	1.4	-4.8	-
Real wage per employee in the manufacturing sector	5.8	1.5	3.7	-

¹ Beginning 2015, real GDP has been rebased to 2010 prices, from 2005 prices previously

² Exclude stocks

³ 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

⁴ Effective 2011, the Consumer Price Index has been revised to the new base year 2010=100, from 2005=100 previously

⁵ Effective 2015, the Producer Price Index has been revised to the new base year 2010=100, from 2005=100 previously

⁶ Based on average USD exchange rate for the period of January-February 2016

^p Preliminary

^f Forecast

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 1.3

Malaysia - Financial and Monetary Indicators

FEDERAL GOVERNMENT FINANCE (RM billion)	2013		2014		2015^p	
Revenue	213.4		220.6		219.1	
Operating expenditure	211.3		219.6		217.0	
Net development expenditure	40.7		38.5		39.3	
Overall balance	-38.6		-37.4		-37.2	
Overall balance (% of GDP)	-3.8		-3.4		-3.2	
Public sector net development expenditure	139.4		154.6		161.5	
Public sector overall balance (% of GDP)	-4.6		-6.0		-8.6	
EXTERNAL DEBT¹						
Total debt (RM billion)	696.6		747.5		833.7	
Medium- and long-term debt	357.7		384.3		481.9	
Short-term debt	338.8		363.2		351.9	
Debt service ratio ² (% of exports of goods and services)						
Total debt	18.4		19.1		22.6	
Medium- and long-term debt	18.3		18.9		22.4	
MONEY AND BANKING						
	Change in 2013		Change in 2014		Change in 2015	
	RM billion	%	RM billion	%	RM billion	%
Money supply M1	37.8	13.0	18.8	5.7	14.0	4.1
M3	107.5	7.9	101.5	7.0	41.5	2.7
Banking system deposits	116.9	8.3	116.4	7.6	29.5	1.8
Banking system loans ³	117.7	10.6	114.1	9.3	105.4	7.9
Loan to deposit ratio (% , end of year) ⁴	84.8		86.7		88.7	
Loan to fund ratio (% , end of year) ^{4,5}	80.7		82.1		83.0	
Loan to fund and equity ratio (% , end of year) ^{4,5,6}	73.3		74.1		74.6	
INTEREST RATES (% , AS AT END-YEAR)						
Overnight Policy Rate (OPR)	3.00		3.25		3.25	
Interbank rates (1-month)	3.20		3.38		3.45	
Commercial banks						
Fixed deposit 3-month	2.97		3.13		3.13	
12-month	3.15		3.31		3.31	
Savings deposit	0.99		1.07		1.04	
Base rate (BR)	-		-		3.86	
Base lending rate (BLR)	6.53		6.79		6.79	
Treasury bill (3-month)	3.00		3.42		2.74	
Malaysian Government Securities (1-year) ⁷	3.03		3.48		2.59	
Malaysian Government Securities (5-year) ⁷	3.66		3.84		3.47	
EXCHANGE RATES (AS AT END-YEAR)						
2013						
2014						
2015						
Movement of Ringgit (%)						
Change against SDR	-7.3		-0.7		-15.1	
Change against USD	-6.8		-6.1		-18.6	

¹ As defined effective from the first quarter of 2014. For more information, please refer to the box article titled 'The Redefinition of External Debt' in the Quarterly Bulletin on Economic and Financial Developments in the Malaysian Economy in the First Quarter of 2014

² Includes prepayment of medium- and long-term debt

³ Includes loans sold to Cagamas

⁴ 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

⁵ Funds comprise deposits and all debt instruments (including subordinated debt, debt certificates/sukuk issued, commercial paper and structured notes)

⁶ Equity comprise ordinary and preferred shares, share premium and retained earnings

⁷ Refers to data from FAST, Bank Negara Malaysia

^p Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Table 1.4

Real GDP by Expenditure (2010=100)					
	2015 ^p	2014	2015 ^p	2014	2015 ^p
	% of GDP	Annual change (%)		Contribution to growth (ppt)	
Domestic Demand¹	91.6	5.9	5.1	5.4	4.6
Private sector expenditure	69.2	7.9	6.1	5.3	4.2
<i>Consumption</i>	52.4	7.0	6.0	3.6	3.1
<i>Investment</i>	16.9	11.0	6.4	1.8	1.1
Public sector expenditure	22.4	0.4	2.1	0.1	0.5
<i>Consumption</i>	13.5	4.4	4.3	0.6	0.6
<i>Investment</i>	8.9	-4.7	-1.0	-0.5	-0.1
Gross Fixed Capital Formation	25.8	4.8	3.7	1.3	1.0
Change in Stocks				-0.6	0.6
Net Exports of Goods and Services	8.6	12.8	-3.7	1.1	-0.3
<i>Exports</i>	73.0	5.1	0.7	3.9	0.5
<i>Imports</i>	64.4	4.2	1.3	2.8	0.8
Real Gross Domestic Product (GDP)	100.0	6.0	5.0	6.0	5.0

¹ Excluding stocks
^p Preliminary

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

manufactured products. In the second half of the year, external trade improved due to a rebound in export growth arising from higher demand for manufactured products and commodities, and the positive valuation effect from the ringgit depreciation. For the whole year, the trade surplus was higher, supported by both manufactured and commodity products.

Domestic demand remained the main source of growth

Domestic demand remained the key driver of growth, but its growth moderated to 5.1% during the year (2014: 5.9%). The slower performance reflected the moderation in growth of private sector activity, particularly in the second half of the year. Public sector expenditure, meanwhile, improved marginally following a smaller contraction in public investment.

Private consumption growth moderated to 6.0% in 2015 (2014: 7.0%), as households adjusted their spending due to the increasing cost of living, arising from fiscal reform measures such as the implementation of GST and administrative price adjustments, and the depreciation in ringgit. Similar to other

Table 1.5

Real GDP by Kind of Economic Activity (2010=100)					
	2015 ^p	2014	2015 ^p	2014	2015 ^p
	% of GDP	Annual change (%)		Contribution to growth (ppt) ¹	
Services	53.5	6.5	5.1	3.5	2.8
Manufacturing	23.0	6.2	4.9	1.4	1.1
Mining and quarrying	8.9	3.3	4.7	0.3	0.4
Agriculture	8.8	2.1	1.0	0.2	0.1
Construction	4.4	11.8	8.2	0.5	0.3
Real Gross Domestic Product (GDP)	100.0¹	6.0	5.0	6.0	5.0

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

^p Preliminary

Source: Department of Statistics, Malaysia

countries' experiences in implementing GST, households frontloaded purchases prior to the commencement of the tax in the first quarter of 2015, particularly in the transport, food and beverages, and communication categories. From the second quarter onwards, private consumption growth moderated as households adjusted to the new tax. Upward adjustments to administered prices, including cigarettes, toll rates and public transport fares also contributed to the moderation in spending. In addition, weaker sentiments due to greater uncertainty in the global and domestic environment, and the ringgit depreciation, further weighed down private consumption growth during the second half of the year.

Private consumption expanded at a more moderate pace

Notwithstanding these developments, households received some support from higher disposable income through targeted Government measures to the low- and middle-income households. This included the higher amount of Bantuan Rakyat 1Malaysia (BR1M) cash transfers, the reduction in individual income tax rates for the 2015 assessment year by one to three percentage points and savings derived from the lower fuel prices during the year. Additionally, developments in the labour market continued to remain supportive of wage growth and private consumption. Average nominal wage growth in the manufacturing sector

Impact of Goods and Services Tax on Private Consumption in Malaysia

Introduction

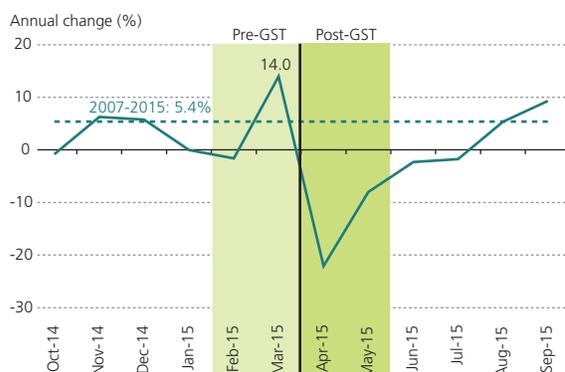
On 1 April 2015, the Goods and Services Tax (GST) was introduced at a standard rate of 6%. While the GST represents a key component of the Government's long-term fiscal reform initiatives, a combination of adverse economic developments and shocks after the introduction of the GST has impacted household spending pattern. Similar to the experiences in other countries, the major impact of GST was on the change in behaviour of households towards consumption spending in the period before and after the implementation of the GST.

Frontloading of consumption spending pre-GST implementation

Prior to the implementation of GST¹, it was observed that households brought forward their purchases of goods in anticipation of higher prices post the tax introduction. In particular, households frontloaded purchases of durable items such as passenger cars, furniture and electrical appliances. Notably, the uncertainty over the impact of GST on car prices led to a marked increase in car sales, particularly in March 2015 (Chart 1). Households also frontloaded purchases of basic necessities, such as food and beverages and household items. This was reflected in the higher growth of 10.5% in the retail trade index during the first quarter of 2015 (Chart 2). Most retailers, particularly supermarkets, experienced a substantial increase in sales during the last few weeks leading up to the introduction of the GST.

Chart 1

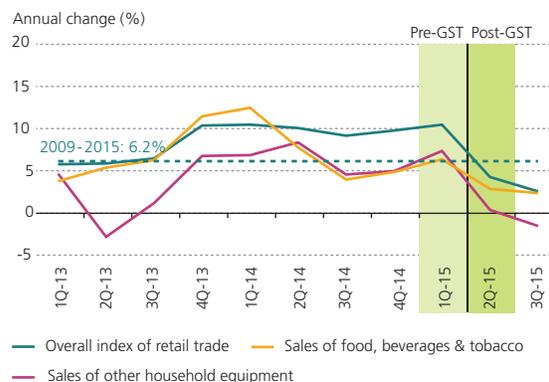
Surge in Car Sales in March 2015 was Followed by a Decline in April 2015



Source: Malaysian Automotive Association (MAA)

Chart 2

Higher Growth of Index of Retail Trade and Its Sub-component in 1Q 2015, before Moderating in 2Q-3Q 2015



Source: Department of Statistics, Malaysia

The surge in household spending was also reflected in other consumption indicators. In February - March 2015, credit card spending increased significantly by 21.8%, while narrow money (M1) rose by 9% (Chart 3). On aggregate, private consumption expanded strongly by 8.8% in the first quarter of 2015, significantly higher than its long-run average growth of 6.7% (1990-2014). This was similar to the experiences in Japan and Singapore, whereby the frontloading of purchases prior to the GST implementation boosted private consumption growth above its long-term average by two to four percentage points.

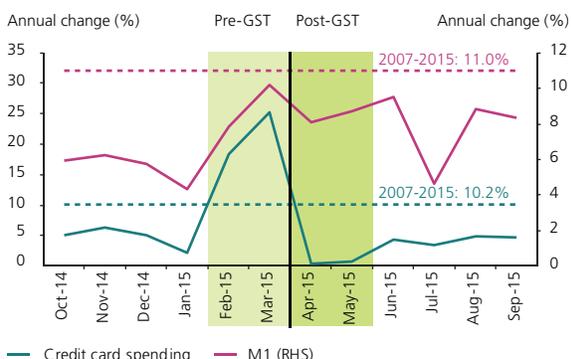
As expected, the surge in consumption expenditure during the period leading up to the GST introduction was only temporary. As with the experiences of other economies² that introduced a

¹ GST replaces the Sales and Services Tax in Malaysia to enhance the efficiency and effectiveness of the existing taxation system.

² Following the introduction of GST, Australia (2000) and New Zealand (1986), for example, experienced a temporary boost in private consumption pre-GST implementation followed by a decline in retail sales during the quarter of GST implementation.

Chart 3

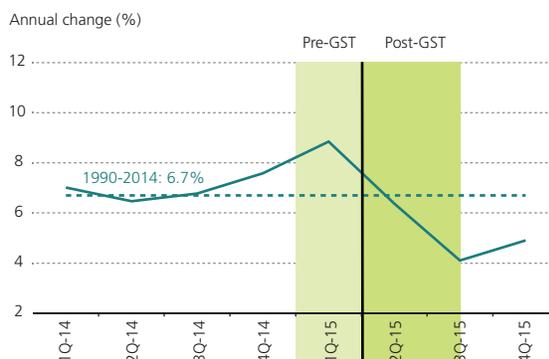
Strong Growth in Credit Card Spending and Narrow Money before Moderating Post-GST



Source: Bank Negara Malaysia

Chart 4

Moderation in Consumption Growth Post-GST Implementation



Source: Department of Statistics, Malaysia

new consumption tax, private consumption growth in Malaysia moderated during the quarter of implementation (Chart 4; 2Q 2015: 6.4%). Households adjusted to the rise in prices by changing their consumption patterns, particularly by cutting down on discretionary spending. Retail trade experienced a broad-based moderation across most consumer goods, particularly household equipment, food, beverages and tobacco. Credit card spending and M1 also registered lower growth rates of 0.6% and 8.4%, respectively, during April – May 2015. Similarly, after the accelerated growth of 14% in March 2015, passenger car sales contracted by 10.8% in 2Q 2015 compared with the same period in the previous year.

New shocks prolonging the period of adjustment post-GST

The macroeconomic environment in which the GST is introduced is a key factor in explaining the duration of the ensuing period of adjustment in household spending. In economies that introduced consumption tax during stable economic growth conditions, household spending typically turned around after about three to six months. In New Zealand, amid firm economic conditions, retail sales declined during the quarter of GST implementation, before rebounding in the subsequent quarter. Similarly, consumption growth began to improve six months after the GST was implemented in Australia during a period of sustained economic growth in the late 1990s. Countries that introduced the GST during more volatile economic conditions, however, have tended to experience a more prolonged period of adjustment in consumer spending³.

In the case of Malaysia, the period after the introduction of the GST saw new shocks that complicated the adjustment process. Most of these shocks were exogenous, particularly the decline in commodity prices, weakening of the ringgit, and were precipitated by external events unforeseen during the period prior to the implementation of the GST. These factors were compounded by several factors including, the upward revision of administered prices in the period after the implementation of the GST, culminating in an increase in the cost of living and a steady decline in consumer confidence. As expected, household spending moderated in second quarter of 2015 to 6.4% and reached a trough of 4.1% in the third quarter, before recovering to 4.9% in the fourth quarter of the year.

It should be noted that when the Government first announced the planned implementation of GST back in October 2013, it also proposed a package of measures designed to help households and businesses to cope with the transition. For households, these included the reduction of individual income tax rates by one to three percentage points and the disbursement of higher cash transfers to low- and middle-income households. Additionally, the exclusion of essential goods and services from

³ In Canada, when the GST was introduced during an economic recession in January 1991, private consumption growth registered three consecutive quarters of contraction before recovering.

the GST helped to alleviate some of the burden of adjustments faced by households, particularly the lower income groups. Subsequently, in October 2015, the Government proposed for an increase in the national minimum wage and civil servants' salaries effective July 2016. Following a new round of shocks to the economy, the Government implemented additional measures in early 2016 to support household consumption. These measures included providing employees with the option to temporarily lower their EPF contribution rate by three percentage points to increase their disposable income.

Conclusion

The introduction of GST in Malaysia led to a temporary change in household spending patterns, and the adjustment process is still continuing at the time of writing. As expected, consumption spending was frontloaded in anticipation of higher prices after the introduction of the GST. The post-GST period has seen a downward adjustment in consumer spending. This period of adjustment could be more prolonged than earlier anticipated, following additional exogenous shocks to the economy in the form of a more subdued global growth environment, a fall in commodity prices and a depreciation of the ringgit exchange rate. These shocks had cumulatively resulted in increased uncertainty and affected business and household sentiments. Nevertheless, looking ahead, the impact of GST is expected to decline, as continued income growth and stable job market conditions provide fundamental support to household spending. Supporting measures by the Government would also provide some impetus to consumption activity. It is envisaged that private consumption will continue to grow in the near to medium term, albeit at a more moderate rate compared to the average growth of 7.1% for the past five years.

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Softening Labour Market Conditions

The labour market remained broadly stable in 2015, as the continued expansion across all economic sectors sustained the demand for labour. The unemployment rate edged higher to 3.2% (2014: 2.9%), as more cautious business sentiments led to softer employment prospects towards the second half of the year (Table 1). The labour force participation rate was stable at 67.6% (2014: 67.5%).

Table 1

Selected Labour Market Indicators

	2011	2012	2013	2014	2015 ^p
Employment ('000 persons)	12,284	12,723	13,210	13,532	13,759
Labour force ('000 persons)	12,676	13,120	13,635	13,932	14,215
Unemployment rate (% of labour force)	3.1	3.0	3.1	2.9	3.2
Layoffs (persons)	12,689	20,031	14,465	12,406	21,713 ¹
Foreign workers ('000 persons)	1,573	1,572	2,250	2,073	2,135

^p Preliminary

¹ Constitutes workers affected by retrenchments and voluntary separation scheme (VSS) offerings in the January-October 2015 period and including layoffs arising from the national airline's corporate restructuring

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

The number of workers laid off totalled 21,713 persons, or approximately 0.2% of total employment. Most of the layoffs (retrenchments and voluntary separation scheme (VSS) offerings) in 2015 were mainly attributable to the decline in global oil prices and reorientation of multinational firms' business strategies. These layoffs were conducted on a global and regional scale, particularly among oil and gas companies and manufacturers in the E&E sub-sector. Among domestic companies, the national airline implemented a large corporate transformation exercise, while financial services firms took steps to enhance their operational efficiency, in line with global trends in the financial services industry.

Total employment continued to expand to 13.8 million workers (2014: 13.5 million workers). The net addition of 226,000 jobs came mainly from the services sector (223,000 jobs), particularly in the distributive trade, education, and human health and social work sub-sectors. The construction sector registered net employment gains of 54,000 jobs, while employment growth in the oil and gas sector remained steady (net gain of 19,000 jobs), despite large scale-backs during the year (Chart 1). In terms of skill levels, employment gains were mainly concentrated in the high-skilled occupations, reflecting a continued shift of the Malaysian economy towards becoming a higher value-added economy (Chart 2). However, demand for low-value

Chart 1

Net Employment Gains¹ by Sectors, 2013-2015



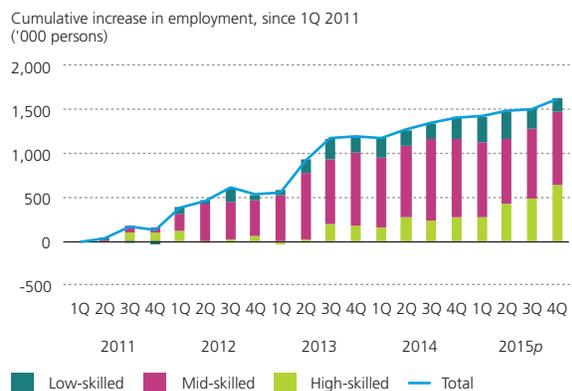
^p Preliminary

¹ Net employment gains are the difference between employment level in a given year compared to the previous year

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

Chart 2

Employment Growth by Skill Levels, 2011-2015



^p Preliminary

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

production and low-skilled workers remained high, as evidenced by the number of registered foreign workers, which increased to 2.14 million workers (2014: 2.07 million workers). The agriculture and construction sectors registered the highest dependence on foreign labour.

Labour productivity, as measured by real value-added per worker, grew by 3.2% (2014: 3.5%), driven mainly by productivity increases in the manufacturing sector (7.0%; 2014: 3.8%). Labour productivity growth in the construction and services sectors, however, were modest at 3.6% and 2.4%, respectively (2014: 13.4% and 2.5%).

was stable at 5.9% (2014: 4.7%), underpinned by strong wage growth in the export-oriented sectors, while the growth of wages in the domestic-oriented sectors remained modest.

Public consumption recorded a sustained growth of 4.3% in 2015 (2014: 4.4%). Spending on emoluments was lower, partly attributable to the freezing of new hiring for selected positions and the absence of bonus payments to civil servants. Continued efforts to rationalise and optimise Government expenditure resulted in lower discretionary spending, particularly on supply of other materials and rental payments. Nevertheless, total spending on supplies and services was higher during the year, supported by maintenance and minor repair work, and communication and utilities.

Gross fixed capital formation (GFCF) expanded by 3.7% in 2015 (2014: 4.8%), due mainly to slower private sector investment. The environment of low and volatile oil prices had affected investment in the upstream mining sector, resulting in oil and gas firms revising their capital expenditure plans during the year. By type of assets, investment in structures registered a lower growth of 6.9% (2014: 9.9%) mainly due to the slower pace of construction activity in both the residential and non-residential sub-sectors. Growth in machinery and equipment expenditure remained in contraction (-0.3%; 2014: -0.5%) with spending being mainly on transport, office and telecommunication equipment.

Private investment registered a slower growth of 6.4% (2014: 11.0%), weighed down partly by the moderation in domestic demand conditions and weak business sentiments. While investment for new oil and gas explorations moderated in 2015, investment in downstream activities remained steady as reflected by further capacity expansion in the petrochemical manufacturing and oil storage facilities. The overall investment performance continued to be supported by the progress of new

and ongoing projects in the manufacturing and services sectors.

Overall investment activity moderated due to slower growth in private sector capital expenditure

Investment in the manufacturing sector (24% share of private investment) expanded further, supported mainly by the export-oriented industries which benefited from the continued demand of manufactured exports. The manufacturing investment approved by MIDA in 2015 remained high at RM74.7 billion (2014: RM71.9 billion), with projects mainly in the petrochemical, natural gas and E&E sub-sectors.

In the services sector (51% share of private investment), investment was underpinned by capital expenditure in the distributive trade, transport and storage, and tourism-related sub-sectors. This was reflected in the rapid pace of development within the regional corridors, such as the Iskandar region (i.e. oil and gas terminals, and healthcare services). Investment in telecommunication services was supported by the ongoing network expansion and infrastructure upgrades nationwide for the rollout of 4G/LTE networks by major telecommunication service providers. Dwellings investment, however, registered a modest expansion in line with the slower residential construction activity.

Public investment registered negative growth in the first half of 2015 following the near completion of several large projects that were undertaken by the public corporations. However, public investment turned around to register a positive growth in the second half of the year due to higher spending on

(continued on page 44)

Investment in the Export-Oriented Industries in Malaysia

Introduction

Over the past decade, Malaysia has successfully attracted large amounts of investment into the export-oriented industries, producing not only a wide range of products but also integrating Malaysia into the global supply chain. Investment in the export sector has been a key success factor in ensuring that Malaysia's manufactured exports remain competitive in a changing global environment and that the Malaysian economy progressively moves towards high value-added activity. This article looks at the major trends of investments in the export-oriented industries in Malaysia.

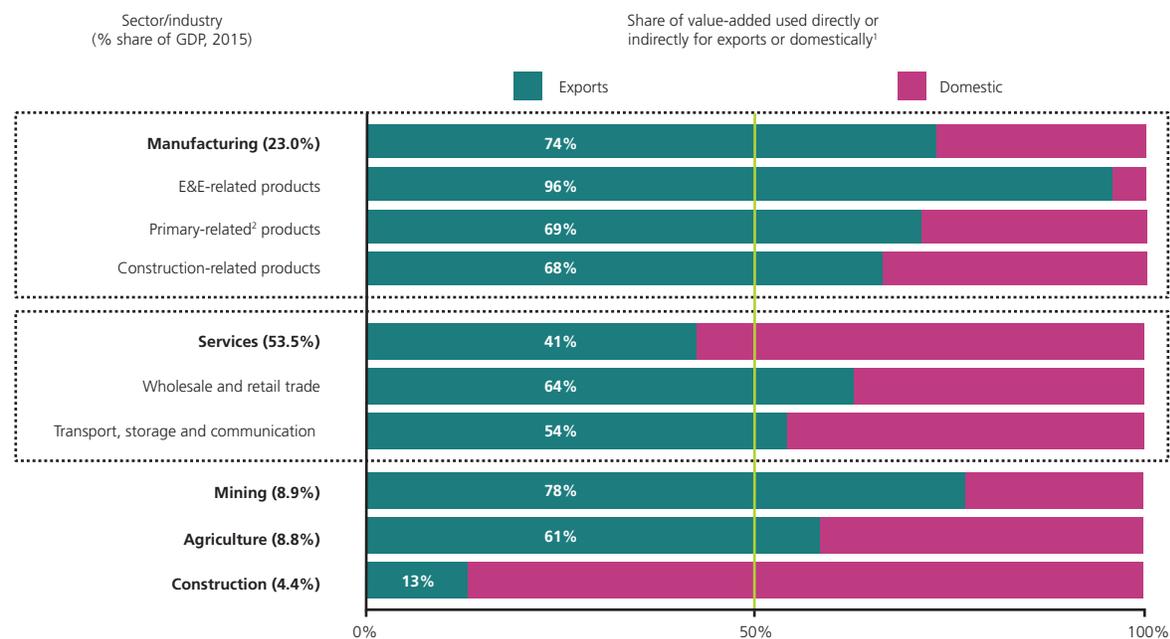
Overview of export-oriented industries in the economy

Investment in Malaysia is concentrated in the manufacturing and services sectors (75% of gross fixed capital formation (GFCF)). Total investment comprises of investment in both the export-oriented and domestic-oriented activities.

Chart 1 provides the export orientation of different sectors within the economy. Broadly, the agriculture, mining and manufacturing sectors are mostly export-oriented, while the construction and services sectors are largely domestic-oriented. Within the manufacturing sector, the export-oriented industries include those involved in the production of electronic and electrical (E&E), petroleum, chemical, rubber, plastic, fabricated metal, iron and steel products. In the services sector, whilst most of the economic activity is related to supporting domestic activity, the logistics, information and communication, as well as distributive trade industries (particularly wholesale trade), also cater to the export sector.

Chart 1

Export Orientation of Selected Industries in Malaysia



Note:

¹ Calculated based on the proportion of an industry's value-added that is exported using the 2010 Input-Output table. If more than 50% of an industry's value-added is exported, it is classified as export-oriented; otherwise it is classified as domestic-oriented.

² Primary-related products refer to textiles, wood, petroleum, chemical, rubber and plastic products, while construction-related products refer to non-metallic, basic metal and fabricated metal products.

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

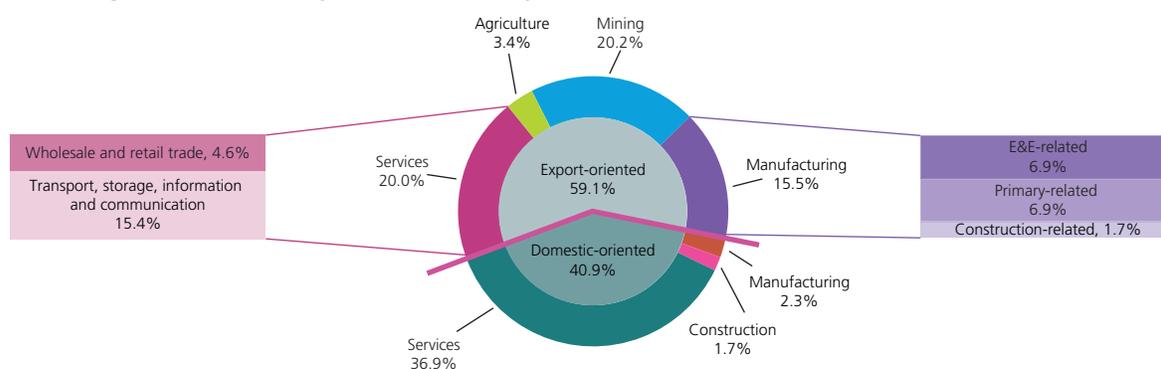
Investment trends for the export-oriented industries

Overall, investments in the export-oriented industries account for an estimated amount of 59% of total GFCF in 2014 (see Chart 2). In the manufacturing sector, investments in the export-oriented industries constitute 87% of total manufacturing investment and 16% of GFCF. These export-oriented manufacturing activities are key to ensuring that Malaysia remains firmly plugged into the supply chain of high value-added products such as solar components and the semiconductors that are used in the automotive, consumer electronics and cloud computing businesses.

In the services sector, investments in the export-oriented industries represent 35% of services investment and 20% of total GFCF. These investments include, among others, capital spending for the expansion of port facilities, upgrading of logistics equipment and warehousing facilities, as well as the construction of oil and gas storage terminals.

Chart 2

Percentage Share of GFCF by Economic Activity, 2014



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

While the growth of investment in the mining sector has been moderating, investments in the export-oriented manufacturing and services industries have recorded strong growth, averaging above 8% from 2011 to 2014 (see Table 1). For the manufacturing sector, investment was driven mainly by capital expenditure in the primary-related and E&E sub-sectors (2011-2014 average growth: 13.6% and 5.6%, respectively). During the same period, investment in the export-oriented services sector was

Table 1

Growth of GFCF in the Manufacturing and Services Sectors

Sectors and sub-sectors	Average growth (2011-2014)
Manufacturing	8.3
<i>E&E-related</i>	5.6
<i>Primary-related</i>	13.6
<i>Construction-related</i>	-1.8
Services	8.0
<i>Wholesale and retail trade</i>	9.5
<i>Transport and communication</i>	11.1
Overall GFCF	9.6

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

undertaken mainly by the transport and communications sub-sectors (2011-2014 average growth: 11.1%) to build new infrastructure and upgrade existing equipment.

Continued focus on promoting investment in the export-oriented industries

Continuous efforts by the Government in promoting investment in various export-oriented industries, such as aerospace, E&E, medical equipment and renewable energy, have contributed towards significant progress in these strategic areas. The success of these efforts can be seen in the increase of investments approved in the export-oriented manufacturing industries, mainly in the E&E, petroleum and petrochemical sub-sectors (see Chart 3). This includes investment by manufacturers of semiconductors, solar panels, aircraft components and petrochemical-based products such as resins, polymers and construction chemicals.



Similarly, in the services sector, further progress has been made in successfully attracting investments to logistic services and in establishing Malaysia as a global and regional operations hub for large multinational corporations (MNCs). In 2014, 234 global corporations were approved to set up operation in Malaysia, with another 224 approvals in 2015¹.

Investment strategically dispersed across regions

In the 1980s and 1990s, investment in the export-oriented industries was mainly concentrated in industrial areas located within the Klang Valley, Penang and Johor. However, following strategic measures such as the promotion of regional growth corridors, these export-oriented investment projects are increasingly more geographically dispersed across the nation (see Table 2). These corridors have attracted key investment projects in niche areas and helped to further boost Malaysia's exports. For instance, the Northern Corridor Economic Region (NCER) has attracted several large MNCs producing higher value-added products such as medical devices and semiconductors for sensors. Similarly, the Iskandar region has attracted investments in E&E manufacturing, as well as in oil and gas storage facilities.

Conclusion

Despite the challenges faced by the global economy, ongoing multi-year investments in the export-oriented industries are expected to continue. In particular, investment by industries in the advanced manufacturing and modern services sectors, including manufacturers of automotive sensors

¹ Source: Malaysian Investment Development Authority (MIDA)

Table 2

Export-oriented Manufacturing Focus Across Regional Corridors

Corridor	Areas of focus	Examples of products
Northern Corridor Economic Region (NCER)	E&E and biotechnology	<ul style="list-style-type: none"> • Medical devices • Automotive sensors • Oleochemicals
East Coast Economic Region (ECER)	Heavy industry and automotive	<ul style="list-style-type: none"> • Metal products • Automotive components
Iskandar Malaysia	Downstream oil and gas	<ul style="list-style-type: none"> • Petrochemical products • Oil and gas refinery
Sarawak Corridor of Renewable Energy (SCORE)	Resource-based products	<ul style="list-style-type: none"> • Aluminium and glass products • Steel products
Sabah Development Corridor (SDC)	Resource-based products	<ul style="list-style-type: none"> • Palm oil products

Source: Regional Corridor Authorities

and medical devices, and advanced logistic services, are expected to progress further. These industries would also benefit from the modest growth in the global economy. This sustained investment will enable the manufacturing and services sectors to move up higher on the value chain and ensure that Malaysia's exports remain globally competitive.

Moderate Growth in Major Economic Sectors

On the supply side, all major economic sectors registered a more moderate pace of growth in 2015, attributable mainly to the slower domestic demand. However, growth in external demand, particularly from the advanced economies, had benefited the export-oriented manufacturing industries and trade-related services sub-sectors.

The services sector expanded at a more moderate pace of 5.1% in 2015 (2014: 6.5%). Growth was weighed down by a moderation in the consumption-related sub-sectors and a contraction in the finance and insurance sub-sector. Growth in the consumption-related sub-sectors, particularly the retail and motor vehicles segments, moderated in line with the slower growth in household spending. The finance and insurance sub-sector registered a small contraction, due mainly to lower fee-based income caused mainly by the weaker capital market activity; and lower insurance premium growth during the year. In contrast, the information and communication sub-sector remained robust, driven by strong demand for data communication services. Growth was further supported by better performance of the wholesale segment and the transportation & storage sub-sector, which benefited from the improvement in trade-related activity.

The manufacturing sector expanded by 4.9% in 2015 (2014: 6.2%), attributable mainly to the continued strength of the export-oriented industries. The performance of the export-oriented industries was primarily driven by strong production growth in the E&E cluster, particularly in the consumer-based electrical segment and selected semiconductor components. Growth was further supported by the primary-related cluster due mainly to sustained regional demand for chemical products. The domestic-oriented industries, however, moderated mainly as a result of slower growth in the consumer-related cluster.

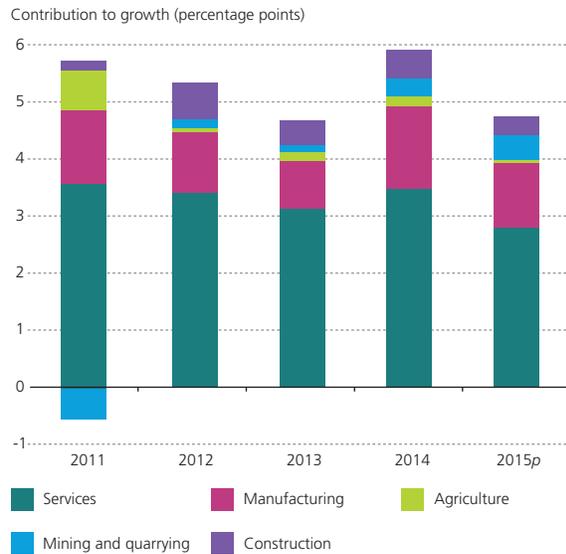
The construction sector grew at a moderate pace in 2015 (8.2%; 2014: 11.8%), due mainly to the slower growth in the residential sub-sector. Construction activity in the residential sub-sector was affected by fewer property launches during the year. Nonetheless, growth in the civil engineering sub-sector picked up, reflecting the progress of existing infrastructure projects as well as the commencement of a large petrochemical project in Johor. Growth in the construction sector was also supported by the non-residential sub-sector, which was underpinned by projects in both the industrial and commercial property segments.

In the agriculture sector, growth moderated to 1.0% (2014: 2.1%) due to lower crude palm oil (CPO) output following unfavourable weather conditions. This includes excessive rains in the first quarter of 2015, causing floods in the east coast of Peninsular Malaysia, and the strong haze and El Nino weather phenomenon in the second half of the year, which led to lower yields.

The mining sector recorded a higher growth of 4.7% (2014: 3.3%) as a result of higher production of crude oil (654,200 barrels per day, the highest since 2010). This was driven by new output from the large Gumusut Kakap deepwater oilfield at offshore Sabah, which commenced operations in the fourth quarter of 2014.

Chart 1

Real GDP by Economic Activity



^p Preliminary

Source: Department of Statistics, Malaysia

Assessing Demand-Supply Conditions in the Malaysian Property Market

Introduction

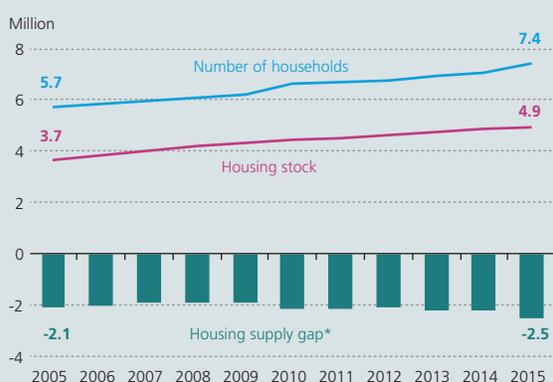
The Malaysian property market is characterised by unevenness across its sub-segments in recent times, with demand outstripping supply in the housing market, while the office and retail markets are experiencing oversupply. The rapid increase in house prices, particularly in the major urban centres, has been attributable partly to a shortfall in supply. The shortage is particularly evident in the supply of affordable housing. This has increasingly priced out more urban Malaysian households from the housing market. In contrast, the increase in the construction of office buildings and retail malls, particularly in major cities, has raised the potential of overbuilding of commercial properties that could adversely impact the real estate market. This article identifies the current demand-supply dynamics and the outlook in three property segments in Malaysia – housing, office and retail, with a focus on the key states¹ (Kuala Lumpur, Selangor, Johor and Pulau Pinang) and seeks to highlight lessons from the experiences of other countries.

Shortage of supply in the affordable housing market

Since 2005, Malaysia's housing stock has increased by 35%. Despite this substantial growth, the shortage of housing supply at the national level has persisted. The gap between the housing stock and the number of households widened to 2.5 million units in 2015 from 2.1 million units in 2005² (Chart 1). The worsening shortfall in housing supply reflected the mismatch between the pace of growth in the supply of new houses and the net increase in the number of households³, particularly in the past five years. Between 2005 and 2008, the number of new houses completed averaged 166,876 units annually, while the number of households increased by about 117,250, implying a surplus supply of housing units of about 49,626 units per year. Over the past five years, however, the annual completion of houses has declined considerably to 80,089 units, far below the 166,000 average net increase in the number of households annually⁴. This suggests an average shortage of 85,911 housing units per year between 2011 and 2015 (Chart 2).

Chart 1

Widening Housing Supply Shortfall over the past Decade...



*Housing supply gap = Housing stock – Outstanding number of households OR Completion of new houses – Net increase in number of households

A negative figure suggests a shortfall in housing supply

Source: National Property Information Centre, CEIC and Bank Negara Malaysia estimates

Chart 2

...as New Housing Supply was Unable to Match Increase in Number of Households over the past Five Years



¹ Key states refer to the major employment centres in Malaysia.

² The estimate assumes that all households are looking to own and are able to afford a house. Currently, there are about two houses for every three households, suggesting some accommodation sharing among households, which underpins the demand for house ownership.

³ This refers to the increase in the number of households at one point in time versus another point in time (i.e. new household formation minus household dissolution through one or two heads of households joining into a single household and/or through the death of a single-person head of household).

⁴ The lower house-building activity reflects partly lower property launches and sales by developers.

The shortage in housing supply has been particularly acute in the affordable housing category. In 2014, half of Malaysian households earned a monthly income of RM4,585 and below. According to the “Median Multiple” methodology developed by Demographia International and recommended by the World Bank and the United Nations to evaluate urban housing markets, a house is considered affordable if a household can finance it with less than three times its annual household income (house price-to-income ratio of 3.0 and below). This suggests that houses priced up to RM165,060 are considered affordable to a median Malaysian household. However, only 21% of new housing launches in Malaysia were priced below RM250,000 in 2014. In contrast, the data points to an oversupply of higher-end properties⁵ priced above RM500,000. Although property launches in this price category accounts for 36% of total new launches in Malaysia, these houses are only within the reach of 5.4% of the population according to the same methodology⁶ (Chart 3). While affordable housing initiatives by the Federal and State Governments, *Syarikat Perumahan Negara Berhad* (SPNB) and *Perumahan Rakyat 1Malaysia* (PR1MA) have gathered some momentum, the current level of house-building in the affordable housing segment has not been sufficient to meet the demand. Nonetheless, a substantial amount of affordable housing units built by these initiatives are currently under various stages of construction.

The imbalance between demand and supply, particularly in the affordable housing segment, has contributed to a rapid increase in house prices⁷. This has compounded housing affordability issues, particularly for the low- and middle-income population. Between 2009 and 2014, average house prices in Malaysia rose by 7.9% in CAGR⁸ terms, exceeding the growth in average household income of 7.3% over the same period. This contrasts sharply with the period in 2004 to 2007 when incomes were rising more than the growth of house prices (Chart 4). With an uneven pace of growth between house prices and income, the affordability of houses across the key states in Malaysia has progressively declined. Houses in Malaysia, on aggregate, were

Chart 3

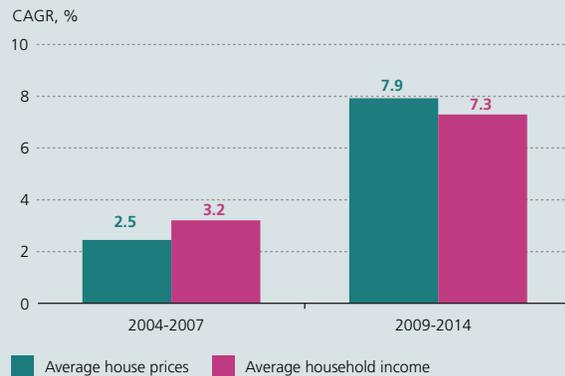
Since 2010, New Launches in Malaysia Have Been Increasingly Skewed towards Houses Priced above RM500,000



Source: National Property Information Centre

Chart 4

House Prices Have Grown at a Faster Pace than Income Levels



Source: National Property Information Centre and Department of Statistics, Malaysia *Household Income and Basic Amenities Survey Reports*

⁵ The oversupply of higher-end residential property is evident particularly in some areas in the key states and in selected property segments (i.e. luxury condominiums).
⁶ Houses priced from RM540,000 are considered affordable for households earning at least RM15,000 a month (5.4% of Malaysia's total population in 2014).
⁷ Another contributing factor to the rapid increase in house prices over the past few years was the use of marketing tools by developers and low real property gains tax (RPGT) rates. For example, the Developer Interest-Bearing Scheme (DIBS) not only artificially inflated property prices, but also encouraged speculators to enter the property market with very small capital outlays. In November 2013, DIBS was prohibited by Bank Negara Malaysia, along with the introduction of more punitive RPGT rates by the Government.
⁸ The Compound Annual Growth Rate (CAGR) is the average annual growth rate over a specified period of time.

considered *seriously unaffordable* in 2014 (house price-to-income ratio of 4.4) according to the “Median Multiple” methodology. In the key states, houses were *severely unaffordable* in Kuala Lumpur and Pulau Pinang, while those in Johor and Selangor were *seriously unaffordable* and *moderately unaffordable*, respectively (Table 1).

The gap between actual house prices and the levels that are considered affordable to the majority of Malaysian households requires comprehensive resolution. In 2014, the median house price prevailing in the market was RM242,000, which was RM76,940 more than what would be an affordable price for a median household⁹. Amongst the key states, the gap was most severe in Kuala Lumpur at RM215,680 (Chart 5). In the major urban employment centres in these key states, the situation is even more acute (Chart 6).

Table 1

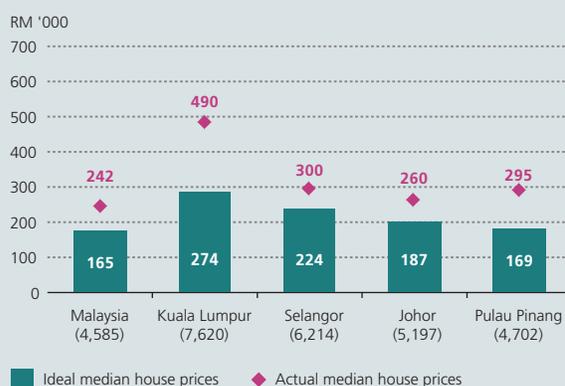
House Prices are Severely Unaffordable in Kuala Lumpur and Pulau Pinang

Location	House Price-to-Income Ratio		Rating	House Price-to-Income Ratio
	2012	2014		
Kuala Lumpur	4.9	5.4	Severely Unaffordable	5.1 & Above
Pulau Pinang	4.1	5.2	Seriously Unaffordable	4.1 to 5.0
Johor	3.7	4.2	Moderately Unaffordable	3.1 to 4.0
Selangor	3.6	4.0	Affordable	3.0 & Below
Malaysia	4.0	4.4		

Source: Department of Statistics, Malaysia *Household Income and Basic Amenities Survey Reports*, National Property Information Centre and 12th Annual Demographia International Housing Affordability Survey 2016

Chart 5

House Prices in Key States are beyond the Reach of Most Malaysians in 2014...



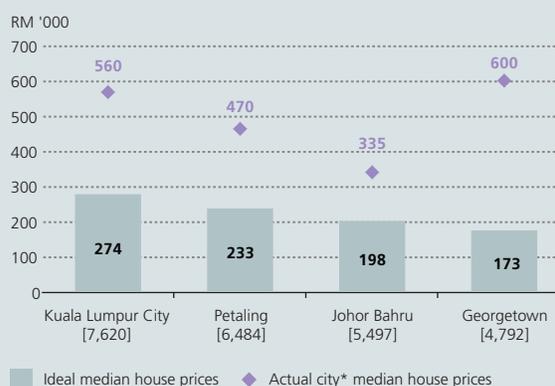
Note: Figures in parentheses () refer to each **state's** median household monthly income in 2014
 Figures in square brackets [] refer to the state's **urban** median household monthly income in 2014, used as a proxy to the median household income in each urban city

*The cities in each state are based upon the delineation of (i) District: Petaling (Shah Alam, Subang Jaya and Petaling Jaya) in Selangor and Johor Bahru in Johor; (ii) Mukim: Kuala Lumpur Town Centre in Kuala Lumpur and Georgetown in Pulau Pinang

Source: Department of Statistics, Malaysia, National Property Information Centre and Bank Negara Malaysia estimates

Chart 6

...and Even More so in the Key Urban Employment Centres

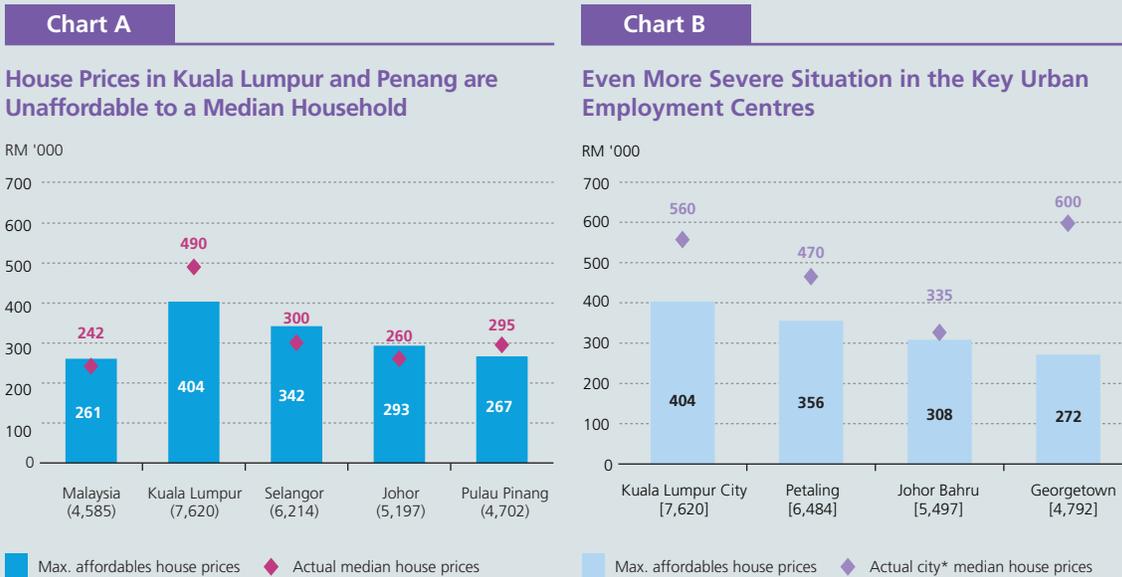


⁹ Houses priced up to a maximum of three times the annual median household income is considered affordable (RM165,060).

Information Box: Housing Loan Affordability

The assessment of housing affordability can alternatively be measured by the households' ability to service mortgage loans using their income. The debt-to-income measure, which has been increasingly adopted by a number of countries with high household debt levels, establishes an upper limit to a household's total loan in relation to its disposable income¹⁰. In this approach, we compare the maximum loan¹¹ amount that a bank can extend to a median household against the actual median house prices. The results concur with our findings using the "Median Multiple" approach.

A median household in Kuala Lumpur and Penang has insufficient capacity to service a mortgage loan based on the median house prices in these areas (Chart A). In the key urban employment centres, that capacity is even less (Chart B).



Note: Figures in parentheses () refer to each state's median household monthly income in 2014. Figures in square brackets [] refer to the state's urban median household monthly income in 2014, used as a proxy to the median household income in each urban city.

* The cities in each state are based upon the delineation of (i) District: Petaling (Shah Alam, Subang Jaya and Petaling Jaya) in Selangor and Johor Bahru in Johor, (ii) Mukim: Kuala Lumpur Town Centre in Kuala Lumpur and Georgetown in Pulau Pinang

Source: Department of Statistics, Malaysia, National Property Information Centre and Bank Negara Malaysia estimates

Moving forward, a substantial increase in the supply of affordable housing is necessary. An estimated 202,571 new houses¹² will be required annually between 2016 and 2020 to match the estimated growth in households during this period, approximately 2.5 times the number of houses built annually

¹⁰ Alfelt, Gustav, *et al.* (2015). There is no general definition of how a debt-to-income limit should be designed and its effects can vary depending on its construction. For example, a debt-to-income limit can be introduced to either target individual households or the banks' lending stock. Furthermore, the definition of debt and income may differ across countries.

¹¹ The loan size is based on 30% housing debt service ratio* (using income net of statutory deductions), 35-year loan tenure, housing loan-to-value ratio of 90% and lending rate of 5%.

¹² The estimate reflects a continuation of historical trends in terms of household formation and the capacity of households to exercise choice in owning a house. Net household growth is thus assumed to continue to expand at its long-term average (between 2005 and 2015) of 2.6% annually between 2016 and 2020.

* Most young buyers tend to be indebted with existing debt obligations (i.e. car loan, outstanding credit card repayments), implying a lesser amount of disposable income that can be allocated for a housing loan.

in the previous five years (Chart 7). The shrinking size of households¹³, combined with continued growth in incomes and population, as well as rapid urbanisation, are expected to remain as important drivers of the overall demand for houses, especially in the major urban areas. Consistent with the underlying demand, especially in the major urban and employment centres, it is crucial to formulate a holistic planning and implementation system to provide sufficient quality housing that is affordable for the low- and middle-income households.

Chart 7

The Supply of New Houses Need to Increase by about 200,000 Units Annually within these Five Years to Match the Estimated Growth in Households



e Estimate
f Forecast

Source: National Property Information Centre, CEIC and Bank Negara Malaysia estimates

Overbuilding in the commercial property market

While the housing market has been confronted with the issue of supply shortage, there are risks of oversupply in the office and retail space market, particularly in the major Malaysian cities.

Office segment

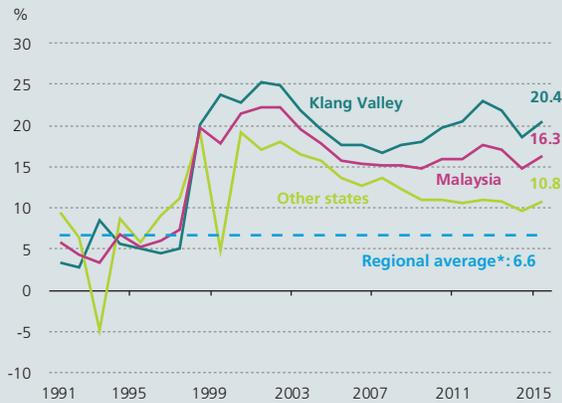
One of the measures of a commercial property's health is the vacancy rate, or how much commercial space is unused, where a higher rate commonly indicates that supply exceeds demand. In 2015, the Klang Valley recorded a vacancy rate of 20.4% for its office space. This stands in stark contrast to the regional average of 6.6% and the national level of 16.3% (Chart 8). In tandem with the high level of vacancy rate in the Klang Valley, monthly rentals of prime office space in Kuala Lumpur is the lowest amongst regional cities, at only USD2.60 per square foot (Chart 9). Despite the low monthly rentals, some recently completed Grade A office buildings in Kuala Lumpur have not achieved satisfactory occupancy rates. Savills Research, in its May 2015 Property Market Overview Report, found that several Grade A office buildings which were completed between 2011 and 2014 have only managed to record occupancy rates of between 50% to 75%.

Over the next few years, the significant incoming supply of large projects could aggravate the oversupply situation in the Klang Valley office segment. According to the 4Q 2015 Quarterly Property Market Report by Jones Lang Wootton, a total of 63 new office buildings are scheduled to be completed in the Klang Valley over the next three years, where an average of 4.9 million square feet of new office space will be added to the market each year. This is significantly higher than the historical average of 2.8 million square feet of new office space added to the market annually between 2001 and 2015 (Chart 10).

¹³ In 1970, there was an average of 5.5 people per household. By 2020, the average is projected to be four people per household. Hence, the number of households will increase at a faster rate compared to population growth. (Source: Khazanah Research Institute, *Making Housing Affordable*, 2015).

Chart 8

Vacancy Rate in Klang Valley is Substantially Higher Compared to National and Regional Averages...

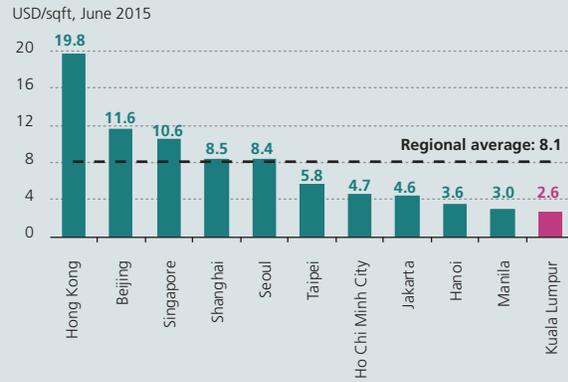


Note: *Regional average refers to simple average for Shanghai, Beijing, Bangkok, Hong Kong and Singapore in 2Q 2015

Source: National Property Information Centre and Colliers International

Chart 9

...and Monthly Rental is the Lowest amongst Regional Cities



Source: Savills Research

Chart 10

Klang Valley Office Supply to Increase Significantly between 2016 and 2018



f Forecast

*New supply in 2016-2018 does not include Tun Razak Exchange, Bukit Bintang City Centre and Bandar Malaysia

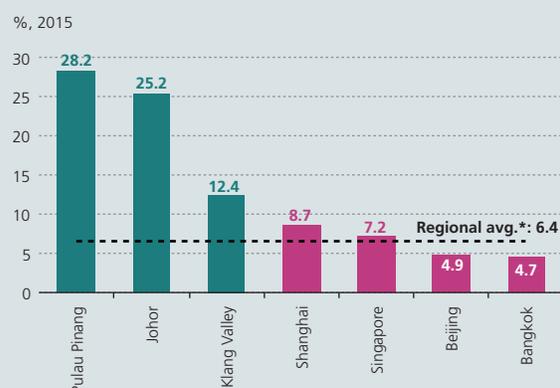
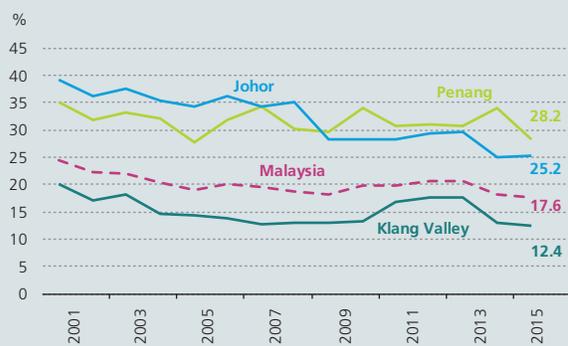
Source: National Property Information Centre, Jones Lang Wootton and Bank Negara Malaysia estimates

Retail segment

Signs of oversupply are also emerging in the retail segment in the major Malaysian urban areas, particularly in Pulau Pinang, Johor and the Klang Valley. Although the vacancy rates in some of these areas have been improving in recent years, the vacancy rates of between 12.4% in the Klang Valley to 28.2% in Pulau Pinang remain relatively higher compared to other regional economies (Chart 11). The high vacancy rate is symptomatic of a mismatch between the demand and supply for shopping malls in Malaysia's major cities. As an illustration, Johor Bahru, Pulau Pinang and the Klang Valley have amongst the lowest household income and population levels compared to other regional cities (Chart 12). However, the prime retail space per capita in these Malaysian cities is notably higher than in the more populous regional cities such as Shanghai and Beijing, and also those with higher incomes, such as Singapore and Hong Kong (Chart 13).

Chart 11

Retail Vacancy Rates Have Moderated in Some Major Urban Areas in Malaysia, but They Remain Relatively Higher than in Other Regional Cities

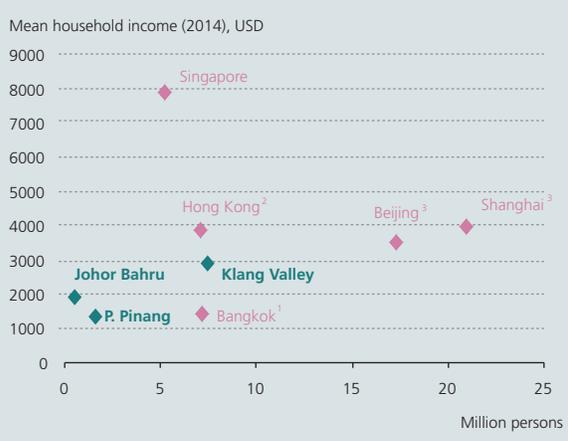


Source: National Property Information Centre

*Regional average refers to 2014 data
Source: National Property Information Centre, Jones Lang LaSalle and Singapore Urban Redevelopment Authority (URA)

Chart 12

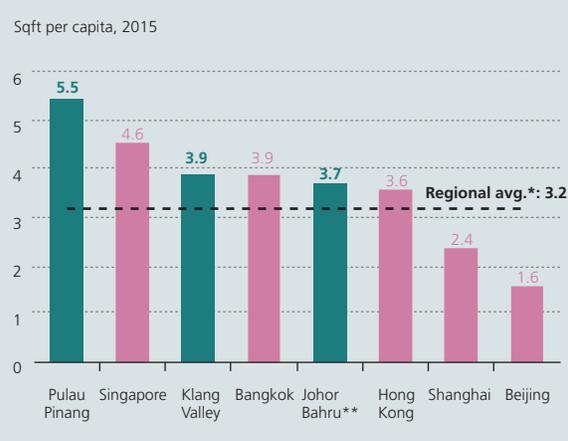
Income and Population Levels of Malaysia's Major Urban Areas Trail that of Most Regional Cities...



Note: ¹ 2013 data
² Median household income for economically active households
³ Disposable income for urban households
Household income data (in local currency) for each city is converted using average exchange rate in 2014 with the exception of Bangkok (2013)
Source: Department of Statistics, Malaysia, Regional Authorities, Haver and Newsflows

Chart 13

...but Prime Retail Space per Capita are amongst the Highest in Asia

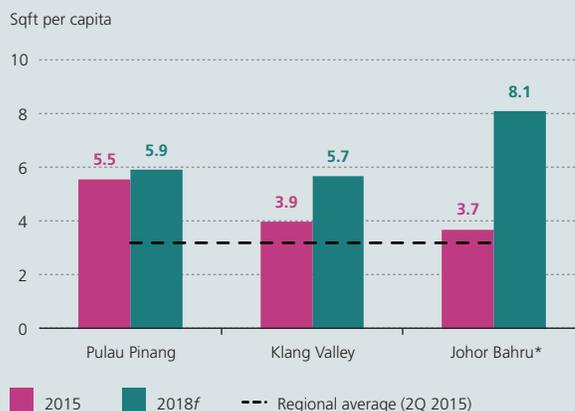


* Refers to simple average for Bangkok, Beijing, Hong Kong, Shanghai and Singapore
** Includes Mukim Bandar Johor Bahru, Plentong and Tebrau
Data for regional cities refer to 2Q 2015
Source: Jones Lang Wootton, Jones Lang LaSalle, Department of Statistics, Malaysia, World Atlas and Bank Negara Malaysia estimates

Data sourced from the National Property Information Centre (NAPIC) shows that there are currently 55 shopping malls under construction in Malaysia, with 35 of these in the Klang Valley, Pulau Pinang and Johor. In 2016 to 2018, an additional 30.9 million square feet of retail space will be completed in these locations, equivalent to about 40% of existing retail space. By 2018, prime retail space per capita in the Klang Valley and Johor Bahru is projected to increase by about 43% and 119% respectively from their already relatively high levels (Chart 14). The emergence of more new shopping malls is likely to increase competition for tenants, resulting in higher vacancy rates, lower rentals and increased risk of dilapidation.

Chart 14

Prime Retail Space per Capita to Increase Further by 2018



Note: Population in Pulau Pinang, Klang Valley and Johor Bahru for 2018 is extrapolated using the average population growth in Malaysia between 2011 and 2015

^f Forecast

* Includes Mukim Bandar Johor Bahru, Plentong and Tebrau

Source: Jones Lang Wootton, Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Oversupply of commercial space may have potential spillover impact on other sectors in the economy

The currently challenging economic conditions could pose additional risks to the demand for commercial space. In the office segment, a prolonged period of low global oil prices would dampen the demand for office space of the oil and gas sector. In the Klang Valley, the oil and gas sector is the largest private sector office-occupier, filling up about 16% of total office space (Jones Lang Wootton, 2015). In the retail segment, the ability of retailers to attract footfall and consumer spending could become more challenging amid weaker consumer sentiments.

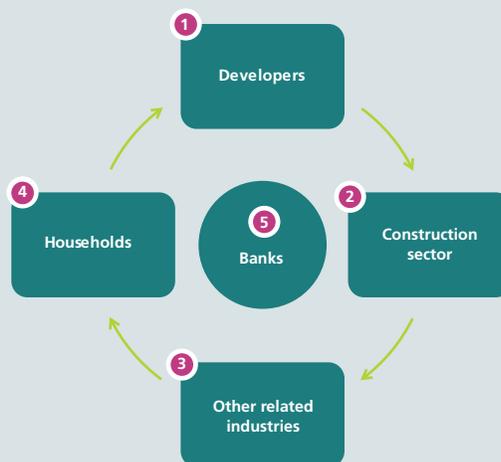
The implications of a significant rise in vacancy rates could extend beyond the commercial property sector, with likely spillovers to other sectors of the economy (Chart 15). A sharp increase in vacancy rates may result in tighter cash-flow conditions amongst developers, which are typically owners of commercial properties. This could have adverse consequences for other sub-sectors within the construction sector and other related industries¹⁴. Further weakness in these related sectors could potentially affect employment prospects, impacting the ability of some households to service their loans.

In several countries, the disorderly unravelling of commercial property booms had resulted in considerable bank loan losses. In the early 1990s, Sweden, Finland, Norway and Japan experienced an abrupt and severe unwinding of commercial property booms. This had resulted in severe spillovers on other economic sectors in these economies, leading to a decline in economic activity. During the 2008/09 Global Financial Crisis, commercial property was also a major driver of loan losses in Australia, France, Ireland and New Zealand, despite generally accounting for a much smaller share of banks' loan books compared to residential property. This was attributable to a sharper pace of contraction in commercial property prices compared to house prices (Matua, 2015).

¹⁴ These include production-related construction materials and construction-related services.

Chart 15

Impact of Commercial Space Oversupply may Spill Over to Other Sectors



Policy experiences in other countries

The demand and supply imbalances in both the housing and commercial property markets are not unique to Malaysia. Many other countries have been confronted with similar issues. Their experiences provide valuable lessons in managing the dynamics of demand and supply in the property sector.

Housing market

In Korea and Singapore, the establishment of a single entity focussed on affordable housing matters resulted in an alleviation of the mismatch between housing demand and supply. The entities in these countries, the Land and Housing Corporation in Korea, as well as the Housing and Development Board (HDB) in Singapore, are responsible for spearheading, centralising and coordinating national and state initiatives related to affordable housing. The consolidation of the various affordable housing entities under one agency had not only allowed for more effective resource planning in these countries, but had also lowered development costs through economies of scale.

Singapore had also successfully reduced its overall construction costs with an extensive adoption of the Industrialised Building Systems (IBS)¹⁵ in its public housing projects. The use of IBS in about 80% of all the HDB buildings had resulted in labour cost savings of more than 45% compared to conventional methods¹⁶. The construction period of HDB buildings had also been significantly reduced, with improvement in the quality of buildings given lower labour intensity and construction standardisation.

In other countries, the rental market is generally accorded equal priority in national housing policies, serving as an important alternative to homeownership. This is evident particularly in countries with unaffordable house price levels¹⁷ (Chart 16). In Switzerland, Germany and Australia, the vibrant private rental markets have contributed towards ensuring sufficient supply of houses to meet the needs of households with diverse income levels and preferences, as well as the shifting demographics. With changing social preferences in a highly globalised world, renting offers households the flexibility and mobility to move for career and education opportunities.

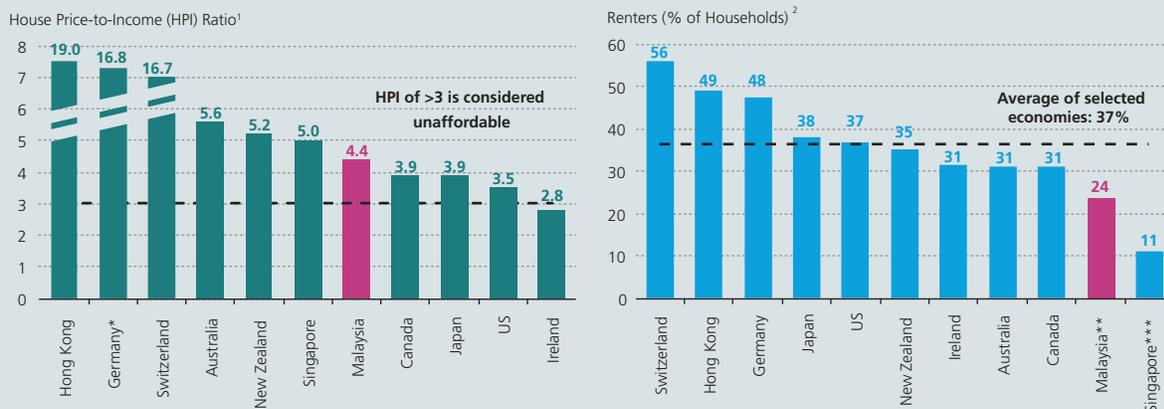
¹⁵ IBS is a construction process that utilises techniques, products, components or building systems that involve prefabricated components and on-site installation.

¹⁶ Thanoon, Waleed., *et al.* (2003).

¹⁷ House price-to-income ratio of more than 3.0.

Chart 16

Countries with Unaffordable House Prices Generally Have a Strong Focus on the Rental Market



Note:

¹ Data as at 3Q 2015, with the exception of Switzerland (2012) and Germany (2013)

² 2014 data, with the exception of Canada (2011), Japan, New Zealand, Singapore and Switzerland (2013)

* Median house price in Germany refers to the median price of single-family houses in Frankfurt, with a built-up of 150 square metres

** For Malaysia, the figure includes households living in quarters

***The high homeownership rate in Singapore reflects the dominance of public housing. About 80% of its population lives in Housing Development Board (HDB) units, where 95% are owner occupiers (Phang, 2010)

Source: 12th Annual Demographia International Housing Affordability Survey 2016, National Property Information Centre, Department of Statistics, Malaysia, National Authorities, Global Property Guide and Trading Economics

Commercial property market

Timely and prudent measures could be undertaken to promote the sustainable development of the commercial property sector. The implementation of large projects could be staggered, in tandem with the prevailing and future demand for office and retail space.

In addition, the experience in lower Manhattan in New York City has highlighted the benefits of converting old commercial buildings to facilitate a better utilisation of land within the city centre. Between 1995 and 2014, more than 17 million square feet of old commercial buildings were converted into a multitude of other uses, including rental residential units, hotels and restaurants¹⁸. While the initial momentum of the conversion was underpinned by the city's financial incentive programmes¹⁹, conversions continued vigorously despite the expiration of the incentives in 2006. These programmes had not only helped to revitalise the city, but also supported the emergence of a residential community within the area. The local authority had also geared its efforts towards reducing the vacancy rates of its office space by providing incentive programmes for businesses to relocate to lower Manhattan²⁰. Reflecting the success of these incentives, the occupancy rates of office space had improved, with a more diverse tenant base, transitioning from its traditional pool of financial, insurance and real estate companies towards those in the media, technology, non-profit and education sectors (CBRE, 2014). Commercial to residential property conversions were also successfully implemented in some areas in London, Toronto, Tokyo and Sydney. In these areas, the rising demand for environmentally-friendly buildings, urban policy, office obsolescence and a tight housing market were the most important drivers of the conversion exercises (Remøy and Wilkinson, 2015).

¹⁸ CBRE Global Research and Consulting (2014).

¹⁹ The redevelopments were initially aided by financial incentive programmes. The 421G programme, which was introduced in 1995, provided tax incentives to encourage developers to convert office buildings constructed before 1975 into residential properties. While some of these residential projects were targeted to the affluent community, the Lower Manhattan Development Corporation had also allocated over USD50 million to develop affordable housing in the area. This programme was stopped in 2006, as it had effectively revitalised lower Manhattan (Mechanic, 2012).

²⁰ These programmes include the Commercial Rent Tax Special Reduction, the Lower Manhattan Relocation Employment Assistance Programme (LM-REAP) and the Lower Manhattan Energy Programme (LMEP).

Conclusion

Malaysia is experiencing an undersupply of affordable houses particularly in the major urban areas, but an oversupply of office and retail space in several major cities and towns. Both of these trends, if left unchecked, may lead to deeper imbalances in the property market, with negative spillovers to other parts of the economy. A comprehensive and carefully-designed national planning policy is needed for the property market and will help to support the Government's aim of delivering more housing, whilst also managing the oversupply of commercial properties. The conversion and repurposing of underutilised surplus commercial space should be a part of that overall strategy, with the cost being borne by property owners rather than taxpayers.

In the housing market, ensuring that the low- and middle-income households have access to quality affordable housing involves not only commitment from the Government, but also the support of the private sector. The experiences of other countries illustrate that constructing more public housing forms only a part of the solution. There is a need for the consolidation of multiple providers of affordable housing across the state and national levels and an equal focus on the rental market. In addition, macroprudential and fiscal measures that are in place, such as the loan-to-value (LTV) measures, Responsible Lending Guideline, higher real property gains taxes (RPGT) and the prohibition of Developer Interest-Bearing Scheme (DIBS), remain instrumental towards maintaining the long-term sustainability of the property market and mitigating potential risks to financial stability.

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fixed assets by both the public corporations and the Federal Government. As a result, public investment improved during the year, but remained in contraction (-1.0%; 2014: -4.7%). The bulk of development expenditure by the Federal Government was channelled into the economic sectors to enhance the productive capacity and competitiveness of the economy. Of significance, the key projects revolved around developing transportation infrastructure (such as construction and upgrading of roads and railways) and upgrading of facilities to spur trade and industry, particularly in the regional economic corridors. Capital spending in the social services sector was also prioritised to enhance and improve essential services, including better education and housing services. Despite the challenging environment, public corporations continued to undertake capital spending to expand and diversify their business activities, particularly in the oil and gas, transportation and utilities sub-sectors, thus providing support to the overall economy.

EXTERNAL SECTOR

In 2015, Malaysia's external sector remained resilient despite the environment of greater uncertainty in the global economy. The current account surplus narrowed amid larger deficits in the services and secondary income accounts, but was supported by a still sizeable trade surplus. The level of international reserves remained sufficient to meet short-term external obligations, thus providing ample buffers against external vulnerabilities.

Amidst a challenging global environment, Malaysia's external position remained resilient in 2015

Broadly, the external trade exhibited diverging trends between the first half and the second half of 2015. In the first half of the year, further declines in commodity prices and sluggish demand for commodities and commodity-related manufactured products resulted in a contraction of 3.1% in Malaysia's gross exports. In particular, LNG demand from Japan was weak due to warmer-than-average weather, while rubber demand from China was affected by the slowdown in domestic consumption.

Table 1.6

Balance of Payments¹

Item (Net)	2013	2014	2015 ^p
	RM billion		
Goods	96.6	113.4	108.9
Services	-9.6	-11.2	-20.5
Primary Income	-34.0	-37.3	-32.2
Secondary Income	-17.5	-17.6	-22.2
Current account balance	35.5	47.3	34.0
<i>% of GNI</i>	3.6	4.4	3.0
Capital account	0.0	0.3	-1.2
Financial account	-20.2	-81.6	-53.3
Direct investment	-6.3	-18.5	0.2
Portfolio investment	-3.0	-38.5	-28.2
Financial derivatives	-0.3	-1.0	-0.5
Other investment	-10.7	-23.6	-24.9
Errors and omissions (E&O) ²	-0.6	-2.5	24.1
<i>% of total trade</i>	0.0	-0.2	1.6
<i>of which:</i>			
Foreign exchange revaluation gain (+) or loss (-)	18.6	7.6	57.3
Overall balance	14.6	-36.5	3.7
Bank Negara Malaysia international reserves, net	441.9	405.3	409.1
USD billion equivalent	134.9	115.9	95.3

¹ The data is compiled in accordance with the Sixth Edition of Balance of Payments and International Investment Position Manual (BPM6) by the International Monetary Fund (IMF)

² Includes unrealised foreign exchange revaluation gains/losses on international reserves

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Slower regional growth also contributed to lower exports of petroleum products. Given the diversity of Malaysia's exports, the weak export performance of commodities was partially mitigated by higher exports of E&E and non-resource based manufactured products. Of significance, E&E demand from the US and EU was strong, mainly for semiconductors for green technology and data processing equipments. Exports of semiconductors were partially lifted by the acceleration of solar-related demand in the US as the solar tax incentive was initially set to expire in late 2016. Continued demand for machinery, appliances and parts, manufacture of metal as well as iron and steel products, from both advanced and regional countries also contributed positively to overall export performance.

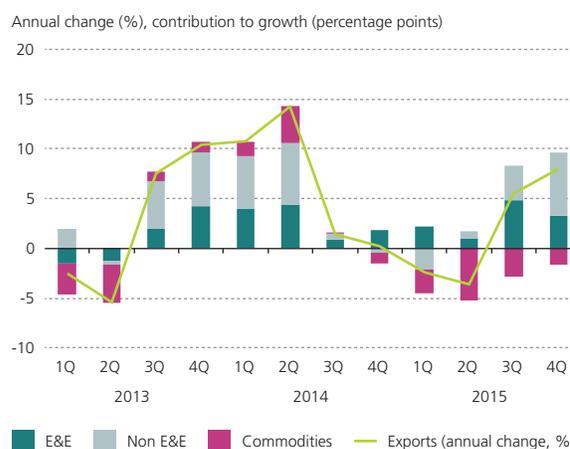
Gross imports also declined in the first half of the year (1H 2015: -2.6%). Imports of intermediate goods, which accounted for 58.2%

of gross imports, were weighed down mainly by the sharp decline in fuel-related inputs following lower demand for resource-based manufactured exports. Imports of capital goods, particularly machinery and equipment, were lower in tandem with the more moderate pace of investment activity in the Malaysian economy. Consumption imports, however, registered strong growth due largely to inelastic demand for imported food and beverages, and consumer goods such as medicines, cosmetic and personal care, as well as clothing and textiles.

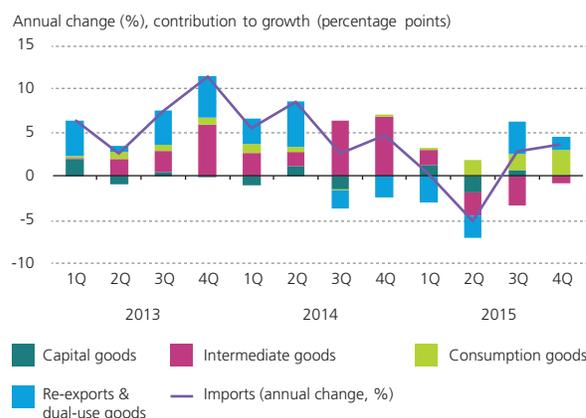
In the second half of the year, export growth rebounded to 6.8%, due to higher demand for manufactured products and commodities, and the positive valuation effect from the ringgit depreciation. The strong growth of E&E exports was primarily supported by higher demand from the US and Singapore for semiconductor devices and electrical machinery, in line with the launch of a series of new electronic products. The continued growth of the regional economies and strong re-export activity supported the performance of non-E&E manufactured exports and commodities such as petroleum products, timber and timber-related products, palm oil and palm-related products, as well as rubber and rubber products. Despite an improvement in demand, commodity exports continued to decline due to falling prices. While the advanced economies remained an important

export destination for Malaysia, exports to ASEAN economies, which accounted for about one-third of Malaysia's total exports, provided further resilience against weak global demand.

Import growth was also relatively higher in the second half of the year (2H 2015: 3.2%), supported by higher imports of capital goods, particularly electrical machinery, telecommunication equipment, and rail coaches. Consumption imports remained strong, particularly for food and beverages, garments and footwear. Imports for re-export, particularly metal products, also picked up during this period. Intermediate imports, however, were affected by lower imports of industrial supplies, particularly nickel, copper and stainless steel, as manufacturers drew down their inventories of these inputs.

Chart 1.4
Export Performance


Source: Department of Statistics, Malaysia

Chart 1.5
Import Performance


Source: Department of Statistics, Malaysia

Table 1.7
External Trade

	Share 2015 (%)	2013	2014	2015 ^p
		Annual change (%)		
Gross exports	100.0	2.5	6.3	1.9
Manufactures	80.2	5.1	7.1	6.5
<i>Electronics and electrical (E&E)</i>	35.6	2.5	8.1	8.5
<i>Non-E&E</i>	44.6	7.1	6.4	5.0
Commodities	19.2	-4.6	3.9	-13.4
<i>Minerals</i>	10.6	3.7	6.2	-20.6
<i>Agriculture</i>	8.6	-14.4	0.5	-2.7
Gross imports	100.0	6.9	5.3	0.4
Intermediate goods	58.2	4.3	7.6	-2.3
Capital goods	14.0	2.2	-2.4	0.0
Consumption goods	9.1	8.8	5.7	24.1
Trade balance (RM billion)	-	71.3	82.5	94.6

^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

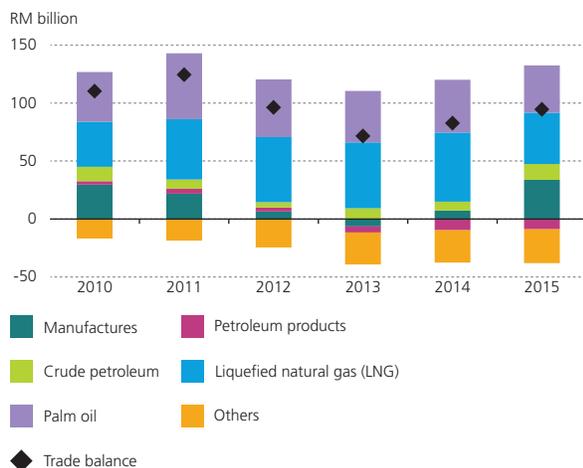
For the year 2015, growth of exports and imports moderated to 1.9% and 0.4%, respectively (2014: 6.3% and 5.3%, respectively). As the slowdown in imports outpaced the moderation in exports, the trade surplus was higher at RM94.6 billion (2014: RM82.5 billion). The sizeable trade surplus emanated from both manufactured and commodity products. Commodities continued to contribute to the trade surplus, as lower commodity exports were also accompanied by a decline in commodity-related imports, while exports of CPO and LNG have minimal corresponding imports.

The services account registered a larger deficit due mainly to lower net receipts from the travel account and higher net payments for other imported services for trade and investment-related activity. Tourism receipts fell in 2015 as tourist arrivals into Malaysia were lower, while there was an increase in outbound travel. During the year, there was a larger deficit in the secondary income account due to larger outward remittances by foreign workers. The deficit in the primary income account narrowed as the decline in payments accrued to foreign direct investors in Malaysia had more than offset the decline in income receipts accrued to Malaysian companies investing abroad.

With the trade surplus exceeding the deficits in the services and income accounts, the current account balance remained in surplus, although the amount was smaller at RM34.0 billion or 3.0% of GNI (2014: RM47.3 billion, 4.4% of GNI). This was reflected in the narrower

Chart 1.6

Trade Balance by Commodities



Source: Department of Statistics, Malaysia

savings-investment (S-I) surplus during the year. Gross national savings (GNS) grew by 0.1% (2014: 8.1%) to 28.8% of GNI (2014: 30.3%), while total gross capital formation expanded at a faster pace of 4.9% (2014: 4.7%). The slower growth in GNS was attributable to both a bigger decline in public savings (-28.7%; 2014: -5.9%) and a more moderate growth in private sector savings (11.2%: 2014: 14.7%). This was due mainly to the lower operating surplus of companies in the commodity-related sectors. On the other hand, public gross capital formation turned around to register a positive growth of 1.9% during the year (2014: -3.2%). Together with the decline in public sector savings, this resulted in a widening of the public S-I deficit to -RM39.7 billion (2014: -RM13.1 billion). Private gross capital formation, however, expanded at a slower pace of 7.5% (2014: 10.1%) arising from

Chart 1.7

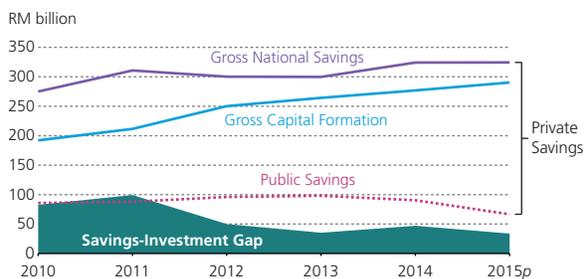
Current Account Balance



Source: Department of Statistics, Malaysia

Chart 1.8

Gross National Savings and Savings-Investment Gap



p Preliminary

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

ASEAN has Provided Positive Support to Malaysia's Trade, Despite Weak Global Demand
Steady increase in exports to ASEAN over the past decade..
..driven by stronger expansion into emerging ASEAN markets..

Chart 1

Malaysia's Exports by Trading Partners

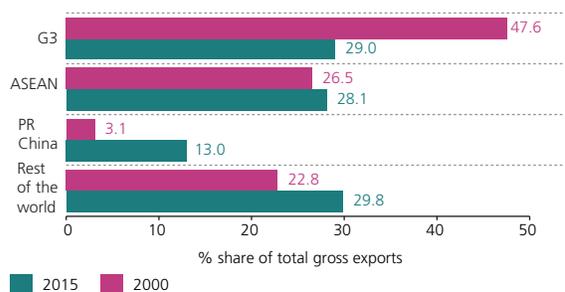
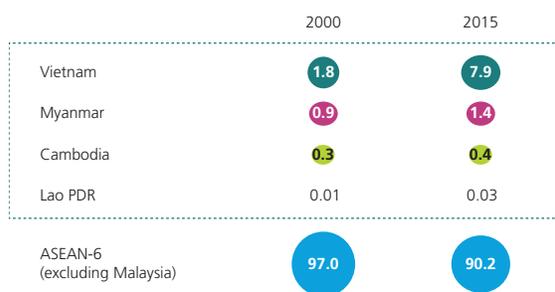


Chart 2

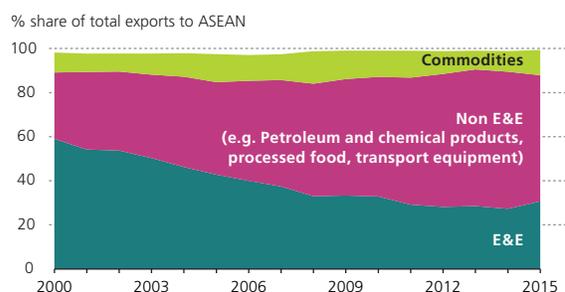
% Share of Total Exports to ASEAN



..and diversification into higher value-added products, and increasingly for final regional demand

Chart 3

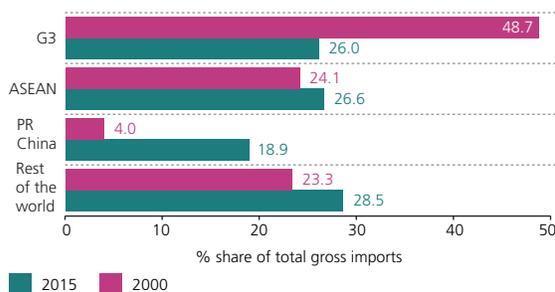
Malaysia's Exports to ASEAN by Products



Malaysia's imports from ASEAN were also higher in the recent period..

Chart 4

Malaysia's Imports by Trading Partners



..and increasingly catered to Malaysia's final demand

Chart 5

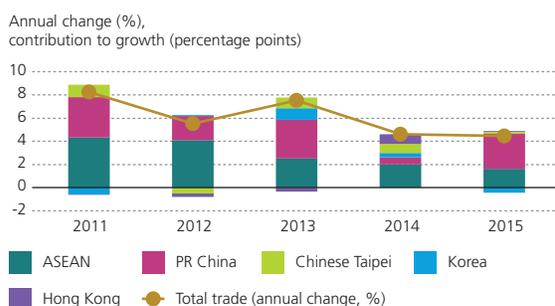
Malaysia's Imports from ASEAN by Type of Goods



Continued positive support from ASEAN despite weak global demand following the 2008 crisis

Chart 6

Malaysia's Total Trade with Selected Asian Trading Partners



Note: G3 refers to the United States, Euro and Japan
 ASEAN-6 refers to Brunei Darussalam, Indonesia, Malaysia, Philippines, Thailand and Singapore

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

the moderation in domestic demand and the more cautious business sentiments. As private savings increased at a faster pace than capital formation, the private sector S-I gap registered a larger surplus of RM73.7 billion in 2015 (2014: RM60.4 billion).

Significant two-way capital flows

Against the backdrop of continued uncertainty in global financial markets, the external sector experienced significant two-way cross-border capital flows for most of 2015. There were significant outflows of foreign portfolio funds during the year. Conversely, Malaysia continued to receive a steady inflow of foreign direct investments. Malaysian companies and resident investors also continued to expand their international presence and acquire portfolio assets abroad, albeit at a slower pace. The other investments account recorded a higher net outflow due mainly to higher outflows by the private sector. Overall, the financial account recorded a net outflow of RM53.3 billion (2014: net outflows of RM81.6 billion).

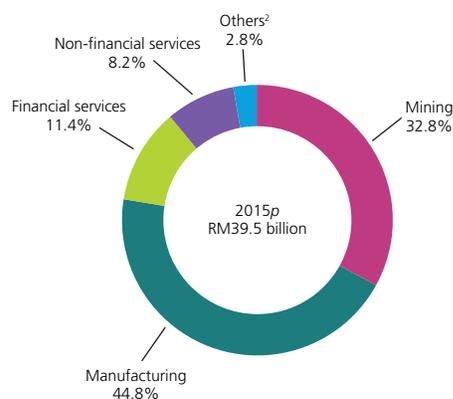
Despite greater headwinds to the global economy, Malaysia remained a competitive destination for foreign entities and multinational corporations to invest in and expand their productive capacity. On the liabilities side, **inward direct investment** registered a net inflow of RM37.6 billion, equivalent to 3.3% of GNI (2014: net inflow of RM34.6 billion, or 3.3% of GNI). A large proportion of the inflow

reflected foreign direct investment (FDI) which amounted to RM39.5 billion, mainly in the form of equity capital injections and drawdown of intercompany loans, while earnings retained for the purpose of reinvestments were sustained. The bulk of the FDI inflows went into the manufacturing sector, primarily in the E&E industries and for the acquisition of assets in the petrochemical-related industries. Despite lower crude oil prices, FDI into the mining sector remained sizeable, reflecting mainly the injection of working capital to support on-going upstream exploration and extraction activities in oil and gas fields located offshore from Sabah and Sarawak. The remainder of FDI comprised mainly investment in the services sector, particularly in the finance and insurance and information and communication sub-sectors. In terms of source countries, these FDI flows originated mostly from the advanced economies, particularly Japan, the United States and Singapore.

On the assets side, **outward direct investment** registered a lower net outflow of RM37.4 billion, or 3.3% of GNI (2014: net outflow of RM53.1 billion or 5.0% of GNI). The lower outflows primarily reflected a moderation in direct investment abroad (DIA) by Malaysian companies which amounted to RM39.3 billion during the year. The moderation in DIA was attributed mainly to lower injections of equity capital amid continued extension of inter-company loans to

Chart 1.9

Net Foreign Direct Investment by Sectors¹



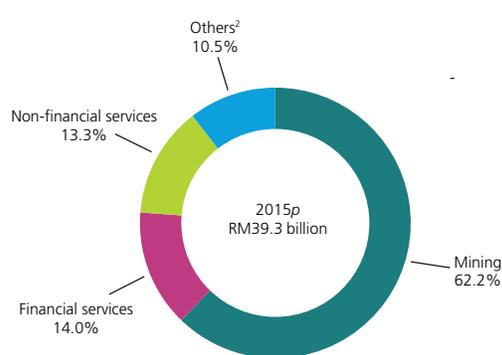
¹ Foreign direct investment as defined according to the 5th Edition of the Balance of Payments Manual (BPM5) by the International Monetary Fund (IMF)

² Refers to agriculture and construction sectors
p Preliminary

Source: Department of Statistics, Malaysia

Chart 1.10

Net Direct Investment Abroad by Sectors¹



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

² Refers to agriculture, construction and manufacturing sectors
p Preliminary

Source: Department of Statistics, Malaysia

Malaysia-ASEAN Investment Flows Continue

FDI flows from ASEAN accounted for about a quarter of total FDI inflows into Malaysia

Chart 1

Foreign Direct Investment¹ in Malaysia



Malaysia's DIA flows to ASEAN has been moderating in recent years

Chart 2

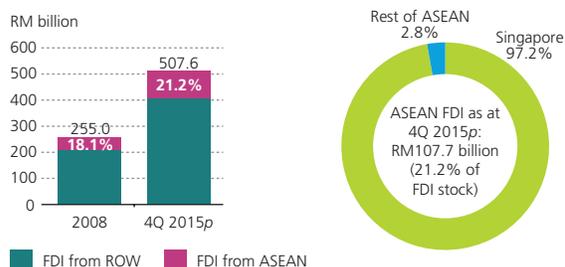
Direct Investment Abroad² by Malaysian Companies



FDI from ASEAN is mostly undertaken by subsidiaries of MNCs located in Singapore

Chart 3

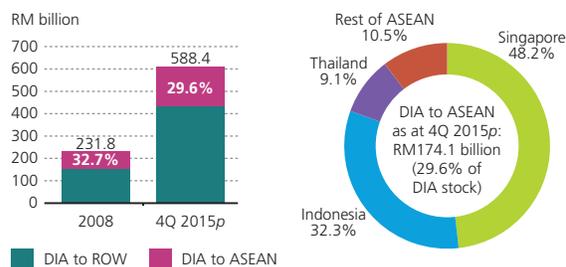
ASEAN Direct Investment Position in Malaysia by Country



DIA to ASEAN is more diversified, mainly to Singapore, Indonesia and Thailand

Chart 4

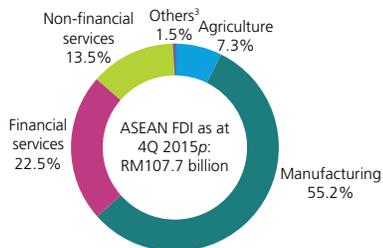
Malaysia's Direct Investment Position in ASEAN by Country



FDI from ASEAN is channeled mainly into manufacturing and financial services

Chart 5

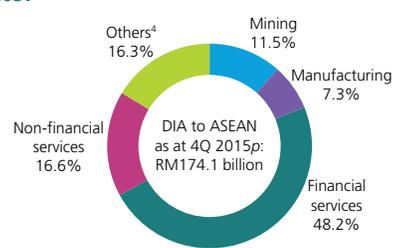
ASEAN Direct Investment Position in Malaysia by Sector¹



Bulk of DIA to ASEAN is in the services sector, particularly financial services

Chart 6

Malaysia's Direct Investment Position in ASEAN by Sector²



Note: ROW refers to rest of the world

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

² Direct Investment Abroad as defined according to the 5th Edition of the Balance of Payments Manual (BPM5) by the International Monetary Fund (IMF)

³ Refers to construction and mining sectors

⁴ Refers to agriculture and construction sectors

p Preliminary

Source: Department of Statistics, Malaysia

subsidiaries abroad. The bulk of DIA continued to be channelled into the mining sector. These investments reflected mainly the extension of long-term loans by the national oil company to an affiliated company to facilitate the strategic acquisition of oil and gas-related assets in Western Asia, along with continued investments in production activities in Central Asia. DIA in the services sector was also sizeable, particularly for the continued expansion of finance and insurance and information and communication operations in the Asian region.

Short-term capital flow movements continued to be adversely impacted by the global financial markets conditions, which had been volatile since the third quarter of 2014. For **non-resident portfolio investments**, there was a significant degree of volatility throughout the year, as uncertainties over the timing and pace of monetary policy normalisation in the US led to a significant rebalancing of exposures by international investors, resulting in broad-based outflows from emerging market economies, including Malaysia. A significant amount of the volatility was also related to the building-up and unwinding of speculative positions in the domestic and off-shore markets. Declining commodity prices and slower growth in EMEs also proved to be a trigger for outflows. Global risk aversion was further exacerbated by periodic bouts of intense volatility, triggered by concerns over the Greek debt crisis in July and the overreaction towards PR China's stock market correction in August. As a consequence of these developments, non-resident investors pared down their holdings of Malaysian

portfolio assets, resulting in net outflows amounting to RM29.1 billion during the first three quarters of the year.

During the period, the liquidation of equities by non-residents resulted in a decline in foreign participation to a 23.0% share of total equity market capitalisation in September 2015. There was a small net inflow into debt securities in the first half of the year, as the redemption of Bank Negara Monetary Notes (BNMNs) upon maturity were mostly offset by purchases of Malaysian Government Securities (MGS) and the issuances of offshore debt securities by a public corporation in the oil and gas sector as well as the issuance of the 10-year and 30-year sukuk by the Malaysian Government. In the third quarter, however, debt securities recorded a large outflow, attributed mainly to the maturing of some MGS and several foreign currency denominated corporate bonds issued by the public corporations. As a result, non-resident holdings fell to 21.5% of total outstanding public debt securities in September 2015. However, investor sentiment improved slightly towards the end of the year, as the Fed's decision to raise interest rates removed some uncertainty from the global financial markets. As such, there was a net inflow of portfolio funds in the fourth quarter, mainly into purchases of MGS. For the year as a whole, portfolio investments by non-residents registered a net outflow of RM19.0 billion (2014: net outflow of RM10.4 billion). As at end-2015, foreign participation in the equity market stood at 22.3%, while non-resident holdings of overall public debt instruments stood at 22.1% (end-2014: 24.1% and 23.0% respectively).

Chart 1.11

Portfolio Investments



^p Preliminary

Source: Department of Statistics, Malaysia

Net outflows of **portfolio investment by residents** moderated to RM9.2 billion during the year (2014: net outflow of RM28.1 billion). These investments mostly represented the diversification strategy of domestic institutional investors, fund managers and financial institutions to acquire financial assets abroad in order to enhance returns and provide a steady dividend stream to their members and shareholders. At the same time, there were also some redemptions of offshore foreign currency debt securities holdings by the domestic financial institutions and corporates, particularly in the second half of the year. Collectively, resident and non-resident portfolio investment recorded a net outflow of RM28.2 billion in 2015 (2014: net outflow of RM38.5 billion).

The **other investment** account registered higher net outflows of RM24.9 billion for the year as a

whole (2014: net outflows of RM23.6 billion), due mainly to net outflows in the banking and non-bank private sector (2015: RM23.0 billion; 2014: RM21.6 billion net outflows). In the banking sector, the net outflows were caused mainly by Malaysian banks extending loans to foreign financial institutions abroad. At the same time, maturing deposits of non-resident financial institutions with the domestic banking system, more than offset the amount of maturing deposits held by Malaysian banks with foreign financial institutions abroad. These interbank transactions, which varied in both magnitude and direction every quarter, underscored the strategies of individual banking institutions in managing their own foreign exchange liquidity exposures. It also reflects the growing regional presence of domestic banks. Net outflows recorded by the non-bank private sector moderated, reflecting mainly the lower net extension of trade credits by Malaysian exporters to their trading partners in line with the slower growth in exports. The public sector recorded net outflows of RM1.9 billion (2014: net outflows of RM2 billion) as the repayment of external borrowings had more than offset the drawdown of new loans, particularly by the public corporations.

In 2015, the overall balance of payments registered a surplus of RM3.7 billion (2014: deficit of RM36.5 billion). Errors and Omissions (E&O) amounted to +RM24.1 billion or +1.6% of total trade, mostly reflecting foreign exchange revaluation gains on international reserves. Excluding revaluation gains, the E&O stood at -RM33.2 billion or -2.3% of total trade.

The international reserves of Bank Negara Malaysia amounted to RM409.1 billion (equivalent to USD95.3 billion) as at end-2015 compared to RM405.3 billion (equivalent to USD115.9 billion) as at end-2014. On account of the quarterly adjustment for foreign exchange revaluation changes, the reserves level in ringgit terms had increased due to the weakening of ringgit against most currencies, especially during the first three quarters of 2015. However, underscoring the diversified composition of foreign currency reserve assets, the reserves level in USD terms had correspondingly declined, amid the strengthening of USD against most other currencies during the same period. In general, the lower international reserves in USD terms reflect the relatively higher outflows of non-resident portfolio investment and continued, albeit lower, resident direct investment

and portfolio investment abroad in 2015. These outflows have more than offset the current account surplus and sustained inflows of foreign direct investment during the year.

The progressive liberalisation of foreign exchange administration rules over the years has promoted greater two-way capital flows and has contributed to the deepening of the domestic financial markets. This has also resulted in a greater decentralisation of international reserves, as reflected in the increasing acquisition of assets abroad by Malaysian entities. As at 31 December 2015, the international reserves accounted for about 25% of Malaysia's total external assets, with the remaining 75% owned by banks and corporations. The availability of external assets enables these entities to meet their external debt obligations without creating a claim on the international reserves. The wide range of monetary policy instruments, and the exchange rate flexibility, has also enabled the economy to reduce its reliance on the Bank's international reserves in managing external pressures.

As at 29 February 2016, the reserves were at RM410.5 billion (equivalent to USD95.6 billion). The international reserves remain ample to facilitate international transactions and are sufficient to finance 8.3 months of retained imports and are 1.2 times the short-term external debt.

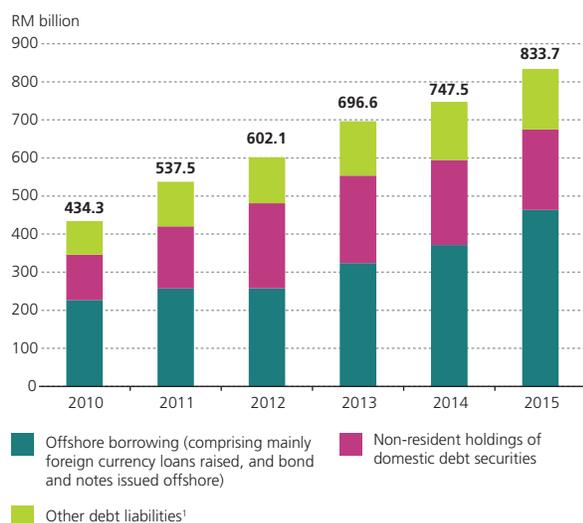
Manageable external debt

Malaysia's external debt stood at RM833.7 billion, equivalent to USD192.2 billion or 72.1% of GDP as at end-2015 (end-2014: RM747.5 billion, equivalent to USD211.8 billion or 67.5% of GDP). The external debt profile remains healthy as more than half was of medium- to long-term tenure (57.8%). By currency, about 36% of the external debt is denominated in ringgit, mainly in the form of non-resident holdings of domestic debt securities and deposits.

As at end-2015, offshore borrowing remained low, accounting for about half of the total external debt and only 40.1% of GDP (Asian Financial Crisis (AFC): 60.0% of GDP). The composition of the offshore borrowing has also changed. While non-bank private corporations were the main borrower during the AFC, their share has declined in recent years as more have sought financing from the more developed domestic financial markets. A large share of offshore borrowing

Chart 1.12

Outstanding External Debt (end-period)



¹Includes non-resident deposits, trade credits, IMF allocation of SDRs and miscellaneous.

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

is now accounted for by banks arising from their greater regionalisation, whereby offshore subsidiaries and branches of domestic banks increasingly placed funds with their head offices in Malaysia under centralised foreign currency liquidity management operations.

Offshore borrowing, denominated largely in foreign currency, remained manageable. In particular, banks and corporations accounted for about 75% of Malaysia's external financial assets² as at end-2015, which are available to meet their external obligations. Their external exposure is also generally hedged, either naturally through foreign currency earnings, or through the use of financial instruments. Furthermore, the offshore borrowing is used mainly to finance the expansion of productive capacity and for better management of financial resources within corporate groups. In the case of intercompany loans, these borrowings are generally on concessionary terms with flexible repayment schedule.

External debt increased by 11.5% in 2015, attributed mainly to the valuation effects from the depreciation of the ringgit against most currencies during the first three quarters of the year. The ringgit depreciation affected mainly offshore borrowing, which increased by RM92.6 billion or 24.9% to RM463.6 billion

² Malaysia's international investment position.

Table 1.8

Outstanding External Debt

	2014	2015
	RM billion	
Offshore borrowing ¹	371.1	463.6
<i>USD billion equivalent</i>	105.2	106.9
<i>Medium- and long-term</i>	211.4	285.9
Public sector	93.1	128.3
Private sector	118.3	157.6
<i>Short-term</i>	159.7	177.7
NR holdings of dom. debt securities	223.3	211.3
<i>Medium- and long-term</i>	162.4	184.1
<i>Short-term</i>	60.9	27.2
NR deposits	87.7	81.6
Others ²	65.5	77.2
<i>Medium- and long-term</i>	10.5	11.9
<i>Short-term</i>	55.0	65.3
Total external debt	747.5	833.7
<i>USD billion equivalent</i>	211.8	192.2
External Debt (Redefined)		
Total debt/GDP (%)	67.5	72.1
Short-term debt ³ /Total debt (%)	48.6	42.2
Reserves/Short-term debt ³ (times)	1.1	1.2 ⁵
Debt service ratio (% of exports of goods and services)	19.1	22.6
External Debt (Previous definition)		
Total debt/GDP (%)	33.5	40.1
Short-term debt ⁴ /Total debt (%)	43.0	38.3
Reserves/Short-term debt ⁴ (times)	2.5	2.3 ⁵
Debt service ratio (% of exports of goods and services)	11.3	15.6

¹ Equivalent to the external debt as previously defined, comprised mainly foreign currency loans raised, and bond and notes issued offshore

² Comprise trade credits, IMF allocation of SDRs and miscellaneous

³ Short-term offshore borrowing, NR holdings of short-term domestic debt securities, NR deposits, short-term trade credits and miscellaneous

⁴ Equivalent to short-term offshore borrowing

⁵ Based on international reserves as at 29 February 2016

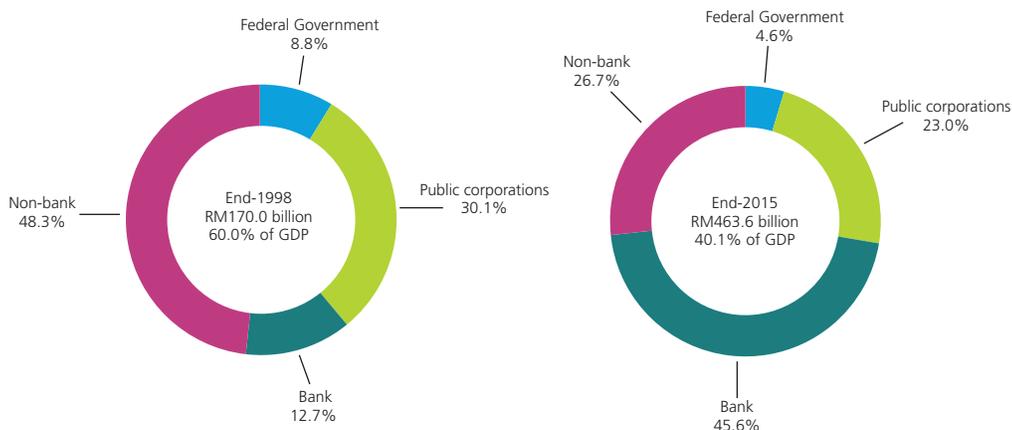
Note: NR refers to non-residents

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

(end-2014: RM371.1 billion). Excluding the foreign exchange revaluation changes, offshore borrowing increased at a more moderate pace of 4.0% during the year, contributing two percentage points to the overall increase in the external debt. This reflects, in particular, the net drawdown of intercompany borrowing by several private corporations in the oil and gas sector. The net drawdown of offshore borrowing by the public corporations during the year was attributed largely to the new issuances of international debt securities as well as sukuk by an oil and gas company in the first quarter of 2015.

Chart 1.13

Offshore Borrowing Remained Low Relative to the Level During the Asian Financial Crisis



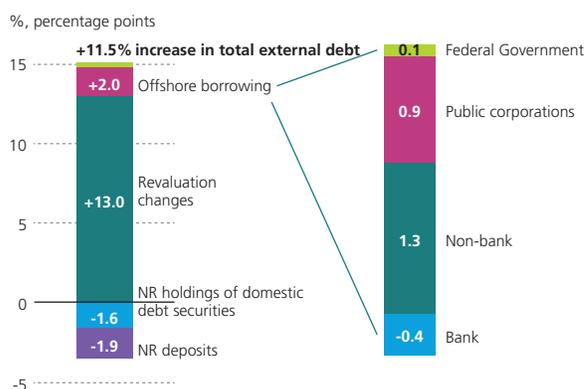
Source: Bank Negara Malaysia

The Federal Government issued 10-year and 30-year sukuk amounting to USD1.5 billion. Part of the proceeds were used to redeem the USD1.25 billion 1Malaysia Sukuk Global that matured during the second quarter of 2015. Of note, the outstanding offshore borrowing by the Federal Government remained low at 4.6% of total offshore borrowing and 1.9% of GDP. On the other hand, banks registered a net repayment of offshore borrowing during the year, reflecting net repayment of interbank borrowing, which more than offset the issuances of medium- and long-term debt securities.

Non-resident holdings of domestic debt securities declined by RM11.9 billion or 5.3% to RM211.3 billion, particularly in the first three quarters of the year (end-2014: RM223.3 billion). The liquidation of domestic debt securities was largely confined to Bank Negara Monetary Notes (BNMNs), which offset the acquisition of Malaysian Government Securities by non-residents during the year. The lower holdings of BNMNs was also partly due to fewer and smaller monetary operations undertaken by the Bank to absorb liquidity during the year. To some extent, in response to the reduction in liquidity arising from the short-term capital outflows, the Bank had stopped new issuances of BNMNs and allowed the instruments to mature in the first half of 2015. The Bank re-issued BNMNs in the latter half of 2015 when the short-term capital outflows began to stabilise in late August and registered net inflows in the fourth quarter. As at end-2015, non-resident holdings of BNMNs increased but remained low at RM23.7 billion or 11.2% of non-resident holdings of domestic debt securities.

Chart 1.14

Higher External Debt in 2015 Attributed Largely to Revaluation Changes



Source: Bank Negara Malaysia

Chart 1.15

NR Holdings of Domestic Debt Securities Indicative of Degree of Contribution to External Debt



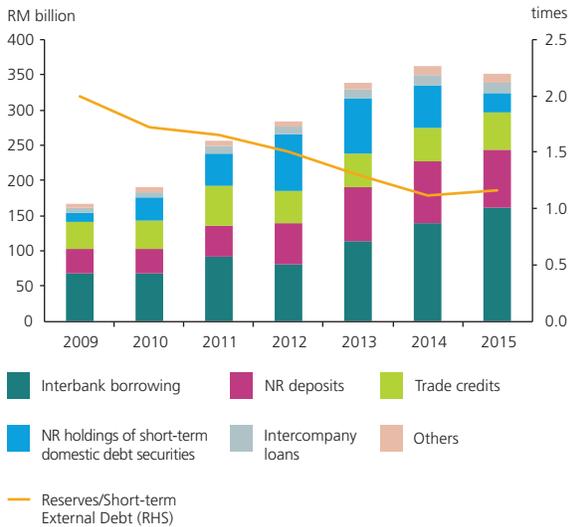
Source: ADB Asian Bond Monitor database and Bank Negara Malaysia

Deciphering Short-term External Debt

Short-term external debt (STED) stood at RM351.9 billion, being equivalent to 30.4% of GDP as at end-2015 (end-2009: RM166.3 billion or 23.3% of GDP), and accounting for 42.2% of the total external debt (end-2009: 42.8%). The upward trend in short-term external debt between 2009 and end-June 2014 reflected mainly the larger non-resident (NR) holdings of short-term domestic debt securities and deposits. Between July 2014 and end-2015, short-term external debt rose because of the valuation effects of the weaker ringgit exchange rate against most currencies. Measured against the international reserves, the reserves coverage of the short-term external debt declined to 1.2 times as at end-2015 (end-2009: 2.0 times).

