QUARTERLY ECONOMY TRACKER

(April – June 2016)

Socio-Economic Research Centre (SERC)

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Executive summary

A. GLOBAL ENVIRONMENT

- **Brexit raises global recession fears.** Amid still-slow and weak global growth, the Brexit's aftershocks have cast a doubt over the global economy. There remains a lot uncertainty over the precise impact of Brexit on global financial markets and economy, particularly in the United Kingdom (UK) and European Union (EU). However, it is comforting that major central bankers have taken all necessary steps to contain the risk of a global financial contagion as well as to avert a sharp slippage in global growth.
- **Mixed performance in advanced and emerging economies.** The US economy is somewhat stabilizing but not that exciting. The moderate growth in eurozone will be challenged by negative spillovers from Brexit. Japan's economy continues to mire in stagnation even if policymakers step up stimulus measures. The on-going rebalancing of China's economy hit the growth target in 1Q16 amid worries of an "L-shaped" recovery.
- **Will Brexit recalibrate global monetary policy?** Major central bankers are facing competing interests. Brexit may force stretched central banks to do more with less given the limited monetary space. The Bank of England (BoE) and European Central Bank (ECB) will have to do more monetary easing. The US Federal Reserve (Fed)'s forward guidance of future interest rates hike not only will be data dependent but also weighs on the Brexit's impact on global economy. Some Asian central banks might err on the side of monetary easing.
- **Key events to watch.** Global financial and economic scenarios will continue to be shaped and influenced by a number of key events or policies uncertainty. i) The Fed's forward guidance of interest rates direction; ii) the cloud of uncertainty surrounding the UK leaving EU; iii) a disruptive China's rebalancing process; iv) the unexpected large devaluation of Chinese renminbi; and v) the US Presidential election on 8 November.

B. MALAYSIA'S ECONOMIC PERFORMANCE AND OUTLOOK

- **Malaysia - Has the slowdown bottomed out?** The Malaysian economy slowed for four successive quarters since 2Q15 to 4.2% yoy in 1Q16 from 4.5% in 4Q15, weighed down by continued external shocks amid moderating domestic demand.
- **Domestic demand remains the driver's seat.** While domestic demand still underpinning overall GDP growth in 1Q16, the strength of private consumption and private investment continued to remain in focus. In particular, private investment growth has slipped to 2.2% in 1Q16, the slowest pace since 3Q11. Cautious consumer and business sentiments would continue to weigh on household and capital spending.

- **Maintain 2016's GDP growth estimate of 4.2%.** Malaysia's growth prospects are expected to remain challenging in remaining quarters given the state of global economic outlook as well as on-going adjustment in domestic economic condition. Lead economic and financial indicators for the second quarter suggest that economic growth will likely to remain flat or slightly better before improving a little in the second half-year.
- **Export outlook is 'guarded'**. There are reasons to expect a slow improvement in Malaysia's exports. 1) A prolonged period of subdued global demand; 2) uneven export performance of electronics and electrical products; and 3) moderate commodity prices.
- **Inflation pressure appears diminishing.** Headline inflation, which averaged 3.4% in 1Q16 eased to 1.6% in June for four consecutive months, aided by the high base a year ago as well as lower pump prices. Inflation is expected to trend lower for the rest of the year due to the low energy and commodity prices.
- **2Q16 GDP growth estimate at 4.0-4.3% yoy**. High-frequency economic data and financial indicators signal further moderate expansion in economic activity. Real GDP growth is estimated to grow by 4.0-4.3% in 2Q16 compared to 4.2% in 1Q.
- **Private consumption and investment indicators**. Car sales turned around to rise marginally in June after falling for five months in a row. Consumption credit remains moderate. Imports of capital picked up strongly while intermediate goods declined marginally in May. Loan indicators showed improvement in May, with loan approvals, applications and disbursement registering increases.
- **The Ringgit's volatility is here to stay.** After a good rally in 1Q16, the ringgit succumbed to downward pressures on investors' risk aversion toward emerging market currencies as investors fret about the Fed's rate hike amid aided by some strength in oil prices. The Brexit's aftershocks also weighed on the ringgit though somewhat milder. In 2Q16, the ringgit down by 3.2% against the US dollar (+10.1% in 1Q16). YTD, the ringgit gained 5.5% against the US dollar to RM4.0710 as of 22 July 2016 from RM4.2935 at end-Dec 2015. The ringgit's volatility is here to stay, influenced by volatile capital flows, continued uncertainty over the Fed's future rate hikes, global oil prices as well as how will Brexit play out?
- **Bank Negara Malaysia (BNM) to maintain accommodative interest rates.** BNM unexpectedly cut its benchmark interest rate by 25 basis points to 3.00% on 13 July after keeping it unchanged at 3.25% since Jul 2014. The Monetary Policy Committee's statement painted a cautious view about the domestic economy, nothing that external uncertainties could weigh on Malaysia's growth prospects. BNM is expected to keep the policy rate steady at 3.00% for now while assessing the incoming data.

BREXIT RAISES GLOBAL RECESSION FEARS

After a rocky start in early this year, **global economic scenario** seems to show some **incipient signs of positive momentum** in recent months, albeit still soft and it is still a long way from being satisfactory. The US economy, as the data's showing, is not exciting but absolutely not recessionary. While economic activities in some emerging economies were somewhat better than expected but still not robust.

The **narrative of global recession risks**, which **seemed elevated in January and February have receded**, supported by incoming data for the second quarter. But, the **unexpected referendum of British leaving the European Union** (EU), Brexit on 23 June has **clouded global financial markets and cast a shadow over global economy**.

The **greatest market fear** is that Brexit, if it is not managed well politically, may spark a **political contagion** within the continent and hence, **trigger the break-up of the United Kingdom (UK)** and along with it, **prompting other members of EU to bid for an independence**, which will result in the **disintegration of the EU**.

There is a fear that Brexit-induced economic and financial market ramifications would risk tipping the already weak and slow global economy into a recession. The main culprit is the anticipated financial and economic risks in the UK and EU. Besides that, the aggressive rate hikes by the Federal Reserve and strong US dollar appreciation as well as a disruptive economic rebalancing of the China economy also remained a risk.

Despite the world's major central bankers' strong state of preparedness to counteract against every financial repercussion from the Brexit's aftershocks, financial disturbances or fresh triggers associated with Brexit's lingering uncertainties will continue to rattle global financial markets in the months ahead.

Immediately after Brexit, the **International Monetary Fund** (IMF) expects the **UK economy** to **contract by between 1.5% and 4.5%** over the medium-term, depending on which Brexit's model the UK will adopt when negotiating its trade relationship with the EU. The IMF also **revised lower eurozone's GDP growth** estimates from 1.7% to 1.6% this year and next year, to just 1.4% from 1.7%. The Brexit's impact will last through 2018, when the eurozone will grow 1.6% rather than 1.7%.

Prior to the Brexit, the **World Bank** its latest Global Economic Prospects report (June) slashed its 2016 global growth forecast to 2.4% from the 2.9% estimated in January, due to stubbornly low commodity prices, sluggish demand in advanced economies, weak trade and diminishing capital flows.

In its **World Economic Outlook July update**, the **IMF marked down global growth estimates by 0.1% pt each** to 3.1% and 3.4% respectively in 2016 and 2017, taking into account the short-and medium-term impact of Brexit on the world economy. GDP growth estimates of major advanced economies also revised lower. The World Economic Outlook (WEO) report, which is slated for release in October, is expected to review global growth estimates for 2016 and 2017.

Will Brexit cause a global recession? In this current weak and slow global growth, the immediate concern is whether the anticipated UK recession and its negative spillovers to the EU would put pressure on global growth, heightening the risk of a global recession. **We peg the risk of a global recession at less than 50%.** While a fragile global growth makes it vulnerable to shocks, policymakers in major advanced and emerging economies must prescribe the right policies to prevent the global growth from falling off the cliff.

There are **fundamentally differences** between the Brexit and 2008-09 Global Financial Crisis (GFC) or Great Recession. The falls across the world weren't deep enough to constitute a Lehman's moment.

- The **Brexit-induced turbulence** is **not inflicted by a severe financial distress or bursting of assets bubble**. There were no over-leveraging problems. Major central banks have ring- fenced to stem a liquidity crisis.
- The **2008-09 GFC was inflicted by the implosion of a scalable US subprime mortgage crisis**, which was uncontainable and morphed into a full-fledged financial crisis. It was the speed and magnitude of falling equities, liquidity crisis, credit crunch as well as massive debt defaults that caused a negative feedback loop to the economy and financial markets. Banks suffered huge losses, capital base shrank and freezed lending. Household balance sheets were severely impaired. As the US was the epicentre of the crisis, this accentuated the depth of global recession, worsened by the European debt crisis erupted in the wake of the Great Recession around late 2009.

Even if the **UK economy (which makes up 3.9% of world GDP)** goes into recession and together with a protracted **slow recovery in the EU** (makes up **16.5% of world GDP**), the **global economy will continue to chug along slowly** amid the downside risks.

The US economy should be able to withstand Brexit's headwinds, growing by 2.0-2.3% but not that exciting. China and India are still riding on the path of expansion, albeit moderately in the case of China. Facing with multi-headwinds, Beijing authorities are expected to safeguard growth and financial stability through targeted fiscal and monetary measures.

With major central banks taking all steps necessary to safeguard financial stability, including liquidity backstop, this helps to ensure the orderly functioning of financial and foreign exchange markets, and hence helping to contain the risk of financial contagion.

The **Bank of England and European Central Bank** are expected to **do more monetary easing** to mitigate the risks on investment, consumption and growth. The **Federal Reserve** is likely to **recalibrate its interest rate hikes** because of Brexit uncertainty.

What risks/events to watch? There remains considerable key events or policies uncertainty that would shape as well as influence global financial and economic scenarios.

i) The **Fed's forward guidance of interest rates direction**;

ii) A **disruptive China's economic rebalancing process** could have strong international spillovers through trade, commodity prices, confidence, financial markets and currency valuations;

iii) The unexpected **large devaluation of Chinese renminbi**;

iv) The **cloud of uncertainty surrounding the UK leaving EU**; and

v) The **US Presidential election on 8 November**.

The outcome of the US presidential election in November will have profound consequences for US economic policy, and thus for the global economy. Republican candidate, Donald Trump's ideas on trade are dangerous and would reverse decades of American leadership's preaching of trade liberalization, with the erection of tariff walls against Chinese goods. Hillary Clinton now opposes the Trans-Pacific Partnership, which she promoted when she was the Secretary of State. The Democrats favor loose monetary policy and a depreciated dollar while Republicans worry about excessively loose monetary policy.

Fig 1: Real GDP Growth (% yoy)

	2014	2015	1Q2016	IMF 2016E	WB 2016E	IMF 2017F	WB 2017F
US	2.4	2.4	1.1	2.2 (+2.4)	1.9	2.5	2.2
Euro area	0.9	1.6	1.5	1.6 (+1.5)	1.6	1.4 (+1.6)	1.6
Japan	-0.1	0.5	1.9	0.3 (+0.5)	0.5	0.1 (-0.1)	0.5
China	7.3	6.9	6.7	6.6 (+6.5)	6.7	6.2	6.5
India	7.3	7.3	7.9	7.4 (+7.5)	7.6	7.4 (+7.5)	7.7
Singapore	2.9	2.0	1.8	1.8	-	2.2	-
Indonesia	5.0	4.8	4.9	4.9	5.1	5.3	5.3
Thailand	0.9	2.8	3.2	3.0	2.5	3.2	2.6
Malaysia	6.0	5.0	4.2	4.4	4.4	4.8	4.5
Philippines	6.1	5.8	6.9	6.0	6.4	6.2	6.2
Vietnam	6.0	6.7	5.5	6.3	6.2	6.2	6.3

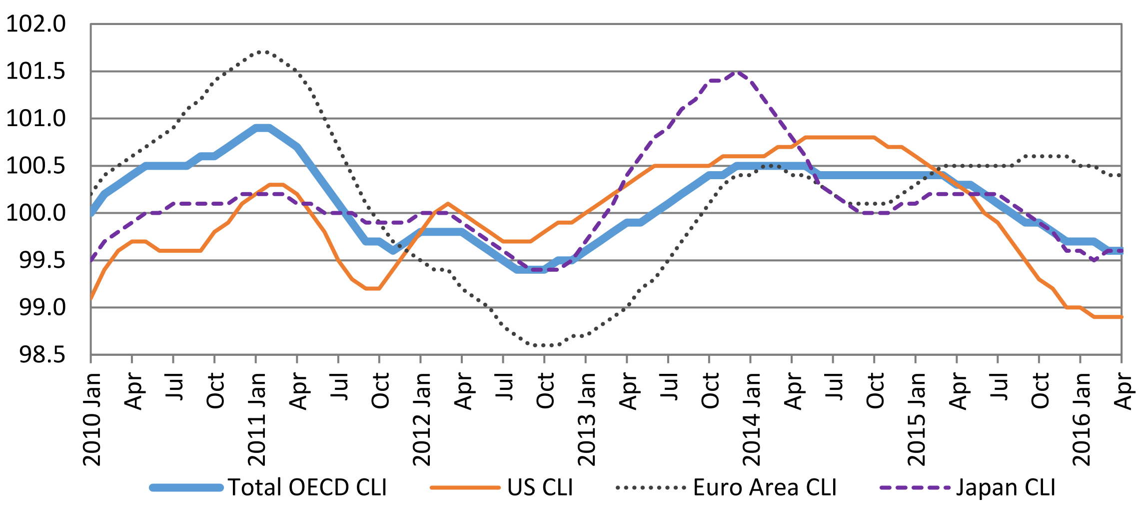
Source: Officials; IMF World Economic Outlook, April 2016; World Bank's Global Economic Prospects, June 2016

Figures in bracket refer to estimates made in April 2016

A. SNAPSHOT REVIEW OF KEY GLOBAL ECONOMIC INDICATORS

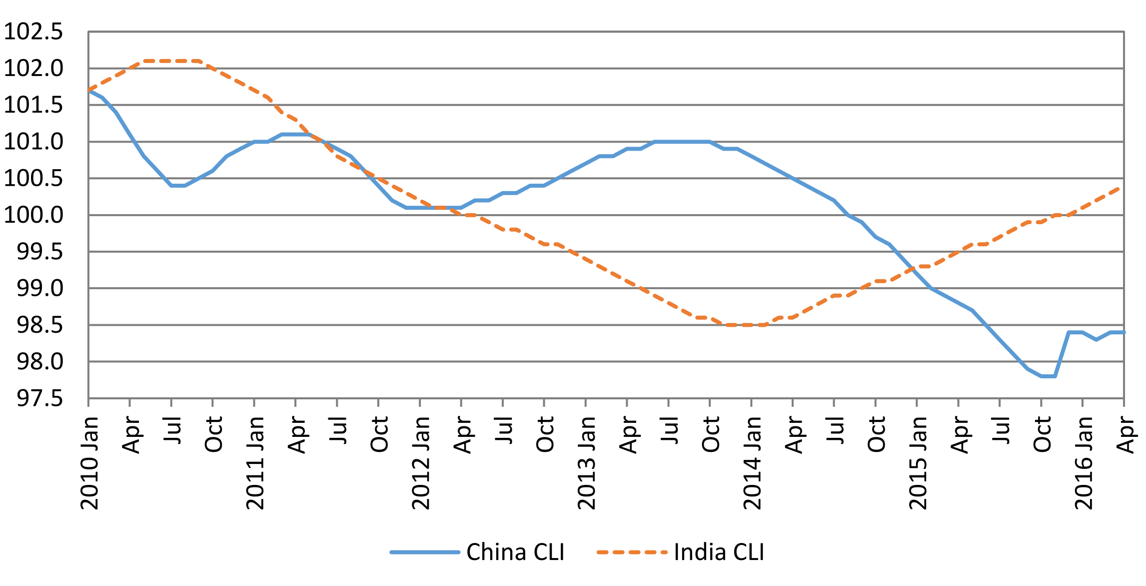
1) The April **OECD composite leading indicators** (CLIs), which anticipate turning points in economic activity relative to trend, point to stable growth momentum in the OECD area. Emerging signs of stable growth momentum remain the outlook for the US, euro area, Japan and China as well as firming growth in India.

