3 September 2018

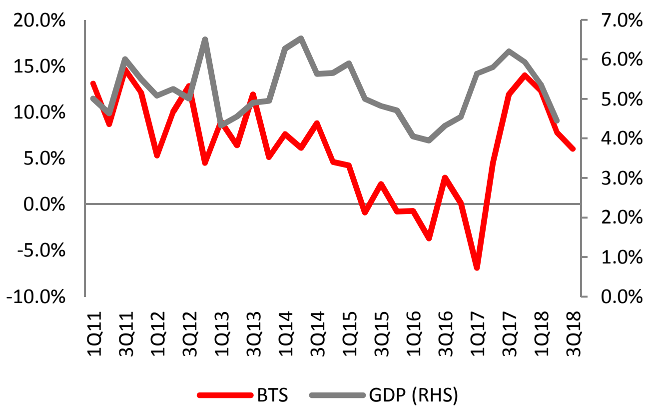
MONTHLY ECONOMIC REVIEW | August 2018

Business Sentiments Moderate to 5 Quarter Low on Uncertainty over Domestic Policies and Trade Tensions

- *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.*
- *GDP growth slowest to 1½ years. Malaysia's GDP growth expands by 4.5%yoy in 2Q18, below our forecast of 4.9%yoy and market expectations of 5.2%yoy. It is the weakest growth in 6-quarters and less than previous year's average of 5.4%.*
- *Malaysia's current account surplus at 2-year low. Current account surplus narrowed sharply to RM3.9b in 2Q18 compared to RM15b in the previous quarter, making it the smallest surplus since 3Q16. The fall was mainly driven by further deficit of services account to RM6.2b from RM5.8b in 1Q18 besides the goods account surplus which declined sharply to RM26.1b from RM35.7b.*

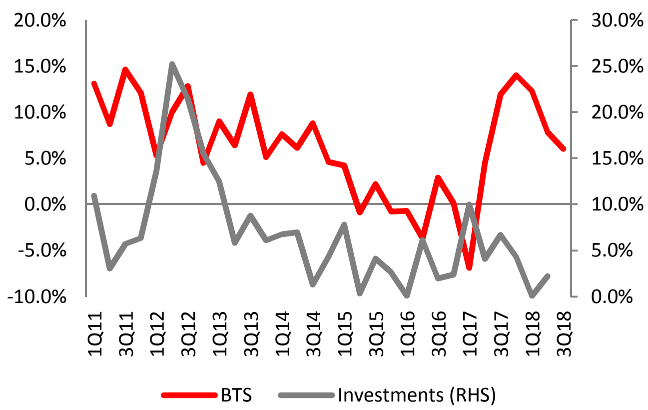
Expected economic slowdown in 3Q18. According to the latest Business Tendency Survey, overall business performance is expected to remain positive albeit at moderate pace given that overall business confidence registered at 6%, lowest in 5-quarter. The moderation is seen across almost all sectors namely 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.

Chart 1: BTS (%) vs GDP (YoY%)



Source: CEIC, MIDFR

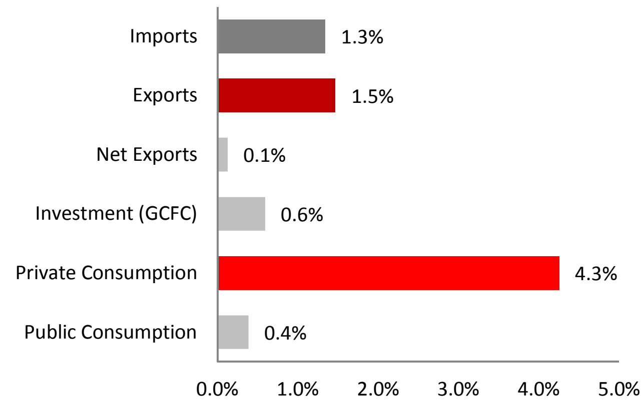
Chart 2: BTS (%) vs Private Investment (YoY%)



