BANK NEGARA 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.

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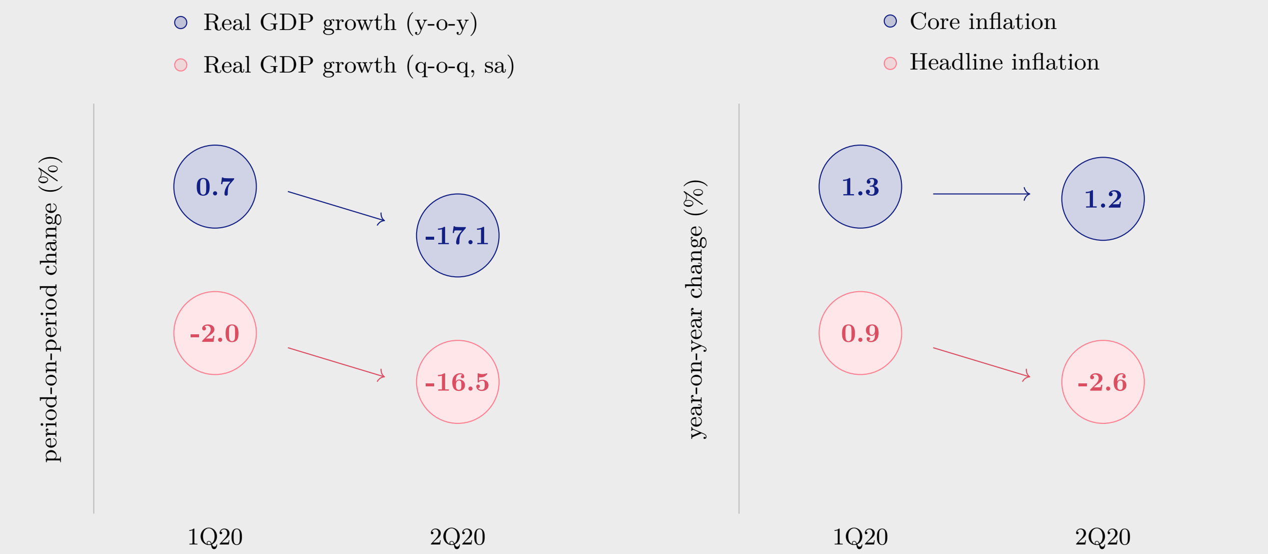
Contraction in economic activity due to weak external conditions and domestic containment measures

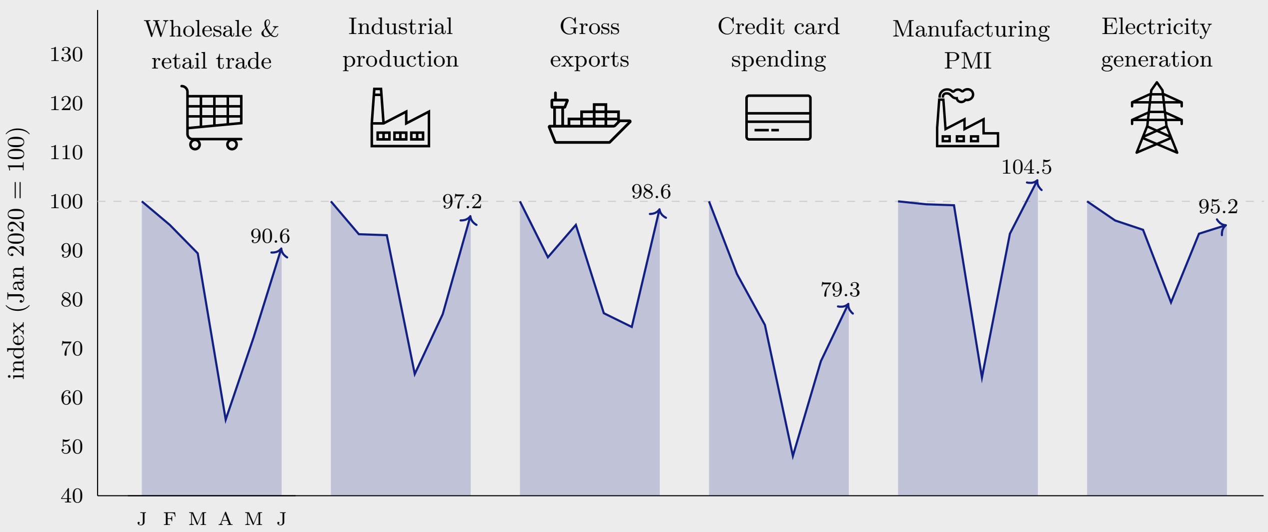
Negative headline inflation due mainly to lower fuel prices; core inflation moderated slightly



Source: Department of Statistics Malaysia and Bank Negara Malaysia estimates

Gradual recovery towards the end of the quarter

Key indicators began picking up in May as MCO restrictions were eased



Source: Department of Statistics Malaysia, IHS Markit, Tenaga Nasional Berhad, and Bank Negara Malaysia

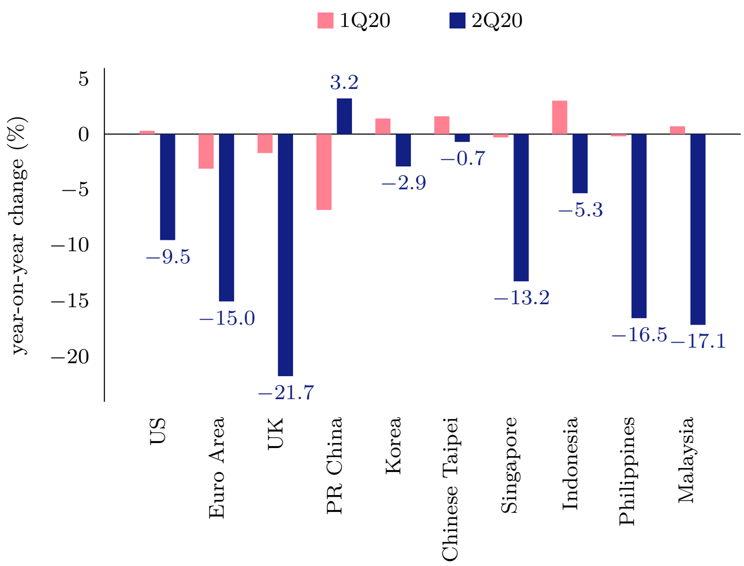
International Economic Environment

Highlights

- The global economy contracted in 2Q 2020 amid widespread COVID-19 pandemic containment measures.
- Regional exports contracted due to production restrictions and weaker external demand conditions.
- Financial market volatility was elevated.

The global economy contracted

Chart 1: GDP Growth of Selected Economies



Source: National authorities

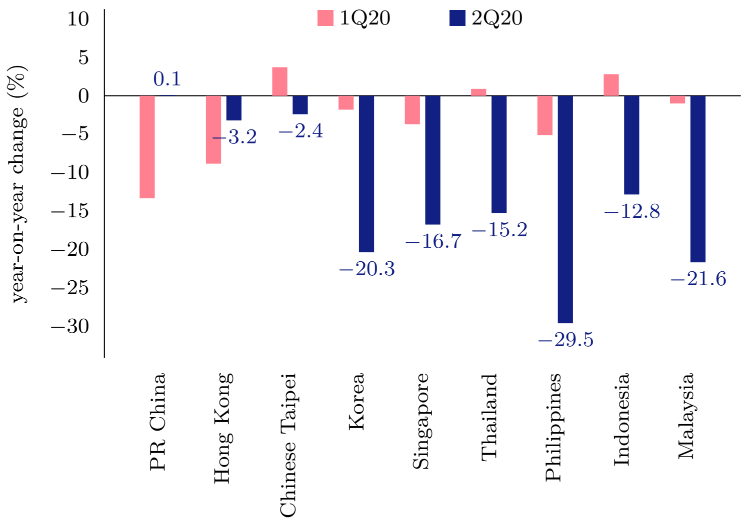
The global economy contracted in 2Q 2020. As the number of COVID-19 cases continued to rise, nationwide lockdowns and travel restrictions were implemented across major advanced and emerging economies. This significantly disrupted production activity, which resulted in a marked deterioration in labour market conditions and private sector expenditure.

In the US, private consumption slowed sharply despite the large fiscal support from government transfers, while investment activity moderated amid heightened risk aversion and weaker demand conditions. In the euro area, output declined due to production disruptions and widespread lockdowns for most of the quarter. Similarly, economic activity in most EMEs moderated considerably from the adverse economic implications of lockdown measures.

In contrast, PR China recorded positive growth of 3.2% in 2Q 2020. As COVID-19 cases declined following an aggressive lockdown in the first quarter, it was able to ease containment measures. A rebound in industrial activity and large government support through public investments resulted in the economy recording positive growth after contracting in the first quarter. Nevertheless, many services sectors, such as retail and tourism, remained weak as private consumption remain depressed.

Weakness in regional exports

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

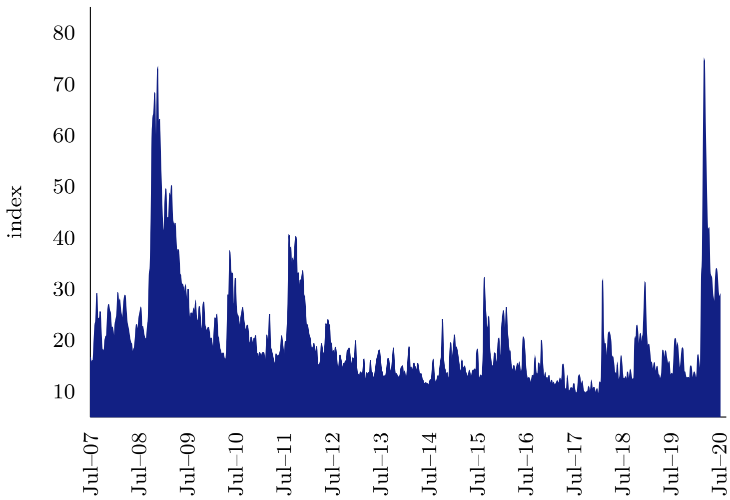


Source: National authorities

Production restrictions and muted demand conditions resulted in a marked slowdown in exports. The Philippines and Korea, whose exports declined by -29.5% and -20.3%, respectively, were significantly affected. Other regional economies such as Singapore, Thailand and Indonesia also recorded weaker export growth. PR China was the only exception to this falling trend as its exports registered a marginal positive growth of 0.1%.

Elevated financial market volatility

Chart 3: CBOE Volatility Index (VIX)



Source: Bloomberg

Financial market volatility during the quarter increased to levels comparable to the Global Financial Crisis as the pandemic escalated. Nonetheless, towards the end of the quarter, volatility started to ease as lockdowns were gradually lifted in some economies, such as the euro area and the US. Equity markets, in particular, recovered some of the losses experienced in the preceding quarter. However, a resurgence of cases in the US and the ongoing risk of secondary outbreaks in countries that had managed to control the spread of the virus, kept financial market volatility elevated.

Brent crude oil price declined to an average of USD33 per barrel during 2Q 2020 (1Q 2020 average: USD51 per barrel), weighed by rising global oil oversupply as global oil demand declined sharply amid the COVID-19 pandemic. Nevertheless, the fall in oil price was partially mitigated by the resumption of the OPEC+ production cuts beginning 1 May 2020 and lower oil production in the US.

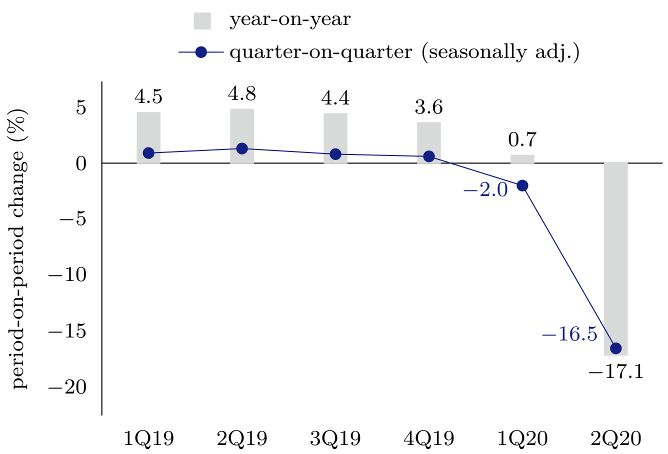
Developments in the Malaysian Economy

Highlights

- The Malaysian economy contracted by 17.1%.
- Headline inflation was negative while core inflation moderated slightly.
- The current account surplus amounted to RM7.6 billion or 2.5% of GDP.

Growth declined in 2Q 2020

Chart 4: Real GDP Growth



Source: Department of Statistics Malaysia

The Malaysian economy was confronted by concurrent supply and demand shocks arising from weak external demand conditions and strict containment measures in 2Q 2020. As a result, the economy registered its first contraction since the Global Financial Crisis (2Q 2020: -17.1%; 3Q 2009: -1.1%). On the supply side, this was reflected in negative growth across most sectors. From the expenditure side, domestic demand declined, while exports of goods and services registered a sharper contraction. On a quarter-on-quarter seasonally-adjusted basis, the economy declined by 16.5% (1Q 2020: -2.0%).

