2 Malaysia

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I. Introduction

Situated in Southeastern Asia, Malaysia lies just north of the equator. It is one of the most developed and economically successful nations in the region today. The country consists of two parts: East Malaysia (Sabah and Sarawak) and West Malaysia (Peninsular Malaysia or Malaysian Borneo). Thailand lies to the north of Peninsular Malaysia, whereas the island state of Singapore lies at its southern tip. The South China Sea separates Peninsular Malaysia from East Malaysia, which is located on the Indonesian island of Borneo. Malaysia consists of 13 states and 3 federal territories. Malaysia practices parliamentary democracy with a constitutional monarch who bears the title Yang di-Pertuan Agong (head of state and customarily referred to as the king) and who is elected from among nine hereditary state rulers (Conference of Rulers) for a five-year term as the ceremonial head of state. In 2016 Malaysia celebrated 59 years of independence from the British. Malaysia is endowed with natural resources. It has large reserves of petroleum and natural gas and is a leading exporter of tin, rubber, palm oil, and tropical hardwoods. Known as one of Asia's tiger economies, Malaysia has grown rapidly—at an annual rate of about 10 percent—since the 1970s. However, its economy, like many across the world today, has experienced a downturn because of the global financial crisis, which began in 2008. Malaysia is an important member of the Pacific Rim organization APEC (Asia-Pacific Economic Forum) and ASEAN (the Association of Southeast Asian Nations). The world's tallest twin towers—the Petronas Towers located in the capital city of Kuala Lumpur—is a strong symbol of Malaysia's many economic achievements as well as its continued aspiration to be a fully developed country by the year 2020.

I.1 Geography and climate

The two parts of Malaysia— East Malaysia and West Malaysia make up a total land area of 127,355 square miles (330,242 square kilometers), slightly larger than the state of New Mexico. Malaysia is the 66th-largest country in the world in terms of land area. East Malaysia makes up around 60 percent of the total land area of the country, whereas West Malaysia makes up the remaining 40 percent. East and West Malaysia are separated by about 400 miles (640 km) of the South China Sea. In the days of sailing ships in the 15th and 16th centuries, harbors along the Straits of Melaka and on the southern tip of the Malay Peninsula were used by traders during the monsoon season as safe ports in which to weather the storms in the South China Sea.

Although Malaysia is hot and humid for most of the year, it does in fact have two seasons—the dry season and rainy season. Rain falls daily during the monsoon season, which has its peak during the months from November to February, but even during the drier part of the year (May to September), there are a couple of rain showers a week. Peninsular Malaysia receives an average rainfall of around 118 inches (300 centimeters), whereas East Malaysia receives 200 inches (508 cm) a year. Kuala Lumpur records an average of 195 rainy days a year and Kota Kinabalu 183. But Kuching holds the record with 247 rainy days a year! The daily average humidity is around 90 percent in Malaysia. Temperatures range from 77°F (25°C) to 95°F (32°C), with mostly cool nights.

I.2 Culture

Malaysia has a multi-ethnic, multicultural, and multilingual society. The original culture of the area stemmed from indigenous tribes that inhabited it, along with the Malays who later moved there. Substantial influence exists from Chinese and Indian culture, dating back to when foreign trade began. Other cultural influences include the Persian, Arabic, and British cultures. Due to the structure of the government, coupled with the social contract theory, there has been minimal cultural assimilation of ethnic minorities.

I.3 Demographics

As of the 2010 census, the population of Malaysia was 28,334,135, making it the 43rd most populated country. In 2017, the population in Malaysia is estimated at 32.0 million with 28.7 million are citizens and 3.3 million are non-citizens. The population of Malaysia consists of many ethnic groups. Malays make up 50.4 per cent of the population, while other bumiputra make up another 11 per cent. According to constitutional definition, Malays are Muslims who practice Malay customs and culture. They play a dominant role politically. Bumiputra status is also accorded to certain non-Malay indigenous peoples, including ethnic Thais, Khmers, Chams and the natives of Sabah and Sarawak. Non-Malay bumiputra make up more than half of Sarawak's population and over two thirds of Sabah's population. There also exist aboriginal groups in much smaller numbers on the peninsula, where they are collectively known as the Orang Asli. Laws over who gets bumiputra status vary between states.

I.4 Language

The official language of Malaysia is Malaysian, a standardized form of the Malay language. Historically English was the de facto administrative language, with Malay becoming predominant after the 1969 race riots. English remains an active second language, and serves as the medium of instruction for maths and sciences in all public schools. Malaysian English, also known as Malaysian Standard English, is a form of English derived from British English. Malaysian English is widely used in business, along with Manglish, which is a colloquial form of English with heavy Malay, Chinese, and Tamil influences. The government discourages the misuse of Malay and has instituted fines for public signs that mix Malay and English.

Many other languages are used in Malaysia, which contains speakers of 137 living languages. Peninsular Malaysia contains speakers of 41 of these languages. The native tribes of East Malaysia have their own languages which are related to, but easily distinguishable from, Malay. Iban is the main tribal language in Sarawak while Dusunic languages are spoken by the natives in Sabah. Chinese Malaysians predominately speak Chinese dialects from the southern provinces of China. The more common dialects in the country are Cantonese, Mandarin, Hokkien, Hakka, Hainanese, and Fuzhou. Tamil is used predominantly by Tamils, who form a majority of Malaysian Indians. Other south Asian languages are also widely spoken in Malaysia, as well as Thai. A small number of Malaysians have Caucasian ancestry and speak creole languages, such as the Portuguese based Malaccan Creoles, and the Spanish based Chavacano language.

I.5 Religion

.The Malaysian constitution guarantees freedom of religion while making Islam the state religion. According to the Population and Housing Census 2010 figures, ethnicity and religious beliefs correlate highly. Approximately 61.3% of the population practice Islam, 19.8% practice Buddhism, 9.2%

Christianity, 6.3% Hinduism and 1.3% practice Confucianism, Taoism and other traditional Chinese religions. 0.7% declared no religion and the remaining 1.4% practiced other religions or did not provide any information

All ethnic Malays are considered Muslim by law of the Constitution. Statistics from the 2010 Census indicate that 83.6% of the Chinese population identify as Buddhist, with significant numbers of adherents following Taoism (3.4%) and Christianity (11.1%), along with small Hui-Muslim populations in areas like Penang. The majority of the Indian population follow Hinduism (86.2%), with a significant minority identifying as Christians (6.0%) or Muslims (4.1%). Christianity is the predominant religion of the non-Malay bumiputra community (46.5%) with an additional 40.4% identifying as Muslims.

II. Overview of Macroeconomics Activities and Fiscal Position

II.1 Macroeconomics Activities

In 2016, the Malaysian economy recorded a growth of 4.2% (2015: 5.0%) despite considerable external and domestic headwinds. The global economic landscape was challenging given the subdued global demand and low commodity prices. International financial markets were also subjected to heightened uncertainty with significant reversal of capital flows from emerging economies. This was driven by the unexpected political developments in the advanced economies, such as the UK and the US, and the macroeconomic policies adopted by these economies. Domestically, the economy continued to face headwinds from the higher cost of living amid soft employment conditions. Concurrently, business and consumer sentiments were affected by a confluence of global and domestic factors, including the heightened volatility in financial markets and the significant underperformance of the ringgit.

Against these external and domestic challenges, all sectors of the economy recorded a modest expansion during the year. Domestic demand continued to anchor growth, supported mainly by private sector spending. Private consumption growth, in particular, was sustained at 6.1% (2015: 6.0%), supported by continued employment and wage growth following the increase in minimum wage and civil servant salaries. Government measures to boost disposable income such as the temporary reduction in employees' contribution to the Employees Provident Fund (EPF), higher Bantuan Rakyat 1Malaysia (BR1M) payouts and tax relief to lower-income tax payers also supported household spending. Public consumption growth moderated to 1.0% (2015: 4.4%) following the expenditure rationalisation adopted by the Government in early 2016 given the lower petroleum related revenue because of low crude oil prices. Gross fixed capital formation (GFCF) expanded moderately by 2.7% in 2016 (2015: 3.7%) driven mainly by lower private investment growth due to weak profitability and business sentiments. Public investment recorded a smaller rate of decline in 2016 (-0.5%; 2015: -1.0%) due to the smaller contraction in spending on fixed assets by public corporations given the higher investment in the downstream oil and gas industry, and the transportation and utilities sub-sectors.

On the supply side, all economic sectors continued to expand in 2016, with the exception of the agriculture sector. Agriculture production declined by 5.1% (2015: 1.2%), as crude palm oil (CPO) output was affected by the El Niño weather phenomenon. While growth in the services sector was higher at 5.6% (2015: 5.1%) following sustained demand in the consumer-related sectors, other sectors expanded more moderately.

Labour market conditions remained broadly stable as employment and wages continued to expand during the year. Net employment gains during the year amounted to 112,300 jobs, concentrated in the high-skilled segments such as professional and managerial jobs, while aggregate nominal wages in the private and public sectors grew by 4.2% and 6.7%, respectively in 2016 (2015: 4.9% and 4.7%, respectively). While total employment continued to expand, the pace however, was not able to fully absorb new labour market entrants as employers adopted a cautious stance and refrained from expanding their workforce too quickly. Consequently, the unemployment rate rose to 3.5% in 2016 (2015: 3.1%).

Inflationary pressures in the economy remained low with headline inflation averaging 2.1% in 2016 (2015: 2.1%). Despite the weaker ringgit exchange rate during the year, low global energy and commodity prices resulted in lower domestic fuel prices and input costs, which mitigated the impact of adjustments to administered prices and higher food prices caused by the El Niño phenomenon. Core inflation was also relatively stable during the year, averaging 2.1% in 2016 (2015: 2.3%) as demand driven inflationary pressures in the economy remained largely contained. This was underpinned by continued modest growth in private consumption and an absence of significant wage pressures.

Malaysia's external position remained resilient in 2016. The current account of the balance of payments remained in surplus, but by a smaller amount. The narrowing of the current account surplus reflected the lower trade surplus and the persistent structural deficits in the services and income accounts. Growth in gross exports moderated to 1.1% in 2016 (2015: 1.6%), reflecting the subdued global growth and low commodity prices. Gross imports recorded a higher growth of 1.9% (2015: 0.4%) driven by higher imports of capital goods amid the ongoing implementation of infrastructure projects and continued expansion in investment activity.

During the year, the financial account of the balance of payments improved against the environment of significant volatile cross-border capital flows. The financial account recorded a smaller net outflow of RM4.2 billion (2015: net outflow of RM50.9 billion) following a higher net inflow in the direct investment account amid lower net outflows in the portfolio and other investment accounts. During the year, the direct investment account recorded a higher net inflow of RM17.9 billion (2015: net inflow of RM4.8 billion) reflecting the lower direct investment abroad by Malaysian companies. The portfolio investment account recorded net outflows of RM19.7 billion (2015: net outflow of RM28.2 billion).

The international reserves of Bank Negara Malaysia (BNM) amounted to USD94.5 billion (equivalent to RM423.9 billion) as at end-2016. As at 28 February 2017, the reserves level amounted to USD95.0 billion (equivalent to RM426.3 billion). The international reserves remain ample to facilitate international transactions and sufficient to finance 8.5 months of retained imports and are 1.1 times the short-term external debt. Furthermore, exchange rate flexibility has enabled the economy to reduce its reliance on the BNM's international reserves.

Malaysia's external debt remains manageable. The external debt stood at RM908.7 billion, equivalent to USD200.6 billion or 73.9% of GDP as at end-2016 (2015: RM833.8 billion). The increase in external debt was partly attributed to valuation effects following the weakening of the ringgit against most currencies during the year. Excluding valuation effects, Malaysia's external debt increased by 6.2%, mainly on account of higher intercompany and interbank borrowings. The profile of Malaysia's external debt remained healthy with more than one-third of total external debt being denominated in ringgit, thus limiting the risks arising from foreign exchange fluctuations. The remaining portion of the external debt, which is denominated in foreign currency, is mostly hedged either naturally using export earnings or through the use of financial instruments. The rollover risks are also contained as more than half of the total external debt is of medium- to long-term maturity. In addition, not all short-term external debts pose a claim on reserves due to the availability of export earnings and external assets which enable borrowers to meet external obligations without necessarily creating a claim on international reserves.

Overall, the strong fundamentals of the Malaysian economy have accorded Malaysia the ability to weather these external and domestic challenges. The diversified sources of growth in the economy have helped to contain the spillover effects of sector-specific shocks. Stable labour market conditions amid continued wage growth continued to support household spending. Healthy financial institutions and ample domestic liquidity also ensured orderly financial intermediation. Notwithstanding the weak global demand, Malaysia's external position remained strong, supported by ample international reserves and manageable levels of external debt.

In addition, an appropriate and timely monetary policy response and targeted pro-growth measures played a key role in supporting growth during the year. The reduction of the Overnight Policy Rate (OPR) by the BNM was complemented by measures to increase household disposable income and support business activities. These included policies to create a conducive ecosystem for a sharing economy to thrive, temporary reduction in employees' EPF contributions, higher BR1M payouts and tax incentives to spur business activities, particularly among the small and medium enterprises (SMEs).

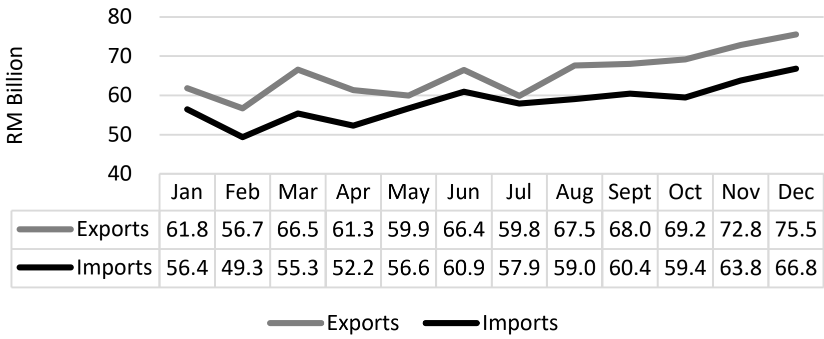
In recognising the impending challenges posed by global and domestic trends such as ageing populations, the influx of new technologies and slower growth in productivity, critical reforms and structural adjustments remained a priority to ensure the future growth of the Malaysian economy is sustained. These include efforts to enhance export competitiveness, ongoing investments to modernize physical and virtual infrastructure and policies to develop a high quality workforce by improving the quality of the education system.

II.1.1. International Environment

A. Trade Balance

Malaysia’s trade in 2016 remained resilient despite the uncertainties in the global environment. Exports rose by 1.1% to RM785.93 billion (2015:RM777.36 billion) and imports increased by 1.9% to RM698.66 billion (2015:RM685.78 billion), resulting in a trade surplus of RM87.27 billion, the 19th consecutive year of trade surplus since 1998.

Figure 1 Malaysia Trade Performance in 2016



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
Exports	61.8	56.7	66.5	61.3	59.9	66.4	59.8	67.5	68.0	69.2	72.8	75.5
Imports	56.4	49.3	55.3	52.2	56.6	60.9	57.9	59.0	60.4	59.4	63.8	66.8

Source: Department of Statistics, Malaysia, Compiled By: Matrade

Exports

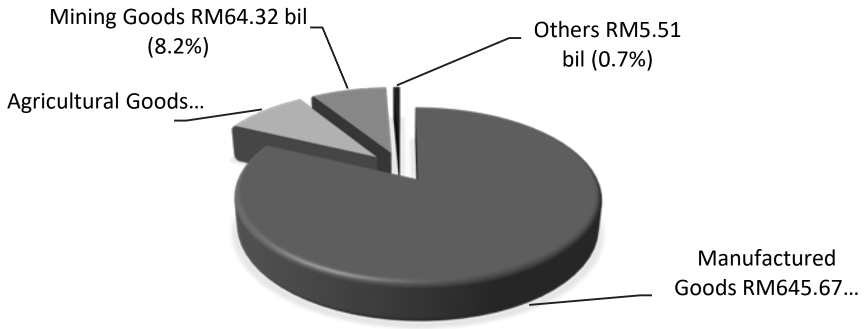
Major contributors to export growth in 2016 were expansion of manufactured and agricultural exports by 3.2% and 4.7%, respectively, compensating for the lower performance of mining goods; and continued growth for electrical and electronics (E&E) exports driven by strong global demand for electronic devices.

Exports of manufactured goods grew by 3.2% or RM20.24 billion to RM645.67 billion. Manufactured exports accounted for a larger share of total exports at 82.2% compared to 80.5% in 2015. Exports of E&E products rose by 3.5% or RM9.8 billion to RM287.72 billion, accounting for 36.6% of total exports. Other manufactured products that contributed to the growth in exports for 2016 were chemicals and chemical products, increased RM3.86 billion to RM58.99 billion; optical and scientific equipment, increased RM2.66 billion to RM28.75 billion; processed food, increased RM1.98 billion to RM19.99 billion; machinery, equipment and parts, increased RM1.53 billion to RM37.69 billion; transport equipment, increased RM1.46 billion to RM13.48 billion; and textiles, apparels and footwear, increased RM671.4 million to RM13.88 billion.

Higher exports of palm oil and palm-based agriculture products contributed to the expansion in exports of agricultural goods, which expanded by 4.7% or RM3.18 billion to RM70.43 billion, accounting for 9% share of total exports in 2016. Exports of palm oil and palm-based agriculture products increased by 5.9% to RM48.27 billion, contributed by higher exports of palm oil. Exports of palm oil increased by 3.3% or RM1.32 billion due mainly to higher AUV. However, exports of natural rubber declined by 10.2% to RM3.61 billion due to lower volume and AUV.

Exports of LNG and crude petroleum declined by 28.2% and 14.6%, respectively due to lower AUV, in tandem with lower global prices despite higher export volume. Exports of crude petroleum amounted to RM22.27 billion while LNG, RM32.02 billion. Reduced exports of these commodities impacted exports of mining goods which contracted by 19.8% or RM15.87 billion to RM64.32 billion. This sector made up 8.2% share of total exports in 2016.

Figure 2 Components of Malaysia's Exports 2016 (RM 785.93 Billion)



Source: Department of Statistics, Malaysia, Compiled By: Matrade

Exports Destinations

ASEAN remained as an important and strategic trading partner for Malaysia, taking up RM230.93 billion of Malaysia’s exports in 2016, an increase of 5.4%. ASEAN’s share of Malaysia’s total exports expanded from 28.2% in year 2015 to 29.4%, the highest share since 1993. Singapore remained the largest export market with a share of 49.6% of total exports to ASEAN. Exports to Viet Nam registered double digit growth for two consecutive years since 2015. In 2016, Viet Nam was Malaysia’s 10th largest export destination, four position up from 14th in 2015.

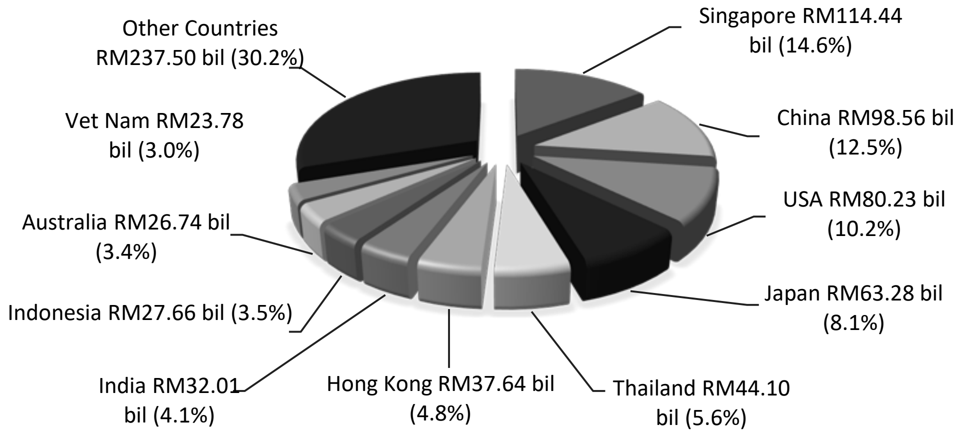
Exports to China were valued at RM98.56 billion, declined by 2.9%. Lower exports were recorded for commodities and manufactured goods particularly, LNG, natural rubber, palm oil and palm-based agriculture products, petroleum products, manufactures of metal as well as E&E products. However, exports of chemicals and chemical products, optical and scientific equipment, processed food, transport equipment and wood products registered increases.

Malaysia maintained sturdy export performance to the USA with an increase of 8.9% to RM80.23 billion. Increased exports to the USA was driven mainly by manufactured goods which accounted for 95.7% of Malaysia’s total exports to the country. Exports of this sector rose 10% to RM76.75 billion owing mainly to E&E products which increased by 10.5% or RM4.44 billion.

Exports to Japan decreased by 12.9% to RM63.28 billion. Lower exports to Japan was due to mining goods which declined by 31.6%, particularly, LNG. The decrease was attributed mainly to the lower Average Unit Value (AUV). On the contrary, better export performance was seen in the exports of manufactured goods to Japan which increased by 1.1%, accounting for 61.7% of total exports to Japan. The increase was contributed by higher exports of manufactures of metal, in particular, aluminium not alloyed, chemicals and chemical products, processed food, machinery, equipment and parts as well as textiles.

Exports to India increased by 1.1% to RM32.01 billion and accounted for 70.5% share of Malaysia's total exports to South Asia. Manufactured goods that made up 54.4% of Malaysia's exports to India grew by 8%, totalling RM17.43 billion in 2016. The expansion was attributed mainly to E&E products, manufactures of metal and transport equipment.

Figure 3 Malaysia's Export Destination 2016 (RM785.93 billion)



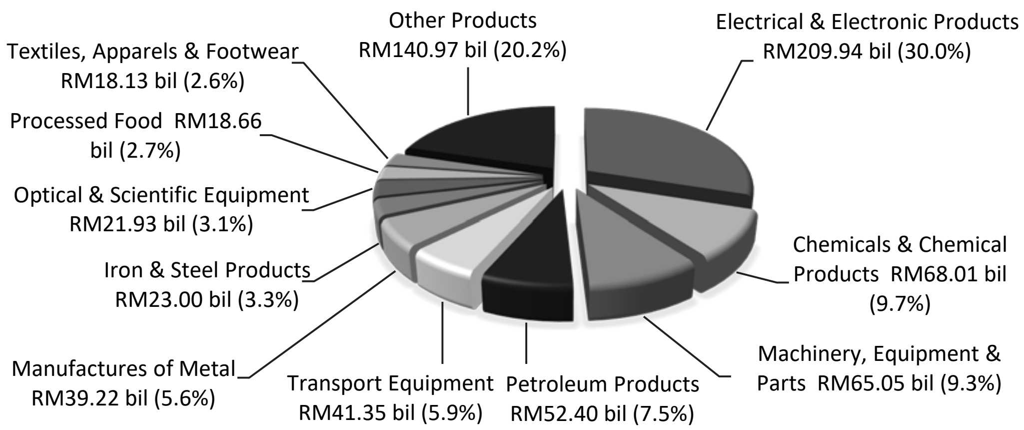
Source: Department of Statistics, Malaysia, Compiled By: Matrade

Imports

In 2016, Malaysia's total imports increased by 1.9% to RM698.66 billion, driven by higher imports of capital and consumption goods. The three main categories of imports by end use in 2016 were intermediate goods valued at RM399.08 billion or 57.1% of total imports, decreased by RM441.8 million or 0.1% from 2015; capital goods (RM100.21 billion or 14.3% of total imports), increased by RM4.66 billion or 4.9%; and consumption goods (RM67.03 billion or 9.6% of total imports), increased by RM4.6 billion or 7.4%.

Imports of manufactured goods, accounted for 88.2% of Malaysia's total imports. Major imports of manufactured goods in 2016 were E&E products, valued at RM209.94 billion, accounted for 30% share of Malaysia's total imports; chemicals and chemical products, RM68.01 billion, 9.7% share; and machinery, equipment and parts, RM65.05 billion, 9.3% share

Figure 4 Malaysia's Top 10 Major Imports 2016 (RM698.66 billion)



Source: Department of Statistics, Malaysia, Compiled By: Matrade

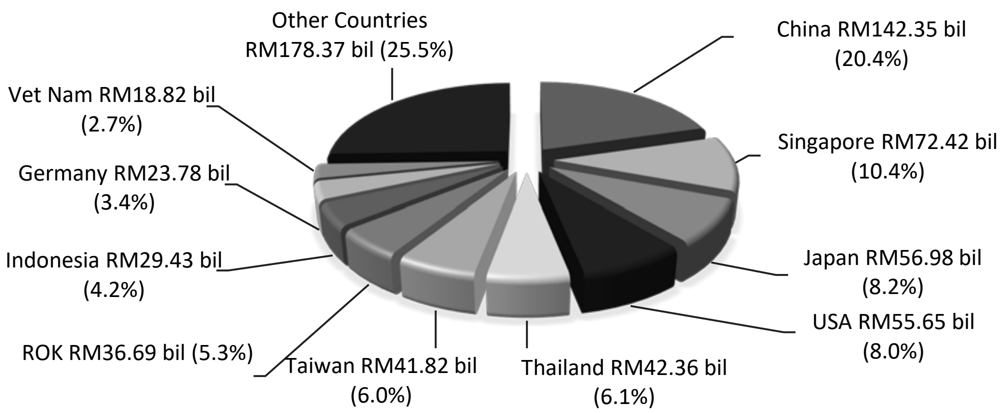
Nature of Imports

China remained the largest import source since 2011, followed by, Singapore, Japan, the USA and Thailand. These countries accounted for 53.1% of total imports. Higher imports from China with 20.4% share of total imports in 2016 were registered for petroleum products, E&E products, chemicals and chemical products as well as machinery, equipment and parts.

In 2016, ASEAN contributed RM171.73 billion or 24.6% share to Malaysia's total imports. Imports from ASEAN contracted by 5.7% to RM171.73 billion and main imports were E&E products, petroleum products, chemicals and chemical products, as well as machinery, equipment and parts.

Imports from the USA increased by 0.5% to RM55.65 billion and the main imports were E&E products, machinery, equipment and parts as well as chemicals and chemical products. Imports from Japan increased by 6.3% to RM56.98 billion in 2016. Major imports were E&E products, machinery, equipment and parts as well as transport equipment. Imports from the EU declined by 0.5% to RM69.22 billion and the main import products were E&E products, machinery, equipment and parts as well as transport equipment.

Figure 5 Malaysia's Top 10 Major Import Countries 2016 (RM698.66 billion)



Source: Department of Statistics, Malaysia, Compiled By: Matrade

B. Balance of Payments

As export growth moderated and imports improved, for the year as a whole, the trade surplus narrowed to RM87.3 billion (2015: RM91.6 billion).

The services account registered a larger deficit, due mainly to higher employment of foreign professional, technical and engineering services (21% growth; 2015: 7.9%), particularly in the aviation, oil and gas, and utilities sectors. This, however, was partially offset by lower net payments in the transport account, in tandem with the modest trade activity. The travel account also recorded a higher surplus following the recovery in tourist arrivals.

In the income account, the primary income deficit widened due to lower net receipts from other investments, but was partially offset by a smaller deficit in direct investment income. In contrast, the secondary income account recorded a smaller deficit due to higher inward remittances amid the continued increase in outward remittances by foreign workers.

Overall, the current account balance remained in surplus as the trade surplus exceeded the deficits in the services and income accounts. The current account position stood at RM25.2 billion or 2.1% of GNI, a smaller amount compared to the previous year (2015: RM34.7 billion, 3.1% of GNI).

The external financial sector of the balance of payments continued to be confronted with significant volatility in the cross border movements of capital flows. However, the financial account recorded a smaller net outflow of RM4.2 billion in 2016 (2015: net outflow of RM50.9 billion), due mainly to higher net inflows in the direct investment account and lower net outflows in both the portfolio and other investment accounts.

On the whole, the overall balance of payments registered a higher surplus of RM14.8 billion (2015: surplus of RM3.8 billion). Errors and Omissions (E&O) amounted to -RM6.3 billion or -0.4% of total trade, reflecting mostly foreign exchange revaluation gains on international reserves. Excluding revaluation gains, the E&O stood at -RM15.2 billion or -1% of total trade.

The international reserves of BNM amounted to USD94.5 billion (equivalent to RM423.9 billion as at end-2016 compared to USD95.3 billion (equivalent to RM409.1 billion) as at end-2015. Besides developments in the current and financial accounts, the reserves level was also affected by foreign exchange revaluation changes. The reserves level in USD terms declined during the year as the USD strengthened against most of the currencies that make up the diversified foreign currency reserve assets. In ringgit terms, the reserves level has correspondingly increased as the ringgit weakened against most currencies during the same period.

As at 28 February 2017, the reserves level amounted to USD95 billion (equivalent to RM426.3 billion). The international reserves remain ample to facilitate international transactions and sufficient to finance 8.5 months of retained imports and are 1.1 times the short-term external debt. Furthermore, the wide range of monetary policy instruments and the exchange rate flexibility have enabled the economy to reduce its reliance on the BNM's international reserves in managing external pressures.

Table 1. Balance of Payments[1]

(RM billion)

Item (Net)	2015	2016*p*
Goods	109.6	101.2
Services	-21.0	-22.6
Primary Income	-32.0	-34.7
Secondary Income	-21.9	-18.7
Current account balance	**34.7**	**25.2**
% of GNI	*3.1*	*2.1*
Capital account	**-1.1**	**0.1**
Financial account	**-50.9**	**-4.2**
Direct investment	4.8	17.9
Portfolio investment	-28.2	-19.7
Financial derivatives	-0.7	-0.8
Other investment	-26.8	-1.7
Errors and omissions (E&O)[2]	21.1	-6.3
% of total trade	*1.4*	*-0.4*
of which:		
Foreign exchange revaluation gain (+) or loss (-)	*57.3*	*8.9*
Overall balance	**3.8**	**14.8**
Bank Negara Malaysia		
international reserve, net	**409.1**	**423.9**
USD billion equivalent	**95.3**	**94.5**

[1] The data are compiled in accordance with the Sixth Edition of the International Monetary Fund's (IMF) Balance of Payments and International Investment Position Manual (BPM6)

[2] Includes unrealised foreign exchange revaluation gains/losses on international reserves

p Preliminary

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

C. External Debt Development

Malaysia's external debt amounted to RM908.7 billion, equivalent to USD200.6 billion or 73.9% of GDP as at end-2016. The increase of RM74.9 billion or 9% from RM833.8 billion at end-2015 was partly attributed to valuation effects following the weakening of the ringgit against most currencies during the year. Excluding valuation effects, Malaysia's external debt position increased by 6.2%, mainly on account of higher intercompany and interbank borrowings.

Malaysia's external debt remains manageable given its currency, maturity and balance sheet profiles. More than one-third of total external debt is denominated in ringgit (34.4%), mainly in the form of non-resident holdings of domestic ringgit debt securities and ringgit deposits in domestic banking institutions. As such, these liabilities are not subjected to valuation changes arising from fluctuations in the ringgit exchange rate. In the course of the year, the total non-resident holdings of domestic debt securities increased by 1.4% to RM214.2 billion (end-2015: RM211.3 billion). Non-resident acquisition of GII and MGS during most parts of the year had offset the liquidation of Bank Negara Monetary Notes (BNMN). This liquidation by non-resident portfolio investors, particularly towards the end of the year, was driven by the increase in the US Federal Reserve's policy rate in December 2016, the anticipation of a faster pace of US interest rate normalisation in 2017, and speculative activity in the non-deliverable forward (NDF) market. On the other hand, the level of non-resident ringgit-denominated deposits in the domestic banking institutions increased by RM6.2 billion or 14.3%.

While the remaining portion of total external debt of RM597.3 billion (65.6%) is denominated in foreign currency, most of it is hedged, either naturally using foreign currency earnings or through the use of financial instruments. Most of these obligations are offshore borrowings5, raised mainly to further expand productive capacity and to better manage financial resources within corporate groups. As at end-2016, the offshore borrowing had declined to 42.7% of GDP compared to 60% of GDP during the Asian Financial Crisis.

Of the total foreign currency-denominated external debt (inclusive of exchange rate valuation effects), around one-third is accounted by interbank borrowing and foreign currency deposits in the domestic banking system, which had increased by RM10.4 billion from end-2015. This reflects the banks' intragroup liquidity management and placements of deposits from foreign parent entities, which are subjected to prudent liquidity management practices. Among these are internal limits on funding and maturity mismatches. This is then followed by long-term bonds and notes issued offshore (RM163.4 billion), primarily to finance asset acquisitions abroad that will generate future income. The net increase of RM40.3 billion in foreign currency-denominated intercompany loans was mainly accrued by private corporations in the oil and gas sector and finance and insurance sub-sector. These obligations are normally subjected to flexible and concessionary terms, such as having no fixed repayment schedules or bearing low interest rates.

From a maturity perspective, more than half of the total external debt is skewed towards medium- to long-term tenures (58.6% of total external debt), suggesting limited rollover risks. Also, not all short-term external debt pose a claim on reserves, given the export earnings of borrowers and external assets. As at end-2016, Malaysia recorded a current account surplus and remains a net creditor nation, with international reserves accounting for only a quarter of total external assets. The majority of total external assets are held by banks and corporations. The availability of these external assets better enable these entities to meet their external obligations without necessarily creating a claim on international reserves. As at end-2016, Malaysia still recorded a net short-term external surplus position of RM327.3 billion, an increase of RM45.2 billion from end-2015 (net short-term asset surplus of RM282.1 billion).

Table 2 External Debt and Debt Servicing

(RM billion)

Item (Net)	2015	2016*p*
Total external debt	**833,817**	**908,704**
USD million equivalent	*192,261*	*200,628*
% GNI	*74.1*	*76.1*
Annual change (%)	*11.5*	*9.0*
By Instrument		
Bonds and notes	157,658	163,513
Interbank borrowing	161,295	170,978
Intercompany loans	92,065	136,088
Loans	52,603	53,754
NR holdings of domestic debt securities	211,347	214,204
NR deposits	81,616	86,184
Other[1]	77,233	83,984
Maturity profile		
Medium-and long-term	481,921	532,140
Short-term	351,896	376,564
Currency composition (% share)	**100.0**	**100.0**
Ringgit	*36.1*	*34.4*
US dollar	*51.4*	*53.4*
Japanese yen	*2.6*	*2.4*
Others	*9.9*	*9.8*
Total servicing (including short-term interest payment)	185,754	207,011
of which:		
Medium-and long-term debt	**184,254**	**204,951**
Repayment[2]	**172,381**	**191,560**
of which:		
Redemption of matured domestic debt securities held by NR	27,695	24,403
Interest payment	**11,872**	**13,391**
of which interest payment on:		
NR holdings of domestic debt securities	6,575	7,409
Debt service ratio (% of exports of goods and services)		
Total debt	**22.6**	**25.0**
Medium-and long-term debt of which:	22.5	24.8
NR holdings of domestic debt securities	4.2	3.8

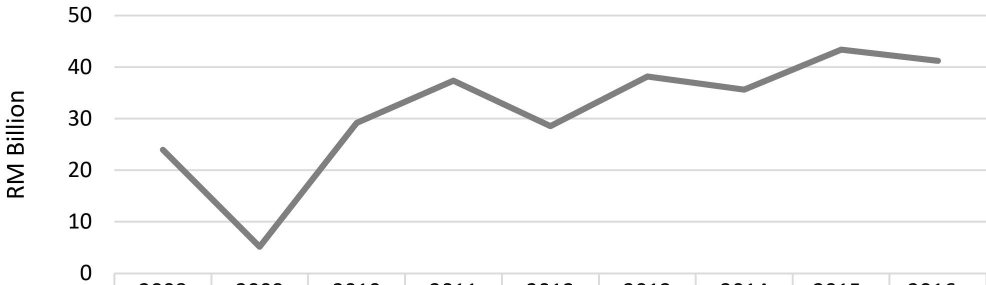
[1] Comprises trade credits, IMF allocation of SDRs and other debt liabilities
[2] Includes prepayment
p Preliminary
Note: Numbers may not necessarily add up due to rounding
NR refers to non-residents
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

D. Foreign Direct Investment (FDI)

The direct investment account recorded a higher net inflow of RM17.9 billion (2015: net inflow of RM4.8 billion), on account of higher net inflows arising from the incurrence of direct investment liabilities and the moderation in net outflows due to a lower level of acquisitions of direct investment assets.

During the year, foreign direct investment (FDI) in Malaysia moderated to RM41.2 billion, equivalent to 3.4% of GNI (2015: RM43.4 billion or 3.9% of GNI), arising mainly from lower investments in the manufacturing and mining sectors. The challenging global environment had resulted in several large multinational corporations (MNCs), particularly in the E&E industry, to undergo restructuring and consolidation of their operations in the region, including those in Malaysia. The environment of low oil prices also led to a considerable decline in foreign investments, particularly in upstream oil and gas activities. However, FDI in the services and construction sectors increased, reflecting mainly the large acquisition of domestic power generation assets by a foreign entity, continued expansion in the finance and insurance, and wholesale and retail trade services sub-sectors and the implementation of ongoing residential and infrastructure projects, particularly in the Klang Valley and Iskandar Malaysia.

