



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 together with a copy of its Financial Statements for the year ended 31 December 2014, 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 2014 is incorporated in Bank Negara Malaysia's Financial Stability and Payment Systems Report 2014 which forms an integral part of this Annual Report 2014.

A handwritten signature in black ink, reading "Zeti Akhtar Aziz".

Zeti Akhtar Aziz
Chairman
Board of Directors

11 March 2015

BOARD OF DIRECTORS

Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz

D.K. (Johor), P.S.M., S.S.A.P., S.U.M.W., D.P.M.J.
Governor and Chairman

Dato' Muhammad bin Ibrahim

P.J.N., D.P.M.S.
Deputy Governor

Datuk Nor Shamsiah binti Mohd Yunus

P.M.W.
Deputy Governor

Dr. Sukudhew Singh

Deputy Governor

Tan Sri Dr. Mohd Irwan Serigar bin Abdullah

P.S.M., S.S.A.P., D.C.S.M., D.P.S.K., D.I.M.P., S.A.P.

Dato' N. Sadasivan a/l N.N. Pillay

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

Tan Sri Dato' Sri Dr. Sulaiman bin Mahbob

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

Datuk Chin Kwai Yoong

P.M.W.

Tan Sri Datuk Dr. Yusof bin Basiran*

P.S.M., P.J.N., J.M.N.

Tan Sri Dato' Seri Siti Norma binti Yaakob*

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

Dato Sri Lim Haw Kuang*

P.N.B.S.

Dato' Lee Yeow Chor*

D.S.A.P

* Appointed to the Board in March 2015.

Dato' N.Sadasivan a/l N.N. Pillay was reappointed as a member of the Board in March 2014.

The Board of Directors wishes to extend its appreciation and gratitude to the two long-serving members, 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	Dato' 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	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	Marzunisham bin Omar
Assistant Governor	Abdul Rasheed Ghaffour
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	Wan Mohd Nazri bin Wan Osman
Financial Surveillance	Madelena binti Mohamed
Prudential Financial Policy	Mohd Zabidi bin Md Nor
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	Mohd. Adhari bin Belal Din
Strategic Human Capital	Mohd. Adhari bin Belal Din
Finance	Eugene Hon Kah Weng
Legal	—
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</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	Lucien de Guise
Human Resource and General Services	Hairi bin Adam**
<i>Chief Representative</i>	
Beijing Representative Office	Albert See Choon Kwang**
London Representative Office	Azizul bin Amiludin**
New York Representative Office	Harris bin Hassan***
<i>Regional Office</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	Yusoff bin Yahaya***
Kuala Terengganu	Omar bin Moin***

* Administrative Head

** Deputy Director

*** Manager

Contents



GOVERNOR'S STATEMENT

EXECUTIVE SUMMARY

ECONOMIC DEVELOPMENTS IN 2014

- 11 The International Economic Environment
- 16 The Malaysian Economy
- 23 *Box Article: Trends in Malaysia's Gross Domestic Product by Income*
- 29 External Sector
- 37 Inflation Developments

MONETARY AND FINANCIAL CONDITIONS IN 2014

- 43 International Monetary and Financial Conditions
- 44 Domestic Monetary and Financial Conditions
- 50 Financing of the Economy

MONETARY POLICY IN 2014

- 55 Monetary Policy
- 57 Monetary Operations
- 61 *Box Article: Financial Imbalances and Policy Responses in Malaysia*

OUTLOOK AND POLICY IN 2015

- 69 The International Economic Outlook
- 72 The Malaysian Economy
- 85 Inflation Outlook
- 86 *Box Article: Price Reforms: Motivation, Impact and Mitigating Measures*
- 92 Monetary Policy
- 93 Fiscal Policy
- 95 *Box Article: The New Reference Rate Framework*



GOVERNANCE, ORGANISATIONAL DEVELOPMENT AND COMMUNICATIONS

- 103** Governance
- 106** Organisational Development
- 107** *Box Article: Bank Negara Malaysia's Business Plan 2012-2014*
- 110** Communications
- 113** Organisation Structure



ANNUAL FINANCIAL STATEMENTS

- 121** Statement of Financial Position as at 31 December 2014
- 122** Income Statement for the Year Ended 31 December 2014
- 123** Notes to the Financial Statement



ANNEX



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

GOVERNOR'S STATEMENT

The economic restructuring and financial sector reforms undertaken during this recent decade have well positioned Malaysia to manage the external challenges experienced during the year. These efforts have improved Malaysia's macroeconomic foundations and have resulted in a well-diversified economic structure. While the export sector remains an integral component of the economy, domestic demand has now become the key driver of growth, anchored by strong private sector activity. Underpinning the robust domestic demand is the revival of investment activity, particularly by the private sector. Private investment has grown at an annual rate of 15% on average since 2010 and it is now more broad-based both across industries and geographically. The re-orientation of the economic structure has also reduced the reliance of the domestic economy on any particular economic sector. Of significance, is that the economic restructuring has been supported by a more well-developed, resilient and inclusive financial system that has been able to effectively meet the changing requirements of the economy.

The more moderate recovery of the global economy projected for 2015 is generating a challenging environment across both the advanced and emerging economies. Although the growth momentum is strengthening in some economies, weaknesses in several major economies suggest that the global economy remains vulnerable to downside risks. In addition, the significant decline in global oil prices is also having a differentiated impact on the world economy. This uneven growth momentum prevailing in the global economy has raised the prospect of a divergence in the direction of monetary policy in the advanced economies, resulting in shifts in global liquidity and increased volatility in the international financial markets. For small and highly open economies, such volatile capital flows have resulted in challenges in pursuing an independent monetary policy.

Given the degree of openness of the Malaysian economy and financial system, we are not insulated from these global developments. The diversified structure of the Malaysian economy and our strengthened fundamentals have however enhanced the resilience of the economy and have placed us on a steady growth path. Economic growth in 2015 will continue to be primarily driven by private sector-led domestic demand with some support from the expansion in exports. While the mining and commodity sectors have an important role in the economy, growth is expected to be sustained by the broad-based expansion in the services, manufacturing and construction sectors that now account for more than two thirds of the economy. Investment is also increasingly being driven by capital spending by the non-energy-related private sector and public enterprises. The lower inflation outlook and the positive labour market conditions will also continue to support household spending during the year.

In this environment, economic management has focused on the areas of vulnerabilities and building the resilience of the economy. This aims to ensure that Malaysia will continue to have the flexibility to respond and manage the challenges when shocks occur. As part of the strategy, targeted measures have been implemented to rein in excesses in the property market and to reduce the level of household indebtedness. These series of measures, implemented since 2010, have now begun to yield results. Additionally, the fiscal reforms, including the subsidy rationalisation, the introduction of the Goods and Services Tax, and the commitment to consolidation have also improved the fiscal position while ensuring that economic growth is not undermined. In the external sector, while the current account of the balance of payments is affected by the lower commodity prices, it has been to a significantly lesser extent. This is largely due to the more diversified export structure and markets including the exports of services. Consequently, despite the considerable decline in commodity prices, the current account balance is expected to remain in surplus.

Over the longer term, the resilience of the Malaysian economy continues to be strengthened following the on-going structural reforms and institutional improvements. These efforts have contributed towards the creation of a more competitive economic environment that is also driven by the diversification into higher value-added activities. A key pillar of the resilience of the economy is the financial system that is supported by a resilient banking system and the more developed financial markets. Ample domestic liquidity conditions in this environment have facilitated the financing of domestic economic activity. As a result, there has not been excessive reliance on external funding. With financial stability preserved, there have not been any disruptions to the intermediation process. The financial inclusion agenda has also advanced during the year, providing all segments of society, particularly small businesses and low income households, access to financial services and thus, enhancing their participation in the economy.

Taking into consideration the downside risks to growth and the more subdued price pressures, the thrust of monetary policy has been to remain accommodative and supportive of economic activity while giving continued attention to risks of destabilising financial imbalances. In managing these challenges, the Bank has relied on a broader policy toolkit that includes targeted micro- and macro-prudential measures which are also complemented by pro-growth measures. Other such growth supporting measures by other parts of the public sector have included assistance to vulnerable segments of the economy, in particular, to the small and medium enterprises and to the low income households. Additionally, the more developed financial markets have better intermediated the large and volatile capital flows. In particular, orderly conditions in the foreign exchange market are important to facilitate international trade and foreign investment flows.

During the year, significant strides were made in the area of regional financial integration and cooperation. Most notably were the efforts to enhance the effectiveness of financial intermediation in the region with the finalisation of the ASEAN Banking Integration Framework (ABIF). The year ahead will be important for ASEAN as it moves closer to becoming an economic community as the economies and financial systems in the region become more integrated. In this regard, as the Chair of ASEAN in 2015, Malaysia will focus on the effective operationalisation of ABIF, advancing retail payment systems integration across ASEAN and elevating financial inclusion as a policy priority for the region. Central bank cooperation in the region has also continued to have a prominent role in managing the challenges presented by the global economy. Collaborative regional forums including the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), the ASEAN Central Bank Meetings, and the platform provided by the South East Asia Central Banks Research and Training Centre (SEACEN) have allowed for increased information sharing, resource pooling, collective capacity building, and the potential for policy coordination and joint actions. In addition, a regional financial architecture for financial stability and regional financial safety nets are well in place, including the arrangements such as the ASEAN Swap Arrangement, the Chiang Mai Initiative Multilateralisation and the EMEAP Monetary and Financial Stability Committee.

During the year, the Bank made further progress in expanding opportunities for higher value activities within the financial system, notably in developing the enabling environment in the Islamic Finance Marketplace and in the strengthening of the eco-system for multi-currency trading, including the appointment of a renminbi clearing bank. The Bank was also successful in our bid to host the headquarters of the Alliance for Financial Inclusion (AFI) and the World Bank's regional office in Sasana Kijang, enhancing Malaysia's role in supporting the regional and global development agenda.

In 2014, the Bank continued to invest in our organisational capacity. This has aimed to ensure robust strategic, risk, talent and financial management to enhance our organisational performance. These have included better risk surveillance, programmes for the acquisition of technical competencies, in addition to leadership development to manage our succession pipeline. In a challenging external environment, having the organisation-wide clarity of purpose and focus has been important for the effective functioning and performance of the Bank. This year, the Bank will embark on its third three-year business plan.

The dedication and perseverance of the Bank's staff are central to the continued effectiveness of the Bank in delivering its mandates. On behalf of the Board and the management, I wish to express our appreciation to the staff for their steadfast commitment to fulfilling our responsibilities and safeguarding the economic and financial well-being of our nation. I am also grateful to the Board of Directors for their continued support and guidance. I would also like to record our greatest appreciation and gratitude to Datuk Oh Siew Nam and Tan Sri Datuk Amar Haji Bujang bin Mohd. Nor, our two long-serving members of the Board of Directors, who completed their term of service in February 2015, for their unwavering support and contributions to the Bank during these two decades of immense challenge. The Bank will continue to strive towards achieving the highest standards of professional excellence to fulfill the mandates that have been entrusted upon us, and to excel as an organisation in the service of our nation.

A handwritten signature in black ink, appearing to read 'Zeti Akhtar Aziz', with a stylized, flowing script.

Zeti Akhtar Aziz
Governor
11 March 2015

2014

EXECUTIVE SUMMARY



The global economy expanded at a moderate pace in 2014, with uneven growth across and within regions. In the advanced economies, while growth in the US continued to show broader signs of improvement, economic activity in the euro area and Japan remained subdued. In Asia, most economies benefitted from higher external demand. Nevertheless, economic growth was divergent across the region as domestic demand moderated in a number of economies amid country-specific developments. As the year progressed, downside risks to global growth re-emerged following geopolitical developments in Eastern Europe and the Middle East, weaker-than-expected economic activity in a number of major economies, and rising concerns over the growth prospects of commodity-producing emerging economies amid the significant decline in the prices of oil and other commodities in the second half of the year. Inflationary pressures remained benign in most economies, reflecting modest wage growth in the advanced economies and the significant decline in global commodity prices. Global financial markets were characterised by two distinct trends in 2014, with relative low volatility in the first eight months of the year, followed by higher volatility in the subsequent period. The heightened volatility in the later part of the year was driven by uncertainty surrounding monetary policy normalisation in the US, a resurgence of concerns over global growth prospects, and increased uncertainty over the implications of the sharp decline in commodity prices on commodity-producing countries.

The Malaysian economy grew at a stronger pace in 2014 with growth being driven by the continued strength in private domestic demand and positive growth in net exports. The Annual Report provides an analysis of the developments in the Malaysian economy and the policies pursued by the Bank during the year. It also provides an assessment of the prospects for the Malaysian economy given current developments and the challenges ahead. Additionally the report highlights the Bank's efforts to enhance its governance, organisational development and communications.

The Malaysian Economy in 2014

The Malaysian economy recorded a stronger growth of 6.0% in 2014 (2013: 4.7%), driven primarily by the continued strength of domestic demand and supported by an improvement in external trade performance. Net exports turned around to contribute positively to growth after seven years of negative contribution, as Malaysia benefitted from the recovery in the advanced economies and the sustained demand from the regional economies. While the growth in private domestic demand remained strong, public sector expenditure registered slower growth, consistent with the Government's fiscal consolidation efforts.

Private consumption grew by 7.1% in 2014, supported by favourable income growth and stable labour market conditions. Private consumption growth was also supported by the targeted Government transfers to low- and middle-income households. These partially mitigated some of the dampening effects on household spending growth from the higher cost of living following adjustments to administered prices. Public consumption recorded a slower growth rate of 4.4% given the more moderate increase in Government expenditure on supplies and services, which was in line with expenditure rationalisation initiatives announced towards the end of 2013.

Although the growth of overall gross fixed capital formation (GFCF) moderated to 4.7%, private investment grew by 11.0% during the year. Consequently, the share of private investment in GFCF increased to 64% (2013: 60%). Growth in private investment occurred in both export-oriented and domestic-oriented industries and was mainly driven by the services and manufacturing sectors. Public investment contracted by 4.9% following the decline in Federal Government development expenditure and lower capital spending by public enterprises. The latter mainly reflected the completion and near-completion of several major projects.

On the supply side, all economic sectors recorded higher growth rates in 2014, driven by domestic and external factors. In particular, the recovery in the advanced economies and the continued demand from regional economies resulted in the

manufacturing sector recording a strong growth of 6.2%. The services sector remained the largest contributor to growth, expanding by 6.3% (2013: 5.9%).

Labour market conditions remained stable as continued expansion across all economic sectors sustained the demand for labour. The labour force participation rate and the total employment increased, while the unemployment rate declined to 2.9%.

Headline inflation averaged at 3.2% in 2014 (2013: 2.1%). After rising in the earlier part of the year, inflation moderated during the last four months due to lower food inflation, the lapse of the impact of the September 2013 fuel price adjustments, and the downward adjustments in fuel prices following the implementation of the managed float fuel pricing mechanism. Inflation during the year was driven mainly by domestic cost factors arising from the adjustments in the prices of several price-administered items since late 2013. The extent of spillovers on the prices of other goods and services was, however, contained given the subdued global prices, stable domestic demand conditions, and the firms' ability to accommodate some of the increase in input costs. As a result, core inflation averaged 2.4% (2013: 1.8%). The contained spillovers and the absence of excessive wage pressures also mitigated the risk of second-round effects.

Malaysia's external sector remained resilient amid continued uncertainty in the global environment. The current account surplus widened compared to the previous year while the level of international reserves remained high and was more than sufficient to meet short-term obligations and to provide ample buffer against external shocks. In the first half of the year, the current account recorded a higher surplus of RM35.8 billion, driven by a stronger trade surplus amid smaller services and income deficits. The growth in gross exports was broad-based amid improvement in demand across markets and products. In the second half of the year, the current account surplus narrowed to RM13.7 billion amid a lower trade surplus and larger deficits in the services and income accounts. Although lower crude oil prices led to lower export proceeds, the net impact on overall trade was somewhat mitigated by the accompanying decline in imports of petroleum products. Furthermore, prices of other major commodities, in particular liquefied natural gas (LNG) and crude palm oil (CPO) remained high, providing support to overall commodity exports.

Overall imports growth moderated following the lower growth in imports of consumption goods and the decline in imports of capital goods in line with the moderation in the growth of capital spending in the second half of the year. For the year as a whole, the current account registered a surplus of RM49.5 billion or 4.8% of gross national income (GNI) (2013: RM39.9 billion or 4.2% of GNI).

The financial account continued to experience two-way financial flows, involving cross-border financial transactions by both residents and non-residents. Reflecting confidence in Malaysia's economic resilience and growth prospects, foreign direct investment (FDI) flows were sustained and were mainly channelled into the mining, financial services, and distributive trade services sectors. Outward direct investment flows by Malaysian companies were higher during the year, driven by investments in the mining, information and communications, and financial services sectors. For most of the year, an improving global outlook and the healthy performance of the Malaysian economy contributed to strong interest by non-residents in Malaysia's financial assets. Consequently, Malaysia experienced non-resident portfolio inflows of RM11 billion in the first three quarters of 2014, channelled mainly into the debt securities market. In the fourth quarter, however, investor sentiments turned negative amid concerns over weakening global growth prospects, the possible increase in interest rates in the US, and the rapid decline in oil prices. As a result, there was a net outflow of non-resident portfolio investments of RM20.6 billion in the fourth quarter, mainly from Bank Negara Monetary Notes. For the year as a whole, non-resident portfolio investments recorded a net outflow of RM9.6 billion. Overall, the financial account registered a net outflow of RM76.5 billion in 2014.

Despite the large swings in portfolio flows, the impact on domestic financial markets was cushioned by the deep and diversified financial markets and continued demand from domestic institutional investors. With greater exchange rate flexibility, some of the shocks were absorbed through adjustments in the ringgit exchange rate. At the same time, the high level of international reserves functioned as a buffer to prevent excessive fluctuations in the exchange rate.

The international reserves of Bank Negara Malaysia amounted to RM405.3 billion as at end-2014 (2013: RM441.9 billion). As at 27 February 2015,

the reserves level amounted to RM386.0 billion (equivalent to USD110.5 billion), which is sufficient to finance 7.9 months of retained imports and is 1.1 times the short-term external debt. The international reserves held by the Bank remain usable and unencumbered.

Malaysia's external debt amounted to RM744.7 billion, equivalent to 69.6% of GDP, as at end-2014 (2013: RM696.6 billion or 70.6% of GDP). In terms of the maturity profile, slightly more than half of the external debt comprised medium- to long-term maturities. By currency, 41.2% of the external debt was made up of ringgit-denominated debt securities and deposits held by non-residents. During the year, particularly in the fourth quarter, the rise in external debt was partly attributable to the valuation effects from the depreciation of the ringgit. These valuation effects accounted for 42.0% of the RM48.1 billion increase in external debt during the year. Excluding these effects, the increase in offshore borrowing for the year largely reflected the drawdown of short-term borrowing by banks and medium- to long-term borrowing by the banking sector and the non-bank private sector. The increase in non-resident deposits in domestic banks also contributed to the higher external debt.

Interbank offshore borrowing accounted for only a small share of the banking system's total funding. This offshore borrowing mainly reflected domestic banks' increased overseas operations and centralised foreign currency liquidity management operations. In terms of the non-bank private sector's offshore borrowings, 70% of the total was sourced from offshore shareholders, parent companies and associated companies, while most of the debt was either financially or naturally hedged. Furthermore, stress tests conducted on large non-bank corporate borrowers indicated that they were resilient to exchange rate fluctuations.

Economic and Monetary Management in 2014

The Monetary Policy Committee (MPC) adjusted the degree of monetary accommodation by raising the Overnight Policy Rate (OPR) by 25 basis points to 3.25% on 10 July 2014. The economy was assessed to be on a sustained growth path and with the prospects for the domestic economy to remain on this steady growth trajectory in 2014. The MPC also took into account the ongoing concerns about the risks of broader financial imbalances. The key consideration was, therefore, in identifying the appropriate timing for the adjustment, taking

into consideration the ongoing assessment of the balance of risks to the outlook for growth and inflation. By May 2014, the expectation was for growth in 2014 to be at the upper end of the initial forecast of 4.5% - 5.5%. There were greater upside risks to inflation, which was expected to trend above its long-run average in 2014 and 2015, driven mainly by domestic cost factors, namely adjustments in administered prices, and the implementation of the Goods and Services Tax (GST). Furthermore, while the implementation of macro- and micro-prudential measures were having the desired effect of moderating the growth of household indebtedness, the MPC assessed that the sustained period of unchanged and low interest rates was creating an environment of understating risks and had the potential of incentivising broader financial imbalances. Thus, the MPC decided to adjust the degree of monetary accommodation at the July 2014 MPC meeting. The adjustment in the policy rate was transmitted efficiently through the financial system and the broader economy. Retail lending rates adjusted quickly to the change in the OPR. Depositors were also compensated with higher rates of return on their savings.

In the later part of the year, the sustainability of external demand became more uncertain following rising concerns over the growth prospects of the global economy. Global growth continued to be uneven, with increasing evidence of a weaker-than-expected growth momentum in a number of major economies. In addition, the marked increase in global financial market volatility and the sharp decline in oil prices towards the end of 2014 further heightened the downside risks emanating from the external environment. As for inflation, despite a number of price adjustments, there was limited evidence of increased pervasiveness of price increases. The absence of external price pressures and the more moderate domestic demand conditions were also expected to mitigate the impact of cost-push inflation. Given the evolving economic and financial environment, and the uncertainty it created around the inflation outlook, and the growth prospects, the MPC was of the view that maintaining monetary conditions at their prevailing level was warranted. The risks of destabilising financial imbalances continued to be monitored.

The performance of the ringgit during the year followed two noticeable patterns. Between February and August 2014, the ringgit was broadly on a strengthening trend due to sustained portfolio inflows. From September, however, the ringgit,

along with most regional currencies, faced depreciation pressures as investors unwound their holdings of financial assets in the region amidst nervousness about a possible change in US monetary policy and signs of weakness in the global growth momentum. For the year as a whole, the ringgit depreciated by 6.1% to RM3.4950 against the US dollar.

Malaysian Government Securities (MGS) yields were affected by domestic and external factors during the year. For the first 11 months, while market expectations and the eventual policy rate increase by the Bank led to upward adjustments at the shorter-end of the MGS yield curve, sustained interest from non-resident and local investors contributed to the downward shift at the longer-end of the MGS yield curve. This downward trend, however, was reversed in December as resident investors consolidated their investment positions towards the end of the year.

Aggregate outstanding liquidity placed with the Bank remained high despite the net withdrawal of liquidity due to net outflows from the external sector. Given the net external sector outflows, private sector liquidity, as measured by broad money (M3), grew at a more moderate pace of 7.0% during the year (2013: 7.9%).

Financing to the private sector remained healthy during the year. The growth in net financing through the banking system, development financial institutions (DFIs) and the private debt securities (PDS) market expanded at an annual rate of 8.7% in 2014 (2013: 9.7%). The growth in outstanding loans to businesses increased to 9.0% with continued double-digit growth in SME loans, amid a higher level of loan disbursements. Demand for funding from the capital markets by private sector corporations also remained robust, with gross funds raised through bond and equity issuances remaining relatively stable during the year at RM101.3 billion (2013: RM98.1 billion). Meanwhile, taking into account financing from both banks and non-banks, the growth in outstanding loans to households continued to moderate as intended following measures to curb pockets of excesses.

Outlook for the Malaysian Economy in 2015

Despite a challenging external environment, the Malaysian economy is expected to register steady growth of 4.5% - 5.5% in 2015, supported mainly by sustained expansion in domestic

demand amid strong domestic fundamentals and a resilient export sector. Domestic demand will continue to anchor growth in 2015, driven by private sector spending. After registering five consecutive years of above-average growth rates, private consumption is expected to grow by 6.0% in 2015. While the implementation of the GST in April and lower earnings in the commodity-related sectors are expected to affect spending, this will, however, be partially offset by higher household disposable incomes from lower fuel prices, the favourable labour market conditions and the Government measures to assist low- and middle-income households.

After three years of double-digit growth, private investment is expected to expand by 9.0%, amid lower investments in the mining sector. Nevertheless, private investment growth will be supported by on-going projects and new investments in the manufacturing and services sectors with firms benefitting from the continued global recovery and expansion in domestic demand.

Public consumption is projected to grow more moderately, with lower spending on supplies and services following the Government's expenditure rationalisation measures. Public investment is, however, expected to turn around to record positive growth, with higher capital spending by public enterprises and to a lesser extent, by the Federal Government. Investments by public enterprises reflect the continued implementation of key infrastructure projects, particularly in the utilities and transportation sub-sectors.

In the external sector, after a strong performance in 2014, the growth of gross exports is projected to moderate, amid lower commodity prices. Exports of manufactured products, however, are expected to increase at a stronger growth rate. Gross imports growth is expected to be higher in 2015, amid continued growth in intermediate imports given the expansion in export-oriented manufacturing; and higher growth in capital and consumption imports in line with the continued growth of domestic demand. Overall, the trade balance is expected to narrow but remain in surplus. The services account is projected to record a smaller deficit, with the expected recovery in tourist arrivals. Overall, the current account surplus is projected to narrow to 2% - 3% of GNI in 2015.

On the supply side, all economic sectors are expected to expand. The services and manufacturing sectors

will remain the key drivers of overall growth. Growth in the mining sector is projected to be sustained amid rising output from a new oil field. Weighed down by lower commodity prices, the agriculture sector is expected to record a marginal positive growth. The construction sector is expected to continue to record high growth, albeit at a more moderate pace. Although activity in the residential sub-sector is expected to increase at a more moderate pace, growth in the non-residential sub-sector is projected to be sustained while new and existing multi-year civil engineering projects will continue to provide additional support to the sector.

Headline inflation is projected to be lower at 2% - 3% in 2015, largely on account of lower global energy and food prices. The decline in global oil prices will lead to lower domestic fuel prices through the managed float fuel pricing mechanism. The more subdued external price pressures would also mitigate increases in the cost of imports stemming from the recent ringgit depreciation, thereby moderating imported inflation. While the implementation of the GST would result in higher prices for some goods and services, the impact on overall headline is expected to be contained. Basic necessities are either zero-rated or exempted from the GST while for some other items, the GST would merely replace the existing Sales and Services Tax (SST). The inflation rate in 2015 would also be affected by the new pricing mechanism for petrol prices in which there would be a more direct transmission of global oil price volatility into domestic prices given the market-based pricing of domestic fuel products. Nevertheless, the expectation is for underlying inflation to still remain relatively stable, amid modest demand pressures.

Economic and Monetary Management in 2015

The external environment in 2015 will be more challenging. While improving, downside risks to the global growth outlook remain given the continued weakness in a number of major economies. In addition, given uneven growth prospects, monetary policies in the major economies could potentially diverge, which may lead to sizable shifts in global liquidity and contribute to greater volatility in global financial markets and capital flows. The sharp decline in the price of oil and the uncertainty over its future price path, coupled with the attendant effects on the prices of other commodities, further compounds the challenging global environment. Amid this challenging landscape, the focus of policies by the Government and

the Bank will be on addressing domestic vulnerabilities and supporting the growth of the Malaysian economy.

Monetary policy in 2015 will continue to support a steady growth of the Malaysian economy amid contained risks to inflation. The operating environment for monetary policy will be shaped by key challenges on the external front, which would affect the overall outlook for the domestic economy. These include the considerable downside risks to global growth prospects, the changed outlook for commodity prices, and the potential divergence in the monetary policies of the major economies. Notwithstanding these external risks, domestic demand is expected to expand at a sustained pace while the export sector will remain resilient. In terms of the inflation outlook, the key consideration for monetary policy is the development of underlying inflation, which is expected to remain relatively stable amid modest demand pressures. In addition, monetary policy decisions will also continue to take into account assessments on the potential risk of a further build-up in financial imbalances.

Fiscal policy in 2015 will focus on strengthening fiscal management amid the environment of low global commodity prices. The expected lower oil-related revenue has prompted the Government to introduce pre-emptive fiscal adjustment measures and to revise the fiscal deficit target from 3% to 3.2% of GDP. The net impact of lower oil prices on Malaysia's fiscal position is expected to be manageable. This is on account of the increased diversification of sources of revenue over the years, which will be further supported by the implementation of the GST, and the expenditure rationalisation measures encompassing fuel subsidy reforms and the scaling back of discretionary spending.

As a highly open economy, in the event that some of the external risks materialise, Malaysia would be adversely affected but the strong prevailing underlying fundamentals would act as a buffer to mitigate the impact. The economy is well-diversified, inflation is low, and the balance of payments position is resilient. Labour market conditions remain healthy. The deep financial markets, strong banking system, and ample liquidity conditions will ensure that effective financial intermediation continues and will provide support to Malaysia's resilience during bouts of volatile capital flows. External debt remains manageable with the majority of debt

being in medium- to long-term tenures, and with more than 40% being denominated in ringgit. This, together with ample international reserves, accords the economy with the policy flexibility to manage external risks. The combination of these factors will cumulatively enable a more effective policy response to mitigate the impact of any external shocks on domestic demand.

Governance, Organisational Development and Communications

The year 2014 marked the completion of the Bank's three-year strategic Business Plan 2012-2014. During this period, the Bank accomplished several key milestones, including strengthening the legislative framework underpinning the domestic financial sector; establishing the Financial Services Talent Council and Financial Services Professional Board to raise the standards of quality and professionalism in the financial sector; and improving the e-payments ecosystem for more efficient payment transactions.

The Board of Directors' oversight of the Bank's governance included matters relating to financial sector development and financial stability, as well as major initiatives such as the establishment of the Monetary Penalty Review Committee (MPRC), as legislated under the Bank's acts. The Board is supported by three Board Committees, namely the Bank Governance Committee (BGC), the Board Audit Committee (BAC) and the Board Risk Committee (BRC). The Board, with the support of the BRC, provides strategic direction on the Bank's risk management. In 2014, risk dashboards were strengthened and a new principle-based policy was introduced to counter the increased risks associated with the greater use of digital information. The risk management function is complemented by a risk-based internal audit function for all critical operations of the Bank.

Organisational development efforts were focused on enhancing productivity, particularly in facilitating expedited learning given the changing talent demographics in the Bank. Other aspects included improving business processes and strengthening the architecture of the Bank's information systems.

The Bank sustained its proactive communications approach through different channels including the Monetary Policy Statement (MPS) and briefings coinciding with economic press releases, Parliamentary sessions, and meetings with investors and analysts. These engagements have a key role in enhancing the understanding of the Bank's assessments and policy actions as well as sustaining overall confidence. The Bank also continued to engage with the international central banking and financial community at large. Key initiatives included hosting the Alliance for Financial Inclusion (AFI) headquarters in Kuala Lumpur to strengthen global financial inclusion efforts; and establishing a renminbi clearing bank to deepen economic ties between Malaysia and PR China.

Other new initiatives during the year included those in support of the national "Going Green" agenda through the use of recycled fit RM1 and RM5 banknotes during festive celebrations, and Currency Education Programmes to enhance the public's knowledge of banknote security features.

Bank Negara Malaysia's Audited Financial Statements for 2014

The financial position of Bank Negara Malaysia, as audited and certified by the Auditor General, remained strong in 2014. The total assets of Bank Negara Malaysia amounted to RM427.6 billion, with a net profit of RM6.4 billion for the financial year ending 31 December 2014. Bank Negara Malaysia declared a dividend of RM3.0 billion to the Government for the year 2014.

2014

ECONOMIC DEVELOPMENTS IN 2014

- 11 The International Economic Environment
- 16 The Malaysian Economy
- 23 *Box Article: Trends in Malaysia's Gross Domestic Product by Income*
- 29 External Sector
- 37 Inflation Developments

THE INTERNATIONAL ECONOMIC ENVIRONMENT

The global economy expanded at a moderate pace in 2014, with uneven growth across and within regions. In the advanced economies, while growth in the US continued to show broader signs of improvement, economic activity in the euro area and Japan remained subdued. In Asia, most economies benefitted from higher external demand, particularly from the US. Nevertheless, growth momentum diverged across the region as domestic demand moderated in several economies amid country-specific developments. As the year progressed, downside risks to global growth re-emerged as a consequence of geopolitical developments in Eastern Europe and the Middle East, weaker-than-expected economic activity in several major economies, and rising concerns over the growth prospects of a number of commodity-producing emerging economies amid the significant decline in energy prices in the latter part of 2014. Given these developments and the benign global inflationary pressures, monetary policy remained accommodative across regions. Although there was some divergence in the direction of monetary policy across the major advanced economies amid the increasing unevenness in economic performances, the stance of monetary policy continued to be highly accommodative in all of these economies.

The global economy expanded at a moderate pace in 2014, with uneven growth across and within regions

Moderate expansion in the global economy

The global economy remained on a gradual path of improvement at the start of 2014, with most advanced economies registering higher growth. Economic activity in the euro area and Japan was supported by improving domestic demand amid accommodative monetary policies and a slower pace of fiscal consolidation. Consumer spending in Japan was

also significantly higher in anticipation of the consumption tax increase that was scheduled to come into effect in April. In the US, while growth slowed in the early months due to unusually adverse weather conditions, the weakness proved to be transitory. Economic activity subsequently rebounded, underpinned by strengthening labour market conditions and sustained business sentiments. The improving global environment supported better export performance for the Asian economies. Nevertheless, economic growth moderated in several regional economies due mainly to policy measures to address country-specific issues. Of significance, growth in PR China continued to trend towards a more sustainable path amid structural reforms to advance economic rebalancing and address areas of vulnerabilities.

In the second quarter of 2014, while growth in the US continued to gain momentum, economic activity in several major economies began to exhibit signs of weaknesses due to varied underlying factors. These weaknesses had become more entrenched by the third quarter, resulting in increasing unevenness in growth performances across the major economies. In the euro area, geopolitical developments in Eastern Europe affected business sentiments. This, together with persistent structural constraints, weighed on investment activity and led to a deceleration in the overall growth momentum. In Japan, consumer spending declined following the increase in the consumption tax in April. As weak demand conditions weighed on business activity, the Japanese economy entered into a technical recession in the third quarter despite better export performance. In PR China, the continued implementation of structural reforms resulted in a larger-than-expected slowdown in economic activity. Nevertheless, the periodic introduction of targeted policy measures to support the productive and rural sectors helped to stabilise overall growth during the year.

As economic performance in several major economies remained below earlier expectations, concerns over the global growth outlook increased towards the fourth quarter of 2014, particularly following the downgrade of the global economic outlook by the International Monetary Fund (IMF).

The weakness in global demand, together with the sizeable excess supply in the global crude oil market, led to a significant decline in the prices of crude oil and other commodities. Uncertainties over the magnitude and persistence of the decline in commodity prices consequently increased concerns over the growth prospects of a number of commodity-producing emerging economies. This in turn resulted in broad-based financial market volatility across the emerging economies, which further exacerbated concerns over global growth. Nevertheless, in Asia, while overall growth was affected by the adverse developments in the external environment, economic expansion continued to be supported by domestic demand and exports, particularly to the US.

Table 1.1

World Economy: Key Economic Indicators

	Real GDP Growth (Annual change, %)		Inflation (Annual change, %)	
	2013	2014e	2013	2014e
World Growth	3.3	3.3	-	-
World Trade	3.4	3.1	-	-
Advanced Economies				
United States	2.2	2.4	1.5	1.6
Japan	1.6	0.0	0.4	2.7
Euro area ¹	-0.5	0.9	1.4	0.4
United Kingdom	1.7	2.6	2.6	1.5
Emerging Asia²	6.5	6.2	2.8	2.5
Other Advanced Asian Economies	2.9	3.3	1.6	1.6
Korea	3.0	3.3	1.3	1.3
Chinese Taipei	2.2	3.7	0.8	1.2
Singapore	4.4	2.9	2.4	1.0
Hong Kong SAR ³	2.9	2.3	4.3	4.4
The People's Republic of China	7.7	7.4	2.6	2.0
ASEAN-4	5.1	4.4	4.4	4.7
Malaysia	4.7	6.0	2.1	3.2
Thailand	2.9	0.7	2.2	1.9
Indonesia	5.6	5.0	6.4	6.4
Philippines	7.2	6.1	2.9	4.2
India⁴	5.0	5.8	10.1	7.2

¹ Refers to EU-18

² Emerging Asia refers to Chinese Taipei, Hong Kong SAR, Indonesia, Korea, Malaysia, Philippines, PR China, Singapore and Thailand

³ Inflation refers to harmonised composite price index

⁴ For India, GDP data is presented on a fiscal year basis

e Estimate

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

Benign inflationary pressures

Inflationary pressures remained benign in many economies, reflecting modest wage growth in the advanced economies and the significant decline in global commodity prices, particularly in the second half of the year.

Crude oil prices moderated to an average of USD99 per barrel¹ in 2014 (2013: USD109 per barrel), with sizeable price movements during the year. In the first half of 2014, crude oil prices increased to peak at USD115 per barrel in mid-June, following concerns over potential supply disruptions amid increasingly adverse geopolitical developments in the Middle East. However, the weaker-than-expected global demand, continued production by the key oil-producing economies and the rising supply from non-conventional sources, particularly shale oil in the US, resulted in considerable oversupply and triggered a large decline in crude oil prices. Uncertainties over the magnitude and persistence of the decline in crude oil prices were further exacerbated by the Organisation of the Petroleum Exporting Countries' (OPEC) decision in November to maintain production levels despite the prevailing oversupply conditions in the global markets. Given the greater financialisation of the energy sector in recent years, the deterioration in market sentiments further accelerated the decline in prices, with crude oil prices ending the year at around USD56 per barrel, more than 50% below its peak in 2014 and the lowest level since May 2009.

In tandem with the decline in crude oil prices, non-energy commodity prices also moderated. Food prices were lower amid favourable weather conditions and better yield performance in key growing regions, particularly for corn, soybean and wheat. The prices of hard commodities, particularly iron ore and copper, were also affected primarily by weaker demand from key emerging economies, including PR China.

In the advanced economies, core inflation, which excludes food and energy prices, remained subdued amid modest wage growth. Headline inflation continued to remain below targets set by central banks, including in the US, due mainly to the lower energy prices. Of significance, the euro area entered into deflation in December, as the significant decline in energy prices exacerbated the already weak inflation. Although inflation

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

(excluding fresh food) in Japan was higher due mainly to the consumption tax increase, estimates by the Bank of Japan (BoJ) that exclude the effects of the consumption tax increase suggested that underlying inflation remained below 1%. In Asia, while inflation eased in most economies, price pressures remained elevated in a few economies such as Indonesia, where it was due mainly to the adjustments in administered fuel prices. The higher inflation in Chinese Taipei and the Philippines reflected stronger domestic demand.

Global policy stance remained supportive of growth

Amid increasing global growth concerns and benign inflationary pressures during the year, the overall policy stance remained supportive of growth in most regions. In the advanced economies, overall monetary policy remained accommodative despite some divergence in monetary policy stances across the major advanced economies. Monetary authorities continued to rely on 'forward guidance' to manage market expectations and minimise uncertainties relating to the future policy direction. In addition, the pace of fiscal consolidation slowed, except in Japan where the consumption tax was increased from 5% to 8% in April. In Asia, the degree of monetary accommodation was increased in a few economies, while targeted fiscal support was introduced in others. Several economies also advanced the implementation of structural reforms to further strengthen macroeconomic fundamentals and enhance medium-term growth sustainability.

In the advanced economies, the monetary policy stance showed signs of divergence amid increasing unevenness in economic performances, particularly during the second half of the year. In the US, following growing signs of strengthening labour market conditions and more broad-based economic improvements, the Federal Reserve (Fed) continued to gradually reduce the pace of asset purchases, to subsequently end all asset purchases in October. As the Fed adjusted its 'forward guidance' to indicate that "it can be patient in beginning to normalise the stance of monetary policy", market expectations remained for interest rate normalisation to begin in 2015. In contrast, the European Central Bank (ECB) and the BoJ further increased the degree of monetary accommodation in the second half of 2014 on account of weak economic growth and rising disinflationary

pressures. Of significance, the ECB reduced the main refinancing rate by a cumulative 20 basis points to 0.05%, and lowered the marginal lending and deposit rates by 45 and 20 basis points to 0.30% and -0.20%, respectively. In addition, to increase its balance sheet size towards levels observed around early 2012, the ECB introduced a series of targeted longer-term refinancing operations (TLTROs) to encourage greater bank lending in the euro area, and embarked on the purchase of asset-backed securities and covered bonds from October. Nevertheless, despite the implementation of these measures, medium-term inflation expectations had continued to trend downwards. In Japan, the BoJ increased its annual asset purchases to JPY80 trillion (previous target: JPY60~70 trillion) and shifted to conducting asset purchases in an open-ended manner amid continued concerns over disinflation.

In PR China, the People's Bank of China (PBoC) reduced its interest rates in November for the first time since July 2012, to lower real lending rates and reduce the financing costs for enterprises. The benchmark lending and deposit rates were lowered by 40 and 25 basis points to 5.60% and 2.75%, respectively. Targeted policy measures were also introduced during the year to support growth in the productive and rural sectors. These included more accommodative lending to the agriculture and rural sectors, increased funding for infrastructure development, government support for consumption particularly in the rural areas, tax reductions for small and medium-sized enterprises (SME), and lower restrictions on the property market.

In Asia, the monetary policy stance was shaped primarily by domestic considerations. The Reserve Bank of India, Bank Indonesia and Bangko Sentral ng Pilipinas increased key policy rates by a total of 25, 25 and 50 basis points, respectively, to contain inflationary pressures. In contrast, the Bank of Korea and the Bank of Thailand lowered their key policy rates due mainly to weaker-than-expected domestic demand. Importantly, while the regional economies experienced significant capital flow reversals and depreciation pressures on their currencies towards the end of 2014, these economies remained resilient against the external challenges, with no disruption of financial intermediation within the regional financial systems.

To further strengthen macroeconomic fundamentals and enhance medium-term growth prospects, several Asian economies continued with the implementation of structural reforms.

Table 1.2

Malaysia - Key Economic Indicators

	2012	2013	2014 ^p	2015 ^f
Population (million persons)	29.5	29.9	30.3	30.6
Labour force (million persons)	13.1	13.6	14.0	14.4
Employment (million persons)	12.7	13.2	13.6	14.0
Unemployment (as % of labour force)	3.0	3.1	2.9	3.0
Per Capita Income (RM)	30,698	31,844	34,123	35,572
(USD)	9,938	10,106	10,426	9,914 ⁶
NATIONAL PRODUCT (% change)				
Real GDP at 2005 prices ¹	5.6	4.7	6.0	4.5 ~ 5.5
(RM billion)	751.9	787.6	835.0	877.2
Agriculture, forestry and fishery	1.3	2.1	2.6	0.3
Mining and quarrying	1.0	0.7	3.1	3.0
Manufacturing	4.8	3.5	6.2	4.9
Construction	18.6	10.9	11.6	10.3
Services	6.4	5.9	6.3	5.6
Nominal GNI	4.9	5.2	8.4	5.5
(RM billion)	905.9	952.6	1,032.6	1,089.4
Real GNI	3.9	5.3	6.0	5.2
(RM billion)	693.6	730.5	774.6	814.9
Real aggregate domestic demand ²	10.7	7.4	6.0	6.0
Private expenditure	11.3	8.6	8.0	6.7
Consumption	8.2	7.2	7.1	6.0
Investment	22.8	13.1	11.0	9.0
Public expenditure	9.2	4.4	0.2	3.7
Consumption	5.0	6.3	4.4	2.7
Investment	14.6	2.2	-4.9	5.1
Gross national savings (as % of GNI)	33.0	31.2	30.9	29.8
BALANCE OF PAYMENTS (RM billion)				
Goods balance	125.2	108.2	125.1	94.2
Exports	686.0	679.1	726.0	723.9
Imports	560.9	570.9	601.0	629.7
Services balance	-16.2	-16.7	-20.5	-16.4
Primary income, net	-36.1	-34.1	-37.4	-38.0
Secondary income, net	-18.5	-17.5	-17.6	-18.5
Current account balance	54.5	39.9	49.5	21.4
(as % of GNI)	6.0	4.2	4.8	2.0 ~ 3.0
Bank Negara Malaysia international reserves, net ³	427.2	441.9	405.3	-
(in months of retained imports)	9.5	9.5	8.3	-
PRICES (% change)				
CPI (2010=100) ⁴	1.6	2.1	3.2	2.0 ~ 3.0
PPI (2010=100) ⁵	0.1	-1.7	1.4	-
Real wage per employee in the manufacturing sector	4.7	5.8	4.4	-

¹ Beginning 2012, real GDP has been rebased to 2005 prices, from 2000 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 2015

^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)		2012		2013		2014 ^p	
Revenue		207.9		213.4		220.6	
Operating expenditure		205.5		211.3		219.6	
Net development expenditure		44.3		40.7		38.4	
Overall balance		-42.0		-38.6		-37.4	
Overall balance (% of GDP)		-4.5		-3.9		-3.5	
Public sector net development expenditure		138.4		133.3		155.3	
Public sector overall balance (% of GDP)		-5.0		-3.9		-7.0	
EXTERNAL DEBT ¹							
Total debt (RM billion)		602.1		696.6		744.7	
Medium- and long-term debt		318.6		357.8		383.9	
Short-term debt		283.5		338.8		360.8	
Debt service ratio ² (% of exports of goods and services)							
Total debt		17.4		17.6		18.2	
Medium- and long-term debt		17.3		17.5		18.1	
MONEY AND BANKING		Change in 2012		Change in 2013		Change in 2014	
		RM billion	%	RM billion	%	RM billion	%
Money supply	M1	30.8	11.9	37.8	13.0	18.8	5.7
	M3	111.2	9.0	107.5	7.9	101.5	7.0
Banking system deposits		109.4	8.4	116.9	8.3	116.4	7.6
Banking system loans ³		104.5	10.4	117.7	10.6	114.1	9.3
Loan-deposit ratio (end of year) ⁴		82.1		84.8		86.7	
Financing-deposit ratio ^{4, 5}		88.7		91.3		93.3	
INTEREST RATES (AS AT END-YEAR)		2012		2013		2014	
		%		%		%	
Overnight Policy Rate (OPR)		3.00		3.00		3.25	
Interbank rates (1-month)		3.06		3.20		3.38	
Commercial banks							
Fixed deposit	3-month	2.97		2.97		3.13	
	12-month	3.15		3.15		3.31	
Savings deposit		1.03		0.99		1.07	
Base lending rate (BLR)		6.53		6.53		6.79	
Treasury bill (3-month)		3.04		3.00		3.42	
Malaysian Government Securities (1-year) ⁶		3.01		3.03		3.48	
Malaysian Government Securities (5-year) ⁶		3.24		3.66		3.84	
EXCHANGE RATES		2012		2013		2014	
Movement of Ringgit (end-period)		%		%		%	
Change against SDR		3.9		-7.3		-0.7	
Change against USD		3.9		-6.8		-6.1	

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 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

⁵ Financing comprises loans and banking institutions' holdings of private debt securities (PDS)

⁶ Refers to data from FAST, Bank Negara Malaysia

^p Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Chart 1.1

Cumulative Movements of Policy Rates (2014)

Note: Current policy rates as at end-2014 in parentheses

Source: National Authorities

In particular, a number of Asian economies, including India, Indonesia and Malaysia, leveraged on the decline in energy prices to rationalise fuel subsidies and strengthen medium-term fiscal sustainability. Several regional economies also introduced measures to enhance the competitiveness of SMEs and improve labour productivity, such as through providing rebates for automation, encouraging full-time employment and accelerating infrastructure development.

THE MALAYSIAN ECONOMY

Overview

The Malaysian economy recorded a stronger growth of 6.0% in 2014 (2013: 4.7%). Growth was driven by the continued strength in private domestic demand, and further lifted by the improvement in external trade performance. In particular, net exports turned around to contribute positively to growth in 2014 after seven consecutive years of negative contribution, as Malaysia's exports benefitted from the recovery in the advanced economies and continued demand from the region. This was reflected in a broad-based improvement in demand across markets and products, including the electrical and electronics (E&E) products. As the growth of real exports of goods and services outpaced the growth of imports, net exports recorded a strong growth of 19.7% in 2014 (2013: -12.6%) and contributed 1.4 percentage points to the overall GDP growth.

Domestic demand remained as the main anchor for growth, albeit at a more moderate pace of expansion, led by private sector activity. Private consumption was supported by favourable income growth and stable labour market conditions. The targeted Government transfers to the low- and middle-income groups provided additional support to private consumption despite the higher inflation during the year. Private investment continued to grow at a double-digit rate, driven by the manufacturing and services sectors. These sectors benefitted from the improvement in the external environment as well as the sustained domestic consumption. In line with the Government's commitment to fiscal consolidation, total public sector expenditure contributed only marginally to growth during the year. The cost-cutting initiatives by the Government to reduce discretionary spending that were announced at the end of 2013, particularly on travel, food and beverages as well as rentals, had partly led to the moderation in public consumption growth in 2014. Public investment, meanwhile, contracted following the lower capital spending by both the Federal Government and the public enterprises. The latter was due mainly to the completion and near-completion of some major projects during the year.

The Malaysian economy recorded a stronger growth of 6.0% in 2014, driven by private domestic demand and positive growth in net exports

On the supply side, all economic sectors recorded higher growth in 2014. The services sector remained the largest contributor to growth, underpinned largely by sub-sectors catering to domestic demand. The stronger performance of the export-oriented industries and the expansion in domestic-oriented industries contributed to the strong growth in the manufacturing sector during the year. The construction sector continued to expand at a double-digit rate, owing mainly to stronger growth in both the residential and non-residential sub-sectors, with further support from the infrastructure projects under the civil-engineering sub-sector.

Table 1.4

Real GDP by Expenditure (2005=100)

	2014 ^p	2013	2014 ^p	2013	2014 ^p
	% of GDP	Annual change (%)		Contribution to growth (ppt)	
Domestic Demand¹	93.1	7.4	6.0	6.8	5.6
Private sector expenditure	70.0	8.6	8.0	5.7	5.5
<i>Consumption</i>	52.5	7.2	7.1	3.6	3.7
<i>Investment</i>	17.5	13.1	11.0	2.0	1.8
Public sector expenditure	23.0	4.4	0.2	1.1	0.1
<i>Consumption</i>	13.2	6.3	4.4	0.8	0.6
<i>Investment</i>	9.8	2.2	-4.9	0.2	-0.5
Gross Fixed Capital Formation	27.3	8.5	4.7	2.3	1.3
Change in Stocks				-0.9	-0.9
Net Exports of Goods and Services	8.0	-12.6	19.7	-1.1	1.4
<i>Exports</i>	88.8	0.6	5.1	0.6	4.6
<i>Imports</i>	80.8	2.0	3.4	1.7	3.2
Real Gross Domestic Product (GDP)	100.0	4.7	6.0	4.7	6.0

¹ Excluding stocks^p Preliminary

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Domestic demand remained the key driver of growth

Domestic demand remained the key driver of growth despite expanding at a more moderate pace of 6.0% during the year (2013: 7.4%). While private domestic demand remained strong, particularly in the first half of the year, public sector expenditure registered a slower growth, following the more moderate growth in public consumption and a decline in public investment.

Private consumption remained firm, supported by strong fundamentals

Private consumption grew by 7.1% in 2014 (2013: 7.2%), supported by strong fundamental factors which helped mitigate the adverse impact from the rise in cost-driven inflation. Household income growth was favourable, while labour market conditions remained stable during the year. Nominal wages in the export-oriented manufacturing industries registered a sustained growth of 5.7% (2013: 7.3%), benefitting from the improvement in external demand. Wages in the domestic-oriented industries continued to grow, albeit at a slower pace of 5.6% (2013: 14.2%), as the impact of

Table 1.5

Real GDP by Kind of Economic Activity (2005=100)

	2014 ^p	2013	2014 ^p	2013	2014 ^p
	% of GDP	Annual change (%)		Contribution to growth (ppt) ¹	
Services	55.3	5.9	6.3	3.2	3.5
Manufacturing	24.6	3.5	6.2	0.9	1.5
Mining & quarrying	7.9	0.7	3.1	0.1	0.3
Agriculture	6.9	2.1	2.6	0.2	0.2
Construction	3.9	10.9	11.6	0.4	0.4
Real Gross Domestic Product (GDP)	100.0¹	4.7	6.0	4.7	6.0

¹ Numbers do not add up due to rounding and exclusion of import duties component^p Preliminary

Source: Department of Statistics, Malaysia

minimum wage implemented in 2013 dissipated. The lower unemployment rate of 2.9% (2013: 3.1%) and an increase in total employment to 13.6 million workers (2013: 13.2 million workers) also provided support to private consumption. Moreover, creditworthy households continued to have access to financing, as reflected in positive growth in outstanding consumption credit to households of 3.7% in 2014 (2013: 8.3%). The higher cost of living partly due to the administered price adjustments posed a challenge to household spending, especially during the first half of the year. Nevertheless, targeted Government transfers to low- and middle-income households partially mitigated the impact of higher prices on household spending. These include both the Bantuan Rakyat 1Malaysia (BR1M), which was expanded in terms of the amount given per recipient and the number of recipients, as well as a one-off disbursement of RM250 to pensioners.

Public consumption recorded a slower growth of 4.4% in 2014 (2013: 6.3%). While spending on emoluments was sustained, growth of Government spending on supplies and services moderated during the year. In particular, the cost-cutting initiatives announced at the end of 2013 had resulted in lower discretionary spending, particularly on travel, food and beverages expenses and rental payments.

In 2014, **gross fixed capital formation (GFCF)** registered a lower growth of 4.7% (2013: 8.5%) due primarily to a decline in public investment by 4.9%. The share of private investment to GFCF rose to 64% (2013: 60%), reflecting the continued growth in private investment, particularly in the first half of the year.

Stable Labour Market Conditions

In 2014, the labour market remained stable, as continued expansion across all economic sectors sustained the demand for labour. The unemployment rate declined to 2.9% (2013: 3.1%), while the labour force participation rate improved to 67.5% (2013: 67.0%), supported by higher female participation in the labour force. Retrenchments, as reported to the Ministry of Human Resources, were also lower at 10,431 workers (2013: 11,195 workers) (Table 1).

Table 1

Selected Labour Market Indicators

	2010	2011	2012	2013	2014 ^p
Employment ('000 persons)	11,900	12,284	12,723	13,210	13,576 ¹
Labour force ('000 persons)	12,304	12,676	13,120	13,635	13,977 ¹
Unemployment rate (% of labour force)	3.3	3.1	3.0	3.1	2.9 ¹
Retrenchments (persons)	7,085	9,450	11,494	11,195	10,431
Foreign workers ('000 persons)	1,818	1,573	1,572	2,250	2,073

^p Preliminary

¹ Based on average employment for the period of January-December 2014

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

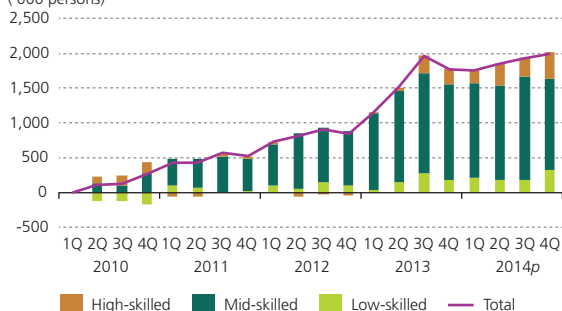
Total employment expanded to 13.6 million workers (2013: 13.2 million workers) with net addition of 366,300 jobs. The net addition to employment was mainly in the services sector (351,900 jobs), particularly in the distributive trade, accommodation and restaurant sub-sectors. Employment in the manufacturing sector increased by 58,200 jobs, but net job losses were recorded in the construction and commodities sectors (-18,500 and -25,400 jobs respectively). In terms of skill levels, employment gain was skewed towards high-skilled occupations, while net additional employment in the low-skilled occupations remained relatively subdued (Chart 1). The number of registered foreign workers declined to 2.07 million workers (2013: 2.25 million workers), with most of the decline occurring in the agriculture and manufacturing sectors.

Labour productivity, as measured by real value-added per worker, improved by 3.2% (2013: 0.9%), driven mainly by productivity growth in the commodities and manufacturing sectors. Labour productivity in the services sector, however, remained modest (Chart 2). Salaries in the private sector continued to increase, as reflected by the average salary increment of 5.4% (2013: 6.6%) reported by the Malaysian Employers Federation (MEF) Salary Survey of Executives and Non-Executives 2014. Based on the Survey, executive workers received a salary increment of 5.5% (2013: 6.3%), while non-executives recorded a salary increment of 5.4% (2013: 6.7%).

Chart 1

Employment Growth by Skill Levels

Cumulative increase in employment since 1Q 2010
(‘000 persons)



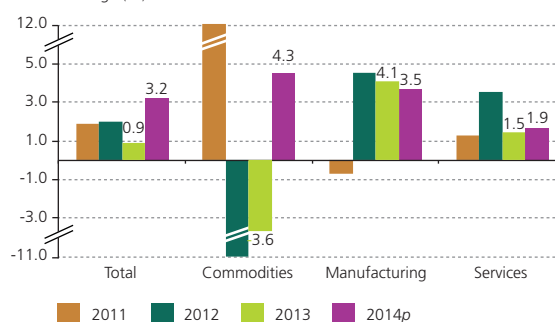
^p Preliminary

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

Chart 2

Labour Productivity Growth by Sectors

Annual change (%)



^p Preliminary

Source: Department of Statistics, Malaysia

Higher Growth across All Economic Sectors

On the supply side, all economic sectors recorded higher growth in 2014, driven by domestic activities and the improvement in external trade performance.

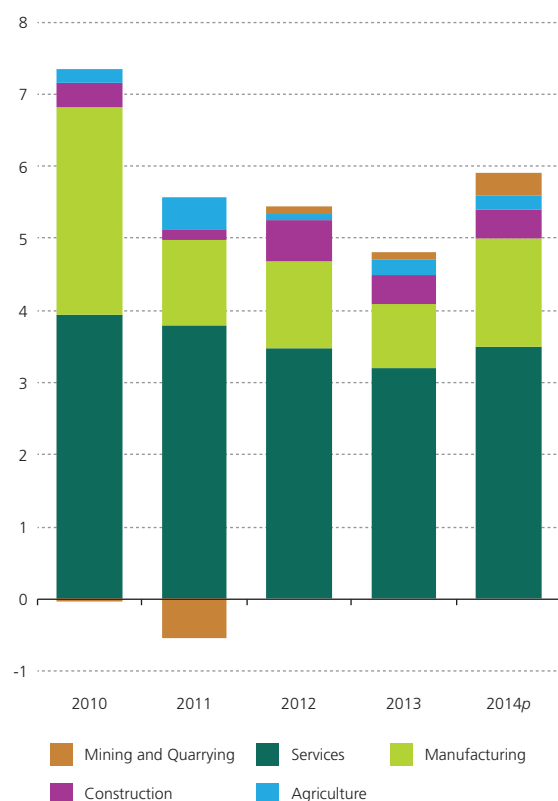
The services sector expanded by 6.3% in 2014 (2013: 5.9%) and remained the largest contributor to growth (3.5 percentage points of overall GDP growth). Growth in the sector was underpinned largely by sub-sectors catering to domestic demand. In particular, the wholesale and retail trade sub-sector recorded a higher growth in tandem with the continued strength in household spending. In the communication sub-sector, growth remained robust, driven by strong demand for data communication services. Performance of the transport and storage sub-sector was sustained, supported mainly by trade-related activity. Growth in the finance and insurance sub-sector improved marginally due to higher growth in the insurance segment.

The manufacturing sector grew at a higher rate of 6.2% (2013: 3.5%), attributable to stronger performance of the export-oriented industries and expansion in the domestic-oriented industries. Export-oriented industries were mainly driven by the significant growth of the E&E cluster, particularly in the first half of 2014, in line with rising global demand. The primary-related cluster was lifted by improving regional demand. Growth in the domestic-oriented industries was supported by the sustained consumption spending and robust domestic construction activity.

Chart 1

Real GDP by Economic Activity

Contribution to growth (percentage points)



^p Preliminary

Source: Department of Statistics, Malaysia

The construction sector registered a higher growth of 11.6% during the year (2013: 10.9%), owing mainly to stronger growth in both the residential and non-residential sub-sectors. The robust growth in the residential sub-sector was attributed to continued progress in high-end housing projects in Johor, Klang Valley and Penang, while construction activities in the non-residential sub-sector were supported by commercial and industrial projects. The civil engineering sub-sector provided further support to the sector, underpinned by existing and new infrastructure projects.

In the agriculture sector, growth was stronger at 2.6% (2013: 2.1%) due to higher production of palm oil as a result of favourable weather conditions, especially in the middle of the year. This was augmented by the higher production of food crops, particularly poultry and vegetables, which provided further support to the sector during the year.

The mining sector recorded a stronger growth of 3.1% (2013: 0.7%) as a result of higher production of natural gas and crude oil. Continued demand for liquefied natural gas (LNG) from North Asia led to higher production of natural gas, while crude oil output registered higher growth, especially in the second half of the year. This mainly reflected the commencement of production from a new major oil field, namely Gumusut-Kakap at offshore Sabah.

During the year, GFCF was mainly supported by investment in both structures, and machinery and equipment. Growth in investment in structures remained robust at 9.9% (2013: 11%), reflecting strong performance across all construction sub-sectors. Investments in machinery and equipment registered a decline of 0.3% (2013: 5.8%), as reflected in lower imports of transport equipment such as aircrafts and ships, imports of office equipment and imports of construction and mining equipment, especially in the second half of the year. The moderation in investment activity was also partly attributed to the near-completion of several major projects, particularly in the mining sector.

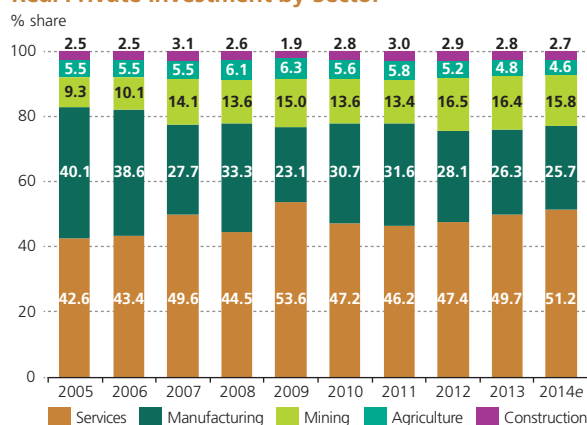
While private investment continued to expand, the pace of total investment activity moderated due to lower capital spending by the public sector

Private investment continued to expand rapidly at 11.0% (2013: 13.1%). Investments in the manufacturing sector (26% of private investment) expanded during the year, amidst the continued recovery in the external environment and sustained domestic consumption. Investments were undertaken in both the export-oriented industries, such as E&E and resource-based manufacturing, and the domestic-oriented industries, particularly food processing and transport equipment.

A similar trend was also observed in the services sector (51% share of private investment), where capital spending was also underpinned by investments in both the domestic- and export-oriented services industries. Capital spending in the domestic-oriented industries was mostly accounted by the distributive trade, telecommunication, business services and private healthcare sub-sectors. For the export-oriented sub-sectors, capital spending was undertaken in the building and expansion of tourism-related infrastructure, such as hotels and theme parks, and the upgrading of ports and petroleum storage terminals. Dwellings investment expanded further with continued progress in residential construction work done during the year. The share of dwellings investment to private investment, however,

Chart 1.2

Real Private Investment by Sector



e Estimate

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

remained unchanged at 17%, as investments in other sectors also experienced strong growth during the year.

Investment in the mining sector (16% share of private investment) remained strong, despite a slight moderation, due to the completion of capital spending in major upstream projects during the year. These projects include the Gumusut-Kakap deepwater field and the enhanced oil recovery from the Tapis oil field.

Public investment registered a negative growth of 4.9% in 2014 (2013: 2.2%) following the decline in the Federal Government's development expenditure and lower capital spending by the public enterprises. The lower spending on fixed assets by the public enterprises reflected mainly the completion or near-completion of several projects as well as lower spending on machinery and equipment during the year, mainly in the utilities and air transportation sub-sectors. Investment in the oil and gas sector and other transportation sub-sectors remained strong during the year. The lower development expenditure by the Federal Government reflected mainly the lower capital spending in the trade and industry, transportation and education sub-sectors. In terms of projects, the bulk of the expenditure was channelled towards the construction and upgrading of transportation infrastructure, particularly in the rural areas. Other projects include agriculture development as well as the construction of new schools and the upgrading facilities in higher learning institutions.

Debunking Malaysia's Investment Myths

Since 2010, Malaysia's private investment has grown at double-digit rates, following a five-year period of relatively low growth. Several misconceptions have, however, surfaced surrounding this positive development.

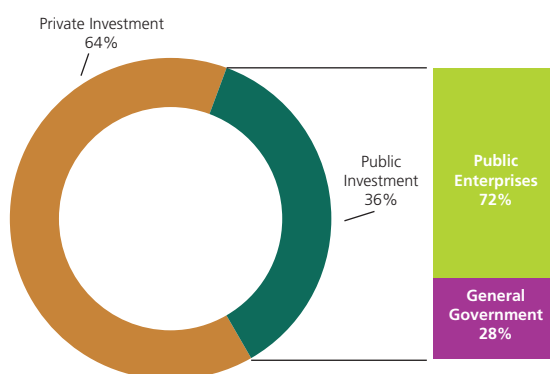
Myth #1: The strong performance in investment has been driven by the Government and Government-linked enterprises

A common misconception is that investment by commercially-run public enterprises (PEs), such as PETRONAS, or in public infrastructure projects, such as the MRT, is classified as private investment. Rather, investment of this nature is classified as public investment, alongside other investment by the General Government under the System of National Accounts 2008¹.

In 2014, investment by the private sector accounted for 64% of total investment. Public investment represented only 36% of total investment. Of the public investment, 72% was undertaken by public enterprises, comprising mainly commercially-run entities such as PETRONAS, Tenaga Nasional Berhad and Telekom Malaysia. Only 28% of public sector investment was undertaken by the General Government, comprising the Federal Government, State Governments, Statutory Bodies and Local Authorities.

Chart 1

Total Gross Fixed Capital Formation (GFCF) by Sector in 2014



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

Myth #2: Most investment is in the property sector

Residential property: In 2014, investment in residential property (also referred to as dwellings investment) accounted for only 17% of private investment. This share has moderated slightly from 18% in 2005, and is lower or comparable to the share of dwellings investment in other countries² (e.g. UK: 39%; US: 20%; Australia: 20%; Korea: 14%).

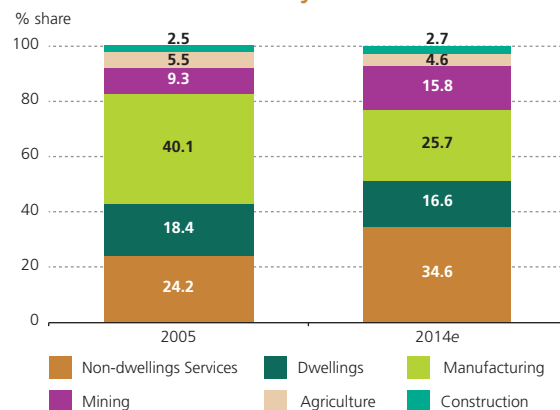
Broad property: The share of investment in broad property, which consists of residential property, office and commercial spaces, has remained at 18% of total investment since 2005.

¹ The System of National Accounts 2008 (2008 SNA) is the international statistical standard for national accounts, adopted by the United Nations Statistical Commission (UNSC). The compilation of Malaysia's national accounts statistics by the Department of Statistics, Malaysia, is based on the 2008 SNA.

² Source: CEIC database.

Chart 2

Real Private Investment by Sector



e Estimate

Note: Dwellings investment is classified under the services sector by the Department of Statistics, Malaysia. The breakdown between dwellings and non-dwellings services investment, however, is not published by the Department of Statistics, and is estimated by Bank Negara Malaysia.

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

Myth #3: Capital spending is concentrated in the oil and gas industry

The mining sector, which consists mainly of the upstream oil and gas industry, only accounted for 16% of private investment and around 19% of total GFCF in 2014. In terms of contribution to growth, the mining sector contributed 1.1 percentage points to the growth in private investment. Capital spending in the sector reached a peak in 2012, mainly due to the simultaneous commencement of several major oil and gas projects under the Economic Transformation Programme (ETP), such as the deepwater exploration activity in Gumusut-Kakap and enhanced oil recovery in the Tapis field.

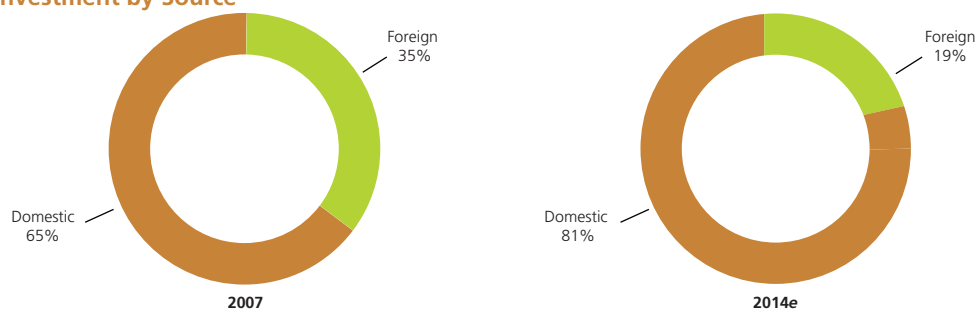
Going forward, the share of investment in the oil and gas sector is expected to decline slightly, but remain supported by new projects in the pipeline, including the Pengerang Integrated Petroleum Complex (PIPC).

Myth #4: Private investment in Malaysia is undertaken mainly by foreign entities

In 2014, an estimated 19% of private investment was accounted for by foreign direct investment (FDI). This share has declined from an estimated 35% in 2007. The bulk of private investment continues to be undertaken by Malaysian companies and funded domestically via the banking system, internally generated funds and capital markets.

Chart 3

Private Investment by Source



e Estimate

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

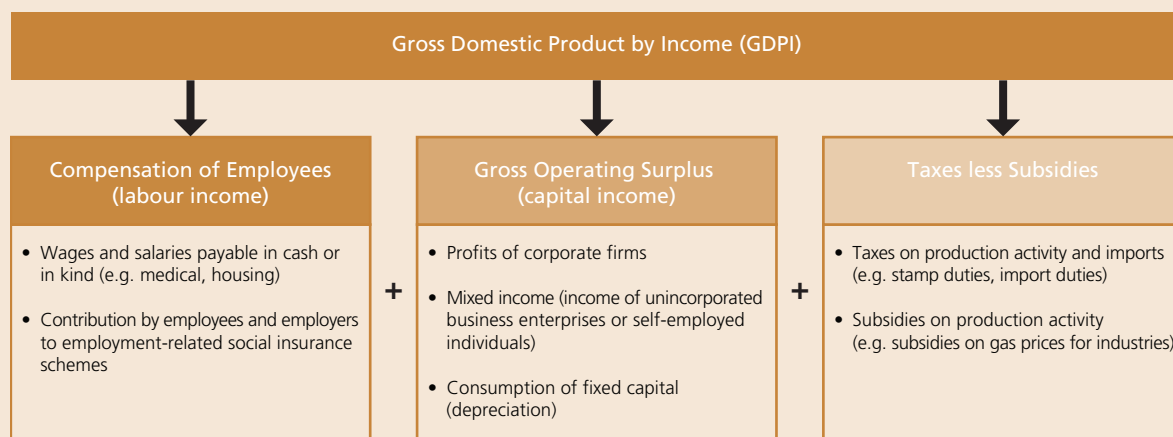
Trends in Malaysia's Gross Domestic Product by Income

Introduction

In July 2014, the Department of Statistics, Malaysia (DOSM) published the nominal Gross Domestic Product by Income (GDPI) for Malaysia, covering annual data from 2005 to 2013. This income-based approach complements the existing computations of Gross Domestic Product (GDP) using the production and expenditure approaches, thus providing more comprehensive information on Malaysia's economy. GDPI measures the total income that the production activity generates for the owners of capital, for labour and for the government (United Nations, 2004). The three components of GDPI are: (i) Compensation of Employees (CoE, henceforth referred to as labour income); (ii) Gross Operating Surplus (GOS, henceforth referred to as capital income); and (iii) Taxes less Subsidies on Production and Imports (Diagram 1).

Diagram 1

GDPI Consists of Three Components



Source: Department of Statistics, Malaysia

Drawing on the release of the GDPI data, this article provides a preliminary analysis on the trends in labour and capital income, with a special focus on the share of labour income in Malaysia.

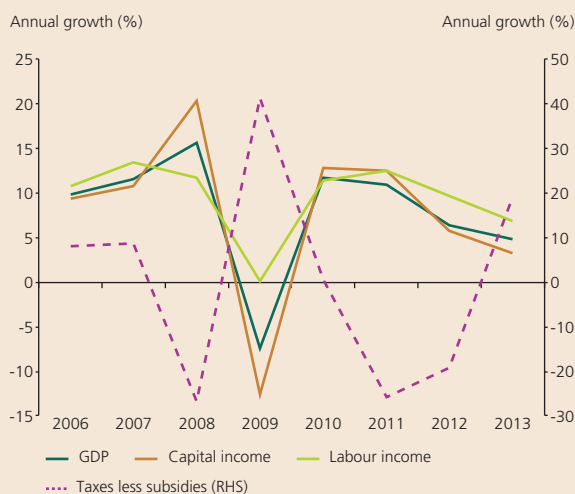
Growth trends of labour and capital income

The trends in the growth rates of the GDPI components relative to overall GDP are shown in Chart 1, whereby the growth rate of labour income is slightly more stable throughout the period relative to capital income. This reflects the fact that wages generally tend to be more sticky, and changes to overall income are more likely to be reflected in the returns to capital. This was observed during the height of the 2009 financial crisis in the advanced economies, when the contraction in nominal GDP was reflected in both capital income and labour income, but more so in the former rather than the latter.

Chart 2 shows the performance of labour and capital income by economic sectors in recent years. Between 2005 and 2013, labour income grew at a compounded annual growth rate of 9.5%, outpacing capital income growth of 7.4%. This trend partly reflected the strong performance of labour income growth in the services, construction and mining sectors. In the services sector, labour income recorded double-digit growth of 10.7% per annum, while capital income grew by 8.1%. Almost all services sub-sectors experienced higher growth in labour income compared with capital income, except for the transportation, storage and communication sub-sector. Similarly, labour income expanded at double-digit growth rates of 13.1% and 10.2% in the construction and mining sectors, respectively, outpacing the average growth of capital income.

Chart 1

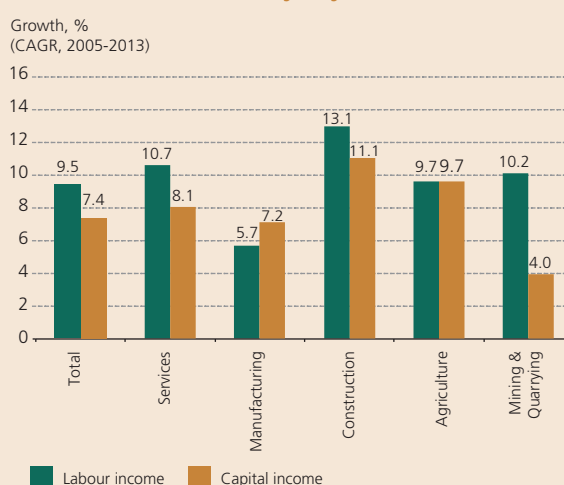
Growth Rates of Labour and Capital Income Co-move with Nominal GDP



Source: Department of Statistics, Malaysia

Chart 2

Average Growth in Labour Income Outpace Capital Income Growth, Driven by Key Sectors



Source: Department of Statistics, Malaysia

Chart 3

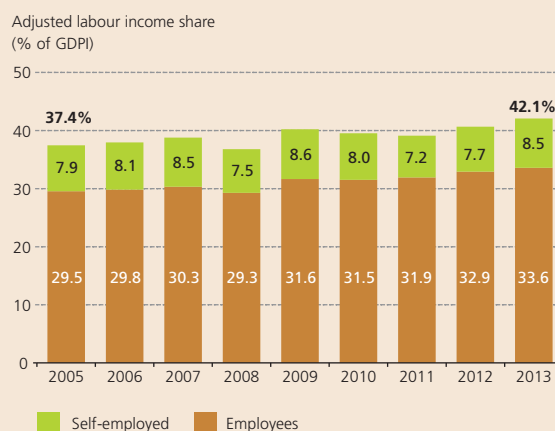
The Largest Component of GDP is Capital Income



Source: Department of Statistics, Malaysia

Chart 4

Labour Income Share Has Been Increasing Since 2005



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

Trends in share of labour income

In terms of share, capital income forms the largest component of GDP (Chart 3). However, with the growth of labour income outpacing the growth of capital income, the share of labour income to GDP has risen steadily from 29.5% in 2005 to 33.6% in 2013. By definition, however, the labour income component in GDP excludes income earned by self-employed individuals¹. Therefore, to be more representative of the actual overall labour income, Gollin (2002) suggested to include the estimated income earned by the self-employed workers, especially for countries with large numbers of self-employed individuals (see Explanation Box). With such adjustments, the share of labour income for Malaysia is higher, on average, by 8.0 ppt. throughout the period (Chart 4).

¹ A sub-component of capital income is mixed income (Diagram 1), which is income accrued to self-employed individuals or unincorporated businesses. The breakdown for mixed income in GDP, however, is not available.

Explanation Box: Adjusting labour income to include both employed and self-employed workers

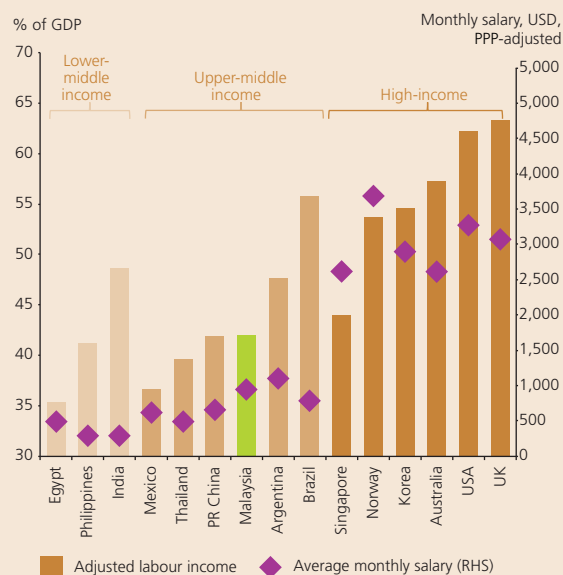
In Malaysia, self-employed individuals account for 21% of total employment (DOSM Labour Force Survey, 2013). As a result, the labour income component of GDP, by definition, is likely to understate the total income accrued to workers. Following Gollin (2002), the labour income is augmented by estimating the earnings of the self-employed. These estimates of self-employment earnings are removed from capital income and added to labour income, resulting in the adjusted labour income.

Both the adjusted and non-adjusted measures display a similar trend of the rising share of labour income between 2005 and 2013. By 2013, the adjusted labour income that included both employed and self-employed workers amounted to 42.1% of total GDP. Accordingly, the adjusted capital income is lower from 58.1% of total GDP in 2005 to 55.7% in 2013.

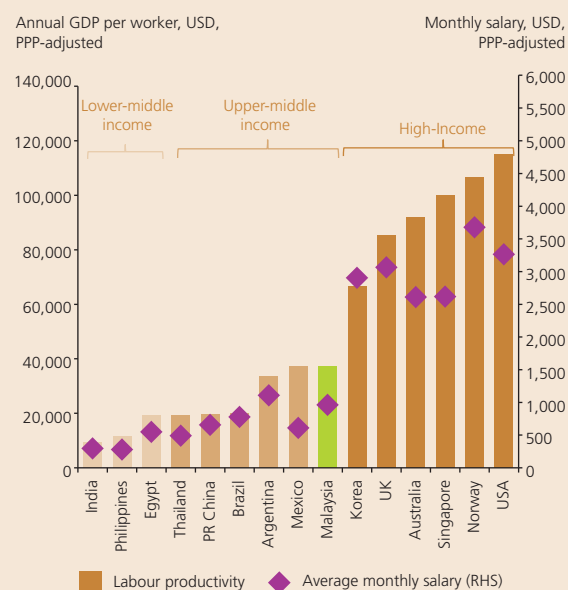
Cross-country comparison of labour income shares

Despite the rising trend, the labour income share in Malaysia, even after accounting for the income of the self-employed, remains relatively low compared with other upper-middle income economies (Chart 5). Within the region, Malaysia's adjusted labour income share (42.1%) is lower than Korea (54%) and Singapore (44%).

While this may be a cause for concern, it is important to note that a higher share of labour income does not necessarily correspond with higher average wages. As noted in both Chart 5 and 6, Brazil and India, for instance, have higher labour income shares than Malaysia, but lower average monthly wages. On the other hand, Singapore has a relatively low labour income share, but a high average wage level. Of significance, most advanced economies tend to have both high average salaries as well as higher labour income shares.

Chart 5**High Labour Income Shares Do Not Correspond with High Average Salaries**

Source: Penn World Table; Statista; Department of Statistics, Malaysia; and Bank Negara Malaysia estimates

Chart 6**Average Salaries Generally Coincide with Labour Productivity**

Source: The Conference Board; Statista; Department of Statistics, Malaysia; and Bank Negara Malaysia estimates

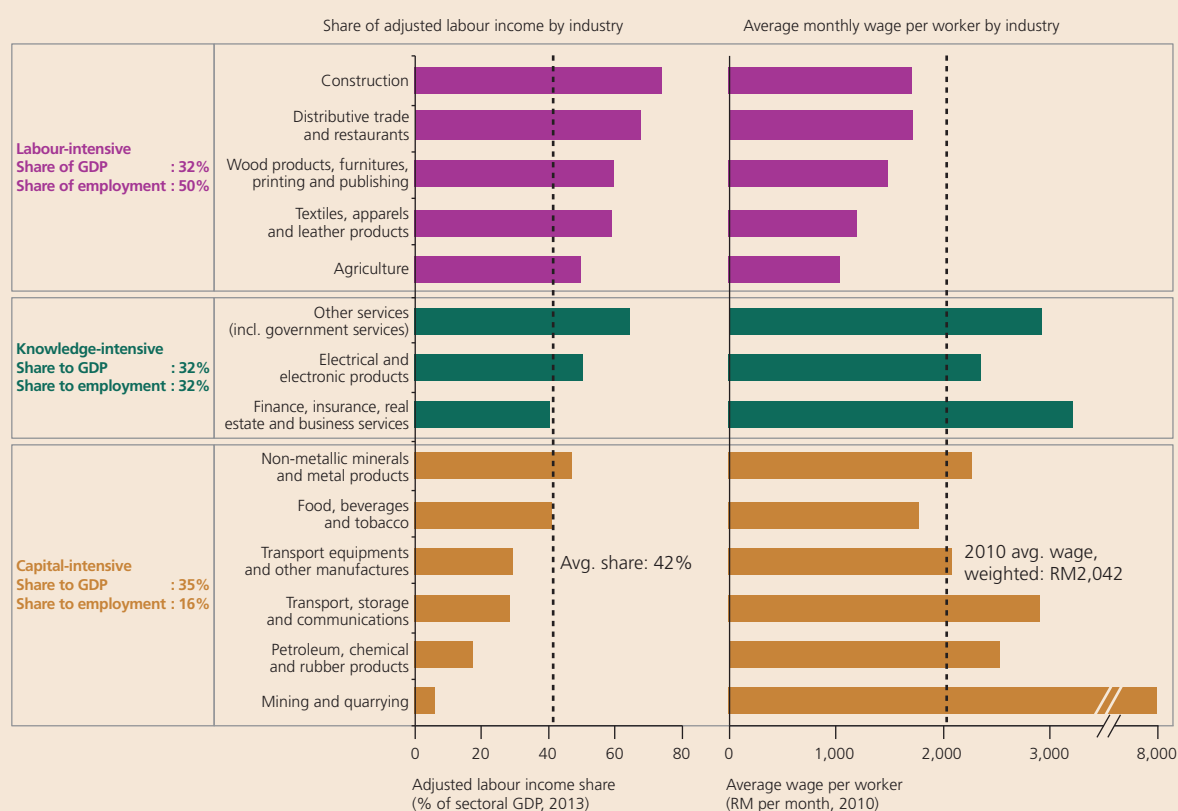
The cross-country variations are the outcome of differences in economic structures. Economies that are more involved in low-productivity, labour-intensive industries tend to have lower average wages but will have a high share of labour income in GDP due to the large pool of low-skilled workers. On the other hand, economies with higher productivity levels like Korea and Australia are characterised by high value-added activities with a preponderance of high-skilled jobs. These economies tend to enjoy high average wages which, in turn, correspond with high labour income shares as well. This is supported by Chart 6, which shows that average wages tend to correspond with productivity levels of the economies. This simply re-emphasises the point that high value-added economic activity and higher productivity levels are necessary to raise average wages and consequently, labour income shares in an economy.

Sectoral analysis of labour income shares and average wages in Malaysia

Turning specifically to Malaysia, a sectoral analysis is undertaken by classifying the industries into three broad categories², based on the intensity and quality of labour used as a factor of production, relative to capital. The first category is the labour-intensive industries, which has a large proportion of labour relative to capital. This includes the plantation, hotels and restaurant services, construction and manufacturing of furniture and garments industries. The capital-intensive industries, such as the oil and gas, and steel fabrication manufacturing industries, on the other hand, have a larger capital-to-labour ratio³.

Chart 7

High Labour Income Shares Do Not Necessarily Coincide with High Average Wages



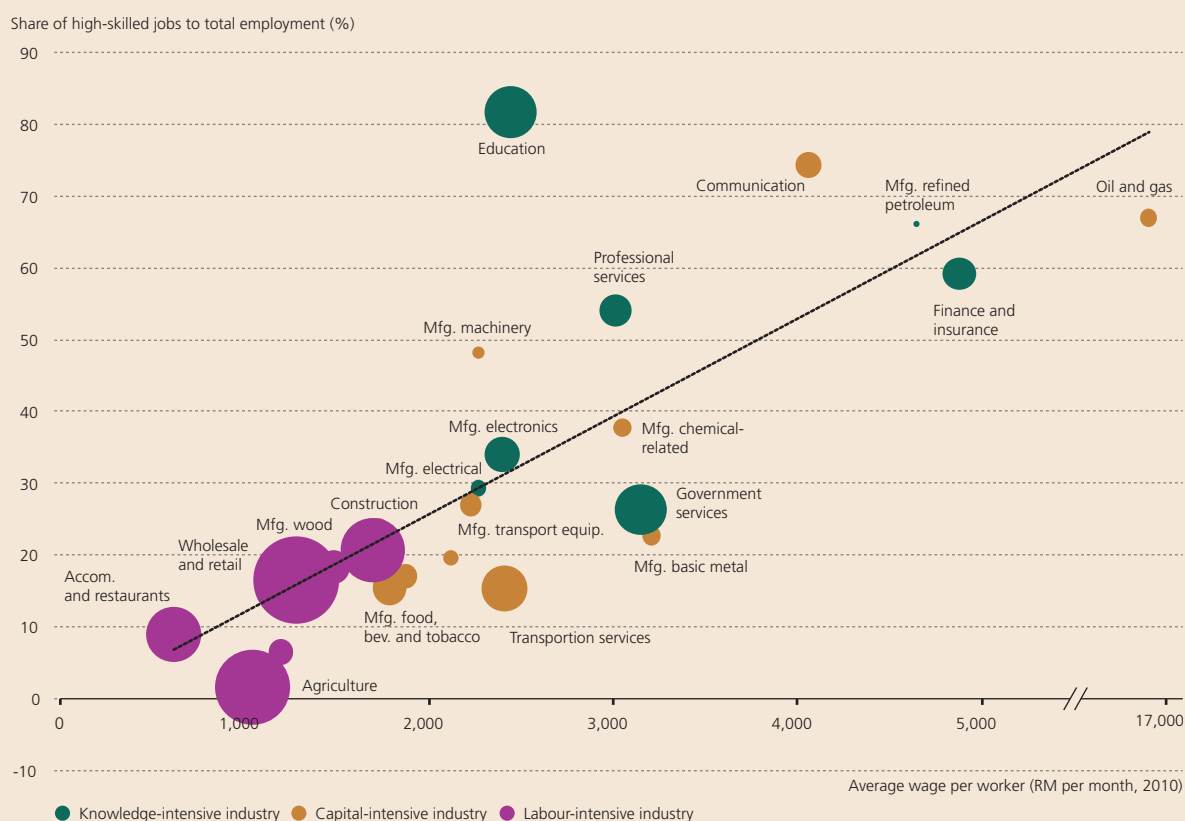
Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

² The classification of labour-intensive, capital-intensive and knowledge-intensive industries was adopted from McKinsey's 2012 report on global labour market development.

³ The labour-to-capital and capital-to-labour ratios are proxied by taking the ratios of employment to fixed assets, and vice versa.

Chart 8

Positive Relationship between Share of High-skilled Jobs and Average Wage Per Worker



The third category, the knowledge-intensive industries, refers to industries with large proportions of high-skilled⁴ employees, such as the design and development of electronics and electrical products and professional services industries.

Chart 7 provides a snapshot of the adjusted labour income shares and average wages⁵ across industries in Malaysia. Similar to the cross-country observations, the variations in labour income shares across industries do not necessarily correspond with the variations in average wage levels. For example, the share of labour income in the labour-intensive industries tends to be higher than average, but the average wage levels are lower than the national average. This may reflect the reliance of these industries on large groups of low-skilled, low-productivity workers, including low-skilled migrant workers⁶, and their slow pace of technological adoption.

On the other hand, wages in some capital-intensive industries tend to be higher than average, despite the lower-than-average share of labour income. This can be observed particularly in

⁴ High-skilled labour refers to employees in managerial positions, professionals, executives, technicians and associate professionals.

⁵ In this article, wages and salaries are used interchangeably to refer to basic wages, bonuses, commission, overtime pay, dismissal pay and allowances, before the deduction of employee's contribution to the Employees Provident Fund (EPF), social security schemes and other deductions.

⁶ The share of foreign labour is particularly high in the oil palm plantation (close to 80% of workforce) and in the construction and manufacture of wood-related products (36% and 31% of workforce in the respective industries). The national average share of foreign workers is 17% of total employment in 2013.

industries which utilise advanced and complex machinery and automation processes, and require fewer but mostly highly-skilled workers. The oil and gas, and petroleum-related products industries are examples of this category.

More interestingly, the knowledge-based industries have both higher-than-average wage levels and share of labour income. This is due to their dependence on a highly-skilled workforce, which command higher wages. As shown in Chart 8, given that high-skilled workers are typically more productive, the wages earned by these workers tend to be higher. This is also consistent with the earlier observations in the cross-country comparison.

Conclusion

In summary, the GDP by income approach captures the total income accrued to households and firms engaged in the productive activity of an economy. In Malaysia, on average, capital income constitutes the largest component of GDPI. The share of labour income, however, has been increasing gradually between 2005 and 2013. The analysis presented in this article reinforces the need for Malaysia to continue to focus on strategies to increase the average wage levels, with the effect of raising the share of labour income. This could be achieved through the promotion of high value-added economic activities and through attracting quality investments, particularly in the knowledge-intensive industries, which will create more opportunities for high-skilled, high-paying jobs. Equally important are strategies to increase productivity in all areas of economic activity through the adoption of more advanced technology and elevating the overall skill level of the workforce. Finally, a comprehensive development of high quality human capital remains paramount in the country's progress into a highly productive and high income economy.

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EXTERNAL SECTOR

In 2014, Malaysia's external sector remained resilient amid continued uncertainty in the global economic and financial environment. The trade and current account surpluses widened. The level of international reserves of Bank Negara Malaysia remained high and were more than sufficient to meet short-term external obligations and to provide ample buffers against external shocks.

The external sector remained resilient amid continued uncertainty in the global environment

The performance of the external sector in 2014 was characterised by two distinct periods. In the first half of the year, the current account recorded a higher surplus of RM35.8 billion, driven by a stronger trade surplus amid lower services and income deficits. Gross exports grew strongly by 12.5%, continuing the trend that began in the third quarter of 2013. The growth performance was broad-based amid an improvement in demand across markets and products.

The strong growth of E&E exports (1H 2014: 13.2%) was primarily supported by an improvement in demand for semiconductors, as manufacturers increasingly diversify away from the personal computers sub-segment into several fast-growing

Table 1.6

Balance of Payments¹

Item	2013			2014 ^p		
	+	-	Net	+	-	Net
	RM billion					
Goods	679.1	570.9	108.2	726.0	601.0	125.1
Services	126.8	143.5	-16.7	126.2	146.7	-20.5
Balance on goods and services	806.0	714.4	91.5	852.2	747.7	104.5
Primary Income	47.5	81.6	-34.1	51.8	89.2	-37.4
Secondary Income	7.6	25.1	-17.5	10.3	27.9	-17.6
Balance on current account	861.0	821.1	39.9	914.3	864.8	49.5
% of GNI			4.2			4.8
Capital account			-0.0			0.3
Financial account			-15.8			-76.5
Direct investment ²			-5.5			-17.1
Assets			-41.2			-51.3
Liabilities			35.7			34.2
Portfolio investment			-3.0			-37.9
Assets			-32.1			-28.3
Liabilities			29.1			-9.6
Financial derivatives			-0.3			-1.0
Other investment			-7.1			-20.6
Balance on capital and financial accounts			-15.8			-76.2
Errors and omissions (E&O) ³			-9.4			-9.8
of which:						
Foreign exchange revaluation gain (+) or loss (-)			18.6			7.6
Net E&O as % of total trade			-0.7			-0.7
Overall balance			14.6			-36.5
Bank Negara Malaysia international reserves, net			441.9			405.3
USD billion equivalent			134.9			115.9

¹ The balance of payments 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 Asset flows also referred to as 'Outward direct investment'; while liability flows are also referred to as 'Inward direct investment'

³ 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

Table 1.7

External Trade

	2013	2014 ^p
	Annual change (%)	
Gross exports	2.5	6.4
Manufactures	5.7	7.3
<i>Electronics and electrical (E&E)¹</i>	3.0	8.4
<i>Non-E&E</i>	8.3	6.3
Commodities	-4.4	4.5
<i>Agriculture</i>	-14.4	0.6
<i>Minerals</i>	4.2	7.3
Gross imports	6.9	5.3
Capital goods	2.2	-2.1
Intermediate goods	4.3	7.6
Consumption goods	8.8	5.7

¹ Including machinery and equipment^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

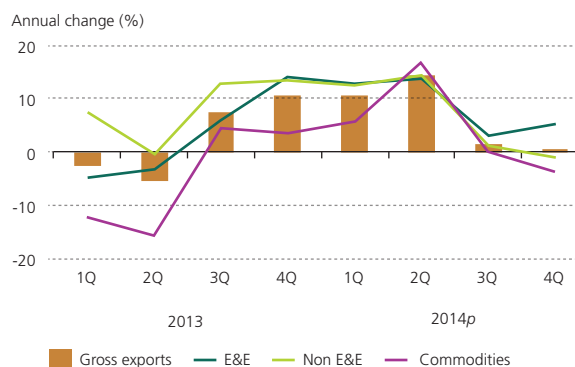
sub-segments such as automotive components and mobile devices. The continued growth in the regional economies and strong re-export activity supported the performance of non-E&E manufactured exports (1H 2014: 13.4%) such as petroleum products, chemicals and chemical products as well as optical and scientific equipment. Higher prices and strong demand for Malaysia's key commodity exports, in particular crude petroleum and LNG, also supported the robust overall export performance in the first half of the year.

Import growth was also relatively high in the first half of the year (7.1%). The strength of manufactured exports and robust investment and consumption activities had contributed to the strong growth in all major components of imports. The services and income deficits narrowed during this period, attributed mainly to higher net travel receipts and lower net primary income payments, respectively. The increase in net travel receipts was due to the higher number of tourist arrivals particularly in the first quarter, while higher profits of Malaysian companies investing abroad contributed to the decrease in net income payments.

In the second half of the year, the current account surplus narrowed to RM13.7 billion. The slower export growth (2H 2014: 1.0%) was attributed partly to a base effect from the

Chart 1.3

Export Performance

^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

second half of 2013 when exports started to register strong growth, and lower crude oil prices in the fourth quarter. The performance of E&E exports moderated but continued to register positive growth (2H 2014: 4.2%). Imports grew at a slower pace of 3.6% in 2H 2014, amid a slowdown in imports of capital and consumption goods following the moderation in domestic demand. Intermediate imports, however, expanded at a stronger pace driven by a continued expansion in manufacturing activity as well as a relocation of a multi-national company's operations to Malaysia.

A major external development in the second half-year was the sharp decline in global crude oil prices to USD56.40 per barrel (Brent) on 31 December 2014, the lowest level since May 2009. Nevertheless, this development did not significantly impact the overall trade balance in 2014 because the impact of lower crude oil prices on crude oil exports was accompanied by a decline in prices of oil-related imports. While Malaysia was a net exporter of crude oil with net exports amounting to RM8.8 billion in 2014, the country remained a net importer of petroleum products during the same period with net imports of RM9.7 billion. Meanwhile, prices of LNG and CPO, which account for the bulk of the trade balance, remained relatively high in 2014 despite the decline in crude oil prices, providing support to overall commodity exports.

The services deficit in the current account had widened, driven by lower net travel receipts and higher net transportation payments. High-profiled tragic air incidents played a contributing role in

Chart 1.4

Import Performance



p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

the lower tourist arrivals during the second half of the year, while higher outbound travel was observed during the same period, thus contributing to the decrease in net travel receipts. The income deficit also widened in the second half, due to the higher profits made by foreign direct investors in Malaysia which more than offset income earned by Malaysian companies operating abroad.

Overall, the current account recorded a larger surplus of RM49.5 billion or 4.8% of gross national income (GNI) in 2014 (2013: RM39.9 billion or 4.2% of GNI), as reflected in the wider savings-investment (S-I) surplus. Gross national savings expanded by 7.3% to 30.9% of GNI (2013: -0.4% and 31.2% of GNI, respectively), while total gross capital formation grew at a slower pace of 4.8% (2013: 5.4%). The widening of the private sector S-I surplus,

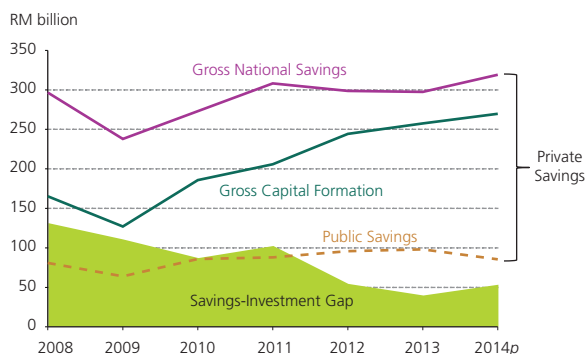
which more than offset the public sector S-I deficit, contributed to the higher S-I surplus during the year. Private sector savings increased at a faster rate of 18.3% to RM235.7 billion (2013: -1.7% and RM199.3 billion, respectively), while private gross capital formation expanded by 10.2% (2013: 7.1%). On the other hand, both public sector savings and gross capital formation contracted in 2014. However, public sector savings registered a larger decline of 14.9% to RM83.5 billion, due to the lower operating surplus of public enterprises, compared to a decline of 3.3% in public gross capital formation (2013: +2.2% and +3.1%, respectively).

As an open economy, Malaysia continued to experience two-way capital flows amid an environment of volatile global financial market conditions in 2014. In the financial account, long-term investment flows remained sizeable, primarily in the form of foreign direct investment. The country's deep capital markets, resilient growth performance and on-going structural and fiscal reform measures, also attracted portfolio investments from international investors. These short-term portfolio investments were, however, subjected to heightened volatility in the international financial markets, particularly in the second half of the year. Direct investment abroad by Malaysian companies and acquisitions of portfolio assets by domestic investors increased during the year. Overall, these developments resulted in a net outflow of RM76.5 billion in the financial account for the year (2013: net outflows of RM15.8 billion).

Despite uncertainties surrounding global growth during the year, Malaysia's economic resilience and stable growth prospects continued to support foreign investor confidence, leading to sustained inward direct investment flows of RM34.2 billion, or 3.3% of GNI (2013: inflows of RM35.7 billion, or 3.7% of GNI). These flows were predominantly in the form of foreign direct investment (FDI), through injections of equity capital, while the continued profitability of multinational companies (MNCs) resulted in continued favourable earnings retained in the country for the purpose of reinvestment. During the year, FDI was mainly undertaken to finance exploration and extraction activities in the mining sector, support strategic acquisitions in the financial sub-sector, and investments in the distributive trade services sub-sector. FDI in the manufacturing sector

Chart 1.5

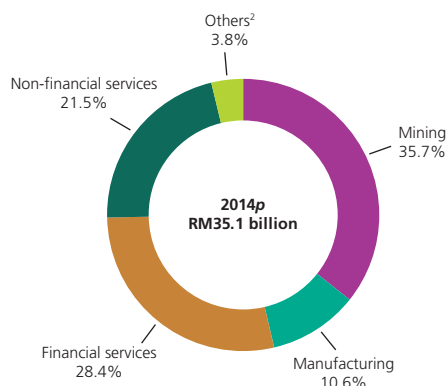
Gross National Savings and Savings-Investment Gap



p Preliminary

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

Chart 1.6

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

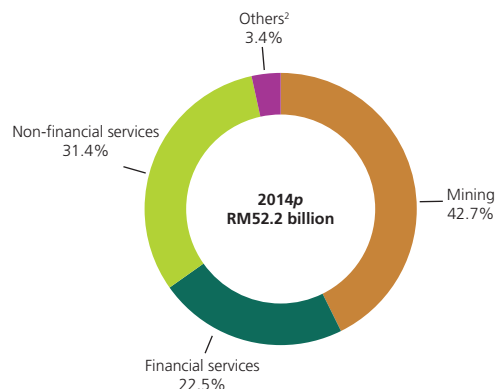
Source: Department of Statistics, Malaysia

moderated during the year. In terms of source countries, these FDI flows emanated from the advanced economies, particularly the Netherlands. Among the Asian economies, there were sizeable investments from Singapore and Hong Kong.

On the assets side, outward direct investment registered higher outflows of RM51.3 billion, or 5.0% of GNI (2013: outflows of RM41.2 billion or 4.3% of GNI). These outflows comprised mainly direct investment abroad (DIA) by Malaysian companies. The higher DIA was supported by larger extensions of intercompany loans to subsidiaries operating abroad, amid relatively sustained equity capital and earnings retained abroad for reinvestment. DIA in the mining sector remained large, attributable to the continued expansion in the international operations of Malaysian oil and gas companies. Investments in the services sector were primarily in the information and communications segment in India and the financial services sub-sector in the regional economies.

Portfolio investment flows by non-residents exhibited considerable volatility during the year, mainly on account of external factors. In January, widespread concerns over the timing and pace of the scale back of the Fed's quantitative easing (QE) programme led to significant rebalancing of international investors' portfolio assets, resulting in a

Chart 1.7

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

broad-based outflow from emerging market economies. Nevertheless, despite the tapering and the eventual conclusion of the Fed's QE programme, Malaysia's relatively robust domestic fundamentals and, to a lesser extent, increased expectations of a higher OPR, had attracted foreign portfolio investments for most of the year. Net inflows of non-resident portfolio investment amounted to RM11 billion in the first three quarters of 2014. These inflows were mainly channelled into the public debt securities market, whereby non-resident holdings of ringgit-denominated public debt securities rose to 27.5% of total outstanding public debt securities in July (end-2013: 25.7%). Foreign participation in the equity market increased to 24.1% of total market capitalisation at mid-July (end-2013: 23.9%), in line with the increase in the KLCI, which peaked at 1,892.7 points in the same month (end-2013: 1,867.0 points).

In September, however, investor sentiments took a negative turn. Concerns over weakening global growth prospects and the possibility of monetary policy normalisation in the US, led to outflows of portfolio investment and the subsequent decline of most EME currencies. For Malaysia, investor confidence and sentiments were further affected by the rapid decline in oil prices. These factors had led to an intensification of outflows towards the end of November and in early December. As a result, in the fourth quarter, non-resident portfolio investment experienced a net outflow

of RM20.6 billion, mainly from the selling and liquidation of Bank Negara Monetary Notes (BNMNs) upon maturity. Consequently, non-resident holdings of BNMNs declined to 56.6% of total outstanding BNMNs at end-2014 (2013: 72.5%). The issuance of BNMNs was part of the Bank's monetary policy operations to absorb excess liquidity from the banking system. The selling of BNMNs by non-residents did not materially affect bond yields and therefore pose no material impact to financial stability. As a whole, non-resident holdings of public debt instruments declined to 23% of total outstanding public debt securities as at end-2014 (end-September 2014: 25.9%). Nevertheless, non-resident participation in the equity market remained steady at around 24% of total market capitalisation, despite the decline of the KLCI by 5.7% to close at 1,761.3 points. For the year as a whole, non-resident portfolio investments registered a net outflow of RM9.6 billion (2013: net inflow of RM29.1 billion).

Portfolio investment by residents recorded an outflow of RM28.3 billion in 2014 (2013: -RM32.1 billion) as domestic institutional investors, including unit trusts and fund management companies, continued with their strategy of diversifying into global equity and fixed income assets in order to enhance the value of returns to their members. Collectively, resident and non-resident portfolio investment recorded a net outflow of RM37.9 billion in 2014 (2013: net outflow of RM3.0 billion).

While the greater volatility in global financial markets contributed to large swings in Malaysia's portfolio flows, the impact on domestic financial markets has been cushioned by the role of domestic institutional investors in providing continued demand for domestic financial assets. Furthermore, deep and diversified domestic financial markets were able to accommodate the large gross volumes of capital flows, as observed by the uninterrupted functioning of domestic financial markets and financial intermediation in the real economy. The high level of international reserves acted as a buffer in preventing excessive fluctuations in the exchange rate during the periods of large reversals of short-term flows. Additionally, the adjustments in the ringgit also absorbed some of the shocks emanating from the turbulent international financial markets. Thus, greater exchange rate flexibility, deeper financial markets, a strong banking system, adequate international reserves buffer and the availability of more

Chart 1.8

Portfolio Investment



p Preliminary

Source: Department of Statistics, Malaysia

policy instruments have strengthened Malaysia's resilience to sharp movements in capital flows and ensured that the real economy is not affected by this volatility.

Other investment also recorded outflows of RM20.6 billion (2013: outflow of RM7.1 billion), as net extension of trade credit and repayments of external loans by the public sector had more than offset the net inflows received by the banking sector. During the year, the net inflows in the banking sector were mainly from the placement of deposits by non-residents and interbank borrowings to manage their foreign exchange liquidity exposures.

Following these developments, the overall balance of payments registered a deficit of RM36.5 billion in 2014 (2013: +RM14.6 billion). Errors and Omissions (E&O) amounted to -RM9.8 billion or -0.7% of total trade, partly reflecting foreign exchange revaluation gains on international reserves. Excluding revaluation gains, the E&O stood at -RM17.4 billion or -1.2% of total trade.

The international reserves of Bank Negara Malaysia amounted to RM405.3 billion (equivalent to USD115.9 billion) at end-2014 (end-2013: RM441.9 billion or equivalent to USD134.9 billion). The decline in reserves during the year reflected the relatively higher net capital outflows which offset the current account surplus. The reserves as at end-2014 has also taken into account the cumulative unrealised foreign exchange revaluation gain following the depreciation of the ringgit against major and regional currencies,

particularly in the fourth quarter of 2014. As at 27 February 2015, the reserves level amounted to RM386.0 billion (equivalent to USD110.5 billion). The reserves, which remained ample and continues to be useable and unencumbered, are sufficient to finance 7.9 months of retained imports and is 1.1 times the short-term external debt.

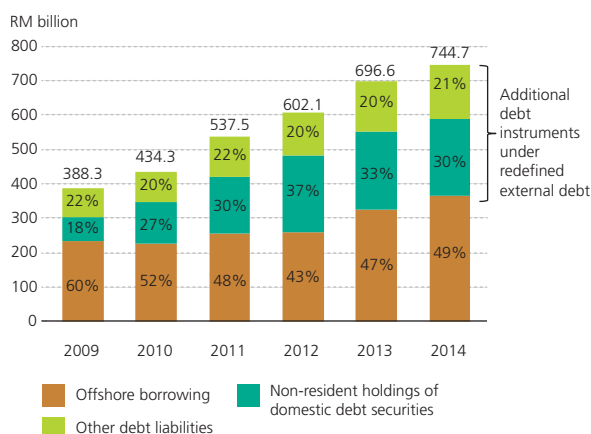
Manageable external debt

With effect from the first quarter of 2014², Malaysia's external debt was redefined to be consistent with the latest international best practice. The redefined external debt better reflects the increasing depth and breadth of Malaysia's financial markets and the consequent rise in foreign investors' participation in domestic debt securities. Of note, about two-thirds of the increase in the total external debt arising from the redefinition was attributed to the inclusion of non-resident holdings of domestic debt securities, in particular MGS and BNMNs, as external debt.

Malaysia's external debt amounted to RM744.7 billion as at end-2014 (end-2013: RM696.6 billion), which is equivalent to USD211.0 billion or 69.6% of GDP. During the year, the rise in external debt was attributed partly to the valuation effects from the depreciation of the ringgit, particularly in the fourth quarter of 2014. The depreciation affected mainly the offshore borrowing, which increased to RM367.1 billion as at end-2014 (end-2013: RM324.1 billion).

Chart 1.9

Outstanding External Debt (end-period)

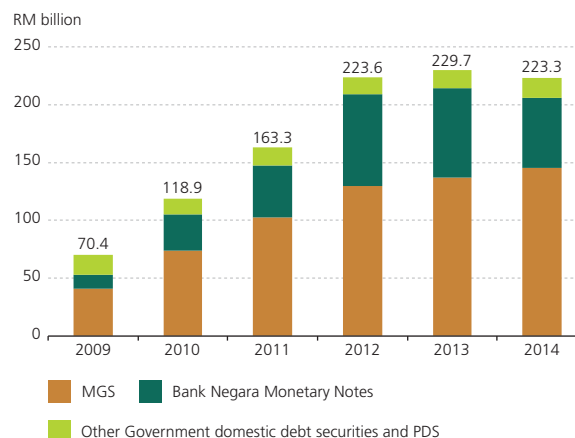


Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

² 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.

Chart 1.10

Non-Resident Holdings of Domestic Debt Securities



Source: Bank Negara Malaysia

Excluding the foreign exchange revaluation changes, the increase in offshore borrowing reflected largely the net drawdown of offshore borrowing by both banks and non-bank private sector. The increase in non-resident deposits in the banking system also contributed to the higher external debt.

The medium- and long-term offshore borrowing was higher on account of the net borrowing by the private sector, which was partially offset by net repayment by the public sector. The Federal Government continued to register a net repayment position in its offshore borrowing. At the end of 2014, the offshore borrowing of the Federal Government remained small at 4.6% of total offshore borrowing and 1.6% of GDP. The public enterprises turned around to record a net repayment position in 2014, due, in particular, to the maturity of several bonds and sukuk in the third quarter. Both banks and non-bank corporations contributed to the higher offshore borrowing by the private sector. For banks, this arises from their efforts to diversify the maturity structure of debt obligations of their funding. For the private sector corporations, several factors contributed to the increase in offshore borrowings. These include the lower cost of funds, the favourable borrowing terms and the need to finance expansion of their overseas operations. Nonetheless, these borrowings remained at a sustainable level given that 70% of the corporate sector's offshore borrowings were sourced from offshore shareholders, parent companies and associated companies. In addition, risks associated with exchange rate

Table 1.8

Outstanding External Debt

	2013	2014
	RM billion	
Offshore borrowing ¹	324.1	367.1
Medium- and long-term	196.0	210.9
Public sector	98.9	93.1
Private sector	97.1	117.8
Short-term	128.1	156.2
NR holdings of dom. debt securities	229.7	223.3
Medium- and long-term	151.1	162.4
Short-term	78.6	60.9
NR deposits	77.3	87.7
Others ²	65.5	66.7
Medium- and long-term	10.7	10.6
Short-term	54.8	56.0
Total external debt	696.6	744.7
USD billion equivalent	209.8	211.0
External Debt (Previous definition)		
Total debt/GDP (%)	32.8	34.3
Short-term debt ³ /Total debt (%)	39.5	42.6
Reserves/Short-term debt ³ (times)	3.4	2.5 ⁵
Debt service ratio (% of exports of goods and services)	10.4	10.8
External Debt (Redefined)		
Total debt/GDP (%)	70.6	69.6
Short-term debt ⁴ /Total debt (%)	48.6	48.4
Reserves/Short-term debt ⁴ (times)	1.3	1.1 ⁵
Debt service ratio (% of exports of goods and services)	17.6	18.2

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 Equivalent to short-term offshore borrowing

⁴ Short-term offshore borrowing, NR holdings of short-term domestic debt securities, NR deposits and other short-term debt

⁵ Based on international reserves as at 27 February 2015

Note: NR refers to non-residents

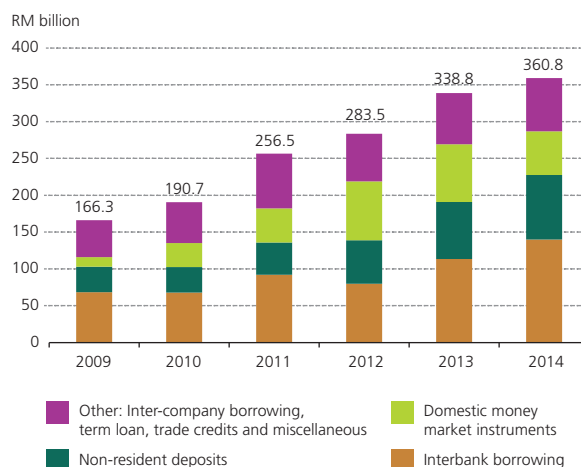
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

fluctuations are minimal for these corporations as their external borrowings were largely hedged, either naturally through foreign currency earnings, or through the use of financial instruments.

The increase in short-term interbank offshore borrowing does not pose any risk as it accounted for small share of the banking system's total funding. Both domestic and locally incorporated foreign banks continued to rely mainly on ringgit deposits for funding. The short-term interbank offshore borrowing mainly reflects the banking sector's centralised foreign currency liquidity

Chart 1.11

Short-Term External Debt by Instruments



Source: Bank Negara Malaysia

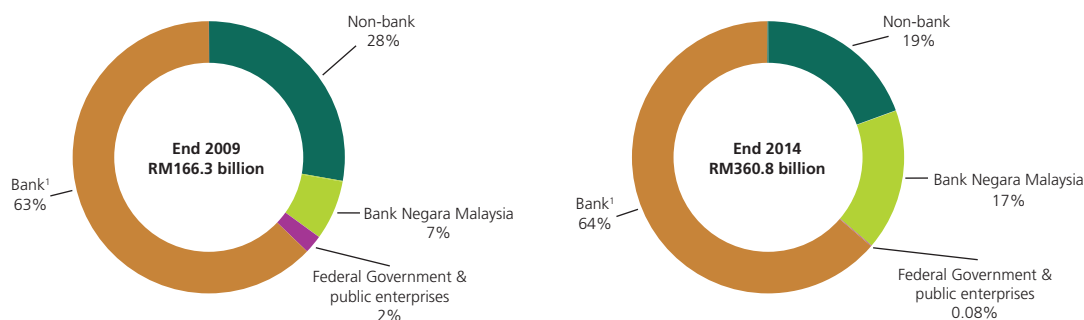
management. Under this arrangement, offshore subsidiaries and branches of domestic banks had increasingly placed funds with their head offices in Malaysia. This is deemed as a more cost-effective and efficient management of foreign currency liquidity. For the locally incorporated foreign banks operating in Malaysia, these borrowings reflected placements of deposits by the overseas entities within the group, including funding arrangement with parent banks. Partly due to this, the non-resident deposits amounted to RM87.7 billion as at end-2014 (end-2013: RM77.3 billion).

Amid Malaysia's favourable growth prospects, non-resident holdings of domestic debt securities rose steadily, particularly in the first three quarters of 2014. Nevertheless, this trend reversed in the fourth quarter following weaker investor sentiment amid higher uncertainty over global growth prospects, expectations of monetary policy normalisation in the US and a sharp decline in oil prices. The liquidation of non-resident holdings in the fourth quarter, was however, largely confined to BNMNs, while non-resident holdings of MGS declined marginally.

Malaysia's external debt remains manageable and poses a low risk to the economy. As 41% of Malaysia's external debt is denominated in ringgit, the impact of foreign exchange fluctuations on Malaysia's external debt is contained. Stress tests conducted on large non-bank corporate borrowers indicate that these corporations would remain

Chart 1.12

Short-Term External Debt by Sector



¹ Include other debt liabilities, apart from interbank borrowing and non-resident deposits

Note: Numbers may not necessarily add up due to rounding

Source: Bank Negara Malaysia

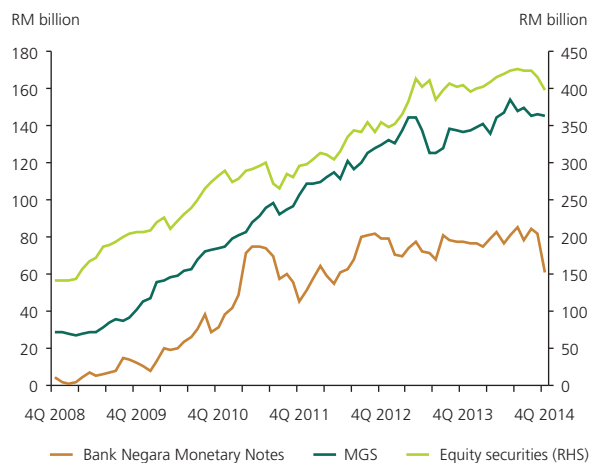
resilient. Even a severe depreciation of the ringgit against the US dollar would have limited impact on their debt servicing capacity and solvency position. In addition, the maturity profile of Malaysia's external debt remained healthy, with more than half skewed towards the medium- and long-term tenure. Risks associated with short-term external debt are manageable. Interbank borrowing and non-resident deposits accounted for 63% of the short-term external debt and represent a small share of banks' total funding. In addition, 52% of non-resident deposits are denominated in ringgit. Furthermore, the non-resident holdings of money market instruments reflected BNM's monetary policy operations to absorb excess liquidity from the banking system.

Trade credit, which forms the bulk of the 'Other short-term debt liabilities' component of the external debt, was relatively sustained in 2014. It accounts for a small share of the short-term external debt and is fundamentally in line with import activity. More importantly, it is generally backed by export earnings.

Overall, while Malaysia's external debt level has increased, external indebtedness indicators remain within the international benchmark for prudence and external soundness. This includes an ample liquidity buffer of 1.1 times international reserves coverage of the short-term external debt and a low overall debt service ratio of 18.2% of exports of goods and services (2013: 17.6%).

Chart 1.13

Non-Resident Holdings of MGS, Bank Negara Monetary Notes and Equity Securities



Source: Bank Negara Malaysia

Resilience against external shocks

As a highly open economy and amid increasing integration with the global economy and financial markets, Malaysia is not insulated from the uncertainty and risks emanating from the external environment. However, the greater degree of resilience, buffers and flexibility that have been built steadily over the years have positioned the country to weather such external shocks. Domestic fundamentals remain sound, enabling strong defence against potential vulnerabilities arising from the external front. Well-developed capital markets, strong financial intermediaries, and the presence of large domestic institutional investors provide the financial system with greater resilience. The wide range of monetary instruments, high level of international reserves and manageable level of external debt also accord the country with the policy flexibility to absorb external shocks.

INFLATION DEVELOPMENTS

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), averaged at 3.2% in 2014 (2013: 2.1%), within the lower end of the Bank's forecasted range of 3 – 4%. Headline inflation continued its uptrend in the first three months of the year following the upward adjustments in administered prices in September 2013 and January 2014. However, it peaked at 3.5% in March, before stabilising around 3.3% from April to August. Inflation subsequently moderated during the last four months of the year to an average of 2.8%. This reflected the moderation in food inflation as well as the lapse of the impact of the September 2013 fuel price adjustments. Although there were upward revisions in fuel prices in October, petrol prices were subsequently readjusted downward in December to reflect the prevailing lower global oil prices. This was following the implementation of the managed float pricing mechanism for fuel. Demand pressures were moderate, with core inflation³ increasing to 2.4% (2013: 1.8%) during the year, reflecting the spillover effects from adjustments in administered prices and higher rentals.

In terms of components, the increase in headline inflation in 2014 was due mainly to higher inflation in the *transport; alcoholic beverages and tobacco*; and *housing, water, electricity, gas and other fuels* categories, which together accounted for 90% of the overall increase in inflation. The *transport*

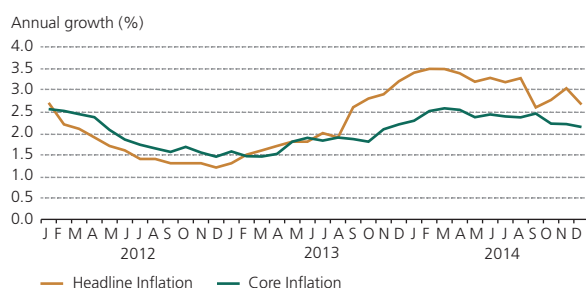
category registered a higher rate of inflation of 4.9% (2013: 2.0%) due to higher retail fuel prices during the year. Inflation in the *alcoholic beverages and tobacco* category also increased significantly by almost twofold to 11.6% (2013: 6.0%), primarily from higher cigarette prices. Inflation in the *housing, water, electricity, gas and other fuels* category also increased to 3.4% in 2014 (2013: 1.7%), reflecting the upward adjustment in electricity tariffs and a broad-based increase in rentals across different types of residential property. Overall, eight out of the twelve categories of consumer goods and services registered higher inflation rates in 2014.

In terms of determinants, inflation during the year was driven mainly by domestic cost factors arising from upward adjustments in the prices of several price-administered items since late 2013 (Table 1.9). These price adjustments led to some spillover effects on the prices of other goods and services, especially in the *restaurants and hotels* and *clothing and footwear* categories. The extent of spillovers was, however, contained as the price adjustments took place at a time of subdued global price pressures and moderate domestic demand pressures.

Global price pressures were subdued during the year given the moderation in global commodity prices. Inflation in Malaysia's main import partners' economies was also lower, reflecting the decline in global commodity prices and their more moderate

Chart 1.14

Consumer Price Inflation

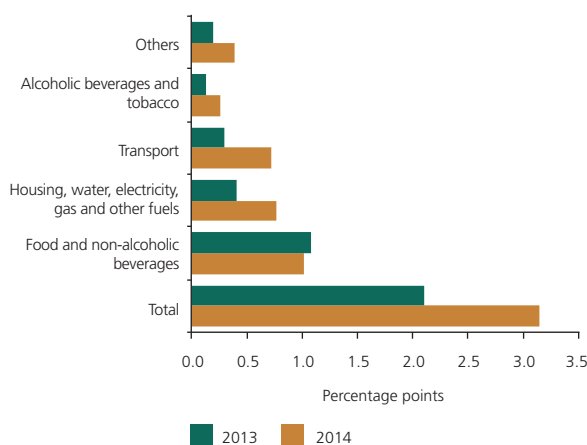


Source: Department of Statistics, Malaysia and Bank Negara Malaysia

³ Core inflation attempts to measure the underlying inflation rate, after excluding price-volatile and price-administered items whose price movements are not likely to be related to changes in demand conditions. However, as it is not possible to distinctively separate demand-related and supply-related inflation, prices of goods and services in the core CPI basket are likely to also reflect the spillover effects from transitory changes in cost and supply factors, such as supply disruptions and price adjustments.

Chart 1.15

Contribution to Inflation



Note: Others refer to *communication; clothing and footwear; health; recreation services and culture; furnishings, household equipment and routine household maintenance; restaurants and hotels; education; and miscellaneous goods and services*

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

domestic demand conditions. The moderation in global commodity prices was underpinned by improvements in the supply of commodities against a modest increase in global demand. Specifically, the modest growth in global food demand, in the absence of any significant disruptions to food supplies, led to lower global food prices compared to the previous year, as reflected in the decline of 4.1% in the IMF's Food Price Index⁴. Global crude oil prices also moderated during the year to average USD96 per barrel (2013: USD104 per barrel)⁵. Of significance is the sharp fall in global crude oil prices after June, reaching an average of USD61 per barrel by December⁶. The oil price decline was largely attributable to increased shale oil production in the United States amid continued large supply from OPEC member countries, which pushed oil

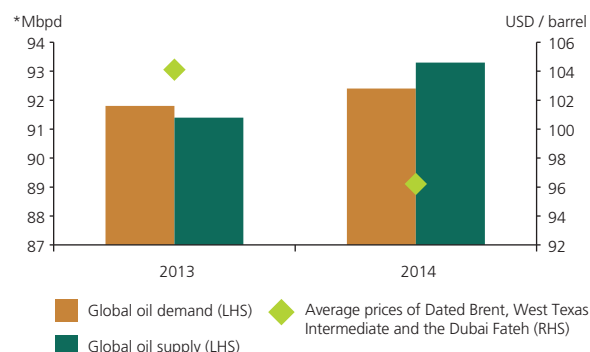
Table 1.9
Adjustments in Administered Prices in late 2013 and 2014

Date	Items	Quantum of Adjustment	
		RM	%
3 September 2013	RON95 petrol Diesel	+20 sen/litre +20 sen/litre	10.5 11.1
30 September 2013	Cigarettes	+RM1.50/pack of 20s	14.3
26 October 2013	Sugar	+34 sen/kg	13.6
1 January 2014	Electricity	Average of 3 sen/kWh for households	10.6
2 October 2014	RON95 petrol Diesel	+20 sen/litre +20 sen/litre	9.5 10.0
5 November 2014	Cigarettes	+RM1.50/pack of 20s	12.5
1 December 2014	RON95 petrol Diesel	-4 sen/litre +3 sen/litre	-1.7 1.4

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

⁵ Simple average of price of Dated Brent, West Texas Intermediate and the Dubai Fateh crude oil.

⁶ Global crude oil prices were elevated in the first half of the year amid heightened geopolitical tensions in major oil producing countries in the Middle East.

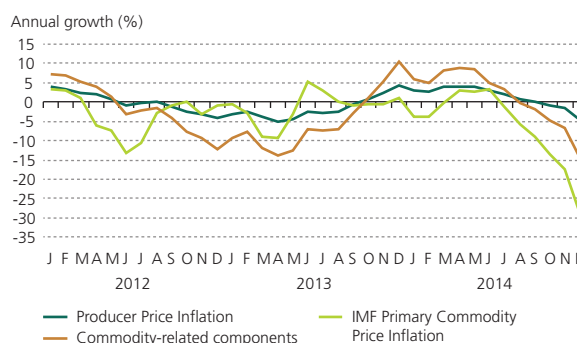
Chart 1.16
Global Demand, Supply and Price of Crude Oil


*Mbpd = Million barrels per day

Source: International Energy Agency (IEA) and International Monetary Fund (IMF)

production to increase in excess of the modest increase in demand for oil (Chart 1.16). As a result, the Producer Price Index (PPI) recorded only a modest increase of 1.4% in 2014 (2013: -1.7%) and was trending downwards in the second half of the year, reflecting the declining commodity prices during the period (Chart 1.17).

Demand pressures during the year were stable amid sustained private consumption growth. There was also adequate productive capacity in the economy to contain demand pressures. This was reflected by output growth being relatively close to potential and the stable capacity

Chart 1.17
Producer Price Inflation and IMF Primary Commodity Price Inflation


Note: 1. Commodity-related components in Producer Price Index (PPI) include crude materials, inedible; mineral fuels, lubricants, etc.; and animal and vegetable oils and fats

2. Non-commodity related components in PPI include food; beverages and tobacco; chemicals; manufactured goods; machinery and transport equipment; miscellaneous manufactured articles; and miscellaneous transactions and commodities

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

Table 1.10

Measures by the Government to Contain Price Increases

Measures	Purpose
1 Active enforcement of the Price Control and Anti-Profiteering Act 2011 and Competition Act 2010	Minimise the instances of profiteering and encourage fair trade
2 - Direct sales of agriculture products to consumers through FAMA's farmers' markets and agrobazaars - Introduce a weekly auction programme for vegetables at FAMA's trading operation centres	Improve distributional efficiency to contain domestic food price increases
3 Establish 1Malaysia Smart Consumers' Portal (<i>Portal 1Malaysia Pengguna Bijak</i> or 1MPB)	Empower consumers with information on prices
4 - Increase the number of 1Malaysia Clinics (<i>Klinik 1Malaysia</i>) - Increase the number of 1Malaysia People's Shop (<i>Kedai Rakyat 1Malaysia</i> or KR1M) outlets and establish mobile KR1M - Offer affordable breakfast and lunch through the 1Malaysia People's Menu (<i>Menu Rakyat 1Malaysia</i> or MR1M)	Increase access to affordable necessities

utilisation rate of 79% (2013: 79%) in the manufacturing sector.

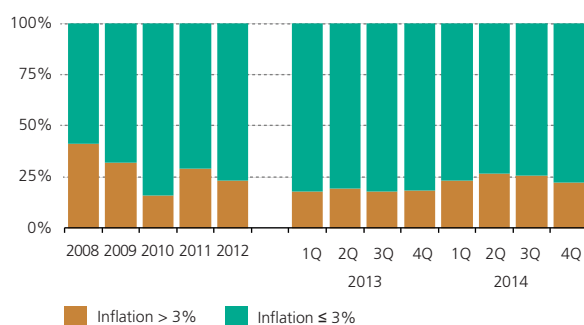
The extent of spillovers on prices of other goods and services was also mitigated by the ability of firms to accommodate some of the increase in domestic cost pressures. This is attributable to two factors. First, findings from the Bank's survey suggested that transportation and utilities costs constitute a relatively small share of firms' total operating cost, which allowed them to absorb some of the higher costs. Second, firms indicated that they have undertaken measures to enhance productivity. The contained spillover effects also reflected the efforts undertaken by the Government to ensure that price

increases were not excessive and broad-based (Table 1.10). Consequently, the share of core CPI items registering an inflation rate of more than 3% throughout the year was at its long-term average of 25% (Chart 1.18).

With inflation expectations on an increasing trend following the multiple price shocks during the year, a key concern was the risks of second-round effects on inflation. However, such risks were assessed to be low due to contained spillovers and the absence of excessive wage pressures. Salaries of both executives and non-executives continued to increase in 2014 but more moderately by 5.4% (2013: 6.6%). The more moderate wage pressure reflected the absence of tight labour market conditions. Despite the declining unemployment rate, the Bank observed that the labour participation rate had remained slightly below its long-term trend and job vacancies were lower relative to unemployment. Structurally, wage increments are primarily determined by employees' performance and companies' profitability. These factors helped to mitigate excessive wage increases. Indeed, the increase in inflation expectations, as derived from the Bank's Consumer Sentiment Survey⁷, turned out to be transitory with expectations stabilising towards the end of 2014.

Chart 1.18

Percentage of Core CPI Components Registering Inflation Above 3%



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

⁷ Bank Negara Malaysia has conducted a monthly survey on households beginning 2013 to gather information related to consumer sentiments and expectations on overall economic conditions in Malaysia.

2014

MONETARY AND FINANCIAL CONDITIONS IN 2014

- 43 International Monetary and Financial Conditions
- 44 Domestic Monetary and Financial Conditions
- 50 Financing of the Economy

INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

Global financial markets in 2014 went through two phases. Throughout most of the first eight months of the year, global financial markets experienced a period of very low volatility, higher valuations across a broad range of asset classes and a compression in spreads. These developments were driven by greater financial risk-taking amidst ample global liquidity, low interest rates and perceptions of reduced policy uncertainty. This, however, subsequently changed, driven by the uncertainty regarding the monetary policy normalisation in the US, the resurgence of concerns over the pace of global growth arising mainly from weaker-than-expected developments in the euro area, and the sharp decline in crude oil and other commodity prices.

Global financial markets experienced greater volatility towards the end of the year following concerns on global growth and the sharp decline in commodity prices

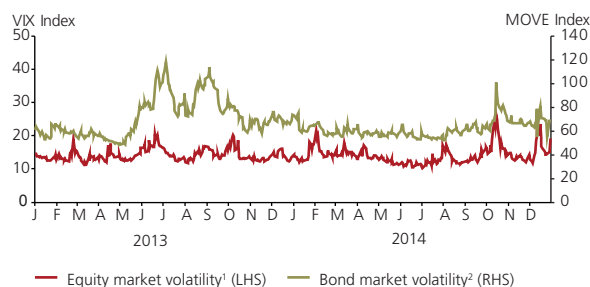
The beginning of the year saw global financial markets momentarily affected by growth concerns in the US and unfavourable developments in several emerging market economies. Nonetheless, the set of adverse country-specific factors was transitory. In the second and third quarters, although economic performance across the major economies was uneven, the improving growth prospects and reduced policy uncertainty in several advanced economies supported positive market sentiments. Correspondingly, asset prices increased and bond yields became more compressed. In addition, the environment of low foreign exchange volatility also contributed to the increased attractiveness of carry trades. As a result, net capital inflows to emerging

markets were estimated to be about USD52 billion¹ during the second and third quarters. Despite intermittent spikes, the Chicago Board Options Exchange Volatility Index (VIX), a gauge of market volatility, fell in July 2014 to low levels last seen prior to the Global Financial Crisis. Correspondingly, the MSCI Emerging Market Index gained 16.2% while the JP Morgan Emerging Market Bond Index (EMBI) spread narrowed by 83.5 basis points from February to August 2014.

The buoyant financial conditions unravelled in September amidst uncertainties over the timing of the start of interest rate normalisation in the US. Given the intensity of the speculative flows and the search for yield driven by the very easy monetary conditions in the advanced economies, the reversal of these flows and risk aversion was equally intense. In October, the spike in global risk aversion intensified sharply following the downward revision of the growth outlook for some major economies. These developments increased investor nervousness, resulting in sharp readjustments in global financial markets. Consequently, the VIX index more than doubled from 12.7 on 17 September to 26.3 on 15 October, its highest daily level since the height of the euro area sovereign debt crisis at the end of 2011. Approximately 70% of portfolio investment

Chart 2.1

Global Financial Market Volatility



Note: ¹Refers to VIX Index

²Refers to Merrill Lynch Option Volatility Estimate (MOVE) Index

Source: Bloomberg

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

flows into emerging markets since January 2014 reversed over the period 16 September to 22 October. Between 1 September and 16 October, the MSCI Emerging Market Index declined by 10.8% while the JP Morgan EMBI spread increased by 63.1 basis points.

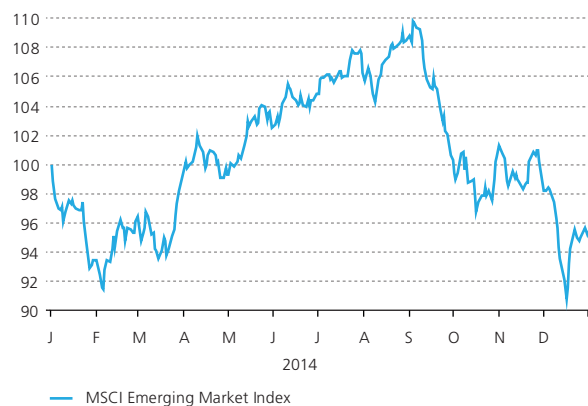
The prices of oil and most other commodities had been falling since June as the rising global supply of these commodities exceeded the slowing demand. However, the further decline in oil prices since 28 November, after OPEC's decision to maintain its target supply, shifted the focus of global investors to the potential impact on the major commodity exporting countries, particularly on their fiscal and external positions. During this period, currencies of oil exporting countries² were under depreciation pressures, weakening between 2.3% and 20.0% in the face of significant capital outflows. As a whole, between 28 November and 31 December, the MSCI Emerging Market Index fell further by 5.6% while the JP Morgan EMBI spread increased sharply by 51.7 basis points.

Going forward, the increasing unevenness in the growth across major economies, the expected divergence in the monetary policies of the advanced economies and the uncertain oil prices will continue to cause shifts in global liquidity flows, accompanied by heightened volatility in financial markets and currencies.

Chart 2.2

MSCI Emerging Market Index

Index (Dec 2013 = 100)



Source: Bloomberg

² These countries include Algeria, Canada, Malaysia, Mexico, Nigeria, Norway and Russia.

Chart 2.3

JP Morgan Emerging Market Bond Index (EMBI) Spread



Source: Bloomberg

DOMESTIC MONETARY AND FINANCIAL CONDITIONS

Exchange Rate

While the trend of increasing two-way trade and direct investment flows continued, portfolio flows was the primary driver of the ringgit exchange rate during the year. Ringgit movements during the year followed two noticeable patterns. Between February and August 2014, the ringgit was broadly on a strengthening trend due to sustained portfolio inflows. From September, however, the ringgit, along with most regional currencies, faced strong depreciation pressure as investors unwound their holdings of financial assets in the region amidst investor nervousness about a possible change in US monetary policy and signs of weakness in the momentum of global growth.

The period between February and August 2014 saw the global financial markets experience a period of unusually low volatility. This was mainly driven by rising investor confidence following reduced macroeconomic uncertainty and improved global economic outlook, especially in the advanced economies. This, coupled with expectations that low interest rates and ample global liquidity conditions would continue to prevail, attracted international investors into regional financial assets. Domestically, the continued underlying strength of the Malaysian economy, which was reflected in the stronger-than-expected GDP growth in the first half of the year, contributed to the optimism and strong interest in Malaysia's financial assets. Against this backdrop, Malaysia saw non-resident portfolio inflows of RM11 billion in the first three quarters of

the year. As a result, the ringgit appreciated against the US dollar by 6.0% between February and August 2014, reaching RM3.1570 against the US dollar by the end of August. During the period, the ringgit appreciation against the US dollar was the largest among regional currencies. Given the extremely low volatility, there was growing concern during this period that the increased risk-taking by global investors and the accompanying rise in global asset prices could increase the vulnerability of the global financial markets to sudden shifts in sentiments.

The ringgit exchange rate was influenced by both domestic and external factors

Sentiments started to shift in the September-October period, during which the ringgit, along with other regional currencies, broadly depreciated against the US dollar. The weakening of regional currencies was driven more by developments in the advanced economies than by any specific region or country-related factors. In particular, the developments reflected the strengthening US dollar amid the better economic prospects in the US and the possibility of an increase in US interest rates. For Malaysia, non-resident capital inflows that had accumulated over the first eight months of the year reversed sharply beginning in September. Capital outflows intensified towards the end of November

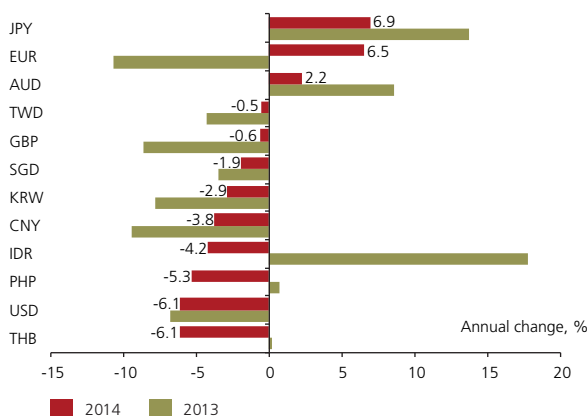
and in early December. This reversal of portfolio flows resulted in the weakening of the ringgit.

For the year as a whole, the ringgit depreciated by 6.1% to end the year at RM3.4950 against the US dollar. The ringgit also depreciated against the pound sterling but strengthened against the euro and Japanese yen. Against regional currencies, the ringgit was broadly weaker. The ringgit's Nominal Effective Exchange Rate (NEER), a measure of ringgit performance against the currencies of Malaysia's major trading partners, however, remained relatively stable with a depreciation of only 0.6%.

Activities in the foreign exchange derivatives market during the year also reflected the shift in investor sentiments since September. The volume was low early in the year, with the average daily volume of foreign currency derivatives standing at USD4.7 billion between February and August 2014. As the financial markets and ringgit exchange rate became more volatile from September onwards, the average daily volume rose to USD5 billion in September-October. Part of the increased activity was driven by local exporters hedging their foreign currency exposures through forward selling of the US dollar, taking advantage of the US dollar appreciation against most other currencies. The increased market volatility and strengthening US dollar increased the overall demand for hedging and resulted in an increase in the cost of borrowing in US dollars through the cross-currency USD/RM swap market.

Chart 2.4

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

Chart 2.5

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 Taiwanese 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

The 5-year USD/RM cross-currency swap rates widened from an average of 73 basis points between February and August to 84 basis points in the September-October period.

With the prospect of the Federal Reserve (Fed) starting to normalise its monetary policy amidst continued monetary easing by the European Central Bank and Bank of Japan, the volatility of capital flows, financial markets and exchange rates will continue. Policy measures undertaken to ensure that such capital flow volatility and the corresponding fluctuations in the domestic financial markets and exchange rates do not spill over into the real economy will be a key focus of policy. In this regard, efforts to strengthen domestic buffers and resilience to tolerate larger and more volatile capital flows have become important. For Malaysia, strong domestic fundamentals, greater exchange rate flexibility, adequate levels of international reserves, deeper and more diversified financial markets and a strong banking system, have all been crucial to Malaysia's resilience to bouts of capital flow volatility. Policy flexibility, including the ability to use micro- and macroprudential tools, has also been important in managing the risks associated with such capital flows.

Interest Rates, Bond Yields and Equity Prices

Interest rates rose in 2014 following the Monetary Policy Committee (MPC)'s decision to raise the Overnight Policy Rate (OPR) by 25 basis points in July 2014. Interest rates also adjusted higher during the year as competition in the deposit market further intensified in both the retail and wholesale segments. Depositors were compensated with a higher rate of return on their savings following the increase in the OPR. Reflecting the increase in the cost of funds to banks, the cost of borrowing to the households and businesses were also revised higher. Despite the increase in the borrowing costs, however, monetary conditions continued to be supportive of growth.

Following the 25 basis points increase in the OPR, the transmission to the money and financial markets was rapid. The average overnight interbank rate (AOIR) increased by 22 basis points on 11 July 2014 from 3.00% to 3.22%, with interbank rates of other maturities also increasing. Beyond the influence of the OPR, interbank rates of longer maturities also trended higher. During the year, banks sought

to increase their level of stable funding³ to comply with the phasing in of the new Basel III Liquidity Coverage Ratio (LCR)⁴. The competition for more stable funding was, however, made more intense due to the overall slower growth in deposits due to net external outflows which partly reflects diversification of investments by corporates abroad and portfolio outflows. To increase their level of stable funding for compliance with the LCR, banks competed to attract large corporate deposits by offering higher deposit rates, resulting in shifts in corporate deposits across banks. The banks which experienced a withdrawal of corporate deposits turned to borrowing from the interbank market to replace the loss of funds, bidding up the cost of interbank borrowing. For the year as a whole, the 3-month Kuala Lumpur Interbank Offered Rates (KLIBOR) increased from 3.31% to 3.86%.

A moderation in the 3-month KLIBOR was observed, however, following BNM's announcement on 30 January 2015 on the arrangements to facilitate a smooth transition to the full implementation of the LCR by 2019. These arrangements include broadening the scope of recognition of high-quality liquid assets (HQLA)⁵ and further clarification on the treatment of banks' expected cash outflows, which have helped to ease funding pressures.

Rates on interest rate swaps and 3-month KLIBOR futures increased in the first half of 2014 in anticipation of an OPR increase in the second half of the year, and continued to trade higher after the OPR increase in July. These rates, however, moderated towards the end of the third quarter as market expectation for a further OPR increase was tempered by the MPC's decision to maintain the OPR at 3.25% in September.

The rise in the OPR resulted in an upward revision to retail deposit rates, compensating savers with

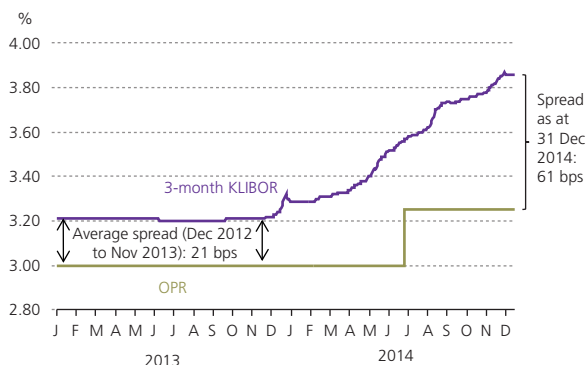
³ Under the Liquidity Coverage Ratio (LCR), stable forms of funding are those with a low likelihood of withdrawal during episodes of financial stress. Funding which is deemed the most stable are those sourced from retail deposits, followed by corporate deposits, while funding from other financial institutions are most at risk of being withdrawn.

⁴ Refer to the Financial Stability and Payment Systems Report 2014 for a detailed discussion on the LCR.

⁵ HQLA refers to assets which can be easily and immediately converted into cash at little or no loss of value, even in times of stress. In the case of the Malaysian banking system, HQLA currently comprises mainly of banks' holdings of government securities and deposit placements with BNM.

Chart 2.6

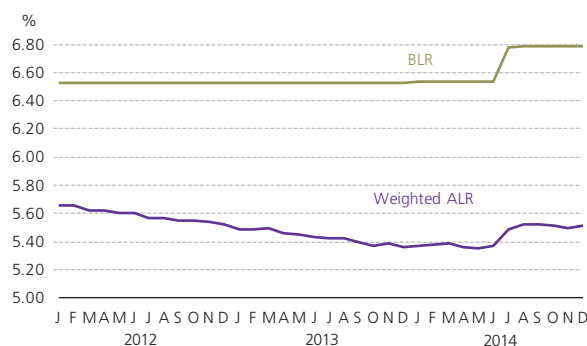
Money and Financial Market Rates



Source: Bank Negara Malaysia and Bloomberg

Chart 2.7

Commercial Banks' Lending Rates (at end-period)



Source: Bank Negara Malaysia

a higher rate of return. The average quoted fixed deposit (FD) rates of commercial banks for the 1 to 12 months tenures rose between 15 to 17 basis points to 3.07% to 3.30% as at end-July. Banks also competed to attract deposits by launching deposit campaigns that offered higher deposit rates for large deposit placements at selected maturities.

The cost of borrowing for households adjusted upwards, reflecting the financial institutions' higher cost of funds. The benchmark lending rate, as measured by the average base lending rate (BLR), increased by 25 basis points to 6.79%. Retail lending rates for the purchase of property and securities adjusted higher by 22 basis points and 25 basis points respectively. Following the implementation of the Risk Informed Pricing, hire purchase rates increased

by a larger magnitude, reflecting the enhancement of banks' risk management practices. Lending rates to businesses also adjusted upwards, but by a lower degree, due to intense competition between banks.

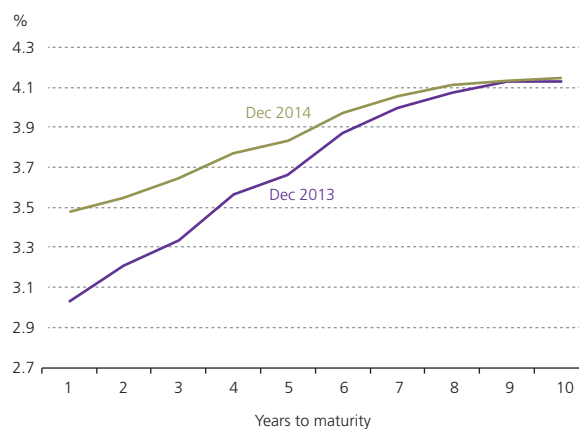
Malaysian Government Securities (MGS) yields were affected by a confluence of domestic and external factors during the year. For the first 11 months, while market expectations and the eventual policy rate increase by the Bank led to upward adjustments at the shorter-end of the MGS yield curve, sustained interest from investors contributed to the downward shift at the longer-end of the MGS yield curve. This downward trend, however, was reversed in December following an increase in the long-term MGS yields.