Weak growth across most economic sectors

Chart 5:
Growth by Economic Sectors

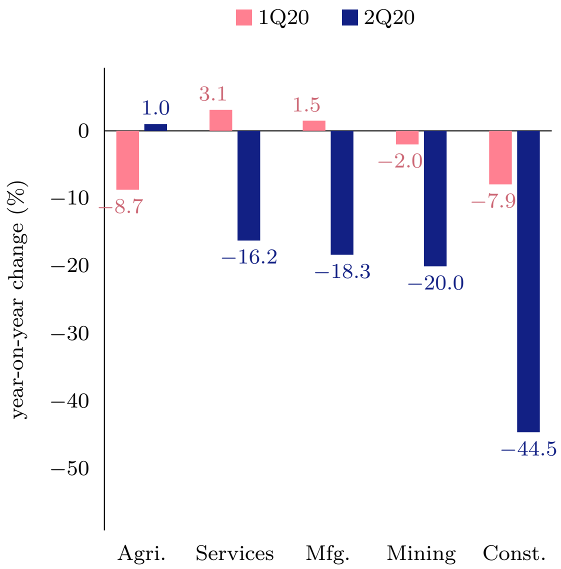
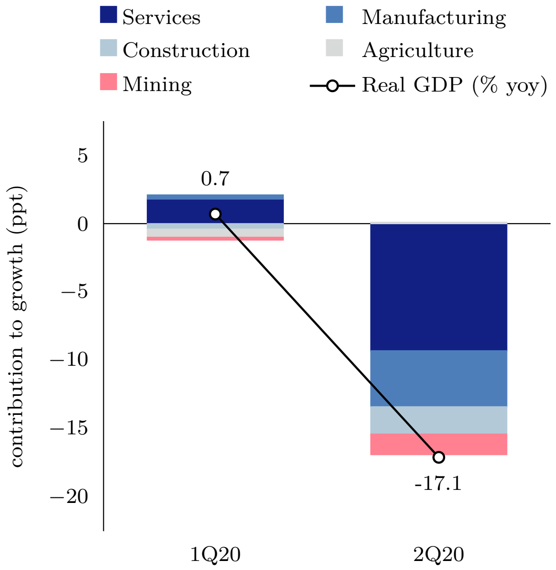


Chart 6:
Contributions to Real GDP by Economic Sector



Source: Department of Statistics Malaysia

Weak growth was recorded across most economic sectors amid the imposition of the Movement Control Order (MCO), followed by the Conditional and Recovery MCO, during 2Q 2020.

The services sector contracted by 16.2% (1Q 2020: 3.1%). The sector was affected by the implementation of a nationwide restrictive MCO, with only essential services such as food-related retail, utilities, banking, transportation as well as information and communication entities allowed to operate with very limited capacity. The subsequent transition to Conditional MCO (CMCO) in May and Recovery MCO (RMCO) in June provided some relief to businesses in the sector. The lockdown had substantially affected consumer spending and tourism activity, as shown by the significant declines in the wholesale and retail trade, as well as food and beverages and accommodation sub-sectors. The transport and storage sub-sector was impacted by a sudden stop in tourist arrivals due to travel restrictions imposed domestically as well as the international border closures. Growth in the finance and insurance sub-sector was weighed down by lower net interest income, and lower fee-based income amid subdued capital market activity. Meanwhile, growth in the information and communication sub-sector was relatively sustained by the continued high demand for data communication services especially during this period of remote working arrangements.

The manufacturing sector contracted by 18.3% (1Q 2020: 1.5%), due largely to the imposition of MCO restrictions as well as weak demand conditions. The extension of the MCO from end-March throughout April curtailed production activity across all industries. Essential sectors and those in the related supply-chain sectors operated at reduced capacity to ensure sufficient social distancing at workplaces, while non-essential sectors such as transport equipment and textile-related industries did not operate. Following the lifting of MCO restrictions in May, manufacturing firms gradually restarted operations, but did so while observing sector-specific health protocols amidst subdued demand conditions externally and domestically. The latter had particularly affected the performance of the primary- and consumer-related clusters. Nevertheless, the impact of weak demand was partially mitigated by a backlog of orders which supported a faster production recovery, observed mainly in the electric and electronics (E&E) industry.

The mining sector recorded a sharper contraction of 20.0% in 2Q 2020 (1Q 2020: -2.0%). Oil and gas output were affected by a sharp decline in demand due to the MCO as well as maintenance works in East Malaysia. Growth was also weighed by lower production in the other mining segment due to restrictions during the MCO period.

Activity in the construction sector declined by 44.5% (1Q 2020: -7.9%), as almost all activities came to a standstill particularly in the month of April. Despite the partial reopening of the economy on 4 May, most construction sites faced challenges restarting due to adjustments required to comply with the strict COVID-19 Standard Operating Procedures (SOPs). Most of the construction sites were reported to remain idle as developers faced challenges to restart, including financial constraints, initial lack of clarity over the SOPs and COVID-19 testing, and disruptions in the supply of construction materials. However, the situation improved significantly towards the end of the quarter after the Government implemented additional measures to facilitate the revival of the economy[1].

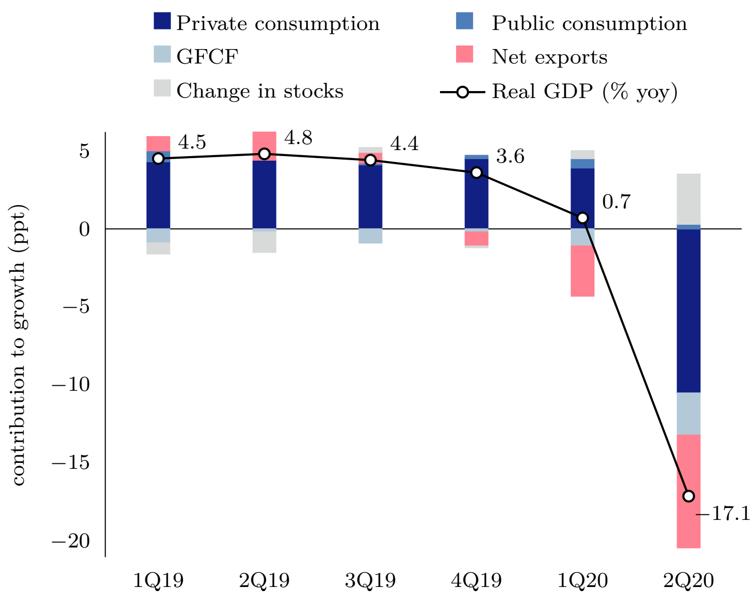
However, the agriculture sector rebounded in the quarter at 1.0% (1Q 2020: -8.7%), mainly due to the recovery in oil palm production as fresh fruit bunch yields normalised from the earlier impact of dry weather and fertiliser cutbacks. The oil palm recovery was also supported by higher harvesting activities, arising from the greater presence of workers in estates during the MCO period[2]. This more than offset the weaker production in the other agriculture subsectors, such as fisheries and livestock, due to weak demand.

[1] These measures included providing details on SOPs by publishing a set of frequently asked questions, and subsidising COVID-19 tests for workers covered by SOCSO. Workers were encouraged to use the MySejahtera mobile application to aid contact tracing if needed.

[2] Greater presence of workers was attributed to the border closures during MCO which prevented foreign workers from returning to their home countries especially during the festive season.

Sharp contraction in domestic demand

Chart 7: Contribution of Expenditure Components to Real GDP Growth



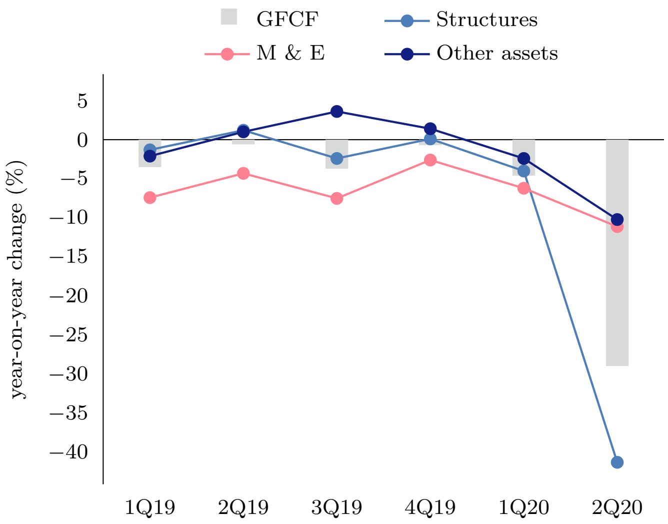
Source: Department of Statistics Malaysia

Domestic demand declined by 18.7% in 2Q 2020 (1Q 2020: 3.7%), due mainly to weaker private sector expenditure. Spending by the private sector was impacted by lower income, movement restrictions and subdued consumer and business sentiments. While net exports continued to decline, the contribution of the external sector to the economy improved due mainly to the larger contraction in imports vis-a-vis the previous quarter.

Private consumption growth declined by 18.5% in 2Q 2020 (1Q 2020: 6.7%). Household spending was particularly impacted by the strict movement restrictions in the early part of the quarter and income losses amid weak economic conditions. As movement restrictions were gradually relaxed towards the end of the quarter, retail and financing data indicated some improvement in spending, albeit remaining subdued. During this challenging period, stimulus measures such as the disbursement of Bantuan Prihatin Nasional cash transfers, EPF i-Lestari withdrawals and the implementation of the loan moratorium helped to cushion consumption spending.

Public consumption continued to expand, albeit at a more moderate pace of 2.3% (1Q 2020: 5.0%). Growth was supported by continued increase in emoluments amid lower spending on supplies and services.

Chart 8: GFCF Growth by Type of Assets



Source: Department of Statistics Malaysia

Gross fixed capital formation (GFCF) registered a sharper contraction of 28.9% (1Q 2020: -4.6%), weighed by significantly lower capital spending by both public and private sectors. By type of asset, both investment in structures and machinery & equipment (M&E) declined by 41.2% (1Q 2020: -4.0%) and 11.1% (1Q 2020: -6.2%), respectively.

Private investment declined by 26.4% (1Q 2020: -2.3%), due mainly to the COVID-19 containment measures and heightened uncertainty which affected business sentiments and investment intentions. During the quarter, investment was affected by mobility restrictions, which temporarily halted the implementation of projects. Despite the gradual relaxation of the MCO, firms maintained a cautious approach to capital expenditure amid slower production and disruptions to global value chains. Furthermore, businesses also faced challenges in the delivery and installation of M&E amid border closures.

Public investment also recorded a larger decline of 38.7% (1Q2020: -11.3%). This was due to a contraction in capital spending by both general government and public corporations due mainly to the movement restrictions.

Negative headline inflation due to decline in fuel prices; risk of deflation is minimal

Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), declined to -2.6% during the quarter (1Q 2020: 0.9%). The lower headline inflation was primarily due to the substantial decline in retail fuel prices (average RON95 petrol price per litre in 2Q 2020: RM 1.37; 1Q 2020: RM 1.96) and the implementation of the tiered electricity tariff rebate beginning the month of April.

Notwithstanding the negative headline inflation, the decline in prices was not broad-based. In April, a relatively larger share of CPI items recorded unchanged prices (61%; March: 50%) amid the MCO which resulted in a significant reduction in economic activity. As economic activity gradually resumed under the CMCO and RMCO beginning from early May, there were some signs of normalisation in prices with a gradual increase in the share of CPI items recording price increases (May: 36%; June: 44%).

Core inflation moderated slightly to 1.2% (1Q 2020: 1.3%). Despite the moderation in overall demand pressure and weaker labour market conditions, some essential goods and services such as food away from home and small household appliances experienced price increases during the quarter. This suggests the continued presence of underlying demand especially for necessities.

Chart 9: Contribution to Headline Inflation by Components

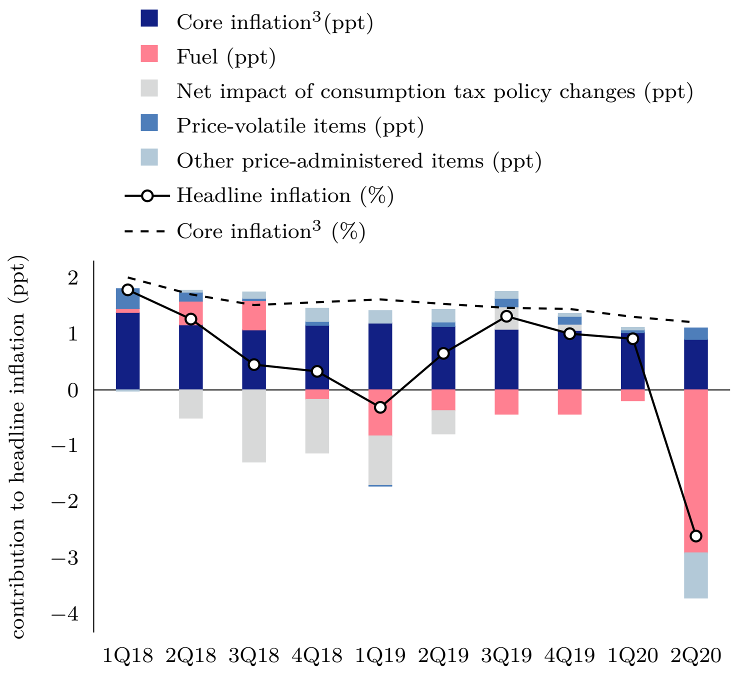
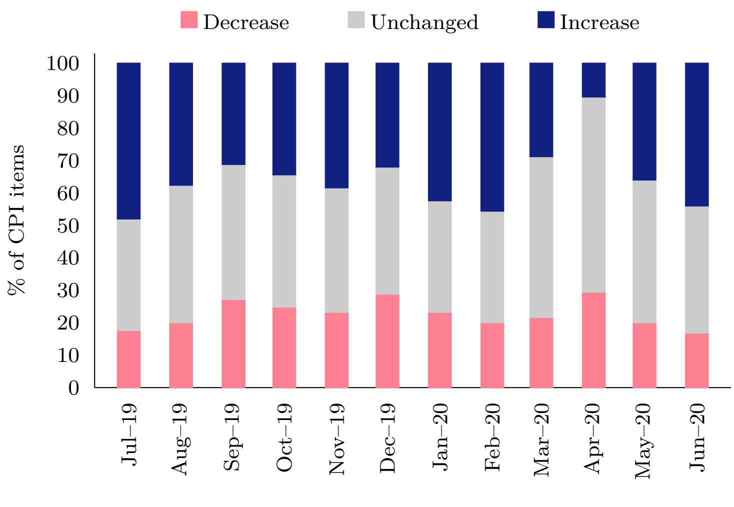


Chart 10: Month-on-Month Price Changes of CPI Items[4]



Source: Department of Statistics Malaysia and Bank Negara Malaysia estimates

[3] Core inflation is computed by excluding price-volatile and price-administered items. It also excludes the estimated direct impact of consumption tax policy changes.

[4] Based on the month-on-month inflation for 125 CPI items at the 4-digit level.

Box Article

COVID-19: Impact on Inflation

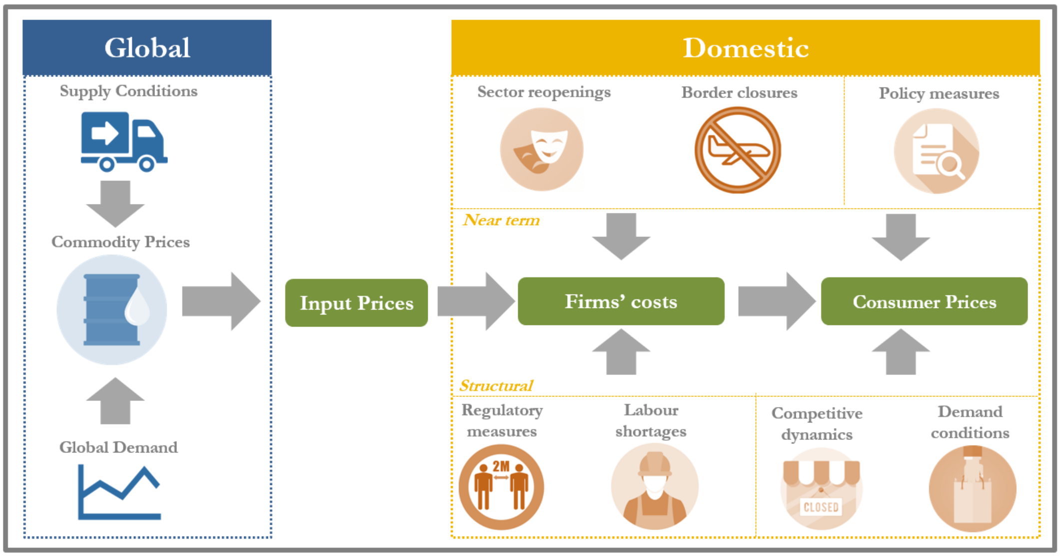
by Peter Aun Maojun *and* Nur Aimi Abdul Ghani

Introduction

The COVID-19 pandemic and the ensuing "Great Lockdown" (International Monetary Fund (IMF), 2020) involves a unique combination of shocks to both demand and supply (Baqaee and Farhi, 2020). As such, there has been debate surrounding whether this will lead to deflationary pressures or higher inflation.

Generally, a decline in aggregate demand amid heightened uncertainty and income fragilities may act to dampen inflationary pressures. However, higher production costs, due to supply chain disruptions and the impact of physical distancing and cross-border movement restrictions on labour supply, could lead to upward cost-push inflationary pressures. The initial lockdown at the onset of the pandemic has led to a shift in demand patterns that if permanent, could translate into changes in the degree of market power firms can exercise, ultimately affecting equilibrium inflation. This article aims to evaluate some of the channels that have affected inflation in the near-term, and provide an interim assessment of the structural changes in inflation dynamics that could materialise, yet remain highly uncertain.

Figure 1: Illustration of several global and domestic factors and their potential impact on prices



Source: Bank of England (2020) and Portes (2020)

Observed impact on inflation: What we have seen so far

Figure 1 illustrates the various factors at play. The crisis has brought about a significant decline in the demand for many key commodities. Global oil prices experienced a steep decline in March and April, as worldwide lockdowns led to a significant reduction in demand for energy products.[1] This translated into low domestic retail fuel prices, which had a large negative contribution on domestic headline inflation since March. However, prices of food commodities rose due to export restrictions amid preservation of supplies in producer nations, coupled with disruption in export logistics. For example, Vietnam and Cambodia initially elected to place temporary export restrictions on rice to ensure adequate domestic rice supply, which led to costlier imported rice.[2]

On the domestic front, significant supply disruptions were observed at the onset of the crisis due to strict movement restrictions, which led to some upward price pressures for certain perishable food items. Meanwhile, with the reopening of the economy, there is some evidence that sectors previously required to temporarily cease operations[3] continue to experience tepid demand given health concerns, leading to promotional pricing to entice customers.

The legal enforcement of health-related regulatory measures has also affected inflation. Alongside the strict stay-at-home order instituted during the Movement Control Order (MCO) period, the Government had also implemented sector-specific Standard Operating Procedures in efforts to contain the spread of the virus.[4] There has been mixed evidence showing that businesses with more inelastic demand (e.g. hair salons) were able to pass on costs to consumers, while others, such as hotels and entertainment outlets, largely absorbed cost increases to spur demand amid precautionary behaviour. The Government has also implemented measures aimed at easing cost burdens[5] which have helped to dampen inflationary pressures.

Altogether, Malaysia has experienced muted inflationary pressures since the onset of the pandemic, largely due to low global oil prices – an experience similar to other countries. The IMF has since revised inflation projections downwards for 2020, attributing a combination of lower commodity prices and weaker economic activity as key factors (see Table 1).

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[1] The decline was exacerbated by the failure of the Organization of the Petroleum Exporting Countries and its allies (collectively known as OPEC+) to agree on production cuts (Woodmac, 2020).

[2] Rice constitutes 1.1% of the Consumer Price Index (CPI) basket, of which imported rice makes up 20%.

[3] For example, entertainment and well-being outlets (e.g. reflexology services).

[4] Some of these measures include social distancing, usage of hygiene-related material (e.g. sanitisers, disinfectants, masks, gloves) within premises and other precautionary measures (e.g. digital menus, testing for employees, digital thermometers).

[5] These include tiered electricity tariff rebates and price controls on some essential goods.

Table 1: IMF Inflation Projections

	2020 projections		**2021 projections**	
	Jan-20	Jun-20	Jan-20	Jun-20
Advanced Economies	1.7	0.3 ↓	1.9	1.1 ↓
Emerging Markets & Developing Economies	4.6	4.4 ↓	4.5	4.5 ∼

Source: IMF World Economic Outlook Update Reports (January & June 2020)

Moving forward, while initial concerns are beginning to dissipate, the outlook would still depend on evolving COVID-19 developments and the pace of economic recovery. At this juncture, there are limited risks of a broad-based and persistent decline in prices, with price pressures showing signs of normalisation[6] since the gradual reopening of the economy. In addition, while underlying inflation is expected to be subdued, it is expected to average within earlier expectations for the year as a whole, reflecting the gradual resumption of economic activity and improvement in demand conditions.

Structural factors and the longer-term impact on inflation: What remains uncertain

While the impact from the various shocks outlined above were assessed based on existing frameworks (as illustrated in Figure 1), it is imperative to note that inflation channels may evolve. This section discusses where these structural changes could occur going forward.

1) **Shift in consumption patterns during the pandemic**

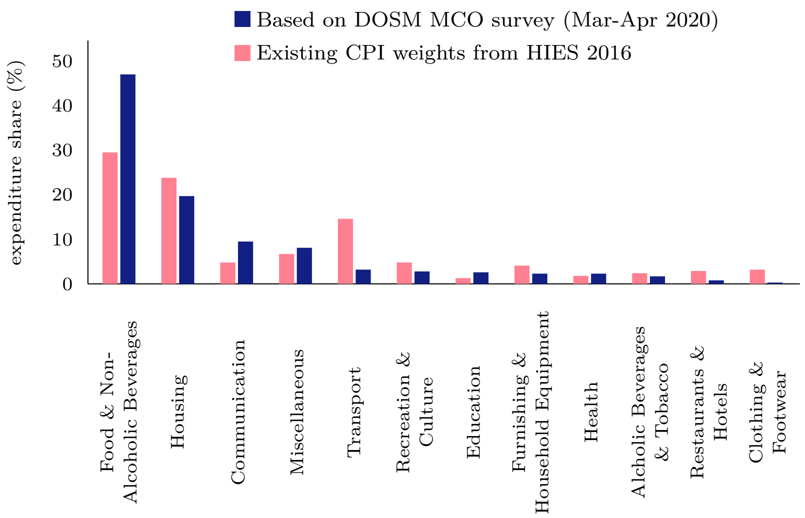
   Households' consumption patterns shifted significantly during the implementation of the MCO as evident from the study on the Impact of MCO on Household Expenditure conducted by the Department of Statistics Malaysia (DOSM).[7]

   The survey showed a shift towards higher consumption of food products, as households stock-piled during the initial MCO period and generally consumed more food at home. There was also a drop in expenditure for categories such as transport, restaurants and hotels, as well as recreation and clothing, amid movement restrictions and mandatory closures of selected sectors.

[6] The share of items displaying price increases has steadily recovered: (June: 44% of CPI items; May: 36%; April: 10%; 2010-18 Average: 46%).

[7] Current CPI weights are based on DOSM's 2016 Household Income and Expenditure Survey (HIES).

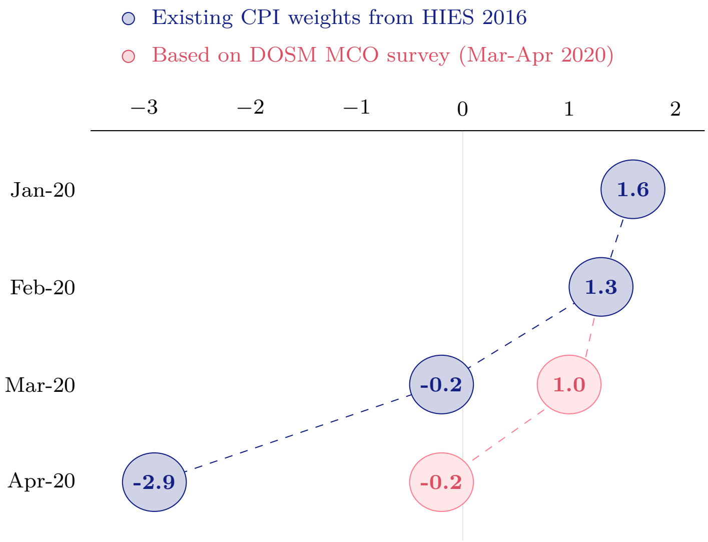
Figure 2: Shift in Expenditure Shares during the MCO period



Source: Department of Statistics Malaysia and Bank Negara Malaysia estimates

To provide a COVID-19 perspective and evaluate the impact on the measurement of inflation in Malaysia, we computed the inflation numbers by updating the Consumer Price Index (CPI) basket weights using findings from the previously mentioned study on the impact of the MCO conducted by DOSM.

Figure 3: Headline Inflation based on Various Expenditure Patterns



Source: Department of Statistics Malaysia and Bank Negara Malaysia estimates

As seen in Figure 3, headline inflation would have been higher for March and April once the shift in consumption patterns are accounted for. These findings are similar to those observed in other countries, such as the United States, France, the United Kingdom and Japan, among others[8], where researchers found that the official inflation rate would have been higher when taking into account changes in expenditure patterns (Cavallo, 2020).

Due to this distinct shift in consumption patterns, there were initial concerns surrounding the accuracy of inflation assessments. While these concerns are valid, it is important to note that according to international standards, CPI basket weights should not be adjusted in response to short-term changes in expenditure patterns.

Based on current assessments, these expenditure patterns are expected to gradually normalise as the economy recovers, health concerns dissipate and restrictions are removed. As such, no further adjustments to the CPI weights are necessary at this juncture. However, if these shifts in consumption continue as a result of other forms of structural changes in the economy, this could warrant the need to incorporate such shifts in ensuring an accurate assessment of inflationary pressures.

2) **Change in competitive dynamics**

Aside from the shift in consumption patterns, the crisis could also alter competitive dynamics (Pastor, 2020). As firms exit as a result of the pandemic, the resulting composition of surviving firms could potentially impact inflation dynamics in Malaysia. The impact could depend on whether large international chains or small businesses make up the majority of firms that survive. In the case of the former, prices of domestic goods could potentially become more sensitive to global price movements.

The responsiveness of inflation to slack in the economy may also change due to a shift in market structure (Guilloux-Nefussi, 2020). It has been shown that firms, primarily large ones with high market power, act strategically by adjusting their mark-ups in response to perceived competition, also known as strategic complementarity. It has been found that these firms mostly adjust prices in response to changes in the prices set by competitors, rather than their own costs (Amiti et al., 2019). Thus, the degree of pass-through of cost shocks to domestic prices would highly depend on whether local industries mainly constitute a few large firms, as they are more likely to employ strategic mark-up adjustments. At this juncture, such structural changes and their subsequent impact on inflation remain uncertain given the evolving developments. Going forward, more data and deeper surveillance are required to ascertain any shifts in industry composition.

[8] Cavallo (2020) also found similar results for Brazil, Uruguay, Korea, Chile, Colombia, Turkey, Spain, Argentina and Canada.

3) **Impact from economic scarring and shifts in labour market**

Economists have also raised concerns on the potential longer-term damage to the economy, or “economic scarring” (IMF, 2020), particularly on the labour market, which could have implications on inflation dynamics. Should economic recovery be more sluggish than expected, there may be a rise in unemployed individuals, particularly in sectors heavily affected by the pandemic. Some may exit the labour force altogether. In addition, prolonged unemployment for these individuals may lead to skills atrophy over time, which could lead to both a decline in the productivity of the working population (Neuman, 1995) and the labour force participation of individuals with obsolete skills (Van Loo et al., 2001). In fact, past epidemics were associated with a decline in labour productivity of 6 percent five years later in affected countries (World Bank, 2020). Nonetheless, the impact on prices remains uncertain. While the increased slack, coupled with the increase in technological adoption by firms as seen during this pandemic may lead to downward wage pressures, the decline in labour force participation and productivity growth rates may lead to higher cost pressures.

This pandemic may have also accelerated the shift to more flexible forms of employment, such as gig workers in selected sectors (Moulds, 2020). Such forms of employment could affect inflation dynamics mainly through its downward pressure on wage inflation due to the decline of employees’ bargaining power and lower costs for firms as a result of reduction in firms’ turnover costs in labour markets (Duca, 2018). In the long run, some may not be offered permanent employment, which would lead to smaller pressures on wage inflation when the economy eventually recovers (Cœuré, 2017).

If the pandemic and containment measures persist, disruptions to the labour market would delay the recovery of output to pre-COVID-19 levels. The extent of the permanence of these output losses would certainly depend on how deep and persistent the pandemic would be. While a complete and definitive assessment on these structural changes would not be possible at this current stage given the uncertainty surrounding the ongoing crisis, it is prudent to closely monitor the developments and their impact, if any, on inflation.

Conclusion

The COVID-19 pandemic and the ensuing unprecedented containment measures have brought about significant changes to the way the economy operates. Beyond the near-term impact, there are also channels that would lead to structural implications on inflation dynamics in the longer term. As we transition into a new normal, however, there remains a significant amount of uncertainty surrounding the future assessment of inflation and growth trajectories – a common sentiment across countries.

While the situation has begun to stabilise, it is certain that we are not in the clear yet and thus greater vigilance is necessary as we continue to assess any changes in inflation dynamics. To this end, the Bank will continue to closely monitor price developments and inflation expectations, complemented by real-time and high frequency indicators, as well as engage industry players to gain deeper insights. In addition, the Bank will continue to communicate clearly to the public on inflation developments and outlook as they unfold to ensure that price expectations remain anchored.

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Weak labour market conditions

Chart 11: Employment and Private Sector Wage Growth[5]

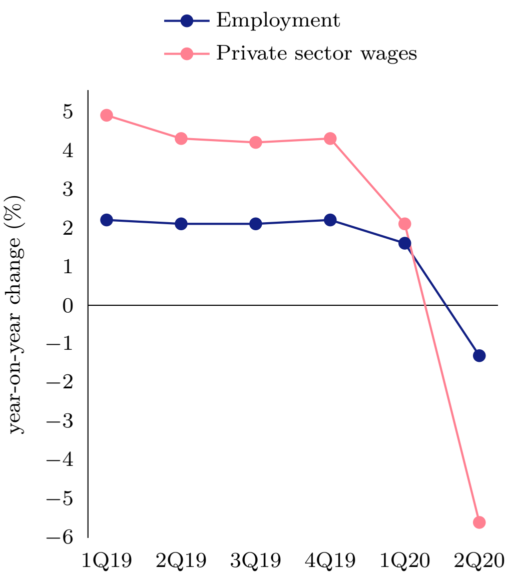
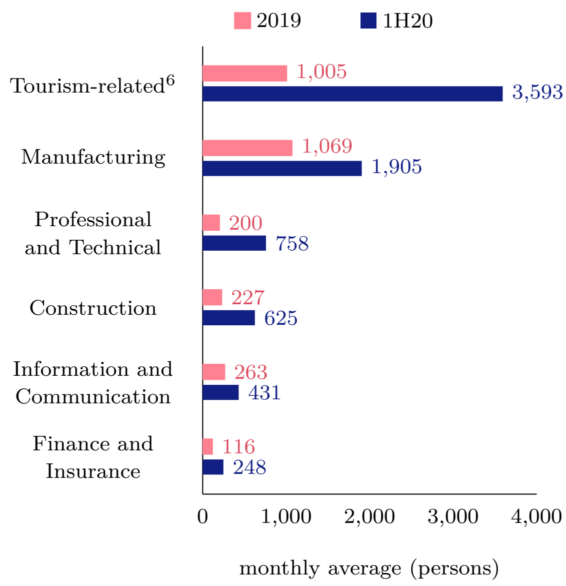


Chart 12: Average Monthly Jobless Claims for Key Industries



Source: Department of Statistics Malaysia and Employment Insurance System, Social Security Organisation

Labour market conditions weakened as containment measures and weak demand led firms to undertake cost-cutting actions. Measures such as retrenchments, pay-cuts and unpaid leave weighed on employment and income conditions. Employment declined by 1.3% (1Q 2020: +1.6%). Job losses were concentrated in the tourism-related industries as demand weakened considerably amid border closures. As a result, the unemployment rate rose to 5.1 % (1Q 2020: 3.5%).

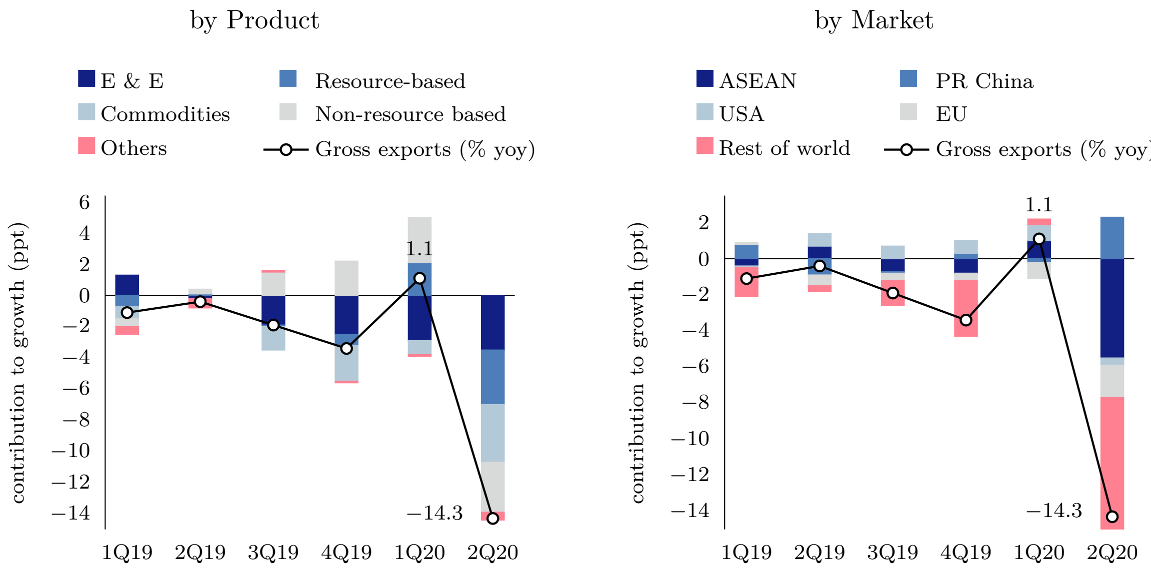
In addition to the job losses, shorter working hours and pay-cuts among those who remained in employment resulted in negative private sector wage growth in 2Q 2020 (-5.6%, 1Q 2020: 2.1%). The negative private services wage growth in 2Q 2020 (-6.4%, 1Q 2020: 1.4%) was driven mainly by tourism-related services, such as wholesale and retail trade, food and beverage, and accommodation (-3.5%; 1Q 2020: 1.9%) as well as transportation and storage (-29.7%; 1Q 2020: -3.5%) sub-sectors. In the manufacturing sector, wages contracted by 4.0% (1Q 2020: +3.4%). This was mainly due to lower wage growth in the transport equipment and other manufactures sub-sector (-13.3%; 1Q 2020: 1.3%) and the textiles, wearing apparel, leather and footwear sub-sector (-15.3%; 1Q 2020: 2.4%) that were unable to operate during the MCO period.

[5] Private sector wages are derived from the salaries and wages data published in the Monthly Manufacturing Statistics and Quarterly Services Statistics by the Department of Statistics Malaysia. They cover 62.9% of total employment.

[6] Refers to wholesale retail trade, food and beverage, accommodation, transport and storage, entertainment and recreation, and administrative and support services.

Trade activity declined due to contraction in manufacturing & commodities exports, and weaker demand from main trade partners

Chart 13: Gross Exports by Product and Market



Source: Department of Statistics Malaysia

In 2Q 2020, gross exports declined by 14.3% (1Q 2020: 1.1%) weighed by weaker growth in both manufactured and commodities exports. Gross imports contracted by 15.1% (1Q 2020: 1.3%) due to lower intermediate and consumption imports. The trade surplus[7] narrowed to RM27.6 billion (1Q 2020: RM37.0 billion).

Malaysia's export performance in 2Q 2020 was affected by COVID-19 lockdowns globally, which resulted in disruptions to the global supply chains, lower demand from key trade partners and weaker commodity prices. Domestically, while the MCO restrictions had affected production in the early part of the quarter, manufactured exports registered a positive turnaround in June once the restrictions were eased. This was partly due to firms meeting a backlog of orders, particularly in the E&E sector. For the second quarter as a whole, manufactured exports contracted by 12.1% (1Q 2020: 2.5%) due mainly to lower non-E&E exports, which registered double-digit decline at -14.1% (1Q 2020: 11.2%). This was attributed to lower exports of petroleum products, metal manufactures and chemical & chemical products. E&E exports contracted further (-9.5%; 1Q 2020: -7.6%) amid lower exports to key trade partners, including the EU, US and Japan. Commodities exports worsened (-24.7%; 1Q 2020: -5.6%) due mainly to a sharp contraction in mineral exports following weaker prices and export volumes.

Intermediate imports contracted by 23.4% (1Q 2020: 8.1%) during the quarter due to lower imports of industrial supplies and fuel & lubricants amid weaker manufacturing activity. Consumption imports also declined (-9.3%; 1Q 2020: 4.8%), driven primarily by a sharp contraction in consumer durable goods. Meanwhile, capital imports increased by 14.8% (1Q 2020: -27%), due mainly to the import of a large floating structure.

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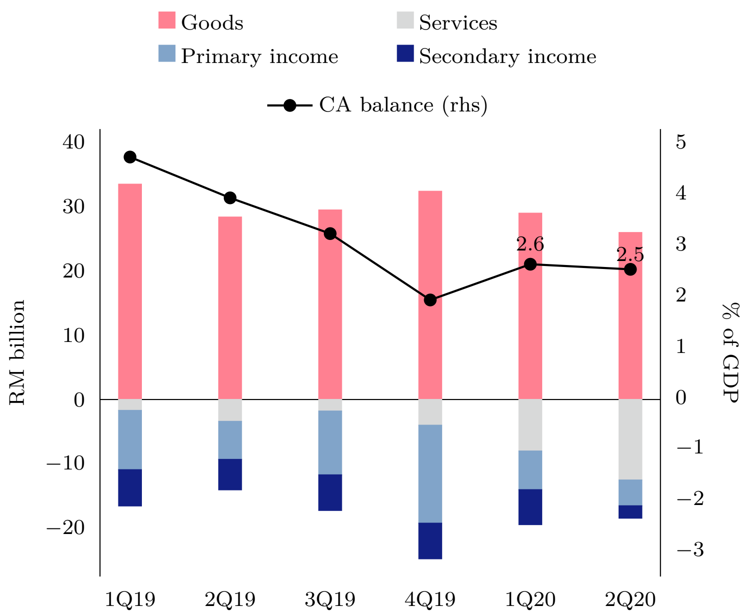
[7] The goods and trade surpluses differ because goods for processing, storage and distribution (with no change in ownership) are excluded from the goods account. This is as per the 6th Edition of the Balance of Payments and International Investment Position Manual by the IMF.

Current account balance registered a surplus of RM7.6 billion

Chart 14: Current Account Balance



Source: Department of Statistics Malaysia

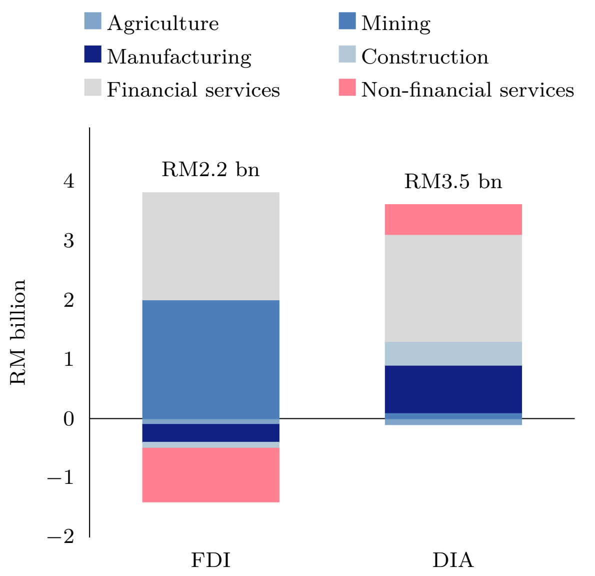
The current account of the balance of payments registered a surplus of RM7.6 billion or 2.5% of GDP in 2Q 2020 (1Q 2020: RM9.5 billion or 2.6% of GDP). The goods surplus decreased to RM25.9 billion (1Q 2020: RM28.9 billion), as the decline in the level of exports outpaced that of imports. In the services account, the deficit widened to RM12.5 billion (1Q 2020: -RM8.0 billion), the largest ever recorded. This was due primarily to a travel deficit (-RM3.1 billion; 1Q 2020: +RM2.1 billion) amid international travel restrictions.

The primary income account registered a lower deficit of RM4.0 billion (1Q 2020: -RM6.0 billion). This mainly reflected higher direct investment income from Malaysian investments abroad.

The deficit in the secondary income account narrowed to RM1.9 billion (1Q 2020: -RM5.4 billion). Outward remittances by foreign workers were lower due to the broad-based weakness in economic activity during the quarter.

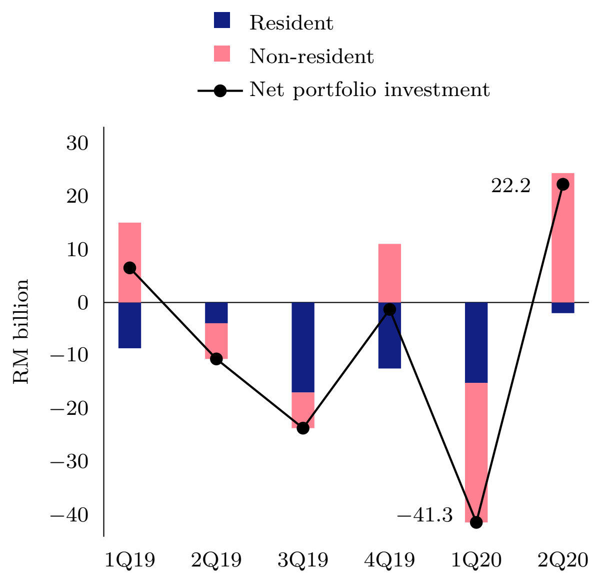
Financial account registered a net outflow

Chart 15: Net Direct Investment Flows by Sector



Note: For DIA, positive (negative) values refer to net outflows (inflows). Figures may not sum due to rounding.

Chart 16: Portfolio Investments



Source: Department of Statistics Malaysia and Bank Negara Malaysia

The financial account registered a net outflow of RM19.8 billion (1Q 2020: -RM13.3 billion), due mainly to outflows from the other investment account. This was partly offset by a turnaround in the portfolio investment account.

The direct investment account turned around to register a small net outflow of RM1.2 billion (1Q 2020: +RM3.4 billion), as direct investment abroad (DIA) recorded higher outflows amid smaller foreign direct investment (FDI) inflows. DIA recorded outflows of RM3.5 billion in the second quarter (1Q 2020: -RM3 billion). These investments were mainly channelled into the services sector, particularly the financial services and information and communication services sub-sectors. FDI recorded smaller inflows amounting to RM2.2 billion (1Q 2020: +RM6.4 billion), amid the contraction in global growth. Inflows were mainly channelled into the mining sector, followed by the services sector, particularly financial services.

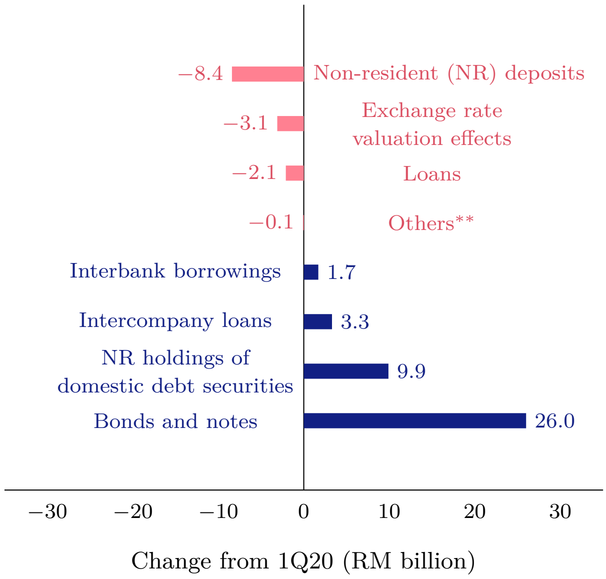
The portfolio investment account registered a sizeable net inflow of RM22.2 billion (1Q 2020: -RM41.3 billion), following inflows from non-residents (NR) amid a moderation in residents' portfolio investments abroad. NR investments recorded a net inflow of RM24.3 billion (1Q 2020: -RM26.2 billion). These inflows were channelled into debt securities (RM33.1 billion), and were partly offset by continued outflows from the equity market (RM8.9 billion). This follows the issuance of long-term bonds by the national oil and gas firm, and NR inflows into Malaysian Government Securities (MGS). Portfolio investment by residents recorded a small net outflow of RM2 billion (1Q 2020: -RM15.1 billion).

The other investment account recorded a significant net outflow of RM41.3 billion (1Q 2020: +RM22.1 billion). This mainly reflected net interbank lending abroad by the domestic financial sector. Net errors and omissions amounted to +RM5.9 billion during the quarter, or +1.5% of total trade.

External debt increased but remains manageable

Chart 17: Changes in External Debt

Net change*: + RM27 billion



*Changes in individual debt instruments exclude exhange rate valuation effects.

**Comprises trade credits, IMF allocation of SDRs, and other debt liabilities.

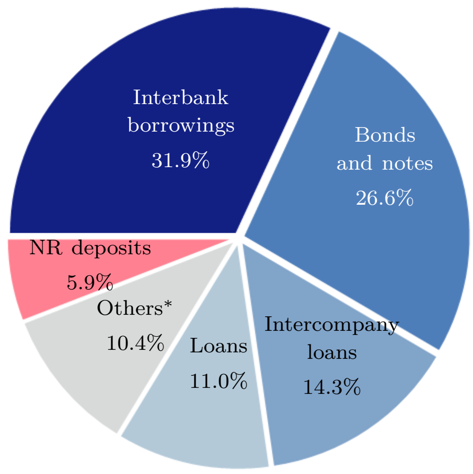
Source: Ministry of Finance Malaysia and Bank Negara Malaysia

Malaysia's external debt amounted to RM1,003 billion, or 69.3% of GDP as at end-June 2020 (end-March 2020: RM975.9 billion or 64.4% of GDP). The higher external debt mainly reflects a net issuance of international bonds and notes, and an increase in NR holdings of MGS. This was partly offset by lower NR deposits in the banking system and valuation effects following the stronger ringgit against selected major and regional currencies in the second quarter of 2020.

Malaysia's external debt remained manageable, given its currency and maturity profiles, and the availability of large external assets. Ringgit-denominated external debt amounted to RM305.2 billion, or 30.4% of total external debt (end-March 2020: 30.4%), mainly in the form of NR holdings of domestic debt securities (64.4% share of ringgit-denominated external debt) and NR ringgit deposits (19% share) in domestic banking institutions. As such, these liabilities were not subject to valuation changes that arise from fluctuations in the ringgit exchange rate.

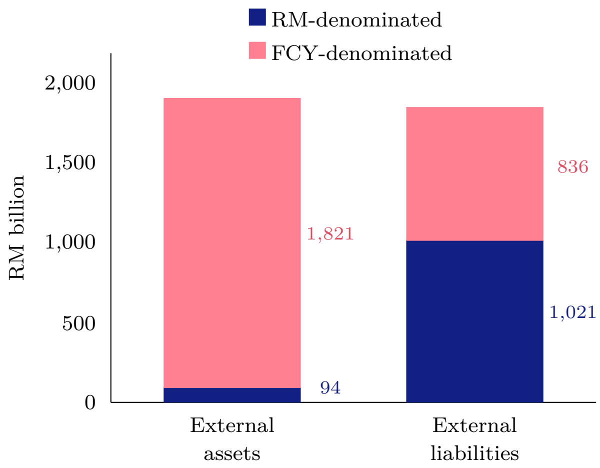
The remaining external debt of RM697.8 billion, or 69.6% of total external debt were denominated in foreign currency (FCY). The corporate sector accounted for 49% of FCY-denominated external debt and are largely subject to prudential and hedging requirements. Long-term bonds and notes issued offshore, accounting for 26.6% of total FCY-denominated external debt, stood at RM185.3 billion as at end-June 2020. These were mainly by non-financial corporations and channelled primarily to finance asset acquisitions abroad. Intercompany loans, amounting to RM100 billion or 14.3% of FCY-denominated external debt, were typically on flexible and concessionary terms.

Chart 18: Breakdown of FCY-Denominated External Debt (% share)



*Comprises trade credits, IMF allocation of SDRs, and other debt liabilities.

Chart 19: International Investment Position



Source: Ministry of Finance Malaysia, Department of Statistics Malaysia, and Bank Negara Malaysia

Interbank borrowings and FCY deposits in the domestic banking system accounted for 37.7% (or RM263.2 billion) of FCY-denominated external debt. Around 82.1% of interbank borrowings were in the form of intragroup borrowings, which were generally more stable, thereby limiting rollover risks faced by banks. Meanwhile, foreign-currency risk, measured in terms of the net open position of FCY-denominated exposures[8], remained low at 4.9% of banks' total capital.

During the quarter, banks' FCY-denominated short-term external debt declined by RM9.8 billion driven by lower liquidity needs of onshore banks as bank funding of ringgit operations remained predominantly domestically sourced. The stable domestic funding and liquidity conditions which saw banks benefitting from lower funding costs following successive OPR cuts, an expansion of the deposit base and ample liquidity have further reduced attractiveness of external borrowings. However, the decline in borrowings by onshore banks was partly offset by higher borrowings by foreign bank branches in Labuan International Business and Financial Centre (LIBFC). Funds received by foreign LIBFC banks were mostly sourced from their parent banks and subsequently onlent to non-resident clients, a reflection of their 'out-out' business activities.

From a maturity perspective, 58.7% of the total external debt was skewed towards medium- to long-term tenure (end-March 2020: 56.8%), suggesting low rollover risk. Short-term external debt accounted for the remaining 41.3% of external debt. Of which, 47.9% were intragroup borrowings among banks and corporations, which were generally stable and on concessionary terms. About another 12.1% were accounted by trade credits, largely backed by export earnings and are self-liquidating.

