QUARTERLY ECONOMY TRACKER

(JAN-MAR 2019)

Socio-Economic Research Centre (SERC)

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Socio-Economic Research Centre (SERC)

Executive Director

Mr. Lee Heng Guie - *hglee@acccimserc.com*

Senior Researcher

Mr. Lee Soon Thye - *stlee@acccimserc.com*

Researcher

Mr. Low Kok Tong - *ktlow@acccimserc.com*

Mr. Goh Kong Jun - *kjgoh@acccimserc.com*

Ms. Look Yuen Kei - *yklook@acccimserc.com*

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Executive Summary

World Economic Situation and Prospects for 2019

Global growth is moderating amid fears of a global recession. In the second half-year of 2018, isolated evidence and high frequency indicators confirmed that global growth had peaked. The data since the turn of the year has been unambiguous with major advanced economies and China looking weaker than they did twelve months ago. All signs are pointing towards a synchronized slowdown in advanced and emerging economies. Moderating economic activities and heightened policy risks are clouding global economic prospects. Global trade and investment have softened. Business and consumer confidence have fallen on concerns about the global economy.

Global growth forecasts lowered. The International Organisations and Institutions have concurrently lowered global growth forecasts, citing rising risks associated with trade tensions and tightening financial conditions. (a) The International Monetary Fund (IMF) further cut its global growth projection for 2019 to 3.3% from 3.5% previously, marking the third revision from 3.7% and 3.9% previously; (b) The Organisation for Economic Co-operation and Development (OECD) lowered its forecast to 3.3% for this year, down from the 3.5% made in November 2018; and (c) The World Bank downgraded its outlook for the global economy to grow by 2.9% in 2019 from 3.0% forecasted in June last year.

Signs of slowing momentum in most major advanced and emerging economies. (a) The US economy is reeling the effect of fading fiscal stimulus, lingering uncertainties about the trade friction outcome and the lagged impact of monetary tightening; (b) Growth in euro area is dampened by sluggish global trade, geopolitical uncertainty and policy risk about sovereign debt and budget in Italy; (c) Japan's too is influenced by global trade uncertainty, slowing China demand and a downturn in the global tech cycle; and (d) China's growth is teetering on a slowing path due to ongoing structural reforms, trade disputes amid monetary easing and fiscal support.

Global central banks switching towards a dovish monetary mode. Worrying about the risks clouding global economic prospects and the spillover effects on domestic economy, it makes sense for global central bankers to go into a wait and see mode, slanting towards more dovish shift in monetary policy. The US Federal Reserve (Fed) has pivoted towards renewed dovishness as it signalled the pausing of interest rate normalisation amid ending its balance sheet reduction by September this year. Some emerging market central banks have switched from tightening into easing mode starting February, taking cue from the Fed's dovish turn and a dollar rally that has run out of steam, for now.

Four clouds undermining the global economy. While the risk of an outright global recession is low for this year, we are heading into a year of synchronised global growth deceleration. The main factors undermining the global economy are: (a) Unresolved trade tensions and tariff escalations; (b) Tightening of financial condition; (c) Uncertainty related to Brexit outcome; and (d) Spillover impact from an accelerated slowdown of the US and China economy.

Malaysia's Economic and Financial Conditions

Economic environment still challenging in 2019. Weighing on moderating global growth, weakening exports amid cautious domestic sentiments, SERC expects real GDP growth to grow by 4.5-4.7% this year (4.7% in 2018), which is somewhat in line with Bank Negara Malaysia (BNM)'s estimates of 4.3-4.8% released in March. The balance of risks is tilted towards the downside.

Economic indicators pointing towards growth moderation. The leading index, which indicates the direction of economy in average four to six months ahead, exports, industrial production and loans data suggest that domestic economic and business conditions continued to remain moderate. Our preliminary estimate of GDP growth for the first quarter is 4.4% as against 4.7% in 4Q18.

Tracking of private consumption and private investment indicators. Consumer spending has turned cautious as reflected in car sales volume growth moderated to 0.4% yoy in February from 10.7% in January. Imports of consumption goods contracted by 11.6% in February while loans extended for consumption credit also grew moderately. The payment of the first phase of 2019 Cost of Living Aid (BSH) of RM300 for eligible households on 28 Jan is expected to benefit up to 4.1 million households involving an allocation of RM1.2 billion. Private investment indicators, loans extended for businesses and imports of capital goods were disappointing. This coupled with cautious business conditions are expected to weigh on private investment.

ACCCIM's M-BECS suggests cautious economic and business conditions. The Associated Chinese Chambers of Commerce and Industry Malaysia (ACCCIM) Malaysia's Business and Economic Conditions Survey (M-BECS) lend credence to our assessment of a challenging year for the economy and businesses. Faced with the softening global growth, still considerable external headwinds amid weak domestic sentiment, businesses in Malaysia are generally cautious about the economic outlook in 1H19 with 50.2% of respondents were "neutral" and 37.5% were "pessimistic". Only 12.3% of total respondents were "optimistic". On balance, businesses are of the view that the Malaysian economy would remain challenging in 2019 as there are higher respondents (32.6%) who are "pessimistic" relative to being "optimistic" (15.3%).

Exports unexpectedly contracted in February. Amid the shorter working days during the festive celebration, exports fell more than expected by 5.3% yoy in February, the first contraction since August last year as trade slowed with most of its partners and also major products (palm oil, crude petroleum and petroleum products). External trade for the months of March to May are crucial to watch as the market is awaiting the US-China's trade talks outcome. SERC estimated total exports growth to pace at a slower rate of 3.3% in 2019 compared to 6.8% in 2018. The dampening factors on exports are slowing global demand, weak global semiconductor sales as well as moderate commodity prices.

Negative inflation for two successive months. The Consumer Price Index (CPI) continued to contract by 0.7% yoy in January and 0.4% yoy in February, marking the first deflation since end-2009. It is merely a technical deflation due to the decline in fuel prices and the replacement of Goods and Services Tax (GST) with Sales and Service Tax (SST). Domestic demand conditions though have softened but did not experience a broad-based fall in prices of goods and services. Core inflation stays in positive territory. SERC expects headline inflation to average 1.0-1.5% in 2019 (1.0% in 2018) as against BNM's estimated 0.7-1.7% due to some cost pass-through from domestic cost factors. These include the lapse in consumption tax policy; increase in minimum wage and higher electricity surcharges for businesses; and potential higher increase in food prices.

Domestic interest rate on watch. With inflation risk being put on the back burner, BNM is expected to focus on sustaining domestic demand to counter the impact of moderating global growth on exports. The monetary policy decision will be data dependent. Chances of a cut in BNM's overnight policy rate (OPR) have increased in the Monetary Policy Committee (MPC) meeting on 7 May. We expect the OPR to reach 3.00% by end-2019 (3.25% at end-2018).

The ringgit continues to face headwinds. On the back of lingering uncertainties in external environment such as moderating global economic growth, slowing exports amid the outcome of ongoing trade friction negotiations, the ringgit continues to move between RM4.0605 and RM4.1425 per US dollar in recent months.

It remains vulnerable to the bout of negative sentiment and developments that would trigger portfolio investment rebalancing. The announcement by FTSE Russell putting Malaysia on a watch list of fixed income markets for a review for potential downgrade to "1" from "2" currently would render Malaysia ineligible for inclusion in FTSE World Government Bond Index (WGBI) at the September 2019 review. This may add downward pressure on the ringgit as foreign investors rebalance their portfolio investment holdings. Nevertheless, the pressure from increasing Fed fund rate is relieved at the moment as the Fed released a stronger pausing signal of rate hike for this year, at least. On home front, the fundamental factors like the projected continued economic growth, current account surplus and regaining ground of foreign reserves would continue to support the ringgit. The ringgit is estimated at RM4.00-4.15 per US dollar at end-2019 (End-2018: RM4.1385/US$).

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GLOBAL ECONOMY SLOWING; RECESSION RISK LOW

From a synchronised expansion to growth deceleration. Major International Institutions and almost all market consensus is forecasting the global economy, which was firing on all cylinders in 2018 with its growth had peaked in 2H18, is now looking to grow less strongly in 2019, moving from a synchronised growth expansion to growth deceleration.

Table 1: Real GDP growth (% YoY)

	2017	2018	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019*e* (IMF)	2019*e* (WB)	2020*f* (IMF)	2020*f* (WB)
United States	2.2	2.9	2.6	2.9	3.0	3.0	2.3	2.5	1.9	1.7
Euro Area	2.4	1.9	2.4	2.2	1.6	1.2	1.3	1.6	1.5	1.5
China	6.8	6.6	6.8	6.7	6.5	6.4	6.3	6.2	6.1	6.2
Japan	1.9	0.8	1.3	1.5	0.1	0.3	1.0	0.9	0.5	0.7
India[1]	7.2		7.7	8.0	7.0	6.6	7.3	7.5	7.5	7.5
Malaysia	5.9	4.7	5.4	4.5	4.4	4.7	4.7	4.7	4.8	4.6
Singapore	3.9	3.2	4.7	4.2	2.4	1.9	2.3	-	2.4	-
Indonesia	5.1	5.2	5.1	5.3	5.2	5.2	5.2	5.2	5.2	5.3
Thailand	4.0	4.1	5.0	4.7	3.2	3.7	3.5	3.8	3.5	3.9
Philippines	6.7	6.2	6.5	6.2	6.0	6.3	6.5	6.5	6.6	6.6
Vietnam	6.8	7.1	7.5	6.7	6.8	7.3	6.5	6.6	6.5	6.5

Source: Officials (unadjusted data except quarterly GDP for Euro Area); IMF (World Economic Outlook, Apr 2019); World Bank (Global Economic Prospects, Jan 2019; South Asia Economic Focus, Spring 2019)

Risks to global economy. Global trade tensions, monetary policy uncertainty in advanced economies, downside risks in Europe and an apparent slowdown in China are cited as key factors to watch in 2019. These anxieties come at the time when the US economy is experiencing some real feedback effects from the tightening of financial conditions, trade tensions with China, volatility in the stock market, the strong dollar, the cumulative impact of higher cost of borrowing on interest sensitive sectors.

The outlook for many emerging-market economies, especially for those exports-and commodity driven will remain susceptible to external vagaries. The chief risks include slowdowns in the US or China economy, higher US inflation and a subsequent change in the Fed's monetary stance, how the US-China's trade truce play out as well as the direction of oil and commodity prices.

High frequency data pointing to easing momentum. Leading the pack is the February 2019's OECD Composite Leading Indicators (CLIs), which anticipate turning points in economic activity relative to trend six to nine months ahead, continue to anticipate easing growth momentum in most major economies while that of China points to signs of stabilizing growth momentum. Both business and consumer confidence have been continuously falling in recent months. Next is global Purchasing Managers' Index (PMI) for manufacturing sector remained weak as new orders stagnated and new export business contracted. Global trade and industrial output also exhibited similar weakening trend.

The World Trade Organisation (WTO) slashed its world merchandise trade growth forecast to 2.6% this year from 3.7% previously (3.0% in 2018) but expects some pick-up to a 3.0% growth in 2020. In addition, the World Semiconductor Trade Statistics (WSTS) expects its 2019's sales performance to contract by 3.0%, revised lower from a moderate growth of between 2.6% and 5.2% previously (13.7% in 2018), dragged by lower sales in memory products.

Brent crude oil prices have upped more than 30% since end-2018 (US$51/bbl) to US$68/bbl in end-March and crossed above US$70/bbl level in April. In 1Q19, Brent crude oil prices averaged at US$63.10 per barrel. The OPEC+ (OPEC and allies), which have pledged to cut the crude oil supply by 1.2 million barrel per day in 1H19 may reduce the quantum in the forthcoming meeting in June to regain market share, could cap further increase in crude oil prices.

Global central banks on easing mode. Taking cue from the Fed's dovishness of pledging no rate hike for this year and also to end its balance sheet reduction by end-September, global central bankers are generally erring on the caution side or have lowered interest rates to mitigate unwanted side effects of slowing global growth on domestic economy.

Essentially, the central banks have to make careful assessment about the balance of risks between growth and inflation (financial imbalances). This boils down to whether they are behind or ahead of the interest rate curve without significantly reducing demand for goods and services.

The current signs of softening US economic growth warrant the Fed to pause its interest rate hiking journey to ensure a gentle soft landing given the onslaught of external headwinds. However, the Fed can always recalibrate its monetary stance should it assessed that the economy no longer needs supportive accommodative monetary policy. It must be noted the labour market remains robust, and if wages rise more coupled with high wage demand-fuel inflation, the Fed may reconsider its patience in holding the monetary tightening.

The **European Central Bank** (ECB) pledges to maintain its key interest rates at least through the end of 2019 and also provides fresh loans facility to stimulate bank lending in the face of weakening growth and external risks.

Bank of Japan (BOJ) is expected to continue with its stimulus program in order to achieve the Bank's inflation target in a stable manner for an extended period of time as price pressures remain subdued.

The **People's Bank of China** (PBC) has implemented easing monetary measures via the reduction in reserve requirement ratio (RRR) to free up more funds in the market as well as supporting financial assistance to the small and private enterprises. PBC is expected to maintain a balanced or slightly accommodative monetary stance this year to keep economic growth at above 6%.

The Reserve Bank of India unexpectedly lowered policy rates twice in the first quarter of 2019 and also changed its policy stance to "neutral" to boost a slowing economy after a sharp slide in the inflation rate.

Table 2: Policy rate (%)

End-period of	2011	2012	2013	2014	2015	2016	2017	2018	2019 (Mar/Apr)	2019*E*
US, Fed **Federal Funds Rate**	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.25-0.50	0.50-0.75	1.25-1.50	2.25-2.50	2.25-2.50	2.25-2.50
Euro Area, ECB **Deposit Facility**	0.25	0.00	0.00	-0.20	-0.30	-0.40	-0.40	-0.40	-0.40	-0.40
Japan, BOJ **Policy Rate**	0.00-0.10	0.00-0.10	0.00-0.10	0.00-0.10	0.00-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
China, PBC **1-Year Benchmark Loan I/R**	6.56	6.00	6.00	5.60	4.35	4.35	4.35	4.35	4.35	4.35
India, RBI **Policy Repo Rate**	8.50	8.00	7.75	8.00	6.75	6.25	6.00	6.50	6.00	6.00
Korea, BOK **Base Rate**	3.25	2.75	2.50	2.00	1.50	1.25	1.50	1.75	1.75	1.75
Malaysia, BNM **Overnight Policy Rate**	3.00	3.00	3.00	3.25	3.25	3.00	3.00	3.25	3.25	3.00
Indonesia, BI **7-Day RR Rate**	6.50	5.75	7.50	7.75	7.50	4.75	4.25	6.00	6.00	6.00
Thailand, BOT **1-Day Repurchase Rate**	3.25	2.75	2.25	2.00	1.50	1.50	1.50	1.75	1.75	1.75
Philippines, BSP **Overnight RR Facility**	4.50	3.50	3.50	4.00	4.00	3.00	3.00	4.75	4.75	4.75

Source: Officials; SERC

CURRENT AND FORWARD INDICATORS

A slew of high frequency indicators indicates slowing global momentum ahead. The pace of growth in the manufacturing sector has decelerated while that of services grew unevenly. Global semiconductor sales continue to contract on the back of a prolonged slowdown in demand.

Figure 1: CLIs continue pointing to easing momentum in overall OECD area

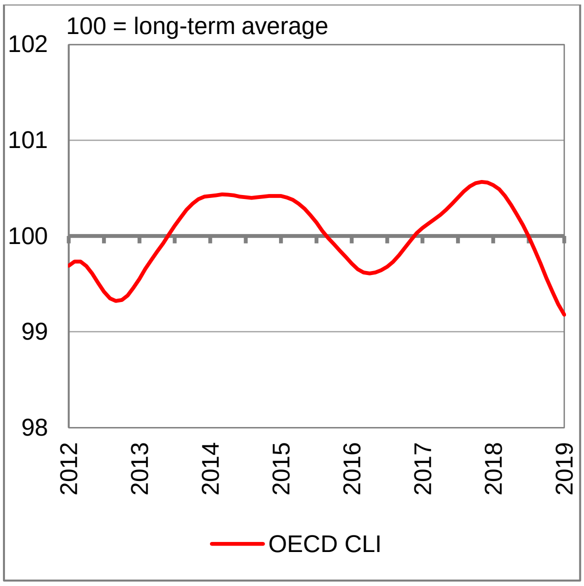


Figure 2: Global manufacturing sector remained weak, lowest in nearly three years

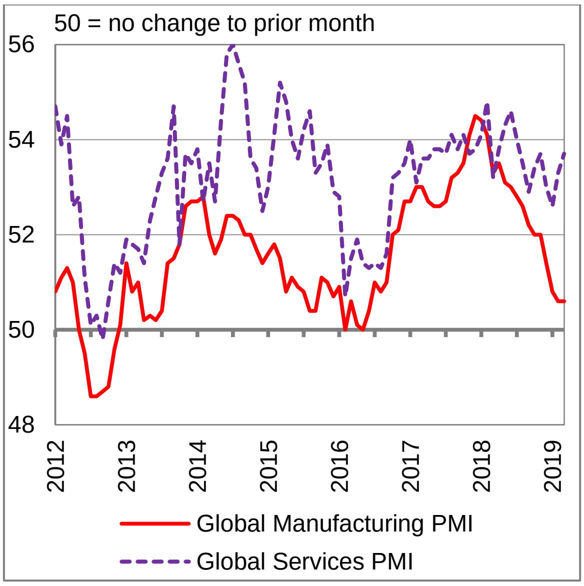


Figure 3: Both world trade volume and production are adversely impacted by the elevated trade war

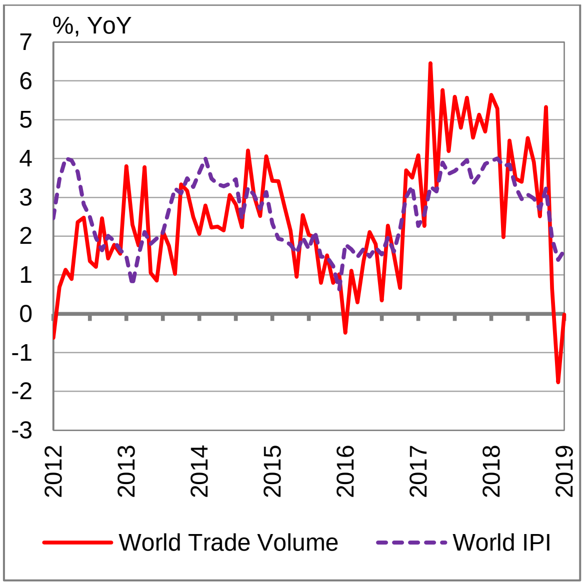
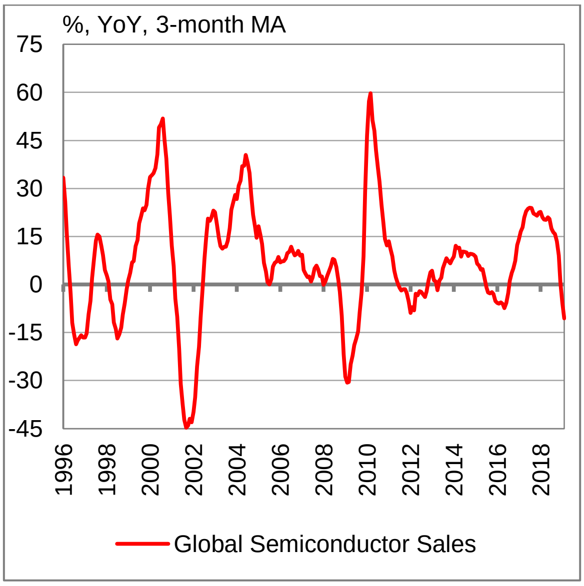


Figure 4: Global semiconductor sales contracted across all major regions in February



Source: OECD; Markit; CPB Netherlands Bureau for Economic Policy Analysis; Semiconductor Industry Association (SIA)

Global business and consumer confidence slip on concerns surrounding global economy, trade tensions, geopolitical and policy risks in advanced economies.

Figure 5: OECD Business Confidence Index

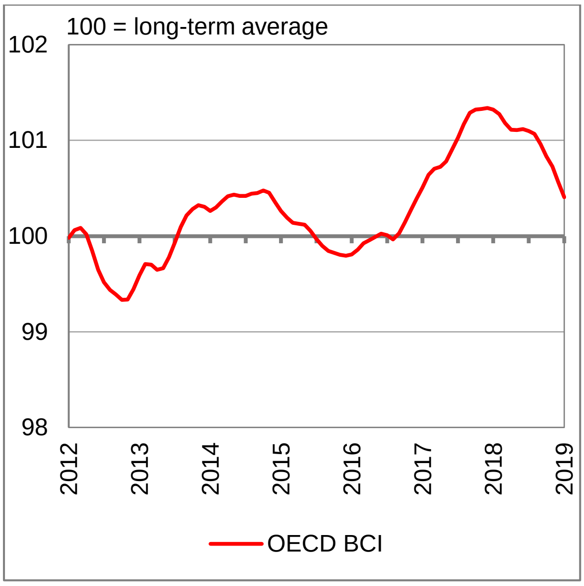
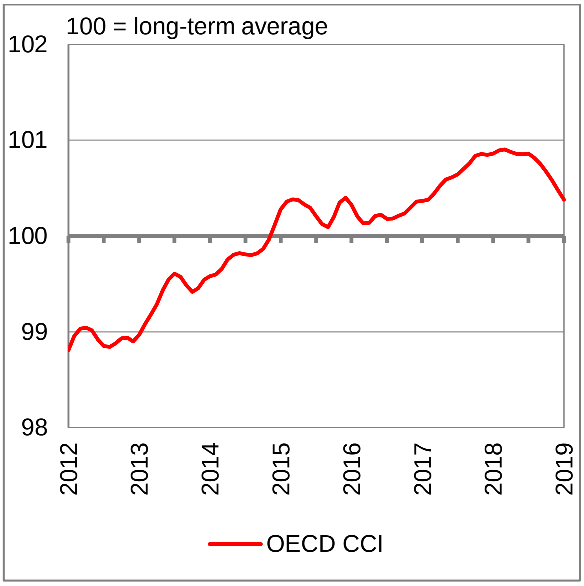


Figure 6: OECD Consumer Confidence Index



Source: OECD

Crude oil prices rallied on persistent themes of OPEC+'s oil output cut discipline, sanctions on Iranian/Venezuelan exports and seemingly resilient demand.

Figure 7: US EIA projects Brent crude oil prices to average at US$65/bbl in 2019

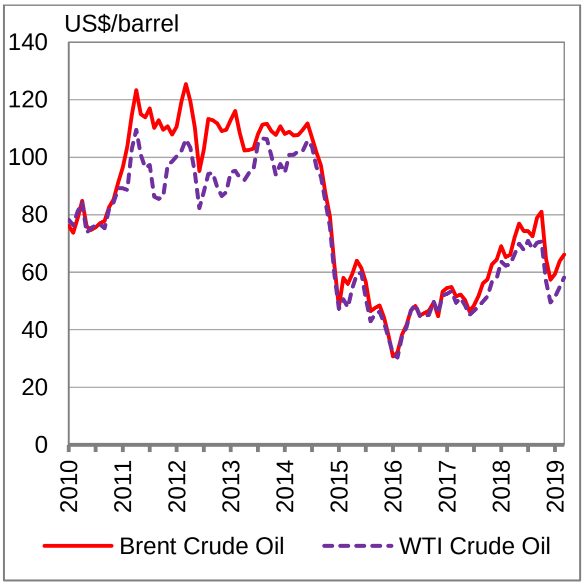
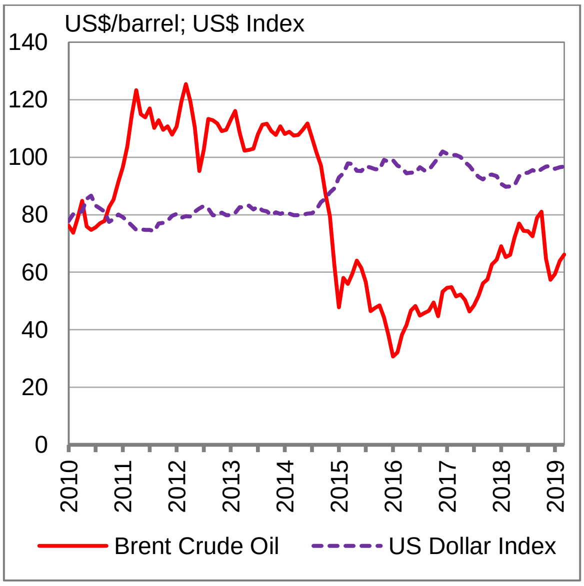


Figure 8: Brent crude oil price vs. the US dollar index



Source: US Energy Information Administration (EIA); The Wall Street Journal

CPO prices seen supported by mild weather conditions, the rationalisation of palm oil inventories in Malaysia and Indonesia as well as easing fears of a worsening trade war between the US and China.

