



NATIONAL TAX CONFERENCE 2014:

*“Economic Outlook for
Malaysia”*

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12 August 2014



Presentation Outline

- ❖ **Selected key economic indicators**
- ❖ **MIER 2Q 2014 surveys**
- ❖ **Near-term outlook**
- ❖ **Downside risks**
- ❖ **Policy directions**

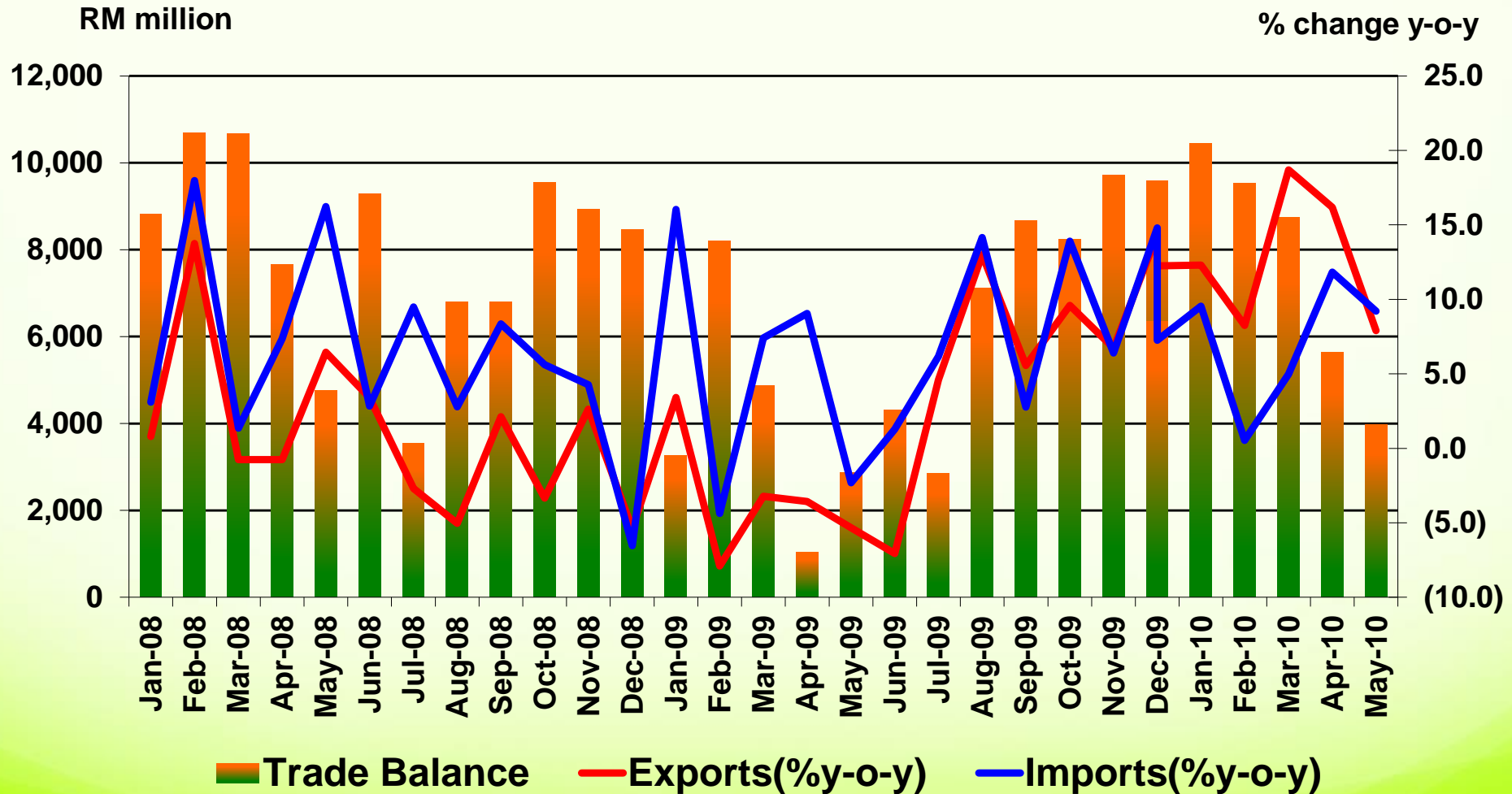
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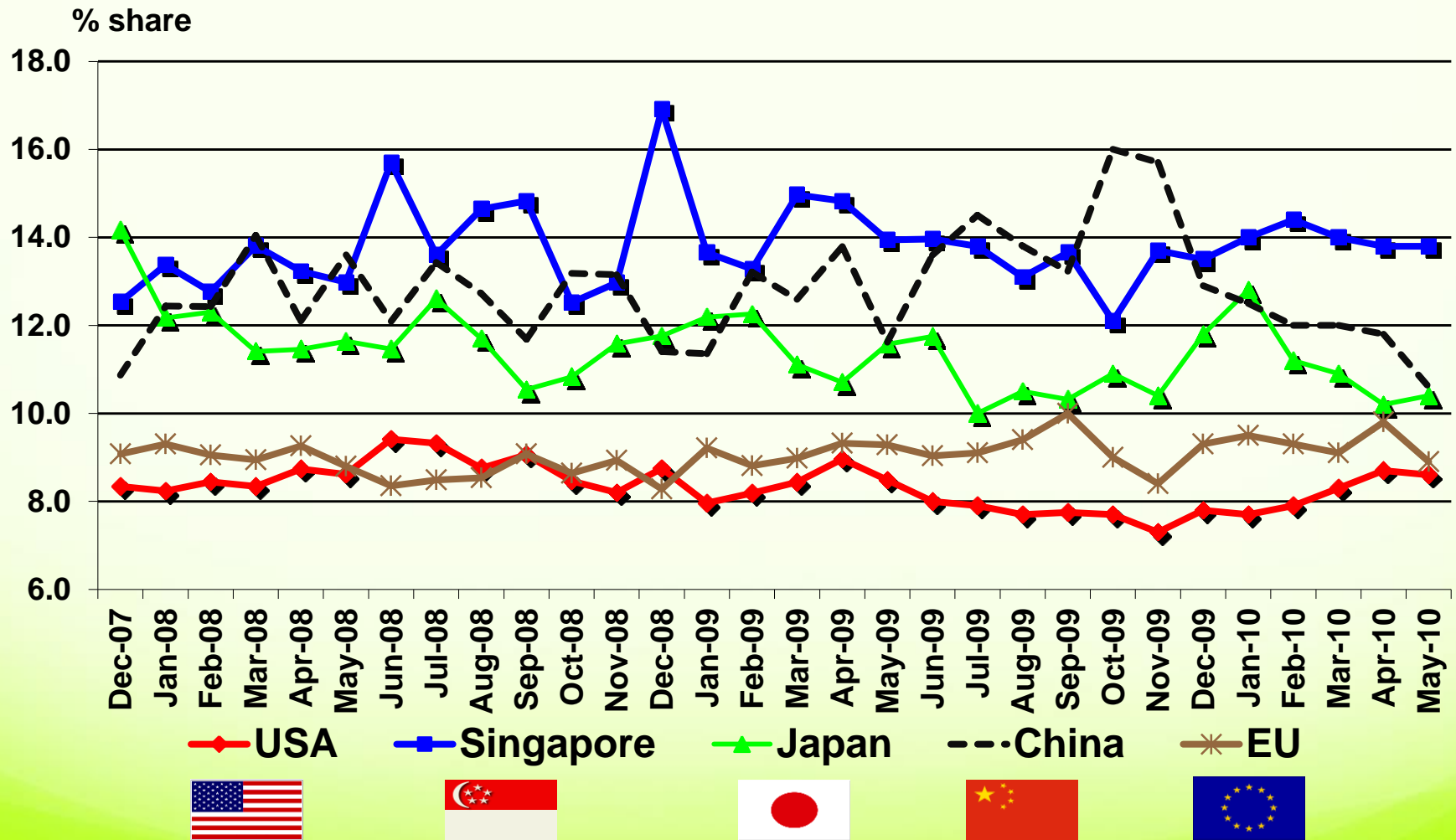
Key Economic Indicators

- ❖ External Trade
- ❖ Foreign Direct Investment (FDI)
- ❖ Industrial Production Index (IPI)
- ❖ Monetary Indicators
- ❖ Foreign Reserves
- ❖ Exchange Rate
- ❖ Inflation
- ❖ Unemployment

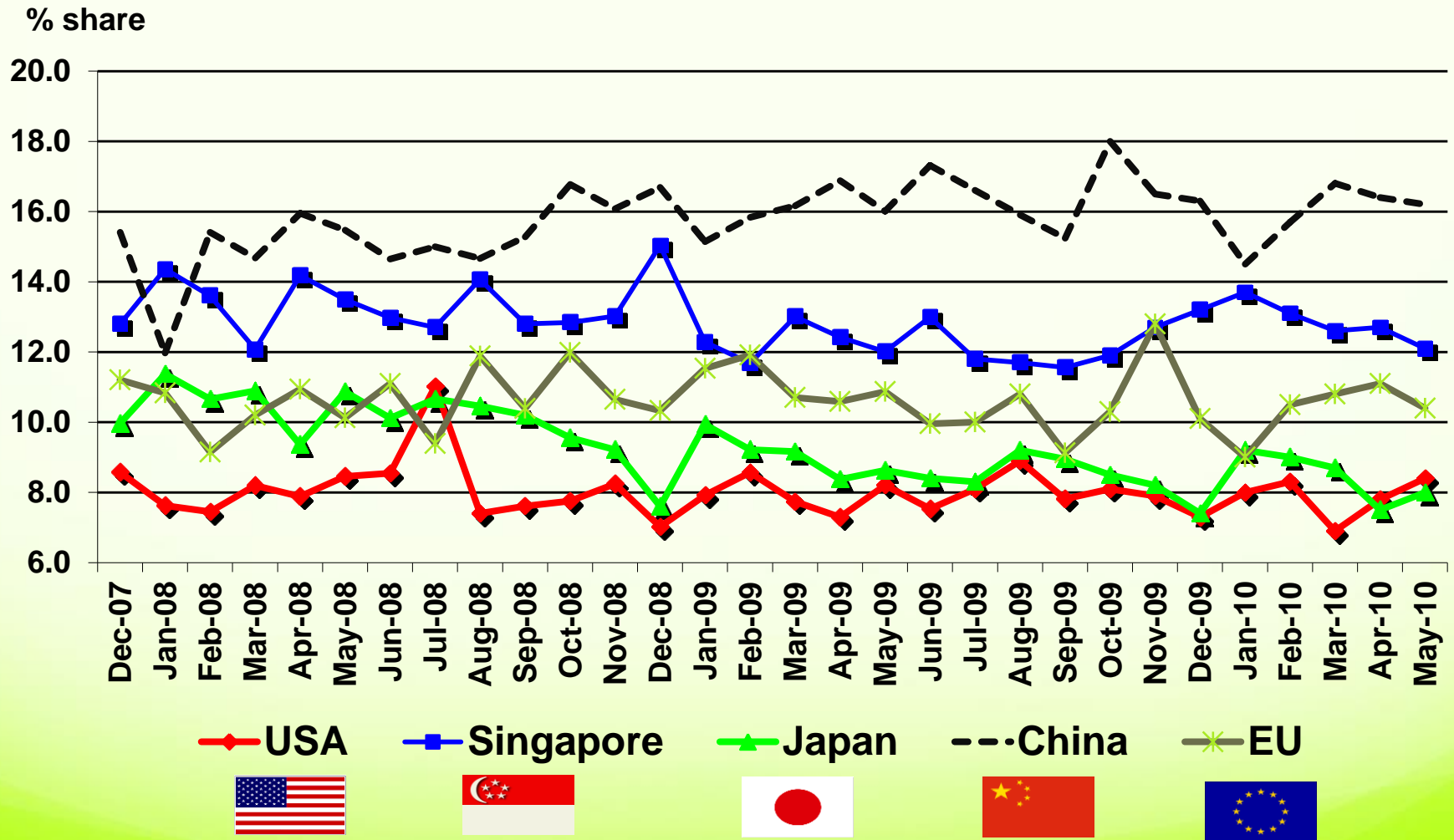
External Trade



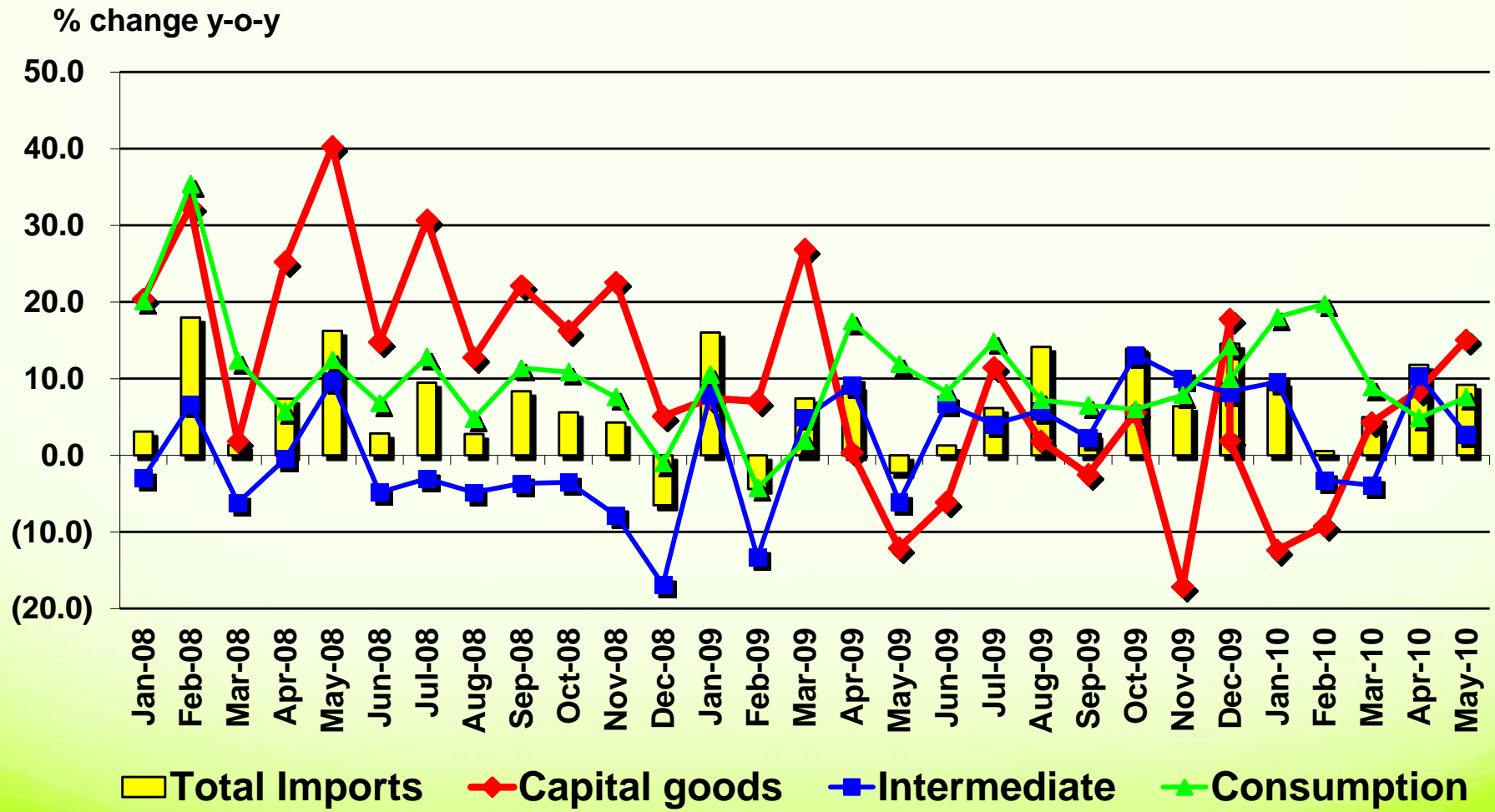
Exports to Major Partners



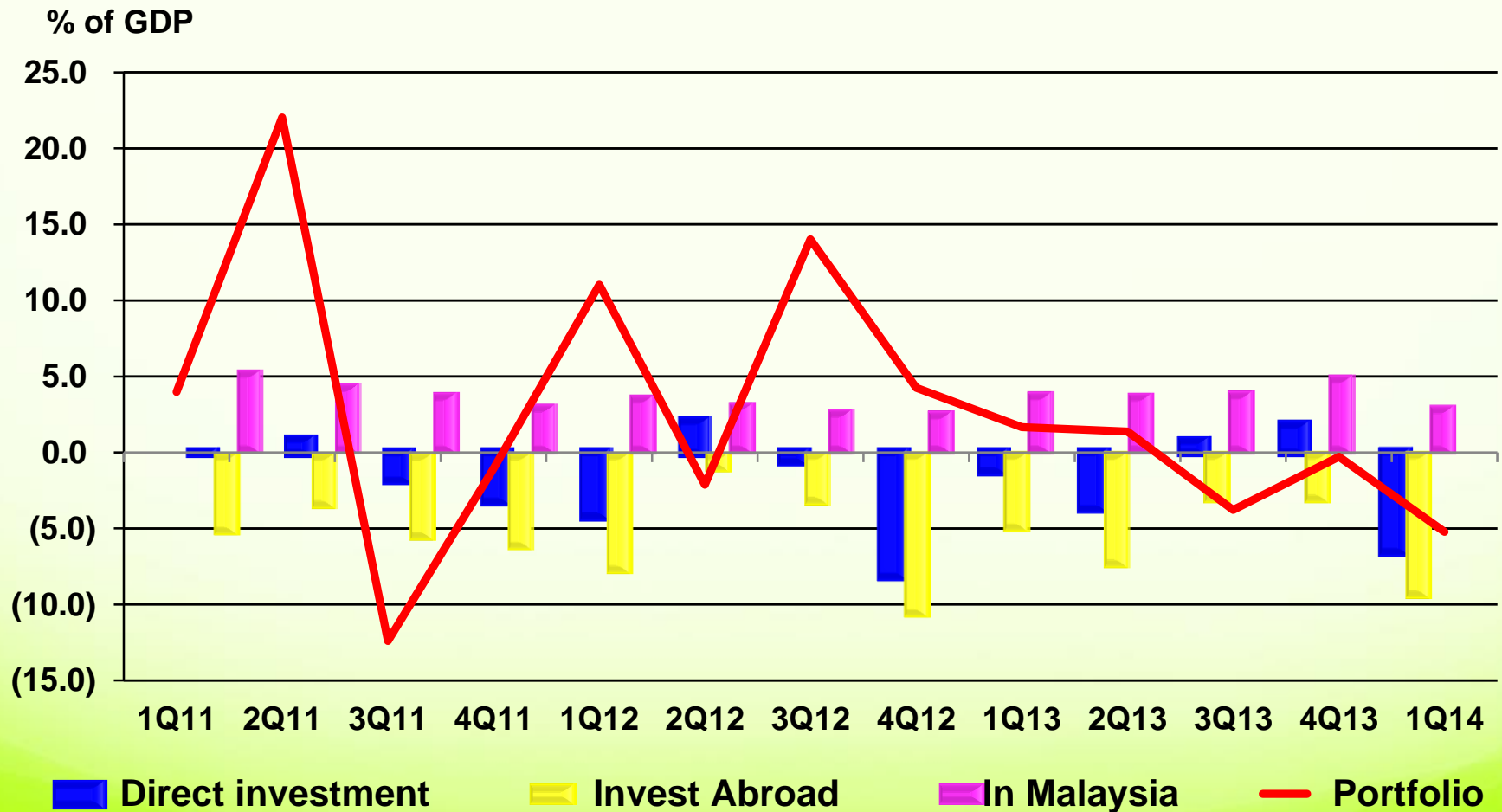
Import Sources



Imports by Category



Foreign Direct Investment (FDI)



