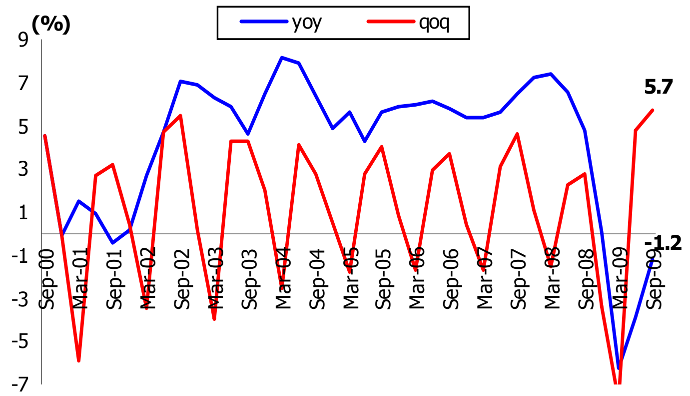
Economy

AMB

MALAYSIA: 3Q09 & 2009 GDP Review, 2010 Outlook

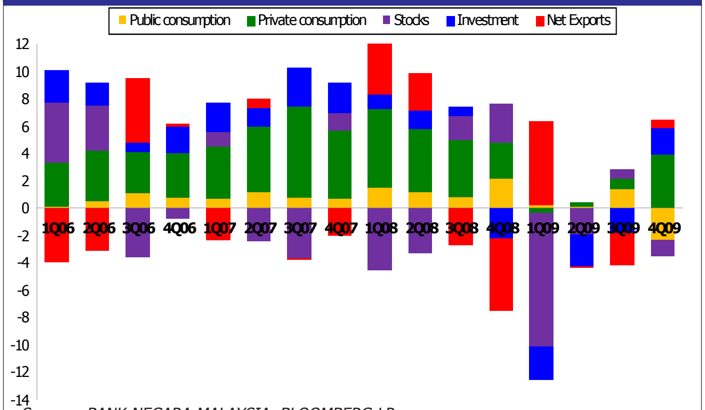
25 NOVEMBER 2009
2009/057

GROSS DOMESTIC PRODUCT (%YOY & %QOQ)



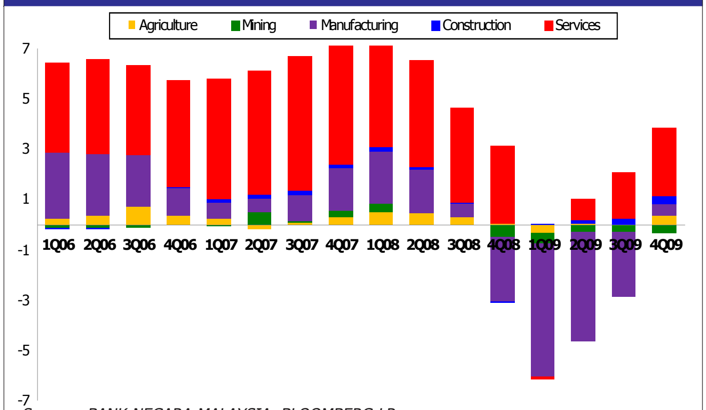
Source : BANK NEGARA MALAYSIA, BLOOMBERG LP

GDP BY EXPENDITURE (% points contribution)



Source : BANK NEGARA MALAYSIA, BLOOMBERG LP

GDP BY ACTIVTIES (% points contribution)



Source : BANK NEGARA MALAYSIA, BLOOMBERG LP

SUMMARY

Real GDP contracted by 1.2% yoy in 3Q09, moderating from the 3.9% decline in 2Q09 and substantially better than the market and our expectations of -2.0% and -2.6% respectively. On a quarterly basis, GDP grew by 5.7% following a growth of 4.8% in 2Q09, reaffirming our view that growth momentum is picking up and a positive annual growth in 4Q09 seems imminent. The strengthening of domestic demand following improved private consumption and faster public spending contributed to the smaller overall growth contraction in 3Q09, and would support a 3.0% expansion in 4Q09. Overall, we are revising our 2009 GDP growth estimate to -2.0% yoy from -2.5% earlier. For 2010, we maintain our GDP growth forecast of +3.5% yoy on the back of firmer consumer spending, while recovery in external demand could probably be sluggish.

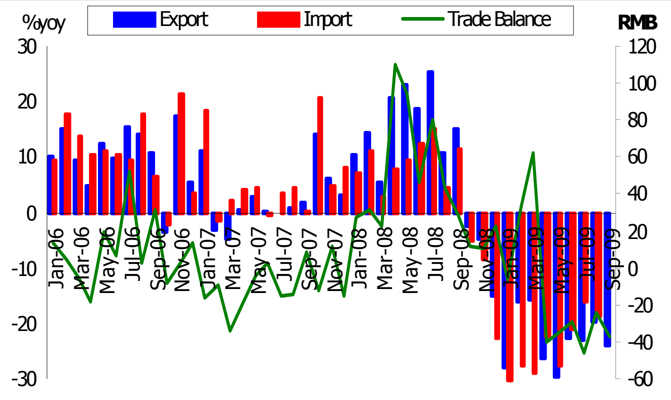
3Q09 REVIEW AND 4Q09 ESTIMATE

- Domestic demand continued to buffer the weakness on the external front in the 3Q09, posting its first annual growth for the year (+0.4% yoy) following two consecutive contractions in 1Q09 (-2.9%) and 2Q09 (-2.2%). Swifter implementations of the two stimulus packages together with higher government operating expenditure contributed the most in consumption, as the rate of increase in public consumption spending accelerated to 10.9% yoy in 3Q09 from 1.0% in the previous quarter, and added 1.4 percentage-points to the overall GDP growth, the biggest among demand components.

- Public spending could continue to boost growth in the final quarter of the year given an approximate 30% or RM5.1 billion to be spent in 4Q09, based on Government announcements that about 70% of the total allocation for 2009 from the two stimulus packages had been spent up to September. However, the high base effect from the same quarter last year could drag the annual growth of public consumption to -12.0% in 4Q09, taking the overall 2009 public consumption to contract by a 0.9%.

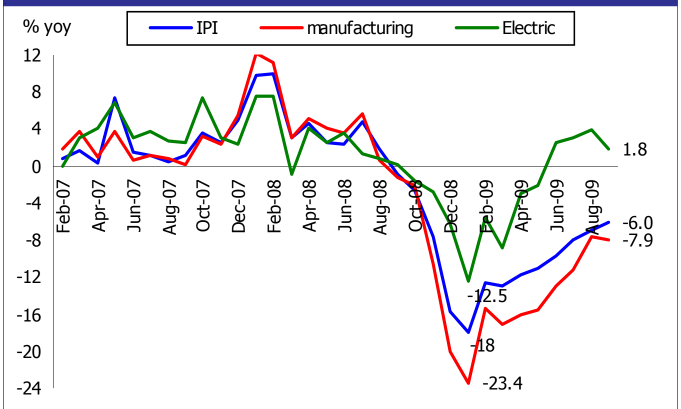
- Similarly, private consumption continued to improve in 3Q09, expanding by 1.5% yoy following a 0.5% increase in 2Q09. Higher household consumption on food and beverages, transport and communication due to festive season helped push the overall consumer spending in 3Q09 while stability in the job market injected further consumer confidence. Consumer sentiment is expected to strengthen further in

EXPORTS, IMPORTS & TRADE BALANCE (%YOY)



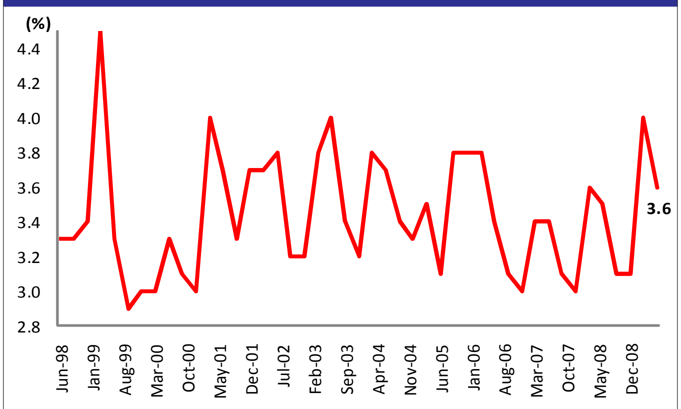
Source : MATRADE, BLOOMBERG LP

INDUSTRIAL PRODUCTION INDEX (%YOY)



