社会经济研究中心

SOCIO-ECONOMIC RESEARCH CENTRE

UCSI's Malaysia's Economic Model Forum

Malaysia: Where do we go from here?

Lee Heng Guie
Executive Director, SERC

14 October 2017

Agenda

- Malaysia's economic management in perspective
- Malaysia's economy: Now and prospects
- But, there are risks to the macro story
- Conclusion

Key messages

Malaysia remains resilient to external challenges

- Domestic demand remains the dominant driver of growth
- Unrelentingly consumer spending
- Private investment growth supported by public-and private-initiated projects

Macroeconomic fundamentals remain supportive of growth

- Diversified sources of growth
- Diversified export and product markets
- Stable labor market conditions and young demographic dividends
- Conducive investment destination for FDI
- Strong and stable financial system

Malaysia faces challenges in a position of strength

- The Malaysian economy is gaining ground but growth remains vulnerable
- Step-up structural policy actions to boost growth potential and productivity
- Address as well as contain vulnerabilities to build economic resilience

Section 1:

Malaysia's economic management in perspective

Malaysia has a track record of economic reinvention through timely policy formulation and implementation

1960s	1980s	1990s	2000s
Agriculture Diversification	Industrialization	Increased connectivity	Services-based economy

Game-changing policies

Diversification of commodities	**Industrialisation** *Attracted FDI* *Promotion of Invst. Act*	**Physical connectivity** *North-South Highway*	**Services sector enabler** *Financial sector reforms* *High speed broadband*

Major global shifts

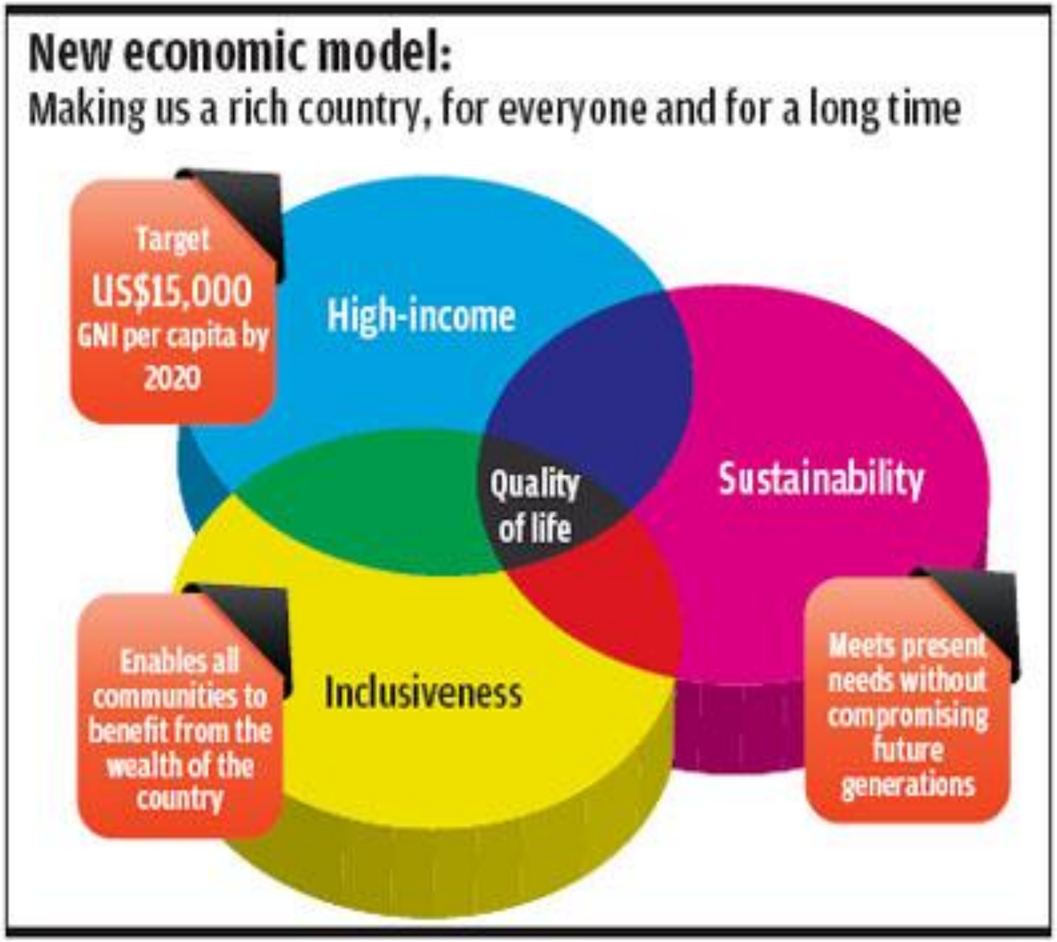
More global demand for commodities	**Plaza Accord** *Japanese firms* *Investing abroad*	**Rise of global value chain**	**China's integration with the world** **High commodity prices**

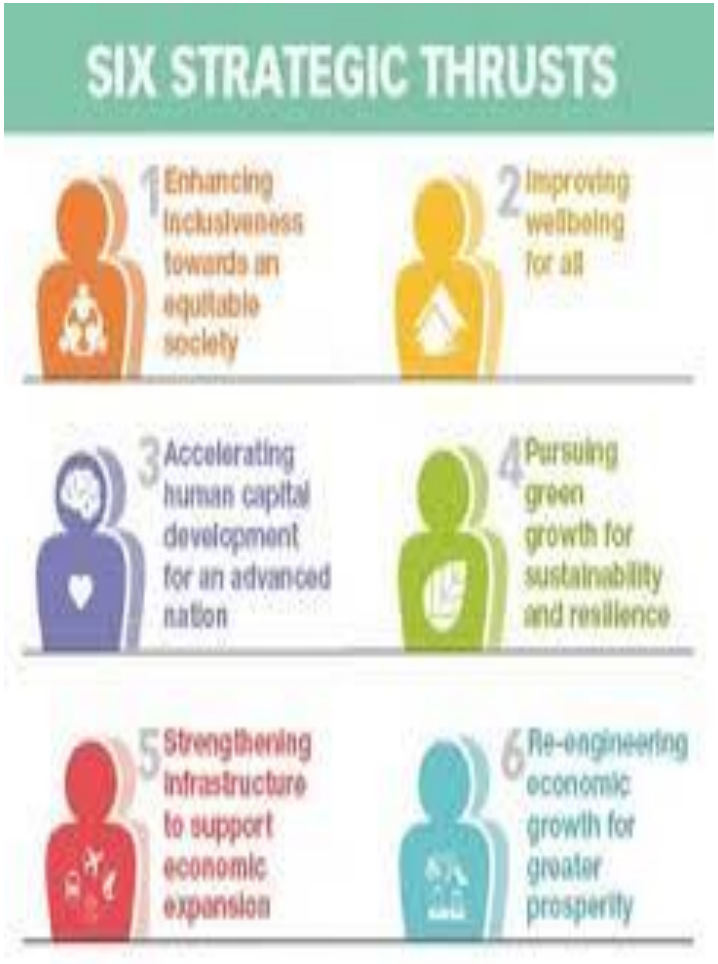
Rapid rise of industrial commodities *CPO: 39% to 83% of total agriculture (1960-1979)*	**Substantial increase in FDI and enhanced physical infrastructure** *Net FDI: RM2bn to RM15bn (1980-1995)* *Road coverage: 26,000 km to 54,000 km (1980-1990)*	**Rising share of services sector** *Services sector: 49% to 54% of GDP (2000-2016)*

Source: Bank Negara Malaysia

Taking the road less travelled towards high income

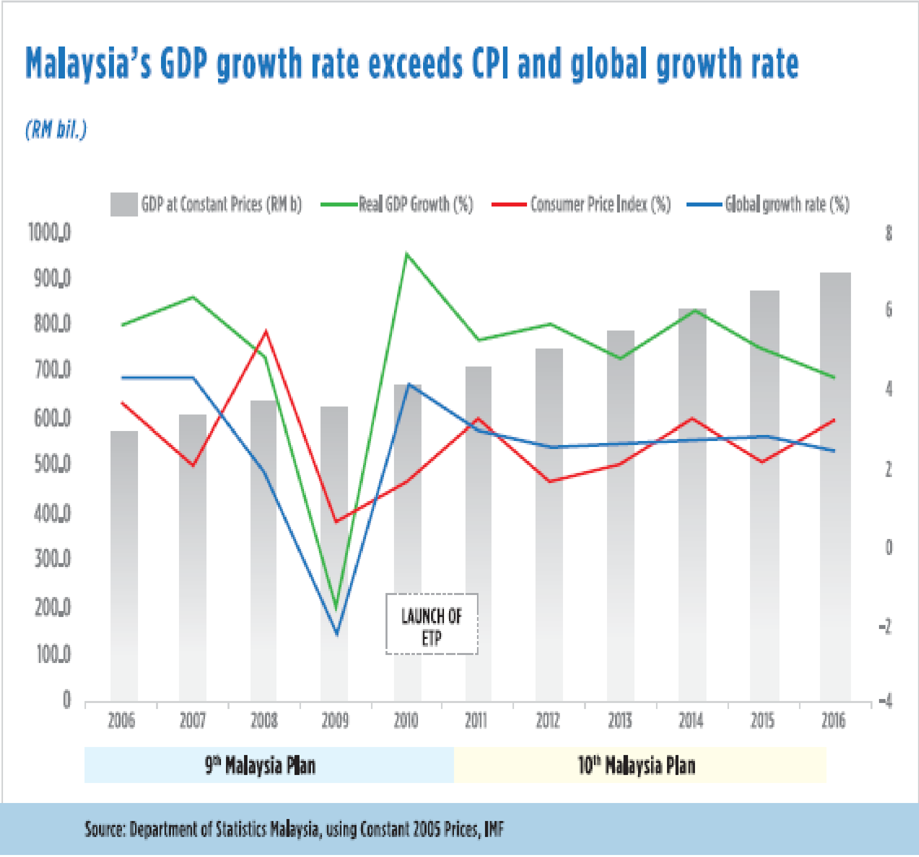
- Private sector-driven development to achieve sustainable growth. The NTP also focuses on enhancing inclusiveness within the economy through socioeconomic outcomes

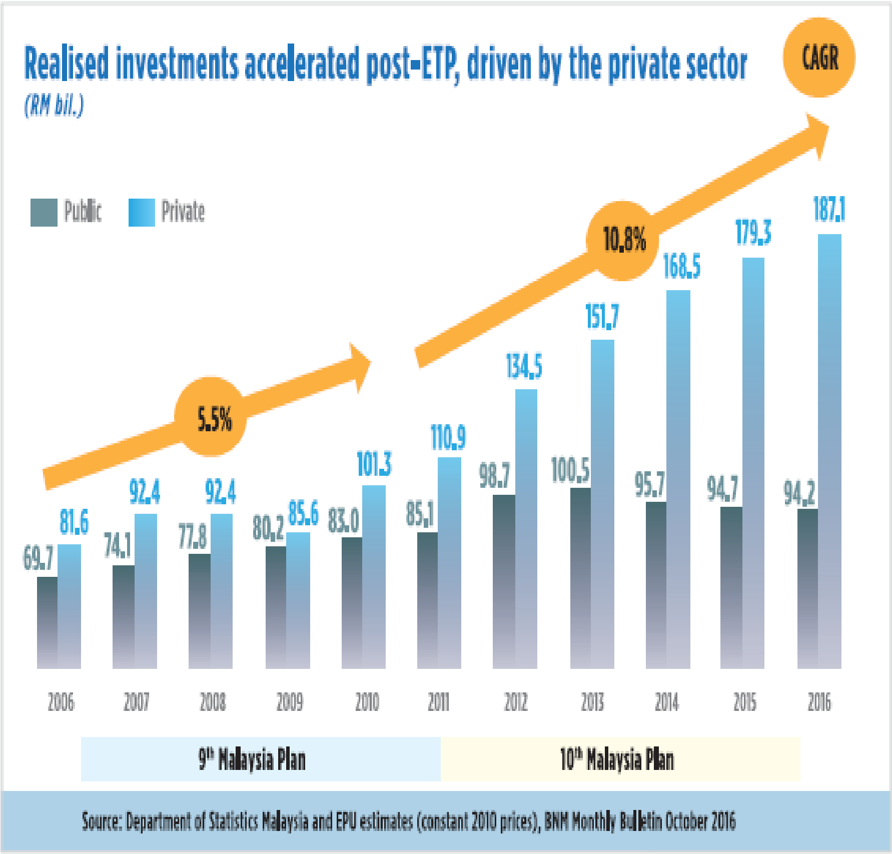




Sustainable and resilient economic growth

- Powered by domestic demand, thanks to supportive fiscal, monetary and financial policies and initiatives

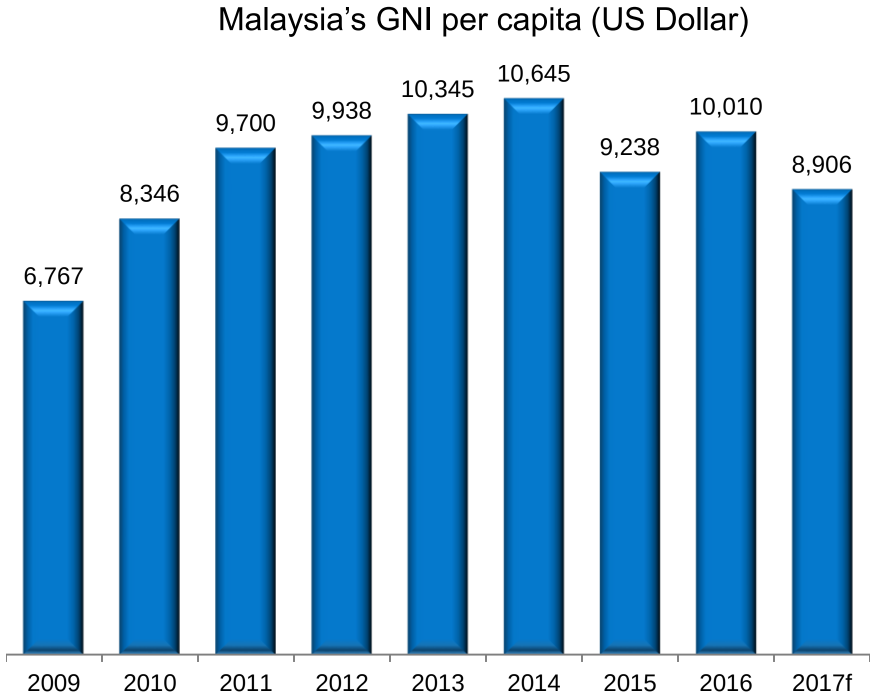


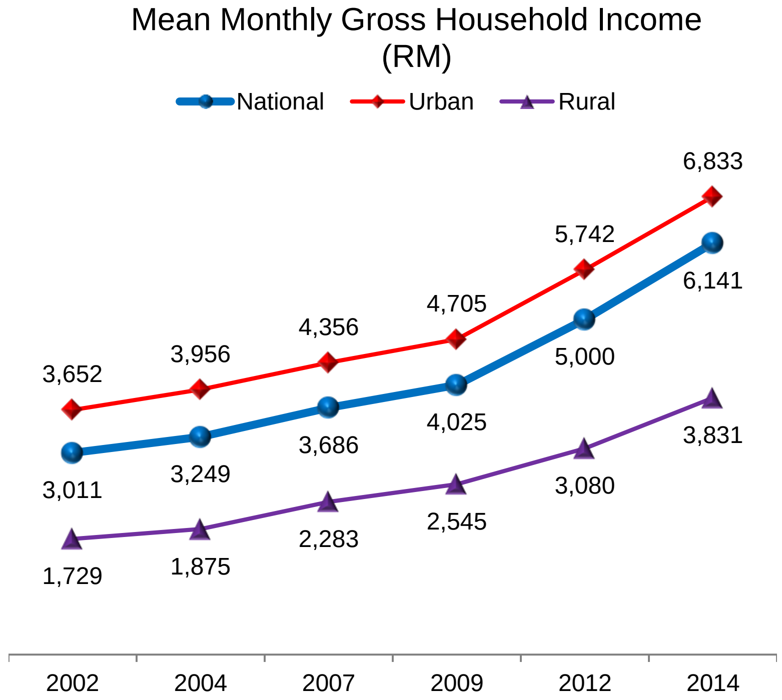


Source: National Transformation Program (NTP) Annual Report 2016

Malaysia has moved out of the "middle-income trap"

- Six years into the implementation of the National Transformation Program, Malaysia has escaped the middle-income trap, with GNI per capita hitting US$10,010 in 2016 (US$6,767 in 2009).
- Mean household income increased by 8.1% pa to RM6,958 in 2016 from RM4,025 in 2009. In real terms, it grew by 7.7% pa for the same period.
- Gini's coefficient had improved steadily from 0.44 in 2007-09, 0.430 in 2012, 0.401 in 2014 and further to 0.399 in 2016.

