From the Desk of the Chief Economist

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Better-than-expected 2Q2019 GDP growth but…

2Q2019 GDP came in higher at 4.9%

It was mind blowing to say the least. The 2Q2019 Gross Domestic Product (GDP) grew by 4.9% year-on-year (y-o-y), surpassing the median estimates of 4.7% (Bank Islam: 4.5%). Such an outturn was definitely impressive especially when the regional economies were struggling during the June quarter. Singapore's economic growth was almost grind to a halt with GDP grew by only 0.1% (1Q2019: 1.1%). Philippines economy grew slightly slower to 5.5% (1Q2019: 5.6%) while Indonesia growing at the same pace of 5.1% (1Q2019: 5.1%). As usual, the devil always lies in the details.

Stronger Malaysian GDP growth was predominantly attributed by continued expansion in the domestic demand (2Q2019: 4.6% vs. 1Q2019: 4.4%). Consumer spending and private investment were clearly the main pillars, growing at 7.8% (1Q2019: 7.6%) and 1.8% (1Q2019: 0.4%) respectively in 2Q2019. Higher wage growth among the services (2Q2019: 4.4% vs. 1Q2019: 3.8%) and wholesale & retail trade subsector employees (2Q2019: 4.1% vs. 1Q2019: 3.3%), as well as stable labour market condition as reflected in unemployment rate of 3.3% (1Q2019: 3.3%) were the key drivers to household spending. By the same token, festive spending and Government transfers program, such as special aids for Aidilifitri and Bantuan Sara Hidup (BSH) have provided support to consumer spending. To some degree, slightly better sentiment among consumers may have also helped luring people to spend more (MIER Consumer Sentiment Index (CSI) edged up to 93.0 points in 2Q2019 from 85.6 points in 1Q2019).

There is also a ray of life seen in the investment activities. Gross Fixed Capital Formation (GFCF) declined by a smaller magnitude to -0.6% from -3.5% in the preceding quarter. Investment in structures turned around to 1.2% (1Q2019: -1.3%) in view of some improvement in the residential property segment. However, investment in machine and equipment fell 4.2% albeit better than 7.4% decline in the previous quarter. This was due to higher spending on information and communication technology (ICT). GFCF by sector showed public investment persistently declining at a rate of 9.0% (1Q2019: -13.2%) while private investment improved to 1.8% after experiencing a flat growth in the previous quarter (1Q2019: 0.4%).

As for the external sector, real exports recorded a flat growth at 0.1% in 2Q2019 (1Q2019: 0.1%) while real imports fell further by 2.1% in 2Q2019 (1Q2019: -1.4%). This clearly showed that global demand is softening as reflected by the JP Morgan Global Purchasing Managers Index (PMI) for manufacturing industries which has fallen below 50-point demarcation line for the third consecutive month (July: 49.3 vs. Jun: 49.4). Consequently, this has resulted in an expansion of net exports to 22.9% in 2Q2019 from 10.9% previously.

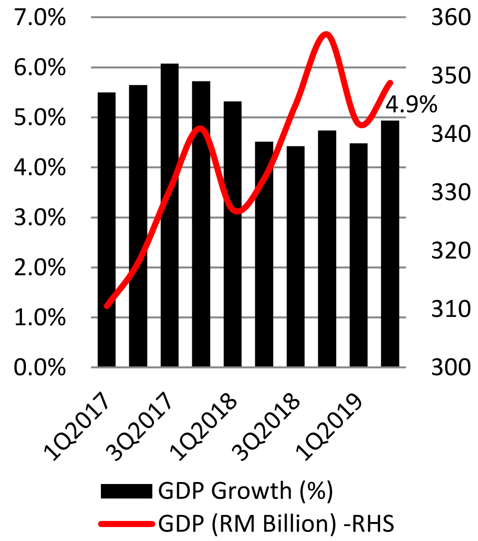
While we could boast about the double digit growth in net exports, the primary drivers was contraction in imports. We would rather go slow and not oversell on this point. Plus, strong consumption among the households may not last long as sentiments are still fairly weak with CSI remaining below 100-point threshold for three consecutive quarters. Hence, it's only a matter of time for consumers to change their tact and starts tighten their budget in order to save more. The BNM has done their part by delivering the 25 basis points cut in the Overnight Policy Rate (OPR) on 7 May. They may want to do more but at this juncture, the BNM would want to wait for the outcome of the FTSE Russell review in September. Perhaps, the federal government would want to play an active role going forward.

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

Y-o-Y %	Share (2018)	1Q2018	2Q2018	3Q2018	4Q2018	1Q2019	2Q2019
GDP	**100.0%**	**5.3%**	**4.5%**	**4.4%**	**4.7%**	**4.5%**	**4.9%**
Domestic Demand	**94.1%**	**4.1%**	**5.5%**	**6.8%**	**5.7%**	**4.4%**	**4.6%**
Private Sector	**74.2%**	**5.2%**	**7.3%**	**7.9%**	**7.8%**	**5.9%**	**6.2%**
-Consumption	57.0%	**6.6%**	**7.9%**	**8.9%**	**8.4%**	**7.6%**	**7.8%**
-Investment	17.3%	1.1%	5.5%	5.0%	5.8%	0.4%	1.8%
Public Sector	**19.8%**	**-0.3%**	**-1.6%**	**2.1%**	**0.0%**	**-1.4%**	**-2.8%**
-Consumption	12.5%	**0.4%**	**3.1%**	**5.2%**	**4.0%**	**6.3%**	**0.3%**
-Investment	7.4%	-1.3%	-9.9%	-2.7%	-5.9%	-13.2%	-9.0%
Net Exports of Goods and Services	**7.0%**	**58.0%**	**-6.0%**	**-9.4%**	**15.5%**	**10.9%**	**22.9%**
-Exports	67.6%	2.4%	2.6%	0.7%	3.1%	0.1%	0.1%
-Imports	60.6%	-2.3%	3.6%	2.0%	1.8%	-1.4%	-2.1%
Change in Stocks (RM billion)	**-1.1%**	**-3.3**	**-2.2**	**-6.9**	**-2.0**	**-5.1**	**-4.6**

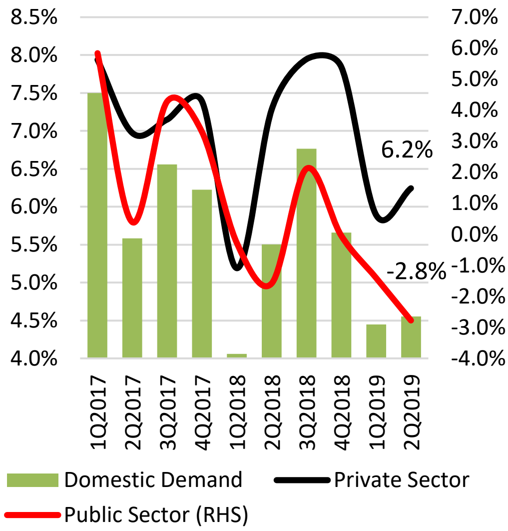
Source: CEIC, Strategic Management, Bank Islam Malaysia Berhad

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



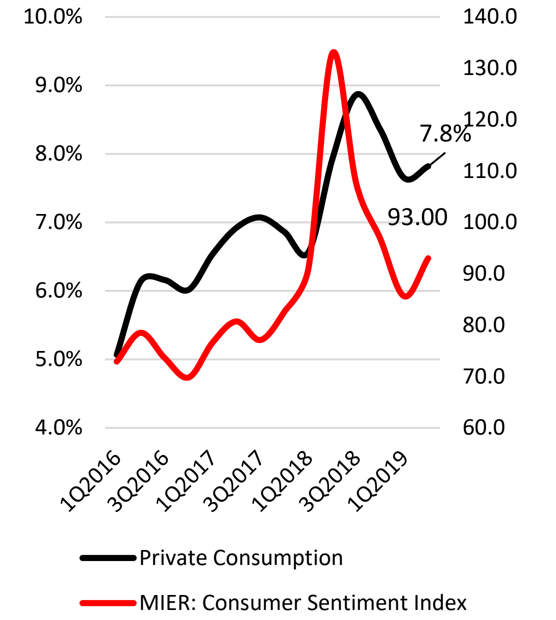
Source: CEIC

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



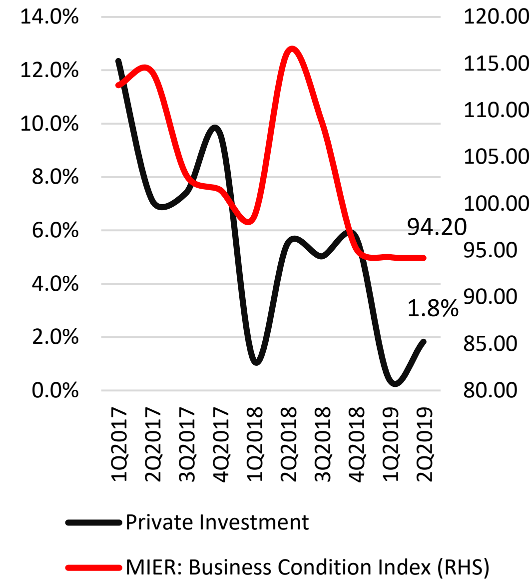
Source: CEIC

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



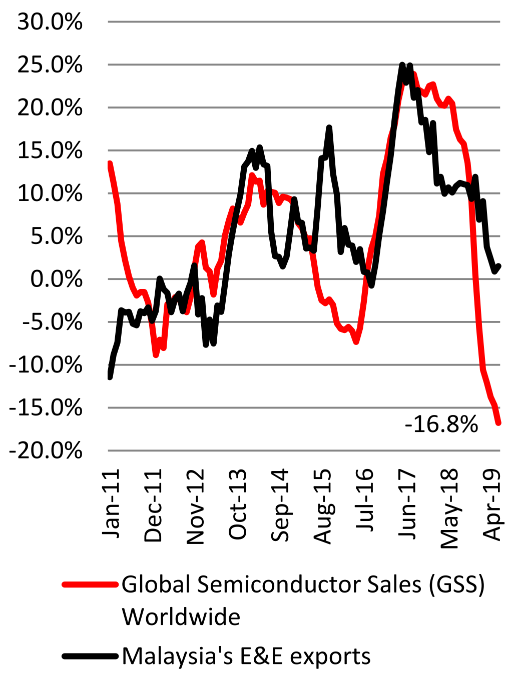
Source: CEIC

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



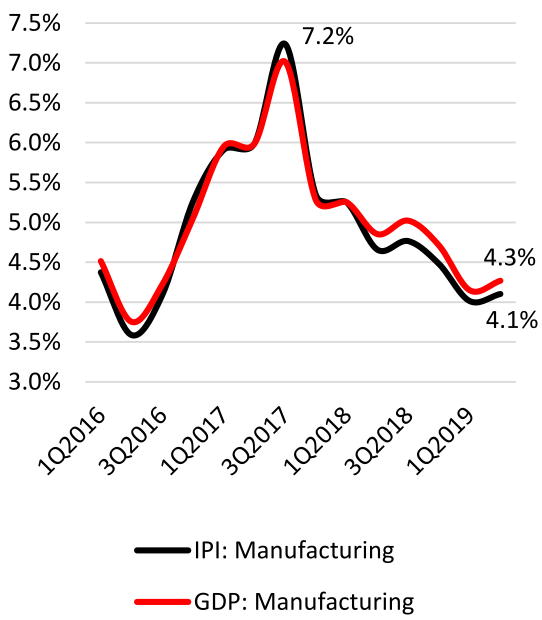
Source: CEIC

Chart 5: GSS (%) vs. Exports: E&E (%)



Source: CEIC

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



Source: CEIC, DOSM

Supply-side GDP – services and manufacturing the main driver for growth

On the supply side, all of the sectors recorded positive growth. This was primarily driven by services and manufacturing sectors which accounted for 79.1% of total GDP. Services sector grew modestly by 6.1% in 2Q2019 from 6.4% in 1Q2019 and remained as the largest contributor to the economy at 56.7%. The softer performance was largely attributed by the subdued growth in Wholesale Trade (2Q2019: 4.8% vs. 1Q2019: 5.1%) and Retail Trade (2Q2019: 9.2% vs. 1Q2019: 9.5%) sub-sector. On the same note, communication and insurance came in lower for the second quarter by 6.3% (1Q2019: 7.2%) and 2.2% (1Q2019: 11.0%) respectively. The manufacturing sector recorded an improvement from 4.1% in 1Q2019 to 4.3% in 2Q2019. The growth was supported by higher beverages & tobacco subsector which accelerated by 7.3% (1Q2019: 0.6%) accompanied with expansion in non-metallic, basic & fabricated metal products by (2Q2019: 5.6% vs. 1Q2019: 3.1%) and petroleum, chemical, rubber & plastic products (2Q2019: 5.9% vs. 1Q2019: 5.0%).

The agriculture sector had declined to 4.2% in 2Q2019 (1Q2019: 5.6%) which was underpinned by the slump in the production activities of Rubber (2Q2019: 2.2% vs. 1Q2019: 12.0%) and Forestry and Logging (2Q2019: -5.8% vs. 1Q2019: 3.0%). Similarly, Marine Fishing continued to post a weak performance as it dropped from 9.4% in 1Q2019 to 1.9% in 2Q2019. On the other hand, mining and quarrying sector recorded a better performance, rebounding into positive territory (2Q2019: 2.9% vs. 1Q2019: -2.1%) after six consecutive quarters of contractions since 4Q2017. This was due to the strong recovery in the natural gas output which shot up to 9.4% (1Q2019: -0.5%) growth during the quarter under review. However, output for crude oil and condensate fell 4.2% (1Q2019: -4.4%), representing 10 consecutive quarters of decline.

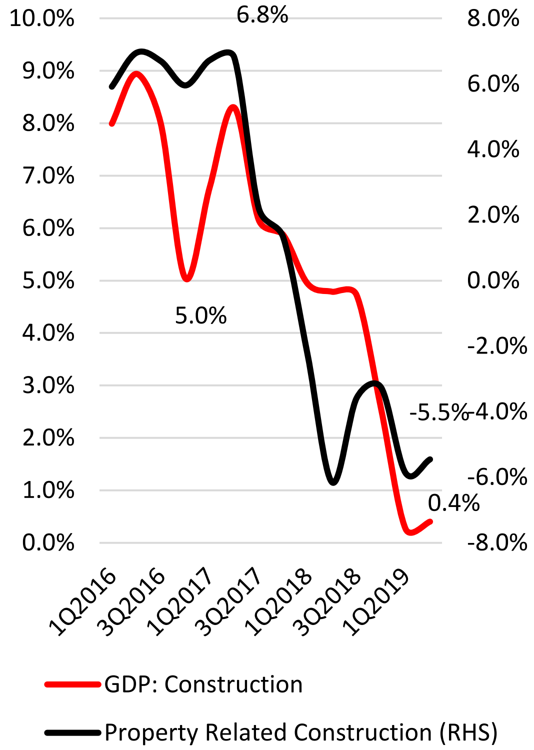
Construction sector was pretty much flat with only 0.5% growth recorded in 2Q2019 (1Q2019: 0.3%). Weak property market was the main driver with construction of residential and non-residential building declined by -1.1% (1Q2019: -7.2%) and -9.1% (1Q2019: -4.0%) respectively. Similarly, civil engineering growth was slowing from 7.1% (4Q2018: 11.0%) to 5.4% in the 2Q2019.

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

Y-o-Y %	Share (2018)	1Q2018	2Q2018	3Q2018	4Q2018	1Q2019	2Q2019
Services	56.7%	6.5%	6.5%	7.3%	6.9%	6.4%	6.1%
Manufacturing	22.4%	5.3%	4.9%	5.0%	4.7%	4.1%	4.3%
Mining & Quarrying	7.6%	-0.6%	-3.4%	-5.7%	-0.7%	-2.1%	2.9%
Agriculture	7.3%	3.1%	-1.7%	-0.7%	-0.1%	5.6%	4.2%
Construction	4.9%	4.9%	4.8%	4.7%	2.6%	0.3%	0.5%

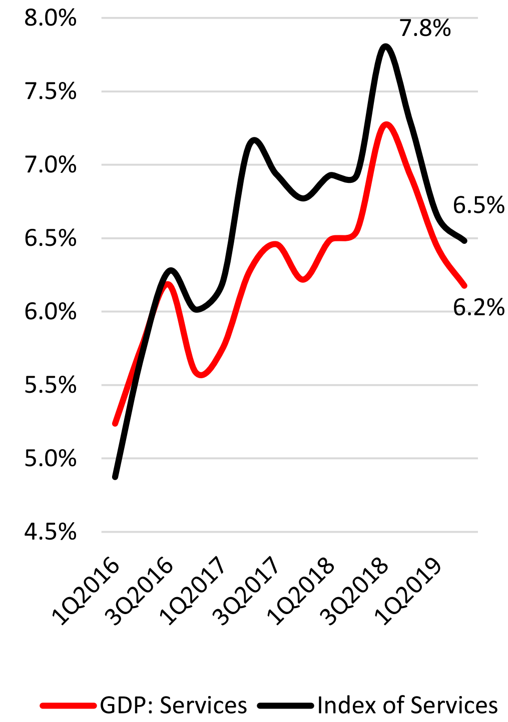
Source: CEIC, Strategic Management, Bank Islam Malaysia Berhad

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 RM16.4 billion or 4.5% of GDP in 1Q2019 to RM14.3 billion or 3.8% of GDP in the 2Q2019. This was attributed by the lower surplus balance in goods account as it declined from RM33.8 billion in 1Q2019 to RM28.1 billion in 2Q2019. However, lower deficit posted in the primary income (2Q2019: -RM5.5 billion vs. 1Q2019: -RM10.1 billion) and secondary income (2Q2019: -RM4.9 billion vs. 1Q2019: -RM5.5 billion) have supported the current account surplus. Meanwhile, financial account registered net outflows or RM18.6 billion, higher than RM13.8 billion net outflows in the previous quarter. This was underpinned by the outflow in portfolio investment (RM10.2 billion), direct investment (RM8.2 billion) and financial derivatives (RM0.5 billion).

Table 3: Balance of payments (RM million)

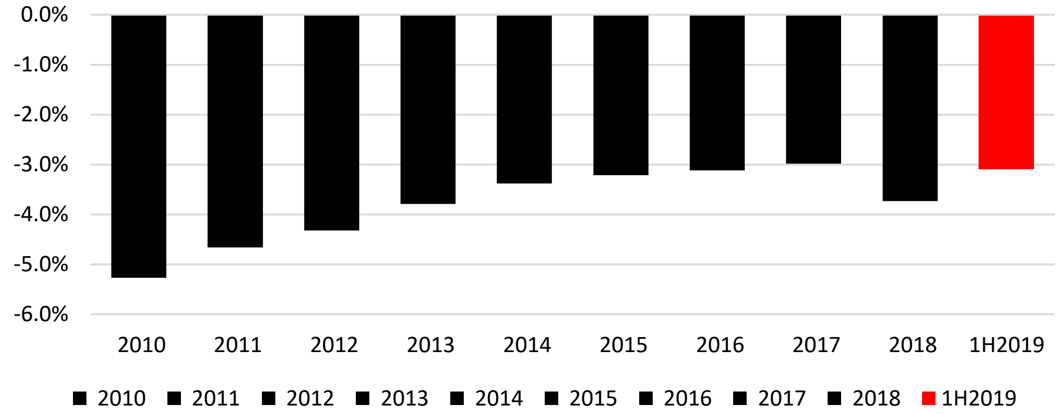
	2Q 2017	3Q 2017	4Q 2017	1Q 2018	2Q 2018	3Q 2018	4Q 2018	1Q 2019	2Q 2019
Current Account	**10,187**	**12,159**	**10,892**	**13,609**	**2,801**	**3,342**	**10,835**	**16,387**	**14,257**
% GDP	3.0%	3.5%	3.0%	3.9%	0.8%	0.9%	2.9%	4.5%	3.8%
Goods	27,376	31,579	32,844	34,156	25,919	26,373	32,733	33,849	28,104
Services	(4,726)	(4,995)	(7,135)	(5,510)	(5,572)	(2,886)	(3,757)	(1,836)	(3,437)
Primary Income	(8,168)	(10,132)	(10,212)	(10,396)	(12,751)	(15,517)	(12,922)	(10,115)	(5,540)
Secondary Income	(4,238)	(4,418)	-4761	(4,666)	(4,736)	(4,628)	(5,219)	(5,511)	(4,870)
Financial Account	**8,986**	**(6,261)**	**858**	**11,910**	**10,536**	**2,307**	**(6,145)**	**(13,816)**	**(18,552)**
Direct Investment	(7,147)	9,146	4,964	9,230	(493)	524	2,080	16,260	(8,236)
Asset	(15,563)	(6,336)	(277)	(3,187)	(4,486)	(5,573)	(10,044)	(6,881)	(11,475)
Liabilities	8,416	15,481	5,241	12,417	3,993	6,097	12,124	23,141	3,239
Portfolio Investment	17,513	(9,854)	9,357	(1,500)	(37,919)	786	(5,769)	2,053	(10,160)
Asset	(2,773)	(8,941)	1,254	(9,563)	(724)	4,427	(3,252)	(11,423)	(5,039)
Liabilities	20,286	(913)	8,103	8,062	(37,194)	(3,641)	(2,517)	13,476	(5,121)
Financial Derivatives	(286)	570	(1,127)	846	780	32	(687)	(237)	(456)
Other Investment	(1,094)	(6,123)	(12,335)	3,334	48,168	965	(1,769)	(31,892)	300
Errors and Omissions	**(8,895)**	**309**	**(9,606)**	**(7,287)**	**(14,204)**	**(9,064)**	**(10,792)**	**2,923**	**2,948**
Overall Balance	**10,278**	**6,208**	**2,144**	**18,233**	**(867)**	**(3,415)**	**(6,102)**	**5,494**	**(1,347)**

Source: CEIC, Strategic Management, Bank Islam Malaysia Berhad

Federal government fiscal position has been quite decent with deficits narrowing from RM30.8 billion of 4.4% of GDP in the 1H2018 to RM22.4 billion or 3.1% of GDP. This was mainly on account of higher revenue growth of 17.8% to RM125.8 billion (1H2018: RM106.8 billion, +10.0%) while operating and net development expenditure expanded by 5.9% and 18.2% to RM124.8 billion and 23.4 billion during first six months of 2019. As such, government expenditure was very much skewed towards servicing the operational purposes rather than to fund development expenditure.

Judging from the narrowing fiscal deficits, the government was clearly very mindful of their finances. This certainly works well with the credit rating agencies (CRAs) with the big three firms (S&P, Fitch & Moody's) have reaffirmed Government of Malaysia (GOM) prevailing sovereign rating at A-/A3. However, such fiscal discipline has become a "tax" to the economy and if the government to continue to operate in this way, economic growth could slow further in the months ahead. Having said that, the recent remarks from the ministry of finance (MOF) has been supportive as the 3% deficits target for next year may not be met in view of the challenging economic outlook. This would mean the government is sending a message that it will spend more especially on the development expenditure to support the economic activities which has been negatively impacted by the global factors.

Chart 9: Fiscal deficits as percentage of GDP



Sources: BNM & CEIC

Forward Looking View

Several important issues have been discussed with the BNM yesterday during the briefing for the 2Q2019 GDP performance:

1. Downside risks from the external front, trade tension and geopolitical events such as Brexit could immediately translate into slower export performance.
2. The monetary policy stance by the BNM on the Overnight Policy Rate (OPR) is accommodate growth.
3. Major economies are slowing down and the large emerging market countries are also vulnerable.
4. Private investment remained ease but several efforts have been undertaken to attract more investment from abroad.
5. Current progress on the market liquidity and accessibility on Foreign Exchange market. The BNM aimed to add more flexibility by providing excess liquidity outside operating hour, as well as to provide better access for the investors. Apart from that, the BNM also want to simplify the documentation process and to standardized the documentation requirement and make it easier for the investors to manage their foreign exchange risks.
6. The BNM is not looking for a negative global growth next year but admitted that the risks are considerable. Moreover, they are really concern on how trade tension will evolve plus the US election scenario next year.

All in all, we maintain our **4.5% GDP projection for the year. This would mean the economy would grow at a much slower rate of 4.3% in the 2H2019 from 4.7% growth in the 1H2019**. As such, the case for lower Overnight Policy Rate (OPR) is building up and the scope for monetary policy accommodation is widely open in view of lower inflation rate this year. In addition, the current growth dynamics requires immediate attention from the fiscal authorities especially to speed up the implementation of infrastructure projects which have been kept for review.