



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

The BNM Quarterly Bulletin presents a quarterly review of Malaysia's economic, monetary and financial developments. It includes the Bank's latest assessments on the direction of the economy going forward. The Bulletin also provides insights on current economic and financial issues, including highlights of policy initiatives undertaken by Bank Negara Malaysia in pursuit of its mandates.

Contents

P4 **Key Highlights**

P7 **International Economic Environment**

P9 **Developments in the Malaysian Economy**

P19 *Box Article 1: Trade Disputes: Implications for Trade and Investments*

P25 *Box Article 2: Global Slack as a Determinant of Inflation*

P33 **Monetary and Financial Developments**

P37 **Managing Risks to Financial Stability**

P45 **The Bank's Policy Considerations**

P47 **Macroeconomic Outlook**

P50 *Feature Article: Improving Quality and Transparency of Services to Financial Consumers*

P57 **Annex**

Key Highlights on Economic and Financial Developments in 1Q 2018

Firm GDP growth of 5.4%

Continued expansion in domestic demand and across economic sectors

Real GDP Growth



Continued expansion in private sector activity



External demand provided further support

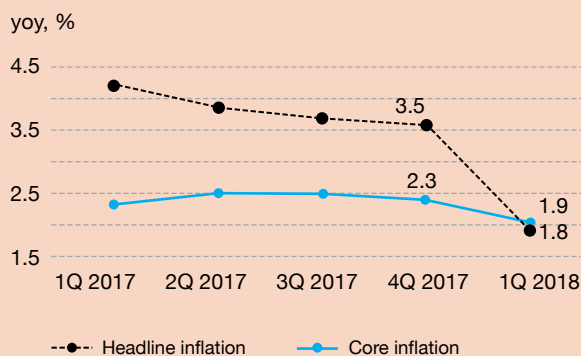


On the supply side, manufacturing and services sectors remained the key drivers

Both headline and core inflation declined in 1Q 2018

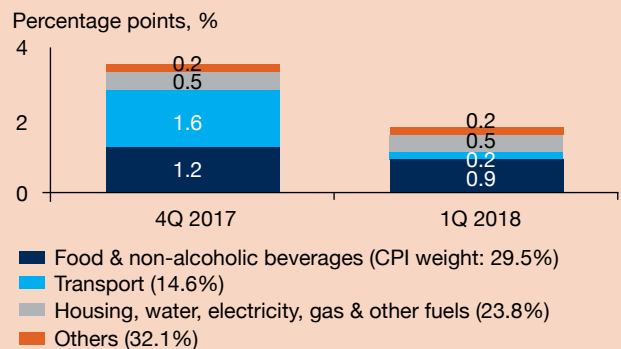
Headline inflation declined to 1.8% in 1Q 2018...

Headline and Core Inflation



...reflecting smaller increase in global oil prices and favourable domestic food supply conditions

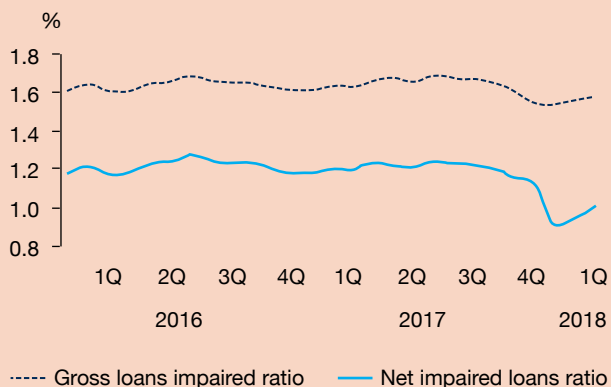
Contribution to Inflation by CPI Categories



Sustained resilience in the financial system

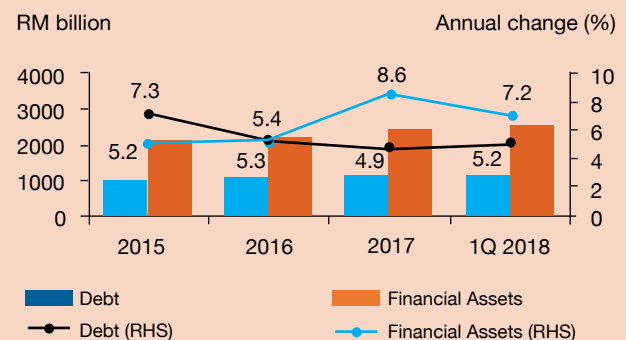
Banking system asset quality remains healthy

Banking System Asset Quality



Growth in household financial assets continued to outpace debt

Household Sector Debt and Financial Assets

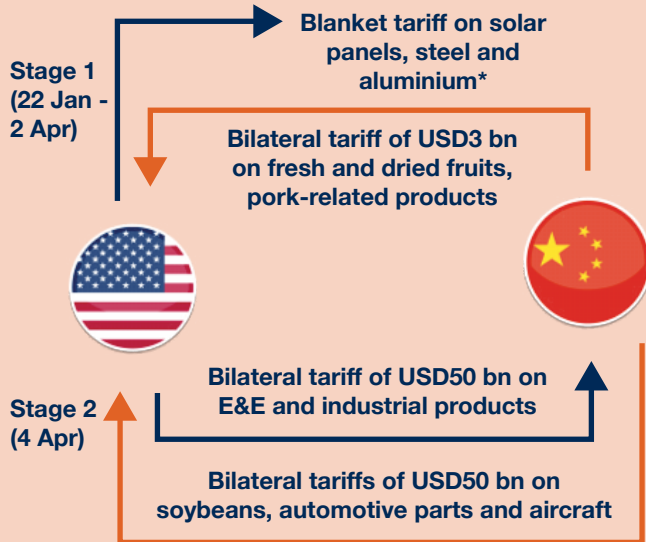


Key Highlights on Box and Feature Articles

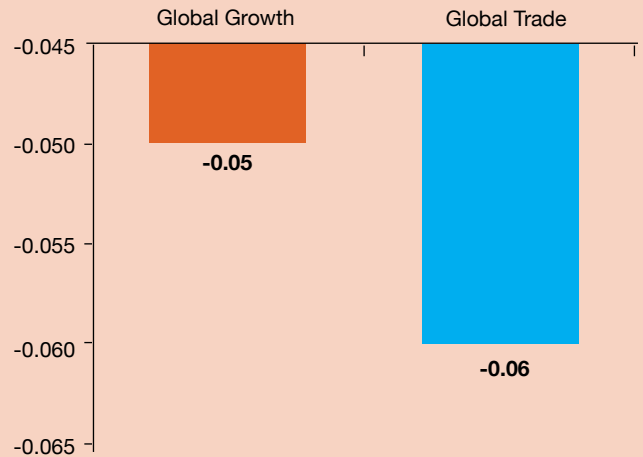
Trade Disputes: Implications for Trade and Investments

The emergence of trade disputes poses downside risks to global growth

However, in its current form, the impact to global growth is estimated to be minimal



Annual Ppt. Impact (% yoy)



* Countries exempted from the steel and aluminium tariffs include Canada, Mexico, Korea and the Euro area

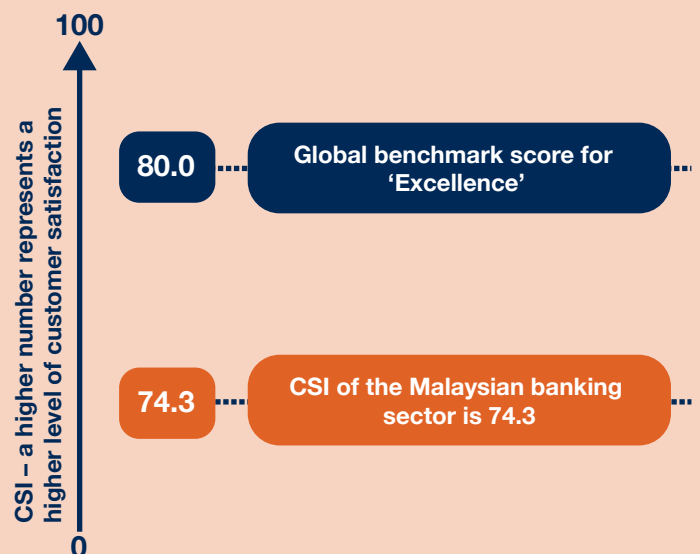
Improving Quality and Transparency of Services to Financial Consumers

The enhanced Customer Service Charter and the establishment of a Customer Satisfaction Index are expected to further elevate the quality and transparency of banking services to financial consumers

1 Enhanced Customer Service Charter



2 Customer Satisfaction Index (CSI) Survey



Source: National authorities, Bank Negara Malaysia estimates, Association of Banks in Malaysia, Association of Islamic Banking and Financial Institutions Malaysia, Malaysia Productivity Corporation, Bank Negara Malaysia unless stated otherwise. For more information, visit www.bnm.gov.my

International Economic Environment

HIGHLIGHTS

- The global economy continued to expand at a strong pace.
- Robust export growth supported by broad-based improvements in global demand.
- Higher financial market volatility amid concerns surrounding trade tensions between major economies.

Global growth expanded further

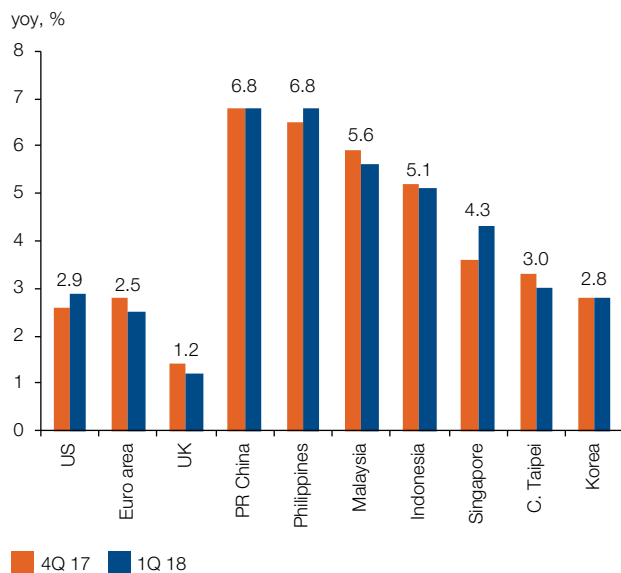
In the first quarter of 2018, the global economic expansion continued at a robust pace. Most major and regional economies recorded strong quarterly growth, suggesting the positive global growth momentum from the previous year was sustained.

In the advanced economies, growth was driven mainly by private consumption. Labour market conditions continued to improve, which supported household spending. Investment activity expanded amid solid demand, with the 1Q 2018 Purchasing Managers Index (PMI) for the manufacturing sector firmly in expansionary territory¹, at 59.7 and 58.3 in the US and euro area, respectively.

Growth in the Asian region was supported by robust global demand conditions, with several economies maintaining double-digit export growth during the quarter. Domestic demand remained resilient, due to policy support and higher infrastructure spending.

Global economic activity expanded at a strong pace in 1Q 2018

Chart 1: GDP Growth of Selected Economies

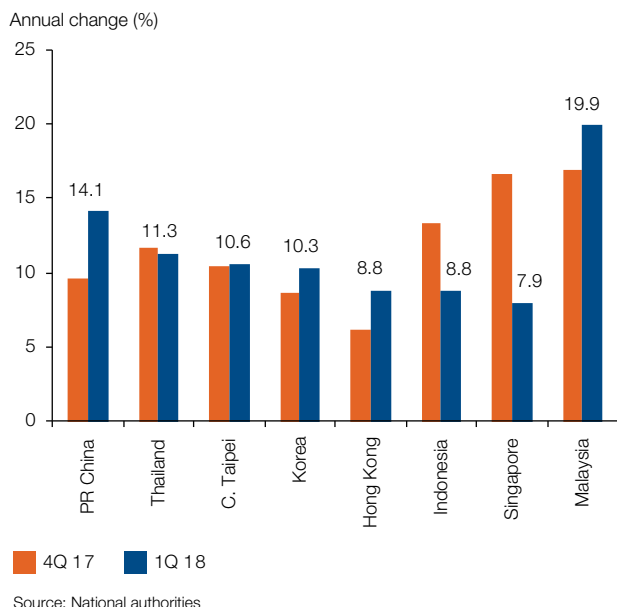


Source: National authorities

¹ Manufacturing PMI of more than 50 represents an expansion.

Robust export performance in 1Q 2018

Chart 2: Export Growth of Selected Economies (in USD terms)



Export growth remained robust

Global trade continued to expand at a robust pace despite a high base effect. This was driven mainly by broad-based improvements in global demand.

Demand for E&E products, particularly from Korea and C. Taipei, continued to increase during the quarter. This reflects resilient demand for consumer electronics, particularly in automotives, smart devices and appliances such as refrigerators and vacuum cleaners with installed sensors.

As a result, the region as a whole recorded strong double-digit growth in exports during the quarter.

High volatility in the financial markets

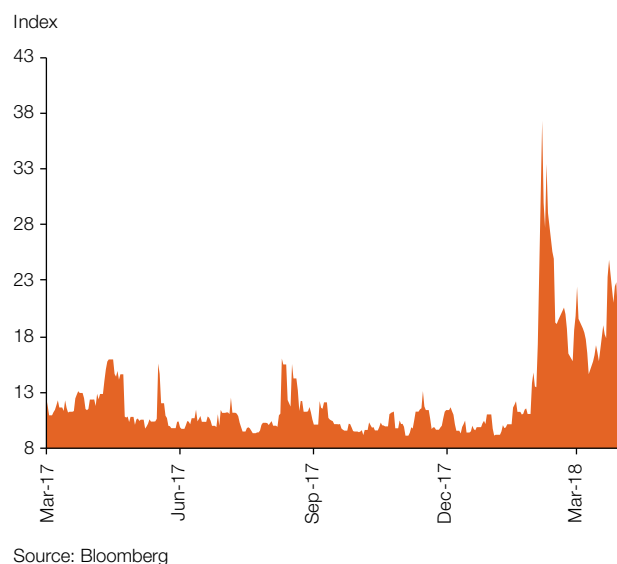
Global financial market volatility spiked during the quarter, triggered by the announcement of intended US tariff actions on steel and aluminum. This development, and subsequent retaliatory actions by PR China, raised concerns of a potential trade war between the major economies.

The volatility subsided towards the end of the quarter, but remained elevated due to uncertainty with regard to the prospects of trade measures and counter-measures. Financial markets were largely unaffected in relation to monetary policy, as the timing and pace of policy adjustments were in line with expectations.

In the commodities market, Brent crude oil prices recorded a higher average of USD67² per barrel in 1Q 2018 (4Q 2017: USD62). The increase in oil price was supported mainly by investors' optimism in the futures market, following news of a potential extension to the OPEC's oil output cuts beyond 2018. Prices also rose on concerns over supply disruptions in the Middle East and Venezuela.

Higher volatility in the financial markets

Chart 3: Chicago Board Options Exchange (CBOE) Volatility (VIX)



² Based on global Brent crude oil 1-month futures price.

Developments in the Malaysian Economy

HIGHLIGHTS

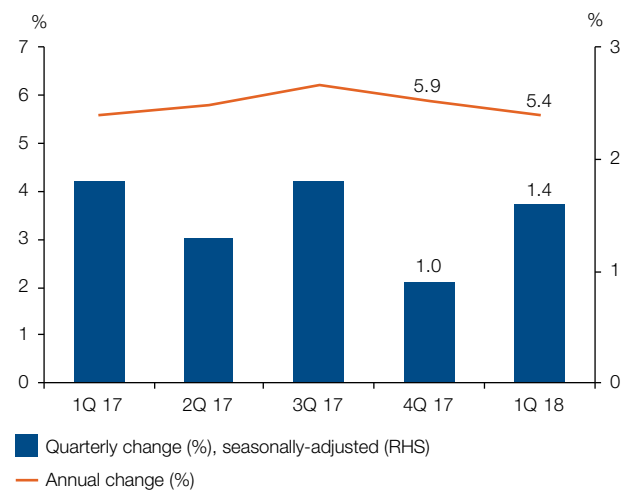
- The Malaysian economy registered a growth of 5.4% in the first quarter.
- Headline and core inflation declined to 1.8% and 1.9%, respectively.
- Current account balance widened to 4.4% of GNI, driven mainly by a sizeable goods surplus.

The Malaysian economy grew by 5.4% in the first quarter of 2018

The Malaysian economy expanded by 5.4% in the first quarter of 2018 (4Q 2017: 5.9%), driven by continued growth in private sector spending (5.2%; 4Q 2017: 7.4%) and strong growth in net exports (62.4%; 4Q 2017: 2.3%). On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 1.4% (4Q 2017: 1.0%).

More moderate growth in 1Q 2018

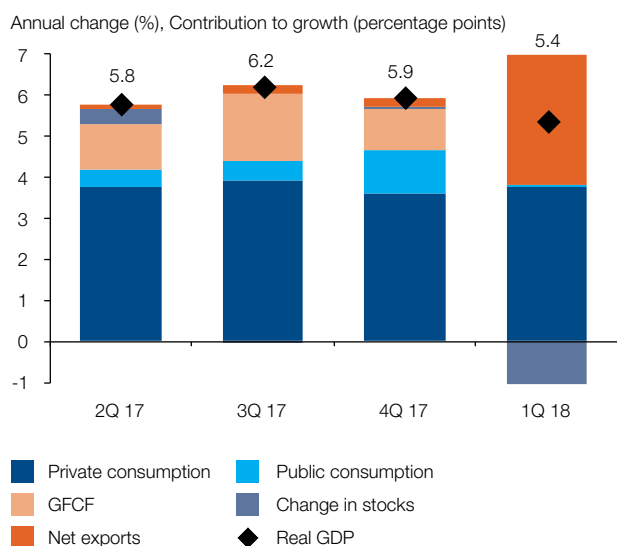
Chart 4: GDP Growth



Source: Department of Statistics, Malaysia

Growth supported by private sector spending and net exports

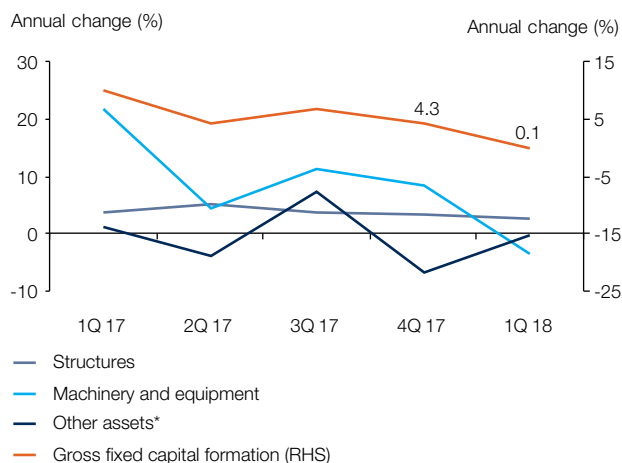
Chart 5: Contribution of Expenditure Components to GDP Growth



Source: Department of Statistics, Malaysia

Gross fixed capital formation expanded at a slower pace

Chart 6: GFCF Growth by Type of Assets



*Other assets include mineral exploration, research & development and capitalised planting.

Source: Department of Statistics, Malaysia

Domestic demand driven by the private sector

Domestic demand recorded a moderate growth of 4.1% (4Q 2017: 6.2%), due to lower growth of private sector expenditure (5.2%; 4Q 2017: 7.4%) and a marginal decline in public sector spending (-0.1%; 4Q 2017: +3.4%).

Private consumption registered a sustained growth of 6.9% (4Q 2017: 7.0%), supported by continued strength in wage and employment growth.

Growth of private investment moderated to 0.5% (4Q 2017: 9.2%). Private investment was weighed down by lower capital spending in structures, particularly in residential and commercial properties, and machinery and equipment during the quarter. On a sectoral basis, private investment was supported mainly by the services sector, particularly the education and healthcare sub-sectors.

Public consumption growth was lower at 0.4% (4Q 2017: 6.8%) on account of lower expenditure on supplies and services.

Public investment continued to decline in the first quarter (-1.0%; 4Q 2017: -1.4%), attributed to the contraction in spending on fixed assets by public corporations. The lower capital spending by public corporations was due mainly to the near completion of a few large-scale projects.

Gross fixed capital formation (GFCF) growth moderated to 0.1% (4Q 2017: 4.3%). By type of assets, capital spending on machinery and equipment registered a contraction of 3.6% (4Q 2017: +8.3%). Investment in structures grew more moderately (2.8%; 4Q 2017: 3.3%) while investment in other types of assets recorded a smaller decline of 0.2% (4Q 2017: -6.8%).

Continued expansion across major economic sectors

On the supply side, services and manufacturing sectors remained the key drivers of growth.

The services sector expanded at a faster pace during the quarter. The improvement was attributed mainly to higher growth in the finance and insurance sub-sector, resulting from higher lending activity, particularly in the household segment. Growth in the information and communication sub-sector also improved, driven by increased demand for data communication services. The wholesale and retail trade sub-sector continued to expand, supported by sustained strength in household spending.

