



The Malaysian Economy: Current Situation and Prospect

Akira Nakamura
Deputy General Manager and Principal Economist
akira_nakamura@iima.or.jp
Economic Research Department
Institute for International Monetary Affairs (IIMA)

< Abstract >

1. The Malaysian economy is expected to continue on its upswing trend mainly supported by an increase of household income due to increased employment and expanding exports. Consumer price inflation is forecast to continue a moderate rise due to contained fuel prices following stabilization of crude oil prices and impact of abolition of GST.
2. Fiscal deficits had been forecast to remain under 3% of nominal GDP for both 2018 and 2019, as was in 2017, but they are now expected to increase more than initially planned mainly due to the abolition of Goods and Services Tax (GST).
3. The current account balance continues to be in surplus. The trade surplus, the biggest component of the current account, is expected to continue to increase for some time to come as the economies of trading partners will keep growing and the prices of mineral fuels, the main export items of Malaysia, will remain firm. Thus there is a high possibility that the current account surplus will also continue.
4. The possibility cannot be denied that the current account would fall into deficit should the world economy decelerate, contrary to the forecast, as much as it declined during the global financial crisis of 2009, and should the stagnation of exports lead to a dramatic shrink of Malaysian trade surplus. Even in that case, however, risks of avoidance of investment in or withdrawal of funds from Malaysia by overseas investors would be small judging from its advantages such as (i) its rich endowment of natural resources, (ii) favorable investment environment, and (iii) sound banking management.

5. Looking at the external debts of Malaysia by their denomination, over 60% of foreign currency-denominated debts that account for a larger share of its external debts consists of debts with relatively low risks in view of the counterpart of credit like (i) intercompany credits and (ii) trade credits, and those with limited risks on the net basis like (iii) interbank loans and (iv) deposits from nonresidents. Therefore, there will be no need to be much concerned about the debt outstanding in spite of its apparent size.
6. The government announced that by adding to the public debts previously published those government-guaranteed obligations of state owned enterprises with low ability to repay and payments of lease fees to the Public-Private Projects, “the public debt outstanding at the end of 2017 proved to have largely exceeded the amount already published by the former administration”.
7. This announcement, however, overstates the fact, and it seems that one of the purposes of this statement was to give an impression both at home and abroad that the former administration headed by ex-prime minister Najib had concealed the real debts.
8. The government decided to reintroduce the old Sales and Services Tax (SST) while announcing the abolition of the GST. The change is expected to decrease tax revenues by 8.3% of annual revenues and by 1.6% of nominal GDP.
9. To make up for the declining revenues, the government is promoting reviews of infrastructure projects including those under implementation, but the effect on restraining expenditures is yet to be seen. Furthermore, taking it into account that the reintroduction of fuel subsidies will be a factor to increase expenditures, the government will have to be more careful in implementing additional fiscal policies since the fiscal deficit is already expected to expand more rapidly than was initially planned.

1. Development of the Real Economy of Malaysia

The Malaysian economy continues its solid growth supported by a strong personal consumption following improved employment situation and by rising exports. The real GDP grew 5.6% y/y in the January-March quarter of 2018 after growing 5.9% in 2017 over the previous year. It slowed to 4.5% in the April-June quarter due to negative contribution of inventory changes while personal consumption maintained its high growth (8.0% y/y) and private capital investment picked up (to 6.1% y/y). Consumer price inflation recorded a relatively high rise of 3.8% y/y in 2017, but in 2018 it remains subdued on the level of 1% reflecting stabilized fuel prices (Figures 1 and 2).

In the meanwhile, in the 2018 general election (for members of the Dewan Rakyat, lower house of the Parliament) held in May, the Pakatan Harapan (Alliance of Hope) coalition led by the former prime minister Mahathir Mohamad (which had been an opposition party prior to the

election) won the majority of all seats to become a new ruling party. The new administration, with Mr. Mahathir taking the office as prime minister again, immediately started to implement the economic policies like the abolition of the GST that they pledged during the election campaign.

