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GDP grows markedly slower at 4.4% in 3Q2019

Domestic demand is weakening

Malaysia's Gross Domestic Product (GDP) grew by 4.4% year-on-year (y-o-y) in 3Q2019, slowing from 4.9% growth in the preceding quarter (Consensus: 4.4%, Bank Islam: 4.3%). This was mainly on account of weakening domestic demand from 4.6% growth to 3.5% expansion in the period under review. Consumer spending, which is the main pillar of private sector expenditure, has normalized to 7.0% during the September quarter from 7.8% previously. Household spending appears to have reverted towards its long-term trend following the strong base effects from the tax holiday spending last year. In addition, the private sector wage growth for the manufacturing and service sector employees have softened from 4.2% in 2Q2019 to 3.8% in 3Q2019. This suggests that private consumption is shifting into a lower gear in the next foreseeable future as income growth is not forthcoming. A survey done by Malaysian Institute of Economic Research (MIER) also indicated that the Consumer Sentiment Index (CSI), which dropped to 84.0 points in 3Q2019 from 93.0 points in 2Q2019, indicates that the consumers are more likely to be more cautious in their spending plans.

Apart from that, the Gross Fixed Capital Formation (GFCF) has also in dire straits. It contracted by 3.7% in 3Q2019, extending the 0.6% decline in the preceding quarter. Public investment has persistently declined at a rate of 14.1% in 3Q2019 (2Q2019: -9.0%) while private investment flattened at 0.3% in 3Q2019 from 1.8% growth previously. Lower capital spending across major economic sectors resulting from heightened uncertainty in the external conditions, as well as weakness in the property segment have weigh down the performance in private investment. By type of assets, investment in structures slumped by 2.4% in 3Q2019 from 1.2% expansion in 2Q2019, while investment in machinery and equipment dropped further to 7.4% in 3Q2019 from -4.2% in 2Q2019.

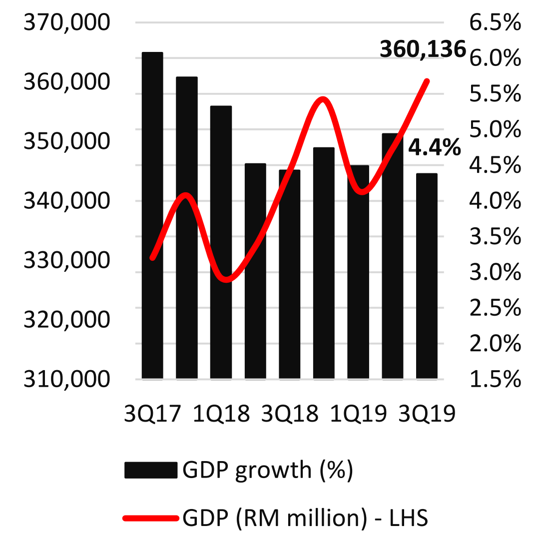
As for the external sector, real exports contracted by 1.4% in 3Q2019 (2Q2019: 0.1%), while imports fell further by 3.3% in 3Q2019 (2Q2019: -2.1%). This was mainly contributed by the slower global demand conditions as the trade war intensified. Following this, businesses were taken aback and has resulted in weaker sentiments. The J.P. Morgan Global Manufacturing Purchasing Manager's Index (PMI) has fallen below the 50-point threshold since May this year all the way to September (49.8 points in May, 49.7 points in September and 49.8 points in October). Among the regional economies, China also has shown a moderation in its GDP growth at 6.0% in 3Q2019 (2Q2019: 6.2%) which stemmed from softer private expenditure. In addition, Singapore growth was stagnating at and 0.1% (2Q2019: 0.1%). Meanwhile, South Korea sustained at 2.0% growth for two consecutive quarters from 1.7% expansion in the 1Q2019 as fiscal pump priming enacted in April has significant positive impact to growth. As such, government across the globe is taking a proactive measures to safeguard economic growth.

Table 1: Gross Domestic Product (GDP) y-o-y%

Y-o-Y%	Share (2018)	3Q 2018	4Q 2018	1Q 2019	2Q 2019	3Q 2019	9M 2018	9M 2019
GDP	**100.0%**	**4.4%**	**4.7%**	**4.5%**	**4.9%**	**4.4%**	**4.7%**	**4.6%**
Domestic Demand (excluding stocks)	94.1%	6.8%	5.7%	4.4%	4.6%	3.5%	5.5%	4.1%
Private Sector	**74.2%**	**7.9%**	**7.8%**	**5.9%**	**6.2%**	**5.4%**	**6.8%**	**5.8%**
-Consumption	57.0%	8.9%	8.4%	7.6%	7.8%	7.0%	7.8%	7.5%
-Investment	17.3%	5.0%	5.0%	0.4%	1.8%	0.3%	3.9%	0.9%
Public Sector	**19.8%**	**2.1%**	**0.0%**	**-1.4%**	**-2.8%**	**-4.6%**	**0.1%**	**-3.0%**
-Consumption	12.5%	5.2%	4.0%	6.3%	0.3%	1.0%	3.0%	2.4%
-Investment	7.4%	-2.7%	-5.9%	-13.2%	-9.0%	-14.1%	-4.5%	-12.3%
Net Exports of Goods and Services	**7.0%**	**-9.4%**	**15.5%**	**10.9%**	**22.9%**	**15.9%**	**9.9%**	**16.0%**
-Exports	67.6%	0.7%	3.1%	0.1%	0.1%	-1.4%	1.9%	-0.4%
-Imports	60.6%	2.0%	1.8%	-1.4%	-2.1%	-3.3%	1.1%	-2.3%

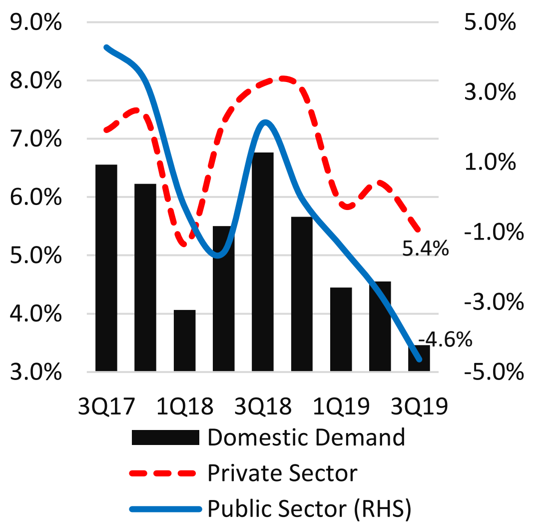
Source: CEIC, Strategic Management, Bank Islam Malaysia Berhad

Chart 1: Gross Domestic Product (GDP) growth (y-o-y%) and Total (RM billion)



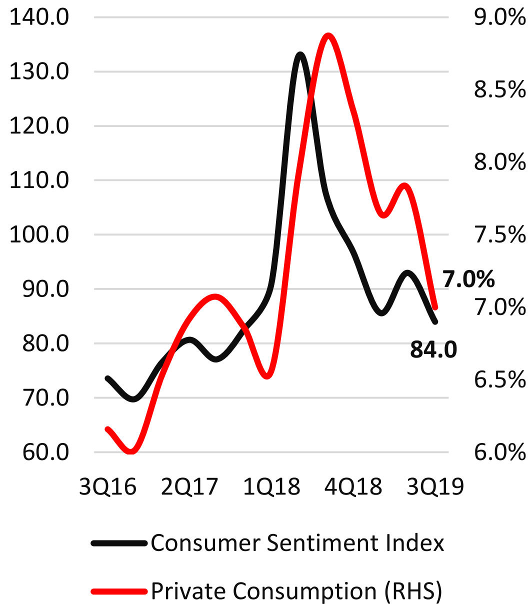
Source: CEIC

Chart 2: Private and Public Sector Growth (y-o-y%)



