INTERNATIONAL MONETARY FUND

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MALAYSIA

March 2015

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALAYSIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with Malaysia, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 13, 2015, following discussions that ended on November 24, 2014, with the officials of Malaysia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 23, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its February 13, 2015 consideration of the staff report that concluded the Article IV consultation with Malaysia.
- A **Statement by the Executive Director** for Malaysia.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

MALAYSIA

January 23, 2015

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

KEY ISSUES

Near-term outlook. Prospects for Malaysia's well diversified economy are favorable despite lower prices for its exports of energy and other commodities. Growth is expected to moderate in 2015 to 4.8 percent from 5.9 percent in 2014. Headline inflation will increase slightly, to 3.2 percent in 2015 from 3.1 percent in 2014, reflecting the net impact of subsidy rationalization, Goods and Services Tax (GST) implementation, and exchange rate depreciation. Inflationary pressures should remain subdued, aided by lower oil and gas prices.

Impact of lower oil prices. The sharp decline in energy prices is expected to have a modest negative impact on Malaysia's near-term growth prospects and lower its current account surplus. Although lower commodity prices will be a drag on the economy, manufacturing exports should get a boost, aided by a weaker exchange rate and higher growth in the U.S.

Macroeconomic policy mix. The current macroeconomic policy mix is appropriate. Fiscal consolidation is well timed, appropriately paced, and remains on track. While monetary policy is on hold reflecting increased global uncertainty, a market-driven tightening of domestic liquidity and financial conditions is under way.

Fiscal Policy. The elimination of fuel subsidies and introduction of the GST are timely and decisive reforms with long-lasting benefits. In the near term, eliminating fuel subsidies will help offset the fiscal impact of lower energy revenues. In the medium term, these reforms will also help the authorities diversify budgetary revenues, balance the budget, and lower the debt to GDP ratio.

Financial stability. High house prices and household debt remain a concern, although rising real interest rates should dampen growth of financial risks. BNM is pro-actively managing the risks through stress testing, enhanced supervision, and targeted macroprudential policies. Nevertheless, further macroprudential measures may be needed.

Structural policies. The authorities are implementing structural reforms on a wide front in support of Malaysia's goal of achieving high-income status by 2020. Continued investment in infrastructure and in research and development can help spur home-grown innovation. Together with improvements in the quality of education and increased female labor force participation, these efforts can help raise productivity, support higher sustainable growth, and foster a more inclusive society.

Approved By

Hoe Ee Khor and Ranil Salgado

Mission dates: November 13–24, 2014.

The mission comprised Alex Mourmouras (Head), Niamh Sheridan, Juan Manuel Jauregui, (all APD), Lewis Murara (FAD, and Geoffrey Heenan (Singapore Resident Representative). Hoe Ee Khor (APD Reviewer) participated in the policy discussions.

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APPENDICES

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

1. **Recent developments**. The Malaysian economy continued to perform well in 2014 and the authorities have taken advantage of favorable conditions provided by the growing economy, full employment, and a benign political calendar to implement key fiscal reforms. These decisive steps, driven by the authorities' multiyear adjustment and reform agenda, are consistent with Fund policy advice (Appendix 1). Growth accelerated to 5.9 percent as the recovery of exports and continued strong private demand offset mild headwinds from lower public spending. Private investment continues to be fueled by accommodative financial conditions and the catalytic effects of long term public investment programs. Strong employment and wage growth supported private consumption. The removal of fuel subsidies pushed inflation above its historical average but without any signs of more generalized inflationary pressures, despite a positive output gap. Credit growth has moderated yet remains brisk, with residential property loan growth close to 14 percent in September. Deposit growth has slowed to the single digits and domestic liquidity conditions are beginning to tighten. The ringgit appreciated against the U.S. dollar through mid-August but subsequently depreciated by 10 percent as oil prices fell, for a cumulative depreciation by year-end of about 6.3 percent since January 2014, with further depreciation pressures in early January 2015. Reserves have declined by over US$15 billion between mid-August to end-December 2014 amid capital outflows.

2. **Outlook**. Growth is expected to moderate to a still robust rate of 4.8 percent in 2015. Activity will be led by growth in private investment in the non-oil sector, which is likely to benefit from lower energy costs. Private consumption growth is likely to moderate, reflecting the net effects of lower commodity prices, the impact of GST, and slower credit growth. The projected decline in average crude oil prices for 2015 compared to 2014 is a large negative terms of trade shock for Malaysia (Appendix 2).[1] Nevertheless, only a modest negative impact on growth is expected as lower energy costs should help stimulate the non-oil sector and boost activity in Malaysia's main trading partners. Financial conditions remain accommodative but are tightening, a trend that should continue in 2015 and become a drag on growth, particularly private consumption. GST implementation will increase inflation on introduction in April 2015 but lower fuel prices, subdued underlying inflation, and a narrowing output gap will mitigate the impact.

3. **Risks.** Risks to the baseline are tilted to the downside. Despite the improved outlook for the US economy, weak prospects for Europe and Japan along with falling fuel and commodity prices, are adding to economic uncertainties (see Appendix 3).

- *External risks.* A protracted period of slower growth in advanced economies and emerging markets would slow growth in Malaysia through the trade channel with second round effects on

[1] For an empirical assessment, see the forthcoming Selected Issues Paper "The Impact of Lower Oil Prices on Malaysia: a VAR Approach" by Niamh Sheridan (2015).

domestic demand. Sizeable foreign holdings of local currency assets expose Malaysia to volatility in international capital flows. In a risk scenario, a surge in global volatility could see investors reducing their exposure to Malaysian assets. This risk is mitigated by Malaysia's flexible exchange rate, ample monetary policy credibility, well timed fiscal adjustment, and financial cushions from large official reserves and institutional savings. Malaysia could be vulnerable to contagion and financial volatility in the case of a disorderly adjustment to persistent dollar strength, although the export-oriented manufacturing sector is likely to benefit.

- *Domestic risk*s. The authorities are proceeding with fiscal reforms but should guard against slowdown in reform momentum. It will be important to continue on this path and balance the budget by 2020. The impact of lower global oil and gas prices on Malaysia could be larger, dampening growth through delayed investment plans and the impact of higher real interest rates; in addition the current account surplus could narrow and additional measures would be needed to meet the fiscal targets. Although there are signs of cooling in the housing market and personal lending growth has been curtailed, financial vulnerabilities remain due to high household debt and elevated house prices.

4. **Authorities' views.** The authorities were in broad agreement with staff's assessment.

- They expect growth to remain steady in 2015, led by private demand. Private consumption will continue to expand, albeit at a more moderate rate following implementation of GST and other price adjustments. Slower household credit growth is not expected to have a significant impact on consumption as long as economic growth is sustained. Investment in the oil and gas sector could be affected, if oil prices remain low for an extended period of time. It must be noted that Malaysia's investment is broad-based with the oil and gas sector accounting for less that 20 percent of private investment and the services and manufacturing sectors contributed to 80 percent of growth in investment in 2013. On the external front, commodity and resource-based exports will be affected by lower commodity prices, however, non-resource based manufacturing exports, which account for 53 percent of total exports, will provide support to export growth.

- The authorities viewed the external risks to the outlook as significant. They voiced concerns about the recovery in advanced economies, where growth risks and widening policy divergence could trigger global financial market turbulence with negative spillovers to the real economy.

- In terms of financial sector risks, the authorities were less concerned than staff. They noted that credit and house price growth have moderated while successful implementation of targeted macroprudential measures has curtailed risks and increased financial sector resilience. The authorities have assessed the capacity of banks to withstand and respond to a wide range of shocks and adverse scenarios. These stress tests indicate that bank balance sheets are resilient, including to large changes in house prices and interest rates.

FISCAL POLICY: TIMELY AND DECISIVE MOVES

5. **Background**. The authorities undertook important fiscal reforms in 2014, taking advantage of the favorable conjuncture provided by full employment, strong growth momentum, low inflation and, lately, declining oil prices. On December 1, 2014, remaining fuel subsides on RON95 gasoline and diesel fuel were removed, culminating an effort that began with the floating of prices for RON97 premium petrol in 2010 and also included earlier moves (in September 2013 and October 2014) which raised the prices of diesel and RON95 petrol by 20 sen per liter (about 10 percent) each. Prices for RON95 petrol and diesel are now set monthly to track international oil prices. Implementation of a GST in April 2015 is on track. Other subsidies are being reformed and budget transfers are being better targeted. These moves were timely as well as bold and they will help shield the budget from declining oil and gas revenues and reinforce fiscal sustainability. They will also enhance the efficiency and equity of Malaysia's fiscal policy.

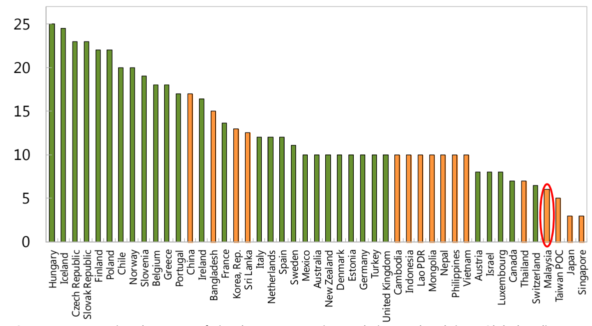
6. **2014 Budget outturn.** Malaysia is on track to meet the 2014 federal budget deficit target of 3.5 percent, down from 3.9 percent in 2013. Revenues have come in higher than budgeted owing to stronger growth and higher oil and gas production, which raised oil-related revenues despite the weakening of oil and gas prices. Over-performance on the revenue side was matched by a higher-than-budgeted wage bill and higher development spending. Subsidy spending was lower reflecting subsidy rationalization.

7. **2015 Budget.** The 2015 budget, including the January 2015 revision, stays the course of steady, gradual fiscal consolidation. As originally promulgated in October, it was based on a Brent crude oil price of US$100 and targeted a budget deficit of 3 percent of GDP, reflecting the GST and the reduction of fuel subsidies announced on October 1. It was revised on January 20 and now assumes an oil price of US$55 (average Tapis crude price of US$61) and the dismantling of fuel subsidies announced on December 1. The revised budget deficit target has been changed to 3.2 percent of GDP in 2015, owing to additional expenditures related to floods that recently affected 200,000 people, partly offset by a reduction in lower priority operational spending. The 2015 Budget includes measures to ease the impact of GST, including reductions in individual and corporate income taxes as well as the SME tax of between 1–3 percentage points. As a result, only a small net positive revenue impact from GST is expected in 2015. The removal of fuel subsidies is expected to bring in savings of RM10.7 billion (0.9 percent of GDP). This savings will be offset by lower oil and gas revenues in the baseline scenario. The revenue loss will be lower if oil prices come in higher, in which case it would be important to save the windfall. If Tapis oil prices fall below US$60, the budget would face a net loss, requiring additional measures to meet the deficit target.

8. **GST.** Staff welcomes the introduction of GST, which will help broaden the base of Malaysia's fiscal system and reduce its reliance on volatile oil and gas revenues. GST preparations are well advanced and registration of taxpayers for the GST credit-invoice procedure is running ahead of projections; staff encourages the authorities to save any upside GST revenue. Looking ahead, GST effectiveness could be enhanced by gradually narrowing the list of exempt and zero-rated items

which would help raise GST buoyancy. In addition, fewer GST exemptions would allow tax authorities to generate more information through cross-checking of returns, which would raise compliance. There is also room to gradually raise the GST rate as part of the strategy to reduce fiscal dependence on hydrocarbons and balance the budget: Malaysia's 6 percent GST rate is the lowest in the region (Singapore's and Thailand's GST is 7 percent; it is 10 percent elsewhere in Asia).

OECD and Selected Asian Countries: Rate at Introduction
(In percent)



Sources: International Bureau of Fiscal Documentation website; and Deloitte, *Global Indirect Taxes*, 2013.

9. Subsidy rationalization. Staff welcomes the elimination of subsidies on diesel and RON95 petrol. Fuel prices were floated when the gap between the market and subsidized price was small. Along with the removal of sugar subsidies and a 15 percent increase in electricity prices in January 2014, the authorities are now closer to achieving their goal of eliminating untargeted price subsidies. LPG use in the fishing and transportation sectors is still subsidized at an estimated cost of RM2 billion (0.2 percent of GDP) in 2015. In future, consideration could be given to imposing GST on fuels and also to taking into account carbon content, in order to capture the negative effects on Malaysia's environment and global climate change. These measures would help support the Prime Minister's commitment to lowering the carbon intensity of Malaysia's economy and creating a "new energy economy".

10. Enhanced protection for the poor. Strengthening the social safety net is an integral part of the authorities' fiscal strategy. Untargeted fuel subsidies were regressive: households in the top two quintiles of per capita consumption received 60 percent of the subsidies while only 3 percent went to the bottom decile. The elimination of fuel subsidies freed up resources that can be redirected to better support the poor. To mitigate the impact of subsidy rationalization and GST, the 2015 budget calls for increased cash transfers to poorer households (those earning less than RM4,000 per month). The authorities are also reviewing overlapping and fragmented cash transfer programs.

11. Medium-term fiscal strategy. The authorities' goal of balancing the budget by 2020 will help reduce the federal debt to near pre-crisis levels and give them more room to deal with major shocks and absorb contingent liabilities. Balancing the budget will require a continuous effort amidst pressures from oil revenues that are declining in relation to GDP and from rising expenditure commitments. Lower energy prices highlight the need for fiscal consolidation to remain ambitious, to continue with the drive to broaden revenue bases and diversify them away from hydrocarbons, and to increase expenditure equity and efficiency. If the decline in oil prices is permanent more measures would be required over the medium term to meet the fiscal targets which remain feasible in light of GST implementation – a powerful revenue mobilization tool—and the removal of consumer fuel subsidies. Potential additional measures include broadening the GST base or increasing the rates combined with rationalization of subsidies from public enterprises, for example, electricity and gas, and operational expenditure restraint. The authorities' commitment to sound public finances allows flexibility in phasing the adjustment effort. Automatic stabilizers and countercyclical policies could be employed if the economy slows down by more than expected and the adjustment could be stretched beyond to 2020.

12. Fiscal framework. Malaysia is making important progress in reforming its fiscal institutions. Top-down macro-fiscal control was strengthened significantly with the creation of the Fiscal Policy Committee (see 2013 staff report), while the size of supplementary budgets has been substantially reduced. The move toward performance-based budgeting is welcomed, as is the piloting of accrual accounting in 2015 ahead of full implementation in 2016. The government would benefit from publishing its medium-term fiscal framework; from adopting a fiscal risks management framework and publication of an annual fiscal risks statement; and from reducing further the use of supplementary budgets.[2] And while Malaysia's federal government and most Government-linked Corporates (GLCs) are increasingly transparent, more proactive communication and greater transparency of business objectives and operations for all GLCs would help.

13. Authorities' views. The authorities reiterated their commitment to sound public finances and to far-reaching fiscal reforms supported by strengthened fiscal institutions. They emphasized the need for a gradual approach to reducing the deficit and for the need to protect the vulnerable. The change in the budget deficit target announced on January 20 is a timely and pragmatic change in response to sharply lower energy prices than envisaged earlier. Their strong political commitment will help them overcome implementation challenges. And although contingent liabilities are sizable, government loan guarantees have a low probability of being called as they are granted strategically to nonfinancial entities with healthy balance sheets.

MONETARY POLICY: GETTING THE BALANCE RIGHT

14. Monetary policy stance. Bank Negara Malaysia (BNM) raised its Overnight Policy Rate (OPR) in July 2014, the first increase since May 2011. BNM has since adopted a wait and see attitude and this cautious stance is appropriate for now taking into consideration lower expected inflation, the slowdown in domestic economic growth, which will narrow the output gap, and increased uncertainty surrounding the domestic and global outlook. In addition, a market-driven tightening of domestic liquidity conditions is underway amidst capital outflows and intensified bank competition for deposits following a slowdown in deposit growth and ahead of the phased implementation of the Liquidity Coverage Ratio (LCR) beginning in June 2015. Moreover, there is no evidence of generalized price pressures, and while GST introduction will push headline inflation up by 0.7–0.9 percent, it is a one-off fiscal shock that should be accommodated and the impact could be offset by lower fuel

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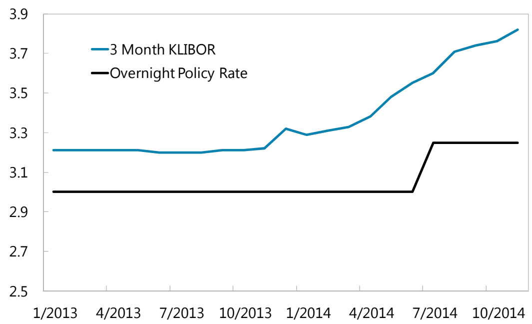
[2] For more details see the forthcoming Selected Issues Paper, "Fiscal Risks and Resilience in Malaysia: Lessons from the Domestic and International Experience," by Juan Jauregui and Lewis Murara (2015).

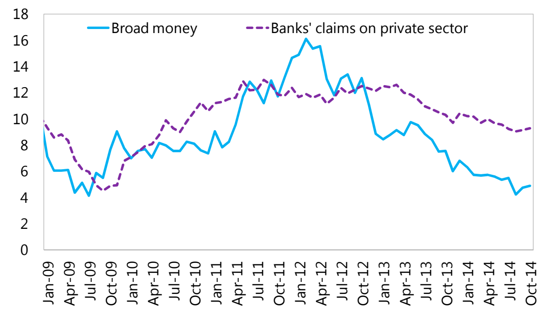
prices. In staff's view, it would be prudent to move from the current accommodative monetary policy stance towards a neutral stance consistent with the need to maintain price stability and curb financial imbalances once the uncertainty surrounding the global outlook dissipates. The calibration of monetary policy could prove challenging though: too slow a pace risks further build-up of financial imbalances yet too fast risks an over-correction of the real economy. In the event global financial volatility were to lead to large capital outflows and a squeeze on liquidity, BNM should stand ready to provide liquidity to maintain orderly market conditions and prevent an excessive tightening in monetary conditions.

Overnight Policy Rate and 3 month KLIBOR
(Percent)



Sources: CEIC Data Co. Ltd.

Broad Money and Credit Growth 1/
(In percent, year-on-year)



Sources: IMF, *Integrated Monetary database*; and IMF staff calculations.
1/ At depository corporations level.

15. Macroprudential policies. Monetary policy should continue to be complemented by macroprudential policies. Until the rate tightening in July, and with the strength of the domestic recovery uncertain, BNM appropriately relied on macroprudential policies to dampen financial risks. BNM's macroprudential policies were aimed at reducing credit and house price increases but have also focused on enhancing the resilience of the banking system (see table 8 and paragraph 18).

16. Authorities' views. The authorities viewed the current monetary policy stance as being appropriate to maintaining price stability and consistent with sustainable growth prospects. Their step towards monetary policy normalization in July 2014 reflected assessments at the time of lower downside risks to growth and an increase in upside risks to inflation. The decision also took into consideration the risks of destabilizing financial imbalances. They viewed their current policy setting as appropriate, taking into account: the increased uncertainty since the summer in the growth outlook in major advanced and emerging markets economies; the fall in oil and commodity prices; and the heightened risk of global financial volatility along with a moderating risk of domestic financial imbalances. Further adjustments, given the significant uncertainty, remain contingent on new information.

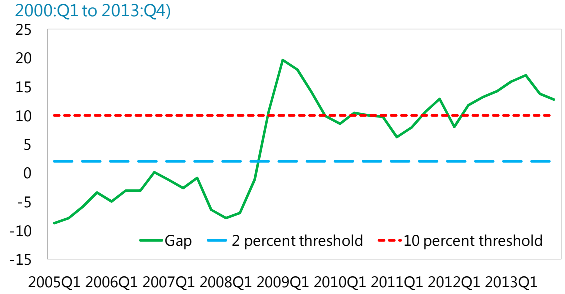
FINANCIAL STABILITY: MANAGING LEVERAGE AND ADDRESSING IMBALANCES

17. Leverage and risks. Malaysia's financial system is strong and well diversified, Malaysian banks are well-capitalized and profitable, and the authorities have made significant progress on FSAP recommendations (see Appendix 7). Financial sector vulnerabilities reflect several years of rapid credit growth and significant increase in leverage. Credit has increased by over 60 percent since end-2009 and the ratio of credit-to-GDP is above long-term trend. Real interest rates on deposits have been negative since 2009 and deposit growth has slowed while savings in financial products have grown strongly, raising concerns about disintermediation in the banking sector and excessive financial risk-taking (see Appendix 8).

	2008	2013
In percent of GDP		
General Government Debt	39.8	54.7
Household Debt	60.4	86.8
Non-financial Corporate Sector Debt	94.4	107.5

Credit-to-GDP Gap 1/

(In percent of GDP, deviation from one-sided HP filter, estimation period 2000:Q1 to 2013:Q4)



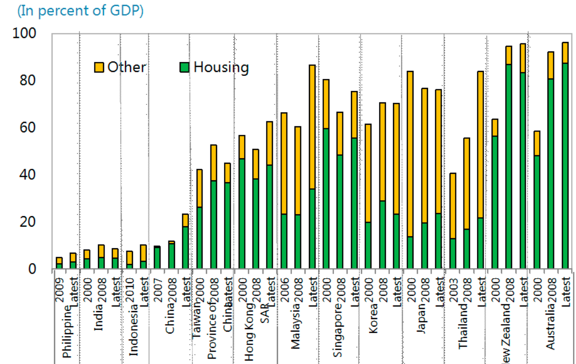
Sources: CEIC Data Co., Ltd.; and staff calculations.

1/ The credit-to-GDP gap is computed using the Basel III methodology. The 2 percent and 10 percent lines indicate thresholds at which regulators are expected to begin imposing the countercyclical capital buffer and when it should be fully deployed.

18. Household debt. Household debt has grown rapidly since 2008, reflecting growth in both mortgages and personal credit. Just over half the debt is owed on residential property, of which about 70 percent are variable rate mortgages. NBFI lending to households has doubled since 2009 and accounted for about 20 percent of household debt at end-2013. Since 2008, house prices have increased by 60 percent, outpacing income and rental growth. Mitigating the risks are strong financial buffers, with household financial assets at just over twice household debt. However lower income borrowers are more highly leveraged. And while there are signs of cooling in the housing market, this could also be a temporary respite reflecting property re-pricing ahead of GST implementation and the prohibition of Interest Capitalization Schemes. Macroprudential measures have been successful in curbing risks. Personal loan growth has slowed in response to measures targeting NBFIs in July 2013 and tighter caps on debt-service ratios of lower income households. An enhanced framework for risk-based pricing is also helping reduce loan applications and approvals. Nevertheless, additional macro-prudential measures, such as LTV caps on second and first mortgages, may be needed.

Asia: Household Debt

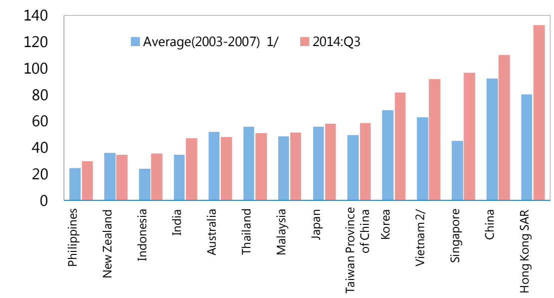
(In percent of GDP)



Sources: CEIC Data Co. Ltd. ; Haver Analytics, World Economic Outlook database; and IMF staff calculations.

19. Corporate sector debt. Corporate sector debt has increased in Malaysia and is now close to the average for other Asian countries. The debt securities and sukuk markets are an important source of financing. Debt issuance is mostly long term and ringgit denominated with limited holding by foreigners. Nonfinancial private offshore external debt is about 9 percent of GDP and resident companies with foreign currency exposure either hedged using onshore banks or have a natural hedge of foreign currency earnings. On aggregate, corporate solvency and liquidity ratios appear comfortable.

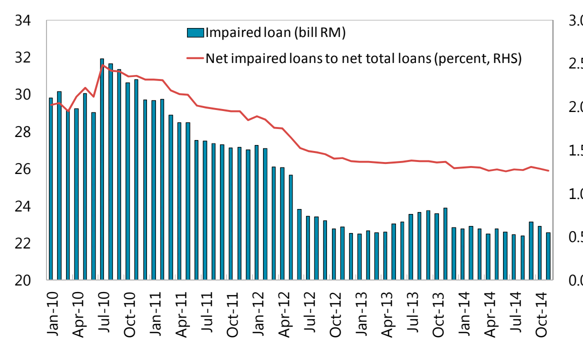
Non-financial Corporate Credit to GDP Ratio
(In percent of GDP)



Sources: CEIC Data Co. Ltd.; HAVER Analytics; and IMF staff calculations.
1/Except for Singapore, which is average for 2004-07, and for China, which is average for 2007 only.
2/ For Vietnam graph shows private-sector-credit-to-GDP ratio.

20. Asset quality. Asset quality continues to improve, with a nonperforming loan ratio of 1.8 percent compared with 6 percent at end-2007. Against a backdrop of strong credit growth, the improvement is also confirmed by a decline in the amounts of impaired loans. Vintage analysis by BNM shows that the default rate by months-on-book has been declining for loans originating in later periods. Provisioning is adequate with a ratio just over 100 percent. To address a gradual decline in collective impairment provisioning, BNM will require that by end 2015, banks maintain, on aggregate, collective impairment provisions and regulatory reserves of at least 1.2 percent of total outstanding loans (net of individual impairment provisions). Risk-informed price standards, which came into effect in March 2014, require banks to articulate costs and expected losses for different retail loan and financing product segments and ensure that these are in line with banks' risk management plans.

Commercial Banks' Impaired Loans, November 2014



Source: CEIC Data Co. Ltd.

21. Disintermediation. Deposit growth has been trending down since end-2011 and was 7.8 percent y-o-y at end November 2014, compared with 8.3 percent at end-2013. Growth in deposits by individuals has also declined to 3.8 percent at end November, compared with 6.0 percent at end-2013. Combined with strong loan growth this has pushed up the loan-to-deposit ratio to 86.6 percent at end-November 2014 compared with 84.6 percent at end-2013. The banks remain predominately deposit funded but slow system-wide deposit growth along with the pending implementation of the Basel III LCR is nudging up deposit interest rates. The new reference rate framework for loan pricing, which came into effect in 2015, should ensure that higher funding costs are passed on to retail lending rates, although this could be offset by stiff competition in the mortgage market. A higher policy rate would help to ease these pressures by increasing deposit rates, encouraging savings to remain in the banking system and curbing the pace of disintermediation, while also reversing negative real interest rates and curtailing the growth in leverage. Savings in financial products has grown rapidly since 2009, almost doubling in size; this development reflects ongoing structural development in the financial market but also fueled by low interest rates and the search for yields by investors.

22. Foreign currency and overseas exposure of banks. Overseas operations of domestic banks continue to expand within Asia, primarily into Indonesia and Singapore. Total assets of overseas subsidiaries and branches grew by 16.3 percent during 2013. The assets of overseas operations are dominated by loans and investment in plain vanilla debt securities and are largely funded by local currency deposits, limiting potential cross-border funding risks. Malaysian banks are primarily deposit-funded, however, foreign currency borrowing has increased, reflecting the foreign currency needs of their customers and as part of the banks' foreign currency liquidity management.

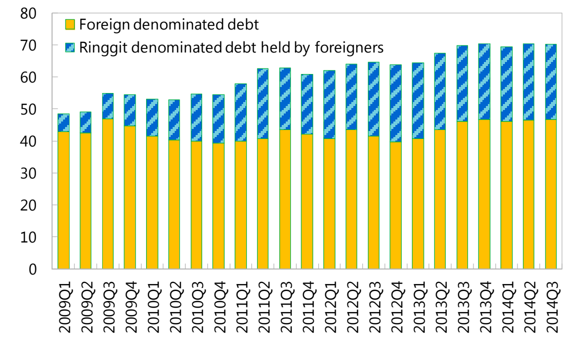
23. Authorities' views. The authorities view financial sector vulnerabilities as having moderated pointing to a slowdown in the growth of household debt and in lending from the nonbank sector and a decline in speculative behavior in the real estate market. These developments reflect macroprudential measures taken by BNM and other government agencies in a holistic approach to address rising household indebtedness and house prices. Their approach has been deliberately gradual and targeted in order to avoid any over-correction. The authorities do not see the need for additional policy action in this area at this time. Existing measures—such as risk informed pricing, more rigorous borrower affordability assessment, continued supervisory vigilance over underwriting practices and additional capital requirements—continue to be effective in strengthening the risk taking practices of financial institutions (including the nonbanks). The authorities are of the view that slowing deposit growth is a natural consequence of financial sector development.

