5 November 2018

MONTHLY ECONOMIC REVIEW | October 2018

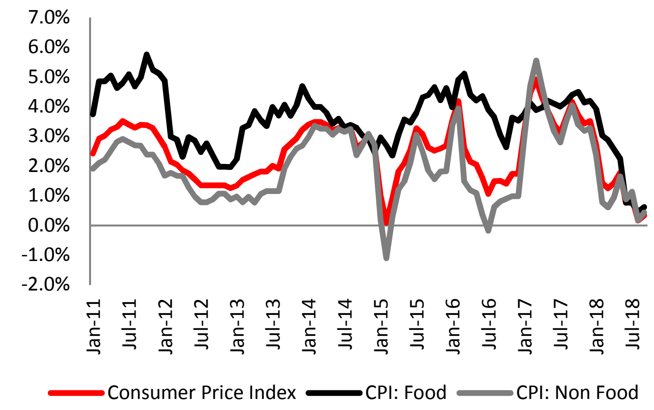
Domestic Economy Remain Resilient Despite Threat of External Headwinds

- *Budget 2019: A game-changer to Malaysian economy. As guided by the mid-term review of 11th Malaysian Plan, the fiscal policy approach of the new government will see significant structural changes in term of revenue and expenditure. Heavier weightage will be put on development expenditure particularly on social services or Rakyat-oriented projects.*
- *Inflation matched our forecast. Consumer price index increased 0.3%yoy in Sep-18, marginally higher than 0.2%yoy recorded in the preceding month and in line with our expectation. The trivial increase was anticipated as SST returns in Sep-18. However, inflation rate still remain below 1% for the fourth consecutive month despite the reintroduction of SST, probably due to the significant impact of RON95 fuel subsidization.*
- *Wholesale and retail at new record high. Distributive trade rose by 10.7%yoy to a fresh record high of more than RM107b in Aug-18 as both wholesale and retail trade reached a new all-time high of RM50.9b and RM43.5b respectively. It is the highest growth since Aug-17 fueled by a ramp-up consumer spending as tax holiday period came to an end.*

Budget 2019: A game-changer to Malaysian economy. As guided by the mid-term review of 11th Malaysian Plan, the fiscal policy approach of the new government will see significant structural changes in term of revenue and expenditure. Heavier weightage will be put on development expenditure particularly on social services or Rakyat-oriented projects. On operating expenditure, we expect increase in subsidies and restructuring in other components of the expenditure. As for revenue stream, broaden tax base is among key important highlights in order to cover the loss of revenue from GST. Rebound in petroleum tax revenue may not be sustainable particularly in the current challenging environment amid volatility in global energy prices and heighten trade tension. Nevertheless, we expect total government revenue to grow at reasonable pace in the next 3 years between a range of 4%-6% per annum underpinned by steady domestic demand, stable job market and solid economic fundamentals. Challenging external environment however could posed a risk for the estimate.

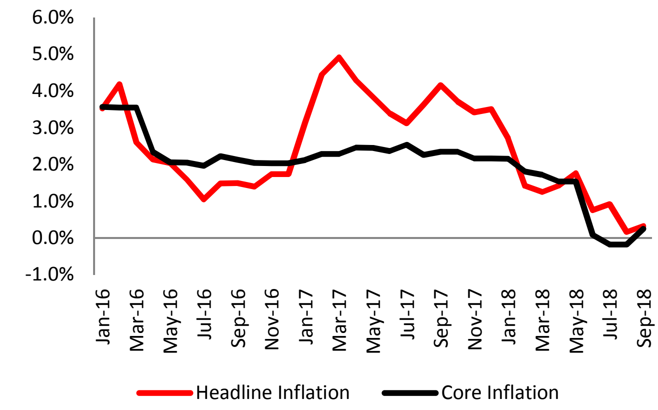
Inflation matched our forecast. Consumer price index increased 0.3%yoy in Sep-18, marginally higher than 0.2%yoy recorded in the preceding month and in line with our expectation. The trivial increase was anticipated as SST returns in Sep-18. However, inflation rate still remain below 1% for the fourth consecutive month despite the reintroduction of SST, probably due to the significant impact of RON95 fuel subsidization. Transport prices increased but at a far slower pace of 0.3%yoy (2.1%yoy in Aug-18). Meanwhile, core inflation rebounded to a positive territory of 0.3%yoy after maintaining at deflationary level for the past two consecutive months. Looking ahead, Malaysia's inflation is expected to gradually increase in the upcoming months.

