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ECONOMIC REPORT | **Malaysia Monthly Outlook**

5 April 2017

2017 GDP Forecast Revised to 4.9%, up from 4.3%

- *Blockbuster trade performance, a catalyst for GDP 2017 forecast upgrade. As we have mentioned in our report released on Monday (see GDP Revision on the Horizon), the upgrade to 2017 GDP growth forecast is pending a strong February trade data. Indeed, the data far beat ours and consensus expectations.*
- *2017 GDP, exports forecast to 4.9% and 8.5% respectively. The February trade data give reasons to believe that the uptrend in global trade activity could sustain for the year – a stretch of positive growth for 4 consecutive months. Besides, uptrend in the credit market reflects improving real business and investment sentiment.*
- *Upbeat economic outlook raises odds for OPR rate hike – yet uncertain. With GDP growth on the horizon, the odds for an OPR has also increased – combined with the potential of more aggressive rate hike plan by the Fed and the expected elevated inflationary environment.*
- *Current account to improve, reiterate USD/MYR forecast of 4.30 by year-end*

Blockbuster trade performance, a catalyst for GDP 2017 forecast upgrade. As we have mentioned in our report released on Monday (*see GDP Revision on the Horizon*), the upgrade to 2017 GDP growth forecast is pending a strong February trade data. Indeed, the external trade data far beat ours and consensus expectations. Exports and imports are up by 26.5% and 27.7% respectively during the month– the strongest readings for both in 7 years. This is in line with the regional trend where most of the closely tracked Asian countries performed well with trade figures in the double digit except China and Thailand (Chart 1 & 2).

The strong trade performance were observed in all sectors with E&E being the major contributor, followed by palm oil, chemical products, refined and crude petroleum as well as a rebound in LNG demand.

Chart 1: Regional rebound in trade activity (YoY %)

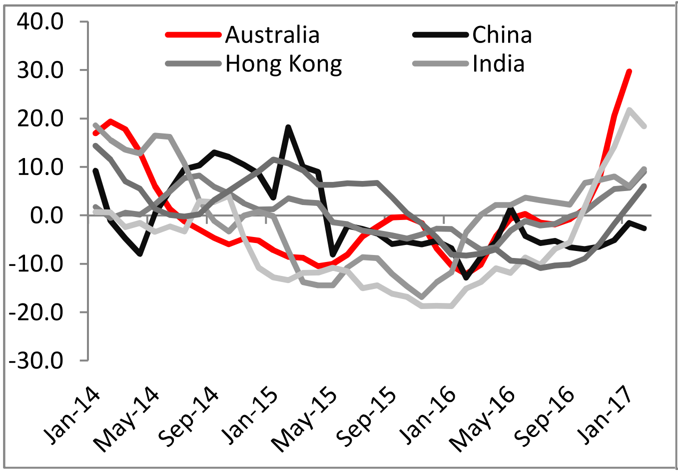
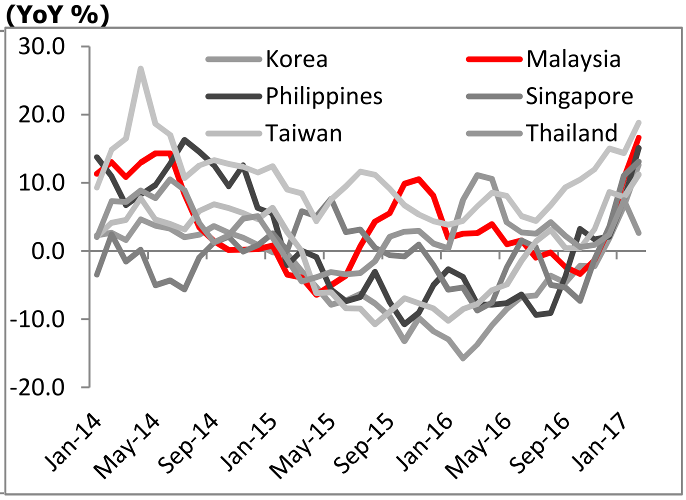


Chart 2: Growth in Malaysia's exports in line with peers (YoY %)



Source: CEIC; MIDF Research

Chart 3: 2017 GDP growth revised to 4.9% from 4.3%

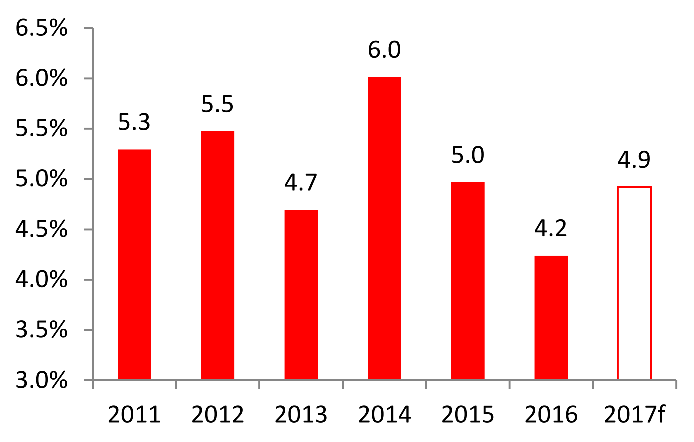
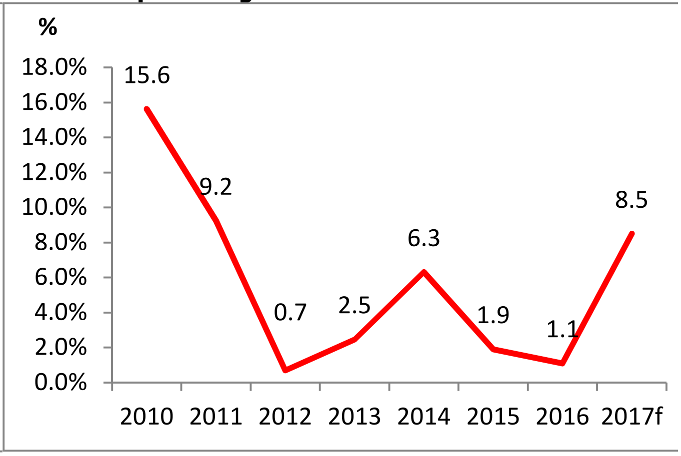


Chart 4: Exports to grow 8.5% in 2017



Source: CEIC; MIDF Research

2017 GDP, exports forecast to 4.9% and 8.5% respectively. The February trade data give reasons to believe that the uptrend in global trade activity could sustain for the year – a stretch of positive growth for 4 consecutive months. The windfall from surging trade is a boon especially to exports-oriented industries i.e E&E, chemicals, petroleum products and rubber. Further, there will be high possibility of a positive trickle-down effect to domestic production.

Looking from the supply side perspective, outputs of crude palm oil have increased substantially, recording three consecutive months of increment since December – a trend likely to continue. Last year, the agriculture sector contracted 5.1% and shed 0.5% point growth from the overall GDP. Even at a marginal rebound of 1.0% in the sector will help to contribute around 0.4 – 0.5% point to GDP. With all these factors considered, we have revised our 2017 GDP growth projection to 4.9%, up 0.6% percentage point from our previous forecast of 4.3% while exports forecast is upgraded to 8.5% from 3.0% previously.

Uptrend in the credit market reflects improving real business and investment sentiment. Loan growth was bottoming in the third quarter last year but had since established a sustained uptrend – in large due to boost in working capital loans – driven by rebound in manufacturing sector (Chart 3 & 4). The recovery was rather expected given the surge in external demand. Total credit growth remained above 5% in February but moderated slightly from the previous month. We opine the development in credit growth reflects improving real business and investment sentiment – a slight contrast to the pessimism suggested by local business confidence indexes. We see uptick in manufacturing growth from 4.4% in 2016 to 5.0%.

Chart 5: Loan Growth Picking up Pace (YoY)

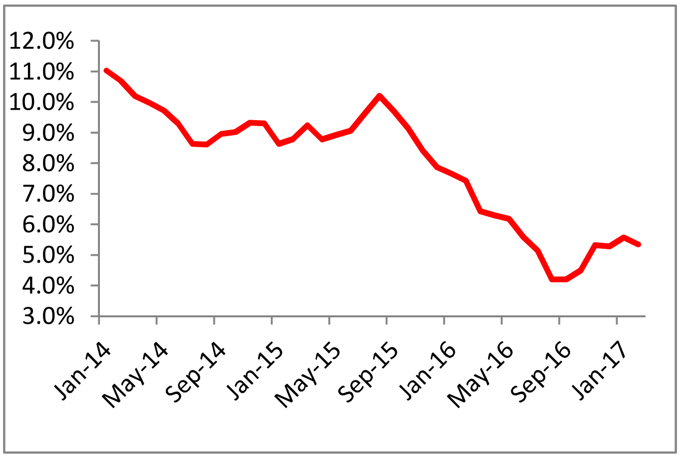
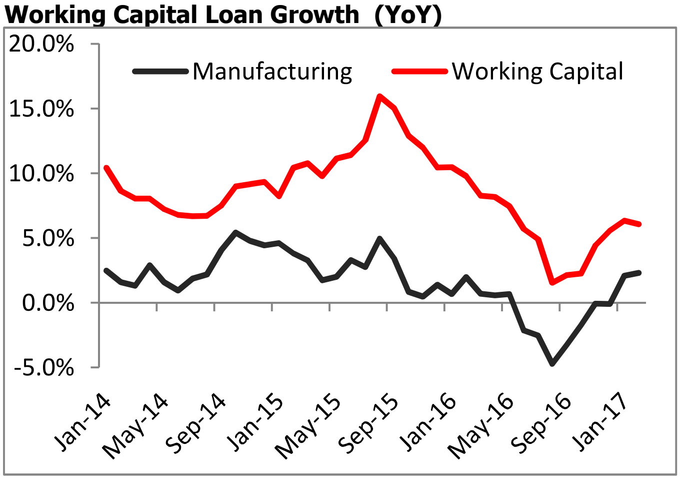


Chart 6: Rebound in Manufacturing and up trending Working Capital Loan Growth (YoY)



Source: CEIC; MIDF Research

Upbeat economic outlook raises odds for OPR rate hike – yet uncertain. With GDP growth on the horizon, the odds for an OPR has also increased – combined with the potential of more aggressive rate hike plan by the Fed and the expected elevated inflationary environment. We see headline inflation to average 4.5% this year – mainly reflecting a cost-driven situation due to pump price differential between 2017 and last year. Bank Negara Malaysia did comment last week that this development (high inflation) is not a surprise – but leaving no direct hints on future direction of interest rate. The only cue (if any) was that it noted economic growth had pick up pace but operating close to its potential output estimate at 4.7% this year.

On the expectation of two additional rate hikes by the Fed this year, we opine the threshold would be a 5.5% GDP growth in any quarter and core inflation to rise above 3.0% for BNM to seriously consider a rate hike. Otherwise, expect OPR to remain unchanged throughout 2017.

Current account to improve, reiterate USD/MYR forecast of 4.30 by year-end. We reckon current account will improve this year, bucking the downtrend established since 2011. In 2016, current account to GNI ratio was 2.1%. This could lend some support to Ringgit to strengthen from the current level of USD/MYR 4.4300. Higher commodity prices have so far translated into better terms of trade which in turn drive bigger trade surplus. For the first two months of the year, trade balance was up 5.5% as compared to the same corresponding period a year earlier.

Plus, under the new BNM mandate, a minimum of 75% of exports proceeds need to be converted into Ringgit which based on the expectation of higher current account, there would be higher demand for our local currency. However, we note liquidity flows have more bearings to Ringgit rather than fundamental factors due to speculative nature of the currencies market. On that front, there was huge decline in portfolio investments in 4Q16 but it should turn positive this quarter – having observed net foreign fund inflow into the equity market reaching close to RM6b this year. However, the outflow from the bonds market by foreign investors may have offset some gains in Ringgit but we believe much of the portfolio rebalancing activity has been done. We maintains our Ringgit forecast of USDMYR 4.30 by year-end.

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