Fig 2: OECD CLI points to stable growth momentum



Source: OECD

Fig 3: China's and India's CLI show positive change in growth momentum



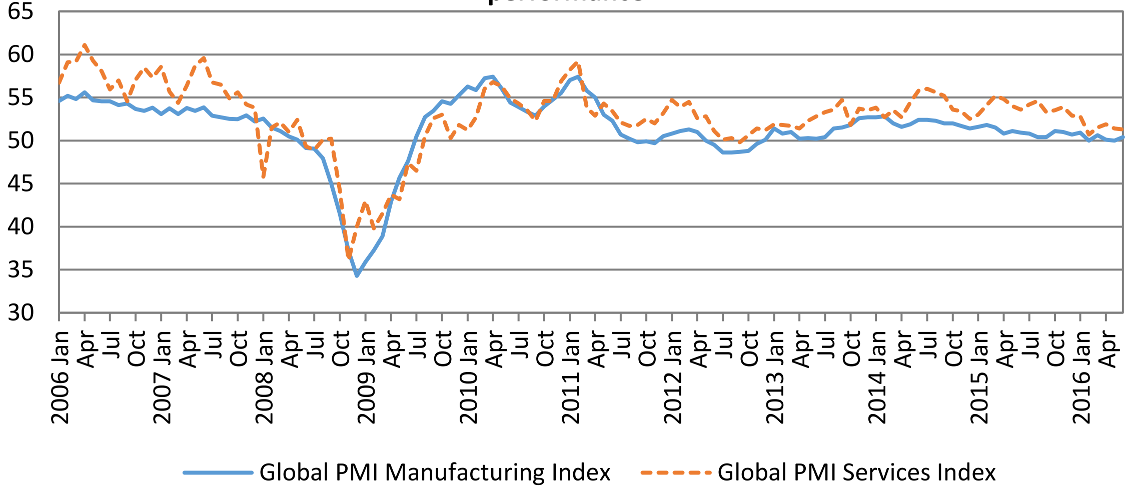
Source: OECD

2) Growth of **global manufacturing sector output**, as measured by the **Purchasing Managers Index (PMI) edged up marginally to 50.4 in June** from 50.0 in May after slipping for two months in a row. It is still below its three-year average. June saw marginal increases in global manufacturing production, new orders and export orders, indicating the **still lackluster performance of global manufacturing sector**.

   Note, however, that almost all the survey responses were received before the UK's vote to leave the EU.

3) The **PMI for services sector eased slightly to 51.3 in June** from 51.4 in May, remained well below long-run average of 53.0% in the period 2006-15. This goes to indicate that **the sector remained stuck in low gear**. A sustained strong expansion is still a long way to go.

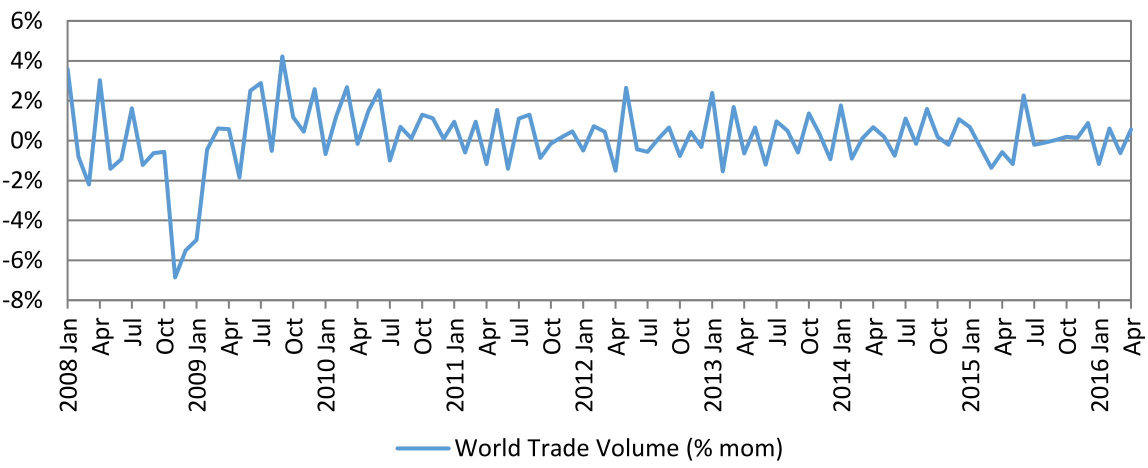
Fig 4: Global PMI for manufacturing and services showed mixed performance



Source: CEIC

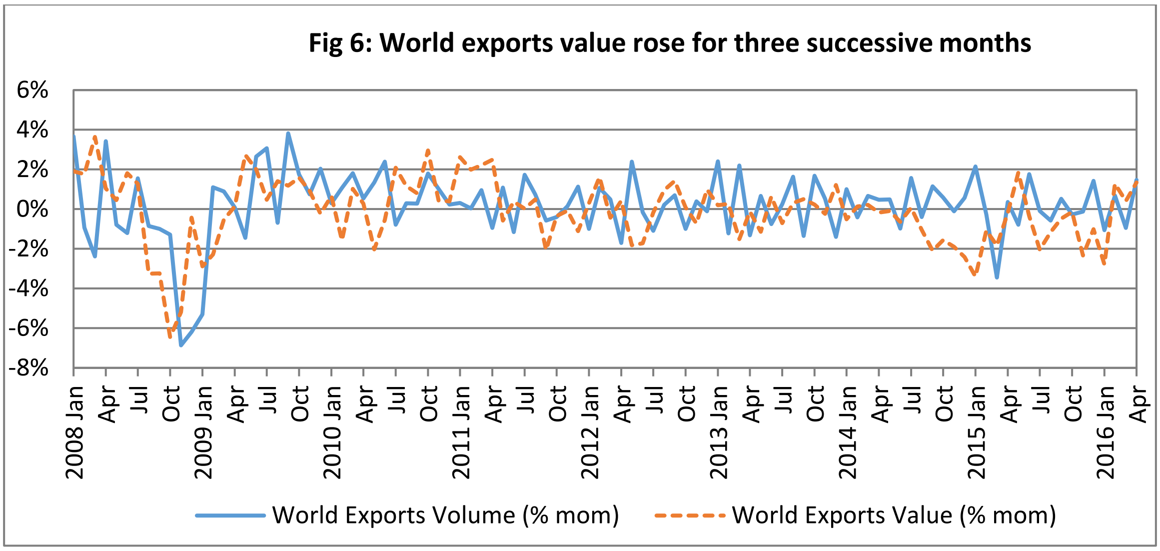
4) **World trade** in terms of volume and value **turned around to increase by 0.6% mom and 2.2% mom respectively in April** (-0.6% and -0.3% respectively in Mar). The underlying trend remains uneven, weighed by the slow and weak growth in advanced and emerging economies.

Fig 5: World trade turned around to rise in April



Source: Netherlands Bureau for Economic Analysis

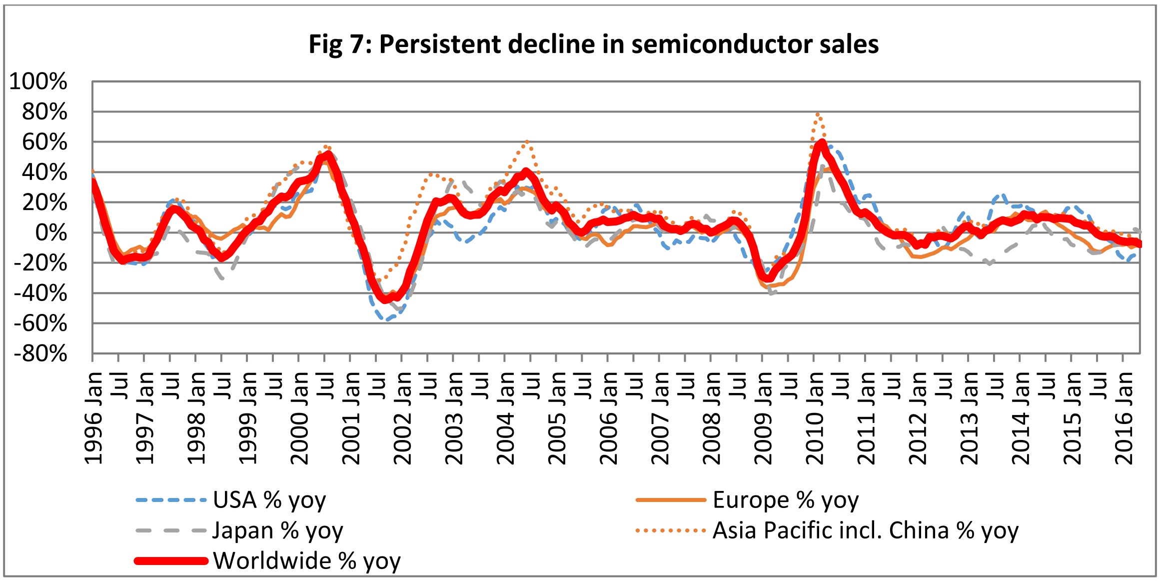
World exports volume rose 1.5% mom in April (-0.9% in Mar). Export value expanded three months in a row, by 1.3% mom in April (+0.4% in Feb), reflecting higher exports in advanced economies (+2.1%) while subdued demand from emerging economies (+0.4%). Further gains need to be seen to get global trade activity back on track after what has been a long stretch of soft and downward growth trajectory.



Source: Netherlands Bureau for Economic Analysis

5) **Global semiconductor sales rose 0.4% mom** to US$25.9 billion in May (-0.9% in Apr. But, total sales declined by a larger magnitude of 7.7% yoy in May (-6.2% in Apr), continuing a contraction trend since Jul 2015.

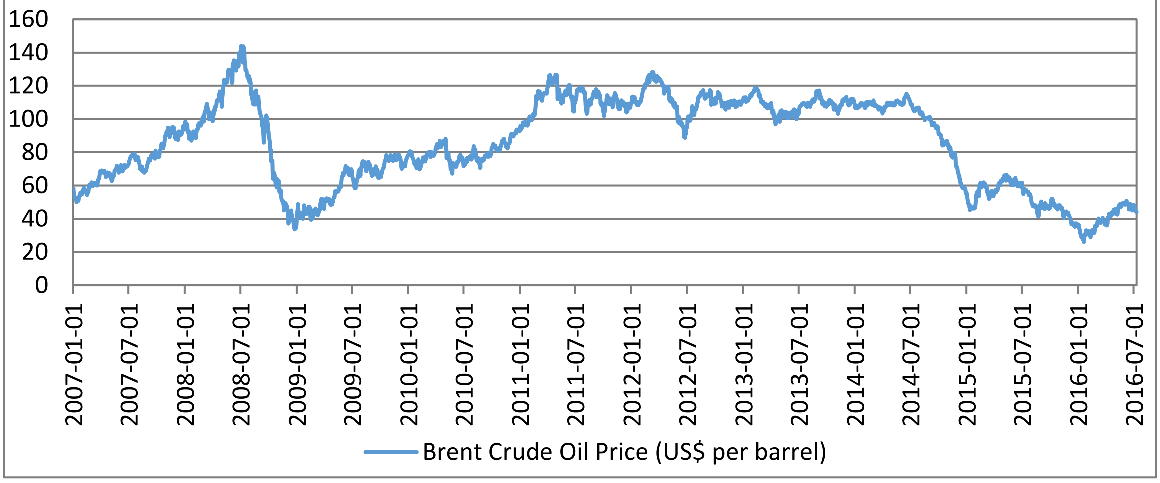
- The **annual decline in sales remained large in the US market** (-15.0%), followed by Asia-Pacific region, excluding China (-11.5%), Europe (-8.8%) and China (-0.5%). Semiconductor sales in Japan continued to rise by 0.4% in May for three consecutive months.
- The **overall market demand for semiconductor continues to struggle**, weighed down by soft demand and unfavorable macroeconomic conditions. The persistent sharp drop in sales in the US market remains the drag on the sector's struggling to gain traction.
- The **World Semiconductor Trade Statistics (WSTS)** projects **annual chip sales to decline 2.4% to US$327.2 billion this year** (-0.2% in 2014) before **picking up in the next two years** (+2.0% to US$333.7 billion in 2017 and +2.2% to US$340.9 billion in 2018 respectively).



