

## MONTHLY ECONOMIC REVIEW | OCTOBER 2015

### Forecasts Updated Upon Budget Revelations

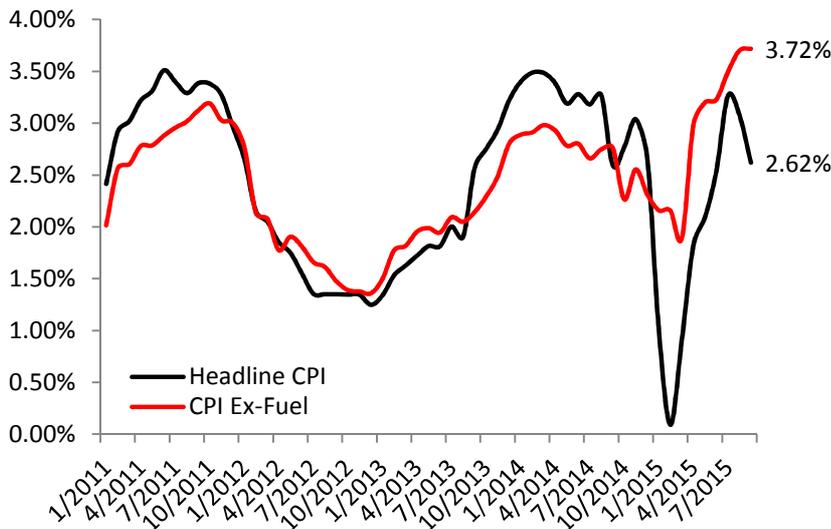
- *Overall, most of the indicators are showing the likelihood that the third quarter economy will be slightly better than our initial expectation. Currently we are expecting that the economy will grow by 4.8% in 3Q15 and will go lower to 4.6% in the 4Q15, leading to an overall real GDP growth of 5.0% in 2015.*
- *Inflationary pressure will continue to be capped by lower pump price relative to last year, although that situation will most likely reverse in January and February 2016. We are expecting inflation will come at 2.60% in October and 2.35% in November 2015.*
- *Interest rate is most likely to remain at 3.25% throughout 2016, although there will be a pressure to increase the rate if the inflation persists at a higher pace and/or if the US tightened its monetary policy at a faster pace than expected. However, BNM may only consider increasing the rate if the economy begins to show promises of stabilisation.*

**Malaysia's leading indicator 3-month moving average was flat in August.** Malaysia's leading indicator contracted by 0.17%yoy, making it the second time this year that the indicator went into the negative territory after May 2015. However, the 3-month moving average was flat at 0.34% since July. As the leading indicator has been able to forecast the direction of the economy quite precisely for two quarters ahead, we could expect that the economy will most likely remain below 5.0% growth until 1Q16.

**Industrial production index fell to 3.0% in August.** IPI fell to 3.0% in August, after surging to 6.1% in July. However, there is nothing alarming on the gap of the two figures, as the height of July was due to the temporary slowdown in July 2014 for natural gas production, while the low figure in August 2015 was also due to the transitory slowdown in natural gas production, despite the production returned to normal level in August 2014. On average, the two months are still growing by 4.55%, slightly above the 4.33%yoy IPI growth in 2Q15.

**Trade balance surged to RM10.8 billion in August.** Malaysia's merchandise exports surged to RM66.5 billion in August 2015 from RM63.2 billion in July 2015 and RM63.9 billion in August 2014, which translates to a growth of 5.2%mom and 4.1%yoy. On the other hand, imports declined to RM56.3 billion in the same month, leading to a contraction in imports value by 7.4%mom and 6.1%yoy. We believe the sharp increment in exports and the decline in imports were due to the significant depreciation of Ringgit for the month. As Ringgit went lower in September, we are expecting the trend will continue, possibly leading to a positive balance of goods and services growth in the third and fourth quarter this year after two successive year-on-year contraction in the first two quarters this year.

**Chart 1: YoY Inflation**



Source: DoS, CEIC, MIDF Research

**Inflationary pressure continues to be capped by pump price.** Headline CPI grew by 2.62% in September, due to the lower pump price in September 2015 relative to September last year. If the pump price is being taken out of the basket, the CPI actually grew by 3.72%, the highest since global financial crisis. However, due to the high pump price in fourth quarter last year, we would expect that the CPI will continue to remain low in the coming months i.e. 2.60% in October. As a side note, from our analysis, we would expect that the recent toll hike will cause a one-off inflationary pressure of approximately 40 basis points. However, as the toll hike was conducted in the middle of October, the increase in price may be seen partly in the October CPI figure and partly in November.

**As expected, there was no rate hike in October FOMC meeting, however a rate hike in December is very likely.** The Fed was of the opinion that the economy is growing moderately, with the economy growing in line with our expectation by 1.5% in the third quarter 2015. Although the inflation will remain low for quite some time, at least below the 2% level target by the Fed which was set previously by Ben Bernanke, both the US domestic economy and labour market is relatively healthy. Inflation targeting was conducted by central banks as conventional wisdom is saying that by having price stability, both the economy and employment level will remain healthy. Currently both the economy and the labour markets are healthy, hence it is a question of whether the Fed will still focuses on the inflation rate or will look more at the overall economy and labour market condition. We reiterate our expectation that the Fed will conduct an interest rate hike in December meeting with 25 basis points.

**China's economy grew by 6.9% in the third quarter according to the authority.** There are a lot of economists being sceptical with China's GDP figure, particularly as it came just slightly below the 7.0% target. Although we are also sceptical with the 6.9% growth figure, from our analysis, China's GDP would still be growing around 6-7% level. This is because although there was a contraction in China's exports, the reduction in its imports were significantly bigger. This leads to an all-time high of China's trade balance year to date, where it approximately grew by \$196 billion (+85%yoy) relative to the same period last year. Combined with the rebounding consumer consumption data, it is plausible that the two factors are sufficient to cushion the pullback coming from the slowdown in industrial and investment sectors of the economy.

## October Key Economic Events

**5 Oct 2015: US and 11 other countries reach landmark Pacific trade pact.** There are still a number of obstacles for the trade pact to proceed. However, in the event that the trade pact continues, it should be beneficial for Malaysia as currently most of our competitors for commodities are not in the pact.

**23 Oct 2015: China loosens its monetary policy.** China cut its lending and deposit rate by 25 basis points to 4.35% and 1.50% respectively in trying to achieve the 7% growth target. The PBOC has also lift the cap on deposit rate in order to let the banks become more competitive.

**26 Oct 2015: Indonesia intends to join TPPA.** It seems that Indonesia was uncomfortable with the idea that the TPPA deal has been concluded and they are not in the pact. Despite their intention, it would take some significant change in their policy in order for them to fulfil the TPPA standards.

**15 Oct 2015: Malaysia toll hike.** From our analysis, we are expecting that the recent toll hike will lead to an approximately 0.40% one-off increase in the CPI. Historically, a toll hike in urban area will lead to higher increase in CPI compared to a toll hike in rural areas.

**23 Oct 2015: Malaysia Budget 2016.** The budget has three main objectives; i) continue with the fiscal consolidation, ii) pump-priming the economy due to uncertain economic condition and iii) looking after the citizens' welfare, particularly the low income group. The government is being pessimistic with the petroleum-related revenue but being quite optimistic with the GST collection.

**29 Oct 2015: China two-child policy.** Finally the Chinese government admits the fact that a one-child policy is not going to provide them with sustainable economic growth in the future. In 10-30 years' time, their working population will contract, dependency ratio will increase and economy will be slowing down as the current huge workforce quit the job market and being replaced with a significantly smaller workforce.

## 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	2.8	3.1
Imports of goods and services	4.2	1.0	3.8	3.5
Net exports	12.8	5.1	-4.1	0.1
Consumer price index	3.2	2.1	3.4	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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