Chart 1

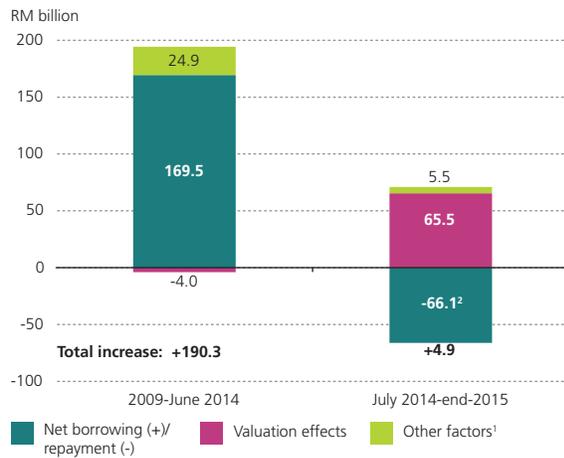
Short-term External Debt



Source: Bank Negara Malaysia

Chart 2

Contribution to the Increase in Short-term External Debt



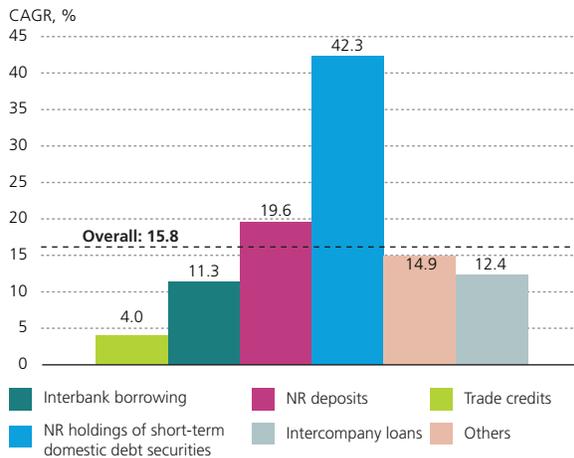
¹ Include price changes especially on domestic debt securities held by non-residents, and other adjustments associated mainly with data classification, coverage and updates

² Mainly liquidation of NR holdings of short-term domestic debt securities

Source: Bank Negara Malaysia

Chart 3

Growth¹ of Short-term External Debt by Component, 2009-1H 2014

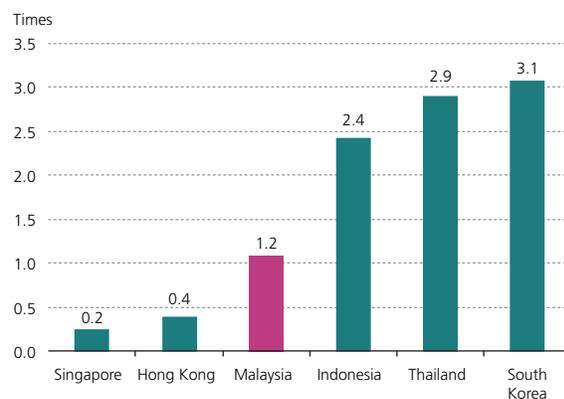


¹ Compounded annual growth rate (CAGR)

Source: Bank Negara Malaysia

Chart 4

Reserves Coverage of Short-term External Debt¹ in Selected Countries



¹As at end of 3Q 2015, except for Malaysia (4Q 2015)

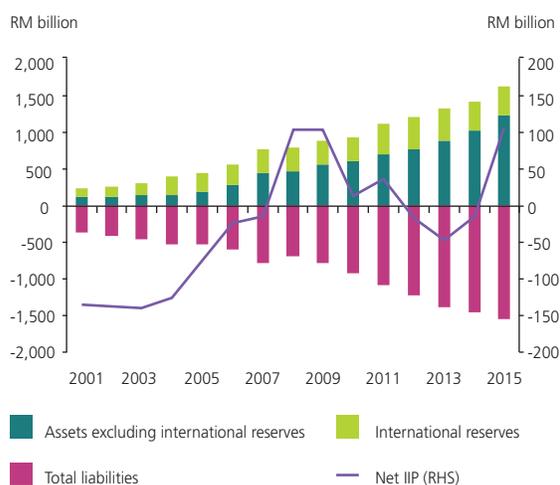
Source: Haver Analytics, Department of Statistics, Singapore and Bank Negara Malaysia

Despite the increase, short-term external debt remains manageable. This assessment is based on key characteristics of the external liabilities and the borrowers. Borrowers, especially banks and corporations, have the servicing capacity to meet their debt obligations. Over the years, Malaysian entities have acquired assets abroad amid the progressive liberalisation of the country's foreign exchange administration rules. Domestic corporations¹ and banks accounted for 75% of Malaysia's RM1.7 trillion in external financial assets² as at end-2015. In particular, corporate short-term external assets³ amounting to RM174.5 billion exceeded the short-term external debt of RM77.5 billion owed by corporates. For the banks, their short-term external debt (RM247.3 billion) was partially covered by their short-term external assets (RM87.5 billion).

The accumulation of external assets by banks and corporations represents the decentralisation of international reserves, which is also evident in the growing foreign currency deposits in the domestic banking system. About two-third of these deposits is accounted by business enterprises, whose foreign currency deposits has increased at a compounded annual growth rate of 23.0% during 2007-2015 to RM90.4 billion as at end-2015. Consequently, not all of the short-term external debt obligations create claims on the international reserves.

Chart 5

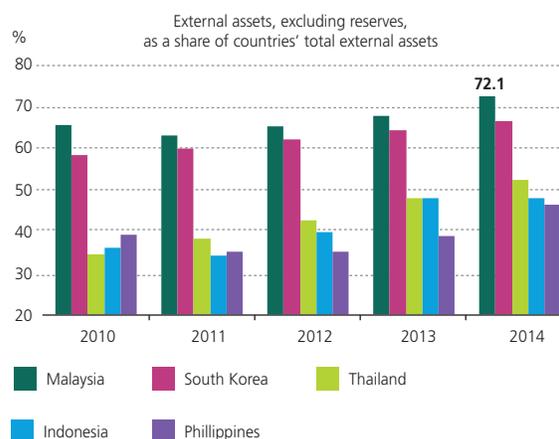
Malaysia's International Investment Position



Source: Department of Statistics, Malaysia

Chart 6

The Sizeable External Assets of Malaysia's Banks and Corporations Underscore their Debt Servicing Capacity



Source: Haver Analytics and Department of Statistics, Malaysia

The adverse effects of exchange rate changes on the short-term external debt are also largely contained. About 25% of the short-term external debt is denominated in ringgit and therefore is not affected by the valuation changes. Of the remaining external debt that is denominated in foreign currency, which is largely hedged, about 70% is held by banks.

Banking sector accounted for the largest share of short-term external debt

The banking sector accounted for about 70% of the short-term external debt. This debt is mainly in the form of interbank borrowings and NR deposits in the domestic banking institutions. To a much lesser extent, the banks' short-term external debt also includes other short-term external debt comprising short-term loans from offshore banks and miscellaneous payables⁴.

¹ Including public corporations.

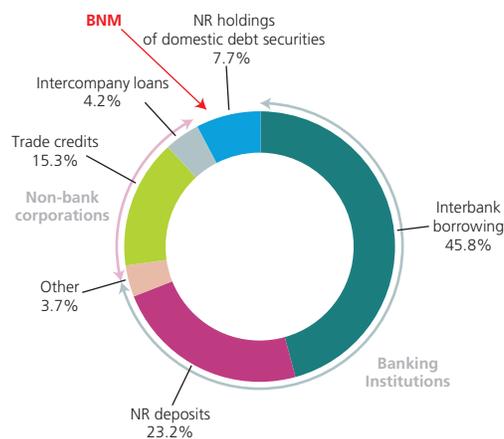
² Malaysia's international investment position.

³ Trade credits, deposits placed abroad, intercompany loan and other short-term assets.

⁴ Include, among others, insurance claims yet to be disbursed and interest payable on bonds and deposits.

Chart 7

Components of Short-term External Debt (% share, end-2015)



Source: Bank Negara Malaysia.

Non-bank corporations constitute the second largest owners of short-term external debt (22%), mainly in the form of trade credits and intercompany loans. Non-resident controlled companies accounted for about 78.7% of the non-bank corporations' short-term external debt. Bank Negara Malaysia is the country's third largest owner of short-term external debt due to the high non-resident ownership of Bank Negara Monetary Notes (BNMNs). The remaining and relatively smaller holdings of short-term domestic debt securities by non-residents are concentrated in the Government's Treasury Bills.

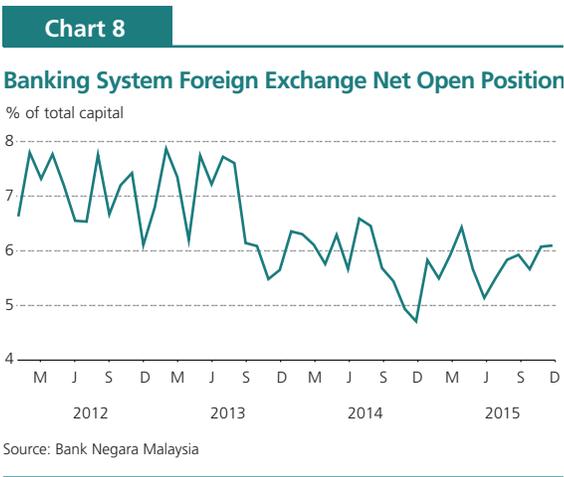
Borrowers' debt servicing capacity has shown resilience to exchange rate shocks

(a) Banking sector – Prudent and active management of liquidity and foreign exchange risks

Interbank borrowing and the placements of funds by foreign entities constitute short-term debt liabilities of the domestic banking institutions. Partly, this reflects the banks' intragroup liquidity management operations which involve the centralised pooling of excess liquidity across the various overseas banking operations. There are also placements of deposits from foreign parent entities in the locally incorporated foreign banks. For banks in Labuan⁵, which accounted for about 40% of total interbank borrowing and NR deposits placements, their debt reflects mainly borrowing by non-resident controlled banks from intra-group entities operating in the regional financial centres, namely in Hong Kong and Singapore. The risks associated with these placements and borrowings are prudently managed through the banks' liquidity management practices. These include, but are not limited to, internal limits on funding and maturity mismatches and the establishment of contingent funding lines with parent banks to absorb foreign currency funding shocks. Of great significance, the risk of maturity mismatch is contained given that the banks' short-term external assets have grown in tandem with the growth in their short-term external debt.

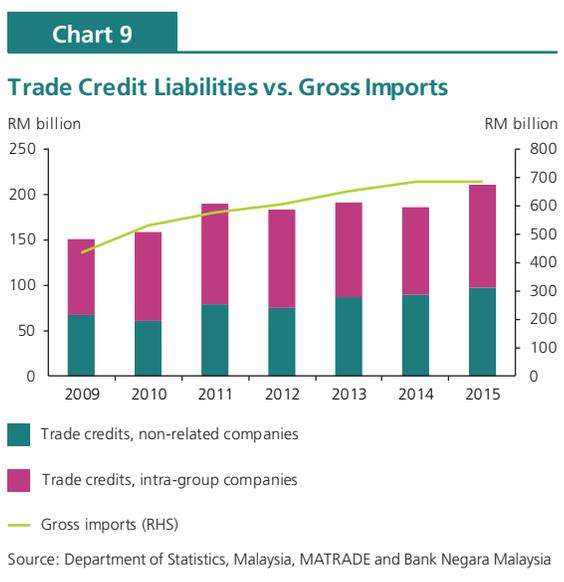
In addition to foreign currency assets, banks are prudently managing the foreign exchange risks of their debt. This was evident in the banks' low net open positions relative to total capital, which incorporates foreign exchange exposures across all tenures (short- and long-term) and sources (domestic and abroad).

⁵ Effective from the first quarter of 2008, entities in Labuan International Business and Financial Centre (Labuan IBFC) have been treated as residents, instead of as non-residents previously, in the compilation of external debt.



(b) Non-bank corporations – availability of export earnings, flexible and concessionary intercompany loans and hedged external exposures

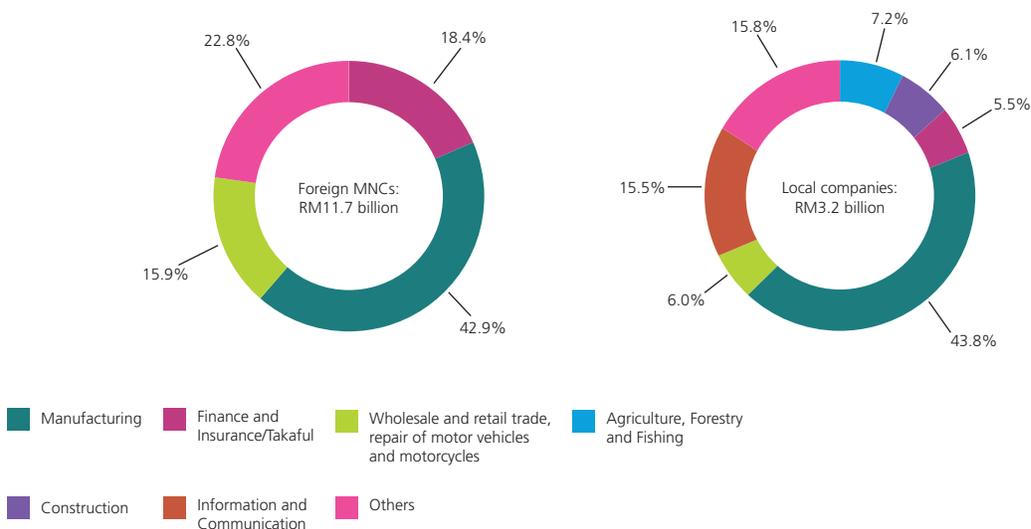
Trade credits and intercompany loans constitute the bulk of non-bank corporations’ short-term external debt. As with any trade-related activity, trade credit liabilities arise from the deferred settlement of outstanding invoices. These trade credits were normally granted by foreign trade partners to importers with sound financial standing and low credit risk. As bulk of imports are intermediate goods for the production of goods for export, a majority of companies with trade credits have foreign currency export earnings. Available data shows that export earnings of 60% of these companies exceed their respective trade credits. In addition, about half of the remaining companies have export earnings that partially offset their trade credits.



Intercompany loans comprise offshore borrowing by foreign multinational corporations (MNCs) from their parent companies and, to a lesser extent by local companies (approximately 20% of total intercompany loans) from their subsidiaries abroad. BNM has liberalised rules governing these loans since 2008 such that they are no longer subjected to any approval requirements. This has allowed for the more flexible management of financial resources within corporate groups.

Chart 10

Distribution of Short-term Intercompany Loans by Activity, end-2015



Source: Bank Negara Malaysia

Based on a recent BNM survey, a significant proportion of intercompany loans are provided on flexible and concessionary terms. These include, in particular, no fixed repayment schedules and zero or low interest rates that are much lower than the prevailing market rates. These flexibilities and concessionary terms enable corporations to meet their debt obligations without much difficulty.

The foreign currency external debt obligations of corporations are largely hedged, either naturally through foreign currency earnings or through financial instruments, thereby limiting any potential adverse impact from the weaker ringgit on their debt servicing capacity.

(c) *BNMNs – An instrument to manage liquidity*

BNMNs were introduced in 2006 as an instrument for BNM to manage liquidity in both the conventional and Islamic financial markets. The main objective of BNMNs is to increase the efficiency of absorbing excess liquidity from the financial system during period of capital inflows. Subsequently, BNMNs can be unwound during periods of capital outflows, re-injecting the liquidity and thus limiting the changes in liquidity conditions within the domestic financial markets.

NR holdings of BNMNs fell from a peak of RM85.7 billion as at end-August 2014 to RM14.0 billion in mid-August 2015. As at end-2015, NR holdings of BNMNs had again increased but moderately to RM23.7 billion. Partly in response to the reduction in liquidity arising from the short-term capital outflows, the Bank had stopped new issuances and allowed the instruments to mature in the first half of 2015. Only in the latter half of 2015 did the Bank re-issue BNMNs when capital flows began to stabilise in late August 2015. In addition to BNMNs, the Bank is well-equipped with a host of monetary policy instruments to manage domestic liquidity.

Conclusion

Malaysia's short-term external debt is manageable. Malaysian entities have increasingly acquired assets abroad over the years amid the progressive liberalisation of the foreign exchange administration rules.

Given the level of external assets and foreign currency earnings, the external debt obligations of these corporations and banks do not create claims on the Central Bank's international reserves. Furthermore, flexible and concessionary intercompany loans enhance the capacity to repay these loans by non-bank corporations while banks actively manage their liquidity and foreign exchange risks. In conclusion, while Malaysia is not immune to global developments, prudent management of external debt will continue to ensure that Malaysia's short-term external debt remains manageable and that it does not undermine the economy's resilience against adverse exchange rate shocks.

Non-resident deposits declined to RM81.6 billion (2014: RM87.7 billion), reflecting maturity of deposits placed with the domestic banking institutions.

Overall, Malaysia's external debt remains manageable. The profile of Malaysia's external debt remains healthy with more than half being skewed towards the medium- to long-term tenures. Risks from foreign exchange fluctuations were largely contained as about 36% of the external debt is ringgit-denominated while the foreign currency-denominated debt is largely hedged. Debt service ratio remained low at 22.6% in 2015 (2014: 19.1%). International reserves are adequate to meet short-term external debt obligations with a coverage of 1.2 times (see also the White Box on Deciphering Short-term External Debt). It is important to note that not all short-term external debt creates a claim on reserves given the export earnings and external assets of borrowers.

Resilience against external shocks

Being a highly open economy with substantial linkages to the global economy and financial markets, Malaysia is certainly not insulated from the heightened uncertainty and risks emanating from external developments. However, Malaysia has demonstrated its ability to withstand external shocks experienced during the year by drawing on its economic adaptability and the safeguards provided by financial buffers and robust policy frameworks that have been built over the course of many years.

Despite considerable volatility of capital flows, the impact on domestic financial markets was not significant, allowing them to function uninterrupted and to maintain effective financial intermediation to support the real economy. Malaysia's deep and diversified domestic financial markets together with a strong and resilient financial sector were able to accommodate and smoothly intermediate the large volumes of capital flows. The presence of domestic institutional investors was pivotal in providing sustained demand for domestic financial assets as foreign investors rebalanced their exposures. In addition, the Bank's monetary operations and the judicious use of several policy instruments helped to ensure the availability of sufficient liquidity to support the orderly functioning of the money and foreign

exchange markets, particularly in times of higher outflows.

Malaysia has demonstrated its ability to withstand external shocks by drawing on its economic adaptability, financial buffers and robust policy frameworks that have been built over the years

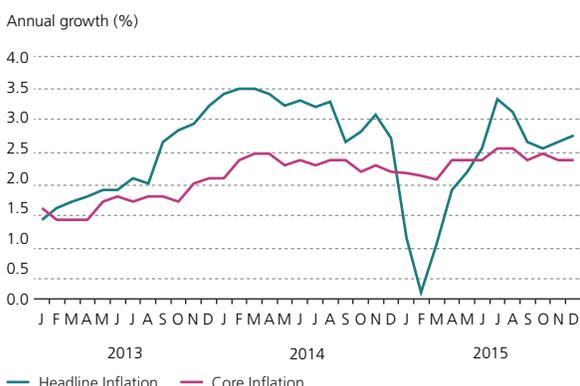
Importantly, despite the challenges posed by the drop in commodity prices and financial markets volatility, Malaysia's core fundamentals have remained sound, enabling the economy to confront domestic and external challenges during the year. The flexibility of the exchange rate allowed the ringgit to adjust appropriately to the changes in external conditions, acting as an absorber of shocks arising from the turbulent global financial markets. At the same time, the international reserves have acted as a buffer by preventing excessive volatility of the exchange rate and ensuring the smooth functioning of financial markets during periods of large short-term capital flows. It is these factors, together with continued surpluses in the current account, the manageable level of external debt, and the diversified domestic economic structure, that have accorded the country with the capacity to weather external shocks.

INFLATION DEVELOPMENTS

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), declined to 2.1% in 2015 (2014: 3.2%). Headline inflation was, however, relatively more volatile in 2015. It declined sharply at the beginning of the year to a low of 0.1% in February but increased in the second quarter to peak at 3.3% in July before moderating slightly thereafter. The volatility in headline inflation largely reflected a series of adjustments in domestic fuel prices. For the year as a whole, the lower headline inflation was largely due to the impact of the lower global energy and commodity prices, which more than offset the effects from a weaker ringgit exchange rate, the implementation of GST, and several upward adjustments in administered prices made towards the end of the year.

Chart 1.16

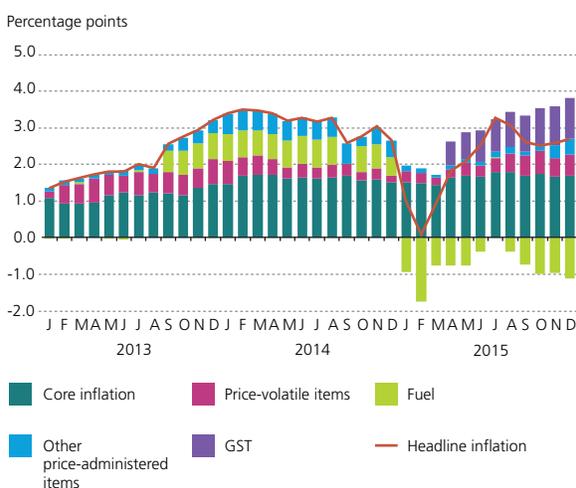
Consumer Price Inflation



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.17

Contribution to Headline Inflation by Components



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Notwithstanding the volatility in headline inflation, core inflation³ was stable averaging 2.3% during the year (2014: 2.3%). The stability of core inflation reflected the moderate domestic demand conditions, the absence of excessive wage pressures, and the benign global inflation environment.

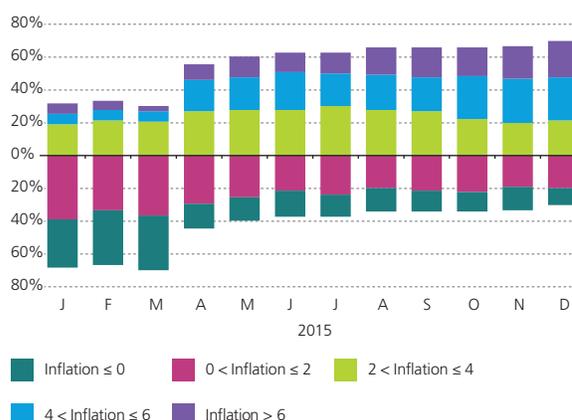
³ Core inflation attempts to measure the underlying inflation rate. For Malaysia, core inflation is computed by excluding price-volatile and price-administered items whose price movements are more likely to be affected by temporary shocks and volatile supply factors rather than persistent changes in underlying factors affecting demand and supply conditions. In addition, core inflation also excludes the estimated direct impact of GST.

While headline inflation was lower in 2015, price increases during the year were more pervasive. The share of items in the CPI basket with inflation above 4%, increased to 32% in the second quarter following the implementation of GST (11% in the first quarter). It continued to increase further to 41% in the second half of the year as some firms that had initially absorbed the GST started to pass on the GST to consumers. This was compounded by the continued weakening of the ringgit and higher prices of fresh food items. Items with inflation above 4% were mainly food items, alcoholic beverages, and personal care and health products. However, as these items account for less than 50% of the weights of the CPI basket, the higher inflation was offset by lower inflation in other items such as fuel, utilities, and clothing and footwear. Notwithstanding this development in headline inflation, to the extent that different households would have different consumption baskets, the rate of inflation experienced would be different across different income groups and locations (See Box Article on Inflation and the Cost of Living).

In terms of categories, the decline in inflation during the year was due mainly to lower inflation in the *transport and housing, water, electricity, gas and other fuels* categories. The *transport* category registered a negative inflation of -4.5% in 2015 (2014: 4.9%) due to the decline in domestic fuel prices. The average prices of RON97 petrol, RON95 petrol and diesel were lower at RM2.33, RM1.98 and RM1.92 per litre, respectively, in 2015 (2014: RM2.78, RM2.15 and RM2.05 per litre, respectively). Domestic fuel prices were lower due to the lower

Chart 1.18

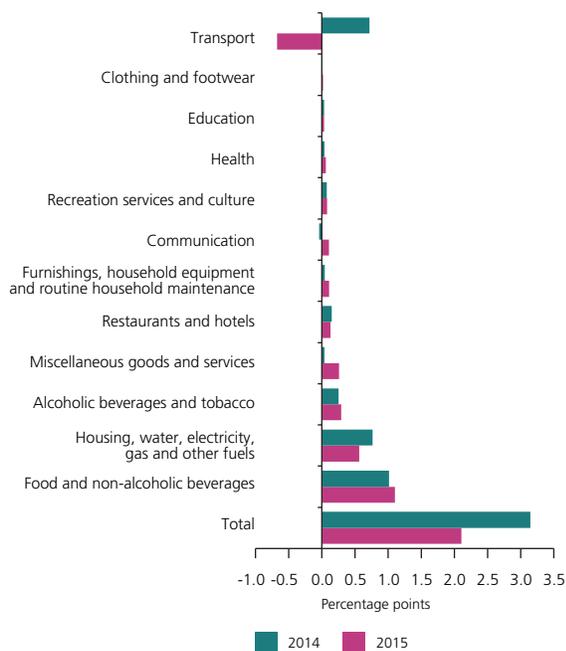
Percentage of CPI Items Registering Different Inflation Ranges



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.19

Contribution to Inflation by Categories



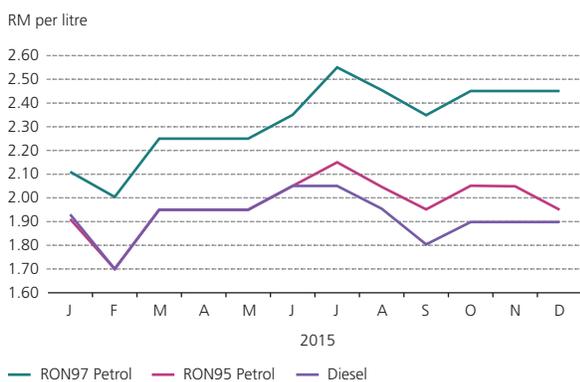
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

global oil prices, which more than offset the impact of the weaker ringgit on imported refined fuels for domestic usage. Inflation in the *housing, water, electricity, gas and other fuels* category was also lower at 2.5% (2014: 3.4%) due to the downward revisions in electricity tariffs in the first quarter of 2015.

The implementation of GST at 6% on 1 April 2015 led to higher inflation for most categories of

Chart 1.20

Domestic Fuel Prices in 2015



Source: Ministry of Domestic Trade, Co-operatives and Consumerism, and Bank Negara Malaysia

Table 1.9

Inflation by Categories (Pre- and Post-GST Implementation)

Categories	1Q 2015 (Pre-GST)	2Q - 4Q 2015 (Post-GST)
	Average inflation (%)	
Food and non-alcoholic beverages	2.5	4.0
Alcoholic beverages and tobacco	10.6	14.4
Clothing and footwear	-0.3	0.8
Housing, water, electricity, gas and other fuels	2.1	2.5
Furnishings, household equipment and routine household maintenance	0.3	3.5
Health	3.4	4.8
Transport	-7.6	-3.5
Communication	-0.9	2.9
Recreation services and culture	0.6	2.1
Education	2.1	2.5
Restaurants and hotels	3.1	4.6
Miscellaneous goods and services	1.6	5.0
Total	0.7	2.6

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

consumer goods and services. The price increases were especially notable in the *furnishings, household equipment and routine household maintenance, communication and miscellaneous goods and services* categories. While the price increases were broad-based across most CPI categories, the overall impact was still contained as GST contributed only 0.7 percentage point to headline inflation in 2015. This was lower than the initial estimate of 1.0 percentage point. The lower-than-expected impact was partly due to the absorption of GST by some firms at the initial stage of implementation. In addition, the spillover effects from GST were small amidst active enforcement of the *Price Control and Anti-Profitteering Act 2011* by the Government to ensure that price increases were not excessive.

Inflation during the year was also influenced by the shortages in the supplies of fresh food amid adverse weather conditions, particularly in the second half of the year. Prices of fresh vegetables rose by 7.7% during the year (2014: 1.6%) as irregular weather and prolonged haze conditions affected the quality and yields of crops. Towards the end of the year, upward adjustments in several administered prices such as toll charges, railway fares and cigarette prices

Table 1.10

Adjustments in Administered Prices in 2015

Date	Items	Quantum of Adjustment	
		RM	%
1 March 2015	Electricity	Average of -1 sen/kWh for households	-3.1
29 June 2015	Cigarettes	+RM0.30/pack of 20	2.2
15 October 2015	Toll charges	Average increase of 40% affecting 18 intracity highways	
4 November 2015	Cigarettes	+RM3.20/pack of 20	23.2
2 December 2015	KTM railway charges	+4 sen/km	36.4
	LRT and Monorail railway charges	Average increase of 10% depending on length of commute	

also contributed to the inflationary pressures. However, given that most of these adjustments were implemented towards the end of the year, the impact on overall inflation for 2015 was small.

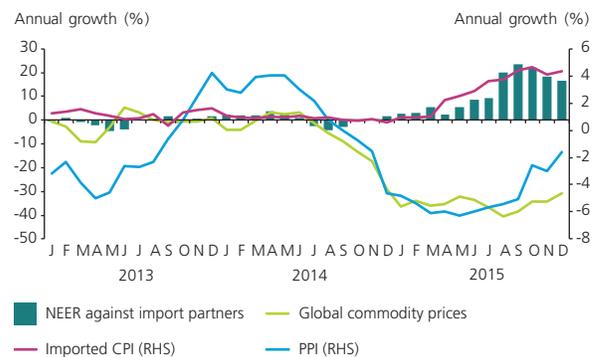
During the year, the ringgit depreciated by 16.6% against the currencies of Malaysia's major import partners. However, despite the depreciation, the impact on domestic inflation, both through the direct and indirect channels, was modest. Through the direct channel, the weaker ringgit resulted in an increase in the prices of imported finished goods. Excluding fuel, imported CPI increased by a higher rate of 3.0% in 2015 (2014: 0.9%). This was driven mainly by higher prices of imported food items, which rose by 5.7% (2014: 2.4%). However, the impact on overall inflation was contained as these imported goods only constitute a small share of the CPI basket at 7.2%.

The indirect impact of the weaker ringgit through imports of raw and intermediate inputs was also modest, being offset by the much larger decline in global commodity prices. The IMF Primary Commodity Price Index fell by a double-digit rate of 35.3% in 2015. The decline in prices was registered across most types of commodities due mainly to ample supplies amidst the weak global demand. Global food prices were lower as reflected by the decline of 17.1% in the IMF Food Price Index⁴ (2014: -4.1%) due mainly to the record high

⁴ The IMF Food Price Index includes the price index of cereal, vegetable oils, meat, seafood, sugar, bananas and oranges.

Chart 1.21

Exchange Rate, Global Commodity Prices, Imported CPI and PPI



Note: The nominal effective exchange rate (NEER) against import partners is calculated based on the weighted average of the bilateral exchange rates against Malaysia's top 15 import partners. A positive figure indicates a depreciation in ringgit against Malaysia's main import partners relative to the year before.

Source: Department of Statistics, Malaysia, International Monetary Fund (IMF), Bloomberg and Bank Negara Malaysia

production of selected crops and overall low energy costs. Notwithstanding the weaker ringgit, the lower global commodity prices had led to an overall reduction in the costs of inputs for local producers. Prices of both raw and intermediate materials faced by producers, for example, declined by 15.6% and 3.4%⁵, respectively during the year (2014: -1.0% and 2.6% respectively), resulting in the Producer Price Index (PPI) declining by 4.8% in 2015 (2014: 1.4%). The impact of the weaker ringgit through the indirect channel was also contained by the small share of imported intermediate inputs in the producers' cost structure⁶ (See Box Article on The Impact of Exchange Rate Depreciation on Inflation in Malaysia).

Domestically, the more moderate domestic demand pressure due to the slower expansion of private consumption and the absence of excessive wage growth, has also helped contain inflationary pressures during the year. Firms' production capacity remained more than sufficient to meet the increase in consumer demand, as reflected by the relatively stable capacity utilisation rate of 77% in 2015 (2014: 79%) in the manufacturing sector. Information from the Bank's surveys also indicated that firms were hesitant to fully pass on the higher cost pressures to consumers given the environment of weaker demand.

⁵ Bank Negara Malaysia estimates. These prices incorporate both prices of imported and locally sourced raw and intermediate materials.

⁶ Based on estimation from the Input-Output Tables 2010 for Malaysia, about 20% of the gross output is imported intermediate inputs.

Inflation and the Cost of Living

This article briefly highlights the differences between Consumer Price Index (CPI) inflation and the cost of living. It also presents analyses of the differences in inflation rates across various income groups and across states in Malaysia, and an assessment of the growth in income and expenditure of Malaysian households, using data from the 2014 Household Income and Basic Amenities Survey (HIS/BA), the 2014 Household Expenditure Survey (HES) and the disaggregated state-level CPI data.

I. Differences between CPI inflation and the cost of living

The inflation rate, as measured by the change in the Consumer Price Index (CPI), reflects the average rate of increase in the price of a basket of goods and services. The CPI is constructed by assuming that there is a single basket of goods and services which represents the consumption basket of all households in the country¹. Prices of goods and services that are used to construct the CPI are the average prices collected from retail outlets across the country. Thus, the CPI captures the average increase in prices with the assumption of homogeneity of spending patterns across households and holding the quantity and quality of the goods and services in the consumption basket as constant. As the CPI reflects average prices in the economy, it provides a good measure of the changes in the overall price level of goods and services in the economy. As such, it is a relevant and useful indicator for the conduct of macroeconomic policies, such as monetary policy, that aim to affect the broader economy.

The cost of living, on the other hand, refers to the amount of expenditure on goods and services incurred by households, including their financial obligations, to maintain a certain standard of living². This spending or cost of living is determined by both household spending patterns and the prices faced by households. Spending patterns differ across households as the patterns are primarily influenced by household income, demography, family structure and area of residence³. Price changes faced by households, in turn, vary by geographical factors.

As the CPI masks the heterogeneity in household spending patterns and the variations in price changes of goods and services faced by households, the inflation rate is considered as an approximation of the rate of increase in the cost of living. To the extent that the dispersion in spending patterns and variation in price changes are insignificant, the CPI is a reasonable gauge of the cost of living. In a situation where the dispersion in spending patterns and price changes are large, the inflation rate could be a weak approximation of the rate of increase in the cost of living. In this regard, the CPI could understate or overstate the cost of living for some segments of households⁴. Given the heterogeneity in spending patterns and significant variations in the prices of goods and services, a more meaningful analysis of the cost of living requires assessing changes in spending patterns and costs across the various household categories and geographical locations. The most common dimension is to assess the changes in the cost of living over time, across different income groups and across states or regions in a country.

II. An analysis of the cost of living using household surveys and disaggregated CPI data

Using data from the Household Income and Basic Amenities Survey (HIS/BA) and the Household Expenditure Survey (HES)⁵ for 2009 and 2014; as well as the disaggregated state-level⁶ CPI data, this

¹ The composition of goods and services in the CPI basket and their respective weights are determined based on the aggregate household expenditure patterns obtained from a nationwide expenditure survey. In Malaysia, the CPI basket is revised every five years based on the Household Expenditure Survey as per international practice. The latest CPI weights, based on the 2014 survey, were released in January 2016.

² The standard of living measures the quality of life or the level of material prosperity enjoyed by individuals.

³ Other factors could include education level and ethnicity.

⁴ Empirical studies show that the CPI can also at times overstate the cost of living because of substitution bias. Due to the fixed CPI basket, it may not capture the substitution to cheaper goods and services, which could effectively lead to a decline in cost of living, despite higher prices.

⁵ Both the HIS/BA and the HES are carried out using a personal interview approach, covering urban and rural areas for all states. The surveys are carried out by probability sampling that represents all households in Malaysia.

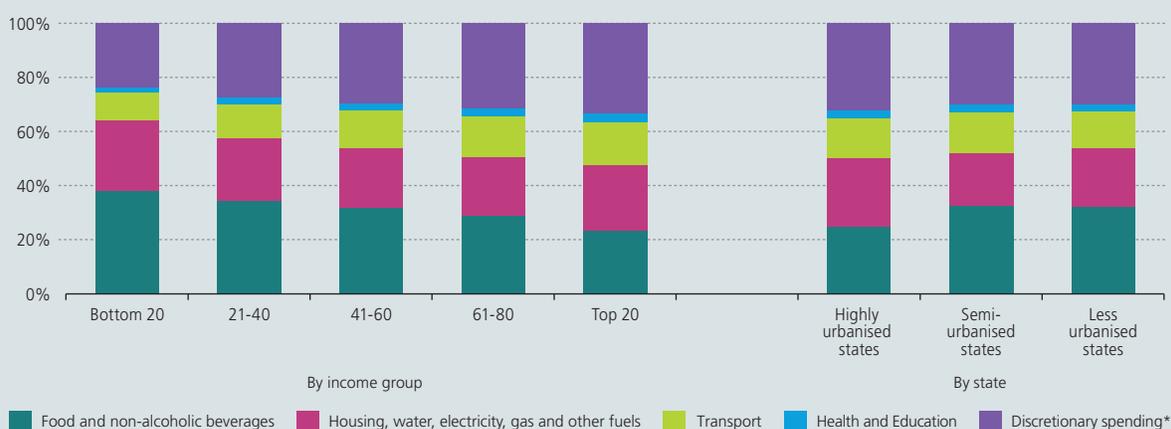
⁶ CPI by states is published by the Department of Statistics, Malaysia, with data series available since 2011.

study analyses the cost of living for different groups of households in Malaysia. The HIS/BA is conducted every two to three years to collect statistics pertaining to the pattern of income distribution of Malaysian households. The HES is conducted once every five years to collect comprehensive information on the level and pattern of consumption expenditure of households.

Chart 1 shows the differences in spending patterns across different income groups for households in Malaysia based on the most recent HES survey. The lower income groups allocate more of their expenditure to food, and less to transport, healthcare, education and discretionary spending compared to the higher income groups. Households in highly urbanised states^{7,8} such as Kuala Lumpur and Selangor spend more on housing, whereas households in the less urbanised states⁹ such as Pahang and Kelantan spend more on food.

Chart 1

Household Consumption Basket by Income Groups and States



*Discretionary spending includes spending on *alcoholic beverages and tobacco, clothing and footwear, furnishings, household equipment and routine household maintenance, communication, recreation services and culture, restaurants and hotels and miscellaneous goods and services.*

Note: 1. The highly urbanised states have urbanisation level of above 70%, semi-urbanised states between 55% to 69% and less urbanised states below 55%.
2. Expenditure in the *food and non-alcoholic beverages* category includes expenditure for *food away from home*.

Source: 2014 Household Expenditure Survey, 2010 Population and Housing Census of Malaysia (Census 2010) and Bank Negara Malaysia estimates

Prices may also vary significantly across different locations. Differences in prices reflect mainly variations in distribution, labour and rental costs, and relative demand and supply conditions. For example, based on the state-level CPI data published by the Department of Statistics Malaysia, rental rates in the more highly urbanised states are typically higher and increase at a faster rate than the less urbanised states. Similarly, price increases particularly in the *food and non-alcoholic beverages, restaurants and hotels, education and recreation services and culture* categories are also generally higher in the highly urbanised states. As a result, highly urbanised states such as Kuala Lumpur, Johor, Pulau Pinang and Selangor registered higher inflation rates (Table 1).

Household inflation rates for 2015 are derived by combining the information obtained from spending patterns across income groups and the price changes across states (Table 2). The findings show that inflation rates do vary across households and can be materially different from the national average.

⁷ Highly urbanised states are states that register urbanisation levels of above 70%. The level of urbanisation is computed in the 2010 Population and Housing Census of Malaysia (Census 2010). These states include Kuala Lumpur, Selangor and Putrajaya, Pulau Pinang, Melaka and Johor.

⁸ For the purpose of this article, the definition of states refers to the 13 states and three federal territories, as categorised in the HIS and HES.

⁹ The less urbanised states are states that register urbanisation levels of below 55%. These states include Sabah, Sarawak, Pahang and Kelantan.

Table 1

Inflation by States based on Level of Urbanisation in 2015

	Highly urbanised states	Semi-urbanised states	Less urbanised states
	Average inflation (%)		
Total	2.5	1.8	1.4
Food and non-alcoholic beverages	4.2	3.2	3.0
Alcoholic beverages and tobacco	13.4	14.1	13.6
Clothing and footwear	0.6	-0.1	0.1
Housing, water, electricity, gas and other fuels	3.5	2.8	0.3
Furnishings, household equipment and routine household maintenance	3.1	2.9	2.3
Health	4.9	4.0	4.2
Transport	-4.8	-4.9	-4.1
Communication	1.9	2.5	2.3
Recreation services and culture	1.8	0.9	1.0
Education	3.4	2.6	2.2
Restaurants and hotels	4.6	3.3	3.6
Miscellaneous goods and services	4.3	4.1	4.1

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

- Higher inflation rates in the highly urbanised states.** The national average inflation rate was generally lower than inflation rates of households in highly urbanised states such as Kuala Lumpur, Selangor and Putrajaya, Pulau Pinang and Johor in 2015. Households in these states account for 43% of the total population of Malaysia. The national average inflation rate was higher than the inflation rates experienced by households in some semi- and less urbanised states, namely Perak, Kedah, Perlis, Sabah and Sarawak. Households in these states account for 36% of the total Malaysian population.
- Higher inflation rates for the lower income groups across most states in Malaysia.** Households in the bottom 20% of the income group experienced inflation rates that were 0.12 to 1.10 percentage points higher than households in the top 20% of the income group. For highly urbanised states, the differentials were higher, averaging 0.6 percentage point (0.4 percentage point for the less urbanised states). As the lower income groups spend a larger share of their expenditure on food, they experienced higher inflation due to the higher food inflation in 2015 (3.6%, 2014: 3.3%). The lower income groups also benefitted less from the decline in domestic fuel prices during the year given the lower share of expenditure on fuel. Thus, the lower income households living in highly urbanised states tend to experience the largest increase in their cost of living¹⁰.

The change in the cost of living was also assessed using the actual household expenditure data from the 2014 HES. Based on this analysis, aggregate household expenditure, including for financial obligations¹¹, rose at a compounded annual growth rate (CAGR) of 8.5% during the period 2010 - 2014. The higher expenditure growth relative to the CAGR of CPI of 2.6% for the same period suggests that growth in expenditure was not only driven by higher prices, but also by an increase in the volume of consumption of goods and services. The strong growth in expenditure was observed across all income groups (Chart 2). Aggregate discretionary spending, in particular, rose strongly by 9.0% (Chart 4), contributed mainly by higher spending on restaurants and hotels, recreational services and communication (Chart 5).

¹⁰ This finding holds for the period 2011-2015.

¹¹ Financial obligations include transfer payments such as contribution to the Employee Provident Fund (EPF) and income tax payments; as well as the repayment of loans.

Table 2

CPI Inflation by States and Income Groups in 2015 (Annual change, %)

		Income percentile					Total
		Bottom 20	21-40	41-60	61-80	Top 20	
MALAYSIA		2.1					
Highly urbanised states	Kuala Lumpur	3.01	2.87	2.78	2.74	2.73	2.78
	Selangor & Putrajaya	2.70	2.51	2.38	2.33	2.16	2.34
	Pulau Pinang	2.72	2.56	2.50	2.46	2.30	2.45
	Melaka	2.57	2.23	2.31	1.76	1.47	1.92
	Johor	3.14	2.92	2.95	2.86	2.49	2.78
Semi-urbanised states	Negeri Sembilan	2.77	2.62	2.56	2.26	1.92	2.30
	Perak	2.06	1.95	1.80	1.77	1.60	1.77
	Kedah & Perlis	2.25	1.93	1.83	1.62	1.29	1.65
	Terengganu	2.04	2.00	1.98	1.97	1.60	1.85
Less urbanised states	Sabah & Labuan	1.08	0.97	0.96	0.82	0.80	0.88
	Sarawak	1.54	1.48	1.47	1.43	1.42	1.45
	Pahang	2.23	2.03	2.00	1.68	1.64	1.83
	Kelantan	2.33	2.08	1.98	1.90	1.69	1.91

Inflation tends to be higher for more urbanised states

Inflation tends to be higher for lower income groups

- Inflation higher than national average by 0.2
- Inflation within the national average by +/- 0.2
- Inflation lower than national average by 0.2

Note: 1. The highly urbanised states have urbanisation level of above 70%, semi-urbanised states between 55% to 69% and less urbanised states below 55%.

2. While the urbanisation level is high in Labuan, its inflation rate is reported together with Sabah as the expenditure patterns and prices of goods and services in the two states are similar.

3. Household inflation rates are derived based on the share of household expenditure by category obtained from the 2014 Household Expenditure Survey and the disaggregated state-level inflation rates.

Source: 2014 Household Expenditure Survey, Department of Statistics, Malaysia and Bank Negara Malaysia estimates

The growth in aggregate expenditure was accompanied by an increase in aggregate household income, which increased by a CAGR of 8.8% during the same period. On average, the level of income exceeded that of expenditure for all income groups, allowing households to save a portion of their income (Chart 3). However, a more detailed analysis of the disaggregated data from the 2014 HIS/BA and 2014 HES reveals the following:

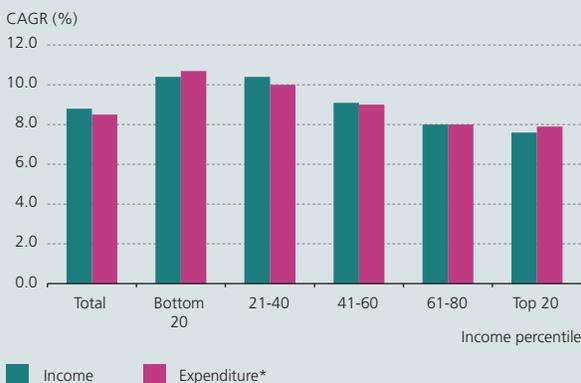
- **Dissaver households.** There are households, mainly from the lower income groups, that spend more than their income.
- **The bottom 40% of households¹².** Financial obligations of these households, including loan repayments, have registered relatively strong growth. Consequently, these households, who only have a relatively small amount of savings¹³, are vulnerable to both income and price shocks.

¹² The bottom 40% of households are households which fall under the bottom 40% of the nation's income distribution, which is below RM3,649 based on the 2014 HIS/BA.

¹³ About 28% of the bottom 40% of households do not save on a monthly basis, while 11% of them save RM100 or less a month.

Chart 2

Growth in Average Household Income and Expenditure*



*Including financial obligations

Source: 2014 and 2009 Household Income and Basic Amenities Survey, 2014 and 2009 Household Expenditure Survey, and Bank Negara Malaysia estimates

Chart 3

Average Household Income and Expenditure*



*Including financial obligations

Source: 2014 Household Income and Basic Amenities Survey, 2014 Household Expenditure Survey, and Bank Negara Malaysia estimates

Chart 4

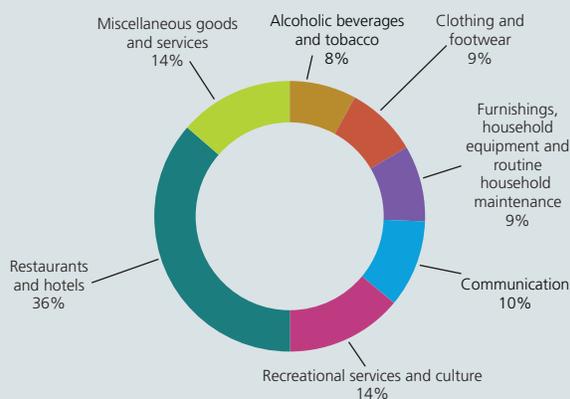
Growth in Average Household Expenditure by Type



Source: 2014 and 2009 Household Expenditure Survey and Bank Negara Malaysia estimates

Chart 5

Contribution to Growth in Discretionary Spending



Source: 2009 and 2014 Household Expenditure Survey and Bank Negara Malaysia estimates

- **Households earning fixed incomes, including pensioners.** While aggregate income grew at an average of 8.8%, there are segments of the total population who experienced a much lower or no income growth.

The analysis has shown that the inflation rates experienced by households vary due to differences in spending patterns and price changes. In particular, households in the lower income groups living in highly urbanised states experienced higher inflation. At the aggregated level, the rise in the cost of living, on average, has been accompanied by a commensurate increase in income. At a disaggregated level, however, analysis of both income and expenditure data shows that there are segments of the society that are vulnerable to the increase in the cost of living, and these are households who dissaved; the bottom 40% of households; and households earning fixed incomes.

Conclusion

In addressing the issue of the rising cost of living, the policy approach must be multi-dimensional, including measures to address the challenges of urbanisation such as housing and connectivity, improving financial education and awareness, and enhancing productivity and income. Of importance, greater efforts would need to be directed at increasing the productivity level of Malaysians through the adoption of modern technology and increasing the skills of workers through access to better education and training. This would enable Malaysians to move up the value chain towards higher value-added jobs to achieve higher income and hence, afford a higher standard of living.

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The Impact of Exchange Rate Depreciation on Inflation in Malaysia

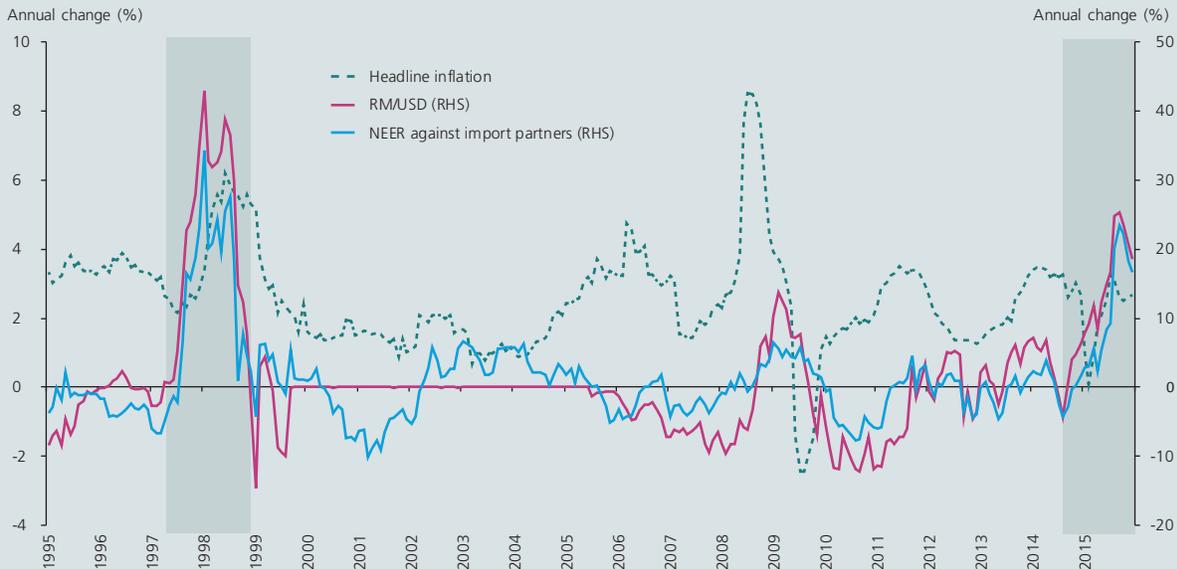
Introduction

The persistent depreciation of the ringgit since September 2014 has raised concerns about the risk of higher inflation in Malaysia. In general, large and persistent exchange rate depreciation in a small and open economy would entail higher domestic inflation as imports become more expensive. The Malaysian experience in the past two decades, however, has shown that episodes of persistent exchange rate depreciation may not always result in significantly higher inflation (Chart 1). The outcome is also dependent on other developments affecting the economy. This is highlighted by the experience that while the ringgit depreciation in the period 1997-1998 resulted in high inflation, the more recent depreciation episode has instead coincided with periods of low inflation.

This article is divided into two parts. The first part presents findings from estimations of the exchange rate pass-through (ERPT) to inflation in Malaysia and the second part provides insights on why inflation could be high in certain episodes of exchange rate depreciation but low in others.

Chart 1

Exchange Rate and Inflation



Note: The nominal effective exchange rate (NEER) against import partners is calculated based on the weighted average of the bilateral exchange rates against Malaysia's top 15 import partners. A positive figure indicates a depreciation in the ringgit against Malaysia's main import partners relative to the year before.

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

A. Exchange rate pass-through to inflation in Malaysia

ERPT to inflation refers to how much domestic prices change in response to changes in the nominal exchange rate. The transmission from the exchange rate to inflation occurs through two main channels. First is the direct channel via imported finished goods in the CPI basket and second is the indirect channel via imported inputs in the production chain (Diagram 1)¹.

- (i) **Direct channel.** Fluctuations in the exchange rate directly impact prices of imported finished goods. The depreciation of the ringgit, against the currencies of Malaysia's import partners, increases the costs of importing finished goods from these economies.

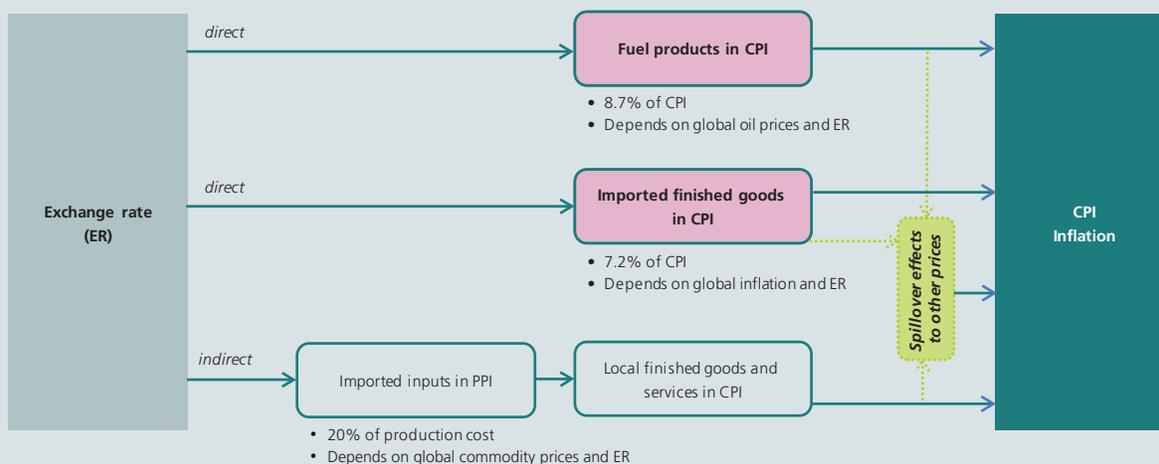
¹ In this article, CPI refers to the Consumer Price Index, CPI-Import is the imported finished goods component of CPI excluding fuel, PPI is Producer Price Index, PPI-Import is the imported component of PPI, and PPI-Local is the domestic component of PPI.

