HongLeong Bank

Global Markets Research

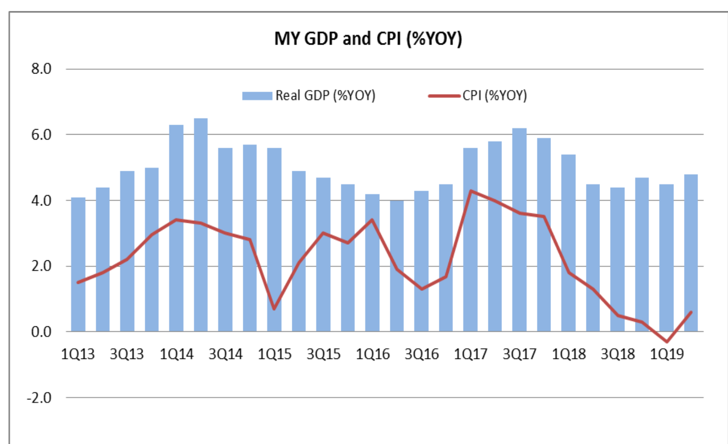
Economics - Malaysia

Quicker 2Q growth amid pick-ups in domestic demand and net exports

The Malaysian economy registered quicker growth of 4.9% YOY in 2Q (1Q: +4.5%), driven by pick-ups in both domestic demand and net exports. Improvement in investment and private consumption boosted domestic demand while deeper fall in imports spurred bigger contribution from net exports. While the quicker expansion in 2Q GDP did, to a certain extent, provide some reliefs to nagging concerns over slowing growth, we remain skeptical that growth could pick-up further in second half of the year given unabated escalation in external risks that would inevitably spill over to the domestic sectors. That said, continued expansion in private consumption albeit at more moderate pace (with the high base effect especially in 3Q last year lifted by one-off tax-holiday spending exerting a drag), coupled with anticipated recovery in investment activities following the revival of mega projects, and some tentative signs of potential gains from trade diversion, are expected to continue anchor growth in the mid-4% region in 2H. We are therefore maintaining our full year 2019 growth forecast of 4.7%. Sustained growth outlook (2018: 4.7%) suggests there is no urgent need for BNM to further adjust its OPR after the preemptive 25bps cut in May. We maintain our house view for OPR to stay unchanged at 3.00% for the remaining of the year, barring further escalation in downside growth risks and worsening financial conditions.

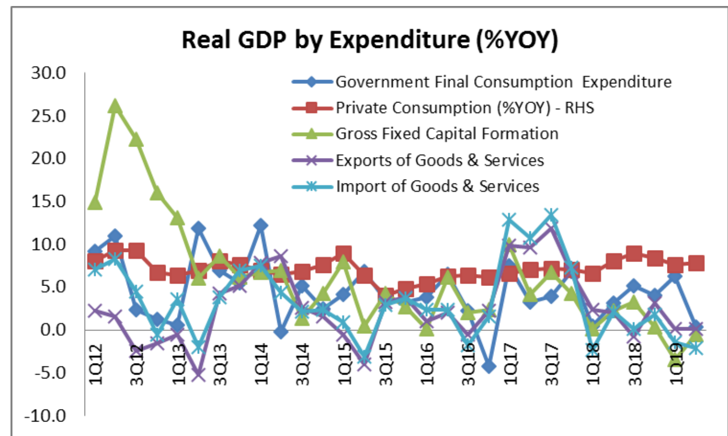
Growth in the Malaysian economy picked up to 4.9% YOY in 2Q... amid continued boost from net exports and private consumption

The Malaysian economy gathered some steam to increase at a faster pace of 4.9% YOY in 2Q (1Q: +4.5%), surpassing ours as well as market consensus estimate of 4.8% and 4.7% YOY respectively. **Sequential upside surprises in the GDP numbers should help alleviate pertinent concerns of a potentially steeper slowdown stemming from double whammy from domestic factors as well as rising downside risks from the global economy.**



Domestic demand halted two straight quarters of softening trend to increase at a faster pace of 4.6% YOY in 2Q (1Q: +4.4%), **thanks to pick-**

ups in private consumption and investment as well as a smaller drag from government investment. Overall domestic demand contributed 4.3ppt to 2Q GDP growth (1Q: +4.1ppt), of which private sector contributed 4.8ppt (1Q: +4.4ppt) while the government sector exerted a bigger drag (-0.5ppt vs -0.3ppt). Bigger contribution from net exports (+1.4ppt vs +0.9ppt) provided the upside surprises**. Net exports surprisingly grew at a much faster pace of 22.9% YOY in 2Q** (1Q: +10.9% YOY), lifted by a bigger decline in imports (-2.1% vs -1.4% YOY) amid sustained exports gain of 0.1% YOY. Again, we would like to reiterate that this is not an encouraging sign as fall in imports suggests softening domestic demand ahead. Meanwhile, inventories continued to dampen overall growth, contracting 4.6% YOY in 2Q (1Q: +5.1%). On a seasonally adjusted QOQ basis, real GDP growth tapered off slightly to increase 1.0% in 2Q (1Q: +1.1%).



Domestic demand gathered steam on the back of pick-up in private consumption and overall investment activities as government consumption nearly stagnated

Mirroring past performances, domestic demand, specifically private sector activities, remained firmly in the driver seat. Growth in the private sector accelerated to 6.2% YOY (1Q: +5.9%) while the government sector saw a bigger fall in its activities (-2.8% vs -1.4% YOY), marking its 2nd straight month of contraction as the government review and tighten its spending. While public investment has since improved somewhat, as reflected in the smaller decline of 9.0% YOY in 2Q (1Q: -13.2%), as a result of higher fixed asset expenditure by the Federal Government, public consumption pulled back quite substantially to 0.3% YOY in 2Q (1Q: +6.3%) as a result of lower spending on supplies and services.

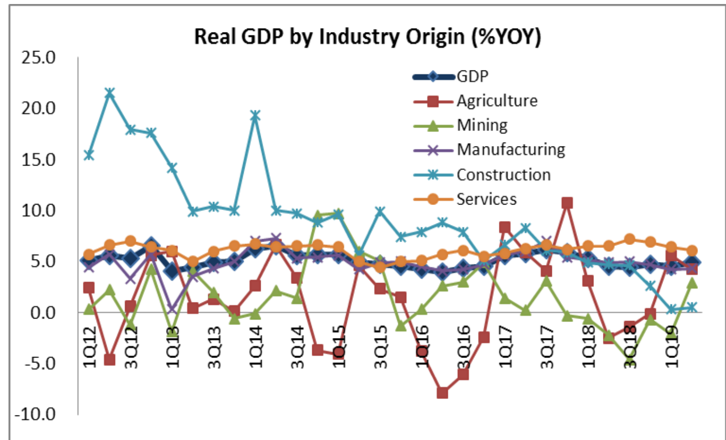
The private sector saw improvement in both spending and investment

Within the private sector, both consumer spending and business investment reported better growth traction. Private consumption growth quickened to 7.8% YOY in 2Q (1Q: +7.6%), spurred by Hari Raya festive spending and financial aids (Bantuan Sara Hidup) from the government. In addition, private investment also bounced back from a 3-year low to increase at a faster pace of 1.8% YOY in 2Q (1Q: +0.4% YOY), thanks to increased capex in the manufacturing and services sector as lingering trade uncertainties and prevailing weakness in the property sector continued to weigh on overall investment activities.

Mining, manufacturing and construction gathered steam; while agriculture and services softened

On the supply side, all sectors registered positive growth with the manufacturing and services sectors remaining the main growth pillar. Quicker growth was reported in the mining, manufacturing and construction sectors while growth in the agriculture and services sectors moderated. The services sector grew more moderately by 6.1% in 2Q (1Q: +6.4%) as a result of more modest growth across most of the subsectors while the agriculture sector expanded by 4.2% YOY (1Q: +5.6%) as slower fishing & forestry as

well as rubber output partially offset continued recovery in palm oil. On a more positive note, the manufacturing sector grew marginally faster by 4.3% YOY in 2Q (1Q: +4.2%), driven by better performance in the domestic-oriented sectors notably automotive and metal-related materials for transport and infrastructure projects. The mining sector turned around after contracting in the last 1.5 years, increasing 2.9% YOY in 2Q (1Q: -2.1%), thanks to recovery in natural gas output which offset planned facility shutdown in East Malaysia. Last but not least, the construction sector registered slightly better growth of 0.5% YOY in 2Q (1Q: +0.3%), underpinned by improvement in the residential and special trade subsectors.



Current account surplus narrowed to RM14.3bn in 2Q (3.9% of GNI)

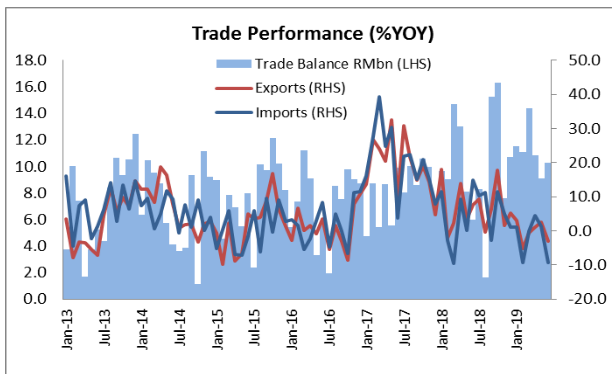
In a separate release, **Malaysia's current account surplus narrowed for the first time in three quarters, to RM14.3bn in 2Q (1Q: RM16.4bn), mainly a result of smaller surplus in the goods account that offset smaller deficits in the income accounts.** Surplus in the goods & services account moderated to RM24.7bn in 2Q (1Q: RM33.8bn) as imports growth outpaced exports growth. The services account deficit widened to RM3.4bn (1Q: -RM1.8bn) due to higher net payments to foreign providers for transport and insurance services while surplus in the travel account narrowed to RM7.1bn (1Q: RM7.9bn) on the back of lower per capital tourist spending. Income balance, the next big moving part, saw its deficit narrowed significantly to RM10.4bn (1Q: -RM15.6bn) due to higher investment income earned by Malaysian firms abroad from direct and portfolio investment and lower outflow from foreign worker remittances. The financial account continued to see bigger net outflow, totaling RM18.6bn in 2Q (4Q: -RM13.8bn), marking its 3rd straight quarter of net outflow due mainly to outflows in direct investment and portfolio investment.

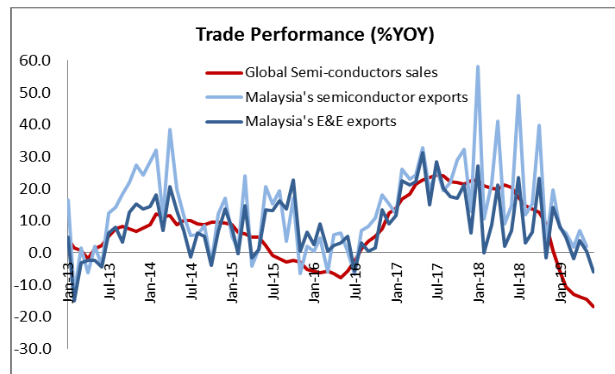
Maintain our full year 2019 growth forecast of 4.7% YOY and OPR pause view

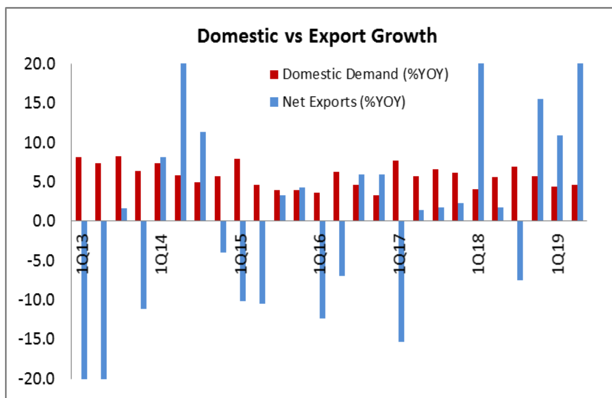
While the quicker expansion in 2Q GDP did, to a certain extent, provide some reliefs to nagging concerns over slowing growth, we remain skeptical that growth could pick-up further in second half of the year given unabated escalation in external risks that would inevitably spill over to the domestic sectors. Trade protectionism disputes between the US and China remained stubbornly unresolved and high in the watch list, exerting increasing downside risks to world trade and the global supply chain. **Trade tensions and its related policy uncertainties aside, geopolitical risks are other key risk factors that could destabilize and weigh on global growth outlook.**

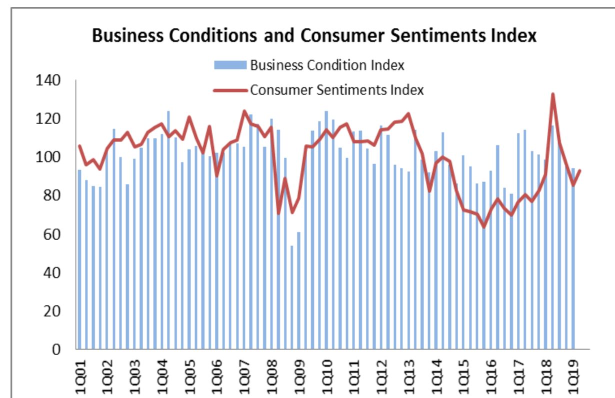
Domestically, continued expansion in private consumption albeit at more moderate pace (with the high base effect especially in 3Q last year lifted by one-off tax-holiday spending exerting a drag), **coupled with**

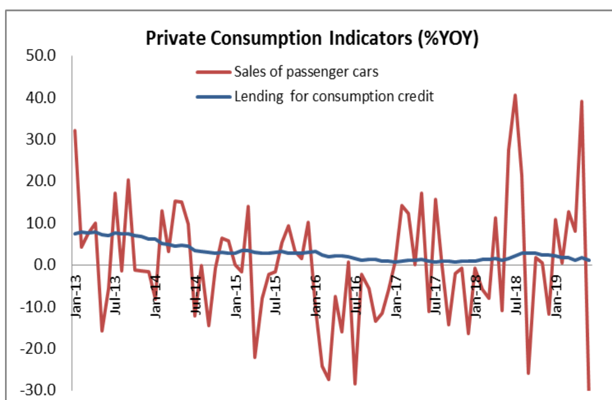
anticipated recovery in investment activities following the revival of mega projects, and some tentative signs of potential gains from trade diversion, are expected to continue anchor growth in the mid-4% region. We are therefore **maintaining our full year 2019 growth forecast of 4.7**%. Sustained growth outlook (2018: 4.7%) suggests there is no urgent need for BNM to further adjust its OPR after the preemptive 25bps cut in May. We maintain our house view for OPR to stay unchanged at 3.00% for the remaining of the year, barring further escalation in downside growth risks and worsening financial conditions.

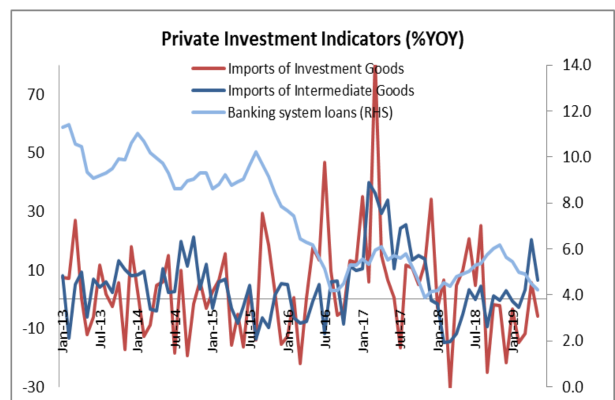












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