Figure 9: Energy prices ticking up while commodity prices moderating

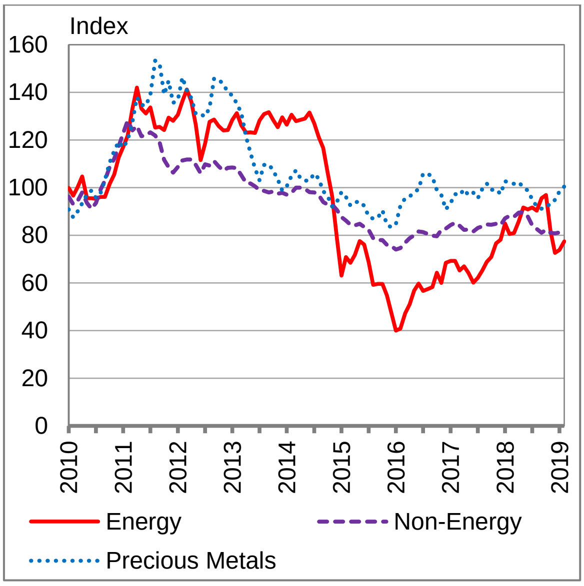
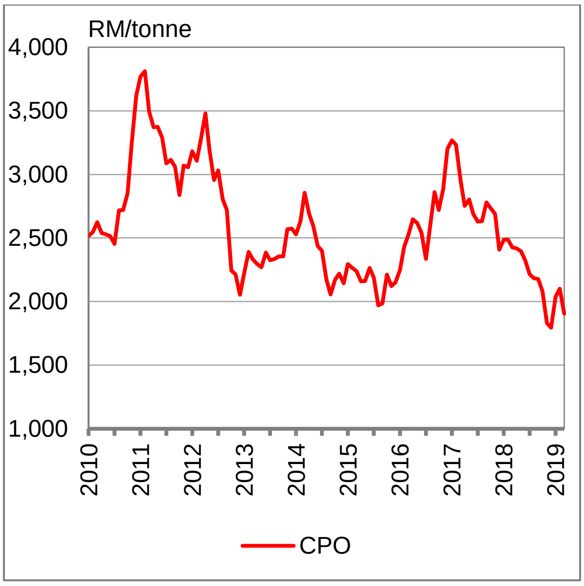


Figure 10: CPO stock drops to 5-month low in March but prices have yet to rebound significantly



Source: World Bank; Malaysian Palm Oil Board (MPOB)

ECONOMIC DEVELOPMENTS IN ADVANCED ECONOMIES AND CHINA

The United States: The economy decelerated noticeably to 2.2% annualised qoq in 4Q18 (3.4% in 3Q and 4.2% in 2Q) on softer consumer spending and declining government spending, blamed on a partial government's shutdown. The lagged impact of monetary tightening and trade spat with China also dampened economic momentum. Available data indicates a further weakening in growth in 1Q19, partly dragged by a partial government's shutdown.

Figure 11: Both manufacturing and services sectors continue to expand, albeit at slower pace

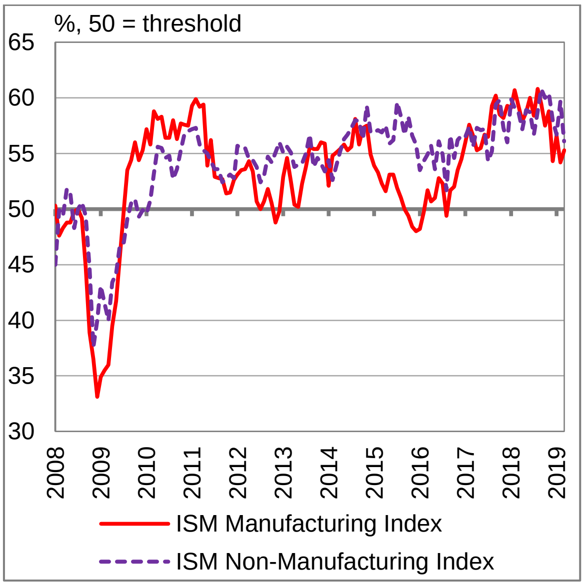


Figure 12: Both production and retail activities slowed down

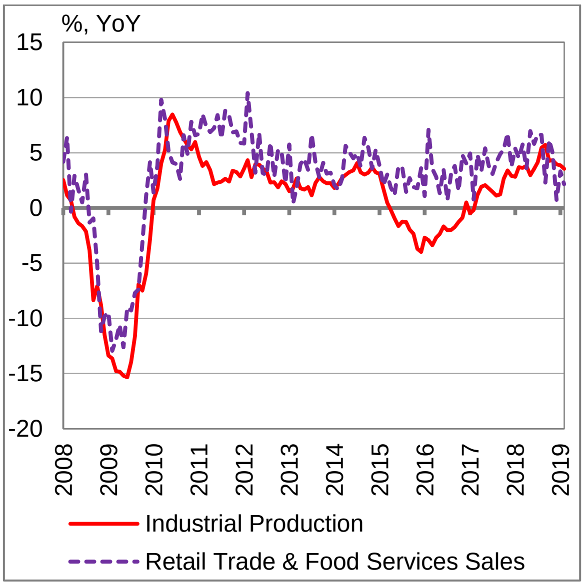


Figure 13: Healthy labour market on continued gains in employment

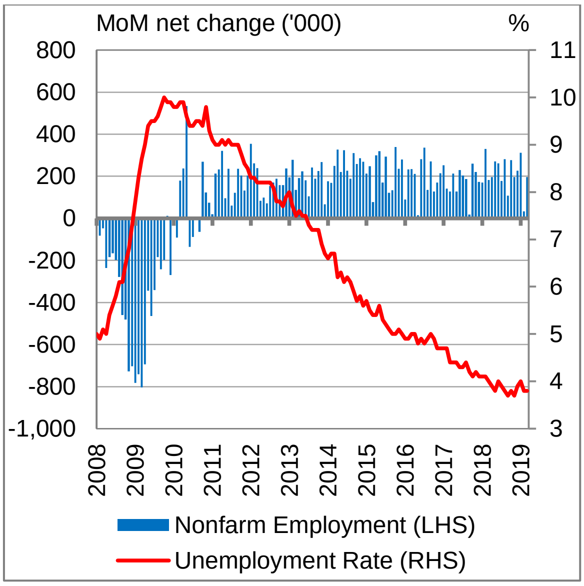
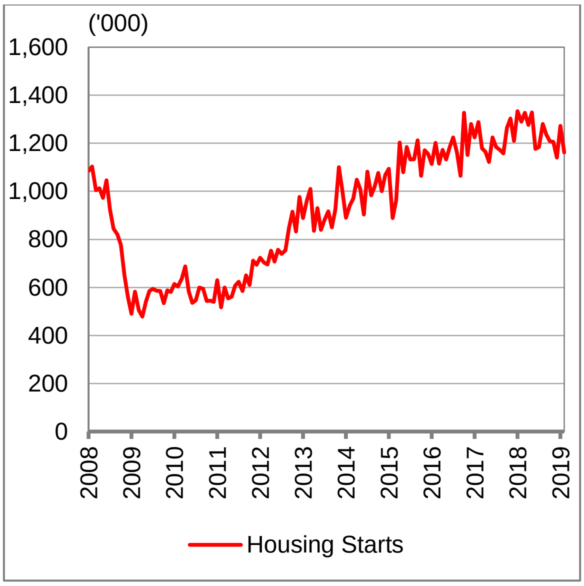


Figure 14: A sharp decline in housing starts in February



Source: Institute for Supply Management (ISM); Federal Reserve System; US Census Bureau; US Bureau of Labor Statistics

Euro area: Growth in eurozone barely moved (0.2% qoq in 4Q18 vs. 0.1% in 3Q), weighed down by weakening consumer and business sentiments, slowing growth in manufacturing as well as policy uncertainty and high sovereign debt risk in Italy. Heightened uncertainty over Brexit and potential trade conflicts between the US and EU as well as lingering concerns about Italy's fiscal problems would temper investor sentiment and growth in 2019.

Figure 15: Manufacturing sector deteriorated the most in nearly six years in March

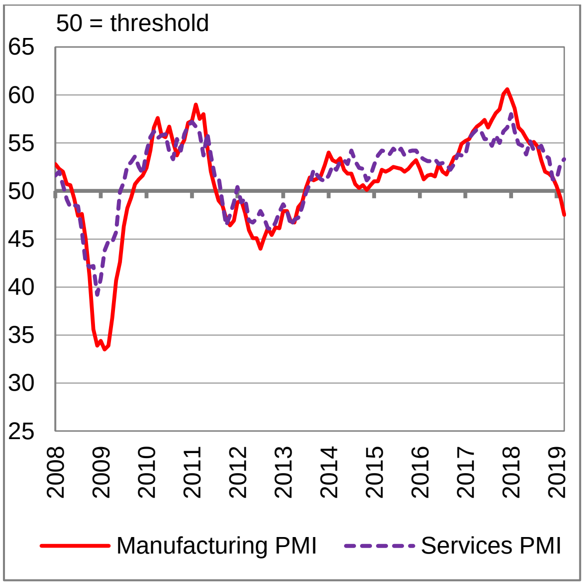


Figure 16: Industrial production growth contracted for four straigth months since Nov 2018

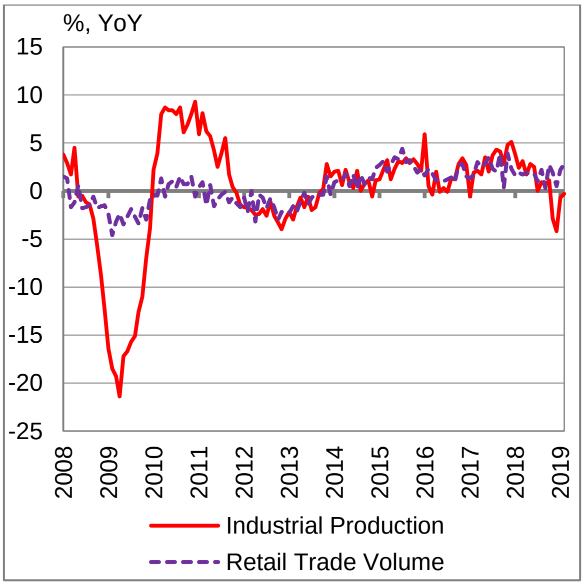


Figure 17: Still large deviation from the targeted inflation rate of 2.0%

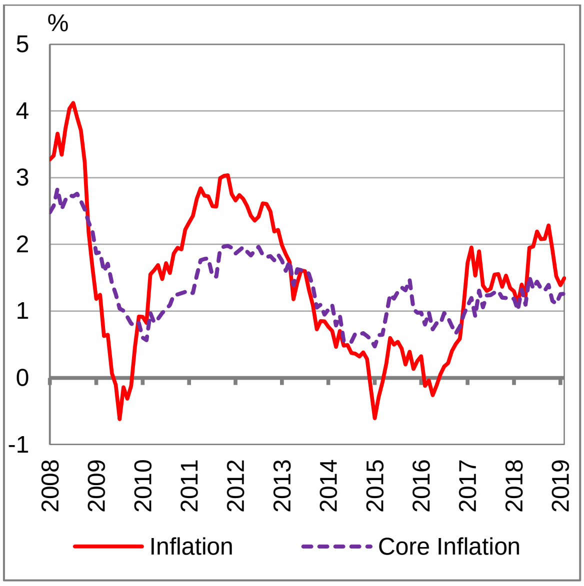
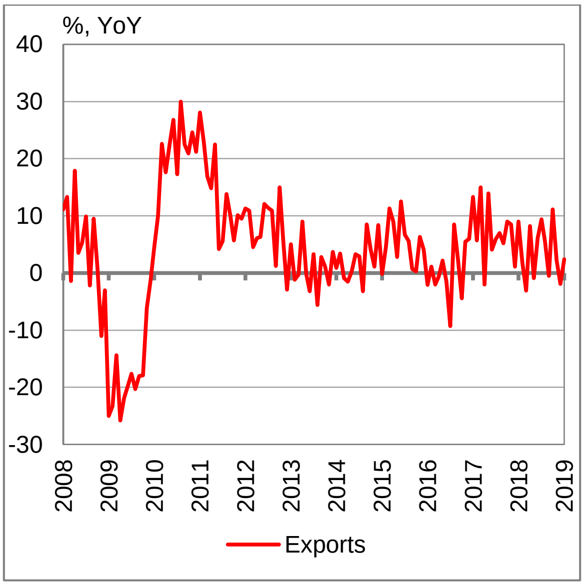


Figure 18: Highly fluctuations in export growth, which oscillates at low side



Source: Markit; Eurostat

Japan: Available data suggests that growth was weak in the first quarter of 2019 (0.5% qoq in 4Q18). Manufacturing PMI has fallen below 50-pt threshold of expansion and hit over two-year low in 1Q; retail and industrial activities remained sluggish; exports contracted for the third consecutive month in February.