Figure 1 : Malaysia’s Real GDP

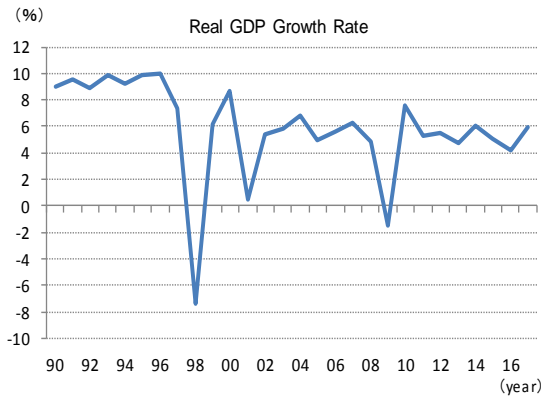
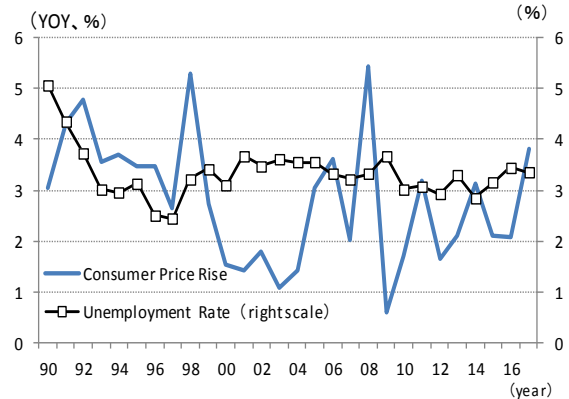


Figure 2 : Malaysia’s CPI and Unemployment



(Source) IMF, Bank Negara Malaysia

Going forward, the domestic demand is forecast to maintain its solid increase centering on private consumption, supported by the increase of household income associated with expansion of employment and under the influence of the abolition of the GST. Exports will also continue to increase helped by the economic expansion in the ASEAN countries and India as well as in advanced economies like Japan and the US, and bottoming out of prices of mineral fuels, main export items of Malaysia. As a result, it is highly likely the Malaysian economy continues to grow firmly. The International Monetary Fund (IMF) forecasted in its World Economic Outlook released in October the real GDP of Malaysia would grow by 4.7% in 2018 and 4.6% in 2019, almost at the same pace of its potential growth rate.

Consumer prices will remain on a modest rise reflecting a continued stability of crude oil prices and an effect of the abolition of GST. The IMF forecast in the October World Economic Outlook that after falling to 1.0% in 2018 consumer price rise will be stabilized at 2.3% in 2019.

The fiscal deficit ended up with below 3% of nominal GDP in 2017 despite a small increase in the negative territory. Although the deficits for 2018 and 2019 were at first estimated to remain within the same level against nominal GDP¹, they are now forecast to increase mainly due to a fall in revenues associated with the abolition of the GST. (For more details, see the Section 4 below: “Impacts of the Abolition of the GST and Others.”)

¹ The IMF had estimated in its World Economic Outlook released in April 2017 the budget deficits of Malaysia for 2018 and 2019 at negative 2.7% and negative 2.5% of nominal GDP respectively.

Figure 3 : Malaysia's Fiscal Balance
(in percent of nominal GDP)

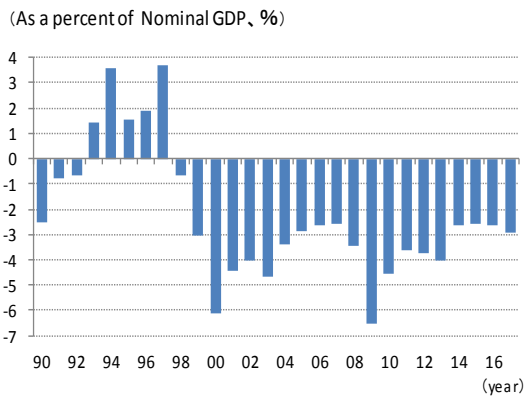
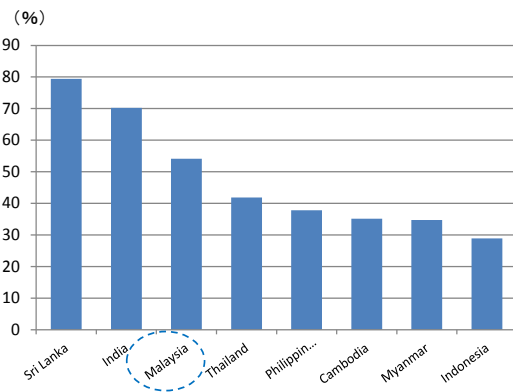


Figure 4 : Public Debts Outstanding
(in percent of nominal GDP, end 2017)



(Source) IMF and Bank Negara Malaysia

2. External Balance and International Investment Position

(1) Current account surplus, reserves and external debts

In 2017 the current account surplus accelerated to increase with its ratio to nominal GDP rising from 2.0% in 2016 to 3.0% in 2017. The main factors included an increase of trade surplus supported by rising exports. The primary income balance, which consists mainly of incomes on direct investment and portfolio investment, recorded the largest deficit, but the deficits have remained smaller in the period from 2005 to 2017 than its peak time scale (Figures and 5 and 6).