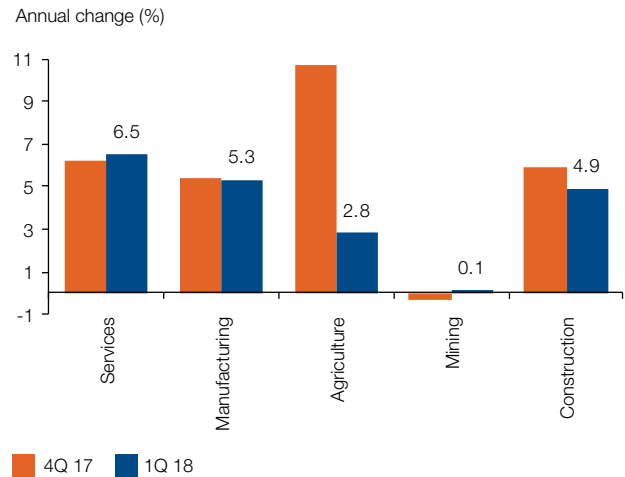
The manufacturing sector registered sustained growth in the quarter supported by improvements in the export-oriented industries and construction-related cluster. These offset the sharp moderation in the consumer-related clusters, which was mainly due to slower production of food-related items and transport equipments. Stronger output growth in the primary-related cluster (e.g. chemical- and petroleum-related products) was supported by higher oil production. The higher growth in the E&E cluster reflected the continued expansion of the global technology upcycle. Higher growth in the construction-related cluster was in line with the strength of civil engineering activities during the quarter.

Growth in the construction sector moderated in the quarter. While growth of the civil engineering sub-sector was stronger, supported by the transportation, petrochemical and power plant projects, the sector's performance was affected by weaker activity in the residential and non-residential sub-sectors. This is consistent with the significant number of unsold residential properties and the ongoing weaknesses in the commercial property segment (oversupply of office spaces and shopping complexes).

Growth in the agriculture sector moderated, reflecting mainly lower rubber tapping activities amid weak rubber prices during the quarter. However, the mining sector's growth rebounded, supported mainly by higher oil production.

Economic sectors continued to expand

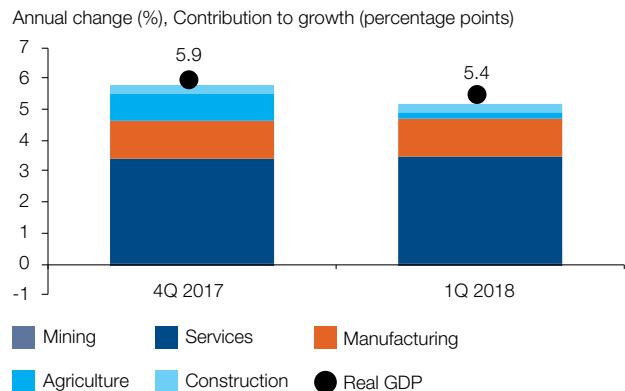
Chart 7: Growth by Sector



Source: Department of Statistics, Malaysia

Services and manufacturing sectors remained the key drivers of growth

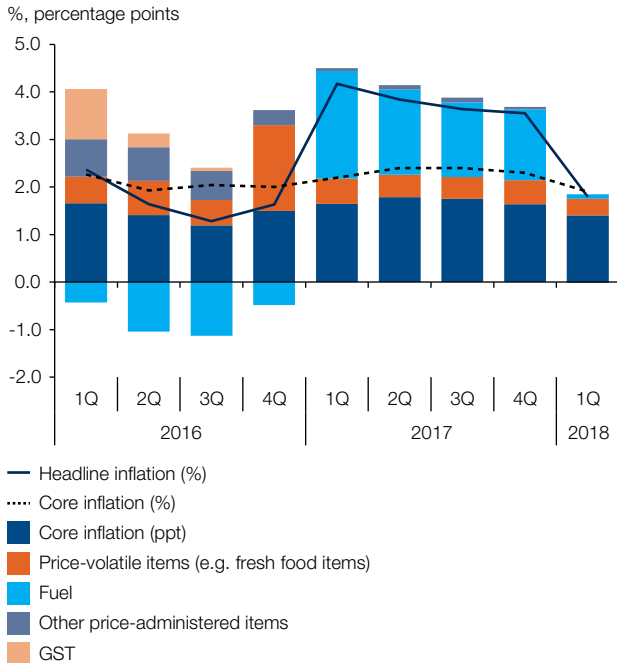
Chart 8: Real GDP by Economic Sector



Source: Department of Statistics, Malaysia

The decline in inflation reflected smaller contribution of domestic fuel prices

Chart 9: Contribution to Headline Inflation by Components



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

Lower headline inflation in the first quarter amid smaller contribution of domestic fuel prices

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), declined to 1.8% in 1Q 2018 (4Q 2017: 3.5%).

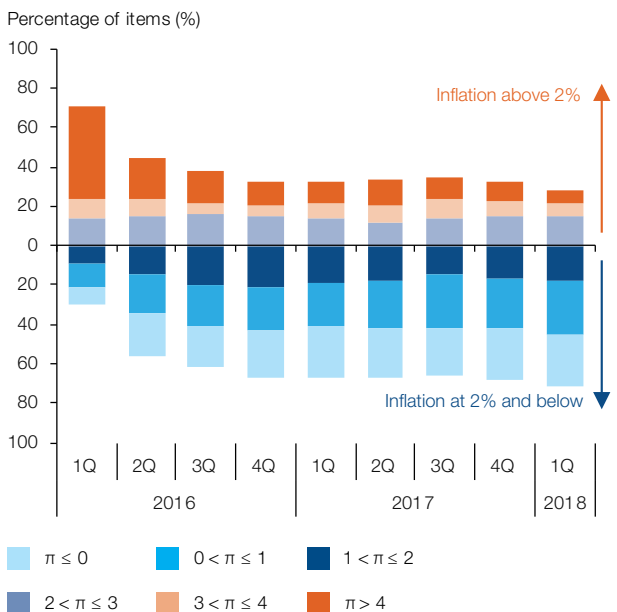
The low inflation outcome reflected the smaller contribution of domestic fuel prices to headline inflation. Despite higher global oil prices during the quarter, the magnitude of increase was smaller than the previous quarter. The impact of higher global oil prices was also offset by the stronger ringgit exchange rate³. As a result, transport inflation declined significantly during the quarter (1Q 2018: 1.3%; 4Q 2017: 11.4%). More favourable supply conditions for fresh food items also helped contain food price increases during the quarter (1Q 2018: 3.2%, 4Q 2017: 4.1%).

Core inflation also moderated during the quarter to 1.9% (4Q 2017: 2.3%). Given the lack of persistent tightness in capital stock and wage pressures, demand-driven inflationary pressures in the economy remained stable.

The decline in inflation was broad-based across the CPI categories. The percentage of items in the CPI basket that registered inflation of more than 2% moderated to 28% in 1Q 2018 (4Q 2017: 32%).

Inflation pervasiveness was slightly lower in 1Q 2018

Chart 10: Inflation Pervasiveness



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

³ The ringgit appreciated to average RM3.9246 against the US dollar in 1Q 2018 from RM4.1626 in 4Q 2017.

Improved labour market conditions

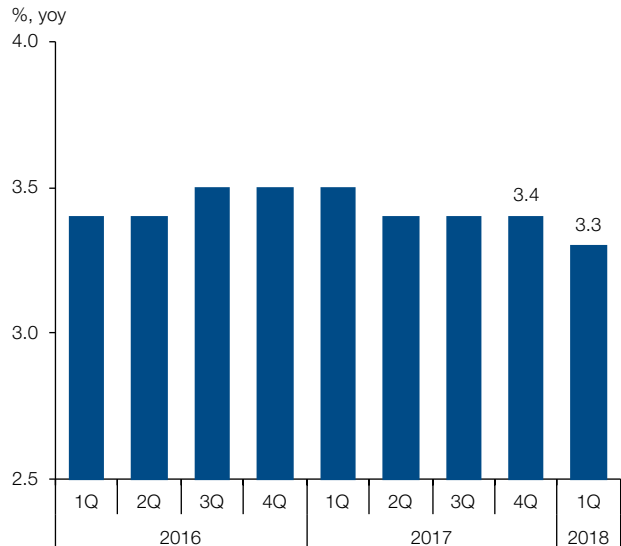
Labour market conditions continued to improve in the first quarter of 2018. Private sector wage growth increased to 6.6% (4Q 2017: 6.3%). During the quarter, net employment gains exceeded labour force expansion, resulting in a slight improvement in the unemployment rate to 3.3% (4Q 2017: 3.4%). This was amid the increase in the number of vacancies posted on a major job search website to 69,238 positions in the 1Q 2018 (4Q 2017: 61,061 positions), which suggests increasing labour demand.

In the financial sector⁴, there was a net employment loss of 668 jobs to 164,216 employed persons in 1Q 2018 (4Q 2017: 164,884 persons). This was mainly due to the losses in mid-skilled occupations (-1,271 jobs), which was partly offset by gains in high-skilled jobs (+642 jobs).

Continued strength in private sector wage growth was driven by the manufacturing sector. Manufacturing wage growth increased to 13.9% (4Q 2017: 9.4%). While the low salary base in January-February 2017 did play a role, manufacturing wages in March 2018 remained strong at 11.9%. When viewed on a quarter-on-quarter basis, manufacturing wages grew by 4.8% in 1Q 2018 (4Q 2017: 2.1%). The wage growth in the major services sub-sectors decreased marginally to 3.5% (4Q 2017: 5.0%), attributed to a broad-based moderation in wage growth across all services subsectors.

Lower unemployment rate

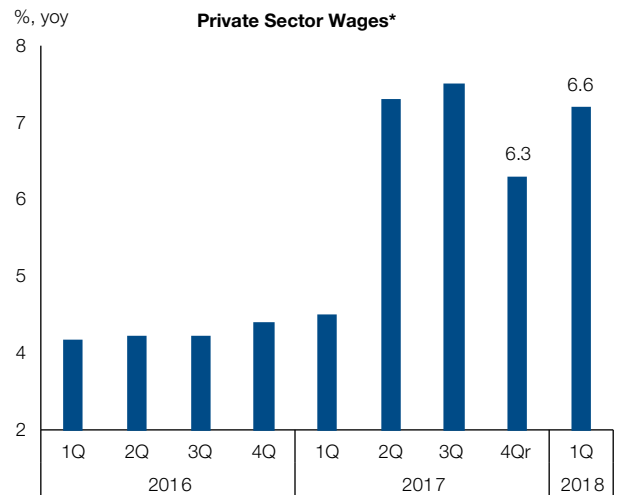
Chart 11: Unemployment rate



Source: Department of Statistics, Malaysia

Expansion in private sector wage growth

Chart 12: Private sector wages



* Private sector wages is derived from the salaries and wages data published in the Monthly Manufacturing Statistics and Quarterly Services Statistics by the Department of Statistics, Malaysia (DOSM). It covers 64% of total employment.

r revised

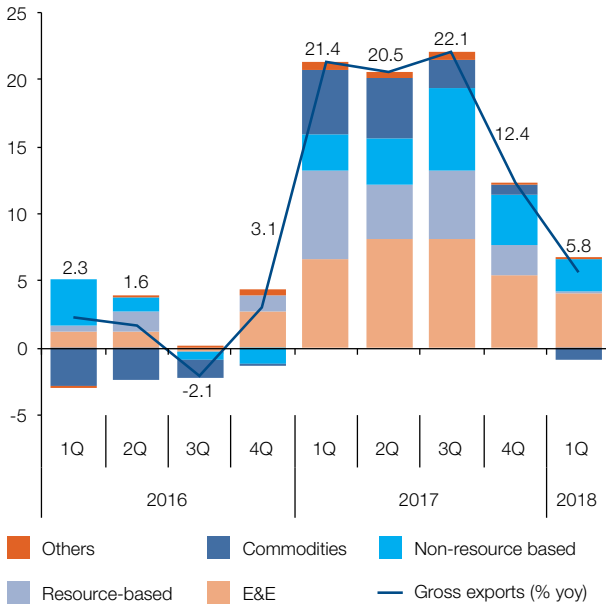
Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

⁴ Covers only the banking institutions, development financial institutions, insurance companies and takaful operators. The information is obtained from an establishment survey conducted by Bank Negara Malaysia.

Export growth supported mainly by manufactured exports

Chart 13: Gross Exports by Products

Annual change (%), Contribution to growth (percentage points)

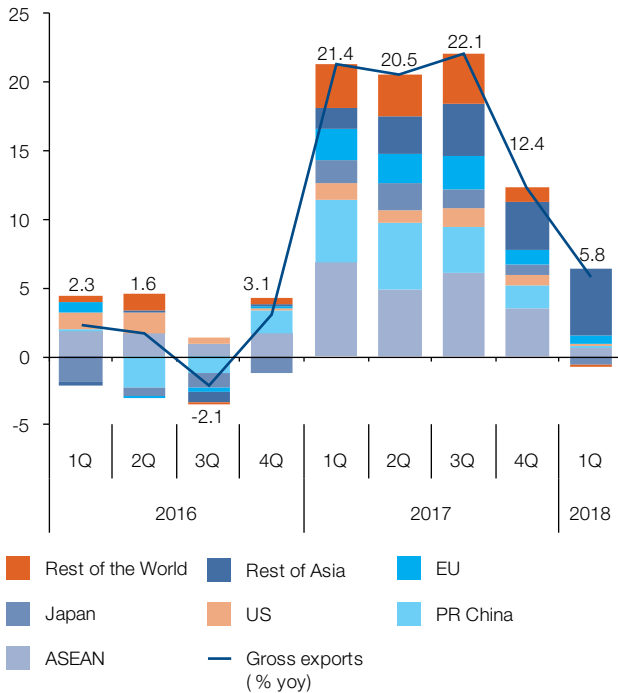


Source: Department of Statistics, Malaysia

Continued export growth to most major markets

Chart 14: Gross Exports by Markets

Annual change (%), contribution to growth (percentage points)



Source: Department of Statistics, Malaysia

Firm external sector performance

In 1Q 2018, gross exports expanded by 5.8% (4Q 2017: 12.4%), supported mainly by manufactured exports. The trade surplus rose to RM33.4 billion (4Q 2017: RM27.7 billion).

Export growth was supported by continued demand from key trading partners, particularly within the region. Manufactured exports moderated, but continued to register a strong growth of 8.2% (4Q 2017: 14.2%). Of note, semiconductor exports accelerated (29.6%; 4Q 2017: 24.4%) in line with continued expansion in the global technology upcycle. Both resource and non-resource based manufactured exports were also supportive of overall exports, driven mainly by chemical and metal products. Commodity exports contracted, owing to the decline in rubber and crude palm oil export prices, and lower LNG demand.

Gross imports declined by -0.8% during the quarter (4Q 2017: 14.4%). Intermediate imports were lower in line with more moderate manufactured export growth. Capital imports contracted amid lower delivery of high-value items compared to 1Q 2017. These weaknesses were partially offset by the strong growth in imports for re-export activity in Malaysia, particularly in the E&E sector.

Higher current account surplus

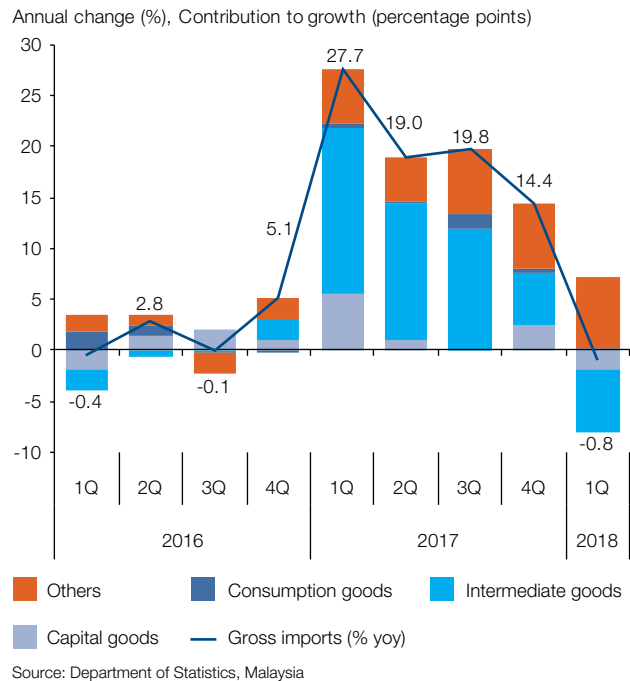
The current account surplus widened to RM15.0 billion in the first quarter of 2018 (4Q 2017: RM13.9 billion), or 4.5% of GNI (4Q 2017: 4.0% of GNI), due mainly to a higher goods surplus and lower services deficit. This was the highest quarterly current account surplus since 2Q 2014 when it reached RM15.3 billion. The secondary income account registered a smaller deficit, while the primary income account deficit widened during the quarter.

In tandem with continued strength in exports and more moderate imports during the quarter, the goods surplus⁵ rose to RM35.7 billion (4Q 2017: RM34.1 billion). In the services account, the deficit moderated to RM5.8 billion (4Q 2017: -RM7.0 billion), owing mainly to lower net payments in the construction and transportation accounts.

The primary income account deficit widened to -RM10.2 billion (4Q 2017: -RM8.4 billion), largely attributable to lower profits earned by Malaysian firms investing abroad mainly in the finance and insurance and wholesale and retail trade services sub-sectors. The secondary income account recorded a deficit of RM4.7 billion (4Q 2017: -RM4.8 billion) due to continued outward remittances by foreign workers.

Gross imports declined slightly, weighed down by contractions in intermediate and consumption goods

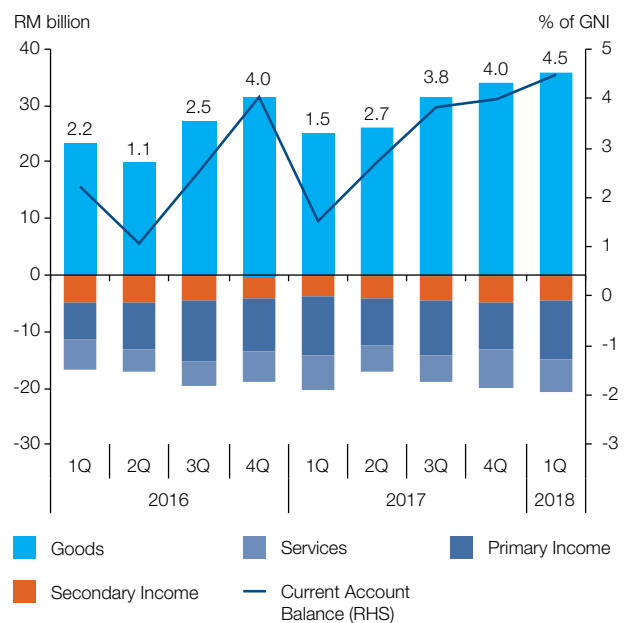
Chart 15: Gross Imports by Products



Source: Department of Statistics, Malaysia

Current account surplus widened

Chart 16: Current account balance

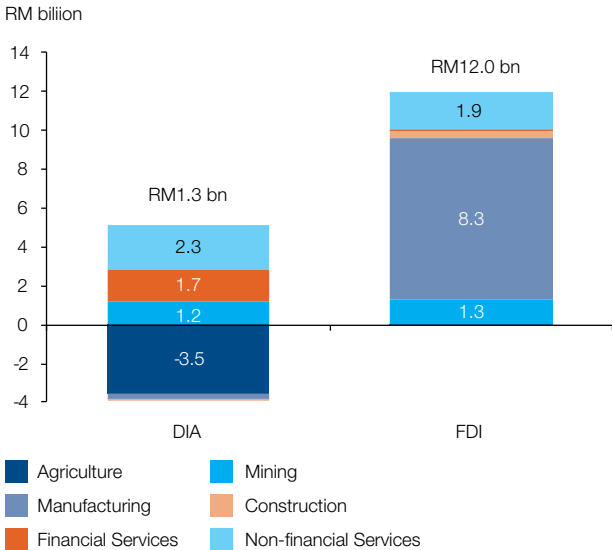


Source: Department of Statistics, Malaysia

⁵ The difference between the goods surplus and trade surplus may arise from the exclusion of goods for processing, storage and distribution in the goods accounts as per the 6th Edition of the Balance of Payments and International Investment Position Manual (BPM6) by the IMF.

Significant foreign direct investments amid low direct investments abroad

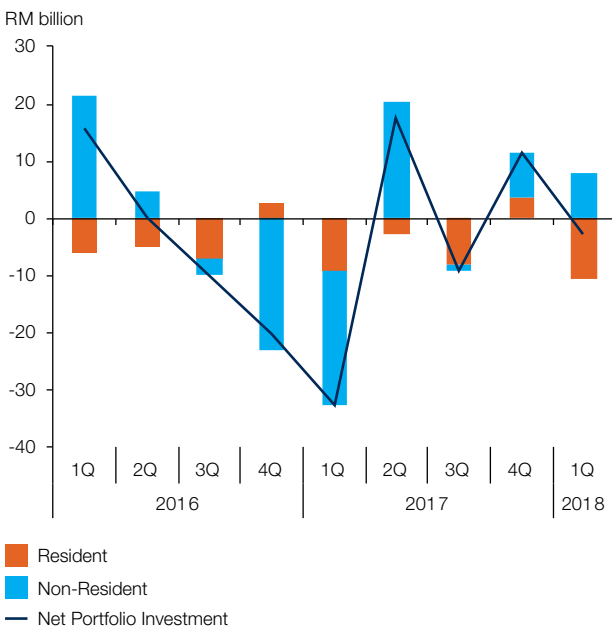
Chart 17: Net Direct Investment Flows by Sector



Note: For DIA, positive values refer to net outflows while negative values refer to net inflows
 Source: Department of Statistics Malaysia and Bank Negara Malaysia

Net outflow in portfolio investment account contributed by residents

Chart 18: Portfolio Investments



Source: Department of Statistics Malaysia and Bank Negara Malaysia

Financial account recorded net inflows

In the first quarter of 2018, the financial account registered a net inflow of RM15.2 billion (4Q 2017: net inflow of RM6.0 billion). This was supported by continued foreign direct investments (FDI), non-resident portfolio investments, and other investment inflows. These inflows were partially offset by portfolio investments abroad by residents.