Chart 1: CPI: Headline vs Food & Non-food (YoY%)



Source: CEIC; MIDFR

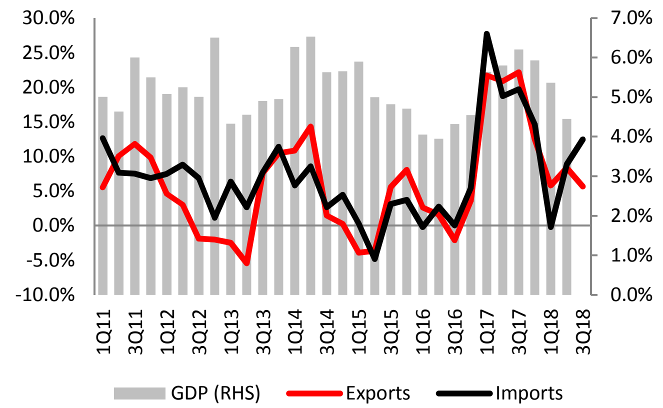
Chart 2: CPI: Headline vs Core (YoY%)



Source: CEIC; MIDFR

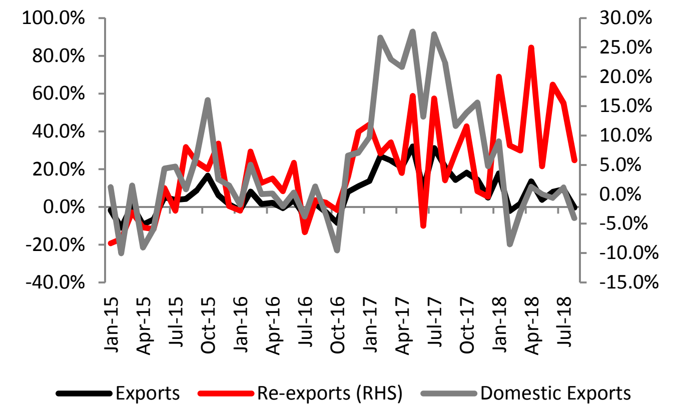
Exports growth turned negative. Exports growth in Aug-18 tumbled on both annually and monthly basis at 0.3%yoy and 5%mom respectively however value remains above RM80b. The fall was partly due to fewer working days as a result of Eid al-adha and Merdeka holidays besides weaker sectoral performances. Manufactured and mining goods grew lesser at 1.8%yoy and 5.5%yoy respectively compared to previous month's figures while agriculture worsened at -20.8%yoy. Despite fewer working days, August imports increased 11.2%yoy and 3%mom to a new high of RM80.2b. As exports still outperformed imports in terms of value, we managed to record a trade surplus of RM1.6b yet the lowest gain in 46 months.

Chart 3: External Trade vs GDP, (YoY%)



Source: CEIC, MIDFR

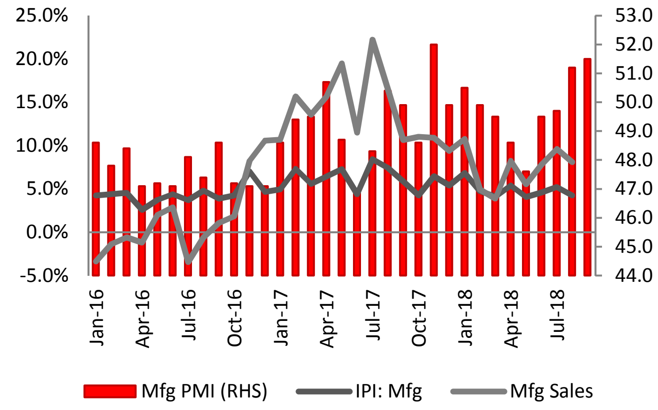
Chart 4: Total Exports: Domestic vs Re-exports (YoY%)