As at 30 July 2020, international reserves stood at USD104.2 billion, sufficient to finance 8.4 months of retained imports, and is 1.1 times the short-term external debt. In addition, Malaysia maintained a sizable net foreign currency asset position. About 95.1% of external assets were denominated in foreign currency compared to 45% of total external liabilities. This demonstrates Malaysia's ability in responding to external shocks. In particular, a depreciation in the ringgit exchange rate will result in a larger increase in external assets compared to external liabilities, thus enhancing Malaysia's external position.

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

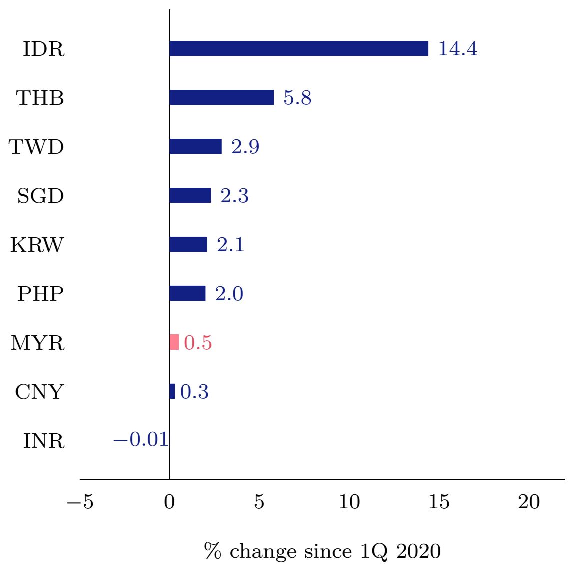
Monetary and Financial Developments

Highlights

- The ringgit appreciated marginally while bond and equity markets improved.
- Nominal interest rates in wholesale and retail markets declined further.
- Net financing continued to expand on an annual basis.

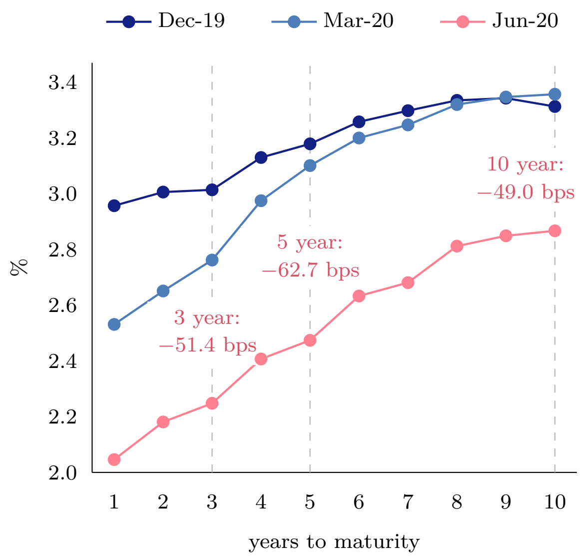
Improved domestic financial market conditions as global risk aversion eased

Chart 20: Performance of Regional Currencies against the US Dollar



Source: Bank Negara Malaysia

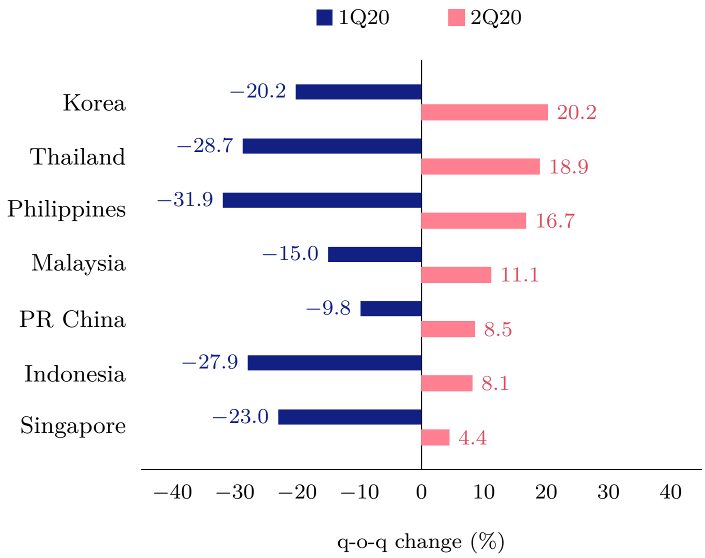
Chart 21: Trend in MGS Yields



Source: Bank Negara Malaysia

The performance of domestic financial markets improved during 2Q 2020, driven by a rebound in investor risk appetite following the quick implementation of large-scale liquidity injections and policy responses by central banks and governments around the world, particularly in advanced economies, to cushion the impact of the COVID-19 pandemic. The unprecedented magnitude of the policy actions by major central banks was sufficient to stabilise market sentiments. Additionally, as countries looked to restart their economies by gradually easing movement restrictions, this also provided further support to investor sentiments.

Chart 22: Performance of Regional Equity Markets



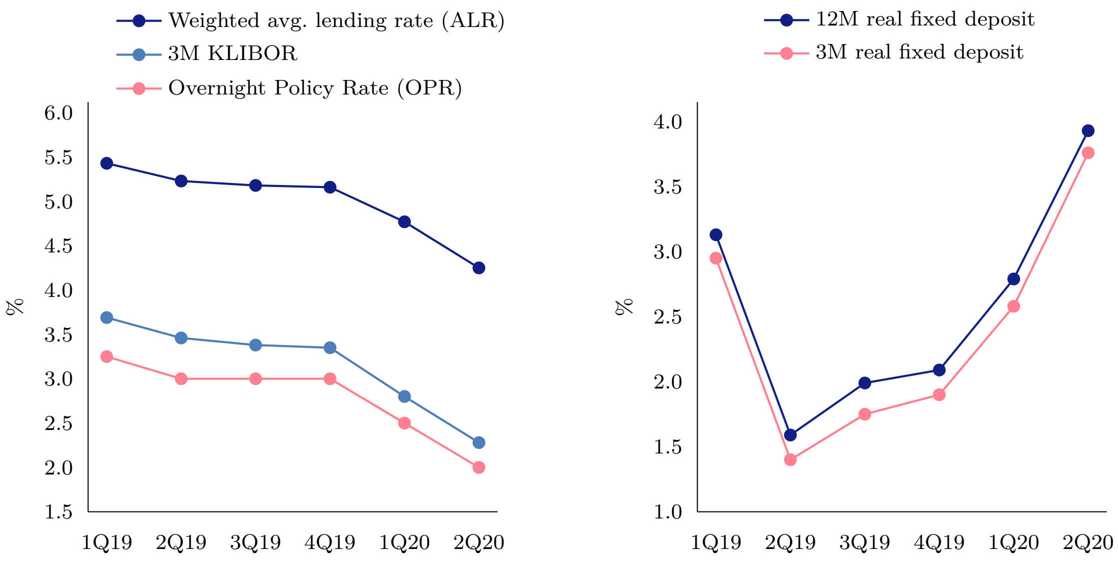
Source: Bloomberg

Consequently, regional financial markets including Malaysia exhibited broad-based improvements across asset markets. In 2Q 2020, domestic financial markets experienced a resumption of non-resident portfolio inflows, which led to an appreciation of the ringgit against the US dollar by 0.5%, in line with most regional currencies. These inflows were channelled into the domestic bond market, which contributed to the decline of the 3-year, 5-year and 10-year MGS yields by 51.4, 62.7 and 49.0 basis points, respectively. The lower bond yields also reflected the further reduction of the Overnight Policy Rate (OPR) in May 2020 by 50 basis points.

Similarly, the performance of domestic equity markets also improved, in line with the regional trend, reflecting positive sentiments from the global equity market rally. Domestically, higher resident participation and a strong performance led by healthcare sector stocks also provided additional impetus to the domestic equity market despite continued non-resident outflows. As at end-June, the FBM KLCI increased by 11.1% to close at 1,501.0 points (end-March: 1,350.9 points).

Nominal interest rates declined further following the reduction in the OPR

Chart 23: Interest Rates (at end-period)



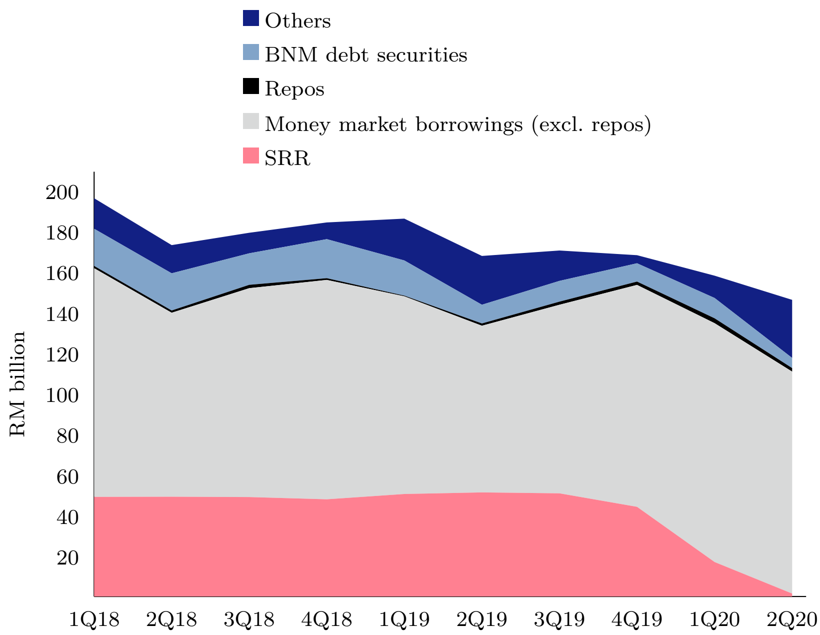
Source: Bank Negara Malaysia and Bloomberg

Interest rates in the wholesale and retail markets declined following the reduction in the OPR by 50 bps in May 2020. There was strong and immediate pass-through of the OPR reduction to interbank rates across all tenures, with the KLIBOR declining by 49 to 50 bps across tenures within one day of the OPR adjustment. The 3-month KLIBOR ended the quarter at 2.28% (1Q 2020: 2.80%). The transmission of the OPR reduction to retail lending rates was also strong, with continued pass-through from the previous OPR reduction in March 2020. This was reflected in the lower weighted average lending rate (ALR) on outstanding loans, which declined by 52 basis points to 4.25% in June (1Q 2020: 4.77%).

Similarly, nominal fixed deposit (FD) rates also decreased during the quarter, across tenures of 1 to 12 months, in line with the quantum of the OPR reduction. Real FD rates increased despite the decline in nominal rates given the lower inflation in June.

Banking system liquidity remained sufficient to facilitate financial intermediation

Chart 24: Outstanding Ringgit Liquidity Placed with BNM (at end-period)



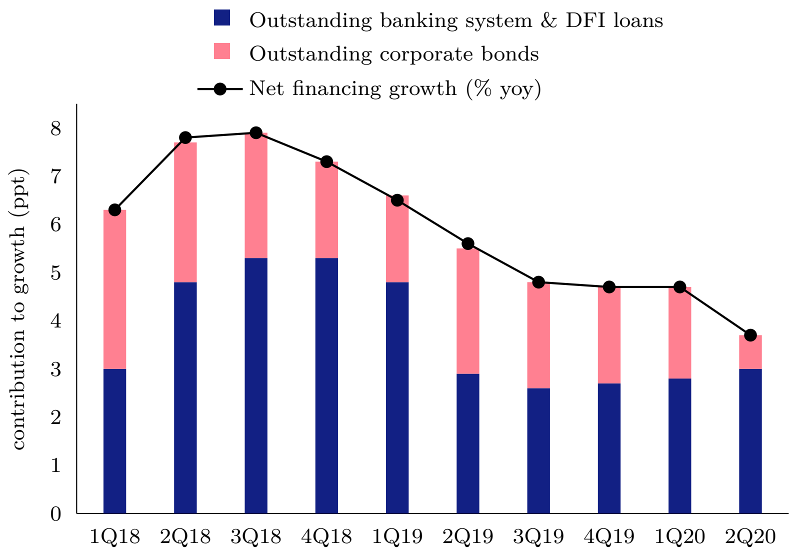
Source: Bank Negara Malaysia

The level of surplus liquidity placed with the Bank declined, due mainly to the higher currency in circulation, reflecting the increased demand for cash during the quarter. Nevertheless, banking system liquidity remained sufficient to facilitate financial intermediation. At the institutional level, most banks continued to maintain surplus liquidity positions with the Bank.

While the Statutory Reserve Requirement (SRR) ratio remained unchanged at 2.00%, the flexibility to use MGS and MGII to fully meet the SRR compliance was provided to all banking institutions in May. This measure has released approximately RM16 billion worth of liquidity into the banking system. The adjustment has provided greater flexibility for banks in their liquidity management and reduced the need for liquidity provision through the Bank's monetary operations. This flexibility provided to banking institutions has also supported the continued smooth functioning of the domestic bond market.

