# Navigator

## Now, next and how for business

Malaysia report

HSBC

# Malaysia

## Shift up the value chain drives future trade growth

After a strong 2017, Malaysian firms enter 2018 in very buoyant mood, and the recent CPTPP agreement will only boost the sense of optimism. Malaysia's rich natural resource base provides an advantage for value-added processing and chemicals production, which will drive strong goods exports over the short and long term. Meanwhile, Malaysia's world class tourism sector will continue to attract swaths of visitors, particularly from large emerging markets with a growing number of middle-income households such as India and China.

## Short-Term Snapshot

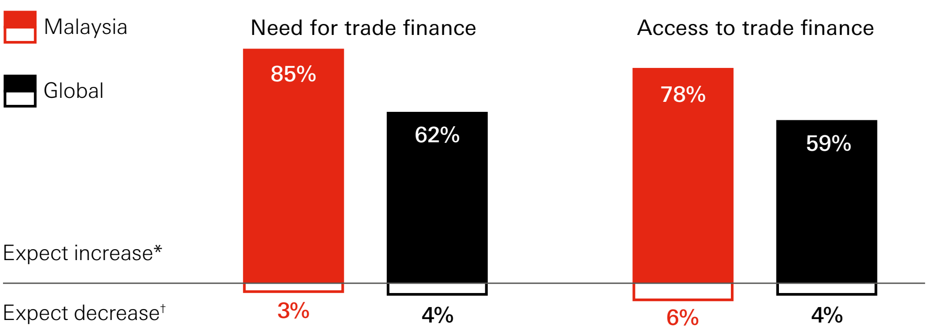
Economic growth rebounded strongly in 2017, boosted by an acceleration in exports and solid domestic activity. And momentum is expected to remain firm in 2018. As we enter another election cycle, the government is likely to ramp up expenditure on more populist policies ahead of the vote (expected in April or May), which in turn suggests 2018 will be another good year for Malaysian households. Meanwhile, businesses have begun the new year in a very buoyant mood. Our survey indicates nearly nine in ten businesses anticipate an increase in trade volumes over the next twelve months, well above the global average of 77%.

Such optimism is underpinned by a wider confidence in the global economy, with 40% of firms citing the favourable economic environment as the top factor supporting growth in trade in 2018. Trade is expected to remain a largely regional affair this year; survey respondents most commonly cited Asian counterparts as their target markets for expansion, with Singapore and Indonesia leading the pack. The transition of the Chinese economy towards a slower, more sustainable growth trajectory is expected to be a gradual process. But even through this transition China will remain a key market for Malaysian goods exports.

### Action points for business

- The current strength of the global economy provides an opportunity for Malaysian firms to expand into new markets and increase market shares.
- The complimentary nature of trade in goods and services in Malaysia should encourage Malaysian firms to exploit existing relationships and package goods and services offerings together.

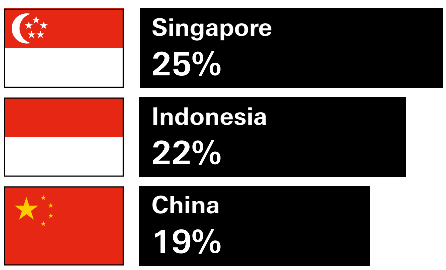
**Outlook for trade finance need and access in the next 12 months**




*Expect increase = Increase significantly + Increase slightly
†Expect decrease = Decrease significantly + Decrease slightly

Source: TNS Kantar

**Which are the top 3 markets where your business will look to expand in the next 3-5 years?**




Source: TNS Kantar

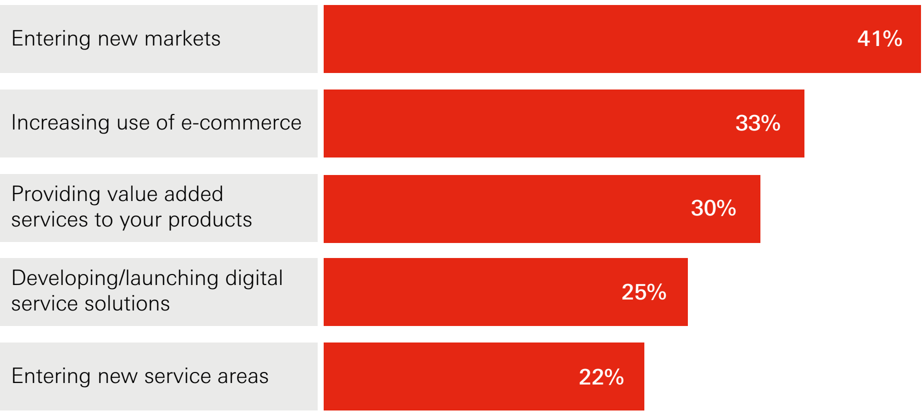
85% of Malaysian firms expect that they will need additional trade finance support in 2018. And this finance is expected to be readily available, with only 6% of respondents anticipating a decline in the ability to access finance, citing concerns over exchange rate volatility as the primary challenge to meeting their financing needs.

Services accounted for around 15% of total exports in 2017, having retained a relatively constant share in total exports during the post financial crisis era. Tourism remains the dominant sector – accounting for more than 50% of total services exports – however transport & distribution and B2B & other services are also important contributors, together accounting for more than one-third of total services exports.

Malaysian businesses are also optimistic for growth in services trade with year, with nearly three-quarters of respondents to our survey expecting an increase 2018. The favourable economic environment is again quoted as the most obvious driver of growth, in conjunction with expanding use of e-commerce and continued technological progress. New market entry is cited by more than 40% of respondents as most likely method of expansion over the next 12 months.

Nearly nine in ten businesses expect trade volumes to increase this year, supported by a robust economy and pick-up in demand.

**How do you plan to grow your services business?**




Source: TNS Kantar

# Trade Policy Developments

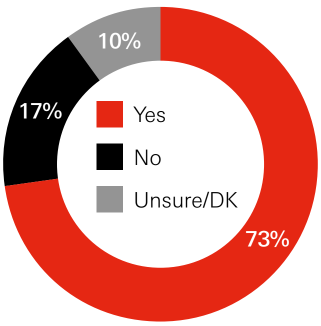
The resurrected Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) deal was signed in March after member states agreed on final provisions, including a requirement from Malaysia concerning the preferential treatment of SOEs in the oil & gas sector. The FTA will provide Malaysian firms with preferential access to 10 markets accounting for 13% of global GDP. However, this positive development was dampened by the news that the EU plans to ban the use of palm oil in motor fuels from 2021 (Malaysia is the largest palm oil exporter in the world).

Despite the agreement on CPTPP, the perception of Malaysian businesses is that protectionism is on the rise. Almost three-quarters of survey respondents believe governments are imposing more protectionist policies, citing concerns over the impact it will have on the cost of doing business, and the effect on trade routes/patterns.

## Action points for business

- Malaysian firms should capitalise on the signing of CPTPP and pursue opportunities to develop new relationships in markets further afield from their traditional base.
- Rising protectionism highlights the importance of a diverse and flexible supply chain management, and Malaysian firms should be ready to react to any foreign policy shifts that may impinge on their business.

**Are governments becoming more protective of their domestic business?**



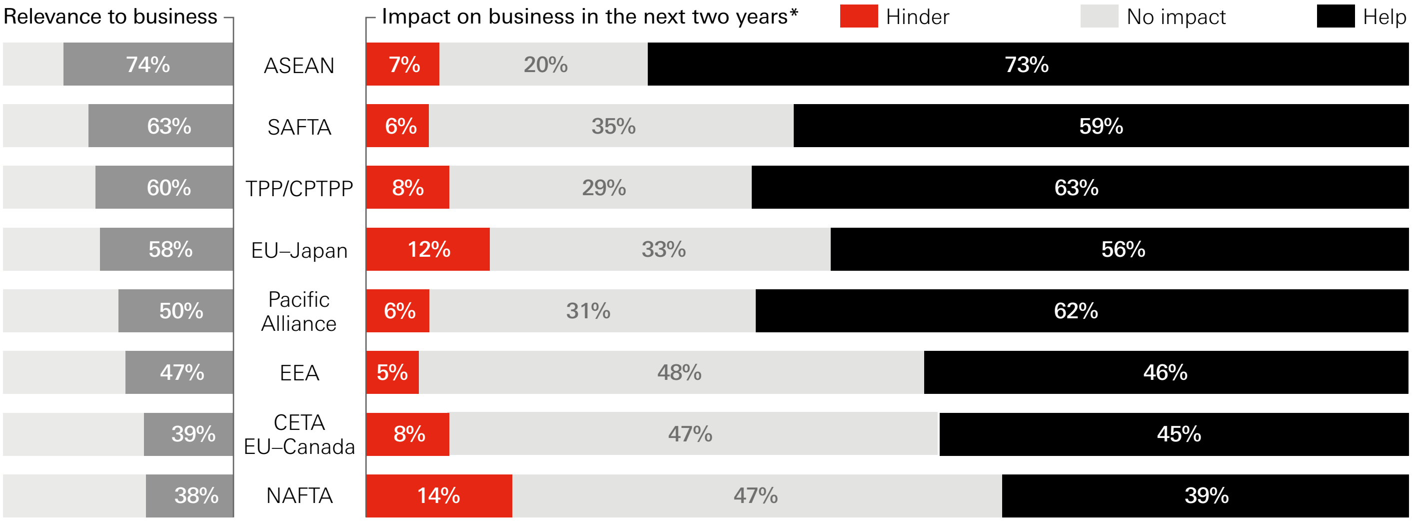

Note: may not total 100% due to rounding

Source: TNS Kantar

**Top 3 impacts of protective policies on my business**


Source: TNS Kantar

**Relevance and impact of trade agreements**




Source: TNS Kantar

*May not total 100% due to rounding

Given the predominance of regional counterparts in the list of top trade partners and fastest growing markets, it is unsurprising that Malaysian firms look towards regional trade initiatives with the most relish. These include the ASEAN 2025 and China's "Belt and Road", which are anticipated to have the largest positive impact, as well as the CPTPP, which is expected to benefit nearly two-thirds of firms in Malaysia.

> Malaysian firms are increasingly concerned over protectionism abroad, while viewing regional trade initiatives with the most optimism.

# Long-Term Outlook for Trade

Businesses in Malaysia will need to exploit the current strength of the global economy by exploring new opportunities abroad, while recycling revenues through investment in efficiency gains and product innovation. Traditional export sectors are threatened by the emergence of new low-cost production centres such as Vietnam, but opportunities abound by moving up the value-chain in both goods and services.

This movement will be aided by government investment in new infrastructure and better education standards, as authorities continue to target a developed market status. Firms should match the governments ambitious targets through improvements in the quality and sophistication of their goods and services offerings abroad. Continued ASEAN integration, China's "belt and Road" initiative and implementation of the CPTPP provide potential upside risk to this process by reducing trade barriers. Malaysian firms are alive to these opportunities, with survey respondents citing the decline in costs of shipping, logistics and storage as one of the key facilitators of trade growth.

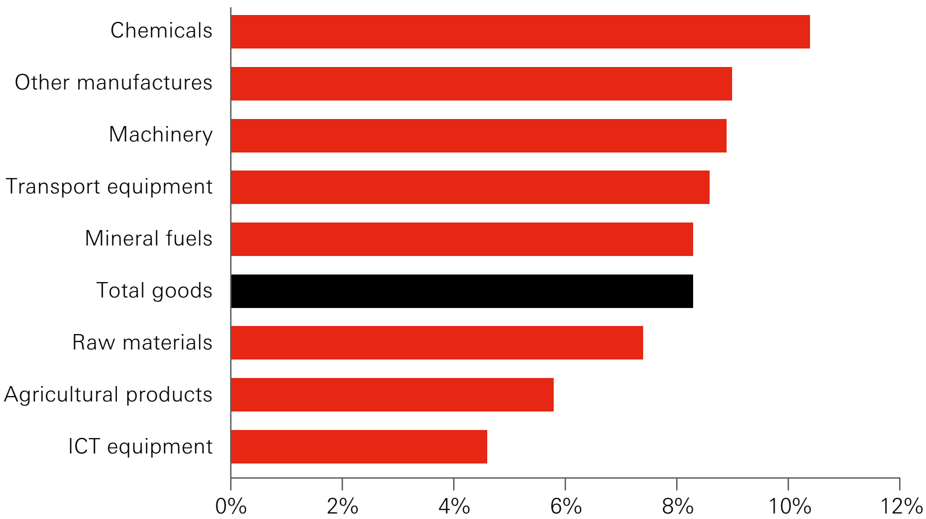
**High value-added exports leading the charge**
Malaysia's onward push towards developed market status is reflected in the evolution of the export mix, which is expected to increase in sophistication over the long term as the country moves up the value chain. This evolution is no better illustrated than through the rise of the Chemicals sector, benefitting from a rich natural resource base through the development of higher value-added processing capabilities. Chemicals exports are expected to outperform all other sectors over the long term, with shipments forecast to rise by more than 10% per annum over 2017-2030, 2 percentage points faster than total goods exports.

Traditional stronghold sectors such as transport equipment, machinery and other manufactured goods are also anticipated to achieve above average growth over the long term, while lagging behind are lower value-added sectors including agricultural products and raw materials. The one exception is the ICT sector, which is expected to achieve export growth of less than 5% per annum over 2017-2030, falling in the list of top export sectors to third by 2030. This will be driven by a loss of competitiveness vis-à-vis low-cost producers such as Vietnam and China, and highlights the importance of diversifying towards a more sophisticated production process. Industrial machinery will overwhelmingly remain the top export sector by 2030.

## Action points for business

- Malaysian firms cannot rest on their laurels. New low-cost producers in sectors such as electronics and ICT highlights the importance of Malaysia maintaining a competitive edge via continued investment and innovation.
- While long-standing partners will continue to dominate the picture for goods and services trade, Malaysian firms should continue to explore opportunities further afield and capitalise on fast growing demand from emerging markets.

**Exports of goods by sector, 2017-30 (average annual growth)**




Source: Oxford Economics

**Top 5 Hotlist destinations of goods exports**

| Rank | 2016 | 2030 |
|---|---|---|
| 1 | Singapore | China |
| 2 | China | Singapore |
| 3 | USA | USA |
| 4 | Japan | India |
| 5 | Hong Kong | Japan |

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

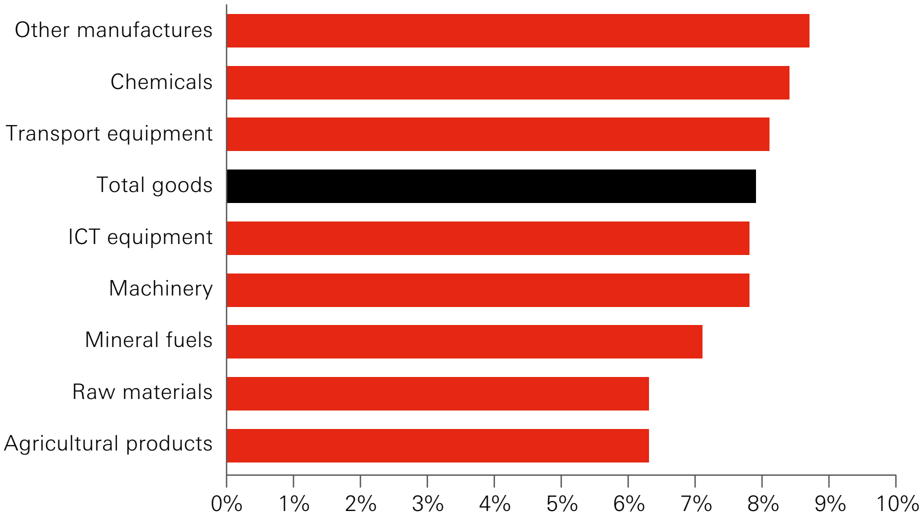
Malaysia's primary export destinations will remain relatively stable over the long term, with Singapore, China, USA and Japan remaining in the top 5 most important export destinations by 2030. Singapore will however be replaced by China as the number one destination, with exports to the latter expected to achieve double-digit annual growth rates over the period to 2030. Other developing markets dominate the list of fastest growing export markets, including Bangladesh, India, Mexico, Turkey and Vietnam, driven by strong demand for industrial machinery. Indeed, rapid export growth will propel India to fourth place in the ranking of top export destinations by 2030.

