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SERC

PORAM Annual Forum 2018

World Economic Outlook for 2018 and Beyond

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Key Messages

GLOBAL GROWTH AT RISK OF GOING OFF TRACK

UNEVEN GROWTH PROSPECTS

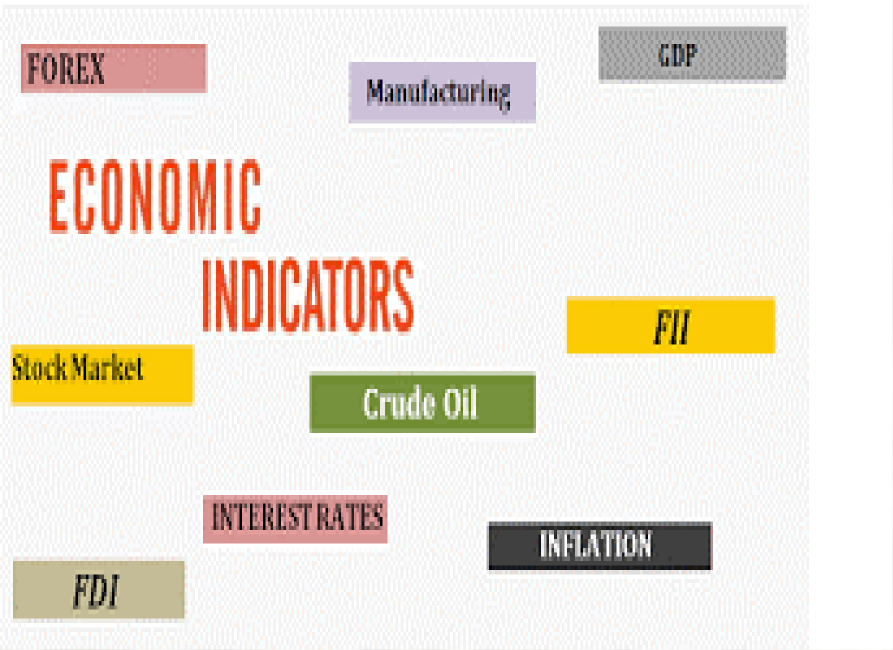
RISING RISKS INFLUENCING THE OUTLOOK

NEW MALAYSIA IN TRANSITION

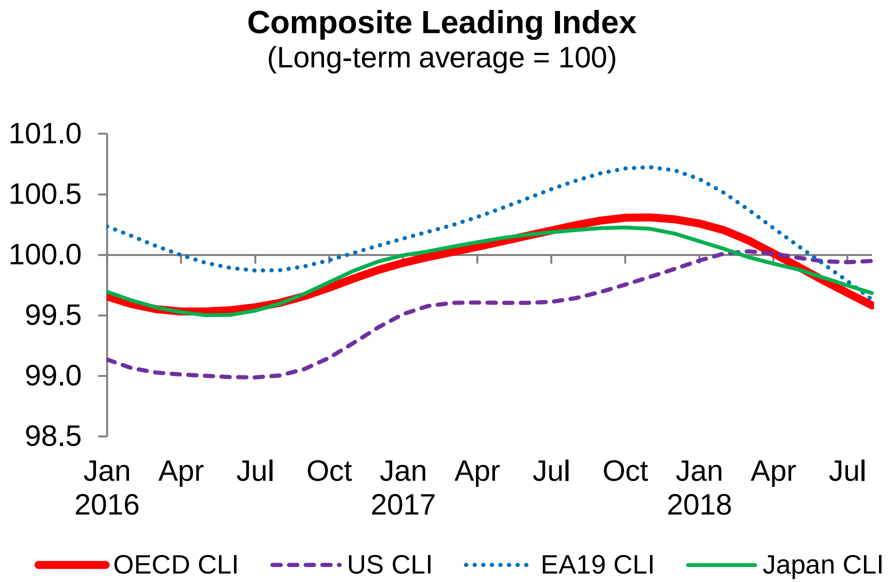
Section 1:

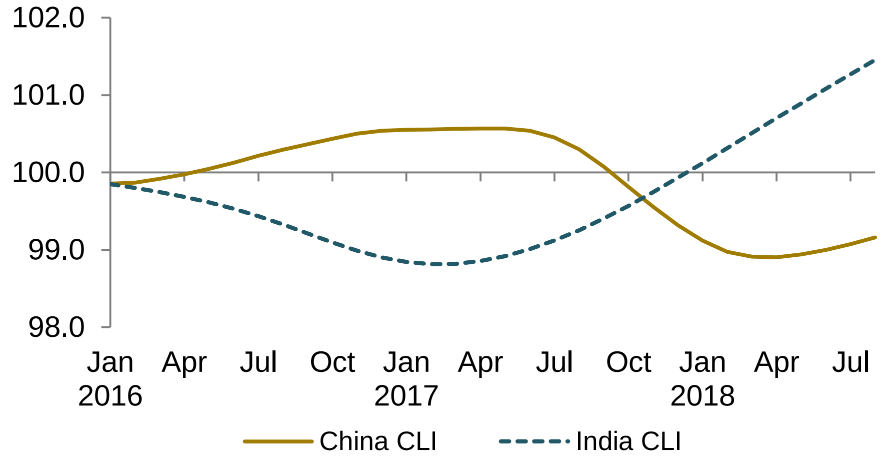
Global Activity Indicators –

Softening momentum



Global leading index has FALLEN below its long-term average

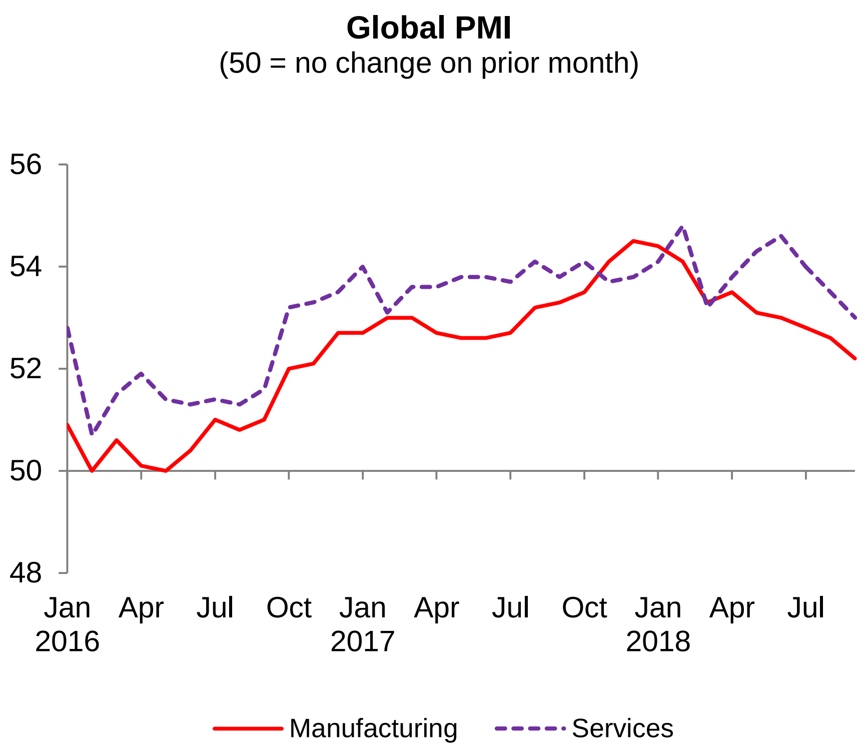




Source: OECD

- **Advanced economies'** growth have **peaked** and some have moderated.
- **Divergent** growth prospects in **advanced** and **emerging economies**.

Manufacturing and services PMIs have eased…

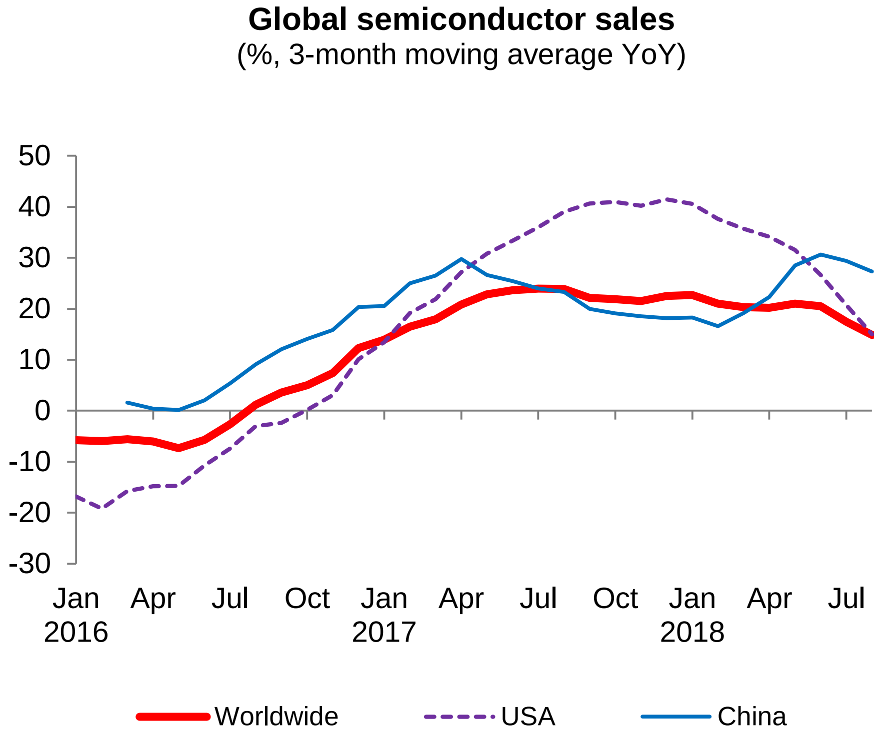


- Both **manufacturing** and **services** activities are **losing growth momentum**, albeit still staying above 50-pt, which separates between expansion and contraction.

- World **industrial production** growth also slowed (2.9% yoy in July vs. 3.3% in 2Q and 4.0% in 1Q).

Source: Markit

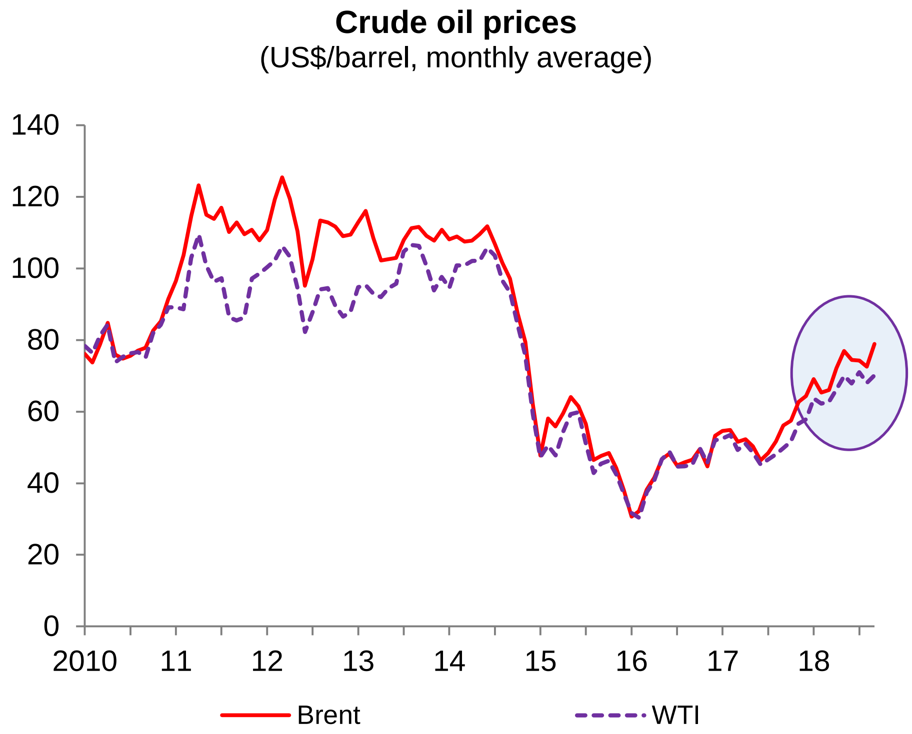
Global chip sales have MODERATED in recent months



- **Broad-based growth** across all regions and product categories.
- **Softer growth outlook**. The WSTS projected global semiconductor sales to grow at **a single-digit of 5.2% in 2019**, coming off from strong double-digit growth of 15.7% in 2018.

Source: Semiconductor Intelligence Association (SIA)

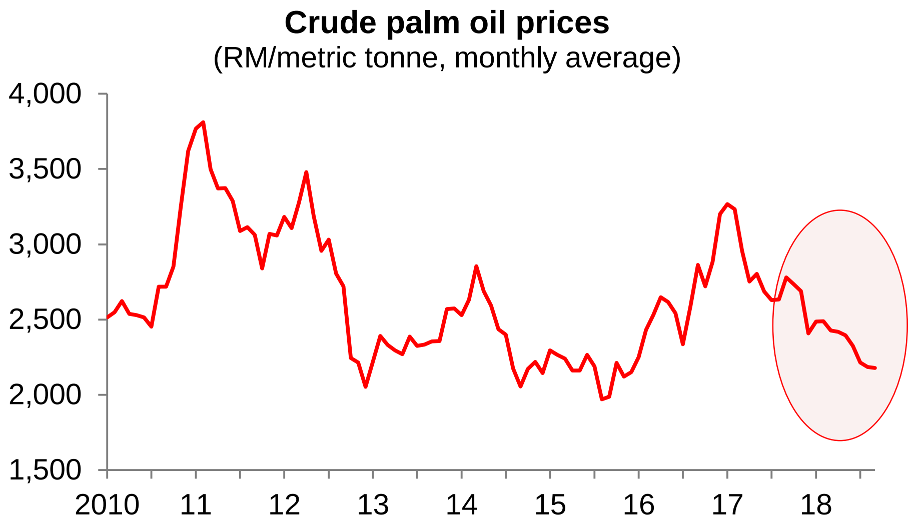
Crude oil prices at the HIGHEST LEVEL since 2014

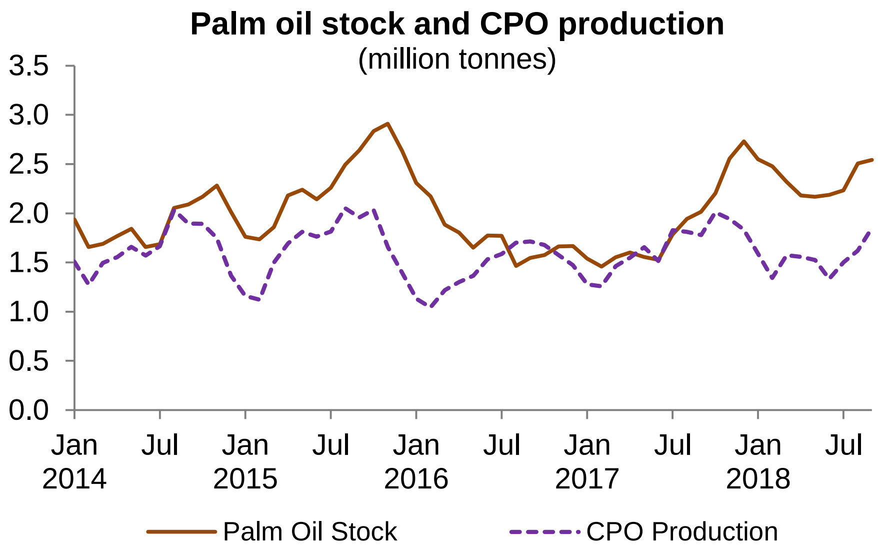


Source: EIA

- Brent crude oil prices have surpassed US$80/barrel in September.
- **Upside risks** to prices in short-term: a faster-than-expected deterioration of Venezuelan production and a large-than-anticipated reduction in Iran's crude exports.
- **Downside risks**: trade tensions, slower global economic growth, higher OPEC output, stronger than expected Canadian and US production.
- IEA expects oil demand to grow by 1.4 mbd and 1.5 mbd in 2018 and 2019 respectively.
- IEA's estimation of **average crude oil prices** (US$73/bbl in 2018; US$74/bbl in 2019).

Prolonged weakness in CPO prices



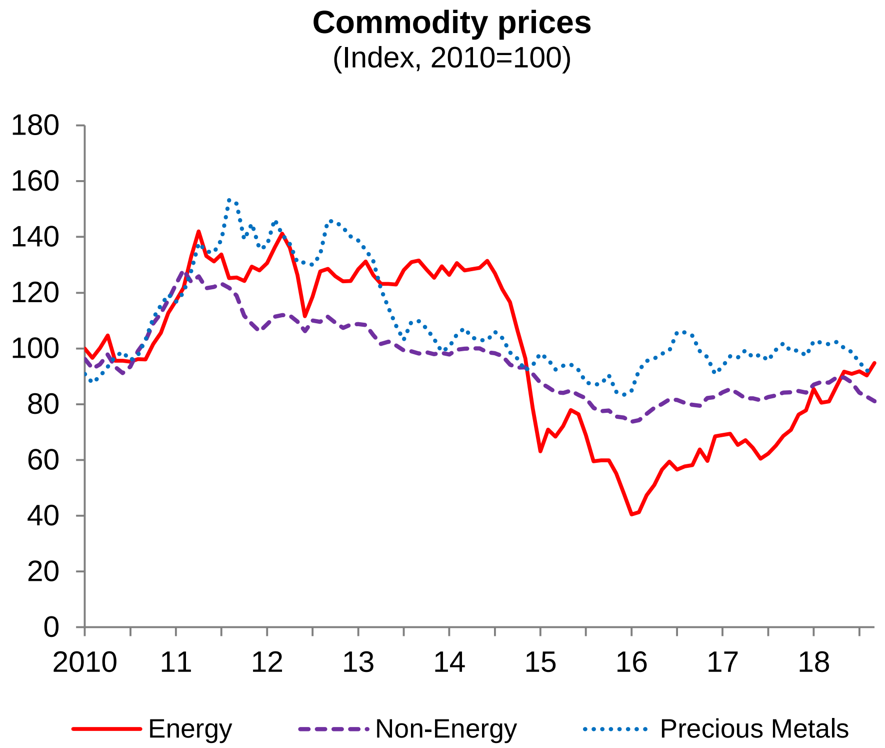


- **Upside to CPO prices** are capped by
  - ❑ High palm oil inventory in Malaysia and Indonesia. Stocks are piling up since May.
  - ❑ Pressure on US soybean price due to the US-China trade war.
  - ❑ Demand uncertainty from weak EM currencies.

- **Risk factors** to watch
  - ❑ Weather – starts of dry seasons, next El Nino.
  - ❑ Soybean planting in South America.
  - ❑ Higher import tariffs imposed by India.
  - ❑ Proposed ban on the utilization of palm oil as biodiesel in Europe starting 2021.

Source: MPOB *Note: Palm oil stock including CPO and processed palm oil*

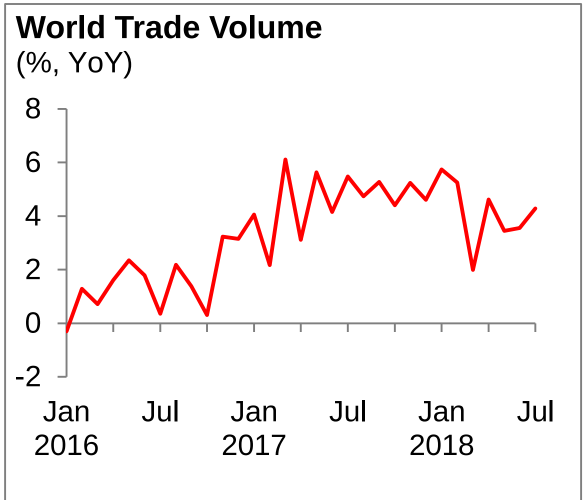
Commodity market moves in DIFFERENT DIRECTIONS

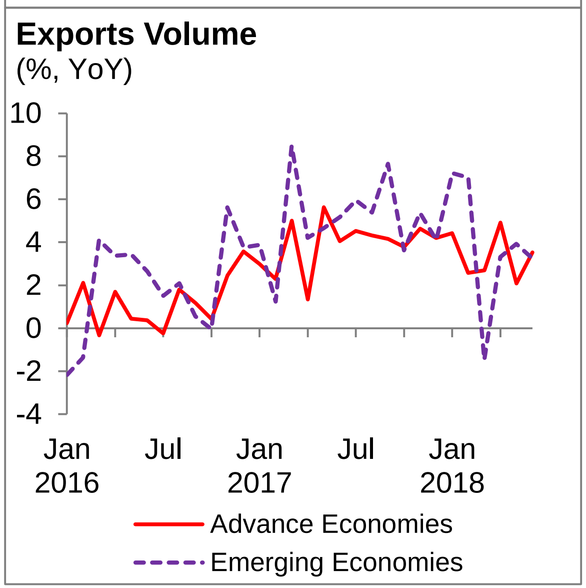


- Energy prices are rising; non-energy and precious metal prices are softening.

Source: World Bank

Global TRADE still on positive trajectory, but …





Source: CPB, Netherlands

… there are unintended consequences from tit-for-tat trade war. The repercussions are highly disruptive and damaging on global economic growth via trade and financial channels.

Trade channel

Curtail trade activity; Asian supply chains disruption and dampen global growth

Financial channel

Share prices of affected companies / industries will be rerated on earnings concern

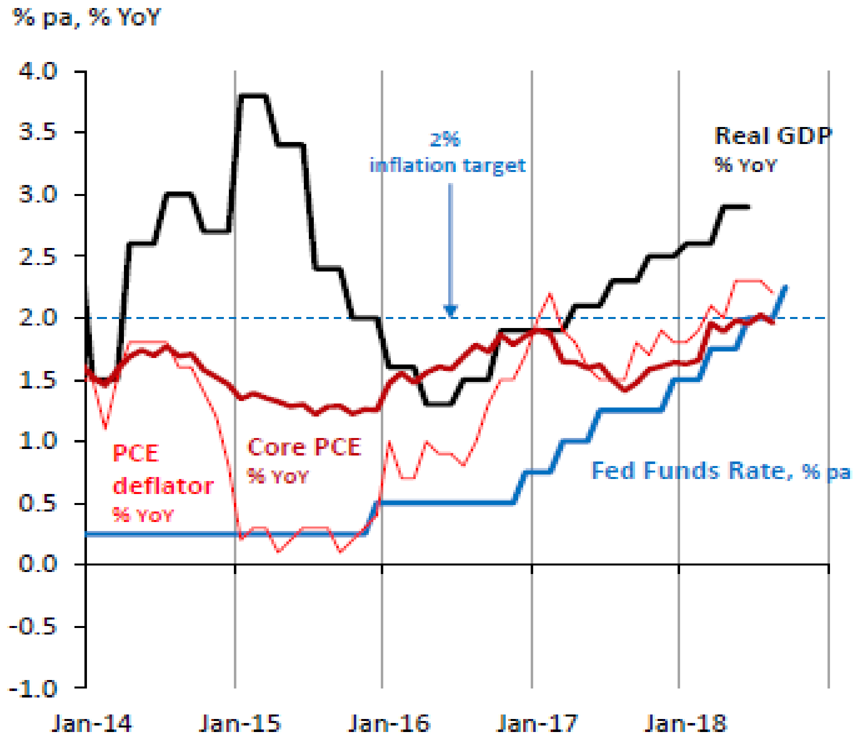
In Sep 2018, WTO revised trade growth projections lower to 3.9% (from 4.4%) in 2018 and 3.7% (from 4.0%) in 2019

Sustained trade tensions could slash Asia's economic growth by up to 0.9 percentage point in coming years

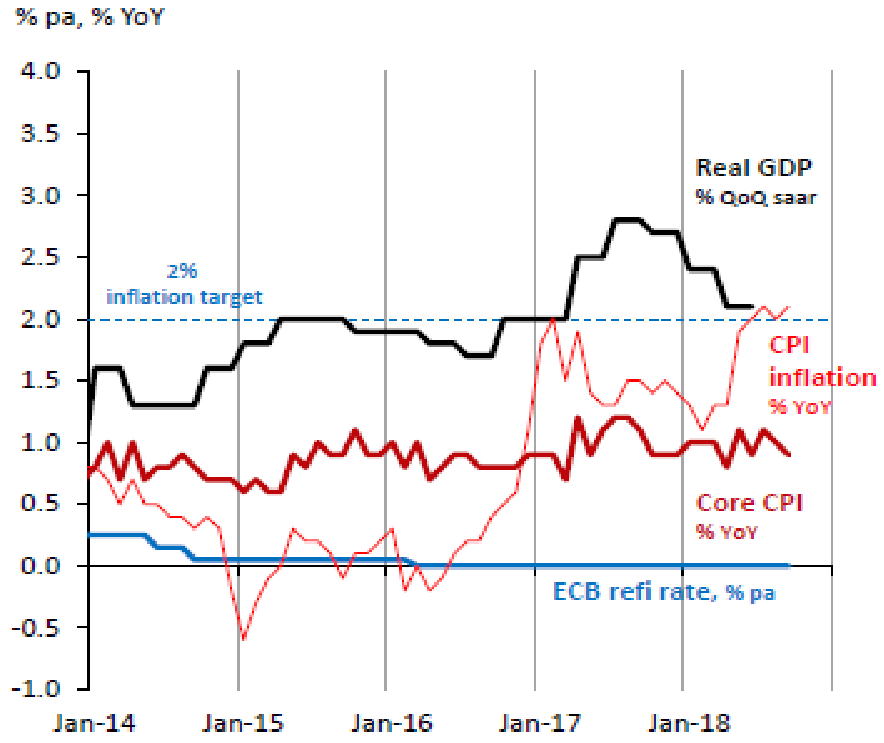
Growth, inflation and interest rates RISING together

- Based on the Fed's guided rate path, the Fed funds rate will rise to **2.25-2.50% by end-2018** and **3.00-3.25% by end-2019** respectively.

Fed policy supported by US fundamentals



ECB's normalization plans lack bite



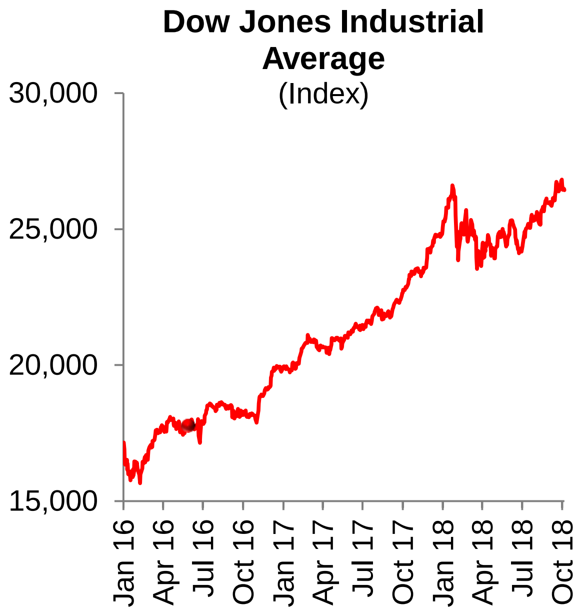
Source: DBS

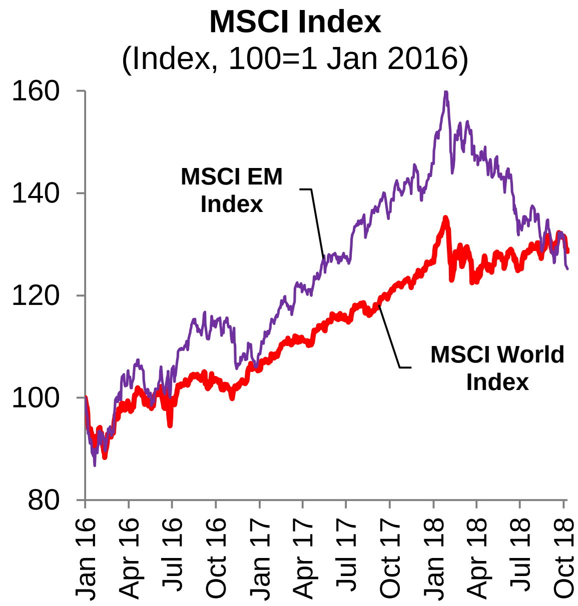
Global equity markets: Dow Jones Industrial Average rallies while emerging markets slide

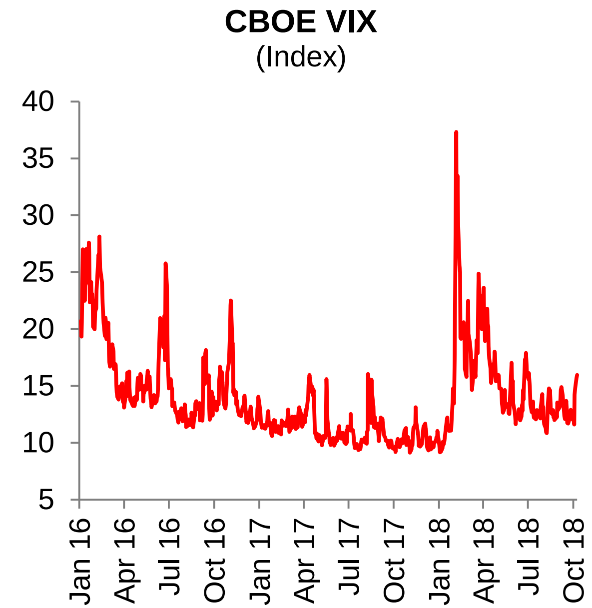
The DJIA is hitting record highs…

…emerging markets falling into bear territory

The 'fear index' indicates some uptick







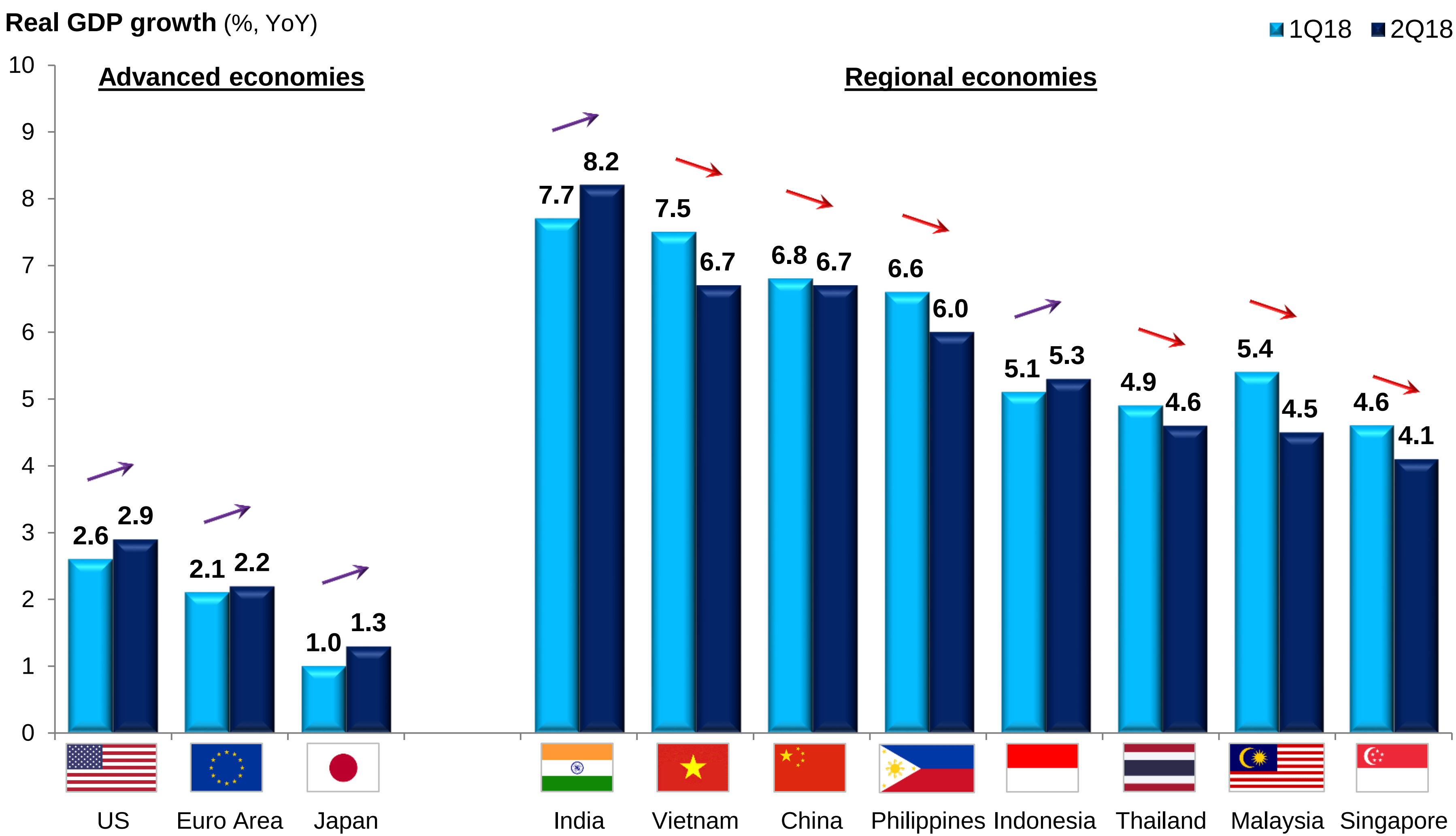
Source: WSJ; MSCI; CBOE

Section 2:

Snapshot of Economic Performance –

Uneven expansion, downside risks to growth

Uneven EXPANSION in advanced and regional economies

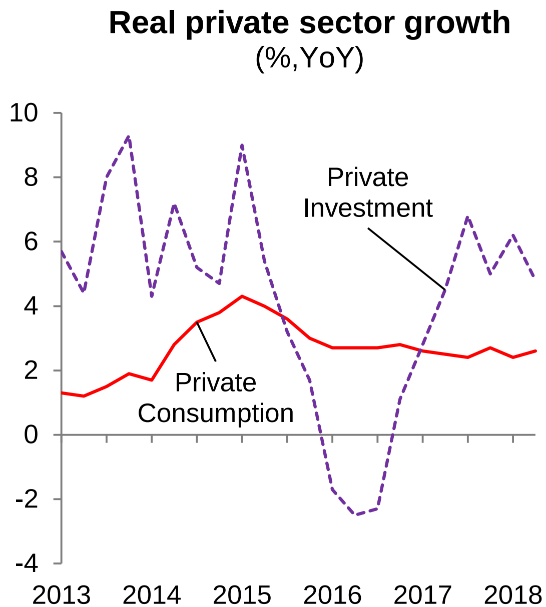


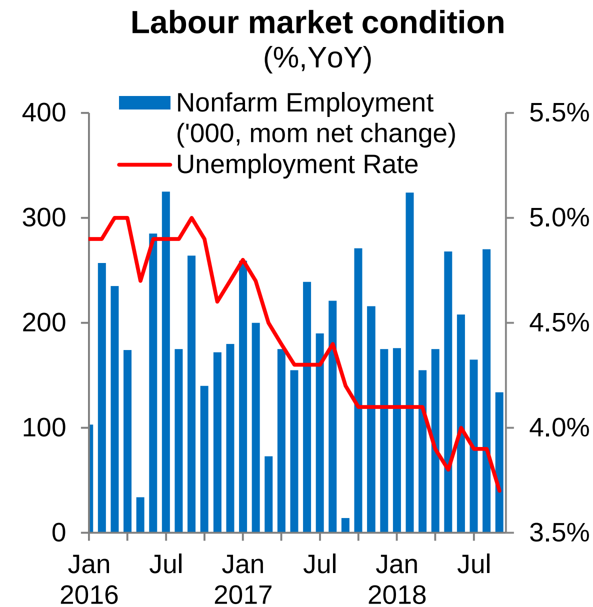
Source: Officials

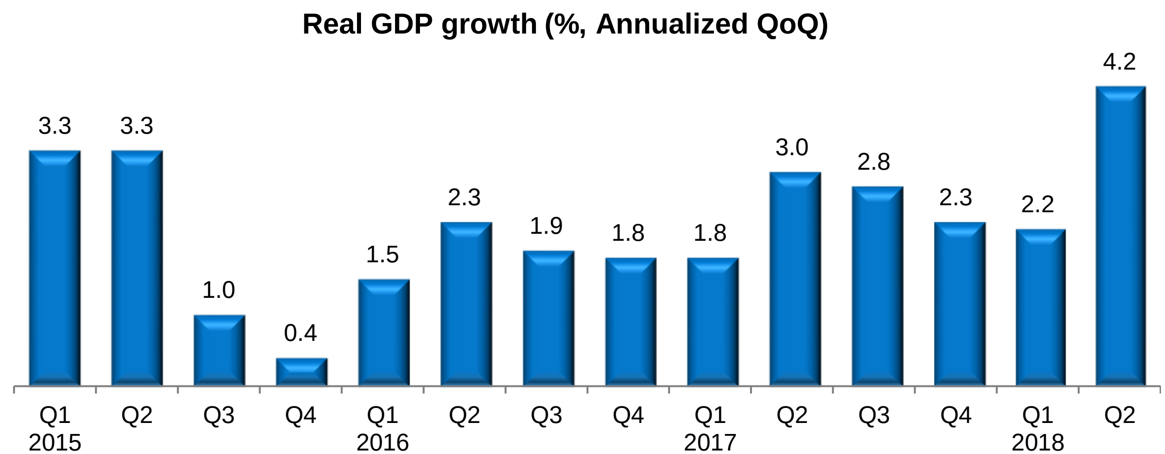
US: Firing on ALL CYLINDERS

(2018E: 2.9%; 2019F: 2.5%)

- **GOING STRONG:** Annualised 4.2% qoq in 2Q18, the highest since 3Q14.
- **FISCAL STIMULUS:** Robust private spending, strong external sector.
- **RISKS TO OUTLOOK:** Escalating trade war; diminishing tax stimulus effects; aggressive hikes in interest rate.





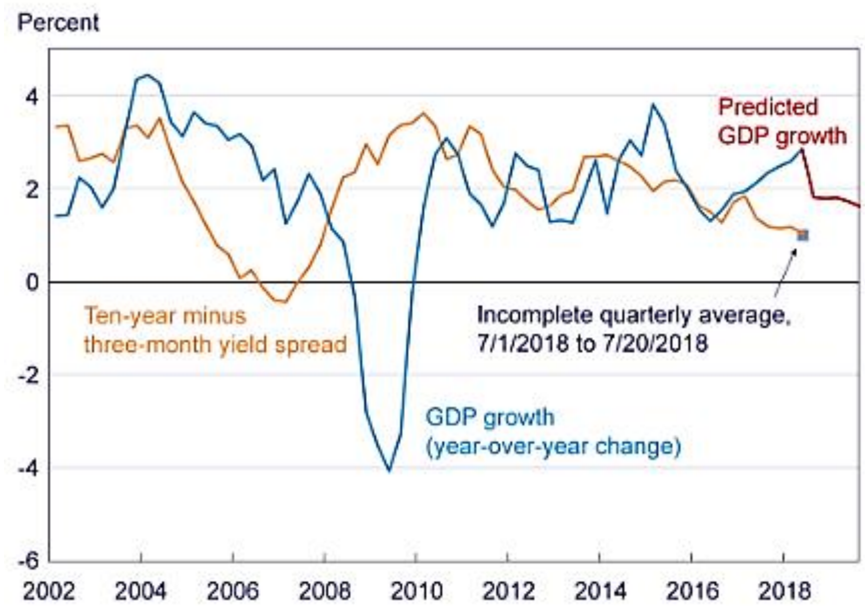


Source: US Bureau of Economic Analysis; US Bureau of Labor Statistics

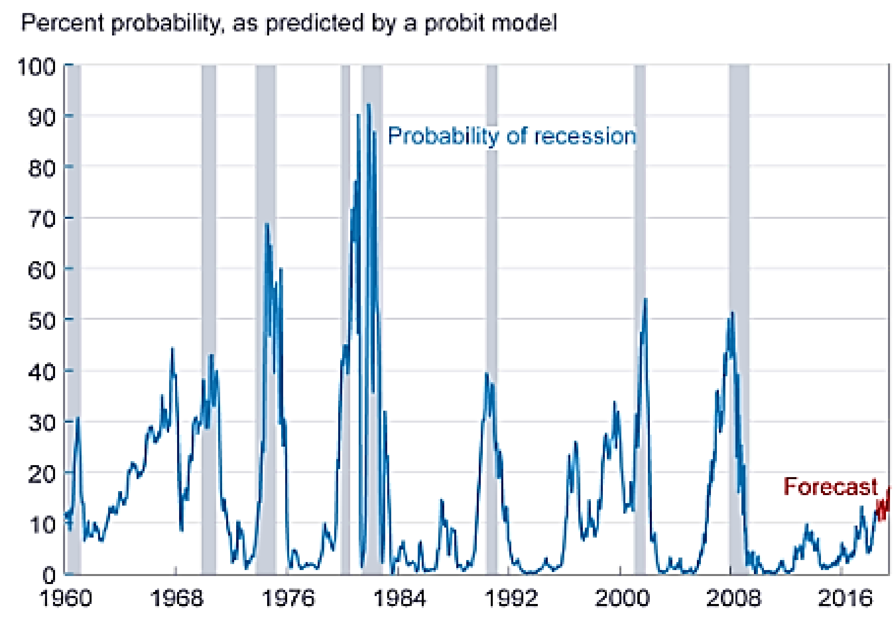
Is INVERTED US yield curve is a harbinger of ECONOMIC TROUBLE?

- The rule of thumb is that **AN INVERTED YIELD CURVE** (short rates above long rates) indicates a recession in about a year, and yield curve inversions have **PRECEDED EACH OF THE LAST SEVEN RECESSIONS**.
- **FLIGHT TO QUALITY AND SAFETY**. The Fed and central banks around the world have been buying up government debt for years, effectively depressing long-term interest rates.

Yield-Curve-Predicted GDP Growth



Sources: Bureau of Economic Analysis; Federal Reserve Board; authors' calculations.



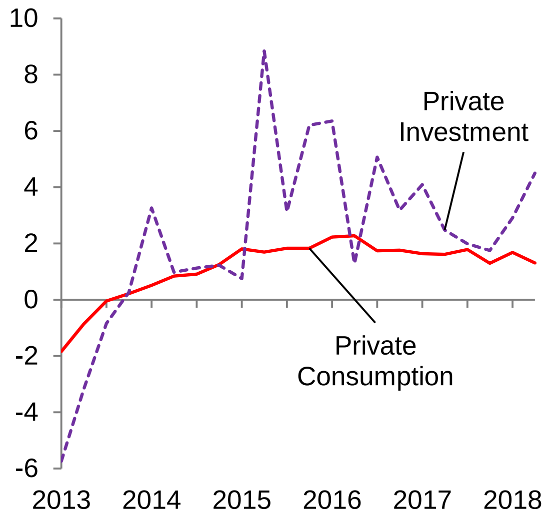
Note: Shaded bars indicate recessions.
Sources: NBER, Federal Reserve Board; authors' calculations.

Euro area: Growth CHALLENGES remain

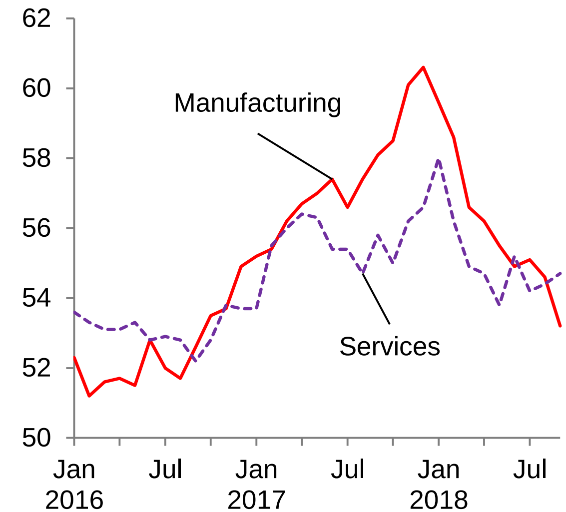
(2018E: 2.0%; 2019F: 1.9%)

- **WEAKEN GROWTH:** GDP growth at 2.2% yoy in 1H18 (2017: 2.4%). Private consumption growth lost steam; fixed investment picked up.
- **RISKS TO OUTLOOK:** A firm euro; trade war; geopolitical tensions; BREXIT deadline and rising inflation.

