# Economic Research

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## *The 2015 Bank Negara Malaysia Annual Report*

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***Please read the disclaimer on the last page of this report***

## In a nutshell

- The increasing divergence between advanced and emerging economies as well as uneven prospects for the global economy have led Bank Negara Malaysia (BNM) to forecast slower economic growth for Malaysia in 2016. The real gross domestic product (GDP) growth is projected to be between 4.0%-4.5% (2015: 5%), which is in line with our projection of 4.4%. While growth is once again anticipated to be supported by domestic demand, the BNM projects private consumption – the key driver of Malaysia's economy in 2016 – to grow at a more moderate pace of 5.1% (MARC: 4.2%) and private investment to expand by 5.5% (MARC: 5.9%). MARC concurs with this assessment as it foresees softer headline growth in 2016 due to sluggish external trade performance, although exports are expected to rebound mildly in 2H2016 due to stronger commodity prices.

- BNM does not anticipate Malaysia's inflation landscape to change dramatically in 2016, and expects it to be at the lower end of its projected range of between 2.5% to 3.5%. While MARC concurs that inflation will remain relatively steady, it foresees cost push factors to lift inflation up to slightly above 3%, especially if pump prices were to rise following a mild but sustained rebound in crude oil prices. The modest growth in the Consumer Price Index (CPI) in recent times is partly explained by low pump prices which dragged the growth of the transportation index. Excluding the transportation index, the CPI has grown at a higher average pace of 4.0% in the past six months. We maintain our inflation rate target at 3.2%, higher than BNM's mid-point of the projected range, on account of cost push factors in 2016.

- Based on BNM's assessment, the overall economic landscape is still supported by a healthy banking sector with capital ratios surpassing the levels required under Basel III. More than 80% of banks' capital was high quality, comprising retained earnings, paid-up capital and reserves. Loan loss reserves (LLR) remain adequate despite a declining LLR ratio (2015: 96.2%; 2014: 100.4%). Notwithstanding this, one of the concerns of credit rating agencies is the rapid increase in the amount of credit to the private sector which, excluding non-bank institutions and outstanding private debt securities, has increased to 125% of GDP in 2015 (2014: 121.1%). History seems to suggest that the credit-to-GDP is a robust single indicator of a build-up of financial vulnerabilities and crisis episode for a large cross section of countries. However, the officials reiterated that declining growth of home prices – an important factor in explaining credit growth – will likely cap Malaysia's credit expansion going forward. In addition, sufficient foreign exchange reserves and stable capitalisation ratios have somewhat mitigated Malaysia's financial vulnerabilities.

- It is notable that the liquidity level in the banking system has been under pressure since mid-2015 amid slower corporate earnings, capital outflows and stiffer competition among banks to raise deposits to meet the liquidity coverage ratio (LCR) requirement. Conditions improved in early 2016 and the 3-month Kuala Lumpur Interbank Offer Rate (KLIBOR) which climbed to as high as 3.84% in late 2015 eased to below 3.8% in March 2016. Going forward, however, MARC still foresees slower deposit growth on the back of weaker corporate earnings, resulting in upward pressure on the loan-deposit ratio (LDR). While BNM acknowledges such developments, it re-emphasised the fact that the phenomenon partly reflects a deepening of Malaysia's financial market whereby banks do not only depend on deposits for funding sources. Instead, wholesale funding, especially via the bond market, will be an important alternative source to deposits. As such, the relevance of the LDR in measuring liquidity in the financial system is diminishing.

- MARC anticipates loan growth to continue decelerating to circa 7% in 2016 on the back of softer headline GDP growth, stricter lending standards and reduced appetite for borrowings. In addition, higher corporate debt post Global Financial Crisis (GFC) will cause financial institutions to be extra cautious in their lending practices. The BNM acknowledged the rising trend of non-financial corporate leverage but stressed that it remains within an acceptable level with a median debt-to-equity ratio of 46.8% for 160 non-financial firms listed on Bursa Malaysia. The median interest coverage ratio (ICR) remains high at 5.3X and above the prudent level of two times while the share of debt borne by firms with ICR of less than 1.5X remained low and stable at 8.9% of total corporate debt. Accordingly, about 75% of outstanding corporate debt continued to be funded domestically and domestic borrowings have grown at a pace close to the long-term trend of 8.6% between 2005 and 2015.

- On the issue of impaired loans, while the BNM remains comfortable with its declining ratio, MARC feels that the rising trend of its value is worth monitoring. Based on our calculations and BNM statistics, total impaired loans in the banking system climbed by 9.3% as at end-January 2016 from its historical low of RM21.3 billion in April 2015. Going forward, with deteriorating corporate credit metrics arising from slower corporate earnings and rising corporate debt as well as a weaker household balance sheet, we see a possibility of higher impaired loans in 2016. On this, BNM acknowledged the deterioration of loan performance in some sectors, particularly real estate, transportation and crude palm oil. The central bank, however, stressed that the median ICR for property corporations, palm oil companies and even oil and gas (O&G) remained decent at 5.3X, 5.2X and 4.4X respectively.

- Macroprudential measures imposed by the BNM in the past several years have borne fruit as evidenced by a slow but steady decline in household loan growth in the banking system. The moderation in household lending is in line with BNM's target to prevent further escalation in household debt which has remained high at 89.1% of GDP in 2015 (2014: 86.8%). This is despite slower growth in household indebtedness of 7.3% (2014: 9.4%). While financial assets remain ample with a ratio to household debt of 2.05X, we think that it is worth monitoring as it continued to decline for a sixth year in 2015 after hitting a peak of 2.74x in 2007. While acknowledging that the distribution of assets and debt remains a debatable issue, BNM pointed out that the proportion of household debt among the low-income group has continued to decline. Specifically, the proportion of those with an income level of RM3,000 and below per month fell further to 23.6% of total household debt (2014: 24.3%; 2013: 28.4%). In relation to this, MARC applauds BNM's move to address the rising trend of household impaired loans through the expansion of the Debt Management Programme under Agensi Kaunseling dan Pengurusan Kredit (AKPK) to include borrowers from non-banks such as credit cooperatives and building societies.

