01 June 2016

ECONOMIC REPORT | Money Supply

Money Supply Remained Weak due to Low Oil Prices

- *Malaysia's money supply growth remained weak in April based on historical standard. On a year-on-year basis, M1 remained in the red zone at -0.44%, while M2 and M3 grew weakly at 1.50% and 1.46% respectively.*
- *While the figures indicate slight improvement from prior month, it still potentially signals a bleak outlook on Malaysia's economic prospects based on conventional economic theory.*
- *Delving deeper into the data, however, we opine that the weak money supply was mainly caused by external factors, i.e. relatively suppressed oil prices and foreign capital outflows, rather than a deteriorating economic fundamental.*

Malaysia's money supply growth remained weak in April based on historical standard. On a year-on-year basis, M1 remained in the red zone at -0.44%, while M2 and M3 grew weakly at 1.50% and 1.46% respectively. While the figures indicate slight improvement from prior month, it still potentially signals a bleak outlook on Malaysia's economic prospects based on conventional economic theory. However, delving deeper into the data, we opine that the weak money supply was mainly caused by external factors, i.e. relatively suppressed oil prices and foreign capital outflows, rather than a deteriorating economic fundamental.

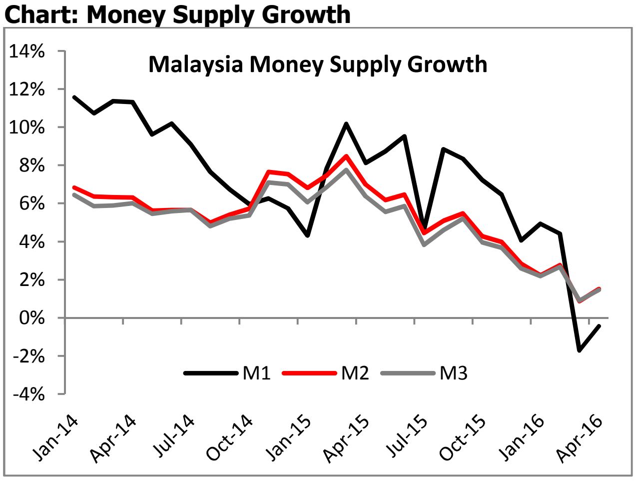
Money supply is supposed to be high among net-exporters. Fundamentally, money supply in net-exporting countries, i.e. countries with trade surplus, tends to exhibit stronger growth rates, ceteris paribus. In economic term, when a country is a net exporter, it technically lends its goods and services to the rest of the world, in exchange for their fiat currencies. Therefore, when domestic exporters convert their foreign currency-denominated export earnings into domestic currency, they effectively increase the stock of money supply in the local economy. Thus, there exists a certain degree of positive correlation between a country's trade performance and its domestic money supply growth.

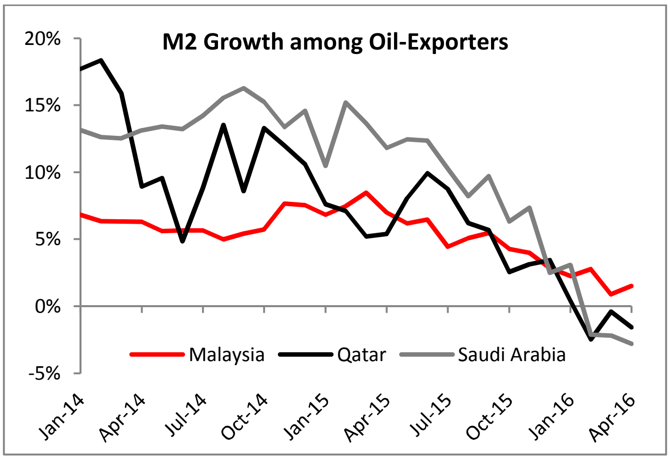
Applying this economic concept to Malaysia's case, it is reasonable to attribute the declining money supply growth to a persistently suppressed crude oil price. The oil price had been remained suppressed at below USD50pb during the entire month of April. This was basically translated into declining export earnings by Malaysian oil exporters. As a result, less foreign money was converted into Malaysian Ringgit, subsequently culminating into a slower pace of money supply growth. In addition to that, against the backdrop of a highly volatile foreign exchange market for Asian currencies in particular, some exporters might be reluctant to exchange their entire export earnings into Ringgit in order to better positioning themselves in times of highly fluctuating foreign exchange rates. As a matter of fact, statistical evidence demonstrates that other oil-exporting countries too exhibit trend similar to Malaysia in term of their money supply growth.

Foreign capital outflows have contributed to the slow growth of money supply. Apart from that, foreign capital outflows too imposed downward pressure on money supply growth. While Fed Chairwoman Janet Yellen had assured market of a gradual rate normalization path in the end of March, concerns among global investors regarding a possible Fed's rate hike still exist in the market to certain degree. As a result, risk-averse investors might have decided to move in advance by transferring their funds from the emerging world to the US. This effectively reduced the money stock in the inflicted economies. Malaysia was arguably not spared from this trend. In fact, it is reasonable to draw parallel the incident of the 2013 taper tantrum to today scenario.

The moderating money supply is a phenomenon among emerging market economies. A dive in money supply has been observed among most emerging economies since mid-2013 where rumour of taper tantrum was prevailing. Back-then, foreign capital outflows were intense and rapid amidst the intensifying fear of taper-tantrum. Market participants were increasingly convinced of the imminent end of Quantitative Easing (QE) with a rising Federal Fund Rate by the then Fed's Chairman Ben Bernanke. In response to that, global investors, particularly those of US-bound, swiftly drained their funds from the emerging world into the US. This eventually culminated into a relatively tepid money supply growth among most emerging markets, which had been the net receivers of the "cheap dollars" injected into the world economy via three waves of QE by the Fed.

Chart: Money Supply Growth





Source: BNM; CEIC; MIDF Research

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER