4 February 2016

MONTHLY ECONOMIC REVIEW | January 2016

Leading Indicator Re-Entered Negative Territory

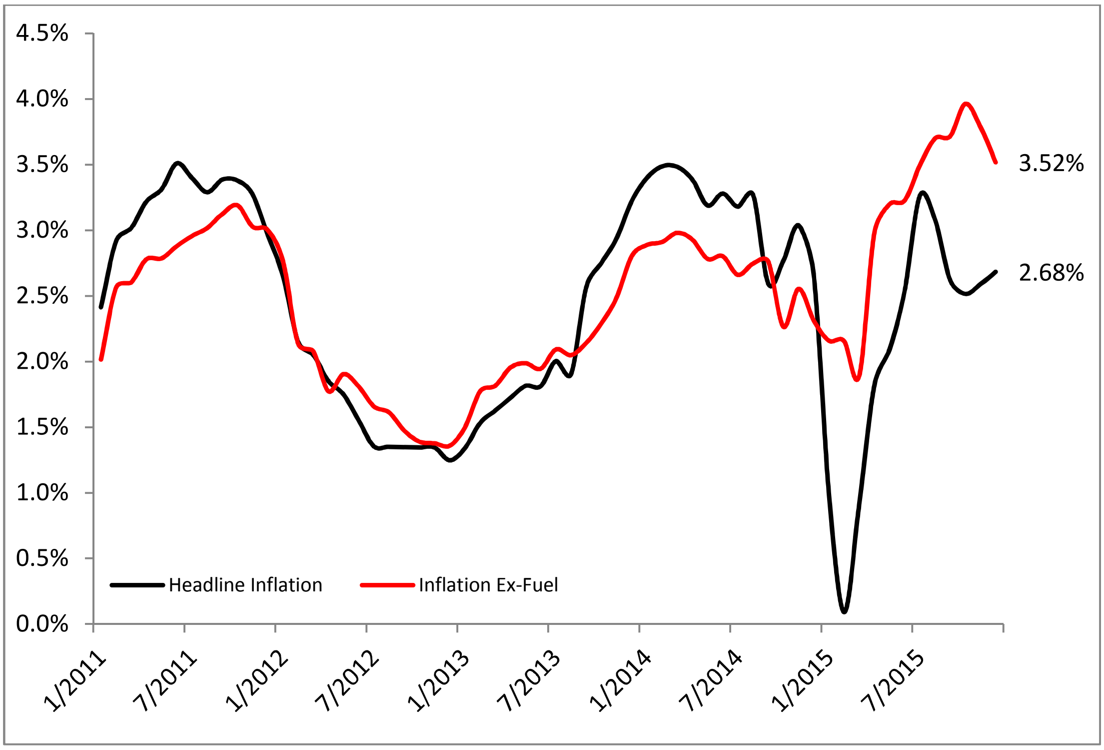
- *Leading indicator has re-entered negative territory in November, after briefly rebounding in the previous month. As such, we could expect the economy to see slower growth in 1H16 while a rebound in the 2H16 is also unlikely due to slow global trade activity this year. We have revised our GDP expectation to 4.4% for year 2016 from 5.0%, underlining a more challenging year compared to 2015 due to both domestic and external headwinds.*
- *Inflationary pressure continues to be capped by low oil price and recent lift on Iran's sanction has put extra pressure on oil prices. We maintain our inflation forecast for year 2016 at 2.90% despite the oil prices is expected to remain weak for the year. Increase in price of tobacco products due to an increase in excise duty by the end of last year will offset the deflationary effect of lower pump price for year 2016.*
- *Recent development in the global economy and mixed economic data from the US economy could pressure the FED to slow down their normalisation plan in 2016. We are revising downward our expectation of US interest rate to 1.00% by end of 2016.*
- *The risk of slowdown in private consumption in 2016 has slightly increased with negative development in the economy as pointed by the leading indicator. Hence we are expecting BNM will cut its interest rate by 25 basis points in the second half of 2016 to 3.00%.*

Malaysia's leading indicator dipped into negative territory for the 5th time in 2015. Malaysia's leading indicator re-entered negative territory in November after rebounding in the previous month. Prior to October, the leading indicator has been negative for three consecutive months on year-on-year basis since July 2015. On a 3-month moving average basis, Malaysia leading indicator was still contracting by 0.28%, albeit slightly better than 0.39% contraction for the 3-month moving average in September. Moving forward, the negative momentum is expected to remain and this will be reflected in the GDP figure with a 2 quarter lag. On this score, we could expect that the economy is likely to be slow in the first half of 2016.

IPI moderated – slowest growth in 16 months. Manufacturing sector and electricity index registered weaker performance in November with year-on-year growth on multiple months low. Manufacturing grew by 4.1%yoy - the lowest in 6 months while reading of 2.0%yoy for Electricity Index was the weakest in 4 months. Mining Index continued to contract by 4.1%yoy as mining industries moderated due to sustained low commodity prices. Overall, IPI growth moderated to 1.9%yoy, lowest in 16 months. On a monthly-seasonally adjusted basis, IPI declined by 1.1%mom in November, the worst reading in 3 months as mining sector continued to be a drag. For 2016, we are expecting IPI growth to moderate to 4.5% - 5.0%.

