12 March 2015

Malaysia

BNM 2014 Annual Report: Moderating growth with inflation closer to trend but current account balance to narrow further

- **BNM's growth projection shows that excluding imports, domestic demand is expected to still hold up well in 2015, mainly driven by private consumption (PCE) with greater contribution from Gross Fixed Capital Formation (GFCF) as net exports growth put a drag on growth. Real GDP is projected to be in line with the government's target of 4.5 – 5.5%**
- **CPI is projected to rise by only 2 – 3% this year (2014: 3.2%) as the central bank expects the moderating demand to contain the impact of GST while petrol prices to be lower than last year's level.**
- **Current account balance is expected to narrow to 2 – 3% of GNI or more than halved the balance recorded in 2014 (4.8% of GNI), as net exports of goods and services projected to be smaller this year. From savings-investment perspective, this is due to the much stronger growth GFCF which is expected to account for 27.7% of GNI in 2015 (2014: 26.4%) while gross national savings expected to come down further.**
- **Household debt-to-GDP ratio edged up to 87.9% (2014: 86.7%) as household debt continued to rise faster than nominal GDP despite having slowed down markedly last year.**
- **Given the lower GDP forecast, BNM expects fiscal deficits in absolute level has to be lower (RM37bn) than that presented by the government in its revised budget (RM38.5bn) if that 3.2% deficit ratio to GDP were to be achieved.**

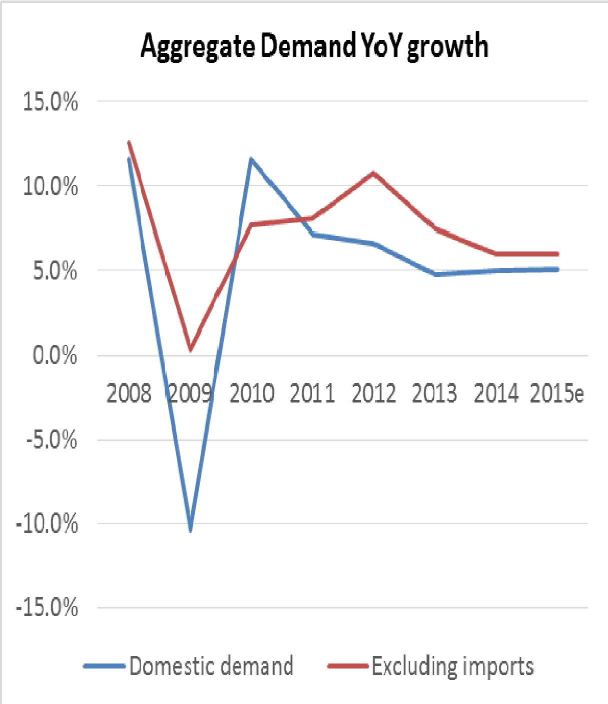
BNM's growth projection shows that excluding imports, domestic demand is expected to still hold up well. In its 2014 Annual Report released yesterday, BNM revealed its macro projections whereby it expects real GDP to be mainly driven by private consumption (PCE), which is expected to moderate but still relatively strong at 6.0%, contributing 3.2p.p. to the 5% mid-range growth projected by BNM (MIDFR estimate: real GDP - 4.7%, PCE - 5.7%). Meanwhile, Gross Fixed Capital Formation (GFCF) is expected to record faster growth of 7.6% (2014: 4.6%) as public investment expected to turn around to rise by 5.1% against a contraction of 4.9% while that of the private sector to ease to 9% (2014: 11%). GFCF is expected to add 2.1p.p. to growth, with 1.6 p.p. contribution to come from the private sector. Exports are projected to slow down to 3.0% while imports to pick up to 4.1% (2014: 5.15 and 3.4%, respectively), yielding smaller net exports of RM61.7bn (2014: RM66.9bn). As a result, that would put a drag on growth by subtracting 0.6p.p. off growth.

Table 1: Key macro numbers – MIDF and BNM projections

			2015e	
(YoY% unless otherwise stated)	2013	2014	MIDF	BNM
Real GDP	4.7	6.0	4.7	4.5 – 5.5
Government Expenditure	6.3	4.4	2.5	2.7
Private Consumption Expenditure	7.2	7.1	5.5	6.0
Gross Fixed Capital Formation	8.5	4.7	4.0	7.6
Exports of Goods & Services	0.6	5.1	2.5	3.0
Imports of Goods & Services	2.0	3.9	3.0	4.1
Net Exports	-12.6	19.7	-3.7	-7.8
Consumer Price Index	2.1	3.0	3.0 - 3.5	2.0 – 3.0
Current Account Balance - % of GNI	4.2	4.8	3.5	2.0 – 3.0
Fiscal balance - % of GDP	-3.9	-3.5	-3.2	-3.2

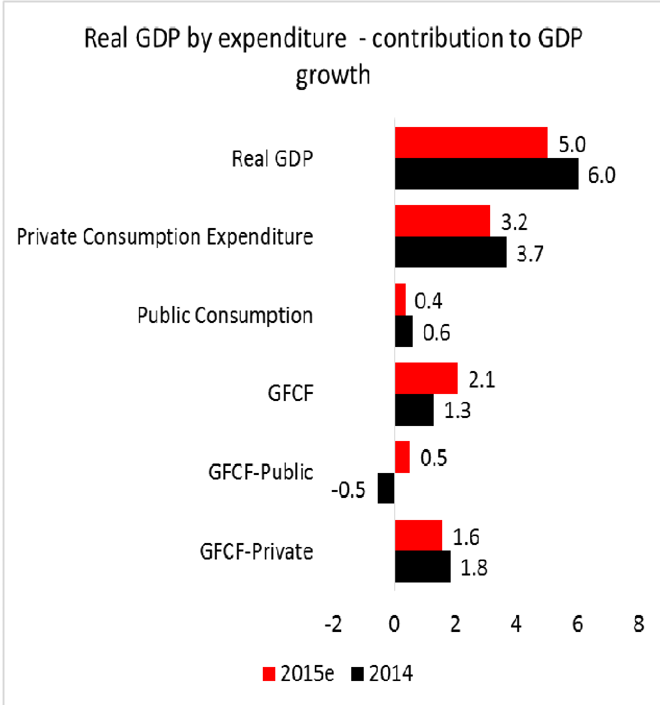
Source: BNM, MIDFR

Chart 1: BNM expects domestic demand to continue to be robust..



Source: BNM

Chart 2:..as net exports expected to shave off growth



Source: BNM

Our forecast of 4.7% real GDP growth for 2015 assumes a much more moderate domestic demand and much weaker exports growth but the much lower imports as a result of the greater easing in domestic demand would relieve the pressure on net exports. BNM projections revealed domestic demand excluding imports to continue to post strong growth of 6% yoy in 2015.

CPI is projected to rise by only 2 – 3% this year (2014: 3.2%) but we think this is rather too low. We believe, given the resilient domestic demand, the upward pressure on prices should be significant. Our own estimation showed that CPI should be around 3.0 – 3.5% assuming fuel prices to stay stable at current level of RM1.90. That was on the back of the assumption that oil prices to rebound slightly to US$60 – 70p.b. At the same time, we believe that the likely sustained strength in domestic demand would entice businesses to continue charging much higher prices on GST factor. We expect the impact of GST should add on about 2.00 – 2.50 p.p. to the current CPI at 1.00%.

Current account (CA) balance is expected to narrow to 2 – 3% of GNI or more than halved the balance recorded in 2014 (4.8% of GNI), as net exports of goods and services is projected to be much smaller this year. From savings-investment perspective, this is due to the much stronger growth GFCF which is expected to account for 27.7% of GNI in 2015 (2014: 26.4%) while gross national savings expected to come down further to 29.8% of GNI (2014: 30.9%). BNM expects the deterioration to come from the Goods balance, recording a 25% drop to RM94.2bn in 2015 (2014: RM125.06bn), while that of Services balance to continue to contract but at a slower pace by RM16.4bn (2014: -RM20.5bn) and the Income balance to contract slightly deeper by RM56.4bn (2014: -RM55bn). Overall that would yield a current account balance of RM 21.4bn - more than halved the level of RM49.5bn recorded last year.

We were looking at CA balance of 4.0% of GNI, which is already deterioration from the ratio of 4.8% of GNI in 2014, as we expect GFCF to slow rather than to pick up. Our prognosis is not solely based on the expectation of the pullback in oil and gas investments, rather, we have to bear in mind that the manufacturing sector is also moderating in line with China's slowdown and that would affect investments too. The weaker Ringgit and the GST could also act as the dampener.

The expectation of further deterioration in the current account balance to 2 – 3% of GNI may be viewed negatively by the market. Bear in mind that the overall balance of payments depends on the performance of our Capital and Financial accounts. If there is continuous net outflows, that would imply our FX reserves to come down further. It stood at RM386.0 billion (USD110.5 billion) as at 27 February 2015 after recording a decline of RM36.6bn over the course of 2014. While this is sufficient to finance 7.9 months of retained imports; its coverage on short-term debt is getting smaller at 1.1 times the short-term external debt as per BNM new definition of external debt. If based on old definition, that would be around 2.5x short-term debt – significantly lower than 3.7x at the end of 2013.

Household debt-to-GDP ratio edged up to 87.9% (2014: 86.7%) as household debt continued to rise faster than nominal GDP despite having slowed down markedly last year. The Financial Stability report that always accompanies the Annual Report revealed that household debt as a ratio to GDP soared higher despite the much faster real GDP growth, to 87.9% from 86.7% in 2014. That was due to the fact that household debt growth, while had been trending lower, was still faster at 9.9% than that of nominal GDP growth at 8.4%. On the other hand, the household financial assets to debt ratio went down to 2.1x from 2.2x. More notably, the household liquid financial asset to debt ratio stood at 1.5x; down from 1.59x in 2013.

Given the lower GDP forecast, BNM expects fiscal deficits in absolute level has to be lower (RM37bn) than that presented by the government in its revised budget (RM38.5bn) if that 3.2% deficit ratio to GDP were to be achieved. The government's revised budget deficit projections put the deficit at 3.2% of GDP– a small ratio despite the bigger deficits projected at RM38.5bn (old budget: RM35.7bn). That was due to the fact that the assumption on nominal GDP had not been revised in tandem. BNM mid-range forecast puts nominal GDP to rise by 5.4% (2014/2015 Treasury projection: 9.0%) If the deficits in absolute level at RM38.5bn to be maintained as what was given by the Treasury, based on BNM's projection for nominal GDP for 2015 at RM1,127.4bn, that deficits should account for 3.4% of GDP instead of the 3.2% estimate.

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