ECONOMIC REPORT | Business Tendency Index

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Mix Business Expectations for 3Q18 as Commodities Related Sectors Brace for Rough Period Ahead

- *Expected economic slowdown in 3Q18. According to the latest Business Tendency Survey, overall business performance is expected to remain positive albeit at moderate pace given that overall business confidence registered at 6%, slowest in 5-quarter. The moderation is seen across almost all sectors namely agriculture, mining, construction and manufacturing.*
- *Bleak outlook for commodity-based sectors. For 2-consecutive quarters, business confidences in agriculture and mining & quarrying remain in pessimistic territory. For agriculture sector, continuous decline in CPO price put a drag on the expansion of agricultural output. OPEC output-cap commitment and supply disruption in mining & quarrying sector are key factors pulling down output production.*
- *Domestic economy to expand by 5.2% in 2018. Based on the current developments and indicators, we anticipate Malaysia's economy to expand by 5.2% this year given the upbeat performance of domestic and external trade sectors.*

Expected economic slowdown in 3Q18. According to the latest Business Tendency Survey, overall business performance is expected to remain positive albeit at moderate pace given that overall business confidence registered at 6%, slowest in 5-quarter. The moderation is seen across almost all sectors namely agriculture, mining, construction and manufacturing. On the other hand, services sector scores better result than the previous quarter, indicating positive response of tax holiday period. The 3Q18 BTS is the second post-GE14 business confidence survey, reflecting responses from various sectors on the current and future outlook of economic performance under the newly-elected government.

Construction players remain pessimistic as anticipated. Business confidence in construction sector went down to -7.7% in 3Q18. This reading is an improvement from the 2Q18 number of -24.8%. The sector is highly-sensitive to change in political conditions as it involves huge government investment on mega infrastructure projects. Uncertainties over fate of government-backed infrastructure projects will undermine the performance of construction sector in 2018.

Bleak outlook for commodity-based sectors. For 2-consecutive quarters, business confidences in agriculture and mining & quarrying remain in pessimistic territory. For agriculture sector, continuous decline in CPO price put a drag on the expansion of agricultural output. CPO price shrinks by -14.5%yoy in 1H18 (12.8%yoy: 1H17). As for mining & quarrying, OPEC output-cap commitment and supply disruption in the sector are key factors pulling down output production. Unlike CPO, Brent crude oil price surges strongly by 40.1%yoy in 1H18 against 25.6%yoy in the same period of last year.

Escalating trade tension put pressures on manufacturing performance. Amid heighten trade tension between major economies namely USA and China, business confidence in the manufacturing sector is weakening gradually. Confidence level in the sector registered 3-quarter low at 9.3% in 3Q18. The downtrend is in line with manufacturing PMI performance especially since early this year. The first tariff imposition made by Trump-led administration was on washers and solar panels in Mar-18. Moving forward, we anticipate further tone down in business confidence in manufacturing sector in Malaysia.

Services sector soars during tax holiday period. Business confidence for the sector increases to 16.5%, better than 2Q18's of 8.6%. Zero-rated GST and stable retail fuel prices are two major factors supporting the optimistic mood. Particularly, retail trade business is benefitting from zero-rated GST, expecting stronger domestic spending during 2H18. As for wholesale trade, businesses in the sub-sector are less optimistic as SST is set to replace GST in Sep-18. Overall, domestic demand is seen to stay strong in 2H18 and 2019, contributing solid support for economic growth.

Table 1: Business Confidences by Sector (%)

	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18
Overall	(6.9)	4.5	11.9	14.0	12.3	7.8	6.0
Industry;	(2.7)	2.2	3.1	9.8	11.9	9.9	2.1
Agriculture	(0.1)	8.7	1.4	25.3	11.8	(3.3)	(7.9)
Mining	(10.7)	(14.3)	16.7	10.0	10.8	(17.9)	(21.5)
Manufacturing	(4.7)	2.4	(3.6)	6.2	10.7	19.7	9.3
Electricity and water	27.8	22.7	36.4	4.5	25.8	16.7	15.4
Construction;	(3.0)	(8.3)	(7.7)	22.8	1.1	(24.8)	(7.7)
Wholesale and retail trade;	(11.7)	3.3	20.7	8.3	0.0	7.4	3.6
Wholesale trade	(7.1)	7.1	30.5	10.7	1.2	13.5	2.0
Retail trade	(17.2)	(3.3)	24.6	3.0	(1.9)	(2.5)	6.3
Services;	(13.0)	11.3	24.0	23.6	20.6	8.6	16.5
Hotels	8.8	25.3	29.4	12.3	26.2	2.7	(5.4)
Transport	8.3	11.8	33.3	14.7	29.9	5.6	13.8
Communications	(24.2)	12.8	31.0	26.2	11.5	26.2	9.5
Finance	(24.4)	12.8	15.7	31.4	29.4	5.6	28.2
Insurance	30.1	33.3	37.5	37.0	21.7	46.0	33.3
Real estate	(35.6)	(30.3)	22.2	(8.3)	(27.3)	(52.8)	(25.7)
Information and communications technology	(5.4)	7.4	10.4	11.7	20.4	15.5	3.7