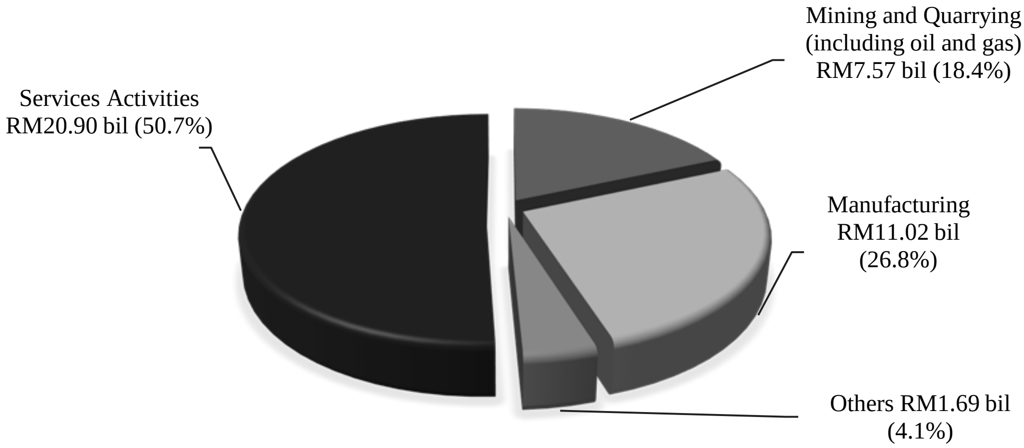
Figure 6 Foreign Direct Investment (FDI)



	2008	2009	2010	2011	2012	2013	2014	2015r	2016p
FDI	23.9	5.1	29.2	37.3	28.5	38.2	35.6	43.4	41.2

r Revised
p Preliminary
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Figure 7 FDI Flows by Sector (2016: RM41.2billion)



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

II.1.2. Domestic Environment

A. Economic Growth Rate

The Malaysian economy registered a growth of 4.2% in 2016 (2015: 5%). Domestic demand continued to anchor growth during the year, supported mainly by private sector spending. Public sector spending, however, moderated following the expenditure rationalization adopted by the Government. On the external front, export growth was weaker against a backdrop of more moderate global expansion, particularly in key trading partners.

Private consumption growth was sustained at 6.1% in 2016 (2015: 6%), mainly supported by continued wage and employment growth, with additional impetus coming from Government measures. Nominal wages in the private sector grew by 4.2%, partly supported by the increase in the minimum wage in July 2016. Public sector wages recorded a higher growth with the increase in civil servants salary in the second half of the year. Government measures to increase household disposable income have also supported household spending. These included the reduction in employees' EPF contributions by 3 percentage points (11% to 8%) from March 2016 to December 2017, higher Bantuan Rakyat 1Malaysia (BR1M) payouts and the special tax relief of RM2,000 to individual taxpayers with a monthly income of RM8,000 or below for the 2015 assessment year.

Public consumption growth moderated to 1% (2015: 4.4%) due to lower spending on supplies and services, in line with the Government's efforts to rationalize expenditure. Spending on emoluments, however, was higher during the year, mainly reflecting the salary increment in July 2016.

Gross fixed capital formation (GFCF) expanded moderately by 2.7% in 2016 (2015: 3.7%). Public investment growth improved, but remained in contraction, while private investment growth continued to moderate.

Public investment recorded a smaller rate of decline in 2016 (-0.5%; 2015: -1%) due to the smaller contraction in spending on fixed assets by public corporations. This reflected mainly the improvement in investment in the downstream oil and gas industry as well as the transportation and utilities sub-sectors. Capital spending by the Federal Government continued to increase in 2016, albeit at a moderate rate, and was focused mainly on developing the transportation infrastructure, enhancing industrial development, improving public utilities and accelerating agriculture and rural development.

As firms adjusted to the shocks emanating from the external and domestic environment, growth of private investment moderated further to 4.4% in 2016 (2015: 6.4%). While financing conditions remained supportive of private investment, profitability and business sentiments remained weak during the year. In terms of sector, overall investment performance continued to be supported by the implementation of new and ongoing projects in the manufacturing and services sectors. Investment in the mining sector continued to be constrained by the low oil price environment.

For GFCF by type of assets, spending on machinery and equipment increased (1.1%; 2015: -0.2%) following the faster pace of expansion in civil engineering investment, particularly in the petrochemical, transportation and utilities sub-sectors. However, growth of investment in structures, which accounted for 56% of total GFCF, moderated to 4.9% (2015: 6.8%) due mainly to lower non-residential investment, particularly in the commercial property sub-sector due to the oversupply of office and retail space. Growth of investment in other assets declined during the year (-4.2%; 2015: 1.6%), due to lower capital expenditure in the development of intellectual property products (e.g. in mineral exploration and evaluation) and cultivated biological products (e.g. livestock and crops).

During the year, gross national savings (GNS) grew by 6.3% (2015: 0%) to remain at 28.9% of gross national income (2015: 28.9% of GNI) on account of higher growth in public savings (36.1%; 2015: -40.4%). Gross capital formation expanded at a faster pace of 10.4%, attributable mainly to stronger growth in private capital formation (15.3%; 2015: 7.7%). As a result, savings-investment gap narrowed further to 2.1% of GNI in 2016 compared to 3.1% of GNI in 2015.

On the supply side, all economic sectors continued to expand in 2016, with the exception of the agriculture sector. Agriculture production declined, as crude palm oil (CPO) output was affected by the El Niño weather phenomenon.

The services sector recorded a higher growth of 5.6% in 2016 (2015: 5.1%). Growth was supported by expansion across all sub-sectors. The finance and insurance sub-sector turned around to register positive growth, driven by higher net interest income and better performance of the life insurance segment. The retail and food and beverage and accommodation sub-sectors recorded higher growth, supported by continued wage and employment growth and a recovery in tourist arrivals. The utilities sub-sector benefited from the hot weather conditions, particularly in the first half of the year, which increased the demand for electricity. The sustained trade-related activity and higher air passenger traffic during the year contributed to the growth in the transportation and storage sub-sector.

The manufacturing sector grew by 4.4% in 2016 (2015: 4.9%), supported by continued expansion in both export- and domestic-oriented industries. The performance of the export-oriented industries was mainly driven by firm growth of the electronics and electrical (E&E) segment, with semiconductors exports growing strongly in response to the recovery in global demand for semiconductors in the second half of 2016. Growth was further supported by higher production of petrochemical products to meet sustained regional demand. The domestic-oriented industries were weighed down by the weak output of motor vehicles, but strong demand for food-related products and construction-related materials provided support to growth.

The construction sector recorded moderate growth in 2016 (7.4%; 2015: 8.2%). The faster pace of expansion in the civil engineering and residential sub-sectors was partially offset by a decline in non-residential activity. Growth in the civil engineering sub-sector was driven by higher activity in existing multi-year projects, particularly in the petrochemical, transportation and utilities segments. Activity in the residential sub-sector was supported by large property launches in the previous years while growth in the special trade sub-sector continued to be supported by early and end-works activity. Growth in the non-residential sub-sector, however, was weighed down by slower activity in the commercial property segment amid the oversupply of office and retail space.

In the agriculture sector, growth contracted by 5.1% (2015: 1.2%), attributable mainly to the decline in CPO production as yields were affected by the El Niño weather phenomenon. In particular, fresh fruit bunch yields declined by 13.9% compared to the previous year. Growth in the mining sector moderated (2.7%; 2015: 4.7%), due partly to the high base effect from 2015 which saw an intensification of production from the Gumusut-Kakap oil field. Nonetheless, higher natural gas production provided support to the sector, following the resumption of operations at the Sabah-Sarawak gas pipeline in mid-2016 and the commissioning of new facilities (LNG Train 9 and PETRONAS' FLNG Satu) in the second half of 2016.

Table 3 Real GDP by Expenditure and by Kind of Economic Activity (2010=100)

	2016*p*	**2015**	**2016*p***	**2015**	**2016*p***
By Expenditure	**% of GDP**	**Annual Change (%)**		**Contribution to Growth (Percentage Point)**	
Domestic Demand[1]	**91.8**	**5.1**	**4.4**	**4.7**	**4.0**
Private sector expenditure	70.2	6.1	5.7	4.2	3.9
Consumption	*53.3*	*6.0*	*6.1*	*3.1*	*3.2*
Investment	*16.9*	*6.4*	*4.4*	*1.1*	*0.7*
Public sector expenditure	21.6	2.1	0.4	0.5	0.1
Consumption	*13.1*	*4.4*	*1.0*	*0.6*	*0.1*
Investment	*8.5*	*-1.0*	*-0.5*	*-0.1*	*0.0*
Gross Fixed Capital Formation	*25.4*	*3.7*	*2.7*	*1.0*	*0.7*
Change in stocks	**0.2**			**0.6**	**0.4**
Net Exports of Goods and Services	**8.1**	**-3.8**	**-1.8**	**-0.4**	**-0.2**
Exports	70.0	0.6	0.1	0.5	0.1
Imports	61.9	1.2	0.4	0.8	0.2
Real Gross Domestic Product (GDP)	**100.0**	**5.0**	**4.2**	**5.0**	**4.2**
By Kind of Economic Activity					
Services	54.2	5.1	5.6	2.7	3.0
Manufacturing	23.0	4.9	4.4	1.1	1.0
Mining and quarrying	8.8	4.7	2.7	0.4	0.2
Agriculture	8.1	1.2	-5.1	0.1	-0.5
Construction	4.5	8.2	7.4	0.3	0.3
Real Gross Domestic Product (GDP)	**100.0[2]**	**5.0**	**4.2**	**5.0**	**4.2**

[1] Excluding stocks
[2] Excluding import duties component
p Preliminary
Note: Figures may not necessarily add up due to rounding
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

B. Inflation

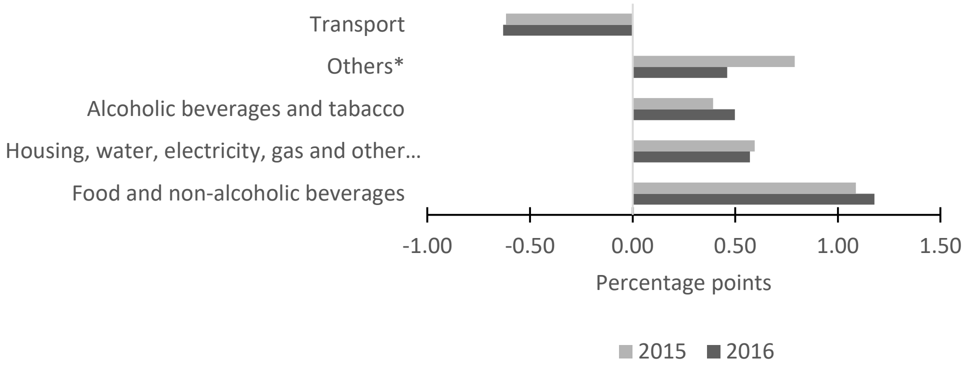
Headline inflation, as measured by the annual percentage change in the Consumer Price Index (CPI), was unchanged at 2.1% in 2016 (2015: 2.1%), which is at the lower end of the BNM's forecast range of 2% - 3%. Inflation during the year was driven mainly by adjustments to administered prices undertaken since the fourth quarter of 2015 and higher prices of fresh food items due to the El Niño weather phenomenon. The inflationary pressures were, however, offset by the lapse in the impact of GST and lower domestic fuel prices. Moderate domestic demand conditions and a subdued external price environment also helped to contain domestic inflationary pressures. Correspondingly, core inflation was broadly stable during the year, averaging 2.1% in 2016 (2015: 2.3%).

While the average headline inflation for the year was unchanged compared to 2015, the monthly headline inflation continued to be volatile due to global factors. Headline inflation started the year at an elevated level, peaking at 4.2% in February 2016. The higher inflation was driven mainly by the base effect from the low domestic fuel prices in the corresponding period in 2015 and the relatively high prices of fresh food following the occurrence of El Niño at the beginning of the year. It, however, moderated quickly to 2.6% in March 2016 as a result of the decline in domestic fuel prices. The price of RON95 petrol was revised downwards to a low of RM1.60 per litre in March 2016 following the decline in global oil prices. The impact of El Niño was also temporary as weather conditions began to normalise in the second half of 2016. Headline inflation continued to moderate further, averaging 1.6% for the remaining nine months of the year amid the lapse in the GST impact and lower domestic fuel prices. In addition, the moderate demand pressures, low global energy and non-food commodity prices and subdued global inflation also helped to keep inflation low. The benign domestic inflationary environment led to the downward revision of the BNM's official forecast range from 2.5% - 3.5% to 2% - 3% in July 2016.

Inflation during the year was driven mainly by domestic cost factors arising from upward price adjustments for several price-administered items undertaken since the fourth quarter of 2015. Electricity tariffs and cooking oil prices were revised upwards in January and November 2016, respectively. In addition, the dry weather conditions caused by El Niño affected the production of fresh food such as vegetables, fruits and fish at the beginning of the year. For the year as a whole, fresh food inflation was higher at 5.6% (2015: 4.2%). However, domestic inflation was dampened by the lapse in the impact of GST and by lower domestic fuel prices during the year. Prices of RON97 petrol, RON95 petrol and diesel averaged lower at RM2.11, RM1.76 and RM1.62 per litre, respectively, in 2016 (2015: RM2.33, RM1.98 and RM1.92 per litre, respectively).

Externally, the continued low global commodity prices also played a key role in mitigating domestic inflation despite the weaker ringgit exchange rate. The IMF Primary Commodity Index declined by 10% in 2016 (2015: -35.3%), driven mainly by lower energy prices amid continued excess supplies. As a result, the lower global commodity prices led to an overall decline in the input costs of firms as reflected in the decline of the Producer Price Index (PPI) by 1.1% in 2016 (2015: -7.4%). The lower costs of production for firms helped in containing prices of domestically produced goods. The weaker ringgit did lead to higher imported inflation during the year. Excluding fuel, the prices of the imported components of the CPI increased by 3.5% (2015: 3%). The increase was driven by higher prices of imported finished food items as the inflationary impact of the weaker ringgit was exacerbated by the higher global food prices. Global food prices were higher for the year amid adverse weather conditions following the occurrence of El Niño, as reflected in the 2% increase in the IMF Food Price Index (2015: -17.1%). Core inflation was relatively stable during the year averaging 2.1% in 2016 (2015: 2.3%). Demand driven inflationary pressures in the economy remained largely stable during the year, underpinned by continued modest growth in private consumption and an absence of significant wage pressures. This was also reflected in the small positive output gap and the relatively stable capacity utilisation rate of 77.5% (2015: 76.5%).

Figure 8 Contribution to Inflation by Categories



*Others include clothing and footwear, health, education, communication, recreation services and culture, furnishings, household equipment and routine household maintenance, restaurants and hotels, and miscellaneous goods and services categories.

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

C. Money Supply

In 2016, banking system liquidity remained ample despite volatility in domestic financial and foreign exchange markets. At the system level, aggregate outstanding liquidity placed with BNM remained ample and stable throughout the year. At the institutional level, most banking institutions continued to maintain surplus liquidity positions.

Throughout the year, the BNM's operations were focused on maintaining stability in the interbank market. As part of a comprehensive effort to ensure sufficient liquidity in the domestic financial system, the BNM reduced the SRR ratio from 4.00% to 3.50% which took effect from 1 February 2016. As a result, there was a broad-based release of liquidity into the banking system which led to greater interbank lending activity. This allowed the BNM to reduce the use of monetary operations, including the reverse repo facility, to provide liquidity to the banking system. Towards the later part of the year, the composition of monetary instruments used to absorb surplus liquidity was also adjusted to provide banks with greater flexibility in managing their liquidity positions. The tenure of instruments used to absorb surplus liquidity shifted towards the shorter maturities, allowing funds lent to the BNM to mature more frequently such that banks can readily meet any sudden withdrawals of funds due to outflows.

Private sector liquidity, as measured by broad money (M3), recorded a higher annual growth rate of 3.0% during the year (2015: 2.6%). The expansion in M3 was underpinned by continued credit extension by banks to businesses and households. The expansion in M3, however, was offset by net foreign outflows. M3 growth was also contained in part by the reclassification and continued growth of Islamic Investment Accounts, as reflected in the contraction of 'other influences'. Adjusting for the impact of this reclassification, M3 would have increased at a higher rate of 4.0% in 2016. Meanwhile, total deposits in the banking system recorded an annual growth rate of 2.0% in 2016, compared to 2.3% in 2015, mainly due to a decline in deposits placed by businesses (2016: -2.3%, 2015: 0.9%). Nevertheless, household deposits continued to register a healthy growth of 5.1% during the year (2015: 5.3%).

Table 4 Malaysia Money Supply: Annual Change and Growth Rates

	2015		2016	
	RM million	**%**	**RM million**	**%**
Currency in circulation	8,699	12.8	8,794	11.4
Demand deposit with commercial banks and Islamic banks	5,343	1.9	11,589	4.1
M1[1]	14,042	4.1	20,383	5.7
Other deposits with commercial banks and Islamic banks[2]	30,325	2.5	27,369	2.2
Deposit with other banking institutions[3]	-3,588	-37.2	110	1.8
M3[4]	40,780	2.6	47,861	3.0

[1] Comprising currency in circulation and demand deposits of the private sector

[2] Comprising savings and fixed deposits, negotiable instruments of deposits (NIDs), repos and foreign currency deposits of the private sector placed with commercial banks and Islamic banks

[3] Comprising call deposits, fixed deposits, negotiable instruments of deposits (NIDs), repos and foreign currency deposits of the private sector placed with merchant banks/investment banks. Excludes interplacements among the banking institutions

[4] Comprising M1 plus other deposits of the private sector placed with commercial banks and Islamic banks and deposits of the private sector placed with other banking institutions, namely the merchant banks/investment banks

Source: Bank Negara Malaysia

D. Remittances

The remittance and money changing industry in Malaysia has grown significantly in the last decade. Traditionally, remittance service in Malaysia was provided only by the banking institutions. With the growing importance and significance of remittance flows, in particular remittances abroad by foreign workers in the country and the objectives to increase access to formal remittance channels, the BNM has liberalized the policy to allow non-bank players to provide remittance services. The number of non-bank remittance service providers had increased to 39 as at end 2010 from 3 as at end 2005, hence increasing the access points for remittance services. Consequently, total outward remittance through the formal channels had grown significantly by 119.7% to RM13.4 billion in 2010 (2005:RM6.1 billion). A more competitive environment in the remittance industry has also contributed towards enhancing services to consumers in terms of lower cost, faster speed and more extensive channels for remittance transactions.

The money-changing industry has evolved over time. Over the years, the money-changing industry has developed gradually as reflected in the increased total turnover of exchange transactions. As at end August 2011, the total turnover of the industry stood at RM17.7 billion, an increase of 49% from 2005. Presently, there are over 800 licensees operating at more than 1,000 premises.

The remittance industry is regulated under the Exchange Control Act 1953 and the Payment Systems Act 2003. Specific legislation to regulate the money-changing industry, that is the Money-Changing Act 1998, was enacted in March 1998. Both industries are regulated by BNM. In addition to licensed money-changers which provide retail money changing services, BNM also regulates currency wholesalers. The main objective of regulation is to promote the protection of consumers though reliable, transparent and professional conduct in the provision of remittance and money-changing services, and preventing the industry from being used as a conduit for money laundering and terrorist financing.

In 2009, BNM initiated a review of the legal and regulatory framework for the money changing, remittance services and wholesale currency business industry in Malaysia, with the objective of modernizing the industry landscape, and strengthening safeguards to protect the integrity of the industry. The review culminated in the passing of the Money Services Business Act 2011 (MSB) in July 2011 which provides for the licensing, regulation and supervision of money changing, remittances and wholesale currency business under a single Act. Collectively, these businesses are described as money services business in the new landscape.

Remittance growth

The retail and wholesale money-changing segments of the MSB industry continued to grow by 21.1% and 38.5% respectively in 2016 (2015: RM60.7 billion and RM7.7 billion respectively). This was attributable to the strong demand for common currencies such as the US dollar, Singapore dollar, euro and regional currencies from both inbound and outbound travellers. Meanwhile, overall outward remittances declined slightly by 1.9% to RM34.3 billion (2015: RM34.9 billion), due to lower repatriation of salaries and remuneration through banking remittance channels. Non-bank remittance service providers, however, continued to register a modest growth of 4.6% in outward remittances by migrant workers, mainly to Indonesia, Bangladesh and India.

Table 5 Total Outward and Inward Remittances

	2012	2013	2014	2015	2016
	RM million				
Total Outward[1]	**18,375.5**	**22,717.1**	**28,457.0**	**34,898.7**	**34,252.6**
Remitted via:					
Banks[2]	7,543.3	8,577.2	10,989.0	14,265.9	12,678.0
Money service business licensees[3]	10,814.2	14,139.9	17,468.0	20,632.8	21,574.6
Total Inward[4]	**4,966.6**	**5,764.8**	**7,115.1**	**8,588.6**	**9,106.3**
Remitted via:					
Banks	4,362.9	4,984.6	6,134.4	7,267.2	7,226.5
Money service business licensees	603.7	780.2	980.7	1,321.4	1,879.8
As at end of period					
No. of remittance service providers	**79**	**77**	**77**	**76**	**76**
Commercial banks	43	43	43	43	43
Development financial institution	2	2	3	3	3
Licensed non-bank remittance service providers	34	32	31	30	30

[1] Refers to total funds remitted from Malaysia to other countries for workers' remittances and remuneration for employees
[2] Remittance transactions adjusted for funds channelled through Malaysia from a country of origin to another destination country. These funds comprise primarily the international worker remittances conducted via the MSB licensees approved under the Money Services Business Act (MSBA) 2011
[3] Refers to non-bank remittance service providers and development fi nancial institutions licensed under the MSBA 2011
[4] Refers to total funds remitted from other countries to Malaysia for workers' remittances and remuneration for employees
Source: International Transactions Information System (ITIS), e-SURVEY on bank remittance transactions and Money Services Business Statistical Report on Remittance Business and Bank Negara Malaysia

II.1.3. Fiscal Position

The Government continues to consolidate its fiscal position, while ensuring economic growth remains sustainable. Given the current economic challenges including lower global crude oil prices, the Government will leverage existing resources and continue to undertake fiscal reforms. Therefore, the fiscal deficit is targeted to reduce further from 3.2% of gross domestic product (GDP) in 2015 to 3.1% in 2016.

The Government's measures to enhance revenue and optimise expenditure are expected to help strengthen the fiscal position. The implementation of the Goods and Services Tax (GST) since 2015, reduction of tax leakages at duty-free islands, optimisation of revenue from the redistribution and bidding process of telecommunication spectrum, relaxation on income tax penalty and enhancement of foreign workers levy are expected to diversify the revenue base. The spending optimisation measures across ministries and agencies will be continued, with emphasis on minimising non-critical expenditure without affecting public service delivery. Furthermore, improvement to enhance control mechanism on Government physical projects management were introduced in September 2016, which prohibits any variation and addition to the initial approved scope and cost of the projects. This is to ensure all Government projects are implemented based on actual needs in line with implementation of efficient project management towards achieving prudent spending. These initiatives will continue to strengthen the Government's financial position.

The Fiscal Policy Committee (FPC) continues to play an active role in charting the direction of the fiscal consolidation initiatives. To further strengthen the fiscal management framework, the FPC has agreed to form the Fiscal Risks and Contingent Liability Technical Committee in May 2016. The Committee is responsible for evaluating and proposing measures to rein in the Federal Government's fiscal risks and contingent liability to ensure medium- and long-term fiscal sustainability. It comprises the Ministry of Finance; the Economic Planning Unit and the Public Private Partnership Unit of the Prime Minister's Department; and Bank Negara Malaysia. Meanwhile, the Government continues to adopt the Medium-Term Fiscal Framework (MTFF) which outlines fiscal projections that will enable an efficient and effective public finance management.

Table 6 Malaysia Federal Government Financial Position

	2015	2016[1]	2015	2016[1]	2015	2016[1]
	RM million		% Change		% of GDP	
Revenue	219,089	212,595	-0.7	-3.0	18.9	17.2
Operating expenditure	216,998	207,126	-1.2	-4.5	18.8	16.8
Current balance	**2,091**	**5,469**	**101.6**	**161.5**	**0.2**	**0.4**
Gross development expenditure	40,768	45,000	3.2	10.4	3.5	3.7
Less: Loan recovery	1,483	804	41.0	-45.8	0.1	0.1
Net development expenditure	39,285	44,196	2.2	12.5	3.4	3.6
Overall balance	**-37,194**	**-38,727**	**-0.6**	**4.1**	**-3.2**	**-3.1**

[1] Revised estimate.
Note: Total may not add up due to rounding.
Source: Economic Report 2016/2017, Ministry of Finance Malaysia

A. Tax Revenue

Federal Government's revenue in 2016 is expected to decline 3% (2015: -0.7%) to RM212.6 billion mainly due to the lower collection of petroleum-related revenue by 34.4% following lower crude oil prices. However, this is expected to be cushioned by better collection of GST and additional revenue from measures announced during the budget recalibration. Thus, total revenue as a percentage to GDP is estimated at 17.2% (2015: 18.9%).

Table 7 Federal Government Revenue 2015-2017

	2015	2016[1]	2017[2]	2015	2016[1]	2017[2]	2015	2016[1]	2017[2]
	RM million			% Change			% of Share		
Tax revenue	**165,440**	**167,101**	**180,580**	**0.8**	**1.0**	**8.1**	**75.5**	**78.6**	**82.2**
Direct tax	111,770	110,500	120,739	-11.8	-1.1	9.3	51.0	52.0	55.0
of which:									
CITA	63,679	63,193	69,193	-2.4	-0.8	9.5	29.1	29.7	31.5
Individuals	26,321	28,163	29,853	7.8	7.0	6.0	12.0	13.2	13.6
PITA	11,559	8,517	10,637	-57.1	-26.3	24.9	5.3	4.0	4.8
Indirect tax	53,670	56,601	59,841	43.3	5.5	5.7	24.5	26.6	27.2
of which:									
GST	27,012	38,500	40,000	-	42.5	3.9	12.3	18.1	18.2
Excise duties	11,890	11,801	13,111	-8.0	-0.7	11.1	5.4	5.6	6.0
Import duty	2,732	2,736	3,008	2.3	0.1	9.9	1.2	1.3	1.4
Export duty	1,039	813	731	-45.1	-21.7	-10.1	0.5	0.4	0.3
Non-tax revenue	**53,649**	**45,494**	**39,146**	**-4.9**	**-15.2**	**-14.0**	**24.5**	**21.4**	**17.8**
of which:									
Licences and permits	12,540	11,843	12,061	-12.0	-5.6	1.8	5.7	5.6	5.5
Investment income	32,838	23,299	17,591	-2.7	-29.0	-24.5	15.0	11.0	8.0
Total revenue	**219,089**	**212,595**	**219,726**	**-0.7**	**-3.0**	**3.4**	**100.0**	**100.0**	**100.0**
% of GDP	**18.9**	**17.2**	**16.6**						

[1] Revised estimate.
[2] Budget estimate, excluding 2017 tax measures.
Note: Total may not add up due to rounding
Source: Economic Report 2016/2017, Ministry of Finance Malaysia

Tax revenue remains the main source of Federal Government's revenue, accounting for 78.6% of total revenue. Tax revenue is projected to increase marginally by 1% in 2016 to RM167.1 billion (2015: 0.8%; RM165.4 billion) or 13.6% of GDP. Direct tax, contributing 52% to total revenue, is projected to reduce 1.1% to RM110.5 billion in 2016 (2015: 51%; -11.8%; RM111.8 billion). Corporate income tax (CITA), constituting 37.8% of total tax revenue, is estimated to decline 0.8% to RM63.2 billion (2015: -2.4%; RM63.7 billion). This is partly due to the reduction in CITA rate from 25% to 24%, while for small and medium enterprises (SMEs) from 20% to 19% beginning the year of assessment 2016. Meanwhile, individual income tax collection is expected to increase 7% to RM28.2 billion, underpinned by stable growth of employment and income. Collection of petroleum income tax (PITA), representing 5.1% of total tax revenue, is estimated to reduce 26.3% to RM8.5 billion (2015: 7%; -57.1%; RM11.5 billion) due to lower assumption of crude oil price at USD40 per barrel (2015: USD52 per barrel). Efforts in improving tax administration, increasing tax compliance and strengthening tax audit are continuously undertaken. The relaxation on tax penalty as well as an increase of 3.6% in revenue collection from other direct taxes mainly stamp duty and real property gains tax (RPGT), is expected to partly offset the reduction in direct tax collection.

Indirect tax is forecast to increase 5.5% to RM56.6 billion, mainly contributed by substantial GST collection. Since its implementation, the number of registrants has increased to 423,920 as of 30 September 2016. GST collection in 2016 is expected to surge 42.5% to RM38.5 billion compared with RM27 billion in 2015, reflecting a full year implementation. Excise duties are estimated to decline 0.7% to RM11.8 billion following expected lower sales volume of motor vehicles to 580,000 units (2015: 666,674 units). In line with lower commodity prices and smaller export volume, export duties are projected to drop 21.7% to RM0.8 billion (2015: -45.1%; RM1 billion).

Non-tax revenue is anticipated to decline 15.2% to RM45.5 billion (2015: -4.9%; RM53.6 billion), due to lower receipts from investment income mainly from Petroliam Nasional Berhad (PETRONAS) dividend of RM16 billion (2015: RM26 billion). Total receipts from licences and permits are expected at RM11.8 billion, contributed mainly by petroleum royalties at RM3.7 billion (2015: RM5.1 billion), levy on foreign workers at RM2.8 billion (2015: RM2.2 billion) and motor vehicles licence at RM2.8 billion (2015: RM2.6 billion). In addition, the redistribution and bidding process of telecommunication spectrum are expected to contribute RM1 billion to the collection of service fees. Furthermore, monetisation of asset is expected to contribute RM1.1 billion to the non-tax revenue collection.

Figure 9 Federal Government Revenue 2012

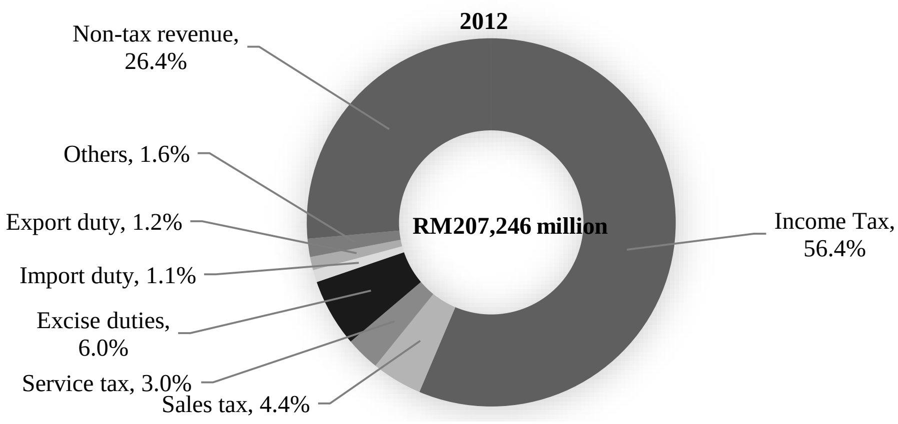
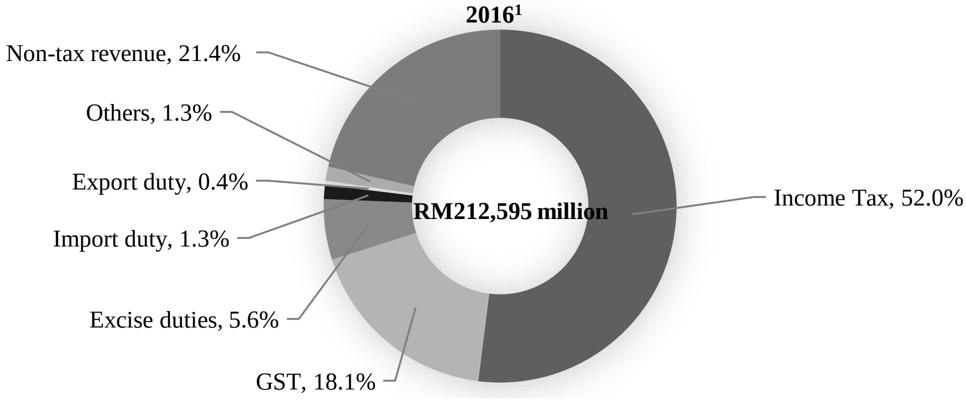


Figure 10 Federal Government Revenue 2016



[1] Revised estimate.

Source: Ministry of Finance Malaysia

B. Expenditure

The Federal Government's total expenditure in 2016 is estimated to decrease 2.2% to RM252.1 billion with a share of 20.5% to GDP (2015: -0.5%; RM257.8 billion; 22.3%). A sum of RM207.1 billion (82.2%) is allocated for operating expenditure, while RM45 billion (17.8%) is for development expenditure. Government expenditure continues to focus on programmes and projects with high multiplier effect to the economy amid a challenging environment, while ensuring the well-being of the rakyat.

Table 8 Federal Government Operating Expenditure by Object, 2015 -2017

	2015	2016[1]	2017[2]	2015	2016[1]	2017[2]	2015	2016[1]	2017[2]
	RM million			% Change			% of Share		
Emoluments	70,050	73,866	77,422	4.6	5.4	4.8	32.3	35.7	36.0
Retirement charges	18,872	18,993	21,763	3.6	0.6	14.6	8.7	9.2	10.1
Debt service charges	24,283	26,639	28,866	7.5	9.7	8.4	11.2	12.9	13.4
Grant and transfers to state government	6,921	6,931	8,058	6.0	0.2	16.3	3.2	3.3	3.8
Supplies and services	36,373	29,702	32,020	6.2	-18.3	7.8	16.8	14.3	14.9
Subsidies and social assistance	27,269	24,642	22,431	-31.3	-9.6	-9.0	12.6	11.9	10.4
Grants to statutory bodies	15,487	12,948	9,396	-5.3	-16.4	-27.4	7.1	6.3	4.4
Refunds and write-offs	947	924	802	-29.1	-2.4	-13.2	0.4	0.4	0.4
Others	16,796	12,481	14,042	23.0	-25.7	12.5	7.7	6.0	6.5
Total	**216,998**	**207,126**	**214,800**	**-1.2**	**-4.5**	**3.7**	**100.0**	**100.0**	**100.0**
% of GDP	**18.8**	**16.8**	**16.2**						

[1] Revised estimate.

[2] Budget estimate, excluding 2017 tax measures.

Note: Total may not add up due to rounding

Source: Economic Report 2016/2017, Ministry of Finance Malaysia

Operating expenditure (OE) is expected to decline 4.5% to RM207.1 billion with its share to GDP at 16.8% (2015: -1.2%; RM217 billion; 18.8%) on account of measures to optimise and rasionalise supplies and services, grants and subsidies as well as purchase of assets. These measures are implemented mainly through scaling down of programmes and activities as well as minimising duplication of roles and functions among agencies, hence further enhancing spending efficiency.

Emoluments remain the largest component, constituting 35.7% of OE (6% of GDP). It is expected to grow 5.4% to RM73.9 billion (2015: 4.6%; RM70 billion) contributed mainly by special financial assistance in January and June 2016 to ease the cost of living as well as a salary increment in July 2016 and the implementation of Minimum Wages Order 2016. The size of civil service is maintained at 1.6 million in efforts to contain the growth in emolument bill. At the same time, the Government continues to focus on increasing the productivity and efficiency of the public service.

Supplies and services, constituting 14.3% of OE, is estimated to decrease 18.3% to RM29.7 billion (2015: 16.8%; 6.2%; RM36.4 billion). In terms of percentage to GDP, supplies and services is estimated at 2.4%, lower than the annual average of 3.2% for the past five years. The decrease is due to a large reduction in noncritical expenses such as outlays on travel and transport, utilities, refurbishment and renovation as well as events and functions. The Government, through the National Blue Ocean Strategy (NBOS), continues to reduce cost and redundancies mainly by optimising information and communications technology (ICT) systems as well as government-owned facilities and premises for trainings and events.

Debt service charges, which must be served before all other commitments, are projected to increase 9.7% to RM26.6 billion (2015: 7.5%; RM24.3 billion) and remain manageable at 12.9% of total OE. Retirement charges, accounting for 9.2% of OE, is expected to grow 0.6% to RM19 billion (2015: 8.7%; 3.6%; RM18.9 billion).

The Government remains committed to subsidy rationalisation. In this regard, subsidies and social assistance is expected to decline 9.6% to RM24.6 billion, contributing 11.9% to total OE (2015: -31.3%; RM27.3 billion; 12.6%). However, the Government will continue to subsidise essential services such as education, health and public transportation. To further assist low-income households, 1Malaysia People's Aid (BR1M) payment was increased up to RM1,050 per recipient. This is expected to cost the Government RM5.4 billion this year benefiting 4.2 million households and 3.1 million single individuals.

