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ECONOMIC REVIEW | 2Q 2016 National Account

Malaysia GDP Grew by 4.0% in 2Q16 Despite the Low Base Effect

- *Malaysia GDP grew by 4.0%yoy in 2Q16, in line with economist median consensus though slightly higher than our own estimate at 3.9%yoy. We believe the higher number as compared to our forecast was mostly due to June's economic numbers, which see a significant rebound in trade and production activity.*
- *Recall that GST implementation on 1 April 2015 caused a significant pullback in consumption and investment activity, leading to a low base effect for the year-on-year growth in 2Q16. Private consumption and investment activity grew by 6.3%yoy and 6.1%yoy respectively, though on seasonally adjusted quarter-on-quarter basis the growth moderated to 0.7%qoq and 0.5%qoq.*
- *Exports and imports grew by a marginal 1.0%yoy 2.0%yoy respectively, leading to the lowest net exports in three years by RM19.7 billion. This alone led the GDP growth to be lower by 0.6%yoy, confirming our worries that the slow global trade activity will eventually affect our economic growth.*
- *The recent decline in oil price and Brexit vote near the end of June is likely to halt positive economic momentum gained in June, causing the surprised numbers in June to be transitory. At the moment, we are maintaining our GDP forecast for year 2016 at 4.0% while remaining our expectation for GDP growth in 3Q16 at 4.1%yoy.*

GDP grew by 4.0% in 2Q16 in line with consensus. Malaysia GDP grew by 4.0%yoy in 2Q16, in line with economist median consensus though slightly higher than our own estimate at 3.9%yoy. We believe the higher number as compared to our forecast was mostly due to June's economic numbers, which see a significant rebound in trade and production activity. Despite the numbers coming out close to economist forecast, it is not necessarily reflect a healthy economy. Most of the economists made the GDP forecast on the expectation of an economic slowdown, which can be seen by the quarter-on-quarter growth by a marginal 0.7%qoq, the lowest in 13 quarters.

Growth of private consumption was high but mostly due to low base effect. Recall that GST implementation on 1 April 2015 caused a significant pullback in consumption and investment activity, leading to a low base effect for the year-on-year growth in 2Q16. Private consumption grew by 6.3%yoy in 2Q16, higher than 5.3%yoy in 1Q16, though on seasonally adjusted quarter-on-quarter basis the growth moderated to 0.7%qoq from 2.9%qoq in 1Q16. We believe the private consumption is beginning to be hit by moderating income and employment in the labour market. At the moment, we fail to see any catalyst that could stimulate higher private consumption activity in the coming quarters.

Gross Fixed Capital experienced a slight rebound. Despite the various uncertainties and weaknesses in the global economy, investment activity continues to grow in 2Q16. On year-on-year basis, investment grew by 6.1%yoy in 2Q16, significantly higher as compared to 0.1%yoy in 1Q16, though most of the extreme numbers were contributed from the low and high base effect respectively. Private and public investment grew by 5.6%yoy and 7.5%yoy respectively. It is worth to note that even with the low base effect, private investment number was much lower than the 5-year average of 11.4%. On seasonally adjusted basis, investment activity grew marginally by 0.5%qoq, rebounding after 1.5%qoq contraction in the previous quarter.

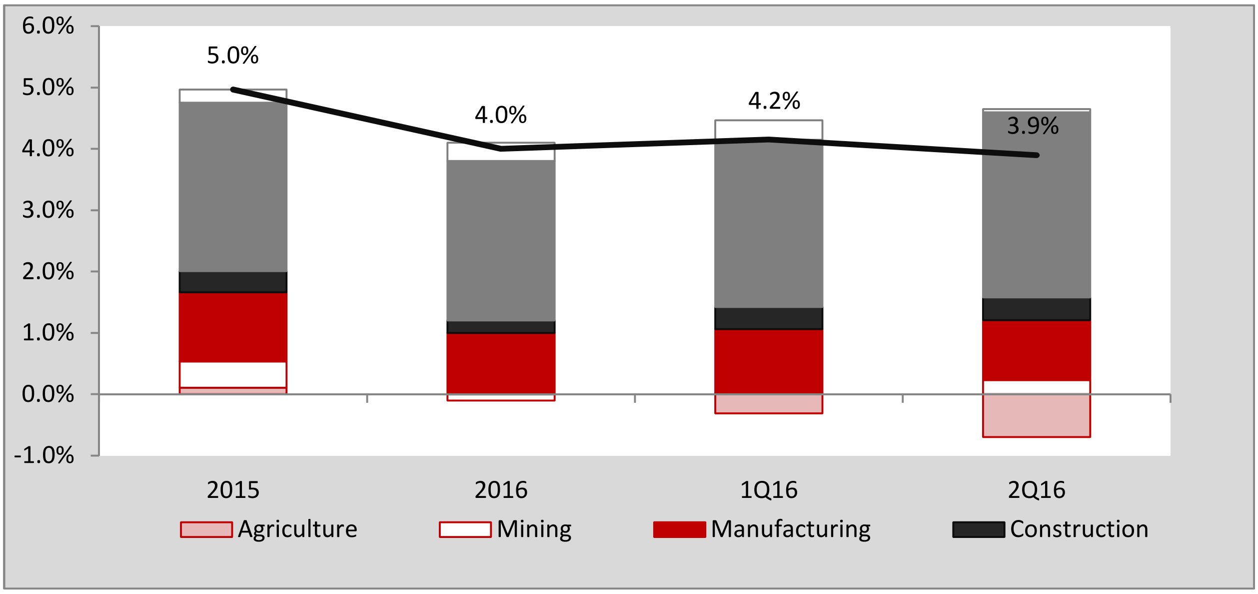
Table 1: Real GDP performance – by type of expenditure and economic activity

YoY%	2014	2015	2Q 15	3Q 15	4Q 15	1Q 16	2Q 16
Real GDP	6.0	5.0	4.9	4.7	4.5	4.2	4.0
Private consumption expenditure	7.1	6.0	6.4	4.1	4.9	5.3	6.3
Public consumption expenditure	4.4	4.4	6.9	3.6	3.3	3.8	6.5
Gross fixed capital formation	4.7	3.7	0.4	4.2	2.7	0.1	6.1
Structure	6.6	9.3	5.8	6.9	5.0	5.7	5.9
Machinery and equipment	0.2	0.1	-7.4	1.3	-0.1	-7.1	8.1
GFCF - Public	-3.2	0.6	-8.1	1.8	0.4	-4.5	7.5
GFCF - Private	13.0	8.1	3.9	5.5	4.9	2.2	5.6
Net Exports	13.2	-3.8	-11.1	3.4	4.3	-12.4	-7.0
Exports	5.0	0.6	-4.0	3.2	4.0	-0.5	1.0
Imports	4.0	1.2	-3.1	3.1	4.0	1.3	2.0
Agriculture	2.1	1.2	4.6	2.3	1.5	-3.8	-7.9
Mining	3.5	4.7	6.0	5.1	-1.3	0.3	2.6
Manufacturing	6.2	4.9	4.2	4.9	5.0	4.5	4.1
Construction	11.7	8.2	5.6	9.9	7.4	7.9	8.8
Services	6.6	5.1	5.0	4.4	5.0	5.1	5.7

Source: Department of Statistics (DoS), CEIC

No signs of a rebound in global trade activity. Exports and imports grew by a marginal 1.0%yoy 2.0%yoy respectively, leading to the lowest net exports in three years by RM19.7 billion. This alone led the GDP growth to be lower by 0.6%yoy, confirming our worries that the slow global trade activity will eventually affect our economic growth. There have been signs of a rebound in global trade activity in June, however the Brexit vote will most likely diminish all hope. Furthermore, signs of success in China's economy to reduce their imports activity have led to a decrease in our own exports activity, leading to a much lower trade balance with China.

Chart 1: Percentage point (p.p.) share contribution to growth – By economic activity



Source: DoS, MIDFR

Services sector expanded faster amid better growth in wholesale & retail trade. Year-on-year, the services industry grew by 5.7% during the quarter, following growth of 5.1% in 1Q16. After a rough start to the year due to heightened economic uncertainties, consumer confidence started to improve in the second quarter. The consumer index surveyed by MIER notched 78.5 in the 2Q16 compared to 72.9 and 63.8 in the previous two quarters. Though it was still below the optimism threshold, the index indicated that people's perception was recovering from the record low in late 2015 hence validating the growth in the wholesale and retail trade. However, we note the sector might receive a slight seasonal boost as Eid festival came earlier this year compared to 2015.

Insurance industry rebounded but low base partly help the case, real estate and businesses services sector rose higher. Insurance made a turnaround in the second quarter to expand by 7.7% after contracting in the past four quarters. Despite the case, the rebound contributed marginally to overall economic expansion, boosting growth by 0.1% during the quarter. Meanwhile, we think that the growth in the real estate and business services sectors was actually contributed by the latter rather than the former. This seems to be the case because there was still heavy pessimism in the market, reflected by worsening MIER real estate index from 111.2 in 1Q16 to 100.6 in 2Q16. Besides, quite a number of property players are actually reporting deteriorating earnings during the quarter.

Agriculture was the biggest drag to the headline GDP figure, pulling 0.7% growth off the headline figure. The agriculture sector plunged by -7.9%yoy for the quarter with the value added from the palm oil sector dived by almost 20%. The palm oil contributed almost half to the agriculture industry during the quarter. El Nino continued to impact the weather, bringing a dry and high temperature climate which ultimately caused palm palm oil estate yield to plunge. Decline in the sector contributed about -0.7% drag to the overall growth. We earlier expect that the situation to improve in the quarter as temperature seems to moderate relatively to the first quarter besides the higher rain volume. This provides a good lesson though that there was a certain lag impact to the production especially when the El Nino was severe. Moving forward, we believe palm oil production

Expansion in the E&E industry surged to 8.8% from 5.7%, as demand for exports grew. The better figures in the E&E sector was largely anticipated as trade data reveals E&E exports grew 3.4% on year-on-year basis in 2Q16. Demand from the USA was the major driver despite demand China was deteriorating as the country starts to internally source for the intermediate goods for their final production.

There was a glimpse of hope in June, but Brexit vote may have destroyed it. Most of June economic data globally has been a surprise to most economist, including Malaysia's data where exports grew by 3.4%yoy against economists' expectation of a contraction by 3.7%yoy, while industrial production expanded by 5.3%yoy against forecast of 2.3%yoy. However, with the recent decline in oil price and Brexit vote near the end of June, we opine that the surprised numbers in June will be transitory. At the moment, we are maintaining our GDP forecast for the whole year of 2016 at 4.0% while remaining our expectation for GDP growth in 3Q16 at 4.1%yoy.

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