



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Statutory Requirements

In accordance with section 13 of the Central Bank of Malaysia Act 2009, Bank Negara Malaysia hereby publishes and has transmitted to the Minister of Finance a copy of this Annual Report 2016 together with a copy of its Financial Statements for the year ended 31 December 2016, which have been examined and certified by the Auditor General. The Financial Statements will also be published in the Gazette.

For the purposes of section 115 of the Development Financial Institutions Act 2002, the annual report on the administration of the Development Financial Institutions Act 2002 and other related matters for the year ended 31 December 2016 is incorporated in Bank Negara Malaysia's Financial Stability and Payment Systems Report 2016 which forms an integral part of this Annual Report 2016.

A handwritten signature in black ink, appearing to read 'Muhammad bin Ibrahim'.

Muhammad bin Ibrahim

Chairman
Board of Directors
23 March 2017

Contents



Governor's Statement

Executive Summary

Economic Developments in 2016

- 13** The International Economic Environment
- 16** The Malaysian Economy
- 24** External Sector
- 30** Inflation Developments
- 33** *Box Article: Understanding the Changing Dynamics of the Current Account of the Balance of Payments in Malaysia*
- 38** *Box Article: Payoffs from Going Global: Assessing the Returns from Malaysia's Direct Investment Abroad*

Monetary and Financial Conditions in 2016

- 47** International Monetary and Financial Conditions
- 49** Domestic Monetary and Financial Conditions
- 58** *Box Article: Exchange Rate Volatility and Disconnect: Structural or Cyclical?*

Monetary Policy in 2016

- 67** Monetary Policy
- 69** Monetary Operations

Contents

Outlook and Policy in 2017

75	The International Economic Outlook
75	The Malaysian Economy
80	External Sector
81	Inflation Outlook
82	Monetary Policy
83	Fiscal Policy
85	<i>Box Article: Structural Reforms in ASEAN-5 Economies: Past Successes and Future Challenges</i>
90	<i>Box Article: Demystifying the Affordable Housing Issue in Malaysia</i>
99	<i>Box Article: Youth Unemployment in Malaysia: Developments and Policy Considerations</i>

Governance, Organisational Development and Communications

109	Governance
113	Organisational Development
119	Communications
123	Organisation Structure
124	List of Senior Officers

Board of Directors and Committees of the Bank

127	Board of Directors
129	Management Committee
131	Monetary Policy Committee
133	Financial Stability Executive Committee
135	Shariah Advisory Council
137	Financial Stability Committee

Annual Financial Statements

145	Statement of Financial Position as at 31 December 2016
146	Income Statement for the Year Ended 31 December 2016
147	Notes to the Financial Statement

Annex



Governor's Statement

2016 was a year of aberrations – a year of departures from the conventional wisdom of global development, characterised by major policy and socio-political shifts. The larger and longer-term impact of these shifts are still unfolding. These developments have become a source of great uncertainty and volatility for the global economy and financial markets. As these developments continue to unfold and shape events, we need to be agile and pragmatic in reviewing and rethinking our strengths and weaknesses in our effort to strengthen the economy's resilience.

Fundamental shifts in political and social dynamics have made the environment increasingly challenging. These add to existing risk factors that remain present, such as uncertainties surrounding the monetary policy path of the US, sharp movements in global commodity prices and the uncertain trajectory of global growth. In 2016, these factors were compounded by unexpected developments such as the UK's EU referendum (Brexit) and the outcome of the US presidential election, which set a new tone for the global economy and its development. In the advanced economies, prospects for policy shifts have added a layer of complexity and uncertainty to the long-shared aims of globalisation, trade integration, and capital and labour mobility. These developments have also brought renewed optimism that fiscal policies would take centre stage in supporting growth in the global economy. But a qualifier is appropriate here. As the fiscal positions of governments get increasingly stretched, we might see a similar fate befalling monetary policy – overburdened and diminished in its effectiveness.

Faced with such a dynamic and challenging environment, it is critical for us to contemplate and renew our resolve. First, there is a need to reflect on and examine the current state of play and the policy choices at hand. Monetary and fiscal policies have their limitations. With greater challenges, new strategies and approaches are therefore needed to support existing policies. Most likely, the use of technology will give us alternative sources of growth. Second, continuous renewals should always be pursued and implemented proactively before events dictate our course of actions. Bold, but pragmatic renewals may be warranted to reduce short-term vulnerabilities, build future resilience and raise productivity. Finally, once these strategic renewals on policies have been agreed upon, there should be strong resolve and perseverance by all stakeholders to carry these policies to their finality.

Reflecting on Malaysia's performance, the domestic economy continued to record commendable growth despite these challenging times, driven by domestic demand. Household spending was supported by continued wage and employment growth, with additional lift from targeted measures for low- and middle-income households. Investment activities continued to be anchored by the ongoing implementation of infrastructure projects and capital spending. On our part, the Bank was pre-emptive in its policy calibration to support the sustainable growth of the Malaysian economy.

The Bank's policy adjustment in 2016 was a pragmatic decision. Timing was key. The Bank took advantage of the window of opportunity to restore the degree of monetary accommodativeness and leveraged on the benign domestic inflationary environment. The policy move was further made possible given the subdued risks of destabilising financial imbalances. Macro- and microprudential, and fiscal policies implemented over the years to contain financial imbalances have been successful and played a central role in complementing monetary policy. Employing a broad toolkit of policies has allowed policy measures to remain well-balanced without the overburdening of any single policy tool.

Likewise, continued efforts have been directed towards optimising the trade-offs between liberalisation strategies and their associated risks. In May 2016, the Bank established the Financial Markets Committee (FMC), drawing from the vast experience of various market participants from different industries. The FMC was entrusted with the mandate of formulating strategies to further develop the domestic financial market and provide an effective engagement platform to discuss potential issues and risks related to financial market development. Since its inception, proactive measures have been introduced to develop the onshore foreign exchange market, mitigate speculative activities and correct imbalances that existed within the onshore foreign exchange market.

Malaysia's continued economic and financial resilience is an outcome of previous and ongoing fundamental reforms and institutional improvements. These reforms have accorded us the capacity and dexterity to navigate through uncertain times. Over the past few decades, Malaysia's successful economic diversification strategies have made the economy more resilient to external shocks while strategic investments in infrastructure have increased the country's growth potential. At the same time, ongoing investments to improve labour mobility and quality will equip the workforce with the relevant skills and readiness to tap new opportunities in a fast-changing environment. The Government has also maintained and committed to the course of fiscal reforms and should achieve its eighth consecutive year of fiscal consolidation in 2017. The resilience of Malaysia's economy is further supported by continued efforts to strengthen our domestic financial and banking system.

It is imperative that we remain disciplined in pursuing the required reforms to preserve our resilience while searching for new sources of growth. Malaysia's economy should be further diversified and deepened to encourage private investments, allowing the public sector to shift resources to other priorities, especially infrastructure. New and diversified sources of revenue are also required to fund new infrastructure that can advance Malaysia's transition towards becoming a high value-added, high-income nation. Malaysia must create a competitive niche in the rapidly evolving new economy. In this respect, the Bank is playing its role by providing a conducive regulatory environment that harnesses the potential of financial technology (FinTech) to modernise, deepen and inject competition to the domestic financial and funding markets.

In embracing technological advancements in the pursuit of new growth opportunities, all segments of society should enjoy the benefits and not be dislocated in the process. It is thus important to strike the right balance between innovation, stability and equality. To this end, the Bank continues to accord priority to financial inclusion. The Bank will also strive to adapt our approach to maintain relevance in the conduct of macroeconomic policies and understanding of issues faced by households and businesses. Various platforms have been established to actively engage households and businesses, such as the establishment of the Financial Ombudsman Scheme to assist the public in their dealings with financial institutions. Granular data analyses are also carried out extensively to deepen our understanding of the impact of shocks and policies. This will enable better and effective policy prescriptions. Moving forward, exploration into big data could become an effective tool in supporting macroeconomic and financial stability analyses.

Beyond the domestic front, the Bank continues to engage in key initiatives that reinforce regional cooperation and integration. Bank Negara Malaysia is committed to deepen regional financial integration through the establishment of the ASEAN Banking Integration Framework (ABIF). The bilateral agreement with Otoritas Jasa Keuangan of Indonesia, for example, allows greater presence of ABIF Qualified ASEAN Banks. Significant achievements have also been made to settle trade and investment in domestic currency. With the operationalisation of bilateral agreements with the Bank of Thailand and Bank Indonesia, businesses will have more options in settling their trade transactions. The Bank continued to take concrete steps to provide the enabling environment that enhances regional macroeconomic and financial stability via collaborative arrangements under ASEAN, ASEAN+3, the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) and the South East Asia Central Banks (SEACEN) Research and Training Centre. Adding to the intellectual cluster in Sasana Kijang, the opening of the World Bank Group Global Knowledge and Research Hub further raises Malaysia's profile as a regional centre of excellence that promotes learning opportunities and enhances thought leadership.

Going forward, plans to further develop Malaysia into a progressive high-income nation have a high probability of success if we remain resolute in our reforms and public policies. This cannot be done single-handedly. It requires collective effort from all policymakers to advance agreed public policies that are well-designed and inclusive. Once these policies have been announced and implemented, we must remain steadfast to ensure policy objectives are met. As an open and liberalised economy, we had enjoyed benefits from open trade and we should continue with this strategy despite rising protectionist sentiments.

The strength of our institutional arrangements has always been tested and proven in times of change and uncertainty. The year 2016 was no exception. Despite these testing times, the foundations laid have accorded us stability and continuity in our policies. For this, the Bank owes Governor Dr. Zeti Akhtar Aziz a deep debt of gratitude for her vast and invaluable contributions. Her visionary leadership has brought the organisation to new heights, setting the Bank on a sure and strong footing to deliver our mandates. The Bank has always adopted an agile and innovative approach and will continue to embrace the necessary changes to ensure we stay relevant and effective. During the year, the Bank allocated additional resources for financial intelligence and enforcement activities as well as implemented measures to enhance our information security and technology. We shall continue to emphasise on the highest standard of excellence in our work, corporate culture and ethical conduct.

Central to the Bank's ability to meet increasing demands is the highest level of dedication and professionalism of the Bank's staff. The Bank values its talent base and is committed to continuously improve talent management and development. On behalf of the Board and the management, I wish to express our appreciation for the commitment and hard work by all the Bank's staff. I am also thankful to the Board of Directors for their continuous support and guidance. The Bank will continue to deliver the mandates entrusted upon us, and in these challenging times, with greater vigour and perseverance.



Muhammad bin Ibrahim

Governor

23 March 2017

Executive Summary



Executive Summary

In 2016, the world economy recorded the lowest growth rate since the Global Financial Crisis. Global trade continued to moderate reflecting the weakness in economic activity. With the exception of some Asian economies, growth was slower in most advanced and emerging economies. The advanced economies expanded more modestly. This was partly due to subdued investment activity amid weak business sentiments and heightened political and policy uncertainties. Emerging economies also experienced a slower growth momentum given the subdued external demand, weak commodity prices and volatile financial markets arising from the heightened global uncertainties. In Asia, while PR China's economy expanded at a more gradual pace due to ongoing reforms and rebalancing towards a consumption-led growth model, many other Asian economies recorded stronger growth. The expansion was driven by higher infrastructure investments and implementation of monetary, fiscal and structural policy measures to support growth. Global inflationary pressures remained low reflecting mainly the weak demand and weak commodity prices, especially crude oil.

Confronted with increasing growth concerns and low inflationary pressures, the stance of macroeconomic policies turned more accommodative in most countries. In the advanced economies, monetary policy continued to be the key policy instrument. The Federal Reserve adopted a more gradual path towards monetary policy normalisation than previously expected, whereas central banks in Australia, New Zealand, Norway and Sweden reduced key policy rates. Along with monetary easing, some advanced economies such as the euro area and Japan also implemented some structural reforms. In Asia, many economies employed a combination of fiscal and monetary measures to bolster domestic economic activity, and continued to pursue structural reforms to enhance economic resilience and support sustainable growth.

As the conventional and unconventional policy space has narrowed, vulnerabilities in many economies have

also increased. Global leverage has risen amid unprecedented quantitative easing, productivity growth has remained low and the benefits from ongoing structural reforms have yet to fully materialise. These were compounded by the heightened political and policy uncertainties in major economies that raised concerns about the future of the global economy going into 2017 and beyond. In this environment, policy makers faced an increasingly daunting task to deliver short-term growth while maintaining steadfastness in undertaking necessary and difficult reforms to achieve sustainable growth over the longer term.

Despite the challenging economic environment, the Malaysian economy registered a commendable growth of 4.2% in 2016. The Annual Report provides an analysis of the developments in the Malaysian economy and outlines the challenges ahead. The report also highlights the Bank's efforts to enhance its governance, organisational development and communications.

The Malaysian Economy in 2016

In 2016, the Malaysian economy recorded a growth of 4.2% (2015: 5.0%) despite considerable external and domestic headwinds. The global economic landscape was challenging given the subdued global demand and low commodity prices. International financial markets were also subjected to heightened uncertainty with significant reversal of capital flows from emerging economies. This was driven by the unexpected political developments in the advanced economies, such as the UK and the US, and the macroeconomic policies adopted by these economies. Domestically, the economy continued to face headwinds from the higher cost of living amid soft employment conditions. Concurrently, business and consumer sentiments were affected by a confluence of global and domestic factors, including the heightened volatility in financial markets and the significant underperformance of the ringgit.

Against these external and domestic challenges, all sectors of the economy recorded a modest expansion during the year. Domestic demand continued to anchor growth, supported mainly by private sector spending. Private consumption growth, in particular, was sustained at 6.1% (2015: 6.0%), supported by continued employment and wage growth following the increase in minimum wage and civil servant salaries. Government measures to boost disposable income such as the temporary reduction in employees' contribution to the Employees Provident Fund (EPF), higher Bantuan Rakyat 1Malaysia (BR1M) payouts and tax relief to lower-income tax payers also supported household spending. Public consumption growth moderated to 1.0% (2015: 4.4%) following the expenditure rationalisation adopted by the Government in early 2016 given the lower petroleum-related revenue because of low crude oil prices. Gross fixed capital formation (GFCF) expanded moderately by 2.7% in 2016 (2015: 3.7%) driven mainly by lower private investment growth due to weak profitability and business sentiments. Public investment recorded a smaller rate of decline in 2016 (-0.5%; 2015: -1.0%) due to the smaller contraction in spending on fixed assets by public corporations given the higher investment in the downstream oil and gas industry, and the transportation and utilities sub-sectors.

On the supply side, all economic sectors continued to expand in 2016, with the exception of the agriculture sector. Agriculture production declined by 5.1% (2015: 1.2%), as crude palm oil (CPO) output was affected by the El Niño weather phenomenon. While growth in the services sector was higher at 5.6% (2015: 5.1%) following sustained demand in the consumer-related sectors, other sectors expanded more moderately.

Labour market conditions remained broadly stable as employment and wages continued to expand during the year. Net employment gains during the year amounted to 112,300 jobs, concentrated in the high-skilled segments such as professional and managerial jobs, while aggregate nominal wages in the private and public sectors grew by 4.2% and 6.7%, respectively in 2016 (2015: 4.9% and 4.7%, respectively). While total employment continued to expand, the pace however, was not able to fully absorb new labour market entrants as employers adopted a cautious stance and refrained from expanding their workforce too quickly. Consequently, the unemployment rate rose to 3.5% in 2016 (2015: 3.1%).

Inflationary pressures in the economy remained low with headline inflation averaging 2.1% in 2016 (2015: 2.1%). Despite the weaker ringgit exchange rate during the year, low global energy and commodity prices resulted in lower domestic fuel prices and input costs, which mitigated the impact of adjustments to administered prices and higher food prices caused by the El Niño phenomenon. Core inflation was also relatively stable during the year, averaging 2.1% in 2016 (2015: 2.3%) as demand driven inflationary pressures in the economy remained largely contained. This was underpinned by continued modest growth in private consumption and an absence of significant wage pressures.

Malaysia's external position remained resilient in 2016. The current account of the balance of payments remained in surplus, but by a smaller amount. The narrowing of the current account surplus reflected the lower trade surplus and the persistent structural deficits in the services and income accounts. Growth in gross exports moderated to 1.1% in 2016 (2015: 1.6%), reflecting the subdued global growth and low commodity prices. Gross imports recorded a higher growth of 1.9% (2015: 0.4%) driven by higher imports of capital goods amid the ongoing implementation of infrastructure projects and continued expansion in investment activity.

During the year, the financial account of the balance of payments improved against the environment of significant volatile cross-border capital flows. The financial account recorded a smaller net outflow of RM4.2 billion (2015: net outflow of RM50.9 billion) following a higher net inflow in the direct investment account amid lower net outflows in the portfolio and other investment accounts. During the year, the direct investment account recorded a higher net inflow of RM17.9 billion (2015: net inflow of RM4.8 billion) reflecting the lower direct investment abroad by Malaysian companies. The portfolio investment account recorded net outflows of RM19.7 billion (2015: net outflow of RM28.2 billion).

The international reserves of Bank Negara Malaysia amounted to USD94.5 billion (equivalent to RM423.9 billion) as at end-2016. As at 28 February 2017, the reserves level amounted to USD95.0 billion (equivalent to RM426.3 billion). The international reserves remain ample to facilitate international transactions and sufficient to finance 8.5 months of retained imports and are 1.1 times the short-term external debt. Furthermore,

exchange rate flexibility has enabled the economy to reduce its reliance on the Bank's international reserves.

Malaysia's external debt remains manageable. The external debt stood at RM908.7 billion, equivalent to USD200.6 billion or 73.9% of GDP as at end-2016 (2015: RM833.8 billion). The increase in external debt was partly attributed to valuation effects following the weakening of the ringgit against most currencies during the year. Excluding valuation effects, Malaysia's external debt increased by 6.2%, mainly on account of higher intercompany and interbank borrowings. The profile of Malaysia's external debt remained healthy with more than one-third of total external debt being denominated in ringgit, thus limiting the risks arising from foreign exchange fluctuations. The remaining portion of the external debt, which is denominated in foreign currency, is mostly hedged either naturally using export earnings or through the use of financial instruments. The rollover risks are also contained as more than half of the total external debt is of medium- to long-term maturity. In addition, not all short-term external debts pose a claim on reserves due to the availability of export earnings and external assets which enable borrowers to meet external obligations without necessarily creating a claim on international reserves.

Overall, the strong fundamentals of the Malaysian economy have accorded Malaysia the ability to weather these external and domestic challenges. The diversified sources of growth in the economy have helped to contain the spillover effects of sector-specific shocks. Stable labour market conditions amid continued wage growth continued to support household spending. Healthy financial institutions and ample domestic liquidity also ensured orderly financial intermediation. Notwithstanding the weak global demand, Malaysia's external position remained strong, supported by ample international reserves and manageable levels of external debt.

In addition, an appropriate and timely monetary policy response and targeted pro-growth measures played a key role in supporting growth during the year. The reduction of the Overnight Policy Rate (OPR) by the Bank was complemented by measures to increase household disposable income and support business activities. These included policies to create a conducive ecosystem for a sharing economy to thrive, temporary reduction in employees' EPF contributions, higher BR1M payouts and tax incentives to spur business activities, particularly among the small and medium enterprises (SMEs).

In recognising the impending challenges posed by global and domestic trends such as ageing populations, the influx of new technologies and slower growth in productivity, critical reforms and structural adjustments remained a priority to ensure the future growth of the Malaysian economy is sustained. These include efforts to enhance export competitiveness, ongoing investments to modernise physical and virtual infrastructure and policies to develop a high quality workforce by improving the quality of the education system.

Economic and Monetary Management in 2016

Monetary policy in 2016 was focused on ensuring monetary conditions remained supportive of the sustainable growth of the domestic economy with price stability. This was against a challenging policy environment characterised by material shifts in the balance of risks to the domestic economic outlook and significant volatility in the financial markets. In particular, the risks to domestic growth increasingly shifted to the downside by mid-year, originating from a confluence of external developments including the weaker-than-expected global growth momentum and policy uncertainties in the US and PR China. The challenging external environment was further exacerbated by the uncertainties surrounding the outcome of the UK's European Union (EU) referendum and the increase in global geopolitical risks. Against this downside shift in the risks to growth, the Monetary Policy Committee (MPC) adjusted the degree of monetary accommodativeness by reducing the OPR by 25 basis points to 3.00% on 13 July 2016. The adjustment was a pre-emptive measure aimed at ensuring the Malaysian economy continued on a steady growth path. At the level of 3.00%, the OPR was considered to be consistent with the intended policy stance given the growth and inflation outlook.

Since the adjustment in July, the MPC assessed that the monetary policy stance has remained consistent with the macroeconomic outlook and kept the policy rate unchanged at 3.00% for the rest of the year. The domestic economy remained on track to expand as projected for 2016 and 2017. During the course of the year, the MPC was also vigilant to the heightened degree of volatility in the domestic financial markets and the ringgit exchange rate given shifts in global liquidity and investor sentiments. The MPC emphasised through the Monetary Policy

Statement (MPS) that the Bank would continue to provide sufficient liquidity to ensure the orderly functioning of the domestic financial markets, such that overall domestic liquidity remains sufficient for efficient financial intermediation.

In 2016, the ringgit, along with most major and regional currencies, continued to be influenced by shifts in portfolio flows. For the year as a whole, the ringgit depreciated by 4.3% and ended the year at RM4.486 against the US dollar. In the first four months of the year, the ringgit was broadly on a strengthening trend against the US dollar due to sustained inflows driven mainly by expectations of a delay in the US interest rate normalisation and further monetary easing in advanced economies. Subsequently, sentiments started to shift, and the ringgit, together with several regional currencies, depreciated against the US dollar. Sentiments among investors were affected by persistent expectations of an interest rate increase in the US before year-end, continued volatility in global crude oil prices during this period and geopolitical uncertainty following the UK's referendum to exit the EU. These developments led to a reversal of portfolio flows from emerging market economies, which affected the performance of most of these currencies, including the ringgit. The strength of the US dollar was further reinforced by the anticipation of a faster pace of US interest rate normalisation in 2017 amid expectations of an expansionary fiscal policy in the US following the outcome of the US presidential election. For Malaysia, these developments had contributed to further capital outflows in November and early December, which reversed the earlier gains in the ringgit.

During the year, the volatility of the ringgit exchange rate was exacerbated by speculative activities in the opaque offshore non-deliverable forward (NDF) market, particularly in November. Speculation in the NDF market led to the sharp disconnect between the exchange rate and underlying domestic economic fundamentals. Consequently, the non-transparent pricing mechanism in the NDF market spilled over to the onshore foreign exchange market which then disrupted the domestic price discovery process during the period.

Volatility in the ringgit was also due to the rising supply and demand imbalances in the domestic foreign exchange market. Despite the sustained current account surplus, insufficient export proceeds were converted into ringgit which had the effect of

weakening the structural demand for the ringgit. Conversely, the undertaking of investments by Malaysian companies abroad had increased the demand for foreign currencies. These underlying imbalances left the ringgit vulnerable to the sharp movements of portfolio investment flows by non-resident investors, which resulted in frequent ringgit overshooting in response to global developments. To rectify these imbalances, the Financial Markets Committee (FMC), in collaboration with Bank Negara Malaysia, introduced several measures to deepen and broaden the domestic foreign exchange market. The measures included promoting foreign exchange hedging within the domestic foreign exchange market and requiring the conversion of foreign currency export proceeds into ringgit. The renewed flow of foreign currency export proceeds into the domestic market would subsequently improve foreign currency liquidity in the onshore market.

Monetary operations in 2016 focused on ensuring the domestic money market continued to effectively intermediate short-term funds in an environment of heightened global financial market uncertainties. As part of a comprehensive effort to ensure sufficient liquidity in the domestic financial system, the Bank reduced the Statutory Reserve Requirement (SRR) ratio from 4.00% to 3.50%, which took effect from February 2016 onwards. The broad-based release of liquidity into the banking system led to increased liquidity in the interbank market and eased the pressure on interbank borrowing costs. As the volatility of capital flows increased towards the later part of the year, the composition of monetary instruments used to absorb surplus liquidity was also adjusted in favour of shorter tenures to provide banks with greater flexibility in managing their liquidity positions. This enabled banks to readily meet any sudden withdrawals of funds due to capital outflows. As such, notwithstanding the volatility in domestic financial and foreign exchange markets, aggregate banking system liquidity remained ample throughout the year.

Domestic financial intermediation was uninterrupted during the year, with net financing to the private sector growing by 5.5% in 2016 (2015: 8.2%). The more moderate pace of growth in net financing during the year was in line with economic activity, reflecting mainly the lower growth of outstanding loans to both households and businesses. The moderation in the growth of household debt was also attributable to moderate domestic demand

and in part due to the pre-emptive macro- and microprudential measures implemented by the Bank to ensure prudent levels of household debt. The slower outstanding business loan growth was confined to certain sectors, with limited evidence of broad-based tightening in access to financing. Capital market funding to businesses also remained healthy with the bond market remaining as a key source of financing for the private sector.

Outlook for the Malaysian Economy in 2017

Global economic activity is projected to improve in 2017, underpinned by an expansion in domestic demand in the advanced and emerging market economies, boosted in part by expansionary fiscal policies in selected major economies. These pro-growth policies would spur global demand and provide impetus to global trade. The outlook would also be supported by a recovery in commodity prices amid the move to reduce oversupply conditions. Nonetheless, the global economy will continue to be subjected to several downside risks. These include a potential retreat from globalisation and free trade in the advanced economies, and uncertainty over the UK and EU negotiations and geopolitical developments. Anticipation of monetary policy divergence between the US and the other major economies could also result in overadjustment in the foreign exchange markets amidst destabilising capital flows.

With the gradual improvement in global growth, recovery in global commodity prices and the continued growth of domestic demand are expected to collectively support Malaysia's growth performance. The Malaysian economy is projected to register a sustained growth of 4.3% - 4.8% in 2017.

Domestic demand will continue to be the principal driver of growth, underpinned by private sector activity. Notwithstanding the higher inflation, private consumption growth is expected to be sustained by continued wage growth and the increase in disposable income due to selected Government measures and higher global commodity prices. In an environment of cautious business sentiment and continued uncertainty in the economy, investment growth is projected to remain modest. Nonetheless, private investment activity will be supported by higher capital expenditure in export-oriented industries and implementation of ongoing and new projects, particularly in the manufacturing and

services sectors. While public expenditure would be lower as a result of the Government's continued commitment to fiscal consolidation, the public sector is projected to support growth, driven mainly by higher public investment arising from the ongoing implementation of key infrastructure projects in selected sectors.

Malaysia's external sector is expected to remain resilient despite continued uncertainties in the global environment. Both exports and imports are expected to strengthen in 2017, underpinned by the projected improvements in global growth, higher commodity prices and sustained domestic demand. Nonetheless, import growth is expected to continue to outpace export growth, resulting in a lower trade surplus. The services account is projected to register a larger deficit, in line with higher trade and improvement in investment activity. Overall, the current account is expected to register a surplus of 1.0% - 2.0% of GNI in 2017.

On the supply side, all economic sectors are projected to register positive growth in 2017. The services and manufacturing sectors would be the key contributors to overall growth. The agriculture sector is expected to rebound as yields recover from the El Niño weather phenomenon. Growth in the mining sector is expected to remain steady, as a stronger expansion in natural gas output offsets a moderation in the crude oil sub-sector.

Headline inflation is projected to average higher in the range of 3.0% - 4.0% in 2017, given the prospect of higher global commodity and energy prices, and the impact of the depreciation of the ringgit exchange rate. These cost-push factors, however, are not expected to cause significant spillovers to broader price trends, given the stable domestic demand conditions. Core inflation is, therefore, expected to increase modestly.

Economic and Monetary Management in 2017

As the global landscape is set to experience concurrent shifts in policy stance, there could be varying implications for the Malaysian economy. In particular, the prospect of increased protectionism among the major economies would have a dampening effect on global trade. The prospect of increasing monetary policy divergence between the US and other major economies could lead to tighter financial market conditions, with higher volatility in capital flows and exchange rates. The

materialisation of these external risks would be a source of heightened uncertainty for the Malaysian economy and financial system, with implications for sentiments and labour market conditions. In addition, the persistence of earlier domestic headwinds, such as higher cost of living and weak sentiments, could also moderate the growth of domestic demand.

Nonetheless, the Malaysian economy's strengths derived from its highly diversified economic structure, resilient external position and policy flexibility would provide it with the ability to weather these challenges going forward. Financial intermediation will remain supportive of growth, supported by strong bank balance sheets and a well-developed financial market. Looking ahead, the challenging global environment necessitates continued emphasis on enhancing the nation's economic resilience and broadening the sources of growth. Efforts are being intensified to rebuild policy space, proactively address potential vulnerabilities and unlock new growth areas.

Monetary policy in 2017 will continue to ensure that its stance is consistent with sustaining a steady growth path amid price stability. The policy environment is expected to remain challenging. Although growth is expected to improve due to better performance of the external sector, the economy will be challenged by higher inflation, volatile capital flows and lingering uncertainties in the global economic and financial environment. While the risk of destabilising financial imbalances has remained largely contained, it will continue to be closely monitored. Given the expectation of continued volatility in capital flows, the Bank's monetary operations will ensure that domestic liquidity in the financial system remains sufficient in order to support the orderly functioning of the domestic financial markets.

Fiscal policy in 2017 will focus on further strengthening of the Government's fiscal position, while ensuring continued support for domestic growth and promoting economic inclusiveness. The Federal Government's fiscal deficit is expected to narrow further, underpinned by sustained growth in revenue and a modest expansion in operating expenditure. In the 2017 Budget, fiscal resources have been strategically prioritised towards high impact infrastructure projects and programmes for

capacity building. The budget was also consistent with efforts to ensure inclusive and sustainable growth. In particular, welfare enhancement programmes and socio-economic support are expected to sustain the capacity of lower- and middle-income segments to cope with the rising cost of living and provide support to private consumption.

Governance, Organisational Development and Communications

Individuals who work in the Bank are committed to the mandates of maintaining monetary and financial stability that are critical towards achieving sustainable economic growth. The Bank's staff are held accountable by strong governance and oversight exercised by the Board of Directors (the Board). In 2016, there were several changes to the composition of the Board. Dr. Zeti Akhtar Aziz completed her term of service as the Governor on 30 April 2016 and Muhammad bin Ibrahim was appointed as Governor on 1 May 2016. Shaik Abdul Rasheed bin Abdul Ghaffour was appointed as the Deputy Governor on 16 July 2016 and Nor Shamsiah binti Mohd Yunus completed her tenure as Deputy Governor on 15 November 2016. Consequently, the size of the Board decreased from 12 to 11 members. The Board currently comprises the Governor as Chairman, the two Deputy Governors and the Secretary-General to the Treasury and seven independent non-executive members.

In 2016, the Bank's risk appetite and tolerance statements were reviewed to strengthen the Bank's risk management capabilities. These statements indicate the amount and type of risks that the Bank is willing to take in meeting its mandates. In strengthening audit processes, the Internal Audit Department (IAD) engaged an independent external party to conduct a quality assurance review of its auditing practices. The IAD's auditing practices is in general conformance with the highest rating of the International Standards for the Professional Practice of Internal Auditing. As part of the Bank's business plan for 2016, new initiatives were introduced to address emerging priorities, such as fostering an enabling environment for financial technology (FinTech) solutions, accelerating the development of the insurance industry and building new capabilities in data analytics.

During the year, the Bank further improved succession planning, talent management and talent

development. In particular, the Bank streamlined the succession and corporate talent pools. This integration allowed for more targeted development interventions for staff, aimed at preparing them to assume more critical roles. An independent review of the Bank's physical security management was also conducted aimed at enhancing the Bank's response to emerging threats. The review covered all aspects of security management, people, processes and technology. Several security initiatives were implemented to enhance security at the Bank. An independent review of the Bank's IT infrastructure was also completed and the Bank has embarked on a four-year transformation of the IT services, which will result in more specialised IT skill sets, new technology platforms and architectures.

Communication channels and practices were strengthened to relay important announcements and developments to the public. In line with shifting global media trends, digital platforms were utilised for better outreach to different groups of stakeholders. Embargo times on press releases were reduced to earlier in the day to allow ample time for markets to assess and understand the implications of various communications.

In 2016, the Bank established the FMC to serve as a more inclusive forum to recommend strategies aimed at fostering the development of Malaysia's financial market. This committee comprises of representatives from the Bank, financial institutions, corporations and other key stakeholders in the financial market. The Financial Technology Enabler Group (FTEG) was also established during the year to formulate and enhance regulatory policies on technological innovations in the Malaysian financial services industry. The setting up of FTEG is part of the Bank's commitment to support

innovations which will improve the quality, efficiency and accessibility of financial services in Malaysia.

The Bank's revamped website is now more user-friendly with an improved browsing experience on mobile devices. The new enhanced live streaming infrastructure introduced during the Bank's hosting of international events allowed for live telecasts on multiple platforms, with broadcasts accessible to event participants.

As collaboration among central banks is critical for knowledge sharing in the various areas of central banking, the Bank's Sasana Kijang has become a focal centre for such activities. Notable events during the year included the launch of the World Bank Group Global Knowledge and Research Hub, the Wharton Global Forum, the SEACEN Conference in honour of a past governor who was instrumental in deepening regional central banking cooperation, the Responsible Finance Summit and meetings in collaboration with the Bank for International Settlements (BIS). Apart from being the permanent headquarters of the Alliance for Financial Inclusion (AFI) and the World Bank Group Global Knowledge and Research Hub, Sasana Kijang also functions as an interim campus for the Asia School of Business (ASB).

Bank Negara Malaysia's Audited Financial Statements for 2016

The financial position of Bank Negara Malaysia, as audited and certified by the Auditor General, remained strong in 2016. The total assets of Bank Negara Malaysia amounted to RM451.0 billion, with a net profit of RM6.5 billion for the financial year ending 31 December 2016. Bank Negara Malaysia declared a dividend of RM2.5 billion to the Government for the year 2016.

Economic Developments in 2016

- 13** The International Economic Environment
- 16** The Malaysian Economy
- 24** External Sector
- 30** Inflation Developments
- 33** *Box Article: Understanding the Changing Dynamics of the Current Account of the Balance of Payments in Malaysia*
- 38** *Box Article: Payoffs from Going Global: Assessing the Returns from Malaysia's Direct Investment Abroad*

Economic Developments in 2016

THE INTERNATIONAL ECONOMIC ENVIRONMENT

The year 2016 recorded the lowest world GDP growth since the Global Financial Crisis. International trade growth underperformed world GDP growth for the second consecutive year. The moderation in GDP growth was driven by subdued investment activities in most economies and weak commodity prices amid heightened political and policy uncertainties in major economies. Sustainable recoveries remained an elusive goal for many economies while inflation continued to be below target for many major central banks. As conventional and unconventional policy space narrowed further, vulnerabilities in many economies also increased. Global leverage rose amid unprecedented quantitative easing, while productivity growth remained low. Benefits from ongoing structural reforms have yet to fully materialise. The growing scepticism over the benefits of globalisation, manifested in the UK's EU referendum and the result from the US Presidential election, raised concerns about the future of the global economy going into 2017 and beyond. In this environment, policymakers faced an increasingly daunting task to deliver short-term growth while maintaining the momentum to follow through the necessary and difficult reforms to achieve sustainable growth over the longer run.

World economy recorded the lowest growth rate since the Global Financial Crisis

More moderate world growth

Global economic growth moderated for the second consecutive year since 2014, defying initial expectations of an improvement from the growth rate recorded in 2015. As a result, the IMF revised the global growth projection downwards, from 3.4%

in January 2016 to 3.1% in October 2016. Global trade growth moderated further in 2016 due to subdued investment growth across major economies and economic rebalancing in PR China. World trade volume for goods and services registered its slowest pace of expansion since the crisis, leaving global trade elasticity¹ to fall to 0.6.

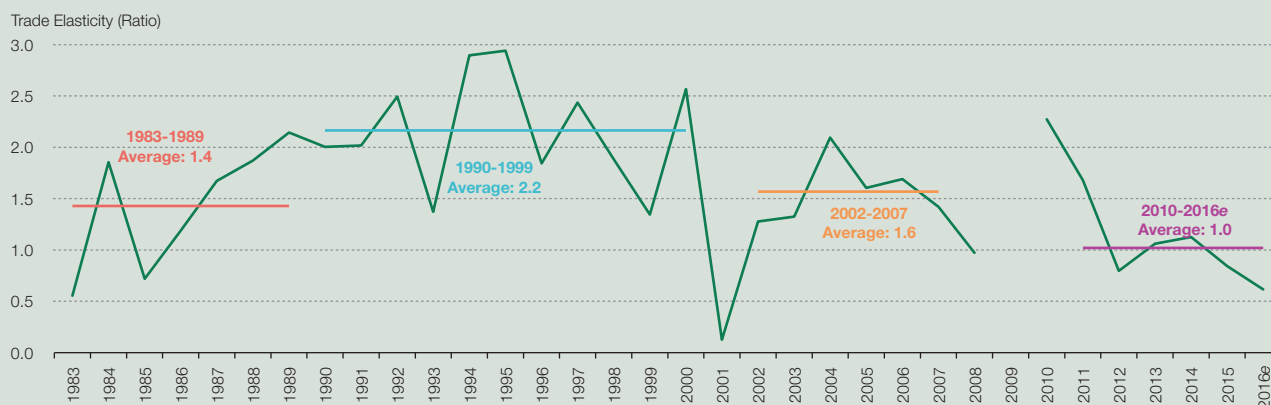
Advanced economies experienced modest economic growth, which was partly attributable to subdued investments. In the US, private consumption also moderated leading to lower GDP growth in 2016. Despite favourable labour market conditions, earnings growth slowed. In the euro area, business lending continued to decline and business sentiments remained weak amid the heightened policy and political uncertainty in member states. Despite experiencing a major political event, namely the unexpected referendum outcome to leave the EU, the UK economy sustained a growth rate of 1.8%, underpinned by favourable household spending. Higher wealth effects arising from improving house prices and strengthening labour market conditions continued to support consumer spending. However, investment activity remained weak, particularly in non-residential properties and construction, transportation equipment and intangible fixed assets.

In the emerging markets, growth was slower than expected. Commodity prices recorded a larger contraction relative to earlier projections, weighing on the pace of recovery in some regions such as Latin America and Commonwealth of Independent States. Headwinds to growth, particularly private consumption activity, remained, reflecting the adverse impact from the implementation of structural reforms, including those relating to energy, tax and prices. The currencies of most emerging market economies were also affected by the volatility in capital flows

¹ Global trade elasticity is calculated as the ratio of world trade growth to GDP growth.

Chart 1.1

Global Trade Elasticity



e Estimate

Source: International Monetary Fund (IMF)

arising from heightened global risk aversion. Subdued external demand, as indicated by the moderation in global trade activity, continued to affect the more open emerging economies.

PR China's growth expanded at a more gradual pace due to ongoing rebalancing from an investment-driven growth model towards a consumption-led one. This led to reforms to curb excess capacity in the heavy industries, such as steel, coal and cement. Many economies in the rest of Asia registered stronger expansion, allowing the region to grow at a faster pace relative to other emerging market economies. An increased focus on expanding infrastructure investments by both the public and private sector provided support to capital spending, with expectations of reduced structural constraints to future growth. The implementation and introduction of additional fiscal, monetary and structural measures to support economic activity by policymakers lifted the region's growth trajectory. On the demand front, weak export performance was offset by improvements in domestic demand conditions.

Global inflation remained low

Inflationary pressures remained low in many economies as inflation rates continued to be below target for most inflation-targeting economies and lower than historical levels for many others, reflecting mainly weak domestic demand. Nevertheless, in many countries, headline inflation was on a slight upward growth trajectory during the year. The increase was a reflection of the diminishing

Table 1.1

World Economy: Key Economic Indicators

	Real GDP Growth (Annual change, %)		Inflation (Annual change, %)	
	2015	2016e	2015	2016e
World Growth	3.2	3.1	-	-
World Trade	2.7	1.9	-	-
Advanced Economies				
United States	2.6	1.6	0.1	1.3
Japan	1.2	1.0	0.8	-0.1
Euro area	1.9	1.7	0.0	0.3
United Kingdom	2.2	1.8	0.0	0.7
Emerging Asia¹	5.8	5.7	1.7	1.9
Other Advanced Asian Economies	2.0	2.2	0.4	1.0
Korea	2.6	2.7	0.7	1.0
Chinese Taipei	0.7	1.5	-0.6	1.0
Singapore	1.9	2.0	-0.5	-0.5
Hong Kong SAR	2.4	2.0	3.0	2.4
The People's Republic of China	6.9	6.7	1.4	2.0
ASEAN-4	4.6	4.8	3.6	2.4
Malaysia	5.0	4.2	2.1	2.1
Thailand	2.9	3.2	-0.9	0.2
Indonesia	4.9	5.0	6.4	3.5
Philippines	5.9	6.8	1.4	1.8
India²	7.5	7.5	4.9	4.9

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

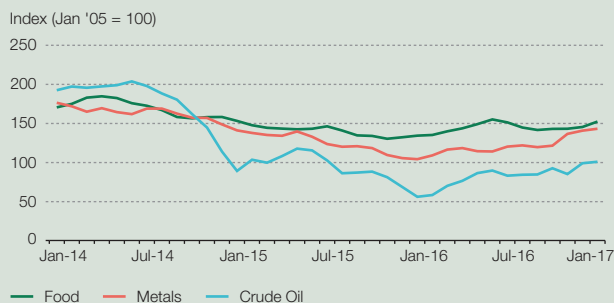
² For India, GDP data is presented on a fiscal year basis

e Estimate

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

Chart 1.2

Indices of Primary Commodity Prices



Source: International Monetary Fund (IMF)

impact of the sharp decline in commodity prices in 2014-15 following a modest recovery in prices. Other factors that affected inflationary pressures included changes to administered prices and exchange rate movements.

The IMF commodity price indices showed a return to an upward trajectory for food, metals and crude oil during the year. In the crude oil markets, Brent prices reached a 12-year record low of USD28² per barrel in mid-January, following the lifting of international sanctions on Iran. The lower crude oil prices were reinforced by concerns over worsening global oversupply amid subdued aggregate demand growth and strong supply by OPEC members. However, as the year progressed, unplanned disruptions to output combined with expectations of future production cuts led to rising crude oil prices. On 30 November 2016, OPEC and Russia agreed to their first production cuts in eight years.

Similarly, metal prices improved, supported by production cuts in the tin, lead and zinc markets. Iron ore prices were driven by greater demand for steel in PR China, as public infrastructure spending rose. The cost of food increased as well, as prices of agricultural products such as rice, soybeans, palm oil and sugar were driven higher by weak production amid adverse weather conditions.

The recovery in commodity prices led headline inflation rates to edge higher across major advanced and emerging economies. Among the advanced economies, headline inflation rose in the US and the UK due to a smaller contraction in transport costs, while headline inflation was modest in the

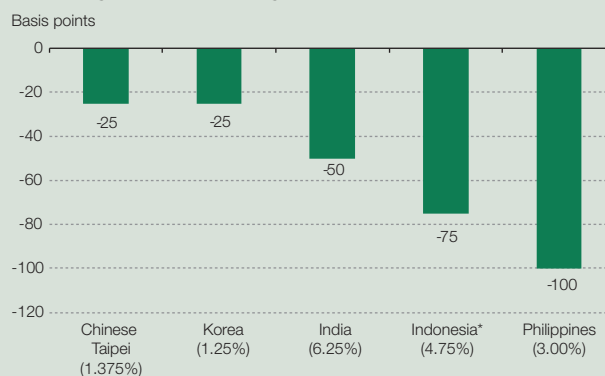
euro area, averaging 0.3% in 2016 (2015: 0%). Comparable trends were observed in some Asian economies, including Thailand and Korea. Inflation in PR China and India was further supported by rising food prices. Nonetheless, subdued demand in many economies had kept underlying price increases modest, as reflected by the low growth in core inflation. The only major exception was the US, where core inflation was supported by a continued expansion of private consumption, particularly of services such as medical care.

Further policy support globally

Confronted with increasing growth concerns and low inflationary pressures, the policy stance turned more accommodative in most regions. In the advanced economies, monetary policy remained as the key policy option as some governments continued to rebuild their fiscal positions. The Federal Reserve adopted a more gradual path on monetary policy normalisation than previously expected, increasing the federal funds rate target by 25 basis points to a range of 0.50% - 0.75% on 14 December 2016, while in other major advanced economies, central banks undertook further monetary easing. Following the UK's EU referendum results, the Bank of England launched a package of measures designed to provide support to growth. Across other advanced economies, central banks in Australia, New Zealand, Norway and Sweden also reduced key policy rates following higher downside risks to inflation and growth. Along with monetary

Chart 1.3

Cumulative Movements of Policy Rates (January 2016 - January 2017)



Note: Current policy rates as at end January 2017 in parentheses
*Indonesia official policy interest rate changed to the 7-day reverse repo rate in April 2016

Source: National Authorities

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

easing, several advanced economies implemented structural reforms during the year to enhance macroeconomic fundamentals and medium-term growth sustainability. The Japanese government launched two committees to spearhead structural changes in agriculture, medicine and undertake labour market reforms to boost productivity. In the euro area, structural reforms continued to take place, particularly in enhancing the labour market and improving the business environment.

In Asia, many economies employed a combination of monetary and fiscal policies to spur domestic economic activities. Additionally, policymakers in Asia continued to pursue structural reforms to strengthen macroeconomic fundamentals and enhance medium-term growth sustainability. PR China, Chinese Taipei and Thailand implemented fiscal measures to bolster domestic economic activity. These measures were in the areas of providing financing support for state-owned enterprises and small businesses, and higher public investment. Asian policymakers also introduced measures to accelerate infrastructure investment, prioritising both hard and soft infrastructures, through upgrading transportation networks, enhancing existing public-private partnership (PPP) frameworks as well as increasing broadband penetration. Additionally, efforts were focused on improving governance, liberalising industrial sectors and enhancing the ease of doing business (see also the Box Article on 'Structural Reforms in ASEAN-5 Economies: Past Successes and Future Challenges').

Challenges from the continuing legacies of the financial crisis, growing domestic vulnerabilities and increasing strains in the global financial and foreign exchange markets complicated policy considerations throughout the year. This was compounded by narrowing policy space in many economies and rising public discontentment against existing trade and political arrangements. The operating environment will become even more challenging in 2017 as the international economic policy and political landscape will be reshaped by the potential change in the relationship between the UK and the European Union and new policy stances from the US. Policymakers will have to be proactive and move strategically, utilising all available policy options, to achieve the objectives of supporting short-term growth and enhancing long-term economic prospects.

THE MALAYSIAN ECONOMY

In 2016, the Malaysian economy continued to face considerable external and domestic headwinds. While some of the impact of earlier domestic shocks gradually dissipated during the year, growth performance was affected by the materialisation of new risks and ongoing adjustments to external shocks that have impacted the economy since end-2014³. Despite these challenges, however, the economy recorded a commendable performance and grew by 4.2% in 2016.

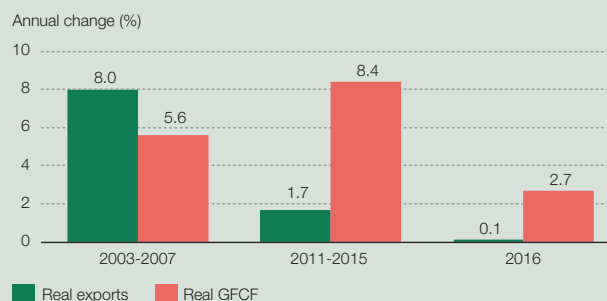
Despite the challenging economic environment, the Malaysian economy registered a commendable growth of 4.2% in 2016

The challenging global landscape necessitated continued spending adjustments by households, businesses and the Government, amid the dissipating impact of previous domestic shocks. Export performance and investment activity were relatively subdued throughout the year following lacklustre global demand and low commodity prices (Chart 1.4). In addition, the unexpected outturn of political developments in the advanced economies, especially the UK and the US, and the macroeconomic policies adopted by these economies, have led to heightened uncertainty in financial markets and a significant reversal of capital flows from emerging economies.

On the domestic front, the economy continued to face headwinds from higher cost of living and weak sentiments. Ongoing adjustments by households, especially the low

Chart 1.4

Real Exports and Gross Fixed Capital Formation (GFCF) (2010=100)



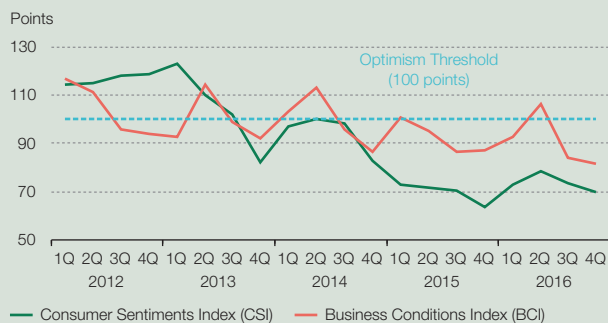
Source: Department of Statistics, Malaysia

³ External shocks include weak commodity prices, lower growth in both advanced and regional economies, and geopolitical developments.

and middle-income groups, to the increased cost of living was further exacerbated by soft labour market conditions (See Information Box on 'Soft Labour Market Conditions'). Concurrently, business and consumer sentiments were affected by a confluence of global and domestic factors, including the heightened volatility in financial markets and the prolonged underperformance of the ringgit (Chart 1.5).

Chart 1.5

Quarterly MIER Consumer Sentiments and Business Conditions Indices



Source: Malaysian Institute of Economic Research (MIER)

These external and domestic challenges resulted in a slower expansion across all sectors of the economy during the year. The environment of higher prices and increased uncertainties led to moderate growth of household spending. While tentative signs of a recovery in the spending momentum emerged towards the second half of the year, overall growth of household spending remained below its long-term average of 6.6% (1990 - 2015). Investment growth moderated amid the multiple shocks to the economy and the uncertain business environment. In early 2016, the projection of lower petroleum-related revenue arising from low crude oil prices resulted in the recalibration of the Government's Budget and re-prioritisation of Government expenditure. The reduction in Government spending further weighed down on real activity.

In the external sector, the current account of the balance of payments remained in surplus, but by a smaller amount. This stemmed from a lower trade surplus as export growth moderated in line with the subdued global demand. The persistent structural deficits in the services and income accounts also contributed further to the narrowing of the current account surplus. The financial account continued to record net outflows. While direct investment registered net inflows, portfolio investment inflows in the first half of the year were offset by larger net outflows in the second half of the year.

The strong fundamentals of the Malaysian economy have accorded Malaysia the ability to weather these challenges. The diversified sources of growth in the economy have allowed the adverse impact of sector-specific shocks to remain manageable. Despite some softening, labour market conditions remained stable with continued income growth providing continued support to household spending. Healthy financial institutions and ample domestic liquidity also ensured orderly financial intermediation. Notwithstanding the weak global demand, Malaysia's external position remained strong, supported by ample international reserves and manageable levels of external debt.

In addition, appropriate and timely policy responses played a key role in supporting growth during the year. These included a combination of an accommodative monetary policy and targeted pro-growth measures. Bank Negara Malaysia adjusted the Overnight Policy Rate (OPR) downwards to maintain the degree of monetary accommodativeness. The reduction in the OPR was complemented by efforts to increase household disposable income and support business activity. For example, the Government embarked on policies to create a conducive ecosystem for a sharing economy that would unlock new sources of income for households. Other measures, such as the reduction of employees' EPF contributions and higher payments from Bantuan Rakyat 1Malaysia (BR1M), were also introduced during the year to support low and middle-income households, while incentives were provided to spur business activity, particularly among the small and medium enterprises (SMEs). These included funds and incentives to increase adoption of technology, promote entrepreneurship and increase research and development (R&D) activity.

In recognising the challenges posed by global and domestic trends such as ageing population, the influx of new technologies and lower productivity gains, critical reforms and structural adjustments remained a priority. Efforts to enhance export competitiveness were accelerated in line with the role of the external sector as an important engine of growth for the economy. Ongoing investments to modernise the physical and virtual infrastructure remain on track to meet the rising demand for greater interconnectedness. In developing a high quality workforce, the quality of the education system remained a policy priority, with increased emphasis on skills improvement and life-long learning. Notwithstanding the limited impact on economic growth in the short-term, these structural reforms are key to the sustained future growth of the Malaysian economy.

Table 1.2

Malaysia - Key Economic Indicators

	2014	2015	2016^p	2017^f
Population (million persons)	30.7	31.2	31.7	32.1
Labour force (million persons)	14.3	14.5	14.7	14.9
Employment (million persons)	13.9	14.1	14.2	14.3
Unemployment (as % of labour force)	2.9	3.1	3.5	3.6 ~ 3.8
Per Capita Income (RM)	34,839	36,078	37,738	39,656
(USD)	10,645	9,238	9,096	8,906 ³
NATIONAL PRODUCT (% change)				
Real GDP at 2010 prices	6.0	5.0	4.2	4.3 ~ 4.8
(RM billion)	1,012.5	1,062.8	1,107.9	1,158.5
Agriculture, forestry and fishery	2.1	1.2	-5.1	4.0
Mining and quarrying	3.5	4.7	2.7	2.7
Manufacturing	6.2	4.9	4.4	4.3
Construction	11.7	8.2	7.4	8.0
Services	6.6	5.1	5.6	4.9
Nominal GNI	8.7	5.2	6.2	6.7
(RM billion)	1,069.8	1,125.1	1,194.6	1,274.7
Real GNI	6.1	6.8	4.4	4.7
(RM billion)	972.6	1,038.5	1,084.4	1,135.5
Real aggregate domestic demand ¹	5.9	5.1	4.4	4.4
Private expenditure	7.9	6.1	5.7	5.6
Consumption	7.0	6.0	6.1	6.0
Investment	11.1	6.4	4.4	4.1
Public expenditure	0.4	2.1	0.4	0.5
Consumption	4.3	4.4	1.0	-0.2
Investment	-4.7	-1.0	-0.5	1.5
Gross national savings (as % of GNI)	30.4	28.9	28.9	27.9
BALANCE OF PAYMENTS (RM billion)				
Goods balance	113.3	109.6	101.2	98.4
Exports	678.9	685.4	686.0	723.4
Imports	565.5	575.8	584.8	625.1
Services balance	-10.7	-21.0	-22.6	-24.0
Primary income, net	-36.6	-32.0	-34.7	-36.3
Secondary income, net	-17.4	-21.9	-18.7	-20.7
Current account balance	48.6	34.7	25.2	17.4
(as % of GNI)	4.5	3.1	2.1	1.0 ~ 2.0
Bank Negara Malaysia international reserves, net ²	405.3	409.1	423.9	-
(in months of retained imports)	8.3	8.4	8.7	-
PRICES (% change)				
CPI (2010=100)	3.2	2.1	2.1	3.0 ~ 4.0
PPI (2010=100)	1.5	-7.4	-1.1	-
Real wage per employee in the manufacturing sector	1.5	3.7	4.1	-

¹ Exclude stocks² All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account³ Based on average USD exchange rate for the period of January-February 2017^p Preliminary^f Forecast

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 1.3

Malaysia - Financial and Monetary Indicators

FEDERAL GOVERNMENT FINANCE (RM billion)		2014		2015		2016p	
Revenue		220.6		219.1		212.4	
Operating expenditure		219.6		217.0		210.2	
Net development expenditure		38.5		39.3		40.6	
Overall balance		-37.4		-37.2		-38.4	
Overall balance (% of GDP)		-3.4		-3.2		-3.1	
Public sector net development expenditure		164.5		138.6		158.1	
Public sector overall balance (% of GDP)		-7.4		-7.8		-7.3	
EXTERNAL DEBT							
Total debt (RM billion)		747.8		833.8		908.7	
Medium-and long-term debt		383.7		481.9		532.1	
Short-term debt		364.1		351.9		376.6	
Debt service ratio ¹ (% of exports of goods and services)							
Total debt		19.1		22.6		25.0	
Medium-and long-term debt		18.9		22.5		24.8	
MONEY AND BANKING		Change in 2014		Change in 2015		Change in 2016	
		RM billion	%	RM billion	%	RM billion	%
Money supply	M1	18.8	5.7	14.0	4.1	20.4	5.7
	M3	101.5	7.0	40.8	2.6	47.9	3.0
Banking system deposits		116.4	7.6	28.8	1.8	25.0	1.5
Banking system loans ²		114.1	9.3	105.4	7.9	76.4	5.3
Loan to deposit ratio (% , end of year) ³		86.8		88.7		89.8	
Loan to fund ratio (% , end of year) ^{3&4}		82.1		83.0		84.3	
Loan to fund and equity ratio (% , end of year) ^{3,4&5}		74.2		74.6		75.3	
INTEREST RATES (% , AS AT END-YEAR)		2014		2015		2016	
Overnight Policy Rate (OPR)		3.25		3.25		3.00	
Interbank rates (1-month)		3.38		3.45		3.10	
Commercial banks							
Fixed deposit	3-month	3.13		3.13		2.92	
	12-month	3.31		3.31		3.06	
Savings deposit		1.07		1.04		0.99	
Weighted average base rate (BR)		-		3.77		3.61	
Base lending rate (BLR)		6.79		6.79		6.65	
Treasury bill (3-month)		3.42		2.74		3.06	
Malaysian Government Securities (1-year)		3.48		2.59		3.26	
Malaysian Government Securities (5-year)		3.84		3.47		3.70	
EXCHANGE RATES (AS AT END-YEAR)		2014		2015		2016	
Movement of Ringgit (%)							
Change against SDR		-0.7		-15.1		-0.8	
Change against USD		-6.1		-18.6		-4.3	

¹ Includes prepayment of medium- and long-term debt² Includes loans sold to Cagamas³ Deposits exclude deposits accepted from banking institutions. Loans exclude loans sold to Cagamas and loans extended to banking institutions. Beginning July 2015, loans exclude financing funded by Islamic Investment accounts⁴ Funds comprise deposits and all debt instruments (including subordinated debt, debt certificates/sukuk issued, commercial paper and structured notes)⁵ Equity comprises ordinary and preferred shares, share premium and retained earnings

p Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Domestic Demand Anchored Growth in 2016

The Malaysian economy registered a growth of 4.2% in 2016 (2015: 5%). Domestic demand continued to anchor growth during the year, supported mainly by private sector spending. Public sector spending, however, moderated following the expenditure rationalisation adopted by the Government. On the external front, export growth was weaker against a backdrop of more moderate global expansion, particularly in key trading partners.