- BNM officials reiterated its past finding that rising home prices is one of the key determinants of the high ratio of household debt to GDP. In the case of Malaysia, MARC is of the view that rapid increases in home prices are largely due to some structural issues in the housing market. Specifically, there exists a demand-supply gap in different segments of the market, particularly a low supply of homes for the middle-income group which makes up the majority of the population. Statistics suggest that the bulk of unsold properties in major cities (Klang Valley, Penang and Johor) are concentrated in the high-rise unit and two- to three-storey terrace house segments where prices are mostly above RM500,000 and not affordable for the middle-income group. What is of concern is that the size of the middle-income household group, which is in dire need of affordable homes, has remained stubbornly at roughly 40% of total households.

- BNM's disclosure of the breakdown of foreign holders of Malaysian government bonds comes as a pleasant surprise. According to BNM, there is now a considerable portion (29%) held by foreign central banks and governments while another 13% is held by pension funds. As such groups are generally considered long-term investors, the risk of sudden and massive outflows of capital in the event of unfavourable economic conditions is now lower than before. However, we remain cautious about the relatively huge portion of bonds held by asset managers (44%) who tend to respond rather quickly to economic and market conditions.

- On interest rates, although there is now greater pressure on the BNM to trim its policy rate – the Overnight Policy Rate (OPR) - we sense that it will not happen too soon unless real GDP growth starts to dip below 3.5%, which is roughly 0.5 standard deviations (SD) below its long-term mean. We think that the BNM's reluctance to cut the OPR stands from the point of view that the cost of doing so (i.e. high household debt) may outweigh the benefits in terms of supporting the growth at this juncture. As such, BNM may continue to tinker with the Statutory Reserve Requirement (SRR) through further reductions unless GDP growth starts to falter. Otherwise, we are of the view that the maximum cut in the OPR will only be 25 basis points (bps) to 3% in 2016.

- Overall, MARC views BNM's assessment of the economy and financial system risks and vulnerabilities as realistic. While household leverage remains a concern and corporate leverage is on the rise, both cyclical and structural systemic risks and vulnerabilities are being contained by appropriate and timely macro-prudential policies. At the sovereign level, the government's dependency on external financing remains minimal. We see public sector debt remaining on a sustainable path as the government remains committed to fiscal consolidation.

## Introduction

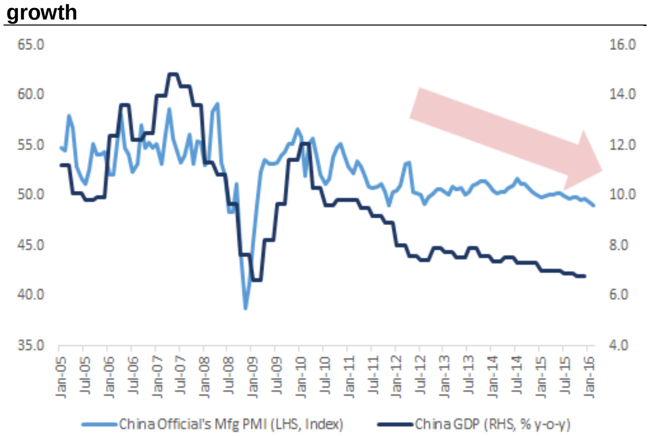
- In its Annual Report and Financial Stability and Payment Systems Report released on March 23, 2016, the BNM acknowledged the increasing divergence between advanced and emerging economies as well as the uneven prospects of the global economy which are affecting the outlook of the Malaysian economy in 2016. In reviewing the financial sector's performance in 2015, the BNM also addressed some of the key concerns on banking system liquidity, asset quality as well as household and corporate debt. In addition, BNM also proffered its perspective on the limitation of monetary tools to support the economy as seen in many countries in recent times.

## Prospects for the global economy in 2016

- The BNM acknowledged the adverse impact of the increasing divergence between advanced and emerging economies as well as uneven prospects of the global economy. While the United States (US) economy continues to exhibit resilience, China's weakening economy is sparking fears of a hard landing scenario. The benign prospects of China's economic growth is reflected in the recent growth target revision by the Chinese leaders to circa 6.5% to 7% for 2016. The manufacturing Purchasing Managers' Index (PMI) remains below the 50-point threshold for the seventh consecutive month in February, while inflation remains muted, clocking a 1.4% pace in 2015, the lowest since 2009. At the macro level, while China's weakening growth may not look too disruptive to the global economy, the "financial accelerator" factor that normally works through the financial market may act to speed up the effects on other global economies. In addition, the People's Bank of China's (PBoC) current stance of averting a deeper depreciation of the renminbi may prevent a quick recovery of its export sector, thus limiting the upside of the economy.

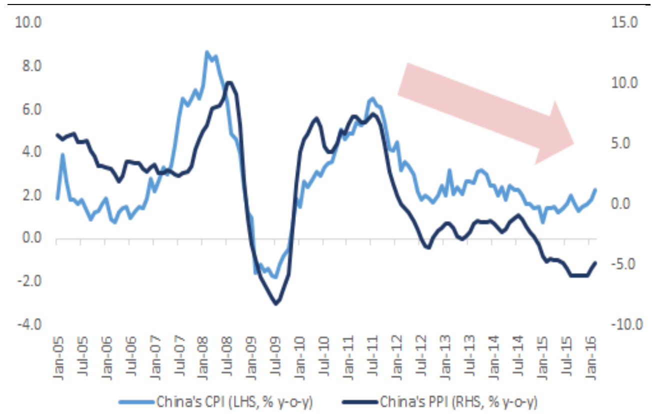
- Notwithstanding the current jitters over China's economic prospects, we are of the view that their policymakers will delicately maneuver the economy to avoid a hard landing scenario. We believe that China has the necessary ammunition to do so (high external reserves, low government debt) through fiscal and monetary policies. Fiscal measures have been carefully crafted to avoid creating further economic imbalances (i.e. property bubbles, high corporate debt) as they did in 2008-2009. The monetary space remains ample as reflected in the reserve requirement ratio (RRR) level which remains high at 17%.