The direct investment account registered a net inflow of RM10.7 billion (4Q 2017: net inflow of RM5.3 billion), on account of strong FDI, amid low direct investments abroad (DIA) during the quarter. FDI registered a large net inflow of RM12.0 billion (4Q 2017: net inflow of RM3.4 billion), reflecting the successful formation of two joint ventures for the Refinery and Petrochemical Integrated Development (RAPID) project and continued investments by MNCs in the E&E sector. Following these developments, the majority of FDI inflows were channelled into the manufacturing sector, followed by the services sector, particularly the real estate and wholesale and retail trade sub-sectors. DIA by Malaysian companies recorded a small net outflow of RM1.3 billion (4Q 2017: net inflow of RM1.9 billion), as DIA outflows were partly offset by inflows following partial divestment of a specialty oils and fats manufacturing business in Europe. DIA outflows were channelled mainly into the services sector, particularly the real estate and financial services sub-sectors, followed by the mining sector.

The portfolio investment account registered a net outflow of RM2.6 billion (4Q 2017: net inflow of RM11.6 billion), attributed mainly to a resumption in net acquisitions of foreign financial assets by resident fund managers and banks (1Q 2018: net outflow of RM10.5 billion; 4Q 2017: net inflow of RM3.5 billion). This was partially offset by non-resident portfolio investments, which recorded a net inflow of RM7.9 billion (4Q 2017: net inflow of RM8.1 billion). Investor sentiments in the domestic financial markets continued to be supported by better-than-expected fourth quarter economic performance in 2017 and higher global crude oil prices during the quarter.

The other investment account turned around to record a net inflow of RM6.4 billion (4Q 2017: net outflow of RM9.5 billion), due mainly to the extension of short-term loans by non-residents. These inflows were partially offset by residents' loan extensions and placements of currency and deposits abroad. Net errors and omissions, excluding revaluation changes on international reserves⁶, amounted to -RM12.0 billion or -2.7% of total trade. The international reserves of Bank Negara Malaysia amounted to USD107.8 billion as at end-March 2018, compared to USD102.4 billion as at end-December 2017.

⁶ As part of ongoing efforts to enhance BOP reporting, quarterly net E&O now excludes reserves revaluation changes. This practice is backdated up to 1Q 2010.

Manageable external debt

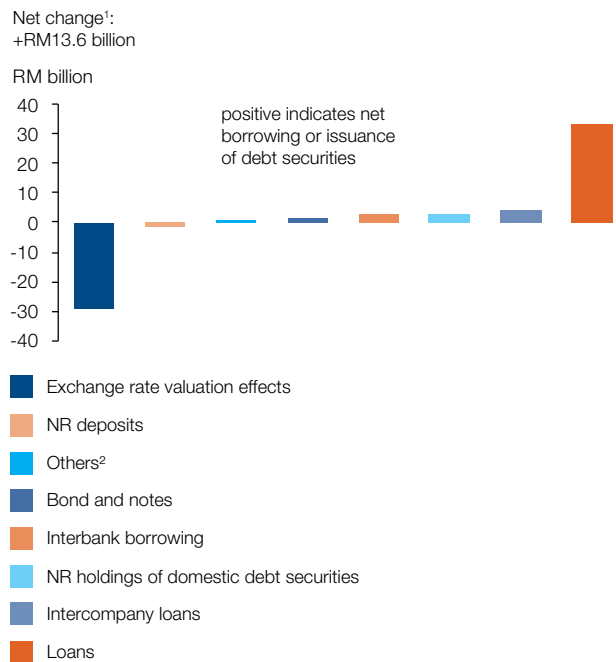
Malaysia’s external debt amounted to RM893.4 billion, equivalent to USD229.0 billion or 61.8% of GDP as at end-March 2018 (end-December 2017: RM879.8 billion or USD214.6 billion or 65.0% of GDP). The higher external debt reflects the increase in loans by the non-financial corporations segment to finance investment activity. This was partially offset by valuation effects following the strengthening of the ringgit against selected major and regional currencies during the first quarter of 2018.

Malaysia’s external debt remains manageable given its currency and maturity profiles, and the availability of large external assets. More than one-third of total external debt is denominated in ringgit (34.8%; end-December 2017: 34.4%), mainly in the form of NR holdings of domestic debt securities and in ringgit deposits in domestic banking institutions. As such, these liabilities are not subjected to valuation changes from the fluctuations in the ringgit exchange rate.

The remaining external debt of RM582.8 billion or 65.2% of total external debt is denominated in foreign currency (FC) and is subject to prudential liquidity management practices and hedging requirements on banking institutions and corporations. The bulk of these obligations are offshore borrowings, raised mainly to expand productive capacity and to better manage financial resources within corporate groups. As at end-March 2018, offshore borrowing stood at 35.8% of GDP (end-December 2017: 37%).

Higher external debt in 1Q 2018

Chart 19: Changes in External Debt

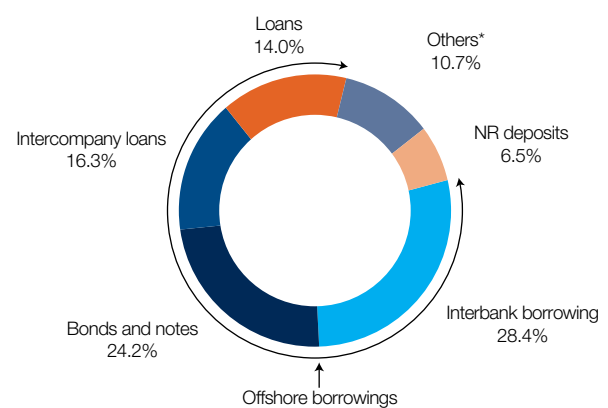


¹ Changes in individual debt instruments exclude exchange rate valuation effects
² Comprises trade credits, IMF allocation of SDRs and other debt liabilities
 Note: NR refers to non-residents

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

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

Chart 20: Breakdown of Foreign Currency-denominated External Debt (% share)



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

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Of the total FC-denominated external debt (inclusive of valuation effects), more than one-third (or amounting to RM202.9 billion) is accounted by interbank borrowing and FC deposits in the domestic banking system. This largely reflects the banks' intragroup liquidity management and placements of deposits from foreign parent entities, which are subjected to prudent liquidity management practices. Among these are internal limits on funding and maturity mismatches. This is followed by long-term bonds and notes issued offshore which amounted to RM141.2 billion as at end-March 2018, primarily to finance asset acquisitions abroad that will generate future income. The intercompany loans are typically on flexible and concessionary terms, such as no fixed repayment schedule or low interest rate.

From a maturity perspective, more than half of the total external debt is skewed towards medium- to long-term tenure (55.5% of total external debt; end-December 2017: 56.9%), suggesting limited rollover risks. Given the export earnings of borrowers and external assets, international reserves is not the only means for banks and corporations to meet their short-term external obligations. International reserves account for about a quarter of total external assets, with the remaining external assets being held by banks and corporations. As at 30 April 2018, international reserves is 1.1 times the short-term external debt and is sufficient to finance 7.5 months of retained imports.

1
Box
Article

Trade Disputes: Implications for Trade and Investments

Authors: Mohamad Ishaq Hakim, Muhamad Aizuddin, Afiah Yahya, Ooi Kiesha and Lim Boon Seong

HIGHLIGHTS

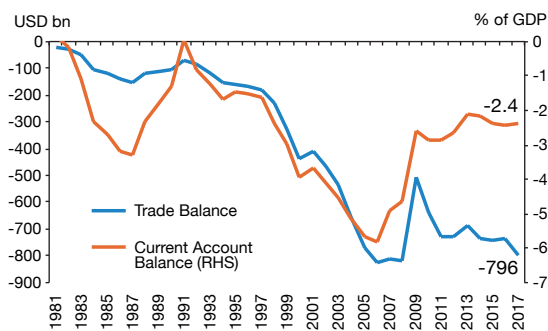
- Recent trade disputes have introduced downside risks to global growth. The possibility of higher tariffs poses a downside risk to the strong growth momentum from the previous year.
- In its current state, the proposed tariff measures by the US and PR China are estimated to have minimal impact on global and regional growth.
- Malaysia must continue to take a pragmatic stance on open trade policies by widening its trade relationships and ensuring that domestic policies continue to support economic growth.

Global trade liberalisation since the 1980s has unlocked a vast source of growth for many advanced and emerging economies. However, there has recently been a shift towards a more protectionist stance, which may undermine this important source of growth. This box article assesses the potential effects of the recent protectionist trade policies on the global economy and Malaysia.

Background

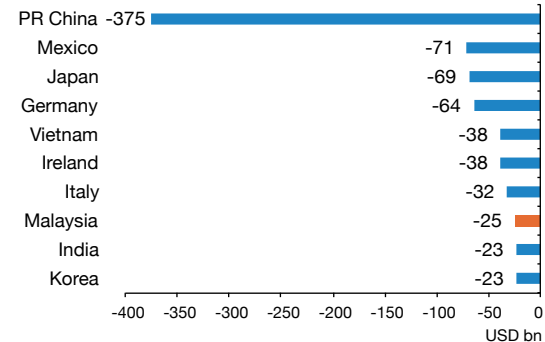
The US has continued to record a prolonged and widening trade deficit as it imports more goods from its trading partners than it exports (Chart 1). Among its trading partners, PR China accounts for almost 50% of the US' trade deficit (Chart 2). This partly underlies the basis for the US to enact higher tariffs on other countries, including PR China. The US claimed that PR China has taken an unfair advantage of its lower domestic input costs to deflate prices of tradable goods globally, and that increasing the US tariff rate on imports from PR China may level the playing field for American businesses.

Chart 1: US Trade and Current Account Balance



Source: US Census Bureau, US Bureau of Economic Analysis

Chart 2: US Trade Balance by Country (2017)





Source: US Census Bureau, US Department of Commerce

Developments and Details

The series of trade actions initially rose in January 2018, when the US announced a blanket rise in tariffs on solar panels, followed by steel and aluminium in March (Table 1: Stage 1). The trade actions became more country-specific by end-March and early-April when the US unveiled the findings of its Section 301 report on PR China's intellectual property practices, and the proposal to increase import tariffs on 1,333 products from PR China worth USD50 billion. In response, PR China announced proposed tariffs on 106 US products worth USD50 billion (Table 1: Stage 2).

Table 1: Details of Trade Actions Between the US and PR China

Details of Actions	 United States	 PR China
Stage 1	<p>Jan 2018 - Mar 2018</p> <p>Blanket tariff on all countries*</p> <ul style="list-style-type: none"> • Solar panels (+30%) • Steel (+25%) • Aluminium (+10%) 	<p>Early Apr 2018</p> <p>Targeted tariff on products from the US</p> <ul style="list-style-type: none"> • Fresh and dried fruits, wine, ethyl alcohol, and steel pipes (+15%) • Pork-related products and recycled aluminium (+25%)
Stage 2	<p>Mar - Apr 2018</p> <p>Import tariffs on products from PR China</p> <ul style="list-style-type: none"> • +25% import tariffs on 1,333 products worth USD50 bn • E.g. home appliances, machinery, electrical equipment 	<p>Mid-Apr 2018</p> <p>Targeted tariff on products from the US</p> <ul style="list-style-type: none"> • +25% import tariffs on 106 products worth USD 50 bn • E.g. soybeans, automotive parts and aircraft.

* Countries exempted from the steel and aluminium tariffs include Canada, Mexico, Korea and the euro area
 Source: US Trade Representative Office, PR China Ministry of Commerce, Newsflows

The announced products that will be subject to higher tariffs account for 13% of PR China's exports to the US, and 41% of US exports to PR China. While these figures may seem substantial on a bilateral basis, the products targeted with higher tariffs constitute only a small portion of the US' and PR China's total exports to the world (2.4% and 3.4% of the total US and PR China's exports, respectively).

Impact on the Global Economy

Thus far, the proposed trade actions are expected to have only marginal effects on the global economy, mainly through the trade and investment channels.

For the trade channel, the assessment is conducted in multiple steps. First, a measure of trade elasticity is used to estimate the impact of price increases (via higher tariffs) on import volume for the US and PR China, respectively. Second, the indirect spillover to regional countries via the global value chain is computed. For the investment channel, the impact to GDP growth is assessed through lower profits from exporters, the deterioration in financial conditions, and the resultant dampening on business sentiments and investment activities. Third, the adverse effect of lower trade on labour income and potentially higher prices is accounted for.

The proposed tariffs imposed by the US is estimated to reduce PR China's GDP growth by 0.04 ppt, and the region's GDP growth by 0.01 – 0.02 ppt (Table 2). This result highlights the high integration of EA-8 economies in PR China's production value chain, particularly for E&E products with ~18% share of value-added (VA share) sourced from the region. As such, regional economies such as Chinese Taipei and Korea, who are key suppliers of intermediate goods to PR China, are the most affected by the higher bilateral tariffs.

On the other hand, corresponding measures by PR China on the US is estimated to reduce US GDP growth by 0.06 ppt, while the region's GDP growth is reduced by less than 0.01 ppt. Regional GDP growth is only marginally affected by PR China's retaliatory tariffs because North American countries such as Canada and Mexico are more integrated in the US' production value chain than countries in the Asian region.

Table 2: Impact on GDP Growth via the Trade Channel

Ppt. Impact (% yoy)	Impact of US Tariffs	Impact of PR China Tariffs
PR China	-0.04	
US		-0.06
Asia ex. PR China	-0.01 - 0.03	
Global Growth	-0.02	
Global Trade	-0.02	

Note: Asia ex. PR China includes Hong Kong, Korea, Singapore, C. Taipei, Indonesia, Malaysia, Philippines, Thailand and Vietnam. Asia ex. PR China growth rates are calculated in US Dollar terms.

Source: Bank Negara Malaysia staff estimates

These preliminary results indicate that the implementation of higher tariffs will adversely affect the US more than PR China. In part, this is due to the higher value-added (VA) sourced domestically for the US (~82% VA share) compared to PR China (~64% VA share). For example, the manufacturing of most consumer E&E products, such as smartphones, in PR China requires component parts from many regional countries (OLED display panel from Korea and semiconductor chips from Chinese Taipei). In this regard, PR China's deep integration with Asian economies and its more diversified sources of value-added growth from the region works to its advantage by mitigating some of the decline in its GDP growth.

The combined effect of the announced US and PR China tariffs through trade is estimated to lower global GDP growth marginally by 0.02 ppt, with a corresponding 0.02 ppt decrease in global trade. Research and past episodes also suggest that the adverse effects through investment, due to deteriorating business sentiments may lower global GDP by an additional 0.03 ppt. Taking both trade and investment effects into consideration, global GDP is estimated to be lower by up to 0.05 ppt, with a corresponding 0.06 ppt decrease in global trade growth (Table 3).

Table 3: Combined Impact on GDP Growth via the Trade and Investment Channel

Ppt. Impact (% yoy)	Global Growth	Global Trade
Impact from Trade Channel	-0.02	-0.02
Impact from Investment Channel	-0.03	-0.04
Combined Impact on GDP Growth	-0.05	-0.06

Source: Bank Negara Malaysia staff estimates

Given Malaysia's trade and financial openness, the proposed trade actions by the US and PR China, if implemented, would have an impact on Malaysia's growth prospects. Lower trade activity would weigh on firms' profitability and households' income. Greater financial market volatility would also dampen sentiments. Nonetheless, as the materialisation of the current proposed trade actions is estimated to have limited effects on the global economy, the impact to Malaysia is assessed to only be a marginal decline of 0.05 – 0.15 ppt in GDP growth. These impact estimates would be further mitigated by potential trade re-direction away from the US and PR China as source countries to the rest of the world. However, the impact estimates also have the potential to increase should the trade actions escalate beyond those currently proposed.

Uncertainty Over Implementation and Financial Market Reaction

Despite the many announcements of higher import tariffs by the US and PR China, at this juncture, the announced measures remain a rhetoric. This is because the implementation of these tariffs are subject to several proceedings which include:

- 1) The US seeking public feedback on the proposed tariffs on 1,333 products from PR China until end-May 2018; while PR China does not have a clear implementation timeline.
- 2) The US utilising discretion for tariff exemptions, as shown in allowing exemptions to seven countries for its steel and aluminium tariffs.
- 3) Greater political will in the US and PR China to negotiate before pursuing higher tariffs.

The overall impact to the Malaysian economy is also subject to several factors, such as the coverage of tariffed products, Malaysia's exposure to the product segments and the timing of implementation. The impact on the real economy could also be larger in the longer run, as prolonged uncertainty over trade policy dampen sentiments among firms and households could generate negative spillover effects on economic activity beyond the industries involved.

Moreover, the risk to growth prospects will be exacerbated if financial market conditions deteriorate, leading to higher volatility in currency movements and a decline in asset prices. This would be the case if the trade actions between the US and PR China are prolonged or if the actions extend beyond trade and into currency-based measures. Prolonged uncertainties about trade policy could lead to capital outflows from countries perceived to be heavily affected by the potential trade actions. While it remains unlikely, trade and currency wars are unfavourable scenarios for the global economy.

Policy Imperatives for Malaysia

In pursuing Malaysia's vision to transform into a high-income and high-performance economy, Malaysia has always been committed to a growth model premised on openness. This is in recognition that Malaysia's businesses thrive on being innovative, efficient, competitive and on actively expanding their global reach to access new markets. In trade, Malaysia has consciously undertaken policy efforts to diversify its products and markets to mitigate the risks of over-reliance on certain products and markets. This has reduced the risks of external market volatility on overall growth and employment. While Malaysia has embraced trade liberalisation through active participation in bilateral, regional and global trade negotiations, recent events have demonstrated an even greater need for swift and decisive policy actions to counter the rise of trade protectionist measures. Malaysia remains committed to its existing trade policies, and can only benefit by widening and deepening its trade relationships.

Disruptions in trade have adverse effects not only on growth among the economies directly involved, but also those in the supply chain. Global value chains, which encompass activities in the production of goods from materials sourcing to final assembly that happens across different countries, are now more integrated than ever before. In Malaysia, this includes the production of parts and components for international brands such as Apple, Samsung, Intel, BMW and Airbus.

While it has tremendously improved the scale and speed of production of many traded goods, global value chains also amplify the downside risks of trade protectionism for the economies that are involved in this global production ecosystem. In the prevailing environment of global trade uncertainty, it is important for Malaysia to take a broader perspective in which the country taps into globalisation to support our long-term economic development goals. Wide-spread automation has changed the dynamics of production and services delivery. A low-cost growth model dependent on foreign labour is neither sustainable nor capable of improving competitiveness in this current global economic landscape. Technological upgrading, further automation and innovation must be embraced more fervently for Malaysia to expand our production capabilities and to move up the value chain. There is room for Malaysia to enhance our economic resilience via greater diversification of the product mix and product complexity. Some of these products include those from the electronics and commodity sectors, and increasingly the chemical and plastic industries. Malaysia has vast experience and significant productive capabilities in these industries (*refer to BNM Annual Report 2017 Box Article on Complexity and Growth: Malaysia's Position and Policy Implications*).

Reforms are also urgently needed to ensure that domestic demand in Malaysia remains resilient. This includes undertaking policies to raise labour productivity through upskilling and reskilling initiatives to remain relevant in an increasingly competitive and globalised world. Efforts should be directed towards the more treasured source of value-added in the future, and the provision of quality services. Malaysia's policies in this area emphasise the development of world-class human capital through comprehensive education, effective communication and high competitiveness. Diversifying our sources of growth is critical to ensure our sustainability going forward.

Conclusion

Trade disputes that have the potential to disrupt global trade activity pose a downside risk to growth. At the current juncture, the risks to global growth prospects and the Malaysian economy remain marginal. However, the adverse effects could rise if the uncertainty over trade policy is prolonged and, in particular, if global financial conditions deteriorate as a result. These trade actions will not only affect those countries directly involved, as the impact will likely spillover to the rest of the world via the global supply chain, investment activity and financial channels. Trade disputes should be resolved through dialogue and negotiations. The policy imperative for major and emerging economies today is to reaffirm the common goal of economic prosperity through open and fair trade.

2

Box
Article

Global Slack as a Determinant of Inflation¹

Authors: Eilyn Chong Yee Lin and Ho Sui-Jade

HIGHLIGHTS

- Global slack² has been an important determinant of inflation in Asia-Pacific economies. However, its influence on inflation has waned after 1990 as the effects of global commodity prices and the exchange rate become more dominant.
- Globalisation, through increased trade and offshoring of production processes, has contributed towards weakening the relationship between domestic slack and inflation.
- The considerable influence on domestic inflation dynamics from factors associated with globalisation implies that these factors can provide relevant information to central banks when developing monetary policy and communication strategies. This has been the approach adopted by Bank Negara Malaysia, given its broader consideration of factors affecting the domestic economy, consistent with its inflation-anchoring framework.