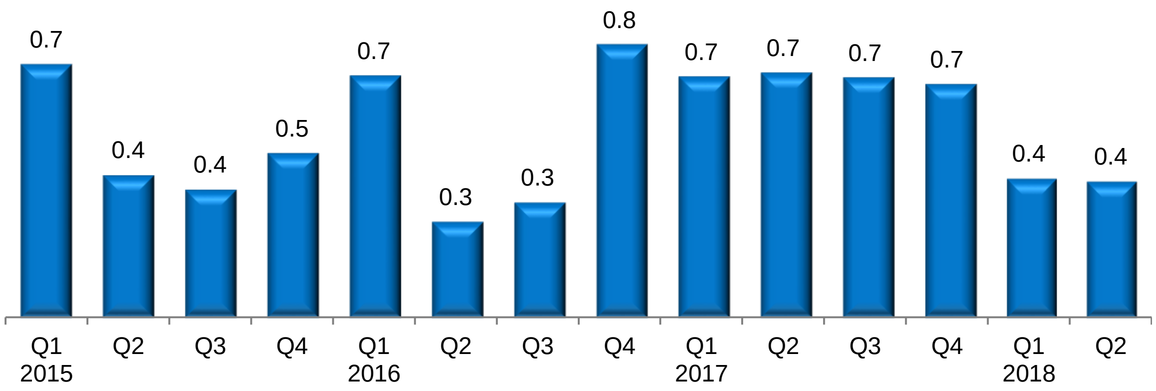
Real private sector growth
(%,YoY)



PMI



Real GDP growth (%, QoQ)

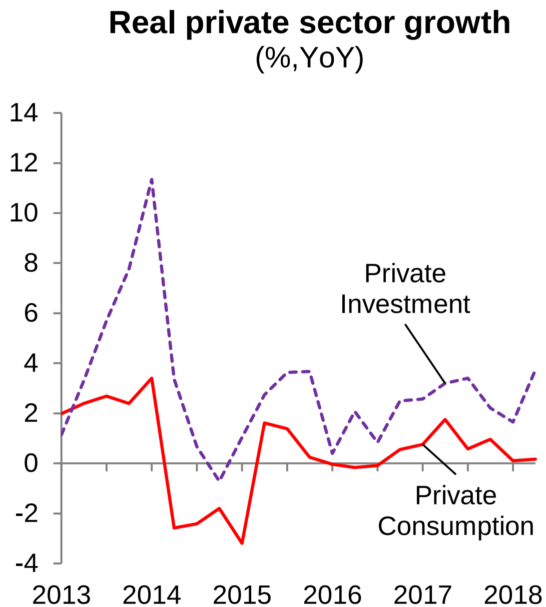


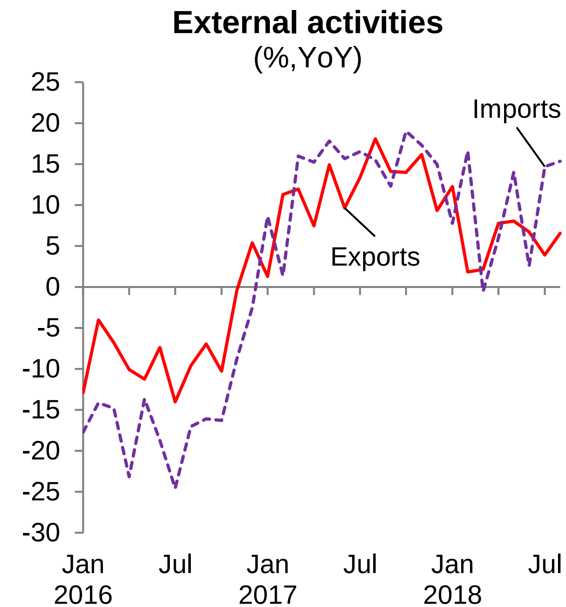
Source: Eurostat; Markit

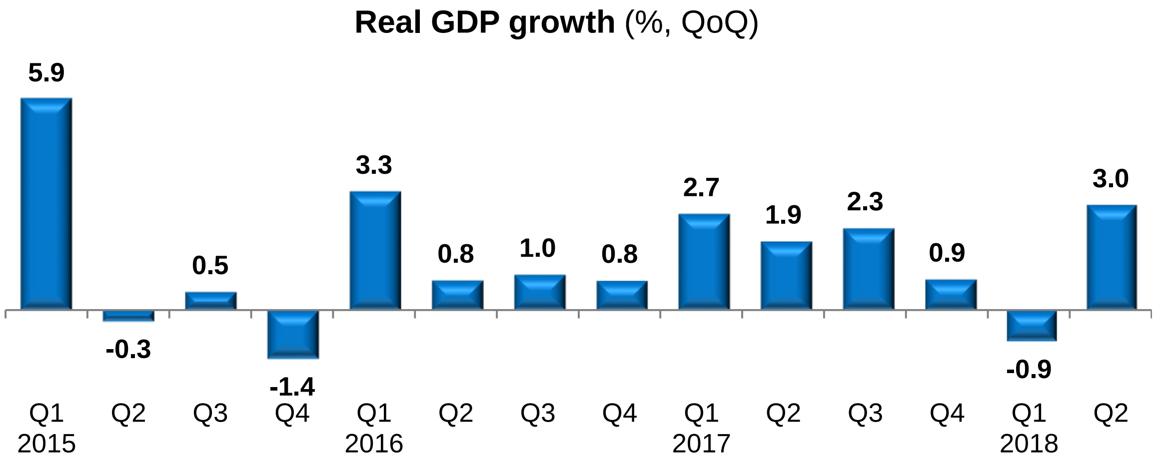
Japan: Still growing but RISKS remain

(2018E: 1.1%; 2019F: 0.9%)

- **GROWTH REBOUNDED:** GDP accelerated to 1.3% yoy or 3.0% qoq in 2Q (1Q: +1.0% yoy / -0.9% qoq).
- Accommodative financial conditions, robust labor market and construction projects related to the 2020 Tokyo Olympics.
- **RISKS TO GROWTH:** Rising trade protectionism; geopolitical risks could strengthen the yen.





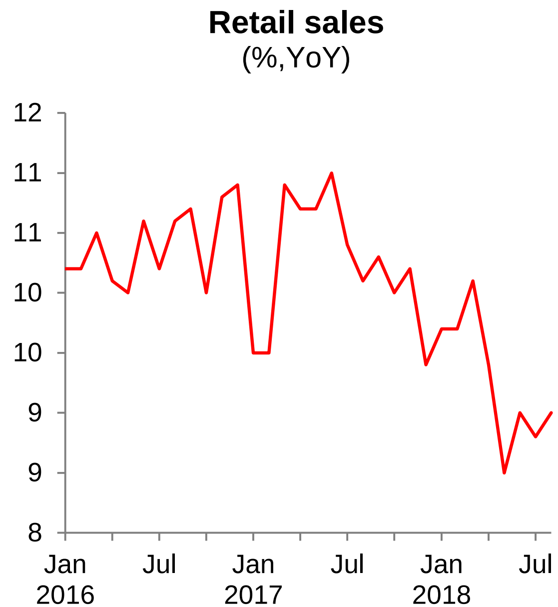


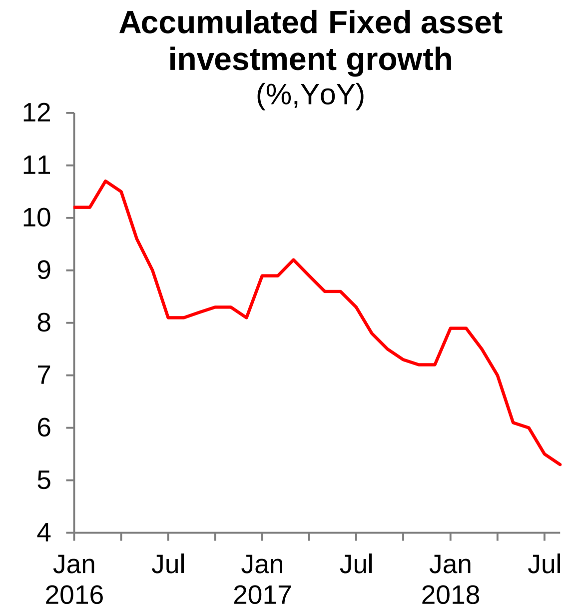
Source: Economic and Social Research Institute; Japan Customs

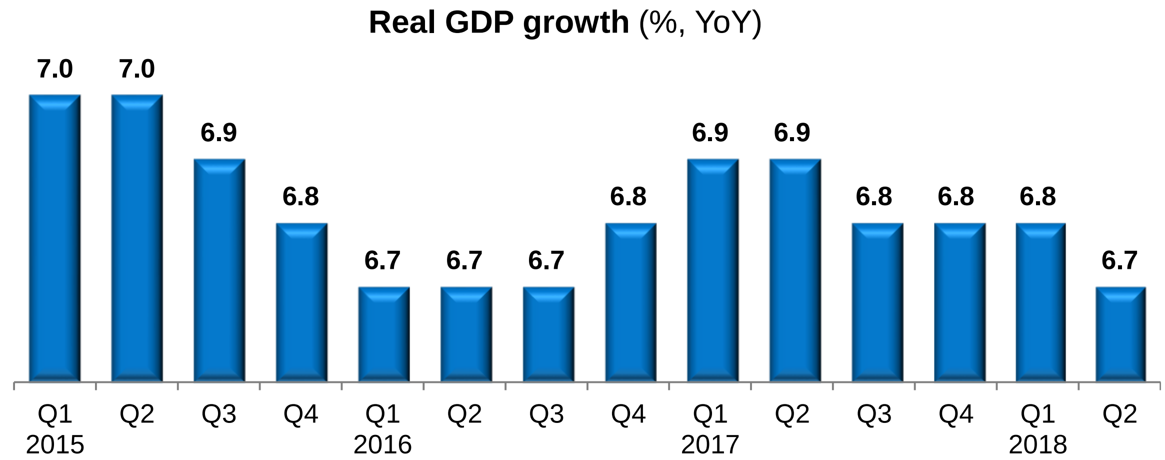
China: COOLING amid a full blown trade war

(2018E: 6.6%; 2019F: 6.2%)

- **GROWTH COOLS:** GDP eased to 6.7% yoy in 2Q (1Q: 6.8%).
- Continued financial deleveraging weighed on investment and property lending. Investment growth slowed to a record low.
- PBOC cut the reserve requirement (release liquidity to banks) for the fourth time by 1% to spur growth.
- **RISKS TO GROWTH:** Escalating trade war with the US; a sudden slowdown in the property market and potential corporate defaults.





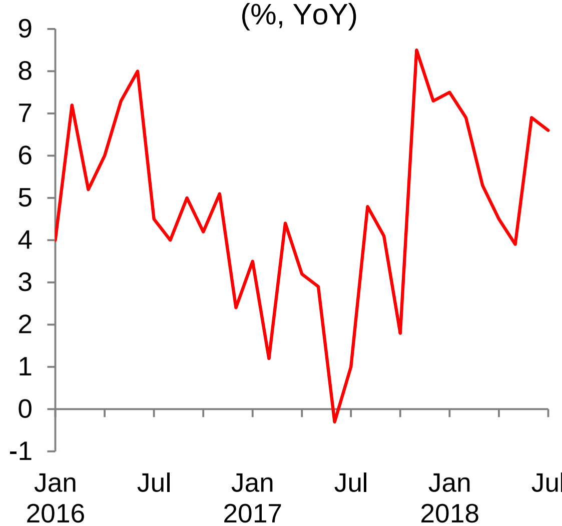


Source: National Bureau of Statistics of China

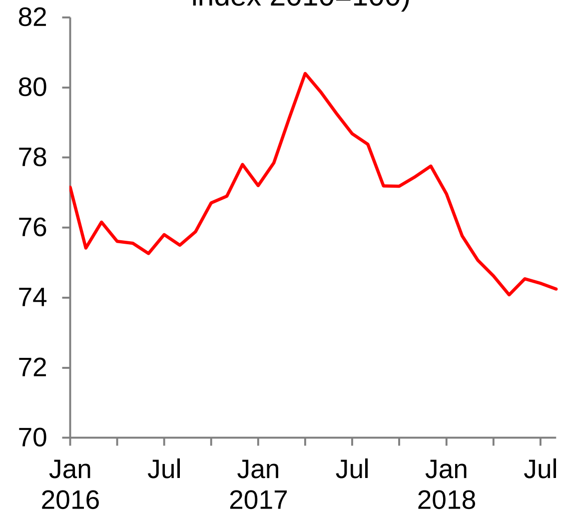
India: STRONG expansion amid weakening rupee
(2018E: 7.3%; 2019F: 7.5%)

- **GROWTH ACCELERATED.** The strongest in two years 2018 (8.2% in 2Q vs. 7.7% in 1Q), buoyed by surging private consumption.
- **RISKS TO GROWTH.** Fiscal slippage ahead of next year's general elections; global trade tensions, higher oil prices and weakening rupee.

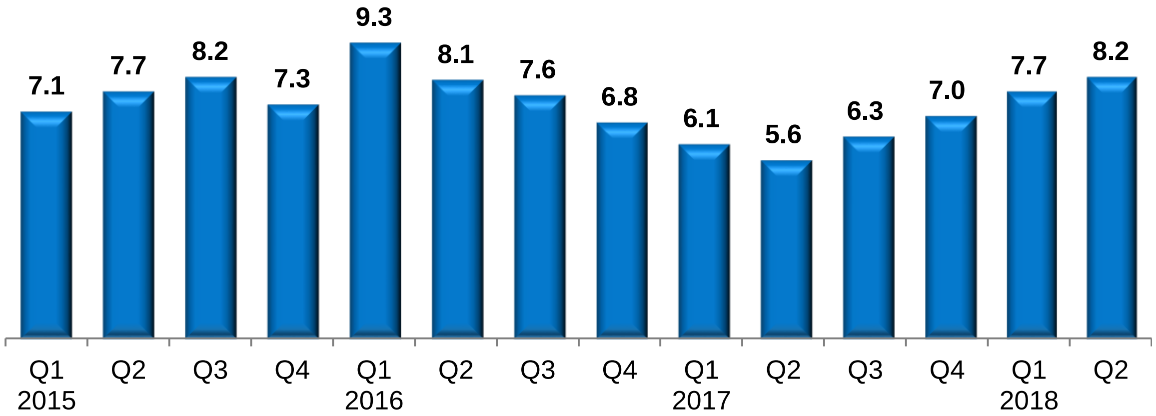
Industrial production growth
(%, YoY)



Indian rupee performance
(Nominal effective exchange rate, index 2010=100)



Real GDP growth (%, YoY)

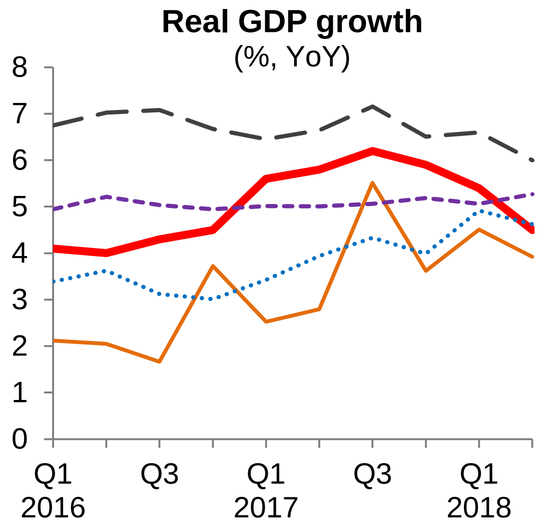


Source: Ministry of Statistics and Programme Implementation, India; Bank of International Settlements

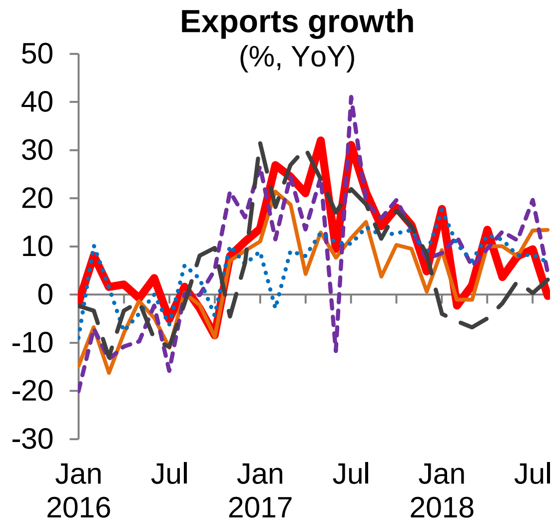
ASEAN-5 economies still GROWING but risks remain

- **Malaysia:** New political landscape and policies transition adjustment
- **Indonesia:** Tightening monetary policy; plunging rupiah
- **Thailand:** Softer external demand. General elections will be held by May 2019
- **Singapore:** Highly open economy subjects to financial volatility and trade tensions
- **Philippines:** Large fiscal stimulus. Rising fiscal and current account deficits

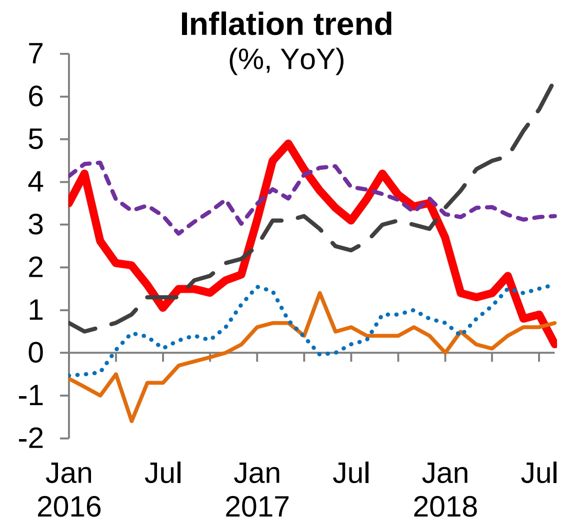
Uneven growth



Exports growth moderated from high levels



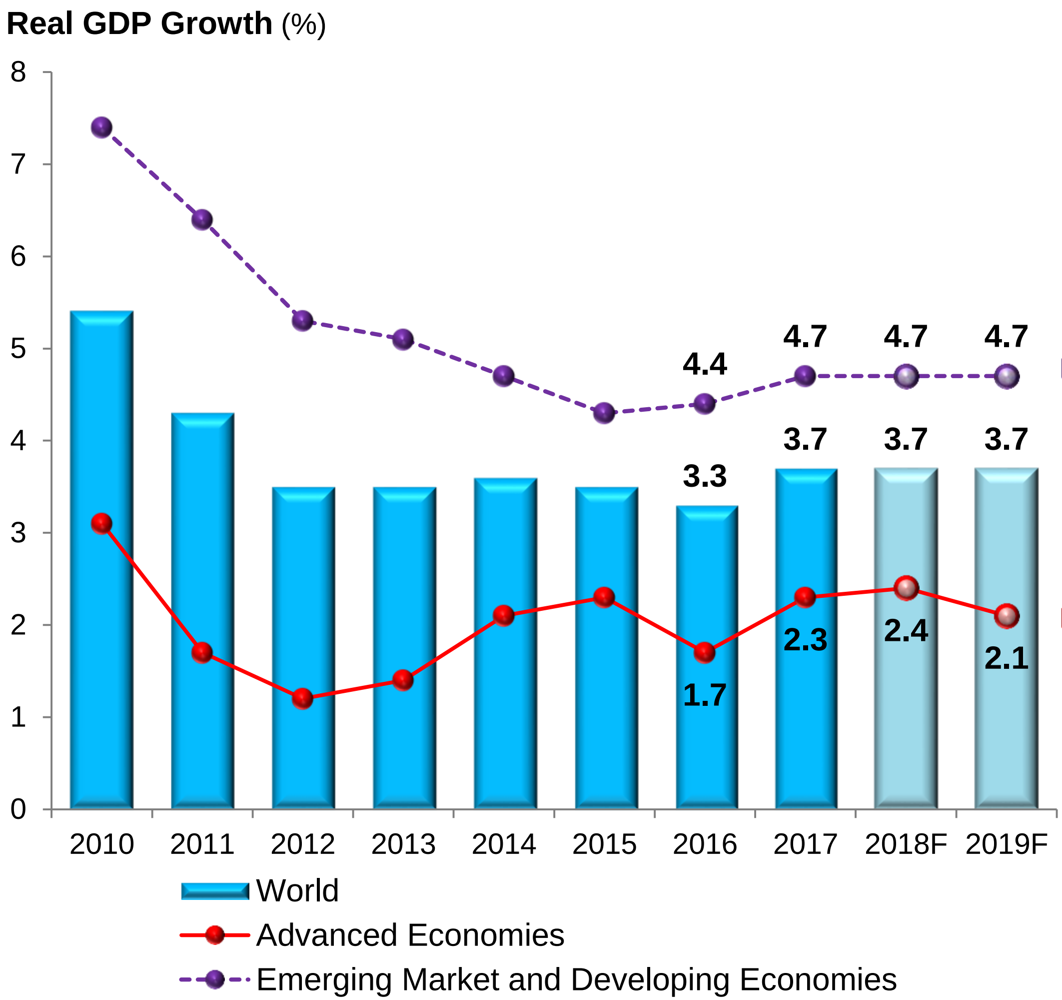
Inflation shows mixed trend

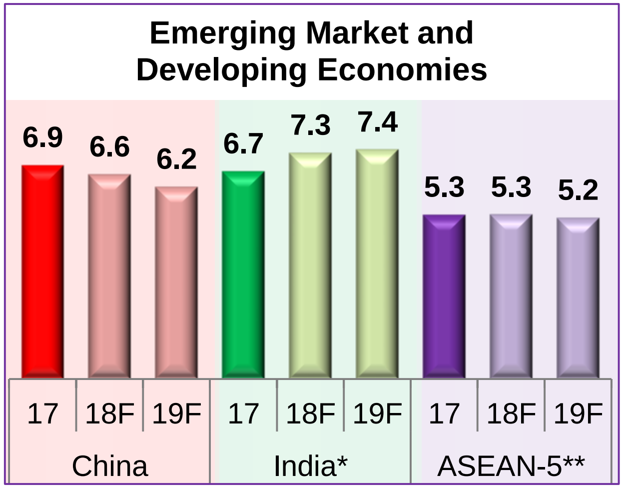


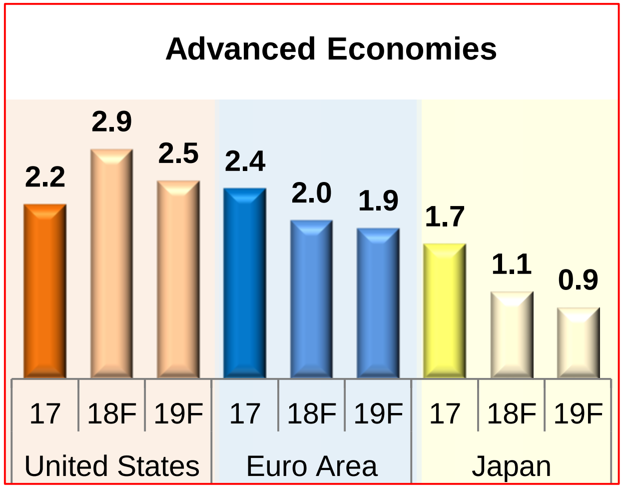
Malaysia Singapore Indonesia Thailand Philippines

Source: Various

GROWTH prospects for advanced and emerging economies







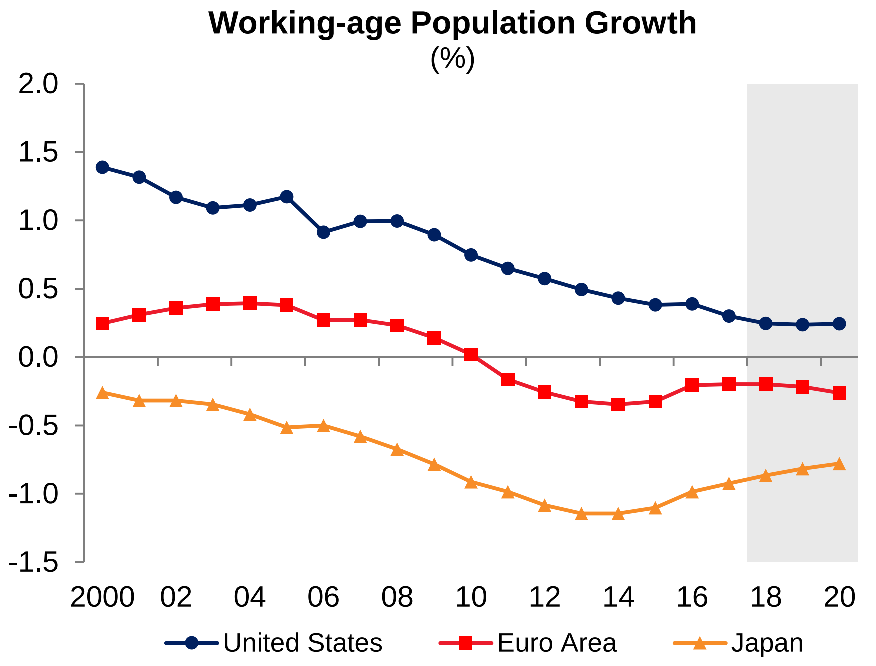
Source: Officials; IMF (WEO, October 2018)

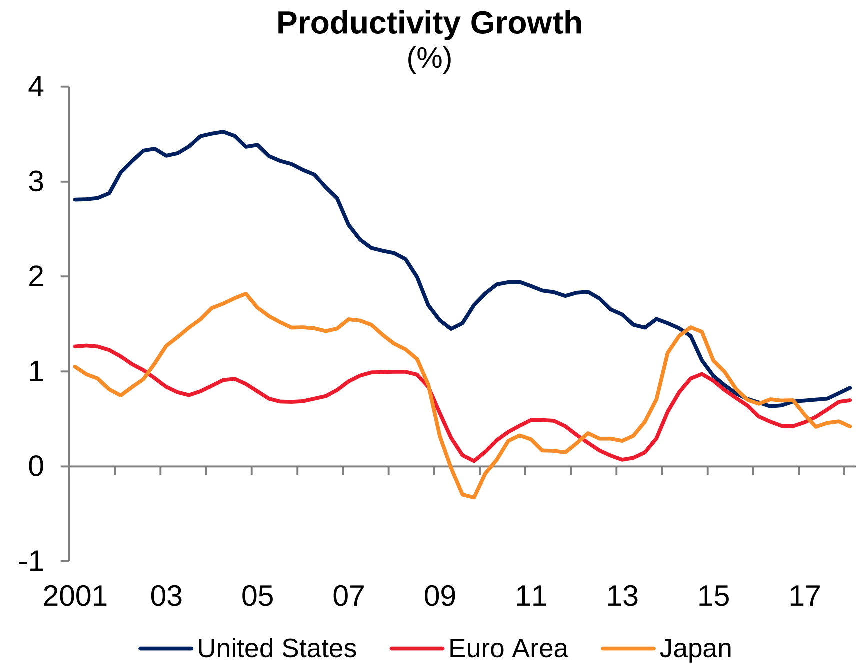
* *Annual GDP for India is on fiscal year basis*

** *ASEAN-5: Malaysia, Indonesia, Philippines, Thailand, Vietnam*

STRUCTURAL risks to restraint potential growth

- **Shrinking working population (aging workforces)** in eurozone and Japan and slower growth in the US.
- Along with **trending slower productivity growth** would constrain the potential output growth and poses downside risks to the longer-term economic growth.





Source: World Bank; Haver Analytics

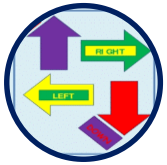
Section 3:

Risks to Global Growth –

Growing downside risks

Global economy still GROWING but MULTIPLE RISKS ahead

Global growth has **MATURED** and **PASSED ITS PEAK**. **INCREASING DOWNSIDE RISKS** to growth over next 18 months.



UNEVEN EXPANSION and **LESS SYNCHRONIZED** in advanced economies and emerging Asia.

"**FIVE RISKS**" increase **global uncertainty**:

1. TRADE WAR

4. INTENSIFIED RISKS IN EMERGING MARKETS

2. RISING US INTEREST RATES

5. POLITICAL AND GEOPOLITICAL RISKS

3. FINANCIAL VOLATILITY

1 TRADE WAR gets ugly; when will it end?

- **First**, **SPILLOVER EFFECTS**. Impact felt not only in the countries involved but across the value chains that span several countries;
- **Second**, **ESCALATION**. Trade flows would be impaired and global growth would be undermined; and
- **Third**, **UNCERTAINTY**. Dampen business confidence and unsettle financial markets.

(Percentage point)	Impact from trade channel	Impact from investment channel
Impact of US tariffs to China	-0.04	
Impact of China tariffs to US	-0.06	
Asia excl. China	-0.01 to -0.03	
Global growth	-0.02	-0.03
Global trade	-0.02	-0.04

IMPACT on Malaysia: Estimated a marginal decline of 0.05-0.15 ppt in GDP growth

Source: BNM

Trade disputes ADVERSELY AFFECT THE US MORE THAN CHINA, due to higher value-added sourced domestically (US: ~82%; China: ~64%)

High integration of EA-8 economies in China's production value chain, particularly E&E products (~18% share of value-added)

- ➔ **LOWER PROFIT from exporters**
- ➔ **DETERIORATION in financial conditions**
- ➔ **DAMPENED business sentiments and investment activities**

1a US-CHINA'S TRADE NUMBERS at a glance

Total Exports in 2017: US$1,546bn
- To China: US$130bn (Share: 8.4%)

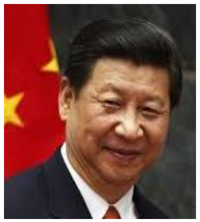
Total Imports in 2017: US$2,342bn
- From China: US$505bn (Share: 21.6%)

Trade deficit with China: US$375bn

Total Exports in 2017: US$2,264bn
- To US: US$430bn (Share: 19.0%)

Total Imports in 2017: US$1,841bn
- From US: US$154bn (Share: 8.4%)

Trade surplus with US: US$276bn



Trade war timeline

First Stage

US imposed tariffs on US$50bn worth of China's imports and retaliated by China with same amount:
(i) US$34bn effective on 6 July; and
(ii) US$16bn effective on 23 Aug

Second Stage

US announced tariffs of 10% on additional US$200bn worth of China's products, effective 24 Sep (will up to 25% comes 2019) and retaliated by China at 5-10% tariffs on additional US$60bn worth of US's products.

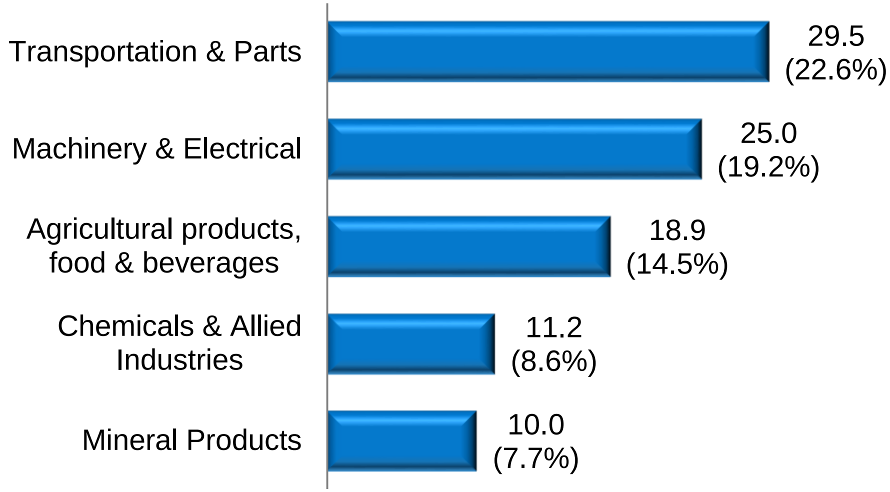
	US's tariffs on US$250bn of Chinese goods	China's tariffs on US$110bn of US's goods
Share of US's total imports	10.7%	
Share of US's total exports		7.1%
Share of imports from China	49.5%	
Share of exports to China		84.7%

	US's tariffs on US$250bn of Chinese goods	China's tariffs on US$110bn of US's goods
Share of China's total imports		6.0%
Share of China's total exports	11.0%	
Share of imports from US		71.5%
Share of exports to US	58.2%	

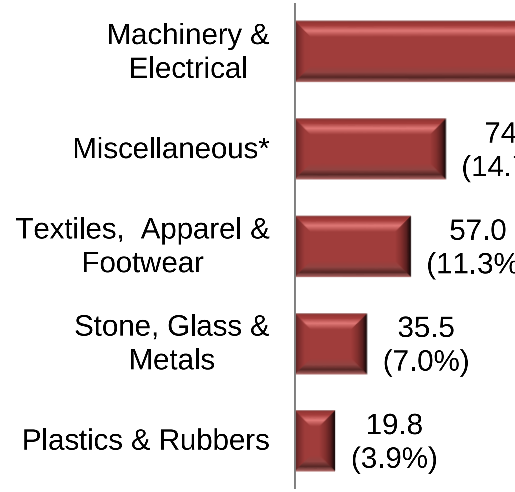
Source: US Census Bureau; China Customs

The industries most AT RISK in the US-China trade war

The US industries most at risk in a trade war with China
Leading export categories by HS code
United States to China in 2017 (US$ billion)



The Chinese industries most at risk in a trade war with US
Leading export categories by HS code
China to United States in 2017 (US$ billion)



** Miscellaneous including furniture & parts, toys, games & sport equipment, optic & medical instruments, etc.*

Figure in parenthesis indicates % share of gross exports in 2017

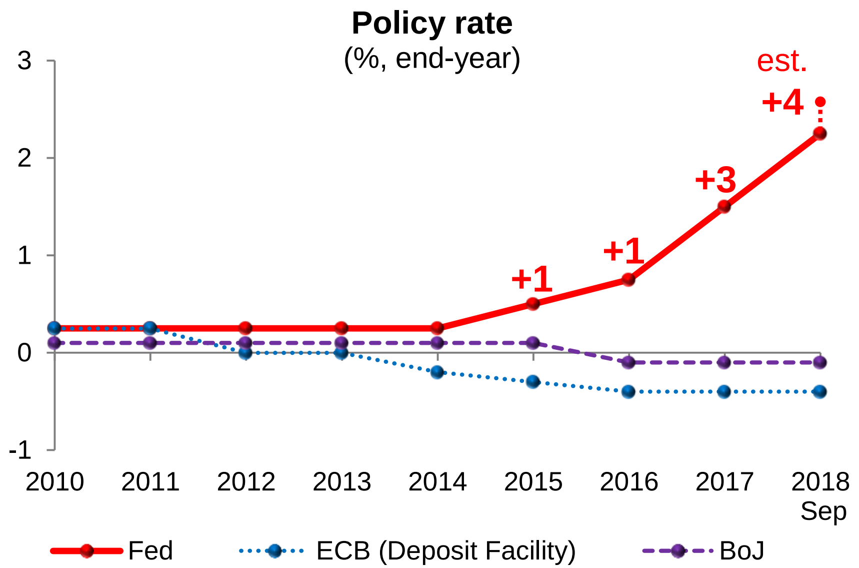
Exposure to the value chain (%)

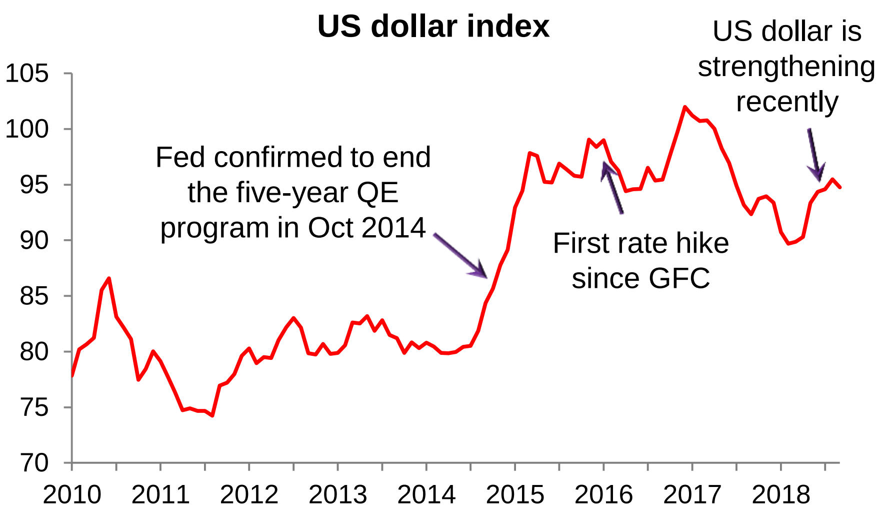
	Indonesia	Malaysia	Singapore	Thailand		Indonesia	Malaysia	Singapore	Thailand
Wood & products	0.1	0.0	0.0	0.1	**Textiles**	1.1	0.6	0.3	0.7
Food products	0.2	0.1	0.0	0.1	**Machinery**	1.1	0.7	0.4	0.5
Electronics	3.4	6.6	2.7	3.0	**Motor vehicles**	0.1	0.0	0.0	0.0
Paper & products	0.1	0.0	0.0	0.0	**Other transport**	0.1	0.1	0.0	0.0
Chemicals	1.0	0.5	0.2	0.4	**Basic metals**	0.9	0.3	0.1	0.1
Electrical machinery	2.8	2.5	1.1	1.8	**Total**	**10.9**	**11.4**	**5.0**	**6.8**

Source: US Census Bureau; Oxford Economics

2 RISING interest rates mean TIGHTER liquidity conditions

- The risk of **RAPID INFLATION** has heightened.
- Further **US INTEREST RATE TIGHTENING CYCLE** (2018E: 2.25-2.50%; 2019F: 2.75-3.25%); ECB to start raise rate in 2H19.
- **HIGHER DEBT SERVICING; TIGHTER FUNDING COST** and **US DOLLAR LIQUIDITY CONDITION**.
- **CAPITAL OUTFLOWS** and **CURRENCIES PRESSURE** in emerging markets.

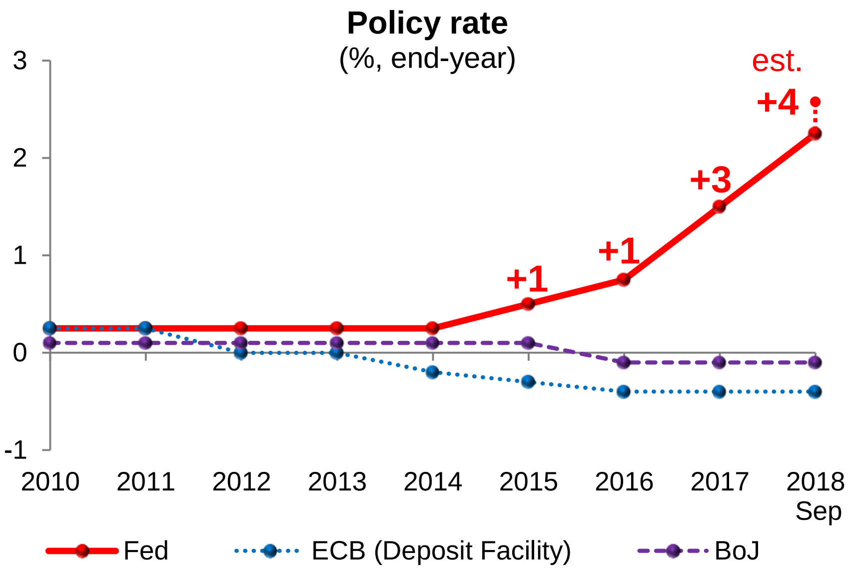


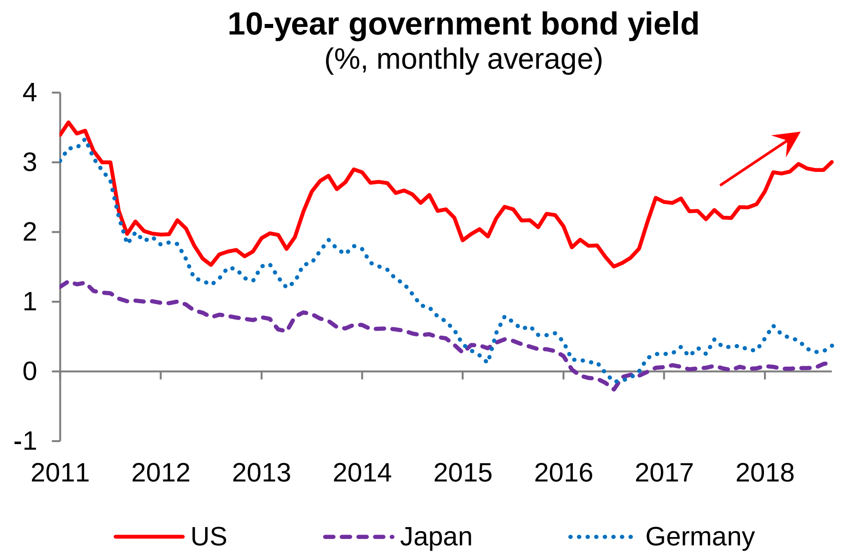


Source: Federal Reserve; ECB; BoJ; The Wall Street Journal

3 FINANCIAL VOLATILITY induces markets' pressure

- Two things are happening that threaten to tighten global financial conditions even more:
- **First**, **HIGHER US INTEREST RATES** and **CONTINUED UNWINDING OF THE FED'S BALANCE SHEET** which withdraws US dollar liquidity from global markets; and
- **Second, INCREASED ISSUANCE** of **US TREASURY BILLS** to fund fiscal expansion, which accentuates tightness in US dollar funding.
- More acute **WITHDRAWAL OF US DOLLAR LIQUIDITY** induces **SERIOUS BOUTS OF FINANCIAL VOLATILITY**.



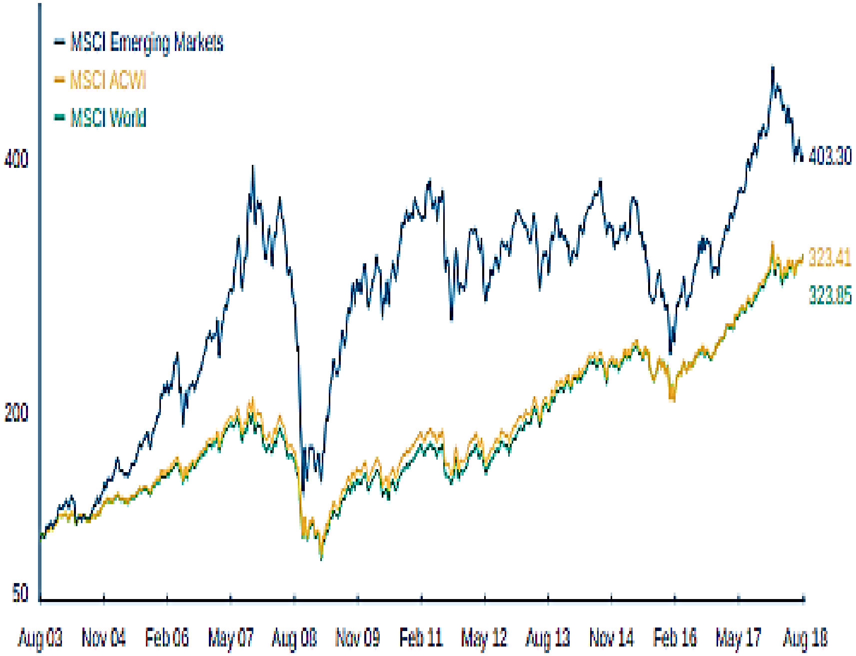


Source: Federal Reserve; ECB; BoJ; U.S. Department of the Treasury; MOF, Japan; Eurostat

CURRENCY CONTAGION RISK in emerging markets

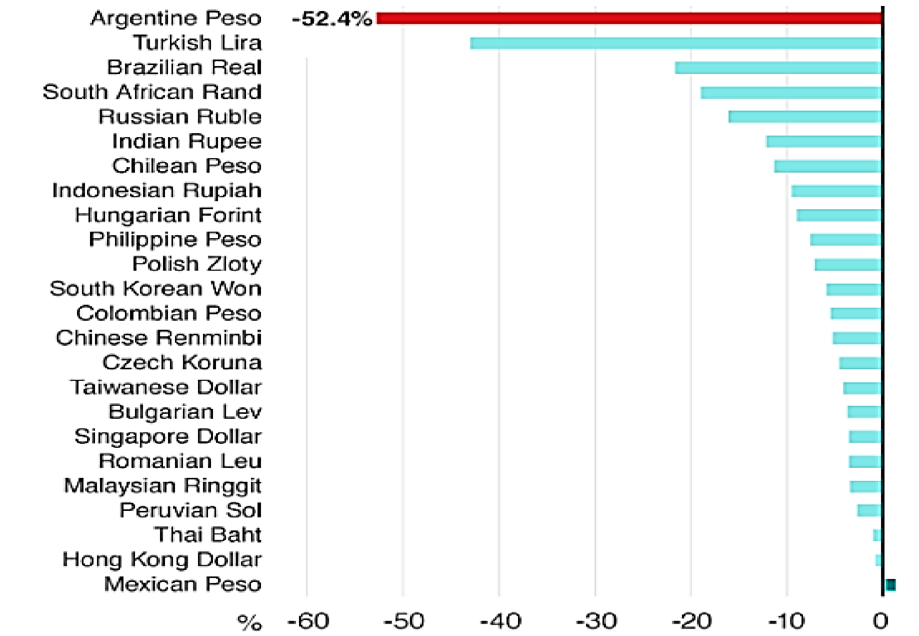
- **POWERFUL CROSSWINDS**: Higher global crude oil prices, rising US interest rates and bond yields, strong US dollar, the escalation of US-China trade war and political conflicts.
- **CAPITAL REVERSALS** and **CURRENCIES PRESSURES** on countries with **WEAK ECONOMIC FUNDAMENTALS** (twin deficits in both budget and external payments position, large foreign debt exposure and high domestic inflation pressures).

Cumulative index performance – net returns (USD) (Aug 2003 – Aug 2018)



Source: MSCI

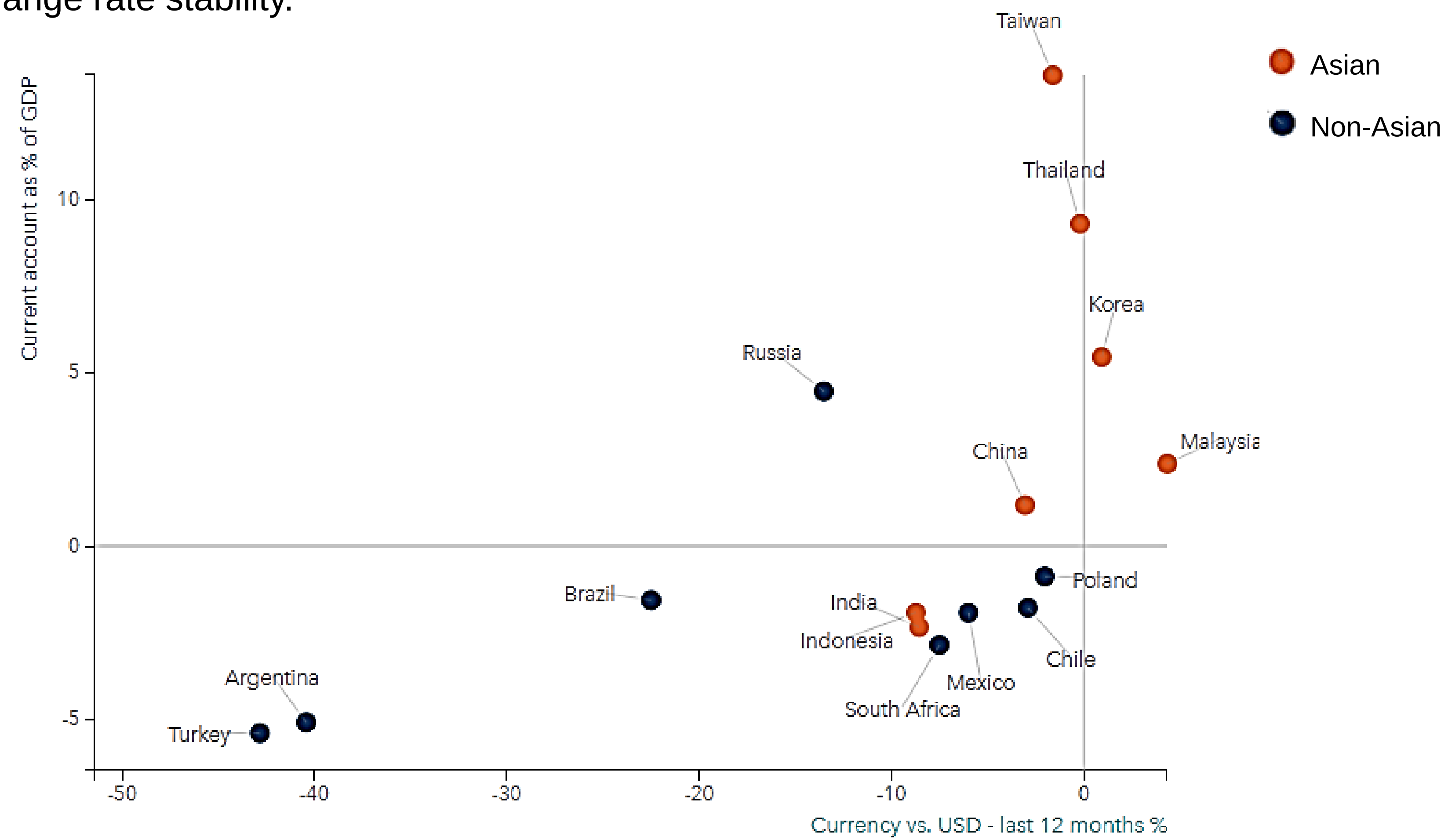
Argentina peso is the worst performing currency against the US dollar in 2018



Source: Bloomberg. Last update 06/09/2018

4 a CONTAGION FEAR in emerging Asia

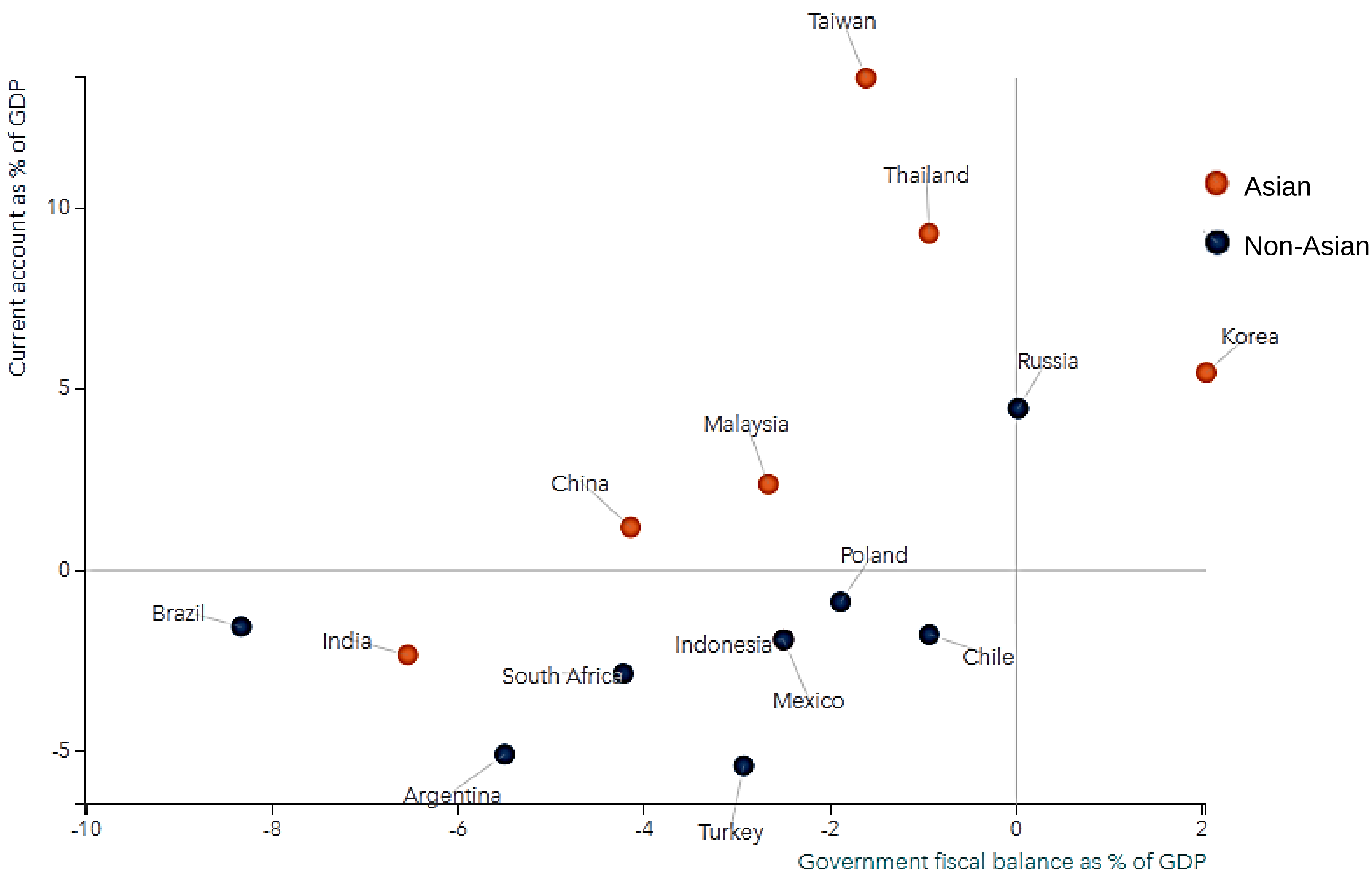
- **STRONGER ECONOMIC FUNDAMENTALS:** Larger foreign reserves and bank capital buffers; robust financial regulatory frameworks. Pre-emptive interest rate hikes to support exchange rate stability.



Source: BlackRock Investment Institute (23 Aug 2018)

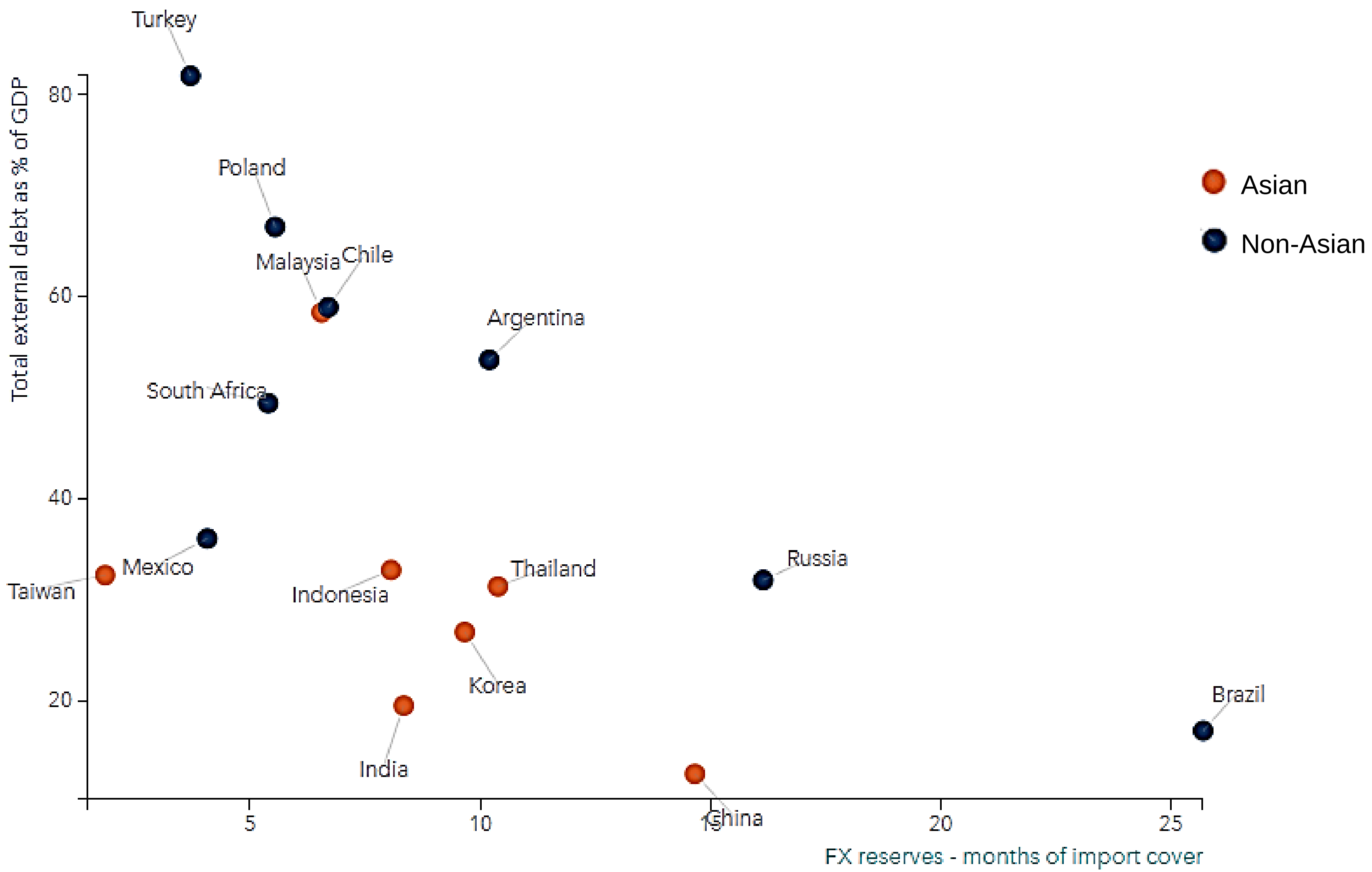
4 b

CONTAGION FEAR in emerging Asia



Source: BlackRock Investment Institute (23 Aug 2018)

4 c CONTAGION FEAR in emerging Asia



Source: BlackRock Investment Institute (23 Aug 2018)

GEOPOLITICAL and POLITICAL risks

PRESIDENT TRUMP – the US **MID-TERM ELECTIONS** (6 November) incites Donald Trump to implement his electoral promises on trade.

The US's SANCTIONS on **IRAN** and **SYRIA WAR** tend to drive up the oil price.

EUROZONE: fiscal slippage in Italy – the coalition government‘s commitment to take the follow actions.

BREXIT NEGOTIATIONS are stalling and governments (in the UK and in the rest of the EU) are openly preparing contingency plans in case of no agreement on 31 March 2019 (Hard Brexit).

CURRENCY CRISIS in **HIGH RISK EMERGING MARKETS** - Turkish financial crisis may get even worse; Argentina's currency woes crisis deepens.

Next GLOBAL RECESSION – What will trigger and when?

First, US's fiscal-stimulus effects **RUNNING OUT OF STEAM**.

Second, with inflation rising above target **PUSHING THE FEDERAL FUNDS RATE TO AT LEAST 3.5%** by 2020. By then, other central banks would have normalized interest rates; reduce global liquidity and put upward pressure on interest rates and the US dollar.

Third, the Trump administration's **ESCALATING TRADE SPATS** with China and other trading partners, leading to slower growth and higher inflation.

Fourth, other countries will retaliate against US protectionism. **CHINA'S GROWTH** will be challenged by continued deleveraging; highly vulnerable emerging markets will be significantly pressured by capital reversals.

Fifth, GLOBAL EQUITY MARKETS ARE GETTING FROTHY. US P/E ratio is 50% above historical average, steep market valuations, government bonds are too expensive. Global debt has hit another high (US$247 trillion, exceeding 318% GDP at end-Mar). Some of the US$3.7 trillion in debt taken on in the ten years since the 2008-09 Global Financial Crisis.

THE EXPANSION IS NINE YEARS OLD. AN ILL-TIMED END OF FISCAL STIMULUS, CORPORATE DEBT BUBBLE AND THE TRADE WAR ARE THE POWERFIRES THAT COULD MOST EASILY END IT

Section 4:

Domestic economic conditions:

Challenging Transition for New Malaysia

New Malaysia in TRANSITION: Policy PRIORITIES

POLITICAL AND ECONOMIC POLICIES TRANSITION – adjustment and transition costs; short-term pain for long-term gains if the Government wants to be **LEANER, MEANER AND BETTER**.

First, is to **RESTORE THE RULE OF LAW AND ACCELERATE INSTITUTIONAL REFORMS** for better Government and governance.

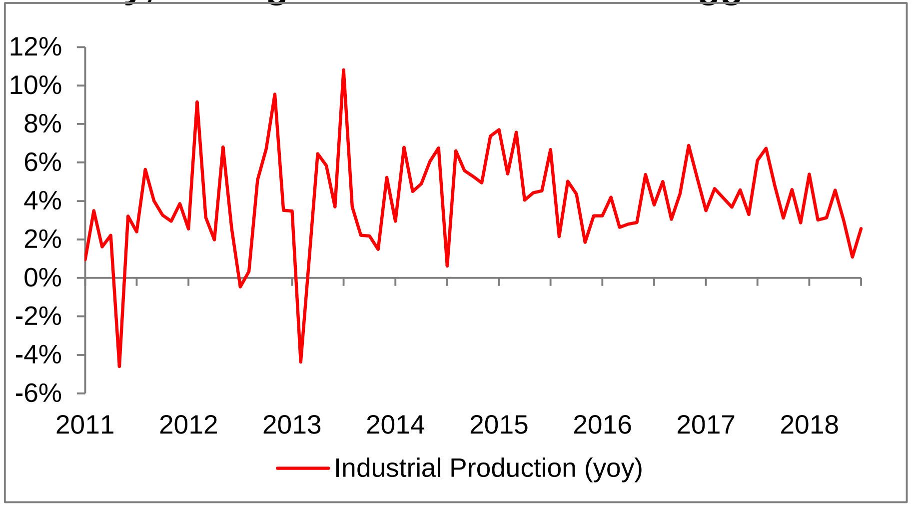
Second, **FISCAL RECONSTRUCTION** to maintain **FISCAL DISCIPLINE AND RESPONSIBLE BUDGET** as well as debt controls through reduced waste, leakage and weed out corruption.

Third, **RESTRUCTURE THE GOVERNMENT (PUBLIC SECTOR, including GLCS)** and **INSTITUTIONS** to restore public trust; to become a more effective and responsive enabler as well as good regulator.

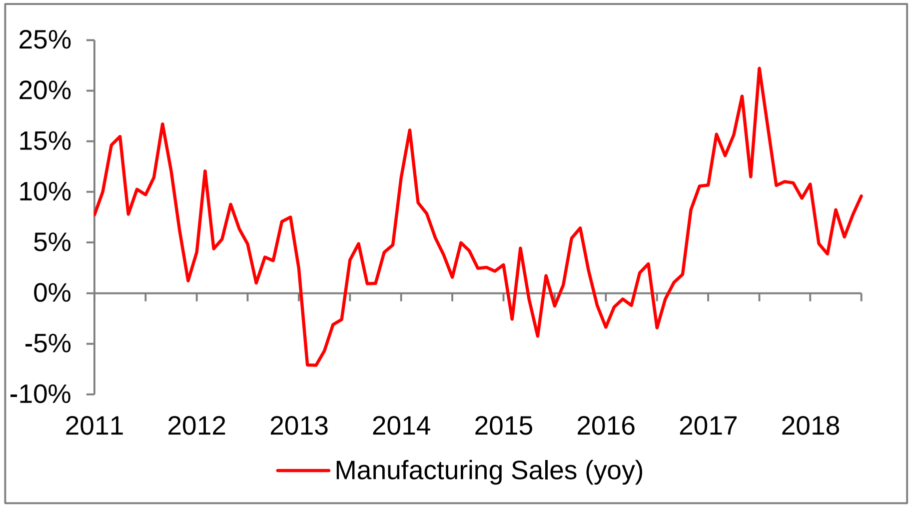
A SMALLER, LESS INTRUSIVE ROLE FOR GOVERNMENT, MUCH MORE CONTAINED PUBLIC SERVICE AND A BIGGER ROLE FOR THE PUBLIC-PRIVATE PARTNERSHIPS UNDER MALAYSIA INCORPORATED

Malaysia: ACTIVITY INDICATORS remain on track

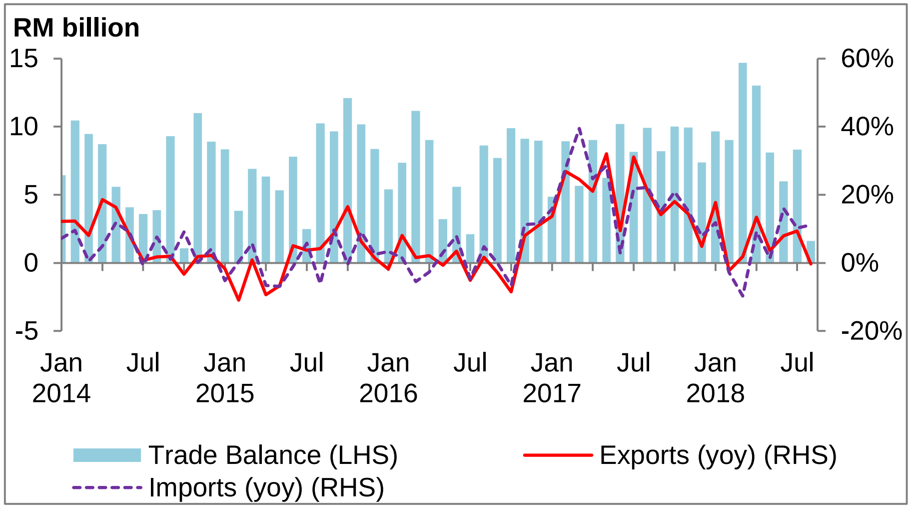
Manufacturing production continues to grow steadily; mining activities remained sluggish



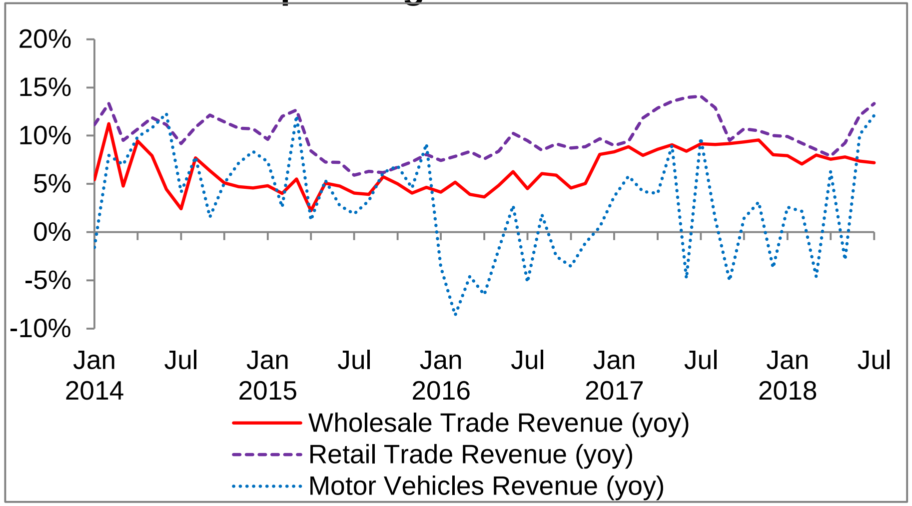
Manufacturing sales growth is regaining traction



In September, exports growth contracted for the second time in 2018



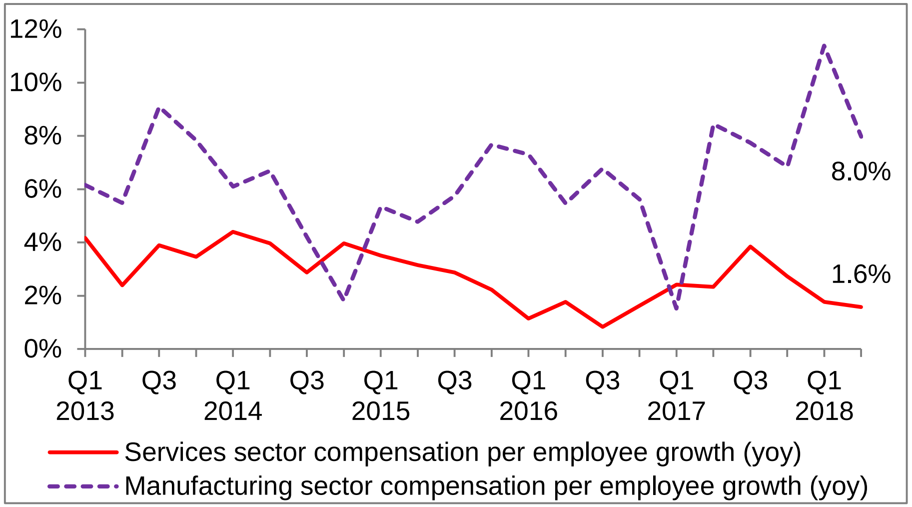
Three months tax holiday (zero-rated GST) boosted retail spending. Will it be a one-off?



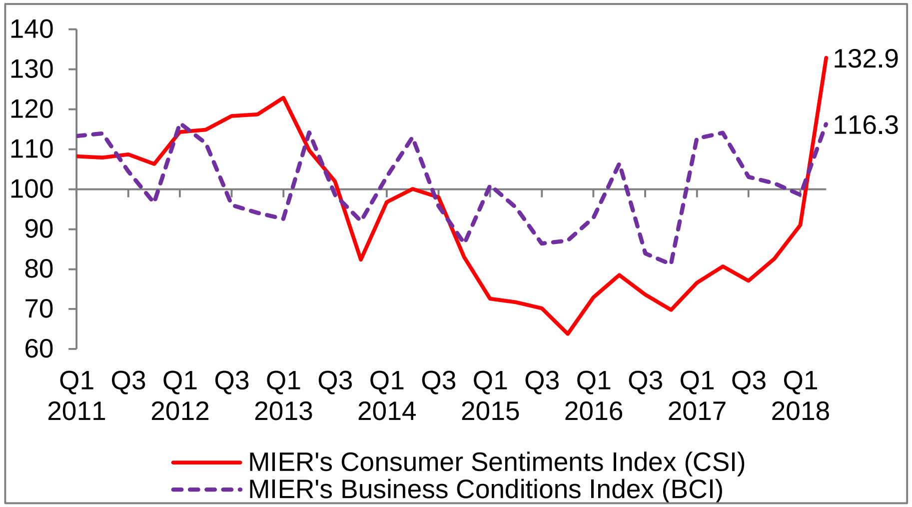
Source: DOSM

Consumption RESILIENCE; IMPROVED investment sentiment

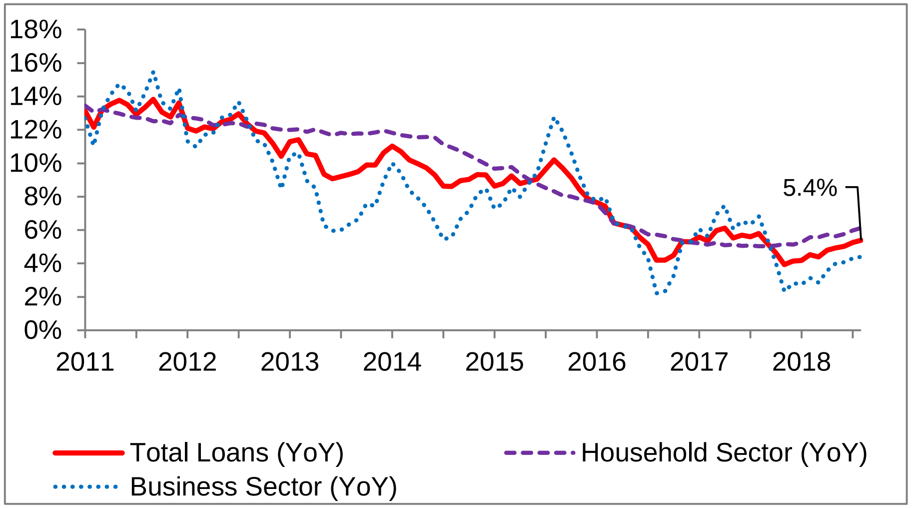
Growing salaries and wages in private sector, albeit slower in services sector



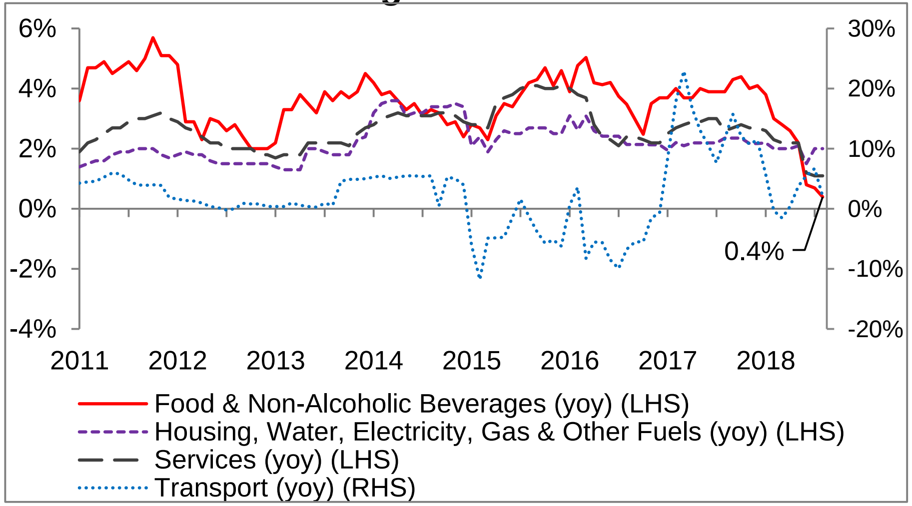
Consumer sentiments surged to 21-year high; better business confidence



Higher loan growth since April, lifted by both households and business sectors



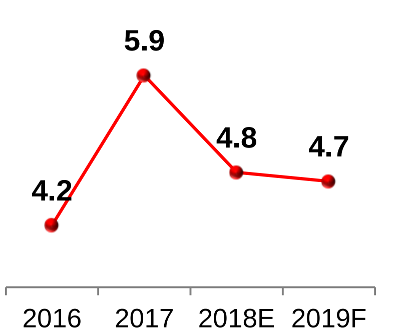
Marginal increase in food prices, core CPI has declined for two straight months



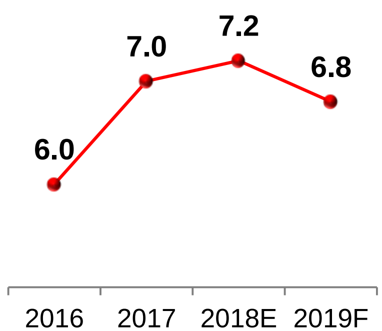
Source: DOSM; MIER; BNM

Malaysia's key ECONOMIC INDICATORS

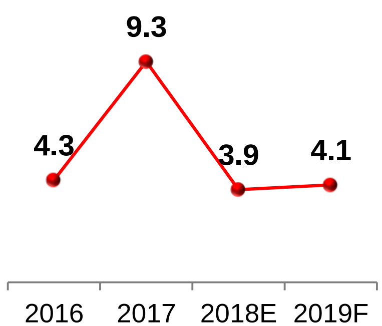
Real GDP growth
(%)



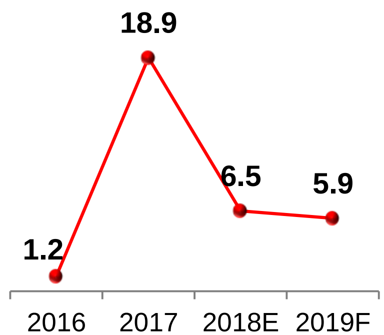
Private consumption growth
(%)



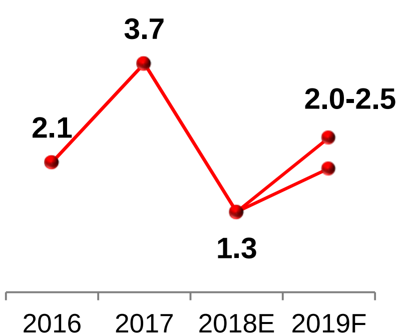
Private investment growth
(%)



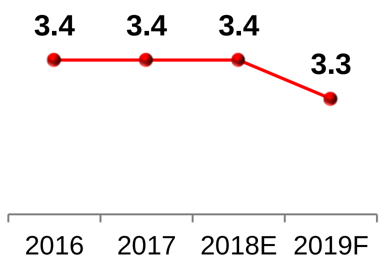
Gross export growth
(%)



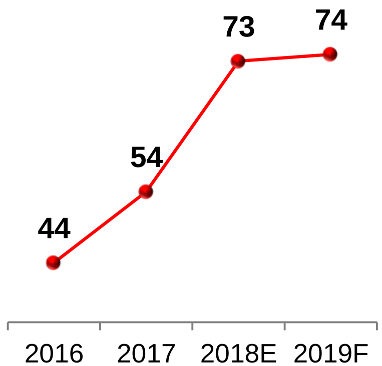
Inflation rate
(%)



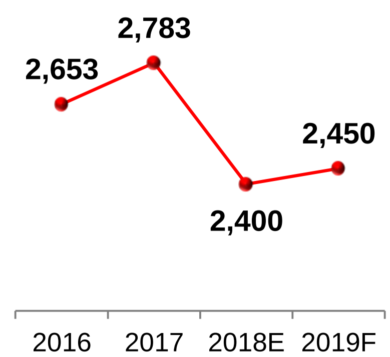
Unemployment rate
(%)



Brent crude oil price
(US$/barrel)



Crude palm oil price
(RM/tonne)



Source: DOSM; BNM; EIA; MPOB; SERC

Malaysia economy in TRANSITION

STILL POSITIVE GROWTH MOMENTUM. Based on an average 4.9% growth in 1H18, we estimate this year's GDP growth at 4.8%, underpinned largely by consumers demand and exports, albeit negative sentiment risks from the trade tariffs battle and damaging market volatility.

EXPORTS are expected to rise at a moderate pace (2018E: 6.5% vs. 18.9% in 2017). In the first seven months of 2018, exports up 7.3% yoy, with the drivers coming from electronics and electrical products as well as higher crude oil prices.

PRIVATE CONSUMPTION (2018E: 7.2% vs. 7.0% in 2017), thanks to cost of living allowance, stabilized fuel prices, zerorised GST and personal income tax rate cut. The introduction of SST on 1 Sep is expected to take some heat off consumer spending.

PRIVATE INVESTMENT growth had a very subdue start of 3.4% yoy in the first half-year of 2018 on lingering uncertainty ahead of the General Election 14, will likely to pace cautiously given the political and new government's policies transition as well as external headwinds. But, **GOOD GOVERNANCE** and **TRANSPARENCY** will enhance investment prospects over the medium-term.

Growth OUTLOOK for 2019

SUSTAINED POSITIVE ECONOMIC GROWTH. Baseline GDP growth estimate is 4.7% for 2019, supported by continued global growth and trade as well as domestic demand, albeit moderately. Downside risks have increased.

EXPORTS are expected to rise at a moderate pace (2019F: 5.9% vs. 6.5% in 2018), supported by moderate global demand and recovery in commodity prices.

PRIVATE CONSUMPTION (2019F: 6.8% vs. 7.2% in 2018) as households' spending normalize amid the stabilization of fuel prices and the implementation of SST on 1 September 2018.

PRIVATE INVESTMENT growth (2019F: 4.1% vs. 3.9% in 2018) will improve slightly on continued cautious about external environment due to the likely protracted and deepening trade war between the US and China. The review, deferment and cancellation of major infrastructure projects will continue to impact private investment.

DOWNSIDE RISKS to GDP growth: DEEPENING TRADE TARIFFS BATTLE; AGGRESSIVE HIKES IN US INTEREST RATE DRIVE CAPITAL REVERSALS AND FINANCIAL MARKET VOLATILITY

社会经济研究中心

SOCIO-ECONOMIC RESEARCH CENTRE

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