- (ii) **Indirect channel.** Exchange rate movements affect input costs of firms that use imported inputs in the production of local goods and services. These imported inputs could be in the form of raw materials like wood and wheat, or in the form of intermediate inputs like fabric and metal rods.

In addition, prices of goods and services that are affected by movements of the exchange rate, through either one or both of the channels, could have spillover effects on prices of other goods and services in the CPI. This can consequently lead to a general increase in prices².

Diagram 1

Transmission Channels from Exchange Rate to Inflation in Malaysia



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The conceptual relationship between exchange rate movements and inflation is illustrated in Chart 2 where depreciation has an inflationary impact while appreciation has a disinflationary impact. The impact of changes in the exchange rate on inflation can differ in strength between periods of appreciation and depreciation³. This asymmetry arises because firms typically react more to pass on the increases in the cost of imports to consumer prices following an exchange rate depreciation but firms tend to be less responsive when there is a reduction in costs due to an exchange rate appreciation. In addition, should exchange rate depreciation exceed a certain threshold, firms can change their behaviour significantly, resulting in a larger impact on inflation.

Using historical data over the last two decades, a scatter plot shows a weak positive relationship between the exchange rate⁴ and inflation (Chart 3). This suggests that changes in the exchange rate may have a small impact on domestic inflation. Applying standard methodologies from the literature, the ERPT was empirically estimated⁵ using the nominal effective exchange rate (NEER) with quarterly data from 1995 to 2015. The results are summarised as follows:

² Changes in the exchange rate could also affect domestic inflation indirectly through the substitution effect. If the exchange rate depreciation makes imported goods more expensive, consumers may switch to domestic products and this can exert upward pressures on prices of domestically produced goods. In addition, the depreciation could also lead to higher demand for exports and result in stronger aggregate demand that can create inflationary pressures.

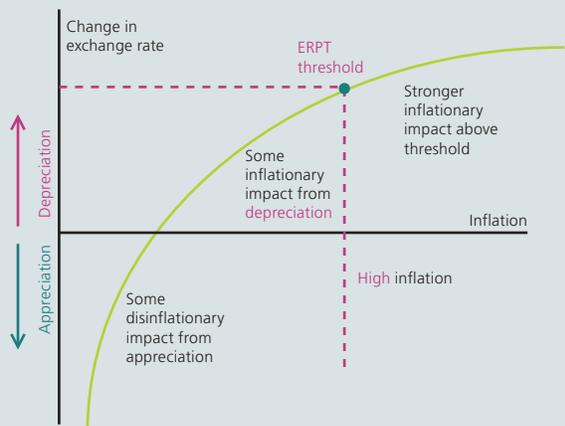
³ Pricing strategies of firms tend to be different during periods of depreciation and appreciation, which will determine the asymmetric effects of exchange rate pass-through to inflation. Inflationary impact during depreciation tends to be larger in size compared to the disinflationary impact during appreciation.

⁴ Unless otherwise stated, the exchange rate in this article refers to the nominal effective exchange rate (NEER).

⁵ The empirical specification follows a linear Phillips curve equation, which controls for lagged inflation, global commodity prices and the output gap. The estimations are carried out using the NEER and results are robust for the nominal bilateral exchange rate (RM/USD).

Chart 2

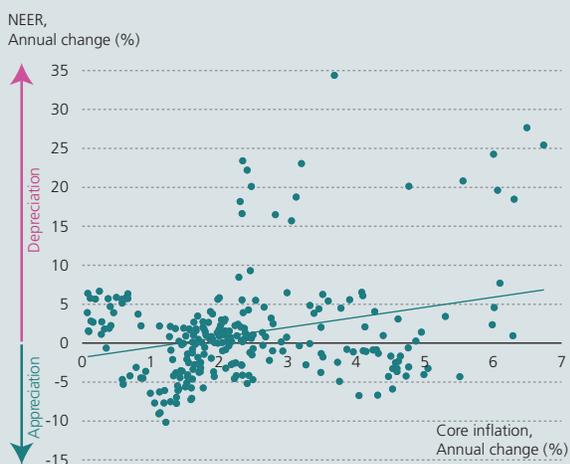
Conceptual Relationship between Exchange Rate Changes and Inflation



Source: Bank Negara Malaysia

Chart 3

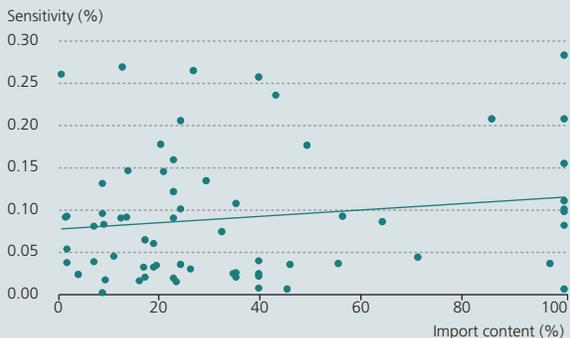
Scatter Plot of Exchange Rate Changes and Inflation



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

Chart 4

Import Content of CPI Items and Their Price Sensitivity to Exchange Rate Changes



Note: Sensitivity refers to the degree of ERPT for the individual CPI items at the 4-digit level.

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

Chart 5

Exchange Rate Changes and Inflation



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

- (i) **Exchange rate pass-through to core inflation is low.** A 10% depreciation in the exchange rate is associated with an increase in core inflation between 0.2% and 0.6%⁶. Over time, the degree of ERPT has remained low and relatively stable⁷.
- (ii) **Analysis of disaggregated CPI data shows no significant positive relationship between import content and sensitivity⁸ to the exchange rate.** Conventional wisdom suggests that prices of items with higher import content would be more sensitive to exchange rate changes compared

⁶ The range refers to short-run ERPT. Variations in the estimates of pass-through arise from different specifications of the estimating equation (e.g. number of lags for inflation, number of lags for exchange rate and the number of control variables, such as demand conditions, and their lags).

⁷ The ERPT remained stable when comparing two sample periods, 1995-2002 against 2003-2015. Mihaljek and Klau (2008) also conclude that the ERPT in Malaysia has been low and stable when comparing two sample periods, 1994-2000 against 1994-2006.

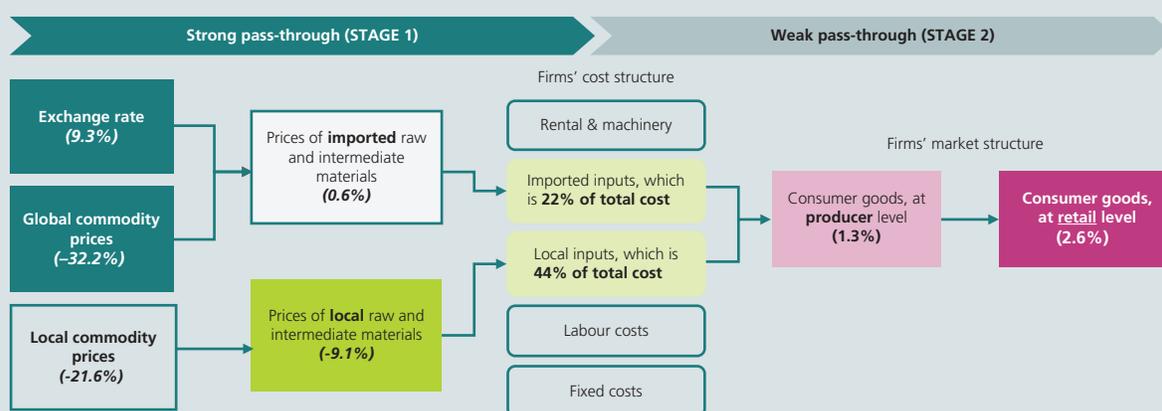
⁸ Sensitivity refers to the degree of ERPT for the individual CPI items at the 4-digit level.

to items with lower import content. The scatter plot (Chart 4), however, shows that this relationship is weak⁹. Examining the individual items of the CPI basket shows that most goods and services have moderate import content¹⁰ and estimations of the ERPT for these items indicate that a 10% depreciation is associated with higher inflation of at most 3%.

- (iii) **Analysis by stage of processing using disaggregated PPI data suggests that exchange rate pass-through via the indirect channel is also low and incomplete.** The ERPT is estimated at two different stages of the production chain, which begins at the firm level and ends at the consumer level (Diagram 2). At the first stage of the production chain, the ERPT to input costs is estimated to be low and incomplete, whereby a 10% change in the exchange rate is associated with a 1.3% change in the costs of imported raw and intermediate inputs. At the second stage, the pass-through from input prices to consumer prices is even smaller, whereby a 10% increase in input prices leads to an increase in prices of consumer goods by only 0.4%.

Diagram 2

Exchange Rate, Global Commodity Prices and Prices Along the Production Chain



Note: Numbers in the parenthesis () represent the average of the annual change in the variables during the depreciation episode between October 2014 and December 2015. For local commodity prices, data is from October 2014 to September 2015.

Source: Department of Statistics, Malaysia, International Monetary Fund (IMF), Bloomberg and Bank Negara Malaysia estimates

- (iv) **Exchange rate depreciation and appreciation have asymmetric impact on inflation.** It is important to note that estimations of the ERPT capture both periods of depreciation and appreciation. Studies, however, have shown that the size of the impact on inflation tends to be larger during periods of depreciation compared to periods of appreciation. The asymmetric relationship between exchange rate changes and inflation (as conceptually illustrated in Chart 2) is also observed in the Malaysian data (Chart 5)¹¹. Empirical estimations to distinguish ERPT during depreciation and appreciation episodes in Malaysia show that ERPT is indeed larger during periods of depreciation.
- (v) **Lack of robust evidence to suggest threshold effects between exchange rate depreciation and inflation.** Firms tend to absorb the initial increase in costs if they view the depreciation as small or transitory. As the exchange rate depreciation becomes prolonged and exceeds a certain threshold, firms may change their price-setting behaviour. At this stage, price sensitivity to the exchange rate depreciation may also increase disproportionately. In the case of Malaysia, however, threshold effects are not conclusively observed. Evidence of threshold effects would indicate that as the size of the exchange rate depreciation becomes larger, inflation would also increase at a much faster pace and to some extent

⁹ This follows from Forbes (2015). In addition, Choudhri and Hakura (2006) and Aron, MacDonald and Muellbauer (2014) find no significant link between ERPT and openness (import-to-GDP ratio, import dependence and number of importers).

¹⁰ Source: Input-Output Tables 2010 for Malaysia. Most items in the CPI basket have import content less than 40%.

¹¹ The data fits a logarithmic trendline as the rising rate of change in the exchange rate coincides with higher inflation.

Chart 6

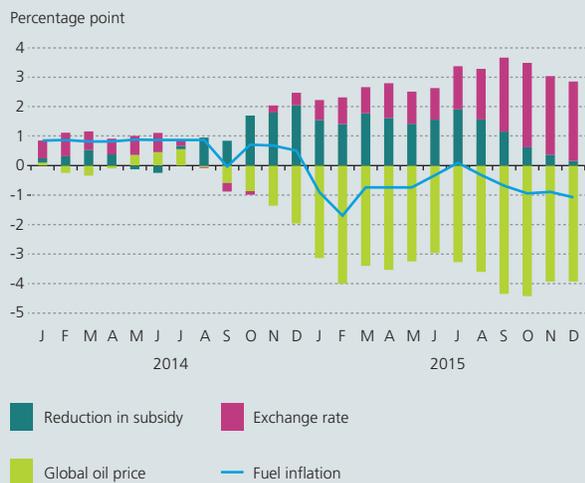
Average Inflation for Different Magnitudes of Exchange Rate Changes



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

Chart 7

Contribution to Fuel Inflation



Source: Ministry of Domestic Trade, Co-operatives and Consumerism, Department of Statistics, Malaysia, Bloomberg and Bank Negara Malaysia estimates

non-linearly. Chart 6 shows that core inflation in Malaysia remained stable, averaging close to 2% when the exchange rate depreciation was below 6%. As the exchange rate depreciation exceeded 6%, core inflation edged up to average at 3.6%. This, however, was driven mainly by data in the period 1997-1998. Although this observation may seemingly indicate some threshold effects, empirical estimations¹² suggest that the results are not statistically significant. This could be primarily due to the fact that from the sample data, Malaysia has limited experience of both high inflation and large exchange rate depreciation.

In summary, the degree of ERPT has remained relatively low in Malaysia. This is consistent with a previous study¹³ by the Bank in 2011 and general findings for Malaysia in the literature. The low ERPT can be attributed to the following factors:

- **Presence of administered-price policies.** About 17.5% of the items in the CPI basket are subject to administered-price policies¹⁴. The Government also implements other measures to ensure price increases are not excessive. These measures include the issuance of more import permits to increase food supplies during periods of shortages, price reduction campaigns and the enforcement of the *Price Control and Anti-Profiteering Act 2011*.
 - This for example has resulted in low sensitivity of fuel inflation to global oil prices and the exchange rate. Prior to December 2014, domestic fuel prices were classified as one of the price-administered items. While fuel for domestic consumption is primarily imported from abroad, their prices were not sensitive to changes in global oil prices and the exchange rate due to the presence of fuel subsidies. This contained the ERPT to inflation. It is, however, important to note that since the removal of the fuel

¹² Estimations are based on threshold regressions from Hansen (1999 and 2000) where the Phillips curve equation is estimated for a series of exchange rate changes that could reflect potential threshold effects.

¹³ See Box Article on "Impact of Ringgit Appreciation on Import Prices and Inflation" in BNM Annual Report 2011.

¹⁴ The pricing mechanisms of administered items in the CPI are mainly governed by the *Price Control and Anti-Profiteering Act 2011*, which replaced the *Price Control Act 1946*. In general, there are two types of price-administered items in the CPI. The first comprises items where the Government determines the retail prices for these goods. Examples include flour and cooking oil, which are also subsidised by the Government. The second comprises items that require Government approval for changes to be made on their prices. Examples include cigarettes, electricity tariffs and public transport fares. With the administered-price mechanisms in place, the impact of shocks on domestic prices is smaller, less direct and less immediate.

subsidies and the implementation of the managed-float pricing mechanism for fuel prices in December 2014, movements in both global oil prices and the exchange rate have had a more direct and faster impact on domestic fuel prices (Chart 7)¹⁵.

- **Limited import content.** Imported finished goods captured in CPI-Import have a low share in the consumption basket of the average household (7.2%). From the supply side, based on the Input-Output Tables 2010 for Malaysia, intermediate imported inputs account for about 20% of total gross output and PPI-Import accounts for 33% of the total PPI basket. Hence, the limited dependency on imports contributes, in part, to the low ERPT to domestic prices.
- **Pricing-to-market.** Price-setting behaviour of firms is greatly influenced by global and domestic market structures. These factors include the degree of competition, product differentiation and substitutability, and the strategic reactions of other firms. Increased competition, due to greater globalisation and liberalisation of markets, has generally increased the elasticity of demand and supply and, in turn, lowered the pricing power of firms. Hence, in response to higher costs amid exchange rate depreciation, firms tend to absorb the higher costs by varying their profit margins or improving cost management by increasing efficiency or switching to cheaper substitutes. In assessing the impact of these factors, anecdotal evidence in Malaysia suggests that firms tend to typically wait for at least six months to assess the strength of demand before reviewing their prices, and either adjust their profit margins or pass on the higher costs. However, some retailers, notably importers of finished goods, tend to fully pass on the higher costs to consumer prices if there are no local substitutes.

B. Inflation developments in Malaysia during episodes of depreciation

Given the low ERPT, expectations are for exchange rate depreciation to have limited impact on inflation. However, past episodes of depreciation have seen different outcomes for inflation. Over the last two decades, Malaysia experienced two episodes of persistent ringgit depreciation. These periods were: (i) April 1997 - December 1998 during the Asian Financial Crisis (AFC); and (ii) October 2014 - December 2015 during the period of a sustained drop in global commodity prices and strengthening of the US dollar. Table 1 and Chart 1 both show that inflation surged during the first episode but remained relatively subdued in the second episode following the depreciation of the ringgit.

Analysing the stylised facts recorded during these episodes highlights that the final overall impact on inflation has to be assessed with consideration to other important factors beyond the ERPT. These factors include the trajectory of the exchange rate depreciation, and other determinants of inflation such as global commodity prices and domestic demand conditions. In the Malaysian experience, these other factors are certainly pivotal in determining the inflationary impact on the economy, which can be clearly contrasted between these depreciation episodes. In particular, during these two episodes there were some ERPT but the mitigating factors in the current episode, namely the prolonged decline in global commodity prices, played a more significant role in containing the overall impact on inflation.

April 1997 - December 1998: Sharp ringgit depreciation caused a spike in import costs and led to an acceleration in inflation

During this period, the NEER depreciated by an average of 13.1%¹⁶. The depreciation trajectory was sudden and steep amid large and sharp fluctuations in the exchange rate. Globally, commodity prices were also on a declining trend, but at a more modest pace compared to the more recent period. While domestic demand conditions weakened as the economy contracted sharply following the adverse impact from the AFC, there was notable evidence of demand-driven inflationary pressures at the onset

¹⁵ The net impact on inflation would, however, depend on the magnitude and direction of the changes in both global oil prices and the exchange rate. See Chart 7.

¹⁶ Between April 1997 and December 1998, the NEER had depreciated by 31.9%. The depreciation of 13.1% refers to the average of annual change in the NEER on a monthly basis, which is used as a like-for-like comparison against inflation. Inflation is also measured in a similar manner.

Table 1

Selected Economic Indicators during the Two Exchange Rate Depreciation Episodes

Average of annual change during the period, % ¹	Episode 1	Episode 2
	(Apr 1997 – Dec 1998)	(Oct 2014 – Dec 2015)
Headline CPI	4.1	2.2
Core CPI ²	4.4	2.3
CPI-Import	5.7	2.5
PPI	7.4	-4.3
PPI-Local	7.5	-6.7
PPI-Import	6.7	0.7
Output gap ³	-0.1	0.3
Real GDP	-1.0	5.1
NEER against import partners ⁴	13.1	9.3
RM/US Dollar	21.2	13.9
IMF Primary Commodity Price Index	-14.4	-32.2
Brent oil price	-24.2	-43.5
Global CPI ⁵	4.5	1.1
RON95 petrol price, RM/litre	1.06	2.04
Diesel price, RM/litre	0.65	1.98

¹ With the exception of output gap, petrol and diesel prices, all other indicators refer to average of the annual change during the period. Output gap captures the average deviation of actual output from potential output during the period. Prices for RON95 petrol and diesel refer to the average prices during the period.

² Core CPI inflation attempts to measure the underlying inflation. It is computed by excluding price-volatile and price-administered items whose price movements are more likely affected by temporary shocks and volatile supply factors rather than persistent changes in underlying factors affecting demand and supply conditions. In addition, core inflation also excludes the estimated direct impact of GST.

³ Output gap captures the percentage deviation of actual output from potential output, which is an estimate of the highest level of output that an economy is capable of producing in a non-inflationary environment.

⁴ The nominal effective exchange rate (NEER) against import partners is calculated based on the weighted average of the bilateral exchange rates against Malaysia's top 15 import partners. A positive figure indicates a depreciation in the ringgit against Malaysia's import partners relative to the year before.

⁵ Global CPI inflation refers to the aggregate inflation of Malaysia's top 15 import partners, weighted by the share of imports from these economies.

Source: Ministry of Domestic Trade, Co-operatives and Consumerism, Department of Statistics, Malaysia, International Monetary Fund (IMF), Bloomberg and Bank Negara Malaysia estimates

of the crisis. In particular, there was a large positive output gap that was reflected in labour market tightness, strong import growth and supply bottlenecks¹⁷. Together with the sharp ringgit depreciation, the domestic developments created a substantial spike in the cost of imports over a short interval of time and these were quickly passed on to consumer prices. Specifically, these factors precipitated the marked increase in the prices of imported finished goods (CPI-Import), which accelerated by 9.1% in 1998 (1997: 1.8%) and prices of imported inputs (PPI-Import), which surged by 9.3% (1997: 2.8%). The quick and sharp rise in the cost of imports also showed that the moderate decline in commodity prices was insufficient to offset the inflationary impact from the large and sharp ringgit depreciation. As a result, headline inflation increased significantly from 2.1% in July 1997 to peak at 6.2% in June 1998 (averaging 5.3% in 1998). Both headline and core inflation remained persistently above 4% throughout 1998.

October 2014 - December 2015: Persistent ringgit depreciation mitigated by downtrend in commodity prices

In comparison to the AFC, the current depreciation episode differs in two ways: the magnitude of the depreciation was relatively more modest, as the NEER depreciated by an average of 9.3%¹⁸ during the period, and the depreciation trajectory was in fact more gradual and persistent with smaller fluctuations

¹⁷ See BNM Annual Report 1997 and 1998 for details.

¹⁸ Between October 2014 and December 2015, the NEER had depreciated by 20.5%. The depreciation of 9.3% refers to the average of annual change in the exchange rate on a monthly basis, which is used as a like-for-like comparison against inflation. Inflation is also measured in a similar manner.

in the exchange rate. The depreciation did cause CPI-Import¹⁹ to increase by 3.0% in 2015 but the overall impact on inflation was offset by the drop in fuel prices of 9.0%. Of importance, the large decline of 32.2%²⁰ in global commodity prices during the period played a significant role in mitigating the impact of exchange rate depreciation on inflation. This is reflected by the decline in PPI by 4.8% in 2015 and only a small increase in PPI-Import by 0.7%. The mitigating effects from the prolonged downtrend in global commodity prices were also evident in the developments of the other price indices along the production chain (Diagram 2). Prices of imported raw and intermediate materials only increased by 0.6% during this episode following the ringgit depreciation, while prices of local raw and intermediate materials recorded a large decline of 9.1%. In addition, domestic demand conditions remained moderate with no signs of demand-driven inflationary pressures. Overall, headline inflation remained modest at 2.1% in 2015 while core inflation remained relatively stable at 2.3%.

Conclusion

Analyses of data in the past two decades suggest that the exchange rate pass-through to inflation has generally been low in Malaysia. The low degree of pass-through is due mainly to the prevalence of administered prices in the CPI, moderate dependency on imported goods and pricing-to-market by firms. While the pass-through is generally low, the 1997-1998 experience shows that exchange rate depreciation can be accompanied by substantial changes in inflation. In the more recent period, however, inflationary pressures have remained moderate despite the persistent depreciation. This is mainly on account of the offsetting impact from the large decline in global oil and commodity prices.

Going forward, the changing economic landscape following reforms towards more market-based pricing could change the inflation dynamics in Malaysia. Since 2010, there has been a gradual removal of subsidies from key necessities including food items, fuel products and utilities. Of note are the adjustments that have impacted the price-setting behaviour of firms, namely the minimum wage policy in 2013 and market-based pricing mechanism for fuel products in 2014. These changes could lead to greater flexibility of domestic prices, which in turn could make firms more responsive not only to changes in the exchange rate but also to global prices.

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¹⁹ In the breakdown for CPI-Import, prices of food and non-food components rose from 2.0% and -0.8% respectively in December 2014 to reach 7.5% and 1.5% in December 2015.

²⁰ Represents average annual change during the period for the IMF Primary Commodity Price Index.

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2015

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MONETARY AND FINANCIAL CONDITIONS IN 2015

INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

Global financial markets experienced high uncertainty and volatility throughout most of 2015 due to a confluence of factors. These included the shifting expectations on interest rate normalisation in the US, concerns about the slowing momentum of global growth and sovereign debt concerns in the euro area. The continued decline in global crude oil and commodity prices also affected sentiments in the global financial markets primarily with regard to its impact on commodity-exporting economies. The volatility was exacerbated by speculative position-taking and the unwinding of those positions, as well as “risk-on” and “risk-off” investment cycles that led to volatile capital flows.

Global financial markets experienced high uncertainty and volatility during the year

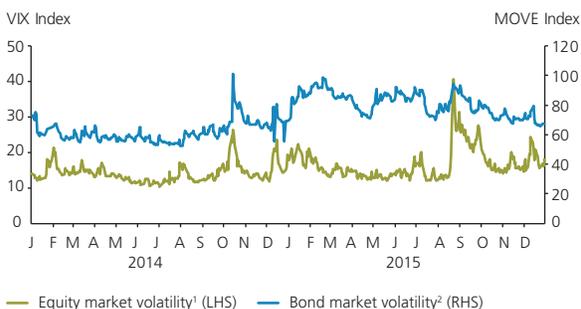
Early in the first quarter of 2015, global financial markets were briefly affected by concerns about the slowing momentum of global growth and the continued decline in global oil prices. An environment of heightened risk aversion accompanied the downward revision of global growth forecasts by the IMF and World Bank in

January. Furthermore, the decline in global crude oil prices (Brent) to levels below USD50 per barrel led to concerns regarding the impact on commodity-exporting economies and the potential to add to the deflationary pressures in the advanced economies. The expectations of weakening growth in emerging market economies led to a sell-off in most emerging equity markets and depreciation of some regional currencies against the US dollar. However, sentiments in global financial markets improved in April. The markets took comfort from the monetary easing by the European Central Bank (ECB) and the People’s Bank of China (PBOC), which led to renewed demand for emerging market financial assets. Capital flows to emerging economies recovered while most regional currencies underwent appreciation.

The period of positive sentiments was, however, transitory as global financial market volatility increased again in the second and third quarters of 2015. During this period, signs of market fragility emerged amid greater financial market volatility and tighter liquidity in the bond markets. Financial conditions tightened for most emerging markets, as reflected by rising long-term sovereign bond yields, lower equity prices and weaker exchange rates. The period of volatility reached its peak in August, when the Chicago Board Options Exchange Volatility Index (VIX), a gauge of market volatility, rose to levels last seen during the height of the euro area sovereign debt crisis

Chart 2.1

Global Financial Market Volatility



Note: ¹ Refers to VIX Index
² Refers to Merrill Lynch Option Volatility Estimate (MOVE) Index

Source: Bloomberg

Chart 2.2

MSCI Emerging Market Index



Source: Bloomberg

Chart 2.3

JP Morgan Emerging Market Bond Index (EMBI) Spread



Source: Bloomberg

in 2011. Capital outflows from emerging markets were estimated to have been about USD53 billion during the second and third quarters of 2015¹. Correspondingly, the MSCI Emerging Market Index fell by 18.7% while the JP Morgan Emerging Market Bond Index (EMBI) spread increased by 64 basis points over the same period. During this period, several factors were affecting global financial markets.

First, the uncertainty surrounding monetary policy in the US led to shifting expectations with regards to the timing of interest rate normalisation by the Federal Reserve (Fed). This was evident from the shifts in the market-implied federal funds rate², which showed expectations for Fed normalisation moving from the second half of 2015 towards later in the year. In particular, global financial markets were reactive to economic data releases or Fed statements that altered market expectations with regards to the timing of interest rate normalisation. During this period, there were more positive economic data releases and statements by Fed officials that appeared bullish, paving the way for an increase in interest rate. These led to international investors reallocating their portfolio investments towards the US financial markets and as a result, strengthened the US dollar vis-à-vis other currencies.

Second, increasing concerns on the slowing momentum of global growth, particularly that

of PR China, which is now the second largest economy in the world, became an additional source of volatility in global financial markets. While earlier in the second quarter of 2015 investor sentiments were supported by the continued easing measures by the Chinese authorities, this trend reversed following the release of weaker economic data from PR China and concerns over an overvaluation in Chinese stocks. Investor sentiments were adversely affected in August by stock market corrections in PR China³ and an unexpected move by the PBOC to lower the central parity rate of the renminbi (RMB). The sharp decline in Chinese equities triggered heightened global risk aversion as investors tried to digest the implications of developments in PR China for other economies.

Chart 2.4

Market-Implied Federal Funds Rate*

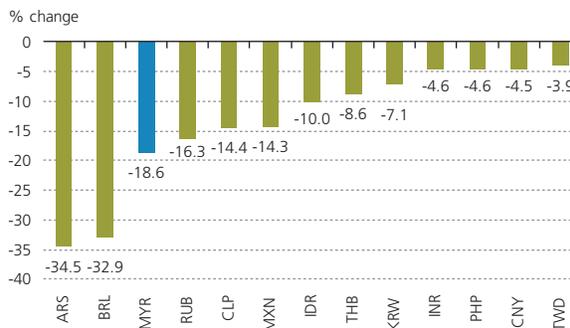


* The market-implied federal funds rate is derived from 1-month federal funds rate futures contracts. The prices of these contracts are typically used to gauge market expectations for the federal funds rate.

Source: Bloomberg, Bank Negara Malaysia calculations

Chart 2.5

Performance of Selected Emerging Market Currencies against the USD in 2015



Source: Bank Negara Malaysia, Bloomberg

¹ Source: Emerging Market Portfolio Research (EPFR) Global.

² The market-implied federal funds rate is derived from the prices of federal funds rate futures and is commonly used to gauge market expectations of where the US interest rate might be in the future.

³ The Shanghai Stock Exchange Composite Index fell sharply in August 2015, especially on 24 and 25 August where it fell by 15% over the two days.

Third, the uncertainty surrounding the Greek sovereign debt crisis also exerted considerable pressure on global financial markets. This mainly revolved around the solvency of the country as it struggled to meet its debt obligations. The prolonged negotiations over a third bailout package in five years, which resulted in Greece having to impose capital controls and default on its payments to the IMF in June, amplified investor risk aversion and added further to the global financial market volatility seen in the second and third quarter of 2015. Nevertheless, concerns on the Greek debt crisis subsided following the securing of the third bailout package in August.

Fourth, the decline in global commodity prices, especially crude oil, continued to exert pressure on global exchange rates, particularly on the currencies of commodity-exporting countries. Although the global crude oil price improved to USD68 per barrel (Brent) in the second quarter of 2015, it subsequently fell to a six-year low of USD42 per barrel in the third quarter. While global crude oil prices were affected by weaker global demand, the increasing global supply of crude oil was the primary factor behind the declining prices. This included the continued strong production by OPEC members and the US during the period. Most commodity exporters experienced large capital outflows and depreciation pressure on their exchange rates due to concerns over the impact of falling commodity prices on their economies.

Apart from these macroeconomic developments, the volatility in the global financial markets was exacerbated by the speculative behaviour of global investors. Globally, the rising role of the asset management industry – estimated to be intermediating USD76 trillion in assets globally (equivalent to about 100% of the world GDP and 40% of global financial assets)⁴ – have been a key conduit contributing to the increased volatility in global fund flows. Herding behaviour among global portfolio managers has become more prevalent, and this has amplified shocks to the global financial markets. As a result, the large movements of investment funds across global financial markets, triggered by “risk-on” and “risk-off” events, have resulted in large movements in prices of global financial assets. In most cases, these movements have been more

than what is warranted by the underlying economic fundamentals. For instance, the search for assets with higher returns by global investors led to capital flows into emerging markets in April as the ECB and the PBOC both announced further easing measures. This quickly reversed with the onset of the “risk-off” phase in the second and third quarters of the year as a sharp deterioration in investor sentiments led to a flight to safety. The rapid unwinding of emerging market financial assets and the reversal of capital flows towards safe-haven assets in the advanced economies led to negative trends in the financial markets and exchange rates of the affected emerging markets. These sudden shifts in investor risk attitudes and risk-taking behaviour were an important driver of global financial market volatility during the year.

While the eventual interest rate lift-off by the Fed has reduced a major source of uncertainty, other factors remain. The continued divergence in the monetary policies of the major central banks, against the backdrop of moderate and uneven global growth, persistently low global crude oil prices and negative geopolitical developments, points to the continuation of high volatility and large shifts in liquidity in the global financial markets.

DOMESTIC MONETARY AND FINANCIAL CONDITIONS

Exchange Rate

The ringgit, along with most major and regional currencies experienced significant depreciation pressure during the year. In large part, the exchange rate reflected global developments, in particular the slower growth momentum of emerging market economies and the uncertainty around monetary policy changes in the advanced economies. The decline in commodity earnings further hurt the value of currencies belonging to commodity-exporting economies. The ringgit, therefore, depreciated more than its peers during the year due to the sharp fall in global crude oil prices and negative sentiments arising from domestic developments.

For the year as a whole, the ringgit depreciated by 18.6% to end the year at RM4.2920 against the US dollar. Against major and regional currencies, the ringgit was broadly weaker. The ringgit’s Nominal Effective Exchange Rate (NEER),

⁴ IMF Global Financial Stability Report, April 2015.

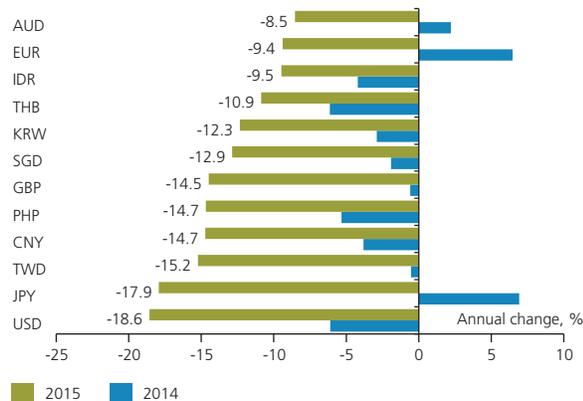
a measure of the ringgit's performance against the currencies of Malaysia's major trading partners, depreciated by 14.5%.

Ringgit depreciated against a stronger US dollar, due to domestic and global developments

Ringgit developments in 2015 were heavily influenced by flows of portfolio investment arising primarily from external factors. The broad depreciating trend of the ringgit in 2014 carried forward into the first quarter of 2015 as the factors that were affecting the ringgit in 2014 continued to remain unresolved. First, the anticipation and eventual normalisation of interest rates in the US resulted in the rebalancing of portfolio investments towards US financial assets. This led to the significant appreciation of the US dollar. As a result, the US Dollar Index⁵, a gauge of US dollar performance against a basket of currencies, appreciated by 9.3% in 2015. Against this backdrop, regional currencies depreciated against the US dollar within a range of 3.9% and 18.6%. Second, rising concerns about the global economic outlook following the downward revisions of 2015 global growth projections by the IMF and the World Bank also affected global sentiments. This combination of factors led to

Chart 2.6

Summary of Malaysian Ringgit (RM) Performance against Major and Regional Currencies



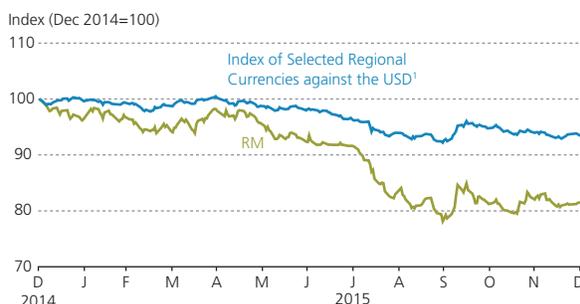
Note: (+) indicates an appreciation of the ringgit against foreign currency

Source: Bank Negara Malaysia

⁵ Source: Bloomberg.

Chart 2.7

Exchange Rate of the Malaysian Ringgit (RM) and Selected Regional Currencies against the US Dollar (USD)



¹ Regional currencies: Chinese renminbi, Indonesian rupiah, Korean won, Philippine peso, Singapore dollar, New Taiwan dollar and Thai baht. Each currency carries equal weight.

Note: An increase in the index represents an appreciation of the ringgit or of selected regional currencies against the US dollar

Source: Bank Negara Malaysia

portfolio investment outflows from most emerging markets, including Malaysia. Third, the ringgit, along with the currencies of most other commodity-exporting countries, was also affected by concerns over the impact of lower prices for crude oil and commodities on the economy. Finally, the negative sentiments on the ringgit were exacerbated by the uncertainty surrounding domestic developments. As a result, the ringgit depreciated to a low of RM4.4725 against the US dollar, coinciding with the peak of uncertainties in the global financial markets between August and September.

For an open economy like Malaysia, that is deeply integrated with the global economic and financial systems, the depreciation of the ringgit was a necessary adjustment to the external headwinds facing the domestic economy. The shift in global liquidity conditions and the signs of weakness in global growth coincided with declining and persistently low commodity prices. The ringgit adjusted in tandem with these developments, and thus helped contain the negative impact on the external sector of the economy. First, as most exports are priced in US dollar, a weaker ringgit allows Malaysia's exporters to mitigate potential losses from lower commodity prices through higher earnings from currency conversions. Second, when other currencies are depreciating, the depreciation of the ringgit is helpful in ensuring that the relative competitiveness of Malaysian exporters is not undermined by currency movements. Without nominal adjustments in the exchange rate, the burden of adjustments would

have been shifted to other parts of the economy. For instance, a loss in competitiveness may result in the shift of manufacturing investments away from Malaysia, resulting in job losses and falling incomes. In such an environment, the flexibility of the ringgit to adjust in response to global developments has been a key feature of the managed float regime that has allowed exchange rate changes to absorb external shocks and mitigated their impact on the domestic economy.

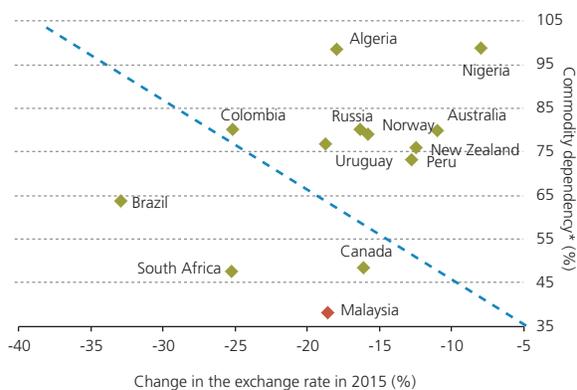
Nevertheless, given the highly volatile global financial markets, massive shifts in cross-border capital flows have also resulted in over-adjustments in the exchange rate. This has caused the ringgit to be undervalued and become misaligned from underlying economic fundamentals. The ringgit's weakness was further amplified by misperceptions about Malaysia's dependence on commodities and its position as the only net oil exporter in the region. The fact that the magnitude of ringgit depreciation is comparable to currencies of countries with much higher degree of commodity dependence points to this misperception. The ringgit was also weighed down by domestic developments that affected investor sentiments towards ringgit financial assets. Overall, the ringgit's overshooting during the year was driven by a rapid deterioration of investor sentiments, rather than significant changes in the underlying fundamentals of the economy.

Going forward, it is important for Malaysia to be able to withstand and ride out the volatility emanating from the external sector. Thus far, despite the volatility in the financial markets and the depreciation of the ringgit, there have been no disruptions to financial intermediation and, more importantly, no dislocation of economic activity. The impact of a weaker ringgit on inflation has been mitigated by the significant decline in global commodity prices. Balance sheets of financial institutions remain strong and financing activity continues to grow. The current account balance remains in surplus, bolstered by strong export growth. In addition, the impact of the depreciation of the ringgit on offshore borrowing in foreign currency, which would rise as the ringgit value of the debt increases, remains contained at 40.1% of GDP.

These volatile conditions are expected to continue as long as uncertainties on monetary policy, global growth and global commodity prices persist. In this regard, it is crucial for policy makers to have access to a wide range of policy tools to manage these risks. First, the flexible ringgit and the ample international reserves will act as shock absorbers to mitigate the impact of financial market volatility on the real economy. Second, Malaysia's deep financial markets and strong banking system will ensure that financial intermediation continues uninterrupted. Third, Malaysia's diversified economy helps ensure against risks emerging from any particular sector or any particular trading partner. Fourth, sustaining domestic demand through pro-growth measures will ensure that Malaysia's economic growth is sustained during these times of uncertainty.

Chart 2.8

The ringgit's performance does not reflect Malaysia's relatively low dependence on commodities



*Commodity dependency = Total exports of primary commodities/Total exports (%) in 2014. Primary commodities refer to beverages and tobacco, crude materials, foods, fuels, oils and fats, and metals.

Source: Bloomberg, Bank Negara Malaysia and UN Conference on Trade and Development (UNCTAD)

Interest Rates, Bond Yields and Equity Prices

Despite the developments in the domestic and international financial markets, domestic interest rates remained broadly stable throughout the year. In the money market, reflecting the unchanged Overnight Policy Rate (OPR), the daily average overnight interbank rate (AOIR) traded within a close range of 3.03% and 3.25%. Interbank rates of other short-term tenures⁶ were also relatively steady.

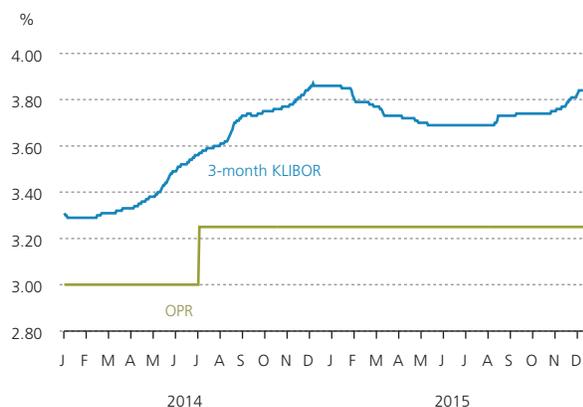
Longer-tenured interbank rates continued their elevated trend from end-2014. Higher interbank rates were a reflection of the increase in the funding costs of banks arising from greater

⁶ Short-term tenures refer to 1-month tenures or less.

competition for stable funding. The competition for stable funds was due to slower growth in deposits arising from net external outflows and the phasing-in of the Basel III Liquidity Coverage Ratio (LCR)⁷ requirements. However, following the Bank's announcement on 30 January 2015 on the arrangements to facilitate the transition to the full implementation of the LCR, a moderation in interest rates was observed in the second quarter. These arrangements, which have helped ease funding pressures, include broadening the scope of recognition of high-quality liquid assets (HQLA) and the clarifications on the treatment of banks' expected cash outflows. Reverse repo operations by the Bank to inject liquidity into the interbank market also facilitated the downward trend in interbank rates. In the second half of the year, interbank rates again began to trend higher, reflecting the shift in liquidity towards the shorter tenures. This reflected the resumption of capital outflows at the end of the third quarter. Nevertheless, the more recent increase in interbank rates was more modest. For the year as a whole, the 3-month Kuala Lumpur Interbank Offered Rates (KLIBOR) decreased from a high of 3.86% at the start of 2015 to a low of 3.69% from end-May to end-August, before increasing to 3.84% at the end of the year.

Chart 2.9

Policy and Interbank Market Rates

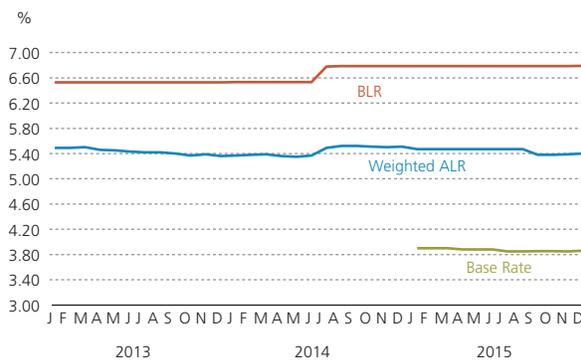


Source: Bank Negara Malaysia and Bloomberg

⁷ The objective of the Liquidity Coverage Ratio (LCR) is to promote the short-term resilience of the liquidity risk profile of banks. It does this by ensuring that banks have an adequate stock of unencumbered high-quality liquid assets (HQLA) that can be converted easily and immediately in private markets into cash to meet their liquidity needs for a 30-calendar day liquidity stress scenario.

Chart 2.10

Commercial Banks' Lending Rates (at end-period)



Source: Bank Negara Malaysia

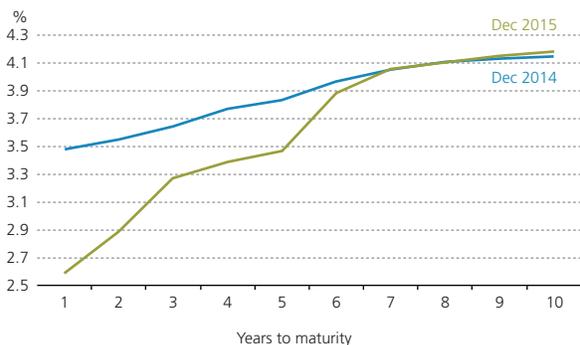
Retail lending rates were broadly stable throughout the year despite the movements in the money market interest rates. On 2 January 2015, the Base Rate (BR) for the banking system, which replaced the Base Lending Rate (BLR) as the main reference rate for new retail floating-rate loans and financing facilities, averaged 3.90% at its introduction. The transition to the BR was neutral on retail lending rates, with the majority of banks maintaining the same effective lending rates. Since the introduction of the BR, five banks have reduced their BRs downwards in the middle of the year in tandem with the decline in the KLIBOR during the period, bringing the average BR of the banking system to 3.85%. Towards the end of the year and early 2016, some of these banks revised their BRs higher following the upward movement of the KLIBOR. Nevertheless, the average BR of the banking system at 3.86% remained lower than at the beginning of the year. Reflecting the decline in the BR, the weighted average lending rate (ALR) on outstanding loans decreased slightly during the year (January 2015: 5.47%; December 2015: 5.40%). Lending rates on new loans to businesses and households were generally stable across most sectors and purposes.

The average quoted fixed deposit rates of commercial banks for the 1 to 12-month tenures were also relatively steady, ranging between 3.09% and 3.31%. Depositors continued to benefit from positive real rates of return on their savings in 2015.

The yields on Malaysian Government Securities (MGS) during the year continued to be influenced by both external and domestic factors. Despite prolonged uncertainties in

Chart 2.11

MGS Benchmark Yield Curve



Source: Bank Negara Malaysia

global financial markets, the spillover effects on Malaysia’s bond market were relatively contained. For the year as a whole, yields on both the 3 and 5-year MGS declined by 37 basis points, while those on the 10-year MGS increased by 4 basis points. Non-resident holdings of MGS were at a historical high of 47.7% of total MGS outstanding (2014: 44.1%).

Conditions in the domestic bond market were broadly stable despite heightened volatility in the global financial markets

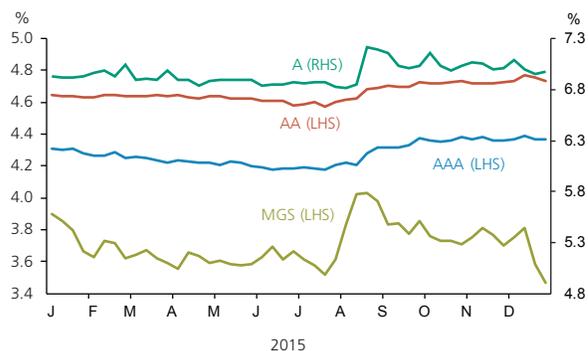
While Malaysia experienced net outflows primarily from Bank Negara Monetary Notes (BNMNs) and the equity market, the domestic sovereign bond market remained relatively stable due to continued non-resident portfolio inflows amounting to RM16.8 billion into the MGS market. In the first half of the year, monetary policy easing by major central banks contributed to the decline in long-term yields in advanced economies. Such developments further reinforced the search for higher yields among global investors in emerging sovereign bond markets, including Malaysia. This in turn, resulted in MGS yields, particularly at the shorter-end of the yield curve⁸, remaining low in the first half of 2015.

The downward pressure at the shorter-end of the yield curve was, however, offset by the reduction

⁸ Refers to 3-year MGS yield and below.

Chart 2.12

5-year MGS and 5-year PDS Yields



Source: Bank Negara Malaysia

of domestic banks’ MGS holdings. Banks were able to exercise greater flexibility in managing their MGS holdings as most of them had exceeded their LCR requirements. As a result, the banks played a stabilising role by containing excessive adjustments in the yields amid increased foreign participation in the MGS market.

Increased non-resident holdings of MGS continued throughout the year except for the temporary sell-off during the period between July and September 2015. Non-resident investors reduced MGS holdings by RM13.0 billion during this period, reflecting increased market expectations over a possible interest rate increase by the Fed in September coupled with the slowdown in PR China’s economic growth that led to concerns over the spillover effects on regional growth. Consequently, MGS yields increased across all tenures by 12 to 42 basis points during this period.

In the private debt securities (PDS) market, yields were generally unchanged in the first seven months before rising slightly in the subsequent months. The spillover from the MGS market was relatively contained due to the low and stable foreign participation in the PDS market (2015: 2.7%; 2014: 3.0%). For the year, yields on the 5-year AAA, AA and A-rated papers registered marginal increases of 10, 13 and 10 basis points, respectively. The relatively stable PDS yields ensured continued fundraising activity in the PDS market to support economic activity. New PDS issuances amounted to RM128.8 billion during the year (2014: RM117.3 billion)⁹, primarily reflecting the demand for financing for new activity,

⁹ Refers to conventional and Islamic securities issued in Malaysia by both local and foreign companies which can be either short-term, medium-term or long-term papers.

working capital and general corporate purposes. Liquidity in the PDS market also continued to remain healthy in 2015, as reflected by higher total turnover which amounted to RM114.5 billion (2014: RM112.4 billion).

Domestic equity market affected by global financial developments

In 2015, the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) declined by 3.9% (2014: -5.7%) to close at 1692.5 points. For the most part of the year, the performance of the domestic equity market was mainly affected by weak global investor sentiment and to a certain extent, uncertainties surrounding domestic developments.

In early 2015, despite bouts of volatility amid heightened uncertainties in global conditions, the domestic equity index rose steadily. This was primarily driven by the announcements of strong corporate earnings for 4Q 2014, particularly in the banking sector, which had recorded higher net interest income. In addition, the attractive valuations of equities prompted domestic institutional investors to increase their equity holdings. Positive sentiments following the announcement of monetary easing measures by the ECB also resulted in increased buying in regional equity markets by non-resident investors. In the KLCI, this was reflected by a resumption of non-resident inflows after seven consecutive months of net outflows. As a result, the index reached a year-to-date high of 1862.8 points on 21 April 2015.

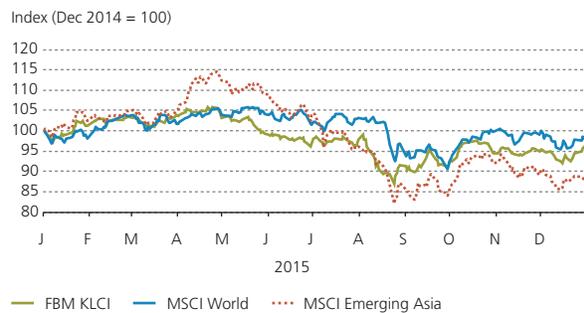
By May, however, the index was significantly affected by weak global and domestic market sentiments. The driving factors for the weak global sentiments included among others, the impending interest rate normalisation by the Fed which would lead to narrowing return differentials between advanced and emerging market financial assets. Furthermore, investors became increasingly concerned about PR China's economic growth and its implication on the sustainability of regional growth. These factors led to heightened risk aversion towards emerging market equities, which resulted in a reduction in non-resident equity holdings within the region, including in Malaysia. Of significance, non-resident investors sold domestic equities worth RM15.0 billion between May to

September 2015. Given the sizeable exposure of the KLCI to the resource-based sectors¹⁰, the sharp decline in global oil prices in August 2015 also contributed to the underperformance of the index. The weaker corporate earnings also resulted in negative domestic market sentiments. In particular, the telecommunication and transportation industries were affected by higher input costs due to the depreciation of the ringgit. The revenue of retail companies was also affected due to the moderation in consumer spending following the implementation of GST. As a result, the FBM KLCI reversed its upward trend and declined to its lowest level for the year at 1532.1 points on 24 August 2015.

Towards the end of the year, the performance of the domestic equity market improved, albeit modestly, supported by a temporary rebound in global commodity prices which boosted the plantation

Chart 2.13

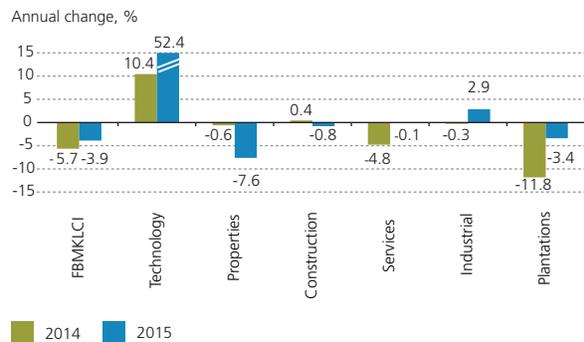
Equity Market Indices



Source: Bloomberg

Chart 2.14

Performance of Sectoral Equity Indices



Source: Bloomberg

¹⁰ Resource-based sectors account for almost 30% of total market capitalisation in the main market.

and oil and gas-related stocks. In addition, the announcement of pro-active economic measures by the Government on 14 September 2015 provided some stability to the market. The measures, which included reactivating ValueCap to support undervalued shares with a fund size of RM20 billion, managed to lift selected blue-chip stocks, which contributed to the FBM KLCI remaining relatively stable for the remainder of the year.

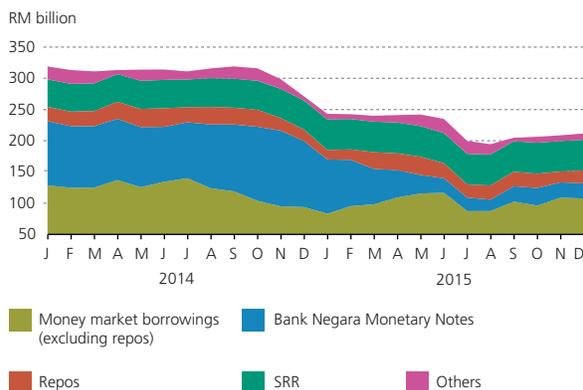
Liquidity and Monetary Aggregates

In 2015, banking system liquidity remained ample despite being lower due to net outflows in the external sector. At the system level, aggregate outstanding liquidity placed with Bank Negara Malaysia remained high. At the institutional level, most banking institutions continued to maintain surplus liquidity positions.

