

MONTHLY ECONOMIC REVIEW | July 2016

Economic Performance Optimistic In Recent Months, Remain Cautious Due to Brexit Vote

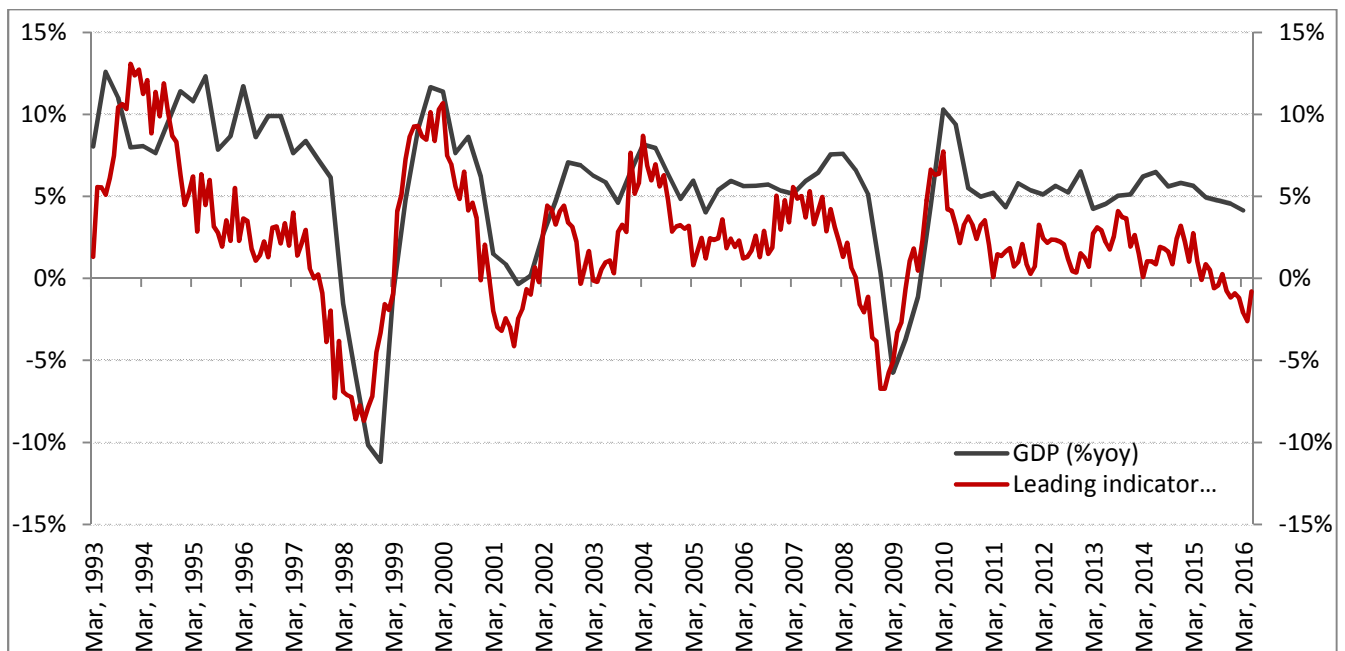
- *Exports rose at the fastest pace in four month. Exports expanded by 3.4%yoy beating our forecast of 2.5%yoy growth and median economists' estimate which were expecting a contraction by 3.7%yoy. On a seasonally adjusted basis, exports surged 10.6%mom, the highest in 52 months. Year to date, exports growth improved to 1.2% from 0.8% last month but still below 2015 average of 1.5%.*
- *Malaysia 2Q16 GDP is expected to moderate to 3.9% from 4.4% in the first quarter. Contraction in the leading indicators eased to -0.8%yoy in May from -2.6%yoy in the previous month, though it was still the 7 consecutive months in the red. This suggests that there will be further slowdown in the economy moving ahead and industrial production had so far moving in step, moderating from above 4.0% earlier this year to only 2.7% in May.*
- *We expect BNM to conduct one more rate cut by 25bps this year. We are maintaining our OPR forecast at 2.75% by year-end 2016, reflecting a possible move in September or November this year.*

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June inflation was loosely in line with consensus forecast at 1.6%yoy. Inflation in June slipped further to 1.6%, marking the fourth consecutive week of tapering inflation rate from February's peak of 4.2%. The reading was roughly in line with the consensus forecast of 1.7% surveyed by Bloomberg. The initial price shock due to GST implementation last year continue to fade while unchanged pump price in June kept inflationary pressure on the lid. However, inflation in food items edged slightly higher to 4.2% from 4.1% last months. Fresh meat prices increased by 3.3%mom after remained flat in May. The prices, in retrospect, have been declining for 3 consecutive months from February through April. The surge in prices was potentially driven by the increasing demand due to festive season.

Ringgit forecast maintained at RM3.95 amid expectation of no rate hike by Fed. Post Brexit, fund managers had actively rebalance their portfolios more towards emerging markets as the Fed is unlikely to raise interest rate hike this year. Taiwan, Korea and regional peers have seen huge inflows in the period after post Brexit though inflow to Malaysia was largely marginal so far. Nevertheless, we are maintaining our forecast for Ringgit at RM3.95/USD by year end 2016.

Chart 1: GDP and Leading Indicator



Source: DoS, CEIC, MIDF Research

Malaysia 2Q16 GDP is expected to moderate to 3.9% from 4.4% in the first quarter. Contraction in the leading indicators eased to 0.8%yoy in May from 2.6% in the previous month, though it was still the 7 consecutive months in the red. This suggests that there will be further slowdown in the economy moving ahead and industrial production had so far moving in step, moderating from above 4.0% earlier this year to only 2.7% in May. Higher trade dependence means the country is more sensitive towards current cyclical slowdown in the global trade compared to its larger population regional peers. We are maintaining our GDP forecast for 2Q16 at 3.9% 4.0% for the full year.

We expect BNM to conduct one more rate cut by 25bps this year. We have previously anticipated two rate cuts by BNM in 2H16 but the central bank's early move in July indeed surprise the markets. . Weak external factor was cited as the main reason for the rate cut. However, we believe the move was also done to provide support to the domestic economy as recent indicators shows fatigue in the economy. We are maintaining our OPR forecast at 2.75% by year-end 2016, reflecting a possible move in September or November this year.

Diverging policy by Bank of England (BOE) will quash hope of a Fed rate hike this year. The BOE's dual actions last week i.e cutting key benchmark interest rate for the first time in more than 7 years and expansion of bond purchasing program by an additional of GBP60 billion should quash any hope of the Fed to normalise its interest rate this year. Better non-farm payroll job report in June and July, adding on average more than 250,000 jobs during the two months has helped to build positive sentiments towards a possible rate hike by September or December. However, employment statistics are often lagging indicators. US GDP only grew 1.2%yoy in the second quarter and weak private investments should weigh on future growth. Hence, we are maintaining our forecast that there will be no rate hike by the Fed as such diverging action will hurt trade with the UK, one of the US's key trade partner and strengthen dollar further which will erode repatriated corporate profits.



(YoY%) unless stated otherwise	2014	2015	2016f	1Q16	2Q16f	3Q16f	4Q16
Real GDP	6.0	5.0	4.0	4.2	3.9	4.1	3.9
Private consumption expenditure	7.1	5.5	4.5	5.3	5.0	4.8	2.7
Government expenditure	4.4	4.7	4.5	3.8	3.3	4.2	6.6
Gross fixed capital formation	4.8	3.4	0.2	0.1	4.7	-0.3	-3.6
Exports of goods and services	5.1	0.6	-1.8	-0.5	1.3	-3.6	-4.6
Imports of goods and services	4.2	1.2	-2.0	1.3	2.2	-4.6	-6.7
Net exports	12.8	-3.3	-0.5	-12.4	-5.5	3.6	12.2
Nominal GDP	8.6	4.5	4.1	4.7	4.4	4.3	4.2
Exports of Goods (f.o.b)	6.3	1.9	-0.5	2.2	-1.6	-2.3	0.9
Imports of Goods (c.i.f)	5.3	0.4	1.3	2.3	0.6	1.7	3.1
Trade Balance – RMb	82.5	94.3	81.9	23.9	16.4	14.4	27.1
Consumer price index	3.2	2.2	2.6	3.4	2.0	2.3	2.4
Current account – RMb	47.3	34.0	25.0	-	-	-	-
Current account - % of GNI	4.8	2.8	2.5	-	-	-	-
Fiscal balance - % of GDP	-3.5	-3.2	-3.1	-	-	-	-
Federal government debt - % of GDP	52.7	54.3	53.8	-	-	-	-
	2014	2015	2016f	1Q16	2Q16f	3Q16f	4Q16
Brent Crude Oil (Avg)	99.4	53.6	45.0	-	-	-	-
Crude Palm Oil (Avg)	2,415	2,168	2,450	-	-	-	-
USD/MYR (Avg)	3.273	3.907	4.050	-	-	-	-
EUR/MYR (Avg)	4.347	4.336	4.400	-	-	-	-
JPY/MYR (Avg)	3.096	3.228	3.500	-	-	-	-
SGD/MYR (Avg)	2.583	2.840	2.950	-	-	-	-
Brent Crude Oil (End of)	57.3	37.3	50.0	39.0	49.0	50.0	50.0
Crude Palm Oil (End of)	2,297	2,200	2,500	2,600	2,378	2,500	2,500
USD/MYR (End of)	3.497	4.294	4.100	3.900	4.000	3.970	3.950
EUR/MYR (End of)	4.251	4.691	4.300	4.446	4.500	4.400	4.300
JPY/MYR (End of)	2.922	3.572	4.000	3.464	3.970	4.000	4.000
SGD/MYR (End of)	2.647	3.040	2.950	2.895	3.000	2.950	2.950
Yield on generic 10-year MGS (%)	4.15	4.19	3.65	3.77	3.85	3.70	3.65
3-month KLIBOR (%)	3.86	3.84	3.20	3.71	3.65	3.40	3.20
Overnight policy rate (%)	3.25	3.25	3.00	3.25	3.25	3.00	3.00

