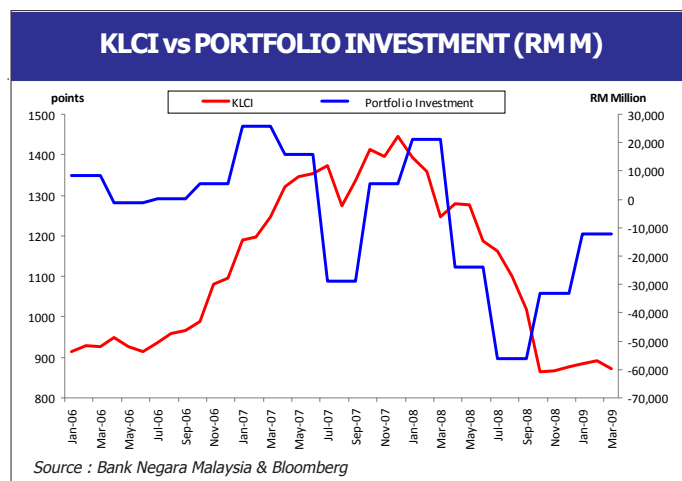


Malaysia: When will the capital outflow stop?

3 JULY 2009
2009/0033

- The Department of Statistics (DOS) reported that Malaysia recorded a fourth consecutive quarter of outflow in its capital account in 1Q09, mainly due to the outflow in both portfolio investment (-RM12.5B) and other investment (-RM20.8B presumably external loan repayment).
- Nonetheless, total capital outflow was much slower than the previous quarter, declining by a total of RM29.8B as compared to an outflow of RM75.7B in 4Q08. As the outflow subsided, surplus of the current account were able to upset the shortfall in capital account, resulting in a balance of payments (BOP) surplus of RM3.3B in 1Q09, the first surplus since 2Q08.
- Consequently, this surplus was translated into high external reserve of Bank Negara Malaysia (BNM) in the same quarter, rising to RM320.7B as at end of March, after falling by almost RM100B since 2Q08, due to a staggering RM149.3B capital outflow throughout the same period.
- As we expect the current account to retain its large surpluses for the remaining half of the year, the question is, when will the capital outflow reverse and will it have much impact, if any, on Malaysia's liquidity level?
- Following the general election last year, total outflow in portfolio investment until 1Q09 amounted to RM121.5B, far much higher than the recorded RM57.2B of portfolio investment inflow since 2006. This trend mirrored the performance of the stock market and was largely due to global deleveraging process in 2008.
- Assuming only a slight increase in BNM's reserve level to RM320B by the end of June 2009 (versus RM318.4B as at June 15) and as trade surplus remained wide in 2Q09, the hemorrhage of net investment outflow did not seem to stop in the current quarter. This was despite the 28.5% rally of the Kuala Lumpur Composite Index from its bottom reached in March this year.
- Between 2Q08 to 2Q09, we estimated a whopping net outflow of RM130B in Malaysia's portfolio investment. As



the deleveraging process comes to its end in 2Q09, we believe the 2H09 could possibly register a further increase in the external reserve of BNM, even without a significant change in the net portfolio investment as the current account would still post huge surplus.

- What it means is that new liquidity would be added to an already flush domestic system. This would require further intervention by BNM to keep the current real interest rates from falling.
- On the other hand, if the international investment community during the later part of the year were to respond positively to the liberalization measures introduced by the government, along with some recovery in macroeconomic fundamentals, it would only result the external reserves moving higher to more than US\$100B.
- Either way, there is no stopping the accumulation in reserves.
- While a stronger reserve position would strengthen the ringgit, ceteris paribus, the main issue would be the underutilized liquidity in the system. Whether it will lead into a liquidity trap or even a long term inflationary environment, that remains another issue to be tackled.

MALAYSIA: BALANCE OF PAYMENTS (RM million)

| | 2Q07 | 3Q07 | 4Q07 | 1Q08 | 2Q08 | 3Q08 | 4Q08 | 1Q09 |
|---|---------|---------|---------|---------|---------|---------|---------|---------|
| Balance on Current Account | 25,070 | 29,384 | 26,341 | 23,778 | 37,046 | 38,714 | 30,399 | 31,421 |
| Credit | 180,542 | 196,392 | 200,554 | 185,959 | 214,189 | 222,040 | 184,727 | 147,240 |
| Debit | 155,471 | 167,008 | 174,213 | 162,182 | 177,143 | 183,326 | 154,328 | 116,350 |
| Capital Account | -21 | -24 | -38 | 797 | -37 | -119 | -55 | -64 |
| Capital Transfers | -22 | -21 | -25 | -24 | -21 | -102 | -26 | -38 |
| Non-Produced, Non-Financial Assets | 0 | -3 | -13 | 821 | -15 | -17 | -29 | -26 |
| Financial Account | 7,680 | -30,888 | -17,264 | 25,655 | -12,271 | -61,360 | -75,620 | -29,758 |
| Direct Investment | 82 | -4,952 | -5,022 | -2,978 | 2,909 | -18,971 | -1,610 | 3,195 |
| Abroad | -11,381 | -12,292 | -9,603 | -6,333 | -14,483 | -19,851 | -6,614 | 435 |
| In Malaysia | 11,463 | 7,341 | 4,580 | 3,355 | 17,392 | 881 | 5,004 | 2,761 |
| Portfolio Investment | 15,929 | -28,732 | 5,580 | 21,070 | -24,020 | -56,179 | -33,189 | -12,153 |
| Other Investment | -8,331 | 2,796 | -17,821 | 7,563 | 8,841 | 13,790 | -40,821 | -20,799 |
| Official Sector | -1,182 | -3,386 | -942 | -712 | 1,605 | -2,738 | -866 | -967 |
| Private Sector | -7,149 | 6,182 | -16,879 | 8,275 | 7,236 | 16,527 | -39,955 | -19,832 |
| Balance on Cap. & Fin. Acc. | 7,658 | -30,911 | -17,301 | 26,452 | -12,307 | -61,479 | -75,675 | -29,822 |
| Errors and Omissions | 1,115 | -2,829 | -8,743 | -1,287 | 1,474 | -8,758 | -16,604 | 1,665 |
| Overall Balance (surplus +/- deficit -) | 33,843 | -4,356 | 297 | 48,942 | 26,213 | -31,523 | -61,880 | 3,264 |

Source : Bank Negara Malaysia & Department of Statistics Malaysia