Investment Approvals

	2012	2013	Jan-May 2014
Total Investment (RM Million)	41,126	52,101	41,753.4
Domestic (RM Million)	20,207	21,565	16,576.4
Foreign (RM Million)	20,919	30,536	25,177.0
Potential Employment	76,631	92,988	39,567
Number of projects	804	787	349

Foreign Approvals by Major Industries

	Industry	2013				2012			
		No.	Domestic Investment (RM mil)	Foreign Investment (RM mil)	Total Capital Investment (RM mil)	No.	Domestic Investment (RM mil)	Foreign Investment (RM mil)	Total Capital Investment (RM mil)
1	Electronics & Electrical Products	118	1,319.3	8,495.6	9,815.0	112	734.6	3,252.0	3,986.6
2	Transport equipment	73	4,446.4	2,160.4	6,606.8	85	5,931.9	1,923.8	7,855.7
3	Petroleum Products (Incl.Petrochemicals)	7	2,926.8	3,243.8	6,170.6	14	4,660.6	1,376.8	6,037.4
4	Chemical & chemical products	68	2,035.3	3,758.0	5,793.3	73	766.3	5,671.2	6,437.5
5	Basic metal products	35	1,147.3	4,425.8	5,573.1	37	1,859.1	1,934.0	3,793.1
6	Food Manufacturing	73	2,056.1	2,297.7	4,353.8	67	2,281.4	1,118.0	3,399.5
7	Rubber Products	20	2,833.5	794.5	3,628.0	20	131.7	1,218.6	1,350.3
	TOTAL (1-7)		16,764.7	25,176.0	41,940.7		16,365.7	16,494.4	32,860.1

Source: MIDA

Foreign Approvals in Manufacturing

Country	2013		2012	
	No. of projects	Foreign Investment	No. of projects	Foreign Investment
		(RM Million)		(RM Million)
USA	19	6,320.6	16	295.8
Singapore	126	4,522.3	109	2,214.6
Korea, Republic	13	5,478.8	17	1,637.0
Japan	55	3,591.9	62	2,792.9
Netherlands	11	2,382.0	18	834.8
China	22	3,017.7	23	1,977.8
Germany	17	1,717.0	15	693.3
TOTAL (above)		27,030.3		10,446.1

Foreign Approvals by Major Industries

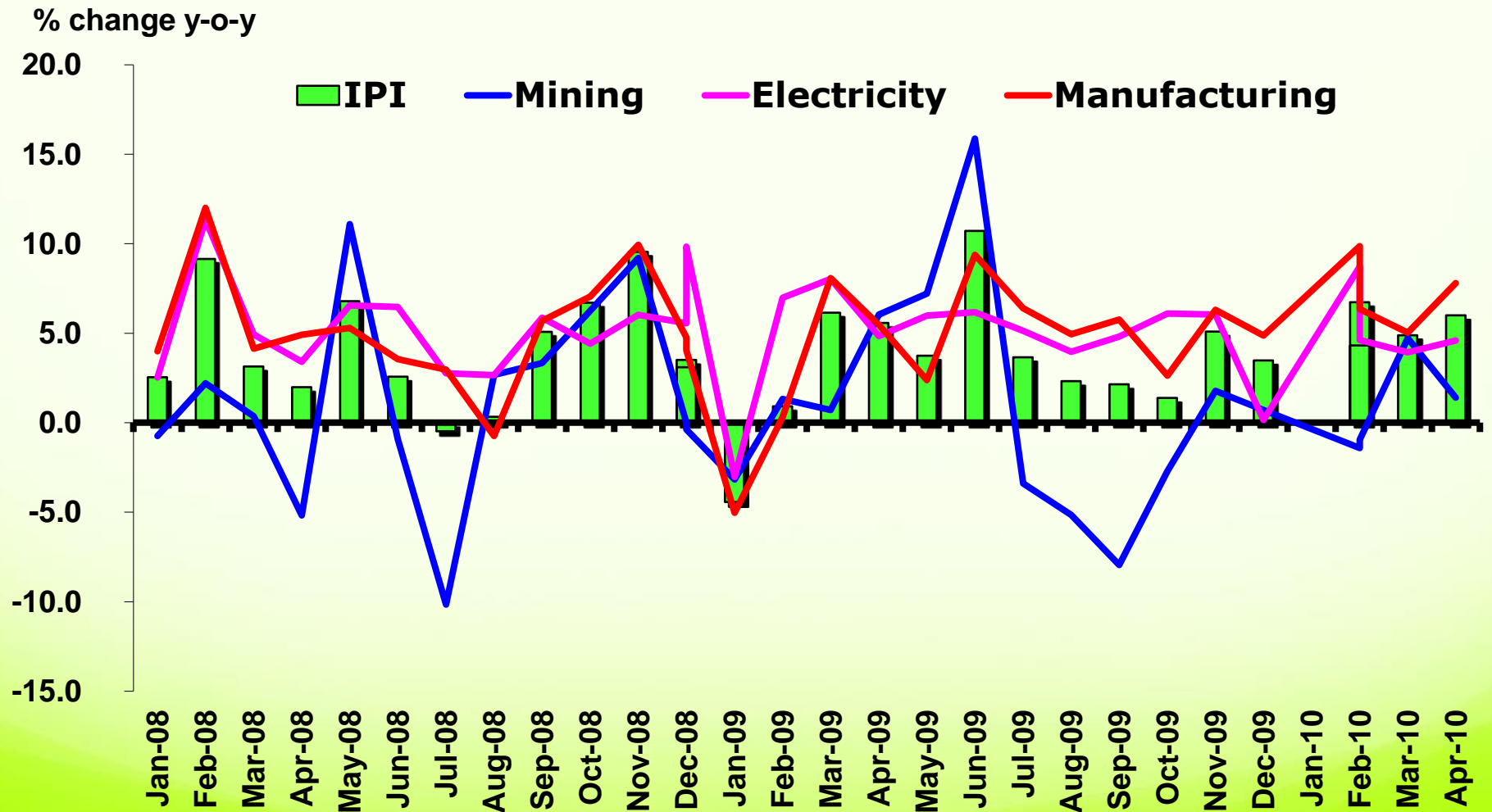
	Industry	Jan-May 2014				2013			
		No.	Domestic Investment (RM mil)	Foreign Investment (RM mil)	Total Capital Investment (RM mil)	No.	Domestic Investment (RM mil)	Foreign Investment (RM mil)	Total Capital Investment (RM mil)
1	Chemical & Chemical Products	47	6,224	8,243	14,467	68	2,035	3,758	5,793
2	Electronics & Electrical Products	31	222	6,147	6,369	118	1,319	8,496	9,815
3	Basic Metal Products	18	638	6,176	6,813	35	1,147	4,426	5,573
4	Food Manufacturing	22	655	500	1,154	73	2,056	2,298	4,354
5	Transport Equipment	22	578	426	1,004	73	4,446	2,160	6,607
6	Fabricated Metal Products	38	716	225	941	73	595	812	1,407
7	Petroleum Products (Incl. Petrochemicals)	7	4,903	1,861	6,764	7	2,927	3,244	6,171
	TOTAL (1-7)	185	10,555	23,577	37,513	447	14,526	25,193	39,719

Source: MIDA

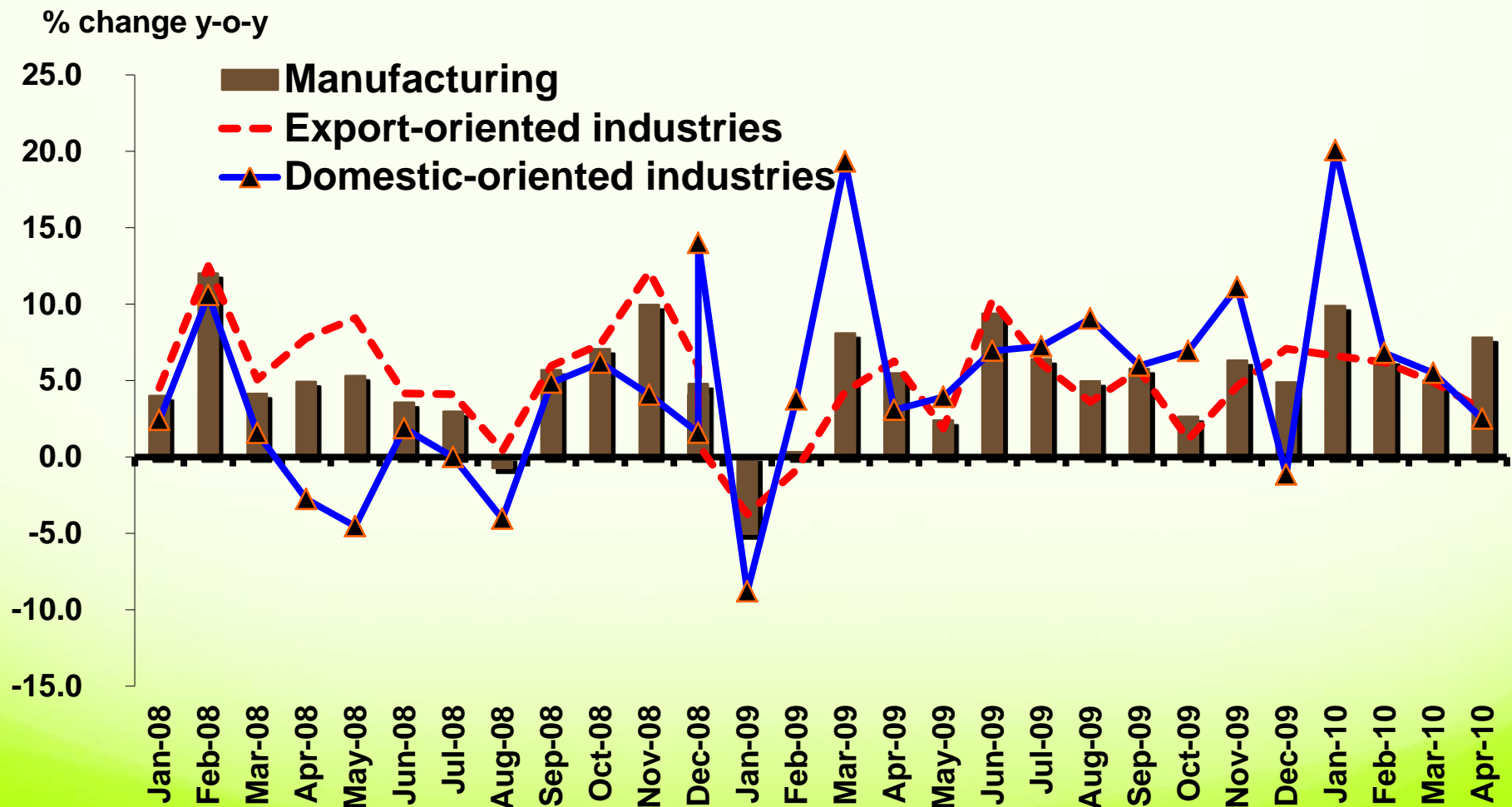
Foreign Approvals in Manufacturing

Country	Jan-May 2014		2013	
	No.	Foreign Investment	No.	Foreign Investment
		(RM Million)		(RM Million)
Japan	33	8,903	55	3,592
China	10	4,421	22	3,018
Germany	4	4,123	17	1,717
Singapore	52	3,237	126	4,522
South Africa	1	681	1	1
Taiwan	16	489	18	131
India	6	460	1	10
TOTAL (above)	122	22,315	240	12,990

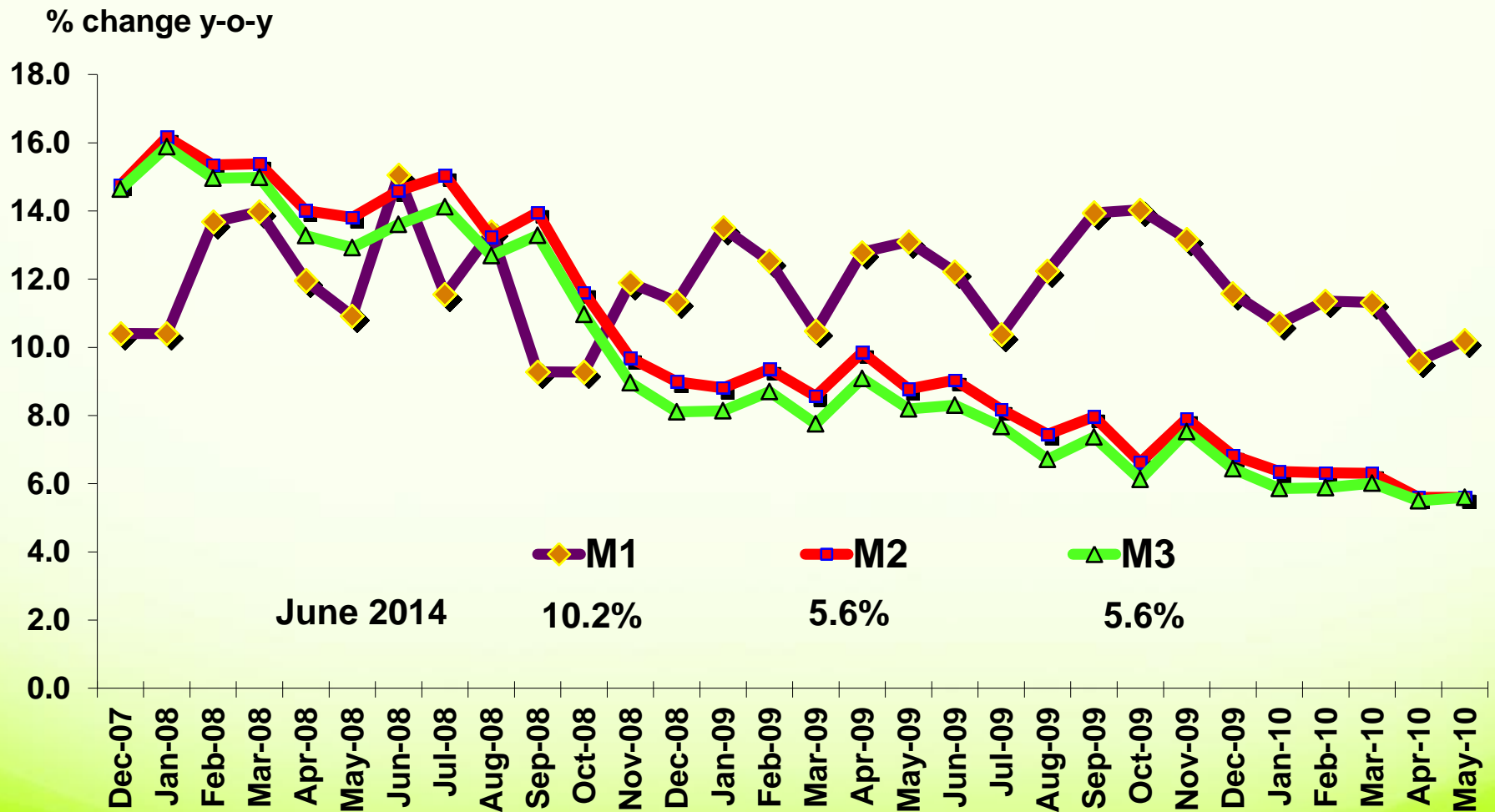
Industrial Production Index (IPI)



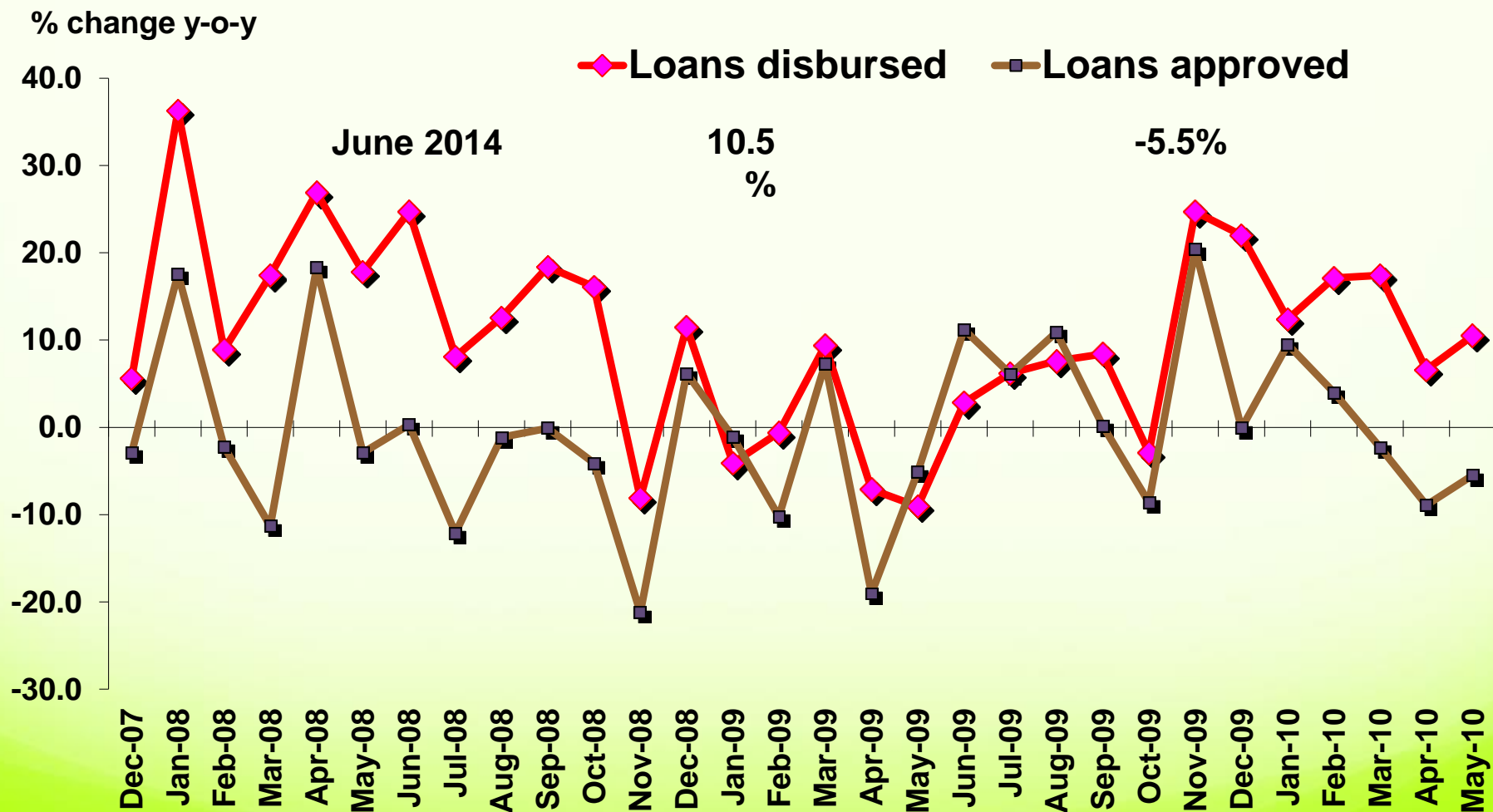
IPI: Export-oriented & Domestic-oriented Manufacturing Indices