Figure 5 : Malaysia's Current Account Balance

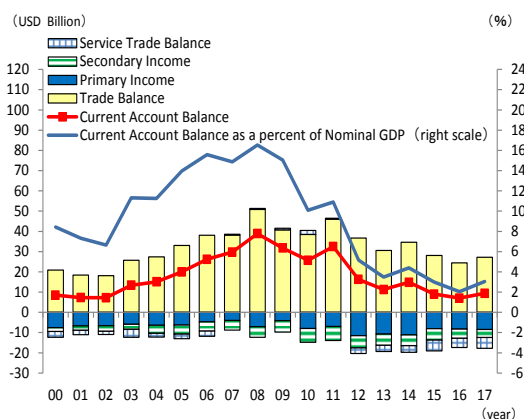
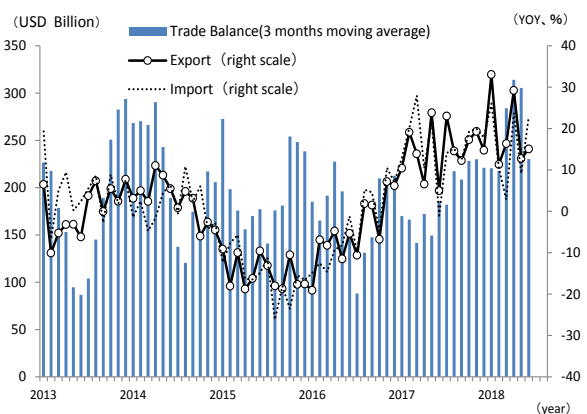


Figure 6 : Malaysia's Trade Balance



(Source) IMF, Bank Negara Malaysia

In this situation, the foreign exchange reserves which had tended to fall increased to \$106.8 billion (an increase of \$6 billion over the previous year) in 2017 for the first time in five years.

The main reason for this increase may reflect the suspension of intervention by the Bank Negara Malaysia of buying the ringgit against the dollar as the ringgit generally tended to rise during the year. The reserves stood at 6 months equivalent of imports as of the end of 2017, which was well above the 3 months equivalent regarded as a minimum satisfactory level, although they decreased from 8 months equivalent reached in 2016 due to an increase of imports (Figures 7 and 8).

Figure 7 : Malaysia's Official Reserves

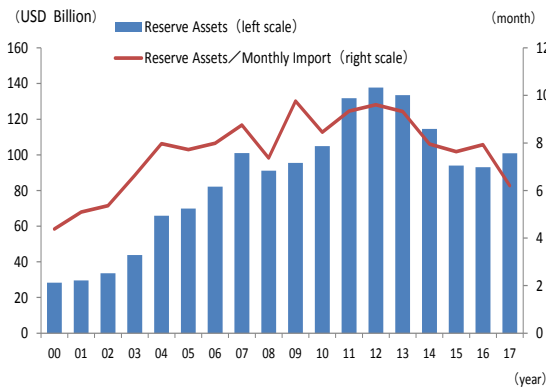


Figure 8 : Foreign Exchange Rates of the Ringgit



(Source) IMF, Bank Negara Malaysia

On the other hand, the ratio of short-term external debts to foreign exchange reserves stood at 83% at the end of 2017, which is at higher level among the Asian emerging economies but the amount of their outstanding is still lower than the foreign exchange reserves. The ratio of total external debts to nominal GDP stood at 65.3% as of the same time above, showing a relatively high level among the major Asian countries (Figures 9 and 10).

Figure 9 : Ratio of Short-term External Debts to Reserves (2017)

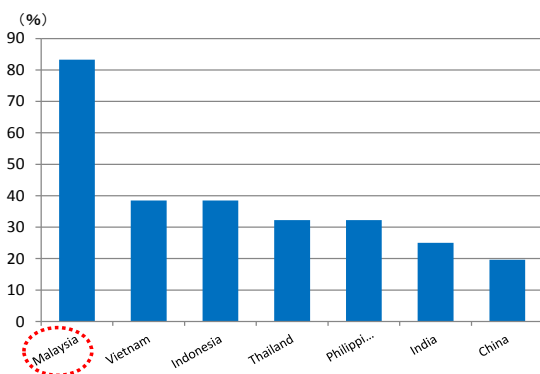
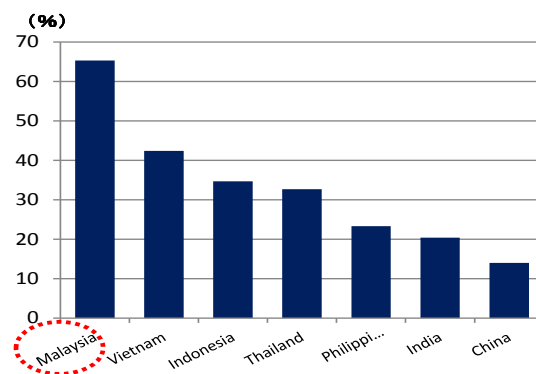


Figure 10: Ratio of External Debts to Nominal GDP (2017)



(Source) World Bank, IMF

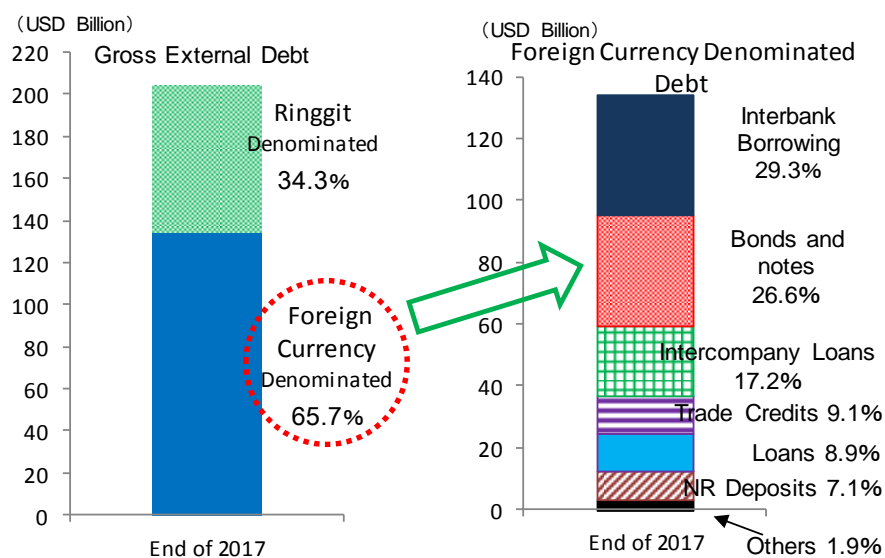
(2) External debts by currency denomination and components

The currency breakdown of the external debts of Malaysia which stood at \$204.6 billion (65.3% of nominal GDP) as of the end 2017 showed that the locally denominated debt amounted to \$70.18 billion (34.3% of the total) and foreign-currency-denominated debts \$134.42 billion (65.7% of the total), with the latter making up a larger fraction.

The Figure 11 shows the breakdowns of the external debts denominated in foreign currency. Among them, (i) intra-group-company credits (\$23.12 billion, 17.2% of the foreign currency denominated debts) and (ii) trade credits (\$12.23 billion, 9.1%) are considered to be less risky on repayments in respect of credibility of the counterparts and their contents. The liabilities of banks like (iii) the interbank loans (\$39.39 billion, 29.3% of foreign-currency-denominated debts) and (iv) nonresident deposits (\$9.54 billion, 7.1%) make up a relatively large share of 36.4%, but the risks for them are limited on a net base since banks hold almost the same amount of external assets denominated in foreign currencies².

The large scale of debts denominated in foreign currency may require caution in the context of increasing repayment in case of fall in ringgit exchange rate. However, despite its apparent bigness, the current debt outstanding will not warrant too much caution since the contents of more than 60% of the debts are considered to be less risky as seen above.

Figure 11 : Share of Foreign Exchange -denominated External Debts and their Breakdowns



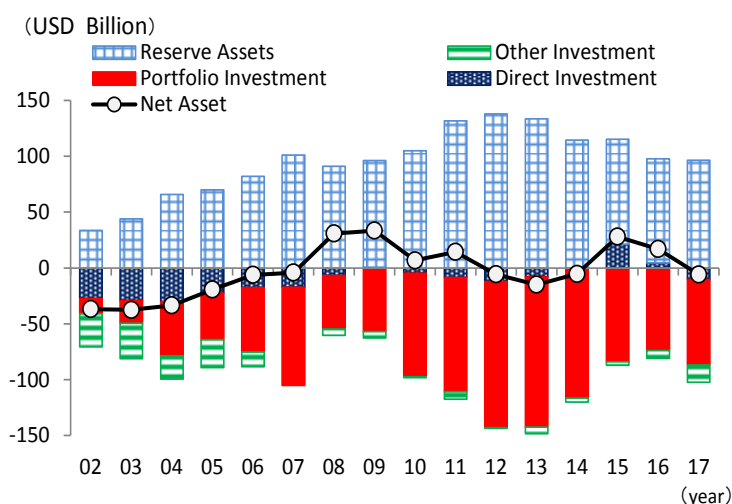
(Source) Bank Negara Malaysia, “Quarterly Bulletin”

² The External Sector Assessment in the IMF 2018 Article IV Consultation Report states that “short-term FX-denominated debt largely belongs to the banking system and a good portion is matched by short-term foreign currency assets, which is being closely supervised by Bank Negara Malaysia.”