Throughout the year, the Bank’s operations were focused on maintaining stability in the interbank money market. The large placements of liquidity with the Bank served as a buffer for the banking system during periods of outflows as the contractionary pressure on liquidity was offset by the net release of funds placed with the Bank. The composition of monetary instruments used to absorb surplus liquidity was also adjusted to provide banks with greater flexibility in managing their liquidity positions. The issuance of Bank Negara Monetary Notes (BNMNs) was replaced with other instruments of shorter maturities, such as money market borrowings and repos. Consequently, funds lent to the Bank matured more frequently, allowing banks to

Chart 2.15

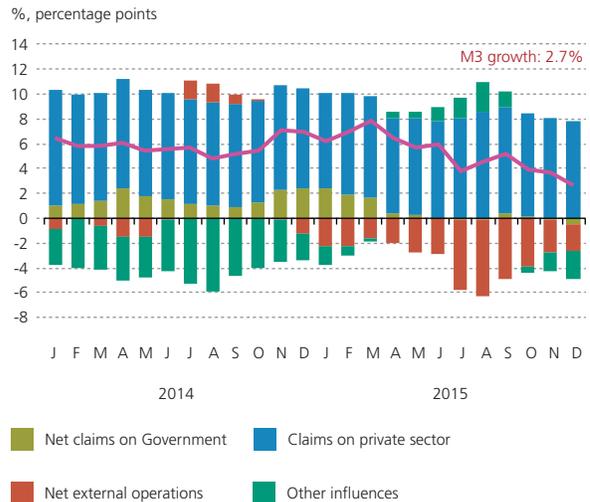
Outstanding Liquidity Placed with Bank Negara Malaysia (at end-period)



Source: Bank Negara Malaysia

Chart 2.16

Contribution to M3 Growth



Source: Bank Negara Malaysia

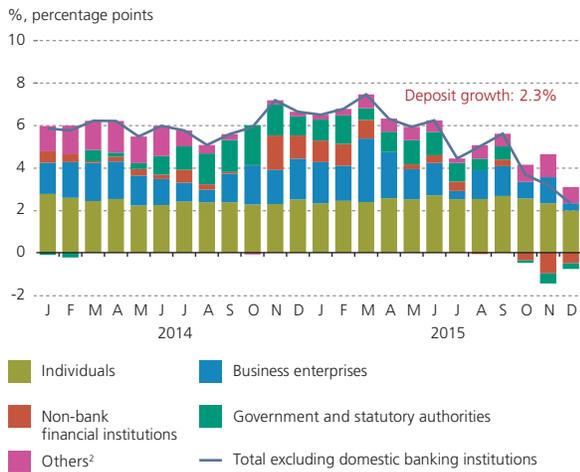
readily meet any sudden withdrawals of funds due to outflows. The Bank also used its monetary operations, including the reverse repo facility, to provide liquidity to the banking system during the year. As part of a comprehensive effort to further ensure sufficient liquidity in the domestic financial system, the Bank reduced the Statutory Reserve Requirement (SRR) ratio from 4.00% to 3.50%, effective from 1 February 2016.

Private sector liquidity, as measured by broad money (M3), grew at a more moderate pace of 2.7% during the year (2014: 7.0%). The moderation in broad money growth was due mainly to the net external sector outflows, given the large outflow of portfolio funds during the year. The net outflows also partly reflected structural factors such as the narrowing of the current account surplus, the regional expansion of domestic businesses and the greater diversification of investments by domestic institutional investors. This was reflected in the slower growth of deposits placed by domestic non-bank financial institutions (2015: -4.1%, 2014: 9.0%) and businesses (2015: 0.9%, 2014: 5.1%). As a result, total banking system deposits¹¹ also grew at a more moderate pace of 2.3% in 2015 (2014: 6.6%). Household deposits, however, continued to register a healthy growth of 5.3% during the year (2014: 6.7%).

¹¹ Excluding domestic interbank deposits.

Chart 2.17

Contribution to Banking System Deposit¹ Growth



¹ Excludes domestic interbank deposits

² Includes domestic other entities and foreign entities

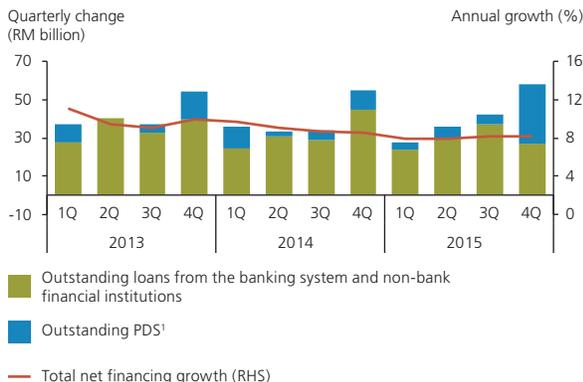
Source: Bank Negara Malaysia

FINANCING OF THE ECONOMY

The growth in net financing through the banking system, non-bank financial institutions¹² and the PDS market expanded at an annual rate of 8.2% in 2015 (2014: 8.6%). The more moderate pace of growth during the year was driven by the lower

Chart 2.18

Total Net Financing to the Private Sector through Banks, Non-bank Financial Institutions and PDS Market



¹ Excludes issuances by Cagamas and non-residents.

Source: Bank Negara Malaysia

¹² Non-bank financial institutions comprise development financial institutions (DFIs), Lembaga Pembiayaan Perumahan Sektor Awam (previously Treasury Housing Loans Division), insurance and stockbroking companies, and others.

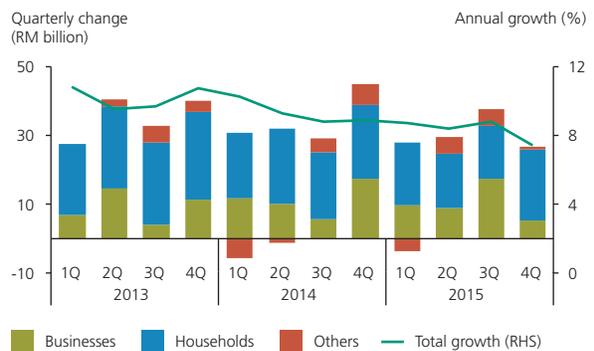
growth of outstanding loans¹³ (2015: 7.5%; 2014: 8.9%), particularly to the household sector. Financing to businesses, however, remained robust and in line with economic activity, with higher growth in outstanding loans and net issuances of PDS by businesses (2015: 9.4%; 2014: 8.3%).

Financing to the private sector remained healthy with continued strong growth in outstanding loans to SMEs

Outstanding business loans¹⁴ grew by 7.7%, mainly due to the strong growth in SME loans of 14.6% in 2015 (2014: 9.0% and 13.3%, respectively). The increase in SME loans growth was largely driven by loans to the *services* sector and for the purposes of *working capital* and the *purchase of non-residential property*. The level of loan disbursements to businesses, including to SMEs, was sustained (monthly average over 2015: RM67.1 billion; 2014: RM65.6 billion) with a larger volume of loans extended to the *agriculture; education, health and other services; finance, insurance and business services; and mining and quarrying* sectors.

Chart 2.19

Outstanding Loans by Borrowers¹



¹ Comprises banking system and non-bank financial institutions outstanding loans

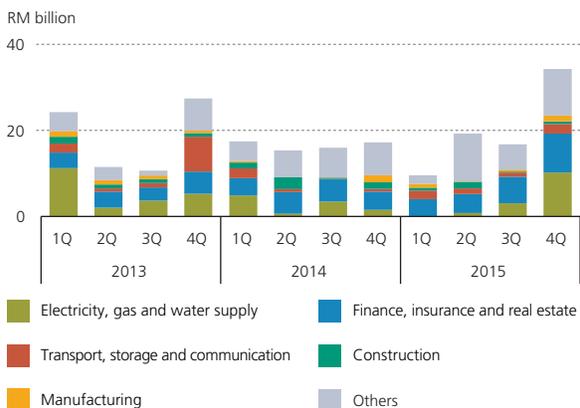
Source: Bank Negara Malaysia

¹³ Includes outstanding loans extended by the banking system and non-bank financial institutions.

¹⁴ Includes outstanding loans of non-financial public corporations, but excludes outstanding loans of domestic financial institutions, domestic non-bank financial institutions, Government, domestic other entities, and foreign entities with the banking system and DFIs.

Chart 2.20

Gross PDS Issued by Sector¹



¹ Excludes issuances by financial institutions, Cagamas and non-residents

Source: Bank Negara Malaysia

Business demand for funding from the capital markets, particularly from the bond market, remained relatively stable amid financial market uncertainty that affected overall market sentiments. New PDS

issuances¹⁵ amounted to RM79.9 billion in 2015 (2014: RM66 billion) with issuances mainly from the *electricity, gas and water supply* and *finance, insurance and real estate* sectors. Financing via the equity market¹⁶ was sustained at RM11.3 billion in 2015 (2014: RM13.1 billion), with two large rights issuances and an Initial Public Offering (IPO) from corporations in the *trading and services* and *property* sectors.

The growth in household debt¹⁷ continued to moderate during the year to 7.3% (2014: 9.4%). This in part is the outcome of the pre-emptive macro- and microprudential measures implemented by the Bank and fiscal measures introduced by the Government since 2010 to ensure the sustainable growth of household debt. In particular, there was a moderation in loans for the *purchase of securities* (2015: 1.7%; 2014: 12.3%) and the *purchase of non-residential property* (2015: 8.1%; 2014: 10.6%). The growth in *residential property* loans, which account for 49% of total household debt, remained robust (2015: 11.0%; 2014: 12.4%).

¹⁵ Excludes funds raised by financial institutions, Cagamas and non-residents.

¹⁶ Excludes financial institution-related issuances.

¹⁷ Comprises outstanding household loans extended by banks and non-bank financial institutions. Non-bank financial institutions comprise two development financial institutions, Lembaga Pembiayaan Perumahan Sektor Awam (previously Treasury Housing Loans Division), insurance and stockbroking companies, and others.

2015

MONETARY POLICY IN 2015

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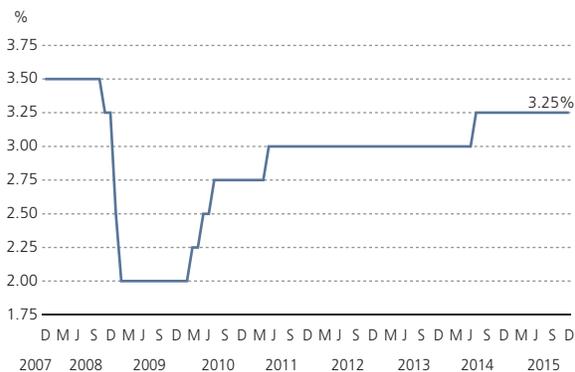
MONETARY POLICY

The Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.25% in 2015, with the focus of ensuring that monetary conditions supported the sustainable growth of the Malaysian economy and price stability. The monetary policy stance was accommodative and supportive of economic activity. This was against a backdrop of increased uncertainties in the policy environment arising from a series of external and domestic developments that affected the outlook of the Malaysian economy and posed risks to overall macroeconomic stability. However, with the low interest rate environment, the MPC also maintained its vigilance against risks related to financial imbalances.

In 2015, the MPC focused on ensuring that monetary conditions supported the sustainable growth of the Malaysian economy and price stability, in an environment characterised by significant volatility and uncertainty

Chart 3.1

Overnight Policy Rate (OPR)



Source: Bank Negara Malaysia

The Malaysian economy was projected to grow at a steady pace of between 4.5% and 5.5% in 2015. This outlook was premised on the expectation that domestic demand would be the anchor of growth amid weak external demand, in line with the prospects of moderate global growth and lower prices for commodity exports. Growth in private consumption was expected to moderate compared to previous years given the higher costs faced by households, especially in the second half of the year, and a more uncertain economic environment. Nevertheless, it was assessed that household spending would continue to be supported by wage growth and stable employment conditions during the year. Similarly, investment activity was projected to remain resilient, with broad-based capital spending by both the private and public sectors cushioning the lower oil and gas investment activity. Investment activity was expected to be led by capital spending in the manufacturing and services sectors, as well as by infrastructure projects.

Headline inflation was forecasted to range between 2 - 3%. The expectation was for the lower global commodity prices and the generally lower global inflation to offset the increase in domestic cost factors given the implementation of the Goods and Services Tax (GST) and other domestic price adjustments, as well as the weaker ringgit exchange rate. From a trough in the first quarter of 2015, headline inflation was projected to trend higher, subsequently peaking in the first quarter of 2016, and moderating thereafter. Throughout the year, underlying inflation was assessed to remain relatively moderate amid the slower growth of domestic demand.

During the course of the year, this baseline outlook for domestic growth and inflation was subject to uncertainties arising from a series of external and domestic developments that affected the Malaysian economy. In the deliberations throughout the year, the MPC carefully monitored these developments and continuously assessed their potential risks to overall macroeconomic stability. In the beginning of the year, the main source of concern was the significantly changed and uncertain outlook for commodity prices and the risks it posed to the continued resilience of the Malaysian economy. In particular, the concerns were on the impact to the

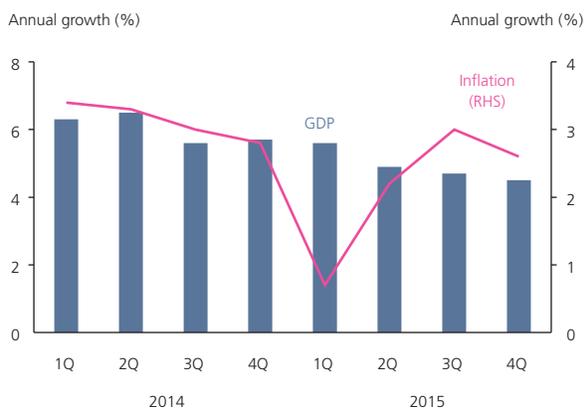
oil and gas sector and the spillovers to broader investment and export activity, as well as on the implications to the overall balance of payments and the Government's fiscal position. The MPC was also concerned about the misperception that the Malaysian economy was highly dependent on commodities. The reality was that Malaysia's economy was well-diversified, with the services and manufacturing sectors playing a key role. In its communications, the Bank sought to address this misperception. The MPC also paid close attention to the outcome of the GST introduction in April 2015. While beneficial to the economy over the longer term, the near-term impact on household and business behaviour could have economic consequences. The direct impact on inflation was deemed to be a lesser concern given the benign global and domestic inflation environment. However, there were concerns about possible profiteering and the pricing behaviour by firms, especially given that there were a number of other changes in domestic prices, such as the implementation of the managed-float pricing mechanism for domestic fuel products.

In the latter part of the year, concerns relating to the negative impact arising from the decline in commodity prices and possible disorderly adjustments to the GST waned. Nevertheless, a number of key global risks identified in the beginning of the year materialised. These included slower global growth arising from the weakening growth momentum in a number of major advanced and emerging economies, heightened volatility in global financial markets arising in part from policy uncertainty in the major economies, and the continued volatility in commodity prices. These external developments significantly affected the domestic financial markets and the ringgit exchange rate in the second half of the year. To a degree, domestic factors also worsened investor sentiments towards ringgit financial assets. Cumulatively, these developments led to the overall deterioration of economic sentiments among domestic households and businesses. By some measures, domestic economic sentiments reached levels last experienced during the crisis in the advanced economies in 2008-2009¹.

¹ For example, the Malaysian Institute of Economic Research (MIER) Consumer Sentiments Index reached a level lower than that experienced in 2008, while the MIER Business Conditions and Employment Indices were at the lowest since 2009 and 2008 respectively.

Chart 3.2

GDP and Inflation



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Despite these developments, the initial expectations on the outlook for domestic growth and inflation were not derailed. Malaysia's economy proved to be resilient. The well-diversified nature of the economy and its exports helped to sustain economic growth. The deep financial markets and well-capitalised financial institutions were able to withstand the large and volatile capital flows and continued to provide financing to support economic activity. Importantly, while global and domestic developments affected the ringgit exchange rate and domestic financial markets, overall domestic liquidity remained sufficient with financial institutions continuing to operate with strong capital and liquidity buffers.

Against this backdrop, the MPC assessed that the stance of monetary policy was appropriate and consistent with the achievement of price stability and sustainable economic growth. The policy stance, together with earlier macro- and microprudential measures, also continued to play a role in ensuring the sustainable growth of household debt and reducing the risks of financial imbalances. The MPC is vigilant to the heightened degree of uncertainty in the global and domestic economic environment, and has requested the Bank staff to undertake more intensive monitoring of these developments and their impact on the Malaysian economy. In its communications through the Monetary Policy Statements (MPS), the MPC has sought to provide greater clarity regarding its assessment of the economic and price outlook and the risks that it sees to this outlook.

Evolution of the Monetary Policy Committee of Bank Negara Malaysia: Key Milestones over the Years

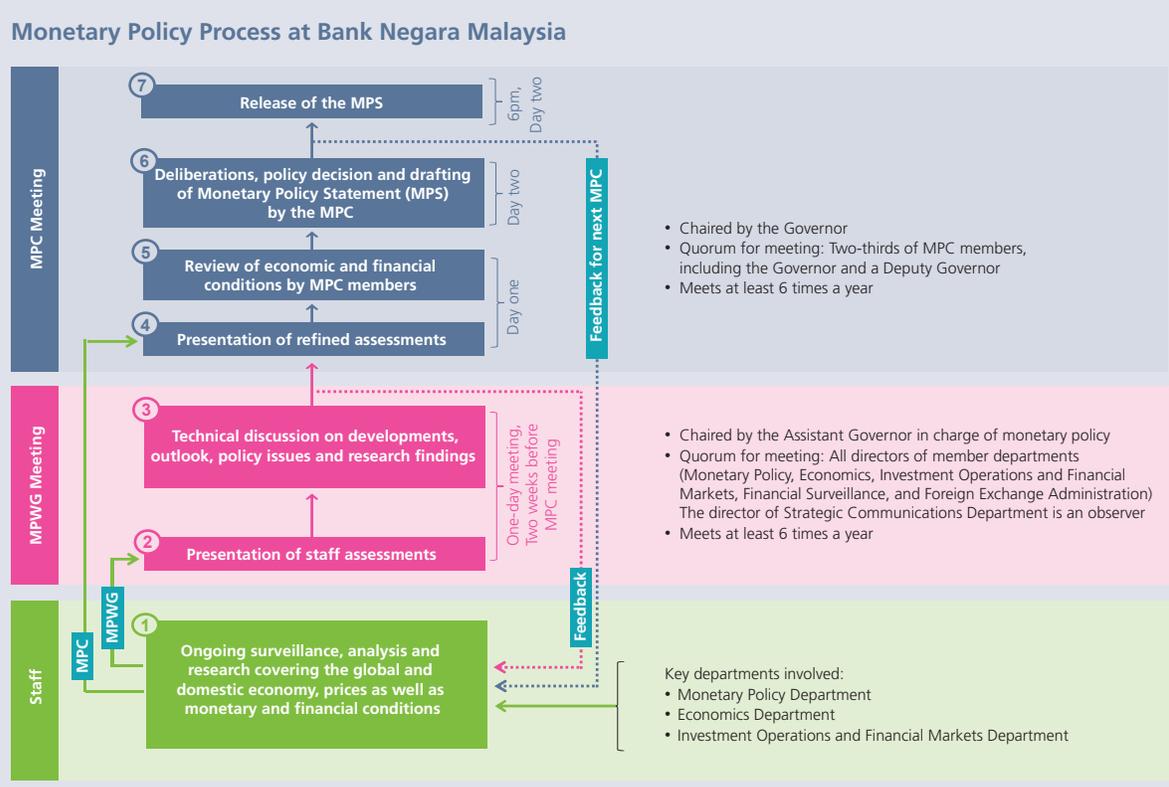
Bank Negara Malaysia's Monetary Policy Committee (MPC) had its first meeting fourteen years ago. Since then, it has evolved and enhanced its effectiveness as the sole body responsible for the formulation of Malaysia's monetary policy and policies for the conduct of monetary policy operations. This box article summarises the key milestones in the evolution of the MPC from its formation.

2002 to 2008: Laying the Foundations

The MPC was formed in 2002. In its initial form, it was an advisory committee comprising of the senior management of Bank Negara Malaysia (the Bank) that supported the Governor, who was the single decision-maker on monetary policy. The MPC meetings typically took place for a day, starting with staff presentations, followed by discussions among the committee members and ending with a decision by the Governor on the stance of monetary policy. The MPC met at regular intervals, to consistently assess the state of the economy and ensure that the monetary policy stance was appropriate given the changes to the outlook for growth and inflation.

An integral part of the monetary policy decision-making process is the internal processes leading up to the MPC meeting. In this regard, the Monetary Policy Working Group (MPWG) plays an essential role. The MPWG was established in 2002 as an internal forum to discuss staff assessments on the latest economic, monetary and financial market developments and outlook, policy issues and research findings before the presentations are prepared for the MPC. Apart from its quality control function, the MPWG also ensures that the views of all relevant parts of the Bank are taken into account and considered carefully. The MPWG is chaired by the Assistant Governor in charge of monetary policy

Diagram 1



Note: Numbering reflects the sequencing of the monetary policy process
Source: Bank Negara Malaysia

and the members are the directors of departments covering the areas of monetary policy, economics, investment operations and financial markets, financial surveillance, and foreign exchange administration. Initially, the MPWG met at least once a month, but this was subsequently changed to eight times a year in 2005 and six times a year in 2010, corresponding to the frequency of the MPC meetings.

An important component in the conduct of monetary policy is the communication of the policy decision to the public and the financial markets. For the MPC, the main policy communication tool is the Monetary Policy Statement (MPS). The first MPS was issued in August 2003, and was initially scheduled for release four times a year, coinciding with the release of Malaysia's quarterly GDP performance. The release dates were subsequently changed to coincide with the MPC meeting dates beginning in December 2005, which also saw for the first time the release of an advance calendar of the MPC meetings for the year ahead. The MPS is a forward-looking statement, outlining the monetary policy stance and the rationale for the policy decision.

2009: Autonomy and Institutionalisation

The year 2009 marked a very important milestone in the evolution of the MPC, with the enactment of the Central Bank of Malaysia Act 2009¹ (the Act). The Act stipulates that monetary policy shall be autonomously formulated and implemented by the Bank and legally recognises the MPC as the body responsible for formulating monetary policy and the policies for the conduct of monetary policy operations in the country. The Act also institutionalised and provided greater clarity to some established aspects of the conduct of monetary policy by the Bank. These include, for example, the objective of monetary policy, namely maintaining price stability while giving due regard to developments in the economy, and the formal requirement to publish an MPS following each meeting.

Beyond that, the Act introduced important governance procedures that would serve to provide the framework to improve the robustness of not only the monetary policy decision-making environment, but would also allow the MPC to further evolve in the future. The governance of the monetary policy process is also guided by the MPC by-laws, which amongst others, provide a set of practices for efficient and robust policy decision-making; define the roles, responsibilities and accountability of MPC members; and define the monetary policy decision-making cycle. The by-laws include provisions such as the need for an optimal mix of representation of constituencies in the composition of the MPC to mitigate biasness, the approach to decision-making and the structure of the MPC meetings.

The MPC developed into a collegial decision-making committee in which decisions are made by consensus, with the Governor, as the Chair, having the role in leading the discussions and deliberations, as well as building a consensus among the MPC members. The membership criteria of the MPC also became more clearly defined in the Act. The overarching consideration to being nominated to the MPC is having the expertise and experience relevant to the responsibilities and functions of the MPC; and being a person of probity, competence and sound judgement. The Governor and the Deputy Governors remain as members of the MPC for so long as they hold office. The other members are appointed by the Bank's Board of Directors from amongst senior officers at the Bank with relevant expertise, on the recommendation of the Board Governance Committee of the Bank². The Board Governance Committee may recommend external members to the Minister of Finance for their appointment to the MPC.

The duration of each MPC meeting was also extended to two days. This was to allow sufficient time for in-depth presentations by staff and for the MPC members to appraise and discuss the implications

¹ For a detailed account, refer to "White Box: Monetary Policy Process under the Central Bank of Malaysia Act 2009", in Chapter 3 of Bank Negara Malaysia's Annual Report 2009.

² The Board Governance Committee assists the Board of Directors in its oversight role, whose members are non-executive directors. The Board Governance Committee is responsible for recommending the persons to be appointed to the MPC and other Committees of the Bank, among other responsibilities. For further details refer to "White Box: The Central Bank of Malaysia Act 2009", in Chapter 5 of Bank Negara Malaysia's Annual Report 2009.

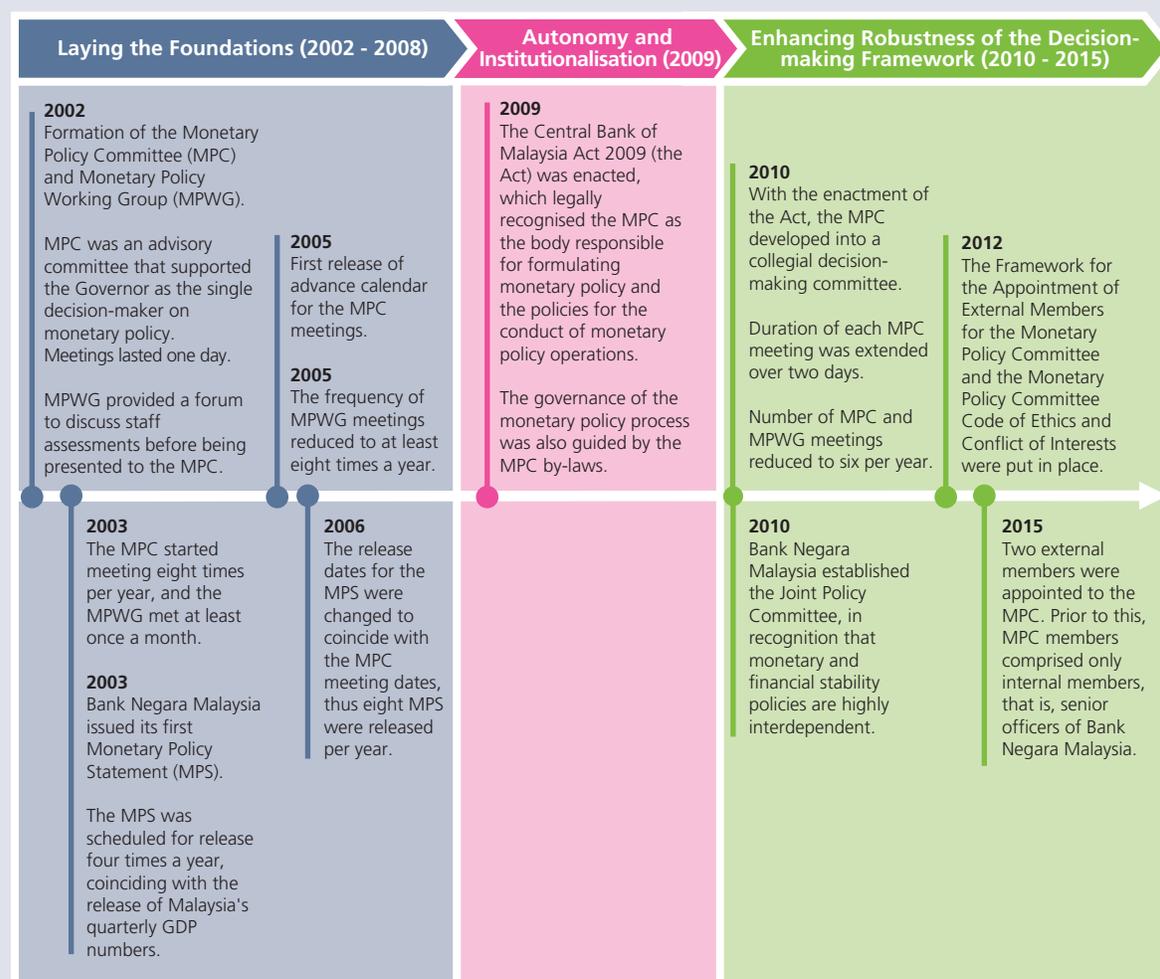
of new developments. The additional time also enabled the evolution of a consensus view of the policy direction, and finally the drafting of the MPS. The Act also specified that the MPC should meet six times a year, with the flexibility to convene additional meetings should it become necessary.

2010 to 2015: Enhancing Robustness of the Decision-making Framework

In the years after the global recession, the policy environment of the Bank continued to be challenging, arising in large part from the significant developments and uncertainties in the global economic and financial market environment. During this period, the Bank made a number of efforts to further strengthen its policy decision-making framework. The Bank established the Joint Policy Committee in 2010, a high-level policy committee that consists of members from both the MPC and the Financial Stability Committee of the Bank³. This is in recognition of the fact that monetary and financial stability policies are highly interdependent, such that effective coordination of these policies is critical for preserving macroeconomic and financial stability. The Joint Policy Committee facilitates broader surveillance and a more comprehensive risk assessment of issues by combining macroeconomic

Diagram 2

Evolution of the Monetary Policy Committee of Bank Negara Malaysia



Source: Bank Negara Malaysia

³ Further discussion on the Joint Policy Committee can be found in “Box Article: Bank Negara Malaysia’s Joint Policy Committee”, in Chapter 3 of Bank Negara Malaysia’s Annual Report 2012.

surveillance with micro-level analysis of the financial sector. This allows the Bank to deliberate on cross-cutting issues and to ensure the effective coordination of policies that may have an impact on both the financial system and the broader economy.

In 2012, the process further evolved when the Monetary Policy Committee Code of Ethics and Conflict of Interests (Code) was put in place. The Code established guidelines to preserve the integrity of decision-making by the MPC by seeking to minimise and manage any conflict of interest. In addition, an internal Framework for the Appointment of External Members for the Monetary Policy Committee (Framework) was developed in 2012. The Framework provides guiding principles, based on the criteria set out in the Act and the MPC by-laws, to facilitate the Bank's Board Governance Committee in assessing the suitability of the external candidates to be recommended as members of the MPC. The Framework strengthens safeguards already in place, such as specifying that in recommending any person to be a member of the MPC, the Board Governance Committee should be satisfied that the person will strengthen the diversity of expertise and experience available within the MPC, and requiring external members to include disclaimers in views expressed in members' professional capacity elsewhere so as to distinguish these views from those of the MPC.

Two external members were appointed to the MPC in April 2015. The inclusion of external members is a significant milestone. It reflects the ongoing progress of the MPC as a decision-making committee, with the external members bringing additional diversity of views and relevant expertise to the monetary policy decision-making process.

Conclusion

The foundations put in place over the last fourteen years of its existence, in particular the governance framework and established processes, provide the MPC with a solid platform to effectively discharge its responsibility of formulating monetary policy and policies for the conduct of monetary policy operations in Malaysia.

MONETARY OPERATIONS

The heightened uncertainties in global financial markets led to capital outflows during the year. The capital outflows were mainly from short-term money market instruments and to some extent, equity investments. The domestic sovereign bond market, however, recorded net inflows of RM25.7 billion for 2015. The net outflows from the money market led to a reduction in the aggregate surplus liquidity placed with the Bank from RM269.9 billion as at end-2014 to RM205.1 billion at the end of the year. The monetary operations of the Bank were thus focused on managing this reduction in excess liquidity by ensuring that the financial intermediation process continued to function smoothly with orderly financial market conditions.

In the first half of 2015, the Bank significantly reduced the issuance of Bank Negara Monetary Notes (BNMNs), partly in response to the reduction in liquidity caused by the outflows. Only in the latter half of 2015 did the Bank start to re-issue BNMNs to long-term investors² when capital flows began to stabilise in late August 2015. Outstanding BNMNs thus fell from

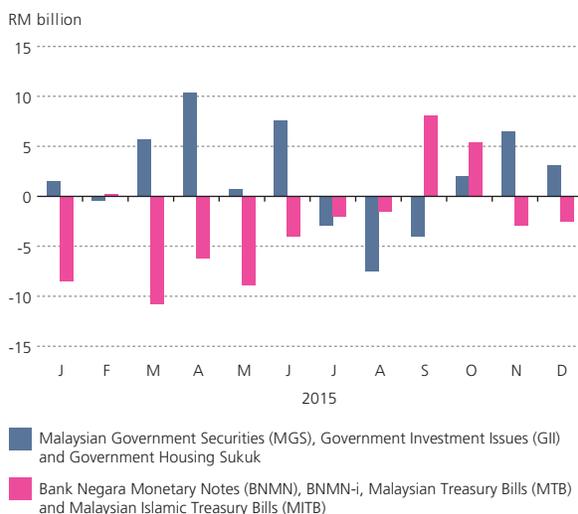
RM107.1 billion as at end-2014 to RM24.5 billion at the end of the year, of which 97% were held by long-term investors.

Arising from the increased volatility of capital flows during the year, the banking institutions' preference for managing their liquidity profile shifted in favour of shorter maturities to manage the uncertainty in liquidity requirements. Correspondingly, the Bank shortened the tenures of money market borrowings and repos, thereby reducing the overall average duration of liquidity absorption operations from 56 days as at end-2014 to 34 days as at end-2015. The Bank also provided liquidity to the banking system during the year, amounting to RM39.5 billion as at end-2015. The provision of liquidity was undertaken in part through the reverse repo facility introduced since March 2015, which allows eligible participants to obtain liquidity of tenures ranging from one month to six months by pledging high-quality collateral to the Bank.

The Bank adopted a similar strategy in managing Islamic liquidity, with an additional emphasis on the use of the competitively auctioned Commodity Murabahah Programme (CMP) to further promote profit rate transparency in the Islamic money market. Islamic banks have progressively switched their Wadiah placements with the Bank to

Chart 3.3

Monthly Change in Non-Resident Holdings of Ringgit Securities

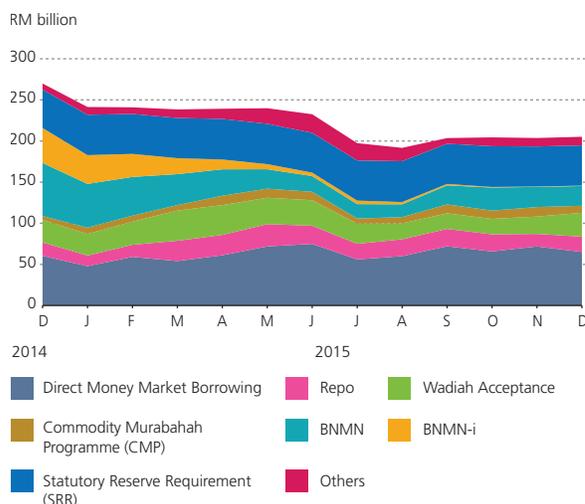


Source: Bank Negara Malaysia

² These long-term investors adopt buy-and-hold strategies and are committed to rolling over maturing BNMNs and Malaysian Government Securities (MGS) to maintain country exposure for investment mandates.

Chart 3.4

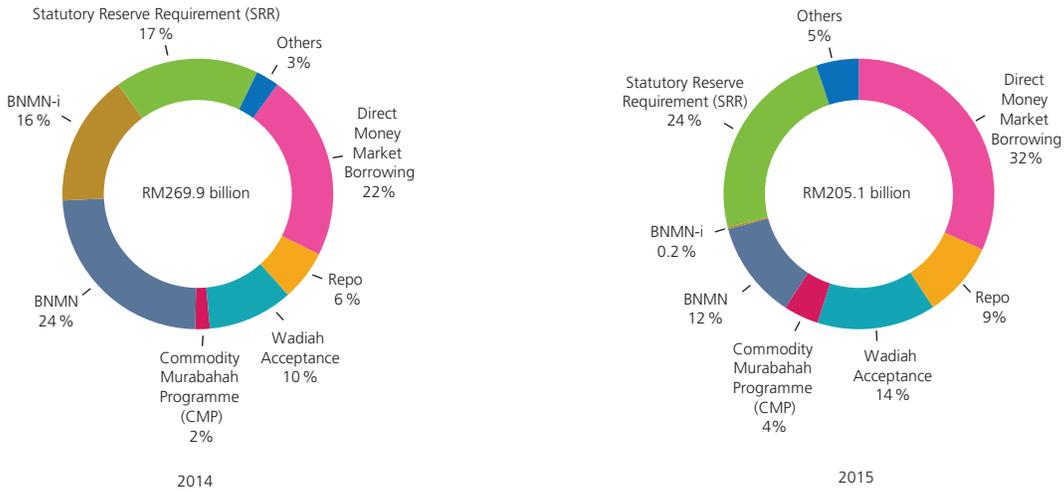
Outstanding Liquidity Placed with Bank Negara Malaysia



Source: Bank Negara Malaysia

Chart 3.5

Composition of Outstanding Liquidity Placed with Bank Negara Malaysia



Source: Bank Negara Malaysia

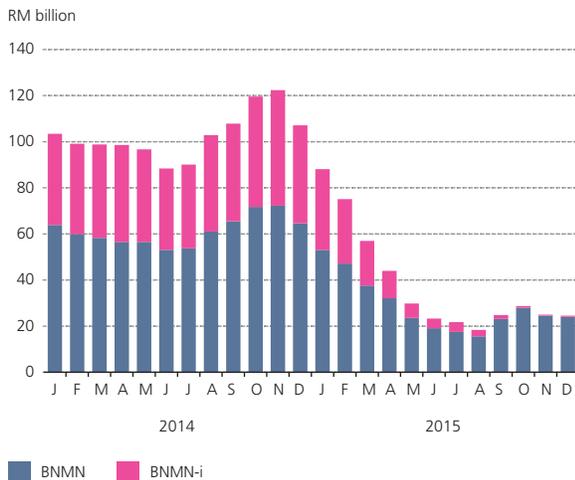
CMP, with the share of CMP against total Islamic short-term acceptances increasing from 14.5% in 2014 to 22.7% in 2015. The Bank also introduced the Bank Negara Malaysia – Mudarabah Certificate (BNM M-Cert), a hybrid equity instrument, to add variety to the instruments available for liquidity management. The BNM M-Cert is structured based on a profit-sharing agreement between the Bank and sukuk holders, where the Bank undertakes the role of investment manager by investing funds in Shariah-compliant assets and distributing the

profits according to the agreed profit-sharing ratio. The BNM M-Cert is recognised as Level 1 high-quality liquid assets (HQLA) and is tradable in the secondary market.

While short-term money market rates with tenures of one week or less remained stable, with the average overnight interbank rate (AOIR) tracking the OPR and trading within the range of 3.03% to 3.25%, the longer-term money market rates fluctuated and trended higher during the year. Longer-term interbank rates with tenures

Chart 3.6

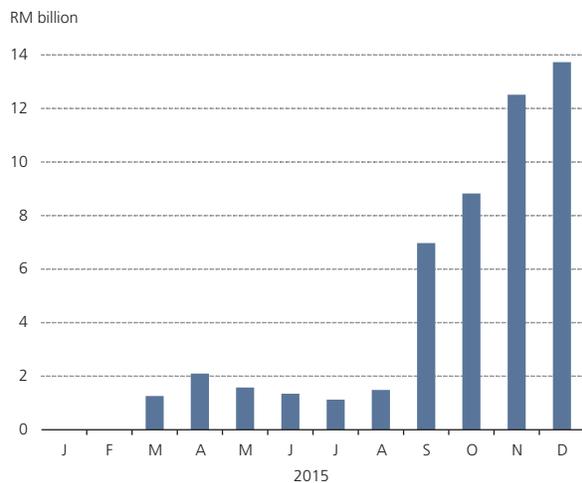
Outstanding Amount of BNMNs



Source: Bank Negara Malaysia

Chart 3.7

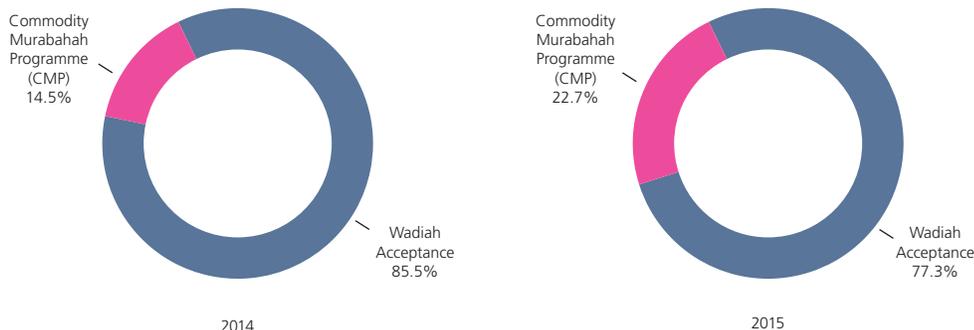
Outstanding Reverse Repos



Source: Bank Negara Malaysia

Chart 3.8

Outstanding Amount of Islamic Short-term Acceptances



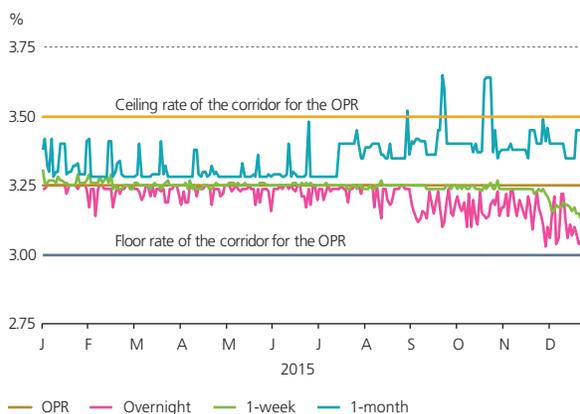
Source: Bank Negara Malaysia

of above one month were already at elevated levels in early 2015, following the rising trend in late 2014 which reflected an increase in the funding costs for banks, arising from greater competition for stable funding. The competition for stable funding was due to the slower growth in deposits because of net external outflows as well as banks preparing for the phasing-in of the Basel III Liquidity Coverage Ratio (LCR)³ requirements, which became fully enforceable in June 2015. However, these interest rates gradually declined, with the 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) easing from a peak of 3.86% to 3.69% in the first half of the year, following the broadening of scope of recognition of HQLA

to include the Statutory Reserve Requirement (SRR) and term deposits placed with Bank Negara Malaysia, as well as clarification by Bank Negara Malaysia on the treatment of banks' expected cash outflows. The reverse repo operations by the Bank also injected liquidity into the interbank market⁴, alleviating the pressure on banks to seek long-term funding from the interbank market. In the second half of the year, interbank rates trended higher again with the 3-month KLIBOR reaching 3.84% at the end of the year, as banks again competed for stable funding to support their loan-to-deposit ratios in an environment of net external outflows.

Chart 3.9

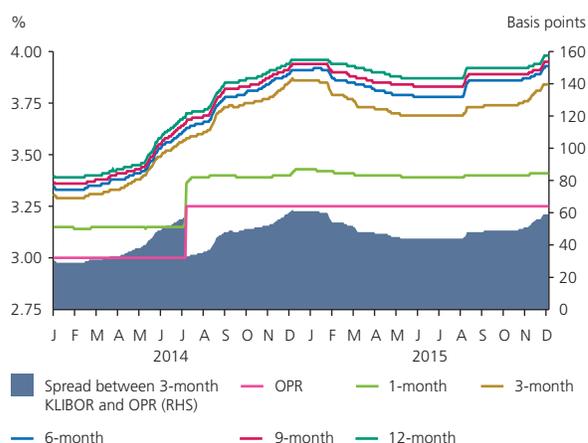
OPR and Interbank Rates



Source: Bank Negara Malaysia

Chart 3.10

KLIBOR Rates



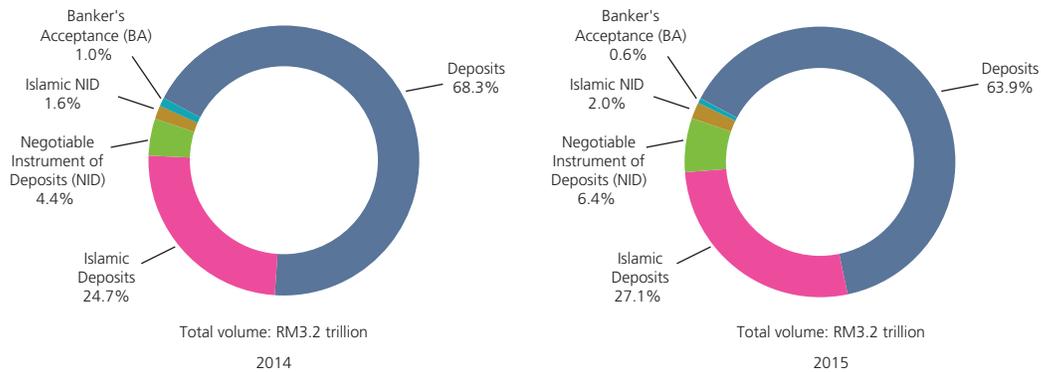
Source: Bloomberg and Bank Negara Malaysia

³ The objective of the LCR is to promote the short-term resilience of the liquidity risk profile of banks. It does this by ensuring that banks have an adequate stock of unencumbered HQLA that can be converted easily and immediately in private markets into cash to meet their liquidity needs for a 30-calendar day liquidity stress scenario.

⁴ Banks were able to pledge the securities which were gradually built up for the implementation of the LCR as collateral for the reverse repo, thereby allowing them to monetise their holdings of the HQLA.

Chart 3.11

Breakdown of Interbank Money Market Transactions



Source: Bank Negara Malaysia

Total interbank money market transactions, which comprised deposits and acceptances, banker's acceptance (BA), and negotiable instrument of deposits (NID) in both the conventional and Islamic money markets, were unchanged at RM3.2 trillion (2014: RM3.2 trillion). Although deposits (conventional unsecured borrowing and lending) remained the main instrument traded, there was an increase in NID

transactions due to its recognition as HQLA under the LCR requirements.

Moving forward, it is expected that domestic liquidity conditions will continue to be affected by swings in capital flows. The Bank's monetary operations will continue to focus on ensuring that liquidity remains ample to support financial intermediation and the orderly functioning of the domestic financial markets.

2015

OUTLOOK AND POLICY IN 2016

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THE INTERNATIONAL ECONOMIC OUTLOOK

The global economy is expected to improve at a modest pace in 2016. The growth outlook, however, remains vulnerable to considerable downside risks arising from policy developments in the major economies, high uncertainty surrounding the direction of global commodity prices and abrupt financial market adjustments. Growth in the advanced economies is expected to proceed at a gradual and uneven pace. Even with highly accommodative monetary policies, the advanced economies are experiencing persistent economic slack stemming from unresolved structural issues and weakness in domestic demand. For the emerging economies, growth is projected to recover from the shock to external demand experienced in 2015. Nevertheless, the extent of the recovery will be contingent on several factors, including commodity price developments, financial market conditions and the ability of economies to contain rising domestic vulnerabilities. In this environment, global trade activity is expected to register only a modest improvement. The confluence of external and domestic headwinds will make 2016 a challenging year for policymakers globally.

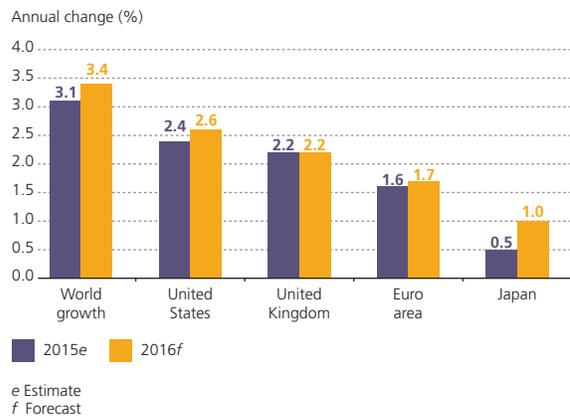
Global economy to improve in 2016 although considerable downside risks remain

Uneven growth momentum across major economies

The **US** economy is expected to remain on a steady growth path, underpinned by a continued expansion in private consumption. Private consumption, which accounts for about two-thirds of GDP, is projected to strengthen on account of favourable labour market conditions and improving household balance sheets. In particular, labour market slack is diminishing as evidenced from the declining trend in the number of part-time workers who would rather work full-time and the number of workers who are marginally-attached,

Chart 4.1

Growth: World and Major Advanced Economies (2015 - 2016)



Source: International Monetary Fund and National Authorities

including discouraged workers. The ongoing improvement in the labour market amid an environment of low energy prices will continue to support growth in real personal incomes, which have risen by an average of 4.1% in 2015 (2003-2007 average: 3%). These trends have positive spillovers to the housing market. House prices have shown continued improvement, following the recovery in housing demand amid diminishing supply. This provides support to home equity and has strengthened household balance sheets. The share of homeowners that have mortgage loans with a higher balance than the fair market value of their property is now less than half of what it was at its peak in the first quarter of 2012. Residential investment has also improved gradually, with single-family homebuilding continuing to trend up and multi-family construction remaining at a high level. Notwithstanding these positive trends, the strength of the recovery of the US economy will be weighed down by weakness in energy-related industries and to some extent, spillovers from developments in the financial markets and the external sector.

Growth in **PR China** is expected to moderate as domestic demand faces the immediate effects of the ongoing structural adjustments. While sustained growth in the services sector continues

to support the Chinese economy, this is expected to be offset by the slowdown in sectors with excess capacity, such as the industrial and property sectors. In addition, the potential re-emergence of financial market volatility may affect sentiment and poses downside risks to financial stability and growth. In view of these challenges, domestic policy is likely to remain accommodative to support growth. Thus far, Chinese policymakers have announced wide-ranging measures such as higher infrastructure investment, ensuring continued access to credit for viable sectors in the economy, and tax reductions on vehicle and house purchases.

In the **euro area**, while the gradual improvement in economic activity is expected to continue, the pace of recovery is likely to be uneven across the region. In the core economies, such as Germany and France, private consumption activity is anticipated to be driven by improvements in the labour market and favourable credit conditions. The unemployment rate has declined to 10.9% (2012 - 2014 average: 11.7%) while private sector credit growth is beginning to recover albeit at a gradual pace (2015: 0.7%; 2012-2014 average: -1.6%). However, the outlook for some of the crisis-affected economies remains fragile amid slow progress in structural reforms and reduction in public debt. Policy decisions involving

further structural and financial sector reforms, including deregulation of the labour markets, reduction of public debt and the completion of the banking union, will continue to be critical elements in promoting confidence and supporting a sustained economic recovery.

Economic activity in **Japan** is expected to expand at a very modest pace. Growth will be supported primarily by monetary and fiscal stimulus. Of significance, the Cabinet has approved a ¥3.5 trillion (0.7% of nominal GDP) supplementary budget to support domestic demand through enhanced welfare services, cash hand-outs to pensioners and accelerated reconstruction in areas devastated by the March 2011 earthquake and tsunami. The Bank of Japan has adopted increasingly aggressive monetary policy. The growth trajectory, however, remains contingent upon the effective transmission of these policy measures to real economic activity, the progress of structural reforms, the prospects for wage growth and increased capital expenditure.

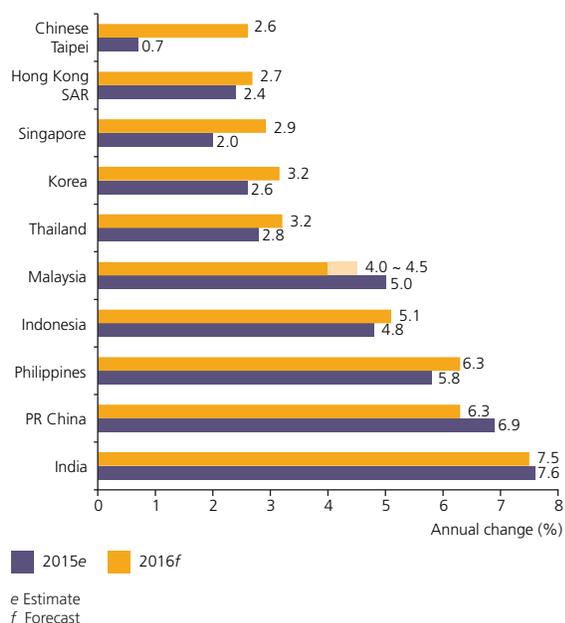
Economic growth in **Asia** is projected to improve in 2016, driven mainly by continued expansion in domestic demand and a modest recovery in external demand. In most Asian economies, growth is projected to be higher compared to 2015. Private consumption activity is likely to be underpinned by sustained income growth amid favourable labour market conditions, including increases in minimum wages in some of the regional economies. Infrastructure initiatives are expected to support the expansion in capital spending, particularly in the ASEAN economies. The implementation of additional fiscal measures in a number of Asian economies, including Chinese Taipei, Thailand, Indonesia and Korea, will also bolster domestic economic activity. The measures include financing support for small businesses, higher public investment and rebates to encourage purchases of durable consumer goods.

Global inflationary pressures to remain modest

Global inflation is expected to remain modest in 2016, reflecting weak supply and demand pressures. On the supply side, the risk of cost-push inflation is expected to remain restrained, given expectations for persistently low global commodity prices. In addition to the moderate growth in global demand, crude oil prices are expected to be weighed down by continued oversupply from both the Organisation of the Petroleum Exporting

Chart 4.2

Regional Economies: Real GDP Growth (2015 - 2016)



Source: International Monetary Fund and National Authorities

Countries (OPEC) and non-OPEC members, the restoration of oil supply from Iran following the cessation of economic sanctions and the lift of the ban on US oil exports. Food prices are also expected to remain moderate amid higher crop production and high inventories. For hard commodities, lower demand from several key economies, including PR China, will continue to exert downward pressure on prices, particularly for copper, nickel, zinc and iron ore.

Amid the modest outlook for global commodity prices, headline inflation rates are expected to remain below central banks' inflation targets in most advanced and emerging economies. In some of the advanced economies, underlying inflationary pressures are expected to be subdued, reflecting continued excess capacity and weak demand in these economies. Across the emerging economies, inflation is projected to exhibit diverging trends. While lower fuel prices are easing inflationary pressures in most emerging economies, several economies, including those in the Commonwealth of Independent States, Latin America and the Middle East, are projected to face a faster pace in price increases due to the removal of subsidies amid efforts to consolidate fiscal positions. Additionally, the effect may be exacerbated by imported inflation, mainly reflecting the impact of marked currency depreciations.

Downside risks remain elevated

The projected improvement in the global economy is subject to considerable **downside risks**, amid a highly challenging growth and policy environment.

While PR China's economic rebalancing is necessary for its transition towards a more sustainable growth model, the process faces challenges from domestic vulnerabilities, including high indebtedness and continued excess capacity in a few industrial sectors. Given PR China's rising importance in the global economy and extensive trade and financial linkages, a potential sharper-than-expected growth moderation in the Chinese economy would have significant spillover effects on global trade activity, investor sentiments and commodity prices.

Uncertainty surrounding key commodity prices will continue to affect growth prospects of several large economies. Crucially, a further downward adjustment in commodity prices will lead to a weaker-than-expected outlook for commodity-exporting countries while creating disinflationary pressures in several economies.

The sharp reaction of global financial markets to monetary policy shifts in the advanced economies in the past two years reflects the underlying fragility in the current phase of recovery and the overall financial risk-taking driven by a search for yield. Going forward, investors' behaviour will continue to be affected by the divergences in the monetary policies of the major economies. Bouts of heightened financial market volatility amid large shifts of global liquidity may potentially impact financing conditions and therefore weigh on growth prospects. Moreover, a further escalation of geopolitical tensions in several regions could materially affect sentiments and divert policymakers' focus from strengthening economic fundamentals.

For Asia, the high degree of uncertainty in the external environment will continue to generate high volatility in domestic financial and currency markets. Thus far, financial intermediation in most Asian economies has remained undisrupted. There is also ample room for policymakers to undertake countercyclical policies should the circumstances warrant it. This is due in part to policy measures put in place in the past decade to strengthen macroeconomic fundamentals and preserve financial stability. Going forward, Asia continues to face challenges from the domestic and external environments which require active recalibration of policies while maintaining efforts at structural reforms to support medium-term growth prospects.