EXTERNAL SECTOR

24. External Sector Assessment. Following several years of external rebalancing, the current account surplus shrank from 11 percent of GDP in 2011 to an estimated 3.5 percent of GDP in 2014. The surplus was reduced in the second half of 2014 reflecting lower crude oil and gas prices, although manufacturing exports increased and imports also fell. Despite the dramatic reduction in its current account surplus in recent years, Malaysia's external position is still assessed to be stronger than is consistent with medium term fundamentals and desirable policies (see Appendix 4). For 2014, staff assesses the gap between the cyclically-adjusted current account and its norm to be about 3 percent of GDP and Malaysia's real effective exchange rate (REER) by about 10 percent (consistent with the identified current account gap). In the medium term, staff projects the current account surplus to decline to 2 percent of GDP as external rebalancing continues and lower oil and gas prices reduce the oil and gas trade surplus. Foreign reserves, at about 85 percent of the Fund's reserve-adequacy metric, are assessed to be adequate given the flexibility of the exchange rate.

25. Capital flow volatility. Malaysia's highly open economy is affected by swings in international capital flows. Portfolio flows were volatile again in 2014, with large net inflows in the second quarter followed by outflows in the latter part of 2014 but, similar to previous episodes, the real economy was unaffected. Malaysia's deep and liquid financial markets make it possible for foreign investors, including retail investors, enter and exit easily compared to other emerging short-term domestic currency debt. The flexible exchange rate provides an important first line of defense against the risks from rising debt. Strong bank and corporate balance sheets, which reduce fear of floating, make this buffering role possible. Moreover, exchange rate flexibility and domestic currency borrowing allow Malaysia to avoid the currency mismatch problem associated with "original sin", by creating more balanced risk-sharing with foreign creditors during risk off episodes. The current account surplus, substantial official international reserves, and domestic investors are also important sources of resilience. In particular, deep-pocketed institutions such as the Employee Provident Fund (EPF) have ample liquidity and tend to step in during risk off episodes for opportunistic investments. Hence, while potential outflows by foreigners could be larger in future, they are likely to be accommodated by financial markets and could be offset by lower outflows by domestic investors.

External Debt
(In percent of annualized GDP)



Sources: CEIC Data Co. Ltd; and IMF staff calculations.

26. Authorities' views. The authorities agree that the current account is likely to remain in surplus for the foreseeable future, however, they disagree with staff's assessment of external imbalances, particularly with regard to the exchange rate, pointing to the absence of qualitative evidence that the ringgit is undervalued. The uncertainty surrounding the EBA estimates and poor fit in the case of Malaysia, suggests that caution is warranted in drawing conclusions about Malaysia using this approach. In the authorities' view, Malaysia has over the years, strengthened its resilience to bouts of capital flow volatility, as demonstrated during the May 2013 Fed taper tantrum episode with no spillovers to the real economy.

SUSTAINING GROWTH

27. The record. Malaysia's economic record is impressive. With growth averaging over 6 percent since independence, its per capita income has reached the high middle income mark. Malaysia's public investment has reached a commendable 14 percent of GDP over the last 10 years, partially funded through PPPs. This has contributed to an increase in the national investment rate in recent years and helped improve productivity and growth. Malaysia's diversified economy, political stability, and attractive business climate hold promise that this growth momentum can be sustained.[3]

28. Avoiding the middle income trap. Staff supports the authorities' efforts for Malaysia to avoid a middle income trap and reach high income status by 2020. They are intent on pursuing reforms that would create the conditions for a knowledge-based economy. Their multi-year transformation programs place appropriate emphasis on synergies between the ingredients needed to deliver on this, including plans to improve infrastructure, upgrade the quality of education, and boost Malaysia's research and development spending and raise its effectiveness in generating home-grown innovation. A key priority is infrastructure investment, supported by enhanced public financial management, which can ease bottlenecks in Malaysia's growing urban centers, support sustainable growth and help lower income inequality.[4] As Malaysia's demographic dividend slowly dissipates, it is also necessary to further increase female labor force participation. Taken together, these reforms, reinforced by better services delivery, continued financial sector development and greater financial inclusion, and supported by a strong social safety net, can accelerate productivity growth and encourage higher value-added activities. Staff encourages the authorities to take advantage of current strong economic conditions that offer an opportunity to pursue these reforms.

29. ASEAN economic integration. Continued economic openness, including through deeper regional integration and the pursuit of high-quality trade agreements, should be an integral component of the reform strategy. Malaysia stands to benefit from its outward economic orientation and the strengthening of regional economic and financial integration underway, including the creation of the ASEAN Economic Community (AEC) in 2015. Bold steps forward in ASEAN and regional integration, especially elimination of behind the border barriers, could reap substantial dividends for Malaysia and ASEAN, including upgrading of services sectors, which are fast growing in Malaysia and elsewhere in Southeast Asia. For example, the income gain for Malaysia from the Trans-Pacific Partnership (TPP) has been estimated at 6 percent relative to the status quo.[5] Progress with integration can also help unlock structural reforms yielding further gains.

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[3] In 2014, Malaysia ranked 18th in the World Bank's Ease of Doing Business Report, up two notches from 2013. See http://www.doingbusiness.org/rankings#. Malaysia also improved its ranking in the World Economic Forum's Global Competitiveness Index, where it ranked 20th among 144 countries in 2014/15, an improvement of four relative to 2013/14. See http://www.weforum.org/reports/global-competitiveness-report-2014-2015; and http://www3.weforum.org/docs/GCR2013-14/GCR_Rankings_2013-14.pdf. The Doing Business indicators should be interpreted with caution because of the limited number of respondents, limited geographical coverage, and standardized assumption on business constraints and information availability.

[4] World Economic Outlook, October 2014; Chapter 3; Seneviratne and Yun (2013), "Infrastructure and Income Distribution in ASEAN-5: What are the Links?" IMF Working Paper 13/41.

[5] On ASEAN integration see Almekinders and others, "ASEAN Financial Integration: Harnessing Benefits and Mitigating Risks," IMF Working Paper (forthcoming). On the impact of TPP, see Plummer and Petri, "The TPP and Asia-Pacific Integration: Policy Implications," Peterson Institute for International Economics Policy Brief 12–16 (June 2012).

STAFF APPRAISAL

30. Outlook. The economy continues to perform well and Malaysia is on track to reach high income status by 2020, reflecting the authorities' skillful economic management amidst an uneven global recovery. Robust domestic demand supported by sound macro-financial policies is driving strong, noninflationary growth in the face of uncertain external conditions and declining commodity prices. Inflation remains subdued.

31. Fiscal Reforms. The authorities are to be commended for seizing the opportunity afforded by full employment, low inflation and falling energy prices to implement ambitious fiscal reforms. These reforms will have far-reaching and long-lasting benefits, helping to diversify Malaysia's revenue system away from oil and gas and raising the efficiency and equity of public spending. Fiscal implementation risks have receded. In staff's view, the recent revision of the 2015 federal budget represents a timely and pragmatic response to fast-changing international energy prices. The decision to float RON95 petrol and diesel prices and implement the GST in April 2015 sends a strong signal of the authorities' commitment to achieving fiscal targets for 2015 and beyond. Also on track is work to strengthen Malaysia's social protection mechanisms and public financial management—important elements in ensuring the political sustainability of subsidy and other reforms that are likely to raise the prices of basic goods consumed by the public. The authorities would benefit from having a fiscal risks management framework, including publication of an annual fiscal risks statement.

32. Monetary policy. BNM took a step at normalizing monetary conditions in July but has since paused. This cautious stance is appropriate for now taking into consideration lower expected inflation, the slowdown in domestic economic growth, and increased uncertainty surrounding the domestic and global outlook. Staff considers it prudent to move to a neutral monetary policy stance as soon as the uncertainty in the external environment dissipates. However, should the global financial markets turn turbulent, leading to capital outflows and a squeeze on domestic liquidity, BNM should stand ready to provide liquidity to maintain orderly market conditions and avoid an excessive tightening in monetary conditions.

33. Managing financial sector risks. Despite the recent deceleration of growth in credit and housing prices, risks of financial imbalances remain elevated, the result of a prolonged period of extraordinarily low real interest rates and the consequent buildup of leverage in the economy. The authorities are to be commended for successful implementation of macroprudential policies to date; these have succeeded in lowering personal credit growth and reducing speculative behavior in the property market. However, with interest rate normalization on hold due to heightened global uncertainty, additional macroprudential measures may be needed to contain financial sector risks.

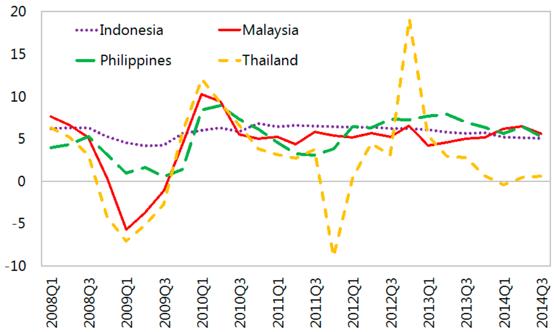
34. Structural reforms. Favorable domestic economic conditions offer a window of opportunity to continue structural reforms in the context of the 11th Malaysia Plan now under preparation. The prospect of lower potential growth in the advanced economies makes it more challenging to sustain strong noninflationary growth and provides additional impetus to the pursuit of structural reforms to raise productivity growth. What is needed is to increase innovation activity, raise the quality of education, address youth unemployment, and increase female labor force participation. Malaysia also stands to benefit from its outward economic orientation and the strengthening of regional economic and financial integration underway, including the creation of the AEC in 2015 and other regional trade initiatives. Accelerating the pace of regional integration should help unlock Malaysia's and ASEAN's economic potential.

35. It is recommended that the next Article IV consultation with Malaysia take place on a standard 12-month cycle.

Figure 1. Malaysia: Growth and Exports

Growth is robust…

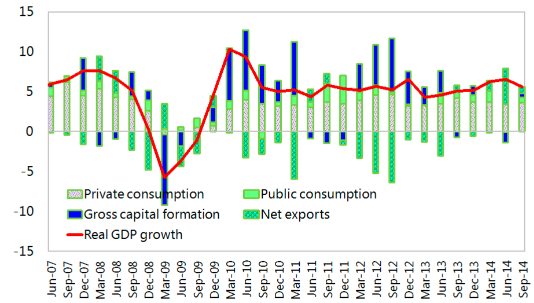
Real GDP Growth
(In percent)



Source: IMF, *World Economic Outlook*.

…with domestic demand buoyant and a positive contribution from net exports.

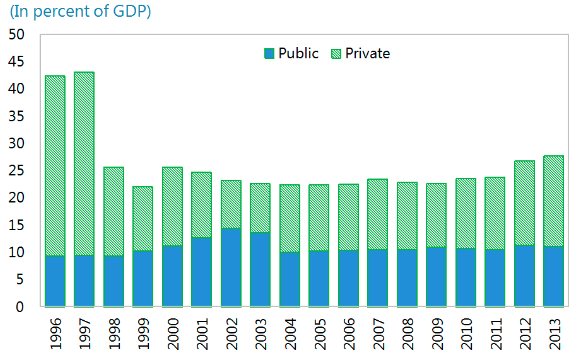
Contribution to Real GDP Growth
(Year-on-year percent change)



Source: CEIC Data Co. Ltd.

The strong pickup in investment, which is growing at its fastest rate since the Asian crisis, has been a key driver, but investment remains below its pre-Asian crisis levels.

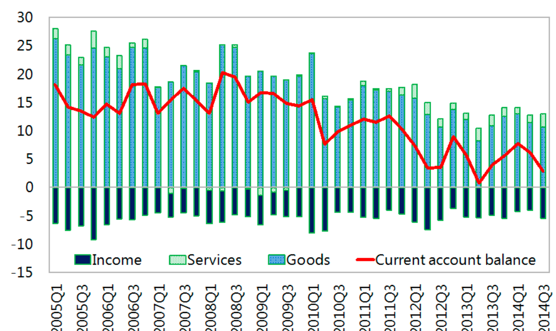
Real Gross Fixed Capital Formation
(In percent of GDP)



Source: CEIC Data Co. Ltd.

The current account surplus narrowed again as net exports of goods weakened and the income deficit widened.

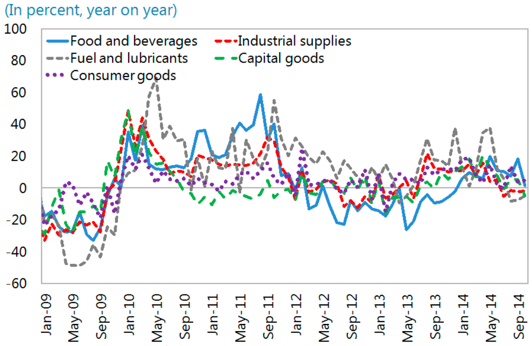
Current Account Balance
(In percent of GDP)



Source: CEIC Data Co. Ltd.

Exports grew strongly in the first half of the year but subsequently weakened.

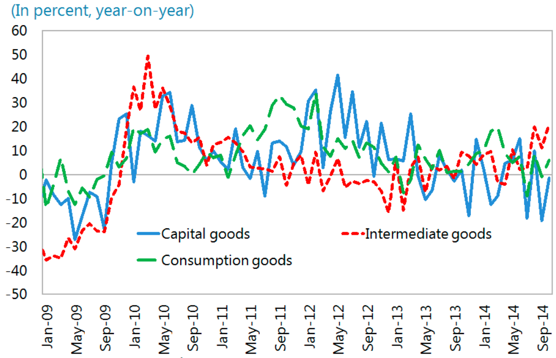
Export Growth
(In percent, year on year)



Source: CEIC Data Co. Ltd.

Imports of intermediate goods grew strongly in the second half of the year.

Import Growth
(In percent, year-on-year)

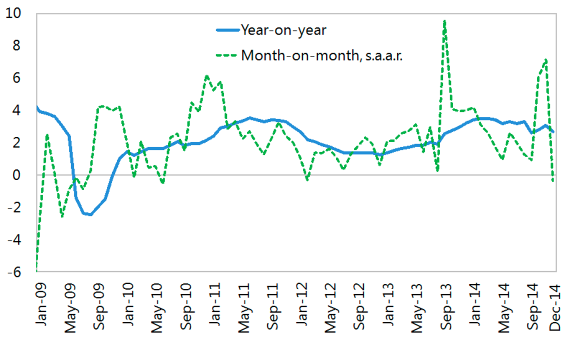


Source: CEIC Data Co. Ltd.

Figure 2. Malaysia: Inflation and Domestic Resource Constraints

Inflation remains low, although subsidy rationalization and administered price adjustments pushed up headline inflation in October 2014.

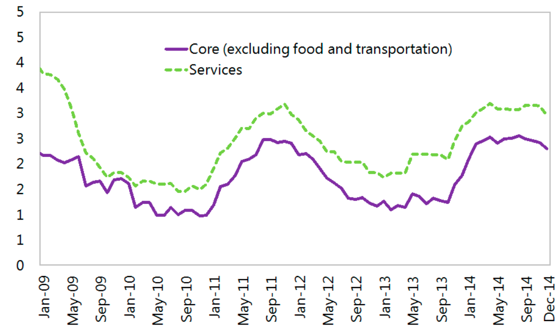
Consumer Price Index
(Percent change)



Sources: CEIC Data Co. Ltd.; and IMF staff calculations.

Core inflation remains subdued but was higher than in 2013…

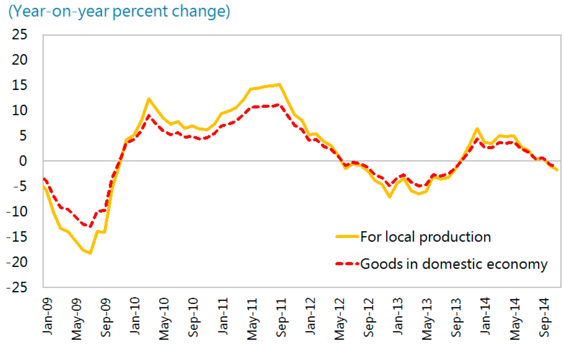
Inflation
(Year-on-year percent change)



Sources: CEIC Data Co. Ltd.; and IMF staff calculations.

…while producer price inflation has fallen and is now negative.

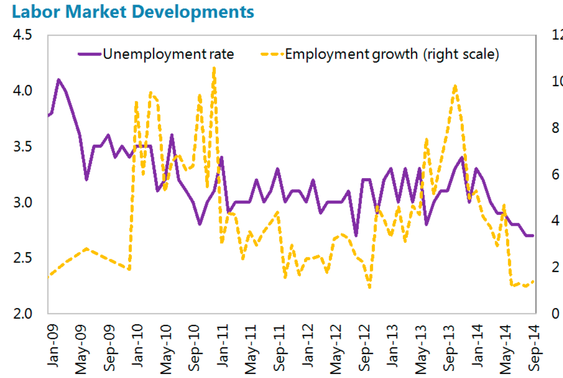
Producer Price Index
(Year-on-year percent change)



Sources: CEIC Data Co. Ltd.; and IMF staff calculations.

The labor market remains tight with low unemployment and …

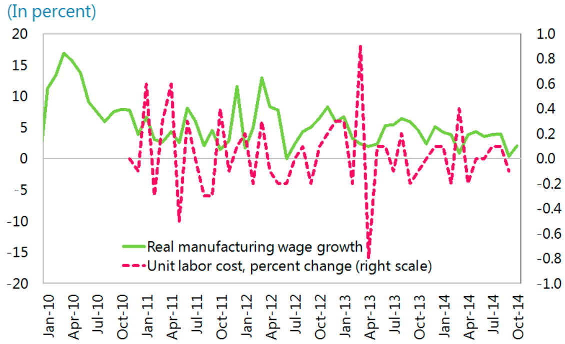
Labor Market Developments



Source: CEIC Data Co. Ltd.

…strong wage pressures.

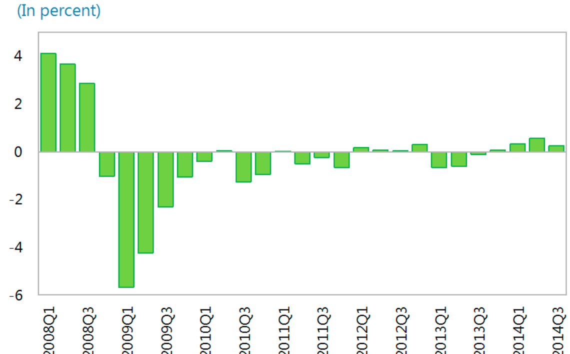
Real Wages and Unit Labor Costs in Manufacturing
(In percent)



Sources: CEIC Data Co. Ltd; and IMF staff calculations.

A positive output gap opened up at end-2013

Output Gap
(In percent)

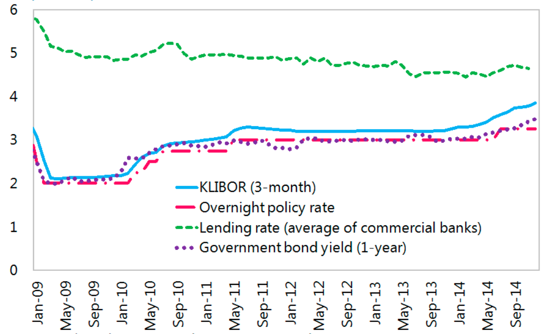


Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

Figure 3. Malaysia: Monetary Developments

Market interest rates have increased…

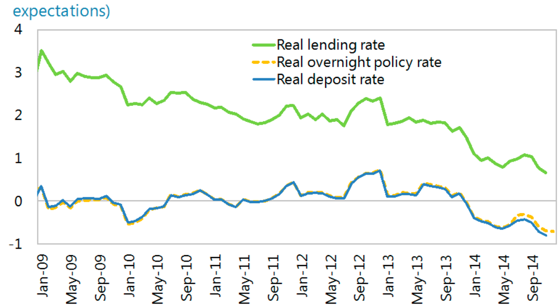
Interest Rates
(In percent per annum)



Sources: Bloomberg L.P.; and CEIC Data Co. Ltd.

…although real rates declined, as inflation picked up. Real deposit rates are negative…

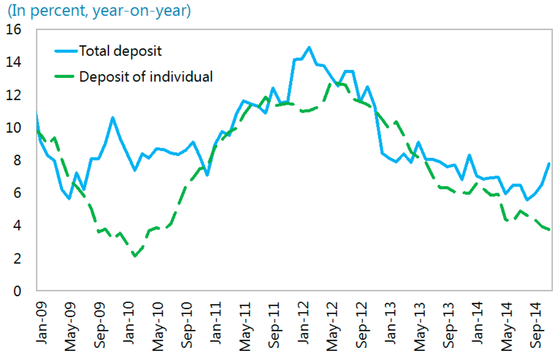
Real Interest Rates
(Percent per annum; nominal rates adjusted for 1–year ahead inflation expectations)



Sources: Bloomberg L.P.; CEIC Data Co. Ltd; Consensus Economics Inc.; and IMF staff estimates.

… and banking system deposit growth has slowed down.

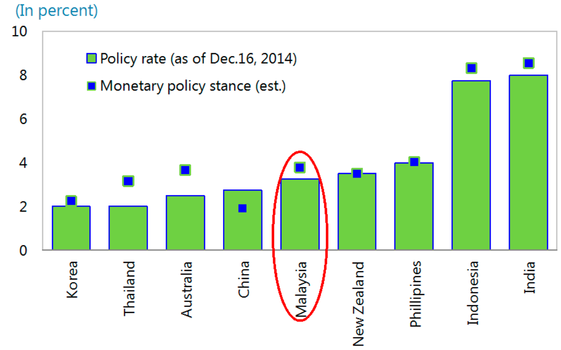
Banking System Deposit Growth
(In percent, year-on-year)



Sources: CEIC Data Co. Ltd.; and IMF staff calculations.

Policy rates are well calibrated to current conditions

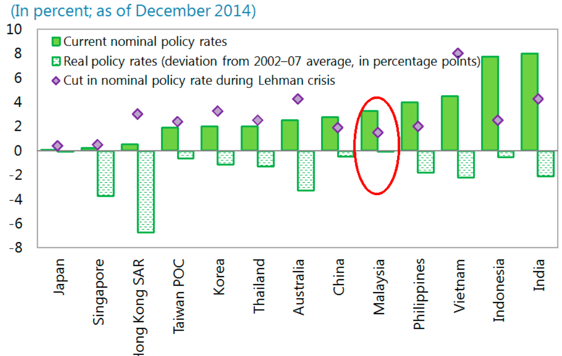
Monetary Policy Stances
(In percent)



Source: IMF staff calculations.

BNM has ample space to ease policy in a downside scenario.

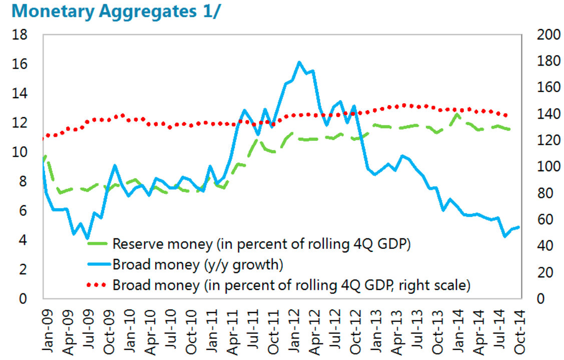
Selected Asia: Policy Rates
(In percent; as of December 2014)



Source: IMF, *Asia and Pacific Regional Economic Outlook*.

Broad money growth is slowing down.

Monetary Aggregates 1/

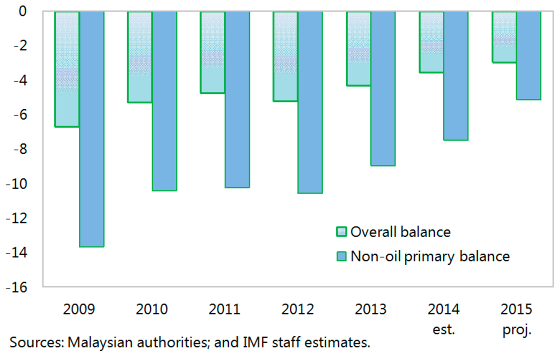


Sources: IMF, *Integrated Monetary database*; and IMF staff calculations.
1/ At depository corporations level.

Figure 4. Malaysia: Fiscal Policy Developments

The budget deficit is expected to decline in 2014–2015…

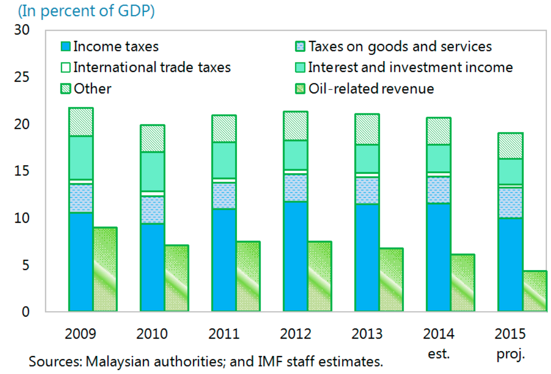
Federal Government Overall and Non-Oil Balance
(In percent of GDP)



Sources: Malaysian authorities; and IMF staff estimates.

… even as revenue declines.

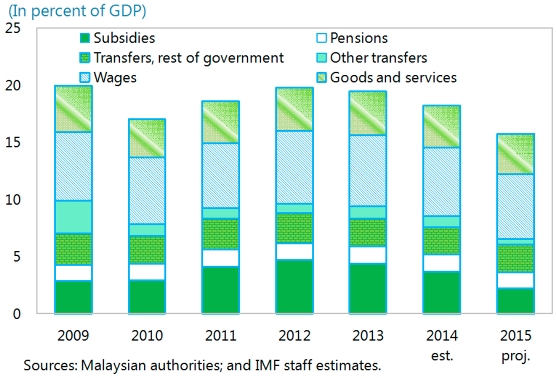
Federal Government Revenue
(In percent of GDP)



Sources: Malaysian authorities; and IMF staff estimates.

Expenditure is expected to decline with the recent subsidy reforms…

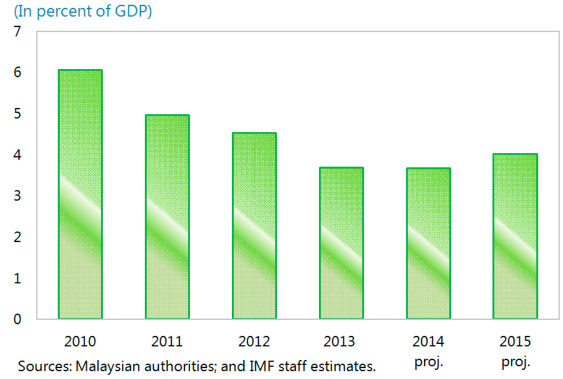
Federal Government Current Expenditures
(In percent of GDP)



Sources: Malaysian authorities; and IMF staff estimates.

…while federal development spending increases slightly.

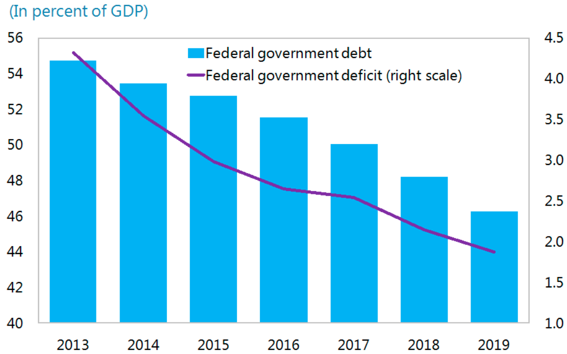
Federal Government Development Spending
(In percent of GDP)



Sources: Malaysian authorities; and IMF staff estimates.

Under staff's baseline projection, federal government debt would decline to below 50 percent in the medium-term.

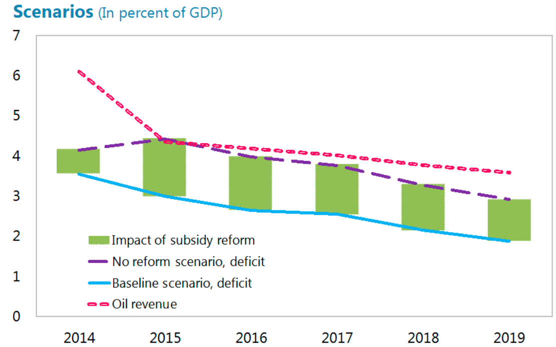
Medium–Term Fiscal Outlook
(In percent of GDP)



Source: IMF staff estimates.

Subsidy reform in the second half of 2014 has secured critical reduction in spending.

