11 November 2016

ECONOMIC REVIEW | 3Q 2016 National Account

Higher Trade Balance Gives the Vital Push to 3Q16 GDP

- *The strength of Malaysia's economy in 3Q16 is a surprise to many, particularly as our exports activity has not been doing so well recently. GDP grew by 4.3%yoy, against economists' expectations at 4.1%. Looking at the details, the strong numbers came mostly from the low base effect and a better exports performance relative to imports during the quarter.*
- *Solid double-digit growth from insurance industry and finance pushed the services sector expansion to a 6 quarters high at 6.1%. Year-on-year, the insurance industry grew by 14.9% during the quarter - the fastest pace in almost 4 years. This added 0.2% point growth to the overall GDP.*
- *Agriculture was the still the biggest drag to the headline GDP figure, shedding 0.6% GDP growth. Contraction in the agriculture sector narrowed to -5.9%yoy for the quarter from -7.9%yoy amid great stride from the palm oil industry. The sector declined 13.8%yoy but there was great momentum in the recovery judging from the quarter-on-quarter growth.*
- *The strong GDP growth on year-on-year basis at 4.3%, which is in line with BNM expectation, should hold off BNM from conducting any further rate cut for the year. As such, we are revising our OPR expectation from 2.75% to 3.00% by year-end 2016, while remaining one rate cut next year which will lead the benchmark interest rate to end year 2017 at 2.75%. We are also revising our GDP growth forecast for year 2016 from 4.0% to 4.1% and 4Q16 GDP growth from 3.8% to 4.0%. At the same time, we are expecting Malaysia economy will grow by 4.3% in 2017.*

GDP grew by 4.3% in 3Q16, above economist expectation. The strength of Malaysia's economy in 3Q16 is a surprise to many, particularly as our exports activity has not been doing so well recently. GDP grew by 4.3%yoy, against economists' expectations at 4.1%. Looking at the details, the strong numbers mostly came from the low base effect and a better exports performance relative to imports during the quarter. We believe the one that has been dropping are imports of services, as imports cif only contracted by a marginal 0.1%yoy for 3Q16, as compared to exports fob which dropped by 2.3%yoy.

Growth of private consumption was high at 6.4%yoy, but mostly due to low base effect. Once again, despite the strong year-on-year performance at 6.4%yoy, the growth of private consumption was mostly due to the low base effect. On seasonally adjusted basis, private consumption only grew by a marginal 0.2%qoq, its weakest momentum since 4Q16. Despite the salary increment of government officials in July, the higher unemployment rate for the quarter at 3.5% gave an adverse impact to private consumption.

Investment activity remains moderate. Gross fixed capital formation grew by 2.0%yoy in 3Q16, as compared to the strong 6.1%yoy in the previous quarter. Much of the decline was caused by public investment, which declined by 3.8%yoy (2Q16: 7.5%yoy) while private investment remained relatively strong at 4.7%yoy (2Q16: 5.6%yoy). However, the moderating investment activity is becoming a global phenomenon, with little or no sign of recovery due to the global economic condition.

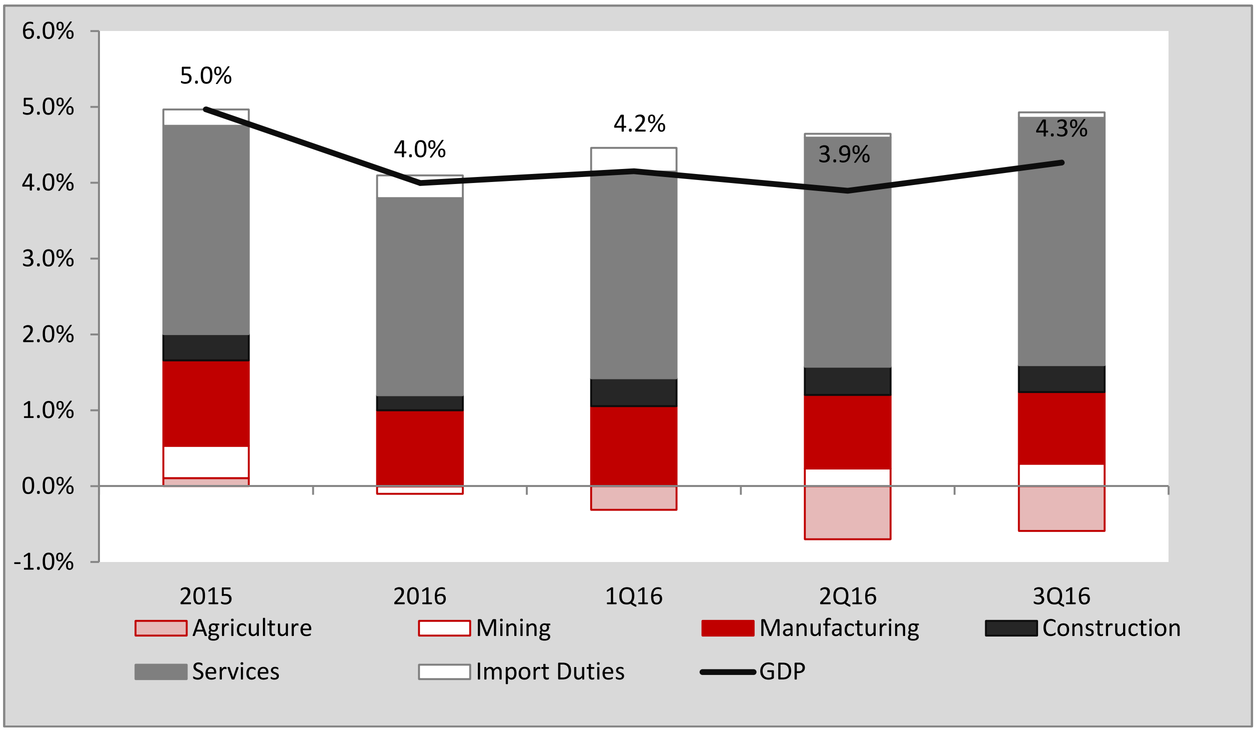
Table 1: Real GDP performance – by type of expenditure and economic activity

YoY%	2014	2015	3Q 15	4Q 15	1Q 16	2Q 16	3Q 16
Real GDP	6.0	5.0	4.7	4.5	4.2	4.0	4.3
Private consumption expenditure	7.1	6.0	4.1	4.9	5.3	6.3	6.4
Public consumption expenditure	4.4	4.4	3.6	3.3	3.8	6.5	3.1
Gross fixed capital formation	4.7	3.7	4.2	2.7	0.1	6.1	2.0
Structure	6.6	9.3	6.9	5.0	5.7	5.9	5.0
Machinery and equipment	0.2	0.1	1.3	-0.1	-7.1	8.1	0.9
GFCF - Public	-3.2	0.6	1.8	0.4	-4.5	7.5	-3.8
GFCF - Private	13.0	8.1	5.5	4.9	2.2	5.6	4.7
Net Exports	13.2	-3.8	3.4	4.3	-12.4	-7.0	5.9
Exports	5.0	0.6	3.2	4.0	-0.5	1.0	-1.3
Imports	4.0	1.2	3.1	4.0	1.3	2.0	-2.3
Agriculture	2.1	1.2	2.3	1.5	-3.8	-7.9	-5.9
Mining	3.5	4.7	5.1	-1.3	0.3	2.6	3.6
Manufacturing	6.2	4.9	4.9	5.0	4.5	4.1	4.2
Construction	11.7	8.2	9.9	7.4	7.9	8.8	7.9
Services	6.6	5.1	4.4	5.0	5.1	5.7	6.1

Source: Department of Statistics (DoS), CEIC

Our trade balance improved, contributing 0.5pp to the overall GDP growth. Exports declined by 1.3%yoy in 3Q16 while imports performed lower with a contraction of 2.3%yoy. However, imports cif (merchandise) only declined by a marginal 0.1%yoy, which signals that most of the decline in imports was coming from services sector. Imports of services declined by 0.6%yoy, the first contraction since 3Q09. Most of the weakness in imports of services came from travelling, which declined by 4.2%yoy and transportation by 5.3%yoy.

Chart 1: Percentage point (p.p.) share contribution to growth – By economic activity



Source: DoS, MIDFR

Solid double-digit growth from insurance industry and finance pushes services sector expansion to 6 quarters high at 6.1%. Year-on-year, the insurance industry grew by 14.9% during the quarter - the fastest pace in almost 4 years. This adds 0.2% point growth to the overall GDP. Remarkably better claims ratio of the insurances companies improved their bottom line during the quarter and this happened due to a positive structural change i.e. enhancement in claims management system on Malaysian Motor Insurance Pool (MMIP). On the flipside, we see less catalyst in the near future for the industry hence expects growth to normalize.

Meanwhile, we also note that the finance industry experienced positive rebound, increasing by 2.0%yoy after contracting marginally by 0.2%yoy in 2Q16. Banks might be seeing lesser provision and better OPEX in the quarter after undertaking huge provisions earlier this year which overall improved their earnings.

Agriculture was the still the biggest drag to the headline GDP figure, shedding 0.6% GDP growth. Contraction in the agriculture sector narrows to -5.9%yoy for the quarter from -7.9%yoy amid great stride from the palm oil industry. The sector declined 13.8%yoy but there was great momentum in the recovery judging from the quarter-on-quarter growth. In the past two quarters, the industry averaged 21.0%qoq growth. We think there are considerable reasons to believe the growth momentum could continue hence expects agriculture sector to be a lesser drag in coming quarters.

Manufacturing industry received supports from the unlikely corner, growth improved marginally to 4.2%. E&E sub-sector contributed nearly a third of the manufacturing industry saw its growth moderated in the third quarter to 6.6%yoy from 8.8% in 2Q16. The result though was expected as E&E exports took hit in the quarter hence affecting local production. Nonetheless, the manufacturing sector still expanded faster in the quarter due to higher value added in the production of the food industries. The food processing industry rebounded from 4.0%yoy contraction in 2Q16 to 0.8%yoy growth in 3Q16. We opine this was due to higher demand achieved during festival seas

Due to the strong year-on-year performance, we are no longer expecting a rate cut in November. The strong GDP growth on year-on-year basis at 4.3%, which is in line with BNM expectation, should hold off BNM from conducting any further rate cut for the year. As such, we are revising our OPR expectation from 2.75% to 3.00% by year-end 2016, while remaining one rate cut next year which will lead the benchmark interest rate to end year 2017 at 2.75%. At the moment, there are signs of a better global trade activity next year, though we remain cautious with any possible protectionism policy set up by the newly president-elect Donald Trump as he has been promising during his manifesto. We are also revising our GDP growth forecast for year 2016 from 4.0% to 4.1% and 4Q16 GDP growth from 3.8% to 4.0%. At the same time, we are expecting Malaysia economy will grow by 4.3% in 2017.

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER