29 March 2019

MONTHLY ECONOMIC REVIEW | March 2019

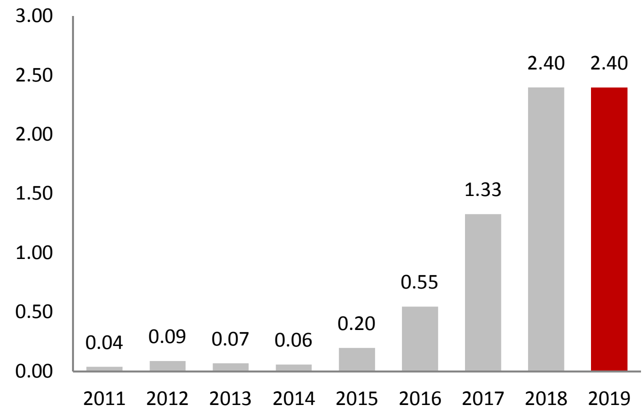
Malaysia's Economy Remains on Expansionary Path as Global Monetary Pressure Eased

- *Fed's funds rate to stay at 2.25-2.50% in 2019. Following the latest FOMC meeting, we downgrade our call of two times of rate hike to zero hike in 2019. The interest rate will stay at the range of 2.25-2.50%. The Fed made significant changes in its projections in Mar-19. As compared to projections made in Dec-18, the central bank reduces its GDP forecast for 2019 to 2.1% (2.3% Initial estimate).*
- *Consumer confidence skyrocketed to record high. Domestic demand in China strengthens as consumer confidence hits highest ever record at 126 points in Feb-19. We have seen the uptrend since mid-18 despite of trade war with the US. The last time China had its consumer index surpassed 120 points level was back in 1993.*
- *Malaysia remains in deflation. Consumer price index contracted -0.4%yoy in the second month of 2019 continuing the deflationary trend. The deflationary pressure came mainly from the transport component. Transport prices continued to drop by -6.8%yoy in Feb-19, registering four-consecutive months of negative growth. Meanwhile, core inflation improved marginally by 0.3%yoy.*

Fed's funds rate to stay at 2.25-2.50% in 2019. Following the latest FOMC meeting, we changed our expectation from two times rate hikes to no rate hike in 2019, i.e. US Fed fund rate will stay at the range of 2.25-2.50% throughout this year. The US Fed made significant changes to its projections in Mar-19. As compared to projections made in Dec-18, the central bank reduced its GDP forecast for 2019 to 2.1% (from 2.3%). Moreover, unemployment rate is projected to be slightly higher at 3.7% against 3.5% earlier whereas core PCE inflation target remains unchanged at 2%. As guided by the latest projections, the Fed reduces its interest rate forecast from median 2.9% to 2.4% in 2019.

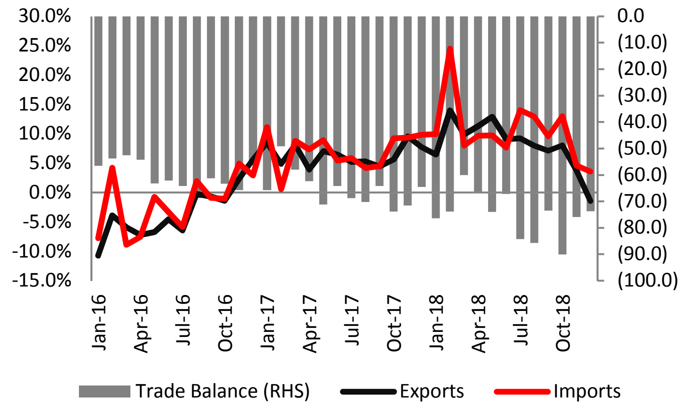
US trade deficit narrowed to USD51.1B in Jan-19 as imports declined, the lowest since Jun-18 while exports rose. Exports expanded 3.0%yoy in Jan-19 due to high abroad sales of food & beverages, mainly soybean, and rise in outbound shipment of motor vehicle parts especially passenger cars. By country, exports to China remained in negative territory since Aug-18 amid the ongoing trade tension. Meanwhile, imports grew by a gradual 1.6%yoy in Jan-19 as oversea purchases of capital goods went down particularly semiconductors and civilian aircraft. Imports from Canada remained in negative territory for 3 consecutive months at -11.0%yoy. Moving forward, we foresee the US external trade performance to grow at a modest pace as both China and the US are still on negotiation stage.

