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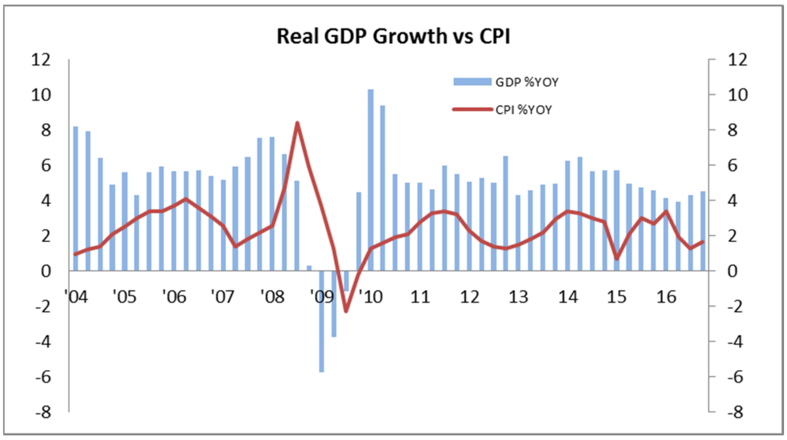
GDP growth quickened for a 2nd straight quarter

The Malaysian economy gathered steam for the 2nd straight quarter to increase 4.5% YOY in 4Q16, thanks to more robust exports that mitigated sharply slower growth in domestic demand. Full year growth moderated to 4.2% YOY in 2016 as expected, its slowest since 2009 but we opine growth outlook has turned more sanguine going forward, hence our slightly higher GDP growth of 4.4% this year (2016: +4.2%). While we are expecting a brighter external outlook, we would like to exercise a note of caution given the sharp 3.0%-point pullback in domestic demand within a span of six months that could dampen overall growth outlook going forward as domestic demand accounts for more than 90% of the country's GDP. Against a backdrop of modestly higher growth outlook and upward creeping inflation, reinforced by a more neutral tone in the latest BNM monetary policy statement, we maintain our view that OPR will stay unchanged at 3.0% this year.

Real GDP growth gained momentum for a 2nd straight quarter, bringing full year growth to 4.2% for 2016 as expected

The Malaysian economy picked up steam for the 2nd straight quarter, as real GDP growth quickened to 4.5% YOY in 4Q16 (3Q16: +4.3%) as expected, its best growth pace in a year, lifted by more robust exports as growth in domestic demand tapered off. **This resulted in a 4.2% YOY growth for the full year of 2016,** moderating from the 5.0% expansion in 2015, also within expectations.

Sustained net exports growth of 5.8% YOY in 4Q (3Q: +5.9%) provided the much anticipated lift as domestic demand grew at a much slower pace of 3.3 YOY in 4Q. This marked its 2nd straight quarter of moderation and the weakest growth since 4Q09 during times of global financial crisis. **Deeper contraction in the public sector (-2.6% vs -0.2% YOY) as the government restrained spending to keep budget deficit target intact was the biggest culprit dampening domestic demand, overshadowing steady growth (+6.0% YOY) in private sector activities** during the quarter. On a seasonally adjusted QOQ basis, real GDP also sustained a 1.4% increase in 4Q (3Q: +1.4% revised).

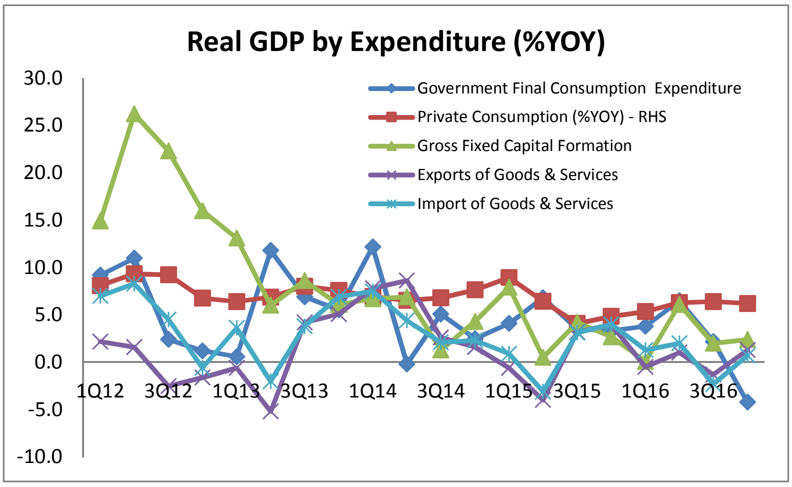


Continuous pullback in domestic demand a stoking concern…

Despite the back-to-back acceleration in growth momentum in 4Q16, **we remain cautious on the sustainability of further upticks going forward.** As mentioned in our last quarter's commentary, **the hefty pullback in domestic demand remains a stoking concern.** Growth in domestic demand almost halved over a short 6-month period from 6.3% YOY in 2Q16 to only 3.3% YOY in 4Q16 (3Q: +4.6%), approaching levels last seen during the 2008/09 global financial crisis. **While the private sector remained the main anchor for growth,** with consumption holding up at 6.2% YOY in 4Q (3Q: +6.4%), and growth in investment marginally quicker at 4.9% YOY (3Q: +4.7%), **bigger falls in public spending** as the government rationalizes supplies and services as well as slower spending on emoluments **dented overall activities in the domestic sector.** If MIER consumer sentiments and business conditions indices were of any guide, which they do, both indices fell further in 4Q16 pointing to a less sanguine growth outlook for both consumers and businesses going forward.