Federal Government Overall Deficit: Baseline Versus Alternate Scenarios (In percent of GDP)

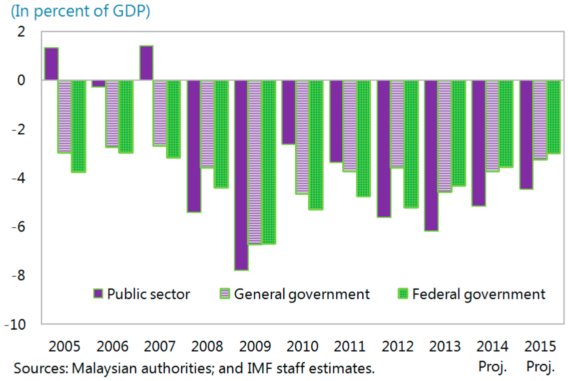


Sources: Malaysian authorities; and IMF staff estimates.

Figure 5. Malaysia: Public Sector Fiscal Stance and Prospects

The public sector balance has turned into a persistent deficit since 2008…

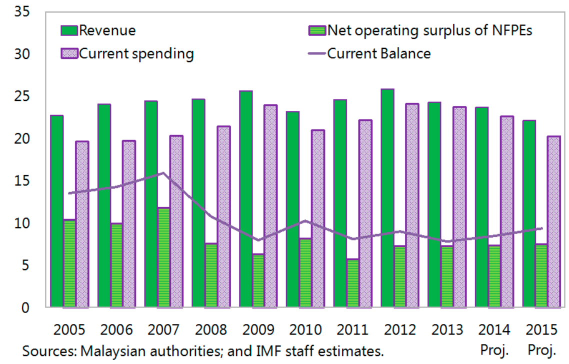
Fiscal Balance
(In percent of GDP)



Sources: Malaysian authorities; and IMF staff estimates.

…driven mainly by a decline in the net operating surplus of NFPEs and higher current spending.

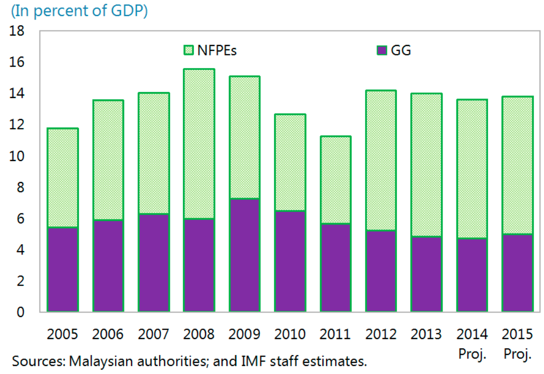
Current Balance of the Public Sector
(In percent of GDP)



Sources: Malaysian authorities; and IMF staff estimates.

Development spending (in particular by NFPEs) increased during the crisis and again in 2012, contributing to the public sector deficit.

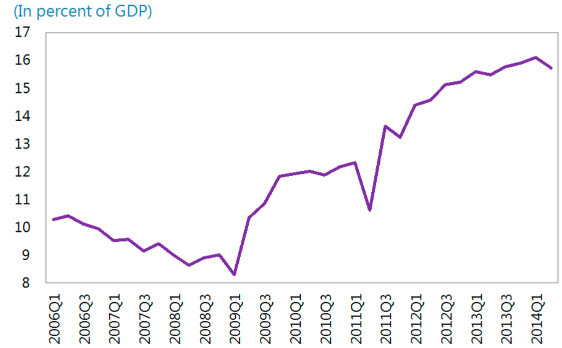
Development Spending
(In percent of GDP)



Sources: Malaysian authorities; and IMF staff estimates.

Federal government loan guarantees, a significant part of which is for NFPEs, have increased considerably since 2009.

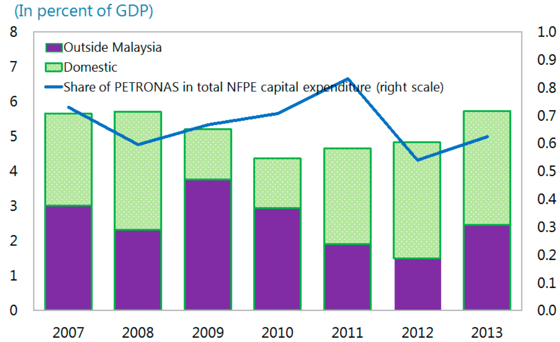
Federal Government Loan Guarantees
(In percent of GDP)



Source: CEIC Data Co.Ltd.

The oil and gas sector has been an important driver of capital expenditure by NFPEs which has shifted towards domestic projects in recent years.

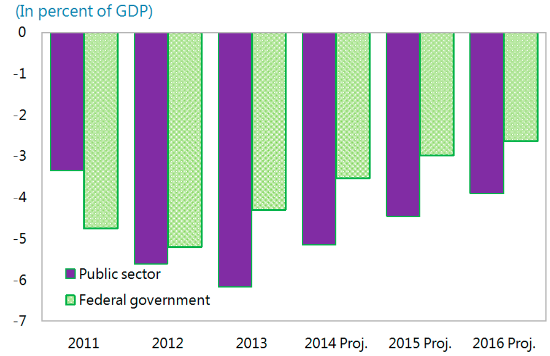
Capital Spending by PETRONAS
(In percent of GDP)



Sources: PETRONAS; Malaysian authorities; and IMF staff calculations.

The deficit of both the public and the federal government is expected to fall in the next medium term.

Fiscal Balance
(In percent of GDP)

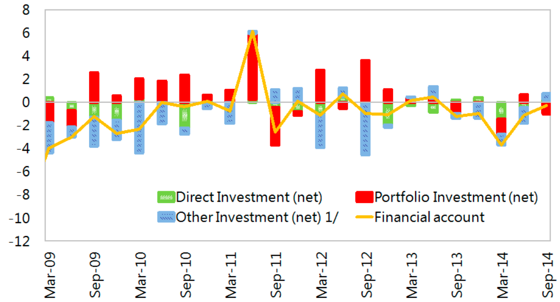


Sources: Malaysian authorities; and IMF staff estimates.

Figure 6. Malaysia: Capital Flows

Capital inflows have been volatile.

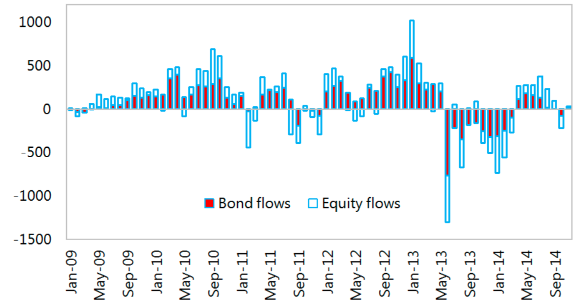
Financial Account
(In percent of 4-quarter rolling GDP)



Sources: CEIC Data Co. Ltd.; and IMF staff calculations.
1/ Includes financial derivatives.

The outflows after May 2013 reversed early this year, but resumed recently.

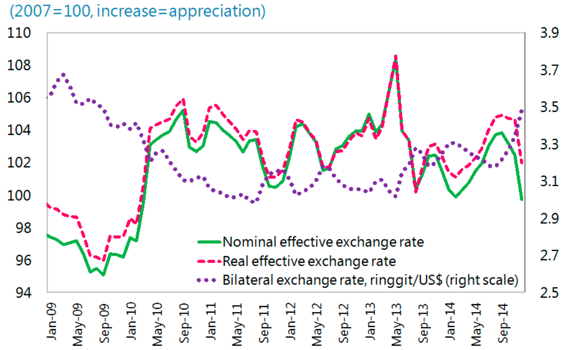
EPFR Global Funds Flows: Equity and Bond Funds 1/
(In millions of U.S. dollars)



Source: Haver Analytics.
1/ Monthly flows. Includes exchange traded funds and mutual funds.

The exchange rate has appreciated in the first part of the year and depreciated sharply recently.

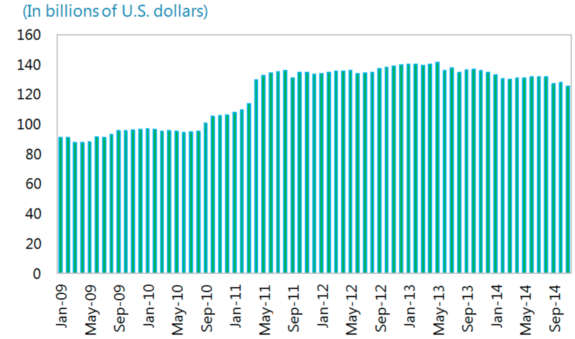
Effective Exchange Rate
(2007=100, increase=appreciation)



Sources: CEIC Data Co. Ltd.; and IMF staff calculations.

Reserves declined since May 2013.

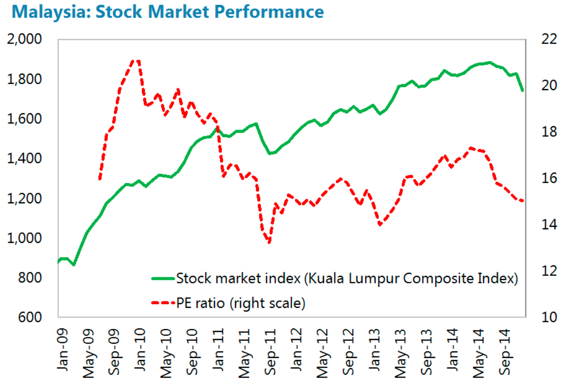
Reserves
(In billions of U.S. dollars)



Source: CEIC Data Co. Ltd.

The equity market declined in the last part of the year.

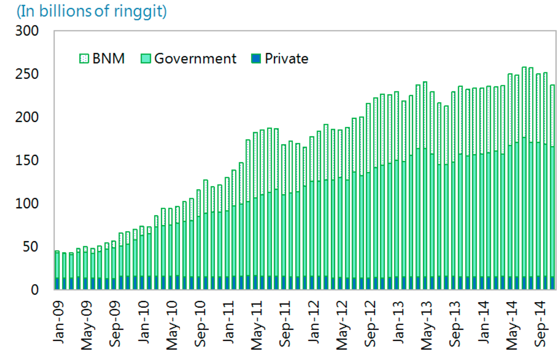
Malaysia: Stock Market Performance



Source: Bloomberg L.P.

Foreign holdings of debt securities declined.

Foreign Holdings of Debt Securities
(In billions of ringgit)

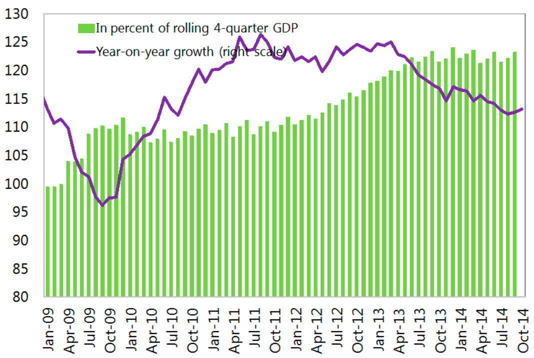


Sources: CEIC Data Co. Ltd.; and IMF staff calculations.

Figure 7. Malaysia: Financial Sector Developments

Aggregate credit growth has slowed down.

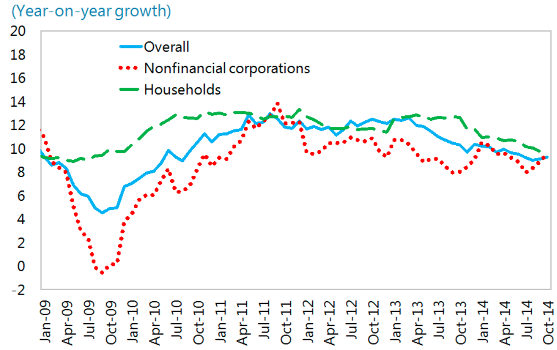
Banks' Claims on Private Sector



Sources: IMF, *Integrated Monetary database*; and IMF staff calculations.

Household credit growth has also slowed down but remains stronger than credit to businesses.

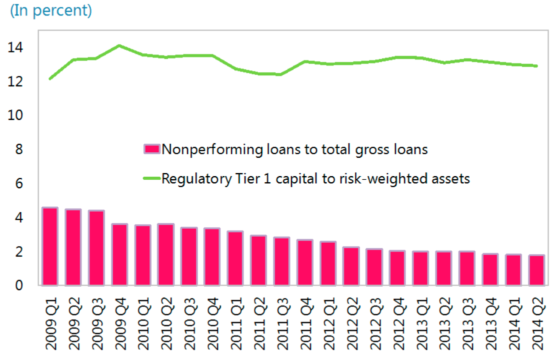
Banks' Claims on Private Sector
(Year-on-year growth)



Sources: IMF, *Integrated Monetary database*; and IMF staff calculations.

The banking system is well capitalized, while credit quality has steadily improved.

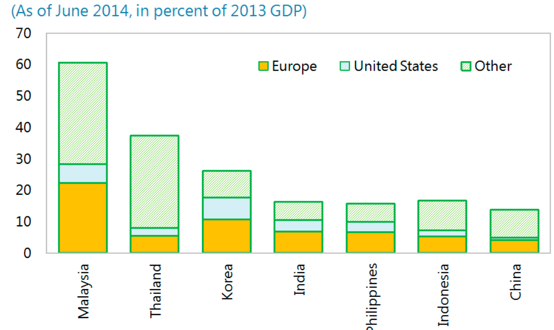
Banks' Financial Soundness Indicators
(In percent)



Source: IMF, *Financial Soundness Indicators* database.

Claims by foreign banks in Malaysia are high as a share of GDP...

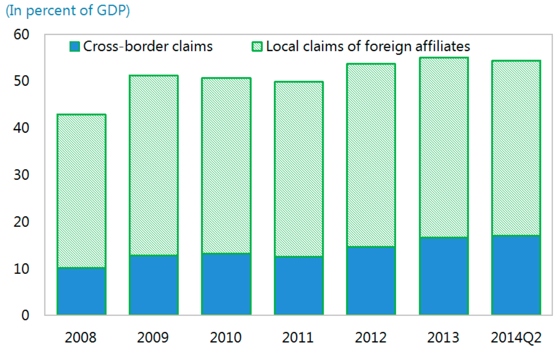
Foreign Banks' Claims on Selected Asian Countries
(As of June 2014, in percent of 2013 GDP)



Sources: Bank for International Settlements; IMF, *World Economic Outlook*.

...however, they reflect mostly claims by local affiliates of Singaporean and UK banks and are deposit funded.

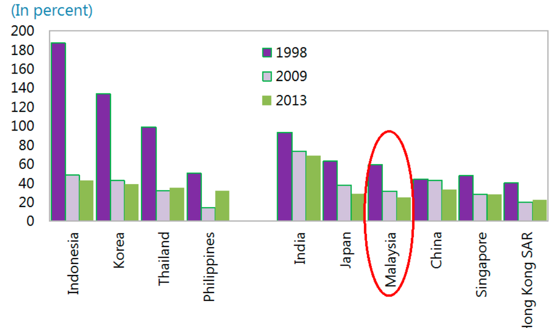
Total Claims by Foreign Banks
(In percent of GDP)



Sources: Bank for International Settlements; and IMF staff calculations.

Corporate leverage has declined significantly since the Asian Crisis.

Corporate Debt-to-Equity Ratio 1/
(In percent)

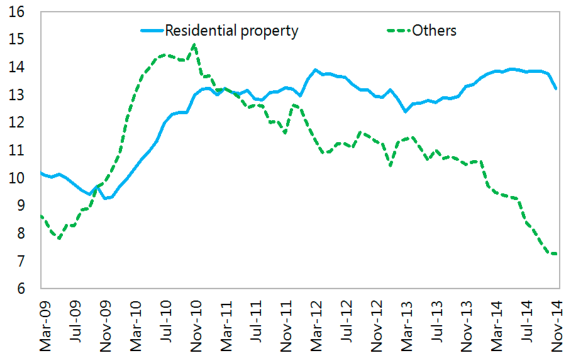


Source: IMF, *Corporate Vulnerability Indicators*.
1/ Median for nonfinancial corporates.

Figure 8. Malaysia: Household Debt

Housing and personal loans have grown rapidly, although personal lending growth has slowed considerably. …

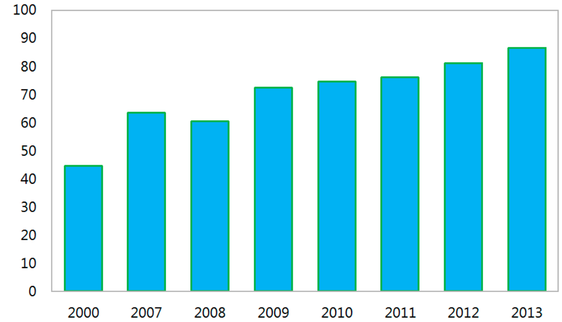
Household Loan Growth
(In percent, year-on-year)



Sources: CEIC Data Co. Ltd; and IMF staff calculations.

As a result, household debt has increased and…

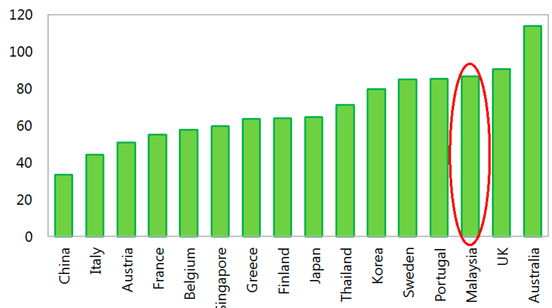
Household Debt
(In percent of GDP)



Sources: CEIC Data Co. Ltd.; and IMF staff calculations.

… is high compared to other countries…

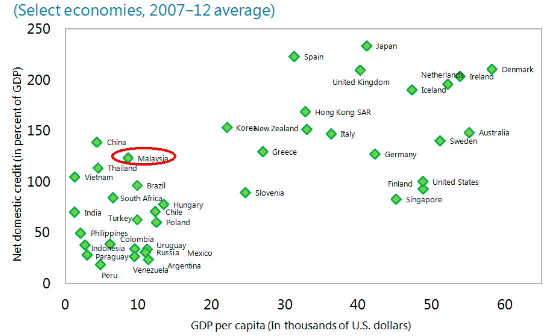
Household Debt, 2014 Q2
(In percent of GDP)



Sources: BIS Database; CEIC Data Co. Ltd.; IMF, *World Economic Outlook*; and IMF staff estimates.

… and is above the ratio in countries with a similar GDP per capita.

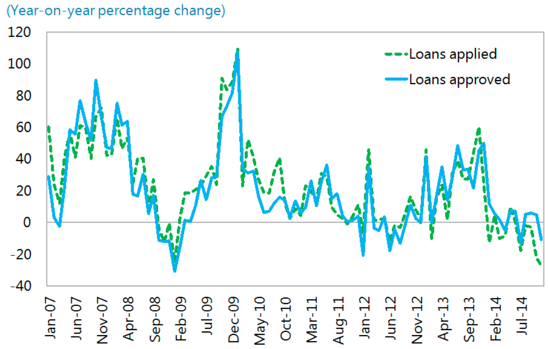
Net Domestic Credit and GDP per Capita
(Select economies, 2007–12 average)



Sources: World Bank, *World Development Indicators*; IMF, *World Economic Outlook*; and IMF staff calculations.

Loan approvals and applications have declined; a first sign of property market cooling.

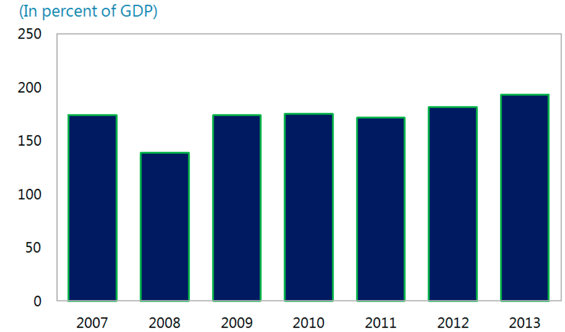
Malaysia: Loan Applications and Approvals
(Year-on-year percentage change)



Source: CEIC Data Co. Ltd.

High household financial assets mitigate the vulnerability from growing household debt.

Household Financial Assets
(In percent of GDP)

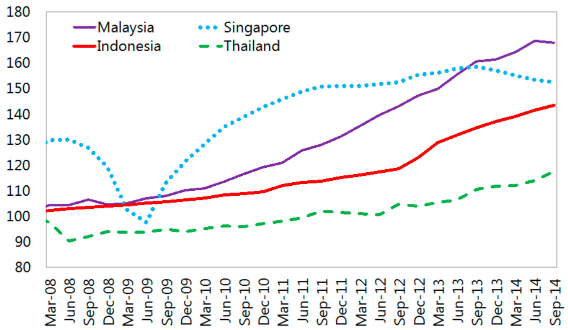


Sources: Malaysian Employee Provident Fund; CEIC Data Co. Ltd.; and IMF staff estimates.

Figure 9. Malaysia: House Prices

House prices have risen steadily…

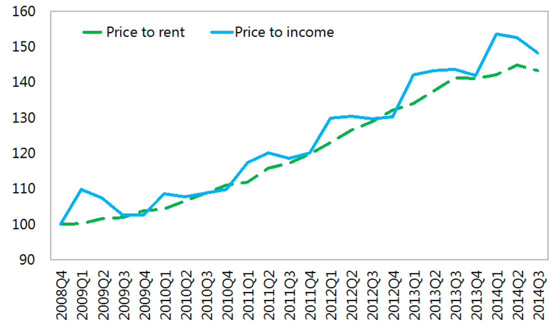
House Price Index
(2007:Q1 = 100)



Sources: CEIC Data Co. Ltd; and IMF staff calculations.

… outpacing incomes and rents.

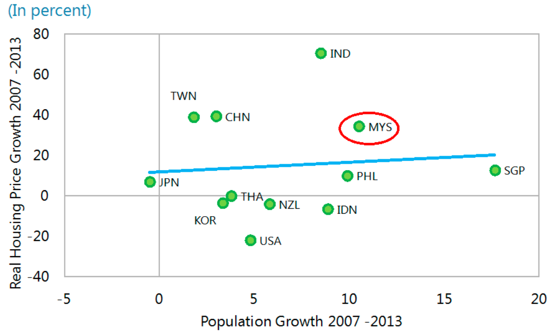
House Prices
(Ratio of indices, 2008:Q4=100)



Sources: CEIC Data Co. Ltd.; and IMF staff calculations.

Although population growth is strong this cannot fully explain the increase in house prices compared with other countries.

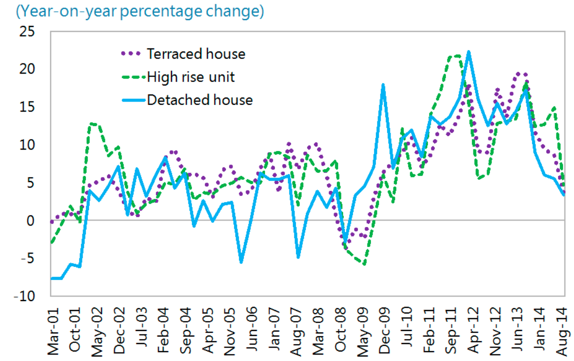
Housing Price and Population Growth
(In percent)



Sources: Global Property Guide; IMF, *World Economic Indicators*; and IMF staff estimates.

However, there are tentative signs of cooling in the housing market in Kuala Lumpur.

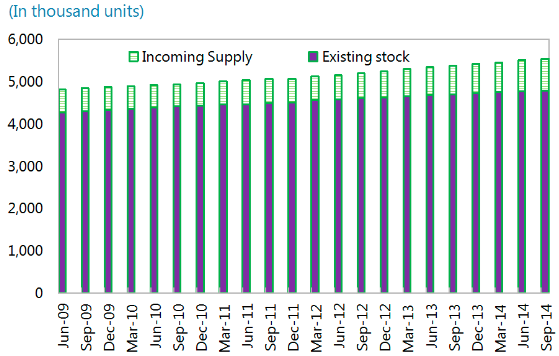
Malaysia: House Prices in Kuala Lumpur
(Year-on-year percentage change)



Source: CEIC Data Co. Ltd.

Residential supply is increasing…

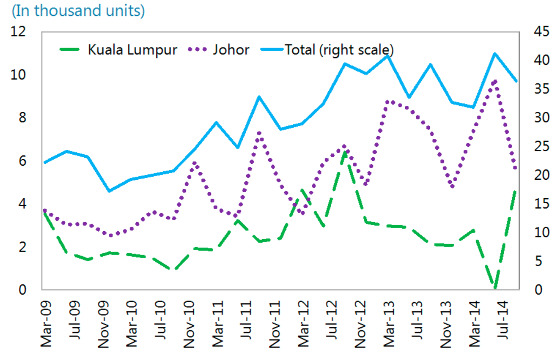
Residential Property Supply
(In thousand units)



Source: CEIC Data Co. Ltd.

…and is particularly strong in Johor and has recently recovered in KL.

Residential Property: Construction Started
(In thousand units)

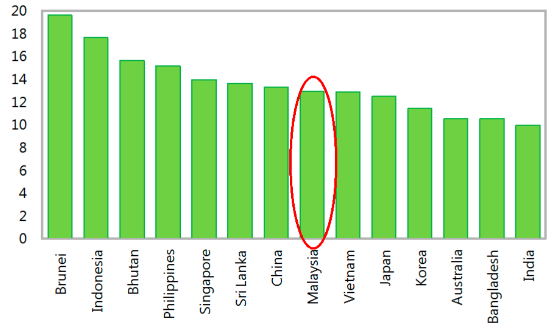


Source: CEIC Data Co.Ltd

Figure 10. Financial Soundness Indicators, 2014:Q2

Malaysian banks' capital buffers are strong…

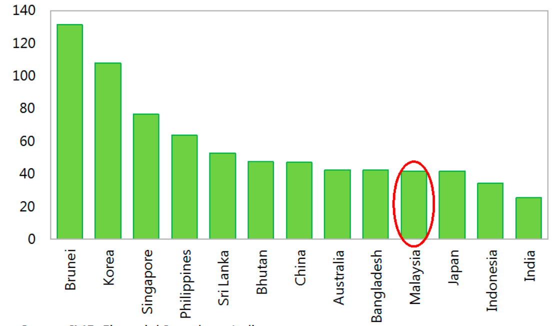
Regulatory Tier 1 Capital to Risk-Weighted Assets
(In percent)



Source: IMF, *Financial Soundness Indicators*.

…but one-year liquidity coverage could improve further.

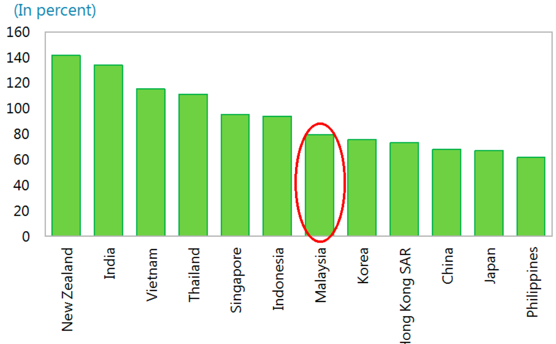
Liquid Assets to Short-Term Liabilities
(In percent)



Source: IMF, *Financial Soundness Indicators*.

Lending in proportion to deposits is reasonable…

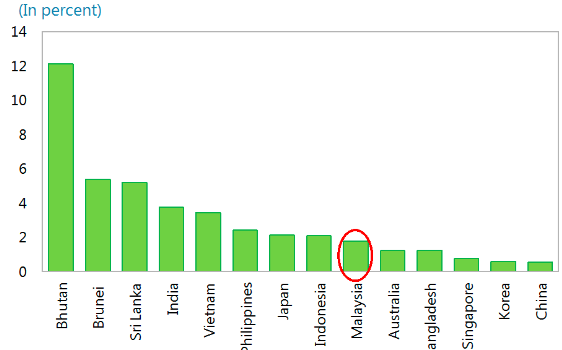
Loan to Deposit Ratio
(In percent)



Sources: CEIC Data Co. Ltd.; Haver Analytics; and IMF staff calculations.

… while asset quality is moderately high

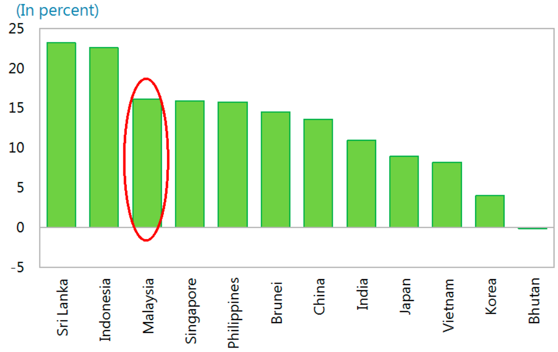
Nonperforming Loans to Total Gross Loans
(In percent)



Source: IMF, *Financial Soundness Indicators*.

Banks are profitable

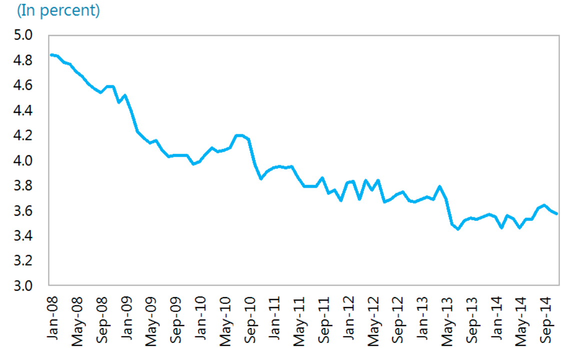
Return on Equity
(In percent)



Source: IMF, *Financial Soundness Indicators*.

… but interest rate spreads have fallen.

Interest Rate Spreads
(In percent)



Sources: Bank Negara Malaysia; and IMF staff calculations.

Table 1. Malaysia: Selected Economic and Financial Indicators, 2010–15

Nominal GDP (2013): US$313 billion
Main export (percent of total): electrical & electronic products (39%), commodities (23%)
GDP per capita (2013): US$10,468
Population (2013): 29.9 million
Unemployment rate (2013): 3.1 percent

	2010	2011	2012	2013	Est. 2014	Proj. 2015
Real GDP (percent change)	7.4	5.2	5.6	4.7	5.9	4.8
Total domestic demand	11.1	7.1	11.1	6.4	5.5	5.4
Consumption	6.2	8.8	7.5	7.0	6.5	5.1
Private consumption	6.9	6.9	8.2	7.2	7.6	6.2
Gross capital formation	25.3	3.0	20.3	4.9	3.0	5.9
Public gross fixed capital formation	4.9	2.6	14.6	2.2	2.6	4.4
Private gross fixed capital formation	18.4	9.4	22.8	13.1	9.0	6.5
Saving and investment (in percent of GDP)						
Gross domestic investment	23.3	23.2	25.9	26.1	26.8	27.6
Gross national saving	34.2	34.8	31.7	30.1	30.3	30.5
Fiscal sector (in percent of GDP)						
Federal government overall balance 1/	-5.3	-4.8	-5.2	-4.3	-3.5	-3.2
Revenue	19.9	20.9	21.3	21.1	20.7	19.3
Expenditure and net lending	25.2	25.7	26.5	25.4	24.2	22.5
Federal government non-oil primary balance	-10.4	-10.2	-10.6	-9.0	-7.5	-5.0
Consolidated public sector overall balance 2/	-2.6	-3.4	-5.6	-6.2	-5.2	-4.7
General government debt	53.5	54.2	56.2	57.7	56.4	55.9
Inflation and unemployment (period average, in percent)						
CPI inflation (period average)	1.7	3.2	1.7	2.1	3.1	3.2
Unemployment rate	3.3	3.1	3.0	3.1	3.0	3.0
Money and credit (end of period, percentage change)						
Total liquidity (M3)	6.8	14.3	9.0	8.1	7.1	...
Credit to private sector	9.7	12.1	11.9	9.9	9.3	...
Three-month interbank rate (in percent)	3.0	3.2	3.2	3.2	3.9	...
Corporate debt (in percent of GDP) 3/	52.5	45.3	47.6	54.4	57.7	...
Household debt (in percent of GDP)	74.5	76.2	81.2	86.6	...	...
House prices (percentage change)	6.9	9.8	11.8	10.9	...	...
Balance of payments (in billions of U.S. dollars)						
Current account balance	27.1	33.5	17.6	12.3	11.7	10.4
(In percent of GDP)	10.9	11.6	5.8	4.0	3.5	2.9
Trade balance	42.5	49.5	40.5	34.3	35.4	33.1
Services and income account balance	-8.6	-9.2	-16.9	-16.1	-17.1	-18.1
Capital and financial account balance	-6.2	7.6	-7.5	-5.0	-30.5	-2.7
Overall balance	-0.8	30.9	1.3	4.6	-18.8	7.7
Gross official reserves (US$ billions)	106.5	133.6	139.7	134.9	116.1	123.8
(In months of following year's imports)	5.9	7.1	7.4	6.8	5.6	5.6
(In percent of short-term debt) 4/ 5/	121.0	126.1	119.1	104.4	81.0	78.7
Total external debt (US$ billions)	141.8	169.4	196.2	211.7	230.0	249.7
(In percent of GDP)	57.3	58.5	64.3	67.6	69.4	69.5
Of which: short-term (in percent of total) 4/	62.1	62.6	59.8	61.1	62.3	63.1
Debt service ratio 5/						
(In percent of exports of goods and services)	8.4	11.1	11.4	11.7	12.0	12.2
(In percent of exports of goods and nonfactor services)	8.8	11.8	12.0	12.4	12.7	12.9
Memorandum items:						
Nominal GDP (in billions of US$)	248	289	305	313	331	359

Sources: CEIC Data Co. Ltd; Data provided by the authorities; Dealogic; and Fund staff estimates.

1/ Based on staff's estimate of the federal government fiscal balance using GFSM 2001, which differs from the authorities' cash-based measure of the fiscal deficit.

2/ Capital expenditure in the budget includes foreign fixed assets and other items, such as purchase of shares and land, which are excluded from public investment in the national accounts.

3/ Non-financial corporates by parent nationality.

4/ By remaining maturity.

5/ On foreign currency denominated debt only.

Table 2. Malaysia: Indicators of External Vulnerability, 2009–14

	2009	2010	2011	2012	2013	Est. 2014
Financial indicators						
General government debt (in percent of GDP) 1/	52.8	53.5	54.2	56.2	57.7	56.4
Total liquidity (M3: percent change, 12-month basis)	9.2	6.8	14.3	9.0	8.1	7.1
Private sector credit (percent change, 12-month basis)	6.2	9.7	12.1	11.9	9.9	9.3
Treasury bill interest rate (percent, 12-month average) 2/	2.1	2.6	2.9	3.2	3.2	3.9
External indicators						
Exports (percent change, 12-month basis in U.S. dollars)	-21.1	26.9	14.9	-2.9	-3.0	5.0
Imports (percent change, 12-month basis in U.S. dollars)	-20.7	33.8	14.4	1.4	-0.2	5.3
Current account balance (in billions of U.S. dollars)	31.4	27.1	33.5	17.6	12.3	11.7
Current account balance (in percent of GDP)	15.5	10.9	11.6	5.8	4.0	3.5
Capital and financial account balance (in billions of U.S. dollars)	-22.8	-6.2	7.6	-7.5	-4.7	-30.5
Gross official reserves (in billions of U.S. dollars)	96.7	106.5	133.6	139.7	134.9	116.1
In months of following year's imports of goods and nonfactor services	6.1	5.9	7.1	7.4	6.8	5.6
As percent of total liquidity (M3)	32.5	30.0	34.2	31.6	32.0	29.4
As percent of monetary base	603.8	532.6	440.2	420.7	451.8	417.0
Total short-term external debt by:						
Original maturity (in billions of U.S. dollars)	48.6	62.3	80.8	92.1	102.9	117.4
Remaining maturity (in billions of U.S. dollars)	64.3	88.0	106.0	117.3	129.2	143.3
Original maturity to reserves (in percent)	50.2	58.5	60.5	66.0	76.2	101.1
Original maturity to total external debt (in percent)	42.8	43.9	47.7	47.0	48.6	51.1
Remaining maturity to reserves (in percent)	66.5	82.7	79.3	84.0	95.8	123.4
Remaining maturity to total external debt (in percent)	56.7	62.1	62.6	59.8	61.1	62.3
Total external debt (in billions of U.S. dollars)	113.4	141.8	169.4	196.2	211.7	230.0
Of which : public and publicly guaranteed debt	38.2	52.6	60.1	71.9	72.9	73.2
Total external debt to exports of goods and services (in percent)	57.8	58.4	60.1	71.7	78.1	80.9
External amortization payments to exports of goods and services (in percent)	5.2	6.5	9.1	9.2	9.3	9.3
Financial market indicators						
Kuala Lumpur Composite Index (KLCI), end of period	1,273	1,519	1,531	1,689	1,867	1,804
10-years government securities yield (percent per annum, average)	4.1	4.0	3.9	3.5	3.7	3.8

Sources: Haver Analytics; data provided by the authorities; and Fund staff estimates.

1/ Gross debt.
2/ Discount rate on 3-month treasury bills.

Table 3. Malaysia: Balance of Payments, 2010–15

	2010	2011	2012	2013	Proj. 2014	Proj. 2015
			(In billions of U.S. dollars)			
Current account balance	27.1	33.5	17.6	12.7	11.7	10.4
Trade balance	42.5	49.5	40.5	34.3	35.4	33.1
Exports, f.o.b.	199.0	228.6	222.1	215.5	226.3	228.6
Imports, f.o.b.	156.6	179.1	181.6	181.2	190.8	195.5
Services and income account balance	-8.6	-9.2	-16.9	-16.1	-17.1	-18.1
Receipts	43.8	53.3	51.6	55.3	57.8	60.2
Of which : income	11.9	17.2	13.7	15.1	16.6	17.2
Payments	52.5	62.5	68.5	71.4	74.9	78.3
Of which : income	20.1	24.3	25.4	25.9	26.2	26.5
Net transfers	-6.8	-6.9	-6.0	-5.6	-6.6	-4.5
Capital and financial account balance	-6.2	7.6	-7.4	-5.0	-30.5	-2.7
Capital account	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-6.2	7.6	-7.4	-5.0	-30.5	-2.7
Net foreign direct investment	-4.3	-3.1	-7.9	-1.7	-5.6	-6.0
Portfolio investment	15.0	8.5	20.7	-1.0	14.9	16.2
Drawings	1.4	2.1	0.2	0.2	0.2	0.2
Repayments	0.3	2.0	0.2	0.3	0.3	0.4
Other investment	-16.9	2.1	-20.2	-2.3	-39.9	-12.8
Errors and omissions	-21.7	-10.1	-9.0	-3.0	0.0	0.0
Overall balance	-0.8	30.9	1.3	4.6	-18.8	7.7
Overall financing	0.8	-30.9	-1.3	-4.6	18.8	-7.7
Gross official reserves	106.5	133.6	139.7	134.9	116.1	123.8
In months of following year's imports of goods and nonfactor services	5.9	7.1	7.4	6.8	5.6	5.6
In percent of short-term debt 1/	121.0	126.1	119.1	104.4	81.0	78.7
			(In percent of GDP)			
Current account balance	10.9	11.6	5.8	4.0	3.5	2.9
(Excluding oil and gas)	4.1	4.1	-1.0	-2.1	-2.2	-1.4
Trade balance	17.2	17.1	13.3	11.0	10.7	9.2
Exports	80.4	79.0	72.8	68.8	68.3	63.6
Imports	63.3	61.9	59.5	57.9	57.6	54.4
Services and income account balance	-3.5	-3.2	-5.5	-5.2	-5.2	-5.0
Capital and financial account balance	-2.5	2.6	-2.4	-1.6	-9.2	-0.8
Net foreign direct investment	-1.8	-1.1	-2.6	-0.6	-1.7	-1.7
			(Annual percentage change)			
Memorandum items:						
Export value growth (in U.S. dollars)	26.9	14.9	-2.9	-3.0	5.0	1.0
Export volume growth	10.1	5.3	-3.8	1.9	1.9	7.4
Import value growth (in U.S. dollars)	33.8	14.4	1.4	-0.2	5.3	2.5
Import volume growth	18.1	4.6	0.3	5.9	4.3	4.7
Terms of trade	2.0	0.1	-0.7	-0.4	9.3	-3.9
Net international investment position						
(In billions of U.S. dollars)	4.0	11.9	-5.8	-15.0	…	…
(In percent of GDP)	1.6	4.1	-1.9	-4.8	…	…

Sources: Data provided by the authorities; and Fund staff estimates.

1/ By remaining maturity.

Table 4. Malaysia: Illustrative Medium-Term Macroeconomic Framework, 2011–20 1/

				Est.	Proj.					
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Real sector (percent change)										
Real GDP growth	5.2	5.6	4.7	5.9	4.8	4.9	5.0	5.0	5.0	5.0
Total domestic demand	7.1	11.1	6.4	5.5	5.4	5.5	5.6	5.7	5.5	5.2
CPI inflation (period average)	3.2	1.7	2.1	3.1	3.2	3.0	3.0	3.0	3.0	3.0
Saving and investment (in percent of GDP)										
Gross domestic investment	23.2	25.9	26.1	26.8	27.6	27.6	27.6	27.9	28.1	28.2
Private, including stocks	13.7	15.2	15.6	16.6	17.3	17.6	17.8	18.1	18.5	18.9
Of which: gross fixed capital formation	12.7	14.9	16.3	16.8	17.3	17.6	17.8	18.1	18.5	18.9
Public	9.5	10.8	10.5	10.2	10.3	10.0	9.8	9.7	9.6	9.3
Gross national saving	34.8	31.7	30.1	30.3	30.5	30.0	29.8	29.9	30.1	30.3
Private	26.7	22.7	22.3	21.9	21.2	20.5	20.2	19.7	19.5	19.6
Public	8.1	9.0	7.84	8.4	9.3	9.5	9.6	10.2	10.6	10.7
Fiscal sector (in percent of GDP)										
Federal government overall balance	-4.8	-5.2	-4.3	-3.5	-3.2	-2.6	-2.5	-2.1	-1.9	-1.5
Revenue	20.9	21.3	21.1	20.7	19.3	19.8	19.8	20.2	20.5	20.4
Tax	15.2	16.1	15.8	15.8	14.8	15.7	15.7	16.3	16.7	16.8
Non-tax	5.7	5.2	5.2	4.8	4.5	4.2	4.1	3.9	3.8	3.6
Expenditure	25.7	26.5	25.4	24.2	22.5	22.4	22.3	22.3	22.4	21.8
Current	20.7	22.0	21.7	20.5	18.7	18.6	18.6	18.5	18.6	18.4
Development	5.0	4.5	3.7	3.7	3.8	3.8	3.7	3.7	3.8	3.5
Federal government non-oil primary balance	-10.2	-10.6	-9.0	-7.5	-5.0	-4.2	-4.0	-3.4	-3.0	-2.5
Consolidated public sector overall balance 2/	-3.4	-5.6	-6.2	-5.2	-4.7	-3.8	-3.5	-2.8	-2.3	-1.6
General government debt	54.2	56.2	57.7	56.4	55.9	54.6	53.0	51.2	49.3	47.2
Of which: federal government debt	51.5	53.3	54.7	53.4	52.9	51.6	50.0	48.2	46.3	44.2
Balance of payments (in billions of U.S. dollars)										
Trade balance	49.5	40.5	34.3	35.4	33.1	36.9	40.0	42.6	46.6	50.9
Services and income account balance	-9.2	-16.9	-16.1	-17.1	-18.1	-20.3	-22.6	-24.5	-26.7	-28.7
Current account balance	33.5	17.6	12.3	11.7	10.4	9.4	9.4	9.4	10.3	11.9
(In percent of GDP)	11.6	5.8	4.0	3.5	2.9	2.4	2.2	2.0	2.0	2.1
Capital and financial account balance	7.6	-7.5	-5.0	-30.5	-2.7	1.3	1.1	1.6	0.0	-3.1
Errors and omissions	-10.1	-9.0	-3.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	30.9	1.3	4.6	-18.8	7.7	10.7	10.5	11.0	10.3	8.8
International trade (annual percent change)										
Export value	14.9	-2.9	-3.0	5.0	1.0	7.8	6.8	6.3	5.9	5.9
Import value	14.4	1.4	-0.2	5.3	2.5	7.2	6.4	6.2	5.3	5.3
Terms of trade	0.1	-0.7	-0.4	9.3	-3.9	-0.8	-0.7	-0.6	-0.1	-0.1
Gross official reserves (in billions of U.S. dollars)	133.6	139.7	134.9	116.1	123.8	134.5	145.0	156.0	166.3	175.1
(In months of following year's imports)	7.1	7.4	6.8	5.6	5.6	5.7	5.7	5.7	5.7	5.7
(In percent of short-term debt) 3/	126.1	119.1	104.4	81.0	78.7	81.3	84.3	90.3	98.5	97.0
Total external debt (in billions of U.S. dollars)	169.4	196.2	211.7	230.0	249.7	263.1	274.7	281.2	294.7	309.3
(In percent of GDP)	58.5	64.3	67.6	69.4	69.5	67.3	63.9	59.6	56.8	55.0
Short-term external debt (percent of total) 3/	62.6	59.8	61.1	62.3	63.1	62.9	62.6	61.4	57.3	58.4
Debt-service ratio										
(In percent of exports of goods and services)	11.1	11.4	11.7	12.0	12.2	11.9	11.2	10.0	8.8	8.1
Net international investment position (in billions of U.S. dollars)	11.9	-5.8	-15.0	...	...	...	...	...	...	...
Memorandum items:										
Nominal GDP (in billions of ringgit)	885	942	987	1,081	1,156	1,247	1,353	1,469	1,594	1,728

Sources: Data provided by the authorities; and Fund staff estimates.

1/ Period ending December 31.

2/ Capital expenditure in the budget includes foreign fixed assets and other items, such as purchases of shares and land, which are excluded from public investment in the national accounts.

3/ By remaining maturity.

Table 5. Malaysia: Summary of Federal Government Operations and Stock Positions, 2010–15

	2010	2011	2012	2013	2014 Proj.	2015 Proj.
I. Statement of Government Operations						
			(In millions of ringgit)			
Revenue	158,453	185,419	200,913	208,001	223,562	223,104
Taxes	109,515	134,885	151,643	155,952	171,066	170,763
Other revenue	48,938	50,534	49,270	52,049	52,496	52,341
Expenditure	200,729	227,511	250,015	250,574	261,545	260,140
Expense	152,429	183,639	207,357	213,893	221,952	215,840
Compensation of employees	46,663	50,148	60,016	61,002	65,357	65,652
Use of goods and services	26,507	32,660	35,553	37,898	39,750	39,662
Interest	15,621	17,716	19,537	20,776	23,334	25,486
Subsidies	23,106	36,256	44,075	43,349	39,508	26,988
Of which : fuel subsidies (including cash assistance)	9,605	20,375	27,898	27,355	20,591	7,304
Grants	27,862	32,157	32,631	34,795	36,245	38,788
Social benefits and other expense	12,670	14,703	15,545	16,073	17,758	19,264
Net acquisition of nonfinancial assets	48,299	43,871	42,658	36,681	39,593	44,300
Gross operating balance	6,024	1,779	-6,445	-5,891	1,609	7,264
Net lending/borrowing	-42,276	-42,092	-49,103	-42,572	-37,984	-37,036
Overall fiscal balance (authorities' definition) 1/	-43,276	-42,509	-41,951	-38,583	-37,984	-37,036
Net acquisition of financial assets	-2,156	3,527	-5,773	-3,269	-1,145	-1,428
By financial instrument						
Currency and deposits	-3,156	3,109	1,378	721	-1,145	-1,428
Loans and equity	1,000	417	-7,151	-3,990	0	0
By holder residence						
Domestic	-2,156	3,527	-5,773	-3,269	-1,145	-1,428
Foreign	…	…	…	…	…	…
Net incurrence of liabilities	40,120	45,619	43,331	39,305	36,839	36,099
By financial instrument						
Debt securities	36,456	45,069	43,344	39,526	…	…
Loans	3,664	550	-14	-222	…	…
By holder residence						
Domestic	3,567	15,811	15,204	30,268	…	…
Foreign	36,553	29,808	28,127	9,037	…	…
			(In percent of GDP)			
Revenue	19.9	20.9	21.3	21.1	20.7	19.3
Taxes	13.7	15.2	16.1	15.8	15.8	14.8
Other revenue	6.1	5.7	5.2	5.3	4.9	4.5
Expenditure	25.2	25.7	26.5	25.4	24.2	22.5
Expense	19.1	20.7	22.0	21.7	20.5	18.7
Compensation of employees	5.9	5.7	6.4	6.2	6.0	5.7
Use of goods and services	3.3	3.7	3.8	3.8	3.7	3.4
Interest	2.0	2.0	2.1	2.1	2.2	2.2
Subsidies	2.9	4.1	4.7	4.4	3.7	2.3
Of which : fuel subsidies (including cash assistance)	1.2	2.3	3.0	2.8	1.9	0.6
Grants	3.5	3.6	3.5	3.5	3.4	3.4
Social benefits and other expense	1.6	1.7	1.7	1.6	1.6	1.7
Net acquisition of nonfinancial assets	6.1	5.0	4.5	3.7	3.7	3.8
Gross operating balance	0.8	0.2	-0.7	-0.6	0.1	0.6
Net lending/borrowing	-5.3	-4.8	-5.2	-4.3	-3.5	-3.2
Overall fiscal balance (authorities' definition) 1/	-5.4	-4.8	-4.5	-3.9	-3.5	-3.2
II. Stock Positions						
			(In millions of ringgit)			
Liabilities (nominal value)	407,101	456,128	501,617	539,858	…	
By financial instrument						
Debt securities	346,813	392,033	439,970	481,895	…	
Loans	60,288	64,095	61,647	57,963	…	
By holder residence						
Domestic	315,344	333,755	352,359	381,426	…	
Foreign	91,757	122,373	149,258	158,432	…	
Memorandum items:						
Cyclically adjusted balance (percent of potential GDP)	-4.8	-4.9	-5.5	-4.5	-3.9	-2.8
Structural primary balance (percent of potential GDP)	-2.8	-2.9	-3.4	-2.4	-1.7	-0.6
Primary balance (percent of GDP)	-3.3	-2.8	-3.1	-2.2	-1.4	-1.0
Non-oil and gas primary balance (percent of GDP)	-10.4	-10.2	-10.6	-9.0	-7.4	-5.0
Oil and gas revenues (percent of GDP)	7.1	7.5	7.4	6.7	6.1	4.0
General government balance (percent of GDP) 2/	-4.7	-3.7	-3.6	-4.5	-3.7	-3.5
Public sector balance (percent of GDP) 2/	-2.6	-3.4	-5.6	-6.2	-5.1	-4.7
Nominal GDP (in millions of ringgit)	797,327	885,341	941,950	986,733	1,080,608	1,156,425

Sources: Data provided by the Malaysian authorities; and Fund staff estimates.

1/ Authorities' measure of the overall fiscal balance and the IMF's measure of fiscal balance (net lending/borrowing) are different due to differences in methodology/basis of recording (GFSM2001 versus authorities' modified-cash based accounting) and differences in the treatment of certain items.

2/ General government includes federal government, state and local governments and statutory bodies. Public sector includes general government and NFPEs.

Table 6. Malaysia: Monetary Survey, 2010–14

	2010	2011	2012	2013	2014 1/
	(In millions of ringgit; end of period)				
Net foreign assets	284,190	356,968	347,381	327,165	320,047
Foreign assets	420,705	541,182	560,083	583,632	591,034
Foreign liabilities	136,514	184,214	212,702	256,466	270,987
Net domestic assets	780,755	863,756	981,330	1,091,692	1,162,992
Net domestic credit	1,005,859	1,127,900	1,254,165	1,399,702	1,478,893
Net credit to nonfinancial public sector	56,766	63,870	69,849	93,186	99,978
Credit to private sector	879,943	988,555	1,108,437	1,223,492	1,309,768
Net credit to other financial corporations	69,151	75,475	75,880	83,025	69,147
Capital accounts	164,564	191,463	207,478	248,470	273,496
Other items (net)	-60,540	-72,681	-65,358	-59,540	-42,405
Broad money	1,064,945	1,220,725	1,328,710	1,418,857	1,483,039
Narrow money	239,784	272,942	308,954	347,676	352,794
Currency in circulation	47,685	53,488	56,798	62,715	65,737
Transferable deposits	192,100	219,454	252,156	284,961	287,057
Other deposits	798,978	919,714	992,648	1,049,244	1,100,087
Securities other than shares	26,183	28,058	25,885	21,767	30,158
Repurchase agreements	0	10	1,223	170	0
	(Contribution to 12-month growth in broad money)				
Net foreign assets	-0.4	6.8	-0.8	-1.5	-1.4
Net domestic assets	7.7	7.8	9.6	8.3	6.3
Memorandum items:					
Broad money (12-month percent change)	7.3	14.6	8.8	6.8	4.9
Currency in circulation (12-month percent change)	9.8	12.2	6.2	10.4	7.4
Money multiplier (broad money/narrow money)	4.4	4.5	4.3	4.1	4.2

Sources: IMF, *International Financial Statistics;* and Bank Negara Malaysia.
1/ Data for 2014 is for end-October

Table 7. Malaysia: Banks' Financial Soundness Indicators, 2009–14

	2009	2010	2011	2012	2013	2014 Jun.
			(In percent)			
Capital adequacy						
Regulatory capital to risk-weighted assets	18.2	17.5	17.7	17.6	14.6	14.5
Regulatory Tier 1 capital to risk-weighted assets	14.1	13.5	13.2	13.4	13.1	12.9
Asset quality						
Nonperforming loans net of provisions to capital 1/	11.8	13.9	11.6	8.3	8.1	7.5
Nonperforming loans to total gross loans	3.6	3.4	2.7	2.0	1.8	1.8
Total provisions to nonperforming loans	82.5	89.5	99.3	98.7	99.5	105.0
Earnings and profitability						
Return on assets	1.2	1.5	1.5	1.6	1.5	1.6
Return on equity	13.4	16.3	16.8	17.3	15.8	16.1
Interest margin to gross income	57.7	59.8	53.5	54.8	59.6	60.5
Non-interest expenses to gross income	45.2	41.5	45.2	45.0	42.6	42.2
Liquidity						
Liquid assets to total assets (liquid asset ratio)	14.3	15.7	12.9	13.8	13.2	13.3
Liquid assets to short term liabilities	43.0	48.1	36.6	42.5	41.0	41.4
Loan-deposit ratio 2/	77.9	81.3	80.9	82.1	84.6	85.8
Sensitivity to market risk						
Net open position in foreign exchange to capital	3.9	9.3	11.7	8.7	9.1	10.3
Sectoral distribution of total loans to nonbanking sector						
Residents	98.1	98.0	97.7	97.7	97.2	97.3
Other financial corporations	3.4	3.1	3.1	2.6	2.8	2.6
General government	2.0	2.7	2.7	2.6	2.1	1.8
Nonfinancial corporations	38.4	37.6	37.3	37.6	36.9	36.9
Other domestic sectors	54.4	54.6	54.4	54.9	55.4	56.0
Nonresidents	1.9	2.0	2.3	2.3	2.8	2.7

Sources: CEIC Data Co. Ltd.; and IMF, *Financial Soundness Indicators* database.

1/ Loans are classified as nonperforming if payments are overdue for three months or more. Total loans include housing loans sold to Cagamas Berhad. Net NPL exclude interest-in-suspense and specific provisions.
2/ Deposits include repos and negotiable instruments of deposit. Loans exclude loans sold to Cagamas Berhad.

Table 8. Malaysia: Macroprudential Measures Since 2010 (Based on effective date)	
January 2010	Reintroduced 5 percent Real Property Gains Tax (RPGT) for properties sold in less than 5 years.
January 2010	Imposed a 5 percent RPGT on properties sold within 5 years.
November 2010	Imposed LTV caps of 70 percent on third and subsequent mortgages.
February 2011	Capital risk-weights were raised to 100 percent for mortgages with LTVs exceeding 90 percent and were also raised for personal loans with a tenure of more than 5 years.
March 2011	The minimum income eligibility for new credit card holders was set at RM 24,000 per annum. Cardholders earning less than RM 36,000 per annum were limited to two credit card issuers and the maximum credit per issuer capped at two times monthly income.
December 2011	Introduced an LTV cap of 60 percent on housing loans for corporates.
January 2012	Issued guidelines on responsible financing and the computation of debt service ratios (DSR) based on a borrower's net income.
January 2012	Increased the RPGT rate to 10 percent on properties sold in less than 2 years and 5 percent RPGT for properties sold between 3 and 5 years. The minimum house price for foreigners was increased to RM500,000 from RM 250,000.
January 2013	Increased the RPGT rate to 15 percent on properties sold before 2 years and to 10 percent on properties sold between 3 and 5 years.
July 2013	Imposed a maximum mortgage term of 35 years and a maximum tenure of 10 years on financing extended for personal use. Prohibited the offering of pre-approved personal financing products.
January 2014	Distinguished between RPGT for Malaysians, foreigners and corporates. For foreigners, the RGPT is 30 percent for properties sold before 5 years and 5 percent after 5 years. For Malaysians, the RPGT is 30 percent for properties sold up to 2 years; 20 percent up to 3 years; 15 percent up to 4 years; after 5 years 0 percent for individuals and 5 percent for corporates. Increased minimum house price for foreigners to RM 1,000,000. Banned Developers Interest Bearing Scheme (DIBS).