**Chart 1: China's official manufacturing PMI and real GDP growth**




*Source: Bloomberg, CEIC, MARC Economic Research*

**Chart 2: China's consumer and producer inflation**

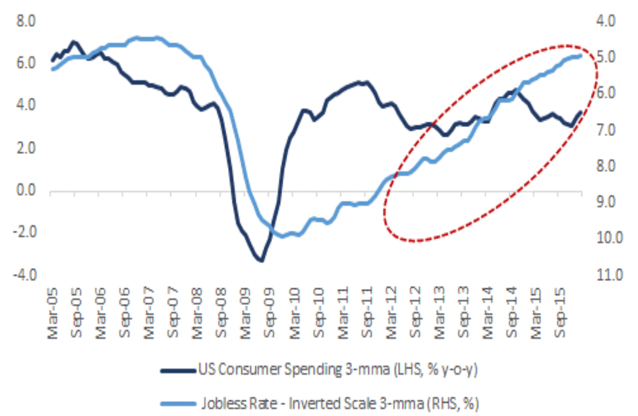



*Source: CEIC, MARC Economic Research*

- The US economy, on the other hand, remains a key support to global recovery. Robust labour market statistics as evidenced by non-farm payroll (NFP) numbers are a crucial factor in anticipating stronger consumer spending growth and thus further hikes in the federal funds rate (FFR) by the US Federal Reserve (Fed). With an average 207K increase in NFP in January-February 2016, it is possible that the unemployment rate could hit its Non-Accelerating Inflation Rate of Unemployment (NAIRU) in 2H2016. Inflation numbers have also improved of late, with the core CPI standing at 2.2% in the 12 months to

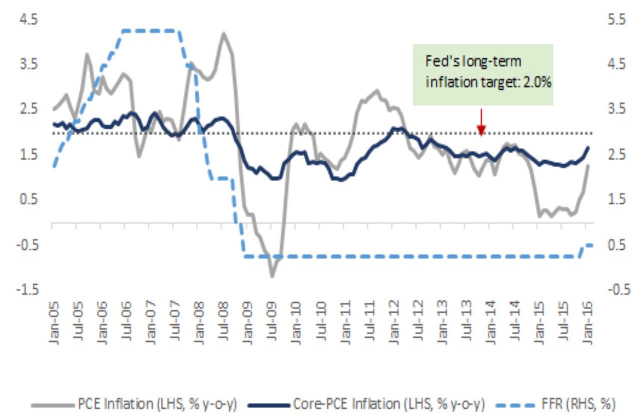
February. At the same time, the Fed's preferred inflation gauge, the core Personal Consumption Expenditures (PCE) price index, picked up to 1.7% in January from 1.5% in December, the highest level since February 2013. This is above the Fed's median forecast for 4Q2016 of 1.6%. The marked increase in core PCE inflation was notably attributed to an acceleration in housing inflation and health care inflation. The rising trend in core PCE is expected to become an important factor that will move the Fed to raise interest rates despite recent rhetoric against it.

**Chart 3: US consumer spending and jobless rate**



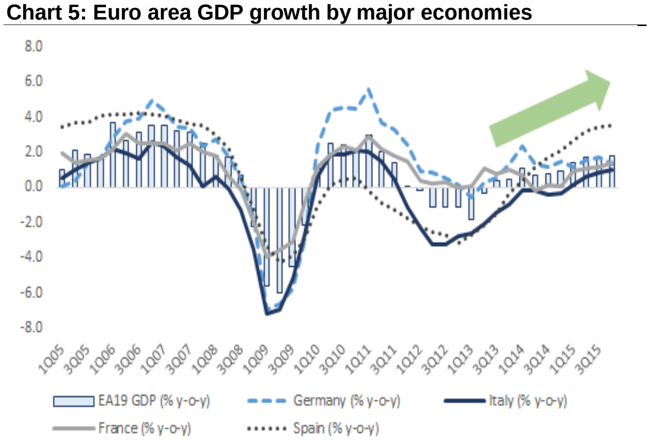

*Source: CEIC, CEIC, MARC Economic Research*

**Chart 4: PCE inflation and FFR**



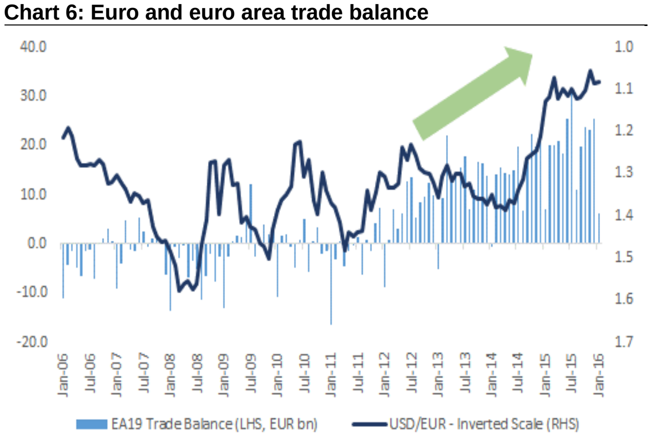

*Source: CEIC, MARC Economic Research*

**Chart 5: Euro area GDP growth by major economies**




*Source: CEIC, MARC Economic Research*

**Chart 6: Euro and euro area trade balance**




*Source: CEIC, MARC Economic Research*

- In the euro zone, the overall prospects remain positive, although the global slowdown has somewhat rippled through its economy. While the recent PMI data has fallen to the weakest level in 13 months in February, it remained above the 50-point threshold line, in contrast to other major economies (US: 49.5, China: 49.0). The industrial production index also posted its strongest monthly performance in more than six years in January, rising 2.1% from the previous month and up by 2.8% from a year earlier, the biggest annual jump since 2011. Nevertheless, downside risks remain with inflation continuing to be well below the 2.0% target, prompting the central bank to ramp up further stimulus measures in mid-March. The European Central Bank (ECB) reduced the benchmark rate to zero, lowered the rate on cash parked overnight by banks by 10 bps to -0.4% and increased the bond purchases limit from EUR60 billion of asset-backed securities (ABS), government and covered bonds to EUR80 billion and expanded the limit to include investment-grade corporate bonds. In particular, the economy's performance has been relatively stable in recent quarters as the decline in energy prices and weak euro have somewhat supported private consumption and lifted exports in 2015. While a sharp improvement in the euro economy is unlikely this year, we foresee an encouraging trend to emerge in both business and consumer segments in 2016.