Source: CEIC; MIDFR

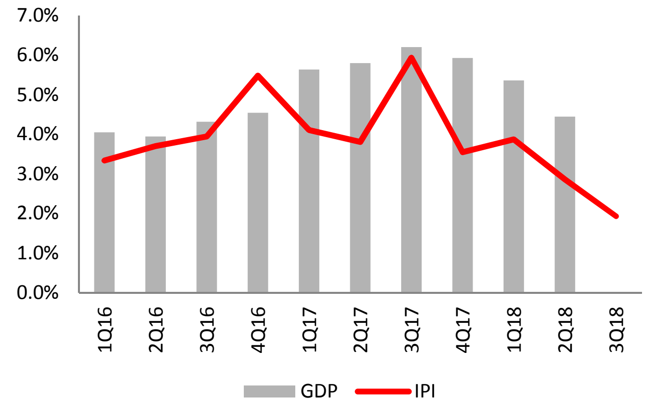
IPI growth matched our estimate. Malaysia's industrial production expands by 2.2%yoy in Aug-18, meeting our forecast but lower than market estimates of 2.5%yoy. By major components, manufacturing and electricity outputs were up 4.2%yoy and 4%yoy respectively while mining continues declining for 4-consecutive months. On monthly basis, mining output rose strongly by 5.7%mom underpin by rising global energy prices. Moderating trend in IPI performance is in tandem with the slowdown of Malaysia's external trade in Aug-18. Moving forward, we foresee IPI performance to expand at slower pace for the second half of 2018 amid escalating trade tension, declining business optimism and volatility risks in global commodity prices & currencies.

Chart 5: Manufacturing IPI & Sales (YoY%) vs PMI (Points)



Source: CEIC, MIDFR

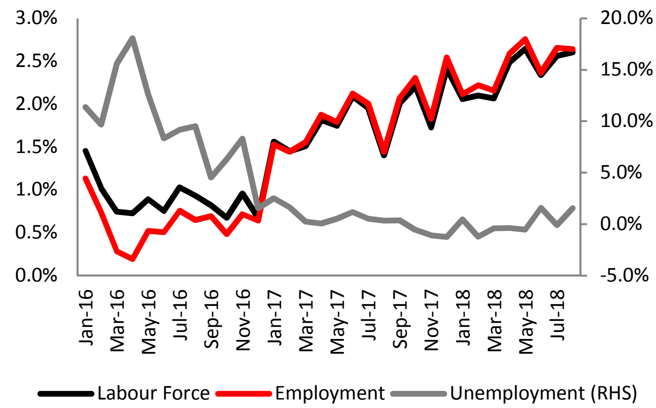
Chart 6: IPI vs GDP (YoY%)



Source: CEIC, MIDFR

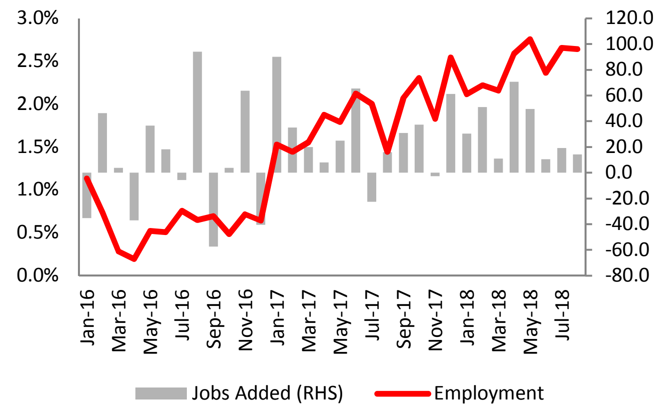
Labour market remains strong. Labour force expanded by 2.6%yoy to 15.4 million in Aug-18, higher than the previous month's figure. Employment growth slowed marginally to 2.6%yoy to 14.9 million in Aug-18 and jobs added in the economy registered at 14.1K during the month (19.2K in Jul-18), in line with external trade performances. Unemployment rate maintained at full-employment condition of 3.4% for the third consecutive month. Besides that, growths in both labour force and employment have been outpacing unemployment growth for the last 18-month since Mar-17.

Chart 7: Labour Market Key Indicators (YoY%)



Source: CEIC, MIDFR

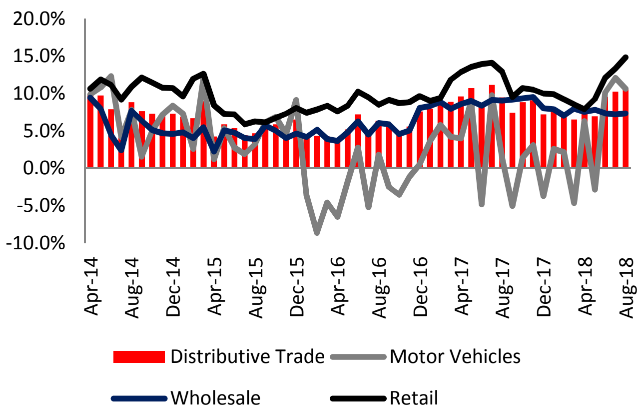
Chart 8: Jobs Added ('000) vs Empl. (YoY%)



