BANK MALAYSIA
CENTRAL BANK OF MALAYSIA

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

P5 Key Highlights

P7 International Economic Environment

P9 Developments in the Malaysian Economy

P19 Box Article 1: Unresolved Trade Disputes One Year On

P27 Monetary and Financial Developments



[2] Credit refers to outstanding loans from the banking system and development financial institutions (DFIs), and outstanding corporate bonds

International Economic Environment

HIGHLIGHTS

- The global economy grew at a more moderate pace in the second quarter of 2019.
- Lower external demand led to weaker export performance in regional economies.
- Financial market volatility increased as trade tensions escalated in May.

Global growth moderated

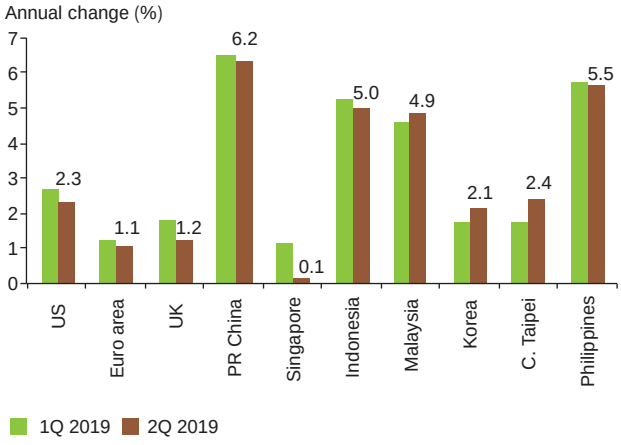
The global economy grew at a more moderate pace in the second quarter of 2019.

In the US, GDP growth moderated in the second quarter of 2019. The latest data release was accompanied by a revision to the back series to indicate stronger growth from 2017 to the third quarter of 2018, but slower growth in the fourth quarter of 2018 and first quarter of 2019. This suggests that growth peaked in the first half of 2018, and has slowed more than previously anticipated, due mainly to weaker investment activity. Meanwhile, growth in the euro area moderated to its weakest level since the fourth quarter of 2013. Besides softer consumption demand, industrial production remained in contraction, weighed by sluggish global trade activity and supply constraints in the automotive sector. Growth in the UK moderated due mainly to a drawdown of inventories amid sustained private consumption.

In Asia, growth in PR China continued to moderate, as weaker private consumption was only partially offset by an improvement in policy driven investments. Growth in the rest of the Asian region also slowed, mainly affected by weaker external demand amid the ongoing trade dispute between the US and PR China.

Most economies moderated in 2Q 2019

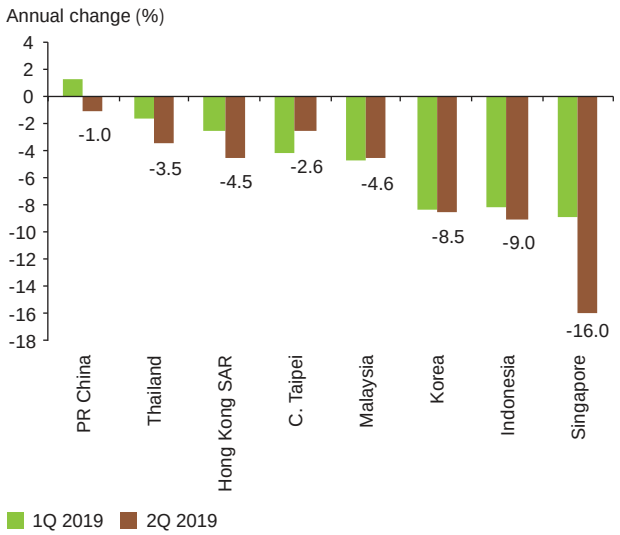
Chart 1: GDP Growth of Selected Economies



Source: National authorities

Lower export growth in 2Q 2019

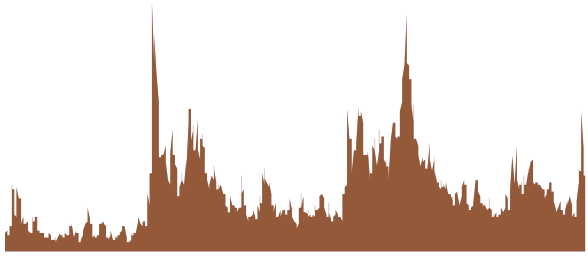
Chart 2: Export Growth of Selected Economies (in USD terms)



Source: National authorities

Financial market volatility increased

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



Source: Bloomberg

Contraction in exports

Exports in all Asian economies contracted in the second quarter, indicating weaknesses in external demand and e ects from the ongoing trade tensions between the US and PR China.

PR China's exports declined by 1.0% in the second quarter as shipments to the US, particularly for electrical parts and equipment, continued to contract. Similarly, across Asian economies, the contraction in exports was contributed mainly by a slowdown in exports of electronic equipment and parts.

Higher financial market volatility

Market volatility rose during the quarter. This was triggered by an escalation in trade tensions when the US raised tari s on USD200 billion of imports from PR China from 10% to 25% in May 2019, and placed sanctions on Huawei, a Chinese telecommunications company.

Nevertheless, market volatility gradually receded as the increased downside risks from trade tensions and a subdued in ation outlook prompted the US Federal Reserve to signal a higher probability of a cut in interest rates. This shift to a dovish policy stance helped ease overall market anxiety[1]. Market volatility also continued to trend lower towards the end of the quarter after the US and PR China agreed to restart trade negotiations at the G20 Summit in end-June.

Brent crude oil price averaged higher at USD68 per barrel in the second quarter of 2019 (1Q 2019: USD64), driven mainly by worsening supply disruptions in Venezuela and Iran as well as ongoing voluntary output cuts by OPEC+.

[1] The Federal Open Market Committee of the Federal Reserve subsequently reduced the federal funds rate by 25 bps on 31 July 2019.

Developments in the Malaysian Economy

HIGHLIGHTS

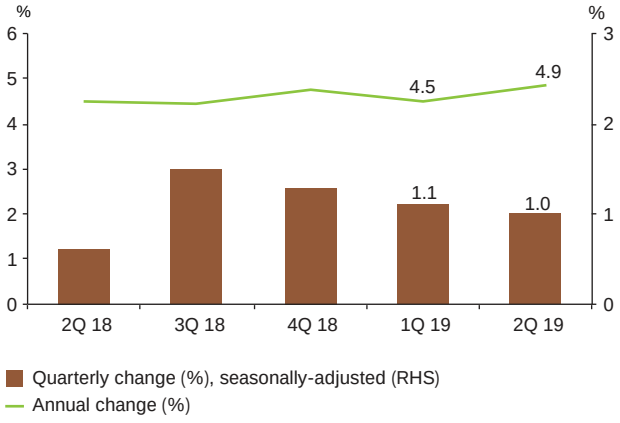
- The Malaysian economy expanded by 4.9% in the second quarter of 2019.
- Headline inflation increased mainly reflecting the lapse in the impact of the Goods and Services Tax (GST) zerorisation, while core inflation remained stable.
- Current account surplus was sizeable at RM14.3 billion.

The Malaysian economy grew at a stronger pace of 4.9% in the second quarter of 2019

GDP registered a higher growth of 4.9% in the second quarter of 2019 (1Q 2019: 4.5%), supported by continued expansion in domestic demand. On a quarter-on-quarter seasonally-adjusted basis, the economy grew by 1.0% (1Q 2019: 1.1%).

