17 November 2014

MALAYSIA

Robust consumption underpinned real GDP growth in 3Q 14 but external position deteriorated

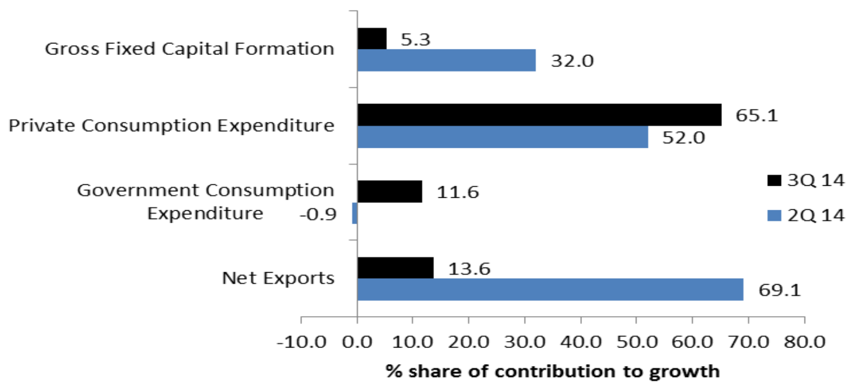
- **Real GDP growth at 5.6% in the 3Q14 was still robust considering that 2Q14 growth was revised upwards to 6.5%. While we view this positively, we note that much of the growth was driven by mainly Consumption while total Gross Fixed Capital Formation (GFCF) or Fixed Investment growth slumped to just 1.1% during the quarter – the slowest since 3Q09.**
- **Net exports still adding positive contribution to real GDP growth but this was on the back of weak Imports as Exports growth was also very weak (2.8% VS 8.8% in 2Q14).**
- **We expect Consumption would inevitably have to come down and with the expected moderate rebound in GFCF, growth is likely to trend lower closer to its potential of 4.5 – 5.0% in 2015.**
- **Our external position deteriorated, with the Current Account in the 3Q14 stood at 2.95 of GNI (2Q14: 6.3%) and the overall Balance of Payment declined by RM6.7 billion on Portfolio outflows while external debt edged up to 68.7% of GDP during the quarter (2Q14: 67.7%)**

Consumption-driven growth.. Private Consumption Expenditure grew at a faster rate of 6.7% during the quarter (2Q14: 6.5%) despite the already high base in the same period last year, contributing 66% or 3.6 percentage points (p.p.) to the 5.6% growth. Together with Public Consumption which rebounded from a contraction in the 2Q 14 to post a growth of 5.3% during the same period, Final Consumption Expenditure explained 77.7% of the growth recorded for the quarter.

..as Fixed Investment slumped. Gross Fixed Capital Formation (GFCF) slumped to post a meagre growth of 1.1% during the quarter (2Q14: 7.2%) – the slowest since 3Q 2009. It added just 0.3p.p. to the 5.6% growth. The dismal performance was led by the decline in spending on machinery and equipment by 7.5% during the quarter (2Q14: 9.1%) although growth in spending on structures rebounded to 8.3% (2Q14: 6.7%). While we expect that the slowdown is rather brief and the pace will rebound in the coming quarters, but the main driver will continue to be that in structures as spending on machinery and equipment will likely be rather modest in line with the cooling off in the Manufacturing sector.

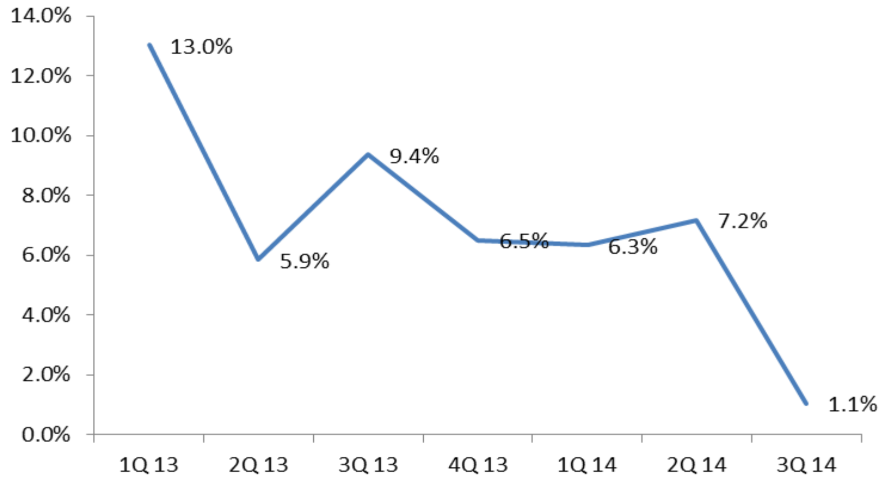
Net Exports no longer main driver, but still a small positive contribution. It contributed 13.6% or 0.8p.p. to growth during the quarter, as compared to being the main driver last quarter with 69.1% contribution. Despite the fact that the still positive net exports growth, the weak Exports growth poses a concern and with Imports also weak, it may indicate that Exports is in for a downtrend.

Chart 1: Consumption-driven growth



Source: Department of Statistics

Chart 2: The sharp slowdown in the Gross Fixed Capital Formation may be short-lived but rebound is likely to be modest thereafter



Source: Department of Statistics

By sector, Services growth remained firm but Manufacturing showed deceleration. Services grew by 6.1%, not much change from the previous quarter's pace of 6.2% and that was in line with the string Consumption spending during the quarter and retained its role as the main driver of growth. Nonetheless, the Manufacturing sector took a breather during the quarter, expanding at a slower pace of 5.3% (2Q14: 7.3%).

Table 1: Real GDP by Expenditure – YoY% changes

	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14
Government Expenditure	0.6%	11.9%	7.8%	5.2%	12.3%	-0.5%	5.2%
Private Consumption Expenditure	6.4%	6.8%	8.0%	7.4%	7.1%	6.5%	6.7%
Gross Fixed Capital Formation	13.0%	5.9%	9.4%	6.5%	6.3%	7.2%	1.1%
Exports of Goods & Services	-3.4%	-4.4%	4.6%	5.7%	7.9%	8.8%	2.8%
Imports of Goods & Services	-2.2%	-1.3%	4.2%	7.1%	7.1%	3.9%	2.2%
Net Exports	-12.9%	-37.1%	9.9%	-6.8%	14.9%	91.0%	11.4%

Source: Department of Statistics

Table 2: Real GDP by Sector

	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14
Agriculture	6.2%	0.3%	2.0%	0.2%	2.3%	7.1%	4.0%
Mining	-1.4%	4.4%	1.4%	-1.2%	-0.8%	2.1%	1.4%
Manufacturing	0.4%	3.8%	4.3%	5.2%	6.8%	7.3%	5.3%
Construction	14.2%	10.0%	10.2%	9.8%	18.9%	9.9%	9.7%
Services	6.1%	5.0%	6.0%	6.4%	6.6%	6.2%	6.1%

Source: Department of Statistics

Our external position deteriorated. Our Current Account balance surplus narrowed to RM7.6 billion during the quarter from RM16.0 billion on the back of smaller Goods balance and widening deficits in Services and Income accounts. As a percentage of GNI, the Current Account stood at only 2.9% against 6.3% in the preceding quarter.

Financial Account improved but still negative, Portfolio outflows led to the drawdown in FX reserves. The Financial Account deficits narrowed to RM2.8 billion from a deficit of RM11.8 billion and although the net FDI rebounded to RM 2.1 billion from a deficit of RM4.4 billion, Portfolio account recorded a bigger outflow of RM11.0 billion after recording an inflow of RM6.9 billion in the preceding quarter. The overall Balance of Payments worsened to show a further drawdown in FX reserves by RM6.7 billion during the quarter (2Q 14: -RM1.0 billion). The Financial Account

Short-term external debt continued to edge up, causing total external debt to swell. While total external debt rose by only RM11.3 billion, short-term debt edged up by RM20.3 billion to RM283.5 billion from the 2Q14 level. That caused the share of short-term debt to total external debt to rise to 49.1% from 47.6% in th preceding quarter. FX reserves which stood at RM416.9 billion is just enough to cover 1.2x of the short-term debt and while the old definition may show a better picture, the ratio actually declined to just 2.8x compared with the norm of 3.0 – 3.5x in recent years.

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