The Bank Negara Malaysia stated in its “BNP Quarterly Bulletin” (in the 4th quarter issue of 2017) that “careful liquidity management and risk hedge are needed for external debts denominated in foreign currencies.” It also expressed the view that looking at the external debts as a whole they are still manageable in both respects of currency and maturity”, and regarding the repayment ability, “it should be taken into account that the debtors hold external assets almost equivalent to debts³.”

In fact, the short-term debts account for 42.6% of the total debts, and they remain within the outstanding of international reserves despite their high level. On the international investment position, the overseas asset holdings of Malaysian residents almost balance with the Malaysian assets held by foreigners (Figure 12).

Figure 12 : International Investment Position of Malaysia



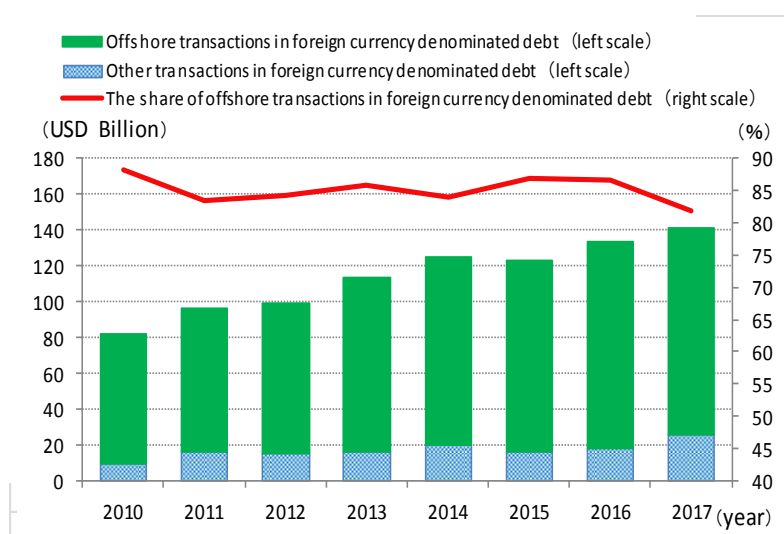
(Note) Others include bank loans, etc.

(Source) Bank Negara Malaysia

According to the central bank, offshore transactions account for 82% of the external debts denominated in foreign currencies (Figure 13).

³ It is seen that it is intended to show that as far as short-term external debt is concerned Malaysia has foreign exchange reserves exceeding its debt outstanding.

Figure 13 : Offshore Transactions in Foreign-Currency-Denominated External Debts



(Source) Bank Negara Malaysia: “Bank Negara Malaysia Annual Report”

(3) Sustainability of the current account surplus

The key to the prospect of sustainability of the current account surplus is the development of trade balance which accounts for the largest share in the current account and which fluctuates widely. After it declined in two consecutive years in 2015 and 2016, the trade surplus picked up in 2017, contributing to the expansion of the current account surplus. (Figure 5).

Looking at the export destinations by region to forecast the future prospect, the ASEAN countries (excluding Malaysia), the largest trading partner (share of 29.2% to exports), and India (3.7%) are expected to grow favorably from now on to next year. Also the economies relatively large shares like China (13.5%), the US (9.5%) and Japan (8.0) will all grow in 2019 at a similar pace as in 2018, albeit somewhat decelerating⁴. In addition, prices of mineral fuels like oil and natural gas, important export items of Malaysia, have picked up since 2017, and they are expected to remain firm from now on and in 2019. Therefore, the exports are expected to maintain its expansionary trend until 2019. Even if some increase of imports is taken into account, the trade surplus will continue to increase for some time to come. Thus, the current account surplus is also likely to be maintained for the moment (Tables 1 and 2).

⁴ The IMF forecast in its revised edition of the World Economic Outlook released in October 2018 the growth rates of countries and regions for 2018 and 2019 as 5.3% and 5.2% for ASEAN, 7.35 and 7.4% for India, 6.6% and 6.2% for China, 2.9% and 2.5% for the US and 1.1% and 0.9% for Japan respectively.

Table 1 : Major Trading Partners of Malaysia (2017)

(%)	
	Percent Distribution
China	13.5
U.S.	9.5
Japan	8.0
Hong Kong	5.1
India	3.7
Korea	3.1
Taiwan	2.5
ASEAN(except Malaysia)	29.2
EU	10.2

(Source) Bank Negara Malaysia

Table 2: Prospect of Oil and Gas Prices

	2016	2017	2018	2019
Crude oil (\$/bbl)	42.8	52.8	65.0	65.0
Natural gas (\$/mmbtu)	2.49	2.96	3.03	3.10

(note) Oil price is the average of Brent, Dubai and West Texas Intermediate.