## Malaysia – decelerating domestic and external demand

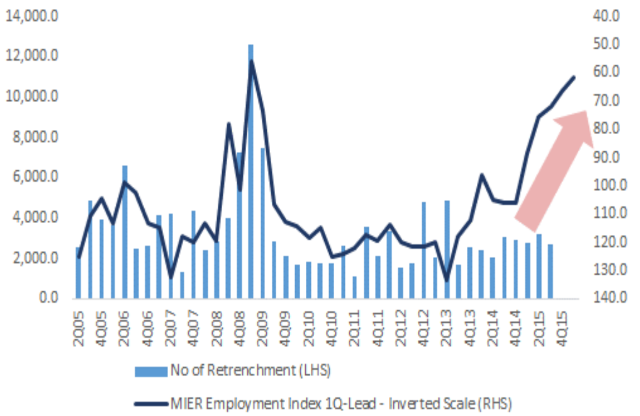
- The BNM expects Malaysia's real GDP to grow between 4.0%-4.5% (2015: 5%) in 2016, which is in line with our projection of 4.4%. While growth is once again anticipated to be supported by domestic demand, the BNM projects private consumption – the key driver of Malaysia's economy in 2016 – to grow at a more moderate pace of 5.1% (MARC: 4.2%) and private investment to expand by 5.5% (MARC: 5.9%). MARC concurs with this assessment as it foresees softer headline growth in 2016 due to sluggish external trade performance, although exports are expected to rebound mildly in 2H2016 due to stronger commodity prices.

- Private consumption, which contributed roughly 63% of the headline growth in 2015, is anticipated to bear the brunt of higher cost of living due to the ongoing subsidy rationalisation measures (i.e. increases in transportation-related charges, reduction in electricity rebates and an increase in prices of flour) as well as the lag impact from the implementation of Goods and Services Tax (GST) in April 2015. Weaker consumer sentiment is evidenced by the Malaysian Institute of Economic Research's (MIER) consumer sentiment index (CSI) which remained below the 100-point threshold level for six consecutive quarters between 3Q2014 and 4Q2015, longer than during the GFC in 2008-2009 (four quarters). In addition, job cuts in the oil & gas as well as in services sectors and reduced credit availability will likely increase jitters among consumers and dent their spending going forward. Moreover, the high base factor due to the pre-GST rally in consumption in 1H2015 will put a lid on growth in consumer spending in 1H2016. Going into, 2H2016 however, we foresee a slight improvement in consumer spending as economic sentiment recovers in line with better trade performance. A sustained increase in palm oil prices as a result of the El Nino phenomenon will boost the income of the rural population, spurring consumption. Overall, we see a bottoming of consumer spending in 2016 and a recovery in 2017.

- The recent plunge in crude oil prices which dragged export performance down is a crucial factor of our benign outlook for the Malaysian economy in 2016. In ringgit terms, exports of petroleum products, crude oil and liquefied natural gas (LNG) contracted by 31.4%, 20.3% and 26.2% respectively in 2015 from 2014, underscoring the turmoil in the global crude oil market. The only support came from the electronic & electrical products (E&E) sector where exports – which accounted for 36% of total shipments – registered a positive growth of 8.5% in 2015. Going forward, we foresee a continuing sluggish trend in exports, especially in 1H2016 as global demand weakens following China's slower-than-expected growth. However, going into 2H2016, we foresee a slight improvement in the export performance as the US economy continues to gather strength and China's economy stabilises. In addition, we do not expect the euro economy to deteriorate further in light of new easing measures implemented by the ECB to support the region's economy. A mild recovery in crude oil prices will add to the strength of Malaysia's export sector in 2H2016.

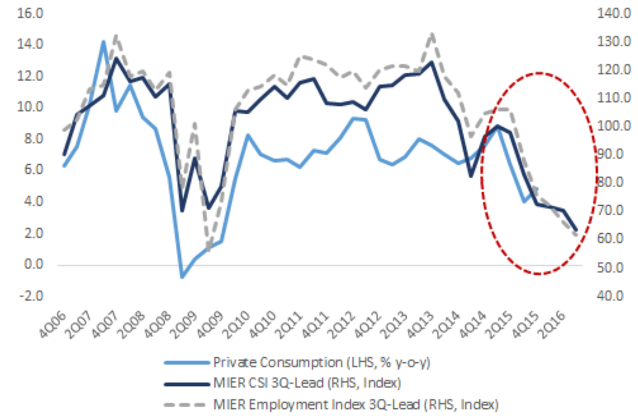
- Reiterating our previous macro outlook report published end-December 2015, we view the current extreme weakness in oil prices as a transient phenomenon, although we do not expect a sharp rebound going forward. We are of the opinion that crude oil prices below USD30 per barrel are not likely to be sustainable based on fundamental and technical aspects. Therefore, recent increases in crude oil prices cannot be explained by short covering positions alone. From a fundamental point of view, the smaller-than-projected world liquid balance as predicted by the US Energy Information Administration (EIA) is a critical factor in driving up oil prices despite lingering concerns about the high inventory level. We acknowledge the fact that supply will remain ample in the near term, outstripping demand in 2016. However, production by Organisation of the Petroleum Exporting Countries (OPEC) and non-OPEC members have generally eased. In addition, a supply upsurge from Iran has not materialised so far. Besides, demand has been grossly underestimated. China's 24% year-on-year jump in oil imports in February is a case in point as car sales continued to accelerate. From a technical aspect, history seems to suggest that the current price at 2 SD below its long-term mean would tend to revert to 1 SD or 2 SD below its mean due to the oversold position.