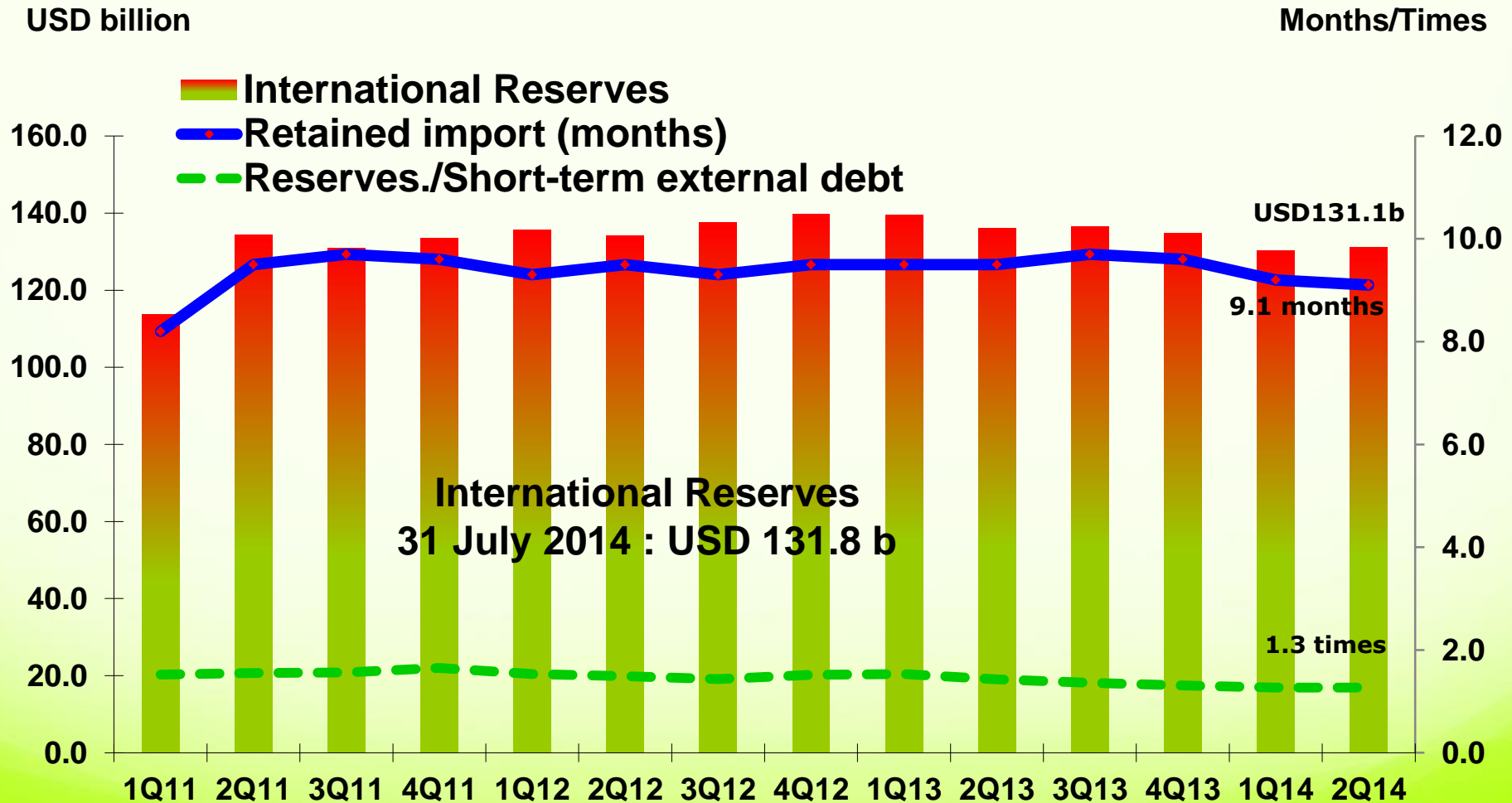
Monetary Indicators



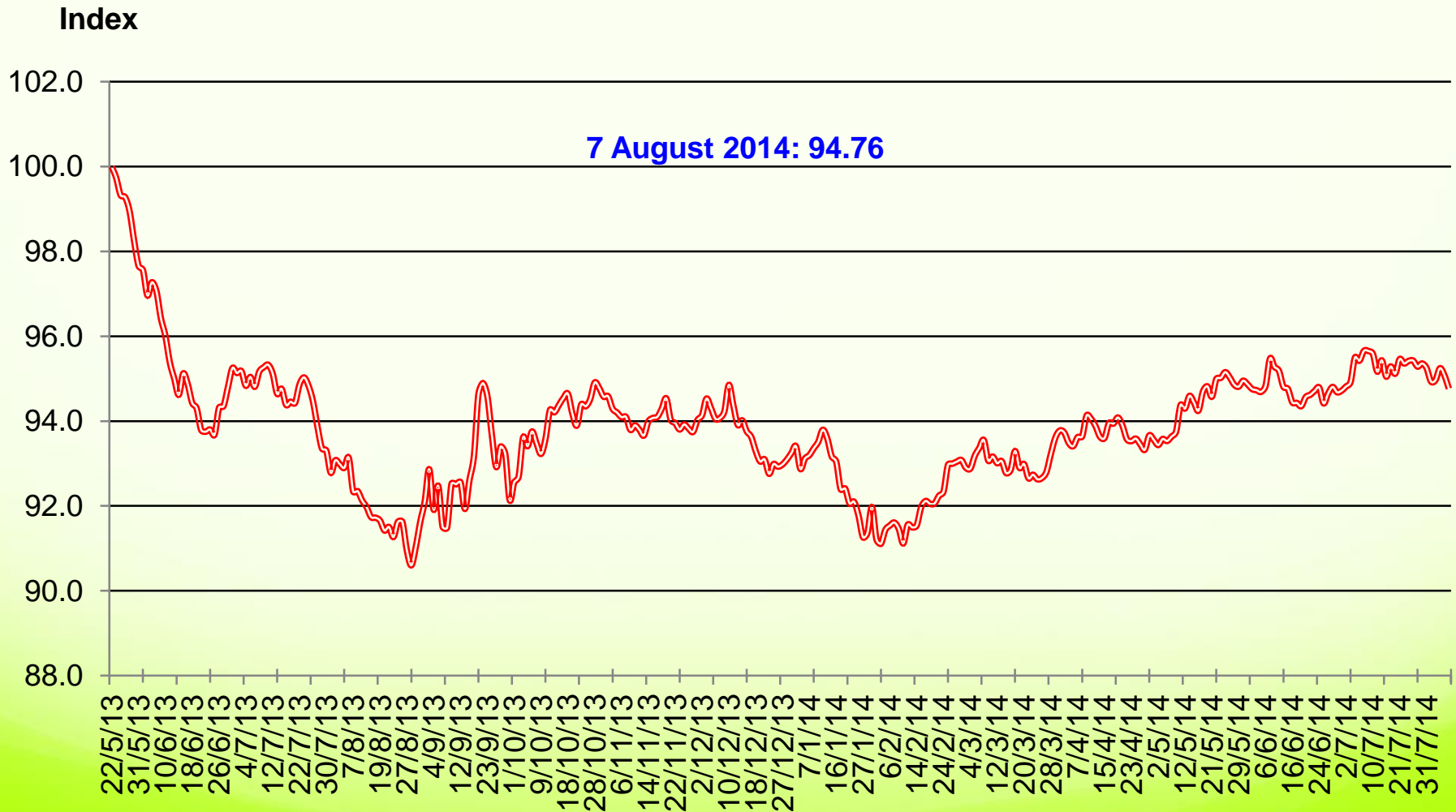
Loans Approved and Disbursed



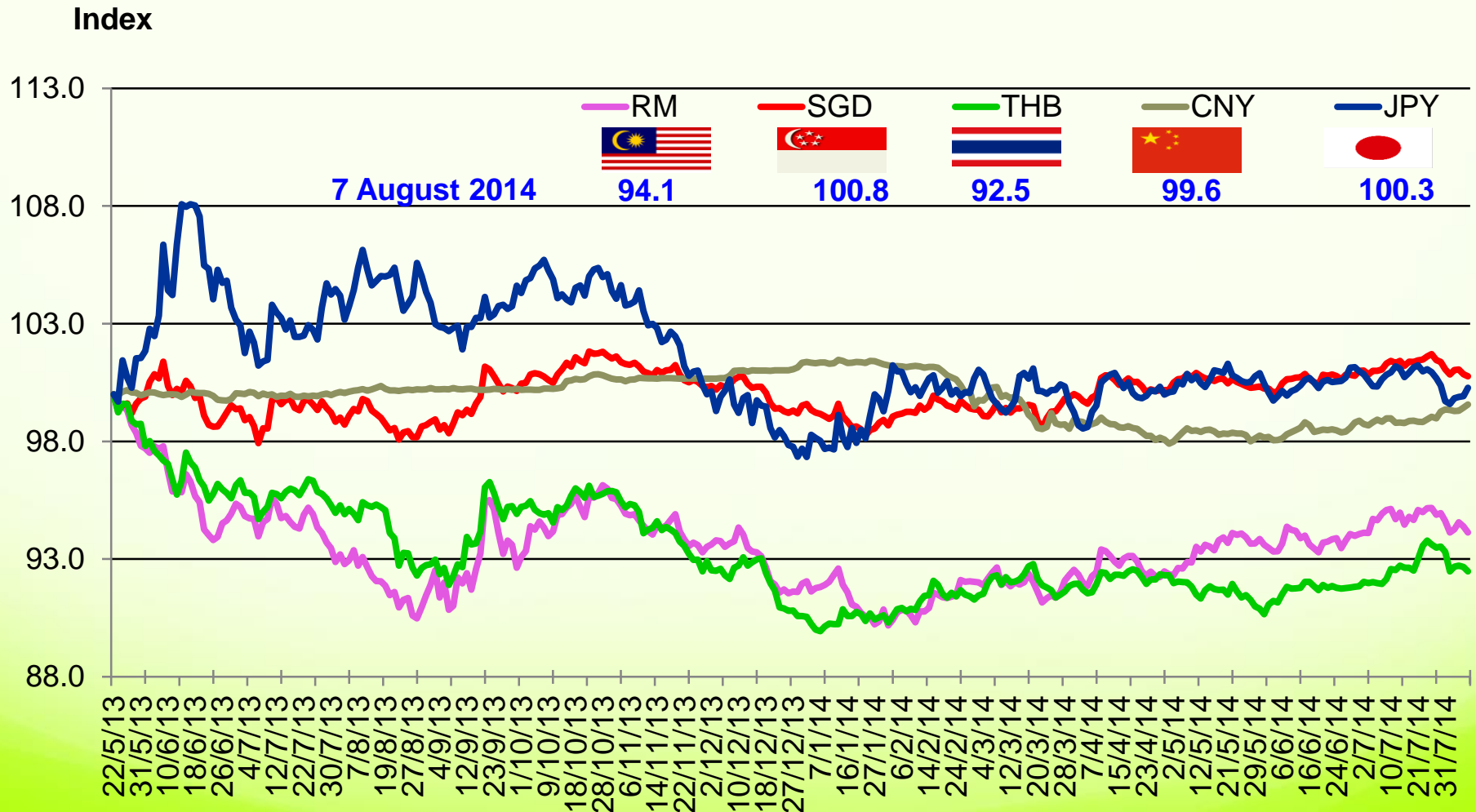
International Reserves



Ringgit against basket of currencies of major trading partners*

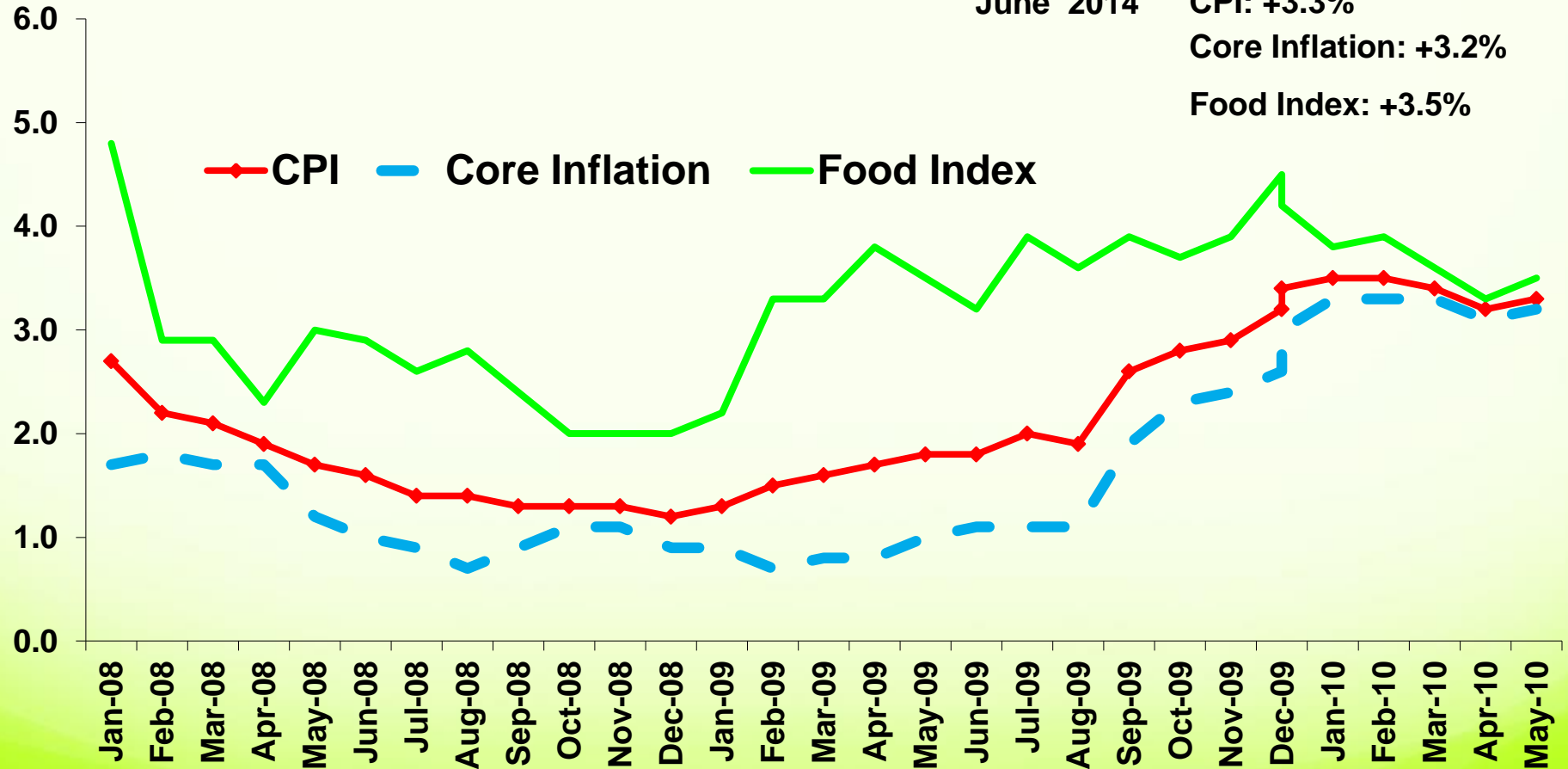


Ringgit and regional currencies against the USD

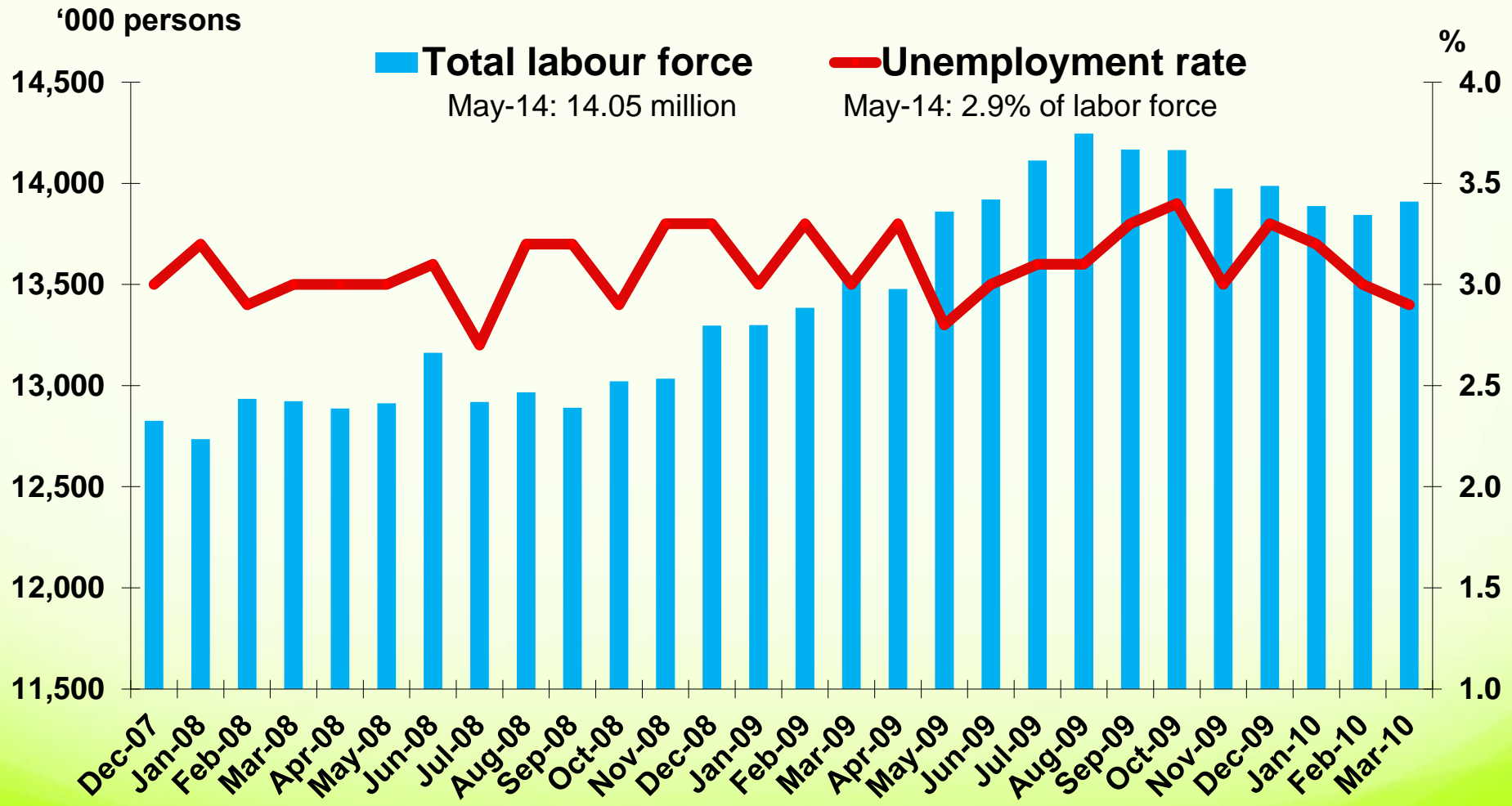


Inflation Rate

% change y-o-y



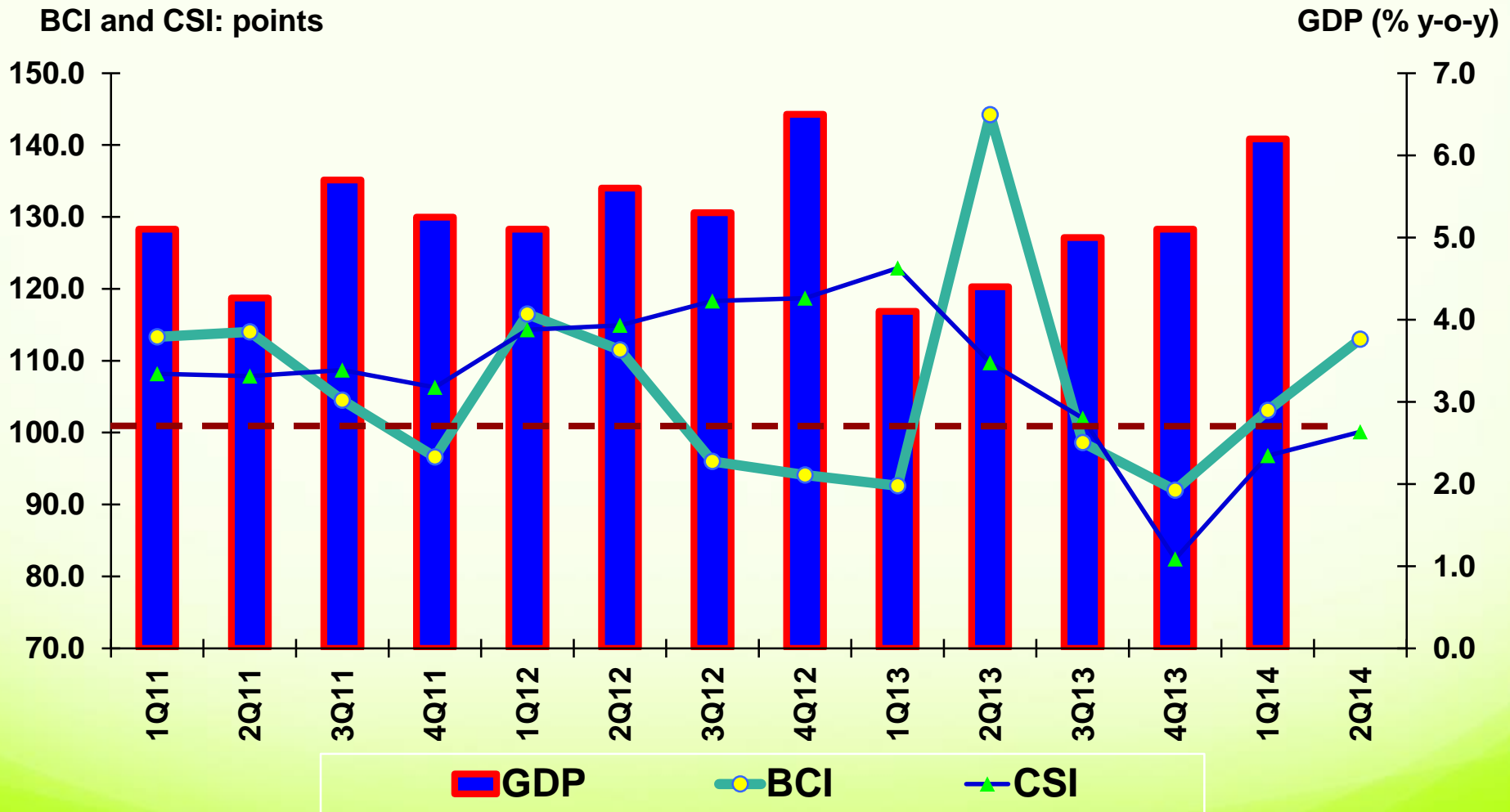
Unemployment Rate



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BCI, CSI and Real GDP Growth



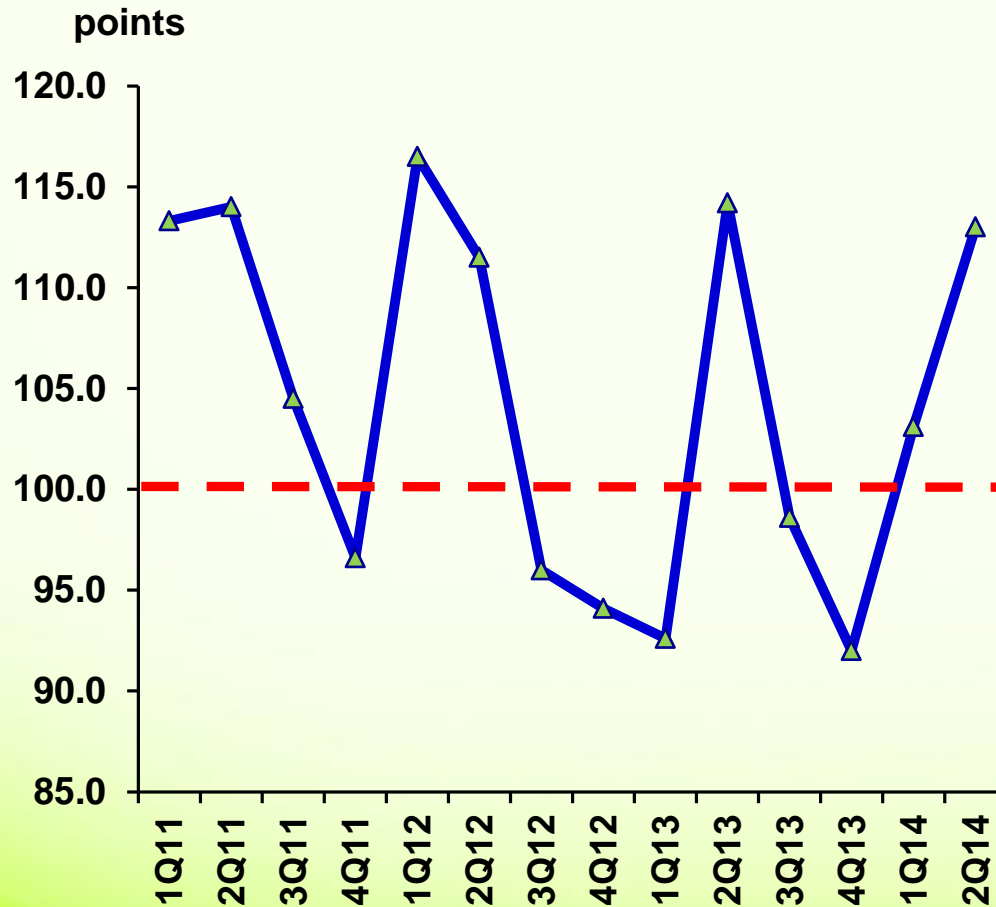
MIER 2Q2014

Survey Results:

BCI & CSI

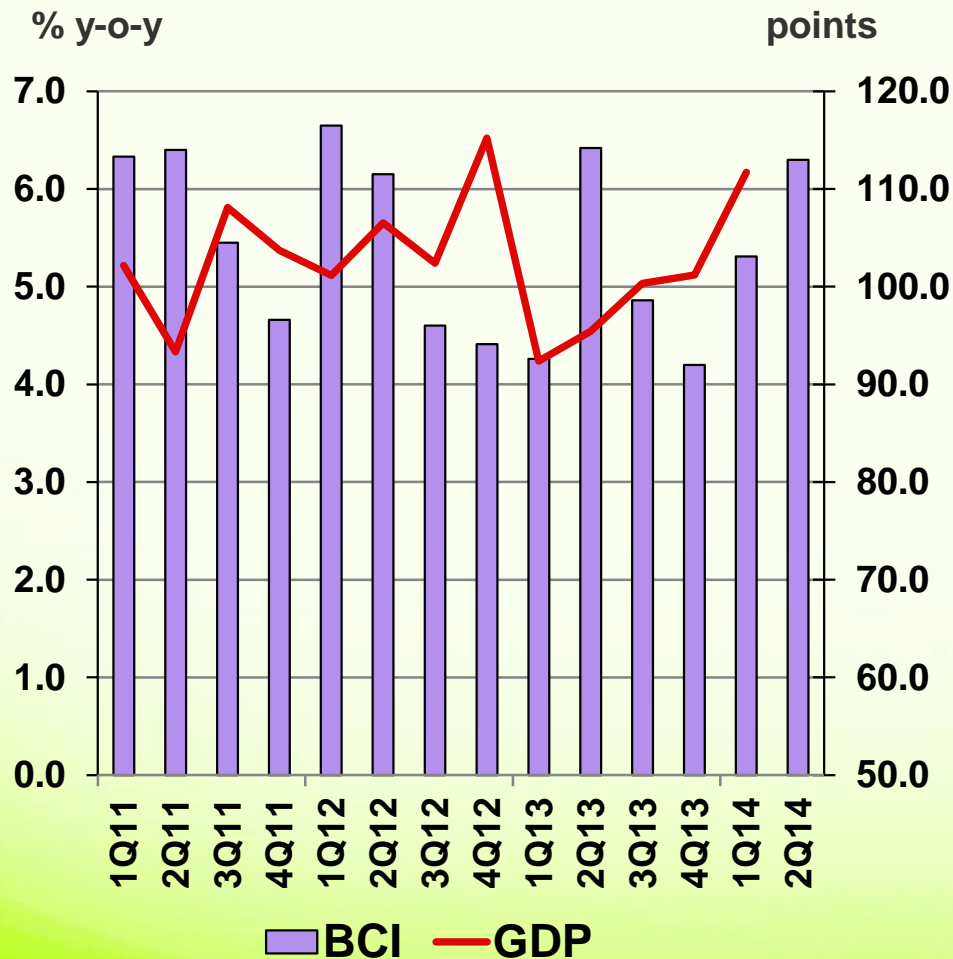
Business Conditions Survey

...BCI moves further up...



- BCI rose 9.9 points to settle at 113.0 points.
- Current Index (CI) increased by 17.7 points.
- Expected Index (EI) loss 13.7 points.
- All six components in the CI registered q-o-q increases.
- Both component indices in the EI drop.

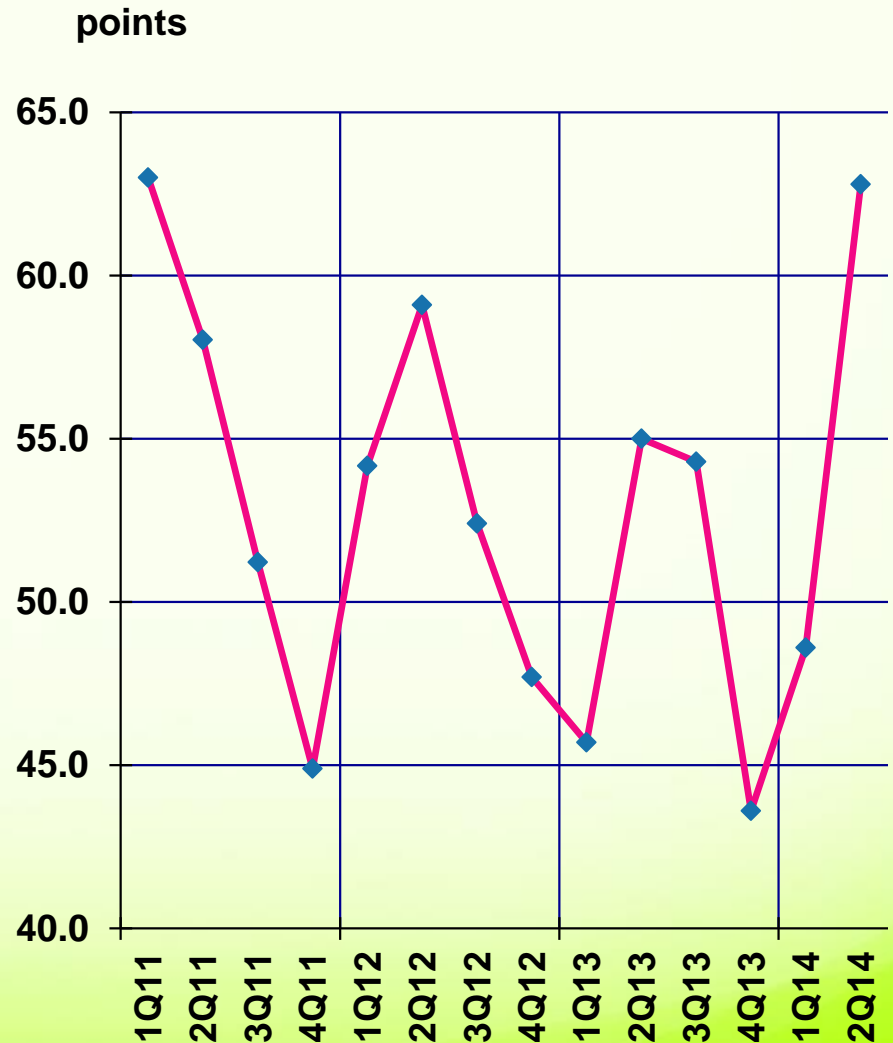
BCI and Quarterly GDP Growth