(Source) World Bank:“Commodity market outlook”

Although the possibility is fairly low, it cannot be ruled out that the current account would fall into deficit⁵ should the growth of the world economy rapidly decelerate as much as it experienced at the time of global financial crisis of 2009⁶ and the trade surplus of Malaysia dramatically shrink due to a decline of exports. Even in that case, however, the risks that the foreign investors will avoid investment in Malaysia or withdraw the capitals from Malaysia will be small due to such strength that Malaysia has as (i) its rich endowment of natural resources, (ii) favorable investment environment, and (iii) sound banking management.

Firstly, Malaysia has been well industrialized to reach a middle income status with its per capita nominal GDP exceeding \$9,000 while it is rich in natural resources like (i) crude oil, (ii) natural gas, (iii) palm oil and (iv) natural rubber. Secondly, it has been ranked relatively high for many years in the “Doing Business” Index of the World Bank which is used as a guide for easy business conditions for the companies in the world to do business. Thus the investment environment is good for foreign capitals. In its 2018 version, Malaysia ranked 24th among 190 countries with (i) electric power condition, (ii) construction permit, and (iii) protection of small sized investors evaluated highly. Thirdly, financial indicators of banks are generally good, with return on equity capital ranking second to Indonesia among the ASEAN countries, and non-performing ratio remaining on the lowest level (Table 3).

⁵ At a time of Global Financial Crisis of 2009 the trade surplus fell by \$10.1 billion from 2008 due to export decline associated with the global recession, but the current account continued to remain in surplus since the current account surplus stood at around \$40 billion in 2008. However, as the current account surplus narrowed to \$9.4 billion in 2017, it may possibly fall into deficit should the trade surplus decrease as much as in 2009.

⁶ Under the influence of the Global Financial Crisis which was triggered by the collapse of the Lehman Brothers in September 2008, many countries and regions experienced negative growth including minus 2.8% for the US, minus 4.2% for the EU, and minus 4.2% for Japan, with the world recording the first minus growth of 0.2% in 30 years.

Table 3 : Banking Indicators of Major ASEAN Countries

(%)

	Capital Ratio			Return on Equity			NPL Ratio		
	2015	2016	2017	2015	2016	2017	2015	2016	2017
Indonesia	21.4	22.9	23.2	17.3	14.5	16.0	2.4	2.9	2.9
Malaysia	16.6	16.5	17.1	12.3	12.5	13.0	1.2	1.2	1.1
Philippine	15.2	14.7	15.3	9.8	10.5	10.2	2.1	1.9	1.7
Singapore	15.9	15.9	16.5	10.3	10.8	10.4	0.9	1.1	1.5
Thailand	17.4	18.0	18.5	11.1	10.7	9.1	2.6	2.8	3.0

(Source) Bank Negara Malaysia: “Financial Stability and Payment Systems Report 2017”, national central banks, the IMF and others.

On the influence of ongoing trade frictions between the US and China, Malaysia will have a negative influence from a reduced exports to China of product parts and materials made in Malaysia which are used in the Chinese export goods to the US. On the other hand, it will be benefitted from a shift of export goods where the Chinese exports to the US will decrease due to higher prices associated with the imposition of customs tariffs while exports from Malaysia will increase, and the shift of production base from China to Malaysia. Therefore, the net influence will be mostly neutral as Malaysia is likely to have both positive and negative influences from the US-China trade conflicts.

3. Public Debts Reviewed by the Government

(1) Government reveals additional public debts

In late May 2018, the government announced that “the public debt outstanding proved to stand at RM1,087.3 billion (\$252.86 billion, or 80.3% of nominal GDP) at the end of 2017, considerably exceeding RM686.8 billion (\$159.7 billion, or 50.8%) that the previous administration had published.” The difference between the two figures includes MYR199.1 billion (\$46.3 billion, or 14.7% of nominal GDP) for government guarantees to the debts of state owned companies unable to serve their debts, and MYR201.4 billion (\$46.8 billion, or 14.9% of nominal GDP) for the payment of lease fees to PPP projects (Table 4).

Table 4 : Public Debts by the Government Definition

	Amount		as a percentage of nominal GDP
	Ringgit billion	USD billion	
Public debt by the previous government definition	686.8	159.7	50.8
Government guarantees to the debts of state owned companies	199.1	46.3	14.7
Danainfra Nasional Bhd	42.2	9.8	3.1
1Malaysia Development Bhd	38.0	8.8	2.8
Prasarana Malaysia Bhd	26.6	6.2	2.0
Malaysia Rail-Link Sdn Bhd	14.5	3.4	1.1
Govco Holdings Bhd	8.8	2.0	0.7
Payment of lease fees to PPP projects	201.4	46.8	14.9
Public debt by the new government definition	1,087.3	252.9	80.3

(Source) Press release of the Malaysian Ministry of Finance

(2) Evaluation of the added public debts

Generally, guaranteed debt is recognized as a contingency liability that has not been determined as debt at the time of guarantee. According to the IMF Manual “Public Sector Debt Statistics—Guide for Compilers and Users”, for the statistical purpose of macroeconomic statistics, the Contingencies, such as the granting of most one-off guarantees are not included in the debt of the guarantor. Also a rating agency Moody’s said on 13th June that “its assessment of contingent liability risks posed by non-financial sector public institutions has not changed following some statements by the new Federal Government led by Pakatan Harapan”. On the same day it reported that “it is maintaining its estimate of Malaysia's direct government debt at 50.8% of GDP in 2017,” and maintained Malaysia’s sovereign rating at A3. Accordingly, it is considered that the government guaranteed debts published by the new government should not be included in the direct debts at this moment, although the management of the guaranteed SOEs needs a continued careful observation.

According to a release by the Malaysian Ministry of Finance, payment of lease fees to PPP projects involves government payment of lease fees in relation to the use of infrastructure equipment such as schools, roads, police offices and hospitals that are held and administered by the PPP operating bodies. As far as the government borrows the PPP related infrastructure equipment on a lease without directly owing them, the payment for lease should not be accounted as debt.

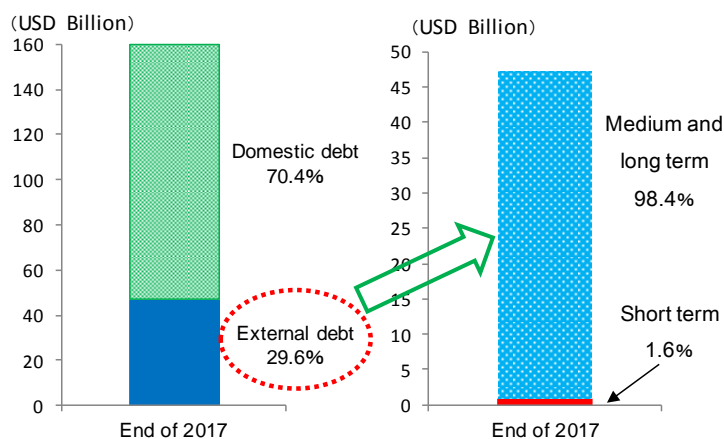
The debts the government additionally acknowledged were those that had been already published by the former administration and therefore it is not a new one. So the announcement that “the public debt outstanding would far exceed the already published amount when the two items noted above are included” overstates the truth. Probably one of the purposes of the announcement was to give an impression in and out of the country as if the former

administration led by ex-Prime Minister Najib had tried to conceal the debt. It is also considered that another intention was to raise the people’s crisis consciousness on the size of public debt and make it easier to restrain expenditures such as suspended infrastructure projects in exchange for the implementation of economic policies that would aggravate fiscal balance like scrapping of the GST and reintroduction of fuel subsidies which the administration had pledged in the election campaign.

(3) Public Debts Seen from the Official Statistics

As was seen above, the public debt outstanding at the end of 2017 is considered to have amounted to MYR686.9 billion (\$159.7 billion, or 50.8% of GDP) in the official statistics. Of which, foreign investors owned MYR202.8 billion (\$47.2 billion, 15.0%), or less than 30% of the total, and the majority was held by domestic investors. Therefore Malaysia’s public debt structure is seen less vulnerable to the actions of foreign investors (Figure 14).

Figure 14 : Public Debt Holding by Investors at Home and Abroad



(Source) Bank Negara Malaysia website.

4. Impacts of the Abolition of the GST and Others by the Government

Soon after taking the office, the government revealed its plan to reduce the GST rate from the existing 6% to 0% effective June 1 in preparation to abolish the GST which the Hope Alliance (PH) had pledged as a campaign promise. Instead, it decided to reintroduce effective September 1 the Sales and Services Tax (SST) that had been implemented before. Table 5 shows the size of tax changes summarized on the basis of releases of the Malaysian government and various media reports, which suggests the net decrease of tax income by 8.3% of revenues and 1.6% of nominal GDP.

Table 5 : Size of the Abolition of the GST and Reintroduction of the SST

	Ringgit billion	USD billion	as a percentage of revenue	as a percentage of nominal GDP
Decrease of tax revenue due to abolition of the GST	42	9.77	15.8	3.1
Increase of tax revenue due to reintroduction of the SST	20	4.65	7.5	1.5

(Source) Government releases and various media reports

Meanwhile, in order to make up for the decline of revenues, the government is promoting to review large infrastructure projects including the ones already under implementation. Table 6 shows infrastructure projects that the government expressed to suspend.