Higher growth in 2Q 2019

Chart 4: Real GDP Growth



Source: Department of Statistics, Malaysia

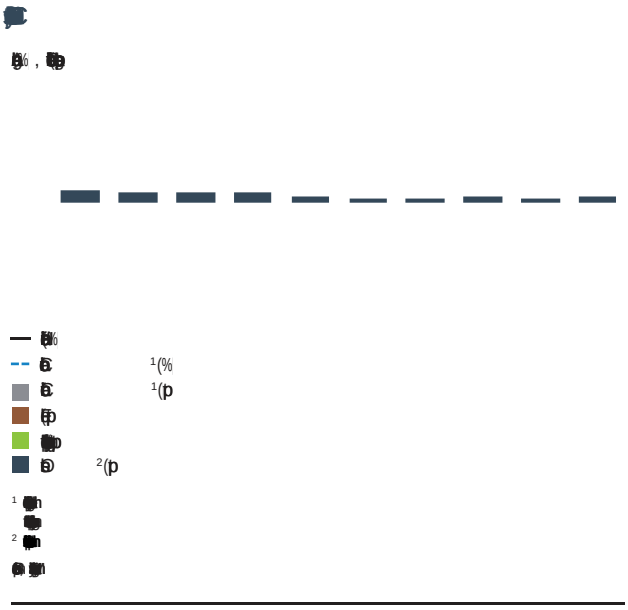
Private sector activity remained the key driver of growth

Domestic demand expanded by 4.6% in the second quarter (1Q 2019: 4.4%), supported by

Expansion across all economic sectors

The services sector expanded by 6.1% in the second quarter of 2019 (1Q 2019: 6.4%). Growth in the wholesale and retail trade subsector was relatively sustained across the wholesale, retail and motor vehicle segments amid rm household spending. The nance and insurance subsector

The increase in headline inflation reflected the lapse in the impact of the GST zerorisation



Headline inflation increased mainly reflecting the lapse in the impact of the GST zerorisation

Headline in ation, as measured by the annual percentage change in the Consumer Price Index (CPI), averaged higher at 0.6% in 2Q 2019 (1Q 2019: -0.3%).

The increase mainly re ected the lapse in the impact of the GST zerorisation that was implemented in June 2018. This contributed to the rise in headline in ation in June 2019 to 1.5% (May 2019: 0.2%; April 2019: 0.2%).

Fuel in ation recorded a smaller negative largely due to domestic fuel prices averaging higher during the quarter in addition to the base e ect (Average RON95 petrol price per litre in 2Q 2019: RM2.08; 1Q 2019: RM2.02).

Core in ation, excluding the impact of consumption tax policy changes, was unchanged at 1.6%. Demand-driven in ationary pressures remained broadly stable and contained, amid the absence of excessive wage pressure and some degree of spare capacity in the capital stock.

Stable labour market conditions

Current account surplus remained sizeable

The current account surplus of the balance of payment remained sizeable at RM14.3 billion or 3.9% of GNI in the second quarter of 2019 (1Q 2019: RM16.4 billion or 4.7% of GNI). This was due to higher investment income earned by Malaysian rms abroad which partly o set the lower goods surplus.

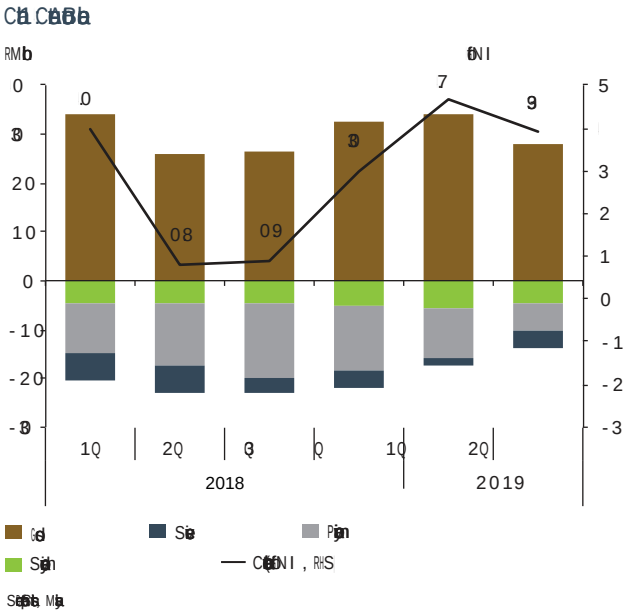
As the improvement in import growth outpaced export growth, the goods surplus narrowed to RM28.1 billion (1Q 2019: RM33.8 billion).

The primary income account registered a smaller de cit of RM5.5 billion (1Q 2019:-RM10.1 billion) due to the increase in investment income earned by Malaysian rms abroad, particularly from direct and portfolio investments. These investments were mainly in the nance and insurance, mining, information and technology sectors. This development more than o set the increase in investment income accrued to foreign direct investors and foreign portfolio investors in publicly-listed rms.

In the services account, the de cit widened to RM3.4 billion (1Q 2019: -RM1.8 billion). This was attributable to higher net payments to foreign providers for transport and insurance services, in line with higher trade activity during the quarter. The travel account surplus narrowed to RM7.1 billion (1Q 2019: RM7.9 billion) on account of lower tourist per capita spending.

The secondary income account de cit amounted to RM4.9 billion (1Q 2019: -RM5.5 billion), re ecting mainly outward remittances by foreign workers.

Sizeable current account surplus



Manageable external debt

Malaysia's external debt amounted to RM931.1 billion, or 61.3% of GDP as at end-June 2019 (end-March 2019: RM903.7 billion or 59.5% of GDP). The increase re ects mainly the net drawdown of interbank borrowings and intercompany loans. There was also

By instrument, 36.9% (or RM234.9 billion) of FC-denominated external debt are accounted by interbank borrowings and FC deposits in the domestic banking system. 78.3% of the interbank borrowings are in the form of largely stable intragroup borrowings from related o ces abroad, including parent banks, regional o ces and subsidiaries. This re ects banks' centralised liquidity and funding management practices.

During the quarter, banks' FC-denominated short-term external debt increased by RM20.6 billion driven by higher interbank borrowings. This was largely attributable to parent bank placements with foreign banks' in Malaysia (including banks in Labuan International Banking and Financial Centre (LIBFC)) to facilitate lending and investment activities. Funds received by foreign LIBFC banks were largely invested abroad with non-resident clients, a re ection of LIBFC banks' 'out-out' business activities. For locally-incorporated foreign banks, intragroup funds continue to be primarily used for short-term investments and lending in the domestic interbank market. Domestic banking groups accounted for the remaining increase in interbank borrowings re ecting their central role in managing liquidity and funding needs on a group-wide basis. In line with these developments, banks' total external assets also increased during the quarter by RM22.8 billion.

Overall, banks' funding and liquidity risks continue to be proactively managed via robust internal controls and policies, including internal limits on (i) interbank borrowings; (ii) foreign currency funding and liquidity positions; and (iii) foreign exchange market risk exposures. Foreign-currency risk, measured in terms of the net open position of FC-denominated exposures[4] remained low at 4.9% of banks' total capital.

Long-term bonds and notes issued o shore stood at RM161.7 billion as at end-June 2019, accounting for 25.4% of total FC-denominated external debt. These were mainly by non- nancial corporations and channelled primarily to nance asset acquisitions abroad. Intercompany loans, which amount to RM110.5 billion and account for 17.4% of FC-denominated external debt, are typically on exible and concessionary terms. About 80% of these intercompany loans were obtained by multinational corporations (MNCs) from parent or a liate companies abroad.

From a maturity perspective, 58.3% of the total external debt is skewed towards medium- to long-term tenure (end-March: 59.2%), suggesting limited rollover risks. Short-term external debt accounted for the remaining 41.7% of external debt. While rollover risks may be inherent, this is well contained. Close to half of the short-term external debt are intragroup borrowings among banks and corporations which are generally stable, while another 11% are accounted by trade credits, largely backed by export earnings. As at 31 July 2019, international reserves stood at USD103.9 billion, su cient to nance 7.6 months of retained imports, and is 1.1 time the short-term external debt.

Of signi cance, reserves are not the only means for banks and corporations to meet their external obligations. The progressive liberalisation of foreign exchange administration rules has resulted in signi cant increase in non-reserves external assets. In particular, banks and corporations held roughly three-quarters of Malaysia's RM1.8 trillion external assets, which can be drawn down to meet their RM728.3 billion external debt obligations. While the exible exchange rate remains the rst line of defence, adequate international reserves and availability of substantial foreign currency external assets by banks and corporations continue to serve as important bu ers against potential external shocks.

[4] Refers to the aggregated sum of the net short or long foreign currency positions for all currencies across banks.

Box Article 1

Unresolved Trade Disputes One Year On

Authors: Muhamad Aizuddin, Daryl Yong, Ooi Kiesha, Catharine Kho, Chang Wen Huei

HIGHLIGHTS

- Trade tensions in the past year have broadened in terms of products and countries.
- In addition to impacting global trade and growth, trade tensions have also spurred the reconfiguration of global value chains.
- Latest assessment finds the impact of trade tensions to reduce Malaysia's 2019 export growth by -0.5 to -0.8 ppt.

Over a year since it started, the trade disputes between the US and PR China, as well as with some other economies, remain unresolved and continue to cast its shadow over the global economy. What began as the imposition of tariffs on selected imports, namely steel, aluminium and solar products, have widened to encompass a broader range of goods, with increasingly large spillover effects on global trade and growth. As the disputes escalated, the adverse impact on growth morphed from just the transmission of higher trade costs, to amplification through the Global Value Chain (GVC), increased policy uncertainty for firms in the tradable sector and heightened volatility in financial markets.

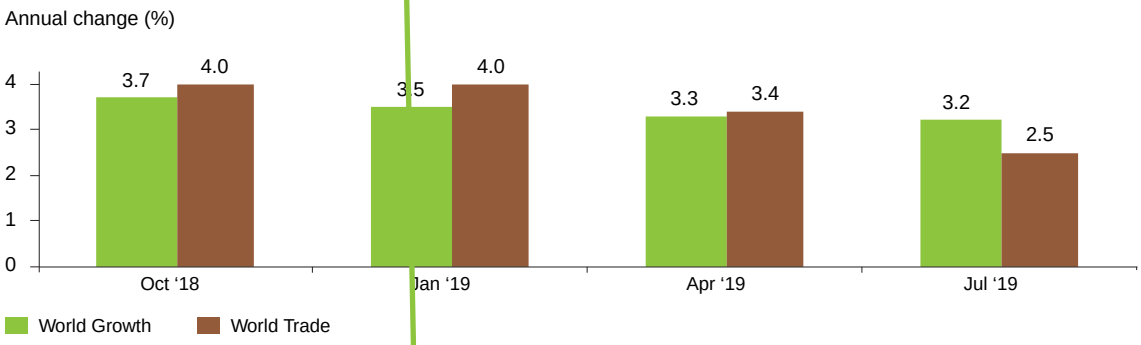
This box article is the third in a series of articles[1] on the ongoing global trade dispute, reflecting on the past year of shifting trade tensions, with a focus on: (i) recent trade developments; (ii) emerging trends; and (iii) implications for Malaysia.

Recent developments reignited trade tensions

The second quarter of 2019 solidified fears of many since March 2018 that trade tensions were going to persist and propagate to other countries. After the US implemented tariffs of 10% on USD200 bn of imports from PR China in September 2018, tensions eased towards end-2018 as both countries agreed on a truce. This respite was short-lived when the US further raised tariffs from 10% to 25% on USD200 bn of Chinese imports in May 2019, and banned the Chinese telecommunications company, Huawei from purchasing from US companies without government approval. What followed thereafter was a series of developments that vacillated between an intensification and de-escalation of trade tensions, sometimes within the span of a few days. First, the US delayed its decision to implement blanket tariffs on automobile imports. Subsequently, the US threatened and suspended its threat to impose tariffs on Mexico within a week. Thereafter, the US removed India and Turkey as beneficiaries under the Generalised System of Preferences (GSP) programme. The US then agreed on a temporary truce with PR China in June 2019 which also eased restrictions on Huawei. However, this truce was not extended to other countries as the US imposed higher tariffs and circumvention rulings on steel imports from Vietnam in July 2019. Most recently, the US announced tariffs of 10% on all remaining imports from PR China worth USD300 bn to be implemented on 1 September 2019[2].

[1]

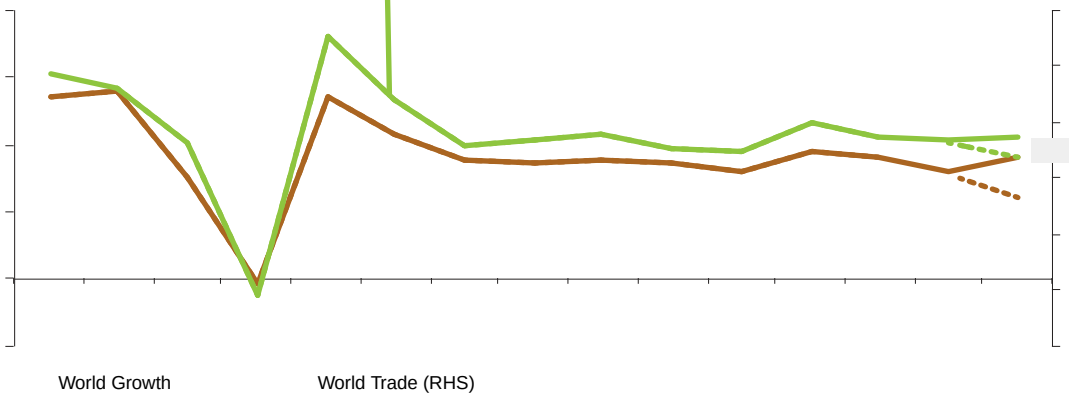
Chart 2: Evolution of IMF World GDP Growth and Trade Forecasts for 2019



Source: IMF World Economic Outlook

While global growth is expected to improve going forward, this is heavily premised on a resolution of existing trade disputes. In the worst-case scenario of an all-out trade dispute in which blanket tariffs are imposed on automobiles and electronics, global growth could potentially fall to its lowest level since the Global Financial Crisis (Chart 3).

Chart 3: Long-Term Global GDP and Trade Growth



Source: IMF World Economic Outlook, authors' estimation

The inertia against global growth recovery is expected to be prolonged as trade tensions persist. This is more so as trade actions between the US and PR China expanded to encompass technology products and the protection of intellectual property (IP) rights, which would take time to resolve. The continued widening of trade disputes a\ecting more countries, a larger variety of products and a broader range of strategic sectors, will ultimately be detrimental to global growth and global trade prospects.

For Malaysia, the prolonged trade disputes and the resulting impact on lower global trade has mainly a \ected Malaysia s trade activity. Not only are Malaysia s exports to a\ected countries lower (direct channel), exports to countries within the GVC (indirect channel) have also been a\ected. The latter channel is not negligible, given Malaysia s position as one of the most integrated economies in the GVC, even among regional peers (Chart 4).

The impact of lower trade activity on growth is also compounded by increased business uncertainty. Should the downside risks[4] from the ongoing trade dispute materialise, this could potentially reduce Malaysia s export growth by up to an additional -0.2 ppt and GDP growth by approximately -0.1 ppt in 2019[5].

Trend 2: Volatile Þnancial markets and high investor uncertainty

The rapidly changing trade developments have also induced sigÞcant uncertainties, manifesting in deteriorating sentiments andÞnancial market volatility. The extent of the trade-related uncertainty is illustrated by the s-28.2656n addl BTM7.144 Tm .01 Tc [(frr)1: V

[3] GVC participation is estimated as the sum of backward linkage (measures use of imported inputs to produce goods for exports) and forward linkage (measures exports of intermediate goods that are used as inputs for the production of another country s exports) relative to total exports of an economy. The higher the GVC participation index, the more integrated an economy is in the GVC.

[4] The downside risks for 2019 are higher tariffs on all remaining imports from PR China. For 2020, downside risks also include blanket tariffs on automobile and technology imports.

[5] This is an updated estimate since the 3Q 2018 Quarterly Bulletin box article. The lower downside risks in the current assessment for 2019 is due mainly to the shift in the expected implementation of blanket tariffs on automobiles and technology imports from 2019 to 2020. In addition, the impact of the materialisation of downside risks in 2019 is expected to be smaller as the end-year approaches. Nonetheless, the expected prolonged trade tensions could lead to larger downside risks to growth in 2020.

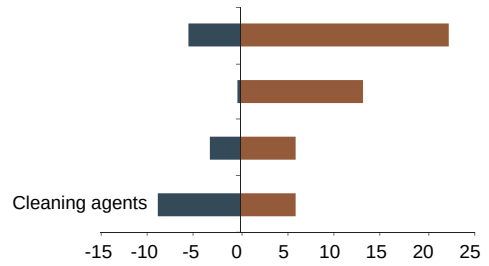


[6] The US Treasury Department has three criteria for identifying countries that possibly conduct unfair currency practices. These are (i) significant bilateral trade surplus with the US; (ii) material current account surplus, and (iii) persistent, one-sided intervention in currency markets.

[7] Exploring US and China trade diversion , Nomura Global Markets Research (2019).

[8] Selected products are tariffed products in which Malaysia has a meaningful presence (Malaysia's exports account for at least 5% of US import) and recorded an increase in share in the US at the expense of PR China between July 2018 and April 2019. The same method applies to PR China's imports from Malaysia.

Chart 8: Change in share of PR China imports for selected products (%) (Malaysia and US)



Source: Global Trade Atlas

In other cases, firms that have presence in PR China and across the region have leveraged on their network to set up dual supply chains, namely one to cater for PR China demand and one for other markets. The decoupling of the supply chain involves tasking Chinese factories to produce goods for the domestic market or destinations other than the US, while instructing other regional production plants to meet the orders from the US.

Apart from sourcing inputs from other countries, firms have also signaled more willingness to diversify their supply chain by investing in production facilities in other countries given the persistence of the ongoing trade tensions. However, such investment re-direction will most likely only be realised in the longer term. A recent survey by the American Chamber of Commerce China noted that 30.2% of its

Monetary and Financial Developments

HIGHLIGHTS

- The ringgit depreciated in the second quarter amid global and domestic uncertainties.
- The performance of domestic bond and equity markets were supported by sustained demand from domestic institutional investors.

The performance of domestic financial markets were mixed during the second quarter

During the first two months of the quarter, domestic financial markets were affected by cautious investor sentiments amid the moderating global growth outlook and escalations in global trade tensions. Domestically, potential reviews on Malaysia's inclusion in the FTSE Russell World Government Bond Index (WGBI) also weighed down sentiments in the domestic bond market. As a result, non-resident portfolio outflows of RM5.1 billion led the ringgit to depreciate by 1.5% against the US dollar during the quarter. Despite the weak sentiments, domestic bond and equity markets remained supported by sustained demand from domestic institutional investors throughout the quarter.

Ringgit depreciated against the US dollar, driven by non-resident portfolio outflows

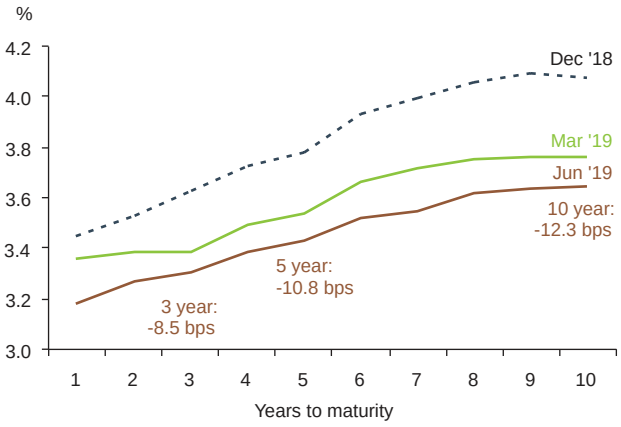
Chart 19: Performance of Regional Currencies Against the US Dollar (1 April - 28 June 2019)



Source: Bank Negara Malaysia

MGS yield curve shifted downwards during the second quarter

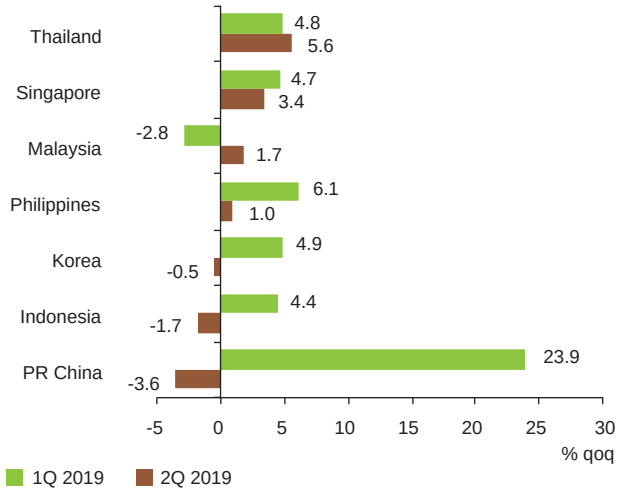
Chart 20: Trend in MGS Yields



Source: Bank Negara Malaysia

Domestic equity market performance improved during the quarter

Chart 21: Performance of Regional Equity Markets



Source: Bloomberg

Towards the end of the quarter, the performance of domestic bond and equity markets were lifted by a recovery in investor sentiments. In June, expectations of monetary policy easing by major central banks led to an improvement in global investor risk appetite, which spurred a recovery in non-resident portfolio in ows. As a result, the FBM KLCI increased by 1.7% in the second quarter to close at 1,672.1 points as at end-June (end-March 2019: 1,643.6 points) and the 3-year, 5-year and 10-year MGS yields declined by 8.5, 10.8 and 12.3 basis points, respectively.