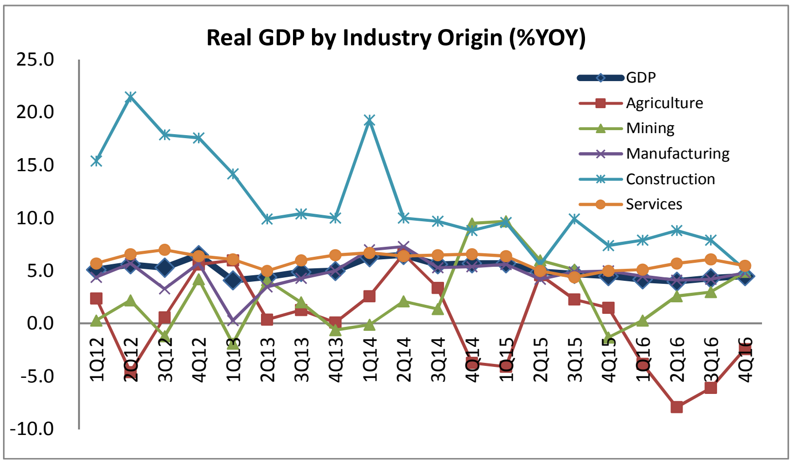
…net exports the savior again

Net exports provided the much needed boost for the 2nd straight quarter, increasing 5.8% YOY in 4Q (3Q: +5.9%), as exports of goods and services turned around to increase 1.3% YOY in 4Q (3Q: -1.3%), and outpacing the 0.7% YOY increase in imports (3Q: -2.3%).



Improvement in the manufacturing, mining, and agricultural sectors

On the supply side, **all sectors registered positive growth with the exception of agriculture,** which nevertheless saw smaller contraction (-2.4% vs -6.1%) thanks to diminishing impact of El Nino on CPO yields. The mining sector grew at a faster pace of 4.9% YOY in 4Q (3Q: +3.0%) thanks to higher natural gas production. **Growth in the manufacturing sector quickened for the 2nd straight quarter** to 4.8% YOY in 4Q (3Q: +4.2%), driven by higher growth from both the domestic- and export-oriented sectors, in line with improvement seen in global demand. **Growth in the services sector however softened to 5.5% YOY in 4Q** (3Q: +6.1%) but nevertheless remained supported by wholesale & retail (+6.2%), information & communication (+7.7%), and business services (+8.2%). The construction sector also registered slower growth of 5.1% YOY in 4Q (3Q: +7.9%) with civil engineering subsector remaining the biggest driver.



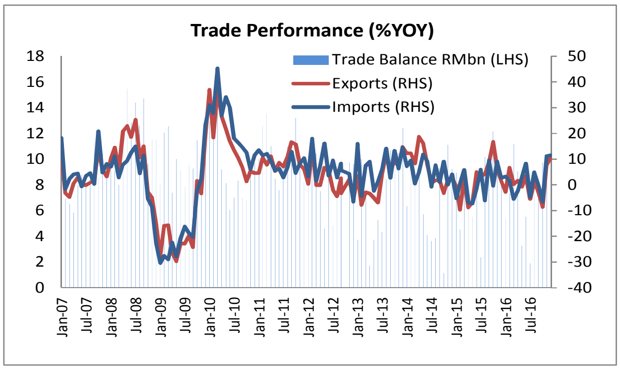
Current account position continues to improve whilst financial account saw bigger deficit due to outflow

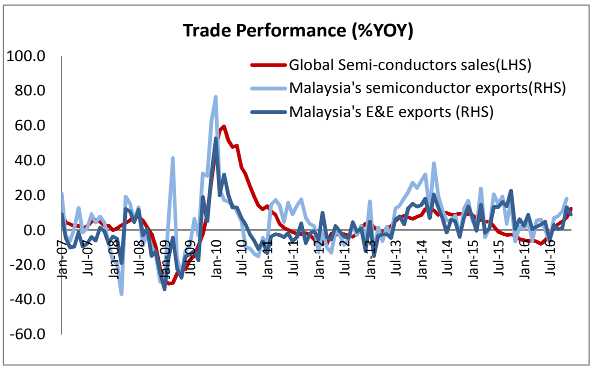
In a separate release, Malaysia's **current account surplus continued to increase by leaps and bounds for the 2nd quarter in a row.** After tripling to RM6.0bn in 3Q16, from RM1.9bn in 2Q16, **current account surplus doubled to RM12.2bn in 4Q16,** alleviating concerns on any possible reversal into deficit position. Increase in the surpluses of goods account to RM31.3bn during the quarter (3Q: RM26.5bn) as well as smaller deficit in the income account (-RM13.1bn vs –RM15.4bn) helped widen the surplus position. This more than offset wider deficit in the services account at RM6.0bn (3Q: -RM5.1bn). **The financial account however recorded a higher deficit of RM13.2bn due mainly to higher net outflow in portfolio investment** of RM22.3bn (3Q: -10.6bn), offsetting bigger net inflow in FDI of RM10.8bn (3Q: +RM6.5bn).

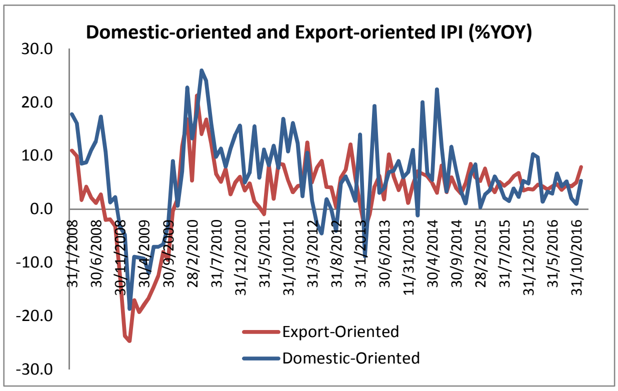
Brighter growth outlook but prevailing uncertainties will keep BNM on hold this year

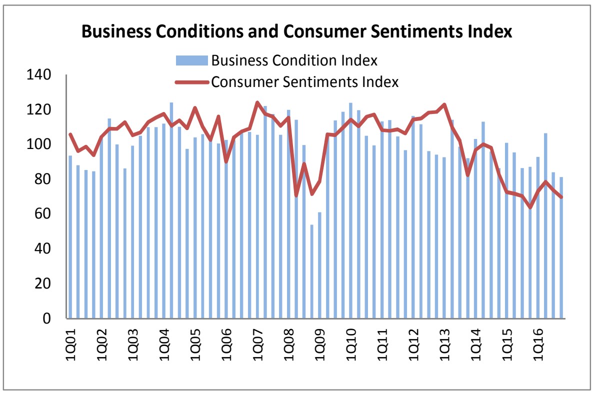
Moving forward, we opine growth outlook has turned more sanguine despite ongoing domestic and external challenges. Growth in the Malaysian economy managed to shrug off the soft patch in early 2016 to end the year on a high note, paving the way for modestly higher growth in 2017. **We maintain our view for real GDP growth to pick up to 4.4% this year, capitalizing on brighter external outlook** as major advanced economies take on a steadier growth path despite prevailing policy and geopolitical challenges.

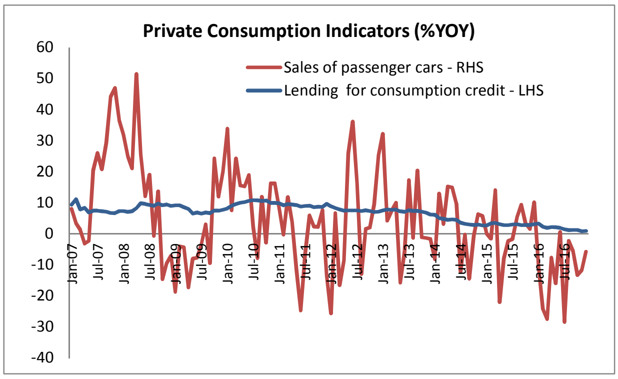
Stabilization in China would also invariably lend a helping hand in supporting growth in emerging Asia economies, which would augur well with Malaysia given its high trade linkages with ASEAN and China, which collectively accounted for more than 40% of Malaysia total trade last year. On the domestic front, growth will continue to be supported by the private sector, with private consumption staying on the forefront amid expectations for continued moderate growth in investment and normalization in public spending. **Premising on modestly higher growth outlook and upward creeping inflation, reinforced by a more neutral tone in the latest BNM monetary policy statement, we maintain our view for OPR to stay unchanged at 3.0% this year.**

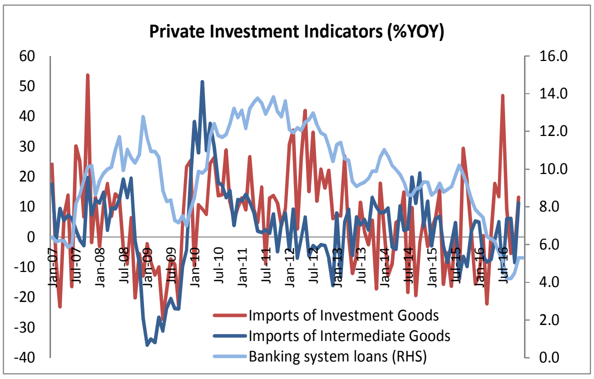

Trade Performance (%YOY)
Trade Balance RMbn (LHS)
Exports (RHS)
Imports (RHS)


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 - RHS
Lending for consumption credit - LHS


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

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