July Key Economic Events

2 July 2016: Australian Federal Election, 2016. Due to the closest fight since 1961, the official result of Australian Federal Election 2016 only came eight days after the election took place. House of Australian Representatives required 76 seats to form a majority government and the Coalition party managed to secure exactly 76 seats. The number was down as compared to their previous win with 90 seats, reflecting weakening support for the party. The Labor party on the other hand obtained 69 seats, up from the previous 55 seats in 2010 federal election.

13 July 2016: BNM Cuts OPR by 25 bps to 3.00% Amid Heightened Global Risk. Monetary Policy Committee decided to cut OPR by 25 bps to 3.00%, against economists expectation surveyed by Bloomberg, where 17 out of 18 economists were expecting BNM to keep at the current rate. Weak external factor has been the main reason for the rate cut. However, we opine that the weak external factor alone does not warrant a rate cut, but rather the possibility the weak global demand to eventually affect domestic income, employment and investment level. We are maintaining with our expectation that BNM will cut OPR by 50 bps in 2H16, which we expect the next rate cut would be in September 2016 by another 25 bps.

19 July 2016: Turkey Cuts Key Interest Rate After Failed Coup. Turkey's central bank cut Tuesday cut one of its key rates for the fifth consecutive month after an attempted coup triggered fears about repercussions for the country's economy. The Monetary Policy Committee in Ankara said it cut the overnight lending rate to 8.75% from 9%. It kept its benchmark one-week repo rate steady at 7.5% and its overnight borrowing rate at 7.25%.

27 July 2016: Abe Plans For 28 trillion yen stimulus. In an effort to fight deflation, Japan's Prime Minister Shinzo Abe announced fiscal stimulus amounting to 28 trillion yen (USD265 billion) fiscal stimulus. As part of the stimulus, Japan will spend 6.2 trillion yen (\$61 billion) on infrastructure to help double the number of tourists visiting the country, speed up the construction of a magnetic levitation line and aid building projects overseas.

13 July 2016: Theresa May elected as the new Prime Minister of United Kingdom. Theresa May will be elected as the new UK prime minister today, as David Cameron decided to resign early on Wednesday possibly due to the worsening financial market condition caused by the uncertainty aroused from the British people's decision for a Brexit. On Monday, Theresa May stated in her speech "Brexit means Brexit," in which she mentioned that there will be no attempts to remain inside the EU, either it be by re-joining from the back door or a second referendum.

14 July 2016: Bank of England Leaves Interest Rate Unchanged. The Bank of England held its benchmark interest rate steady Thursday but officials said they expect to launch fresh stimulus on multiple fronts next month, as the economy stumbles under Britons' decision to exit the European Union. The BOE said in a monthly policy statement that the nine-member Monetary Policy Committee voted 8-1 to maintain the central bank's benchmark interest rate at 0.5% for another month. The British pound increased and U.K. stocks trimmed earlier gains after the announcement, while U.S. stocks climbed after the British central bank indicated it had plans for fresh stimulus measures. Sterling surged higher against the U.S. dollar.

27 July 2016: Fitch Downgrade Ringgit Denominated Sovereign Bond. Fitch downgrade Malaysia's government long-term local bond rating to 'A-' from 'A' last week. The international credit rating agency cited the absence of strong public finance fundamentals against external finance fundamental and the preferential treatment of local-currency creditors against the foreign-currency ones.

29 July 2016: Bank of Japan's Stimulus. Bank of Japan decided to increase its purchase of exchange-traded funds (ETF) so that their amount outstanding will increase at an annual pace of about 6 trillion yen, from the previous pace of about 3.3 trillion yen. Furthermore, it also doubled the size of a lending program for local companies to USD24 billion for a period up to 4 years while keeping interest rate steady at -0.1%. The market was disappointed with the seemingly soft monetary policy after all the hypes about helicopter money and aggressive easing.

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