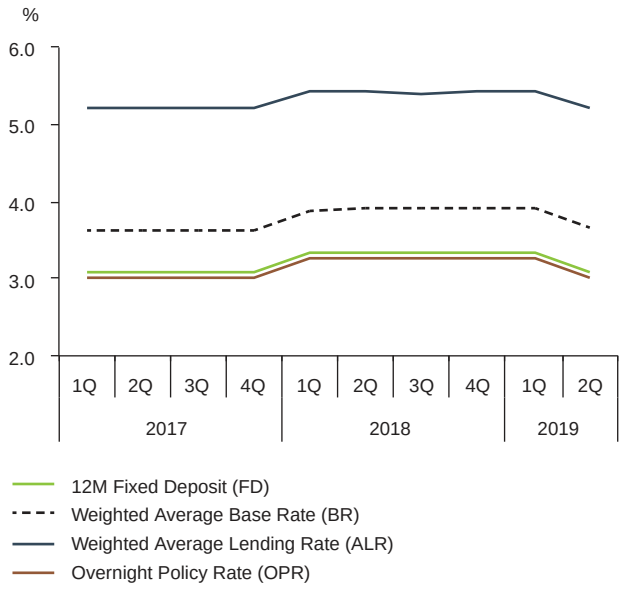
Interest rates decreased during the quarter given the reduction in the Overnight Policy Rate (OPR)

Following the reduction in the OPR on 7 May 2019, interest rates in the wholesale and retail markets trended lower. In the interbank market, strong and immediate pass-through was observed, with the 3-month KLIBOR decreasing by 23 basis points to 3.46% (1Q 2019: 3.69%). Similarly, nominal fixed deposit (FD) rates also decreased following the OPR adjustment. The decline ranged from 24 to 25 basis points across tenures of 1 to 12 months. Correspondingly, real FD rates decreased given the decline in nominal rates and higher inflation during the quarter.

For the retail segment, the transmission of OPR to base rate (BR) was also strong, with all banks revising their BRs downwards by 25 basis points to the current weighted average of 3.68% (1Q 2019: 3.92%). By end-quarter, the weighted average lending rate (ALR) on outstanding loans was also lower by 20 basis points at 5.23% (1Q 2019: 5.43%).

Interest rates decreased following the reduction in the OPR

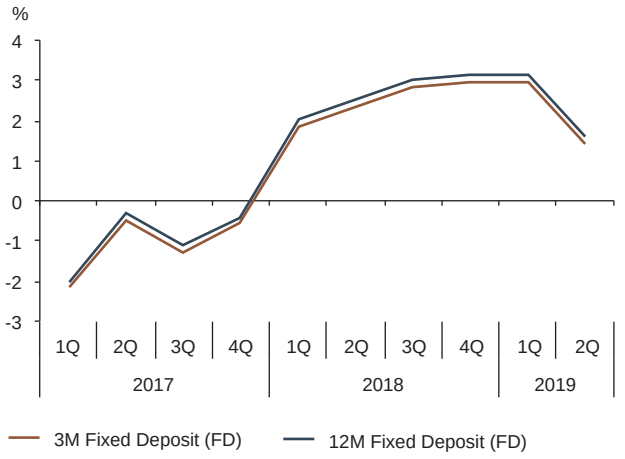
Chart 22: Fixed Deposit Rate, Base Rate and Average Lending Rate (at end-period)



Source: Bank Negara Malaysia

Real deposit rates declined

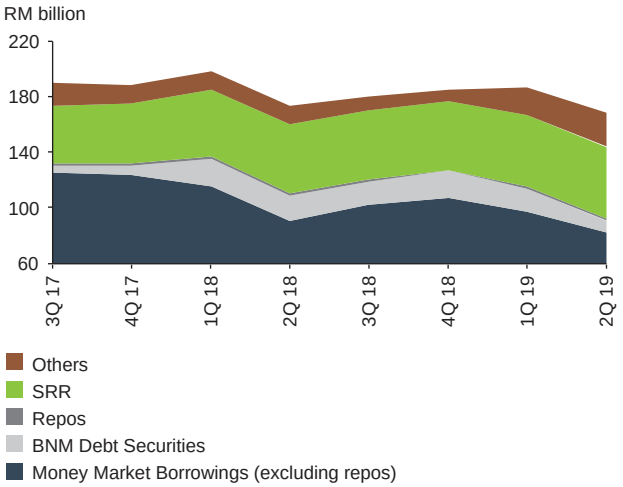
Chart 23: Real Fixed Deposit Rates by Maturity (at end-period)



Source: Bank Negara Malaysia

Outstanding surplus ringgit liquidity placed with the Bank declined

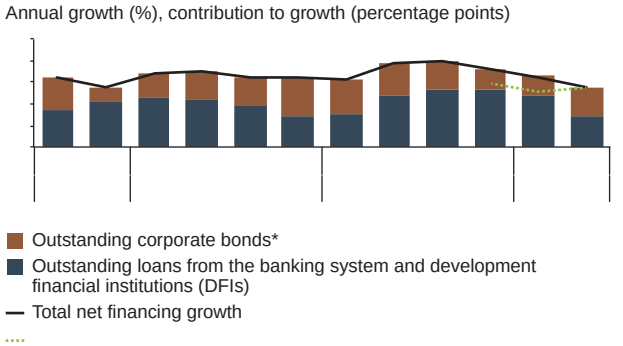
Chart 24: Outstanding Ringgit Liquidity Placed with Bank Negara Malaysia as at end-period



Source: Bank Negara Malaysia

Net financing continued to grow as outstanding loans and corporate bonds continued to expand

Chart 25: Contribution to Net Financing Growth



Source: Bank Negara Malaysia

Liquidity conditions remained su Äcient to facilitate financial intermediation

The level of surplus liquidity placed with the Bank decreased, re ecting the net out ows during the quarter. Notwithstanding this, liquidity conditions remained su cient in the banking system at both the system-wide and institutional levels, with most banks continuing to maintain surplus liquidity positions with the Bank.

Net financing continued to expand during the quarter

In the second quarter, net nancing expanded by 5.6% on an annual basis (1Q 2019: 6.5%), driven by the continued expansion of outstanding corporate bonds[5] and loans[6]. Growth of outstanding corporate bonds increased to 10.6% during the quarter (1Q 2019: 7.1%), largely driven by a one-o issuance in the nance, insurance, real estate and business services sector. Outstanding total loans recorded a 3.9% growth on an annual basis (1Q 2019: 6.4%), with outstanding business loans expanding by 2.7% (1Q 2019: 4.4%), while outstanding household loans grew by 4.8% (1Q 2019: 7.5%). Apart from a low base e ect for the rst quarter of 2019 due to the inclusion of data for a newly licensed commercial bank from April 2018 onwards[7], the moderation in growth of outstanding total loans in the second quarter of 2019 re ected the high loan repayments, which outpaced disbursements.

For the business segment, a steady level of loans were disbursed to both SMEs and non-SMEs (total loans disbursed to businesses: RM197.2 billion, 1Q 2019: RM193.8 billion). Loans were mainly disbursed to the manufacturing; wholesale and retail trade, restaurants and hotels; and construction sectors, in line with the continued economic expansion in these sectors. Demand for nancing among businesses showed some signs of improvement during the quarter as loan applications[8] increased (RM95.5 billion, 1Q 2019: RM77.4 billion). For the household segment, loans for residential property continued to be the primary driver of household loan expansion (contribution to growth: 3.8 percentage points), supported by sustained approval rates for housing loans.

[5] Corporate bonds exclude issuances by Cagamas and non-residents.
[6] Loans from the banking system and development nancial institutions (DFIs).
[7] E ective June 2019, data for April 2018 onwards were revised to include data from a newly licensed commercial bank (MBSB Bank Berhad). It was previously classi ed as a non-bank nancial institution. The inclusion of the outstanding loan gures resulted in higher nancing annual growth rates for a transitory period from 2Q 2018 to 1Q 2019 due to the lower base in preceding years.
[8] Loan applications to the banking system only.

The Bank's Policy Considerations

HIGHLIGHTS

- The MPC reduced the OPR by 25 basis points to 3.00% at the May 2019 MPC meeting. The adjustment was intended to preserve the degree of monetary accommodativeness.
- Subsequently, the MPC kept the OPR unchanged at the July 2019 MPC meeting. At this prevailing level, the stance of monetary policy is accommodative and supportive of growth and inflation.

The MPC reduced the OPR by 25 basis points to 3.00% at the May MPC meeting and kept the OPR unchanged at the July MPC meeting

In May 2019, the Monetary Policy Committee (MPC) reduced the Overnight Policy Rate (OPR) by 25 basis points to 3.00%. Against the backdrop of a challenging global environment, the Malaysian economy was expected by the MPC to grow within the projected range of 4.3% — 4.8% in 2019. However, there were downside risks to domestic growth from heightened uncertainties in the global and domestic environment, trade tensions and extended weakness in commodity-related sectors. While domestic monetary and nancial conditions have remained supportive of economic growth, there were some signs of tightening of nancial conditions. The adjustment to the OPR was therefore intended to preserve the degree of monetary accommodativeness.

At the subsequent meeting in early July 2019, the MPC kept the OPR unchanged at 3.00%. At this prevailing level, the stance of monetary policy is accommodative and supportive of growth and in ation.

Average headline in ation is expected to be broadly stable in 2019 compared to 2018. The trajectory of headline in ation will, however, continue to be dependent on global oil prices and policy measures such as the timing of the lifting of the price ceiling on domestic retail fuel prices. Underlying in ation is expected to remain stable, supported by the continued expansion in economic activity and in the absence of strong demand pressures.

The MPC will continue to assess the balance of risks to domestic growth and in ation, to ensure that the monetary policy stance remains conducive to sustainable growth amid price stability.

Other policy highlights in the second quarter of 2019

Policy highlights	Salient requirements
Trade Credit Insurance/Trade Credit Takaful (TCIT) – Policy Document (PD)	• The PD came into force on 3 May 2019, setting out regulatory expectations on the o ering of TCIT, including requirements surrounding the approval process and information submission. • The enhanced regulatory clarity is intended to increase the availability of trade facilitation products, including Shariah compliant products, that will facilitate the growth of Malaysian halal business. • The o ering of TCIT will also contribute towards portfolio diversi cation for licensed insurers and takaful operators.
Framework for Electronic Trading Platforms (ETP) – Exposure Draft (ED)	• The ED was issued on 14 June 2019, setting out the Bank's requirements and expectations on market participants that o er ETP services in the Malaysian money and foreign exchange markets. • The ED aims to ensure that ETP services o ered to Malaysian participants are secure, e cient urs requireecur

Macroeconomic Outlook

HIGHLIGHTS

- In 2019, global growth is expected to remain moderate.
- For Malaysia, economic growth to remain within the range of 4.3% — 4.8%.
- Headline inflation is expected to average higher in 2H 2019.

Moderate global growth in 2019

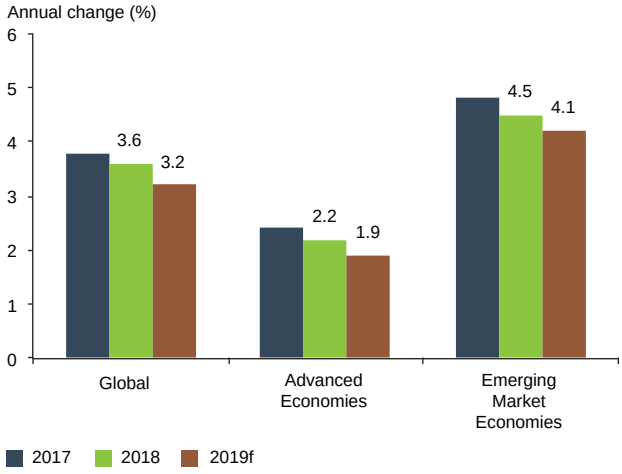
The global economy is expected to grow at a moderate pace in 2019 compared to 2018. The IMF revised downward its 2019 global growth forecast, by 0.1 ppt to 3.2%.

Despite continued labour market strength, US GDP growth is expected to slow as investment activity moderates from waning scal support and uncertainties from the trade con ict with PR China. Euro area growth is projected to be adversely a ected by moderating domestic and external demand. Economic activity in the Asian region is also expected to be slower, given weaker external demand. Active policy stimulus will help to support growth in PR China.

Risks to the outlook remain tilted to the downside, emanating from a potential escalation of trade disputes, continued uncertainties in Brexit negotiations, and excessive nancial market volatility.

Moderating global growth in 2019

Chart 26: GDP Growth



f Forecast

Source: IMF World Economic Outlook (July 2019)

Growth in the Malaysian economy to remain within 4.3% — 4.8% in 2019

Growth of the Malaysian economy continued to improve, mainly supported by the recovery from commodity-related shocks experienced last year.

While the recovery from supply shocks is expected to continue into the second half of the year, the slower global growth amid ongoing trade tensions would continue to weigh on growth. In this environment, economic growth is projected to remain supported mainly by private sector activity. Household spending will continue to be driven by stable labour market conditions, while investment activity will be supported by capacity expansion in key sectors such as manufacturing and services.

The baseline projection, therefore, remains within the range of 4.3% - 4.8%. Nonetheless, the outlook is subject to downside risks from lingering uncertainties in the global and domestic environment, worsening trade tensions and extended weakness in commodity-related sectors. Positive conclusion to ongoing trade negotiations would pose as an upside risk.

Headline inflation is expected to average higher in the second half of 2019

Headline in ation in the second half of 2019 is expected to average higher compared to the rst half of 2019 following the lapse in the impact of consumption tax policy changes.

For the rest of the year, the trajectory of headline in ation will be dependent on global oil prices and policy measures including the timing of the lifting of the price ceiling on domestic retail fuel prices. Price control policies such as the enhancement of the festive season price control scheme may result in a relatively subdued food in ation.

Underlying in ation is expected to remain stable, supported by the continued expansion in economic activity and in the absence of strong demand pressures.

Steering Through Volatility: Enhancing Market E I ciency to Preserve Financial Market Stability

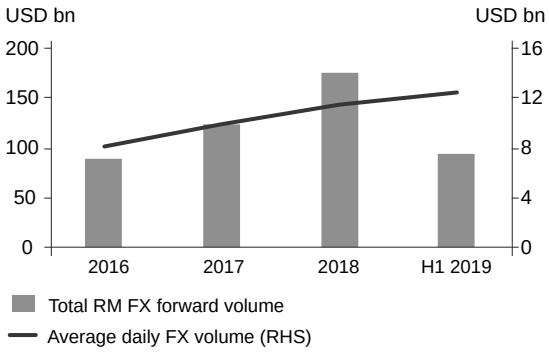
Author: Ei-Jean Kong, CFA and Reza Baharin, CFP

HIGHLIGHTS

- A deep and liquid Þnancial market is fundamental to preserve market stability.
- The Bank is committed to enhance market liquidity, risk management capabilities and transparency in order to strengthen the role of Þnancial markets in supporting economic activity.
- Financial market development to enhance access to the onshore market reßect current priorities based on the nation's state of development.

