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Exports surged "beyond expectation" at 17.7% in October

Facts

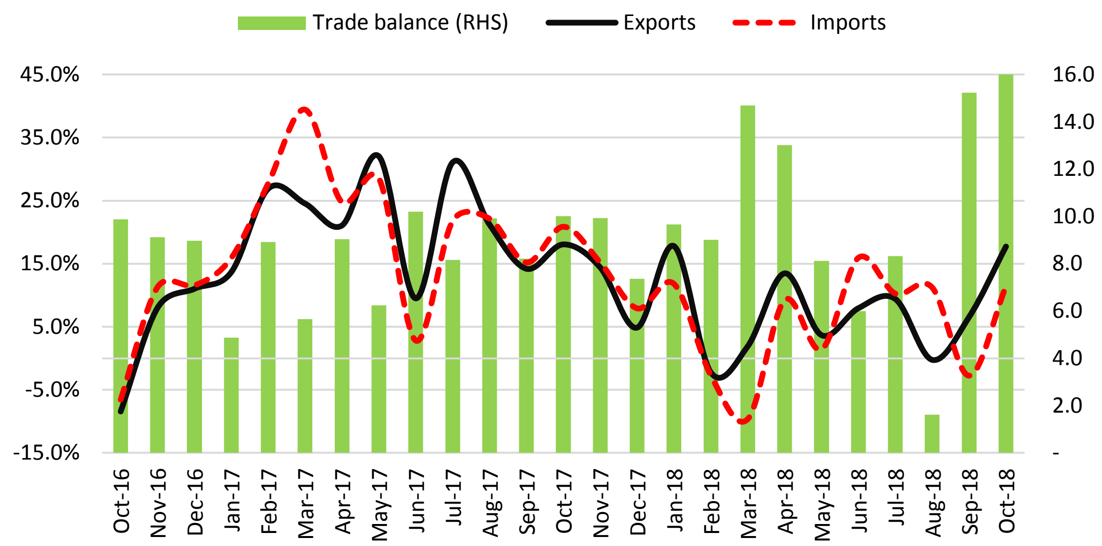
- Malaysian exports jumped 17.7% y-o-y in October after growing 6.5% in the preceding month (Aug: -0.3%). This was way higher from the consensus estimates of 5.7% (Bank Islam at 3.6%). The key drivers were due to acceleration in Electrical and Electronics (E&E) products from 6.5% in September to 23.3% in October as well as Liquefied Natural Gas (LNG) exports which surged to 39.0% in October (Sept: 3.2%). Both products accounted for 39.8% and 4.2% of total exports respectively. Apart from that, rubber gloves increased sharply to 32.3% in October compared 14.6% growth previously.
- Within E&E, strong growth was largely contributed by Electronic Integrated Circuits (Oct: 60.5% vs. Sept: 25.7%) which accounted for 50.6% of total E&E exports. Thus far, Global Semiconductor Sales (GSS) continued to post double digit growth for 22 consecutive months since August 2016 albeit at slower pace now (Sep: 13.8% vs. 19.1% average for 9M2018). This have benefitted semiconductor players in Malaysia such as Globetronics which posted 9MFY2018 revenue of RM245.7 million, higher by 23% compared to last year.
- Meanwhile, exports of palm oil continue to decline at 11.9% in October (Sept: -11.5%) following lower Average Selling Price (ASP) owing to substitution effect from lower soybean oil prices.
- While trade tension between the US and China remain highly uncertain, export growth to China has been commendable at 33.0% in October after declining 0.6% in September. This followed by Australia (Oct: 47.0% vs. Sept: 23.0%) and Vietnam (Oct: 36.3% vs. Sept: 7.5%).
- On the same note, total imports rebounded to 11.4% October after 2.8% contraction in the previous month. This was mainly supported by the increased in the imports of intermediate goods (Oct: 1.0% vs. Sept: -9.3%) and consumption goods (Oct: 7.6% vs. Sept: -10.0%). Consequently, trade balance continued to expand from RM15.3 billion in September to RM16.3 billion in October, suggesting Malaysia's current account surplus balance should be well supported from merchandise balance.
- Cumulatively, total exports posted at 7.5% growth between January and October 2018. This is lower compared to 21.0% expansion recorded in the same period last year. Similarly, total imports expanded at a rate of 5.6% in 10M2018, slower than 21.6% growth in 10M2017. As a result, Malaysia's trade surplus balance widened from RM81.2 billion in 10M2017 to RM102 billion in 10M2018.

Table 1: External Trade (Y-o-Y %)

Y-o-Y%	Jul-18	Aug-18	Sep-18	Oct-18	10M 2017	10M 2018
Export	9.4%	-0.3%	6.5%	17.7%	21.0%	7.5%
Import	10.3%	11.2%	-2.8%	11.4%	21.6%	5.4%
Trade balance (RM bn)	8.3	1.6	15.2	16.3	81.2	102.0
Export by product						
Electrical & Electronic Products	23.6%	3.2%	6.5%	23.3%	20.5%	12.1%
Palm Oil	-13.7%	-22.9%	-11.5%	-11.9%	17.8%	-11.7%
Liquefied Natural Gas	-36.2%	-20.4%	3.2%	39.0%	28.6%	-4.4%
Petroleum Products	-12.3%	5.4%	20.5%	37.3%	29.8%	14.0%
Machinery, Appliances and Parts	2.0%	-7.1%	1.8%	4.2%	7.4%	0.8%
Crude Petroleum	90.1%	70.8%	54.5%	32.8%	32.2%	33.7%
Optical and Scientific Equipment	9.1%	7.9%	17.1%	10.3%	13.3%	12.1%
Professional, Sci. & Controlling Inst.	9.9%	11.6%	24.4%	13.7%	13.0%	14.9%
Rubber Gloves	10.5%	16.3%	14.6%	32.3%	21.0%	11.2%
Heating and Cooling Equi.& Parts	-9.0%	-22.9%	-16.2%	-20.8%	-5.7%	-13.2%
Export by country						
Singapore	-1.7%	-2.2%	7.9%	18.3%	21.3%	1.2%
China	37.5%	4.5%	-0.6%	33.0%	33.3%	12.2%
EU	2.2%	-8.9%	3.1%	8.5%	21.1%	5.5%
US	6.7%	-2.0%	0.1%	7.6%	11.7%	1.8%
Japan	-17.1%	-22.9%	-10.7%	10.2%	21.4%	-8.8%
Thailand	6.0%	15.6%	7.5%	20.8%	16.3%	13.6%
Hong Kong	80.8%	55.8%	48.7%	42.1%	21.9%	8.6%
Australia	6.3%	11.4%	23.0%	47.0%	16.1%	24.7%
Germany	1.7%	-4.2%	-7.0%	8.7%	21.1%	1.8%
Vietnam	12.8%	6.9%	7.5%	36.3%	21.7%	65.8%
Philippines	4.3%	4.9%	5.1%	9.8%	24.5%	3.6%
Import by end-use						
Capital	4.6%	25.1%	-25.2%	-2.0%	13.4%	-1.0%
Intermediate	-0.1%	4.3%	-9.3%	1.0%	23.1%	-4.9%
Consumption	11.1%	14.2%	-10.0%	7.6%	7.0%	2.3%

