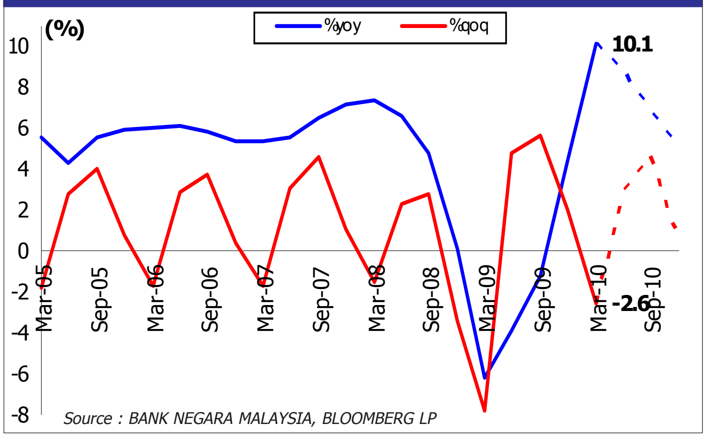
MALAYSIA: 1Q10 GDP Review, 2010 Outlook - The uneven year

19 MAY 2009
2010/019

SUMMARY

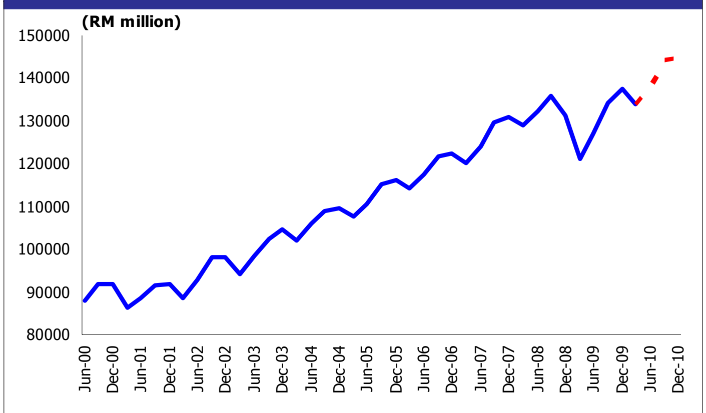
- **Malaysia's real GDP expanded robustly at 10.1% yoy in 1Q10 from 4.5% in 4Q09 and the fastest since 1Q00 (11.7%). This came a tad lower than our 10.2% estimate but higher than market consensus of 9.6%.**
- **Growth was broad based, spearheaded by the buoyant performance of manufacturing and services sectors while on the demand side, it was led by exports, private consumption and investment. However, the value of real GDP remained 1.8% below the level in 3Q08.**
- **Given the buoyant 1Q10, we maintain our forecast of 7.0% to 7.5% growth for the whole year of 2010 with a view of a slower GDP increase during 2H10. Exports will continue to lead economic growth for the year, to be supported by sustained domestic spending.**
- **Risks to forecast are more to the downside and externally induced particularly the contagion effects of European debt crisis, unwavering high unemployment rates in major economies and rising inflationary fears among emerging countries. These could derail Malaysia's export recovery and overall growth.**
- **OPR is expected to be maintained in BNM's July meeting at 2.50% as uncertainties on the external front heightens, but the hike may continue in September by 25 bps as the central bank embarks on normalisation of the interest rate level.**
- **Inflation is expected to remain subdued for the balance of the year and is projected to average between 2.0% to 2.5% given the limited demand and supply price pressures.**
- **Ringgit is expected to remain strong throughout the year at 3.15 to 3.20 against the US dollar as the external current account surplus remains large and real interest rate level continues to be positive throughout the year.**

GROSS DOMESTIC PRODUCT (%YOY & %QOQ)



Source : BANK NEGARA MALAYSIA, BLOOMBERG LP

GROSS DOMESTIC PRODUCT (RM BILLION)