**Chart 7: Number of retrenchment and MIER employment index**



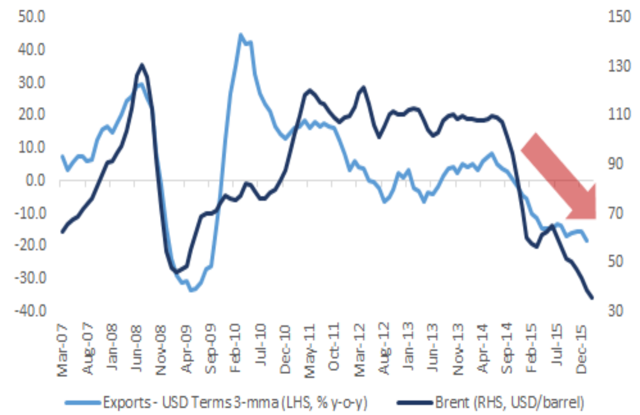

*Source: CEIC, BNM, MARC Economic Research*

**Chart 8: Private consumption growth and MIER CSI and Employment Index**



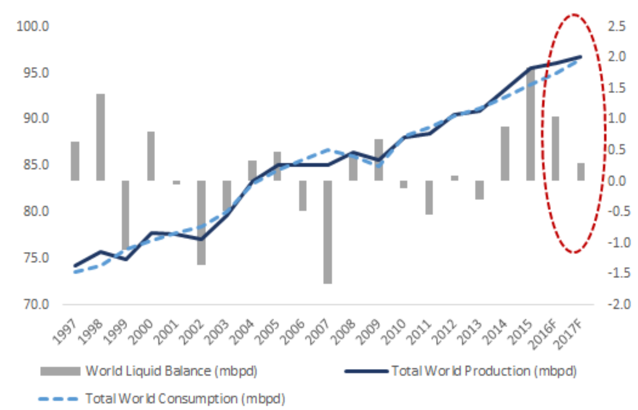

*Source: CEIC, MARC Economic Research*

**Chart 9: Exports growth in USD terms and Brent crude oil price**




*Source: Bloomberg, WTO, MARC Economic Research*

**Chart 10: Global oil production and consumption**




*Source: EIA, MARC Economic Research*

**Table 1: Real GDP growth – demand side**

| Growth (%y-o-y) | 2011 | 2012 | 2013 | 2014 | 2015 | MARC 2016F | BNM 2016F |
|---|---|---|---|---|---|---|---|
| GDP | 5.3 | 5.5 | 4.7 | 6.0 | 5.0 | 4.4 | 4.0 - 4.5 |
| Domestic Demand | 7.8 | 10.7 | 7.3 | 5.9 | 5.1 | 4.4 | 4.3 |
| Private Consumption | 6.9 | 8.3 | 7.2 | 7.0 | 6.0 | 4.2 | 5.1 |
| Public Consumption | 14.2 | 5.4 | 5.9 | 4.4 | 4.3 | 3.9 | 2.0 |
| Private Investment | 9.5 | 21.4 | 12.8 | 11.0 | 6.4 | 5.9 | 5.5 |
| Public Investment | 2.6 | 15.9 | 1.9 | -4.7 | -1.0 | 3.4 | 1.1 |
| Real Exports | 4.2 | -1.7 | 0.3 | 5.1 | 0.7 | 3.1 | 3.2 |
| Real Imports | 6.3 | 2.9 | 1.7 | 4.2 | 1.3 | 4.2 | 3.4 |

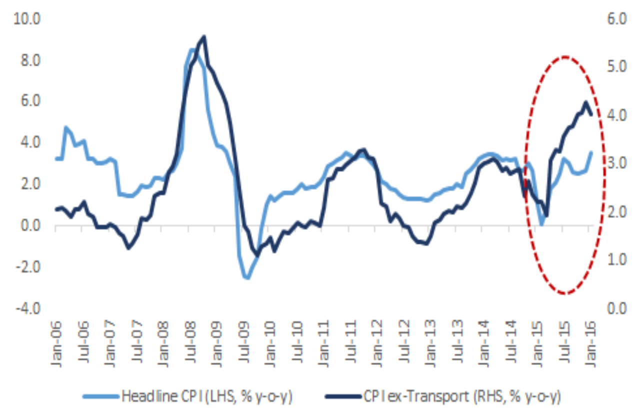
*Source: CEIC, BNM, MARC Economic Research*

## Inflation and interest rates

- The BNM does not anticipate Malaysia's inflation landscape to change dramatically in 2016, and expects it to be at the lower end of its projected range of between 2.5% to 3.5%. While MARC concurs that inflation will remain relatively steady, it foresees cost push factors to lift inflation to slightly above 3%, especially if pump prices were to rise following a mild but sustained rebound in crude oil prices. The modest growth in the CPI in recent times is partly explained by low pump prices which dragged the growth of the transportation index. Excluding the transportation index, the CPI has grown at a higher average pace of 4.0% in the past six months. We maintain our inflation rate target at 3.2%, higher than BNM's mid-point of the projected range, on account of cost push factors in 2016.

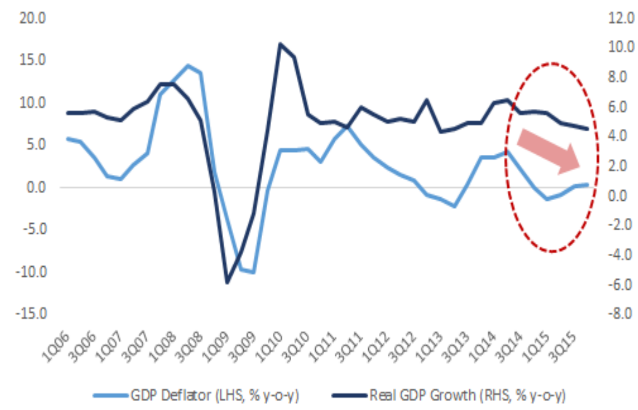
- The broad inflation measure – the GDP deflator – has remained weak, contracting by 0.4% in 2015 due to the moderation in economic activity. Going forward, weaker economic momentum will prevent demand-induced inflation from trickling into the economy, suggesting that the GDP deflator will likely remain muted. The CPI, however, will likely pick up due to cost push factors such as increases in transportation-related charges, an increase in prices of flour and higher levies on foreign workers, which producers tend to pass on to consumers. In addition, the low base factor in 1H2015 will likely cause inflation to jump in 1H2016.