Grants to statutory bodies are anticipated to decline significantly by 16.4% to RM12.9 billion (2015: -5.3%; RM15.5 billion) due to rationalisation of grants. This measure is aimed at reducing dependency of statutory bodies on federal grants, particularly entities with a steady income stream, high reserves and self-sustaining.

About 55% of the grants is channelled to public universities, while the remaining is allocated for regional and agricultural development authorities as well as trade and investment promotion agencies. Meanwhile, RM6.9 billion is allocated to state governments as provided under the Constitution as well as other transfers.

C. Financing

The Federal Government maintains its funding mainly from domestic sources, which is expected to constitute 93.2% of total gross borrowings. This strategy helps to lessen the impact of adverse exchange rate movements on debt valuation and debt servicing, while not crowding out private sector financing given the ample liquidity in the market. In 2016, total Federal Government gross borrowings is estimated at RM92.8 billion mainly for principal repayment amounting to RM53.3 billion, while the balance is for deficit financing.

Table 9 Federal Government Financing, 2015 -2016

	2015	2016[2]	2015	2016[2]
	RM million		% Share	
Gross borrowings	**98,059**	**92,853**	**100.0**	**100.0**
Domestic	**92,500**	**86,500**	**94.3**	**93.2**
MGS	51,500	44,000	52.5	47.4
MGII	41,000	42,500	41.8	45.8
External	**5,559**	**6,353**	**5.7**	**6.8**
Market loans	5,303	6,087	5.4	6.5
Project loans	256	266	0.3	0.3
Repayments	**54,402**	**53,341**	**100.0**	**100.0**
Domestic	53,569	48,141	91.7	90.3
External	4,833	5,200	8.3	9.7
Net borrowings	**36,658**	**39,512**	**-**	**-**
Domestic	38,931	38,359	-	-
External	727	1,153	-	-
Change in assets[1]	**-2,464**	**-785**	**-**	**-**
Total financing needs	**37,194**	**38,727**	**-**	**-**

[1] (+) indicates a drawdown of assets; (-) indicates accumulation of assets.
[2] Estimate.
Note: Total may not add up due to rounding.
Source: Economic Report 2016/2017, Ministry of Finance Malaysia

Gross domestic borrowings for 2016 are expected to record RM86.5 billion. Malaysian Government Securities (MGS) remain as the major source of domestic funding, amounting to RM44 billion or 50.9% (2015: RM51.5 billion; 55.7%) while the balance are Malaysian Government Investment Issues (MGII).

The growing demand for Islamic financial instruments has resulted in higher issuance of MGII. During the ten year period, the share of MGII issuance of total gross borrowings will almost double in 2016 compared with 25.7% in 2006. For 2016, MGII issuance is expected to grow to RM42.5 billion or 45.8% of total gross borrowings (2015: RM41 billion; 41.8%). The increase reflects the continuous efforts and commitment to promote Islamic financial instruments and provide a benchmark as well as to support the increasing demand for Shariah-compliant papers.

For the first half of 2016, both instruments issuance have been oversubscribed by an average of 2.3 times, reflecting a strong demand for Government papers. Yields on 5-year MGS ranged between 3.340% and 3.615%, while yields on 10-year MGS ranged between 3.744% and 3.930%. On average, MGII offers a higher yield of 15 basis points over MGS. As share of MGII issuance increase, the yield variance between the two instruments is narrower, which translate to lower financing cost to the Federal Government.

Gross offshore borrowings for 2016 are expected to amount to RM6.3 billion mainly through market loan issuance. In April 2016, the Federal Government successfully issued a dual-tranche (10-year and 30-year) Wakalah Global Sukuk of USD1.5 billion. The 10-year tranche was priced at 3.179% while the 30-year tranche at 4.080%. This sukuk issuance is the first sovereign sukuk utilising 100% non-physical assets, positioning Malaysia as the leader in Islamic finance innovation. In addition, a total of RM266 million is expected to be drawn down for project loans through bilateral and multilateral arrangements to finance ongoing programmes and projects.

D. Debt

The management of Federal Government debt is based on various legal provisions. Under Article 111 of the Federal Constitution, the Federal Government shall not borrow except under the authority of federal law. There are several legislations that empowers the Federal Government to borrow or to raise funds including Loan (Local) Act 1959 [Act 637], Government Funding Act 1983 [Act 275], External Loans Act 1963 [Act 403] and Treasury Bills (Local) Act 1946 [Act 188]. Apart from empowering the

Federal Government to borrow or raise funds, these acts also impose certain restrictions on the Federal Government to ensure prudent management of federal debts.

Act 637 and Act 275 set the debt ceiling at 55% of GDP, which is confined to the outstanding of MGS, MGII and Malaysian Islamic Treasury Bills (MITB) instruments. Hence, as at end-June 2016, the debt outstanding from these instruments stood at 48.5% of GDP, reflecting a strict adherence to the Acts. The accumulated offshore borrowing is limited at RM35 billion under Act 403, while Malaysian Treasury Bills (MTB) is set at a threshold of RM10 billion as provided under Act 188.

The Federal Government debt stood at RM655.7 billion (53.2% of GDP) as at end-June 2016, mainly due to higher domestic debt issuance to finance DE. Domestic debt continued to account for the largest share of total debt at 95.9%, while the remaining is from offshore borrowing.

As at end-June 2016, the Federal Government *domestic debt* registered RM628.8 billion, comprising mainly MGS and MGII. MGS, the largest instrument of Government issuance, stood at RM365.9 billion or 55.8% of total Federal Government debt, while MGII registered RM230 billion. The share of MGII to total Federal Government debt has increased to 35.1% compared to 21.8% in 2010, reflecting continuous Government's efforts to promote Malaysia as an international Islamic finance hub. In addition, given the well-capitalised domestic institutions and advanced domestic capital market, the Federal Government domestic debt were held mostly by large and long-term investors. The bulk of MGS and MGII were held by financial institutions at 27.1%, followed by the Employees Provident Fund (23.1%) and insurance companies (4.9%).

To ensure better cash-flow management, MTB and MITB are issued periodically with maturities 12-month and below. As at end-June 2016, total outstanding MTB and MITB stood at RM4.5 billion (0.3% of GDP), accounting for 0.7% of total Federal Government debt. Following the increase in Islamic instrument issuance in the recent years, MGII and MITB accounted for 35.3% of total Federal Government debt (end-2015: 34.2%), while the remaining were conventional instruments.

The maturity profile of Federal Government debt remains well-spread, with average time to maturity of 9.7 years. Instruments with maturity below five years constitute 51%, 6 to 10 years 33.6%, while maturity more than 10 years represent 15.4% of total outstanding debt. Since most instruments will mature in the medium- and long-term, it reflects a low refinancing risk as only 8.1% of MGS and MGII will mature in 2016 (2015: 10%).

Table 10 Malaysian Government Debt 2015-2016

	2015	**2016[2]**	**2015**	**2016[2]**	**2015**	**2016[2]**
	RM million		**% Share**		**% of GDP**	
Domestic debt	**609,063**	**628,791**	**96.6**	**95.9**	**52.6**	**51.0**
Treasury bills	4,700	4,500	0.8	0.7	0.4	0.3
MGS	340,063	365,891	53.9	55.8	29.4	29.7
MGII	214,000	230,000	33.9	35.1	18.5	18.7
Housing Loan Fund[1]	50,300	28,400	8.0	4.3	4.3	2.3
Offshore borrowing	**21,477**	**26,954**	**3.4**	**4.1**	**1.9**	**2.2**
Market loans	15,179	20,291	2.4	3.1	1.3	1.6
Project loans	6,298	6,663	1.0	1.0	0.6	0.6
Total	**630,540**	**655,745**	**100.0**	**100.0**	**54.5**	**53.2**
Memorandum item:						
Non-resident holdings of ringgit-denominated Government debt securities	175,963	206,182	28.9	32.8	15.2	16.7

[1] Effective 1 January 2016, Housing Loan Fund under the Housing Loan Fund Act 1971 has been discontinued. A sum of RM21,900 million term loan has been transferred to LPPSA. The remaining debt comprise of Sukuk Pinjaman Perumahan.

[2] As at end-June 2016.

Note: Total may not add up due to rounding.

Source: Economic Report 2016/2017, Ministry of Finance Malaysia

On 1 January 2016, the corporatised Treasury Housing Loan Division, now known as the Public Sector Home Financing Board (LPPSA) commenced its operations. The establishment of LPPSA will enable a more efficient and effective management of civil servant housing loan scheme while maintaining existing benefits and terms of the loan facilities. LPPSA will manage assets and liabilities independently. As part of the corporatisation exercise, a sum of RM21.9 billion of RM50.3 billion from the existing liabilities was transferred to LPPSA. This resulted in a lower total Federal Government debt by 1.8% of GDP at the beginning of 2016.

Offshore borrowings which consist of market and project loans, stood at RM26.9 billion. Of this, outstanding market loans accounted for 75.3%, while the remaining were for project loans. The outstanding project loans were from previous bilateral and multilateral arrangements to finance specific programmes and infrastructure projects such as housing, sewerage and reservoir.

Malaysia's external debt stood at RM848.2 billion (68.8% of GDP) as at end-June 2016 (end-2015: RM833.7 billion; 72.1%). The bulk of the debt comprised of deposits and ringgit-denominated debt securities held by non-residents at RM309.6 billion or 25.1% of GDP, followed by private sector debt at RM166.7 billion or 13.5% of GDP. Meanwhile, the public sector offshore borrowings accounted for 9.9% of GDP, of which the Federal Government debt constituted only 2%.

Offshore borrowings increased 0.7% to RM466.7 billion as at end-June 2016. This was mainly contributed by issuances of foreign currency debt papers, which include the issuance of Wakalah Global Sukuk of USD1.5 billion in April 2016; drawdown of interbank borrowings; long-term offshore loans by banks; and intercompany loans by non-bank private corporations. The Federal Government offshore debt increased to RM24.6 billion due to valuation effect as well as pre-funding issuance for the redemption of global sukuk USD1.2 billion in July 2016 and remained low at 5.3% of total offshore borrowings. Similarly, the short-term offshore borrowings was also on the uptrend, registering RM178.4 billion or 14.5% of GDP. As at end- June 2016, the debt service ratio6 for offshore borrowings stood at 13.9%.

Non-resident holdings of ringgit-denominated debt securities, largely in the form of medium- and long-term securities, increased to RM232.2 billion as at end-June 2016. As majority of the investors were asset managers, central banks and pension funds, it reflects an improved investors' confidence in domestic economic fundamentals as well as increased appetite for quality instruments with higher returns. Foreign investors' holdings of MGS and MGII accounted for 34% (end-2015: 31.2%).

Table 11 Malaysian External Debt 2015-2016

	2015	**2016[3]**	**2015**	**2016[3]**	**2015**	**2016[3]**
	RM million		**% Share**		**% of GDP**	
Offshore borrowing	**463,621**	**466,743**	**55.6**	**55.0**	**40.1**	**37.9**
Medium and long-term debt	285,900	288,373	34.3	34.0	24.7	23.4
Public sector	128,319	121,671	15.4	14.3	11.1	9.9
Federal Government	21,477	24,654	2.6	2.9	1.9	2.0
Public corporations	106,842	97,017	12.8	11.4	9.2	7.9
Private sector	157,581	166,702	18.9	19.7	13.6	13.5
Short-term debt	177,721	178,370	21.3	21.0	15.4	14.5
Non-resident holdings of ringgit-denominated debt securities	**211,347**	**232,258**	**25.3**	**27.4**	**18.3**	**18.8**
Medium and long-term debt	184,131	215,763	22.1	25.4	15.9	17.5
Federal Government	172,629	202,823	20.7	23.9	14.9	16.5
Others[1]	11,502	12,940	1.4	1.5	1.0	1.0
Short-term debt	27,216	16,495	3.2	1.9	2.4	1.3
Non-resident deposits	**81,616**	**77,330**	**9.8**	**9.1**	**7.1**	**6.3**
Others[2]	**77,233**	**71,911**	**9.3**	**8.5**	**6.6**	**5.8**
Total	**833,817**	**848,242**	**100.0**	**100.0**	**72.1**	**68.8**

[1] Include private sector and public corporations.
[2] Comprise trade credits, IMF allocation of Special Drawing Rights and miscellaneous.
[3] As at end-June 2016.
Note: Total may not add up due to rounding.
Source: Economic Report 2016/2017, Ministry of Finance Malaysia

III. Tax Structure

III.1 Inland Revenue Board of Malaysia (IRBM)

The Inland Revenue Board of Malaysia (IRBM) is one of the main revenue collecting agencies of the Ministry of Finance. IRBM was established in accordance with the Inland Revenue Board of Malaysia Act 1995 to give it more autonomy especially in financial and personnel management as well as to improve the quality and effectiveness of tax administration. The Department of Inland Revenue Malaysia became a board on March 1, 1996, and is now formally known as IRBM.

A. Responsibilities of IRBM

IRBM is responsible for the administration of the following laws:

a. Income tax Act 1967;
b. Petroleum Act (Income Tax) 1967;
c. Real Property Gains Tax Act 1976;
d. Stamp Act 1949;
e. Labuan Offshore Business Activity Tax Act 1990;
f. Promotion of Investment Act 1986.

IRBM must comply with all Double Taxation Agreements (DTAs) signed by the Malaysian Government with governments of foreign countries. In addition, IRBM must comply with all regulations related to the administration of IRBM:

a. Federal Constitution 1957;
b. Interpretation Act 1948 and 1967;
c. Limitation Act 1953;
d. Courts of Judicature Act 1964;
e. Companies Act 1965;
f. Bankruptcy Act 1967;
g. National Land Code 1965;
h. Criminal Procedure Code (Act 593);
i. Penal Code (Act 574);
j. Company Winding-Up Rules 1965;
k. Rules of the High Court 1980; and
l. Subordinate Courts Rules 1980

IRBM also continues to administer several repealed legislations to resolve outstanding cases from previous years:

a. Estate Duty Enactment 1941; and
b. Share Transfer Tax Act (Land based Companies) 1984

B. Members of the Inland Revenue Board of Malaysia

A board member was appointed to check the function and objective of IRBM. The member is regulated by the following Board Members:

a. The Secretary General of Malaysian Treasury cum IRBM Chairman;

b. Attorney General or its representative;
c. Director General of Public Services or its representative;
d. Two other individuals appointed by the Finance Minister to represent the government; and
e. Two other individuals appointed by the Finance Minister from the private sector.

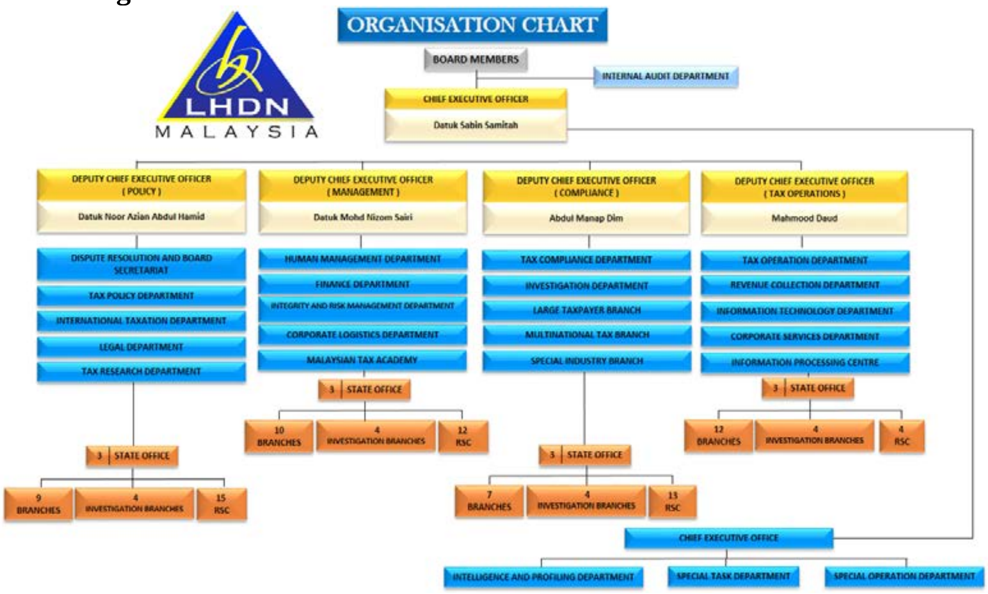
C. Functions of the Board

a. To act as agent of the Government and to provide services in administering, assessing, collecting and enforcing payment of income tax, petroleum income tax, real property gains tax, estate duty, stamp duties and such other taxes as may be agreed between the Government and the Board.
b. To advise the Government on matters relating to taxation and to liaise with the appropriate Ministries and statutory bodies on such matters;
c. To participate in or outside Malaysia in respect of matters relating to taxation;
d. To perform such other functions as are conferred on the Board by any other written law;
e. May act as a collection agent for and on behalf of any body for the recovery of loans due for repayment to that body under any written law.

D. Powers of the Board

a. To enter into contracts;
b. To utilise all property of the Board, movable and immovable, in such manner as the Board may think expedient including the raising of loans by mortgaging such property;
c. To engage in any activity, either alone or in conjunction with other organisations or international agencies, to promote better understanding of taxation;
d. To provide technical advice or assistance, including training facilities, to tax authorities of other countries;
e. To impose fees or charges for services rendered by the Board;
f. To grant loans to employees of the Board for any purpose specifically approved by the Board;
g. To provide recreational facilities and promote recreational activities for, and activities conducive to, the welfare of employees of the Board;
h. To provide training for employees of the Board and to award scholarships or otherwise pay for such training; and
i. To do anything incidental to any of its powers.

Figure 11 Organisation Chart



Source: Inland Revenue Board of Malaysia

III.2 Malaysia Royal Custom Department

On the other hand, the Royal Malaysian Customs Department (RMCD) is the government agency responsible for administrating the nation's indirect tax policy. In other words, RMCD administers seven main and thirty-nine subsidiary laws.

The RMCD is responsible for the administration of the following laws:

a. Custom Act 1967,
b. Excise Act 1976,
c. Goods and Services Tax Act 2014,
d. Free Zones Act 1990,
e. Goods Vehicle Levy Act 1983,
f. Windfall Profit Levy 1998,
g. Sales Tax Act 1972 (until 31 March 2015)
h. Service Tax Act 1975 (until 31 March 2015).