Source: CEIC, MIDFR

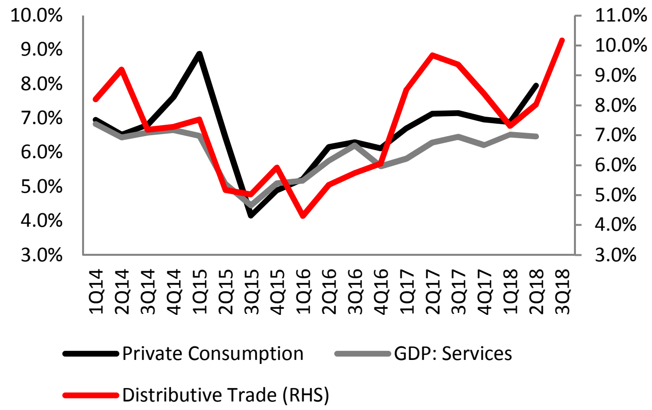
Wholesale and retail at new record high. Distributive trade rose by 10.7%yoy to a fresh record high of more than RM107b in Aug-18 as both wholesale and retail trade reached a new all-time high of RM50.9b and RM43.5b respectively. It is the highest growth since Aug-17 fueled by a ramp-up consumer spending as tax holiday period came to an end. In addition, motor vehicles continued to expand by 10.6%yoy to RM13.5b. On monthly basis, wholesale trade rebounded by 3.6% while retail sales grew at tepid pace of 0.1%. In contrast, motor vehicles sales dropped 2.8% after three consecutive months of positive growth despite the last month of tax holiday period. With the reintroduction of SST in Sep-18, we foresee a trivial decline in distributive trade during the month as consumers spending might experience a temporary transition shock.

Chart 9: Distributive Trade, DT (YoY%)



Source: CEIC, MIDFR

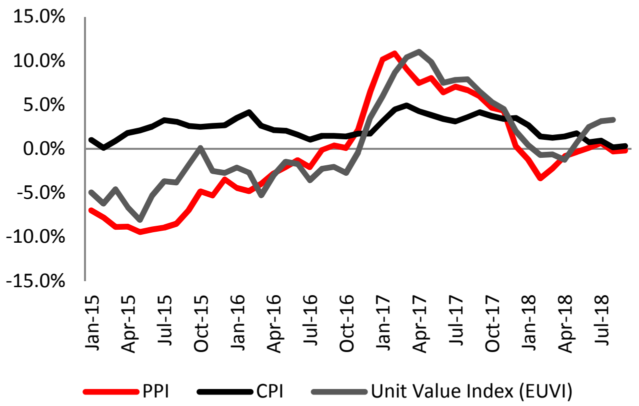
Chart 10: DT vs Private Consumption vs Services (YoY%)



Source: CEIC, MIDFR

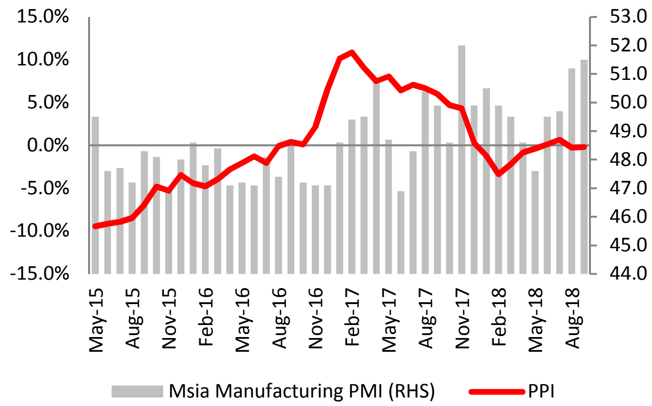
PPI continue to dip. Malaysia's producer inflation contracted for the second consecutive month at -0.2%yoy in Sep-18. Manufacturing sector which hold the largest weightage of total PPI basket at 81.6% dragged the overall PPI as it continued to decline at 1.7%yoy. In addition, agriculture, forestry & fishing contracted further by 16.4%yoy. Meanwhile, mining input prices remain strong, soaring by 28.9%yoy, the sixth consecutive month of double digit growth since Apr-18. Looking ahead, we foresee overall PPI will rise modestly following pick-up in global crude oil prices and implementation of SST.