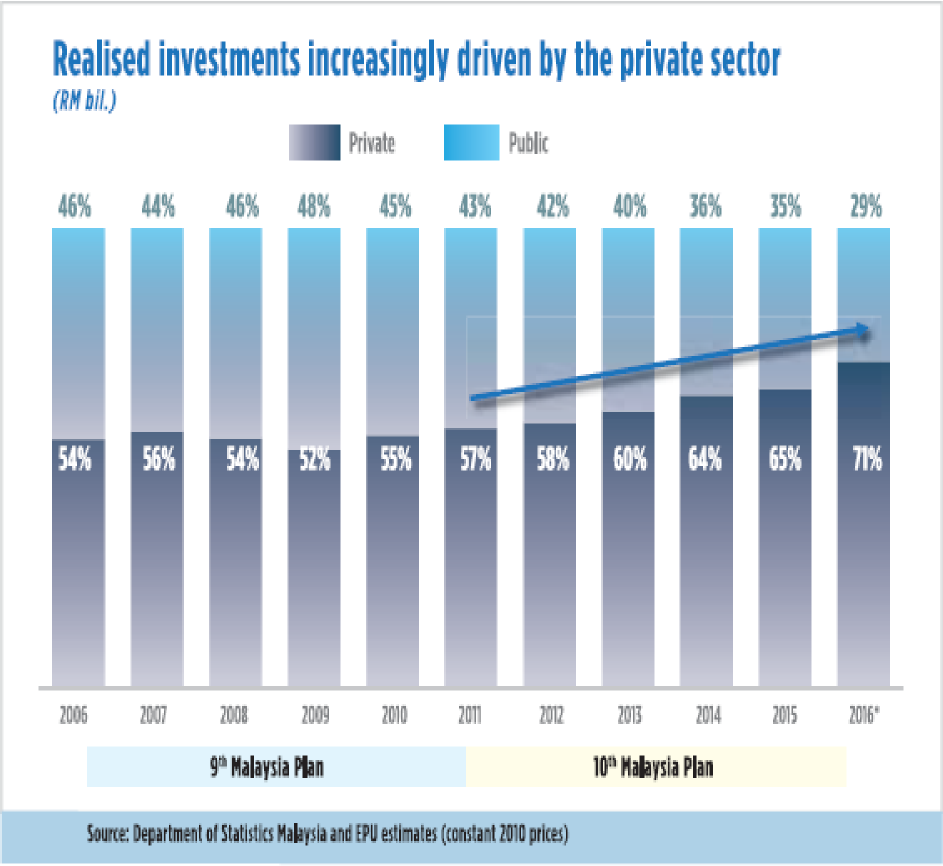


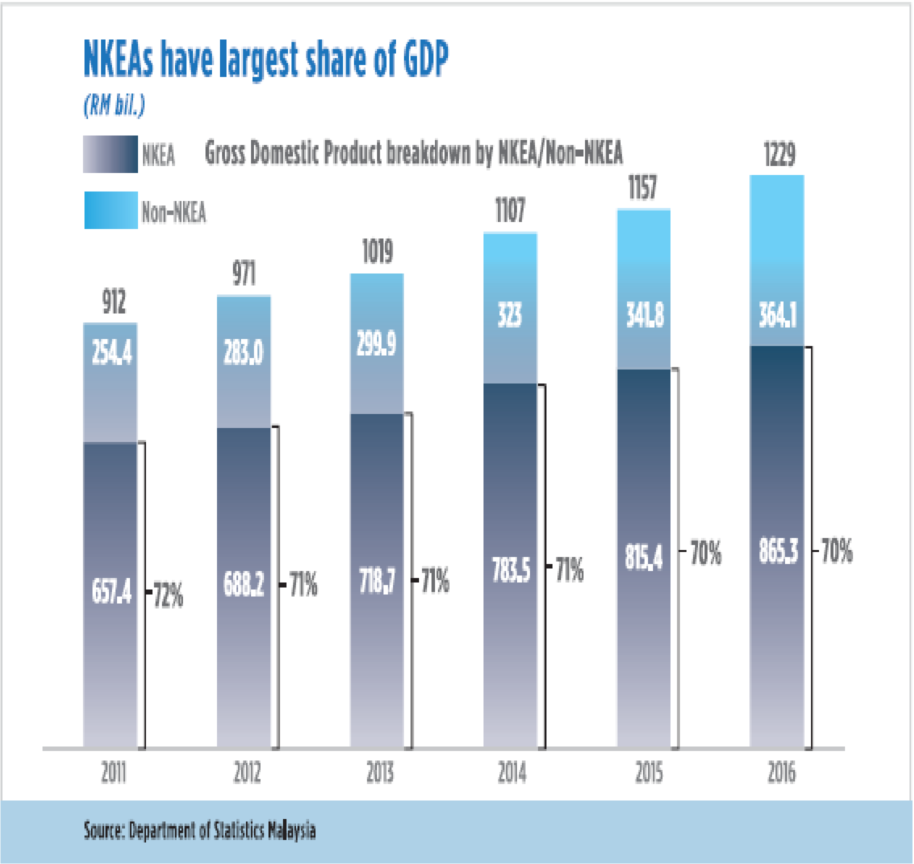


Source: BNM; PEMANDU; EPU

Private sector showed clear dominance…

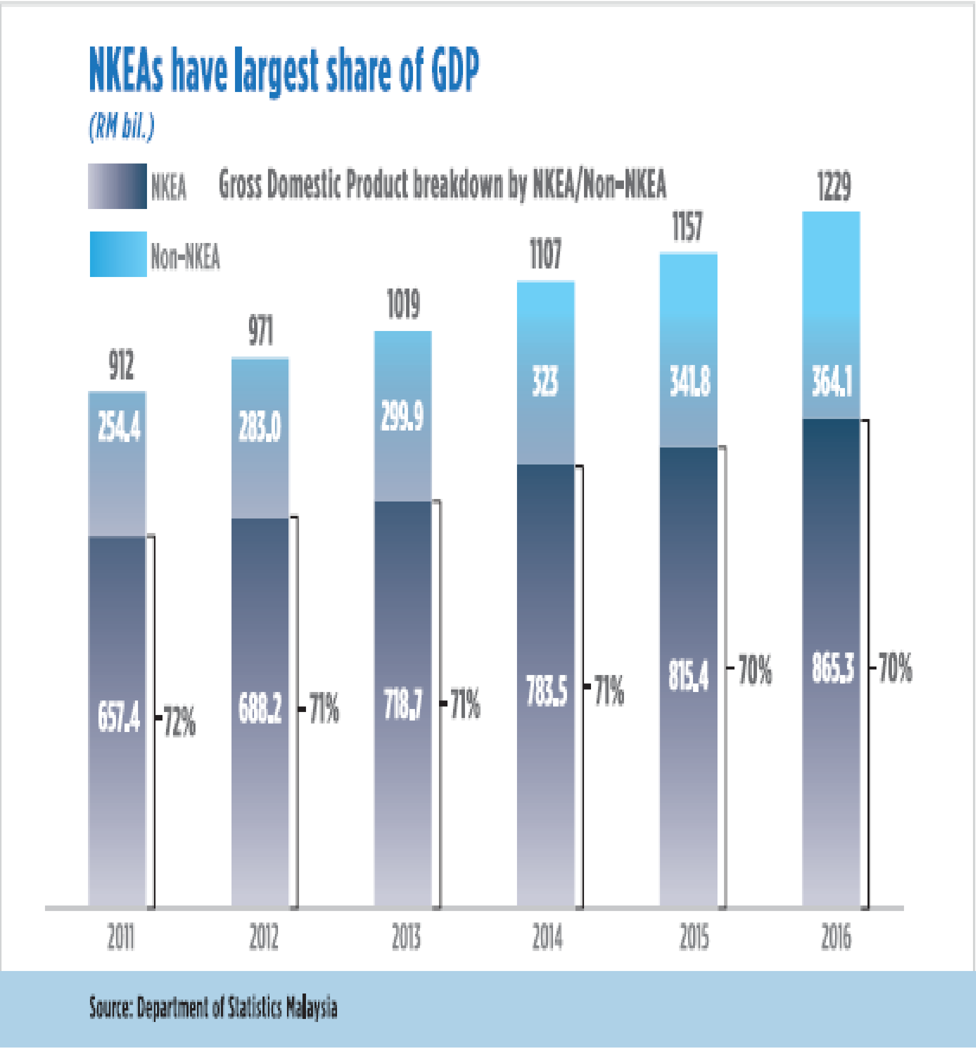
- The vibrant landscape for private investment has been enabled by the NTP's focus on 12 National Key Economic Areas (NKEAs) designed to position the private sector as the engine of economic growth.





Source: National Transformation Program (NTP) Annual Report 2016

NKEAs accounted for the largest share of GDP (RM865.3 billion or 70%) of GDP in 2016

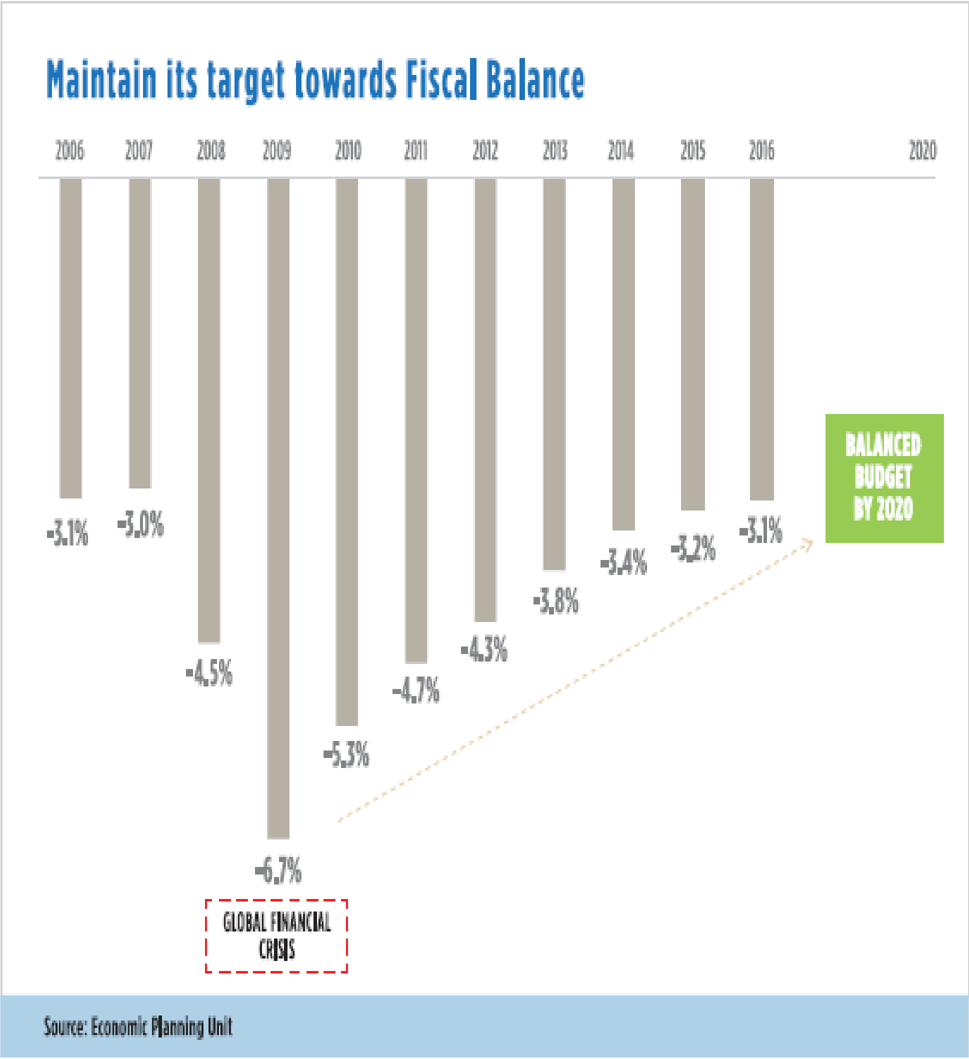


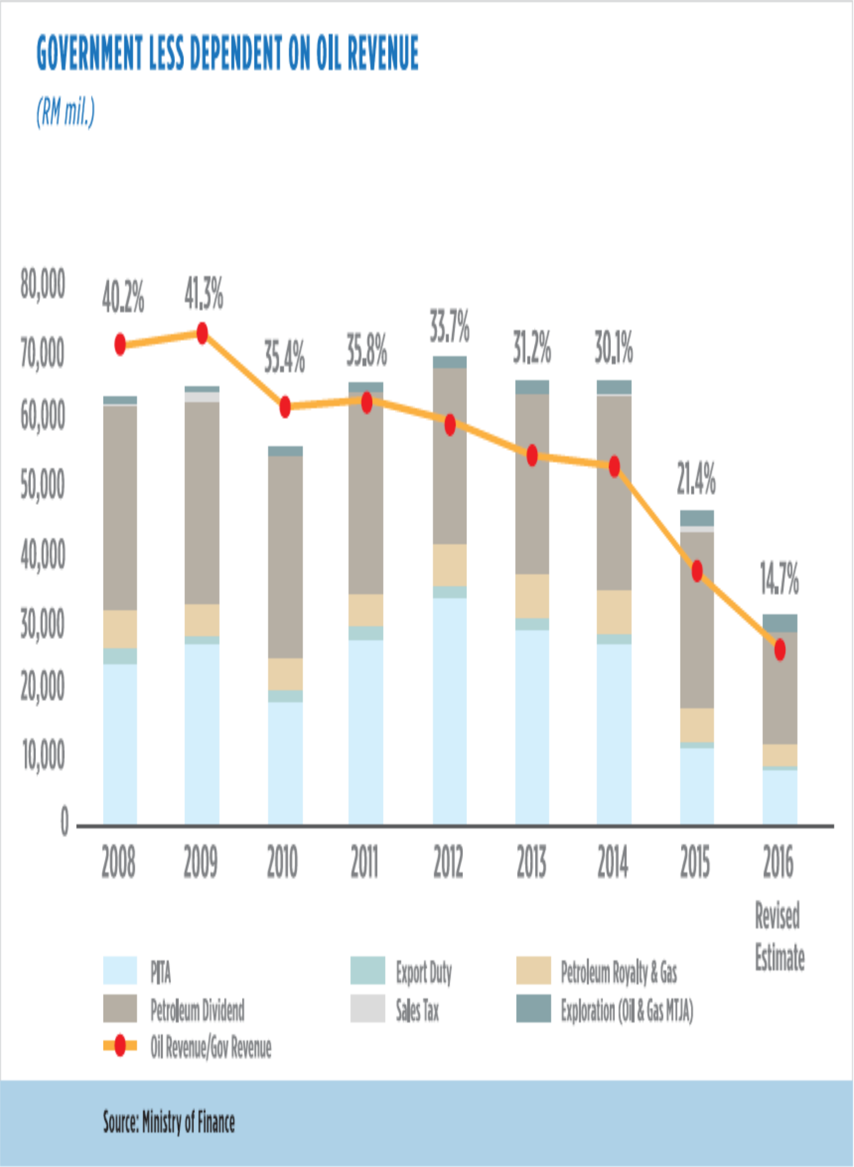
Source: National Transformation Program (NTP) Annual Report 2016

GNI VALUE (RM BILLION)

NKEA SECTOR	2016
Agriculture	68.1
Palm Oil/Rubber	64.9
Oil, Gas & Energy	179.7
Electrical & Electronics	57.0
Wholesale & Retail	181.9
Education	9.7
Healthcare	10.9
Communication Content & Infrastructure	58.1
Tourism	73.3
Financial Services	64.8
Business Services	58.6
TOTAL NKEA	**827.2**
Other Industries	**367.5**
TOTAL GNI	**1,194.6**