THE MALAYSIAN ECONOMY

The international economic and financial landscape is likely to remain challenging and will be a key factor that will influence the prospects of the Malaysian economy in 2016. The strength of global economic growth and the trajectory of the global oil prices will have important implications for the growth of the Malaysian economy. The Malaysian economy also remains affected by growth prospects of its key trading partners, conditions in the financial markets and the state of investor and consumer confidence.

Nevertheless, Malaysia will face these challenges from a position of strength, afforded by the country's diversified structure, strong fundamentals and policy flexibility. Growth will continue to be anchored by domestic demand. Financial intermediation is expected to remain supportive of growth, underpinned by the strength of the financial institutions and the deep and well-developed financial markets. While subdued prices will continue to weigh on commodity exports, Malaysia's exports

are expected to be supported by the gradual improvement in the advanced economies and continued growth in the regional economies. The diversified nature of Malaysia's exports in terms of products and markets continues to accord resilience to Malaysia's trade performance.

The Malaysian economy is expected to grow by 4 – 4.5% in 2016

Overall, the Malaysian economy is expected to grow by 4 – 4.5% (2015: 5.0%). Domestic demand will continue to be the principal driver of growth, sustained primarily by private sector spending. The pace of expansion in domestic demand, however, is expected to be more moderate amid ongoing adjustments by consumers and investors to the challenging economic environment. Private consumption growth is projected to trend below its long-term average, as households continue to make expenditure adjustments in response to the lingering effects of the GST implementation, and changes in administered prices. Household spending will also be affected by weaker consumer sentiments due to the uncertain conditions in the labour and financial markets. These moderating effects, however, will be partially offset by continued growth in income, employment and some support from Government measures targeted at enhancing households' disposable income. In an environment of prolonged uncertainty and cautious business sentiments, private investment growth is projected to be less buoyant compared to its performance over the past five years, when it registered an average growth of 12.2%. Private sector capital spending is expected to be underpinned by the implementation of ongoing and new investment projects in the manufacturing and services sectors.

The current account of the balance of payments is projected to remain in a surplus position of about 1 – 2% of gross national income (GNI), largely from a sizeable surplus in the trade account. Benefitting from the measures introduced to ease travel from selected countries and targeted marketing and promotional efforts, tourist arrivals are expected to boost tourism income and contribute to a lower deficit in the services account.

Headline inflation is projected to be higher at 2.5 – 3.5% in 2016 (2015: 2.1%), due mainly to adjustments in the prices of several price-

administered items and the weak ringgit exchange rate. However, the impact of these cost factors on inflation will be mitigated by the low global energy and commodity prices, generally subdued global inflation, and more moderate domestic demand. The trajectory of inflation, however, could be more volatile as it is subject to uncertainties such as those relating to global growth, global oil prices and the ringgit exchange rate.

The projected growth of the Malaysian economy in 2016 is premised on expectations of a modest improvement in global growth and firm private sector spending domestically. It is recognised that **downside risks** to growth have heightened following the increase in uncertainties on both the global and domestic fronts. One of the key sources of risks to the growth forecast continues to be on the momentum of growth in PR China, as the country progresses with its economic rebalancing. While PR China remains one of Malaysia's main trading partners, the likelihood of a significant direct impact is limited as PR China accounts for only 13% of exports. Nonetheless, exports could also be affected indirectly should there be significant spillover effects from weaker regional trade and a further dampening of global commodity prices. Further compounding this challenging global economic environment are the continued uncertainties surrounding global oil prices and the high volatility in capital flows and financial markets. Domestically, the transmission and magnitude of these external shocks are a source of heightened uncertainty to the economy and financial system, particularly to the labour market, business sentiments and financial intermediation activities.

Past experience has demonstrated that Malaysia has the economic and financial adaptability to get through these challenging environments. Malaysia's strength rests on four factors, namely sound macroeconomic fundamentals, a diversified economic structure, a strong and well-developed financial system, and a robust policy toolkit. Macroeconomic fundamentals have been supported by a steady growth path between 4 – 6% for several years, with stable inflation and low unemployment. The external position is expected to remain favourable, underpinned by the continued surplus in the current account of the balance of payments, sustained FDI and healthy levels of international reserves.

Structural reforms undertaken over the years have endowed Malaysia with multiple sources of growth.

The economy continued to grow at a steady rate in 2015 despite sharp declines in commodity prices and more moderate Federal Government spending. The strength and depth of the financial sector is also another source of economic resilience. Financial shocks from volatile capital flows have been effectively and efficiently intermediated by the strong banking institutions as well as the deep and developed domestic financial markets. As a result, access to financing remains uninterrupted and continues to facilitate economic activity. The pre-emptive macroprudential measures to contain financial imbalances have provided ample space for effective policy-making. Importantly, past fiscal reforms have enabled the Government to remain firm in its commitment to fiscal consolidation. In addition, monetary policy has remained accommodative to support growth. Overall, policymakers in Malaysia have the capacity to undertake the necessary policy measures to manage further shocks to the economy.

Domestic demand continues to be the principal driver of growth

Domestic demand growth is projected to moderate to 4.3% in 2016 (2015: 5.1%). This is following the expectations that economic agents would continue

Table 4.1

Real GDP by Expenditure (2010=100)

	2015p	2016f	2015p	2016f
	Annual change (%)		Contribution to growth (percentage point)	
Domestic Demand¹	5.1	4.3	4.6	4.0
Private sector expenditure	6.1	5.2	4.2	3.6
<i>Consumption</i>	6.0	5.1	3.1	2.7
<i>Investment</i>	6.4	5.5	1.1	0.9
Public sector expenditure	2.1	1.6	0.5	0.4
<i>Consumption</i>	4.3	2.0	0.6	0.3
<i>Investment</i>	-1.0	1.1	-0.1	0.1
Change in Stocks			0.6	0.0
Net Exports of Goods and Services	-3.7	1.1	-0.3	0.1
Exports	0.7	3.2	0.5	2.3
Imports	1.3	3.4	0.8	2.2
Real Gross Domestic Product (GDP)	5.0	4.0~4.5	5.0	4.0~4.5

¹ Excluding stocks
 p Preliminary
 f Forecast

Note: Figures may not necessarily add up due to rounding
 Source: Department of Statistics, Malaysia and Bank Negara Malaysia

to make the necessary adjustments to manage the impact of higher consumer prices and greater uncertainties on the external fronts. Domestic demand, nevertheless, would remain as the anchor of growth, driven primarily by private sector spending. Reflecting the Government's commitment to fiscal consolidation, growth of public sector expenditure would remain moderate in 2016, but continue to be supportive of overall growth.

Private expenditure will remain as the key driver of growth, with continued support from the public sector

Reflecting largely the continued household adjustments to an environment of higher prices and greater uncertainty, **private consumption** growth is projected to moderate to 5.1% in 2016 (2015: 6.0%). Households are expected to continue making expenditure adjustments due to the higher cost of living arising from the implementation of the GST and changes in the administered prices of several goods and services. Additionally, household spending will be affected by weaker consumer sentiments due to uncertainty on labour market conditions, financial markets and ringgit performance. These adverse effects, however, will be partially offset by continued growth in income, employment and Government measures targeted to increase households' disposable income. These measures include reduction in employees' EPF contribution by three percentage points, higher Bantuan Rakyat 1Malaysia (BR1M) cash transfers and additional tax relief of RM2,000¹.

Private consumption will continue to expand despite households adjusting to higher cost of living

While growth in the first half of the year is expected to be more moderate, consumer spending is projected to register a gradual improvement as the impact of GST lapses. This improvement will be further lifted by the

¹ This tax relief is applicable to individual taxpayers with a monthly income of RM8,000 or below for the assessment year 2015.

Expansion in Key Economic Sectors

In 2016, key economic sectors are projected to expand at a more moderate pace. The services and manufacturing sectors would remain the key drivers of overall growth, while growth in the construction sector is expected to be sustained. Despite the lower oil and gas prices, growth in the mining sector will be supported by the introduction of new gas production capacity. The agriculture sector is expected to record a marginal contraction due to the lower yields caused by the El-Nino weather phenomenon.

Table 1

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

	2015 ^p	2015 ^p	2016 ^f	2015 ^p	2016 ^f
	% of GDP		Annual change (%)	Contribution to growth (percentage point)	
Services	53.5	5.1	4.4	2.8	2.4
Manufacturing	23.0	4.9	4.1	1.1	0.9
Mining and quarrying	8.9	4.7	3.5	0.4	0.3
Agriculture	8.8	1.0	-0.3	0.1	0.0
Construction	4.4	8.2	7.9	0.3	0.3
Real GDP	100.0¹	5.0	4.0 ~ 4.5	5.0¹	4.0 ~ 4.5

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

^p Preliminary

^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The services sector will continue to expand in 2016, albeit at a more moderate rate. Growth in consumption-related sub-sectors such as retail trade, food & beverages and accommodation is anticipated to moderate in tandem with slower growth of private consumption. In contrast, the information and communication sub-sector is expected to register robust growth as demand for data communications services remains strong. The transportation and storage sub-sector will continue to expand, benefiting from higher trade activity. The performance of the finance and insurance sub-sector is expected to remain weak, in line with the more moderate loan growth and slower capital market activity.

Growth in the manufacturing sector is expected to moderate in 2016 mainly due to slower expansion in the export-oriented industries. The expected softening in regional demand will affect the performance of the primary-related cluster. While the electronics and electrical (E&E) cluster will remain supportive of growth, the weakening demand from emerging market economies and the strength of the US dollar is likely to weigh down on global demand for electronic goods. Growth in the domestic-oriented industries is also expected to soften in line with weaker domestic demand conditions.

Growth momentum in the construction sector is projected to moderate slightly in 2016. In the residential sub-sector, the expansion is projected to remain modest amid weak housing approvals and property launches. Performance in the non-residential sub-sector is expected to be more moderate amid slower construction activity in the industrial and commercial property segments. The overall performance of the construction sector, however, will be supported by new and existing multi-year civil engineering projects, particularly in the transport and petrochemical segments.

In the commodity sector, agriculture production is expected to record a marginal contraction in 2016. This is largely due to lower palm oil yields following the hot and dry weather conditions brought about by the strong El Nino weather phenomenon. Growth in the mining sector will be supported by new gas production capacity from the Train 9 LNG production facility in Bintulu, Sarawak.

increase in the national minimum wage and the salary increment for civil servants effective July 2016. Consumption spending is also anticipated to be supported by higher crude palm oil and rubber prices, particularly spending by rural households.

The Malaysian labour market is expected to remain broadly stable. While the labour force will continue to grow in line with population growth, employment gains are expected to be moderate. Risks originate from weak sentiments among jobseekers and businesses, following the uncertainties surrounding global oil prices and global growth prospects. Nevertheless, moderate domestic demand and a gradually improving external sector are expected to remain supportive of the labour market. The unemployment rate may increase slightly but is expected to remain low at around 3.3 – 3.5% (2015: 3.2%). While the job market gradually adjusts to these conditions, wages will continue to grow in line with overall economic expansion. The Malaysian Employers Federation (MEF) annual survey reports that employers expect salary increments to average around 5.5% in 2016² (2015: 5.7%). Wage growth would likely be supported by robust wage growth in the export-oriented sectors, while wages in the domestic-oriented sectors will continue to expand moderately.

Private investment will be supported by ongoing and new investment projects, particularly in the manufacturing and services sectors

Given the continued environment of uncertainty and the cautious business sentiments, **private investment** growth is projected to trend below its long-term average and grow by 5.5% in 2016. The environment of continued low commodity prices would affect capital expenditure in the upstream mining sector, particularly investment related to activity involving marginal oil fields. Nonetheless, private sector capital spending will be supported by the implementation of ongoing

² Source: MEF Salary Survey Reports for Executives and Non-Executives 2015.

and new investment projects, particularly in the manufacturing and services sectors.

With the modest growth in demand from the advanced economies, investment in the manufacturing sector is expected to be driven by the expansion of capacity in the export-oriented manufacturing industries such as E&E and resource-based manufacturers. Furthermore, manufacturers are also expected to increase their capital spending to support the adoption of automation in order to increase efficiency and productivity, given the more competitive business environment.

In the services sector, investment would be driven by the continued implementation of existing capacity expansion projects, particularly in the tourism-related, transportation, healthcare and telecommunications sub-sectors. Specifically, investment in the telecommunications sub-sector will be driven by infrastructure expansion to cater for the growing nationwide demand for reliable and high-speed internet, including the 4G/LTE network expansion and fibre structures. Projects in the residential property segment, however, are expected to continue to expand at a more moderate pace as new housing approvals and launches remain modest.

Public sector expenditure to remain supportive of overall growth

Public consumption growth is expected to moderate to 2.0% in 2016, reflecting mainly the lower spending on supplies and services given the Government's commitment to more prudent spending under the current uncertain environment. However, public consumption will continue to contribute positively to overall growth, supported by the continued expansion in emoluments.

Public investment is projected to turn around to register a positive growth of 1.1%. While the Federal Government has announced a scale back in expenditure and reprioritisation of development projects, the total spending on fixed assets would still be higher in 2016 compared with the previous year. Public corporations, meanwhile, are expected to continue the positive investment momentum recorded in the second half of 2015,

Malaysia's Potential Output

Potential output can be described as the maximum output an economy can produce without exerting pressure on prices. The divergence of the actual output from its potential is the output gap, a useful indicator to assess the intensity of utilisation of an economy's resources. While it is unobserved and estimates tend to be sensitive to model specifications, the output gap is one of the indicators which is often used by policymakers to forecast inflation and make interest rate decisions.

In estimating Malaysia's potential output and output gap, Bank Negara Malaysia has adopted three broad approaches. These approaches include univariate models (Hodrick-Prescott (HP) filter and the univariate state space), the structural model (Cobb-Douglas production function) and multivariate models (Kalman filter and the model-based multivariate filter). All these approaches are used to obtain an average estimate of the output gap. As each of these models individually has its own strengths and limitations¹, the use of a combination of estimation methods allows for comparisons and cross-checking of the results.

Potential Output and Output Gap in 2015-2016

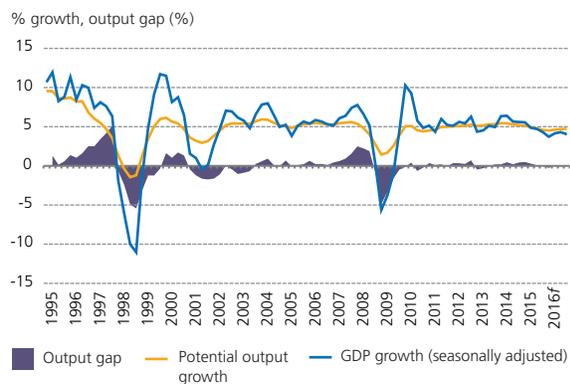
In 2015, Malaysia's output gap² narrowed to +0.21% (2014: +0.32%), with the potential growth also moderating to approximately 4.8%. While continued domestic investment and the broadly stable employment and labour participation rates (2015: 67.6%; 2014: 67.5%) remained supportive of potential output, global developments, namely declines in global oil prices, had a negative impact on the path of potential output³. In this regard, potential output growth was affected mainly through the investment channel, as firms in the oil and gas industry lowered their capital expenditure in response to the declines in oil prices resulting in a slower rate of capital accumulation. As the potential output growth moderated concurrently with the actual output (2015: 5%, 2014: 6%) the output gap narrowed during the year. Consistent with the narrower output gap, domestic inflation was at 2.1% (2014: 3.2%).

The output gap is forecast to be close to zero in 2016, with potential output expected to grow at approximately 4.6% (2015: 4.8%) (Chart 1). Continued capital accumulation, stable employment conditions and improvements in total factor productivity are expected to underpin the growth in potential output. While investments in the oil and gas industry are likely to remain weak in 2016, investments in the non-energy sectors are expected to continue in 2016 thus generating positive spillovers into the rest of the economy. In addition, labour participation rates are expected to be sustained in 2016 and therefore supportive of growth of potential output.

Demand pressure is expected to be contained. Aggregate demand is projected to grow at 4.3% compared to 5.1% in 2015, consistent with the

Chart 1

Output Gap, Potential and Actual Output Growth, 1995-2016f

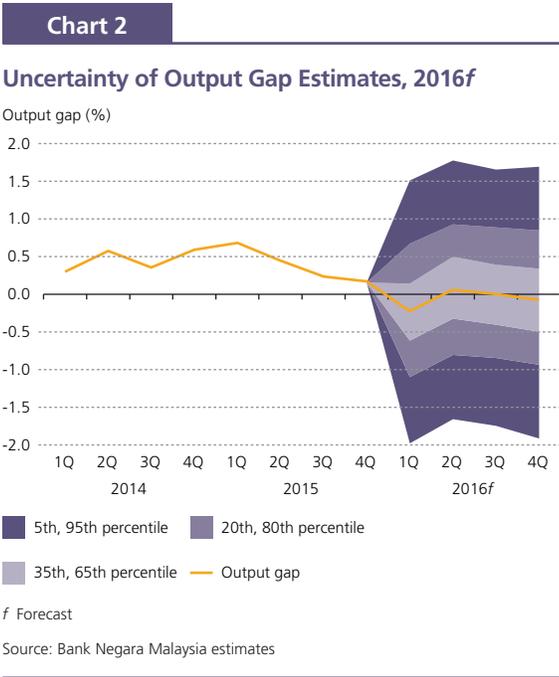


f Forecast
Source: Bank Negara Malaysia estimates

¹ Chuah L.L and Shahrier, N. A. (2014). Estimating Malaysia's Output Gap: Have we Closed the Gap?, Bank Negara Working Paper Series WP4/2014.
² The output gap is the average of the results obtained from five estimation methods, which include the Hodrick-Prescott (HP) filter, univariate state space (USS), Cobb-Douglas production function, multivariate Kalman filter (MVKF) and a model-based multivariate filter.
³ Studies have shown that oil price fluctuations could have broad consequences on economic activity. For example, see Jiménez-Rodríguez, R. and Sánchez, M. (2004). Oil Price Shocks and Real GDP Growth. Empirical Evidence for Some OECD Countries. ECB Working Paper Series, No. 362 / May 2004.

resources available in the economy. Inflation which is projected to increase slightly to 2.5 – 3.5% (2015: 2.1%), would be driven mainly by the adjustments of several price-administered items and the weak exchange rate. Domestic demand pressures are therefore not expected to be the main factor driving inflation.

Some uncertainty remains as shown in the dispersion of the fan chart (Chart 2). The output gap lies in the inner band of the fan chart which ranges from -0.46% to +0.34%. Given this uncertainty, information gathered from the industry is used as means to evaluate the model-based assessments. From the Bank’s surveys and engagement with businesses, firms in the export-oriented sectors generally expressed cautious optimism based on improvements in global conditions. Nonetheless, external risks such as the weakness of the ringgit and the slowdown in China will continue to weigh on firms’ business decisions. In view of this cautious outlook, firms are selective in their investment and hiring decisions and hence, will continue to invest only in areas important to their operations and hire workers critical for their production. Altogether, these information point to an outlook of moderate growth in both output and potential output in 2016.



after registering negative growth since 2014. This reflects the ongoing implementation of key infrastructure projects in diversified sectors, including in the utilities, transportation as well as the downstream oil and gas sectors.

External sector to remain resilient

In line with the projected improvement in external demand, Malaysia's export performance is likely to remain positive in 2016. Gross exports are forecast to expand by 2.4% in 2016, sustained by a modest improvement in demand from the advanced economies and continued growth in the regional economies. Subdued commodity prices will continue to weigh on Malaysia's exports but to a smaller extent than in 2015. The well-diversified nature of Malaysia's exports will continue to support the overall growth of exports.

The current account of the balance of payments will remain positive in 2016

With broad-based expansion in both E&E and non-E&E products, manufactured exports are projected to register a positive growth. E&E exports are likely to continue to benefit from the progressive diversification in the sector. Steady demand for semiconductors for a wide range of consumer and business applications in the fast growing industries, such as mobile devices, automotive and photosensitive sensors would likely bolster E&E export growth. Non-E&E exports will continue to expand, supported by sustained regional demand for resource-based products such as chemicals, petroleum and rubber products.

Persistent weakness in prices of mining products will affect commodity exports. This is expected to be further exacerbated by the softer overall global demand for commodities. However, the degree of decline in mining prices is unlikely to be as severe as in 2015, hence, the negative impact of lower commodity prices on exports will be smaller in 2016. Moreover, the crude palm oil (CPO) price is likely to inch higher, amid steady demand and lower supply due to lower yields caused by the El-Nino weather conditions. This will provide some support to commodity exports.

Gross import growth is projected to increase to 4.9% in 2016. Intermediate imports, which

form the bulk of Malaysia's imports, are expected to increase in tandem with firm production activity for exports and domestic consumption and investment. Continued expansion in domestic investment activity, particularly in the services and manufacturing sectors, is anticipated to contribute to the higher growth in capital imports. Growth in the intermediate and capital imports categories are likely to be higher, partially due to the relatively low base effect in 2015. Imports of consumption goods would register a more moderate growth, although imports of food and beverages, which are relatively inelastic in demand, will continue to drive the growth of consumption imports.

Given the sustained performance of manufactured exports and a continued surplus in the commodity trade balance, the overall trade balance in 2016 is expected to continue to record a surplus. The surplus will, however, be smaller in magnitude. As a large net exporter of LNG and CPO, the prices of these commodities will affect Malaysia's trade balance. The lower price of LNG will weigh on Malaysia's trade balance. The impact, however, will be partially mitigated by the improvement in CPO prices. With minimal corresponding imports for LNG and CPO, the contribution of these commodities to Malaysia's trade balance

Table 4.2

External Trade

	2015 ^p	2016 ^f
	Annual change (%)	
Gross exports	1.9	2.4
<i>of which:</i>		
Manufactures	6.5	5.6
Agriculture	-2.7	-3.8
Minerals	-20.6	-17.0
Gross imports	0.4	4.9
<i>of which:</i>		
Capital goods	0.0	8.9
Intermediate goods	-2.3	4.7
Consumption goods	24.1	3.0
Trade balance (RM billion)	94.6	79.5

^p Preliminary
^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

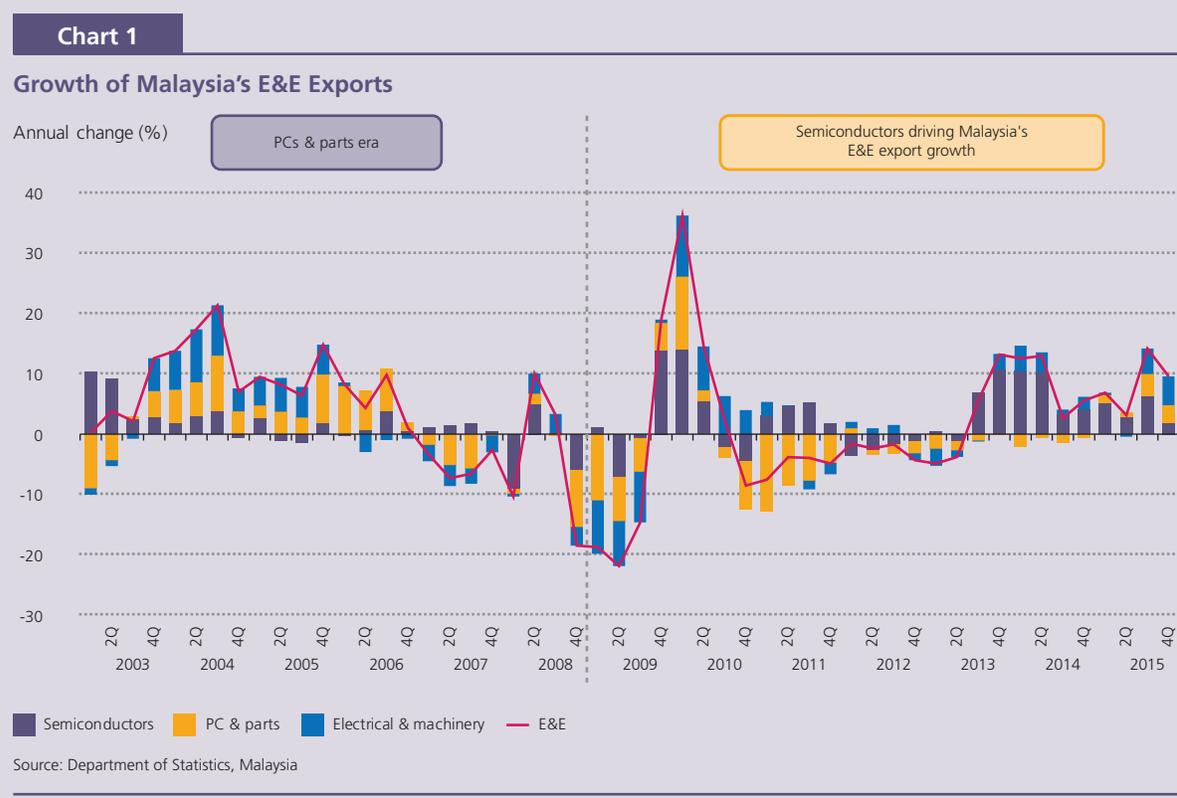
Shifting Shapes, Turning Tides: The Evolution of Malaysia's Electronics and Electrical (E&E) Industry

The global electronics and electrical (E&E) industry has experienced several transformations since the start of the new millennium. Firstly, post its ascension to the World Trade Organisation (WTO) in 2000, PR China has emerged as the world's largest E&E exporter, with aspirations to rapidly move up the value chain. Secondly, the progression towards more modern smart devices and wireless technology came to some extent at the expense of traditional personal computers (PCs) and parts manufacturers, which has been one of the industry's main drivers of growth until the Global Financial Crisis (GFC). Conversely, the increasing ubiquity and proliferation of electronics into all types of products, besides PCs and telecommunication equipment, have provided greater support for semiconductor manufacturers. Thirdly, the more diffused global E&E supply chain has also led to the increased competition among economies in attracting and retaining foreign direct investments (FDIs) from multinational companies (MNCs). Taken together, all these forces have prompted many participating economies and firms to recalibrate their strategies in the E&E industry.

Against this backdrop, Malaysia's E&E industry has had to adapt to the changing global environment to remain both relevant and competitive. In addition, the recent downturn in global commodity prices has drawn greater attention to the ability of Malaysia's E&E exports to mitigate the impact of the downturn in commodities and overall exports, whilst providing support to growth. These structural adjustments are observed in the on-going diversification of the local E&E industry away from PCs and parts into new emerging growth areas as well as products that are higher up in the value chain.

Shifting Shapes

From the early 2000s until the financial crisis in the advanced economies, Malaysia's E&E output and exports were mainly driven by products related to the PCs and parts industry (Chart 1). This ranged from testing and assembly services for integrated circuits (ICs) to the manufacturing of components. It can be observed that while the financial crisis caused a **cyclical weakness** in demand for electronic

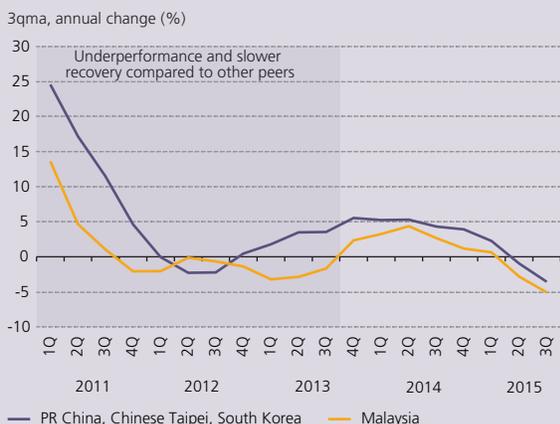


products, Malaysia's E&E export performance was further affected by a **structural shift** in consumer preferences away from PCs to smartphones and tablets. Combined with the prolonged weakness in demand from advanced economies after the financial crisis, Malaysia registered a much weaker recovery in E&E exports in 2012 and 2013 compared to its regional peers that are more involved in the fast-growing smart devices market (Chart 2).

Faced with this structural shift in the industry, many E&E manufacturing firms in Malaysia – both multinational and domestic – decisively moved towards diversifying away from the traditional PCs and parts segments into faster-growing and higher value-added segments. For example, many in the data processing semiconductor industry, especially data storage firms, have leveraged on the rising demand for cloud computing – arising from increasing internet-related activities – by increasing their involvement in the enterprise servers market. Another significant development is Malaysia's increasing involvement in automotive semiconductors (Chart 3). With continued robust demand for automotive sensors driven by safety and efficiency reasons, this industry is projected to experience long-term and stable growth compared to the smartphones and tablets segments. This will likely provide impetus for more sustained growth of Malaysia's semiconductor industry. These on-going E&E diversification efforts have enhanced Malaysia's ability to capitalise on the growth upturn in the advanced economies.

Chart 2

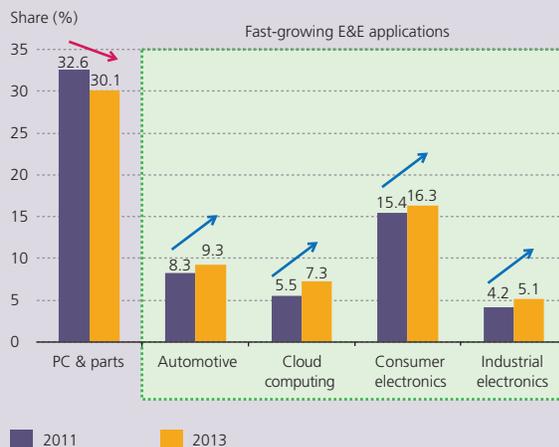
E&E Export Growth for the Major Asian Economies (in USD)



Source: Global Trade Atlas

Chart 3

Share of Malaysia's Total Semiconductor Sales



Source: Gartner Dataquest (December 2013) and Bank Negara Malaysia estimates

However, despite the encouraging tailwinds in the E&E industry, there remains room for further diversification of Malaysia's semiconductor product mix into other fast-growing segments. For example, in the coming years, the increasing pervasiveness of sensors and semiconductors in a great variety of industrial and consumer products, integrated by wireless technology and sophisticated software – known colloquially as the "Internet of Things (IoT)" – will provide a strong catalyst for the growth of Malaysia's E&E industry. While still at its infancy, the wide product coverage in the IoT space, ranging from wearables, common electrical appliances as well as bio-medical devices, represent exciting diversification opportunities for semiconductor players in Malaysia. In fact, many in the industry are already positioning themselves in this new growth area.

Recognising that public policy would need to act in concert with the E&E manufacturers to reap the most gains from this diversification process, the Government has launched, among others, the National IoT Strategic Roadmap and the National Aerospace Blueprint 2015-2020. These provide both the strategic spotlight and the framework to allocate public resources in support of greater entry into these new frontiers. The re-orientation of incentives and greater selectivity towards higher value-added investments further complement existing initiatives to spur more innovation-driven

operations in Malaysia. It is important for policymakers to conduct periodic re-assessments of existing incentives and policies to ensure that Malaysia catches the next technological wave early enough to derive significant economic benefits. Continuous collaboration with the private sector to identify and respond to emerging trends is necessary to maintain Malaysia's relevance in the global E&E value chain. Also, the National Exports Council (NEC) was created to spearhead policies that further enhance Malaysia's exports competitiveness, including that of the E&E industry.

Turning Tides?

While the adaptability in gaining a strategic foothold in new fast-growing market segments is vital in ensuring Malaysia's competitive edge in the E&E industry, it still needs to be complemented with measures that bolster its underlying fundamentals. The increased access to larger markets and the added attraction for FDIs provided by the Trans-Pacific Partnership Agreement (TPPA) are likely to draw focus on the ability of Malaysia's E&E industry to maximise its potential in an environment of increasing competition. This will require Malaysia to concurrently build on the progress made towards driving automation and to increase the supply of high-skilled talent. The latter is crucial in deepening Malaysia's presence in research and development (R&D) and design and development (D&D) activities, which is paramount given the increasing competition and limited space for growth in the lower value-added segments. Despite successes in incentivising major global E&E players to further increase their exposure in these high value-added activities in Malaysia through policy interventions, there is still some way to go before a critical mass of firms is achieved. While the transition up the value chain and higher productivity will likely exert pressures on those that are overly reliant on labour-intensive operations, the re-orientation of Malaysia's focus to more innovation-driven investments and activities is crucial in achieving a high value-added and high-income economy.

Current signs point towards a brighter future and a major role of the E&E industry in Malaysia's diversified economy provided the industry continues to undertake the necessary measures needed to further enhance its competitiveness. As more frequent technological disruptions become the norm, the ability to spot changing trends and to adapt accordingly will be an increasingly critical factor that affects the competitiveness of the economies involved in the E&E industry. With a major presence in the global value chain, Malaysia is strategically positioned to benefit from the positive developments in the industry.

will remain positive. At the same time, the modest improvement in global demand is likely to generate continued positive contribution to the export performance of manufactured products.

The services account is projected to record a narrower deficit. This is premised upon the expected improvement in tourist arrivals and higher tourist spending. The introduction of e-Visa for tourists from selected countries and the easing of travel requirements for tourists from China, coupled with intensified promotional efforts for targeted tourism industries such as medical, sports and Halal tourism, would attract more foreign tourists to Malaysia. Growth in services imports, however, will be driven by continued dependence on foreign service providers for transportation and other services such as business and professional services, in line with the expansion in trade and investment activities during the year.

In the primary income account, profits from Malaysian companies investing abroad are expected to be lower, mostly on account of the lower income of oil and gas companies, which accounted for more than a third of Malaysia's investment income abroad. Nevertheless, this is likely to be partially offset by continued profits from other overseas investments. Reflecting the sustained growth in manufactured exports, higher investment income is expected for the multinational corporations operating in Malaysia. Altogether, this will result in the deficit in the primary income account to increase in 2016. The continued deficit in the secondary income

account, meanwhile, is mainly attributable to higher expected outward remittances, which will more than offset the expected increase in inward remittances.

Overall, given a gradual improvement in exports, the net export of goods and services is projected to provide some support to real GDP growth in 2016. The current account surplus may be lower at RM19.1 billion or 1 – 2% of GNI, on account of lower goods surplus and wider income deficits.

The international economic and financial landscape is expected to remain challenging in 2016, with investor sentiments being affected by the downside risks to the global growth outlook. As a consequence, Malaysia will likely be confronted by continued sizeable two-way movements in capital flows, shaped by the large and volatile shifts in global liquidity. Despite these uncertainties, Malaysia's deep and developed financial markets remain well positioned to intermediate these highly volatile flows, thus ensuring that the functioning of the domestic financial markets continues to be orderly and supportive of the real economy. Malaysia's ability to withstand external shocks will also be further augmented by the availability of ample buffers, robust policy frameworks, economic adaptability and ample policy space.

INFLATION OUTLOOK

Headline inflation is projected to increase to 2.5 – 3.5% in 2016 (2015: 2.1%), due mainly to adjustments in the prices of several price-administered items and the weak ringgit exchange rate. However, the impact of these cost factors on inflation will be mitigated by the low global energy and commodity prices, generally subdued global inflation, and more moderate domestic demand. The trajectory of the inflation forecast, however, could be more volatile as it is subject to uncertainties in global oil prices and the ringgit exchange rate.

Several adjustments in administered prices have been undertaken since October 2015. These price adjustments include increases in intra-city highway toll charges, railway charges and a reduction in electricity tariff rebates. In addition, prices of cigarettes were increased by about 23% in November following the increase in excise duty on tobacco products. As most of

Table 4.3

Current Account of Balance of Payments¹

Item (Net)	2015 ^p	2016 ^f
	RM billion	
Goods	108.9	99.5
Services	-20.5	-19.2
Primary income	-32.2	-38.0
Secondary income	-22.2	-23.1
Current account balance	34.0	19.1
<i>% of GNI</i>	<i>3.0</i>	<i>1~2</i>

¹ The data are compiled in accordance with the Sixth Edition of Balance of Payments and International Investment Position Manual (BPM6) by the International Monetary Fund (IMF)

^p Preliminary
^f Forecast

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

these price adjustments were implemented towards the end of 2015, the inflationary impact will mostly be felt in 2016.

Inflationary pressures from adjustments to administered prices and the weaker ringgit exchange rate will be offset by low global energy and commodity prices

The weak ringgit exchange rate will likely contribute to higher inflationary pressures in 2016. Imported finished goods are likely to cost more. Imported raw and intermediate materials could also be more expensive, resulting in higher prices of locally manufactured goods. However, the overall impact of price increases due to the weaker ringgit exchange rate is not expected to be large as imported finished consumer goods excluding fuel only account for 7.2% of the CPI basket, while imported intermediate inputs only account for 20% of the gross output³.

In 2016, the IMF projects global oil prices to average at USD35 per barrel⁴ (average 2015: USD51 per barrel) as a result of the continued high global production amidst moderate growth in global demand. The large build-up in global inventories and the removal of sanctions on Iran would also contribute to the oil supply glut, exerting further downward pressures on global oil prices. The Food and Agriculture Organisation of the United Nations (FAO) projects global food prices to also continue trending lower in 2016 given favourable supply conditions amidst slower global demand. The projected low energy and commodity prices are expected to mitigate upward price pressures from the weak ringgit exchange rate. Domestic fuel prices, for example, are expected to remain low in 2016 as global oil prices will continue to be low. However, the extent of this offsetting impact from low global oil prices is not expected to be as large as in 2015, due to the more modest decline in global oil prices. Given the low global energy and commodity prices and subdued domestic demand in some of Malaysia's

³ Estimated based on Input-Output Tables 2010 for Malaysia.

⁴ Average price of Dated Brent, West Texas Intermediate (WTI) and Dubai Fateh crude oil, equally weighted, as projected by the IMF Primary Commodity Price Forecast in February 2016.

major trading partner economies, imported inflation is also expected to remain low.

Inflationary pressures stemming from domestic demand factors are expected to be modest, given the slower expansion in household spending amidst more moderate real wage growth. The output gap is expected to be close to zero in 2016. With more moderate demand conditions, firms may hesitate to fully pass on the increase in costs from adjustments to administered prices and weak exchange rate to consumers.

The inflation outlook in 2016 is subject to two risks. First, the trajectory of inflation could be volatile and uncertain, arising mainly from the uncertainties surrounding the movements of global oil prices and the ringgit exchange rate. These uncertainties would affect inflation mainly through their impact on domestic fuel prices. Second, changes in ringgit exchange rate could also have varying implications on the prices of imported goods and services. The pass-through of exchange rate changes to domestic inflation remains highly uncertain and is dependent on the prevailing economic conditions and the behaviour of firms and households.

MONETARY POLICY

Monetary policy in 2016 will focus on ensuring monetary conditions remain supportive of the sustainable growth of the domestic economy with price stability. This is against a challenging policy environment, characterised by the expectation of more moderate domestic growth, higher headline inflation and a high degree of uncertainty in the global and domestic environment. In particular, there are downside risks to global growth, given weaknesses in both the advanced and emerging economies, the uncertainty surrounding the outlook for energy and commodity prices, and the expectation of continued volatility in the international financial markets. The implications of these developments on the domestic growth and inflation outlooks will be closely monitored during the year. In addition, monetary policy will also continue to consider the risk of financial imbalances.

Against a challenging global environment, the Malaysian economy is projected to expand at a more moderate pace of 4.0 - 4.5% in 2016, anchored by private sector-driven domestic demand. Headline inflation is expected to range

between 2.5% and 3.5% in 2016. The higher inflation compared to 2015 will be driven mainly by upward adjustments in administered prices and the weak ringgit exchange rate, although this will be partly offset by the continued low global energy and commodity prices. The uncertainty around the path of the ringgit exchange rate and global energy prices, however, is a risk to the outlook for inflation. Nevertheless, underlying inflation is expected to remain relatively stable given the more moderate domestic demand conditions.

Monetary policy in 2016 will focus on ensuring monetary conditions remain supportive of sustainable economic growth with price stability

The baseline outlook for both domestic growth and inflation will be subject to risks during the year, given the high degree of uncertainty prevailing in the external and domestic environment. The focus of the Monetary Policy Committee would thus be to

ensure that the stance of monetary policy remains consistent with the achievement of price stability and sustainable growth given the evolving risks in the global and domestic economies. In addition, given the expectation of continued volatility in external flows, the Bank's monetary operations will be directed towards ensuring that domestic liquidity will continue to be sufficient in the financial system, in order to support the orderly functioning of the domestic financial markets.

FISCAL POLICY

Fiscal policy in 2016 will continue to focus on fiscal consolidation amid challenging external and domestic conditions. The 2016 Budget, tabled in October 2015, was recalibrated in January 2016 to incorporate the expected decline in global oil prices⁵, which would have an implication on the Government's revenue. The recalibration entails the implementation of prudent and pre-emptive measures to reprioritise Government spending. This is underpinned by cost-cutting measures in the Government's operating expenditure and reprioritisation of its development expenditure. Measures to broaden revenue sources⁶ were

Table 4.4

Federal Government Finance

	RM billion			% change		
	2015	2016 ^r		2015	2016 ^r	
Oil price	52	30	35			
Revenue	219.1	216.3	217.9	-0.7	-1.3	-0.5
Total expenditure	257.8	255.7	257.2	-0.5	-0.8	-0.2
<i>Operating expenditure</i>	217	210.7	211.2	-1.2	-2.9	-2.7
<i>Gross development expenditure</i>	40.8	45.0	46.0	3.2	10.4	12.8
Loan recoveries	1.5	0.8	0.8			
Overall balance	-37.2	-38.7	-38.5			
% of GDP	-3.2	-3.1	-3.1			
<i>Sources of financing:</i>						
Net domestic borrowing	38.9	-	-			
Net external borrowing	0.7	-	-			
Realisable assets ¹ and adjustments	-0.2	-	-			

¹ A negative (-) sign indicates a build-up in assets

^r Recalibration

Note: Numbers may not add up due to rounding

Source: Ministry of Finance, Malaysia

⁵ The assumption on global oil price was revised downward to between USD30 - USD35 per barrel (2016 Budget: USD48 per barrel).

⁶ These include redistribution and bidding of the telecommunications spectrum, strict duty enforcement on sales of cigarettes, liquors and imported vehicles in duty-free islands and streamlining the foreign worker levy system.

also introduced to further enhance the revenue collection. As a result, the Government fiscal deficit target for 2016 remained at 3.1% of GDP (2015: 3.2%) as announced in October 2015.

Despite the more challenging economic environment, the Government will continue to implement fiscal reform measures to further consolidate its fiscal position. This includes measures to rein in the growth of operating expenditures, which includes the rationalisation of subsidies and the reduction of non-critical spending on supplies and services, and asset purchases. The share of operating expenditure as a percentage of GDP is expected to decline to about 17% in 2016 compared to 18.8% in 2015. The implementation of the Goods and Services Tax (GST) has broadened the sources of income for the Government. This would help to mitigate the revenue loss from lower oil prices and reduce dependence on highly volatile commodity-based revenues. The contribution of oil-related revenue to total revenues has indeed declined to 21.5% in 2015 compared to 30% in 2014. This is expected to further decline to between 13% and 14% in 2016.

Fiscal resources in 2016 will be prioritised towards high impact infrastructure projects with larger multiplier effects⁷. This is also in line with the objectives of the Eleventh Malaysia

Plan (11th MP) that charts the development priorities of the Government for the next five years (2016-2020). Government expenditure will be channelled towards expanding connectivity and infrastructure, building an efficient public transportation system and enhancing technology and telecommunications, which would increase the productive capacity of the economy. Emphasis will continue to be accorded towards ensuring inclusive and sustainable growth through welfare enhancement. Socio-economic support to the lower- and middle-income segments will continue to be provided in order to sustain the capacity of these groups to cope with the rising cost of living⁸ and to support private consumption.

Over the medium term, sustaining fiscal reform would remain a key element of the Government's economic transformation agenda. The strengthening of public finances is one of the fundamental indicators of the resilience of the economy. A sound fiscal position provides the space for more effective counter-cyclical macroeconomic policy, and supports the Government's pursuit of nation-building initiatives. Towards this end, further enhancement of the Medium Term Fiscal Framework will be important to support the Fiscal Policy Committee in ensuring a sustainable and effective role of the Government's fiscal policy.

Table 4.5

Fiscal Adjustment Measures Announced in the 2016 Budget Recalibration

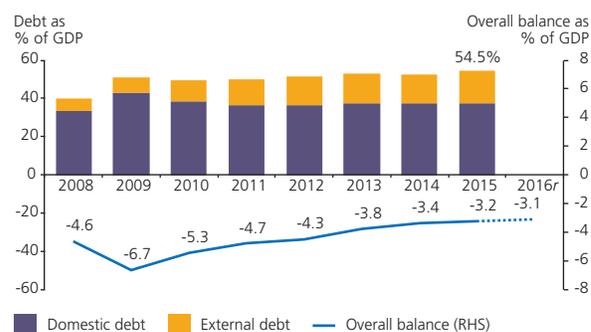
		RM billion
Expenditure optimisation measures		9.0*
1	2 – 5% scale down in supplies and services	1.7
2	Rationalisation of grants and transfers	1.0
3	Lower subsidy on LPG and diesel	1.0
4	Delay asset purchase	0.2
5	Reprioritisation of development expenditure	5.0

*Figure may not add up due to rounding
Source: Prime Minister's Speech on 28 January 2016

⁷ These include strategic investments such as Cyber City Centre, Aeropolis KLIA and Iskandar Malaysia.

Chart 4.3

Federal Government Fiscal Balance and Debt



r Recalibrated
Note: External debt refers to offshore borrowing and non-resident holdings of ringgit-denominated Government debt (MGS, Gil, T-bills, etc.)

Source: Ministry of Finance, Malaysia

⁸ These include the increase in the national minimum wage, increments in various fiscal transfers and income tax relief for the middle-income group. The Budget Recalibration further complements these measures with a temporary reduction of EPF employees' contribution and special tax relief for individual taxpayers with a monthly income of RM8,000 or below for the year of assessment 2015.

2015

GOVERNANCE, ORGANISATIONAL
DEVELOPMENT AND COMMUNICATIONS

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As an institution that serves in the best interest of the nation, the Bank has always placed great emphasis on strengthening its governance standards and internal capabilities. This sustained focus ensures that the Bank can effectively deliver its mandates with the highest level of professionalism, credibility and integrity. The Bank's robust internal governance starts from the strong oversight role exercised by the Board of Directors. The Board of Directors oversees the institution's general policies, administration, performance in delivering its mandates, management of risks, financial management, and reserves and currency management. The observance and practice of good corporate governance is emphasised at all levels of the Bank's operations.

In order to drive and deliver the Bank's mandates, priority is placed on having highly capable professionals in both technical and leadership roles. The Bank's code of ethics dictates the need for the Bank's staff to act with the highest level of professionalism and integrity. During the year, the Bank continued to focus on initiatives to attract and retain the right calibre talent, including investing to build their leadership, analytical and surveillance skills. Much of the work within the organisation requires teamwork and collaboration across the many job functions and departments.

The Bank also places high priority on the availability of a reliable and secured Information and Communications Technology (ICT) infrastructure to support critical functions such as payment systems, surveillance, monetary operations, data collection, and decision-making. Independent reviews and development work are regularly undertaken to ensure the resilience and continuous availability of the Bank's critical ICT infrastructure.

Given its high public accountability, the Bank communicated extensively with stakeholders including the media, economists, analysts, fund managers, parliamentarians and the public. These engagements were aimed at deepening the awareness of the Bank's stance, policies and actions, and for the Bank to understand the perspectives and views of stakeholders.

GOVERNANCE

Effective oversight by the Board of Directors

The Board of Directors (the Board) comprises the Governor, the three Deputy Governors and the Secretary-General of the Treasury as ex-officio members, and seven independent non-executive members. The Board is supported by three Board committees, namely the Board Governance Committee, Board Audit Committee and Board Risk Committee, which comprise exclusively of non-executive directors.

During 2015, two Board members completed their terms and four new Board members were appointed. As a result, the size of the Board increased from ten to twelve members, with seven independent non-executive directors. The Board approved the appointment of two new external members to the Monetary Policy Committee (MPC), who began their two-year tenures in April 2015. This marks the first time that the MPC has included members from outside the Bank and increases the total membership of the MPC from eight to ten members. The new appointments add to the diversity and collective experience, expertise and knowledge of the Board and the MPC, further strengthening the Board's oversight of the Bank and delivery of the MPC's functions.

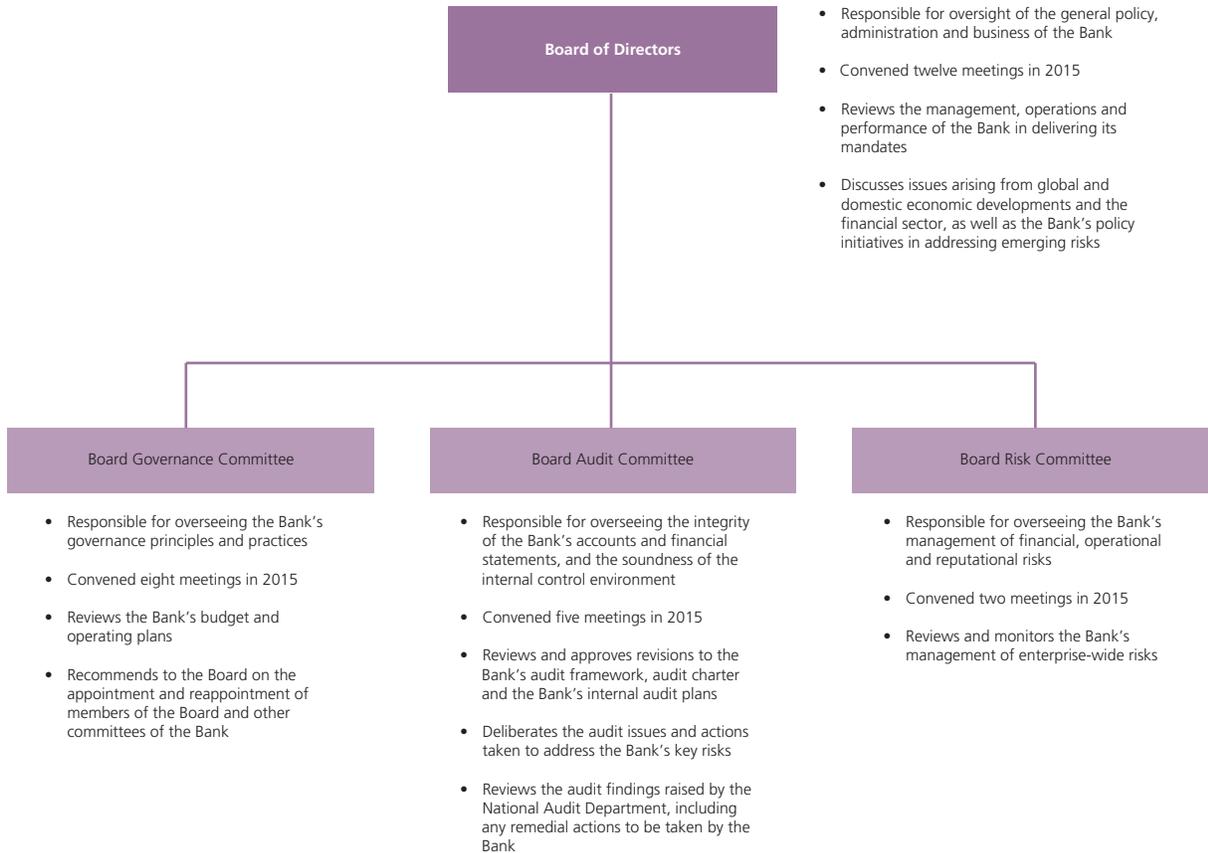
Throughout the year, the Board continued to have frequent engagements with the Bank's senior management and exercised strong oversight of the Bank's annual strategic planning, performance, risk management, finances and international reserves. The Board was also apprised on the progress of the Bank's key projects in the areas of investment and treasury operations, currency management, statistics and data management, and the Bank's ICT infrastructure.

Risk management supported by robust governance

The Bank's robust risk governance framework ensures the integrity and continuity of the Bank's operations even under very dynamic and challenging situations. In anticipation of emerging risks, risk mitigation strategies are put into place. These risks could emerge from various scenarios,

Chart 5.1

The Board and Board Committees



Source: Bank Negara Malaysia

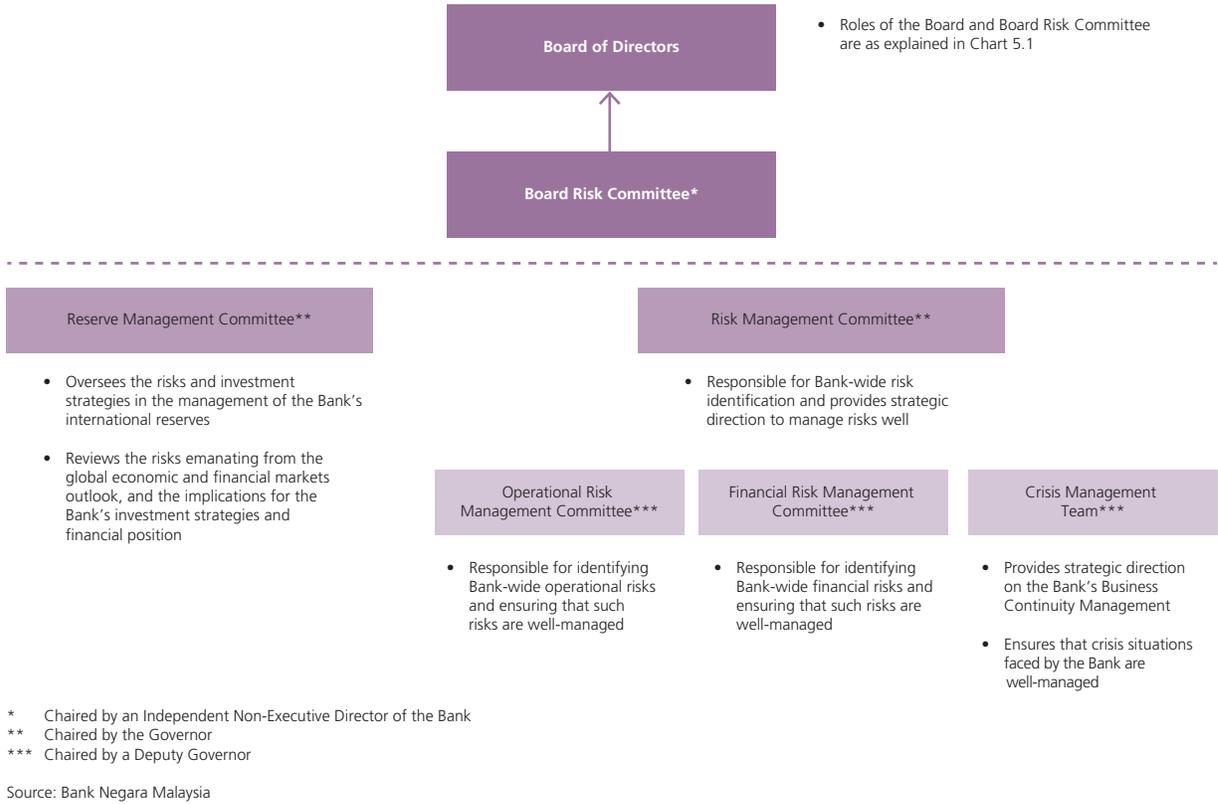
which include changes in the domestic and external environment, new global standards or contagion from crisis, or proliferation of social media.