Introduction

The standard Phillips curve relationship implies that the rapid increase in domestic utilisation of labour and capital would lead to resource shortages that generate upward pressure on inflation³. Over the past decades, many have documented a weaker response of domestic inflation to domestic resource utilisation – a phenomenon widely dubbed as the flattening of the Phillips curve⁴. The most recent experience of this was evident in the unexpectedly low inflation especially in the advanced economies, despite the narrowing of domestic slack that followed the economic recovery from the financial crisis of 2007-08.

In explaining this phenomenon, one popular view among economic commentators and policymakers is that, the global factors associated with globalisation are playing a larger role, compared to domestic factors, in determining domestic inflation processes (Carney, 2017). In particular, globalisation – through the integration of product, labour and capital markets across economies – has offered opportunities for countries to access a greater amount of cheaper and more efficient inputs as well as final goods and services across national borders. The low inflation in the last decade has been attributed to the considerable amount of resources available at the global level, known as global slack.

This article looks into the influence of the factors associated with globalisation on inflation dynamics in the Asia-Pacific economies, by addressing two questions:

- How does global slack influence domestic inflation?
- Which features of globalisation are dominant in affecting domestic inflation dynamics?

¹ A technical version is forthcoming in the Bank Negara Malaysia Working Paper series.

² Global slack, or also commonly known as global output gap, reflects the extent to which global resources such as labour and capital, are utilised. It is defined as the relation between worldwide demand and global productive capacity (Milani, 2009).

³ The original wage Phillips curve traces the relationship between unemployment and wage growth. The lower the unemployment rate, the faster the wage rise. The price Phillips Curve generalises the relationship at the economy level, and traces the relationship between inflation and domestic slack.

⁴ See, for example, Blanchard, Cerutti, and Summers (2015).

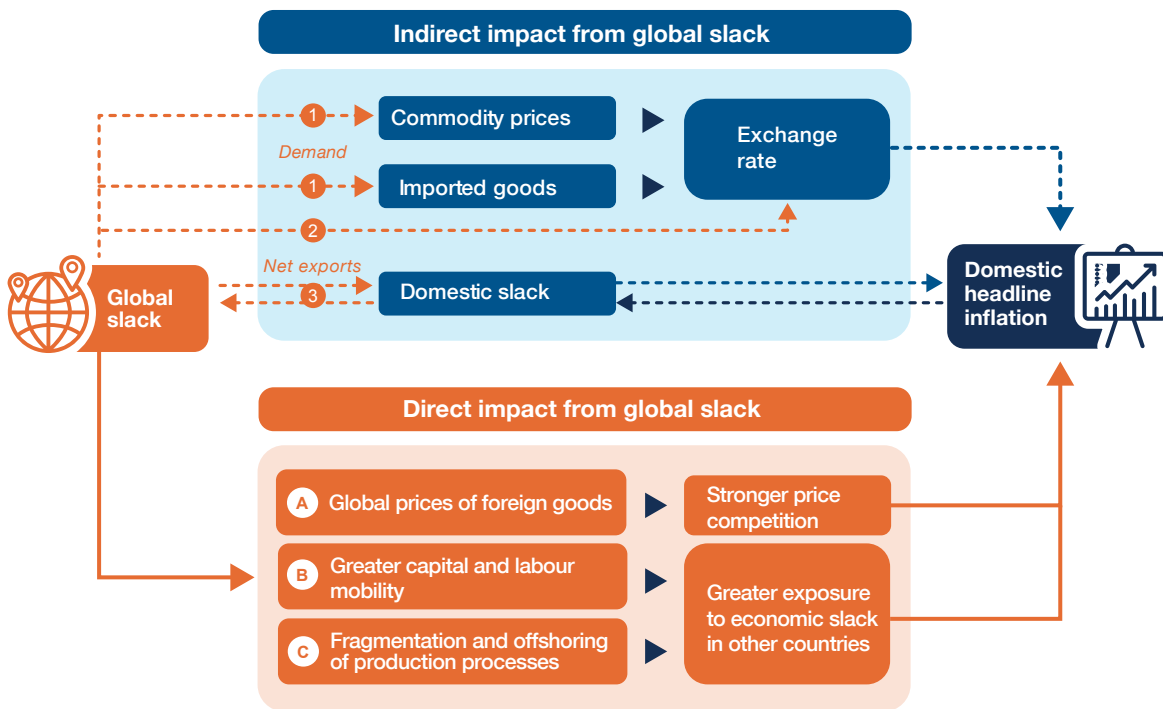
A. In theory, global slack could have both direct and indirect effects on domestic inflation

The traditional view is that global slack has always affected inflation in indirect ways through other inflation determinants (European Central Bank, 2017). Global slack would have a direct impact on inflation if it directly influences the pricing decision of producers. An indirect impact occurs when global slack affects other inflation determinants (such as global commodity prices and exchange rate) that influence the pricing decision. Figure 1 shows a stylised representation of the channels through which global slack can influence domestic inflation.

Consider, for instance, the strong global economic upturn that PR China experienced prior to 2008. To meet the stronger demand for goods and services, producers in PR China ramped up production, thereby increasing the utilisation of their labour and capital. Higher resource utilisation in PR China eventually worked its way to higher inflation in other countries through three indirect channels:

- i. **Global prices of commodity and intermediate inputs.** More intense production activity in PR China raised demand for imported raw commodities and intermediate inputs. The higher demand drove up the global prices of these inputs, some of which were imported for use in production in other countries.
- ii. **Exchange rate.** Cross-border capital and financial flows that accompanied the increased cross-border flows of goods and services affected exchange rates. Countries with weaker exchange rates faced higher import prices, which passed through to higher inflation.
- iii. **Domestic slack through net exports.** The economic strength in PR China also led to rising imports by PR China, which encouraged exporters in other countries to ramp up their own production and resource utilisation to meet PR China’s demand for goods and services. The higher domestic resource utilisation in those countries, in turn, generated upward pressure on their respective domestic inflation.

Figure 1: Indirect and direct channels through which global slack can affect domestic inflation



Notes: The dashed arrows reflect the indirect impact from global slack to inflation, the solid arrows reflect the direct impact on inflation.

Source: Adapted from the European Central Bank’s illustration of drivers of inflation in ECB Economic Bulletin 4 / 2017

A more recent view is that globalisation has strengthened the direct impact from global slack to domestic inflation, and weakened the response of inflation to domestic slack. In theory, the direct impact works through three channels:

- i. **Stronger competition from a larger global marketplace** makes domestic producers more attuned to global demand conditions in order to maintain market share.
- ii. **Greater capital and labour mobility** reduce the sensitivity of capital costs and wages to domestic demand conditions, and correspondingly increase the exposure to demand conditions in countries from where capital and labour are sourced⁵.
- iii. **Fragmentation and offshoring of production processes (global value chain, GVC)** make inflation more sensitive to the demand conditions of countries involved in the production chain.

An example based on the production of T-shirts to illustrate the channels through which a decrease in global slack can influence the domestic inflation of T-shirts

This section illustrates the channels through which global slack could have influence on domestic inflation using a simple example based on the production of cotton T-shirts in Malaysia. In this example, assume that global demand conditions are strong such that there is an increase in demand for cotton T-shirts. To cater to the stronger demand, T-shirt producers worldwide would respond by producing more T-shirts and increasing resource utilisation at a rapid pace. The increase in resource utilisation worldwide would have the following indirect impact on inflation of T-shirts in Malaysia:

- i. To meet the increase in the production of T-shirts, producers worldwide would demand for more cotton as inputs. Given a fixed supply of cotton globally, this would push up the global cotton price and raise the costs of imported cotton for Malaysian producers.
- ii. The increase in worldwide demand for T-shirts, along with higher global cotton price, may also push up prices of imported T-shirts for Malaysian T-shirt importers.
- iii. Changes in global demand conditions and commodity prices may have influence on the ringgit exchange rate. An appreciating ringgit exchange rate, for example, would make it less costly for Malaysian producers to import inputs and finished goods.
- iv. If Malaysian T-shirt producers also benefit from stronger worldwide demand for their T-shirts, they may respond by increasing the production volume. If the production volume increases beyond their capacity such that it becomes costlier to produce an additional T-shirt, producers may decide to raise domestic prices.

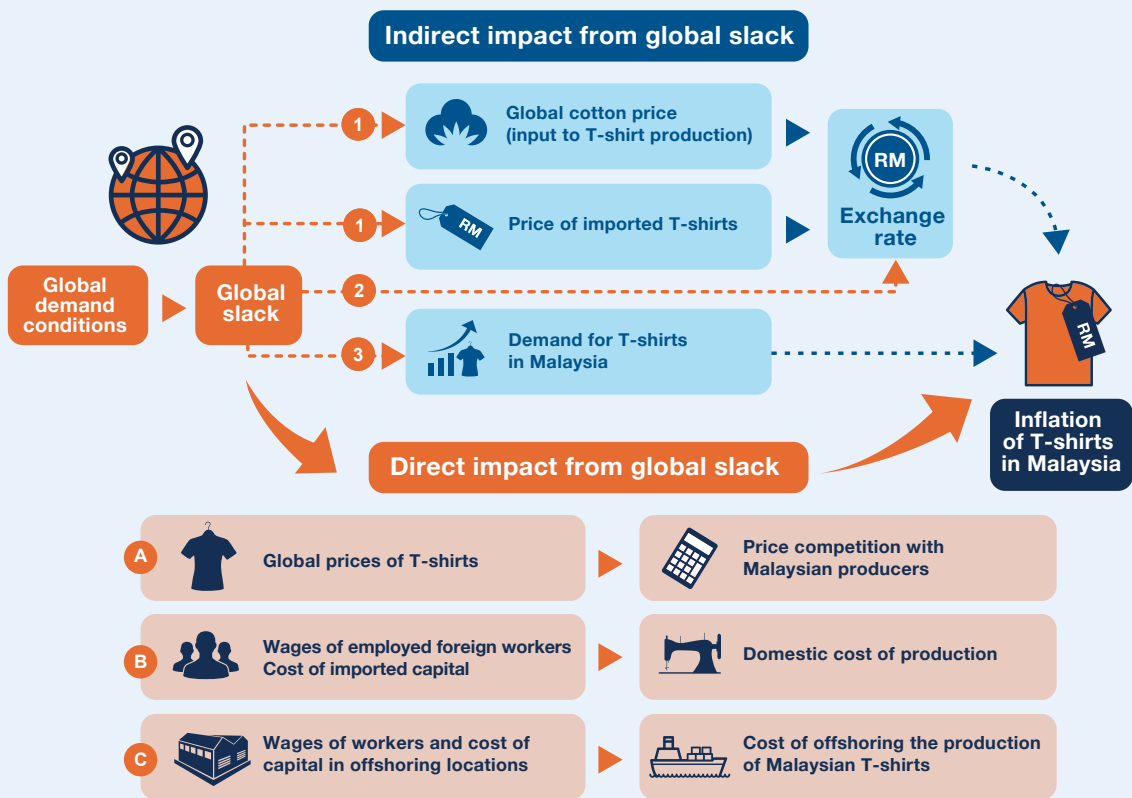
At the same time, the rapid increase in resource utilisation worldwide to produce T-shirts could also have a more direct impact on domestic inflation of T-shirts:

- i. A drawdown on resources in some countries could raise the cost of domestic production for their local T-shirt producers, and affect their pricing decisions. Given stronger competition between T-shirt producers worldwide amid market integration, the pricing decision by these foreign T-shirt producers could directly affect the pricing decision of Malaysian producers.

⁵ For example, competition for jobs with fellow domestic workers and also those abroad makes it harder for domestic workers to demand for higher wages in response to tighter domestic labour conditions.

- ii. Malaysian producers may be employing foreign workers and importing machinery from abroad to produce T-shirts. As a result, insufficient workers or machinery in countries from which these inputs are sourced could directly affect input costs for these producers.
- iii. Alternatively, Malaysian T-shirt producers could outsource some parts of the production process or the entire process to other countries (offshoring), and would thus utilise their labour and capital to produce T-shirts to be sold in Malaysia. In this case, T-shirt prices would be more sensitive to the wages and capital costs in the country to which the production is outsourced, and would in turn, be affected by the extent of slack in those countries.

Figure A: Indirect and direct channels through which global slack can affect the domestic inflation of T-shirts



Notes: The dashed arrows reflect the indirect impact from global slack to inflation, the solid arrows reflect the direct impact on inflation.

Source: Bank Negara Malaysia

B. The empirical evidence on the relevance of global slack is mixed

Despite the popular view that global slack has a greater influence on domestic inflation, the empirical evidence on this is not conclusive. The seminal paper by Borio and Filardo (2007) for instance, finds support for the importance of global slack on domestic inflation for fifteen advanced economies. They thus argue for a more global-centric approach in thinking about the inflation process, rather than a country-centric one. On the other hand, several others, including Calza (2008), Ihrig, Kamin, Lindner and Marquez (2010), and Martinez-Garcia and Wynne (2012), find that globalisation has a limited impact on the inflation dynamics of advanced economies. While contrasting findings may reflect the different empirical approaches, the difficulty in establishing a consistent finding is compounded by the uncertainties surrounding the slack measures and the challenges in combining country-level economic slack into a composite measure of global slack⁶.

Several major central banks also find little support for the relevance of global slack. Using data through early 2017, Federal Reserve Board staff find that global slack does not appear to exert an appreciable direct effect on domestic inflation in the US and most other advanced economies (Yellen, 2017). The European Central Bank also finds limited support for including measures of global slack and of the integration in global value chains in explaining inflation in the euro area (European Central Bank, 2017).

C. Global slack has been an important determinant of inflation in Asia-Pacific

The current literature on this line of research has mainly focused on the experiences of advanced economies. To add a new perspective to studies on this topic, this article looks into the relationship between global slack and domestic inflation for 13 Asia-Pacific economies^{7,8}.

Figure 2 summarises the results for Asia-Pacific economies based on the empirical estimation using annual data between 1970 and 2015.

- Domestic slack is positively associated with inflation, but its correlation has trended downward after 1990, consistent with common findings in other economies.
- Global slack has been an important determinant of domestic inflation for Asia-Pacific economies. In fact, the correlation between inflation and global slack is stronger than the correlation with domestic slack.
- Global commodity prices and exchange rate are key determinants of domestic inflation.

As corroborating evidence on the impact of globalisation on inflation, the timeline of the change in inflation dynamics is also of interest. Some observers have suggested that the dependency of inflation on global slack has become more dominant since the early 1990s, when globalisation was increasing at a rapid pace (Borio and Filardo, 2007).

However, Asia-Pacific economies exhibit different results. The direct impact of global slack appears to have gotten weaker over time, although we cannot rule out the possibility that global slack may exert a stronger indirect impact on inflation through global commodity prices and exchange rate. Specifically, the correlation between global slack and domestic inflation was stronger before 1990, and has since waned. Instead, other global factors, such as global commodity prices and exchange rate, have become more dominant in explaining inflation⁹.

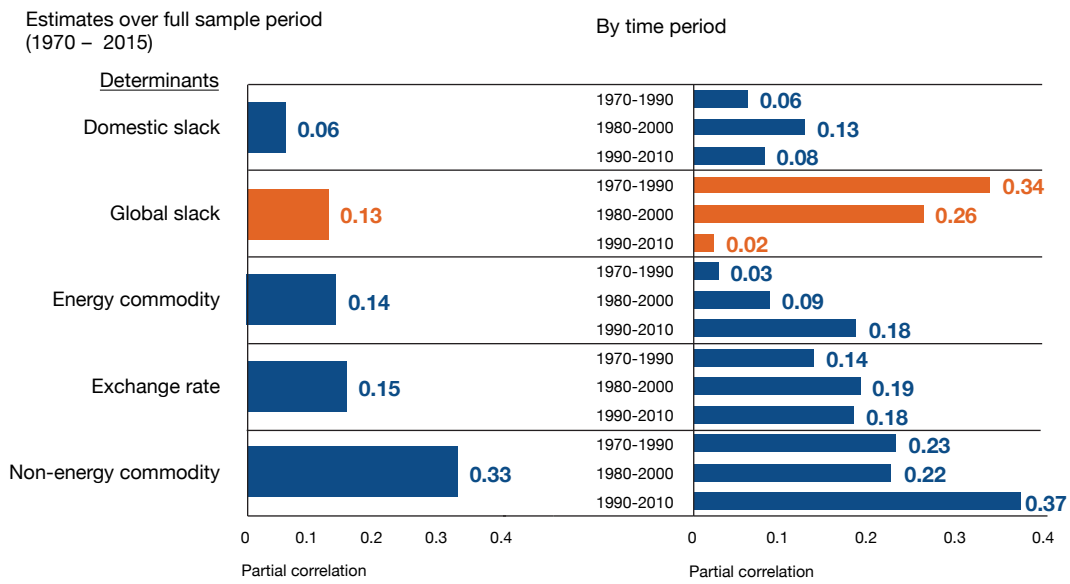
⁶ See Gerlach (2011) and Tanaka and Young (2008) for further discussion on the uncertainties surrounding the slack measure.

⁷ The analysis is undertaken by first estimating a version of the hybrid New Keynesian Phillips Curve (NKPC) model with only domestic slack. Next, an extension of the model that includes a measure of global slack is included. Countries included in this study are PR China, Japan, Thailand, Vietnam, Singapore, Korea, Philippines, Indonesia, Hong Kong, India, Malaysia, Australia and New Zealand.

⁸ The standard version of the Phillips curve always includes a term for inflation expectations. However, data limitations restricted our ability to develop a good proxy for inflation expectations for the purpose of our estimation.

⁹ This development could be explained partly by the greater reliance on commodities for the production of goods and services.

Figure 2: Partial correlation between inflation and its determinants



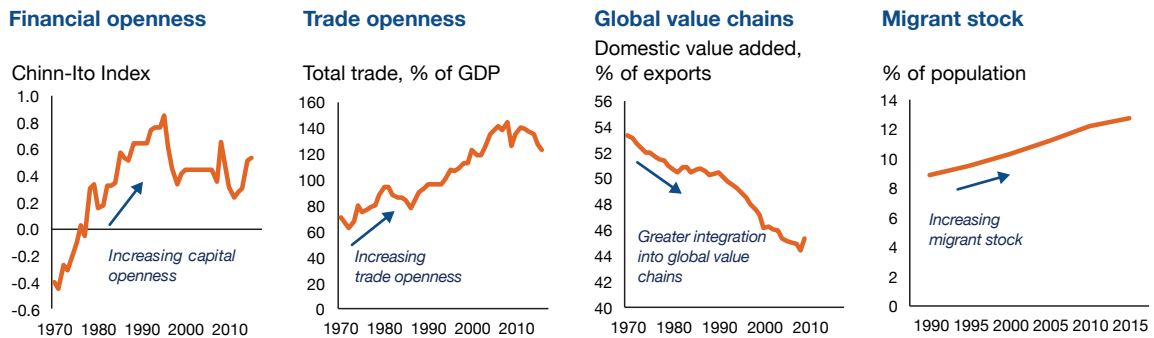
Source: Bank Negara Malaysia estimates

The weaker direct impact of global slack on inflation may come as a surprise if globalisation is perceived to have accelerated only later in the 1990s. For Asia-Pacific economies, significant increases in financial openness, trade openness, and integration into the global value chains, have been evident since 1970 (Figure 3).

The specific channels through which the forces of globalisation have altered domestic inflation dynamics warrant particular attention. We investigate four features of globalisation, which form the direct channels through which global slack has a direct influence on inflation. These four are (1) financial openness; (2) trade openness; (3) integration in global value chains (GVC); and (4) migrant stock. Intuitively, the more dominant channels would have reduced the correlation between domestic slack and inflation more significantly¹⁰. Our analysis shows that trade openness and GVC appear to have noticeably reduced the correlation between inflation and domestic slack, while the impact of financial openness and migrant stock appear to be small and not statistically significant. The results suggest that the dominant channels through which global slack has a more direct impact on domestic inflation in Asia-Pacific economies are stronger competition from a larger global marketplace (Channel A in Figure 1) and offshoring of production processes (Channel C).

¹⁰ We interact both domestic and global slack with measures of financial openness, trade openness, integration into global value chains, and migrant stock. A positive interaction term for domestic slack, for example, suggests that the relationship between inflation and domestic slack is stronger given the feature of globalisation, while a negative interaction term would suggest a weaker relationship. The empirical setup will be detailed in the forthcoming working paper.

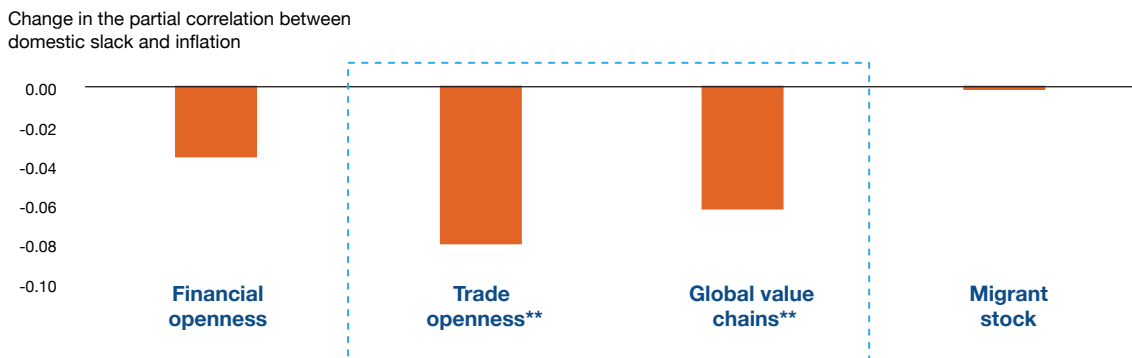
Figure 3: Features of globalisation for Asia-Pacific economies



Notes and sources:

1. Financial openness is proxied by the Chinn-Ito index, which is an index measuring a country's degree of capital account openness. Source: Chinn and Ito (2006).
2. Trade openness is measured as the sum of exports and imports of goods and services, as a share of gross domestic product (GDP). Source: World Bank and OECD national accounts data.
3. One measure of global value chain is the domestic value-added share of exports, which is the value-added content in the country of origin's exports divided by total gross exports. For a country that is more integrated into the global value chain, the measured level of domestic value-added would be relatively lower. Intuitively, a higher degree of production fragmentation would imply that each country's value-added in the supply chain would be smaller. Source: Johnson and Noguera (2017) database.
4. International migrant stock is the share of foreign-born population in total population in a country. A higher share would indicate a larger potential labour supply, above what can be offered by the local population. Source: United Nations Population Division, Trends in Total Migrant Stock: 2008 Revision.

Figure 4: Impact of the features of globalisation on the relationship between domestic slack and inflation in Asia-Pacific economies



Note: ** signifies statistical significance at the 5% level.
 Source: Bank Negara Malaysia estimates

Conclusion

In summary, the evidence in this article points to a considerable impact from factors associated with globalisation on inflation dynamics in Asia-Pacific economies. This implies that these factors have the potential to provide relevant information to central banks, and should not be ignored when developing monetary policy strategy. Moreover, a weaker response of inflation to domestic demand – i.e. a flatter Phillips curve – makes it more difficult to manage inflation using just traditional demand management tools, and may warrant the deployment of additional policy tools. To that end, structural policies can play a complementary role to ensure a stable macroeconomic environment amid the transitions that take place following globalisation. This has been the approach adopted by Bank Negara Malaysia, given its broader consideration of factors affecting the domestic economy, consistent with its inflation-anchoring framework.

References

- Baxter, M., King, R.G., 1999. Measuring business cycles: approximate band-pass filters for economic time series. *The Review of Economics and Statistics* 81, 575–593.
- Blanchard, O., Cerutti, E., Summers, L., 2015. Inflation and activity – two explorations and their monetary policy implications (Working Paper No. 21726). National Bureau of Economic Research.
- Borio, C., Filardo, A., 2007. Globalisation and inflation: New cross-country evidence on the global determinants of domestic inflation (BIS Working Papers No. 227). Bank for International Settlements.
- Calza, A., 2008. Globalisation, domestic inflation and global output gaps: Evidence from the euro area (Working Paper Series No. 890). European Central Bank.
- Carney, M., 2017. [De]Globalisation and inflation. Presented at the 2017 IMF Michel Camdessus Central Banking Lecture.
- Chinn, M.D., Ito, H., 2006. What matters for financial development? Capital controls, institutions, and interactions. *Journal of Development Economics* 81, 163–192.
- European Central Bank (ECB), 2017. Domestic and global drivers of inflation in the euro area. *ECB Economic Bulletin* 72–96.
- Gerlach, P., 2011. The global output gap: measurement issues and regional disparities. *BIS Quarterly Review* 29.
- Ihrig, J., Kamin, S.B., Lindner, D., Marquez, J., 2010. Some simple tests of the globalization and inflation hypothesis*. *International Finance* 13, 343–375.
- Johnson, R.C., Noguera, G., 2017. A portrait of trade in value-added over four decades. *The Review of Economics and Statistics* 99, 896–911.
- Martinez-Garcia, E., Wynne, M.A., 2012. Global slack as a determinant of U.S. inflation (Globalization and Monetary Policy Institute Working Paper No. 123). Federal Reserve Bank of Dallas.
- Milani, F., 2009. Does global slack matter more than domestic slack in determining US inflation? *Economics Letters* 102, 147–151.
- Tanaka, M., Young, C., 2008. The economics of global output gap measures. *Bank of England Quarterly Bulletin* 48.
- Yellen, J., 2017. Inflation, uncertainty, and monetary policy. Presented at the Prospects for Growth: Reassessing the Fundamentals” 59th Annual Meeting of the National Association for Business Economics, Cleveland, Ohio.

Monetary and Financial Developments

HIGHLIGHTS

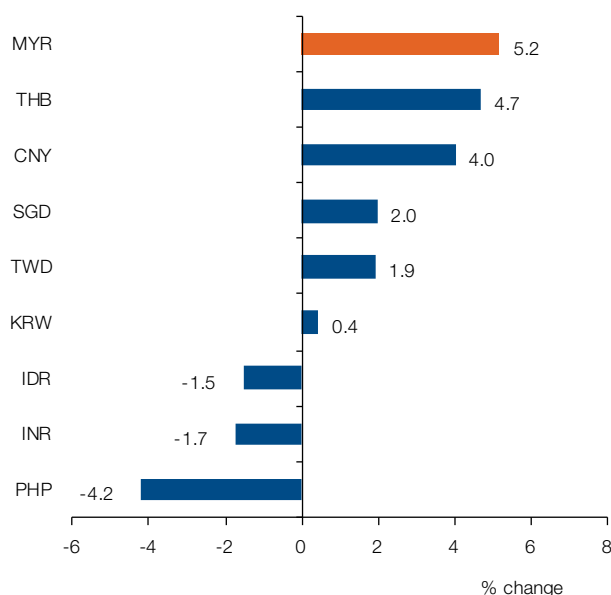
- The ringgit was the best performer in the region during the quarter.
- Despite heightened uncertainties in global financial markets, the performance of domestic financial markets was strong amid non-resident inflows following positive domestic developments.
- Following the OPR increase on 25 January 2018, interest rates in wholesale and retail markets trended higher. The growth of net financing was sustained.

The ringgit outperformed regional currencies in the first quarter of 2018

The ringgit continued to appreciate against the US dollar and regional currencies in the first quarter of the year. The strength of the ringgit was driven mainly by non-resident portfolio inflows as investors viewed adjustment to the degree of monetary accommodation by Bank Negara Malaysia as a sign of a sustained strong growth outlook for the economy. Higher global crude oil prices during the quarter also, to some extent, lent support to the currencies of commodity-exporting countries, including the ringgit. The ringgit and regional currencies experienced higher volatility during the quarter due to uncertainties surrounding the pace of monetary policy normalisation in the US and concerns over rising trade disputes and its repercussions. Going forward, the ringgit will continue to be driven by a confluence of external and domestic factors. These include the timing and pace of monetary policy normalisation by major central banks, global geopolitical developments, and the domestic economic performance.

Most regional currencies appreciated against the US dollar

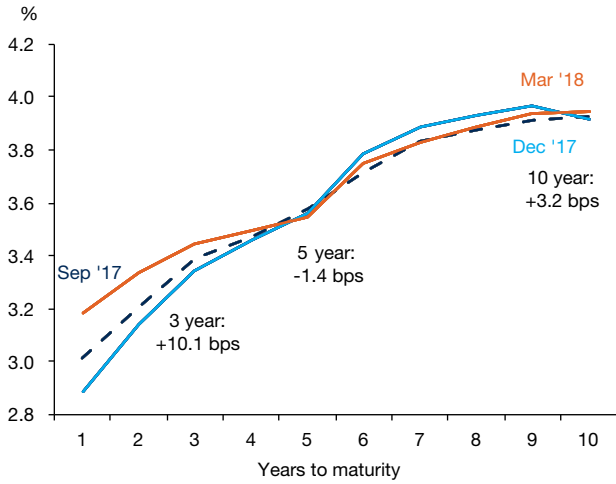
Chart 21: Summary of Performance of Regional Currencies Against the US Dollar (1 January - 30 March 2018)



Source: Bank Negara Malaysia

MGS yield curve flattened during the first quarter

Chart 22: Trend in MGS Yields



Source: Bank Negara Malaysia

Mixed performance in government bond yields amid volatile global financial markets

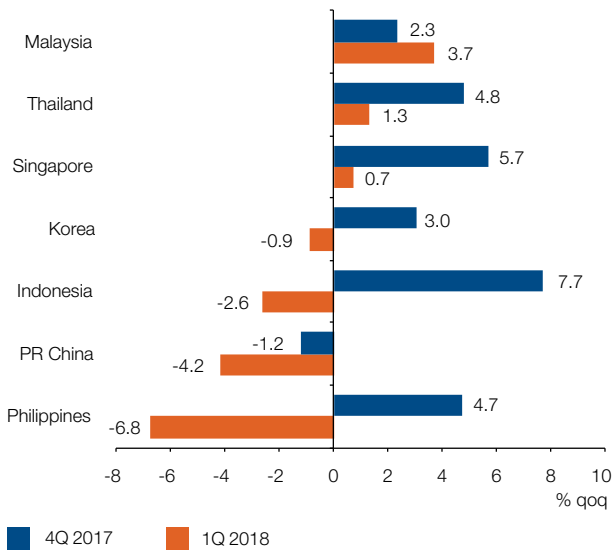
At the beginning of the quarter, bond yields trended upward in line with the increase in the OPR and volatile global financial markets amid expectations of a faster pace of monetary policy normalisation by the Federal Reserve. The upward pressure eased in March 2018. Non-resident demand increased as concerns on a faster pace of policy rate increases by the Federal Reserve eased following slower US jobs growth. For the quarter as a whole, the 3-year and 10-year MGS yields increased by 10.1 and 3.2 basis points, respectively, while the 5-year MGS yield declined by 1.4 basis points.

Despite heightened uncertainties in global financial markets, the FBM KLCI increased during the quarter

During the first quarter, the FBM KLCI increased by 3.7% to close at 1,863.5 points as at end-March 2018 (end-December 2017: 1,796.8 points). The domestic equity market experienced strong buying activities from non-resident investors driven mainly by positive sentiments in the domestic market following higher global crude oil prices and stronger ringgit performance. Sentiments in the domestic market were further supported by the release of better-than-expected Malaysian 4Q 2017 GDP growth. The gains, however, were partially offset following heightened volatility in the US equity market amid uncertainties surrounding the pace of US policy normalisation and concerns over trade disputes.

Domestic equity market increased during the first quarter

Chart 23: Performance of Regional Markets



Source: Bloomberg and Bank Negara Malaysia calculations

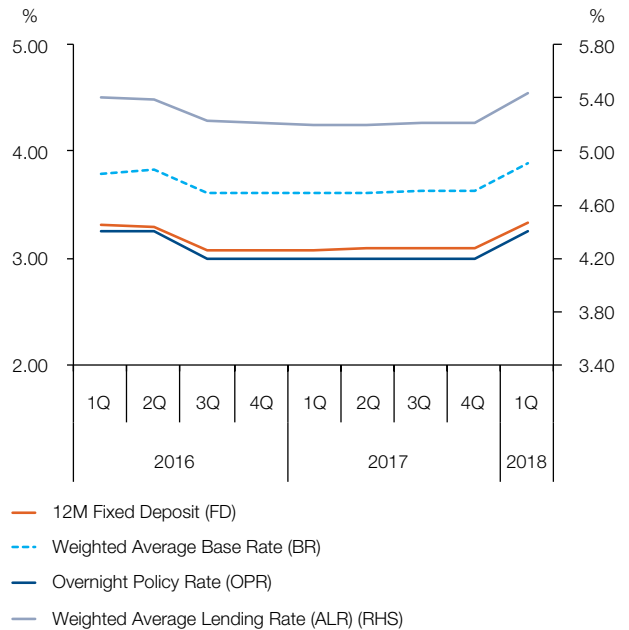
Interest rates increased during the quarter due to the increase in the OPR

Following the OPR increase on 25 January 2018, interest rates in wholesale and retail markets trended higher. In the interbank market, strong and immediate pass-through was observed, with the 3-month KLIBOR increasing by 25 basis points to 3.69% (4Q 2017: 3.44%). Similarly, nominal fixed deposit (FD) rates also increased following the OPR adjustment. The increase ranged from 21 basis points to 23 basis points across tenures of 1 to 12 months. Correspondingly, real FD rates turned positive given the increase in nominal rates and lower inflation during the quarter.

For the retail segment, the transmission of OPR to base rate (BR) was strong, with most banks revising their BRs upwards by 25 basis points to reach the current weighted average of 3.89% (4Q 2017: 3.64%). By end-quarter, the weighted average lending rate (ALR) on outstanding loans was also higher by 22 bps to 5.43% (4Q 2017: 5.22%).

Interest rates increased following the increase in the OPR

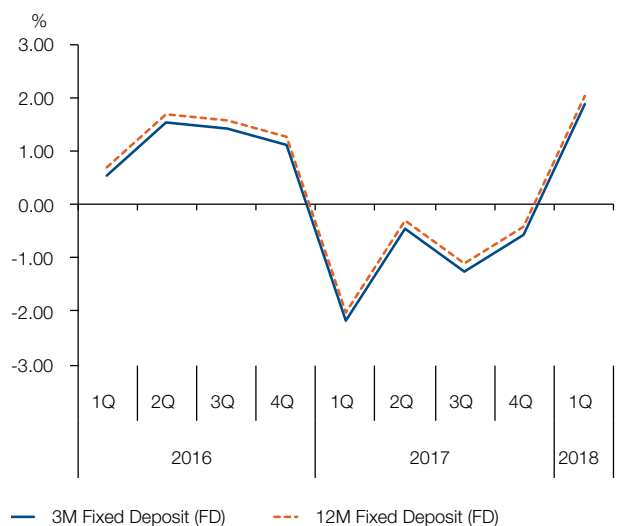
Chart 24: Fixed Deposit Rate, Base Rate and Average Lending Rate, as at End-period



Source: Bank Negara Malaysia

Real deposit rates turned positive, reflecting the higher OPR and lower inflation

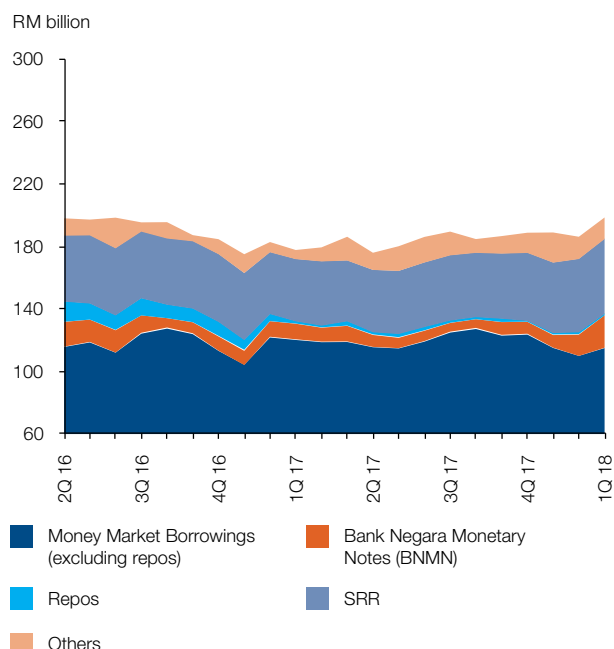
Chart 25: Real Fixed Deposit Rates (by Maturity), as at End-period



Source: Bank Negara Malaysia

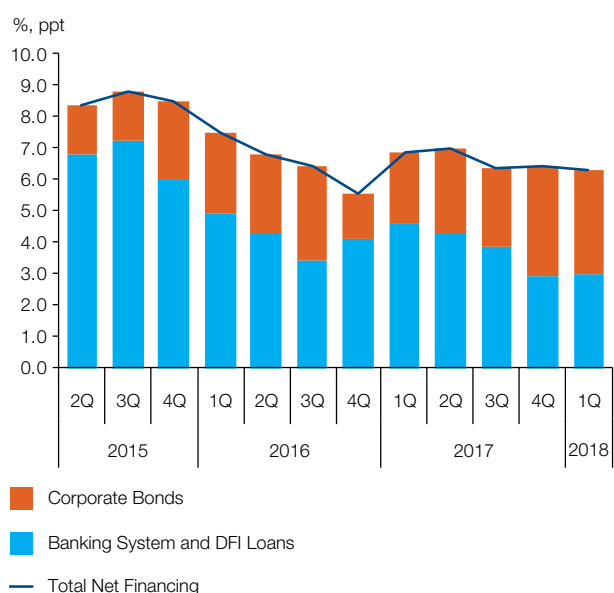
Outstanding surplus ringgit liquidity placed with Bank Negara Malaysia increased during the quarter

Chart 26: Outstanding Ringgit Liquidity Placed with Bank Negara Malaysia, as at End-period



Net financing growth supported by growth of loans and corporate bonds

Chart 27: Contribution to Net Financing Growth



* Net financing comprises outstanding banking system and DFI loans, and outstanding corporate bonds

Liquidity conditions remained sufficient to facilitate financial intermediation

In the banking system, liquidity conditions remained sufficient at both the institutional and system-wide levels. Reflecting the overall net capital inflows during the quarter, the level of surplus liquidity placed with the Bank also increased. At the institutional level, most banks continued to maintain surplus liquidity positions.

Net financing sustained during the quarter

The growth of net financing was sustained at 6.3% in the first quarter of 2018 (4Q 2017: 6.4%), reflecting the steady growth of outstanding loans⁷ (1Q 2018: 3.9%; 4Q 2017: 3.8%). The growth of net outstanding issuances of corporate bonds⁸ continued at a double-digit rate during the quarter of 14.2% (4Q 2017: 15.4%). The growth of outstanding business loans was stable at 1.3% (4Q 2017: 1.3%), mainly supported by the *real estate; construction; and finance, insurance and business services* sectors. During the quarter, the growth and level of total business disbursements were higher relative to repayments, especially for businesses other than SMEs, reversing the trend from the previous quarter. Loan growth to SMEs moderated to 5.1% (4Q 2017: 5.3%) and the amount of loans disbursed sustained during the quarter (1Q 2018: RM75.9 billion; 4Q 2017: RM 78.4 billion). The growth of household loans increased to 5.2% during the period (4Q 2017: 4.9%), mainly driven by loans for the *purchase of residential properties and securities*.

⁷ Loans extended by both banking system and development financial institutions (DFIs).

⁸ Corporate bonds exclude issuances by Cagamas, Danaharta, Danamodal and non-residents.

Managing Risks to Financial Stability

HIGHLIGHTS

- Businesses and households continued to demonstrate sound debt servicing capacity.
- Domestic financial stability is expected to remain intact, supported by sound financial institutions, orderly markets and liquidity conditions.

Financial stability sustained with financial intermediation and domestic market conditions remaining orderly

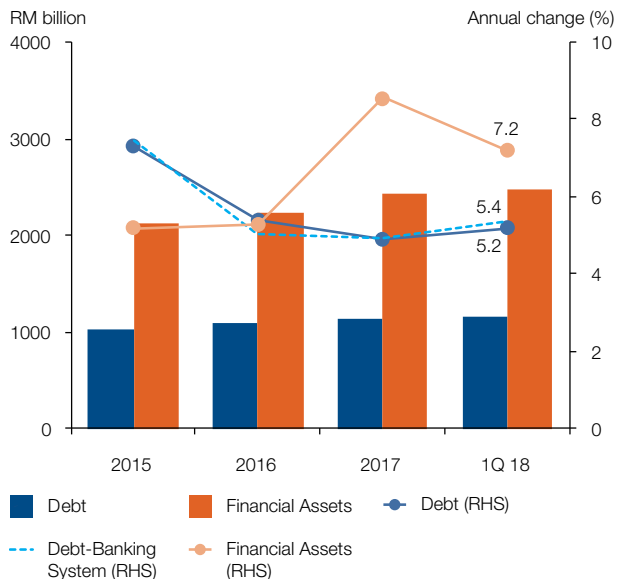
Credit intermediation activities continued to be supportive of real economic activities. Credit risk remained stable, supported by sound debt servicing capacity of both households and businesses. Domestic financial market conditions remained orderly despite heightened volatility driven by developments on the external front. Domestic financial institutions demonstrated resilience with healthy asset quality, sound profitability and ample liquidity. These sustained overall financial stability.

Stable debt servicing capacity of households and businesses

The annual growth in household debt⁹ increased to 5.2% in the first quarter of 2018 (4Q 2017: 4.9%). Of this, banking system loans¹⁰ extended to households registered a higher growth of 5.4% (4Q 2017: 4.9%) while the growth of loans extended by development financial institutions and non-bank financial institutions (NBFIs) moderated to 4.3% (4Q 2017: 5.1%).