Fiscal consolidation remains on track



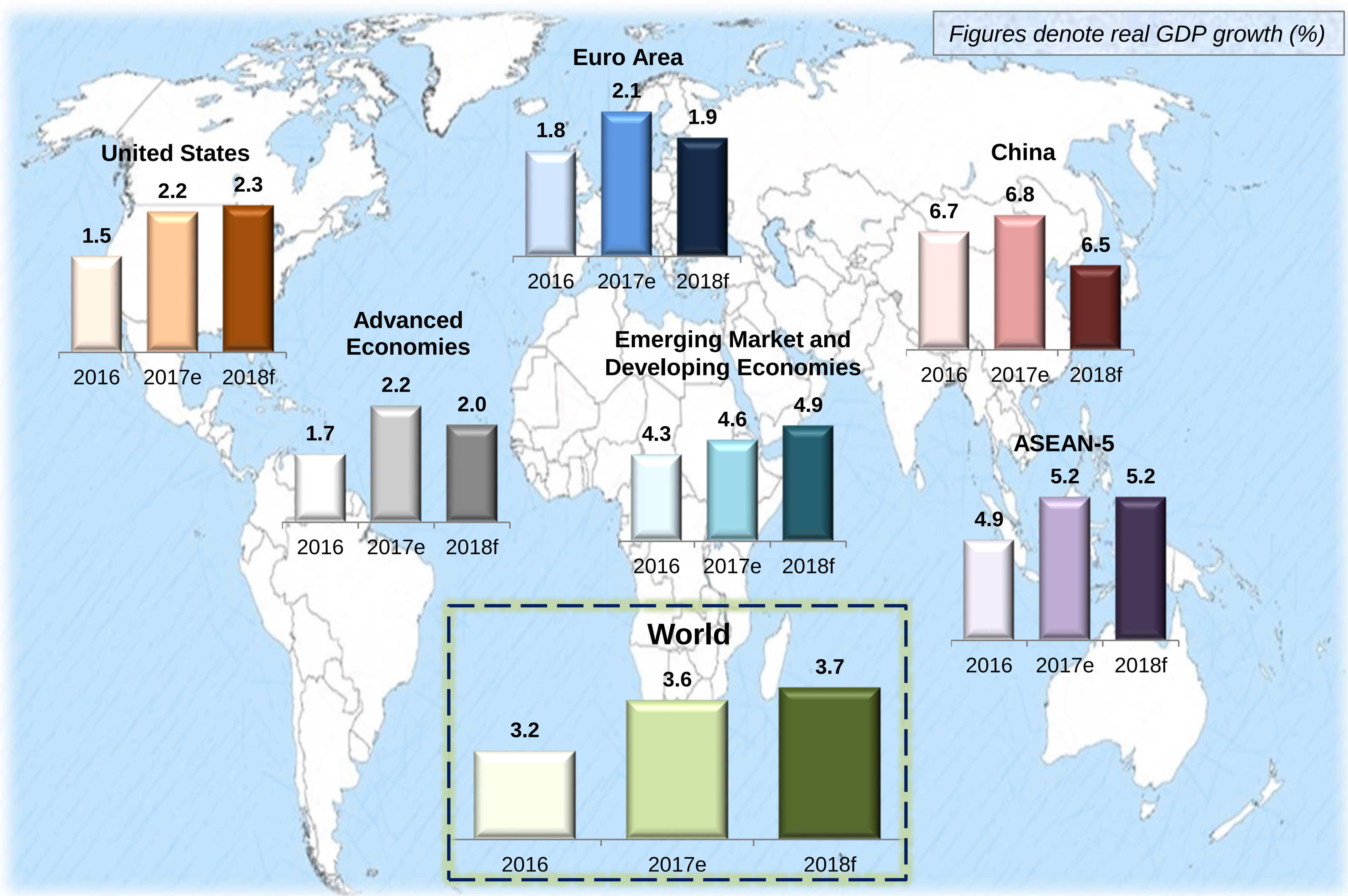


Source: National Transformation Program (NTP) Annual Report 2016

Section 2:

Malaysia: Turning around; looking for growth

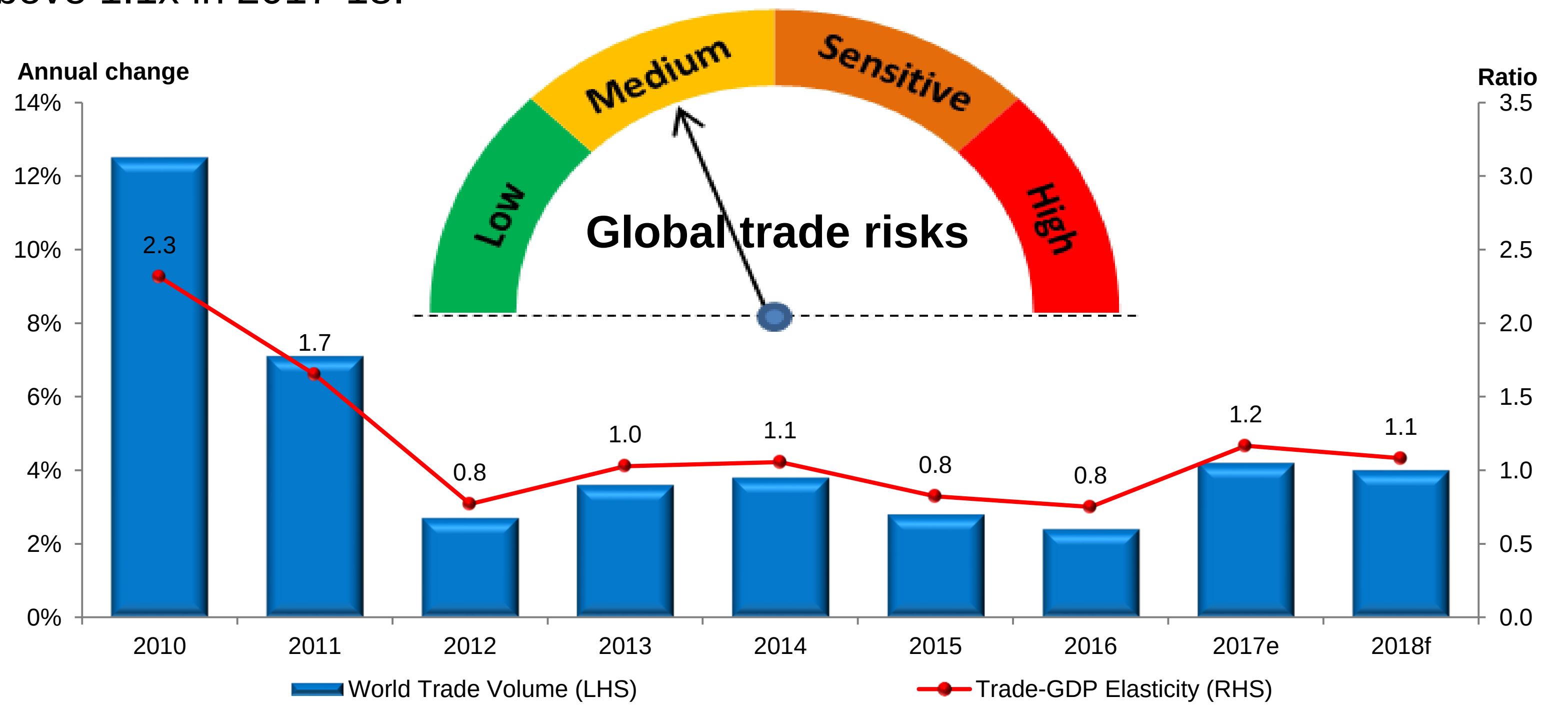
Global economy is in a synchronised recovery



Source: IMF's WEO Report, October 2017

Global trade rebounding but risks remain

- WTO revised upwards this year's global trade growth to 3.6% vs. IMF's 4.2% (1.3% in 2016) from 2.4% previously. For 2018, global trade growth is estimated at 3.2% vs. IMF's 4.0%.
- Rebounding trade growth is supported by accelerating economic growth and rising import demand in China and the United States, which spurred trade within Asia.
- Trade to GDP ratio, which had slumped to about 1.1x since the GFC from 2.0x, should rise to above 1.1x in 2017-18.

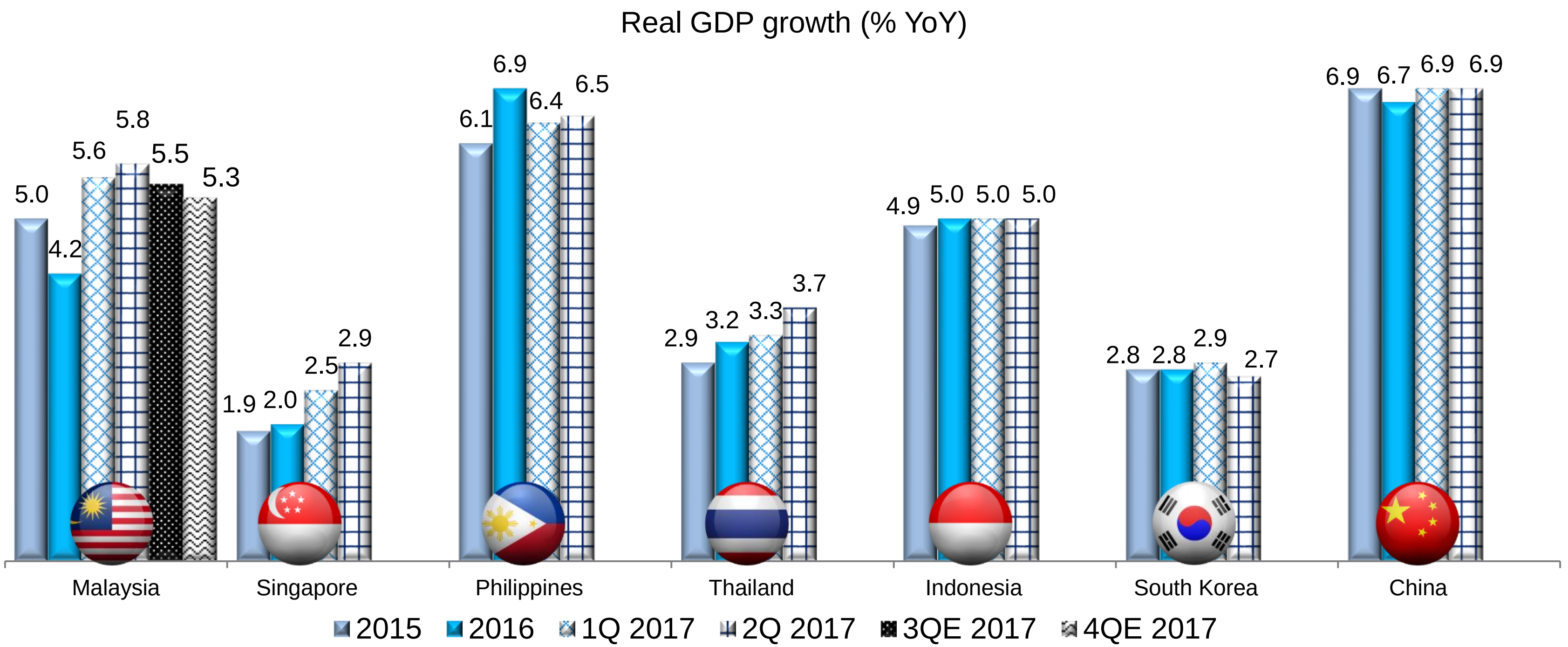


Source: IMF (WEO October 2017); SERC's computation

The Malaysian economy is gaining ground

- The economy is looking up as the headwinds of past two years dissipate.
- The economy held up strongly (5.7% yoy in 1H17 vs. 4.1% in 1H16), the highest in more than two years. 2017's economic growth will hit 5.5% and estimated 5.1% in 2018.
- Resilient domestic demand, improving prospects for exports and corrective policy steps.

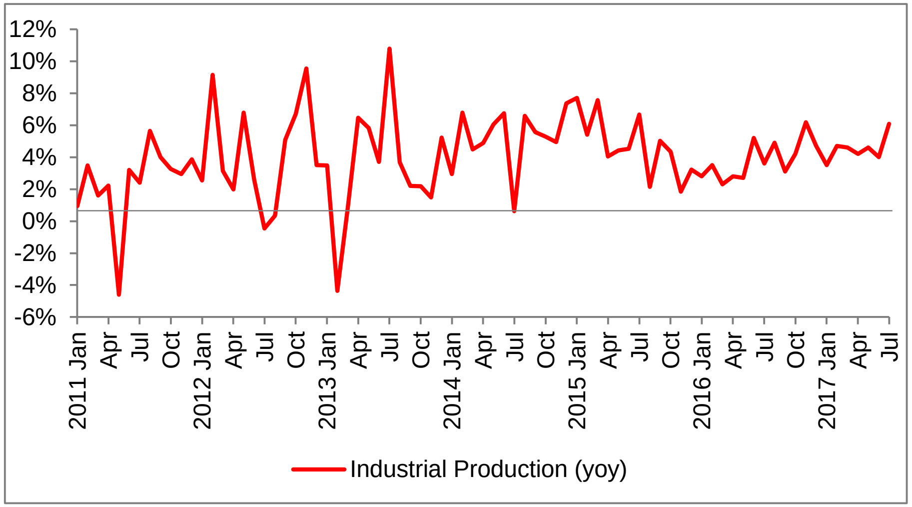
Malaysia was among the fastest-growing economies



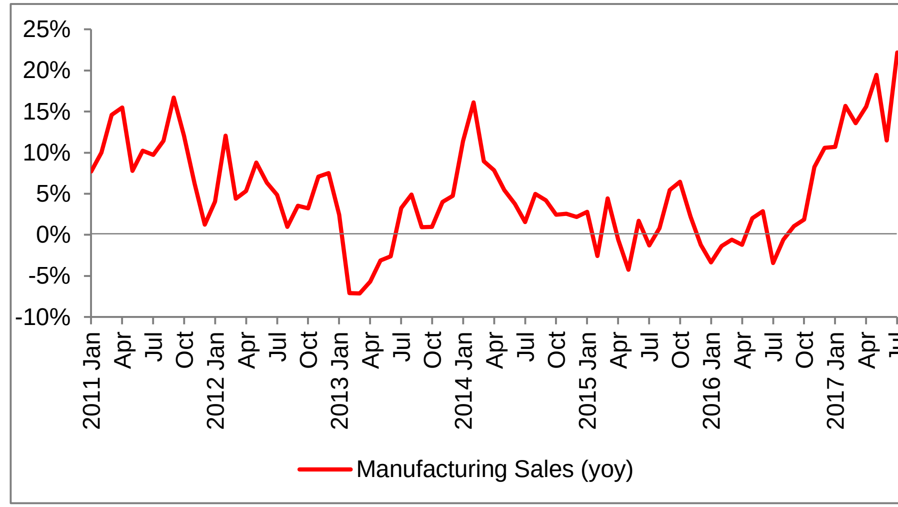
Source: Various officials

Snapshot of real economic and sentiment indicators

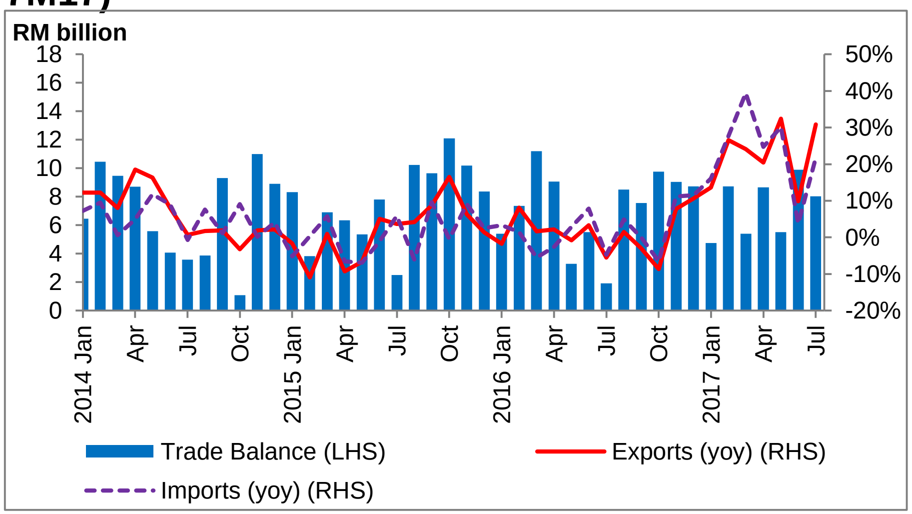
Industrial production grew steadily



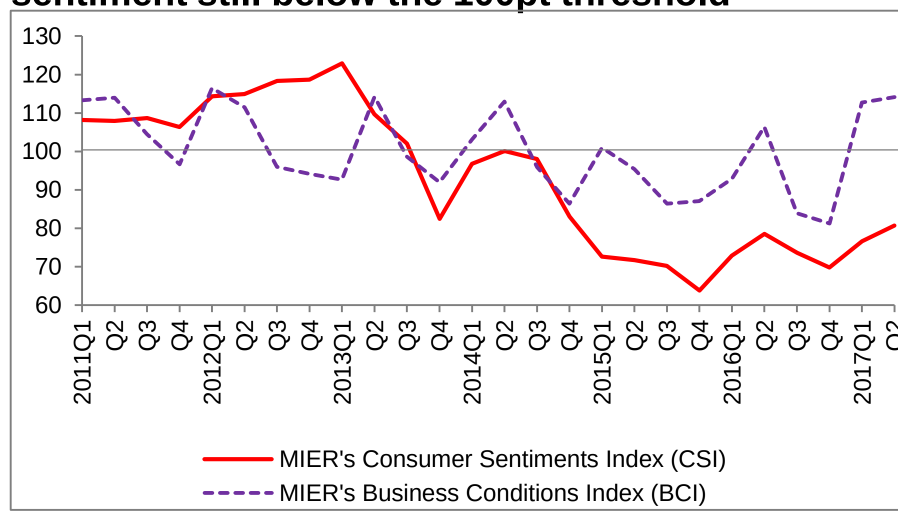
Manufacturing sales recorded highest growth since March 2010



Exports still growing at a robust pace (22.3% in 7M17)



Business condition improves while consumer sentiment still below the 100pt threshold

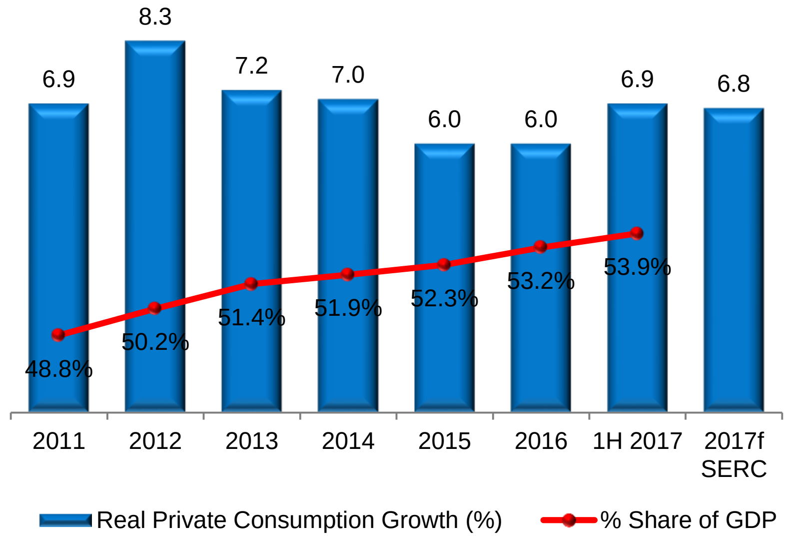


Source: DOS, Malaysia; MIER

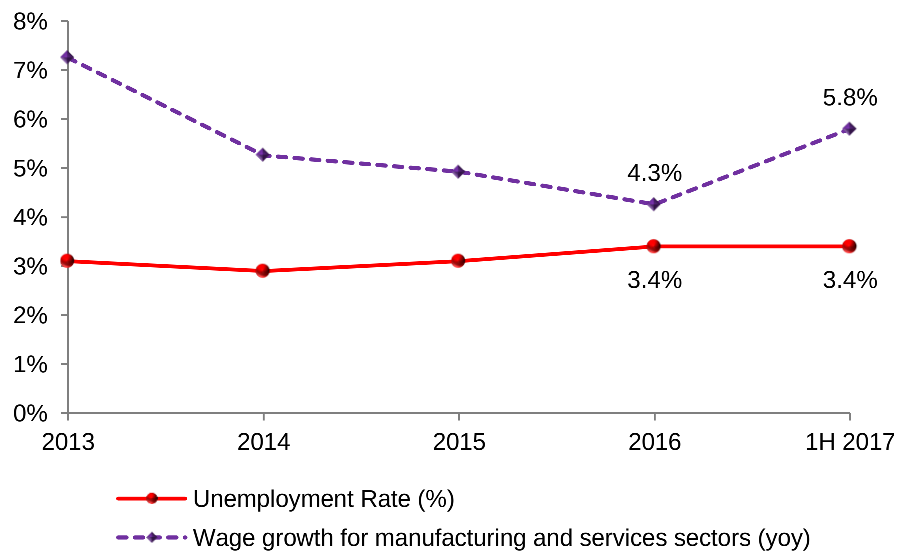
Private consumption still powering the economy

- Resilient consumer spending (6.9% yoy in 1H17; 2017E: 6.8%).
- Factors underpinning consumer spending: employment, wage growth, commodity income and income-support measures.
- Private consumption will remain the dominant driver of growth (2016-2020F: 6.4% pa vs. 7.1% pa in 2011-15).

Real private consumption growth trend (% YoY)



Stable labour market conditions

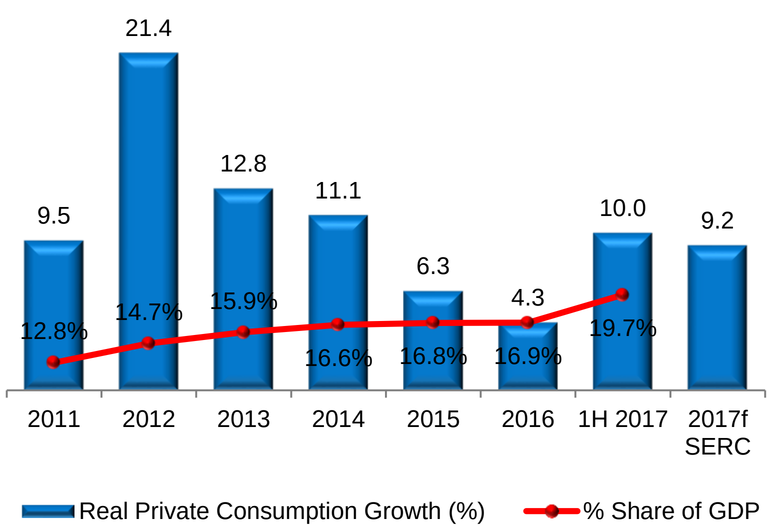


Source: DOS, Malaysia; SERC

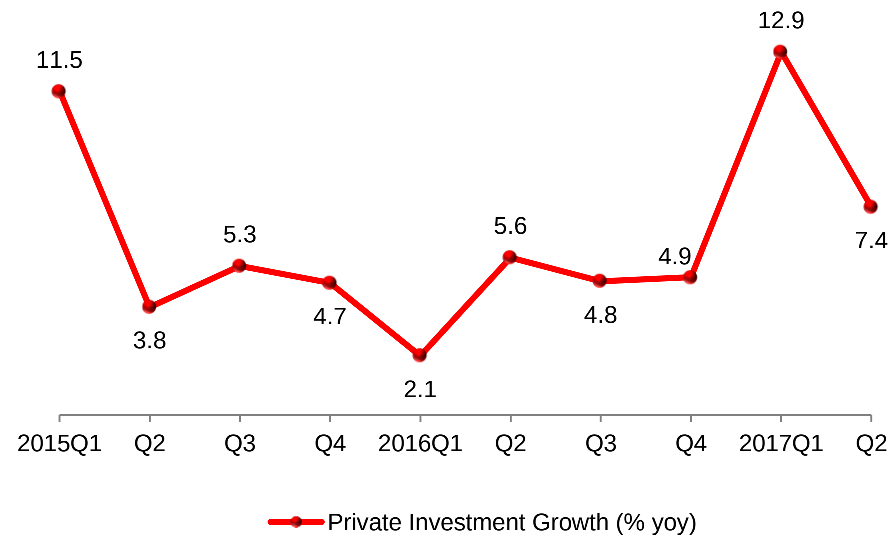
Private investment makes a strong comeback

- Private investment staged a strong expansion of 10.0% yoy in 1H2017 after trapped in lower growth trajectory since 2Q 2015.
- High capital spending in the services and manufacturing sectors.
- Uncertainty ahead of GE14 may temper private investment (2017E:9.2%, 2016-2020F: 8.2% pa vs. 12.2% pa in 2011-15).

Real private investment growth trend (% YoY)



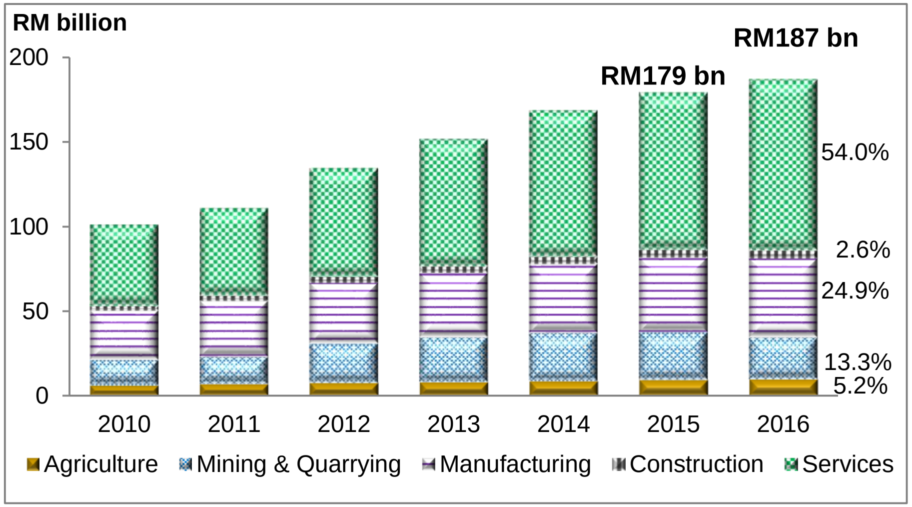
Quarterly real private investment growth (% YoY)



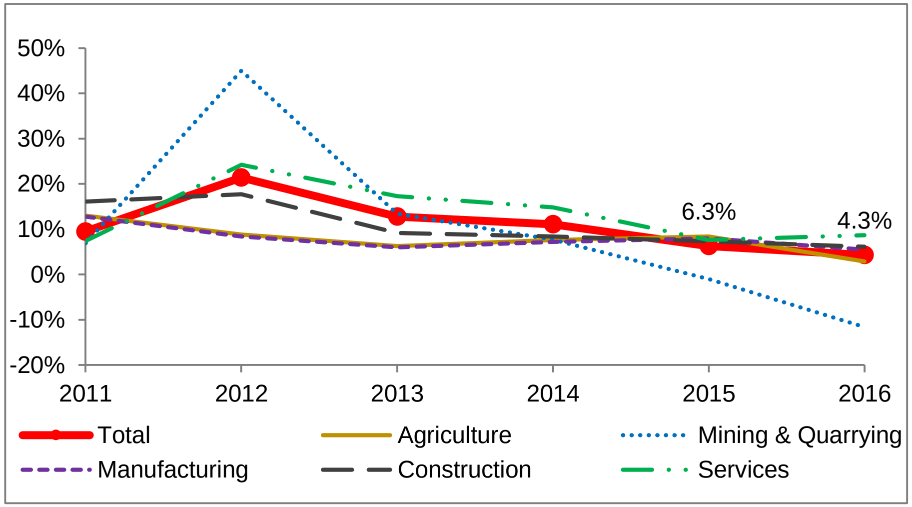
Source: DOS, Malaysia; SERC

Snapshot of private investment

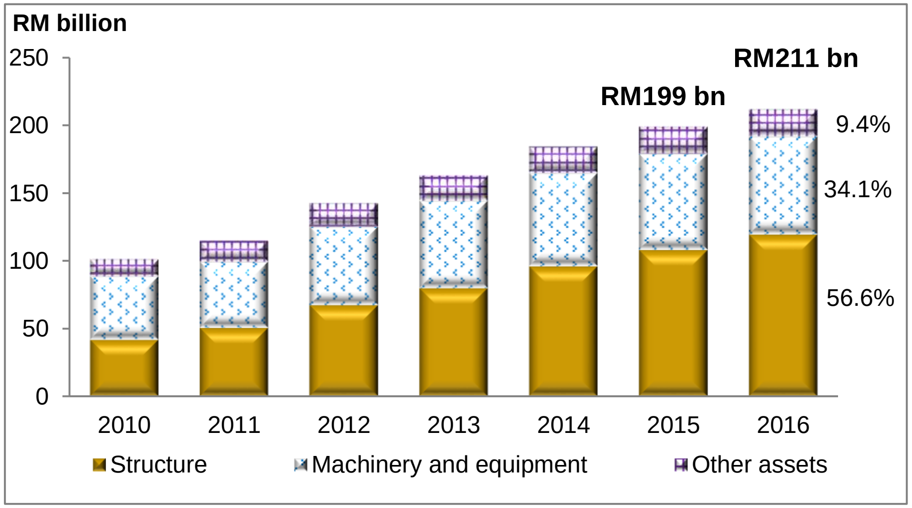
Real private investment by sector



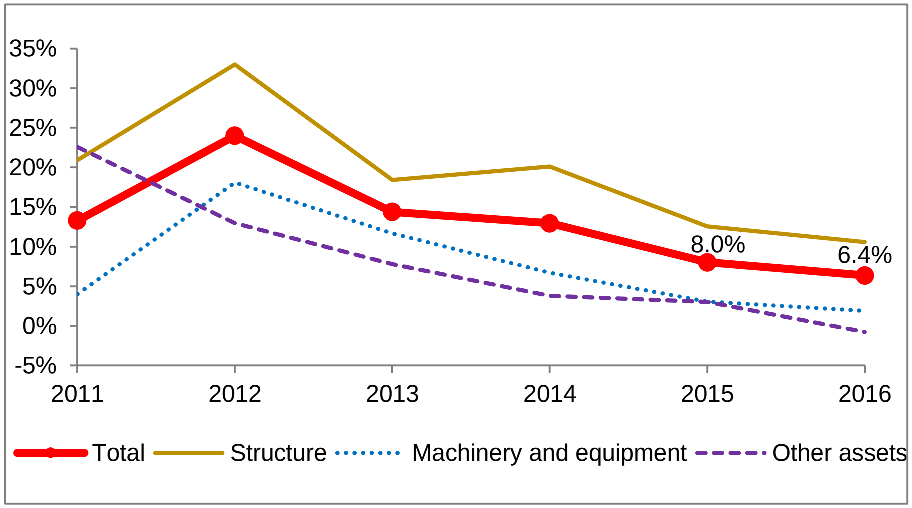
Real private investment growth by sector



Nominal private investment by type



Nominal private investment growth by type

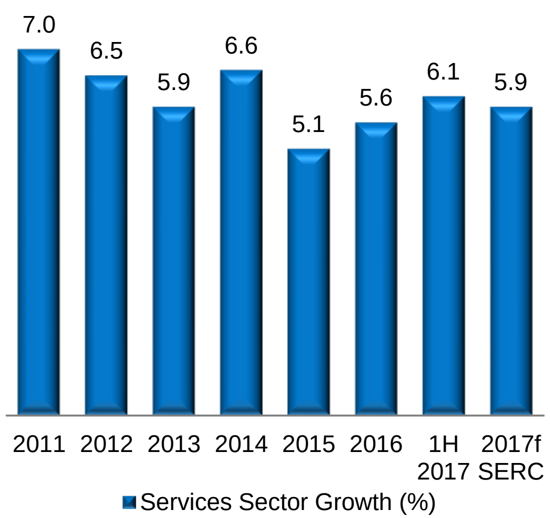


Source: DOS, Malaysia

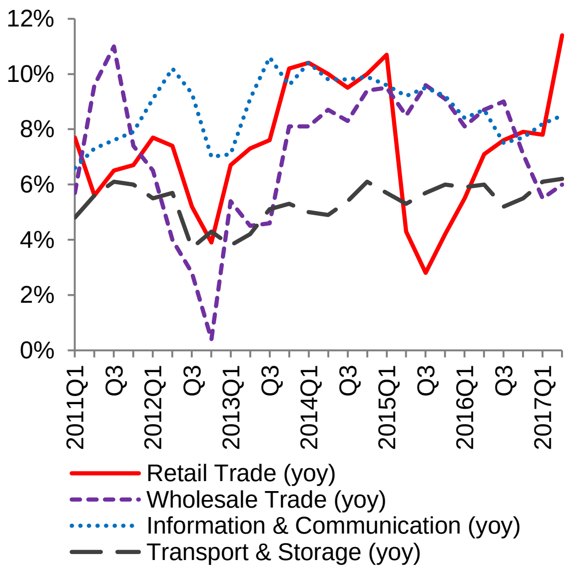
Services: Dominant driver of GDP growth

- The services sector grew by 6.1% yoy in 1H17 (2017E:5.9%, 2016-2020F:5.8% pa vs. 6.2% pa in 2011-15).
- At 54.4% of GDP in 2016, there is still some way to achieve the Government's target of 58.0%.
- Broad-based expansion: trade-related, consumption-based and financial services.
- E-commerce and Digital Free Trade Zone will boost the services growth.

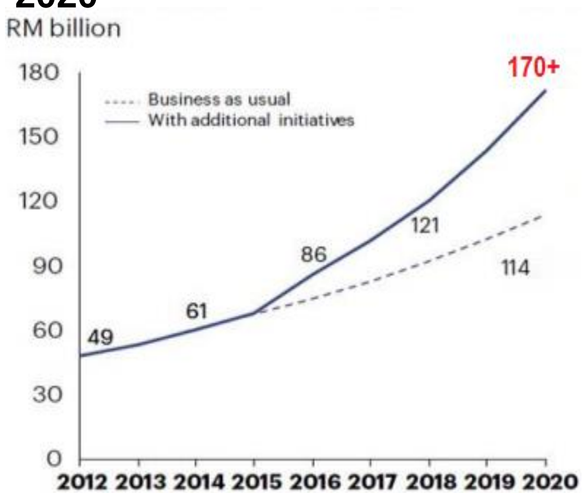
Output growth of services sector



Performance of services subsectors



E-commerce growth will double to 20.8% pa in 2015-2020

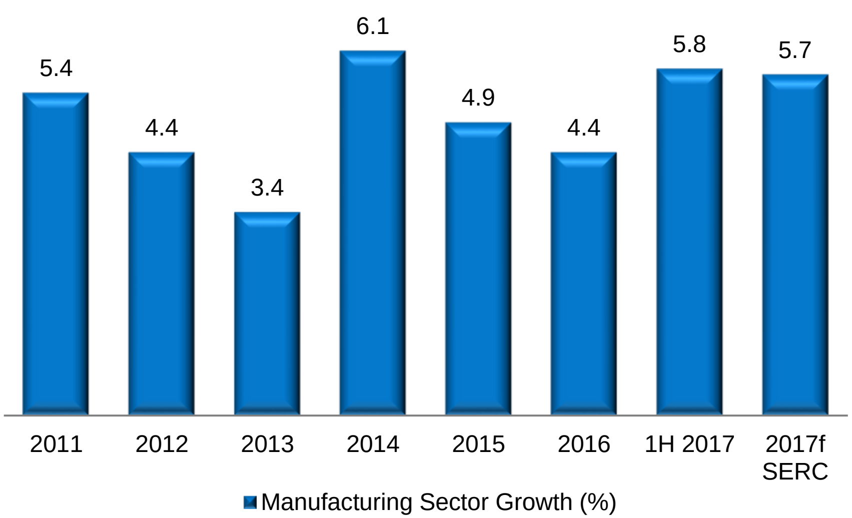


Source: DOS, Malaysia; National E-Commerce Strategic Roadmap; SERC

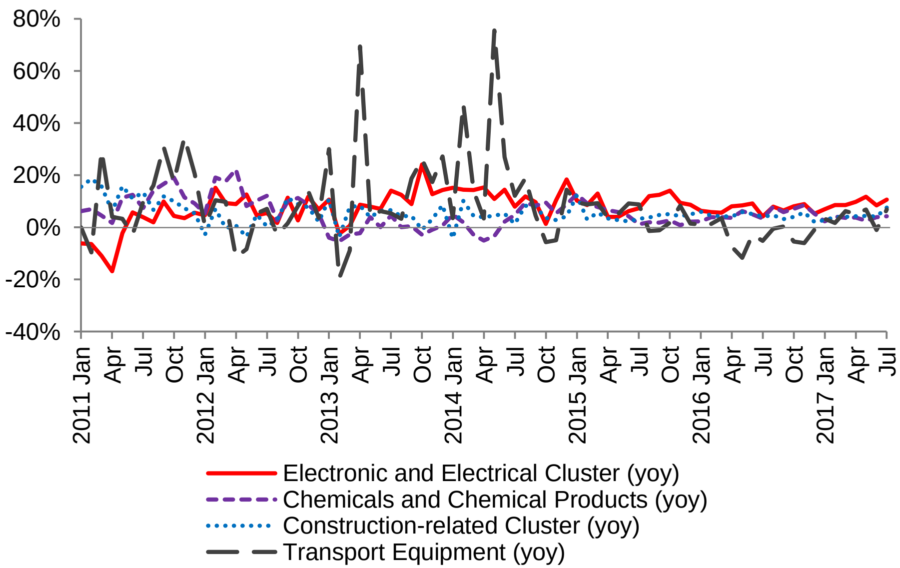
Manufacturing: Still growing decently

- The manufacturing sector sustained higher growth of 5.8% yoy in 1H17 (2017E: 5.7%, 2016-2020F: 5.3% pa vs. 4.8% pa in 2011-15).
- Export-oriented industries (electronics, technology products and chemical-based products). Growth in the domestic-oriented industries -- production of food and construction-related materials (ECRL, MRT, HSR, Pan Borneo Highway, ports, and real estate development).
- Complex business landscape, high cost of doing business, lingering issues about foreign workers and the weak ringgit could dampen the sector's growth in the near-term.

Output growth of manufacturing sector



Performance of key industries



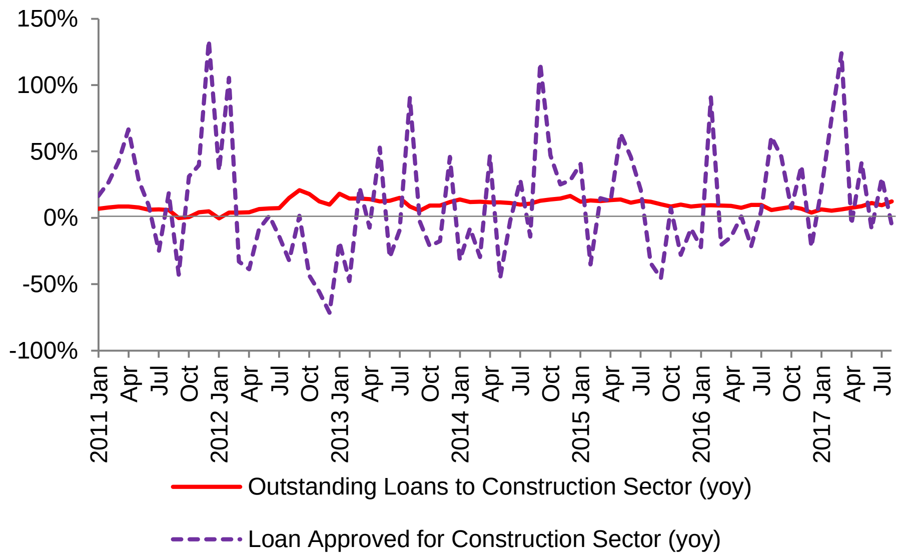
Source: DOS, Malaysia; BNM; SERC

Construction: Promising outlook

- Growth in the construction sector is projected to expand at a faster pace in 2017 (estimated 8.0% vs. 7.4% in 2016) and 8.7% pa in 2016-2020 (10.6% pa in 2011-15).
- Public spending on transportation projects (MRT, LRT, rail, HSR), highways (Pan Borneo Highway), ports and the public-driven affordable housing development.
- An estimated RM212 billion value of construction jobs covering on-going and new ones over the next five years. Positive spillovers and multiplier effects on more than 140 sub-sectors.

Output growth of construction sector

Indicators of construction sector



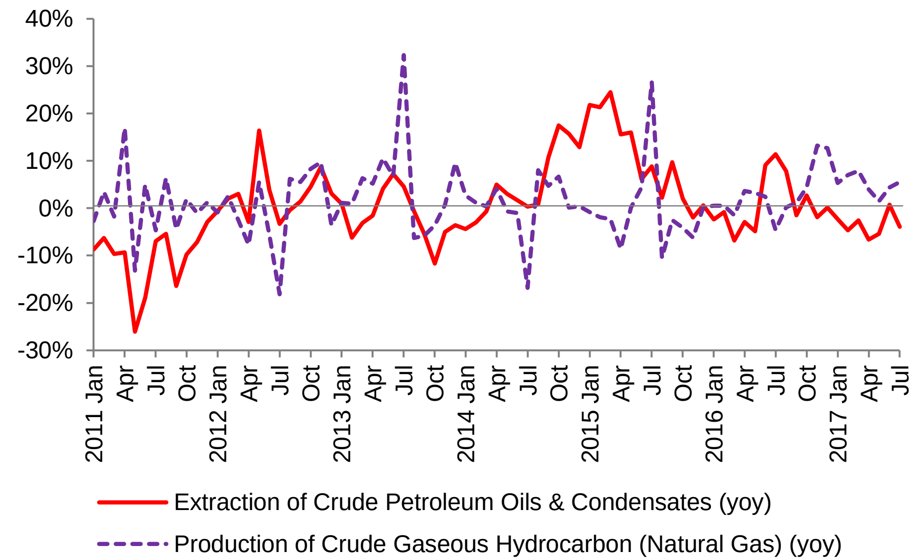
Source: DOS, Malaysia; BNM; SERC

Mining: Sustained recovery is well underway

- The mining sector growth is estimated to pace slower at 1.0% in 2017 (2.7% in 2016), supported by natural gas production as well as new oil field. Output growth is estimated to increase by 1.8 pa in 2016-2020 (1.3% pa in 2011-15).
- PETRONAS's voluntary 20,000 barrels per day crude oil supply cut to dampen the sector's performance in 1H2017.
- SERC estimates crude oil price of US$55-60 per barrel in 2017-18 vs. BNM's US$50-55 per barrel in 2017 (US$43.67 in 2016).

Output growth of mining sector

Crude oil and natural gas output

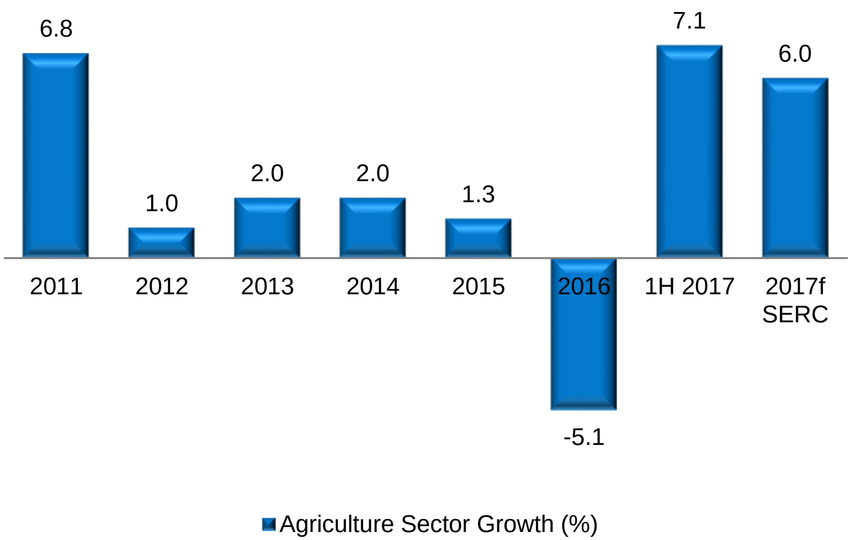


Source: DOS, Malaysia; SERC

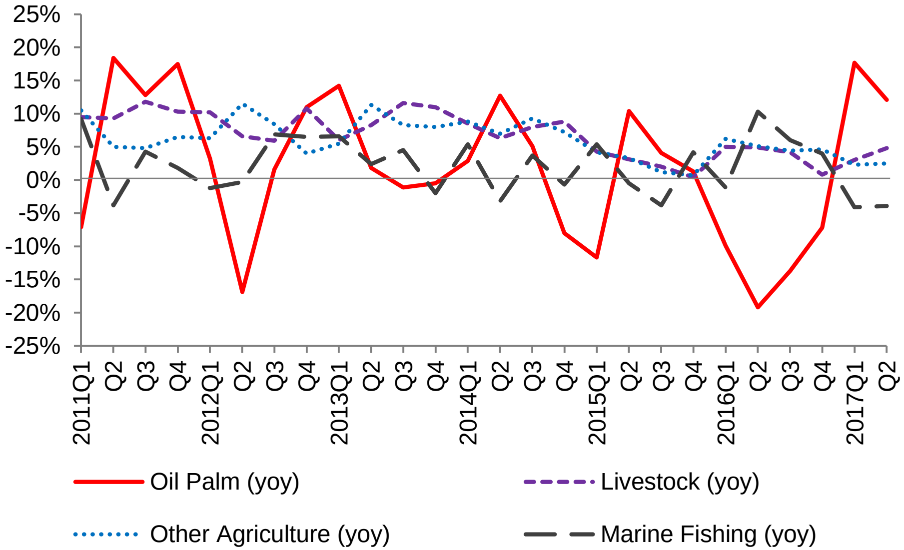
Agriculture: From contraction to expansion

- The agriculture sector rebounded strongly to expand by 7.1% yoy in 1H17 and estimated 6.0% in 2017 from a decline of 5.1% in 2016 as the adverse impact of El Niño dissipated.
- Agriculture output is projected to grow by 2.0% pa in 2016-2020 vs. 2.6% pa in 2011-15.
- Palm oil price forecast: RM2,700 per tonne for 2017, RM2,750-2,850 in 2018-2020 (RM2,647 in 2016).

Output growth of agriculture sector



Subsectors of agriculture

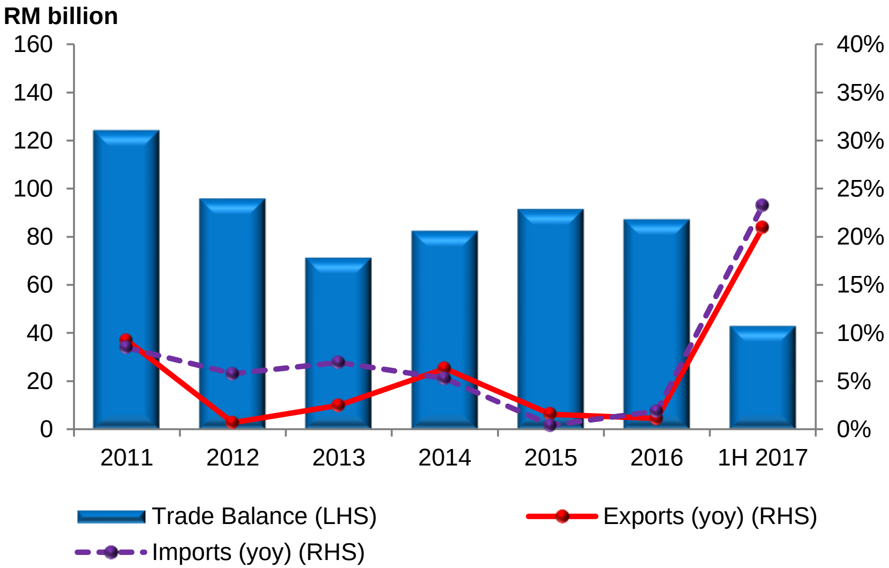


Source: DOS, Malaysia; SERC

Exports swing from a drag to driver of growth

- Exports have staged a recovery since Nov 2016 (estimated 14.5% in 2017 vs. 1.1% in 2016). Exports are projected to rise by 7.5-10.5% pa in 2018-2020.
- Three fundamental drivers: improved global demand, tech demand and higher commodity prices. Base and weak exchange rate effects have inevitably played some part.
- Risks to trade could come from trade protectionism and disruptive policies in advanced economies.