**Chart 11: Headline CPI and CPI ex-transport**



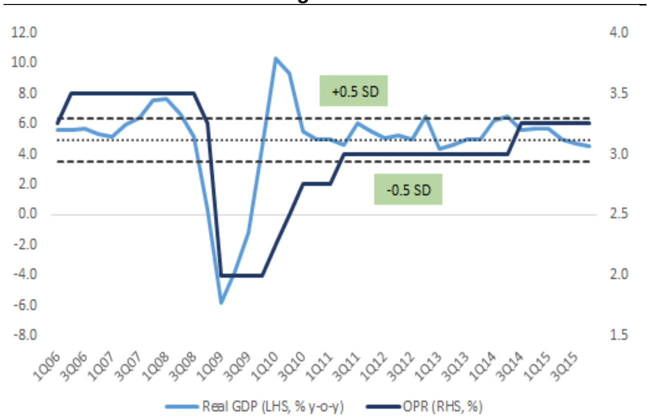

*Source: CEIC, MARC Economic Research*

**Chart 12: GDP deflator and real GDP growth**



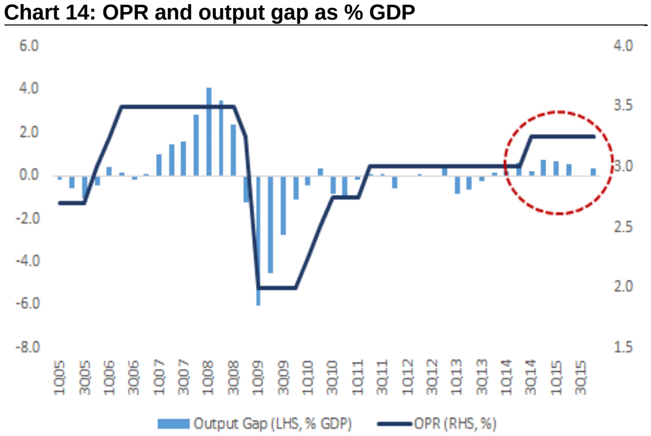

*Source: CEIC, MARC Economic Research*

**Chart 13: OPR and real GDP growth**




*Source: CEIC, MARC Economic Research*

**Chart 14: OPR and output gap as % GDP**

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- On interest rates, although there is now greater pressure on the BNM to trim its OPR, we believe that it will not happen too soon unless real GDP growth starts to dip below 3.5%, which is roughly 0.5 SD below its long-term mean. We think that the BNM's reluctance to cut the OPR stands from the point of view that the cost of doing so (i.e. high household debt) may outweigh the benefits in terms of supporting growth at this juncture. Going forward, BNM may continue to tinker with the SRR through further reductions unless GDP growth starts to falter. Otherwise, we are of the view that the maximum cut in the OPR will only be 25 bps to 3% in 2016.

## Performance of banking and non-banking financial institutions

- Based on BNM's assessment, the overall economic landscape is still supported by a healthy banking sector with capital ratios surpassing the levels required under Basel III. More than 80% of banks' capital was high quality, comprising retained earnings, paid-up capital and reserves. The LLR remained adequate despite a declining LLR ratio (2015: 96.2%; 2014: 100.4%) while the impaired loan ratio remained low at 1.2%.

- Notwithstanding this, one of the concerns of credit rating agencies is the rapid increase in the amount of credit to the private sector which, excluding non-bank institutions and outstanding private debt securities, has increased to 125% of GDP in 2015 (2014: 121.1%). History seems to suggest that the credit-to-GDP gap is a robust single indicator of a build-up of financial vulnerabilities and crisis episode for a large cross section of countries. However, the officials reiterated that declining growth of home prices – an important factor in explaining credit growth – will likely cap Malaysia's credit expansion going forward. In addition, sufficient foreign exchange reserves and stable capitalisation ratios have somewhat mitigated Malaysia's financial vulnerabilities.

- It is notable that the liquidity level in the banking system has been under pressure since mid-2015 amid slower corporate earnings, capital outflows and stiffer competition among banks to raise deposits to meet the LCR requirement. However, conditions improved in early 2016 and the 3-month KLIBOR which climbed to as high as 3.84% in late 2015 eased to below 3.8% in March 2016. Going forward, however, MARC still foresees slower deposit growth on the back of weaker corporate earnings, resulting in upward pressure on the LDR. While BNM acknowledges such developments, it re-emphasised the fact that the phenomenon partly reflects a deepening of Malaysia's financial market whereby banks do not only depend on deposits for funding sources. Instead, wholesale funding, especially via the bond market, will be an important alternative source to deposits. As such, the relevance of the LDR in measuring liquidity in the financial system is diminishing.

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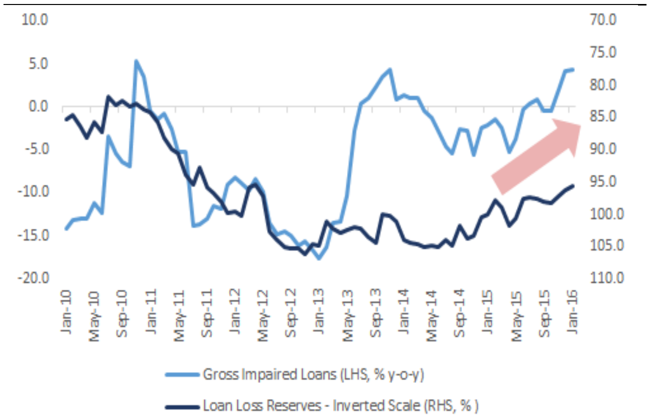
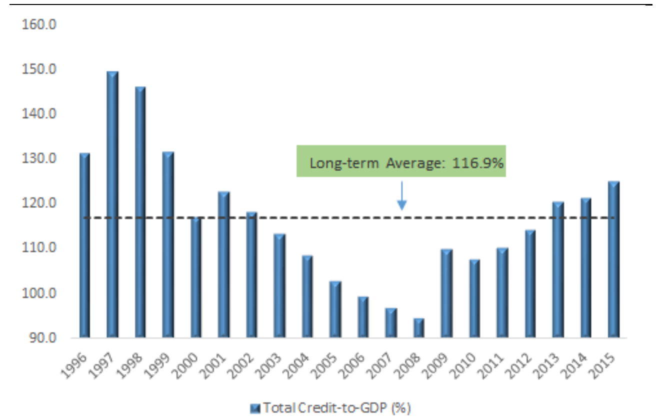
- On the issue of impaired loans, while the BNM remains comfortable with its declining ratio, MARC feels that the rising trend of its value is worth monitoring. Based on our calculations and BNM statistics, total impaired loans in the banking system climbed by 9.3% as at end-January 2016 from its historical low of RM21.3 billion in April 2015. Going forward, with deteriorating corporate credit metrics arising from slower corporate earnings and rising corporate debt as well as a weaker household balance sheet, we see a possibility of higher impaired loans in 2016. On this, BNM acknowledged the deterioration of loan performance in some sectors, particularly real estate, transportation and crude palm oil. The central bank, however, stressed that the median ICR for property corporations, palm oil companies and even O&G remained decent at 5.3X, 5.2X and 4.4X respectively.

