04 December 2015

MONTHLY ECONOMIC REVIEW | November 2015

Inflation Expectation Revised due to Low Oil Price

- *The economy is expected to slow down further particularly due to weak private consumption in the coming quarters. However, the rebound in exports performance are giving hope of a better economic performance in year 2016, particularly beginning the second half of 2016.*
- *Inflationary pressure continues to be capped by low oil price, and the likelihood of oil price to rebound above $50 per barrel without OPEC cutting its production remains low. We are revising down our inflation forecast for year 2016 to 2.90%, due to the slower than expected recovery in the oil price.*
- *The possibility of a cut in interest rate for year 2016 heighten, as the barrier for a rate cut previously – possible further weakening of Ringgit – has started to diminish. If the private consumption remains weak until the third quarter of 2016, there is a possibility of a rate cut in the second half of 2016. However, for now we are not expecting any change in the interest rate for year 2016.*

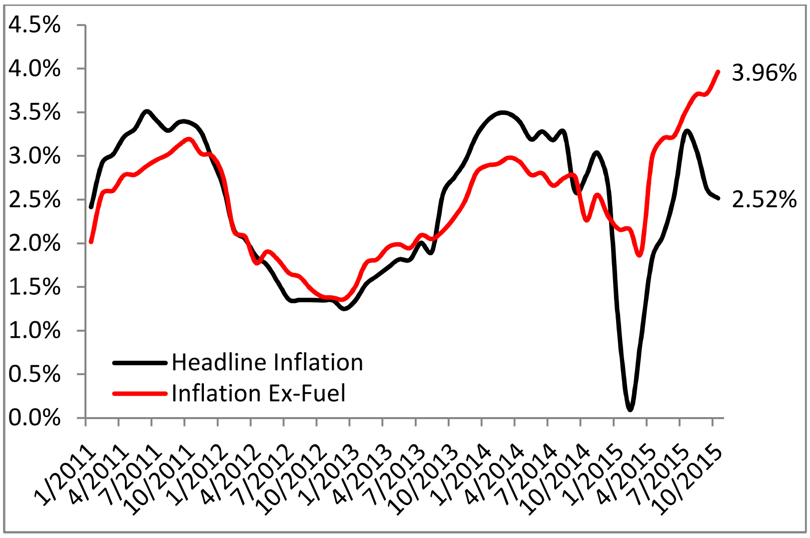
GDP growth is within our expectation for 3Q15. GDP growth in the third quarter moderated to 4.7%yoy, slightly lower than our forecast of 4.8%yoy although the figure is still within our expectation. This is slightly lower than GDP growth in 2Q15 at 4.9%yoy and significantly lower than GDP growth in 3Q14 at 5.6%yoy. Most of the movements in the GDP components are in line with our expectation. Private consumption moderated, investment experienced a rebound relative to the second quarter while net exports make a positive comeback after contracted by double digit figures in the first half of 2015. On a seasonally adjusted basis, GDP grew by 0.6%qoq in 3Q15, lower than the growth in the 2Q15 by 1.1%qoq.

Malaysia's leading indicator remains in negative territory on year-on-year basis. Malaysia's leading indicator contracted by 0.34%yoy in September, after declining by 0.68%yoy in August. From July to August, Malaysia's leading indicator contracted by 0.37%yoy, the first time that the leading indicator in contraction for a 3-month average since the global financial crisis. However, it is likely that the leading indicator will begin to rebound from here onwards; as Malaysia's economic performance has been improving particularly with our exports performance. Despite that, the lower leading indicator in recent months is pointing to a lower GDP growth in the coming quarters, where we are expecting the 4Q15 GDP growth to come at 4.6%yoy.

Industrial production grew by 5.1%yoy in September. IPI came in at 5.1%yoy in September, beating all of the economists' forecasts in Bloomberg with a median of 3.0%yoy. All major sub-indices had a positive growth, led by manufacturing index which grew by 5.5%yoy. On a seasonally adjusted basis, IPI had its highest month-on-month growth in September with 2.4%mom, the highest increment in 17 months. Due to the improvement in our exports performance, we are expecting that IPI will continue to grow above 5.0%yoy in the coming months.

Trade balance remains high at RM9.7 billion in September. Both Malaysia's exports and imports surged in September with exports passed the RM70 billion mark to reach RM70.2 billion (8.8%yoy) and imports increased to RM60.5 billion (9.6%yoy) in September. The increase in both exports and imports value could be contributed to the weakening of Ringgit and recovery in global trade activity as can be seen in most country's trade data for September. Despite the higher increase in imports on year-on-year basis, trade balance remains sizable at RM9.7 billion.

Chart 1: YoY Inflation



Source: DoS, CEIC, MIDF Research

Inflationary pressure begins to stabilise, though there is no guarantee that it remains so in the coming months. On year-on-year basis, consumer price index rose by 2.52%yoy, close with our expectation of 2.60%yoy. Food and non-alcoholic beverages (FNAB) index grew by 4.67%yoy, the highest increment on year-on-year basis for 45 months, contributing 58.2% of the increment in CPI. Due to the large difference for the pump price on year-on-year basis i.e. RM2.30/litre in October 2014 against RM2.05/litre in October 2015, transportation index contracted by 5.74%yoy, where the fuel and lubricating sub-index contracted up to 10.81%yoy. The impact of toll price hike is yet to be seen in the October figure, probably due to the data collection being conducted prior to the price hike. As such, higher inflationary pressure may continue to persist in the coming months.

Sentiments on Ringgit recover after 1MDB successfully sold its Edra unit. Tan Sri Zeti, BNM's governor has been reiterating that the current value of Ringgit is caused by negative sentiments rather than the fundamental factors, reflecting that the current value of the Ringgit is undervalued. All this while, the question is more on what can cause the negative sentiments to recede, and it seems like the latest development where 1MDB successfully finish its first step of its debt rationalisation plan seems to bring Ringgit closer to its fair value. There are two more strategies in its debt rationalisation plan, namely the sale of at least 60% of 1MDB's equity stake in the Bandar Malaysia project and a debt-for-equity swap exercise with Abu Dhabi's International Petroleum Investment Co (IPIC), which is expected to be done in the middle of next year. We are expecting that the gap between Ringgit and its fair value would continue to contract as the debt rationalisation plans continue.

November Key Economic Events

5 Nov 2015: TPPA full text made public. Our overall assessment of the final TPPA text is that most of the main concerns raised by the public have been tackled for. There should be no significant increase in the medical cost and Bumiputra's economic interest has also been protected. Pension funds, sovereign wealth fund, PNB and Tabung Haji have been carved out from the SOE's ruling under TPPA.

19 Nov 2015: China cuts its standing lending facility. The overnight lending rate on its SLF, to banks has been cut from 4.50% to 2.75%. PBOC also lowered down the seven-day bank-loan rate to 3.25%, from 5.50%. We do not think that China's banks will be lending more simply due to the rate cuts.

21 Nov 2015: KL Declaration. The KL Declaration marks the beginning of Asean Community, which comprises of three core pillars, namely the Asean Political Security Community (APSC), Asean Economic Community (AEC) and Asean Socio-Cultural Community (ASCC). However, the success of the Asean Community lies with the people, the governments need to play a vital role in promoting the idea of Asean Community

23 Nov 2015: 1MDB sold its Edra unit. 1MDB sold all of its energy assets worth 9.83 billion ringgit ($2.3 billion) to China General Nuclear Power (CGN). The transaction will be done in cash and CGN will assume all gross debt and cash of Edra. Ringgit rebounded to RM4.21/USD two days after the announcement. It seems that the market perceive 1MDB successfully rationalise its debt as a positive development, and that the impact of negative sentiments on Ringgit recede because of that.

27 Nov 2015: Japan to roll out additional stimulus spending. The stimulus will include support for rural areas hit by the Trans-Pacific Partnership free-trade deal, and cash payouts to low-income groups to spur private consumption. Japan would also increase spending on social programs and raise the minimum wage. The government would give cash handouts to the elderly poor, and build child-care and elder-care facilities to help people enter and stay in the workforce, as part of a stimulus package expected to cost at least ¥3 trillion ($24 billion). As usual, we are not expecting much from the government's stimulus except for a temporary impact.

Yearly Forecast

(YoY%) unless stated otherwise	2014	2015f	2016f	2017f
Real GDP	6.0	5.0	5.0	5.2
Private consumption expenditure	7.1	6.5	6.8	7.0
Government expenditure	4.4	5.2	4.2	4.0
Gross fixed capital formation	4.8	3.0	3.2	3.8
Exports of goods and services	5.1	1.5	3.4	3.1
Imports of goods and services	4.2	1.0	3.8	3.5
Net exports	12.8	5.1	0.6	-4.3
Consumer price index	3.2	2.1	2.9	3.1
Fiscal balance - % of GDP	-3.5	-3.5	-3.3	-3.0
Federal government debt - % of GDP	53.2	54.0	53.8	53.0
USD/MYR – Year End	3.497	4.500	4.200	3.800
Overnight policy rate (%)	3.250	3.250	3.250	3.200

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