Source: CEIC, MIDFR

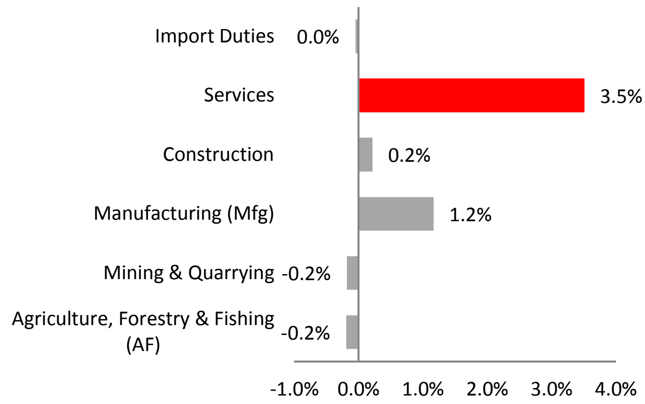
GDP growth slowest to 1½ years. Malaysia's GDP growth expands by 4.5%yoy in 2Q18, below our forecast of 4.9%yoy and market expectations of 5.2%yoy. It is the weakest growth in 6-quarters and less than previous year's average of 5.4%. Among others, domestic demand contributes about 4.3% of the total growth during the quarter. From supply side, services and manufacturing sectors contribute 3.5% and 1.2% respectively. We opine the slowdown in GDP growth was in tandem with moderating performances of industrial production, manufacturing sales, distributive trade and external trade during the quarter. Moderating inflationary pressure, strengthening domestic demand and accommodative economic policies as well as strong exports growth are expected to be major drivers for GDP performance in the second half 2018.

Chart 3: Contribution by Expenditure Components



Source: CEIC, MIDFR

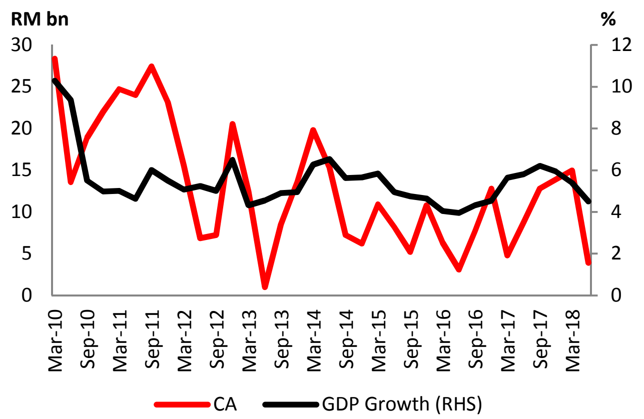
Chart 4: Contribution by Supply-Side Components



Source: CEIC; MIDFR

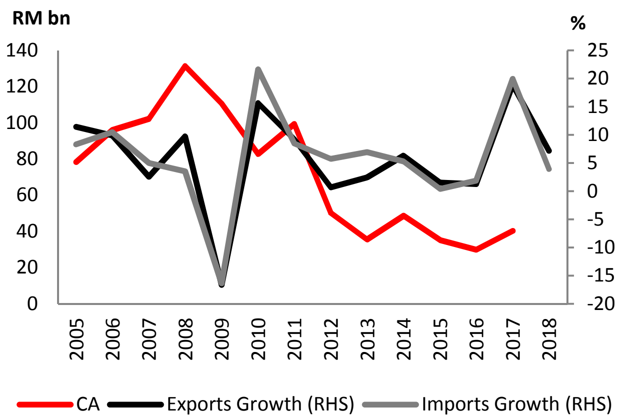
Malaysia's current account surplus at 2-year low. Current account surplus narrowed sharply to RM3.9b in 2Q18 compared to RM15b in the previous quarter, making it the smallest surplus since 3Q16. The fall was mainly driven by further deficit of services account to RM6.2b from RM5.8b in 1Q18 besides the goods account surplus which declined sharply to RM26.1b from RM35.7b. The decline in surplus was partly due to modest trade surplus of USD27.2b in 2Q18 which is lower than RM33.4b in 1Q18. In addition, average imports growth of 8.1%yoy in 2Q18 was not significantly different than those of exports (8.4%yoy). Nevertheless, Malaysia still positioned as net external creditor built up from a record of current-account surpluses.