III.3 Tax Specific Analysis

III.3.1. Individual Income Tax

A. Background

The self-assessment system (SAS) for individuals (include salaried individual and sole proprietors) and for partnership was implemented with effect from Year of Assessment (YA) 2004 following the release of the Income Tax (Amendment) Act 2002. Under SAS, which is based on the concept of 'File and Pay', individuals are required to:

a. file their completed income tax return forms to the IRBM together with the payment of the balance of tax payable (if any).
b. pay their income tax liability through monthly salary deductions for salaried individuals or through bimonthly installments for individuals having business income.

B. Estimate of Tax

For individuals other than salaried individuals, the IRBM may issue a prescribed form (Form CP500) setting out the estimate of tax payable (ETP) under an installment scheme. ETP is determined by the IRBM based on the tax assessed in the preceding year. The taxpayer is required to pay the ETP in 6 bi-monthly installments as directed by the IRBM commencing from the month of March. Each installment payment accompanied by a remittance slip (Form CP501) must be paid to the IRBM within 30 days from the due date. For salaried individuals, income tax will continue to be deducted through the monthly salary deductions under the Monthly Tax Deduction (MTD) scheme.

C. Variation of Installments

Every individual under an installment payment scheme may apply to revise the installment payments not later than 30 June of the relevant year by submitting the Form CP502. The IRBM will issue a revised notice of installment payments (Form CP503) if the application is successful, setting out the revised installment payments. Where the revised estimate exceeds the amount of installment paid to date, the difference shall be payable in the remaining months of the installment scheme. In addition, if the revised estimated tax for a year of assessment is less than RM300, the individual is allowed to stop the subsequent payment starting from the date of submission of the Form CP502.

D. Penalty Provisions

a. Late payment of installment

Where any installment due and payable on the date specified by the IRBM has been paid within 30 days from the due date, a penalty of 10% shall be imposed on the amount unpaid without any further notice.

b. Difference between revised estimate submitted and final tax liability

When the tax payable excluding tax attributable to employment income, if any, exceeds the revised estimate (if a revision is submitted) by an amount exceeding 30% of the tax payable, the difference exceeding the 30% will be subject to a penalty of 10%.

E. Filing of Tax Returns

Every individual who:

a. has chargeable income for a year of assessment; or
b. has no chargeable income for that year of assessment but:

   I. has chargeable income for the year of assessment immediately preceding that year of assessment; or
   II. has furnished a return for the immediately preceding year; or
   III. has been required to furnish a return (but failed to furnish a return) for the immediately preceding year,

Must file a tax return to the Director General by 30 April of the following year unless that individual with no chargeable income receives a waiver from the Director General or has business income. The tax-filing deadline for a person carrying on a business, such as sole proprietor, partnership, club association and Hindu joint family, is 30 June of the following year. Under SAS, no supporting documents need to be submitted to the IRBM, but should be kept for the purpose of tax audit. The taxpayer also has to indicate whether he/she has complied with the Public Ruling issued by the IRBM.

An individual and his/her spouse are required to file separate income tax return forms regardless of whether tax return forms are filed on a separate or combined assessment basis. The tax return furnished by the taxpayer is deemed to be a notice of assessment and the notice of assessment and the notice are deemed to be issued on the day the return is submitted to the IRBM. Any balance of tax payable after taking into account the installment payment made via the installment payment scheme or salary deductions, if any, would have to be remitted to the IRBM by 30 April/30 June of the following year.

With effect from YA2012, information on total income, MTDs, Employees Provident Fund contributions, insurance and zakat are pre-filled by the IRB for salaried taxpayers using the e-Filing system. Such information must be submitted by their employers to the IRB.

Meanwhile, with effect from YA 2013, taxpayers who file income tax returns before the expiry of the stipulated due date will be given compensation of 2% per annum on the amount of tax refunded late by the IRBM computed on a daily basis commencing 1 day:

a. After 90 days from the due date for e-Filing; and
b. 120 days from the due date for manual tax filing.

With effect from YA 2014, salaried individuals may elect not to file a tax return provided that they meet the conditions specified according to the Income Tax Act 1967 (ITA 1967). Where an employee meets the conditions and no return for that year of assessment has been furnished by that employee, the total amount of the MTD deducted shall be deemed to be the tax payable of the employee for that year of assessment. However, the Director General retains the power to raise a deemed assessment or an additional assessment and disregard the total amount of MTD deducted as the final tax payable for that year of assessment.

F. Amendment to the Self-Assessed Return

A new provision has been gazette in the ITA 1967 effective from YA 2009 to allow taxpayers to make self amendments for additional assessment under the following conditions:

a. Amendments allowed are in respect of errors resulting in increased assessments.
b. Self-amendments be allowed only once for each year of assessment.
c. Self-amendment be allowed within a period of 6 months from the due date of furnishing the tax forms
d. Taxpayer makes self-amendment in specified forms.

G. Penalty Provisions

a. Failure to submit a tax return

Failure to submit a tax return will constitute an offence under the Act and upon conviction; the taxpayer will be liable to a fine ranging from RM200 to RM20,000 or to imprisonment for a term not exceeding 6 months or both. The IRBM is allowed to impose a penalty of up to 3 times the amount of tax and/or additional tax payable if no prosecution action is taken against the taxpayer. Under the new S. 112(1A) of the ITA 1967, a taxpayer who fails to submit a tax return in respect of any year of assessment for 2 years or more, upon conviction, shall be liable to a fine ranging from RM1,000 to RM20,000 or to imprisonment for a term not exceeding 6 months or both and a special penalty equal to treble the amount which the Director General may, according to the best of his judgement, determine as the tax charged on the chargeable income of that person for those years of assessment. Additionally, under the new S. 120(1)(h) of the ITA 1967 that failure to furnish the correct particulars as required by the Director General in the tax return, upon conviction, shall be liable to a fine ranging from RM200 to RM20,000 or to imprisonment for a term not exceeding 6 months or both. As a matter of practice, with effect from 1 October 2011, the IRBM will impose penalties ranging from 20% to 35% of the tax payable for late filing of tax returns.

b. Failure to remit tax payable

Failure to remit the balance of tax payable by 30 April for salaried group and 30 June for sole proprietor and partnership, the following year will attract a penalty of 10%. A further 5% penalty will impose on any balance remaining unpaid after 60 days.

c. Under declaration of income or excessive claim on deduction or expenses.

A taxpayer who makes a self-amendment within 6 months from the due date of furnishing the return will not be subject to a penalty for under-declaration of income or excessive claim on deduction or expenses. However, he/she will be subject to a late payment penalty equivalent to the penalty imposed on a taxpayer who files a correct return but defaults in paying tax due within the stipulated period.

H. Individual Income Tax Rate

Malaysia uses both progressive and flat rates for personal income tax, depending on an individual's duration and type of work in the country. As expatriates may fall into either tax category depending on their work, it is important to understand Malaysia's basic tax structure.

The Income Tax Act of 1967 structures personal income taxation in Malaysia, while the Malaysian government's annual budget can change the rates and variables for an individual's taxation. The Malaysian 2016 budget increased tax rates between 2015 and 2016, raising the maximum an individual could pay to 28 percent from its earlier 25 percent.

Table 12 Income Tax Rate – Resident Individuals

Chargeable Income		Y/A 2009		Y/A 2010 to Y/A 2012		Y/A 2013 to Y/A 2014		Y/A 2015		Y/A 2016 onwards	
	RM	Tax Rate %	Tax Payable RM	Tax Rate %	Tax Payable RM	Tax Rate %	Tax Payable RM	Tax Rate %	Tax Payable RM	Tax Rate %	Tax Payable RM
First	2,500	0	0	0	0	0	0	0	0	0	0
Next	2,500	1	25	1	25	0	0	0	0	0	0
On	5,000		25		25		0		0		0
Next	5,000	3	150	3	150	2	100	1	50	1	50
On	10,000		175		175		100		50		50
Next	10,000	3	300	3	300	2	200	1	100	1	100
On	20,000		475		475		300		150		150
Next	15,000	7	1,050	7	1,050	6	900	5	750	5	750
On	35,000		1,525		1,525		1,200		900		900
Next	15,000	12	1,800	12	1,800	11	1,650	10	1,500	10	1,500
On	50,000		3,325		3,325		2,850		2,400		2,400
Next	20,000	19	3,800	19	3,800	19	3,800	16	3,200	16	3,200
On	70,000		7,125		7,125		6,650		5,600		5,600
Next	30,000	24	7,200	24	7,200	24	7,200	21	6,300	21	6,300
On	100,000		14,325		14,325		13,850		11,900		11,900
Next	50,000	27	13,500	26	13,000	26	13,000	24	12,000	24	12,000
On	150,000		27,825		27,325		26,850		23,900		23,900
Next	100,000	27	27,000	26	26,000	27	26,000	24	24,000	24	24,000
On	250,000		54,825		53,325		52,850		47,900		47,900
Next	150,000	27	40,500	26	39,000	26	39,000	24.5	36,750	24.5	36,750
On	400,000		95,325		92,325		91,850		84,650		84,650
Next	200,000	27	54,000	26	52,000	26	52,000	25	50,000	25	50,000
On	600,000		149,325		144,325		143,850		134,650		134,650
Next	400,000	27	108,000	26	104,000	26	104,000	25	100,000	26	104,000
On	1,000,000		257,325		248,325		247,850		234,650		238,650
Exceeding	1,000,000	27		27		26		25		28	

Source: Inland Revenue Board of Malaysia

Generally, an individual is a non-resident under Malaysian tax law if he stay less than 182 days in Malaysia in a year, regardless of his citizenship or nationality. Non-resident individual is taxed at a different tax rate on income earned or received from Malaysia.

Table 13 Income Tax Rate – Non-Resident Individuals

Types of Income	Rate (%)
Business, trade or profession Employment Dividends Rents	28
Public Entertainer Interest	15
- Royalty - Payments for services in connection with the use of property or installation, operation of any plant or machinery purchased from a non-resident - Payments for technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme - Rent or other payments for the use of any movable property	10

Source: Inland Revenue Board of Malaysia

III.3.2. Corporate Tax

A. Background

Following the announcement of the 1999 Budget and the subsequent release of the Income Tax (Amendment) Act 2002, the official assessment system was changed to the self-assessment system. The effective years of self-assessment system are as follows:

a. Companies – effective year is 2001
b. Business, partnership and co-operatives – effective year is 2004
c. Salaried individual - effective year is 2004

Under the self- assessment system, the burden of computing the taxpayer's liability is shifted from the IRBM to the taxpayer and accordingly, taxpayers are expected to compute their tax liability based on the tax laws, guidelines and ruling issued by the IRBM. The tax returns submitted will no longer be subject to a detailed review by the IRBM.

The main objective of the self-assessment system is to inculcate a practice of voluntary compliance by the taxpayers and at the same time reduce the workload of the IRBM to enable them to concentrate on areas in which have a high tax risk and a potentially significant loss in revenue. The implementation of the self-assessment system has also resulted in changes to the tax compliance cycle and the penalty provisions. These changes are explained in greater detail below.

B. Estimate of Tax Payable

Under the self-assessment system, every company is required to determine and submit in a prescribed form (Form CP204) an estimate of its tax payable for a year of assessment, 30 days before the beginning of the basis period. However, when a company first commences operations ('i.e. during the first basis period), the estimate of tax payable must be submitted to the IRBM within 3 months from the date of commencement of its business and thereafter no later than 30 days before the beginning of the basis period.

The estimate of tax payable submitted for a particular year cannot be less than the revised estimate or the estimate of tax payable (if no revised estimate was submitted) for the immediately preceding year of assessment. With effect from YA 2006 and subsequent years, the estimate of tax payable for that year cannot be less than 85% of the revised estimate of tax payable for the immediate preceding year of assessment or if no revised estimate is furnished, cannot be less than 85% of the estimate of tax payable for immediate preceding year of assessment.

A company is still required to submit the prescribed Form CP204 within the stipulated deadline even if it expects its estimate of tax payable to be NIL. With effect from YA 2008, where a SME first commences operations in a year of assessment, the SME is not required to furnish an estimate of tax payable or make installment payments for a period of 2 years beginning from the year of assessment in which the SME commences operations. With effect from YA 2011, where a company first commence operations in a year of assessment and the basis period for that year of assessment is less than 6 months, that company is not required to furnish an estimate of tax payable or make installment payment for that year of assessment.

With effect from 30 December 2014, in order to be exempted from filing a tax estimate for a period of 2 years commencing from the year of assessment in which a SME commences operations, the SME must be a tax resident and incorporated in Malaysia.

With effect from YA 2018, the tax estimate or revised tax estimate must be submitted by way of an electronic medium or electronic transmission.

When the estimate of tax payable has been submitted to the IRBM, the company is required to remit this amount to the IRBM in equal monthly installments according to the number of months in its basis period. For example, if a company has a 12-month basis period, the estimate of tax payable must be paid over a 12-month installment scheme. Each month installment is due and payable to the IRBM by the 10^{th} day of the following month. For example, the January installment will be due for payment by the 10^{th} of February and so forth. However, where a company first commences operations (i.e. during the first basis period); its first installment will commence from the 6^{th} month of the basis period.

C. Revision of Estimate of Tax Payable

Under s. 107C(7) of the ITA 1967, every company is allowed to revise its estimate of tax payable by submitting a Form CP204A in the 6^{th} month and/or 9^{th} month of its basis period from YA 2003 onwards. Where the revised estimate exceeds the amount of installments paid to date, the difference shall be payable in the remaining months of the installment scheme. Conversely, when installments paid to date exceed the revised estimate, the company may discontinue its original installment scheme.

D. Penalty Provision

a. Failure to furnish estimate of tax payable

Under s. 120(1)(f) of the ITA 1967, any company which, without reasonable excuse fails to submit the estimate of tax payable for a year of assessment shall be guilty of an offence and upon conviction, be liable to a fine ranging from RM200 to RM20,000 or face imprisonment for a term not exceeding 6 months or both. With effect from YA 2011, where no prosecution is instituted by the Director general and no direction is issued by the Director General under s. 107C(8) of the ITA 1967; but there is a tax payable by that company for that year of assessment, such amount of tax payable will be subject to a penalty of 10%.

b. Late payment penalty

As explained earlier, monthly payments should be remitted to the IRBM by the due dates, i.e. by the 10^{th} day of the following month. Failure to remit the installments on a timely basis will result in an automatic penalty of 10% being imposed on the unpaid amount.

c. Difference between the estimate submitted and final tax payable

When the tax payable for a particular year of assessment exceeds the original or the revised estimate (if a revision is submitted) by an amount exceeding 30% of the tax payable, the difference will be subject to a penalty of 10%.

E. Tax Return

A fundamental difference between the previous official system and the newly introduced self-assessment system is the discontinuance of a detailed review of returns submitted and the subsequent issuance of notices of assessment by the IRBM. This is due to the fact that the burden of computing the tax liability is passed on to the taxpayer. Accordingly, all the returns submitted by the taxpayer would be deemed as notices of assessment being served on the taxpayer. Under the self-assessment system, all companies must file the tax returns within 7 months from the end of the accounting period (S77 (1A), ITA 1967) from YA 2003 onwards. For example, a company with an accounting period ending on 31 January must file its tax return to the IRBM by 31 August.

Effective Y/A 2014, the tax return must be submitted by way of an electronic medium or electronic transmission.

F. Penalty Provisions

a. Failure to submit a tax return

Failure to submit a tax return will constitute as an offence under the ITA 1967 and upon conviction, the taxpayer will be liable to a fine ranging from RM200 to RM20,000 or face imprisonment for a term not exceeding 6 months or both. However, if no prosecution is initiated, the Director General may require the person to pay a penalty equal to treble the amount of tax and/or additional tax which is payable (before any set-off, repayment or relief) for that year.

Effective 30 December 2015, the fine for failure to furnish tax return for 2 years of assessment or more shall upon conviction, be liable to a fine ranging from RM1,000 to RM20,000 and a special penalty equal to treble the amount to be determined by the Director General at his best judgement. However, if no prosecution is initiated, the Director General may require the person to pay a penalty equal to treble the amount of tax and/or additional tax which is payable (before any set-off, repayment or relief) for that year.

As a matter of practice, with effect from 1 October 2011, the IRBM will impose penalties ranging from 20% to 35% of the tax payable for late filing of tax returns.

b. Failure to remit tax payable

As explained above, since the tax return is deemed as a notice of assessment, the balance of tax payable (if any) should be remitted to the IRBM together with the tax return. Failure to do so will result in the IRBM imposing a penalty equivalent to 10% on the balance of tax payable and if the tax is still not paid after 60 days, a further 5% penalty will be imposed.

G. Corporate Income Tax Rate

For both resident and non-resident companies, corporate income tax is imposed on income accruing in or derived from Malaysia. The current corporate income tax rates are provided in the following table:

Table 14 Income Tax Rate – Companies

Types of Companies	Y/A 2016	Y/A 2017
Resident company with paid up capital of RM2.5 million and below at the beginning of the basis period*		
- On first RM500,000 chargeable income	19%	18%
- On subsequent chargeable income	24%	24%
Resident company (other than described above)	24%	24%
Non-resident company/branch	24%	24%

* Such company does not control, directly or indirectly, another company that has paid-up capital of more than RM2.5 million, and is not controlled, directly or indirectly, by another company that has paid-up capital of more than RM2.5 million.

Source: Inland Revenue Board of Malaysia

III.3.3. Tax Audit

A. Nature

Under the self assessment system, tax audits will be IRBM's key enforcement tool to ensure that the tax returns submitted are correct and have been prepared in accordance with the provisions of the law, guidelines and rulings issued by the IRBM. Essentially, an audit is an examination of a taxpayer's records to ensure that the income and tax liability declared to the IRBM in the tax return are true, correct and comply with the tax laws and rulings.

IRBM carries out 2 types of audits namely desk audit and field audit. The former will involve the review of documents / information obtained by correspondence and interviews at the IRBM's offices whilst the latter would entail a visit to the taxpayer's premises for a detailed review of all relevant documents. Cases for audit are selected through the computerised system based on risk analysis criteria and on various criteria such as business performance, financial ratios, type of industry, past compliance records, third party information, etc.

Once a taxpayer is selected for an audit, the IRBM will inform the taxpayer via a telephone call followed by an official notification letter sent via mail or fax. The period between the date of notification and the audit visit is 14 days. A shorter period of notification may be fixed by IRBM with the consent of the taxpayer. The scope of a tax audit under self assessment normally covers a period of 1 to 3 years, unless there are valid reasons to go beyond that period. The time frame for the conclusion of a tax audit is normally within 4 months. The IRBM will notify the taxpayer if it requires more than 4 months to be completed.

Programme for Monitoring Deliberate Tax Defaulters ["MDTD"] was introduced to monitor taxpayers who have failed to comply with the laws, i.e. those who have committed offence in furnishing incorrect information in their income tax returns, including omission of business code or use of wrong business code. These non-compliant taxpayers will be removed from listing of MDTD if the monitoring finds that they no longer commit offences in the subsequent years of assessment.