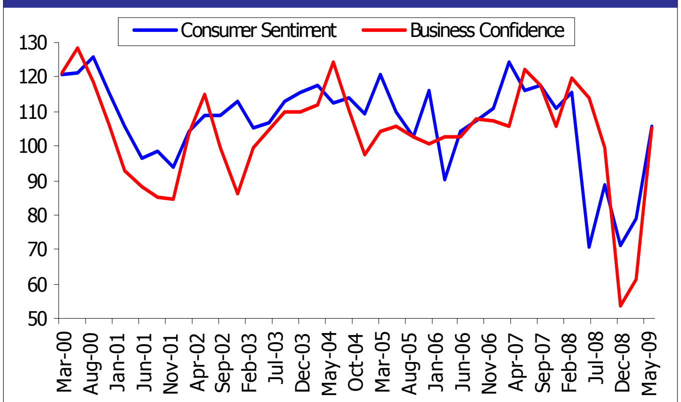
Source : DEPARTMENT OF STATISTICS, BLOOMBERG LP

UNEMPLOYMENT (%)



Source : MINISTRY OF HUMAN RESOURCE, BLOOMBERG LP

MIER CONSUMER & BUSINESS CONFIDENCE INDEX



Source : MIER, BLOOMBERG LP

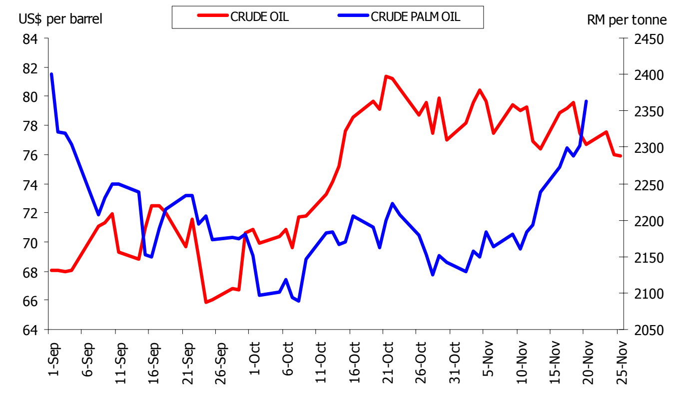
the final quarter of the year as the pace of retrenchment had declined significantly, while manufacturers had begun rehiring for four consecutive months since June 2009. Furthermore, the rally in the local stock market (+50% from bottom in March) and improving commodity prices would build greater confidence as well as create stronger wealth effects to further support spending. As such, also supported by the holiday season towards the end of the year, private consumption could expand by 7.3% in the final quarter of the year.

- Investment however failed to track the pace of consumption albeit posting a smaller decline than the previous quarter, suggesting a speedier implementation of projects under the stimulus packages and the ongoing deleveraging process, while businesses were still wary of the prospect of the economy. Fixed capital formation in 3Q09 fell by a smaller magnitude of 7.9% yoy as compared to 9.6% in 2Q09 and continued to drag the overall GDP by 1.8 percentage-points. However, given the quicker and more aggresive implementation of stimulus projects and the slight improvement in the global and domestic business environment amid sustained low and stable interest rates, investment may see positive growth in 4Q09, estimated at 9.5% yoy.

- Exports continued to be the biggest drag to the local economy in 3Q09 as demand from major economies remained depressed. Although the rate of contraction has narrowed substantially from 24.0% in 2Q09 to 13.4% in 3Q09, the smaller contraction in imports (-12.9% in 3Q09 vs -20.0% in 2Q09) resulted in the rate of decline in net exports to have widened to 16.9% in 3Q09 from -0.7% in 2Q09. Imports could continue to outpace exports in 4Q09 as recent data suggested that recovery in exports remained patchy while domestic demand derives its expansion principally from consumption and restocking activities. Thus for the entire year, exports is expected to contract by 9.3% from a gain of 1.3% in 2008, while imports would decline by 11.4% in 2009 from +1.9% in the preceding year.