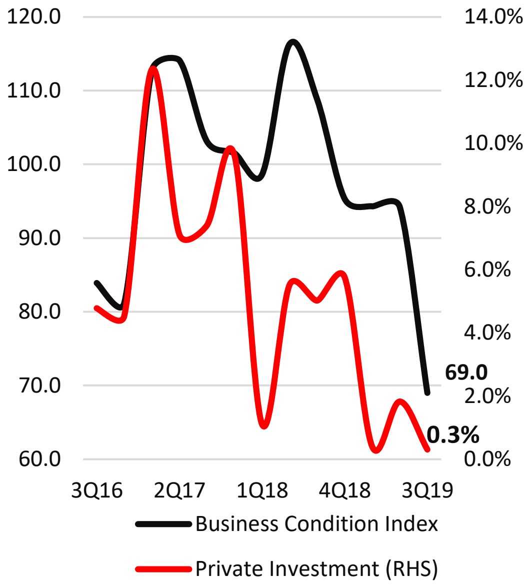
Source: CEIC

Chart 3: Private Consumption (%) vs. MIER Consumer Sentiment Index (points)



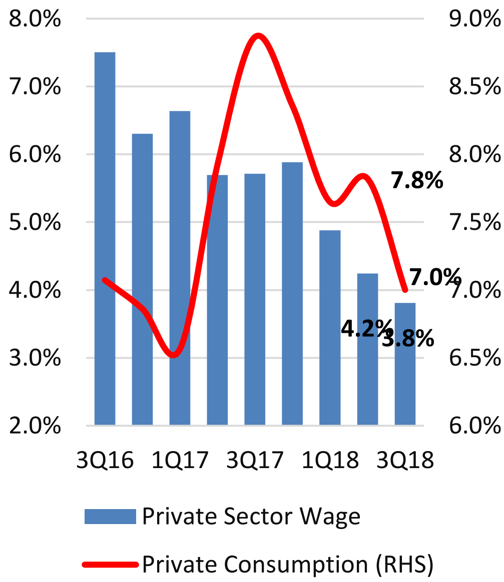
Source: CEIC

Chart 4: Private Investment (y-o-y%) vs. MIER: Business Condition Index (points)



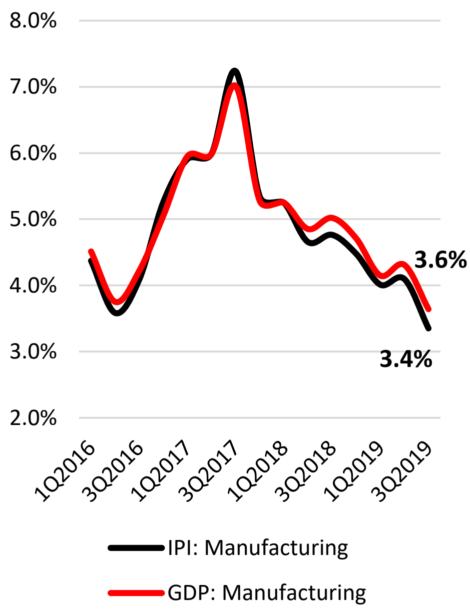
Source: CEIC

Chart 5: Private Consumption (y-o-y%) vs. Private Sector Wages Growth (y-o-y%)



Source: CEIC, DOSM

Chart 6: IPI: Manufacturing (y-o-y%) vs. GDP: Manufacturing (y-o-y%)



Source: CEIC, DOSM

Supply-side GDP – Softer growth in main sectors while construction and mining & quarrying fell

On the supply side, services and manufacturing sectors (79.1% of total GDP) continued to be the anchor for growth albeit at a softer pace. Services sector registered at 5.9% growth in 3Q2019, slower from 6.1% in 2Q2019. Within the subsector, wholesale trade increased by 6.3% as compared to 4.8% in 2Q2019. Nevertheless, lower expansion in retail trade (3Q2019: 8.1% vs. 2Q2019: 9.2%) and motor vehicles (3Q2019: 2.4% vs. 2Q2019: 4.6%), weighing heavily on the services activity's performance. On further scrutiny, growth for communication, transport & storage as well as finance subsectors softening by 6.0% (2Q2019: 6.3%), 7.0% (2Q2019: 6.8%) and 4.4% (2Q2019: 5.7%) respectively in 3Q2019.

By the same token, manufacturing sector moderated by 3.6% in 3Q2019 after recorded 4.3% growth in the preceding quarter. This was largely attributed by weak expansion in electronics related products which posted 2.3% growth as compared to 4.1% in previous quarter. Additionally, manufacturing of motor vehicles & transport equipment registered at 6.8% in 3Q2019 (2Q2019: 7.2%), mainly underpinned by high base during tax holiday period in 2018.