Chart 11: PPI vs CPI vs Import Unit Value Index (YoY%)



Source: CEIC, MIDFR

Chart 12: PPI (YoY%) vs Manufacturing PMI (Points)



Source: CEIC, MIDFR

Table 1: Macroeconomic Data Updates

(YoY%) Unless Stated Otherwise	2016	2017	2018^f	1Q18	2Q18	3Q18^f	4Q18^f
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	7.5	-	-	-	-
End of Unless States Otherwise	**2016**	**2017**	**2018^f**	**1Q18**	**2Q18**	**3Q18**	**4Q18^f**
Brent Crude Oil (Avg)	46.0	55.7	70.0	67.3	75.1	76.1	
Crude Palm Oil (Avg)	2,677	2,733	2,400	2,480	2,350	2,150	
USD/MYR (Avg)	4.15	4.30	4.00	3.92	3.95	4.10	
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

October 2018 Key Economic Events

1 Oct: China to cut import tariffs on wide range of products. China will cut import tariffs on textile products and metals, including steel products, to 8.4 percent from 11.5 percent, effective Nov. 1, the finance ministry said on Sunday. Beijing has pledged to take steps to increase imports this year amid rising tension with some of its biggest trade partners, such as the United States. Earlier in July, China reduced import tariffs on a range of consumer items including apparel, cosmetics, home appliances, and fitness products to fulfil pledges to further open China's consumer market.

3 Oct: Canada, U.S. reach new NAFTA deal. Canada and the U.S. have agreed on a new North American Free Trade Agreement, concluding an acrimonious 13-month negotiation that had hindered the Canadian economy and damaged relations between the two countries. They did not immediately release the full details on which the deal will ultimately be judged. The news that they have struck any kind of deal, though, means Prime Minister Justin Trudeau has achieved a long-sought goal: convincing U.S. President Donald Trump to preserve a trade accord Trump has repeatedly threatened to terminate.

7 Oct: China pumps $109 billion into economy as trade war against US bites on growth. China's central bank said on Sunday that it was cutting the reserve requirement ratios (RRRs) by one per cent from October 15 which will inject a net USD 109.2 billion in cash into the banking system, amid a deepening trade war with the US that has increased pressure on growth in the world's second-largest economy. The reserve cut, the fourth by the People's Bank of China (PBOC) this year, came after Beijing pledged to speed up plans to invest billions of dollars in infrastructure projects as the economy shows signs of cooling further.

8 Oct: IMF cuts its global growth forecasts, citing trade tensions between the US and its trading partners. The International Monetary Fund has cut its global growth forecasts as trade tensions between the U.S. and trading partners have started to hit economic activity worldwide. The IMF said the global economy is now expected to grow at 3.7 percent this year and next year — down 0.2 percentage points from an earlier forecast, according to the fund's latest World Economic Outlook report released on Tuesday.

18 Oct: Highlights of RMK11 midterm review. Malaysia today unveiled new economic forecasts and goals in its mid-term review of the five-year development plan covering 2016 to 2020. Here are the key targets and forecasts from the report (all are for 2016-2020 period, unless stated otherwise. .

19 Oct: China moves to lift confidence as economic growth hits weakest pace since 2009. China's economic growth cooled to its weakest quarterly pace since the global financial crisis, with regulators moving quickly to calm nervous investors as a years-long campaign to tackle debt risks and the trade war with the United States began to bite.

23 Oct: Trump eyeing a 10 percent middle-income tax cut plan. U.S. President Donald Trump, speaking to reporters at the White House as he left on a campaign trip to Texas, said on Monday his administration planned to produce a resolution within two weeks calling for a 10 percent tax cut for middle-income people. "We're putting in a resolution sometime in the next week or week-and-a-half, two weeks," Trump said. "We're giving a middle-income tax reduction of about 10 percent. We're doing it now for middle-income people".

31 Oct: 10 things to look out for in Budget 2019. The tone of Budget 2019 is expected to be one where the government keeps a tight lid on the purse strings, as it is down by some RM35bil due to unpaid taxes this year. On top of that, Pakatan Harapan has declared that the federal government debt stands at RM1.087 trillion and not RM686.8bil as stated by the previous government. Under the old government, the federal government's fiscal deficit for 2018 was projected at 2.8% of gross domestic product (GDP). The deficit, which is the shortfall between government revenue and spending, was expected to reduce until 2020.

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