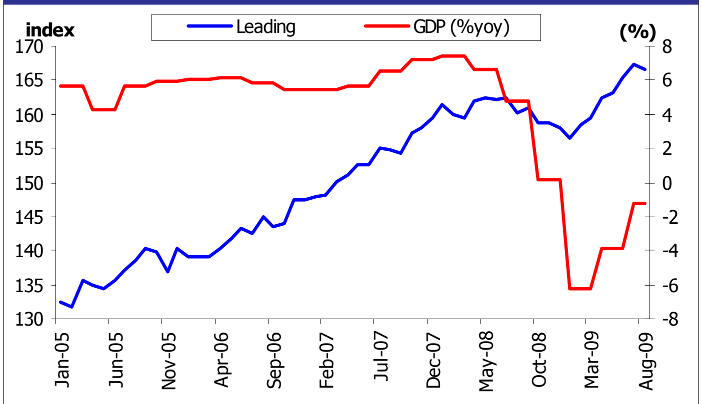
- On the supply side, the services (+3.4% yoy in 3Q09 vs 1.6% in 2Q09) and construction (2.0% yoy in 3Q09 vs 1.0% in 2Q09) sectors contributed the most to the better GDP performance in 3Q09. The manufacturing sector also saw its rate of contraction narrowed from 14.5% yoy in 2Q09 to 8.6% in 3Q09 but remained as the worst performing sector. The smaller depletion in stocks however signaled a possible beginning of restocking activities following nine consecutive quarters of stocks outflow. However, as suggested by the bumpy recovery in industrial production and the uncertain outlook on external demand, manufacturing is only expected to post a small growth of 1.5% in 4Q09, mostly attributed to low base effect. For the whole of 2009, manufacturing sector would register a decline of 10.0% from a growth of 1.4% in 2008.

CRUDE OIL & PALM OIL SPOT PRICES



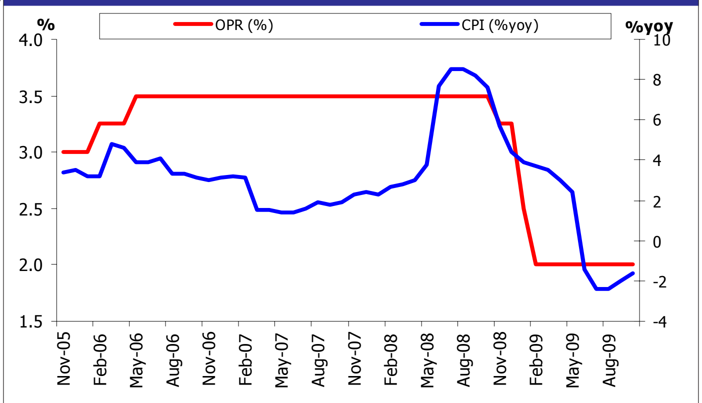
Source : BLOOMBERG LP,

COMPOSITE LEADING INDEX vs GDP



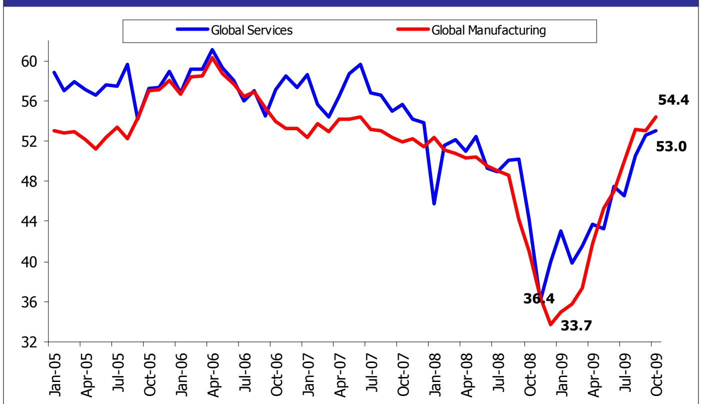
Source : BANK NEGARA MALAYSIA, DOS, BLOOMBERG LP

CPI & OPR



Source : DOS, BLOOMBERG LP, Bank Negara Malaysia

PMI GLOBAL MANUFACTURING & SERVICES INDEX



Source : JP MORGAN, BLOOMBERG LP

2010 ECONOMY PROSPECTS

- The domestic economy will continue to face challenges next year and growth is expected to be subpar and below potential. As one of the largest trade-dependent economies, Malaysia's performance in 2010 will continue to track global economic performance driven by the developed countries, especially the United States. Despite signs of recession ending, the high unemployment rates (10.2% in the US and 9.7% in the Euro region) and the continued deleveraging process would hinder any strong recovery in the major economies, and could also cause a relapse of economic downturn to the global economy.

- Nonetheless, given the massive fiscal stimulus worldwide coupled with the loose monetary policy that will likely be maintained at least until the recovery is more entrenched, the current economic risks is more to the upside. External demand could regain traction especially towards 2H10 as global financial crisis unwinds and the commencement of inventory cycle globally could prompt demand for Malaysia's products. Evidently, the global PMI Manufacturing Index and Services Index had both risen significantly and maintained in the expansionary level since August, while at the same time the OECD Composite Leading Indicator, one of the most widely used gauges of the global economic outlook, advanced for the eight consecutive months in October.

- To a significant extent, the local economic activity will be supported by higher domestic demand in 2010 as the mild recovery in exports will likely boost consumer and business confidence as well as stimulating an improvement in the job market. As it stands, the domestic unemployment rate fell in 2Q09 to 3.6% from 4.0% in 1Q09 whilst the manufacturing sector registered a modest net increase in employment for the fourth month in September and wages were up for the fifth consecutive month. Furthermore, stability in commodity prices could further instill consumer confidence and at the same time adds to the rural income.

- In the same vein, private investment is also projected to increase next year from a low base in 2009 as businesses and investors resume their investment in an expected improvement of the macroeconomic environment. The liberalization measures announced in 2009, and possibly more next year, could draw investments from both local and foreign entities as the Government stimulates the private sector to become the main engine of growth. However, following the contractionary 2010 Budget announced in October, public consumption as well as investment will be significantly lower next year. Although the current economic environment portends towards an upside potential, the fiscal consolidation in 2010 could pose as a major downside risk to growth to the domestic economy should the global economy fails to recover or the downturn relapses.

- On the assumption of further improvement in consumer spending and recovery in private investments, the services sector could accelerate and continue to lead other economic activities in 2010. This is also aligned with the Government's focus of shifting towards services driven growth strategy in the soon to be announced New Economic Model. Manufacturing sector is also expected to expand, albeit moderately next year as inventory liquidation in the past two years will be replaced by restocking activities following recovery in external demand. Higher demand for raw materials given the resumption in production and pick up in global trade will lend support to both agriculture and mining activities, instigating a faster growth in 2010 as compared to 2009. Construction is the only sector expected to grow slower next year, amid limited public sector support. Smaller allocations for transport infrastructure may imply that some major infrastructure projects could be funded off-budget.

- **Overall, we expect 2010 GDP to expand by 3.5%, following an estimated 2.0% contraction in 2009, led by private consumption and investment.**

- As a result of fiscal tightening in 2010, we expect monetary and credit policy to remain accomodative next year. With the output gap remaining negative through most of 2010, demand pull inflation is likely to remain subdued. Although the supply side inflation pressures from subsidy adjustments in early 2010 could pose upside risks to our 2.0% 2010 CPI inflation forecast, this is unlikely to trigger a significant change in monetary policy stance. Given the rising household debt, consumer spending and asset quality could be affected if interest rates were to be raised too rapidly from current low levels. Indeed, the central bank in its latest monetary policy meeting provided no signs of an exit strategy while reiterated that the current policy stance was assessed to be appropriate. As such, we maintain our view that OPR will only be raised in 2H10 at the earliest.

MALAYSIA GROSS DOMESTIC PRODUCT

	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09e	2008	2009e	2010f
GROSS DOMESTIC PRODUCT	**4.8**	**0.1**	**-6.2**	**-3.9**	**-1.2**	**3.0**	**4.6**	**-2.0**	**3.5**
Agriculture	3.3	0.5	-4.3	0.3	-0.5	3.9	4.0	0.0	2.6
Mining	-0.3	-5.7	-5.2	-2.6	-0.6	-3.4	-0.7	-4.2	1.1
Manufacturing	1.8	-8.8	-17.9	-14.5	-8.6	1.8	1.4	-10.0	3.2
Construction	1.2	-1.6	1.1	2.8	2.0	3.0	2.2	6.2	3.2
Services	7.1	5.7	-0.2	1.6	3.4	4.5	7.3	2.5	5.1
Consumption	7.9	7.1	-0.2	0.6	3.3	2.3	9.0	1.6	3.0
Public consumption	6.4	12.7	2.1	1.0	10.9	-12.0	10.9	-0.9	-3.0
Private consumption	8.2	5.3	-0.7	0.5	1.5	7.3	8.5	2.2	4.5
Stocks	48.2	-76.0	572.8	131.3	-39.6	134.0	10.0	804.2	-95.3
Investment	3.1	-10.2	-10.8	-9.6	-7.9	9.4	0.8	-5.3	1.5
Net Exports	8.3	-11.4	-23.9	-21.3	-16.9	7.7	2.2	7.8	-16.8
Exports	4.5	-13.3	-15.2	-17.3	-13.4	11.1	11.0	-9.3	3.0
Imports	7.7	-10.2	-23.5	-19.7	-12.9	11.4	1.9	-11.4	6.0

Source : Bank Negara Malaysia, Department of Statistics Malaysia, Bloomberg LP, Research Division PNB