Source: CEIC, MIDFR

Economic outlook for 2H18 stays healthy. Referring to business expectations for the next 6 months, overall business performance is expected to improve. Overall business performance for 3Q-4Q18 is expected to enjoy steady pick-up especially for manufacturing, domestic trade and services sectors. The impacts of zero-rated GST and stable fuel prices are seen as booster for Malaysia's domestic demand to stay robust despite of SST implementation in Sep-18. On external front, re-exports activity is expected to drive-up manufacturing sector even though trade tension is heating up. As for agriculture, declining in commodity prices will remain as a drag while supply disruption and OPEC commitment will continue halting expansion in mining & quarrying sector for the next 6-month.

Table 2: Business Expectations for Next 6-Month by Sector (%)

	1Q17-2Q17	2Q17-3Q17	3Q17-4Q17	4Q17-1Q18	1Q18-2Q18	2Q18-3Q18	3Q18-4Q18
Overall	3.5	11.5	21.0	29.9	17.1	4.4	11.6
Industry	8.8	11.8	22.1	30.2	15.4	(0.3)	5.3
Agriculture	11.5	13.0	25.0	32.0	8.7	0.0	(16.0)
Mining	(14.3)	(14.3)	6.7	20.0	6.7	(14.3)	(7.1)
Manufacturing	8.0	12.4	23.7	33.6	18.0	4.0	11.2
Electricity and water	63.6	63.6	36.4	18.2	27.3	(8.3)	30.8
Construction	(5.6)	13.9	18.6	24.0	17.4	(26.6)	(2.9)
Wholesale and retail trade	(11.8)	10.0	13.4	26.1	7.5	9.5	12.6
Wholesale trade	(8.7)	14.3	19.5	26.0	6.2	21.9	4.3
Retail trade	(15.5)	2.5	8.7	25.0	9.3	(9.3)	25.0
Services	2.1	11.4	22.8	32.1	25.0	15.3	25.3
Hotels	2.9	20.7	29.4	36.9	25.0	10.8	0.0
Transport	37.5	23.5	32.0	48.0	45.5	25.0	8.0
Communications	(27.3)	23.1	42.9	42.9	28.6	14.3	7.1
Finance	(6.7)	0.0	11.8	23.5	23.5	16.6	46.1
Insurance	55.6	62.5	25.0	33.3	33.3	55.6	55.6
Real estate	(30.0)	(45.5)	8.3	8.3	(27.3)	(50.0)	(15.4)
Information and communications technology	18.8	11.1	25.0	45.0	25.0	5.0	0.0

Source: CEIC, MIDFR

Escalating trade tension to affect global trade activities. Manufacturing PMI for USA and EU indicate moderating trends in Aug-18, yet still recording above expansionary line of 50 points. Manufacturing PMI for USA went down to 9-month low while EU touched 54.6 points, weakest since Nov-16. As for Japan, strong domestic orders push up manufacturing PMI to 52.5 points in Aug-18, better than the previous month. Exports orders for Japan contracted according to the flash PMI result. The moderating trends of manufacturing PMI in major economies reflect the immediate impacts of escalating trade war. Decrease in exports orders, rise in input prices and market uncertainties are putting pressure on businesses across the globe. Moving forward, we foresee global trade growth to slowdown in 2H18. According to IMF, escalating trade war will drag global growth by -0.5%.

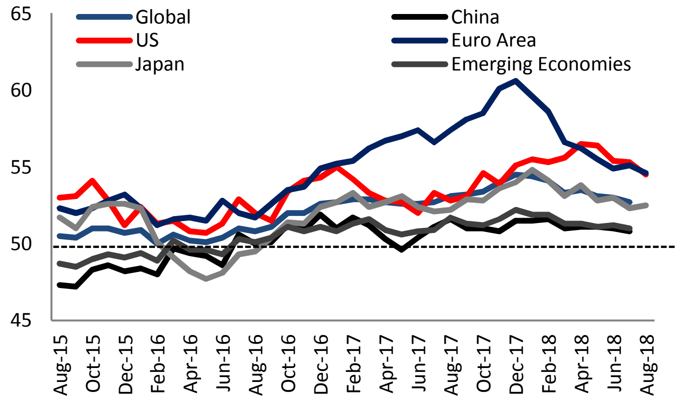
Regional PMI indicates promising outlook. Business confidences in emerging economies as well as Asean remain in optimistic path as most economies recording above expansionary line of 50 points. Among the top 5 Asean economies, manufacturing PMI in Malaysia registered below 50 points in Jul-18. In fact, the PMI figure has been below 50 points for 6-consecutive months since Feb-18. Looking ahead, escalating trade war and rising inflationary pressure are major risks to emerging as well as developed economies for 2H18. We expect further moderating trend in business confidences in both global and emerging markets.