Chart 5: Current Account (RMb) vs GDP (YoY%)



Source: CEIC, MIDFR

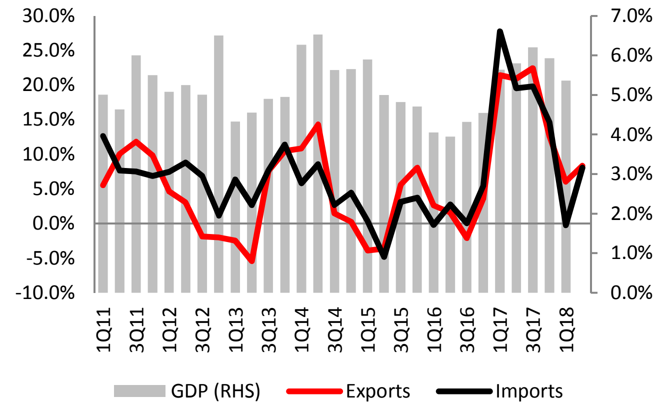
Chart 6: Current Account (RMb) vs Ex. Trade (YoY%)



Source: CEIC; MIDFR

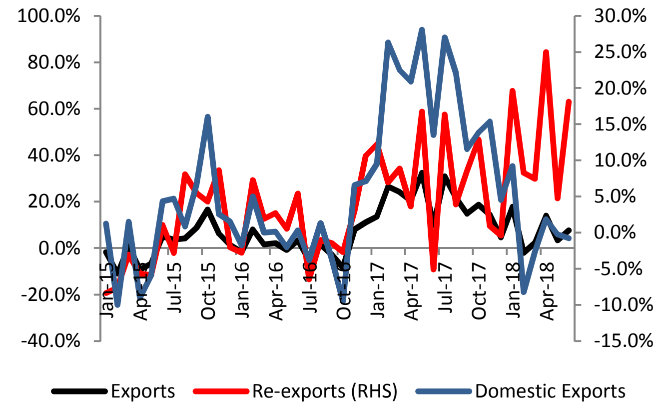
Exports growth doubled. Exports growth expanded by 7.6%yoy in Jun-18, improved from 3.4%yoy gain registered in the preceding month. However, exports value dropped back to below RM80b. The expansion was mainly impelled by continuous and larger growth in manufactured goods (12.7%yoy). However, mining goods returned to negative territory in Jun-18 by shrinking 10.9%yoy after a stellar performance of 40%yoy in May-18 while agriculture goods continued to decrease by 18.7%yoy. Meanwhile, imports growth surged to 14.9%yoy during the same month compared to merely 0.1%yoy growth in May-18. For the first time this year, imports growth outperformed exports, resulting in a lesser trade surplus of RM6b. In upcoming month, we foresee Malaysia's exports to remain positive on the back of zero-rated GST, tax holiday period and stable retail fuel price. Nevertheless, protectionism and trade tension remain a concern to the economy.

Chart 7: External Trade vs GDP (YoY%)



Source: CEIC; MIDFR

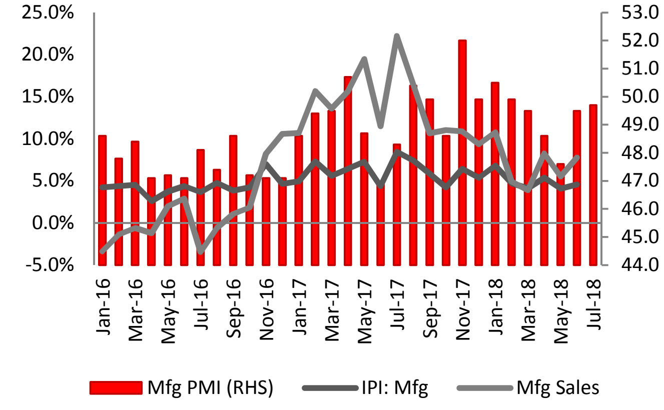
Chart 8: Exports: Domestic vs Re-exports (YoY%)



Source: CEIC; MIDFR

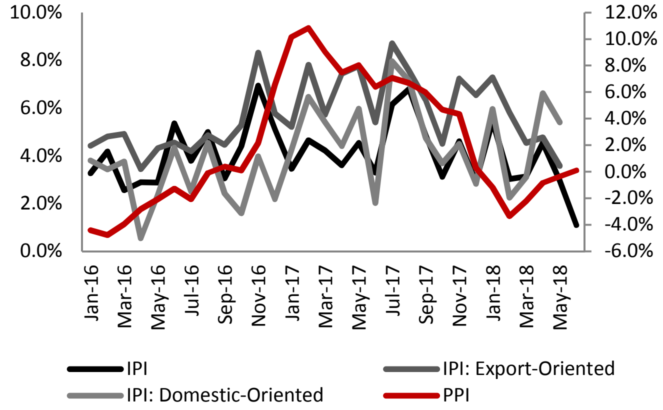
IPI misses market estimates. Malaysia's industrial production expands by 1.1%yoy in Jun-18, lower than market expectations of 3.2%yoy. By major components, manufacturing and electricity outputs up by 4.6%yoy and 3%yoy respectively while mining contracted sharply by -9.4%yoy. The declining trend is partly due to tepid growth in domestic exports which shrink by -0.8%yoy in Jun-18. For 1H18, average IPI growth recorded at 3.4%yoy, lower than previous year growth of the same period, 4%yoy. Moving forward, we foresee IPI performances to expand at steady pace for the second half of 2018 amid escalating trade tension, moderating inflation and supportive policy changes for businesses such as tax-holiday and stable retail fuel prices.

Chart 9: Mfg. IPI & Sales (YoY%) vs PMI (Points)



Source: CEIC; MIDFR

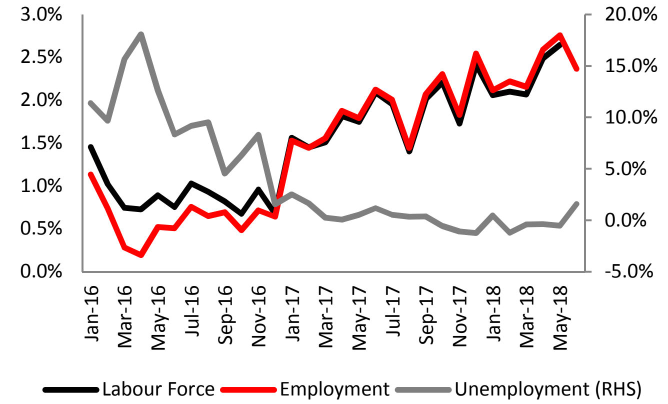
Chart 10: IPI vs PPI (YoY%)