Continued expansion of financing supporting business needs

Chart 25: Contribution to Net Financing Growth



Source: Bank Negara Malaysia

In 2Q 2020, net financing expanded by 3.7% on an annual basis (1Q 2020: 4.7%). Outstanding loan growth[9] increased during the quarter (4.1%; 1Q 2020: 3.8%), while the growth in outstanding corporate bonds[10] declined to 2.5% (1Q 2020: 7.6%) due mainly to a high base effect from a one-off large issuance in 2Q 2019.

Growth in outstanding business loans increased to 3.9% (1Q 2020: 3.4%), supported by loans for working capital purposes[11]. By sector, the wholesale and retail trade, restaurants and hotels (WRRH) and manufacturing sectors registered higher loan growth during the period. For the household segment, growth in outstanding loans was sustained (3.7%; 1Q 2020: 3.8%), supported by loans for the purchase of residential properties and personal use.

Disbursement and repayment levels were subdued during the quarter due to the MCO and ongoing moratorium on loan/financing repayments[12]. Following the gradual relaxation of the MCO, business loan disbursements normalised in June from the low levels in April and May, with high disbursements for working capital needs, in line with increased demand for financing during the quarter[13]. This was reflective of various policy measures to alleviate cash flow pressures faced by businesses due to the COVID-19 pandemic, supported by cheaper borrowing costs with monetary policy easing. Meanwhile, demand for household loans experienced a broad-based decline amid the MCO and cautious sentiments in line with the economic conditions.

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[9] Loans from the banking system and development financial institutions (DFIs).

[10] Excludes issuances by Cagamas and non-residents.

[11] Classification of loans by purpose is only available for the banking system, which makes up 93% of outstanding loans extended to businesses.

[12] Refers to the automatic moratorium on household and SME loan/financing repayments for 6 months which came into effect on 1 April 2020, and the moratorium on eligible corporate loans/financing as assessed and facilitated by the banking institutions.

[13] Indicated by loan applications to the banking system.

The Bank's Policy Considerations

Highlights

- **The MPC reduced the OPR by 25 basis points to 1.75% in July.**
- **In total, the MPC has reduced the OPR by 125 basis points in 2020.**

The MPC reduced the OPR to provide support to the economic environment and to accelerate the pace of economic recovery

The Monetary Policy Committee (MPC) reduced the Overnight Policy Rate (OPR) by a cumulative 125 basis points on four occasions in 2020. This has brought the OPR to the current level of 1.75%. The ceiling and floor rates of the corridor for the OPR were correspondingly reduced to 2.00% and 1.50%, respectively.

The OPR reduction of 25 basis points in January 2020 was a pre-emptive measure to sustain growth amid price stability. At that point in time, although the global economy was expected to continue expanding, uncertainty from various trade negotiations, geopolitical tensions, and heightened volatility in financial markets posed downside risks to the outlook. There were also downside risks to the domestic economy emanating from domestic factors that included weakness in the commodities sector and delays in the implementation of projects.

As the COVID-19 outbreak in PR China evolved into a global pandemic, measures taken to contain the pandemic had a significant impact on both global and domestic economic activity. The OPR adjustments at the March and May 2020 MPC meetings, by 25 basis points and 50 basis points, respectively, were thus intended to cushion the economic impact of the COVID-19 pandemic on businesses and households. Further ahead, the easier monetary conditions would also support the improvement in economic activity amid the gradual easing of the Movement Control Order (MCO) from early May 2020.

More recently, at the July 2020 MPC meeting, the OPR was reduced by a further 25 basis points to 1.75%. Economic activity has begun to recover from the trough in 2Q 2020. In 2H 2020, growth is expected to be supported by the resumption in economic activity across the various sectors as Malaysia gradually exits from the movement restriction orders, a gradual improvement in sentiments, and positive effects from the fiscal stimulus packages. The projected improvement in domestic economy is expected to be further supported by a gradual recovery in global growth conditions. The pace and strength of the domestic economic recovery, however, remain subject to downside risks emanating from both domestic and external factors. These include the prospect of secondary outbreaks of the pandemic leading to reimpositions of containment measures, more persistent weakness in labour market conditions, and a weaker-than-expected recovery in global growth. This OPR reduction is therefore intended to provide additional policy stimulus to accelerate the pace of economic recovery. The MPC will continue to assess evolving conditions and their implications on the overall outlook for inflation and domestic growth.

The reductions in the OPR were swift and sizeable, given the fast-moving nature of this unprecedented public health crisis and the consequent impact to the economy. The OPR reductions would lend broad-based support to the economy. In particular, in an environment where households' and businesses' incomes are being affected by lower economic activity, the OPR reductions would ease debt servicing burdens, total borrowing costs, and thus cash constraints, for households, SMEs, and corporates. The lower interest rates would also lower the cost of financing and thus lend support to credit expansion and fund-raising activity.

These OPR adjustments complement other monetary and financial measures undertaken by Bank Negara Malaysia, as well as fiscal measures implemented. These include financial relief measures, regulatory and supervisory measures, lending facilities for SMEs, and adjustments to the Statutory Reserve Requirement (SRR) in March and May 2020. In particular, the adjustments to the SRR, which include both the reduction in the SRR ratio from 3.00% to 2.00%, and flexibility to all banking institutions to use Malaysian Government Securities (MGS) and Malaysian Government Investment Issues (MGII) to fully meet the SRR compliance, were part of the Bank's continuous efforts to ensure sufficient liquidity to support financial intermediation activity. The Bank will continue to utilise its policy levers as appropriate to create enabling conditions for a sustainable economic recovery.

Other policy highlights in the second quarter of 2020

Policy highlight	Salient details
Policy Document (PD) on Electronic Know-Your-Customer (e-KYC)	• The PD was issued on 30 June 2020 with objectives to: ▪ promote the safe and secure application of e-KYC technology in the financial sector; ▪ maintain effective AML/CFT control measures; and ▪ pave the way for greater innovation and complete end-to-end offering of digital financial services for consumers. • The PD sets out standards and expectations on: ▪ desirable outcomes in the use of e-KYC; and ▪ requirements, best practices and parameters on risk identification, monitoring and reporting to ensure integrity of the on-boarding process for customers.

Macroeconomic Outlook

Highlights

- **Deep global recession projected in 2020.**
- **Malaysian economy to recover gradually in 2H 2020.**
- **Muted inflationary pressures to continue in 2H 2020.**

Global economy to enter a severe recession in 2020

The IMF revised down its projection of global growth in 2020 to -4.9% in June from its earlier estimate of -3.0% in April. The slowdown in economic conditions from the containment measures and weakness in labour market conditions were deeper than expected. Although growth is expected to recover in 2021, this is conditional on the effective curbing of the COVID-19 pandemic by the end of 2020.

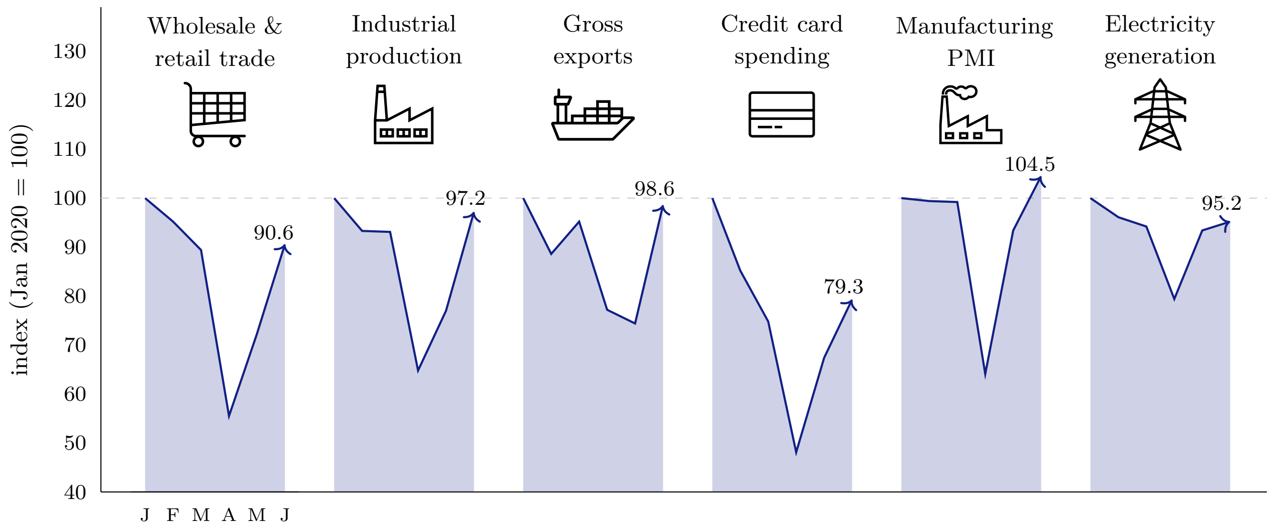
The projected growth contraction in 2020 across the advanced and emerging economies is expected to be deeper compared to the Global Financial Crisis. Overall, consumption and services output are expected to decline, as restricted mobility hampers retail sales, tourism and recreation, and transportation. Private sector expenditure and external demand conditions will remain muted as labour market weaknesses persist. Nevertheless, proactive government stimulus measures are a key support to growth, and the gradual re-opening of economic sectors will reduce the degree of the contraction.

Downside risks to global growth remain elevated. A resurgence in COVID-19 cases could necessitate economies to reinstate lockdown measures, which will further dampen growth prospects. This will also accentuate the volatility of capital flows in vulnerable EMEs and could trigger an unwinding of external sector imbalances.

Malaysian economy to recover gradually as the economy progressively re-opens and external demand improves

Economic activity in Malaysia contracted sharply in the first half of the year (-8.3%) as the measures introduced to contain the pandemic globally and domestically resulted in a concurrent supply and demand shock to the economy. However, growth is expected to have troughed in 2Q 2020. Economic activity has resumed significantly since the economy began to re-open in early May. Monthly indicators such as wholesale and retail trade, industrial production, electricity generation, and gross exports all grew faster in June than in the period between March and May.

Chart 26: Key Economic Indicators



Source: Department of Statistics Malaysia, IHS Markit, Tenaga Nasional Berhad, and Bank Negara Malaysia

The improvement in growth in 2H 2020 will also be supported by the recovery in global growth and continued policy support. In particular, consumption and investment activities are expected to benefit from the wide-range of measures in the fiscal stimulus packages, continued financial measures and low interest environment. While there is upside potential to growth, the pace and strength of the recovery remain susceptible to downside risks emanating from domestic and external factors. Growth could potentially be lifted by a larger-than-expected impact from stimulus measures. Nevertheless, the prospect of secondary COVID-19 outbreaks leading to the re-imposition of containment measures, more persistent weakness in labour market conditions, and a weaker-than-expected recovery in global growth pose downside risks to growth.

Inflationary pressures to remain muted in 2H 2020

In 2H 2020, average headline inflation is expected to remain negative largely due to low retail fuel prices. Stimulus measures to alleviate cost burdens, such as the tiered electricity tariff rebate, would also keep inflation low. However, headline inflation is projected to decline by a smaller magnitude compared to 2Q 2020 as global oil prices continue to recover and economic conditions gradually improve. The risks of a broad-based and persistent decline in prices are assessed to be limited as economic activity gradually resumes and demand conditions improve. While underlying inflation, as measured by core inflation, is expected to be subdued, it is projected to average within earlier expectations for the year as a whole.

Annex

Table 1	GDP by Expenditure Components (at constant 2015 prices)
Table 2	GDP by Economic Activity (at constant 2015 prices)
Table 3	Balance of Payments
Table 4	Outstanding External Debt
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Table 6	Loan Indicators
Table 7	Banking System Profitability Indicators
Table 8	Insurance and Takaful Sector Profitability Indicators
Table 9	Federal Government Finance

Table 1: GDP by Expenditure Components (at constant 2015 prices)

	2019 share %	2019		2020		
		2Q	1H	1Q	2Q	1H
		Annual growth, %				
Aggregate domestic demand (excl. stocks)	94.0	4.5	4.5	3.7	−18.7	−7.7
Private sector	75.6	6.1	6.0	4.7	−20.5	−8.2
Consumption	58.7	7.8	7.7	6.7	−18.5	−6.0
Investment	16.8	1.5	1.1	−2.3	−26.4	−15.2
Public sector	18.5	−2.4	−2.0	−0.6	−10.6	−5.5
Consumption	12.2	0.3	3.2	5.0	2.3	3.6
Investment	6.3	−7.8	−11.0	−11.3	−38.7	−24.2
Net exports	7.0	32.9	21.1	−37.0	−38.6	−37.7
Exports of goods and services	63.7	0.5	0.3	−7.1	−21.7	−14.4
Imports of goods and services	56.7	−2.3	−2.0	−2.5	−19.7	−11.2
GDP	100.0	4.8	4.7	0.7	−17.1	−8.3
GDP (q-o-q seasonally adjusted)	-	1.3	-	−2.0	−16.5	-

Source: Department of Statistics Malaysia

Table 2: GDP by Economic Activity (at constant 2015 prices)

	2019 share %	2019		2020		
		2Q	1H	1Q	2Q	1H
		Annual growth, %				
Services	57.7	6.1	6.3	3.1	−16.2	−6.7
Manufacturing	22.3	4.3	4.2	1.5	−18.3	−8.7
Mining	7.1	0.9	−0.3	−2.0	−20.0	−11.0
Agriculture	7.1	4.3	5.1	−8.7	1.0	−3.9
Construction	4.7	0.5	0.4	−7.9	−44.5	−25.9
Real GDP	100.0[1]	4.8	4.7	0.7	−17.1	−8.3

[1] Figures may not add up due to rounding and exclusion of import duties

Source: Department of Statistics Malaysia

Table 3: Balance of Payments[1]

	2019		2020		
	2Q	1H	1Q	2Q	1H
	RM billion				
Current account	14.3	31.3	9.5	7.6	17.1
(% of GDP)	3.9	4.3	2.6	2.5	2.5
Goods	28.3	61.7	28.9	25.9	54.8
Services	–3.4	–5.1	–8.0	–12.5	–20.4
Primary income	–5.9	–15.1	–6.0	–4.0	–9.9
Secondary income	–4.7	–10.2	–5.4	–1.9	–7.4
Financial account	–18.9	–32.2	–13.3	–19.8	–33.1
Direct investment	–9.2	4.7	3.4	–1.2	2.1
Assets	–11.8	–20.4	–1.8	–1.4	–3.2
Liabilities	2.6	25.0	5.2	0.2	5.3
Portfolio investment	–10.6	–4.1	–41.3	22.2	–19.1
Assets	–3.9	–12.4	–15.1	–2.0	–17.2
Liabilities	–6.7	8.3	–26.2	24.3	–1.9
Financial derivatives	–0.5	–0.7	2.5	0.6	3.1
Other investment	1.4	–32.0	22.1	–41.3	–19.2
Net errors and omissions[2]	3.2	5.0	–4.7	5.9	1.2
Overall balance	–1.4	4.1	–8.7	–6.4	–15.0

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 6th 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: Figures may not add up due to rounding

Source: Department of Statistics Malaysia and Bank Negara Malaysia

Table 4: Outstanding External Debt

	2019	2020	
	end-June	end-Mar	end-June
	RM billion		
Total external debt	933.0	975.9	1,003.0
USD billion equivalent	*223.1*	*223.3*	*231.7*
By instrument			
Bonds and notes[1]	164.6	160.5	185.8
Interbank borrowings[1]	199.7	223.8	223.9
Intercompany loans[1]	147.7	132.3	135.0
Loans[1]	71.1	82.4	79.6
Non-resident holdings of domestic debt securities	181.3	186.8	196.6
Non-resident deposits	91.4	106.1	98.8
Others[2]	77.3	84.0	83.2
Maturity profile			
Medium and long-term	544.8	554.3	588.4
Short-term	388.2	421.6	414.6
Currency denomination			
Ringgit	287.2	296.8	305.2
Foreign	645.8	679.1	697.8
Total debt / GDP (%)	61.8	64.4	69.3
Short-term debt / Total debt (%)	41.6	43.2	41.3
Reserves / Short-term debt (times)	1.1	1.0	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 30 July 2020.

Note: Figures may not add up due to rounding

Source: Ministry of Finance Malaysia and Bank Negara Malaysia

Table 5: Financing of the Private Sector through the Banking System, DFIs and Capital Markets

	2019		2020			2019		2020		
	2Q	1H	1Q	2Q	1H	2Q	1H	1Q	2Q	1H
	Change during the period (RM billion)					Annual growth (%)				
Total net financing	45.3	68.3	25.5	21.5	47.1	5.6	5.6	4.7	3.7	3.7
Outstanding:										
Loans[1,2]	12.4	21.1	13.1	19.5	32.6	3.9	3.9	3.8	4.1	4.1
Business enterprises	2.2	3.5	8.3	5.4	13.7	2.7	2.7	3.4	3.9	3.9
SMEs[3]	−0.9	−2.5	2.0	11.0	13.0	−1.2	−1.2	−11.9	−8.2	−8.2
Non-SMEs	3.1	6.0	6.3	−5.6	0.7	6.5	6.5	17.7	15.0	15.0
Households	11.2	21.5	0.5	11.4	12.0	4.8	4.8	3.8	3.7	3.7
Corporate bonds[4]	32.9	47.1	12.5	2.0	14.5	10.6	10.6	7.6	2.5	2.5

[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 the reclassification exercise of SMEs to non-SMEs by financial institutions.
Between January 2018 to December 2019, a net amount of RM60.4 billion of outstanding SME loans was reclassified as outstanding non-SME loans. RM38.3 billion was reclassified during the fourth quarter of 2019.

[4] Excludes issuances by Cagamas and non-residents.

Note: Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Table 6: Loan Indicators

	2019		2020			2019		2020		
	2Q	1H	1Q	2Q	1H	2Q	1H	1Q	2Q	1H
	During the period (RM billion)					Annual growth (%)				
Total										
Loan applications[1]	228.4	422.7	197.1	168.1	365.1	2.4	−2.2	1.4	−26.4	−13.6
Loan approvals[1]	109.7	200.5	86.9	66.6	153.5	8.8	4.9	−4.3	−39.3	−23.4
Loan disbursements[2]	311.3	625.1	317.4	263.4	580.8	2.9	3.7	1.1	−15.4	−7.1
Loan repayments[2]	314.3	633.6	319.8	253.9	573.7	4.3	6.0	0.2	−19.2	−9.4
Of which:										
Business enterprises[3]										
Loan applications	104.1	188.5	92.4	96.5	189.0	2.2	−3.9	9.6	−7.3	0.3
Loan approvals	52.3	93.4	41.4	41.8	83.3	9.4	6.7	0.9	−20.1	−10.9
Loan disbursements	219.8	441.2	227.8	206.1	433.9	1.4	3.3	2.9	−6.2	−1.7
Loan repayments	223.3	449.9	220.2	199.4	419.5	3.0	6.4	−2.8	−10.7	−6.7
SMEs[4]										
Loan applications	48.7	92.6	47.5	47.7	95.2	−0.4	−0.3	8.1	−2.0	2.8
Loan approvals	16.7	32.1	14.1	15.0	29.1	0.3	1.2	−8.4	−10.3	−9.3
Loan disbursements	76.3	152.1	63.5	56.3	119.8	3.7	1.7	−16.2	−26.2	−21.2
Loan repayments	76.5	153.3	65.8	51.1	117.0	3.1	3.0	−14.3	−33.1	−23.7
Non-SMEs[3]										
Loan applications	55.4	95.8	45.0	48.8	93.8	4.7	−7.0	11.2	−11.9	−2.2
Loan approvals	35.7	61.3	27.3	26.9	54.2	14.2	9.8	6.5	−24.7	−11.7
Loan disbursements	143.4	289.1	164.3	149.8	314.1	0.2	4.2	12.8	4.4	8.6
Loan repayments	146.9	296.6	154.3	148.2	302.6	2.9	8.2	3.1	0.9	2.0
Households										
Loan applications	124.3	234.3	104.6	71.5	176.2	2.5	−0.8	−4.9	−42.4	−24.8
Loan approvals	57.4	107.1	45.5	24.8	70.3	8.3	3.4	−8.6	−56.8	−34.4
Loan disbursements	91.5	183.9	89.6	57.3	146.9	6.7	4.4	−3.0	−37.4	−20.1
Loan repayments	90.9	183.7	99.6	54.5	154.2	7.7	5.2	7.4	−40.0	−16.1

[1] Loan applications and approvals for all segments include data from the banking system only.
[2] Loan disbursements and repayments for all segments include data from the banking system and development financial institutions (DFIs). With effect from 1 April 2020, an automatic moratorium was implemented on loan/financing repayments/payments by household and SME borrowers for a period of 6 months.
[3] Includes domestic non-bank FIs, domestic FIs, government, domestic other entities and foreign entities.
[4] Partly reflects the reclassification exercise of SMEs to non-SMEs by financial institutions.

Note: Effective June 2019, data from April 2018 were revised to include data from a newly licensed commercial bank (MBSB Bank Berhad), previously classified as a non-bank FI.
Numbers may not add up due to rounding

Source: Bank Negara Malaysia

Table 7: Banking System Profitability Indicators

	2019				2020	
	1Q	2Q	3Q	4Q	1Q	2Q*p*
Return on equity (%)	11.5	13.0	12.9	13.0	10.4	10.2
Return on assets (%)	1.3	1.5	1.5	1.5	1.2	1.2
	RM million					
Net interest income	12,438	12,009	12,701	13,113	12,696	10,081
Add: Fee-based income	2,548	2,619	2,670	3,233	2,583	2,298
Less: Operating cost[1]	8,385	8,421	8,626	9,146	8,607	8,185
Gross operating profit	6,601	6,206	6,745	7,200	6,672	4,193
Less: Impairment[2] and other provisions	164	322	820	33	2,757	2,047
Gross operating profit after provision	6,437	5,884	5,925	7,167	3,915	2,146
Add: Other income	2,548	5,506	4,302	3,694	4,644	6,237
Pre-tax profit	8,985	11,390	10,227	10,860	8,559	8,384
	Annual growth (%)					
Return on equity (percentage points)	−0.8	−0.3	0.2	0.3	−1.1	−2.8
Return on assets (percentage points)	−0.08	−0.01	0.04	0.06	−0.12	−0.30
Net interest income	3.3	−2.3	1.7	2.6	2.1	−16.1
Add: Fee-based income	−2.2	4.0	7.9	29.4	1.3	−12.2
Less: Operating cost[1]	3.5	6.3	10.3	9.8	2.7	−2.8
Gross operating profit	0.8	−9.9	−5.5	3.5	1.1	−32.4
Less: Impairment[2] and other provisions	−75.9	−30.9	18.5	−95.5	1,579.8	535.4
Gross operating profit after provision	9.7	−8.3	−8.1	15.3	−39.2	−63.5
Add: Other income	−16.4	35.2	92.0	9.7	82.3	13.3
Pre-tax profit	0.8	8.6	17.7	13.3	−4.7	−26.4

[1] Refers to staff costs and overheads
[2] Refers to 12 Months Expected Credit Losses (ECL), Lifetime ECL Not Credit Impaired and Lifetime ECL Credit Impaired based on the Malaysian Financial Reporting Standard 9 (MFRS 9)

p Preliminary

Source: Bank Negara Malaysia

Table 8: Insurance and Takaful Sector Profitability Indicators

	2019				2020	
	1Q	2Q	3Q	4Q	1Q	2Q*p*
	RM million					
Life Insurance & Family Takaful						
Excess income over outgo	8,561	7,947	3,795	3,859	−11,611	16,354
General Insurance and General Takaful						
Operating profit	716	677	785	730	541	1,158
Claims ratio (%)	57	62	59	59	59	52
	Annual growth (%)					
Life Insurance & Family Takaful						
Excess income over outgo	109.0	750.6	−50.1	481.9	−235.6	105.8
General Insurance and General Takaful						
Operating profit	27.5	−10.8	−35.0	53.2	−24.4	71.0
Claims ratio (percentage points)	−0.1	3.0	6.0	2.0	2.5	−9.5

p Preliminary

Source: Bank Negara Malaysia

Table 9: Federal Government Finance[p]

	2019p		2020p		
	2Q	1H	1Q	2Q	1H
	RM billion				
Revenue	62.1	125.8	45.3	56.4	101.8
Annual growth (%)	18.3	17.8	–28.8	–9.1	–19.1
Operating expenditure	65.3	124.8	62.5	63.9	126.5
Annual growth (%)	3.8	5.9	5.2	–2.1	1.4
Current account	–3.2	1.0	–17.2	–7.5	–24.7
Net development expenditure	12.1	23.4	10.9	16.4	27.3
Annual growth (%)	33.2	18.2	–3.6	35.7	16.7
Overall balance	–15.3	–22.4	–28.2	–23.9	–52.0
Memo:					
Total net expenditure	77.4	148.2	73.5	80.3	153.8
Annual growth (%)	7.5	7.7	3.8	3.8	3.8
Total Federal Government debt (as at end-period)	799.1	799.1	823.8	854.1	854.1
Domestic debt	609.1	609.1	631.3	649.2	649.2
External debt	190.0	190.0	192.5	204.8	204.8
Non-resident holdings of RM-denominated debt	165.6	165.6	167.2	179.8	179.8
Offshore borrowing	24.4	24.4	25.2	25.1	25.1

p Preliminary
Note: Numbers may not add up due to rounding

Source: Ministry of Finance Malaysia and Bank Negara Malaysia