Expansion in household financial assets continued to outpace that of debt

Chart 28: Household Sector Debt and Financial Assets



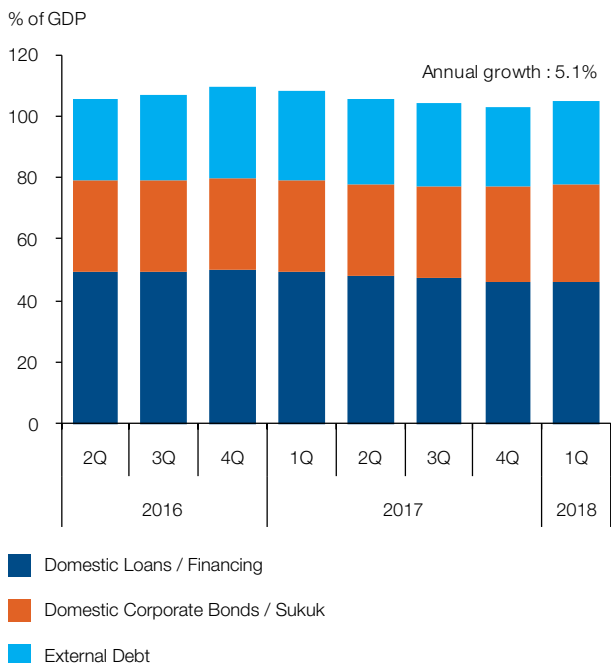
Source: Bank Negara Malaysia, Bloomberg, Department of Statistics, Malaysia, Securities Commission Malaysia and internal computation

⁹ Loans extended by banks (including MBSB Bank), development financial institutions and major NBFIs

¹⁰ Including MBSB Bank

Total business borrowings was driven by stable corporate issuances in the capital market

Chart 29: Business Sector NFC-Debt-to-GDP



Source: Bank Negara Malaysia

The increase in overall household debt was attributed to loans for the purchase of residential properties (contribution to growth in 1Q 2018: 4.4 ppt; 4Q 2017: 4.3 ppt), primarily for houses priced between RM500,000 and RM750,000. The increase was also supported by loans for the purchase of securities (contribution to growth in 1Q 2018: 0.3 ppt; 4Q 2017: 0.1 ppt), both in unit trust funds and equities.

The overall debt repayment capacity of households is expected to remain sound, supported by sustained wage growth as a result of favourable labour market conditions. Aggregate household financial assets and liquid financial assets continued to be adequate at 2.1 and 1.5 times of debt, respectively. In addition, the growth of household financial assets (7.2%) continued to outpace debt (5.2%) for the fifth consecutive quarter. At the end of the first quarter of 2018, total household debt stood at 84% of GDP (4Q 2017: 84.2%). Excluding lending by non-banks, the total banking system loans to households as a share of GDP was 69.2% (4Q 2017: 69.3%).

The overall asset quality of banks and non-banks remained sound. The aggregate impairment ratio for loans to households was sustained at 1.6%, while the aggregate delinquency ratio improved to 1.2% (4Q 2017: 1.4%). Strengthened affordability assessments by lenders further contributed towards receding risks of financial imbalances arising from the household sector. The majority of new household borrowers have prudent debt service ratios (DSR), with most having DSR of below 60%. The share of borrowings by vulnerable borrowers (those with monthly earnings below RM3,000) declined to account for 19.9% of total household debt by end of 2017 (2016: 21.9%) of total household debt. Potential losses to banks from vulnerable households under a simulated scenario based on assumptions of a tripling of prevailing probabilities of default and severe loss given default were estimated at less than 10% of banks' excess capital buffers (above the regulatory minimum).

Borrowings by the business sector grew by 5.1% on an annual basis in the first quarter of 2018 (4Q 2017: 3.2%). This was driven by increased fund raising in the capital market which grew by 15.3% (4Q 2017: 14.3%), led by non-financial corporations in the infrastructure, utilities and real estate sectors. Corporate external borrowings were higher as new borrowings offset the positive exchange rate valuation effects. New borrowings mainly comprised loans by businesses in the manufacturing and oil and gas (O&G) sectors. Financing by banks and development financial institutions (DFIs) to businesses sustained its expansion at 1.3% (4Q 2017: 1.3%). Of this, financing to SMEs expanded by 5.1% in the first quarter (4Q 2017: 5.3%).

The financial position of firms remained healthy supported by improving domestic and external demand. The aggregate leverage of non-financial corporations (NFCs)¹¹ as measured by the median debt-to-equity ratio decreased in 4Q 2017 (47%; 3Q 2017: 51.9%). This was attributed to lower debt levels among firms in the telecommunications, transportation and construction-related sectors.

Aggregate debt servicing capacity and liquidity positions remained sound. The median interest coverage ratio (ICR) was sustained at 9.6 times in 4Q 2017 (3Q 2017: 9.6 times), comfortably above the prudent threshold of two times. The median current cash-to-short-term debt ratio (CASTD) was also above the prudent threshold of one time, at 1.5 times in 4Q 2017 (3Q 2017: 1.6 times). Overall, the ratio of impaired and delinquent loans in 1Q 2018 remained low at 2.6% and 0.3% of total bank lending to businesses, respectively (4Q 2017: 2.5% and 0.3%, respectively).

The ratio of impaired loans in the O&G sector increased to 8.7% (4Q 2017: 5.5%), in the first quarter of 2018. The higher impairment was driven by non-SMEs in the shipping and fabrication segments. Risks to the banking system from exposures to the O&G-related sector continued to be small (6% of total domestic exposures to businesses), with provisions against potential credit losses fully accounted for. The anticipated higher capital expenditure by major oil and gas firms for the year amid an increasing trend in oil prices may positively impact the earnings of service providers in this sector moving forward.

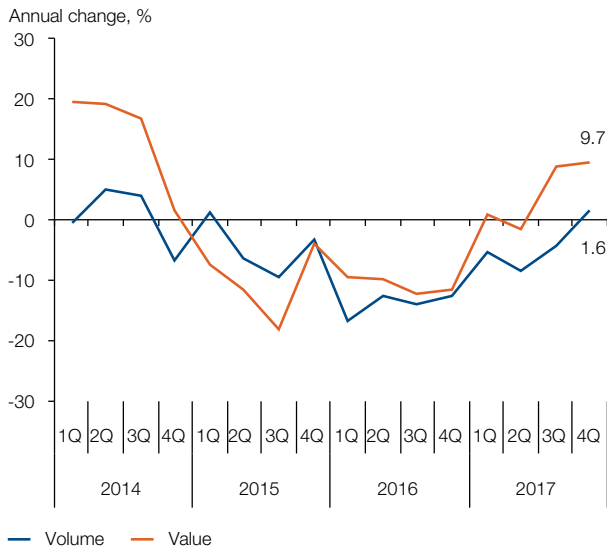
The modest increase in housing market activities has yet to translate into better debt repayment capacity in the real estate sector. The impaired loans ratio marginally increased to 1.9% of total bank lending to businesses in the real estate sector (4Q 2017: 1.7%), driven mainly by SMEs in the real estate services segment. The median ICR and median CASTD of property developers¹² were stable at 5.7 times and 0.9 times, respectively (3Q 2017: 5.8 times and 0.8 times, respectively). Risks to domestic financial stability arising from exposures to property developers remained minimal. Based on the sensitivity analysis conducted on banks' overall credit exposures (including investments in bonds and sukuk) to the property market and related sectors, banks have sufficient buffers to absorb potential cumulative losses (For more details, please refer to Chapter 1 of the Bank Negara Malaysia Financial Stability and Payment Systems Report 2017).

¹¹ Based on 120 listed firms on Bursa Malaysia with 85% market capitalisation (excluding financial institutions).

¹² Based on 94 listed property developers on Bursa Malaysia.

Housing market activities picked up in 4Q 2017

Chart 30: Residential Property Transaction Volume and Value



Source: National Property Information Centre

Rental rate of shopping complexes improved slightly in 4Q 2017

Chart 31: Office Space and Shopping Complex Vacancy and Rental Rates



Source: National Property Information Centre, Knight Frank, Jones Lang Wootton and internal computation

Modest improvements in housing market activities

In the housing market, both total housing transaction volume and value increased by 1.6% and 9.7%, respectively in 4Q 2017 (3Q 2017: -4.2% and 8.7%, respectively). The improvement was driven largely by transactions of houses priced between RM500,000 and RM1 million. House prices (as measured by the Malaysian House Price Index) grew by 6.5% in 3Q 2017 (2Q 2017: 6.8%; 4Q 2017 preliminary: 5.8%). A similar upward trend was observed across almost all house types and states.

Banks continued to extend loans for the purchase of residential property to eligible borrowers, including to first-time house buyers. Outstanding loans extended by banks for house financing were sustained at 8.9% on an annual basis in 1Q 2018 (4Q 2017: 8.9%). Loan approval rates for houses priced below RM500,000 stood at 71.5%, with most major states recording housing loans approval rates above 70%.

Demand for financing for speculative house purchases continued to be low. During the quarter, the share of the number of housing loans settled within three years (the typical duration required to complete construction after a property is acquired) stood at 7.5% of total settled housing loans (4Q 2017: 7.9%). The annual growth in the number of borrowers with three or more outstanding housing loans (a proxy for speculative buyers) remained low at 0.8% (4Q 2017: 0.9%). The credit quality for overall housing loans remained sound, with both impairment and delinquency ratios remaining low at 1.1% of total bank loans (4Q 2017: 1% and 1.3%, respectively).

The oversupply situation in the office space and shopping complex segment continued to persist despite some pickup in rental rates for selected shopping complexes in choice locations. Direct risks to banks from end-financing exposures to the office space and shopping complex segments have been small at 3.1% of total bank loans. Banks continue to maintain sound underwriting and valuation practices, even though excess supply in these segments were apparent. Banks remained cautious in extending lending to these segments as reflected in the lower loan approval rates for the construction and purchase of such properties (1Q 2018: 62% and 71.3% respectively; 4Q 2017: 66.9% and 74.7% respectively). The delinquency and impairment ratios for the non-residential property segment remained low at 0.6% and 1.3%, respectively (4Q 2017: 0.7% and 1.2%, respectively).

Orderly domestic financial market conditions despite higher volatility

Investor sentiments have been affected by developments on the external front. This includes the global equity market correction in early February, the interest rate hike by the Federal Reserve in March and heightened concerns over trade disputes between the US and PR China. Despite the continued uncertainties, overall volatility in the domestic financial market rose. The 90-day volatility of the FBM KLCI and ringgit increased to 8.7% and 4.8%, respectively (4Q 2017: 5.6% and 3.9%, respectively). However, the 90-day volatility of 10-year MGS yields declined to 7.3% (4Q 2017: 9.9%).

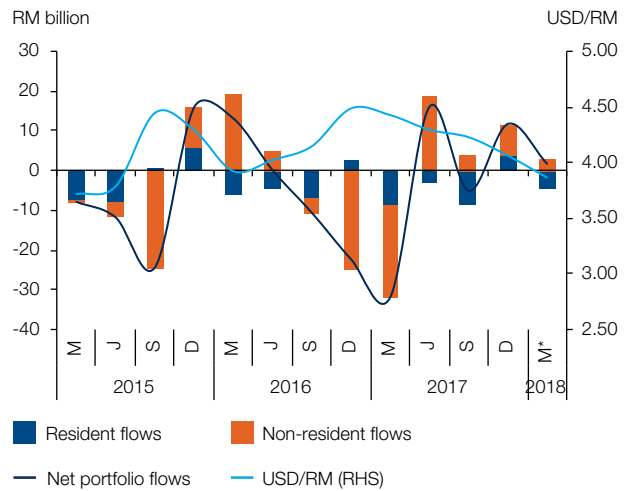
In the first quarter of 2018, portfolio investments recorded net outflows of RM2.6 billion (4Q 2017: net inflows of RM11.6 billion) attributed mainly to a resumption in net acquisitions of foreign financial assets by resident fund managers and banks. However, this was offset by non-resident investments in the equity and bond markets. Non-resident investor holdings of government bonds decreased slightly to 27.4% of total outstanding Malaysian government bonds (4Q 2017: 27.7%). The composition of non-resident investors in government bonds remained broadly unchanged, consisting mainly of long-term investors such as central banks, governments, pension funds and insurance companies (52% of total non-resident holdings). In addition, non-resident holdings were mostly concentrated in medium and longer-dated bonds of more than 3 years (68%).

Non-resident participation in the domestic equity market increased to 24.2% of total equity market capitalisation (4Q 2017: 23.2%). The FBM KLCI ended the quarter at 1,863.46 points (4Q 2017: 1,796.81 points), reaching a high of 1,876.87 points on 22 March 2018 before settling lower on the announcement of potential higher tariffs on PR China's imports by the US. The price-to-earnings (PE) ratio for the FBM KLCI stood at 17.6 times (4Q 2017: 16.2 times; 2010-2017 average: 16.8 times).

Market liquidity continued to remain ample. The average bid-ask spread for MGS and FBM KLCI remained unchanged at 0.1% and 0.4% of the mid-price, respectively (4Q 2017: 0.1% and 0.4%, respectively). Daily average USD/MYR bid-ask stood at 26.1 pips (4Q 2017: 24.3 pips). Liquidity in the foreign exchange market improved, as the transaction volume for all currency pairs increased to a daily average of USD11.2 billion (4Q 2017: USD9.9 billion).

Net portfolio investment inflow mainly driven by continued investment by non-residents in the domestic asset market

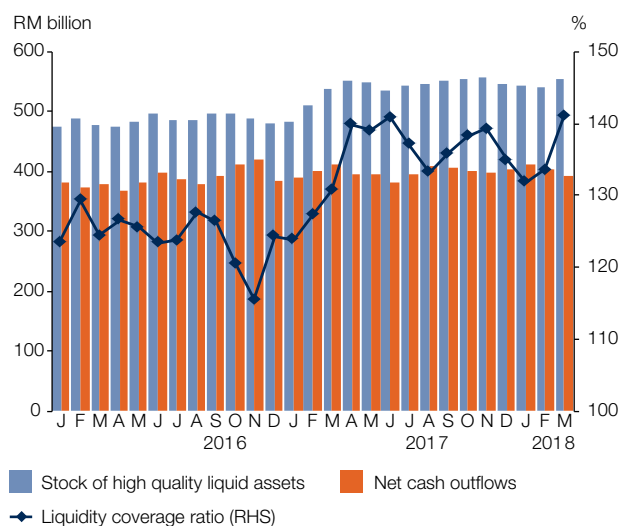
Chart 32: Financial Market Net and Gross Portfolio Flows and Ringgit Exchange Rate Movement



Source: Department of Statistics, Malaysia

Banking system liquidity sufficient to buffer for adverse liquidity shocks

Chart 33: Banking System Basel III Liquidity Coverage Ratio



Source: Bank Negara Malaysia

The ringgit continued to appreciate against the US dollar by 5.2% to end the quarter at RM3.8620 per US dollar (4Q 2017: RM4.0620). A similar trend was observed against most other major currencies. However, spreads on long-term onshore USD liquidity, as reflected by the 5-year cross-currency basis swap spreads, widened to 40 basis points (bps) (4Q 2017: 25 bps) as external developments weighed on market sentiment. The 5-year sovereign credit default swap spread increased to 73.1 bps, although it remained lower than the 2017 peak of 139.6 bps (4Q 2017: 58.4 bps).

Market risk exposures largely mitigated by risk management strategies

Banks' aggregate market risk exposures remained stable. FX risk, measured in terms of the net open position of foreign currency denominated exposures, declined to 5.3% of total capital (4Q 2017: 6.1%). Interest rate risk in the trading book and equity risk remained low at 1.1% and 0.8% of total capital, respectively (4Q 2017: 1% and 1.9%, respectively). Interest rate risk in the banking book also declined to 3.3% (4Q 2017: 3.7%) of total capital.

For the insurance and takaful industry, market risk exposures stood at 14.9% of total capital available (4Q 2017: 15.4%). Equity risk, which formed the bulk of insurers' market risk exposures, decreased slightly to 9% of total capital available (4Q 2017: 9.1%).

Ample liquidity conditions continued to support intermediation activities

Outstanding ringgit surplus liquidity placed with Bank Negara Malaysia stood at RM198.5 billion as at end 1Q 2018 (4Q 2017: RM188.7 billion) in the form of placements, reverse repos and statutory reserves. The Liquidity Coverage Ratio (LCR)¹³ for the banking system stood at 141% as at end-March 2018 (4Q 2017: 135%). All banks recorded LCR levels well above the current minimum regulatory requirement of 90%.

¹³ The Basel III LCR has been phased in since June 2015, with initial compliance set at 60% and progressive increments of 10% each year until 100% with effect from 2019. As of 1 January 2018, the minimum requirement is set at 90%.

Domestic funding conditions remained stable during the quarter. Both the average cost of deposits¹⁴ for banks and the 3-month KLIBOR increased to 2.54% and 3.69%, respectively as at end 1Q 2018 (4Q 2017: 2.51% and 3.43%, respectively) following the 25 bps hike in the overnight policy rate (OPR). Banks continued to be predominantly funded by deposits (70.1% of total funding) and in local currency. On aggregate, bank deposits including Islamic investment accounts recorded a higher growth of 5.2% (4Q 2017: 4%), supported by stronger growth in business sector deposits (1Q 2018: 11.3%, 4Q 2017: 7.1%). Banks maintained a diversified funding structure through the utilisation of medium-term ringgit and foreign currency denominated funding instruments. The loan-to-funds ratio¹⁵ (LTF), which takes into account the broader funding structure of Malaysian banks, stood at 82.4% (4Q 2017: 84%).

Strong capitalisation and sustained profitability of financial institutions

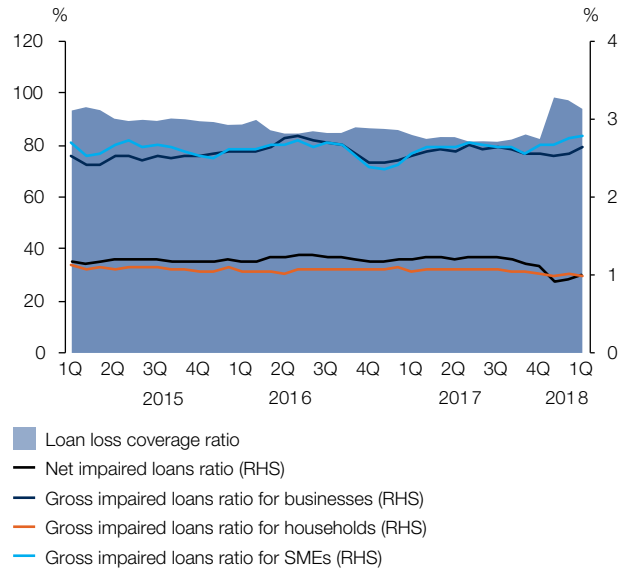
Malaysian financial institutions remained well-capitalised. In the banking system, the Common Equity Tier 1 capital ratio, Tier 1 capital ratio and total capital ratio stood above minimum regulatory requirements at 13.2%, 14% and 17.5%, respectively (4Q 2017: 13.5%, 14.5% and 17.3%, respectively). Similarly, the insurance and takaful sector reported an aggregate capital adequacy ratio of 237.3% (4Q 2017: 233.8%), above the 130% minimum required.

At the banking system level, asset quality remained sound. Overall gross impaired loans ratio stood at 1.57% (4Q 2017: 1.54%). Following the adoption of MFRS 9¹⁶ in January 2018, banks' provisioning levels increased to RM23.7 billion (4Q 2017: RM20.1 billion). The increase was anticipated given refinements in impairment provisioning methodologies under the new standard. Consequently, the loan loss coverage ratio (including regulatory reserve) was higher at 126.9% (4Q 2017: 114.7%).

Net interest income from lending/financing activities was sustained while higher income was recorded from treasury activities. This was offset by a reduction in income from non-recurring items (e.g. dividend and sale of non current assets). Correspondingly, pre-tax profit of the banking system reduced to RM9 billion (4Q 2017: RM10 billion) in the first quarter of 2018. Banks' financing (including interest) margin net of operating costs and loan loss provisions increased to 0.81 percentage points (ppts) (4Q 2017 average: 0.71 ppts), largely due to higher recoveries from impaired loans.

Healthy Asset Quality Observed in the Banking System

Chart 34: Banking System Asset Quality



Source: Bank Negara Malaysia

¹⁴ The average cost of deposit is computed based on rolling 12-months average of interest expense on deposit over total deposit.

¹⁵ Funds comprise deposits and all debt instruments issued (including subordinated debt, debt certificates/sukuk, commercial papers and structured notes).

¹⁶ Malaysian Financial Reporting Standards 9: Financial Instruments

In the insurance and takaful sector, life insurers and family takaful operators recorded lower excess income over outgo of RM4.0 billion (4Q 2017: RM 4.9 billion). This was partly attributed to net capital losses from holdings of debt securities together with lower valuations. The operating profits of general insurers and takaful operators also declined to RM563.3 million in the first quarter (4Q 2017: RM783.4 million) driven by higher claims cost in the motor line of business. The industry overall claims ratio increased to 56.9% (4Q 2017: 54.9%).

imSME, an online SME referral platform, reduces search costs for businesses

The imSME platform, launched by Credit Guarantee Corporation (CGC) on 9 February 2018, matches SMEs to suitable financing products according to their business profile, credit standing and financing needs. The platform currently offers 28 financing products from 15 institutions, including both conventional and Islamic products. As at 3 April 2018, RM2.4 million in financing to SMEs was approved as a result of successful matches through the platform.

The imSME platform has been effective in reducing search costs for businesses seeking financing. SMEs that previously had to visit multiple banks for financing successfully reduced travel and waiting

time by up to 3 hours¹⁷ per financial institution. In addition, SMEs saved up to 10 days in preparing loan documentation, freeing up resources to focus on their core business operations.

A dedicated Financial Advisory Team formed by CGC was also established to conduct diagnostics and provide structured assistance to unmatched and rejected applicants, benefitting 350 SMEs to-date. Most unmatched or rejected SMEs were found to have submitted inaccurate financial information, which affected their eligibility for financing. The Financial Advisory Team provided various forms of targeted assistance to address specific challenges faced by SMEs, including:

- Advise and guidance on providing the correct information in re-submissions of financing applications;
- Advise on the amount and tenure of financing, which would be more in line with repayment capacity;
- Referrals to capacity building agencies such as Centre for Development and Research (CEDAR) and Institut Keusahawanan Negara (INSKEN) for assistance on financial management and business planning to improve eligibility for financing; and
- Information on alternative financing avenues, including peer-to-peer (P2P) financing platforms for SMEs which lacked financial track records.

