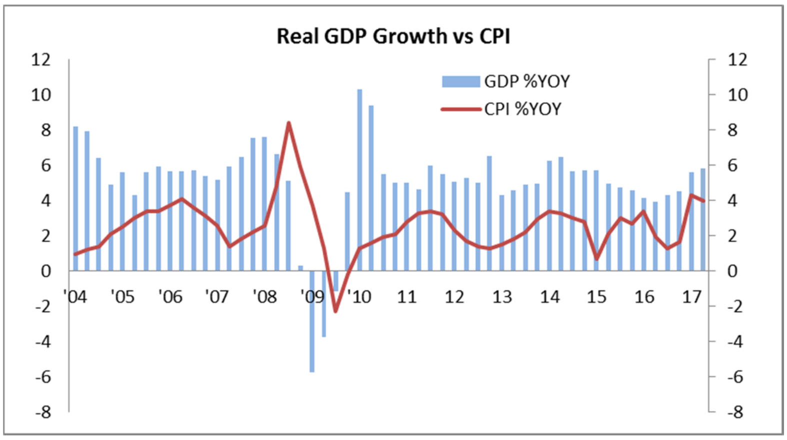
Another quarter of pleasant surprise

The Malaysian economy surprised on the upside again with growth quickening to 5.8% YOY in 2Q17. This marked its fastest growth pace in three years spurred by private consumption and a lift from positive net exports. Robust growth in 1H17 and a brighter global growth prospect prompted us to revise our full year growth forecast higher to 5.4%. Even though we maintain our view that the current growth momentum is unsustainable (given that 2Q details are not as strong as the headline number), a more upbeat growth outlook globally led by the major economies and resiliency in the China economy suggests moderation in the second half of the year will be relatively contained. We expect growth to moderate to 5.1% YOY in 2H17, from +5.7% in 1H17, in anticipation of softer momentum in domestic demand which is already evident in 2Q. Despite the more upbeat growth outlook, we believe there are no compelling reasons for any policy adjustment this year, although we do acknowledge that odds of a rate hike has increased, more so if the upbeat growth momentum can sustain going into 2018.

Real GDP growth surprised on the upside for another quarter at 5.8% YOY, its fastest in three years

The Malaysian economy offered another pleasant surprise again with **growth accelerating for the 4th straight quarter to 5.8% YOY in 2Q (1Q: +5.6%).** The fastest growth in three years was **spearheaded by an acceleration in private consumption and a positive boost from net exports**, offsetting slower growth in public spending and investment.

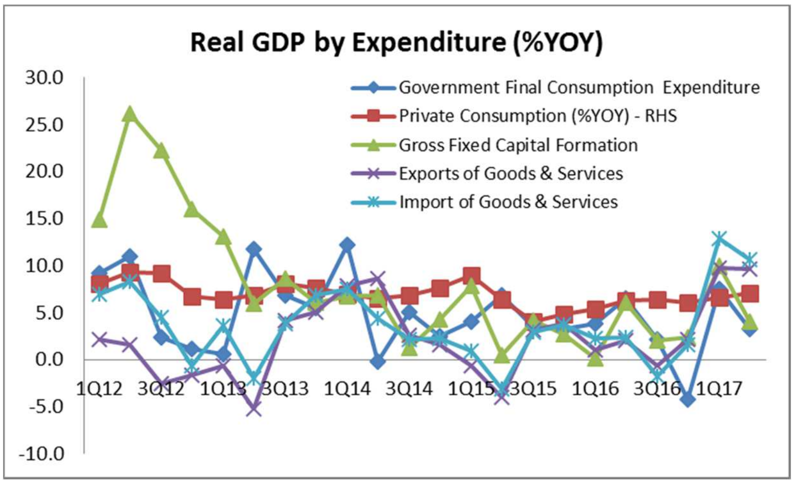
Growth in domestic demand tapered off to 5.7% YOY in 2Q17, in line with expectations that the sharp rally to 7.7% YOY in 1Q17 was not sustainable. Net exports turned positive (+1.4% YOY vs -14.5%), thanks to strong demand for manufactured and commodity exports while real imports growth weakened on the back of moderating investment activities. On a seasonally adjusted QOQ basis, real GDP increased at a slower pace of 1.3% in 2Q (1Q: +1.8%).



Domestic demand continued to grow albeit slower

The reprieve on slowing domestic demand after the hefty surge in 1Q proved shortlived. The private sector saw more moderate growth of 7.2% YOY in 2Q (1Q: +8.2%) **as a slowdown in investment negated the pick-up in consumption**. Private consumption growth quickened to 7.1% YOY in 2Q (1Q: +6.6%), riding on sustained labour market and wage growth. Meanwhile, investment in the manufacturing and services sectors continued to drive private investment, albeit at a slower pace of 7.4% YOY in 2Q (1Q: +12.9%).

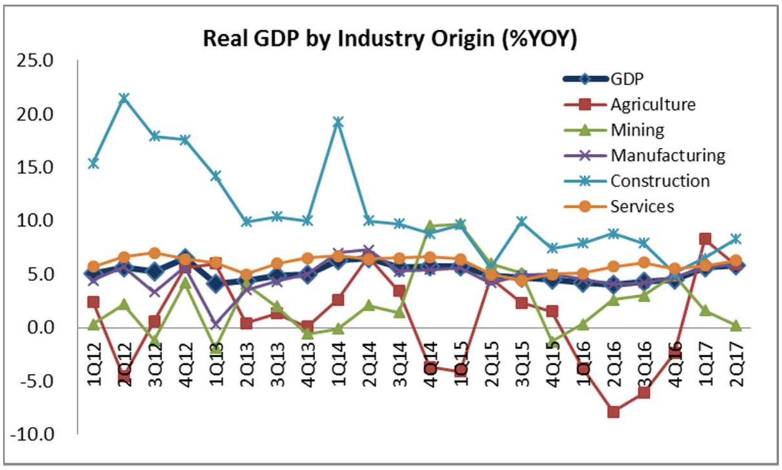
Public sector activities came to a near halt, eking out a mere 0.2% YOY growth in 2Q (1Q: +5.8%), as public spending growth more than halved to 3.3% YOY in 2Q (1Q: +7.5%) due to slower growth in the spending of emolument, supplies and services. In addition, public investment contracted 5.0% YOY (1Q: +3.2%) hit by lower spending on fixed assets by public corporation.



Services remain firmly in the driver seat; commodity related sectors decelerated

On the supply side, growth was broad-based with **quicker expansion in services, manufacturing, and construction while commodity-related sectors registered softer growth.** The services sector grew at a faster pace of 6.3% YOY in 2Q (1Q: +5.8%) driven by wholesale & retail trade, finance & insurance as well as transport & storage sub-sectors. Growth in the manufacturing sector also gathered steam, increasing 6.0% YOY in 2Q (1Q: +5.6%), spurred by both export- and domestic-oriented sectors namely E&E, food & beverages, and construction-related materials, in tandem with more robust growth in the construction sector (+8.3% vs +6.5%) spurred by construction in the transportation and power plant sectors.

On the contrary, the agriculture sector grew at a slower pace of 5.9% YOY in 2Q (1Q: +8.3%) while growth in the mining sector decelerated to 0.2% YOY in 2Q (1Q:+1.6%) amid lower crude oil production in line with global production cut and maintenance shutdown of a large gas field in Sabah that impacted natural gas production.



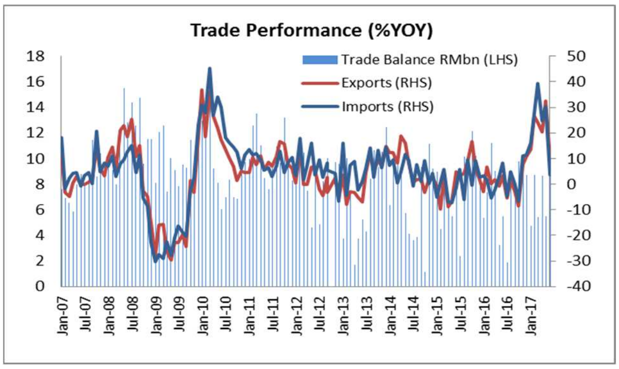
Higher current account surplus amid widening surplus in goods account and smaller deficits in services and income accounts

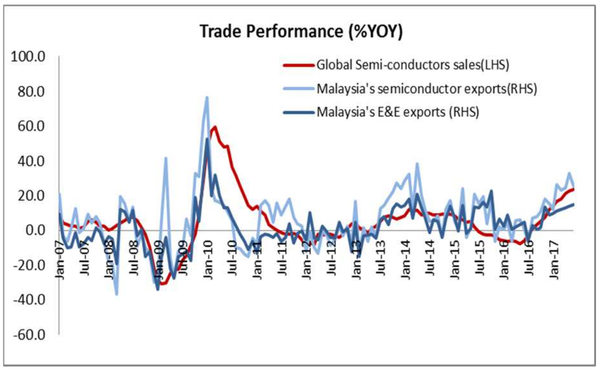
In a separate release, Malaysia's current account surplus widened again after narrowing last quarter. **The surplus position in the current account widened to RM9.6bn in 2Q17,** from RM5.3bn in 1Q17**.** The higher surplus was due to **higher surplus in the goods account** (RM27.0bn vs RM25.3bn) **as well as lower deficits in the services account** (-RM5.0bn vs -RM6.2bn) **and income account** (-RM12.4bn vs -RM13.8bn). **The financial account turned around to register a positive position for the first time in a year, at RM7.3bn** (1Q: -RM8.8bn), thanks mainly to a net inflow of RM16.0bn in portfolio investment, vs a net outflow of RM31.9bn in the preceding quarter.

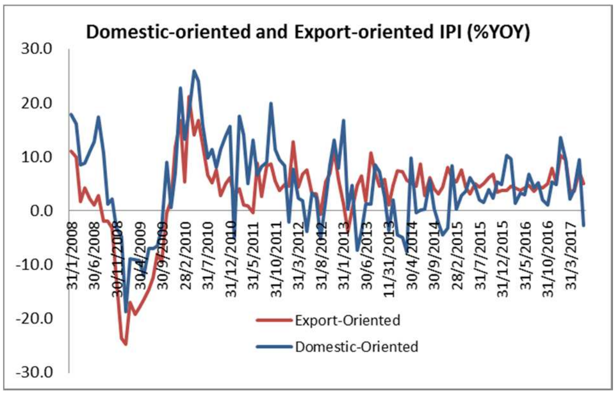
Revising full year growth forecast higher to 5.4% but no change to our view for a softer 2H

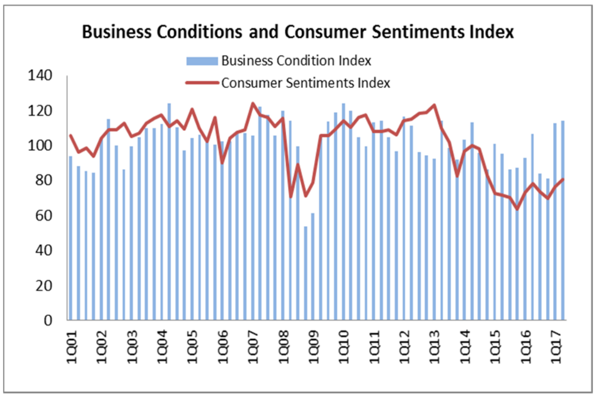
Two consecutive quarters of upside surprises in real GDP growth and a brighter growth prospect prompted us to revise our full year growth forecast higher to 5.4%. Even though we maintain our view that the current growth momentum is unsustainable and will moderate going forward, a more upbeat growth outlook globally led by the major economies and resiliency in the China economy suggests moderation in the second half of the year will be relatively contained.

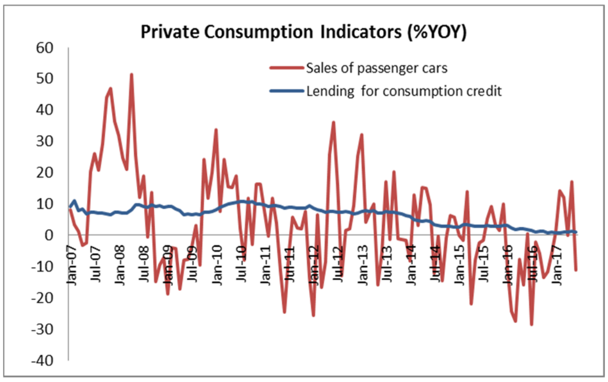
We expect growth to moderate to 5.1% YOY in 2H17, from +5.7% in 1H17, in anticipation of softer momentum in domestic demand which is already evident in the 2Q numbers. Recent upticks in consumer sentiments and business condition indices as surveyed by MIER are expected to keep private sector activities in check nevertheless, which shall remain the main pillar of growth. Despite the more upbeat growth outlook, **we believe there are no compelling reasons for any policy adjustment this year,** although we do acknowledge that odds of a rate hike has increased, more so if the upbeat growth momentum can sustain going into 2018.

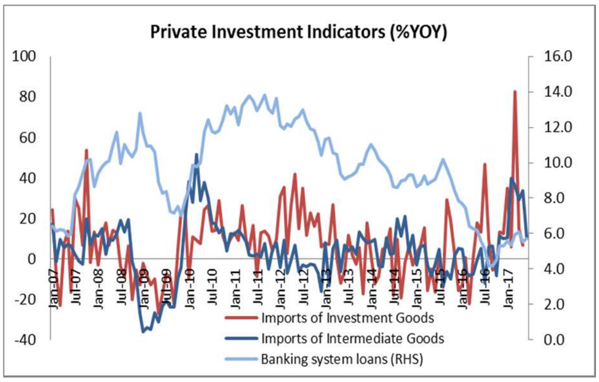

Trade Performance (%YOY)
Trade Balance RMbn (LHS)
Exports (RHS)
Imports (RHS)


Trade Performance (%YOY)
Global Semi-conductors sales(LHS)
Malaysia's semiconductor exports(RHS)
Malaysia's E&E exports (RHS)


Domestic-oriented and Export-oriented IPI (%YOY)
Export-Oriented
Domestic-Oriented


Business Conditions and Consumer Sentiments Index
Business Condition Index
Consumer Sentiments Index


Private Consumption Indicators (%YOY)
Sales of passenger cars
Lending for consumption credit


Private Investment Indicators (%YOY)
Imports of Investment Goods
Imports of Intermediate Goods
Banking system loans (RHS)

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