Yield curve flattened during the year

After a period of relative stability in the earlier part of the year, short-term MGS yields trended upwards beginning May following market expectations of a policy rate increase. Yields continued to increase even after the OPR adjustment in July as market participants were anticipating another increase in the policy rate in September. Short-term yields were stable after the MPC's decision to keep the OPR unchanged in September. Towards the end of the year, however, yields increased as non-resident investors unwound their portfolio investments. For the year as a whole, the 1-year MGS yields increased by 45 basis points.

Chart 2.8

MGS Yield Curve



Source: Bank Negara Malaysia

In contrast, the long-term yields were on a downward trend for the most part of 2014. Portfolio inflows into the domestic bond market during the first three quarters of the year saw the share of non-resident holdings of MGS increase to reach its peak of 48.4% in July (end-December 2013: 44.9%)⁶. As a result, despite the 25 basis points increase in the OPR in July, the 10-year MGS yield declined by 25 basis points⁷ between January and July 2014. In addition, there was also an increase in MGS holdings by resident investors, namely financial institutions, in anticipation of Basel III requirements which further contributed to the

Chart 2.9

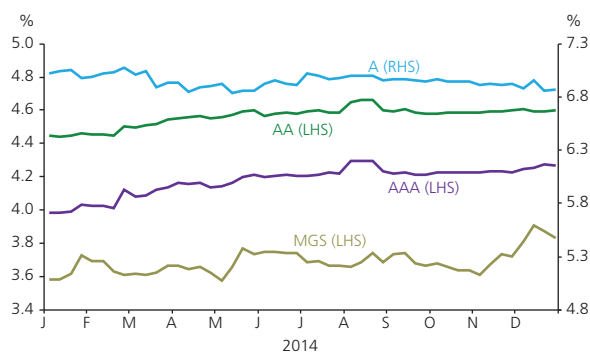
MGS Yields



Source: Bank Negara Malaysia

Chart 2.10

5-year MGS and 5-year PDS Yields



Source: Bank Negara Malaysia

⁶ As at end 2014, non-resident holdings of total government securities amounted to 28.0%. Total government securities include Malaysian Government Securities (MGS), Government Investment Issues (GII), Treasury bills and *Sukuk Pinjaman Perumahan Kerajaan (SPPK)*.

⁷ The decline in the spread between 10-year MGS yield and the OPR was therefore 50 basis points over January to July 2014.

decline in long-term yields in the first 11 months. Nevertheless, 10-year MGS yield increased in mid-December as resident investors consolidated their investment position towards the end of the year. The 10-year MGS yield increased by 29 basis points in December. For the year as a whole, the 10-year MGS yields increased by only 2 basis points.

In the private debt securities (PDS) market, yields were broadly higher, reflecting the change in the OPR. Yields on the 5-year AAA and AA-rated papers increased by 31 and 20 basis points respectively during the year. Total new issuances of PDS⁸ amounted to RM117.3 billion in 2014 (2013: RM117.9 billion). Of note, the domestic market saw the issuance of the largest renminbi bond in South East Asia amounting to RMB1.5 billion which was oversubscribed by 3.1 times. Additionally, during the year, the PDS market saw the issuance of a sukuk by the first Islamic bank from Turkey amounting to RM3.0 billion.

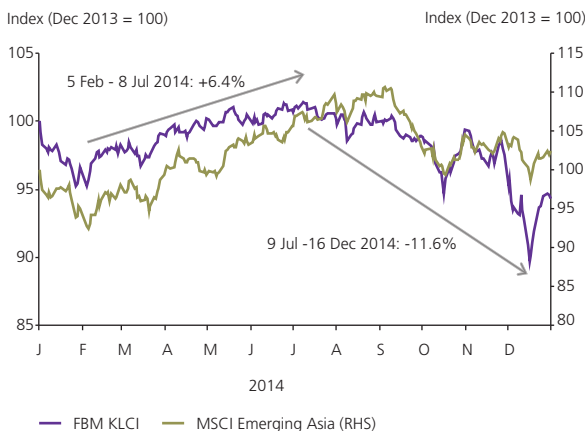
PDS yields remained supportive of private sector financing

Like the bond market, the performance of the domestic equity market also followed two noticeable trends during the year that largely reflected changes in the global environment. The domestic equity market was generally on an upward trend between February and mid-July given the positive global and domestic sentiments. Against the background of low global financial market volatility, low interest rates in the major economies and ample global liquidity, international investors were attracted to the domestic equity market by the positive earnings prospects amid the strong domestic macroeconomic performance. During the period, the share of non-resident holdings of the domestic equity market increased to 24.1% in July (end-2013: 23.9%). Strong demand from non-residents was reinforced by resident investors, resulting in the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) reaching its new historical peak of 1,892.7 points on 8 July 2014, an increase of 6.4% from February.

⁸ Refers to securities issued in Malaysia by both local and foreign companies which can be either short-term, medium-term or long-term papers in Conventional or Islamic principles.

Chart 2.11

Equity Market Indices



Source: Bloomberg

The rally in the domestic equity market subsequently reversed due to rising global uncertainties and, to some extent, domestic developments. The upward trend was initially interrupted by the Malaysia Airlines flight MH17 incident which affected investor sentiments. Additionally, the market was also affected by disappointing second quarter corporate earnings, particularly in the plantation sector, in view of the weak crude palm oil prices. The downward trend was further weighed down by profit-taking and the unwinding of portfolio investments by non-resident investors from regional equity markets, including Malaysia.

Sentiments in the domestic equity market were largely affected by external factors

Towards year-end, sentiments in the domestic equity market were also affected by the sharp decline in oil prices. Concerns over the impact of lower oil prices on the domestic economy led to a sell-off in the domestic equity market. The oil and gas sector was particularly affected amid concerns that lower oil prices would lead to lower corporate earnings and investments. The index declined by 11.6% from its peak to reach its lowest level for the year at 1673.9 points on 16 December 2014. For the year, the FBM KLCI declined by 5.7% (2013: +10.5%) to close at 1761.3 points. As at

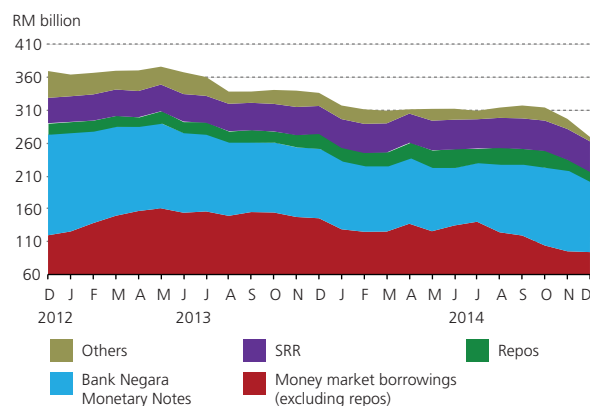
end-December 2014, the FTSE Bursa Malaysia's market capitalisation stood at RM1.65 trillion (2013: RM1.70 trillion).

Liquidity and Monetary Aggregates

In 2014, aggregate outstanding liquidity placed with Bank Negara Malaysia remained high despite the net withdrawal of liquidity due to net outflows from the external sector. At the individual bank level, most banking institutions continued to operate within surplus liquidity positions.

Chart 2.12

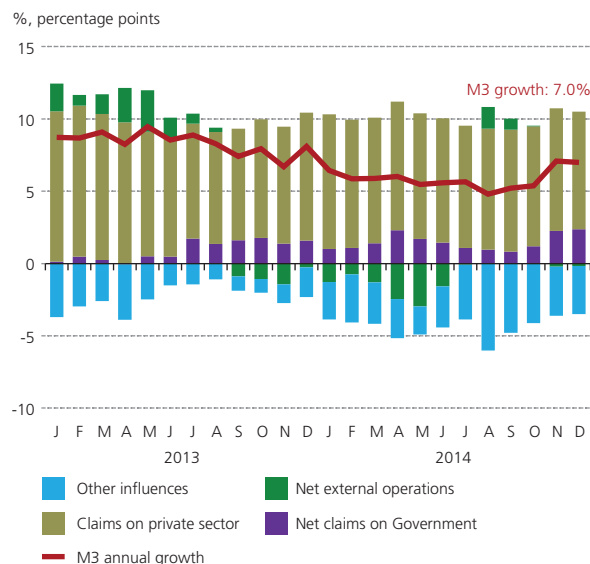
Outstanding Liquidity Placed with Bank Negara Malaysia (at end period)



Source: Bank Negara Malaysia

Chart 2.13

Contribution to M3 Growth



Source: Bank Negara Malaysia

Throughout the year, Bank Negara Malaysia's operations were focused on maintaining stability in the interbank money market. During periods of outflows, the large placements with Bank Negara Malaysia served as a liquidity buffer for the banking system as the contractionary pressure on liquidity was offset by the net release of funds lent to the Bank.

Given the net external sector outflows, private sector liquidity, as measured by broad money (M3), grew at a more moderate pace of 7.0% during the year (2013: 7.9%). The moderation in M3 growth was also partly due to the slower growth in bank lending to households.

FINANCING OF THE ECONOMY

For the year as a whole, the growth in net financing through the banking system, development financial institutions (DFIs) and the private debt securities (PDS) market expanded at an annual rate of 8.7% in 2014 (2013: 9.7%; average over 2006-2013: 10.7%). Financing to businesses remained healthy with higher growth in outstanding loans to businesses. The growth in outstanding loans to households continued to moderate as intended following measures to ensure prudent levels of household debt.

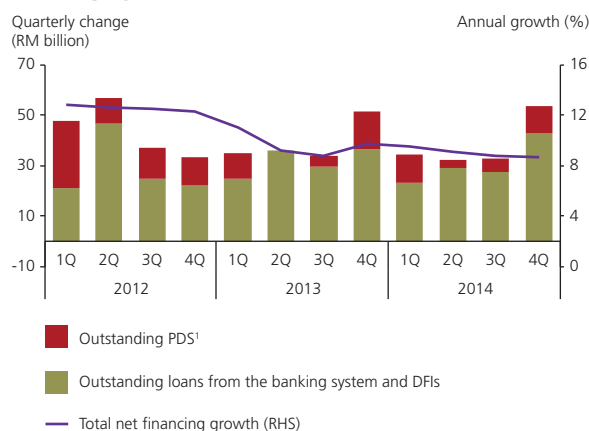
Financing to the private sector remained healthy with higher growth in outstanding loans to businesses

The growth of outstanding business loans⁹ was higher at 9.0% with continued double-digit growth in SME loans of 13.3% in 2014 (2013: 7.9% and 12.7% respectively). This was despite the faster pace of growth in loan repayments relative to loan disbursements between January and August 2014. The level of loan disbursements, including to SMEs, remained robust (monthly average in 2014: RM65.6 billion; 2013: RM55.3 billion) moving in tandem with the growth in domestic demand. The increase in loan disbursements was broadly distributed across various sectors, particularly to the *wholesale and retail trade, restaurants and hotels; manufacturing; and finance, insurance and business services* sectors.

⁹ Includes outstanding loans of public enterprises, but excludes outstanding loans of domestic banking institutions, domestic non-bank financial institutions, Government, domestic other entities, and foreign entities with the banking system and DFIs.

Chart 2.14

Total Net Financing to the Private Sector through the Banking System, DFIs and PDS Market



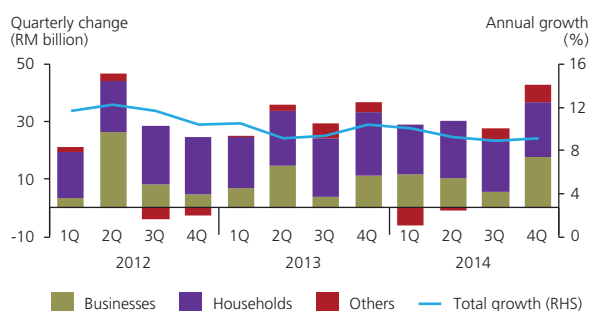
¹Excludes issuances by non-residents, Cagamas, and of short-term papers

Source: Bank Negara Malaysia

Demand for funding from the capital market¹⁰ also remained robust with the bond market continuing as a key source of financing for the private sector. New PDS issuances¹¹ amounted to RM82.1 billion in 2014 (2013: RM82.1 billion) with issuances mainly from the *finance, insurance, real estate and business services* sector. A substantial portion was also raised by businesses, including public enterprises, for working capital and project financing purposes. Financing via the equity market amounted to RM19.2 billion in 2014 (2013: RM16 billion), with two large rights issuances from corporations in the *finance and trading and services* sectors.

Chart 2.15

Outstanding Loans by Borrowers¹



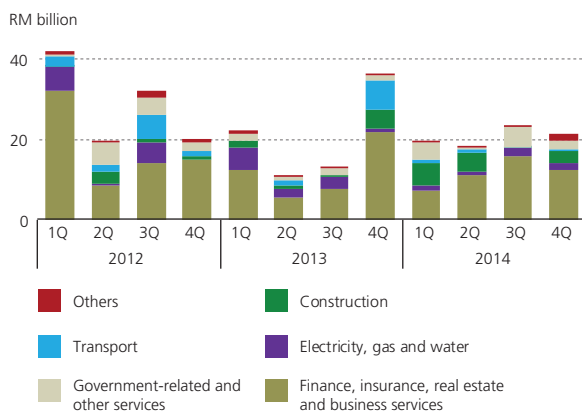
¹ Comprises banking system and DFI outstanding loans

Source: Bank Negara Malaysia

¹⁰ Includes funds raised by domestic banking institutions and non-bank financial institutions.

¹¹ Excludes PDS issuances by non-residents, Cagamas and of short-term papers.

Chart 2.16

Gross PDS Issued by Sector¹

¹ Excludes issuances by non-residents, Cagamas, and of short-term papers

Source: Bank Negara Malaysia

The growth in the outstanding loans of the banking system and DFIs to households, and the overall growth in household debt¹² moderated during the year (2014: 9.8% and 9.9% respectively; 2013: 11.6% and 11.5%). This was attributable to the pre-emptive macro-

and microprudential measures implemented by the Bank since 2010 and the Risk Informed Pricing guidelines introduced in March 2014. The moderation was observed across household loans¹³ for most purposes, particularly loans for the *purchase of passenger cars and securities, and for personal use*.

The growth in *residential property* loans, however, increased slightly to 13.2% in 2014 (2013: 12.9%), reflecting the continued disbursement in stages of previously approved loans. The growth in new approvals of *residential property* loans to households moderated significantly to 4.2% in 2014 (2013: 26.8%) reflecting the lower growth in loan applications during the year, in part due to the increase in the real property gains tax (RPGT) and the prohibition of developer interest bearing schemes (DIBS) by the Government in January 2014. These measures contributed to a moderation in credit-driven speculative purchases in the property market which was further evidenced by the lower growth in the number of household borrowers with more than three housing loan accounts.

¹² Comprises outstanding household loans extended by banks and non-banks (DFIs, other non-bank financial institutions, Treasury Housing Loans Division, insurance and stockbroking companies).

¹³ Includes outstanding household loans with the banking system and DFIs, but excludes loans extended by other non-banks.

2014

MONETARY POLICY IN 2014

55	Monetary Policy
57	Monetary Operations
61	<i>Box Article: Financial Imbalances and Policy Responses in Malaysia</i>

MONETARY POLICY IN 2014

MONETARY POLICY

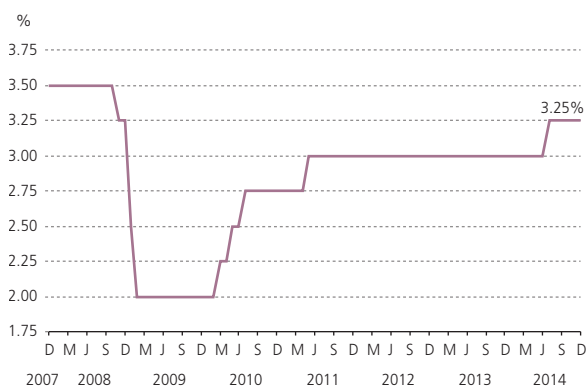
The Monetary Policy Committee (MPC) adjusted the degree of monetary accommodation by raising the Overnight Policy Rate (OPR) by 25 basis points to 3.25% on 10 July 2014, amid firm growth prospects and with inflation projected to remain above its long-run average. The normalisation of monetary conditions also aimed at mitigating the risk of a build-up of financial imbalances that could undermine the growth prospects of the Malaysian economy. Notwithstanding the increase in the OPR, monetary conditions continued to remain supportive of economic activity during the year.

The OPR was raised to 3.25% in July 2014 amid firm growth prospects and expectations of inflation remaining above its long-run average

Since the monetary policy stance was last adjusted in May 2011, the Malaysian economy had continued to experience sustained growth. Despite the challenging external environment, the domestic economy recorded steady growth,

Chart 3.1

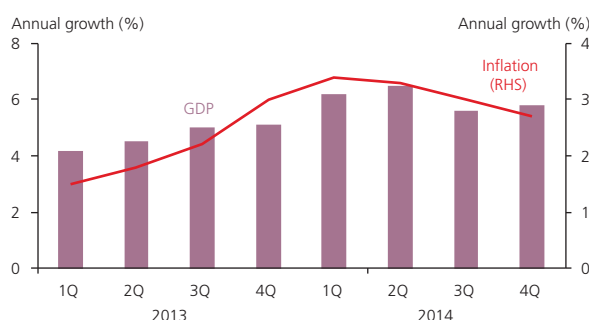
Overnight Policy Rate (OPR)



Source: Bank Negara Malaysia

Chart 3.2

GDP and Inflation



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

driven mainly by domestic demand. In light of this improved growth performance and with the prospects for the domestic economy continuing on a steady growth path in 2014, monetary policy was assessed to be considerably supportive of the economy. Thus, the MPC at the beginning of the year recognised the need for an adjustment in the degree of monetary accommodation. This recognition also took into account the ongoing concerns about the risks of broader financial imbalances given the extended period of relatively low and unchanged interest rates. The key consideration was, therefore, in identifying the appropriate timing for the adjustment, taking into consideration the ongoing assessment of the balance of risks to the outlook for growth and inflation.

In early 2014, the Malaysian economy was projected to continue on a steady growth path. Net exports growth was expected to improve, in line with the positive outlook for global growth. Domestic demand would remain the main driver of growth, supported by robust investment, particularly private investment. Private consumption growth was expected to trend towards its long-term average after experiencing above-trend growth during the previous years. By May 2014, the expectation was for growth in 2014 to be at the upper end of the initial forecast of 4.5% – 5.5%. Nevertheless, the MPC recognised that downside risks to growth

remained, particularly in relation to the risk of a moderation in private consumption growth and weaker external demand.

There were greater upside risks to inflation, which was expected to trend above its long-run average of 3% in 2014 and 2015. The higher inflation would be driven mainly by domestic cost factors, namely the upward adjustments in retail fuel prices, electricity tariffs as well as the implementation of the Goods and Services Tax (GST) in 2015. However, the risk of excessive spillovers arising from these adjustments to administered prices was deemed to be relatively small given the more moderate domestic demand and subdued global price pressures that were expected to prevail over the remainder of 2014 and into 2015. The increase in inflation was, therefore, assessed to be temporary, with inflation projected to decline to below its long-run average in 2016.

Amid the firm growth outlook, and with inflation expected to remain above its long-run average, the MPC decided to adjust the degree of monetary accommodation at the July 2014 MPC meeting. The normalisation of monetary conditions also took into consideration the need to mitigate the risk of a broader build-up of financial imbalances that could undermine medium-term growth prospects. While the implementation of macro and microprudential measures were having the desired moderation in the growth of household indebtedness, the MPC assessed that the sustained period of unchanged and low interest rates was creating an environment of understating risks and had the potential of incentivising broader financial imbalances.

Table 3.1

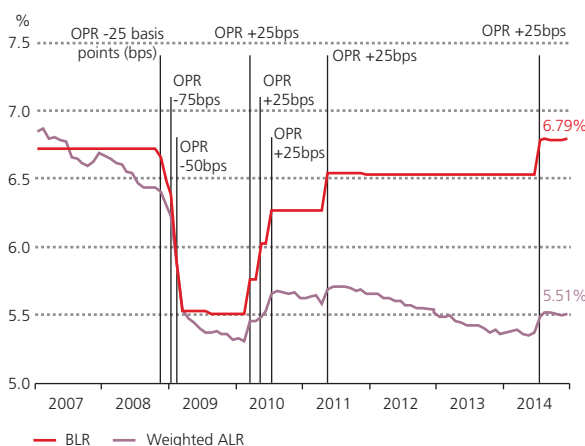
MPC Meetings and Policy Decisions in 2014

MPC Decision Dates	OPR	
	Change	Level (%)
29 Jan 2014	-	3.00
6 Mar 2014	-	3.00
8 May 2014	-	3.00
10 Jul 2014	+ 25 basis points	3.25
18 Sept 2014	-	3.25
6 Nov 2014	-	3.25

Source: Bank Negara Malaysia

Chart 3.3

Base Lending Rate and Weighted Average Lending Rate of Commercial Banks



Source: Bank Negara Malaysia

The adjustment in the policy rate occurred smoothly without disruption to the financial system and the broader economy. Retail lending rates adjusted quickly to the change in the OPR, with the average base lending rate (BLR) of commercial banks being raised by 25 basis points to 6.79% by end-August 2014. Depositors were also compensated with higher rates of return on their savings, with the average quoted fixed deposit (FD) rates of commercial banks for the 1 to 12 month tenures increasing by between 15 to 17 basis points to a range of 3.07% and 3.30% as at end-July 2014.

In the latter part of the year, the sustainability of external demand became more uncertain following rising concerns over the prospects of the global economy. Global growth continued to be uneven, with increasing evidence of weaker-than-expected growth momentum in a number of major economies. In addition, the marked increase in global financial market volatility beginning in September 2014 and the sharp decline in oil prices towards the end of the year further heightened the downside risks emanating from the external environment. The MPC, therefore, assessed that there was a need to establish greater certainty on the outlook for domestic growth.

As for inflation, despite a number of price adjustments, there was limited evidence of any pervasiveness in price increases. The absence of

external price pressures and the more moderate demand conditions were also expected to mitigate the impact of cost-push inflation. Nevertheless, inflation was expected to be above its long-run average. The MPC, therefore, remained vigilant to any upside risks to inflation, arising from possible second-round effects and changes in inflation expectations.

Given the evolving economic and financial environment, and the uncertainty it created around the inflation, and particularly, the growth outlook, the MPC was of the view that maintaining monetary conditions at their prevailing level was warranted. The MPC would also continue to monitor the risks of destabilising financial imbalances. In addition, the increase in the OPR in July 2014 had served as a warning against excessive risk-taking by sending the message that the interest rate outlook may not always be benign.

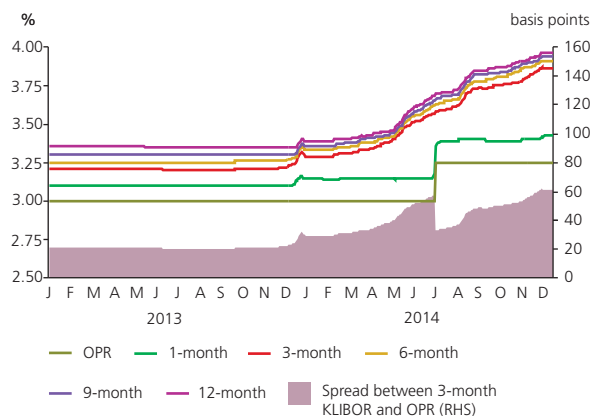
MONETARY OPERATIONS

The average overnight interbank rate (AOIR) remained stable around the OPR with an average deviation of 2 basis points. The AOIR traded between 2.90% to 3.00% before the OPR adjustment on 10 July 2014 and trended upwards to reach 3.27% in the subsequent months. Reflecting the increase in the OPR, the AOIR increased on 11 July 2014 from 3.00% to 3.22%.

During the year, interbank rates were influenced by market expectations for and the eventual increase in the OPR. These developments provided an early impetus for the rising trend in interbank

Chart 3.5

KLIBOR Rates



rates witnessed in 2014. In addition, for interbank rates with tenures above 1-month, the uptrend in rates continued until the end of the year despite the unchanged OPR after July 2014. This reflected the bidding up of interbank rates by banks as they experienced lower growth in deposits amid intense competition for stable funding. The competition for stable funding was to comply with the phasing in of the new Basel III regulatory liquidity requirements, amid overall slower growth in deposits due to net capital outflows. As at end-December 2014, the spread between the 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR) and OPR widened by 61 basis points, above the average spread over the December 2012 to November 2013 period of 21 basis points.

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, recorded a marginal increase in volume to RM3.2 trillion (2013: RM3.1 trillion). Among the instruments, conventional deposits, which were unsecured borrowing and lending, was the main instrument traded and contributed 68.3% of the total volume. Aggregate surplus liquidity in the system declined from RM336.8 billion as at end-2013 to RM269.9 billion at the end of the year due to capital outflows, particularly in the fourth quarter following expectations for interest rate normalisation by the Federal Reserve amid the recovery in the US economy and heightened concerns over the impact of the sharp fall in oil prices on the Malaysian economy.

Chart 3.4

OPR and Interbank Rates

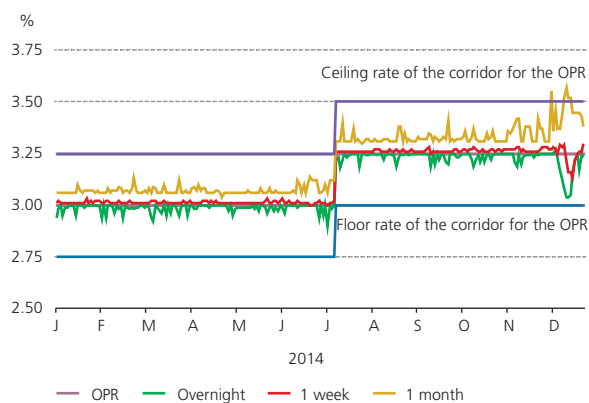
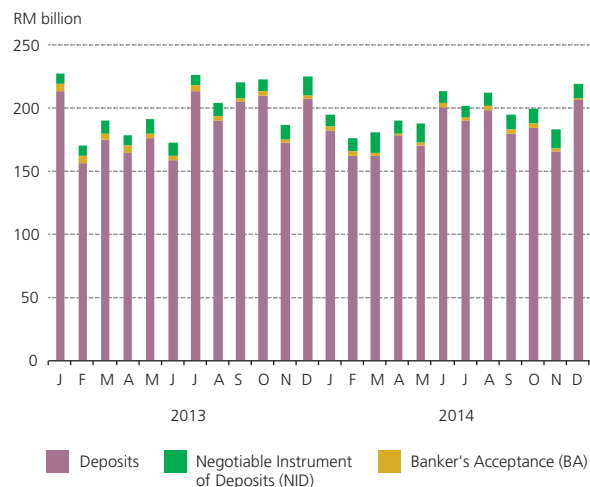


Chart 3.6

Conventional Interbank Money Market Transactions

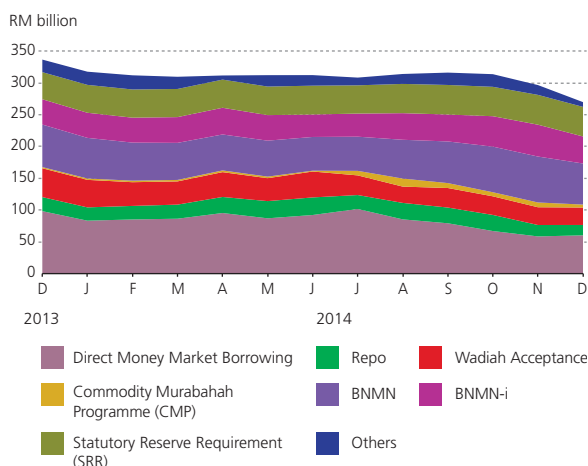


Source: Bank Negara Malaysia

Despite the decline in aggregate surplus liquidity, liquidity conditions remained ample at the system-wide level to support efficient intermediation and orderly market adjustments. The variety of monetary instruments available for the liquidity management of the banking system accorded flexibility to the Bank in meeting market expectations and liquidity needs. Amid rising yields on market expectations for an increase in the OPR, higher issuances of Bank Negara Monetary Notes (BNMNs), especially from July 2014 to October 2014, were undertaken to meet the strong market demand, including that of the non-resident portfolio investors. Consequently, total outstanding BNMNs rose from

Chart 3.8

Outstanding Liquidity Placed with Bank Negara Malaysia

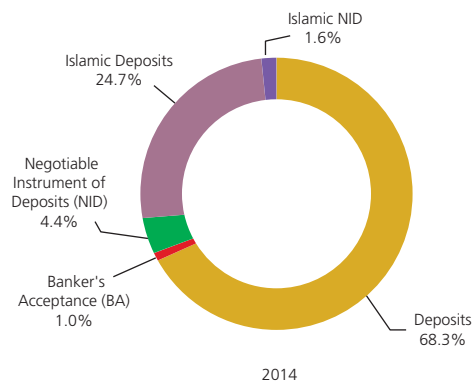


Source: Bank Negara Malaysia

RM106.7 billion as at end-2013 to RM122.4 billion by November 2014, in which non-resident holdings accounted for more than half of the total outstanding BNMNs. In December 2014, in response to the weak demand for BNMNs amid capital outflows, the issuances of BNMNs were adjusted accordingly and total outstanding BNMNs fell to RM107.1 billion at the end of the year. Given the volatility in the global financial markets during the year, BNMNs have been an effective tool in managing domestic liquidity arising from short-term capital flows. In particular, the ability to issue BNMNs to absorb excess liquidity during periods of large inflows and subsequently, unwinding these notes during

Chart 3.7

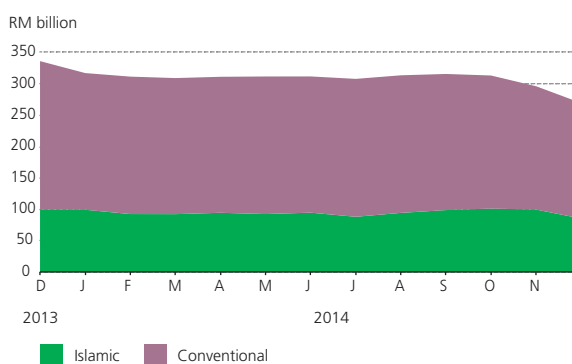
Breakdown of Interbank Money Market Transactions



Source: Bank Negara Malaysia

Chart 3.9

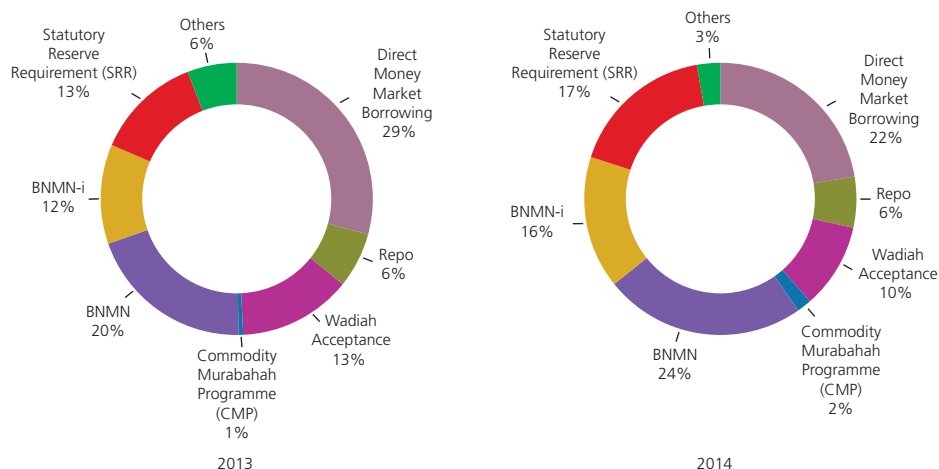
Outstanding Liquidity Placed with Bank Negara Malaysia (Conventional-Islamic)



Source: Bank Negara Malaysia

Chart 3.10

Breakdown of Outstanding Monetary Policy Instruments



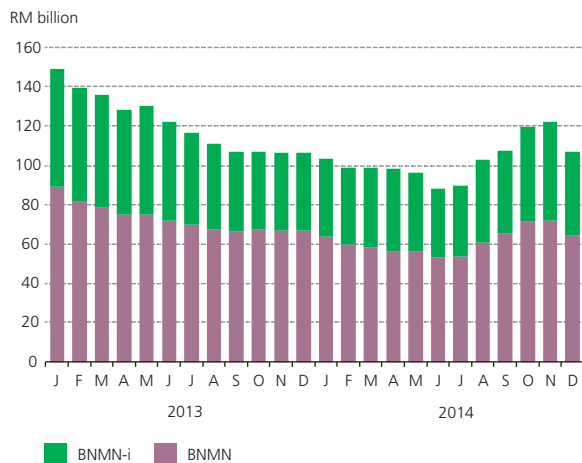
Source: Bank Negara Malaysia

periods of capital reversals, has ensured that adjustments in the domestic financial market remain orderly with minimal impact on overall domestic liquidity conditions. During this period, banks also shifted their liquidity profile to favour shorter maturities to manage uncertainties in corporate liquidity needs towards the end of the year. Correspondingly, the Bank facilitated these requirements by shortening the duration of money market borrowings and increasing the frequency of the Range Maturity Auction (RMA), which is typically a weekly feature of the Bank's operations.

The share of Islamic interbank surplus liquidity as a percentage of total market surplus liquidity continued to increase to 31.7% in 2014 from 23.4% in 2009, reflecting the growth and the development of the Islamic banking industry. With the requirement to distinguish between Islamic deposit and investment accounts under the implementation of the Islamic Financial Services Act 2013 (IFSA), it is expected that there will be greater use of commodity murabahah transactions as an instrument of Islamic deposits in the Islamic financial market. Accordingly, the Bank has increased the use of the Commodity Murabahah

Chart 3.11

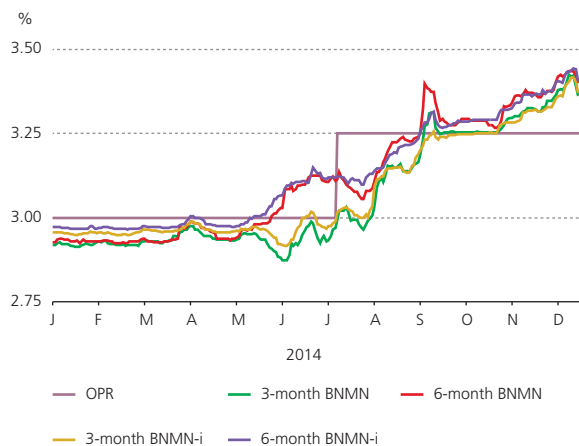
Outstanding Amount of BNMNs



Source: Bank Negara Malaysia

Chart 3.12

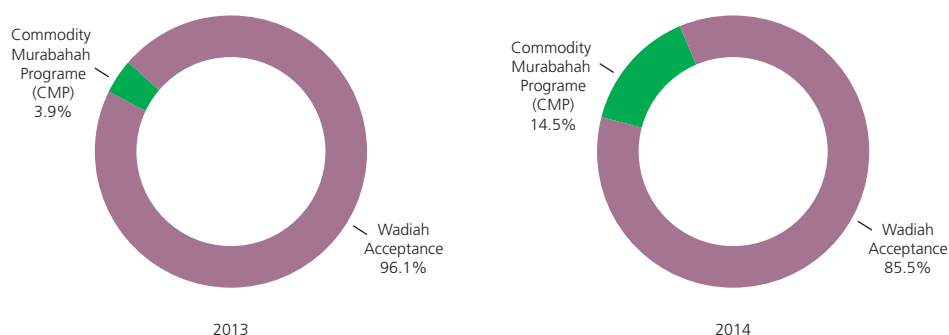
BNMN Yields and OPR



Source: Bank Negara Malaysia

Chart 3.13

Outstanding Amount of Islamic Short-term Borrowings



Source: Bank Negara Malaysia

Programme (CMP) in its Islamic liquidity management operations since early July 2014. Consequently, banks have progressively switched their short-term placements with the Bank to the CMP, as evidenced by the increase in the share of the CMP from 3.9% in 2013 to 14.5% of total Islamic short-term borrowings in 2014.

As innovative structures evolve in the issuance of Shariah compliant securities, the Bank has taken the initiative to move its Islamic securities issuances towards the more efficient and cost-effective trustee-based structure. The new Islamic BNMNs (BNMN-i), under the Murabahah concept

of using a trustee-based structure, were issued at the beginning of September 2014. This was a change from the previously used special purpose vehicle (SPV)-based structure. Although other characteristics of the BNMN-i remain unchanged, the new trustee-based structure simplifies the issuance structure by allowing the Bank to be the direct issuer of the BNMN-i, instead of an SPV. This eases investors' understanding of the BNMN-i issuances structure and facilitates risk assessments on the issuer of the BNMN-i, and subsequently, may attract wider interest from both Islamic and conventional investors.

Financial Imbalances and Policy Responses in Malaysia

Financial Imbalances

While there have been numerous studies and discussions on financial imbalances, there is no clear or specific definition of financial imbalances. Rather, financial imbalances are often defined by their symptoms or manifestations. These could include over-investment in specific sectors, excessive credit growth, sharp increases in asset prices, or fiscal and current account imbalances. The most typical and frequently identified symptoms are asset price misalignments and excessive credit growth. These imbalances reflect the misallocation of resources and the disintermediation of funds towards speculative activity in asset markets.

As financial imbalances result in a build-up of domestic vulnerabilities and are ultimately unsustainable, they could lead to destabilising adjustments in the economy and pose risks to macroeconomic and financial stability. This phenomenon is not new. Historically, the build-up of financial imbalances has often preceded financial and economic busts¹. As illustrated by the experience of the advanced economies in the recent financial crisis, the slow build-up of financial imbalances, if left unchecked, can unravel rapidly and in a disorderly manner, leading to financial and economic disruptions, threatening price stability and longer-term economic growth prospects. Of greater relevance to emerging economies, in the post-crisis period, the unprecedented monetary policy accommodativeness in the advanced economies had led to a surge in capital inflows into these economies. These inflows can directly increase asset prices as foreign investors purchase assets, or they can lead to increased liquidity in the financial system, which in turn can intensify pressure on banks to lend, leading to credit booms and asset price bubbles. Such inflows and the consequent downward pressure on the interest rates of recipient countries can significantly influence monetary and financial conditions in small open economies.

Financial imbalances, at their core, are driven by shifts in the risk-taking behaviour of economic agents and a pervasive underestimation of risk exposures. Through the conventional transmission channels of monetary policy, which include the interest rate, credit and asset price channels, a prolonged period of low interest rates may induce investors or savers to take on greater risks. This could occur when valuations and incomes are expected to remain high, or in search of yield given low returns on safe investments. These channels, when interacting with the risk-taking channel, aggravate the risk of financial imbalances², as a prolonged period of low interest rates may lead to a fundamental shift in the perception and tolerance of risk.

With the risk-taking channel, a prolonged period of low interest rates results in lower measured risk and an increase in the search for yield. From the perspective of banks, a low interest rate environment eases loan repayment obligations and boosts asset and collateral values, consequently lowering banks' estimates of probabilities of defaults. When improvements observed are misperceived to be permanent in nature, banks become more willing to supply credit on terms that may not necessarily reflect the actual risks associated with the loans. Banks may also actively seek to go beyond conventional loan origination methods and take on riskier investments in order to boost nominal returns. The cumulative effect is a rise in the riskiness of the banks' asset portfolios³.

The risk-taking channel is also closely linked to liquidity⁴. When there is an increase in liquidity, assets become easier to trade with minimal impact on prices (market liquidity) and funds can be easily sourced (funding liquidity). This increase in liquidity further amplifies risk-taking behaviour as the lower perceived

¹ In a historical account of over 40 financial crises, Kindleberger (2000) describes financial crises as the end result of a process where expectations lead to speculative excesses, facilitated by excessive credit creation. Claessens, Kose and Terrones (2011) find that recessions associated with episodes of financial disruption, notably house price busts, tend to be longer and deeper than other recessions.

² The risk-taking channel is different from the credit channel in that it strengthens the financial accelerator with amplification mechanisms *within* the financial sector, namely risk perception and tolerance, as well as liquidity. See Borio and Zhu (2008), and Adrian and Shin (2009) for further details.

³ This channel is also associated with excessive bank balance sheet expansion through leverage (Adrian and Shin, 2010).

⁴ See Borio and Zhu (2008).

risks increases the appetite to participate in the asset markets and to undertake a search for higher returns. For small open economies, liquidity in the financial system can be significantly influenced by external sector inflows. Capital inflows affect asset markets and banks' balance sheets, contributing to higher asset prices and an increase in liquidity with banks^{5,6}. Banks are thus able to match credit demand while maintaining low or stable lending rates. In fact, the ample liquidity could increase competition to lend and thereby increase the risk appetite of banks. The combined effects may result in monetary and financial conditions becoming looser even if the policy interest rate remains unchanged. Crucially, the possible reversals of capital inflows and their attendant adverse effects may not be fully taken into account by the banks and their customers.

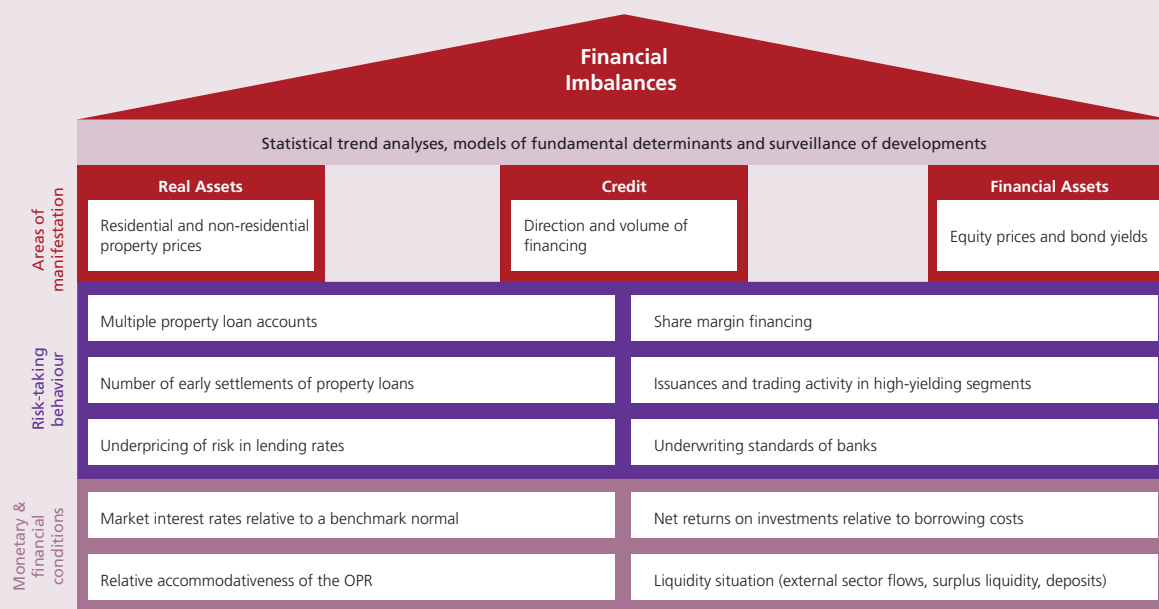
Indicators of Financial Imbalances

In assessing the build-up of financial imbalances in the economy, the Bank conducts surveillance using a wide range of indicators, both in granular and aggregate form. The main focus of surveillance is on (i) the accommodativeness of monetary and financial conditions, (ii) manifestations of increased risk taking, and (iii) signs of excessive credit growth and potential asset price misalignments.

The surveillance of monetary and financial conditions takes into account various price and quantity indicators which set the baseline for risk-taking behaviour. These indicators include borrowing costs and net returns on investments, as well as external sector inflows, surplus liquidity and deposits growth. To gauge risk-taking behaviour, the Bank monitors the risk-taking capacity of banking institutions by assessing their measured risk, and evaluates if shifts in this capacity translate into changes in lending practices. In evaluating credit growth and asset market developments, statistical trend analyses and econometric estimations are carried out. This is complemented by continuous surveillance of economic developments, which help differentiate

Chart 1

A Snapshot of Key Indicators for the Assessment of Financial Imbalances



⁵ Persistent current account surpluses also lead to a rise in banks' sources of funds, and potentially, domestic structural surplus liquidity.

⁶ Singh (2014) provides a discussion on the direct and indirect effects of global liquidity on Malaysia's monetary and financial conditions. Meanwhile, Bruno and Shin (2014) elaborate specifically on how prolonged loose monetary policy in advanced economies translates into greater risk tolerance by local banks in other countries through the increased leverage of global banks and their cross-border funding of these other banks.

fundamental and cyclical factors, as well as speculative elements. For example, when assessing the housing market, the Bank analyses structural factors such as housing supply, demographic changes and construction costs, which may explain deviations in price trends vis-à-vis income. At the same time, information such as the early settlement of loans and the number of borrowers with multiple loan accounts are also taken into consideration, in order to make an assessment of the level of speculative activity. This comprehensive approach enhances the robustness of assessments⁷.

At the aggregate level, the Bank also monitors the financial cycle. The financial cycle captures the evolution of credit and asset prices over time, which reflects changing perceptions of risk and financing constraints⁸. Empirically, peaks in the financial cycle have been shown to be closely associated with financial crises⁹. Additionally, financial cycles also tend to be longer in duration compared to business cycles. Consequently, financial imbalances tend to build up and unwind over a longer period compared to business cycle fluctuations.

Bank Negara Malaysia's Policy Approach to Financial Imbalances

As financial imbalances tend to build up gradually with the potential destabilising effects only emerging at time horizons that are beyond those of conventional monetary policy, it is important to pre-emptively react to early signs of financial imbalances. In this regard, apart from the main focus on the near-term balance of risks to the inflation and growth outlook, the Bank's monetary policy decisions also take into account the potential risks related to financial imbalances¹⁰.

At the same time, the policy approach does not overly rely on any single policy tool, including monetary policy, as adjustments to the policy interest rate would have a broad-based impact across the entire economy. As part of the Bank's broad policy toolkit, policy measures such as macro- and micro-prudential instruments are also considered and deployed to reign in financial imbalances. Coordination with fiscal policy, and the introduction of tax measures, increases the overall effectiveness in dealing with financial imbalances. The decision to use monetary policy or other policy measures, or a combination of these measures, in response to financial imbalances is based on their relative benefits and costs given the assessment of the prevailing situation. When imbalances are assessed to be contained in specific segments of the economy, targeted macro- and micro-prudential as well as fiscal measures may be more effective in curbing excesses while minimising unintended cross-sectional policy spillovers to other segments of the economy¹¹.

It is important to highlight that while these other measures can complement monetary policy, they are usually not a substitute for having the right level of the policy interest rate. In this regard, three key considerations make a strong case for monetary policy action. First, if prolonged loose monetary conditions are a likely source of financial imbalances, a change in the monetary policy stance may be better than treating the symptoms using other measures, as the cause of distortion is addressed directly. Second, if there are signs of financial imbalances becoming pervasive, driven by widespread underlying risk-taking behaviour, a monetary policy adjustment ought to be considered rather than relying solely on a set of more targeted measures. This is because monetary policy broadly affects the returns on assets and borrowing costs and is less subject to circumvention. In contrast, the use of a variety of other measures on a large scale may lead to distortions and substantial administrative costs. Third, the bluntness of monetary policy is less of a concern if the cost to near-term growth and inflation is low and is outweighed by the likely

⁷ The assessments form part of the staff evaluations deliberated upon by the Monetary Policy Committee in determining the balance of risks to growth and inflation. Given the nature of the issues and indicators, however, there is some overlap with the surveillance carried out under the financial stability mandate, which encompasses rigorous assessments on the risks to the financial system. See the Bank's annual publication, Financial Stability and Payment Systems Report for further details.

⁸ See Borio (2012).

⁹ Drehmann, Borio and Tsatsaronis (2012) find for a sample of seven industrialised countries, that all the financial crises with domestic origin occur at, or close to, peaks of the financial cycle.

¹⁰ For an earlier discussion on the role of monetary policy in addressing financial imbalances, refer to Bank Negara Malaysia (2010).

¹¹ For broad principles guiding the design, deployment and calibration of macroprudential policies in Malaysia, refer to Ibrahim (2014).

benefit to future growth and inflation. This trade-off tends to be smaller when the business cycle and financial cycle are synchronised.

This approach is reflected in the Bank's policy responses to the potential emergence of financial imbalances in the recent period. After reducing the Overnight Policy Rate (OPR) to a historic low of 2.00% during the financial crisis in the advanced economies in 2008-2009, the Bank progressively reduced this extraordinary monetary accommodation, raising the OPR by a 100 basis points to 3.00% between March 2010 and May 2011. The Bank recognised that keeping the OPR unusually low for an extended period could induce broad-based financial imbalances. This was especially so when asset prices and credit growth had also recovered fairly strongly amid sustained capital inflows arising from the highly accommodative monetary policy stance among advanced economies. Hence, at the earliest possible opportunity, when domestic economic growth was assessed to be more entrenched, the OPR was normalised. However, at the same time, it was recognised that higher interest rates could attract further capital inflows, potentially complicating efforts to avoid a build-up in financial imbalances. In this regard, the Bank's broad policy toolkit, which includes sterilised intervention under a flexible exchange rate regime, and the Statutory Reserve Requirement (SRR), had played an important role in complementing monetary policy. The Bank relies on a wide range of sterilisation instruments for liquidity management. After the initial reduction during the financial crisis in the advanced economies, the Bank raised the SRR by 300 basis points to 4.00% between April and July 2011¹². This move was aimed at providing longer-term sterilisation of the excess liquidity in the financial system.