Private consumption growth was sustained at 6.1% in 2016 (2015: 6%), mainly supported by continued wage and employment growth, with additional impetus coming from Government measures. Nominal wages in the private sector grew by 4.2%, partly supported by the increase in the minimum wage in July 2016. Public sector wages recorded a higher growth with the increase in civil servants salary in the second half of the year. Government measures to increase household disposable income have also supported household spending. These included the reduction in employees' EPF contributions by 3 percentage points (11% to 8%) from March 2016 to December 2017, higher Bantuan Rakyat 1Malaysia (BR1M) payouts and the special tax relief of RM2,000 to individual taxpayers with a monthly income of RM8,000 or below for the 2015 assessment year.

Table 1

Real GDP by Expenditure (2010=100)

	2016p	2015	2016p	2015	2016p
	% of GDP	Annual change (%)		Contribution to growth (ppt)	
Domestic Demand¹	91.8	5.1	4.4	4.7	4.0
Private sector expenditure	70.2	6.1	5.7	4.2	3.9
<i>Consumption</i>	53.3	6.0	6.1	3.1	3.2
<i>Investment</i>	16.9	6.4	4.4	1.1	0.7
Public sector expenditure	21.6	2.1	0.4	0.5	0.1
<i>Consumption</i>	13.1	4.4	1.0	0.6	0.1
<i>Investment</i>	8.5	-1.0	-0.5	-0.1	0.0
<i>Gross Fixed Capital Formation</i>	25.4	3.7	2.7	1.0	0.7
Change in stocks	0.2			0.6	0.4
Net Exports of Goods and Services	8.1	-3.8	-1.8	-0.4	-0.2
Exports	70.0	0.6	0.1	0.5	0.1
Imports	61.9	1.2	0.4	0.8	0.2
Real Gross Domestic Product (GDP)	100.0	5.0	4.2	5.0	4.2

¹ Excluding stocks
p Preliminary

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Public consumption growth moderated to 1% (2015: 4.4%) due to lower spending on supplies and services, in line with the Government's efforts to rationalise expenditure. Spending on emoluments, however, was higher during the year, mainly reflecting the salary increment in July 2016.

Gross fixed capital formation (GFCF) expanded moderately by 2.7% in 2016 (2015: 3.7%). Public investment growth improved, but remained in contraction, while private investment growth continued to moderate.

Public investment recorded a smaller rate of decline in 2016 (-0.5%; 2015: -1%) due to the smaller contraction in spending on fixed assets by public corporations. This reflected mainly the improvement in investment in the downstream oil and gas industry as well as the *transportation* and *utilities* sub-sectors. Capital spending by the Federal Government continued to increase in 2016, albeit at a moderate rate, and was focused mainly on developing the transportation infrastructure, enhancing industrial development, improving public utilities and accelerating agriculture and rural development.

As firms adjusted to the shocks emanating from the external and domestic environment, growth of private investment moderated further to 4.4% in 2016 (2015: 6.4%). While financing conditions remained supportive of private investment, profitability and business sentiments remained weak during the year. In terms of sector, overall investment performance continued to be supported by the implementation of new and ongoing projects in the manufacturing and services sectors. Investment in the mining sector continued to be constrained by the low oil price environment.

For GFCF by type of assets, spending on machinery and equipment increased (1.1%; 2015: -0.2%) following the faster pace of expansion in civil engineering investment, particularly in the petrochemical, transportation and utilities sub-sectors. However, growth of investment in structures, which accounted for 56% of total GFCF, moderated to 4.9% (2015: 6.8%) due mainly to lower non-residential investment, particularly in the commercial property sub-sector due to the oversupply of office and retail space. Growth of investment in other assets declined during the year (-4.2%; 2015: 1.6%), due to lower capital expenditure in the development of intellectual property products (e.g. in mineral exploration and evaluation) and cultivated biological products (e.g. livestock and crops).

During the year, gross national savings (GNS) grew by 6.3% (2015: 0%) to remain at 28.9% of gross national income (2015: 28.9% of GNI) on account of higher growth in public savings (36.1%; 2015: -40.4%). Gross capital formation expanded at a faster pace of 10.4%, attributable mainly to stronger growth in private capital formation (15.3%; 2015: 7.7%). As a result, savings-investment gap narrowed further to 2.1% of GNI in 2016 compared to 3.1% of GNI in 2015.

Soft Labour Market Conditions

The unemployment rate rose to 3.5% in 2016 (2015: 3.1%, average 2011-2015: 3%), due mainly to slower job creation amid more moderate economic growth. While total employment continued to expand, the pace remained insufficient to absorb new labour market entrants. The labour force expanded by 168,000 people, while net employment gains amounted to 112,300 jobs. Industrial engagements throughout the year reaffirmed the view that employers adopted a cautious stance and refrained from expanding their workforce too quickly. The younger labour force was the most affected, as the moderate growth environment made it more challenging for youth to secure employment. The labour force participation rate slipped marginally to 67.6% of working-age population (2015: 67.9%).

Table 1

Selected Labour Market Indicators

	2012 ^r	2013 ^r	2014 ^r	2015 ^r	2016 ^p
Employment ('000 persons)	12,821	13,545	13,853	14,068	14,180
Labour force ('000 persons)	13,222	13,981	14,264	14,518	14,686
Unemployment rate (% of labour force)	3.0	3.1	2.9	3.1	3.5
Layoffs ¹ (persons)	33,989	33,086	25,917	44,343	37,699
Foreign workers ('000 persons)	1,572	2,250	2,073	2,135	1,866

^p Preliminary

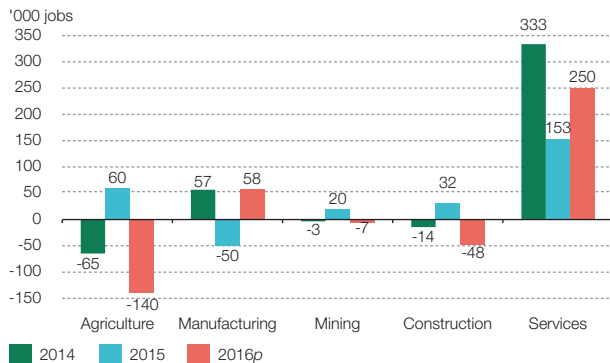
^r Figures for 2012-2015 have been revised to reflect new population estimates

¹ Constitutes workers affected by retrenchments and voluntary separation scheme (VSS) offerings

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

Nonetheless, overall labour market conditions generally remained stable, as employment and wages continued to expand during the year. Employment gains were driven mainly by the services sector, particularly by the *wholesale and retail trade, accommodation and food and beverage, and education* sub-sectors, while gains in the manufacturing sector were moderate (Chart 1). In terms of skills, net job gains were mostly concentrated in the high-skilled segments such as professional and managerial jobs, a continuation of the trend since 2014 (Chart 2). However, job gains in these segments remained insufficient to address the high rates of youth unemployment, particularly among tertiary-educated youth¹ (2016: 10.5%; 2015: 10.7%, See Box Article on ‘Youth Unemployment in Malaysia: Developments and Policy Considerations’).

Chart 1

Net Employment Gains¹ by Sectors, 2014-2016

p Preliminary

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

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

Chart 2

Employment Growth by Skill Levels, 2012-2016

o Preliminary

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

Layoffs reported to the Ministry of Human Resources remained elevated (37,699 persons; 2015: 44,343 persons) but were concentrated within selected industries, reflecting industry-specific trends. These include restructuring of operations due to shifting consumer preferences and technological advancement in the banking sector, mergers and acquisitions in the electronics and electrical (E&E) sector, and streamlining of operations in the mining industry in response to lower global oil prices. In the agriculture sector, employment contracted, due to the impact of adverse weather conditions on the plantation sector. Of note, the number of registered low-skilled foreign workers in Malaysia declined to 1.87 million in 2016 (2015: 2.14 million). These workers remain concentrated in the construction, manufacturing and agriculture sectors.

Aggregate nominal wages in the private² and public sectors grew by 4.2% and 6.7%, respectively in 2016 (2015: 4.9% and 4.7%, respectively). Wage growth was partly supported by the new minimum wage³ and salary increments for civil servants, which took effect on July 2016. In the private sector, higher wage growth was seen in the manufacturing sector (6.2%; 2015: 5.8%), while wages in major services sub-sectors⁴ grew at a more moderate rate (3.3%; 2015: 4.6%). Labour productivity, as measured by real value-added per worker, grew by 3.2% (2015: 3.4%), driven mainly by productivity increases in the manufacturing and construction sectors (3.7% and 7.9%, respectively; 2015: 7.2% and 5.5%, respectively). Labour productivity growth in the services sector was modest at 2.1% (2015: 3.3%).

¹ Among the labour force between the ages of 15 - 24.

² Private sector wages refers to wages in the manufacturing and selected services sectors published by the Department of Statistics, Malaysia.

³ The upward revision of the minimum wage sets the level at RM1,000 per month in Peninsular Malaysia and RM920 per month in Sabah and Sarawak (Previous: RM900 and RM800, respectively).

⁴ Major services sector consists of wholesale and retail trade and food and beverages, accommodation; information and communications, transportation and storage; health, education and arts, entertainment and recreation; and professional and real estate services sub-sectors.

Continued Expansion in Most Economic Sectors

On the supply side, all economic sectors continued to expand in 2016, with the exception of the agriculture sector. Agriculture production declined, as crude palm oil (CPO) output was affected by the El Niño weather phenomenon.

Table 1

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

	2016 ^p	2015	2016 ^p	2015	2016 ^p
	% of GDP	Annual change (%)		Contribution to growth (ppt) ¹	
Services	54.2	5.1	5.6	2.7	3.0
Manufacturing	23.0	4.9	4.4	1.1	1.0
Mining and quarrying	8.8	4.7	2.7	0.4	0.2
Agriculture	8.1	1.2	-5.1	0.1	-0.5
Construction	4.5	8.2	7.4	0.3	0.3
Real Gross Domestic Product (GDP)	100.0¹	5.0	4.2	5.0	4.2

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

^p Preliminary

Source: Department of Statistics, Malaysia

The services sector recorded a higher growth of 5.6% in 2016 (2015: 5.1%). Growth was supported by expansion across all sub-sectors. The *finance and insurance* sub-sector turned around to register positive growth, driven by higher net interest income and better performance of the life insurance segment. The *retail* and *food and beverage and accommodation* sub-sectors recorded higher growth, supported by continued wage and employment growth and a recovery in tourist arrivals. The *utilities* sub-sector benefited from the hot weather conditions, particularly in the first half of the year, which increased the demand for electricity. The sustained trade-related activity and higher air passenger traffic during the year contributed to the growth in the *transportation and storage* sub-sector.

The manufacturing sector grew by 4.4% in 2016 (2015: 4.9%), supported by continued expansion in both export- and domestic-oriented industries. The performance of the export-oriented industries was mainly driven by firm growth of the *electronics and electrical* (E&E) segment, with semiconductors exports growing strongly in response to the recovery in global demand for semiconductors in the second half of 2016. Growth was further supported by higher production of petrochemical products to meet sustained regional demand. The domestic-oriented industries were weighed down by the weak output of motor vehicles, but strong demand for food-related products and construction-related materials provided support to growth.

The construction sector recorded moderate growth in 2016 (7.4%; 2015: 8.2%). The faster pace of expansion in the *civil engineering* and *residential* sub-sectors was partially offset by a decline in *non-residential* activity. Growth in the *civil engineering* sub-sector was driven by higher activity in existing multi-year projects, particularly in the petrochemical, transportation and utilities segments. Activity in the *residential* sub-sector was supported by large property launches in the previous years while growth in the *special trade* sub-sector continued to be supported by early and end-works activity. Growth in the *non-residential* sub-sector, however, was weighed down by slower activity in the commercial property segment amid the oversupply of office and retail space.

In the agriculture sector, growth contracted by 5.1% (2015: 1.2%), attributable mainly to the decline in CPO production as yields were affected by the El Niño weather phenomenon. In particular, fresh fruit bunch yields declined by 13.9% compared to the previous year.

Growth in the mining sector moderated (2.7%; 2015: 4.7%), due partly to the high base effect from 2015 which saw an intensification of production from the Gumusut-Kakap oil field. Nonetheless, higher natural gas production provided support to the sector, following the resumption of operations at the Sabah-Sarawak gas pipeline in mid-2016 and the commissioning of new facilities (LNG Train 9 and PETRONAS' FLNG Satu) in the second half of 2016.

EXTERNAL SECTOR

Modest global demand in 2016 and weak commodity prices

Amid subdued growth of Malaysia's major trading partners and a further decline in commodity prices, gross exports registered a growth of 1.1% in 2016 (2015: 1.6%), the lowest since 2012. In terms of markets, exports to key trading partners such as PR China and Japan fell by 2.9% and 12.9%, respectively. Cumulatively, exports to these economies accounted for 20.6% of gross exports. Exports to PR China were lower due mainly to lower exports of commodities and non-resource based products, while exports to Japan were affected by weak LNG demand, attributable to the restart of nuclear power plants that were shut down following the Fukushima disaster in 2011. Conversely, exports to the US (10.2% share) grew by 8.9% driven

Table 1.4

Balance of Payments¹			
Item (Net)	2014	2015	2016 _p
	RM billion		
Goods	113.3	109.6	101.2
Services	-10.7	-21.0	-22.6
Primary Income	-36.6	-32.0	-34.7
Secondary Income	-17.4	-21.9	-18.7
Current account balance	48.6	34.7	25.2
<i>% of GNI</i>	4.5	3.1	2.1
Capital account	0.3	-1.1	0.1
Financial account	-80.0	-50.9	-4.2
Direct investment	-18.0	4.8	17.9
Portfolio investment	-39.4	-28.2	-19.7
Financial derivatives	-1.0	-0.7	-0.8
Other investment	-21.7	-26.8	-1.7
Errors and omissions (E&O) ²	-5.5	21.1	-6.3
<i>% of total trade</i>	-0.4	1.4	-0.4
<i>of which:</i>			
Foreign exchange revaluation gain (+) or loss (-)	7.6	57.3	8.9
Overall balance	-36.5	3.8	14.8
Bank Negara Malaysia international reserves, net	405.3	409.1	423.9
USD billion equivalent	115.9	95.3	94.5

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

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

p Preliminary

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

by continued demand for semiconductors, while exports to the ASEAN region (29.4% share) grew by 5.4%, mostly on account of E&E and petroleum products. In sum, Malaysia's diversified trade structure helped to partially mitigate the impact of negative developments in some major export partners on the overall trade performance.

Malaysia's external trade remained subdued, reflecting modest global growth and low commodity prices

Gross imports recorded a higher growth of 1.9% (2015: 0.4%), driven largely by higher imports of capital goods in line with the on-going implementation of infrastructure projects and continued expansion in investment activity. In addition, intermediate imports registered a smaller contraction, due mainly to lower imports of fuel-related inputs following persistent weakness in commodity prices.

Some tentative signs of recovery in external trade performance began to emerge towards the end of the year. This was observed in the upticks in export and import growth in the last two months of 2016 (average November - December 2016 growth: 9.2% and 11.4%, respectively). This reflected

Table 1.5

External Trade				
	Share 2016 (%)	2014	2015	2016 _p
		Annual change (%)		
Gross exports	100.0	6.3	1.6	1.1
<i>of which:</i>				
Manufactures	82.2	7.1	6.5	3.2
Electronics and electrical (E&E)	36.6	8.1	8.5	3.5
Non-E&E	45.5	6.4	5.0	3.0
Commodities	17.1	3.9	-14.9	-8.6
Agriculture	9.0	0.5	-2.8	4.7
Minerals	8.2	6.2	-22.9	-19.8
Gross imports	100.0	5.3	0.4	1.9
<i>of which:</i>				
Intermediate goods	57.1	7.6	-2.1	-0.1
Capital goods	14.3	-2.4	-0.3	4.9
Consumption goods	9.6	5.7	24.1	7.3
Trade balance (RM billion)	-	82.5	91.6	87.3

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

both the stronger demand momentum from regional economies and positive price movements. Of importance, E&E exports grew by 11.1% in the last two months of the year. There were also positive valuation effects from the depreciation of the ringgit and gradual improvement in commodity prices towards the end of the year.

Chart 1.6

Export Performance

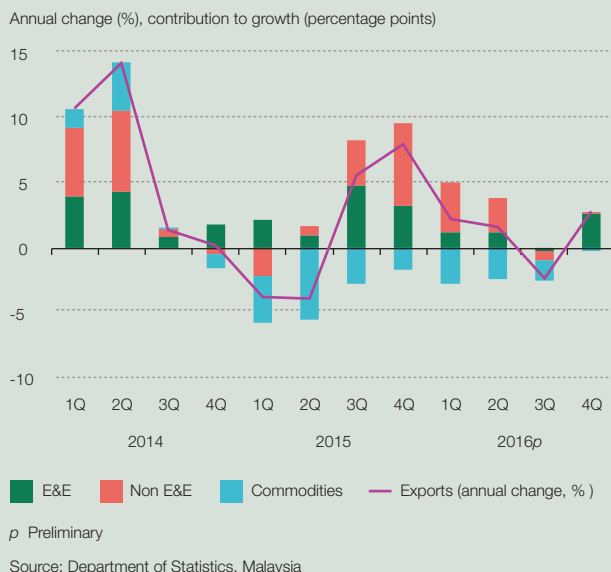


Chart 1.7

Import Performance

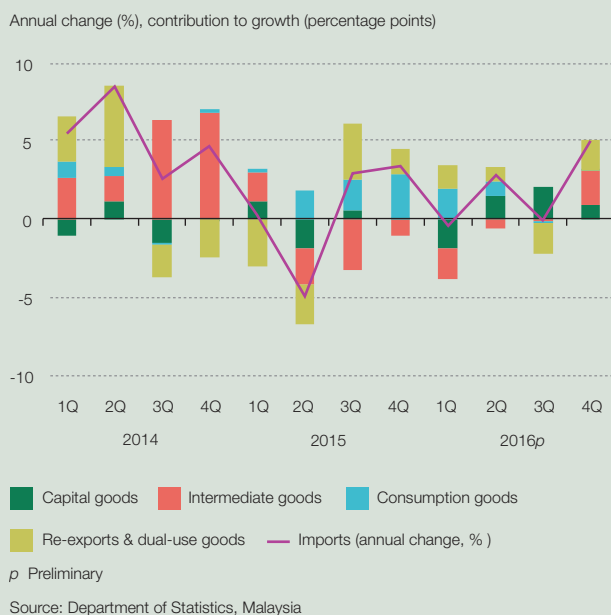
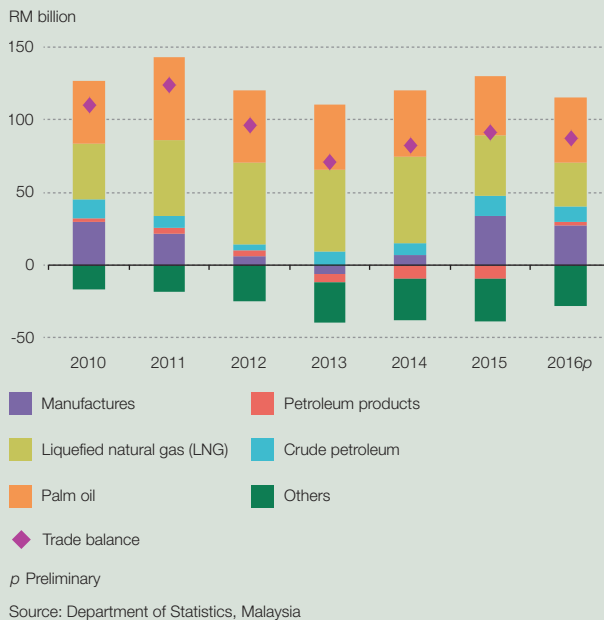


Chart 1.8

Trade Balance by Commodities



As export growth moderated and imports improved, for the year as a whole, the trade surplus narrowed to RM87.3 billion (2015: RM91.6 billion).

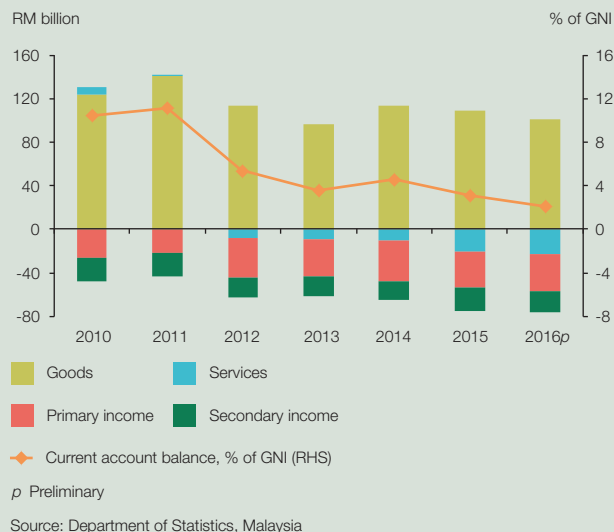
The services account registered a larger deficit, due mainly to higher employment of foreign professional, technical and engineering services (21% growth; 2015: 7.9%), particularly in the aviation, oil and gas, and utilities sectors. This, however, was partially offset by lower net payments in the transport account, in tandem with the modest trade activity. The travel account also recorded a higher surplus following the recovery in tourist arrivals.

In the income account, the primary income deficit widened due to lower net receipts from other investments, but was partially offset by a smaller deficit in direct investment income. In contrast, the secondary income account recorded a smaller deficit due to higher inward remittances amid the continued increase in outward remittances by foreign workers.

Overall, the current account balance remained in surplus as the trade surplus exceeded the deficits in the services and income accounts. The current account position stood at RM25.2 billion or 2.1% of GNI, a smaller amount compared to the previous year (2015: RM34.7 billion, 3.1% of GNI).

Chart 1.9

Current Account Balance



Significant two-way movement of capital flows

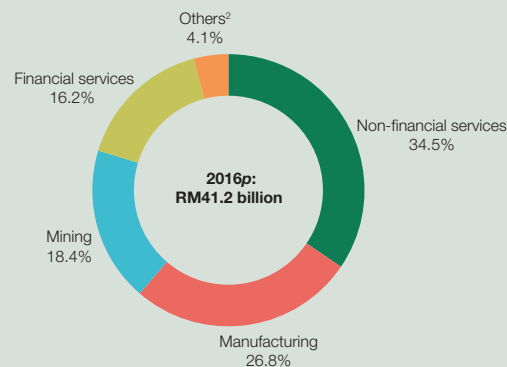
The external financial sector of the balance of payments continued to be confronted with significant volatility in the cross border movements of capital flows. However, the financial account recorded a smaller net outflow of RM4.2 billion in 2016 (2015: net outflow of RM50.9 billion), due mainly to higher net inflows in the direct investment account and lower net outflows in both the portfolio and other investment accounts.

Supported by ample reserves, a floating exchange rate and manageable external debt levels, the external financial position remained resilient despite considerable volatility in capital flows

The direct investment account recorded a higher net inflow of RM17.9 billion (2015: net inflow of RM4.8 billion), on account of higher net inflows arising from the incurrence of direct investment liabilities and the moderation in net outflows due to a lower level of acquisitions of direct investment assets⁴.

⁴ The main difference between 'direct investment assets/liabilities' and 'DIA/FDI' is the treatment of intercompany loans that has been changed from a directional basis to an asset-liability basis, in accordance with the 6th edition of the Balance of Payments and International Investment Position Manual (BPM6) by the International Monetary Fund (IMF). For further details, please refer to the White Box on 'Classification of Direct Investment in BPM6' in Bank Negara Malaysia's Annual Report 2013.

Chart 1.10

Net Foreign Direct Investment by Sectors¹

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

² Refers to agriculture and construction sectors

p Preliminary

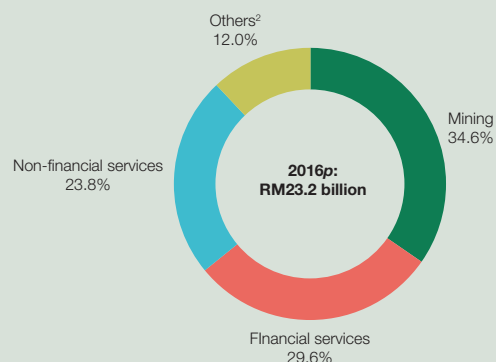
Source: Department of Statistics, Malaysia

During the year, foreign direct investment (FDI) in Malaysia moderated to RM41.2 billion, equivalent to 3.4% of GNI (2015: RM43.4 billion or 3.9% of GNI), arising mainly from lower investments in the manufacturing and mining sectors. The challenging global environment had resulted in several large multinational corporations (MNCs), particularly in the E&E industry, to undergo restructuring and consolidation of their operations in the region, including those in Malaysia. The environment of low oil prices also led to a considerable decline in foreign investments, particularly in upstream oil and gas activities. However, FDI in the services and construction sectors increased, reflecting mainly the large acquisition of domestic power generation assets by a foreign entity, continued expansion in the *finance and insurance*, and *wholesale and retail trade services* sub-sectors and the implementation of ongoing residential and infrastructure projects, particularly in the Klang Valley and Iskandar Malaysia.

Direct investment abroad (DIA) by Malaysian companies declined to RM23.2 billion or 1.9% of GNI (2015: RM38.7 billion or 3.4% of GNI). This was attributed mainly to investment in the mining sector declining by 67% to RM8 billion (2015: RM24.4 billion). This reflected the downscaling and deferment of capital expenditure for international upstream oil and gas activities amid cost optimisation measures, mainly by the national oil company. Nevertheless, DIA into the services sector improved, particularly in the *finance and insurance* sub-sector.

Chart 1.11

Net Direct Investment Abroad by Sectors¹



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

² Refers to manufacturing, agriculture and construction sectors

p Preliminary

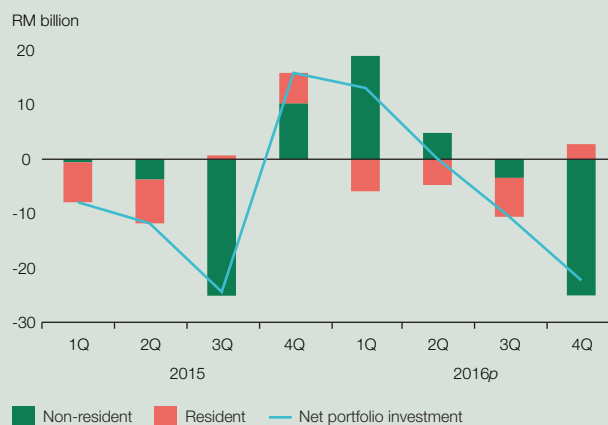
Source: Department of Statistics, Malaysia

Portfolio investment registered a lower net outflow of RM19.7 billion in 2016 (2015: net outflow of RM28.2 billion). In particular, portfolio investment by non-residents were largely characterised by two distinct periods. In the first half of the year, there were net inflows amounting to RM23.8 billion. The inflows were driven mainly by the purchase of debt securities, as the continued search for yield by non-resident fixed income investors led to strong demand for Malaysian Government Securities (MGS) and Government Investment Issues (GI). As a result, non-resident holdings of total outstanding public debt securities rose to 23% as at end-June 2016 (end-December 2015: 22.1%). In the second half of the year, non-resident portfolio flows recorded a net reversal amounting to RM28.5 billion. These outflows were mainly a reaction on the part of international investors to expectations of a faster pace of monetary policy normalisation by the Federal Reserve and expectations of growth-positive policies under the new US administration. The outflows during the period reflected mainly the maturity of foreign currency-denominated Wakala Global Sukuk issued by the Federal Government and the lower holdings of MGS and Bank Negara Monetary Notes (BNMN). Consequently, non-resident holdings of total outstanding public debt instruments declined to 20.8%. Notwithstanding some liquidation of equity securities during the year, foreign participation was sustained at 22.3% of stock market capitalisation as at end-December 2016 (end-December 2015: 22.3%).

Portfolio investment by residents recorded a higher net outflow of RM15 billion during the year (2015: net outflow

Chart 1.12

Portfolio Investments



p Preliminary

Source: Department of Statistics, Malaysia

of RM9.1 billion). These investments reflected mainly the continued purchases of foreign financial assets by domestic institutional investors, fund managers and financial institutions in line with their diversification strategies.

Despite the significant volatility in short-term capital flows, the impact on the overall financing conditions remained manageable. Malaysia's deep and diversified financial markets, coupled with a resilient financial sector, which continues to operate with strong capital and liquidity buffers, has enabled the domestic financial system to smoothly intermediate the large volumes of capital flows. The presence of large domestic institutional investors also played an instrumental role in stabilising the financial markets by providing sustained demand for domestic financial assets as foreign investors rebalanced their exposures.

The other investment account recorded a lower net outflow of RM1.7 billion (2015: net outflow of RM26.8 billion). The private sector recorded a net inflow of RM1.3 billion (2015: net outflow of RM24.9 billion). This turnaround was mainly attributable to loan repayments by non-resident financial institutions to Malaysian banks and the maturity of overseas deposits held by Malaysian banks. There was also a lower net extension of trade credits by Malaysian exporters to their trading partners, reflecting the subdued growth in exports. The public sector, however, registered a higher net outflow of

RM2.9 billion (2015: net outflow of RM1.9 billion), following a moderation in drawdown of new external borrowings amid continued repayment of external loans.

On the whole, the overall balance of payments registered a higher surplus of RM14.8 billion (2015: surplus of RM3.8 billion). Errors and Omissions (E&O) amounted to -RM6.3 billion or -0.4% of total trade, reflecting mostly foreign exchange revaluation gains on international reserves. Excluding revaluation gains, the E&O stood at -RM15.2 billion or -1% of total trade.

The international reserves of Bank Negara Malaysia amounted to USD94.5 billion (equivalent to RM423.9 billion as at end-2016 compared to USD95.3 billion (equivalent to RM409.1 billion) as at end-2015. Besides developments in the current and financial accounts, the reserves level was also affected by foreign exchange revaluation changes. The reserves level in USD terms declined during the year as the USD strengthened against most of the currencies that make up the diversified foreign currency reserve assets. In ringgit terms, the reserves level has correspondingly increased as the ringgit weakened against most currencies during the same period.

As at 28 February 2017, the reserves level amounted to USD95 billion (equivalent to RM426.3 billion). The international reserves remain ample to facilitate international transactions and sufficient to finance 8.5 months of retained imports and are 1.1 times the short-term external debt. Furthermore, the wide range of monetary policy instruments and the exchange rate flexibility have enabled the economy to reduce its reliance on the Bank's international reserves in managing external pressures.

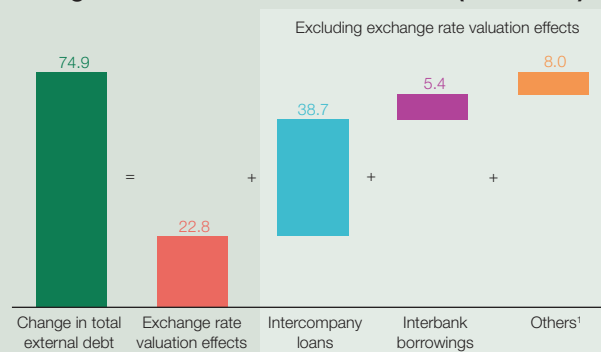
Manageable external debt

Malaysia's external debt amounted to RM908.7 billion, equivalent to USD200.6 billion or 73.9% of GDP as at end-2016. The increase of RM74.9 billion or 9% from RM833.8 billion at end-2015 was partly attributed to valuation effects following the weakening of the ringgit against most currencies during the year. Excluding valuation effects, Malaysia's external debt position increased by 6.2%, mainly on account of higher intercompany and interbank borrowings (Chart 1.13).

Malaysia's external debt remains manageable given its currency, maturity and balance sheet profiles. More than one-third of total external debt is denominated

Chart 1.13

Changes in Total External Debt in 2016 (RM billion)



¹ Include other instruments such as bonds and notes, loans, non-resident (NR) holdings of domestic debt securities, NR deposits, trade credits, IMF allocation of SDRs and miscellaneous, such as insurance claims yet to be disbursed and interest payables on bonds and notes

Source: Bank Negara Malaysia

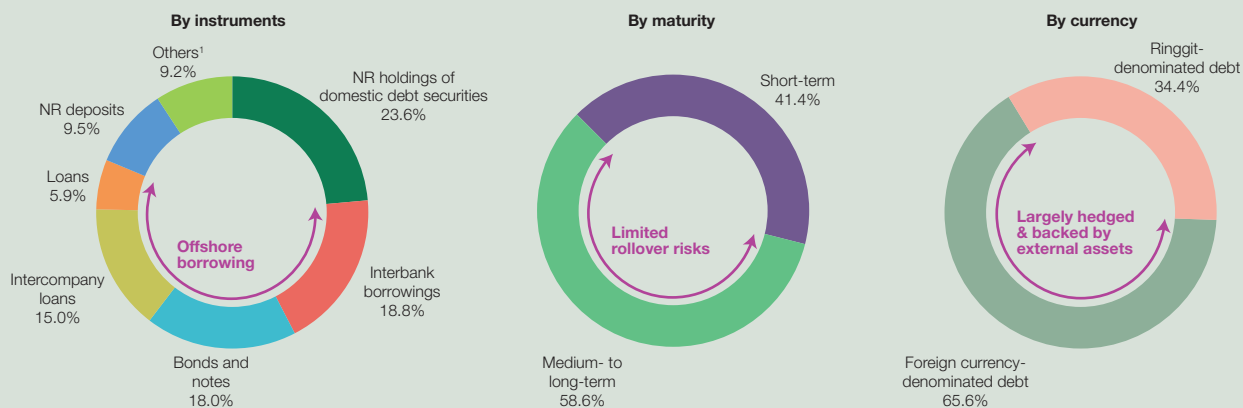
in ringgit (34.4%), mainly in the form of non-resident holdings of domestic ringgit debt securities and ringgit deposits in domestic banking institutions. As such, these liabilities are not subjected to valuation changes arising from fluctuations in the ringgit exchange rate. In the course of the year, the total non-resident holdings of domestic debt securities increased by 1.4% to RM214.2 billion (end-2015: RM211.3 billion). Non-resident acquisition of GII and MGS during most parts of the year had offset the liquidation of BNMN. This liquidation by non-resident portfolio investors, particularly towards the end of the year, was driven by the increase in the US Federal Reserve's policy rate in December 2016, the anticipation of a faster pace of US interest rate normalisation in 2017, and speculative activity in the non-deliverable forward (NDF) market. On the other hand, the level of non-resident ringgit-denominated deposits in the domestic banking institutions increased by RM6.2 billion or 14.3%.

While the remaining portion of total external debt of RM597.3 billion (65.6%) is denominated in foreign currency, most of it is hedged, either naturally using foreign currency earnings or through the use of financial instruments. Most of these obligations are offshore borrowings⁵, raised mainly to further expand productive capacity and to better manage financial resources within corporate groups. As at

⁵ Equivalent to the external debt as previously defined, comprised mainly foreign currency loans raised, and bond and notes issued offshore.

Chart 1.14

Breakdown of Malaysia's Total External Debt (% share)



¹ Includes trade credits, IMF allocation of SDRs and miscellaneous, such as insurance claims yet to be disbursed and interest payables on bonds and notes

Source: Bank Negara Malaysia

end-2016, the offshore borrowing had declined to 42.7% of GDP compared to 60% of GDP during the Asian Financial Crisis.

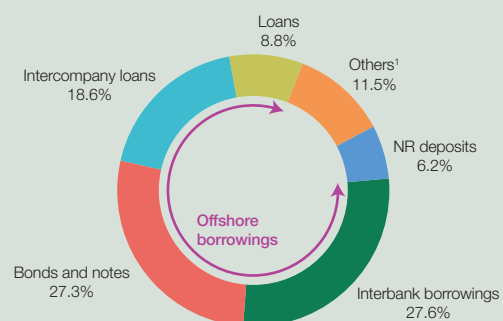
Of the total foreign currency-denominated external debt (inclusive of exchange rate valuation effects), around one-third is accounted by interbank borrowing and foreign currency deposits in the domestic banking system (Chart 1.15), which had increased by RM10.4 billion from end-2015. This reflects the 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 then followed by long-term bonds and notes issued offshore (RM163.4 billion), primarily to finance asset acquisitions abroad that will generate future income. The net increase of RM40.3 billion in foreign currency-denominated intercompany loans was mainly accrued by private corporations in the oil and gas sector and finance and insurance sub-sector. These obligations are normally subjected to flexible and concessionary terms, such as having no fixed repayment schedules or bearing low interest rates.

From a maturity perspective, more than half of the total external debt is skewed towards medium- to long-term tenures (58.6% of total external debt), suggesting limited rollover risks. Also, not all short-term external debt pose a claim on reserves, given the export earnings of borrowers and external assets. As at end-2016, Malaysia recorded a current

account surplus and remains a net creditor nation (Chart 1.16), with international reserves accounting for only a quarter of total external assets. The majority of total external assets are held by banks and corporations. The availability of these external assets better enable these entities to meet their external obligations without necessarily creating a claim on international reserves. As at end-2016, Malaysia still recorded a net short-term external surplus position of RM327.3 billion (Chart 1.17), an increase of RM45.2 billion from end-2015 (net short-term asset surplus of RM282.1 billion).

Chart 1.15

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



¹ Includes trade credits and miscellaneous, such as insurance claims yet to be disbursed and interest payables on bonds and notes

Source: Bank Negara Malaysia

Chart 1.16

Net International Investment Position (IIP)

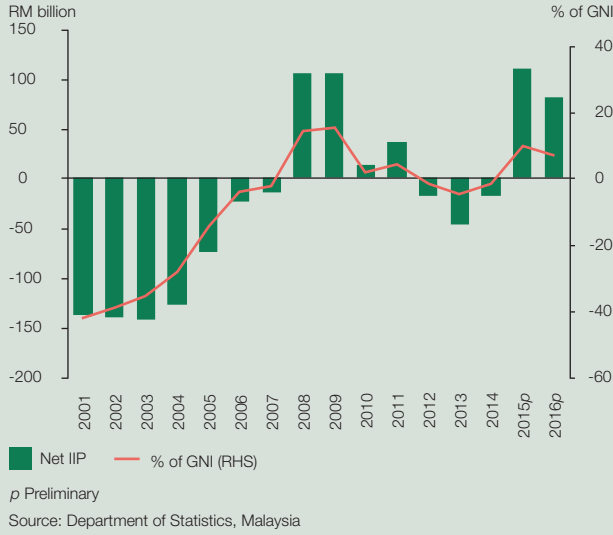


Chart 1.18

Contribution to Headline Inflation by Components

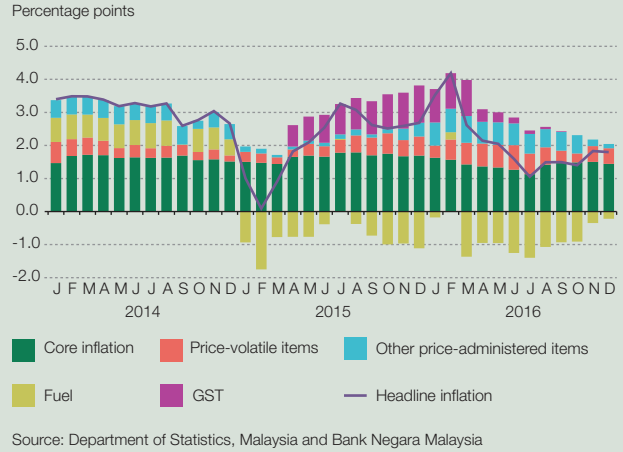


Chart 1.17

Short-term External Assets and Liabilities (RM billion)

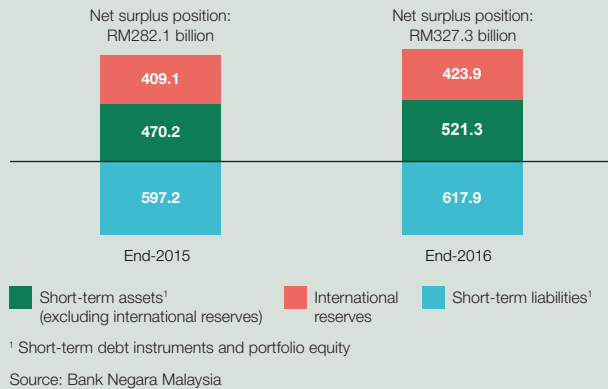
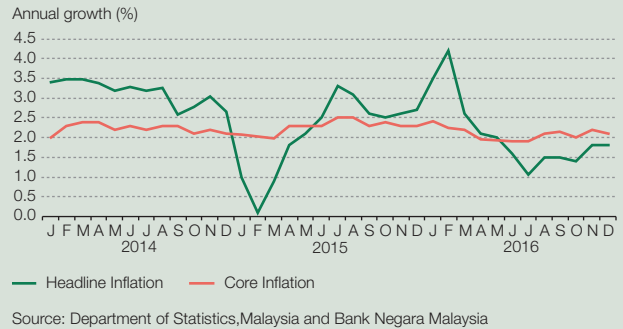


Chart 1.19

Consumer Price Inflation



INFLATION DEVELOPMENTS

Headline inflation remained low in 2016

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), was unchanged at 2.1% in 2016 (2015: 2.1%), which is at the lower end of the Bank’s forecast range of 2% - 3%. Inflation during the year was driven mainly by adjustments to administered prices undertaken since the fourth quarter of 2015⁶ and higher

prices of fresh food items due to the El Niño weather phenomenon. The inflationary pressures were, however, offset by the lapse in the impact of GST and lower domestic fuel prices. Moderate domestic demand conditions and a subdued external price environment also helped to contain domestic inflationary pressures. Correspondingly, core inflation⁷ was broadly stable during the year, averaging 2.1% in 2016 (2015: 2.3%).

While the average headline inflation for the year was unchanged compared to 2015, the monthly headline inflation continued to be volatile due to global factors. Headline inflation started the year at an elevated level, peaking at 4.2% in February 2016. The higher inflation was driven mainly by the base effect from the low domestic fuel prices in the corresponding

⁶ The administered price items are toll charges (October 2015), cigarette prices (November 2015), railway fares (December 2015), reduction in electricity rebates (January 2016) and cooking oil (November 2016).

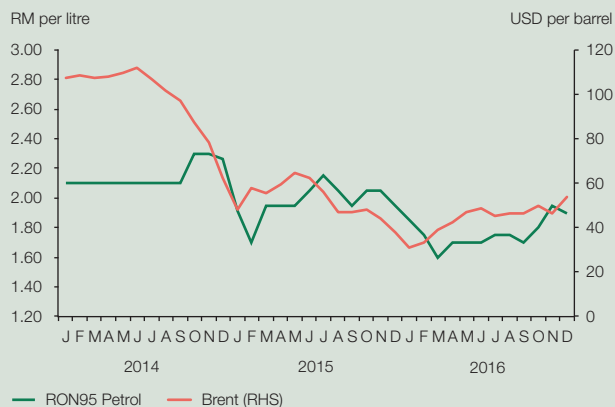
⁷ Core inflation is computed by excluding price-volatile and price administered items. It also excludes the estimated direct impact of GST.

period in 2015 and the relatively high prices of fresh food following the occurrence of El Niño at the beginning of the year. It, however, moderated quickly to 2.6% in March 2016 as a result of the decline in domestic fuel prices. The price of RON95 petrol was revised downwards to a low of RM1.60 per litre in March 2016 following the decline in global oil prices. The impact of El Niño was also temporary as weather conditions began to normalise in the second half of 2016. Headline inflation continued to moderate further, averaging 1.6% for the remaining nine months of the year amid the lapse in the GST impact and lower domestic fuel prices. In addition, the moderate demand pressures, low global energy and non-food commodity prices and subdued global inflation also helped to keep inflation low. The benign domestic inflationary environment led to the downward revision of the Bank's official forecast range from 2.5% - 3.5% to 2% - 3% in July 2016.

Inflation during the year was driven mainly by domestic cost factors arising from upward price adjustments for several price-administered items undertaken since the fourth quarter of 2015. Electricity tariffs and cooking oil prices were revised upwards in January and November 2016, respectively. In addition, the dry weather conditions caused by El Niño affected the production of fresh food such as vegetables, fruits and fish at the beginning of the year. For the year as a whole, fresh food inflation was higher at 5.6% (2015: 4.2%). However, domestic inflation was dampened by the lapse in the impact of GST and by

Chart 1.21

Domestic Fuel and Global Oil Prices



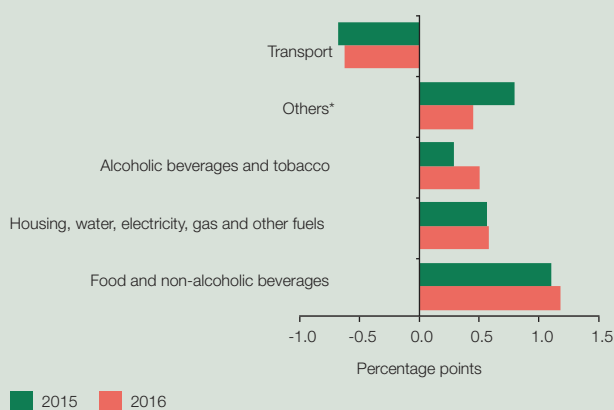
Source: Ministry of Domestic Trade, Co-operatives and Consumerism, and Bloomberg

lower domestic fuel prices during the year. Prices of RON97 petrol, RON95 petrol and diesel averaged lower at RM2.11, RM1.76 and RM1.62 per litre, respectively, in 2016 (2015: RM2.33, RM1.98 and RM1.92 per litre, respectively).

Externally, the continued low global commodity prices also played a key role in mitigating domestic inflation despite the weaker ringgit exchange rate⁸. The IMF Primary Commodity Index declined by 10% in 2016 (2015: -35.3%), driven mainly by lower energy prices amid continued excess supplies. As a result, the lower global commodity prices led to an overall decline in the input costs of firms as reflected in the decline

Chart 1.20

Contribution to Inflation by Categories

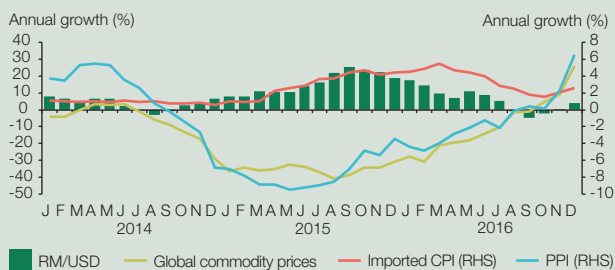


*Others include clothing and footwear, health, education, communication, recreation services and culture, furnishings, household equipment and routine household maintenance, restaurants and hotels, and miscellaneous goods and services categories.

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1.22

Exchange Rate, Global Commodity Prices, Imported CPI and PPI



Note: For RM/USD, annual growth refers to the annual change in the monthly average. A positive figure indicates a depreciation in ringgit against the US dollar.

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

⁸ On the impact of ringgit depreciation on domestic inflation, see Box Article on 'The Impact of Exchange Rate Depreciation on Inflation in Malaysia' in Bank Negara Malaysia's Annual Report 2015.

of the Producer Price Index (PPI) by 1.1% in 2016 (2015: -7.4%). The lower costs of production for firms helped in containing prices of domestically produced goods. The weaker ringgit did lead to higher imported inflation during the year. Excluding fuel, the prices of the imported components of the CPI increased by 3.5% (2015: 3%)⁹. The increase was driven by higher prices of imported finished food items as the inflationary impact of the weaker ringgit was exacerbated by the higher global food prices. Global food prices were higher for the year amid adverse weather conditions

following the occurrence of El Niño, as reflected in the 2% increase in the IMF Food Price Index (2015: -17.1%).

Core inflation was relatively stable during the year averaging 2.1% in 2016 (2015: 2.3%). Demand driven inflationary pressures in the economy remained largely stable during the year, underpinned by continued modest growth in private consumption and an absence of significant wage pressures. This was also reflected in the small positive output gap and the relatively stable capacity utilisation rate of 77.5% (2015: 76.5%).

⁹ Excluding fuel, imported items only account for a small share of 6.7% of the CPI basket. Hence, its impact on overall inflation is small.

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

By Cheah Wenn Jinn, Low Ai Loon and Nooraihan Mohd Radzuan

Introduction

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

Chart 1

Narrowing Current Account Balance Since 2008



Source: Department of Statistics, Malaysia

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

Given the narrowing current account surplus, it would be insightful to understand the factors which contribute to the changing dynamics of the current account over time. Building on a previous article on the current account

position in 2012¹, this article provides a closer and more up-to-date examination of the drivers of the current account balance. We continue to evaluate the trends from the perspectives of international trade and the saving-investment gap, before concluding with a brief assessment on the outlook for the current account balance going forward.

Drivers of Malaysia's Current Account Balance

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

Chart 2

Slower Global Growth (Real GDP)

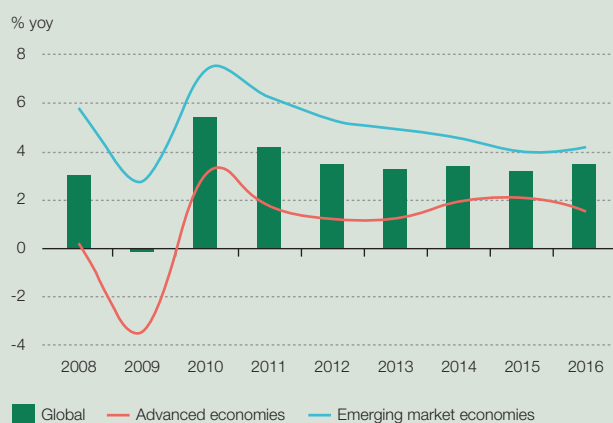
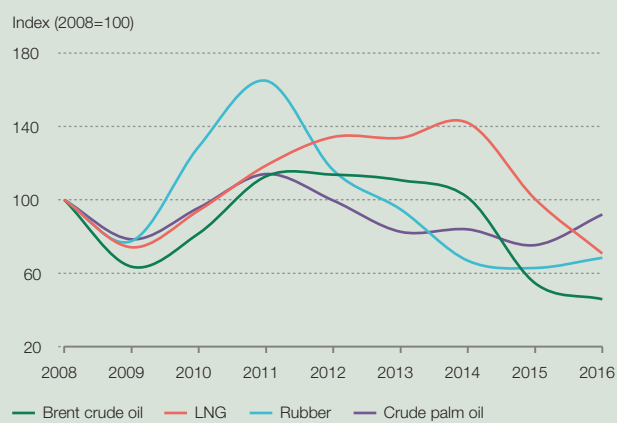


Chart 3

Sharp Decline in Commodity Prices



From the international trade perspective, these factors have manifested in a lower goods surplus and higher services and income deficits (Chart 4). The goods surplus has declined as the subdued external environment weighed on Malaysia's export performance. At the same time, a period of strong domestic investment (2012 - 2016 average: 7.7%, 2003 - 2007 average: 5.6%) had contributed to the rise in imports². Amid rapid capacity expansion and the implementation of large infrastructure projects, capital imports increased to an average of RM97 billion between 2012 and 2016 (2003 - 2007 average: RM57 billion).

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

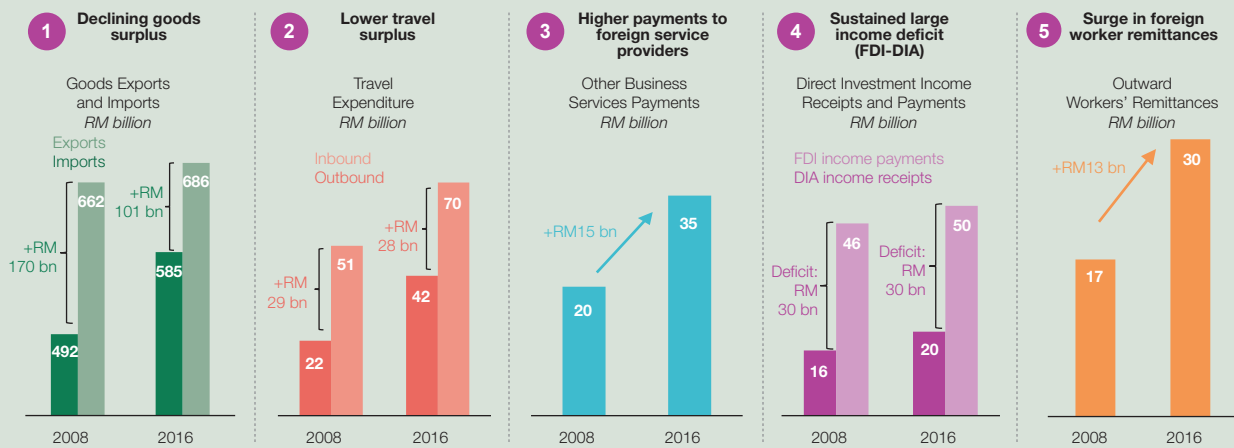
Payments to foreign service providers, particularly for technical and engineering services, have also increased. Domestic technical expertise and consultancy management services have steadily been complemented by foreign

¹ Refer to the Box Article on 'Current Account Balance in Malaysia: Recent Developments and Outlook', Bank Negara Malaysia's Annual Report 2012.

² Refer to the Box Article on 'Private Investment in Malaysia: Drivers and Sustainability', Bank Negara Malaysia's Annual Report 2012.

Chart 4

Five Key Developments in Malaysia's Current Account Balance



Source: Department of Statistics, Malaysia

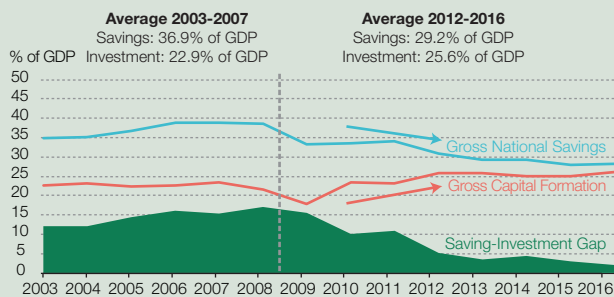
expertise and advisors, particularly for projects that use more complex technologies. Foreign services that require skilled and specialised knowledge have been used, mainly by the oil and gas, transportation and the utilities sectors.

The deficit in the investment income account has remained sizeable³, as incomes accrued to Malaysian companies investing abroad, particularly in the mining and services sectors, were affected by the weaker global demand conditions. At the same time, foreign investors in Malaysia, particularly those in the manufacturing sector continue to earn sizeable profits from their investments in Malaysia. Foreign worker remittances also continued to grow, reflecting the increased reliance on foreign workers in the labour-intensive sectors of the economy.

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

Chart 5

Narrowing Surplus Reflects Higher Investments Amid Moderating Savings in Malaysia



Source: Department of Statistics, Malaysia

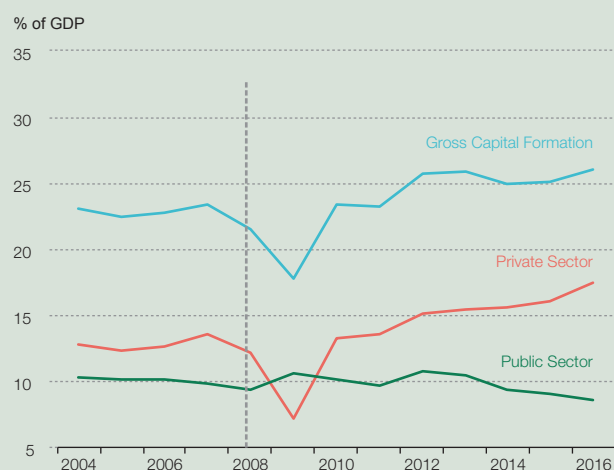
³ Refer to the Box Article on 'Payoffs from Going Global: Assessing the Returns from Malaysia's Direct Investment Abroad'.

The private sector continued to be the key driver of investments in Malaysia (Chart 6). On average, private investments advanced by 11.2% between 2012 and 2016 (2002 - 2007 average: 9%), underpinned by the implementation of large infrastructure projects and capacity expansion in high value-added services, manufacturing and mining sectors, which accounted for 92% of total private investment in 2015. Public investment remained broadly stable owing to sustained capital spending by public corporations, mainly in the oil and gas, transportation and utilities sub-sectors. These investments have also had a discernible impact on Malaysia's productive capacity, particularly in the oil and gas sector. Of note, the development of the new oil field in Gumusut-Kakap contributed to the increase in Malaysia's oil production capacity from 570,000 barrels per day (bpd) in 2013 to 661,000 bpd in 2016. Development expenditure by the Federal Government also supported public investment, focusing mainly on education, healthcare, housing, transport system and industrial infrastructure spending⁴.