Figure 19: The leading gauge of economic growth suggests moderation ahead

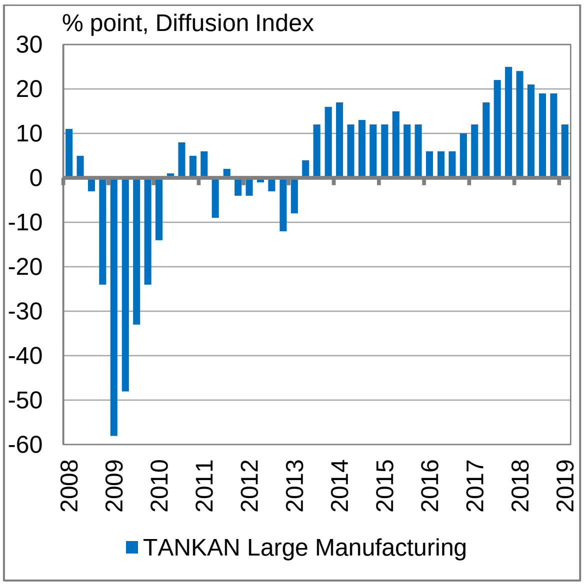


Figure 20: Retail sales growth nearly flat amid contracted industrial production growth

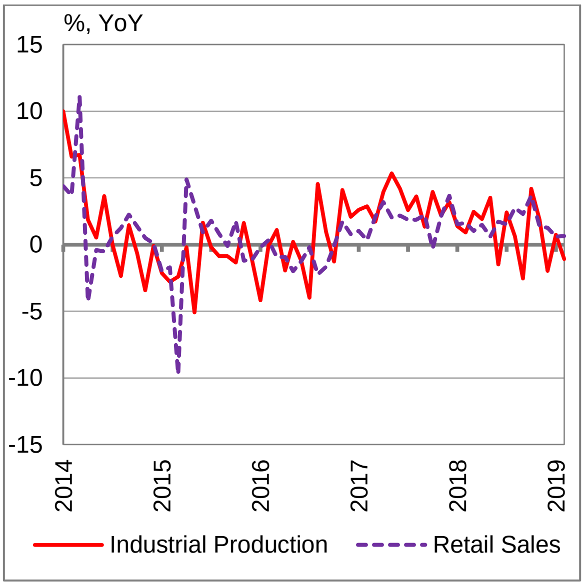


Figure 21: Inflation rate remains subdued since Dec 2018

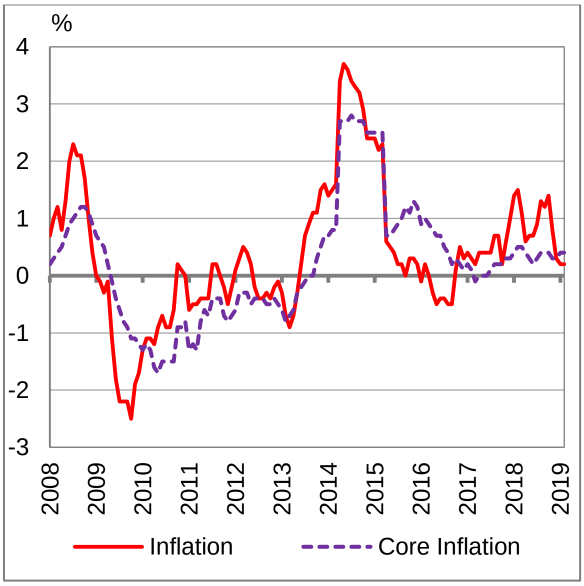
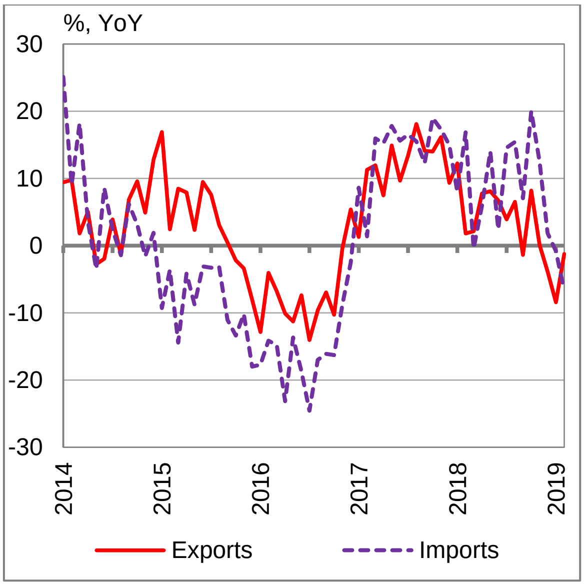


Figure 22: Export growth contracted for third consecutive month



Source: Bank of Japan (BOJ); Ministry of Economy, Trade and Industry (METI), Japan; Japan Customs; Statistics Bureau, Japan

China: Prompt policy intervention (monetary and fiscal) seem to help stabilising growth, albeit moderately. The outcome of the trade talks remains a wild card. Total fixed investment has picked up slightly, especially property investment as well as advanced manufacturing and services investment. Industrial production growth jumped to 8.5% yoy in March; retail sales paced to a six-month high, reflecting some positive effect from the policy stimulus. However, it is still early to convince that a solid recovery is firmly entrenched. While exports were better than expected, imports fell below expectations, indicating still weak domestic demand.

Figure 23: Manufactuing PMI returned to expansion pace after three months of contraction

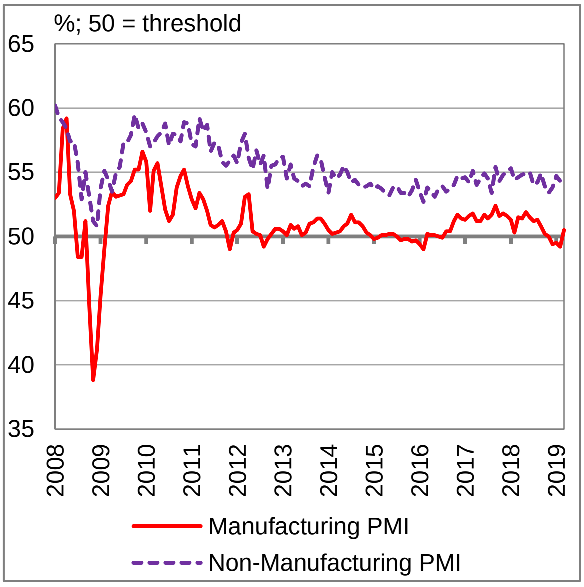


Figure 24: A surprise growth in industrial production in March while retail sales also seem stabilising

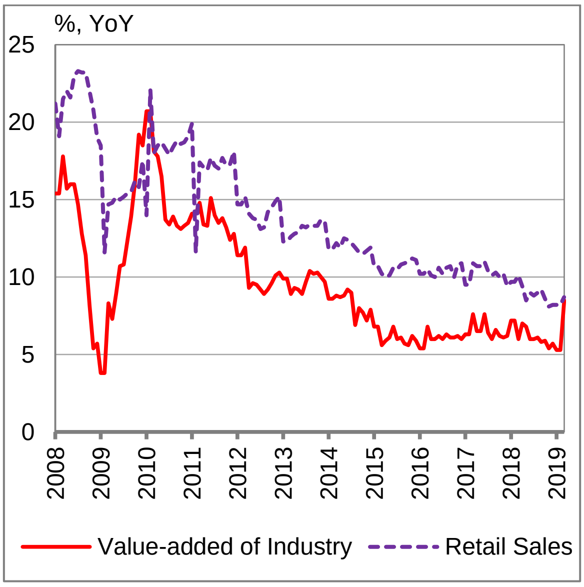


Figure 25: Fixed assets investment growth picks up

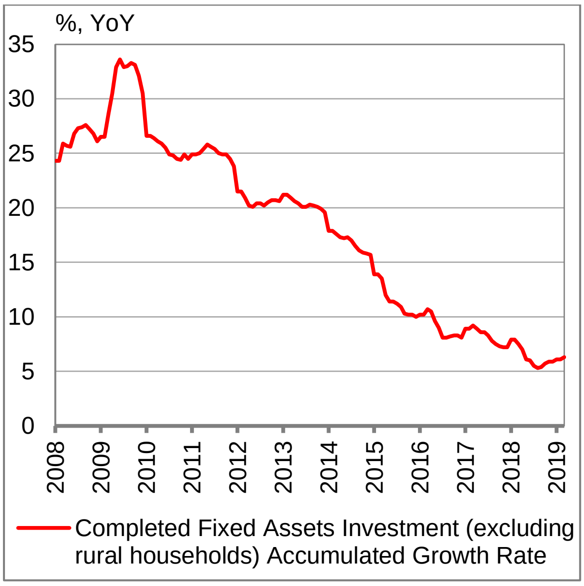
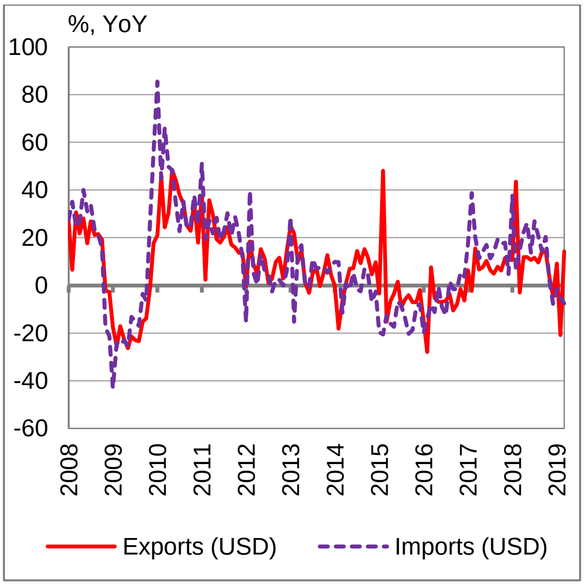


Figure 26: Export growth correlates with on-going trade dispute negotiations



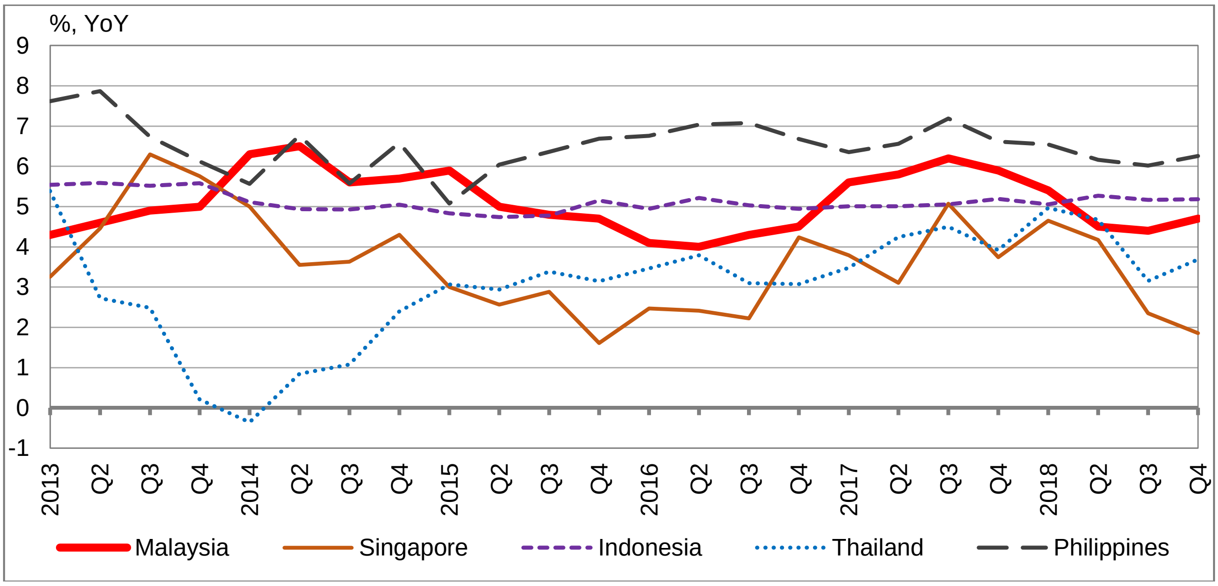
Source: National Bureau of Statistics of China; General Administration of Customs, China

ASEAN-5 ECONOMIES' KEY ECONOMIC DATA TRACKER

ASEAN-5 (Malaysia, Singapore, Indonesia, Thailand and the Philippines) experienced mixed pace of economic growth in 4Q18, but uniformly lost ground in export growth. Taking cue from a weak growth in industrial production, which is a proxy of overall economy, economic growth is likely to remain moderate in 1Q19.