The agriculture sector weakened to 3.7% in 3Q2019 (2Q2019: 4.2%), dragged by the slump in the forestry & logging (3Q2019: -12.4% vs. 2Q2019: -5.8%) and aquaculture (3Q2019: -15.1% vs. 2Q2019: -18.4%). On top of that, oil palm growth has moderated during 3Q2019, registering at 8.4% from 9.5% in the preceding quarter.

On a different note, construction sector plummeted into contraction zone at -1.5% in 3Q2109 (2Q2019: 0.5%). The main culprit was the construction work done in non-residential and residential, declining by 11.6% (2Q2019: -9.3%) and 2.7% (2Q2019: -1.1%) respectively in 3Q2019. In the residential subsector, it continued to fall for 7 straight months amid rising number of property overhang. The unsold units for residential property increased by 3.5% y-o-y to 130,517 units (2Q2018: 126,118 units). Similarly, civil engineering and special trades growth were slowing to 7.5% (2Q2019: 8.2%) and 2.8% (2Q2019: 5.9%) respectively in 3Q2019.

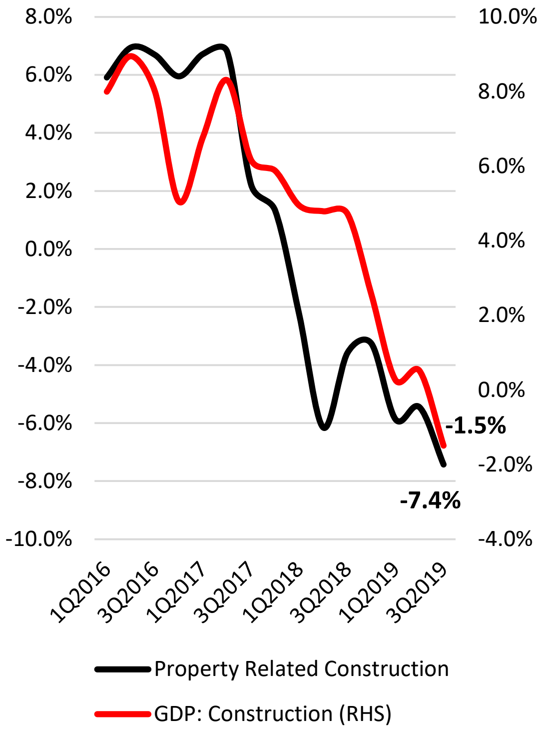
In mining & quarrying sector, it grew negatively by 4.3% in 3Q2019 (2Q2019: 2.9%). This was mainly due to the lower production of crude petroleum (IPI 3Q2019: -12.8% vs. IPI 2Q2019: -1.8%) as scheduled maintenance works have impinged heavily on the mining sector output growth.

Table 2: Gross Domestic Product (GDP) y-o-y% by Industry

Y-o-Y %	Share (2018)	3Q2018	4Q2018	1Q2019	2Q2019	3Q2019	9M2018	9M2019
Agriculture	7.3%	-0.7%	-0.1%	5.6%	4.2%	3.7%	0.1%	4.5%
Mining & Quarrying	7.6%	-5.7%	-0.7%	-2.1%	2.9%	-4.3%	-3.2%	-1.2%
Manufacturing	22.4%	5.0%	4.7%	4.1%	4.3%	3.6%	5.0%	4.0%
Construction	4.9%	4.7%	2.6%	0.3%	0.5%	-1.5%	4.8%	-0.3%
Services	56.7%	7.3%	6.9%	6.4%	6.1%	5.9%	6.8%	6.1%

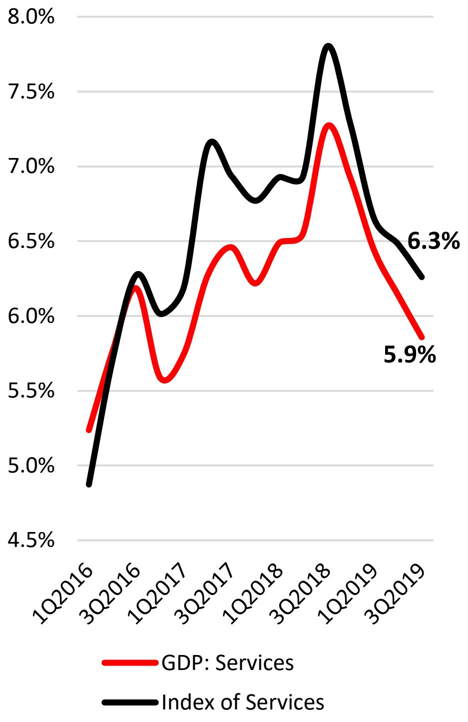
Source: CEIC, Strategic Management, Bank Islam Malaysia Berhad

Chart 7: Property Related Construction (y-o- y%) vs. GDP: Construction (y-o-y%)



Source: CEIC, DOSM

Chart 8: Index of Services (y-o-y%) vs. GDP: Services (y-o-y%)



Source: CEIC, DOSM

Other indicators such as current account surplus balance narrowed from RM14.3 billion or 3.9% of GDP in 2Q2019 to RM11.5 billion or 3.1% of GDP in the 3Q2019. This was attributed by the larger deficit balance in primary income (3Q2019: -RM12.2 billion vs. 2Q2019: -RM5.5 billion) and secondary income (3Q2019: -RM5.5 billion vs. 2Q2019: -RM4.9 billion). However, higher surplus balance in goods account at RM30.7 billion in 3Q2019 (2Q2019: RM 28.1 billion) has supported the current account surplus. Meanwhile, financial account registered net outflows of RM1.3 billion, lower than RM18.6 billion deficits in the previous quarter. This was underpinned by the inflows in financial derivatives (3Q2019: RM0.9 billion vs. 2Q2019: -RM0.5 billion) and other investment (3Q2019: RM25.3 billion vs. 2Q2019: 0.3 billion).

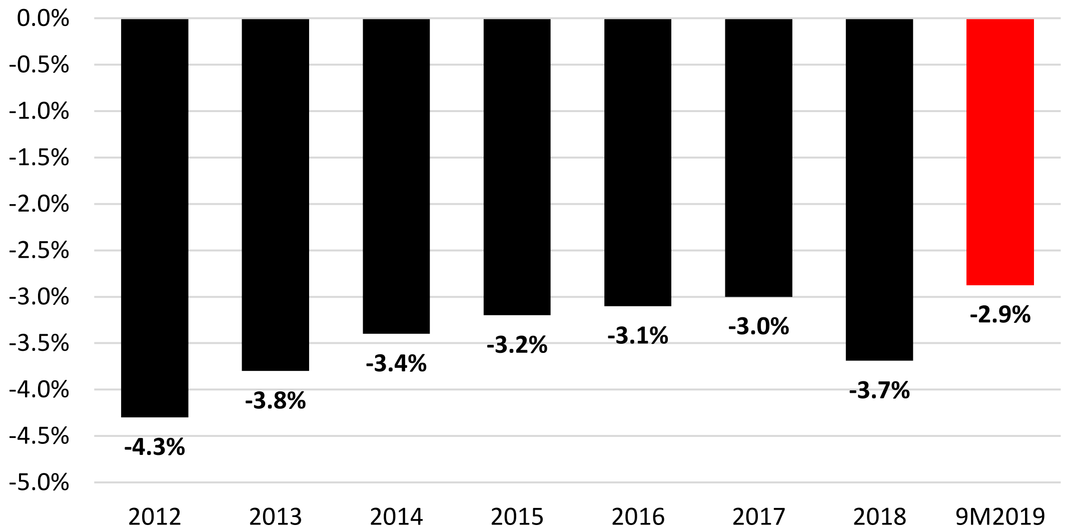
Table 3: Balance of payments (RM million)

