QUARTERLY ECONOMY TRACKER

(JUL-SEP 2019)

Socio-Economic Research Centre (SERC)

This research paper was commissioned and funded by ACCCIM SERC Trust and managed by Socio-Economic Research Centre (operating under SERC Sdn. Bhd.).

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World Economic Situation and Prospects for 2019

Risk of a global recession is high and rising. Fears of a global recession are rising, taking cue from the signals transmitted through bonds, equities, currencies and commodities, which are increasingly disturbing for investors. The wheels of global economic slowdown already set in motion as reflected in further weaknesses in global trade, investment and manufacturing data. The silver lining is the continued growth in service sector, albeit moderately. Heightened concerns over a global recession risk brought on by slower global growth and the worsening of the US-China trade hostility have badly shaken global financial markets and weighed on business and investors' sentiment.

Advanced economies are feeling the heat. Amid resilient consumer spending, the US economy will ease in 2H 2019 on a weaker global outlook and the ongoing US-China trade dispute weighing on business investment, manufacturing and exports. Growth in euro area is slowing sharply this year due to lingering weakness in the industrial and external sectors amid elevated risks from slower-than-expected growth in China, a hard Brexit and other political concerns. While Japan's growth is supported by domestic demand and construction works related to the 2020 Tokyo Olympics, the intensified trade war is hurting Japan's all-important external sector. Uncertainty linked to the trade war with the US will continue to weigh on China economy while domestic economic imbalances pose further risks to its growth outlook. Nevertheless, fiscal stimulus and accommodative monetary policy should buttress the economy.

Zero or negative interest rate is a new normal again? What began as a measured pace of rate easing by the Federal Reserve in July has evolved into a situation in which almost every major central bank races to cut interest rate to stay ahead of trade and currency wars. The European Central Bank (ECB) has reduced the deposit rate to minus 0.5% from minus 0.4% and revived its bond purchase program from 1 November at a pace of 20 billion euros (US$22 billion) a month for as long as necessary to hit its inflation goal. While the global economy is not in recession yet, but some central banks have almost exhausted their monetary arsenal on overriding concerns over the negative transmission of trade spats and financial volatility on the domestic economy.

Do Governments have sufficient policy tools to avert a financial crisis or global recession? A severe enough economic or financial shock could usher in a global recession, even if central banks respond rapidly. Monetary policy tools are limited for most central banks as interest rates are already at very low level. In Europe and Japan, central banks are already in negative-rate territory for a longer while. Faced with slow growth prospects, political discontent, and large fiscal deficits and debt burdens of government would constraint the deployment of fiscal policy for some countries.

Malaysia’s Economic and Financial Conditions

Still credible economic growth in 2Q19, but likely to ease in 2H. Bucking regional economies, which have printed a slower GDP growth in the second quarter, the Malaysian economy expanded further to register higher economic growth rate of 4.9% yoy in the second quarter of 2019 (4.5% in 1Q), taking the growth to 4.7% in the first half-year of 2019. Even if the economic growth slows to an average of 4.5%-4.7% in the second half-year, it is likely to meet the mid-range of Bank Negara Malaysia (BNM)’s estimate of 4.3%-4.8% for this year. SERC maintained this year’s GDP growth estimate at 4.7% (4.5%-4.7% previously) and forecast economic growth of 4.5% for 2020.

Domestic demand remains key pillar of the economy. Domestic demand growth, which grew by 4.6% yoy in 2Q (4.4% in 1Q), was largely underpinned by consumer spending (57.0% of total GDP), which increased higher by 7.8% in 2Q (7.6% in 1Q). Going into 2H 2019, households spending is likely to continue, albeit slower due to cautious discretionary spending amid the support of lower interest rate. While the unemployment rate remained unchanged at 3.3% in May-July (1Q: 3.3%), private sector wages grew slower by 4.2% (1Q: 4.9%). Private consumption is estimated to grow by 7.2% in 2019 and 6.7% in 2020.

Private investment remains slackened. Private investments printed a subdued growth of 1.8% yoy in 2Q though had improved from 0.4% in 1Q. In 1H 2019, private investment grew 1.2% (3.4% in 1H 2018). Nonetheless, uncertainty surrounding global trade tensions and prevailing weaknesses in the broad property segment, especially residential and commercial properties continued to weigh on the investment growth performance. We expect private investment to expand moderately by 2.6% in 2019 and 3.5% in 2020.

The slackening private investment growth corresponds with The Associated Chinese Chambers of Commerce and Industry of Malaysia (ACCCIM)’s Malaysia Business and Economic Conditions Survey (M-BECS) findings for 1H and 2H 2019, which revealed that 42.7% of respondents indicated that they either have invested or plan to invest in Malaysia over next 12-24 months while 57.3% indicated that they have no intention to invest over next 12-24 months. Within the group of respondents planning to invest, 26.1% of respondents adopt a “wait-and-see” approach as they are still waiting for a clearer direction on the economy and government’s policy landscape as well as weighed by the uncertainties surrounding global economy.

Exports estimated to grow by 0.5%-1.0% in 2019 and 2.0%-3.0% in 2020. Slowing global demand and negative spillover effects from the trade hostilities. Exports have displayed uneven trends to decline by 0.4% in Jan-Jul 2019 (2Q: -0.4% and 1Q: -1.1%), dragged down by weak global demand, slower exports of electronics and electrical products as well as moderate commodity prices.

The external sector though added 1.4 percentage points to 2Q’s GDP growth, it was due to a compression in imports (largely intermediate and capital goods) relative to subdued exports. This is not a good sign as it shows that businesses were not undertaking capex spending as spending on machinery and equipment had contracted for three consecutive quarters (4Q18: -1.3%; 1Q19: -7.4%; and 2Q19: -4.2%).

Headline inflation will remain benign. Headline inflation continues to rise moderately by 1.4%-1.5% in recent months, mainly to reflect the lapsing of consumption tax. In Jan-Jul 2019, inflation was averaged 0.3%. We estimate headline inflation to average lower at 0.8% yoy in 2019 (1.0% in 2018) and 2.0% in 2020 as the anticipated pick-up in consumer inflation, mainly from fuel-related items to remain weak. Pending the implementation of targeted fuel subsidy scheme for RON95, there could be some upside risks to the petrol prices. Even with the removal of RON95 price cap, prices are expected to be on the low side in line with softening global crude oil prices, which are affected by slowing global economy and the intensified trade tensions. That said, volatile crude oil prices remain a wild card.

Bank Negara Malaysia has leeway to cut interest rates if growth weakens. Bank Negara Malaysia (BNM) is amongst the few central banks that was ahead of the curve to cut interest rates by 25 basis points (bps) to 3.00% in May to provide an insurance against increasing external risks on the domestic economy.

While low inflation gives BNM's space to lower interest rate should the economy under threat, the central bank will continue to monitor the incoming data and global development, and would reserve its monetary arsenal while continue to assess the impact of May's rate cut on domestic demand. It must be noted that the rate cut takes a lag impact of 2-3 quarters. In this regard, Bank Negara Malaysia is expected to keep the policy rate at 3.00% for now.

Ringgit will remain volatile. Along with other regional currencies, the ringgit is likely to move in a tight range, tracking with the performance of the US dollar and Chinese renminbi. Two policy risk events to watch are (a) The FTSE Russell's decision whether to exclude Malaysia bonds from its World Government Bond Index (WGBI) on 26 Sep; and (b) The US Treasury's review of Malaysia in the Monitoring List on currency practices and macroeconomic policies in 4Q. Investors are eyeing on the tabling of Federal Budget 2020 on 11 October, keeping a close tab on the fiscal deficit path and pinning hopes on the Budget will deliver some positive catalysts to growth. SERC estimates the ringgit to trade between RM4.15 and RM4.20 per US dollar at end-Dec 2019 (End-Dec 2018: RM4.1385/US$).

2020 Budget on 11 October should be expansionary. The budget deficit for 2020 is estimated to be around 3.2% of GDP, a slight improvement from estimated 3.4% of GDP in 2019. Gross development expenditure is estimated to rise by 4.0% to RM55.5 billion in 2020 (estimated RM53.4 billion in 2019).

The 2020 Budget policies can be crafted to allow some room for an expansionary stance, focusing on high impact sectors, quick gains initiatives and measures that would protect growth-enhancing spending and investment.

The Budget's thrusts must aim at strengthening economic resilience, sustaining domestic spending and investment, save jobs, create jobs and help viable companies staying afloat. It also prepares Malaysia to emerge stronger and enhance our capabilities and competitiveness for the medium- to long-term.

GLOBAL ECONOMY SLOWING ON ESCALATING TRADE TENSIONS

The International Monetary Fund (IMF) has lowered its estimate of 2019's global growth for four consecutive times, taking the latest estimates to 3.2% in its World Economic Outlook Update in July. The IMF cited in addition to the escalated trade tensions and prolonged Brexit deadlock, the downside risks to global economy would come from (i) Disruptions to trade and technology supply chains; (ii) Abrupt shifts in risk sentiment; (iii) Disinflationary pressures; and (iv) Climate change, political risks and conflicts.

Table 1: Real GDP growth (% YoY)

	2017	2018	2019 Q1	2019 Q2	2019*e* (IMF)	2019*e* (WB)	2020*f* (IMF)	2020*f* (WB)
United States	2.4	2.9	2.7	2.3	2.6	2.5	1.9	1.7
Euro Area	2.5	1.9	1.3	1.2	1.3	1.2	1.6	1.4
China	6.8	6.6	6.4	6.2	6.2	6.2	6.0	6.1
Japan	1.9	0.8	1.0	1.0	0.9	0.8	0.4	0.7
India	7.2	6.8	5.8	5.0	7.0	7.5	7.2	7.5
Malaysia	5.7	4.7	4.5	4.9	4.7	4.6	4.8	4.6
Singapore	3.9	3.1	1.1	0.1	2.3	-	2.4	-
Indonesia	5.1	5.2	5.1	5.0	5.2	5.2	5.2	5.3
Thailand	4.0	4.1	2.8	2.3	3.5	3.5	3.5	3.6
Philippines	6.7	6.2	5.6	5.5	6.5	6.4	6.6	6.5
Vietnam	6.8	7.1	6.8	6.7	6.5	6.6	6.5	6.5

Note: Annual GDP for India is on fiscal year basis.
Source: Officials (unadjusted data except quarterly GDP for Euro Area); IMF (World Economic Outlook (WEO), Apr 2019, WEO Update, Jul 2019); World Bank (Global Economic Prospects, Jun 2019)

Global central banks race to lower their interest rates, more so when Fed cut their policy rate for the first time in July since 2008 as it provides accommodative space for them to loosen their monetary policy. On 18 Sep, the Fed concluded a second rate cut for the year (1.75%-2.00%), keeping the door opens for further monetary easing if economic conditions continue to weaken.

Throughout the period 1 July-19 September, the following central banks have moved the needle on interest rates: The ECB deepen its negative interest rates, cutting deposit rate facility by 10 basis points (bps) to -0.50% from -0.40% and also will revive the asset purchase programme (APP) at a monthly pace of €20 billion starting 1 November amid continued to reinvest the maturing securities in full amount; The Reserve Bank of India (RBI) made the fourth round of rate cut this year, by a larger-than-usual range of 35 bps (making a total of 110 bps cut since Feb); Bank Indonesia (BI) cut its policy rate for three consecutive rounds in Jul-Sep; The Bangko Sentral ng Pilipinas (BSP) also had its second rate cut within 100 days while Bank of Thailand (BOT) and The Bank of Korea (BOK) cut rate for the first time since 2015 and 2016 respectively. Nevertheless, Bank of Japan (BOJ) maintained its ultra-easing monetary policy unchanged despite the easing monetary actions by both the Fed and ECB.

Table 2: Policy rate (%)

End-period of	2011	2012	2013	2014	2015	2016	2017	2018	2019 (Aug/Sep)	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	1.75-2.00	1.50-1.75
Euro Area, ECB Deposit Facility	0.25	0.00	0.00	-0.20	-0.30	-0.40	-0.40	-0.40	-0.50	-0.50
Japan, BOJ Short-term Policy I/R	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 (LAF)	8.50	8.00	7.75	8.00	6.75	6.25	6.00	6.50	5.40	5.40
Korea, BOK Base Rate	3.25	2.75	2.50	2.00	1.50	1.25	1.50	1.75	1.50	1.50
Malaysia, BNM Overnight Policy Rate	3.00	3.00	3.00	3.25	3.25	3.00	3.00	3.25	3.00	3.00
Indonesia, BI 7-Day RR Rate	6.50	5.75	7.50	7.75	7.50	4.75	4.25	6.00	5.25	5.00
Thailand, BOT 1-Day Repurchase Rate	3.25	2.75	2.25	2.00	1.50	1.50	1.50	1.75	1.50	1.50
Philippines, BSP Overnight RR Facility	4.50	3.50	3.50	4.00	4.00	3.00	3.00	4.75	4.25	4.25

Source: Officials; SERC

CURRENT AND FORWARD INDICATORS

High frequency data charted a continued moderation in global growth. Weighed by the escalation of trade hostilities, the manufacturing Purchasing Managers' Index (PMI) reading fell to near seven-year low of 49.3 in July and 49.5 in August. As investors remain cautious about undertaking investment expansion as disrupted by trade war and a slowdown in global economy, world trade volume growth remained lacklustre while industrial production also paced slowly. Global semiconductor sales growth continued to contract in recent months. The World Semiconductor Trade Statistics (WSTS) expects semiconductor sales across major regions to increase by 3.1%-5.4% in 2020 (estimated -13.3% in 2019) with a higher growth expectation for optoelectronics.

Figure 1: Growth in the US and euro area continues to ease

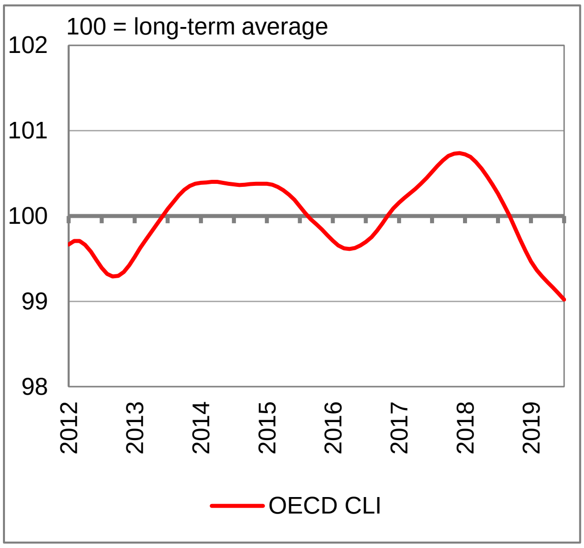


Figure 2: Global manufacturing PMI fell below 50-pt threshold for four straight months

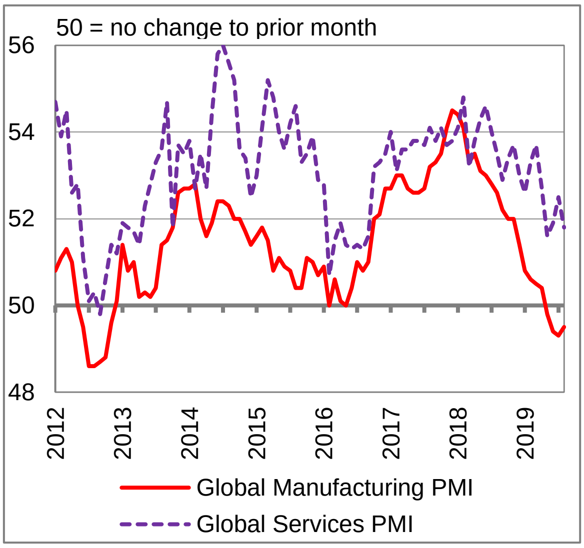


Figure 3: Both WTO goods and services trade barometers signal weak trade performance in 2H 2019

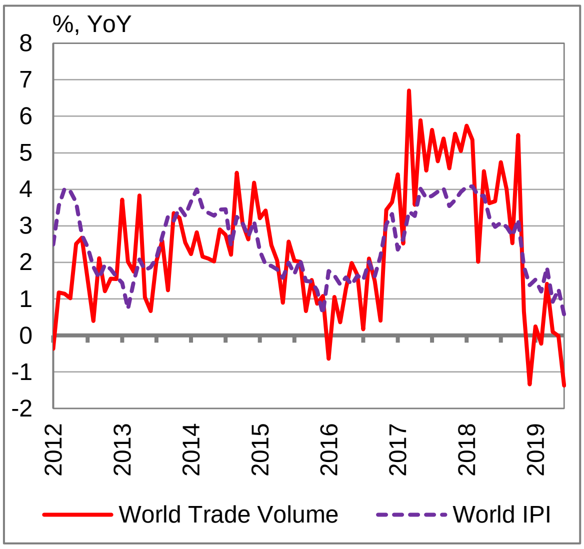
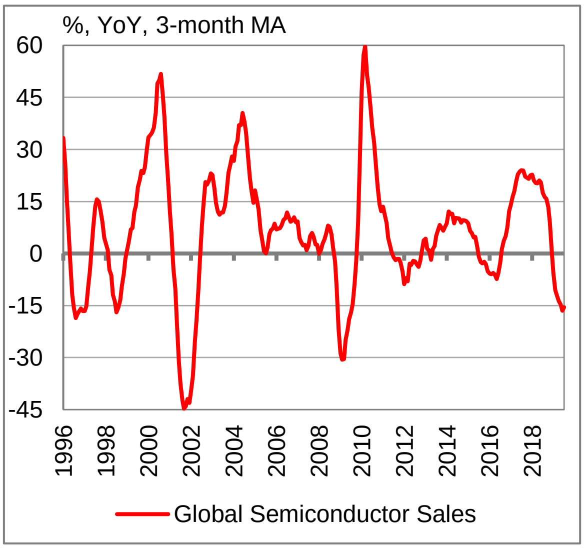


Figure 4: WSTS expects semiconductor sales to contract by 13.3% in 2019 but will rebound to grow by 4.8% in 2020



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

OECD business confidence weakened at a faster pace given the escalated trade tensions and heightened geopolitical risks. Meanwhile, **OECD consumer confidence** was also shaken though the index slightly above the optimism threshold.

Figure 5: OECD Business Confidence Index

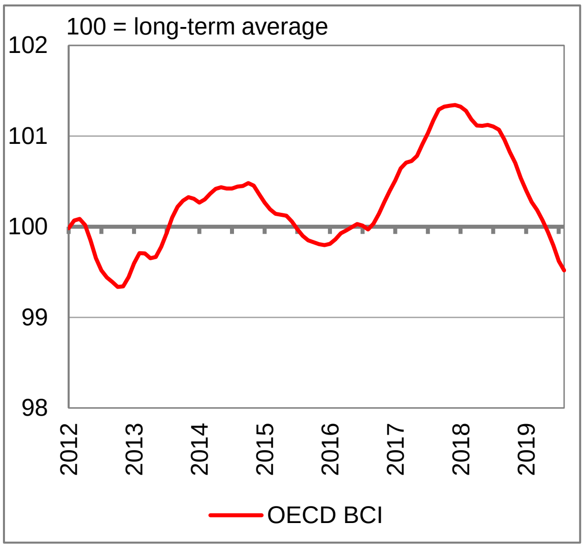
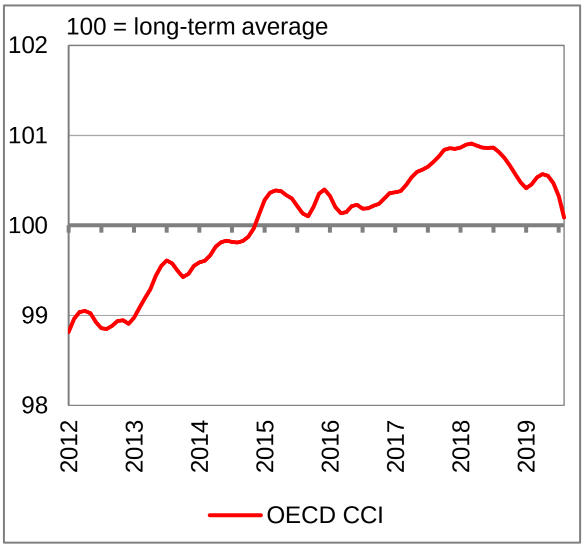


Figure 6: OECD Consumer Confidence Index



Source: OECD

Crude oil prices surged by 11.7 % to US$68.42 per barrel for Brent crude on 16 Sep (from US$61.25/bbl on 13 Sep) after the drone strike on Saudi Arabia's oil facilities. The attack has knocked out about five percent global oil supply (almost 5.7 million barrels per day). The market is concerned about the duration of supply disruption amid the continuation of crude oil supply cut until March 2020 agreed by OPEC+.

Several factors affecting the near-term movement of crude oil prices: (i) The duration of production disruption and recovery pace of Saudi Arabia's oil facilities; (ii) Adequacy of global stock in covering the supply disruption; (iii) Will OPEC+ supply cut continue?; (iv) Disruption from the US-China trade war; (v) Increasing shale oil production and production recovery of conventional crude from Hurricane Barry in the US; and (vi) The US-Iran tensions.

Figure 7: Crude oil prices spiked after the attack on Saudi Arabia's oil facilities

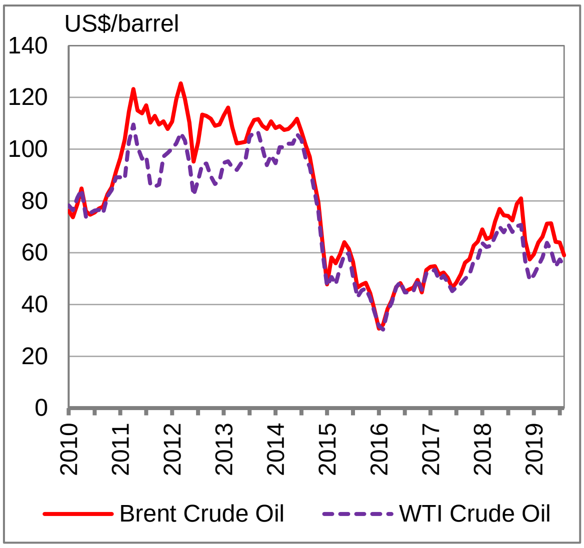
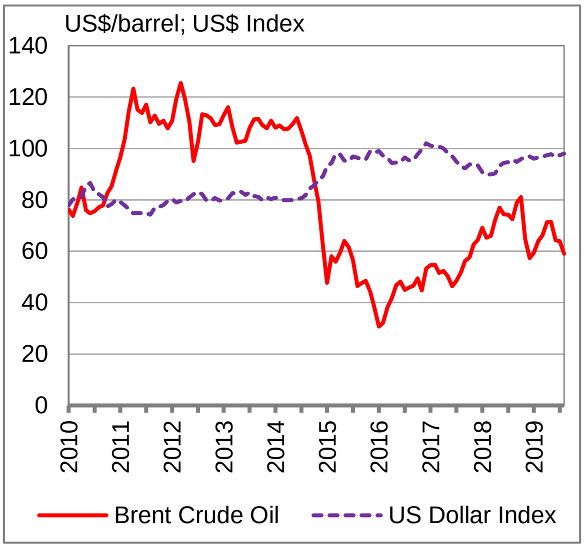


Figure 8: Brent crude oil price vs. the US dollar index



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

CPO prices crawled back to its highest point this year at RM2,195.50/mt on 26 August and averaged at RM1,987.50/mt in Jan-Aug. Nevertheless, the current price level remained low when compared to levels seen in 2016-2017 despite a continued reduction in inventory since February 2019 and firm external demand. In the first eight months of 2019, total exports volume of palm oil increased by 19.7% yoy to 12.6 million tonnes, with increases mainly contributed by India, China, Iran, Italy and Spain. Downside risks to CPO demand remain: (a) India's tariff policy on the importation of palm oil; and (b) Development related to the EU's phase out and eventually ban biofuels made from palm oil.

Figure 9: Precious metal prices are rising robustly in the face of higher external uncertainties

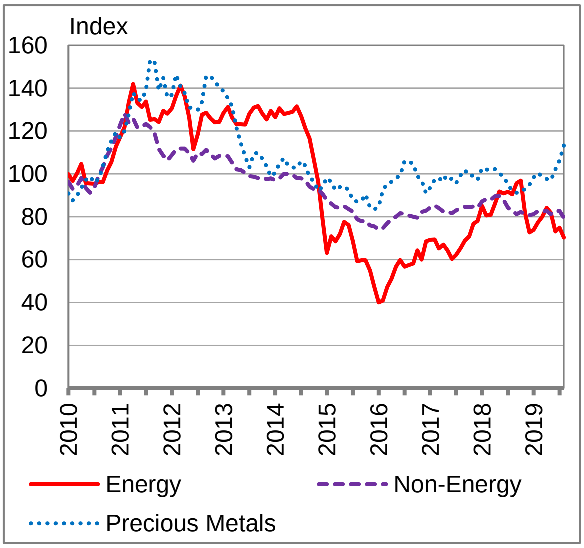
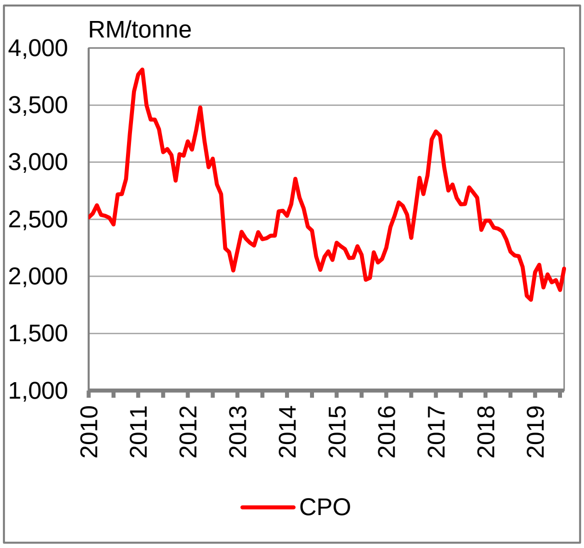


Figure 10: CPO's stockpiles at 13-month low in August



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

ECONOMIC DEVELOPMENTS IN ADVANCED ECONOMIES AND CHINA

The United States: Weakening exports and investment had dampened the US's economic growth in 2Q19 (2.0% annualised qoq vs. 3.1% in 1Q) amid resilient consumer spending backed by a healthy labour market. Buoyed by lower mortgage rate, the housing starts rose to a 12-year high in August. The ISM Manufacturing PMI printed below 50-pt threshold for the first time in August 2019 since August 2016. Industrial production weakened to 0.4% yoy in Aug and 0.5% in July (1.2% in 2Q and 2.9% in 1Q). The Fed cut its policy rate in July and September, taking it to 1.75%-2.00% so as to provide an insurance against the trade war-induced risks on the US economy. The Fed remains open to further rate cut if the economic conditions weaken.

Figure 11: ISM manufacturing PMI dropped below 50-pt threshold in Aug

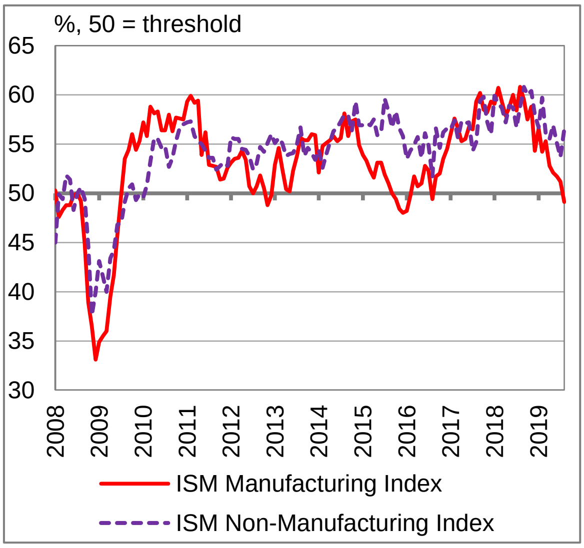


Figure 12: Industrial production growth remains lacklustre

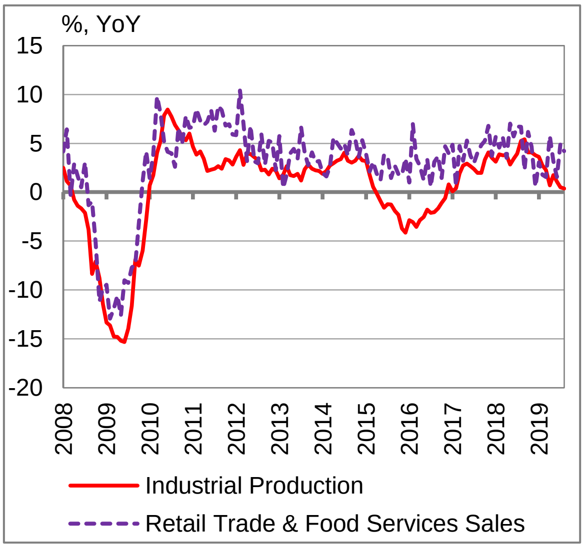


Figure 13: Unemployment rate sustained at 3.6%-3.8% since Feb

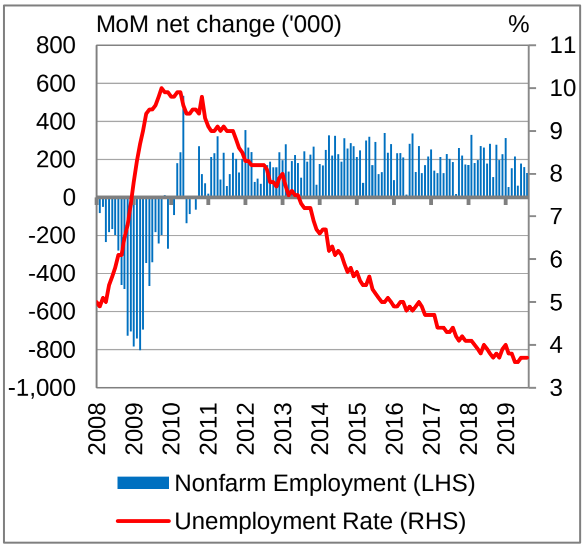
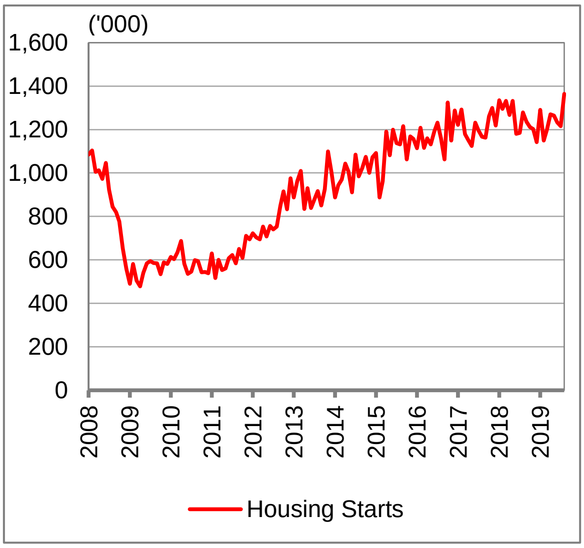


Figure 14: Housing starts surged to 12-year high in Aug



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

Euro area: Growth in the euro area expanded at a slower pace in 2Q19 (0.2% qoq vs. 0.4% in 1Q), blamed it on weak external sector. Germany registered a negative economic growth while Italy's growth stagnated. The increasing risk of a recession in Germany may also drag down the overall economy performance of the eurozone, particularly towed by its weakened export-dependent manufacturing sector. With the looming threat of a no-deal Brexit deadline approaching 31 October and potential risk of higher tariff imposition from the US as well as the political divide in some member countries, this has dampened confidence and investment prospects in euro area.

Figure 15: Manufacturing PMI nears seven-year low

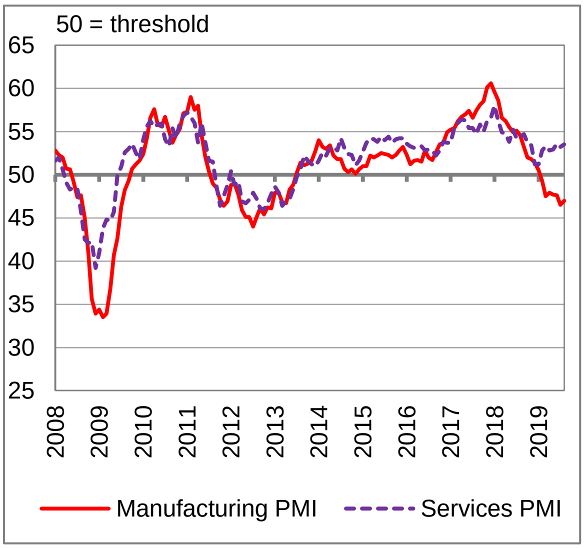


Figure 16: Industrial production contracted for nine consecutive months

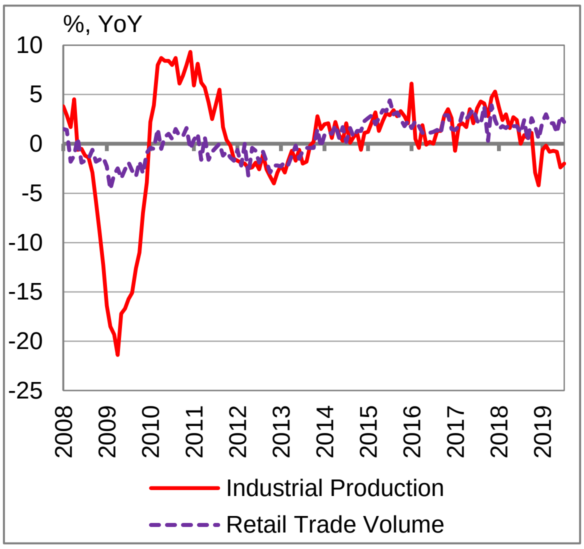


Figure 17: Headline inflation rate remained lethargic

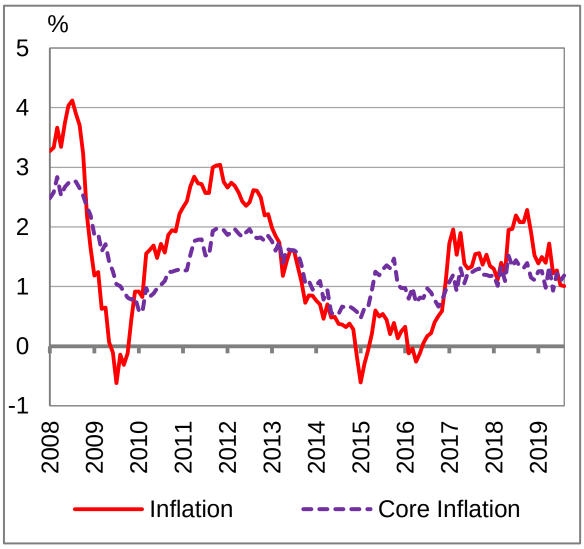
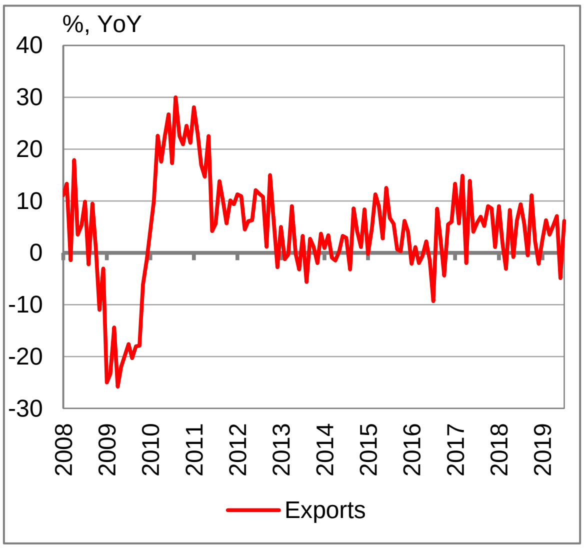


Figure 18: Uneven extra-EA exports



Source: Markit; Eurostat

Japan: The economy expanded for third consequent quarter in 2Q, albeit at a slower pace (0.3% qoq vs. 0.5% in 1Q). Leading indicators suggest slower growth ahead, core machinery orders are projected to decline by 6.1% qoq in 3Q. Retail sales did not reflect a front-loading consumer purchases effect despite the sales tax will be hiked to 10% comes October. Construction activities related to 2020 Tokyo Olympics may provide some growth support backed by increased public spending. Overall, the Government has limited policy tools to sustain the economy given restrained monetary stimulus amid a tight fiscal condition. BOJ had long pursued ultra-loose monetary policy (negative interest rate and bonds purchase) to prop up economic growth but was derailed by muted inflation, a strong indication of still weak domestic demand.

Figure 19: TANKAN suggests a more moderated growth ahead

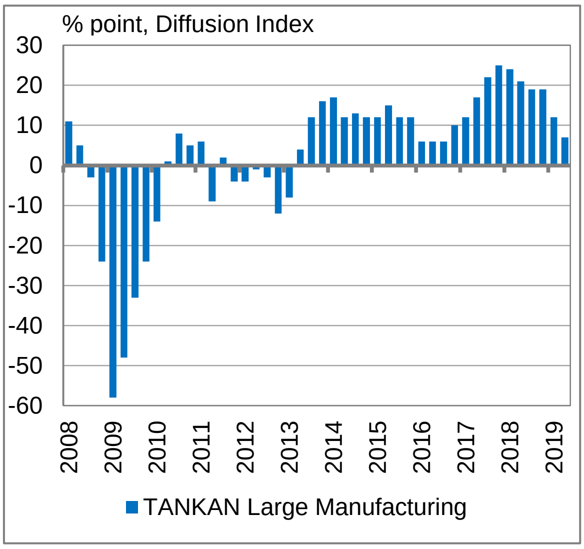


Figure 20: Retail sales contracted for the first time in Jul since Oct 2017

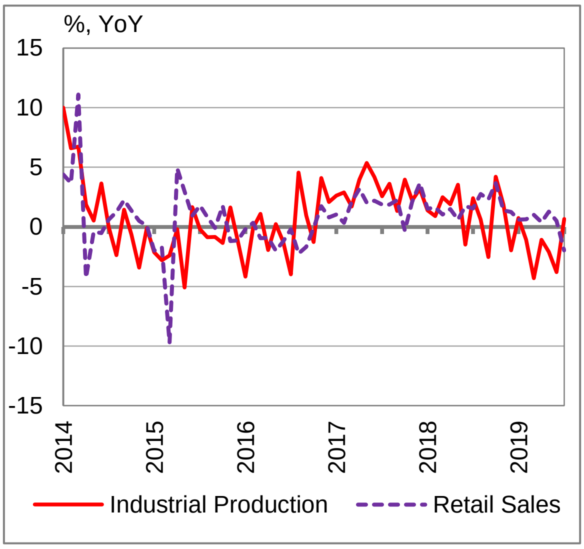


Figure 21: Muted inflation rate

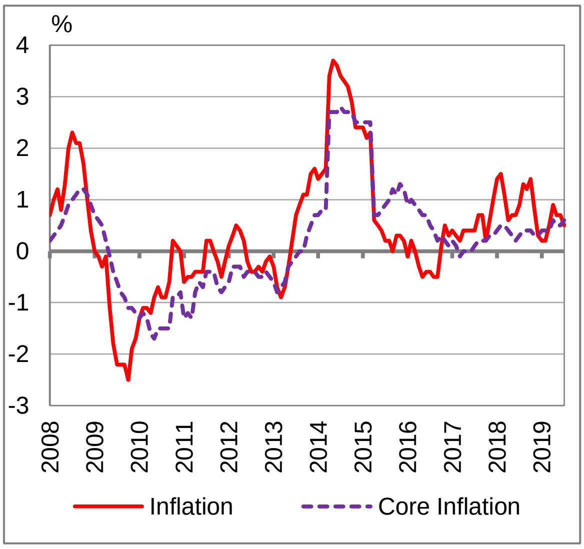
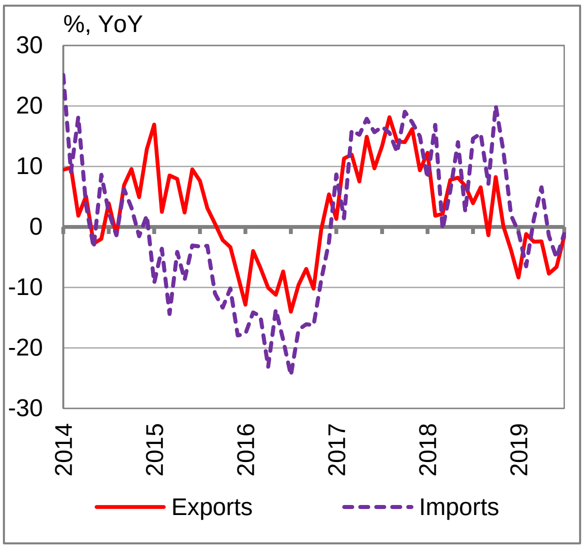


Figure 22: Trade deficit exceeded 1 trillion yen in Jan-Jul



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

China: Despite the economy expanded at a 27-year low rate of 6.2% yoy in 2Q19 (6.4% in 1Q), it is still commendable amid ongoing trade tensions with the US. The monetary easing and fiscal stimulus effect have been supporting the economy while the transformation and optimisation economic restructuring process continue to take place. However, China will have to diversify its export markets and re-orientate its supply chains to mitigate the impact of the trade tariffs war with China. After the initial US$250 billion of China's products have been taxed mostly at 25%, the remaining US$300 billion of products will have the full tariff imposition by mid-Dec 2019. The incoming data shows significant moderation across vary segments, indicating further growth moderation in the second half-year of 2019. The global complexity poses a real testing time for the landing speed of China, and there were views that without making meaningful structural reforms in the labour and product markets, state-owned enterprises as well as financial market, an economic growth of below 6.0% is likely to be another new normal for China in the coming years.

Figure 23: Manufacturing PMI fell below threshold for four consecutive months

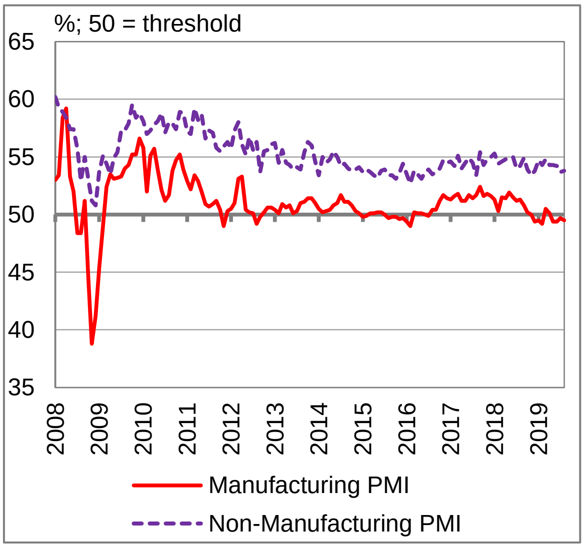


Figure 24: Both industrial production and retail sales are moderating

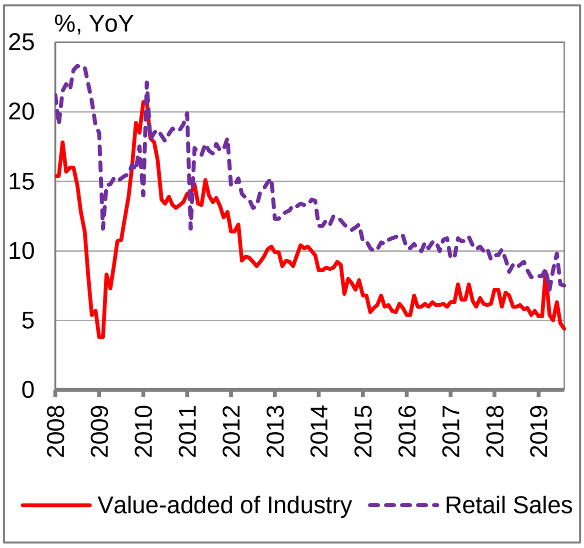


Figure 25: Fixed assets investment growth were broadly stable

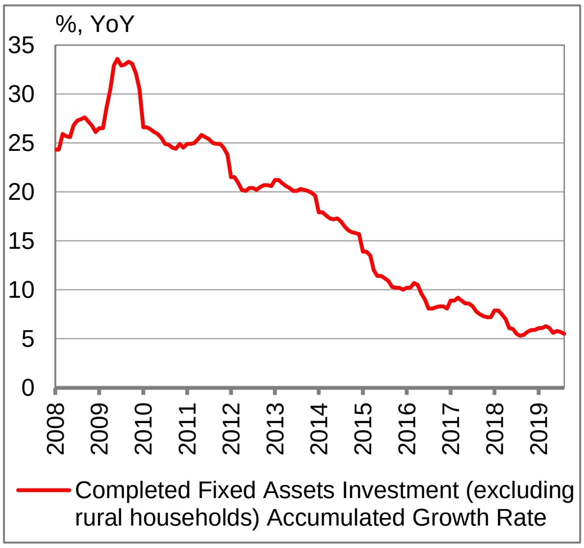
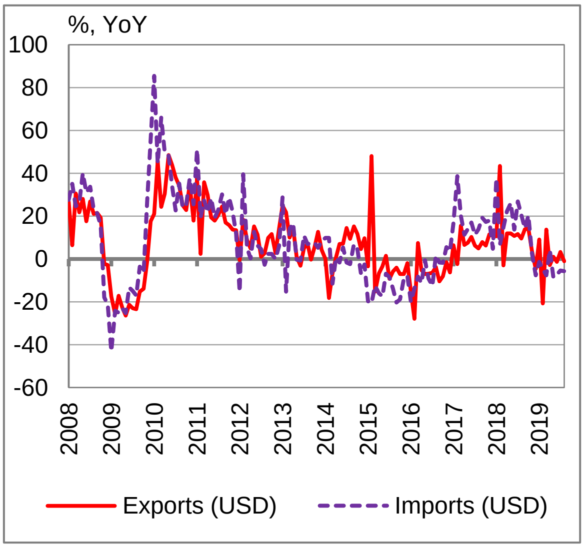


Figure 26: External trade remains uneven

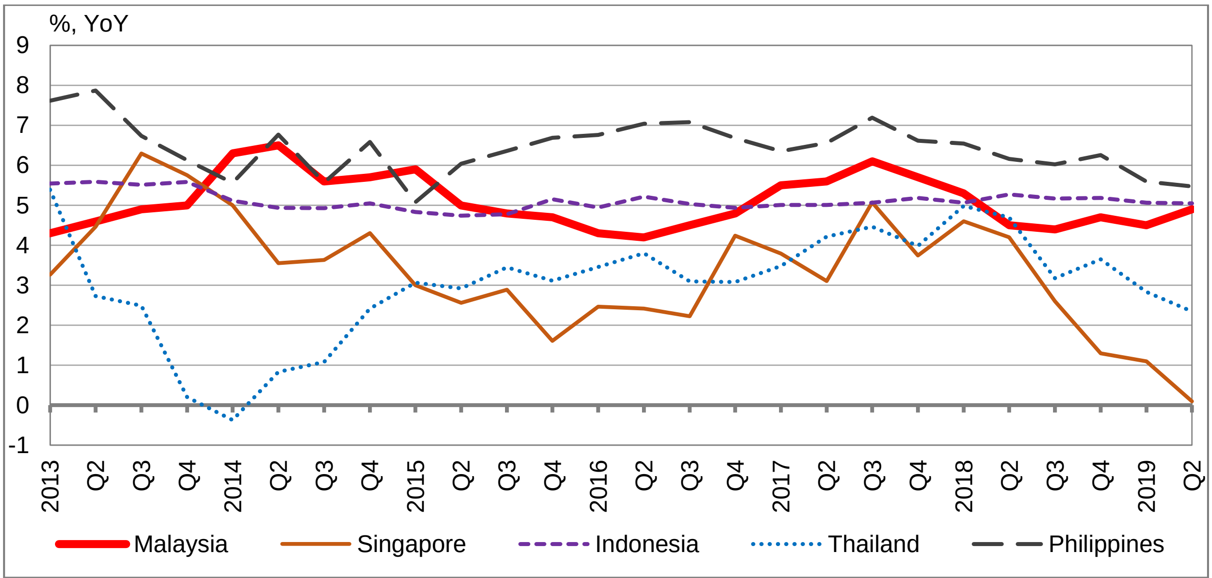


Source: National Bureau of Statistics of China; General Administration of Customs, China

ASEAN-5 ECONOMIES' KEY ECONOMIC DATA TRACKER

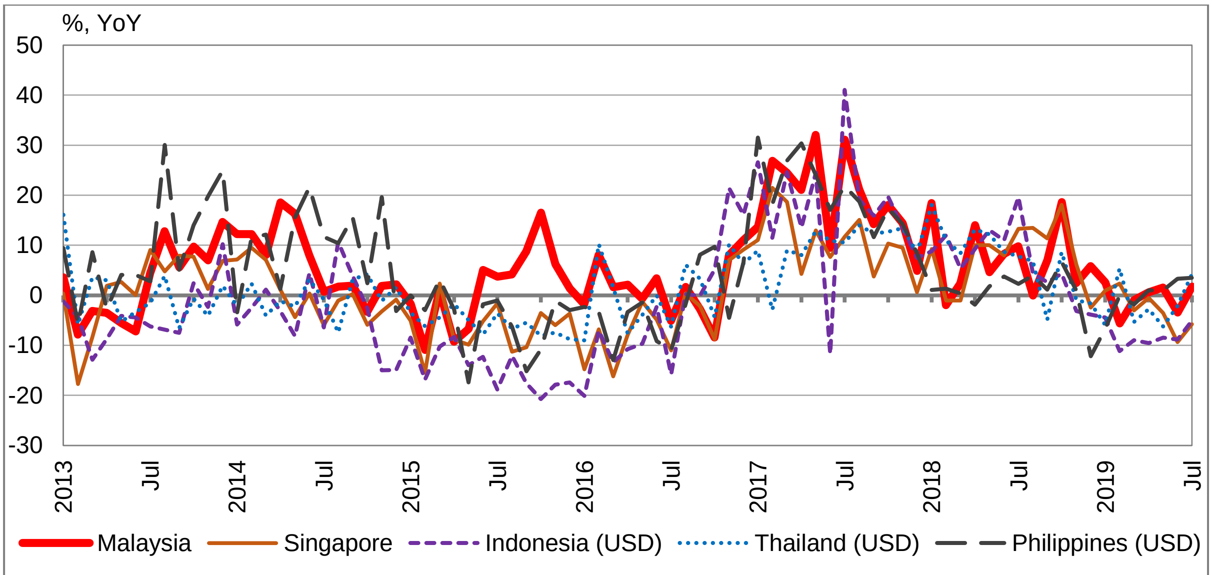
ASEAN-5 economies (Malaysia, Singapore, Indonesia, Thailand and the Philippines) have displayed mixed economic performance in 2Q19. Malaysia recorded a higher GDP growth while Singapore's economic growth nearly stagnated at 0.1% yoy and the risk of a technical recession is high as exports continue to contract sharply in recent months. In the first seven months, exports for these five economies have either contracted or stagnated, dragged by weak global demand and trade disruption. Industrial production for Singapore, Thailand and the Philippines have also contracted for at least three succeeding months in tandem with the deteriorated ASEAN manufacturing PMI.

Figure 27: Real GDP growth trend



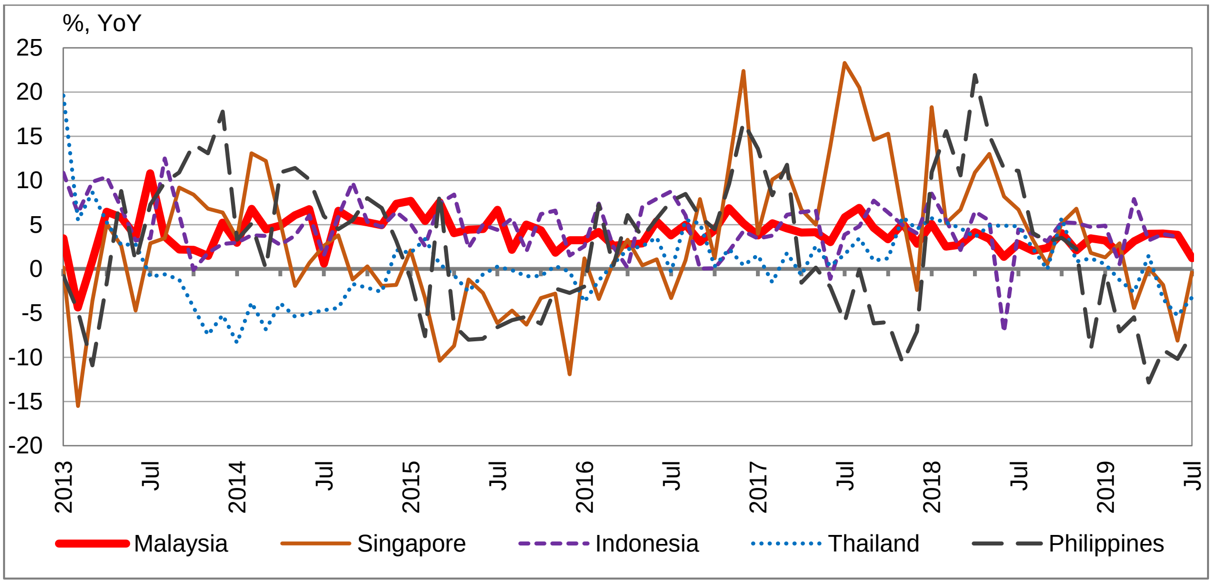
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; National Economic and Social Development Board, Thailand; Philippine Statistics Authority

Figure 28: Export growth trend



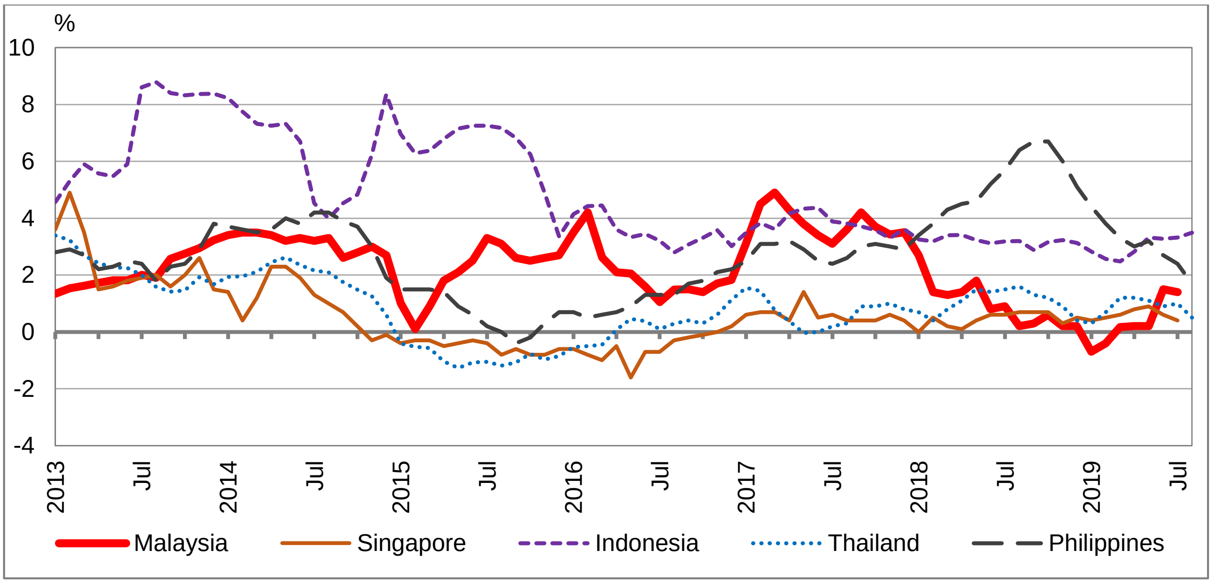
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Bank of Thailand; Philippine Statistics Authority

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

Higher GDP growth in 2Q19. Malaysia has managed to register higher GDP growth of 4.9% yoy in 2Q19 (4.5% in 1Q19), thanks largely to resilient consumer spending, which has been the prime mover of the economy. Both exports and private investment still weak. The continued expansion in services, manufacturing, and agriculture sectors along with a turnaround in mining output helped to deliver better 2Q GDP growth. Growth in the construction sector continues to languish for many quarters, due to the stubbornly property overhang in residential and commercial properties.

While Malaysia's 2Q GDP growth touted as better recent GDP growth number, but can it be sustained? While we expect continued positive economic growth, but the growth rate will likely be slower estimated 4.6%-4.7% in 2H 2019 given the heightened trade tensions could nudge the world economy towards a recession. Central banks worldwide are cutting interest rates to provide an insurance against the unattended global recession risk. However, a severe enough shock could usher in a global recession, even if central banks respond rapidly.

There are reasons for taking a cautious assessment of Malaysia's economic conditions in 2H 2019 and 1H 2020. These include lingering uncertainty about the trade tensions, global recession fears that roiled global bonds, equities, currencies, and commodities.

Overall, we estimate real GDP to increase by 4.7% in 2019 and 4.5% in 2020. With the persistent trade tensions and increasing global economy risks that would continue to weigh on exports, domestic demand, especially private consumption will have to be sustained to carry the weight of the Malaysian economy.

Private consumption growth though will slow but unlikely to pull pack sharply given still stable employment and wage growth. The continued payment of cost of living aid (BSH) will support the targeted households. Nonetheless, the high private consumption growth base effect in 3Q 18 due to the zerorisation of consumption tax in June to August 2018 would challenge a technical yoy comparison in 3Q19. Overall, private consumption growth is estimated to increase by 7.2% in 2019 (8.0% in 2018).

Private investment indicators suggest continued weak performance ahead. Imports of intermediate goods and capital goods are contracting while the overall capacity utilisation rate as surveyed by MIER fell below 80% to 77.6% in 2Q as businesses are keeping a cautious stance. Total approved investments in services, manufacturing and mining sectors increased by 7.6% yoy to RM92.0 billion in the first half-year of 2019. Foreign investment made up 53.8% of the investments with a 97.2% yoy growth while domestic investment made up a balance of 46.2% share. Approved domestic investment contracted further by 29.6%, underscoring domestic investors' uneasiness about economic prospects and the economic policies direction. Overall, private investment is expected to expand moderately by 2.6% this year (4.3% in 2018).

Slowing global demand and negative spillover effects from the trade hostilities, exports fell by 0.4% yoy in Jan-Jul 2019. The export sector remains clouded by the prolonged trade tensions over the next 12 months, contingent on the negotiations between the US and China on highly contentious areas such as intellectual property rights, forced technology transfer as well as subsidies on state-owned enterprises. SERC estimates exports to grow by 0.5%-1.0% in 2019 (18.9% in 2018) and 2.0%-3.0% in 2020.

Headline inflation has normalised starting June and will continue to rise moderately by 1.4%-1.5% in recent months. Headline inflation is expected to average 0.8% in 2019 (1.0% in 2018). Some upside risks may come from the removal of fuel subsidy and be replaced by a targeted fuel subsidy scheme based on the income threshold. Volatile global crude oil prices remain a wild card.

While low inflation gives BNM's space to lower interest rate should the economy under threat, the central bank will continue to monitor the incoming data and global development, and would reserve its monetary arsenal while continue to assess the impact of May's rate cut on domestic demand. It must be noted that the rate cut takes a lag impact of 2-3 quarters. In this regard, Bank Negara Malaysia is expected to keep the policy rate at 3.00% for now.

Ringgit will remain volatile. Along with other regional currencies, the ringgit is likely to move in a tight range, tracking with the performance of the US dollar and Chinese renminbi. Two policy risk events to watch are (a) The FTSE Russell's decision whether to exclude Malaysia bonds from its World Government Bond Index (WGBI) on 26 Sep; and (b) The US Treasury's review of Malaysia in the Monitoring List on currency practices and macroeconomic policies in 4Q. Investors are eyeing on the tabling of Federal Budget 2020 on 11 October, keeping a close tab on the fiscal deficit path and pinning hopes on the Budget will deliver some positive catalysts to growth. As at 13 September, the ringgit has appreciated against South Korean won (5.6%), euro (2.7%), Chinese renminbi (2.3%), pound sterling (2.2%) and Indian rupee (0.9%). The ringgit was on par with Singapore dollar but depreciated against Thai baht (7.3%), Indonesian rupiah (4.3%), Japanese yen (2.7%), Philippine peso (2.1%) and the US dollar (0.6%). It is expected that the ringgit will likely trade between RM4.15 and RM4.20 per US dollar at end-2019.

Table 3: Real GDP growth (% YoY)

Economic Sector [% share to GDP in 2018]	**2017**	**2018**	**2019 Q1**	**2019 Q2**	**2019 1H**	**2019*E* (BNM)**	**2019*E* (SERC)**
By economic sector							
Agriculture [7.3%]	5.7	0.1	5.6	4.2	4.9	2.8	4.6
Mining & Quarrying [7.6%]	0.4	-2.6	-2.1	2.9	0.3	0.8	0.5
Manufacturing [22.4%]	6.0	5.0	4.2	4.3	4.2	4.8	4.4
Construction [4.9%]	6.7	4.2	0.3	0.5	0.4	3.0	0.8
Services [56.7%]	6.2	6.8	6.4	6.1	6.3	5.7	6.1
By expenditure approach							
Private Consumption [57.0%]	6.9	8.0	7.6	7.8	7.7	6.6	7.2
Public Consumption [12.5%]	5.5	3.3	6.3	0.3	3.2	1.2	2.7
Private Investment [17.3%]	9.0	4.3	0.4	1.8	1.2	4.9	2.6
Public Investment [7.4%]	0.3	-5.0	-13.2	-9.0	-11.3	-7.1	-8.9
Exports of Goods and Services [67.6%]	8.7	2.2	0.1	0.1	0.1	0.1	0.3
Imports of Goods and Services [60.6%]	10.2	1.3	-1.4	-2.1	-1.8	0.0	-1.6
Overall GDP	**5.7**	**4.7**	**4.5**	**4.9**	4.7	**4.3-4.8**	**4.7**

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

Positive drivers/underpinning factors

(a) Malaysia is in a position of strength to face headwinds. Still-sound economic and financial fundamentals supported by facilitative policies and accommodative monetary policy. Bank Negara Malaysia (BNM) has the monetary space to lower interest rate from the current 3.00% level to counter the trade and financial transmission impact from a severe global economic downturn. During the 2008-09 Global Financial Crisis, BNM's overnight policy rate was cut to 2.00% in 2009.

(b) A well-diversified trade, economic sectors and sources of foreign direct investments. This helps to reduce vulnerability and risks inflicted by a particular sector and industry as well as country. The manufacturing sector is likely to be impacted the most, particularly the export-oriented industries (largely electronics and electrical products) while the services sub-sectors are transport and communication and wholesale. Both agriculture and mining sectors too would be affected by softening prices and lower demand.

(c) The Government's fiscal policy can be recalibrated to allow some room for an expansionary budget, focusing on sectors, initiatives and measures that would protect growth-enhancing spending and investment. A marginal reduction in the budget-deficit to GDP ratio of 3.2% for 2020 from estimated 3.4% of GDP in 2019 is acceptable given the need to turn on spending taps under the threat of a bigger global economic slowdown and its spillover effect on domestic economy via both trade and financial transmissions.

(d) The 2020 Budget policies must aim at strengthening economic resilience, sustaining domestic spending and investment, save jobs, create jobs and help viable companies staying afloat. It also prepares Malaysia to emerge stronger and enhance our capabilities and competitiveness for the long term. The measures should cover the following aspects: (i) Jobs preservation and creation; (ii) Enhancement of bank lending, especially to SMEs through enhancing existing schemes on risk-sharing initiative; (iii) Enhancing business cash-flow and cost of doing business; (iv) Strengthening competitiveness and innovation though Accelerated Capital Allowance (ACA); Reinvestment Allowance (RA), credit rebate and grants for innovation and adoption of IR4.0; (iv) Supporting households, especially B40 and targeted vulnerable group; (v) Green initiatives, renewable energy, public infrastructure and ports projects. Development of suburban nodes, road and rail networks, drainage and sewerage networks, and flood mitigation projects. Tourism promotion activities must be stepped up to capitalise on the Visit Malaysia Year 2020. Some recalibration of property measures to ease the property overhang in the residential and non-residential properties sector.

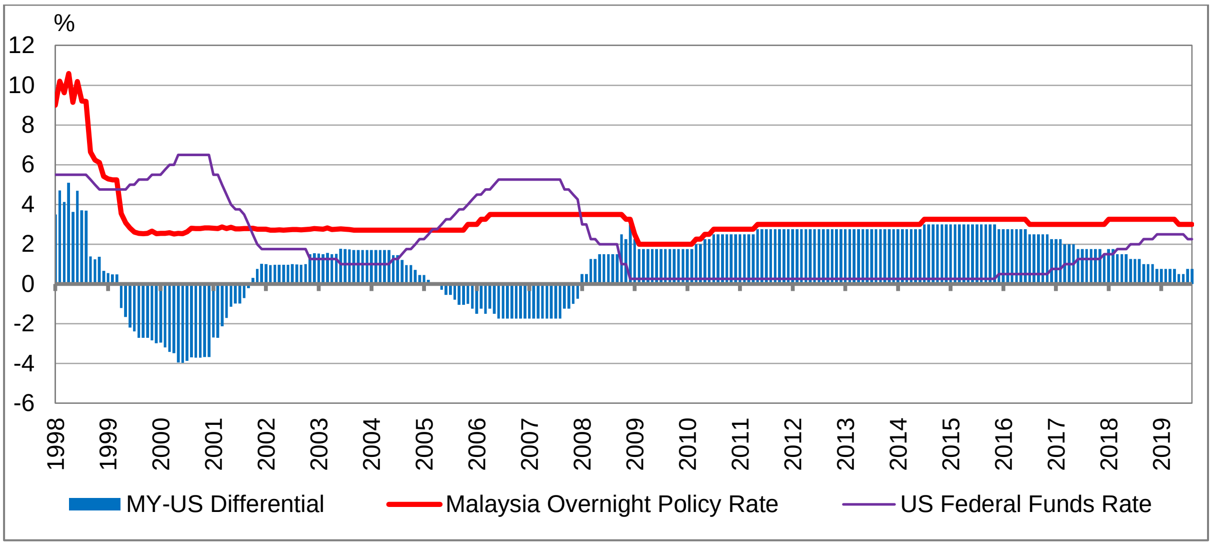
Negative headwinds/dampening factors

(a) There remains uncertainty about the progress of the US-China's trade negotiation. The Trump administration not only keeps on moving the goal post of striking a clear deal with China but also continues to veil threat of upping the ante on tariffs war, raising the risk that tariffs war will remain effect throughout 2020. The worsening trade tensions accompanied by global supply chains would significantly drag down business and sentiment in financial market, slow down trade and investment. Malaysia's exports will be dampened further, which we estimate to grow by 0.5%-1.0% this year and 2.0%-3.0% in 2020.

(b) Global recession fears have roiled the bonds, currencies, commodities and caused extreme volatility in global financial markets. The volatility also spillovers to Malaysia's equity and bond markets in the face of general emerging markets' risk-off sentiment. The continued financial volatility would weigh on market and investors' sentiment, accelerates capital outflows as the risk-adverse investors seek refuge on safe haven assets and currencies causing more downward pressures on the Ringgit.

(c) While domestic consumer spending has held up pretty well, we should remain wary about consumer resilience in the wake of global recession risk as they worry about the spillover effects on domestic economy via both trade and financial channels. The slackening private investment growth remains a concern, which requires prompt actions and measures to reinvigorate its vitality over the medium-term.

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

Leading indicators suggest continued economic growth, albeit slower in 2H 2019 due to a high-base effect in 2H 2018. Manufacturing production sustained at 4.0% yoy in July (4.1% in 2Q and 4.0% in 1Q), a decent start for overall economy in 3Q. After contracting for six consecutive quarters, mining output, which had turned around to grow by 3.3% in 2Q reversed to contract sharply by 8.4% in July due to an estimated one-month shutdown of Gumusut-Kakap oilfield in offshore Sabah for maintenance purposes.

Figure 32: Leading index indicates easing growth ahead

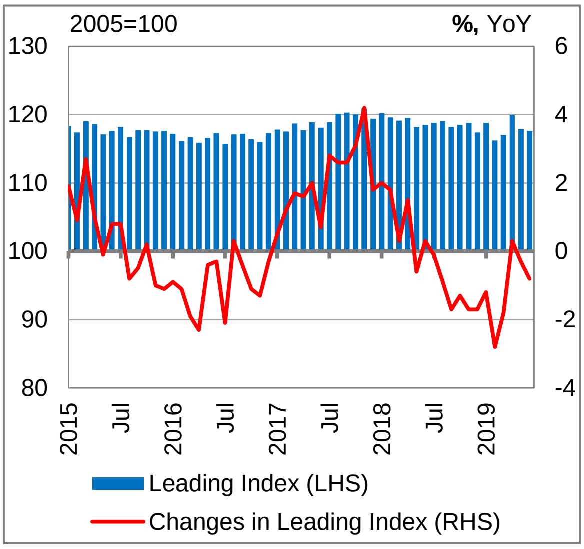
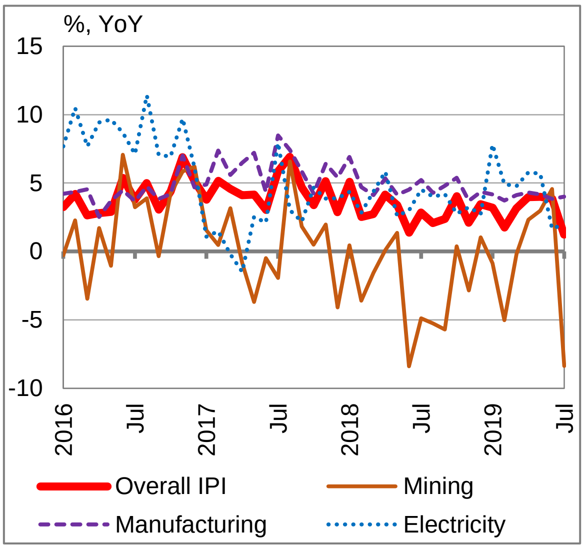


Figure 33: Manufacturing production growth sustained; mining output declined sharply in July



Source: Department of Statistics, Malaysia

Exports; Manufacturing sales and Distributive trade

Exports expanded by 1.7% yoy in July after contracting for two consecutive quarters (-0.4% in 2Q and -1.1% in 1Q). However, it still declined by 0.4% in Jan-Jul, mainly dragged by the drop in palm oil and refined petroleum products in the first quarter. Clouded by the escalating trade tensions between the US and China, exports are estimated to grow by 0.5%-1.0% in 2019. Manufacturing sales and wholesale trade growth continue while retail sales had moderated somewhat. Motor vehicle sales declined in June and July due to the zerorisation of GST in Jun-Aug last year; the same trend is expected to continue in August.

Figure 34: Trading activities remained sluggish

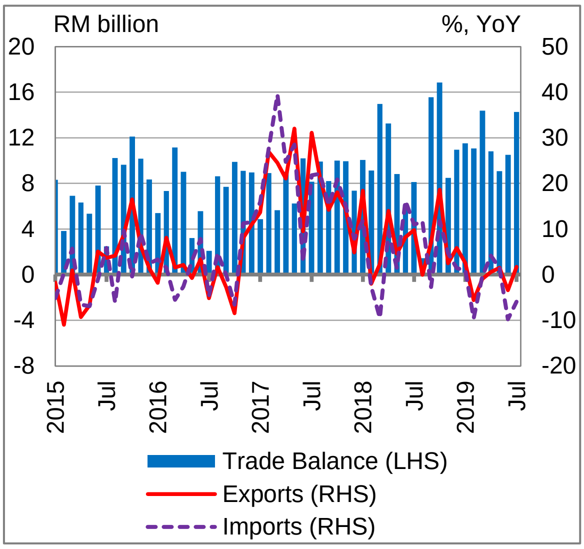


Figure 35: Non electronics and electrical products exports nearly stagnated

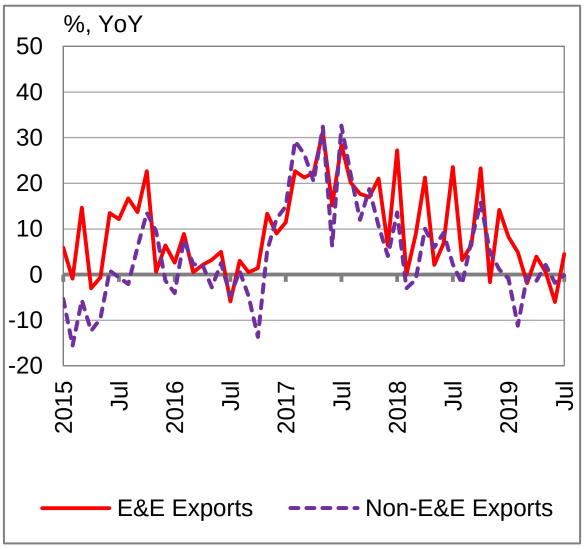


Figure 36: Manufacturing sales growth sustained

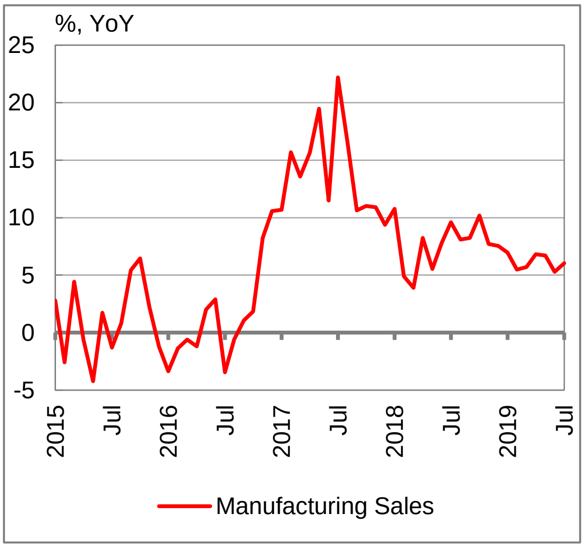
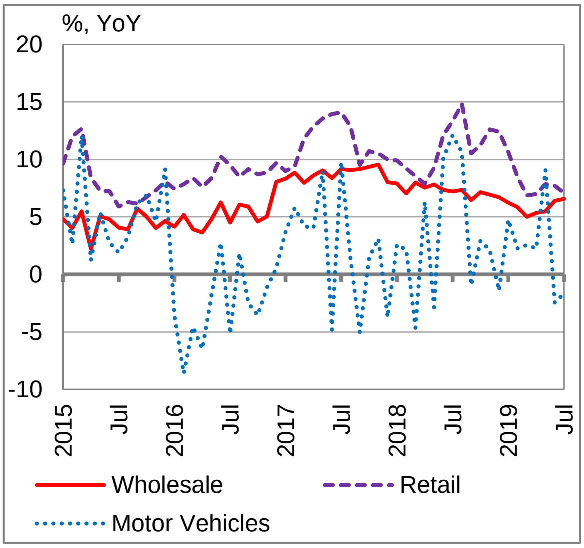


Figure 37: Wholesale and retail sales continue to grow, except motor vehicles



Source: Department of Statistics, Malaysia

Private consumption indicators

The final tranche of Cost of Living Aid (BSH) totalling RM1.23 billion were distributed starting 28 Aug, is expected to support consumer spending amid still cautious consumer sentiments. Subdued passenger car sales since June are expected due to the zerorisation of GST in Jun-Aug last year, which distorted the yoy growth comparison. Meanwhile, several private consumption indicators signalled some moderation ahead. Overall, SERC expects private consumption to pick up in the final quarter of 2019, backed by festive season demand and school holidays as well as back to school spending. SERC expects private consumption to grow by 7.2% in 2019 (8.0% in 2018).

Figure 38: The sharp decline in passenger car sales since June is distorted by the lapsing of consumption tax policy

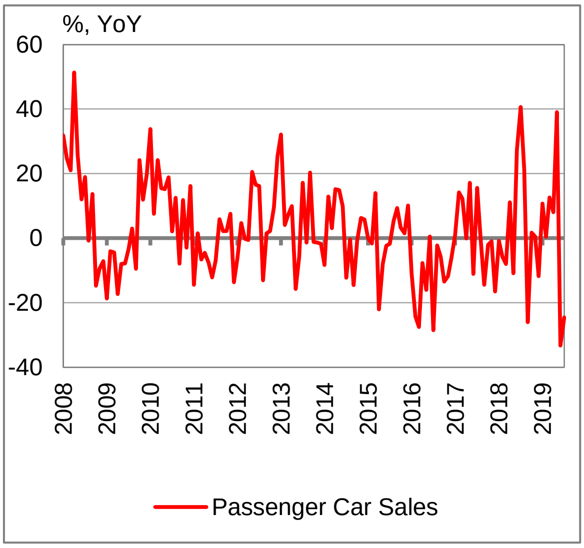


Figure 39: Selected private consumption indicators

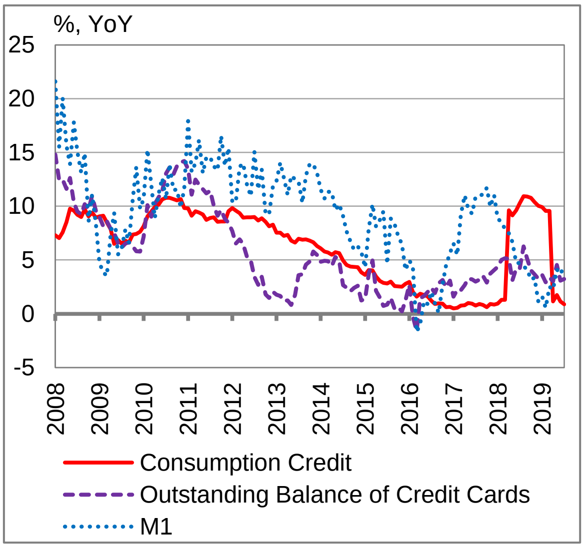


Figure 40: Low growth in employee compensation

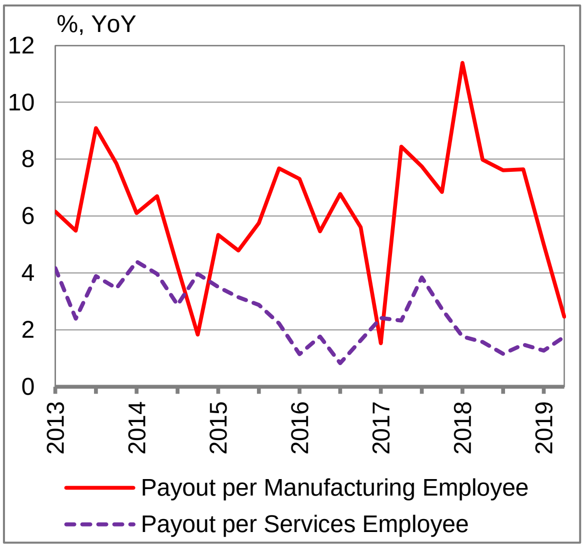
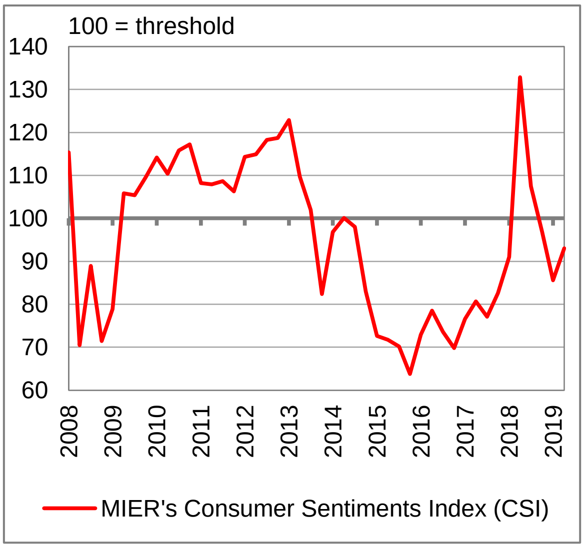


Figure 41: Consumer sentiments improve cautiously



Note: Loan data for April 2018 onwards have been revised to include MBSB Bank Berhad.
Source: Department of Statistics, Malaysia; Malaysian Institute of Economic Research

Private investment indicators

Private investment indicators suggest uninspiring investment activities ahead. Growth in imports of intermediate goods and capital goods in recent months presage weak industrial output and exports. Capacity utilisation rate fell below 80% in 2Q. MIER surveys revealed that sales have deteriorated amid a decline in export sales expectation, suggesting worsening business conditions. With commercial vehicles sales declined by 35.7% yoy in July and 40.6% in June, this year's sales target is highly unachievable. According to ACCCIM's M-BECS, Malaysian businesses are keeping a cautious stance on business conditions in 2H 2019. Given the increasing external uncertainties and unresolved domestic business issues, private investment is expected to grow moderately by 2.6% in 2019 (4.3% in 2018).

Figure 42: Selected private investment indicators

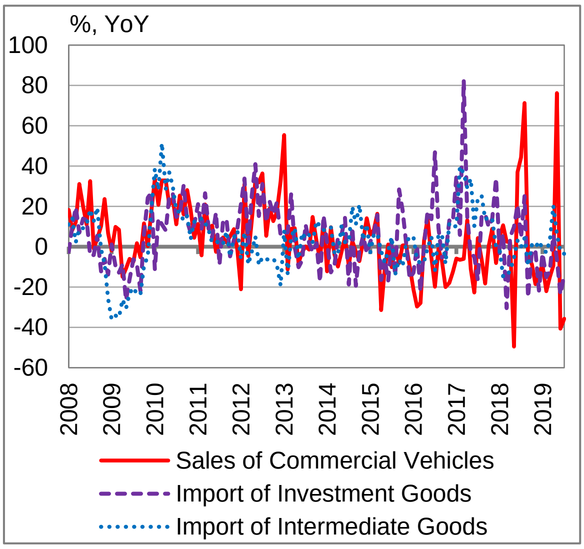


Figure 43: Real private investment trend

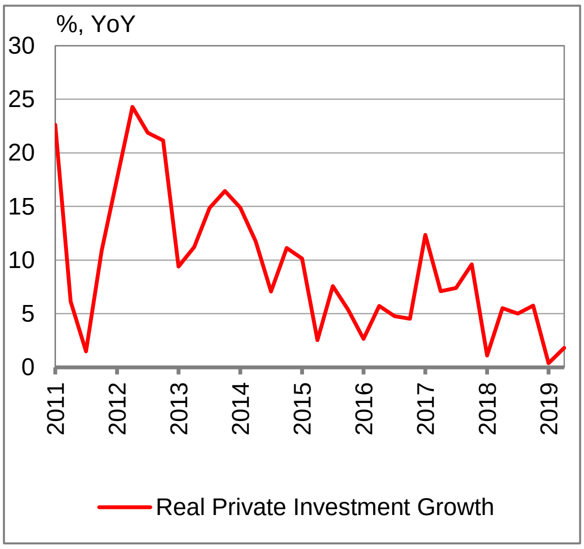


Figure 44: Capacity utilisation rate dropped to 77.6% from 81.4%

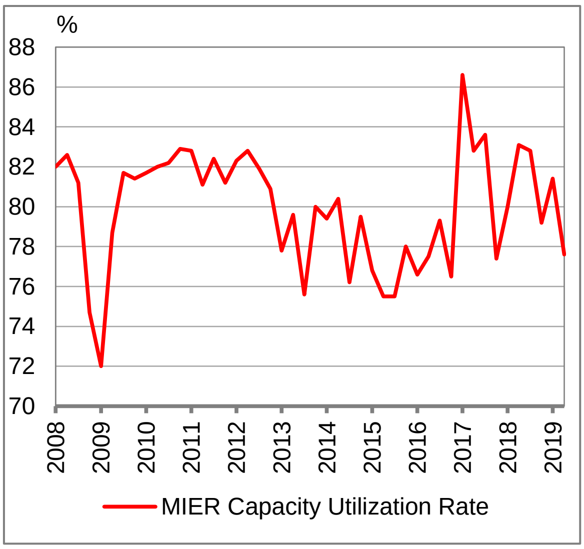
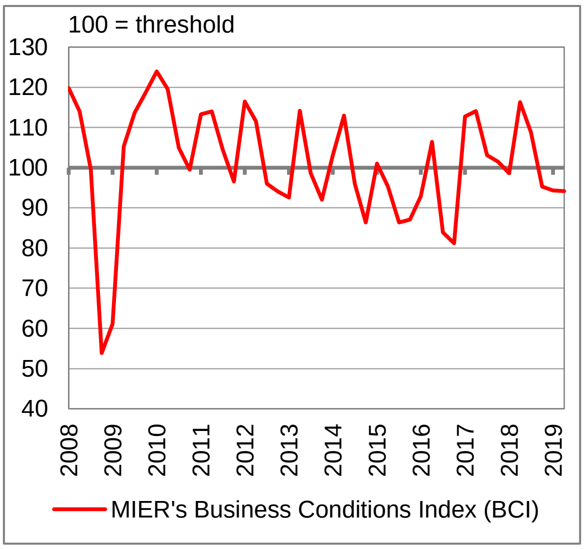


Figure 45: Business conditions dip below optimism threshold for third consecutive quarter



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

Price indicators

Inflation rate crawled back to 1.4% yoy in June and 1.5% in July after a year of subdued consumer inflation in 2018. Though the price increases are expected on low base effect (lower prices due to the zerorisation of GST), the general price levels have not elevated to a worrying level, thanks to still-subsidised fuel prices for RON95. Excluding the effect of consumption tax policy, core inflation has sustained at 1.4%-1.6% since June 2018. Headline inflation is expected to average 0.8% in 2019 (1.0% in 2018). Some upside risks may come from the removal of fuel subsidy.

Figure 46: Inflation has normalised starting June

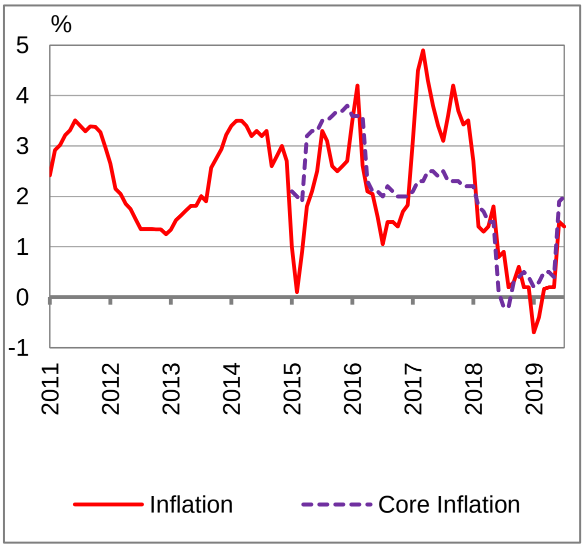
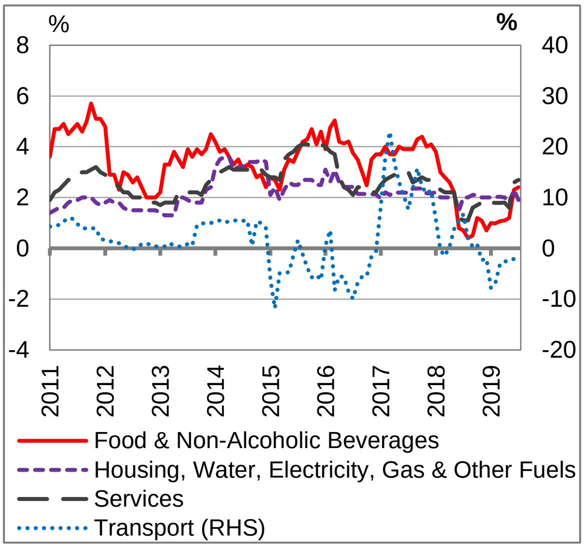


Figure 47: Price levels remain manageable with the lapsing impact of consumption tax changes



Source: Department of Statistics, Malaysia

Banking loan indicators

Total outstanding loans extended by banking system expanded at a much slower pace of 3.9% yoy in July (4.2% in June and 4.5% in May), dragged by both household sector (4.7% in July and 4.9% in June) and business sector (2.5% in July and 3.4% in June). Loans extended for purchases of transport vehicles contracted while for residential property and working capital softened. The growth trend for loan applications, approvals and disbursement have been very uneven in recent months: Loan applications grew by merely 0.5% in July (-11.3% in June); loan approvals increased by 11.2% in July (-3.0% in June); and loan disbursement growth rose by 1.8% in July (-11.8% in June). Non-performing loans ticked higher to 1.60% of gross loans in July (1.57% in June and 1.48% in March), mainly due to the increases in business sectors, particularly the manufacturing sector (3.2% of gross loans in the manufacturing sector in July vs. 2.9% in June and 2.2% in March).

Figure 48: Business loan growth slowed significantly to 2.5% in July (3.4% in June)

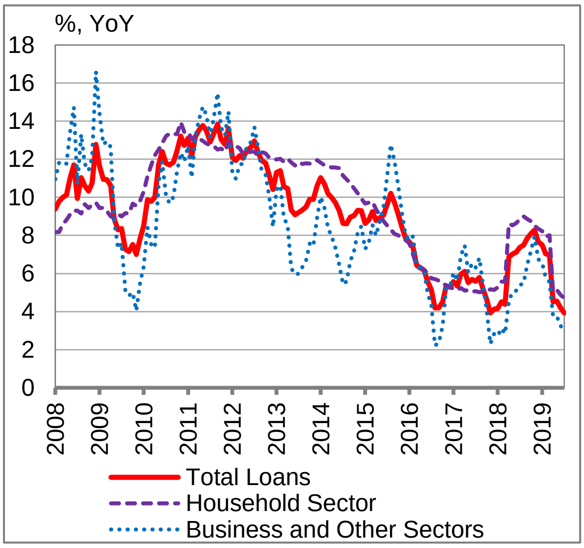


Figure 49: Loan applications growth

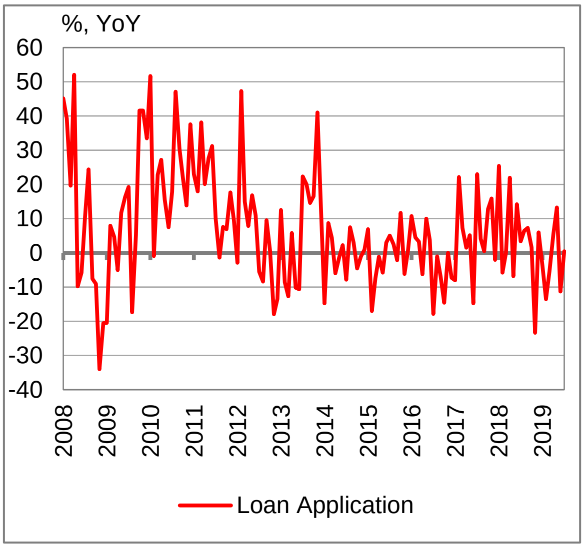


Figure 50: Loan approvals growth

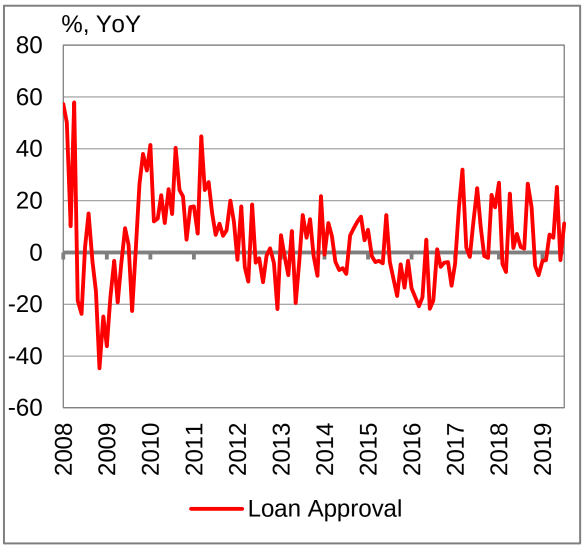
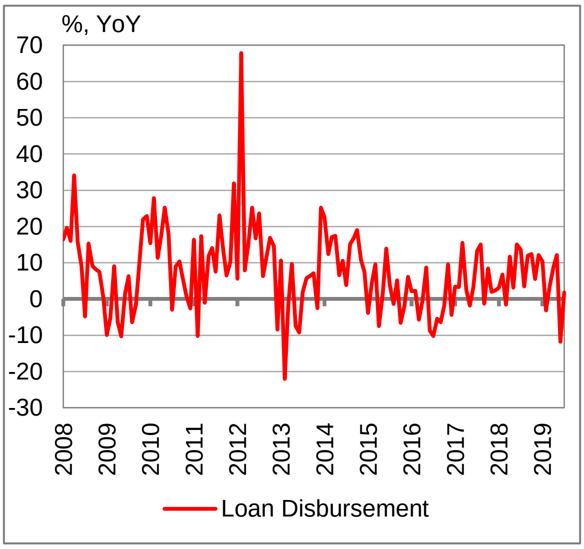


Figure 51: Loan disbursements growth



Note: Loan data for April 2018 onwards have been revised to include MBSB Bank Berhad.
Source: Bank Negara Malaysia

Financial indicators

Foreign reserves accumulated by US$2.1 billion to US$103.5 billion as at end-August 2019, compared to US$101.4 billion as at end-2018. The reserves position is sufficient to finance 7.6 months of retained imports and is 1.1 times of total short-term external debt.

Foreign investors' holding of domestic equities and bonds were uneven throughout the period of Jan-Aug. Foreigners had made a net selling of RM5.9 billion of government debt securities (MGS, GII, T-bills and Islamic T-bills) in 2Q, net-off the RM5.7 billion net purchases in 1Q. They returned to the market making a net purchase position of RM5.8 billion in July and sold a little (RM0.1 billion) in August. Overall, foreign ownership of MGS picked up to 37.7% as at August from 36.9% as at June, but still lower than 38.7% as at March.

The potential risk of Malaysia's exclusion from the World Government Bond Index (WGBI) continued to weigh down investors' sentiments on domestic debt securities. Foreign investors continued to trim their holding of domestic equities. In the first eight months of 2019, a net selling of RM7.4 billion worth of stocks were committed by foreign institutional and retail investors (a net sold of RM11.9 billion in 2018). Overall, the net outflows in portfolio investment has exerted downward pressure on the Malaysian ringgit.

As of 13 September, the ringgit is running behind the greenback by 0.6% to RM4.1645/US$ compared to RM4.1385/US$ as at end-Dec 2018 (RM4.1420/US$ at end-June and RM4.0810/US$ at end-Mar 2019). Against other major and regional currencies, the ringgit has appreciated against South Korean won (5.6%), euro (2.7%), Chinese renminbi (2.3%), pound sterling (2.2%) and Indian rupee (0.9%). The ringgit was on par with Singapore dollar but depreciated against Thai baht (7.3%), Indonesian rupiah (4.3%), Japanese yen (2.7%) and Philippine peso (2.1%). The ringgit is estimated to trade between RM4.15 and RM4.20 per US dollar as at end-Dec 2019. Risks to the ringgit include the judgement day from the FTSE Russell on 26 September, 2020 Federal Budget in terms of the fiscal deficit level and budget measures on 11 October as well as the continued global policy and geopolitical risks.

Figure 52: International reserves slid by a tad US$0.4 billion to US$103.5 billion in Aug

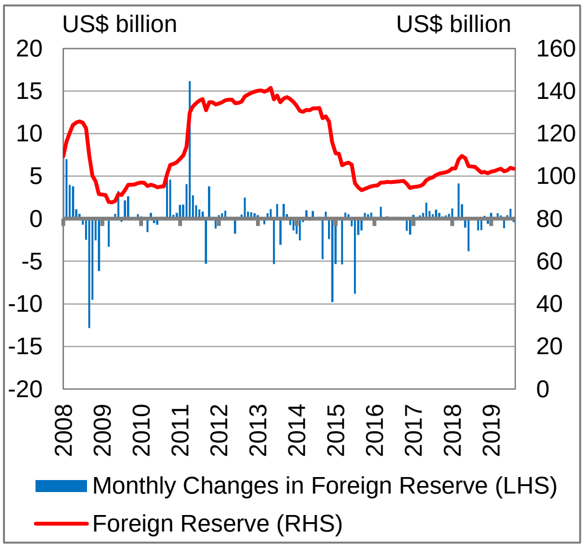


Figure 53: Ringgit's effective exchange rate

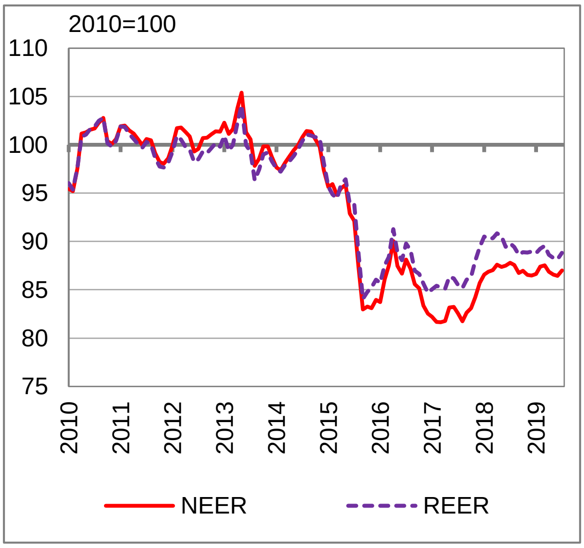


Figure 54: Ringgit against major foreign currencies

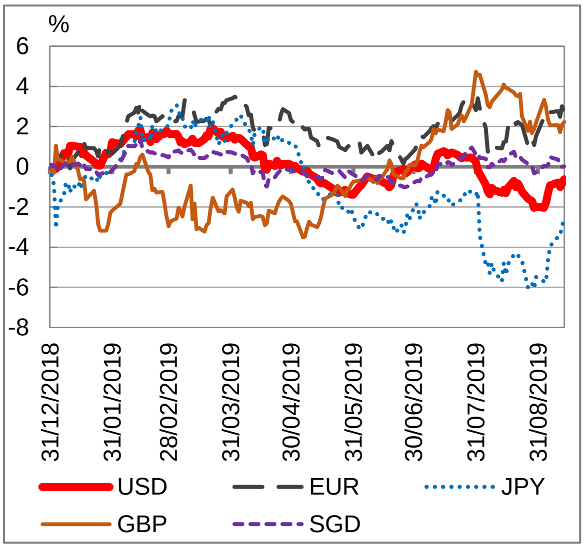
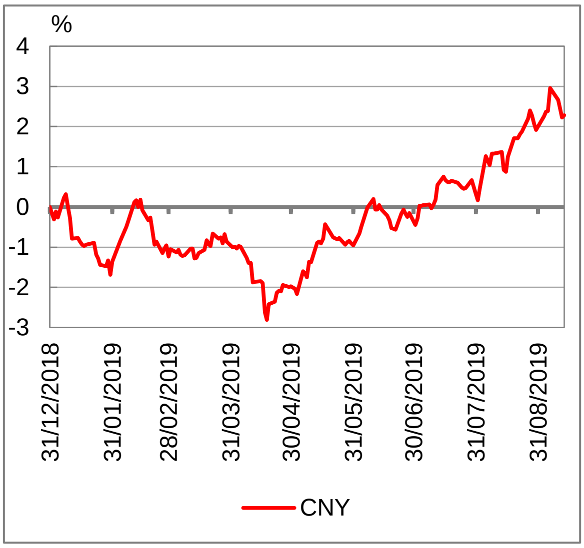


Figure 55: Ringgit against Chinese renminbi



Source: Bank Negara Malaysia; Bank for International Settlements

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