Highest trade surplus for the first eleven months in 3 years. Despite the rather muted performance of November trade, Malaysia recorded the highest trade balance for the first eleven month of trade in 3 years. Trade balance in November stood at RM10.2 billion, the second highest figure of the year. Both exports and imports grew on year-on-year basis by 6.3% and 9.1% respectively but decline on a seasonally adjusted month-on-month basis by 5.2% and 1.3% respectively. Manufactured goods continued to drive exports performance, expanding by 9.0%yoy while mining goods still on the downtrend – declining by 11.0%yoy. Chemicals and petroleum products were the standout performer which saw exports of both items grew by 24.7%yoy. We noted that exports to Philippines expanded tremendously by 40.3%yoy while exports to China also notched double-digit growth at 14.3%yoy.

Chart 1: YoY Inflation



Source: DoS, CEIC, MIDF Research

Headline inflation reached 2.68%yoy in December, inflation in January 2016 is expected to edge higher. On year-on-year basis, consumer price index rose by 2.68%yoy. Food and non-alcoholic beverages (FNAB) index grew by 4.56%yoy, continuing the stretch of inflation figure above 4% for the 5th month. In contrary, fuel and lubrication items are still experiencing lower prices as pump prices remains low. Inflation ex-fuel, where we took out the fuel price from the CPI basket, edged lower to 3.53% in December compared to 3.79% in November. On the other hand the headline resumed its upward trajectory to 2.68%, up from 2.59% in November. As previously mentioned, due to the low oil price in the first quarter of 2015, we are expecting that the gap between headline inflation and inflation ex-fuel would gradually reduce.

Fed interest rates normalisation process is expected to moderate. US labour market has improved further, however labour market indicators could be considered as a lagging indicator. Moving forward, due to the various headwinds in both global and financial market, there is a higher risk for the recovery of US economy. The fact that the employment to population ratio post Global Financial Crisis remains low is making the US economy vulnerable towards economic headwinds. For now, we are expecting that downside risks of Asian economy could be the catalyst for the Fed to slow down its normalisation process. Since there are higher downside risks in the Asian economy, we are revising our fed funds rate expectation to 1.00% by end of this year, reflecting 50 basis points increase for the whole of 2016. We are expecting that the uncertainty in the Asian economy will cause the Fed to slow down its normalisation process in monetary policy.

Lift of sanction on Iran will not have immediate effect on the global oil supply. Post lifting of sanctions on Iran, the top-10 oil producing nation globally could potentially flood the market with an addition 500-to-1,000kbpd of crude oil daily. However, the surge in production would not necessarily be immediate due to various factors such as licensing, contracting and issues with their financial system. Major oil producers such as Lukoil, Total, BP, Shell, Statoil, Repsol, Eni, OMV and Mol have displayed interests to return to Iran after the sanctions are lifted.

China's economy recorded slowest growth in decades; Q4 2015 came in at 6.8%. China economy grew by 6.8%yoy in 4Q15, leading to an overall economic growth of 6.9% for year 2015. As expected, the secondary industry slowed down further from 7.3% growth in year 2014 to only 6.0%, while services industry improved from 7.9% to 8.3%. For the services industry, despite the fact that it grew by 8.3% for the whole year, the industry actually slowed down in the fourth quarter, from 8.6% in 3Q15 to 8.0% in 4Q15. However, we believe the lower growth in the fourth quarter was partly due to the high base effect. The more prevalent issue is the GDP deflator. China's GDP deflator became negative for three out of four quarters in 2015, with the lowest value in 4Q15 at -0.9. It should be noted that China never had a negative GDP deflator except during financial crisis i.e. Asian Financial Crisis and Global Financial Crisis.

Table 1: China GDP Growth vs GDP Deflator

Year	GDP Deflator	GDP Growth	Remarks
1998-1999*	-0.6	7.7	Asian Financial Crisis
2009	-0.3	9.2	Global Financial Crisis
2014	-6.3	7.3	
2015	-0.36**	6.9	

Note: *=Average figure for the years of 1998-1999
**=Annualised GDP Deflator based on the first 3 quarters figure
Source: CEIC, MIDFR