	3Q 2017	4Q 2017	1Q 2018	2Q 2018	3Q 2018	4Q 2018	1Q 2019	2Q 2019	3Q 2019
Current Account	**12,159**	**10,892**	**13,609**	**2,801**	**3,342**	**10,835**	**16,387**	**14,257**	**11,452**
% GDP	3.5%	3.0%	3.9%	0.8%	0.9%	2.9%	4.5%	3.9%	3.1%
Goods	31,579	32,844	34,156	25,919	26,373	32,733	33,849	28,104	30,773
Services	(4,995)	(7,135)	(5,510)	(5,572)	(2,886)	(3,757)	(1,836)	(3,437)	(1,627)
Primary Income	(10,132)	(10,212)	(10,396)	(12,751)	(15,517)	(12,922)	(10,115)	(5,540)	(12,171)
Secondary Income	(4,418)	-4761	(4,666)	(4,736)	(4,628)	(5,219)	(5,511)	(4,870)	(5,521)
Financial Account	**(6,261)**	**858**	**11,910**	**10,536**	**2,307**	**(6,145)**	**(13,816)**	**(18,552)**	**(1,334)**
Direct Investment	9,146	4,964	9,230	(493)	524	2,080	16,260	(8,236)	(788)
Asset	(6,336)	(277)	(3,187)	(4,486)	(5,573)	(10,044)	(6,881)	(11,475)	(3,238)
Liabilities	15,481	5,241	12,417	3,993	6,097	12,124	23,141	3,239	2,450
Portfolio Investment	(9,854)	9,357	(1,500)	(37,919)	786	(5,769)	2,053	(10,160)	(26,773)
Asset	(8,941)	1,254	(9,563)	(724)	4,427	(3,252)	(11,423)	(5,039)	(18,851)
Liabilities	(913)	8,103	8,062	(37,194)	(3,641)	(2,517)	13,476	(5,121)	(7,922)
Financial Derivatives	570	(1,127)	846	780	32	(687)	(237)	(456)	920
Other Investment	(6,123)	(12,335)	3,334	48,168	965	(1,769)	(31,892)	300	25,307
Errors and Omissions	**309**	**(9,606)**	**(7,287)**	**(14,204)**	**(9,064)**	**(10,792)**	**2,923**	**2,948**	**(3,667)**
Overall Balance	**6,208**	**2,144**	**18,233**	**(867)**	**(3,415)**	**(6,102)**	**5,494**	**(1,347)**	**6,451**

Source: CEIC, Strategic Management, Bank Islam Malaysia Berhad

Currently, the federal government finances has been decent with fiscal deficits further narrowed from RM34.5 billion or 3.2% of GDP in 9M2018 to RM32.0 billion or 2.9% of GDP in first nine months this year. This was mainly on account of increase in revenue growth by 17.4% to RM194.6 billion in 9M2019 (9M2018: RM165.7 billion, +6.4%) while both operating and net development expenditure increased by 12.0% (9M2018: 8.5%) and 20.9% (9M2018: -7.8%) to RM193.6 billion (9M2018: RM172.9 billion) and RM33.0 billion (9M2018: RM27.3 billion) in 9M2019. Against such backdrop, the government is on track to achieve its fiscal deficits target of 3.4% in 2019. This would sends a message to the credit rating agencies that the government is committed to ensure their finances will remain in order.

Chart 9: Budget deficits (% of GDP)



Sources: BNM & CEIC

Forward Looking View

We had the opportunity to meet with BNM officials yesterday to discuss about the 3Q2019 GDP performance. Several important issues were discussed during the briefing which includes:

1. The latest contraction for Mining and Quarrying was the result from disruption in the maintenance oil field which has dented the production activities in July. Moving forward the BNM expect the sector to rebound in 4Q2019.
2. Current Household Debt to GDP ratio is at 82.4% and still is deemed high. There is no specific target aimed by the BNM for now. However, the BNM will make sure that the level of household indebtedness will be reduced overtime.
3. The BNM exerted that financing impairment level is still low. However, the recent uptick in the impairment ratio for residential property purchases financing was due to higher impairment in property above RM500k. Apart from that, challenging economic conditions has affected the ability for self-employed person to service their borrowings. In other words, the impairment cases are selective and not broad based.
4. Output gap – BNM expect 0% this year and slight negative next year. Therefore, the economy is expected to tread below potential next year. (Somewhat perplexing since the MOF growth target of 4.8% next year seems to us that the output gap would be positive).
5. Downside risks would revolve around these three factors:
   a) Trade tensions
   b) Technology cycle
   c) Oil and gas sector (crude oil price volatility)

All in all, we maintain our **4.5% GDP projection in 2019 (2018: 4.7%). This would mean the final quarter GDP would grow in the region of 4.3% to 4.4%**. **We have also pencilled in the 2020 GDP growth target of 4.3%** as the external environment is expected to be less conducive while domestic spending would remain guarded.