Review And Outlook For The Malaysian Economy

2015 Review Of The Economic Performance

Global economic recovery in 2015 has remained modest, amid slowing world trade, moderate growth in the emerging economies, and the ongoing concerns on the durability of recovery in the advanced economies. It was against a landscape of monetary policy normalisation in the US, continued policy easing in other major economies, and the collapse of energy prices arising from both short-term and structural changes in global supply-and-demand conditions.

These developments have generated large shifts in capital flows and heightened volatility in the international financial markets, which will continue to unfold in 2016. The expectation is for the global environment to remain highly uncertain. With the global landscape changed, it will not revert to periods experienced in the past. To secure sustainable global growth, it will be dependent on the efforts across advanced and emerging economies to adapt to this changing landscape.

Being a highly open economy with increasing integration with the international financial system, Malaysia's domestic economy is significantly affected by both global and regional developments. Despite the challenges, the economy has been able to weather the developments in 2015 and register a respectable growth of 5.0 per cent GDP supported by continued expansion in domestic demand that was primarily driven by the private sector and modest improvements in external demand in the second half of the year.

Private consumption expanded moderately as households adjusted their spending to the higher cost of living arising from the implementation of Goods and Services Tax (GST), adjustments in administrative prices, and the depreciation in the ringgit. Support from the higher cash transfers under the Bantuan Rakyat 1Malaysia (BR1M) scheme, reduction in individual income tax rates for the 2015 assessment year, savings derived from lower domestic fuel prices during the year, continued income growth, stable labour market conditions and inflation supported household spending. Besides, public consumption growth came from the Government's continuous efforts to provide support for growth while remaining committed to the steady reduction in the fiscal deficit.

Slower private investment was due to moderate domestic demand and cautious business sentiments. While investment in new oil and gas explorations toned down, overall private investment continued to be supported by downstream oil and gas activities, and new and on-going projects in the manufacturing and services sectors. Public investment improved with a smaller decline as the Federal Government and public corporations continued to undertake capital spending, thus providing support to the economy.

On the supply side, all major economic sectors grew at a moderate pace with the exception of the mining sector. The moderation reflected a slower expansion of activity in industries catering to domestic demand. However, export-oriented manufacturing and trade-related services benefited from the modest improvement in external demand.

Trade performance was weighed down by the decline in commodity prices and the sluggish demand for commodities and commodity-related manufactured products in the first half of 2015. It improved in the second half of the year following a rebound in export growth supported by higher demand for manufactured products and commodities and ringgit depreciation. For the full year, trade surplus was high, supported by both manufactured and commodity products, and led to a current account surplus that narrowed during the year.

External debt remained manageable although it rose to 72.1 per cent of the GDP as at end-2015, which is equivalent to USD192.2 billion. The rise was due to valuation effects from the depreciation of the ringgit against most currencies during the year.

The Monetary Policy Committee (MPC) maintained the Overnight Policy Rate (OPR) at 3.25 per cent in 2015. The aim was to ensure that monetary conditions are supported for a sustainable growth while maintaining price stability. Against the backdrop of a challenging external environment that affected the outlook for the economy, the monetary policy stance remained accommodative.

Labour market conditions remained broadly stable in 2015 as demand for labour was sustained by the continued expansion across all economic sectors reflected by the steady labour force participation rate at 67.6 per cent (2014: 67.5 per cent) with the unemployment rate edged higher to 3.2 per cent as more cautious business sentiments led to softer employment prospects towards the second half of the year.

2016 Economic Prospects

Growth prospects for the Malaysian economy remain despite a continued challenging external environment and financial landscape that will be a key factor influencing the prospects of the domestic economy. Domestic economic resilience in facing the current difficult environment will depend on the continued strength of the economic fundamentals, structural adjustments and reforms undertaken. A key aspect of this is the diversification of the structure of the domestic economy from an over-dependence on exports to develop new domestic sources of growth. It

has reduced the reliance of the economy on any single source of growth and thus vulnerability to shocks in any particular industry.

Besides, growth has become more balanced with sustained private sector-led domestic demand and a series of measures implemented to rein in excesses and imbalances. Financial system is also a key pillar to the economic strength. Although the domestic financial markets and the ringgit were affected by the large shifts in capital flows, the more resilient and developed financial system together with high international reserves and manageable level of external indebtedness have strengthened the capacity of the economy to cope with the external shocks. It has ensured that financial intermediation has remained uninterrupted.

With global developments expected to pose both upside and downside risks added with the economy continuing to be in a period of adjustment with the ongoing implementation of fiscal reforms alongside with weak ringgit exchange rate that have affected the cost of living for households, particularly for the lower-income segment, a decent growth of between 4.0 to 4.5 per cent is projected of 2016.

Domestic demand will continue to be the principal driver of growth supported by private sector spending. Private consumption growth is envisaged to trend below its long-term average, owing to the continued adjustment by households to an environment of higher prices and greater uncertainties. However, continued growth in income and employment as well as support from Government measures targeted at enhancing households' disposable income will provide support to household spending.

Underpinned by uncertainties and cautious business sentiments, the private sector investment will grow at a slower pace compared to its performance in the past five years. Capital expenditure in the upstream mining sector will remain affected by the environment of low energy and commodity prices. Private sector capital spending will mainly come from the implementation of on-going and new investment projects, particularly in the manufacturing and services sectors.

Public sector expenditure is expected to be moderate in tandem with the Government's commitment to be more prudent. Nonetheless, public investment will benefit from higher spending by the Federal Government on fixed assets and the continued implementation of key infrastructure projects by public corporations.

The external sector is poised to remain resilient. Despite subdued commodity prices, export performance is projected to remain positive, supported by the well-diversified nature of Malaysia's exports. On a positive note, gross imports are projected to expand amid an increase in intermediate imports to support the sustained performance of manufactured exports and the higher growth in capital imports due to the continued expansion of domestic private investment. Still, the overall trade balance in 2016 should record a smaller surplus.

On the supply side, all economic sectors are projected to expand moderately in 2016. The services and manufacturing sectors will remain the key drivers of overall growth. Despite the lower oil and gas prices, growth in the mining sector will be supported by new gas production capacity. Growth momentum in the construction sector is projected to moderate slightly in 2016 amid a modest expansion in both residential and non-residential sub-sectors.

Headline inflation will remain manageable around 2.0 to 2.5 per cent supported by low global energy and commodity prices, generally subdued global inflation and more moderate domestic demand. They will be able to mitigate the higher prices coming from several price-administered items and the weak ringgit.

Monetary policy in 2016 will focus on ensuring that monetary conditions remain supportive of sustainable domestic growth with price stability, taking into consideration the evolving risks in the external and domestic environments. It will continue to take into account the risk of financial imbalances, given the expectation of continued volatility in external flows.

Fiscal policy will centre on fiscal consolidation. The 2016 Budget was recalibrated in January 2016 to incorporate the expected decline in global oil prices. Government spending was reprioritised and measures were introduced to broaden revenue sources. Fiscal spending will be prioritised towards high impact infrastructure projects that could have large multiplier effects by increasing the productive capacity of the economy. Emphasis will continue to be towards ensuring inclusive and sustainable growth through welfare enhancements, particularly in the form of socio-economic support to the lower- and middle-income segments to help them cope with the rising cost of living.

Given the expectation of a challenging global financial environment, the economy will likely be confronted by volatile movements in capital flows. Hence, the policies are designed to address immediate-term vulnerabilities and at the same time provide sustainable growth. With a deep and developed financial markets, the economy is well positioned to intermediate any flows by ensuring that the functioning of the domestic financial markets will continue to be orderly and supportive of the real economy.