Upon the completion of an audit, the IRBM will issue a tax computation summarising the tax adjustments based on their findings and subsequently an additional assessment to collect the additional taxes from the taxpayer. The taxpayer may still appeal against this assessment by submitting the appeal, through the prescribed Form Q to the Special Commissioners of Income Tax within 30 days from when the assessment is raised.

With effect from 1 January 2014, the time-bar for tax audits is reduced from 6 years to 5 years.

B. Framework

To maintain and enhance public confidence in the tax administration, the IRBM has issued the Tax Audit Framework. The main areas covered in the frameworks are as follows:

a. Criteria for audit selection;
b. Tax audit methodology;
c. Rights and responsibilities of taxpayers and tax agents, audit officers;
d. Settlement upon completion of an audit; and
e. Offences and penalties.

The IRBM issued a revised Tax Audit Framework, which takes effect from 1 May 2017. This revised tax audit framework replaces the Tax Audit Framework issued in February 2015.

C. Penalty Provision

a. Penalties for omission / non-disclosure

Under the tax audit system, the IRBM has also introduced a new penalty regime for non-disclosure and omission of information that affects a taxpayer's tax liability. The penalty regime is summarized as follows:

Table 15 Penalty Rate

Type of Voluntary		Penalty Rate
Voluntary disclosure before selection for audit	Within 60 days from the due date for furnishing the return form	10%
	More than 60 days but less than 6 months from the due date for furnishing the return form	15.5%
	> 6 months and above	35%
Non-disclosure (discovery during audit)		100% of tax undercharged (may consider for 45% for 1st offence)
Repeated offences under the MDTD cases		100%

Source: Inland Revenue Board of Malaysia

b. Penalty for not providing reasonable facilities and assistance

Under S. 116 of the ITA 1967, failure by a taxpayer to provide reasonable facilities and assistance to the IRB when conducting an audit is an offence and upon conviction, the taxpayer may be liable to a fine of between RM1,000 to RM10,000 or face imprisonment for a term not exceeding 1 year or to both.

c. Failure to keep sufficient records
d.

Under S. 119A of the ITA 1967, the company or persons responsible, upon conviction will be liable to a fine of between RM300 to RM10,000 or face imprisonment for a term not exceeding 1 year or to both.

D. Appeal against An Assessment

If a taxpayer is dissatisfied with an assessment deemed to be served on him/her, the taxpayer should file an appeal by submitting a Form Q within 30 days of the assessment being served on him/her, i.e. within 30 days of the date of submission of the tax return. Specific details and the grounds of appeal should be stated in the Form Q.

In the event the IRBM is unable to reach an agreement with the taxpayer, the case will be forwarded to the Special Commissioners. Effective Y/A 2009, taxpayers with no chargeable income can file an appeal by using the Notification of Non Chargeability instead of notice of assessment. The appeal is to be filed through the Director General using Form Q.

Effective 1 January 2012, the issuance of Notification of Non-Chargeability is extended to the following cases: (i) persons exempted from tax under the ITA 1967 or the Promotion of Investments Act 1986 (PIA 1986); (ii) persons with no statutory income from a business source but assessment has been made in respect of other sources of income.

III.3.4. Tax Investigation

The IRBM always want to create a fair, transparent and equitable tax administration which will increase public confidence in the tax system. Compliance with tax laws must be strictly enforced. Tax offences such as non-compliance and tax evasion will be dealt with in accordance with the provisions of ITA 1967 and other acts administered by the IRBM. One of the methods of enforcement carried out by IRBM is tax investigation. A taxpayer who is convicted of an offence is liable to a penalty, fine and/or imprisonment.

A. Investigation Activities

Tax investigation is examination of books, documents, objects, articles, materials and things (hereinafter referred to as 'documents') relating to a taxpayer’s business and financial matter, including personal documents. This examination is carried out to determine that the correct amount of income is reported, and the tax thereon is charged and paid in accordance with the tax laws and regulations.

Investigation is conducted to gather admissible evidence with a view towards prosecution and conviction of tax offences in court in accordance with the provisions of ITA (or other acts in paragraph 2.2), Penal Code [Act 574], Criminal Procedure Code [Act 593], Evidence Act 1950 [Act 56], Whistleblower Protection Act 2010 [Act 711] and other relevant acts.

B. Objectives of Investigation

The main objectives of investigation are to:

a. deter tax evasion;
b. identify and prosecute tax evaders;
c. enhance voluntary tax compliance;
d. to be fair to compliant taxpayers; and

e. collect the correct amount of tax.

C. Period of Investigation

There is no limitation to the period of investigation in cases of fraud, willful default or negligence. Assessment can be raised at any time in accordance with subsection 91(3) of ITA.

D. Offences and Penalties

Willful evasion is an offence under Section 114 of the ITA. Any person guilty of the offence shall, on conviction be liable to a fine of not less than RM1,000 and not more than RM20,000 or to imprisonment for a term not exceeding three years or to both and shall pay a special penalty of treble (300%) the amount of tax which has been undercharged.

III.3.5. Real Property Gains Tax Rates and Exemptions

Real Property Gains Tax (RPGT) is charged on gains arising from the disposal of real property, which is defined as any land situated in Malaysia and any interest, option or other right in or over such land. RPGT is also charged on the disposal of shares in a real property company (RPC). A RPC is a controlled company holding real property or shares in another RPC of which the defined value is not less than 75% of the value of the company's total tangible assets.

With effect from 1 January 2012, a tax rate of 10% was imposed for a holding period of up to 2 years, 5% for a holding period exceeding 2 years until 5 years and 0% for a holding period exceeding 5 years. With effect from 1 January 2013, a tax rate of 15% was imposed for a holding period of up to 2 years, 10% for a holding period exceeding 2 years until 5 years and 0% for a holding period exceeding 5 years.

With effect from 1 January 2014, the uniform RPGT rates applicable for individuals and companies will no longer apply. For companies and individuals who are Malaysian citizens and permanent residents, a tax rate of 30% will be imposed for a holding period of up to 3 years, 20% for a holding period exceeding 3 years and up to 4 years and 15% for a holding period exceeding 4 years and up to 5 years. RPGT of 5% will be imposed for a holding period exceeding 5 years for companies while individuals who are Malaysian citizens or permanent residents will not suffer RPGT if the holding period exceeds 5 years. Individuals who are not Malaysian citizens will be subject to RPGT at the rate of 30% for a holding period up to 5 years and 5% for a holding period exceeding 5 years.

III.3.6. Goods and Services Tax (GST)

Goods and Service Tax (GST) replaced the Sales Tax and Service Tax (SST) in Malaysia effective 1 April 2015. RCDM is being given responsible to collect this type of tax. With the Malaysian Government declaring that GST is a contributing factor to the stability of the Malaysian economy, GST is an important source of revenue for the country. GST is charged and levied on any supply of goods and services made in Malaysia and any importation of goods into Malaysia. It is currently charge rate is 6%.

GST is also charged and levied on the importation of goods and services into Malaysia. All imported goods except goods prescribed as zero-rated and exempt or given relief from the payment of GST, will be subject to GST. All imported services acquired for the purpose of business except exempt supply of services will be subject to GST. The GST on imported services is payable by the recipient of the services using the reverse charge mechanism.

A. Categories of GST

In Malaysia, GST largely falls under 4 different categories. These are standard-rated supplies, exempt supplies, zero-rated supplies and supplies that are beyond the scope of GST. GST zero-rated supply means that the goods and services that fall under this category are not taxed while exempted supplies are non-taxable supplies for example such as education and health services that are not subjected to GST. Goods and Services that fall under the GST zero-rated supply category include utility and basic food. Goods & services that fall under each of these categories are pre-determined by the RCDM. Below is the overview of these GST categories for better understanding:

a. Supply of goods and services determined as zero-rated
   i. Exports goods and services;
   ii. Agricultural and food stuff products such as cooking oil, rice and vegetables;
   iii. Livestock supplies such as meat of buffalos and goats;
   iv. Poultry such as live and unprocessed meat of chicken;
   v. Supply of treated water to domestics' users;
   vi. Supply of 300 units of electricity to domestics' user.

b. Supply of goods and services determined as exempt supply
   i. Exports goods and services;
   ii. Sale and lease of residential property;
   iii. Financial services such as insurance and family takaful;
   iv. Toll highway;
   v. Private health and education;
   vi. Domestic transportation such as bus, monorail and taxi;
   vii. Land for agricultural purposes;
   viii. Land for general use such as government building and burial ground.

Source: P.U. (A) 272 Goods and Services Tax (Zero-Rated Supply) Order 2014

B. Taxable Period

Every taxable person will be assigned a taxable period for which he is required to account for tax in his return to be furnished to the Director General. The taxable period shall be a period of one month or three months ending on the last day of any month of any calendar year. The assignment of a taxable period is determined by the annual turnover of all taxable supplies of a taxable person. Annual turnover is the GST-exclusive value of the supplies which a business makes in a 12-month period.

In calculating the annual turnover, it can be on the present annual turnover which includes the value of taxable supplies made in the current month plus value of taxable supplies made in the preceding 11 months. This is called the historical method. The second way of calculating is on the projected annual turnover which includes the value of supplies made in the current month plus the value of supplies likely to be made in the next 11 months. This is called the future method.

The assignment of taxable period is as follows:

a. Taxable supplies in the period of 12 months is five million ringgit or more, the taxable period shall be a period of 1 month ending on the last day of any month of any calendar year; or
b. Taxable supplies in the period of 12 months is less than five million ringgit, the taxable period shall be a period of 3 months ending on the last day of any month of any calendar year.

C. Registration

The GST registration threshold is RM500,000. The threshold applies in the following ways if a person has begun making taxable supplies:

a. Retrospectively – at the end of any month, where the total value of all his taxable supplies in that month and the 11 months immediately preceding the month has exceeded the amount of RM500,000.

b. Prospectively – at the end of any month, where there are reasonable grounds for believing that the total value of all his taxable supplies in that month and the 11 months immediately succeeding the month will exceed the amount of RM500,000.

A person who is liable to be registered must notify the Director General by applying to be registered under the GST-01 form within 28 days from the end of the month that he is liable to be registered.

If a business has not yet made taxable supplies or if the value of its taxable supplies is below the registration limit, the business may register for GST voluntarily. A business that registers for GST voluntarily must remain registered for at least 2 years.

A non-established business refers to a business that has no business establishment or other fixed establishment in Malaysia. In the circumstances where the business makes a taxable supply in Malaysia and is required to be registered for GST, the said business should appoint an agent to act on its behalf on the GST compliance and administrative matters. Irrespective of the agent's registration status, the agent shall be liable for the GST and comply with any other requirement imposed by the GST legislation as if the agent is the non-established business.

D. Late Registration Penalty

Any person who is liable to be registered for GST prior to 1 April 2015 but still remains unregistered commits an offence. Upon conviction, he may be liable to a fine not exceeding RM30,000 or imprisonment for a term not exceeding 2 years or both.

For liability to register arising after 1 April 2015, statutory penalties for late registration will be imposed on applications made after the date that he is liable to be registered as follows:

a. RM1,500 for each late registration period of 30 days; or
b. Up to RM20,000 if the late registration period is more than 365 days.

The late registration period refers to the date that the taxable person should have been registered to the date immediately before the date he is registered.

Besides, the taxable person may also be subject to other penalties, such as for late payment of GST and late submission of GST returns.

E. Deregistration

A registered person who has ceased to make, or has ceased to have the intention of making a taxable supply is required to notify Customs within 30 days from the date of such occurrence.

A taxable person shall cease to be liable to be registered if the Director General is satisfied that the value of taxable supplies of the taxable person for the next 12 months will not exceed the registration threshold of RM500,000.

F. Time of Supply

The time when GST becomes due is called the time of supply.

The general time of supply rules for goods and services depend on the basic tax point. The basic tax point for goods is the date that goods are removed from the supplier's premises or the date the goods are made available to the person to whom the goods are supplied. For services, the basic tax point is the date when the services are completely performed.

If an invoice is issued or a payment is received prior to the basic tax point, the time of supply shall be the earliest of the following events:

a. The date of issuance of tax invoice
b. The date of receipt of payment

If the invoice is issued after the basic tax point, the time of supply shall be the date of the invoice provided that the invoice is issued within 21 days from the basic tax point. If the invoice is issued later than 21 days from the basic tax point, the time of supply shall be the basic tax point.

G. Imported Goods

GST on importation of goods into Malaysia shall be charged, levied and payable together with other customs duties, if any, at the point of entry or when the goods leave a bonded warehouse (Warehousing Scheme) or free commercial zone (known as duty point).

H. Imported Services

The term "Imported services" refers to any services made by a supplier who does not belong in Malaysia or who carries on business outside Malaysia, to a recipient who belongs in Malaysia, and the services are consumed in Malaysia.

Imported services for business purposes are subject to reverse charge, which is a form of self-assessment of GST. If the reverse charge applies, the recipient of the services (regardless of whether he is a taxable person) shall account for output tax (effectively on behalf of the supplier).

The output tax accounted for via reverse charge is deductible as input tax by the recipient of services (the taxable person), subject to any restriction in the input tax claim, when the invoice is issued by the overseas supplier or when payment has been made to the supplier for the services consumed, whichever is earlier.

I. Recovery of GST by Taxable Persons

A taxable person may recover the GST incurred on its expenses as input tax if the input tax is incurred in making taxable supplies or certain prescribed supplies. Input tax with respect to a taxable person refers to GST incurred on goods and services or goods imported into Malaysia that are used or to be used for the purpose of any business carried on or to be carried on by the taxable person. A taxable person generally recovers input tax through its GST returns, by deducting it from output tax. A valid tax invoice or customs import declaration form must be held to support a claim for input tax.

A taxable person is required to repay to Customs any input tax claimed for which payment has not been made to the supplier for more than 6 months after the time of supply.

Input tax directly related to making exempt supplies is generally not recoverable. If a taxable person makes both exempt and taxable supplies, the person may not recover the person's input tax in full. This situation is referred to as "partial exemption." Zero-rated supplies are treated as taxable supplies for these purposes.

Input tax directly attributable to taxable supplies can be claimed while input tax directly attributable to exempt supplies is not claimable. Input tax which is not attributable to any supply (residual input tax) such as input taxon rental, utilities, purchase of stationery, computer and maintenance services will be apportioned. The proportion attributable to taxable supplies is claimable.

III.3.7. Import Duties

A. Rates of Duties

Import duties are levied on goods that are subject to import duties and imported into country. Import duties are generally levied on an ad valorem basis but may also be imposed on a specific basis.

The ad valorem rates of import duties range from 0% to 50%. Raw materials, machinery, essential foodstuffs and pharmaceutical products are generally non-dutiable or subject to duties at lower rates.

Claim to pay duty at preferential rate can be made in respect of qualifying goods originating from country that has a free trade agreement with Malaysia. In addition, in- and out-quota tariff rate is applicable to certain goods subject to tariff rate quota.

B. Tariff Rate Quota

Certain agricultural products, such as chicken, hen eggs, cabbages imported are subject to tariff rate quota (TRQ). Under TRQ, the tariff charged depends on the volume of imports. Import within quota will be subject to the in-quota tariff rate, whilst import in excess of quota will be subject to out–quota tariff rate, which is generally higher (sometimes much higher) than the in quota tariff rate. The quota applicable is determined by the relevant agency, e.g. Department Veterinary Services.

C. Preferential Duty

Qualifying goods originating from China, Japan, Korea, Pakistan, Australia, New Zealand, India and ASEAN countries (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam) imported into Malaysia may enjoy preferential rates of duty under the relevant free trade agreements. The preferential rates can be significantly lower than the standard rates of duty. In order to qualify for the preferential rates can be significantly lower than the standard rates of duty. To qualify for the preferential rate of duty, evidence of qualification (usually a certificate of origin) issued by the relevant Government Agency or Ministry in the exporting country must be produced at the time of importation.

D. Classification of Goods

The rates of import duty on dutiable goods are dependent on the classification of the goods under the Customs Duties Order 2017. Malaysia adopts a coding or classification system commonly referred to as the Harmonized System (HS), which was established under the International Convention on the Harmonized Commodity Description, and Coding system.

The general Rules of Interpretation (GRI) of the HS is an integral part of the Customs Duties Order 2017. Classification of goods under the HS is applicable to goods imported from all countries other than ASEAN. Goods imported from ASEAN countries are classified under the ASEAN Harmonized Tariff Nomenclature (AHTN) in which although based on the HS, allows for certain variations. Imported may apply for classification ruling from the respective State Customs office or Customs Headquarters in advance to avoid potential dispute with Customs during importation/exportation clearance.

E. Value of Goods

The custom value of imported goods is determined largely in accordance with the World Trade Organization (WTO) principles of custom valuation.

F. Exemptions

In general, manufacturers are eligible to apply for the following exemptions.

a. Import duty exemption on raw materials and components used directly for the manufacture of goods for export and domestic markets not available locally; and
b. Import duty and sales tax exemption on machinery and equipment, which are used directly in the manufacturing, process and are not available locally.

Malaysian Industrial Development (MIDA) is the processing authority.

III.3.8. Export Duties

A. Basis of Taxation

Export duties are generally imposed on the country's main commodities. The ad valorem rates of export duty range from 0% to 10%. Some of the commodities that attract export duty are crude petroleum oil (at 10%), rattan whole (at RM2.70 per kg) and crude palm oil (based on scaled rates on gazette value)

B. Value of Goods

For the purpose of computing export duty, the value of the goods is the price, which an exporter would receive for the goods calculated to the stage where such goods are released by customs at the place of export.

III.3.9. Excise Duties

A. Basis of Taxation

Excises duties were previously imposed on a selected range of goods manufactured in Malaysia. With effect from 1 January 2004, the scope of excise duty has been expanded to also cover selected imported goods, including motor vehicles. Goods, which are subject to excise duty, include:

a. Beer, stout and other intoxicating liquor (e.g. cider and perry, rice wine, mead, brandy, whisky rum and tafia, gin);
b. Cigarettes containing tobacco
c. Motor vehicles
d. Playing cards ; and
e. Mahjong tiles

B. Rates of Duties

The rate of excise duties vary from a composite rate of MYR 0.1 per litre and 15% of the value for certain types of spirituous beverages, to as much as 105% of the value of motorcars (depending on engine capacity).

C. Value of Goods

For goods manufactured locally, the definition of 'value' under the Excise Act 1976 for computation of excise duty payable purposes is "the price which a buyer would give for the goods on purchase in the open market at the time when duty is payable but will exclude any excise duty, costs, charges and expenses of transportation and storage immediately after removal from the place of manufacture". In the case of goods imported into Malaysia, the value on which excise duty is charged is the sum total of the value of such imported goods as determined under the Custom Act 1967 and the amount of customs duty, if any, payable on such imported goods.

