

ECONOMIC REPORT | International Development**Brexit: A Long Term Strategic Move by UK**

- *The major idea is to expand Malaysia's penetration into larger markets via international trade and investment. We believe Brexit would have long-run positive impacts on Malaysia especially by having bilateral free trade agreement between the two economies to enhance more trade, investment and knowledge transfer.*
- *Due to Brexit, there are higher chances of UK to have direct free trade deals with China, US, India, Australia and Asian economies. Some may see Brexit is a protectionist move but yet some may see it is a strategic move in shaping a new UK's economic structure in particular the external sector.*
- *Malaysia could be future investment attraction point for UK. In addition, foreign direct investment flows between Malaysia and UK have been in upward trend. In 2016, FDI from UK to Malaysia recorded at RM5.2 billion while FDI from Malaysia to UK registered at RM3.3 billion.*

United Kingdom is to officially start the divorce process from European Union. EU referendum held last year in United Kingdom saw Leave campaign won at a slim margin. 51.9% voted for Leave while 48.1% voted for Remain. Today, Prime Minister Theresa May will trigger the Article 50 of the Lisbon Treaty to precede the Brexit process. The divorce process would take about 2 years and by 2019, UK will be no more member of European Union. Crucial issues to be negotiated among others are UK's exit bill worth £50 billion and single market re-entry rules and regulations. Brexit also means the exit of UK from European Economic Area (EEA) which comprises of EU economies plus Iceland, Liechtenstein and Norway. There are many consequences to face and also opportunities to explore for UK.

UK is one of the biggest economies among European Union members. UK is the second largest economy in the European Union community. UK contributes about 13.8% to the total GDP of European Union in 2015. The exit of UK would nullify the advantage being in the single market of EU, free movement of people, goods and services. In the short term, companies especially the multinational's might shift their operations and headquarters out of UK and to other parts of Europe. This could cost loss in jobs, affects income level, tax revenue and trade activity in the UK economy.

Brexit is not the end. International trade activity would be the best cushion for the UK economy to rebound and rise. Even though not a member of EU, UK could still applies to be a member of European Economic Area such as Norway and Iceland. Non-EU members should adhere and obey to the rules and regulations set by the union to remain in the EU single market. However, as mentioned earlier the re-entry negotiation is expected to be hard for UK. Despite of the break up with EU, UK has many opportunities to venture and explore especially by having more free trade deals with economies outside of Europe. Due to Brexit, there are higher chances of UK to have direct free trade deals with China, US, India, Australia and Asian economies. Some may see Brexit is a protectionist move but yet some may see it is a strategic move in shaping a new UK's economic structure in particular the external sector.

Malaysia may gain from Brexit. The proposed EU-Malaysia free trade agreement is still ongoing process but yet surrounded with pessimistic hope as geopolitical risks in the European region remains a dragging factor. In fact, uncertainties in the region is looming as several crucial EU elections are taking place this year and the results would have significant impact on the direction of EU in the future. On a flip coin, having a direct free trade deal with UK is beneficial for both UK and Malaysia. In 2016, 10.2% of Malaysia's total exports are exported to EU while only 1.1% to UK. Same as imports, 9.9% is from EU and 0.9% is from UK.

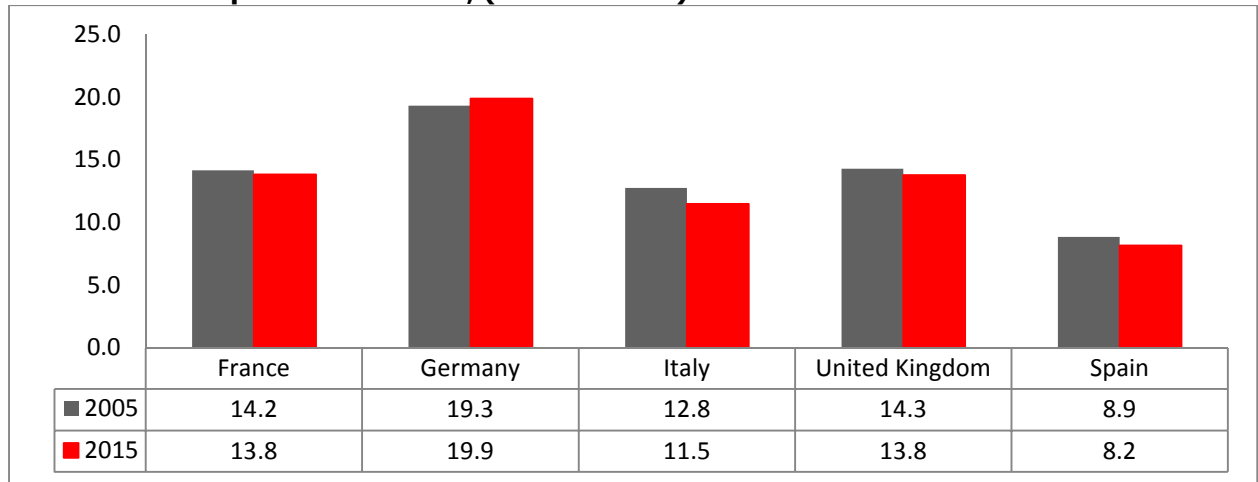
Expand trading market via bilateral trade agreement with UK. Both Malaysia and UK are searching for larger market for trading of goods and services. Despite of populism sentiment, international trade remains important for Malaysia as well as UK to explore further. Currently, most of exported goods to UK are machinery and transport equipment, followed by miscellaneous manufactured articles and manufactured goods. As for imported goods, more than half of them are machinery and transport equipment and chemicals goods. Besides, last year saw tourist arrival from UK reached 400,269 people and the arrival has been more than 400 thousands since 2009. Further strengthening relationship between Malaysia and UK would encourage more tourist arrival from UK and hence supporting and boosting our tourism industry and overall economy.

Malaysia could be future investment attraction point for UK. In addition, foreign direct investment flows between Malaysia and UK have been in upward trend. In 2016, FDI from UK to Malaysia recorded at RM5.2 billion while FDI from Malaysia to UK registered at RM3.3 billion. High value added, technological oriented and services sectors are some of the potential sectors of which can attract FDI from UK.

Brexit leads a new direction for UK economy. The separation of UK from EU may be seen as protectionist move, protecting and limiting the market access had by the UK before. However, Brexit can also be looked as a way of liberalizing the UK economy. It is not that the UK rejects the idea of free trade; it is more about changing and searching for a new trading game with better deals and larger market penetration. Malaysia as an open economy should take the advantage by connecting and have closer relationship with UK and as well as EU. The major idea is to expand Malaysia's penetration into larger markets via international trade and investment. We believe Brexit would have long-run positive impacts on Malaysia especially by having bilateral free trade agreement between the two economies to enhance more trade, investment and knowledge transfer.

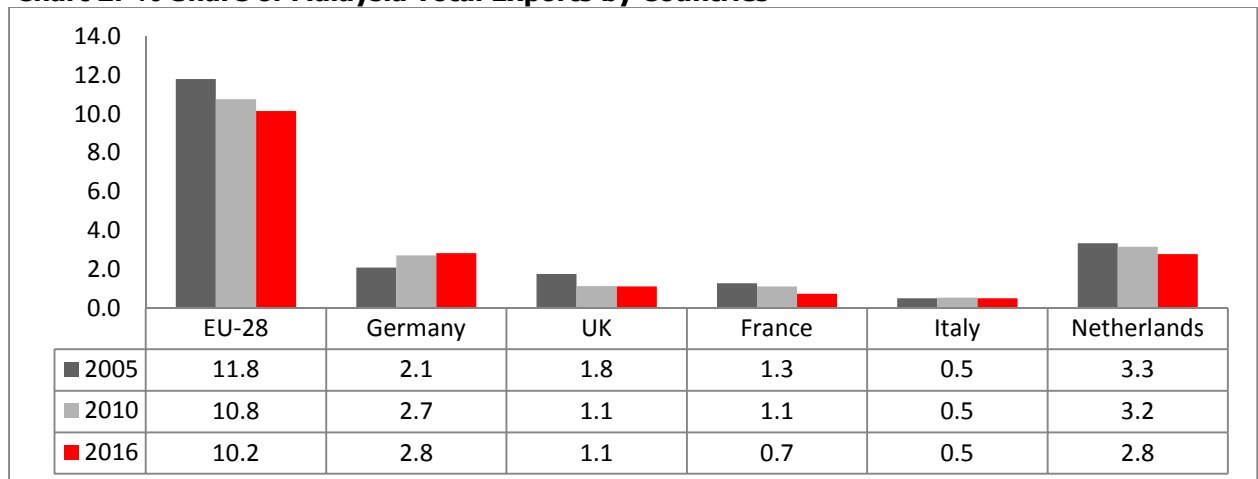


Chart 1: % of Top 5 EU Economies, (2005 vs 2015)



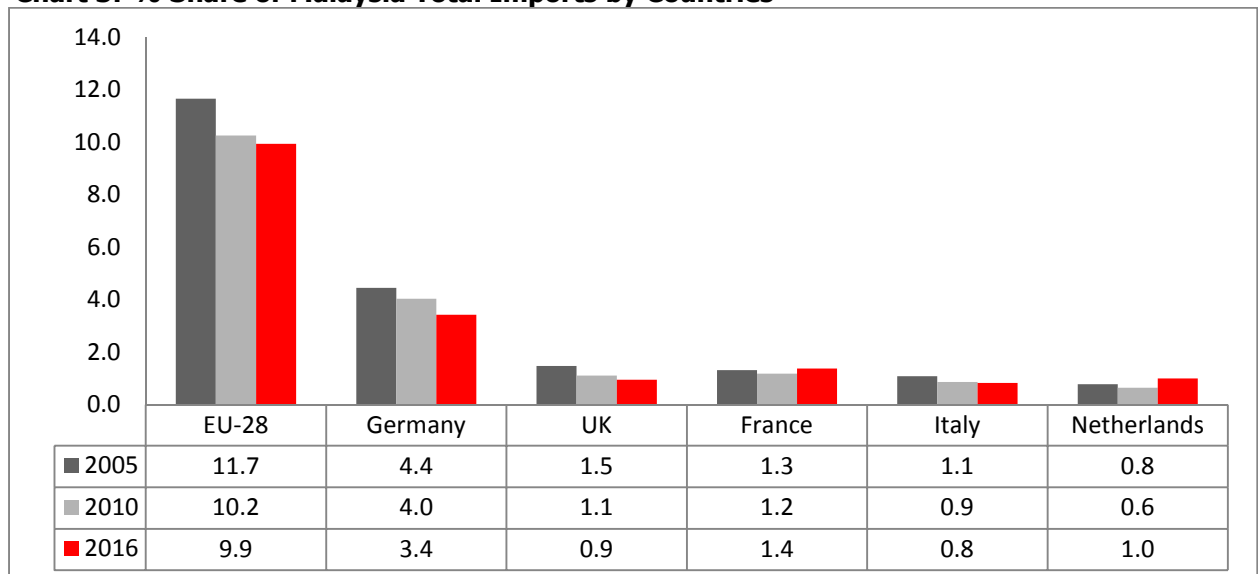
Source: CEIC, MIDFR

Chart 2: % Share of Malaysia Total Exports by Countries



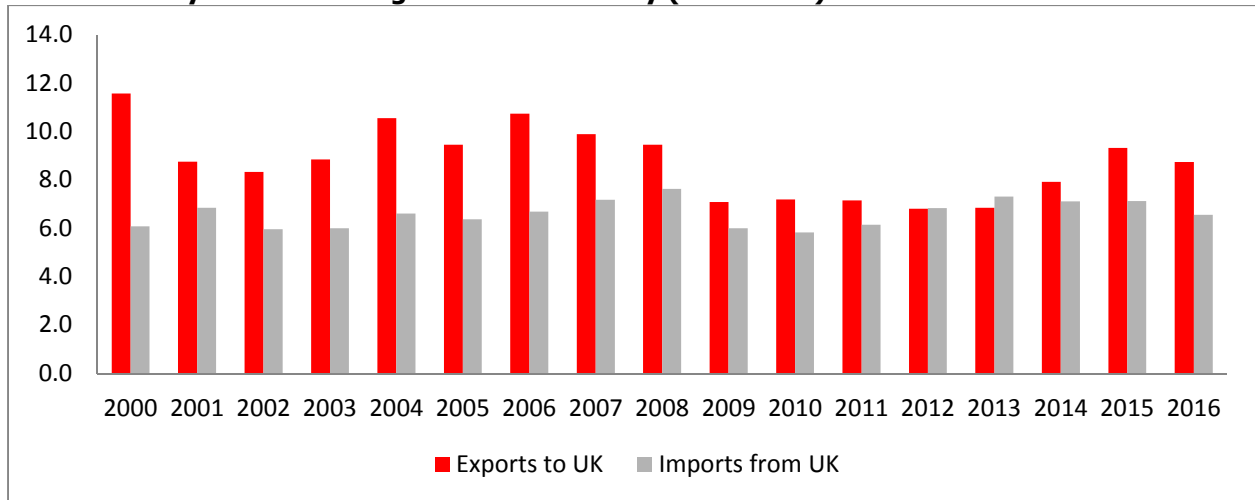
Source: CEIC, MIDFR

Chart 3: % Share of Malaysia Total Imports by Countries



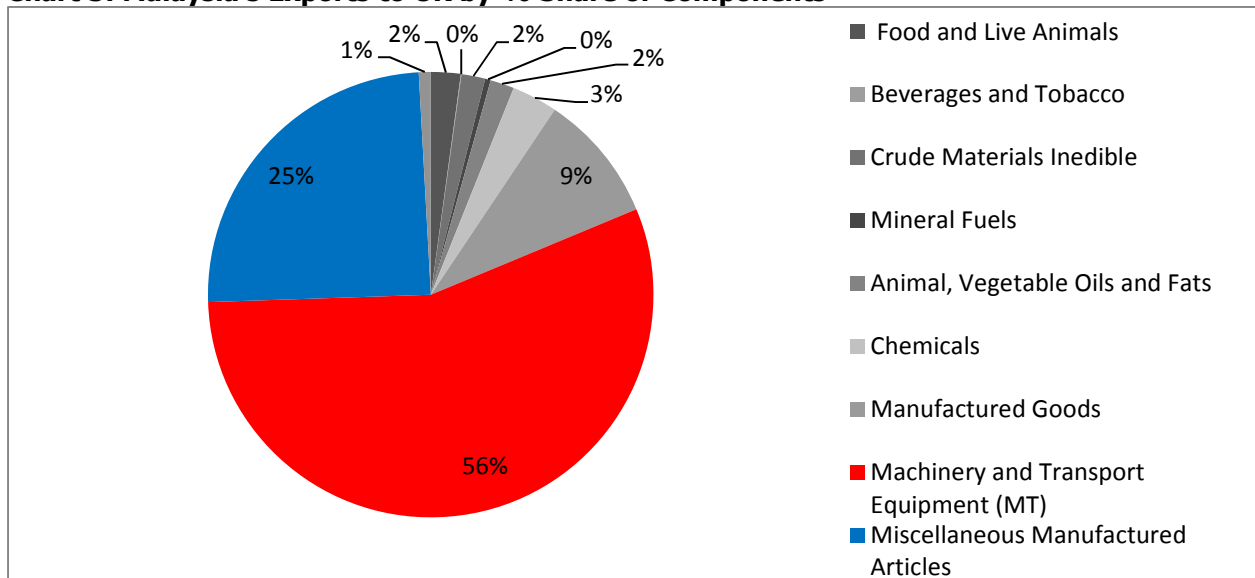
Source: CEIC, MIDFR

Chart 4: Malaysia-United Kingdom Trade Activity (RM Billion)



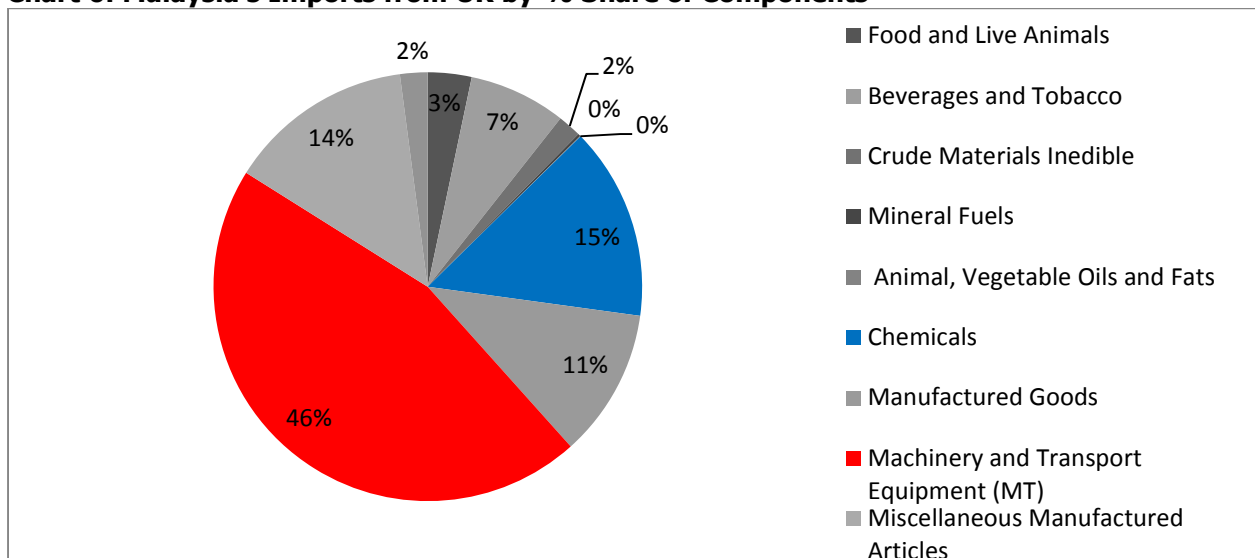
Source: CEIC, MIDFR

Chart 5: Malaysia's Exports to UK by % Share of Components



Source: CEIC, MIDFR

Chart 6: Malaysia's Imports from UK by % Share of Components



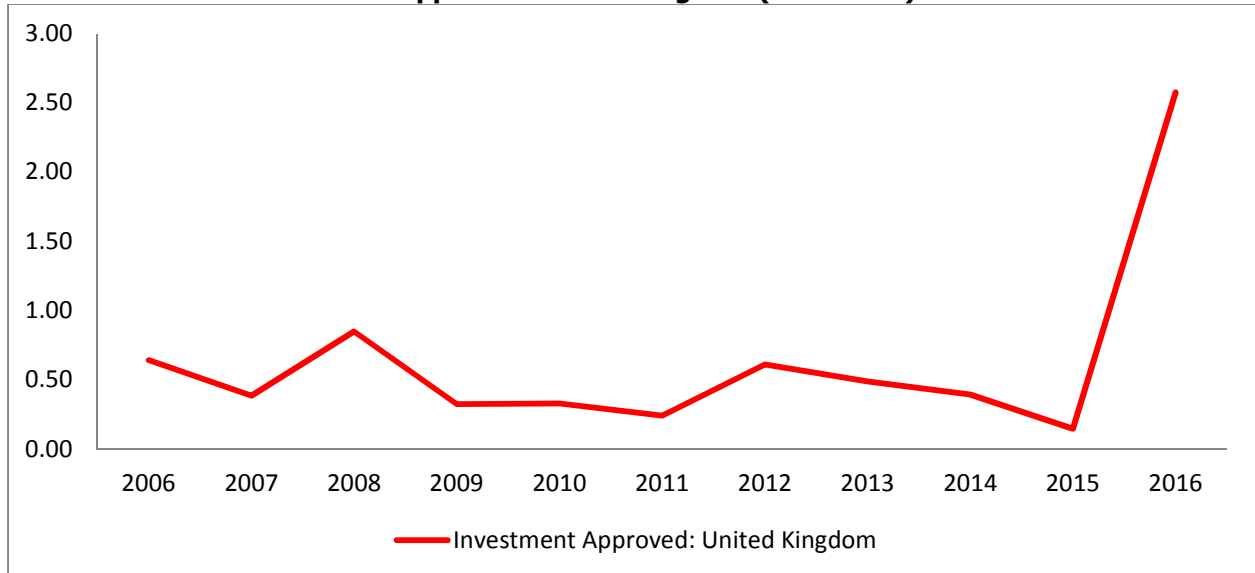
Source: CEIC, MIDFR

Chart 7: Tourist Arrival: United Kingdom (Person)



Source: CEIC, MIDFR

Chart 8: MIDA's Investment Approval: United Kingdom (RM Billion)



Source: CEIC, MIDFR

Table 1: FDI flows of Malaysia-UK (RM Billion)

| | Inflow | Outflow | Net Inflow |
|------|--------|---------|------------|
| 2011 | 2.97 | 1.94 | 1.03 |
| 2012 | 3.95 | 2.97 | 0.99 |
| 2013 | 1.22 | 1.47 | (0.25) |
| 2014 | 2.04 | 2.00 | 0.04 |
| 2015 | 4.29 | 2.03 | 2.27 |
| 2016 | 5.18 | 3.30 | 1.88 |

Note: Inflow means FDI from UK to Malaysia
Source: BNM, MIDFR

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