Table 3: Manufacturing PMI by Selected Economies (Points)

	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18
Global	54.4	54.1	53.3	53.5	53.1	53.0	52.7
China	51.5	51.6	51.0	51.1	51.1	51.0	50.8
US	55.5	55.3	55.6	56.5	56.4	55.4	55.3
Euro Area	59.6	58.6	56.6	56.2	55.5	54.9	55.1
Japan	54.8	54.1	53.1	53.8	52.8	53.0	52.3
Emerging Economies	51.9	51.9	51.3	51.3	51.1	51.2	51.0
Malaysia	50.5	49.9	49.5	48.6	47.6	49.5	49.7
Indonesia	49.9	51.4	50.7	51.6	51.7	50.3	50.5
Thailand	50.6	50.9	49.1	49.5	51.1	50.2	50.1
Philippines	51.7	50.8	51.5	52.7	53.7	52.9	50.9
Singapore	53.6	55.3	53.7	55.6	56.8	56.0	53.0

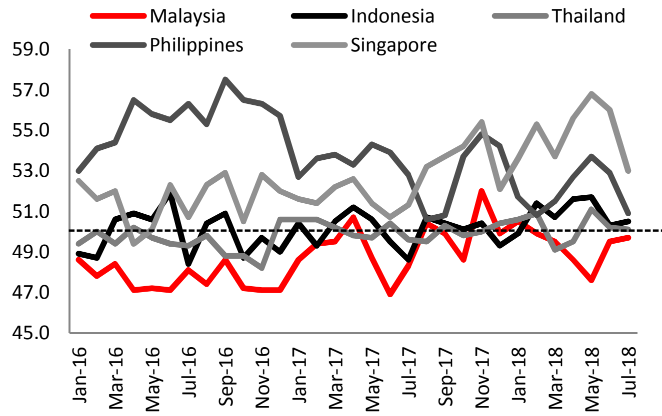
Source: Bloomberg, MIDFR
*Above 50: Expansion Line, Below 50: Contraction Line

Chart 1: Manufacturing PMI by Major Economies (Points)



Source: Bloomberg, MIDFR

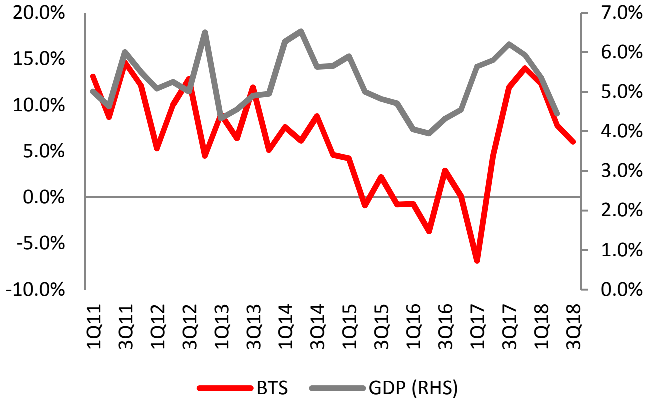
Chart 2: Manufacturing PMI by Regional Economies (Points)



Source: Bloomberg, MIDFR

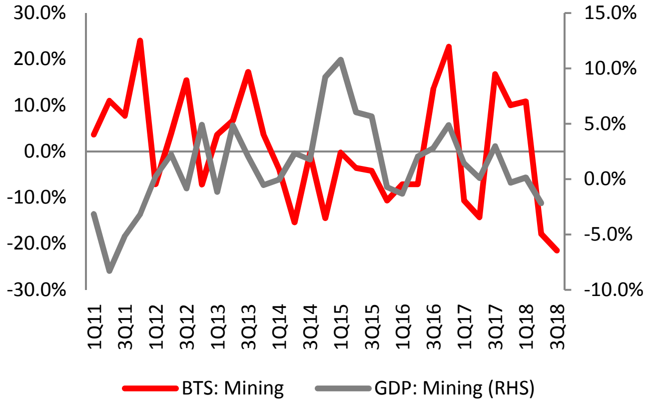
Domestic economy to expand by 5.2% in 2018. Based on the current developments and indicators, we anticipate Malaysia's economy to expand by 5.2% this year given the upbeat performance of domestic and external trade sectors. Besides, supportive economic policies, stable labour market, continued wage growth and moderating inflation will support and spur domestic economy.

Chart 3: BTS (%) vs GDP (YoY%)



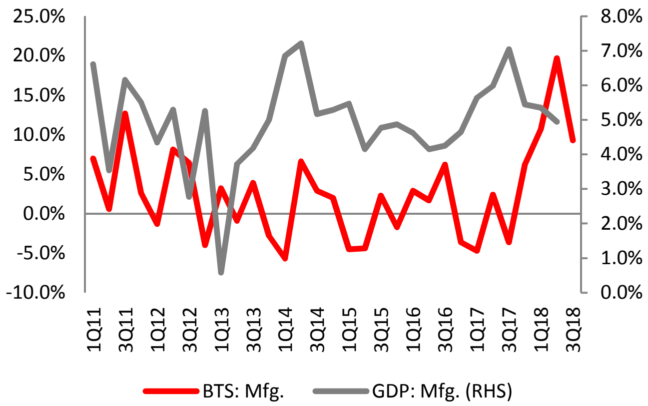
Source: CEIC, MIDFR

Chart 4: Mining & Quarrying: BTS (%) vs GDP (YoY%)



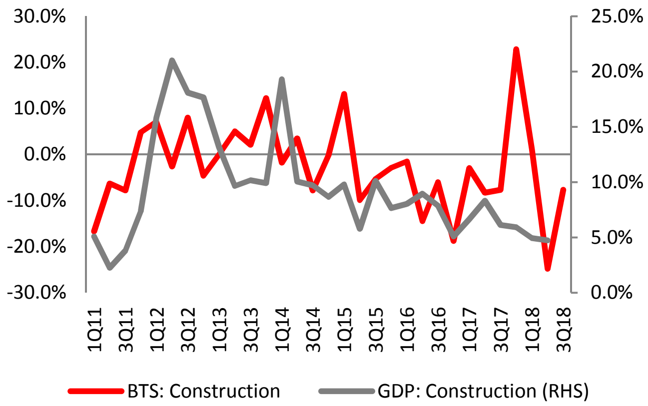
Source: CEIC, MIDFR

Chart 5: Manufacturing: BTS (%) vs GDP (YoY%)



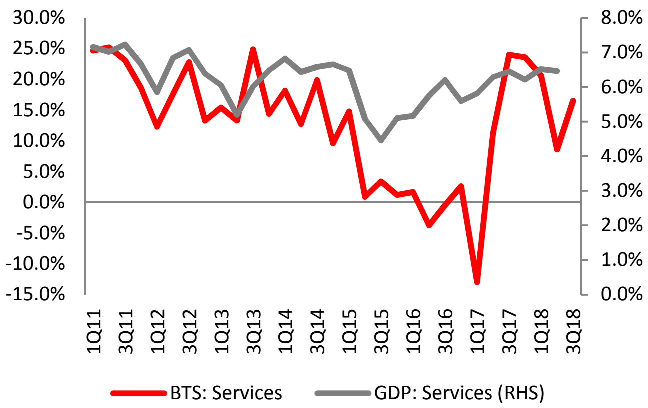
Source: CEIC, MIDFR

Chart 6: Construction: BTS (%) vs GDP (YoY%)



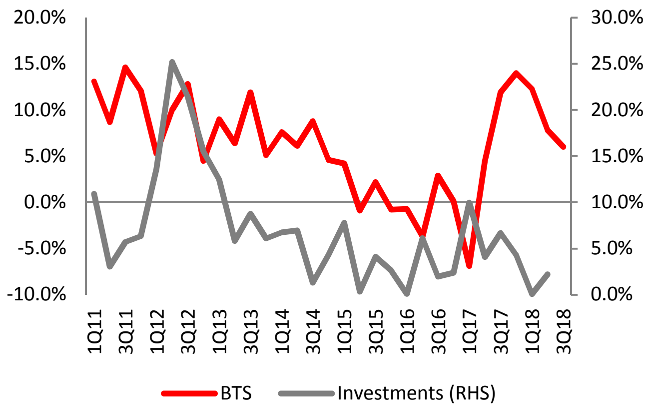
Source: CEIC, MIDFR

Chart 7: Services: BTS (%) vs GDP (YoY%)



Source: CEIC, MIDFR

Chart 8: BTS (%) vs Private Investment (YoY%)



Source: CEIC, MIDFR

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