The Bank further developed its risk appetite and tolerance statements following the availability of more granular data

Enterprise risks are reviewed holistically at the highest level. The Board, supported by the Board Risk Committee, reviews the risk assessments as part of its oversight role. The senior management of the Bank conducts regular risk assessments through various internal risk management committees, as explained in Chart 5.2.

In 2015, the Bank refined its risk appetite and tolerance statements based on the availability of more granular risk data. These statements communicate to the Bank's staff the senior management's expectations on the level and type of risks that the Bank is willing to tolerate in implementing its strategies. This enables more informed decision making that takes into consideration the risks involved in the implementation of strategies and daily operations, and pre-emptively considers appropriate mitigating measures. Risk management is inculcated among the Bank's staff through targeted risk awareness programmes, such as workshops and knowledge sharing sessions. The integration of risk management and business planning also promotes a more mature risk management culture. This minimises the occurrence of negative outcomes, either from planned activities or due to unforeseen events.

Risk Management Governance Structure



The monitoring of the Bank's overall risk profile is facilitated by having more comprehensive risk dashboards and reports. These include more granular information gained through departmental self-assessments and analysis of transversal risks that detect emerging threats across the Bank's activities. Examples of transversal risks include people, legal, technology and information security risks. The results from these reports and related mitigation strategies are then deliberated at the Bank's risk committees.

Strengthening business continuity management practices

There are sustained enhancements to the Bank's business continuity management. This is to ensure the delivery of the Bank's core business functions under any circumstance, even in situations of a crisis. Rigorous crisis simulation exercises based on multiple scenarios were conducted in 2015. These scenarios were designed to identify gaps, in particular interdependencies that require improvements in internal coordination. The Bank also engaged with financial institutions, the National Security

Council and other stakeholders to ensure that crisis management arrangements are well-integrated, both internally and externally.

The simulation exercises result in the adoption of latest practices and technologies to ensure that the Bank's crisis management arrangements remain effective. Examples include measures to deal with pandemic and natural disasters based on recommendations by the World Health Organisation, and learning from events such as the spread of the Middle East Respiratory Syndrome coronavirus, and the earthquake which occurred during the year in Sabah.

Strong internal controls and assurance

The Internal Audit Department (IAD) provides an independent assurance of the adequacy and effectiveness of the governance processes, risk management measures and internal controls at all levels across the Bank. The Bank's risk management function is subject to the IAD's review to provide assurance that the Bank's key risks are well-managed.

The auditor's reports, recommendations and the audited department's responses are actively deliberated at the Board Audit Committee (BAC), which meets on a quarterly basis. The BAC provides direction to the IAD on further actions that need to be taken to ensure that the audit issues are properly rectified by the management of the audited departments. In support of the IAD's effectiveness and impact, the BAC provides continuous guidance to strengthen the internal audit approach and methodology. The audit issues and rectification actions are also elevated to the senior management of the Bank for awareness and to ensure that proper follow-up actions have been taken. This in turn allows the BAC to support the Board in overseeing the effectiveness of the Bank's overall internal control environment.

The IAD also provides assurance to the Bank's related entities on the risk management and internal control systems of the entities. Audits are conducted to ensure that the activities of these entities do not pose undue risks to the Bank. The outcomes of the audits, and recommendations to improve controls and processes, are shared with the related entities' senior management and board of directors. The interventions to address the audit issues remain the primary responsibility of the respective entity.

The IAD adopts a risk-based audit approach where critical areas are subjected to more frequent review and all departments are audited at least once within a three-year audit cycle. During the year, the IAD completed the audits based on its plan, in addition to performing other ad-hoc audit assignments and investigations.

In 2015, the IAD audited the Bank's reserve management, finance operations and back-office functions, currency operations management, and the Bank's representative offices in London and New York. The audits were to ensure completeness of information and accuracy of records and financial data. Other major assessments included the areas of governance, internal controls and processes in the formulation of prudential policies, human resources management and legal advisory services. The IAD also completed ICT audits, including on the Bank's critical ICT application systems for currency management, retail payment infrastructure and operations, and credit bureau services (Central Credit Reference Information System or CCRIS).

The IAD's audit methodology and work processes were further strengthened during the year with the review of its audit charter and audit framework for the Bank's subsidiaries and related entities. Measures were also identified to improve the quality of audit assurance through the IAD's self-assessment against the International Professional Practices Framework issued by The Institute of Internal Auditors. The IAD also conducted surveys to seek feedback from its auditees and stakeholders, including the Board and senior management of the Bank, and the National Audit Department, on the quality of its audits and their expectations. The capabilities of the IAD's auditors were continually strengthened through training in areas such as treasury, accounting and ICT.

ORGANISATIONAL DEVELOPMENT

Focus and clarity of the Bank's outcomes

The Bank's Business Plan 2015 -17 (Business Plan) provides staff with clarity of the Bank's key outcomes and strategies over the medium-term. This includes their specific roles and the required collaboration with others across the Bank to achieve those outcomes. The Business Plan outlines seven key focus areas as shown in Chart 5.3. These include monetary and financial system stability, greater financial

Chart 5.3

The Business Plan's Seven Focus Areas



Source: Bank Negara Malaysia

intermediation, financial inclusion and consumer empowerment. The Bank also focuses on strengthening the payments ecosystem and deepening ties with regional and international economies. Talent development for the Malaysian financial industry is also a key focus area given the need for a ready pool of highly capable talent who will also act with the highest levels of responsibility, good governance and ethics. To effectively meet all its mandates, the Business Plan makes clear the expectation that the Bank places upon itself to be a high performing and sustainable organisation. This includes the continuous investments in strengthening its internal capabilities and resources.

Financial management and internal service excellence

The Bank’s investments in its people, ICT and physical infrastructures were undertaken with prudent financial management and a cost conscious culture. The Bank continues to contain its operating expenditures at sustainable levels through stringent criteria and processes for the approval of budgets.

The Bank uses good project management principles for greater operational effectiveness and efficiency. The Bank’s key projects cover areas such as investment and treasury operations, currency management, statistics and data management, and upgrading the Bank’s ICT infrastructure to support the national payment and settlement systems and internal operations of the Bank. The skill sets of staff involved in project management were enhanced to improve project governance, risk management, quality standards, contract and vendor management, stakeholder engagement, and monitoring and controls.

The Bank continues to adopt prudent financial management, improve project management discipline and capabilities, and pursue internal organisational efficiency

The Bank’s Centralised Shared Services (CSS) continued to improve the delivery, quality and cost-effectiveness of corporate services provided

within the Bank. This was achieved through the refinement of service level agreements to provide clearer standards of delivery, better management of third party services, leveraging on the creativeness of in-house talent and enhancing the CSS service portal, as a single online interface for the provision of common services. Qualified vendors were also empanelled for more efficiency when the Bank procures goods and services.

The Bank adopts stringent procurement processes which are clearly specified in its policy and procedures for procurement management. The policy and procedures are underpinned by the principles of transparency, clear accountability and governance, process and product standardisation, open and competitive tendering processes, and risk management.

Competent and progressive workforce

The Bank places a high priority on continuously investing in attracting, developing and retaining its talent. The Bank’s initiatives are designed to ensure that its talent proposition remains relevant and competitive. The human capital policies and strategies in the Bank are constantly being adapted to keep pace with the changing landscape of talent management. These trends include the shifts in talent mobility, technological change and new talent management practices.

As illustrated in Chart 5.4, the Bank adopts an integrated approach in its talent management. The Bank’s talent management framework links its business strategy with talent demand, talent supply and the management of people risks. In 2015, the Bank conducted a comprehensive review of jobs and accountabilities, including the

Chart 5.4
The Bank’s Talent Management Architecture



Source: Bank Negara Malaysia

knowledge and skills required to perform those jobs. This exercise was conducted for staff holding critical roles to ensure that the jobs are aligned to the Bank's Business Plan and are consistent with the Bank's succession plan.

The Bank's talent management initiatives focus on preparing its talent base for readiness and fit to assume greater managerial and leadership responsibilities. Efforts are directed towards ensuring a healthy succession pool, particularly for critical positions that enable the Bank to continue achieving its mandates. As shown in Chart 5.5, the succession planning framework involves targeted leadership development programmes for all levels of staff across the Bank. This approach reinforces the Bank's overall talent management architecture, ensuring that the right people are in the right jobs. Coaching and mentoring help to build competencies and readiness, and instil

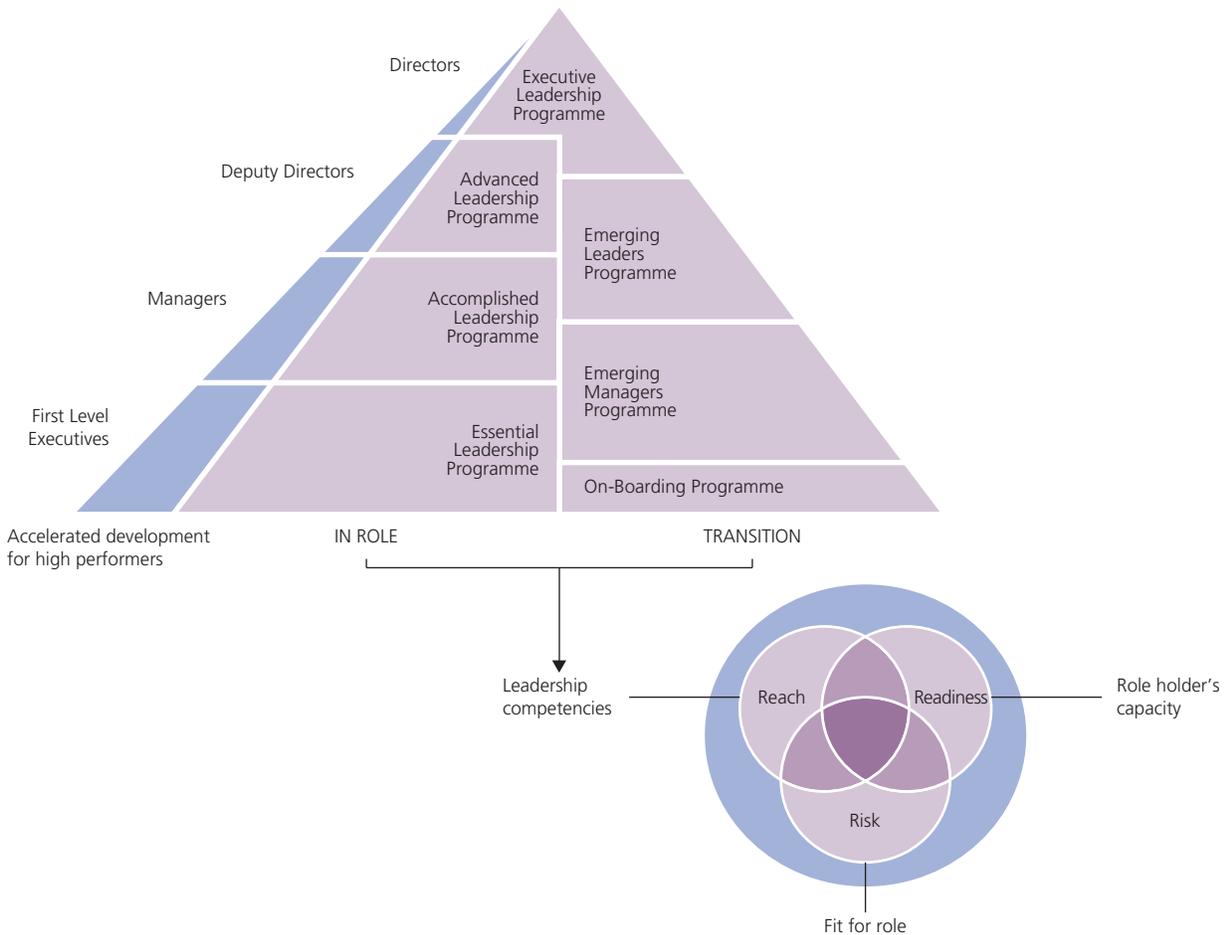
the desired corporate culture among successive generations of central bankers.

Sufficient resources are directed towards ensuring a healthy succession pool

The Bank has practised differentiated performance rewards as part of its efforts to attract, motivate and retain talent. This is accompanied by on-going initiatives to foster and reinforce the values of the Bank. The Bank's code of ethics provides clear standards of conduct to guide staff, including the obligation to act with the highest standards of integrity. Breaches of the code of ethics are swiftly dealt with by the Bank, reflecting its low tolerance for improper behaviour or conduct among staff.

Chart 5.5

The Bank's Leadership Development and Succession Planning Framework



Source: Bank Negara Malaysia

During the year, the Bank also focused on nurturing the wellness of its staff through targeted fitness programmes, sporting events, better in-house medical facilities, and the provision of counselling services for career management. These efforts reflect the Bank's continuous endeavour to create a safe and conducive working environment in line with changes in demographics, technology and lifestyle choices.

Developing the Bank's workforce through continuous investment in learning and knowledge management

The Bank's staff are provided with learning opportunities to build new competencies to meet the demands of their jobs. In 2015, the Bank's staff training expenditure over total gross salary was 5.1%, including scholarships for staff to pursue post-graduate studies. To strengthen the Bank's talent pipeline, it also awarded scholarships to deserving students for pre-university and undergraduate studies. Cumulatively, the Bank's investments in staff training and scholarships amounted to 12.2% of its total gross salary.

The Bank's efforts and investments reflect the commitment to build the leadership, technical and personal competence of its people. To strengthen leadership competence, the Bank implemented a comprehensive leadership development programme across all levels (Chart 5.5). The learning opportunities included conversations with international personalities who have demonstrated exceptional leadership across such diverse fields as physical endurance, music, sports, and helping the poor and disadvantaged.

Targeted and tailored technical programmes were designed together with functional departments in the Bank to ensure sufficient availability of talent equipped with the necessary central banking skills and knowledge. Staff are actively encouraged to continuously develop personal effectiveness, including through courses to sharpen integrated thinking, communication and ICT skills. Apart from formal learning, other learning modes were also made available for staff to pursue lifelong learning in a self-directed manner. This included the provision of a wide range of physical and online resources in various areas of knowledge relevant to the Central Bank. The 'Learning Tube'

was introduced to provide a collection of on-line videos for staff to learn anytime and anywhere.

The Bank actively encourages the formation of a vibrant learning community among its staff. This happens through the regular sharing of work experiences, leadership lessons, new ideas and policy insights among the Bank's staff. Staff also build good working relationships with each other through activities within the Bank such as sporting and festive events, volunteer activities and wellness programmes.

The Bank awards scholarships to maintain a continuous talent pipeline and to contribute to nation building. In 2015, a total of 71 scholarships were granted to exceptional students to pursue pre-university, first degree and post-graduate programmes relevant to the Bank's talent needs. Upon their return, scholars are placed in various departments based on specialisation, interest and role-fit. The Bank's intellectual capital is also strengthened with opportunities for staff to pursue relevant fields of post-graduate study.

Four deserving students were awarded the prestigious Kijang Emas Scholarship in 2015. This scholarship began in 2005 to support nation building and as such, the recipients return to serve the country. Since then, 44 high potential young Malaysians have been given the opportunity to study medicine, dentistry, genetics, biochemistry, dietetics, physics, engineering, law, psychology and architecture in top global universities. To date, 21 recipients of the scholarship have completed their studies, of whom twelve have returned while nine are still pursuing further specialisations in their relevant fields.

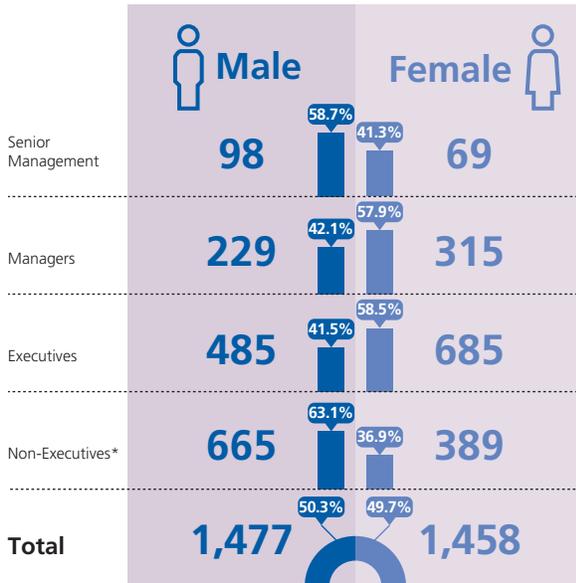
Staff strength

Between 2013 and 2015, the Bank's workforce increased by approximately 4.1% or 115 staff to 2,935 staff. The Bank's scholars remain a key source of new talent for the Bank. During the same period, the Bank's overall attrition rates remained stable, at the range of 3.6% to 4.6%, out of which an average of 1.5% was due to staff retiring from work.

The Bank's gender composition is well-balanced across various levels in the Bank for executives and non-executives, with an overall ratio of male to female staff of 1:1 (Chart 5.6). For executives, the ratio tips towards females who represent 56.8% of total executives in the Bank.

Chart 5.6

The Bank's Gender Composition



*Includes the Bank's security force

Source: Bank Negara Malaysia

Effective ICT infrastructure

The Bank's ICT infrastructure was secure and fully operational throughout 2015. There were no major disruptions to the Bank's critical ICT services and infrastructure, which also underpin the national payment and settlement systems.

To ensure that the Bank continues to keep pace with the growing sophistication of the ICT technologies, the Bank commenced an independent review of its ICT architecture in 2015. Based on this review, the Bank established a programme management office to oversee the implementation of specific ICT initiatives to upgrade the Bank's ICT infrastructure and to further enhance its resilience.

Decision making processes across the system development lifecycle were improved to further strengthen the Bank's ICT governance structure. The ICT architecture review also provided greater clarity of the resources required to support higher standards of system availability and the management of ICT services. As a result, the Bank strengthened its capabilities and resources in areas such as network architecture and database systems administration.

The independent review is still on-going and will include a detailed assessment of the Bank's

ICT maturity level and the design of its future ICT infrastructure.

In 2015, the Bank also undertook an information security certification exercise to ensure compliance with high standards for managing and keeping its information assets secure. As a result, the Bank was awarded with the ISO/IEC 27001:2013 Information Security Management System for its Real-time Electronic Transfer of Funds and Securities System (RENTAS) infrastructure services by CyberSecurity Malaysia. Emerging cyber threats were also managed by the Bank proactively through ethical hacking exercises, vigilant surveillance of ICT infrastructure and robust security controls.

COMMUNICATIONS

The year 2015 proved to be challenging for the Bank's communications given the increased uncertainty in the economic domain, financial markets and other areas, both domestically and internationally. There was a marked increase in the number of press conferences, interviews and engagement sessions with key stakeholders. For instance, ad-hoc press conferences were held to address the growing public misperception of the Bank's mandates and volatility of the Ringgit. During these sessions, the Bank focused on clarifying its stance on domestic issues and providing its assessment of the stability of the financial system.

Communications were intensified throughout 2015 to promote better understanding of developments affecting the Malaysian economy and the financial system

The Bank's monetary policy decisions were communicated through monetary policy statements after each MPC meeting. The statements cover the Bank's assessment of global and regional economic developments and their implications for the domestic economy. More importantly, the statements explain the rationale for the Bank's monetary policy decisions, which were then reinforced by the Bank's senior management in their commentaries and speeches at various official events. These efforts played a

key role in shaping market expectations through a clearer understanding of the factors driving monetary policy.

Elevating public awareness through outreach programmes

Throughout 2015, the Bank continued to focus on reaching out to Malaysians through various channels such as the Bank's primary point of contact with the public, namely BNMLINK, TELELINK and the Bank's regional offices, and its website, social media and mobile applications. These outreach efforts enable the Bank to understand the needs of the public and to explain policies and measures undertaken by the Bank to assist them.

The Bank engaged with entrepreneurs and Small Medium Enterprises (SME) nationwide to create awareness of the various schemes available to meet their financing needs. This includes the Bank's provision of special funds at reasonable financing rates, namely the Funds for Small and Medium Industries (FSMI2) and New Entrepreneurs Funds 2 (NEF2).

The Bank also provided information on the availability of other avenues of financing, such as the Skim Pembiayaan Mikro to support micro-enterprises. SMEs facing business problems were advised to seek assistance in restructuring their existing financing under the Bank's Small Debt Resolution Scheme.

In 2015, the Bank engaged with individuals and businesses affected by floods in the states of Kelantan, Terengganu, Perak, Sabah and Sarawak. The Bank established a Special Relief Facility scheme to assist the rebuilding of businesses in those regions. The Bank assisted to ease the financial hardship of the local community in Ranau following the earthquake and mud-flood disaster. Financial service providers were encouraged by the Bank to offer financial relief to those in Ranau by way of loan restructuring and moratorium schemes.

To better serve the needs of the public in regions across Malaysia, the Bank's branches in Kuching, Sarawak, and Kota Kinabalu, Sabah, were converted into Regional Offices (ROs) during the year. The Bank's other ROs are in Penang and Johor Bahru, Johor. The ROs facilitate greater engagement by the Bank at the state and municipal levels in areas covering economic and

financial surveillance, financial inclusion, financial education and currency management.

The Bank also engages the public and SMEs across Malaysia to encourage greater awareness and adoption of electronic payments (e-payments). Through various road shows and campaigns in 2015, the Bank explained how migrating to e-payments lowers the cost of doing business and improves overall efficiency of the Malaysian economy. E-payments also support greater financial inclusion by extending financial services to the unbanked communities. These communication programmes help to promote public understanding of the various e-payment initiatives such as payment cards, online fund transfers, JomPay for bill payments and safe online payment practices.

The Bank also participates in dialogues with Malaysian businesses and financial institutions to explain the benefits of using the Renminbi for cross-border trade settlement and investment. To increase the use of the cross-border Renminbi settlement channels, the Bank collaborated with various government agencies, such as the Ministry of International Trade and Industry, the Ministry of Plantation, Industries and Commodities, and the Royal Customs of Malaysia. From 2009 to 2015, the amount of trade settlement in Renminbi with PR China has registered a compounded annual growth rate of 50%.

The Bank's Museum and Art Gallery (Museum) provides a unique experience for the public to learn more about the origins and variety of money, history and roles of the Bank, progress of the Malaysian economy and evolution of the global Islamic financial system. The Museum also educates young Malaysians on adopting prudent money management through its Children's Gallery, exhibition on financial literacy and various programmes for school children. In 2015, approximately 37,000 children and students from kindergartens to tertiary institutions visited the Museum (2014: 31,000).

The Museum also showcases the works of local and regional artists to highlight the cultural heritage and historical milestones achieved by Malaysia and other countries in the ASEAN region. The Museum's galleries and thematic exhibitions throughout the year attracted close to 64,000 members of the public (2014: 55,000), including approximately 2,000 foreign visitors.

Increasing international engagements

During the year, the Bank continued to play a role in shaping central banking issues globally, on topics that have included Islamic finance, financial inclusion, prudential regulations, financial crisis, governance, monetary policy, and regional financial integration. The Bank's senior management have been called upon to share views on issues of strategic interest to the financial and economic communities as well as the academia. Platforms to share the Bank's views included the Group of 20 Presidency - International Monetary Fund Flagship Seminar on Islamic Finance, 2015 Meetings of the World Bank Group and International Monetary Fund, 2015 Meetings of the Bank for International Settlements, the Yale Financial Crisis Forum and Global Ethical Finance Forum.

The Bank's thought leadership and advocacy roles have also been recognised through the appointment of the Governor as Chair for Responsible Finance Institute's Council of Advisors, and the Bank's role as observer, one out of three emerging countries appointed, for the Basel Committee on Banking Supervision, and Chair of the BIS Central Bank Governance Group. Global recognition for the Bank's senior leadership has also included the Alliance for Financial Inclusion leadership award and Maya declaration award for global leadership in financial inclusion; "Lifetime Achievement Award for the global development of Islamic finance" awarded by His Highness Sheikh Mohammed bin Rashid Al Maktoum, Ruler of Dubai; the prestigious Wharton Dean's Medal to recognise outstanding leaders of private enterprise, public services and academia; and the "Lifetime Achievement Award" by Central Banking Publications.

The World Bank research office and the new headquarters of the Alliance for Financial Inclusion (AFI) were successfully opened in 2015 at the Bank's premises at Sasana Kijang. The presence of these international entities facilitates Malaysia's greater contribution towards meeting the global agendas of poverty eradication and financial inclusion.

The Asia School of Business (ASB), a collaboration between the Bank and the Massachusetts Institute of Technology Sloan School of Management (MIT Sloan), will operate from Sasana Kijang in its initial years. The ASB supports the growth of talent by meeting

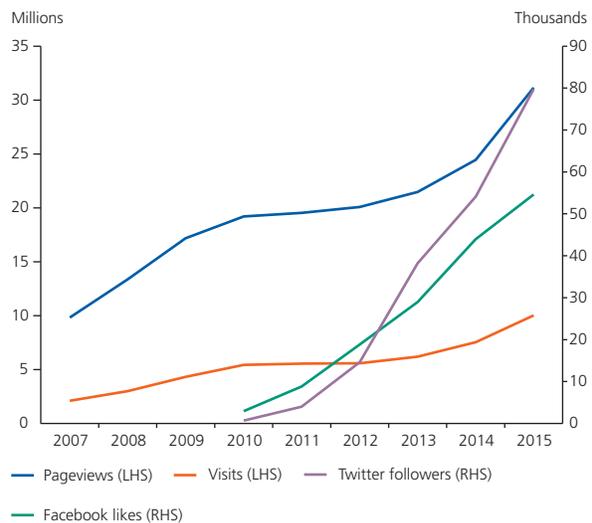
the increasing demand for leadership and management capabilities, especially given Asia's continuous transformation and growth potential. The ASB offers two key value propositions: the practical orientation of business management education, which will be based on MIT Sloan's Action Learning approach; and as a global learning centre that focuses on issues and challenges from the emerging world, especially from the Asian region. The first flagship ASB Masters in Business Administration programme, which will leverage on the core curriculum offered by MIT Sloan's main campus, is scheduled to commence in September 2016.

In 2015, the Bank continued to support international technical cooperation initiatives by facilitating structured programmes, study visits and information exchanges for policymakers from over 60 countries. Through these sessions, the Bank's staff shared their experiences in various areas, including Islamic finance as well as financial inclusion, in collaboration with AFI. The BNM-AFI courses have attracted strong interest and participation from global policymakers to improve the design and implementation of effective financial inclusion strategies.

Sasana Kijang continues to fulfil its role as an international meeting place for thought leadership and collaboration in central banking. In total, Sasana Kijang hosted 1,560 events in

Chart 5.7

Usage of the Bank's Website and Social Media



Source: Google Analytics, Facebook Insights and Twitter Analytics

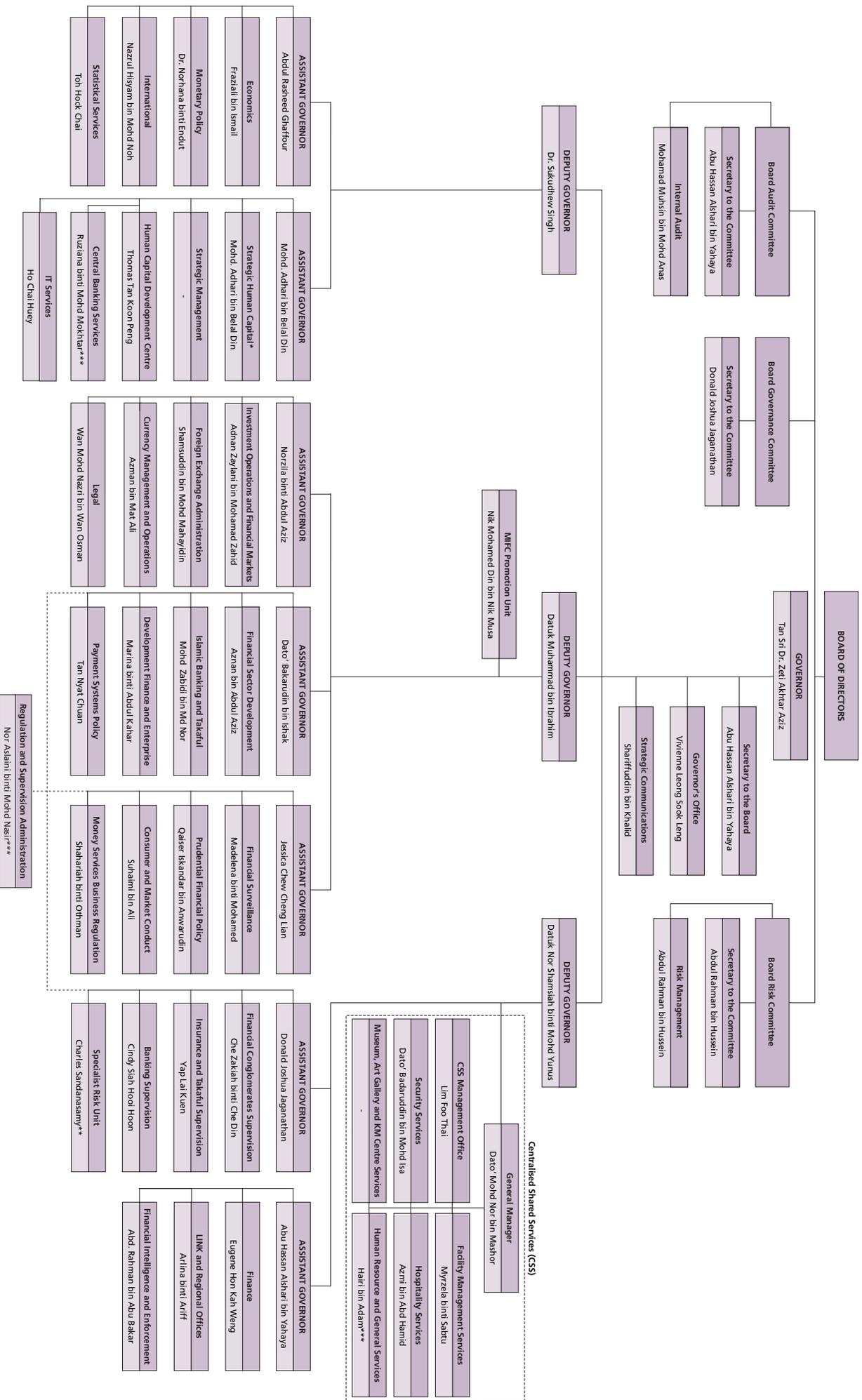
2015, of which 104 were international events, including high level meetings, programmes and global conferences.

Engaging stakeholders through online and mobile channels

As shown in Chart 5.7, the Bank's website and social media platforms continue to provide the public with convenient access to relevant information updates and to provide feedback to the Bank. In line with the growing preference for mobile communications, the Bank developed four consumer-centric mobile applications in 2015, namely MyRinggit, MyBNM, MyLINK and MyTabung.

These applications give wider segments of the population easier access to the knowledge and skills to make more informed and prudent financial decisions. The applications provide important information to financial consumers, including the security features of the Ringgit, updated information on financial matters and tools to plan and manage their finances and exercise their consumer rights. The Bank also alerts financial consumers on individuals and entities that are not authorised or approved under the relevant laws and regulations administered by the Bank, including advice on how to detect illegal financial schemes.

BANK NEGARA MALAYSIA Organisation Structure



* Reports to Dato' Nor Shamsiah binti Mohd Yunus
 ** Administrative Head
 *** Deputy Director

2015

ANNUAL FINANCIAL STATEMENTS

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REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF BANK NEGARA MALAYSIA FOR THE YEAR ENDED 31 DECEMBER 2015

Report on the Financial Statements

I have audited the financial statements of Bank Negara Malaysia which comprise the Statement of Financial Position as at 31 December 2015 and Income Statement for the year then ended, a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation and fair presentation of the financial statements in accordance with the Central Bank of Malaysia Act 2009 and applicable financial reporting standards approved in Malaysia to the extent that it is, in the opinion of the directors, appropriate to do so, having regard to the objects and functions of the Bank. The directors are also responsible for such internal control as the management determines is necessary to enable the preparation of the financial statements that are free from material misstatement or omission, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on the financial statements based on the audit. The audit has been carried out in accordance with the Audit Act 1957 and in conformity with the auditing standards approved in Malaysia. Those standards require that I comply with ethical requirements as well as to plan and perform the audit in order to obtain reasonable assurance that the financial statements are free from material misstatement or omission.

The audit involves performing procedures to obtain audit evidence on the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment including the assessment of the risks of material misstatement or omission of the financial statements, whether due to fraud or error. In making those risks assessments, the auditor considers the internal control relevant to Bank Negara Malaysia in the preparation and presentation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control of Bank Negara Malaysia. The audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements give a true and fair view of the financial position of Bank Negara Malaysia as at 31 December 2015 and of the financial performance and the results of its operations for the year then ended, in all material respects, in accordance with the Central Bank of Malaysia Act 2009 and the financial reporting standards approved in Malaysia to the extent that it is, in the opinion of the directors, appropriate to do so, having regard to the objects and functions of the Bank. The preparation of the financial statements differs in some aspects, from the approved accounting standards in Malaysia. In accordance with the requirements of Section 9 of the Act, I also report that in my opinion, the accounting records and other records required by the Act have been properly kept by Bank Negara Malaysia.



(TAN SRI HJ. AMBRIN BIN BUANG)
AUDITOR GENERAL
MALAYSIA

PUTRAJAYA
7 MARCH 2016



STATEMENT BY CHAIRMAN AND ONE OF THE DIRECTORS

We, Zeti Akhtar Aziz and Chin Kwai Yoong, being the Chairman and one of the Directors of Bank Negara Malaysia, do hereby state that in the opinion of the Board, the financial statements are drawn up so as to give a true and fair view of the state of affairs of Bank Negara Malaysia as at 31 December 2015 and of the results of operations for the year ended on that date.

On behalf of the Board,



ZETI AKHTAR AZIZ
CHAIRMAN

24 FEBRUARY 2016
KUALA LUMPUR

On behalf of the Board,



CHIN KWAI YOONG
DIRECTOR

24 FEBRUARY 2016
KUALA LUMPUR

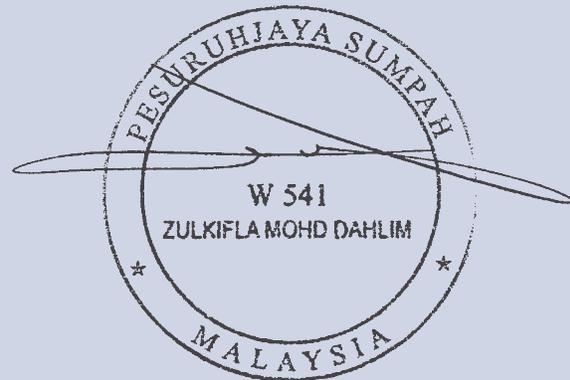
DECLARATION BY THE OFFICER PRIMARILY RESPONSIBLE FOR THE FINANCIAL MANAGEMENT OF BANK NEGARA MALAYSIA

I, Eugene Hon Kah Weng, being the officer primarily responsible for the financial management of Bank Negara Malaysia, do solemnly and sincerely declare that the financial statements for the year ended 31 December 2015, are to the best of my knowledge and belief, correct and I make this solemn declaration conscientiously believing the same to be true and by virtue of the provisions of the Statutory Declarations Act, 1960.

Subscribed and solemnly declared)
by the abovenamed at Kuala Lumpur)
this 24 February 2016.)



Before me,



NO: 17, JALAN PETALING
50000 KUALA LUMPUR

Bank Negara Malaysia

Statement of Financial Position as at 31 December 2015

		2015 RM million	2014 RM million
ASSETS			
	Note		
Gold and Foreign Exchange	3	398,178	397,092
International Monetary Fund Reserve Position	4	3,291	3,296
Holdings of Special Drawing Rights	4	7,657	6,518
Malaysian Government Papers	5	1,917	2,455
Deposits with Financial Institutions	6	1,290	1,731
Loans and Advances	7	6,958	6,499
Land and Buildings	8	2,114	2,114
Other Assets	9	19,163	7,912
Total Assets		440,568	427,617
LIABILITIES AND CAPITAL			
Currency in Circulation		88,157	77,735
Deposits from: Financial Institutions		157,170	141,161
Federal Government		10,213	5,263
Others	10	588	2,034
Bank Negara Papers		24,114	105,477
Allocation of Special Drawing Rights	4	8,009	6,819
Other Liabilities	11	21,083	17,877
Total Liabilities		309,334	356,366
Paid-up Capital	12	100	100
General Reserve Fund	13	14,572	14,537
Risk Reserve	14	112,716	52,827
Land Revaluation Reserve	15	752	752
Unappropriated Profits	16	3,094	3,035
Total Capital		131,234	71,251
Total Liabilities and Capital		440,568	427,617

Notes on the following pages form part of these financial statements.

Bank Negara Malaysia

Income Statement for the Year Ended 31 December 2015

		2015 RM million	2014 RM million
	Note		
Total Income	17	11,792	8,532
Less:			
Recurring Expenditure	18	(1,206)	(1,148)
Development Expenditure	19	(2,740)	(948)
Total Expenditure		(3,946)	(2,096)
Net Profit Before Tax		7,846	6,436
Less: Taxation	20	(52)	(51)
Net Profit After Tax		7,794	6,385
Less: Transfer to Risk Reserve	14	(4,700)	(3,350)
Unappropriated Profits of the year		3,094	3,035

Notes on the following pages form part of these financial statements.

Notes to the Financial Statements for the Year Ended 31 December 2015

1. General Information

Bank Negara Malaysia (the Bank) is a statutory body established under the Central Bank of Malaysia Act 1958 which has been repealed by the Central Bank of Malaysia Act 2009. The principal place of business is located at Bank Negara Malaysia, Jalan Dato' Onn, 50480 Kuala Lumpur.

The principal objects of the Bank are to promote monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy. In this regard, the Bank's primary functions are as follows:

- (a) to formulate and conduct monetary policy in Malaysia;
- (b) to issue currency in Malaysia;
- (c) to regulate and supervise financial institutions which are subject to the laws enforced by the Bank;
- (d) to provide oversight over money and foreign exchange markets;
- (e) to exercise oversight over payment systems;
- (f) to promote a sound, progressive and inclusive financial system;
- (g) to hold and manage the foreign reserves of Malaysia;
- (h) to promote an exchange rate regime consistent with the fundamentals of the economy; and
- (i) to act as financial adviser, banker and financial agent of the Government.

The Board of Directors approved the annual financial statements on 24 February 2016.

2. Accounting Policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These accounting policies are consistently applied to both of the financial years presented, unless otherwise stated.

2.1 Basis of Preparation of Financial Statements

- (a) These financial statements have been prepared in accordance with the Central Bank of Malaysia Act 2009 and applicable Malaysian Financial Reporting Standards (MFRS). Section 10 of the Central Bank of Malaysia Act 2009 provides that the Bank, in preparing its financial statements, shall comply with accounting standards to the extent that it is, in the opinion of the directors, appropriate to do so, having regard to the objects and functions of the Bank. The directors, having considered its responsibilities for the formulation and conduct of effective monetary policy and promoting financial stability, is of the opinion that, it is appropriate to differ, in certain aspects, from the MFRS.
- (b) The preparation of the financial statements on the basis stated in 2.1 (a) requires the management to make judgements, estimates and assumptions based on available information that may affect the application of accounting policies and the reported amounts of assets and liabilities as well as disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the financial year. Although these estimates are based on the management's best knowledge of current events and actions, the actual results could differ from those estimates.

2.2 Measurement Base and Accounting Basis

The financial statements have been prepared on an accrual basis, using the historical cost convention, except as otherwise disclosed.

2.3 Foreign Currency Translation

- (a) The financial statements have been prepared using Ringgit Malaysia, the currency of the primary economic environment in which the Bank operates.
- (b) Assets and liabilities in foreign currencies are translated into Ringgit Malaysia using the exchange rate prevailing as at the end of the financial year. Transactions in foreign currencies during the year are translated into Ringgit Malaysia using the exchange rate prevailing at the transaction dates.
- (c) All foreign exchange unrealised gains or losses arising on translation are recognised in Risk Reserve while realised gains or losses upon settlement are recognised in the income statement.

2.4 Gold

Gold is carried at fair value. Unrealised gains and losses from changes in the fair value on gold are recognised in Risk Reserve. Realised gains or losses from the sale of gold are recognised in the income statement.

2.5 Securities and Investments

Securities and investments are stated mainly at cost less impairment for diminution in value as at 31 December 2015.

2.6 Net Profit

The net profit of the Bank is appropriated in accordance with section 7 of the Central Bank of Malaysia Act 2009 and only realised gains are available for distribution.

2.7 Repurchase and Reverse-Repurchase Agreements

The amount borrowed under repurchase agreements is reported under Other Liabilities while the amount lent under reverse repurchase agreements is reported under Other Assets. For repurchase agreements, the difference between the sale and repurchase price is recognised as interest expense in the income statement. Conversely, for reverse repurchase agreements, the difference between purchase and resale price is recognised as interest income in the income statement.

2.8 Land and Buildings

- (a) The Bank capitalises all its land while buildings are maintained at nominal cost of RM10 each.
- (b) The amount of land capitalised at initial recognition is the purchase price along with any further costs incurred in bringing the land to its present condition.
- (c) After initial recognition, land is stated at revalued amount. Professional valuations of the Bank's land will be carried out once every ten years with any surplus arising on revaluation to be recognised directly in the Land Revaluation Reserve.
- (d) Gain or loss arising from the disposal of land is determined as the difference between the net disposal proceeds and the carrying amount of the land and is recognised in the Income Statement on the date of disposal.

2.9 Other Fixed Assets

All other fixed assets are completely written-off in the year of acquisition.

3. Gold and Foreign Exchange

	2015 RM million	2014 RM million
Gold	5,620	4,774
Foreign Securities	311,459	347,071
Foreign Deposits	8,778	14,201
Balances with Other Central Banks	52,091	11,970
Others	20,230	19,076
	<u>398,178</u>	<u>397,092</u>

4. International Monetary Fund (IMF) Reserve Position, Holdings of Special Drawing Rights (SDR) and Allocation of Special Drawing Rights

The IMF objectives are to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth and reduce poverty around the world. The IMF also provides advice and temporary funding in the event of balance of payments difficulties to member countries.

IMF Reserve Position

This consists of the reserve tranche position of Malaysia's quota, lending under the Financial Transaction Plan (FTP) and New Arrangements to Borrow (NAB). The IMF quota determines the member country's voting strength, the financial contributions to the IMF, the amount of financing the member can access in the event of balance of payment difficulties and the amount of SDRs allocated to the member. Both FTP and NAB programmes are used to provide loans if the IMF has a need for funds in excess of quota resources.

Holdings of Special Drawing Rights

Holdings of Special Drawing Rights (SDR) are an international reserve asset created by the IMF. SDR is periodically allocated to IMF member countries on the basis of the size of member countries' quota. A member may use SDR to obtain foreign exchange reserves from other members and to make international payments, including to the IMF.

Allocation of Special Drawing Rights

This liability to the IMF represents an equivalent amount of SDR received since its inception.

5. Malaysian Government Papers

Malaysian Government Papers refer to holdings of Government debt instruments that are among the instruments that can be used in the Bank's monetary policy operations.

	2015 RM million	2014 RM million
Malaysian Government Securities	<u>1,917</u>	<u>2,455</u>

6. Deposits with Financial Institutions

Deposits with financial institutions comprise deposits placed by the Bank with financial institutions under section 75(i) and section 100 of the Central Bank of Malaysia Act 2009.

7. **Loans and Advances**

Loans and advances comprise mainly of advances extended by the Bank to the participating institutions under various schemes such as Fund for Small and Medium Industries and New Entrepreneur Fund aimed at promoting growth and development of small and medium business establishments. The extensions of these advances are provided under section 48, section 49 and section 100 of the Central Bank of Malaysia Act 2009.

8. **Land and Buildings**

	2015 RM million	2014 RM million
Freehold land, at cost	1,250	1,250
Freehold land, at revaluation	864	864
	<u>2,114</u>	<u>2,114</u>

Freehold land, at cost, were purchased in 2014. Freehold land, at revaluation, were revalued by Jones Lang Wootton (JLW) on 1 August 2014. Buildings recorded at nominal value amounts to RM3,550 (2014: RM3,570).

9. **Other Assets**

Included in other assets are securities purchased under reverse-repurchase agreements of RM13,747 million (2014: RM2,549 million) and investments in shares and bonds of RM4,589 million (2014: RM4,595 million) acquired under section 48(1) and section 100 of the Central Bank of Malaysia Act 2009.

10. **Deposits from Others**

A substantial part of these deposits comprises deposits from national institutions, government agencies and public authorities.

11. **Other Liabilities**

Other liabilities include mainly placements by financial institutions under the repurchase agreements.

12. **Paid-up Capital**

The paid-up capital of RM100 million is owned by the Government of Malaysia.

13. **General Reserve Fund**

	2015 RM million	2014 RM million
As at 1 January (as previously reported)	14,572	14,537
Prior year adjustments:		
Transfer made to General Reserve Fund reclassified to Unappropriated Profits	(35)	(56)
	<u>14,537</u>	<u>14,481</u>
As restated	14,537	14,481
Amount approved and transferred to the General Reserve Fund during the year	35	56
As at 31 December	<u>14,572</u>	<u>14,537</u>

In the previous years, the appropriations of net profits to the general reserve fund and dividends to the Government were recognised prior to the approval of the Minister. With effect from 2015, appropriations of net profits to the general reserve fund and dividends to the Government are recognised upon the approval by the Minister as provided under section 7 of the Central Bank of Malaysia Act 2009.

The transfer to general reserve fund for the year ended 2014 of RM35 million was approved by the Minister on 4 February 2015.

14. **Risk Reserve**

The risk reserve are financial buffers comprising unrealised gains or losses on translation of foreign currency assets and liabilities and fair value changes from available for sale securities.

A market risk measurement framework is used to estimate financial buffers required to cushion unexpected loss arising from unfavourable circumstances not within the control of the Bank. Financial buffers are built from the appropriation as provided under section 7 of the Central Bank of Malaysia Act 2009.

15. **Land Revaluation Reserve**

Land Revaluation Reserve relates to unrealised surplus of land upon their revaluation.

16. **Unappropriated Profits**

	2015 RM million	2014 RM million
Balance 1 January	3,035	-
Prior year adjustment – 2013 net profits transferred to General Reserve Fund and Dividend payable to the Government reclassified to Unappropriated Profits	-	1,556
As restated	<u>3,035</u>	<u>1,556</u>
Less: Appropriations approved during the year		
Transfer to General Reserve Fund	(35)	(56)
Dividend payable to the Government	<u>(3,000)</u>	<u>(1,500)</u>
	-	-
Current year's unappropriated profits	<u>3,094</u>	<u>3,035</u>
Balance 31 December	<u><u>3,094</u></u>	<u><u>3,035</u></u>

For the year ended 31 December 2015, the Board recommends a transfer to the general reserve fund of RM94 million and dividend payable of RM3 billion to the Government.

In accordance with section 7 of the Central Bank of Malaysia Act 2009, appropriations to the general reserve fund and declaration of dividends to Government are subject to the approval of the Minister, and if approved will be recognised in the next financial year ending 31 December 2016. The dividend paid to the Government for the year ended 2014 amounted to RM3 billion was approved by the Minister on 4 February 2015.

17. **Total Income**

Total income comprises revenue from foreign reserves management which includes interest and dividends, non-treasury income, realised capital gains or losses, and is stated at net of amortisation/accretion of premiums/discounts and monetary policy cost.

18. Recurring Expenditure

Recurring expenditure are expenses incurred in the management and administration of the day-to-day operations of the Bank.

19. Development Expenditure

Development expenditure are expenses incurred mainly to finance developmental and long term projects undertaken by the Bank that are in line with its principal objects and functions.

20. Taxation

The Bank is exempted from payment of income tax and supplementary income tax as set out in the Income Tax (Exemption) (No. 7) Order 1989. Tax expenses mainly relates to unclaimable withholding taxes on foreign income.

21. Contingencies and Commitments**21.1 Contingent Assets**

Total contingent assets as at 31 December 2015 amounted to RM1,400 million. These comprise the Bank's total contributions to International Centre for Leadership in Finance (ICLIF) Trust Fund of RM800 million and International Centre for Education in Islamic Finance (INCEIF) Trust Fund of RM600 million to finance activities related to training, research and development of human resource in banking and financial services managed by The ICLIF Leadership and Governance Centre and INCEIF respectively. It is provided in the Trust Deeds that the total contributions will be returned to the Bank when the Centres become self-sufficient in the future.

21.2 Commitments

Total commitments as at 31 December 2015 comprise the following:

(a) Membership with IMF

- (i) The Bank has an obligation to pay to IMF an equivalent amount of RM7,491 million in SDR or other convertible currencies which represents the unpaid portion of Malaysia's quota in the IMF under the Articles of Agreement.
- (ii) On 15 December 2010, in accordance with the Board of Governors Resolution No. 66-2, the IMF adopted the 'Fourteenth General Review of Quotas and Reform of the Executive Board' under which the quotas of members of the Fund shall be increased. As at 31 December 2015, Malaysia has consented to the quota increase of SDR1,860 million (equivalent to RM11,066 million).
- (iii) The Bank has participated in the New Arrangements to Borrow (NAB), a set of credit arrangements between the IMF and its member countries to provide supplementary source of financing to IMF for the purpose of safeguarding the stability of the international monetary system. As at 31 December 2015, the amount of undrawn credit under the NAB is SDR307 million (equivalent to RM1,826 million).
- (iv) On 23 July 2012, the Bank has pledged a USD1,000 million (equivalent to RM4,294 million) bilateral contribution to the IMF for precautionary and financial crisis resolution purposes.

(b) Investment with Bank for International Settlements (BIS)

The Bank has a commitment of SDR12 million (equivalent to RM72 million) which refers to the uncalled portion of the 3,220 units of shares held by the Bank in the BIS based on the nominal value of SDR5,000 each using the SDR rate at the date of the Statement of Financial Position.

(c) Swap Arrangements**(i) ASEAN Swap Arrangement**

The Bank has participated in the multilateral ASEAN Swap Arrangement (ASA) together with other ASEAN central banks and monetary authorities to provide short-term foreign currency liquidity support to member countries with balance of payments difficulties. As at 31 December 2015, the Bank's total commitment amounted to USD300 million (equivalent to RM1,288 million) and there was no request for liquidity support under ASA from any member country during the financial year.

(ii) Bilateral Currency Swap Arrangement

(a) On 20 April 2015, the Bank renewed the Bilateral Currency Swap Arrangement (BCSA) agreement with the People's Bank of China with the objective of promoting and facilitating trade settlement in local currency between the two countries. As at 31 December 2015, the Bank's total commitment under the BCSA is RM90 billion and there has been no request to activate the BCSA during the financial year.

(b) On 20 October 2013, the Bank signed the BCSA agreement with the Bank of Korea with the objective of promoting bilateral trade and facilitating trade settlement in local currency between the two countries. As at 31 December 2015, the Bank's total commitment under the BCSA is RM15 billion and there has been no request to activate the BCSA during the financial year.

(iii) Chiang Mai Initiative Multilateralisation Arrangement

The Bank has participated in the Chiang Mai Initiative Multilateralisation (CMIM) arrangement to provide financial support to ASEAN+3 member countries facing balance of payments and short-term liquidity difficulties. The effective date of the CMIM Agreement is 24 March 2010. Under the CMIM arrangement, member countries facing balance of payments and short-term liquidity constraints can obtain financial support in US dollar through swap arrangements against their respective local currencies. As at 31 December 2015, the Bank's total commitment is USD9.1 billion (equivalent to RM39 billion) and there was no request for liquidity support from any member country.

(iv) Repurchase Agreement with Central Banks and Monetary Authorities

The Bank has entered into repurchase agreements totalling USD5 billion (equivalent to RM22 billion) with various central banks and monetary authorities under the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) to provide liquidity assistance in times of emergency. As at 31 December 2015, there was no request for liquidity assistance from any counterpart.

22. Financial Risk Management

The Reserve Management Committee oversees the assessment, measurement and the control of the investment risks in the management of reserves to be within acceptable levels to ensure that the objectives of capital preservation, liquidity and return are met. In undertaking this function, the major risks of the investments fall into the following areas:

(a) Market Risk

Market risk is the exposure of the Bank's investments to adverse movements in market prices such as foreign exchange rates, interest rates and equity prices. Market risk is assessed and monitored on a daily basis. A benchmark policy approved by the Board of Directors reflects the long-term objectives and acceptable risk-return profile of the investments. Investments may be made in instruments that are different than the

benchmark. This deviation in investment is controlled through a set of risk management limits, governance arrangements and investment guidelines that are also approved by the Board of Directors. Sensitivity analysis and stress testing are undertaken to assess emerging risk and potential marked-to-market losses from adverse movements and volatility in the market, as well as liquidity conditions.

(b) **Credit Risk**

Credit risk is the risk of default of the issuer of the debt or failure of the counterparty to perform its contractual obligation to the Bank resulting in the Bank not receiving its principal and/or interest that has fallen due in a timely manner. A comprehensive credit risk framework governs the permissible investments and the risk appetite of the Bank. This ensures investments are placed with issuers and counterparties of high credit standing and the probability of losses from this risk is low. The framework, which is approved by the Board, also incorporates market-based credit indicators such as ratings implied from financial market prices, and internal credit assessment. This enhances the credit framework by providing a more dynamic and forward-looking credit assessment.

(c) **Operational Risk**

Operational risk is the risk of financial losses due to failed internal processes, inadequate controls and procedures, or any other internal or external events that impede operations. Operational risk is mitigated through a robust governance framework and effective implementation of risk controls and limits. A comprehensive operational risk surveillance mechanism is in place to support the identification of emerging risk in the Bank's operations for action to be taken in managing gaps and in mitigating financial losses.

23. **Bank Negara Malaysia Staff Welfare Account (SWA) and Bank Negara Malaysia Staff Welfare Account (Medical Fund) (termed as the 'Medical Fund account')**

The SWA was established on 1 March 1991 under section 15 (5) and (6) of the Central Bank of Malaysia Act 1958 while the Medical Fund Account was established on 21 June 2006 under section 15 (6) of the Central Bank of Malaysia Act 1958. Both the SWA and the Medical Fund continue to exist under section 83 (4) and (5) of the Central Bank of Malaysia Act 2009.

The SWA is governed under the Bank Negara Malaysia Staff Welfare Account Trust Directions 1991. As stipulated in the Trust Directions 1991, the SWA shall be administered by a committee authorised by the Board (Authorised Committee of the Board). The accounts of the SWA are to be maintained separately from the other accounts of the Bank and shall be audited in the same manner of the Bank's Account. The objective of the SWA is to provide loans to the staff for certain allowable activities, finance the activities of the staff's associations, gives education excellence awards to children of staff. The SWA also manages the insurance compensation received by beneficiaries of the deceased staff who have yet to attain the legal age.

The Medical Fund Account is governed under the Bank Negara Malaysia Staff Welfare Account (Medical Fund) Trust Directions 2006. The objective is to assist the Bank to meet its medical expenses of eligible retirees and their dependents. As stipulated in the Staff Welfare Account (Medical Fund) Trust Directions 2006, the Medical Fund shall be administered by a Medical Fund Committee. The Medical Fund Account is to be maintained separately under the Staff Welfare Account and shall be audited in the same manner of the Staff Welfare Account.

24. Comparatives Figures

Certain comparative figures have been restated to conform with the current year's presentation. The effects of these changes on the comparative figures are as follows:

	Note	As previously stated RM million	Reclassification RM million	As restated RM million
<u>Statement of Financial</u>				
<u>Position</u>				
Gold and Foreign Exchange	a	395,559	1,533	397,092
Other Assets	a	9,445	(1,533)	7,912
Other Liabilities	b	20,877	(3,000)	17,877
General Reserve Fund	b	14,572	(35)	14,537
Unappropriated Profits	b	-	3,035	3,035
<u>Income Statement</u>				
Total Income	c	8,481	51	8,532
Tax Expense	c	-	(51)	(51)

Note:

- Reclassification of investments in securities issued by non-residents to Gold and Foreign Exchange which was previously classified under Other Assets.
- With effect from 2015, appropriations of profits to the general reserve fund and dividends to the Government are recognised upon the approval by the Minister.
- Reclassification of tax expense which was previously deducted from Total Income.

2015

ANNEX



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Table A.1

Gross Domestic Product by Kind of Economic Activity at Constant 2010 Prices

	2011	2012	2013	2014	2015 ^p	2016 ^f
	RM million					
Agriculture	88,555	89,406	91,097	92,979	93,904	93,576
Mining and quarrying	85,373	86,751	87,789	90,645	94,917	98,211
Manufacturing	202,960	211,921	219,216	232,868	244,247	254,215
Construction	29,524	34,880	38,646	43,190	46,728	50,398
Services	449,854	479,300	507,935	541,185	569,046	594,025
Plus: Import duties	8,654	10,004	10,577	11,639	13,805	15,675
GDP at purchasers' prices¹	864,920	912,261	955,260	1,012,506	1,062,647	1,106,100
	Annual change (%)					
Agriculture	6.8	1.0	1.9	2.1	1.0	-0.3
Mining and quarrying	-4.9	1.6	1.2	3.3	4.7	3.5
Manufacturing	5.4	4.4	3.4	6.2	4.9	4.1
Construction	4.6	18.1	10.8	11.8	8.2	7.9
Services	7.0	6.5	6.0	6.5	5.1	4.4
Plus: Import duties	12.8	15.6	5.7	10.0	18.6	13.5
GDP at purchasers' prices	5.3	5.5	4.7	6.0	5.0	4.0 ~ 4.5

¹ Numbers may not necessarily add up due to rounding

^p Preliminary

^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.2

Growth in Manufacturing Production (2010=100)

	2012	2013	2014	2015	2013	2014	2015
	Index				Annual change (%)		
Export-oriented industries	110.4	114.5	120.8	126.7	3.7	5.6	4.8
Electronics and electrical products cluster	106.7	117.3	131.1	143.1	9.9	11.8	9.2
<i>Electronics</i>	108.2	128.3	141.8	142.9	18.5	10.6	0.7
<i>Electrical products</i>	100.7	96.9	110.0	145.2	-3.8	13.5	32.1
Primary-related cluster	112.1	113.1	116.0	118.9	0.9	2.5	2.5
Chemicals and chemical products	121.9	121.1	125.4	131.2	-0.7	3.6	4.6
Petroleum products	108.3	108.6	109.2	110.5	0.2	0.6	1.2
Textiles, wearing apparel and footwear	105.2	102.4	113.5	122.0	-2.6	10.8	7.5
Wood and wood products	103.1	99.9	107.7	115.3	-3.1	7.8	7.1
Rubber products	124.3	134.5	132.8	139.5	8.2	-1.3	5.1
Off-estate processing	104.6	111.5	117.2	113.1	6.6	5.1	-3.5
Paper products	112.9	115.5	114.2	117.7	2.3	-1.1	3.0
Domestic-oriented industries	114.4	121.2	130.6	136.7	5.9	7.7	4.7
Construction-related cluster	114.7	120.4	125.5	131.2	4.9	4.3	4.5
Construction-related products	105.6	106.9	112.3	117.4	1.3	5.1	4.5
<i>Non-metallic mineral products</i>	115.4	115.0	122.9	131.3	-0.4	6.9	6.8
<i>Basic iron & steel and non-ferrous metals</i>	95.4	98.6	101.4	102.9	3.4	2.8	1.6
Fabricated metal products	138.6	155.6	159.9	167.3	12.2	2.8	4.6
Consumer-related cluster	114.1	122.1	135.8	142.3	7.0	11.2	4.8
Food products	112.5	116.7	123.0	126.1	3.8	5.4	2.5
Transport equipment	115.8	131.8	150.7	158.6	13.8	14.4	5.2
Beverages	105.6	103.3	121.6	135.8	-2.1	17.7	11.7
Tobacco products	123.6	101.3	106.2	115.9	-18.0	4.8	9.1
Others	117.5	105.5	116.6	108.8	-10.2	10.6	-6.7
Total	111.3	116.0	123.0	128.9	4.2	6.1	4.8

Source: Department of Statistics, Malaysia

Table A.3

Services Sector Performance at Constant 2010 prices

	2011	2012	2013	2014	2015 ^p	2011	2012	2013	2014	2015 ^p
	Annual change (%)					Share to GDP (%)				
Services	7.0	6.5	6.0	6.5	5.1	52.0	52.5	53.2	53.5	53.5
Intermediate services	6.5	7.5	5.4	5.9	4.6	20.0	20.4	20.5	20.5	20.4
<i>Finance and insurance</i>	6.8	7.8	2.0	2.3	-0.7	7.6	7.8	7.6	7.3	6.9
<i>Real estate and business services</i>	5.8	7.5	8.0	8.0	6.6	4.0	4.0	4.2	4.2	4.3
<i>Transport and storage</i>	5.6	4.8	4.6	5.2	5.7	3.5	3.5	3.5	3.5	3.5
<i>Information and communication</i>	7.4	8.9	9.1	9.7	9.4	4.9	5.1	5.3	5.5	5.7
Final services	7.3	6.0	6.3	7.0	5.5	32.0	32.2	32.6	32.9	33.1
<i>Wholesale and retail trade</i>	6.8	4.6	6.3	8.9	6.9	13.9	13.8	14.0	14.4	14.7
<i>Food & beverages and accommodation</i>	6.2	5.6	5.9	6.5	6.4	2.7	2.7	2.7	2.7	2.8
<i>Utilities</i>	3.9	4.9	4.4	3.8	3.5	2.7	2.6	2.6	2.6	2.5
<i>Government services</i>	11.1	9.6	7.6	6.1	4.0	8.3	8.6	8.8	8.8	8.8
<i>Other services</i>	5.0	4.5	5.6	4.8	4.7	4.5	4.4	4.5	4.4	4.4

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Table A.4

GNI by Demand Aggregates

	2011	2012	2013	2014	2015 ^p	2016 ^f
	at Current Prices (RM million)					
Consumption	558,333	616,680	667,571	727,554	778,176	830,759
<i>Private consumption</i>	437,340	482,238	527,749	579,908	626,037	674,508
<i>Public consumption</i>	120,993	134,442	139,822	147,646	152,139	156,251
Investment	202,251	246,343	269,814	287,498	302,922	319,738
<i>Private investment</i>	114,759	142,307	162,815	183,902	198,747	212,674
<i>Public investment</i>	87,492	104,037	106,999	103,595	104,175	107,064
Change in stocks ¹	9,164	3,741	-5,522	-10,697	-12,631	-1,800
Exports of goods and services	777,302	770,202	770,368	817,176	821,420	851,520
Imports of goods and services	635,316	665,714	683,408	714,950	733,007	771,264
GDP at purchasers' value	911,733	971,252	1,018,821	1,106,580	1,156,881	1,228,952
Net factor payments abroad	-21,600	-35,841	-33,975	-37,322	-32,192	-37,981
GNI	890,133	935,411	984,846	1,069,258	1,124,689	1,190,971
	at Constant 2010 Prices (RM million)					
Consumption	540,359	582,015	622,517	662,490	699,693	731,180
<i>Private consumption</i>	422,376	457,625	490,798	524,979	556,304	584,900
<i>Public consumption</i>	117,983	124,390	131,719	137,511	143,389	146,281
Investment	195,996	233,203	252,271	264,276	274,144	285,001
<i>Private investment</i>	110,863	134,543	151,749	168,510	179,375	189,211
<i>Public investment</i>	85,133	98,659	100,522	95,765	94,768	95,789
Change in stocks ¹	4,793	4,289	-3,177	-8,598	-2,069	-2,000
Exports of goods and services	743,919	730,961	732,856	770,503	775,530	800,153
Imports of goods and services	620,147	638,206	649,208	676,165	684,652	708,234
GDP at purchasers' value	864,920	912,261	955,260	1,012,506	1,062,647	1,106,100
Net factor payments abroad	-25,868	-40,457	-38,357	-40,589	-24,531	-28,428
GNI	839,052	871,804	916,903	971,917	1,038,116	1,077,671

¹ Includes statistical discrepancy^p Preliminary^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5

Savings-Investment Gap

	2011	2012	2013	2014	2015 ^p
	RM million				
Public savings	87,998	94,383	96,131	90,465	64,486
Public gross domestic capital formation	87,492	104,037	106,999	103,595	104,175
Deficit/surplus	506	-9,654	-10,868	-13,130	-39,689
Private savings	222,741	205,879	203,646	233,653	259,831
Private gross domestic capital formation	123,923	146,048	157,293	173,205	186,116
Deficit/surplus	98,818	59,831	46,353	60,448	73,715
Gross national savings	310,739	300,262	299,777	324,118	324,317
(as % of GNI)	34.9	32.1	30.4	30.3	28.8
Gross domestic capital formation	211,415	250,084	264,291	276,801	290,291
(as % of GNI)	23.8	26.7	26.8	25.9	25.8
Balance on current account	99,324	50,177	35,485	47,317	34,026
(as % of GNI)	11.2	5.4	3.6	4.4	3.0

^p Preliminary

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

Table A.6

Labour Market: Selected Indicators

	2011	2012	2013	2014	2015 ^p
	(number of positions/persons)				
Vacancies by Industry¹					
Agriculture, forestry & fishing	399,522	337,466	306,542	240,552	269,469
Mining & quarrying	3,369	2,180	1,880	2,605	9,929
Manufacturing	689,422	598,890	456,478	352,784	313,396
Construction	388,241	310,954	308,783	202,878	208,912
Services	778,994	369,983	329,007	275,199	287,050
<i>Electricity, gas & water supply²</i>	15,091	6,521	7,043	8,339	5,834
<i>Wholesale & retail trade; accommodation & food services</i>	185,577	109,117	95,966	87,385	99,310
<i>Transport & storage; information & communication</i>	20,100	17,921	14,864	19,375	39,068
<i>Finance & insurance; real estate & business services³</i>	372,346	114,099	96,399	75,936	70,784
<i>Public administration & defence; compulsory social security</i>	6,897	5,115	4,020	2,485	1,360
<i>Community, social & other service activities</i>	178,983	117,210	110,715	81,679	70,694
Total vacancies	2,259,548	1,619,473	1,402,690	1,074,018	1,088,756
Retrenchments by Industry⁴					
Agriculture, forestry & fishing	172	156	180	77	173
Mining & quarrying	24	81	117	318	863
Manufacturing	5,635	7,616	7,940	5,716	3,328
Construction	290	1,002	353	564	383
Services	3,329	2,639	2,605	3,756	4,783
<i>Electricity, gas & water supply²</i>	66	46	-	67	127
<i>Wholesale & retail trade; accommodation & food services</i>	1,322	743	742	1,759	1,482
<i>Transport & storage; information & communication</i>	293	292	362	478	925
<i>Finance & insurance; real estate & business services³</i>	672	827	628	888	1,313
<i>Public administration & defence; compulsory social security</i>	545	511	548	339	747
<i>Community, social & other service activities</i>	431	220	325	225	189
Total retrenchments	9,450	11,494	11,195	10,431	9,530
Employment by Industry⁵ ('000 persons)					
Agriculture, forestry & fishing	1,410	1,602	1,682	1,660	1,635
Mining & quarrying	76	81	87	84	103
Manufacturing	2,222	2,228	2,215	2,266	2,222
Construction	1,134	1,164	1,244	1,226	1,280
Services	7,443	7,649	7,982	8,296	8,519
<i>Electricity, gas & water supply²</i>	122	142	144	145	135
<i>Wholesale & retail trade; accommodation & food services</i>	2,942	3,073	3,236	3,388	3,471
<i>Transport & storage; information & communication</i>	813	833	813	805	826
<i>Finance & insurance; real estate & business services³</i>	1,157	1,231	1,258	1,374	1,418
<i>Public administration & defence; compulsory social security</i>	749	698	764	745	760
<i>Community, social & other service activities</i>	1,660	1,672	1,767	1,840	1,908
Total employment	12,285	12,723	13,210	13,532	13,759
Labour force participation rate (% of working-age population)	64.4	65.5	67.0	67.5	67.6
Unemployment rate (% of labour force)	3.1	3.0	3.1	2.9	3.2

¹ Refers to vacancies reported by employers through the JobsMalaysia portal. Data from 2012 onwards are not comparable to previous years due to a reclassification exercise

² Refers to electricity, gas, steam and air conditioning supply; water supply, sewerage, waste management and remediation activities

³ Refers to finance and insurance/takaful, real estate, professional, scientific and technical services, administrative and support service activities

⁴ For 2015, based on total retrenched workers for the period of January-October 2015

⁵ For preliminary estimates of 2015, based on average employment for the period of January-December 2015

^p Preliminary

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

Table A.7

Private Consumption Indicators

	2010	2011	2012	2013	2014	2015
Sales of passenger cars ('000 units)	543.6	520.5	552.2	576.7	588.3	591.3
Annual change (%)	11.8	-4.3	6.1	4.4	2.0	0.5
Imports of consumption goods (RM billion)	34.5	41.0	43.7	47.6	50.3	62.5
Annual change (%)	9.5	19.0	6.6	8.8	5.7	24.1
Tax collection						
Sales tax (RM billion)	8.2	8.6	9.5	10.1	10.9	5.2
Service tax (RM billion)	3.9	5.0	5.6	5.9	6.3	3.0
Narrow money (M1)						
Annual change (%)	11.7	15.4	11.9	13.0	5.7	4.1
Loans disbursed by banking system						
Consumption credit (excl. passenger cars)						
Annual change (%)	12.5	13.3	-3.6	5.9	-0.1	1.7
Wholesale and retail trade, restaurants and hotels						
Annual change (%)	16.3	13.8	26.0	3.4	21.5	-9.8
MRA retail sales (Annual change in %)	8.4	8.1	5.5	4.5	3.4	2.0 ^e
Credit card turnover spending ¹ (RM billion)	79.8	88.8	94.1	99.7	105.5	112.7
Annual change (%)	15.1	11.3	6.0	6.0	5.8	6.8
MIER Consumer Sentiment Index ²	117.2	106.3	118.7	82.4	83.0	63.8
FBM KLCI	1,518.9	1,530.7	1,689.0	1,867.0	1,761.3	1,692.5
Commodity prices						
Crude palm oil (RM/tonne)	2,752.1	3,278.9	2,863.5	2,374.5	2,412.4	2,165.5
Brent crude oil (USD/barrel)	80.3	110.9	111.7	108.7	99.4	53.7
Rubber (sen/kg)	1,069.6	1,366.5	962.4	785.9	554.2	521.3

¹ Resident spending only² Refers to fourth quarter^e Estimates

Source: Malaysian Automotive Association; Department of Statistics, Malaysia; Ministry of Finance, Malaysia; Malaysia Retailers Association; Malaysian Institute of Economic Research; Bursa Malaysia Berhad; Malaysian Palm Oil Board; Bloomberg; Malaysian Rubber Board; and Bank Negara Malaysia

Table A.8

Private Investment Indicators

	2010	2011	2012	2013	2014	2015
Sales of commercial vehicles ('000 units)	61.6	65.0	75.6	79.1	78.1	75.4
Annual change (%)	21.8	5.6	16.2	4.7	-1.3	-3.5
Imports of capital goods (RM billion)	73.8	80.2	96.1	98.2	95.9	95.9
Annual change (%)	13.2	8.7	19.9	2.2	-2.4	0.0
Approvals by MIDA (Manufacturing sector)						
No. of projects	910	846	804	787	811	680
Capital investment (RM billion)	47.2	56.1	41.1	52.1	71.9	74.7
<i>Local</i>	18.1	21.9	20.2	21.6	32.3	52.8
<i>Foreign</i>	29.1	34.1	20.9	30.5	39.6	21.9
New investment (% share)	50.6	59.0	65.4	73.1	60.5	80.6
Reinvestments (% share)	49.4	41.0	34.6	26.9	39.5	19.4
Loans disbursed by banking system						
Businesses sector						
Annual change (%)	9.8	12.5	20.7	-1.0	18.6	2.2
Private Debt Securities (excluding short-term papers)						
Total funds raised (RM billion)	52.1	69.6	121.1	83.9	85.5	85.6
New activities	13.5	8.4	19.5	7.5	13.1	20.0
Initial Public Offerings (Bursa Malaysia)						
Total funds raised (RM billion)	19.8	7.4	22.9	8.2	5.9	4.4
MIER Business Conditions Survey						
Business Conditions Index ¹	99.5	96.6	94.1	92.0	86.4	87.1
Capacity Utilisation Rate ¹	82.9	81.2	80.9	80.0	79.5	78.0
MSC-Status Companies						
No. of companies	218	215	213	236	229	249
Approved investment (RM billion)	1.5	2.5	2.9	3.0	2.9	4.6

¹ Refers to fourth quarter

Source: Department of Statistics, Malaysia; Bursa Malaysia Berhad; Malaysian Investment Development Authority; Malaysian Institute of Economic Research; Multimedia Development Corporation; and Bank Negara Malaysia

Table A.9

Balance of Payments

	2012			2013		
	+	-	Net	+	-	Net
	RM million					
Goods¹	644,864	531,835	113,030	637,683	541,131	96,552
Services	125,337	133,879	-8,542	132,685	142,277	-9,592
Transportation	13,761	35,801	-22,040	14,701	38,610	-23,909
Travel	62,548	37,726	24,821	67,733	38,566	29,167
Other services	48,771	59,680	-10,908	49,951	64,583	-14,632
Government transactions n.i.e.	257	672	-415	300	518	-218
Balance on goods and services	770,202	665,714	104,488	770,368	683,408	86,959
Primary income	42,297	78,138	-35,841	47,656	81,631	-33,975
Compensation of employees	3,994	7,076	-3,082	4,486	8,492	-4,007
Investment income	38,303	71,062	-32,760	43,170	73,138	-29,969
Secondary income	6,661	25,130	-18,469	7,597	25,096	-17,498
Balance on current account	819,160	768,983	50,177	825,620	790,135	35,485
% of GNI			5.4			3.6
Capital account			241			-15
Financial account			-23,014			-20,216
Direct investment			-24,415			-6,276
Assets			-51,957			-41,928
Liabilities			27,542			35,653
Portfolio investment			63,859			-3,012
Assets			-21,464			-32,088
Liabilities			85,323			29,076
Financial derivatives			972			-253
Other investment			-63,431			-10,675
Official sector			-1,674			-3,965
Private sector			-61,756			-6,710
Balance on capital and financial accounts			-22,773			-20,231
Errors and omissions			-23,531			-605
of which:						
Foreign exchange revaluation gain (+) / loss (-)			-7,686			18,611
Overall balance (surplus + / deficit -)			3,873			14,649
Bank Negara Malaysia international reserves, net²						
RM million			427,204			441,853
USD million			139,715			134,902
Reserves as months of retained imports			9.5			9.5

¹ Adjusted for valuation and coverage to the balance of payments basis

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

p Preliminary

f Forecast

n.i.e. Not included elsewhere

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

2014			2015 _p			2016 _f		
+	-	Net	+	-	Net	+	-	Net
RM million								
679,913	566,500	113,414	685,757	576,866	108,891	707,610	608,106	99,504
137,263	148,451	-11,188	135,663	156,141	-20,478	143,910	163,158	-19,249
15,618	41,726	-26,108	15,814	41,535	-25,722	15,957	45,072	-29,115
73,951	40,478	33,472	68,725	40,930	27,796	75,236	43,643	31,592
47,404	65,620	-18,216	50,797	72,769	-21,972	52,363	73,475	-21,111
289	626	-337	326	906	-580	353	968	-615
817,176	714,950	102,226	821,420	733,007	88,413	851,520	771,264	80,255
52,310	89,632	-37,322	48,785	80,977	-32,192	44,981	82,963	-37,981
5,149	10,150	-5,000	6,303	12,237	-5,934	6,176	12,180	-6,004
47,160	79,482	-32,322	42,482	68,740	-26,259	38,805	70,783	-31,978
10,308	27,894	-17,586	11,712	33,906	-22,195	11,610	34,748	-23,138
879,794	832,476	47,317	881,916	847,890	34,026	908,111	888,975	19,136
		4.4			3.0			1~2
		272			-1,151			
		-81,597			-53,277			
		-18,480			232			
		-53,096			-37,406			
		34,616			37,638			
		-38,536			-28,155			
		-28,111			-9,156			
		-10,425			-18,998			
		-975			-491			
		-23,606			-24,863			
		-2,030			-1,880			
		-21,576			-22,984			
		-81,325			-54,428			
		-2,500			24,143			
		7,573			57,299			
		-36,507			3,741			
		405,345			409,096			
		115,930			95,283			
		8.3			8.4			

Table A.10

Gross Exports

	2013	2014	2015 ^p	2014	2015 ^p	2015 ^p
	RM million			Annual change (%)		% share
Manufactures	548,146	587,175	625,475	7.1	6.5	80.2
<i>of which:</i>						
Electrical and electronic products	236,982	256,145	277,923	8.1	8.5	35.6
<i>Semiconductors</i>	111,442	127,366	137,460	14.3	7.9	17.6
<i>Offices machines and automatic data processing equipment</i>	48,999	46,214	51,951	-5.7	12.4	6.7
<i>Electrical machinery, apparatus and appliances, and parts</i>	38,134	41,518	47,864	8.9	15.3	6.1
<i>Telecommunications and sound-recording and reproducing equipment</i>	38,407	41,047	40,648	6.9	-1.0	5.2
Chemicals and chemical products	47,470	51,447	55,142	8.4	7.2	7.1
Petroleum products	68,369	70,356	54,552	2.9	-22.5	7.0
Machinery, equipment and parts	27,068	29,998	36,140	10.8	20.5	4.6
Manufactures of metal	28,164	26,444	34,909	-6.1	32.0	4.5
Optical and scientific equipment	20,837	23,661	26,111	13.6	10.4	3.3
Rubber products	18,943	18,003	20,183	-5.0	12.1	2.6
Processed food	14,241	16,560	18,011	16.3	8.8	2.3
Wood products	14,183	14,716	15,453	3.8	5.0	2.0
Agriculture	68,799	69,175	67,278	0.5	-2.7	8.6
<i>of which:</i>						
Palm oil and palm-based products	47,028	48,266	45,612	2.6	-5.5	5.8
Natural rubber	7,025	4,574	4,029	-34.9	-11.9	0.5
Sawn timber and moulding	3,140	3,372	4,007	7.4	18.8	0.5
Minerals	97,937	104,051	82,667	6.2	-20.6	10.6
<i>of which:</i>						
Liquefied natural gas (LNG)	59,567	63,750	47,070	7.0	-26.2	6.0
Crude petroleum	31,013	32,723	26,075	5.5	-20.3	3.3
Others	5,110	5,015	4,526	-1.9	-9.8	0.6
Total	719,992	765,417	779,947	6.3	1.9	100.0

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

There are some minor changes on the selection of codes for manufactured exports of major and selected products, to streamline the product classification among the compiler and main users of external trade statistics

Data in this table are not directly comparable to the Annual Report 2014 publication due to differences in classification

Source: Department of Statistics, Malaysia

Table A.11

Gross Imports

	2013	2014	2015 ^p	2014	2015 ^p	2015 ^p
	RM million			Annual change (%)		% share
Capital goods	98,202	95,882	95,908	-2.4	0.0	14.0
Capital goods (except transport equipment)	78,352	80,246	85,609	2.4	6.7	12.5
Transport equipment industrial	19,850	15,636	10,299	-21.2	-34.1	1.5
Intermediate goods	379,455	408,181	398,807	7.6	-2.3	58.2
Food and beverages, mainly for industry	16,740	17,978	19,747	7.4	9.8	2.9
Industrial supplies	166,324	172,390	167,192	3.6	-3.0	24.4
Fuel and lubricants	46,326	58,108	39,835	25.4	-31.4	5.8
Parts and accessories of capital goods (except transport equipment)	131,615	138,845	146,989	5.5	5.9	21.4
Parts and accessories of transport equipment	18,450	20,859	25,044	13.1	20.1	3.7
Consumption goods	47,584	50,309	62,456	5.7	24.1	9.1
Food and beverages, mainly for household consumption	20,080	21,490	25,510	7.0	18.7	3.7
Transport equipment non-industrial	1,434	1,084	1,056	-24.4	-2.5	0.2
Consumer goods, n.e.s	26,071	27,735	35,890	6.4	29.4	5.2
Others	123,455	128,566	128,220	4.1	-0.3	18.7
<i>of which:</i>						
Dual use goods	28,610	26,088	21,923	-8.8	-16.0	3.2
Re-exports	92,002	99,540	103,217	8.2	3.7	15.1
Total	648,695	682,937	685,391	5.3	0.4	100.0

^p Preliminary

n.e.s. Not elsewhere specified

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart A.12

Malaysia's Trading Partners



Table A.13

Outstanding External Debt¹ and Debt Servicing

	2011	2012	2013	2014	2015 ^p
	RM million				
Offshore borrowing²	257,273	257,594	324,088	371,067	463,621
Medium- and long-term	153,525	165,139	195,986	211,417	285,900
<i>Federal Government</i>	18,105	16,848	16,763	16,776	21,477
<i>Public Corporations</i>	69,562	71,392	82,141	76,343	106,842
<i>Private sector</i>	65,859	76,899	97,082	118,298	157,581
Short-term	103,748	92,455	128,102	159,651	177,721
<i>Banking sector</i>	92,302	79,981	113,530	139,917	161,301
<i>Non-bank private sector</i>	11,446	12,474	14,573	19,734	16,420
NR holdings of domestic debt securities	163,268	223,606	229,655	223,260	211,346
<i>Government securities</i>	104,270	132,410	141,669	151,377	175,964
<i>Others</i>	58,998	91,196	87,986	71,883	35,382
NR deposits	43,917	58,963	77,325	87,665	81,616
Others³	72,997	61,897	65,524	65,493	77,162
Total external debt:	537,456	602,060	696,592	747,485	833,745
Total external debt (USD million)	167,908	194,646	209,792	211,818	192,245
<i>% GNI</i>	60.4	64.4	70.7	69.9	74.1
<i>Annual change (%)</i>	23.8	12.0	15.7	7.3	11.5
Currency composition (% share)	100.0	100.0	100.0	100.0	100.0
<i>Ringgit</i>	42.6	49.2	45.9	41.0	36.2
<i>US dollar</i>	44.0	39.2	43.2	47.6	51.3
<i>Japanese yen</i>	4.7	3.2	2.6	2.4	2.6
<i>Others</i>	8.6	8.4	8.3	9.0	9.9
Total servicing (including short-term interest payment)	124,124	139,988	141,923	155,847	185,548
of which:					
Medium- and long-term debt	123,114	138,739	140,716	154,366	184,049
Repayment⁴	114,706	128,849	130,603	143,219	172,071
of which:					
Redemption of matured domestic debt securities held by NR	18,369	23,982	23,490	23,698	27,695
Interest payment	8,408	9,890	10,113	11,147	11,978
of which interest payment on:					
NR holdings of domestic debt securities	3,679	5,067	5,694	6,941	6,645
Debt service ratio (% of exports of goods and services)					
Total debt	16.0	18.2	18.4	19.1	22.6
Medium- and long-term debt	15.8	18.0	18.3	18.9	22.4
of which:					
NR holdings of domestic debt securities	2.4	3.1	3.0	2.9	3.4

¹ As redefined effective from the first quarter of 2014. For more information, please refer to the box article titled 'The Redefinition of External Debt' in the Quarterly Bulletin on Economic and Financial Developments in the Malaysian Economy in the First Quarter of 2014

² Offshore borrowing is equivalent to the external debt under the previous definition. It comprises mainly foreign currency loans raised, and bonds and notes issued offshore

³ Comprises trade credits, IMF allocation of SDRs and other debt liabilities

⁴ Includes prepayment

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

NR refers to non-residents

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Table A.14

Consumer Price Index

	Weights (%) (2010=100)	2012	2013	2014	2015
		Annual change (%)			
Total	100.0	1.6	2.1	3.2	2.1
<i>of which:</i>					
Food and non-alcoholic beverages	30.3	2.7	3.6	3.3	3.6
Alcoholic beverages and tobacco	2.2	0.4	6.0	11.6	13.5
Clothing and footwear	3.4	-0.6	-0.6	-0.2	0.5
Housing, water, electricity, gas and other fuels	22.6	1.6	1.7	3.4	2.5
Furnishings, household equipment and routine household maintenance	4.1	2.0	1.5	1.0	2.7
Health	1.3	2.0	1.9	2.9	4.5
Transport	14.9	0.7	2.0	4.9	-4.5
Communication	5.7	-0.6	-0.7	-0.7	1.9
Recreation services and culture	4.6	1.2	0.1	1.5	1.7
Education	1.4	2.4	2.4	2.4	2.4
Restaurants and hotels	3.2	2.9	2.5	4.7	4.1
Miscellaneous goods and services	6.3	2.0	0.3	0.7	4.1

Source: Department of Statistics, Malaysia

Table A.15

Producer Price Index

	Weights (%) (2010=100) ¹	2012	2013	2014	2015
		Annual change (%)			
Total	100.0	0.1	-1.7	1.4	-4.8
<i>of which:</i>					
Food	5.7	0.3	1.5	4.4	1.2
Beverages and tobacco	1.0	0.7	1.3	2.8	0.5
Crude materials, inedible	6.7	-12.7	-12.8	-2.1	-3.8
Mineral fuels, lubricants, etc.	19.9	5.7	-0.6	0.3	-22.1
Animal and vegetable oils and fats	7.3	-10.0	-15.2	7.5	-6.2
Chemicals	8.2	-0.5	0.8	2.2	0.1
Manufactured goods	11.3	-0.5	-0.6	0.5	0.2
Machinery and transport equipment	33.9	1.9	0.9	1.3	2.2
Miscellaneous manufactured articles	5.4	0.8	0.5	0.8	1.8
Miscellaneous transactions and commodities	0.6	3.2	-4.9	-2.5	6.2
Local production	66.7	-0.4	-2.7	1.5	-7.4
Import	33.3	1.2	0.5	1.0	0.7

¹ Effective from 2015, the Producer Price Index has been revised to the new base year 2010=100, from 2005=100 previously

Source: Department of Statistics, Malaysia

Table A.16

Broad Money (M3)

	Annual change					As at end
	2011	2012	2013	2014	2015	2015
	RM million					
Broad money (M3) ¹	155,581	111,211	107,470	101,490	41,456	1,595,264
Currency in circulation ²	5,142	3,971	5,913	5,319	8,613	76,643
Demand deposits	28,854	26,998	32,013	13,333	5,087	282,874
Broad quasi-money	121,585	80,242	69,545	82,838	27,756	1,235,747
<i>Fixed deposits</i>	72,789	60,894	66,957	39,956	25,342	746,186
<i>Savings deposits</i>	10,728	8,070	8,025	3,166	659	135,591
<i>NIDs</i>	-1,239	-1,392	-1,626	4,005	-8,921	9,256
<i>Repos</i>	-1,701	2,150	100	-1,592	-497	0
<i>Foreign currency deposits</i>	13,125	14,090	4,434	15,397	42,714	138,228
<i>Other deposits</i>	27,883	-3,570	-8,345	21,905	-31,541	206,486
Factors Affecting M3						
Net claims on Government	2,803	-3,339	21,164	34,317	-8,762	95,568
<i>Claims on Government</i>	4,838	868	15,794	31,336	-1,471	153,880
<i>Less: Government deposits</i>	2,035	4,207	-5,370	-2,981	7,292	58,312
Claims on private sector	105,116	129,747	118,033	117,955	120,132	1,559,398
<i>Loans</i>	111,787	106,870	107,934	111,388	106,122	1,396,418
<i>Securities</i>	-6,670	22,877	10,099	6,568	14,010	162,981
Net foreign assets	117,621	20,448	13,298	-9,952	23,074	527,520
<i>Bank Negara Malaysia³</i>	94,530	4,095	14,185	-35,003	1,027	401,087
<i>Banking system</i>	23,091	16,353	-888	25,051	22,047	126,433
Other influences	-69,959	-35,645	-45,024	-40,830	-92,987	-587,223

¹ Excludes interplacements among banking institutions

² Excludes holdings by banking system

³ Includes exchange rate revaluation loss/gain

Note: Numbers may not add up due to rounding

Table A.17

Money Supply: Annual Change and Growth Rates

	2011		2012		2013		2014		2015	
	RM million	%	RM million	%	RM million	%	RM million	%	RM million	%
Currency in circulation	5,803	12.2	3,907	7.3	5,449	9.5	5,189	8.2	8,699	12.8
Demand deposits with commercial banks and Islamic banks	28,769	16.3	26,872	13.1	32,318	13.9	13,630	5.2	5,343	1.9
M1 ¹	34,572	15.4	30,779	11.9	37,768	13.0	18,820	5.7	14,042	4.1
Other deposits with commercial banks and Islamic banks ²	120,878	14.5	87,005	9.1	73,696	7.1	89,386	8.1	30,504	2.5
Deposits with other banking institutions ³	131	0.5	-6,574	-25.2	-3,993	-20.5	-6,715	-42.3	-3,091	-33.8
M3 ⁴	155,581	14.3	111,211	9.0	107,470	7.9	101,490	7.0	41,456	2.7

¹ Comprising currency in circulation and demand deposits of the private sector

² Comprising savings and fixed deposits, negotiable instruments of deposits (NIDs), repos and foreign currency deposits of the private sector placed with commercial banks and Islamic banks

³ Comprising call deposits, fixed deposits, negotiable instruments of deposits (NIDs), repos and foreign currency deposits of the private sector placed with merchant banks/investment banks. Excludes interplacments among the banking institutions

⁴ Comprising M1 plus other deposits of the private sector placed with commercial banks and Islamic banks and deposits of the private sector placed with other banking institutions, namely the merchant banks/investment banks

Note: Numbers may not add up due to rounding

Table A.18

Interest Rates (%)

	As at end-year										As at end-month in 2015											
	2009	2010	2011	2012	2013	2014	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.				
Overnight interbank	1.99	2.72	2.99	3.00	2.99	3.13	3.24	3.24	3.24	3.19	3.24	3.24	3.25	3.25	3.12	3.18	3.15	3.05				
1-week interbank	2.02	2.77	3.01	3.01	3.02	3.30	3.27	3.24	3.25	3.26	3.25	3.24	3.24	3.25	3.24	3.26	3.22	3.13				
1-month interbank	2.07	2.83	3.05	3.06	3.20	3.38	3.41	3.29	3.28	3.28	3.28	3.48	3.45	3.35	3.60	3.64	3.45	3.45				
Commercial banks																						
Fixed deposit																						
3-month	2.03	2.74	2.99	2.97	2.97	3.13	3.13	3.13	3.13	3.14	3.13	3.14	3.14	3.14	3.14	3.13	3.13	3.13				
12-month	2.50	2.97	3.22	3.15	3.15	3.31	3.31	3.31	3.31	3.31	3.31	3.31	3.31	3.31	3.31	3.31	3.31	3.31				
Savings deposit	0.86	1.00	1.15	1.03	0.99	1.07	1.06	1.06	1.07	1.07	1.06	1.06	1.06	1.05	1.06	1.05	1.04	1.04				
Base lending rate (BLR)	5.51	6.27	6.53	6.53	6.53	6.79	6.79	6.79	6.79	6.79	6.79	6.79	6.79	6.79	6.79	6.79	6.79	6.79				
Base rate							3.90	3.90	3.88	3.88	3.88	3.88	3.85	3.85	3.85	3.85	3.85	3.86				
Treasury bills (91 days) ¹	1.98	2.82	2.99	3.04	3.00	3.42	3.35	3.28	3.19	3.12	3.12	3.06	3.19	3.11	3.14	2.96	2.77	2.74				
Government Securities ¹																						
1-year	2.12	2.85	2.82	3.01	3.03	3.48	3.35	3.27	3.21	3.13	3.19	3.04	3.08	3.08	3.20	2.81	2.60	2.59				
5-year	3.79	3.39	3.23	3.24	3.66	3.84	3.66	3.63	3.59	3.59	3.59	3.67	3.62	3.98	3.86	3.71	3.70	3.47				
Private debt securities ¹																						
AAA																						
3-year	3.72	3.63	3.65	3.53	3.71	4.00	4.04	4.00	4.01	3.99	4.00	3.99	4.00	4.07	4.12	4.12	4.14	4.13				
5-year	4.32	4.07	3.99	3.80	3.96	4.27	4.28	4.25	4.22	4.20	4.22	4.19	4.21	4.32	4.38	4.38	4.36	4.37				
AA																						
3-year	4.50	4.34	4.29	4.04	4.16	4.33	4.38	4.37	4.41	4.39	4.41	4.35	4.38	4.41	4.44	4.45	4.44	4.49				
5-year	5.07	4.75	4.65	4.30	4.41	4.60	4.63	4.64	4.64	4.62	4.64	4.58	4.60	4.69	4.73	4.73	4.73	4.73				
A																						
3-year	6.80	6.90	6.57	6.34	6.32	6.25	6.29	6.39	6.40	6.28	6.28	6.22	6.22	6.44	6.10	6.25	6.31	6.34				
5-year	7.57	7.53	7.11	6.98	7.02	6.87	6.93	7.04	6.99	6.88	6.88	6.87	6.82	7.19	7.03	7.03	7.01	6.97				
BBB																						
3-year	10.18	10.40	10.21	10.06	10.02	10.16	10.37	10.46	10.50	10.28	10.28	9.89	10.00	10.46	10.04	10.01	10.01	9.90				
5-year	11.32	11.43	11.24	11.14	11.17	11.17	11.37	11.50	11.53	11.27	11.27	10.80	10.90	11.40	11.22	11.23	11.26	11.13				
BB & below																						
3-year	12.58	12.78	12.62	12.53	12.52	13.03	13.63	13.68	13.73	13.42	13.42	12.66	12.94	13.46	12.96	13.05	12.89	12.55				
5-year	14.02	14.51	14.13	13.76	13.70	14.60	14.89	14.99	15.04	14.62	14.42	13.78	13.98	14.78	14.34	14.42	14.35	13.89				

¹ Source: FASTI, Bank Negara Malaysia

Table A.19

Movements of the Ringgit

	RM to one unit of foreign currency ¹			Annual change (%)		Change (%)
	2005	2014	2015	2014	2015	21 Jul. '05 - Dec. '15
	21 Jul. ²	End-Dec.				
SDR	5.5049	5.0853	5.9912	-0.7	-15.1	-8.1
US dollar	3.8000	3.4950	4.2920	-6.1	-18.6	-11.5
Singapore dollar	2.2570	2.6449	3.0356	-1.9	-12.9	-25.6
100 Japanese yen	3.3745	2.9255	3.5645	6.9	-17.9	-5.3
Pound sterling	6.6270	5.4396	6.3607	-0.6	-14.5	4.2
Australian dollar	2.8823	2.8664	3.1338	2.2	-8.5	-8.0
Euro	4.6212	4.2513	4.6918	6.5	-9.4	-1.5
100 Thai baht	9.0681	10.627	11.922	-6.1	-10.9	-23.9
100 Indonesian rupiah	0.0386	0.0281	0.0311	-4.2	-9.5	24.4
100 Korean won	0.3665	0.3201	0.3651	-2.9	-12.3	0.4
100 Philippine peso	6.8131	7.8066	9.1494	-5.3	-14.7	-25.5
100 New Taiwan dollar	11.890	11.068	13.056	-0.5	-15.2	-8.9
Chinese renminbi	0.4591	0.5637	0.6610	-3.8	-14.7	-30.5

¹ US dollar rates are the average of buying and selling rates at noon in the Kuala Lumpur Interbank Foreign Exchange Market

Rates for foreign currencies other than US dollar are cross rates derived from rates of these currencies against the US dollar and the RM/US dollar rate

² Ringgit shifted from a fixed exchange rate against the US dollar to a managed float against a basket of currencies

Table A.20

Housing Credit Institutions

	Year of establishment	Objective	Lending rate for new housing loans (%)		No. of branches	
			2014	2015	2014	2015
Commercial banks	-		4.38 ^{1,2}	4.54 ^{1,2}	4,243 ³	4,254 ³
Lembaga Pembiayaan Perumahan Sektor Awam (previously Treasury Housing Loans Division)	1970	To provide housing loans to Government employees	4.00 ¹	4.00 ¹	1	1
Bank Kerjasama Rakyat Malaysia Berhad	1954	A co-operative society which collects deposits and provides banking facilities according to Syariah principles	6.90 ¹	7.00 ¹	147	148
Malaysia Building Society Berhad	1950	To be a consumer driven financial institution offering property lending and deposit taking activities leading to wealth creation for its valued customers	7.43 ~ 7.54	7.40 ~ 7.61	46	45
Borneo Housing Mortgage Finance Berhad	1958	To provide housing loans mainly to Sabah and Sarawak State Government employees	6.75 ~ 7.50	6.75 ~ 7.50	2	2
Bank Simpanan Nasional	1974	To promote and mobilise savings particularly from small savers and to inculcate the habit of thrift and savings	4.93 ¹	4.96 ¹	402	400
Sabah Credit Corporation	1955	To uplift the social economic development of Malaysians in Sabah through the provision of easy access to financial credit	3.00 ~ 7.50	3.00 ~ 7.50	12	13

¹ 12-month average lending rate

² Excludes Islamic banks

³ Includes Islamic banks

Source: Bank Negara Malaysia and various housing credit institutions

Table A.21

Housing Loans Outstanding

	2014	2015 ^p	2014	2015 ^p	2014	2015 ^p
	RM million		Annual change (%)		% share	
Commercial banks ¹	367,950	411,280	13.1	11.8	86.2	86.0
Lembaga Pembiayaan Perumahan Sektor Awam (previously Treasury Housing Loans Division)	43,898	50,225	20.9	14.4	10.3	10.5
Bank Kerjasama Rakyat Malaysia Berhad	2,361	2,599	-8.1	10.1	0.6	0.5
Malaysia Building Society Berhad	5,303	5,467	-1.4	3.1	1.2	1.1
Borneo Housing Mortgage Finance Berhad	714	755	8.3	5.7	0.2	0.2
Bank Simpanan Nasional	6,430	7,794	28.5	21.2	1.5	1.6
Sabah Credit Corporation	69	58	-14.7	-16.3
Total	426,725	478,177	13.7	12.1	100.0	100.0

¹ Includes Islamic banks

^p Preliminary

... Negligible

Note: Numbers may not necessarily add up due to rounding

Source: Bank Negara Malaysia and various housing credit institutions

Table A.22

Housing Loans Approved

	2014	2015 ^p	2014	2015 ^p	2014	2015 ^p
	RM million		Annual change (%)		% share	
Commercial banks ¹	115,628	99,764	3.8	-13.7	89.4	86.2
Lembaga Pembiayaan Perumahan Sektor Awam (previously Treasury Housing Loans Division)	9,314	9,452	3.0	1.5	7.2	8.2
Bank Kerjasama Rakyat Malaysia Berhad	659	1,113	16.4	68.9	0.5	1.0
Malaysia Building Society Berhad	936	1,113	82.8	18.9	0.7	1.0
Borneo Housing Mortgage Finance Berhad	130	95	-23.8	-26.9	0.1	0.1
Bank Simpanan Nasional	2,703	2,583	6.7	-4.4	2.1	2.2
Sabah Credit Corporation	0	1,610	1.4
Total	129,370	115,730	4.1	-10.5	100.0	100.0

¹ Includes Islamic banks

^p Preliminary

... Negligible

Note: Numbers may not necessarily add up due to rounding

Source: Bank Negara Malaysia and various housing credit institutions

Table A.23

Financing of the Economy

By customer By financing type/institution	Businesses ¹		Households	Government	Total Financing
	Total	of which: SMEs			
RM million					
Net Change in Financing (2014)					
Financial Intermediaries					
Banking Institutions	48,493	27,798	68,912	-3,343	114,062
Development Financial Institutions (DFIs) ²	3,000	326	5,352	-	8,352
Other Domestic Intermediaries ³	-4,457	102	7,974	-	3,517
Capital Market					
Bond Market ⁴	30,598	-	-	37,557	68,155
Equity Market	19,163	-	-	-	19,163
External Financing					
Foreign Direct Investment	35,344	-	-	-	35,344
Offshore Borrowing ⁵	20,579	-	-	13	20,593
Total	152,720	28,226	82,238	34,227	269,185
Net Change in Financing (2015p)					
Financial Intermediaries					
Banking Institutions	47,737	33,782	58,996	-1,311	105,421
Development Financial Institutions (DFIs) ²	2,033	1,172	5,088	-	7,121
Other Domestic Intermediaries ³	-7,715	-182	6,873	-	-842
Capital Market					
Bond Market ⁴	47,371	-	-	38,931	86,301
Equity Market	17,919	-	-	-	17,919
External Financing					
Foreign Direct Investment	39,520	-	-	-	39,520
Offshore Borrowing ⁵	66,468	-	-	4,701	71,169
Total	213,333	34,773	70,956	42,320	326,609

¹ Businesses include domestic banking institutions, non-bank financial institutions, other non-business entities and foreign entities

² Refers to DFIs governed under the Development Financial Institutions Act, 2002

³ Other domestic intermediaries include insurance companies, Employees Provident Fund (EPF), housing credit institutions, leasing and factoring companies, and Lembaga Pembiayaan Perumahan Sektor Awam (previously Treasury Housing Loans Division)

⁴ Refers to the change in outstanding private debt securities (PDS) and Government securities (Malaysian Government Securities and Government Investment Issues), held by both residents and non-residents. Data excludes Cagamas bonds, short-term papers and issuances by non-residents

⁵ Refers to all offshore borrowings under the redefined external debt effective first quarter 2014, except short-term offshore borrowings by the banking sector

p Preliminary

Note: Numbers may not add up due to rounding

Table A.24

Consolidated Public Sector Finance

	2012	2013	2014	2015 ^p	2016 ^f
	RM billion				
Revenue ¹	188.8	192.4	204.9	216.0	225.8
% growth	17.5	1.9	6.5	5.4	4.5
Operating expenditure	227.2	237.0	243.4	245.0	243.5
% growth	15.9	4.3	2.7	0.7	-0.6
Current balance of NFPCs ²	129.8	137.4	126.1	90.7	96.2
Total public sector current balance	91.3	92.8	87.6	61.6	78.4
% of GDP	9.4	9.1	7.9	5.3	6.4
Development expenditure ³	138.4	139.4	154.6	161.5	173.4
% growth	36.7	0.7	10.9	4.5	7.4
General Government ⁴	53.0	49.5	48.9	51.0	55.0
NFPCs	85.4	89.9	105.7	110.5	118.3
Overall balance	-47.1	-46.6	-66.9	-99.8	-95.0
% of GDP	-4.8	-4.6	-6.0	-8.6	-7.7

¹ Excludes transfers within General Government

² Refers to 29 NFPCs from 2014 onwards

³ Adjusted for transfers and net lending within public sector

⁴ Comprises Federal Government, state and local governments, and statutory bodies

^p Preliminary

^f Forecast

Note: Numbers may not add up due to rounding

Source: Ministry of Finance, Malaysia and Non-Financial Public Corporations (NFPCs)

Table A.25

Major Advanced Economies: Key Economic Indicators

	2011	2012	2013	2014	2015e	2016f
	Annual change (%)					
REAL GDP						
United States	1.6	2.2	1.5	2.4	2.4	2.6
Japan	-0.5	1.7	1.4	0.0	0.5	1.0
Euro area	1.6	-0.8	-0.3	0.9	1.6	1.7
<i>Germany</i>	3.7	0.6	0.4	1.6	1.7	1.7
United Kingdom	2.0	1.2	2.2	2.9	2.2	2.2
INFLATION						
United States	3.2	2.1	1.5	1.6	0.1	1.1
Japan	-0.3	0.0	0.3	2.8	0.8	0.4
Euro area	2.7	2.5	1.3	0.4	0.0	1.0
<i>Germany</i>	2.1	2.1	1.5	0.9	0.2	1.2
United Kingdom	4.5	2.8	2.6	1.5	0.0	1.5
	% of labour force					
UNEMPLOYMENT						
United States	8.9	8.1	7.4	6.2	5.3	4.9
Japan	4.6	4.3	4.0	3.6	3.4	3.5
Euro area	10.2	11.4	12.0	11.6	10.9	10.5
<i>Germany</i>	5.9	5.4	5.2	5.0	4.6	4.7
United Kingdom	8.1	8.0	7.6	6.2	5.4	5.5
	% of GDP					
CURRENT ACCOUNT BALANCE						
United States	-3.0	-2.8	-2.3	-2.2	-2.6	-3.0
Japan	2.2	1.0	0.8	0.5	3.3	3.0
Euro area	0.1	1.2	1.8	2.0	3.0	3.0
<i>Germany</i>	6.1	6.8	6.4	7.4	8.2	8.0
United Kingdom	-1.7	-3.3	-4.5	-5.1	-4.7	-4.3
FISCAL BALANCE¹						
United States	-9.6	-7.9	-4.7	-4.1	-3.8	-3.6
Japan	-9.8	-8.8	-8.5	-7.3	-5.9	-4.5
Euro area	-4.1	-3.6	-2.9	-2.4	-2.0	-1.7
<i>Germany</i>	-0.9	0.1	0.1	0.3	0.5	0.3
United Kingdom	-7.6	-7.8	-5.7	-5.7	-4.2	-2.8

¹ Refers to general government fiscal balance

e Estimate

f Forecast

Source: International Monetary Fund and National Authorities

Table A.26

Emerging Asia: Key Economic Indicators

	2011	2012	2013	2014	2015e	2016f
REAL GDP	Annual change (%)					
Regional Countries						
The People's Republic of China	9.5	7.7	7.7	7.3	6.9	6.3
Korea	3.7	2.3	2.9	3.3	2.6	3.2
Chinese Taipei	3.8	2.1	2.2	3.9	0.7	2.6
Singapore	6.2	3.7	4.7	3.3	2.0	2.9
Hong Kong SAR	4.8	1.7	3.1	2.6	2.4	2.7
Malaysia	5.3	5.5	4.7	6.0	5.0	4.0~4.5
Thailand	0.8	7.2	2.7	0.8	2.8	3.2
Indonesia	6.2	6.0	5.6	5.0	4.8	5.1
Philippines	3.7	6.7	7.1	6.1	5.8	6.3
INFLATION	Annual change (%)					
Regional Countries						
The People's Republic of China	5.4	2.6	2.6	2.0	1.4	1.8
Korea	4.0	2.2	1.3	1.3	0.7	1.8
Chinese Taipei	1.4	1.9	0.8	1.2	-0.3	1.0
Singapore	5.2	4.6	2.4	1.0	-0.5	1.8
Hong Kong SAR	5.3	4.1	4.3	4.4	3.0	3.0
Malaysia	3.2	1.7	2.1	3.2	2.1	2.5~3.5
Thailand	3.8	3.0	2.2	1.9	-0.9	1.5
Indonesia	5.3	4.0	6.4	6.4	6.4	5.4
Philippines	4.8	3.2	2.9	4.2	1.4	3.4
CURRENT ACCOUNT BALANCE	% of GDP					
Regional Countries						
The People's Republic of China	1.8	2.5	1.6	2.1	3.1	2.8
Korea	1.6	4.2	6.2	6.3	7.1	6.7
Chinese Taipei	8.2	9.9	10.8	12.4	14.5	11.8
Singapore	22.0	17.2	17.9	19.1	19.7	18.0
Hong Kong SAR	5.6	1.6	1.5	1.9	2.2	2.5
Malaysia	10.9	5.2	3.5	4.3	3.0	1.0~2.0
Thailand	2.4	-0.4	-1.1	3.8	8.8	5.4
Indonesia	0.2	-2.7	-3.2	-3.1	-2.1	-2.1
Philippines	2.5	2.8	4.2	3.8	5.0	4.5
FISCAL BALANCE¹	% of GDP					
Regional Countries						
The People's Republic of China ²	-0.5	0.0	-1.1	-1.2	-1.9	-2.3
Korea ²	1.7	1.6	0.7	0.8	-0.5	0.4
Chinese Taipei ²	-4.0	-4.3	-3.2	-2.7	-2.7	-2.4
Singapore ²	8.5	7.8	5.5	3.3	1.1	2.1
Hong Kong SAR ²	4.1	3.3	1.1	3.8	3.5	2.7
Malaysia	-4.7	-4.3	-3.8	-3.4	-3.2	-3.1
Thailand	-1.4	-4.0	-2.2	-2.0	-1.9	-1.4
Indonesia	-1.1	-1.8	-2.2	-2.1	-2.3	-2.3
Philippines	-2.0	-2.3	-1.4	-0.6	-0.1	-0.6

¹ Refers to central government fiscal balance

² Refers to general government fiscal balance

e Estimate

f Forecast

Source: International Monetary Fund (IMF), National Authorities and Bank Negara Malaysia estimates