Source : BANK NEGARA MALAYSIA, BLOOMBERG LP

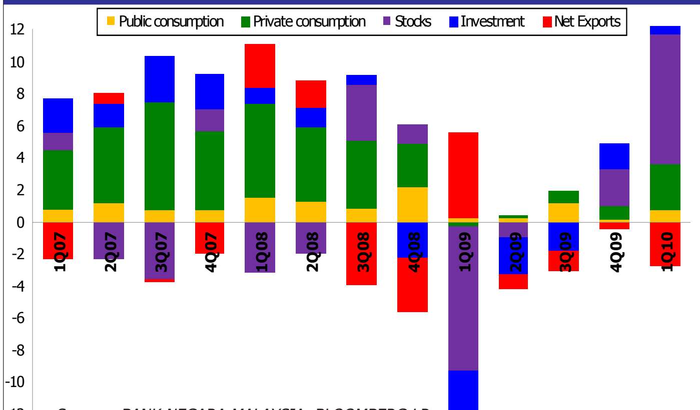
1Q10 MALAYSIA GDP REVIEW

- The Malaysian economy began the year on a strong note, with growth accelerating to 10.1% yoy in 1Q10 from 4.5% in the preceding quarter. This is also the strongest pace seen since 1Q00, when the economy expanded by 11.7%. A sturdy recovery in exports together with improvements in both the consumption and investment spending contributed the most in overall growth in 1Q10, amidst the depressed base in 1Q09, which was also the weakest point of the downcycle following the global economic crisis.

- On a quarterly basis, real GDP shrank by 2.6% in 1Q10 following +2.0% in 4Q09 due to seasonal factors. This was consistent with the past years trend. The strength of the recovery momentum was also evident during the quarter, as the quarterly decline was much smaller than the previous 10 years 1Q average contraction of 3.2%. However, the value of GDP in 1Q10 remained 1.8% below the level in 3Q08, before the economy slid into recession in 1Q09.

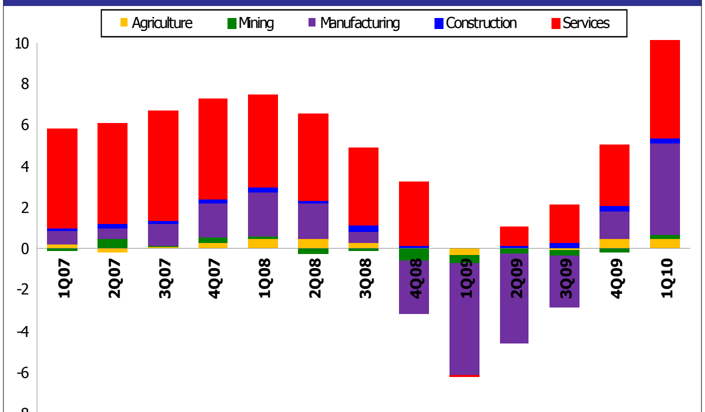
- Exports posted a strong recovery in 1Q10, growing at 19.3% from +6.0% in 4Q09. Sustained global recovery propelled growth in external demand while the depressed base in 1Q09, when exports contracted by 15.5%, helped boost export growth. However, given the severe deterioration in export performance during the 1H09 as a consequence of the global financial crisis, its recovery in 4Q09 and 1Q10 was still insufficient to lift its value back to the pre-crisis level. It was still 9.6% lower than the value achieved in 3Q08.

GDP BY EXPENDITURE (% points contribution)



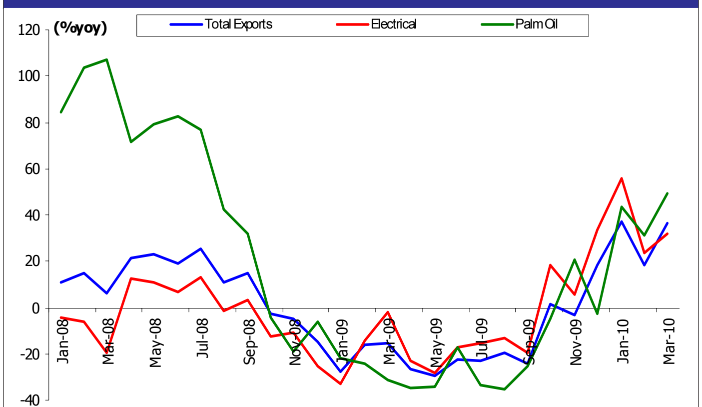
Source : BANK NEGARA MALAYSIA, BLOOMBERG LP

GDP BY ACTIVTIES (% points contribution)



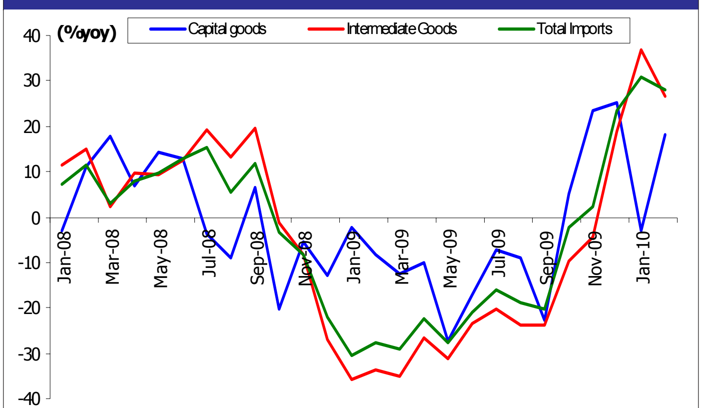
Source : BANK NEGARA MALAYSIA, BLOOMBERG LP

EXPORTS (%YOY)



Source : MATRADE, BLOOMBERG LP

IMPORTS (%YOY)



Source : DEPARTMENT OF STATISTICS, BLOOMBERG LP

- Meanwhile, imports continued to outpace exports during the quarter, resulting in a wider contraction of net exports of 12.9% and caused a 2.7 percentage-point negative contribution to the overall GDP growth. The strengthening of domestic demand during the 1Q10 accelerated import growth to 27.5% from 7.0% in 4Q09, thus depressing net exports.

- Domestic demand strengthened further in 1Q10, expanding by 5.4% from 2.8% in 4Q09 on the back of a faster public expenditure and further improvement in private consumption. Private sector contributed the most in terms of consumption during the quarter, adding 2.9 percentage points despite growing slower than public consumption. The pickup in private consumption was helped by improved consumer confidence given the better environment of the job market, firmer recovery of the stock market, higher commodity prices which boosted rural income and also the continuing accommodative interest rate level. Domestic consumption spending in 1Q10 was further supported by higher government operating expenditure which grew by 6.3% from 0.7% in 4Q09.

- Gross capital formation or investment was the only component on the demand side which moderated in 1Q10, with a growth of 5.4% from 8.2% in 4Q09 as the pace of government stimulus spending begins to slow. According to Government reports, the total amount spent under the 1st and 2nd stimulus packages had only increased to 63.2% as at end of March, from 60% at the end of 2009. At the same time, private investment had remained weak given the uncertainties on both the external and domestic fronts.

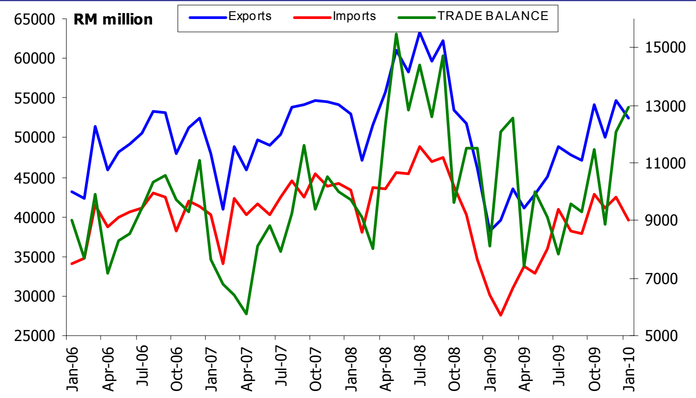
- Inventories resumed its contraction during the quarter by RM2.4 billion, after shrinking by a smaller RM0.3 billion in 4Q09. However, as the decline was significantly smaller than the RM12.4 billion drop in 1Q09, its contribution to the overall GDP growth increased to surpass exports, at 8.0 percentage points. Inventories had contracted for 11 straight quarters since 3Q07, reflecting manufacturers and possibly service providers are slow to respond to the actual growth in external and domestic demand.

- On the supply side, manufacturing had led the other sectors with a double-digit growth of 16.9% in 1Q10 from 5.0% in 4Q09, in tandem with the robust pace in exports. The acceleration in manufacturing sector growth was also amplified by low base effects. However, manufacturing output remained lower compared with the pre-crisis level by 7.0%, despite posting strong growth for two consecutive quarters, reflecting the severity of the impact of global economic crisis on the sector.

- The services sector, which accounted for 57.1% of total GDP, rose by 8.5% in 1Q10 following a 5.2% gain in the previous quarter on the back of a stronger growth in consumer spending and a turnaround in trade activities. Given its largest share of the GDP, the services sector contributed the most to the overall GDP growth amounting to 4.9 percentage points, despite growing at a slower pace as compared to manufacturing sector which added 4.4 percentage points.

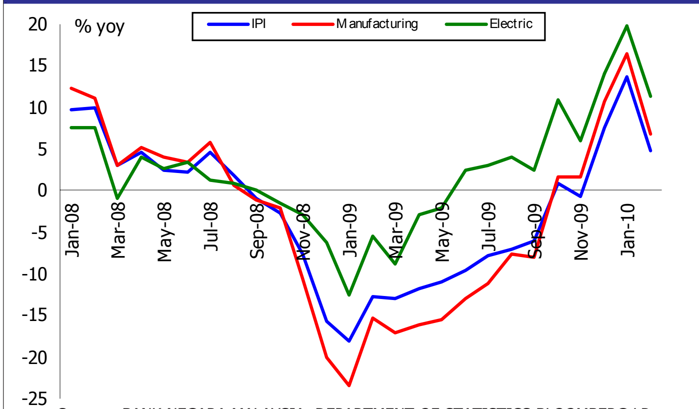
- Construction sector continued to enjoy the cumulative effect of Government's stimulus spending, despite its growth moderating to 8.7% in 1Q10 from 9.3% 4Q09. Both the agriculture and mining sectors also grew faster by 6.8% and 2.1% respectively in 1Q10, from 5.9% and -2.8% in 4Q09.

EXTERNAL TRADE (RM BILLION)



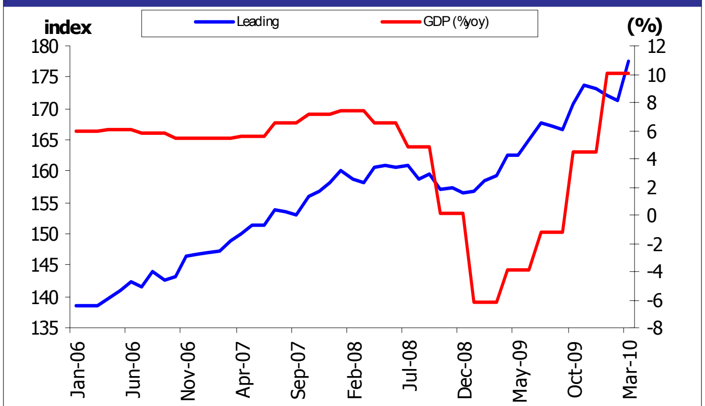
Source : BANK NEGARA MALAYSIA, MATRADE, BLOOMBERG LP

IPI (% YOY)



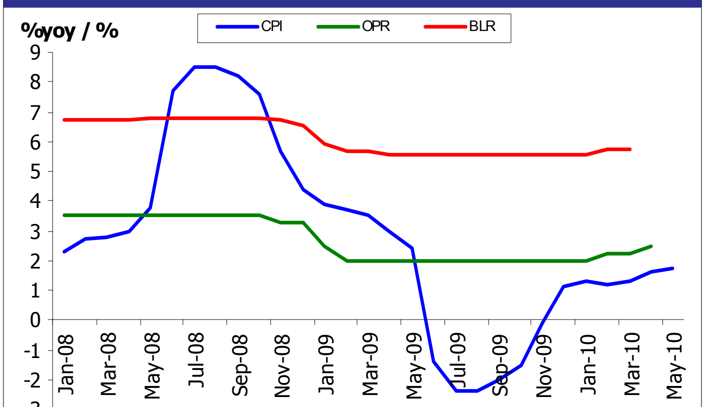
Source : BANK NEGARA MALAYSIA, DEPARTMENT OF STATISTICS BLOOMBERG LP

UNEMPLOYMENT RATE (%)



Source : BANK NEGARA MALAYSIA, DEPARTMENT OF STATISTICS BLOOMBERG LP

CPI vs OPR vs BLR (%)



Source : BANK NEGARA MALAYSIA, BLOOMBERG LP

GLOBAL ECONOMIC PERFORMANCE

- **Global economy continued to improve with almost all countries recorded positive GDP growth in 1Q10.** Despite concerns of the sovereign debt crisis in Europe, the latest economic data indicate that global economy continued to recover, with economic activities in emerging economies were already within or past their pre-crisis levels while major economies were beginning to show some semblance of self-sustainability. After the global economy contracted smaller than expected in 2009 by 0.6%, cushioned by vigorous fiscal and monetary stimulus, the recovery momentum remained intact in 1Q10 with inventory build-up, trade volume and private demand begin to subtly taking over from public demand and initiatives as the main driver of the economy.

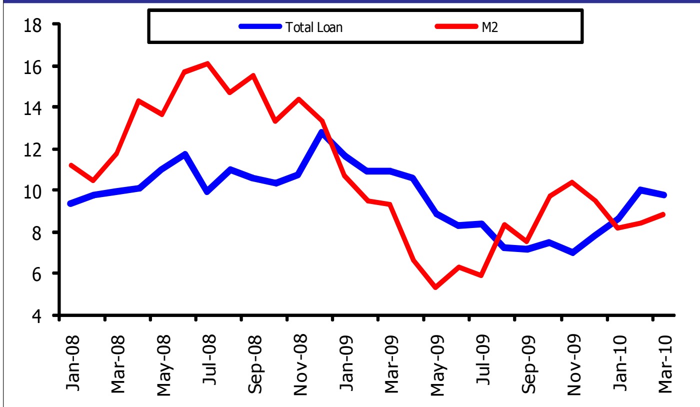
- The global PMI Manufacturing Index in April rose to its highest level since September 2006, reflecting the sustainability of global industrial production activities leading the recovery. At the same time, the Global PMI Services Index which had so far lagged the manufacturing index since the bottom in November 2008, has also picked up to match the manufacturing activity. Thus, the broadening base of the recovery from manufacturing to services signals a much sustainable recovery trend, especially among developed economies. Given these positive developments, the IMF in their latest WEO report upgraded its 2010 Global GDP growth projection to 4.2% from 3.9%.

- Among the major economies, US recorded the fastest growth in 1Q10, at 3.2% on quarterly annualised basis. However, this was slowercompared with growth of 5.6% and 2.2% in 4Q09 and 3Q09 respectively. Despite the deceleration, consumer spending accelerated by 3.6% in 1Q10, more than double the 1.6% increase recorded in 4Q09 and was the main contributor to the overall GDP growth by 2.6 percentage points. Despite the economy growing for three straight quarters and adding an average of 143,000 jobs since January 2010, the US unemployment rate rose in April to 9.9%. These suggest the while the US economy had improved for the past few quarters, it still needs to grow at a stronger pace to ensure a more wholesome recovery.

- The European Union (EU) economy posted its first annual growth since 3Q08, rising by 0.5% yoy in 1Q10 from -2.5% in 4Q09. Growth however was unbalanced among its country members, with major countries such as Germany and France, equipped with stronger fiscal capacity, outperformed the smaller countries. The sovereign debt crisis currently faced by Greece and could potentially spread to other financially challenged countries such as Portugal, Ireland, Italy and Spain may delay Eurozone's recovery process. Even though the US$1 trillion rescue package announced is widely expected to stabilise Europe's credit market, the austerity measures imposed on participating countries would limit its fiscal capacity to stimulate growth.

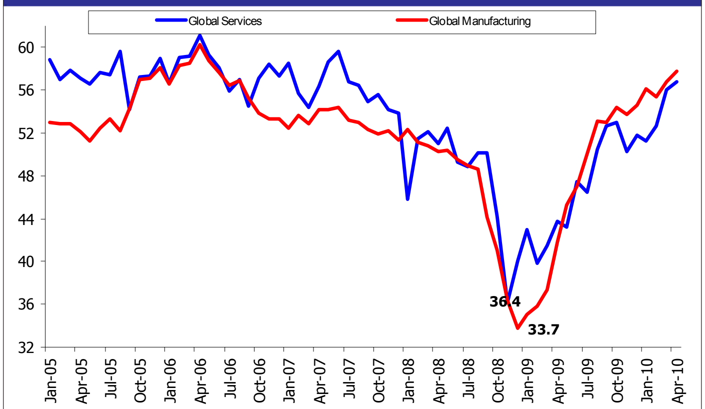
- Japan's strong export performance, higher household consumption and improving labor conditions portend towards a strong turnaround in its 1Q10 annual GDP growth rate, despite the persistent deflationary environment. Robust demand from China and improving shipments to other developed countries pushed exports growth to 43.2% yoy in 1Q10 after contracting by 5.8% in the previous quarter.

LOAN GROWTH vs M2 MONEY SUPPLY (%YOY)



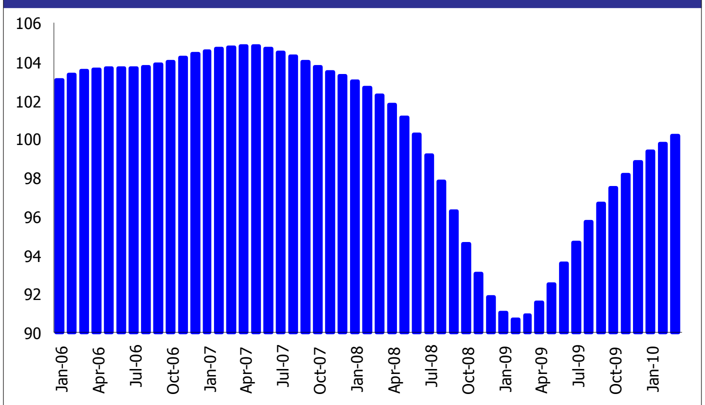
Source : BANK NEGARA MALAYSIA, BLOOMBERG LP

PMI GLOBAL MANUFACTURING & SERVICES INDEX



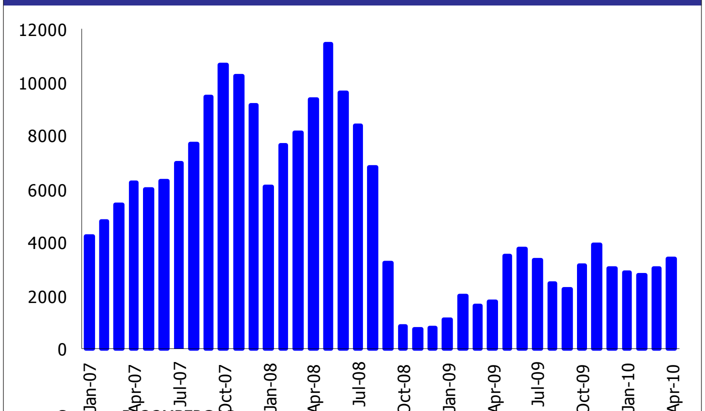
Source : BLOOMBERG LP

OECD COMPOSITE LEADING INDICATOR INDEX



Source : BLOOMBERG LP

BALTIC DRY INDEX



Source : BLOOMBERG LP

Household consumption also resumed its recovery, growing by 4.4% yoy in March, the fastest since December 2006, following various Government incentive measures and improvement in the labor market conditions which saw unemployment rate dropped to 5.0% in March from the 5.6% peak reached in July 2009.

- Developing Asian countries continued to lead the pace of global economic recovery and had strengthened further in 1Q10. Singapore, China and South Korea were among the first to announce their 1Q10 GDP which grew strongly by 13.1%, 11.9% and 7.8% respectively. Accelerating industrial production, robust domestic demand amidst high government spending and strong regional trade, especially with China, also suggested other regional countries such as Indonesia, Vietnam and Thailand to expand at a relatively similar pace in 1Q10.

MALAYSIA GROWTH PROSPECTS

- **Export recovery, fiscal stimulus spending and low interest rate would continue to support growth of the domestic economy in 2Q10.** While exports sustain a double-digit growth, domestic demand would continue to expand supported by the remaining allocations of the stimulus package and accommodative monetary policy. However, given the slightly higher base in 2Q09, GDP growth in 2Q10 is expected to moderate slightly to 8.0% to 8.5%. Thus the 1H10 GDP growth would average 9.1% to 9.4%.

- **However, the 2H10 is expected to see a slowdown as the effect of global stimulus package waning and the base effect normalising.** Globally, we expect GDP expansion for almost all countries to have peaked in 4Q09 and 1Q10 as the recovery momentum aided by the depressed base weakens and slowly adjusting to a more normal and sustainable pace going forward. Evidently, the monthly growth of the OECD composite leading indicator, a key gauge for global growth, had slowed for eight consecutive months, raising concerns over the strength of global recovery going into 2H10.

- **This was further intensified by the ongoing European sovereign debt crisis and its contagion risks to other countries.** After Greece's bailout by the EU and IMF, focus was shifted to other fiscally challenged economies both within and outside of Europe, prompting into a possible earlier than expected unwinding of the fiscal and monetary policy support. At the same time, fears of financial imbalances and inflation in developing economies such as China and India could also lead into implementation of tightening measures to curb these risks. As such, the impact of austerity measures, fiscal restoration and monetary policy tightening would derail global recovery momentum thus, Malaysia's growth prospect.

- **At this juncture however, the risk of a substantial slowdown or a double-dip is fairly remote, in our view.** Latest comments from policy makers globally continue to reflect their commitment in ensuring a more entrenched economic recovery before embarking on significant policy withdrawal. The massive rescue package announced by the EU leaders and the US dollar credit extension provided by the Federal Reserve reflect this commitment as they attempt to avoid the potential contagion risks of the European sovereign debt crisis. If anything, the latest crisis in Europe would turn policy makers to be more cautious and could potentially prolong the accommodative fiscal and monetary policies.