(YoY%) unless stated otherwise	2014	2015e	2016f	4Q15e	1Q16f	2Q16f	3Q16f
Real GDP	6.0	5.0	4.4	4.6	4.2	4.2	4.7
Private consumption expenditure	7.1	5.5	3.1	2.6	2.0	3.1	3.3
Government expenditure	4.4	4.7	3.6	4.6	2.9	2.9	3.8
Gross fixed capital formation	4.8	3.4	3.8	1.0	-0.4	5.3	2.4
Exports of goods and services	5.1	1.0	3.6	4.3	4.5	7.8	1.8
Imports of goods and services	4.2	1.5	3.6	3.7	3.4	8.5	2.1
Net exports	12.8	-2.0	3.7	9.4	2.5	-0.2	0.1
Nominal GDP	8.6	4.4	4.1	4.2	4.7	4.5	3.8
Exports of Goods (f.o.b)	6.3	1.9	3.9	8.0	7.5	5.9	3.1
Imports of Goods (c.i.f)	5.3	0.4	3.2	4.0	4.4	9.3	1.9
Trade Balance – RMb	82.5	94.3	101.0	30.4	28.0	16.0	25.0
Consumer price index	3.2	2.2	2.9	2.6	3.9	3.0	2.3
Current account – RMb	49.5	30.0	25.0	-	-	-	-
Current account - % of GNI	4.8	2.8	2.5	-	-	-	-
Fiscal balance - % of GDP	-3.5	-3.2	-3.1	-	-	-	-
Federal government debt - % of GDP	52.7	54.3	53.8	-	-	-	-
	2014	**2015**	**2016f**	**4Q15**	**1Q16f**	**2Q16f**	**3Q16f**
Brent Crude Oil (Avg)	99.4	53.6	40.0	44.7	-	-	-
Crude Palm Oil (Avg)	2,415	2,168	2,300	2,160	-	-	-
USD/MYR (Avg)	3.273	3.907	4.175	4.283	-	-	-
EUR/MYR (Avg)	4.347	4.336	4.525	4.692	-	-	-
JPY/MYR (Avg)	3.096	3.228	3.400	3.527	-	-	-
SGD/MYR (Avg)	2.583	2.840	2.850	3.043	-	-	-
Brent Crude Oil (End of)	57.3	37.3	45.0	37.3	35.0	35.0	45.0
Crude Palm Oil (End of)	2,297	2,200	2,200	2,220	2,500	2,300	2,200
USD/MYR (End of)	3.497	4.294	4.000	4.294	4.150	4.050	4.100
EUR/MYR (End of)	4.251	4.691	4.500	4.691	4.550	4.500	4.550
JPY/MYR (End of)	2.922	3.572	3.350	3.572	3.450	3.350	3.400
SGD/MYR (End of)	2.647	3.040	2.850	3.040	2.900	2.800	2.850
Yield on generic 10-year MGS (%)	4.15	4.19	4.06	4.19	3.90	3.85	3.75
3-month KLIBOR (%)	3.86	3.84	3.60	3.84	3.80	3.75	3.60
Overnight policy rate (%)	3.25	3.25	3.25	3.25	3.25	3.25	3.00

January Key Economic Events

4 Jan 2016: Saudi Arabia cut ties with Iran. Saudi Arabia cut off diplomatic relations with Iran on Sunday, giving its diplomats 48 hours to vacate their embassy, as anger spread across the Shiite Muslim world following the kingdom's execution of prominent Shiite cleric Nemer al-Nemer. Crowds of incensed Shiites demonstrated in cities from Tehran to Beirut, condemning the execution and calling for the downfall of the Saudi government.

12 Jan 2016: Moody's Cuts Malaysia Credit-Rating Outlook. Moody's Investors Service lowered its credit-rating outlook for Malaysia, citing an external environment that has crimped government revenue despite Prime Minister Najib Razak's efforts to improve the country's finances. The ratings company cut the outlook on the A3 sovereign rating to stable from positive.

22 Jan 2016: BNM Cut SRR by 50 Basis Points. Monetary Policy Committee cut the Statutory Reserve Requirement (SRR) by 50 basis points to 3.50% in January as to ensure ample liquidity in the financial institutions. The loan to deposit ratio in the financial system is beginning to tighten as it reached 91.0% level November 2015, significantly higher than 86.6% in November 2014.

5 Jan 2016: Manufacturing in U.S. Contracts at Fastest Pace in Six Years. Manufacturing in the U.S. contracted in December at the fastest pace in more than six years as factories, hobbled by sluggish global growth, cut staff at the end of 2015. The Institute for Supply Management's index declined to 48.2, the weakest since June 2009, from 48.6 a month earlier, the Tempe, Arizona-based group's report showed Monday. Readings lower than 50 indicate contraction.

13 Jan 2016: Crude Falls Below $30. Oil dropped below $30 a barrel in New York for the first time in 12 years on concern that turmoil in China's markets will curb fuel demand. West Texas Intermediate crude tumbled to the lowest since December 2003. Concerns that China's economic growth may slow has soured investors on the prospects for a quick recovery, turning hedge funds the least bullish in five years.

28 Jan 2016: Budget 2016 Recalibrated. Due to the lower than expected oil price, Malaysia Government has issued a recalibrated Budget 2016, with two base case scenario; one is if the oil price average at $35 per barrel, and the other is if the oil price average at $30 per barrel. The expenditure cut is divided proportionately by 50% each for both operating and development expenditure. The overall budget deficit is still maintained at 3.1% as Government is steadfast in keeping with its fiscal consolidation plan.

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