A series of macro- and micro-prudential measures were also implemented in stages between 2010 and 2013 to curb financial excesses, which were mainly confined to segments of household lending. These targeted incremental measures have been effective, generally preserving sound lending standards and improving affordability assessments; thus contributing to the significant moderation in the growth of personal loans, particularly among non-banks. Along with fiscal measures, these measures led to reduced speculative activity in the property market¹³. In July 2014, amid firm growth prospects for the economy, and with inflation remaining above its long-run average, the Bank adjusted the degree of monetary accommodation. While the macro- and micro-prudential measures continued to have the desired effects, there remained risks of a broader build-up of financial imbalances. Consequently, the OPR was increased by 25 basis points to 3.25%.

The use of a comprehensive set of measures in tackling financial imbalances reflects the Bank's overall policy philosophy of considering all policy tools available to it and the mix that would most effectively address the issues at hand. Such an approach is necessary given the increasingly complex interactions within and between the financial system and the economy.

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¹² See press statements on the increases in the SRR in March, May and July 2011 to manage the build-up in liquidity which may result in financial imbalances.

¹³ For more details on the measures implemented, refer to Chapter 1 of Bank Negara Malaysia's Financial Stability and Payment Systems Report over 2010-2013.

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2014

OUTLOOK AND POLICY IN 2015

69	The International Economic Outlook
72	The Malaysian Economy
85	Inflation Outlook
86	<i>Box Article: Price Reforms: Motivation, Impact and Mitigating Measures</i>
92	Monetary Policy
93	Fiscal Policy
95	<i>Box Article: The New Reference Rate Framework</i>

THE INTERNATIONAL ECONOMIC OUTLOOK

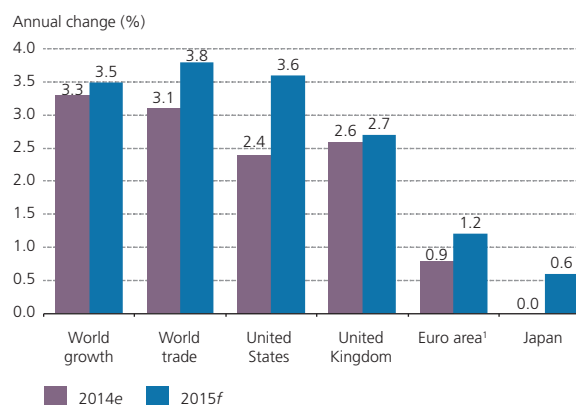
The global economy is expected to continue expanding at a moderate pace in 2015, with increasing divergence in the growth momentum among the major economies. Global growth will be supported by gradual but uneven improvements in the advanced economies and sustained growth in most emerging economies. While growth in the US is projected to gather momentum amid higher private sector spending, economic activity in the euro area and Japan will remain weighed down by structural weaknesses. In PR China, growth is projected to continue to moderate towards a more sustainable path, as policymakers continue to undertake structural reforms to rebalance the key drivers of the economy. Nevertheless, growth prospects in most emerging economies are expected to be sustained by the continued expansion in domestic demand and the gradual improvement in external demand, following the recovery in several advanced economies. In addition, the low global crude oil prices are expected to provide additional lift to global growth. Lower inflation and higher disposable incomes will support higher consumer spending, while lower production costs could encourage further business investment in non-energy-related sectors, particularly in industries with already high capacity utilisation rates.

Global economy to remain on a moderate growth path in 2015, with increasing divergence in growth momentum among major economies

Nevertheless, there remain downside risks to the global growth outlook. The prolonged weakness in domestic demand and persistence of disinflation or even deflation in several major advanced economies, together with adverse geopolitical developments, could have spillovers on global trade activity. Uncertainty over commodity price movements could also affect the growth prospects of the commodity-producing emerging economies.

Chart 4.1

World Growth, World Trade and Growth in Major Advanced Economies (2014-2015)



¹ Refers to EU-18
e Estimate
f Forecast

Source: International Monetary Fund and National Authorities

These, together with uncertainty arising from the potential divergence of monetary policy stance in the major advanced economies, could result in heightened volatility and potential disruptions in the international financial markets. Of significance, large and volatile shifts in global liquidity could have implications on the financial markets and growth prospects of the emerging economies.

Uneven growth performances across major economies

In the **US**, economic recovery is expected to become more entrenched, underpinned by a continued expansion in private sector demand and lower fiscal headwinds. Private consumption is projected to strengthen on account of improving household balance sheets and favourable labour market conditions. Of significance, job creation has been more broad-based. While some degree of labour market slack remains, it is expected to gradually diminish, as reflected by the ongoing decline in the unemployment rate and the lower number of involuntary part-time workers. The low energy prices will also provide further impetus to private consumption through lower inflation and higher disposable income. On the investment front, non-residential capital expenditure will be supported by rising new orders and higher capacity

utilisation rates, which have already exceeded pre-crisis levels (December 2014: 79.4% of total capacity; 2003-2007 average: 78.9%). Although mining investment will be weighed down by the lower crude oil prices, this is expected to be offset by higher investment in the other industries amid lower production costs and improving demand. Fiscal headwinds are projected to moderate amid a slower pace of fiscal consolidation in the near term. Possible fiscal challenges have broadly been alleviated, as the US Congress had passed a funding package for most federal agencies through Fiscal Year 2015, thus removing the possibility of a government shutdown. Nevertheless, the pace of economic expansion in the US could be affected by adverse spillovers arising from weaker-than-expected growth in several other major economies and the reversal of earlier US dollar weakness. Of significance, lower export performance and corporate earnings could affect the strength of investment activity.

In contrast, growth in the **euro area** is expected to remain subdued in 2015. Private consumption activity is anticipated to grow at a modest pace, as employment and real wage growth remain weak. Investment activity will likely remain low amid ample spare capacity, weak business sentiments amid persistent geopolitical developments, the modest implementation of structural reforms, and still unfavourable although improving financing conditions. Nevertheless, a broadly neutral fiscal stance, together with the introduction of the European Fund for Strategic Investments, could provide some support to investment activity going forward. Domestic demand may also benefit from the highly accommodative monetary policy stance, particularly following the implementation of the expanded asset purchase programme of EUR60 billion per month by the European Central Bank (ECB). On the external front, trade activity is expected to be supported in part by a gradual strengthening of external demand and the depreciation of the euro.

Economic activity in **Japan** is also expected to remain subdued in 2015. While export performance will continue to be supported by improving external demand and the weak yen, the lingering effects from the consumption tax increase in April 2014 could continue to limit the strength of domestic private sector recovery. Nevertheless, the postponement of the second consumption tax increase from 2015 to 2017 will likely mitigate further weakness in domestic

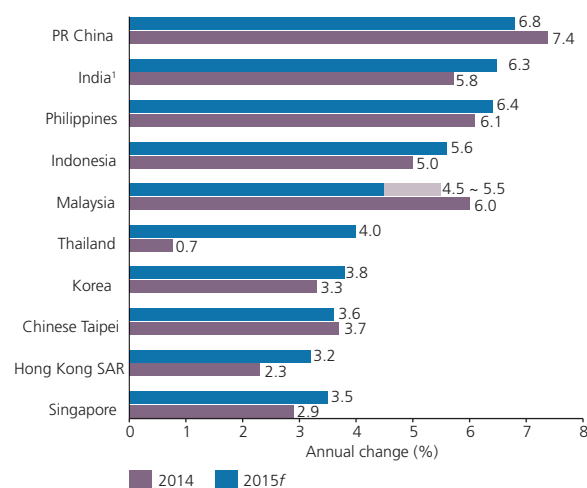
economic activity. Over the longer term, higher wage growth and further structural reforms aimed towards raising productivity and improving fiscal sustainability remain vital to the growth prospects.

In **PR China**, economic activity is expected to continue to trend towards a more sustainable growth path amid the implementation of further structural reforms to rebalance the key drivers of the economy. The pace of growth moderation is, nevertheless, expected to remain gradual. Of significance, the Chinese policymakers continue to have ample policy space to support overall growth, particularly through targeted measures to key productive sectors as well as accelerated infrastructure and rural development, and to mitigate potential risks confronting the Chinese economy.

In **Asia**, growth is expected to be sustained in 2015, supported by the continued expansion in domestic activity and improving external demand. Of significance, capital spending, particularly on infrastructure development, will continue to support the expansion in domestic demand. In the external sector, the improving growth prospects of several advanced economies, particularly the US, will continue to benefit Asia's export performance. Nevertheless, the degree of improvement will vary across economies based on their trade exposure, especially to the US and

Chart 4.2

Regional Economies: Real GDP Growth



¹ For India, GDP data and forecast are presented on a fiscal year basis

f Forecast

Source: International Monetary Fund, Asian Development Bank and National Authorities

PR China. For the major commodity exporters in the region, the lift from improving external demand could also be partly mitigated by the low commodity prices. Overall, the Asian region is projected to remain an important driver of global economy activity, contributing to over 50% of global growth in 2015.

Global inflationary pressures to remain modest

Global inflationary pressures are expected to remain modest in 2015, reflecting the persistence of low commodity prices amid favourable supply conditions and weak demand from several key economies. Given the moderate growth outlook for the global economy, the persistence of low inflation will provide further support to consumer spending.

In the global commodities markets, crude oil prices are likely to remain subdued on account of ample supply from both the Organisation of the Petroleum Exporting Countries (OPEC) and non-OPEC producers. Food prices are also projected to remain moderate amid higher crop production. For hard commodities, improved supply conditions and lower demand from several key economies, such as PR China, are likely to continue to exert downward pressures on prices, particularly for iron ore and copper.

Amid the subdued outlook for global commodity prices, headline inflation is expected to continue to trend below central banks' inflation targets in most advanced and emerging economies. Of significance, in the euro area, persistently low commodity prices amid a persistent negative output gap and subdued wage growth could increase the risk of protracted deflation. In contrast, for several advanced economies, such as the US, the potential for improving wage growth amid the further narrowing of economic slack could dampen the downward pressures on overall inflation. In Asia, the subdued commodity price outlook will help to contain price pressures emanating from improving domestic demand and further price adjustments in a few economies.

Downside risks to global growth remain

There, however, remain several downside risks to the global growth outlook in 2015. Despite highly accommodative monetary policies, prolonged economic slack and unresolved structural issues in several advanced economies could lead to weaker-than-expected growth momentum in these economies, with adverse

spillovers on global trade activity. The possibility for weaker-than-expected growth momentum in these economies could be further exacerbated by the persistence of disinflation or even deflation amid low commodity prices. While recent episodes of geopolitical developments have not resulted in sizeable disruptions to production, an increase in adverse geopolitical developments, particularly in the euro area, Eastern Europe and the Middle East, could affect global sentiments and dampen the strength of overall global growth. In addition, uncertainties over commodity price movements could have implications on the growth prospects of commodity-producing emerging economies.

Overall policy mix to remain supportive of growth

Monetary policy is expected to remain accommodative across regions. Nevertheless, amid the uneven growth outlook, the monetary policy stance in the major advanced economies could potentially diverge in 2015. In the euro area and Japan, the ECB and the Bank of Japan will continue to increase the degree of monetary accommodation through further asset purchases. In contrast, as the recovery in the US economy becomes more entrenched, the Federal Reserve (Fed) could begin normalising interest rates from the current low levels in 2015. There will, however, remain considerable uncertainty over the timing and pace of interest rate normalisation in the US, as policy adjustments by the Fed will depend on the actual turnout of economic and financial developments, as well as the balance of risks emanating from strengthening economic conditions and downward pressures on inflation emanating from lower energy prices.

The uncertainty over the timing and pace of monetary policy adjustments by the major advanced economies will likely lead to large and volatile shifts in global liquidity. The emerging economies, particularly Asia given the region's high degree of financial interconnectedness, will remain susceptible to the bouts of heightened financial market volatility. Of significance, as the Asian region was a major recipient of capital inflows during the earlier periods of asset purchases by central banks in the major advanced economies, Asia will continue to be vulnerable to large and sudden capital flow reversals. Nevertheless, the Asian economies are expected to remain resilient, with little disruption to financial intermediation, supported by the continued implementation of policy measures to strengthen macroeconomic fundamentals and address areas of vulnerabilities over the years.

In addition, the prioritisation of reforms to address infrastructure constraints, accelerate urbanisation, expand social safety nets and advance human capital development will further enhance the competitiveness and strengthen the medium-term growth potential of Asia. Furthermore, amid increasing focus on the quality of growth in the region, successful implementation of such policies will yield significant benefits in terms of the prospects for sustainable growth in Asia and the improvements in the economic welfare of its people.

THE MALAYSIAN ECONOMY

Overview

The international economic and financial landscape has become more challenging since late 2014 and into 2015. Beyond the sharp decline in commodity prices, the growth momentum in several major economies is also weaker than earlier expectations. Different growth momentums could lead to divergent monetary policy stances in the major economies, precipitating volatility in capital flows. Against this backdrop, the international financial markets are likely to remain volatile during the year.

As a highly open economy, Malaysia's economic outlook will be affected by these developments. Export growth is projected to be lower due to the low commodity prices. At the same time, uncertainties regarding the strength of global economic outlook and the sharp decline in the global oil prices have raised concerns on the country's fiscal and balance of payments positions. These developments have affected market sentiments and resulted in greater volatility in the capital markets in late 2014 and early 2015.

Although the commodity sector is an important contributor to production, exports and employment, the highly diversified structure of the Malaysian economy provides a buffer against the consequences of the sharp decline in global oil prices. Domestic economic activity and employment are expected to be sustained by the continued growth of the services, manufacturing and construction sectors, which together accounts for almost 84% of GDP. While the Government's fiscal position will be affected, the impact is mitigated by the fact that the dependency of the Government on oil-related revenue has declined over the years following efforts to broaden the revenue base. Importantly, the pre-emptive measures announced by the Government on 20 January 2015, which involved

both revenue enhancement and expenditure rationalisation measures, will contain the impact of the external developments on the overall fiscal position.

Despite facing significant external shocks, the Malaysian economy is expected to remain on a steady growth path of 4.5 – 5.5% in 2015

A positive development for Malaysia's exports in 2015 is the expected improvement in the US economy and the sustained growth of regional economies. Lower energy prices are expected to provide a lift to consumption and investment spending in net oil-importing economies such as the US, PR China and regional economies which are Malaysia's key trading partners. In addition, the global demand for mobile devices, tablets and automotive sensors continues to be strong. These developments are expected to drive Malaysia's manufactured exports (77% of total exports), in particular electronics and electrical (E&E) and non-resource based exports. The more diverse nature of exports in terms of products and markets will help sustain a surplus in the current account balance. The balance of payments position is therefore, expected to remain resilient, with the current account balance remaining positive.

Overall, the Malaysian economy is projected to register a steady growth of 4.5 – 5.5% in 2015 (2014: 6.0%), supported mainly by a sustained expansion in domestic demand amid strong domestic fundamentals and a resilient export sector. Domestic demand will continue to anchor growth in 2015, driven by private sector spending. Private consumption is forecasted to record a more moderate growth during the year, after registering five consecutive years of above-average growth rates since the financial crisis in the advanced economies. While household spending is expected to be affected by the implementation of the Goods and Services Tax (GST) in April and lower earnings in the commodity-related sectors, its impact will, however, be partially offset by Government measures to assist targeted groups, the additional disposable incomes from lower fuel prices and the favourable labour market conditions. Similarly, after three consecutive years of double-digit growth, private investment is expected

to moderate due mainly to lower investment in the mining sector following weak global crude oil prices. Nevertheless, private investment growth will be supported by on-going and new investments in the manufacturing and services sectors as firms benefit from the continued global recovery and lower cost of inputs. Public sector spending, in particular public investment, is expected to improve amidst higher spending on fixed assets, particularly by the public enterprises. In 2015, the contribution to growth from the Government is expected to remain modest.

On the external front, the current account of the balance of payments is projected to remain in a surplus position of about RM21.4 billion or 2 - 3% of gross national income (GNI). Even though gross exports are expected to record slower growth amid lower commodity prices, the improvement in economic activity in several advanced economies and sustained growth of regional economies will lend support to manufactured exports. At the same time, a stronger travel account in conjunction with 'Malaysia - Year of Festivals 2015' tourism promotion is expected to provide a lift to the services account. Gross imports are projected to increase at a faster pace as intermediate imports remain strong. After registering a negative growth in 2014, capital imports are expected to recover, reflecting continued investment activity which will improve Malaysia's productive capacity and export competitiveness in the medium- and long-term.

Headline inflation is expected to average 2 - 3% in 2015 (2014: 3.2%) due mainly to lower energy and food prices. The decline in global oil prices would lead to lower domestic fuel prices through the managed float fuel pricing mechanism. The subdued external price pressures would also mitigate increases in the cost of imports stemming partly from the recent ringgit depreciation, thereby reducing overall imported inflation. These would partly offset some of the impact from the implementation of the GST on 1 April 2015. While there is a risk that the monthly inflation trajectory could be subject to the volatility in global oil prices, the underlying inflation is expected to remain relatively stable.

While the latest projection is for a gradual improvement to global growth in 2015 relative to 2014, there are several **downside risks** to the growth outlook. In the advanced economies, the implementation of much needed structural reforms will determine the strength of economic

recovery in the immediate term and the sustainability of the recovery over the longer term. A sharper-than-expected slowdown in PR China poses downside risks to global growth and trade. In addition, the uneven growth prospects are raising the possibility of a divergence in the monetary policies of the major central banks. Such a development could result in sizeable global liquidity shifts and contribute to greater volatility in global financial markets and capital flows. The sharp decline in the price of oil and the uncertainty over its future price path, coupled with the attendant effects on the prices of other commodities, further compounds the challenging global environment.

In the event that some of these risks materialise, the Malaysian economy would be adversely affected, but its strong underlying fundamentals would act as a buffer to mitigate the impact. The economy is well-diversified, inflation is low, and the balance of payments position is resilient. At the same time, labour market conditions remain healthy, with an unemployment rate of 3%. In addition, financial system stability is intact, supported by financial institutions that have strong capitalisation levels and sound risk management practices. This will allow financial intermediation to continue and provide support to economic activity in the event of an external shock. The deeper and more matured financial markets and the strong banking system have also increased Malaysia's resilience to bouts of capital flow volatility. On the external front, the long-term prospects for FDI remain positive while Malaysia's external debt remains manageable, with a debt profile that is skewed towards the medium- and longer-term tenures. A significant share of the external debt is also ringgit-denominated, which reduces the impact of foreign exchange fluctuations. This, together with ample international reserves will further accord the policymakers with flexibility to manage these external risks. The combination of these factors will cumulatively also enable a more effective policy response to mitigate the impact of any external shocks on domestic demand and growth.

Domestic demand continues to underpin growth

Domestic demand is expected to register a sustained growth of 6.0% in 2015 (2014: 6.0%), anchored by private sector expenditure. Private sector spending is expected to remain resilient amid an improvement in public expenditure growth.

Expansion in All Economic Sectors

In 2015, all economic sectors are expected to expand, albeit at a more moderate pace. The services and manufacturing sectors would remain as key drivers of overall growth, benefiting from the resilience of domestic demand. Growth in the mining sector is projected to be sustained amid rising output from a new oil field. Weighed down by lower commodity prices, the agriculture sector is expected to record lower but still positive growth.

Table 1

Real GDP by Kind of Economic Activity (2005=100)

	2014 ^p	2014 ^p	2015 ^f	2014 ^p	2015 ^f
	% of GDP		Annual change (%)	Contribution to growth (percentage point)	
Services	55.3	6.3	5.6	3.5	3.1
Manufacturing	24.6	6.2	4.9	1.5	1.2
Mining and quarrying	7.9	3.1	3.0	0.3	0.2
Agriculture	6.9	2.6	0.3	0.2	0.0
Construction	3.9	11.6	10.3	0.4	0.4
Real GDP	100.0¹	6.0	4.5 ~ 5.5	6.0¹	4.5 ~ 5.5

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 is projected to remain as the largest contributor to growth in 2015. Growth in consumption-related activities such as retail trade, accommodation and restaurants will be supported by household spending. Higher tourist arrivals, in conjunction with the 'Malaysia - Year of Festivals 2015' tourism promotion, will further support growth. The communication sub-sector will continue to register robust growth, driven by strong demand for data services amidst higher usage of mobile devices, particularly smartphones. The continued expansion in trade-related activity will support growth in production-related services such as wholesale, transport and storage. In the finance and insurance sub-sector, growth is projected to be sustained, supported by stable demand for financing, particularly from businesses, and higher fee income from capital market activity.

The manufacturing sector is expected to continue to expand in 2015 despite slower growth in key clusters. While the lower oil prices will affect the production of petroleum-related products, growth in the export-oriented cluster will be supported by the sustained demand for Malaysia's E&E goods. Growth in the consumer- and construction-related clusters will remain supported by the favourable domestic demand conditions.

The construction sector is expected to continue to record high growth, albeit at a more moderate pace in 2015. After several years of robust growth, activity in the residential sub-sector is expected to increase at a more moderate pace due to lower housing approvals and property launches. Nonetheless, growth in the non-residential sub-sector is projected to be sustained, amid higher construction activity for industrial and commercial buildings. New and existing multi-year civil engineering projects, particularly in the transport and utility segments, will continue to provide additional support to the sector.

In the commodity sector, agriculture production is expected to record a marginal positive growth, in tandem with the lower commodity prices. In addition, production of palm oil will be affected by the lagged impact of the dry weather conditions which occurred in early 2014. Growth in the mining sector is expected to be sustained, supported by oil production from the new Gumusut Kakap field offshore Sabah.

The projected GDP growth in 2015 points to the economy operating close to its potential output. While the estimated positive output gap of 0.39% suggests that the economy would be operating slightly above its potential, the gap is relatively modest and is not expected to put a strain on resources within the economy¹.

Private expenditure is expected to remain resilient amid an improvement in public expenditure

After registering five consecutive years of above-average growth rates following the crisis in the advanced economies, **private consumption** is projected to grow by 6.0% in 2015 (2014: 7.1%). The implementation of the GST in April 2015 may have some effect on household spending. This will, however, be partially offset by the Government's measures to assist targeted groups, the additional household disposable income from lower fuel prices, and the favourable labour market conditions. The targeted Government assistance to low- and middle-income groups is expected to provide support to private consumption. These include the higher amount of *Bantuan Rakyat 1Malaysia (BR1M)* cash transfers, the RM100 cash assistance programme to primary and secondary school students, and the *Baucar Buku 1Malaysia (BB1M)* for Malaysian students in higher learning institutions. The reduction of individual income tax rates by one to three percentage points with the implementation of the GST is also expected to increase the household disposable income. The lower fuel prices will support household spending in two ways: through savings from paying lower prices for fuel and from lower inflation. All these factors are expected to raise disposable income and consequently, support consumption spending.

Overall wage growth is also expected to remain favourable. In particular, the latest Malaysian Employers Federation's survey suggests a slightly higher forecast for salary increment of 5.8% in 2015 (2014: 5.4%). Although workers in the agriculture and mining sectors will experience lower earnings, they account for a relatively small share of total employment (about 13%). Wages

¹ For details of the output gap, refer to the White Box on the 'Estimating Malaysia's Potential Output'.

Table 4.1

Real GDP by Expenditure (2005=100)

	2014p	2015f	2014p	2015f
	Annual change (%)		Contribution to growth (percentage point)	
Domestic Demand¹	6.0	6.0	5.6	5.6
Private sector expenditure	8.0	6.7	5.5	4.7
<i>Consumption</i>	7.1	6.0	3.7	3.2
<i>Investment</i>	11.0	9.0	1.8	1.6
Public sector expenditure	0.2	3.7	0.1	0.9
<i>Consumption</i>	4.4	2.7	0.6	0.4
<i>Investment</i>	-4.9	5.1	-0.5	0.5
Change in Stocks			-0.9	0.1
Net Exports of Goods and Services	19.7	-7.8	1.4	-0.6
Exports	5.1	3.0	4.6	2.6
Imports	3.9	4.0	3.2	3.2
Real Gross Domestic Product (GDP)	6.0	4.5~5.5	6.0	4.5~5.5

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

in selected export-oriented industries, particularly the non-resource-based manufacturing sectors, are projected to improve in line with continued export growth. Growth of wages in the domestic-oriented sectors is also expected to be sustained given the favourable domestic demand conditions.

In addition, employment conditions remain favourable, with sustained demand for labour in the domestic-oriented services sectors. In 2015, the unemployment rate is projected to remain stable at 3.0% (2014: 2.9%).

After three years of strong double-digit growth, **private investment** is expected to expand by 9.0% in 2015. Private sector capital spending will continue to be supported by on-going projects and a steady inflow of new investments, particularly in the manufacturing and services sectors. In addition, measures to strengthen private investment, as outlined by the Government in the 2015 Budget and the Prime Minister's Special Address in January 2015, are expected to provide support to investment by local firms, including the SMEs.

Estimating Malaysia's Potential Output

Introduction

Potential output refers to the concept of maximum productive capacity of an economy without exerting pressure on prices. Another important concept is the difference between an economy's potential output and its actual output, known as the output gap. The output gap is a useful gauge of the intensity of utilisation of an economy's resources and is often used by policy makers as one of the indicators to forecast inflation and make interest rate decisions. Nevertheless, estimating a country's output gap can be challenging as it is not directly observable and is sensitive to model specifications. Structural changes in the economy further compound the difficulty to make estimates.

In estimating Malaysia's potential output and output gap, Bank Negara Malaysia has adopted three broad approaches. These approaches include univariate models (linear trend, Hodrick-Prescott (HP) filter and the univariate state space), structural models (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 limitations (see Chuah and Shahrier, 2014)¹, the use of a combination of estimation methods allows for comparisons and cross-checking of the results, hence providing a better understanding of the robustness of the output gap estimates.

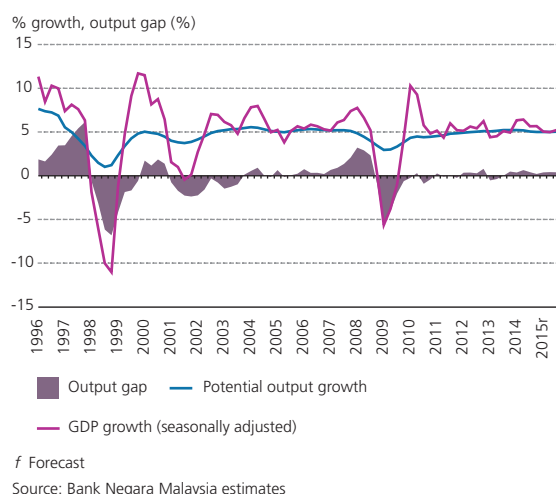
Malaysia's Output Gap in 2014-2015

Based on the Bank's estimates, Malaysia's potential output grew by approximately 5.1% in 2014. As growth in actual output was relatively strong in 2014, the average output gap derived from the three broad approaches is estimated to be +0.41%. Continued private and public sector investment activity (gross fixed capital formation: 8.5% in 2013; 4.7% in 2014) as well as high labour participation (67.5%; 2013: 67%) during the year contributed to the expansion of the productive capacity in the economy.

Although the Malaysian economy registered a positive output gap of +0.41% in 2014, this did not necessarily signal an overheating of the economy. Not only was the gap relatively small, its duration was also relatively short (Chart 1). Demand pressures that were a contributing factor to the positive output gap, dissipated during the second half of the year (aggregate demand 1H 2014: 6.6%; 2H 2014: 5.4%).

Chart 1

Output Gap, Potential and Actual Output



¹ Details of the models are discussed in the paper by Chuah and Shahrier (2014), Estimating Malaysia's Output Gap: Have We Closed the Gap?, *Bank Negara Working Paper Series WP4/2014*.

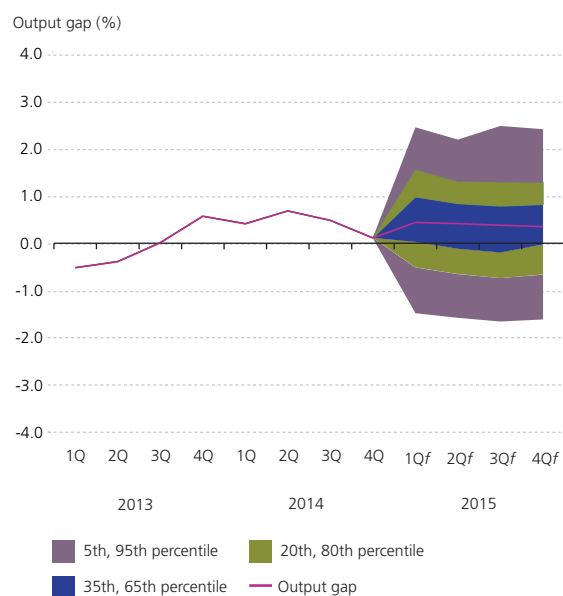
Capacity utilisation in the manufacturing sector was below 80%² (78.5%; 2013: 79.2%), indicating the availability of ample capacity in the economy to absorb any excess demand. In addition, wage pressures remained moderate. A survey by the Malaysian Employer Federation (MEF) on the salaries of Executives and Non-Executives showed that average wages increased by 5.4% in 2014 (2013: 6.6%). While inflation was higher in 2014 (3.2%; 2013: 2.1%), it was mainly driven by shocks to domestic costs.

In 2015, the potential output growth is estimated to be approximately 5% with the output gap estimated to be +0.39%. The pace of economic activity is expected to be consistent with the resources available in the economy. The estimated output gap, which is slightly smaller than the one in 2014, suggests that demand pressures will remain contained.

The fan chart (Chart 2) aims to capture the uncertainty in the output gap estimates, arising particularly from potential measurement errors. The estimated output gap lies within the inner band of the fan chart, which ranges between -0.08% to +0.85%. Given this uncertainty, information gathered from the industry is used to corroborate the model-based assessments of the output gap. From the Bank's engagements with the industry, firms have indicated that demand conditions will remain stable in 2015. While some domestic-oriented firms project a modest growth in sales, there are downside risks to these projections. In general, the electrical and electronic (E&E) firms are more optimistic about demand conditions as these firms expect to benefit from the strengthening US economy. However, export-oriented firms in other sectors expect demand to be stable. In terms of wages, firms are not expected to raise wages beyond the normal 5-6% yearly increments. The labour market remains balanced, with no apparent labour shortages, except potentially in the construction sector.

Chart 2

Uncertainty of Output Gap Estimates, 2015



² In 2007/08 when there was a significant buildup in output gap, the capacity utilisation rate was 80.6%.

The moderation in private investment growth from the previous year is mainly attributable to the mining sector. The decline in global oil prices is expected to affect upstream oil and gas projects, particularly in the enhanced oil recovery (EOR) and marginal oilfield activity. The impact will, however, be partially mitigated by the implementation of projects that have already been contracted out and existing long-gestation projects such as deepwater exploration.

Private investment is expected to be driven by the continued expansion in export-oriented manufacturing activity

In line with the continued expansion in domestic-oriented activity, investment growth in the services sector is projected to be driven by the inflow of new projects and the continued implementation of existing investment, particularly in the tourism-related, transportation and business-related sub-sectors. The residential property segment will continue to expand, albeit at a slower pace, and will be mainly concentrated in the mass-market and affordable housing segments.

In the manufacturing sector, investment is expected to be driven by the continued expansion in export-oriented activity, amidst the gradual improvement in external demand. This is also reflected in the significantly higher total manufacturing investment approvals in 2014 (RM71.9 billion), relative to the level of investment approvals in the previous year (2013: RM52.1 billion). The increase in investment approvals points towards robust investment activity for 2015 and beyond, particularly in the E&E and refined petroleum and petrochemical products sub-sectors.

Public consumption is projected to expand by 2.7% in 2015, reflecting sustained growth in emoluments amid lower spending on supplies and services following the Government's expenditure rationalisation measures.

Public investment will turn around to register a positive growth of 5.1%. While capital spending by both the public enterprises (PEs) and the Federal Government is expected to increase in 2015, the larger contribution will come from PEs. Investments by PEs reflect the continued

implementation of key infrastructure projects, particularly in the utility and transportation sub-sectors. These investments will provide additional support to public investment amid lower but still-sizable capital spending in the oil and gas sector. The Federal Government's development expenditure will be channeled mainly towards improving access and connectivity of urban public transport and rural infrastructure. In the social services sector, expenditure will be channeled primarily to the healthcare and housing sub-sectors.

External sector to remain resilient

As Malaysia is a highly open economy and a commodity exporter, its performance would be affected by the lower commodity prices and the weaker growth momentum in several major economies. However, the diversity of Malaysia's exports in terms of products and markets would mitigate some of these impacts and provide support to the overall export growth.

Despite the negative terms of trade shock, the current account of the balance of payments will remain positive in 2015

In 2015, the growth of gross exports is projected to moderate to 1.5% due mainly to lower commodity exports. Commodity exports, which constitute 23% of Malaysia's total exports, will be weighed down by lower prices of crude oil, liquefied natural gas (LNG) and crude palm oil (CPO). Nevertheless, the decline in CPO prices is not expected to be as severe as the decline in oil prices, given the projected lower supply of CPO following the dry weather conditions in first half of 2014, and the higher demand arising from the mandatory palm oil-based blending of biodiesel in several countries. In addition, LNG prices will also be supported by continued demand from the regional economies.

Malaysia's manufactured products stand to benefit from the improvement in economic activity in several of the advanced economies and the sustained growth in Asia. These manufactured exports, which comprise 77% of Malaysia's total exports, are diverse in terms of products and markets, and are expected to remain resilient in this challenging external environment.

The Impact of Lower Commodity Prices on the Malaysian Economy

Lower crude oil and commodity prices present a challenging economic environment

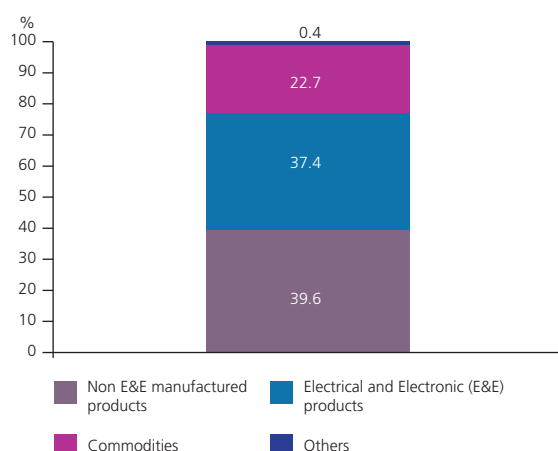
Following nearly four years of relative stability, crude oil prices have experienced a sharp decline since the second half of 2014¹. The decline is expected to also lower the prices of other major commodities, including crude palm oil (CPO) and liquefied natural gas (LNG). As the commodity sector (agriculture and mining) accounts for almost a quarter of exports and around 15% of production, the decline in prices will have an impact on the Malaysian economy. Nevertheless, the transformation of the Malaysian economy over the recent decade towards one that is more diversified and developed, has enhanced the country's economic resilience. This article seeks to provide an overview of the likely impact of lower commodity prices on the Malaysian economy in terms of exports, the current account of the balance of payments, domestic demand, employment, production, the fiscal position and the overall impact to growth prospects.

The current account balance will narrow but remain in surplus, supported by Malaysia's diverse trade structure

Commodity exports, including that of crude oil, liquefied natural gas (LNG) and crude palm oil (CPO), constitute 23% of total exports in Malaysia. While the sharp decline in commodity prices will have implications for overall exports, the impact is mitigated by Malaysia's diverse export structure in terms of both products and markets (Chart 1 and Chart 2). Manufactured products comprise 77% of gross exports, and will benefit from the improvement in global growth². In particular, stronger growth momentum in the US as well as the continued expansion in PR China and regional economies will support external trade, as these economies are a significant source of final demand for Malaysia's products³. This diversity in Malaysia's exports will thus cushion the fall in commodity exports and ensure continued, although more moderate, expansion in **gross exports** in 2015.

Chart 1

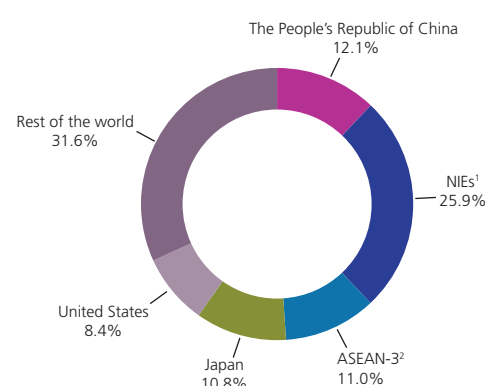
Malaysia's Exports by Major Products (2014)



Source: Department of Statistics, Malaysia

Chart 2

Malaysia's Exports by Trading Partners (2014)



¹ NIEs refers to Singapore, Hong Kong SAR, Chinese Taipei and Korea
² ASEAN-3 refers to Thailand, Indonesia and the Philippines

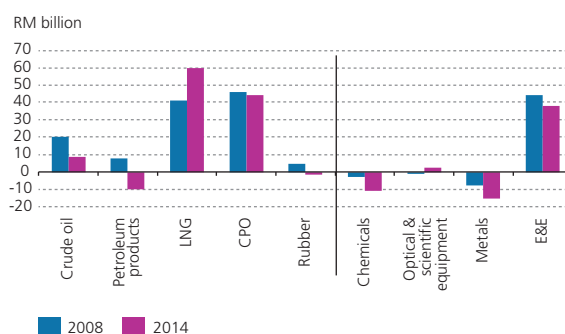
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

- ¹ The price of Brent crude declined by 52.5% from mid-June 2014 to end-December 2014, reaching a five-year low of USD47 per barrel on 13 January 2015. This is mainly a reflection of persistent oversupply of crude oil in the global markets, accompanied by some slowing in demand growth.
- ² The decline in commodity prices comes at an opportune time for the global economy, as it helps to partially offset weaker-than-expected growth momentum in several major economies. Although the effects will be uneven with selected major commodity exporters being adversely affected, the lower commodity prices are a net positive and will provide some support to economic activity and the global recovery.
- ³ The US and PR China accounted for 17.7% and 9.9%, respectively, of the foreign final demand for Malaysia's goods and services in 2009, making them the two largest sources of foreign final demand for Malaysia (BNM estimates based on latest available OECD-WTO Trade in Value Added database).

In terms of the trade balance, as a large net exporter of LNG and CPO, the lower prices of these commodities will weigh on the trade position in 2015 (Chart 3). However, the net export position of both commodities will remain positive as the imports of LNG and CPO are minimal. In terms of oil, although Malaysia will receive less proceeds from exports of crude oil, the trade position will also benefit from the lower cost of imported petroleum products. The improvement in global growth will also provide support to manufactured exports and the overall trade position. Therefore, while lower commodity prices will contribute to a narrower **trade and current account balance** in 2015, both are expected to remain in a surplus position.

Chart 3

Net Export Position of Major Products



Source: Department of Statistics, Malaysia

Domestic demand will remain resilient, as households and non-oil and gas enterprises will benefit from lower prices and costs

In terms of **domestic demand**, the private sector is expected to benefit from lower commodity prices and remain the key driver of economic growth in 2015. For households, lower fuel prices will lead to additional disposable income and support **private consumption**. BNM estimates suggest that the lower pump prices, if sustained, would translate to a total annual savings of RM7.5 billion⁴ on fuel expenditure by households. This is expected to outweigh the effect of lower incomes in the commodity sector, which constitutes just 13% of total **employment**⁵.

For businesses, while **total investment** in the mining sector, which accounts for 19% of investment in the economy, will be affected, overall capital spending in Malaysia is broad-based (Chart 4) and is expected to remain resilient. Investment plans in the services and manufacturing sectors, which contributed 76% of total investment in 2013, are expected to continue as firms will benefit from the continued global recovery and lower costs of inputs. Thus, domestic investment is expected to remain resilient.

Similarly, in terms of **production**, the commodity sector accounted for only 15% of real⁶ GDP in 2014. The services and manufacturing sectors, which accounted for 80% of GDP (Chart 5), will continue to support the growth momentum going forward. Therefore, although selected segments of the economy will be affected by lower commodity prices, **overall growth** is projected to remain within the 4.5-5.5% range in 2015.

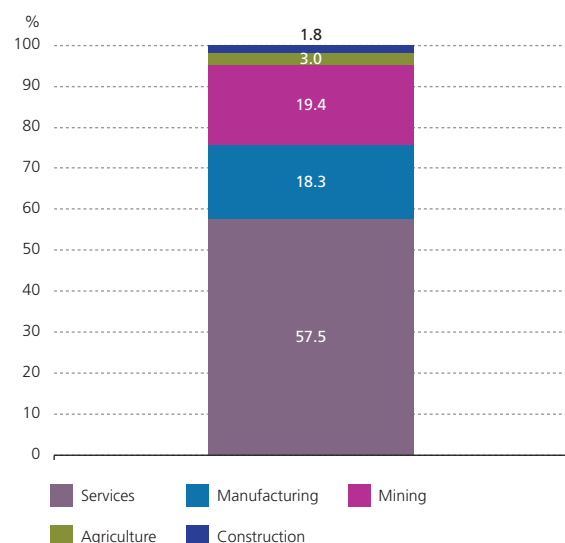
⁴ Based on the savings to households under the managed float pricing mechanism assuming a USD40 per barrel decline in crude oil prices. If 40% of savings are spent, this will lead to an additional RM3 billion in household spending.

⁵ This is compared to 61% and 17% in the services and manufacturing sectors, respectively.

⁶ At constant 2005 prices.

Chart 4

Total Investment by Sector (2013)*



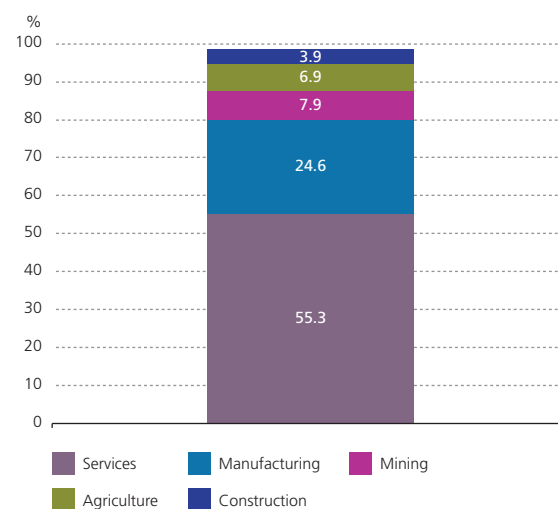
* Figures for 2014 will be released by the Department of Statistics, Malaysia in June 2015

Note: Numbers do not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Chart 5

Real GDP* by Kind of Economic Activity for Malaysia (2014)



* At constant 2005 prices

Note: Numbers do not necessarily add up due to rounding and the exclusion of import duties component

Source: Department of Statistics, Malaysia

The fiscal position will be affected but the impact is being proactively managed

In terms of the **fiscal position**, a persistent decline in crude oil prices will result in lower oil-related revenues. Nonetheless, proactive measures designed to diversify fiscal revenues undertaken over the last few years, together with the pre-emptive measures that were announced on 20 January 2015 will ensure that the overall impact on the fiscal position will be contained and manageable.

Chief among the measures are reforms to broaden and diversify sources of Government revenue as well as reduce the dependency on oil revenue⁷. In this regard, the contribution of oil revenue to total Government revenue has been on a declining trend from its peak of around 41.3% in 2009⁸ to 30.0% in 2014. This reflects the increased contribution of non-oil revenue in tandem with the sustained economic growth and the efforts by the Inland Revenue Board to further improve tax compliance and collections. The increase in the contribution of non-oil revenue is expected to continue going forward given the GST implementation in April. Besides the revenue enhancement measures, the Government has also undertaken expenditure rationalisation, underpinned by the transition to the managed float pricing mechanism for the price of RON95 fuel. This transition will reduce the subsidy burden of the Government, help raise efficiency and support the long-term sustainability of not only the fiscal position but overall growth prospects (See Box Article on *Price Reforms: Motivation, Impact and Mitigating Measures*).

Importantly, recognising the high likelihood of lower oil-related revenue in 2015, the Government, on 20 January 2015, announced pre-emptive revenue enhancement and expenditure reprioritisation measures to ensure that the fiscal deficit will remain on a consolidation path despite the challenging

⁷ A comprehensive enhancement to tax administration has been underway since 2011. These include: (i) Programmes to increase tax awareness and compliance amongst tax payers, reduce tax arrears and broaden the tax base, as well as the provision of online tax services such as e-Filing, e-Register and e-Payment; and (ii) Monthly industrial engagements with businesses to increase tax compliance while expanding audit investigations.

⁸ The higher share of oil-related revenue in 2009 is due in part to lower non-oil-related revenue due to the economic slowdown arising from the financial crisis in the advanced economies.

environment. Going forward, the Government has the policy space to undertake further adjustments if the need arises, to achieve the medium-term objective of a balanced budget by 2020. Nonetheless, the adjustments will be undertaken with due consideration to overall growth prospects of the economy.

Financial market conditions are expected to remain orderly despite heightened volatility

In the **financial markets**, expectations of interest rate normalisation by the Federal Reserve amidst the recovery in the US economy, and concerns on the global growth outlook have led to capital flow reversals from the emerging markets. This, in turn, has led to a depreciation of emerging market currencies against the US dollar. In addition, concerns over the potential impact of lower commodity prices on commodity-exporting economies have resulted in a larger adjustment in their exchange rates, including that of the ringgit.

Notwithstanding the capital reversals and the impact on the ringgit, the domestic financial markets have remained orderly. The recent outflows have been limited to Bank Negara Monetary Notes (BNMNs) and the equity market. The ability to manage the outflows by unwinding instruments such as the BNMNs ensured that the domestic bond market was not significantly impacted. This has allowed domestic bond yields, particularly long-term yields, across tenures to remain relatively stable despite the volatility of capital flows. There was no disruption in financial intermediation, with financing to the economy continuing uninterrupted.

Going forward, Malaysia remains well positioned to ensure that further bouts of financial market volatility do not spill over to the real economy. Malaysia has in the past experienced similar magnitudes of capital outflows and BNM has managed these episodes. The ability to navigate these challenges stems from having an ample reserves buffer, greater policy flexibility, a wider range of policy tools, a strong banking system and well-developed financial markets to intermediate volatile capital flows. In addition, the large domestic investor base, particularly the well-diversified institutional investors, has the capacity to support the market in the event of liquidation by non-resident investors. These conditions will ensure the continued orderly functioning of domestic financial markets, and ultimately, a financial system that is supportive of the real economy.

The Malaysian economy is expected to remain resilient in 2015 despite the challenging external environment

The decline in the prices of major commodities will have implications for economies across the world. As a small and open economy, this development will impact Malaysia. However, as the Malaysian economy is well-diversified and has sound economic fundamentals, the economy has the resilience to weather this shock. Nonetheless, policymakers will continue to monitor these developments and remain vigilant to emerging risks in the global and domestic environment. In the event of more severe shocks to the economy, policymakers have the policy space and the ability to undertake the necessary adjustments.

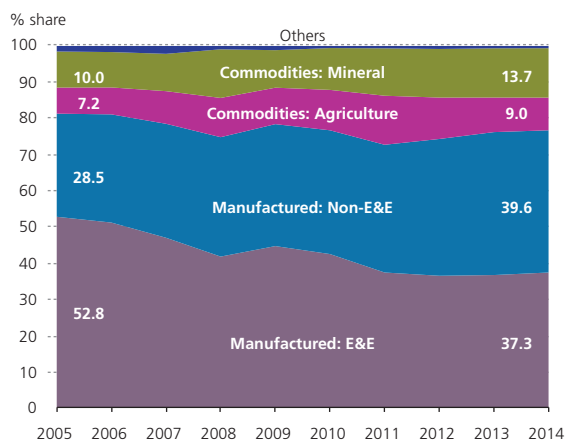
The expected improvement in manufactured exports in 2015 will be driven mainly by the E&E sector. E&E exports will be supported by an improvement in private sector activity in the US, in particular continued investment growth amid high capacity utilisation rates. In addition, the semiconductor industry is expected to remain resilient with the global semiconductor sales continuing to record steady growth, driven by sustained demand for smart devices. These positive trends augur well for semiconductor exports as Malaysia's E&E firms have ventured into industries with fast growing

global demand, such as mobile devices, tablets and automotive sensors. Non-E&E exports will continue to expand, albeit at a more moderate pace, supported by sustained regional demand. The moderate growth of non-E&E exports is expected to emanate mainly from the resource-based products, particularly chemicals, petroleum and rubber products.