D. Licensing

Unless exempted from licensing, a manufacturer of tobacco, intoxicating liquor or goods subject to excise duties must have a license to manufacture such goods. A warehouse tobacco, intoxicating liquor or goods subject to excise duty also permits the holder to store such goods.

E. Payment of Duty

As a general rule, duty is payable at the time the goods leave the place of manufacture or any other place under excise control. However, for motor vehicles, duty is payable at the time the vehicles are registered with the Road Transport Department, or, if not registered, within 4 years from the date of removal from the place of manufacture.

F. Export

No excise duty is payable on dutiable goods that are exported.

IV. Malaysia Fiscal Issues

Fiscal policy in 2017 is aimed towards further strengthening of the Government's fiscal position, while ensuring continued support for domestic growth and promoting economic inclusiveness. The Federal Government's fiscal deficit is expected to narrow further to 3.0% of GDP in 2017 (2016: -3.1%), underpinned by sustained growth in revenue and a marginal expansion in operating expenditure. Continued fiscal consolidation despite the challenging domestic and external economic environment is a reflection of the Government's commitment to fiscal reforms while recognising the need to ensure a pro-growth environment in the economy.

Following fiscal reforms, the Government has managed to rein in the growth of operating expenditure. The share of operating expenditure as a percentage of GDP has declined to 17.1% in 2016 compared to 18.8% in 2015. This is expected to decline further to 16.2% following efforts to reduce non-critical spending on grants and transfers to statutory bodies, and the further rationalization of subsidies. The Government also continues to diversify its revenue sources to ensure resilience amidst uncertainties in global commodity markets. As a result, despite expectation of higher oil prices, the contribution of oil-related revenue is expected to decline to 13.8% in 2017 compared to 14.6% in 2016. In addition, the establishment of a special tax unit, the Collection Intelligence Arrangement (CIA), reflects the Government's effort to enhance tax compliance.

In the 2017 Budget, fiscal resources have been strategically prioritised towards high impact infrastructure projects and programmes for capacity building. These include public infrastructure such as highways and railways that expand connectivity between urban and rural areas. Development of human capital will be strengthened through enhancement of up-skilling programmes and industrial training. The improvement of the quality of talent to meet the needs of industry is critical to accelerate Malaysia's progress towards becoming a high-income nation.

The budget was also consistent with the efforts to ensure inclusive and sustainable growth. Through welfare enhancement programmes, the Government will continue to focus on sustaining the capacity of the lower- and middle-income segments to cope with the rising cost of living. Socio-economic support to these groups is dispersed through various forms of assistance, including affordable housing schemes and fiscal transfers. These measures would also provide support to private consumption.

In May 2016, the Fiscal Policy Committee (FPC) tasked a newly established Technical Committee on Fiscal Risks and Contingent Liabilities to evaluate and enhance measures to contain the Federal Government's fiscal risks and contingent liabilities. This committee is expected to further strengthen public finances while ensuring fiscal flexibility and sustainability into the future.

In the International Monetary Fund (IMF) Malaysia Country Report 2017, the IMF agreed that the authorities' medium-term fiscal policy is well anchored on achieving a near-balanced federal budget by 2020. The planned consolidation will help alleviate risks from elevated government debt levels and contingent liabilities and build fiscal space for future expansionary policy, as needed. The IMF recommended that the pace of consolidation reflect economic conditions and that any counter-cyclical fiscal policy measures be well-targeted and temporary. The IMF noted that improvements to the fiscal framework, such as elaborating medium-term projections and preparing and publishing an annual fiscal risks statement, would help anchor medium-term fiscal adjustment and mitigate risks.

In additions, monetary policy in 2017 will continue to ensure the monetary policy stance is consistent with sustaining a steady economic growth path amid price stability. The policy environment is expected to remain challenging. Although growth is expected to improve due to better performance of the external sector, the economy will be challenged by higher inflation, volatile capital flows and lingering constraints in the global economic and financial environment.

Malaysia’s external sector is expected to remain resilient despite continued uncertainties in the global environment. Overall, following the gradual improvement in exports, the net export of goods and services is projected to provide some support to real GDP growth in 2017. The current account is expected to register a surplus of 1% - 2% of GNI in 2017. Both exports and imports are expected to strengthen in 2017, underpinned by the projected improvements in global growth, commodity prices and sustained domestic demand. Given the firm domestic demand, import growth is expected to continue to outpace export growth. This would result in a lower trade surplus. As the largest component of the current account, developments in trade will significantly influence the current account position. Moving forward, the prospects for trade and the current account will be shaped by three key factors, namely the state of global demand, commodity prices and the strength of domestic demand.

As a highly open economy with well-diversified export products and markets, Malaysia stands to benefit from the better global growth prospects. Gross exports are expected to increase by 5.5% in 2017 (2016: 1.1%), while gross imports are expected to increase by 6.4% (2016: 1.9%).

Manufactured exports are expected to strengthen, supported by broad-based expansion in both E&E and non-E&E exports. E&E exports will be bolstered by a recovery in demand for semiconductors in 2017, particularly in new segments such as the automotive, industrial and storage markets, in addition to the steady demand for traditional devices such as smartphones. Non-E&E exports will continue to grow, supported by demand for resource-based products such as oleo-chemicals and petrochemicals from the region. In tandem with higher manufacturing exports, intermediate imports, which form the bulk of Malaysia’s imports, are projected to rise further.

Reflecting the sustained growth in domestic investment activity, capital imports are projected to register stronger growth, particularly for the manufacturing and services sectors. In addition, the higher crude oil prices will also increase intermediate imports such as fuel and lubricants. Imports of consumption goods are also expected to increase due mainly to higher imports of food and beverages.

The services account is projected to register a larger deficit, in line with higher trade and improvement in investment activities. Services imports will continue to be supported by imports of transportation and other services including business and professional services. However, services exports are also expected to improve, supported by a larger travel account surplus amidst the expected increase in tourist arrivals and tourist spending. The increased coverage of countries from which Chinese and Indian tourists are eligible to apply for e-Visa and the intensified promotional endeavours to target specific tourism industries such as medical and sports tourism are expected to attract more tourists to Malaysia.

In the income account, profits from Malaysian companies investing abroad are expected to improve, mostly on account of the higher income of oil and gas companies, which account for more than a third of Malaysia’s investment income abroad. Nevertheless, this is likely to be partially offset by the higher profits of foreign direct investors in Malaysia. Reflecting the sustained growth in manufactured exports, investment income for multinational corporations operating in Malaysia is expected to be higher. Taken together, this will result in a higher deficit in the primary income account in 2017. The secondary income account is expected to continue to register a deficit, mainly attributable to higher expected outward remittances, which will more than offset the expected increase in inward remittances.

The global economy is anticipated to improve gradually in 2017. Nevertheless, it will continue to be confronted with significant downside risks. Global growth remains susceptible to adverse shocks to international trade, arising from the threat of trade protectionism, geopolitical developments and other unfavourable developments in the major economies. Moreover, the expected shifts in global liquidity and capital flows given the anticipation of monetary policy normalisation in the US would have spillover effects on the domestic financial markets and the ringgit exchange rate. The implications of these developments on the balance of risks to the domestic growth and inflation outlooks will be assessed closely during the year.

Given the uncertainties in the global economic and financial environment, the Malaysian economy is projected to expand at a moderate pace of 4.3% - 4.8% in 2017, driven primarily by domestic demand from the private sector. While the projected improvement in external demand and recovery in commodity prices would lend support to the anticipated stronger economic expansion compared to 2016, domestic headwinds such as continued adjustments to higher cost of living and cautious economic sentiments could weigh on Malaysia's growth prospects.

Headline inflation is projected to increase in 2017 averaging between 3.0% - 4.0% (2016: 2.1%), reflecting primarily the pass-through impact of the increase in global oil prices on domestic retail fuel prices. This cost-driven inflation, however, is not expected to cause significant spillovers into the broader price trends, given the stable domestic demand conditions. Underlying inflation is, therefore, expected to only increase modestly.

Global oil prices are expected to be higher in 2017 following the decision by members of OPEC and several other oil producing countries to reduce crude production to ease the glut in global oil supply. The higher global oil prices, along with the depreciated ringgit exchange rate, will translate into higher domestic retail fuel prices. As of first quarter of 2017, the pump price of RON95 petrol has been higher, averaging RM2.23 per litre, significantly above the average price of RM1.76 per litre recorded in 2016. The increase in fuel prices from their low base, coupled with a notable share of expenditure on fuel in the consumption basket of Malaysian households, will have a noticeable effect on headline inflation for the year. Beyond oil, other global costs factors are also expected to put some upward pressure on domestic inflation.

While global food prices are expected to remain low amid improved weather and supply conditions, the outlook is for overall commodity prices to register a modest rate of increase in 2017, underpinned by higher prices for agriculture and metal-based products. The inflation rates of Malaysia's major trading partners are also projected to register small positive increases. However, the pass-through of these external price factors to domestic prices would be somewhat mitigated by the fact that domestic production and consumption contain relatively modest imported content. The spillovers into domestic prices are also not expected to be significant, especially given that domestic demand is projected to remain stable. With the absence of strong enabling demand conditions, firms' willingness and ability to pass-on increases in costs to consumers are expected to be more limited. Domestic sources of inflationary pressure are also expected to be contained. Underlying inflation is, therefore, expected to only increase modestly in 2017.

The inflation outlook is, however, subject to three key risks. First, headline inflation could average higher if global oil prices were to increase more than anticipated. The projected trajectory of domestic headline inflation will be dependent on the future trend in global oil prices which remains highly uncertain. Second, the depreciation in ringgit exchange rate could also have a larger pass-through effect on domestic prices, causing the headline inflation to be higher than projected. A third factor would be the strength of growth in both Malaysia and its trading partners, which could create upward or downward pressures on domestic inflation.

The continuing uncertainty surrounding the outlook for both domestic growth and inflation poses a greater challenge in assessing the likely path of baseline growth and inflation. Monetary policy will also continue to consider the risk of destabilizing financial imbalances, although these have largely remained contained. Given the expectation of periods of volatility in capital flows, the BNM's monetary operations will continue to ensure that domestic liquidity in the financial system will remain sufficient to support the orderly functioning of the domestic financial markets. The focus of the Monetary Policy Committee would therefore be on ensuring that the stance of monetary policy remains consistent with the achievement of steady growth and stable inflation, supported by healthy financial intermediation in the economy.

With regard to this issue, the IMF agreed that the current monetary policy stance is appropriate. Going forward, BNM should continue to carefully calibrate monetary policy to support growth while being mindful of financial conditions. The IMF emphasized that global financial market conditions could affect the monetary policy space and should be carefully monitored.

However, the IMF noted that the banking sector is sound overall and that financial sector risks appear contained. Nonetheless, the IMF cautioned that potential pockets of vulnerability should be closely monitored. The IMF noted that household debt remains relatively high, while in the corporate sector, there are emerging vulnerabilities in some sectors. The IMF suggested that macroprudential measures be adjusted if needed. In additions, the IMF underscored the central role of macroeconomic policy and exchange rate flexibility in helping the economy adjust to external shocks. In this regard, the IMF welcomed the authorities' commitment to keeping the exchange rate as the key shock absorber. The IMF recommended that reserves be accumulated as opportunities arise and deployed in the event of disorderly market conditions. Noting the authorities' aim to improve the functioning of the onshore forward foreign exchange market, the IMF urged the BNM to monitor the effects of the recent measures introduced in this regard, recognizing their benefits and costs. The IMF emphasized that close consultation and communication by BNM with market participants will be essential in further developing the foreign exchange market and bolstering resilience.

V. Conclusion: Where we stand? Where we go?

The Malaysian economy performed better than expected in the first half of 2017. Real GDP grew by 5.6%, year-on-year basis (y-o-y) in the first quarter and further expanded to 5.8% in the second quarter. The growth was supported by stronger domestic demand due to the improvement in both investment and consumption, and further reinforced by upbeat export demand. The external sector continued to progress as the world trade activities strengthened. Global economy is expected to grow stronger than expected supported by faster growth in the advanced economies as well as the continued enhancement in the emerging market and developing economies.

Global trade flows strengthened as most major economies are growing faster than expected. The IMF projected that world trade volume to grow at 4.2% y-o-y, the second upward revision for this year. Malaysia's external sector benefited from stronger performance of its major trading partners coupled with undervalued ringgit. For the first seven months of this year, gross exports of goods grew substantially by an average of 22.6% as compared to 1.1% for the same period of the previous year. Meanwhile, gross imports, grew at a stronger rate of 23.4% for the same period. Nevertheless, surplus in the current account of the balance of payments continued to deteriorate attributable to stronger growth in imports over exports in the merchandise account, larger deficit in the services account and bloating primary income transfers due to growing remittances by foreign workers amidst weaker ringgit.

Notwithstanding that imports are growing faster than exports, it will benefit the economy in the medium to longer run. Imports were dominated by intermediate goods representing about half of total imports. The remaining half of total imports is split between capital and consumption goods. Capital goods are important for production capacity expansion. High growth in capital goods will contribute to capital accumulation or investment in the economy. This is good for a long-term growth potential. Growth in intermediate goods, in turn, is good for a medium-term growth prospect as intermediate goods are used for making final goods, which are mostly for the export markets. Imports of capital goods grew by 42.0% a year in the 1Q2017 and 6.9% in the 2Q2017. Imports of intermediate goods grew by 27.8% and 23.9% in the 1Q2017 and 2Q2017, respectively. Imports of consumption goods, on the other hand, grew by only 4.0% and 1.5% in the 1Q2017 and 2Q2017, respectively.

The latest release Purchasing Managers' Index (PMI) for September 2017 indicated that global economic growth remains broad-based, both for the manufacturing and services sector. The pace of global economic growth revealed by PMI index is near a two-and-a-half year high, which is at the rate last recorded in the 1Q2015. The "all industry" as well as services and manufacturing indices are on a rising trend since the 1Q2016.

The advanced economies are rising beyond expectation for this year except for the United Kingdom which is growing as expected. The US economy is growing on track but subject to a greater risk scattering due to uncertainties on Trump's policy administration. Stronger growth in the euro area, particularly for Germany, Spain, Italy and France, is reinforced by strong domestic demand which is in advance momentum in the last couple of quarters. The unemployment rate for the region recorded an eight year low of 9.1%. Strong output growth in the euro area is demonstrated by rising industrial output for the past two years, as shown by the Euro-zone Industrial Production index. Meanwhile, stronger growth for the Japanese economy is supported by an improvement in its external demand and a stronger domestic demand as business conditions and labor market improves on the back of expansionary policy for both monetary and fiscal.

China's growth has been supported by strong investments and strong credit growth. Bilateral trade between China and Malaysia has improved because of better-than-expected demand from China. Total trade between China and Malaysia for the period January-August 2017 has increased in terms of market share as well as values compared to the same period of last year. Total trade values rose by 30.6% from RM148.9 billion in the period January-August 2016 to RM194.4 billion in the period January-August

2017.

On the domestic front, the first half of 2017 growth was primarily driven by domestic demand, which was growing by 7.7% y-o-y in the first quarter and 5.7% in the second quarter, underpinned by strong growth in both consumption and investment. Private consumption continued to grow at a faster pace (1Q2017: 6.6%; 2Q2017: 7.1%), while public spending rebounded from a negative growth in the fourth quarter of last year (1Q2017: 7.5%; 2Q2017: 3.3%). Meanwhile, investment was dominated by the private sector with a double-digit growth of 12.9% in the 1Q2017 and moderated a bit to 7.4% in the 2Q2017. However, public investment decelerated 5.0% in the 2Q2017 after growing at 3.2% in the 1Q2017. Strong domestic demand to some extent is derived from external demand as shown by the pattern of growth in the Industrial Production Index (IPI). The improved performance of IPI was largely supported by the manufacturing index. The manufacturing index grew by 6.0% for the 1H2017, which in turn, supported by a strong growth in the export oriented industries index. The average growth of the index for export oriented industries for the 1H2017 was 6.5% and continued to grow strongly at 8.2% in July, mainly supported by major export-oriented subsectors, namely electrical and electronics products and petroleum, chemical, rubber and plastic products.

Better-than-expected growth in the first half of 2017 exerts positive sentiments about the economy, reflected by several indicators. Among others, the domestic financial market recorded positive inflows of portfolio investment amounting to RM16.0 billion for the 2Q2017. Apart from good first quarter performance, the portfolio inflows also resulted from measures to develop the domestic financial market. Given the development in the financial market and good macroeconomic indicators, ringgit rallied strongly against the USD. For the first nine months of 2017, ringgit has appreciated by 6.3% against the USD.

Notwithstanding the above-expectation economic performance of the 1H2017, consumer confidence remains weak as the third quarter's Malaysian Institute of Economic Research Consumer Sentiments Index (CSI) continues to be below the demarcation level of 100 points. Nonetheless, in general consumers remain optimistic about the economy since the index is still above the 4Q2016's index, which is the lowest in the last six quarters. Consumers are also appeared to be more optimistic about the employment outlook for the third quarter of 2017. Accordingly, the survey revealed that consumers are having ambitious spending plans ahead.

Crude oil prices were rising moderately this year after hitting the lowest in the 1Q2017. The accord made by the Organization of the Petroleum Exporting Countries (OPEC) to cut oil outputs to combat the global supply glut witnessed more favorable prices in 2017. The compliance rate on the agreed quotas among OPEC members was quite high in the 1Q2017. Nevertheless, total world production began to upsurge in May as OPEC production rose 6.5% above the quota, mostly contributed by Nigeria and Libya, the two-member countries exempted from the quota. OPEC production continues to rise and concurrently the non-OPEC productions are also rising, hence exerting a downward pressure on prices. Crude oil prices are expected to average out at USD55 per barrel in 2017 and further improve to USD60 per barrel in 2018.

For the agriculture commodity, crude palm oil (CPO) was enjoying better prices starting from the beginning of this year due to stronger demand coupled with weather-related supply disruption last year. However, better harvest this year saw production on the rise and simultaneously prices are sliding down. The imposition of tariff on edible oils by India, the largest importer of Malaysian CPO, worsen the outlook for the industry.

The growth projection for 2018 is maintained at a range of 4.7 - 5.3% as of now while awaiting fresh leads. Current account balances for this year as well as for 2018 are maintained as per July forecast, estimated to be 1.8% and 1.6% of GNI, respectively. Balances on goods account for 2017 and 2018 are also maintained at 8.4% and 8.2% of GNI, respectively.

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