- **Given the backdrop of a moderation in global recovery, Malaysia's economic expansion in the 2H10 will also slow.** Exports which is estimated to expand by 18.8% in 1H10 could slow to 9.5% to 10.0% pace in 2H10 as demand from major economies declines. This however could be cushioned by the strong intra-regional trade on the back of robust domestic demand in Asian countries, particularly China, together with higher commodity prices. The faltering pace in exports growth would also prolong its full recovery, currently at 14.5% below 3Q08 level and only expected to fully recover in 1Q11.

- **Despite the slowdown, exports is expected to continue to lead overall growth as domestic demand will remain hinged on external demand performance and overall global economy prospect.** Given the expected volatility of economic data from both the global and domestic fronts, the growth pace of private spending and investment would remain below trend while interest rate normalisation could impact the situation further. Public spending however could help cushion the overall decline as the Government spends the remaining balance of the two stimulus package, estimated at RM7.7 billion. In addition, the Government had proposed a further allocation of RM12 billion supplementary budget to implement the six National Key Result Areas (NKRAs) under the Government Transformation Programme (GTP).

- **Overall, the rate of GDP expansion in 2H10 is projected to decelerate to 5.5%-6.0% from 9.1% to 9.4% in 1H10. Therefore, for the whole year of 2010 real GDP growth would average 7.0%-7.5%, after declining by 1.7% in 2009.**

- Given BNM's concern over the escalating sovereign debt problems in Europe and the expected diminishing effects of fiscal policy support as well as the modest recovery in advance economies, **we view that BNM may momentarily pause raising the OPR over the immediate term but may resume the normalising exercise over the later part of the year. In this regard, we expect the OPR to be raised by another 25 bps during its September meeting and to be maintained at 2.75% until the end of the year.**

- For 2011, we expect growth to slow due to the higher base effect and the boost from inventory rebuilding to be reversed. Furthermore, the gradual unwinding of the fiscal and monetary policy support would mean less support to growth in the coming years. In addition, the planned subsidies' reform and GST implementation, if implemented, could lower sentiment and slow domestic demand. **As such, we project the GDP growth to moderate to 5.0% to 5.5% in 2011.**

MALAYSIA GROSS DOMESTIC PRODUCT

%yoy	2Q09	3Q09	4Q09	1Q10e	2Q10f	3Q10f	4Q10f	2008	2009	2010F
Real GDP	**-3.9**	**-1.2**	**4.4**	**10.1**	**8.8**	**6.8**	**5.1**	**5.0**	**-1.7**	**7.6**
Agriculture	0.3	-0.4	5.9	6.8	4.6	4.3	1.6	4.0	0.6	4.2
Mining	-3.5	-3.6	-2.8	2.1	1.9	2.9	6.3	-2.5	-3.8	3.3
Manufacturing	-14.5	-8.6	5.0	16.9	15.3	10.8	5.3	1.3	-9.7	11.8
Construction	4.4	7.9	9.3	8.7	7.3	-1.1	2.1	6.7	5.8	4.0
Services	1.7	3.4	5.2	8.5	7.0	6.0	5.5	7.2	3.3	6.7
Consumption	0.6	2.9	1.4	5.4	4.0	1.1	6.1	9.1	1.2	4.2
Public consumption	1.5	9.4	0.7	6.3	9.1	6.4	8.4	10.9	3.1	7.6
Private consumption	0.3	1.3	1.6	5.1	2.8	-0.3	5.3	8.6	0.7	3.2
Stocks (Change/RMB)	460	8	-91	-81	-177	-66	2,468	-256	231	-39
Investment	-9.6	-7.9	8.2	5.4	5.9	1.1	-1.2	0.6	-5.6	2.7
Net Exports	-6.7	-10.3	-4.7	-12.9	19.0	51.1	70.2	-5.9	5.0	23.1
Exports	-24.0	-30.0	6.0	19.3	18.4	13.1	6.4	1.2	-10.4	13.9
Imports	-20.0	-32.0	7.0	27.5	18.4	8.8	0.9	2.1	-12.3	12.6

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

MALAYSIA KEY STATISTICS

	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10
FINANCIAL SYSTEM								
OPR (%)	2.00	2.00	2.00	2.00	2	2	2.25	2.25
M1 (%yoy)	6.4	10.5	13.6	9.8	10.7	15.3	20	-
M2 (%yoy)	7.5	9.7	10.4	9.5	8.2	8.4	8.8	-
M3 (%yoy)	6.9	9.2	10	9.2	8	8.2	8.7	-
Loan Growth (%yoy)	7.2	7.5	7	7.8	8.6	10	9.8	-
Deposit Growth (%yoy)	8.1	9	10.6	9.3	8.4	7.4	8.4	-
NPL (% of total loans)	2.1	2.1	1.9	1.8	1.8	1.9	1.8	-
RWCR					15.0	15.1	14.9	-
CONSUMER PRICE INDEX	-2	-1.5	-0.1	1.1	1.3	1.2	1.3	-
EXTERNAL TRADE								
Exports (%yoy)	-24.2	1.5	-3.3	18.7	37	18.4	36.4	-
Electrical	-19.4	18.5	5.9	33.4	55.5	23.5	31.2	-
Crude Oil	-53.4	-29.5	-16.3	77.3	35.4	125.2	55.7	-
Chemical	-16.7	-3.1	15.1	30.8	49.5	32.9	60.2	-
LNG	-35.8	-40.7	-52	-36.1	-18.7	-31.5	11.5	-
Palm Oil	-25.5	-5.2	20.3	-3.1	44	31	49.3	-
Imports (%yoy)	-20.3	-2.4	2.3	23.3	31	27.9	45.3	-
Intermediate Goods	-23.8	-9.6	-4.4	18.8	36.7	26.4	49.4	-
Capital Goods	-22.7	5	23.3	25.3	-2.9	18.1	16.1	-
Consumer Goods	-0.5	9.4	3.1	6.7	19.4	17.1	18.7	-
INDUSTRIAL								
Industrial Production (%yoy)	-6.1	0.8	-0.8	7.5	13.8	4.9	14.1	-
Manufacturing	-8.1	1.6	1.7	10.8	18.1	6.8	20.3	-
Electric	2.4	11	5.9	14.1	19.8	11.4	24.9	-
Mining	-3.1	-2.6	-7.3	-0.2	4	-1.5	-0.6	-
BNM RESERVES								
USD	96.0	96.0	96.1	96.7	97.0	96.9	95.3	96.0
MYR	332.7	327.5	326.5	332.6	330.8	329.8	310.8	305.7
MAJOR COMMODITIES								
Crude Oil (USD per barrel)	70.61	77.00	77.28	79.36	72.89	79.66	83.76	86.15
Palm Oil (MYR per tonne)	2175	2151	2428	2590	2436	2600	2580	2561
Rubber (MYR per kg)	726.50	787.00	889.50	953.75	992.50	1047.75	1053.25	996.00

GLOBAL KEY STATISTICS

Country	Real GDP growth (%yoy)								Inflation		Central Bank
	3Q09	4Q09	1Q10	2Q10f	3Q10f	2009	2010f	2011f	2009	2010F	Rate (%)
US*	2.2	5.6	3.2	2.8	3.3	-2.4	3.2	3.1	-0.4	2.0	0.25
Eurozone	-4.1	-2.2	0.5	0.7	1.2	-4.1	1.1	1.5	0.3	1.4	1.00
UK	-5.3	-3.1	-0.3	-0.3	1.1	-4.9	1.2	2.0	2.2	2.7	0.50
Japan*	-0.6	3.8	1.2	1.0	1.5	-5.2	2.1	1.9	-1.4	-1.2	0.10
China	9.1	10.7	11.9	11.0	10.5	8.7	10.1	9.3	-0.7	3.4	5.31
Hong Kong	-2.4	2.5	8.2	6.9	5.7	-2.7	5.3	4.9	0.5	2.3	0.50
Indonesia	4.2	5.4	5.7	5.5	5.9	4.6	5.8	6.2	4.9	4.5	6.50
Malaysia	-1.2	4.4	10.1	8.0	7.5	-1.7	5.0	4.4	0.7	2.2	2.50
Singapore	0.6	4.0	13.1	10.1	7.0	-2.0	6.5	5.4	0.6	2.5	0.03
S.Korea	1.0	6.0	7.8	7.2	5.8	0.2	5.3	4.3	2.8	2.8	2.00

Source : Bank Negara Malaysia, Department of Statistics Malaysia, Bloomberg LP, Research Division PNB
** GDP growth on annualized quarterly basis*