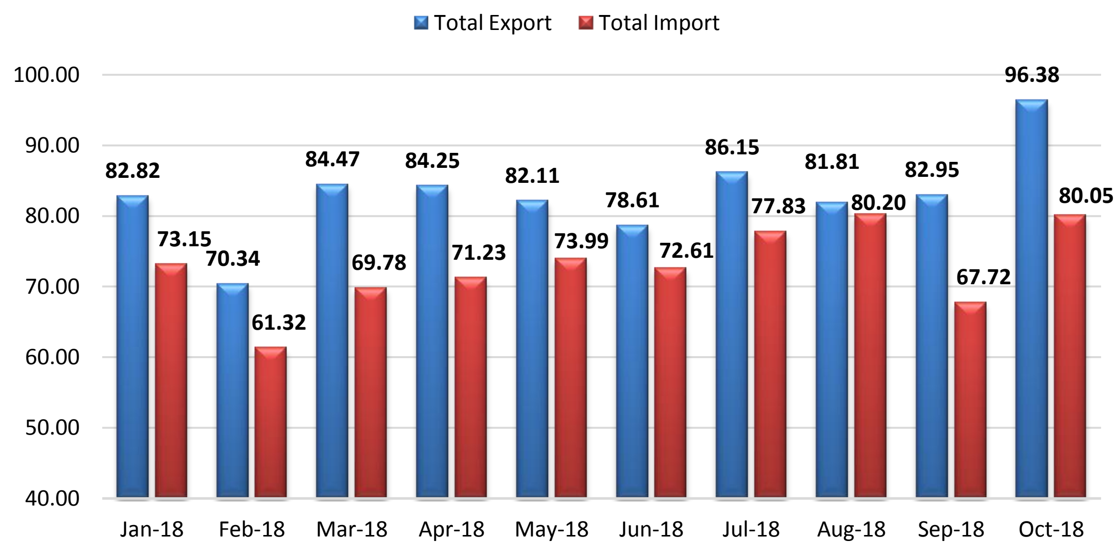
Source: CEIC, DOSM

Chart 1: Exports and Imports (y-o-y %), Trade Balance (RM Billion)



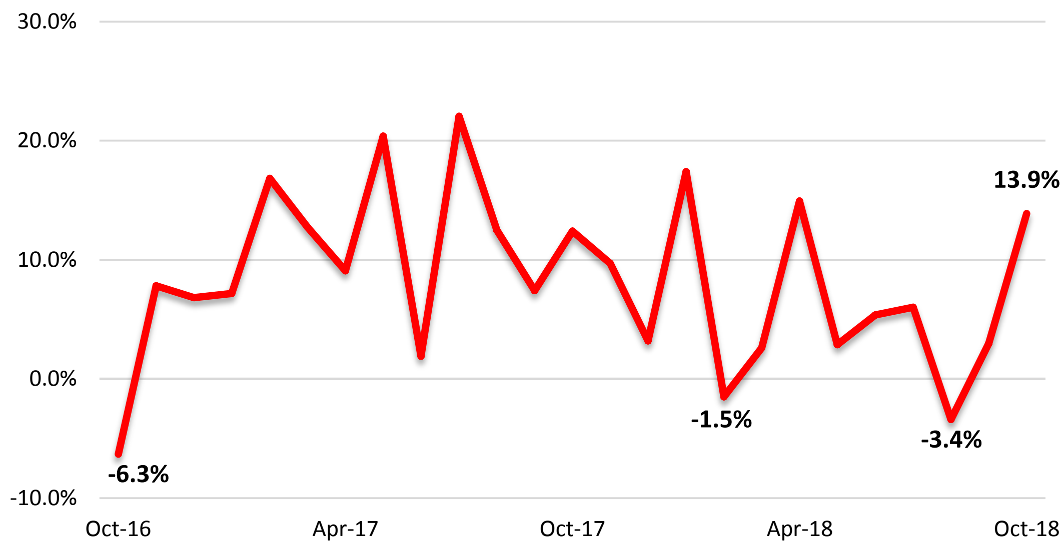
Source: CEIC

Chart 2: Exports and Imports (RM Billion)



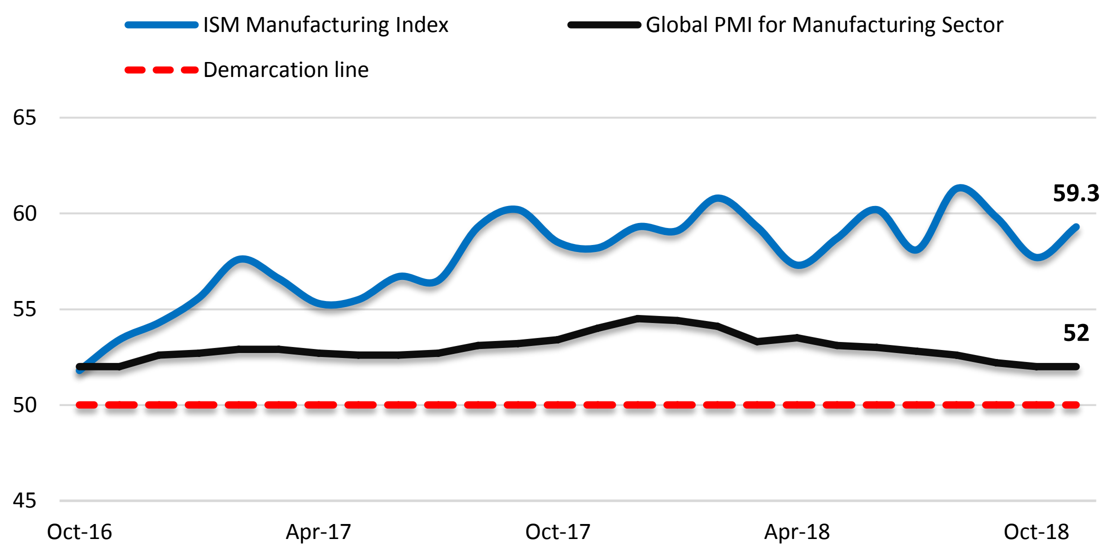
Source: CEIC

Chart 3: Export Volume Index (EVI) y-o-y%



Source: Bloomberg, CEIC

Chart 4: Global PMI vs. US Institute for Supply Management (ISM) Index - Manufacturing

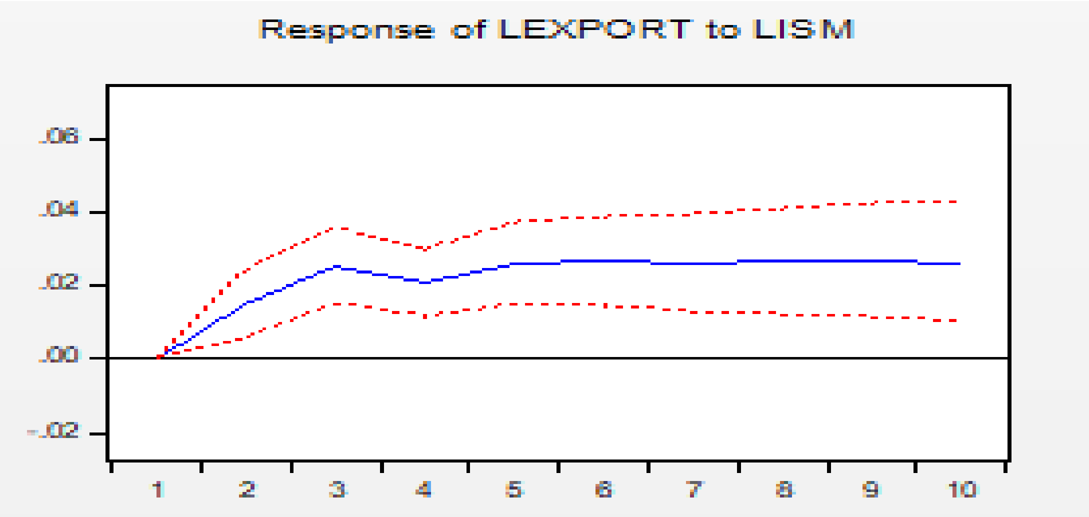


Source: Bloomberg, CEIC

Our view

Total exports in October has been commendable and this has been supported by strong demand from abroad. Judging from Vector Auto Regression (VAR) model, the relationship between Malaysia's exports and the US ISM index for manufacturing is quite close. This would mean better sentiment among US manufacturers would translate into higher Malaysia exports. Based on the Impulse Response Function, the most optimum length criteria in which exports responded to US ISM Index is three months. This suggests that there is a lag effect of three months for Malaysia's exports to respond to US ISM Index. The latest outturn showed the US ISM Index rose from 57.7 points in October to 59.3 points in November. Therefore, we can infer that exports could continue to perform favourably in February next year.

Chart 5: Impulse Response Function (IRF) – Response of Export to US ISM Manufacturing Index



Source: Strategic Management, Bank Islam

While there seems to be hope that exports could do well in the immediate terms, the recent flattening of the US yield curve should serve us a reminder that the US economy would eventually be recording slower growth. To some degree, the risk of recession in the US could not be ruled out should the yield curve inversion started to emerge. This is especially true when US Federal Reserve is likely to increase the Federal Fund Rate (FFR) at the upcoming meeting on 18 & 19 December. Empirically speaking, the yield curve is deemed to be a good predictor for US recession[1]. Currently, the difference between the 10- and 2-year US Treasury yields is 12 basis points. Perhaps, a 25 basis points hike in FFR could lead to curve inversion as the 2-year yield is typically very responsive to the central bank policy rate. In the past, it takes about 12 months to 27 months for recession to happen once the yield curve inverted. As such, we are cautious on 2019 economic outlook given the close association between our economy and the US GDP growth.

[1] "The yield curve as predictor of recession" https://www.bis.org/publ/confp02n.pdf