16 February 2017

ECONOMIC REVIEW | 4Q 2016 National Account

4Q16 Growth Jumps to 4.5% Amid Accelerated Recovery in Agriculture and Boost in Manufacturing Sectors

- *Expansion reached 4.5% in 4Q16, exceeding consensus. Malaysia GDP grew at the fastest rate for the year at 4.5%yoy in 4Q16, beating the economist consensus as surveyed by a Bloomberg poll. It however matched exactly our expectation as we did highlight in our IPI report dated 10 February.*
- *Public spending in contraction, fiscal consolidation continues. The change in public expenditure is perhaps the most eye-catching for pundits. Government spending fizzled, contracting sharply during the quarter by 4.2% - the first time since the second quarter of 2014. In fact, the quarterly decline at 7.3% was the biggest since the revision to the 2010 base year. This is unsurprising to us given that Putrajaya repeatedly reiterated its commitment to fiscal consolidation.*
- *Agriculture improved in 4Q16 despite remaining in negative territory. Agriculture shrank by 2.4%yoy, its best performance for four quarters (3Q16: -6.1%yoy). The clear winner in 4Q16 was the rubber industry, which experienced its first year-on-year growth for the year at 1.0%yoy. Meanwhile, manufacturing had a strong rebound as exports surged. In 4Q16, the manufacturing sector grew 4.8%yoy.*
- *Lesser probability for BNM to loosen up interest this year but we maintain one OPR cut forecast for 2017. If the growth momentum holds this year, we should expect a status quo in the benchmark interest rates. Nonetheless, we maintain our forecast of one OPR cut this year in May as we opine monetary policy to remain accommodative.*

Expansion reached 4.5% in 4Q16, exceeding consensus. Malaysia GDP grew at the fastest rate for the year at 4.5%yoy in 4Q16, beating the economist consensus as surveyed by a Bloomberg poll. It however matched exactly our expectation as we did highlight in our IPI report dated 10 February. On a seasonally adjusted basis GDP expanded 1.4%qoq, matching the rate recorded in the previous quarter. In part, there has been ample evidence from the supply side that economy will ride on higher momentum in this quarter. Trade activity has also picked up in the last two months of the year with exports growing healthily at 7.8% and 10.7% in November & December respectively. Overall, the fourth quarter GDP capped a modest year where economic output moderated to 4.2% in 2016 vs 5.0%.

Private consumption steadied while investments edged up. Consumption from firms and households moderated slightly in the quarter, growing by 6.2% from 6.4% in the previous quarter. On quarterly basis, it did expanded by more than 2%, a historically healthy level for the Malaysian economy. Gross fixed capital formation (GFCF) rose 2.4%, up from 2.0% in 3Q16 amid rebound in the trade activity. It expanded 4.8%saqoq, the highest in more than 4 years but that has to do more with the paltry growth performance in the past 3 quarters.

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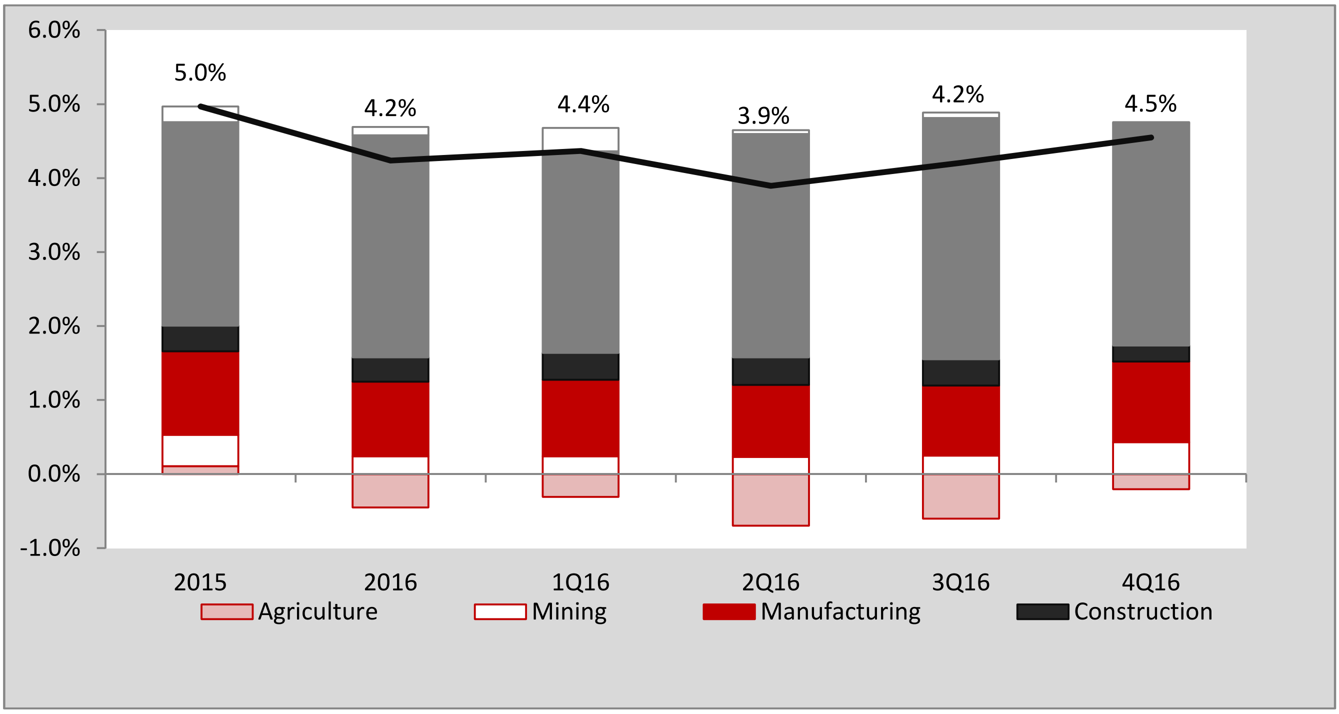
Table 1: Real GDP performance – by type of expenditure and economic activity