**Chart 15: Gross impaired loans growth and loan loss reserves**



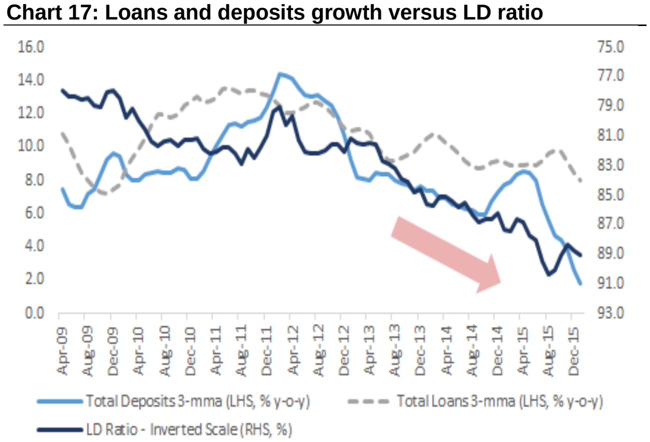

*Source: BNM, CEIC, MARC Economic Research*

**Chart 16: Total credit from the banking system as % of GDP**



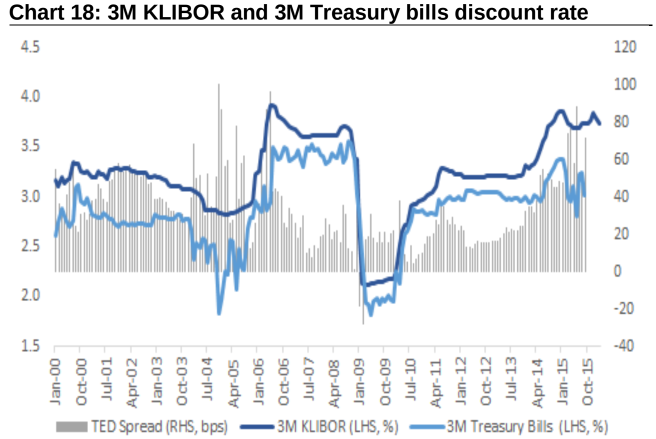

*Source: BNM, CEIC, MARC Economic Research*

**Chart 17: Loans and deposits growth versus LD ratio**




*Source: BNM, CEIC, MARC Economic Research*

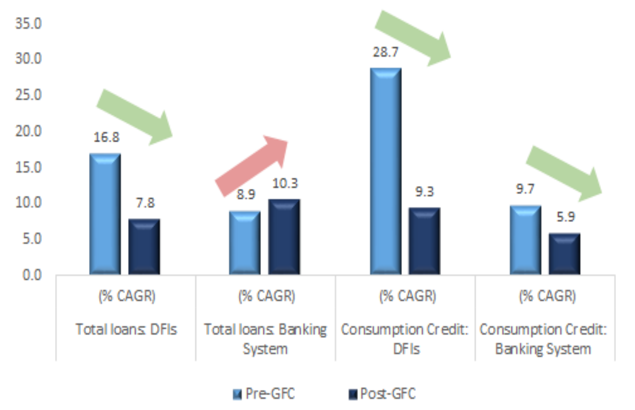
**Chart 18: 3M KLIBOR and 3M Treasury bills discount rate**




*Source: BNM, CEIC, MARC Economic Research*

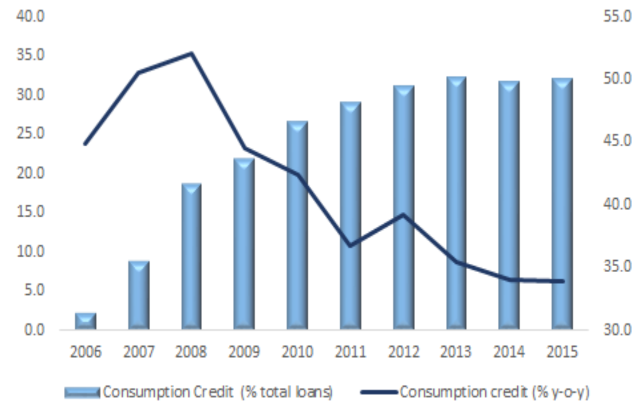
- MARC views positively the declining trend of lending by Development Financial Institutions (DFI) which eased to 5.7% in 2015 (2014: 7.3%). On a compound annual growth rate (CAGR) basis, lending growth had halved to 7.8% in 2010-2015 from as high as 16.8% in the five-year period prior to the GFC. Similarly, consumption credit growth eased to 9.3% on a CAGR basis post-GFC, compared to a blistering 28.7% increase in 2005-2009. Nevertheless, the proportion of consumption credit remained broadly unchanged at 50.0% of the total loan book in 2015 (2014: 49.7%) from as low as 29.6% a decade earlier. Its growth, however, has moderated to 6.2% in 2015 (2014: 6.4%). It is also worth noting that personal financing granted by non-bank financial institutions (NBFI), which include credit cooperatives and building societies, has continued to increase at a slower pace of RM3 billion in 2015 (2014: RM4.4 billion, 2013: RM10.2 billion), although they have remained the biggest provider of this loan segment. Macroprudential measures have indeed helped to mitigate the risks of overextended borrowing by households, particularly from the non-bank segment. This is evidenced by the average financing amount disbursed which declined further to a low of RM22,000 per facility from RM68,000 previously.