Gross import growth is projected to increase to 6.0% in 2015, driven by the continued growth in intermediate imports and domestic demand. Intermediate imports, which form the

Chart 4.3

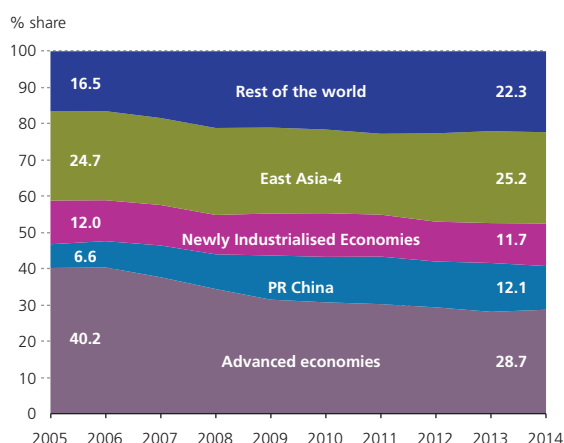
Export by Products



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 4.4

Export by Markets



Note: Advanced economies include US, EU28 and Japan; Newly Industrialised Economies include Hong Kong, Chinese Taipei and Korea while East Asia-4 include Singapore, Thailand, Philippines and Indonesia

Source: Department of Statistics, Malaysia

bulk of Malaysia's gross imports, are expected to expand further, amid the continued expansion in manufacturing activity to meet the improved global demand. In addition, capital imports are expected to grow at a faster pace, driven mainly by the ongoing investment projects, a steady inflow of new large private sector projects, and the continued implementation of key infrastructure projects. The slightly higher growth of consumption imports reflects the continued growth in food and beverages imports, which account for the largest share of consumption imports, and are relatively inelastic in demand.

The trade balance in 2015 is expected to narrow but remain in a surplus position, supported by the improvement in manufactured exports and a continued surplus in the commodity trade balance. While crude oil exports will be affected by the lower crude oil prices, the impact on the trade balance will be partially mitigated by the lower cost of imported petroleum products. Given that Malaysia is a large net exporter of LNG and CPO, the projected lower prices of these two commodities will weigh on the commodity trade surplus. Based on past trends, the price decline of LNG and CPO will not be as significant as the decline in crude oil prices. Furthermore, exports of these two commodities have minimal corresponding imports, lending support to Malaysia's position as a net commodity exporter. At the same time, net exports of E&E will be supported by the continued expansion in global demand.

In the services account, the projected narrower deficit will be mainly supported by the recovery in tourist arrivals and higher tourist spending amid 'Malaysia - Year of Festivals 2015' promotion and the intensification of other tourism promotional activities. Nevertheless, growth in services imports will be driven by continued payments for transportation and other services, in line with the expansion in trade and investment activity during the year.

Table 4.2

External Trade

	2014p	2015f
	Annual change (%)	
Gross exports	6.4	1.5
of which:		
Manufactures	7.3	8.4
Agriculture	0.6	-10.8
Minerals	7.3	-30.4
Gross imports	5.3	6.0
of which:		
Capital goods	-2.1	10.0
Intermediate goods	7.6	6.8
Consumption goods	5.7	6.8
Trade balance (RM billion)	83.1	53.6

p Preliminary

f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

In the income account, profits from Malaysian companies investing abroad are expected to be sustained. The lower income from oil and gas companies, which constituted more than a third of Malaysia's investment income abroad, will be partially offset by an improvement in profits from other overseas investments by Malaysian companies, amidst a modest improvement in global demand and lower costs of oil-related inputs. Nevertheless, this will likely be surpassed by the higher profits and dividends accrued to multinational corporations operating in Malaysia in line with the expected improvements in manufactured exports. As a result, net outflows in the primary income account are likely to increase in 2015. The continued deficit in the secondary income account is expected to be driven by lower inward remittances amid sustained outward remittances.

Overall, given a more moderate growth of exports and robust imports, net exports of goods and services will turn around to register a small negative contribution to real GDP growth in 2015. Alongside a wider income deficit, the current account surplus of the balance of payments in 2015 is projected to be lower at RM21.4 billion or 2 - 3% of GNI. This lower current account surplus also reflects a narrowing of the savings-investment gap.

Table 4.3

Balance of Payments

	2014 ^p	2015 ^f
	RM billion	
Goods	125.1	94.2
Services	-20.5	-16.4
Balance on goods and services	104.5	77.8
Primary income	-37.4	-38.0
Secondary income	-17.6	-18.5
Balance on current account	49.5	21.4
% of GNI	4.8	2-3
Capital account	0.3	
Financial account	-76.5	
Balance on capital and financial accounts	-76.2	
Errors and omissions	-9.8	
of which:		
Foreign exchange revaluation gains	7.6	
Overall balance	-36.5	

^p Preliminary

^f Forecast

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Strength and flexibility to withstand external shocks

Amid continued uncertainty in the global financial markets, Malaysia will continue to experience volatile two-way capital flows. Nevertheless, the financial system is well-positioned to intermediate these flows given the country's deep, developed and liberalised financial markets, thus reducing its impact on the economy. Malaysia will continue to receive steady inflows of long-term capital as FDI prospects remain positive, driven by its strong economic fundamentals and international competitiveness, as attested by the various global competitiveness rankings. The positive outlook for FDI is reflected in the increase in foreign manufacturing investment approvals in 2014 (RM39.6 billion; 2013: RM30.5 billion), mainly in non-resource based industries.

Malaysia's external debt is expected to remain manageable. The potential for sizable foreign exchange revaluation changes would be mitigated as more than 40% of the external debt is denominated in ringgit. In particular, risks associated with exchange rate fluctuations are minimal for the private sector corporations as their external borrowings are largely hedged, either naturally through foreign currency earnings, or through the use of financial instruments. The maturity profile of Malaysia's external debt is expected to remain healthy, with more than half of the external debt being in the medium- and long-term tenures. The short-term external debt would continue to be manageable. Although banking institutions account for more than half of the short-term external debt, this constitutes a small share of banks' total funding. Furthermore, external debt liabilities of banking institutions mainly reflect centralised foreign currency liquidity management operations. In addition, the extension of trade credits to resident companies and short-term intercompany loans are largely backed by export earnings.

Although there are improvements in the global economy, 2015 will nevertheless be a challenging year given the risks facing the global economy. In this uncertain environment, Malaysia's strong fundamentals will enable the economy to weather any adverse developments in the external sector. Should global and economic conditions turn out to be more favourable than expected, these same strong fundamentals will allow Malaysia to benefit from these developments and experience higher growth.

INFLATION OUTLOOK

Headline inflation is projected to be lower at 2 - 3% in 2015 (2014: 3.2%), due mainly to lower energy and food prices. In particular, the decline in global oil prices would lead to lower domestic fuel prices through the managed float fuel pricing mechanism. The subdued external price pressures would also mitigate increases in the cost of imports stemming from the recent ringgit depreciation, thereby moderating imported inflation. These would partly offset some of the impact from the implementation of the GST on 1 April 2015. While headline inflation is expected to be lower in 2015, there is the possibility that the inflation rate could be subject to the volatility in global oil prices given the now market-based pricing of domestic fuel products. However, underlying inflation is still expected to remain relatively stable.

Lower energy and commodity prices are expected to partly offset the impact of the GST on inflation

External price pressures are projected to remain weak, reflecting mainly lower global energy and food prices. The Food and Agriculture Organisation of the United Nations (FAO) projects global food prices to trend lower in 2015 given ample supply, particularly for cereals and oil crops, amid favourable weather conditions in the major producing countries. For oil, the IMF projects global prices to average lower at USD51 per barrel², after experiencing a sharp decline from the peak of USD108 per barrel in June 2014, to reach an average of USD61 per barrel in December 2014. Excess supply, supported by continued high global production amid modest growth in global demand, is projected to maintain lower oil prices in 2015. The large build-up in global oil inventories would also contribute to the downward pressures on oil prices. The downward pressures would also be exacerbated by the unwinding of financial investments in the commodity markets, especially

in oil, amid expectations for interest rate normalisation in the US and a stronger dollar. While excess supply would keep oil prices low compared to the previous year, the trajectory could become uncertain as the market reacts to incoming news and developments surrounding global oil supply and demand conditions. Given the lower commodity prices and subdued domestic demand in some of Malaysia's major trading partner economies, inflationary pressures emanating from the external sector are therefore expected to be low.

Domestically, although the implementation of the GST will result in higher prices for some goods and services, the extent of the inflationary impact will be contained by two factors. First, basic necessities such as fresh food and utilities are zero-rated or exempted from the GST³, hence reducing the extent of overall price increases. Second, some items such as clothing and electrical appliances are already subjected to the same or higher tax rates under the Sales and Services Tax (SST). With the GST replacing SST, prices of some of these items should remain relatively stable.

The implementation of the managed float fuel pricing mechanism since December 2014 allows for the pass-through of lower global oil prices to the domestic fuel prices. Given the expectation for global oil prices to remain low, this would contribute to lower domestic inflation in 2015. Inflationary pressures stemming from domestic demand factors are also expected to be modest following more moderate growth in household spending and relatively stable wage growth. While the economy is projected to operate slightly above its potential, the positive output gap is relatively small and therefore, is not expected to exert significant upward pressures on domestic prices.

However, there is a risk that the inflation trajectory during the year could be subject to some degree of volatility. This stems largely from the uncertainty surrounding the direction of global oil prices, which would have a direct influence on the inflation dynamics in Malaysia through its impact on domestic fuel prices. Excluding the volatile fuel prices and the one-off impact of the GST, the underlying inflation is, however, expected to remain relatively stable.

² Average price of Dated Brent, West Texas Intermediate (WTI) and Dubai Fateh crude oil, equally weighted, as projected by the International Monetary Fund (IMF) in the January 2015 World Economic Outlook.

³ Based on the Bank's internal estimates, only 50% of the CPI basket is subject to the 6% GST, while 30% is zero-rated and the remaining 20% is exempted from the GST.

Price Reforms: Motivation, Impact and Mitigating Measures

Introduction

In Malaysia and several other developing economies, subsidies and price controls have been an important feature of the policy toolkit. However, as economies become more developed, the costs of maintaining such policies increasingly outweigh their benefits. As a consequence, many developing economies have embarked on subsidy rationalisation and price reforms. This box article provides a background on price controls and subsidies, the importance of price reforms and the impact of such reforms. It also discusses the various mitigating measures that will be implemented to ensure that price reforms will lead to a more sustainable and inclusive growth for the Malaysian economy.

Background

One of the key aims of economic policy is to ensure sustainable and inclusive growth. An efficient allocation of resources is critical to the smooth functioning of a competitive economy, and this is often achieved through price signals¹. However, markets by themselves will not guarantee inclusive growth where the benefits from growth and development are widely enjoyed by all levels of society. Market failures or inefficiencies could also arise when the price mechanism fails to account for the social costs and benefits of producing and consuming certain types of goods², especially public goods such as defence, education and healthcare. Therefore, government measures, such as the provision of subsidies and price controls³, could in some cases be necessary for improving welfare and ensuring inclusiveness.

It has been conventionally argued that subsidies and price controls introduce distortions in the allocation of resources and have long-term adverse effects on economic efficiency. However, as with any economic policy, the costs must be weighed against the potential benefits. Where a substantial part of the population is living in poverty, especially in economies at early stages of development, widespread government measures such as price controls and subsidies ensure that the prices of key necessities remain stable and affordable for the intended target group⁴. Similarly, when most industries are at an infancy stage, subsidies and price controls provide the necessary initial support to compete, remain viable and grow into established industries. Hence, despite distortions to prices and resource allocation, these policies can enhance long-term sustainability and inclusiveness of economic growth.

As an economy develops, the costs of subsidies and price controls will steadily outweigh their benefits⁵. With growing incomes, more households would progress from low- to middle- or high-income brackets. Blanket subsidies or price controls would thus be subject to leakages, as those that do not belong in the vulnerable groups will continue to receive assistance. Artificially low prices also encourage wastage and overconsumption, and hence, a misallocation of resources. Importantly, as industries progress to a more mature stage, price distortions could inhibit the incentives to improve productivity, to innovate and achieve greater product sophistication, to adopt higher technological intensity and to move to higher value-added activities. Subsidies and price controls could thus pose an obstacle to economic development. Hence, as economies develop, the nature and rationale for subsidies and price controls often need to evolve toward more targeted and time-bound assistance, and less of a blanket subsidy.

¹ In a market economy, scarce resources will command higher prices than abundant resources. As a result, producers and consumers will use scarce resources for only higher-valued purposes, ensuring an efficient allocation of these scarce resources.

² An example of such a market failure is pollution. As the costs of pollution are widespread, and not confined to the individuals directly involved, an absence of government intervention will result in excessive pollution.

³ For the purpose of this box article, a subsidy is broadly defined as any government action that lowers either the cost of production or the price of consumption, while price control refers to any government regulation that establishes a maximum or a minimum price to be charged for specific goods and services.

⁴ While it is economically and socially desirable to target subsidies to selected groups, the costly and complex task of identifying recipients and distributing the benefits could justify an initial widespread intervention (blanket subsidy) in economies at early stages of development.

⁵ There are exceptions. It is widely accepted that subsidies and/or government involvement in areas where market failures exist is justifiable. For example, government measures to ensure adequate provision of education and healthcare are often necessary to reap their widespread benefits. A similar case can be made for public goods such as defence and infrastructure.

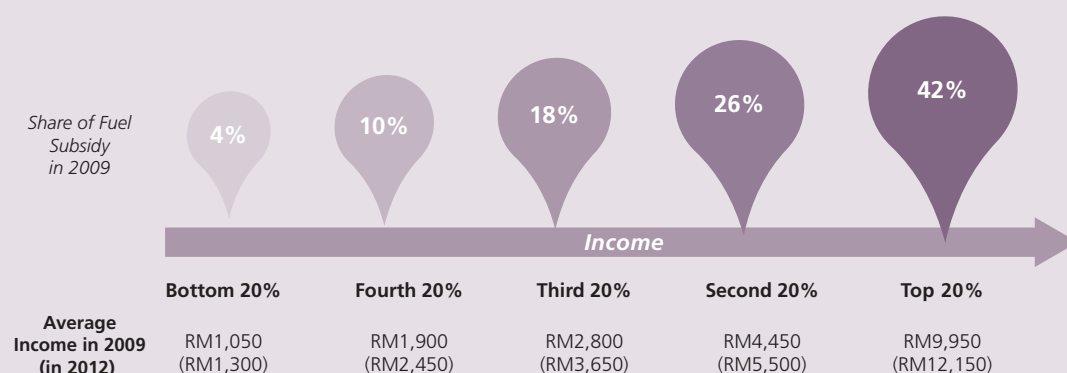
Subsidies and Price Controls: The Need for Reform

In Malaysia, subsidies and price controls have long been a feature of the economy. In 2009, subsidies and price controls were present in a range of products, including petrol, natural gas, electricity, cooking oil, sugar, toll charges and bus fares, which account for about a fifth of the CPI basket. At earlier stages of development, these policies helped to provide some degree of stability to the prices of domestic goods and supported the development of infant industries. Nevertheless, as Malaysia transitions to a high-income economy⁶, the economic costs of subsidies and price controls far outweigh the benefits of such measures for a number of reasons.

First, most subsidies in Malaysia are blanket in nature, and hence, become more regressive as the economy develops. In a middle- or high-income economy, the benefits of most blanket subsidies will accrue more to the more affluent groups, especially if these groups consume larger quantities of the subsidised items. For example, in the case of the fuel subsidy in Malaysia, the benefits are enjoyed disproportionately by high-income households, who consume a larger amount of fuel as they are more likely to own multiple vehicles with larger engine capacities. It is estimated that the bottom 20% of households in Malaysia only receive 4% of the fuel subsidy, while the richest 20% receive 42% of the subsidy (Chart 1). Thus, the blanket subsidy has become a less effective tool in ensuring the benefits of low fuel prices are widespread and inclusive⁷.

Chart 1

Share of Fuel Subsidy Received by Each Income Group



Source: Household Expenditure Survey 2009/10 and Household Income and Basic Amenities Surveys 2009 and 2012, Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Second, subsidies and price controls result in price distortions by artificially depressing the prices of key goods and services in the economy. This could distort both consumption and production decisions in a number of ways, and hence, lead to a misallocation of resources in an economy. Key among these distortions is an overconsumption of the subsidised or price-controlled items by both households and firms. To illustrate, petrol consumption per capita in Malaysia has increased over the last decade and is higher than in other regional economies (Table 1)⁸. Coupled with a moderating trend in production (Chart 2), this has contributed to Malaysia becoming a net importer of crude oil and refined petroleum products in 2014.

From a structural perspective, subsidies and price controls could also hinder incentives to improve productivity and efficiency, thus holding back long-term development. Subsidies and price controls would result in an overreliance on cheap inputs by firms, which could lead firms to being trapped in

⁶ Other developing economies that have undertaken price and subsidy reforms, in most cases for fuel and/or electricity, include Chile, Brazil, the Philippines, Turkey, India and Indonesia.

⁷ The situation is worse if the impact of illegal fuel smuggling is considered.

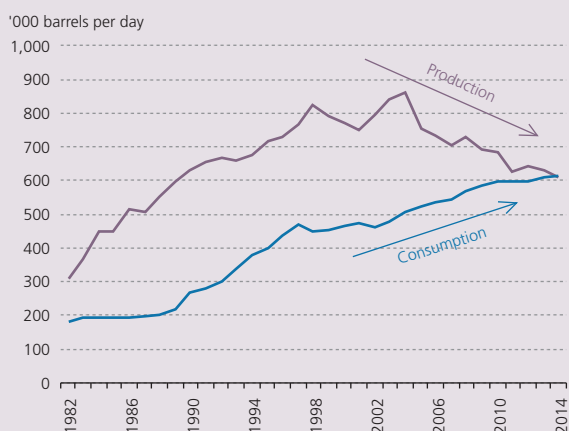
⁸ Overall petroleum product usage has grown at 3.0% annually on average over the last 10 years.

low-cost, energy-intensive sectors. This would reduce incentives to improve productivity, undertake research and development (R&D) or to innovate and move up the value chain, thereby impeding these firms' international competitiveness. Price reforms are thus needed to counter these effects. This is evidenced by findings from a survey by Bank Negara Malaysia that suggest that the majority of firms in Malaysia would adopt productivity-enhancing measures to manage rising costs following the upward fuel price adjustment in September 2013 (Chart 3).

Table 1
**Road Sector Petrol Consumption Per Capita
(2000-2011)**

Country	Average 2000-2005	Average 2006-2011
	(kg of oil equivalent)	
United States	1,270	1,170
Japan	347	335
Malaysia	279	294
United Kingdom	340	259
Euro area	254	191
Singapore	163	173
Korea	151	155
Thailand	81	74
Indonesia	53	71
The People's Republic of China	31	46
Philippines	34	29
India	7	10

Source: World Development Indicators, World Bank

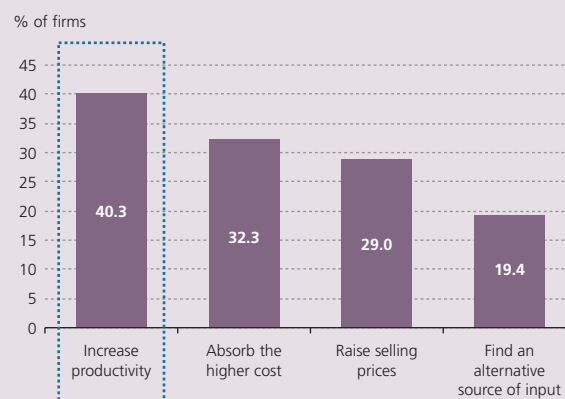
Chart 2
Production* and Consumption of Oil in Malaysia


*Refers to crude oil and refinery gains

Source: US Energy Information Administration and PETRONAS

Specifically, for industries that are required to maintain low prices through price controls, they would become uncompetitive when costs rise and hence, would be less inclined to undertake quality enhancements. In extreme cases where prices are set at an artificially low level, revenue would be insufficient to incentivise firms to produce adequate output to meet demand. This could create shortages and black market transactions, as observed in the cement and steel industry in Malaysia in the past (Thillainathan, 2009). These effects are often reversed when industries are deregulated, underscoring the need for such reforms. For example, after the reforms of the electricity industry in Chile in the 1980s and 1990s, the industry experienced improved efficiency in generation and transmission, higher investment, more competitive prices and greater quality of services, particularly in rural areas (Pollitt, 2004).

In addition, maintaining subsidies and price controls also leads to challenges for public policy decision-making. Despite rising costs, it is often politically difficult to undertake upward adjustments of prices. As a result, prices of the controlled products are often left unchanged

Chart 3
Survey Findings on Firms' Response to the Increase in Domestic Fuel Prices


Based on responses by 62 firms in the manufacturing and services sectors

Source: Bank Negara Malaysia Quarterly Survey 3Q 2013

for extended periods until significant increases in costs render these prices unsustainable. Eventually, this will result in large price hikes that would not only lead to large economic dislocation but also socioeconomic pressures⁹.

Finally, subsidies and in certain cases price controls, also impose a burden on the government. Attempting to keep prices of resources low amid rising global market prices and overconsumption by households and firms will ultimately weigh on the fiscal position of the government. For Malaysia, subsidies on retail petrol alone accounted for RM23.5 billion¹⁰ or 2.4% of GDP in 2013, higher than some regional economies¹¹. This figure also does not account for the cost of implicit subsidies in terms of revenue foregone by public enterprises and the Government under price controls, such as the provision of natural gas below market prices to electricity generation companies to enable lower electricity tariffs. Ultimately, this reduces the funds available for the Government to spend on other key development areas that would significantly benefit the nation over the long term, such as infrastructure, health, education and social protection.

Thus, price reforms have the potential to benefit the Malaysian economy in the short and long term. For both households and firms, it is an important transition away from the regressive blanket assistance towards a more targeted support system. In the medium to long term, it not only reduces wastage but encourages productivity enhancements and further progress up the value chain, creating high-income knowledge-intensive jobs. It frees up resources for the Government to finance critical public spending on social protection, education, healthcare and infrastructure. A review of the literature by the IMF (2013) finds that subsidy reforms boost competitiveness over the long term by stimulating private investment, encouraging productivity-enhancing public spending and promoting efficient use of scarce resources. In summary, price reforms are a critical part of the overall strategy during the transition to a high productivity and high value-added economy, supporting the creation of more high-income jobs in Malaysia.

Price Reforms: Timing and Impact

It has been recognised that reforms have a higher chance of success if they are undertaken gradually and in an environment of growth and stability (IMF, 2013). Under such circumstances, households and firms are in a better position to adjust to higher prices and costs, and are able to undertake the necessary changes without creating large disruptions in economic activity. With this in mind, the Government has gradually lifted price controls and undertaken several price adjustments over the last several years¹². More recently, the Government implemented additional price adjustments and introduced the managed float pricing mechanism for fuel, against a backdrop of steady growth prospects for the economy. The environment of lower global crude oil prices hence provided an opportune time to undertake this reform without the need for a price increase.

Nonetheless, it is acknowledged that price reforms have led to an increase in costs for households and firms. The challenges of managing these costs will continue, with movements in global commodity prices having a more direct effect on domestic cost conditions. While external price pressures are expected to remain subdued in 2015, the upward pressure on domestic costs could increase in the event of higher global commodity prices going forward. For households, in the absence of subsidies and price controls, an increase in the cost of living would have a disproportionate impact on vulnerable groups such as low-income groups, middle-income urban households, young working adults and senior citizens. These groups, particularly those with low savings, could face financial hardship. Firms, particularly small and medium enterprises, need to also cope with volatile costs and might find it difficult to pass on the additional costs to their customers

⁹ These pressures have been observed in response to actual or attempted price adjustments in developing economies, such as Indonesia in 2012, India in 2010 and Jordan in the late 1980s and early 2000s (World Economic Forum, 2013).

¹⁰ Based on the 2015 Budget speech.

¹¹ Based on the International Energy Agency statistics, total fuel subsidy in 2013, expressed as a percentage of GDP is 0.2% in PR China, 0.9% in Thailand, 2.5% in India and 3.3% in Indonesia.

¹² These include adjustments to the prices of fuel, electricity, sugar and other price-controlled items.

in order to remain competitive. Greater uncertainty on future costs and prices could also affect firms' investment and hiring decisions.

Therefore, a key policy thrust is to ensure that short- and long-term measures are earnestly implemented to partially mitigate the adverse effects of price reforms. The Government has undertaken targeted short-term measures, which include financial aid to support vulnerable households and firms in undertaking adjustments. Crucially, the Government has also enacted the Price Control and Anti-Profiteering Act 2011 to reduce profiteering¹³ by businesses and firms. Efforts are currently geared towards strengthening enforcement of the Act to monitor and take action against errant parties. To this end, there have also been initiatives to promote awareness of consumer rights and of prices of goods through the media and online tools for price comparison. This will ensure that consumer activism can play a greater role in preventing excessive price hikes. Bank Negara Malaysia, through its monetary policy, remains vigilant on factors that could contribute to excessive inflationary pressures at the economy-wide level.

Price reforms must be complemented with measures to assist vulnerable groups, so as to achieve growth that is both sustainable and inclusive. To this end, a comprehensive social protection system¹⁴ that covers social assistance, social insurance and human capital development programmes is being formulated to replace the regressive blanket assistance. The system will be targeted, sustainable and, most importantly, will help build the capacity of its recipients. This system will therefore not only provide short-term support to vulnerable households but would provide the opportunity to increase earnings by enhancing skills and capabilities. Such a system is a common feature in the advanced economies. For firms, specific incentives and grants will continue to be provided to encourage productivity improvements and innovation. Such assistance will support firms in adjusting to higher cost and facilitate the movement up the value chain into more sophisticated, technology-intensive and profitable ventures.

In addition, in a more deregulated pricing environment, the Government's role will evolve, from one that sets prices and provides subsidies to one that shapes regulations to foster a well-functioning and competitive market. Measures such as the introduction of the Competition Act 2010 and the establishment of Malaysian Competition Commission (MyCC) would promote effective competition and deter anti-competitive behaviour among firms. Well-developed regulation and enforcement can protect consumers and enable them to benefit from a wider range of better quality goods and services at affordable prices. These efforts to promote competition are consistent with the Strategic Reform Initiative (SRI) on Competition, Standards and Liberalisation¹⁵, which has made considerable progress, contributing to improvements in Malaysia's business environment.

Taken together, these measures will enhance the ability of the economy to adjust to cost and price fluctuations, thus making it more resilient to shocks. As with all policies, the key success factor will be clear communication, consistent monitoring, effective implementation and enforcement, and continuous policy improvements.

Conclusion

Price reforms are a critical component of Malaysia's objective of achieving inclusive and sustainable growth as it evolves into a high-income economy. To support inclusiveness, the regressive blanket subsidies and price controls will be replaced by a more targeted social protection system that can provide sustainable support to households that are in need of such assistance. In enhancing growth sustainability, price reforms will incentivise firms to increase productivity, undertake innovation and

¹³ Based on the Price Control and Anti-Profiteering Act 2011, profiteering refers to the act of making unreasonably high profit, after taking into consideration factors such as cost of production, supply and demand conditions and any tax imposition.

¹⁴ Social assistance includes cash transfers, food stamps and targeted subsidies; social insurance includes insurance for disability, unemployment, health and other risks; human capital programmes include training and upskilling as well as public education and healthcare.

¹⁵ Based on the Economic Transformation Programme Annual Report 2013.

move up the value chain, and avoid overreliance on cheap subsidised inputs. At the same time, the savings from the reforms create an opportunity for the Government to undertake more productive spending on infrastructure, healthcare and education. Consequently, Malaysia will benefit from a more productive and inclusive economy, more opportunities for the creation of high-skilled high-income jobs, greater access to higher quality goods and services, and an enhanced flexibility to manage shocks. Thus, while there are short-term challenges to manage, price reforms will ultimately place the economy on a more sustainable and inclusive growth path.

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MONETARY POLICY

Monetary policy in 2015 will focus on ensuring steady growth of the Malaysian economy amid contained risks to inflation. The operating environment for monetary policy will be shaped by a number of factors including external developments that would affect the overall outlook for the domestic economy. These include the considerable downside risks to the global growth prospects, the implications of a changed outlook for commodity prices, and the potential divergence in the monetary policies of the major economies. Notwithstanding these external developments, the Malaysian economy is expected to remain on a steady growth path of 4.5 - 5.5%, supported by a sustained expansion of domestic demand and a resilient export sector. Headline inflation will be lower during the year given the significant decline in commodity prices. In addition to these developments, monetary policy will also consider the potential risk of financial imbalances that may have medium-term implications for the Malaysian economy.

Monetary policy in 2015 will focus on ensuring steady growth of the Malaysian economy amid contained risks to inflation

Global growth is expected to improve moderately in 2015 but will remain uneven, with considerable downside risks. Although growth in the US is expected to improve and growth in many Asian economies will be sustained, the growth momentum in a number of key major economies is weaker than earlier expected. While overall supportive of global growth, the decline in commodity prices has also raised concerns over the growth prospects for net commodity exporters. The magnitude and timing of monetary policy shifts in the major economies are also uncertain. Against this backdrop, international financial markets are expected to continue to be volatile during the year.

The Malaysian economy is expected to grow by 4.5 - 5.5% in 2015. Domestic demand will continue to anchor growth. Private

consumption will be supported by higher disposable income from lower fuel prices and favourable labour market conditions. After three years of double-digit growth, growth in private investment is expected to moderate due mainly to lower investment in the mining sector as a result of the weak global crude oil prices. Nevertheless, private investment growth will be supported by on-going and new investment plans in the manufacturing and services sectors as firms benefit from the continued global recovery and lower cost of inputs. The export sector is expected to remain resilient, with the continued growth in manufactured exports, mitigating the impact of lower commodity prices on commodity exports. Against a backdrop of continued uncertainty in the global economic and financial landscape, the key risks to the growth outlook for the Malaysian economy will therefore emanate mainly from the external environment.

The risks to the inflation outlook are assessed to be relatively contained going forward. Headline inflation is projected to be lower at 2 - 3% in 2015, largely reflecting the impact of lower global oil prices on domestic fuel prices and the lower imported inflation, which are expected to partly offset some of the impact of the GST on inflation. Going forward, the inflation rate could be subject to the volatility in global oil prices. Nevertheless, underlying inflation is expected to remain contained amid the stable domestic demand conditions.

Given the uncertain global economic outlook and the potential divergence in the monetary policies of the major economies, large shifts in capital flows can be expected to continue in 2015. Together with other emerging economies, Malaysia is also expected to experience volatile capital flows. However, the availability of a wide range of policy instruments, policy flexibility and sufficient buffers have improved Malaysia's ability to manage these volatile capital flows. In addition, a strong banking system and well-developed financial markets will be able to absorb and intermediate swings in capital flows without disruptions to financial intermediation or dislocations to underlying economic activities. Most importantly, monetary and financial conditions are expected to remain accommodative and supportive of real economic activity.

FISCAL POLICY

Fiscal policy in 2015 will focus on strengthening fiscal management amid the challenging environment of low global energy prices. The expected lower oil-related revenues as a result of a sharp decline in global oil prices since late 2014 had prompted the Government to introduce pre-emptive fiscal adjustment measures and revise the fiscal deficit target from 3% of GDP to 3.2% of GDP. These measures are intended to maintain the Government's commitment to fiscal consolidation while recognising the need to ensure a pro-growth environment in the economy.

Following the fiscal reforms, the reliance on oil-related revenue has declined from 41% in 2009 to 30% in 2014. This is a reflection of the measures undertaken to diversify the sources of revenue, especially enhancements to the tax and customs administration and compliance. The implementation of the GST will further support the diversification of the sources of revenue. In addition, expenditure rationalisation measures encompassing fuel subsidy reforms and the scaling-down of discretionary spending will moderate the growth in operating expenditure. In the aftermath of the December 2014 floods, the Government also announced flood assistance measures which include financial aid for flood victims, as well as rebuilding and flood prevention efforts.

Table 4.4

Federal Government Finance

	RM billion		% change	
	2014	2015 ^r	2014	2015 ^r
Revenue	220.6	222.9	3.4	1.0
Total expenditure	259.1	260.9	2.2	0.7
Operating expenditure	219.6	212.4	3.9	-3.3
Gross development expenditure	39.5	48.5	-6.4	22.8
Loan recovery	1.1	1.0		
Overall balance	-37.4	-37.0		
% of GDP	-3.5	-3.2		
<i>Sources of financing:</i>				
Net domestic borrowing	37.6	-		
Net external borrowing	-0.4	-		
Realisable assets ¹ and adjustments	0.2	-		

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

Note: Numbers may not add up due to rounding

Source: Ministry of Finance, Malaysia

Table 4.5

Pre-emptive Fiscal Adjustment Measures Announced on 20 January 2015

		RM billion
Revenue Enhancement Measures		1.4
1	Additional GST revenue from higher-than-expected number of registrants	1.0
2	Additional dividend from Government Linked Companies, Government Linked Investment Companies and other agencies	0.4
Expenditure Optimisation Measures (Operating Expenditure)		5.5
1	Optimisation of spending on supplies & services	1.6
2	Postponement of National Service Programme (PLKN)	0.4
3	Rationalisation of grants & transfers to statutory bodies, public enterprises and trust funds, especially those with consistent revenues and high reserves	3.2
4	Reschedule purchases of non-critical assets	0.3
Total Savings		6.9

Source: Prime Minister's speech on 20 January 2015

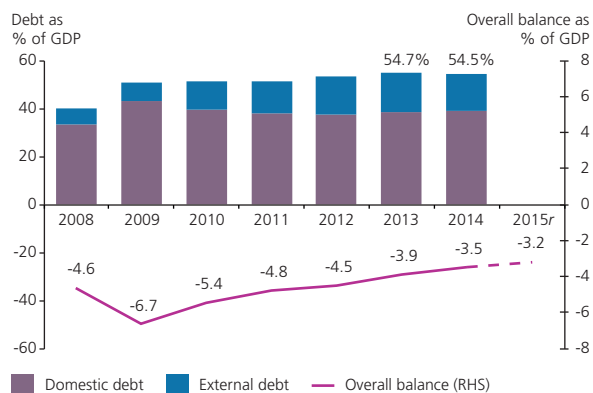
In the 2015 Budget, fiscal resources had been strategically prioritised towards infrastructure projects with larger multiplier effects, investments to enhance future productive capacity and programmes for capacity building. These include public infrastructure projects such as highways, railways and urban public transport as well as incentives to accelerate technology- and knowledge-based investments by the private sector⁴. To cultivate a competent and productive labour force, human capital development efforts continue to emphasise education, up-skilling, industrial training and entrepreneurship programmes.

Emphasis is also accorded to inclusive growth, particularly in ensuring the quality of life and a balanced development of urban and rural

⁴ To encourage investment projects based on technology, innovation and knowledge, the Government introduced specialised incentive packages and research funds such as the Research Incentive Scheme for Enterprises (RISE) and Public Private Research Network.

Chart 4.5

Federal Government Fiscal Balance and Debt



r Revised

Source: Ministry of Finance, Malaysia

areas. Socio-economic support to underserved groups also continues to be provided through various forms of assistance including affordable housing schemes and fiscal transfers for the lower-income and less fortunate groups⁵. These measures provide support to increase private consumption spending.

Going forward, in facing the uncertain environment, the Government has indicated its commitment to ensuring that the fiscal consolidation plan remains on track towards achieving a balanced budget over the medium-term. Nevertheless, in pursuing the fiscal reform agenda, equally important is to ensure that the economic transformation initiatives to transition Malaysia into a high-income economy will stay on course.

⁵ Examples of affordable housing schemes include the *Perumahan Rakyat 1Malaysia* and *Program Perumahan Rakyat* while fiscal transfers include, among others, the *Bantuan Rakyat 1Malaysia* and welfare assistance programmes for poor households and disabled groups.

The New Reference Rate Framework

On 2 January 2015, the Base Rate (BR) replaced the Base Lending Rate (BLR) as the main reference rate for new retail floating-rate loans and financing facilities. This article discusses the general role of a reference rate, the motivation for the replacement of the BLR, the key features and benefits of the new BR framework and the transition from the BLR to the BR. The article concludes by providing an overview of the current reference rate landscape under the BR.

(i) Roles of a reference rate

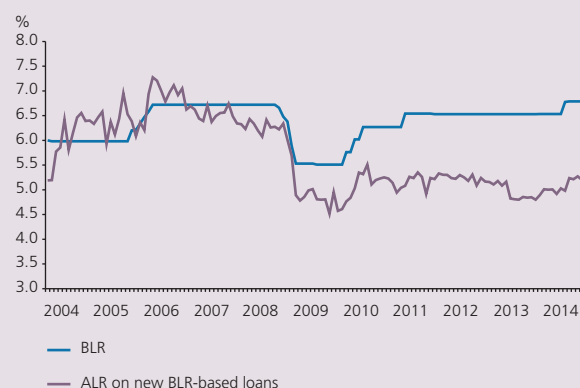
A reference rate constitutes a key component of the lending rate on a floating-rate loan. In general, a reference rate serves three important roles. First, as a reference rate is typically linked to the bank's cost of funds, it forms the basis for the pricing of loans. Second, it allows banks to vary floating lending rates to reflect changes in their funding costs that could arise from changes in central bank policies and general market funding conditions. Third, it ensures that changes in monetary policy are transmitted to borrowers and thereby influence decisions related to consumption, investment and debt.

(ii) Motivation for a new reference rate

Since its introduction in 1983, the BLR served as the main reference rate on floating-rate loans in Malaysia. In recent times, however, the BLR appeared to have become less meaningful as a basis for pricing, as retail lending rates on new loans were being offered at substantial discounts to the BLR (Chart 1). A survey of housing loan rates across major commercial banks in 2013 indicated that these loans were offered at between 2.0% and 2.5% below the BLR¹. In addition to the cost of funds and the Statutory Reserve Requirement (SRR), the BLR also included the cost of managing liquidity risk, profit margins and operating costs (Chart 2). The inclusion of these components had made changes in the BLR less transparent. This contributed to an asymmetry in BLR adjustments to changes in the monetary policy and resulted in instances of the BLR not fully adjusting to reductions in the Overnight Policy Rate (OPR). For example, following the cumulative 150 basis points OPR reduction in 2008 and 2009, the BLR adjusted downwards by only 121 basis points. In contrast, when the OPR was subsequently increased by 100 basis points, the BLR adjusted fully. The incomplete pass-through to repayments of existing borrowers reduced the effectiveness of a key channel of monetary policy transmission to the economy. Uneven monetary policy pass-through was also observed between new and existing loans when the OPR was increased, as the competition among banks for new loans ensured that these loans were more competitively priced. The BLR also appeared less sensitive to changes in funding costs arising from factors such as market conditions that were unrelated

Chart 1

Commercial Banks: BLR and ALR on New BLR-based Loans



Source: Bank Negara Malaysia

¹ This observation of negative spread is not unique to Malaysia, and in recent years appears to be a common occurrence in countries with a base lending rate framework.

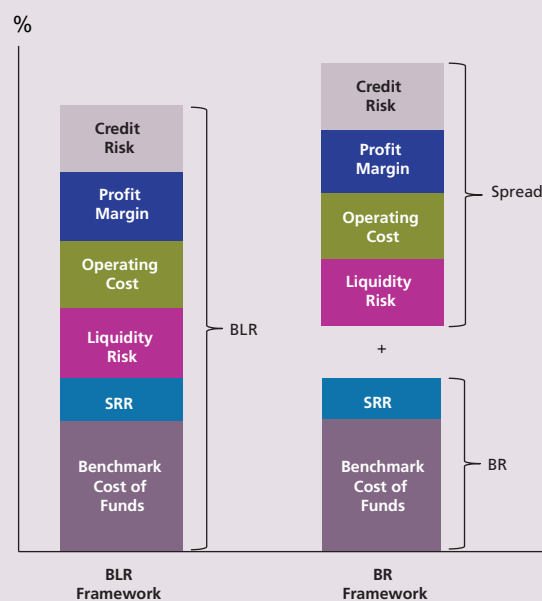
to changes in monetary policy. These shortcomings have motivated the need for a new reference rate framework that would allow banks to effectively manage interest rate risk, that is fair and transparent to borrowers, and that facilitates effective monetary policy transmission.

(iii) Key features and benefits of the Base Rate framework

The BR replaced the BLR as a basis for the pricing of new retail loans tied to a reference rate. Unlike the BLR, the BR is a cost of funds based reference rate². Accordingly, the BR is determined only by the SRR and a financial institution's funding costs (Chart 2). In terms of the latter, financial institutions have been given the flexibility in choosing the appropriate benchmark money market or financial market rate to reflect the funding costs associated with making the loan. Other components of loan pricing such as borrower credit risk, liquidity risk premiums, operating costs and profit margins are reflected in the spread above the reference rate, which will remain fixed throughout the life of the loan³.

Chart 2

Comparison of the BLR and the BR Frameworks



Source: Bank Negara Malaysia

The new BR is expected to benefit borrowers and financial institutions, while facilitating a more effective transmission of monetary policy changes to the economy. A key aspect of the BR is that it is more transparent and fair to borrowers. Unlike the BLR which allowed changes in factors other than those related to the funding costs to be reflected in the lending rate after the loan has been contracted, the lending rate of a BR-based loan will vary only in response to changes in funding costs. As the funding costs are referenced off money and financial market rates that are readily visible⁴ to borrowers, there will be an increase in the transparency of changes to the BR.

² A cross-country survey of loan pricing practices indicates that the use of reference rates is common practice. In general, there are two types of reference rates – base lending rate and cost of funds based reference rate. Both share a strong link to the cost of funds. A base lending rate, however, allows for other elements such as the profit margin and operating costs to be included in the reference rate, while with the cost of funds framework, the reference rate comprises only the cost of funds – all other components are included in the spread on top of the reference rate.

³ The pricing of the spread can only change if the loan is restructured due to a severe deterioration of borrower credit risk which impairs the ability to meet the repayment obligation.

⁴ For example, the Kuala Lumpur Interbank Offered Rate (KLIBOR) is published in most major local newspapers, as well as on Reuters and Bloomberg.

For financial institutions, the BR enables the lending rate on existing loans to adjust to changes in market funding conditions. This would support their management of market interest rate exposures. The BR is also expected to provide financial institutions with a meaningful basis for pricing floating-rate loans, as it reflects the relevant benchmark cost of funds for making the loan. An important consequence of this is that financial institutions will not have the incentive to price loans below the BR as it will not be profitable to contract the loan below their benchmark cost of funds, while all other non-cost components are priced as a positive spread over the BR. The introduction of a new reference rate framework will also promote greater discipline in banks' pricing practices. Under the BR, all non-cost factors in loan pricing, including the risk premiums, are fixed throughout the life of the loan. As such, the new framework incentivises banks to effectively price and manage these risks.

For most financial institutions, floating-rate loans are benchmarked off a short-term money market rate. Changes in these rates in response to monetary policy adjustments have typically been symmetric, regardless of the direction of policy. Thus, unlike the BLR which did not always adjust equally to increases and reductions in the OPR, changes in the OPR will be reflected symmetrically in the BR. In addition, the BR is also likely to facilitate a more even transmission of changes in market funding conditions to both new and existing loans. This will enhance the effectiveness of monetary policy changes in influencing spending and borrowing decisions, and consequently, better influence the economy in the intended direction.

As the new framework entails a shift towards benchmarking retail lending rates against rates that are driven by market forces, the risk of transmitting financial market volatilities to the borrower during a crisis period may also increase. To mitigate this, banks can price such a risk into the liquidity spread. Additionally, under such circumstances, Bank Negara Malaysia would also conduct its monetary operations to manage volatility in domestic money markets. These mitigating factors will ensure that there will not be an excessive transfer of bank funding cost risk to borrowers during periods of high financial market stress.

(iv) Transition from the Base Lending Rate to the Base Rate

Existing floating-rate loans which were granted prior to 2 January 2015 will continue to remain priced against the BLR. To ensure that borrowers with existing BLR-based loans are not worse off than new borrowers with loans referenced to the BR, any future adjustments to the BLR shall be tied directly to the changes in the BR. As such, financial institutions are required to display both their BRs and BLRs at all branches and websites.

It is important to note that the implementation of the BR does not represent a change in the monetary policy stance. As such, the proposed changes should not affect the overall level of lending rates for retail loans in the economy⁵, as the quoted BR and borrower-specific spread reflect the financial institutions' existing loan pricing practices. The shift to the new framework is to strengthen the link between retail lending rates and the reference rates that financial institutions use to manage the risk of future changes to funding costs incurred in providing the loans (Chart 3).

(v) Reference rate landscape under the Base Rate

Under the new BR, financial institutions are given the flexibility in choosing the appropriate benchmark money market or financial market rate to appropriately reflect the cost associated with making the loan. As at 2 January 2015, floating-rate loans for most financial institutions are benchmarked off the 3-month Kuala Lumpur Interbank Offered Rate (KLIBOR)⁶. Besides the KLIBOR, a few banks opted to use a composite funding cost approach as the benchmark to determine the BR. The composite funding cost

⁵ Notwithstanding any changes in monetary policy and market funding conditions, new floating retail lending rates under the BR should not differ from current effective lending rates under the BLR framework, under the assumption that all risks associated with the loan are appropriately accounted for.

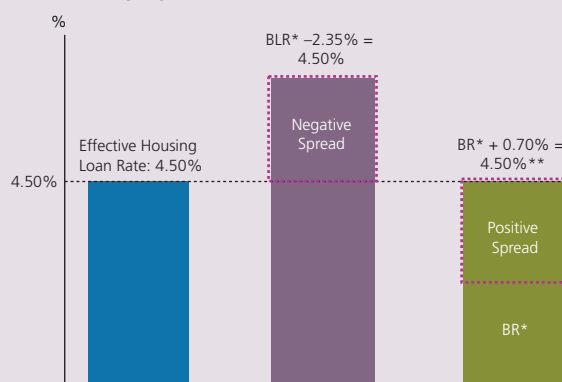
⁶ The reason for choosing the KLIBOR reflects a number of factors. When presented with a lending opportunity, the 3-month KLIBOR is the marginal cost of raising new funds in the wholesale market through interbank borrowing or corporate deposits. The 3-month KLIBOR is also the standard reference for financial contracts and the settlement of hedging instruments such as the interest rate swaps and KLIBOR futures, which are used by banks to manage interest rate risks. The choice of the KLIBOR will also increase the transparency in the movements of the BR, as the KLIBOR is an observable market rate that is published on a daily basis.

reflects the average cost of raising new funds through a variety of instruments including retail deposits and wholesale funding. The difference in BR methodologies has several implications for borrowers.

First, compared to the BLRs that were relatively uniform across banks, it is likely that there would now be some divergence in BRs across financial institutions. Upon introduction, the BRs of banks ranged between 3.20% - 4.25%. At the onset, this disparity may appear to favour banks offering lower BRs as their loans could be perceived as being less costly by borrowers. Nevertheless, it is important for borrowers to compare the effective lending rate, which also includes risk premiums, operating costs and profit margins, rather than just the level of the BR alone. In this regard, a survey of the effective lending rates on housing loans across the banking system following the implementation of the BR framework suggests that the effective rates charged by various banks remain highly competitive despite the differences in the BRs. To facilitate comparison and assist borrowers in making an informed financial decision, Bank Negara Malaysia requires banks to publish the effective lending rate of a standard housing loan product⁷ offered to the most credit-worthy customer.

Chart 3

Comparison of Quoted Lending Rates under the Base Lending Rate (BLR) Framework and Base Rate (BR) Framework



* For illustrative purposes, the BLR is assumed to be 6.85%, while the BR is assumed to be 3.80%.

** Effective lending rate under both the BLR framework and the BR Framework is assumed to be similar, under the assumption that all risks are appropriately accounted for.

Source: Bank Negara Malaysia

Second, two BRs derived using different methodologies can be expected to respond with varying degrees to OPR changes. While KLIBOR-based loans are likely to change almost completely, the composite funding cost approach is expected to adjust by a lesser extent due to the insensitivity of savings and current account deposits which pay minimal or no interest. This diversity in BR computation can cater to borrowers with varying needs and risk appetites. BR loans tied to the composite funding cost will provide borrowers with greater stability of repayments even when the OPR changes. On the other hand, borrowers of BR loans tied to the KLIBOR are likely to experience greater variability in repayments, but would benefit from a larger decrease in repayments should the OPR be reduced.

As the BR reflects changes in market funding conditions, it may entail more frequent changes compared to the BLR. Consequently, to reduce the volatility of the BR to small changes in market funding conditions, most banks are adopting a buffer, whereby only permanent increases or reductions in funding costs beyond a certain threshold would trigger a revision of the BR. For most banks, this threshold ranges between 5 – 10 basis points. Nevertheless, any adjustment to the stance of monetary policy will warrant an immediate review of the BR to ensure swift transmission to borrowers.

⁷ A standard housing loan product is defined as a 30-year loan with a principle value of RM350,000 and without a lock-in period.

In conclusion, the new reference rate is a further step towards a more mature financial landscape in the country. Going forward, the inherent flexibility of the framework allows reference rates to evolve as borrowers become more sophisticated in choosing products that suit their individual appetite for risk. Financial institutions will be able to offer a range of products based on different reference rates to manage changes in their funding composition and strategies, as well as the different elements of risks. Bank Negara Malaysia will closely monitor the implementation of the BR mechanism to ensure that it achieves its intended objectives of increasing the transparency of loan pricing and improving the efficiency of monetary policy transmission.

2014

GOVERNANCE, ORGANISATIONAL DEVELOPMENT AND COMMUNICATIONS

103	Governance
106	Organisational Development
107	<i>Box Article: Bank Negara Malaysia's Business Plan 2012-2014</i>
110	Communications
113	Organisation Structure

The Bank continued to focus on meeting its key mandates of preserving monetary and financial stability, and nurturing a progressive financial system that supports the needs of the real economy. In addition, the Bank fostered greater financial inclusion and a more efficient and competitive e-payments eco-system during the year. The year 2014 also marked the end of the Bank's 3-year strategic Business Plan 2012-2014. During this period, the Bank accomplished several key milestones, including strengthening the legislative framework governing the domestic financial sector; hosting the Alliance for Financial Inclusion Headquarters and setting up the World Bank office in Malaysia; and establishing the Financial Services Talent Council and Financial Services Professional Board to raise the standards of quality and professionalism in the financial sector. A brief of the key achievements is included in the accompanying box article entitled 'Bank Negara Malaysia's Business Plan 2012-2014'.

The Bank's sustained performance is attributable to the commitment to continuously invest in the Bank's capabilities in terms of governance, organisational development and communications. The holistic approach to further develop our capacity and capability covered the development of our talent base, enterprise risk management, and financial prudence. Focus was also given to improving organisational productivity through better training and greater adoption of information and communications technologies (ICT). The Bank also leveraged on multiple communication channels to increase the level of awareness and understanding of the Bank's policies amongst external stakeholders, especially where those policies impacted on the general public. Interaction with the public which includes roadshows also provided insights on issues facing consumers in the financial sector, which served as valuable input for policy formulation in the Bank.

GOVERNANCE

Effective oversight by the Board of Directors

The Board of Directors (Board) comprises the Governor, three Deputy Governors and the Secretary-General of the Treasury as ex-officio members, and five independent

non-executive members. In February 2015, two members completed their terms as a member of the Board. In March, the size of the Board was increased from 10 to 12, where the composition of the independent non-executive members was raised from five to seven, consistent with the existing provisions of the Central Bank of Malaysia Act 2009. As a result, four new members will be appointed to the Board. The aim was to further strengthen the Board's oversight function to support the Bank in delivering its mandate effectively.

The Board has responsibility for the oversight of the general policy, administration and business of the Bank. The Board meets monthly to review the management, operations and performance of the Bank in delivering its mandates. At these meetings, the Board discusses issues arising from global and domestic economic developments as well as the financial sector and financial stability matters, and the Bank's policy initiatives in addressing emerging risks. The Board reviews the Bank's strategic planning, risk management practices, financial position, reserves and currency management, and any significant developments that could impact operations and finances.

During the year, the Board approved the establishment of the Monetary Penalty Review Committee (MPRC), which is legislated under the Financial Services Act 2013 (FSA) and the Islamic Financial Services Act 2013 (IFSA). The MPRC is an independent committee responsible for considering appeals from parties affected by the quantum of administrative monetary penalties or pecuniary remedies imposed by the Bank in exercising its administrative enforcement powers under the FSA and IFSA. The Board also oversaw the Bank's key project management initiatives for system enhancements in the areas of statistics and data management, investment and treasury operations, and currency management.

Governance framework to support the Board of Directors

The Board is supported in its oversight functions by three Board Committees, namely the Board Governance Committee (BGC), the Board Audit Committee (BAC) and the Board Risk

Committee (BRC). These committees are comprised exclusively of non-executive directors.

The BGC is responsible for overseeing the Bank's governance principles and practices. The BGC convened five meetings in 2014, and made recommendations to the Board on the appointment and reappointment of members of the Board and other Committees established by the Bank. The BGC also reviewed the Bank's budget and operating plans for 2015 to ensure prudent financial management.

The BAC is responsible for overseeing the integrity of the Bank's accounts and financial statements, and a sound internal control environment. The BAC also reviewed the financial statements of the Bank, given that this is a key role of the BAC. The BAC oversees the Bank's Internal Audit Department and approves its audit plan, scope of work and resource requirements. The BAC convened five meetings during the year to approve the Bank's internal audit plans, and to deliberate on the audit findings and actions taken to ensure that internal control systems were effective in addressing the Bank's key operating risks.

The BRC is responsible for overseeing the Bank's management of risks that could cause financial loss, disruption to the Bank's operations, failure to meet the Bank's mandates or damage to the Bank's reputation. In 2014, the BRC met three times to review and monitor the Bank's management of enterprise-wide risks. In the area of Treasury Operations, the BRC reviewed the Bank's processes and strategies for investing in new asset classes and markets to ensure that adequate controls were in place to manage the associated risks.

Risk Management in the Bank

Effective risk management ensure the prudent and responsible conduct of the Bank's operations and activities. The Bank adopts an integrated approach in identifying and managing risks across the Bank. This is supported by an Enterprise Risk Management (ERM) Framework that encompasses the Operational Risk Management Framework, Financial Risk Management Framework and Business Continuity Management Framework.

Risk Management governance structure

A robust risk management governance structure, supported by dedicated risk management

committees, ensures that risk management practices within the Bank remain effective with the necessary checks and balances as well as clear accountability for risks.

The Board and Board Risk Committee (BRC) have oversight responsibility for the management of risks in the Bank. The Board, assisted by the BRC, provides strategic direction on the Bank's risk management policies, systems and resources and keeps under review the management of key risks identified in the Bank's operations and activities.

The Risk Management Committee (RMC), chaired by the Governor, has primary management responsibility for ensuring the effective implementation of policies, procedures and systems for identifying, controlling and reporting risks, including emerging risks faced by the Bank. The RMC is supported by three sub-committees, namely the Operational Risk Management Committee, the Financial Risk Management Committee, and the Crisis Management Team, each headed by a designated Deputy Governor.

The Reserves Management Committee (ReMC), chaired by the Governor, oversees the risks and investment strategies in the management of the international foreign currency reserves. The ReMC reviews the risks emanating from the global economic and financial markets outlook, and the implications for the Bank's investment strategies and financial position. Following these reviews, the ReMC may make recommendations to the BRC and the Board on changes to investment strategies and policies for managing investment risks.

Key initiatives to strengthen risk management framework, tools and practices

The Bank makes use of a wide range of risk management and reporting tools in its decision-making and operations. The systems and tools contribute to a robust risk culture, and include the Risk Control Self-Assessment (RCSA), Incident Reporting System (IReport), centralised repository of internal policies and guidelines (IComply), risk dashboards and transversal risk reports. These tools provide a systematic process to identify, prioritise, treat and review risks. Risk dashboards are continuously enhanced by incorporating analytics from the IReport and RCSA systems. This enables the prioritisation of risk mitigation

actions based on trends and risk indicators. Incidents reported through the IReport system are also used to examine the root causes and responses to risk events in order to share lessons learnt and strengthen controls where appropriate.

The internal Transversal Risk Report is used to promote awareness across the Bank of cross-cutting risks such as people, technology, legal, physical security, information security and process risks. Data from transversal risk assessments support management decisions in relation to corporate planning, budgeting, procurement and talent management, and enable the Bank to take pre-emptive measures to mitigate emerging risks that are identified through the transversal risk assessments.

Information security risk was an area of focus in 2014. The Bank's Information Security Management Policy was reviewed in anticipation of emerging information security risks from developments in ICT. The policy has been strengthened to reflect these risks and the increasing use of digital information in the Bank's operations. In particular, it expands on the oversight arrangements as well as the roles and responsibilities of information owners and users in managing information security risks. Enhancements were also introduced to ensure that the policy remains responsive to advancements in technology that will continue to change how information is generated, transmitted and stored by the Bank.

Strengthening Business Continuity Management practices

The Bank's Business Continuity Management (BCM) aims to ensure that the Bank can continue to deliver its core business functions under any circumstances, from minor operational or system disruptions to a full-scale crisis. Crisis simulation exercises and live testing of disaster recovery plans are regularly conducted by the Bank to affirm the effectiveness of the Bank's BCM and identify areas for improvement. Over the years, the exercises have evolved to test more complex scenarios to enhance system recovery capabilities, as well as more extensive coordination and collaboration with internal and external stakeholders. The BCM Portal provides a one-stop centre for all BCM related matters in the Bank, including communications with relevant parties during a crisis and serving as a central repository for all BCM related documents.

Internal Controls and Assurance

The Internal Audit Department (IAD), which reports to the Board Audit Committee, provides independent assurance of the adequacy and effectiveness of the governance processes, risk management measures and internal controls at all levels and across the Bank's significant activities. The IAD also assesses the risk management and internal control systems of the Bank's related entities.

The IAD adopts a risk-based audit approach. Audits are planned such that every department within the Bank would be subjected to an audit review at least once within a 3-year audit cycle. Annual audits are performed on critical areas such as reserves management, currency operations management (including branch operations), financial operations and procurement management. The audits are designed to identify significant changes in the risk profile of the Bank's business activities and operations, and to test the adequacy of controls, policies and procedures that are in place. An important focus of audits, particularly in the core business areas of the Bank, is the reliability of data used in the performance of the Bank's functions.

The risk management function is also subject to review by the IAD to provide assurance of its effectiveness in ensuring that key risks to the Bank are well managed. The audit reports, audit recommendations and the management's responses to the audit findings and recommendations are presented for the BAC's deliberation. The IAD also reports quarterly to the BAC and senior management on the rectification actions taken to resolve audit issues.

During 2014, reviews by the IAD included assessments of the effectiveness of the Bank's internal controls on data management and information security around the process of monetary policy formulation; governance processes for the performance of the Bank's regulatory and surveillance functions in the area of foreign exchange administration operations; and the framework implemented for enforcement actions taken by the Bank in cases of non-compliance.

The IAD also assessed the effectiveness of policies and controls for the Bank's general services and support including IT functions. The IT audits included recommendations to further enhance the critical IT operations and infrastructure in terms of the integrity, reliability and availability of the Bank's

IT systems. These included the Real Time Electronic Transfer of Funds and Securities System (RENTAS), National Electronic Cheque Information Clearing System (eSPICK), IT security and network, as well as, the management of the Data Centre and the Recovery Centre.

Audits on the Bank's related entities are conducted mainly to identify the potential for the activities of these entities to introduce risks that needs to be captured and monitored by the Bank as part of its enterprise-wide risk management process. The outcomes of these audits are shared with the senior management and boards of the entities and interventions to address issues raised at the entity-level remain the primary responsibility of the entity.

The IAD also performs an advisory role in providing feedback on the adequacy of controls and effective implementation in areas such as project management, procurement and tendering processes. In order to maintain its independence, the IAD does not get involved in the vendor selection or implementation process.

During the year, initiatives were undertaken to further improve the effectiveness of the audit function, including providing specific training for the Bank's auditors to update and broaden their knowledge of business areas, and new audit methodologies. The IAD also regularly benchmarks its audit practices to international standards and the practices of central banks globally.

ORGANISATIONAL DEVELOPMENT

The year 2014 marked the conclusion of the Bank's 2012-2014 business planning cycle. The accompanying White Box on 'Bank Negara Malaysia's Business Plan 2012-2014' highlights the Bank's achievements under the Business Plan. The process undertaken to formulate the next three-year Business Plan for the period 2015-2017 similarly incorporates senior management's strategic visioning of key priorities for the Bank, with the identification of detailed action plans that are aligned to the new business and organisational priorities.

Organisational development efforts were focused on enhancing productivity, including through specific initiatives aimed at reducing the time to competence for new staff, improving business processes and strengthening the architecture of the Bank's information systems. Internal policies and systems

that support continuous learning also continued to be improved to increase the depth and breadth of knowledge required of the Bank's workforce to perform effectively in a more complex operating environment. With a growing pool of young talent in the Bank, investments in learning and development interventions have been an important priority of the Bank.

The medium and long-term investments in the Bank's resources, namely its people, ICT and physical infrastructure, are complemented with prudent financial management and a more cost conscious culture. The Bank's emphasis on more stringent criteria when approving operating and project budgets successfully contained the operating expenditures at sustainable levels. The Bank has initiated a number of projects across the organisations and involving different functional areas with the objective of further enhancing the Bank's performance capacity to support its core mandates going forward. The Bank's ability to delivery such projects efficiently and effectively is supported by a new Project Management Framework, which was adopted to ensure that projects in the Bank have clear outcomes, that risks are recognised and appropriately managed, and timelines, budgets and standards of quality are adhered to.

Human Capital Management and Development

The strategies to develop the Bank's talent base continued to address critical challenges arising from the demographic shift towards a younger workforce and the need to accelerate the time taken for staff to achieve the required level of professional competence to perform their roles. The Bank's human capital policies had to also adapt to challenges that arose from changes in work practices due to new technologies and market demands. The Bank has consistently focused on building a healthy talent pipeline, ensuring individuals are fit for their job roles at all levels, and raising productivity by developing competencies, broadening job sizes and adopting better work processes.

The Bank enhanced its talent assessments, which resulted in the more effective profiling of candidates to ensure the best job-fit both when hiring new talent into the Bank, and when progressing existing talent in their careers within the Bank. To build a healthy talent pipeline for mission critical positions, the succession planning framework was strengthened to incorporate more rigorous and structured leadership development programmes to accelerate the personal growth and readiness of

Bank Negara Malaysia's Business Plan 2012-2014

Overview

The Bank charts its medium-term outcomes through three-year business plans. In 2014, the Bank concluded its 2012-2014 Business Plan (BP). The business planning process provides clarity and focus in achieving the Bank's mandates, in addition to facilitating the convergence of roles and better coordination, particularly where specific outcomes are shared across various departments within the Bank. The BP has also been useful in communicating the Bank's planning priorities and deliverables with external stakeholders.

The Bank's BP has seven focus areas. Each of these areas is supported by specific outcomes and strategies, which provides visibility across the broad mandates of the Bank. The focus areas cover monetary and financial stability; developing a progressive and inclusive financial system; evolving a more efficient e-payments eco-system; ensuring effective financial intermediation; and strengthening Malaysia's financial linkages with regional and global economies. Equally important is the focus on enhancing the Bank's internal capacity and capability to deliver its mandates effectively in the nation's best interests. The Bank's role toward meeting its mandates is multi-faceted, and includes research, surveillance, regulation, supervision, treasury operations and an advisory role to the Government. The BP is outcome-driven, and regular assessments are made on the Bank's performance against the BP, which is presented at the end of every year to the Board. This operational accountability to the Board also provides an effective feedback mechanism for the Board in performing its oversight function.

Key Achievements of the Business Plan 2012-2014

The Bank continued to sustain its strong performance in achieving its mandates, with a broad range of measurable outcomes across the seven focus areas, which included many of the longer-term initiatives under the 10-year Financial Sector Blueprint. Highlights of the key achievements are provided below, with details having been reflected in prior annual reports:

- Monetary and financial system stability continued to be preserved, which provided a conducive environment for economic activity and contributed to economic growth. Pre-emptive actions were taken to address risks to monetary and financial stability, particularly in managing the risks of financial imbalances within a challenging environment of volatile capital flows.
- Domestic financial intermediation was well-supported by sound financial institutions, orderly financial market conditions and sustained confidence in the financial system. In particular, financing continued to flow to productive sectors of the economy, supporting job creation and economic growth. Important to this is the robust surveillance mechanism and strengthened regulatory and supervisory frameworks. The Bank's enforcement efforts were strengthened to preserve the integrity of, and confidence in, the Malaysian financial sector.
- The Bank made further progress in expanding opportunities for higher value activities within the Malaysian financial system, notably by further solidifying Malaysia's position as the World's Islamic Finance Marketplace; strengthening the eco-system for multi-currency trading; and establishing initiatives to build or further modernise the institutions that can provide a full range of financial services education for both domestic and international talent development. During the 2012-2014 BP, the Bank established the Financial Sector Talent Council and the Financial Services Professional Board to provide a strategic focus on talent development and to raise professional standards of conduct in the financial sector.
- The Bank's role in the international community continued to increase, enabling it to play a more prominent role in shaping central banking issues at the regional and global level. Significant progress was made in intensifying collaborative efforts with other central banks to strengthen regional crisis management. In addition, the Bank also contributed to thought leadership at international financial forums by sharing the Bank's insights, experiences and views on the critical challenges facing central banks. The choice of Kuala Lumpur as the new headquarters of Alliance for Financial Inclusion would provide an opportunity for the Bank to contribute further on the important global agenda to expand financial inclusion across the globe.

The Bank delivered the desired results whilst successfully capping the increase in the level of financial and human capital resources during the three-year period. This higher level of productivity is attributable to a focus on effective implementation, supported by continued investments in strengthening the Bank's capabilities in line with a culture of high performance.

talent to assume these roles. Together, the profiling and succession planning initiatives have facilitated placements of talent in roles that optimise their performance potential and contribution.

As a performance driven organisation, the Bank subscribes to the principle of performance differentiated rewards as part of its efforts to attract, retain and motivate talent. This is accompanied by on-going initiatives to nurture and reinforce the values of the Bank. All Bank staff must comply with the Bank's Code of Ethics (CoE) which establishes the expected conduct of staff, including an obligation to act with the highest standards of integrity. Breaches of the CoE are swiftly dealt with by the Bank, reflecting its low tolerance for improper behaviour or conduct among staff.

Developing the Bank's Workforce: Learning and Knowledge Management

The Bank has continued to invest in the development of a competent and progressive workforce. Learning priorities focused on accelerating the time to competence using targeted learning solutions that are designed to meet the specific developments needs of individual staff and resolve capability gaps.

The Bank continued to develop potential leaders through leadership development programmes that reinforce learning and sustain behaviour change. The programmes include personalised and peer coaching, as well as mentoring and on-the-job learning. Such learning interventions have enabled supervisors to take greater ownership of talent development by actively engaging with staff to identify their strengths and areas for development. Greater emphasis has also been placed on measuring the demonstration of the desired leadership attributes within the workplace.

Demands for specific technical learning opportunities have also increased in response to new challenges in central banking. Working with internal subject matter experts, the Bank has developed and delivered a number of customised programmes for staff, including programs in the areas of supervision, financial stability management, economic and Islamic finance. This is complemented by on-going training in communication and soft skills, such as effective business writing, interpersonal communication, critical thinking and problem solving. Apart from structured programmes,

the Bank's Toastmasters Club also provided another vibrant platform for staff to practise their skills. To accelerate the assimilation of new hires into the Bank's work environment, a re-designed On-Boarding Programme was introduced, to inculcate the Bank's shared values, enhance personal growth and provide basic central banking knowledge.

Staff in the Bank are encouraged to take initiatives and responsibility for their individual development. They are helped in this by extensive learning opportunities that are provided through various forums, access to e-learning tools and a well-resourced Knowledge Management Centre.

Managing the talent pool

The Bank has a long commitment of awarding scholarships to build its own talent pool and to contribute to nation building. In 2014, a total of 44 scholarships were awarded to exceptional students to pursue pre-university, first degree and post-graduate programmes in selected universities. The Bank's scholarships include investments in staff to pursue relevant fields of post-graduate study as part of the overall talent management strategy. The structured Scholars' Development Programme, implemented since 2012, helps prepare and equip new as well as existing scholars with the necessary skills, knowledge and experience to gain entry into top ranking universities. This includes enhancing English language proficiency and building self-confidence. As a result, in 2014, 50% (2013: 39%) of the Bank's scholars were accepted into the universities of their choice amongst selected leading universities, locally and globally. During the year, 63 returning scholars were successfully placed in various departments based on their specialisation, interest and role fit.

The prestigious Kijang Emas Scholarship, established in 2005 to support nation building, was awarded in 2014 to three deserving students who had demonstrated academic excellence and perseverance, and were given the opportunity to pursue their preferred fields of study at selected top universities around the world. As the Kijang Emas Scholarships are in support of nation building, recipients are required to return and serve the country upon graduation. To date, 46 high potential talents have been awarded the Kijang Emas Scholarship. The recipients are currently pursuing diverse fields of study including medicine, dentistry, genetics, biochemistry, dietetics, physics,

engineering, law, psychology and architecture in top universities. A total of 12 Kijang Emas scholars have completed their studies and have returned to serve the nation.

Staff strength

In 2014, the staff strength remained constant at 2,829 (2013: 2,834). This includes staff seconded or attached with other organisations. The Bank's attrition rate declined to 3.6% (2013: 4.6%). The ratio of executive to non-executive staff remained at 3.5:2. Continuous process improvements and periodic reviews of jobs across the Bank against demands on the Bank's resources help ensure that the manpower level is adequate at all times for the Bank to effectively deliver on its mandates.

International Technical Cooperation Programmes

The Bank has a long history of sharing its knowledge on central banking practices and building collaborative relationships with other central banks and regulatory agencies from around the world. During the year, the Bank maintained an active role in fostering regional and international collaboration. Apart from contributing in a wide range of international events, the Bank extends technical cooperation through structured programmes, study visits, and exchanges of information. In 2014, 662 officials from 74 countries in Asia, Africa, Middle East and Latin-America participated in these programmes.

The Bank's international technical cooperation in 2014 included the organisation of 13 structured programmes in the areas of financial inclusion, financial stability, Islamic finance and organisational development. Where possible, such programmes are organised in collaboration with domestic and international partners to enrich their content and optimise resources. During the year, the Bank collaborated with, among others, the Malaysian Technical Cooperation Programme (MTCP), Alliance for Financial Inclusion (AFI), Asian Development Bank (ADB), Islamic Financial Services Board (IFSB), International Islamic Liquidity Management Corporation (IILM), The South East Asian Central Banks (SEACEN) Research and Training Centre, International Centre for Education in Islamic Finance (INCEIF) and Japan International Cooperation Agency (JICA). Throughout the year, the Bank also received study visits from 37 delegations comprising 267 officials

that were interested to learn from the Bank's experience in a wide range of areas including Islamic finance, internal audit, risk management, talent development, facilities management, currency management and branch operations.

A key objective of technical cooperation is to support the financial integration agenda under the Association of South-East Asian Nations (ASEAN). In 2014, 348 participants from ASEAN countries enrolled in programmes organised by the Bank, of which 219 were from Cambodia, Laos, Myanmar and Vietnam. Three programmes in the areas of banking supervision, financial sector development and financial stability were designed to support capacity building needs in these ASEAN countries.

The Bank continued to receive strong demand for technical cooperation in Islamic finance, both at fundamental and intermediate levels. In total, 72 participants from 27 countries attended the Islamic finance programmes organised in 2014. These have contributed to expanding the Islamic finance talent pool globally, and the growth of Islamic finance as well as re-affirming Malaysia's position in Islamic finance education and training.

Driving Service Excellence

The Bank's Centralised Shared Services (CSS) division comprises the CSS Management Office and various services units, namely Facility Management; Security Services; Hospitality Services; Museum, Art Gallery and KMC Services and Human Resource and General Services. CSS was established in 2012 to improve the delivery of corporate services functions and quality of common services across the Bank's operations.

Sasana Kijang as a centre of excellence in knowledge and learning in central banking and financial services hosted 1,513 events during the year, of which 87 were international events. These events reflect the Bank and nation's important role in advocating the development of Islamic finance, advancing regional financial integration and promoting educational excellence.

The increasing number of events has also enhanced the visibility of the Bank Negara Malaysia Museum and Art Gallery, resulting in a 34% increase in visitors to the Gallery. The Museum has provided an avenue for local artists to showcase their works, in addition

to preserving Malaysia's cultural heritage, particularly those aspects related to economics and finance.

The implementation of innovative processes continued to deliver efficiency gains during the year, notably in terms of more efficient energy consumption and cost savings on procurement, travel and project management expenditure, in addition to enhancing the quality of services provided to the Bank staff. A new business model was also introduced to effectively manage the assets of the Bank.

Maintaining Effective Information and Communications Technology Infrastructure

The Bank continuously upgrades its IT infrastructure to ensure the availability, reliability and security of IT services that support its operations. This has become more important given the increased reliance on ICT and the accelerating pace of emergence of new IT security risks, particularly threats from targeted cyber-attacks. The Bank's IT infrastructure can have an impact on financial stability as it has an extensive online network that serves both national and international financial payments and settlements systems. Given the impact on financial stability, pre-emptive control measures and surveillance mechanisms have been put in place to safeguard the Bank's IT infrastructure. This has ensured that all critical infrastructure and IT facilities remained secure.

Infrastructure with enhanced reliability and security

In 2014, the Bank obtained certification under the latest revised ISO/IEC 27001 Information Security Management System (ISMS) standard for the Real-Time Electronic Transfer of Funds and Securities (RENTAS) IT infrastructure. The certification affirms the resilience of the Bank's critical IT infrastructure and information assets is on par with international standards and best practices. It also demonstrates compliance with the requirements of the ISO standards for holistic management and governance of information security.

The mitigation of any operational risks to the nation's payment and settlement operations requires a continuous upgrading of the Bank's critical IT infrastructure for financial market systems. Such upgrades sustain the availability of these operations, with minimal downtime. The infrastructure's robustness and resilience, including that of the Bank's Data Centre, has been tested through numerous industry-wide business

contingency exercises to ensure that the systems are ready to handle any unplanned disruptions.

IT solutions that leverage on mobile event technology were also used more extensively in international and regional conferences hosted by the Bank. Such applications provided participants with interactive and user-friendly information on the event's proceedings, such as agenda information, downloadable presentations, personalised and interactive note-taking, and post-event summary reports, which were conveniently made accessible via the participants' own mobile devices.

To provide IT services that enhance workplace productivity and enable business process efficiency, an independent review of the Bank's technology infrastructure has been initiated. The aim is to further strengthen the Bank's capacity to utilise emerging technologies to better respond to future business needs, support high standards of governance and facilitate efficient work processes. Over the next few years, this initiative will identify and implement strategic improvements that will sustain the continuous availability of IT services and enhance work productivity through the adoption of appropriate emerging technologies. This includes plans for innovative and practical IT services to facilitate work anywhere, anytime, via any device in a secured manner.

COMMUNICATIONS

Communications play a vital role in sustaining the public and investors' confidence and trust in the Bank, the Malaysian financial system and the Malaysian economy. Central bank communications require well thought out strategies to engage with a wide range of stakeholders on the measures taken in maintaining monetary and financial system stability as well as supporting growth. Communication initiatives were also carried out to educate the public on responsible financial management.

Promote understanding of the policies of the Bank

An important objective of the Bank's communications is to promote greater understanding and appreciation of the Bank's policies and actions. The main communication tool for monetary policy is the Monetary Policy Statement (MPS) issued by the Monetary Policy Committee after each meeting. The rationale for each monetary policy decision is conveyed in the MPS. The messages are

reinforced by the Bank's senior management in their commentaries and speeches at various official events. These communication efforts play a key role in shaping market expectations, thus enabling the smooth implementation of monetary policy.

Communication strategies were integral to a number of other important policy initiatives during 2014. One of these initiatives was the nation's migration to e-payments. A sustained programme of media engagements was effectively used to raise public awareness on the benefits of e-payments, leading to the higher utilisation of online banking and other online payments services.

Similarly, in supporting the national agenda of 'Going Green', the Bank's communication efforts promoted the use of recycled fit banknotes during festive celebrations. This was accompanied by Currency Education Programmes to inform the public of banknote security features and ways to detect counterfeit notes. These programmes were also used to create awareness of Coin Deposit Machines to improve the circulation of coins.

Sustaining confidence in the economy and financial system

A key communications agenda is sustaining confidence in the strength of the Malaysian economy and financial system. Varied communication platforms are used by the Bank to engage with the press, economists and analysts, fund managers, Malaysian government officials, members of Parliament, and the foreign diplomatic community to relay the Bank's assessment of the economy and the financial sector. These platforms include briefings at the release of the Bank's Annual and Financial Stability Reports, the quarterly GDP press conferences, Parliamentary sessions, regular meetings with fund managers and analysts, and the annual roundtable meeting with economists and analysts. Current information on economic conditions is provided through publications such as the quarterly and monthly statistical bulletins.

Engaging international stakeholders

The Bank's communication with the international financial community covers a diverse range of issues, which include its monetary and financial stability policies, the internationalisation of Islamic finance, supporting the global financial inclusion agenda, and strengthening financial cooperation to deepen linkages with regional trade partners. The Bank also sought to create greater awareness of the Bank's

cooperation with other central banks in facilitating deeper trade and investment linkages. These efforts included the establishment of a Renminbi clearing bank that will further enhance economic ties between Malaysia and China.

The Bank has long championed the importance of more inclusive financial systems, and in 2014, won the bid for Malaysia to host the headquarters of the Alliance for Financial Inclusion (AFI). The opportunity to host AFI's headquarters will allow Malaysia to further support the global collaborative efforts in achieving greater financial inclusion and more balanced economic progress.

During the year, the Bank's senior management shared perspectives with the regional and international community in areas such as managing financial crises in a more interconnected world and deepening regional financial cooperation. Senior management also exchanged views with regional central bankers in high-level conferences that covered issues such as monetary policy frameworks in emerging economies; the role of statistical systems for better decision making; developments in the money services business industry and the challenges faced in combating money laundering and terrorism financing threats.

Educating financial consumers

The Bank continued to intensify efforts to raise the public's awareness of financial scams. The Bank issued frequent media advertisements and updated the Financial Consumer Alerts list on the Bank's website. The number of entities placed on the list that were neither authorised nor approved under the Bank's laws and regulations increased by 66 entities to a total of 197 entities.

The Bank, in partnership with government agencies and financial institutions, continued its outreach programmes to Small and Medium Enterprises (SMEs) and micro entrepreneurs through nation-wide events. The main aim of these programmes is to increase awareness on the various financing schemes and assistance available to support SMEs and micro entrepreneurs in growing their businesses. Media advertisements were also used to highlight the role of the Small Debt Resolution Schemes in helping distressed SMEs.

The Credit Counselling and Debt Management Agency (AKPK) embarked on efforts to highlight its growing role in promoting financial

wellbeing, alongside its more established role as a debt restructuring agency. The AKPK also improved financial management capabilities of many segments of Malaysians by building smart partnerships with selected institutions, including cooperatives. Reflecting the high demand for its services, total counselling cases handled by AKPK as at end December 2014 stood at 309,663 (December 2013: 248,491 cases). Of this, 121,495 cases were further assisted under AKPK's Debt Management Programme (December 2013: 100,871 cases). In addition, the POWER! Programme attracted 203,174 participants since its introduction in 2011 (December 2013: 172,455) while the total consumer outreach in 2014 stood at 2.2 million people (2013: 1.4 million). The media was also supportive of financial education efforts by providing free media coverage during the year to AKPK's public outreach campaigns. The Financial Mediation Bureau (FMB), in collaboration with several agencies such as the Bank, Malaysia Deposit Insurance Corporation (PIDM) and AKPK, continued to promote greater awareness on the services provided by the FMB as an alternative avenue for dispute resolution.

The FMB handled a total of 2,721 cases in 2014 (2013: 3,622 cases), of which, 1,030 cases were brought forward from 2013 and 1,691 were new (2013: 1,881 new cases). As at 31 December 2014, a total of 2,106 cases were resolved (2013: 2,592 cases), comprising 1,362 cases related to insurance and takaful (64.6%) and the remaining 744 cases (35.4%) related to banking. The number of outstanding cases was reduced to 615 (2013: 1,030 cases).

The decreasing number of complaints registered by FMB and the lower number of cases outstanding as at 31 December 2014 is a positive reflection of the intense efforts undertaken by the financial services providers and FMB in resolving disputes effectively. The improvements can be attributed to better complaints handling by the

financial services providers and greater public understanding of the dispute resolution process under FMB, as well as the basis on which cases are adjudicated.

Growing significance of online communication channels

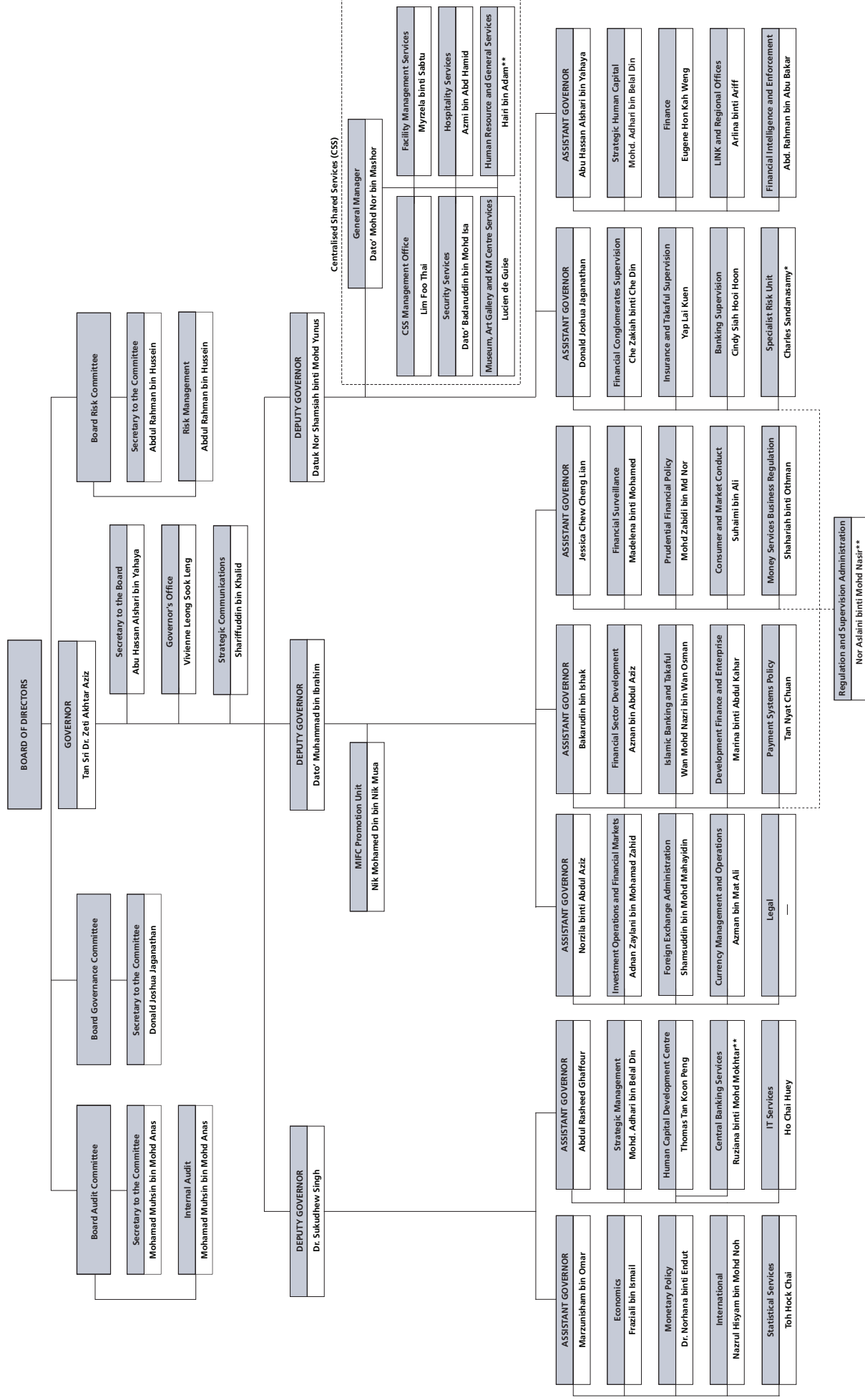
In line with the latest developments in mobile phone technology, the Bank has introduced BNM Mobile App, an interactive communication channel between the Bank and the public. The application includes five key modules, namely, Banknotes and Coins of Malaysia, Fraud Alert and Awareness, Complaint Management, Useful Tools and Financial Education which will be phased-in from early 2015. The App can be downloaded for free.

Reflecting the increasing popularity of online communications, the number of visits on the Bank's Website increased by approximately 21 percent to 7.5 million visits in 2014 (2013: 6.2 million) while the number of unique visitors increased to 3.5 million (2013: 2.5 million). Access to the website through mobile devices increased by 35 percent to 1.3 million (2013: 960,000). Social media was also utilised to allow the public to make enquiries and the Bank to share important messages and information. The number of fans on the Bank's Facebook increased significantly by 52 percent to 43,986 (2013: 28,952) while the Bank's Twitter followers increased by 42 percent to 54,100 (2013: 38,200).

Enhancing internal communications to improve productivity

The Bank's intranet, Kijang.net, plays a major role in facilitating the flow of information within the Bank and improving staff productivity. This internal channel encourages the sharing of work experience, knowledge and general information among staff to enhance work performance. It also provides opportunities for senior management to share their views and insight with the staff more broadly.

BANK NEGARA MALAYSIA Organisation Structure

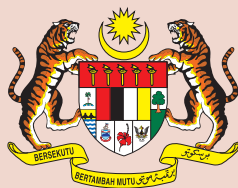


**Administrative Head
**Deputy Director

2014

ANNUAL FINANCIAL STATEMENTS

- 121** Statement of Financial Position as at 31 December 2014
- 122** Income Statement for the Year Ended 31 December 2014
- 123** Notes to the Financial Statements



REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF BANK NEGARA MALAYSIA FOR THE YEAR ENDED 31 DECEMBER 2014

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 2014 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 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 2014 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 differ, 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 DATO' SETIA HAJI AMBRIN BIN BUANG)
AUDITOR GENERAL
MALAYSIA

PUTRAJAYA
17 FEBRUARY 2015



STATEMENT BY CHAIRMAN AND ONE OF THE DIRECTORS

We, Zeti Akhtar Aziz and N.Sadasivan, 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 2014 and of the results of operations for the year ended on that date.

On behalf of the Board,

On behalf of the Board,



ZETI AKHTAR AZIZ
CHAIRMAN

16 FEBRUARY 2015
KUALA LUMPUR



N.SADASIVAN
DIRECTOR

16 FEBRUARY 2015
KUALA LUMPUR

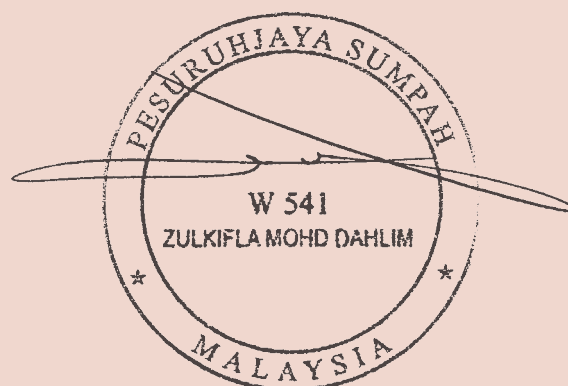
DECLARATION BY THE OFFICER PRIMARILY RESPONSIBLE FOR THE FINANCIAL MANAGEMENT OF BANK NEGARA MALAYSIA

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, 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 13 February 2015.)



Before me,



NO: 17, JALAN PETALING
50000 KUALA LUMPUR

Bank Negara Malaysia

Statement of Financial Position as at 31 December 2014

		2014 RM	2013 RM
ASSETS	Note		
Gold and Foreign Exchange	3	395,559,281,287	432,209,463,509
International Monetary Fund Reserve Position		3,295,258,378	3,183,163,738
Holdings of Special Drawing Rights		6,518,068,438	6,488,214,835
Malaysian Government Papers	4	2,454,717,462	1,852,122,439
Deposits with Financial Institutions	5	1,730,586,027	16,444,346,374
Loans and Advances	6	6,499,251,321	6,681,648,479
Land and Buildings	7	2,113,933,570	112,006,381
Other Assets	8	9,445,411,770	7,296,920,314
Total Assets		427,616,508,253	474,267,886,069
LIABILITIES AND CAPITAL			
Currency in Circulation		77,734,642,894	73,030,918,741
Deposits from: Financial Institutions		141,160,587,660	198,707,476,320
Federal Government		5,263,624,767	7,106,526,875
Others	9	2,033,677,999	2,892,230,514
Bank Negara Papers		105,476,712,764	105,897,166,260
Allocation of Special Drawing Rights	10	6,819,246,401	6,790,312,388
Other Liabilities	11	20,877,653,661	25,259,228,604
Total Liabilities		359,366,146,146	419,683,859,702
 Paid-up Capital	12	 100,000,000	 100,000,000
General Reserve Fund	13	14,571,973,385	14,536,961,990
Risk Reserve	14	52,826,461,523	39,947,064,377
Land Revaluation Reserve	15	751,927,199	-
Total Capital		68,250,362,107	54,584,026,367
Total Liabilities and Capital		427,616,508,253	474,267,886,069

Notes on the following pages form part of these financial statements.

Bank Negara Malaysia

Income Statement for the Year Ended 31 December 2014

		2014 RM	2013 RM
Total Income	Note 16	8,480,790,521	6,747,594,782
Less:			
Recurring Expenditure	17	1,148,226,525	1,120,455,560
Development Expenditure	18	947,552,601	170,893,518
Total Expenditure		2,095,779,126	1,291,349,078
Net Profit		6,385,011,395	5,456,245,704
Appropriation of Net Profit:			
Transfer to Risk Reserve	19	3,350,000,000	3,900,000,000
Transfer to General Reserve Fund		35,011,395	56,245,704
Amount Payable to Federal Government		3,000,000,000	1,500,000,000
Net Profit		6,385,011,395	5,456,245,704

Notes on the following pages form part of these financial statements.

Notes to the Financial Statements for the Year Ended 31 December 2014

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 12 February 2015.

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 Bank, appropriate to do so, having regard to the objects and functions of the Bank. The Bank, having considered its responsibilities for the formulation and conduct of effective monetary policy, is of the opinion that, it is appropriate to differ, in some 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 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 at the date of the Statement of Financial Position. Transactions in foreign currencies during the year are translated into Ringgit Malaysia using the exchange rate prevailing at the transaction dates.
- (c) The unrealised revaluation gains or losses arising from changes in the exchange rates are recognised in Risk Reserve.

2.4 Securities and Investments

Securities and investments are stated mainly at cost less provisions for diminution in value as at 31 December 2014. Financial instruments classified as Available-For-Sale are stated at fair value and the unrealised revaluation gains or losses arising from changes in market prices are recognised in Risk Reserve.

2.5 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.

2.6 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'. The difference between the amount received and the amount paid under repurchase and reverse-repurchase agreements is recognised as interest expense and interest income respectively on a straight-line basis.

2.7 Land and Buildings

- (a) In the previous years, the Bank recorded land and buildings at a nominal cost of RM10 each. With effect from the current year, the Bank changed its accounting policy to capitalise land while the recording of building will be maintained at a 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.

2.8 Other Fixed Assets

All other fixed assets are completely written-off in the year of acquisition.

3. Gold and Foreign Exchange

	2014 RM	2013 RM
Gold	4,774,070,324	4,617,069,254
Foreign Securities	347,070,572,889	370,973,012,213
Foreign Deposits	14,200,483,867	13,753,641,155
Balances with Other Central Banks	11,970,658,666	14,656,338,583
Others	17,543,495,541	28,209,402,304
	<u>395,559,281,287</u>	<u>432,209,463,509</u>

4. **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.

	2014 RM	2013 RM
Malaysian Government Securities	<u>2,454,717,462</u>	<u>1,852,122,439</u>

5. **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.

6. **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 mainly provided under section 48, section 49 and section 100 of the Central Bank of Malaysia Act 2009.

7. **Land and Buildings**

Land comprises freehold land. Land carried at cost amounts to RM1,250,000,000 and represent land purchased in 2014. Other land revalued in 2014 amounts to RM863,930,000. Buildings recorded at nominal value amounts to RM3,570.

8. **Other Assets**

Other assets include investments in shares and bonds of RM4,595,065,420 acquired under section 48(1) and section 100 of the Central Bank of Malaysia Act 2009.

9. **Deposits from Others**

A substantial part of these deposits comprises deposits from national institutions, government agencies and public authorities.

10. **Allocation of Special Drawing Rights**

IMF member countries are allocated Special Drawing Rights (SDR) in proportion to their subscription to the IMF. The allocation represents a dormant liability of the Bank to the IMF, against which assets are received in SDR from the IMF. The net cumulative allocation of SDR was SDR1,346,143,721 equivalent to RM6,819,246,401.

11. **Other Liabilities**

Other liabilities include mainly placements by financial institutions under the repurchase agreements.

12. **Paid-up Capital**

The paid-up capital of RM100,000,000 is owned by the Government of Malaysia.

13. **General Reserve Fund**

	2014 RM	2013 RM
As at 1 January (as previously reported)	14,424,959,189	14,368,713,485
Prior year adjustment – Capitalisation of land	112,002,801	112,002,801
As restated	14,536,961,990	14,480,716,286
Transfer from Net Profit	35,011,395	56,245,704
As at 31 December	<u>14,571,973,385</u>	<u>14,536,961,990</u>

14. **Risk Reserve**

This reserve is to account for unrealised revaluation gains or losses arising from changes in exchange rates and market prices and to absorb any potential future losses resulting from unfavourable circumstances not within the control of the Bank.

15. **Land Revaluation Reserve**

Land Revaluation Reserve relates to unrealised surplus of land upon their revaluation.

16. **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.

17. **Recurring Expenditure**

Recurring expenditure are expenses incurred in the management and administration of the day-to-day operations of the Bank.

18. **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.

19. **Transfer to Risk Reserve**

The transfer to Risk Reserve is made in accordance with section 7 of the Central Bank of Malaysia Act 2009.

20. **Contingencies and Commitments**20.1 **Contingent Assets**

Total contingent assets as at 31 December 2014 amounted to RM1,400,000,000. These comprise the Bank's total contributions to International Centre for Leadership in Finance (ICLIF) Trust Fund of RM800,000,000 and International Centre for Education in Islamic Finance (INCEIF) Trust Fund of RM600,000,000, 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. 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.

20.2 **Commitments**

Total commitments as at 31 December 2014 comprise the following:

(a) **Membership with IMF**

- (i) The Bank has an obligation to pay to IMF an equivalent amount of RM5,948,893,693 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 2014, Malaysia has consented to the quota increase of SDR1,859,900,000 (equivalent to RM9,421,814,464).

- (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 2014, the amount of undrawn credit under the NAB is SDR299,181,875 (equivalent to RM1,515,584,772).
- (iv) On 23 July 2012, the Bank has pledged a USD1,000,000,000 (equivalent to RM3,496,500,000) 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 SDR12,075,000 (equivalent to RM61,169,100) 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 2014, the Bank’s total commitment amounted to USD300 million (equivalent to RM1,049.0 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 8 February 2012, 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 2014, 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 2014, 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 2014, the Bank’s total commitment is USD9.1 billion (equivalent to RM31.8 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 USD5.0 billion (equivalent to RM17.5 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 2014, there was no request for liquidity assistance from any counterpart.

21. **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 and investment guidelines that is 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 degree of credit exposure 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.

22. **Income Tax**

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.