The imSME platform is accessible at <https://imsme.com.my>.

¹⁷ Based on a survey conducted by CGC on successful imSME applicants to determine the impact of imSME on businesses applying for financing.

The Bank's Policy Considerations

HIGHLIGHTS

- The MPC maintained the policy rate in March and May, as the degree of monetary accommodativeness was deemed consistent with ensuring a steady growth path amid lower inflation.

The OPR remained accommodative

In January 2018, the Monetary Policy Committee (MPC) normalised the degree of monetary accommodation by raising the Overnight Policy Rate (OPR) by 25 basis points to 3.25%. Malaysia's strong growth performance in 2017 was expected to be sustained through 2018, amid more broad-based, entrenched and synchronised global economic expansion. Headline inflation was expected to average lower in 2018, on expectations of a smaller effect from global cost factors, while a stronger ringgit exchange rate compared to 2017 would mitigate import costs. Importantly, the adjustment does not constitute a tightening of monetary conditions, but rather a normalisation of the degree of monetary accommodation that would contribute towards the sustainability of growth.

At the subsequent meetings in early March and May, the MPC kept the OPR unchanged, assessing that the degree of monetary accommodativeness after the normalisation to the degree in January was consistent with the policy stance to ensure that the

domestic economy continues on a steady growth path amid lower inflation. In late March, the Bank had released its 2018 forecast for sustained growth of within 5.5% – 6.0%, and for lower headline inflation within the range of 2.0% – 3.0%.

Although there are downside risks to global growth prospects from potential worsening trade and geopolitical tensions and subsequent volatility in the international financial markets, risks to the global growth outlook remained balanced. However, the MPC will continue to monitor closely the evolving balance of risks to the economic outlook, including the impact of the OPR adjustment in January 2018.

Despite the recent intermittent volatility due to external developments, domestic financial markets have remained resilient. The financial sector is strong and monetary, financing and financial conditions are supportive of economic growth in the post-election environment. The Bank's monetary operations will continue to ensure that domestic liquidity conditions remain sufficient to support the orderly functioning of the domestic financial markets.

Other policy highlights

In view of the proliferation of digital currencies in Malaysia and its associated risks, the Bank has issued a policy document setting out the obligations of digital currency exchangers (DCE) as reporting institutions under the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA). This aims to support surveillance activities and provide effective safeguards against money laundering/ terrorism financing (ML/TF) risks associated with the use of digital currencies. It also serves to increase the transparency of digital currency activities in Malaysia. The list of new reporting institutions is published on the Bank's website.

A key development to foster an enabling environment for the wider adoption of mobile payments to complement debit cards in displacing cash is the issuance of the Interoperable Credit Transfer Framework (ICTF) by the Bank, which will be effective on 1 July 2018. The ICTF promotes collaborative competition (co-opetition) between banks and non-bank e-money issuers by fostering collaboration at the infrastructure level to expand network reach and lower costs, while promoting competition at the product level to enhance service levels and customer experience. Payments Network Malaysia Sdn Bhd (PayNet), the operator of the country's shared payment infrastructure, will provide banks and eligible non-bank e-money issuers with open and fair access to its payment and clearing infrastructure. This will be facilitated by the Real-time Retail Payments Platform (RPP) targeted to be launched by PayNet in 3Q 2018, which would enable payments to be made

conveniently between bank accounts and e-money accounts through the use of common identifiers (e.g. mobile phone numbers, NRIC numbers or business registration numbers) and a common Quick Response (QR) code.

The Bank also issued strengthened requirements on the management of credit risk by financial institutions in January 2018. The revised standard aims to further elevate credit risk management practices across the industry given an increased diversity of product offerings, overseas expansion of financial institutions' operations and the growing role of capital markets as an alternative source of financing particularly for large corporates. Requirements under the enhanced standard will take effect on 1 July 2018 for banking institutions. These requirements will also be made applicable, for the first time, to financial holding companies, insurers and takaful operators, with a longer transition period until 1 July 2019 and 1 January 2021 to comply with the standard.

As part of efforts to encourage and preserve a strong and ethical culture within financial institutions, beginning 1 July 2018, financial institutions are required to undertake mandatory screening of prospective new hires. This involves employment reference checks with past and current employers of new hires, and an obligation placed on all financial institutions to investigate conduct breaches by their employees, maintain records and disclose relevant information in response to reference checks. Improved transparency on conduct histories of individuals is intended to facilitate financial institutions in making informed hiring decisions.

Macroeconomic Outlook

HIGHLIGHTS

- Global growth to expand at a faster pace in 2018, supported by synchronised growth in both advanced and emerging market economies.
- Growth in the Malaysian economy is expected to remain favourable in 2018.
- Headline inflation is expected to moderate in 2018 due mainly to a smaller contribution from global cost factors and a stronger ringgit compared to 2017.

Global growth to expand at a faster pace

Global growth is projected to strengthen in 2018. This outlook is underpinned by synchronised expansions in both the advanced and emerging market economies.

In advanced economies, economic activity will be supported by continued improvements in labour market conditions, with expectations for wage growth to pick up and boost private consumption. In the US, the Tax Cuts and Jobs Act is likely to encourage further investment in the near term, as businesses benefit from corporate tax cuts and increased deductions for capital spending. Higher public spending is expected, following the February 2018 bipartisan budget agreement.

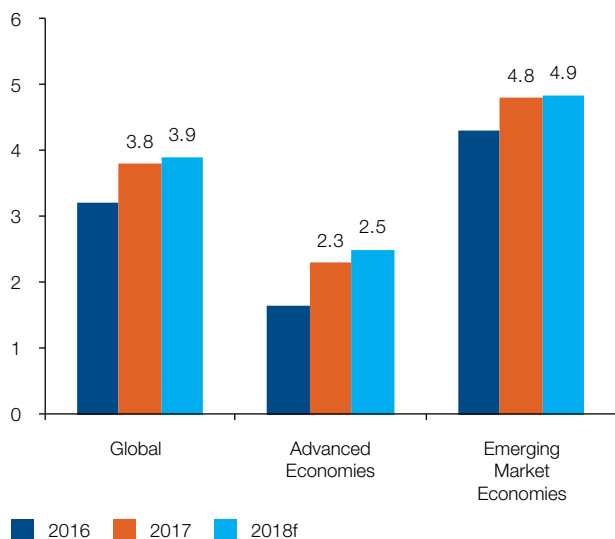
The Asian region, through trade channels, will continue to benefit from strong domestic demand in the advanced economies. Expansionary fiscal measures, namely higher infrastructure spending, will complement the strength in external demand throughout 2018.

However, there remain risks to the global growth outlook. Upside risks include higher-than-expected investment growth due to the pro-cyclical fiscal policy in the US and stronger wage growth in the advanced economies, which can also lead to positive spillovers to the rest of the world through trade. On the downside, a significant risk stems from trade conflict between major economies. While the direct impact of

Growth improvements projected across regions

Chart 35: GDP Growth

Annual change (%)

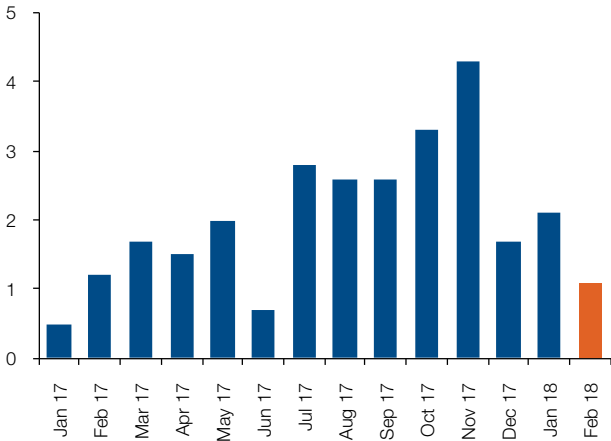


Source: IMF World Economic Outlook (April 2018)

Leading indicators suggest continued expansion in the domestic economy

Chart 36: Composite Leading Index

Annual change (%)

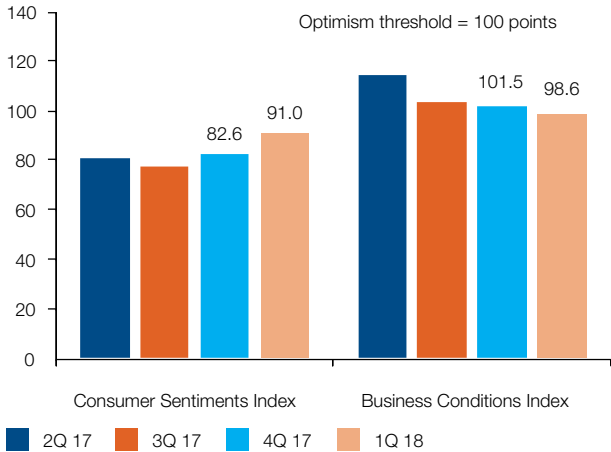


Source: Department of Statistics, Malaysia

Consumer Sentiments Index continued to improve

Chart 37: MIER Consumer Sentiments and Business Conditions Index

Points



Source: Malaysian Institute of Economic Research (MIER)

the measures implemented so far is expected to be small, an escalation of current tensions may dampen investor sentiment, triggering financial market volatility. Uncertainty regarding the timing, pace and magnitude of monetary policy normalisation in major economies, potential reversals of capital flows in emerging markets, and a sudden escalation of geopolitical tensions also pose downside risks to the global economic outlook.

Growth in the Malaysian economy to remain favourable in 2018

In 2018, growth is projected to remain favourable, with domestic demand as the key driver of growth. The positive growth prospects are supported by continued spillovers from the external sector to domestic economic activity. Trade performance is expected to benefit from favourable global demand, new export production capacity and exposure to the global technology cycle.

On the domestic front, leading indicators such as the Department of Statistics Malaysia’s Composite Leading Index, MIER Business Conditions Index and MIER Consumer Sentiments Index point toward continued expansion of the economy. Private consumption will be underpinned by continued wage and employment growth, with support from Government measures. Investment activity will be supported by capital spending for new and ongoing projects amid positive business sentiments.

Headline inflation to moderate in 2018 due mainly to a smaller contribution from global cost factors

For 2018 as a whole, headline inflation is projected to average within the range of 2 to 3%, given expectations of a smaller contribution from global cost factors and a stronger ringgit exchange rate compared to 2017.

While inflation is expected to moderate in 2018, the trajectory will depend on future global oil prices which remain highly uncertain. In particular, the near-term upside risks to global oil prices have increased, amid the rising geopolitical tensions in the Middle East and the potential extension to OPEC's oil output cut agreement.

Underlying inflation, as measured by core inflation, is also expected to remain moderate in 2018, due to a smaller cost pass-through to retail prices compared to the previous year. Given the lack of persistent and broad-based wage pressures, and on-going investments for capacity expansion, demand-driven inflationary pressures are expected to be contained.

Feature
Article

Improving Quality and Transparency of Services to Financial Consumers

Authors: Aidora Mubarak and Nor Amalia Che Azhar

HIGHLIGHTS

- Continuous efforts have been taken by banking institutions and Bank Negara Malaysia to improve the quality of banking services in order to provide better banking experiences to financial consumers.
- In 2017, an enhanced Customer Service Charter was published and a Customer Satisfaction Index survey was conducted for the banking sector.
- The enhanced Customer Service Charter and the establishment of a Customer Satisfaction Index are expected to further elevate the quality and transparency of banking services to financial consumers through increased competition among banks and greater financial consumer activism.
- The banking sector scored an overall Customer Satisfaction Index of 74.3 against the level of global excellence of 80.0.

Introduction

The delivery of high quality and transparent customer services by financial service providers (FSPs) is key in ensuring financial consumers' trust and confidence in the financial system. FSPs gain competitive advantage by building customer loyalty through the provision of services that meet and exceed customers' expectations. This is particularly important in the current environment of intense competition within and from outside of the financial industry, where non-bank financial institutions and financial technology providers are offering more choices to financial consumers.

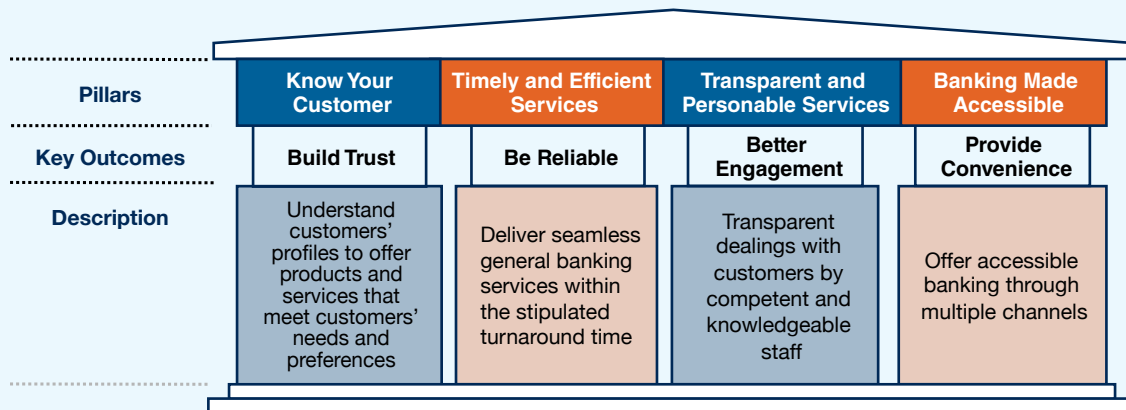
To promote and maintain high standards of transparency and quality in FSPs' delivery of services to financial consumers, Recommendation 5.2.7 of the Financial Sector Blueprint 2011-2020 advocates the publication of customer charters by all FSPs, with processes in place for measuring performance against the published charters. In line with this recommendation, the banking institutions through the Association of Banks in Malaysia (ABM) and the Association of Islamic Banking and Financial Institutions Malaysia (AIBIM), collaborated with Bank Negara Malaysia (the Bank) to publish an enhanced Customer Service Charter and conduct a Customer Satisfaction Index survey on banking services in 2017.

Publication of the Customer Service Charter

In an effort led by ABM, Customer Service Charters were first published by all banks in 2011. Despite having the Charter in place, 60.0% of complaints received by the Bank from banking customers between 2011 and 2016 were on operational inefficiencies and poor customer service.

In light of these observations and to reflect higher expectations of service quality among financial consumers, ABM and AIBIM introduced a new Customer Service Charter for the banking sector in September 2017. The new Charter focuses on service quality based on four main pillars (Diagram 1). It sets out more specific and measurable service standards, including commitments by banks to observe minimum acceptable standards on turnaround time for common and routine banking services, such as opening of accounts, processing of loan applications and handling of complaints.

Diagram 1: Four Pillars of the New Charter Focus on Service Quality



Source: Association of Banks in Malaysia and Association of Islamic Banking and Financial Institutions Malaysia

The Customer Satisfaction Index (CSI) survey

The CSI survey was conducted by the Malaysia Productivity Corporation to assess financial consumers' expectations and actual experiences with banking services against the standards set in the new Charter. It also served to establish a CSI for the banking sector, against which the performance of individual banks can be benchmarked. The CSI survey will be carried out once in every two years. Eighteen¹ member banks of ABM and AIBIM with a significant size of retail banking business participated in the survey. Fieldwork for the survey took place between October and November 2017, covering a total of 4,500 respondents (250 respondents per bank) across Malaysia.

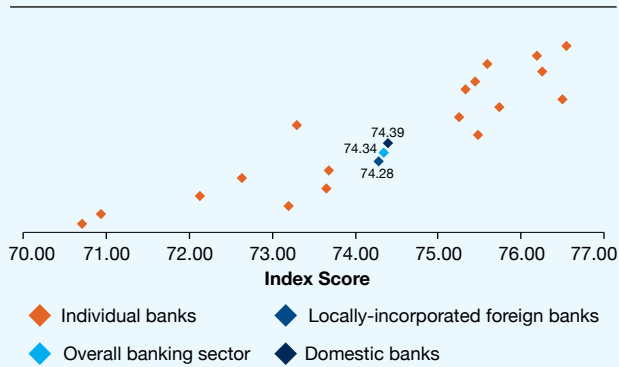
The CSI is measured on a scale of 0 to 100, based on the American CSI (ACSI) model. It assesses banking customers' expectations and actual experiences on 16 indicators which build upon the four pillars of the new Charter.

Against the global benchmark for excellent banking services at 80.0, the Malaysian banking sector's CSI score for 2017 was 74.3. Across individual participating banks, differences between the CSI scores were observed to be marginal, ranging between 70.71 and 76.54 (Chart 1). As the survey does not probe and control for differences in the level of expectations that may be formed by customers of different banks, it should be noted that the results may be shaped by these differences. To the extent that efforts were made to achieve a comparable demographic representation of respondents for each bank, the differences are not assumed to be significant, although this will be an area for future refinements to the survey.

¹ The 18 banks are:

- Banking groups (comprised of commercial and Islamic banks of the groups in Malaysia) – (1) Affinbank Group, (2) Alliance Group, (3) AmBank Group, (4) CIMB Group, (5) Hong Leong Group, (6) HSBC Group, (7) Maybank Group, (8) OCBC Group, (9) Public Bank Group, (10) RHB Banking Group and (11) Standard Chartered Group;
- Locally-incorporated foreign banks – (12) Citibank and (13) United Overseas Bank; and
- Stand-alone Islamic banks – (14) Agrobank, (15) Al Rajhi Bank, (16) Bank Islam, (17) Bank Muamalat and (18) Bank Rakyat.

Chart 1: Marginal Differences in the CSI Scores Should Motivate Banks to Further Compete in Achieving a Higher Customer Satisfaction Level



Source: Malaysia Productivity Corporation

The publication of the CSI scores is expected to drive sustained improvements in service quality for the banking sector in Malaysia. Findings from the CSI survey also provide visibility for the banking sector to identify and pursue collective measures that can further improve service quality. This would be particularly relevant in the context of industry infrastructural enhancements and process improvements that are dependent on third parties. The next CSI survey will be conducted in 2019.

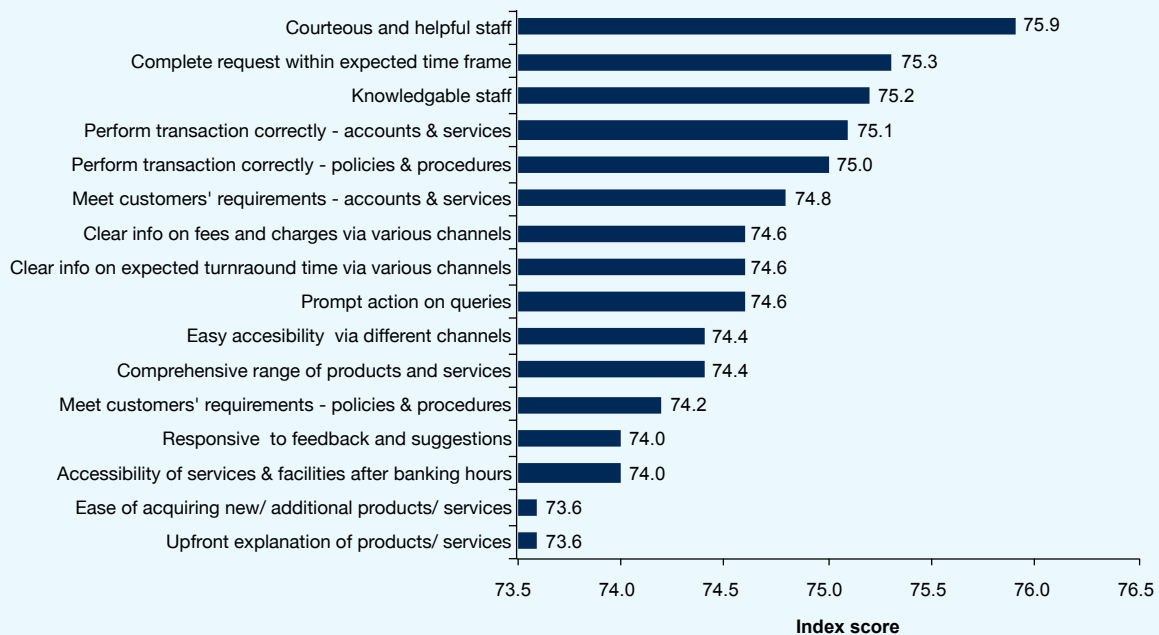
Based on the respondents' feedback, areas that scored the highest on customer satisfaction were (Chart 2):

- courtesy and helpfulness of banking staff (75.9);
- timeliness in completing transactions (75.3); and
- staff's knowledge and understanding of customers' financial needs and in offering suitable solutions (75.2).

Conversely, areas which scored the lowest were:

- transparency of information on products and services to customers at the point of sale (73.6); and
- the ease of acquiring new/additional products and services (73.6).

Chart 2: Continuous Improvements Required on All Aspects of Customer Service to Achieve Higher Level of Excellence



Source: Malaysia Productivity Corporation

Several recent global studies identify the key drivers of customer satisfaction in retail banking services to include competent and skilled bank staff, quality of products and services offered, the ease of carrying out banking transactions (which includes a positive digital experience in interactions with banks) and timeliness of services. Addressing these drivers are therefore likely to lead to higher levels of customer satisfaction and loyalty.