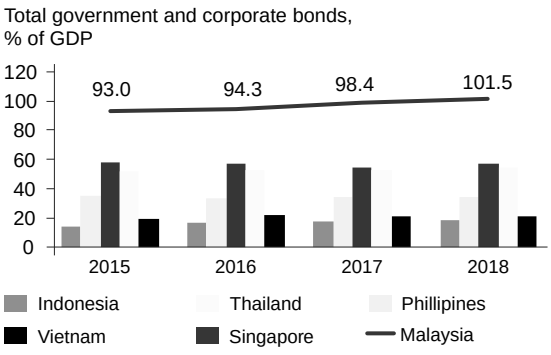
Malaysia's deep Þnancial markets continue to facilitate e I cient allocation of resources in order to support economic growth

Malaysia's onshore FX market continues to grow in support of economic growth



Source: Bank Negara Malaysia

Malaysia's bond market is the largest in Southeast Asia

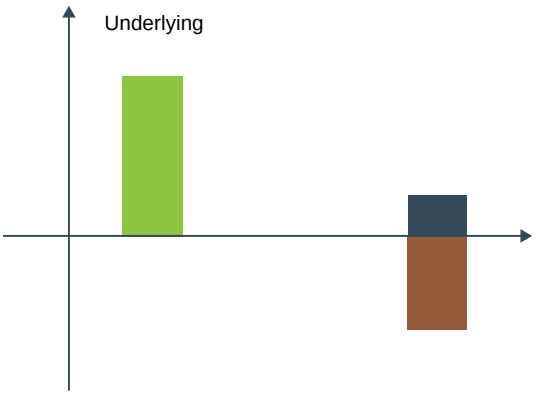


Source: Asian Bonds Online

Market development initiatives aim to further enhance market access and liquidity, while containing risks to stability

Recognising the importance of well-developed financial markets to economic growth and performance, measures continue to be taken to further enhance access, liquidity and efficiency of Malaysia's financial markets. A well-defined legal framework, robust market infrastructure and sound macroeconomic to further enhance market acceitabilite an, liquiditinclude:d

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Source: Bank Negara Malaysia

Annex

Table 1

GDP by Expenditure Components (at constant 2015 prices)

	Share 2018 (%)	2018		2019		
		2Q	1H	1Q	2Q	1H
		Annual growth (%)				
Aggregate Domestic Demand (excluding stocks)	94.1	5.5	4.8	4.4	4.6	4.5
Private sector	74.2	7.3	6.3	5.9	6.2	6.1
Consumption	57.0	7.9	7.2	7.6	7.8	7.7
Investment	17.3	5.5	3.4	0.4	1.8	1.2
Public sector	19.8	-1.6	-0.9	-1.4	-2.8	-2.1
Consumption	12.5	3.1	1.8	6.3	0.3	3.2
Investment	7.4	-9.9	-5.4	-13.2	-9.0	-11.3
Net Exports	7.0	-6.0	22.7	10.9	22.9	16.0
Exports of Goods and Services	67.6	2.6	2.5	0.1	0.1	0.1
Imports of Goods and Services	60.6	3.6	0.6	-1.4	-2.1	-1.8
GDP	100.0	4.5	4.9	4.5	4.9	4.7
GDP (q-o-q growth, seasonally adjusted)	-	0.6	-	1.1	1.0	-

Source: Department of Statistics, Malaysia

Table 2

GDP by Economic Activity (at constant 2015 prices)

Annual growth (%)	Share 2018 (%)	2018		2019		
		2Q	1H	1Q	2Q	1H
Services	56.7	6.5	6.5	6.4	6.1	6.3
Manufacturing	22.4	4.9	5.0	4.2	4.3	4.2
Mining	7.6	-3.4	-2.0	-2.1	2.9	0.3
Agriculture	7.3	-1.7	0.7	5.6	4.2	4.9
Construction	4.9	4.8	4.9	0.3	0.5	0.4
Real GDP	100.0[1]	4.5	4.9	4.5	4.9	4.7

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

Source: Department of Statistics, Malaysia

Table 3

Balance of Payments [1]

	2018		2019		
	2Q	1H	1Q	2Q	1H
	RM billion				
Current Account	2.8	16.4	16.4	14.3	30.6
(% of GNI)	0.8	2.4	4.7	3.9	4.3
Goods	25.9	60.1	33.8	28.1	62.0
Services	-5.6	-11.1	-1.8	-3.4	-5.3
Primary income	-12.8	-23.1	-10.1	-5.5	-15.7
Secondary income	-4.8	-9.4	-5.5	-4.9	-10.4
Financial Account	10.5	22.4	-13.8	-18.6	-32.4
Direct investment	-0.5	8.7	16.3	-8.2	8.0
Assets	-4.5	-7.7	-6.9	-11.5	-18.4
Liabilities	4.0	16.4	23.1	3.2	26.4
Portfolio investment	-37.9	-39.4	2.1	-10.2	-8.1
Assets	-0.7	-10.3	-11.4	-5.0	-16.5
Liabilities	-37.2	-29.1	13.5	-5.1	8.4
Financial derivatives	0.8	1.6	-0.2	-0.5	-0.7
Other investment	48.2	51.5	-31.9	0.3	-31.6
Net errors & omissions [2]	-14.2	-21.5	2.9	2.9	5.9
Overall Balance	-0.9	17.3	5.5	-1.4	4.1

Assets: (-) denotes outflows due to the acquisition of assets abroad by residents
Liabilities: (+) denotes inflows due to the incurrence of foreign liabilities
[1] In accordance with the Sixth Edition of the Balance of Payments and International Investment Position Manual (BPM6) by the International Monetary Fund (IMF)
[2] As at 1Q 2018, quarterly net E&O excludes reserves revaluation changes. This practice is backdated up to 1Q 2010.

Note: Numbers may not add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 4

Outstanding External Debt

	2018	2019	
	end-June	end-Mar	end-June
	RM billion		
Total External Debt	**927.3**	**903.7**	**931.1**
USD billion equivalent	226.9	219.3	222.6
By instrument			
Bonds and notes[1]	149.5	158.1	162.2
Interbank borrowings[1]	223.3	175.7	199.1
Intercompany loans[1]	132.0	140.9	147.7
Loans[1]	71.9	72.1	71.5
NR holdings of domestic debt securities	185.1	186.9	181.9
NR deposits	85.6	93.6	91.3
Others[2]	79.9	76.3	77.4
Maturity profile			
Medium- and long-term	523.1	535.2	542.7
Short-term	404.2	368.5	388.4
Currency denomination			
Ringgit	293.1	295.7	295.0
Foreign	634.2	607.9	636.1
Total debt/GDP (%)	64.1	59.5	61.3
Short-term debt/Total debt (%)	43.6	40.8	41.7
Reserves/Short-term debt (times)	1.0	1.1	1.1[3]

[1] These debt instruments constitute the offshore borrowings.
[2] Comprise trade credits, IMF allocation of SDRs and miscellaneous.
[3] Based on international reserves as at 31 July 2019.
Note: NR refers to non-residents
Figures may not add up due to rounding.

