Economic Research, Strategic Management

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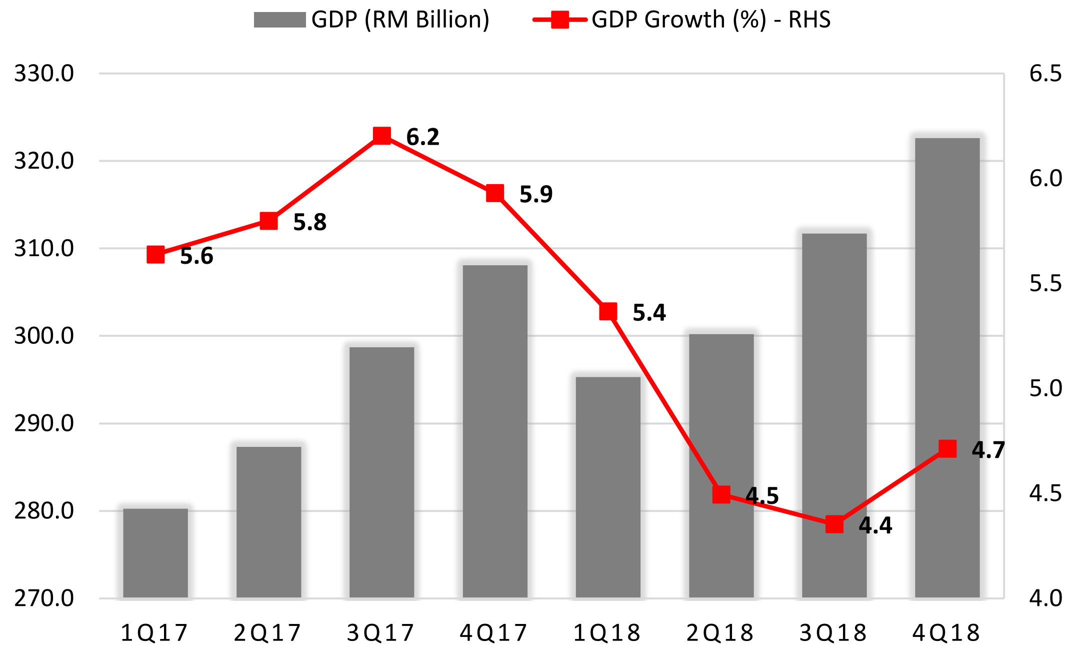
Malaysia's GDP grew 4.7% in 4Q2018

Higher than expected growth

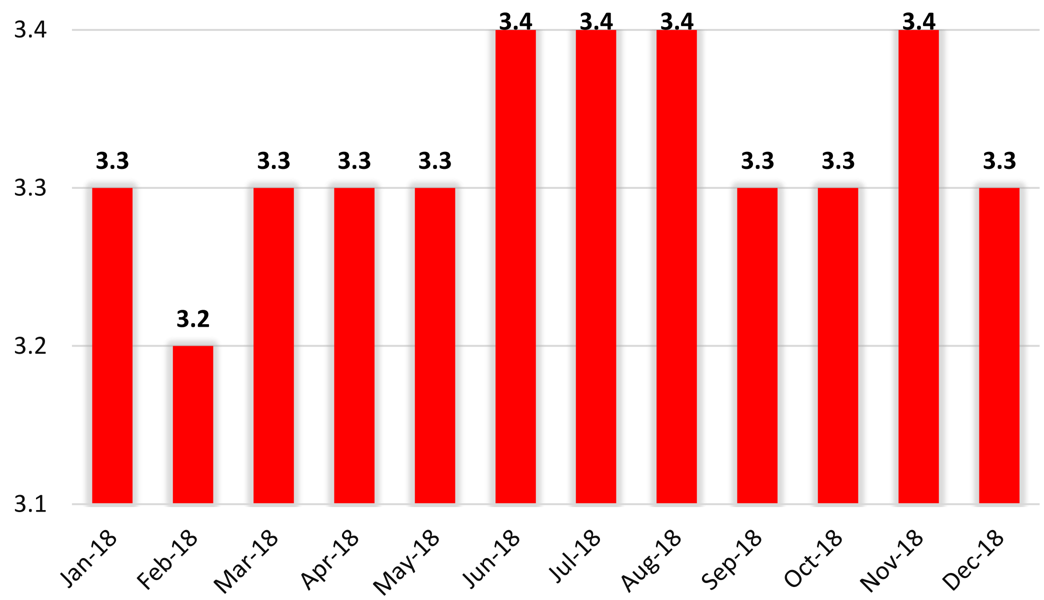
Malaysia's Gross Domestic Product (GDP) grew 4.7% year-on-year (y-o-y) in 4Q2018 (3Q2018: 4.4%), higher than the consensus estimates of 4.5% (Bank Islam: 4.8%). The strong growth was primarily driven by domestic demand (4Q2018: 5.6% vs. 3Q2018: 6.9%) as well as positive net exports growth (4Q2018: 9.9% vs. 3Q2018: -7.5%). From the demand side, private consumption recorded a higher growth of 8.5% (4Q2017: 7.0%). This was mainly due to the continuous improvement in income and employment growth. Government initiatives and supports to alleviate costs of living also contributed to higher consumer spending during the final three months of 2018. The labour market still remains healthy and supportive. Such notion was premised on lower unemployment rate at 3.3% in 4Q2018 compared to 3.4% in the preceding quarter. Private sector wages growth also improved from 5.7% y-o-y in 3Q2018 to 5.9% in 4Q2018, suggesting that households are generally has the means to spend. Notwithstanding, private investment growth moderated to 4.4% (3Q2018: 6.9%) owing to slower capital spending across major economic sectors. This reflects that most of the businesses are now tend to preserve their cash by deferring their capital expansion plan.

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



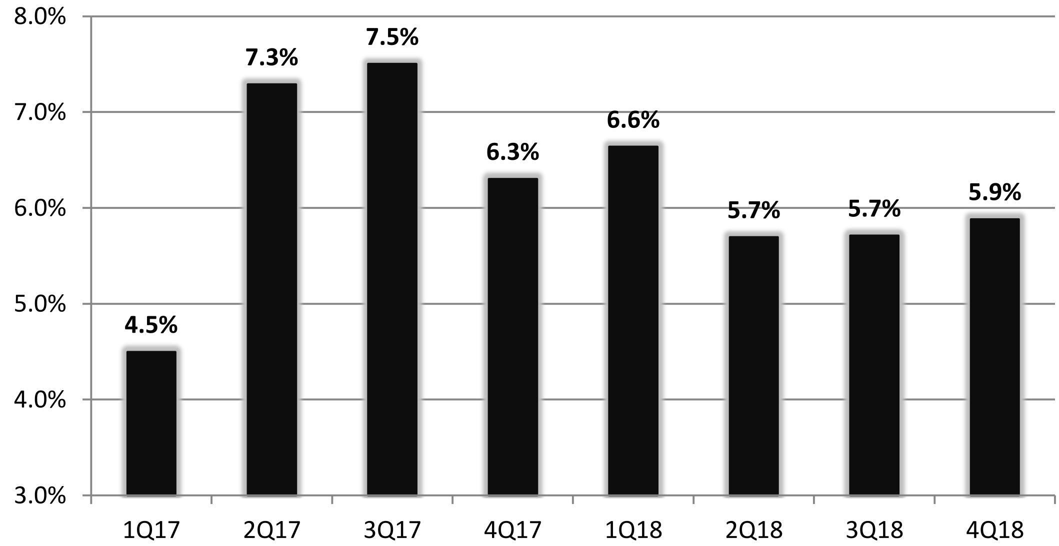
Source: CEIC

Chart 2: Unemployment Rate (%)



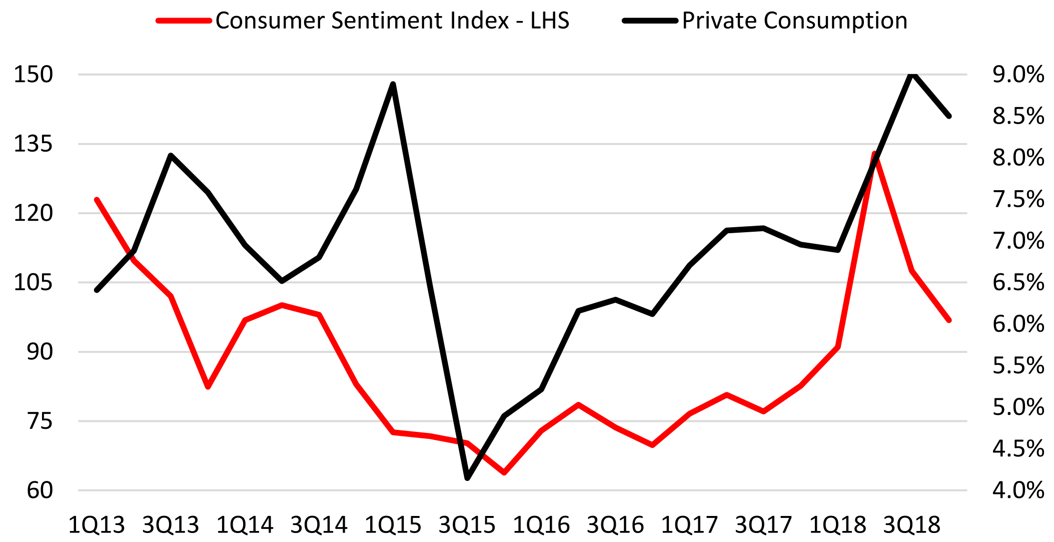
Source: CEIC

Chart 3: Private Sector wages growth (%)



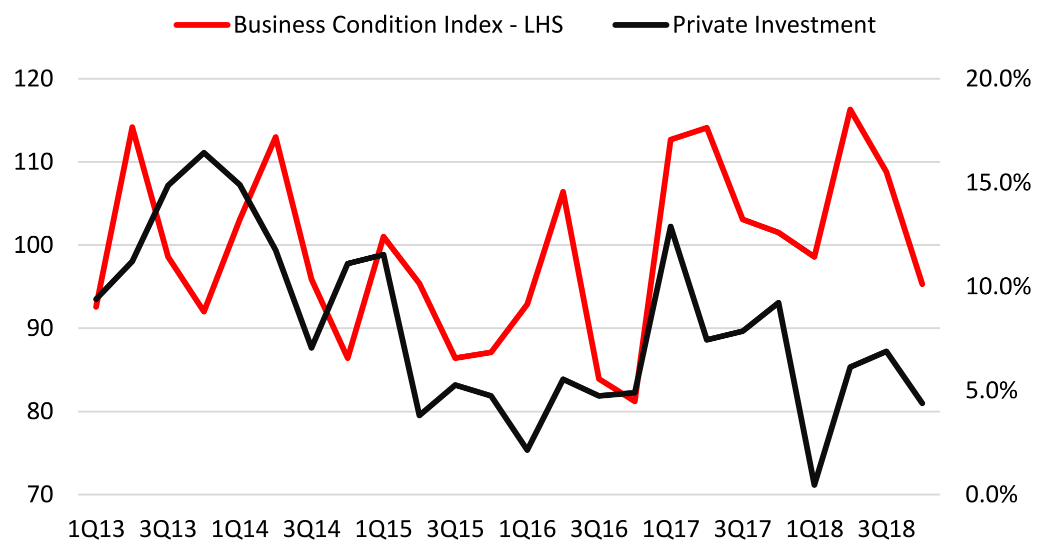
Source: DOS, Malaysia

Chart 4: Consumer Sentiment Index (CSI) vs. Private Consumption growth y-o-y%



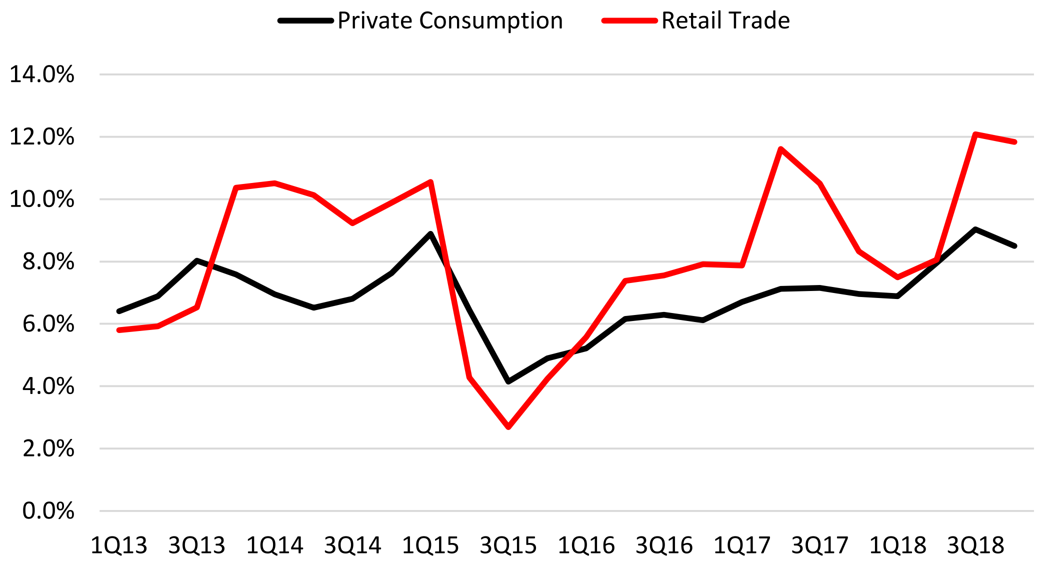
Source: CEIC

Chart 5: Business Condition Index (BCI) vs. Private Investment growth y-o-y%



Source: CEIC

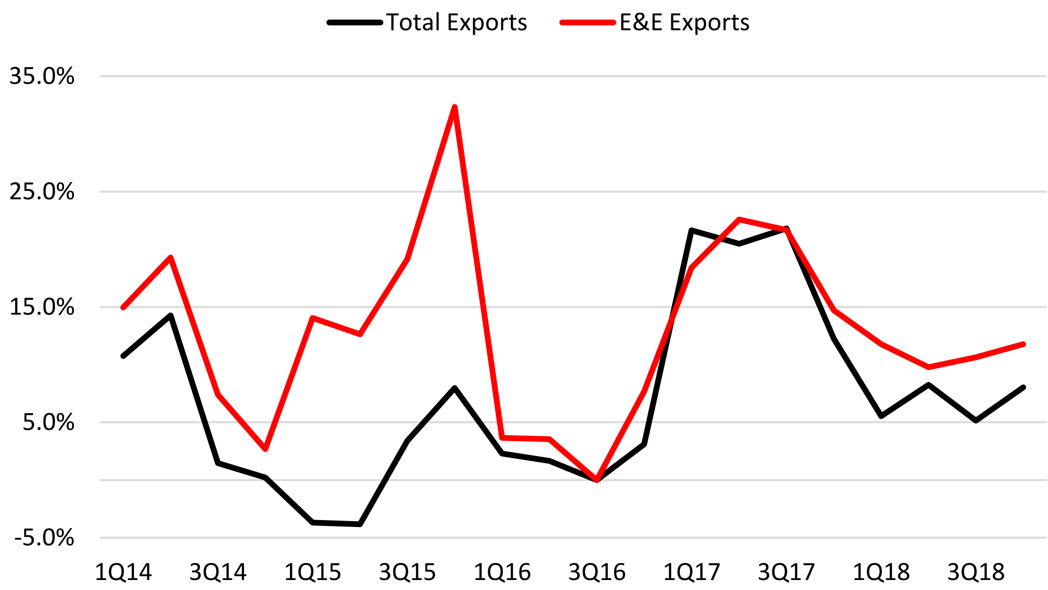
Chart 6: Business Condition Index (BCI) vs. Private Investment growth y-o-y%



Source: CEIC

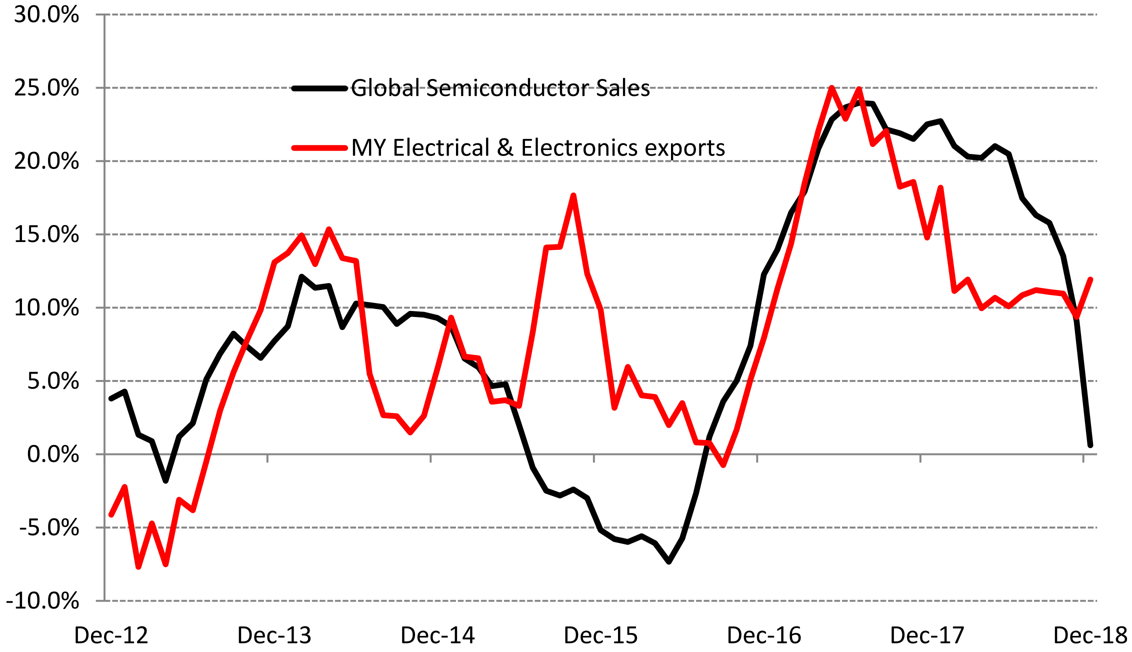
Similarly, net exports of goods and services posted a stellar performance at 9.9% in 4Q2018 after contracting 7.5% in the previous quarter. The expansion in the export growth was primarily driven by the Electrical & Electronics (E&E) exports which expanded by 11.8% after declining 9.8% in the previous month. The E&E industries contributed 38.2% to total exports which help to boost up Malaysian exports during 4Q2018.

Chart 7: Real exports (%) vs. Electrical & Electronic products (%)



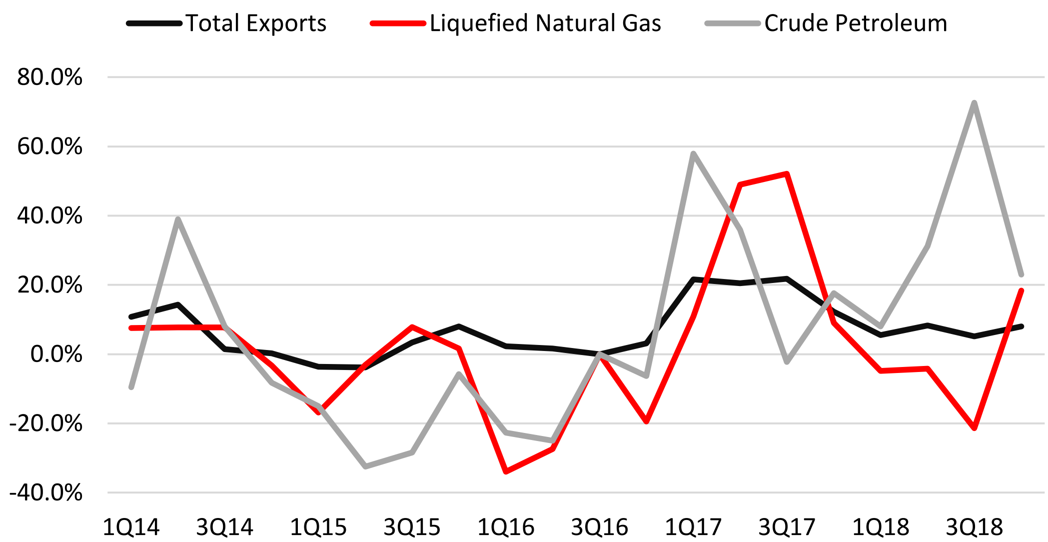
Source: CEIC

Chart 8: Malaysia Electrical & Electronics Exports (%) vs. Global Semiconductor Sales (%)



Source: CEIC

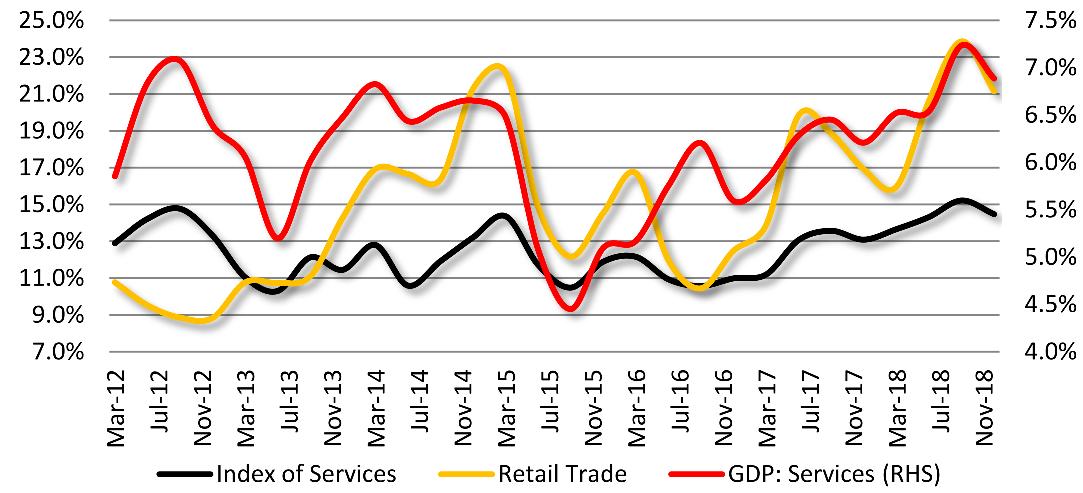
Chart 9: Real exports (%) vs. LNG & Crude Petroleum exports (%)



Source: CEIC

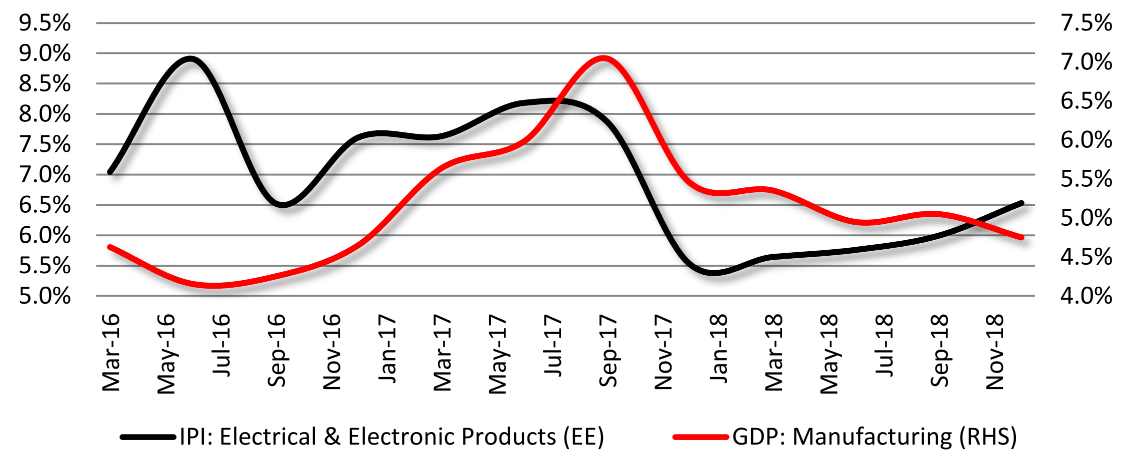
On the supply side, services and manufacturing sector accounted for 78.8% in GDP continued to be the main drivers to Malaysian economic growth. Services sector grew by 6.9% (3Q2018: 7.2%) while the manufacturing sector output increased by 4.7% in 4Q2018 (3Q2017: 5.0%). In the services sector, the sustained growth was supported by higher retail trade subsector which grew by 21.2% in 4Q2018 (3Q2018: 23.9%). Growth in the manufacturing sector was largely contributed by the E&E industries which increased by 6.5% in 4Q2018 (3Q2018: 6.0%).

Chart 10: Index of Services vs. GDP: Services (Y-o-Y %)



Source: CEIC

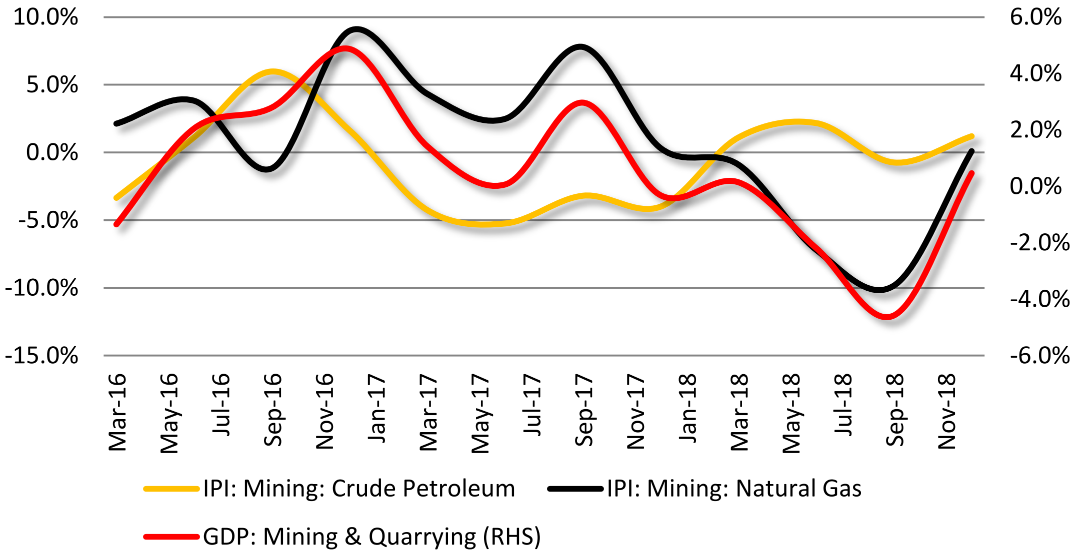
Chart 11: IPI: E&E growth vs. GDP: Manufacturing growth (Y-o -Y %)



Source: CEIC

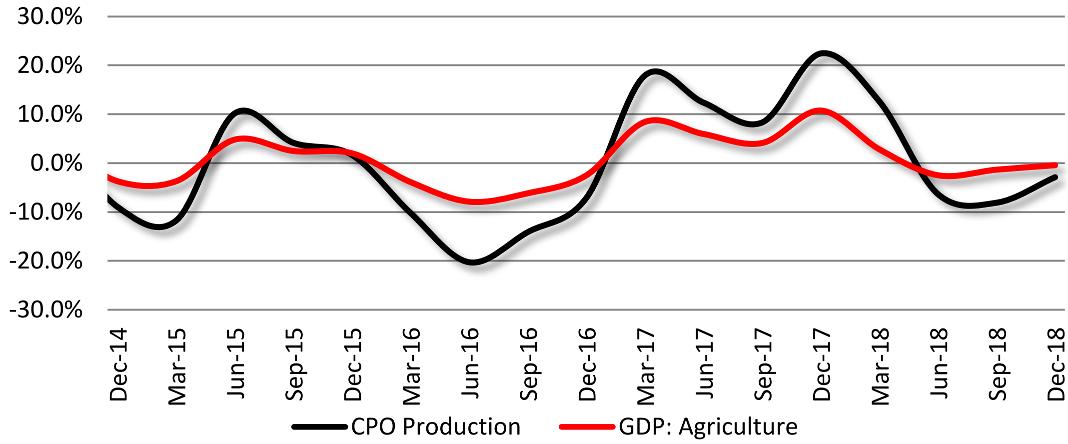
Meanwhile, the mining sector posted a positive growth of 0.5% in 4Q2018 after two consecutive quarters of contraction previously (3Q2018: -4.6%). The turnaround in output growth was aided by recovery in Liquefied Natural Gas production from -9.8% in 3Q2018 to 0.1% in 4Q2018 (source: Industrial Production Index). Nevertheless, agriculture sector declined albeit at slower pace of 0.4% in 4Q2018 (3Q2018: -1.4%). This was due to further contraction in Crude Palm Oil production (4Q2018: -2.9% vs. 3Q2018: -8.1%) and Forestry & Logging output (4Q2018: -3.1% vs. 3Q2018: -16.7%).

Chart 12: IPI: Mining vs. GDP: Mining (Y-o-Y %)



Source: CEIC

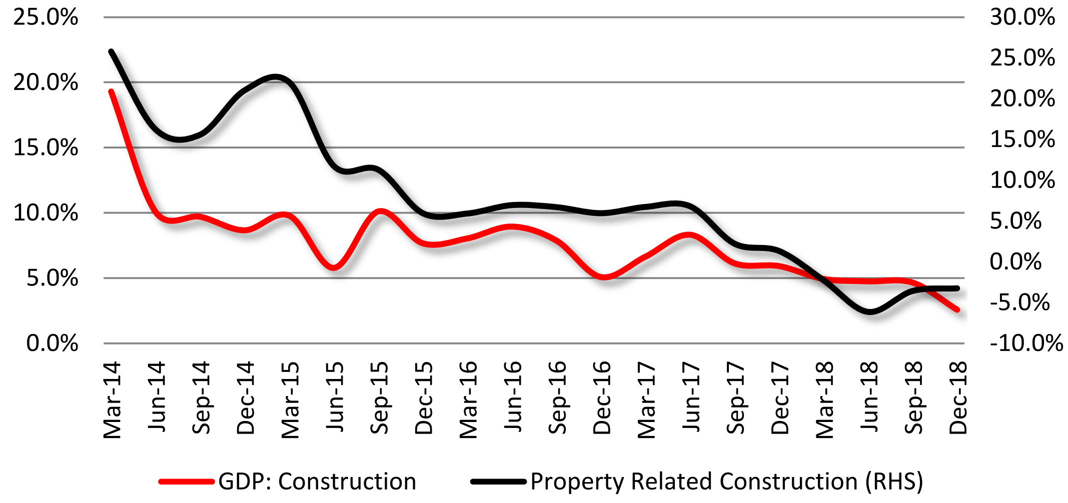
Chart 13: CPO production growth vs. Agriculture growth (Y-o-Y %)



Source: CEIC

Additionally, construction sector staged a slower growth of 2.6% in 4Q2018 (3Q2018: 4.6%) dragged by lower value of construction work done (4Q2018: 4.1% vs. 3Q2018: 5.2%). This was mainly underpinned by property related construction (residential and nonresidential property) which fell by 3.3% in 4Q2018 (3Q2018: -3.6%) while civil engineering edged up by 14.3% in the 4Q2018 (3Q2018: 17.7%). The slower growth in civil engineering subsector was affected by near completion of large petrochemical projects and delays in highway construction. Cumulatively, Malaysia's GDP is expanding at slower rate of 4.7% in 2018 compared to 5.9% in 2017. Moderation in domestic demand from 6.5% in 2017 to 5.6% in 2018 was the main factor while net exports grew 13.4% during 2018 (2017: -1.9%) following slower growth in real imports of 0.1% (10.9%) versus 1.5% (2017: 9.4%) growth in real exports. However, the fact remains: external sector was slowing.

Chart 14: Property Related Construction growth vs. GDP: Construction growth (Y-o-Y %)



Source: CEIC

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

Y-o-Y%	1Q 2017	2Q 2017	3Q 2017	4Q 2017	1Q 2018	2Q 2018	3Q 2018	4Q 2018	2017	2018
GDP	**5.6%**	**5.8%**	**6.2%**	**5.9%**	**5.4%**	**4.5%**	**4.4%**	**4.7%**	**5.9%**	**4.7%**
By expenditure										
Consumption	6.8%	6.4%	6.6%	6.9%	5.7%	7.0%	8.3%	7.5%	6.7%	7.2%
-Private	6.7%	7.1%	7.2%	7.0%	6.9%	8.0%	9.0%	8.5%	7.0%	8.1%
-Public	7.5%	3.3%	3.9%	6.8%	0.4%	3.1%	5.2%	4.0%	5.4%	3.3%
Investment	10.0%	4.1%	6.7%	4.3%	0.1%	2.2%	3.2%	0.3%	6.2%	1.4%
-Private	12.9%	7.4%	7.9%	9.2%	0.5%	6.1%	6.9%	4.4%	9.3%	4.5%
-Public	3.2%	-5.0%	4.1%	-1.4%	-1.0%	-9.8%	-5.5%	-4.9%	0.1%	-5.2%
Net Exports	-15.3%	1.9%	2.0%	2.3%	62.4%	1.7%	-7.5%	9.9%	-1.9%	13.4%
Exports	9.8%	9.4%	11.8%	6.7%	3.7%	2.0%	-0.8%	0.2%	9.4%	1.5%
Imports	13.0%	10.4%	13.3%	7.3%	-2.0%	2.1%	0.1%	1.3%	10.9%	0.1%
By Industry										
Agriculture	8.4%	5.9%	4.1%	10.7%	2.8%	-2.5%	-1.4%	-0.4%	7.2%	-0.4%
Mining	1.4%	0.1%	3.0%	-0.3%	0.1%	-2.2%	-4.6%	0.5%	1.0%	-1.5%
Manufacturing	5.6%	6.0%	7.0%	5.4%	5.4%	4.9%	5.0%	4.7%	6.0%	5.0%
Construction	6.6%	8.3%	6.1%	5.9%	4.9%	4.7%	6.8%	2.6%	6.7%	4.2%
Services	5.8%	6.3%	6.5%	6.2%	6.5%	6.5%	7.2%	6.9%	6.2%	6.8%

Source: CEIC, Strategic Management, Bank Islam Malaysia Berhad

Other indicator such as current account surplus balance widened from RM3.8 billion or 1.0% of GDP in 3Q2018 to RM10.8 billion or 2.9% of GDP in the 4Q2018. Larger surplus balance was helped by growing goods balance from RM26.6 billion to RM33.0 billion in the final quarter of 2018. Nonetheless, current account surplus balance narrowed from RM40.3 billion (3.0% of GDP) in 2017 to RM33.5 billion or 2.3% of GDP in 2018. Although the goods balance have been widening from RM116.8 billion in 2017 to RM121.4 billion in 2018, the deficits in primary and secondary income have been increasing to RM49.4 billion (2017: RM36.4 billion) and RM18.8 billion (2017: RM17.3 billion) respectively. Foreign investors have been sending back their investment income (profits + dividend + interest income) to their home country as well as higher overseas remittances by the foreign workers in Malaysia. This would mean Malaysia has lower Savings and Investment (S-I) gap, implying limited liquidity condition in the system.

Table 2: Balance of payments (RM million)

	1Q 2017	2Q 2017	3Q 2017	4Q 2017	1Q 2018	2Q 2018	3Q 2018	4Q 2018	2017	2018
Current Account	**4,786**	**8,772**	**12,800**	**13,916**	**14,977**	**3,909**	**3,784**	**10,834**	**40,275**	**33,505**
% GDP	1.5%	2.7%	3.7%	3.9%	4.4%	1.1%	1.0%	2.9%	3.0%	2.3%
Goods	25,010	26,027	31,672	34,056	35,681	26,055	26,594	33,031	116,766	121,362
Services	(6,171)	(4,849)	(4,823)	(6,972)	(5,846)	(6,180)	(3,337)	(4,336)	(22,815)	(19,700)
Primary Income	(10,147)	(8,168)	(9,631)	(8,408)	(10,192)	(11,230)	(15,022)	(12,933)	(36,354)	(49,377)
Secondary Income	(3,905)	(4,238)	(4,418)	-4761	(4,666)	(4,736)	(4,451)	(4,927)	(17,322)	(18,780)
Financial Account	**(8,313)**	**8,986**	**(6,261)**	**858**	**11,910**	**10,536**	**2,307**	**(6,145)**	**(4,730)**	**18,609**
Direct Investment	9,209	(7,147)	9,146	4,964	9,230	(493)	524	2,080	16,171	11,341
Asset	(2,058)	(15,563)	(6,336)	(277)	(3,187)	(4,486)	(5,573)	(10,044)	(24,234)	(23,290)
Liabilities	11,267	8,416	15,481	5,241	12,417	3,993	6,097	12,124	40,405	34,632
Portfolio Investment	(32,374)	17,513	(9,854)	9,357	(1,500)	(37,919)	786	(5,769)	(15,358)	(44,402)
Asset	(8,983)	(2,773)	(8,941)	1,254	(9,563)	(724)	4,427	(3,252)	(19,442)	(9,112)
Liabilities	(23,391)	20,286	(913)	8,103	8,062	(37,194)	(3,641)	(2,517)	4,084	(35,290)
Financial Derivatives	646	(286)	570	(1,127)	846	780	32	(687)	(197)	971
Other Investment	14,206	(1,094)	(6,123)	(12,335)	3,334	48,168	965	(1,769)	(5,346)	50,699
Errors and Omissions	**1,333**	**(7,472)**	**(337)**	**(12,633)**	**(8,672)**	**(15,297)**	**(9,494)**	**(10,824)**	**(19,109)**	**(44,287)**
Overall Balance	**(2,195)**	**10,286**	**6,202**	**2,141**	**18,216**	**(852)**	**(3,403)**	**(6,135)**	**16,436**	**7,826**

Source: CEIC, Strategic Management, Bank Islam Malaysia Berhad

Our views

Going forward, we expect the economy would grow at slower pace this year. **We maintained our 2019 forecast at 4.5% which was made in December 2018.** The line of reasoning revolves around the uncertainty in the external sector such as the ongoing trade friction between the US and China, the UK Brexit deal, slowing China's economy as well as volatility in the crude oil and financial markets. Thus far, the vibes from the President Trump has been forthcoming as deadline for the USD200 billion tariff rates which is slated to be raised from 10% to 25% by 1 March could be delayed. Such announcement came amidst deputy-level talks this week in Beijing. High-level discussions, led by US Treasury Secretary Steven Mnuchin and Chinese Vice Premier Liu He, are due to begin Thursday (14 February) as both parties scrambled to make progress before the March 1 deadline.

The external development aside, Malaysia's domestic condition has been quite soft. Sentiments among the business community have weakened as indicated by the recent PMI indices which remained below the 50-point demarcation line for four consecutive months. Similarly, the MIER's BCI has also fell below the 100-point threshold in the final quarter of 2018, signaling manufacturers have become pessimistic. The same is also true for consumers when the CSI descended dramatically from the 21-year high in the 2Q2018 to 96.8 points in 4Q2018.

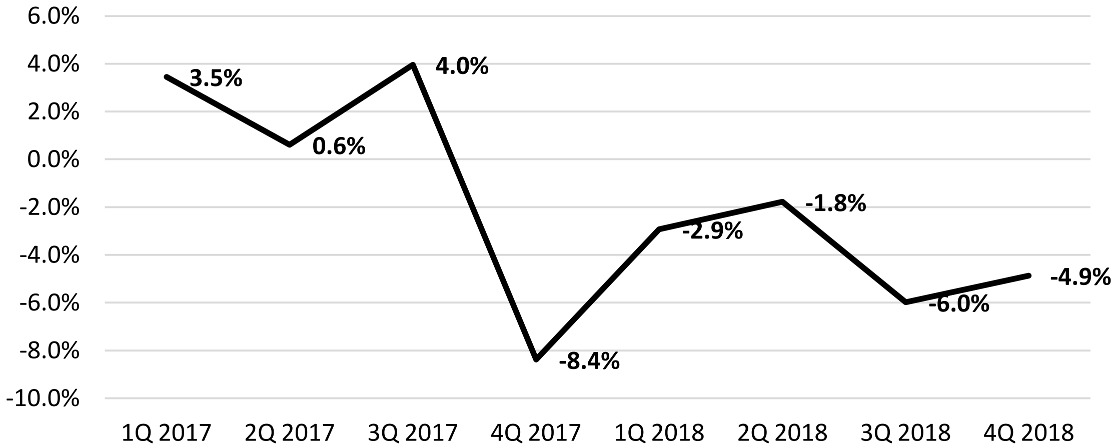
On the supply side, it appears that the industry is experiencing excess capacity which indicates that the input factor such as labour and capital are not fully utilised. Rising property overhang to 127,267 units as of 3Q2018 (3Q2017: 97,004 units) suggests that property developers are expected to focus on clearing up their existing inventory. This would mean slower property related construction activities which is in line with the 9.2% y-o-y (3Q2018: -7.7%) contraction in total construction work done for residential properties in 4Q2018. By extension, this would result in slower demand for building materials such as steel and cement.

Chart 15: Total unsold units for residential properties (completed, under construction and not constructed)

Sources: NAPIC & CEIC

Additionally, the recent International Data Corporation (IDC) Worldwide Quarterly Mobile Phone Tracker showed that the worldwide smartphone sales fell by 4.9% y-o-y to 375.4 million units in the 4Q2018. This represents 5 consecutive quarters of decline since 4Q2017. According to IDC, several factors have contributed to such weak performance such as lengthening replacement cycles, increasing penetration levels in many large markets, political and economic uncertainty, and growing consumer frustration around continuously rising price points. At the same time, the World Semiconductor Trade Statistics (WSTS) forecasted world semiconductor to grow at a much slower rate of 2.6% in 2019 from an estimated growth of 15.9% in 2018. This would affect Malaysia's E&E performance in view of their linkages in the global supply chain within the smartphones industries. The E&E command sizeable share in Malaysia's total exports at about 38.2% in 2018.

Chart 16: Worldwide smartphone sales y-o-y%



Source: IDC

Table 3: World Semiconductor Trade Statistics (WSTS) forecast summary

Autumn 2018	Amounts in US$M			Year on Year Growth in %		
	2017	2018	2019	2017	2018	2019
Americas	88,494	105,823	107,343	35.0	19.6	1.4
Europe	38,311	43,387	44,231	17.1	13.2	1.9
Japan	36,595	40,099	41,108	13.3	9.6	2.5
Asia Pacific	248,821	288,628	297,460	19.4	16.0	3.1
Total World - $M	412,221	477,936	490,142	21.6	15.9	2.6
Discrete Semiconductors	21,651	24,194	25,144	11.5	11.7	3.9
Optoelectronics	34,813	38,715	41,354	8.8	11.2	6.8
Sensors	12,571	13,402	14,091	16.2	6.6	5.1
Integrated Circuits	343,186	401,625	409,553	24.0	17.0	2.0
Analog	53,070	58,803	61,039	10.9	10.8	3.8
Micro	63,934	68,041	70,093	5.5	6.4	3.0
Logic	102,209	109,672	113,879	11.7	7.3	3.8
Memory	123,974	165,110	164,543	61.5	33.2	-0.3
Total Products - $M	412,221	477,936	490,142	21.6	15.9	2.6

Source: World Semiconductor Trade Statistics (WSTS)

So what does this mean to the Overnight Policy Rate (OPR)? We believe the inflation rate is expected to be contained this year. Our CPI forecast stands at 2.2% for 2019 but we may want to tweak it lower in view of the prevailing crude oil prices. In that sense, the BNM has the policy space to reduce the OPR should they foresee the economic outlook would begin to deteriorate. Additionally, the US Federal Reserve is seen to be maintaining their rates at 2.50% in 2019. In fact, the interest rate futures contract showed that probability of rate cuts have actually increase in November 2019 and January 2020. Perhaps, cutting the OPR may not be such a bad idea.

The BNM's Quarterly Bulletin indicated that the Monetary Policy Committee (MPC) is of the view that the balance of risks are tilted to the downside. They mentioned slower growth in the major economies, escalation of trade tensions, tighter global financial conditions amid an uncertain pace and timing of monetary policy normalisation in the US, heightened political and policy uncertainty, and commodity-related shocks as the main factors in their assessment. As such, the BNM has increasingly become data dependent and would stand ready to react should the adverse situation happens. **At the moment, we are still maintaining our OPR call at 3.25% in 2019.** Lower surplus balance in the current account to 2.3% of GDP in 2018 (2017: 3.0% of GDP) as well as volatility in the capital flows and exchange rate would be the main consideration by the BNM.