

**Global Markets Research****Economics - Malaysia**

## ***BNM Annual Report 2016: Moderate outlook amid higher inflation***

*The Malaysian economy is expected to expand at a faster pace for the first time in three years, by 4.3-4.8% in 2017 according to the latest BNM Annual Report 2016. This marked a narrowing in forecast band (previous 4.0-5.0%) reflecting BNM assessment on reduced downside risks in the Malaysian economy. The mid-point forecast was left little changed at 4.6%, slightly above our projection of 4.4%. Growth will be driven by sustained domestic demand and improvement in exports. Against a backdrop of improving global commodity prices notably oil, and subsequent spillover effects, inflation forecast has been revised sharply higher by a full percentage point to 3.0-4.0% (vs ours 3.7%). Given the transitory and cost-push nature of this spike in inflation, we opine it does not warrant a policy response.*

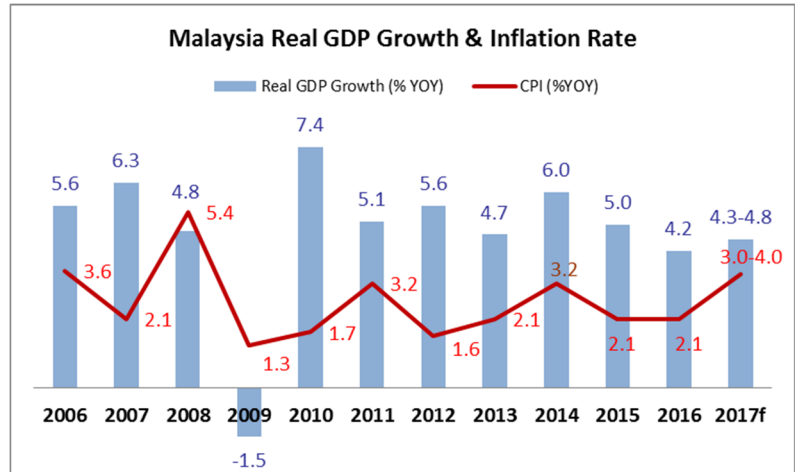
*Comments on monetary policy in the Annual Report is a tad more cautious vs the March MPC statement in our view and we therefore maintain that OPR will be kept unchanged for the year. Moderately higher growth and price outlook, as well as the central bank's quest to maintain financial stability, shall all be supportive of a rate pause. Risks of financial imbalances have also been largely contained, evident in the first pullback in household debt to GDP ratio in eight years (88.4% as at end-2016 vs 89.1% as at end-2015).*

*The Malaysian economy is expected to expand at a faster pace of 4.3-4.8% YOY in 2017, first pick-up in three years*

### **2017 Growth Prospects**

According to the latest BNM Annual Report 2016, **the Malaysian economy is expected to pick up for the first time in three years, to 4.3-4.8% YOY in 2017 (2016: +4.2%), driven by an improving external environment** as reflected in a reversal in net exports (+5.3% vs -1.8% YOY in 2016) **and sustained domestic demand growth** of 4.4% YOY.

**The narrower forecast band** of 4.3-4.8% (previous 4.0-5.0%) **reflects BNM assessment on reduced downside risks in the Malaysian economy** in the wake of decreasing uncertainties and volatility in the global economy and financial markets. There was however **no change to the central bank's mid-point growth forecast at 4.6%. We foresee upside risks to our 2017 growth forecasts of 4.4% should domestic demand rise against all odds and pan out better than expected.**



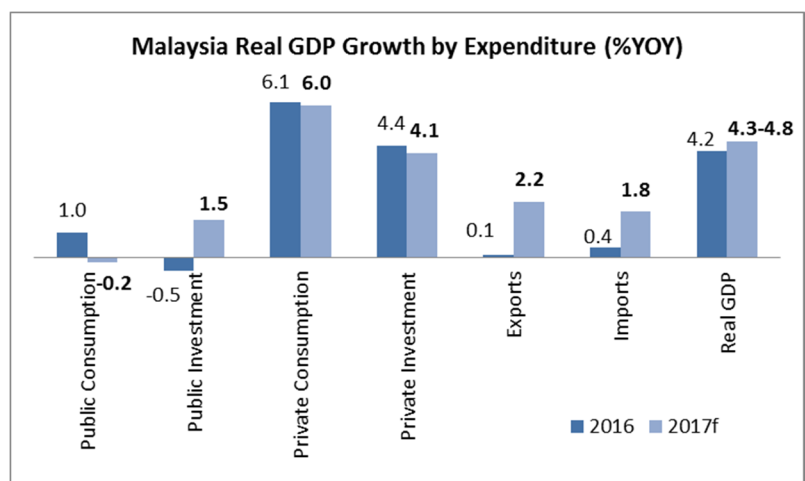
Source: BNM Annual Report 2016

*Domestic demand will continue to underpin growth with exports lending a helping hand*

**Domestic demand will continue to be the main growth pillar**, contributing 4.0ppt to overall growth despite maintaining a 4.4% YOY increase in 2017. **Of this, the private sector will remain in the driver seat**, continue to expand at a healthy rate of 5.6% YOY in 2017 (2016: +5.7%) supported by continued albeit more moderate increases in both consumption (+6.0% vs +6.1%) and investment (+4.1% vs +4.4%). **The public sector is also expected to see slightly quicker expansion** of 0.5% YOY in 2017 (2016: +0.4%), as higher investment in key infrastructure projects helped offset decline in public spending amid the government effort to reprioritize spending and reduce non-critical expenditure.

*Further lift from manufacturing and commodity exports*

**An improving external environment is also expected to help spur growth in the Malaysian economy.** Both export and imports are expected to pick up to increase at stronger paces, by 2.2% and 1.8% YOY respectively (2016: +0.1% and +0.4%). Manufacturing exports are expected to increase at a slightly faster rate while commodity exports are also expected to see better days riding on recovery in global commodity prices.



Source: BNM Annual Report 2016

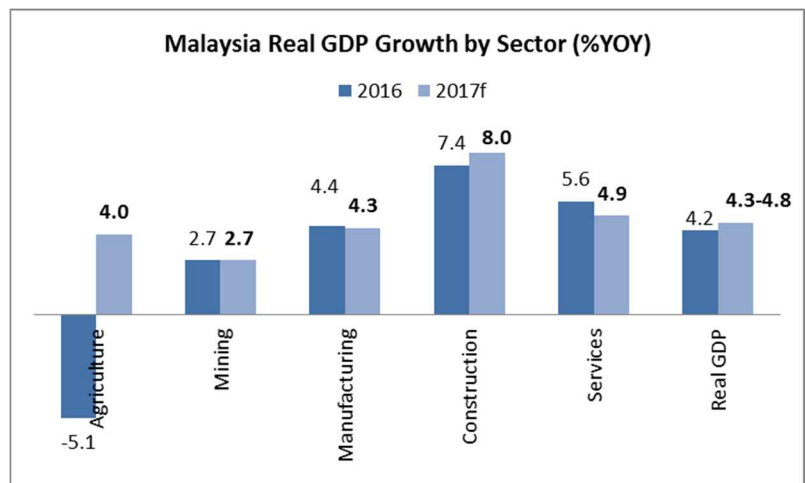
*Broad-based growth across all sectors...manufacturing and services remained in the forefront*

On the supply side, **all sectors are expected to register positive growth in 2017.** Even though growth in the services and manufacturing sectors are expected to moderate to 4.9% and 4.3% YOY respectively in 2017 (2016: +5.6% and +4.4%), these two sectors remained the biggest growth engines,

contributing 2.6ppt and 1.0ppt to growth this year. **Growth in the services sector will be driven by consumption-related services** namely wholesale & retail trade, food & beverages as well as transport & storage, and the ICT sector. **For manufacturing, growth will be supported by export-oriented sectors notably the electronics industry and construction-related manufacturing activities.** The construction sector is expected to grow at a faster pace of 8.0% YOY (2016: +7.4%), spurred by new and ongoing civil engineering projects in the utilities, transportation, and petrochemical sectors.

The primary clusters namely agriculture and mining sectors are also expected to perform well. **The agriculture is expected to stage a rebound** to increase 4.0% YOY in 2017 (2016: +5.1%), on the back of recovery in yields from adverse weather of El Nino. **The mining sector is expected to sustain a 2.7% YOY growth** supported by higher production of natural gas (LNG Train 9 and PETRONAS FLNG Satu) and crude oil (new Malikai oil field).

*Turnaround in agriculture and sustained growth in mining*



Source: BNM Annual Report 2016

**Inflation**

**Acknowledging the rapid build-up in inflation, full year CPI forecast has been revised a full percentage-point higher to 3.0-4.0% for 2017** (2016: +2.1%). This is in line with our full year forecast of 3.7%, as spikes in transport prices and the resulting spillover effects from higher transportation and a weaker Ringgit will certainly add on to price risks. That said, **inflationary pressure remains very much cost-push amid overall subdued demand, hence the transitory spike in inflation is not expected to prompt BNM to raise its policy rate in our view.**

**Labour Market**

Labour market condition is expected to be soft amid a backdrop of moderate growth and cautious business sentiments. Even though employment continues to expand, it may not be sufficient to fully absorb new entrants to the labour force. As a result, **unemployment rate is expected to rise to 3.6-3.8% in 2017** (2016: 3.5%).

**Monetary Policy**

Monetary policy in 2017 will focus on ensuring steady growth and stable inflation, supported by healthy financial intermediation in the economy. **BNM**

*Inflation forecast revised sharply higher to 3.0-4.0% for 2017*

*Soft labour market amid cautious business sentiments*

*Monetary policy to ensure sustainable growth and price stability amid healthy financial intermediation*

**reiterated downside risks in the global economy** stemming from adverse shocks in international trade, and expected shifts in global liquidity and capital flows that could have undesirable implications on the domestic economy and financial markets. **The central bank also cautioned that continued adjustments to higher cost of living and cautious economic sentiments could weigh on Malaysia’s growth prospects.**

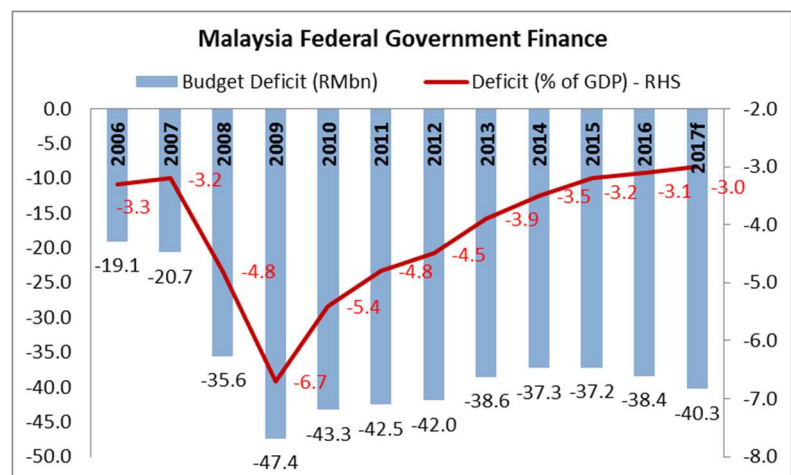
**We opine comments on monetary policy from the Annual Report are a tad more cautious vs its monetary policy statement at the March MPC meeting. This has reinforced our view for OPR to stay unchanged at 3.00% this year** amid moderate growth outlook, transitory higher price outlook as well as healthy financial intermediation.

**Fiscal Policy**

The government remains committed to fiscal consolidation, continues walking a tight rope to balance between sustaining growth and maintaining fiscal prudence. **There has been no change in revenue and spending projections from the budgeted numbers first tabled last October, keeping the government’s budget deficit target intact at 3.0% of GDP for 2017.**

That said, although budget deficit as a percentage of GDP is expected to continue improve, absolute deficit level is expected to notch higher by RM1.9bn to RM40.3bn in 2017 (3.0% of GDP), from an estimated RM38.4bn in 2016 (3.1% of GDP). This was a result of increases in both operating and development expenditure to RM214.8bn (+2.2%) and RM46.0bn (+9.5%) respectively (2016: RM210.2bn; RM42.0bn), which overshadowed the RM7.3bn or 3.4% increase in revenue to RM219.7bn. No change from previously, the deficit will be mainly financed by domestic sources. It is also comforting to note that **debt to GDP ratio has retreated to 52.7% as at end-2016** (end-2015: 54.5%).

*Fiscal deficit target of 3.0% of GDP intact...focus on high impact infrastructure projects*



Source: BNM Annual Report 2016

**Balance of Payments**

The current account is expected to register a smaller surplus for the 3<sup>rd</sup> consecutive year in 2017. **Surplus in the current account is expected to narrow to RM17.4bn in 2017 or 1.0-2.0% of GNI (2016: RM25.2bn or 2.1% of GNI).** Lower surpluses in the goods account as imports is expected to grow at a faster pace than exports, as well as bigger deficits in the services and income

*Smaller surplus in current account for the 3<sup>rd</sup> consecutive year*

accounts, are exerting a drag on overall surplus position. Gross exports are expected to pick up to increase 5.1% YOY in 2017 (2016: +1.1%) while imports are expected to grow at an even faster pace of 6.4% YOY in 2017 (2016: +1.9%). Meanwhile, net outflows in the income account will likely stay little changed due to higher profits, dividends and interests accruing to MNCs operating in Malaysia. The secondary income account will also see continued deficit as a result of lower inward remittances vis-à-vis outward remittances by foreign workers.

**Balance of Payments (RM billion)**

	2012	2013	2014	2015	2016p	2017f
Balance on Goods	113.0	96.6	113.4	109.6	101.2	98.4
Balance on Services	-8.5	-9.6	-11.2	-21.0	-22.6	-24.0
Primary Income	-35.8	-34.0	-37.3	-32.0	-34.7	-36.3
Secondary Income	-18.5	-17.5	-17.6	-21.9	-18.7	-20.7
<b>Balance on Current Account</b>	<b>50.2</b>	<b>35.5</b>	<b>47.3</b>	<b>34.7</b>	<b>25.2</b>	<b>17.4</b>
Capital Account	0.2	-0.0	0.3	-1.1	0.1	-
Financial Account	-23.0	-20.2	-79.9	-50.9	-4.2	-
<i>Direct Investment</i>	-24.4	-6.3	-18.0	4.8	17.9	-
<i>Portfolio Investment</i>	68.9	-3.0	-39.3	-28.2	-19.7	-
<i>Financial derivatives</i>	0.9	-0.2	-1.0	-0.7	-0.8	-
<i>Other Investment</i>	-63.4	-10.7	-21.7	-26.8	-1.7	-
Errors & Omissions	-23.5	-0.6	-5.4	21.1	-6.3	-
<b>Overall Balance</b>	<b>3.9</b>	<b>14.6</b>	<b>-36.5</b>	<b>3.8</b>	<b>14.8</b>	<b>-</b>

Note: p= Preliminary, f= Forecast

Source: Bank Negara Malaysia Annual Report 2016

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