Chart 1: Fed's Funds Rate (%)



Source: CEIC, MIDFR

Chart 2: USA's External Trade (YoY%)

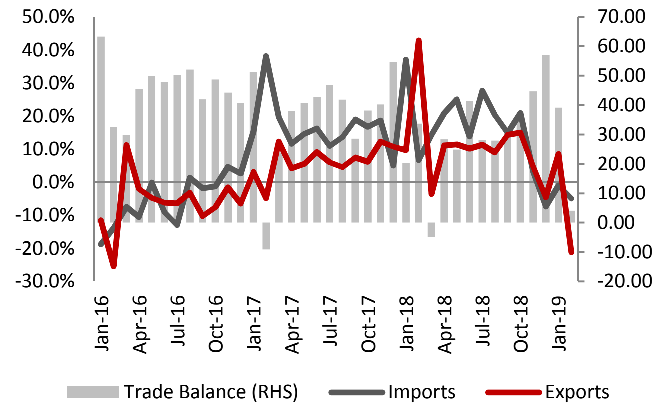


Source: CEIC, MIDFR

Slowdown in external trade. China's trade surplus narrowed sharply to USD4.1B in Feb-19 (Feb-18: USD32.3B) and missed market expectation of USD26.4B. The lowest trade surplus since a deficit in Mar-18 was due to exports declining more than imports amid Chinese New Year holidays. Exports plunged -20.7%yoy, far worse than market forecast of a -4.8% drop and the largest decline since Feb-16 driven by low sales of aluminum, steel products and rare earths. Similarly, imports fell -5.2%yoy which was also worse than market estimate of a shallow -1.4% decline. Purchases of soybean fell -17.8%yoy and tumbled -39.5%mom amid higher tariff imposed on shipments from the US. In regards to trade surplus with the US, it narrowed sharply to USD14.7B (Jan-19: USD27.3B).

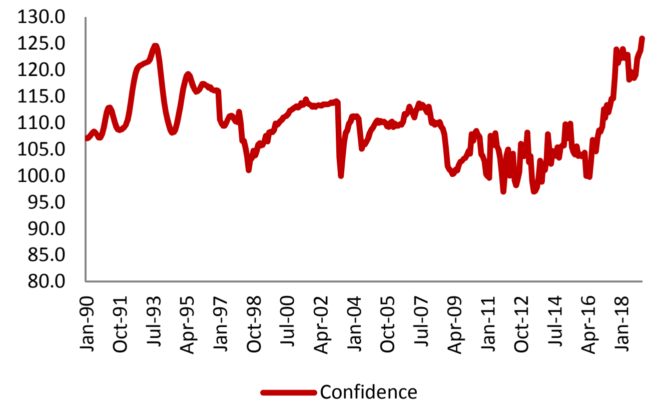
Consumer confidence skyrocketed to record high. Domestic demand in China strengthened as consumer confidence hit highest ever record at 126 points in Feb-19. We have seen the uptrend since mid-18 despite the on-going trade war with the US. The last time China had its consumer index surpassed 120 points level was back in 1993. The idea of shifting its macro focus from export-led to consumer-led strategy is showing progressive results. Moving forward, we foresee the growth in China will increasingly be supported by domestic demand.

Chart 3: China's External Trade (YoY%)



Source: CEIC, MIDFR

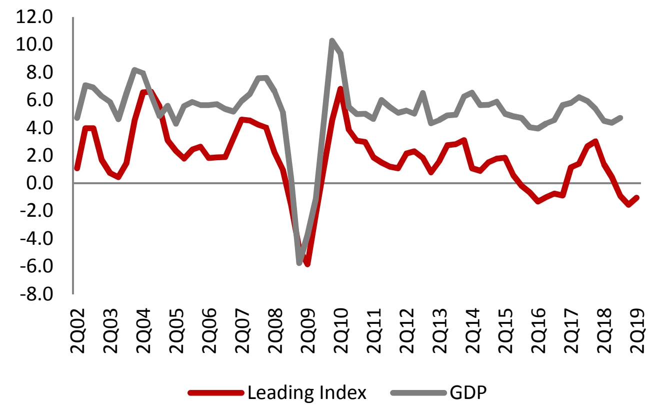
Chart 4: China's Consumer Confidence (Points)



Source: CEIC, MIDFR

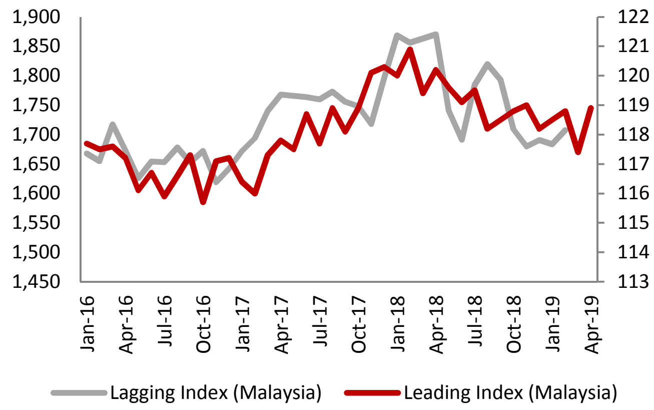
Expecting modest recovery in 2Q19. Based on the latest leading index, we expect tepid economic growth in 1Q19 with slight recovery in 2Q19. The index inched up to a 5-month high at 118.9 in Feb-19. Weak growth in 1Q19 was mainly due uncertainties over the trade negotiation between the US and China. This is in tandem with the pessimistic trend reflected by the Nikkei Manufacturing PMI for Malaysia, registering below 50 points for five consecutive months since Oct-18. Moving forward, we foresee a steady recovery towards 2Q19 and also 2H19 amid gradual pick-up in commodity prices, strong domestic demand and receding trade war effects. Brent crude oil price improved steadily since Jan-19 at an average of $60.5pbd and latest in Mar-19 at $66.1. Global demand is expected to recover particularly if the US and China eventually strike a trade deal. On local front, full-employment condition and shallow inflationary pressure are key supporting factors of the domestic demand. In addition, further announcements on government-related infrastructure projects would engender positive sentiments aiding to the economic growth.

Chart 5: GDP Growth vs Leading Index (YoY%)



Source: CEIC, MIDFR

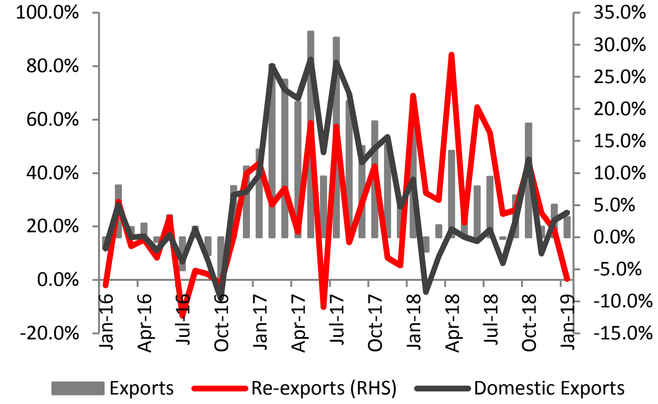
Chart 6: KLCI vs Leading Index



Source: CEIC, MIDFR

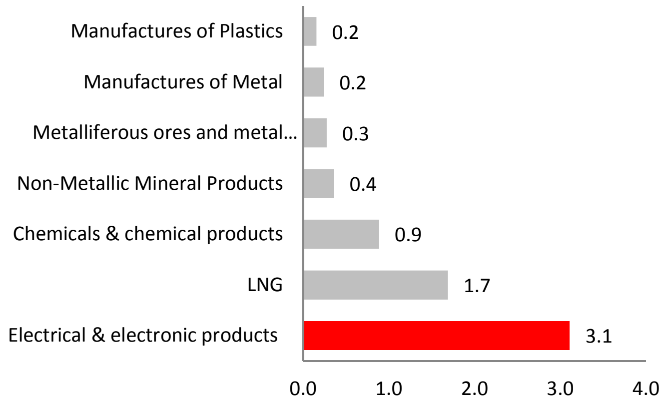
Trade surplus at 3-month high. Malaysia's trade surplus widened to RM11.5B in Jan-19 (Dec-18: RM10.7B) as exports growth outperformed those of imports. Exports expanded by 3.1%yoy in Jan-19 (Dec-18: 5.1%yoy) higher than 1%yoy growth (Dec-18: 1%yoy) recorded in imports. Exports expansion was mainly contributed by a double-digit growth of mining goods at 23.5%yoy, compared to a negative growth of -1.5%yoy in the previous month, besides continuous growth of manufactured goods at 2.9%yoy, which nevertheless slowed from preceding month's 7.9%yoy rise. Besides that, outbound shipments of agriculture goods posted lower negative growth at -13.6%yoy in Jan-19 compared to -19.1%yoy in Dec-18. On monthly basis, both exports and imports advanced by 2.2% and 1.4% respectively.

Chart 7: Total Exports: Domestic vs Re-exports (YoY%)



Source: CEIC, MIDFR

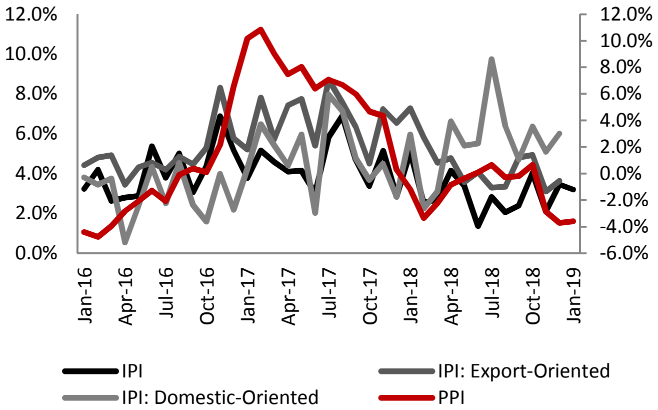
Chart 8: % Contribution to Exports Growth by Products



Source: CEIC, MIDFR

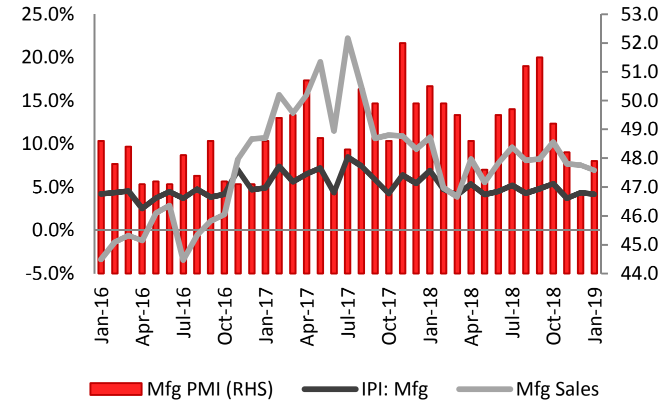
1-1/2-year-high electricity growth supports IPI performance. Malaysia's industrial production expanded 3.2%yoy in Jan-19 supported by the increase in the index of electricity and manufacturing. The electricity sector index advanced 7.8%yoy, the highest since Jul-17 while factory output grew 4.1%yoy, moderated from 4.4%yoy in the previous month. Meanwhile, mining output returned to a negative rate of -0.9%yoy due to lower global oil prices during the month. Moving forward, we foresee IPI performance to expand at a steady pace in 2019 amid tapering trade tension, strong global demand, expected improvement in business environment and gradual pick-up in global commodity prices & currencies.

Chart 9: IPI vs PPI (YoY%)



Source: CEIC, MIDFR

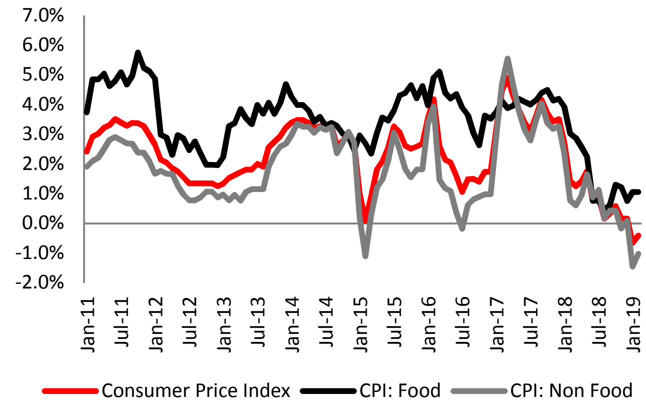
Chart 10: Manufacturing IPI & Sales (YoY%) vs PMI (Points)



Source: CEIC, MIDFR

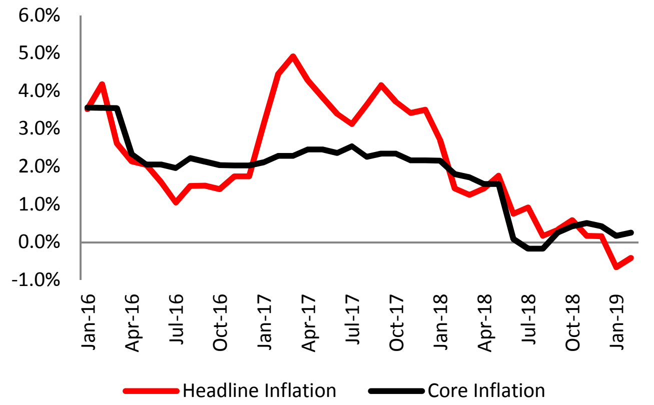
Malaysia remains in deflation. Consumer price index contracted -0.4%yoy in the second month of 2019, continuing the deflationary streak. The deflationary pressure came mainly from the transport component. Transport prices continued to drop by -6.8%yoy in Feb-19, registering four consecutive months of negative growth. Meanwhile, core inflation improved marginally by 0.3%yoy. Looking ahead, Malaysia's consumer inflation is likely to stay low at level following the lower capped prices of RON95 and Diesel at RM2.08 and RM2.18 per litre respectively. Nevertheless, demand-push factor remains firm amid stable job market and steady wage growth.

Chart 11: CPI: Headline vs Food & Non-food (YoY%)



Source: CEIC, MIDFR

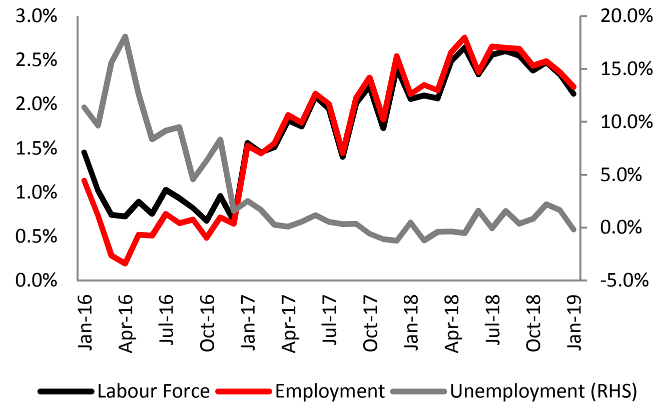
Chart 12: CPI: Headline vs Core (YoY%)



Source: CEIC, MIDFR

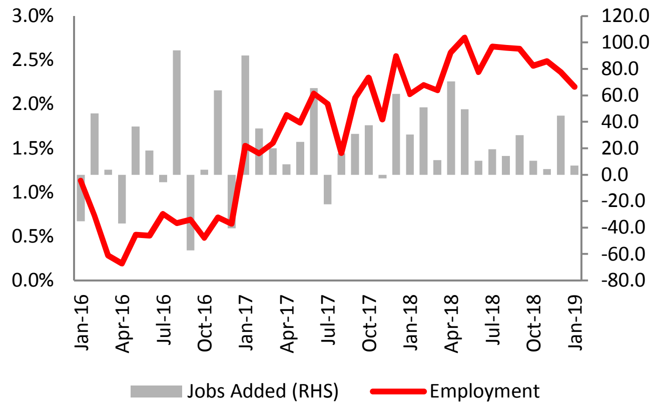
Labour market remains strong. Labour force expanded by 2.1%yoy to 15.5 million in Jan-19. Employment growth improved 2.2%yoy to 15 million while jobs added in the economy registered at 6.8K. The number of unemployed contracted -0.2%yoy. In addition, growth in both labour force and employment has been outpacing unemployment growth for the last 23 months since Mar-17. The stable job market reflects healthy development of Malaysia's economy and providing a solid fundamental factor for the economy particularly in supporting domestic demand.

Chart 13: Labour Market Indicators (YoY%)



Source: CEIC, MIDFR

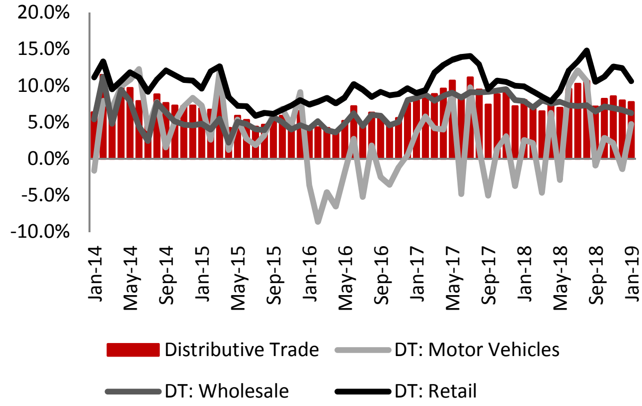
Chart 14: Jobs Added ('000) vs Empl. (YoY%)



Source: CEIC, MIDFR

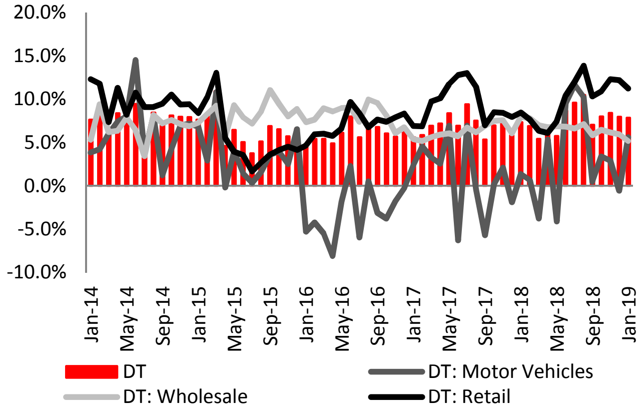
Domestic spending remains solid. Distributive trade grew 7.8%yoy in Jan-19 as motor vehicle sales bounced back with 4.8%yoy rise and retail sales sustained its double digit growth for the eight consecutive months. Wholesale trade increased at a moderating pace of 6.2%yoy. Looking ahead, we view continuous solid domestic demand in 2019 to be underpinned by stable job market, wage growth, low inflationary pressure and steady economic growth.

Chart 15: Distributive Trade, DT (YoY%)



Source: CEIC; MIDFR

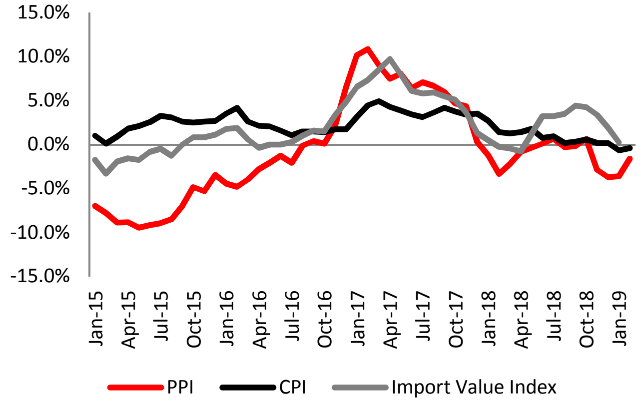
Chart 16: Distributive Trade Volume, DT (YoY%)



Source: CEIC; MAHB; MIDFR

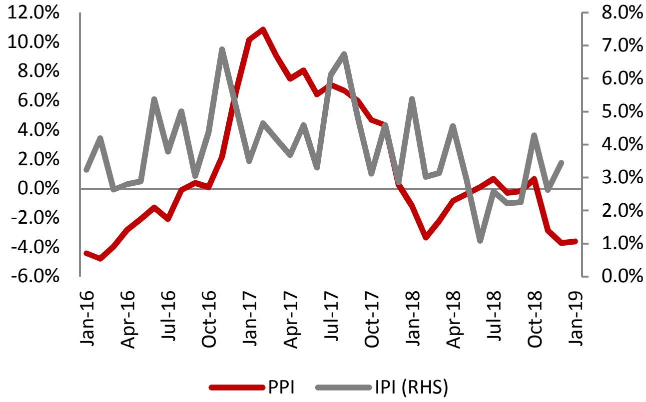
PPI stays on contractionary path. Malaysia's producer cost remains deflationary as PPI shrank -1.6%yoy in Feb-19. This was mainly due to continuous falling input prices of manufacturing and agriculture sectors. Factory input price has been on negative growth for 14 consecutive months. Manufacturing sector still held the largest share at 81.6% in determining the producers' inflation. We expect the PPI to remain low for the first half of 2019 given that retail fuel prices of RON95 and Diesel are capped at lower levels than 2018's average prices.

Chart 17: PPI vs CPI (YoY%)



Source: CEIC, MIDFR

Chart 18: PPI vs IPI (YoY%)



Source: CEIC, MIDFR

Table 1: Macroeconomic Data Updates

(YoY%) Unless Stated Otherwise	2013	2014	2015	2016	2017	2018	2019^{f}
Real GDP	4.7	6.0	5.1	4.2	5.9	4.7	4.9
Private Consumption	7.2	7.0	6.0	6.0	7.0	8.1	7.5
Public Consumption	5.8	4.4	4.5	0.9	5.4	3.3	1.3
Gross Fixed Capital Formation	8.1	4.8	3.6	2.7	6.2	1.4	1.6
Exports of goods & services	0.3	5.0	0.3	1.3	9.4	1.5	2.0
Imports of goods & services	1.7	4.0	0.8	1.3	10.9	0.1	1.9
Net Exports (RMb)	83.6	94.7	91.2	92.8	91.0	103.2	106.0
Agriculture etc.	2.0	2.0	1.4	(5.2)	7.2	(0.4)	1.1
Mining & Quarrying	1.2	3.3	5.3	2.1	1.0	(1.5)	1.3
Manufacturing	3.4	6.1	4.8	4.4	6.0	5.0	4.9
Construction	10.6	11.7	8.4	7.4	6.7	4.2	2.1
Services	5.9	6.6	5.3	5.7	6.2	6.8	6.2
Exports of Goods (f.o.b)	2.5	6.7	1.5	1.4	19.3	7.3	3.6
Imports of Goods (c.i.f)	7.0	5.4	0.6	2.0	20.2	5.6	3.0
Trade Balance - RMb	71.3	82.5	91.6	88.1	98.5	119.8	126.3
Consumer Price Index	2.1	3.1	2.1	2.1	3.8	1.0	2.2
End of Unless States Otherwise	**2013**	**2014**	**2015**	**2016**	**2017**	**2018^{e}**	**2019^{f}**
Brent Crude Oil (Avg)	108.4	97.5	54.4	46.0	55.7	71.6	75.0
Crude Palm Oil (Avg)	2,435	2,384	2,237	2,642	2,659	2,293	2,280
USD/MYR (Avg)	3.15	3.27	3.90	4.14	4.30	4.00	4.05
USD/MYR	3.25	3.48	4.28	4.46	4.08	4.10	4.00
Overnight Policy Rate (%)	3.00	3.25	3.25	3.00	3.00	3.25	3.25

Source: MIDFR

March 2019 Key Economic Events

1 March: Brent Dips Below Sour Crude As Heavy Supply Tightens. The price of the Brent international crude oil benchmark dipped below two Middle Eastern benchmarks that represent heavier, sour grades, Reuter's reports, citing industry sources. Based on light sweet crude grades produced in the North Sea, Brent has traditionally traded at a premium to sour grades with higher sulfur content that have been typically considered sort of lower quality than light sweet blends that yield higher amounts of fuels such as gasoline.

4 March: Gov't moots cost of living index to determine wage increase rate. The government has proposed the creation of an index to accurately measure the cost of living to assist employers in determining appropriate salary increases for their workers. Finance Minister Lim Guan Eng said the current Consumer Price Index (CPI) does not accurately portray the day-to-day situation faced by the rakyat, as it comprises several factors which do not apply to them, such as estimates on business production costs and input costs.

8 March: Norway's $1tn wealth fund to divest from oil and gas exploration. The world's largest sovereign wealth fund, which manages $1tn (£770bn) of Norway's assets, is to dump investments in firms that explore for oil and gas, but will still hold stakes in firms such as BP and Shell that have renewable energy divisions. The Government Pension Fund Global (GPFG), whose assets exceed those of rival sovereign wealth funds such as China's, said it would phase out oil exploration from its "investment universe".

14 March: Brexit: PM to bring third Brexit deal vote to Commons. Theresa May will make a third attempt to get her EU withdrawal deal through Parliament in the next week. She told MPs that if her deal fails again to get their backing, a lengthy delay to Brexit may be needed. The prime minister's warning comes ahead of a Commons vote later on whether to ask the EU for permission to delay Brexit beyond 29 March.

20 Mar: Dr M: Malaysia to boycott EU products if palm oil discrimination continues. If the European Union (EU) continues to discriminate against palm oil, Malaysia will retaliate by boycotting certain European products, says Prime Minister Tun Dr Mahathir Mohamad. "Yes, we think we will stop buying some European products. That is one thing that we can do," he told a press conference at the Parliament lobby on Wednesday (March 20). On Tuesday (March 19), Dr Mahathir said the government had written to all the heads of government of the EU regarding the matter, so say that Malaysia would retaliate if they continue with this "unfair discrimination against palm oil".

22 March: Overcapacity sends Malaysia Airlines further into turbulence. MALAYSIA Airlines Bhd says it expects to see improved performance for all key operational statistics and financial results this year. However, the challenging operating environment is likely to keep it from meeting its turnaround goal again, putting the airline in the line of fire of analysts and critics wearied by previous disappointments. According to the flag carrier, volatility in fuel prices and foreign exchange will continue to threaten its ability to turn around.

24 Mar: Italy signs massive deal with China despite cautions from France and Germany. Italy became the first G7 nation to sign up for Beijing's multibillion-dollar Belt and Road Initiative. The deal was struck amid warnings from Rome's EU partners against negotiating with China alone. The memorandum of understanding was signed during Chinese leader's Xi Jinping three-day trip to Rome. The nations also struck additional deals, including in the steel and energy sectors. Endorsing Beijing's massive infrastructure project, Italy hopes to boost its economy by gaining access to the Chinese market. Former Italian Prime Minister Franco Frattini earlier told RT that Beijing's Belt and Road Initiative holds "very high significance" for Rome, and partnership with China is aimed "to maximize European interests."

26 Mar: The Fed shows its hand by hitting the pause button on rate hikes. As expected, the Federal Reserve opted to hold rates steady in its March policy announcement. But while Wednesday's decision was as expected, there was a larger question mark surrounding the longer-run pathway for rates. In December, the dot plot — the visual representation of Fed policymakers' expectations for the fed funds rate — showed the Fed hiking rates potentially twice more in 2019. The latest version showed no further Fed action in the remaining nine months of the year, just one hike in 2020 and again none in 2021, in line with market expectations.

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