YoY%	2014	2015	1Q 16	2Q 16	3Q 16	4Q 16
Real GDP	6.0	5.0	4.2	4.0	4.3	4.5
Private consumption expenditure	7.1	6.0	5.3	6.3	6.4	6.2
Public consumption expenditure	4.4	4.4	3.8	5.5	2.3	-4.2
Gross fixed capital formation	4.7	3.7	0.1	6.1	2.0	2.4
Structure	6.6	9.3	5.7	8.5	7.6	5.4
Machinery and equipment	0.2	0.1	-7.1	9.1	1.7	3.8
GFCF - Public	-3.2	0.6	-4.5	9.6	-1.8	1.7
GFCF - Private	13.0	8.1	2.2	7.5	6.9	7.1
Net Exports	13.2	-3.8	-12.4	-7.0	5.9	5.8
Exports of Goods and Services	5.0	0.6	-0.5	1.0	-1.3	1.3
Imports of Goods and Services	4.0	1.2	1.3	2.0	-2.3	0.7
Agriculture	2.1	1.2	-3.8	-7.9	-6.1	-2.4
Mining	3.5	4.7	0.3	2.6	3.0	4.9
Manufacturing	6.2	4.9	4.5	4.1	4.2	4.8
Construction	11.7	8.2	7.9	8.8	7.9	5.1
Services	6.6	5.1	5.1	5.7	6.1	5.5

Source: Department of Statistics (DoS), CEIC

Trade activity rejuvenates, pushing up stocks accumulation. In a dramatic turnaround for the quarter, exports and imports rebounded in 4Q16, expanding 1.3%yoy and 0.7%yoy respectively. As a result, net exports reached RM24.3b or 5.8% higher compared to the same period last year. We note there is a clear stock accumulation in the economy as reflected by the positive change in inventories. Disregarding the potential effect of holding gains due to inflation, we reckon this reflects the positive linkage with higher demand from both domestic and external fronts. There is a stronger reason to believe this is case since intermediate goods imports and industrial output are also showing obvious signs of faster expansion during the quarter.

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



Source: DoS, MIDFR

Agriculture improved in 4Q16 despite remaining in negative territory. Agriculture shrank by 2.4%yoy, its best performance for four quarters (3Q16: -6.1%yoy). On seasonally adjusted basis, the sector grew by 1.3%qoq, as higher commodity prices help to aid corporate earnings in the last quarter of 2016. The clear winner in 4Q16 was the rubber industry, which experienced its first year-on-year growth for the year at 1.0%yoy. On the other hand, palm oil remains negative at -7.7%yoy, though it has clearly improved from the -13.8%yoy in 3Q16. For year 2017, we believe the industry will be among the main beneficiary, particularly as the commodity prices continue to stabilize along with improving global demand.

Mining and quarrying activity was strong, but mainly due to low base effect. Mining and quarrying activity surged to 4.9%yoy in 4Q16, but it was mostly due to the low base effect. On seasonally adjusted quarter-on-quarter basis, the sector only grew by a marginal 0.4%qoq. Despite that, the higher oil price since the end of November should eventually push up the sector, particularly as the price has continued to stabilize and in a gradual uptrend. Along with the manufacturing sector, the mining sector will become one of the key drivers for Malaysia's economic growth in 2017.

Manufacturing had a strong rebound as exports surged. The main contributor for the strong GDP numbers in 4Q16 was the manufacturing sector which had a relatively strong growth at 4.8%yoy, the strongest in the past four quarters (3Q16: 4.2%). The performance was even more outstanding when looked at seasonally adjusted quarter-on-quarter basis, where the manufacturing sector grew by 2.1%qoq, the highest quarterly growth in 10 quarters. Though the data did not come as a surprise, as the rebound in China's manufacturing activity particularly since November last year has caused Malaysia's exports performance to surge. Moving forward, we are optimistic with the manufacturing sector an continues to expect it to become the main driver for Malaysia's economy in year 2017.

Construction continues to slowdown, while services remained resilient. Construction sector slowed down to 5.1%yoy (3Q16: 7.9%yoy), while services moderated to 5.1%yoy (3Q16: 6.1%yoy). The slowing down of the construction sector has been under our expectation, particularly as the property sector is still in cooling down period while the Government's fiscal consolidation process is going to continue. On the services sector, the financial and insurance industry remains at a relatively weak level as compared to their respective historical growth, and the rebound recently has been mostly coming from a low base effect. We are expecting the services sector will begin to rebound once there is an improvement in unemployment level, which we expect to be at the second half of 2017.

Lesser probability for BNM to loosen up interest this year but we maintain one OPR cut forecast. The central bank was seen as preemptive last year, cutting interest rate as early as July last year. If the growth momentum holds, we should expect a status quo in the benchmark interest rates. Besides, as the market expects faster normalization rate by the Federal Reserve, loosening of the interest rate by BNM could cause unnecessary capital outflow. Nonetheless, we maintain our forecast of one OPR cut this year in May as central bank looks to remain accommodative. That would help to balance out any negative loop from the ongoing fiscal consolidation by the government. Additionally, we think there is a quite a chance that Trump may just disappoint in delivering his key fiscal stimulus, hence drawing back reflation expectation on the world largest economy and pulling back the pace of US interest rate normalization.

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