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Headline	Bank Negara's 2016 annual report The good, the bad and the ugly
MediaTitle	The Edge
Date	27 Mar 2017
Section	Corporate
Page No	10,63
Language	English
Journalist	N/A
Frequency	Weekly

Bank Negara's 2016 annual report: The good, the bad and the ugly

The Good Year-on-year GDP growth affirmed, firmer current account balance, lower headline household debt

BY CINDY YEAP

Malaysia's economy is projected to grow at least 4.3% this year, just ahead of 2016's 4.2% gross domestic product (GDP) growth, says Bank Negara Malaysia's 2016 annual report released last Thursday.

While the upper end of Bank Negara's GDP growth projection of 4.8% for this year is below the 5% government projection when the Economic Report 2016-2017 was released last October, the central bank's projection affirmed that Malaysia's economy is set to see its first year-on-year growth since 2012.

In fact, working numbers in the annual report indicate a 4.57% GDP growth for this year. Last year, working numbers was 4.1% when headline projections were between 4% and 5%. The projected GDP growth for this year is set to be the highest since the blip in 2009.

The country's current account (CA) balance for this year — the surplus that keeps Malaysia from having a twin deficit situation which could trigger a sovereign debt rating downgrade — had also been revised upward to RM17.39 billion (1% to 2% of gross national income) compared with the RM14.77 billion (0.5% to 1.5% of GNI) projected last October.

The CA balance will remain closely watched, with the surplus projected to narrow further this year despite the improved forecast from last October. The CA balance had narrowed to 2.1% of GNI last year, compared with 17.6% of GNI in 2008, something that Bank Negara says is not unexpected as Malaysia invests more abroad.

Malaysia's export performance is projected to improve in line with higher global demand and commodity prices. The central bank acknowledged a need to expand fiscal space through continued reforms that will be critical in determining the country's CA balance, going forward.

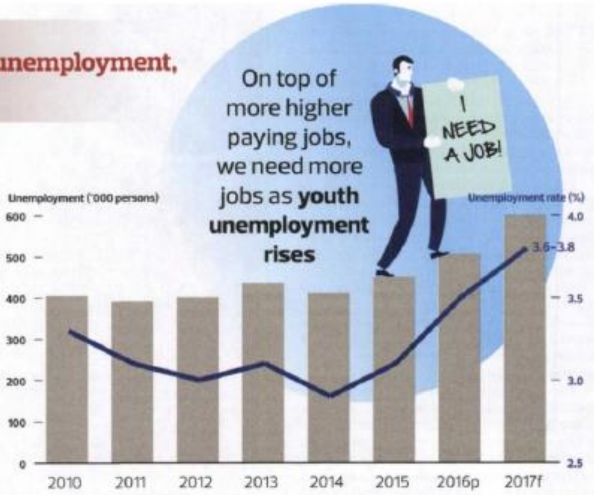
Another bright spot is that household debt as a percentage of GDP fell to 88.4% last year from 89.1% in 2015, the first reduction since 2010 — "potentially marking a turning point for adjustments in household leverage", the central bank said in its Financial Stability and Payment Systems Report 2016. Not only did the annual growth in total household debt moderate further to 5.4% last year (7.3% in 2015, 14.2% in 2010), the share of borrowings from vulnerable households also reduce further, improving the quality of the overall loan portfolio, Bank Negara says.

Even so, the headline household debt to GDP figure is only half the story as the absolute amount of household debt is still higher year on year. This is also true for corporate as well as federal government debt. ■

Highlights

	2015	2016	2017f – BNM (March,2017)	2017f – Economic Report 2016/17 (Oct,2016)
GDP growth	5%	4.2%	4.3% to 4.8%	4% to 5%
Inflation	2.1%	2.1%	3% to 4% (4.5% in Feb 2017)	2% to 3%
Current account surplus	RM34.658 billion	RM25.169 billion	RM17.386 billion	RM14.771 billion
	3.1% of GNI	2.1% of GNI	1% to 2% of GNI	0.5% to 1.5% of GNI
Unemployment	3.1%	3.5%	3.6% to 3.8%	3.2%
Unemployed	0.45 million	0.512 million (Dec 2016)	0.6 million (0.514 mil in Jan 2017)	NA
Per capita income	RM36,078	RM37,738	RM39,656	
	US$9,238	US$9,096	US$8,906	
Implied US$1 to ringgit	4.01	4.15	4.45	
Fiscal deficit	RM37.194 billion	RM38.4 billion	RM40.3 billion	RM40.3 billion
	3.2% of GDP	3.1% of GDP	3% of GDP	3% of GDP

The Bad Cost-push inflation, rising unemployment, unaffordable homes



With February 2017 headline inflation at 4.5%, it is little wonder that Bank Negara's inflation projection of 3% to 4% for this year is above the 2% to 3% projected by the government last October. The average for the first two months of the year is 3.9%, with increases seen in most groups. RON95 petrol prices in the first quarter of this year, for instance, averaged RM2.23 per litre compared with RM1.76 per litre last year.