Source: Ministry of Finance and Bank Negara Malaysia

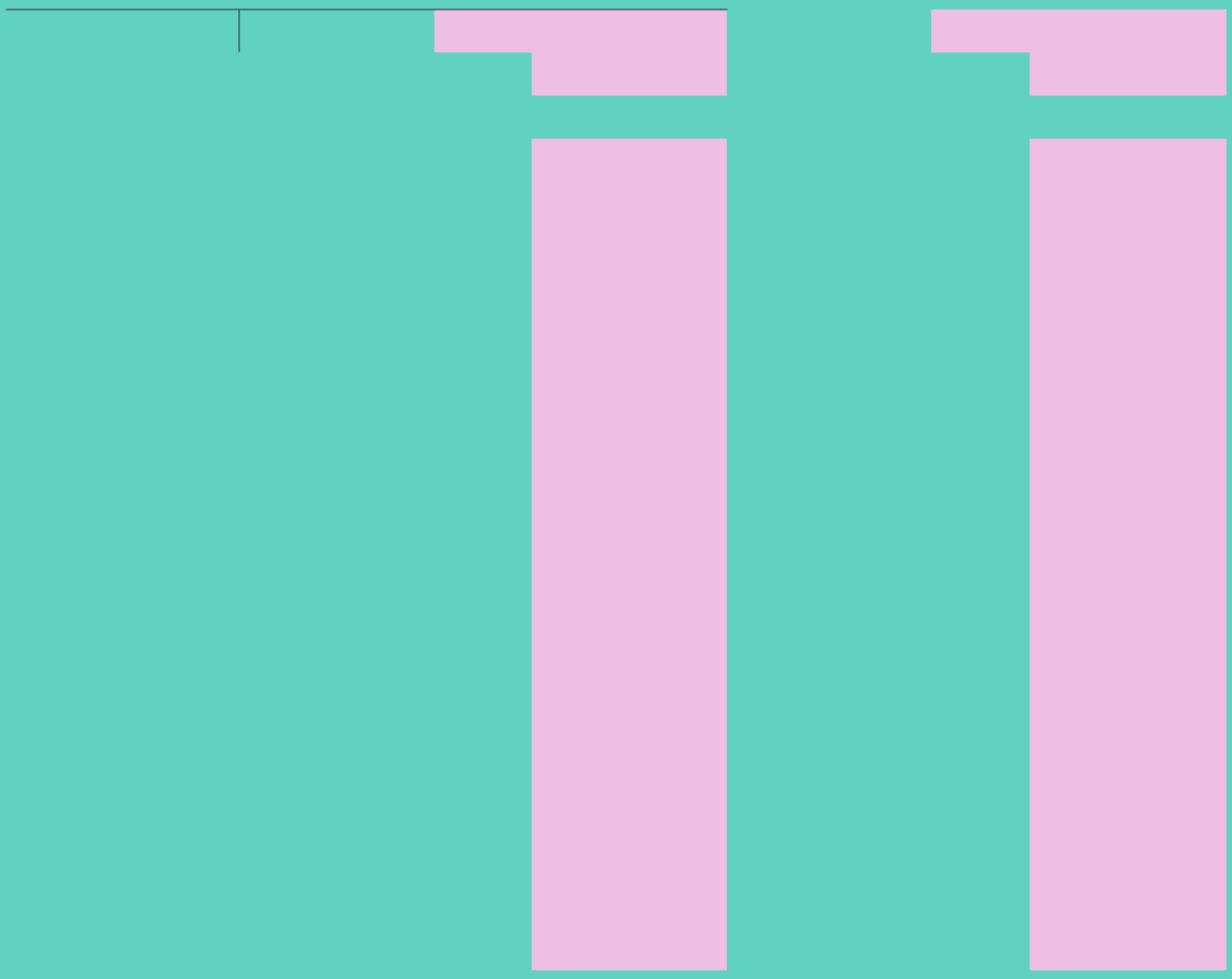
Table 5

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

	2018		2019			2018		2019		
	2Q	1H	1Q	2Q	1H	2Q	1H	1Q	2Q	1H
	Change during the period (RM billion)					Annual growth (%)				
Net total financing	**64.6**	**101.3**	**23.0**	**45.3**	**68.3**	**7.8**	**7.8**	**6.5**	**5.6**	**5.6**
Outstanding loans[1,2]	53.4	71.7	8.8	12.4	21.1	6.4	6.4	6.4	3.9	3.9
Of which:										
Business enterprises	13.0	21.6	1.3	2.2	3.6	3.2	3.2	4.4	2.7	2.7
SMEs[3]	3.8	5.9	-1.6	-0.9	-2.5	5.3	5.3	0.2	-1.2	-1.2
Non-SMEs	9.2	15.7	2.9	3.1	6.0	1.2	1.2	8.7	6.5	6.5
Households	37.1	48.7	10.3	11.2	21.5	7.9	7.9	7.5	4.8	4.8
Outstanding corporate bonds[4]	11.3	29.6	14.2	32.9	47.1	12.4	12.4	7.1	10.6	10.6

[1] Loans from the banking system and development financial institutions (DFIs). Effective June 2019, data for April 2018 onwards were revised to include data from a newly licensed commercial bank (MBSB Bank Berhad). It was previously classified as a non-bank financial institution. The inclusion of the outstanding loan figures resulted in higher financing annual growth rates for a transitory period from 2Q 2018 to 1Q 2019 due to the lower base in preceding years
[2] Includes loans sold to Cagamas
[3] Partly reflects an ongoing reclassification exercise of SMEs to Non-SMEs by financial institutions
[4] Excludes issuances by Cagamas and non-residents
Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia



Banking System Profitability Indicators

	2018				2019	
	1Q	2Q	3Q	4Q	1Q	2Q*p*
Return on equity (%)	12.4	13.3	12.8	12.7	11.5	13.0
Return on assets (%)	1.4	1.5	1.4	1.4	1.3	1.5
	RM million					
Net interest income	12,045	12,287	12,483	12,782	12,438	12,009
Add: Fee-based income	2,606	2,517	2,476	2,499	2,548	2,619
Less: Operating cost[1]	8,101	7,919	7,820	8,326	8,385	8,421
Gross operating profit	6,550	6,885	7,138	6,955	6,601	6,206
Less: Impairment[2] and other provisions	682	466	692	737	159	274
Gross operating profit after provision	5,868	6,418	6,446	6,218	6,442	5,933
Add: Other income	3,048	4,071	2,240	3,368	2,548	5,532
Pre-tax profit	**8,916**	**10,489**	**8,686**	**9,586**	**8,990**	**11,465**
	Annual growth (%)					
Return on equity(percentage points)	0.6	0.6	-0.1	-0.4	-0.8	
Return on assets(percentage points)	0.1	0.1	0.0	0.0	-0.1	
Net interest income	6.7	5.7	6.3	9.6	3.3	
Add: Fee-based income	4.3	-0.4	-3.1	-17.7	-2.2	
Less: Operating cost[1]	7.1	3.2	1.8	1.8	3.5	
Gross operating profit	5.2	6.3	7.9	6.7	0.8	
Less: Impairment[2] and other provisions	126.9	-43.3	31.1	77.7	-76.7	
Gross operating profit after provision	-0.9	13.5	5.9	1.9	9.8	
Add: Other income	52.0	13.8	-26.3	-12.3	-16.4	
Pre-tax profit	**12.4**	**-10.3**	**-4.9**	**-3.6**		

Federal Government Finance[p]

	2018		2019		
	2Q	1H	1Q	2Q	1H
	RM billion				
Revenue	52.5	106.8	63.7	62.1	125.8
% annual growth	4.0	10.0	17.2	18.3	17.8
Operating expenditure	62.9	117.8	59.5	65.3	124.8
% annual growth	17.5	6.0	8.3	3.8	5.9
Current account	**-10.4**	**-11.0**	**4.2**	**-3.2**	**1.0**
% of GDP	***-3.0***	***-1.6***	***1.2***	***-0.9***	***0.1***
Net development expenditure	9.1	19.8	11.3	12.1	23.4
% annual growth	-14.8	-0.7	5.5	33.2	18.2
Overall balance	**-19.5**	**-30.8**	**-7.1**	**-15.3**	**-22.4**
% of GDP	***-5.5***	***-4.4***	***-2.0***	***-4.1***	***-3.1***
Memo:					
Total net expenditure	72.0				
% annual growth	12.1				
Total Federal Government debt (as at end-period)					
% of GDP					
Domestic Debt					
% of GDP					
External Debt					
% of GDP					
Non-resident holdings of RM-denominated Federal Government debt					
% of GDP					
Offshore borrowing					
% of GDP					