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3Q2018 GDP – saved by the consumers

Facts

- Malaysia Gross Domestic Product (GDP) grew 4.4% y-o-y in the 3Q2018 (2Q2018: 4.5%). This is lower compared to the consensus estimates of 4.6% (Bank Islam: 4.7%). From the demand persepctive, slower growth was driven by a sharp declined in the net exports growth of 7.5% (2Q2018: 1.7%) followed by contraction in the public investments at 5.5% in 3Q2018 (2Q2018: -9.8%)
- Private consumption continued to be the main driver with growth registered at 9.0% in the 3Q2018 (2Q2018: 8.0%). Strong consumption among the households was on the back of Goods and Services Tax (GST) holiday commencing from June to August 2018 as well as stable labour market condition seen during quarter under review. Labour market remains healthy although there was a slight uptick in the unemployment rate to 3.4% during 3Q2018 (2Q2018: 3.3%). This was mainly on account of higher labour force participation rate at 68.5% (2Q2018: 68.4%) due to new entrants in the labour markets.
- Similarly, private investment growth accelerated further from 6.1% in 2Q2018 to 6.9% in 3Q2018, suggesting that private firms continue to build up its production capacity. This can been seen from higher growth in machinery and equipment spending from 3.6% to 5.9% in the 3Q2018 while its share to total Gross Fixed Capital Formation (GFCF) improved from 35.6% to 38.1% during the quarter.
- On the supply side, services and manufacturing sector continued to be the key contributor to economic growth. Services sector rose to 7.2% (2Q2018: 6.5%) while the manufacturing sector output expanded to 5.0% in the 3Q2018 (2Q2018: 4.9%).
- However, mining sector contracted significantly to 4.6% from 2.2% decline in the previous quarter owing to sharp drop in Liquefied Natural Gas (LNG) growth from -7.2% to -9.8% in the 3Q2018 (source: Industrial Production Index). The negative shock in LNG was due to unplanned supply outages and pipeline repairs in East Malaysian facilities. Similarly, agricultural output growth fell by -1.4% (2Q2018: -2.5%) as the sector continue to be affected by lower production in Palm Oil (-8.0% in 3Q2018 vs. -6.4% in 2Q2018) and Rubber (-0.1% in 3Q2018 vs. -21.5% in 2Q2018).
- Additionally, construction sector grew moderately to 4.6% in 3Q2018 (2Q2018: 4.7%) brought by lower value of construction work done (3Q2018: 5.2% vs. 2Q2018: 5.3%). This was primarily driven by the fall in residential construction of -7.7% in the 3Q2018 (2Q2018: -7.6%) while civil engineering growth was holding up at 17.7% between July and September (2Q2108: 23.6%).

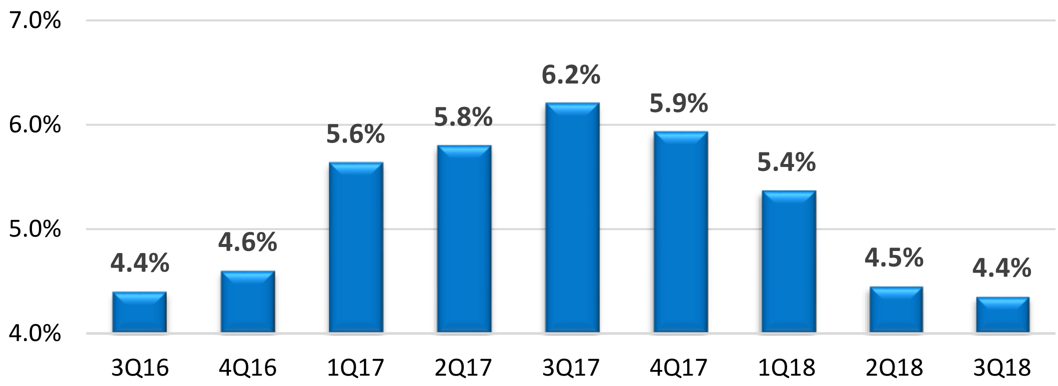
- Cumulatively, Malaysia's GDP is expanding at a slower rate of 4.7% between January and September this year compared to 5.9% in 9M2017. Household spending was very instrumental in supporting the overall growth following better consumer sentiments especially during the 2Q and 3Q2018. Stable labour market condition has allowed income stream among workers to remain steady, providing the necessary means for consumers to spend. Net exports growth was commendable at 14.8% in the 9M2018 but this was due to significant jump in growth during the 1Q2018 at 62.4%. Thereafter, net exports were wearing off, suggesting moderating external demand which is in tandem with the decline in Global Purchasing Managers Index (PMI) for manufacturing sector from 54.5 points in December 2017 to 52.1 points in October 2018.
- In an environment of heightened uncertainties, private investment managed to record respectable gain of 4.5% in 9M2018 (9M2017: 9.3%) while the share of spending in machinery and equipment has also gone up between July and September. This should translate into higher productivity and demand for high-skilled workers. Public investment, on the other hand, contracted by 5.3% in 9M2018 from 0.8% in the same period last year as some projects were mostly completed (RAPID, Pengerang Johor).

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

Y-o-Y%	1Q 17	2Q 17	3Q 17	4Q 17	1Q 18	2Q 18	3Q 18	9M2017	9M2018
GDP	**5.6%**	**5.8%**	**6.2%**	**5.9%**	**5.4%**	**4.5%**	**4.4%**	**5.9%**	**4.7%**
By expenditure									
Consumption	6.8%	6.4%	6.6%	6.9%	5.7%	7.0%	8.3%	6.6%	7.1%
-Private	6.7%	7.1%	7.2%	7.0%	6.9%	8.0%	9.0%	7.0%	8.0%
-Public	7.5%	3.3%	3.9%	6.8%	0.4%	3.1%	5.2%	4.8%	3.0%
Investment	10.0%	4.1%	6.7%	4.3%	0.1%	2.2%	3.2%	6.8%	1.8%
-Private	12.9%	7.4%	7.9%	9.2%	0.5%	6.1%	6.9%	9.3%	4.5%
-Public	3.2%	-5.0%	4.1%	-1.4%	-1.0%	-9.8%	-5.5%	0.8%	-5.3%
Net Exports	-15.3%	1.9%	2.0%	2.3%	62.4%	1.7%	-7.5%	-3.5%	14.8%
Exports	9.8%	9.4%	11.8%	6.7%	3.7%	2.0%	-0.8%	10.3%	1.6%
Imports	13.0%	10.4%	13.3%	7.3%	-2.0%	2.1%	0.1%	12.2%	0.1%
By Industry									
Agriculture	8.4%	5.9%	4.1%	10.7%	2.8%	-2.5%	-1.4%	6.0%	-0.4%
Mining	1.4%	0.1%	3.0%	-0.3%	0.1%	-2.2%	-4.6%	1.5%	-2.2%
Manufacturing	5.6%	6.0%	7.0%	5.4%	5.4%	4.9%	5.0%	6.2%	5.1%
Construction	6.6%	8.3%	6.1%	5.9%	4.9%	4.7%	4.6%	7.0%	4.8%
Services	5.8%	6.3%	6.5%	6.2%	6.5%	6.5%	7.2%	6.2%	6.8%

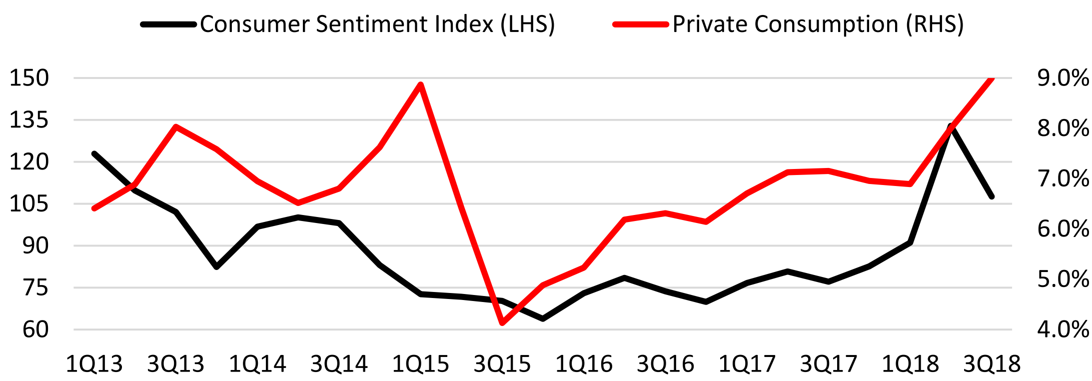
Source: CEIC, Strategic Management BIMB

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



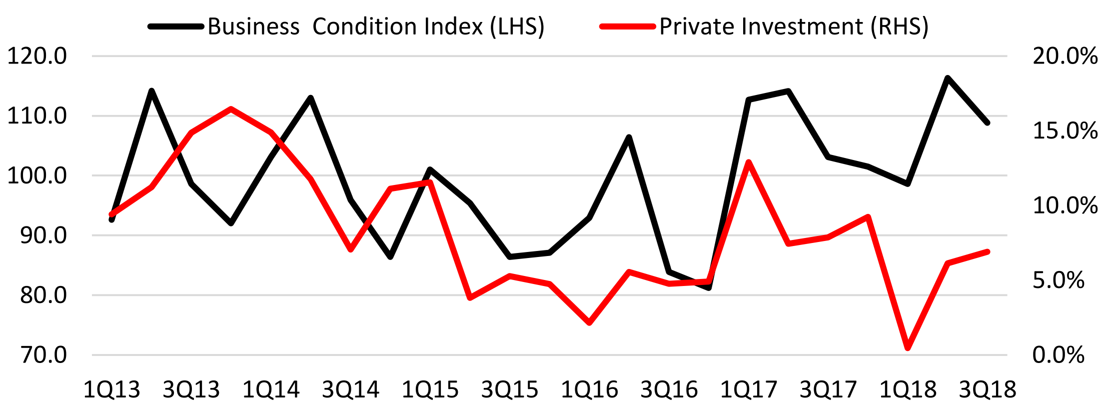
Source: CEIC

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



Source: CEIC

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



Source: CEIC

Our view

The immediate concern is none other than the impact of the trade war has on our economy in 2019 and beyond. Already, we can see the expansion in net export has dwindled from a massive growth of 62.4% in the 1Q2018 to 7.5% contraction in the latest reported quarter. Based on the Box Article in BNM Quarterly Bulletin, the impact from the prevailing trade frictions are estimated to lead to a reduction in annual global growth of 0.3 percentage points (ppt). However, if the trade tension continue to intensifies, it could shave off 0.8 ppt to the baseline global GDP growth forecast. This would mean global GDP could grow as low as 3.2% in 2019. At this rate, the global economy is expanding below its trend level of around 3.8% growth. Following this, the Malaysian economy will be affected via trade, income and investment channels. In its current forms, the trade tensions are expected to weigh down **Malaysia's GDP in 2019 by 0.3 – 0.5 ppt**. However, **it could slash Malaysia's GDP growth by as much as 1.3 to 1.5 ppt** should US raise the tariff rates to 25% on the remaining trade with China[1] and blanket tariff on auto tariffs. **This would mean Malaysia's GDP could grow as low as 3.4% in 2019 from a baseline growth forecast of 4.9%.**

What does it mean to the Overnight Policy Rate (OPR)? Based on our discussion with BNM officials on 16 November 2018, the central bank would consider various factors before prescribing the right policy response. This would include inflation rate, financial and asset market development among others. Consumer Price Index (CPI) is expected to be gradually rising in 2019 on account of higher fuel prices. This was due to the implementation of Automatic Price Mechanism (APM) for non-subsidised fuel which will be implemented in the 2Q2019. The nature of inflation appears to be cost driven as demand is expected to remain guarded. Therefore, inflation rate should recede beyond September 2019. In that sense, we can safely rule out the possibility of higher OPR next year. As for MYR, the BNM acknowledged the fact that the monetary tightening in the US will have direct impact to the emerging markets currencies including Malaysia. The BNM also stressed that the central bank would intermittently intervene the foreign exchange markets in order to ensure an orderly adjustment to the exchange rate.

What do we think? We believe the bias for OPR is on the downside but the BNM will try to maintain the policy rate at 3.25% for as long as possible as the central bank is cognisant on the financial market volatility. In particular, the surplus in current account balance has been trending down to RM22.7 billion or 2.1% of GDP in the 9M2018 (9M2017: RM26.4 billion or 2.6% of GDP). The risks of current account balance turning into deficits appears to be fairly contained in view of sustained surplus balance in the goods account (9M2018: RM88.3 billion vs. 9M2017: RM82.7 billion). More importantly is the decline in services account deficits from RM6.2 billion in the 2Q2018 to RM3.3 billion in the 3Q2018. The main factor for the narrowing in deficits was due to large surplus balance in travel account (3Q2018: RM8.0 billion vs. 2Q2018: RM6.6 billion) following higher tourists arrivals as well as lower construction services deficits (3Q2018: -RM1.3 billion vs. 3Q2018: -RM3.2 billion) owing to the cancellation and deferment of selected major projects.

[1] Jul – Sep 2018 – the US announced 10% on USD200 billion worth of China imports. The tariff rate will be raised to 25% on 1 January 2019 (Source: US Trade Representative - https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/september/ustr-finalizes-tariffs-200)

Therefore, promoting tourism sector and its supply chain (aviation, accommodation, transportation etc.) is critical to ensure our current account surplus balance can be sustained. Also, the review of mega projects has help to contain the deficits in construction services account. In this regards, it is also imperative to reduce our reliance on low-skilled foreign labour as this will affect our balance of payment via the overseas remittances. Based on Ministry of Finance (MOF) projection, overseas remittance in 2018 is estimated at RM35.7 billion as higher payments will be made to Bangladesh, India, Indonesia, Mynmar and Nepal by foreign workers. Next year, the overseas remittance will continue to expand to RM37.1 billion.

In a nutshell, the downside risks have become increasingly visible. As such, **we maintained our 2018 and 2019 GDP growth forecast at 4.8% and 4.5%** respectively. Assuming the government baseline forecast materialises (2019 GDP: 4.9%), the BNM would keep the **OPR unchanged at 3.25% in 2019**.

Table 2: Balance of payments (RM million)

	1Q 2017	2Q 2017	3Q 2017	4Q 2017	1Q 2018	2Q 2018	3Q 2018	9M2017	9M2018
Current Account	**4,786**	**8,772**	**12,800**	**13,916**	**14,977**	**3,909**	**3,784**	**26,359**	**22,670**
% GDP	1.5%	2.7%	3.7%	3.9%	4.4%	1.1%	1.0%	2.6%	2.1%
Goods	25,010	26,027	31,672	34,056	35,681	26,055	26,594	82,709	88,330
Services	(6,171)	(4,849)	(4,823)	(6,972)	(5,846)	(6,180)	(3,337)	(15,843)	(15,364)
Primary income	(10,147)	(8,168)	(9,631)	(8,408)	(10,192)	(11,230)	(15,022)	(27,946)	(36,444)
Secondary income	(3,905)	(4,238)	(4,418)	(4,761)	(4,666)	(4,736)	(4,451)	(12,562)	(13,853)
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Financial Account	**(8,313)**	**8,986**	**(2,837)**	**5,965**	**15,236**	**9,151**	**188**	**(2,164)**	**24,575**
Direct investment	9,209	(7,147)	8,772	5,300	10,704	(715)	57	10,834	10,046
Asset	*(2,058)*	*(15,563)*	*(6,666)*	*(580)*	*(3,111)*	*(3,219)*	*(5,774)*	(24,287)	(12,104)
Liabilities	*11,267*	*8,416*	*15,438*	*5,879*	*13,815*	*2,503*	*5,831*	35,121	22,150
Portfolio investment	(32,374)	17,513	(9,094)	11,639	(2,638)	(38,272)	630	(23,956)	(40,280)
Asset	*(8,983)*	*(2,773)*	*(8,181)*	*3,544*	*(10,538)*	*(1,042)*	*4,271*	(19,937)	(7,308)
Liabilities	*(23,391)*	*20,286*	*(914)*	*8,095*	*7,900*	*(37,231)*	*(3,641)*	(4,019)	(32,972)
Financial derivatives	646	(286)	983	(1,452)	753	(213)	316	1,343	856
Other investment	14,206	(1,094)	(3,498)	(9,523)	6,417	48,352	(816)	9,614	53,953
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Errors & omissions	**1,333**	**(7,474)**	**(3,759)**	**(17,739)**	**(11,997)**	**(13,912)**	**(7,375)**	**(9,900)**	**(33,284)**
Overall balance	**(2,195)**	**10,284**	**6,205**	**2,141**	**18,216**	**(852)**	**(3,403)**	**14,294**	**13,961**

Source: CEIC