According to Bank Negara, the higher inflation "will mainly be cost-driven" and is not expected to cause significant spillovers into the broader price trends as demand is not expected to strengthen significantly. Still, its inflation outlook is subject to three key risks. These include higher-than-expected global oil prices and a significant change in the strength of Malaysia and its trading partners' economic growth.

The depreciation in ringgit exchange rate "could also have a larger pass-through effect on domestic prices, causing the headline inflation to be higher than projected", said the central bank, whose studies found a weaker ringgit having "limited, at best" boost on exports.

"While most Asian economies are in a better position to manage the depreciation and extreme exchange rate volatility, prolonged disconnect of the exchange rate can eventually spill over to the real economy. These spillover effects can manifest in various forms. These include higher inflation as the prolonged weakness in currencies forces producers to pass on the higher costs to consumers, potential external and foreign exchange debt distresses, adverse sentiments among household and businesses, and the vicious cycle of self-fulfilling expectations," Bank Negara's report reads.

The higher inflation is likely to keep real interest rates in negative territory. An interest rate hike is seen unlikely at this juncture, given that inflation is cost-pushed rather than demand-driven.

It is hoped that most people's wages will rise higher than the increase in the cost of living this year.

Malaysia is forecast to have 14.3 million people in employment this year, up from 14.18 million last year and 14.07 million in 2015. However, jobs growth "will not be sufficiently robust to absorb new entrants into the labour force, causing unemployment to edge higher" to between 3.6% and 3.8% this year.

The latter is comparable to the 3.7% charted in 2009. Back then, 11.6 million were employed and around 500,000 were unemployed. It is worth noting that unemployment had reduced to 3.3% in 2010, with around 400,000 unemployed. This year, however, as many as 600,000 may be unemployed — up from about 506,000 last year.

Still, Bank Negara said "domestic demand and a gradually improving external sector are expected to lend support to the labour market, and wages are expected to continue growing at a moderate pace". Notwithstanding higher inflation, the central bank sees wage growth, increase in disposable income from selected government measures and higher commodity prices sustaining domestic consumption growth.

Employers see salary increments averaging 5.4% this year, slightly lower than 5.5% last year, the central bank said, citing The Malaysian Employers Federation annual survey. "Wage growth is likely to be supported by the export-oriented manufacturing sector, while wages in the domestic-oriented services sector are expected to expand moderately," it said.

The bigger policy concern here is rising youth unemployment, particularly among tertiary-educated young men and women, with the youth unemployment rate at 10.5% last year versus 10.7% in 2015. Malaysia is not alone. The global youth unemployment rate is about three times the rate of adults and more than two times the overall global unemployment rates, Bank Negara's study showed.

In Malaysia, the 273,841 unemployed youths in 2015 were among "more than 70 million young adults around the world who are experiencing difficulty finding meaningful employment" — a number the International Labour Organisation expects to rise this year after "improving slightly between 2012 and 2015".

Youth unemployment in Malaysia rose as hiring growth slowed since late 2014 amid cautious business sentiments and moderating economic performance. Only 16% of the 2.57 million Malaysians, aged between 15 and 24 (youth labour force), have tertiary education (405,000 persons). Among the 273,841 unemployed youths, only 23% or about 62,000 have tertiary education — not all of whom have skills employers want. Malaysia also

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continues to face challenges in attracting high-quality investment that would create more high-paying, high-skilled jobs. Some 54% of graduates earn less than RM2,000 a month upon graduation, the 2015 Graduate Tracer Study Report showed.

The study also found weighted average starting salaries of first-degree graduates were "stagnant" at between 2007 and 2015, moving only 2.91% a year in the past eight years from RM1,734 in 2007 to RM2,182 in 2015 — making it tough for them to be a house owner.

Based on Bank Negara estimates, a household with RM4,585 median income (without any other debt obligations or savings) can only afford to buy a house priced below RM260,000, after taking into account living expenses. However, the national average house price is 29% more at RM334,736 as at end-September last year. In urban centres, the average transacted house prices are at least 67% to 323% more at between RM435,000 and RM1.1 million.

Even the RM260,000 threshold is not ideal as it is the highest of the three approaches used to define affordable housing. The three methods are median multiple (MM) being three times annual income; housing cost burden (HCB) that wants housing expenses, such as mortgage payments, to be below 30% household income; and residual income (RI) which deducts costs of basic necessities from household income and takes into account the impact of leverage to arrive at a monthly debt repayment.