Quarter	BCI (points)	GDP (%)
1Q2012	116.5	5.1
2Q2012	111.5	5.7
3Q2012	96.0	5.2
4Q2012	94.1	6.5
1Q2013	92.6	4.2
2Q2013	114.2	4.5
3Q2013	98.6	5.0
4Q2013	92.0	5.1
1Q2014	103.1	6.2
2Q2014	113.0	-

More sales

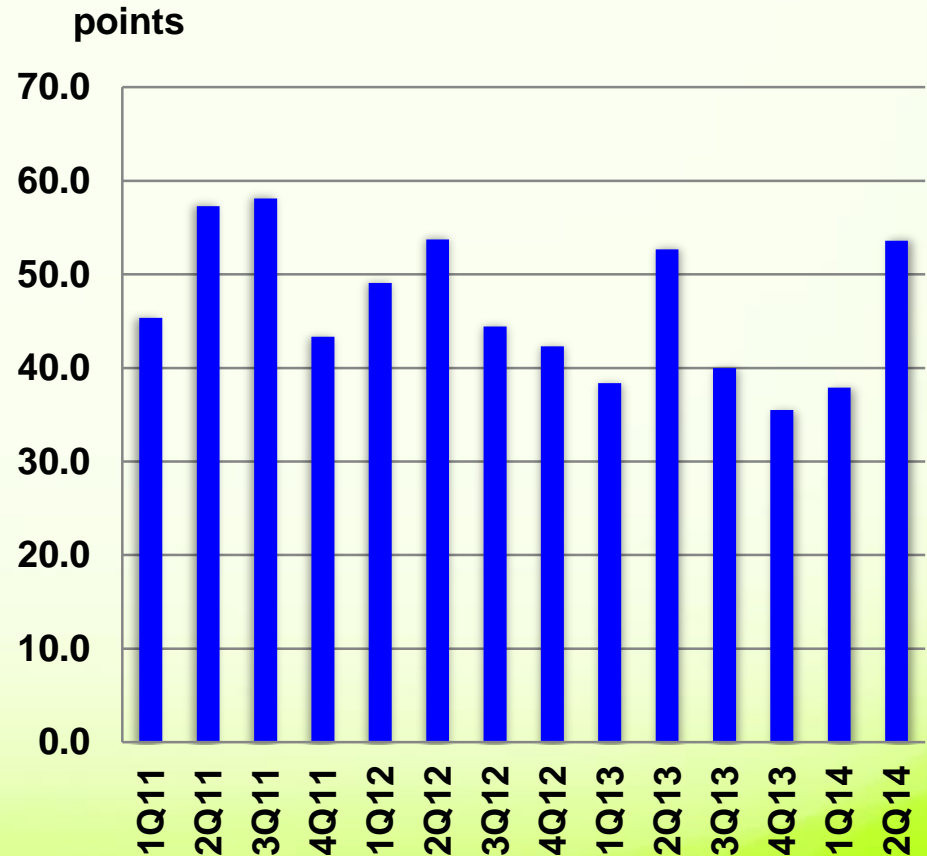
- The manufactured goods sales component sub-index of the BCI increased by 14.2 points quarter-on-quarter, settling higher at 62.8 points.
- Year-on-year, the sub-index was 7.8 points higher.
- Local sales are expected to weaken in the next three months as the sub-index drop by 4.4 points.
- Sectors producing paper & paper products, rubber, plastics, non-metallic and metal products reported doing relatively better quarter-on-quarter in terms of overall sales performance.



Strong domestic demand

- New local orders trended higher 15.7 points q-o-q, to settle at 53.6 points.
- Six out of eleven sectors covered in this survey, such as food, beverage & tobacco, textile & clothing, paper & paper products, rubber, plastics, and metal products did relatively better q-o-q in terms of new local orders.

New Local Orders



Rise in export orders

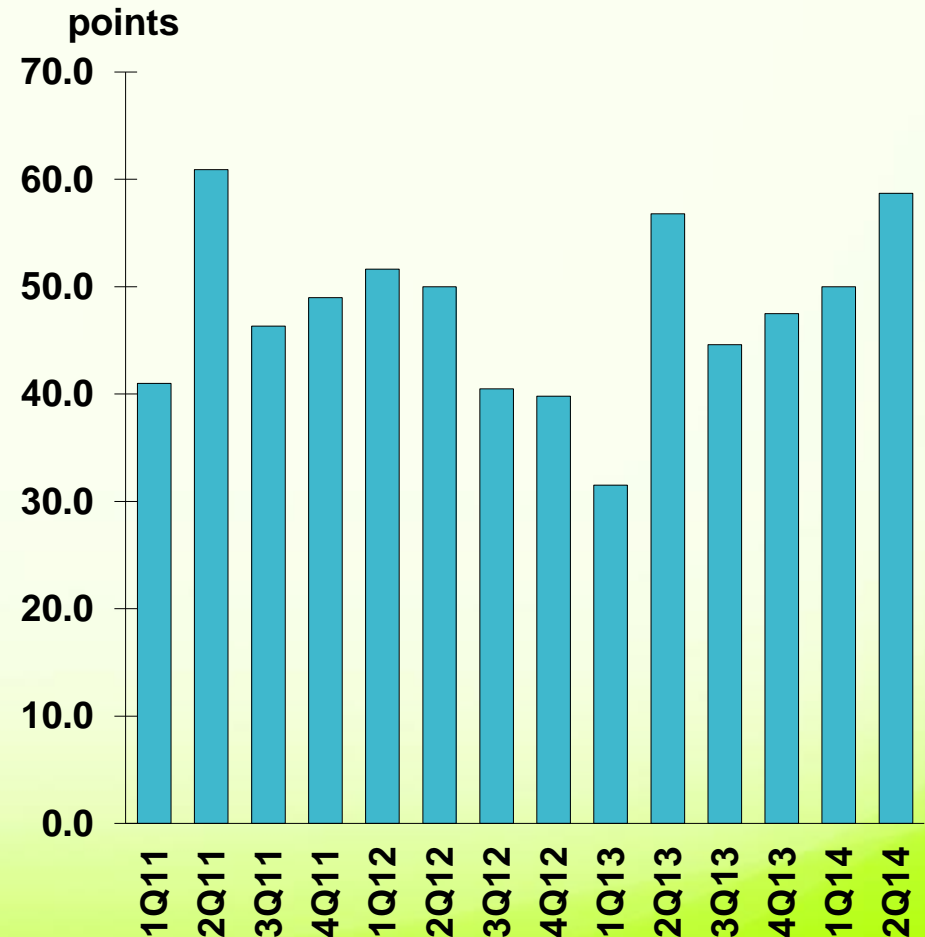
- The sub-index settled higher at 60.7 points.
- Orders for food, beverage & tobacco, textile & clothing, paper & paper products, rubber, chemical, plastic, non-metallic, metal products and electrical & electronics products reported doing better compared with the previous quarter as confirmed by most of the respondents.



Production expands further

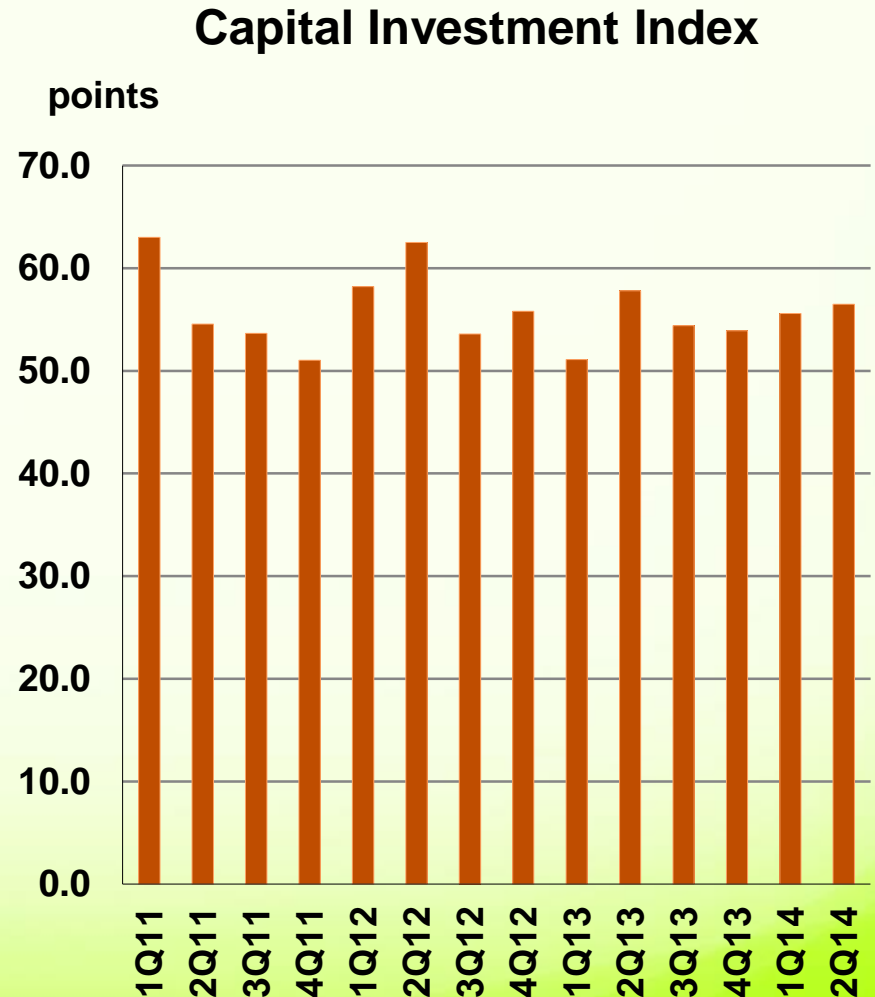
- Production output component sub-index of the BCI settled higher at 58.7 points, gaining 8.7 points quarter-on-quarter.
- Bullish production activities were evident in the food, beverage & tobacco, textile & clothing, paper & paper products, plastics and metal products.

Production Volume Component Index



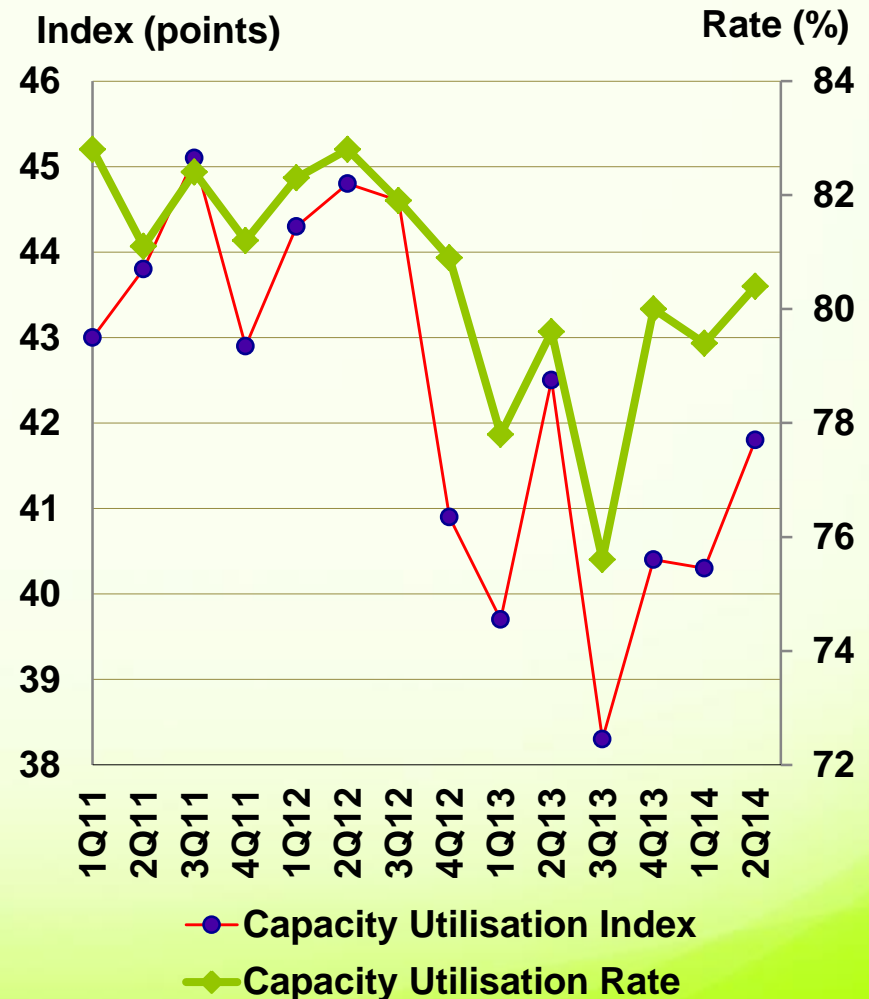
More investment

- The sub-index ended 56.5 points. Higher by 1.0 point q-o-q, but loss 0.8 points y-o-y.
- Investment spending were most active in industries producing paper & paper products, plastic, non-metallic as well as metal products.



Step up in capacity utilisation

- Capacity utilization sub-index of the BCI shifted higher to 41.8 points.
- Capacity utilization rate also settled higher at 80.4%. It was 1.0 percentage point higher q-o-q.
- The majority of the producers of paper & paper products, chemical and electrical & electronic products, kept operating rate at 81-100% range. Other sectors like wood & wood products, plastic and non-metallic operated mainly within 61 - 80% range.



Business Expectations

...for 3Q2014...

- ◆ **Business conditions to deteriorate over the next three months**
- ◆ **Lower production and export sales**
- ◆ **Negative prospects for local and export orders**
- ◆ **Unexciting job prospects**
- ◆ **Wage pressures to rise**
- ◆ **Local prices to decrease**

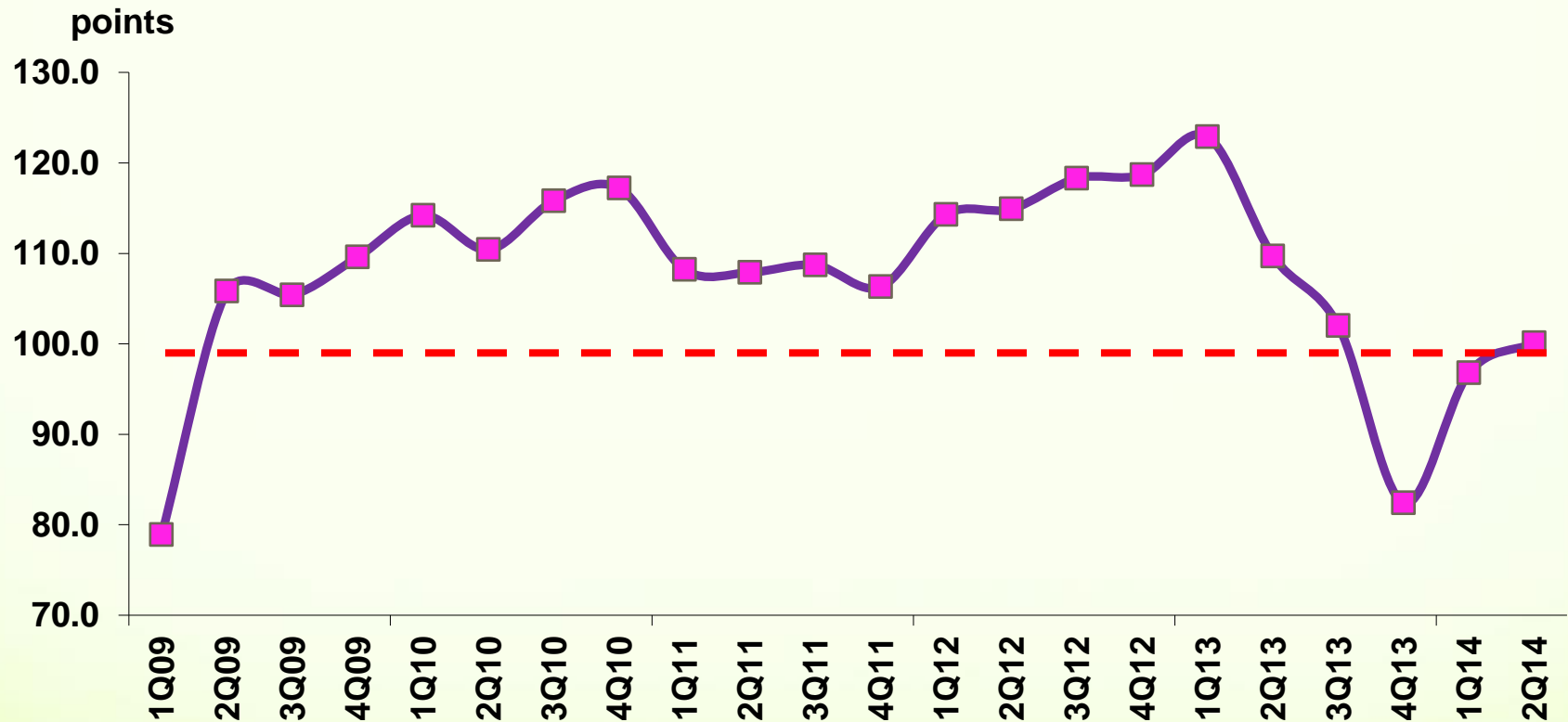
MIER 2Q2014

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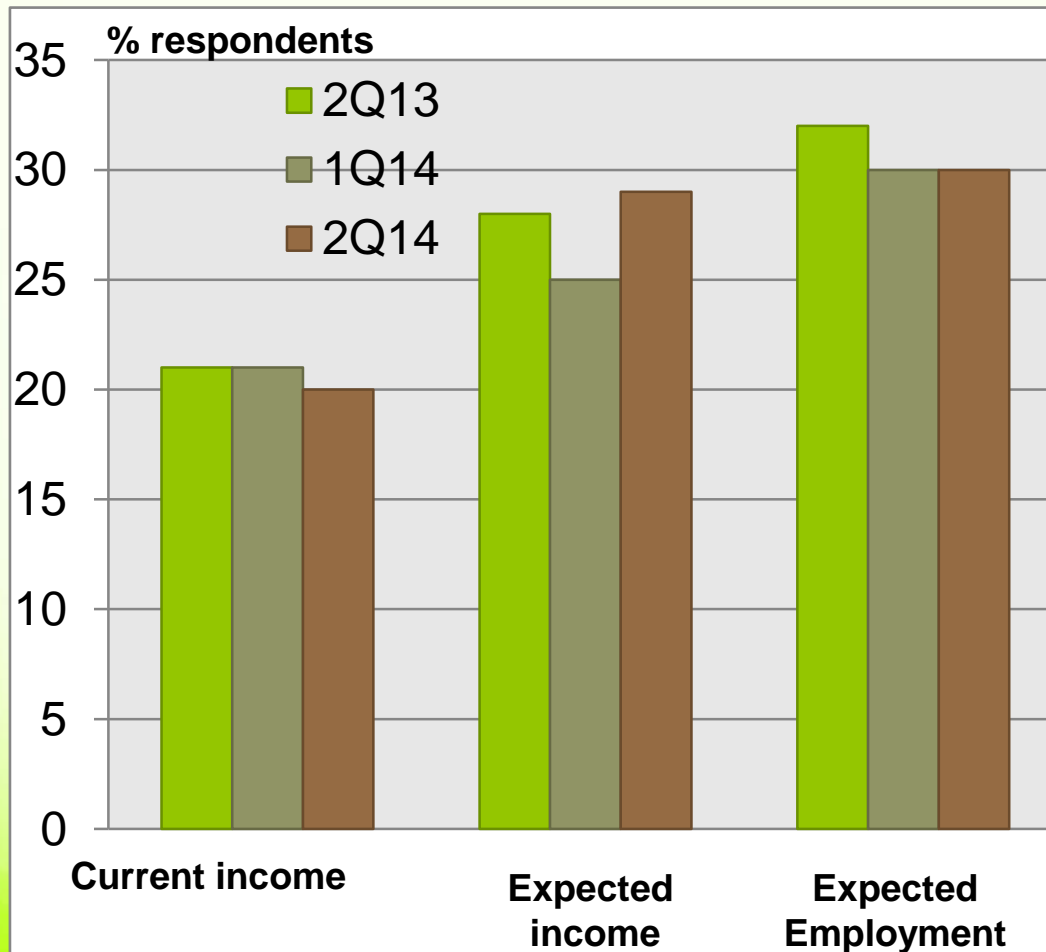
Consumer Sentiments Index

...turning a corner...



- CSI turns neutral as it passes 100-point optimism threshold to stand at 100.1 points
- Income optimism drives consumer sentiments

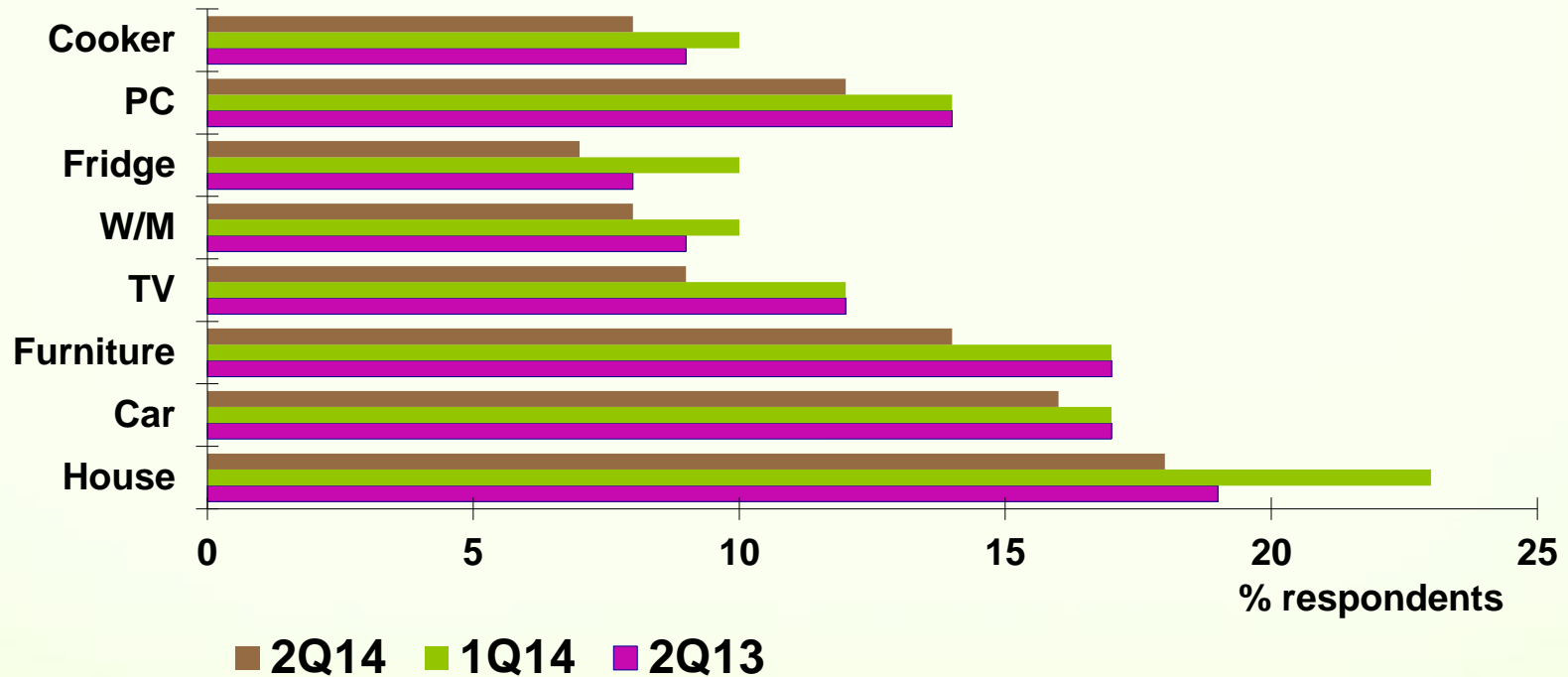
Component Consumer Sentiments



- Current household finances steady but improving.
- Employment outlook firm, income expectations looking up.

Spending Plans

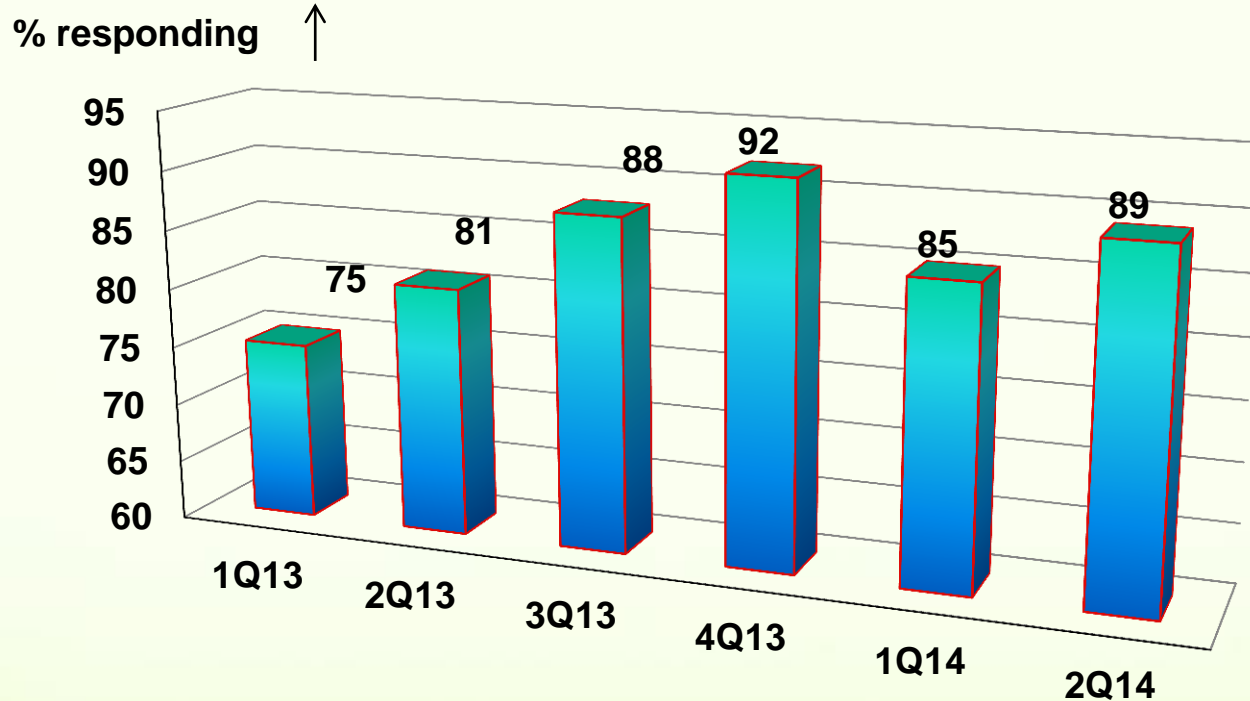
...less ambitious...



- Consumers less willing to spend
- Housing records sharpest decline in favorable replies
- Home plans more likely from high-income, urban and central region households
- Cars, furniture, TV, washing machines, refrigerators, PCs and cookers less appealing

Inflationary Expectations

...more jittery...



- 89% of respondents expect higher prices soon, up from 85% in 1Q14 and 81% in 2Q13
- Across-the-board increase in respondents expecting price increase soon

Consumer Expectations

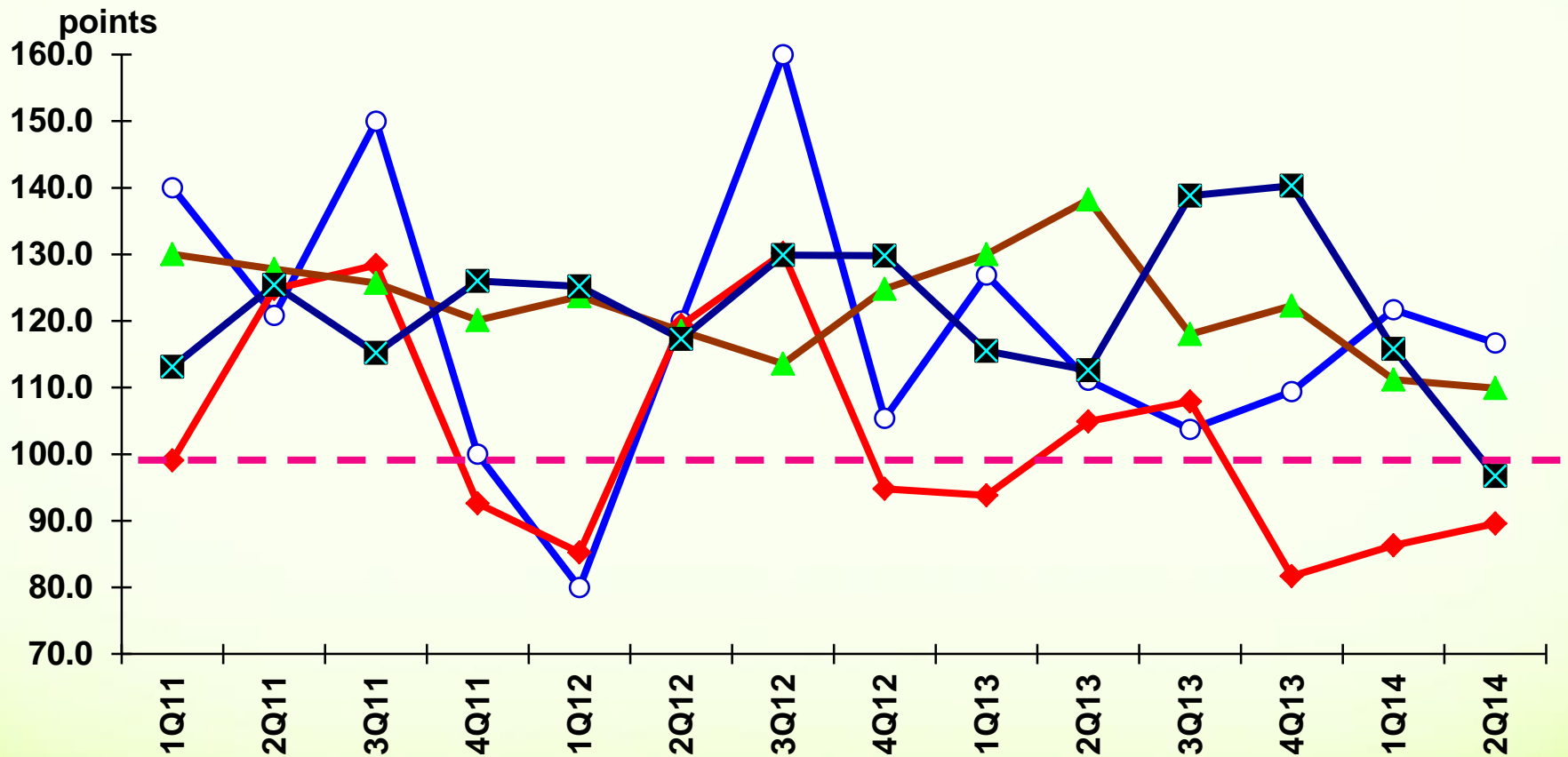
...for 3Q2014...

- ❖ **Household incomes to improve**
- ❖ **Firm employment outlook**
- ❖ **Higher anxiety over rising prices**
- ❖ **Spending plans on major consumer durables take a breather**

MIER 2Q2014

Sectoral Survey Results

MIER's Sectoral Indices



Auto Industry Index - down

Retail Trade Index - up

Residential Property Index - down

Tourism Market Index - down

Residential Property Index (RPI)

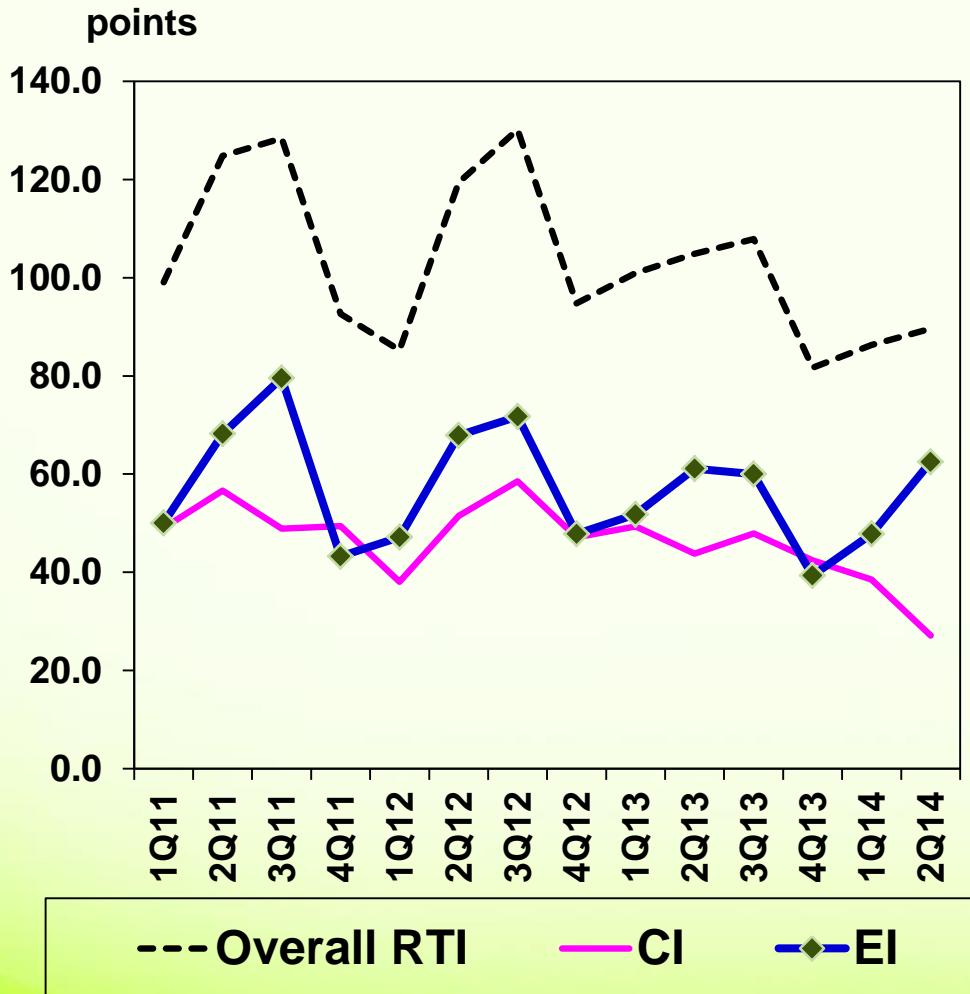
...Tower optimism...



- RPI falls to 109.9 points in the second quarter
- Residential sales and new bookings pick up
- Home mortgage applications and approvals up
- Prices of residential properties steady
- Near-term expectations cautious

Retail Trade Index

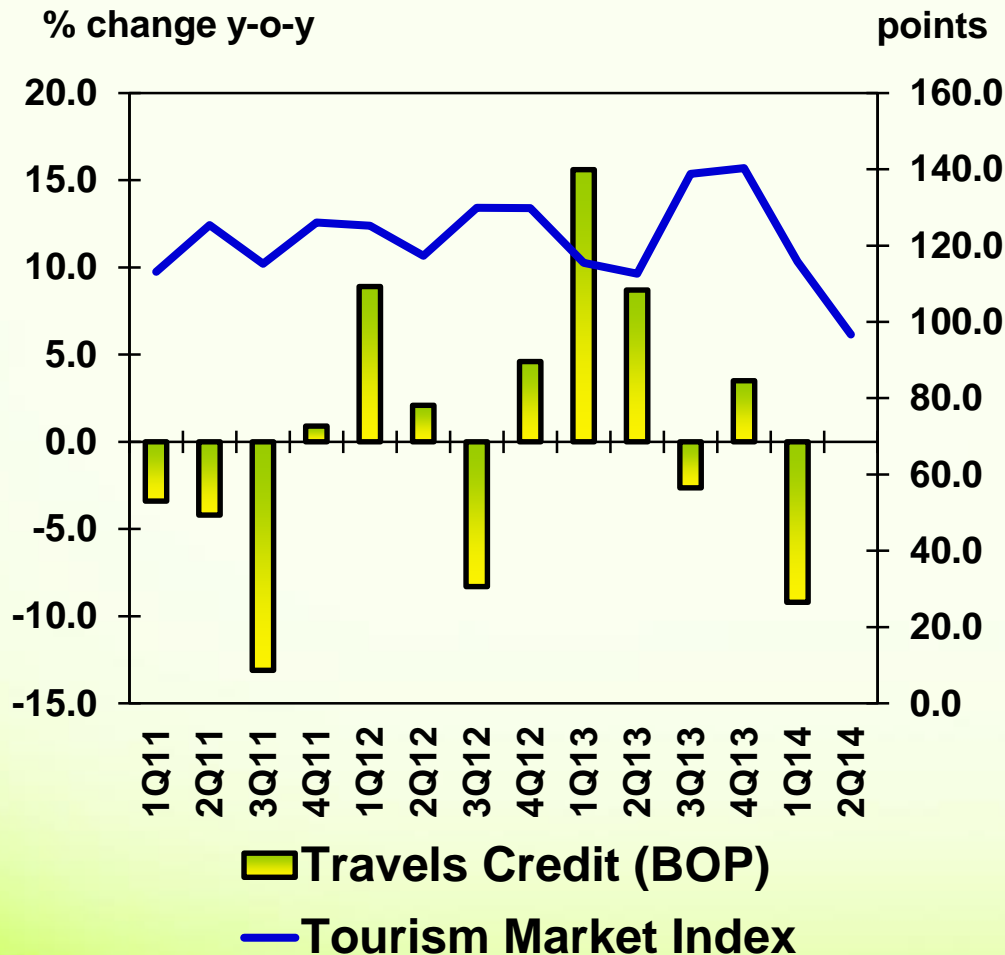
...Inflection Point – Transition Quarter...



- The RTI settles at 89.6 points, third consecutive quarter below the 100 points threshold
- EI sub-index higher but CI sub-index lower
- Retailers expect busier months ahead
- Recovery expected to be seen in 3Q14

Tourism Market Index

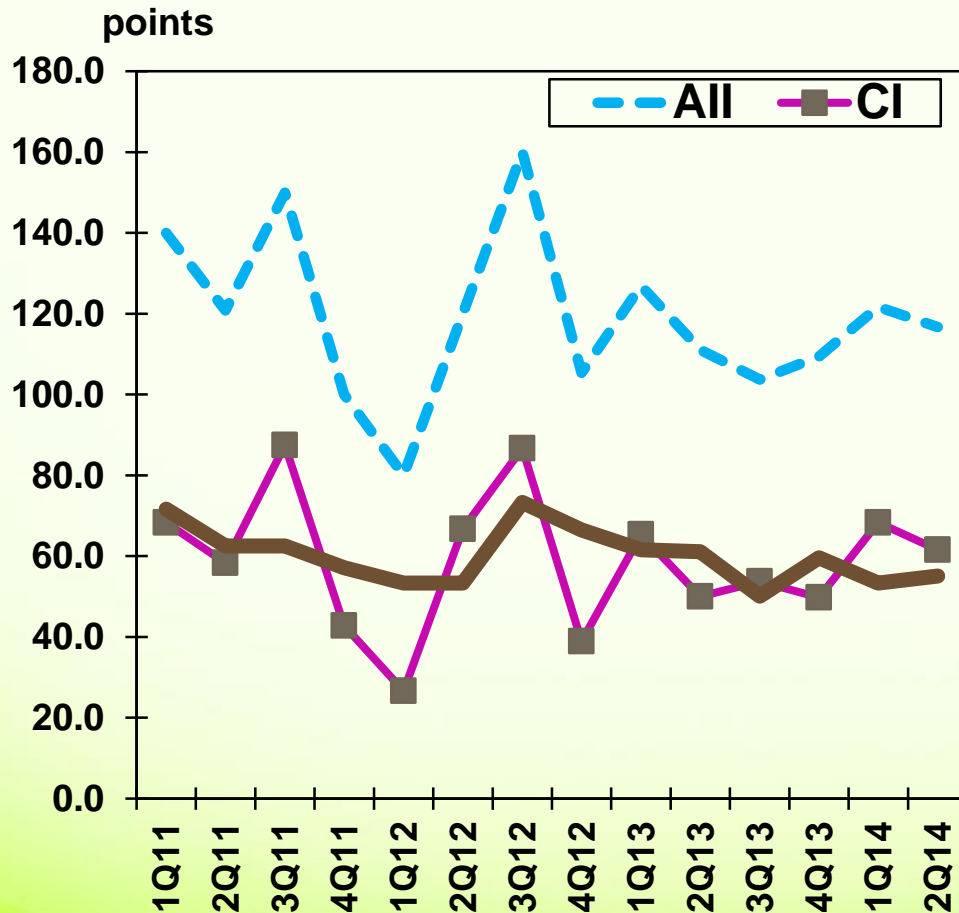
...sinking to a new low...



- Tourism Market Index (TMI) dropped 19.1 points to settle at 96.7 points.
- Poor showing in Current Index (CI) and Expected Index (EI) in both Hotel Operators Index (HOI) and Travel Agencies Index (TAI).
- Hotel occupancy and sales of tour packages cooled further.
- Reservations deteriorate for both industries.
- Inactive employment for both industries.

Automotive Industry Index

...Bumpy Road Ahead...



- Automotive Industry Index reads lower at 116.7 points in 2Q14 from 121.7 points in 1Q14
- EI (Expectations Index) sub-index higher at 55.1 points but CI (Current Index) sub-index lower at 61.6 points
- Positive cumulative sales growth in May 2014 due to a low base effect.
- Festive promotions to stimulate sales in the coming months

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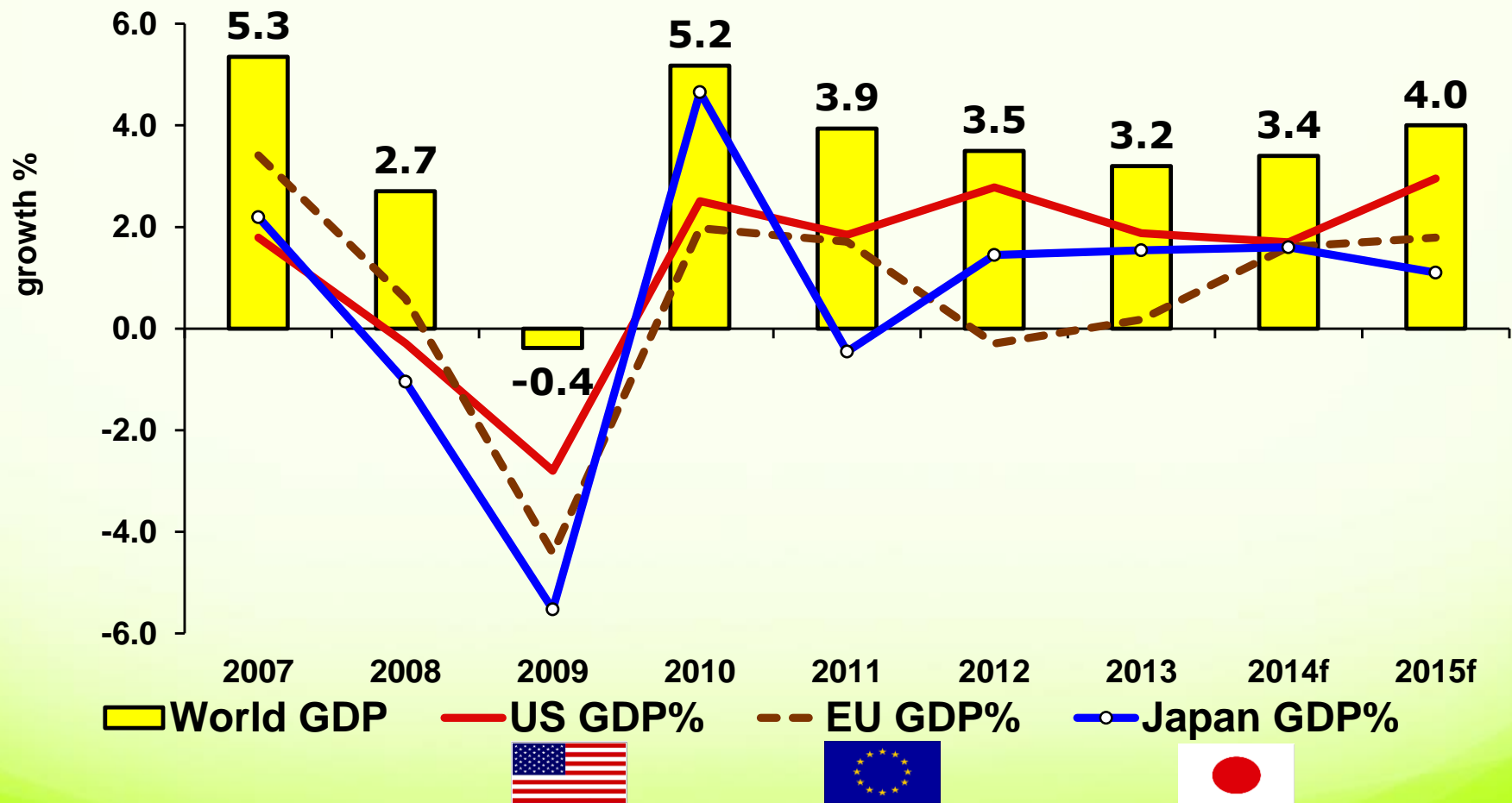
Global Economy...

- **Global growth is strengthening**, supported by stronger growth in major advanced economies. Activity to gain momentum in the second half of 2014, and to accelerate in 2015. Growth in emerging market and developing economies is projected to decelerate slightly to 4.6% in 2014 (2013: 4.7%), but then strengthen to 5.2% in 2015. Continued tightening of global financial conditions and prospect of higher long-term interest rate.
- **US economy** – first quarter growth shrank by -2.9% due to severe winter. Acceleration in growth in the second quarter 2014 and expected to register growth of 1.7% for the year as a whole. Growth will be higher at 3% in 2015. Need orderly withdrawal from QE scheme, as Fed policies have “spillover” effects on other countries. Medium-term budget framework needs to be precise.
- **Euro area** - growth in the euro area is expected to strengthen to 1.1% in 2014 and 1.5% in 2015. Growth may have accelerated in the second quarter, according to Markit Economics. The ECB announced a package of measures, including cutting a key interest rate below zero. Nonetheless, there are new geo-political risks, related to crisis in Ukraine and Russia's retaliatory sanctions.

Global Economy (2)...

- **Japan** – growth in Japan is projected to be higher at 1.6% in 2014 and to slow down to 1.1% in 2015, especially with the planned unwinding of fiscal stimulus. PM Abe unveiled a package of measures to boost Japan's long-term economic growth. Bigger role for women and foreign workers, among others.
- **Emerging market and developing economies** – sluggish growth momentum, due to domestic weaknesses and external vulnerabilities. These include weak investment, structural bottlenecks, capacity constraints and regulatory obstacles. Tightening of domestic financial conditions. Susceptible to capital outflows and currency depreciation as domestic credit conditions tighten.
- **China's economy slows down gradually-** GDP grew by 7.7% in 2013, faster-than expected and well above official target. Market-oriented and institutional reforms continue. Growth will be 7.4% this year and 7.1% in 2015 (revised downward by IMF), providing enough support to other emerging market and developing economies.

Global Economy: Key advanced economies



Source: IMF WEO (April, 2014)

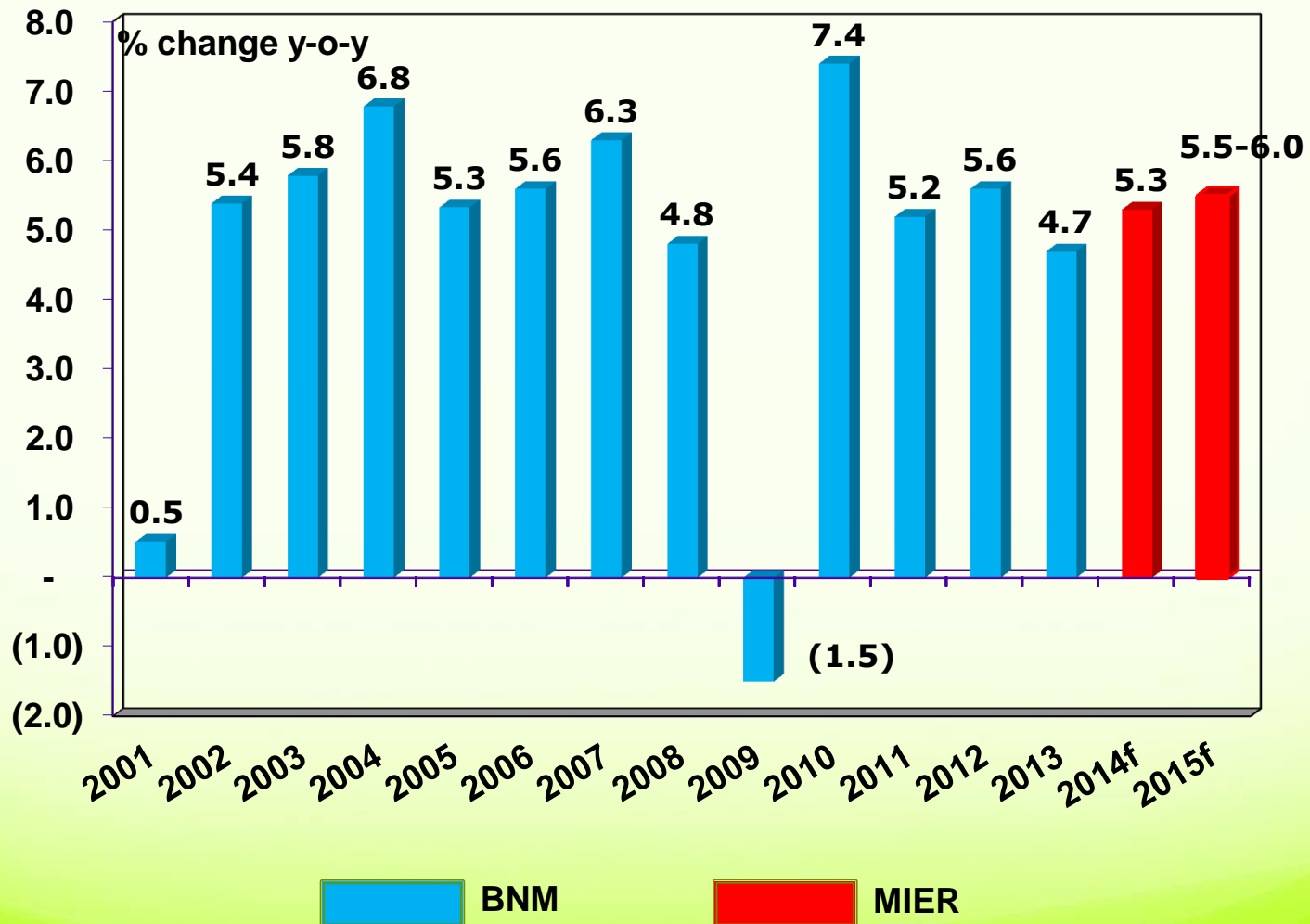
Asean-5 Economy

	2012	2012				2013	2013				2014	2014	2015
		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		Q1	
ASEAN-5	6.2					5.2					4.6		5.6
Indonesia	6.3	6.3	6.3	6.2	6.2	5.8	6.0	5.8	5.6	5.7	5.4	5.2	5.8
Philippines	6.8	6.5	6.3	7.3	7.1	7.2	7.7	7.6	6.9	6.5	6.5	n.a	6.5
Singapore	1.9	1.7	3.3	0.4	2.2	4.1	0.6	4.2	5.8	5.5	3.6	5.1	3.6
Thailand	6.5	0.4	4.4	3.1	19.1	2.9	5.4	2.9	2.7	0.6	2.5	n.a	3.8
Malaysia	5.6	5.1	5.7	5.2	6.5	4.7	4.2	4.5	5.0	5.1	5.2	6.2	5.0

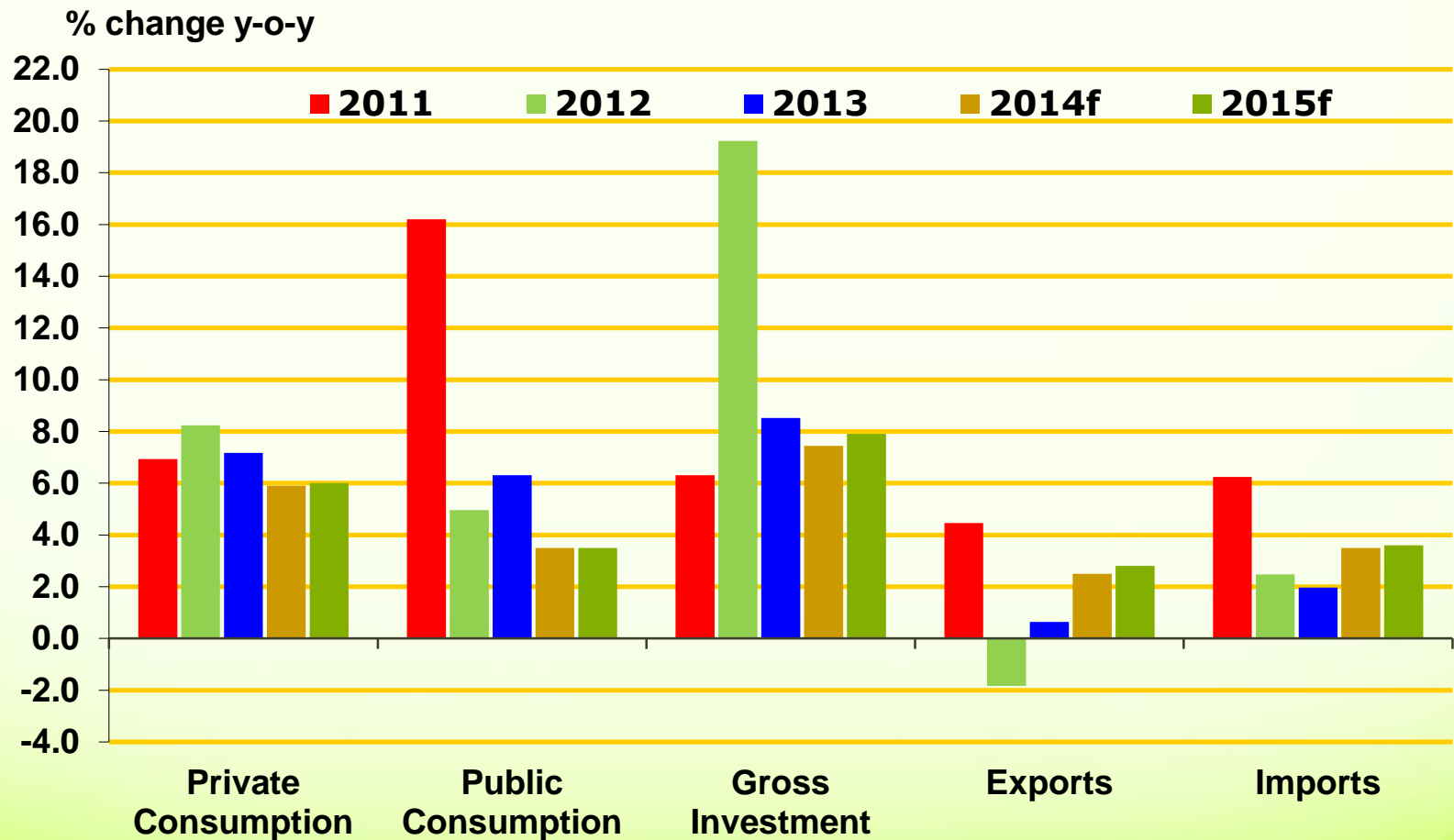
Note: Shaded cells indicate IMF staff estimates

Source: MOF, IMF WEO (April, 2014)

