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MALAYSIA

2Q 14 Real GDP stronger-than-expected, growth to moderate in the 2H 2014

The faster-than-expected real GDP growth in the 2Q 14 was mainly driven by the large Net Exports of Goods & Services given the suppressed growth in Imports while domestic demand had remained strong during the quarter. Going forward, we expect growth to moderate in the 2H 2014, as Exports are likely to moderate and on the back of the high base effect factor, with growth to average around 4.5 – 5.0% in the 2H. That would bring the overall growth to about 5.4 – 5.7%. We now revised upwards our growth forecast to 5.5%, although we should highlight that the downside risks remain high.

Real GDP growth accelerated in the 2Q 14; beating consensus expectation. Growth accelerated from 6.2% in the 1Q 14 to 6.4% in the 2Q 14, well above the consensus and our expectation of 5.8%. Growth during the quarter was mainly driven by the Net Exports of Goods and Services which grew by 91.0% YoY during the quarter (1Q 14: 15.0%), and contributed as much as 4.5% to the 6.4% growth. Private domestic demand eased but held up well, with Private Consumption Expenditure and Private Investment growth remaining strong at 6.5% and 12.1% respectively (1Q 14: 7.1% and 14.1% respectively). The main drag came from Public sector and Inventories which shaved off 0.5p.p. and 3.4p.p. from the 6.4% growth in real GDP.

Net Exports of Goods & Services significantly larger than expected. If we look at the Merchandise trade balance for the period, Both Exports and Imports recorded faster growth relative to the 1Q 14; with Imports growing by 8.6% YoY against 5.7% in the preceding quarter. Hence, it came as a surprise that Imports of Goods & Services in real terms came in at a much lower pace of 3.9% YoY in 2Q 14 against 7.1% in the preceding quarter. The moderation in domestic demand was well within expectation, although spending on Public side was higher than generally expected.

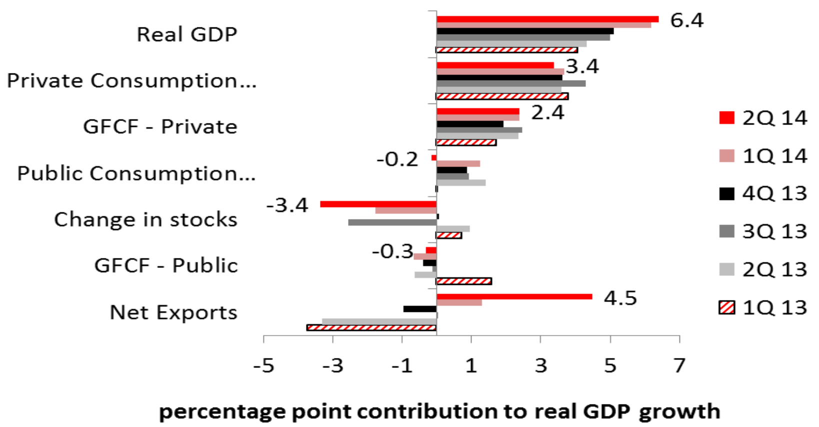
By sector, Services continued to be the driver supported by the acceleration in the Manufacturing sector. While Service sector recorded a slower growth of 6.0% against 6.6% in the preceding quarter, it explained 51.5% of the growth generated in the 2Q 14. Manufacturing sector powered ahead, recording faster growth of 7.3% during the quarter (1Q 14: 6.8%), fuelling 28.7% share of growth during the quarter. Agriculture sector rebounded strongly to 7.1% from 2.3% in the previous quarter while Mining recovered with a small positive growth of 2.1% after contracting by 0.8% in the 1Q 14. On the other hand, Construction sector slowed rather significantly, posting a 9.9% growth against 18.9% in the preceding quarter.

The robust growth unlikely to be sustained in the 2H 14. We expect Imports growth inevitably would have to pick up if Exports to continue to thrive, especially given the fact that recovery in Exports was mainly driven by the Manufactured Exports particularly the E&E sector. Having said that, the slow imports in the 2Q 14 suggested that Exports going forward would indeed lose momentum and that would pose a drag to growth in the 2H 14. On top of that we expect moderation in the domestic demand to continue as we expect further adjustments in prices of controlled items in line with further cutback in fiscal spending. The high base effect in the 2H of last year would also be another factor pointing to slower growth pace in 2H 2014. Growth is likely to average at around 4.5 – 5.0% in the 2H. That would bring the overall growth to about 5.4 – 5.7%. We now revised upwards our growth forecast to 5.5%, although we should highlight that the downside risks remain high.

Current account surplus narrowed in the 2Q 14 to RM16 billion - equivalent to 6.3% of GNI from RM19.8 billion or 7.9% of GNI in 1Q 14. Hence, while Net Exports of Goods & Services was much bigger YoY, it was much smaller when compared to that in the previous quarter on the back of smaller Net Exports of Goods and bigger Net Services balance deficits. The bigger deficits in primary Income accounts posed further drag to the Current Account balance.

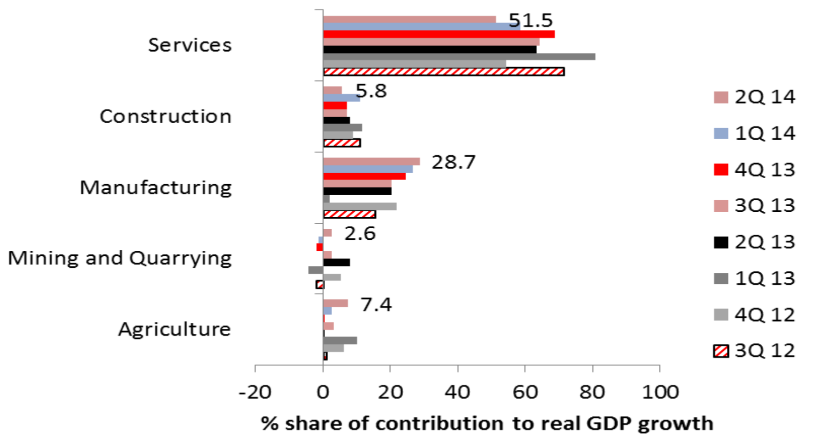
External debt inched higher but FX reserves edged lower, resulting in smaller FX reserves/short-term debt ratio. External debt as defined by the new classification by BNM (which includes non-resident holdings of ringgit denominated deposits and debt securities) edged up from RM65.4 billion at the end of 1Q 14 to RM67.9 billion at the end of 2Q 14, although short-term debt increased only marginally during the quarter to RM260.9 billion (1Q 14: RM258.3 billion). Nonetheless, FX reserves declined albeit marginally from RM424.6 billion at the end if 1Q 14 to RM 423.6 billion at the end of 2Q 14, resulting in the FX/Short-term debt ratio easing to 1.2x from 1.3x previously.

Chart 1: Real GDP by expenditure – contributionto growth in percentage points (p.p.)



Source: BNM

Chart 2: Real GDP by Sector – % share of contribution to growth (%)



Source: BNM

Chart 3: Larger deficits balance in Services sector posed a drag to the overall Net Exports of Goods & Services in 2Q 14 (RM billion)

Source: Department of Statistics

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TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	*Negative* total return is expected to be -15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
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NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.