The affordability threshold for a median income household in 2014 was RM165,060 under the MM method, RM248,000 with the HCB method and RM261,000 with the RI approach.

All three approaches found housing affordability had "deteriorated significantly" in 2012 and 2014 in varying severity across locations — it did not help that some completed low-cost houses "fail to meet quality and location requirements".

In 2014, the shortage of affordable homes was estimated to be 960,000 units, Bank Negara said.

While the government wants new houses priced up to RM300,000 to be limited to first-time buyers since last year and additional supply of affordable units are expected to enter the market "from on-going initiatives by various government agencies and PR1MA to build more affordable houses, further price adjustments by private developers will be necessary to meet demand and reduce the debt burden for potential house buyers", Bank Negara said.

Houses priced below RM250,000 only accounted for 28.6% (2015: 26.3%) of new launches in the first half of last year, compared with 45.1% (2015: 32.8%) for units priced between RM250,000 and RM500,000, and 26.3% (2015: 40.9%) for units priced above RM500,000.

Citing policy lessons from other countries addressing the same issue, Bank Negara recommends that a single authority be empowered to spearhead the planning and delivery of affordable homes nationwide to unlock scale efficiencies. It also calls for the setting up of a central repository to systematically monitor and manage the supply and demand of affordable houses. Rental also needs to be a viable option and not a last resort for households. Bank Negara also recommends innovative financing schemes such as shared ownership, which allows buyers to acquire partial interest in a home so as not to overburden those who do not have the ability to repay housing loans. ■

The Ugly

Mounting debt burden

TOTAL EXTERNAL DEBT	HOUSEHOLD DEBT	CORPORATE DEBT TO GDP	FEDERAL GOVERNMENT DEBT	DEBT GUARANTEED BY FEDERAL GOVERNMENT
2016	2016	2016	2016	2016
RM908.704 billion [US$200.628 billion]	RM1.0862 trillion	RM1.3264 trillion	RM648.475 billion	RM191.085 billion (end-Sept 2016)
76.1% of GNI	88.4% of GDP	107.9% of GDP	52.7% of GDP	
2015	2015	2015	2015	2015
RM833.817 billion [US$192.261 billion]	RM1.0306 trillion	RM1.2129 trillion	RM630.54 billion	RM177.729 billion
74.1% of GNI	89.1% of GDP	105.5% of GDP	54.5% of GDP	

Total household debt was RM1.09 trillion last year, up 5.4% from RM1.03 trillion in 2015, although when measured as a percentage of GDP, headline figures were smaller at 88.4% last year from 89.1% in 2015. Tellingly, total household debt had doubled in just seven years from RM516.1 billion (72.4% of GDP) in 2009 — having grown an average of 11.2% a year between the period.

While 62.6% of household debts are secured by properties and principal-guaranteed investments which contribute to wealth accumulation, central bank data also show aggregate leverage for households vulnerable to financial shocks (those earning below RM3,000 have low financial buffers) increasing to 8.1 times from 7.7 times, largely driven higher by debt for house purchases.

Corporate debt levels, too, remain high at RM1.33 trillion or 107.9% of GDP, although the growth rate had moderated to 8.6% from 12.7% in 2015. For the 12 months ending September last year, corporate debt-at-risk (share of debt borne by firms with less than two times interest coverage ratio) rose to 7.7% from 6.2% in 2015, mainly in firms in the automotive, real estate and oil and gas sectors where deterioration was "within expectations".

Nonetheless, the central bank said the overall quality of business loans in the banking system remains sound, citing "broadly low and stable" impaired and delinquent loans. The central bank continues to monitor the financial conditions of large borrower groups, which could have a material bearing on the stability of financial institutions. So far, aggregate debt servicing capacity remains supported by cash buffers and satisfactory financials.

As the government looks to expand fiscal space to spur greater economic growth, a move to significantly reduce the federal government's debt and debt service charges is probably overdue. Debt service charges, projected to rise to RM28.87 billion this year, are enough to build six Second Penang Bridges (RM4.5 billion to construct) and are nearly two-thirds this year's total development expenditure (RM46 billion). The charges are also more than four times the RM6.8 billion allocation for BR1M this year, 72% of the RM40 billion expected GST collection for this year and almost the same as the RM29.8 billion expected individual income tax collection — surely it is high time something was done. Already, federal government debt had more than doubled in just eight years to RM648.5 billion (52.7% of GDP) last year from RM308.4 billion (39.8% of GDP) in 2008. ■