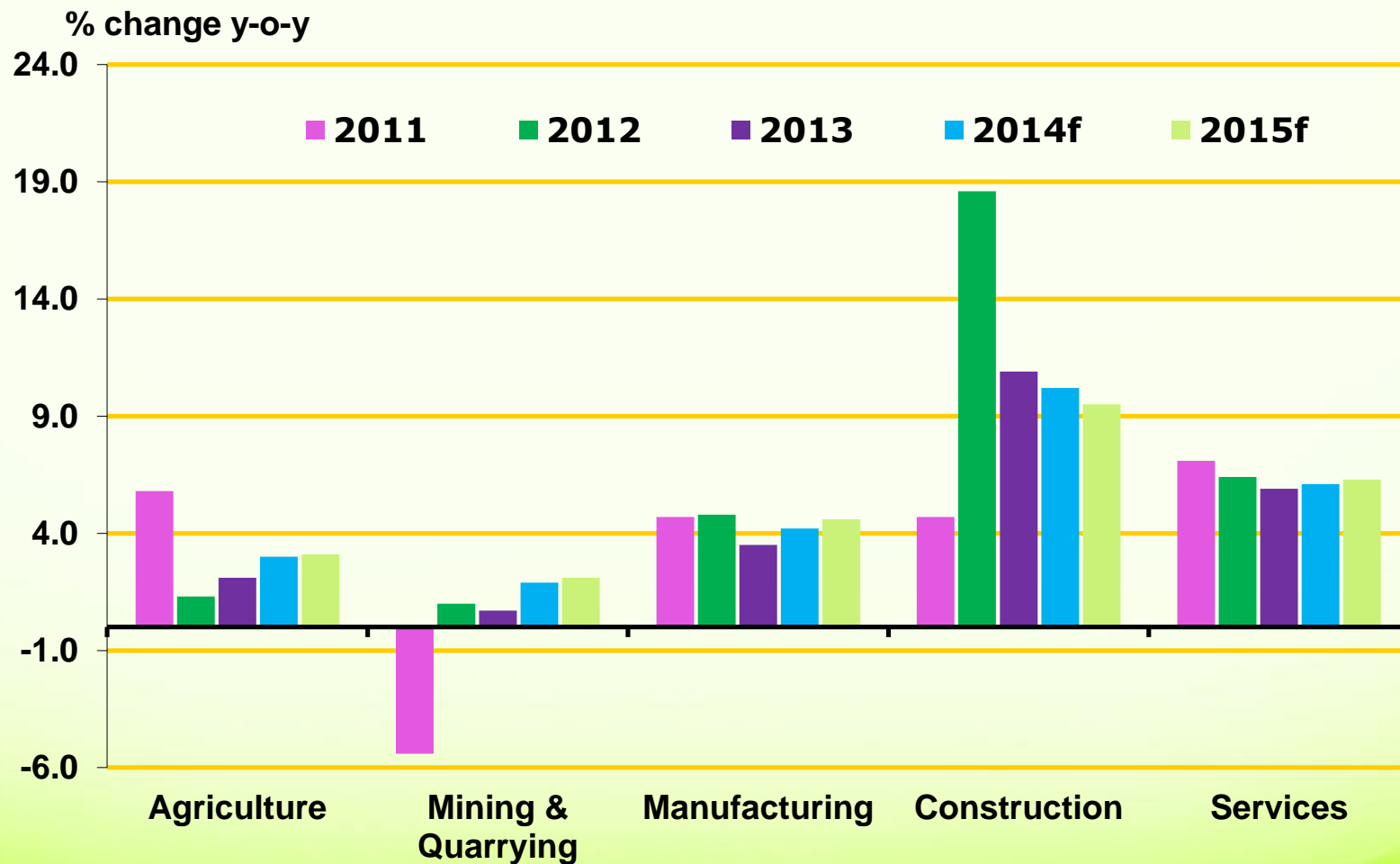
Malaysia: Real GDP Growth



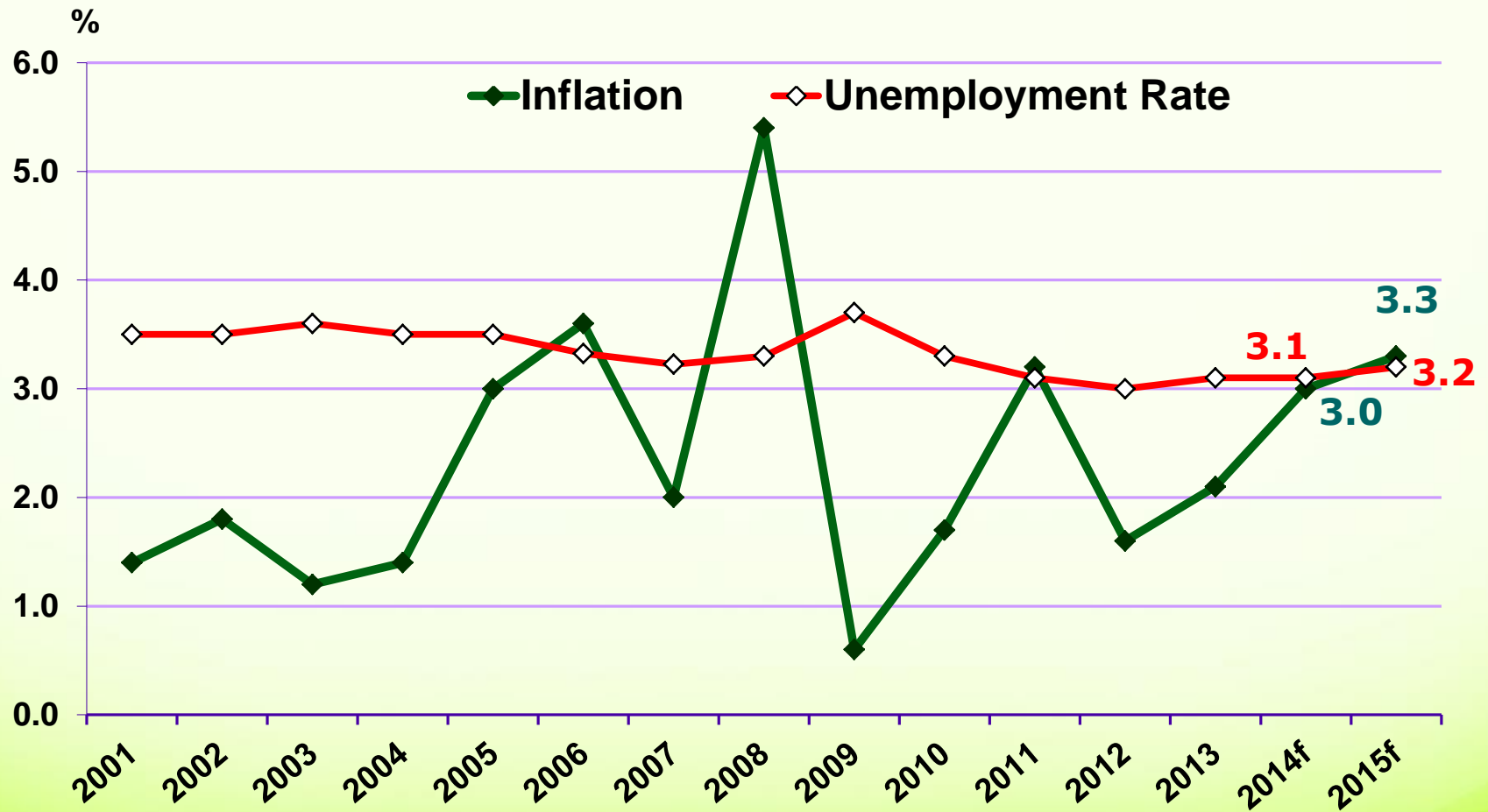
Malaysia: Growth by expenditure



Malaysia: Growth by sector



Malaysia: Inflation and Unemployment



Malaysia: Summary of Growth Performance in Q12014

- **Real GDP grew 6.2% in Q12014:** domestic demand remained the key driver of growth. Growth and contribution from net exports of goods and services (external demand) were also higher.
- **External demand strengthened in the first quarter of 2014:** exports grew by almost 8%, supported by stronger activities in key advanced economies, while imports remained flat at 7.1%. BOP current account improved significantly to RM19.8 billion in the first quarter (Q4 2013: RM14.8 billion).
- **Inflationary pressures remained strong in the first quarter of 2014:** domestic cost-push factors far outweigh demand-driven inflationary pressures. Inflation rate is on moderating trend in recent months, especially with softer global commodity prices, ringgit appreciation and continuing low inflation in key advanced economies.

Malaysia: Summary of Growth Performance in Q12014 (cont..)

- **Growth in monetary aggregates decelerated**, as net foreign assets declined markedly. Net financing moderated.
- **Labour market** conditions remained favourable. Labour force is shrinking, especially with declining participation rate.
- **Balance of payments** has deteriorated during the quarter, especially with stronger outflows in financial account.
- **Federal Government finance** remained weak, with lower revenue in the first quarter. Overall balance improved marginally to -5.1% of GDP.

Malaysia: Key features of growth expected in 2014/2015

- **Growth** will be moderately higher this year and the momentum is expected to continue into 2015. There will be strong contribution from external demand, while moderating domestic demand remains the key driver of growth. Growth forecasts, however, still below **socially efficient level of output**, estimated at 5.5%, and **output gap** is narrowing, going forward.
- **Inflation** will be largely domestically-driven, especially with recent hike in OPR to 3.25%, continued subsidy rationalization, direct cash transfers, GST implementation and also rising demand for higher wages and benefits. Softening in global commodity prices will help to offset domestic cost-push factors somewhat.

Malaysia: Key features of growth expected in 2014/2015 (cont...)

- **Monetary regime shift:** average interbank rates (3-month) is rising sharply, reaching 3.45% (June 2014), pointing to higher interest rates. Recent hike in OPR to 3.25% on 10 July 2014 will push interest rates to higher levels. With tightening domestic liquidity conditions and higher interest rates, net financing activity is expected to moderate.
- **Current account surplus of BOP** is narrowing, driven by continuing deficits in both services and primary as well as secondary balance accounts. Soft commodity prices, such as palm oil and rubber causing lower exports of processed and raw commodities. Exports of natural resources, especially oil and gas are expected to improve with higher prices.

Malaysia: Key features of growth expected in 2014/2015 (cont...)

- **Ringgit** is on an appreciating trend since January 2014. Appreciating ringgit will help to reduce import bills and moderate domestic inflation rate. Expectations of further hike in OPR could see ringgit strengthens in the coming months.
- **Net international reserves remained on the downtrend**, amounted to USD131.8 billion as at 31 July 2014 (end-Dec 2013: USD134.9 billion). However, ratio of international reserves to short-term external debt is worsening, especially with Malaysia's redefined external debt. The ratio is at 1.3 times, slightly above the standard international threshold of 1.0 time. External indebtedness is a source of concern for portfolio investors.

Malaysia: Key economic forecasts

% growth, year-on-year	DOS		BNM	MOF		MIER	
	2012	2013	2014f	2013e	2014f	2014f	2015f
Real GDP	5.6	4.7	4.5-5.5	4.7	5.0-5.5	5.3	5.5-6.0
By Expenditure Components:							
Private Consumption	8.2	7.2	6.6	6.7	6.2	5.9	6.0
Public Consumption	5.0	6.3	2.8	7.1	3.3	3.5	3.5
Gross Investment	19.2	8.5	9.0	12.2	6.6	7.4	7.9
Private Investment	22.8	13.1	13.6	16.6	12.7	11.0	11.4
Public Investment	14.6	2.2	2.0	6.2	(2.7)	2.0	2.1
Domestic Demand	10.7	7.4	6.8	8.4	5.9	6.0	6.2
Exports of Goods & Services	(1.8)	0.6	3.1	3.2	1.6	2.5	2.8
Imports of Goods & Services	2.5	2.0	5.1	6.6	2.2	3.5	3.6
By Economic Activity:							
Agriculture Sector	1.3	2.1	3.5	2.4	3.0	3.0	3.1
Mining Sector	1.0	0.7	1.7	2.6	3.1	1.9	2.1
Manufacturing Sector	4.8	3.5	3.4	3.2	3.8	4.2	4.6
Construction Sector	18.6	10.9	9.5	10.1	9.6	10.2	9.5
Services Sector	6.4	5.9	6.0	5.4	5.7	6.1	6.3

Source: DOSM, BNM, MOF, MIER

Balance of Payments (RM million)

Net	2011	2012				2012	2013				2013	Q1 2014
		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		
Goods & Services	145,293	30,581	25,414	22,235	30,750	108,979	25,458	14,461	22,395	29,223	91,537	30,851
Goods	151,565	36,004	30,139	25,509	33,537	125,190	28,048	19,617	27,227	33,338	108,230	33,562
Services	(6,272)	(5,423)	(4,726)	(3,275)	(2,787)	(16,210)	(2,590)	(5,156)	(4,832)	(4,115)	(16,693)	(2,711)
Primary Income	(21,806)	(8,653)	(12,806)	(9,032)	(5,560)	(36,050)	(8,037)	(8,092)	(7,969)	(10,028)	(34,126)	(6,449)
Secondary Income	(21,061)	(5,410)	(4,650)	(4,878)	(3,531)	(18,469)	(4,210)	(4,533)	(4,399)	(4,361)	(17,504)	(4,560)
Balance on Current Account	102,426	16,519	7,958	8,324	21,659	54,460	13,211	1,836	10,027	14,834	39,907	19,842
Capital Account	(133)	(136)	(6)	(10)	393	241	(3)	(4)	5	(19)	(21)	(2)
Financial Account	23,266	(10,368)	6,484	(8,959)	(10,171)	(23,014)	1,184	4,384	(11,659)	(9,715)	(15,048)	(37,577)
Direct Investment	(9,336)	(9,454)	4,646	(1,308)	(18,299)	(24,415)	(2,757)	(8,295)	1,615	3,986	(5,450)	(14,621)
Abroad	(46,661)	(18,004)	(2,742)	(7,751)	(24,455)	(52,952)	(11,706)	(17,069)	(7,467)	(7,446)	(43,689)	(21,585)
In Malaysia	37,325	8,550	7,388	6,444	6,156	28,537	8,950	8,774	9,082	11,432	38,238	6,964
Portfolio Investment	26,139	25,099	(4,961)	33,338	10,384	63,859	3,917	3,277	(9,466)	(769)	(3,041)	(13,397)
Financial Derivatives	(76)	(20)	992	(64)	64	972	211	(1,421)	564	393	(253)	(1,487)
Other Investment	6,539	(25,993)	5,807	(40,925)	(2,320)	(63,431)	(187)	10,822	(4,373)	(13,325)	(7,062)	(8,072)
Error & Omissions	(30,876)	(13,235)	(1,739)	(6,881)	(5,958)	(27,814)	(10,349)	(4,698)	13,391	(7,775)	(9,431)	444
Overall Balance	94,683	(7,221)	12,697	(7,525)	5,923	3,873	4,043	1,518	11,763	(2,675)	14,649	(17,294)
International Reserves (USD bil)	133.6	135.7	134.2	137.5	139.7	139.7	139.7	136.1	136.5	134.9	134.9	130.2
Months of retained import	9.7	9.4	9.4	9.2	9.5	9.5	9.7	9.5	9.7	9.6	9.6	9.2
Reserves./Short-term external debt*	1.7	1.5	1.5	1.4	1.5	1.5	1.5	1.4	1.4	1.3	1.3	1.3

Source: DOSM, BNM(*redefined external debt)

Federal Government Financial Position (RM billion)

	2011	2012				2012	2013				2013	2014	2014*
		Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4		Q1	
Revenue	185.4	47.9	50.7	52.1	57.2	207.9	43.8	51.6	57.0	61.1	213.4	49.2	224.1
Operating expenditure	182.6	45.6	48.2	50.1	61.6	205.5	49.9	49.2	53.4	58.8	211.3	55.2	217.7
Current balance	2.8	2.3	2.5	2.0	(4.5)	2.4	(6.1)	2.4	3.6	2.3	2.1	(6.0)	6.4
Gross development exp.	46.4	8.5	10.3	10.9	17.2	46.9	9.5	6.9	9.2	16.6	42.2	7.1	44.5
Loan recoveries	1.1	0.4	1.5	0.1	0.5	2.6	0.7	0.1	0.2	0.6	1.5	0.2	0.9
Net development exp.	45.3	8.1	8.8	10.8	16.6	44.3	8.8	6.8	9.0	16.0	40.7	7.0	43.6
Overall balance	(42.5)	(5.8)	(6.3)	(8.8)	(21.1)	(42.0)	(14.9)	(4.4)	(5.4)	(13.8)	(38.6)	(13.0)	(37.2)
% to GDP	(4.8)	(2.6)	(2.7)	(3.7)	(8.7)	(4.5)	(6.4)	(1.9)	(2.2)	(5.2)	(3.9)	(5.1)	(3.5)
Memo item:													
Total Fed. Govt. debt. (end of period)	456.1	470.8	476.7	484.6	501.6	501.6	508.9	519.3	529.2	539.9	539.9	560.6	-
% to GDP	51.5	50.0	50.6	51.4	53.3	53.3	51.6	52.6	53.6	54.7	54.7	52.2	-
Domestic debt	333.8	342.6	345.6	345.2	352.4	352.4	352.2	360.9	379.9	381.4	381.4	398.5	-
% to GDP	37.7	36.4	36.7	36.6	37.4	37.4	35.7	36.6	38.5	38.7	38.7	37.1	-
External Debt**	122.4	128.1	131.1	139.4	149.3	149.3	156.7	158.4	149.3	158.4	158.4	162.1	-
% to GDP	13.8	13.6	13.9	14.8	15.8	15.8	15.9	16.1	15.1	16.1	16.1	15.1	-

Source: MOF (*Budget 2014), BNM (**redefined external debt)

Presentation Outline

- ❖ Selected key economic indicators
- ❖ MIER 2Q 2014 surveys
- ❖ Near-term outlook
- ❖ **Downside risks**
- ❖ Policy directions

Downside Risks (*External*)

New and emerging risks need to be carefully monitored, especially geopolitical risks. External downside risks are as follows:

- **World economy:** financial market turbulence and capital flow volatility due to global portfolio reallocation back to advanced economies. Tightening of financial conditions in emerging market economies (EMEs). Faltering recovery in key advanced economies and commodity price swings.
- **Euro zone:** fragile recovery and risks of deflation or low inflation. ECB cut its benchmark interest rate to a record low in June 2014, resulting in an extended period of record low interest rate. Rising in real interest rates. Lack of structural reforms may stifle growth in the medium-term.
New geopolitical risks, especially those related to Eastern Ukraine and conflicts in the Middle East.

Downside Risks (*External*)

(cont...)

- **US economy:** degree of monetary policy normalization/tapering of asset purchase program. Continued low interest rates will result in increased vulnerabilities, as seen prior to the 2008 crisis. Lack of medium-term fiscal plan to reduce high public debt.
- **Japan:** the absent of comprehensive medium-term fiscal adjustment road-map to reduce the rising public debt. Real test is debt sustainability and impact on the financial sector. Impact of sales tax hike In April 2014 on domestic demand. Strength of supply side reforms in boosting growth.

Downside Risks (*External*)

(cont...)

- **China:** Overcapacity and excessive level of investment. Sharper-than-expected slowdown in economic growth or adverse shocks, triggered by shadow banking system, credit excesses and domestic bond defaults. “Lehman moment”, as experienced in the US in 2008 could possibly happen - fall in house prices affects financial system and as a consequence, shortfall in spending. Cooling property market.
- **Emerging market and developing economies:** structural and financial imbalances are the key potential risk. Tighter domestic liquidity conditions. Reversal in capital flows.
- **Geo-political risks:** Escalating tensions in Eastern Ukraine, fighting in Iraq and Palestine, Middle-east conflicts spreading and deepening, maritime territorial disputes in South China Sea, etc

Downside Risks (*Domestic*)

- Higher inflation and **rising cost of living**. Rising inflation and building up in inflation expectations (not fully anchored). While inflation rate is moderating (June 2014: 3.3%, May 2014: 3.2%, March 2014: 3.5%), it is still above the long run average inflation rate, estimated at 2.5% (January 2008 - June 2014) for Malaysia. Upward adjustment in Government-administered prices and strong demand for higher wages will affect inflation. Producer price index has also accelerated in recent months.
- Growing economic and financial imbalances, as seen in tightening of domestic financial conditions and rising **interest rates**. Despite 25 bps hike in OPR on 10 July 2014, real OPR rate is estimated to remain in a negative territory. Higher debt servicing and borrowing costs for borrowers

Downside Risks (*Domestic*)

(cont...)

- **Federal Government debt** exceeds ceiling of 55% and loan guarantees/contingent liabilities getting larger. Rising household debt (property and car loans > 80%) and increasing banks' exposure to real estate and property development as 70% loans tied to floating mortgage rates.
- **Destabilizing capital outflows**, especially with an early phased out of QE scheme, expected in October 2014, based on Fed FOMC minutes. US unemployment rate fell to 6.1% in June 2014, earlier than expected (end-December 2014).
- **Environment threats:** 2014 is an El-Nino year, driving up possibly economic, health and environmental costs.
- **Societal risks** – influx of foreign migrants, migration of talents, interfaith disharmony, radical religion, Islamic militancy, *etc.*

Presentation Outline

- ❖ **Selected key economic indicators**
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- ❖ **Near-term outlook**
- ❖ **Downside risks**
- ❖ **Policy directions**

Major Policy Directions (1)

- **Monetary policy** – Continue with the dual mandate (output growth and price stability), but assign greater weight on price stability in the reaction function. Credit growth, asset prices and real exchange rate should also be taken into consideration. “Forward guidance” and signalling also help. Need optimal international reserve management. Pre-emptive macro-prudential and micro-prudential measures need to be implemented now, during an expansion phase of business cycle (good times) rather than during the crisis. Be active and systematic, but not too aggressive. Avoid being dictated by market speculation and bets, and minimize welfare losses. There should not be one-way speculation of monetary policy actions.
- **Fiscal policy** – continue with fiscal prudence and foster equality of opportunity or social equity. More importantly, address Government wasteful spending and greater focus be given on wider distributional considerations. Public expenditure must be backed with adequate revenue mobilization and fiscal resource base (revenue) needs to be broaden. Enhance tax equity and efficiency with minimal tax effort. Go ahead with GST implementation next year and maintain commitment on fiscal consolidation process.

Major Policy Directions (2)

- **Interactions between monetary and fiscal policies:** need strong interaction and coordination. Fiscal policy focuses more on prudence spending and fiscal sustainability. Monetary policy should be forward looking, pro-active and systematic. Focus more on short-term stabilization measures: controlling rising inflation, protecting ringgit from depreciating, enhancing international reserves and addressing tight domestic liquidity conditions. Long-term growth and sustainable development require strong support from fiscal and regulatory policies as well as administrative measures. Rules-based policies are much better than strong interventions and too much discretion. In terms of policy implementation, ensure policy credibility and maintain good reputation.
- **Tax cuts** to the private sector are more effective in promoting growth than Government spending rises. Transfers to factors of production (labour, entrepreneurs and capital owners) generate more multiplier effects on the economy than unrequited transfers to final consumers and households. Financing structure of fiscal policy matters to the private sector behaviour.

Major Policy Directions (3)

- Reverse rising income inequality and maintain fiscal policy that promotes greater inclusion (inclusive growth). Market-oriented reforms and liberalization exacerbate income inequality, as shown by worsening Gini coefficients.
- **Strengthen social safety net.** Conditional cash transfers, rather than minimum income threshold. More targeted subsidies and transfers to the poor and low-income households.
- **Public spending on infrastructure,** especially health and education result in improved human capital, productivity gains and nation's competitiveness, long after expenditure has been expended. Forward linkages are also high. Moreover, this expenditure helps to strengthen potential output growth of the economy.

THANK YOU