Appendix 1. Malaysia—Staff Policy Advice from the 2012 and 2013 Article IV Consultations

Staff Advice	Policy Actions
Fiscal	
Bring down debt to sustainable levels (e.g., pre-2008 levels by 2020) and articulate credible revenue and spending measures to achieve that target (2012 and 2013).	The authorities' medium term fiscal consolidation and reform plans remain on track. They reduced the federal deficit further, to 3.5 percent of GDP in 2014 and are targeting a fiscal deficit of 3.2 percent of GDP by 2015 and a balanced budget by 2020. They are developing a medium term budget framework and have established a Fiscal Policy Committee (FPC) that strengthened top down macro-fiscal control.
Strengthen macro-fiscal framework and public financial management and issue a statement of fiscal risks (2012 and 2013).	The authorities are strengthening their fiscal systems and institutions. The federal government and most GLCs are increasingly transparent, although more progress is needed in this area, including publication of the authorities' medium term fiscal framework and DSA as well as a fiscal risks statement, and more proactive communication and greater transparency for all GLCs. The authorities are on track with multi-year plans to adopt outcomes based budgeting and are piloting accrual accounting in 2015 ahead of full adoption in 2016.
Broaden tax bases by implementing a GST and rationalizing tax incentives (2012 and 2013).	GST implementation in April 2015 remains on track. The authorities are undertaking a study on the effectiveness and costs of tax incentives.
Phase out subsidies and replace with targeted cash transfers to the needy (2012 and 2013).	The authorities took additional decisive action in this area in 2014. These included hikes in electricity tariffs (by 15 percent in January) and additional increases in diesel and RON95 prices (by 10 percent, in October). Then on December 1, they took advantage of declining international crude oil prices to float fuel prices. They are also reviewing their cash transfer schemes with a view to better targeting these to the poorer segments of the population.
Monetary and Financial Policies	
Begin normalizing monetary conditions, taking into account the unusual degree of uncertainty around the external environment and consistent with the need to safeguard domestic financial stability (2012 and 2013).	The authorities raised their overnight policy rate by 25 bps in July and then paused, consistent with the benign inflation outlook, declining energy prices and the increased uncertainty surrounding the global environment.
Continue to employ macroprudential policies to dampen financial risks, such as those from rapid credit growth to households and continue to enhance monitoring. Strengthen monitoring of risks through collection of granular data on household assets and liabilities (2012 and 2013).	The authorities continued use a variety of macroprudential measures and introduced an enhanced framework for risk-based pricing to deal with rising household indebtedness (Table 8). These efforts have reduced risks from credit growth and house price increases and also increased the resilience of the banking system, as evidenced by slowing down of personal credit growth and reduction in both loan applications and approvals.
Continue to monitor regional exposures; deepen co-operation between home and host country supervisors and strengthen crisis prevention and mitigation mechanisms, as outlined in Malaysia's Financial Sector Blueprint (2012 and 2013).	The authorities continue to collaborate with other countries on information sharing and collaboration in cross border supervision. The adoption of the CMIM amendment and the conversion of AMRO to an international organization in 2014 are important first steps in strengthening regional surveillance and crisis prevention and mitigation.

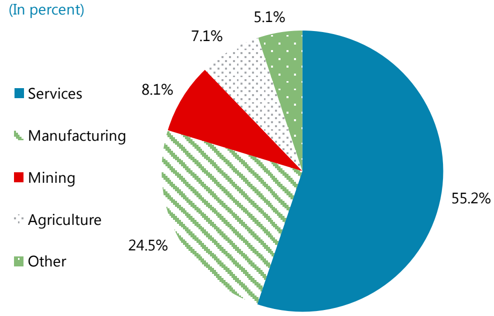
Structural	
Boost growth, productivity and inclusiveness by scaling up infrastructure and by reforming the education system to improve educational attainment (what students actually know), upgrade skills and human capital, and retain Malaysian-grown talent in the domestic economy (2012 and 2013).	The authorities are making progress on a broad front implementing a variety of multi-year transformation programs, including the Economic Transformation Program and Government Transformation Program, whose substance is consistent with staff recommendations. They have reformed the Ministry of Education in accordance with the Malaysian Education Blueprint 2013−25) and consistent with good international practice.
Strengthen the social safety net to make government policies more inclusive and help reduce precautionary savings and narrow the current account surplus (2012 and 2013).	The elimination of fuel subsidies and the improved targeting of cash transfers should strengthen the budget and make government policies more inclusive.
Develop defined contribution private pension plans and increase the age of withdrawal from EPF accounts from 55. Increase the retirement age for public workers to 60, in line with the private sector (2012). Provide an option for workers to receive their pensions in the form of annuities (2012).	A private retirement scheme (defined contribution) has been introduced. The retirement age for private workers has been increased to 60 from 55, although workers can still withdraw savings from the EPF at 55.

Appendix 2. Malaysia—The Impact of Lower Oil Prices

Introduction. This Appendix examines the impact of lower crude oil and natural gas prices on Malaysia's economy. The net effect is not clear cut a priori: Malaysia has an important hydrocarbons exploration, extraction and processing sector but diversified long ago into industry and services, which now account for more than 80 percent of its output.

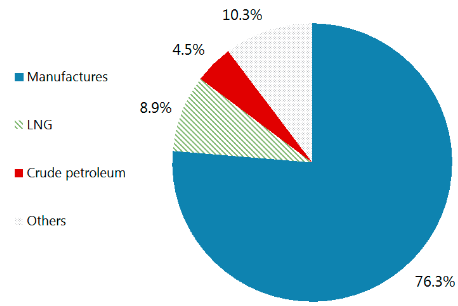
Energy intensity, production and trade. Malaysia is a high middle income country with a diversified economy dominated by services (55 percent of GDP) and manufacturing (25 percent), with mining (8 percent) and agriculture (7 percent) following in the distance. Malaysia's economy is also highly open to international trade. Exports amount to over 70 percent of GDP, of which three quarters are manufactures and oil and gas about 14 percent. This has undoubtedly contributed to the energy intensity of Malaysia's GDP remaining relatively stable, unlike the declining pattern seen in most advanced economies.

Malaysia: GDP Composition, 2013
(In percent)



Source: CEIC Data Co. Ltd.

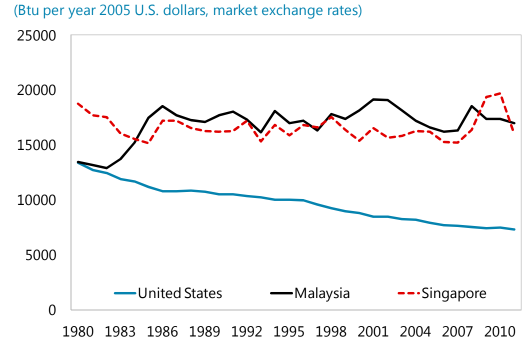
Malaysia: Exports Composition, 2013
(In percent)



Source: CEIC Data Co. Ltd.

The economic role of energy and other commodities. Energy and other commodities are nevertheless an important driver of economic growth and are especially important for fiscal and balance of payments developments. The national oil company PETRONAS dominates upstream and downstream activity in the energy sector. The production, processing and exports of energy products (crude oil and products and natural gas) and of other commodities (crude palm oil, rubber, forestry products and tin) amounted to 15 percent of GDP in 2014 and contributed a net surplus of about 6 percentage points of GDP to the trade balance. Oil and gas revenue of the federal government amounted to about 30 percent of total revenue. Malaysia's business and commodity cycles are positively correlated; in addition, empirical evidence indicates that supply-driven reductions in energy prices lead to lower GDP growth in Malaysia (see Selected Issues Paper). Domestic energy consumption has until recently been subsidized.

Total Primary Energy Consumption per Dollar of GDP
(Btu per year 2005 U.S. dollars, market exchange rates)

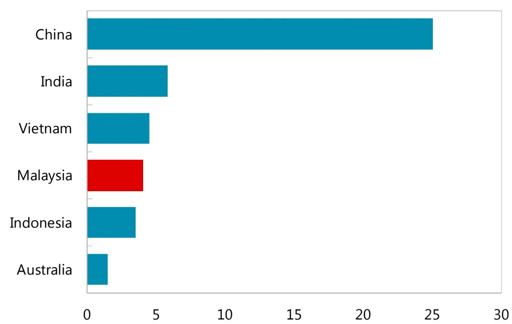


Source: US Energy Information Administration

Crude oil

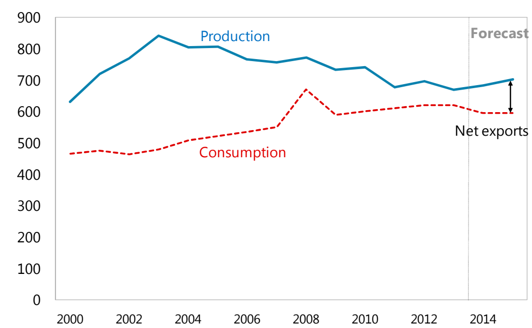
Background. Malaysia is Southeast Asia's second largest crude oil producer after Indonesia. Almost all of its crude oil comes from offshore fields. Malaysia produces a light sweet crude oil called Tapis whose price is a benchmark in Asia. Because Tapis oil can produce higher-value products, it is priced higher than other benchmarks. During 2014, Tapis oil averaged about US$10 above the IMF's average spot price for crude oil. Futures markets indicate a Tapis crude average price of US$64 in 2015.

Top Asia-Pacific Proven Oil Reserve Holders, January 2014
(Billion barrels)



Source: *Oil & Gas Journal*

Malaysia: Petroleum and Other Liquids Production and Consumption, 2000-15
(Thousand barrels per day)



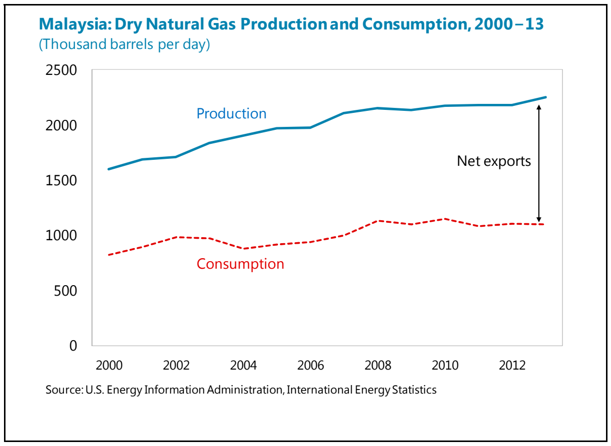
Source: U.S. Energy Information Administration, *Short-Term Energy Outlook*, October 2014

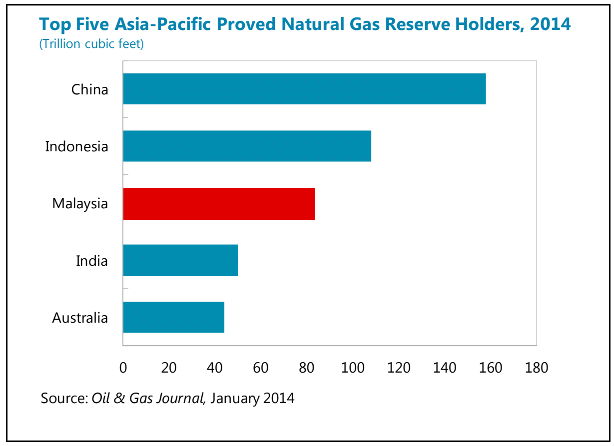
Oil production. Malaysia's crude oil production for the first 11 months in 2014 was about 590,000 barrels per day (bbl/d), down from a peak of about 844,000 bbl/d in early 2000s. The decline was caused by the maturing of oil fields and has prompted Malaysia to seek joint ventures with partners and the government has provided incentives to undertake enhanced oil exploration in order to prolong the life of mature oil fields.

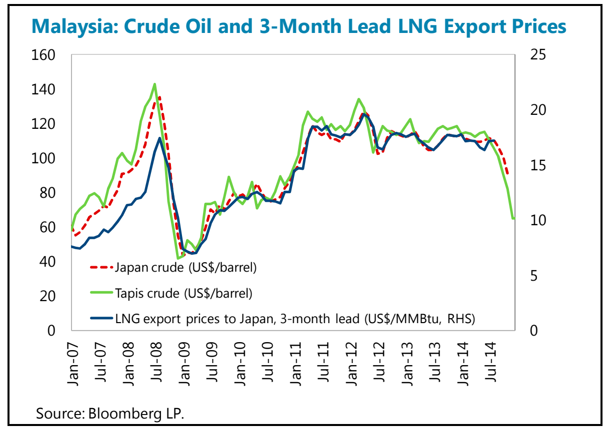
Oil consumption and exports. Rapid economic growth in recent years has raised domestic energy demand and consumption of crude oil. Coupled with declining output, this has resulted in a reduction of crude oil exports. Malaysia remained a net exporter of crude oil and products in 2013, with exports of 240,000 bb/d in 2013 and imports of 183,000 bb/d. It exports sweet crude, which commands a premium, and imports heavier crude oils from the Middle East and other locations for refining and domestic consumption. Primary export destinations are Australia, India, Thailand and Japan.

Natural gas

Overview. Natural gas is playing an increasingly important role in Malaysia's energy production and trade. Its proven gas reserves of 83 trillion cubic feet are the third largest in Asia. Production comes from offshore fields in Sabah and Sarawak and has steadily increased steadily to 2.3 Tcf per year in 2013. Domestic consumption has also risen to meet the needs of power generation (50 percent) and industry (33 percent). Demand for natural gas is expected to remain strong as Malaysia transitions to high income status, both to for power generation and industrial use. A number of ongoing and new gas projects are under way. Interestingly, high demand for natural gas in peninsular Malaysia has forced Malaysia to import LNG and invest in regasification.







Natural gas exports. Malaysia is the world's second largest exporter of LNG after Qatar with exports reaching 1.2 Tcf in 2013. Major destinations are Japan (60 percent), Korea (17 percent), Taiwan Province of China (12 percent) and China (11 percent). Most of Malaysia's natural gas exports are subject to medium and long term contracts. These contracts stipulate a floor and a ceiling, to protect the seller and the buyer respectively, but are tied to spot crude prices for Japan—the so-called Japan crude cocktail (JCC). In practice, prices for Malaysia's LNG exports tend to follow those of the JCC with a lag of about 3–5 months. These prices tend to be higher than those for domestic consumers of gas, which are regulated by the government. In addition, PETRONAS maintains a fleet of LNG tankers that meet spot demand for natural gas worldwide.

Bottom line: the effects of lower oil and gas prices

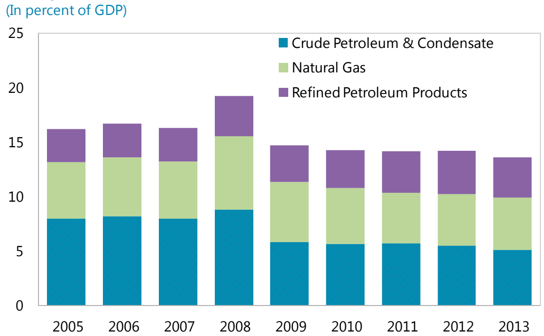
Growth and inflation. Malaysia's diversified production structure makes the economy resilient to energy shocks. Thus, while the recent decline in oil prices is expected to be a drag on Malaysia's energy production, it should have only a modest negative overall effect on growth. (This is also confirmed by empirical work presented in the related Selected Issues Paper, using a Vector Auto Regression approach).[1] For one, the large oil and gas sector comprises important downstream activity which benefits from lower energy prices. In addition, lower energy costs can benefit the nonenergy sectors, although the effect will be muted: at crude oil prices in the US$65–75 range, domestic energy users face about the same cost of energy as before fuel subsidies were eliminated, although this would change if Tapis oil prices remain below US$60).[2] Improved prospects in the

[1] Sheridan, Niamh "The Impact of Lower Oil Prices on Malaysia: a VAR approach," Selected Issues Paper (2015).

[2] Tapis crude prices reached a low of US$ 55 on January 6, 2015.

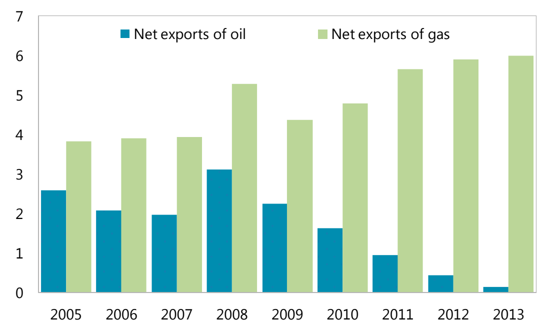
United States and a weaker exchange rate should also provide a fillip to Malaysia's sizeable export-oriented manufacturing sector and partial relief to the commodity sector. Regarding the impact of lower energy prices on inflation, domestic fuel prices have declined significantly only since January 1. While lower inflation in advanced economies tends to reduce inflationary pressures in Malaysia, this impact is likely to be somewhat offset by the recent exchange rate depreciation.

Malaysia: Oil and Gas Sector
(In percent of GDP)



Source: CEIC Data Co. Ltd.

Malyasia: Net Exports of Oil and Gas
(In percent of GDP)

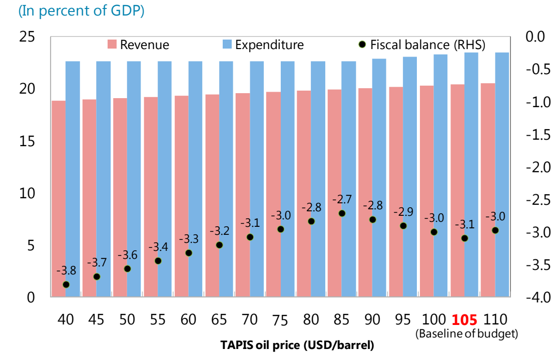


Source: CEIC Data Co. Ltd.

Current Account. Lower energy prices are estimated to reduce Malaysia's oil and gas trade surplus by about 1¼ percent of GDP in 2015. Oil and gas volumes unlikely to be affected: they are set by long-term contracts for gas exports and, moreover, Malaysia is a low cost gas producer. Export earnings from crude palm oil (the major non-energy commodity export) will also be somewhat reduced. The reduction of the commodities trade balance should be partially offset from expanding manufacturing exports as lower oil prices boost the US economy—Malaysia's most important final export destination (18 percent of value added of exports). As a result the current account is expected to remain in comfortable surplus, projected at about 2.9 percent of GDP in 2015.

Budget. Lower oil prices, fuel subsidy removal, and GST introduction will all have important budgetary impacts, both on the revenue and spending sides (see text chart). The 2015 budget was formulated with an underlying assumption of US$105 per barrel for Tapis oil, Malaysia's benchmark light sweet crude. Oil and gas revenues (royalties, income tax and dividends) amount to 30 percent of the total. With a projected average Tapis oil price of US $61, savings from subsidy removal are smaller than the reduction in oil and gas revenues, necessitating the Budget revision announced on January 20, 2015. If oil prices remain below this threshold, the revenue loss would be larger and additional measures would be needed to meet the deficit target of 3.2 percent of GDP. A permanently lower oil and gas prices will have a substantial medium terms effects on the budget and fiscal consolidation would have to rely on broad-based taxes, such as the GST, And additional spending rationalization.

2015 Federal Budget: Impact of Crude Oil Prices
(In percent of GDP)



Sources: Malaysian authorities; and IMF staff estimates.

Appendix 3. Malaysia—Risk Assessment Matrix 1/

(Potential deviations from the baseline)

Risks	Likelihood and Transmission	Expected Impact of Risk	Recommended Policy Responses
Side-effects from global financial conditions: a surge in financial volatility.	**High** Investors could reallocate assets away from Malaysia, resulting in capital flow reversals and depreciation of the Ringgit. Weaker global growth would reduce export volumes and commodity prices, with second round effects on domestic demand.	**Medium** High share of foreign holdings of sovereign and BNM securities makes these markets vulnerable to risk-on, risk off cycles, but this is offset by demand by domestic institutional investors. Recent and earlier outflow episodes have had limited impact on credit or the real economy.	The exchange rate should be allowed to act as a shock absorber, intervening only to smooth excessive volatility. Liquidity support (including in FX) could be provided. Given limited fiscal space, any fiscal expansion should be temporary, well-targeted, and anchored in a credible medium term consolidation plan.
Side-effects from global financial conditions: Financial imbalances from protracted period of low interest rates continue to build.	**Medium** Malaysia would continue to experience strong capital inflows, putting upward pressure on the exchange rate and fueling growth in leverage.	**Low to Medium** Higher household and corporate debt would increase Malaysia's vulnerability to external shocks. In addition, continued rapid credit growth could fuel asset price bubbles.	A faster pace of fiscal consolidation would offset the expansionary impact of strong capital inflows on aggregate demand. Macroprudential policies can help curb growing domestic financial risks. Rapid growth in shadow banking merits close monitoring.
Side-effects from global financial conditions: Persistent dollar strength.	**Medium** The main impact on Malaysia will be through trade channels, with a depreciated domestic currency boosting exports. Malaysia could be vulnerable to contagion and experience capital outflows in the case of a disorderly adjustment.	**Low to Medium** Malaysia's external debt is primarily denominated in local currency, reducing the balance sheet effects of U.S. dollar appreciation. Resident companies with foreign currency exposure are either hedged or have a natural hedge.	The exchange rate should be allowed to act as a shock absorber, intervening only to smooth excessive volatility.
Protracted period of slower growth in advanced economies and emerging markets.	**High** Trade (both volume and price), would be the dominant channel, with adverse second round effects on domestic demand.	**Low to Medium** Prolonged weakness in external demand would likely dampen domestic demand, lowering growth, increasing unemployment, dampening housing and asset prices, weakening bank, corporate, and sovereign balance sheets, in a negative feedback loop.	The ability of policy to provide a long-lived cushion against a protracted slump is limited. Policymakers would need to adjust to slower medium-term growth although carefully selected infrastructure projects and structural reforms could increase productivity.
Implementation risks associated with fiscal consolidation and reforms envisaged in the 2014 and 2015 budgets. Reforms, such as the GST introduction, entail political, design, and execution risks.	**Low to Medium** Realization of implementation risks would have adverse consequences for the credibility of fiscal policies, raising the sovereign's financing cost and result in higher interest rates throughout the economy.	**Medium to High** Higher financing costs for the sovereign, a relatively high public debt, and failure to implement fiscal reforms would exacerbate concerns about public debt sustainability together with a potential sovereign credit downgrade. Capital outflows further compound the harmful effects of lack of fiscal resolve on the economy.	The authorities' ability to mount countercyclical responses would be limited and policy procyclicality would be heightened. The exchange rate should be allowed to act as a shock absorber, intervening only to smooth excessive volatility.
Sharp decline in house prices, in a rising global interest rate environment: house price growth has been rapid in recent years	**Low to Medium** The real economy would be adversely affected through weaker household and bank balance sheets, along with negative wealth and confidence effects.	**Medium** Household debt is high at 86 percent of GDP and one half of this is mortgages. Offsetting this are high household financial assets.	Monetary policy easing, exchange rate flexibility, along with a temporary fiscal stimulus anchored in a credible medium term fiscal sustainability framework, could help support growth.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Appendix 4. Malaysia—External Sector Assessment

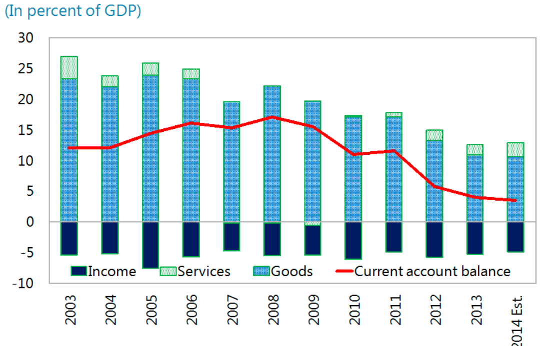
Overview of External Sector Developments

Current Account (CA)

Malaysia's economy has undergone a large external rebalancing in recent years, and its once very large current account surplus has declined by about 8 percentage points since 2011, to an estimated 3.5 percent of GDP in 2014. The current account narrowing is largely structural, reflecting Malaysia's comprehensive reform agenda, which has led to a broad-based boost in investment and a higher investment-to-GDP ratio, while domestic consumption growth has also been strong. Rebalancing by the rest of the world and, more recently, declines in energy and other commodity prices have also contributed to the adjustment in the current account balance.

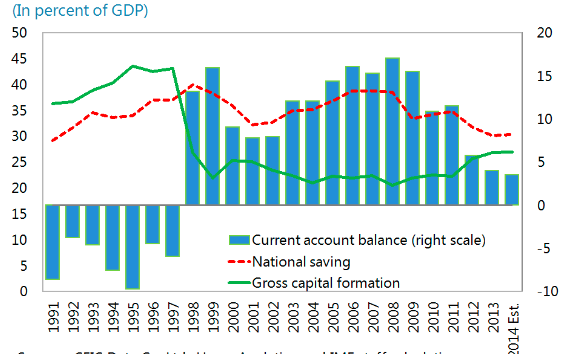
In terms of the saving-investment balance, the narrowing of the current account surplus reflects both lower savings and higher investment. The savings rate declined sharply in 2008 at the onset of the crisis, from about 38 percent to 35 percent of GDP, and then declined further to an estimate of about 31 percent in 2014. The fall in savings was driven by robust private consumption growth fueled by rapid credit growth and, more recently, lower commodity incomes. Gross domestic investment rose from 22 percent of GDP in 2008 to an estimate of about 27 percent in 2014, driven by investment in large ETP-related projects, that are highly import intensive. This sustained and substantial increase in investment is a welcome development. It is the first time in which the investment ratio has moved significantly following its slump during the Asian financial crisis. It could help ease supply bottlenecks, boost productivity, and support efforts to modernize the economy and raise incomes.

Current Account Balance
(In percent of GDP)



Sources: CEIC Data Co. Ltd; and IMF staff estimates.

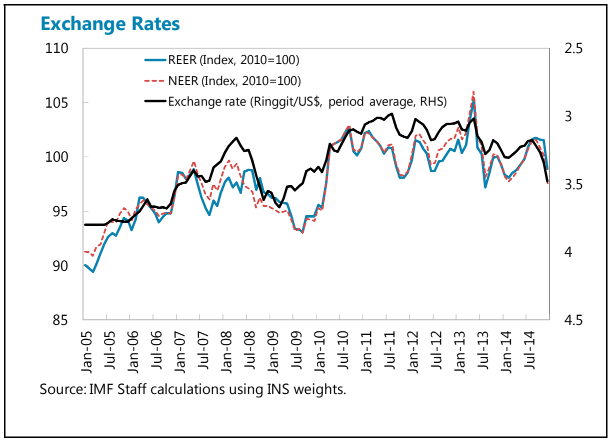
National Saving, Investment, and Current Account Balance
(In percent of GDP)

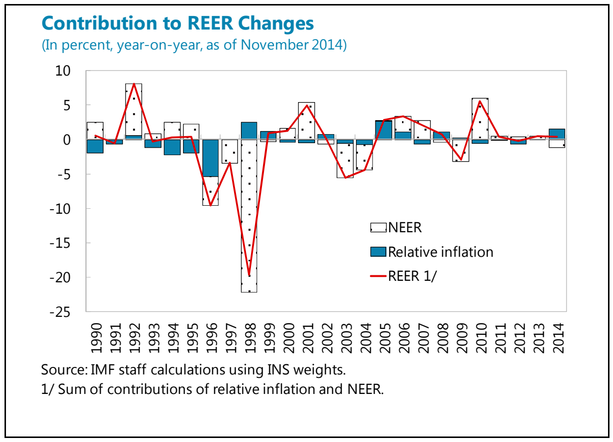


Sources: CEIC Data Co. Ltd.; Haver Analytics; and IMF staff calculations.

Real Effective Exchange Rate (REER)

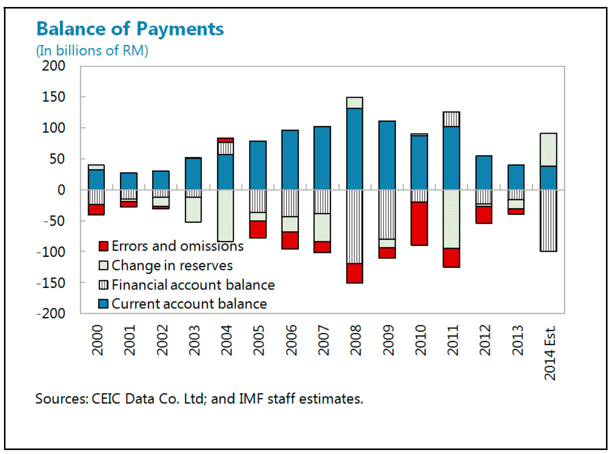
The ringgit strengthened by about 4 percent against the U.S. dollar during the first eight months of 2014 but has depreciated by about 10 percent between September and end-2014 as energy priced turned sharply lower, other commodity prices weakened, and the U.S. dollar strengthened. In the absence of large movements in inflation differentials, nominal depreciation of the ringgit leads to real depreciation. Fluctuations in the multilateral effective exchange rate have been smaller than those of the ringgit against the U.S. dollar, since currencies of other trading partners have had similar movements against the dollar.

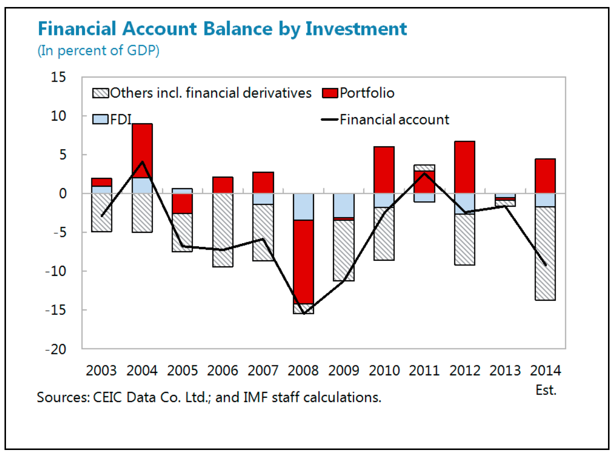




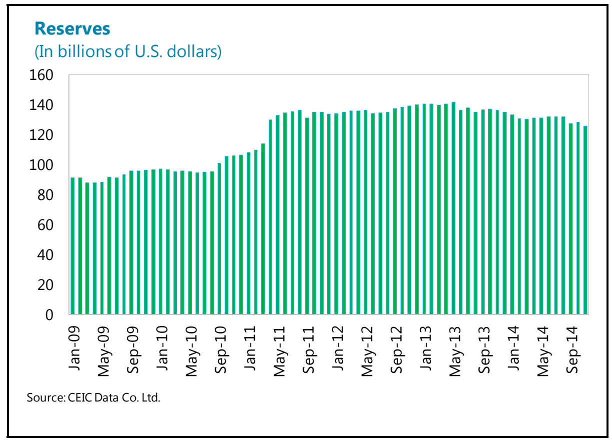
The Financial Account and Reserve Accumulation

Like other emerging market economies in recent years, Malaysia has experienced volatile capital flows that reflected both push and pull factors, including shifting global risk aversion, low policy rates in advanced economies and Malaysia's strong fundamentals and deep financial markets. A healthy (albeit narrowing) current account surplus and deep financial markets, including large institutional investors, have limited the impact of capital flow volatility on the real economy.[1] Malaysia has typically recorded net capital outflows. Although net FDI flows are generally small, gross FDI flows are large, reflecting the growing importance of Malaysia as a direct investor abroad. In the first three quarters of 2014, net outflows were about 7 percent of GDP, with portfolio outflows accounting for more than 2 percent of GDP.



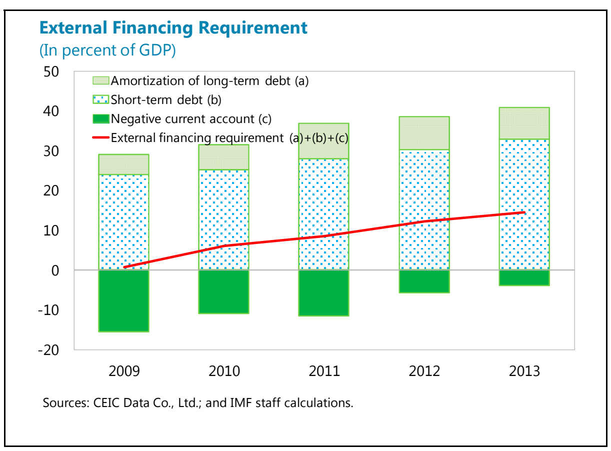


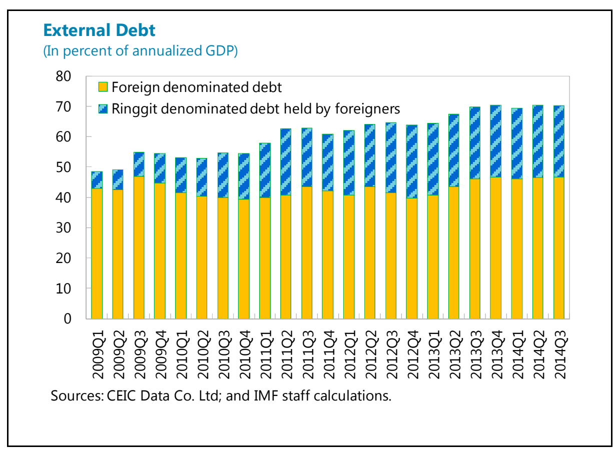
[1] See "What Explains the Malaysia's Resilience to Capital Outflows?" Staff Report, 2013 Article IV Consultation.



At the end of December of 2014, official reserves stood at about 85 percent of the IMF's composite reserve adequacy metric, and covered 81 percent and 27 percent of short-term external debt and broad money, respectively. Therefore, current reserve levels are adequate and there is no need for additional accumulation for precautionary purposes. BNM intervention seeks to limit excess exchange rate volatility and has generally been two-sided. The authorities have continued to liberalize FX administration, including via greater flexibility for resident companies to undertake foreign direct investment abroad and obtain loans from related resident and nonresident companies.

The net international investment position (NIIP)—was -4.8 percent of GDP at end 2013. Gross liabilities (including both ringgit—and foreign currency-denominated liabilities) were about 142 percent of GDP at end 2013. In September of 2014, total external debt was 70 percent of GDP, of which 50 percent is short-term debt. Foreign-currency debt was 45 percent of GDP. Ringgit-denominated debt held by nonresidents, particularly Malaysian government securities, has increased rapidly since the global financial crisis. Malaysia's slightly negative NIIP is a puzzle in light of its large current account surplus in the last decade. Valuation adjustments and possible current account measurement issues may be at play.





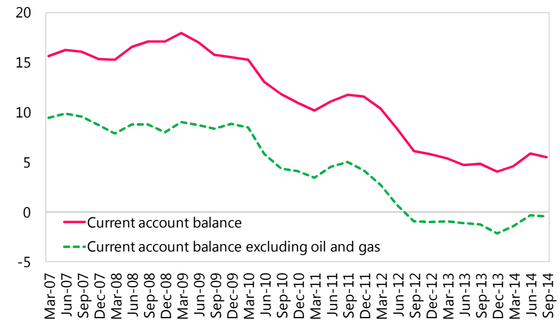
Standard Benchmarks

The External Balance Assessment (EBA), a regression based model analysis, suggests that the cyclically adjusted current account is stronger (by about 4.3 percentage points of GDP) than the level consistent with medium-term fundamentals and desirable policies. Applying the EBA methodology, based on data and projections available as of October 2014, the estimated 2014 current account norm for Malaysia is 0.2 percent of GDP, adjusted for relative output gaps and for commodity terms of trade. The current account balance in 2014 is estimated at 3.5 percent of GDP and the cyclically adjusted current account balance at 4.5 percent of GDP. The resulting EBA-estimated gap of

4.3 percent of GDP comprises policy gap contributions of about 1.1 percent of GDP, and an unexplained residual of 3.2 percent. However, Malaysia's current account surplus mainly reflects factors that are not well captured in the EBA. This is the case in particular for insufficient social safety nets, which drive up saving rates; bottlenecks to investment, resulting in relatively low private investment rates, despite the recent increase. This first factor is not fully captured by health spending, which is the variable used in EBA to proxy for safety nets. Taking these factors and the uncertainty surrounding model estimates into consideration, we assess the current account gap to be in the order of 4 percentage points of GDP.

EBA estimates Malaysia's real effective exchange rate (REER) to be 29 percent below levels warranted by fundamentals and desirable policies, although most of the gap (24 percent) is an unexplained residual.[2] Staff's preferred estimate of the degree of REER undervaluation is about 10.3 percent. This range is consistent with staff's view of the current account gap based on the macro-balance approach and relies on the semi-elasticity of the current account with respect to the REER. The estimate of the semi-elasticity is -0.29 and it takes into account Malaysia's trade openness and commodity exports.

Current Account Balance
(In percent of GDP)



Sources: CEIC Data Co. Ltd.; and IMF staff calculations.

The Role of Fiscal Consolidation

Malaysia's multiyear fiscal consolidation also affects the current account in the medium term. Staff estimates that every 1 percentage point improvement in the fiscal balance could strengthen the current account by 0.4 percentage point, although the composition of the fiscal adjustment matters.[3] The impact on the current account depends on how different measures affect saving and investment of private agents. For example, fuel subsidy rationalization is likely to have a positive direct effect on the current account. From a macroeconomic perspective, a stronger fiscal position increases the sustainability of the external sector.

The Role of Oil and Gas Exports

Malaysia is an important commodities producer and exporter, including nonrenewable resources. Its oil and gas trade surplus is estimated at 5.7 percent of GDP in 2014, and its current account deficit, excluding oil and gas, is estimated at 2.2 percent of GDP. The EBA captures the fact that the current account surplus is a salient characteristic of oil- and gas-exporting countries. Two aspects are

[2] The fit of the EBA REER regression for Malaysia has fallen off in recent years, and part of the problem arises from the EBA proxy measure for trade openness.

[3] See "A Medium-Term Fiscal Strategy for Malaysia," Staff Report, 2013 Article IV Consultation.

important: first, from an intergenerational perspective, it is optimal for countries to save part of their earnings from exporting nonrenewable resources, which results in an increase in their current account balance. Second, the fraction of their resource earnings that is saved and exported also depends on the longevity of these resources—according to the Permanent Income Hypothesis, short-lived increases in national income should be primarily saved.[4] In terms of the impact of oil and gas exports on Malaysia's current account, EBA estimates that Malaysia's oil and gas reserves contributes about 1.7 percent of GDP to the estimated current account norm.

Malaysia: Quantitative External Sector Assessment

	Norm 1/	Projection 1/	Gap
Current account		(In percent of GDP)	
EBA 2.0 current account	0.2	4.5	4.3
Of which: Contribution of identified policy gaps 2/			1.1
Unexplained residual			3.2
External sustainability approach 3/			4.1
Staff assessment	1.5	4.5	3.0
Of which: Contribution of identified policy gaps (based on EBA 2.0)			1.1
Other			1.9
Exchange rate misalignment		(Percentage)	
EBA 2.0 Real exchange rate regression approach 4/	...	...	-29.0
Of which: Contribution of identified policy gaps 2/	...	...	-5.0
Unexplained residual	...	...	-24.0
Staff estimate using elasticity approach 5/	...	...	-10.3

1/ Staff's estimate of the multilaterally consistent cyclically adjusted norm and projection for 2014, based on EBA 2.0 October 2014.
2/ Policy Gaps refers to policy distortions that can arise either from domestic policies or as a result of the policies of other
See 2014 Pilot External Sector Report.
3/ From EBA 2.0 October 2014. Based on 2012 NFA/GDP ratio of -5.2 percent of GDP and an adjusted medium-term CAB of 4.2 percent.
4/ Misalignment based on EBA 2.0 October 2014.
5/ The semielasticity of the current account balance with respect to the REER is η_{CA}= -0.29, computed according to $\eta_{CA}=\eta_{Xnc}\, s_{Xnc}-(\eta_M-1)\, s_M-s_{Xc}$, where η_{Xnc} is the elasticity of the volume of non-commodity exports with respect to the REER, η_M is the elasticity of the volume of imports with respect to the REER, estimated at η_{Xnc}= - 0.82, η_M= 0.26, s_{Xnc}= 58.2 percent is the share of non-commodity exports in GDP, s_{Xc}= 16.8 percent is the share of commodity exports in GDP, and s_M= 61 percent is the share of imports in GDP.

Overall Assessment

Malaysia's current account surplus is elevated on account of structural factors that boost private savings and constrain public investment. From a multilateral perspective, and consistent with the authorities' intentions, stronger social safety nets and efforts to remove bottlenecks to investment

[4] Malaysia's proven oil reserves are the equivalent of more than 25 years worth of current production levels, while gas reserves are larger, at more than 40 years.

would help to further rebalance the economy towards domestic demand led growth and moderate the current account surplus. The sharp reduction in energy prices in the second half of 2014, not fully captured in the current EBA, should, if sustained, help to narrow Malaysia's oil and gas trade surplus and help reduce the CA gap. A sustained real depreciation should boost Malaysia's noncommodity exports and also reduce imports, thus working to offset the deterioration in the energy trade balance.

Appendix 5. Malaysia—Public Debt Sustainability Analysis

Background. The debt sustainability analysis (DSA) framework for market access countries is used to assess Malaysia's debt sustainability and other risks related to its funding and debt structure. The new framework uses a risk-based approach and expands upon the basic DSA to include: (i) an assessment of the realism of baseline assumptions and the projected fiscal adjustment; (ii) an analysis of risks associated with the debt profile; (iii) macro-fiscal risks; (iv) a stochastic debt projection taking into account past macro-fiscal volatility; and (v) a standardized summary of risks in a heat map. This DSA also examines the implications of implementation risks by considering a no-adjustment scenario.

Coverage. This DSA is performed on federal budget and debt. It excludes local and state governments and statutory bodies which borrow from the federal government or receive explicit government guarantees. The liabilities of these entities are captured in the federal government's gross debt and stock of loan guarantees.[1] Borrowing by GLCs, which are in some cases under federal government guarantees, has increased in recent years and is projected to continue to increase in the medium term.

Macro-fiscal assumptions. Growth is projected at 5.9 percent in 2014, slowing to 4.8 percent in 2015, and expected to average 5 percent in the medium term. In staff's baseline, the federal deficit is reduced from 3.5 percent of GDP in 2014 to 3.2 percent in 2015 and 1.5 percent in 2019. The fiscal consolidation assumed in the baseline is consistent with the authorities' targets and is supported by reforms being implemented in 2014-15, including the elimination of fuel subsidies and their gradual replacement with targeted cash transfers to lower income groups. The introduction of a goods and services tax (GST) in 2015 is also assumed.

Choice of framework. Malaysia's relatively high federal debt and gross financing requirement call for using the more detailed (higher scrutiny) version of the new DSA framework. Federal gross debt increased sharply in 2009, reflecting sizable discretionary fiscal stimulus, declining real and nominal growth, and a large fall in oil prices. Although growth has recovered since then, primary deficits have remained high, pushing the debt-to-GDP ratio to about 55 percent, the authorities' self-imposed debt ceiling. Gross financing needs (GFN) are estimated at 10.6 percent of GDP in 2013 and are expected to remain below 10 percent in the medium term.

Realism. An important strength of the new DSA framework is that it tests the realism of staff's baseline assumptions. The median forecast error for real GDP growth during 2005−13 is zero, so there is no evidence of a systemic projection bias that could undermine the assessment. The median forecast error for the GDP deflator is 2.9 percent, suggesting that staff forecasts have been conservative. The median forecast error for primary balance of -0.72 percent of GDP suggests that staff projections have been slightly pessimistic, but this forecast bias has declined recently.

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[1] Gross debt of consolidated general government is not published.

Results. Cross-country experience suggests that the projected fiscal adjustment is feasible. The maximum three-year adjustment in the cyclically adjusted primary balance (CAPB) over the projection period is 3.2 percent of GDP, which is ambitious but realistic because it is premised upon concrete measures endorsed by the government. The maximum level of the primary balance (0.4 percent of GDP) assumed in the projections is reasonable when compared to the experience in other market-access countries. Malaysia's government debt-to-GDP ratio remains below 70 percent and its gross financing needs remain below 15 percent of GDP under different macroeconomic and fiscal shocks.

- Under the baseline, the federal debt-to-GDP ratio is projected to fall to about 45 percent by 2019. If, on the other hand, the projected consolidation were to not take place, as captured under the constant primary balance simulation, federal debt would decline to only 50 percent of GDP by 2019. Under most macro-fiscal stress tests, the federal debt-to-GDP ratio continues to decline; however, in the event of a one standard deviation shock to real GDP growth, the federal debt-to-GDP ratio initially rises to about 55 percent in 2016 and declines thereafter. A macro-fiscal shock combined with a permanent 20 percent oil price shock leads to a flat debt-to-GDP profile in the medium term. Stochastic simulations based on historical volatilities in Malaysia's macroeconomic variables show that the federal debt remains below 70 percent of GDP with high probability of 90 percent. Gross financing needs under all scenarios remain below 12 percent. The exception is the stress test where contingent liabilities are realized. In this scenario, gross financing needs peak at about 17 percent before declining to below 12 percent by the end of the projection horizon.

- A contingent liability shock whereby the federal government would have to absorb all loans it has guaranteed (about 15 percent of GDP) over two years would increase risks significantly. If the economy were also hit by a persistent shock to growth and interest rates rose by 150 basis points, the debt-to-GDP ratio would remain just below the 70 percent debt benchmark. Although this is a low-probability scenario, the simulations underscore the risks posed by contingent liabilities.

Heat map. The heat map (page 52) is benign. The exception is the high external financing requirement (34 percent) and large share of public debt held by foreigners (30 percent). The external financing requirement is above the upper threshold of early warning benchmarks and the share of debt held by foreigners is also relatively high. As discussed in the main text, Malaysia has the advantage that a significant portion of its foreign debt is denominated in its national currency and is traded in deep and liquid domestic markets in which large domestic institutional investors are active, making opportunistic investments, thus providing some comfort along this dimension.

Malaysia Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP unless otherwise indicated)

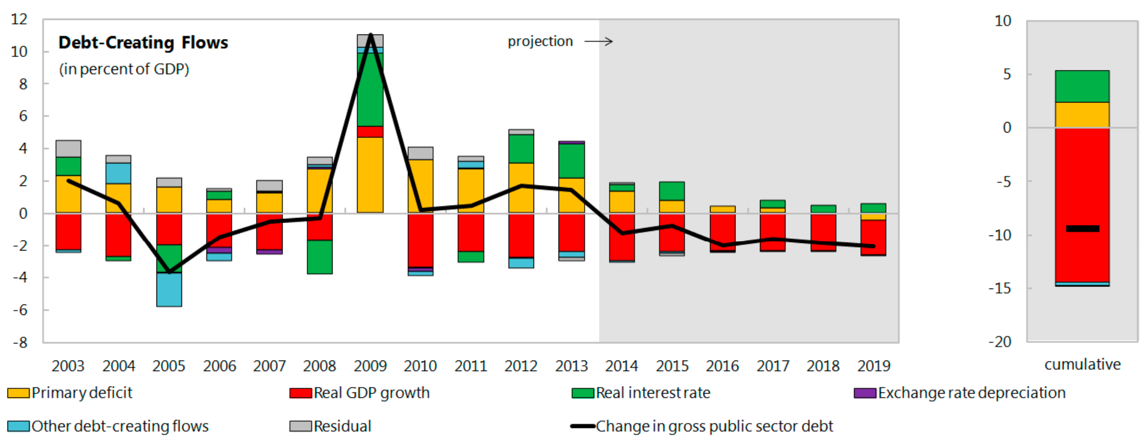
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	45.2	53.3	54.7	53.5	52.7	50.7	49.2	47.3	45.3
Public gross financing needs	9.1	10.9	10.6	9.3	9.0	8.9	9.6	9.1	6.9
Real GDP growth (in percent)	5.0	5.6	4.7	5.9	4.8	4.9	5.0	5.0	5.0
Inflation (GDP deflator, in percent)	4.6	0.7	0.0	3.4	2.0	4.3	3.4	3.5	3.4
Nominal GDP growth (in percent)	10.0	6.4	4.8	9.5	6.9	9.4	8.6	8.7	8.6
Effective interest rate (in percent) [4/]	5.2	4.3	4.1	4.3	4.3	4.4	4.5	4.7	4.9

As of October 14, 2014		
Sovereign Spreads		
EMBI (bp) 3/		141
CDS (bp)		93
Ratings	Foreign	Local
Moody's	A3	A3
S&Ps	A-	A
Fitch	A-	A

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.9	1.73	1.46	-1.2	-0.7	-2.0	-1.6	-1.9	-2.0	-9.4	
Identified debt-creating flows	0.4	1.43	1.69	-1.3	-0.6	-2.0	-1.6	-1.9	-2.0	-9.4	
Primary deficit	2.4	3.1	2.2	1.4	0.8	0.4	0.4	-0.1	-0.4	2.4	-1.6
Primary (noninterest) revenue and grants	20.8	21.3	21.1	20.7	20.3	20.3	20.2	20.6	20.8	122.8	
Primary (noninterest) expenditure	23.2	24.5	23.3	22.0	21.1	20.7	20.5	20.5	20.4	125.2	
Automatic debt dynamics [5/]	-1.9	-1.1	-0.2	-2.6	-1.3	-2.4	-1.9	-1.8	-1.6	-11.5	
Interest rate/growth differential [6/]	-1.9	-1.0	-0.3	-2.6	-1.3	-2.4	-1.9	-1.8	-1.6	-11.5	
Of which: real interest rate	0.2	1.7	2.1	0.4	1.1	0.0	0.4	0.5	0.6	2.9	
Of which: real GDP growth	-2.0	-2.7	-2.4	-2.9	-2.4	-2.4	-2.3	-2.3	-2.2	-14.5	
Exchange rate depreciation [7/]	-0.1	-0.1	0.1	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.1	-0.6	-0.3	-0.1	-0.1	0.0	0.0	0.0	0.0	-0.3	
General government net privatization proceeds (negativ	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other change in financial assets	-0.1	-0.6	-0.3	-0.1	-0.1	0.0	0.0	0.0	0.0	-0.3	
Residual, including asset changes [8/]	0.6	0.3	-0.2	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ EMBI.

4/ Defined as interest payments divided by debt stock at the end of previous year.

5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

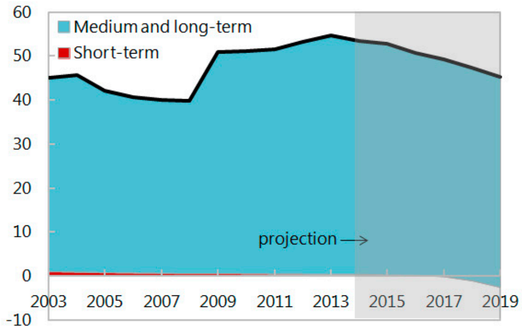
8/ For projections, this line includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

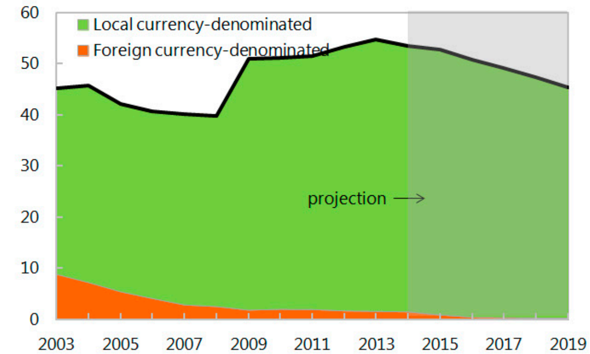
Malaysia Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



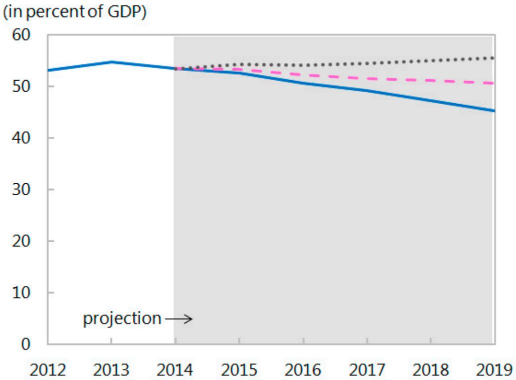
By Currency
(in percent of GDP)



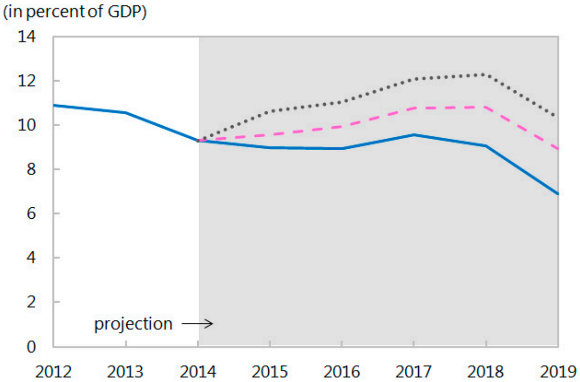
Alternative Scenarios

Baseline · Historical · Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	5.9	4.8	4.9	5.0	5.0	5.0
Inflation	3.4	2.0	4.3	3.4	3.5	3.4
Primary Balance	-1.4	-0.8	-0.4	-0.4	0.1	0.4
Effective interest rate	4.3	4.3	4.4	4.5	4.7	4.9
Constant Primary Balance Scenario						
Real GDP growth	5.9	4.8	4.9	5.0	5.0	5.0
Inflation	3.4	2.0	4.3	3.4	3.5	3.4
Primary Balance	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Effective interest rate	4.3	4.3	4.4	4.5	4.7	4.9

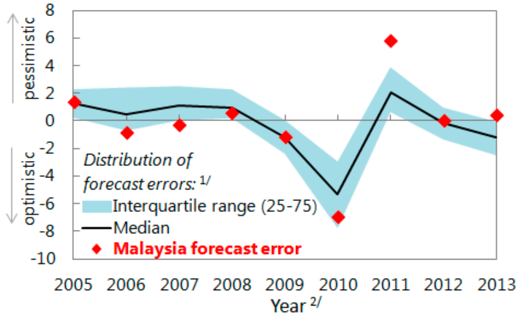
Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	5.9	5.0	5.0	5.0	5.0	5.0
Inflation	3.4	2.0	4.3	3.4	3.5	3.4
Primary Balance	-1.4	-2.4	-2.4	-2.4	-2.4	-2.4
Effective interest rate	4.3	4.3	4.4	4.5	4.7	4.9

Source: IMF staff.

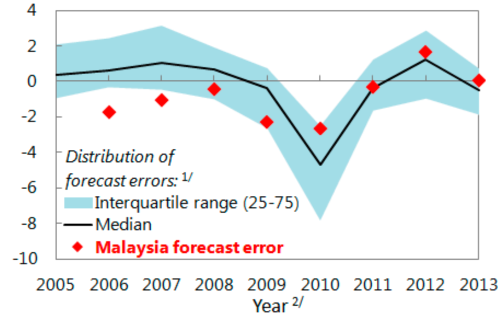
Malaysia Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

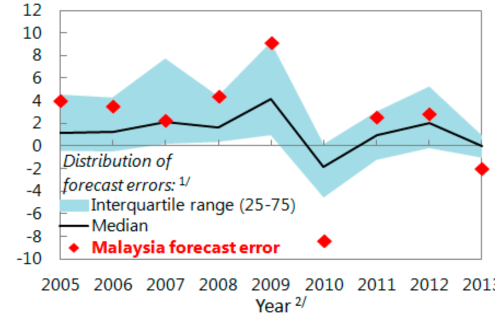
Real GDP Growth
(in percent, actual-projection)
Malaysia median forecast error, 2005-2013: **0.03**
Has a percentile rank of: **44%**



Primary Balance
(in percent of GDP, actual-projection)
Malaysia median forecast error, 2005-2013: **-0.72**
Has a percentile rank of: **35%**

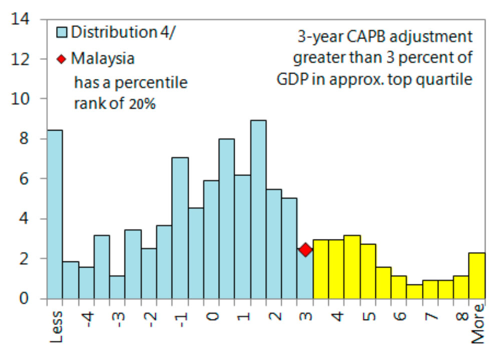


Inflation (Deflator)
(in percent, actual-projection)
Malaysia median forecast error, 2005-2013: **2.86**
Has a percentile rank of: **68%**

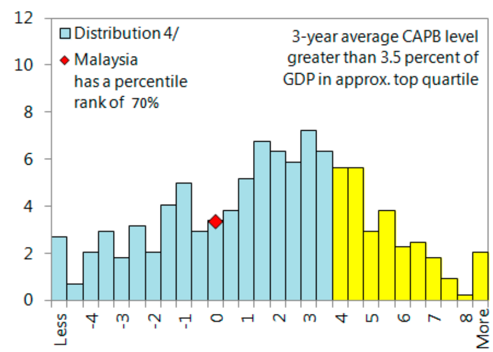


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

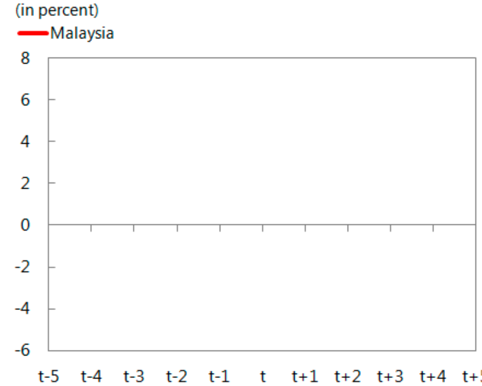


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

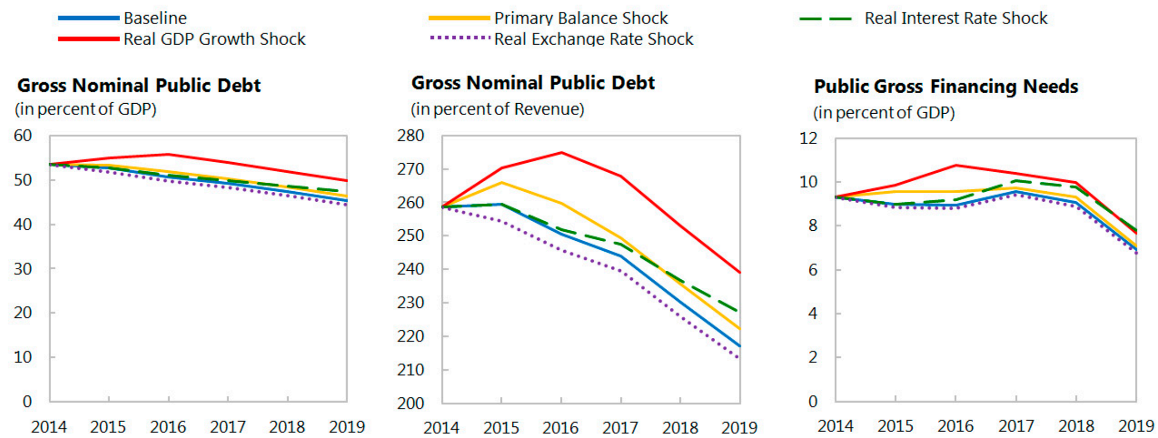
Real GDP growth
(in percent)



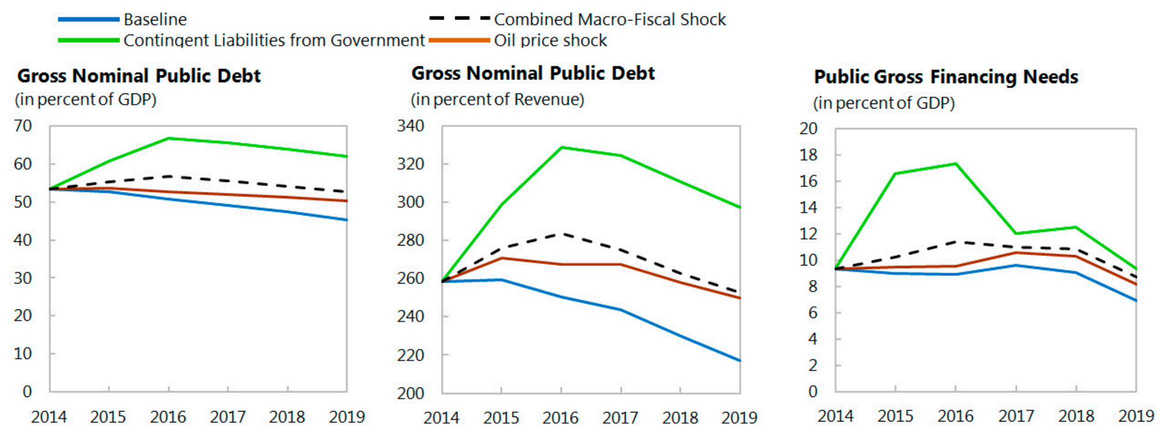
Source : IMF Staff.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Malaysia.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Malaysia Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	5.9	4.8	4.9	5.0	5.0	5.0
Inflation	3.4	2.0	4.3	3.4	3.5	3.4
Primary balance	-1.4	-1.3	-1.0	-0.4	0.1	0.4
Effective interest rate	4.3	4.3	4.4	4.6	4.8	4.9
Real Interest Rate Shock						
Real GDP growth	5.9	4.8	4.9	5.0	5.0	5.0
Inflation	3.4	2.0	4.3	3.4	3.5	3.4
Primary balance	-1.4	-0.8	-0.4	-0.4	0.1	0.4
Effective interest rate	4.3	4.3	4.9	5.5	6.1	6.7
Combined Shock						
Real GDP growth	5.9	2.3	2.4	5.0	5.0	5.0
Inflation	3.4	1.4	3.7	3.4	3.5	3.4
Primary balance	-1.4	-1.7	-2.0	-0.4	0.1	0.4
Effective interest rate	4.3	4.4	5.0	5.6	6.2	6.7
Contingent Liabilities from Government Guarantees						
Real GDP growth	5.9	3.8	3.9	4.0	4.0	4.0
Inflation	3.4	2.0	4.3	3.4	3.5	3.4
Primary balance	-1.4	-8.3	-7.9	-0.4	0.1	0.4
Effective interest rate	4.3	4.3	4.8	5.1	5.1	5.2

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	5.9	2.3	2.4	5.0	5.0	5.0
Inflation	3.4	1.4	3.7	3.4	3.5	3.4
Primary balance	-1.4	-1.4	-1.7	-0.4	0.1	0.4
Effective interest rate	4.3	4.3	4.4	4.6	4.8	5.0
Real Exchange Rate Shock						
Real GDP growth	5.9	4.8	4.9	5.0	5.0	5.0
Inflation	3.4	4.3	4.3	3.4	3.5	3.4
Primary balance	-1.4	-0.8	-0.4	-0.4	0.1	0.4
Effective interest rate	4.3	4.4	4.4	4.5	4.7	4.9
Oil price shock						
Real GDP growth	5.9	3.8	3.9	4.0	4.0	4.0
Inflation	3.4	2.0	4.3	3.4	3.5	3.4
Primary balance	-1.4	-1.2	-0.8	-1.0	-0.6	-0.3
Effective interest rate	4.3	4.4	4.4	4.5	4.8	5.0

Source: IMF staff.

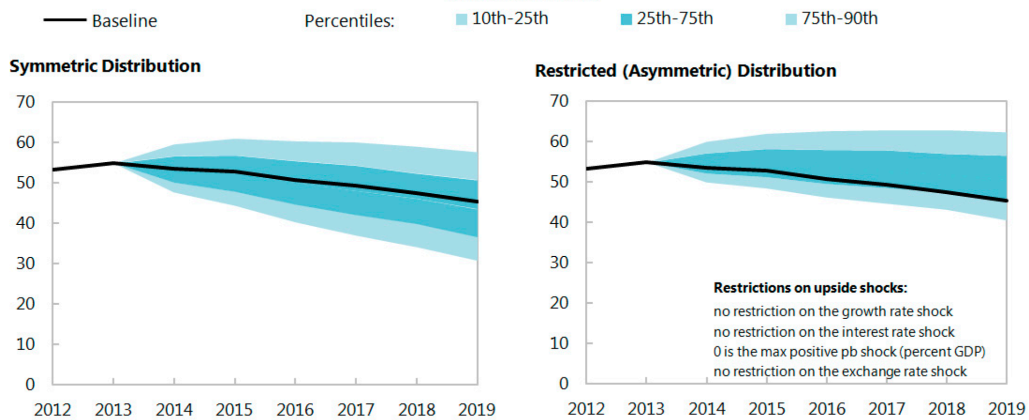
Malaysia Public DSA—Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

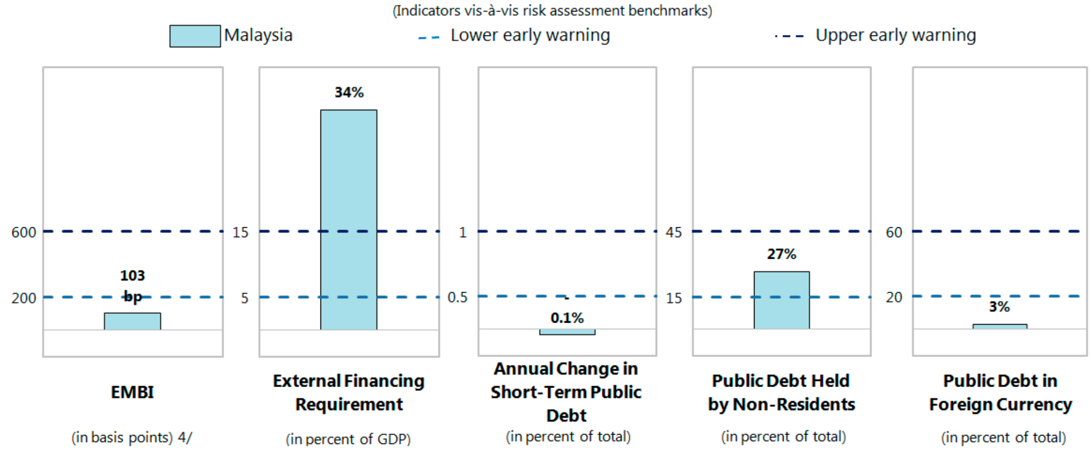
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

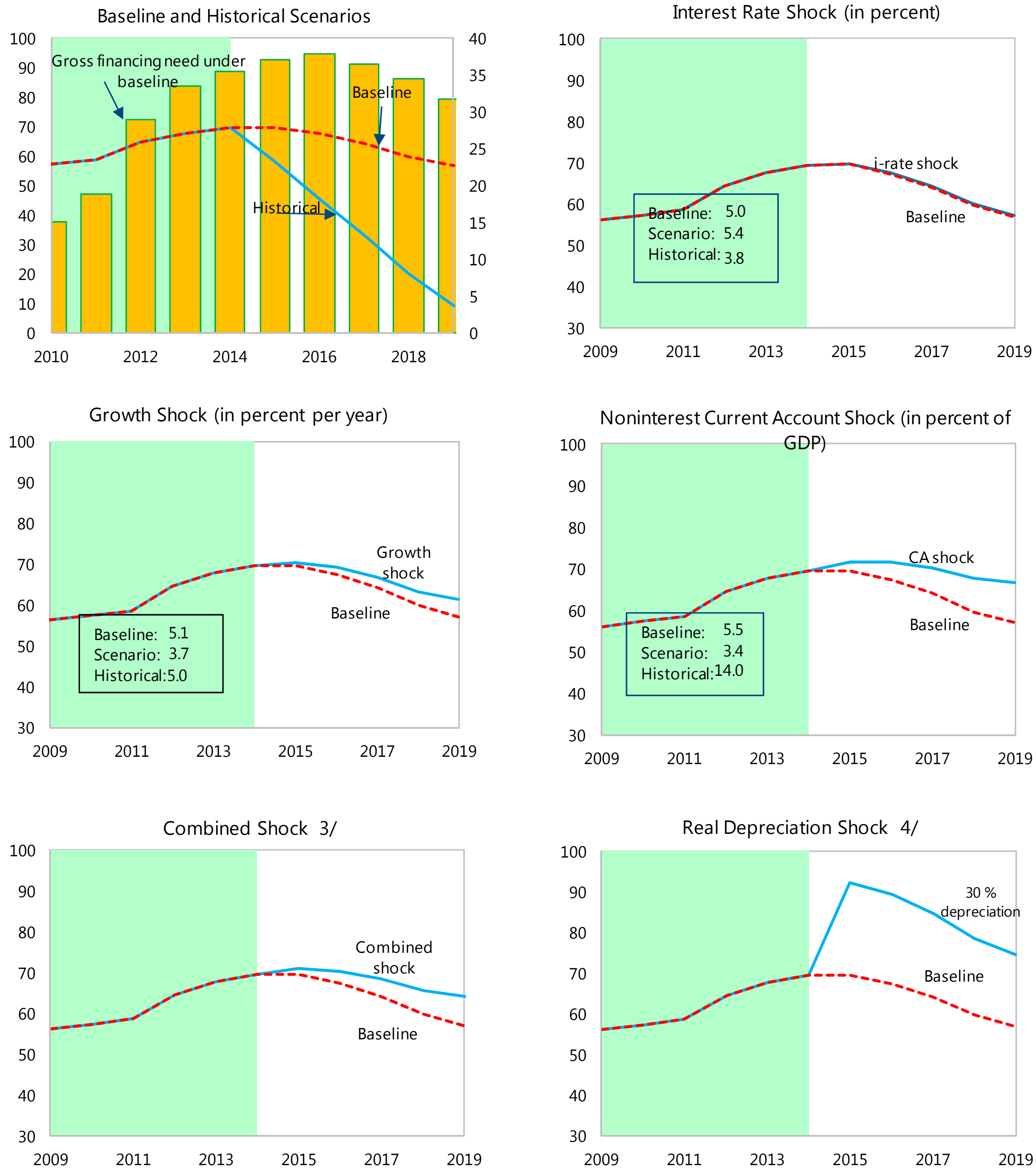
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ An average over the last 3 months, 16-Jul-14 through 14-Oct-14.

Appendix 6. Malaysia—External Debt Sustainability Analysis

Summary. Malaysia's external debt is relatively high at present but is expected to remain on a steady downward trend over the medium term, falling to about 57 percent of GDP by 2019. The 12 percentage point decline in the external debt to GDP ratio from 2014 to 2019 mostly reflects sustained current account surplus. Stress tests indicate that external debt would remain manageable under a variety of shocks, including weaker GDP growth, a lower current account balance, and a one-time 30 percent depreciation of the ringgit. Under most of these scenarios, the external debt to GDP ratio rises above the baseline over the projection period by only modest margins. However, in the case of the exchange rate depreciation scenario, the debt ratio would rise sharply to about 90 percent of GDP on impact, but would subsequently fall to 75 percent of GDP by 2019.

Figure 6.1. Malaysia: External Debt Sustainability: Bound Tests 1/ 2/
(External debt, in percent of GDP)



Sources: International Monetary Fund, country desk data; and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2015.

Table 6.1. Malaysia: External Debt Sustainability Framework, 2008–2018

(In percent of GDP, unless otherwise indicated)

	Actual						Projections						
	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 1/
Baseline: external debt 2/	57.3	58.5	64.3	67.6			69.4	69.5	67.3	63.9	59.6	56.8	-0.6
Change in external debt	1.2	1.3	5.8	3.2			1.8	0.1	-2.2	-3.4	-4.3	-2.8	
Identified external debt-creating flows (4+8+9)	-17.6	-17.5	-5.2	-5.4			-4.8	-3.5	-3.5	-3.9	-3.8	-3.4	
Current account deficit, excluding interest payments	-12.8	-13.5	-7.8	-6.0			-5.8	-5.5	-5.6	-5.7	-5.4	-5.1	
Deficit in balance of goods and services	-17.0	-16.4	-11.6	-9.2			-8.4	-6.7	-6.9	-6.7	-6.3	-6.2	
Exports	93.3	91.5	85.3	81.7			80.7	75.6	74.6	72.3	70.0	67.4	
Imports	76.3	75.1	73.7	72.5			72.3	68.9	67.7	65.7	63.6	61.2	
Net nondebt creating capital inflows (negative)	2.8	1.7	3.7	0.7			2.5	2.5	2.0	1.3	1.1	1.3	
Automatic debt dynamics 3/	-7.6	-5.6	-1.1	-0.1			-1.5	-0.5	0.1	0.5	0.5	0.4	
Contribution from nominal interest rate	1.9	1.9	2.0	2.1			2.3	2.6	3.2	3.5	3.4	3.1	
Contribution from real GDP growth	-3.4	-2.5	-3.1	-3.0			-3.8	-3.1	-3.1	-3.1	-2.9	-2.7	
Contribution from price and exchange rate changes 4/	-6.1	-5.0	0.0	0.8			...	...	...	...	...	...	
Residual, including change in gross foreign assets (2–3) 5/	18.8	18.7	11.0	8.6			6.6	3.6	1.3	0.6	-0.5	0.6	
External debt-to-exports ratio (in percent)	61.4	64.0	75.5	82.8			86.0	91.9	90.2	88.4	85.2	84.3	
Gross external financing need (in billions of U.S. dollars) 6/	37.2	54.6	88.3	105.0			117.5	132.8	148.1	156.1	162.6	164.5	
In percent of GDP	15.0	18.9	29.0	33.5			35.5	37.0	37.9	36.3	34.5	31.7	
Scenario with key variables at their historical averages 7/					10-Year Historical Average	10-Year Standard Deviation	69.4	57.9	45.1	32.9	20.2	9.2	0.9
Key macroeconomic assumptions underlying baseline													
Real GDP growth (in percent)	7.4	5.2	5.6	4.7	5.0	2.5	5.9	4.8	4.9	5.0	5.0	5.0	
GDP deflator in U.S. dollars (change in percent)	13.9	11.1	-0.2	-2.0	6.0	8.1	0.0	3.4	3.7	4.7	4.5	4.7	
Nominal external interest rate (in percent)	4.1	3.9	3.6	3.3	3.8	0.3	3.6	4.0	5.1	5.7	5.8	5.7	
Growth of exports (U.S. dollar terms, in percent)	24.9	14.6	-1.8	-1.6	8.9	13.2	4.6	1.5	7.4	6.6	6.2	5.9	
Growth of imports (U.S. dollar terms, in percent)	31.3	15.0	3.4	1.0	9.8	13.6	5.5	3.3	7.0	6.6	6.4	5.7	
Current account balance, excluding interest payments	12.8	13.5	7.8	6.0	14.0	4.2	5.8	5.5	5.6	5.7	5.4	5.1	
Net nondebt creating capital inflows	-2.8	-1.7	-3.7	-0.7	-1.5	3.6	-2.5	-2.5	-2.0	-1.3	-1.1	-1.3	

1/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and nondebt inflows in percent of GDP) remain at their

2/ Malaysia has made a methodological change about external debt statistics. The new methodology statistics begin in 2009.

3/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,

4/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

5/ For projection, line includes the impact of price and exchange rate changes.

6/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and nondebt inflows in percent of GDP.

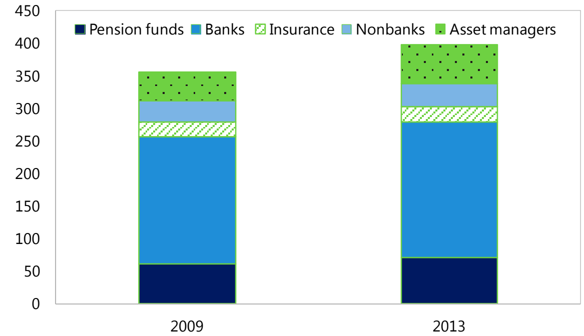
Appendix 7. Malaysia—2013 FSAP—High Priority Recommendations

Strengthening Financial Sector Oversight
Implement proposed new Financial Services Act (FSA) at an early date; and strengthen legal and regulatory requirements for Islamic banks. *The FSA and related Islamic Financial Services Act (IFSA) were implemented on June 30, 2013. The IFSA strengthens legal and regulatory requirements for Islamic banks including those for capital, financial reporting, and audit. BNM has re-issued some polices and regulations under the new legislation, covering for example, powers relating to external auditors, financial reporting for Islamic banks, financial reporting for takaful operator, and streamlining capital funds for Islamic banks.*
Strengthen framework for consolidated supervision of financial holding companies (FHC) including capital standards and risk management. *BNM has extended its legal powers over FHC with the adoption of FSA and IFSA in June 2013. BNM is currently in discussion with the financial institutions (for financial groups which have not been identified under the previous legislation, BAFIA 1989) to identify and assess the appropriate holding companies to be designated as FHC by June 2015, as provided under the legislations. BNM has issued a strategy paper on the Bank's plan with regard to regulation and supervision of financial groups; re-issued final regulatory expectations extending to FHC the application of the standards on External Auditors and Financial Reporting; issued regulatory expectations concept papers on Consolidated Capital Standards and Compliance. During 2015, BNM intends to issue concept papers on Corporate Governance and Risk Governance, applicable to financial institutions and FHCs.*
Ground the operational independence of the Securities Commission (SC) by changing the legal provisions on removal of Commission members and protections given to Commission members and its staff. *Related amendments to the SC Act have been submitted to the Ministry of Finance for tabling at the Parliament in March 2015.*
Strengthen the definition of connected lending. *BNM issued a revised policy to strengthen the definition of connected lending that includes definition of connected party, influential shareholders and close relatives. This was added in the 'Guidelines on credit transactions and exposures with connected parties' in July 2014.*
Labuan International Business and Finance Center
Impose prudential and regulatory requirements on Labuan financial institutions in line with international standards and best practice. *During 2014, Labuan FSA has issued guidelines to enhance capital adequacy requirements for (Re)insurers; to harmonize financial reporting standards to complement capital requirements; and to enhance the fitness and propriety person requirements. During 2015, there are plans to issue guidelines to further enhance capital guidelines for (Re)insurers; to increase Basel capital adequacy requirements for Banks; and to provide explicit legal backing to prudential requirements.*
Undertake more proactive engagement and effective communication of LFSA with home supervisors and external auditors. *The BNM continues to sign new MoUs with home supervisors of Labuan entities (5 more added in 2013 and 2014). These cover exchange of supervisory information and collaboration in enforcement. Labuan FSA has written to the home regulators of Labuan licensed entities to seek their confirmation that the coverage of their consolidated supervision includes Labuan entities and had obtained some responses.*
Systemic Risk Management
Formalize a high-level committee involving BNM, SC, PIDM and the fiscal authority with the responsibility for ongoing systemic risk monitoring, information sharing and crisis action. *The Financial Stability Executive Committee (FSEC) formed in 2010 now also includes, the Chairman of the*

Securities Commission as a permanent member of the Executive Committee (since 2012) along with the BNM, PIDM and MoF.
Macro-Financial Risks
Enhance data capture for household sector to facilitate a more robust and granular monitoring and assessment of household sector leverage and issues especially in accordance to income category; and review effectiveness of macroprudential measures. *Enhancements to the data capture for households are undertaken in phases. The first phase involves the matching of credit and income data from the tax authority. This is in progress and expected to be completed by second half of 2015.*
Adopt multiyear top-down and bottom-up macroeconomic stress testing, and introduce more conservative credit loss parameters in bottom up exercise. *The Bank has implemented a top-down multi-year macro stress test framework in 2013, with a number of enhancements to the framework made in 2014 which include enhanced satellite models for multi-year income/expenses shocks and projections by detailed income segments (net interest income, net trading and investment income, fee income and staff costs/overheads); quantitative models to project multi-year balance sheet growth (credit, market, operational risk-weighted assets); and simulated multi-year Basel III phase-out of capital instruments.* *This is complemented with enhanced calibration methods (multivariate regressions) using a wider range of data inputs to derive better estimates of conservative sectoral credit risk shocks (probability of default, loss given default)* *The application of the multi-year stress test for bottom-up stress test has also been rolled out in 2014.*

Appendix 8. Malaysia—Nonbank Financial Institutions

Malaysia: Financial System
(In percent of GDP)



Sources: Data provided by the authorities; and IMF staff calculations.

Background. The nonbank sector in Malaysia[1] includes pension funds, assets under management, and nonbank credit intermediaries. The Employees Provident Fund (EPF) and the Government Pension Fund (KWAP) manages mandatory employee contributions for the private and public sectors, respectively, and the combined assets are about 70 percent of GDP. Assets under management (AUM) which amounts to about 60 percent of GDP, include unit trusts, money market mutual funds, and other funds; with approximately 85 percent invested in domestic assets. The nonbank sector allows savers and owners of wealth to diversify their portfolio away from bank deposits and housing.

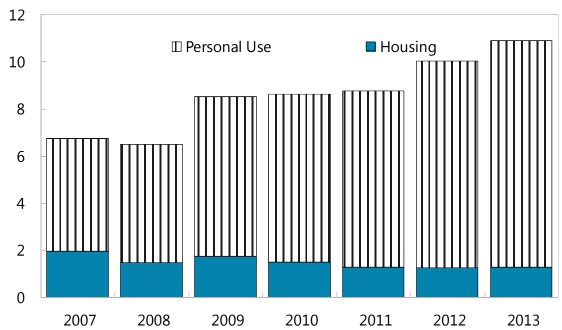
Recent developments. The nonbank sector in Malaysia has grown from about 140 percent of GDP at end-2009 to about 165 percent of GDP by end-2013, with strongest growth in the assets under management segment, which increased by over 30 percent over the same period. In addition, growth in nonbank credit intermediaries out-stripped the pace of growth in the banking system. The experience in Malaysia is not unlike other emerging market economies which have also experienced rapid growth in nonbank financial intermediaries since the global financial crisis. For example, in Thailand assets of the nonbank sector increased as a share of GDP by over 9 percentage points.

Nonbank credit intermediaries. Lending from nonbank credit intermediaries to households increased strongly in recent years. It has doubled since 2009, accounting for about 20 percent of household debt at end-2013 (see Box 4: Household Debt, 2013 Malaysia Staff Report), and contributing to rapid growth in household debt from 72 percent of GDP at end-2009 to 86 percent of GDP by end-2013. Much of the increase from nonbank intermediaries was in personal lending. Credit risk is relatively low, especially loans to government workers which are serviced through automatic salary deductions with an aggregate deduction cap of 60 percent. However, asset growth was also driven in part by increased offerings of personal finance products with unfavorable terms, such as unrealistically long tenors. Measures taken by BNM in July 2013, using powers to address systemic risk outside the regulatory perimeter, have been very effective in curtailing risks and slowing growth in unsecured personal credit (see text chart). These measures included limiting tenors on unsecured personal lending and prohibiting unsolicited offers of credit. The Financial

[1] BNM defines non-bank financial institutions as those which undertake financial intermediation (including credit intermediation) activities that are not under its regulatory and supervisory purview. The Securities Commission regulates the fund management industry; Provident Funds and some development Financial Institutions are regulated by government ministries; and the Malaysian Co-operative Societies Commission has oversight of cooperatives. Building Societies and Factoring and Leasing companies are unregulated.

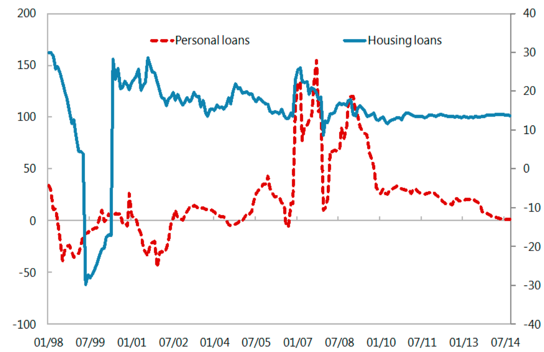
Services Act 2013 (FSA) and Islamic Financial Services Act 2013 (IFSA) came into force on 30 June 2013. These gave BNM broad powers to regulate and supervise nonbanks, when there is a risk to financial stability.

Malaysia: Household Loans from NBFIs and DFIs by purpose
(In percent of GDP)



Sources: BNM; Annual Reports of NBFIs; and staff calculations

Malaysia: Banking System, Housing and Personal Loans
(Year-on-year percentage change)

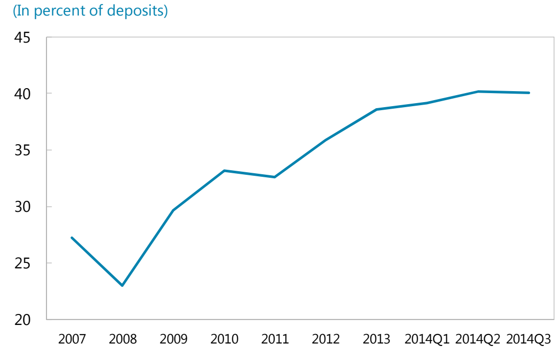


Sources: CEIC

Linkages with the banking system. Systemic risks to the banking system, stemming from direct linkages with nonbank financial institutions, are likely to be limited. Nonbank credit intermediaries are small, noncomplex entities, funded by internally-generated funds, bank borrowing, debt securities, and, in some cases, deposits. Direct linkages with the banks are limited—deposits of nonbank financial institutions with banks represents about 6 percent of total bank deposits while bank lending to nonbank credit intermediaries (including holdings of debt) amounts to just 2.1 percent of total banking system assets, and are covered by BNM's regulations on single counterparty exposures. Nevertheless, there could be indirect linkages with the banking system through participation in the domestic capital markets.

Assets under management (AUM). Assets under management have increased from 45 to 60 percent of GDP between end-2009 and end-2013 or from 30 percent deposits to 40 percent of deposits (see text chart). This rapid growth reflects ongoing development of the financial market in Malaysia but cyclical factors such as negative real interest rates on deposits have also contributed, adding to concerns about financial risk-taking. The unit trust segment has exhibited the strongest growth, increasing by over 150 percent since end-2009 and now accounts for over half of assets under management and about 20 percent of stock market capitalization. The fund management industry is largely regulated by the Securities Commission (SC) of Malaysia.

Assets under Management
(In percent of deposits)



Sources: CEIC; Securities Commission Malaysia

INTERNATIONAL MONETARY FUND

MALAYSIA

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 23, 2015

Prepared By

Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of December 31, 2014)

Membership Status: Joined March 7, 1958; Article VIII

General Resources Account

	SDR Millions	Percent of Quota
Quota	1,773.90	100.00
Fund holdings of currency (exchange rate)	1,164.22	65.63
Reserve tranche position	609.68	34.37
Lending to the Fund		
New Arrangement to Borrow	40.82	

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	1,346.14	100.00
Holdings	1,286.64	95.58

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to the Fund: None.

Exchange Arrangement:

On July 21, 2005, Bank Negara Malaysia announced the adoption of a managed float with the exchange rate of the ringgit to be monitored against an undisclosed trade-weighted basket of currencies. Based on information on the exchange rate behavior, the de facto exchange rate regime is classified as "other managed."

Malaysia maintains bilateral payments arrangements with 23 countries. The authorities have indicated that these arrangements do not have restrictive features.

Capital control measures imposed in early 1994 and in 1998 in the wake of the Asian crisis have mostly been lifted, except for the internationalization of the ringgit. In particular, since May 2001, nonresident portfolio investors are freely allowed to repatriate their principal sums and profits out of the country at any time. Malaysia further liberalized exchange control regulations during 2002−13. The main measures were a relaxation of regulations on investment abroad by domestic institutions, an easing of regulations on ringgit borrowing obtained by nonresidents from residents for use in Malaysia, ringgit and foreign currency borrowing obtained by residents from non-residents, abolition of overnight limits on all foreign currency accounts maintained by residents and of the net open position limit imposed on licensed onshore banks, allowing residents to open and maintain foreign currency accounts for any purpose, abolition of several reporting requirements, and a relaxation of the conditions on residents and nonresidents to enter into foreign exchange forward contracts to hedge current and capital account transactions with licensed onshore banks.

The Malaysian authorities view remaining exchange control regulations as prudential in nature and necessary to ensure the availability of adequate information on the settlement of payments and receipts as part of the monitoring mechanism on capital flows. These controls do not contravene Malaysia's obligations under Article VIII.

Malaysia, in accordance with the UN Security Council resolutions, maintains restrictions on payments and transfers for current international transactions with respect to some designated individuals and entities. These measures are maintained for the reasons of national and international security and have been notified to the Fund pursuant to the IMF Executive Board Decision No. 144 (52/51). Malaysia also restricts current international transactions between Malaysian residents and Israeli companies and individuals; however, since these restrictions affect the underlying transactions themselves, they are not subject to Fund jurisdiction under Article VIII, Section 2(b).

Article IV Consultation:

Malaysia is on the standard 12-month consultation cycle. Discussions for the 2013 Article IV consultation took place during December 5–16, 2013 (IMF Country Report No. 14/80). Staff discussions for the 2014 Article IV consultation were conducted on a mission to Kuala Lumpur during November 13–24, 2014. In addition, a staff visit took place during June 18–27, 2014.

Financial Sector Assessment Program (FSAP) Participation:

Malaysia conducted its first FSAP in 2012 (IMF Country Report Nos. 13/52, 13/53, and 13/56–13/60).

Technical Assistance:

Fiscal Affairs Department (FAD): A fiscal ROSC mission was fielded in May–June 2011. A mission on fiscal risks took place in January 2013. A mission to assist with implementation of the Goods and Services Tax was conducted in March 2014. Several missions on Public Financial Management were fielded in 2014.

Legal Department (LEG): Missions were fielded in May and September 2011 to help draft a Centralized Asset Management Corporations Bill, in the context of a three-year project to assist Malaysia in implementing an asset forfeiture regime. Technical Assistance

Monetary and Capital Markets Department (MCM): Mission in October 2009 on macrofinancial risk analysis and vulnerability analysis for corporate and financial institutions. Workshop in May 2010 on monitoring financial risks. Technical assistance missions on stress testing capital markets was conducted in 2013.

Statistics Department (STA): A mission to assist with implementing the sixth edition of the *Balance of Payments and International Investment Position Manual* (*BPM6*) was conducted during May–June, 2013. Technical assistance missions on Government Financial Statistics were conducted during 2014.

Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT):

In November 2014, Malaysia's AML/CFT regime was subject of an on-site assessment by the Asia Pacific Group on Money Laundering (APG) under the new methodology of the Financial Action Task Force (FATF), the global standard setter for AML/CFT. LEG participated in the assessment and is contributing to the final report, which is scheduled for discussion in APG's July 2015 Plenary. In addition, FATF admitted Malaysia as an observer country in October 2014, and is working with authorities towards meeting all requirements for full FATF membership.

Resident Representative/Advisor: None.

STATISTICAL ISSUES

(As of January 10, 2015)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance. However, further efforts to improve statistics for the consolidated general government and public sector are necessary.
National accounts: Currently, the Department of Statistics Malaysia (DOSM) compiles and publishes annual and quarterly estimates of GDP by activity and by expenditure at current and constant prices, and annual estimates for gross disposable income, saving, and net lending for the economy based on the *1993 SNA*. The quarterly data are released about two months after the reference quarter. **Price statistics**: The CPI and the PPI are available on a timely and comprehensive basis. A revised CPI was introduced in January 2011; it covers all 14 states and features a more disaggregated measure of the consumption basket and updated expenditure weights based on a 2009/10 comprehensive household income and expenditure survey.
Government finance statistics: There is a need to improve the timeliness, detail, and availability of data on NFPEs and the state and local governments. Dissemination of more detailed data on nonlisted NFPEs' assets and liabilities and domestic and foreign financing by type of debt instrument and holder would be desirable; efforts in this direction will require continued close collaboration among the Economic Planning Unit (EPU), the Treasury, and Bank Negara Malaysia (BNM). There is also a need to disseminate more information on public private partnerships.
Monetary statistics: The monetary and financial statistics (MFS) are reported on a timely and regular basis and are broadly in conformity with the Fund's data needs. There is a need to improve the institutional coverage of the financial corporations, sectorization of the domestic economy, and classification and valuation of financial instruments to ensure full adherence to the IMF's *Monetary and Financial Statistics Manual*. In addition, due to the growing importance of insurance corporations, pension funds, and other financial intermediaries in Malaysia, coverage of MFS should be expanded to include these institutions. The MFS missions of January 2004 and 2005 developed an integrated monetary database to be used for publication and operational needs of the BNM, STA, and APD. The Bank Negara Malaysia reports data in STA's standardized report forms (SRFs) which provide more detailed classification of certain items, fuller sectoral and instrument breakdown, and currency aggregation. MFS based on the SRFs are published in the quarterly *IFS Supplement on Monetary and Financial Statistics*.
Balance of payments: Department of Statistics Malaysia compiles and publishes quarterly balance of payments estimates in accordance with the sixth edition of the Balance of Payments Manual and the SDDS. The quarterly data are released three months after the reference quarter. No data are shown for the capital transfers or acquisition/sale of nonproduced nonfinancial assets, and transactions in reserve assets are computed as differences in amounts outstanding and thus include valuation changes. The international investment position data on other investment—assets and liabilities—are reported only in an aggregate form.
II. Data Standards and Quality
Malaysia subscribes to the Special Data Dissemination Standard (SDDS). It is using a timeliness flexibility option for general government operations (within six quarter lags after the end of reference year).

Malaysia: Table of Common Indicators Required for Surveillance

(As of January 23, 2015)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange rates	1/23/2015	1/23/2015	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	1/22/2015	1/22/2015	Bi W	Bi W	Bi W
Reserve/base money	1/22/2015	1/22/2015	Bi W	Bi W	Bi W
Broad money	11/14	1/9/2015	M	M	M
Central bank balance sheet	11/14	1/9/2015	Bi W	Bi W	Bi W
Consolidated balance sheet of the banking system	11/14	1/9/2015	M	M	M
Interest rates[2]	1/23/2015	1/23/2015	D	D	D
Consumer price index	12/14	1/15	M	M	M
Revenue, expenditure, balance and composition of financing[3]—general government[4]	2013	2014	A	A	A
Revenue, expenditure, balance and composition of financing[3]—federal government	2014:Q3	11/14	Q	Q	Q
Stocks of central government and central government guaranteed debt[5]	2014:Q3	11/14	Q	Q	Q
External current account balance	2014:Q3	11/14	Q	Q	Q
Exports and imports of goods and services	11/14	1/15	M	M	M
GDP/GNP	2014:Q3	11/14	Q	Q	Q
Gross external debt	2014:Q3	11/14	Q	Q	Q
International Investment Position	2013	11/14	A	A	A

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing is only available on an annual basis.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A).

Press Release No. 15/88
FOR IMMEDIATE RELEASE
March 3, 2015

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes Article IV Consultation with Malaysia

On February 13, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Malaysia.

Malaysia's well diversified economy continued to perform well in 2014. Growth accelerated to 5.9 percent, aided by robust domestic private demand and a recovery in exports. Lower energy costs helped contain inflation to 3.1 percent despite the removal of fuel subsidies and increase in electricity tariffs. Investment sustained its rising trend, reaching 26.8 percent of GDP in 2014, fueled by accommodative financial conditions and continued public spending on infrastructure. Growth is expected to moderate to 4.8 percent in 2015. Strong investment momentum should help offset headwinds from continued fiscal consolidation. Lower energy prices will be a drag on oil and gas production but should provide a boost to the large non-oil sector. Consumption growth will moderate following the introduction of goods and services tax (GST), although a strong labor market and supportive—albeit gradually tightening—domestic financial conditions and lower energy costs should help consumers.

Fiscal consolidation is well timed, appropriately paced, and remains on track. The authorities recently revised the federal budget resulting in a slight change of the budget deficit ceiling, to 3.2 percent from 3.0 percent of GDP, in a timely and pragmatic response to the sharp recent decline in international crude oil prices. They took bold fiscal action in 2014, continuing a multi-year drive to reduce costly and untargeted subsidies. After raising electricity tariffs in early 2014, they took advantage of lower energy prices in the second half of 2014 to reduce and ultimately remove remaining gasoline and diesel subsidies. Subsidy reform together with the GST, which is on track to be introduced in April, should help offset the reduction in energy revenues. They should also help broaden the base of federal revenue system and diversify it away from volatile oil and gas revenues. A strengthening of Malaysia's social safety net is an integral part of the authorities' fiscal strategy. The removal of subsidies freed up resources that can be redirected to better support poorer households through better targeted cash transfers. Malaysia is making progress in reforming its fiscal institutions. Top-down fiscal management and control are also

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

being strengthened and the size of supplementary budgets has been substantially reduced. These reforms will help reinforce the sustainability of Malaysia's public finances and make the fiscal system more effective in promoting efficiency, equity and growth.

Bank Negara Malaysia (BNM) took a step at normalizing monetary conditions in July but has since paused as downside risks to growth increased and inflation remained low, while risks to financial stability abated. Headline inflation will increase slightly, to 3.2 percent in 2015 from 3.1 percent in 2014, reflecting the net impact of subsidy rationalization, GST implementation, and exchange rate depreciation. BNM has adopted a wait-and-see attitude, and this cautious stance is appropriate for now taking into consideration lower expected inflation, the slowdown in domestic economic growth, and increased uncertainty surrounding the domestic and global outlook. It would be prudent to move to a neutral monetary policy stance as soon as the uncertainty in the external environment dissipates. Malaysia's financial system is sound and well-placed to withstand stresses, including from a potentially bumpy and asynchronous normalization of monetary policies in the advanced economies. The high level of household debt together with large participation of foreign investors in Malaysia's financial markets warrant continued vigilance. The flexible exchange rate system and substantial financial buffers, as well as offsetting action by domestic institutional investors, provide multiple lines of defense against capital flow volatility.

Favorable domestic economic conditions offer a window of opportunity to continue structural reforms to raise productivity growth by increasing innovation, raising the quality of education, addressing youth unemployment, and increasing female labor force participation. Malaysia also stands to benefit from its outward economic orientation and the strengthening of regional economic and financial integration underway, including the creation of the ASEAN Economic Community in 2015 and other trade initiatives. Accelerating the pace of regional integration should help unleash Malaysia's and ASEAN's economic potential.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They considered that Malaysia's economic prospects remain favorable, notwithstanding risks from softening external demand, volatile capital flows, and lower commodity prices. Directors shared the view that Malaysia is well-placed to address these risks, given a track record of skilful macroeconomic management, strong policy frameworks, and a sound financial system.

Directors commended the authorities' continued commitment to fiscal prudence. They welcomed their response to weaker oil-related revenues, especially the removal of poorly-targeted fuel subsidies which creates budgetary space for needed social and capital investment. Directors cautioned, however, that a prolonged period of depressed commodity prices may require further fiscal adjustment. Accordingly, they encouraged the authorities to consider broadening the

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

revenue base, phase out remaining untargeted subsidies, and further improve public financial management and social transfers.

Directors agreed that the current accommodative monetary policy stance is appropriate, given subdued inflation and the likelihood that prospective price increases related to the introduction of a value-added tax will be offset by lower energy prices. More broadly, they commended Bank Negara Malaysia's cautious policymaking to ensure that monetary policy continues to support non-inflationary growth and financial stability.

Directors noted that Malaysia's financial system is sound and benefits from a strong regulatory and supervisory framework. They considered that policies have been successful so far in containing financial vulnerabilities, although high household debt warrants continued vigilance. In this regard, Directors cautioned that additional macroprudential measures could be needed if the low interest rate environment leads to excessive leverage.

Directors welcomed the ongoing reduction of Malaysia's current account surplus, which reflects in part the economy's rebalancing toward domestic demand. They took note of the staff's assessment that the external position remains somewhat stronger than warranted by medium-term fundamentals, but stressed the uncertainty surrounding such an assessment.

Directors praised Malaysia's impressive strides in economic development, which is the outcome of comprehensive initiatives to boost investment, improve infrastructure, and upgrade human capital. They agreed that Malaysia's commitment to regional integration should also help support the country's transition to high-income status by further enhancing competition and productivity.

Table 1. Malaysia: Selected Economic and Financial Indicators, 2010–15

Nominal GDP (2013): US$313 billion

Main export (percent of total): electrical & electronic products (39%), commodities (23%)

GDP per capita (2013): US$10,468

Population (2013): 29.9 million

Unemployment rate (2013): 3.1 percent

	2010	2011	2012	2013	Est. 2014	Proj. 2015
Real GDP (percent change)	7.4	5.2	5.6	4.7	5.9	4.8
Total domestic demand	11.1	7.1	11.1	6.4	5.5	5.4
Consumption	6.2	8.8	7.5	7.0	6.5	5.1
Private consumption	6.9	6.9	8.2	7.2	7.6	6.2
Gross capital formation	25.3	3.0	20.3	4.9	3.0	5.9
Public gross fixed capital formation	4.9	2.6	14.6	2.2	2.6	4.4
Private gross fixed capital formation	18.4	9.4	22.8	13.1	9.0	6.5
Saving and investment (in percent of GDP)						
Gross domestic investment	23.3	23.2	25.9	26.1	26.8	27.6
Gross national saving	34.2	34.8	31.7	30.1	30.3	30.5
Federal government overall balance 1/	-5.3	-4.8	-5.2	-4.3	-3.5	-3.2
Revenue	19.9	20.9	21.3	21.1	20.7	19.3
Expenditure and net lending	25.2	25.7	26.5	25.4	24.2	22.5
Federal government non-oil primary balance	-10.4	-10.2	-10.6	-9.0	-7.5	-5.0
Consolidated public sector overall balance 2/	-2.6	-3.4	-5.6	-6.2	-5.2	-4.7
General government debt	53.5	54.2	56.2	57.7	56.4	55.9
CPI inflation (period average)	1.7	3.2	1.7	2.1	3.1	3.2
Unemployment rate	3.3	3.1	3.0	3.1	3.0	3.0
Money and credit (end of period, percentage change)						
Total liquidity (M3)	6.8	14.3	9.0	8.1	7.1	...
Credit to private sector	9.7	12.1	11.9	9.9	9.3	...
Three-month interbank rate (in percent)	3.0	3.2	3.2	3.2	3.9	...
Corporate debt (in percent of GDP) 3/	52.5	45.3	47.6	54.4	57.7	...
Household debt (in percent of GDP)	74.5	76.2	81.2	86.6	...	...
House prices (percentage change)	6.9	9.8	11.8	10.9	...	...
Balance of payments (in billions of U.S. dollars)						
Current account balance	27.1	33.5	17.6	12.3	11.7	10.4
(In percent of GDP)	10.9	11.6	5.8	4.0	3.5	2.9
Trade balance	42.5	49.5	40.5	34.3	35.4	33.1
Services and income account balance	-8.6	-9.2	-16.9	-16.1	-17.1	-18.1
Capital and financial account balance	-6.2	7.6	-7.5	-5.0	-30.5	-2.7
Overall balance	-0.8	30.9	1.3	4.6	-18.8	7.7

Gross official reserves (US$ billions)	106.5	133.6	139.7	134.9	116.1	123.8
(In months of following year's imports)	5.9	7.1	7.4	6.8	5.6	5.6
(In percent of short-term debt) 4/ 5/	121.0	126.1	119.1	104.4	81.0	78.7
Total external debt (US$ billions)	141.8	169.4	196.2	211.7	230.0	249.7
(In percent of GDP)	57.3	58.5	64.3	67.6	69.4	69.5
Of which: short-term (in percent of total) 4/	62.1	62.6	59.8	61.1	62.3	63.1
Debt service ratio 5/						
(In percent of exports of goods and services)	8.4	11.1	11.4	11.7	12.0	12.2
(In percent of exports of goods and nonfactor services)	8.8	11.8	12.0	12.4	12.7	12.9
Memorandum items:						
Nominal GDP (in billions of US$)	248	289	305	313	331	359

Sources: CEIC Data Co. Ltd; Data provided by the authorities; Dealogic; and Fund staff estimates.

1/ Based on staff's estimate of the federal government fiscal balance using GFSM 2001, which differs from the authorities' cash-based measure of the fiscal deficit.

2/ Capital expenditure in the budget includes foreign fixed assets and other items, such as purchase of shares and land, which are excluded from public investment in the national accounts.

3/ Nonfinancial corporates by parent nationality.

4/ By remaining maturity.

5/ On foreign currency denominated debt only.

Statement by Mr. Wimboh Santoso, Executive Director for Malaysia and Ms. Nooraihan Mohd Radzuan, Advisor to Executive Director

February 13, 2015

1. On behalf of the Malaysian authorities, we would like to thank the IMF team for the constructive and open discussions on macroeconomic developments and policy issues in Malaysia. For the most part, there is broad agreement on almost all the major policy thrusts. We are further encouraged by the assessment that the current policy stance is appropriately calibrated to reflect the outlook and risks facing the economy. This statement will provide an update on the latest developments in Malaysia and elaborate on selected policy issues.

Economic Outlook

2. The outlook for the Malaysian economy remains favorable, despite the more challenging global environment. The authorities have projected the Malaysian economy to expand at a steady pace of between 4.5% and 5.5% in 2015, driven mainly by domestic demand. The staff estimates and recent forecasts by private sector economists are therefore, in line with the authorities' projection. Private consumption will remain supported by the steady rise in incomes, stable employment conditions and the additional disposable income from the lower oil prices. Investment activity is projected to remain resilient, with broadbased capital spending by both the private and public sectors cushioning the lower oil and gas-related investment. On the external front, the expected improvement in manufactured exports will partly offset the impact of lower commodities exports. With lower energy and commodity prices, inflation for 2015 is expected to be lower than earlier anticipated. The projected lower energy prices will partially offset other domestic cost factors, including the impact of the introduction of the Goods and Services Tax (GST).

3. Malaysia has, over the last decade, embarked on various structural reforms and initiatives to achieve strong foundations and well-diversified economic structure. Thus, while the commodities sector has an important role in the economy, the existing structure of the economy will allow the country to weather the negative impact from the sharp decline in commodity prices. The mining sector accounts for only 8% of GDP, a relatively small share compared to the services (55% share of GDP) and manufacturing (25% share) sectors. In terms of exports, the commodities sector accounts for 23% of gross exports while the bulk of Malaysia's exports is manufactured goods (76% of gross exports). In addition, the higher disposable income from the lower fuel prices will offset the fall in commodity-related income. Employment in the commodity sectors account for only 13% of total employment, compared to 60% and 17% shares in the services and manufacturing sectors, respectively. While the oil shock will affect investment in the oil and gas sector, capital spending in Malaysia remains broad-based, with 83% of the growth in total investment in 2013 coming from the services and manufacturing sectors.

External Sector Assessment

4. The current account balance will narrow but is expected to remain in surplus. While the sharp decline in energy prices will result in a narrowing of the commodities surplus, exports of manufactured goods will continue to expand, in line with the improvement in the

global growth trajectory. Malaysia's external sector will continue to reflect the changing global environment and the on-going structural transformation of the domestic economy.

5. Given the significant degree of integration with the global economy and financial markets, Malaysia has experienced increased volatility in recent months amid shifts in global liquidity and heightened uncertainty, particularly with regard to global growth prospects and the decline in commodity prices. This has led to capital flow reversals and a depreciation of the Malaysian ringgit, developments that have also affected other emerging economies. Notwithstanding the challenging external environment, Malaysia's well-developed financial markets and well-capitalized banking institutions have ensured that these reversals of flows were effectively intermediated by the financial system, without adversely affecting real economic activity. Greater exchange rate flexibility, a healthy level of international reserves and the availability of a wide range of monetary instruments have also accorded authorities the policy flexibility to manage these external shocks. In this regard, the recent market overreaction that resulted in portfolio flow reversals provided clear evidence of the need for an open economy like Malaysia to have a sufficient reserves buffer. Going forward, authorities will remain focused on their mandate to maintain orderly financial market conditions and mitigate risks of abrupt adjustments to the exchange rate over a short period of time in order to minimize potential disruptions to the real economy.

Monetary Policy

6. The current monetary policy stance remains accommodative and is assessed to be appropriate given the balance of risks to the outlook for domestic growth and inflation, having taken into consideration the greater downside risks emanating from the external environment and the lower than anticipated inflation going forward. The Monetary Policy Committee (MPC) of BNM will continue to carefully assess the external developments and their implications for the Malaysian economy. The MPC will also continue to monitor the risks of destabilizing financial imbalances. This is to ensure that the monetary policy stance is consistent with the longer-term sustainability of the Malaysian economic growth.

Fiscal Policy

7. The Malaysian authorities have remained steadfast in their commitment towards fiscal consolidation. Since first announcing its target of achieving a balanced budget by 2020, the Government has consistently achieved its annual fiscal targets. The fiscal consolidation strategy was comprehensive, with reforms to broaden the Government's revenue base and reduce reliance on oil-related revenue over the longer-term. As a result, the share of oil related revenue to total Federal Government revenue has fallen from around 40% in 2009 to 30% in 2013.

8. Going forward, the conduct of fiscal policy will continue to be centered on ensuring sound public finances while remaining supportive of policies for sustainable and balanced economic growth. In response to the significant decline in oil prices, the Government had proposed a mix of expenditure-optimization and revenue-enhancement measures to ensure that fiscal consolidation would remain on track. As a result of these measures, the fiscal deficit is expected to further decline from 3.5% of GDP in 2014 to 3.2% of GDP in 2015, the sixth consecutive decrease in the fiscal deficit to GDP. While this is a more gradual

consolidation compared to the earlier announced fiscal deficit target of 3%, the course of fiscal consolidation remains intact and will be underpinned by reforms to broaden the Government's revenue base, the removal of fuel subsidies and greater optimization of supplies and services expenditure. As a result of the measures announced, the Federal Government debt-to-GDP ratio will be contained within 55%.

9. The Malaysian authorities remain committed to ongoing reforms to strengthen public finances over the long-term. Fiscal reforms and a more strategic management of resources will continue to be judiciously pursued on several fronts without undermining economic growth and the well-being of the population, particularly, the low-income and vulnerable groups. In light of the lower oil prices, the Government had removed fuel subsidies and implemented a managed float system for fuel prices. Of significance, the broad-based and more efficient Goods and Services Tax (GST) is on target to be introduced in April 2015. The move is expected to streamline the present tax structure to make it more efficient, transparent and business friendly. Other initiatives to enhance fiscal sustainability include the implementation of accrual accounting and the adoption of outcome-based budgeting. Apart from embracing fiscal reforms to strengthen the Government's financial position, fiscal resources will be geared towards invigorating high value-added investments, intensifying human capital development and enhancing public sector delivery.

Financial Sector

10. Financial stability continued to be preserved in 2014 supported by financial strength and capital buffers both at the system and institutional levels. Stress tests undertaken by the authorities and staff have demonstrated the resilience of the banking system to major economic and financial market shocks. Of significance, the recent volatility in financial markets has not disrupted financial intermediation, with lending activities continuing smoothly. Businesses, including small and medium enterprises, continue to have access to financing from banking institutions and the capital market. Banking system liquidity also remains ample.

11. Growth in household debt has moderated since its peak in 2010, underpinned by the moderation in personal financing. Risks to domestic financial stability arising from household indebtedness remain manageable, supported by strong overall household financial capacity as well as continued improvement in the quality of new household debt. At the aggregate level, household financial assets remained healthy at 2.2 times of household debt. The likelihood of a material impact on the stability of the financial system arising from exposures to the household sector remains low, given the strong capitalization and financial strength of financial institutions.

12. While banking system deposit growth has moderated, this has largely been driven by a confluence of factors. These include growing investment abroad by large domestic institutional investors such as pension and provident funds and asset and fund management companies for revenue diversification and increase investments in higher yielding assets such as unit trust funds for wealth management and retirement savings purposes by households via the institutional fund/asset managers.

13. The macroprudential alongside fiscal measures introduced by the authorities in 2010-2013 have yielded positive results. Growth in personal financing by the non-bank financial sector has slowed considerably and growth in house prices has moderated. These measures were wide-ranging and include enhancing responsible lending practices by key credit providers, increasing the property gains tax, prohibiting the development and financing of property projects with elements of interest capitalization schemes and requirements on greater transparency in property prices by developers. Furthermore, the measures announced were targeted, in order to minimize unintended cross-sectional spillovers. Instead of a broadbased LTV ratio limit, the limit was aimed to curb speculative purchases whilst ensuring that eligible first time home buyers and those investing in a second house for wealth diversification would continue to have access to financing. Whilst the authorities deem the current macroprudential measures to be sufficient at this juncture and risks are assessed to be contained, the authorities continue to maintain their surveillance and supervisory vigilance at a heightened level. The authorities stand ready to act preemptively to address any resurgent of build-up of risks and threats to domestic financial stability.

14. The legislative framework underpinning Malaysia's financial sector was further strengthened with the enactment of the AMLATFA (Amendment) Bill addressing the risks and threats of money laundering and terrorist financing. In addition, the enactment of the Netting of Financial Agreements Act has now established Malaysia as a netting friendly jurisdiction.

Regional initiatives

15. Malaysia's chairmanship of ASEAN in 2015 comes at a critical juncture, with the ASEAN Economic Community 2015 (AEC 2015) expected to be established by the end of the year. Through collective efforts, the establishment of AEC 2015 aims to create a single market and production base and will entail the reduction or elimination of tariffs, the progressive liberalization and removal of barriers to trade and services, much of which have already been accomplished. As ASEAN chair in 2015, Malaysia will also help to develop the region's 10-year post-integration plan which will steer ASEAN's continued growth strategies from 2016 to 2025.

Reforms to enhance growth potential

16. Reform initiatives to accelerate Malaysia's transformation into a high-income economy by 2020 have also advanced. In recent years, the Government had implemented farreaching reforms to raise productivity, including raising the retirement age, implementing the minimum wage policy and enhancing the quality of education through the National Education Blueprint. Going forward, reform initiatives include tabling the Companies Bill 2014 which introduces provisions relating to Corporate Insolvency Law and the implementation of measures to improve logistics and enhance trade facilitation.

Final remarks

17. The authorities remain vigilant that the global economy is facing important economic shifts. The commodity price shock is sizable and there remains considerable uncertainty about global growth prospects. Investor sentiments have also been adversely affected. Nonetheless, the Malaysian economy is well-diversified, which will allow the economy to

weather these shocks with greater resilience. Economic fundamentals remain sound following decades of policy efforts to strategically and pro-actively address areas of vulnerabilities, and to build buffers to absorb any shocks to the system. While growth may be affected in the short-term, the Malaysian economy will continue to perform well, driven by the private sector across a diversified range of economic activities. Of importance, employment remains strong and incomes are rising. Inflation will remain anchored and the current account balance will remain in surplus. The strength of Malaysia's external position remains intact, with international reserves at healthy levels and external debt within prudent limits.

18. The authorities are pleased to inform the Executive Board that they agree to the publication of the full suite of reports, covering the 2014 Malaysia Article IV Staff Report and the Selected Issues Papers.