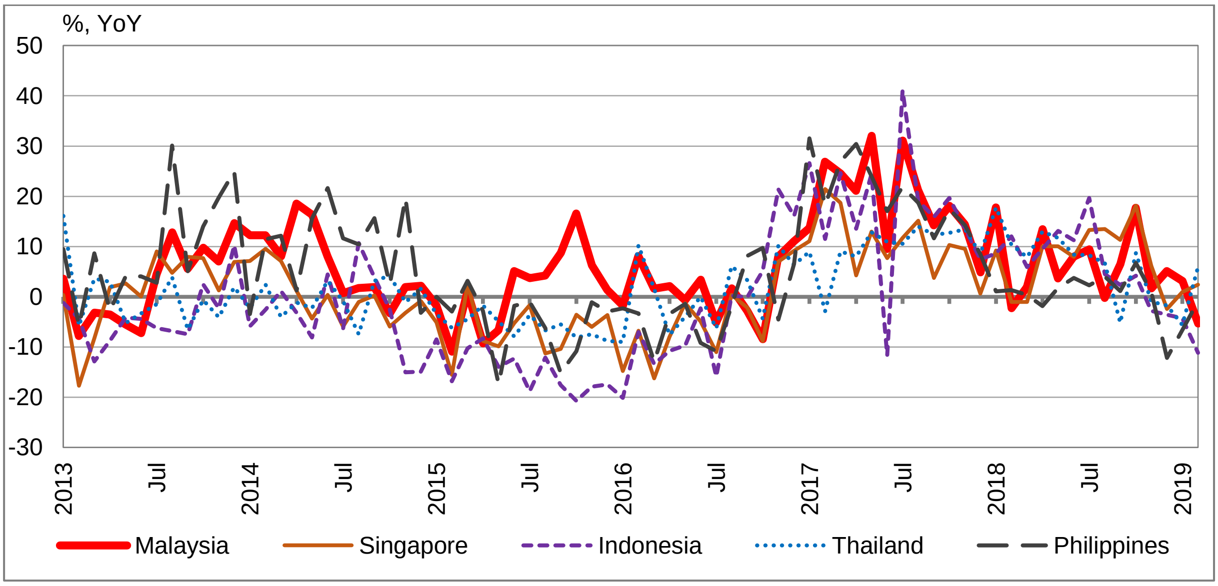
Singapore announced a much lower advance estimate of GDP growth at 1.3% for 1Q19 while Bank of Thailand has further cut its growth estimates for 2019 to 3.8% from 4.0% and 4.2% previously. Nevertheless, ASEAN Manufacturing PMI moved back to rise above 50-pt threshold of expansion and witnessed a slight improvement in March, suggesting higher possibility of better prospect for 2Q19.

Figure 27: Real GDP growth trend



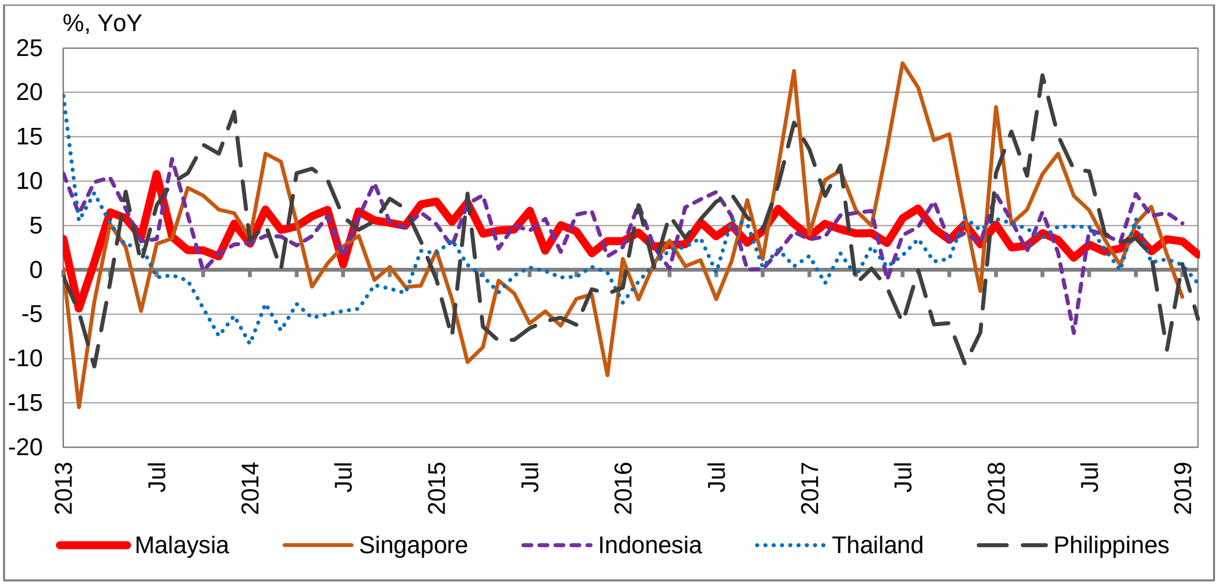
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; National Economic and Social Development Board, Thailand; Philippine Statistics Authority

Figure 28: Export growth trend



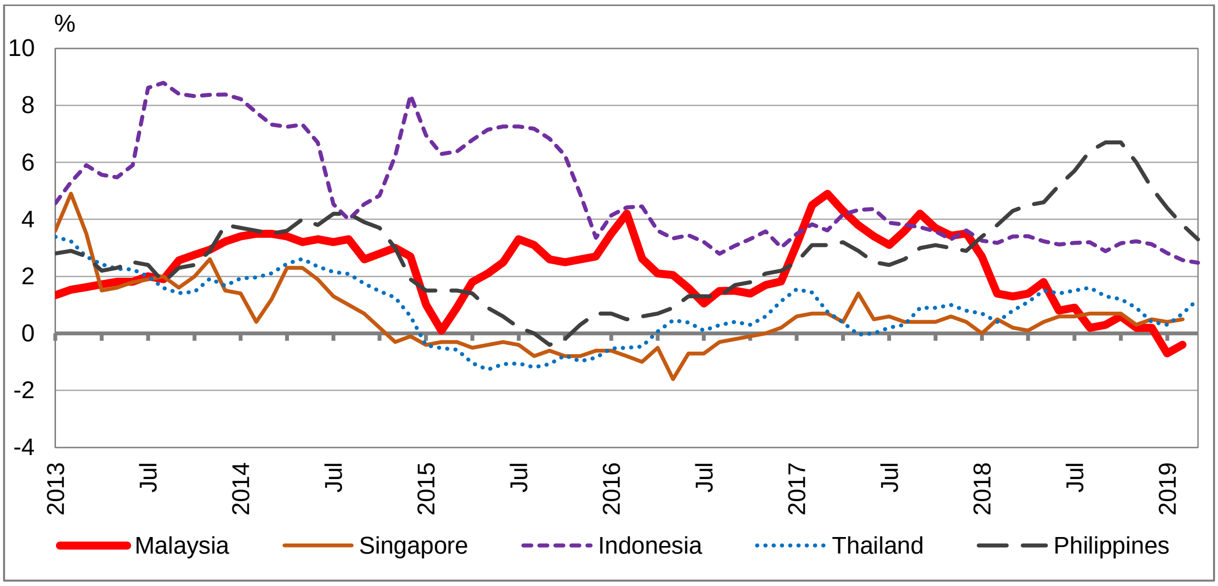
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Bank of Thailand; Philippine Statistics Authority

Figure 29: Industrial production growth trend



Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Office of Industrial Economics, Thailand; Philippine Statistics Authority

Figure 30: Inflation trend



Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Bank Indonesia; Ministry of Commerce, Thailand; Philippine Statistics Authority

MALAYSIA'S ECONOMIC AND FINANCIAL CONDITIONS

The challenge to sustaining momentum. Slowing global growth and exports as well as slower pace of domestic demand pose challenges to Malaysia in sustaining economic momentum this year. The Malaysian economy has slowed to 4.7% in 2018 from 5.9% in 2017 on weakening exports, contracted public investment and slackened private investment.

GDP growth estimated 4.5-4.7% in 2019. SERC estimates real GDP growth to expand by 4.5-4.7% in 2019, with domestic demand still underpinning overall growth. This is somewhat in line with Bank Negara Malaysia's estimated 4.3-4.8% for 2019. High frequency data for global and domestic condition suggests moderate pace of expansion ahead. Our preliminary estimate of GDP growth for the first quarter is 4.4%, guided by the leading index, exports, industrial production and loans data.

Cautious economic outlook in 1H19 and 2019. The Associated Chinese Chambers of Commerce and Industry Malaysia (ACCCIM) Malaysia's Business and Economic Conditions Survey (M-BECS) revealed that businesses in Malaysia are generally cautious about the economic outlook in 1H19 with 50.2% of respondents were "neutral" and 37.5% were "pessimistic". Only 12.3% of total respondents were "optimistic". On balance, businesses are of the view that the Malaysian economy would remain challenging in 2019 as there are higher respondents (32.6%) who are "pessimistic" relative to being "optimistic" (15.3%).

Businesses' guardedness about economic conditions will likely to improve in 2H19 as lower respondents (29.6% in 2H19 vs. 37.5% in 1H19) having pessimistic views while those with optimistic views improved to 17.8% from 12.3% in 1H19.

Rising cautious optimism about the economy in 2020 (25.7% respondents "optimistic" vs. 15.3% in 2019) is probably premises on a more stable domestic policy landscape as well as the projected healthier fiscal balance sheet in 2020. The Government has set a three-year period to bring the country back on track.

Consumer spending will slow but still firm at estimated 6.8% in 2019 (8.1% in 2018), backed by a stable labour market condition (unemployment rate at 3.3-3.4%), continued wage growth as well as cost of living aid. The payment of the first phase of 2019 Cost of Living Aid (BSH) of RM300 for eligible households on 28 Jan is expected to benefit up to 4.1 million households involving an allocation of RM1.2 billion, in addition to RM300 million allocation to 3 million unmarried B40 recipients in end-March. In addition, RON95 petrol price has been capped at RM2.08 per litre until the targeted subsidy plan rolls out by end-June.

Private investment growth is expected to remain moderate to increase by 4.3% in 2019, a slight moderation from 4.5% in 2018. This reflects the continued investors' cautiousness about investing given the uncertainties surrounding external environment and wary about domestic policy landscape. Private investment indicators, loans extended for businesses and imports of capital goods were disappointing. This coupled with cautious business conditions are expected to weigh on private investment. During Jan-Feb, RM7.9 billion of GST and income tax has been refunded. ACCCIM M-BECS revealed that 62.3% of total respondents would utilise 1-10% of total GST and income tax refunds for capex, which bodes well for domestic investment.

Capital investment on wait-and-see mode. ACCCIM M-BECS indicated that businesses have become cautious about their capex spending plans. Less than half of total respondents (49.3%) have increased capital expenditure in 2H18, leaving 39.3% and 11.5% either have maintained or lowered their capex respectively. Going into 1H19, we see lower respondents (45.7% vs. 49.3% in 2H18) will increase capex, suggesting some cautiousness in investors' sentiment, inflicted by concerns over domestic economic conditions and external headwinds.

Economic and financial indicators all pointing still moderate growth in economic activities, consumer spending and investment activities. These include the leading index has been on a contraction mode for seven consecutive months since July 2018, suggesting a moderate economic growth ahead. In Jan-Feb 2019, exports contracted by 0.8% yoy in Jan-Feb while industrial output growth average at 2.5%, slower than 3.0% in 2018 and 3.2% in 4Q18. Banking system's loan growth paced slowly to expand by 5.0% in February (5.5% in Jan), the lowest since June 2018, with loan applications, approvals and disbursement registering contraction in February.

Exports will remain a drag on GDP. Exports unexpectedly contracted by 5.3% yoy in February from a 3.1% rise in January. While the shorter-working days during the festive celebration had pulled down the exports in February, the large contraction reflects the general slowdown in global demand, weak sales of petroleum products as well as moderate energy and palm oil prices. SERC estimates total exports to increase by 3.3% in 2019 (6.8% in 2018).

Technical deflation in a number of months will disappear as the base distortion due to the decline in transport prices normalizes. In Jan-Feb 2019, headline inflation was average negative 0.5%, marking the first deflation since end-2009. Nonetheless, it is merely a technical deflation due to the decline in fuel prices and the replacement of GST with SST. Excluding the effect of changes in consumption tax policy, core inflation remained stable at 1.4-1.6% since May 2018. Overall, some cost pass-through from domestic cost factors such as increase in minimum wage, utility cost and food prices would result in a moderate rise in headline inflation to between 1.0% and 1.5% in 2019 (1.0% in 2018).

Bank Negara Malaysia's monetary policy on ready mode. Following the release of Bank Negara Malaysia's Annual Report 2018, which marked down this year's GDP estimate has stirred market expectations for a rate cut this year while Bank Negara Malaysia has indicated that it will be data dependent. Risks to growth is tilted more towards the downside. It will depend on how the economy responds to the ongoing attendant risks and the first quarter's GDP growth performance.

There is an even chance that Bank Negara Malaysia would deliver a rate cut in May's MPC meeting given the considerable external uncertainties that could risk undermine consumer and business sentiments and economic growth ahead. We expect the OPR to reach 3.00% by end-2019 (3.25% at end-2018).

The ringgit continues to face headwinds. On the back of lingering uncertainties in external environment such as moderating global economic growth, slowing exports trading activities amid the outcome of ongoing trade friction negotiations, the ringgit continues to move within a tight range between RM4.0605 and RM4.1425 per US dollar in recent months.

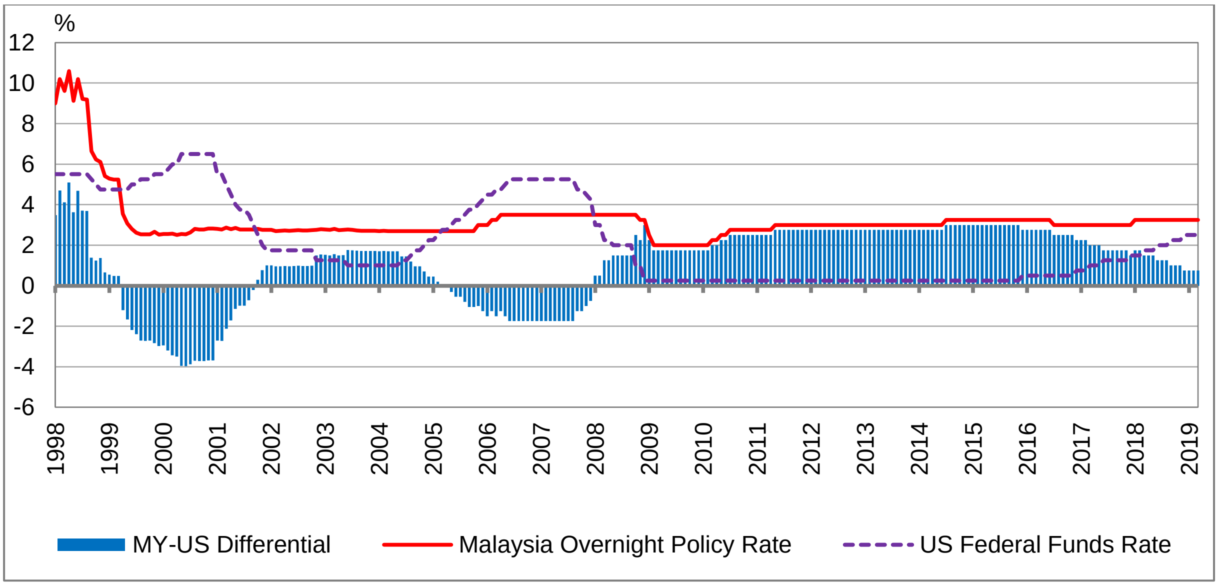
It remains vulnerable to the bout of negative sentiment and developments that would trigger portfolio investment rebalancing. The announcement by FTSE Russell putting Malaysia on a watch list of fixed income markets for a review for potential downgrade to "1" from "2" currently would render Malaysia ineligible for inclusion in FTSE World Government Bond Index (WGBI) at the September 2019 review. This may add downward pressure on the ringgit. Nevertheless, the pressure from increasing Fed fund rate is relieved at the moment as the Fed released a stronger pausing signal of rate hike for this year, at least. On home front, the fundamental factors like the projected continued economic growth, current account surplus and regaining ground of foreign reserves would continue to support the ringgit. The ringgit is estimated at RM4.00-4.15 per US dollar at end-2019 (End-2018: RM4.1385/US$).

Table 3: Real GDP growth (% YoY)

Economic Sector [% share to GDP in 2018]	**2017**	**2018**	**2018 Q1**	**2018 Q2**	**2018 Q3**	**2018 Q4**	**2019*E* (BNM)**	**2019*E* (SERC)**
By economic sector								
Agriculture [7.8%]	7.2	-0.4	2.8	-2.5	-1.4	-0.4	2.8	1.8
Mining & Quarrying [7.9%]	1.0	-1.5	0.1	-2.2	-4.6	0.5	0.8	0.5
Manufacturing [23.0%]	6.0	5.0	5.3	4.9	5.0	4.7	4.8	4.5
Construction [4.5%]	6.7	4.2	4.9	4.7	4.6	2.6	3.0	4.4
Services [55.5%]	6.2	6.8	6.5	6.5	7.2	6.9	5.7	5.8
By expenditure approach								
Private Consumption [55.5%]	7.0	8.1	6.9	8.0	9.0	8.5	6.6	6.8
Public Consumption [12.8%]	5.4	3.3	0.4	3.1	5.2	4.0	1.2	1.8
Private Investment [17.4%]	9.3	4.5	0.5	6.1	6.9	4.4	4.9	4.3
Public Investment [7.3%]	0.1	-5.2	-1.0	-9.8	-5.5	-4.9	-7.1	-4.8
Exports of Goods and Services [70.6%]	9.4	1.5	3.7	2.0	-0.8	1.3	0.1	1.5
Imports of Goods and Services [62.2%]	10.9	0.1	-2.0	2.1	0.1	0.2	0.0	1.3
Overall GDP	**5.9**	**4.7**	**5.4**	**4.5**	**4.4**	**4.7**	**4.3-4.8**	**4.5-4.7**

Source: Department of Statistics, Malaysia; Bank Negara Malaysia (Annual Report 2018); SERC

Figure 31: Malaysia-US's interest rate differentials



Source: Bank Negara Malaysia; Federal Reserve

REVIEW OF KEY ECONOMIC AND FINANCIAL INDICATORS

Leading indicators and Industrial production

GDP growth for the first quarter of 2019 is estimated to grow by 4.4% yoy (4.7% in 4Q18), with persistent downside risks. Weak mining and manufacturing output continue to signal slowing growth.

Figure 32: Leading index suggests better performance in May-Jul, albeit annual change remained negative

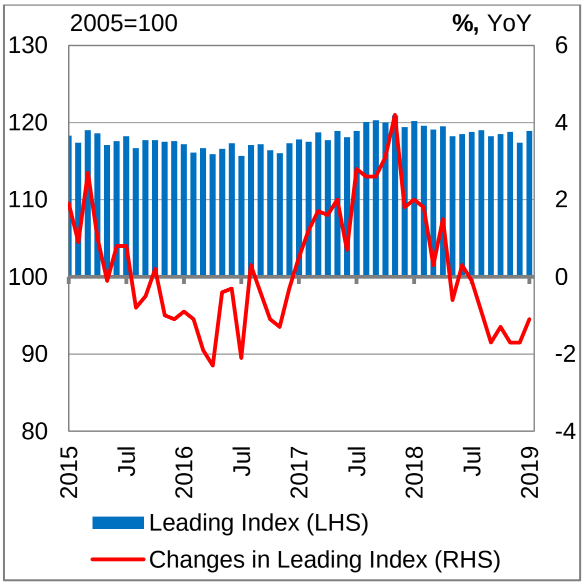
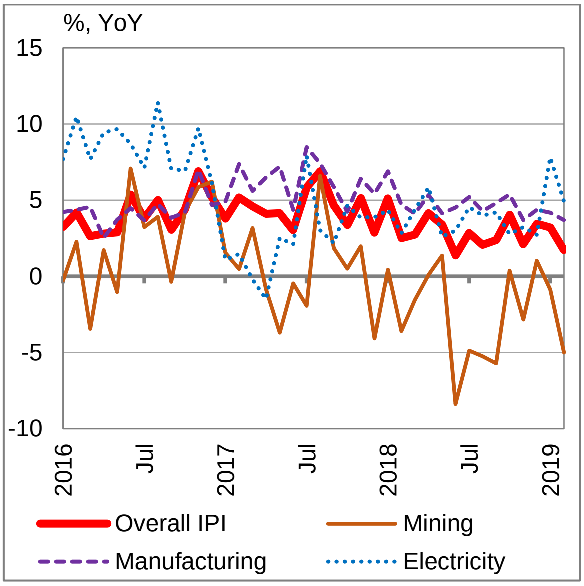


Figure 33: Industrial production growth moderated significantly in February on contracted oil and gas production



Source: Department of Statistics, Malaysia

Exports, Manufacturing sales and Distributive trade

Exports are expected to experience uneven growth as investors are pinning hopes on positive outcome from the trade negotiations between the US and its major trading partners. Slowing global demand, weakening semiconductor sales and commodity prices are expected to weigh on overall exports this year. Manufacturing output stays on cautious expansion path. Retail Group Malaysia (RGM) forecasts a 4.5% growth in retail sales for this year, underpinned by festive celebration and generally improved sentiment and festive demand towards year-end.

Figure 34: External sector remains challenging on slowing global growth and trade flows

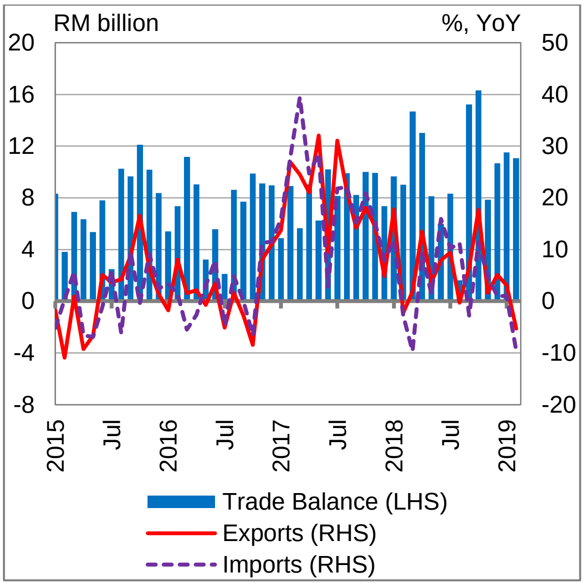


Figure 35: Electronics and electrical products as well as petroleum products slowed sharply in February

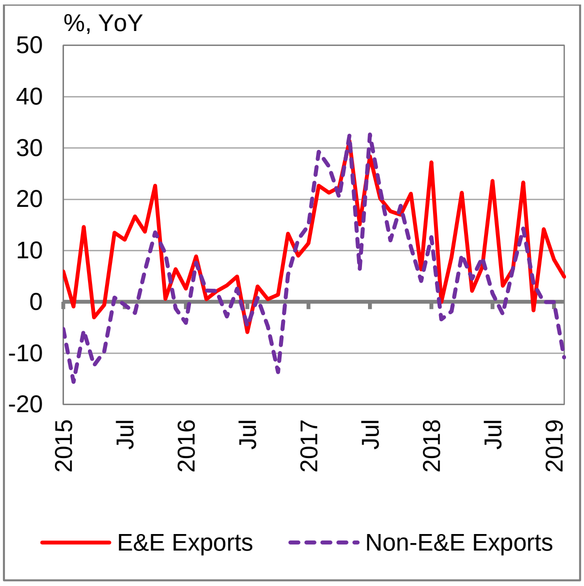
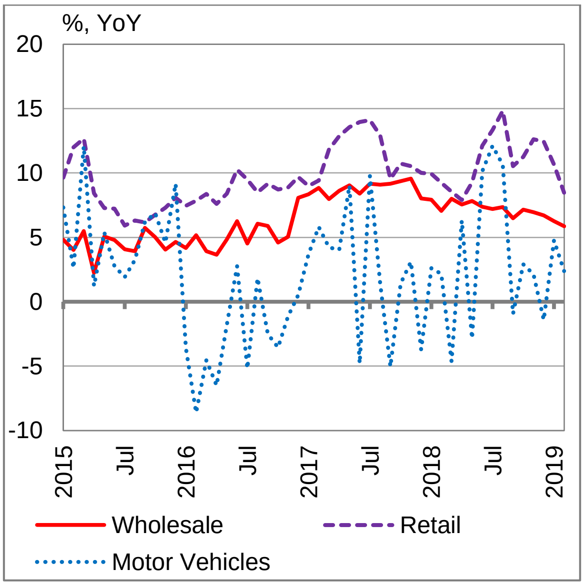


Figure 36: Manufacturing sales value moderated in most key sub-sectors

Figure 37: Softening wholesale and retail sales growth



Source: Department of Statistics, Malaysia

Private consumption indicators

Consumer spending still continues, albeit slower, supported by cost of living aid (BSH) and higher minimum wage. Cautious spending plan on big-ticket items on concerns about income growth. MIER's Consumer Sentiments Index (CSI) slides further below confidence threshold on current and expected finances lacklustre. There were growing jitters over increasing prices despite negative inflation in Jan-Feb.

Figure 38: The launching of several new car models supporting the buying interest

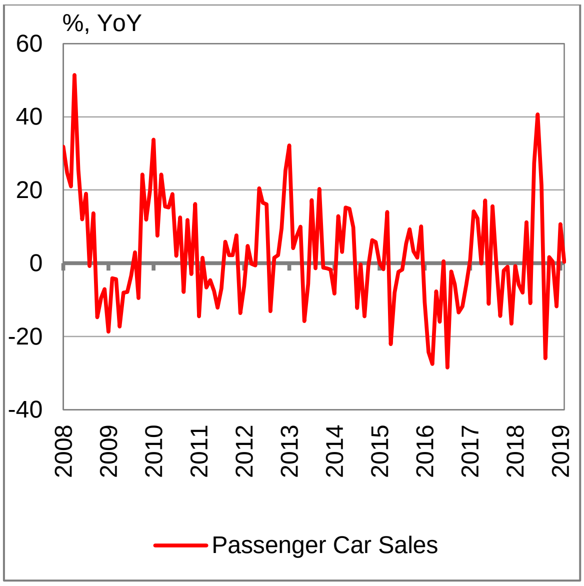


Figure 39: Selected private consumption indicators

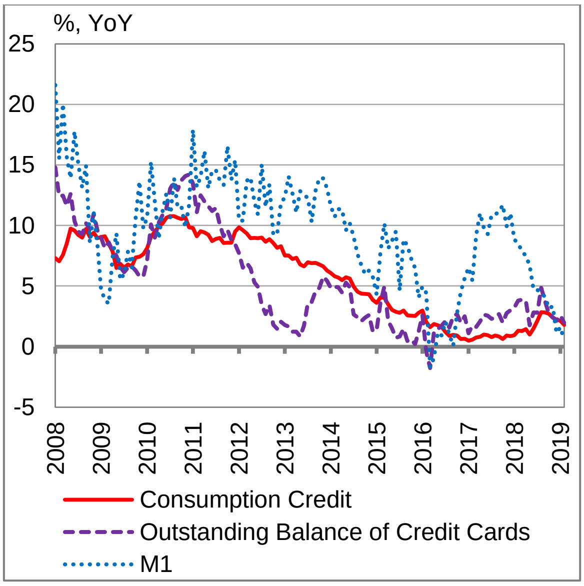


Figure 40: Salary payout continues growing at a slower rate

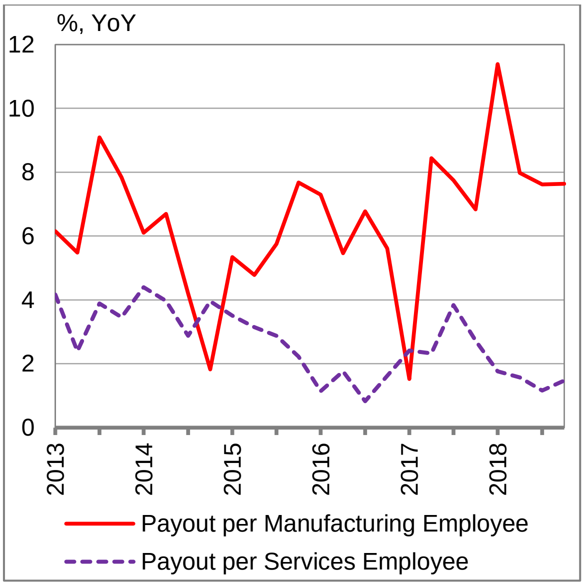
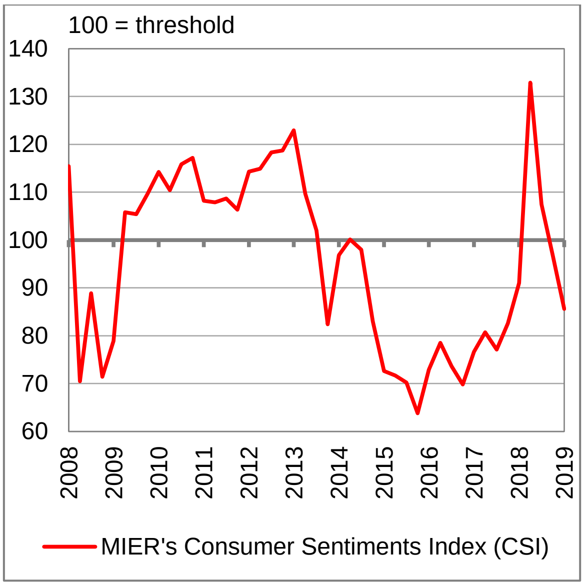


Figure 41: Consumer sentiments turned pessimistic again



Source: Department of Statistics, Malaysia; Malaysian Institute of Economic Research

Private investment indicators

Weakening global economy, challenging domestic economic and business conditions amid policy uncertainty have dampened investment interests. Businesses are generally feeling more upbeat in 2H19 on a relatively more stable policy environment.

Figure 42: Selected private investment indicators

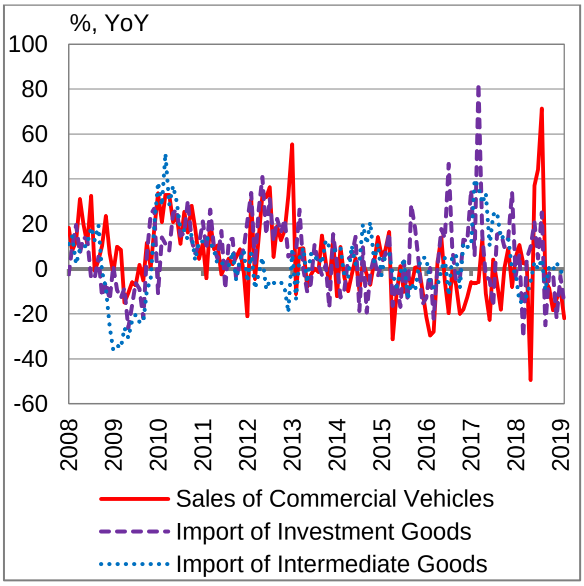


Figure 43: Real private investment trend

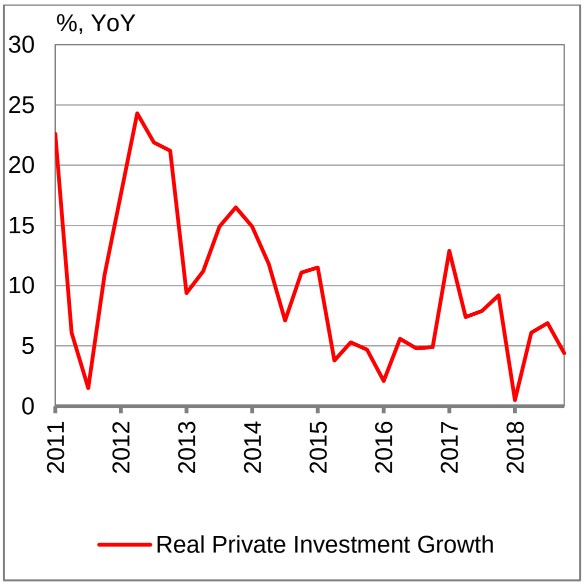


Figure 44: A slight increase in the number of manufacturing companies reporting production close to full capacity (38% in 1Q19 vs. 32% in 4Q18)

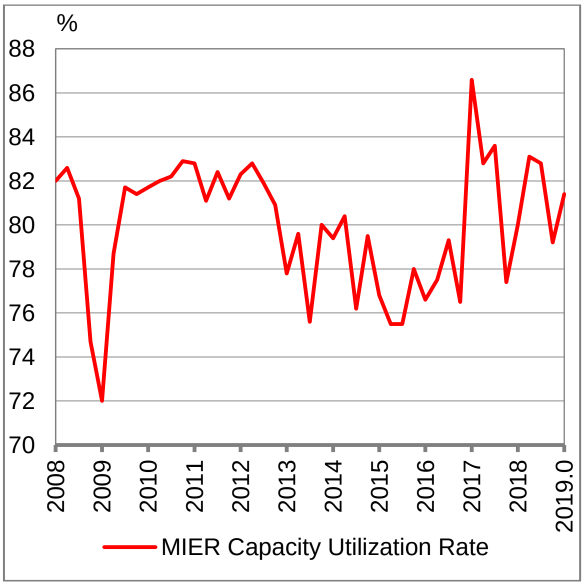
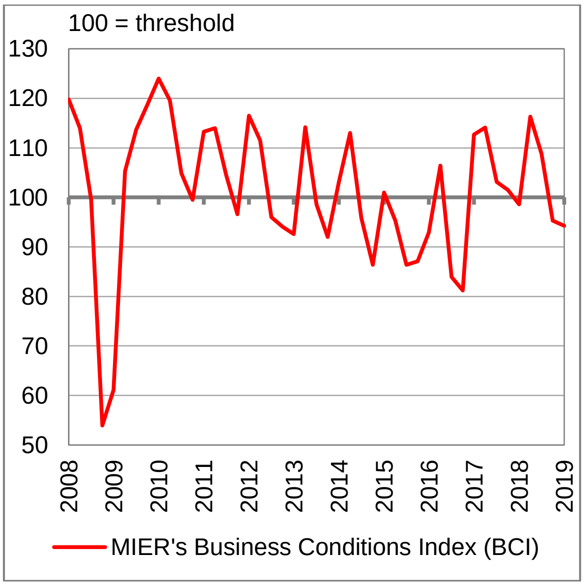


Figure 45: Overall business conditions deteriorated



Source: Department of Statistics, Malaysia; Malaysian Institute of Economic Research

Price indicators

Two successive months of negative inflation are merely technical deflation, mainly due to the change in consumption tax policy (from GST to SST) and lower RON95 petrol price (average RM1.98/litre in Jan-Feb 2019 vs. RM2.17/litre in Jan-Feb 2018). Excluding the effect of consumption tax policy, core inflation remained broadly stable at 1.4-1.6% since May 2018. Headline inflation will be normalised by June as the effect of tax policy changes faded.

Figure 46: First deflation since end-2009 …

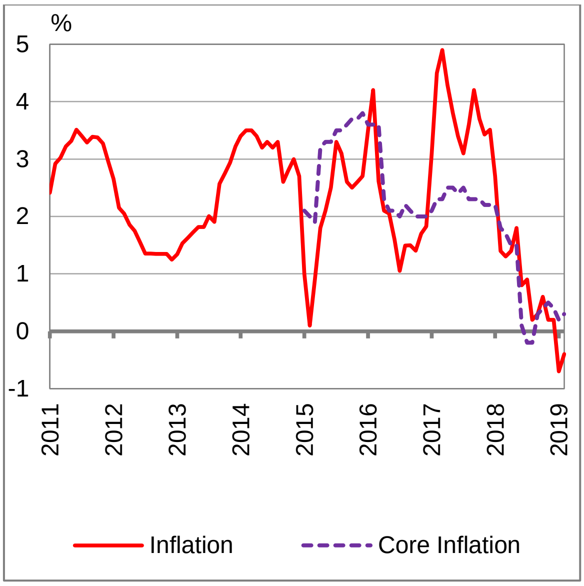
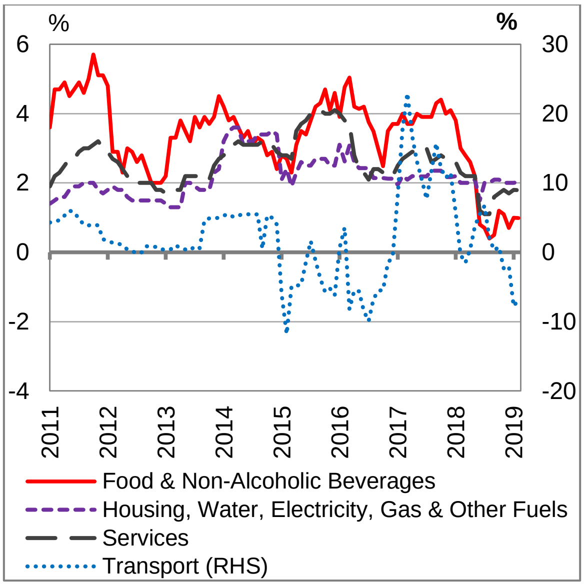


Figure 47: … due to the change in consumption tax policy and lower RON95 petrol price



Source: Department of Statistics, Malaysia

Banking loan indicators

Both businesses' and households' loan outstanding expanded at a slower pace (4.7% and 5.2% respectively in February vs. 5.4% and 5.5% respectively in January), reflecting weaker consumer demand and slowing business expansion.

Figure 48: Banking system's loan outstanding growth eases

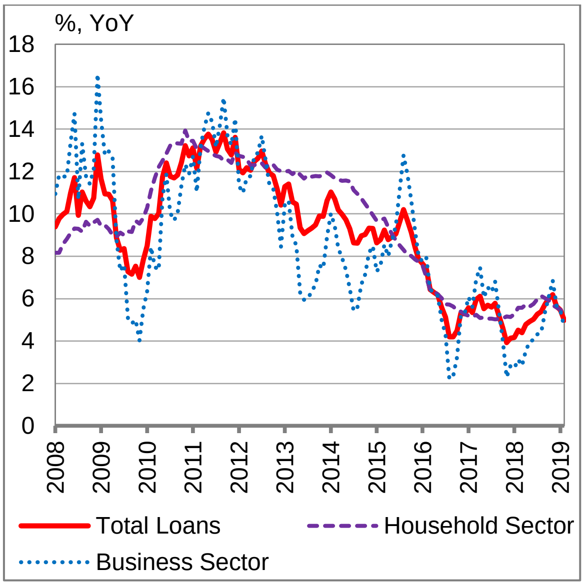


Figure 49: Loan application growth

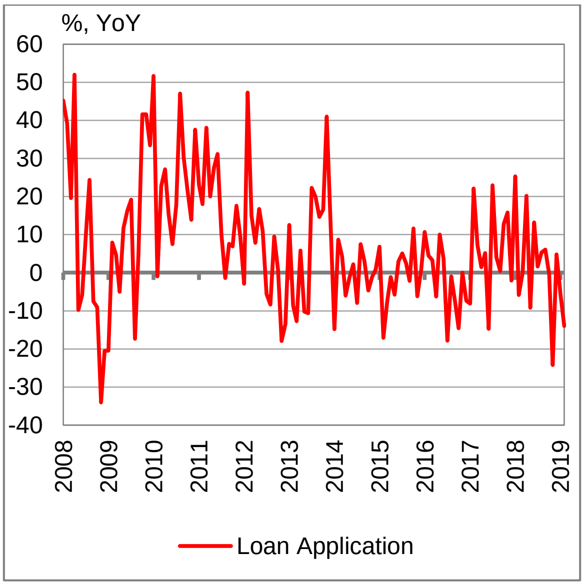


Figure 50: Loan approval growth

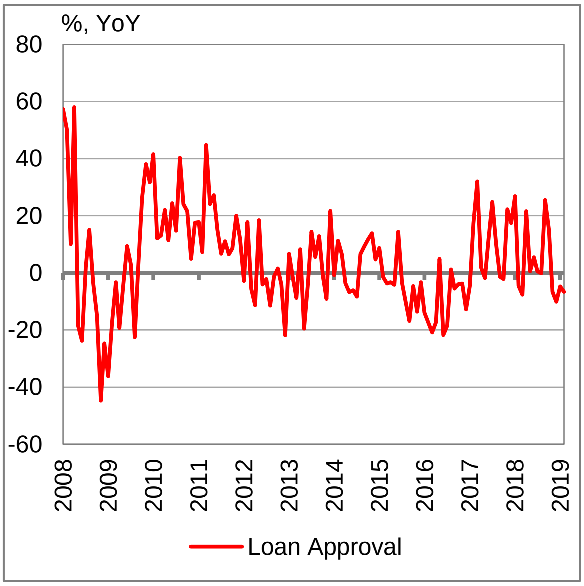
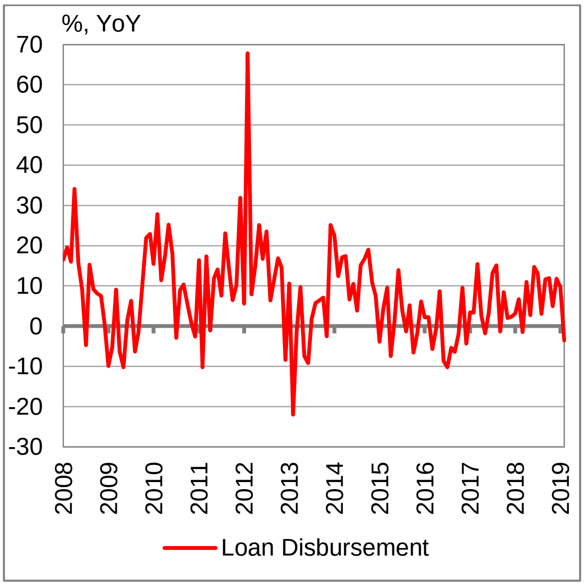


Figure 51: Loan disbursement growth



Source: Bank Negara Malaysia

Financial indicators

Foreign reserves continued to stay marginally above US$100.0 billion level and is sufficient to finance 7.5 months of retained imports and is 1.0 time of total short-term external debt. Foreigners had made net purchase of RM5.7 billion of government debt securities (MGS, GII, T-bills and Islamic T-bills) in 1Q19 and owned 38.7% of MGS worth RM150.7 billion as at end-March 2019. On the contrary, foreign investors sold a total of RM1.4 billion of equities in 1Q19 following increasing uncertainties around the globe. Compared to end-2018, the ringgit recorded a mixed performance against major and regional currencies as at end-March.

Figure 52: International reserves position regaining ground

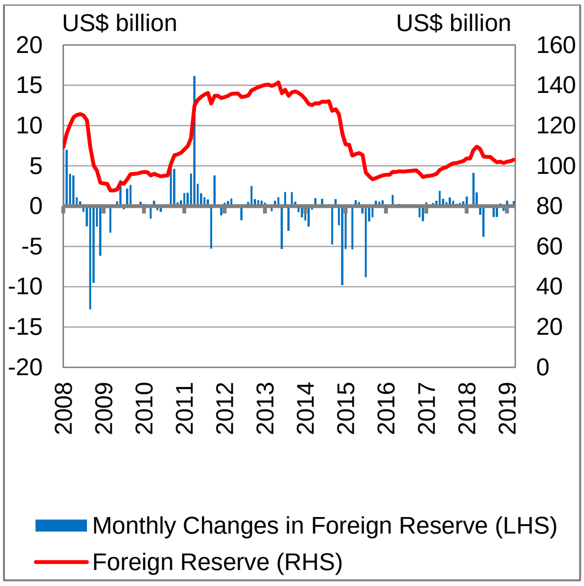


Figure 53: Ringgit against major foreign currencies

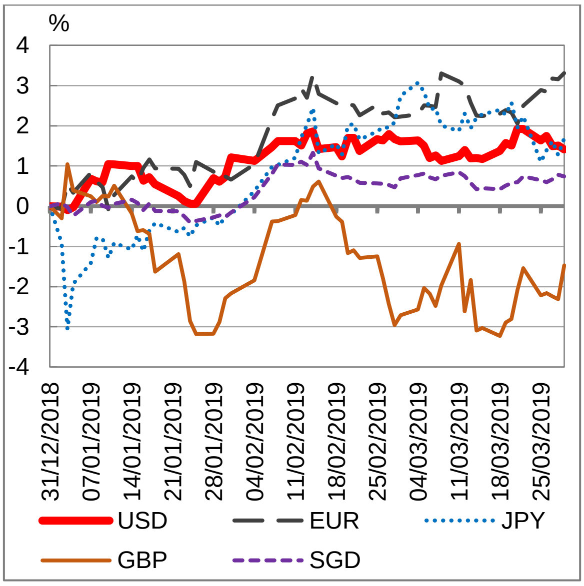


Figure 54: Ringgit against Chinese renminbi

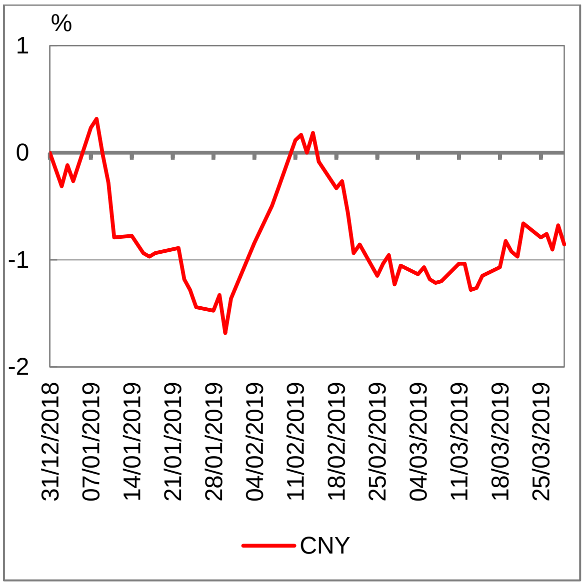
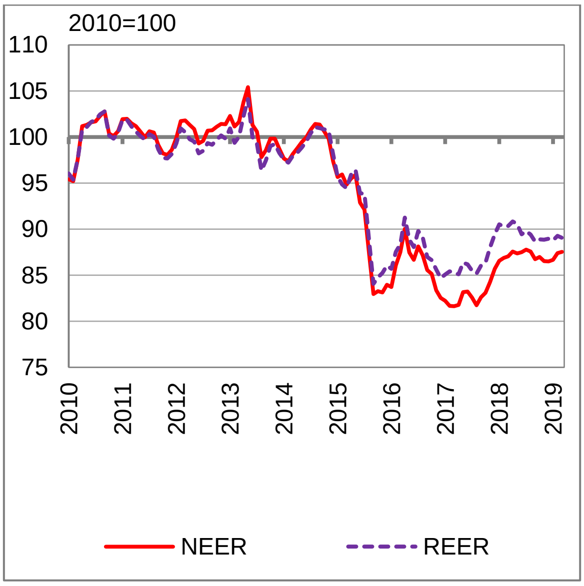


Figure 55: Ringgit's effective exchange rate



Source: Bank Negara Malaysia; Bank for International Settlements

SOCIO-ECONOMIC RESEARCH CENTRE (SERC)
SERC SDN BHD (Company No.: 918837-W)

6th Floor, Wisma Chinese Chamber,
258, Jalan Ampang, 50450 Kuala Lumpur, Malaysia.
Tel: (603) 4260 3116 / 3119 Fax: (603) 4260 3118
Email: serc@acccimserc.com
Website: http://www.acccimserc.com