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

Chart 6

Higher Investments Driven by the Private Sector



Source: Department of Statistics, Malaysia

Chart 7

Moderating Savings Amid Lower Private Sector Savings

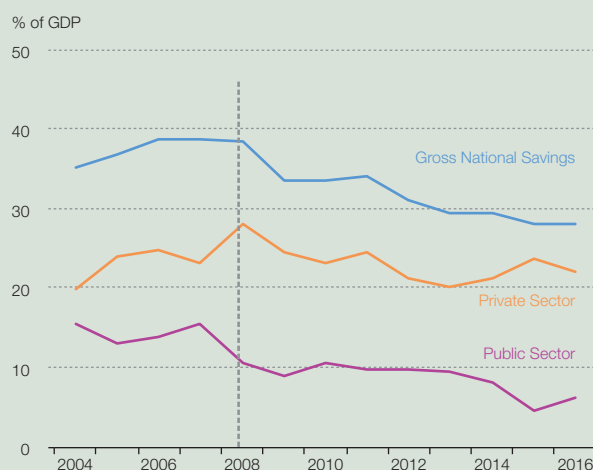


Table 1

Productive Investments to Enhance Domestic Productive Capacity and Export Competitiveness

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

Source: News flows

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

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

For the public sector, savings were broadly stable. Firms in the mining sector, which include public corporations, reported marginal growth in operating surpluses (2012 - 2015 average: 1.8%; 2011: 7.0%). Nevertheless, public corporations in the transportation, storage and communication services sub-sectors recorded relatively higher growth in profits, thus providing support to public savings (2012 - 2015 average: 5.9%; 2011: 12.3%). The smaller General Government⁵ current deficit also alleviated pressure on public savings as efforts were taken to broaden the tax base and rationalise subsidies. Notable measures include the introduction of the Goods and Services Tax (GST) and the removal or reduction of subsidies on vehicle fuel, sugar and cooking gas. Despite these trends, Malaysia's gross national savings remained high at 28.1% of GDP in 2016 (2015: 28.1% of GDP), compared to the average savings rate of 22.9% of GDP in emerging market economies, excluding PR China⁶. This high rate of savings has enabled Malaysia to finance economic growth mainly from domestic sources.

Prospects for the Current Account

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

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

⁵ General Government comprise the Federal, State and Local Governments, as well as statutory bodies.

⁶ Gross national savings rate of emerging economies including PR China is 32.5% of GDP in 2015.

Payoffs from Going Global: Assessing the Returns from Malaysia's Direct Investment Abroad

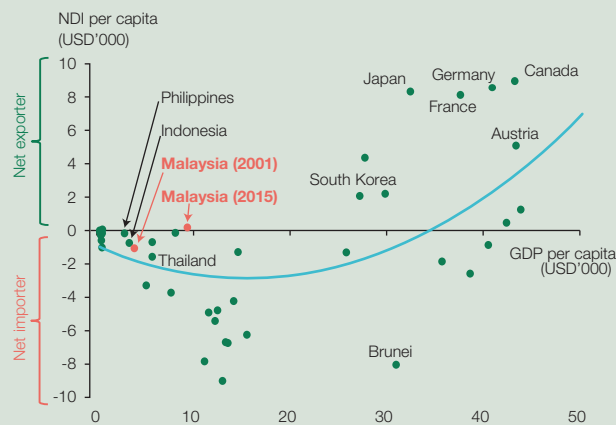
By Mohd Shazwan Shuhaimen and Lim Ming Han

Introduction

As a highly open economy, Malaysia has been a longstanding recipient of foreign direct investment (FDI), which has been a vital source of capital formation for economic growth. However, compared to its peers, Malaysia has transitioned from being a net importer of long-term capital to being a net exporter within the recent decade on account of the rapid expansion of direct investment abroad (DIA)¹ by Malaysian corporations (Chart 1). This evolution underscores the growing maturity and capability of domestic firms to compete on a global and regional scale and the changing structure of the economy as it progresses towards a high-income nation. Of significance, Malaysia's DIA stands out as among the largest in the region as a proportion to the size of the economy, second only to Singapore (Chart 2). Since such capital outflows reflect, in part, a recycling of domestic savings abroad, this study assesses the returns of Malaysia's DIA from the profitability perspective².

Chart 1

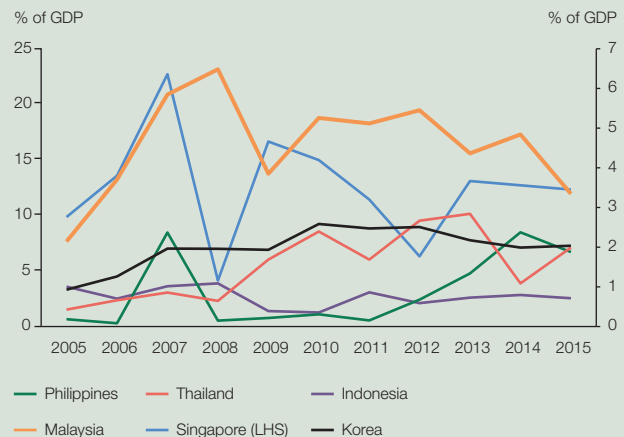
Net Direct Investment (NDI) and GDP per capita, 2015



Source: United Nations Conference on Trade and Development (UNCTAD), International Monetary Fund (IMF) and Department of Statistics, Malaysia

Chart 2

DIA Flows: Selected Regional Economies, 2005 – 2015



Source: UNCTAD, IMF and Department of Statistics, Malaysia

Overview of Malaysia's Direct Investment Abroad

The rapid expansion of DIA has been facilitated by key regulatory and policy developments. Foreign exchange administration rules have been progressively deregulated with the aim of enhancing the competitiveness of resident companies by providing greater flexibilities to invest abroad, obtain external financing, manage cross-border movement of funds and hedge their foreign currency exposures. Equally important is the deepening economic co-operation and integration among regional economies through initiatives such as bilateral and regional trade agreements. These initiatives have reduced regulatory barriers, lowered the costs of doing business and opened up new markets for trade and investment. Finally, the domestic financial system has become more diversified, competitive and resilient. This has supported the internationalisation of Malaysian firms through more effective intermediation of cross-border financial flows and greater access to financing.

¹ Direct investment abroad, as defined according to the 5th edition of the Balance of Payments Manual (BPM5) by the International Monetary Fund (IMF), refers to the cross-border investment by a resident in Malaysia having control or a significant degree of influence on the management of an enterprise that is resident in another country. This control or influence is achieved when the direct investor owns at least 10 percent of the voting power in the direct investment enterprise.

² DIA investment performance may also be assessed from other dimensions, for example, in terms of cost of financing, dividend policy, asset turnover or operational efficiency perspectives.

Chart 3

DIA and FDI Flows

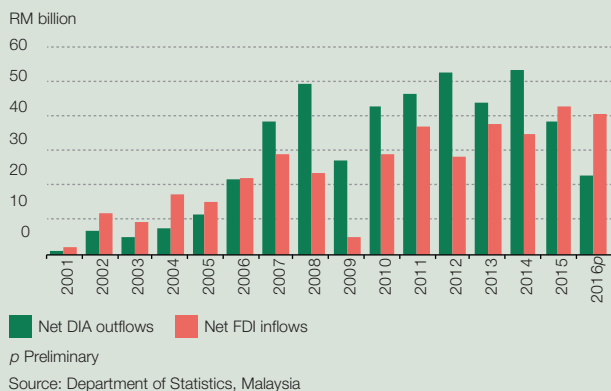


Chart 4

DIA and FDI Stock (end-position)

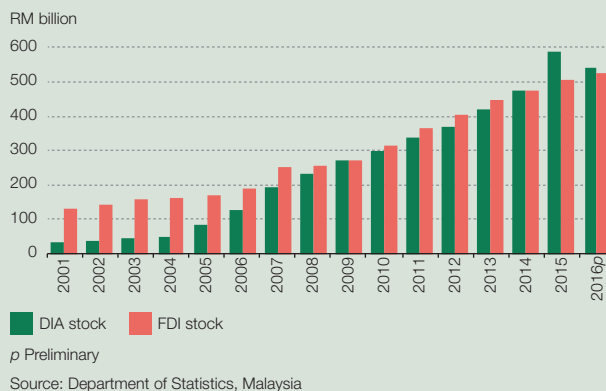
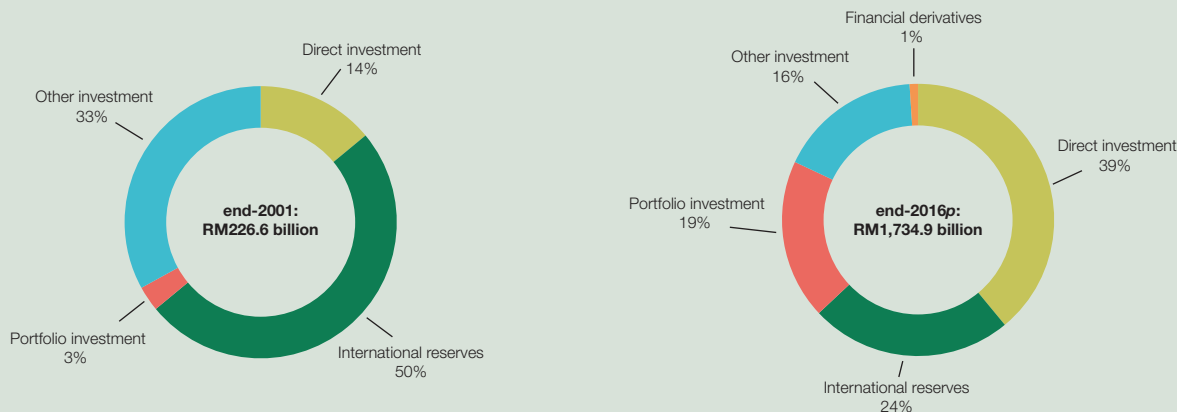


Chart 5

Composition of Malaysia's External Assets



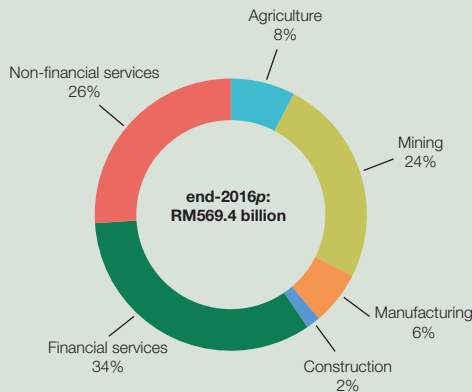
These developments have complemented the aspirations of Malaysian firms to expand their global footprint. Thus, DIA outflows have increased significantly in recent years and have consistently surpassed FDI inflows since 2007. Since 2015, however, DIA has moderated amid subdued global growth environment and prolonged weakness in commodity prices (Chart 3). Nevertheless, from an international investment position (IIP) perspective, Malaysia has become a net creditor of direct investment since 2015. The stock of DIA has exceeded the stock of FDI, in part reflecting capital gains arising from exchange rate revaluation (Chart 4). As at end-2016, DIA accounted for a 39% share of Malaysia's overall external assets. This is even larger than the level of international reserves (24% share) (Chart 5).

It is important to consider the underlying structure of Malaysia's DIA in relation to its FDI, in order to understand the relative characteristics of the returns and income generated by both types of long-term capital. In terms of sectorial composition, DIA is concentrated in the services sector, underscoring the growing regionalisation of Malaysian corporations in the finance, insurance, real estate and business services; information and communication; and utilities sub-sectors. This is followed by sizeable investments in the mining and agriculture sectors (Chart 6). Conversely, the bulk of FDI in Malaysia is channelled into the manufacturing and services sectors (Chart 7).

In terms of its geographical distribution, the bulk of DIA was channelled into the regional economies namely Singapore, Indonesia, India and Thailand, as well as the advanced economies such as Canada and Australia. A sizable share

Chart 6

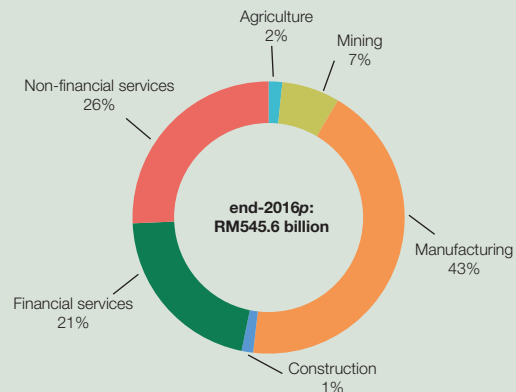
Direct Investment Abroad Position by Sector



p Preliminary
Source: Department of Statistics, Malaysia

Chart 7

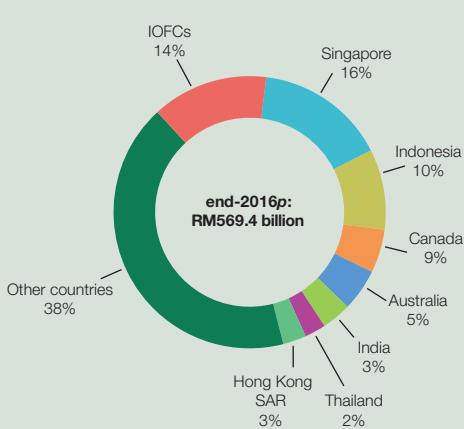
Foreign Direct Investment Position by Sector



p Preliminary
Source: Department of Statistics, Malaysia

Chart 8

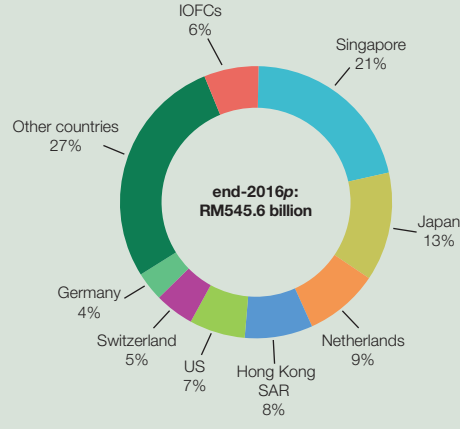
Direct Investment Abroad Position by Country



p Preliminary
Note: IOFCs refer to International Offshore Financial Centres
Source: Department of Statistics, Malaysia

Chart 9

Foreign Direct Investment Position by Country



p Preliminary
Note: IOFCs refer to International Offshore Financial Centres
Source: Department of Statistics, Malaysia

went to the International Offshore Financial Centres (IOFCs), where investible funds were pooled before being redirected to economic sectors in various other locations (Chart 8). On the other hand, a larger share of FDI is sourced from the advanced economies directly, namely Japan, Netherlands, United States and Switzerland, followed by the regional economies such as Singapore and Hong Kong SAR (Chart 9).

Assessing the Returns from Malaysia's Direct Investment Abroad

In evaluating the returns of DIA on the economy, both the direct and indirect benefits must be considered. Typically, countries that have a large number of home-grown multinational corporations (MNCs) enjoy positive spillover benefits in the form of greater productivity growth from enhanced firm competitiveness; higher wages and inward remittances from employment opportunities abroad; and the formation of backward linkages in terms of input sourcing from its domestic operations and other local firms. However, recent studies for Malaysia³ suggest that evidence of these benefits was

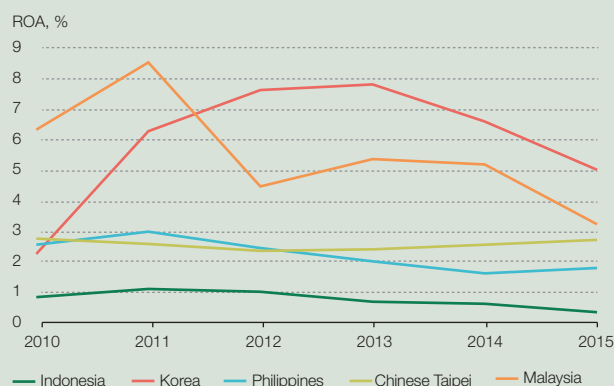
³ Empirical studies on the impact of DIA on economy by Goh and Wong (2014), Goh et al (2013), Wong (2013) and Chen et al (2012).

inconclusive and would only potentially materialise over a longer timeframe. These studies allude to the fact that Malaysia's DIA has limited scope for backward linkages as it is largely in the services rather than manufacturing sectors. The inability of local suppliers and small and medium enterprises (SMEs) to meet the varied procurement needs of outward bound Malaysian firms was possibly another constraint hindering deeper backward linkages. The studies also demonstrated that the channelling of domestic savings for investment abroad occurred because of relatively low growth in domestic capital formation, particularly from 2005 to 2009. Nevertheless, the sustained inflows of FDI and the revival of domestic capital spending since 2010, particularly by the private sector⁴, were more than sufficient to offset the upward trend in DIA.

The direct benefits of DIA can be measured in a more straightforward manner. From a profitability perspective, a firm's DIA performance can be assessed from the amount of income generated or the return on assets (ROA) arising from its investments abroad. As a percentage of outstanding DIA stock, the direct investment income⁵ of Malaysian corporations has fared better compared to some regional peers (Chart 10), underscoring their relative competitiveness. In 2016, the ROA of Malaysia's DIA was 3.5%. This means that an income of RM3.50 is generated for every RM100 invested abroad. Nevertheless, in recent years, the returns have trended downwards in tandem with its regional peers, reflecting the more challenging global economic environment.

Chart 10

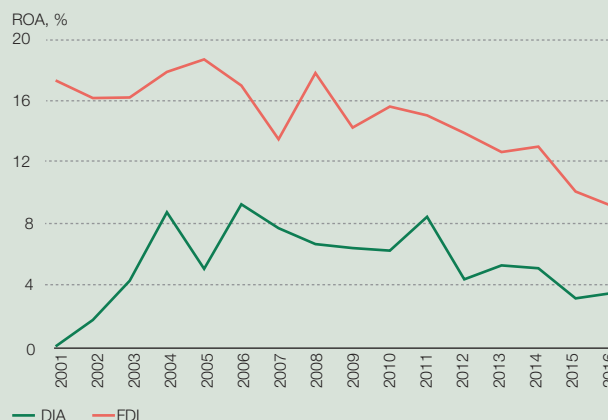
Returns on DIA of Selected Asian Economies, 2010-2015



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

Chart 11

Returns on Malaysia's DIA and FDI, 2001-2016



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

An alternative approach in assessing DIA returns is to benchmark against the performance of FDI in Malaysia. Chart 11 shows that DIA generated much lower returns compared to its FDI counterpart, though the latter also has been trending downwards. In level terms, the amount of income generated by DIA is also lower than FDI, with the divergence most apparent in the manufacturing, financial and non-financial services subsectors. DIA companies have also repatriated a smaller share of their income to their parent companies, compared to their FDI counterparts (Chart 12). This deficit in the direct investment income account, along with the structural deficits in the services and secondary income accounts has led to a narrowing of Malaysia's current account surplus. It should be noted that Malaysia is not unique in experiencing investment income deficits as several other regional countries with large FDI presence also share a similar characteristic (Chart 13). This is attributable, in part, to the rise of global value chains over the past several decades, whereby multinational corporations (MNCs) had diversified their presence by investing and operating in various stages of production across countries in the region, thus reaping the benefits of improved cost optimisation and profitability through specialisation and greater economies of scale.

⁴ For a more detailed account, please refer to Box Article on 'Debunking Malaysia's Investment Myths' in Bank Negara Malaysia's Annual Report 2014 and 'Private Investment in Malaysia: Drivers and Sustainability' in Bank Negara Malaysia's Annual Report 2012.

⁵ The receipts of direct investment income measures the returns accrued to Malaysian corporations from their investment abroad. It consists of earnings from the firm's productive activities in the current period that may be distributed in the form of dividends or reinvested into the firm's operations, plus interest on intercompany debt.

Chart 12

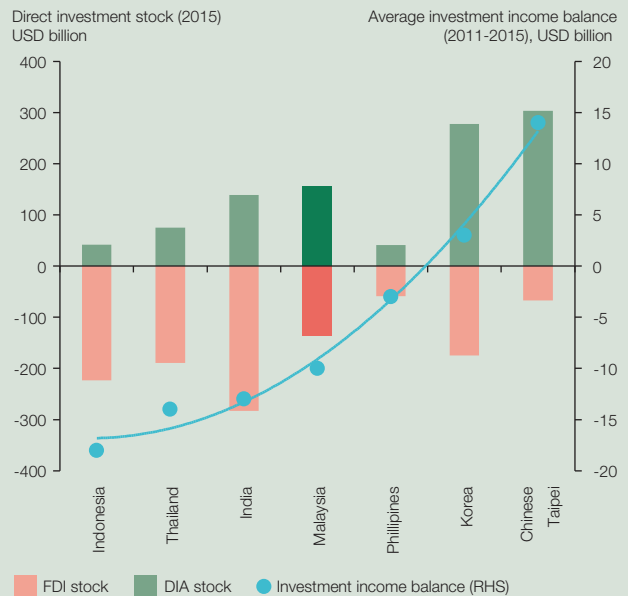
Average FDI and DIA Investment Income Generated and Repatriated by Sector, 2010-2016



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

Chart 13

Direct Investment Stock and Average Investment Income Balance of Selected Regional Peers, 2011-2015



Source: UNCTAD, Haver

The differences in the rate of returns between DIA and FDI can be attributable to several factors⁶. The first is the timing and level of maturity between domestic and foreign firms in the global arena⁷. Although Malaysian corporations are market leaders domestically, most are at a relatively nascent stage of venturing abroad in terms of organisational capacity and managerial experience. DIA, which only began in earnest during the 1980s and 1990s⁸, were undertaken mainly by public corporations in the mining and agriculture sector. Since the mid-2000s, private sector participation has increased significantly, expanding mostly in the services sector. By contrast, FDI is led by large MNCs which have established a longer presence in Malaysia. It is worth noting that several reputable foreign financial institutions have been in existence in Malaysia as early as the 1880s, while rapid industrialisation in the 1970s witnessed the influx of Japanese and US investments in the manufacturing sector. As these MNCs possess more recognisable brands, intellectual property assets, better supply chain management and a wider customer base, they are able to obtain a steadier and higher income stream.

The second factor is the divergence in underlying investment motivations. There are a host of reasons that can influence a firm's decision to expand beyond its shores. Based on research⁹, firms most often are seeking natural resources, markets, production efficiency, strategic assets, or some combination of these. In this respect, Malaysia's DIA is driven mainly by market-seeking and resource-seeking motives, whereas FDI is primarily influenced by efficiency-seeking purposes. Being new entrants into the host country, Malaysian firms in the finance and insurance, information and communication and utility sub-sectors (comprising 47% share of DIA) tend to incur high start-up costs,

⁶ Adapted from 'On Returns differentials' (Curcuro et al, 2013).

⁷ Firms' years of experience in foreign markets are considered a key measure of international competitiveness, in addition to geographical and product variety, and share of foreign operations (Clarke et al, 2013).

⁸ For a more detailed account, refer to Box Article on 'Malaysia: Trends in Direct Investment Abroad' in Third Quarter 2006 Bank Negara Malaysia's Quarterly Economic Bulletin.

⁹ Research has identified four key motivations for direct investment (USAID, 2005 and Dunning, 1980). They are: 1) *Natural resource-seeking* – to access to a natural resource not available in the company's home market; 2) *Market-seeking* – to gain access to new customers and export markets; 3) *Efficiency-seeking* – to reduce production costs by gaining access to competitively priced input and labour; and 4) *Strategic asset-seeking* – to gain strategic assets in another economy, such as brands or new technologies.

prioritising brand-building strategies over better margins in order to attract customers and gain market share. They also undertake strategic acquisition of established players in the host country to accelerate their footprint expansion process. Similarly, DIA in the mining and agriculture sector (24% and 8% share of DIA, respectively) often involves large expenditure to acquire oil fields and plantations, obtain exploration and land rights and develop the necessary infrastructure. Compounded by fluctuations in global commodity prices, a longer gestation period is therefore needed to recoup these initial capital outlays before it yields steady returns. On the other hand, FDI in the manufacturing sector (43% share of FDI) tends to have a shorter time to maturity. The outperformance of MNCs in export-oriented industries are supported, in part, by their cost-effective supply chain network optimisation strategies, better utilisation of technology and the adaptation into the faster-growing and higher value-added segments.

Third, the macroeconomic and business conditions of the host country also affect the degree of returns. As DIA is channelled into diverse countries, particularly the developing and emerging economies, they are also subjected to the various risks associated with doing business in those markets. These include the growth outlook, level of economic and financial sector development, business regulations, government policies concerning protectionism and liberalisation of industries as well as geopolitical developments. On the other hand, Malaysia has long been favoured as a competitive destination and profit centre for foreign investment, underpinned by pro-business policies, strong rules of protection for foreign investors, educated workforce, sizeable upper middle-income class, well-developed infrastructure and attractive incentives. This can be attested by Malaysia's favourable rankings in international competitiveness surveys such as the World Bank Doing Business Survey (2017: 23rd position), World Economic Forum Competiveness Index (2016 - 2017: 25th position) and the AT Kearney Global Services Location Index (2016: 3rd most attractive location for offshore operations). Thus, MNCs are able to execute their investment plans with a high degree of certainty and predictability, resulting in a shorter time frame between the initial capital injection and when income is eventually realised.

Strategies to Unlock Greater Payoffs from DIA

While underlying structural factors explain the divergence in the rate of returns between DIA and FDI, it is important to note that this gap should narrow over time as the investments abroad by Malaysian corporations eventually mature. Moreover, there is scope to generate greater returns at the firm-level and optimise the intended spillover benefits to the wider domestic economy. To accomplish this, outward bound Malaysian firms should enhance their synergies with domestic operations and local suppliers, thus strengthening the development of backward linkages. For example, the growing presence of Malaysian firms involved in infrastructure and real estate projects overseas should not only be a conduit for greater procurement of locally produced materials and inputs, but also for ancillary service providers such as architecture and design, project management and consultation, legal and financial services. Domestic SMEs should also bolster their competitiveness by continuously moving up the value chain and exploring opportunities abroad. For example, industries that are heavily reliant on foreign labour such as garments, wood and plastic products could shift their production base to other countries with lower labour costs, while retaining their operational headquarters in Malaysia. In this regard, the success of countries such as Korea in promoting their SMEs to invest abroad can be emulated through facilitation and advisory, dissemination of information and a recalibration of incentives. Lastly, subsidiaries of Malaysian corporations abroad should make concerted efforts to raise their operational efficiencies, identify niche markets and innovate continuously.

Conclusion

The increasing DIA trend is expected to continue in line with Malaysia's broader economic development and the deepening integration with the global economy and financial system. Despite the greater number of Malaysian corporations going abroad, the commensurate returns have yet to be fully realised. While Malaysia's DIA has generated better returns compared to some regional peers, there remains a structural underperformance against its FDI counterpart. Hence, the ability to generate greater payoffs from their investments abroad going forward is critical both from a macroeconomic standpoint as well as to achieve a more sustainable rate of return over the longer term. In this regard, there is a need for outbound Malaysian firms to continuously move up the value chain and secure their foothold in the ever shifting global business landscape. This would help in equipping Malaysian corporations to compete and even thrive in international markets, and produce the desired spillover benefits for the Malaysian economy.

References

- Chen, J., E., and Zulkifli, S., A. (2012). 'Malaysian Outward FDI and Economic Growth', *Procedia - Social and Behavioural Sciences*, Vol 65, 17-722.
- Clarke, R., T., and Peter W., L. (2013). 'International Experience in International Business Research: A Conceptualization and Exploration of Key Themes', *International Journal of Management Reviews*, Vol 15, 265-279.
- Curcuru, S., E., Thomas, C., P., and Warnock F., E. (2013). 'On Returns Differentials', *Journal of International Money and Finance*, Volume 36, September 2013, 1-25.
- Dunning, J.H. (1980). 'Toward an Eclectic Theory of International Production: Some Empirical Tests', *Journal of International Business Studies* 11(1): 9-31.
- Goh, S. K., and Wong, K. N. (2014). 'Could Inward FDI Offset The Substitution Effect of Outward Fdi: Evidence from Malaysia', *Prague Economic Papers* 2014, 413-425.
- Goh, S. K., Wong, K. N., and Tham S., Y. (2013). 'Trade Linkages of Inward and Outward FDI: Evidence from Malaysia', *Economic Modelling*, Vol 35, 224-230.
- Wong, K. N., (2013). 'Outward FDI and Economic Growth in Malaysia: An Empirical Study', *International Journal of Business and Society*, Vol. 14 No. 163-172.
- USAID (U.S. Agency for International Development). (2005). *Foreign Direct Investment: Putting It to Work in Developing Countries*. Washington, DC: USA.

Monetary and Financial Conditions in 2016



- 47** International Monetary and Financial Conditions
- 49** Domestic Monetary and Financial Conditions
- 58** *Box Article: Exchange Rate Volatility and Disconnect: Structural or Cyclical?*

Monetary and Financial Conditions in 2016

INTERNATIONAL MONETARY AND FINANCIAL CONDITIONS

Global financial markets remained volatile in 2016

Volatility in global financial markets remained unabated in 2016. Against the backdrop of subdued global growth and inflation, diverging monetary policies in the advanced economies, a strengthening US dollar and low global commodity prices, global financial markets experienced increased volatility as market players became more sensitive to “risk-on” and “risk-off” developments. Investor sentiments were influenced by a number of key risk factors that took place during the year. While concerns on growth and financial market volatility in People’s Republic of China (PR China), monetary policy path of the US and movements of commodity prices remained as key drivers of volatility, political developments in the UK and the US took the markets by surprise. Uncertainties surrounding these developments generated periods of heightened volatility, causing significant adjustments in global exchange rates as well as equity and bond prices.

During the first two months of 2016, global financial markets faced a period of heightened volatility, due to deteriorating investor sentiments arising from increased macroeconomic risks and declining global commodity prices. Market anxiety centred on the slowing momentum of global growth, particularly that of PR China, following the release of weaker economic data at the start of the year¹. PR China’s equity market also became the subject of focus when the Shanghai Composite Index fell by around 10% during the first trading week of the year, triggering circuit breakers

¹ In January, PR China’s GDP growth for 2015 was reported to have slowed to 6.9%, the weakest growth rate in 25 years. Manufacturing data was also reported weaker, with the official Purchasing Managers Index (PMI) indicating continued contraction in PR China’s manufacturing sector.

that halted trading on two separate days and adding to market nervousness². This spilled over to global stock markets, causing significant sell-offs, with major stock market indices falling by an average of around 5% in the first trading week of the year. In addition, global crude oil prices continued their declining trend, bottoming out at USD28 per barrel in mid-January – the lowest level in 12 years – amid prospects of weaker global demand and a supply glut arising from rising global inventories and the removal of key international sanctions. This led to further sell-offs in global financial markets, especially those of commodity exporting countries.

Despite the turbulent start to the year, the risk-averse environment began to gradually dissipate amid expectations of further monetary support in key advanced economies and a recovery in global crude oil prices. Central banks in key advanced economies provided further monetary accommodation through the lowering of policy interest rates and the intensification of asset purchase programmes to provide additional liquidity to the market³. Several central banks in the advanced economies went a step further in monetary accommodation. The Bank of Japan (BOJ) began to implement negative interest rates while the European Central Bank (ECB) took its policy rates further into negative territory. The low or negative short-term interest rate, coupled with the decline in term premium⁴, resulted in many sovereign bond

² PR China’s stock market circuit breaker was implemented on 1 January and is triggered at two levels. If the equity index rises or declines by 5%, trading is suspended for 15 minutes. If the index moves by 7%, trading is halted for the rest of the day.

³ For example, the European Central Bank (ECB) expanded its asset purchase programme in March and began buying corporate bonds in June; and the Bank of England (BOE) cut interest rates to a historical low of 0.25% while expanding its asset purchase programme in August.

⁴ Term premium is the compensation demanded by investors for the risks that are being taken for holding longer-term bonds, more specifically against the risk of higher interest rates in the future. A declining term premium reflects investors’ perception of lower interest rate risk.

yields in advanced economies trading at negative yields. This precipitated yet another round of global search for yield. Global investor risk appetite, especially towards emerging markets, improved further as oil prices recovered within a short time span, reaching above USD50 per barrel in June, following disruptions to global output and increased expectations of future production cuts⁵. As a result, capital flows returned to emerging markets, leading to the higher valuations for financial assets. The Morgan Stanley Capital International (MSCI) Emerging Market Index increased by 22% while emerging market sovereign bond yields declined by an average of around 70 basis points⁶.

Despite the general improvement in risk sentiments during the period, global financial markets remained prone to sudden shifts in sentiments. Consequently, the positive trend in global bond and equity markets during the period was punctuated by changing expectations on the path of US monetary policy and geopolitical events. Notably, the materialisation of two tail-risk events led to a sudden deterioration of investor sentiments. First, the result of the UK's EU referendum (Brexit) in June caused a temporary spike in volatility and a sharp repricing of global financial assets. However, the impact of Brexit was temporary, as markets were soon calmed by swift central bank responses and market normalisation after the initial reaction⁷.

Second, the result of the US presidential election caused another round of significant volatility from November onwards. Expectations of a faster pace of US interest rate normalisation arising from potential pro-growth and inflationary economic policies resulted in a massive rebalancing of global portfolio investments towards US dollar assets, particularly the equity market. The stronger demand for US dollar assets led to the appreciation of the US dollar. Following the US presidential election, the US dollar index appreciated by 3.8% from November to December 2016. The impact of the global portfolio rebalancing was most pronounced in emerging markets. Significant unwinding of portfolio investments in emerging markets led to the sharp depreciation in emerging market currencies.

⁵ Brent recovered from its bottom of USD28 per barrel in mid-January, increasing by around 80% to exceed USD50 per barrel in June.

⁶ For the period March – October 2016.

⁷ Immediately following Brexit, statements were released by the BOE, ECB and the Fed, ensuring liquidity support and that markets will continue to function properly.

Within a short span of two months, emerging market currencies depreciated by between 1.8% and 12.2% against the US dollar. Capital outflows from emerging markets also led to a significant increase in bond yields and a sharp decline in equity prices. The eventual interest rate increase by the US Federal Reserve (Fed) in December reinforced this trend. During the final two months of the year, capital outflows from emerging markets amounted to USD26.8 billion, the MSCI Index fell by 5% and emerging market sovereign bond yields increased by an average of around 30 basis points.

Chart 2.1

MSCI Emerging Market Index



Chart 2.2

US Dollar Index



The year also witnessed continued monetary policy easing across most central banks. One major consequence of the prolonged period of low and negative interest rate environment was the intensification of yield seeking and speculative investment behaviour. With interest rates remaining low for an extended period, market under-pricing of risks became more pronounced. During the year, the

symptom of risk under-pricing was evident in global bond markets, as reflected in global term premiums that had fallen to historical lows and were deeply into negative territory. Combined with expectations of lower short-term interest rates, sovereign bond yields in advanced economies became increasingly negative, driving investors to seek assets in emerging markets that yielded positive returns. It was reported that by July 2016, the outstanding amount of bonds in the advanced economies trading at negative interest rates had exceeded USD10 trillion⁸. As such, investors ventured into alternative asset investments, including property, infrastructure, private equity and hedge funds in search of higher yields. The higher exposure into alternative asset investments by institutional investors could raise solvency risks in the event of a financial shock in the markets⁹. The extent of this under-pricing and risk-taking behaviour could contribute to larger and faster adjustments in term premiums and global bond yields when the risk-taking cycle reverses, with implications for emerging markets. Glimpses of this were seen during the volatile phase in the last two months of the year, where the term premium adjusted sharply to turn positive as markets expected higher interest rates in the US. This was one of the key factors that triggered volatility in the financial markets of emerging economies. The sharp repricing of risk observed from November onwards coincided with large capital outflows and exchange rate depreciations across emerging markets. Given that these term premiums still remain at low levels, further repricing could lead to greater volatility in the future.

Chart 2.3

10-year US Treasury Term Premium



Source: Federal Reserve Bank of New York

⁸ Source: BIS Quarterly Review, September 2016.

⁹ Source: Annual Survey of Large Pension Funds and Public Pension Reserve Funds 2015 (OECD).

Going forward, the uncertain and volatile environment is expected to continue, posing significant challenges for global financial markets. For emerging markets, the challenge is likely to be more pronounced. All the factors that have affected global financial markets in 2016 will continue to linger into 2017 and contribute to the intermittent swings between “risk-on” and “risk-off” investment cycles. Emerging markets have thus far exhibited resilience to the bouts of heightened volatility but will remain susceptible to external factors that shape global monetary and financial conditions.

DOMESTIC MONETARY AND FINANCIAL CONDITIONS

Ringgit volatility remained elevated due to external developments

The ringgit, along with most major and regional currencies, continued to be influenced by shifts in portfolio flows in 2016. In large part, the performance of the ringgit and other emerging market currencies reflected the continued uncertainties in the global economic and policy environment and geopolitical developments that led to swings in “risk-on” and “risk-off” conditions in the global financial markets during the year. These shifts in sentiments were reflected in the two noticeable phases of ringgit movements. In the first four months of the year, the ringgit was broadly on a strengthening trend against the US dollar due to sustained portfolio inflows. The inflows were driven mainly by expectations of a delay in the US interest rate normalisation and further monetary easing in the key advanced economies. From 1 May until year-end, however, the ringgit and most regional currencies faced significant depreciation pressure as investors unwound their holdings of financial assets in the region amid a strengthening US dollar and shifts in the geopolitical landscape.

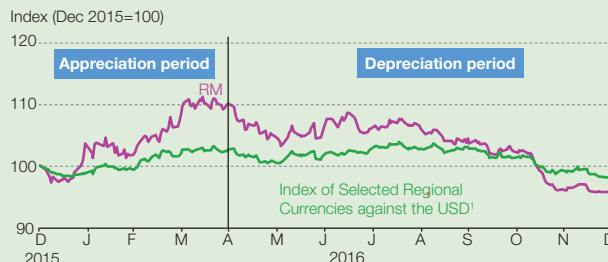
Notwithstanding the global financial market volatility in early January, the period between 1 January and 30 April saw a period of portfolio flows into most regional economies, including into Malaysia’s financial market. Low or negative interest rates in many major economies and expectations of a slower pace of US interest rate normalisation in the earlier part of the year led to the resurgence of global yield-seeking by global investors. The release of better-than-expected economic data from PR China in April also improved global investor sentiments. The increased interest in Malaysia’s

financial assets also partly reflected the improving outlook for commodity-exporting countries following the sharp recovery in global crude oil prices between mid-January and June. Domestically, positive sentiments arising from the Government's commitment to maintain Malaysia's fiscal deficit target during the recalibration of 2016 Budget and the release of positive economic data for the fourth-quarter of 2015 also contributed to the strong demand for Malaysia's financial assets. Against these developments, Malaysia experienced portfolio inflows and the ringgit appreciated against the US dollar by 9.9% between 1 January and 30 April, with the ringgit reaching a high of RM3.865 against the US dollar in April. During the period, the ringgit appreciation against the US dollar was the strongest among regional currencies.

Sentiments, however, started to shift thereafter, and the ringgit along with several regional currencies depreciated against the US dollar. From May onwards, regional currencies were driven mainly by developments in the advanced economies, instead of any specific regional or country-related factors. In particular, the developments reflected the significant strengthening of the US dollar amidst continued expectation of higher interest rates in the US. During this period, the release of positive US economic data and hawkish statements by the Federal Open Market Committee (FOMC) contributed to persistent expectations of an interest rate hike before the end of the year. This affected sentiments among investors and reduced interest in emerging market assets, which affected the performance of most emerging market currencies. At the same time, the currencies of most commodity-exporting countries, including Malaysia, were also affected by the continued volatility in global crude oil prices during this period. The sharp increase in geopolitical uncertainty during the year following the result of Brexit also exacerbated the volatility and depreciation pressure on most emerging market currencies. The strength of the US dollar was further reinforced by the anticipation of a faster pace of US interest rate normalisation in 2017 amid the expectations of expansionary policies following the outcome of the US presidential election. For Malaysia, these uncertainties led to capital flow reversal during this period, with capital outflows intensifying in November and in early December. This reversal of portfolio flows retraced the gains in the ringgit during the first four months of the year.

Chart 2.4

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



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

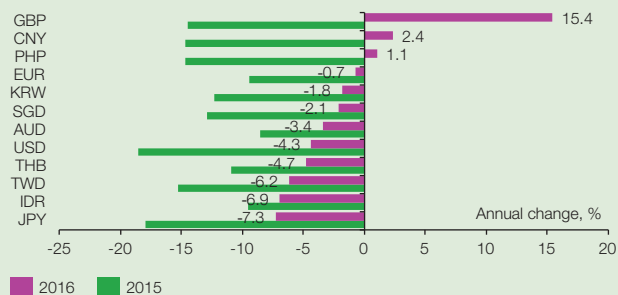
Note: An increase in the index represents an appreciation of the ringgit or of selected regional currencies against the US dollar.

Source: Bank Negara Malaysia

For the year as a whole, the ringgit depreciated by 4.3% to end the year at RM4.486 against the US dollar. The ringgit also depreciated against the euro (-0.7%), the Australian dollar (-3.4%) and the Japanese yen (-7.3%) but strengthened against the British pound (15.4%). Against regional currencies, the ringgit was broadly weaker. The ringgit's nominal effective exchange rate (NEER), a measure of ringgit performance against the currencies of Malaysia's major trading partners, however, remained relatively stable with a depreciation of 1.9%.

Chart 2.5

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



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

Source: Bank Negara Malaysia

During the year, while the ringgit was affected by the same external shocks that impacted regional currencies, the volatility of the ringgit exchange rate was exacerbated by speculative activities in the offshore non-deliverable forward (NDF) market. This was especially evident in November following

the outcome of the US presidential election. As the uncertainty surrounding the election increased, speculation in the NDF market led to the sharp disconnect between the offshore and onshore pricing of the ringgit exchange rate. During this period, the opaque pricing mechanism in the NDF market spilled over to the onshore foreign exchange market and disrupted the domestic price discovery process. The speculative nature of the offshore NDF market, which created a disconnect between the exchange rate and the underlying domestic economic fundamentals, was a key factor behind the misalignment and volatility of the exchange rate (See Box Article on ‘Exchange Rate Volatility and Disconnect: Structural or Cyclical?’).

Ringgit was also subjected to higher volatility due to the supply and demand imbalances in the domestic foreign exchange market. As a net exporter, Malaysia’s current account has been in a surplus position since 1998. Nevertheless, when these export proceeds are not converted into ringgit, it weakens the structural demand for the ringgit. At the same time, as Malaysian companies undertake more investments abroad, their demand for foreign currencies increases. This leads to further imbalances in the foreign exchange market. These underlying imbalances left the ringgit vulnerable to the sharp movements of portfolio investment flows by non-resident investors, which resulted in the frequent ringgit overshooting in response to global developments. Policy intervention was needed to rectify these imbalances. The Financial Markets Committee (FMC), in collaboration with Bank Negara Malaysia, introduced several measures to deepen and broaden the domestic foreign exchange market, including by promoting foreign exchange hedging within the domestic foreign exchange market. Another measure was to require the conversion of foreign currency export proceeds into ringgit, which would address the imbalances where export proceeds were overwhelmingly placed in foreign currency accounts in offshore markets. The renewed flow of foreign currency export proceeds into the domestic market would subsequently improve foreign currency liquidity in the onshore market. These measures were part of a series of market development initiatives to achieve a highly-developed, liquid, deep, transparent and well-functioning foreign exchange market in Malaysia.

Going forward, the volatile conditions are expected to continue as uncertainties on global growth, global monetary policy and global commodity prices

persist. As the world economy faces the realities of the impending global geopolitical shifts, global financial markets will continue to face episodes of sharp adjustments. In this regard, it is crucial for policymakers to have access to a wide range of policy tools to manage these risks. For Malaysia, policymakers will continue to focus on ensuring the domestic financial and foreign exchange markets reflect the developments in the Malaysian economy.

Interest rates declined in 2016, reflecting key policy decisions by the Bank

Domestic interest rates declined in 2016, with interbank rates, retail lending rates and fixed deposit rates trending lower during the year. The moderating trend took place amid stabilisation in the competition for stable funding and reflected key policy measures by the Bank, including the reduction in the Statutory Reserve Requirement (SRR) in February 2016 and the reduction in the Overnight Policy Rate (OPR) in July 2016.

At the beginning of the year, interbank rates for tenures of 1-month and longer were higher, reflecting mainly the increase in funding costs arising from competition for stable funding and the uneven distribution of liquidity among banks. As part of a comprehensive effort by the Bank to ensure sufficient liquidity in the domestic financial system, and to support the orderly functioning of the domestic financial markets, the SRR was reduced from 4.00% to 3.50% effective from 1 February 2016. The reduction in SRR resulted in a broad-based release of liquidity into the banking system, which helped to ease conditions in the interbank markets. Consequently, interbank rates for tenures of 1-month and longer, moderated throughout the first half of the year. By June 2016, the 3-month average interbank rate was lower by 21 basis points and the 3-month KLIBOR had declined by 19 basis points.

Retail lending rates and fixed deposit rates were relatively stable in the first half of 2016. The weighted average base rate (BR) of commercial banks was steady in the range of 3.78% - 3.83% and correspondingly, the weighted average lending rate (ALR) on outstanding loans also remained stable during this period. The average quoted fixed deposit rates of commercial banks for tenures 1 to 12-month were also steady, ranging between 3.08% and 3.31% in the first half of the year.

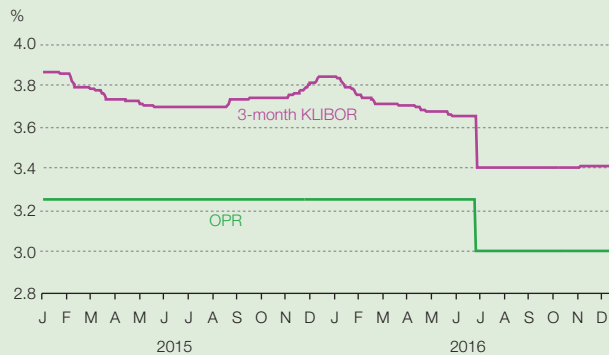
In the second half of the year, developments in domestic interest rates were mainly driven by the reduction in the OPR on 13 July 2016. From 1 to 12 July, the average overnight interbank rate (AOIR) traded within a range of 3.05% - 3.19%. Following the reduction in OPR, the AOIR decreased and stabilised at a lower range of 2.81% - 3.00%. Interbank rates for longer tenures also declined in line with the reduction in OPR. The 3-month KLIBOR fell by 25 basis points within a day after the OPR reduction. For the year as a whole, the 3-month KLIBOR declined by 43 basis points.

The change in OPR was also transmitted to retail lending rates and fixed deposit rates. The weighted average BR of commercial banks decreased by 22 basis points by August 2016, with downward revisions of BR by most banks in response to the OPR reduction ranging from 20 to 25 basis points. By the end of the year, the weighted average BR recorded its lowest level since it was introduced in January 2015 (December 2016: 3.61%; January 2016: 3.78%; January 2015: 3.81%). Correspondingly, the weighted ALR on outstanding loans fell by 21 basis points in the second half of 2016, from 5.42% in June 2016 to 5.21% in December 2016.

In addition, the 1 to 12-month average quoted fixed deposit rates of commercial banks fell by an average of 18 basis points in July 2016 following the reduction in the OPR. By the end of the year, they were at a lower range of 2.86% - 3.06%. Consistent with the decline in the fixed deposit rates, the banks' cost of funds (COF) gradually trended downwards in the second half of the year.

Chart 2.6

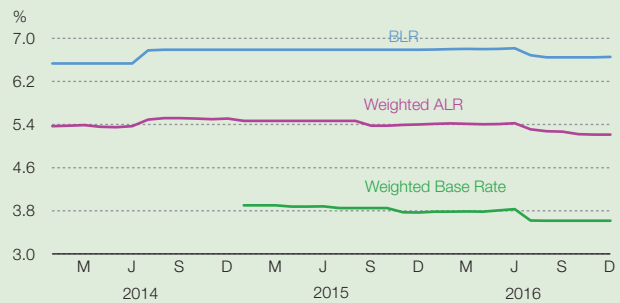
Policy and Interbank Market Rates



Source: Bank Negara Malaysia and Bloomberg

Chart 2.7

Commercial Banks' Lending Rates (at end-period)



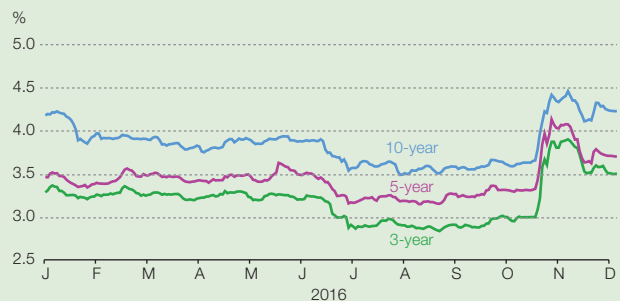
Source: Bank Negara Malaysia

MGS yields increased towards the end of the year, in line with developments in global bond markets

In 2016, yields on Malaysian Government Securities (MGS) were primarily driven by external factors. For the year, the 3-year, 5-year and 10-year MGS yields increased by 24, 23 and 4 basis points, respectively.

Chart 2.8

MGS Yields



Source: Bank Negara Malaysia

During the first ten months of the year, yields were supported by a combination of factors that contributed to the increased demand for domestic bonds. This includes the expectation of subdued global growth and inflation, continued monetary stimulus and negative sovereign bond yields in the advanced economies. The inclusion of Malaysian Government Investment Issues (MGII) in the JP Morgan Government Bond Index – Emerging Markets (GBI-EM), announced in August, also contributed to the increased demand for Malaysian sovereign bonds, resulting in further downward

pressure on sovereign bond yields. During this period, non-resident holdings of Government bonds¹⁰ increased by RM41.1 billion to RM214.8 billion as at end-October 2016, with the share of non-resident holdings at 34% of total Government bonds outstanding (2015: 30%). Correspondingly, the 3-year, 5-year and 10-year MGS yields declined by 27, 16 and 57 basis points, respectively, during the period. The decline in yields also partly reflected the reduction in the OPR in July 2016.

The downward trend in MGS yields reversed from November onwards, as the outcome of the US presidential election resulted in global bond market volatility. Expectations of pro-growth policies in the US, which could potentially boost US corporate earnings, resulted in rebalancing of portfolio investment by non-residents towards the US equity market. This led to sizeable sell-offs in global sovereign bond markets, including in Malaysia. The 3-year, 5-year and 10-year MGS yields increased by 50, 39 and 61 basis points, respectively, over the same period. While there were substantial amounts of non-resident outflows from the domestic bond market, these outflows did not completely offset the inflows during the first ten months of the year. For the year as a whole, non-resident portfolio inflows into Malaysian Government bonds amounted to RM16.2 billion.

In the corporate bond market, yields were broadly lower, reflecting the lower yield environment in the Government bond market and the reduction in the OPR. Despite the upward adjustments in the Government bond yields in November, the impact on corporate bond yields

was relatively contained due to the low and stable non-resident holdings of corporate bonds¹¹ and sustained demand by domestic investors. For the year, 5-year AAA and AA-rated corporate bond yields recorded marginal increases of 3.4 and 4.8 basis points respectively. The relatively stable corporate bond yields ensured that the fund-raising activities in the corporate bond market continued to support the financing needs of the economy. New corporate bond issuances amounted to RM137.3 billion during the year (2015: RM128.8 billion)¹², with the bulk of the issuances being raised to fund infrastructure projects and for refinancing activities. Liquidity and credit conditions in the corporate bond market also continued to remain healthy in 2016, as reflected in the higher total turnover of RM159.5 billion (2015: RM114.5 billion).

The domestic equity market declined amid higher market uncertainties

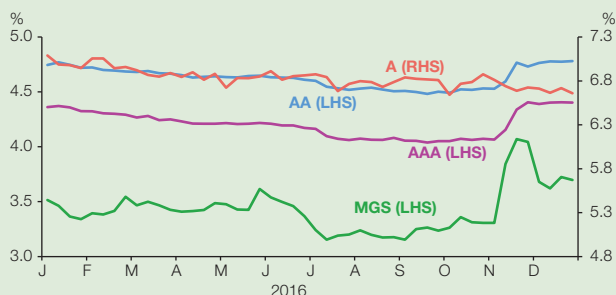
In 2016, the FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI) declined by 3.0% (2015: -3.9%) to close at 1641.73 points, amid higher market uncertainties and tepid investor sentiments.

During the early part of the year, the domestic equity market was affected by negative sentiments arising from the declining global oil prices and the spillover effects from the upheaval in PR China's stock market that roiled equity markets globally. The FBM KLCI reached its lowest point for the year at 1,600.92 points on 21 January 2016. However, global equity markets were then supported by positive sentiments arising from the recovery in global oil prices on rising expectations of future production cuts. The rally in the FBM KLCI was further supported by the resumption of portfolio inflows by non-resident investors amid improved sentiments driven mainly by expectations of a delay in the US interest rate normalisation. The index rebounded to the highest point for the year at 1727.99 points on 15 April 2016.

For the rest of the year, however, market performance was affected by intermittent periods of volatility arising from external developments. Shifting market expectations on the path of US interest rate normalisation that occurred throughout the year

Chart 2.9

5-year MGS and 5-year Corporate Bond Yields



Source: Bank Negara Malaysia

¹⁰ Refers to Malaysian Government Securities (MGS), Malaysian Government Investment Issues (MGII) and Sukuk Perumahan Kerajaan (SPK).

¹¹ The share of non-resident holdings in corporate bonds remained within the 2% - 3% range for the past three years.

¹² Refers to securities issued in Malaysia by both local and foreign companies which can be either short-term, medium-term or long-term papers in Conventional or Islamic principles.

was an important factor in influencing the demand for regional equities. The materialisation of two tail-risk events, namely the outcome of Brexit in June and US presidential election in November, led to portfolio rebalancing by global investors, who in turn, reduced equity holdings in emerging markets. While the impact on the domestic equity market from Brexit was temporary, the heightened uncertainty arising from the result of the US presidential election remained until the end of the year. For the year as a whole, non-resident investors reduced domestic equity holdings by RM3.2 billion (2015: -RM19.7 billion).

Apart from these external challenges, the FBM KLCI was also partly affected by weaker corporate earnings, particularly in the *oil and gas* and *property* sectors. Additionally, the rebalancing of the MSCI Index which trimmed Malaysia's weightage from 3.25% to 2.92% effective 1 June 2016 also added some downward pressures on the index.

Chart 2.10

Regional Equity Indices

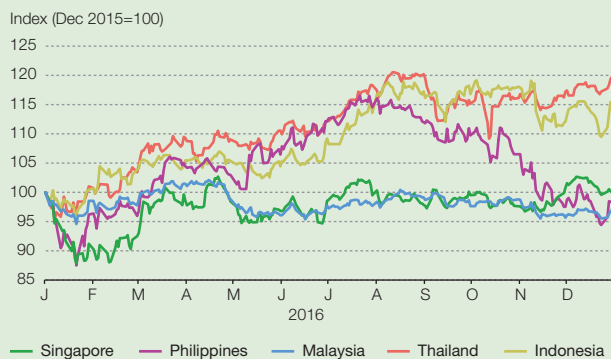


Chart 2.11

FBM KLCI and Volatility of Returns on the KLCI¹



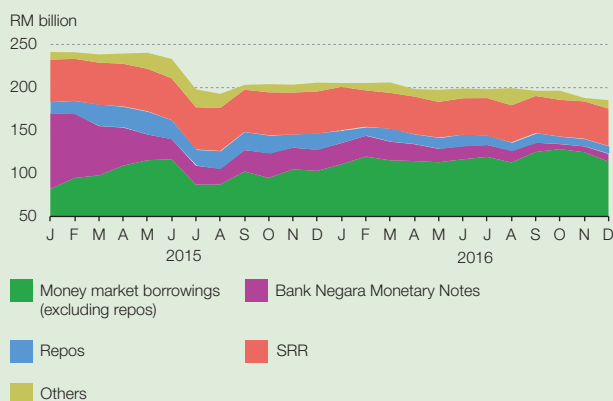
Overall liquidity conditions remained stable with some improvements recorded in M3 growth

In 2016, banking system liquidity remained ample despite volatility in domestic financial and foreign exchange markets. At the system level, aggregate outstanding liquidity placed with Bank Negara Malaysia remained ample and stable throughout the year. At the institutional level, most banking institutions continued to maintain surplus liquidity positions.

Throughout the year, the Bank's operations were focused on maintaining stability in the interbank market. As part of a comprehensive effort to ensure sufficient liquidity in the domestic financial system, the Bank reduced the SRR ratio from 4.00% to 3.50% which took effect from 1 February 2016. As a result, there was a broad-based release of liquidity into the banking system which led to greater interbank lending activity. This allowed the Bank to reduce the use of monetary operations, including the reverse repo facility, to provide liquidity to the banking system. Towards the later part of the year, the composition of monetary instruments used to absorb surplus liquidity was also adjusted to provide banks with greater flexibility in managing their liquidity positions. The tenure of instruments used to absorb surplus liquidity shifted towards the shorter maturities, allowing funds lent to the Bank to mature more frequently such that banks can readily meet any sudden withdrawals of funds due to outflows.

Chart 2.12

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

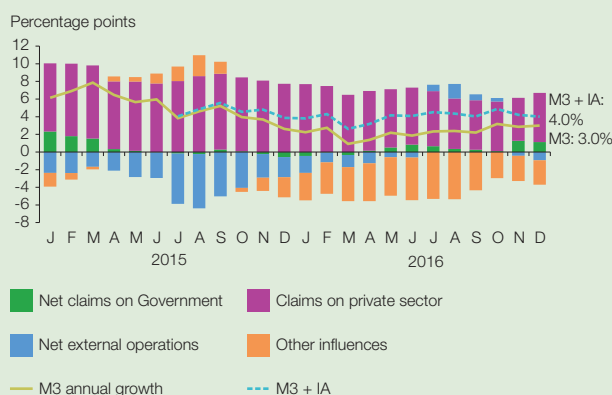


Private sector liquidity, as measured by broad money (M3), recorded a higher annual growth rate of 3.0% during the year (2015: 2.6%). The expansion in M3 was underpinned by continued credit extension by banks to businesses and households. The expansion in M3, however, was offset by net foreign outflows. M3 growth was also contained in part by the reclassification and continued growth of Islamic Investment Accounts, as reflected in the contraction

of 'other influences'. Adjusting for the impact of this reclassification, M3 would have increased at a higher rate of 4.0% in 2016. Meanwhile, total deposits in the banking system¹³ recorded an annual growth rate of 2.0% in 2016, compared to 2.3% in 2015, mainly due to a decline in deposits placed by businesses (2016: -2.3%, 2015: 0.9%). Nevertheless, household deposits continued to register a healthy growth of 5.1% during the year (2015: 5.3%).