The results of the CSI survey indicate that while the Malaysian banking sector performed reasonably well against customers' expectations in terms of having competent staff to assist and advice customers and delivering services within expected time frames, further attention to the following areas is important to improve customer satisfaction:

- ensuring that products and services are delivered as customers have been led to expect;
- enriching the digital experience (via internet and mobile banking) to make it easier and more convenient for customers to access banking services; and
- elevating the professionalism of staff, particularly in providing credible advice and proactively managing customer relationships across all customer segments.

Complaints handling

To provide additional insights on customer service quality, respondents were asked about how their respective banks handled their complaints. Among 183 respondents who have lodged complaints with the participating banks in the last three months, 47.5% considered that their complaints were handled well and 39.9% rated complaints handling at an average level. The remaining 12.6% responded that their complaints were handled poorly. Specific suggestions offered by respondents for banks to deliver a more positive experience in addressing customer complaints included the following:

- ensure that staff are courteous, friendly, accountable and competent to understand and effectively address/resolve complaints lodged;
- ensure prompt responses to non face-to-face complaints (for example, complaints lodged through phone calls or emails);
- simplify processes to enable complainants to quickly reach the right section/staff;
- strive to provide first touch point resolutions. Where follow up is required, banks should acknowledge and provide regular and meaningful updates on the status of the complaints and strive to resolve them in a timely manner; and
- ensure adequate resources at bank branches with appropriate authority given to resolve complaints without having to refer to banks’ head offices in Kuala Lumpur.

Customer experience – efficiency of service delivery channels

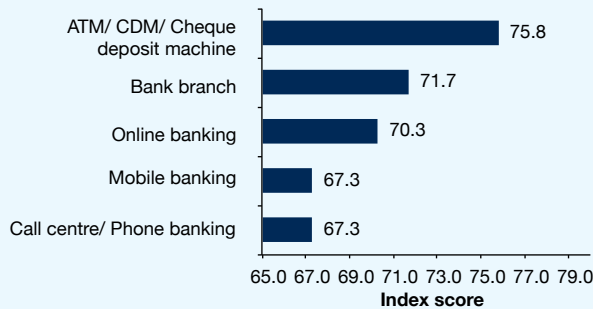
The CSI survey also sought to determine financial consumers’ experiences with various delivery channels provided by banks (Chart 3). Customers were reasonably satisfied with services provided through self-service terminals (SSTs)³ and bank branches, but indicated a few areas for improvement:

- increase the number of ATMs and CDMs on bank premises and in areas with no bank branches;
- improve efficiency and uptime of ATMs and CDMs, particularly during peak hours, public holidays and weekends. Banks should ensure that machines which are out of service are promptly repaired;
- enable withdrawal of smaller currency denominations from ATMs (such as RM10 and RM20 notes); and
- reduce waiting time for over-the-counter transactions at bank branches.

Mobile banking and call centre/phone banking services were rated relatively poorly in terms of customer satisfaction. Given the important influence of a positive digital experience on customer satisfaction, banks should increase efforts to:

- improve the functionality of mobile banking applications to be more agile and responsive to changing customer requirements;
- make mobile banking applications more user-friendly; and
- improve the level and quality of customer support at banks’ call centres.

Chart 3: Financial Consumers’ Experience on Service Delivery Channels Can Be Further Enhanced



Source: Malaysia Productivity Corporation

³ SSTs comprise of automated cash machines (ATMs), cash deposit machines (CDMs) and cheque deposit machines.

Implications for banks' strategies

Feedback from the survey suggest a number of important implications for banks' strategies to improve service quality.

- **Re-defining role profiles and requirements for staff in customer-facing roles to provide appropriate emphasis on customer-centricity.** This should serve to drive and align recruitment activities, incentive structures and coordination across business functions to deliver a superior customer experience. New and distinct competencies which can be leveraged by banks to differentiate themselves will also become more important. For example, customer-facing staff who are not only responsive to customers, but who can also harness behavioural insights from interactions with customers to generate new ideas for improving service quality could be key catalysts to transform the way banks meet their customers' needs.
- **Providing a stronger focus on consistent standards.** In an environment where customer experiences are easily and widely shared in real time through social media platforms, ensuring consistent standards at every touch point is critical for banks to achieve and maintain strong reputations. This should be supported by clearly defined service standards and a robust process for evaluating performance against those standards. Some financial institutions have required staff in customer-facing roles to be accredited against globally benchmarked service quality and performance standards. This serves to provide management with assurance of the organisation's ability, through its people, to deliver high and consistent service quality standards across the organisation. It has also been effectively used to identify and close development gaps at the individual level.
- **Enabling technology-focused solutions to customer service.** Internal limitations (due to talent constraints and legacy systems) need to be well-understood and overcome by banks to leverage more effectively on technology to raise customer service standards. This is likely to involve a re-think of competitive strategies, with strategic collaborations across the industry (e.g. to adopt common technology standards and develop shared platforms), and with fintech companies featuring more prominently in the banking sector. Several banks have already taken steps in this direction as evidenced by innovation labs set up to develop technological solutions to identified customer service issues.
- **Streamlining information and workflow processes to provide a seamless banking experience.** Information and an efficient workflow are the plumbing behind a superior customer experience. This ultimately determines how quickly, accurately and holistically a bank can respond to a customer issue or need. It is imperative that banks continuously review existing arrangements to ensure smooth and efficient workflow and timely access to high quality customer information across the bank. Feedback loops should be in place to inform such reviews.

Conclusion

The new Customer Service Charter and the CSI survey aim to direct and sustain a strong focus of banks on continuously improving the quality and transparency of banking services to financial consumers. The Charter serves to empower consumers and holds banks accountable for meeting service standards that they have committed to their customers. Observations from the survey offer valuable insights for banks to consider and implement specific strategies to not only meet, but exceed customers' expectations. It is important that such strategies should also reflect more fundamental changes within banks that are needed to deliver a superior customer experience.

The new Charter and the CSI survey's executive summary are available in the websites of ABM (www.abm.org.my) and AIBIM (www.aibim.com). Financial consumers will also be able to access the individual banks' Charters at their respective websites and branches.

References

Bank Negara Malaysia (2011): 'Recommendation 5.2.7', Financial Sector Blueprint 2011-2020, Page 159-160.

Association of Banks in Malaysia (2011): Customer Service Charter.

Association of Banks in Malaysia and Association of Islamic Banking and Financial Institutions Malaysia (2017): Customer Service Charter – Service Standards.

Malaysia Productivity Corporation and Market Insights (2018): Executive Summary of Customer Satisfaction Index 2017.

CFI Group (2016): Bank Satisfaction Barometer 2016 (BSB).

Accenture (2015): Banking Customer 2020: Rising Expectations Point to the Everyday Bank.

Annex



Table 1:

GDP by Expenditure Components (at constant 2010 prices)

	Share 2017 (%)	2017			2018
		1Q	4Q	Year	1Q
		Annual growth (%)			
Aggregate Domestic Demand (excluding stocks)	92.2	7.7	6.2	6.5	4.1
Private sector	71.1	8.2	7.4	7.5	5.2
<i>Consumption</i>	53.7	6.7	7.0	7.0	6.9
<i>Investment</i>	17.4	12.9	9.2	9.3	0.5
Public sector	21.0	5.8	3.4	3.3	-0.1
<i>Consumption</i>	13.0	7.5	6.8	5.4	0.4
<i>Investment</i>	8.0	3.2	-1.4	0.1	-1.0
Net Exports	7.7	-15.3	2.3	-1.9	62.4
<i>Exports of Goods and Services</i>	72.8	9.8	6.7	9.4	3.7
<i>Imports of Goods and Services</i>	65.1	13.0	7.3	10.9	-2.0
GDP	100.0	5.6	5.9	5.9	5.4
GDP (q-o-q growth, seasonally adjusted)	-	1.7	1.0	-	1.4

Source: Department of Statistics, Malaysia

Table 2:

GDP by Economic Activity (at constant 2010 prices)

Annual growth (%)	Share 2017 (%)	2017			2018
		1Q	4Q	Year	1Q
Services	54.5	5.8	6.2	6.2	6.5
Manufacturing	23.0	5.6	5.4	6.0	5.3
Mining	8.4	1.4*	-0.3	1.0	0.1
Agriculture	8.2	8.4*	10.7	7.2	2.8
Construction	4.6	6.6*	5.9*	6.7	4.9
Real GDP	100.0¹	5.6	5.9	5.9	5.4

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

* Revised

Source: Department of Statistics, Malaysia

Table 3

Trade Account					
	Share 2017 (%)	2017			2018
		1Q	4Q	Year	1Q
		Annual growth (%)			
Gross Exports	100.0	21.4	12.4	18.9	5.8
Manufactured	82.1	19.5	14.2	18.9	8.2
E&E	36.7	18.4	14.7	19.2	11.8
Non-E&E	45.4	20.3	13.7	18.6	5.5
Resource based	22.9	29.9	9.9	19.3	0.6
Non-resource based	22.5	11.4	17.8	18.0	10.7
Commodities	17.0	27.7	4.3	17.2	-4.8
Agriculture	8.4	29.6	-2.1	10.9	-9.9
Minerals	8.6	25.9	10.8	23.9	-0.1
Gross Imports	100.0	27.7	14.4	19.9	-0.8
Intermediate goods	57.1	27.8	9.0	20.0	-10.5
Capital goods	13.8	42.1	17.1	15.3	-13.0
Consumption goods	8.5	4.0	4.7	6.1	2.3
Others (including re-exports and dual-use goods)	20.6	29.5	32.4	30.2	37.3
Trade balance (RM billion)	-	18.9	27.7	97.2	33.4

Source: Department of Statistics, Malaysia

Table 4:

Malaysia's Direction of Exports					
	Share 2017 (%)	2017			2018
		1Q	4Q	Year	1Q
		Annual change (%)			
European Union (EU)	10.2	22.2	11.0	19.4	5.2
Japan	8.0	18.4	10.3	17.5	-5.8
United States	9.5	11.9	7.9	10.5	2.1
ASEAN¹	29.2	23.8	12.2	18.0	2.4
North East Asia	24.2	23.9	21.5	25.3	21.7
People's Republic of China	13.5	39.8	11.8	28.0	0.3
Hong Kong SAR	5.1	10.0	51.2	26.8	82.8
Korea	3.1	-2.1	34.0	24.8	22.8
Chinese Taipei	2.5	13.8	6.2	11.3	25.6
West Asia²	2.7	6.8	1.6	10.6	-11.8
India	3.7	13.8	-5.3	8.0	9.9
Total exports	100.0	21.4	12.4	18.9	5.8

¹ Singapore, Thailand, Indonesia, Philippines, Brunei Darussalam, Vietnam, Cambodia, Myanmar and Laos² United Arab Emirates, Saudi Arabia, Oman, Iraq, Qatar, Kuwait, Jordan, Lebanon, Bahrain, Syria, Palestine, Yemen and Iran

Source: Department of Statistics, Malaysia

Table 5:

Balance of Payments¹

	2017			2018
	1Q	4Q	Year	1Q
	RM billion			
Current Account	4.8	13.9	40.3	15.0
(% of GNI)	1.5	4.0	3.1	4.5
Goods	25.0	34.1	116.8	35.7
Services	-6.2	-7.0	-22.8	-5.8
Primary income	-10.1	-8.4	-36.4	-10.2
Secondary income	-3.9	-4.8	-17.3	-4.7
Financial Account	-8.3	6.0	3.8	15.2
Direct investment	9.2	5.3	16.1	10.7
Assets	-2.1	-0.6	-24.9	-3.1
Liabilities	11.3	5.9	41.0	13.8
Portfolio investment	-32.4	11.6	-12.3	-2.6
Assets	-9.0	3.5	-16.4	-10.5
Liabilities	-23.4	8.1	4.1	7.9
Financial derivatives	0.6	-1.5	-0.1	0.8
Other investment	14.2	-9.5	0.1	6.4
Net errors & omissions ²	1.3	-17.7	-27.6	-12.0
Overall Balance	-2.2	2.1	16.4	18.2

Assets: (-) denotes outflows due to the acquisition of assets abroad by residents

Liabilities: (+) denotes inflows due to the incurrence of foreign liabilities

¹ In accordance with the Sixth Edition of the Balance of Payments and International Investment Position Manual (BPM6) by the International Monetary Fund (IMF)

² As at 1Q 2018, quarterly net E&O excludes reserves revaluation changes. This practice is backdated up to 1Q 2010.

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 6:

Outstanding External Debt

	2017		2018
	end-Mar	end-Dec	end-Mar
	RM billion		
Total External Debt	894.2	879.8	893.4
<i>USD billion equivalent</i>	200.1	214.6	229.0
By instrument			
Bond and notes ¹	169.0	152.7	142.2
Interbank borrowing ¹	211.6	172.6	168.0
Intercompany loans ¹	137.3	126.1	126.0
Loans ¹	37.3	49.6	81.7
NR holdings of domestic debt securities	176.4	207.4	210.2
NR deposits	77.8	91.1	87.8
Others ²	84.7	80.4	77.6
Maturity profile			
Medium and long-term	488.4	500.4	495.7
Short-term	405.7	379.3	397.7
Currency denomination			
Ringgit	271.8	302.9	310.6
Foreign	622.4	576.9	582.8
Total debt/GDP (%)	66.1	65.0	61.8
Short-term debt/Total debt (%)	45.4	43.1	44.5
Reserves/Short-term debt (times)	1.0	1.1	1.1 ³

¹ These debt instruments constitute the offshore borrowing.

² Comprise trade credits, IMF allocation of SDRs and miscellaneous.

³ Based on international reserves as at 30 April 2018.

Note: NR refers to non-residents

Source: Ministry of Finance and Bank Negara Malaysia

Table 7:

Financing of the Private Sector through the Banking System, DFIs and Capital Market

	2017				2018	2017			2018
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q	
	Change during the period (RM billion)				Annual growth (%)				
Net total financing	36.8	42.5	138.2	37.1	6.8	6.4	6.4	6.3	
Outstanding loans ¹	15.4	22.2	63.1	18.4	6.0	3.8	3.8	3.9	
<i>Of which:</i>									
Business enterprises	8.7	-2.3	8.1	8.9	7.1	1.3	1.3	1.3	
SMEs	3.5	5.1	15.9	3.0	9.3	5.3	5.3	5.1	
Non-SMEs	5.3	-7.5	-7.8	5.8	5.0	-2.5	-2.5	-2.3	
Households	8.2	16.7	46.6	11.4	5.4	4.9	4.9	5.2	
Outstanding corporate bonds	21.4	20.3	75.1	18.7	9.8	15.4	15.4	14.2	

^{*} Includes loans sold to Cagamas

¹ Banking system and development financial institution (DFIs)

Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Table 8:

Loan Indicators

	2017			2018	2017			2018
	1Q	4Q	Year	1Q	1Q	4Q	Year	1Q
	During the period (RM billion)				Annual growth (%)			
Total								
Loan applications ¹	197.5	217.5	841.2	209.0	5.9	9.5	5.1	5.8
Loan approvals ¹	87.4	104.1	380.1	90.3	15.0	11.9	10.2	3.3
Loan disbursements ²	292.4	306.3	1,158.3	297.0	7.6	3.4	5.0	1.6
Loan repayments ²	289.4	297.1	1,146.9	293.0	5.4	6.9	6.7	1.2
Of which:								
Business enterprises³								
Loan applications	86.4	99.9	370.1	94.2	-0.1	8.1	-1.1	9.1
Loan approvals	40.9	51.6	177.7	39.7	17.0	11.2	8.4	-3.0
Loan disbursements	213.8	219.7	835.9	210.2	9.1	0.9	4.8	-1.7
Loan repayments	210.2	216.4	834.0	206.0	5.2	5.4	6.6	-2.0
SMEs								
Loan applications	41.1	47.7	177.2	44.0	1.8	3.4	-2.5	7.0
Loan approvals	13.9	18.5	64.6	15.1	4.0	-4.3	-2.6	8.3
Loan disbursements	71.8	78.4	296.3	75.9	15.3	8.6	10.8	5.7
Loan repayments	69.8	73.4	286.1	74.7	15.4	7.9	9.8	7.0
Non-SMEs³								
Loan applications	45.2	52.2	192.8	50.2	-1.8	12.7	0.2	11.0
Loan approvals	27.0	33.1	113.1	24.6	25.0	22.2	15.9	-8.8
Loan disbursements	142.0	141.3	539.6	134.3	6.3	-3.0	1.8	-5.4
Loan repayments	140.4	143.1	548.0	131.3	0.8	4.2	5.0	-6.5
Households								
Loan applications	111.1	117.6	471.1	114.8	11.1	10.7	10.5	3.3
Loan approvals	46.5	52.5	202.4	50.6	13.3	12.6	11.8	8.9
Loan disbursements	78.6	86.6	322.4	86.8	3.6	10.5	5.3	10.4
Loan repayments	79.1	80.6	312.9	87.0	5.9	11.1	7.1	9.9

¹ Loan applications and approvals for all segments include only banking system loans

² Loan disbursements and repayments for all segments include the banking system and development financial institutions (DFIs)

³ Includes domestic non-bank financial institutions, domestic financial institutions, government, domestic other entities and foreign entities

Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Table 9:

Banking System Profitability Indicators

	2017				2018
	1Q	2Q	3Q	4Q	1Q
Return on equity (%)	11.8	12.7	12.8	13.0	12.5
Return on assets (%)	1.3	1.4	1.4	1.5	1.4
	RM million				
Net interest income	11,314	11,622	11,705	11,662	12,061
Add: Fee-based income	2,538	2,527	2,452	3,036	2,665
Less: Operating cost ¹	7,610	7,670	7,589	8,167	8,132
Gross operating profit	6,242	6,478	6,568	6,530	6,594
Less: Impairment ² and other provisions	301	823	528	415	645
Gross operating profit after provision	5,941	5,655	6,040	6,115	5,949
Add: Other income	2,021	3,577	3,023	3,838	3,053
Pre-tax profit	7,962	9,233	9,063	9,953	9,002
	Annual growth (%)				
Return on equity (<i>percentage points</i>)	-0.5	-0.4	0.014	0.5	0.7
Return on assets (<i>percentage points</i>)	0.0	0.0	0.030	0.1	0.1
Net interest income	6.5	9.6	9.8	5.2	6.6
Add: Fee-based income	4.3	13.0	12.4	20.0	5.0
Less: Operating cost	4.6	4.6	4.1	8.1	6.9
Gross operating profit	8.0	17.7	18.3	7.7	5.7
Less: Impairment and other provisions	-63.2	11.2	17.3	-40.2	114.5
Gross operating profit after provision	19.7	18.8	18.4	13.9	0.1
Add: Other income	-26.3	-13.4	6.1	64.7	51.1
Pre-tax profit	3.3	3.8	14.0	29.3	13.1

¹ Refers to staff cost and overheads² Refers to individual and collective impairment provisions in accordance with the Policy Document on Classification and Impairment Provisions for Loans / Financing

Table 10:

Insurance and Takaful Sector Indicators

	2017				2018
	1Q	2Q	3Q	4Q	1Q
	RM million				
Life Insurance & Family Takaful					
<i>Excess of Income Over Outgo</i>	6,122	4,413	3,518	4,918	4,040
General Insurance & General Takaful					
<i>Operating profit</i>	495	762	654	783	563
<i>Claims ratio (%)</i>	63	55	61	55	57
	Annual growth (%)				
Life Insurance & Family Takaful					
<i>Excess of Income Over Outgo</i>	32.4	67.8	-34.2	647.7	-34.0
General Insurance & General Takaful					
<i>Operating profit</i>	-36.3	-10.6	-26.2	-12.1	13.8
<i>Claims ratio (percentage points)</i>	8.8	-1.2	4.8	-1.7	-6.0

Source: Bank Negara Malaysia

Table 11:

Federal Government Finance^P

	2017			2018
	1Q	4Q	Year	1Q
	RM billion			
Revenue	46.6	64.6	220.4	54.3
<i>% annual growth</i>	-4.4	8.0	3.8	16.5
Operating expenditure	57.6	58.3	217.7	54.9
<i>% annual growth</i>	0.3	16.7	3.6	-4.6
Current account	-10.9	6.3	2.7	-0.6
<i>% of GDP</i>	-3.4	1.8	0.2	-0.2
Net development expenditure	9.3	13.4	43.0	10.8
<i>% annual growth</i>	1.7	-1.9	5.9	15.5
Overall balance	-20.2	-7.2	-40.3	-11.3
<i>% of GDP</i>	-6.2	-2.0	-3.0	-3.3
Memo:				
Total net expenditure	66.9	71.8	260.7	65.7
<i>% annual growth</i>	0.5	12.7	3.9	-1.8
Total Federal Government debt (as at end-period)	664.5	686.8	686.8	705.0
<i>% of GDP</i>	49.1	50.7	50.7	48.7
Domestic Debt	489.5	484.1	484.1	499.5
<i>% of GDP</i>	36.2	35.8	35.8	34.5
External Debt	175.0	202.8	202.8	205.5
<i>% of GDP</i>	12.9	15.0	15.0	14.2
<i>Non-resident holdings of RM-denominated</i>				
<i>Federal Government debt</i>	156.7	186.2	186.2	189.6
<i>% of GDP</i>	11.6	13.8	13.8	13.1
<i>Offshore borrowing</i>	18.3	16.6	16.6	15.9
<i>% of GDP</i>	1.4	1.2	1.2	1.1

^P Preliminary

Note: Numbers may not add up due to rounding

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia