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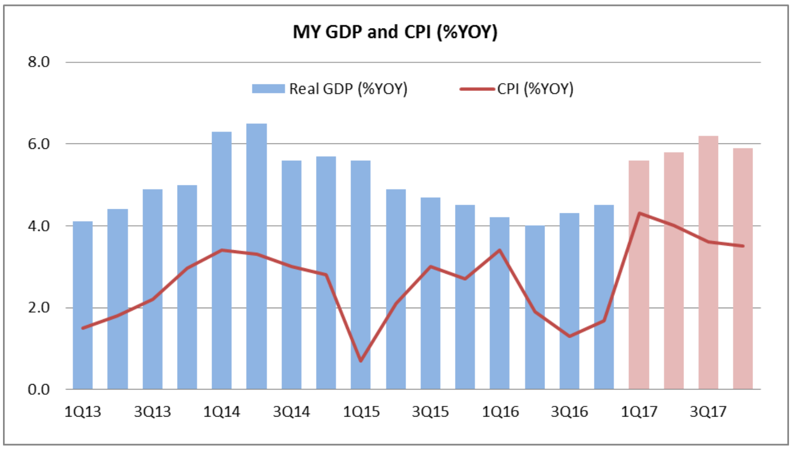
4Q GDP growth surprised on the upside again

The Malaysian economy pulled back for the first time in six quarters, but at a less than expected pace to 5.9% YOY in 4Q, leading to a commendable 5.9% YOY growth for the full year of 2017, its best in three years, thanks to a combination of external and domestic boosts. Growth outlook is expected to turn a tad softer but remain steady nonetheless in 2018. We are expecting real GDP growth to moderate to 5.0% in 2018, pulling back from last year's 5.9%, and at the lower end of the official forecast range of 5.0-5.5%. Domestic demand will remain the main growth pillar albeit expanding at more moderate pace with added support from exports. In addition to the high base effect, a stronger currency and potentially lower CPO prices are also among key dampening factors that would keep a lid on growth performance this year, not forgetting softer growth outlook of our major trading partners save for the US. Against a backdrop of moderating growth and inflation outlook, we expect BNM to keep OPR unchanged for the rest of the year, after raising it by 25bps to 3.25% in January as a preemptive move to prevent risks of overheating.

Real GDP growth softened to 5.9% YOY in 4Q; full year growth settled at a 3-year high of 5.9% in 2017 (2016: +4.2%)

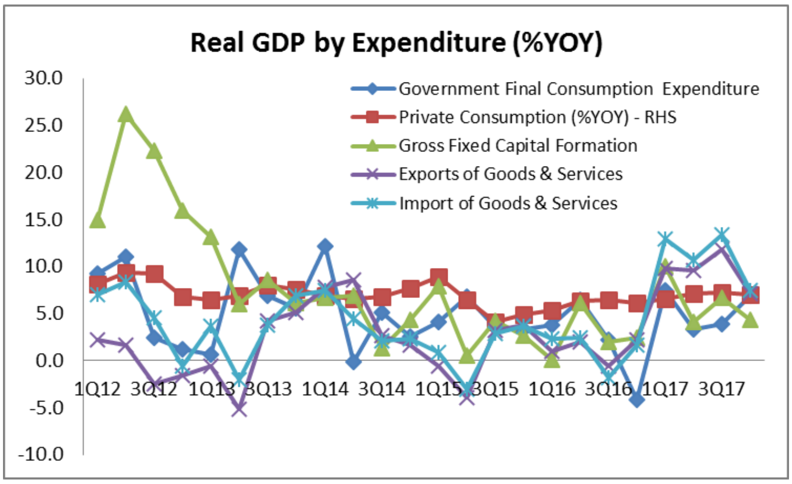
Growth in the Malaysian economy **pulled back from its highest in over three years, albeit at a less than expected pace from 6.2% YOY in 3Q to 5.9% YOY in 4Q.** Despite the moderation, this marked the second best quarter in 2017. A sharp pick-up in net exports from +1.7% to +5.4% YOY offset the slightly slower expansion in domestic demand, of 6.2% in 4Q (3Q: +6.6% YOY). This brings full year growth to 5.9% YOY in 2017 (2016: +4.2%), its strongest in three years. On a seasonally adjusted QOQ basis, real GDP increased at a slower pace of 0.9% in 4Q (3Q: +1.8%), implying slower growth traction.



More moderate growth in domestic demand

At the domestic front, the private sector continued to be the main growth driver witnessing slightly quicker growth of 7.4% YOY in 4Q (3Q: +7.3%) **while the public sector saw more moderate growth** of 3.4% YOY in 4Q (3Q: +4.0%). A pick-up in private sector investment activities helped offset easier growth in private consumption. Private investment grew at a faster pace of 9.2% YOY in 4Q (3Q: +7.9%) riding on business optimism and demand spanning across domestic- and export-oriented sectors. Private consumption growth however tapered off for the first time in four quarters, to 7.0% YOY in 4Q (3Q: +7.2%), supported by continuous expansion in the job market and wage growth.

Growth in public sector activities retreated to 3.4% YOY (3Q: +4.0%), as a pick-up in government spending (+6.9% vs+3.9%) was negated by renewed contraction in public investment (-1.4% vs +4.1%).



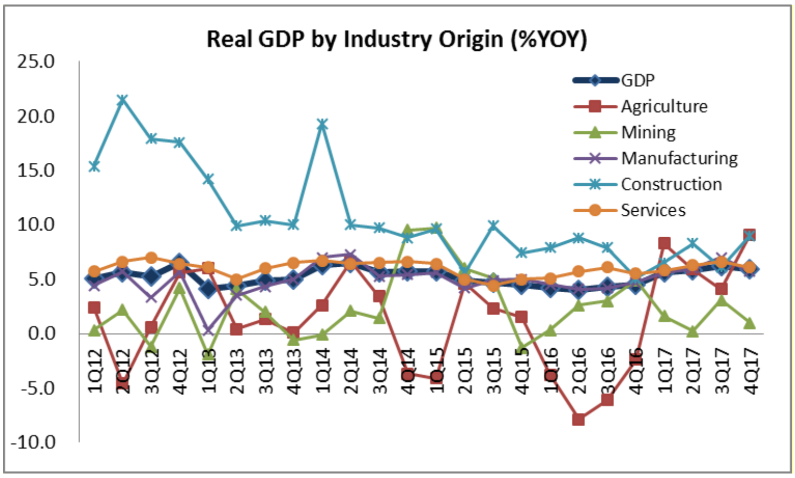
Services and manufacturing remained the biggest growth driver despite easier growth

On the supply side, growth was broad-based but only the agriculture and construction sectors reported faster expansion. Higher CPO output as a result of yield recovery from adverse weather condition boosted value-added in the agriculture sector to 9.1% YOY in 4Q (3Q: +4.1%). Meanwhile, sustained civil engineering activities for infrastructure, petrochemical and energy projects drove growth in the construction sector higher to 9.0% YOY in 4Q (3Q: +6.1%).

Both the manufacturing and services sectors saw slower growth, but nonetheless remained the two biggest contributor, accounting for approximately 80% of growth in 4Q. The slower 6.1% YOY increase in services was a result of more moderate growth in the wholesale and retail subsector, reflecting slower consumer spending. On a more positive note, the finance and insurance subsector registered faster growth while growth in the information and communication subsector remained largely supported by higher demand for data communication and computer services.

In the manufacturing sector, growth moderated to 5.7% YOY in 4Q (3Q: +7.0%), as a result of slowdown in both the domestic- and export-oriented sectors. E&E, petroleum & chemical, transport equipment, food and construction-related sectors all saw slower growth. Growth in the mining sector also slowed as natural gas output was hit by scheduled facilities shutdown in Sarawak.

Higher current account surplus amid widening surplus in goods account; financial account turned positive again on net inflows



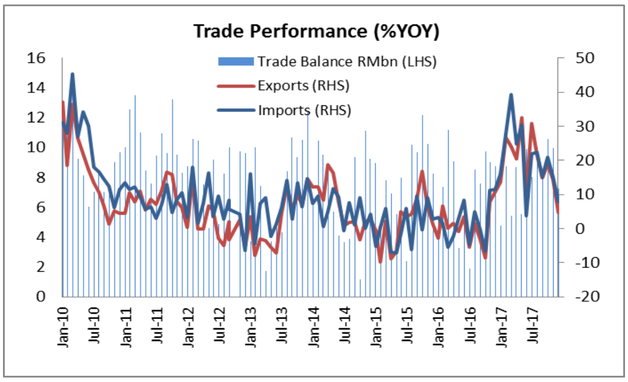
Expect growth to taper off to 5.0% in 2018 with domestic demand remain the main growth pillar

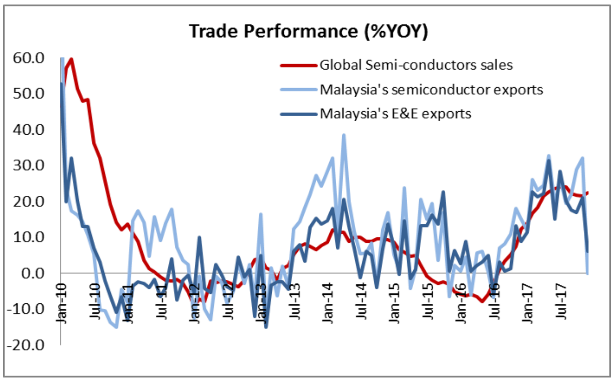
In a separate release, **Malaysia's current account surplus widened for the 3rd straight quarter, to RM12.9bn in 4Q** (3Q: RM12.5bn). H**igher surplus in the goods account** (RM34.1bn vs RM31.7bn) as a result of sustained growth in exports remained the key contributor to higher current account surplus. Again, this served to offset **continuous deficits in the services account**, which came in higher at RM6.9bn in 4Q (3Q: -RM4.9bn) as a result of lower tourism receipts and higher construction services deficit. **The income account also registered sustained deficit** of RM14.3bn in 4Q, as a result of higher profits accrued to foreign investors in Malaysia and continuous net outward remittances by foreign workers. On a positive note, t**he financial account reversed preceding quarter's net outflow and saw a net inflow of RM5.0bn in 4Q,** supported by portfolio investment by both residents and non-residents, and FDIs.

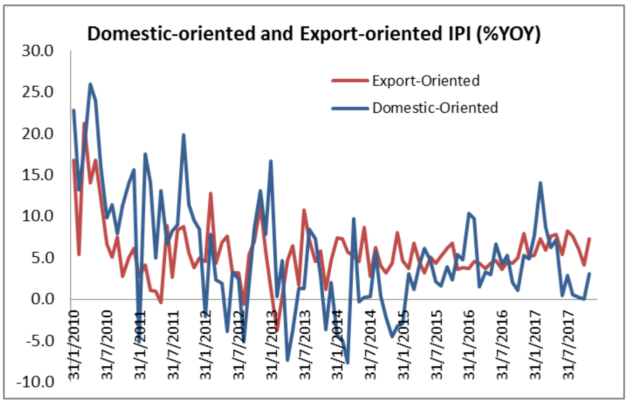
Growth outlook is expected to turn a tad softer but remain steady nonetheless in 2018. We are expecting real GDP growth to moderate to 5.0% in 2018, pulling back from last year's 5.9%, and at the lower end of the official forecast range of 5.0-5.5%. **Domestic demand will remain the main growth pillar albeit expanding at more moderate pace with added support from exports**.

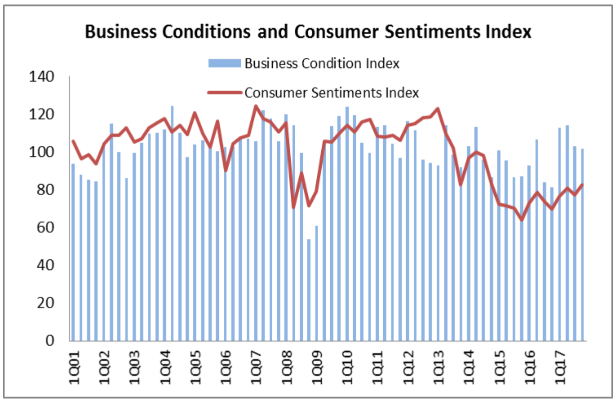
That said, the higher base effects seen last year, average gross exports growth at a 13-year higher of 19.4%, domestic demand growth at a 4-year high of 6.6%, and real GDP growth at a 3-year high of 5.9%, are expected to pressure economic performance this year. **In addition to the high base effect, a stronger currency and potentially lower CPO prices are also among key dampening factors that would keep a lid on growth performance this year, not forgetting softer growth outlook of our major trading partners save for the US.**

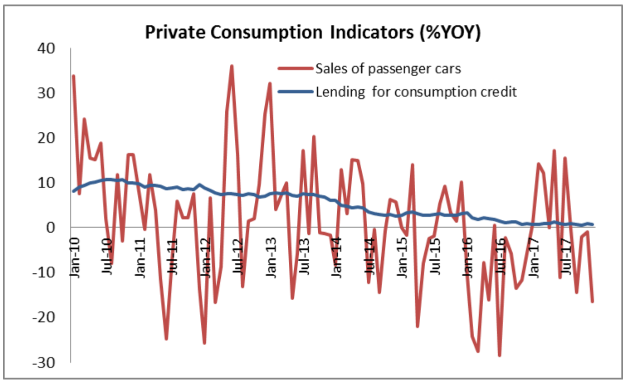
Against a backdrop of moderating growth and inflation outlook, we expect BNM to keep OPR unchanged for the rest of the year, after raising it by 25bps to 3.25% in January as a preemptive move to prevent risks of overheating.

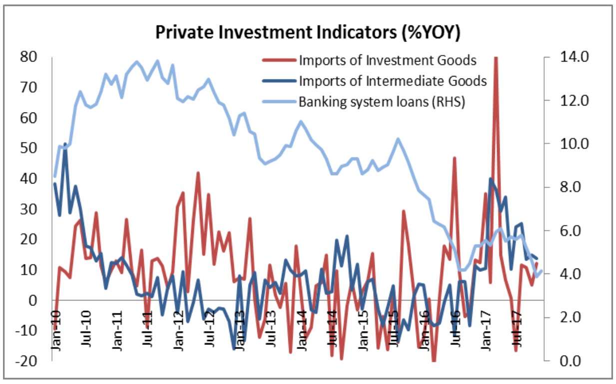

Trade Performance (%YOY)
Trade Balance RMbn (LHS)
Exports (RHS)
Imports (RHS)
16
14
12
10
8
6
4
2
0
50
40
30
20
10
0
-10
-20
Jan-10
Jul-10
Jan-11
Jul-11
Jan-12
Jul-12
Jan-13
Jul-13
Jan-14
Jul-14
Jan-15
Jul-15
Jan-16
Jul-16
Jan-17
Jul-17


Trade Performance (%YOY)
Global Semi-conductors sales
Malaysia's semiconductor exports
Malaysia's E&E exports
60.0
50.0
40.0
30.0
20.0
10.0
0.0
-10.0
-20.0
Jan-10
Jul-10
Jan-11
Jul-11
Jan-12
Jul-12
Jan-13
Jul-13
Jan-14
Jul-14
Jan-15
Jul-15
Jan-16
Jul-16
Jan-17
Jul-17


Domestic-oriented and Export-oriented IPI (%YOY)
Export-Oriented
Domestic-Oriented
30.0
25.0
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
31/1/2010
31/7/2010
31/1/2011
31/7/2011
31/1/2012
31/7/2012
31/1/2013
31/7/2013
31/1/2014
31/7/2014
31/1/2015
31/7/2015
31/1/2016
31/7/2016
31/1/2017
31/7/2017


Business Conditions and Consumer Sentiments Index
Business Condition Index
Consumer Sentiments Index
140
120
100
80
60
40
20
0
1Q01
1Q02
1Q03
1Q04
1Q05
1Q06
1Q07
1Q08
1Q09
1Q10
1Q11
1Q12
1Q13
1Q14
1Q15
1Q16
1Q17


Private Consumption Indicators (%YOY)
Sales of passenger cars
Lending for consumption credit
40
30
20
10
0
-10
-20
-30
Jan-10
Jul-10
Jan-11
Jul-11
Jan-12
Jul-12
Jan-13
Jul-13
Jan-14
Jul-14
Jan-15
Jul-15
Jan-16
Jul-16
Jan-17
Jul-17


Private Investment Indicators (%YOY)
Imports of Investment Goods
Imports of Intermediate Goods
Banking system loans (RHS)
80
70
60
50
40
30
20
10
0
-10
-20
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
Jan-10
Jul-10
Jan-11
Jul-11
Jan-12
Jul-12
Jan-13
Jul-13
Jan-14
Jul-14
Jan-15
Jul-15
Jan-16
Jul-16
Jan-17
Jul-17

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