Source: Semiconductor Industry Association (SIA)

6) International oil price benchmark **Brent crude** has remained in the high US$40s and hit above US$50 but short-lived. Prices bounced off those lows on talk of an OPEC production freeze, which did not materialize. The rally heightened after May's wildfires in Canada's oil sands region and also has been supported by supply outages elsewhere, including Nigeria, Venezuela and Libya.

Fig 8: Brent crude oil price struggles for momentum



Source: US Energy Information Administration

However, it has struggled for momentum and suffered a couple of sharp dips over fears of ongoing oversupply and moderate demand.

The **International Energy Agency (IEA) warned over a global supply glut** with supply and inventories still at significantly higher levels. Attention was also focused on comments from Iran's oil minister that the country will not participate in a deal to freeze supplies at the next Opec meeting and hopes to add another 200,000 barrels a day in exports by the summer. The US dollar strength also plays a part in influencing the oil price movements.

US – A WEAK START IN 1Q BUT NO WORRIES

The US economy started the year on a **subdued note as real GDP growth grew a mere annualized rate of 1.1% in 1Q16**, down from 1.4% in 4Q15. Consumers pinched their pennies, with private consumption slowing to 1.5% growth in 1Q from 2.4% in 4Q15. Companies also scaled back investment and a strong dollar suffocated exports.

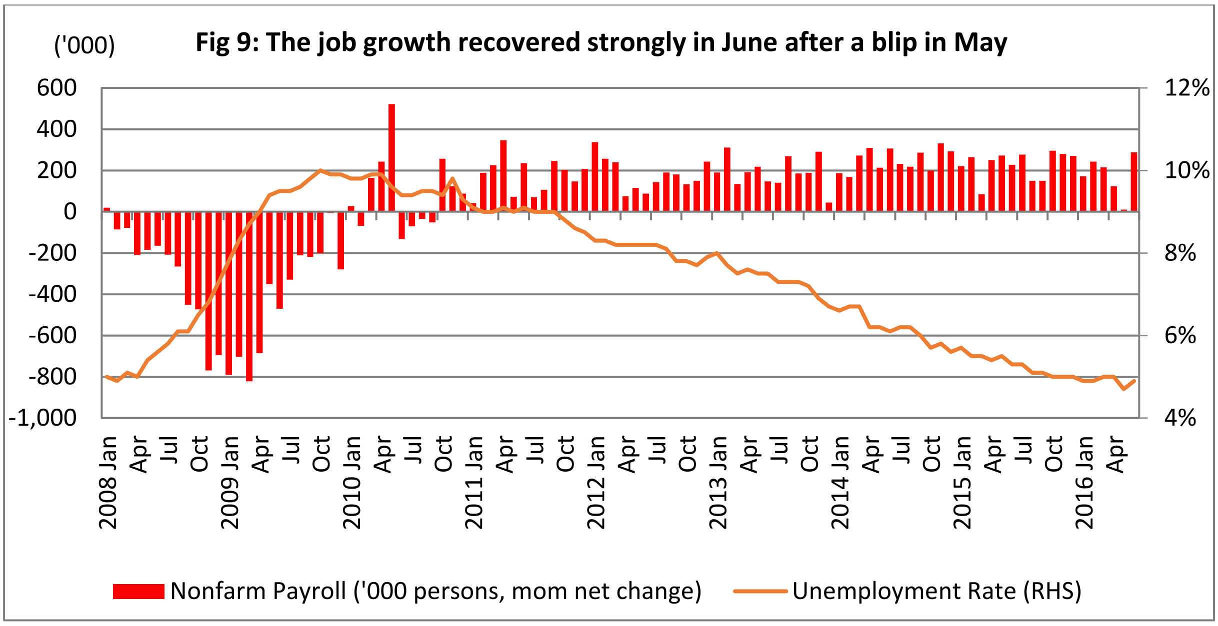
Despite a disappointing start in 1Q, we have reason to believe that **the US economy is most likely continuing to chug along around 2.0-2.3% yoy**. Not exciting, but not a disaster by any means. **Consumer spending and housing sector will provide the main support** going forward.

The latest batch of data suggest that the **economy performed better in Mar-June** than in Jan-Feb, a sign that the economy was regaining momentum at the end of the second quarter.

The Federal Reserve cut its forecast for US economic growth in 2016 to 2.0%, down from 2.2% earlier. For 2017, the Fed expects the economy to expand between 2.0% and 2.3%. On an annual basis, it grew 2.7% yoy in June, up from 2.2% in May.

Retail sales posted a healthy gain in June (+0.6% mom vs. +0.2% in May), indicating that households' spending is gaining traction after not so rosy start in the first quarter. Excluding autos, retail sales rose 0.7% from May. The pick-up in consumer spending bodes well for the broader economy going forward.

After a disappointing 11,000 jobs (revised lower from 38,000) created in May, total **non-farm payroll employment jumped 287,000 in June**, with jobs occurring in leisure and hospitality, health care and social assistance, financial activities, and information. **Wage growth is picking up**, a sign of positive things to come. Average hourly earnings have risen 2.6% yoy in June (+2.5% in May), matching the strongest annual growth rate since the summer of 2009.

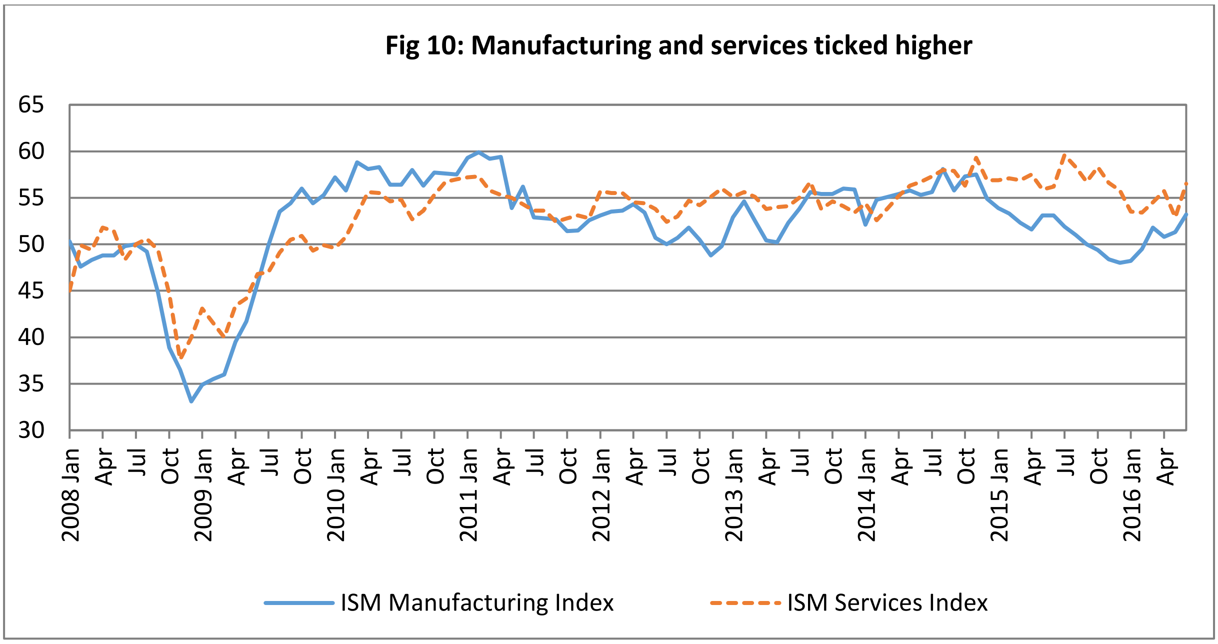


Source: US Bureau of Labour Statistics

Industrial production rose more than expected by 0.6% mom in June (+0.3% in May) on large gains in automotive manufacturing and utility output. It is the strongest gain since July 2015. Manufacturing output rose 0.4% mom in June (0.3% in May); utilities (2.4% vs. 0.9% in May) and mining (0.2% vs. 0.3% in May).

The **pace of growth in both manufacturing and services sectors continued to gain traction in June**, signaling a broad-based momentum in the economy. The **ISM manufacturing index rose to 53.2 in June** from 51.3 in May. Both new orders and manufacturing production rose to a three-month high. The ISM index moved further above a 50-threshold that indicates an expansion in the manufacturing sector. A separate report issued by the ISM Institute showed that a majority of manufacturers saw "negligible" impact from Brexit.

June's ISM index for the services sector rose to 56.5 from 52.9 in May, marking the fastest pace in seven months. The higher index was due to a strong surge in business activity index to 59.5 from 55.1 in May, supporting by sturdy consumer spending.



Source: CEIC

EUROZONE – MODERATE RECOVERY AMID BREXIT'S HEADWINDS

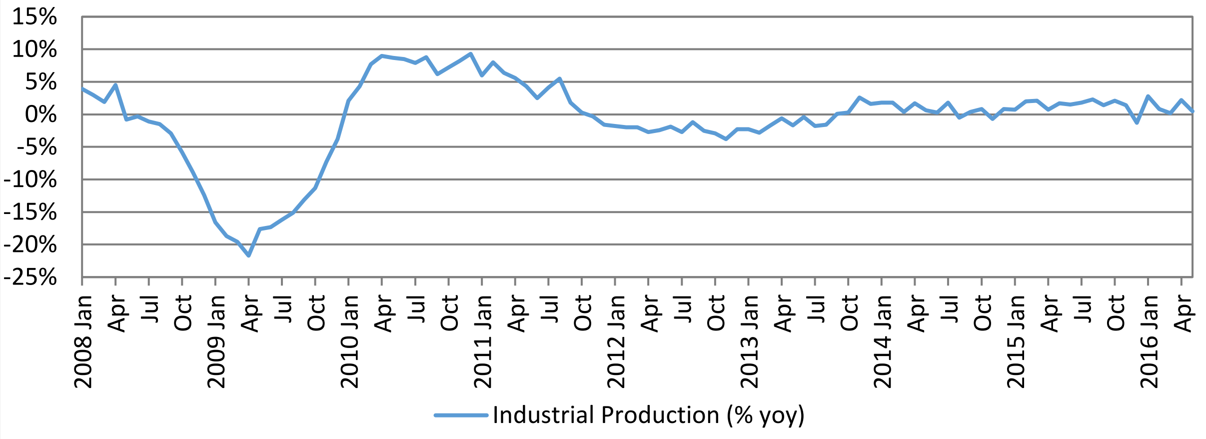
Economic growth in the eurozone picked up less sharply in 1Q16, growing by 0.6% qoq (0.3% in 4Q15). On an annual basis, the eurozone's economy grew 1.5% in 1Q16. The small pick-up in growth was driven by private consumption, thanks to an improving labour market and increasing real income. However, the external sector still experiencing weakness amid the weak euro.

Looking ahead, the **Brexit could have significant negative spillovers to the euro area via trade and financial markets**. The IMF has slashed eurozone's GDP growth estimates from 1.7% to 1.6% this year and next year, to just 1.4% from 1.7%.

Recent data suggest that business activity in the Euro area slightly lost momentum in June. The **Eurozone Composite Purchasing Managers' Index (PMI)** inched down to 52.8 in June from 52.9 in May, marking the lowest reading since January 2015. The easing index was due to a downturn in services growth while the manufacturing sector improved.

Industrial production fell by 1.2% mom in May from a rise of 1.4% in April, due to a broad-based declines in most sectors: production of energy (-4.3%), capital goods (-2.3%), durable consumer goods (-1.4%), intermediate goods (-0.4%) and non-durable consumer goods (-0.1%). On an annual basis, production rose by a drab 0.5% (+2.2% in Apr). The poor print of industrial production indicates the Eurozone GDP growth would slow significantly in 2Q.

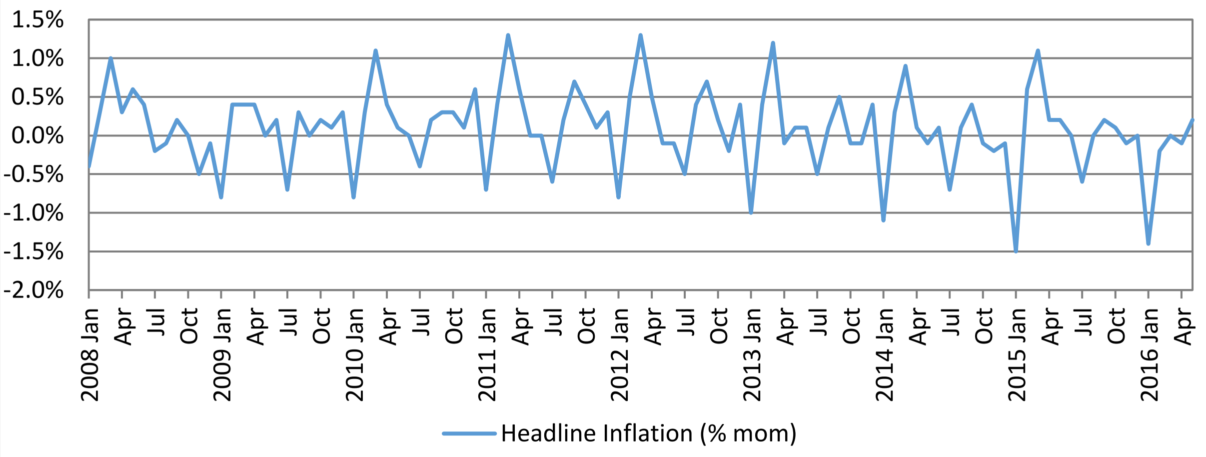
Fig 11: Industrial production slowed in May



Source: Trading economics

After four consecutive months of falling or stable prices, **eurozone prices rose a modest 0.1% yoy and 0.2% mom in June** (-0.1% yoy and -0.1% mom in May), **raising hopes that the deflation is coming to an end**. A rebound in energy prices by 1.7% mom was the principal reason for the small increase in inflation. The little rise in inflation provides the European Central Bank (ECB) with only limited comfort to declare the deflation is over as the annual rate of +0.1% in June is well short of the ECB's target of just below 2%.

Fig 12: Consumer prices rose in May, raising hopes of ending deflation



Source: Trading economics

JAPAN- TOO EARLY TO POP THE CHAMPAGNE

Japan's economy dodges recession in 1Q16 to expand by **an annualized 1.9%,** rebounding from a 1.7% contraction in 4Q15. However, growth is expected to remain weak in the near future. Combined with last month's disappointing retail sales and trade reports, weak industrial output suggests the Japanese economy weakened in the second quarter.