Source: CEIC; MIDFR

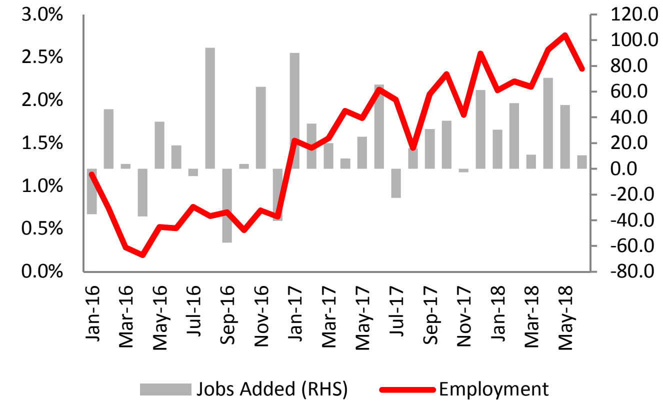
Labour market remains strong. Employment increased by 2.4%yoy to 14.9 million in Jun-18. Similarly, labour force grew by 2.3%yoy to 15.4 million. Nevertheless, jobs added in the economy registered at 10.6K, lowest ever recorded in 2018 so far. Unemployment rate maintains at full-employment condition of 3.4%. For 1H18, the average expansion rate of both labour force and employment are at record high, 2.3% and 2.4% respectively. As compared to 2017, both labour market indicators rose by 1.8% and 1.9% accordingly. As both domestic and external economic activities are on upbeat momentum, growths in both labour force and employment have been outpacing unemployment growth for the last 16-month since Feb-17.

Chart 11: Labour Market Key Indicators (YoY%)



Source: CEIC, MIDFR

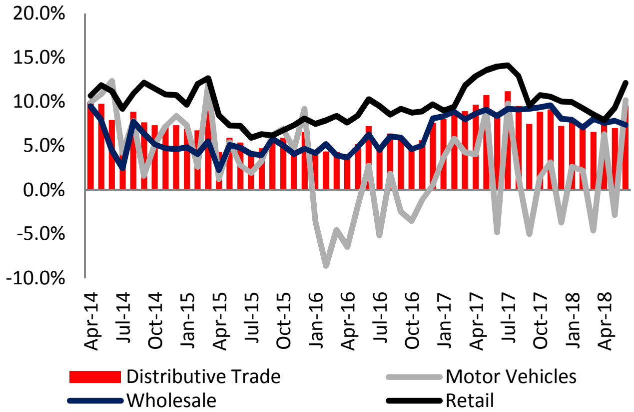
Chart 12: Jobs Added ('000) vs Empl. (YoY%)



Source: CEIC; MIDFR

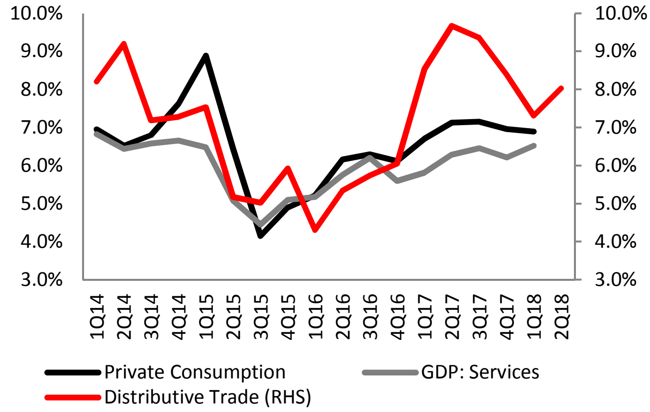
Domestic trade posted all-time high sales figures. Distributive trade rose by 9.6%yoy to a record high of RM106.1b in Jun-18 as retail trade hit highest ever value at RM42.7b. Similarly, motor vehicles sales expand by 10.1%yoy to a record high of RM13b. Furthermore, wholesale trade grew by 7.4%yoy to RM50.4b. On monthly basis, both retail and motor vehicles sales expanded by 4.5%mom and 5.8%mom respectively while wholesale trade dipped by tepid 0.3%mom. As anticipated, consumers have ramped up their expenditures especially on big-ticket items such as motor vehicles after a cautious spending earlier in order to benefit from the 3-month tax holiday period started on 1st June which also coincided with Eid celebration. In fact, total industry volume (TIV) for the automotive industry in Jun-18 registered a massive 50%mom and 28%yoy growth to 64,502 units which was not far off a historical record of 69k.

