

2014

ECONOMIC DEVELOPMENTS IN 2014

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THE INTERNATIONAL ECONOMIC ENVIRONMENT

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

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

Moderate expansion in the global economy

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

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

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

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

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

Table 1.1

World Economy: Key Economic Indicators

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

¹ Refers to EU-18

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

³ Inflation refers to harmonised composite price index

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

e Estimate

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

Benign inflationary pressures

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

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

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

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

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

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

Global policy stance remained supportive of growth

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

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

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

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

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

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

Table 1.2

Malaysia - Key Economic Indicators

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

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

² Exclude stocks

³ All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank's account

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

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

⁶ Based on average USD exchange rate for the period of January-February 2015

^p Preliminary

^f Forecast

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 1.3

Malaysia - Financial and Monetary Indicators

FEDERAL GOVERNMENT FINANCE (RM billion)	2012		2013		2014^p	
Revenue	207.9		213.4		220.6	
Operating expenditure	205.5		211.3		219.6	
Net development expenditure	44.3		40.7		38.4	
Overall balance	-42.0		-38.6		-37.4	
Overall balance (% of GDP)	-4.5		-3.9		-3.5	
Public sector net development expenditure	138.4		133.3		155.3	
Public sector overall balance (% of GDP)	-5.0		-3.9		-7.0	
EXTERNAL DEBT¹						
Total debt (RM billion)	602.1		696.6		744.7	
Medium- and long-term debt	318.6		357.8		383.9	
Short-term debt	283.5		338.8		360.8	
Debt service ratio ² (% of exports of goods and services)						
Total debt	17.4		17.6		18.2	
Medium- and long-term debt	17.3		17.5		18.1	
MONEY AND BANKING						
	Change in 2012		Change in 2013		Change in 2014	
	RM billion	%	RM billion	%	RM billion	%
Money supply M1	30.8	11.9	37.8	13.0	18.8	5.7
M3	111.2	9.0	107.5	7.9	101.5	7.0
Banking system deposits	109.4	8.4	116.9	8.3	116.4	7.6
Banking system loans ³	104.5	10.4	117.7	10.6	114.1	9.3
Loan-deposit ratio (end of year) ⁴	82.1		84.8		86.7	
Financing-deposit ratio ^{4,5}	88.7		91.3		93.3	
INTEREST RATES (AS AT END-YEAR)						
	2012		2013		2014	
	%		%		%	
Overnight Policy Rate (OPR)	3.00		3.00		3.25	
Interbank rates (1-month)	3.06		3.20		3.38	
Commercial banks						
Fixed deposit 3-month	2.97		2.97		3.13	
12-month	3.15		3.15		3.31	
Savings deposit	1.03		0.99		1.07	
Base lending rate (BLR)	6.53		6.53		6.79	
Treasury bill (3-month)	3.04		3.00		3.42	
Malaysian Government Securities (1-year) ⁶	3.01		3.03		3.48	
Malaysian Government Securities (5-year) ⁶	3.24		3.66		3.84	
EXCHANGE RATES						
	2012		2013		2014	
Movement of Ringgit (end-period)	%		%		%	
Change against SDR	3.9		-7.3		-0.7	
Change against USD	3.9		-6.8		-6.1	

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

² Includes prepayment of medium- and long-term debt

³ Includes loans sold to Cagamas

⁴ Deposits exclude deposits accepted from banking institutions. Loans exclude loans sold to Cagamas and loans extended to banking institutions

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

⁶ Refers to data from FAST, Bank Negara Malaysia

^p Preliminary

Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

Chart 1.1

Cumulative Movements of Policy Rates (2014)



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

Source: National Authorities

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

THE MALAYSIAN ECONOMY

Overview

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

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

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

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

Table 1.4

Real GDP by Expenditure (2005=100)

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

¹ Excluding stocks

^p Preliminary

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Domestic demand remained the key driver of growth

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

Private consumption remained firm, supported by strong fundamentals

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

Table 1.5

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

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

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

^p Preliminary

Source: Department of Statistics, Malaysia

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

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

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

Stable Labour Market Conditions

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

Table 1

Selected Labour Market Indicators

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

^p Preliminary

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

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

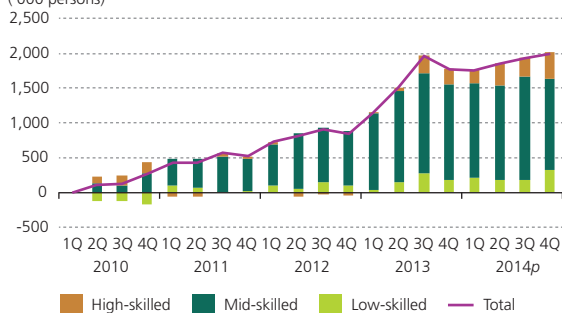
Total employment expanded to 13.6 million workers (2013: 13.2 million workers) with net addition of 366,300 jobs. The net addition to employment was mainly in the services sector (351,900 jobs), particularly in the distributive trade, accommodation and restaurant sub-sectors. Employment in the manufacturing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

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

Chart 1

Employment Growth by Skill Levels

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



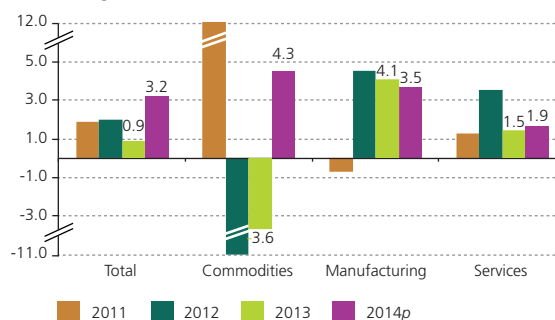
^p Preliminary

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

Chart 2

Labour Productivity Growth by Sectors

Annual change (%)



^p Preliminary

Source: Department of Statistics, Malaysia

Higher Growth across All Economic Sectors

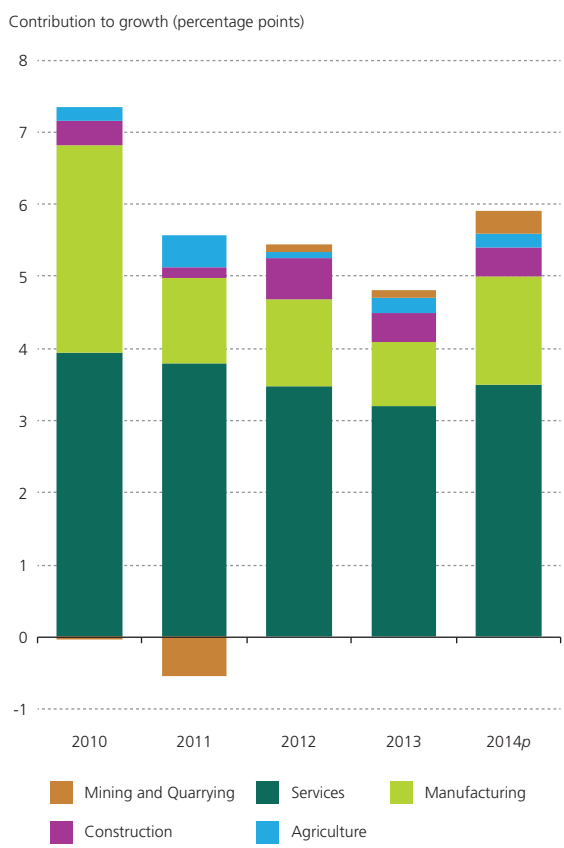
On the supply side, all economic sectors recorded higher growth in 2014, driven by domestic activities and the improvement in external trade performance.

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

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

Chart 1

Real GDP by Economic Activity



^p Preliminary
 Source: Department of Statistics, Malaysia

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

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

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

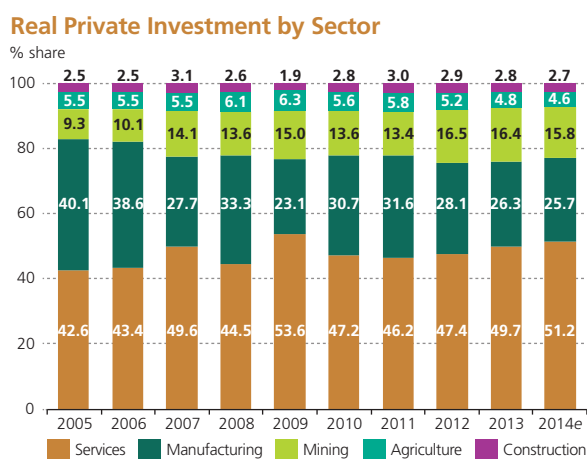
During the year, GFCF was mainly supported by investment in both structures, and machinery and equipment. Growth in investment in structures remained robust at 9.9% (2013: 11%), reflecting strong performance across all construction sub-sectors. Investments in machinery and equipment registered a decline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

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

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

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

Chart 1.2



e Estimate

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

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

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

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

Debunking Malaysia's Investment Myths

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

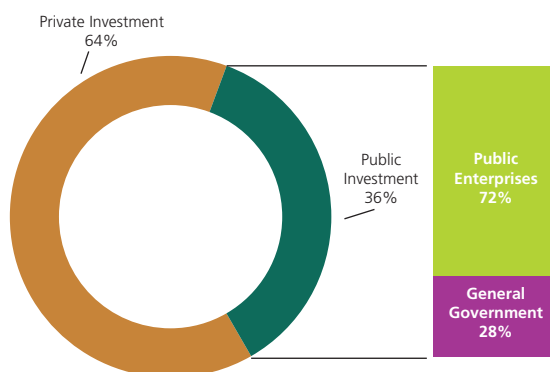
Myth #1: The strong performance in investment has been driven by the Government and Government-linked enterprises

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

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

Chart 1

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



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

Myth #2: Most investment is in the property sector

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

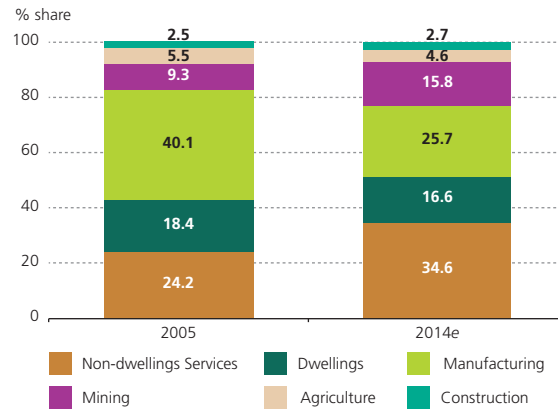
Broad property: The share of investment in broad property, which consists of residential property, office and commercial spaces, has remained at 18% of total investment since 2005.

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

² Source: CEIC database.

Chart 2

Real Private Investment by Sector



e Estimate

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

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

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

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

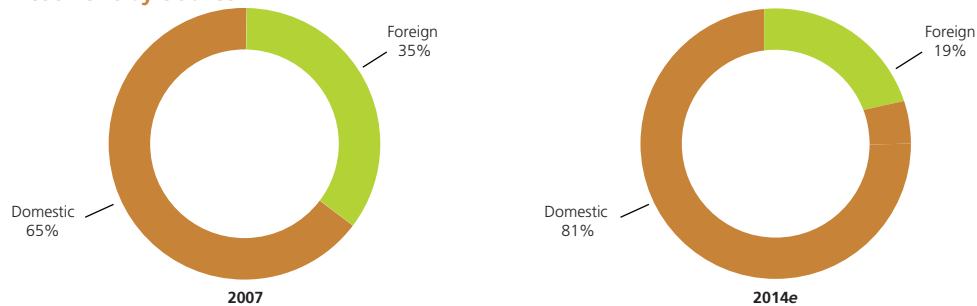
Going forward, the share of investment in the oil and gas sector is expected to decline slightly, but remain supported by new projects in the pipeline, including the Pengerang Integrated Petroleum Complex (PIPC).

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

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

Chart 3

Private Investment by Source



e Estimate

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

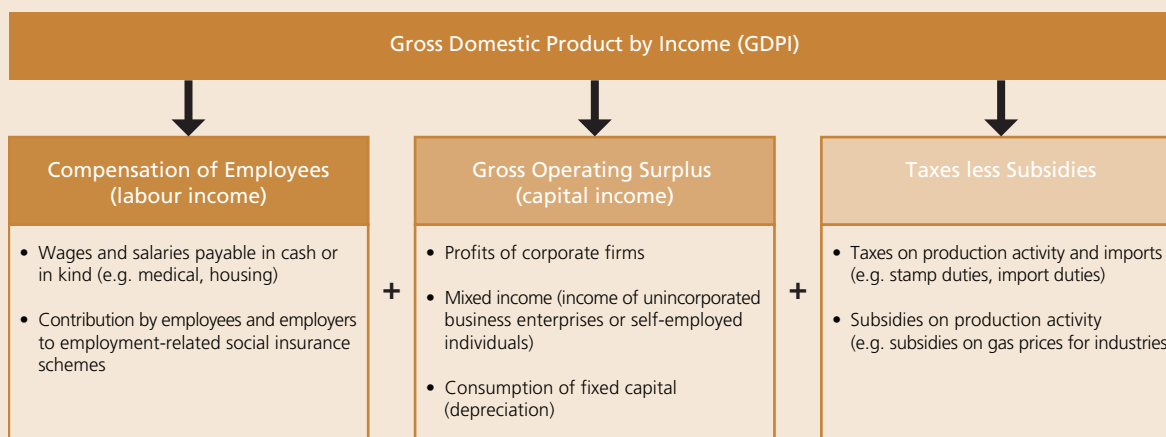
Trends in Malaysia's Gross Domestic Product by Income

Introduction

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

Diagram 1

GDPI Consists of Three Components



Source: Department of Statistics, Malaysia

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

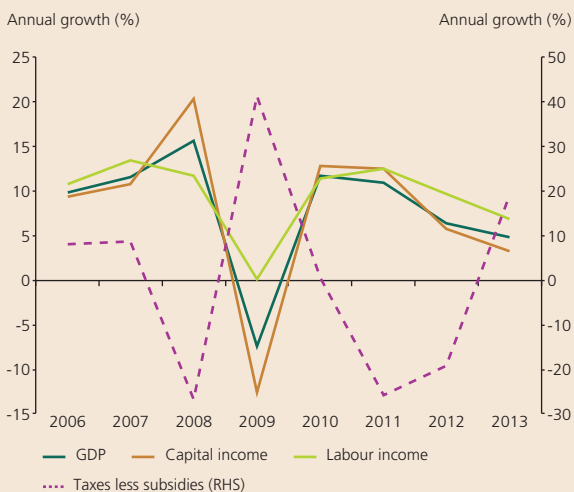
Growth trends of labour and capital income

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

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

Chart 1

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



Source: Department of Statistics, Malaysia

Chart 2

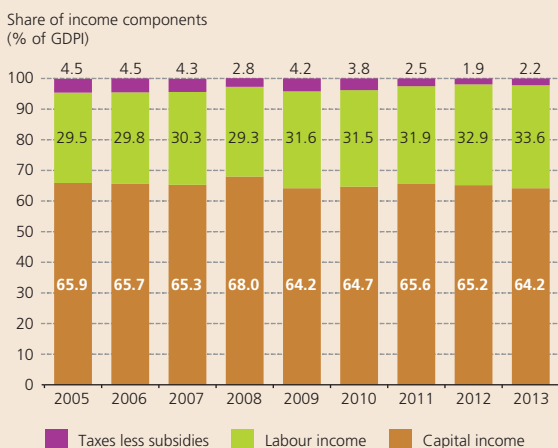
Average Growth in Labour Income Outpace Capital Income Growth, Driven by Key Sectors



Source: Department of Statistics, Malaysia

Chart 3

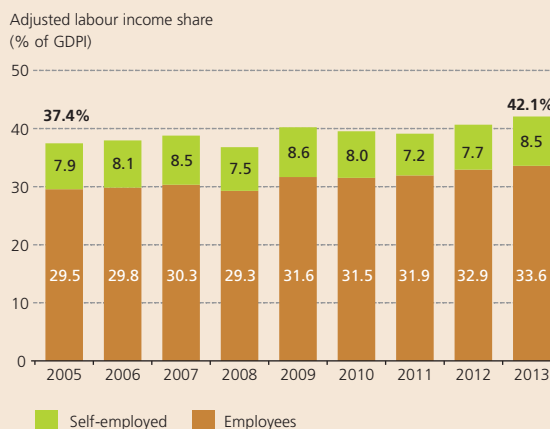
The Largest Component of GDP is Capital Income



Source: Department of Statistics, Malaysia

Chart 4

Labour Income Share Has Been Increasing Since 2005



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

Trends in share of labour income

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

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

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

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

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

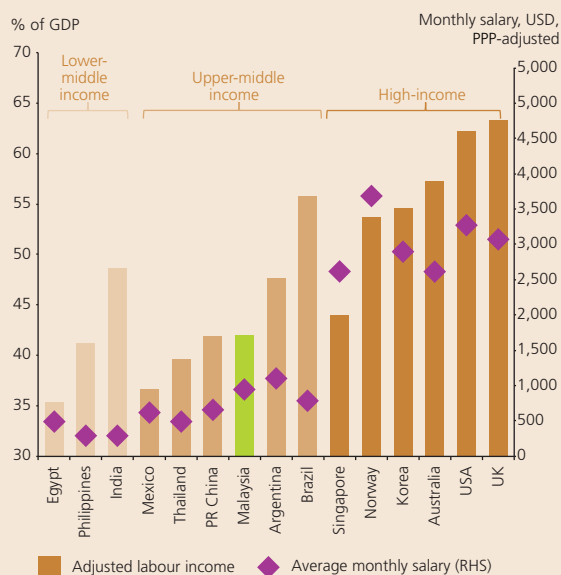
Cross-country comparison of labour income shares

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

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

Chart 5

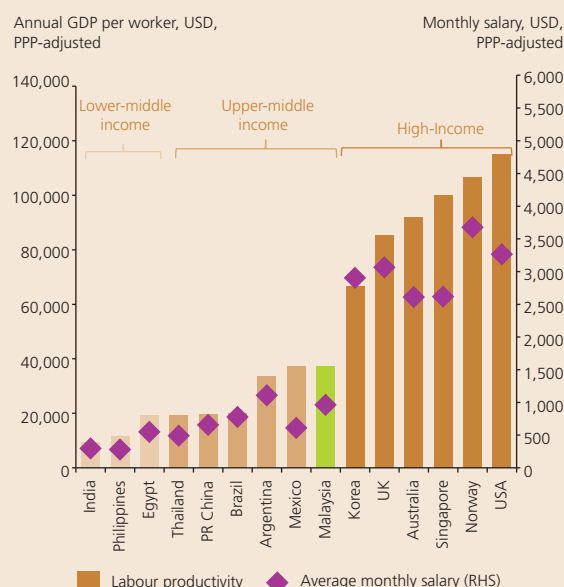
High Labour Income Shares Do Not Correspond with High Average Salaries



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

Chart 6

Average Salaries Generally Coincide with Labour Productivity



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

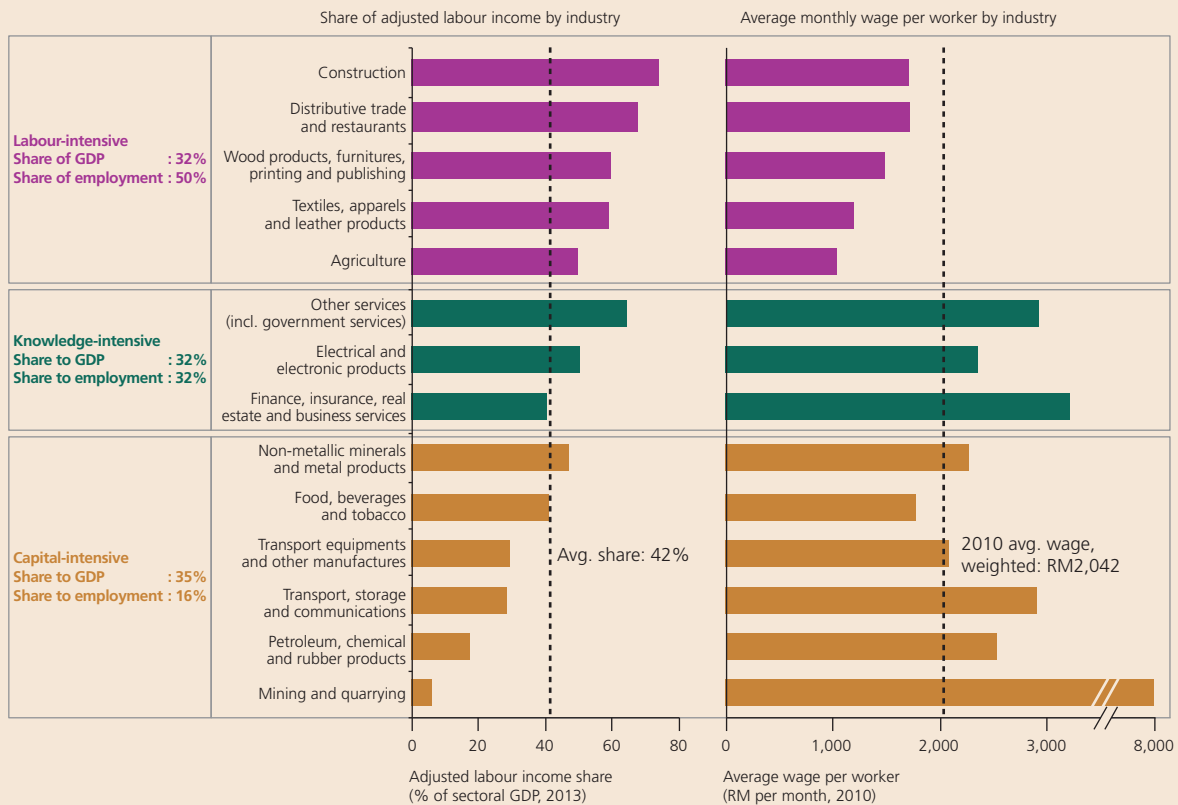
The cross-country variations are the outcome of differences in economic structures. Economies that are more involved in low-productivity, labour-intensive industries tend to have lower average wages but will have a high share of labour income in GDP due to the large pool of low-skilled workers. On the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

Sectoral analysis of labour income shares and average wages in Malaysia

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

Chart 7

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



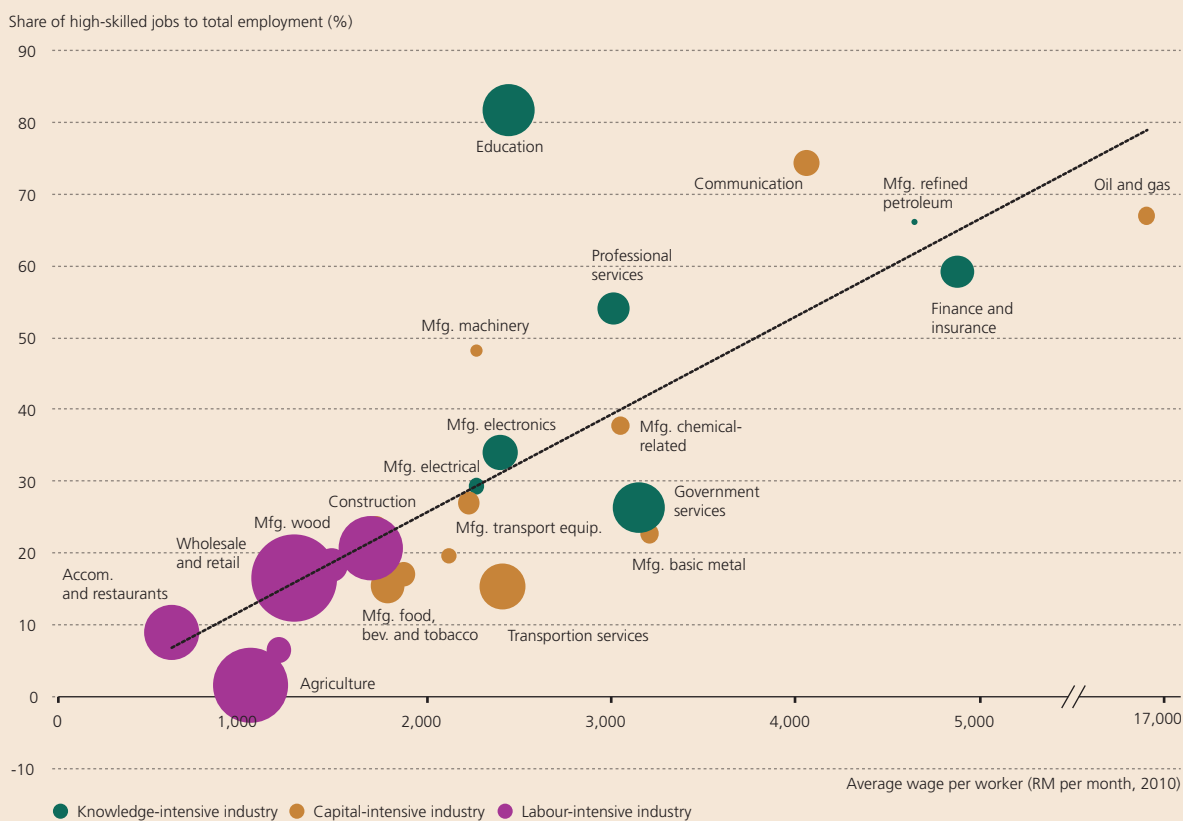
Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

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

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

Chart 8

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



Note: Size of bubble represents the relative size of each industry's employment to total employment

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

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

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

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

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

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

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

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

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

Conclusion

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

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EXTERNAL SECTOR

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

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

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

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

Table 1.6

Balance of Payments¹

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

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

² Asset flows also referred to as 'Outward direct investment'; while liability flows are also referred to as 'Inward direct investment'

³ Includes unrealised foreign exchange revaluation gains/losses on international reserves

^p Preliminary

Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Table 1.7

External Trade

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

¹ Including machinery and equipment

^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

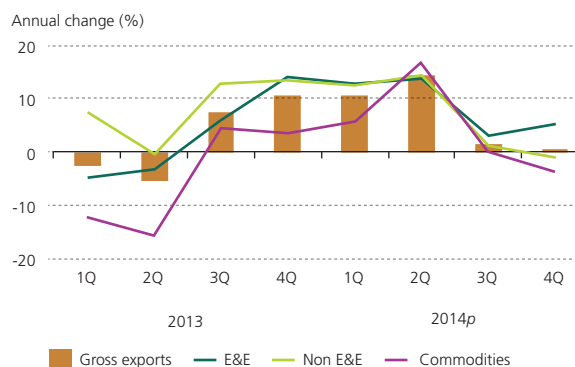
sub-segments such as automotive components and mobile devices. The continued growth in the regional economies and strong re-export activity supported the performance of non-E&E manufactured exports (1H 2014: 13.4%) such as petroleum products, chemicals and chemical products as well as optical and scientific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

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

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

Chart 1.3

Export Performance



^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

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

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

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

Chart 1.4

Import Performance



^p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

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

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

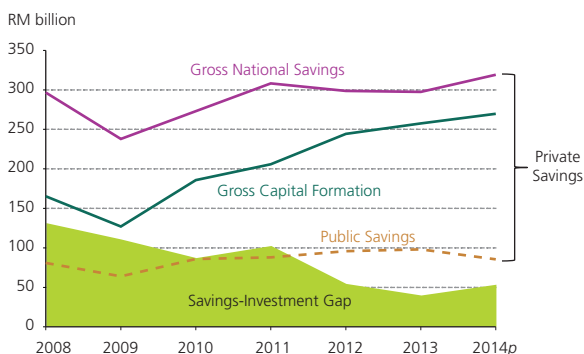
which more than offset the public sector S-I deficit, contributed to the higher S-I surplus during the year. Private sector savings increased at a faster rate of 18.3% to RM235.7 billion (2013: -1.7% and RM199.3 billion, respectively), while private gross capital formation expanded by 10.2% (2013: 7.1%).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

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

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

Chart 1.5

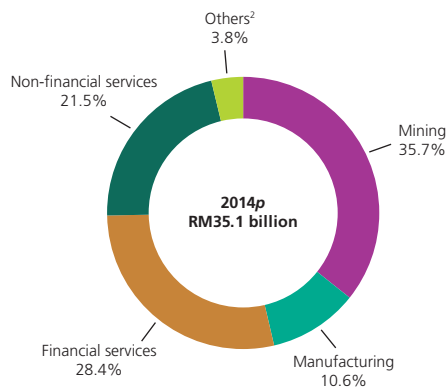
Gross National Savings and Savings-Investment Gap



^p Preliminary

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

Chart 1.6

Net Foreign Direct Investment by Sectors¹

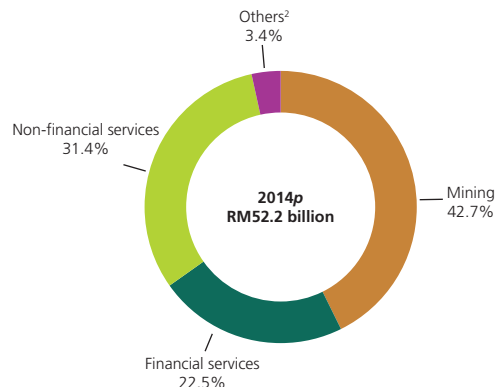
¹ Foreign direct investment as defined according to the 5th Edition of the Balance of Payments Manual (BPM5) by the International Monetary Fund (IMF)

² Refers to agriculture and construction sectors

p Preliminary

Source: Department of Statistics, Malaysia

Chart 1.7

Net Direct Investment Abroad by Sectors¹

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

² Refers to agriculture, construction and manufacturing sectors

p Preliminary

Source: Department of Statistics, Malaysia

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

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

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

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

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

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

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

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

Chart 1.8

Portfolio Investment



p Preliminary

Source: Department of Statistics, Malaysia

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

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

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

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

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

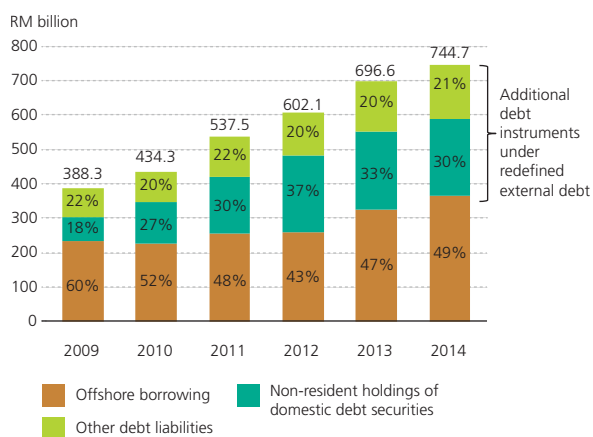
Manageable external debt

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

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

Chart 1.9

Outstanding External Debt (end-period)

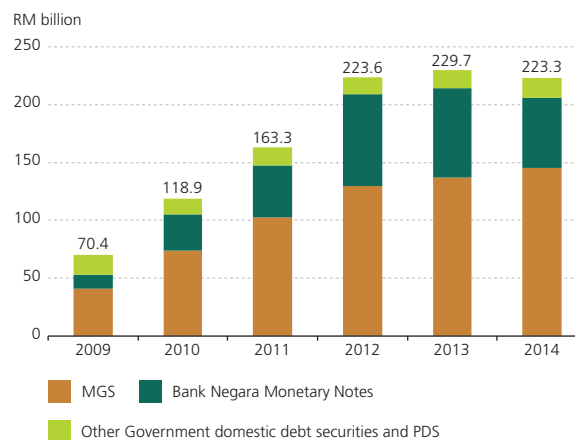


Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

² For more information, please refer to the box article titled 'The Redefinition of External Debt' in the Quarterly Bulletin on Economic and Financial Developments in the Malaysian Economy in the first quarter of 2014.

Chart 1.10

Non-Resident Holdings of Domestic Debt Securities



Source: Bank Negara Malaysia

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

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

Table 1.8

Outstanding External Debt

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

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

² Comprise trade credits, IMF allocation of SDRs and miscellaneous

³ Equivalent to short-term offshore borrowing

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

⁵ Based on international reserves as at 27 February 2015

Note: NR refers to non-residents

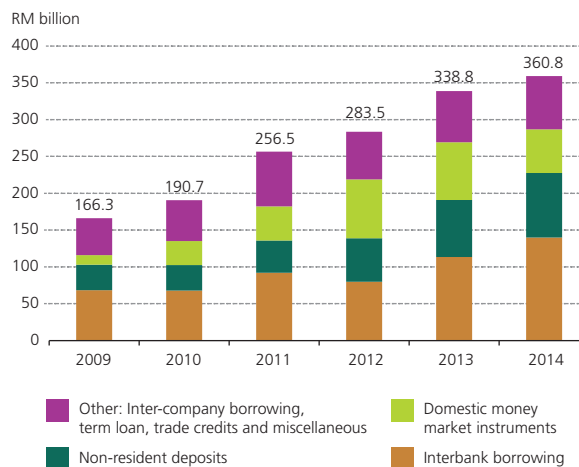
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

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

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

Chart 1.11

Short-Term External Debt by Instruments



Source: Bank Negara Malaysia

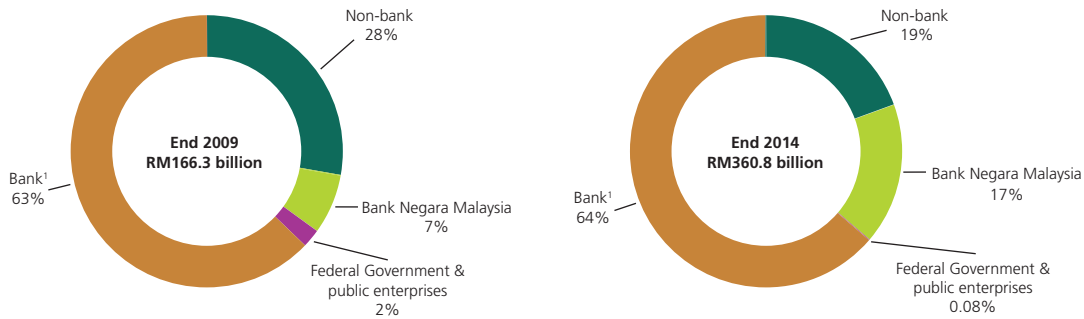
management. Under this arrangement, offshore subsidiaries and branches of domestic banks had increasingly placed funds with their head offices in Malaysia. This is deemed as a more cost-effective and efficient management of foreign currency liquidity. For the locally incorporated foreign banks operating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

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

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

Chart 1.12

Short-Term External Debt by Sector



¹ Include other debt liabilities, apart from interbank borrowing and non-resident deposits
 Note: Numbers may not necessarily add up due to rounding
 Source: Bank Negara Malaysia

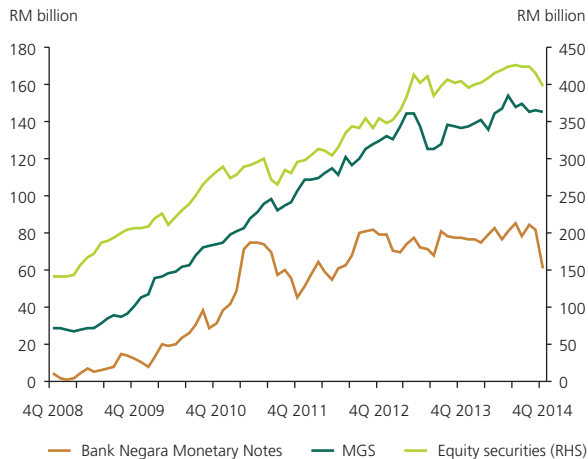
resilient. Even a severe depreciation of the ringgit against the US dollar would have limited impact on their debt servicing capacity and solvency position. In addition, the maturity profile of Malaysia’s external debt remained healthy, with more than half skewed towards the medium- and long-term tenure.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

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

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

Chart 1.13

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



Source: Bank Negara Malaysia

Resilience against external shocks

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

INFLATION DEVELOPMENTS

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

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

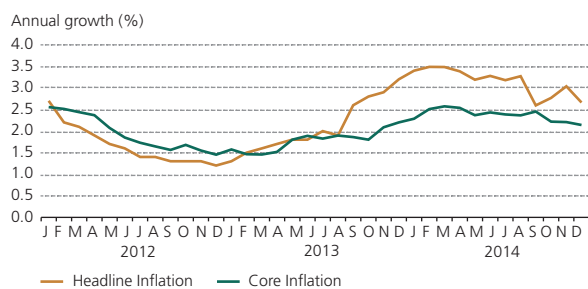
category registered a higher rate of inflation of 4.9% (2013: 2.0%) due to higher retail fuel prices during the year. Inflation in the *alcoholic beverages and tobacco* category also increased significantly by almost twofold to 11.6% (2013: 6.0%), primarily from higher cigarette prices. Inflation in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

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

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

Chart 1.14

Consumer Price Inflation

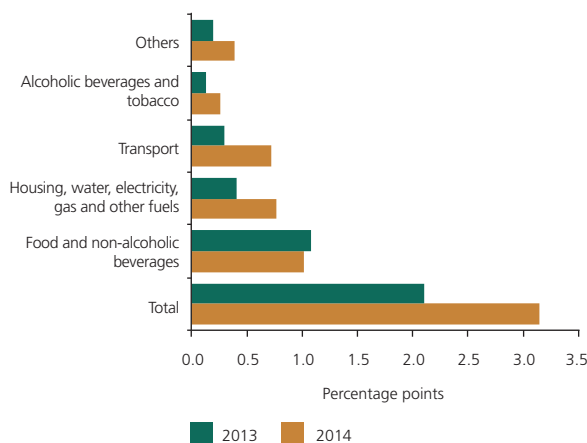


Source: Department of Statistics, Malaysia and Bank Negara Malaysia

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

Chart 1.15

Contribution to Inflation



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

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

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

Table 1.9

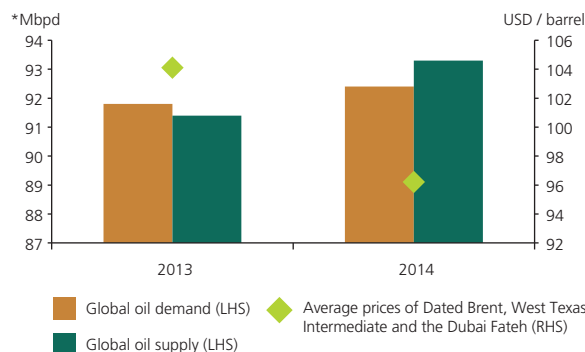
Adjustments in Administered Prices in late 2013 and 2014

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

⁴ The IMF Food Price Index includes cereal, vegetable oils, meat, seafood, sugar, bananas and oranges price indices.
⁵ Simple average of price of Dated Brent, West Texas Intermediate and the Dubai Fateh crude oil.
⁶ Global crude oil prices were elevated in the first half of the year amid heightened geopolitical tensions in major oil producing countries in the Middle East.

Chart 1.16

Global Demand, Supply and Price of Crude Oil



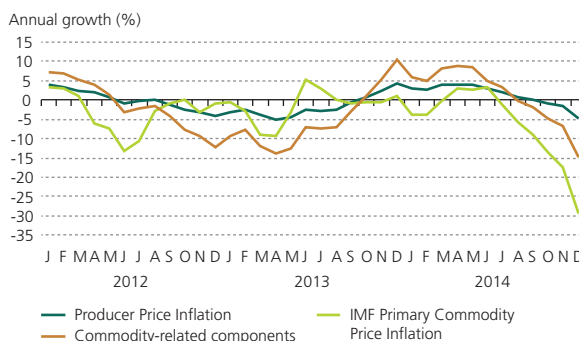
*Mbbpd = Million barrels per day
 Source: International Energy Agency (IEA) and International Monetary Fund (IMF)

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

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

Chart 1.17

Producer Price Inflation and IMF Primary Commodity Price Inflation

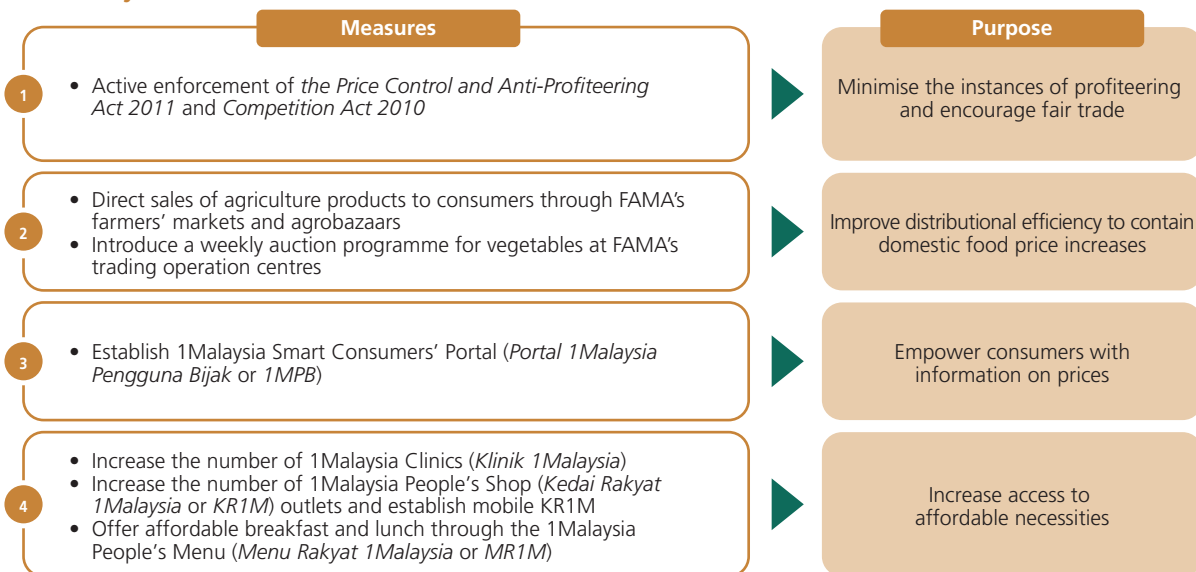


Note: 1. Commodity-related components in Producer Price Index (PPI) include crude materials, inedible; mineral fuels, lubricants, etc.; and animal and vegetable oils and fats
 2. Non-commodity related components in PPI include food; beverages and tobacco; chemicals; manufactured goods; machinery and transport equipment; miscellaneous manufactured articles; and miscellaneous transactions and commodities

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

Table 1.10

Measures by the Government to Contain Price Increases



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

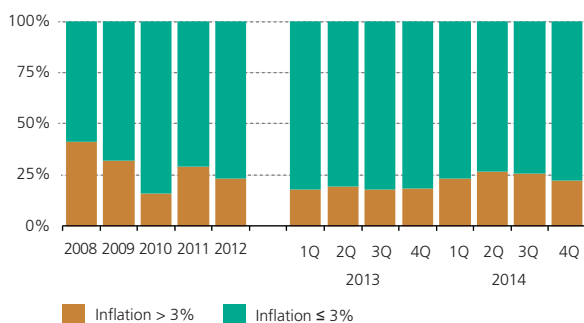
The extent of spillovers on prices of other goods and services was also mitigated by the ability of firms to accommodate some of the increase in domestic cost pressures. This is attributable to two factors. First, findings from the Bank's survey suggested that transportation and utilities costs constitute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

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

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

Chart 1.18

Percentage of Core CPI Components Registering Inflation Above 3%



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

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