With private consumption making a feeable recovery, the rebound is unlikely strong enough to dispel investors' concerns over relapsing into a technical recession in the coming quarters.

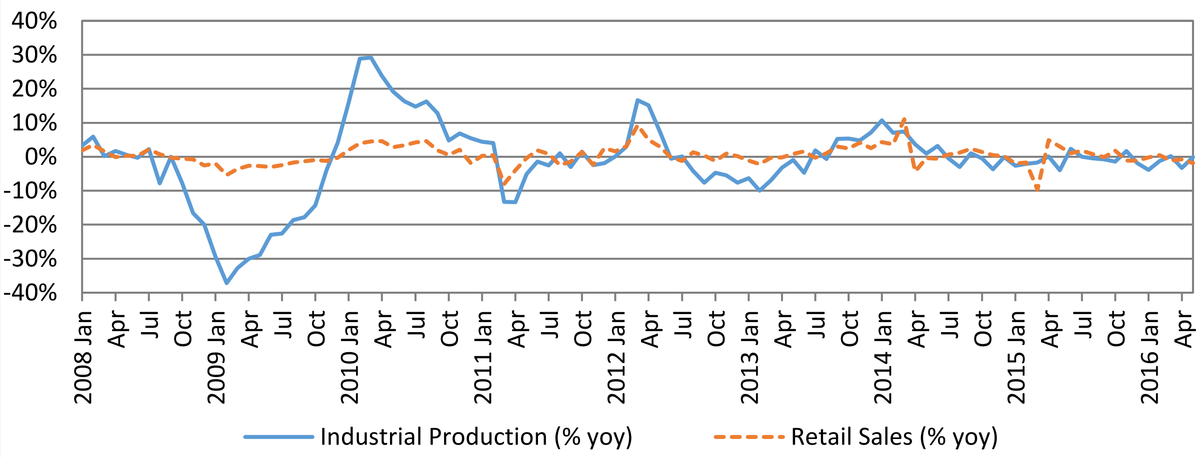
As such, Japan PM Shinzo Abe announced on 1 June that the **planned sales tax hike from 8% to 10% will be delayed from April 2017 to October 2019**. Bank of Japan (BOJ) will likely to ease monetary policy further to complement the anticipated fiscal stimulus package.

PM Abe's strong election boost in both houses of parliament gave him the much needed capital base to change the pacifist constitution, including the power of military. Investors expect the Abenomics programme would be accelerated, betting on **a large fiscal stimulus package that could exceed ¥10tn (US$98.1bn)**, focusing on the construction of **high speed rails and port facilities**.

While the Nikkei Flash **Manufacturing Purchasing Managers' Index (PMI) ticked up to 47.8 in June** from May's 47.7, the index remains well below the 50-threshold that separates expansion from contraction. Both production and new orders declined markedly, led by a sharp drop in international demand. This indicates that the **manufacturing sector remains in the doldrums** due to **a strong yen and negative spillovers from the two earthquakes that hit the Kyushu region** in April.

Industrial production fell 2.3% mom in May (+0.5% in April), as weak exports weighed on manufacturing demand, hastening calls for new economic stimulus measures from the central bank. The drop in industrial output was due to declines in chemicals, general-purpose, production and business oriented machinery as well as electronic parts and devices. On an annual basis, industrial output fell 0.1% in May, which followed a large contraction of 3.3% in April. The wide swings in industrial output growth underscore its unstable trend.

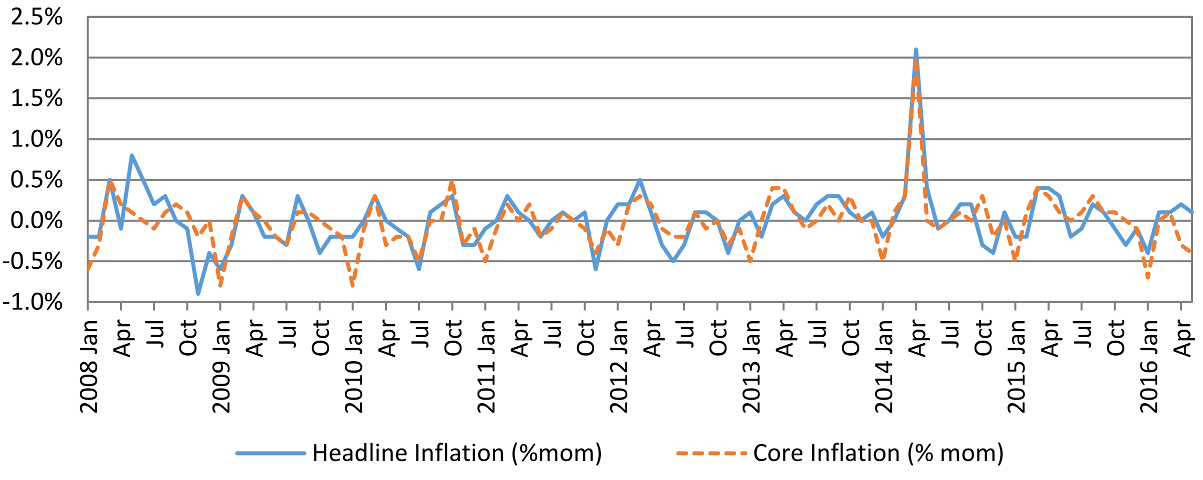
Fig 13: Sluggish industrial output and retail spending



Source: Trading economics

The **Bank of Japan (BoJ) expects the economy** to **expand between 0.8% and 1.4% in the fiscal year 2016** and sees GDP growth of between 0.0% and 0.3% in 2017.

Fig 14: Inflation lingers in ultra low trajectory



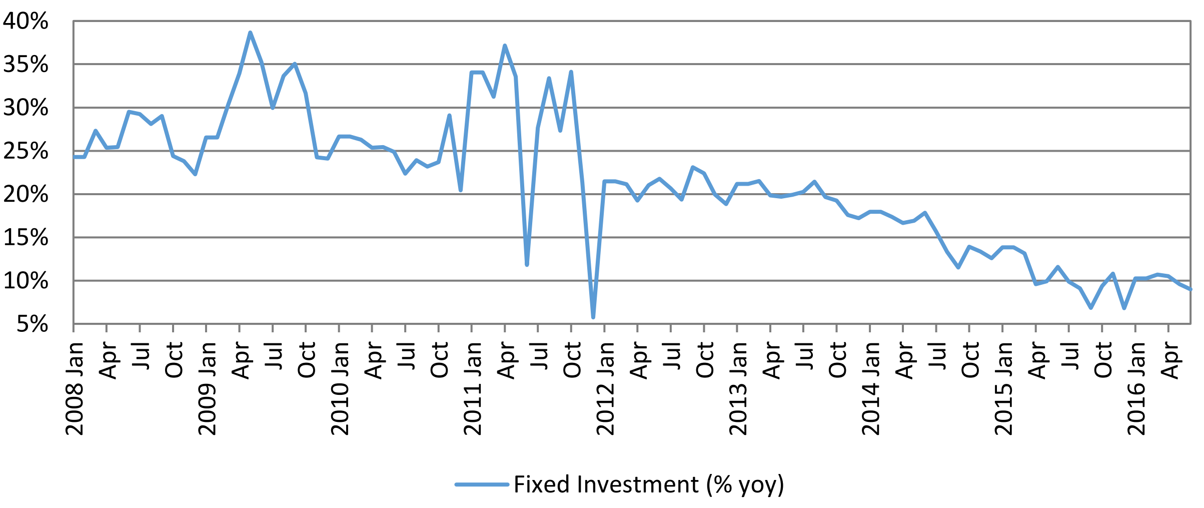
Source: Trading economics

CHINA – GROWTH STABILISATION IS WELL UNDERWAY

The on-going rebalancing of China's economy has **shown signs of stabilization, albeit at uneven pace**. The strong monetary and fiscal support has helped to stabilize GDP growth at 6.7% in 2Q16, the same rate achieved in 1Q16 (+6.8% in 4Q15).

Key economic indicators lend credence to **consumer spending has picked up and economic activities still growing** amid moderating investment. Industrial production climbed 6.2% yoy in June (6.0% in May) and retail sales rose higher by 10.6% (10.0% in May). Fixed-asset investment, however slowed to 9% in the January-June period compared to 9.6% in Jan-May, marking the slowest pace since 2000. There were decelerations in investment in the primary and services sectors, while the industry sector recorded a steady expansion.

Fig 15: Fixed investment (% yoy)



Source: Trading economics

China's **external trade sector continues to remain sluggish** and is still a long way off from full health as both exports and imports fell more than expected in June. This underscores the continued weakness in global demand. Exports contracted 4.8% yoy in June (-4.1% in May) while imports declined at a sharper rate of 8.4% in June (-0.4% in May).

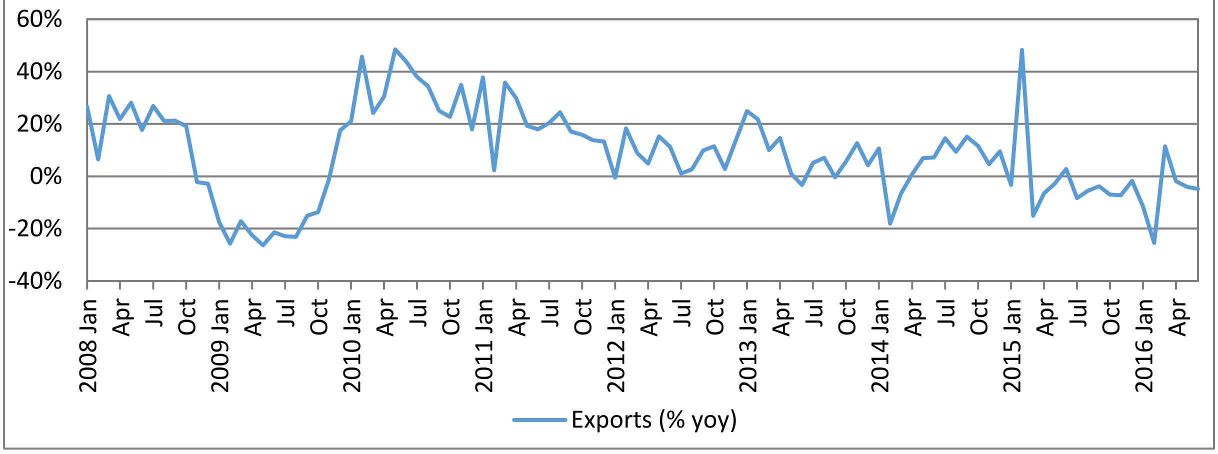


Fig 16: Exports declined three months in a row

Source: Trading economics

The **Purchasing Managers' Index (PMI) in June eased a little to 50.0%** from 50.1% in May while the **PMI for services rose to 52.7%** from 51.2% in May. It was the highest reading since July 2015. This indicates that the **services sector should continue to support China's economic rebalancing** from a lop-sided investment towards more consumption cum services driven growth.

The **closely-watched real estate development indicator**, namely **property prices continued to rise on an annual basis**, albeit slower mom in May. House prices in 70 large- and medium-sized cities rose 0.9% mom and 6.9% yoy in May (+1.2% mom and +6.2% yoy in Apr). Owing to the continued upward trend in prices since May 2015, annual average variation in house prices swung from 0.2% in April to a 16-month high of 1.2% in May. According to the National Bureau of Statistics (NBS), the sales prices of newly-constructed residential buildings declined in 4 cities, increased in 60 cities and remained flat in 6 cities.

China's **gradual transition towards more sustainable levels is continuing**. The markets have been reassured that the authorities have enough ammunitions and able to prevent a hard landing, but at what longer term cost? The risk of a dramatic adjustment in Chinese renminbi remains.

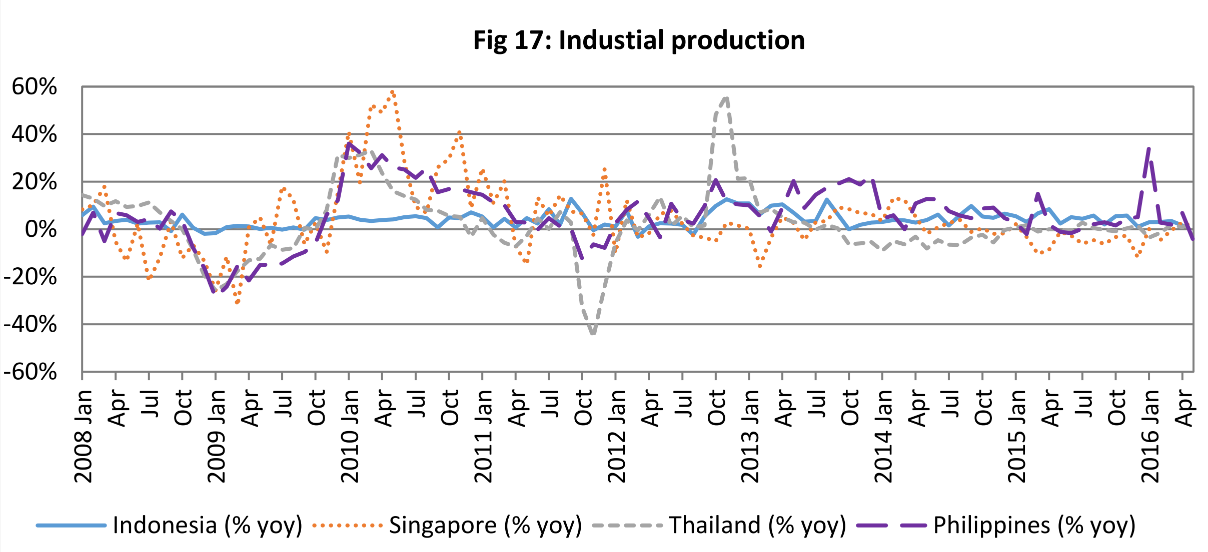
Structural reforms are strongly needed and expedited to reallocate capital and employment more efficiently; **unwind the unsustainable imbalances** or excess capacity as well as contain highly leveraged state-owned enterprises.

Mounting corporate debt is a key fault line in the Chinese economy, which will threaten the country's financial stability. The IMF has warned that China's **soaring corporate debt, which is approximately 145% of GDP** is high by any measure. It is a serious and worsening problem that needs to be tackled quickly so as to avoid potential systemic risk to itself and the global economy.

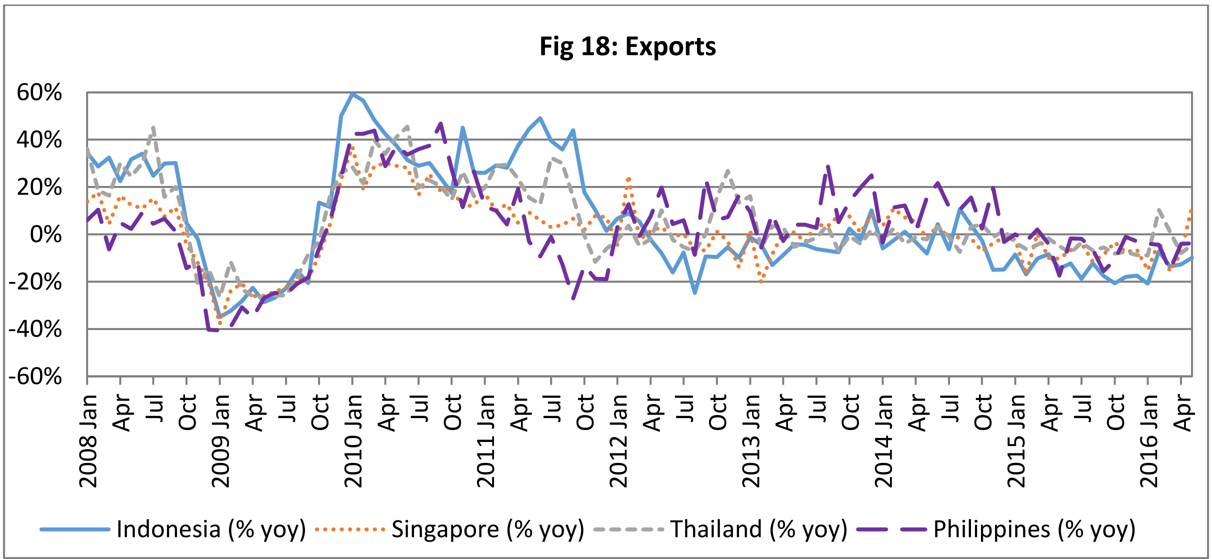
ASEAN-4 ECONOMIC DATA TRACKER

Broadly, Asean-4 economies (Indonesia, Thailand, Singapore and Philippines) printed a mixed set of economic readings, which point to easing growth momentum.

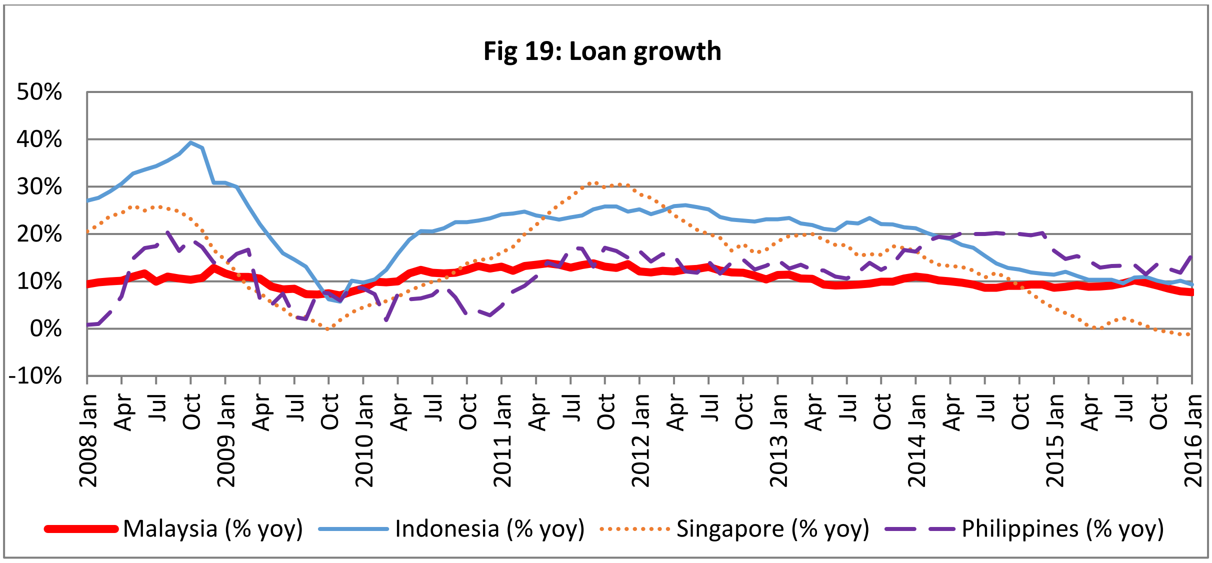
Singapore, which has released its second quarter GDP growth, grew moderately higher by 0.8% qoq and 2.2% yoy (+0.2% qoq and +2.1% yoy in 1Q16). All key sectors grew at subdued pace, underscoring the underlying weakness in growth momentum amid the challenging global environment.



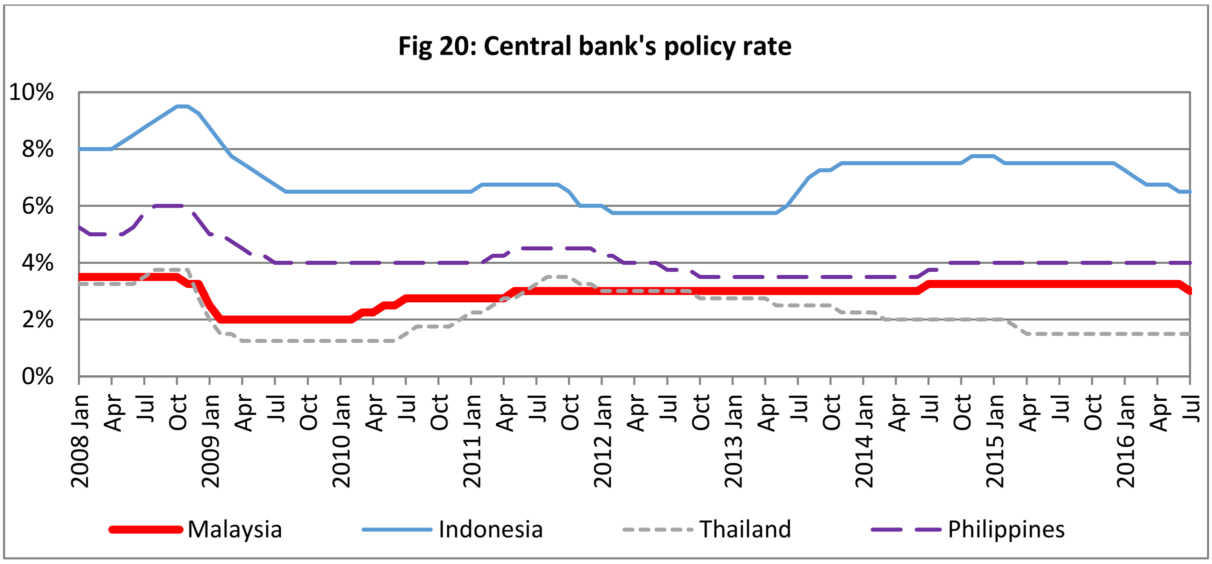
Source: Trading economics



Source: Trading economics



Source: Trading economics



Source: Trading economics

GLOBAL MONETARY POLICY TRACKER

With uncertainty about the global economic outlook, growing capital flows and forex volatility as well as uncertainties surrounding the ramifications of Brexit, monetary policy settings in central banks around the globe continue to remain challenging.

Brexit forces stretched major central bankers to do more with less. It is the unpredictable state of the Fed's monetary policy that would have implications for capital flows and the US dollar. That said, the Fed may be forced to recalibrate its interest rate hikes due to Brexit's uncertainty. As such, the future rate moves will remain data and financial markets dependent.

Asian central banks are expected to maintain monetary bias to mitigate the impact of external uncertainties on their economies, which have already slowed down for some before the Brexit.

Fig 21: Policy Rate Estimates (%)

	2008	2009	2010	2011	2012	2013	2014	2015	2016 (current)	2016E	2017F
US, Fed Funds Rate	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.25-0.50	0.25-0.50 (July)	0.50-0.75	1.00-1.25
Eurozone, ECB (deposit facility)	2.00	0.25	0.25	0.25	0.00	0.00	-0.20	-0.30	-0.4 (July)	-0.4 to -0.60	-0.4 to 0.0
Japan, BOJ	0.10	0.10	0.00-0.10	0.00-0.10	0.00-0.12	0.00-0.10	0.00-0.10	0.00-0.10	-0.1 (July)	-0.20	0.00-0.20
China, PBOC (one-year lending rate)	5.31	5.31	6.56	6.00	6.00	5.60	4.35	5.60	4.35 (July)	4.10	4.10
India, RBI (repo rate)	6.50	4.75	6.25	8.50	8.00	7.75	8.00	6.75	6.50 (July)	6.00	6.00
Korea, BOK (base rate)	3.00	2.00	2.50	3.25	2.75	2.50	2.00	1.50	1.25 (July)	1.25	1.25
Malaysia, BNM (overnight policy rate)	3.25	2.00	2.75	3.00	3.00	3.00	3.25	3.25	3.00 (July)	3.00	2.75-3.00
Indonesia, BI	9.25	6.50	6.50	6.00	5.75	7.50	7.75	7.50	6.50 (July)	6.00	6.00
Thailand, BOT	2.75	1.25	2.00	3.25	2.75	2.25	2.00	1.50	1.50 (July)	1.25	1.25
Philippines, BSP	5.50	4.00	4.00	4.50	3.50	3.50	4.00	4.00	4.00 (July)	4.00	4.00

Source: Central Banks and Author's estimates

MALAYSIA – HAS THE SLOWDOWN BOTTOMED OUT?

The Malaysian economy **eased further to 4.2% yoy in 1Q16** from 4.5% in 4Q15 for the fourth quarter in a row since 2Q15, marking the weakest expansion since the 2008-09 Global Financial Crisis. 1Q's GDP growth moderation was shattered by the continued sluggish external sector amid cautious domestic demand.

Domestic demand slowed to 3.6% growth in 1Q16 from 4.0% in 4Q15, reflecting continued adjustment by the private sector to more challenging domestic and external conditions. Public sector spending also moderated sharply in 1Q due to a contraction in public investment.

Fig 22: GDP by Demand Component (% yoy)

[% share GDP in 2015]	2014	2015	1Q2016	BNM's 2016E	2016E *	2017F *	2018F *
Private consumption [52.4%]	7.0	6.0	5.3	5.1	5.0	5.1	5.5
Public consumption [13.5%]	4.4	4.3	3.8	2.0	1.5	0.9	0.7
Private investment [16.9%]	11.0	6.4	2.2	5.5	4.8	5.4	6.1
Public investment [8.9%]	-4.7	-1.0	-4.5	1.1	1.3	2.2	2.4
Exports of goods and services [73.0%]	5.1	0.7	-0.5	3.2	2.6	2.5	3.3
Imports of goods and services [64.4%]	4.2	1.3	1.3	3.4	3.0	3.3	3.8
Overall GDP	**6.0**	**5.0**	**4.2**	**4.0-4.5**	**4.2**	**4.3**	**4.6**

Source: Department of Statistics, Bank Negara Malaysia, Annual Report 2015; * denotes Author's estimates

What worry us most are the strength of private consumption and private investment, two main pillars of support for economic growth. Though consumer spending has gained traction to 5.3% in 1Q16 from 4.9% in 4Q15, its momentum still be capped by cautious sentiment amid a rise in unemployment rate to 3.5% in March from 3.2% in 4Q15. Consumers remained cautious about spending on big ticket items such as car and consumer durables. Passenger car sales rebounded marginally in June after l down for five straight months.

Private investment growth pulled back sharply to 2.2% in 1Q16 for the **fourth consecutive quarter** (4.9% in 4Q15) as cautious business sentiments and lower commodity prices continued to dampen investments in the upstream mining sector. Nevertheless, there were continued investments in the manufacturing and services sectors. The large contraction of investment in machinery and equipment (-7.1% vs. -0.1% in 4Q15) could presage weak private investment ahead.

Any sharp pullback in private investment growth would dent overall GDP growth as private investment now accounts for 16.9% of total GDP. Though investors' sentiment is being dampened by a slow and weak global growth, cautious domestic demand as well as persistent domestic issues, overall investment activity will remain supported by the implementation of infrastructure projects and capital spending in the manufacturing and services sectors.

Fig 23: GDP by Economic Sector

[% share GDP in 2015]	2014	2015	1Q2016	BNM's 2016E	2016E *	2017F *	2018F *
Agriculture [8.8%]	2.1	1.0	-3.8	-0.3	-0.5	1.0	1.5
Mining [8.9%]	3.3	4.7	0.3	3.5	1.5	2.0	3.0
Manufacturing [23.0%]	6.2	4.9	4.5	4.1	4.5	4.3	5.0
Construction [4.4%]	11.8	8.2	7.9	7.9	8.0	8.5	8.8
Services [53.5%]	6.5	5.1	5.1	4.4	4.8	4.8	5.0
Overall GDP	**6.0**	**5.0**	**4.2**	**4.0-4.5**	**4.2**	**4.3**	**4.6**

Source: Department of Statistics, Bank Negara Malaysia, Annual Report 2015; * denotes Author's estimates

Malaysia's growth prospects are expected to remain challenging in remaining quarters given the state of global economic outlook as well as on-going adjustment in domestic economic condition. Lead economic and financial indicators for the second quarter suggest that economic growth will likely to remain moderate before improving slightly in the second half-year. We are **keeping 2016's real GDP growth estimate of 4.2%.**

Bank Negara Malaysia's Monetary Policy Committee (MPC), which was held on 13 July **has decided to cut the overnight policy rate by 25 basis point to 3.00%** for the first time after keeping the rate unchanged at 3.25% since July 2014. This marks the first rate cut in seven years.

It is a pre-emptive policy action to mitigate the potential destabilizing risks from lingering external uncertainties on domestic growth. The central bank also further justified for a rate cut by reflecting on the risks of destabilising financial imbalances have receded.

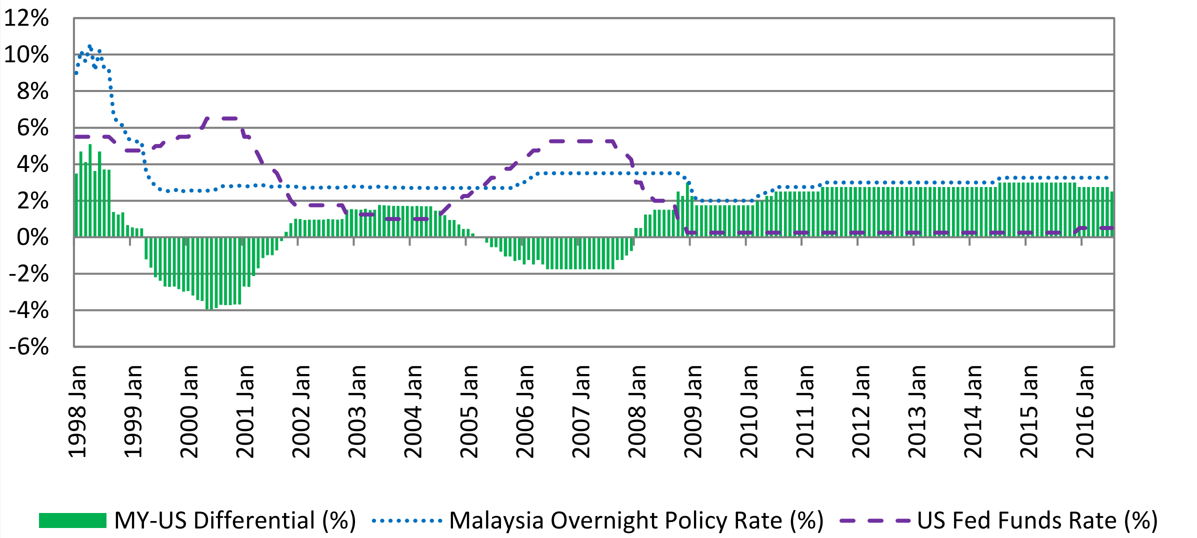
BNM's Governor, Datuk Muhammad Ibrahim **indicated that there is no plan for a "series of rate cuts"**, but the monetary policy committee will assess available data and "keep an open mind" every time it meets.

The **MPC statement** painted somewhat **cautious views about the domestic economy**, nothing that external uncertainties could weigh on Malaysia's growth prospects. BNM reiterates that the economy remains on track to expand in 2016-2017. **BNM's current estimates of GDP growth is 4.0-4.5% for 2016**, with stronger growth expected in 2H16.

The calibration of monetary policy is a forward looking process. It takes into account current information and forward data as well as the projected Malaysia's growth and inflation outlook. Global developments also closely monitored. Forward-guidance of the monetary stance is crucial to anchor market expectations.

With the risk is now assessed to be somewhat balanced between growth and inflation, **BNM is likely to keep the policy rate unchanged at 3.00% until year-end**.

Fig 24: Malaysia cut interest rate for the first time in July 2016 after 7 years

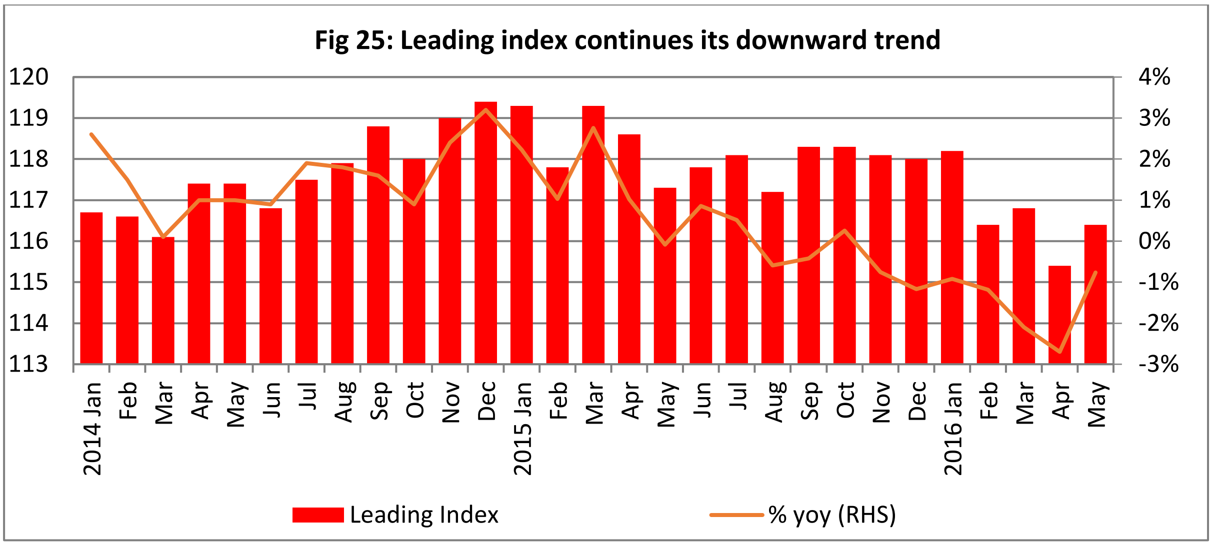


Source: Bank Negara Malaysia and The Federal Reserve

REVIEW OF KEY ECONOMIC INDICATORS

High-frequency economic and financial indicators signal further expansion in economic activity, albeit moderately in the second quarter. **Real GDP growth is estimated to grow by 4.0-4.3% in 2Q16** compared to 4.2% in 1Q. For the full-year, real GDP is estimated at 4.2% against BNM's 4.0-4.5%. BNM expects a stronger economic growth in 2H16, supported by improving consumer spending and continued expansion of investment.

1) The **leading index**, a gauge of forward growth expectations **contracted further, albeit at a smaller magnitude of 0.7% in May (-2.7% in Apr)** for **seven consecutive months**. This indicates that the economic growth will remain positive but at a slower rate in the coming months

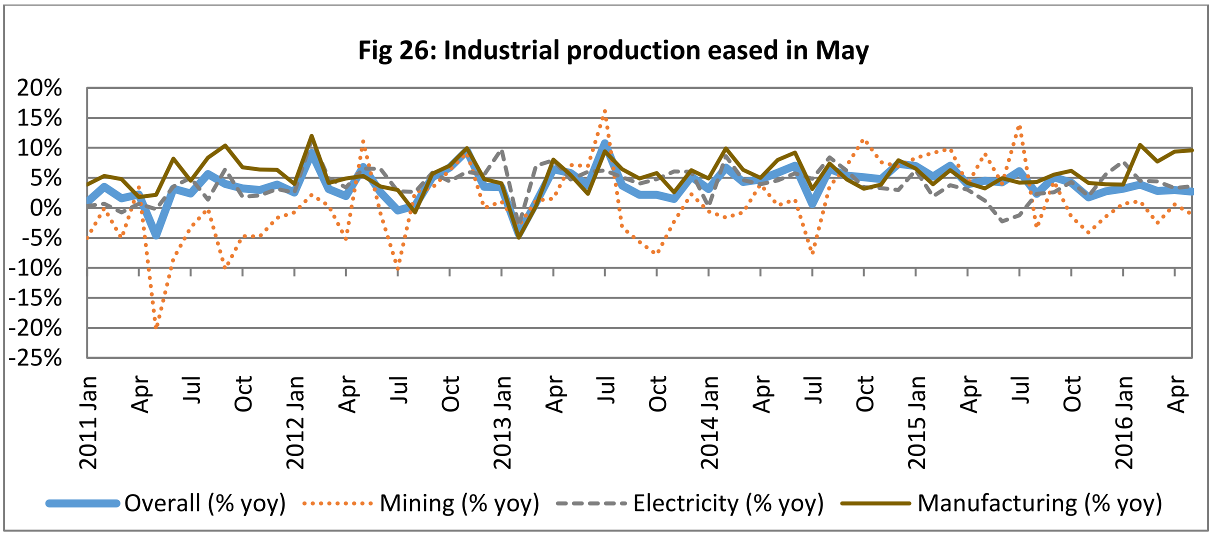


Source: Department of Statistics, Malaysia

2) **Industrial production index** (IPI), a proxy of overall economy **edged down slightly to 2.7% yoy in May** (+3.0% in Apr), supported by higher growth in manufacturing output (3.6% vs. 3.3% in Apr) and production of electricity (9.6% vs. 9.4% in Apr). The mining sector reverted to decline by 1.1% from +0.6% in April.

   Key sectors of manufacturing production that expanded were electrical products and electronics (8.3% in May vs. 7.9% in April), petroleum and chemicals (5.1% vs. 4.8%), non-metallic mineral products (5.8% vs. 4.1%), textiles and apparel (5.9% vs. 5.5%), and wood products (5.3% vs. 3.5%). Meanwhile sectors that contracted were food and beverage (-5.2% vs. -7.1%), and transport equipment (-11.7% vs. -7.5%).

   With overall industrial production and manufacturing output had 'a moderate pace" in Apr-May to the second quarter, **real GDP growth is estimated at 4.0-4.3% in 2Q16** (4.2% in 1Q). We expect the RM1.0bn special Aidilfitri assistance to 1.6 million civil servants, the third stage of the 1Malaysia People's Aid (BR1M) payment as well as festive spending ahead of Hari Raya Aidilfitri celebration in July to help lifting private consumption somewhat.



Source: Department of Statistics, Malaysia

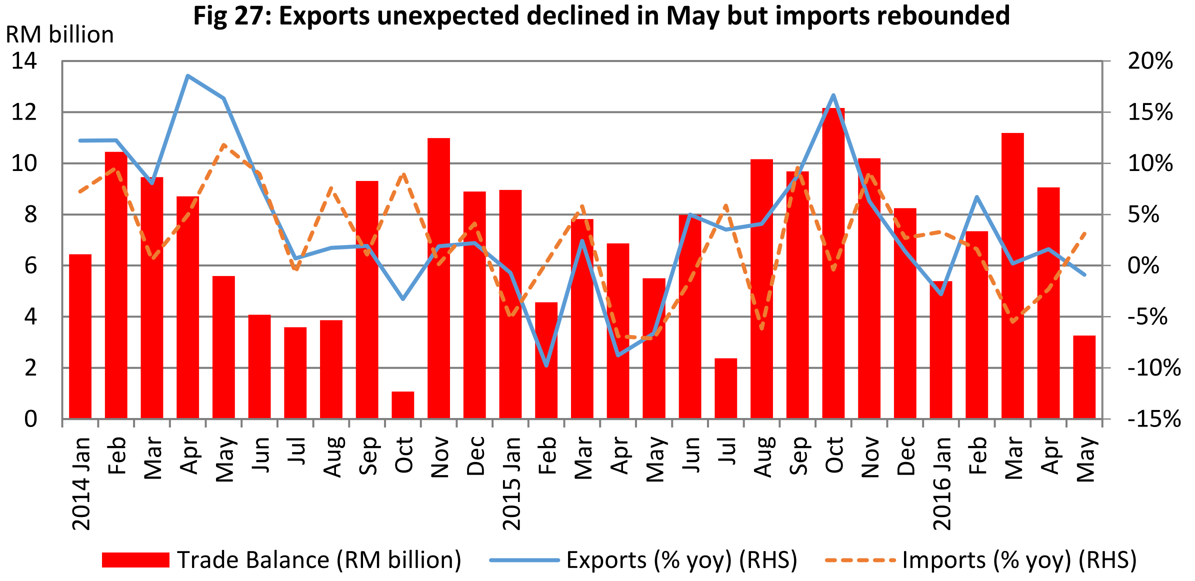
3) The **external sector weakened in May** as trade surplus shrank by more than half to RM3.3 billion in May from a surplus of RM9.1 billion in April. **Exports unexpectedly declined 0.9% yoy in May** (+1.6% in April), due to sharper decline in the non-electrical and electronic segments (-3.1% yoy in May vs. +1.3% in Apr).

   The drop in exports value were in LNG (-29.3%; share 3.1%), palm oil (-5%; share 6.3%), and petroleum products (-13.8%; share 7.0%). However, positive export growth were in machinery and appliances (+ 7.3%; share 5.4%), electrical and electronics (+3.2%; share 36.3%), chemicals (+11.8%; share 7.9%), optical and scientific equipment (+19.6%; share 3.7%), manufacture of metal (+7%; share 4.5%), and processed food (+15.3%; share 2.7%).

   On a positive note, **imports rebounded to +3.1% in May after two months of decline** (-2.3% in Apr and -5.5% in Mar). This is a good sign indicating that domestic demand remains intact. Capital goods imports rose higher by 17.2% (share 16.4%) and consumption imports also expanded, albeit slower at 13.6% (share 10.8%). Imports of intermediate goods, a forward looking indicator of exports, fell at marginal rate of 0.2% (share 55.8%).

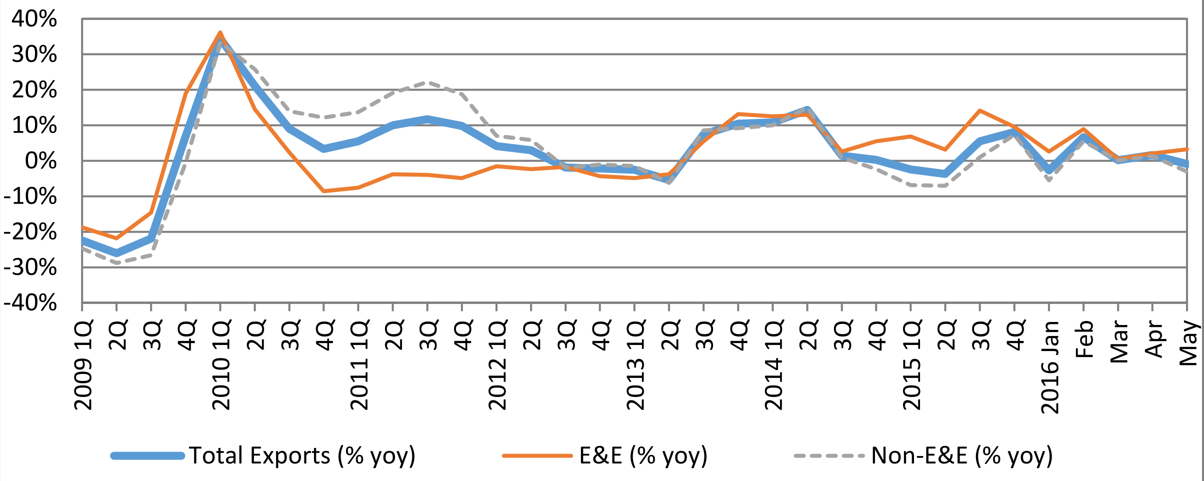
   The **prospects for export should remain unassertive** given the anticipated moderate global growth in major advanced economies and China.

Fig 27: Exports unexpected declined in May but imports rebounded



Source: Department of Statistics, Malaysia

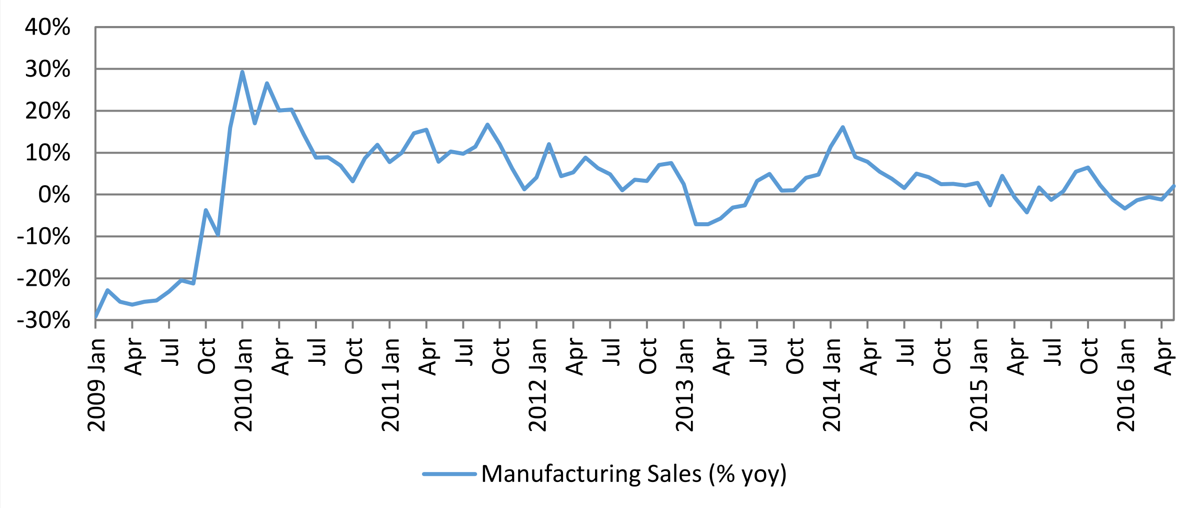
Fig 28: Higher exports of electronics and electrical products



Source: Department of Statistics, Malaysia

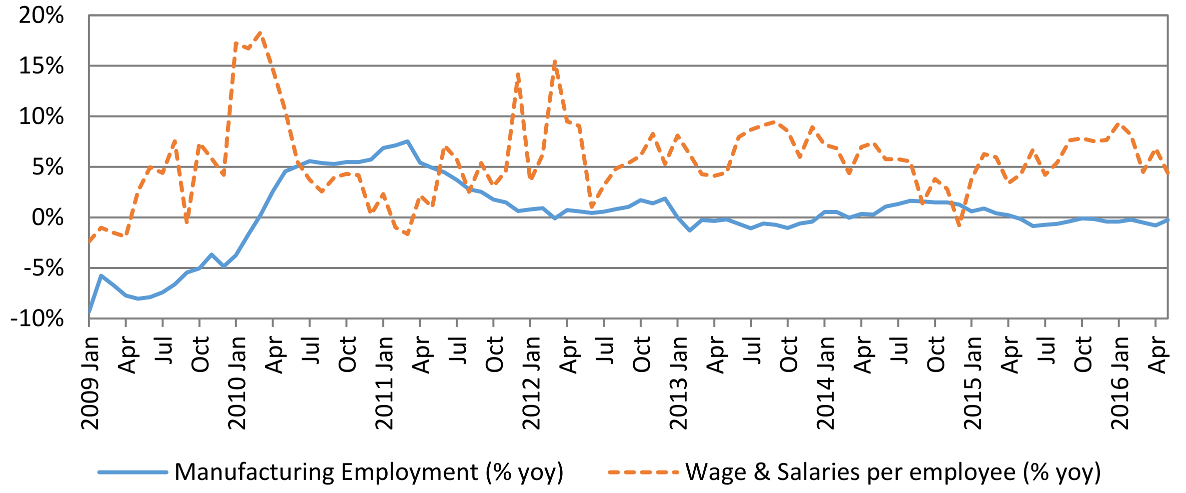
4) **Manufacturing sales increased by 2.0% yoy to RM51.8 billion in May** (-1.2% in Apr) after suffering declines for five consecutive months since Dec 2015. As at end-May, total employment in the sector declined 0.3% yoy to 1,024,759 persons, representing 13 successive months of decline since May 2015. The long streak of negative employment growth indicates that the sector is still weak. Total salaries and wages paid rose by 4.1% yoy in May.

Fig 29: Manufacturing sales rose in May after falling for five months



Source: Department of Statistics, Malaysia

Fig 30: Manufacturing employmen growth declined for 13 consecutive months



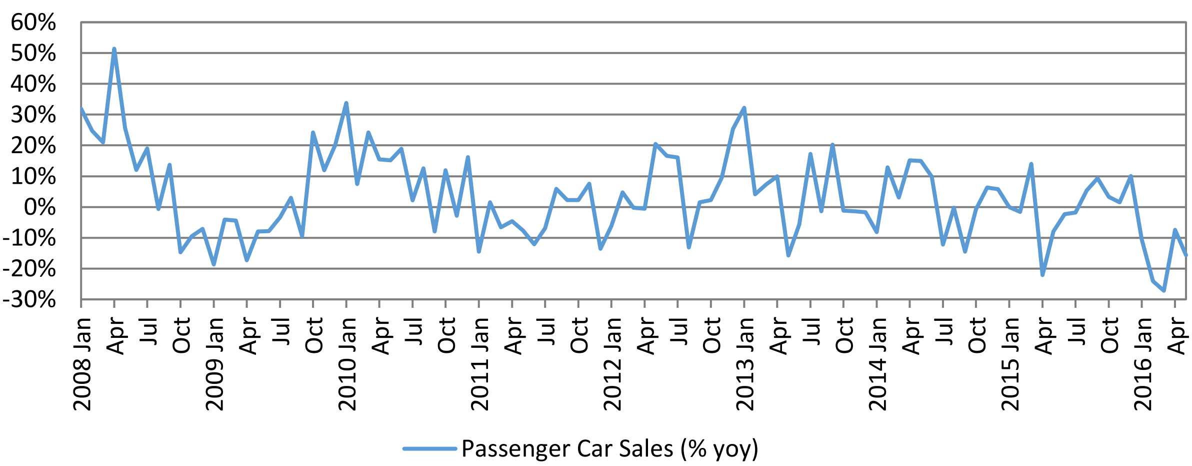
Source: Department of Statistics, Malaysia

5) **Private consumption indicators** present somewhat **mixed consumer spending patterns**. Though MIER's consumer sentiment index up 9.1 points to 72.9 in 1Q16, it is still below threshold level of confidence. Flat current finances, concerns about job outlook and income as well as less clout in consumer spending plans contributed to guarded sentiments.

Passenger car sales turned around to rise by 0.6% yoy in June (- 15.6% yoy in May) after falling for five months in a row. In 1H16, car sales contracted by 14.7% to 244,357 units while production also declined sharply by 20.2% to 241,009 units. This is despite aided by a favourable base effect when car sales plunged 22.1% yoy in April and -8.0% in May 2015, the month Goods and Services tax (GST) was implemented.

It remains to be seen whether the automotive sector is recovering on a firm ground given still cautious consumers' sentiments, more stringent hire -purchase loans approval and high car prices for selected car marques.

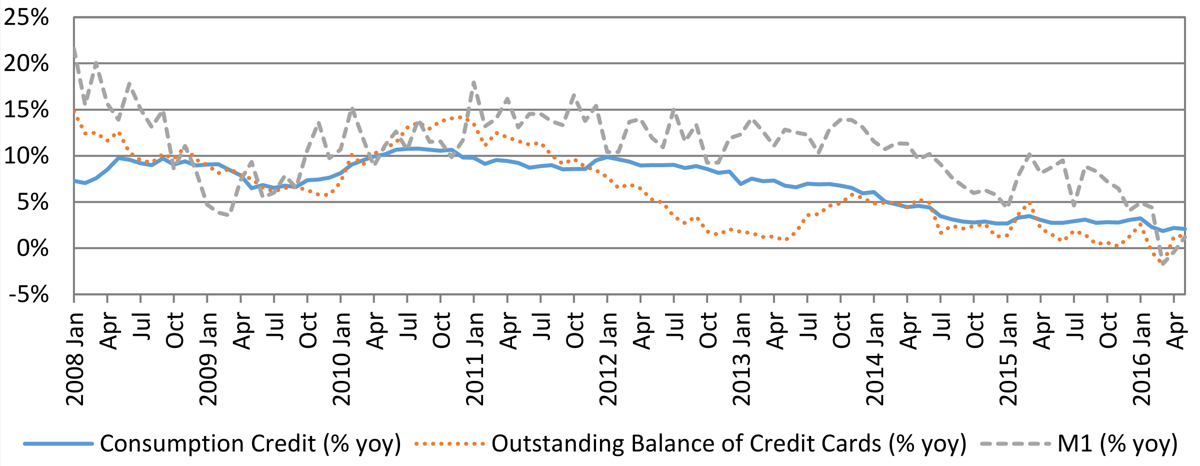
Fig 31: Passenger car sales up in June after down for five months a row



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

6) **Loans extended by the banking system** for **consumption purposes** such as purchase of durables and personal use remained moderate. **Imports of consumption goods** also eased to 13.6% yoy in May (15.3% in Apr) from 24.6% in 1Q. The uneven equity prices, a barometer of wealth effect are expected to have a knock-on impact on consumer sentiment and spending behavior. The relapsing of ringgit weakness in recent months after enjoying a good rally in 1Q16, may dampen consumer spending. **Private consumption growth is anticipated to slow** from +7.1% growth in 2011-15 to around 5.0% in 2016.

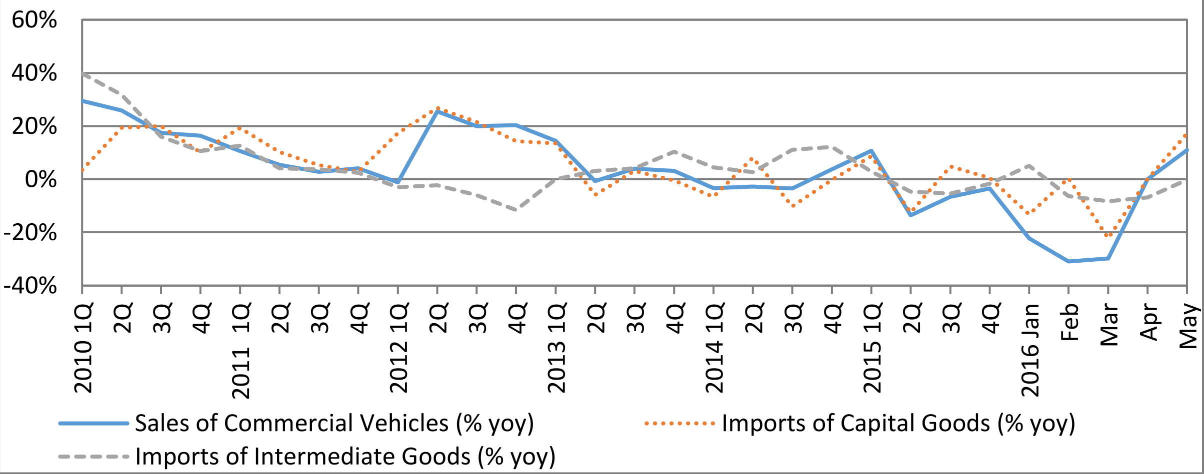
Fig 32: Cautious discretionary consumer spending



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

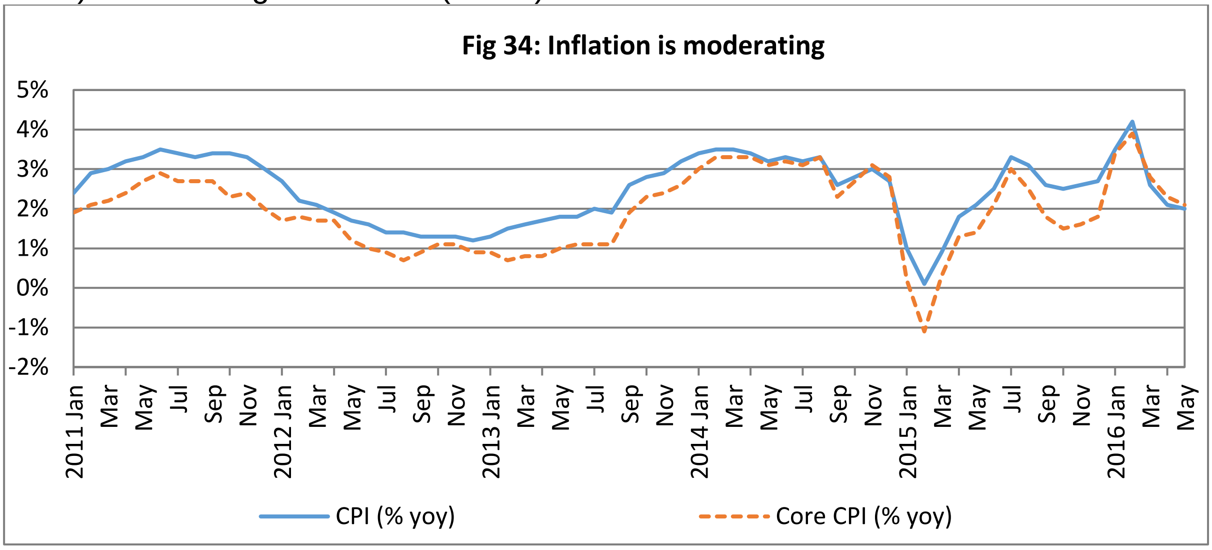
7) **Private investment indicators**, including sales of commercial vehicles, imports of capital and intermediate goods continue to remain weak, though the rates of declines have narrowed. Private investment growth pulled back sharply to 2.2% in 1Q16 for the fourth consecutive quarter (4.9% in 4Q15), the slowest pace since 3Q11 as cautious business sentiments and lower commodity prices continued to dampen investments in the upstream mining sector.

Fig 33: Private investment indicators

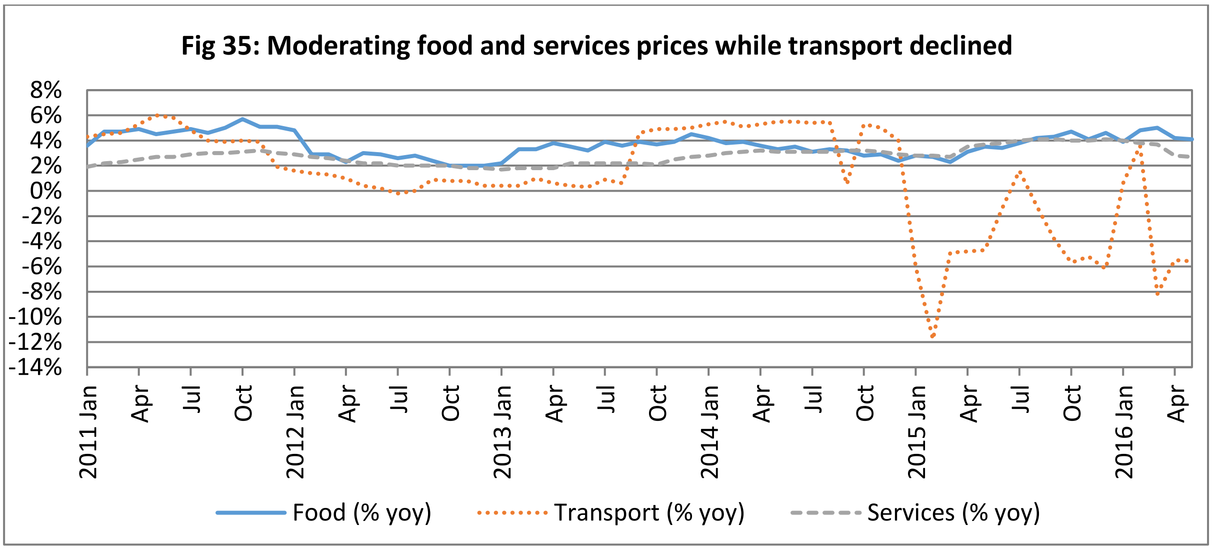


Source: Department of Statistics, Malaysia and Bank Negara Malaysia

8) **Headline inflation eased further to 1.6% yoy in June** (2.0% in May) for four consecutive months since March this year, marking the slowest pace in more than a year. Food prices edged slightly higher (+4.2% vs. +4.1% in May) while prices eased in alcoholic beverages and tobacco (+21.9% vs. 22.1%), restaurants and hotels (+2.2% vs. 2.5%). The price index of transport declined by a larger magnitude of 8.5% in June (-5.6%), reflecting lower petrol prices, followed by communication (-2.2%) and clothing & footwear (-0.6%).

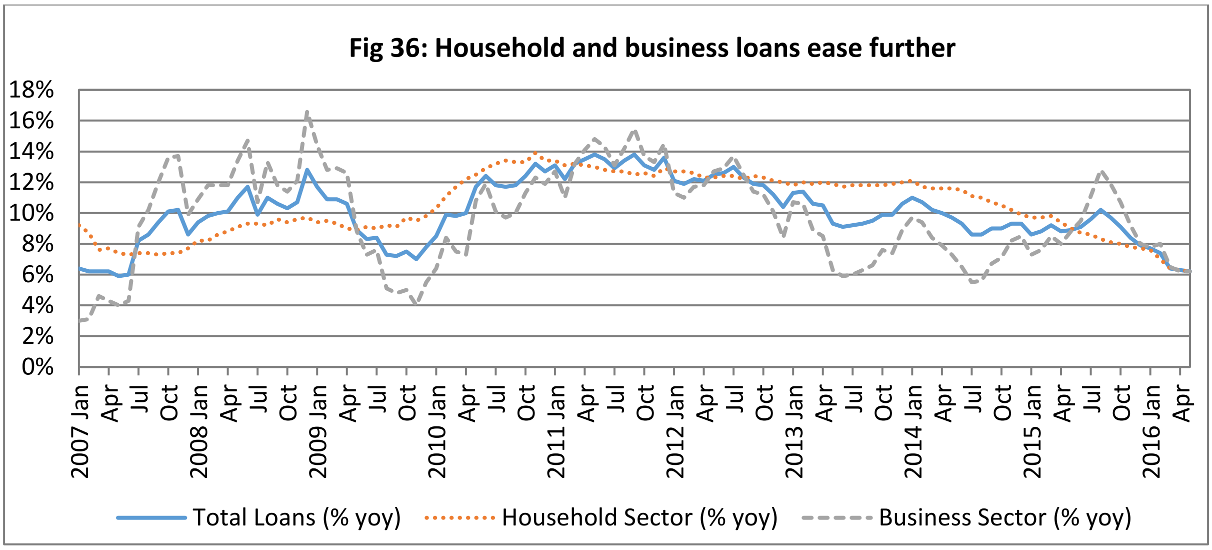


Source: Department of Statistics, Malaysia and Bank Negara Malaysia



Source: Department of Statistics, Malaysia and Bank Negara Malaysia

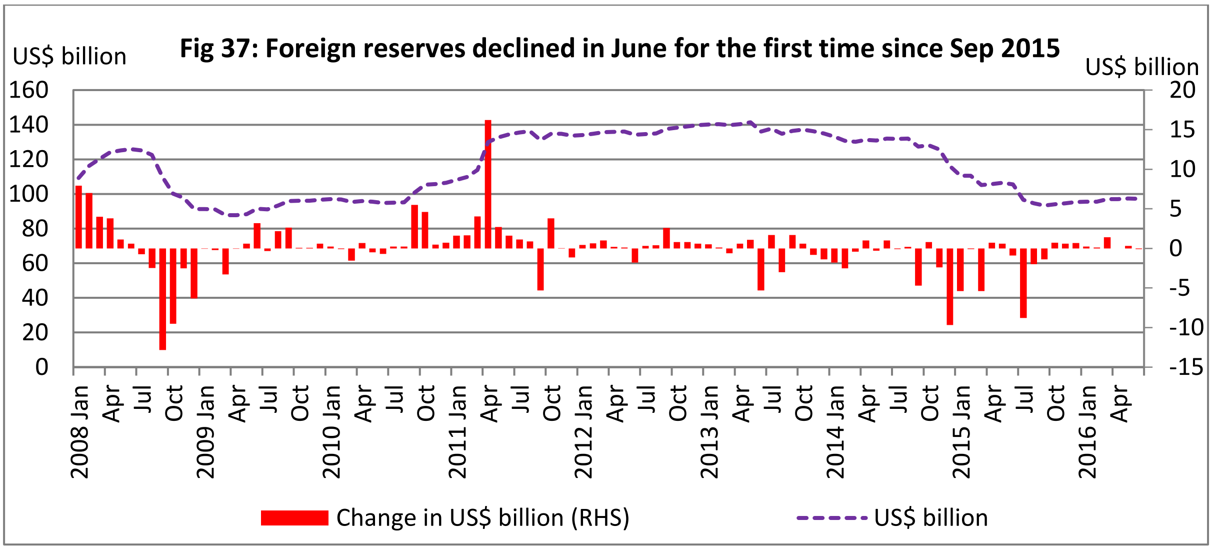
9) **Loan indicators improved in May**, with increases in loan applications (+8.9% vs. -6.0% in Apr), loan approvals (+2.2% vs. -17.2% in Apr) and loan disbursement (+6.9% vs. -1.8% in Apr). **Business loans** growth remained stable at 6.2% in May with a larger volume of loans disbursed to manufacturing; transport, storage and communication and wholesale and retail trade, and restaurants and hotels. The level of loan applications and loan approvals for businesses also increased. **Households' loan growth eased** to 6.2% in May from April's 6.3%, reflecting continued moderation across most purposes.



Source: Bank Negara Malaysia

10) **Bank Negara Malaysia's holdings of foreign exchange** stood at **US$97.3 billion as of 15 July 2016**, an increase of US$2.0 billion from US$95.3 billion as at end-Dec 2015. The level of reserves is sufficient to finance 8.2 months of retained imports and were 1.2 times the short-term external debt.

Foreigners were net sellers of Malaysian equities amounting to **RM1.8 billion in June** (-RM4.3 billion in May) amid a wider pull-out of global liquidity from Asian markets, including Malaysia, attributed to changes in country and stock weightings in the MSCI indices, which became effective June 1. The renewed weakness in ringgit amid the possibility of the Fed lifting US interest rates in June as well as uncertainty ahead of the Brexit on 23 June also induced capital flows volatility.



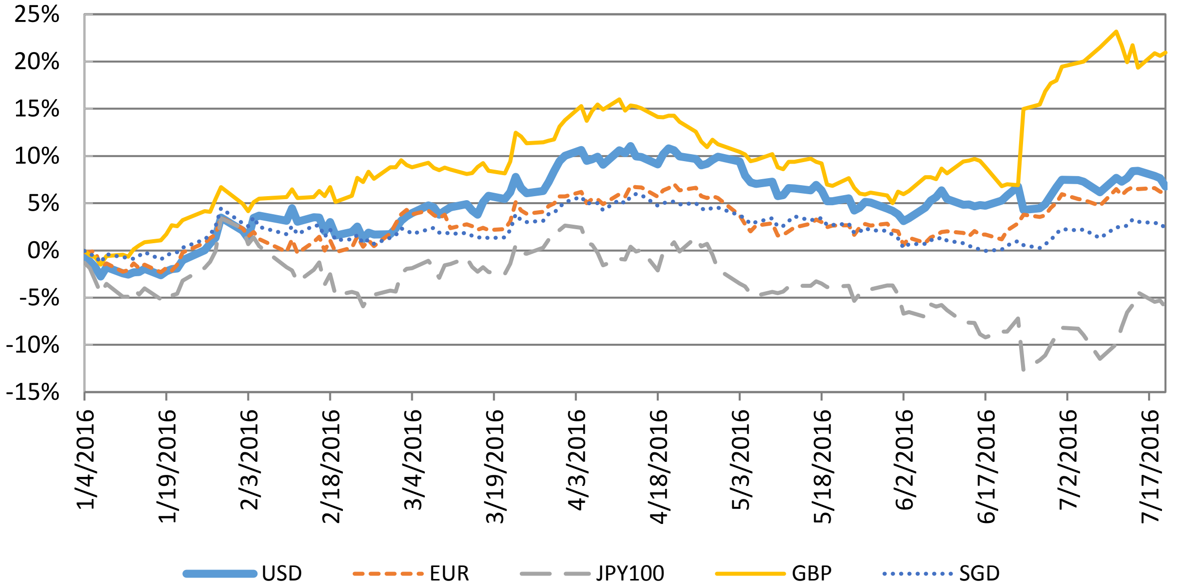
Source: Bank Negara Malaysia

It is deja vu for the ringgit as investors' sentiment towards emerging markets turned sour. With foreign capital flows likely to remain volatile, this will certainly pile pressure on the ringgit, which has already weakened past the critical RM4 per US dollar level for the first time in more than a month. Lingering issues surrounding the 1MDB and the volatile oil prices also weighed on the ringgit.

In Apr-June, the ringgit depreciated against the currencies of Malaysia's major trade partners. The ringgit, along with most regional currencies depreciated against the US dollar due to expectations of a possibility of the Fed lifting US interest rates. Adding to exchange rate volatility is the cloud of uncertainty relating to Brexit. In 2Q16, the ringgit down by 3.2% against the US dollar (+10.1% in 1Q16). YTD, the ringgit gained 5.5% against the US dollar to RM4.0710 as of 22 July 2016 from RM4.2935 at end-Dec 2015.

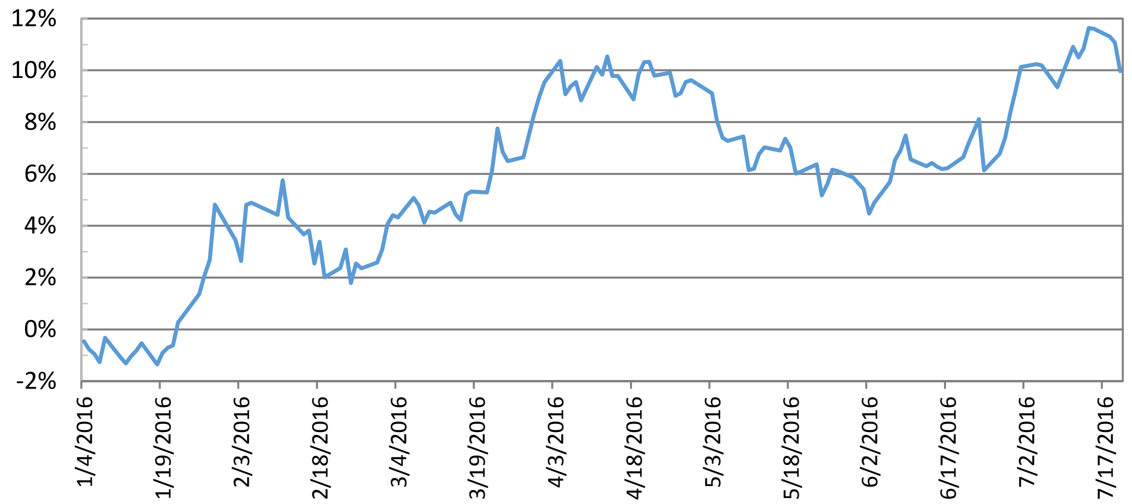
Faced with growing forex volatility and not so encouraging global macro scenario, investors are now leaning towards selling emerging-market currencies, which include the ringgit, and buying safe-haven currencies such as the US dollar. Domestic drivers for the ringgit are economic growth prospect, inflation trajectory, BNM's monetary stance and the direction of the oil price. The ringgit is expected to end the year at RM4.00-4.10 per US dollar (End-2015: RM4.29353).

Fig 38: Ringgit appreciated against USD, EUR, GBP & SGD but depreciated against JPY since end-2015



Source: Bank Negara Malaysia

Fig 39: Ringgit appreciated against CNY since end-2015



Source: Bank Negara Malaysia

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