Chart 13: Distributive Trade, DT (YoY%)



Source: CEIC, MIDFR

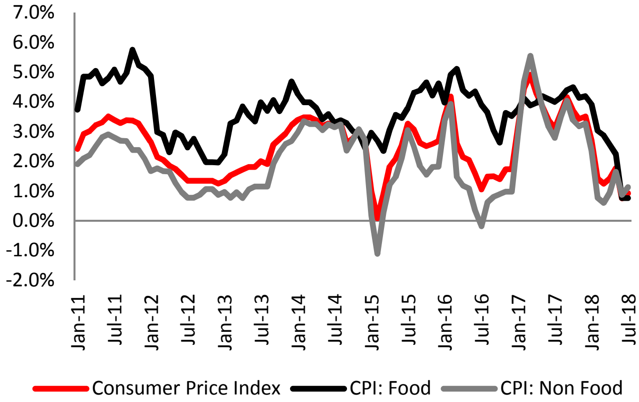
Chart 14: DT vs GDP Selected Components (YoY%)



Source: CEIC, MIDFR

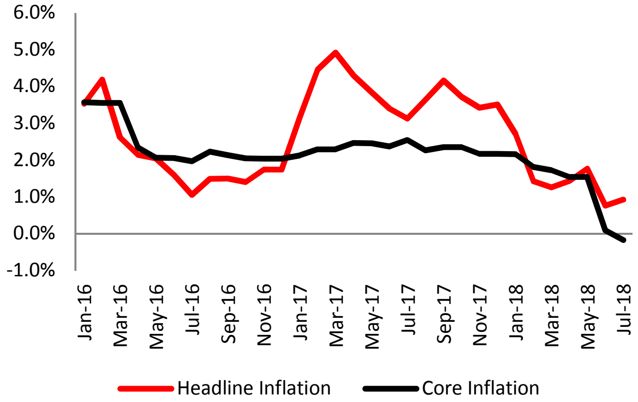
Inflation matched market expectations. Headline inflation rate up 0.9%yoy in Jul-18, as widely projected by most analysts. The inflation rate remains below 1% as it is the second month during the tax holiday period. Inflation of food & non-alcoholic beverages further slowdown to 0.7%yoy, lowest ever recorded. Among others, the marginal rise in overall prices is mainly due to slight pick-up in transport inflation, 6.7%yoy. On the other hand, for the first time core inflation went down to deflationary level of -0.2%yoy. Malaysia's inflation is expected to continue to taper down in upcoming months due to high base effects besides other significant events such as zero-rated GST, tax holiday period until SST implementation in Sep-18 and stable retail fuel price which will reduce business cost.

Chart 15: CPI: Headline vs Food & Non-food (YoY%)



Source: CEIC, MIDFR

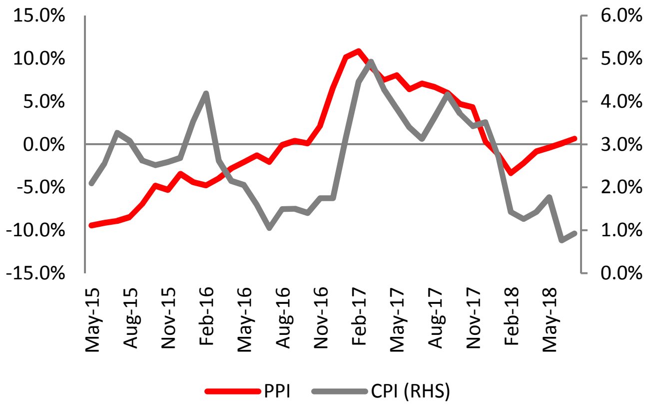
Chart 16: CPI: Headline vs Core (YoY%)



Source: CEIC, MIDFR

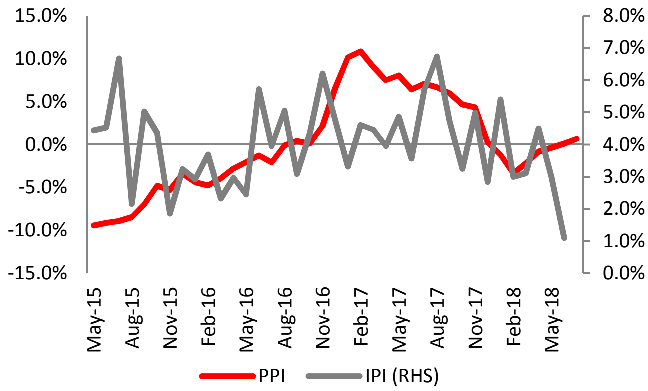
PPI continued to increase for 2nd consecutive month. Malaysia's producer inflation went up to 0.7%yoy in Jul-18 from 0.1%yoy recorded in the previous month. The eight-month high figure also marked the second growth for this year mainly driven by mining, electricity & gas supply and water supply sectors which rose by 32.6%yoy, 1.1%yoy and 0.3%yoy respectively. Meanwhile, prices for agriculture, forestry & fishing, manufacturing and food product declined. On a monthly basis, PPI likewise increased by 0.3% following a fall of 0.7% in Jun-18. In upcoming month, we opine cost inflationary pressure to stay low amid tax-holiday period. However, rising global commodity prices could induce pressure to the estimate.

Chart 17: PPI vs CPI (YoY%)



Source: CEIC, MIDFR

Chart 18: PPI vs IPI (YoY%)



Source: CEIC, MIDFR

Table 1: Macroeconomic Data Updates

(YoY%) Unless Stated Otherwise	2016	2017	2018f	1Q18	2Q18	3Q18f	4Q18f
Real GDP	4.2	5.9	5.1	5.4	4.5	5.2	5.4
Private Consumption	6.0	7.0	7.2	6.9	8.0	7.1	6.9
Public Consumption	0.9	5.4	1.5	0.4	3.1	(1.5)	3.2
Gross Fixed Capital Formation	2.7	6.2	0.5	0.1	2.2	(1.7)	1.5
Exports of goods & services	1.3	9.4	3.0	3.7	2.0	2.3	4.0
Imports of goods & services	1.3	10.9	2.0	(2.0)	2.1	3.2	4.6
Net Exports	92.8	91.0	101.3	29.5	21.3	25.3	25.2
Agriculture etc.	(5.2)	7.2	0.5	2.8	(2.5)	3.6	(1.8)
Mining & Quarrying	2.1	1.0	1.0	0.1	(2.2)	2.5	3.5
Manufacturing	4.4	6.0	5.1	5.4	4.9	4.9	5.0
Construction	7.4	6.7	4.0	4.9	4.7	1.3	5.2
Services	5.7	6.2	6.5	6.5	6.5	6.4	6.7
Exports of Goods (f.o.b)	1.1	14.5	9.3	6.0	8.4	15.0	7.9
Imports of Goods (c.i.f)	1.9	15.5	8.2	(0.3)	8.1	16.0	8.0
Trade Balance - RMb	87.2	97.5	119.9	33.4	27.2	35.0	24.3
Consumer Price Index	2.1	3.8	1.3	1.8	1.3	1.0	1.1
Current Account - RMb	29.0	36.6	39.6	-	-	-	-
Current Account - % of GNI	2.7	3.2	3.2	-	-	-	-
Fiscal Balance - % of GDP	(3.1)	(3.0)	(2.9)	-	-	-	-
Federal Government Debt - % of GDP	53.8	53.0	52.5	-	-	-	-
Nominal GDP	6.3	9.9		-	-	-	-
End of Unless States Otherwise	**2016**	**2017**	**2018f**	**1Q18**	**2Q18**	**3Q18f**	**4Q18f**
Brent Crude Oil (Avg)	46.0	55.7	70.0	68.4	77.4		
Crude Palm Oil (Avg)	2,677	2,733	2,400	2,480	2,350		
USD/MYR (Avg)	4.15	4.30	4.00	3.92	3.95		
USD/MYR	4.48	4.15	3.95	-	-	-	-
Yield on generic 10-year MGS (%)	3.85	4.00	4.10	-	-	-	-
3-month KLIBOR (%)	3.54	3.43	3.60	-	-	-	-
Overnight Policy Rate (%)	3.00	3.00	3.25	3.25	3.25	3.25	3.25

Source: MIDFR

August 2018 Key Economic Events

1 Aug: Fed holds interest rates steady, clears way for hike in September despite escalating tariff fights. Escalating U.S. trade fights with other countries aren't throwing the Federal Reserve off its course of gradually raising interest rates as the economy strengthens. At least not yet. The Fed held interest rates steady Wednesday but upgraded its economic outlook and downplayed the trade skirmishes, clearing the way for a rate increase in September and possibly another at year-end. .

7 Aug: Parliament passes Sales Tax Bill 2018. The Sales Tax Bill 2018 was passed in the Dewan Rakyat today with a resounding majority by voice vote, despite arguments put up by Barisan Nasional backbenchers. The Bill, read for the third time by Finance Minister Lim Guan Eng before it was passed, forms part of the Sales and Services Tax (SST) regime that will be implemented from Sept 1 this year. The other Bill is the Service Tax Bill 2018 that will be debated by Members of Parliament tomorrow, together with the the Goods and Services Tax (Repeal) Bill 2018, which when passed will mark the end of the GST chapter in Malaysia.

14 Aug: M'sian equities hit, ringgit lowest level in 10 months on Turkish troubles. Joining a global sell-off, Malaysian equities took a hit while the ringgit slid to its lowest level since November, as fears climbed over a contagion from the currency crisis gripping Turkey. The US dollar, yen and Swiss franc stood to benefit from the Turkish economic crisis as investors sought shelter in those currencies – widely considered as safe havens. Meanwhile, the ringgit depreciated 0.17% yesterday to end at 4.093 against the US dollar. The currency weakened to 4.098 against the greenback earlier. These were the ringgit's weakest levels since November 2017.

17 Aug: BNM: Malaysia 2Q18 GDP growth slows to 4.5% y-o-y on supply disruptions. The Malaysian economy, as measured by gross domestic product (GDP), grew 4.5% year-on-year (y-o-y) in the second quarter of 2018 (2Q18), driven by the private sector, according to Bank Negara Malaysia (BNM). BNM said in a statement today supply disruptions resulted in the slower y-o-y economic growth of 4.5% in 2Q18 compared to the 5.4% expansion in 1Q18.

17 Aug: Mahathir arrives in Hangzhou to begin 5-day China visit. Malaysian Prime Minister Dr Mahathir Mohamad arrived here today to begin his five-day official visit to China aimed at further strengthening the 44-year-old ties between Kuala Lumpur and Beijing. Hangzhou is the first leg of the visit that will also take him to China's capital, Beijing. Mahathir is making an official visit to China once again as prime minister after a 17-year gap, having made his last official trip to this country in October 2001.

22 Aug: Beijing retaliates as new US tariffs kick in on $16 billion of Chinese goods. A new round of U.S. tariffs on $16 billion worth of Chinese imports kicked in on Thursday, prompting Beijing to retaliate with its own levies on American goods worth the same amount. The latest trade escalation comes as officials from the world's two largest economies meet for tariff negotiations in Washington.

28 Aug: Trump announces US-Mexico trade deal, setting stage for Nafta overhaul. Donald Trump has said he will strike a new trade deal with Mexico while ripping up the North American Free Trade Agreement (Nafta) and threatening a trade war with Canada.

29 Aug: Malaysian businesses expect slower growth in third quarter. Businesses expect growth to slow in the third quarter due to lower confidence levels after recording positive business performance in the second quarter of the year, according to the Statistics Department. The department's Business Tendency Statistics for the third quarter 2018 which presents statistics on business performance based on a survey conducted on a quarterly basis – said the second quarter of the 2018 was positive with an overall net balance of +3.6%, mainly contributed by services sector (+22.0%).

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