Chart 2.13

Contribution to M3 Growth

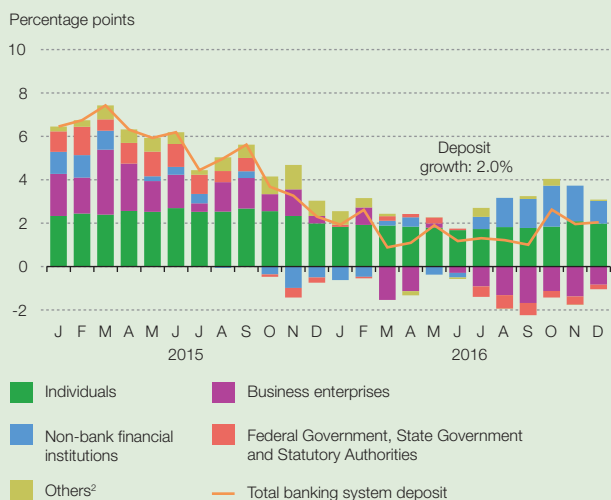


Note: From July 2015 onwards, the compilation of M3 was adjusted to exclude Islamic Investment Accounts (IA) due to a data reclassification exercise. This is reflected as a negative contribution through 'other influences'. The dotted line represents M3 growth had this reclassification not taken place.

Source: Bank Negara Malaysia

Chart 2.14

Contribution to Banking System Deposit¹ Growth by Holder



¹ Excludes domestic interbank deposits.

² Includes domestic other entities and foreign entities.

Source: Bank Negara Malaysia

Financing to the private sector was consistent with the pace of economic activity

Despite an environment of continued volatility, domestic financial intermediation remained uninterrupted during the year. Net financing through the banking system, non-bank financial institutions¹⁴ and the corporate bond market recorded a growth of 5.5% in 2016 (2015: 8.2%). The more moderate pace of growth in net financing during the year was in line with economic activity, reflecting mainly the lower growth of outstanding loans¹⁵ (2016: 5.3%; 2015: 7.5%). While financing through the corporate bond market remained healthy, the annual growth of outstanding corporate bonds as at end-December moderated to 6.1% in 2016 (2015: 10.7%). This was mainly due to the higher base recorded in December 2015 given large one-off issuances by a few companies.

Outstanding business loans¹⁶ grew at a slower pace of 4.8% (2015: 7.7%), with the moderation driven by the slower year-on-year growth of loans in the *mining and quarrying; wholesale and retail trade, restaurants and hotels; electricity, gas and water supply; and agriculture* sectors. The moderation in the growth of credit to businesses reflected the slower pace of economic activity with limited evidence of broad-based tightening in access to financing. All business segments experienced stable loan approval rates. The slower

¹³ Excluding deposits by banks.

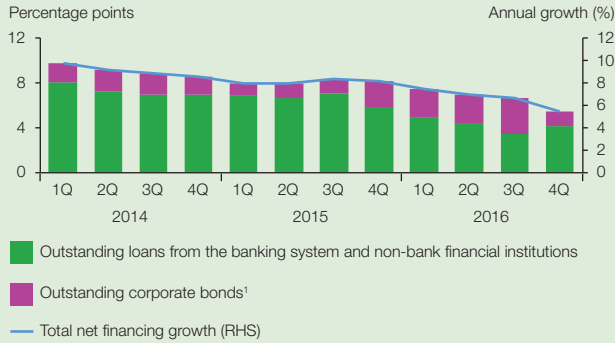
¹⁴ Non-bank financial institutions comprise development financial institutions (DFIs), *Lembaga Pembiayaan Perumahan Sektor Awam* (previously Treasury Housing Loans Division), insurance and stockbroking companies, and others.

¹⁵ Includes outstanding loans extended by the banking system and non-bank financial institutions.

¹⁶ Includes outstanding loans of public enterprises (PEs), but excludes outstanding loans of domestic financial institutions, domestic non-bank financial institutions, Government, domestic other entities, and foreign entities.

Chart 2.15

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



¹ Excludes issuances by Cagamas and non-residents.

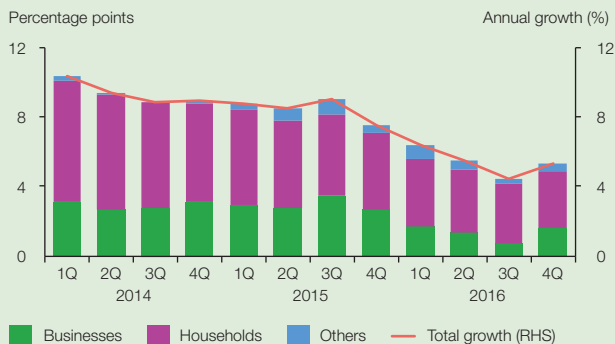
Source: Bank Negara Malaysia

outstanding business loan growth was also partly due to a number of large one-off repayments by a small number of firms. Excluding these repayments, the annual growth of outstanding business loans would have been higher. The growth in financing to SMEs continued to remain healthy at 9.0% as at end-December 2016. The level of loan disbursements to businesses, including to SMEs, was also sustained (monthly average over 2016: RM58.7 billion; 2015: RM59.0 billion) with a larger volume of loans extended to the *transport, storage and communication; agriculture; construction* and *real estate* sectors.

Business demand for funding from the capital markets remained healthy with the bond market being a key source of financing for the private

Chart 2.16

Outstanding Loans by Borrowers¹

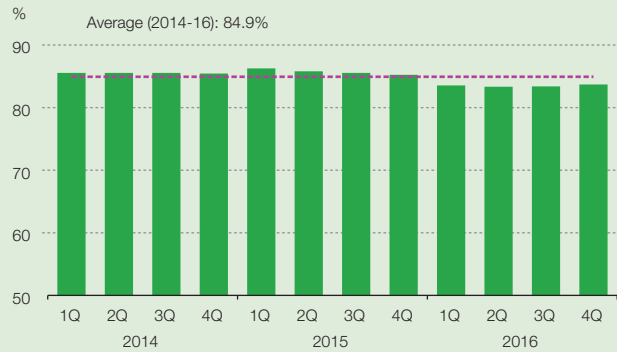


¹ Comprises banking system and non-bank financial institutions outstanding loans.

Source: Bank Negara Malaysia

Chart 2.17

Approval Rate for Banking System Loans Extended to Businesses¹



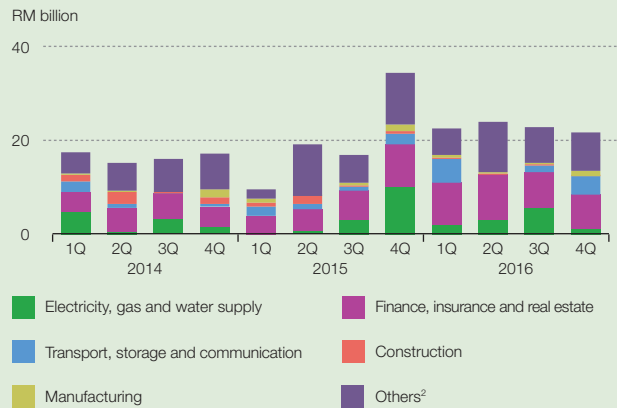
¹ Banking system only.

Source: Bank Negara Malaysia

sector. New corporate bond issuances¹⁷ amounted to RM91.1 billion in 2016 (2015: RM79.9 billion) with issuances mainly from the *finance, insurance and real estate; infrastructure and electricity, gas and water supply* sectors. The bulk of the issuances were raised for the funding of infrastructure projects and refinancing activities. Financing via the equity market¹⁹, however, moderated to RM7.0 billion in 2016 (2015: RM11.3 billion) as the uncertain global market environment affected domestic market sentiments.

Chart 2.18

Gross Corporate Bonds Issued by Sector¹



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

² Includes *infrastructure, wholesale and retail trade, restaurants and hotels and mining and quarrying* sectors.

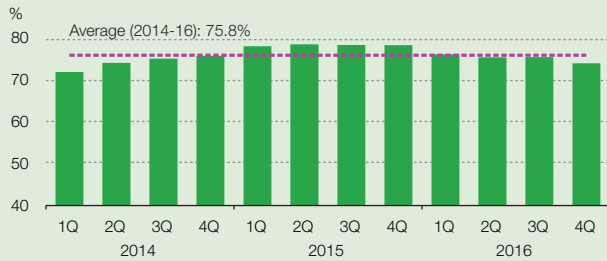
Source: Bank Negara Malaysia

¹⁷ Excludes funds raised by financial institutions, Cagamas and non-residents.

¹⁸ Excludes issuances by financial institutions and non-residents.

Chart 2.19

Approval Rate for Banking System Loans Extended to Households for the Purchase of Residential Property¹



¹ Banking system only.

Source: Bank Negara Malaysia

The growth in household debt¹⁹ continued to moderate during the year to 5.4% (2015: 7.3%). This was attributable to the moderate growth in domestic demand, and was in part due to the pre-emptive macro- and microprudential measures implemented by the Bank to ensure prudent levels of household debt. The moderation was observed across most loan types, particularly loans for the *purchase of non-residential properties; purchase of securities and purchase of passenger cars*. The growth in *residential property* loans, which accounted for 50.0% of total household debt, also moderated to 9.1% during the year (2015: 11.0%). Nevertheless, borrowers with the capacity to service their debt continued to have access to residential property financing during the year, supported by stable approval rates across all house price segments.

¹⁹ Comprises outstanding household loans extended by banks and non-bank financial institutions. Non-bank financial institutions comprise two development financial institutions, *Lembaga Pembiayaan Perumahan Sektor Awam*, insurance and stockbroking companies, and others.

Exchange Rate Volatility and Disconnect: Structural or Cyclical?

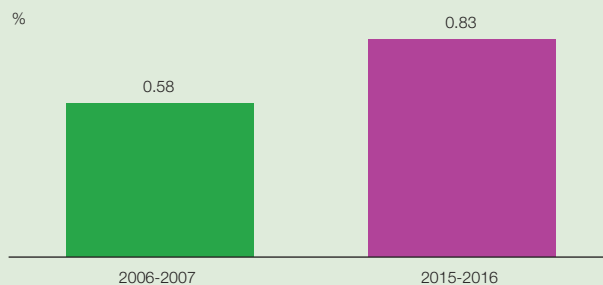
By Ng Jiale, Syed Akmal Shafiq Syed Haris and Sim Wee Haw

Introduction

In recent years, emerging market currencies have experienced a significant rise in the volatility of their exchange rates, particularly after the financial crisis in the developed countries (Chart 1). This volatility has become increasingly persistent, to the extent that it has led to periods of an *exchange rate disconnect*, a situation that describes prolonged deviations between exchange rate movements and the underlying economic fundamentals. Such a disconnect is a reflection of the interactions between a confluence of factors that have shaped the global monetary landscape in recent years. Some drivers of the large fluctuations in exchange rates were cyclical in nature. It was in part due to cycles of “risk-on” and “risk-off” sentiments as a result of shifts in investors’ expectations concerning global growth prospects, policy directions and geopolitical developments. Attributing all the fluctuations to these cyclical global developments and uncertainty, however, is akin to highlighting the waves instead of the underlying current as the global foreign exchange market has structurally evolved over the years. This article looks at the structural changes in the global foreign exchange markets and how these changes in the landscape have exacerbated the volatility of exchange rates – and the consequential implications for small open emerging economies.

Chart 1

Average Intraday Volatility of Emerging Market Currencies against the US Dollar



Note: Intraday volatility is measured by the gap between the high and low exchange rate during the day. Emerging markets include Malaysia, Indonesia, Korea, Singapore, Thailand, Chinese Taipei, India, Philippines, PR China, Mexico, Brazil, Colombia and South Africa.

Source: Bloomberg

Structural changes in the global financial markets have resulted in heightened volatility and prolonged exchange rate disconnect

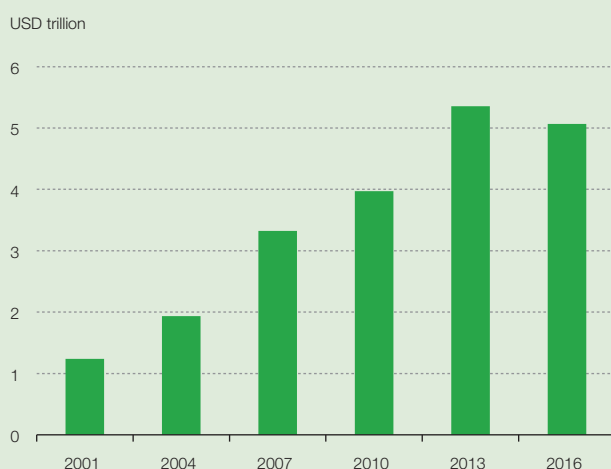
A large part of the rise in exchange rate volatility in recent years can be attributed to cyclical factors, such as the unprecedented introduction of unconventional monetary policies of the major developed countries in the post-crisis years and global developments that have led to shifts in sentiments in the global financial markets. Nevertheless, the structural evolution of the global foreign exchange markets may have exacerbated the degree and persistence of exchange rate volatility. The markets have grown bigger in size and have outpaced the growth of underlying economic activity. At the same time, market players and their behaviour have also evolved as the markets became more complex. These structural developments, coupled with structural rigidities such as the continued reliance on the US dollar, may have contributed to the increased volatility of exchange rates.

A. Bigger and more complex global foreign exchange markets

Despite tighter financial regulation and a secular slowdown in the world economy and trade, the combined global foreign exchange markets still make up the world's largest financial market. After years of globalisation, deregulation and growth in financial services, the size is unlikely to shrink in the near term. While the latest Bank for International Settlements (BIS) Triennial Central Bank Survey of Foreign Exchange and Over-The-Counter (OTC) Derivatives Market Activity showed a slight slowdown in the volume of global foreign exchange trading, the market has still grown by more than four times in the last 15 years (Chart 2). Much of this rise in foreign exchange turnover has been driven by increased trading activity of "other financial institutions", which includes smaller banks, mutual funds, money market funds, insurance companies, pension funds, hedge funds, currency funds and central banks, among others (Chart 3). The increased turnover is driven by greater activity of high-frequency traders and smaller banks and the emergence of retail investors (both individuals and smaller institutions).

Chart 2

Total Foreign Exchange Turnover



Note: Adjusted for local and cross-border inter-dealer double-counting, i.e. 'net-net' basis.

Source: Bank for International Settlements (BIS)

Chart 3

Global Foreign Exchange Turnover by Counterparty



Note: Adjusted for local and cross-border inter-dealer double-counting, i.e. 'net-net' basis.

Source: Bank for International Settlements (BIS)

An important structural change that has enabled the increased foreign exchange trading is the rise of electronic and algorithmic trading, which has reduced transaction costs significantly and increased market liquidity. While these changes have enhanced the depth of the foreign exchange market, they have also inadvertently opened up the market to more speculative behaviour and greater volatility. This is especially evident in episodes of high uncertainty, during which traders tend to show herding behaviour, leading to a drying up of liquidity that can cause sharp swings in prices and hence volatility.

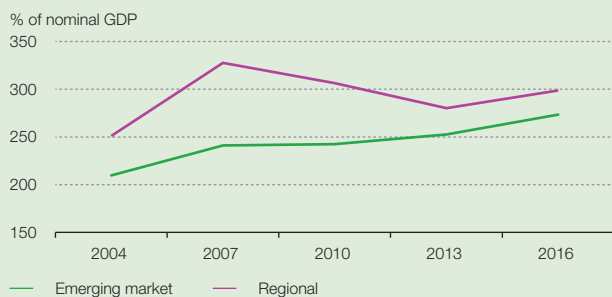
B. Global foreign exchange trading has outpaced real economic flows

Over the years, as global financial flows overwhelm trade flows, the foreign exchange turnover of regional currencies has also increased more than the underlying economic activity¹ (Chart 4 and 5). This implies that the role of the underlying demand for currency that is driven by global trade has become less prominent in determining the exchange rate. Exchange rate movements are now more prone to financial flows, which are predominantly driven by portfolio investors and currency traders, who are generally fickle in nature. As a result, a large part of foreign exchange trading responds to shifts in investor sentiments and external factors, leading to greater exchange rate volatility.

¹ This is also the case globally. Foreign exchange turnover has increased more than underlying economic activity, whether measured by GDP, equity turnover or gross trade flows (The USD4 trillion question: What explains FX growth since the 2007 survey, BIS 2010).

Chart 4

Foreign Exchange Turnover/GDP

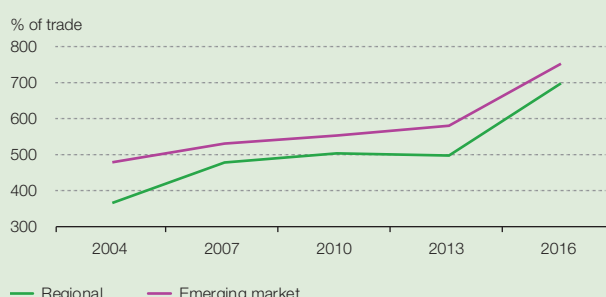


Note: Regional countries include Malaysia, Indonesia, Korea, Singapore, Thailand, Chinese Taipei, India, Philippines and PR China while emerging markets include Mexico, Brazil, Colombia, South Africa and all regional countries. 2016 data up to 3Q.

Source: Bank for International Settlements (BIS) and Bloomberg

Chart 5

Foreign Exchange Turnover/Trade



Note: Regional countries include Malaysia, Indonesia, Korea, Singapore, Thailand, Chinese Taipei, India, Philippines and PR China while emerging markets include Mexico, Brazil, Colombia, South Africa and all regional countries. 2016 data up to 3Q.

Source: Bank for International Settlements (BIS) and Bloomberg

C. Persistent low interest rate environment and abundant liquidity in the global monetary system

Nine years after the financial crisis in the developed world, key policy rates of major central banks remain close to zero, with quantitative easing measures still in place. In fact, policy rates have gone negative for some central banks. While the low interest rate and abundant liquidity environment was initially thought to be temporary and hence was considered cyclical, there are views to suggest that after nine years, they may have fundamentally changed market behaviour. Global yield-seeking behaviour has become entrenched and more structural. As the US Federal Reserve begins to normalise the US interest rates, these behaviours have begun to reverse. Nevertheless, interest rates will continue to remain low. The diverging path of monetary policy between the US and other advanced economies will also continue to cause swings in capital flows and significant volatility in emerging market currencies. Going forward, the fact that economic, financial and geopolitical shocks are becoming more common amidst persistent incentives to seek higher yielding assets points to continued swings between large yield-seeking capital inflows and sudden reversals, leaving emerging market currencies vulnerable to increased fluctuations and overshooting.

D. Continued over-reliance on the US dollar

Despite great efforts globally to encourage the shift away from the US dollar as the major global reserve currency, the US dollar in fact has gained market share in terms of turnover in 2016 (Chart 6). With the US dollar maintaining its dominance in the global financial markets, the relative weakness or strength of the US dollar continues to drive international financial flows. Given its importance, investors tend to react to developments that would affect the US dollar instead of the health of the respective domestic economies. As a result, exchange rate movements reflect economic and policy developments in the US instead of the economic fundamentals of the economies global investors are invested in.

E. Changing investor behaviour amidst increased presence of asset managers

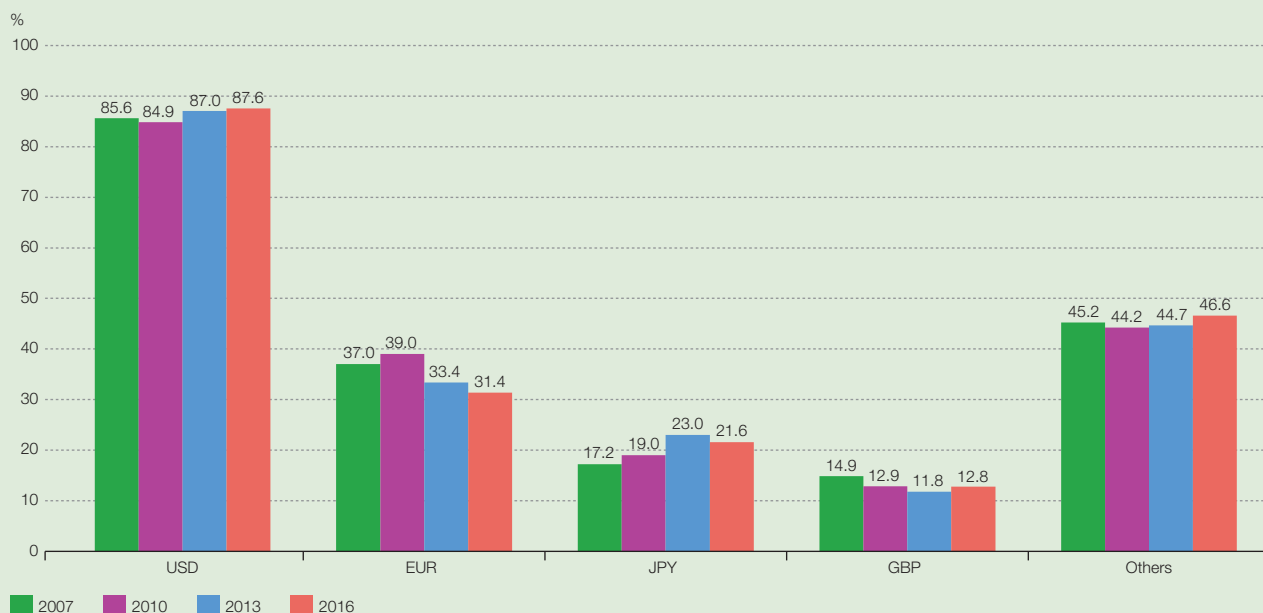
The recent years have also seen an increase in asset managers in the global financial market. Asset management companies (AMC) have so far not been subjected to the same regulatory regime imposed on banks in the wake of the global financial crisis^{2,3}. Driven by the balance sheet pressures of ultimate investors (pension funds and insurance companies), AMCs' behaviour can cause significant volatility in the global financial and foreign exchange markets. Business models of large AMCs may amplify volatility and increase asset market correlations as their views may influence other smaller investors' trading decisions. In addition, common risk management tools used among AMCs can also lead to similar trading outcomes. AMCs' investment in emerging market assets via benchmark indices also poses potential vulnerability. A modest rebalancing of strategy (e.g. country composition and weights) can generate large portfolio

² The Assets under Management (AUM) by the largest 500 AMCs has increased rapidly, doubling from USD35 trillion in 2002 to USD70 trillion in 2012. The industry is mainly dominated by a small number of large players, where the share of the largest 20 AMCs was about 40% of total AUM of largest 500 AMCs as at 2012.

³ Asset management industry includes various investment vehicles (such as mutual funds, exchange-traded funds, money market funds, private equity funds, and hedge funds) and their management companies (IMF Global Financial Stability Report, April 2015).

Chart 6

Share of Average Daily Turnover of Selected Major Currencies in the Global Foreign Exchange Market



Note: As two currencies are involved in each transaction, the sum of shares in individual currencies will total 200%.

Source: Bank for International Settlements (BIS)

adjustments that can significantly increase market volatility for emerging economies. This herding behaviour of the AMCs can often cause fund managers to lose sight of the underlying fundamentals of the assets and cause significant volatility in the foreign exchange markets, especially during periods when market liquidity is low.

F. Increased speculation in the non-deliverable forward (NDF) market

NDF markets, especially for non-internationalised currencies, have long been available. NDF markets emerged and gained importance in policy regimes with restrictions on foreign participation in domestic foreign exchange market and offshore deliverability. Often, investors would utilise the NDF market to circumvent trading in the onshore market for both hedging and speculative purposes. Despite being a market that is opaque, volatile and unregulated, the size of the NDF markets continues to grow⁴. Among the six currencies that have the largest NDF markets globally⁵, accounting for two thirds of all NDFs, turnover increased at a faster pace of 8.7% between 2013 and 2016. The risks for small and open emerging economies are large as the size of the NDF trading volume can easily overwhelm and dominate other factors in determining the exchange rate (Chart 7). While the NDF market provides an avenue for some participants to hedge currency exposures, the market is open to speculative behaviour, especially during periods of market uncertainty. In fact, studies have shown that 60% - 80% of NDF trades are speculative in nature⁶. The speculative activity in the NDF market can lead to major distortions in the price discovery process of domestic foreign exchange markets of emerging economies. This in turn results in significant disconnect between the exchange rate movements and real economic activities in the onshore market. For Malaysia, this was most evident when the offshore ringgit NDF rate deviated sharply from the onshore rate in the days following the US presidential election (Chart 8). It also lends support to Bank Negara Malaysia's efforts to reinforce the policy of non-internationalisation of the ringgit and focus on shifting ringgit-related transactions back to the onshore market.

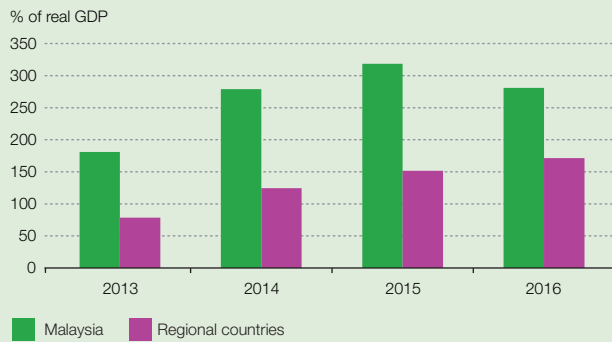
⁴ The 2016 BIS Triennial Central Bank Survey of Foreign Exchange and OTC Derivatives Market Activity shows that NDF turnover grew by 5.3% in dollar terms between April 2013 and April 2016.

⁵ The BIS has highlighted that the top six currencies that are traded in the NDF market in terms of turnover are the Chinese renminbi, Korean won, Indian rupee, New Taiwan dollar, Brazilian real and Russian ruble.

⁶ Federal Reserve Bank of New York 'An Overview of Non-Deliverable Foreign Exchange Forward Markets', May 2005

Chart 7

Non Deliverable Forward (NDF) Volume/GDP

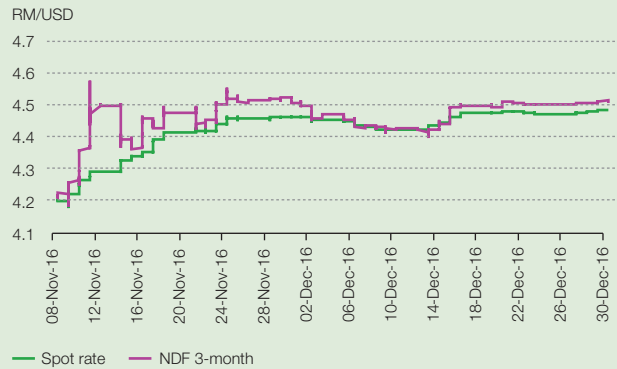


Note: Regional countries include Indonesia, Korea, Chinese Taipei, India and Philippines. NDF volume refers to only regional currencies versus US dollar.

Source: Bloomberg and Haver Analytics

Chart 8

Ringgit Intraday Prices in the Offshore and Onshore Market



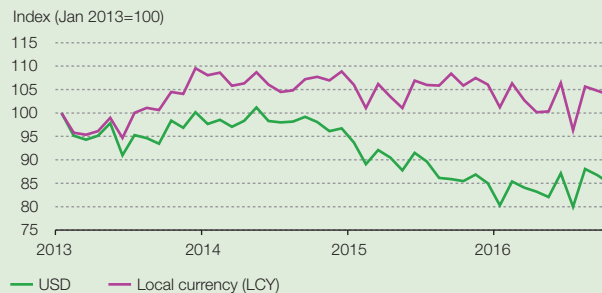
Source: Bloomberg

Negative spillover effects on the real economy amid destabilising foreign exchange markets

Standard textbook theory suggests that exchange rate depreciation should provide the support for exports and hence trade as the weaker exchange rate increases the competitiveness of the exports. Recent experience of regional countries, however, suggests that the evidence of support from a weaker exchange rate in boosting export competitiveness is limited at best. Despite the sharp depreciation in recent years, exports of regional economies have not experienced significant improvement. In Asia, despite a 13% depreciation on average against the US dollar between September 2014 and October 2016, the benefits were only experienced in the form of translation gains. Over the same period, regional exports fell by 13.2% in US dollar terms, but only 1% in local currency terms, supported by favourable conversion, rather than stronger demand (Chart 9). Besides low and uneven global demand amid weaker global trade, the stronger US dollar against most currencies also meant that effective depreciation of any currency has been limited. At the same time, the global supply chain naturally implies that most exports have imported components and the costs increase when the domestic currency is weaker.

Chart 9

Nominal Exports of Regional Economy in US Dollar and Local Currency



Note: Seasonally adjusted nominal exports of regional countries (Malaysia, Indonesia, Thailand, Korea and Philippines) in USD and LCY terms. Data only up to October 2016.

Source: CEIC

While most Asian economies are in a better position to manage the depreciation and extreme exchange rate volatility, prolonged disconnect of the exchange rate can eventually spill over to the real economy. These spillover effects can manifest in various forms. These include higher inflation as the prolonged weakness in currencies forces producers to pass on the higher costs to consumers, potential external and foreign exchange debt distresses, adverse sentiments amongst household and businesses, and the vicious cycle of self-fulfilling expectations.

Increasing challenges for policymakers to find the balance between the costs and benefits of exchange rate flexibility

As exchange rate volatility has become more pronounced and prolonged, it is important for policymakers to manage the trade-off between the benefits of allowing exchange rate flexibility to act as a shock absorber to the economy and the potential costs of allowing sharp adjustments in the exchange rate. While exchange rate flexibility is beneficial during normal times, policymakers must remain pragmatic, especially during periods of high uncertainty. As a regulator, the central bank has a role to address structural imbalances⁷ that can lead to unwarranted distortions to the domestic foreign exchange market. Correcting these imbalances will ensure that exchange rate movements remain orderly to support trade, businesses and genuine investors. This is especially important for small and highly open economies, where the exchange rate is an important price. For Malaysia, our philosophy on financial market developments and exchange rate policy remains the same – that they should reflect the economic realities of Malaysia.

⁷ One of the imbalances is the uneven demand and supply for foreign currencies in the domestic foreign exchange market, due to export proceeds being overwhelmingly placed in offshore markets. The recently announced measure requiring the conversion of foreign currency export proceeds into ringgit will help to address this imbalance.

Monetary Policy in 2016



67	Monetary Policy
69	Monetary Operations

Monetary Policy in 2016

MONETARY POLICY

Monetary policy in 2016 was focused on ensuring the sustainability of Malaysia's growth prospects amid a challenging economic and financial environment

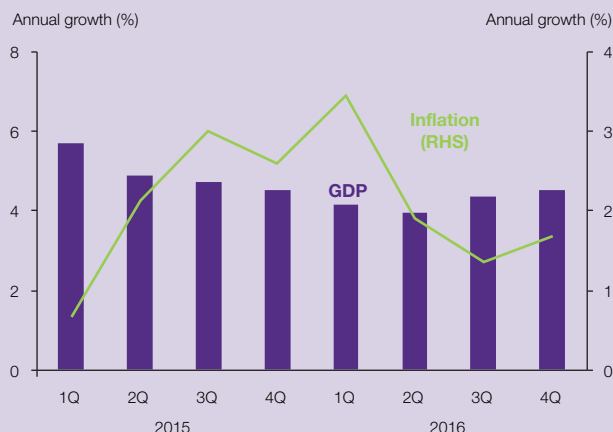
Monetary policy in 2016 was focused on ensuring monetary conditions remained supportive for sustainable growth of the domestic economy with price stability. This was against a challenging policy environment characterised by material shifts in the balance of risks to the domestic economic outlook and significant volatility in the financial markets. In particular, the risks to domestic growth increasingly shifted to the downside by mid-year, emanating from a confluence of external developments including the weaker-than-expected global growth momentum and policy uncertainties in the US and PR China. The challenging external environment was further exacerbated by the uncertainties surrounding the outcome of the UK's EU referendum (Brexit) and the increase in global geopolitical risks. Against this downside shift in the risks to growth, the Monetary Policy Committee (MPC) adjusted the degree of monetary accommodativeness by reducing the Overnight Policy Rate (OPR) by 25 basis points to 3.00% on 13 July 2016. The adjustment was a pre-emptive measure aimed at ensuring the Malaysian economy continued on a steady growth path. At the level of 3.00%, the OPR was considered to be consistent with the intended policy stance for the growth and inflation outlook, and was maintained for the rest of the year.

At the beginning of the year, the Malaysian economy was projected to expand at a more moderate pace in 2016, between 4.0% - 4.5% (2015: 5.0%). The growth prospects were expected to remain anchored by domestic demand, in line with the expectation of continued weak external demand. Private consumption and investment, however, were expected to moderate amid ongoing adjustments in the economy. Nevertheless, growth in

private consumption was expected to be supported by sustained growth in incomes and employment, and measures to lift disposable income¹. Investment activity was expected to be bolstered by ongoing infrastructure investments and capital expenditure in the manufacturing and services sectors. The external sector was anticipated to be constrained by the continued weakness in global demand and low prices for commodity exports.

Chart 3.1

GDP and Inflation



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

In early 2016, headline inflation was forecasted to range between 2.5% - 3.5% for the year (2015: 2.1%). The anticipated higher inflation was based on expectations of upward adjustments in administered prices and the weaker ringgit exchange rate. In terms of trajectory, inflation was expected to peak in the first quarter of the year due in part to the base effect of low oil prices in the first quarter of 2015. For the remainder of the year, inflation was projected to trend downwards due to the lapse of the impact of the Goods and Services Tax (GST) implementation, amidst an environment of

¹ This refers to both fiscal and non-fiscal measures that were announced by the Government.

continued low global energy and commodity prices and the generally subdued global inflation. Underlying inflation was projected to remain relatively moderate amid the slower expansion in domestic demand.

This outlook for domestic growth and inflation was inundated with significant downside risks from the external environment. These included spillovers from weaker global growth and ongoing policy uncertainties in the major economies, particularly surrounding monetary policy in the US and economic policies in PR China. The risk of continued volatility in the international financial and commodity markets and its spillovers to the domestic financial markets and the ringgit exchange rate also weighed on sentiments and outlook throughout the year.

Towards mid-year, the MPC assessed that the balance of risks to growth had shifted to the downside. There were increasing signs of moderating global growth momentum given the cyclical and structural economic weaknesses that continued to weigh on growth in the major economies, leading to more moderate growth in Asia amid persistent weakness in the external sector. The MPC was also concerned that global growth prospects had become more vulnerable to increased downside risks, in view of the potential repercussions of Brexit, renewed volatility in global oil prices, and rising geopolitical risks. On the domestic front, while the expectation was for growth in 2016 to remain within the earlier projection of 4.0% - 4.5%, the MPC recognised the need to ensure the sustainability of the growth momentum going forward. In particular, there were concerns that moderating economic sentiments of businesses and households could weigh on the strength of private consumption and investment. At the same time, the inflation trajectory saw a moderating trend after peaking in the first quarter, as anticipated. With the continued low global energy and commodity prices, the absence of the earlier projected adjustments to administered prices, and benign domestic inflationary environment, the inflation outlook was subsequently revised in July to be lower at 2.0% - 3.0% in 2016.

These considerations led to the MPC's decision that an OPR reduction at the July meeting was warranted as a pre-emptive adjustment to the degree of monetary accommodativeness. This adjustment was consistent with the policy stance to ensure that the domestic economy continued on its steady growth path. In addition, the timing was assessed to be

appropriate given that inflation had trended lower and the risks of destabilising financial imbalances had receded. With regards to financial imbalances, the MPC recognised that macro- and micro-prudential measures as well as supervisory oversight had resulted in more prudent lending standards and contained speculative activities in the property market. In retrospect, the MPC recognised that the policy environment had become increasingly challenging following the more pronounced global financial market volatility towards year-end. These developments underscored the importance of a timely policy decision and having the policy flexibility to take advantage of the window of opportunity as it manifested.

Following the OPR reduction in July, there was an immediate and complete pass-through to interbank rates, with the 3-month KLIBOR declining by 25 basis points the next day. This consequently led to lower lending rates. The weighted average Base Rate (BR) of commercial banks declined by 22 basis points by end-August. Correspondingly, the weighted average lending rate (ALR) on outstanding loans was lower by 15 basis points in the same period.

Since the adjustment in July, the MPC assessed that the monetary policy stance has remained consistent with the macroeconomic outlook and kept the policy rate unchanged for the rest of the year. The domestic economy remained on track to expand as projected for 2016 and 2017. While the baseline estimate was for a slight improvement in global growth in 2017, the downside risks remained elevated following uncertainties over the growth momentum, policy shifts in major economies, unresolved issues post-Brexit and policy uncertainties arising from the outcome of the US presidential election in November. Global financial markets remained susceptible to heightened volatility amid setbacks and shifts in investor sentiments. Nevertheless, the MPC acknowledged that there were signs of positive developments, notably the prospects of a shift towards fiscal support for growth in the advanced economies.

During the course of the year, the MPC was also vigilant to the heightened degree of volatility in the domestic financial markets and the ringgit exchange rate given shifts in global liquidity and investor sentiments. In its communication through the Monetary Policy Statement (MPS), the MPC emphasised that Bank Negara Malaysia would continue to provide liquidity to ensure

the orderly functioning of the domestic financial markets, such that overall domestic liquidity remains sufficient for healthy financial intermediation.

MONETARY OPERATIONS

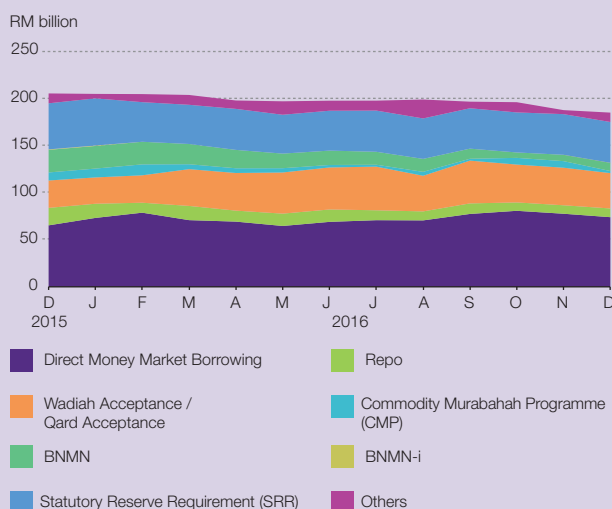
Monetary operations ensured orderly adjustments in banking system liquidity

Monetary operations in 2016 focused on ensuring the domestic money market continued to effectively intermediate short-term funds in a more challenging operating environment of heightened global financial market uncertainties. Several key external events, namely the outcomes of Brexit and the US presidential election, and the US interest rate normalisation in December, have resulted in capital outflows and volatility in the money market rates. The Bank, through its monetary operations, ensured that the adjustments in the banking system liquidity, particularly towards the fourth quarter of 2016, continued in an orderly manner. The aggregate surplus liquidity placed with the Bank remained ample at RM185 billion as at end-2016 (2015: RM205 billion), which provided the necessary buffer amid capital outflows.

Throughout 2016, the Bank's conduct of monetary operations resulted in stable money market rates, as evidenced by the close tracking of the average overnight interbank rate (AOIR) against the OPR.

Chart 3.2

Aggregate Surplus Liquidity Placed with Bank Negara Malaysia



Note: Wadiah acceptance includes Qard acceptance, which was introduced on 15 June 2015

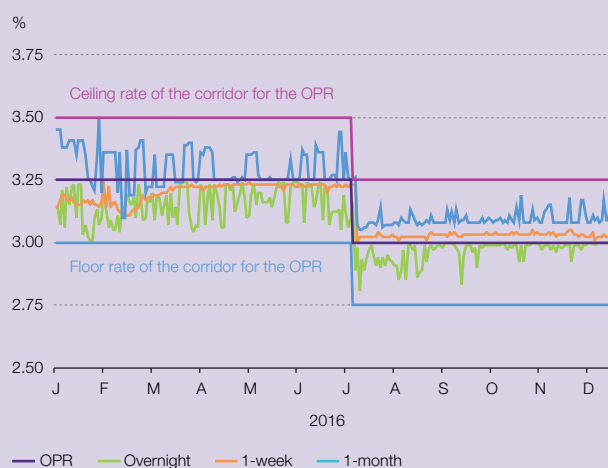
Source: Bank Negara Malaysia

Longer-term money market rates with tenures of one month and above were marginally higher in January and February due to the heightened global financial market volatility. These rates, however, gradually adjusted as volatility in the global financial markets subsided and following the reduction in the Statutory Reserve Requirement (SRR) ratio from 4.00% to 3.50%, which came into effect in February. The SRR reduction injected additional liquidity of RM6.5 billion into the banking system, easing the pressure on interbank borrowing costs. Consequently, the 3-month KLIBOR declined by 5 basis points. In July, interbank rates adjusted lower following the 25 basis points reduction in OPR from 3.25% to 3.00% and remained stable until the volatility triggered by the outcome of the US presidential election in November that pushed longer-term interbank rates marginally higher. Arising from the increased volatility in capital flows, the banking institutions' preference for managing their liquidity profile shifted towards shorter maturities to manage the uncertainty in liquidity requirements. Consequently, the Bank has shortened further the tenure of its liquidity operation through various instruments, which led to the reduction of the average duration of liquidity absorbed by the Bank. The average duration stood at 26 days as at end-2016, compared to 34 days as at end-2015.

Liquidity instruments available for the Bank's monetary operations are diverse and available to both the conventional and Islamic financial institutions. While money market borrowing remained the main instrument for conventional financial institutions, Qard acceptance

Chart 3.3

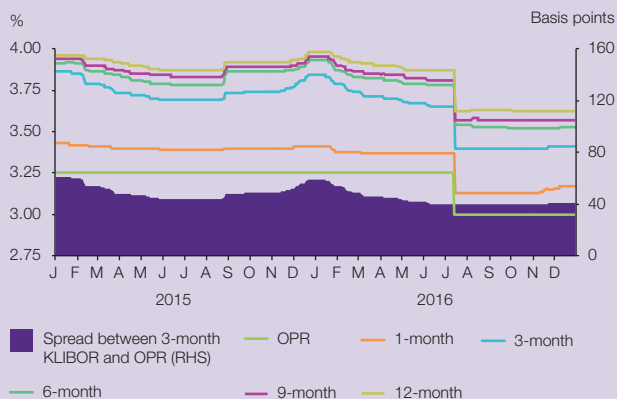
OPR and Interbank Rates



Source: Bank Negara Malaysia

Chart 3.4

KLIBOR Rates



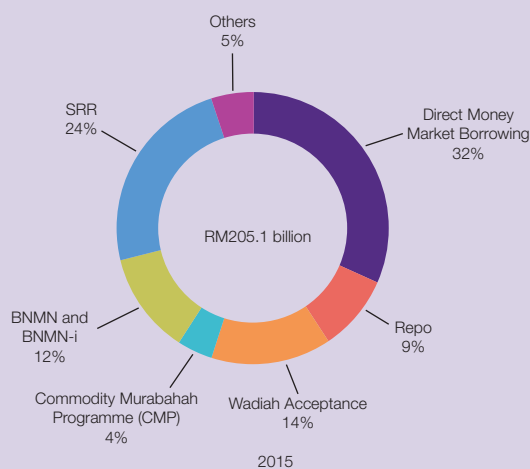
Source: Bloomberg and Bank Negara Malaysia

saw an increase in usage to 20% (2015: 14%²) of the overall liquidity instruments used by the Islamic financial institutions. Utilisation of the reverse repo facility moderated in early 2016, with the outstanding amount declining from RM13.7 billion in December 2015 to a low of RM196 million in September 2016. Demand for reverse repos increased to RM5.7 billion in December due to the capital outflows observed towards the end of the year.

The total volume of interbank money market transactions, which comprised deposits, banker's acceptance (BA),

Chart 3.5

Composition of Liquidity Instruments

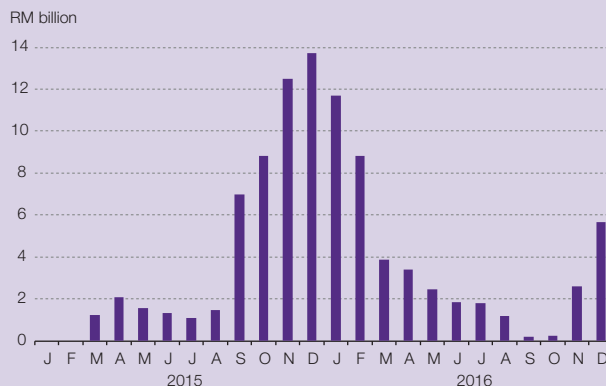


Source: Bank Negara Malaysia

² This refers the sum of the share of Wadiah and Qard acceptance placed with the Bank, as Qard acceptance was introduced on 15 June 2015.

Chart 3.6

Outstanding Reverse Repos



Source: Bank Negara Malaysia

and negotiable instrument of deposits (NID) in both the conventional and Islamic money markets, amounted to RM2.5 trillion in 2016 (2015: RM3.2 trillion). Deposits under the conventional money market remained as the main instrument for liquidity, representing 67% of the total volume traded, followed by the Islamic deposits and NIDs (both conventional and Islamic).

During the year, the Bank has undertaken several initiatives to further expand its liquidity management operations. Given the growing importance of Development Financial Institutions (DFIs) in their role

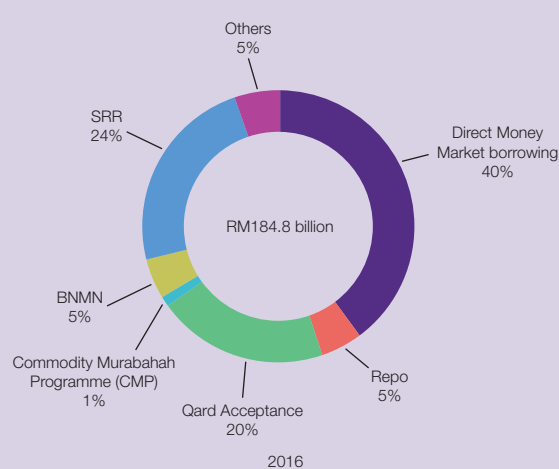
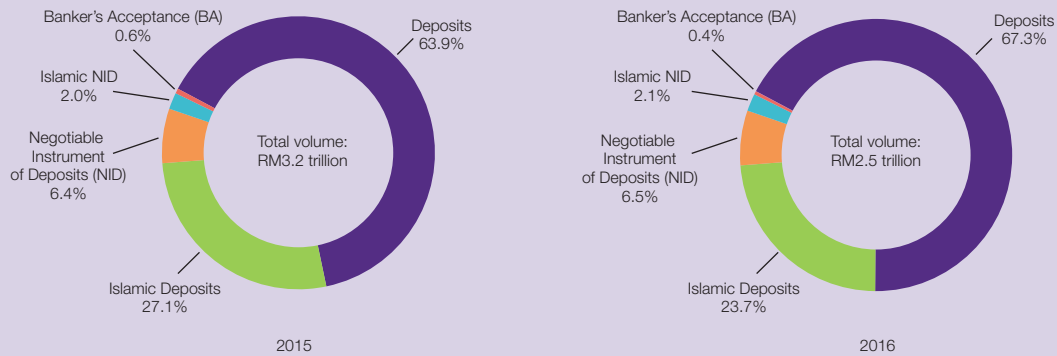


Chart 3.7

Breakdown of Interbank Money Market Transactions



Source: Bank Negara Malaysia

as financial intermediaries, the Bank has extended the offering of Standing Facility to DFIs under its purview. The facility allows DFIs to obtain ringgit liquidity by pledging eligible securities with the Bank. Additionally, the Bank also established the Restricted Committed Liquidity Facility (RCLF), which is a facility that allows banking institutions

to pledge eligible securities. The securities pledged under the RCLF will be recognised as a Level 2B high quality liquid asset (HQLA) for the purpose of the Liquidity Coverage Ratio (LCR) compliance. To participate in the RCLF, banking institutions are charged a monthly Facility Rate, which is currently at 75 basis points per annum.

Outlook and Policy in 2017

75	The International Economic Outlook
75	The Malaysian Economy
80	External Sector
81	Inflation Outlook
82	Monetary Policy
83	Fiscal Policy
85	<i>Box Article: Structural Reforms in ASEAN-5 Economies: Past Successes and Future Challenges</i>
90	<i>Box Article: Demystifying the Affordable Housing Issue in Malaysia</i>
99	<i>Box Article: Youth Unemployment in Malaysia: Developments and Policy Considerations</i>

Outlook and Policy in 2017

THE INTERNATIONAL ECONOMIC OUTLOOK

Global economic activity is projected to expand at a faster pace in 2017, supported by an expansion in domestic demand in the advanced and emerging market economies, and expectations of a recovery in trade activity in the emerging regions. The outlook would be supported by expansionary fiscal plans in selected major economies and recovery in commodity prices. Despite these positive signs, the overall outlook for the global economy still has signs of fragility given its high susceptibility to adverse shocks.

Global economy to improve in 2017 despite the presence of new and prevailing risks

Domestic demand in the advanced and emerging market economies is expected to be boosted by fiscal measures in selected major economies, namely the US, the UK and PR China. In the US, expectations are for the new administration to lower taxation rates and increase infrastructure spending which may provide impetus to global trade. The UK government has also unveiled a plan that includes higher expenditure on infrastructure and housing as well as increased funding for innovation, research and development. These pro-growth policy measures could spur renewed vigour in demand from the advanced economies, consequently lending support to global demand. Furthermore, PR China's continued efforts at rebalancing its growth are likely to be accompanied by policy fine-tuning to achieve a gradual moderation in its growth.

In addition, the recovery in the prices of key commodities such as coal, steel and crude oil will benefit commodity exporters. In the coal and steel markets, PR China has pledged to reduce excess capacity as part of its ongoing structural reforms.

Similarly, members of the Organisation of Petroleum Exporting Countries (OPEC) have lowered their output of crude oil. This is expected to contribute towards a gradual drawdown of inventories and reduce the oversupply of global crude oil.

While positive spillover of expansionary policies by major economies poses an upside risk, the presence of new and prevailing downside risks continue to dominate the global economy. Firstly, the potential retreat of globalisation in the advanced economies and the potential introduction of protectionist trade policies in the US could hamper the recovery in global trade, which is crucial for maintaining a dynamic global economic environment. Secondly, the uncertainty over the length and outcome of the UK and EU negotiations may negatively affect business sentiments, thus impacting international trade activity and investments. Thirdly, monetary policy divergence between the US and the other major economies will intensify in 2017. This anticipation will lead to changes in investor behaviour. In particular, it could result in overadjustments in the currency markets and destabilised capital flows. While interest rates are not expected to rise significantly, governments and corporations with highly leveraged balance sheets may find their debt-servicing capacity being stretched, and this could have consequential implications for financial stability. Finally, geopolitical risks in relation to domestic conflicts, terrorism attacks and territorial disputes remain, which could affect sentiments in the global financial markets and dampen economic activity.

THE MALAYSIAN ECONOMY

Positive prospects for the Malaysian economy in 2017 are premised upon expectations of an improving global economy and the continued growth in domestic demand. The Malaysian economy is projected to register growth of 4.3% - 4.8% in 2017 (2016: 4.2%).

The improvement in global growth is expected to generate positive spillovers to the domestic economy through the trade, investment and income channels. Malaysia's export performance will benefit from higher growth among key trading partners and the projected recovery in commodity prices. On the domestic front, investment activity is expected to be underpinned by capital expenditure in the export-oriented industries, particularly in the manufacturing sector. This, together with the continued roll-out of large-scale infrastructure projects will support investment activity going forward. Meanwhile, private consumption will be sustained by continued wage growth and recent pro-growth Government measures. For the public sector, the Government remains committed to fiscal consolidation, which will be achieved through the reprioritisation of public spending and lower expenditure on non-critical items. Despite this, the public sector is still projected to contribute positively to growth through continued public investment in selected sectors.

The Malaysian economy is projected to expand by 4.3% - 4.8% in 2017

It has become more evident that the global landscape is set to experience concurrent shifts in policy stance, reflecting changes arising from the new US administration and policy shifts after the UK's EU referendum. In this environment, there could be a diverse range of outcomes, with varying implications for the Malaysian economy. In particular, increased

protectionism among the major economies would impact and dampen global trade performance. The prospect of increasing monetary policy divergence between the US and other major economies could lead to tighter and more uncertain financial market conditions, with higher volatility in capital flows and exchange rates. The materialisation of these external risks would be a source of heightened uncertainty for the Malaysian economy and financial system, adversely affecting sentiments and labour market conditions. In addition, the persistence of earlier domestic headwinds, such as the higher cost of living and weak sentiments, could also moderate the growth of domestic demand.

Malaysia will face these challenges from a position of strength. The Malaysian economy's strengths are derived from its highly diversified economic structure, resilient external position and policy flexibility. Financial intermediation will remain supportive of growth, underpinned by strong bank balance sheets and a well-developed financial market. Looking ahead, the challenging global environment necessitates continued emphasis on enhancing the nation's economic resilience and broadening growth sources. Efforts are being intensified to rebuild policy space, proactively address potential vulnerabilities and unlock the potential of new growth areas. These structural reforms and pre-emptive policy measures are envisaged to provide greater support to Malaysia's future growth prospects.

Domestic demand continues to be the principal driver of growth

In 2017, the Malaysian economy is projected to grow by 4.3% - 4.8%. Domestic demand will continue to be the main driver of growth, underpinned primarily by private sector activity. Reflecting the Government's commitment to fiscal consolidation, the contribution of public sector to growth is expected to remain moderate going forward. Nevertheless, public sector expenditure will remain supportive of growth. On the external front, export growth is expected to recover gradually, in line with the improvement in global growth.

Private consumption is projected to expand by 6.0% in 2017. While households are likely to make further expenditure adjustments in response to rising inflationary pressure, consumption spending is expected to remain sustained, supported by a stable labour market and continued wage growth. The implementation of selected Government measures are also expected to increase household disposable income. These measures include the higher amount of *Bantuan Rakyat 1Malaysia* cash transfers, reduction in employees' contribution to EPF by 3 percentage points until December 2017 as well as the special assistance to all civil servants (RM500) and retirees (RM250). The higher commodity prices are also expected to support incomes, particularly for rural households.

In an environment of moderate growth and cautious business sentiments, labour market conditions are expected to remain soft in 2017. While employment is expected to remain expansionary, job growth will not be sufficiently robust to absorb new entrants to the labour force, causing the unemployment rate to edge higher (3.6% - 3.8%;

2016: 3.5%). Nevertheless, domestic demand and a gradually improving external sector is expected to lend support to the labour market, and wages are expected to continue growing at a moderate pace. The Malaysian Employers Federation (MEF) annual survey reports that employers expect salary increments to average at approximately 5.4% in 2017 (2016: 5.5%). Wage growth is likely to be supported by the export-oriented manufacturing sector, while wages in the domestic-oriented services sector are expected to expand moderately.

Private investment is projected to register a modest growth of 4.1% in 2017, as firms are expected to remain cautious amidst continued uncertainty in the economic environment. Nevertheless, private investment will remain supported by implementation of on-going and new projects, particularly in the services and manufacturing sectors. In the services sector, investment activity will be mainly supported by continued capacity expansion in the domestic-oriented industries, particularly in the telecommunications and real estate sub-sectors. Investments in storage facilities will also contribute to investment growth in the services sector. In tandem with the gradual improvement in global growth, investment in the manufacturing sector is expected to be driven primarily by export-oriented industries, especially the E&E and resource-based sub-sectors. Specifically, capital spending in the E&E sector will be supported by the manufacturing of products in the higher-value added segments. Following the improvement in global crude oil prices, mining investment is expected to register a smaller contraction in 2017.

Public consumption growth is expected to register a marginal contraction of 0.2% in 2017, as the Government continues to reprioritise spending and reduce non-critical expenditure. The more prudent spending on supplies and services is expected to weigh on overall growth despite the continued expansion in emoluments.

Public investment is projected to expand by 1.5%, driven by higher capital expenditure by both the Government and public corporations. This reflects the continued implementation of key infrastructure projects in diversified sectors, including in the utilities and transportation sub-sectors, as well as the downstream oil and gas sector.

Table 1

Real GDP by Expenditure (2010=100)

	2016p	2017f	2016p	2017f
	Annual change (%)		Contribution to growth (percentage point)	
Domestic Demand¹	4.4	4.4	4.0	4.0
Private sector expenditure	5.7	5.6	3.9	3.9
<i>Consumption</i>	6.1	6.0	3.2	3.2
<i>Investment</i>	4.4	4.1	0.7	0.7
Public sector expenditure	0.4	0.5	0.1	0.1
<i>Consumption</i>	1.0	-0.2	0.1	0.0
<i>Investment</i>	-0.5	1.5	0.0	0.1
Change in Stocks			0.4	0.1
Net Exports of Goods and Services	-1.8	5.3	-0.2	0.4
Exports	0.1	2.2	0.1	1.5
Imports	0.4	1.8	0.2	1.1
Real Gross Domestic Product (GDP)	4.2	4.3 - 4.8	4.2	4.3 - 4.8

¹ Excluding stocks

p Preliminary

f Forecast

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Broad-based Expansion across All Economic Sectors

All economic sectors are projected to register positive growth in 2017. The services and manufacturing sectors will be the key contributors to overall growth, while the construction sector will expand at a faster pace. The agriculture sector is expected to rebound as yields recover from the El Niño weather phenomenon. Growth in the mining sector is expected to remain steady as higher natural gas output and the start of the new Malikai oil field offset the crude oil supply reduction by PETRONAS in the first half of 2017. The adjustment is part of the global agreement reached in end-2016 to reduce inventory levels and boost oil prices, involving OPEC and several non-OPEC countries, including Malaysia.

Table 1

Real GDP by Kind of Economic Activity (2010=100)					
	2016p	2016p	2017f	2016p	2017f
	% of GDP ¹	Annual change (%)		Contribution to growth (percentage point) ¹	
Services	54.2	5.6	4.9	3.0	2.6
Manufacturing	23.0	4.4	4.3	1.0	1.0
Mining and quarrying	8.8	2.7	2.7	0.2	0.2
Agriculture	8.1	-5.1	4.0	-0.5	0.3
Construction	4.5	7.4	8.0	0.3	0.4
Real Gross Domestic Product (GDP)	100.0¹	4.2	4.3 ~ 4.8	4.2¹	4.3 ~ 4.8

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

p Preliminary

f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The services sector is projected to expand, albeit at a more moderate pace. In particular, the performance of consumption-related services such as *retail trade, food & beverages and accommodation* will be underpinned by stable labour market conditions and continued wage growth. The transport and storage sub-sector will benefit from higher air passenger traffic, commencement of the Mass Rapid Transit (MRT) services and the improvement in trade activity. In the *information and communication* sub-sector, growth will be supported by strong demand for internet and digital services. Growth in the *finance and insurance* sub-sector is, however, anticipated to remain subdued in tandem with the moderate loan growth.

The manufacturing sector is expected to record sustained expansion. Growth will be driven largely by the export-oriented industries, particularly in the electronics segment, reflecting a recovery in the global demand for semiconductors. Sustained regional demand for chemical-related products will continue to provide support to the primary-related cluster despite a fall in crude oil refinery activity. On the domestic front, growth will be supported by resilient consumer spending on food products and firm growth in the construction-related cluster, while demand for motor vehicles is projected to remain subdued.

Growth in the construction sector is projected to expand at a faster pace in 2017, driven mainly by new and existing civil engineering projects in the utilities, transportation and petrochemical segments.

In the commodities sector, agricultural production is expected to rebound as crude palm oil yields recover from the adverse impact of El Niño. Mining sector growth is projected to remain sustained, supported mainly by the acceleration of natural gas production from the LNG Train 9 and PETRONAS' FLNG Satu facilities, as well as production from the new Malikai oil field. Nonetheless, the voluntary 20,000 barrels per day crude oil supply adjustment by PETRONAS is expected to dampen the sector's performance in the first half of the year.

Potential Output and the Output Gap of the Malaysian Economy

Potential output is the level of output that an economy can sustainably produce with its available resources, which include capital, labour and technology, without creating excessive pressure on prices. The difference between actual and potential output, otherwise known as the output gap, indicates the economy's position in the business cycle and the possible presence of inflationary pressures in the case of a positive output gap, or disinflationary pressures in the case of a negative output gap. For instance, a larger positive output gap is normally associated with higher employment, higher wages and, hence, stronger inflationary pressures. Potential output and the output gap are therefore closely monitored by the Bank due to their relevance to its principal objective of promoting "monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy"¹.

In 2016, Malaysia's potential output² is estimated to have expanded by 4.8%, a marginal moderation from 5% in 2015 (2010 - 2014 average potential output growth: 4.9%). This trend is attributable mainly to the slower expansion of the labour force, which was partially offset by sustained increases in productivity and growth of the capital stock. In level terms, actual output was close to potential output in 2016, as reflected in a negligible output gap (2015: 0.5%). The narrowing output gap reflects the moderation in real output growth (2016: 4.2%; 2015: 5%). Indeed, the moderation in the growth of actual and potential output partly reflects the challenging external environment, with modest global growth and periods of heightened financial market volatility during the year.

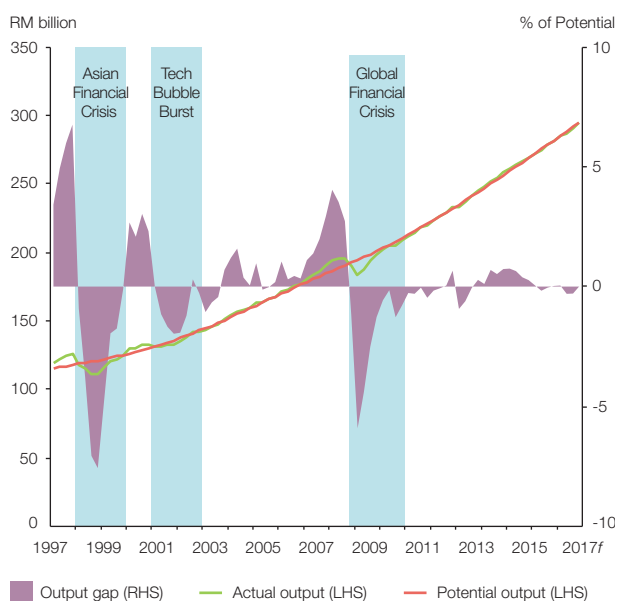
Despite experiencing low commodity prices and weak business sentiments, total investment activity continued to expand in 2016. The expansion was mainly attributable to continued capital expenditures by the private sector. Labour market conditions in Malaysia were softer in 2016. Although layoffs were confined to specific industries, aggregate job creation was insufficient to fully absorb new entrants to the labour force. This led to a rise in the unemployment rate to 3.5% in 2016 (2015: 3.1%; 2010 - 2014 average: 3.1%).

The negligible output gap in 2016 indicates that the economy did not experience substantial price pressures and is consistent with the stable inflation rate of 2.1% registered during the year.

Going forward, the actual output of the Malaysian economy is projected to remain close to its potential. The narrow output gap indicates that the pressure on prices from demand is expected to remain benign. Growth in potential output is expected to be driven by growth in the labour force and sustained growth in private and public investment, leading to expansion of the capital stock. Efforts to increase productivity will be crucial in increasing the growth of potential output and ensuring the sustainability of that growth.

Chart 1

Actual and Potential Output



Year	Annual Growth in Potential Output (%)
2015	5.0
2016e	4.8
2017f	4.5-5.0

e Estimate
f Forecast

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

¹ Central Bank of Malaysia Act 2009.

² Potential output was estimated using the production function approach.

EXTERNAL SECTOR

Malaysia's external sector is expected to remain resilient despite continued uncertainties in the global environment. Overall, following the gradual improvement in exports, the net export of goods and services is projected to provide some support to real GDP growth in 2017. The current account is expected to register a surplus of 1% - 2% of GNI in 2017. Both exports and imports are expected to strengthen in 2017, underpinned by the projected improvements in global growth, commodity prices and sustained domestic demand. Given the firm domestic demand, import growth is expected to continue to outpace export growth. This would result in a lower trade surplus. As the largest component of the current account, developments in trade will significantly influence the current account position. Moving forward, the prospects for trade and the current account will be shaped by three key factors, namely the state of global demand, commodity prices and the strength of domestic demand¹.

The current account of the balance of payments will remain in surplus in 2017

Table 4.1

External Trade		
	2016 ^p	2017 ^f
	Annual change (%)	
Gross exports	1.1	5.5
<i>of which:</i>		
Manufactures	3.2	3.7
Agriculture	4.7	8.9
Minerals	-19.8	21.1
Gross imports	1.9	6.4
<i>of which:</i>		
Capital goods	4.9	7.9
Intermediate goods	-0.1	5.4
Consumption goods	7.3	9.9
Trade balance (RM billion)	87.3	86.4

^p Preliminary
^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

¹ For a more detailed account, refer to Box Article on 'Understanding the Changing Dynamics of the Current Account of the Balance of Payments'.

Gradual improvement in global demand

Global growth is projected to improve in 2017. This is supported by the expansion of domestic demand in the advanced and emerging economies. As a highly open economy with well-diversified export products and markets, Malaysia stands to benefit from the better global growth prospects. Gross exports are expected to increase by 5.5% in 2017 (2016: 1.1%), while gross imports are expected to increase by 6.4% (2016: 1.9%).

Manufactured exports are expected to strengthen, supported by broad-based expansion in both E&E and non-E&E exports. E&E exports will be bolstered by a recovery in demand for semiconductors in 2017, particularly in new segments such as the automotive, industrial and storage markets, in addition to the steady demand for traditional devices such as smartphones. Non-E&E exports will continue to grow, supported by demand for resource-based products such as oleo-chemicals and petrochemicals from the region. In tandem with higher manufacturing exports, intermediate imports, which form the bulk of Malaysia's imports, are projected to rise further.

Despite the improvements in global growth, downside risks remain. The projected pick-up in exports could be undermined by weaker-than-expected growth performance of Malaysia's major trading partners. Moreover, the materialisation of more protectionist trade policies in the major advanced economies, and political and policy uncertainties, could have spillovers on the strength of global growth and global trade.

Table 4.2

Current Account of Balance of Payments ¹		
Item (Net)	2016 ^p	2017 ^f
	RM billion	
Goods	101.2	98.4
Services	-22.6	-24.0
Primary income	-34.7	-36.3
Secondary income	-18.7	-20.7
Current account balance	25.2	17.4
<i>% of GNI</i>	2.1	1~2

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

^p Preliminary
^f Forecast

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Higher commodity prices

Commodity prices have recovered steadily from the lows in early 2016. Crude oil prices have improved following the agreement among OPEC members and several other non-OPEC producers, including Malaysia, to limit supply. In tandem with these production cuts, Malaysia's exports of crude oil are also expected to be lower in volume terms, particularly in the first half of the year despite the support from the ramp up in production from the new Malikai oil field. Nonetheless, gross exports of crude oil are likely to improve, as higher crude oil prices are expected to more than offset the slower growth in export volumes. Exports of liquefied natural gas (LNG) are projected to turn around to record positive growth on account of accelerated production aided by a new floating gas vessel. Similarly, crude palm oil (CPO) exports are expected to rise, following the increase in CPO prices and production volumes, reflecting the recovery from the effects of the El Niño weather conditions.

Sustained domestic demand

Reflecting the sustained growth in domestic investment activity, capital imports are projected to register stronger growth, particularly for the manufacturing and services sectors. In addition, the higher crude oil prices will also increase intermediate imports such as fuel and lubricants. Imports of consumption goods are also expected to increase due mainly to higher imports of food and beverages.

The services account is projected to register a larger deficit, in line with higher trade and improvement in investment activities. Services imports will continue to be supported by imports of transportation and other services including business and professional services. However, services exports are also expected to improve, supported by a larger travel account surplus amidst the expected increase in tourist arrivals and tourist spending. The increased coverage of countries from which Chinese and Indian tourists are eligible to apply for e-Visa and the intensified promotional endeavours to target specific tourism industries such as medical and sports tourism are expected to attract more tourists to Malaysia.

In the income account, profits from Malaysian companies investing abroad are expected to improve, mostly on account of the higher income of oil and gas companies, which account for more than a third of

Malaysia's investment income abroad. Nevertheless, this is likely to be partially offset by the higher profits of foreign direct investors in Malaysia. Reflecting the sustained growth in manufactured exports, investment income for multinational corporations operating in Malaysia is expected to be higher. Taken together, this will result in a higher deficit in the primary income account in 2017. The secondary income account is expected to continue to register a deficit, mainly attributable to higher expected outward remittances, which will more than offset the expected increase in inward remittances.

INFLATION OUTLOOK

Higher inflation will be mainly cost-driven and is not expected to significantly change the medium-term inflation outlook

Headline inflation is projected to increase in 2017 averaging between 3.0% - 4.0% (2016: 2.1%), reflecting primarily the pass-through impact of the increase in global oil prices on domestic retail fuel prices. This cost-driven inflation, however, is not expected to cause significant spillovers into the broader price trends, given the stable domestic demand conditions. Underlying inflation is, therefore, expected to only increase modestly.

Global oil prices are expected to be higher in 2017 following the decision by members of OPEC and several other oil producing countries to reduce crude production to ease the glut in global oil supply². The higher global oil prices, along with the depreciated ringgit exchange rate, will translate into higher domestic retail fuel prices. As of first quarter of 2017, the pump price of RON95 petrol has been higher, averaging RM2.23 per litre, significantly above the average price of RM1.76 per litre recorded in 2016. The increase in fuel prices from their low base, coupled with a notable share of expenditure on fuel in the consumption basket of Malaysian households, will have a noticeable effect on headline inflation for the year.

Beyond oil, other global costs factors are also expected to put some upward pressure on domestic inflation.

² The IMF projected global oil prices to average USD55 per barrel in 2017 in the IMF Primary Commodity Price Forecast in January 2017. The price is the average price of Dated Brent, West Texas Intermediate (WTI) and Dubai Fateh crude oil, equally weighted.

While global food prices are expected to remain low³ amid improved weather and supply conditions, the outlook is for overall commodity prices to register a modest rate of increase in 2017, underpinned by higher prices for agriculture and metal-based products. The inflation rates of Malaysia's major trading partners are also projected to register small positive increases. However, the pass-through of these external price factors to domestic prices would be somewhat mitigated by the fact that domestic production and consumption contain relatively modest imported content. The spillovers into domestic prices are also not expected to be significant, especially given that domestic demand is projected to remain stable. With the absence of strong enabling demand conditions, firms' willingness and ability to pass-on increases in costs to consumers are expected to be more limited. Domestic sources of inflationary pressure are also expected to be contained. Underlying inflation is, therefore, expected to only increase modestly in 2017.

The inflation outlook is, however, subject to three key risks. First, headline inflation could average higher if global oil prices were to increase more than anticipated. The projected trajectory of domestic headline inflation will be dependent on the future trend in global oil prices which remains highly uncertain. Second, the depreciation in ringgit exchange rate could also have a larger pass-through effect on domestic prices, causing the headline inflation to be higher than projected. A third factor would be the strength of growth in both Malaysia and its trading partners, which could create upward or downward pressures on domestic inflation.

MONETARY POLICY

Monetary policy in 2017 will focus on supporting the sustainable growth of the Malaysian economy while maintaining price stability

Monetary policy in 2017 will continue to ensure the monetary policy stance is consistent with sustaining a steady economic growth path amid price stability. The policy environment is expected to remain challenging. Although growth is expected to improve due to better performance of the external sector, the economy will

be challenged by higher inflation, volatile capital flows and lingering constraints in the global economic and financial environment.

The global economy is anticipated to improve gradually in 2017. Nevertheless, it will continue to be confronted with significant downside risks. Global growth remains susceptible to adverse shocks to international trade, arising from the threat of trade protectionism, geopolitical developments and other unfavourable developments in the major economies. Moreover, the expected shifts in global liquidity and capital flows given the anticipation of monetary policy normalisation in the US would have spillover effects on the domestic financial markets and the ringgit exchange rate. The implications of these developments on the balance of risks to the domestic growth and inflation outlooks will be assessed closely during the year.

Given the uncertainties in the global economic and financial environment, the Malaysian economy is projected to expand at a moderate pace of 4.3% - 4.8% in 2017, driven primarily by domestic demand from the private sector. While the projected improvement in external demand and recovery in commodity prices would lend support to the anticipated stronger economic expansion compared to 2016, domestic headwinds such as continued adjustments to higher cost of living and cautious economic sentiments could weigh on Malaysia's growth prospects.

Headline inflation is expected to average higher, within the range of 3.0% - 4.0% in 2017. Nevertheless, the higher inflation compared to 2016 will be mainly cost-driven, and the spillovers to the broader price trends are expected to remain contained. Underlying inflation is expected to increase only moderately in the absence of strong demand conditions. The inflation outlook, however, is subject to key uncertainties surrounding global oil prices and the path of the ringgit exchange rate and the pass-through to domestic prices.

The continuing uncertainty surrounding the outlook for both domestic growth and inflation poses a greater challenge in assessing the likely path of baseline growth and inflation. Monetary policy will also continue to consider the risk of destabilising financial imbalances, although these have largely remained contained. Given the expectation of periods of volatility in capital flows, the Bank's

³ Based on Food and Agriculture Organization of the United Nations (FAO)' Food Outlook report in October 2016.

monetary operations will continue to ensure that domestic liquidity in the financial system will remain sufficient to support the orderly functioning of the domestic financial markets. The focus of the Monetary Policy Committee would therefore be on ensuring that the stance of monetary policy remains consistent with the achievement of steady growth and stable inflation, supported by healthy financial intermediation in the economy.

FISCAL POLICY

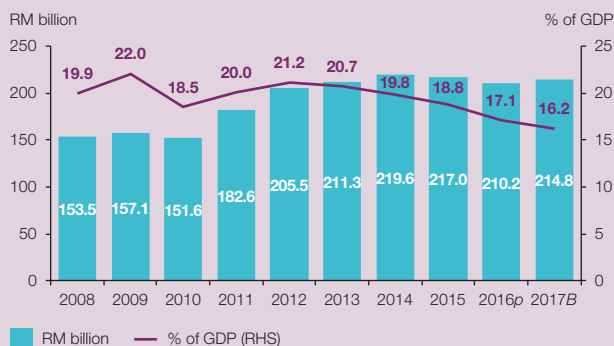
Fiscal deficit to reduce further

Fiscal policy in 2017 is aimed towards further strengthening of the Government's fiscal position, while ensuring continued support for domestic growth and promoting economic inclusiveness. The Federal Government's fiscal deficit is expected to narrow further to 3.0% of GDP in 2017 (2016: -3.1%), underpinned by sustained growth in revenue and a marginal expansion in operating expenditure. Continued fiscal consolidation despite the challenging domestic and external economic environment is a reflection of the Government's commitment to fiscal reforms while recognising the need to ensure a pro-growth environment in the economy.

Following fiscal reforms, the Government has managed to rein in the growth of operating expenditure. The share of operating expenditure as a percentage of GDP has declined to 17.1% in 2016 compared to 18.8% in 2015. This is expected to decline further to 16.2% following efforts to reduce

Chart 4.1

Federal Government Operating Expenditure

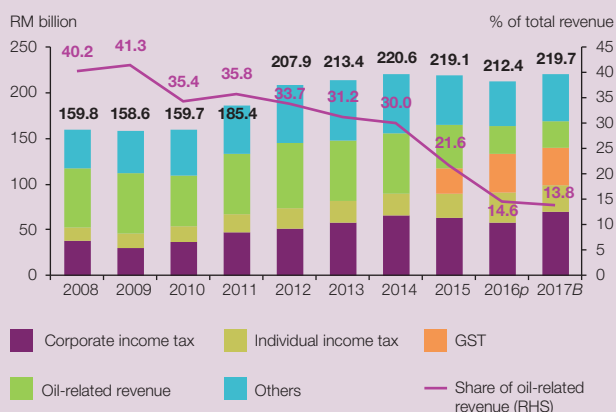


p Preliminary
B Budget

Source: Ministry of Finance, Malaysia

Chart 4.2

Federal Government Revenue



p Preliminary

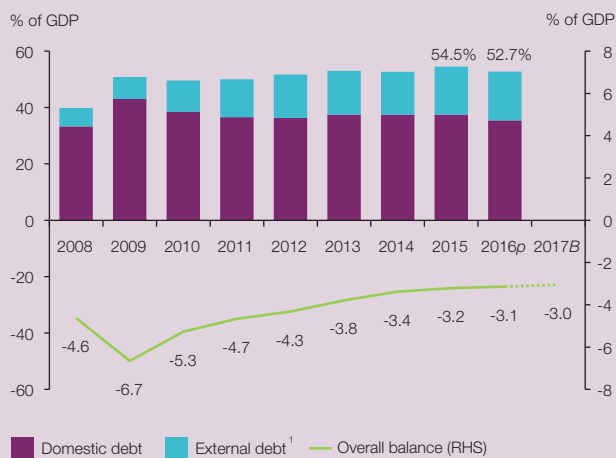
B Budget

Source: Ministry of Finance, Malaysia

non-critical spending on grants and transfers to statutory bodies, and the further rationalisation of subsidies. The Government also continues to diversify its revenue sources to ensure resilience amidst uncertainties in global commodity markets. As a result, despite expectation of higher oil prices, the contribution of oil-related revenue is expected to decline to 13.8% in 2017 compared to 14.6% in 2016. In addition, the establishment of a special tax unit,

Chart 4.3

Federal Government Fiscal Balance and Debt



¹ External debt comprises foreign currency debt (offshore borrowing) and non-resident holdings of RM-denominated Federal Government debt (MGS, Gil, T-bills and Sukuk Perumahan Kerajaan)

p Preliminary
B Budget

Source: Ministry of Finance, Malaysia

Table 4.3

Federal Government Finance

	RM billion		Annual change (%)	
	2016p	2017B	2016p	2017B
Oil price	44	45		
Revenue	212.4	219.7	-3.0	3.4
Total expenditure	252.2	260.8	-2.2	3.4
<i>Operating expenditure</i>	210.2	214.8	-3.1	2.2
<i>Gross development expenditure</i>	42.0	46.0	3.0	9.5
Loan recoveries	1.3	0.7		
Overall balance	-38.4	-40.3		
% of GDP	-3.1	-3.0		
<i>Sources of financing:</i>				
Net domestic borrowing	37.9	-		
Net external borrowing	0.8	-		
Realisable assets ¹ and adjustments	-0.3	-		

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

p preliminary

B Budget

Note: Numbers may not add up due to rounding

Source: Ministry of Finance, Malaysia

the Collection Intelligence Arrangement (CIA), reflects the Government's effort to enhance tax compliance.

In the 2017 Budget, fiscal resources have been strategically prioritised towards high impact infrastructure projects and programmes for capacity building. These include public infrastructure⁴ such as highways and railways that expand connectivity between urban and rural areas. Development of human capital⁵ will be strengthened through enhancement of up-skilling programmes and industrial training. The improvement of the quality of talent to meet the needs of industry is critical to accelerate Malaysia's progress towards becoming a high-income nation.

The budget was also consistent with the efforts to ensure inclusive and sustainable growth. Through

welfare enhancement programmes, the Government will continue to focus on sustaining the capacity of the lower- and middle-income segments to cope with the rising cost of living. Socio-economic support to these groups is dispersed through various forms of assistance⁶, including affordable housing schemes and fiscal transfers. These measures would also provide support to private consumption.

In May 2016, the Fiscal Policy Committee (FPC) tasked a newly established Technical Committee on Fiscal Risks and Contingent Liabilities to evaluate and enhance measures to contain the Federal Government's fiscal risks and contingent liabilities. This committee is expected to further strengthen public finances while ensuring fiscal flexibility and sustainability into the future.

⁴ These include implementation of the new East Coast Rail Line and acceleration of the Pan Borneo Highway.

⁵ Examples include enhancement in the Technical Vocational Education Training (TVET) programme and extension of the 1Malaysia Training Scheme (SL1M) for 20,000 graduates.

⁶ Affordable housing schemes include MyBeautiful New Home, *Projek Perumahan Rakyat* and SPNB People Friendly Home while fiscal transfers include, among others, *Bantuan Rakyat 1Malaysia* and social safety net programmes such as assistance to poor families, senior citizens and disabled groups.

Structural Reforms in ASEAN-5 Economies: Past Successes and Future Challenges

By Gloria Tsan Ern Hui and Ooi Kiesha

Introduction

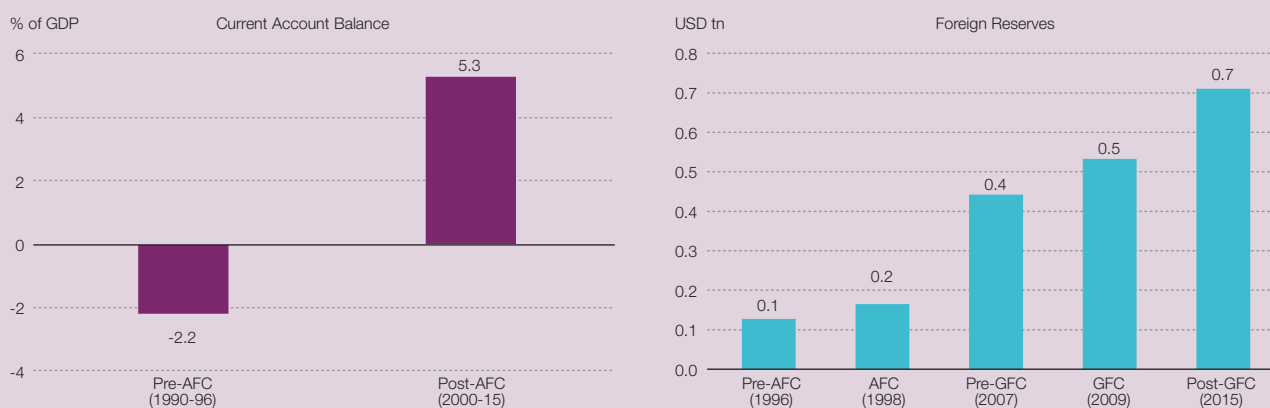
The Asian Financial Crisis (AFC) in 1997 - 1998 marked a significant turning point for several Asian economies. From the viewpoint of the ASEAN-5 economies¹, the experiences from the AFC brought to light the importance of comprehensive reforms to address the underlying weaknesses and structural deficiencies of an economy (Park et. al., 2013). These structural reforms² include an array of policies to support the banking systems, address spillovers into the real economy and strengthen the dynamism and resilience of the crisis-affected economies. While the macroeconomic resilience of the regional economies have been sustained for about two decades, the current global economic and financial environment, especially in the aftermath of the Global Financial Crisis (GFC), increasingly poses significant challenges and downside risks to the sustainability of growth in the ASEAN-5 economies going forward. Furthermore, the rise of Industry 4.0³, rapid urbanisation and the growing importance of climate change also call for proactive structural reforms that help to keep pace with global issues and trends. This article serves to highlight the importance of structural reforms in Malaysia and its ASEAN neighbours against this backdrop.

Critical reforms in the post-AFC period

The AFC brought into view the region's vulnerability associated mainly with financial and economic fragility. On the financial side, an over-reliance on the banking sector, under-supervised and under-regulated financial systems and a deep mismatch between foreign liabilities and foreign assets were key vulnerabilities. The crisis also revealed several structural challenges such as debt-driven investment booms, rigid exchange rate regimes and current account deficits in the 1990s. In the aftermath of the crisis, the crisis-affected economies underwent deep transformation, recovered and thrived by embracing pertinent structural reforms. In the financial sector, policy measures successfully strengthened the supervision and regulation of the banking system, diversified sources of financing and enhanced domestic financial infrastructure. Measures in the real sector focused largely on improving macroeconomic management, strengthening public institutions and building up buffers to manage external shocks. As a result, ASEAN-5 economies today have diversified sources of growth, developed financial sectors, flexible exchange rates and healthier external positions (Chart 1).

Chart 1

Current Account Balance and Foreign Reserves in ASEAN-5*



* Refers to Indonesia, Philippines, Malaysia, Thailand and Singapore

Source: IMF October 2016 WEO, Haver, Bloomberg

¹ ASEAN-5 refers to Indonesia, Malaysia, Philippines, Singapore and Thailand.

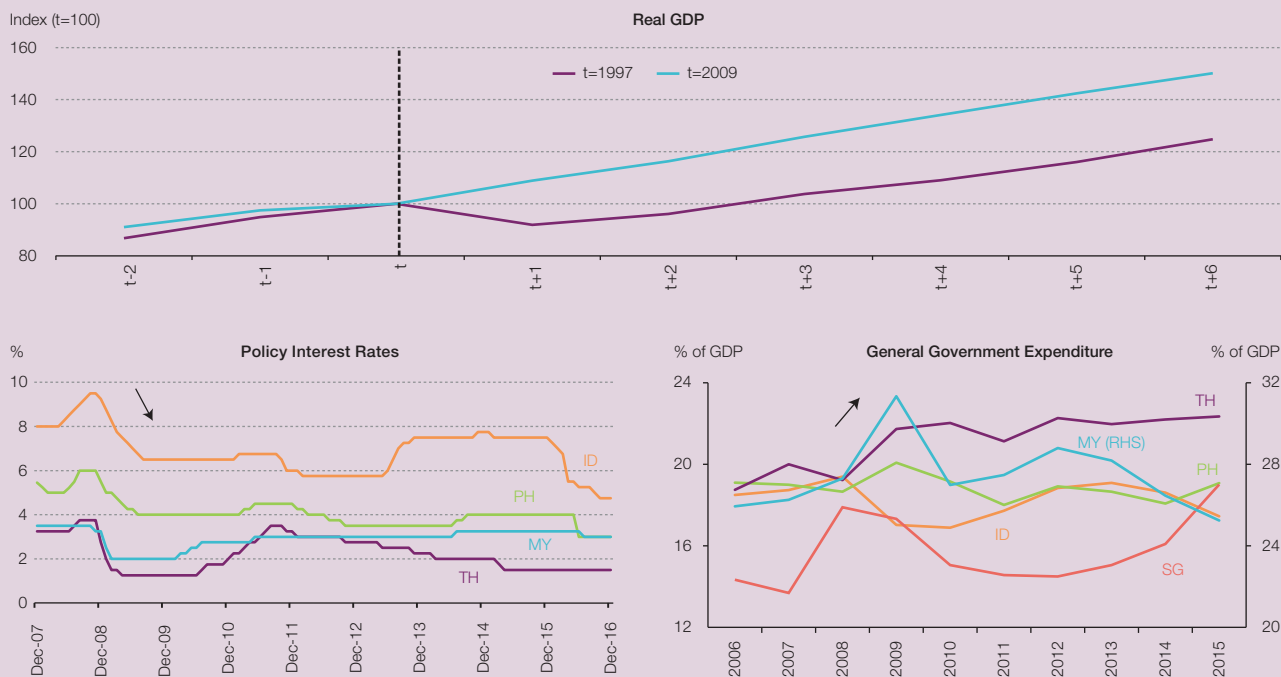
² Refer to policies that improve the productive capacity of an economy by removing impediments to the efficient functioning of markets.

³ Refers to the combination of several major innovations in digital technology, including the Internet of Things, cloud computing, digital fabrication, advanced robotics and artificial intelligence.

ASEAN-5 demonstrated considerable resilience in 2009 during the GFC, much of which could be attributable to the strength in the region's economic fundamentals. While GDP and export growth declined significantly in 2009, the region's financial systems were largely unaffected with continued functioning of financial intermediation. Households and corporates also entered the crisis with generally stronger balance sheets. Of great significance, the more flexible exchange rates and more institutionalised and transparent monetary policy making have allowed the region to pursue more effective monetary policies, thereby cushioning the severity of the crisis. Central banks across ASEAN-5 reduced their key policy rates by an average of 290 basis points from peak to trough between 2007 and 2009. Additionally, fiscal support took place with stimulus packages, including tax cuts and subsidies in several economies. As a result, growth rebounded swiftly, from 2.6% in 2009 to 8.9% in 2010.

Chart 2

Real GDP, Policy Interest Rates and General Government Expenditure in ASEAN-5



Source: IMF October 2016 WEO, Haver

Structural reforms continue to be relevant for ASEAN-5 in the post-GFC period

While the ASEAN-5 economies have experienced success in executing structural reforms post-AFC, **the GFC has unleashed new challenges** for the region that render further structural reforms critical in the current period. These challenges include, but are not limited to:

a) Prolonged weakness in global trade

Against the backdrop of persistent weakness in several of the major advanced economies, global trade has remained sluggish post-GFC. Of significance, the weak recovery in investment growth, which generally has higher import content, contributed to slower growth of trade relative to overall GDP growth. Beyond this cyclical weakness, other structural forces have also weighed on trade activity, including the diminishing impact from past impetuses on trade such as the proliferation of global value chains in the 1990s and early 2000s and PR China's ongoing transformation towards a more consumption-based growth model⁴. Therefore, the external

⁴ For more details, please refer to Box Article on 'Recent Slowdown in Global Trade: Cyclical Bane or Structural Shift?' in Bank Negara Malaysia's Annual Report 2015.

demand that has been a key source of growth for the regional economies prior to the GFC has now become a source of decelerating momentum for ASEAN-5 given the region's trade openness. The trend of lower global trade growth is expected to persist given the lack of new impetus to growth in the major economies amid rising anti-globalisation sentiments. The IMF forecasted that world trade will average 4.1% in the next five years compared to 8.4% from 2003 to 2007⁵. Therefore, the region needs to focus on its competitiveness in this more challenging global environment, if it is to continue experiencing relatively healthy growth rates going forward.

b) Limitations of fiscal space

While the ASEAN-5 economies generally have more macroeconomic policy space to manoeuvre domestically compared to most major advanced economies, headline fiscal balances in a few economies have yet to return to pre-crisis (2003 - 2007) levels. General government gross debt has also risen in several economies amid an environment of low and accommodative interest rates. This highlights the concerns over the need to restore fiscal space to allow for counter-cyclical responses to future shocks. Additionally, fiscal space needs to be generated to address developmental challenges, including greater investments in infrastructure to reduce supply bottlenecks and human capital development. In this respect, encouraging greater private sector participation in the development of physical infrastructure and the provision of financial, education and healthcare services could help to lower the fiscal burden of the government, while also increasing productivity gains and improving the quality of services.

c) A new global financial landscape

Following the GFC, the global financial landscape has been shaped by new regulatory standards such as the Basel III, which has been introduced to strengthen prudential and regulatory standards for the banking sector. In this regard, policy makers in the region have maintained prudent financial positions by building capital and liquidity buffers of regional financial institutions after the AFC (Yao, 2016). This has allowed the region to be well-positioned to meet the requirements of this new global standard. Nonetheless, the financial landscape continues to evolve, providing both opportunities and challenges for the region. Technological advancements have spurred growth in Financial Technology, otherwise known as FinTech, which has the potential to reshape the way financial services are provided. New ways of financing, new products and new participants have emerged, challenging the role and relevance of traditional business models. These include FinTech developments that have expanded the frontiers of banking in areas such as peer-to-peer lending, merchant and e-commerce finance and online trade finance⁶. It is therefore critical for policymakers in the region to provide a supportive legal and regulatory environment that would support innovation, but at the same time ensure consumer protection and the orderly functioning of financial markets.

ASEAN-5's policy focus on structural reforms

Recognising the increasing urgency of implementing comprehensive reforms in this challenging environment, policy makers in the region continue to undertake proactive measures, not only to address potential risks and spillovers from the external environment in the short term, but also to further strengthen the region's growth prospects and competitiveness over the medium term. While the specific mix of reforms to address the challenges unleashed following the GFC may differ across countries, the general reform priorities for ASEAN-5 encompass the following:

a) Enhancing economic productivity

Growth in the region has been achieved through the vibrant external and domestic sectors. Amid prolonged weakness in global trade, it is highly important for the region to undertake reforms to ensure continued balanced growth going forward. This can be done through raising the productive capacity of an economy by improving connectivity, competitiveness and human capital competency. In light of this, the ASEAN-5 economies have been forward-looking reformers that have prioritised investments in both hard infrastructure such as upgrading transportation networks and increasing broadband penetration, and soft infrastructure like improving governance

⁵ Source: IMF October 2016 World Economic Outlook.

⁶ Source: World Economic Forum (2015).

mechanisms and developing human capital. Recognising the need for greater private sector involvement in financing the scaling-up of infrastructure development, regional economies have also taken proactive measures to enhance existing public-private partnership (PPP) frameworks, thus reducing the reliance on government fiscal resources. Efforts to foster productivity through infrastructure development have been complemented by the development of a competent workforce, not only in promoting sustainable growth over the longer term, but also in ensuring an equitable distribution of economic gains. For example, several countries in the region, particularly Malaysia and Singapore, have been steadfast in undertaking instituted labour market reforms such as the implementation of minimum wage, improving accessibility to higher education, and deepening labour skills to enhance competitiveness.

b) Maintaining macroeconomic stability

To further strengthen underlying fundamentals, policy makers in the ASEAN-5 countries, particularly the Philippines, Indonesia and Malaysia have been embarking on reforms to improve fiscal space and public institutional frameworks. In particular, the introduction of tax reforms and subsidy rationalisation, and the diversification and expansion of public income sources have played a vital role in re-building policy space since the GFC period. Economies such as Singapore and Malaysia have also undertaken pre-emptive policies such as macro-prudential measures to manage imbalances in the property market and curb concerns over elevated household indebtedness. A prudent fiscal position and forward-looking policies to reduce vulnerabilities can therefore lay the foundation for better macroeconomic stability.

c) Enhancing flexibility and efficiency of financial systems

With the rapidly evolving global financial landscape, authorities in the region recognise that regulations should not stifle innovation and new approaches to financial development (Arner and Park, 2010). Instead, in keeping abreast with the development of FinTech, continuous efforts have been undertaken to encourage greater experimentation. ASEAN-5 economies such as Singapore and Malaysia, for example, have begun to embrace the emergence of FinTech by introducing regulatory sandboxes. This has enabled financial institutions and FinTech participants to test their innovations in the market within a well-defined environment, with appropriate financial safeguards in place, thereby stimulating competition and promoting innovation while preserving financial stability.

Keeping pace with global trends

Beyond addressing the challenges that have emerged following the GFC, it is equally important for the region to be proactive in carrying out reform efforts to both harness the benefits and minimise the risks from shifting global trends. Policy imperatives include keeping in stride with the rise of Industry 4.0 and promoting an inclusive and green economy. Industry 4.0 has created new growth areas, such as sharing economy and e-commerce. While much has been done in ASEAN-5 to ride on the wave of Industry 4.0, the e-commerce adoption remains fairly nascent, suggesting that there is still considerable room for improvement⁷.

Amid rapid development and urbanisation, the urgency to safeguard against negative social cost has risen. In light of this, regional economies have been implementing reforms to promote inclusive growth by enhancing the access to opportunities for all segments of society. This includes introducing a more comprehensive social protection mechanism such as providing financial services to the unserved and underserved at the individual and business levels. In Malaysia, myriad efforts have been undertaken to improve the access and usage of quality and affordable financial services through innovative channels, products and infrastructure.

In creating an environmentally sustainable growth, efforts to expand and scale up the usage of energy-efficient technologies have also been gradually gaining traction in the region. For example, in 2015, investment in solar projects within the South East Asian region, particularly Thailand, Indonesia and the Philippines, rose to a record high of USD1.7 billion (2010-2014 average: USD0.9 billion)⁸. A few regional economies have also increasingly supported green building adoption,

⁷ Source: A. T. Kearney (2015).

⁸ Source: Clean Energy Pipeline (2016).

by using ecologically-friendly construction materials and conserving energy and space. Singapore, in particular, has taken the lead in Asia by ranking first on the Economist Intelligence Unit's Asian Green City Index⁹.

Regional cooperation beyond national initiatives

The regional economies recognise that policy strategies need to be two-fold, because the deepening of structural reforms at the national level needs to be complemented by initiatives to increase regional cooperation. Of importance, the ASEAN Economic Community (AEC) Blueprint 2025 draws attention to the fact that greater integration allows regional economies to harness the benefits arising from the diversity and complementarities that exist across the economies¹⁰. As such, ASEAN's information sharing and capacity building initiatives play an important role in enhancing the technical capacity of policy makers in undertaking reforms. Taking into account the different development levels and needs of its member states, ASEAN also continues to make progressive efforts in intensifying regional financial integration, promoting financial inclusion and ensuring financial stability. Of note, the ASEAN Banking Integration Framework (ABIF) highlights ASEAN's commitment to strengthen intra-regional trade and investments while preserving regional financial stability.

Conclusion

ASEAN-5's transformation through economic and financial reforms have accorded the region with stronger fundamentals and policy flexibility to withstand external shocks, as illustrated in the region's swift rebound during the GFC. Today, headwinds in the global economic environment, including persistent weakness in international trade activity, prolonged macroeconomic and policy uncertainties, and increased volatility in exchange rates and capital flows necessitate these economies to continue prioritising reforms. Additionally, shifting megatrends such as technological disruptions, rapid urbanisation and climate change offer both challenges and opportunities for the region. By promoting sustainable growth and economic dynamism, the region can raise resilience amid these cyclical and structural shocks. Advancing collaboration amongst economies in the ASEAN region also allows countries to leverage on each other's strengths to reap greater economic and social benefits of reforms.

References

Arner, D. W. and Park, C. Y. (2010), 'Global Financial Regulatory Reforms: Implications for Developing Asia', Asian Development Bank.

ASEAN Secretariat (2015), 'ASEAN Economic Community Blueprint 2025', Jakarta, November.

A.T. Kearney (2015), 'The ASEAN Digital Revolution,' India.

Clean Energy Pipeline (2016), 'South East Asian Clean Energy Project Finance,' March.

Economist Intelligence Unit (2011), 'Asian Green City Index: Assessing the Environmental Performance of Asia's Major Cities,' Siemens AG, Munich.

International Financial Corporation (2011), 'International Finance Institutions and Development Through the Private Sector', Washington, D.C, September.

International Monetary Fund (2016), 'A Guiding Framework for Structural Reforms', Washington, D.C, April.

Park, D., Ramayandi, A., Shin, K. (2013), 'Why Did Asian Countries Fare Better during the Global Financial Crisis than during the Asian Financial Crisis?' Peterson Institute for International Economics.

World Economic Forum (2015), 'The Future of FinTech: A Paradigm Shift in Small Business Finance', Geneva, October.

Yao, W. (2016), 'Why Asian Banks are Well Positioned for Basel III', Federal Reserve Bank of San Francisco, November.

⁹ Source: Economist Intelligence Unit (2011).

¹⁰ Source: ASEAN Secretariat (2015).

Demystifying the Affordable Housing Issue in Malaysia

By Cheah Su Ling and Stefanie Joan Almeida

Introduction

Since 2012, the increase in house prices in Malaysia has outstripped the rise in income levels. Consequently, prevailing median house prices are beyond the reach of most Malaysians. This is primarily attributable to a gross mismatch between housing supply and demand amid diverging expectations between households and developers. The issue has been compounded by the fact that the distribution of new housing supply has been concentrated in the higher-priced categories. The undersupply of housing is particularly acute in the affordable housing segment. The provision of affordable homes has become a challenge for policymakers worldwide, with Malaysia being no exception. It is a similar problem in the United States (US), United Kingdom (UK), Australia and New Zealand (*Demographia International, 2015*). This article¹ aims to define what affordable housing means in the Malaysian context, given income levels and demographic factors. With this, the level of affordable housing supply needed at present and in the future is estimated. The article then identifies some of the policies used by other countries in addressing the shortage of affordable housing which provide important policy lessons for dealing with the situation in Malaysia.

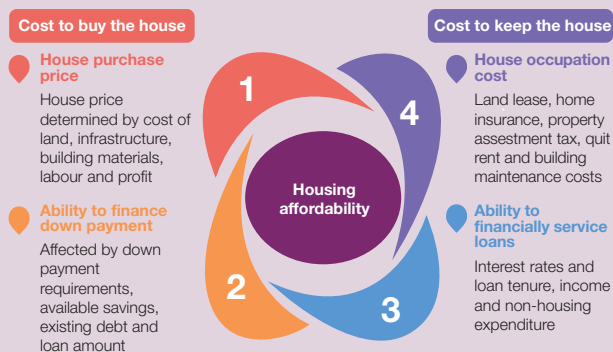
Defining Housing Affordability

Affordable housing is broadly defined as housing which is adequate in quality and location, and is not so costly that it prevents its occupants from meeting other basic living needs². Given the broad scope³ of what constitutes affordable housing, this article focuses on the financial affordability of housing to gauge the extent to which house prices in the market are beyond the financial means of households in Malaysia.

According to UN-HABITAT, the financial affordability of housing is affected by two key components: (i) cost of purchasing the house, and (ii) cost of keeping the house (Diagram 1), which are in turn influenced by property prices, the amount of down payment required and size of financing obtained, as well as the ability to finance the maintenance of the property and

Diagram 1

Basic Components of Financial Affordability of Housing



Source: Adapted from UN-HABITAT (2011)

¹ This article is an extension to the Box Article on 'Assessing Demand-Supply Conditions in the Malaysian Property Market', in Bank Negara Malaysia's Annual Report 2015.

² According to the United Nations Human Settlements Programme (UN-HABITAT, 2011).

³ A broader definition of affordable housing refers not only to affordability in terms of prices, but extends to housing which meets minimum decent standards of living (basic amenities, floor-space, sanitation, without structural building defects) and that is located not too far away from centres of employment, usually one hour away (McKinsey Global Institute, 2014).

monthly mortgage repayments. Given the broad dimensions of affordable housing, several housing affordability metrics have emerged. While there is no universal standard in defining housing affordability, there are however, three approaches that are commonly used, namely the Median Multiple, the Housing Cost Burden and the Residual Income.

According to the Median Multiple (MM)⁴ methodology developed by Demographia International to evaluate urban housing markets, a house is considered affordable if it can be financed by less than three times a household's median annual income. The median multiple of 3.0 is based on the historical trend in six nations⁵ where housing affordability ranged between 2.0 to 3.0 until the 1980s or 1990s. While the accuracy of which the MM indicates an affordable housing market may vary between countries, it is nevertheless a useful broad measure for comparing housing affordability. Secondly, going a step further and taking into account the availability of credit, housing affordability can be thought of as a percentage of household income that is spent on housing. This is the Housing Cost Burden (HCB) approach, commonly used in the US, Australia and the OECD countries. The approach⁶ is based on the rule of thumb by which housing expenditures⁷ of less than 30 percent of household income⁸ are deemed affordable. Households that pay more than 30% are considered housing cost-overburdened, as they risk not having sufficient income for other necessities such as food, transportation and healthcare. The third measure is the Residual Income (RI), which is a more granular approach. The RI considers first, the basic necessities of household costs, and subtracts these costs from the income of a household. What is left is the "residual" income. This would reflect the household's capacity to spend on housing (e.g. mortgage repayments). The RI approach is used by some commercial banks to evaluate mortgage applications. Table 1 depicts a comparison of the three metrics.

Table 1

Comparison of Affordable Housing Metrics

Macro-level method	Approach	Definition of housing affordability	Advantages	Disadvantages
↓ Micro	Median Multiple (MM)	Median house price that is three times or less than the annual income of the median household (e.g. house price-to-income ratio of 3.0 and below).	Easy to calculate. Allows comparison of housing affordability across countries and within a country over time.	Ignores the role of credit.
	Housing Cost Burden (HCB)	Housing expenditure (e.g. mortgage repayment) that is less than 30% of household income.	Considers the effect of leverage and non-housing expenditures of household. Allows comparison of housing affordability across countries and within a country over time.	Rigid threshold of 30%. Accuracy of cross-country comparison could be affected by differences in cost of living and repayment structure of mortgages across countries.
	Residual Income (RI)	Residual income (after deducting non-housing costs) that is sufficient to service monthly mortgage obligations.	Considers the effect of leverage and the household's spending patterns. More reflective of a household's ability to purchase a house.	Limited cross-country comparability. Requires detailed data on household income and attributes, cost of living and housing costs.

Source: Demographia International (2015), UN-HABITAT (2011), Fannie Mae (2016)

⁴ Recommended by the World Bank as well as the United Nations (UN). It is also used by the Joint Centre for Housing Studies, Harvard University, US.

⁵ Australia, Canada, Ireland, New Zealand, UK and US.

⁶ Developed by the US Department of Housing and Urban Development.

⁷ Total housing costs include mortgage principal payments and interest payments or rent, house insurance, mandatory services and charges (sewage and refuse removal), regular maintenance and repairs, taxes and the cost of utilities (e.g. water, electricity, gas and heating). For renters, these costs are counted if paid by the tenant.

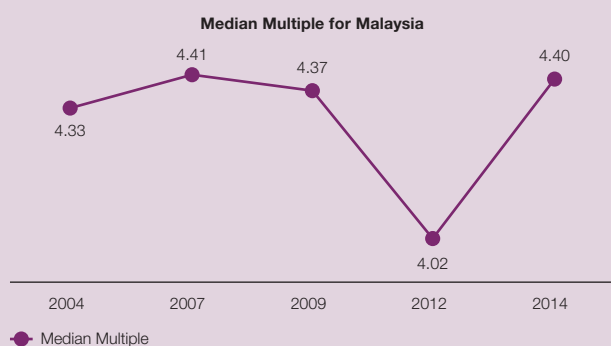
⁸ Household income includes income from work, social benefits, investments and other household income. Disposable income (household income, after taxes and deductions) is sometimes used, as in OECD (2016).

Assessing the Affordability of Houses in Malaysia

Using the MM approach, the ratio of median house price to the median household income has consistently exceeded 3.0 since 2004. By 2014, the housing affordability ratio was 4.4⁹, indicating that houses in Malaysia as a whole, were 'seriously unaffordable' (Chart 1). Within Malaysia, house prices range from 'affordable' in Melaka (affordability ratio of 2.98 in 2014) to 'severely unaffordable' in Terengganu¹⁰, Kuala Lumpur, Penang and Sabah (ratio above 5, Chart 2).

Chart 1

House Prices in Malaysia Have Been Consistently Above the 3.0x Affordability Standard



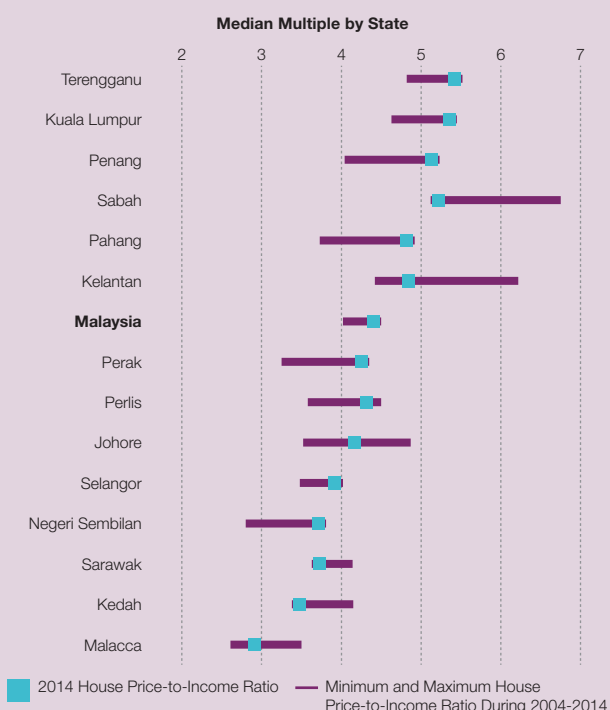
Median Multiple Approach: Affordability Thresholds

Rating	House Price-to-Income Ratio
Severely Unaffordable	5.1 & Above
Seriously Unaffordable	4.1 to 5.0
Moderately Unaffordable	3.1 to 4.0
Affordable	3.0 & Below

Source: Demographia International (2015), National Property Information Centre, Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Chart 2

Houses in Most States are Unaffordable for Households Earning the Median Income



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

Estimates using the HCB and the RI methodologies broadly concur with the above findings. Both the HCB and RI approaches consider housing loans as supporting the ability of households to purchase homes. The price of an affordable house under these two approaches is equivalent to the maximum amount of housing loan¹¹ that the household is able to obtain. This enables the household to afford a house at a higher price than that under the MM approach, which is an indication of the number of times median house prices exceed annual household income without the aid of a housing loan. The price of an affordable house under the RI approach is in turn higher than in the HCB approach. This is because the RI approach releases the 30% housing-cost expenditure constraint imposed by the HCB, acknowledging that households of different income brackets may spend different proportions of their income on housing and non-housing expenditures.

⁹ Latest median household income data available was in 2014 (DOSM, 2014). Using the MM approach, houses in Malaysia were less affordable compared to US (house price-to-income ratio of 3.6), Canada and Ireland (4.3), but more affordable than in UK (4.7), Singapore (5.0), Australia (6.4), New Zealand (8.2) and Hong Kong (17.0) (Demographia International, 2015).

¹⁰ In Terengganu, growth in house prices (2012-2014: 14.1%) outstripped that of household income (11.6%).

¹¹ Other factors considered include prevailing interest rates, 90% loan-to-value and loan tenure of 35 years. Calculations consider the disposable income of households (gross income minus EPF, SOCSO and income tax).

Chart 3

In 2014, Houses are Considered Affordable in Malaysia and in Some Key States...

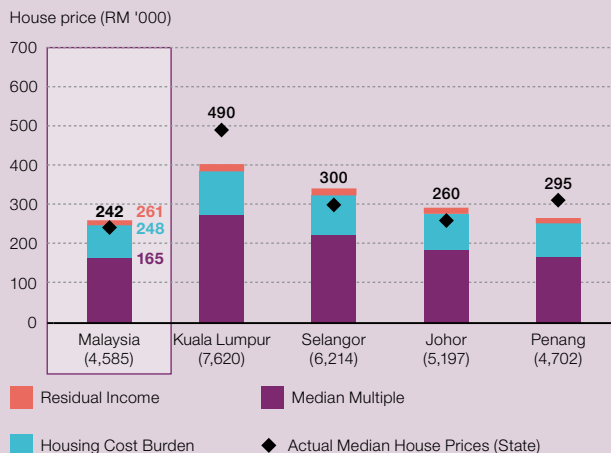
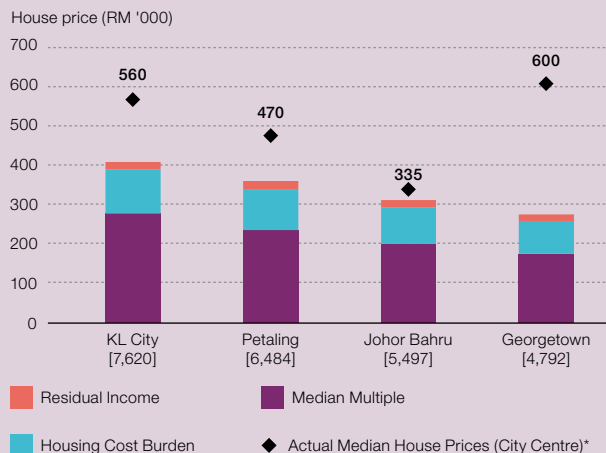


Chart 4

...but Unaffordable in Major Urban Centres in the Four Key States



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

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

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

The shaded area in Chart 3 illustrates this point, where the ideal price of an affordable house for a median household in 2014 (monthly income of RM4,585) is up to RM165,060 using the MM approach, but is higher at RM248,000 with the HCB and RM261,000 with the RI approach. In 2014, the actual median price for a house in Malaysia was RM242,000. This suggests that houses were affordable under the HCB and RI approaches. The same conclusion holds for Selangor and Johor. However, houses in the major urban centres were unaffordable according to all three methods (Chart 4). Across all four major urban centres, the prevailing median market house prices were significantly above the ideal affordable house prices. The situation was particularly acute in Georgetown which suffered the highest median house prices and lowest median household income. Given that house prices increased further in 2016, housing affordability continues to be a current issue for households.

Given the variation in methodology, as expected, each affordability measurement yields different results. Yet, they all point to broadly consistent conclusions. Firstly, housing affordability has deteriorated. All three approaches find that housing affordability has deteriorated significantly over the period 2012 - 2014, with significant unevenness across states. Secondly, given that households typically purchase homes with the aid of a housing loan, more weight is given to the findings of HCB and RI approaches, in which houses in Malaysia as a whole, are considered affordable. However, this conclusion should be treated with caution given that it masks significant disparities between states. Finally, all three measures find that houses are significantly unaffordable in the major urban centres in key states, with varying degrees of severity across different locations.

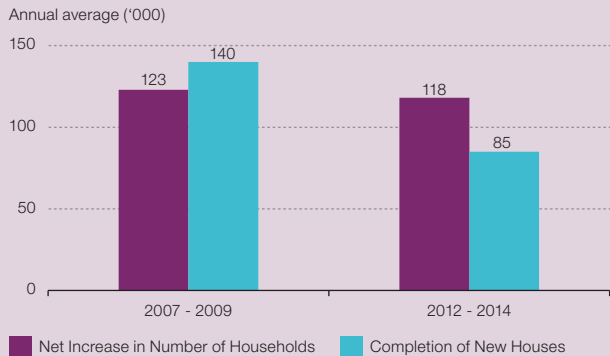
Factors Contributing to Housing Affordability Issues in Malaysia

The issue of affordable housing reflects mainly the supply-demand imbalances in Malaysia, which worsened during the 2012 - 2014 period. During these years, new housing supply fell short of the increase in demand (average supply of 85,000 new units versus the formation of 118,000 new households). This is in contrast to the period 2007 - 2009, when the new supply exceeded the demand for housing (Chart 5).

Secondly, the effect of the supply shortfall on housing affordability was exacerbated by the slower increase in household incomes (12.4%) relative to house prices (17.6%) (Chart 6). Both of these trends were more acute in key states (Charts 5a and 6a).

Chart 5

Insufficient Supply of New Houses Compared to the Increase in Households During 2012-2014



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

Chart 6

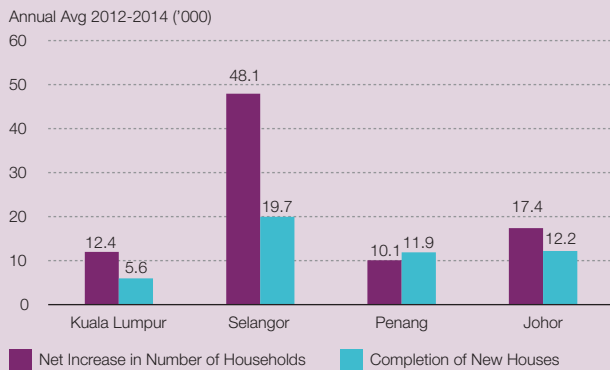
During 2012-2014, the Growth in Median House Prices Has Outpaced the Growth in Median Household Income



*Note: CAGR refers to Compound Annual Growth Rate

Chart 5a

The Undersupply is Evident Across Most Key States in 2012-2014



Source: National Property Information Centre and Department of Statistics Malaysia

Chart 6a

Faster Growth in Median House Prices Compared to Income Levels Across All Key States During 2012-2014

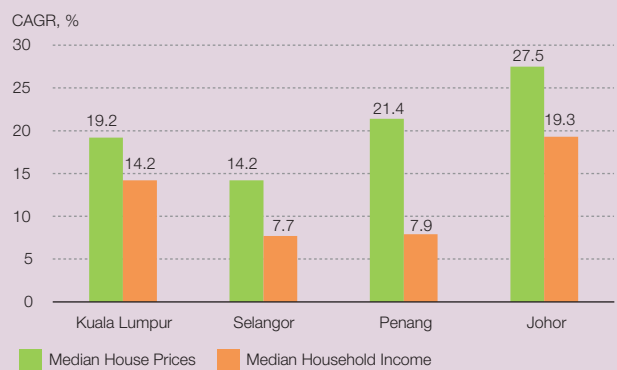
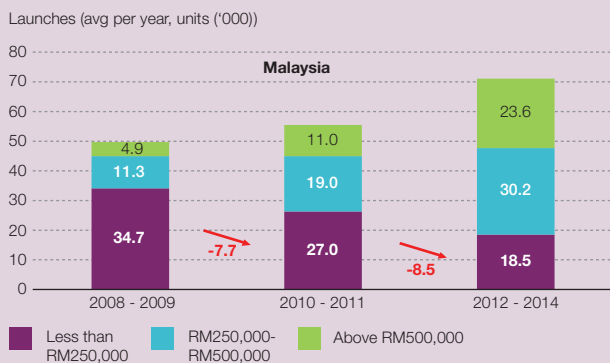


Chart 7

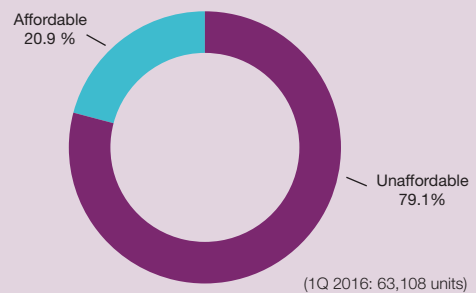
New Housing Launches Have Been Increasingly Skewed Towards the Higher-end Property Segment



Source: National Property Information Centre

Chart 8

Majority of Unsold Houses in Malaysia were Those in the Non-affordable Price Category



Note: Affordable house price estimated with HCB. Total unsold properties include unsold properties that were completed and under construction as at 1Q 2016
Source: National Property Information Centre and Bank Negara Malaysia estimates

A third factor which worsened the housing affordability issue was the trend of higher property launches in the price categories above RM250,000¹² (Chart 7). While there were more launches during 2012 - 2014, the number of new affordable housing units for households earning the median income (below RM250,000¹³) was fewer by 16,200 units per year since the period 2008 - 2009. The oversupply of higher-end properties beyond what households can afford resulted in a significant portion of these non-affordable properties remaining unsold (Chart 8).

Access to Financing for Home Buyers and Industry Players

For home buyers, bank financing for the purchase of residential properties for qualified borrowers continued to be available. Growth in loans outstanding for home purchase averaged at 13.2% during 2012 - 2014 (2008 - 2009: 9.8%). While this moderated to 9.2% in 2016, this moderation was due to the softer housing market. The demand for affordable housing had supported the expansion in end-financing by banks for residential property purchases. As at end-2016, about 56% of loans outstanding were for houses priced below RM250,000, while loans for houses priced between RM250,000 to RM500,000 accounted for another 25%. Rejection rates for housing loan applications also fell further to 23.6% in 2016 (2012 - 2015: 26.1%). These trends are evidence that financing remains ample for eligible home buyers.

Similarly, house builders continued to have access to bank financing. Loans for real estate activities and residential property construction increased at a healthy rate of 11.7% in 2016 (2012 - 2014: 18.5%), reflecting the fewer property launches and incoming supply.

The Level of Affordable Housing That is Needed

On the supply side, it is evident that the housing market has not provided an adequate supply of affordable housing for the lower- and middle-income households. In 2014, the shortage¹⁴ of affordable houses was estimated to be 960,000¹⁵ units. This gap is evident across most states, with Sabah and Sarawak having the highest deficit, accounting for 50% of the total shortage in Malaysia. Among the four states with the highest concentration of urban population, the shortage of affordable housing was largest in Kuala Lumpur, followed by Penang and Johor. On the other hand, Selangor was found to have a surplus of affordable houses. However, this could be an over-estimation given that there is a significant number of low-cost housing in the state that may fail to meet the quality and location requirements of households¹⁶.

While there are multiple programmes by the private sector, and the Federal and State Governments to supply affordable housing, the current level of house-building is not sufficient to meet the demand. If the current trends in population growth, urbanisation and income growth persist, the supply-demand mismatch in the affordable housing segment is expected to worsen going forward. Trends¹⁷ in the country's demography shows that as Malaysia's population increases, the number of households increases at a faster rate than population growth, reflecting the trend of shrinking household size. This suggests that the demand for affordable housing is likely to increase going forward. By 2020, the shortage of affordable housing could very well be more than one million¹⁸ units.

¹² Developers have cited higher land costs, construction materials, labour and compliance costs as some of the reasons for higher property prices.

¹³ The price of an affordable house in 2014 is RM248,000 and RM261,000 using the HCB and RI approaches respectively.

¹⁴ Due to data limitations, the affordable housing gap in this article is estimated based on financial affordability of houses. Ideally, more accurate estimates of the demand of affordable housing should also take into account the requirement of households in terms of quality and location standards of houses, in addition to house prices.

¹⁵ Given that the stock of houses in the affordable price range is not readily available, the estimation is based on the assumption that households can only buy properties they can afford. Hence, the share of affordable housing transactions (i.e transactions occurring up to the price of an affordable house) is used as a proxy for the share of affordable houses in the market. The difference between the stock of affordable houses (supply) and the number of low- and middle-income households (who are likely to demand affordable homes) would then determine the shortage of affordable houses. These steps are repeated individually for each state, and summed up to arrive at an estimated shortage of 960,000 units nationwide in 2014.

¹⁶ Shortcomings of low-cost public housing in Selangor include its location away from institutions of learning and healthcare facilities, as well as building defects such as waterproofing and pipe leakages (Hashim et al, 2012).

¹⁷ From 2000 - 2010, the average annual population growth rate was 1.9%, while the average annual growth rate for the number of households over the same period was 3.2%. Additionally, the average size of households decreased from 4.6 persons per household in 2000 to 4.2 persons per household in 2010 (DOSM, 2010).

¹⁸ Projections are guided by population forecasts in the Eleventh Malaysian Plan and incorporate the trend of affordable housing completions during the period 2014 to 1H 2016.

Policy Lessons in Addressing the Affordable Housing Issue

A shortage in affordable housing is not unique to Malaysia. Other countries have identified both supply and demand-side policies to narrow the affordable housing gap. This challenge requires a multi-pronged approach focusing on four key areas: i) increasing supply and reducing the cost of affordable housing; ii) establishing a central repository as a systematic way of monitoring and managing the demand and supply of affordable housing; iii) developing a thriving rental housing market; and iv) diversifying the sources of financing for affordable homes.

i) Increasing the Supply and Reducing the Cost of Affordable Housing

Addressing the under-provision of affordable houses calls for a more organised approach. The empowerment of a single authority¹⁹ to spearhead the planning and delivery of affordable housing nationwide could unlock scale efficiencies, facilitate the management of a database, as well as to undertake research on policy options to address the affordable housing challenge.

An industrial approach can be used to deliver housing quickly, on a large scale and at a lower cost. Industrial construction techniques to improve labour productivity have shortened the delivery time by 40% - 50% and reduced costs by 30% (*McKinsey Global Institute, 2014*). Additionally, smarter procurement processes such as the establishment of a buying consortia²⁰ have enabled cost savings (via discounts on bulk orders), which can be passed on to the buyers through lower house prices.

ii) Establishing a Central Repository as a Systematic Way of Monitoring and Managing the Demand and Supply of Affordable Housing

In countries which have made significant progress in addressing the housing affordability issue, an integrated database which captures the demand and supply of housing has been useful in helping the provision of affordable housing by the public and private sectors. This central repository, which should ideally be managed and monitored by the single authority mandated to oversee the nation's affordable housing needs, should be updated frequently to reflect the changes in household income as well as the evolving needs and preferences of the households. Regular surveys²¹ can be carried out to keep up with the requirements of households in terms of prices, build-up size, design and location so that future supply can be tailored to reflect their needs.

iii) Developing a Thriving Rental Market

The private rental sector can help reduce the supply-demand gap for affordable housing. In Malaysia, only 24% of households live in rented accommodation²². To manage the demand for affordable housing, rental needs to be a viable option of choice, and not a last resort for households. Policy initiatives in other countries have focused on strengthening the legal and institutional frameworks underlying the rental market.

Globally, governments have safeguarded the rights of tenants and landlords by enacting specific legislations such as Tenancies Act (Australia and New Zealand) or have incorporated these qualities into their Federal Law (Germany). Tenancy protection includes having an enforceable tenancy agreement and a tenancy deposit mechanism involving a neutral third party²³ to protect a tenant's rights to deposit recovery while allowing the landlord to use the money in case the tenant breaches the tenancy agreement.

¹⁹ Singapore's Housing Development Board (HDB) builds and manages affordable homes. About 80% of its population lives in HDB flats. In Korea, the Land and Housing Corporation constructs affordable housing units for the vulnerable, including for rental.

²⁰ The UK Procurement Efficiency Initiative for social housing achieved 15% - 30% savings on material costs (*McKinsey Global Institute, 2014*).

²¹ Sample Household Surveys (SHS) are carried out by the HDB in Singapore on a large scale every five years. The latest survey in 2013 covered 7,800 households living in all 23 HDB towns and estates.

²² This is low when compared to Hong Kong (49%), Japan (38%), New Zealand (35%) and Australia (31%). For more details, please refer to Box Article on 'Assessing Demand-Supply Conditions in the Malaysian Property Market' in Bank Negara Malaysia's Annual Report 2015.

²³ Rental deposits are kept with a third party such as a dedicated government agency (New Zealand Tenancy Services, Residential Tenancies Bond Authority of Victoria, Australia), approved tenancy deposit schemes (UK Tenancy Deposit Scheme, UK Deposit Protection Services) or joint-bank savings account (Germany).

iv) Diversifying Sources of Financing for the Delivery and Purchase of Affordable Homes

Affordable housing development, especially in key economic centres can be cost-prohibitive to developers. Leveraging on private sources is helpful in moving towards a more sustainable market-based approach in the long run. In India, public-private partnerships in a joint-venture model have complemented public channels of financing the supply of public housing (*UN-HABITAT, 2011*).

For households, home financing methods significantly impact affordability. One option is bank financing of housing loans. Following the Global Financial Crisis, innovations in housing finance need to strike a balance between improving access to housing finance for households and avoiding the loose lending standards that could trigger excessive speculation or overburden households that do not have the ability to repay their housing loans. Alternatively, home financing can be supported by creative mechanisms leveraging on multiple sources of funding²⁴ and innovative financing schemes such as shared-ownership which allow buyers to acquire partial interest in a home rather than buying one outright.

Conclusion

The housing market in Malaysia has not been able to provide an adequate supply of affordable housing for the masses. This undersupply of affordable homes is likely to worsen going forward given current trends in income and demographic factors.

Going forward, a carefully-designed strategy of policy interventions is required for the housing market to ensure that it is able to accommodate households of all income groups. Meeting the demand of affordable housing units going forward will require the commitment of both the Government and the private sector. The establishment of a central agency to consolidate the provision of affordable housing as well as a central repository is key. Additionally, reducing costs associated with the development of affordable housing through the implementation of cost-saving and productivity-enhancing technologies would increase the speed and scale of delivery of affordable housing projects going forward. On the demand side, the development of the rental market to bridge the affordability gap could relieve some of the pressure on the Government to build all of the affordable housing needed. This should be complemented by more innovative schemes to fund the delivery of affordable houses. As for end-financing, as in other countries, the Central Bank has introduced macroprudential measures to deter speculative activity in the housing market and to avoid over-borrowing beyond one's means. It is important to note that these measures do not in any way hamper access to financing for eligible borrowers including those who are first-time buyers.

To conclude, while the challenge of bridging the affordability gap is significant, the experiences of other countries show that using a creative mix of innovative and targeted policies, it is not unsurmountable.

²⁴ Mexico has a dedicated housing provident fund (*UN-HABITAT, 2011*).

References

Bank Negara Malaysia (2015). 'Assessing Demand-Supply Conditions in the Malaysian Property Market'. Box Article in Annual Report. Kuala Lumpur.

Cornelius, J. (2014). 'Tenant's Rights Brochure for Germany'. Accessed on 6 January 2017 at <http://www.tenlaw.uni-bremen.de>

Demographia International (2015). '11th Annual Demographia International Housing Affordability Survey 2015: Rating Middle-income Housing Affordability'.

Department of Statistics Malaysia (2010). 'Report on Characteristics of Household, Population and Housing Census of Malaysia'.

Department of Statistics Malaysia (2014). 'Report on Household Income and Basic Amenities Survey'.

Fannie Mae (2016). 'Housing Affordability Primer'.

Hashim, A., Samikon, S., Mat Nasir, N (2012). 'Assessing Factors Influencing Performance of Malaysian Low-Cost Public Housing in Sustainable Environment'. *Journal of Social and Behavioural Sciences*, 50, 920-927.

Housing Development Board (2011). 'Public Housing in Singapore'.

McKinsey Global Institute (2014). 'A Blueprint for Addressing the Global Affordable Housing Challenge'.

New Zealand Tenancy Services under the Ministry of Business, Innovation and Employment (2015). 'Renting and You: A Guide for Landlords and Tenants'. Wellington, New Zealand.

Salvi del Pero, A. et al. (2016). 'Policies to Promote Access to Good-Quality Affordable Housing in OECD Countries'. OECD Social, Employment and Migration Working Papers, No. 176, OECD Publishing, Paris.

UN-HABITAT (2011). 'Affordable Land and Housing in Asia'. UNON, Publishing Services Section, Nairobi.

Youth Unemployment in Malaysia: Developments and Policy Considerations

By Dian Hikmah Mohd Ibrahim and Mohd Zaidi Mahyuddin

Introduction

In the aftermath of the Global Financial Crisis (GFC), the global youth population has been negatively affected by the deep recession, the ensuing environment of prolonged and shallow economic recovery and lacklustre job growth¹. The global youth unemployment rate² rose from a pre-crisis rate of 11.7% in 2007 to 13.1% in 2009, reaching a historic peak of 13.2% in 2013, and is estimated to remain high at 13.1% in 2016. The global youth unemployment rate is approximately three times the unemployment rate of adults, and more than two times the overall global unemployment rate. These figures amount to more than 70 million young people around the world who are experiencing difficulty finding meaningful employment. The International Labour Organisation (ILO) reported that youth unemployment is on the rise again in 2017, particularly in emerging market economies, after improving slightly between 2012 and 2015. The ILO also cited studies which find that early youth unemployment has serious long-term negative effects on future incomes and future risk of unemployment, particularly for youth who were immediately afflicted by unemployment upon graduation from universities³.

This article seeks to shed light on the state of youth unemployment in Malaysia, and provide an overview of immediate and long-term measures to address these issues. Part I of this article discusses developments surrounding youth unemployment in Malaysia, particularly with regard to graduate unemployment. Part II attempts to offer an explanation of these trends, and Part III offers some policy recommendations, drawing lessons from success stories in other countries.

Part I: The State of Youth Unemployment and Increasing Concerns over Graduate Unemployment in Malaysia

Youth in Malaysia have not been spared from these global trends

The youth unemployment rate in Malaysia was estimated to have reached 10.7% in 2015, more than three times higher than the national unemployment rate of 3.1%. Malaysia is among regional economies⁴ with an incidence of youth unemployment in the double-digits, despite a low overall unemployment rate (Charts 1 and 2).

Chart 1

**Youth Unemployment Across the Region in 2015
(% of youth labour force)**



Chart 2

Ratio of Youth Unemployment to National Unemployment in 2015 (times)



Note: Showing 2013 data for Indonesia and Thailand, and 2014 data for Vietnam. Unemployment data for Singapore includes 25-29 year olds. Unemployment data for Indonesia includes discouraged jobseekers.

Source: International Labour Organisation and Bank Negara Malaysia estimates

¹ Scarpetta et.al 2010. Rising Youth Unemployment during the Crisis: How to Prevent Negative Long-term Consequences on a Generation?

² In this article, 'youth' refers to the population, labour force, and employed and unemployed workers between the ages of 15 to 24.

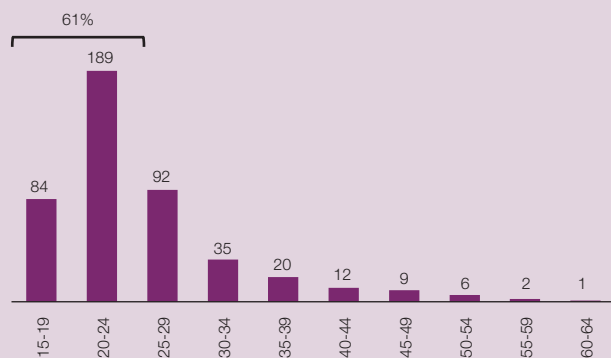
³ ILO 2016. World Employment and Social Outlook: Youth.

⁴ For ASEAN economies, youth unemployment rates hover at around 12.8% in 2013, roughly similar to the global average.

Youth represents more than half of total unemployed workers, despite only making up a third of the labour force (Chart 3). In 2015, the youth unemployment rate increased by 1.2 percentage points from an estimated 9.5% to 10.7%, while the national unemployment rate increased by only 0.2 percentage points (2.9% to 3.1%) during the same period (Chart 4). Youth unemployment has been on the rise in the recent period, as the growth in hiring has slowed since late 2014. Cautious business sentiments and moderating economic performance have restrained businesses from expanding their workforce. The youth are the most vulnerable to these trends; they are likely to be the last to be hired and the first to be made redundant⁵, due to their lack of experience, higher information asymmetry on the labour market, and poor ability to communicate their skills effectively to employers. While a lot of media attention has been focused on the plight of retrenched workers, slower hiring has had a wider impact on the economy, affecting particularly youth and new jobseekers.

Chart 3

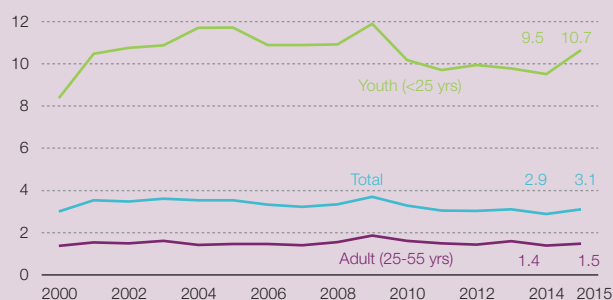
Unemployment by Age Groups, 2015 ('000 people)



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

Chart 4

Historical Unemployment Rates, 2000-2015 (% of labour force in respective age groups)



Graduate employability is a rising concern for Malaysia and a few countries in the region

The youth labour force tends to be more skewed towards youth with lower educational attainment⁶. Among 15 - 24 year-olds, only 16% have tertiary educational attainment, while the highest level of schooling attained by the remaining 84% is secondary education (Profile for overall labour force: Tertiary education: 28%; Primary, Secondary, and No formal education: 72%). Notably, youth with tertiary education make up a relatively larger share of unemployed youth (23% of total unemployed youth, Chart 5). Of concern, among those with tertiary educational attainment, the unemployment rate is higher at 15.3% (Youth without tertiary education: 9.8%) (Chart 6; See Information Box on 'Key Findings from the 2015 Graduate Tracer Study Report').

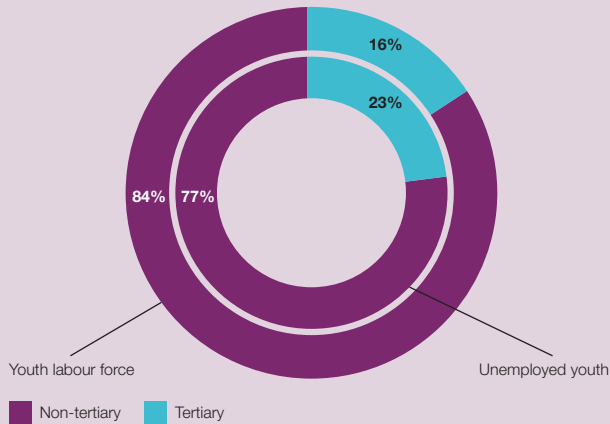
Interestingly, this trend does not appear to be unique to Malaysia. Among regional economies, unemployment rates for young graduates also tend to be higher than non-graduates (Chart 7). This observation appears to be counter-intuitive to the economic wisdom of increasing returns to educational attainment, and seems to be the opposite of the experience in the advanced economies. These trends are likely to be related to the nature of global supply chains and ensuing patterns of job creation in the emerging economies, vis-à-vis the advanced economies. Thus far, research on factors driving comparative trends on graduate vs. non-graduate youth unemployment in advanced and emerging economies have been scant. These developments in graduate unemployment has raised several key policy questions for emerging economies, regarding enhancing the quality and relevance of education systems to prepare for rapidly evolving industries, the types of jobs being created and the readiness of the human capital base, and measures to enhance matching in the labour market and alleviate information asymmetry on industry skill needs.

⁵ OECD 2008. OECD Employment Outlook. Off to a Good Start? Youth Labour Market Transitions in OECD Countries.

⁶ The labour force is divided into four main categories of educational attainment: Primary educational attainment, secondary educational attainment, tertiary educational attainment, and no formal education. In this article, tertiary-educated workers are also called graduates.

Chart 5

Profile of Youth Labour Force and Unemployed Youth by Educational Attainment, 2015



Source: The International Labour Organisation, Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Chart 6

Unemployment Rates by Educational Attainment, 2015

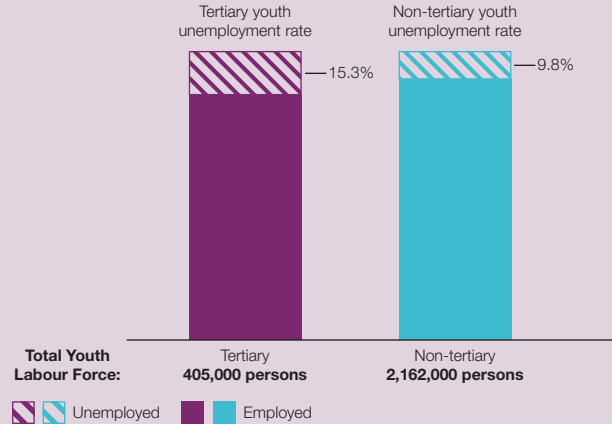


Chart 7

Country Comparison of Youth Unemployment Rates by Educational Attainment



Source: The International Labour Organisation and Bank Negara Malaysia estimates

Part II: Factors Underlying High Youth and Graduate Unemployment

Labour market mismatches arising from both limited high-skilled job creation and inadequate supply of industry-ready graduates

Despite the workforce increasingly becoming more educated, job creation in the Malaysian economy has remained concentrated in the low and mid-skilled jobs⁷ (Chart 8), as domestic industries stay in low-value added activities that emphasise cost efficiency and dependence on cheap labour, rather than pursuing innovation as a source of growth. The Malaysian economy also continues to face the challenge of attracting high-quality investments that would create more high-paying, high skilled jobs for the local workforce⁸. In the meantime, firms point to skills shortage as a key factor which prevents them from making investments to move up the value chain⁹. This mismatch between the changes in educational

⁷ Lim P. J. 2016. Malaysia's Labour Market and Job Creation under the Economic Transformation Plan (ETP) 2011 to 2015.

⁸ Nixon et. al 2017. Fostering inclusive growth in Malaysia.

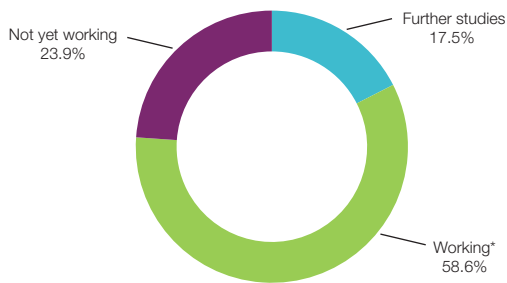
⁹ OECD 2013. Investment Policy Review on Malaysia.

Key Findings from the 2015 Graduate Tracer Study Report

The Ministry of Education's Graduate Tracer Study tracks the status of graduates of higher learning institutions six months after graduation to ascertain whether they have started working, are continuing their studies, or are still looking for employment. Observations are gathered from graduates of public and private universities, university colleges, polytechnics, and community colleges. Of the 273,373 graduates in 2015, a large number hold Bachelor's Degree and Diploma, 45% and 43% of all graduates, respectively. Among all graduates, 53% were reported to have started working, 18% chose to pursue further studies, and 24% of graduates were still unemployed (Chart 1). Bachelor's degree-holders recorded the highest unemployment rate amongst graduates of all qualifications at 27.9% (Chart 2). By fields of study, graduates from the *Sciences*, and *Literature and Social Sciences* tend to have higher rates of unemployment (Chart 3). By household income brackets, graduates from lower-income households also tend to have higher unemployment rates. This observation holds true across qualifications (Chart 4). Empirical evidence elsewhere point to a multitude of reasons, including the readiness of graduates for the world of work, insufficient job creation for some fields, and the lasting implications of socioeconomic backgrounds on learning and social progression. In terms of earnings, 54% of graduates earn less than RM2,000 a month. Starting salaries for graduates have remained largely stagnant since 2007 (Charts 5 and 6), despite certain sectors, namely the financial services and oil and gas industries, offering higher salaries at the entry level. These observations invite further questions for academics and policymakers, and more research is warranted to uncover the root causes of these observations, and to design appropriate policy responses.

Chart 1

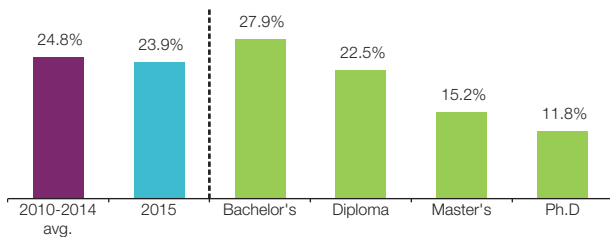
Distribution of Graduates by Employment Status



*Note: Includes graduates waiting for placement and undergoing upskilling
Source: Ministry of Higher Education and Bank Negara Malaysia estimates

Chart 2

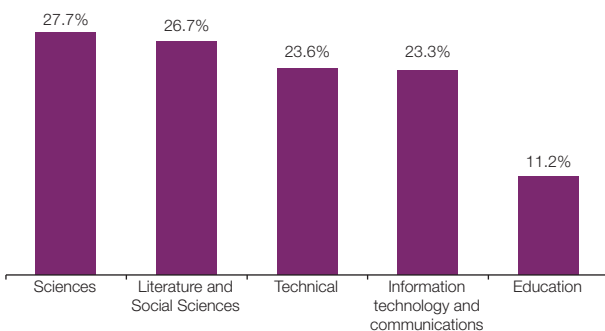
Unemployment Rates of Graduates, and by Qualification*



*Note: Unemployment rates are expressed as a percentage of respective group categories
Source: Ministry of Higher Education and Bank Negara Malaysia estimates

Chart 3

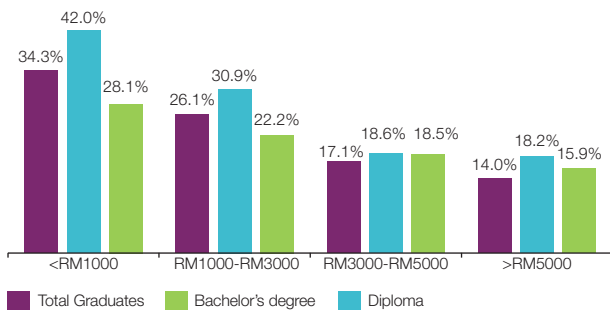
Unemployment Rate by Field of Study*



*Note: Unemployment rates are expressed as a percentage of respective group categories
Source: Ministry of Higher Education and Bank Negara Malaysia estimates

Chart 4

Unemployment Rate of Graduates by Monthly Family Income Brackets*

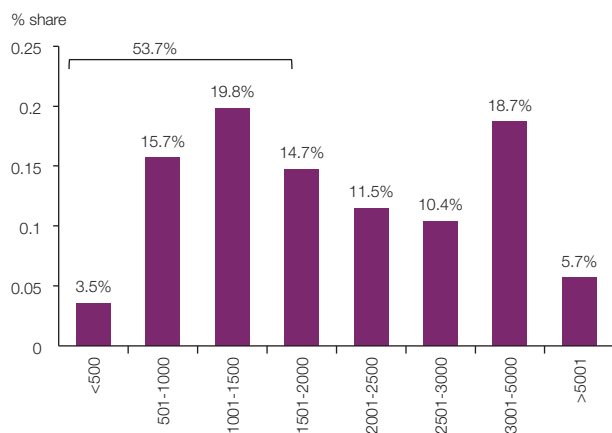


*Note: Unemployment rates are expressed as a percentage of respective group categories
Source: Ministry of Higher Education dan Bank Negara Malaysia estimates

More than half of all graduates earn less than RM2,000 upon graduation

Chart 5

Distribution of Monthly Salary of Graduates

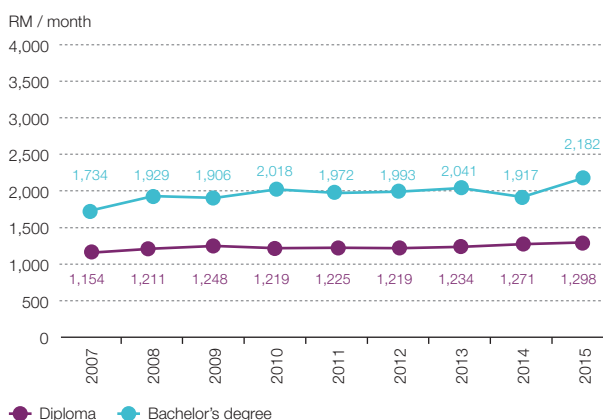


Source: Ministry of Higher Education and Bank Negara Malaysia estimates

Starting salaries of first degree graduates have been stagnant

Chart 6

Weighted Average Monthly Salary for First Degree Graduates, 2007-2015



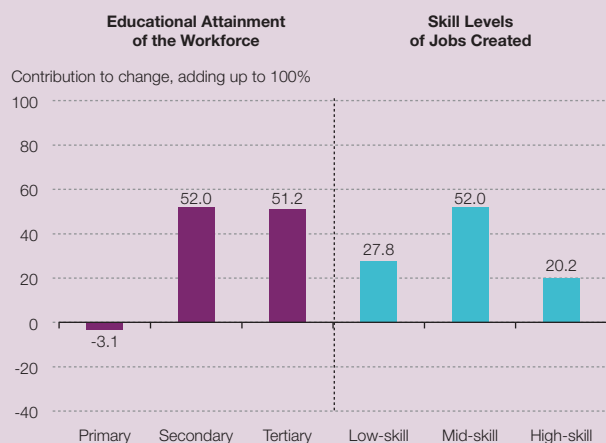
Source: Ministry of Higher Education and Bank Negara Malaysia estimates

attainment of the workforce and the types of jobs created is also manifested to some extent in anaemic demand for fresh graduates, as online job postings for entry-level positions for graduates have remained largely stagnant since 2012 (Chart 9).

Employers continue to cite significant skill gaps among new recruits. A survey conducted by the World Bank and Talent Corporation¹⁰ found that 90% of companies believe that university graduates should have more industrial training by the time they graduate, and 81% of companies surveyed rated communication skills as a major deficit among graduates. Concerns on the marketability and adaptability of graduates to the labour market are frequently attributed to the state of

Chart 8

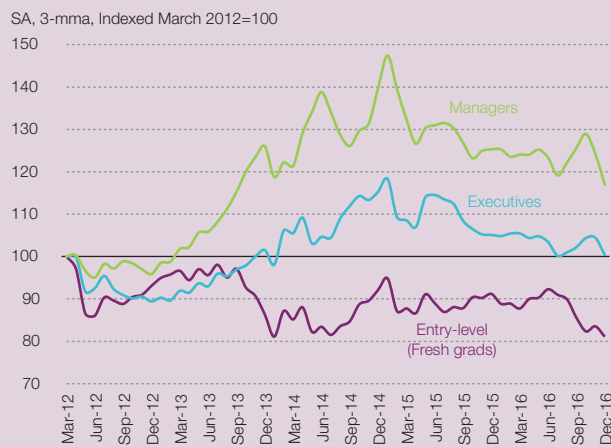
Employment Gains by Educational Attainment and Skill Levels, 2001-2015



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

Chart 9

New Jobs Posted on JobStreet.com by Position, 2012-2016



Source: JobStreet.com and Bank Negara Malaysia estimates

¹⁰ World Bank 2014. Malaysian Economic Monitor: Boosting Trade Competitiveness.

the national education and technical and vocational education and training (TVET) systems¹¹. However, lack of industry involvement in human capital development has also contributed to the dearth of truly effective training programmes for workers. The same TalentCorp survey found that 53% of firms have never engaged career centres in their recruitment efforts. Thus, even though youth may lack requisite skills, effective, meaningful training programmes which would prepare them for work have also not been forthcoming (Chart 10).

Chart 10

Findings from the World Bank and TalentCorp Survey



Source: The World Bank-TalentCorp Survey on Graduate Employability

Part III: Policy must be attuned to equip the younger generation to meet future challenges

Globally, the problem of youth unemployment is not new. However, socioeconomic developments in the past few years have dramatically exacerbated the situation. Going forward, the twin developments of persistent high youth unemployment and rising income inequality may constrain social mobility, and lead to increasing dissatisfaction among the populace¹². In Malaysia, this has already contributed, in part, to brain drain – the flight of high-skilled talent to advanced economies and neighbouring countries, in search of better jobs and pay¹³. Left unattended, a generation of economically disenfranchised youth could have negative and far-reaching ramifications on the economic and social landscape. In the near future, the youth will have to contend with more self-reliant economic arrangements and even more job displacements, with the advent of the wider interconnectedness, alongside rapid technological advancement. Thus, policy must be orientated towards preparing the younger generation to meet these challenges head-on.

Firstly, addressing the root cause of the problem must be a permanent national agenda. Quality education, including an effective TVET sector is important towards building human capital. These goals are highlighted in the Malaysian Education Blueprint (2015 - 2025), which outlines meaningful strategies to transform the national education system, empower institutions of higher learning with greater autonomy and accountability, develop technologically savvy, well-rounded graduates, and improve the quality of the national TVET sector. For youth in particular, research has shown that more access to effective vocational training is linked to lower rates of youth unemployment¹⁴. In Germany, the Dual Vocational Technical Training System pairs “apprentices” from vocational schools with companies to incorporate work-based learning experiences to prepare them for employment. It has been widely credited with keeping youth unemployment low in the country.

Secondly, promoting meaningful industry collaboration in education and training is key in community-building and nurturing a vibrant workforce, which serves the immediate and future needs of industry. A well-funded and effective platform is

¹¹ OECD 2013. Structural Policy Country Notes on Malaysia.

¹² OECD 2011. Social Cohesion in Southeast Asia.

¹³ World Bank 2011. Malaysian Economic Monitor: Brain Drain.

¹⁴ Banerji et. al 2014. Youth Unemployment in Europe: Searching for Solutions.

needed towards offering high-quality training and promoting workforce development. Such a platform would serve as an avenue in which the Government, industry, and education and training sectors could i) consult and develop curriculum and training to fulfil industry skill needs, and ii) actively support implementation and continuous enhancement efforts. In Australia, the Industry and Skills Committee serves as a formal platform for industry leaders to play an active role in policy direction and decision-making for the TVET sector, including development of “training packages” which are informed by both labour market skill gaps and industry requirements.

Third, a comprehensive social security infrastructure needs to be built, including designing active labour market policies (ALMP) which are specifically targeted towards youth, as well as displaced workers. The objective of ALMPs is two-pronged, i) to increase employment opportunities, and ii) to improve the matching of workers to jobs. While still in its infancy, Malaysia is making positive gains in this respect, with the Employment Insurance Scheme (EIS), which was announced in Budget 2015. The EIS is envisioned to be a holistic programme, with ALMP measures as a main feature, including career counselling services and training schemes. Globally, ALMPs specifically targeted towards improving employability of youth are lacking, despite this group’s vulnerability to economic downturns and crisis. Nevertheless, a few countries, notably Sweden and Finland, have widened the social safety infrastructure by experimenting with policy measures such as Youth Guarantee Schemes. In these schemes, Public Employment Services provide personalised needs assessment and employment plans, and guarantee placements for youth by matching them to employment, academic or vocational study, or training to enhance employability and entrepreneurship. The job-matching process may be further facilitated by leveraging on technology, as evidenced by popular smartphone-based career applications and websites such as Switch and LinkedIn, which have become one of the primary avenues for jobseekers to signal their skills to potential employers, and for employers to search for talent¹⁵.

Fourth, conscientious implementation of various blueprints and programmes is key, along with a functional governance structure, effective monitoring and active enhancements to initiatives. A critical piece of the puzzle is reliable information and statistics on the progress of specific programmes, training schemes and grants, and performance of education and training institutions. Currently, gaps in labour market statistics, particularly on job creation, labour turnover, and hiring trends, present a significant challenge for policymakers. Towards this end, the Government’s recognition of the need to establish the Malaysian Bureau of Labour Statistics¹⁶ will go a long way towards ensuring development of high-frequency, reliable indicators on labour market and macroeconomic trends. This is key to planning and monitoring the progress of human capital development and labour market policies and facilitate responsive, evidence-based, and timely policy-making.

Finally, and over the longer-term horizon, policies to tackle youth unemployment need to be reviewed from time to time. Policy-making needs to be flexible and agile, responsive to the rapidly evolving job market of the future. This will include policies and programmes to specifically inculcate a culture of entrepreneurship and innovation, promote lifelong learning and improve workforce adaptability to changing industrial tides. The newly-announced National Transformation plan (TN50) maps the direction of the country in the next 30 years after 2020 and sets a new vision for the nation, with an eye on the aspirations of the youth.

¹⁵ Thomas 2016. Huffington Post. 2016 Best Career Apps and Websites to Land Your Dream Job.

¹⁶ Ministry of Finance 2016. Touch Points: 2017 Budget.

References

Banerji, A., S. Saksonovs, H. Lin, and R. Blavy. 2014, "Youth Unemployment in Advanced Economies in Europe: Searching for Solutions." IMF Staff Discussion Note, Washington DC.

Lim, P. J. 2016, "Malaysia's Labour Market and Job Creation under the Economic Transformation Plan (ETP) 2011 to 2015." Penang Institute Research Paper, Penang.

Ministry of Finance 2016. Touch Points on the 2017 Budget. <https://www.pmo.gov.my/bajet2017/TouchPointsBudget2017.pdf>. Accessed January 2017.

Nixon, S. Asada, H., and Koen, V. 2017, "Fostering Inclusive Growth in Malaysia." OECD Economics Department Working Papers, No. 1371, Paris: Organization for Economic Cooperation and Development.

Organization for Economic Cooperation and Development (OECD) 2008. "Off to a Good Start? Youth Labour Market Transitions in OECD Countries." OECD Employment Outlook, Paris: Organization for Economic Cooperation and Development.

_____. 2011. "Social Cohesion in Southeast Asia." Document from Seminar co-organised by the OECD Development Centre, the Ministry of Foreign Affairs of Thailand, King Prajadhipok's Institute and the Office of the National Economic and Social Development Board of Thailand. <https://www.oecd.org/dev/48923362.pdf>. Accessed January 2017.

_____. 2013. "Structural Policy Challenges for Southeast Asian Countries: Malaysia." OECD Southeast Asian Economic Outlook 2013: With Perspectives on China and India, Paris: Organization for Economic Cooperation and Development.

_____. 2013. Investment Policy Reviews: Malaysia. Paris: Organization for Economic Cooperation and Development.

_____. 2016. World Employment and Social Outlook: Youth. Paris: Organization for Economic Cooperation and Development.

Scarpetta, S., Sonnet A., and Manfredi T. 2010. "Rising Youth Unemployment during the Crisis: How to Prevent Negative Long-term Consequences on a Generation?" OECD Social, Employment and Migration Papers, No. 106, Paris: Organization for Economic Cooperation and Development.

Thomas, S. "2016 Best Career Apps and Websites to Land Your Dream Job." Huffington Post. http://www.huffingtonpost.com/sherri-thomas/2016-best-career-apps-and_b_9125474.html. Accessed February 2017.

World Bank (WB) 2011. "Brain Drain." Malaysian Economic Monitor, Bangkok: World Bank Office.

_____. 2014. "Boosting Trade Competitiveness." Malaysian Economic Monitor, Bangkok: World Bank Office.

Governance, Organisational Development and Communications



109	Governance
113	Organisational Development
119	Communications
123	Organisation Structure
124	List of Senior Officers

Governance, Organisational Development and Communications

Individuals who work in the Bank are committed to the mandates of maintaining monetary and financial stability that are critical towards achieving sustainable economic growth. The Bank's staff are held accountable by the strong governance and oversight that are exercised by the Board of Directors (the Board). The tone from the top is set by the Board and the Management team with the emphasis on serving with a purpose and with the highest level of professionalism and integrity. Given the impact of the Bank's policies on the economy and the country at large, efforts were devoted to further improve organisational effectiveness. The aim is to ensure that the Bank would be able to deliver results that are good for the nation.

The soundness of the Bank's risk culture and ethical conduct is a priority for the Board and the Management team. Risk management practices are embedded in all our business functions. Vigilance and readiness are traits that are emphasised as the Bank has been entrusted to safeguard monetary and financial stability. Technology-driven controls were adopted to strengthen the security and effectiveness of the Bank's information systems.

To sustain a competent workforce, the Bank gives emphasis to succession planning, talent management and continuously building our capabilities and competencies. These reinforce the effort to retain people of the right talent and calibre. The Bank continuously invests in people to deepen expertise and knowledge on different areas of central banking. In the area of learning and development, the Bank supports more diverse learning methods to cater to different learning styles, including through open online courses.

Where necessary, new organisational structures were designed to facilitate the achievement of our mandates. During the year, focus was on filling

up critical positions in areas that were undergoing transformation, such as information technology services, physical security and facilities management. As the insurance industry will undergo significant transformation over the next decade, the Insurance Development Department was established. The resources for enforcement activities were also expanded in view of the increased complexity and focus on anti-money laundering and countering the financing of terrorism.

In managing the many challenges during 2016, the Bank was active on many fronts. As an institution that serves the public interest, our communication, education and awareness initiatives play key roles. In line with changing global media trends, the Bank leveraged on new communication channels and tried out new approaches. In disseminating policy statements and announcements, there was an expansion beyond the mainstream media with the inclusion of social media.

GOVERNANCE

There were several changes to the composition of the Board. Dr. Zeti Akhtar Aziz completed her term of service as Governor on 30 April 2016 and Muhammad bin Ibrahim was appointed as Governor on 1 May 2016. Shaik Abdul Rasheed bin Abdul Ghaffour was appointed as the Deputy Governor on 16 July 2016 and Nor Shamsiah binti Mohd Yunus completed her tenure as Deputy Governor on 15 November 2016.

High priority is placed on good governance and upholding the right values in our stewardship of monetary and financial stability

The size of the Board decreased from 12 to 11 members. The Board comprises the Governor as Chairman, the

two Deputy Governors and the Secretary-General to the Treasury (as ex-officio), and seven independent non-executive members. All members, except the Deputy Governors, are appointed by His Majesty the Yang di-Pertuan Agong. The Deputy Governors are appointed by the Minister of Finance.

The Board is supported by three committees, which are the Board Governance Committee, Board Audit Committee and Board Risk Committee. All the Board committees consisted exclusively of independent non-executive directors. The Board also deliberated on the appointments and re-appointments of the members of the Bank's

various standing committees, namely the Shariah Advisory Council, Monetary Policy Committee, Financial Stability Executive Committee and Monetary Penalty Review Committee.

Effective oversight by the Board of Directors

Throughout the year, the Board deliberated on issues affecting the outlook for the Malaysian economy. Discussions at the Board meetings covered domestic and international economic and financial developments, the major risk factors as well as short-term and long-term issues facing

Table 5.1

Roles and Responsibilities of the Board of Directors and its Committees			
Board of Directors and Board Committees	Chair	Mandate	Number of meetings in 2016
Board of Directors	Governor	<ul style="list-style-type: none"> Responsible for oversight of the overall policy, administration and business of the Bank Reviews the management, operations and performance of the Bank in delivering its mandates Discusses issues arising from global and domestic economic developments and the financial sector, as well as the Bank's policy initiatives in addressing emerging risks 	12
Board Governance Committee	Tan Sri Dato' Sri Dr. Sulaiman bin Mahbob (Independent Non-Executive Director)	<ul style="list-style-type: none"> Reports to the Board Responsible for overseeing the Bank's governance principles and practices Reviews the Bank's budget and operating plans Recommends to the Board on the appointment and reappointment of members of the Board and other committees of the Bank 	5
Board Audit Committee	Datuk Chin Kwai Yoong (Independent Non-Executive Director)	<ul style="list-style-type: none"> Reports to the Board Responsible for overseeing the integrity of the Bank's accounts and financial statements, and provides assurance of the adequacy of internal controls, governance structures, and compliance with legal and regulatory requirements Reviews and approves revisions to the Bank's audit framework, audit charter and the Bank's internal audit plans Deliberates the internal auditor's findings and actions taken to address the Bank's key risks Reviews the National Audit Department's findings, including any remedial actions to be taken by the Bank 	6
Board Risk Committee	Dato' N. Sadasivan a/l N.N. Pillay (Independent Non-Executive Director)	<ul style="list-style-type: none"> Reports to the Board Responsible for overseeing the Bank's management of financial, operational and reputational risks Reviews and monitors the Bank's management of enterprise-wide risks 	2

Source: Bank Negara Malaysia

the Malaysian economy. The Bank’s reserves management strategy was also carefully deliberated to ensure it supports the soundness, liquidity and returns objectives amidst a low-yield environment, financial market volatility and a high degree of economic uncertainty.

The Board continued to be briefed on issues affecting the stability of the financial system and household indebtedness. Issues on the labour market, youth unemployment and over-reliance on migrant workers were deliberated, given their impact on the nation’s overall competitiveness and productivity. Towards developing the financial markets, the Board was briefed on important areas to further promote the development of Islamic finance to enhance Malaysia’s position as an international Islamic financial centre. The Board’s oversight also focused on the digitalisation of payment systems to further facilitate regional integration.

In strengthening organisational resilience, the Board discussed emerging physical and cyber security risks. The emphasis was on the protection of the Bank’s resources and data from cyber threats, and ensuring that the Bank operates in a safe and secure environment.

Holistic risk management

The Bank manages risks in an integrated manner through its Enterprise Risk Management (ERM) framework (Table 5.2). The framework gives an integrated view of the risk exposures across the Bank. These exposures fall into four areas: good governance, our policies and related processes, the tools and methodologies we use and the effectiveness of our practices. To ensure it remains relevant and effective, the framework is periodically reviewed, by benchmarking with other central banks within the International Operational Risk Working Group (IORWG) as well as with the ISO standards.

The Bank places utmost priority on risk management to ensure vigilance against both operational and financial risks. The Board, with the support of the Board Risk Committee, sets the tone from the top in terms of the Bank’s risk tolerance and risk management standards. It ensures that the Bank has adequate resources, systems and processes to effectively implement the risk management framework.

The Bank’s risk governance framework includes the Board, Board Risk Committee, Risk Management Committee and the Reserves Management Committee.

Table 5.2

The Bank’s Enterprise Risk Management Framework		
Governance	Principle 1:	Governance structure with clearly defined roles and responsibilities over risk management
	Principle 2:	Risk reporting mechanism for effective decision making
Policy & Process	Principle 3:	Clearly defined policies to guide the risk management process
	Principle 4:	Standardised approach for risk identification; assessment & measurement; prioritisation & treatment: monitoring & reporting
Tools & Methodology	Principle 5:	Standardised risk management tools to facilitate the process and implementation of ERM practices
	Principle 6:	Clearly defined standards to formulate and assess risk management strategies and internal controls
Effective Practices	Principle 7:	Sound risk management as part of the corporate culture
	Principle 8:	A mechanism and approach on communication to ensure high standards of transparency to internal and external stakeholders
	Principle 9:	A framework and policy for business continuity management to ensure continuity of operations in times of crisis
	Principle 10:	Effective and timely reporting to enable senior management to monitor the effectiveness of risk management; and to assist the Board in its oversight role

Source: Bank Negara Malaysia

Other committees such as the Operational Risk Management Committee, Financial Risk Management Committee, Crisis Management Team and various policy committees and steering committees also play an important role in ensuring that risk management practices are embedded within business functions, business continuity practices and project management. Those who are responsible for the various business areas are also members of these committees. This is to ensure awareness and escalation of matters that may trigger transversal risks, which can affect several business areas. Their representation ensures that transversal risks are monitored at the enterprise level, rather than in isolation at the department level. The overall governance structure, composition and responsibility of the various committees are explained in Chart 5.1.

Business continuity management ensures that the Bank can sustain its core business functions under any disruptive event, be it a minor or full-scale crisis

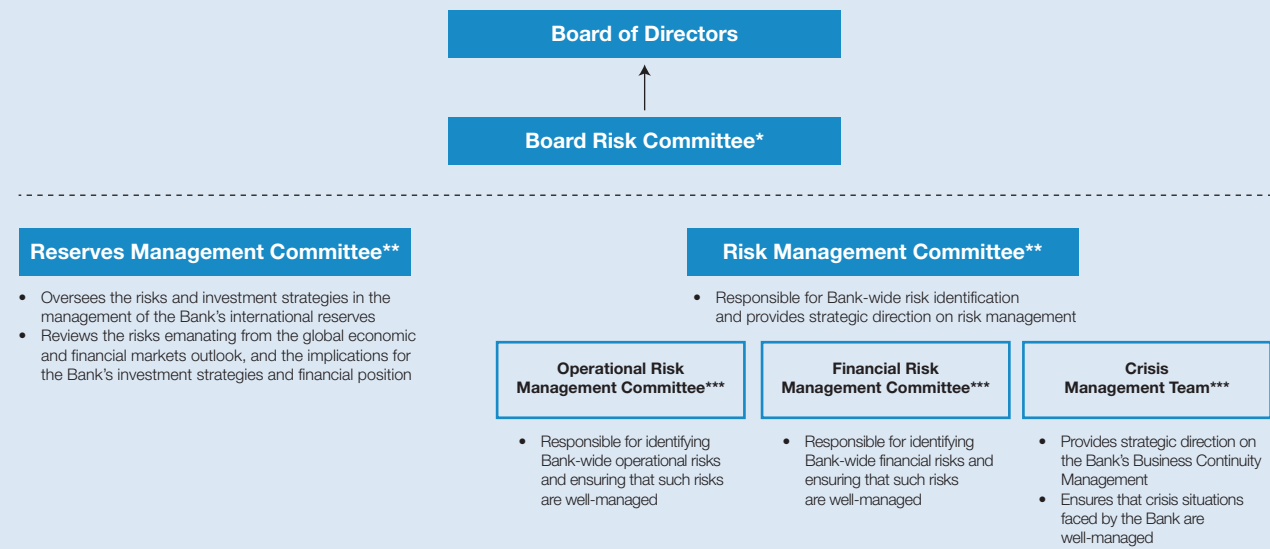
The Bank applies the three lines of defence in its risk management practices. The first line of defence comprises the line departments that are responsible for identifying, mitigating and managing risks within their business areas. The second line of defence is from the Risk Management

Department, which strengthens the Bank’s overall risk management capabilities through the adoption of key risk indicators, incident reporting, risk controls, self-assessments, information security and business continuity management practices. The Internal Audit Department (IAD) provides the third line of defence through its independent assurance of the effectiveness of risk management policies, tools and methodologies.

In 2016, we reviewed our risk appetite and tolerance statements to strengthen the Bank’s risk management capabilities. These statements indicate the amount and type of risk that the Bank is willing to take in meeting its mandates. Key risk indicators (KRIs) were drawn up based on the Bank’s risk appetite and tolerance statements. The exercise of developing the KRIs strengthened the understanding of risk management tools and methodologies, which further enhanced the risk management capabilities at the department level. Building the risk management capabilities across the Bank is an on-going endeavour. The Bank’s corporate culture emphasises that managing risks is a shared responsibility. The Bank undertakes continuous efforts to deepen risk management awareness and understanding among the staff. Much of it is through knowledge sharing and engagement sessions across the Bank, with targeted working level groups and by bringing in relevant external expertise.

Chart 5.1

Structure of the Bank’s Risk Management Governance

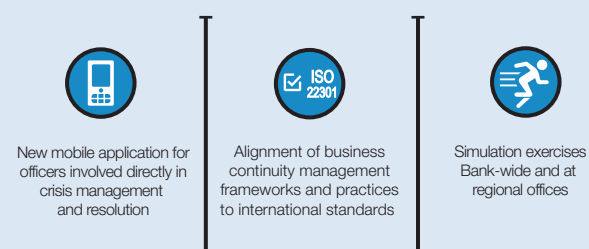


* Chaired by an Independent Non-Executive Director of the Bank
 ** Chaired by the Governor
 *** Chaired by the Deputy Governor

Source: Bank Negara Malaysia

Diagram 5.1

Strengthening Business Continuity Practices in 2016



Source: Bank Negara Malaysia

Strengthening internal controls and assurance

The IAD reports to the Board Audit Committee (BAC) on a quarterly basis. This is to provide the BAC with an independent and objective assessment of the adequacy and effectiveness of the internal controls, risk management measures, governance and processes in the Bank (Diagram 5.2). The review of the audit activities, including the adequacy of audit resources and the performance of the internal audit function were also assessed by the BAC. Rigorous assessments were done on possible risks arising from the significant activities of departments, branches, regional offices and the Bank's related entities. Following this assessment, the identified high risk areas are subjected to an annual audit while all other areas are subjected to audits every three years. The IAD also provides input in the Bank's various management and project committees to ensure adherence to proper internal controls and governance. The IAD provides the Minister of Finance with an independent quarterly report on the Bank's international reserves management activities. This is to assure the Minister that the reserves have been managed in accordance with the established policies and guidelines approved by the Board. In line with the Bank's commitment towards transparency and the quality of audit assurances, auditors from the National Audit Department are invited to attend all BAC meetings.

Internal audits are conducted in conformance with international standards

In strengthening the audit processes, the IAD benchmarks itself against best practices in auditing. The IAD engaged an independent external party

to conduct a quality assurance review of its auditing practices. Based on the review, the IAD's auditing practices were rated as generally conforming to the International Standards for the Professional Practice of Internal Auditing (Standards). This means that the audit charter, policies and processes were judged to meet the highest rating of conformance with the Standards.

An internal competency framework was developed to ensure that our internal auditors have the required skills and knowledge to be effective (Diagram 5.3). This framework was based on the Institute of Internal Auditors' Global Internal Audit Competency Framework and was augmented with the more specific business competencies that were relevant to the Bank.

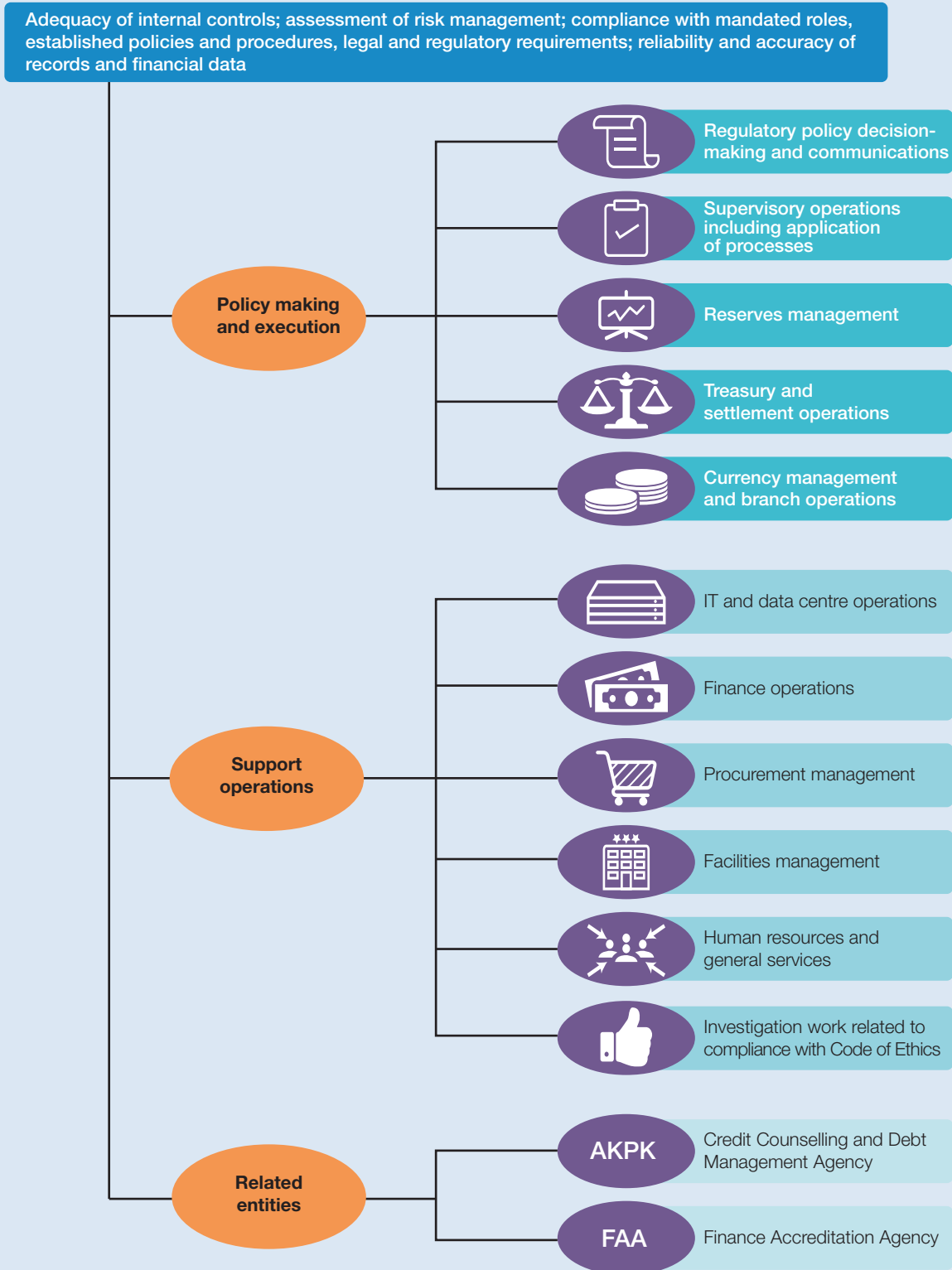
ORGANISATIONAL DEVELOPMENT

Independent external reviews were conducted on the Bank's audit practices, IT services and physical security management. This was to improve effectiveness and detect any blind spots that could pose risks to operations

The Bank's business plan for 2016 was implemented based on the strategies identified for seven focus areas (Diagram 5.4). New initiatives were also introduced to address emerging priorities, such as fostering an enabling environment for financial technology (FinTech) solutions, accelerating the development of the insurance industry and building new capabilities in data analytics. The business plan was also used to measure the Bank's performance. The Board Governance Committee (BGC) and the Board are apprised of the Bank's performance on a regular basis. In assessing our performance, we focus on the impact of our policies for monetary and financial stability. Other key performance metrics include organisational performance such as the adequacy of talent, effective use of financial resources and efficiency of work processes. There is top-down guidance from the Management team, especially on the strategic areas that will meet the mandates and the required investments in the resources to meet the Bank's objectives. These include developing more in-depth expertise in data sciences, improving productivity through increased innovation, financial investments to further transform information technology services and upgrading of the Bank's internal services for facilities and security management.

Diagram 5.2

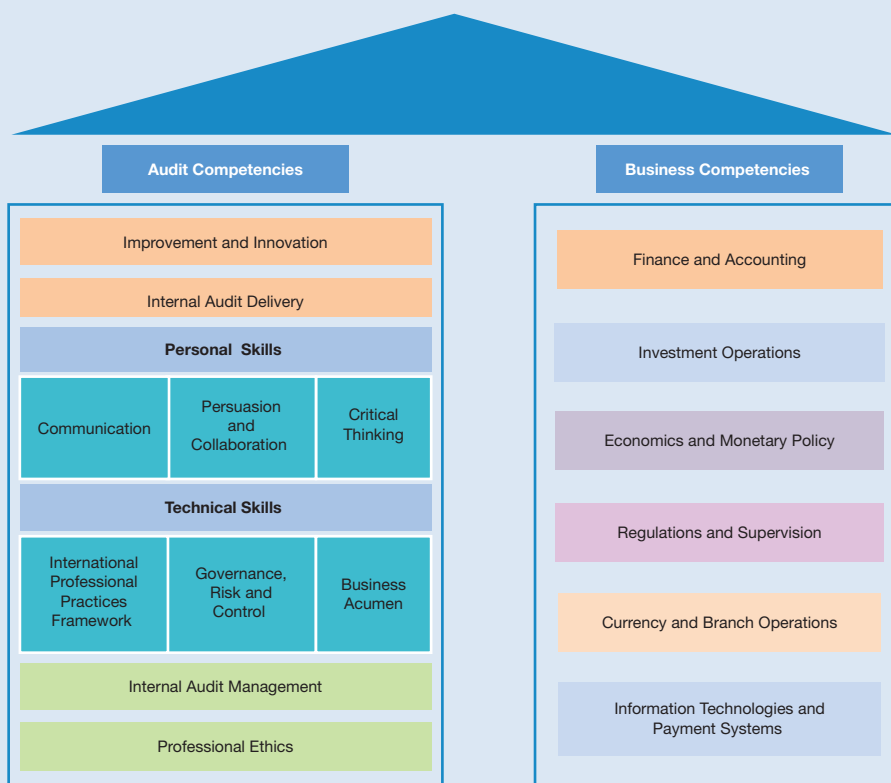
Coverage of Internal Audit in 2016



Source: Bank Negara Malaysia

Diagram 5.3

Internal Audit Competency Framework



Source: The Institute of Internal Auditors and Bank Negara Malaysia

Diagram 5.4

The Business Plan's Seven Focus Areas



Source: Bank Negara Malaysia

Developing people

The continuous renewal of internal capacity and capability is to ensure the Bank is always in a state of readiness to meet new challenges

People are what drive and deliver the central bank's mandates. The Bank strives to attract, retain and develop a pool of high quality talent that can best serve the interest of the nation. In 2016, the Bank brought in further improvements to enhance the succession planning, talent management and talent development.

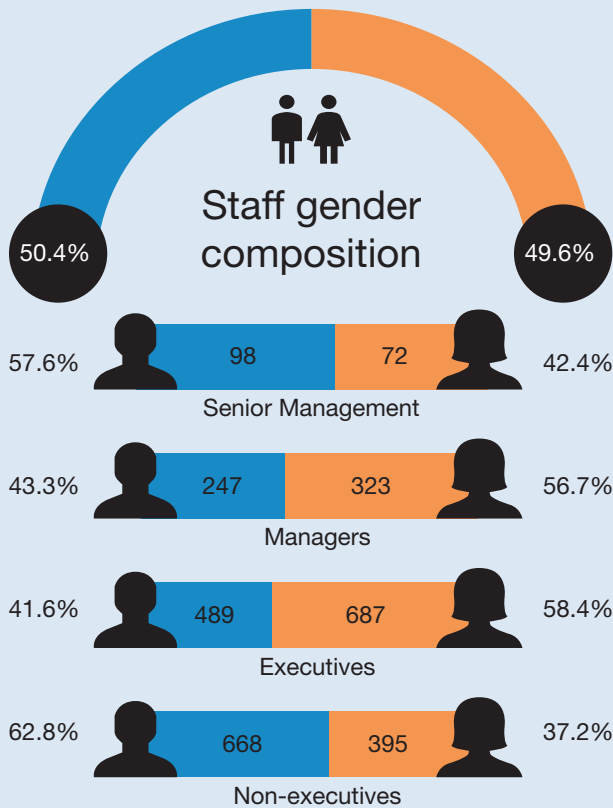
Staff demographics

As at end-2016, the Bank's workforce comprised 2,979 staff, marking an increase of 1.5% from a year earlier. This increase was aimed at strengthening the capacity for critical positions in the information technology and enforcement functions, and to

prepare for the anticipated attrition as staff retire. During the year, the attrition level remained stable at 4% and the gender composition across various levels remained well-balanced (Diagram 5.5).

Diagram 5.5

Gender Composition



Source: Bank Negara Malaysia

Clear and robust succession planning

It is a priority to sustain a healthy succession pool for the Bank’s mission critical positions. In 2016, the Bank streamlined and combined the succession pool (successors to critical positions) and the corporate talent pool (high potential talent). With this integration, there are more targeted development interventions, aimed at preparing more talents to assume more critical roles. The early identification of talent under this unified pool provides adequate time to build the required competencies and address operational risks for critical functions. It also provides developmental opportunities for the Bank’s talent to accelerate their time to become competent in the required areas, especially leadership capabilities, technical skill sets and personal effectiveness.

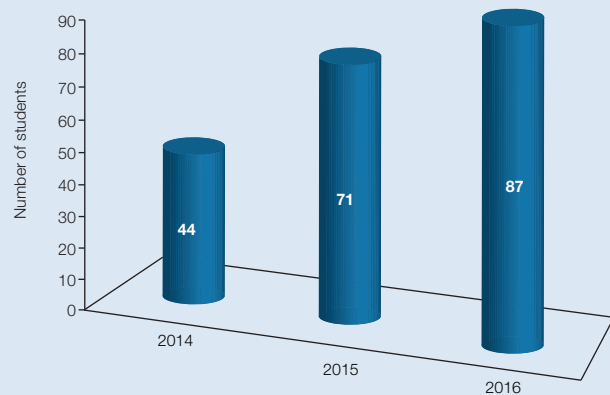
Developing a competent workforce

For the organisation’s workforce to be competent, the necessary technical skill sets for every job level in the Bank were identified. Clarity about the technical competence required for a role would allow more focused talent management and more targeted development efforts. The Bank continued to invest in the development of people. In 2016, the overall training expenditure was 4.5% of total gross salary. The Bank gave priority to strengthening leadership capabilities to ensure that potential leaders are effective in their current roles and are able to transition to assume bigger responsibilities. Customised and structured approaches were adopted in the Leadership Development Programme (LDP). The LDP is a continuous process, involving classrooms, on-the-job training, exposure to new experiences, mentoring and dialogues with senior management.

To accelerate the time to reach competence, a Structured Technical Curriculum (STC) was developed on central banking knowledge in specific areas of work. Apart from the STC, technical programmes and talks were co-created with internal and external experts. Staff whose roles involve regulating and supervising the financial industry were also encouraged to enrol in the Chartered Banker qualifications in order to sharpen their insights on industry issues. The Bank’s commitment to encourage self-directed learning was reflected in the establishment of the new e-library which offers a wide selection of e-books, audio books and Massive Open Online Courses (MOOC).

Chart 5.2

Scholarships Awarded



Source: Bank Negara Malaysia

The Bank continued to award scholarships to high achieving students across the nation. This reflects an enduring commitment to building a robust talent pipeline that is critical to nation building and ensuring future generations of talented and skilled central bankers.

Professionalising our shared services

The consolidation of the Bank's common support services in 2012 under the Centralised Shared Services (CSS) has resulted in improved operational performance and optimisation of resources. The Bank has made efforts to further professionalise support services. This has been achieved through greater leverage on technology to improve service delivery and standards. We have also optimised productivity and intensified the analysis of operational data for more effective decision-making.

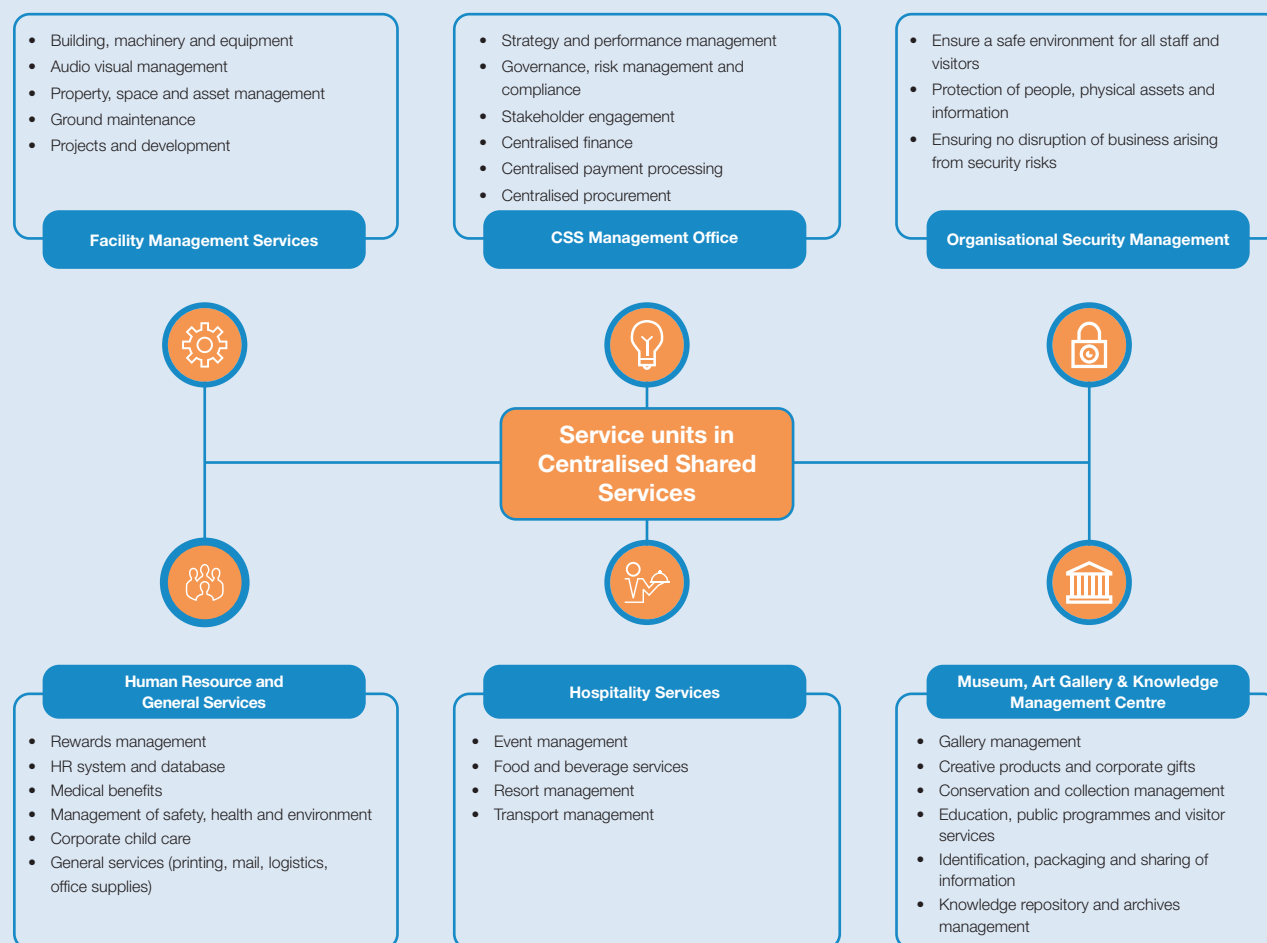
Safety and well-being

The safety and security of people remain an important agenda. An independent review of the Bank's physical security management was conducted to ensure that the Bank has the capabilities to respond to any emerging threats. The review covered all aspects of security management, technology and processes. Several security initiatives were implemented to enhance security at the Bank.

Initiatives were introduced to create a conducive and safe working environment to enhance the well-being of the Bank's staff. Apart from the comprehensive medical benefit scheme in place, pre-emptive health screening was also made available to all staff. A targeted wellness programme was initiated. It focused

Diagram 5.6

The Bank's Centralised Shared Services Sector



Source: Bank Negara Malaysia

on obesity, which included dietary advice for staff who volunteered to participate in the programme. The emergency response capability for medical incidents on the Bank's premises has also been improved.

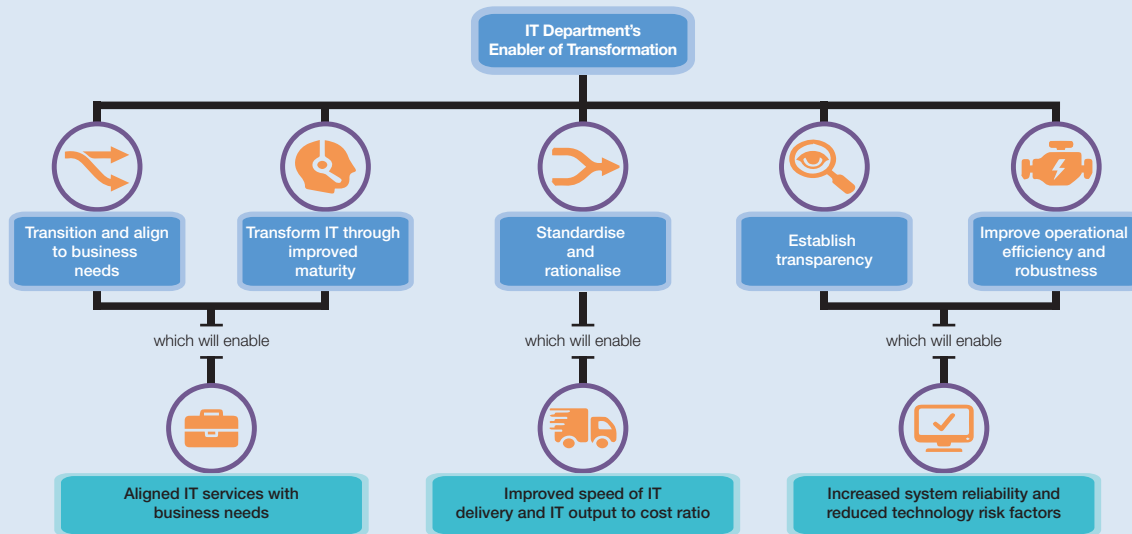
Sustaining ICT resilience

IT transformation to increase resilience against technology risks and cyber threats and enable more efficient ways of working

ICT security is a high priority as a safe, secure and fully operational ICT environment ensures that the Bank can deliver its mandates. The ICT infrastructure, including websites and networks, has remained secure and resilient throughout the year. Resources and data were protected through extensive security controls. Ethical hackers and international penetration testers were engaged to conduct independent vulnerability assessments of our ICT environment. Greater focus was also placed on strengthening the internal IT compliance culture. Regular compliance checks against relevant standards were conducted to ensure that the Bank's ICT practices adhered to the agreed procedures and controls. Further, an independent external review of the Bank's ICT infrastructure was conducted and its findings were used to strengthen ICT security, including new technology to detect and respond to changing threats.

Diagram 5.7

The IT Department's Four-year Transformation Plan

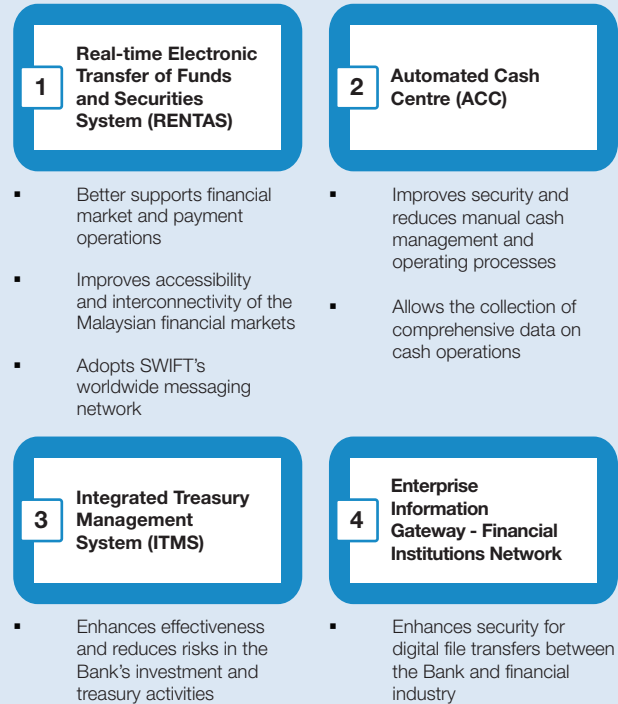


Source: Bank Negara Malaysia

A four-year transformation drive was instituted, which will result in more specialised IT skill sets, new technology platforms and architectures that can better serve the Bank's future needs (Diagram 5.7).

Diagram 5.8

New ICT Services for Critical Systems



Source: Bank Negara Malaysia

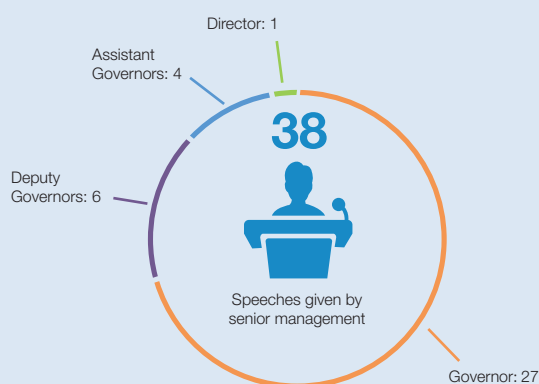
COMMUNICATIONS

Open platforms give us new channels to directly engage with stakeholders

During the year, uncertainties in the external environment were exacerbated by concerns over the impact of the Federal Reserve's interest rate hike, volatile oil prices, Brexit and the slowing PR China's economy. In this environment, the Bank has found it necessary to inform the Malaysian public on a more frequent basis of the impact of these developments on the Malaysian economy and financial system, as well as of its policies. In 2016, the communication channels and practices were strengthened to effectively relay important announcements and developments to the public in a timely manner. For example, in line with shifting global media trends, digital platforms were utilised for better outreach to different groups of stakeholders. Also, embargo times on press releases were reduced to earlier in the day to allow markets more time to assess and understand the implications of various communications.

Diagram 5.9

Communicating Policies



Source: Bank Negara Malaysia

Monetary policy decisions

The Bank announces its monetary policy decisions through the Monetary Policy Statements (MPS) after each Monetary Policy Committee meeting. The Bank issues six MPS a year to provide the public with timely assessments of the latest economic and financial developments, the Overnight Policy Rate (OPR) decisions and rationale for the decisions.

Expanded engagement with industry stakeholders

In progressing towards broader and continuous engagements with market participants, the Bank in 2016 established the Financial Markets Committee (FMC) and the Financial Technology Enabler Group (FTEG). The FMC was established to serve as a more inclusive forum to recommend and advance strategies aimed at fostering the development of Malaysia's financial markets. Comprising representatives from the Bank, financial institutions, corporations and other key stakeholders in the financial markets, the FMC has regularly discussed matters, potential issues and risks in the development of the Malaysian financial market. Meanwhile, the FTEG is responsible for formulating and enhancing regulatory policies to facilitate the adoption of technological innovations in the Malaysian financial services industry. The FTEG is part of the Bank's commitment to support innovations which will improve the quality, efficiency and accessibility of financial services in Malaysia. It also serves as the Bank's dedicated platform on FinTech queries including on regulatory matters related to the adoption of FinTech in the financial services industry.

Engaging stakeholders through online and mobile channels

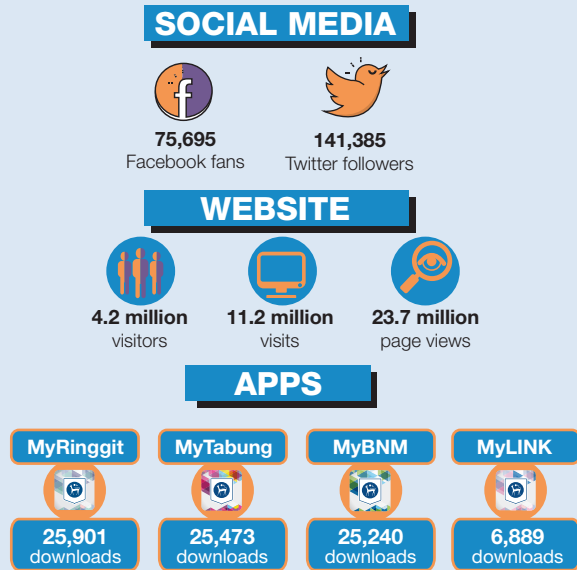
In 2016, the Bank expanded its range of social media tools and channels to better engage with the public. The Bank's revamped website is now more user-friendly with improved browsing experience on mobile devices. The new enhanced live streaming infrastructure introduced during the Bank's hosting of international events allowed for live telecasts on multiple platforms, with broadcasts accessible to event participants. The Bank's staff now have virtual, real time access to the various public events organised by the Bank.

Elevating public awareness through outreach programmes

As the Bank's centralised point of contact with the general public, BNMLINK has facilitated more than three million queries on financial issues and on our latest initiatives and policies. This facilitated a better understanding of the public's needs and this has allowed the Bank to formulate policies and initiatives

Diagram 5.10

Communicating through New Media Channels



Source: Bank Negara Malaysia

that will benefit the public. Since its establishment in 2005, BNMLINK has focused on ensuring that the public's complaints are managed effectively, and ensuring fair treatment and responsible business conduct among the financial service providers (FSPs). There has been good progress in all these objectives. In 2016, the total number of enquiries received by the Bank's advisory services

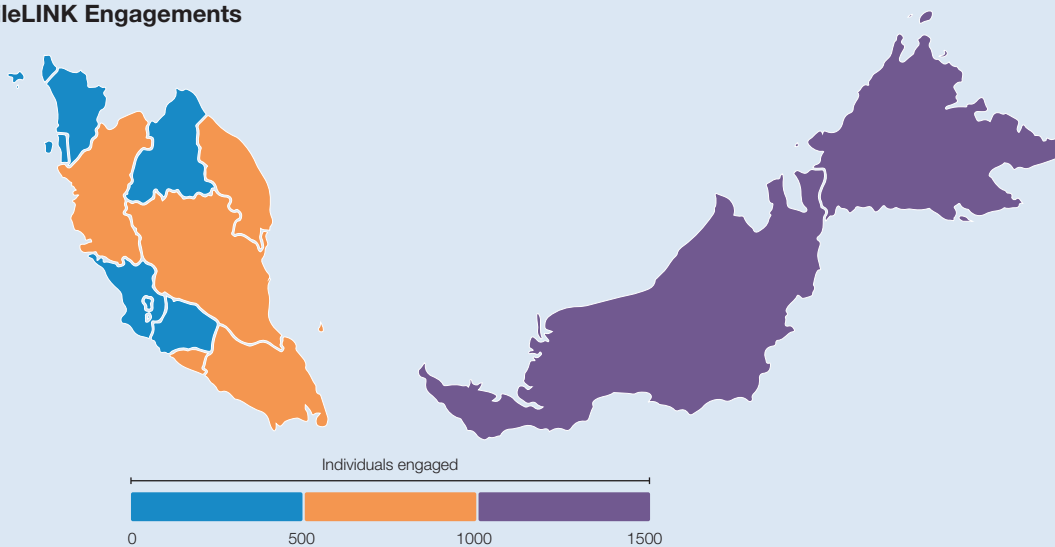
increased by 26% to 613,651 (2015: 488,736). This reflects the enhanced financial literacy levels and increased awareness of consumers on their rights. Complaints against the FSPs lodged with the Bank continued to be on a downward trend. In 2016, the total number of complaints declined by 10% to 6,178 (2015: 6,856). This is due to the Bank's continuous feedback to the FSPs on the areas for improvement, instilling best practices among FSPs, and supervisory actions taken by the Bank based on the complaints received.

Enriching economic intelligence through regional economic surveillance

The dispersion and geographical concentration of Malaysia's economic activity has become wider and further accentuated through the creation of regional economic growth corridors. This has necessitated the expansion of the Bank's economic surveillance at the regional levels. The aim was for closer and deeper monitoring of the economic pulse, identifying emerging trends and providing a sense on the degree of structural changes occurring within regional economies. Since the start of the expansion in 2011, the number of industrial engagements nationwide has grown from 80 in 2011 to 891 in 2016. The direct and frequent engagements by the Bank's Economic Liaison Officers (ELOs) have enabled timely analysis of economic and financial conditions for effective policy decisions and allowed the Bank to communicate and obtain feedback on policy issues.

Diagram 5.11

2016 MobileLINK Engagements



Source: Bank Negara Malaysia

Increasing international engagements

Regional and international collaborations were continuously expanded where, technical cooperation was extended to 711 officials from 83 countries in various areas of central banking, including monetary policy, financial stability and organisational development. As part of our commitment under ASEAN's financial integration, the Bank also focused on financial inclusion capacity building, where we also collaborated with the Alliance for Financial Inclusion and the World Bank. To meet the high demand for training in Islamic finance, the Bank collaborated with other regulatory agencies, financial institutions, professionals and Islamic finance training institutions. The Bank also partnered with several Multilateral Development Institutions such as the Asian Development Bank (ADB) and the Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRIC) to enable officers from low income countries to participate in capacity building programmes organised by the Bank.

Centre for learning and thought leadership

Collaboration between central banks is critical for sharing knowledge in the many areas of central banking, developing a holistic understanding of the changing global economic and financial environment and advancing joint efforts to promote regional economic and financial stability. The Bank's Sasana Kijang has become a centre for activities related to such collaboration and advancing knowledge relevant to central banking. Notable events include the launch of the World Bank Group Global Knowledge and Research Hub, the Wharton Global Forum, the SEACEN Conference in honour of a past governor who was instrumental in deepening regional central banking cooperation, the Responsible Finance Summit, and meetings in collaboration with the Bank for International Settlements (BIS). Apart from being the permanent headquarters of the Alliance for Financial Inclusion (AFI) and the World Bank Group Global Knowledge and Research Hub, Sasana

Table 5.3

Outreach and Engagement Initiatives		
Communication targets	Collaborative partners and channels	Outcome
Increase awareness on various financing and assistance schemes available to SMEs/Micro Entrepreneurs	<ul style="list-style-type: none"> Events organised by ministries, key government agencies and financial institutions Social media channels 	<ul style="list-style-type: none"> Benefitted 24,820 SMEs Successfully disseminated 168,690 information brochures on various BNM funds with reasonable financing rates
"Train-the-Trainers" programmes to provide advisory services on SME financing	<ul style="list-style-type: none"> SME Corporation Malaysia The Association of Islamic Banking Institutions Malaysia (AIBIM) The Association of Banks in Malaysia (ABM) The Association of Development Finance Institutions of Malaysia (ADFIM) 	<ul style="list-style-type: none"> Strengthened the knowledge and financial capability of 6,000 SMEs Equipped 15,725 employees from various domestic and foreign based financial institutions to provide advisory services to SMEs
Small Debt Resolution Scheme for viable SMEs with impaired financing	<ul style="list-style-type: none"> Print media Radio and TV interviews 	<ul style="list-style-type: none"> Increased awareness for financially distressed SMEs to seek assistance
Enhancing financial knowledge and literacy of rural communities	<ul style="list-style-type: none"> MobileLINK coach and counter services Consumer associations and government agencies 	<ul style="list-style-type: none"> Benefitted 8,000 people from 82 sub-districts with average take-up rate of 11% of financial products and services offered Created awareness on affordable financial products like insurance and takaful coverage
Awareness programme for persons with disabilities, towards creating a more inclusive financial system	<ul style="list-style-type: none"> Department of Social Welfare 	<ul style="list-style-type: none"> Attracted 456 participants from various FSPs, associations for persons with disabilities, and consumer associations Introduction of the "cash test card" – a credit card sized plastic card with Braille markings denoting different denominations intended to help the visually impaired in identifying ringgit bank notes and coins
Increase awareness and acceptance of local currency settlement to support bilateral trade	<ul style="list-style-type: none"> Joint conference with the Bank of Thailand 	<ul style="list-style-type: none"> Benefitted 360 entities from the private sector, business chambers, government agencies and financial institutions

Source: Bank Negara Malaysia

Kijang also functions as the interim campus for the Asia School of Business (ASB), a collaborative effort with the Massachusetts Institute of Technology, Cambridge, USA.

Diagram 5.12



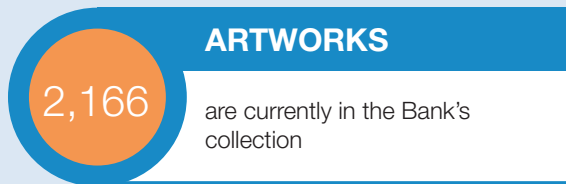
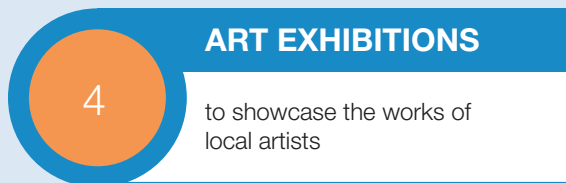
Source: Bank Negara Malaysia

The Museum and Art Gallery

The Bank has sustained its patronage of the arts by exhibiting the works of local artists and young talent at the Museum and Art Gallery (Museum). The Museum was established initially for the Bank to engage the public through the arts. The role of the Museum has evolved and it now provides the public with information on the importance of economics, Islamic finance and financial education. In 2016, the Bank organised art exhibitions showcasing prestigious artists from all over the world as well as programmes for the public, including those aimed at educating children and students. Among the exhibitions showcased at the Museum were 'Terengganu: Selaut Kasih, Sepantai Sayang', 'Works on Paper: Art Inside the Wallet' and 'Kembara Pelangi Menuju Janji'.

Diagram 5.13

The Museum's Activities and Visitors in 2016



Source: Bank Negara Malaysia

Governor	Muhammad bin Ibrahim
Deputy Governor Deputy Governor	Dr. Sukudhew Singh Shaik Abdul Rasheed bin Abdul Ghaffour
Secretary to the Board	Abu Hassan Alshari bin Yahaya
Assistant Governor Assistant Governor Assistant Governor Assistant Governor Assistant Governor	Norzila binti Abdul Aziz Jessica Chew Cheng Lian Donald Joshua Jaganathan Abu Hassan Alshari bin Yahaya Mohd. Adhari bin Belal Din Adnan Zaylani bin Mohamad Zahid
Chief of Staff (Governor's Office)	Nazrul Hisyam bin Mohd Noh
Director Strategic Communications Internal Audit Risk Management	Shariffuddin bin Khalid Mohamad Muhsin bin Mohd Anas Ong Li Ming
<i>Economics</i> Economics Monetary Policy International Statistical Services	Fraziali bin Ismail Dr. Norhana binti Endut Shamsuddin bin Mohd Mahayidin Toh Hock Chai
<i>Regulation</i> Financial Sector Development Islamic Banking and Takaful Financial Surveillance Prudential Financial Policy Development Finance and Enterprise Payment Systems Policy Consumer and Market Conduct Money Services Business Regulation Insurance Development	Aznan bin Abdul Aziz Mohd Zabidi bin Md Nor Qaiser Iskandar bin Anwarudin Madelena binti Mohamed Marina binti Abdul Kahar Tan Nyat Chuan Shahariah binti Othman Nik Mohamed Din bin Nik Musa Yoon Yew Khuen
<i>Supervision</i> Financial Conglomerates Supervision Insurance and Takaful Supervision Banking Supervision Specialist Risk Unit Regulation and Supervision Administration Financial Intelligence and Enforcement	Che Zakiah binti Che Din Hew Ee-Lu Cindy Siah Hooi Hoon Daniel Chin Shen Li Nor Aslaini binti Mohd Nasir* Abd. Rahman bin Abu Bakar
<i>Investment and Operations</i> Investment Operations and Financial Markets Foreign Exchange Administration Currency Management and Operations	Abdul Rahman bin Hussein Azman bin Mat Ali Johari bin Mesar
<i>Organisational Development</i> Strategic Human Capital Strategic Management Finance Legal IT Services Human Capital Development Centre Central Banking Services	Mohd. Adhari bin Belal Din Kristina Rai a/p Hakikat Rai Eugene Hon Kah Weng Wan Mohd Nazri bin Wan Osman Suhaimi bin Ali Thomas Tan Koon Peng Ruziana binti Mohd Mokhtar*
LINK and Regional Offices MIFC Promotion Unit	Arlina binti Ariff Shazmeer Mokhtar*
<i>Centralised Shared Services (CSS)</i> General Manager CSS Management Office Facility Management Services Hospitality Services Organisational Security Management Department Museum, Art Gallery and KM Centre Services Human Resource and General Services	Mohd Nor bin Mashor Lim Foo Thai Johar bin Mokhtar Hairi bin Adam Yusoff bin Sulong Mohd Nor bin Mashor Faizal bin Muhammad Sudin*
<i>Chief Representative</i> Beijing Representative Office London Representative Office New York Representative Office	Albert See Choon Kwang* Raja Syamsul Anwar bin Raja Mohammed Affandi* Harris bin Hassan**
<i>Regional Office Head</i> Johor Bahru Pulau Pinang Kuching Kota Kinabalu	Raman A/L Krishnan* Mohd Daud bin Dahar* Rosnani binti Mahamad Zain* Zambre bin Ismail*
<i>Branch Manager</i> Kuala Terengganu	Yusoff bin Yahaya**

* Deputy Director

** Manager

Board of Directors and Committees of the Bank



127	Board of Directors
129	Management Committee
131	Monetary Policy Committee
133	Financial Stability Executive Committee
135	Shariah Advisory Council
137	Financial Stability Committee

Board of Directors



Muhammad bin Ibrahim
Governor and Chairman



Dr. Sukudhew Singh
Deputy Governor



**Shaik Abdul Rasheed
bin Abdul Ghaffour**
Deputy Governor



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



**Dato' N. Sadasivan
a/l N.N. Pillay**
*Chairman, Board Risk
Committee*
*Member, Board Audit
Committee*



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



Datuk Chin Kwai Yoong
*Chairman, Board Audit
Committee*
*Member, Board Governance
Committee*



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



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



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



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

The Board of Directors wishes to extend its appreciation and gratitude to **Dr. Zeti Akhtar Aziz** and **Nor Shamsiah binti Mohd Yunus** who completed their respective terms as Governor and Deputy Governor in April and November 2016.

Management Committee



Members from left to right

Adnan Zaylani bin Mohamad Zahid

Assistant Governor

Norzila binti Abdul Aziz

Assistant Governor

Abu Hassan Alshari bin Yahaya

Assistant Governor

Dr. Sukudhew Singh

Deputy Governor

Muhammad bin Ibrahim

Governor

Shaik Abdul Rasheed bin Abdul Ghaffour

Deputy Governor

Donald Joshua Jaganathan

Assistant Governor

Jessica Chew Cheng Lian

Assistant Governor

Mohd. Adhari bin Belal Din

Assistant Governor

Monetary Policy Committee



Monetary policy is formulated independently by the Monetary Policy Committee based on a sound governance framework

The primary objective of monetary policy in Malaysia is to maintain price stability while giving due regard to developments in the economy. Under the Central Bank of Malaysia Act 2009 (CBA 2009), the Monetary Policy Committee (MPC) of Bank Negara Malaysia is charged with the responsibility of formulating monetary policy and the policies for the conduct of monetary policy operations¹. In this regard, the MPC sets the policy interest rate, the Overnight Policy Rate (OPR), to influence other interest rates in the economy.

In carrying out this mandate, the MPC determines the direction of monetary policy based on its assessment of the balance of risks to the outlook for both domestic growth and inflation. The MPC also monitors risks of destabilising financial imbalances given their implications for the prospects of the economy. The Committee meets at least six times a year to decide on the OPR and publishes the Monetary Policy Statement (MPS) following each meeting to explain its decisions.

The MPC comprises the Governor, the Deputy Governors, and three to seven other members, including external members who are appointed by the Minister of Finance upon recommendation by the Bank's Board Governance Committee. At present, the MPC has eight members, two of which are external members. The membership of the MPC is intended to bring together a diversity of expertise and experiences that is critical for sound decision-making on monetary policy.

¹ For a detailed account of the evolution of the MPC, and its governance and processes, refer to the 'Box Article: Evolution of the Monetary Policy Committee of Bank Negara Malaysia: Key Milestones over the Years' in the Bank's Annual Report 2015.

Members from left to right

Abu Hassan Alshari bin Yahaya
Assistant Governor

Prof. Dato' Seri Dr. Noor Azlan bin Ghazali
Vice-Chancellor, Universiti Kebangsaan Malaysia

Dr. Sukudhew Singh
Deputy Governor

Muhammad bin Ibrahim
Governor and Chairman

Shaik Abdul Rasheed bin Abdul Ghaffour
Deputy Governor

Prof. Dr. Yeah Kim Leng
*Professor of Economics, Sunway University
Business School, Sunway University*

Norzila binti Abdul Aziz
Assistant Governor

Adnan Zaylani bin Mohamad Zahid
Assistant Governor

Financial Stability Executive Committee



Muhammad bin Ibrahim
Governor and Chairman



Shaik Abdul Rasheed bin Abdul Ghaffour
Deputy Governor



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



Tan Sri Dato' Seri Ranjit Ajit Singh
Chairman of Securities Commission Malaysia



Jean Pierre Sabourin
Chief Executive Officer of Perbadanan Insurans Deposit Malaysia



Datuk Johan bin Idris
External Expert



Yoong Sin Min
External Expert

Financial Stability Executive Committee

The Financial Stability Executive Committee (Executive Committee) was established in 2010 pursuant to Section 37 of the CBA 2009. Its primary purpose is to contribute to the fulfilment of the Bank's statutory mandate of preserving financial stability through its decision making role in specific policy measures proposed by the Bank. These measures which are formulated for purposes of averting or reducing risks to financial stability are:

- The issuance of orders to a person or financial institution that is not supervised by the Bank to undertake specific measures;
- The extension of liquidity assistance to a financial institution that is not supervised by the Bank, or to overseas operations of a licensed financial institution in Malaysia; and
- The provision of capital support to a non-viable licensed financial institution in Malaysia.

The Executive Committee serves to strengthen the accountability framework for the exercise of the broad financial stability powers accorded to the Bank under the CBA 2009. It acts to ensure that proposed measures within its purview are appropriate, sound and comprehensive to address identified systemic risks. The Executive Committee meets at least twice a year. Additional meetings can be convened at any time if deemed necessary in the interest of financial stability. The Executive Committee consists of seven members, a majority of whom must be non-executive members who are independent of the Bank's Management. Members are subject to the Executive Committee's Code of Ethics and Conflict of Interest, which seeks to preserve the integrity of decision making and enhance public confidence in the objectivity, independence and high standards of conduct of the Executive Committee.

In order to contain the excessive growth in household indebtedness, the Executive Committee in 2013 deliberated on and approved the extension of requirements aimed at reinforcing responsible lending practices to major household credit providers not supervised by the Bank. Since the extension of the measures, growth in household loans from non-bank credit providers has moderated to more sustainable levels, supported by improvements in underwriting practices of these institutions.

Shariah Advisory Council



Shariah Advisory Council

The Shariah Advisory Council of Bank Negara Malaysia (SAC) was established in May 1997 as the highest Shariah authority in Islamic banking and takaful in Malaysia. In the CBA 2009, the roles and functions of the SAC were further reinforced as the authority for the ascertainment of Islamic law for the purposes of Islamic financial activities which are supervised and regulated by the Bank.

The SAC assumes a pivotal role in ensuring the consistency of Shariah rulings applied in the Islamic banking and takaful industry. The Shariah rulings by the SAC serve as a main reference for Islamic financial institutions to ensure end-to-end Shariah compliance in the structure and implementation of their financial products and services. In addition, the CBA 2009 provides that any queries on Shariah matters in a court or arbitration proceeding must be referred to the SAC, whose opinions shall be binding.

The SAC provides the Shariah basis for the development of a comprehensive Shariah contract-based regulatory framework for Islamic banking and takaful in Malaysia. In this regard, the SAC defines the essential features of the contracts taking into consideration the various Shariah views, research findings, as well as custom and market practices. Moving forward, the SAC, through its members, individually and collectively, will expand its sphere of influence to support more product innovation and encourage harmonisation of Shariah interpretation locally and globally.

The appointment of the SAC members is made upon approval by the Yang di-Pertuan Agong, on the advice of the Minister of Finance after consultation with the Bank. Currently, the SAC has ten (10) members consisting of prominent Shariah scholars, jurists and legal experts.

Members from left to right

Burhanuddin bin Lukman

Researcher, International Shariah Research Academy for Islamic Finance (ISRA)

Associate Prof. Dr. Asmadi bin Mohamed Naim

Associate Professor, Islamic Business School, Universiti Utara Malaysia

Tan Sri Sheikh Ghazali bin Abdul Rahman

Shariah Legal Advisor, Attorney General Chambers

Dato' A. Aziz bin A. Rahim

Former Judge, Court of Appeal Malaysia

Prof. Dr. Ashraf bin Md. Hashim (Deputy Chairman)

Chief Executive Officer, ISRA Consultancy

Datuk Dr. Mohd Daud Bakar (Chairman)

Founder and Executive Chairman, Amanie Group

Sahibus Samahah Datuk Dr. Zulkifli bin Mohamad Al-Bakri

Mufti of Wilayah Persekutuan

Prof. Dr. Mohamad Akram bin Laldin

Executive Director, ISRA

Dr. Shamsiah binti Mohamad

Senior Researcher, ISRA

Prof. Dr. Engku Rabiah Adawiah binti Engku Ali

Professor, IIUM Institute of Islamic Banking and Finance (IIBF), International Islamic University Malaysia (IIUM)

Financial Stability Committee



Muhammad bin Ibrahim
Governor and Chairman



Dr. Sukudhew Singh
Deputy Governor



**Shaik Abdul Rasheed
bin Abdul Ghaffour**
Deputy Governor



**Jessica Chew
Cheng Lian**
Assistant Governor



**Donald Joshua
Jaganathan**
Assistant Governor



**Adnan Zaylani bin
Mohamad Zahid**
Assistant Governor

Financial Stability Committee

The Financial Stability Committee (FSC) is a high-level internal forum responsible for discussing risks to financial stability stemming from both system-wide and institutional developments (as defined in Section 29 of the CBA 2009 and, where necessary, making decisions on policy responses to avert or reduce risks to financial stability. The FSC meets to:

- Deliberate and decide on the appropriate responses to systemic risks;
- Deliberate and decide on microsurveillance responses and actions including resolution measures to address risks to financial stability and decisions on the non-viability of Bank Negara Malaysia-regulated institutions;
- Make recommendations to the Financial Stability Executive Committee on the appropriate resolution measures for distressed institutions, in accordance with Section 38 CBA 2009; and
- Monitor the implementation of approved policy responses and other actions as directed by the FSC and the Financial Stability Executive Committee.

The FSC is chaired by the Governor and membership comprises all Deputy Governors and Assistant Governors for regulation, supervision, treasury operations and payment systems. The meeting is also attended by selected senior officers of the Bank.

Since 2010, the FSC has deliberated on several macroprudential policies (e.g. maximum loan-to-value ratios and measures on responsible financing) to address issues such as the high household indebtedness and speculative behaviour in the property market. The implementation of these measures along with other policy responses, has contributed towards moderating growth in both household debt levels and residential property prices.

Annual Financial Statements



145	Statement of Financial Position as at 31 December 2016
146	Income Statement for the Year Ended 31 December 2016
147	Notes to the Financial Statement

Annual Financial Statements



REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF BANK NEGARA MALAYSIA FOR THE YEAR ENDED 31 DECEMBER 2016

Report on the Financial Statements

I have audited the financial statements of Bank Negara Malaysia which comprise the Statement of Financial Position as at 31 December 2016 and Income Statement for the year then ended, a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation and fair presentation of the financial statements in accordance with the Central Bank of Malaysia Act 2009 and applicable financial reporting standards approved in Malaysia to the extent that it is, in the opinion of the directors, appropriate to do so, having regard to the objects and functions of the Bank. The directors are also responsible for such internal control as the management determines is necessary to enable the preparation of the financial statements that are free from material misstatement or omission, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on the financial statements based on the audit. The audit has been carried out in accordance with the Audit Act 1957 and in conformity with the auditing standards approved in Malaysia. Those standards require that I comply with ethical requirements as well as to plan and perform the audit in order to obtain reasonable assurance that the financial statements are free from material misstatement or omission.

The audit involves performing procedures to obtain audit evidence on the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment including the assessment of the risks of material misstatement or omission of the financial statements, whether due to fraud or error. In making those risks assessments, the auditor considers the internal control relevant to Bank Negara Malaysia

in the preparation and presentation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control of Bank Negara Malaysia. The audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements give a true and fair view of the financial position of Bank Negara Malaysia as at 31 December 2016 and of the financial performance and the results of its operations for the year then ended, in all material respects, in accordance with the Central Bank of Malaysia Act 2009 and the financial reporting standards approved in Malaysia to the extent that it is, in the opinion of the directors, appropriate to do so, having regard to the objects and functions of the Bank. The preparation of the financial statements differs in some aspects, from the approved accounting standards in Malaysia. In accordance with the requirements of Section 9 of the Act, I also report that in my opinion, the accounting records and other records required by the Act have been properly kept by Bank Negara Malaysia.



(TAN SRI DR. MADINAH BINTI MOHAMAD)
AUDITOR GENERAL
MALAYSIA

PUTRAJAYA
3 MARCH 2017



STATEMENT BY CHAIRMAN AND ONE OF THE DIRECTORS

We, Muhammad bin Ibrahim and Chin Kwai Yoong, being the Chairman and one of the Directors of Bank Negara Malaysia, do hereby state that in the opinion of the directors, the financial statements are drawn up so as to give a true and fair view of the state of affairs of Bank Negara Malaysia as at 31 December 2016 and of the results of operations for the year ended on that date, in accordance with the Central Bank of Malaysia Act 2009 and applicable Malaysian Financial Reporting Standards (MFRS) to the extent that it is, in the opinion of the directors, appropriate to do so, having regard to the objects and functions of the Bank.

On behalf of the Board,



MUHAMMAD BIN IBRAHIM
CHAIRMAN

28 FEBRUARY 2017
KUALA LUMPUR

On behalf of the Board,



CHIN KWAI YOONG
DIRECTOR

28 FEBRUARY 2017
KUALA LUMPUR

BANK NEGARA MALAYSIA

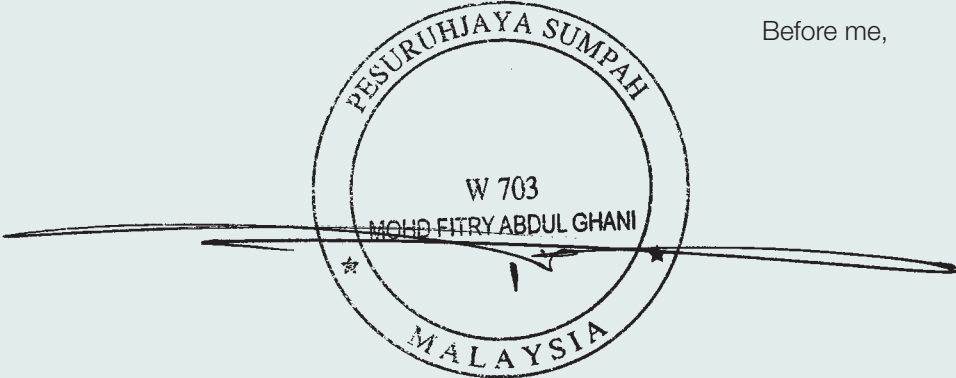
**DECLARATION BY THE OFFICER PRIMARILY RESPONSIBLE
FOR THE FINANCIAL MANAGEMENT OF BANK NEGARA MALAYSIA**

I, Eugene Hon Kah Weng, being the officer primarily responsible for the financial management of Bank Negara Malaysia, do solemnly and sincerely declare that the financial statements for the year ended 31 December 2016, are to the best of my knowledge and belief, correct and I make this solemn declaration conscientiously believing the same to be true and by virtue of the provisions of the Statutory Declarations Act, 1960.

Subscribed and solemnly declared)
by the abovenamed at Kuala Lumpur)
this 28 February 2017.)



Before me,



BANK NEGARA MALAYSIA

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016

		2016 RM million	2015 RM million
ASSETS			
	Note		
Gold and Foreign Exchange	3	415,506	398,178
International Monetary Fund Reserve Position	4	3,467	3,291
Holdings of Special Drawing Rights	4	4,956	7,657
Malaysian Government Papers	5	4,265	1,917
Deposits with Financial Institutions	6	1,528	1,290
Loans and Advances	7	7,740	6,958
Land and Buildings	8	2,114	2,114
Other Assets	9	11,403	19,163
Total Assets		450,979	440,568
LIABILITIES AND CAPITAL			
Currency in Circulation		97,752	88,157
Deposits from: Financial Institutions		170,249	157,170
Federal Government		9,441	10,213
Others	10	534	588
Bank Negara Papers		8,602	24,114
Allocation of Special Drawing Rights	4	8,118	8,009
Other Liabilities	11	11,446	21,083
Total Liabilities		306,142	309,334
Paid-up Capital	12	100	100
General Reserve Fund	13	14,666	14,572
Risk Reserve	14	126,741	112,716
Land Revaluation Reserve	15	752	752
Unappropriated Profits	16	2,578	3,094
Total Capital		144,837	131,234
Total Liabilities and Capital		450,979	440,568

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

BANK NEGARA MALAYSIA

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2016

		2016 RM million	2015 RM million
	Note		
Total Income	17	9,024	11,792
Less:			
Recurring Expenditure	18	(1,124)	(1,206)
Development Expenditure	19	(1,373)	(2,740)
Total Expenditure		(2,497)	(3,946)
Net Profit Before Tax		6,527	7,846
Less: Taxation	20	(49)	(52)
Net Profit After Tax		6,478	7,794
Less: Transfer to Risk Reserve	14	(3,900)	(4,700)
Unappropriated Profits of the year		2,578	3,094

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

BANK NEGARA MALAYSIA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

1. General Information

Bank Negara Malaysia (the Bank) is a statutory body established under the Central Bank of Malaysia Act 1958 which has been repealed by the Central Bank of Malaysia Act 2009. The principal place of business is located at Bank Negara Malaysia, Jalan Dato' Onn, 50480 Kuala Lumpur.

The principal objects of the Bank are to promote monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy. In this regard, the Bank's primary functions are as follows:

- (a) to formulate and conduct monetary policy in Malaysia;
- (b) to issue currency in Malaysia;
- (c) to regulate and supervise financial institutions which are subject to the laws enforced by the Bank;
- (d) to provide oversight over money and foreign exchange markets;
- (e) to exercise oversight over payment systems;
- (f) to promote a sound, progressive and inclusive financial system;
- (g) to hold and manage the foreign reserves of Malaysia;
- (h) to promote an exchange rate regime consistent with the fundamentals of the economy; and
- (i) to act as financial adviser, banker and financial agent of the Government.

The Board of Directors approved the annual financial statements on 28 February 2017.

2. Accounting Policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These accounting policies are consistently applied to both of the financial years presented, unless otherwise stated.

2.1 Basis of Preparation of Financial Statements

- (a) These financial statements have been prepared in accordance with the Central Bank of Malaysia Act 2009 and applicable Malaysian Financial Reporting Standards (MFRS). Section 10 of the Central Bank of Malaysia Act 2009 provides that the Bank, in preparing its financial statements, shall comply with accounting standards to the extent that it is, in the opinion of the directors, appropriate to do so, having regard to the objects and functions of the Bank. The directors, having considered its responsibilities for the formulation and conduct of effective monetary policy and promoting financial stability, are of the opinion that, it is appropriate to differ, in certain aspects, from the MFRS.
- (b) The preparation of the financial statements on the basis stated in 2.1 (a) requires the management to make judgements, estimates and assumptions based on available information that may affect the application of accounting policies and the reported amounts of assets and liabilities as well as disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the financial year. Although these estimates are based on the management's best knowledge of current events and actions, the actual results could differ from those estimates.

BANK NEGARA MALAYSIA

2.2 Measurement Base and Accounting Basis

The financial statements have been prepared on an accrual basis, using the historical cost convention, except as otherwise disclosed.

2.3 Foreign Currency Translation

- (a) The financial statements have been prepared using Ringgit Malaysia, the currency of the primary economic environment in which the Bank operates.
- (b) Assets and liabilities in foreign currencies are translated into Ringgit Malaysia using the exchange rate prevailing as at the end of the financial year. Transactions in foreign currencies during the year are translated into Ringgit Malaysia using the exchange rate prevailing at the transaction dates.
- (c) All foreign exchange unrealised gains or losses arising on translation are recognised in Risk Reserve while realised gains or losses upon settlement are recognised in the Income Statement.

2.4 Gold

Gold is carried at fair value. Unrealised gains and losses from changes in the fair value on gold are recognised in Risk Reserve. Realised gains or losses from the sale of gold are recognised in the Income Statement.

2.5 Foreign Securities

Foreign securities are stated at amortised cost or fair value. Fair value changes are recognised in Risk Reserve or in the Income Statement. Upon derecognition, realised gains or losses are recognised in the Income Statement.

2.6 Net Profit

The net profit of the Bank is appropriated in accordance with section 7 of the Central Bank of Malaysia Act 2009 and only realised gains are available for distribution.

2.7 Repurchase and Reverse-Repurchase Agreements

The amount borrowed under repurchase agreements is reported under Other Liabilities while the amount lent under reverse repurchase agreements is reported under Other Assets. For repurchase agreements, the difference between the sale and repurchase price is recognised as interest expense in the Income Statement. Conversely, for reverse repurchase agreements, the difference between purchase and resale price is recognised as interest income in the Income Statement.

2.8 Land and Buildings

- (a) The Bank capitalises all its land while buildings are maintained at nominal cost of RM10 each.
- (b) The amount of land capitalised at initial recognition is the purchase price along with any further costs incurred in bringing the land to its present condition.
- (c) After initial recognition, land is stated at revalued amount. Professional valuations of the Bank's land will be carried out once every ten years with any surplus arising on revaluation to be recognised directly in the Land Revaluation Reserve.
- (d) Gain or loss arising from the disposal of land is determined as the difference between the net disposal proceeds and the carrying amount of the land and is recognised in the Income Statement on the date of disposal.

BANK NEGARA MALAYSIA

2.9 Other Fixed Assets

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

3. Gold and Foreign Exchange

	2016	2015
	RM million	RM million
Gold	6,411	5,620
Foreign Securities	345,024	311,459
Foreign Deposits	6,306	8,778
Balances with Other Central Banks	41,415	52,091
Others	16,350	20,230
	<u>415,506</u>	<u>398,178</u>

4. International Monetary Fund (IMF) Reserve Position, Holdings of Special Drawing Rights (SDR) and Allocation of Special Drawing Rights

The IMF objectives are to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth and reduce poverty around the world. The IMF also provides advice and temporary funding to member countries in the event of balance of payments difficulties.

IMF Reserve Position

This consists of the reserve tranche position of Malaysia's quota, lending under the Financial Transaction Plan (FTP) and New Arrangements to Borrow (NAB). The IMF quota determines the member country's voting strength, the financial contributions to the IMF, the amount of financing the member can access in the event of balance of payment difficulties and the amount of SDRs allocated to the member. Both FTP and NAB programmes are used to provide loans if the IMF has a need for funds in excess of quota resources.

Holdings of Special Drawing Rights

Holdings of Special Drawing Rights (SDR) are an international reserve asset created by the IMF. SDR is periodically allocated to IMF member countries on the basis of the size of member countries' quota. A member may use SDR to obtain foreign exchange reserves from other members and to make international payments, including to the IMF.

Allocation of Special Drawing Rights

This liability to the IMF represents an equivalent amount of SDR received since its inception.

BANK NEGARA MALAYSIA

5. Malaysian Government Papers

Malaysian Government Papers refer to holdings of Government debt instruments that are among the instruments that can be used in the Bank's monetary policy operations.

	2016 RM million	2015 RM million
Malaysian Government Securities	3,916	1,917
Malaysian Government Investment Certificates	349	-
	<u>4,265</u>	<u>1,917</u>

6. Deposits with Financial Institutions

Deposits with financial institutions comprise deposits placed by the Bank with financial institutions under section 75(i) and section 100 of the Central Bank of Malaysia Act 2009.

7. Loans and Advances

Loans and advances comprise mainly of advances extended by the Bank to the participating institutions under various schemes such as Fund for Small and Medium Industries and New Entrepreneur Fund aimed at promoting growth and development of small and medium business establishments. The extensions of these advances are provided under section 48, section 49 and section 100 of the Central Bank of Malaysia Act 2009.

8. Land and Buildings

	2016 RM million	2015 RM million
Freehold land, at cost	1,250	1,250
Freehold land, at revaluation	864	864
	<u>2,114</u>	<u>2,114</u>

Freehold land, at cost, were purchased in 2014. Freehold land, at revaluation, were revalued by an independent valuer on 1 August 2014. Buildings recorded at nominal value amounts to RM3,540 (2015: RM3,540).

