18 May 2015

ECONOMIC UPDATE

MALAYSIA – 1Q 15 Real GDP Still resilient; external vulnerability relatively little changed

- *The 5.6% growth for real GDP in the 1Q 15 was well within consensus and our expectation of 5.5%. The strong IPI data for 1Q 15 had led some to believe that growth should be close to 6%. Nonetheless, the strong growth in consumer spending and fixed investment was offset by the sharp pullback in next exports.*
- *Nonetheless, there is a possibility that the strong domestic demand growth was driven by the spending loaded upfront before GST kicked off last April 1. As such, we expect domestic demand to cool down in 2Q 15 due to the post-GST effects. Output may stabilize thereafter as demand rebounds modestly and net exports contributing positively. Hence, we still expect growth to come in at 4.7% for the whole of 2015.*
- *While the current account balance improved to RM 10.0b or 3.7% of GNI at the end of 1Q 15, the overall balance of payments still showed a significant drawdown in FX reserves due to persistent outflows. At the same time, total external debt has ticked up in absolute value, although short-term debt fell slightly.*

Real GDP resilient but fell short of the pace where the IPI should be suggesting. The overall growth for the IPI in the 1Q 15 at 6.4% is faster than that recorded in the preceding quarter (5.8%), leading some to believe that growth should be close to 6%. Nonetheless, as we highlighted, the pullback in domestic demand, mainly in Gross Fixed Capital Formation and net exports would offset the robust production data and led real GDP growth to decelerate to come in at 5.0 – 5.5%. However, while we were right about net exports, GFCF was stronger and that complemented real GDP growth driven by consumer spending

Real GDP growth eased to 5.6% (4Q 14r: 5.7%) boosted by private consumption expenditure (PCE). The GDP data is now re-based to be priced in 2010 prices and some revisions put real GDP growth for the 4Q 14 at 5.7% against 5.8% previously. PCE grew by 8.8%yoy (3Q 14: 6.7%) – the strongest since 4Q 12 which we believed was mainly fuelled by pre-GST effects. PCE contributed as much as 4.5 percentage points (p.p.) to the 5.6% growth in real GDP for the 1Q 15.

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

YoY%	2014	1Q 14	2Q 14	3Q 14	4Q 14	1Q 15
Real GDP	6.0	6.2	6.5	5.6	5.7	5.6
Private consumption expenditure	7.1	7.1	6.5	6.7	7.9	8.8
Public consumption expenditure	4.4	12.3	-0.5	5.3	2.7	4.1
Gross fixed capital formation	4.7	6.3	7.2	1.1	4.3	7.9
Structure	9.9	14.7	6.7	8.3	10.4	9.9
Machinery and equipment	-0.3	-1.8	9.1	-7.5	-0.6	5.8
GFCF - Public	1.9	-6.3	-3.2	-8.5	-1.9	0.5
GFCF - Private	12.8	14.9	11.6	7.0	11.0	11.7
Net Exports	15.8	8.2	51.7	7.4	-4.0	-10.2
Exports	5.1	7.9	8.8	2.8	1.9	-0.6
Imports	3.9	7.1	3.9	2.2	2.6	1.0
Agriculture	2.6	2.3	7.1	4.0	-3.7	-4.7
Mining	3.1	-0.8	2.1	1.4	9.5	9.6
Manufacturing	6.2	6.8	7.3	5.4	5.4	5.6
Construction	11.6	18.9	9.9	9.6	8.8	9.7
Services	6.3	6.6	6.2	6.2	6.6	6.4

Source: Department of Statistics (DoS), BNM

Gross Fixed Capital Formation (GFCF) bounced back, again led by the private sector. GFCF which grew by a faster pace of 7.9% (4Q 14: 4.3%) contributed 2.1 p.p. to real GDP growth during the quarter; mainly led by the rebound in the GFCF for 'Machinery & Equipment' while that of 'Structures' continued to sustain strong growth. That is line with the pick-up in the Manufacturing sector as reflected by the recent IPI and export numbers. The slight turnaround in GFCF by the public sector also helped to support growth.

Nonetheless, net exports pulled back significantly. Net exports contracted by 10.2%yoy during the period as Exports of Goods & Services declined by 0.6%yoy. That shaved off growth by as much as 1.1 p.p. The balance of payments data showed that much of the deterioration surprisingly came from the Net Exports of Goods although it remained positive, as Net Exports of Services and Net Income posted a smaller deficit.

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

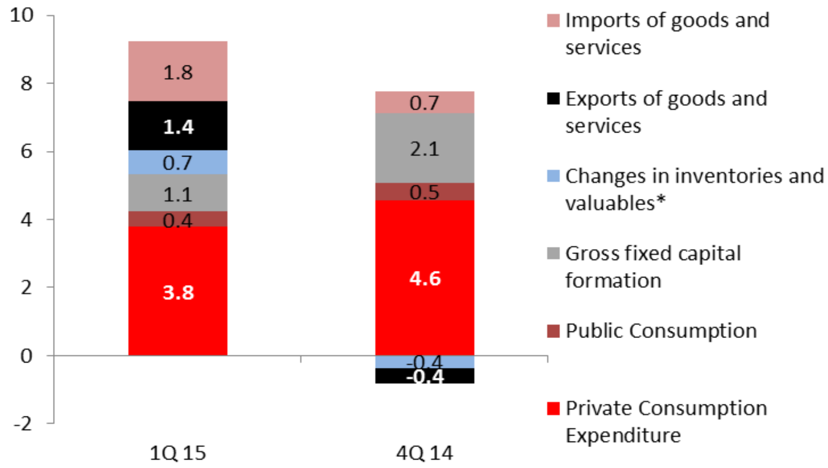
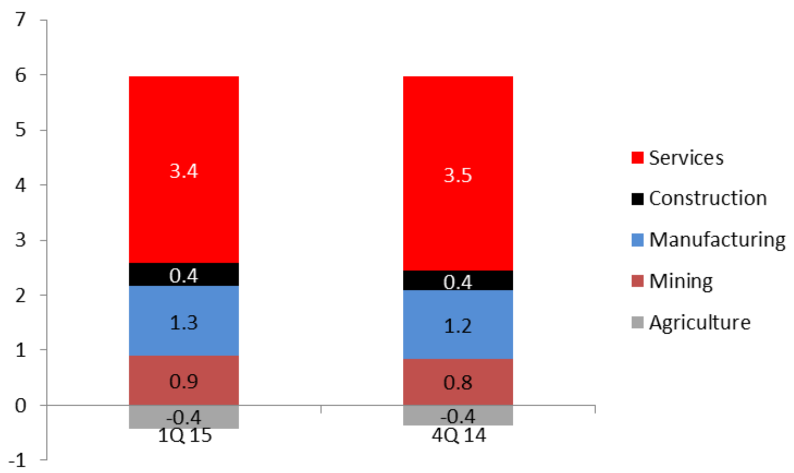


Chart 2: Percentage point (p.p.) share contribution to growth – By economic activity



Source: BNM, DoS

By activity, all sectors posted sustained or slightly faster growth except for Agriculture which continued to contract by a faster pace of 4.7% (4Q 14: -3.7%), led by the continued decline in the value-added of oil palm (-11.7%yoy vs 8.0% in 4Q 14). The sustained performance in the Manufacturing and Mining sector suggested that industrial activities, on the other hand, held up well although that has yet to translate into bigger gains on the Exports front. We expect the El-Nino effect may help prices of CPO to recover marginally but with volume likely to pick up ahead of the upcoming fasting and festivities months, which overall suggest the sub-sector may recover to post a small positive growth in the coming quarters.

Faster growth in Construction may herald the peak in investment in infrastructure projects. The sector posted a stronger growth of 9.7% vs 8.8% in the 4Q 14 led by sustained strength in residential and non-residential sub-sectors as well as the slight turnaround in civil engineering works. We expect going forward, the high base factor and the completion of many infrastructure projects will see growth to start to ease in the coming quarters.

The balance of payments posted bigger deficits despite bigger current account surplus given the continuous big outflows from the financial account.. During the quarter, current account surplus widened to RM10.0b or 3.7% of GNI from RM5.7b (2.1% of GNI). The goods account showed the surplus was smaller by RM1.9b to RM27.5b during the quarter, while the income and services accounts posted smaller deficits, at RM13.8b and RM3.8b respectively (4Q 14: -RM18.2b and –RM5.5b, respectively). The pullback in the financial account continued to be sizeable. The financial account showed an outflow of RM29.7b in the 1Q 25 (4Q 14: -RM26.6b. While the outflow from portfolio investment has dwindled to RM7.9B against the RM20.3b recorded in the 4Q 14 and net FDI posted smaller deficit of RM1.2b (4Q 14: -RM2.5b), the outflow categorized under 'Other investment' posted a huge amount of RM20.6b during the quarter (4Q 14: -RM4b).

..resulting in bigger drawdown in FX reserves. The sharper outflow led to the overall balance of payments positing a drawdown of FX reserves by as much as RM15.7b (4Q 14: -RM11.5b). The FX reserves which stood at RM389.7b (US$105.1b) at end-March 2015 is enough to cover 1.1x short-term debt (based on the new definition by BNM) and about 8 months of retained imports. As at end-April, FX reserves actually rose slightly to RM392.4b (US$105.8b). .

The external debt ticked up, but smaller short-term debt relieved some pressure off FX reserves, but the position is relatively unchanged nonetheless. Total external debt continued to edge up by RM20.6b to RM768.1b over the quarter, against RM747.5b in the 4Q 14. However, the short-term debt levels fell by RM16.9b to RM346.41b now representing a smaller share of total external debt at 45.1% (4Q 14: 48.6%). The medium- to long-term debt rose by RM37.4b during the quarter to RM421.69b, notably bigger than the RM27.7b net increase recorded for the whole of 2014. Due to the higher GNI, total external debt as a % of GNI came down to 65.9% at the end of the 1Q 15 from 67.55 at the end of 2014.

Going forward, we expect domestic demand to cool down in 2Q 15 due to the post-GST effects. On GFCF, the high base factor and the completion of many infrastructure projects will see growth to start to ease in the coming quarters. On sectoral front, we expect some improvement in the Agriculture numbers mainly on slight recovery expected in the CPO value-added numbers. However, the high base factors may see the strong growth in value-added numbers from the Mining of crude oil to taper off in the latter part of the second half of the year. However, net exports should start to contribute small positive growth and with private consumption stabilizing, growth should still be well within our earlier call of 4.7% for the whole of 2015.

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