23. **Comparatives**

Certain comparative figures have been restated to conform with the current year's presentation. In previous years, the Bank recorded land and buildings as part of Other Assets at a nominal cost of RM10 each. With effect from 2014, the Bank changed its accounting policy to capitalise

land. Buildings are recorded at a nominal cost of RM10 each. The change in accounting policy requires reclassification of the nominal sum recorded as Other Assets and an adjustment to the General Reserve Fund for the cost of land capitalised, that was previously expensed off. The effects of these changes on the comparative figures are as follows:

	As restated RM	As previously stated RM
Other Assets	7,296,920,314	7,296,923,894
Land and Buildings	112,006,381	-
General Reserve Fund	14,536,961,990	14,424,959,189

2014

ANNEX



CONTENTS

Key Economic and Financial Statistics

National Accounts

A.1	Gross Domestic Product by Kind of Economic Activity at Constant 2005 Prices	P 1
A.2	Growth in Manufacturing Production (2010=100)	P 2
A.3	Services Sector Performance at Constant 2005 Prices	P 2
A.4	GNI by Demand Aggregates	P 3
A.5	Savings-Investment Gap	P 4
A.6	Labour Market: Selected Indicators	P 5
A.7	Private Consumption Indicators	P 6
A.8	Private Investment Indicators	P 7

External Sector

A.9	Balance of Payments	P 8
A.10	Gross Exports	P 10
A.11	Gross Imports	P 11
A.12	Malaysia's Trading Partners	P 12
A.13	Outstanding External Debt and Debt Servicing	P 13

Consumer and Producer Prices Index

A.14	Consumer Price Index	P 14
A.15	Producer Price Index	P 14

Monetary and Financial Indicators

A.16	Broad Money (M3)	P 15
A.17	Money Supply: Annual Change and Growth Rates	P 16
A.18	Interest Rates (%)	P 17
A.19	Movements of the Ringgit	P 18
A.20	Housing Credit Institutions	P 19
A.21	Housing Loans Outstanding	P 20
A.22	Housing Loans Approved	P 20
A.23	Financing of the Economy	P 21

Public Finance

A.24	Consolidated Public Sector Finance	P 22
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Selected International Economic Indicators

A.25	Major Advanced Economies: Key Economic Indicators	P 23
A.26	Emerging Asia: Key Economic Indicators	P 24

Table A.1

Gross Domestic Product by Kind of Economic Activity at Constant 2005 Prices

	2010	2011	2012	2013	2014 ^p	2015 ^f
	RM million					
Agriculture	51,263	54,250	54,963	56,095	57,528	57,675
Mining and quarrying	66,182	62,607	63,243	63,680	65,650	67,525
Manufacturing	170,261	178,237	186,748	193,237	205,200	215,323
Construction	21,459	22,464	26,640	29,554	32,984	36,380
Services	359,829	385,550	410,339	434,460	462,027	487,887
Plus: Import duties	7,660	8,653	10,001	10,586	11,651	12,384
GDP at purchasers' prices¹	676,653	711,760	751,934	787,611	835,040	877,174
	Annual change (%)					
Agriculture	2.4	5.8	1.3	2.1	2.6	0.3
Mining and quarrying	-0.3	-5.4	1.0	0.7	3.1	3.0
Manufacturing	11.9	4.7	4.8	3.5	6.2	4.9
Construction	11.4	4.7	18.6	10.9	11.6	10.3
Services	7.4	7.1	6.4	5.9	6.3	5.6
Plus: Import duties	9.6	13.0	15.6	5.8	10.1	6.3
GDP at purchasers' prices	7.4	5.2	5.6	4.7	6.0	4.5~5.5

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)

	2011	2012	2013	2014	2012	2013	2014
	Index				Annual change (%)		
Export-oriented industries	104.1	110.8	114.5	120.7	6.5	3.3	5.4
Electronics and electrical products cluster	99.1	107.1	117.8	132.0	8.1	10.0	12.1
<i>Electronics</i>	96.0	108.2	128.3	141.8	12.7	18.6	10.5
<i>Electrical products</i>	104.4	105.3	99.9	115.3	0.9	-5.1	15.4
Primary-related cluster	106.5	112.6	113.0	115.3	5.8	0.3	2.1
Chemicals and chemical products	110.0	121.9	121.1	125.4	10.8	-0.7	3.6
Petroleum products	103.4	108.3	108.5	109.2	4.7	0.2	0.6
Textiles, wearing apparel and footwear	113.2	105.2	102.4	113.5	-7.1	-2.6	10.8
Wood and wood products	94.9	103.1	99.9	107.7	8.7	-3.1	7.8
Rubber products	120.7	124.3	134.5	132.8	3.0	8.2	-1.3
Off-estate processing	108.1	107.2	109.1	110.7	-0.8	1.7	1.5
Paper products	109.5	112.9	115.5	114.2	3.1	2.3	-1.1
Domestic-oriented industries	110.7	112.6	120.3	129.8	1.7	6.8	7.9
Construction-related cluster	111.3	114.7	120.4	125.5	3.1	4.9	4.2
Construction-related products	107.3	105.6	106.9	112.3	-1.5	1.3	5.0
<i>Non-metallic mineral products</i>	112.1	115.4	115.0	122.9	2.9	-0.4	6.9
<i>Basic iron & steel and non-ferrous metals</i>	102.2	95.4	98.6	101.4	-6.6	3.4	2.8
Fabricated metal products	121.8	138.6	155.6	159.9	13.8	12.2	2.8
Consumer-related cluster	110.2	110.8	120.2	133.3	0.5	8.5	10.9
Food products	110.9	107.8	116.9	126.0	-2.8	8.4	7.8
Transport equipment	112.0	115.8	131.8	150.7	3.4	13.8	14.4
Beverages	109.0	105.6	103.3	121.6	-3.2	-2.1	17.7
Tobacco products	111.8	123.6	101.3	106.2	10.6	-18.0	4.8
Others	96.8	99.0	102.1	105.3	2.3	3.2	3.1
Total	105.7	111.3	116.0	123.0	5.2	4.2	6.1

Source: Department of Statistics, Malaysia

Table A.3

Services Sector Performance at Constant 2005 prices

	2010	2011	2012	2013	2014 ^p	2010	2011	2012	2013	2014 ^p
	Annual change (%)					Share to GDP (%)				
Services	7.4	7.1	6.4	5.9	6.3	53.2	54.2	54.6	55.2	55.3
Intermediate services	8.1	6.5	7.5	5.1	5.4	21.8	22.0	22.4	22.5	22.4
<i>Finance and insurance</i>	8.2	6.8	7.9	1.8	2.0	9.1	9.2	9.4	9.1	8.8
<i>Real estate and business services</i>	7.6	5.6	7.2	7.5	7.8	5.4	5.4	5.5	5.7	5.8
<i>Transport and storage</i>	7.1	5.4	4.9	4.6	5.0	3.7	3.7	3.6	3.6	3.6
<i>Communication</i>	9.7	8.3	9.5	10.0	9.9	3.6	3.7	3.9	4.1	4.2
Final services	6.9	7.6	5.7	6.4	7.0	31.4	32.1	32.1	32.7	33.0
<i>Wholesale and retail trade</i>	8.3	7.0	4.6	6.4	8.8	14.1	14.3	14.2	14.4	14.8
<i>Accommodation and restaurant</i>	7.0	6.0	5.4	5.7	6.2	2.4	2.5	2.5	2.5	2.5
<i>Utilities</i>	7.7	3.6	4.3	4.1	3.5	2.6	2.5	2.5	2.5	2.4
<i>Government services</i>	5.9	12.4	9.4	8.3	6.5	7.2	7.7	8.0	8.3	8.3
<i>Other services</i>	4.4	5.1	3.9	5.1	4.9	5.1	5.1	5.0	5.0	5.0

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Table A.4

GNI by Demand Aggregates

	2010	2011	2012	2013	2014 ^p	2015 ^f
	at Current Prices (RM million)					
Consumption	476,273	534,282	588,768	637,749	695,803	745,958
<i>Private consumption</i>	378,791	418,767	461,295	504,045	554,358	599,431
<i>Public consumption</i>	97,482	115,515	127,473	133,704	141,445	146,527
Investment	179,793	197,415	241,562	265,013	282,600	312,195
<i>Private investment</i>	98,555	111,626	140,177	160,461	181,456	201,072
<i>Public investment</i>	81,238	85,789	101,385	104,552	101,144	111,123
Change in stocks ¹	5,955	8,350	2,639	-7,566	-12,913	-8,628
Exports of goods and services	744,034	810,221	803,042	805,962	852,208	861,338
Imports of goods and services	608,728	664,928	694,063	714,425	747,690	783,504
GDP at purchasers' value	797,327	885,339	941,949	986,733	1,070,008	1,127,358
Net factor payments abroad	-26,333	-21,806	-36,050	-34,126	-37,390	-37,961
GNI	770,994	863,533	905,899	952,607	1,032,618	1,089,396
	at Constant 2005 Prices (RM million)					
Consumption	411,768	447,856	481,633	515,327	548,951	578,256
<i>Private consumption</i>	330,385	353,293	382,384	409,817	438,748	465,073
<i>Public consumption</i>	81,383	94,563	99,249	105,510	110,203	113,183
Investment	158,397	168,393	200,773	217,879	228,089	245,401
<i>Private investment</i>	86,699	94,809	116,468	131,703	146,145	159,249
<i>Public investment</i>	71,697	73,584	84,305	86,176	81,944	86,152
Change in stocks ¹	8,129	3,172	5,629	-1,452	-8,849	-8,140
Exports of goods and services	683,391	713,893	700,819	705,260	741,333	763,239
Imports of goods and services	585,031	621,555	636,921	649,404	674,483	701,581
GDP at purchasers' prices	676,653	711,760	751,934	787,611	835,040	877,174
Net factor payments abroad	-40,910	-44,457	-58,364	-57,126	-60,415	-62,279
GNI	635,743	667,303	693,570	730,485	774,625	814,895

¹ Includes statistical discrepancy^p Preliminary^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5

Savings-Investment Gap

	2010	2011	2012	2013	2014 ^p
	RM million				
Public gross domestic capital formation	81,238	85,789	101,385	104,552	101,144
Public savings	85,898	87,998	95,923	98,055	83,471
Deficit/surplus	4,660	2,209	-5,462	-6,497	-17,673
Private gross domestic capital formation	104,510	119,976	142,816	152,895	168,543
Private savings	187,032	220,193	202,738	199,299	235,724
Deficit/surplus	82,522	100,217	59,922	46,404	67,181
Gross domestic capital formation	185,748	205,765	244,201	257,446	269,687
(as % of GNI)	24.1	23.8	27.0	27.0	26.1
Gross national savings	272,930	308,191	298,661	297,354	319,195
(as % of GNI)	35.4	35.7	33.0	31.2	30.9
Balance on current account	87,183	102,426	54,460	39,907	49,508
(as % of GNI)	11.3	11.9	6.0	4.2	4.8

^p Preliminary

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

Table A.6

Labour Market: Selected Indicators

	2010	2011	2012	2013	2014 ^p
	(number of positions/persons)				
Vacancies by Industry¹					
Agriculture, forestry & fishing	327,670	399,522	337,466	306,542	240,552
Mining & quarrying	2,517	3,369	2,180	1,880	2,605
Manufacturing	693,711	689,422	598,890	456,478	352,784
Construction	250,820	388,241	310,954	308,783	202,878
Services	512,503	778,994	369,983	329,007	275,199
<i>Electricity, gas & water supply²</i>	8,269	15,091	6,521	7,043	8,339
<i>Wholesale & retail trade; accommodation & food services</i>	147,303	185,577	109,117	95,966	87,385
<i>Transport & storage; information & communication</i>	17,888	20,100	17,921	14,864	19,375
<i>Finance & insurance; real estate & business services³</i>	168,067	372,346	114,099	96,399	75,936
<i>Public administration & defence; compulsory social security</i>	20,414	6,897	5,115	4,020	2,485
<i>Community, social & other service activities</i>	150,562	178,983	117,210	110,715	81,679
Total vacancies	1,787,221	2,259,548	1,619,473	1,402,690	1,074,018
Retrenchments by Industry					
Agriculture, forestry & fishing	866	172	156	180	77
Mining & quarrying	30	24	81	117	318
Manufacturing	3,854	5,635	7,616	7,940	5,716
Construction	262	290	1,002	353	564
Services	2,073	3,329	2,639	2,605	3,756
<i>Electricity, gas & water supply²</i>	-	66	46	-	67
<i>Wholesale & retail trade; accommodation & food services</i>	662	1,322	743	742	1,759
<i>Transport & storage; information & communication</i>	208	293	292	362	478
<i>Finance & insurance; real estate & business services³</i>	934	672	827	628	888
<i>Public administration & defence; compulsory social security</i>	22	545	511	548	339
<i>Community, social & other service activities</i>	247	431	220	325	225
Total retrenchments	7,085	9,450	11,494	11,195	10,431
Employment by Industry⁴ ('000 persons)					
Agriculture, forestry & fishing	1,614.9	1,410.0	1,601.7	1,682.1	1,659.5
Mining & quarrying	57.2	76.0	80.6	87.1	84.3
Manufacturing	2,108.5	2,222.3	2,227.9	2,214.8	2,273.0
Construction	1,082.7	1,133.6	1,163.7	1,244.1	1,225.6
Services	7,036.4	7,442.6	7,649.2	7,981.9	8,333.8
<i>Electricity, gas & water supply²</i>	122.2	122.4	142.5	143.9	143.4
<i>Wholesale & retail trade; accommodation & food services</i>	2,744.5	2,941.7	3,073.0	3,236.3	3,404.8
<i>Transport & storage; information & communication</i>	733.6	812.8	833.2	812.9	803.1
<i>Finance & insurance; real estate & business services³</i>	1,026.7	1,156.7	1,230.6	1,257.8	1,380.0
<i>Public administration & defence; compulsory social security</i>	787.7	749.0	697.6	764.2	752.4
<i>Community, social & other service activities</i>	1,621.7	1,660.0	1,672.3	1,766.8	1,850.2
Total employment	11,899.5	12,284.4	12,723.2	13,210.0	13,576.3
Labour force participation rate (% of working-age population)	63.7	64.4	65.5	67.0	67.5
Unemployment rate (% of labour force)	3.3	3.1	3.0	3.1	2.9

¹ Refers to vacancies reported by employers through the JobsMalaysia portal. Data from 2012 onwards is not comparable to previous years due to a reclassification exercise

² Refers to electricity, gas, steam, air conditioning; water supply, sewerage, waste management and remediation activities

³ Refers to finance and insurance, real estate, professional, scientific, technical, administrative and support services

⁴ Based on average employment for the period of January-December 2014

^p Preliminary

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

Table A.7

Private Consumption Indicators

	2009	2010	2011	2012	2013	2014
Sales of passenger cars ('000 units)	486.1	543.6	520.5	552.2	576.7	588.3
Annual change (%)	-2.3	11.8	-4.3	6.1	4.4	2.0
Imports of consumption goods (RM billion)	31.4	34.5	39.5	43.7	47.6	50.3
Annual change (%)	-2.7	9.7	14.7	10.7	8.8	5.7
Tax collection						
Sales tax (RM billion)	8.6	8.2	8.6	9.5	10.1	10.9
Service tax (RM billion)	3.3	3.9	5.0	5.6	5.9	6.3
Narrow money (M1)						
Annual change (%)	9.8	11.7	15.4	11.9	13.0	5.7
Loans disbursed by banking system						
Consumption credit (excl. passenger cars)						
Annual change (%)	19.7	12.5	13.3	-3.6	5.9	-0.1
Wholesale and retail trade, restaurants and hotels						
Annual change (%)	-7.4	16.3	13.8	26.0	3.4	21.5
MRA retail sales (Annual change in %)	0.8	8.4	8.1	5.5	4.5	4.9 ^e
Credit card turnover spending ¹ (RM billion)	69.3	79.8	88.8	94.1	99.7	105.5
Annual change (%)	6.2	15.1	11.3	6.0	6.0	5.8
MIER Consumer Sentiment Index ²	109.6	117.2	106.3	118.7	82.4	83.0
FBM KLCI	1,272.8	1,518.9	1,530.7	1,689.0	1,867.0	1,761.3
Commodity prices						
Crude palm oil (RM/tonne)	2,256.8	2,752.1	3,278.9	2,863.5	2,374.5	2,412.4
Brent crude oil (USD/barrel)	62.5	80.3	110.9	111.7	108.7	99.4
Rubber (sen/kg)	642.8	1,069.6	1,366.5	962.4	785.9	554.2

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

	2009	2010	2011	2012	2013	2014
Sales of commercial vehicles ('000 units)	50.6	61.6	65.0	75.6	79.1	78.1
Annual change (%)	-0.2	21.8	5.6	16.2	4.7	-1.3
Imports of capital goods (RM billion)	65.8	73.8	80.3	96.1	98.2	96.2
Annual change (%)	-5.9	12.2	8.9	19.6	2.2	-2.1
Approvals by MIDA (Manufacturing sector)						
No. of projects	766	910	846	804	787	811
Capital investment (RM billion)	32.6	47.2	56.1	41.1	52.1	71.9
Local	10.5	18.1	21.9	20.2	21.6	32.3
Foreign	22.1	29.1	34.1	20.9	30.5	39.6
New investment (% share)	67.6	50.6	59.0	65.4	73.1	60.5
Reinvestments (% share)	32.4	49.4	41.0	34.6	26.9	39.5
Loans disbursed by banking system						
Businesses sector						
Annual change (%)	-3.4	9.8	12.5	20.7	-1.0	18.6
Private Debt Securities (excluding short-term papers)						
Total funds raised (RM billion)	58.6	52.1	69.6	121.1	83.9	85.5
New activities	8.7	13.5	8.4	19.5	7.5	13.1
Initial Public Offerings (Bursa Malaysia)						
Total funds raised (RM billion)	12.2	19.8	7.4	22.9	8.2	5.9
MIER Business Conditions Survey						
Business Conditions Index ¹	118.8	99.5	96.6	94.1	92.0	86.4
Capacity Utilisation Rate ¹	81.4	82.9	81.2	80.9	80.0	79.5
MSC-Status Companies						
No. of companies	284	218	215	213	236	229
Approved investment (RM billion)	2.2	1.5	2.5	2.9	3.0	2.9

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

	2011			2012		
	+	-	Net	+	-	Net
	RM million					
Goods¹	699,591	548,026	151,565	686,047	560,857	125,190
Services	110,630	116,902	-6,272	116,995	133,206	-16,210
Transportation	15,482	40,546	-25,064	13,761	41,755	-27,994
Travel	60,146	31,187	28,959	62,548	37,726	24,821
Other services	34,723	44,367	-9,644	40,429	53,052	-12,623
Government transactions n.i.e.	279	803	-524	257	672	-415
Balance on goods and services	810,221	664,928	145,293	803,042	694,063	108,979
Primary income	52,491	74,297	-21,806	42,262	78,312	-36,050
Compensation of employees	3,707	6,038	-2,331	3,994	7,076	-3,082
Investment income	48,785	68,260	-19,475	38,268	71,236	-32,969
Secondary income	4,683	25,744	-21,061	6,661	25,130	-18,469
Balance on current account	867,395	764,969	102,426	851,965	797,506	54,460
% of GNI			11.9			6.0
Capital account			-133			241
Financial account			23,265			-23,014
Direct investment			-9,337			-24,415
Assets			-55,324			-51,957
Liabilities			45,987			27,542
Portfolio investment			26,139			63,859
Assets			-18,522			-21,464
Liabilities			44,661			85,323
Financial derivatives			-76			972
Other investment			6,539			-63,431
Official sector			-1,337			-1,674
Private sector			7,876			-61,756
Balance on capital and financial accounts			23,132			-22,773
Errors and omissions			-30,876			-27,814
of which:						
Foreign exchange revaluation gain (+) / loss (-)			7,566			-7,686
Overall balance (surplus + / deficit -)			94,682			3,873
Bank Negara Malaysia international reserves, net ²						
RM million			423,331			427,204
USD million			133,610			139,715
Reserves as months of retained imports			9.6			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

2013			2014 ^p			2015 ^f		
+	-	Net	+	-	Net	+	-	Net
RM million								
679,123	570,892	108,230	726,036	600,971	125,064	723,919	629,714	94,205
126,839	143,532	-16,693	126,172	146,718	-20,546	137,419	153,790	-16,372
14,693	44,973	-30,280	15,541	48,441	-32,900	16,181	49,332	-33,151
67,733	38,309	29,424	71,415	40,052	31,363	78,675	42,379	36,295
44,114	59,741	-15,627	38,906	57,667	-18,761	42,190	61,569	-19,380
300	510	-210	311	558	-247	373	509	-136
805,962	714,425	91,537	852,208	747,690	104,518	861,338	783,504	77,834
47,468	81,594	-34,126	51,804	89,194	-37,390	52,586	90,547	-37,961
4,407	8,231	-3,824	5,134	9,761	-4,627	5,352	9,850	-4,498
43,061	73,363	-30,302	46,670	79,433	-32,763	47,235	80,698	-33,463
7,584	25,087	-17,504	10,308	27,927	-17,619	8,864	27,321	-18,457
861,014	821,106	39,907	914,319	864,811	49,508	922,788	901,373	21,415
		4.2			4.8			2-3
		-21			281			
		-15,807			-76,495			
		-5,450			-17,101			
		-41,159			-51,271			
		35,708			34,170			
		-3,041			-37,867			
		-32,116			-28,271			
		29,075			-9,596			
		-253			-975			
		-7,062			-20,553			
		-3,966			-2,030			
		-3,096			-18,523			
		-15,827			-76,215			
		-9,431			-9,801			
		18,611			7,573			
		14,648			-36,507			
		441,853			405,345			
		134,902			115,930			
		9.5			8.3			

Table A.10

Gross Exports

	2012	2013	2014 ^p	2013	2014 ^p	2014 ^p
	RM million			Annual change (%)		% share
Manufactures	519,897	549,337	589,329	5.7	7.3	76.9
<i>of which:</i>						
Electronics, electrical machinery and appliances	256,471	264,050	286,156	3.0	8.4	37.4
Electronics	178,789	186,838	201,225	4.5	7.7	26.3
Semiconductors	101,789	111,442	127,353	9.5	14.3	16.6
Electronic equipment and parts	77,000	75,396	73,872	-2.1	-2.0	9.6
Electrical machinery and appliances	77,682	77,212	84,931	-0.6	10.0	11.1
Electrical industrial machinery and equipment	29,204	30,874	34,311	5.7	11.1	4.5
Industrial and commercial electrical products	25,480	24,114	29,184	-5.4	21.0	3.8
Consumer electrical products	18,714	18,225	16,351	-2.6	-10.3	2.1
Household electrical appliances	4,285	3,998	5,085	-6.7	27.2	0.7
Chemicals and chemical products	47,318	51,901	56,817	9.7	9.5	7.4
Petroleum products	52,785	66,827	68,975	26.6	3.2	9.0
Manufactures of metal	29,475	34,926	35,302	18.5	1.1	4.6
Optical and scientific equipment	22,928	20,837	23,639	-9.1	13.4	3.1
Rubber products	19,466	18,222	17,205	-6.4	-5.6	2.2
Textiles, clothing and footwear	9,488	10,216	11,592	7.7	13.5	1.5
Wood products	8,456	8,437	8,441	-0.2	...	1.1
Agriculture	80,413	68,799	69,200	-14.4	0.6	9.0
<i>of which:</i>						
Palm oil	53,067	41,737	41,641	-21.3	-0.2	5.4
Palm kernel oil	2,460	2,235	2,636	-9.1	17.9	0.3
Rubber	7,864	7,027	4,574	-10.6	-34.9	0.6
Minerals	92,974	96,909	104,018	4.2	7.3	13.6
<i>of which:</i>						
Liquefied natural gas (LNG)	56,129	59,567	64,289	6.1	7.9	8.4
Crude oil and condensates	31,951	31,643	33,790	-1.0	6.8	4.4
Others	9,358	4,947	3,582	-47.1	-27.6	0.5
Total	702,641	719,992	766,129	2.5	6.4	100.0

^p Preliminary

... Negligible

Note: Numbers may not necessarily add up due to rounding

Data compiled in this table are not directly comparable to Monthly External Trade Statistics published by Department of Statistics, Malaysia due to differences in classification

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.11

Gross Imports

	2012	2013	2014 ^p	2013	2014 ^p	2014 ^p
	RM million			Annual change (%)		% share
Capital goods	96,098	98,202	96,177	2.2	-2.1	14.1
Capital goods (except transport equipment)	78,542	78,352	80,538	-0.2	2.8	11.8
Transport equipment industrial	17,556	19,850	15,640	13.1	-21.2	2.3
Intermediate goods	363,714	379,455	408,383	4.3	7.6	59.8
Food and beverages, mainly for industry	20,176	16,740	17,977	-17.0	7.4	2.6
Industrial supplies	157,920	166,324	172,806	5.3	3.9	25.3
Fuel and lubricants	42,036	46,326	58,139	10.2	25.5	8.5
Parts and accessories of capital goods (except transport equipment)	126,694	131,615	138,596	3.9	5.3	20.3
Parts and accessories of transport equipment	16,888	18,450	20,865	9.2	13.1	3.1
Consumption goods	43,746	47,584	50,316	8.8	5.7	7.4
Food and beverages, mainly for household consumption	18,907	20,080	21,494	6.2	7.0	3.1
Transport equipment non-industrial	1,054	1,434	1,082	36.0	-24.5	0.2
Consumer goods, n.e.s	23,785	26,071	27,739	9.6	6.4	4.1
Others	103,119	123,455	128,141	19.7	3.8	18.8
<i>of which:</i>						
Dual use goods	34,460	28,610	26,088	-17.0	-8.8	3.8
Re-exports	65,721	92,002	99,115	40.0	7.7	14.5
Total	606,677	648,695	683,016	6.9	5.3	100.0

^p Preliminary

n.e.s. Not elsewhere specified

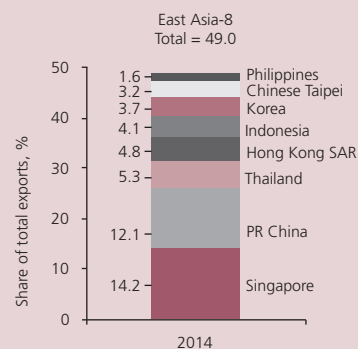
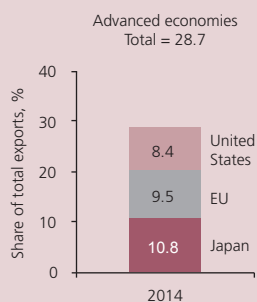
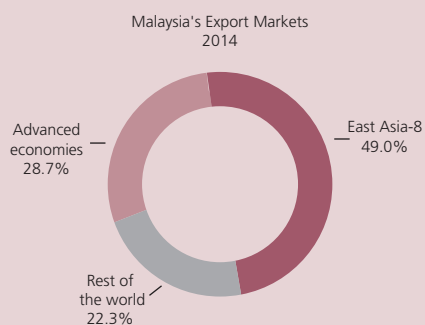
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

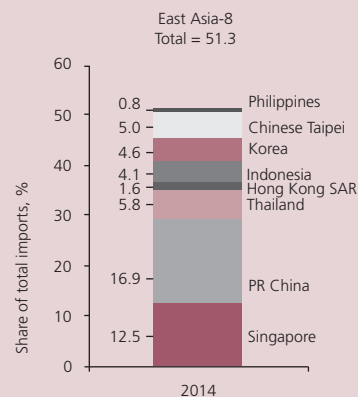
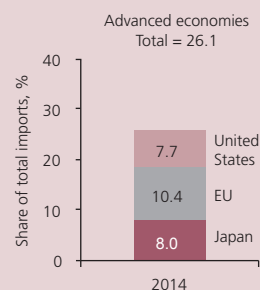
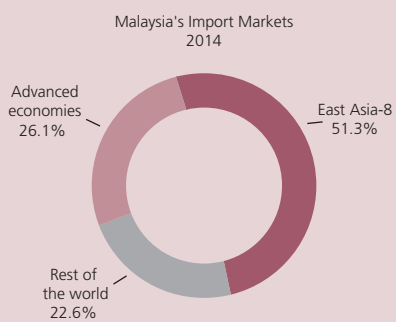
Chart A.12

Malaysia's Trading Partners

Malaysia's Export Markets



Malaysia's Import Markets



Malaysia's Total Trade by Markets

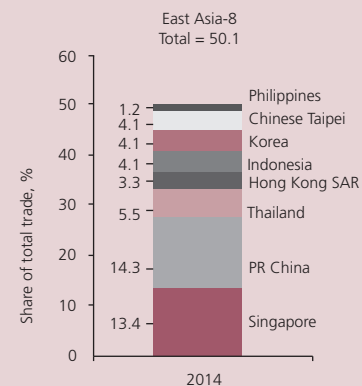
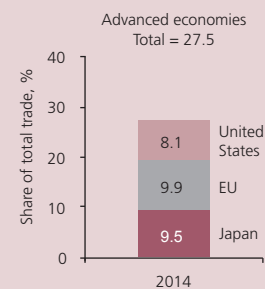
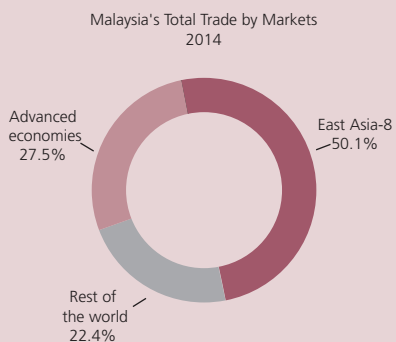


Table A.13

Outstanding External Debt¹ and Debt Servicing

	2010	2011	2012	2013	2014p
	RM million				
Offshore borrowing²	227,072	257,273	257,594	324,088	367,072
Medium- and long-term	147,653	153,525	165,139	195,986	210,872
<i>Federal Government</i>	16,746	18,105	16,848	16,763	16,776
<i>Public Enterprises</i>	70,383	69,562	71,392	82,141	76,343
<i>Private sector</i>	60,524	65,859	76,899	97,082	117,753
Short-term	79,420	103,748	92,455	128,102	156,200
<i>Banking sector</i>	67,982	92,302	79,981	113,530	139,908
<i>Non-bank private sector</i>	11,438	11,446	12,474	14,573	16,292
NR holdings of domestic debt securities	118,935	163,268	223,606	229,674	223,291
<i>Government securities</i>	75,012	104,270	132,410	141,669	151,377
<i>Others</i>	43,923	58,998	91,196	88,005	71,914
NR deposits	34,628	43,917	58,963	77,325	87,672
Others³	53,643	72,997	61,897	65,524	66,665
Total external debt:	434,278	537,456	602,060	696,610	744,700
Total external debt (USD million)	139,263	167,908	194,646	209,797	211,029
<i>% GNI</i>	56.3	62.2	66.5	73.1	72.1
<i>Annual change (%)</i>	11.8	23.8	12.0	15.7	6.9
Currency composition (% share)	100.0	100.0	100.0	100.0	100.0
<i>Ringgit</i>	40.8	42.7	49.2	45.9	41.2
<i>US dollar</i>	44.5	43.9	39.2	43.2	47.4
<i>Japanese yen</i>	5.1	4.7	3.2	2.6	2.4
<i>Others</i>	9.6	8.7	8.4	8.3	9.1
Total servicing (including short-term interest payment)	79,012	123,953	139,758	141,738	155,420
of which:					
Medium- and long-term debt Repayment⁴	78,390	123,114	138,739	140,716	154,186
of which:					
Redemption of matured domestic debt securities held by NR	7,320	18,369	23,982	23,490	23,587
Interest payment	7,326	8,408	9,890	10,113	11,147
of which interest payment on:					
NR holdings of domestic debt securities	2,352	3,679	5,067	5,694	6,941
Debt service ratio (% of exports of goods and services)					
Total debt	10.6	15.3	17.4	17.6	18.2
Medium- and long-term debt	10.5	15.2	17.3	17.5	18.1
of which:					
NR holdings of domestic debt securities	1.0	2.3	3.0	2.9	2.8

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 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)	2011	2012	2013	2014
		Annual change (%)			
Total	100.0	3.2	1.6	2.1	3.2
<i>of which:</i>					
Food and non-alcoholic beverages	30.3	4.8	2.7	3.6	3.3
Alcoholic beverages and tobacco	2.2	4.6	0.4	6.0	11.6
Clothing and footwear	3.4	-0.2	-0.6	-0.6	-0.2
Housing, water, electricity, gas and other fuels	22.6	1.8	1.6	1.7	3.4
Furnishings, household equipment and routine household maintenance	4.1	1.8	2.0	1.5	1.0
Health	1.3	2.7	2.0	1.9	2.9
Transport	14.9	4.4	0.7	2.0	4.9
Communication	5.7	-0.3	-0.6	-0.7	-0.7
Recreation services and culture	4.6	2.0	1.2	0.1	1.5
Education	1.4	2.2	2.4	2.4	2.4
Restaurants and hotels	3.2	5.9	2.9	2.5	4.7
Miscellaneous goods and services	6.3	2.4	2.0	0.3	0.7

Source: Department of Statistics, Malaysia

Table A.15

Producer Price Index

	Weights (%) (2010=100) ¹	2011	2012	2013	2014
		Annual change (%)			
Total	100.0	9.6	0.1	-1.7	1.4
<i>of which:</i>					
Food	5.7	9.4	0.2	1.4	4.4
Beverages and tobacco	1.0	4.6	0.7	1.3	2.8
Crude materials, inedible	6.7	19.5	-12.8	-12.7	-2.1
Mineral fuels, lubricants, etc.	19.9	22.4	5.6	-0.6	0.4
Animal and vegetable oils and fats	7.3	22.5	-10.0	-15.1	7.4
Chemicals	8.2	8.9	-0.4	0.8	2.2
Manufactured goods	11.3	3.6	-0.5	-0.5	0.4
Machinery and transport equipment	33.9	0.7	1.9	0.9	1.2
Miscellaneous manufactured articles	5.4	2.7	0.7	0.5	0.7
Miscellaneous transactions and commodities	0.6	7.3	3.2	-4.9	-2.5
Local production	66.7	12.3	-0.5	-2.7	1.5
Import	33.3	4.0	1.2	0.5	1.1

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
	2010	2011	2012	2013	2014	2014
	RM million					
Broad money (M3) ¹	68,791	155,581	111,211	107,470	101,485	1,553,803
Currency in circulation ²	4,246	5,142	3,971	5,913	5,319	68,029
Demand deposits	18,449	28,854	26,998	32,013	13,333	277,787
Broad quasi-money	46,096	121,585	80,242	69,545	82,833	1,207,986
<i>Fixed deposits</i>	27,038	72,789	60,894	66,957	51,479	732,368
<i>Savings deposits</i>	2,675	10,728	8,070	8,025	3,166	134,931
<i>NIDs</i>	-4,115	-1,239	-1,392	-1,626	4,002	18,174
<i>Repos</i>	655	-1,701	2,150	100	-1,592	497
<i>Foreign currency deposits</i>	1,432	13,125	14,090	4,434	15,397	95,513
<i>Other deposits</i>	18,412	27,883	-3,570	-8,345	10,381	226,503
Factors Affecting M3						
Net claims on Government	-8,119	2,803	-3,339	21,164	34,317	104,331
<i>Claims on Government</i>	-3,116	4,838	868	15,794	31,336	155,350
<i>Less: Government deposits</i>	5,003	2,035	4,207	-5,370	-2,981	51,020
Claims on private sector	96,161	105,116	129,747	118,033	117,980	1,439,327
<i>Loans</i>	91,981	111,787	106,870	107,934	111,388	1,290,296
<i>Securities</i>	4,181	-6,670	22,877	10,099	6,593	149,032
Net foreign assets	17,580	117,621	20,448	13,298	-11,802	502,595
<i>Bank Negara Malaysia³</i>	-1,793	94,530	4,095	14,185	-36,536	398,526
<i>Banking system</i>	19,373	23,091	16,353	-888	24,735	104,069
Other influences	-36,831	-69,959	-35,645	-45,024	-39,011	-492,451

¹ Excludes interplacements among banking institutions² Excludes holdings by banking system³ 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

	2010		2011		2012		2013		2014	
	RM million	%	RM million	%	RM million	%	RM million	%	RM million	%
Currency in circulation	4,246	9.8	5,803	12.2	3,907	7.3	5,449	9.5	5,189	8.2
Demand deposits with commercial banks and Islamic banks	19,221	12.2	28,769	16.3	26,872	13.1	32,318	13.9	13,630	5.2
M1 ¹	23,467	11.7	34,572	15.4	30,779	11.9	37,768	13.0	18,820	5.7
Other deposits with commercial banks and Islamic banks ²	47,343	6.0	120,878	14.5	87,005	9.1	73,696	7.1	89,377	8.1
Deposits with other banking institutions ³	-2,020	-7.2	131	0.5	-6,574	-25.2	-3,993	-20.5	-6,712	-42.4
M3 ⁴	68,791	6.8	155,581	14.3	111,211	9.0	107,470	7.9	101,485	7.0

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 interplacements 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 2014											
	2008	2009	2010	2011	2012	2013	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
	2008	2009	2010	2011	2012	2013	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
Overnight interbank	3.25	1.99	2.72	2.99	3.00	2.99	3.00	2.99	3.00	2.97	3.00	3.00	3.19	3.25	3.20	3.24	3.25	3.23
1-week interbank	3.27	2.02	2.77	3.01	3.01	3.02	3.02	3.01	3.01	3.01	3.01	3.01	3.26	3.26	3.26	3.27	3.26	3.30
1-month interbank	3.30	2.07	2.83	3.05	3.06	3.20	3.06	3.07	3.06	3.06	3.06	3.54	3.31	3.35	3.41	3.36	3.31	3.38
Commercial banks																		
Fixed deposit																		
3-month	3.04	2.03	2.74	2.99	2.97	2.97	2.97	2.97	2.97	2.97	2.97	2.97	3.12	3.12	3.12	3.12	3.13	3.13
12-month	3.50	2.50	2.97	3.22	3.15	3.15	3.15	3.15	3.15	3.15	3.15	3.15	3.30	3.30	3.30	3.30	3.31	3.31
Savings deposit	1.40	0.86	1.00	1.15	1.03	0.99	0.98	0.98	0.98	0.98	1.00	1.01	1.07	1.07	1.08	1.08	1.07	1.07
Base lending rate (BLR)	6.48	5.51	6.27	6.53	6.53	6.53	6.53	6.53	6.53	6.53	6.53	6.53	6.78	6.79	6.79	6.79	6.79	6.79
Treasury bills (91 days) ¹	2.94	1.98	2.82	2.99	3.04	3.00	3.00	2.99	3.01	3.01	3.03	3.04	3.07	3.19	3.27	3.30	3.35	3.42
Government Securities ¹																		
1-year	2.89	2.12	2.85	2.82	3.01	3.03	3.03	3.03	3.07	3.05	3.14	3.17	3.21	3.24	3.26	3.33	3.42	3.48
5-year	3.00	3.79	3.39	3.23	3.24	3.66	3.73	3.61	3.66	3.63	3.73	3.74	3.67	3.68	3.67	3.64	3.72	3.84
Private debt securities ¹																		
AAA																		
3-year	4.17	3.72	3.63	3.65	3.53	3.71	3.77	3.77	3.86	3.86	3.89	3.90	3.91	3.95	3.94	3.96	3.95	4.00
5-year	4.48	4.32	4.07	3.99	3.80	3.96	4.03	4.12	4.14	4.14	4.22	4.21	4.22	4.23	4.21	4.23	4.23	4.27
AA																		
3-year	4.95	4.50	4.34	4.29	4.04	4.16	4.22	4.24	4.28	4.27	4.29	4.29	4.31	4.33	4.30	4.31	4.31	4.33
5-year	5.31	5.07	4.75	4.65	4.30	4.41	4.46	4.51	4.55	4.55	4.60	4.58	4.59	4.60	4.58	4.58	4.60	4.60
A																		
3-year	6.90	6.80	6.90	6.57	6.34	6.32	6.29	6.38	6.25	6.25	6.18	6.27	6.28	6.24	6.22	6.23	6.21	6.25
5-year	7.43	7.57	7.53	7.11	6.98	7.02	6.97	7.07	6.93	6.90	6.85	6.91	6.98	6.95	6.94	6.95	6.92	6.87
BBB																		
3-year	10.32	10.18	10.40	10.21	10.06	10.02	10.01	10.05	9.97	9.84	9.73	9.97	10.06	10.17	10.13	10.15	10.12	10.16
5-year	11.36	11.32	11.43	11.24	11.14	11.17	11.14	11.21	11.09	11.04	10.88	11.06	11.19	11.23	11.19	11.13	11.16	11.17
BB & below																		
3-year	12.68	12.58	12.78	12.62	12.53	12.52	12.45	12.57	12.68	12.39	12.25	12.51	12.69	12.87	12.90	12.78	12.80	13.03
5-year	13.86	14.02	14.51	14.13	13.76	13.70	13.60	13.76	14.05	13.81	13.65	13.84	14.01	14.18	14.45	14.22	14.21	14.60

¹ Source: FAST, Bank Negara Malaysia

Table A.19

Movements of the Ringgit

	RM to one unit of foreign currency ¹			Annual change (%)		Change (%)
	2005	2013	2014	2013	2014	21 Jul. '05 - Dec. '14
	21 Jul. ²	End-Dec.				
SDR	5.5049	5.0481	5.0853	-7.3	-0.7	8.3
US dollar	3.8000	3.2815	3.4950	-6.8	-6.1	8.7
Singapore dollar	2.2570	2.5943	2.6449	-3.5	-1.9	-14.7
100 Japanese yen	3.3745	3.1281	2.9255	13.7	6.9	15.3
Pound sterling	6.6270	5.4076	5.4396	-8.6	-0.6	21.8
Australian dollar	2.8823	2.9299	2.8664	8.6	2.2	0.6
Euro	4.6212	4.5263	4.2513	-10.7	6.5	8.7
100 Thai baht	9.0681	9.9757	10.627	0.2	-6.1	-14.7
100 Indonesian rupiah	0.0386	0.0269	0.0281	17.8	-4.2	37.4
100 Korean won	0.3665	0.3108	0.3201	-7.8	-2.9	14.5
100 Philippine peso	6.8131	7.3908	7.8066	0.7	-5.3	-12.7
100 New Taiwan dollar	11.890	11.009	11.068	-4.3	-0.5	7.4
Chinese renminbi	0.4591	0.5422	0.5637	-9.5	-3.8	-18.6

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	
			2013	2014	2013	2014
Commercial banks	-		4.27 ^{1,2}	4.38 ^{1,2}	4,341 ³	4,243 ³
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	4.51 ¹	4.76 ¹	145	145
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	7.09 ~ 7.33	7.43 ~ 7.54	43	46
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	4.81 ¹	4.00 ¹	400	402
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 rate² Excludes Islamic banks³ Includes Islamic banks

Source: Bank Negara Malaysia and various housing credit institutions

Table A.21**Housing Loans Outstanding**

	2013	2014 ^p	2013	2014 ^p	2013	2014 ^p
	RM million		Annual change (%)		% share	
Commercial banks ¹	325,232	367,950	12.7	13.1	86.7	86.2
Treasury Housing Loans Division	36,318	43,898	-0.3	20.9	9.7	10.3
Bank Kerjasama Rakyat Malaysia Berhad	2,569	2,633	-13.7	2.5	0.7	0.6
Malaysia Building Society Berhad	5,377	5,303	-0.6	-1.4	1.4	1.2
Borneo Housing Mortgage Finance Berhad	660	714	2.8	8.3	0.2	0.2
Bank Simpanan Nasional	5,003	6,233	31.5	24.6	1.3	1.5
Sabah Credit Corporation	81	69	-15.8	-14.7	...	...
Total	375,239	426,800	11.1	13.7	100.0	100.0

¹ Includes Islamic banks^p Preliminary

... Negligible

Source: Bank Negara Malaysia and various housing credit institutions

Table A.22**Housing Loans Approved**

	2013	2014 ^p	2013	2014 ^p	2013	2014 ^p
	RM million		Annual change (%)		% share	
Commercial banks ¹	111,406	115,628	26.9	3.8	89.7	89.6
Treasury Housing Loans Division	9,042	9,314	8.7	3.0	7.3	7.2
Bank Kerjasama Rakyat Malaysia Berhad	566	659	1,351.7	16.4	0.5	0.5
Malaysia Building Society Berhad	512	853	-36.0	66.6	0.4	0.7
Borneo Housing Mortgage Finance Berhad	171	130	86.7	-23.8	0.1	0.1
Bank Simpanan Nasional	2,533	2,467	13.2	-2.6	2.0	1.9
Sabah Credit Corporation	0	0	...	...	...	...
Total	124,230	129,051	25.1	3.9	100.0	100.0

¹ Includes Islamic banks^p Preliminary

... Negligible

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	<i>of which: SMEs</i>			
	RM million				
Net Change in Financing (2013)					
Financial Intermediaries					
Banking Institutions	47,156	22,496	74,005	(3,475)	117,687
Development Financial Institutions (DFIs) ²	3,434	1,285	5,469	-	8,903
Other Domestic Intermediaries ³	(928)	145	307	-	(621)
Capital Market					
Bond Market ⁴	29,012	-	-	41,925	70,937
Equity Market	16,027	-	-	-	16,027
External Financing					
Foreign Direct Investment	38,238	-	-	-	38,238
Offshore borrowing ⁵	33,030	-	-	(85)	32,945
Total	165,970	23,926	79,782	38,365	284,116
Net Change in Financing (2014p)					
Financial Intermediaries					
Banking Institutions	48,493	27,798	68,912	(3,343)	114,062
Development Financial Institutions (DFIs) ²	2,763	326	5,703	-	8,466
Other Domestic Intermediaries ³	(4,457)	102	7,974	-	3,517
Capital Market					
Bond Market ⁴	30,148	-	-	37,557	67,705
Equity Market	19,163	-	-	-	19,163
External Financing					
Foreign Direct Investment	35,085	-	-	-	35,085
Offshore borrowing ⁵	16,593	-	-	13	16,606
Total	147,788	28,226	82,589	34,227	264,604

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 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

	2011	2012	2013	2014 ^p	2015 ^f
	RM billion				
Revenue ¹	160.7	188.8	191.6	206.9	211.9
% growth	26.3	17.5	1.5	8.0	2.4
Operating expenditure	196.1	227.2	236.6	243.0	238.9
% growth	17.3	15.9	4.1	2.7	-1.7
Current surplus of NFPEs ²	107.0	129.8	139.8	116.4	111.3
Current balance	71.5	91.3	94.8	80.3	84.3
% of GDP	8.1	9.7	9.6	7.5	7.4
Net development expenditure ³	101.3	138.4	133.3	155.3	161.4
% growth	-1.7	36.7	-3.6	16.5	3.9
General Government ⁴	51.8	53.0	51.9	49.7	58.6
NFPEs	49.5	85.4	81.5	105.6	102.8
Overall balance	-29.8	-47.1	-38.6	-75.0	-77.1
% of GDP	-3.4	-5.0	-3.9	-7.0	-6.7

¹ Excludes transfers within General Government

² Refers to 29 major NFPEs from 2014 onwards

³ Adjusted for transfers and net lending within public sector

⁴ Comprises Federal Government, state governments, 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 Enterprises (NFPEs)

Table A.25

Major Advanced Economies: Key Economic Indicators

	2010	2011	2012	2013	2014e	2015f
	Annual change (%)					
REAL GDP						
United States	2.5	1.6	2.3	2.2	2.4	3.6
Japan	4.7	-0.5	1.8	1.6	0.0	0.6
Euro area ¹	2.0	1.6	-0.7	-0.5	0.9	1.2
Germany	4.1	3.6	0.4	0.1	1.6	1.3
United Kingdom	1.9	1.6	0.7	1.7	2.6	2.7
INFLATION						
United States	1.6	3.2	2.1	1.5	1.6	0.4
Japan	-0.7	-0.3	0.0	0.4	2.7	1.0
Euro area ¹	1.6	2.7	2.5	1.4	0.4	0.9
Germany	1.2	2.5	2.1	1.6	0.8	0.7
United Kingdom	3.3	4.5	2.8	2.6	1.5	1.0
	% of labour force					
UNEMPLOYMENT						
United States	9.6	8.9	8.1	7.4	6.2	5.4
Japan	5.0	4.6	4.3	4.0	3.6	3.4
Euro area ¹	10.1	10.1	11.3	12.0	11.6	11.2
Germany	6.9	5.9	5.4	5.2	5.0	5.0
United Kingdom	7.9	8.1	8.0	7.6	6.0	5.5
	% of GDP					
CURRENT ACCOUNT BALANCE						
United States	-3.0	-3.0	-2.9	-2.4	-2.2	-1.5
Japan	4.0	2.1	1.0	0.7	0.5	2.3
Euro area ¹	-0.1	-0.1	1.5	2.1	2.0	1.9
Germany	5.7	6.1	7.1	6.8	7.5	7.8
United Kingdom	-2.6	-1.7	-3.7	-4.7	-3.6	-3.3
FISCAL BALANCE²						
United States	-8.5	-8.1	-6.6	-3.4	-2.8	-2.3
Japan	-8.3	-8.8	-8.7	-9.0	-7.8	-6.8
Euro area ¹	-6.2	-4.1	-3.7	-3.0	-2.9	-2.5
Germany	-4.1	-0.9	0.1	0.1	0.8	0.7
United Kingdom	-9.5	-7.4	-7.9	-5.5	-5.5	-4.6

¹ Refers to EU-18² Refers to general government fiscal balance^e Estimate^f Forecast

Source: International Monetary Fund, Economist Intelligence Unit (EIU) and National Authorities

Table A.26

Emerging Asia: Key Economic Indicators

	2010	2011	2012	2013	2014e	2015f
REAL GDP	Annual change (%)					
Regional Countries						
The People's Republic of China	10.6	9.5	7.7	7.7	7.4	6.8
Korea	6.5	3.7	2.3	3.0	3.3	3.8
Chinese Taipei	10.6	3.8	2.1	2.2	3.7	3.6
Singapore	15.2	6.2	3.4	4.4	2.9	3.5
Hong Kong SAR	6.8	4.8	1.7	2.9	2.3	3.2
Malaysia	7.4	5.2	5.6	4.7	6.0	4.5~5.5
Thailand	7.8	0.1	6.5	2.9	0.7	4.0
Indonesia	6.4	6.2	6.0	5.6	5.0	5.6
Philippines	7.6	3.7	6.8	7.2	6.1	6.4
INFLATION	Annual change (%)					
Regional Countries						
The People's Republic of China	3.3	5.4	2.7	2.6	2.0	1.2
Korea	2.9	4.0	2.2	1.3	1.3	1.6
Chinese Taipei	1.0	1.4	1.9	0.8	1.2	1.6
Singapore	2.8	5.3	4.6	2.4	1.0	0.9
Hong Kong SAR ¹	2.3	5.3	4.1	4.3	4.4	3.2
Malaysia	1.7	3.2	1.6	2.1	3.2	2.0~3.0
Thailand	3.3	3.8	3.0	2.2	1.9	2.3
Indonesia	5.1	5.3	4.0	6.4	6.4	6.0
Philippines	4.1	4.8	3.2	2.9	4.2	3.0
CURRENT ACCOUNT BALANCE	% of GDP					
Regional Countries						
The People's Republic of China	4.0	1.9	2.6	1.9	2.0	1.8
Korea	2.6	1.6	4.2	6.1	5.8	5.6
Chinese Taipei	8.9	8.6	10.2	11.2	11.7	11.7
Singapore	23.7	22.8	17.5	18.3	21.6	24.7
Hong Kong SAR	7.0	5.6	1.6	1.8	2.0	2.6
Malaysia	10.9	11.6	5.8	4.0	4.6	2.0
Thailand	3.1	2.8	-0.4	-0.6	2.6	2.5
Indonesia	0.7	0.2	-2.7	-3.2	-2.8	-2.3
Philippines	3.7	2.5	2.6	3.8	4.5	4.0
FISCAL BALANCE²	% of GDP					
Regional Countries						
The People's Republic of China	-1.2	0.6	0.2	-0.9	-1.0	-0.8
Korea ³	1.3	1.4	1.3	1.0	0.5	0.5
Chinese Taipei ³	-3.2	-2.1	-2.4	-1.4	-1.4	-1.2
Singapore ³	0.2	1.2	2.0	1.3	0.5	1.1
Hong Kong SAR ³	4.2	3.8	3.2	1.0	0.8	0.1
Malaysia	-5.4	-4.8	-4.5	-3.9	-3.5	-3.2
Thailand	-1.5	-1.6	-4.4	-2.4	-2.5	-1.7
Indonesia	-0.7	-1.1	-1.9	-2.3	-2.3	-1.8
Philippines	-3.5	-2.0	-2.3	-1.4	-0.8	-2.0

¹ Refers to composite price index² Refers to central government fiscal balance³ Refers to general government fiscal balance

e Estimate

f Forecast

Source: International Monetary Fund (IMF), Economist Intelligence Unit (EIU), Asian Development Bank, National Authorities and Bank Negara Malaysia estimates