Economic Research

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BNM Annual Report 2019

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Macro Projections for 2020

% y-o-y	BNM	MARC
Real GDP	+0.5 ~ -2.0	-1.5 ~ -3.5
Domestic demand	1.1	-0.4
Private consumption	4.2	2.0
Public consumption	5.9	5.2
Private investment	-9.7	-9.1
Public investment	-7.5	-10.4
Export	-13.6	-11.5
Import	-11.9	-14.0

Selected financial soundness indicators of the banking system

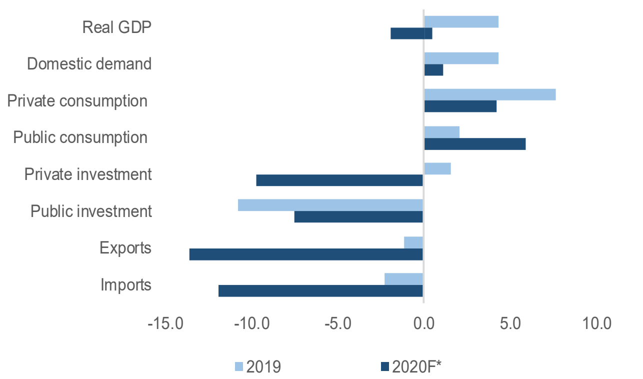
%	2015 – 2018 average	2019
Common Equity Tier (CET) 1 capital ratio	13.7	14.3
Total capital ratio	17.4	18.3
Gross impaired loans (GIL) ratio	1.6	1.5
Net impaired loans (NIL) ratio	1.1	1.0
Return on assets (ROA)	1.4	1.5
Return on equity (ROE)	12.7	13.0
Liquidity coverage ratio (LCR)	132.5	149.1

Key financial ratios of the household sector

	2015 – 2018 average	2019
Household debt-to GDP (%)	85.8	82.7
Household financial assets-to-debt (x)	2.1	2.2
Household liquid financial assets-to-debt (x)	1.4	1.4

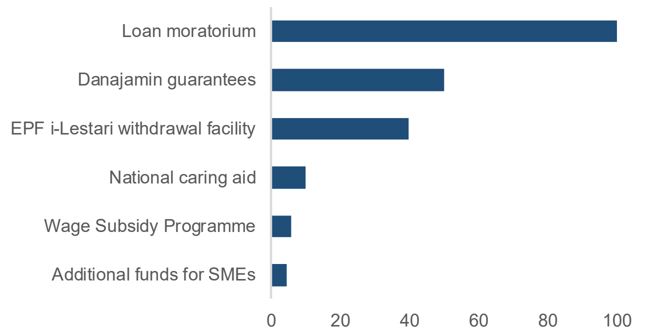
Highlights of BNM's Economic and Monetary Review 2019

Chart 1: Real GDP growth (% y-o-y) by expenditure



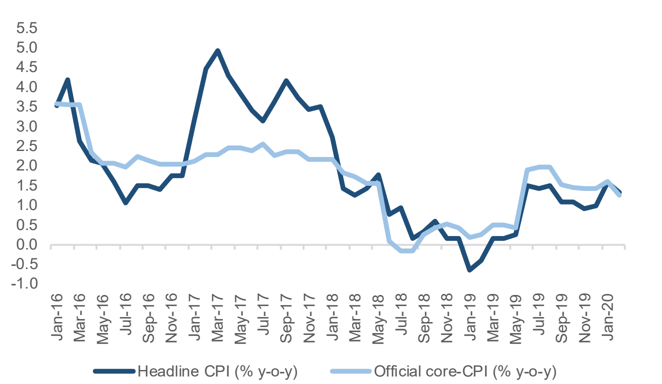
** Forecast by BNM*
Sources: Department of Statistics Malaysia (DOSM), BNM

Chart 2: Size of selected measures in the recent economic stimulus package (RM billion)



Sources: Prime Minister's Office (PMO), MARC Economic Research

Chart 3: Headline inflation and core inflation (% y-o-y)