**Chart 19: Total loans and consumption credit by DFIs and banking system**




*Source: BNM Financial Stability and Payment Systems Report (various issues), MARC Economic Research*

**Chart 20: DFIs' consumption credit growth and as % of total loans**



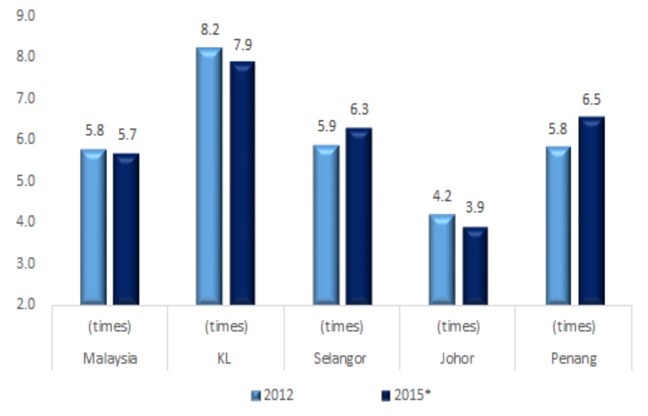

*Source: BNM Financial Stability and Payment Systems Report (various issues), CEIC, MARC Economic Research*

## Issue of household continues to hog limelight

- Macroprudential measures imposed by the BNM in the past several years have borne fruit as evidenced by a slow but steady decline in household loan growth in the banking system. The moderation in household lending is in line with BNM's target to prevent further escalation in household debt which has remained high at 89.1% of GDP in 2015 (2014: 86.8%). This is despite slower growth in household indebtedness of 7.3% (2014: 9.4%). While financial assets remain ample with a ratio to household debt of 2.05X, we think that it is worth monitoring as it continued to decline for a sixth year in 2015 after hitting a peak of 2.74x in 2007. While acknowledging that the distribution of assets and debt remains a debatable issue, BNM pointed out that the proportion of household debt among the low-income group has continued to decline. Specifically, the proportion of those with an income level of RM3,000 and below per month fell further to 23.6% of total household debt (2014: 24.3%; 2013: 28.4%). In relation to this, MARC applauds BNM's move to address the rising trend of household impaired loans through the expansion of the Debt Management Programme under AKPK to include borrowers from non-banks such as credit cooperatives and building societies.

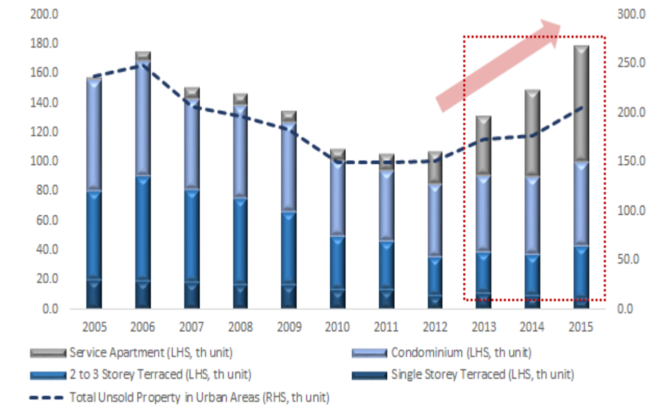
- BNM officials reiterated its past finding that rising home prices is one of the key determinants of the high ratio of household debt to GDP. In the case of Malaysia, MARC is of the view that rapid increases in home prices are largely due to some structural issues in the housing market. Specifically, there exists a demand-supply gap in different segments of the market, particularly a low supply of homes for the middle-income group which makes up the majority of the population. Statistics suggest that the bulk of unsold properties in major cities (Klang Valley, Penang and Johor) are concentrated in the high-rise unit and two- to three-storey terrace house segments where prices are mostly above RM500,000 and not affordable for the middle-income group. What is of concern is that the size of the middle-income household group, which is in dire need of affordable homes, has remained stubbornly at roughly 40% of total households.

**Chart 21: Home price to median income ratio**



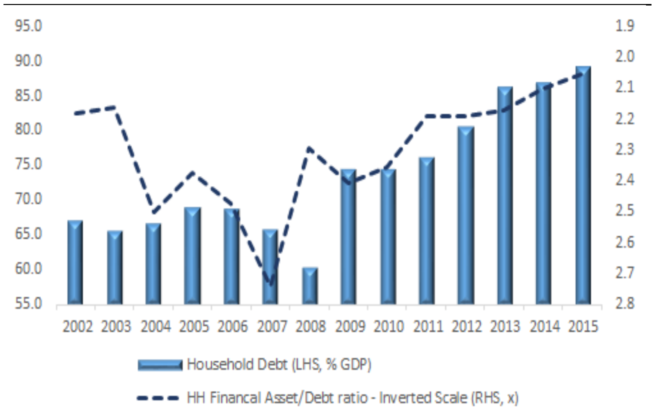

*Source: DOS, NAPIC, MARC Economic Research*
*Note: * = home price as of end 3Q2015, median income as of 2014*

**Chart 22: Total unsold residential properties in urban areas**



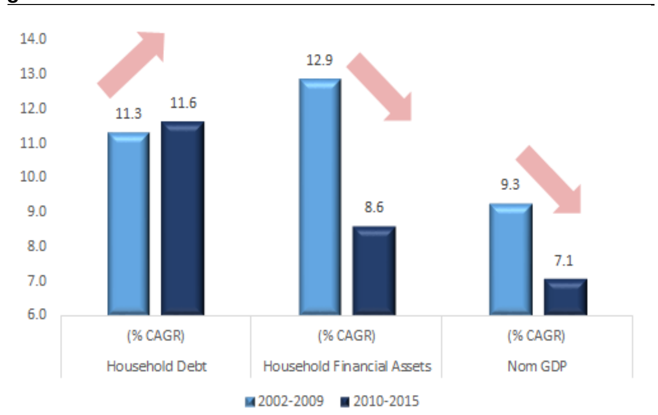

*Source: CEIC, NAPIC, MARC Economic Research*
*Note: Urban areas refer to KL, Selangor, Johor and Penang*

**Chart 23: Household debt as % GDP and financial asset to debt ratio**




*Source: BNM Financial Stability and Payment Systems Report (various issues), CEIC, MARC Economic Research*

**Chart 24: Household debt, financial assets and nominal GDP growth on a CAGR basis**




*Source: BNM Financial Stability and Payment Systems Report (various issues), CEIC, MARC Economic Research*

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