Table 6 : Large Infrastructure Projects to be Suspended

	Large Infrastructure Projects	Total Expenses Ringgit billion	Current Status
①	East Coast Rail Link connecting the South China Sea with strategic shipping routes in Malaysia's west	81.0	the Malaysian government expressed to suspend
②	Natural gas pipeline in Sabah, a Malaysian state on the island of Borneo	11.1	the Malaysian government expressed to suspend
③	High-speed railway to connect Malaysia and Singapore	59.2	the Malaysian government agreed again with the government of Singapore to resume it after two years' freeze

(Source) Various reports

However, suspension of the projects will require to assume payments of penalty, and therefore it does not allow any optimism whether or not the projects will be completely suspended. In fact, although it once announced a suspension of the project, the Malaysian government agreed again with the government of Singapore to resume the high-speed rail project to connect Malaysia and Singapore in May 2020 after two years' freeze. As is the case of many neighboring ASEAN countries, given the necessity of domestic infrastructure investments for improving investment environment, there is a possibility that other infrastructure projects for which suspension was once announced may come to be under review in regard of scale of projects from a perspective of profitability.

As described above, the abolition of the GST will decrease revenues even if the increase of revenues by the reintroduction of the SST is taken into account. On the other hand, although the suspension or start of negotiation for it has been announced, the restraining influence of the suspension of large-scaled infrastructure improvement projects is still unknown. Furthermore, given the increase in expenditures that the already announced reintroduction of fuel subsidies

may incur, the fiscal deficit is expected to rise faster than previously forecast. Going ahead, therefore, the government will have to be more careful to implement additional fiscal policies.

5. Conclusion

The Malaysian economy remains to perform well and is expected to continue its rising trend supported by strong private consumption associated with the increase of household income reflecting expanded employment and increase in exports. Consumer price inflation is forecast to remain suppressed due to continued stability of fuel prices reflecting a stable crude oil prices and impact of scrapping of the GST. While the outlook for economic growth and price stability is good, fiscal deficit is expected to widen mainly due to the abolition of the GST.

On the external balance, the current account has continued to record surplus as was in the past. The trade surplus, the largest composition in the current account, is expected to keep growing for some time to come, supported by the economic growth in the trading partner countries and regions, as well as expected firmness in the price of mineral fuels, one of the main export items. Accordingly, the current account is highly likely to continue to be in surplus.

Should the current account fall into deficit, it may be caused by a sharp deceleration of the world economy, in contrast to the forecast, as much as it experienced at the time of the global financial crisis of 2009, which will drastically narrow the trade surplus of Malaysia due to declining exports. Even in that case, however, the risks that the foreign investors avoid investment in Malaysia or withdraw the funds from Malaysia will remain small, since Malaysia has such advantages as (i) rich endowment of natural resources, (ii) favorable investment environment, and (iii) sound banking management.

In addition, composition of external debts, albeit at a relatively high level, shows that among the external debts in foreign currencies, which account for a larger share of the total external debts, over 60% of them are comprised of debts with relatively low risk in terms of their counterparts and contents like (i) intra-group-company credits, (ii) trade credits, and banking debts with limited risks on the net basis like (iii) interbank loans and (iv) nonresident deposits. Therefore, the debt outstanding may not warrant much concern despite its apparent large size.

Meanwhile, the government announced that “the debt outstanding as of the end 2017 proved to widely exceed the amount published by the previous administration”, after adding to the old public debts the guaranteed debts to SOEs with low repayment capability and payments of lease fees to PPP projects. But this overstates the truth, and one of the purposes of this overstatement is considered to have been to give an impression both at home and abroad that the former administration led by ex-prime minister Najib had concealed the real debts.

The government decided to reintroduce the SST that had been once implemented while

announcing the de-fact abolition of the GST. These change of tax policies is expected to decrease tax collection by 8.3% of revenues and 1.6% of nominal GDP. In order to make up for the loss of revenues from this change, the government is promoting to review infrastructure projects including those already implemented, but its impact to restrain expenditures are still to be seen. Besides, taking into account the fact that the reintroduction of fuel subsidies will become a factor to increase expenditures, the fiscal deficit is expected to increase more than initially forecast. Therefore, it is considered that the government will have to be more careful to implement additional fiscal policies in the time to come.

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〒103-0021 東京都中央区日本橋本石町 1-3-2
電話 : 03-3245-6934 (代) ファックス : 03-3231-5422
e-mail: admin@iima.or.jp URL: <https://www.iima.or.jp>