9. Other Assets

Included in other assets are securities purchased under reverse-repurchase agreements of RM5,735 million (2015: RM13,747 million) and investments in shares and bonds of RM4,602 million (2015: RM4,614 million) acquired under section 48(1) and section 100 of the Central Bank of Malaysia Act 2009.

10. Deposits from Others

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

11. Other Liabilities

Other liabilities include mainly placements by financial institutions under the repurchase agreements of RM9,248 million (2015: RM18,553 million).

BANK NEGARA MALAYSIA

12. Paid-up Capital

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

13. General Reserve Fund

	2016 RM million	2015 RM million
At 1 January (as previously reported)	14,572	14,572
Prior year adjustments:		
Transfer made to General Reserve Fund reclassified to Unappropriated Profits	-	(35)
As restated	<u>14,572</u>	<u>14,537</u>
Amount approved and transferred to the General Reserve Fund during the year	94	35
As at 31 December	<u><u>14,666</u></u>	<u><u>14,572</u></u>

With effect from 2015, appropriations of net profits to the General Reserve Fund and dividends to the Government are recognised upon the approval by the Minister as provided under section 7 of the Central Bank of Malaysia Act 2009.

Transfer to the General Reserve Fund for the year ended 2015 of RM94 million was approved by the Minister on 4 March 2016.

14. Risk Reserve

The Risk Reserve are financial buffers comprising unrealised gains or losses on translation of foreign currency assets and liabilities and fair value changes from securities carried at fair value.

A market risk measurement framework is used to estimate financial buffers required to cushion unexpected loss arising from unfavourable circumstances not within the control of the Bank. Financial buffers are built from the appropriation as provided under section 7 of the Central Bank of Malaysia Act 2009.

15. Land Revaluation Reserve

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

16. Unappropriated Profits

	2016 RM million	2015 RM million
Balance 1 January	3,094	3,035
Less: Appropriations approved during the year		
Transfer to General Reserve Fund	(94)	(35)
Dividend paid to the Government	<u>(3,000)</u>	<u>(3,000)</u>
	-	-
Current year's unappropriated profits	<u>2,578</u>	<u>3,094</u>
Balance 31 December	<u><u>2,578</u></u>	<u><u>3,094</u></u>

BANK NEGARA MALAYSIA

For the year ended 31 December 2016, the Board recommends a transfer to the General Reserve Fund of RM78 million and dividend payable of RM2.5 billion to the Government.

In accordance with section 7 of the Central Bank of Malaysia Act 2009, appropriations to the General Reserve Fund and declaration of dividends to the Government are subject to the approval of the Minister, and if approved will be recognised in the next financial year ending 31 December 2017. The dividend paid to the Government for the year ended 2015 amounted to RM3 billion was approved by the Minister on 4 March 2016.

17. **Total Income**

Total income comprises revenue from foreign reserves management which includes interest and dividends, non-treasury income, realised capital gains or losses, and is stated at net of amortisation/accretion of premiums/discounts and monetary policy cost.

18. **Recurring Expenditure**

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

19. **Development Expenditure**

Development expenditure are expenses incurred mainly to finance developmental and long term projects undertaken by the Bank that are in line with its principal objects and functions.

20. **Taxation**

The Bank is exempted from payment of income tax and supplementary income tax as set out in the Income Tax (Exemption) (No. 7) Order 1989. Tax expense relates to unclaimable withholding taxes on income from foreign dividend and interest and capital gains taxes on sale of foreign investments.

21. **Contingencies and Commitments**

21.1 **Contingent Assets**

Total contingent assets as at 31 December 2016 amounted to RM1,400 million. These comprise the Bank's total contributions to International Centre for Leadership in Finance (ICLIF) Trust Fund of RM800 million and International Centre for Education in Islamic Finance (INCEIF) Trust Fund of RM600 million to finance activities related to training, research and development of human resource in banking and financial services managed by The ICLIF Leadership and Governance Centre and INCEIF, respectively. It is provided in the Trust Deeds that the total contributions will be returned to the Bank when the Centres become self-sufficient in the future.

21.2 **Commitments**

Total commitments as at 31 December 2016 comprise the following:

(a) **Membership with IMF**

- (i) The Bank has an obligation to pay to IMF SDR2,988 million, equivalent to RM18,020 million (2015: SDR1,259 million, equivalent to RM7,491 million) or in other convertible currencies which represents the unpaid portion of Malaysia's quota in the IMF under the Articles of Agreement.

- (ii) The Bank has participated in the New Arrangements to Borrow (NAB), a set of credit arrangements between the IMF and its member countries to provide a supplementary source of financing to IMF for the purpose of safeguarding the stability of the international monetary system. As at 31 December 2016, the amount of undrawn credit under the NAB is SDR288 million, equivalent to RM1,737 million (2015: SDR307 million, equivalent to RM1,826 million).
 - (iii) On 23 July 2012, the Bank has pledged a USD1,000 million, equivalent to RM4,486 million (2015: USD1,000 million, equivalent to RM4,294 million) bilateral contribution to the IMF for precautionary and financial crisis resolution purposes.
- (b) **Investment with Bank for International Settlements (BIS)**
The Bank has a commitment of SDR12 million, equivalent to RM72 million (2015: SDR12 million, equivalent to RM71 million) which refers to the uncalled portion of the 3,220 units of shares held by the Bank in the BIS based on the nominal value of SDR5,000 each using the SDR rate at the date of the Statement of Financial Position.
- (c) **Swap Arrangements**
- (i) **ASEAN Swap Arrangement**
The Bank has participated in the multilateral ASEAN Swap Arrangement (ASA) together with other ASEAN central banks and monetary authorities to provide short-term foreign currency liquidity support to member countries with balance of payments difficulties. As at 31 December 2016, the Bank's total commitment amounted to USD300 million, equivalent to RM1,346 million (2015: USD300 million, equivalent to RM1,288 million) and there was no request for liquidity support under ASA from any member country during the financial year.
 - (ii) **Bilateral Currency Swap Arrangement**
On 20 April 2015, the Bank renewed the Bilateral Currency Swap Arrangement (BCSA) agreement with the People's Bank of China with the objective of promoting and facilitating trade settlement in the local currency between the two countries. As at 31 December 2016, the Bank's total commitment under the BCSA is RM90 billion (2015: RM90 billion) and there has been no request to activate the BCSA during the financial year.
 - (iii) **Chiang Mai Initiative Multilateralisation Arrangement**
The Bank has participated in the Chiang Mai Initiative Multilateralisation (CMIM) arrangement to provide financial support to ASEAN+3 member countries facing balance of payments and short-term liquidity difficulties. The effective date of the CMIM Agreement is 24 March 2010. Under the CMIM arrangement, member countries facing balance of payments and short-term liquidity constraints can obtain financial support in US dollar through swap arrangements against their respective local currencies. As at 31 December 2016, the Bank's total commitment is USD9.1 billion, equivalent to RM41 billion (2015: USD9.1 billion, equivalent to RM39 billion) and there was no request for liquidity support from any member country.

(iv) **Repurchase Agreement with Central Banks and Monetary Authorities**

The Bank has entered into repurchase agreements totalling USD5 billion, equivalent to RM22 billion (2015: USD5 billion, equivalent to RM21 billion) with various central banks and monetary authorities under the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) to provide liquidity assistance in times of emergency. As at 31 December 2016, there was no request for liquidity assistance from any counterpart.

(d) **Liquidity Investment Arrangement (LIA) with International Islamic Liquidity Management Corporation (IILM)**

In December 2016, the Bank as member of the International Islamic Liquidity Management Corporation (IILM) entered into a Liquidity Investment Arrangement (LIA) to further solidify support for the entity. As at 31 December 2016, due to the joint and several liability of the agreement, the total commitment of participating members under the LIA is USD600 million, equivalent to RM2,692 million. However the Bank's net commitment is capped at USD100 million, equivalent to RM449 million as the arrangement allows for counterclaim of USD500 million, equivalent to RM2,243 million against the other participating members .

22. **Financial Risk Management**

The Reserve Management Committee oversees the assessment, measurement and the control of the investment risks in the management of reserves to be within acceptable levels to ensure that the objectives of capital preservation, liquidity and return are met. In undertaking this function, the major risks of the investments fall into the following areas:

(a) **Market Risk**

Market risk is the exposure of the Bank's investments to adverse movements in market prices such as foreign exchange rates, interest rates and prices of bonds and equities. Market risk is assessed and monitored on a daily basis. A benchmark policy approved by the Board of Directors reflects the long-term objectives and acceptable risk-return profile of the investments. Investments may be made in instruments that are different from those in the benchmark. This deviation in investment is controlled through a set of risk management limits, governance arrangements and investment guidelines that are also approved by the Board of Directors. Sensitivity analysis and stress testing are undertaken to assess emerging risks and potential marked-to-market losses from adverse movements and volatility in the market, as well as liquidity conditions.

(b) **Credit Risk**

Credit risk is the risk of default of the issuer of the debt or failure of the counterparty to perform its contractual obligation to the Bank resulting in the Bank not receiving its principal and/or interest that has fallen due in a timely manner. A comprehensive credit risk framework governs the permissible investments and the risk appetite of the Bank. This ensures investments are placed with issuers and counterparties of high credit standing and the probability of losses from this risk is low. The framework, which is approved by the Board, also incorporates market-based credit indicators such as ratings implied from financial market prices, and internal credit assessment. This enhances the credit framework by providing a more dynamic and forward-looking credit assessment.

(c) **Operational Risk**

Operational risk is the risk of financial losses due to failed internal processes, inadequate controls and procedures, or any other internal or external events that impede operations. Operational risk is mitigated through a robust governance framework and effective implementation of risk controls and limits. A comprehensive operational risk surveillance mechanism is in place to support the identification of emerging risks in the Bank's operations to allow for action to be taken in managing gaps and in mitigating financial losses.

23. **Bank Negara Malaysia Staff Welfare Account (SWA) and Bank Negara Malaysia Staff Welfare Account (Medical Fund) (termed as the 'Medical Fund Account')**

The SWA was established on 1 March 1991 under section 15 (5) and (6) of the Central Bank of Malaysia Act 1958 while the Medical Fund Account was established on 21 June 2006 under section 15 (6) of the Central Bank of Malaysia Act 1958. Both the SWA and the Medical Fund continue to exist under section 83 (4) and (5) of the Central Bank of Malaysia Act 2009.

The SWA is governed under the Bank Negara Malaysia Staff Welfare Account Trust Directions 1991. As stipulated in the Trust Directions 1991, the SWA shall be administered by a committee authorised by the Board (Authorised Committee of the Board). The accounts of the SWA are to be maintained separately from the other accounts of the Bank and shall be audited in the same manner of the Bank's Account. The objective of the SWA is to provide loans to the staff for certain allowable activities, finance the activities of the staff's associations and give education excellence awards to the children of staff. The SWA also manages the insurance compensation of the deceased staff received by beneficiaries who have yet to attain the legal age.

The Medical Fund Account is governed under the Bank Negara Malaysia Staff Welfare Account (Medical Fund) Trust Directions 2006. The objective is to assist the Bank to meet the medical expenses of eligible retirees and their dependents. As stipulated in the Staff Welfare Account (Medical Fund) Trust Directions 2006, the Medical Fund shall be administered by a Medical Fund Committee. The Medical Fund Account is to be maintained separately under the Staff Welfare Account and shall be audited in the same manner of the Staff Welfare Account.

Annex



Annex

CONTENTS

Key Economic and Financial Statistics

National Accounts

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

External Sector

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

Consumer and Producer Prices Index

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

Monetary and Financial Indicators

A.16	Broad Money (M3)	P 15
A.17	Money Supply: Annual Change and Growth Rates	P 16
A.18	Interest Rates (%)	P 17
A.19	Movements of the Ringgit	P 18
A.20	Financing of the Economy	P 19

Public Finance

A.21	Consolidated Public Sector Finance	P 20
------	------------------------------------	------

Table A.1

Gross Domestic Product by Kind of Economic Activity at Constant 2010 Prices

	2012	2013	2014	2015	2016 ^p	2017 ^f
	RM million					
Agriculture	89,406	91,181	93,052	94,143	89,325	92,854
Mining and quarrying	86,751	87,789	90,841	95,134	97,669	100,261
Manufacturing	211,921	219,152	232,790	244,205	254,951	265,843
Construction	34,880	38,590	43,115	46,634	50,091	54,073
Services	479,300	507,791	541,070	568,892	600,834	630,123
Plus: Import duties	10,004	10,577	11,639	13,797	14,985	15,307
GDP at purchasers' prices¹	912,261	955,080	1,012,506	1,062,805	1,107,855	1,158,461
	Annual change (%)					
Agriculture	1.0	2.0	2.1	1.2	-5.1	4.0
Mining and quarrying	1.6	1.2	3.5	4.7	2.7	2.7
Manufacturing	4.4	3.4	6.2	4.9	4.4	4.3
Construction	18.1	10.6	11.7	8.2	7.4	8.0
Services	6.5	5.9	6.6	5.1	5.6	4.9
Plus: Import duties	15.6	5.7	10.0	18.5	8.6	2.2
GDP at purchasers' prices	5.5	4.7	6.0	5.0	4.2	4.3 ~ 4.8

¹ Numbers may not necessarily add up due to rounding

^p Preliminary

^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.2

Growth in Manufacturing Production (2010=100)

	2013	2014	2015	2016	2014	2015	2016
	Index				Annual change (%)		
Export-oriented industries	114.5	120.8	126.7	132.6	5.6	4.8	4.7
Electronics and electrical products cluster	117.3	131.1	143.1	153.1	11.8	9.2	7.0
<i>Electronics</i>	128.3	141.8	142.9	155.6	10.6	0.7	8.9
<i>Electrical products</i>	96.9	110.0	145.2	151.9	13.5	32.0	4.6
Primary-related cluster	113.1	116.0	118.9	122.8	2.5	2.5	3.3
Chemicals and chemical products	121.1	125.4	131.1	138.0	3.6	4.6	5.2
Petroleum products	108.5	109.2	110.5	113.9	0.6	1.2	3.1
Textiles, wearing apparel and footwear	102.4	113.5	122.0	130.2	10.8	7.5	6.7
Wood and wood products	99.9	107.7	115.3	123.4	7.8	7.0	7.0
Rubber products	134.5	132.8	139.5	144.9	-1.3	5.1	3.9
Off-estate processing	111.5	117.2	113.1	107.4	5.1	-3.5	-5.0
Paper products	115.5	114.2	117.7	123.1	-1.1	3.0	4.6
Domestic-oriented industries	121.2	130.6	136.7	140.9	7.7	4.7	3.0
Construction-related cluster	120.4	125.5	131.2	137.0	4.3	4.5	4.4
Construction-related products	106.9	112.3	117.4	122.2	5.1	4.5	4.1
<i>Non-metallic mineral products</i>	115.0	122.9	131.3	138.6	6.9	6.8	5.5
<i>Basic iron & steel and non-ferrous metals</i>	98.6	101.4	102.9	105.2	2.8	1.6	2.2
Fabricated metal products	155.6	159.9	167.3	175.8	2.8	4.6	5.1
Consumer-related cluster	122.1	135.8	142.3	144.8	11.2	4.8	1.7
Food products	116.7	123.0	126.1	136.3	5.4	2.5	8.0
Transport equipment	131.8	150.7	158.6	153.7	14.4	5.2	-3.1
Beverages	103.3	121.6	135.8	149.3	17.7	11.7	9.9
Tobacco products	101.3	106.2	115.9	119.4	4.8	9.1	3.0
Others	105.5	116.6	108.8	106.4	10.6	-6.7	-2.2
Total	116.0	123.0	128.9	134.4	6.1	4.8	4.3

Source: Department of Statistics, Malaysia

Table A.3

Services Sector Performance at Constant 2010 prices

	2012	2013	2014	2015	2016 ^p	2012	2013	2014	2015	2016 ^p
	Annual change (%)					Share to GDP (%)				
Services	6.5	5.9	6.6	5.1	5.6	52.5	53.2	53.4	53.5	54.2
Intermediate services	7.5	5.4	5.9	4.6	5.5	20.4	20.5	20.5	20.4	20.7
<i>Finance and insurance</i>	7.8	2.0	2.3	-0.7	2.5	7.8	7.6	7.3	6.9	6.8
<i>Real estate and business services</i>	7.5	8.0	8.0	6.6	6.9	4.0	4.2	4.2	4.3	4.4
<i>Transport and storage</i>	4.8	4.6	5.2	5.7	5.6	3.5	3.5	3.5	3.5	3.6
<i>Information and communication</i>	8.9	9.1	9.7	9.4	8.2	5.1	5.3	5.5	5.7	5.9
Final services	6.0	6.3	7.0	5.5	5.7	32.2	32.6	32.9	33.1	33.6
<i>Wholesale and retail trade</i>	4.6	6.3	8.9	6.9	6.2	13.8	14.0	14.4	14.7	14.9
<i>Food & beverages and accommodation</i>	5.6	5.9	6.5	6.4	7.1	2.7	2.7	2.7	2.8	2.8
<i>Utilities</i>	4.9	4.4	3.8	3.5	5.4	2.6	2.6	2.6	2.6	2.6
<i>Government services</i>	9.6	7.4	6.2	4.0	4.9	8.6	8.8	8.8	8.7	8.8
<i>Other services</i>	4.5	5.6	4.8	4.7	4.8	4.4	4.5	4.4	4.4	4.4

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Table A.4

GNI by Demand Aggregates

	2012	2013	2014	2015	2016 ^p	2017 ^f
	at Current Prices (RM million)					
Consumption	616,680	667,456	727,370	778,228	830,337	898,544
<i>Private consumption</i>	482,238	527,749	579,985	626,239	675,648	742,862
<i>Public consumption</i>	134,442	139,707	147,385	151,989	154,689	155,682
Investment	246,343	269,699	287,417	302,948	317,085	334,528
<i>Private investment</i>	142,307	162,791	183,879	198,822	211,476	224,966
<i>Public investment</i>	104,037	106,908	103,538	104,126	105,609	109,562
Change in stocks ¹	3,741	-5,500	-10,942	-12,601	3,324	3,546
Exports of goods and services	770,202	770,368	816,483	820,459	826,636	871,956
Imports of goods and services	665,714	683,408	713,863	731,895	747,998	797,597
GDP at purchasers' value	971,252	1,018,614	1,106,466	1,157,139	1,229,382	1,310,976
Balance of primary income	-35,841	-33,975	-36,624	-32,011	-34,745	-36,308
GNI	935,410	984,639	1,069,842	1,125,128	1,194,637	1,274,668
	at Constant 2010 Prices (RM million)					
Consumption	582,015	622,410	662,306	699,807	735,173	770,366
<i>Private consumption</i>	457,625	490,798	525,038	556,559	590,498	625,925
<i>Public consumption</i>	124,390	131,612	137,268	143,248	144,675	144,441
Investment	233,203	252,162	264,236	274,008	281,333	290,496
<i>Private investment</i>	134,543	151,698	168,512	179,282	187,117	194,863
<i>Public investment</i>	98,659	100,464	95,724	94,725	94,216	95,633
Change in stocks ¹	4,289	-3,140	-8,725	-2,145	1,894	3,377
Exports of goods and services	730,961	732,856	769,794	774,670	775,633	792,787
Imports of goods and services	638,206	649,208	675,105	683,534	686,178	698,566
GDP at purchasers' value	912,261	955,080	1,012,506	1,062,805	1,107,855	1,158,461
Balance of primary income	-40,457	-38,357	-39,913	-24,278	-23,501	-22,932
GNI	871,804	916,722	972,593	1,038,527	1,084,354	1,135,529

¹ Includes statistical discrepancy^p Preliminary^f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5

Savings-Investment Gap

	2012	2013	2014	2015	2016 ^p
	RM million				
Public savings	94,383	96,131	85,823	51,134	69,606
Public gross domestic capital formation	104,037	106,908	103,538	104,126	105,609
Deficit/surplus	-9,654	-10,777	-17,715	-52,992	-36,003
Private savings	205,879	203,553	239,206	273,871	275,971
Private gross domestic capital formation	146,048	157,291	172,937	186,221	214,800
Deficit/surplus	59,831	46,262	66,269	87,650	61,171
Gross national savings	300,262	299,684	325,029	325,005	345,578
(as % of GNI)	32.1	30.4	30.4	28.9	28.9
Gross domestic capital formation	250,084	264,198	276,475	290,347	320,409
(as % of GNI)	26.7	26.8	25.8	25.8	26.8
Balance on current account	50,177	35,485	48,554	34,658	25,169
(as % of GNI)	5.4	3.6	4.5	3.1	2.1

^p Preliminary

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

Table A.6

Labour Market: Selected Indicators

	2012	2013	2014	2015	2016 ^p
	(number of positions/persons)				
Vacancies by Industry¹					
Agriculture, forestry and fishing	337,466	306,542	240,552	269,469	174,751
Mining and quarrying	2,180	1,880	2,605	9,929	1,857
Manufacturing	598,890	456,478	352,784	313,396	376,349
Construction	310,954	308,783	202,878	208,912	127,985
Services	369,983	329,007	275,199	287,050	173,102
<i>Electricity, gas and water supply²</i>	6,521	7,043	8,339	5,834	2,974
<i>Wholesale and retail trade; accommodation and food services</i>	109,117	95,966	87,385	99,310	31,908
<i>Transport and storage; information and communication</i>	17,921	14,864	19,375	39,068	10,762
<i>Finance and insurance; real estate and business services³</i>	114,099	96,399	75,936	70,784	70,865
<i>Public administration and defence; compulsory social security</i>	5,115	4,020	2,485	1,360	3,736
<i>Community, social and other service activities</i>	117,210	110,715	81,679	70,694	52,857
Total vacancies	1,619,473	1,402,690	1,074,018	1,088,756	854,044
Employment by Industry⁴ ('000 persons)					
Agriculture, forestry and fishing	1,628	1,759	1,694	1,754	1,614
Mining and quarrying	81	88	85	104	97
Manufacturing	2,264	2,316	2,373	2,323	2,381
Construction	1,175	1,292	1,278	1,310	1,262
Services	7,671	8,089	8,422	8,575	8,825
<i>Electricity, gas and water supply²</i>	143	145	147	134	155
<i>Wholesale and retail trade; accommodation and food services</i>	3,091	3,303	3,474	3,512	3,682
<i>Transport and storage; information and communication</i>	833	821	811	829	841
<i>Finance and insurance; real estate and business services³</i>	1,231	1,265	1,392	1,420	1,449
<i>Public administration and defence; compulsory social security</i>	696	761	742	751	752
<i>Community, social and other service activities</i>	1,677	1,793	1,857	1,929	1,946
Total employment	12,821	13,545	13,853	14,068	14,180
Labour force participation rate (% of working-age population)	65.6	67.3	67.6	67.9	67.6
Unemployment rate (% of labour force)	3.0	3.1	2.9	3.1	3.5

¹ Refers to vacancies reported by employers through the JobsMalaysia portal

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

³ Refers to finance and insurance/takaful, real estate, professional, scientific and technical; administrative and support service activities

⁴ For preliminary estimates of 2016, based on average employment for the period of January-December 2016

^p Preliminary

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

Table A.7

Private Consumption Indicators

	2011	2012	2013	2014	2015	2016
Sales of passenger cars ('000 units)	520.5	552.2	576.7	588.3	591.3	514.5
Annual change (%)	-4.3	6.1	4.4	2.0	0.5	-13.0
Imports of consumption goods (RM billion)	41.0	43.7	47.6	50.3	62.4	67.0
Annual change (%)	19.0	6.6	8.8	5.7	24.1	7.4
Narrow money (M1)						
Annual change (%)	15.4	11.9	13.0	5.7	4.1	5.7
Loans disbursed by banking system						
Consumption credit (excluding passenger cars)						
Annual change (%)	13.3	-3.6	5.9	-0.1	1.7	1.5
Wholesale and retail trade, restaurants and hotels						
Annual change (%)	13.8	26.0	3.4	21.5	-9.8	-0.5
MRA retail sales (Annual change in %)	8.1	5.5	4.5	3.4	1.4	3.0 ^e
Credit card turnover spending ¹ (RM billion)	88.8	94.1	99.7	105.5	112.7	118.5
Annual change (%)	11.3	6.0	6.0	5.8	6.8	5.2
MIER Consumer Sentiment Index ²	106.3	118.7	82.4	83.0	63.8	69.8
FBM KLCI	1,530.7	1,689.0	1,867.0	1,761.3	1,692.5	1,641.7
Commodity prices						
Crude palm oil (RM/tonne)	3,278.9	2,863.5	2,374.5	2,412.4	2,165.5	2,645.4
Brent crude oil (USD/barrel)	110.8	111.7	108.7	99.4	53.7	45.0
Rubber (sen/kg)	1,366.5	962.4	785.9	554.2	521.3	567.3

¹ Resident spending only² Refers to fourth quarter^e Estimates

Source: Malaysian Automotive Association; Department of Statistics, Malaysia; Malaysia Retailers Association; Malaysian Institute of Economic Research; Bursa Malaysia Berhad; Malaysian Palm Oil Board; Bloomberg; Malaysian Rubber Board; and Bank Negara Malaysia

Table A.8

Private Investment Indicators

	2011	2012	2013	2014	2015	2016
Sales of commercial vehicles ('000 units)	65.0	75.6	79.1	78.1	75.4	65.6
Annual change (%)	5.6	16.2	4.7	-1.3	-3.5	-13.0
Imports of capital goods (RM billion)	80.2	96.1	98.2	95.9	95.6	100.2
Annual change (%)	8.7	19.9	2.2	-2.4	-0.3	4.9
Approvals by MIDA (Manufacturing sector)						
No. of projects	846	804	787	811	680	733
Capital investment (RM billion)	56.1	41.1	52.1	71.9	74.7	58.5
<i>Local</i>	21.9	20.2	21.6	32.3	52.8	31.1
<i>Foreign</i>	34.1	20.9	30.5	39.6	21.9	27.4
New investment (% share)	59.0	65.4	73.1	60.5	80.6	47.4
Reinvestments (% share)	41.0	34.6	26.9	39.5	19.4	52.6
Loans disbursed by banking system						
Businesses sector						
Annual change (%)	12.5	20.7	-1.0	18.6	2.2	-1.6
Corporate Bond (excluding short-term papers)						
Total funds raised (RM billion)	69.6	121.1	83.9	85.5	85.6	85.3
New activities	8.4	19.5	7.5	13.1	20.0	7.8
Initial Public Offerings						
Total funds raised (RM billion)	7.4	22.9	8.2	5.9	4.4	0.6
MIER Business Conditions Survey						
Business Conditions Index ¹	96.6	94.1	92.0	86.4	87.1	81.2
Capacity Utilisation Rate ¹	81.2	80.9	80.0	79.5	78.0	76.5
MSC-Status Companies						
No. of companies	215	213	236	229	249	361
Approved investment (RM billion)	2.5	2.9	3.0	2.9	4.6	8.1

¹ Refers to fourth quarter

Source: Department of Statistics, Malaysia; Bursa Malaysia Berhad; Malaysian Investment Development Authority; Malaysian Institute of Economic Research; Multimedia Development Corporation; and Bank Negara Malaysia

Table A.9

Balance of Payments

	2013			2014		
	+	-	Net	+	-	Net
	RM million					
Goods¹	637,683	541,131	96,552	678,865	565,538	113,327
Services	132,685	142,277	-9,592	137,618	148,325	-10,706
Transportation	14,701	38,610	-23,909	15,617	41,666	-26,050
Travel	67,733	38,566	29,167	73,951	40,718	33,233
Other services	49,951	64,583	-14,632	47,774	65,315	-17,541
Government transactions n.i.e.	300	518	-218	278	626	-349
Balance on goods and services	770,368	683,408	86,959	816,483	713,863	102,620
Primary income	47,656	81,631	-33,975	52,395	89,019	-36,624
Compensation of employees	4,486	8,492	-4,007	5,170	10,071	-4,902
Investment income	43,170	73,138	-29,969	47,225	78,948	-31,722
Secondary income	7,597	25,096	-17,498	10,496	27,939	-17,443
Balance on current account	825,620	790,135	35,485	879,374	830,821	48,554
% of GNI			3.6			4.5
Capital account			-15			344
Financial account			-20,216			-79,954
Direct investment			-6,276			-17,974
<i>Assets</i>			-41,928			-52,623
<i>Liabilities</i>			35,653			34,649
Portfolio investment			-3,012			-39,354
<i>Assets</i>			-32,088			-28,112
<i>Liabilities</i>			29,076			-11,242
Financial derivatives			-253			-975
Other investment			-10,675			-21,652
<i>Official sector</i>			-3,965			1,083
<i>Private sector</i>			-6,710			-22,735
Balance on capital and financial accounts			-20,231			-79,610
Errors and omissions			-605			-5,451
of which:						
Foreign exchange revaluation gain (+) / loss (-)			18,611			7,573
Overall balance (surplus + / deficit -)			14,649			-36,507
Bank Negara Malaysia						
international reserves, net²						
RM million			441,853			405,345
USD million			134,902			115,930
Reserves as months of retained imports			9.5			8.3

¹ Adjusted for valuation and coverage to the balance of payments basis

² All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account

p Preliminary

f Forecast

n.i.e. Not included elsewhere

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

2015			2016 _p			2017 _f		
+	-	Net	+	-	Net	+	-	Net
RM million								
685,398	575,849	109,550	686,000	584,812	101,188	723,435	625,071	98,364
135,061	156,046	-20,985	140,636	163,186	-22,550	148,803	172,768	-23,966
15,667	40,940	-25,273	15,983	39,929	-23,946	17,348	45,514	-28,166
68,468	41,255	27,213	70,138	41,547	28,590	75,835	42,449	33,386
50,558	72,880	-22,323	54,151	80,660	-26,509	55,232	83,717	-28,485
369	971	-603	364	1,050	-685	387	1,088	-701
820,459	731,895	88,565	826,636	747,998	78,638	872,238	797,839	74,399
48,733	80,744	-32,011	46,264	81,010	-34,745	52,157	88,465	-36,308
6,400	11,995	-5,595	6,506	12,190	-5,684	6,884	12,895	-6,010
42,333	68,749	-26,416	39,758	68,819	-29,061	45,272	75,570	-30,298
11,912	33,807	-21,896	15,872	34,595	-18,724	16,885	37,590	-20,705
881,104	846,446	34,658	888,772	863,603	25,169	941,280	923,894	17,386
		3.1			2.1			1~2
		-1,144			99			
		-50,851			-4,225			
		4,773			17,940			
		-37,153			-34,281			
		41,926			52,221			
		-28,190			-19,676			
		-9,078			-14,989			
		-19,112			-4,687			
		-663			-830			
		-26,770			-1,659			
		-1,878			-2,940			
		-24,892			1,281			
		-51,995			-4,126			
		21,087			-6,265			
		57,303			8,918			
		3,750			14,779			
		409,096			423,874			
		95,283			94,488			
		8.4			8.7			

Table A.10

Gross Exports

	2014	2015	2016 ^p	2015	2016 ^p	2016 ^p
	RM million			Annual change (%)		% share
Manufactures	587,175	625,429	645,673	6.5	3.2	82.2
<i>of which:</i>						
Electrical and electronic products	256,145	277,922	287,726	8.5	3.5	36.6
<i>Semiconductors</i>	127,366	137,462	144,625	7.9	5.2	18.4
<i>Office machines and automatic data processing equipment</i>	46,214	51,945	53,529	12.4	3.1	6.8
<i>Electrical machinery, apparatus and appliances, and parts</i>	41,518	47,865	49,192	15.3	2.8	6.3
<i>Telecommunications and sound-recording and reproducing equipment</i>	41,047	40,650	40,380	-1.0	-0.7	5.1
Chemicals and chemical products	51,447	55,133	58,992	7.2	7.0	7.5
Petroleum products	70,356	54,528	54,497	-22.5	-0.1	6.9
Machinery, equipment and parts	29,998	36,159	37,677	20.5	4.2	4.8
Manufactures of metal	26,444	34,904	33,391	32.0	-4.3	4.2
Optical and scientific equipment	23,661	26,085	28,746	10.2	10.2	3.7
Rubber products	18,003	20,184	20,253	12.1	0.3	2.6
Processed food	16,560	18,009	19,989	8.7	11.0	2.5
Wood products	14,716	15,436	15,680	4.9	1.6	2.0
Agriculture	69,175	67,247	70,429	-2.8	4.7	9.0
<i>of which:</i>						
Palm oil and palm oil-based agricultural products	48,266	45,597	48,275	-5.5	5.9	6.1
Sawn timber and moulding	3,372	4,001	4,211	18.7	5.3	0.5
Natural rubber	4,574	4,025	3,615	-12.0	-10.2	0.5
Minerals	104,051	80,194	64,324	-22.9	-19.8	8.2
<i>of which:</i>						
Liquefied natural gas (LNG)	63,750	44,603	32,017	-30.0	-28.2	4.1
Crude petroleum	32,723	26,075	22,272	-20.3	-14.6	2.8
Others	5,015	4,485	5,509	-10.6	22.8	0.7
Total	765,417	777,355	785,935	1.6	1.1	100.0

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Minor changes were made to the selection of codes for manufactured exports of major and selected products. This was to streamline product classification between the compiler and main users of external trade statistics

Data in this table are not directly comparable to the Annual Report 2014 publication due to differences in classification

Source: Department of Statistics, Malaysia

Table A.11

Gross Imports

	2014	2015	2016 ^p	2015	2016 ^p	2016 ^p
	RM million			Annual change (%)		% share
Capital goods	95,882	95,551	100,266	-0.3	4.9	14.4
Capital goods (except transport equipment)	80,246	85,254	88,453	6.2	3.8	12.7
Transport equipment industrial	15,636	10,296	11,813	-34.2	14.7	1.7
Intermediate goods	408,181	399,526	399,083	-2.1	-0.1	57.1
Food and beverages, mainly for industry	17,978	19,696	17,505	9.6	-11.1	2.5
Industrial supplies	172,390	167,171	172,360	-3.0	3.1	24.7
Fuel and lubricants	58,108	40,277	31,155	-30.7	-22.6	4.5
Parts and accessories of capital goods (except transport equipment)	138,845	147,335	151,396	6.1	2.8	21.7
Parts and accessories of transport equipment	20,859	25,047	26,667	20.1	6.5	3.8
Consumption goods	50,309	62,430	66,976	24.1	7.3	9.6
Food and beverages, mainly for household consumption	21,490	25,484	26,680	18.6	4.7	3.8
Transport equipment non-industrial	1,084	1,052	904	-2.9	-14.1	0.1
Consumer goods, n.e.s	27,735	35,894	39,392	29.4	9.7	5.6
Others	128,566	128,272	132,336	-0.2	3.2	18.9
<i>of which:</i>						
Dual use goods	26,088	22,003	15,740	-15.7	-28.5	2.3
Re-exports	99,540	103,184	113,756	3.7	10.2	16.3
Total	682,937	685,778	698,662	0.4	1.9	100.0

^p Preliminary

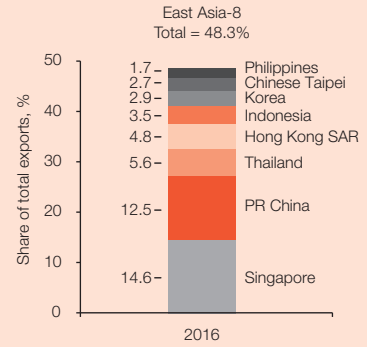
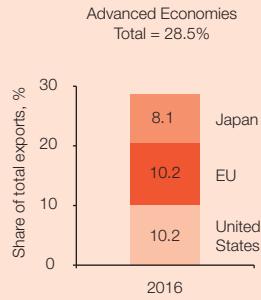
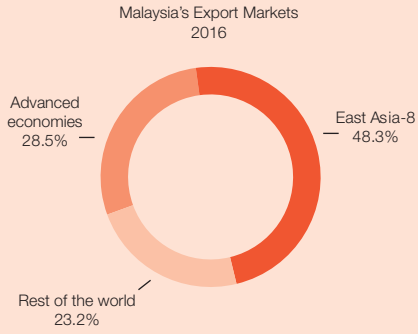
n.e.s. Not elsewhere specified

Note: Numbers may not necessarily add up due to rounding

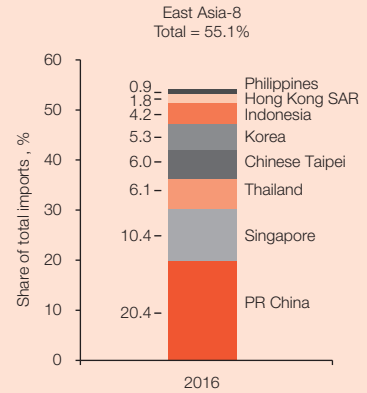
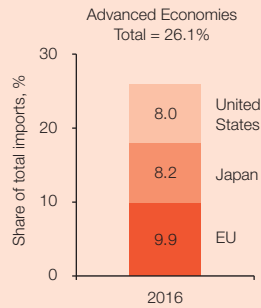
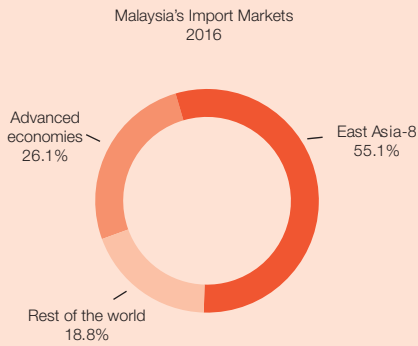
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Malaysia's Trading Partners

Malaysia's Export Markets



Malaysia's Import Markets



Malaysia's Total Trade by Markets

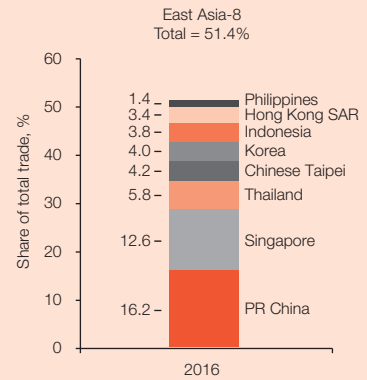
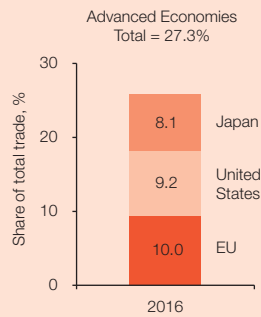
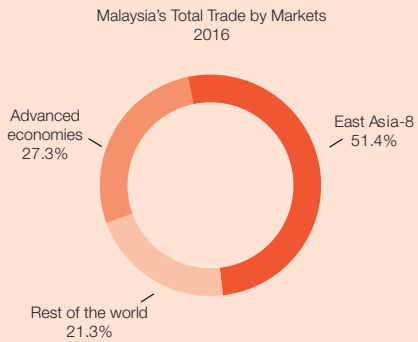


Table A.13

Outstanding External Debt and Debt Servicing

	2012	2013	2014	2015	2016 ^p
	RM million (unless stated otherwise)				
Total external debt	602,060	696,592	747,757	833,817	908,704
<i>USD million equivalent</i>	194,646	209,792	211,895	192,261	200,628
<i>% GNI</i>	64.4	70.7	69.9	74.1	76.1
<i>Annual change (%)</i>	12.0	15.7	7.3	11.5	9.0
By instrument					
Bonds and notes	86,687	107,811	117,146	157,658	163,513
Interbank borrowing	79,981	113,528	149,272	161,295	170,978
Intercompany loans	48,362	62,516	70,072	92,065	136,088
Loans	42,564	40,233	43,189	52,603	53,754
NR holdings of domestic debt securities	223,606	229,655	223,289	211,347	214,204
NR deposits	58,963	77,325	78,050	81,616	86,184
Others ¹	61,897	65,524	66,739	77,233	83,984
Maturity profile					
Medium- and long-term	318,551	357,745	383,697	481,921	532,140
Short-term	283,509	338,847	364,061	351,896	376,564
Currency composition (% share)	100.0	100.0	100.0	100.0	100.0
<i>Ringgit</i>	49.2	45.9	41.0	36.1	34.4
<i>US dollar</i>	39.2	43.2	47.5	51.4	53.4
<i>Japanese yen</i>	3.2	2.6	2.4	2.6	2.4
<i>Others</i>	8.4	8.3	9.1	9.9	9.8
Total servicing (including short-term interest payment)	139,988	141,923	155,685	185,754	207,011
of which:					
Medium- and long-term debt	138,739	140,716	154,311	184,254	204,951
Repayment²	128,849	130,603	143,190	172,381	191,560
of which:					
Redemption of matured domestic debt securities held by NR	23,982	23,490	23,698	27,695	24,403
Interest payment	9,890	10,113	11,121	11,872	13,391
of which interest payment on:					
NR holdings of domestic debt securities	5,067	5,694	6,941	6,575	7,409
Debt service ratio (% of exports of goods and services)					
Total debt	18.2	18.4	19.1	22.6	25.0
Medium- and long-term debt of which:					
NR holdings of domestic debt securities	3.8	3.8	3.8	4.2	3.8

¹ Comprises trade credits, IMF allocation of SDRs and other debt liabilities

² Includes prepayment

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

NR refers to non-residents

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Table A.14

Consumer Price Index

	Weights (%) (2010=100)	2013	2014	2015	2016
		Annual change (%)			
Total	100.0	2.1	3.2	2.1	2.1
Food and non-alcoholic beverages	30.2	3.6	3.3	3.6	3.9
Alcoholic beverages and tobacco	2.9	6.0	11.6	13.5	17.2
Clothing and footwear	3.3	-0.6	-0.2	0.5	-0.4
Housing, water, electricity, gas and other fuels	23.8	1.7	3.4	2.5	2.4
Furnishings, household equipment and routine household maintenance	3.8	1.5	1.0	2.7	2.4
Health	1.7	1.9	2.9	4.5	2.7
Transport	13.7	2.0	4.9	-4.5	-4.6
Communication	5.2	-0.7	-0.7	1.9	-1.5
Recreation services and culture	4.9	0.1	1.5	1.7	2.5
Education	1.1	2.4	2.4	2.4	2.1
Restaurants and hotels	2.9	2.5	4.7	4.1	2.8
Miscellaneous goods and services	6.5	0.3	0.7	4.1	2.9

Source: Department of Statistics, Malaysia

Table A.15

Producer Price Index¹

	Weights (%) (2010=100) ²	2013	2014	2015	2016
		Annual Change (%)			
Total	100.0	-2.7	1.5	-7.4	-1.1
Crude materials for further processing	20.3	-3.5	-2.1	-20.5	3.4
Foodstuffs and feedstuffs	4.1	2.1	4.3	1.2	1.8
Non-food materials	16.2	-4.8	-3.7	-26.5	4.0
Intermediate materials, supplies and components	53.6	-3.5	3.4	-6.2	-3.2
Materials & components for manufacturing	27.9	-7.2	2.7	-2.7	2.2
Materials & components for construction	5.3	-0.2	0.7	0.8	0.3
Processed fuel & lubricants	13.2	-0.2	5.6	-18.7	-16.6
Containers	0.5	-2.1	0.5	0.3	1.5
Supplies	6.7	1.9	2.5	5.3	0.5
Finished goods	26.1	-0.3	0.8	1.2	0.4
Finished consumer goods	8.4	0.2	1.3	1.2	0.9
Capital equipment	17.7	-0.4	0.6	0.9	0.3

¹ The series is for local production. Starting from January 2016, Producer Price Index for the domestic economy, import and export have been discontinued² Effective from 2015, the Producer Price Index has been revised to the new base year 2010=100, from 2005=100 previously

Source: Department of Statistics, Malaysia

Table A.16

Broad Money (M3)						
	Annual change					As at end
	2012	2013	2014	2015	2016	2016
	RM million					
Broad money (M3) ¹	111,211	107,470	101,490	40,780	47,861	1,642,449
Currency in circulation ²	3,971	5,913	5,319	8,613	8,817	85,460
Demand deposits	26,998	32,013	13,333	5,087	11,439	294,313
Broad quasi-money	80,242	69,545	82,838	27,079	27,605	1,262,675
<i>Fixed deposits</i>	60,894	66,957	39,956	25,342	26,002	772,188
<i>Savings deposits</i>	8,070	8,025	3,166	659	9,538	145,129
<i>NIDs</i>	-1,392	-1,626	4,005	-8,922	-934	8,321
<i>Repos</i>	2,150	100	-1,592	-497	0	0
<i>Foreign currency deposits</i>	14,090	4,434	15,397	42,034	-9,822	127,725
<i>Other deposits</i>	-3,570	-8,345	21,905	-31,536	2,821	209,312
Factors Affecting M3						
Net claims on Government	-3,339	21,164	34,317	-8,858	18,079	113,552
<i>Claims on Government</i>	868	15,794	31,336	-1,566	13,000	166,784
<i>Less: Government deposits</i>	4,207	-5,370	-2,981	7,292	-5,080	53,232
Claims on private sector	129,747	118,033	117,955	120,267	88,674	1,648,208
<i>Loans</i>	106,870	107,934	111,388	106,122	83,465	1,479,883
<i>Securities</i>	22,877	10,099	6,568	14,145	5,209	168,325
Net foreign assets	20,448	13,298	-9,952	22,003	-5,983	520,466
<i>Bank Negara Malaysia³</i>	4,095	14,185	-35,003	1,027	14,669	415,756
<i>Banking system</i>	16,353	-888	25,051	20,976	-20,652	104,710
Other influences	-35,645	-45,024	-40,830	-92,632	-52,909	-639,777

¹ Excludes interplacements among banking institutions

² Excludes holdings by the banking system

³ Includes exchange rate revaluation losses/gains

Note: Numbers may not add up due to rounding

Table A.17

Money Supply: Annual Change and Growth Rates

	2012		2013		2014		2015		2016	
	RM million	%	RM million	%	RM million	%	RM million	%	RM million	%
Currency in circulation	3,907	7.3	5,449	9.5	5,189	8.2	8,699	12.8	8,794	11.4
Demand deposits with commercial banks and Islamic banks	26,872	13.1	32,318	13.9	13,630	5.2	5,343	1.9	11,589	4.1
M1 ¹	30,779	11.9	37,768	13.0	18,820	5.7	14,042	4.1	20,383	5.7
Other deposits with commercial banks and Islamic banks ²	87,005	9.1	73,696	7.1	88,888	8.0	30,325	2.5	27,369	2.2
Deposits with other banking institutions ³	-6,574	-25.2	-3,993	-20.5	-6,218	-39.2	-3,588	-37.2	110	1.8
M3 ⁴	111,211	9.0	107,470	7.9	101,490	7.0	40,780	2.6	47,861	3.0

¹ Comprising currency in circulation and demand deposits of the private sector

² Comprising savings and fixed deposits, negotiable instruments of deposits (NIDs), repos and foreign currency deposits of the private sector placed with commercial banks and Islamic banks

³ Comprising call deposits, fixed deposits, negotiable instruments of deposits (NIDs), repos and foreign currency deposits of the private sector placed with merchant banks/investment banks. Excludes interplacements among the banking institutions

⁴ Comprising M1 plus other deposits of the private sector placed with commercial banks and Islamic banks and deposits of the private sector placed with other banking institutions, namely the merchant banks/investment banks

Note: Numbers may not add up due to rounding

Table A.18

Interest Rates (%)	As at end-year						
	2010	2011	2012	2013	2014	2015	2016
Overnight interbank	2.72	2.99	3.00	2.99	3.23	3.05	3.00
1-week interbank	2.77	3.01	3.01	3.02	3.30	3.13	3.02
1-month interbank	2.83	3.05	3.06	3.20	3.38	3.45	3.10
Commercial banks							
Fixed deposit							
3-month	2.74	2.99	2.97	2.97	3.13	3.13	2.92
12-month	2.97	3.22	3.15	3.15	3.31	3.31	3.06
Savings deposit	1.00	1.15	1.03	0.99	1.07	1.04	0.99
Base lending rate (BLR)	6.27	6.53	6.53	6.53	6.79	6.79	6.65
Weighted average base rate						3.77	3.61
Treasury bills (91 days) ¹	2.82	2.99	3.04	3.00	3.42	2.74	3.06
Malaysian Government Securities ¹							
1-year	2.85	2.82	3.01	3.03	3.48	2.59	3.26
5-year	3.39	3.23	3.24	3.66	3.84	3.47	3.70
Corporate bond ¹							
AAA							
3-year	3.63	3.65	3.53	3.71	4.00	4.13	4.25
5-year	4.07	3.99	3.80	3.96	4.27	4.37	4.40
AA							
3-year	4.34	4.29	4.04	4.16	4.33	4.49	4.61
5-year	4.75	4.65	4.30	4.41	4.60	4.73	4.78
A							
3-year	6.90	6.57	6.34	6.32	6.25	6.34	6.13
5-year	7.53	7.11	6.98	7.02	6.87	6.97	6.66
BBB							
3-year	10.40	10.21	10.06	10.02	10.16	9.90	9.17
5-year	11.43	11.24	11.14	11.17	11.17	11.13	10.12
BB & below							
3-year	12.78	12.62	12.53	12.52	13.03	12.55	11.31
5-year	14.51	14.13	13.76	13.70	14.60	13.89	12.69

¹ Source: FAST, Bank Negara Malaysia

Table A.19

Movements of the Ringgit

	RM to one unit of foreign currency ¹			Annual change (%)		Change (%)
	2005	2015	2016	2015	2016	21 Jul. '05 - Dec. '16
	21 Jul. ²	End-Dec.				
SDR	5.5049	5.9912	6.0394	-15.1	-0.8	-8.9
US dollar	3.8000	4.2920	4.4860	-18.6	-4.3	-15.3
Singapore dollar	2.2570	3.0356	3.1016	-12.9	-2.1	-27.2
100 Japanese yen	3.3745	3.5645	3.8442	-17.9	-7.3	-12.2
Pound sterling	6.6270	6.3607	5.5108	-14.5	15.4	20.3
Australian dollar	2.8823	3.1338	3.2436	-8.5	-3.4	-11.1
Euro	4.6212	4.6918	4.7238	-9.4	-0.7	-2.2
100 Thai baht	9.0681	11.922	12.517	-10.9	-4.7	-27.6
100 Indonesian rupiah	0.0386	0.0311	0.0334	-9.5	-6.9	15.8
100 Korean won	0.3665	0.3651	0.3720	-12.3	-1.8	-1.5
100 Philippine peso	6.8131	9.1494	9.0516	-14.7	1.1	-24.7
100 New Taiwan dollar	11.890	13.056	13.915	-15.2	-6.2	-14.6
Chinese renminbi	0.4591	0.6610	0.6455	-14.7	2.4	-28.9

¹ US dollar rates are the average of buying and selling rates at noon in the Kuala Lumpur Interbank Foreign Exchange Market

Rates for foreign currencies other than US dollar are cross rates derived from rates of these currencies against the US dollar and the RM/US dollar rate

² Ringgit shifted from a fixed exchange rate against the US dollar to a managed float against a basket of currencies

Table A.20

Financing of the Economy					
By customer	Businesses ¹		Households	Government	Total Financing
	Total	of which: SMEs			
By financing type/institution	RM million				
Net Change in Financing (2015)					
Financial Intermediaries					
Banking Institutions	47,737	33,782	58,996	-1,311	105,421
Development Financial Institutions (DFIs) ²	2,028	1,172	5,088	-	7,116
Other Domestic Intermediaries ³	-7,715	-182	6,873	-	-842
Capital Market					
Bond Market ⁴	47,372	-	-	38,931	86,302
Equity Market	17,919	-	-	-	17,919
External Financing					
Foreign Direct Investment	43,435	-	-	-	43,435
Offshore Borrowing ⁵	66,468	-	-	4,701	71,169
Total	217,244	34,773	70,956	42,320	330,520
Net Change in Financing (2016p)					
Financial Intermediaries					
Banking Institutions	29,858	23,936	43,222	3,287	76,367
Development Financial Institutions (DFIs) ²	1,858	646	5,911	-	7,769
Other Domestic Intermediaries ³	-8,431	-65	7,602	-	-829
Capital Market					
Bond Market ⁴	29,909	-	-	37,859	67,768
Equity Market	7,090	-	-	-	7,090
External Financing					
Foreign Direct Investment	41,176	-	-	-	41,176
Offshore Borrowing ⁵	51,421	-	-	-391	51,031
Total	152,881	24,518	56,735	40,755	250,371

¹ Businesses include domestic banking institutions, non-bank financial institutions, other non-business entities and foreign entities

² Refers to DFIs governed under the Development Financial Institutions Act, 2002

³ Other domestic intermediaries include insurance companies, Employees Provident Fund (EPF), housing credit institutions, leasing and factoring companies, and Lembaga Pembiayaan Perumahan Sektor Awam (previously Treasury Housing Loans Division)

⁴ Refers to the change in outstanding corporate bonds (CBs) and Government securities (Malaysian Government Securities and Government Investment Issues), held by both residents and non-residents. Data excludes Cagamas bonds, short-term papers and issuances by non-residents

⁵ Refers to all offshore borrowings under the redefined external debt effective first quarter 2014, except short-term offshore borrowings by the banking sector

p Preliminary

Note: Numbers may not add up due to rounding

Table A.21

Consolidated Public Sector Finance					
	2013	2014	2015	2016 ^p	2017 ^f
	RM billion				
Revenue ¹	192.4	202.0	212.0	222.3	231.2
% growth	1.9	5.0	4.9	4.8	4.0
Operating expenditure	237.0	241.3	241.1	235.8	241.1
% growth	4.3	1.8	-0.1	-2.2	2.3
Current balance of NFPCs ²	137.4	122.0	77.4	81.6	83.6
Total public sector current balance	92.8	82.7	48.3	68.1	73.7
% of GDP	9.1	7.5	4.2	5.5	5.6
Development expenditure ³	139.4	164.5	138.6	158.1	158.7
% growth	0.7	18.0	-15.7	14.1	0.3
General Government ⁴	49.5	49.6	49.2	51.1	55.9
NFPCs	89.9	114.9	89.4	107.0	102.8
Overall balance	-46.6	-81.8	-90.3	-90.0	-84.9
% of GDP	-4.6	-7.4	-7.8	-7.3	-6.5

¹ Excludes transfers within General Government

² Refers to 29 NFPCs from 2014 onwards

³ Adjusted for transfers and net lending within public sector

⁴ Comprises of Federal Government, state and local governments, and statutory bodies

^p Preliminary

^f Forecast

Note: Numbers may not add up due to rounding

Source: Ministry of Finance, Malaysia and Non-Financial Public Corporations (NFPCs)

Acronyms and Abbreviations

ABIF	ASEAN Banking Integration Framework
ADB	Asian Development Bank
AFC	Asian Financial Crisis
AFI	Alliance for Financial Inclusion
ALR	average lending rate
AMC	Asset management companies
AOIR	average overnight interbank rate
ASA	ASEAN Swap Arrangement
ASB	Asia School of Business
AUM	Assets under Management
BA	banker's acceptance
BAC	Board Audit Committee
BCSA	Bilateral Currency Swap Arrangement
BGC	Board Governance Committee
BIS	Bank for International Settlements
BNMN	Bank Negara Monetary Notes
BOE	Bank of England
BOJ	Bank of Japan
BR	base rate
BR1M	Bantuan Rakyat 1Malaysia
Brexit	UK's EU referendum
CBA 2009	Central Bank of Malaysia Act 2009
CIA	Collection Intelligence Arrangement
CMIM	Chiang Mai Initiative Multilateralisation
COF	cost of funds
CPI	Consumer Price Index
CPO	crude palm oil
CSS	Centralised Shared Services
DFIs	development financial institutions
DIA	Direct investment abroad
E&E	electronics and electrical
E&O	errors and Omissions
ECB	European Central Bank
ELOs	Economic Liaison Officers
EPF	Employees Provident Fund
ETP	Economic Transformation Programme
EU	European Union

FBM KLCI	FTSE Bursa Malaysia Kuala Lumpur Composite Index
FDI	foreign direct investment
Fed	Federal Reserve
FinTech	financial technology
FMC	Financial Markets Committee
FOMC	Federal Open Market Committee
FPC	Fiscal Policy Committee
FSC	Financial Stability Committee
FSPs	financial service providers
FTEG	Financial Technology Enabler Group
FTP	Financial Transaction Plan
GBI-EM	Government Bond Index – Emerging Markets
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GFCF	gross fixed capital formation
GII	Government Investment Issues
GNI	gross national income
GNS	gross national savings
GST	Goods and Services Tax
HCB	Housing Cost Burden
HQLA	high quality liquid asset
IAD	Internal Audit Department
IILM	International Islamic Liquidity Management Corporation
IIP	International Investment Position
ILO	International Labour Organisation
IMF	International Monetary Fund
INCEIF	International Centre for Education in Islamic Finance
IOFCs	International Offshore Financial Centres
IORWG	Operational Risk Working Group
LCR	Liquidity Coverage Ratio
LDP	Leadership Development Programme
LIA	Liquidity Investment Arrangement
LRT	Light Rail Transit
MEF	Malaysian Employers Federation
MFRS	Malaysian Financial Reporting Standards
MGII	Malaysian Government Investment Issues
MGS	Malaysian Government Securities
MM	Median Multiple
MNCs	multinational corporations

MOOC	Massive Open Online Courses
MPC	Monetary Policy Committee
MPS	Monetary Policy Statement
MRT	Mass Rapid Transit
MSCI	Morgan Stanley Capital International
NAB	New Arrangements to Borrow
NDF	non-deliverable forward
NEER	nominal effective exchange rate
NID	negotiable instrument of deposits
OPEC	Organisation of Petroleum Exporting Countries
OPR	Overnight Policy Rate
OTC	Over-The-Counter
PPI	Producer Price Index
PPP	public-private partnership
PR China	The People's Republic of China
RCLF	Restricted Committed Liquidity Facility
RI	Residual Income
ROA	return on assets
SAC	Shariah Advisory Council
SDR	Special Drawing Rights
SESRIC	Statistical, Economic and Social Research and Training Centre for Islamic Countries
S-I	saving-investment
SMEs	small and medium enterprises
SRR	Statutory Reserve Requirement
STC	Structured Technical Curriculum
SWA	Staff Welfare Account
UK	United Kingdom
US	United States
VSS	voluntary separation scheme