Exports accelerated



Source: DOS, Malaysia

Higher exports across the board

Major export products	2016	1H 2017
Electrical & electronics (36.6%)	3.5%	20.5%
Chemical, with products (7.5%)	7.0%	19.1%
Petroleum products (6.9%)	-0.1%	40.0%
Palm oil (5.3%)	3.3%	26.9%
Machinery equipments (4.8%)	4.2%	3.3%
Manufacturers of metal (4.2%)	-4.3%	2.6%
Liquefied natural gas (4.1%)	-28.2%	23.4%
Optical & scientific equip. (3.7%)	10.2%	7.8%
Crude oil (2.8%)	-14.6%	47.3%
Overall gross exports	**1.1%**	**21.0%**

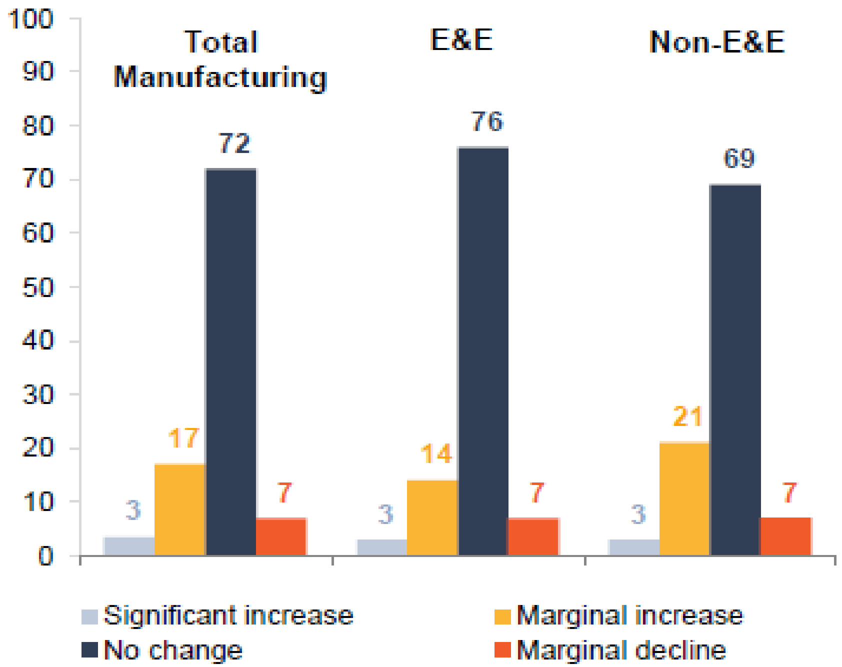
Parenthesis indicates share of overall gross exports in 2016

Exports swing from a drag to driver of growth

Majority of companies surveyed reported marginal or no benefit from ringgit depreciation

Firm Survey: Impact of Exchange Rate Depreciation on Export Order Volumes

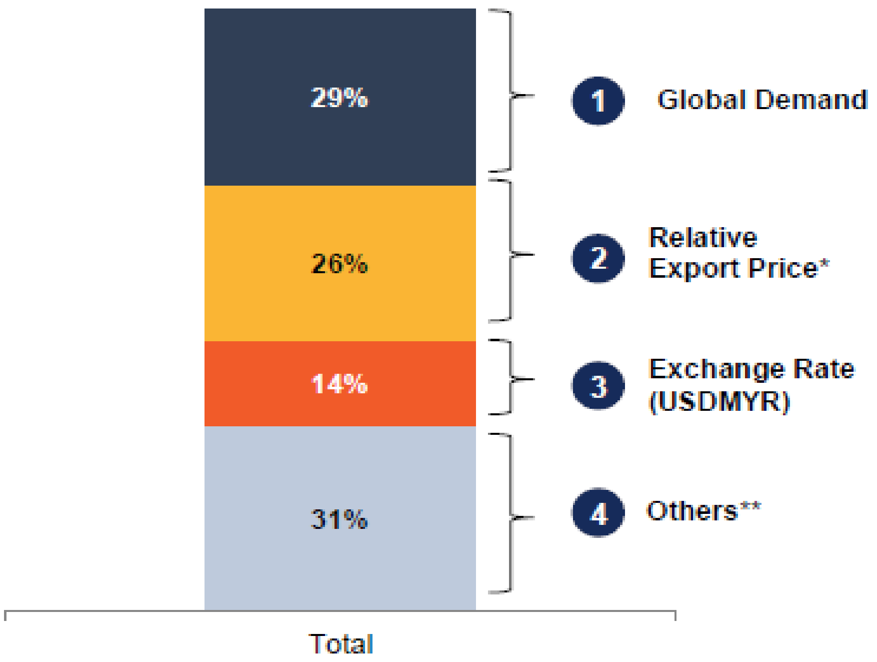
% of respondents



Improving global conditions to underpin export volume growth going forward

Empirical Findings: Contribution to Export Volume Growth, 2005-2016

Share, %



* Ratio of domestic export prices to global export prices

** Other temporary factors affecting exports that are not included in the model (i.e. the shortage of trade credit in 2008-2009 and the introduction of storage facilities that enabled higher re-exports of petroleum)

Source: Industrial engagements; RES Annual Report Survey (March 2017) – 63 manufacturing exporters, Bank Negara Malaysia estimates

Source: BNM

Where is our growth coming from?

- Broad-based output expansion. Domestic demand still calling the shots.
- All economic sectors registered positive growth in 1H 2017.
- Services and manufacturing sectors are the dominant growth drivers.

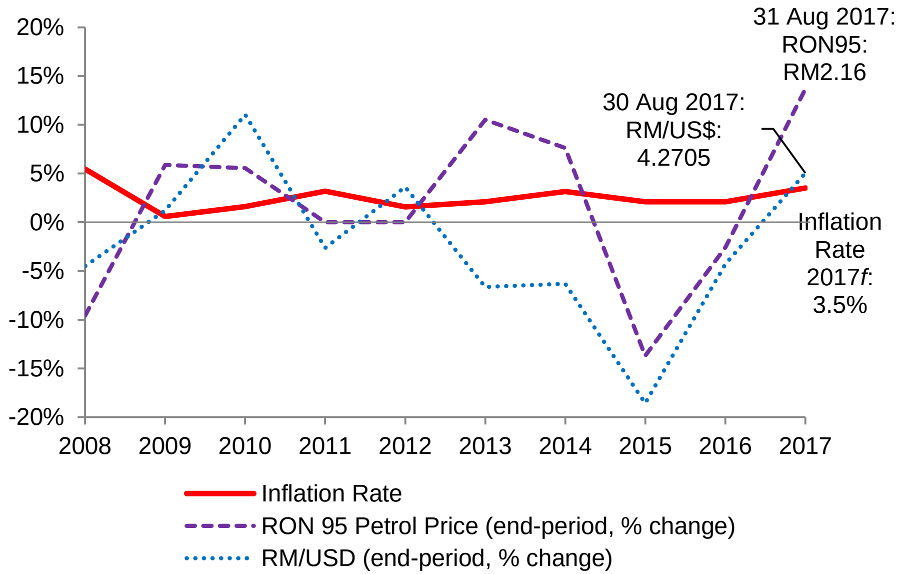
% change, 2010=100	**2015**	**2016**	**2017 1Q**	**2017 2Q**	**2017 1H**	**2017*e* (SERC)**	**2018*f* (SERC)**
GDP by demand component							
Private consumption (54.0%)	6.0	6.0	6.6	7.1	6.9	6.8	6.2
Private investment (16.8%)	6.3	4.3	12.9	10.7	10.0	9.2	8.3
Public consumption (12.5%)	4.4	0.9	7.5	3.3	5.3	5.1	4.0
Public investment (8.3%)	-1.1	-0.5	3.2	-5.0	-0.9	1.2	2.0
Exports of goods and services (68.4%)	0.3	1.1	9.8	9.6	9.7	9.1	6.7
Imports of goods and services (60.3%)	0.8	1.1	12.9	10.7	11.8	11.4	7.8
GDP by economic sector							
Agriculture (8.0%)	1.3	-5.1	8.3	5.9	7.1	6.0	4.0
Mining & quarrying (8.7%)	5.3	2.2	1.6	0.2	0.9	1.0	1.5
Manufacturing (22.9%)	4.9	4.4	5.6	6.0	5.8	5.7	5.5
Construction (4.7%)	8.2	7.4	6.5	8.3	7.4	8.0	9.0
Services (54.4%)	5.1	5.6	5.8	6.3	6.1	5.9	5.6
Overall GDP	**5.0**	**4.2**	**5.6**	**5.8**	**5.7**	**5.5**	**5.1**

Source: DOS, Malaysia; BNM; SERC
Parenthesis indicates % share to GDP in 2017f from BNM

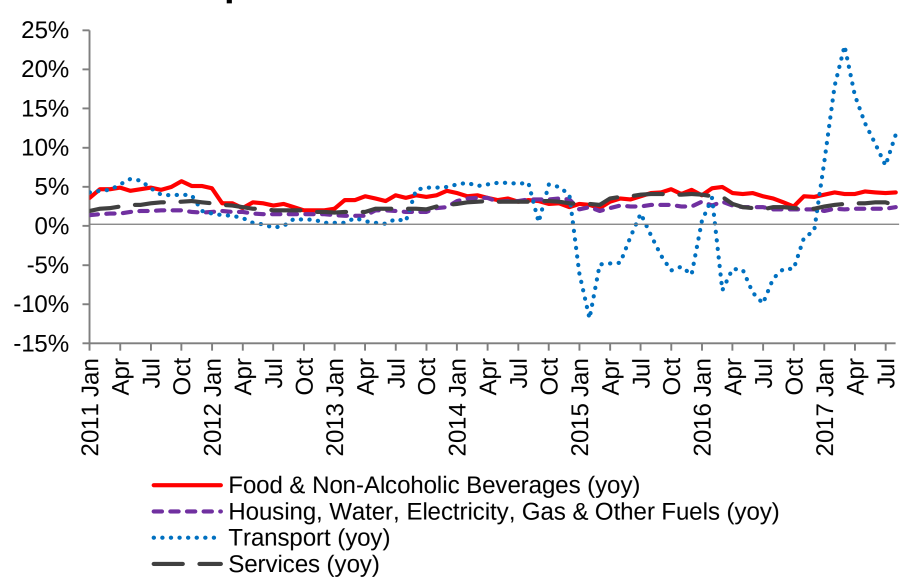
Inflationary trend remains high, fuel price is the wild card…

- High fuel prices-inflicted cost price pressures along with other indirect costs such as the spillover effect of the weakening ringgit pushed inflation higher to 5.1% yoy in March.
- But, it had moderated from 4.3% in 1Q to 4.0% in 2Q and 3.2% in July before moving higher to 3.7% in August. CPI growth up 3.9% in 8M17.
- Inflation is expected to increase by 3.8% in 2017 and 3.0-3.5% in 2018.

Fuel price and exchange rate changes on inflation



Inflation is largely driven by food prices and volatile fuel price

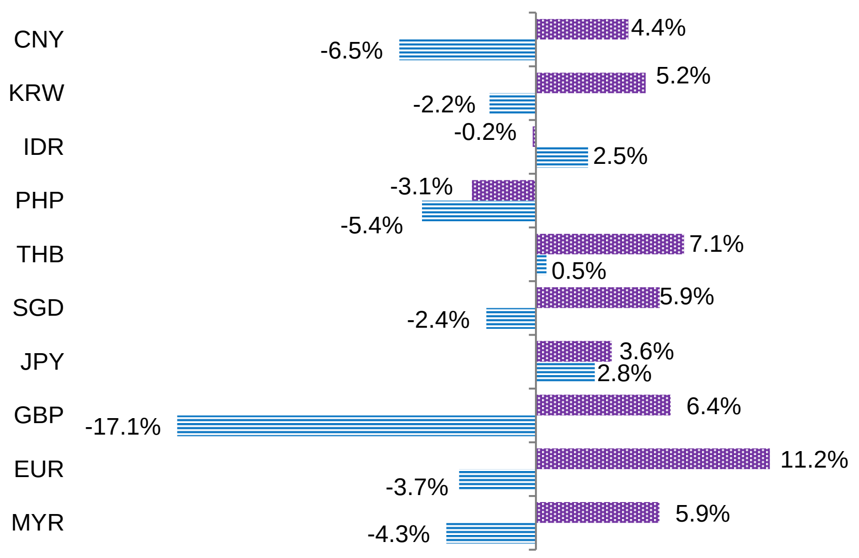


Source: BNM; DOS, Malaysia; SERC

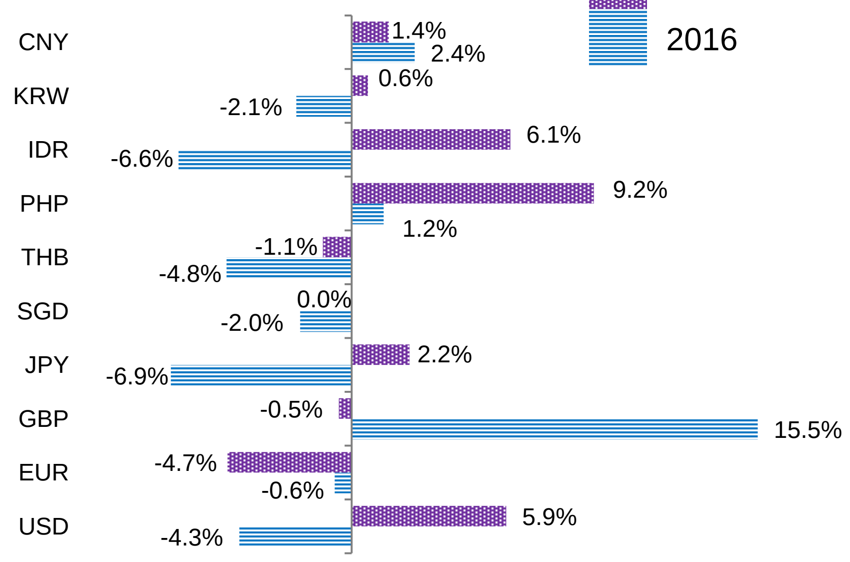
The ringgit does not reflect its fundamental value

- In REER terms, the ringgit has appreciated by 0.5% as of August this year (-15.0% in 2013-16).
- **Positive fundamentals**: Brightening economic growth prospects, firming commodity prices, the onshore ringgit stabilization measures, prospect of domestic interest rate normalization, continued current account surplus, accumulation of foreign reserves.
- **Counteract dampening factors**: Strong US dollar, higher US interest rates and yields, flows into the US dollar assets, geopolitical risks and developments in global financial markets.
- End-2017E: RM4.20/US$1; End-2018F: RM4.10-4.20/US$1