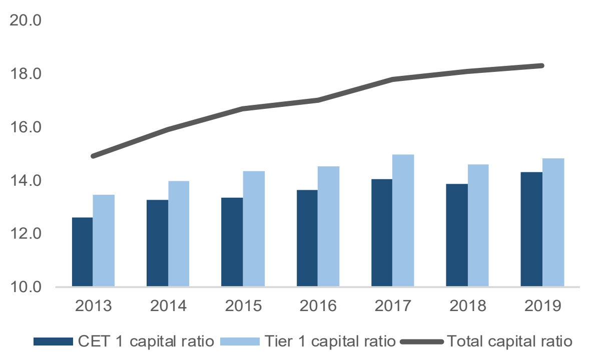


Sources: DOSM, MARC Economic Research

- Bank Negara Malaysia (BNM) expects Malaysia to register real GDP growth of between -2.0% and 0.5% in 2020 (2019: 4.3%) due to the impact of weaker trade (exports: -13.6%) and a downturn in investment activities (private investment: -9.7%; public investment: -7.5%).
- Exports will be weighed by softer global demand following the spread of COVID-19 across major economies. Commodities exports will see a larger contraction mainly due to the lower prices of crude oil and natural gas, as well as continued supply disruptions in the commodities sector.
- The larger contraction in goods exports vis-à-vis weak import growth will contribute towards a narrower current account surplus. BNM expects the current account surplus to narrow to between 1.0% to 2.0% of GDP (2019: 3.3% of GDP).
- Private consumption, the main growth pillar, is expected to be dented by (i) weak labour market conditions; (ii) mobility restrictions imposed in response to the COVID-19 pandemic and; (iii) subdued sentiments. The impact, however, will be partially mitigated by recent policy measures introduced in the economic stimulus package, including cash handouts to vulnerable groups and loan moratoriums.
- Meanwhile, public spending will be underpinned by the continuation of large-scale infrastructure projects such as MRT2, LRT3 and Pan-Borneo Highway, as well as increased allocations as announced in the recent economic stimulus packages. Against this backdrop, domestic demand growth is expected to soften to 1.1% (2019: 4.3%).
- BNM sees subdued inflationary pressure in 2020, with headline inflation averaging between -1.5% and 0.5% (2019: 0.7%). This is mainly premised on expectations of significantly lower global oil and commodity prices as well as softer demand pressures.
- BNM reiterates that future monetary policy considerations will continue to be guided by the balance of risks surrounding the outlook for domestic growth and inflation, which are continuously evolving.

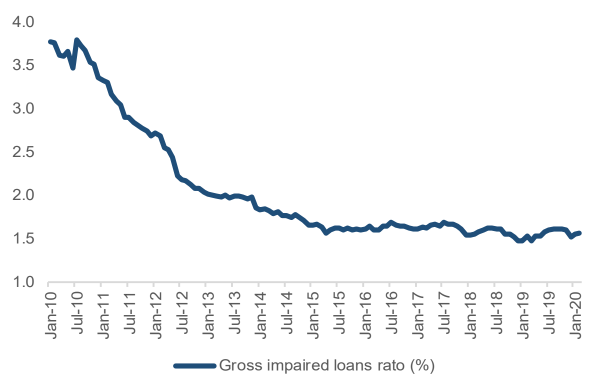
Highlights of BNM's Financial Stability Review 2H2019

Chart 4: Capital ratios of the banking system (%)



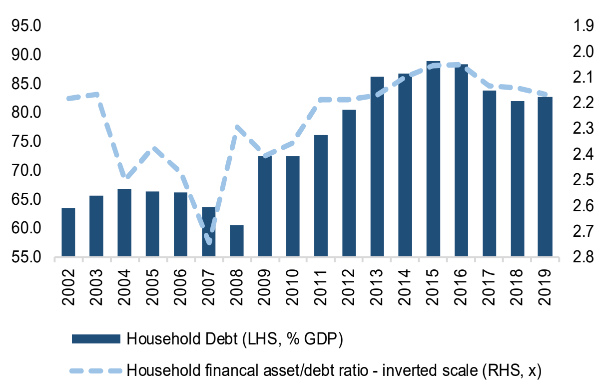
Source: BNM

Chart 5: GIL ratio of the banking system



Source: BNM

Chart 6: Household debt and household financial assets



Source: BNM

- Based on BNM's assessment, the banking sector remains resilient against potential stress, with capital ratios surpassing the regulatory minimum. The CET1 and total capital ratios improved to 14.3% and 18.3% as at end-2019 (end-2018: 13.9% and 18.1%), underpinned by sustained profitability and sound asset quality.
- Banking system profitability remains well above the estimated average cost of capital despite further compression in banks' interest margins following the overnight policy rate (OPR) cuts and slower credit growth. With banks remaining generally prudent in their risk-taking, the drag on banks' earnings is expected to be cushioned by higher non-interest income, continued loan growth and lower debt-servicing burdens of borrowers.
- GIL ratio remains stable at 1.5% as at end-2019 (avg. 2015-2018: 1.6%). Furthermore, BNM's stress tests continue to affirm that banks are well positioned to absorb potential losses arising from various severe shocks, partly helped by the prudent provisioning buffers accumulated over the years. Total provisions including regulatory reserves held by banks against credit losses stood at RM33.9 billion or 126.4% of impaired loans as at end-2019.
- Household debt remains elevated and its ratio to GDP has edged higher to 82.7% as at end-2019 (end-2018: 82.0%). The rise is primarily driven by loans for the purchase of residential properties following the launch of the Home Ownership Campaign by the government. Nevertheless, BNM takes comfort on households' debt-servicing capacity, citing the faster growth pace in household financial assets. Both outstanding household financial assets and liquid financial assets stood at 2.2 times and 1.4 times of debt.
- In line with the more challenging business operating environment, business debt receded below 100% of GDP for the first time since 2015. Of note, business loan growth slowed to 2.4% as at end-2019 (June 2019: 2.7%) due to banks' excessive risk aversion. While the COVID-19 pandemic could weaken the debt-servicing capacity of businesses and consequently increase future credit risks for banks, BNM expects recent measures announced by the authorities to partly mitigate the risks.

Opinion

- In line with BNM's view, we have toned down our growth projections in view of the possible global recession akin to the one seen during the Global Financial Crisis (GFC) in 2008-2009 (MARC: -1.5% to -3.5%). Our projection assumes a more pronounced deterioration in business conditions especially if the pandemic lasts longer than expected due to disruptions in global and domestic supply chains.
- History shows that during the 2009 recession, business conditions (MIER's BCI) fell by roughly 50% during the peak of the crisis then. In addition, we do not foresee a quick global recovery in 2H2020 as individuals and businesses will take time before they revert back to 'business as usual'. We acknowledge, though, that forecast uncertainty is higher than usual and growth trajectory will strongly hinge on the duration of the pandemic.
- In our view, with a material decline in business sentiment and the implementation of the movement control order (MCO) – a necessary measure to curb the pandemic – small businesses have come under great pressure and will likely exhibit dismal performances. Admittedly, the government has provided some relief to individuals and businesses to help them weather these challenging times through its latest stimulus package, PRIHATIN, valued at RM250 billion or 17% of GDP.
- Given the government's limited fiscal space, we feel the private sector can play a critical role in ensuring the Malaysian economic fabric remains intact in the long term. For example, commercial banking institutions can help support the economy by effectively utilising the liquidity made available by BNM by lending to businesses that are in need of lifelines (e.g. small and medium-sized enterprises (SMEs) with good prospects). This is because experience from the GFC shows that a slow pick-up in lending growth (in the US) was a key reason behind the sluggish economic recovery despite the massive liquidity injections by the US Fed through its quantitative easing policy.
- With BNM already lowering its statutory reserve requirement (SRR) by a total of 150 basis points in recent times, ample liquidity has been flushed into the banking system. These funds are useful for businesses struggling to make ends meet especially at a time when there is high cash burn rate (declining revenue and having fixed costs to pay).
- History shows that in the 2009 recession, loan approvals for businesses in the banking system fell on an average of 28% y-o-y between mid-2008 and mid-2009. As such, the economy is in need of an injection of fresh funds by banks through business lending in order to recover.
- We note that the banking sector is in much better shape than it was prior to the 1998 and 2009 recessions. In February 2020, the sector's total capital ratio stood significantly higher at 18.4% (2008: 12.6%). Asset quality had remained relatively steady last year with the GIL ratio at year-end coming in at 1.5%.
- Our experience during the Asian Financial Crisis (AFC) shows that BNM's lending growth target of 8% imposed on banks to complement the National Economic Recovery Plan (NERP) which was implemented in 1998 helped the economy recover in the subsequent years. The setting up of Dana Modal, Dana Harta and the Corporate Debt Restructuring Committee (CDRC) had helped banks to re-capitalise and restructure bad debt so that they could continue lending to businesses. This is critical especially when history shows that even during a shallower recession in 2009, total loan approvals in the banking system fell by an average of 19% y-o-y between September 2008 and May 2009.
- MARC takes comfort from BNM's disclosure that households are in a position to face the challenges going forward given their financial asset-to-debt ratio of 2.2 times. However, with the likelihood of a spike in the jobless rate this year, household balance sheets could come under pressure as incomes deteriorate and lending from banks decline. History testifies to this; in the midst of the GFC, the amount of approved loans to households fell by an average of 1.5% y-o-y between October 2008 and May 2009.
- In conclusion, with the economy going through its most challenging period since the GFC, commercial banks have a critical role in sustaining long-term economic prosperity. They have done a great job supporting Malaysia's economy in the periods post the AFC and GFC; they can surely continue to do so.

Appendix I: Tables

Table 1: Summary of Malaysia's GDP performance

Growth (% y-o-y)	2015	2016	2017	2018	2019	2020F	
						MARC	BNM
GDP	5.1	4.4	5.7	4.7	4.3	-1.5 ~ -3.5	0.5 ~ -2.0
Domestic Demand	5.1	4.3	6.5	5.5	4.3	-0.4	1.1
Private Consumption	6.0	5.9	6.9	8.0	7.6	2.0	4.2
Public Consumption	4.5	1.1	5.5	3.3	2.0	5.2	5.9
Private Investment	6.3	4.5	9.0	4.3	1.5	-9.1	-9.7
Public Investment	-1.1	-1.0	0.3	-5.0	-10.8	-10.4	-7.5
Real Exports	0.3	1.3	8.7	2.2	-1.1	-11.5	-13.6
Real Imports	0.8	1.4	10.2	1.3	-2.3	-14.0	-11.9

Sources: DOSM, BNM, MARC Economic Research

Table 2: Financial soundness indicators of Malaysia's banking system

%	2015	2016	2017	2018	2019
Capital adequacy					
CET 1 capital ratio	13.4	13.6	14.0	13.9	14.3
Tier 1 capital ratio	14.4	14.6	15.0	14.6	14.8
Total capital ratio	16.7	17.0	17.8	18.1	18.3
Asset quality					
GIL ratio	1.6	1.6	1.5	1.5	1.5
NIL ratio	1.2	1.2	1.1	0.9	1.0
Earnings and profitability					
ROA	1.3	1.3	1.5	1.4	1.5
ROE	12.3	12.5	13.1	12.7	13.0
Liquidity					
LCR	127.4	124.3	134.9	143.2	149.1

Sources: BNM, CEIC, MARC Economic Research

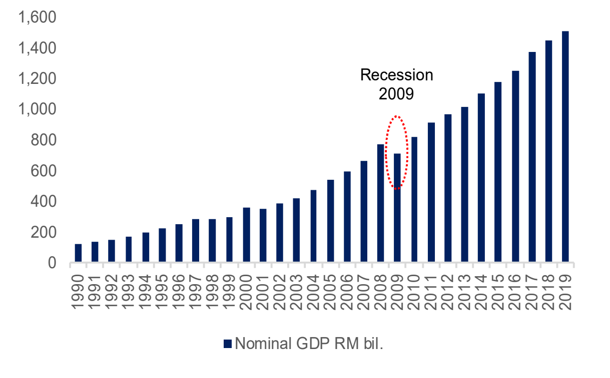
Table 3: Outstanding loans by purpose

Growth (% y-o-y)	2015	2016	2017	2018	2019
Purchase of property	11.5	8.3	6.8	6.6	6.2
Purchase of residential property	12.1	9.2	8.7	8.4	7.3
Purchase of non-residential property	10.2	6.2	2.3	2.3	3.1
Consumption credit	2.8	0.6	0.9	10.0	0.9
Personal Uses	5.8	4.3	3.8	37.3	3.1
Credit cards	1.2	3.1	4.1	3.3	3.2
Purchase of consumer durable goods	-77.3	-8.3	-11.1	-8.3	-13.4
Purchase of passenger cars	2.3	-1.3	-1.1	0.0	-1.0
Working capital	10.4	5.6	0.9	5.7	1.0
Construction	7.6	6.9	4.5	18.1	5.6
Purchase of transport vehicles excluding passenger cars	-4.8	-5.1	4.1	-2.2	-2.5
Purchase of fixed assets excluding land and building	-4.5	-1.1	-12.1	18.1	19.6
Purchase of securities	-1.9	-1.0	0.9	7.1	4.1
Others	-1.6	1.9	14.3	13.3	3.6
Total	7.9	5.3	4.1	7.7	3.9

Sources: BNM, CEIC, MARC Economic Research

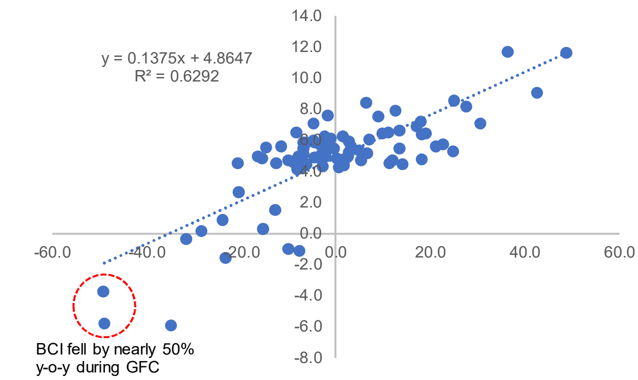
Appendix II: Six charts

Chart 7: Malaysia's annual nominal GDP (RM billion)



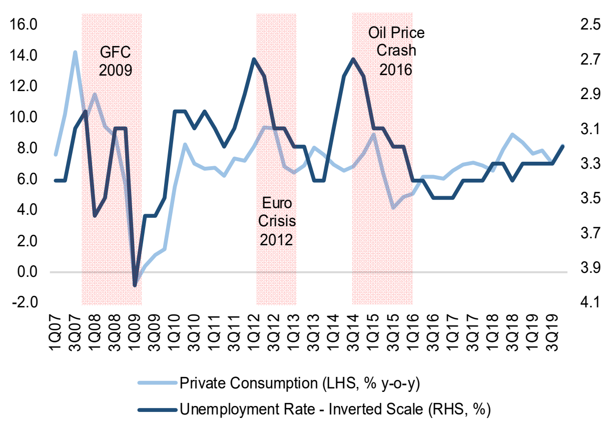
Sources: CEIC, MARC Economic Research

Chart 8: Relationship between MIER's BCI and Malaysia's real GDP growth rate



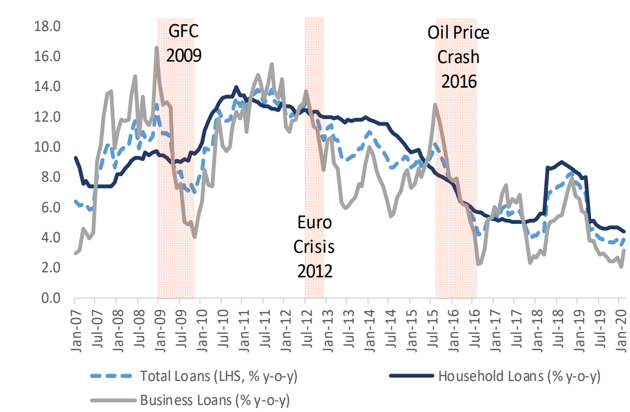
Sources: CEIC, MARC Economic Research

Chart 9: Private consumption and unemployment rate



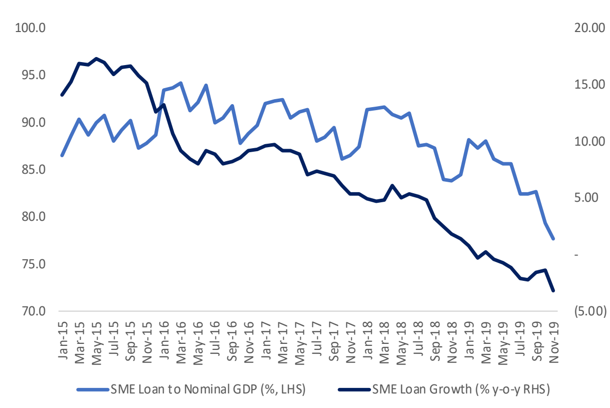
Sources: CEIC, MARC Economic Research

Chart 10: Loan growth



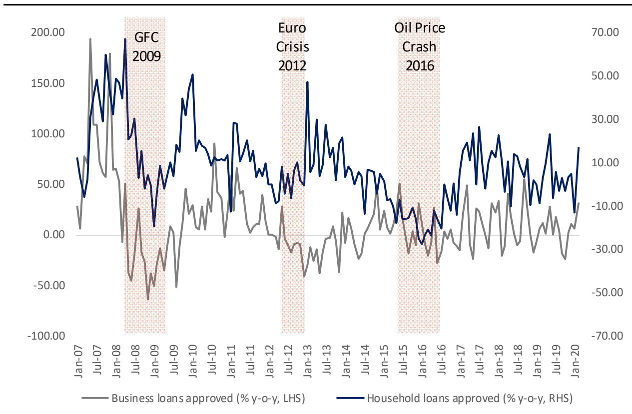
Sources: BNM, MARC Economic Research

Chart 11: Growth of SME loans



Sources: CEIC, MARC Economic Research

Chart 12: Growth of approved loans



Sources: BNM, MARC Economic Research

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