Such developments highlight the need for Malaysian firms to retain a wider perspective when looking to expand their international operations. Only three of the top ten fastest growing export markets in the decade 2021-2030 are in the ASEAN region, an observation that contrasts with the survey data, which indicates a more regional focus for short term trade.

**Infrastructure boosting demand for industrial machinery imports**
A continued push to boost infrastructure investment – including big ticket items such as the high-speed rail connection between Singapore and Kuala Lumper – will continue to drive strong demand for transport & machinery over the long term. Industrial machinery is expected to remain the largest import sector by 2030, contributing nearly 30% of total growth in imports in the decade 2021-2030.

Meanwhile, Malaysia's continued movement up the value chain in production is also reflected in their import mix. Imports of petroleum and petroleum related products are expected to experience continued strong growth, supporting the thriving chemicals industry. And ICT imports will continue to perform well, satisfying the appetite of a growing number of middle income households, while also supporting key growth enablers for the services sector as identified in the survey, including the increased use of technology and exploitation of e-commerce.

**Imports of goods by sector, 2017-30 (average annual growth)**




Source: Oxford Economics

**Top 5 Hotlist origins of goods imports**

| Rank | 2016 | 2030 |
|---|---|---|
| 1 | China | China |
| 2 | Singapore | Singapore |
| 3 | Japan | USA |
| 4 | USA | India |
| 5 | Korea | Japan |

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

Malaysia's top import origins are a near mirror image of the top export destinations, indicating strong bilateral trade relationships with key partners and a similar bias towards regional trade. China and Singapore top the list of most important import partners, both now and in 2030, while Japan and USA feature prominently. The Asian region will continue to be the fastest growing region for imports over the decade 2021-2030, achieving annual growth of 10% per annum. Vietnam is expected to be the fastest growing market in the long term, both for exports and imports, reflecting the growing importance of Vietnam as a trade partner and increasing opportunities for growth that are available.

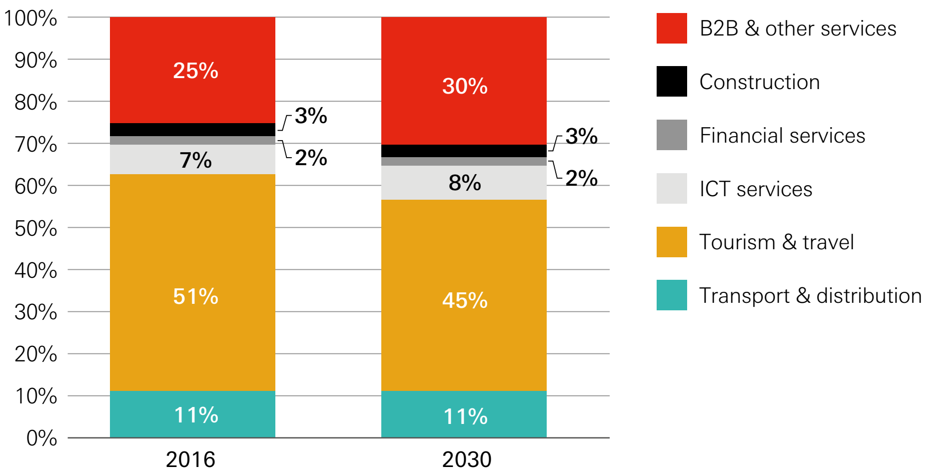
Imports are however increasingly being sourced from further afield, with the list of the fastest-growing markets including Brazil, Mexico, Saudi Arabia and the UAE, with the latter two markets satisfying strong demand for petroleum products.

**Tourism to dominate, but high value-added service exports growing rapidly**
Services exports are expected to grow by 8% per annum over 2017-2030, a similar rate to good exports. Tourism & travel will continue to be the most dominant sector in the long term, contributing more than 40% of growth in services over the decade 2021-2030. However, the share of tourism in total services exports is expected to decline from 51% in 2016 to 45% in 2030, replaced by high value-added service offerings including B2B. The movement to a higher value-added product mix therefore mirrors a similar development expected in the trade in goods forecasts. Strong investment in education aimed at improving standards in Malaysia will support this transition over the long term.

One of the fastest growing sector is expected to be construction services, with annual growth of 9% expected over 2017-2030. Malaysia's continued investment in infrastructure has supported growth in the domestic construction sector, providing an opportunity for firms to achieve scale efficiencies and therefore compete internationally.  However, this is a relatively new phenomenon and construction exports will remain a relatively small component of total services exports in the long term.

While tourism continues to dominate, Malaysia will continue to make progress in higher value-added export markets.

**Sectoral shares in total services exports**




Source: Oxford Economics

**Top 5 Hotlist destinations of services exports**

| Rank | 2016 | 2030 |
|---|---|---|
| 1 | Singapore | Singapore |
| 2 | China | China |
| 3 | USA | India |
| 4 | Japan | USA |
| 5 | Indonesia | Indonesia |

Note: Ranking among the 23 trade partners covered in the forecast

Source: Oxford Economics

Malaysia's top services export destinations are similar to its goods exports destinations. Singapore is the most important market – reflecting the high volume of tourists that cross the straits every year, with nearly 50% of total tourist arrivals in 2017 originating from Singapore. However, future growth will come from further afield, including India, Indonesia and China.

Developing economies dominate the list of fastest-growing markets in the future. This will reflect rising incomes abroad, making Malaysia a more affordable tourist destination, particularly for rising middle classes in India and China. However, Malaysia's increased sophistication in their services export mix will also support this growth, with the ability to provide important B2B and financial services. Malaysia is a market leader in providing sharia-compliant financial services for example, supporting strong exports to fast-growing markets such as Indonesia and the Middle East.

## About the HSBC Navigator

The HSBC Navigator presents a blend of survey evidence, policy analysis, and economic modelling to generate unique and timely insights into the changing landscape for global trade.

The business survey is a quantitative indicator of the short-term outlook for global trade. The survey, which is the largest of its kind, is conducted on behalf of HSBC by Kantar TNS. It is compiled from responses by decision-makers at over 6,000 businesses – from small and mid-market to large corporations – across a broad range of industry sectors in 26 markets. Interviewees were polled on a range of questions including expectations around future growth in trade, trade finance needs, attitudes toward trade policy developments and strategic business plans.

The survey represents a timely source of information on the fast-evolving trade environment. And it can provide a useful contextual setting for interpreting developments in official data. In this way, economists at Oxford Economics are able to blend insights from the survey with their own analysis and modelling of developments in trade.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods and services, in part based on HSBC's own analysis and forecasts of the world economy. A top-down approach is employed, with Oxford Economics' suite of models used to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here.

Oxford Economics employs a global modelling framework, with headline bilateral trade forecasts constructed as a function of demand in the destination market and the exporter's competitiveness (as measured by unit labour costs in nominal USD terms). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2017-20 and 2021-30.

These headline bilateral trade forecasts for goods and services are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each sector, by market:

- For trade in goods, sectors are classified according to the UN's Standard International Trade Classifications (SITC) system at the two-digit level and grouped into 30 sector headings.
- For trade in services, we identify five broad sectors: B2B and other services, tourism & travel, transport & distribution, financial services, ICT services and construction.

Drawing on the Kantar TNS survey results and Oxford Economics' long-term forecasts, Oxford Economics produces in consultation with HSBC a global report and specific reports on the following 23 markets: Argentina, Australia, Bangladesh, Canada, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Japan, Malaysia, Mexico, Poland, Saudi Arabia, Singapore, Turkey, UAE, UK, USA and Vietnam. The analysis of trade in goods also includes trade with Brazil and Korea for a total sample of 25 key trading markets; for trade in services the analysis also includes Korea for a total sample of 24 key trading markets.

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