Regional currencies against USD

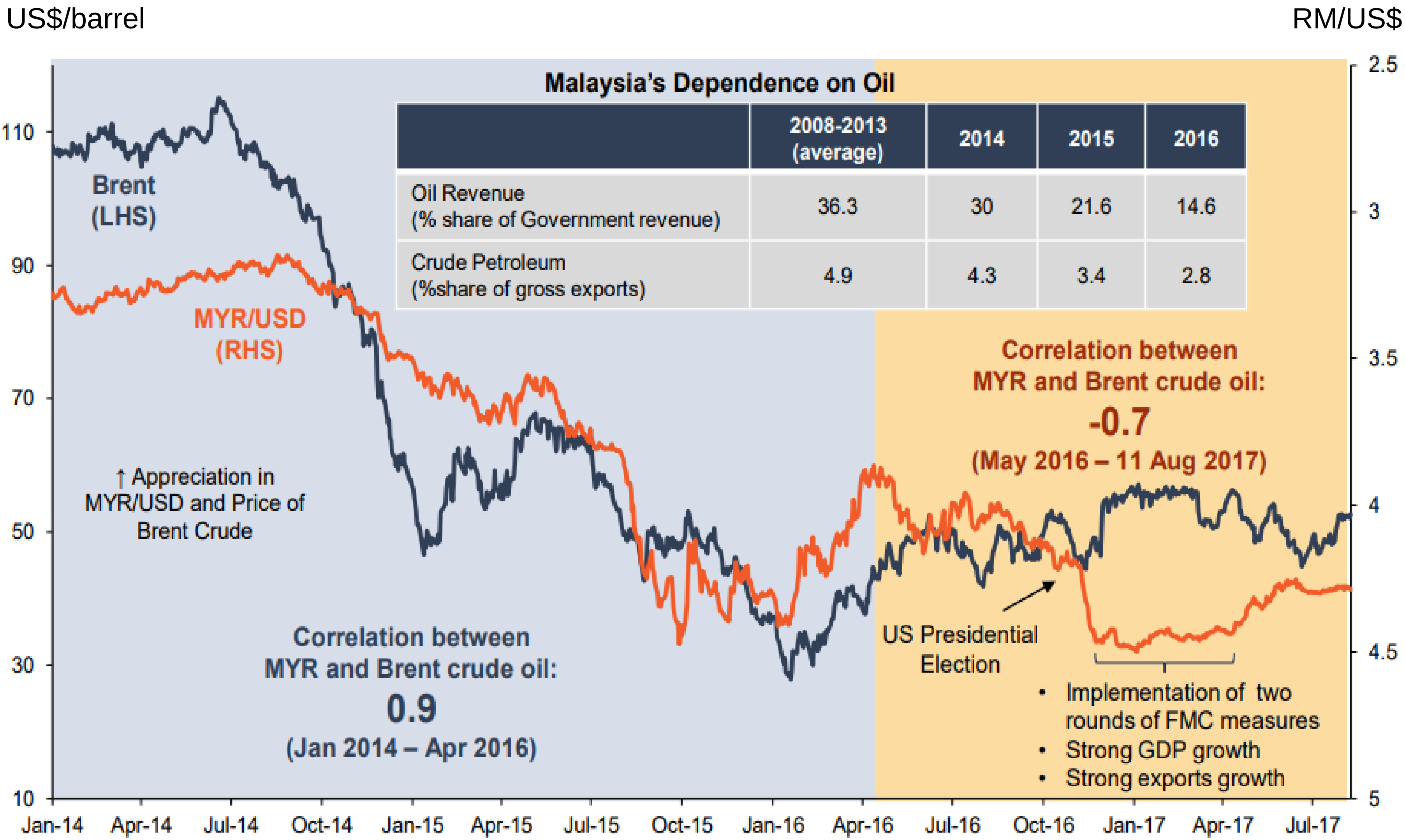


Ringgit performance



Source: Bank Negara Malaysia

The ringgit decouples from crude oil price



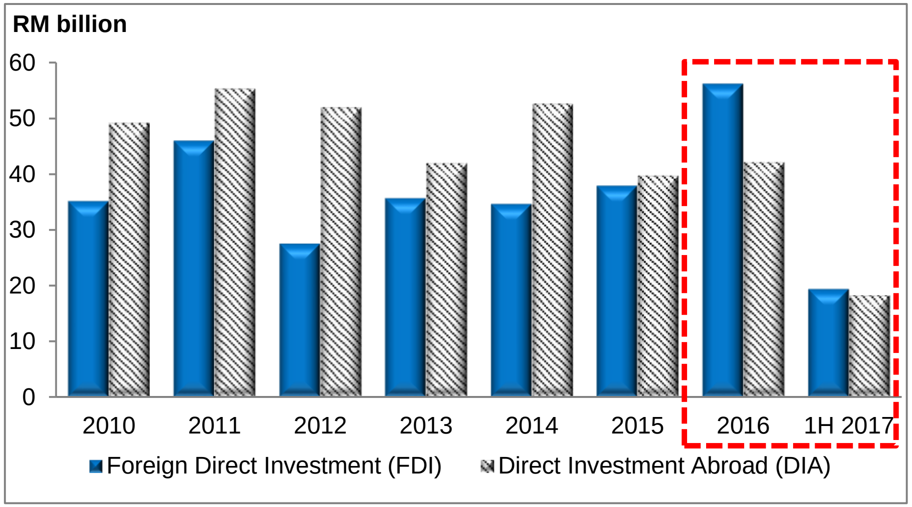
Malaysia's Dependence on Oil

	2008-2013 (average)	2014	2015	2016
Oil Revenue (% share of Government revenue)	36.3	30	21.6	14.6
Crude Petroleum (%share of gross exports)	4.9	4.3	3.4	2.8

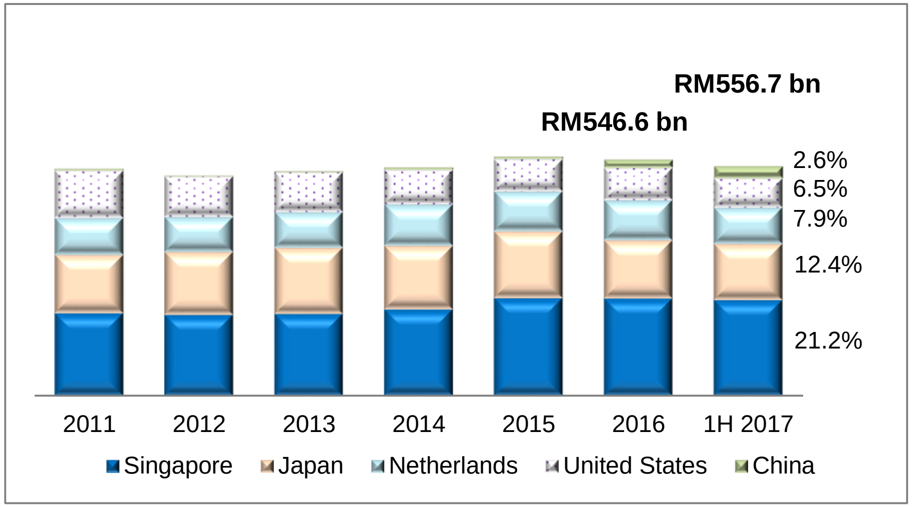
Source: BNM

Does FDI still favor Malaysia?

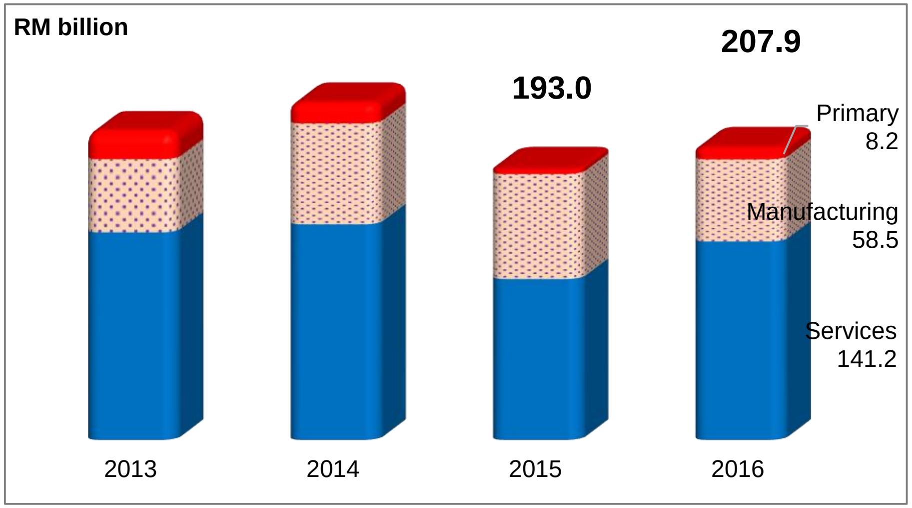
FDI exceeded Malaysia's direct investment abroad



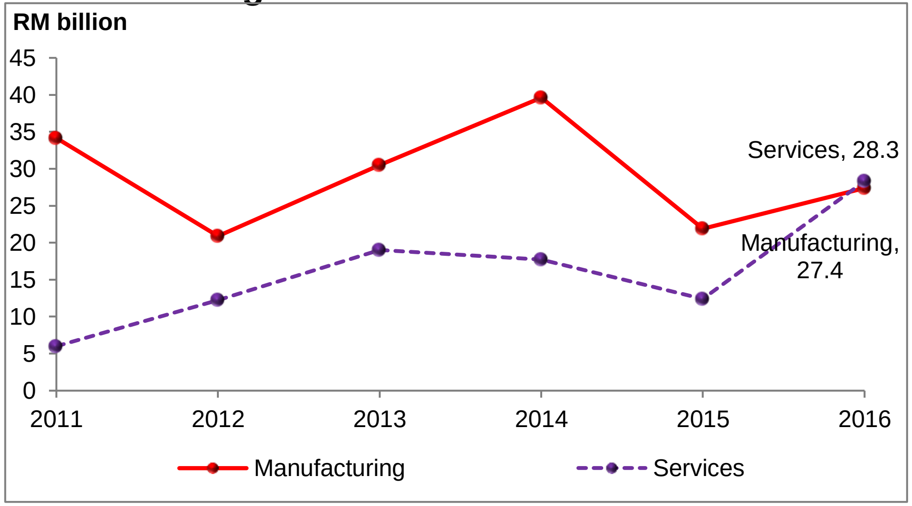
FDI stock in Malaysia: Diversified investors



Higher approved total investment in 2016



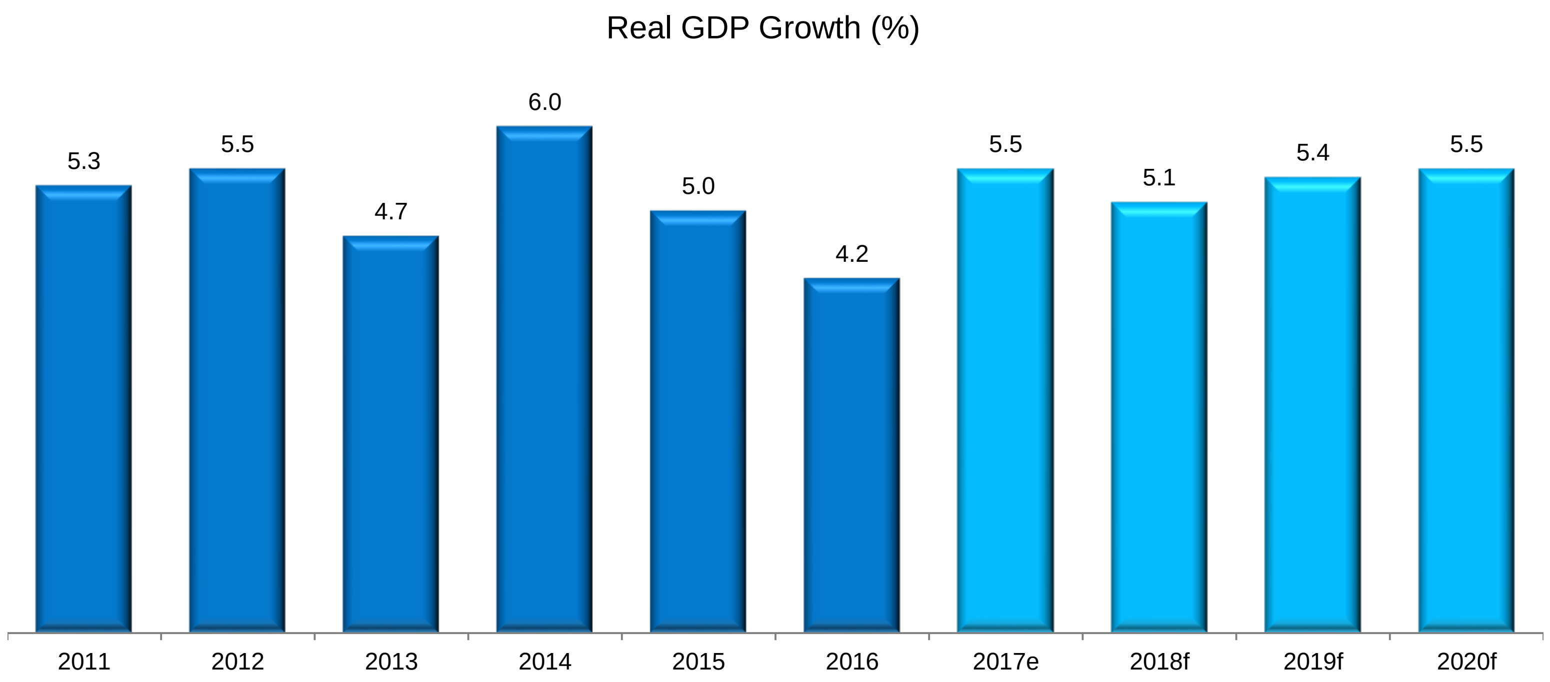
Higher approved foreign investment in manufacturing and services



Source: BNM; MIDA

Malaysia's medium-term economic outlook

- The economy is projected to grow by 5.1% pa in 2016-20 (5.3% pa in 2011-15).
- Private sector expenditure to support the economy. Improved income and increased employment means higher spending power.
- The implementation of ongoing and new projects related to rail, ports, highways, real estate and in major economic sectors (manufacturing, services and mining) are expected to sustain public and private investment.



Source: DOS, Malaysia; SERC

Can BNM afford to increase interest rates?

Policy environment

- Lingering uncertainties in global economic and financial environment
- Higher US interest rates
- Volatile capital flows and exchange rate

Growth, inflation and financial imbalances

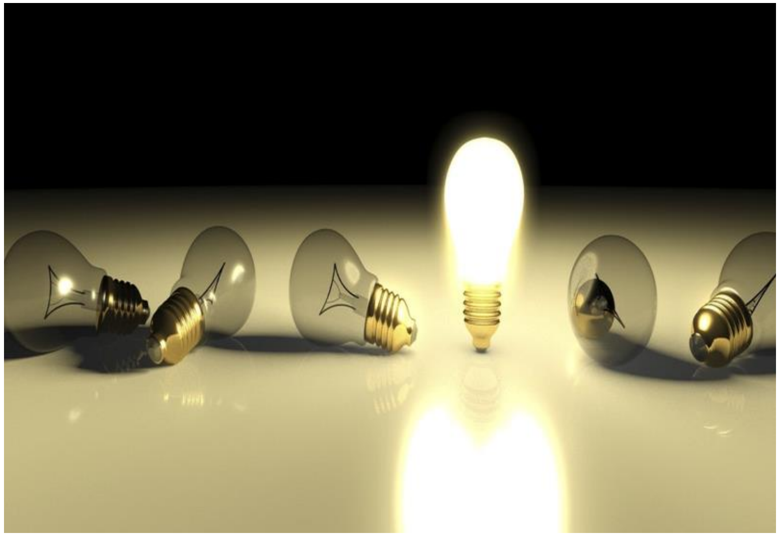
- Is economic growth strong enough?
- Domestic demand faces headwinds (high cost of living and weak consumer sentiment)
- Cost-induced inflation outweighs demand pressure
- Household debt to GDP eased to 85.6% at end-June 2017 (88.4% at end-2016; 89.1% at end-2015)
- Continue to monitor the risk of financial imbalances

	2007	2008	2009	2010	2016	2017*e*	2018*f*
OPR	3.50%	3.25% ↓	2.00% ↓	2.75% ↑	3.00% ↓	3.00% =	3.25-3.50% ↑
GDP	6.5%	4.7% ↓	-1.7% ↓	7.4% ↑	4.2% ↓	5.5% ↑	5.1% ↓
Inflation	2.0%	5.4% ↑	0.6% ↓	1.6% ↑	2.1% =	3.5% ↑	3.0-3.5% ↑

BNM will face a tough yet decisive balancing act if the Fed takes more aggressive run of rate increases ahead

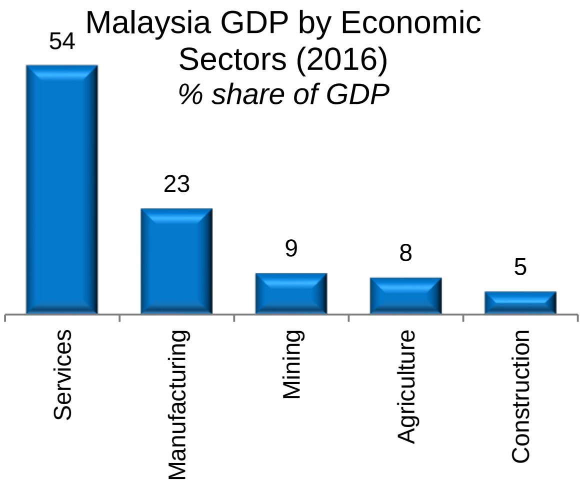
Section 3:

A critical look at Malaysia economy – Challenges, pitfalls and opportunities

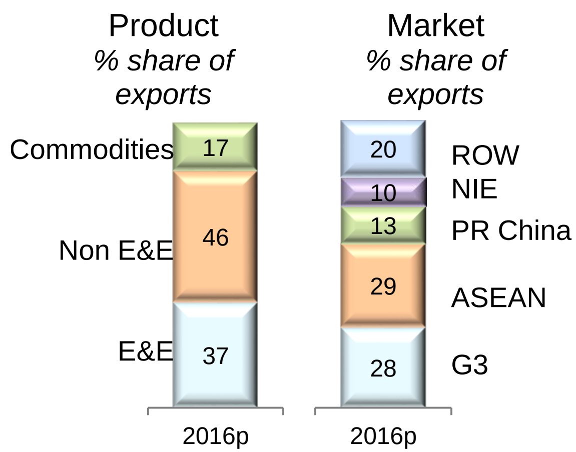


Macroeconomic fundamentals remain supportive of growth

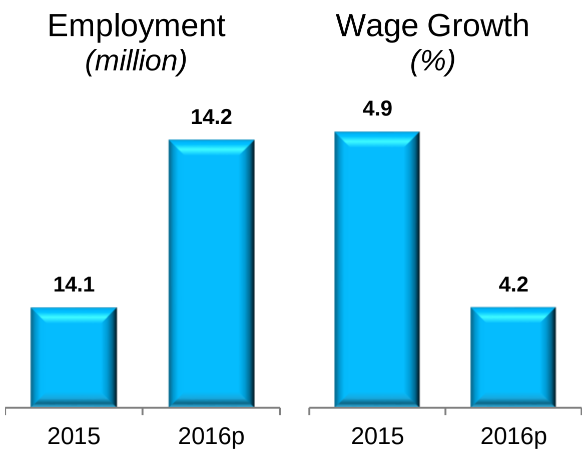
Diversified sources of growth



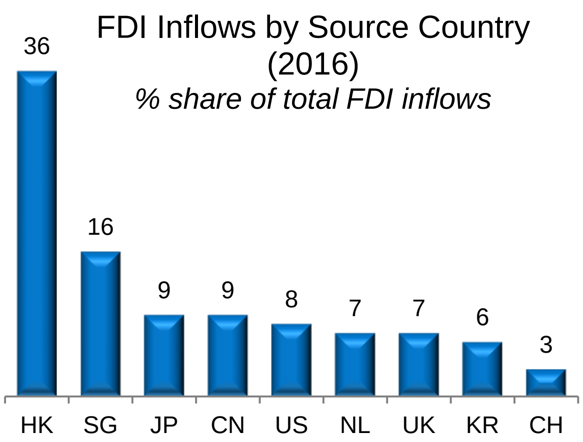
Diversified export market and product



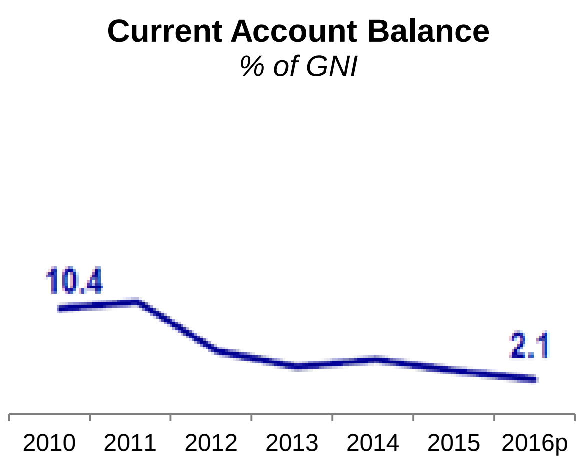
Stable labour market conditions



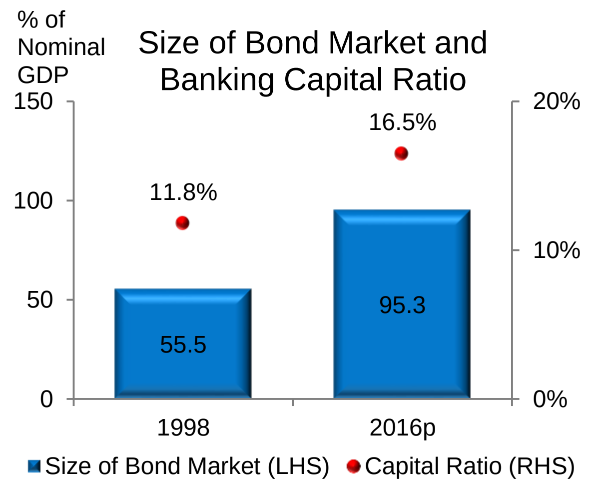
Conducive investment destination for foreign investors



Current account balance reflects strong investment



Deeper markets and strong financial buffers



Source: BNM

Here are four shifting trends casting a challenging future for Malaysia

Driving competitiveness and productivity

- Competitive framework – tax structure and regulatory environment
- Unlocking productivity is critical

Digital technologies and transformation

- Building a connected ecosystem
- Technology disruption

Rising global complexity

- Unpredictable policy shift in advanced economies
- Shifting hotspot of dominant economic power

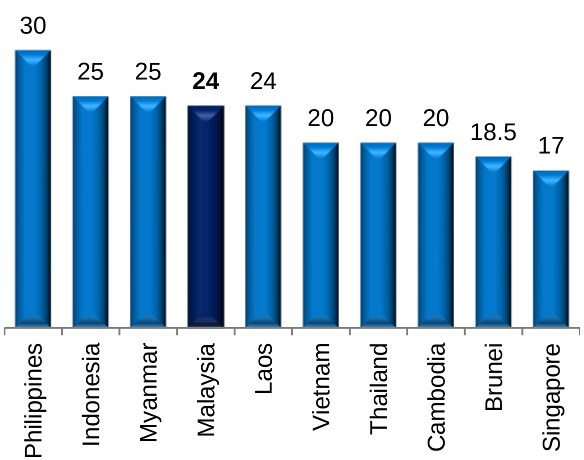
Ageing population

- Widening retirement savings gap
- Rapidly escalating healthcare expenditure

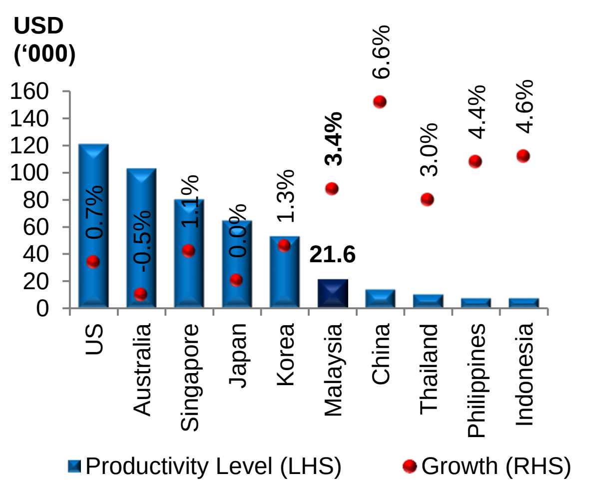
#1 Driving competitiveness and productivity

- Global competition to cut corporate tax heats up
- Malaysia's productivity growth is lagging behind
- **Strategies and initiatives**
  - ❑ Push for competitive tax structure
  - ❑ Restructure and improve the management of foreign workers
  - ❑ Actively encourage the adoption of 4th Industry Revolution
  - ❑ Create dedicated pool of investment funds or align existing fund to drive 4th Industry Revolution agenda nationally

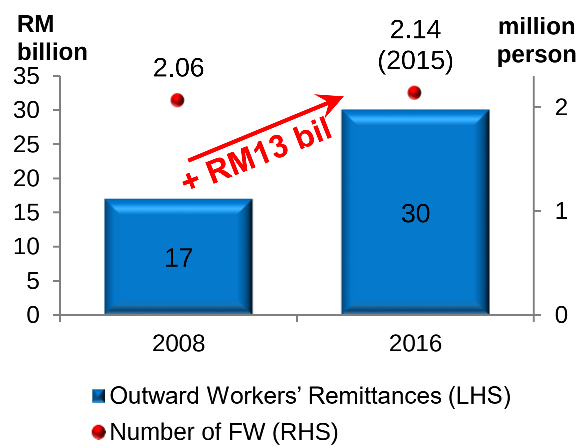
Regional corporate tax rate comparison



Regional labour productivity comparison in 2015



Surge in FW remittances despite only small increase in number of FW

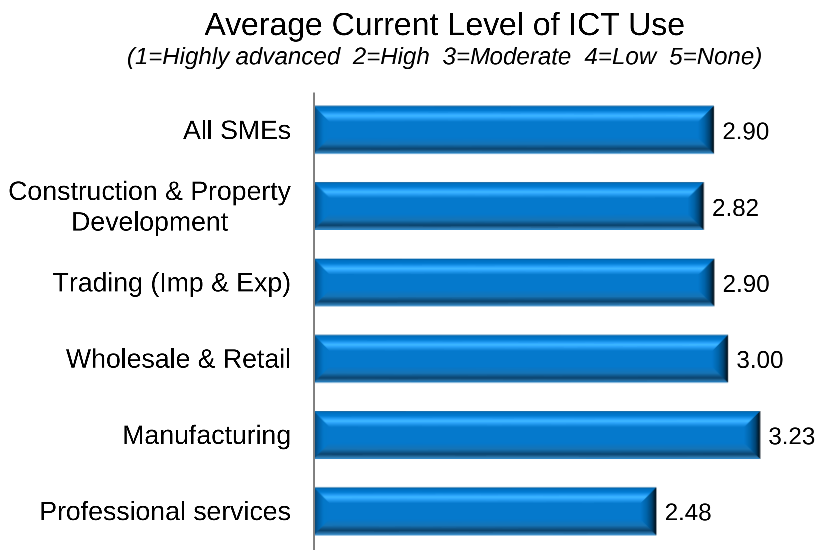


Source: EY; MPC; BNM; EPU

#2 Digital technologies and transformation

- **Transport** – seamless connectivity, safety, reliability and speed
- **Connectivity/communication** – investment in ICT to scale benefits of digitalization, broadband speed and reliability of coverage
- **Space/housing**
- **Manufacturing for the future**
- **Consumer culture (taste, fashion and lifestyle)**

SERC's Survey result



Malaysia introduced National E-Commerce Strategic Roadmap to double the growth

	2015 current	2020 business as usual	2020 with intervention
eCommerce contribution (RM billion)	68	114	170+
eCommerce growth (% CAGR)	12.8 2012–2015	10.8 2015–2020	20.8 2015–2020

Source: National E-Commerce Strategic Roadmap; SERC

#3 Rising global complexity

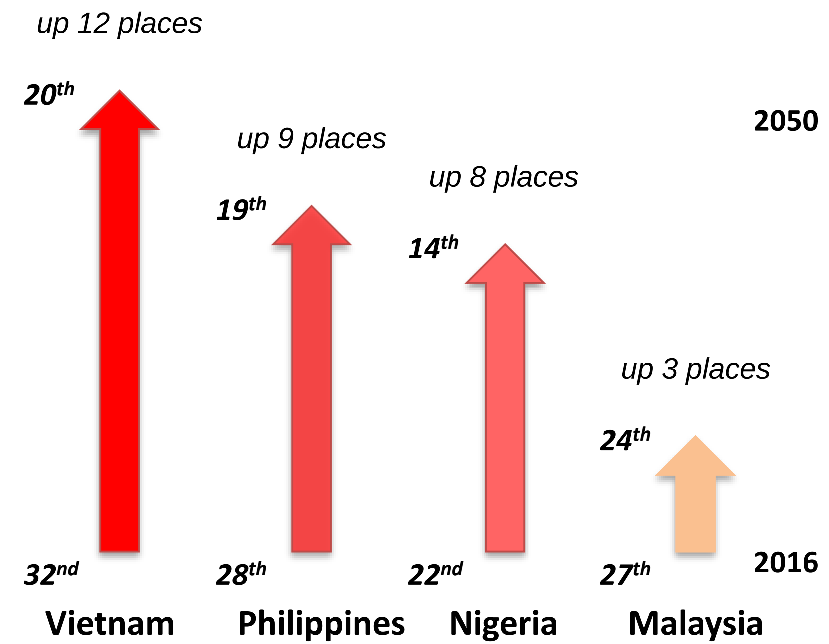
- According to PwC, emerging markets will continue to be the growth engine of the global economy. By 2050, China could be the largest economy in the world, with India in second place and Indonesia in fourth place. Malaysia will improve to 24th placing from 27th in 2016.

Emerging market will dominate the world's top 10 economies in 2050 (GDP at PPPs)

2016		*2030*		*2050*	
China	1	China	1	China	1
US	2	US	2	India	2
India	3	India	3	US	3
Japan	4	Japan	4	Indonesia	4
Germany	5	Indonesia	5	Brazil	5
Russia	6	Russia	6	Russia	6
Brazil	7	Germany	7	Mexico	7
Indonesia	8	Brazil	8	Japan	8
UK	9	Mexico	9	Germany	9
France	10	UK	10	UK	10
Malaysia	27	Malaysia	25	Malaysia	24

E7 economics G7 economies

Vietnam, the Philippines and Nigeria could make the greatest moves up the rankings by 2050



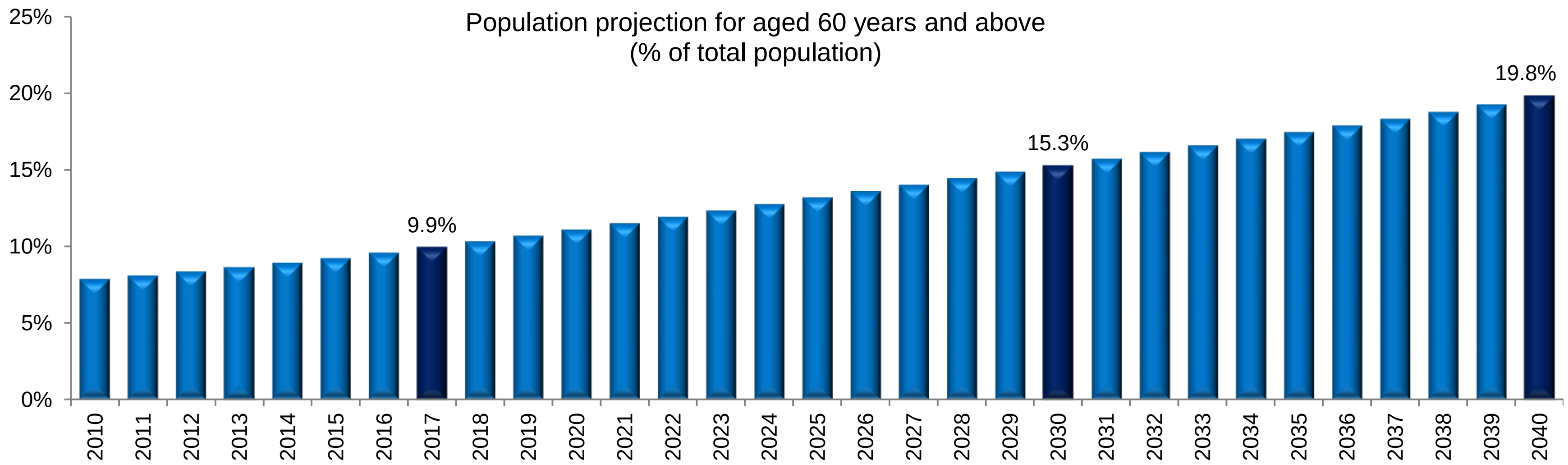
Average annual GDP growth rate, 2016-2050

Vietnam	Philippines	Nigeria	Malaysia
5.1%	4.3%	4.2%	3.5%

Sources: IMF for 2016 estimates, PwC analysis for projection 2050

4 Ageing population

- Malaysia will become an ageing population by 2030 when 15% of our population will be aged 60 and above (10% currently)
- The ageing population and lifestyle illnesses are drivers of growing healthcare expenditure; may deter investment and they spend differently
- Fiscal cost on healthcare, social protection and housing will be substantial for elderly population
- The combined pressures of ageing and the retirement savings gap might redefine the concept of retirement into the future (tapered retirement)



Sources: DOS, Malaysia

Conclusion

1) The global economy is in a synchronized expansion of economic activities. It is a mutual reinforced economic upswing in both advanced and emerging economies.

2) Policy uncertainty will remain in 2018, and the risks include unexpected changes in monetary policies and the shrinking of the Fed's balance sheet, the financial-sector uncertainty in major economies, as well as geopolitical tensions. Pressures for protectionism are building up.

3) The Malaysian economy remains on track for expansion, firing on twin engines (2017E: 5.5%; 2018F:5.1%).

4) Strengthening policy space, addressing vulnerabilities, and enhancing international competitiveness by promoting investment, services, high-end manufacturing and FDI would also boost economic resilience and improve growth prospects.

5) Reaping digital technologies dividend requires the right policy mix and investments such as software and hardware investment, soft skills and the right ecosystem to harness information, communications and technology (ICT) and e-commerce to deliver increased productivity and growth.

社会经济研究中心
SOCIO-ECONOMIC RESEARCH CENTRE

SERC

谢 谢
THANK YOU

SERC Sdn. Bhd.

Address : 6th Floor, Wisma Chinese Chamber,
258, Jalan Ampang, 50450 Kuala Lumpur, Malaysia.
Tel : 603 - 4260 3116 / 3119
Fax : 603 - 4260 3118
Email : serc@acccimserc.com
Website : http://www.acccimserc.com