QUARTERLY ECONOMY TRACKER

(APRIL-JUNE 2017)

Socio-Economic Research Centre (SERC)

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Socio-Economic Research Centre (SERC)

Executive Director

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

Head of Research

Ms. Sum Kum Mooi - *kmsum@acccimserc.com*

Researcher

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

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

Administrative and IT Executive

Ms. Vicki Lai Mun Yee - *vickilai@acccimserc.com*

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Executive Summary

A. GLOBAL ENVIRONMENT

- **Still going steady**. Despite the US economy started on a weak note in 1Q17, which is not unusual, the global economy should stay on course to show a better performance this year. High frequency current and lead indicators, namely, the OECD Composite leading index, global Purchasing Managers' indices for manufacturing and services as well as semiconductor sales continued to firm up, cementing positive optimism about the global growth. Investors' optimism in global equities generally remained intact. Bouts of market volatility associated with intermittent doubts about the Trump's shaping of economic policies, especially the outcome of the inward-looking policies and much awaited tax reforms. Some controversial issues surrounding the White House also spooked the market.
- **2017-18 global growth estimates tweaked higher**. The International Monetary Fund (IMF) raised global growth forecast for 2017 but warns about protectionism. Global growth is expected to reach 3.5% this year (from 3.4% previously) and 3.6% in 2018. However, the IMF warned that risks to global growth remain to the downside with structural issues such as low productivity growth and high-income inequality holding back economic development. Pressures for the inward-looking policies are increasing in advanced economies. The US economy is expected to expand 2.3% this year, up from 1.6% in 2016. China's growth forecast is raised to 6.6% in 2017 and 6.2% in 2018. However, it warned the economy is over-relying on government stimulus and credit to maintain growth. The persistent resource misallocation raises the risk of a disruptive adjustment in China.
- **Global central banks' dovish comments signal an end to easy-money era?** Though the Federal Reserve (Fed) is on track to move interest rates at a measured pace, it remains a challenging task for the Fed to continue normalising its interest rate whilst shrinking its balance sheet so as not to disrupt the economic recovery. The speed at which the Fed raises interest rates will depend on the level of fiscal stimulus and tax reform creates significant inflationary pressure. In the eurozone, the ECB removed reference to further rate cuts though it is too early to end its asset purchase programme. Bank of Japan offers no hint of future rate rises as it battles to reach the inflation target of 2.0%.
- **Political, policy, regulatory and geopolitical risks at play.** The threat of protectionism, the unexpected aggressive stance of the US monetary policy, regulatory barriers, geopolitical tensions in the Middle East, domestic political scenes in some advanced economies, including the on-going UK Brexit negotiations as well as rising terrorism threats represent a substantial drag on the global economic outlook.

B. MALAYSIA'S ECONOMIC PERFORMANCE AND OUTLOOK

- **The economy gets off to a surprisingly strong start in 1Q17.** The Malaysian economy gained stronger traction to grow by 5.6% yoy in 1Q17 from 4.5% in 4Q16, lifted by sturdier domestic demand (7.7% in 1Q vs. 3.2% in 4Q16) and higher exports (9.8% in 1Q vs. 2.2% in 4Q16). This marks the strongest quarter growth in almost two years since 2Q15 (5.7%). Nevertheless, it remains to be seen whether this strong 1Q GDP growth can be sustainable in the remaining quarters given dissipating favourable base effects.
- **Consumer spending defies gravity.** Despite grappling with higher cost-induced inflation pressures, stubbornly high cost of living amid weak consumer sentiment, consumer spending growth rose further by 6.6% in 1Q17 (6.2% in 4Q16), partly thanks to higher cash handouts at estimated RM2.6 billion during the first phase of payment in February. Private investment growth also expanded strongly by 12.9% in 1Q17 (4.9% in 4Q16) after trapped in low single-digit rates for many quarters. Higher capital spending was in services and manufacturing. The strong rebound in 1Q helps to allay fear of losing traction as private investment growth had slowed for four years in a row since 2013.
- **Higher growth in most economic sectors.** Gauging from a slew of latest available economic and financial data indicators and data, the sustained high demand for consumer and trade-related services, continued expansion of the manufacturing, construction and agriculture sectors should continue to underpin economic growth. Our preliminary estimate for real GDP growth to increase by 5.0% yoy in 2Q17 (5.6% in 1Q).
- **2017's GDP growth estimates revised higher.** With higher-than-expected exports and better GDP growth in 1Q17, we have raised this year's GDP growth estimate to 5.0% from 4.3% previously (Bank Negara Malaysia's estimate: 4.3-4.8% in 2017). Following the revision, we now expect GDP growth to average between 4.7-5.0% in the remaining three quarters, taking the full-year growth to 5.0%. The swing factor is the strength of private consumption, investment and exports. We think the strong double-digit growth seen in 1Q17 may not repeat in the quarters ahead due to dissipating favourable base effects in 2H17.
- **Policy balancing to sustain growth and preserve economic resilience.** With the global economic, financial and political landscape remains unpredictable, the challenge for the policy makers is to sustain the gaining momentum. While we reckon that macroeconomic fundamentals should continue to support growth, the economic and financial management policies should focus on: staying on the path of fiscal consolidation to build fiscal space and contain debt; carefully calibrate monetary policy to anchor growth amid financial volatility; continued vigilance on financial risks through macroprudential measures; and leveraging on productivity, innovation and digitalisation to uplift the growth potential.
- **Domestic demand continues to drive the economy.** Households have displayed their spending resilience in 1Q17 despite coping with high cost-induced inflation pressures and rising cost of living. Private consumption growth is now expecting to grow by 6.2% in 2017 and 6.0 % in 2018 respectively (6.0% in 2016), though slowing from an average growth of 7.1% in 2011-15. While lingering uncertainty associated with the General Election 14 (GE14) may temper investors' sentiment, we continue to see better prospects for private investment over the medium-term, backed by the on-going implementation and new infrastructure projects related to rail and ports projects. Real estate development projects and continued investment in manufacturing and services also are prime catalysts. We have revised private investment growth estimates to 8.9% in 2017 (4.1% previously) and 7.8% in 2018 respectively (4.4% in 2016).

- **Surprisingly strong exports.** Exports continued to grow by a strong double-digit rate of 20.6% yoy in April (21.3% yoy in 1Q17; 2.8% in 4Q16), thanks to firm demand for electronics and electrical products, better prices of crude oil and commodities. The weak ringgit's valuation effect also aided higher export value in ringgit terms. The weak ringgit valuation and low base effects seen lifting strong exports in 1Q17 will gradually diminish going into 2H17. We have revised this year's export growth estimate to 14.5% from 5.0% previously.
- **Inflation will moderate in 2H17.** Headline inflation eased further to 3.9% yoy in May (4.4% in April; 4.3% in 1Q17) after hitting an 8-yr high of 5.1% in March, thanks to moderating transport prices. While the cost-push inflation has caused broader price increases, demand pressure inflicted by a wage-price spiral is not seen as core inflation increased moderately (2.6% in May vs. 2.5% in April). Though the headline inflation readings will moderate in 2H17, the pace of price increases will depend on the volatile global crude oil prices. We estimate inflation to average 3.5-4.0% (2.1% in 2016).
- **Private consumption and investment indicators showed mixed reading**. After shunning big-ticket items in 2016, consumers have spent discretionary on motor vehicles, attracted by the launching of new models and some attractive discounts. Car sales rose further by 17.1% in May (a negligible drop in April; 8.9% in 1Q17). Consumption credit continues to grow at moderate pace. Higher increases in imports of capital and intermediate goods while consumption goods rose marginally in April. Loan indicators continued to strengthen in May, including stable household loan growth.
- **The Ringgit's appreciation trends continue.** Bank Negara Malaysia (BNM)'s foreign exchange market stabilisation measures have helped to reduce the ringgit's volatility whilst stabilising the ringgit. A temporary soft dollar also lends a helping hand. While the net foreign buying of Malaysia bonds and equities bode well for the ringgit, there remain hurdles coming from the Fed's rate actions as well as policy risks in advanced economies. The ringgit is expected to be around RM4.20-4.30 by end-2017 (RM4.4860 at end-2016).
- **Domestic interest rates to remain stable at 3.00%.** We expect BNM to maintain the overnight policy rate (OPR) at 3.00% this year, supported by steady domestic demand amid high cost-driven inflation pressures. As the central bank contends that the current inflation is largely cost-induced and no developing signs of demand price pressure, it is unlikely to act sooner to tame inflationary expectations. Nevertheless, we think the central bank should prepare the groundwork for a gradual rise in interest rates in 2018 if the economy continues to strengthen.

GLOBAL GROWTH GOING STEADY AMID DOWNSIDE RISKS

Global growth is steadying. The International Monetary Fund (IMF) in its April World Economic Outlook (WEO) report has raised this year's global growth estimate to 3.5% from 3.4% previously while keeping 2018's estimate at 3.6%. It is a long-awaited recovery in manufacturing, trade and investment in advanced economies that helped to the global economy to stay on the expansion track, buoyed by accommodative monetary policy and fiscal support. Investors are pinning hopes on the Trump administration's reflation policies amid some scepticism about how far the US Congress would support the bold tax reform, and the inward-looking policies.

The seasonally weak 1Q17's US GDP growth does not derail the US economy growth path as supported by strong labour market and improved wage growth. The eurozone recovery is finally lifting, thanks to exports and consumer spending. The weak yen-boosting exports helped to secure economic gains in Japan. China's economic transition is progressing towards more sustainable levels amid the risks of bloated debt and resources misallocation.

Current and forward indicators looking good. The Composite leading indicators, which track the forward looking of OECD economies continued to suggest growth gaining momentum in several advanced and emerging economies. Global Purchasing Managers Index (PMI) for manufacturing and services expanded further in May. Global semiconductor sales saw solid sales growth in April. However, global crude oil prices still behaving unevenly despite the OPEC's decision to extend the oil output cuts to mid-March 2018.

On a caution note, one should not take complacency and must continue to keep wary about the risks associated with political development, including the on-going Brexit negotiations, policy shifts, regulatory changes in some advanced economies and geopolitical tension in the Gulf region and the rising terrorism threats. Topping the list is the inward-looking policies, including the sword of protectionism hanging over global trade; tighter global financial conditions arising from high US interest rates that could trigger disruptive capital outflows from emerging and developing economies.

Figure 1: Real GDP growth (% YoY)

	2015	2016	2017 1Q	2017*e* (IMF)	2017*e* (WB)	2018*f* (IMF)	2018*f* (WB)
United States	2.6	1.6	2.1	2.3	2.1	2.5	2.2
Euro Area	1.9	1.7	1.7	1.7	1.7	1.6	1.5
China	6.9	6.7	6.9	6.6	6.5	6.2	6.3
Japan	1.1	1.0	1.3	1.2	1.5	0.6	1.0
India[1]	8.0	7.1	6.1	7.2	7.2	7.7	7.5
Malaysia	5.0	4.2	5.6	4.5	4.9	4.7	4.9
Singapore	1.9	2.0	2.7	2.2	-	2.6	-
Indonesia	4.9	5.0	5.0	5.1	5.2	5.3	5.3
Thailand	2.9	3.2	3.3	3.2	3.2	3.3	3.3
Philippines	6.1	6.9	6.4	6.8	6.9	6.9	6.9
Vietnam	6.7	6.2	5.1	6.5	6.3	6.3	6.4

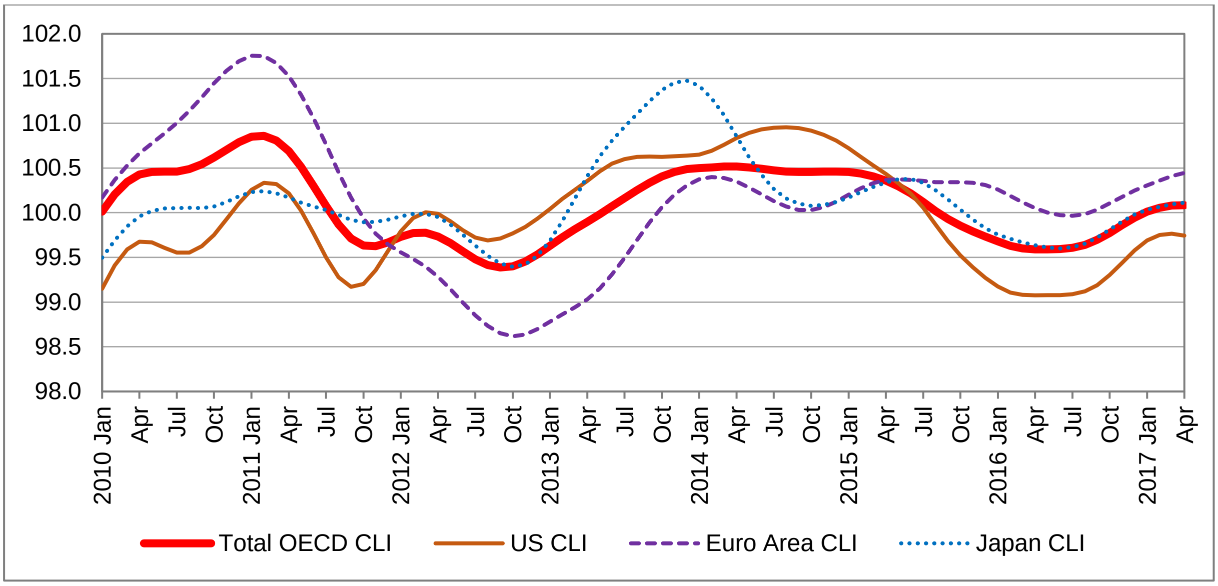
Source: *Officials; IMF (World Economic Outlook, April 2017; Recent Article IV Consultations); World Bank (Global Economic Prospects, June 2017)*

Note 1: *Annual GDP for India is on fiscal year basis, as per reporting practice of the country.*

A. SNAPSHOT REVIEW OF KEY GLOBAL ECONOMIC INDICATORS

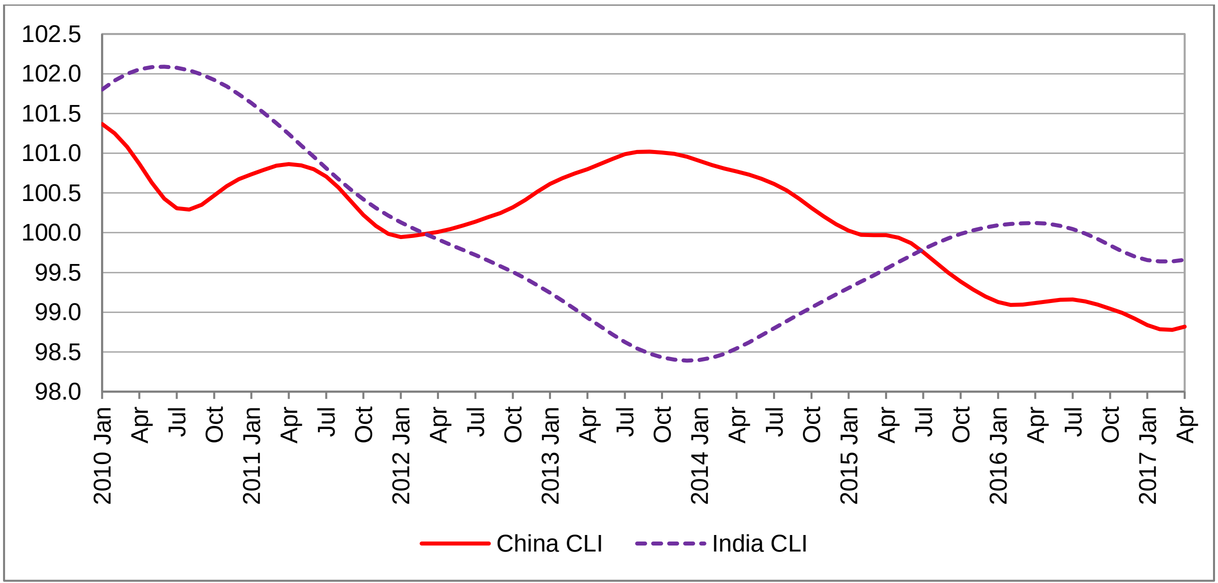
1) **The composite leading indicators (CLIs)** continued to rise by an annual rate of 0.5% yoy in April for six straight months since November 2016, indicating stable growth momentum going forward in major economies in the OECD area. Amongst major emerging economies, the CLIs continue pointing to stable growth momentum in China and India though their indices remained below the 100-pt threshold.

Figure 2: OECD CLI continues to stay above 100-pt threshold since January



Source: OECD

Figure 3: Stable growth momentum in China and India

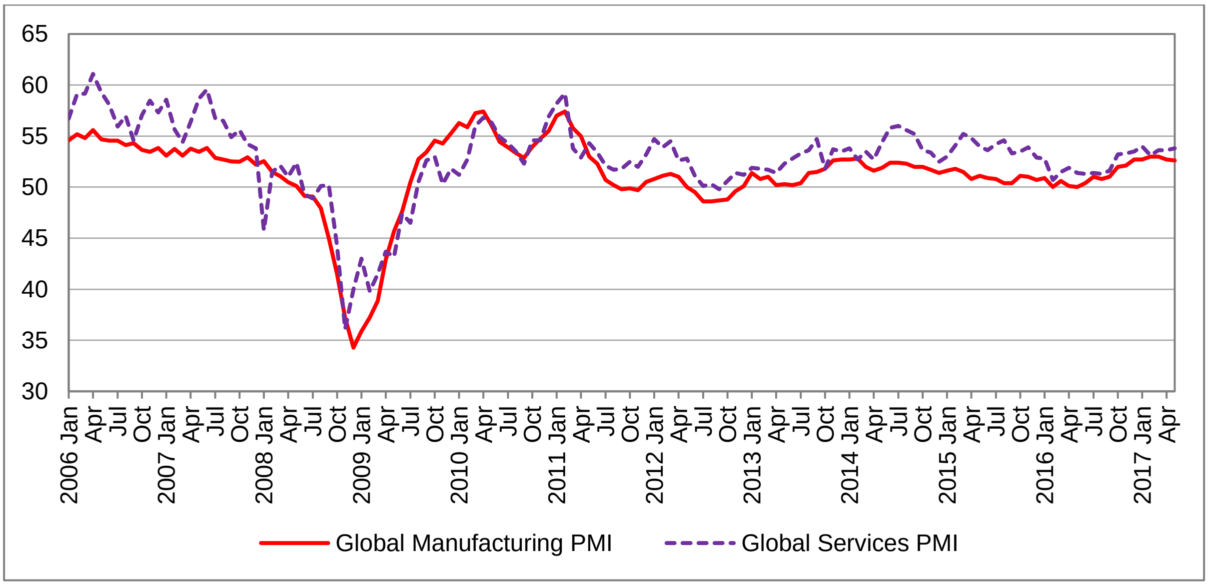


Source: OECD

2) **The global manufacturing sector**, which had a strong start in 1Q17, eased to a six-month low in May (52.6 vs. 52.7 in April), but still above the long-run series average of 51.4. This was supported by sustained growth in new orders and external trade.

3) **The global service sector** shows a contrasting picture as the PMI reading accelerated to a four-month high in May (53.8 vs. 53.6 in April), thanks to higher new orders.

Figure 4: Global PMI for manufacturing and services show positive outlook



Source: Markit

4) **World trade volume** growth declined by 2.1% mom in April after an increase of 2.2% in March (1.8% qoq in 1Q17), marking the lowest rate since January 2009. Both world imports and exports volume contracted by 2.0% and 2.1% respectively.

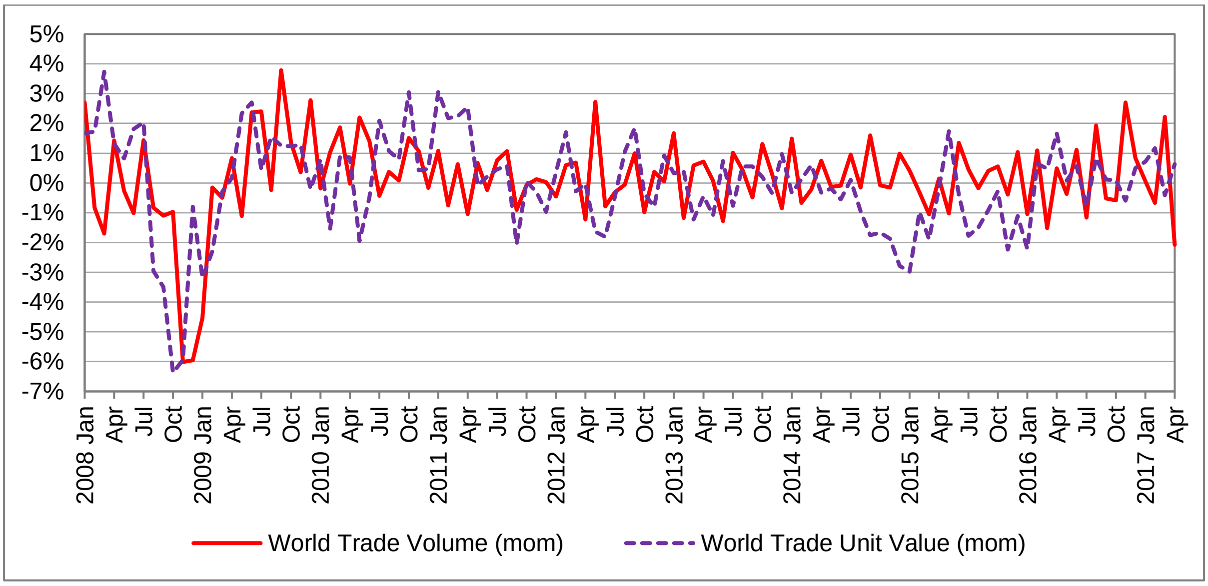
   All regions experienced decline in export volume in May except Africa and Middle East region (+0.5% mom). Leading the drop was Latin America (-9.1%), followed by emerging Asia (-3.4%) and Central and Eastern Europe (-2.1%). This led to an aggregate drop in emerging economies (-3.6% vs. +5.1% in March). Among the advanced economies (-0.9% vs. 0.6% in March), Japan declined, albeit at a smaller magnitude of 1.4% (-2.3% in March).

   Steady global growth path and demand, supported by right fiscal and monetary policies mix in advanced and emerging economies should help to provide a lift to global trade growth after a tepid 1.3% rise in 2016. The ratio of trade growth to GDP growth fell below 1:1 in 2016, for the first time since 2001.

   While strong export orders and container shipping in the early months of 2017 is an indication of trade recovery, but it could be undermined by policy shocks and uncertainties, including the imposition of trade restrictive measures and monetary tightening.

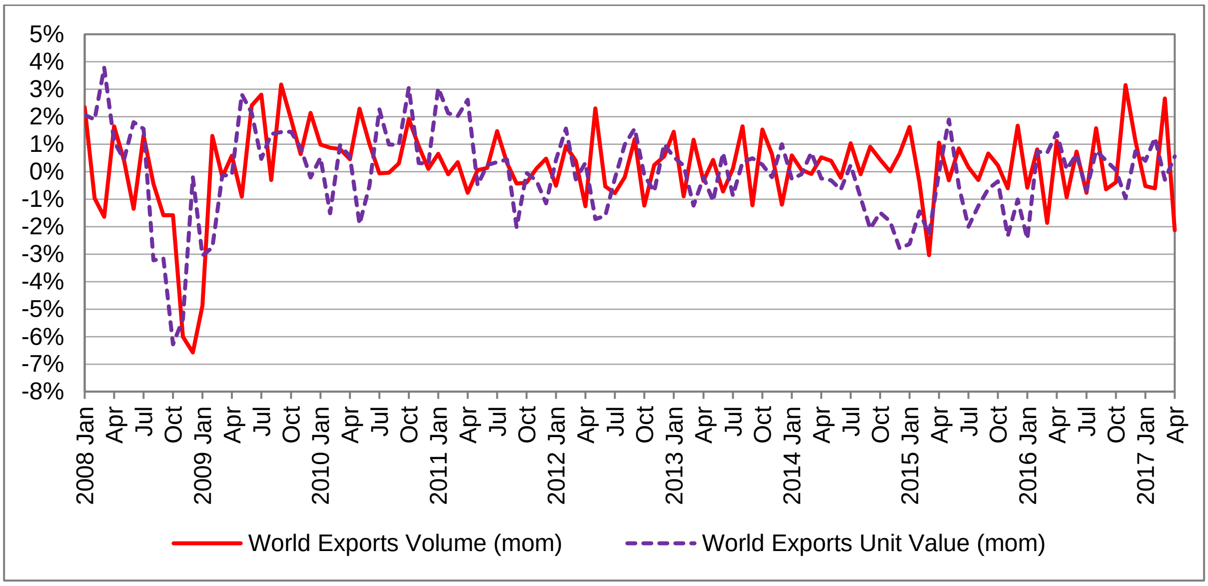
   The World Trade Organisation (WTO) estimates global trade will expand by 2.4% in 2017; however, as deep uncertainty about near-term economic and policy developments raise the forecast risk, this figure is placed within a range of 1.8% to 3.6%. In 2018, global trade growth is projected to rise between 2.1% and 4%.

Figure 5: World trade volume fluctuates more in recent months



Source: CPB Netherlands Bureau for Economic Policy Analysis

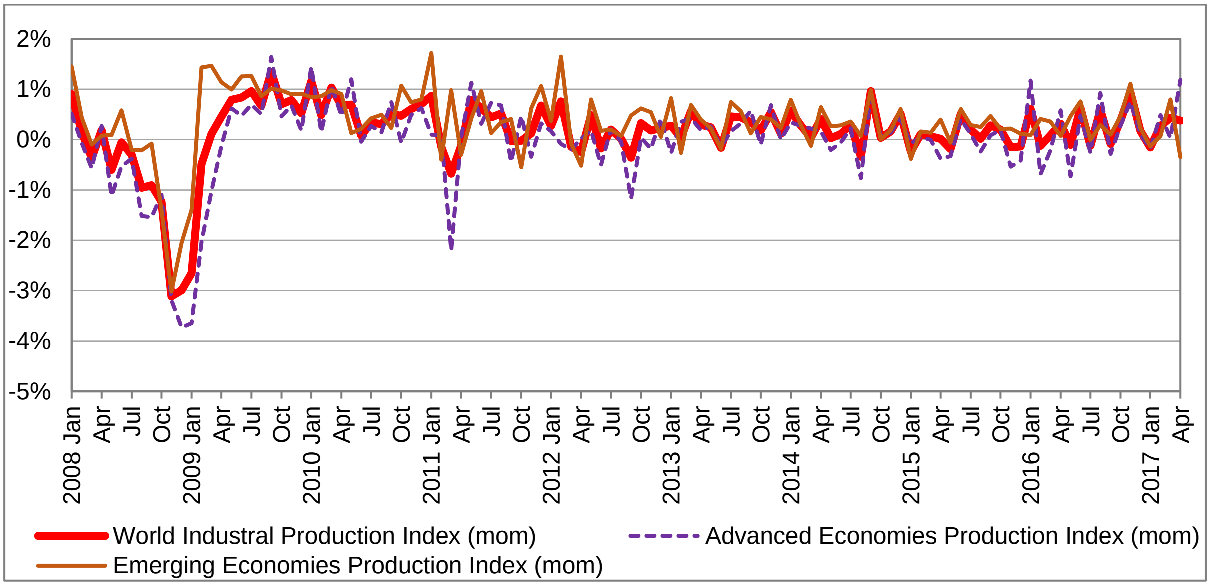
Figure 6: World exports volume experienced the worst decline since March 2015



Source: CPB Netherlands Bureau for Economic Policy Analysis

5) **World industrial production** maintained at the same 0.4% mom as March in April (0.6% qoq in 1Q17 and 1.2% in 4Q16). Advanced economies grew by1.2% (0.0% in March and 0.5% in February), led by Japan (4.0%) and the US (1.1%). On the contrary, emerging economies declined by 0.3% (+0.8% in March), dragged by emerging Asia (-0.6% vs. +1.6% in March) and Africa and Middle East (-0.1% vs. -1.4% in March).

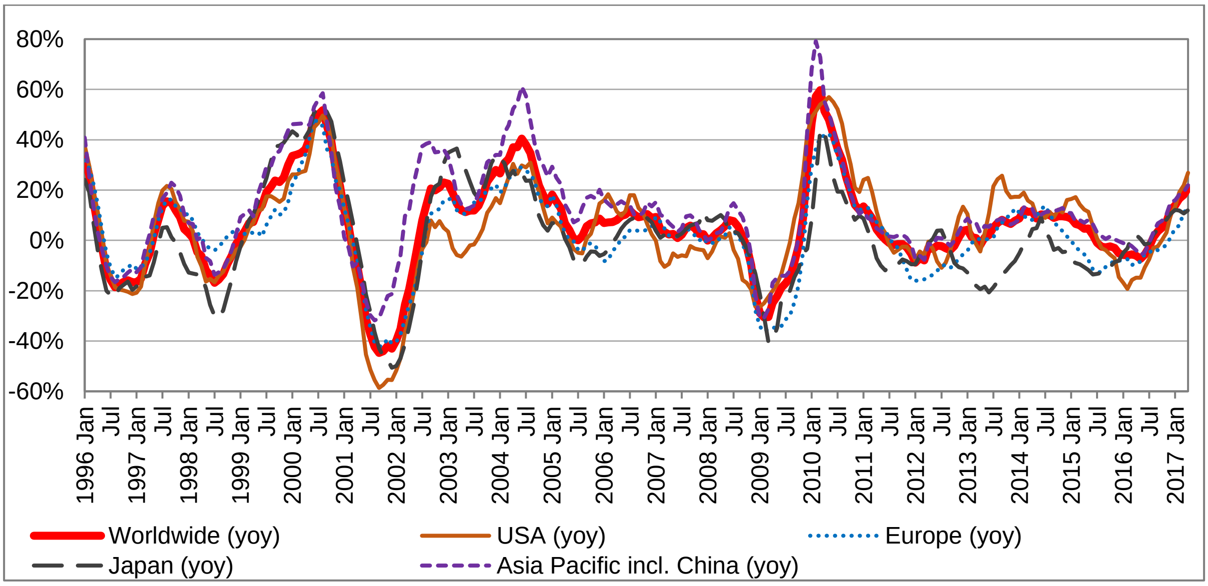
Figure 7: Industrial production for advanced and emerging economies inverted



Source: CPB Netherlands Bureau for Economic Policy Analysis

6) **Global sales of semiconductors** surged 20.9% yoy to US$31.3 billion in April (18.1% in March; 17.8% in 1Q17), marking the largest annual growth since September 2010. Regionally, year-to-year sales increased in China (30.0%), the Americas (26.9%), Asia Pacific/All Other (21.9%), Europe (12.7%), and Japan (12.0%). On monthly basis, all regions also experienced improvement: Asia Pacific/ Other (2.0%), the Americas (1.8%), Japan (1.4%), China (0.7%) and Europe (0.5%).

Figure 8: Global semiconductor sales expansion unabated



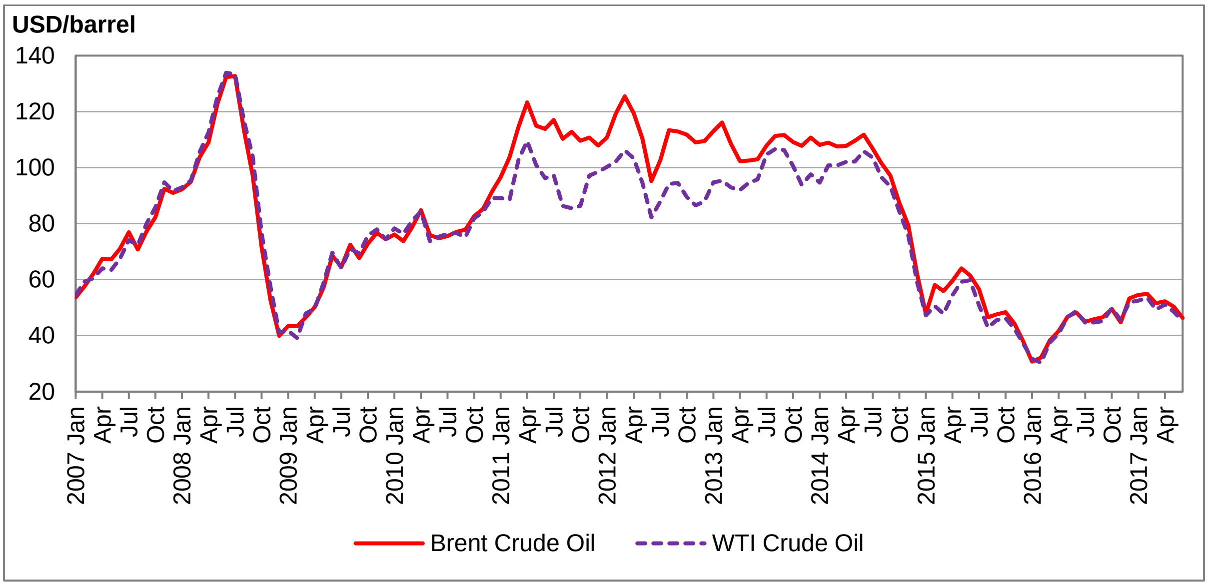
Source: Semiconductor Industry Association (SIA)

The World Semiconductor Trade Statistics (WSTS) projects the industry's worldwide sales to rise by 11.5% to reach US$377.8 billion in 2017, with positive growth increases across all regional markets: Asia Pacific (12.4%), the Americas (12.2%), Europe (8.7%), and Japan (6.6%). Beyond 2017, growth in the semiconductor market is expected to slow across all regions. In terms of products, memory is the main driver registering a strong growth of 30.4% yoy while sensors (13.9%), analog (7.5%) and logic (6.5%) also contributed significantly to the growth in 2017.

Several semiconductor forecasters have revised upward their estimates for 2017 to the growth range of 11% to 16%: IC Insights (11% in Mar's release vs. 5% in Feb's release), WSTS (11.5% in Jun's release vs. 6.5% in Feb's release), Gartner (12.3% in Apr's release vs. 7.2% in Jan's release) and Semiconductor Intelligence (SC-IQ) (16% in May's release vs. 10% in Feb's release). This shows that the semiconductor market is on a very encouraging prospect this year.

7) **Global oil price**, as benchmarked by Brent crude which averaged US$53.59 per barrel in 1Q17, US$52.31 in April and US$50.33 in May is hovering between US$43.98 and US$50.41 per barrel currently. OPEC's first round of oil output cut by 1.16 million bpd failed to stabilise oil price amid the build-up of inventories. The rise in oil price also spurred increased production in the US shale industry, which does not participate in the output deal, thus slowing the rebalancing of global oil supply market.

Figure 9: Crude oil prices trending down



Source: US Energy Information Administration

On 25 May, OPEC and non-members led by Russia decided to extend cuts in oil output by nine months to March 2018. But, market was disappointed as investors were hoping for deeper cuts to speed up the process of balancing supply or extend the oil output cuts until mid-2018. Oil price volatility will remain along with the adjustment of supply and demand rebalancing in 2H17.

The geopolitical crisis in the Gulf, inflicted by a high number of countries (namely Saudi Arabia, the United Arab Emirates, Bahrain, Egypt, Yemen, Eastern government of Libya, Maldives, Mauritania, Senegal and Comoros) that severed diplomatic ties with Qatar remains a risk if it escalates into a deep conflict complicating the adjustment of supply and demand in the oil market. Qatar alone with a production of 0.6 million barrels per day or 2% of total OPEC's production will have a muted impact on the oil price if Qatar backs down from the oil output cuts deal. As the oil market is in an over-supply situation, a scenario which sees an escalation of the Gulf crisis causing major supply disruptions, equivalent to deeper cuts, may provide a lift to oil price. The Energy Information Agency (EIA) forecasts Brent prices to average US$53 per barrel in 2017 and US$57 per barrel in 2018.

US – RECOVERY REMAINS INTACT

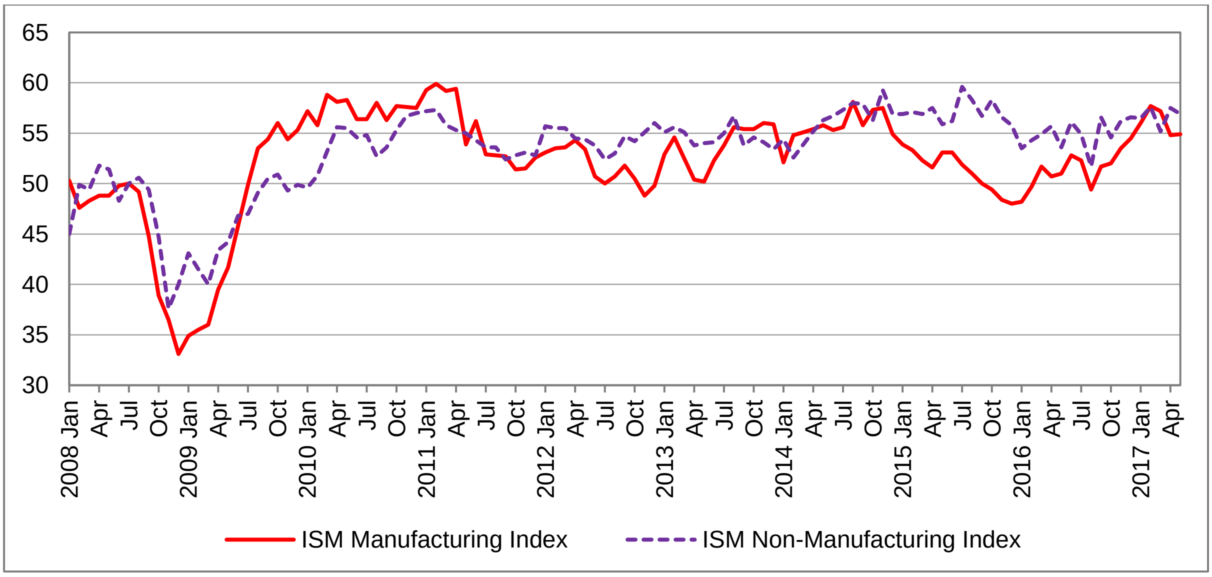
The weak GDP growth in 1Q17 (1.4% qoq vs. 2.1% in 4Q16) does not shake our conviction that the **US economy** will remain on a steady expansion track in the remaining quarters. 1Q's economic growth weakness was largely attributable to a downswing in inventories and seasonal bad weather and one-off factors. The subdued consumer spending (1.1% vs.3.5% in 4Q16), especially for the purchase of automobiles mostly reflected payback for breakneck growth in the latter half of 2016.

Amid a mixed set of readings for current and forward indicators, the US economy's prospects appear solid, fuelled by still resilient consumer spending, supported by continued strong job growth, accelerating wage gains and record stock levels.

The **ISM manufacturing index** inched to 54.9 in May after declined for a second month running in April (54.8 vs. 52.7 in March). This was underpinned by stronger demand for manufacturing production and new orders growth accelerated markedly. The overall picture still healthy as the index is well above the 50-pt expansion mark for the ninth consecutive month since September 2016.

The **service sector** activity fell slightly more than expected in May (56.9 vs. 57.5 in April), dragged by lower new orders. Despite the dip in the ISM index, it was the 89th consecutive month of expansion, underscoring the optimism that the sector has not lost its growth traction.

Figure 10: Both ISM indexes are still healthy



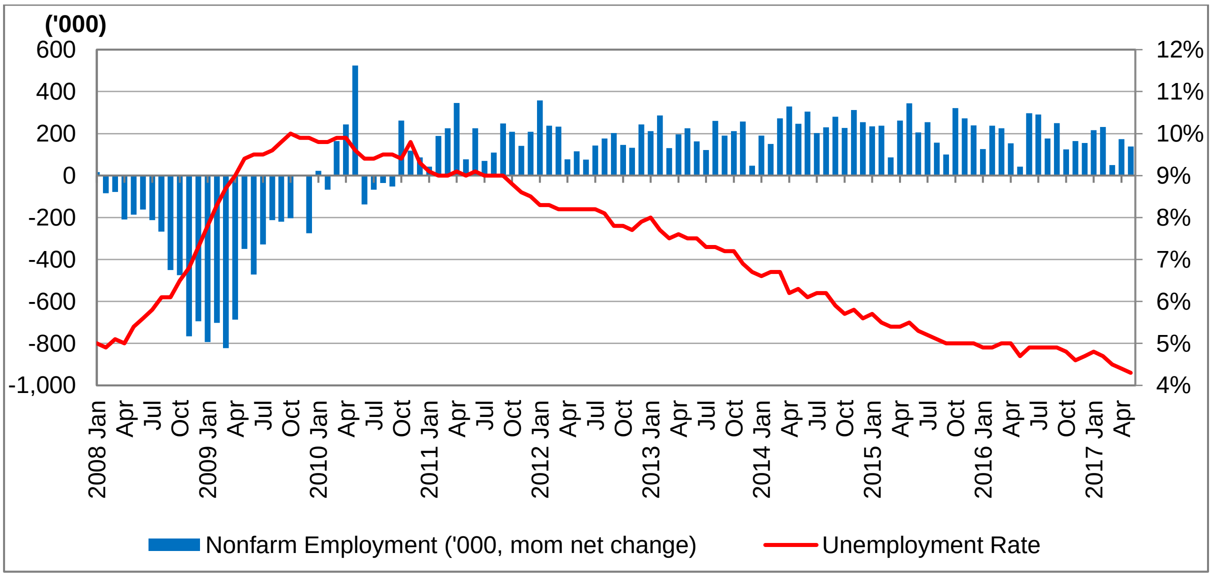
Source: Institute for Supply Management

Retail sales fell the most in more than a year (0.3% mom in May) after an increase of 0.4% in April amid declining purchases of motor vehicles and discretionary spending. On an annual basis, retail sales rose 5.2% in May higher from 3.4% in April. Sales at online retailers increased 4.1% qoq and 14.7% yoy in 1Q17 (1.7% qoq and 14.2% yoy respectively in 4Q16). The e-commerce continues to achieve for an all-time high share of total retail sales in 1Q17 (8.5% vs. 8.2% share in 4Q16).

Industrial production fell flat in May following an increase of 1.1% mom in April amid a drop in manufacturing (-0.4%). Mining output climbed 1.6% while utilities posted a 0.4% gain.

Job growth slowed in May after revising down employment gains in April. Nonfarm payrolls increased 138,000 in May (174,000 in April and 50,000 in March respectively) as the government and retail sectors lost jobs. The **unemployment rate** falling to a 16-year low of 4.3% in May, because 429,000 people dropped out of the labour force. Job growth has decelerated from the 181,000 monthly average over the past 12 months as the labour market nears full employment. The economy needs to create 75,000 to 100,000 jobs per month to keep up with growth in the working-age population. Average hourly earnings rose 4 cents or 0.2% in May (0.2% in April) after a similar gain in April, leaving the year-on-year increase in wages at 2.5%.

Figure 11: Lowest unemployment rate since June 2001



Source: US Bureau of Labor Statistics

Consumer prices dipped 0.1% mom in May (+0.2% in April), weighed down by declining prices for gasoline, apparel, airline fares, motor vehicles, communication and medical care services, among others. On an annual basis, CPI rose 1.9% (2.2% in April), the smallest increase since last November. The so-called core CPI, which strips out food and energy costs, rose 0.1% mom and 1.7% yoy in May after a similar gain on monthly basis and 1.9% yoy in April.

EUROZONE – RECOVERY BROADENS

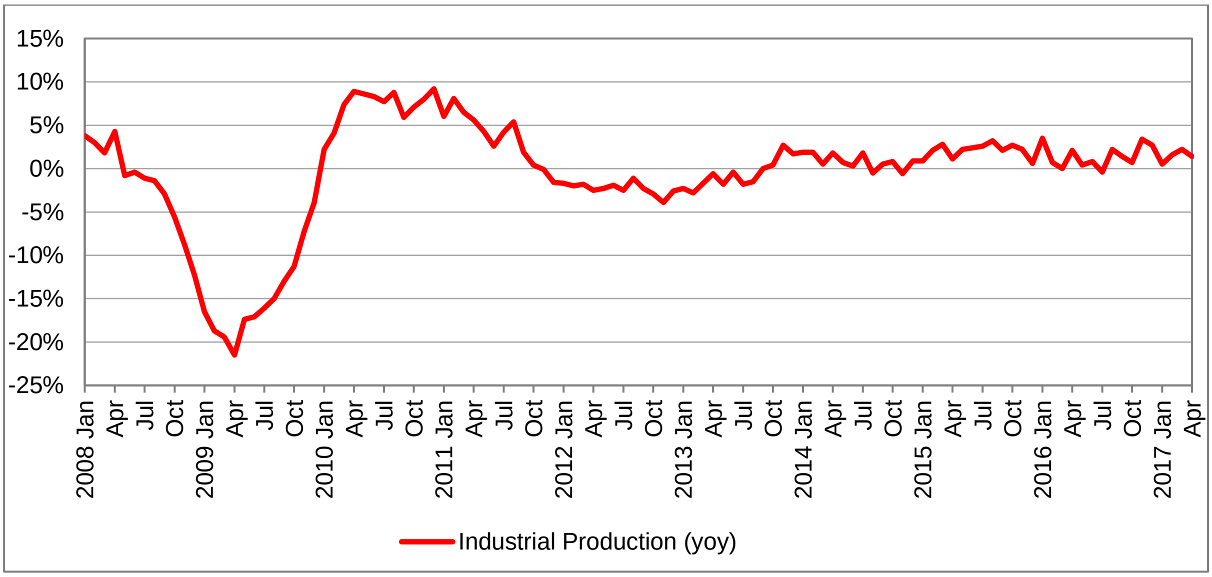
The **eurozone's solid growth momentum** is assured as GDP growth grew 0.6% qoq and 1.9% yoy in 1Q17 (0.5% qoq and 1.8% yoy respectively in 4Q16) amid concerns about the political risks in some countries having their national elections. The growth drivers were domestic demand, supported by an improving labour market and expansionary monetary policy.

Some lead data released year-to-date pointing better recovery ahead. The **Composite Purchasing Managers' Index (PMI)** remained steady at 56.8 in May, the same reading as April. Output expanded at the best pace in six years. **Manufacturing PMI** increased for the ninth month to 57.0 in May from 56.7 in April, the highest reading since April 2011 as exports rose the most in over six years; backlogs of work registered the second-largest rise in six years and the rise in employment was the highest on record.

The **labour market** condition was broadly steady in April, with the number of unemployed falling by 233,000 (58,000 in March). As a result, the unemployment rate eased to 9.3% yoy in April from 9.4% in March, the lowest rate since March 2009.

Industrial production rose 0.5% mom and 1.4% yoy in April (0.2% mom and 2.2% yoy respectively in March). On an annual basis, the rise was due to increases in production of intermediate goods, capital goods and consumer durables.

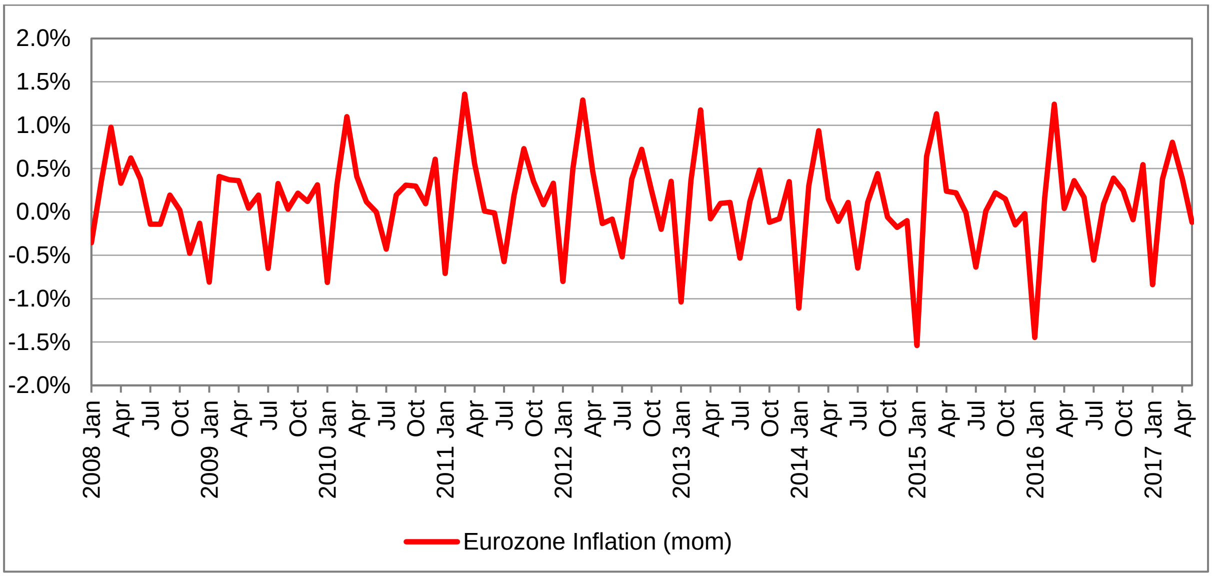
Figure 12: Industrial production rises for nine months in a row



Source: Eurostat

Consumer prices declined by 0.1% mom in May after three consecutive increases since February (0.4% in April). Inflation eased to 1.4% yoy in May (1.9% in April and 1.5% in March), reflecting higher prices for energy. Core inflation (excludes energy, food, alcohol & tobacco) eased to 0.9% from 1.2% in April.

Figure 13: Inflation rate spread narrower



Source: Eurostat

JAPAN - RECOVERY SEEN ON TRACK

Japan's long-stagnant economy has shown signs of life in recent months, with exports and factory output benefiting from a recovery in global demand. Improving domestic demand coupled with resilient exports propelled growth in 1Q17 (0.3% vs. 0.3% qoq in 4Q16). On an annual basis, the economy expanded 1.3% in 1Q (1.6% in 4Q16). Private consumption recovered 0.3% qoq in 1Q after nearly stagnating in 4Q amid lingering worries about the sustainability of households spending in the quarters ahead given moderate wage growth. A weak yen and stronger global demand drove higher export growth of 8.5% in 1Q17.

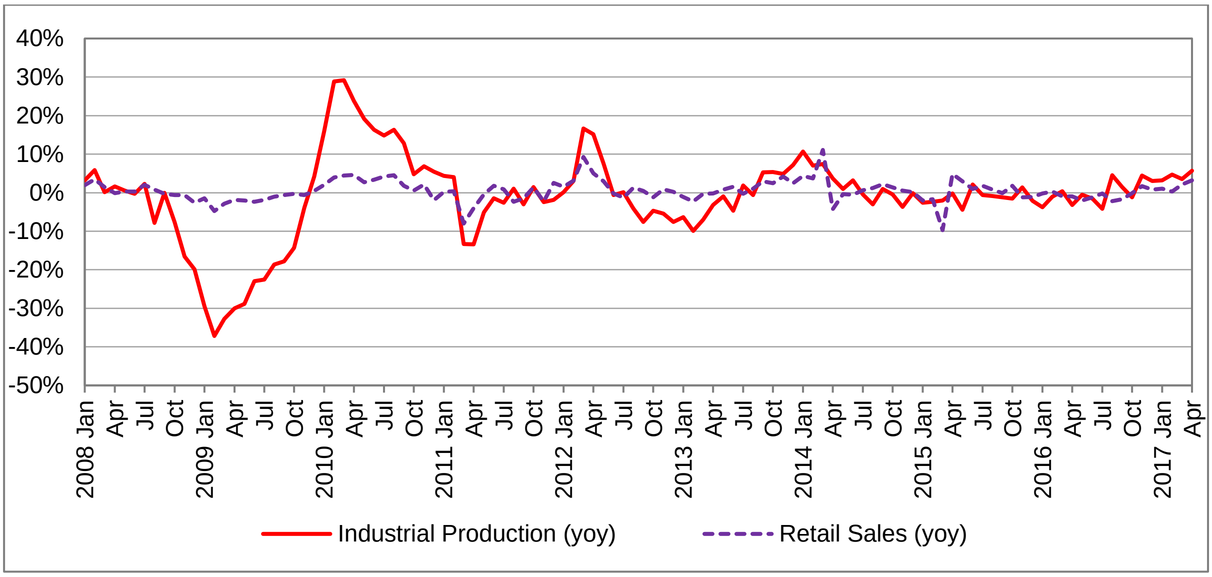
While the accommodative monetary policy and bold fiscal spending would continue to support domestic spending, rising trade protectionist policies and a sharp slowdown in China remains the key downside risks to growth. The US and China are two large export markets of Japan. The Bank of Japan (BoJ) expects the economy to expand between 1.4% and 1.6% in the fiscal year 2017, which ends in March 2018.

Though the **Nikkei Manufacturing Purchasing Managers' Index** (PMI) fell to a seven-month low of 52.4 in June from 53.1 in May, it is still expanding as the index remains above the 50-threshold that separates expansion from contraction. The **services PMI** went up to 53.0 in May from 52.2 in April, marking the eighth straight month of expansion in services activity and the fastest growth since August 2015.

Industrial production turned around to rise by 4.0% mom in April from a contraction of 1.9% in March, driven by transport equipment, general-purpose, production and business oriented machinery as well as electronic parts and devices. On an annual basis, industrial output rose 5.7% in April (3.5% in March), the highest since March 2014.

Retails sales rose to a two-year high of 3.2% yoy in April (2.1% in March), mainly lifted by increases in category of fuel, motor vehicle and fabrics apparel & accessories.

Figure 14: Both industrial output and retail sales growing steadily



Source: Ministry of Economy, Trade and Industry, Japan

Core machinery orders (a leading indicator of capital spending over a three- to six-month period) fell more than expected in April (-1.3% mom vs. +1.4% in March), casting doubt on the strength of companies' capital spending and adding to concerns about the country's fragile economic recovery. It also marked the first drop in three months. The decline was due to a faster fall in non-manufacturing orders (-5.0% vs. -3.9% in March) while manufacturing orders grew at a faster 2.5% (0.6% in March). Compared to a year ago, core machinery orders machinery orders rose 2.7%, rebounding from a 0.7% fall in March. The government forecasted that the changes would be -5.9% qoq and -6.8% yoy in 2Q17.

Consumer prices remained stable at 0.4% yoy in May (0.4% in April and 0.2% in March respectively), the highest inflation rate since January. This was mainly driven by higher food and fuel prices amid continued fall in the cost of housing. Core inflation (all items, less food (less alcoholic beverages) and energy) declined at a slower rate of 0.2% in May (-0.3% each in April and March).

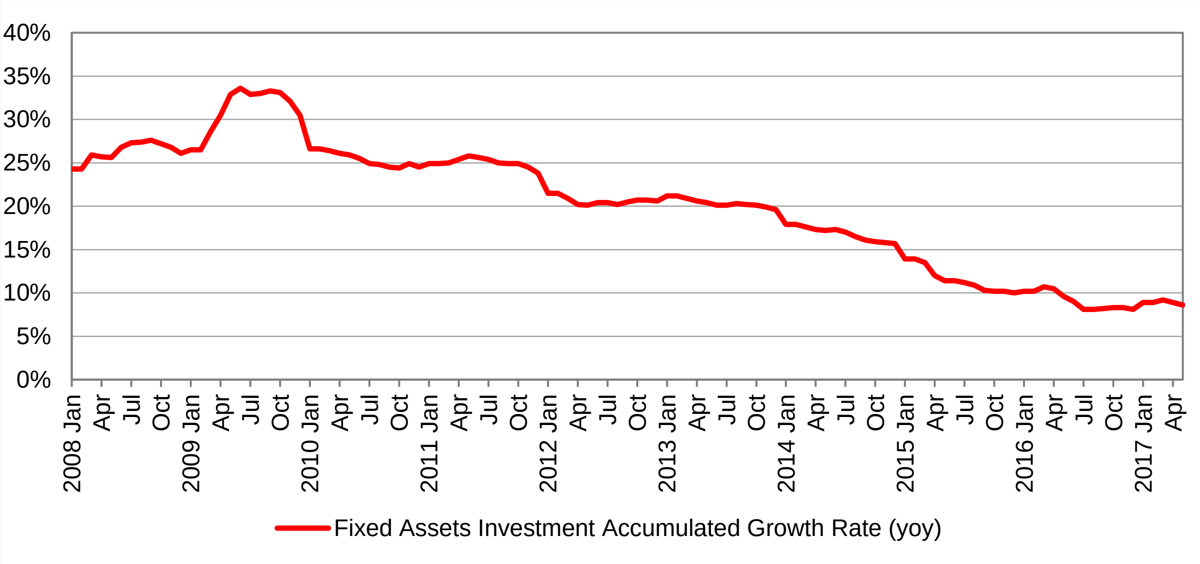
CHINA – STEADY GROWTH AHEAD

China's economy got off to a strong start in the first quarter, with GDP expanding at a higher-than-expected 6.9% yoy (6.8% in 4Q16), driven by consumption and the expansion of services sector. The strong economic performance in the first quarter has laid a solid foundation for the country to achieve its growth target of at least 6.5% this year.

However, growth momentum has softened somewhat at the outset of **2Q. The PMI for manufacturing** recorded the fastest pace of 51.7 in June since March (51.2 each in April and May) though its growth remains uneven. Growth in **non-manufacturing sector or services** rose to 54.9 in June from 54.5 in May (54.0 in April), lifted by higher new orders and business activities expectation.

Industrial production up 6.5% yoy in May, unchanged from April's level. Similarly, **retail sales** held steady at April's annual rate of 10.7% in May, reflecting sustained consumer spending. **Fixed asset investment** rose 8.6% yoy in May, eased moderately from 8.9% in April. In the primary industry, fixed-asset investment jumped the fastest, up 16.9%, followed by service industry (11.6%) and secondary industry (3.6%). Infrastructure investment expanded 20.9% while investment in high-tech manufacturing industry increased by 22.5%.

Figure 15: Stable fixed assets investment growth



Source: National Bureau of Statistics of China

The Chinese authorities have tightened capital controls to slash unproductive outflows in a bid to stabilise the country's foreign reserves and slow the pace of renminbi's depreciation. It also tightened regulations to deter risky lending to contain the rise in debt.

China's massive debt standing at nearly 300% of GDP remains the top policy concerns. If it gets out of hand, will have some serious implications on the financial system and budgetary operations. Moody's Investors downgraded China rating to A1 from Aa3 for the first time in 30 years, citing concerns the financial strength of the economy will erode in coming years as growth slows and debt continues to rise. However, Chinese officials and state media have countered that the debt problem is under control, and see the economy and reform efforts tracking in line with their expectations.

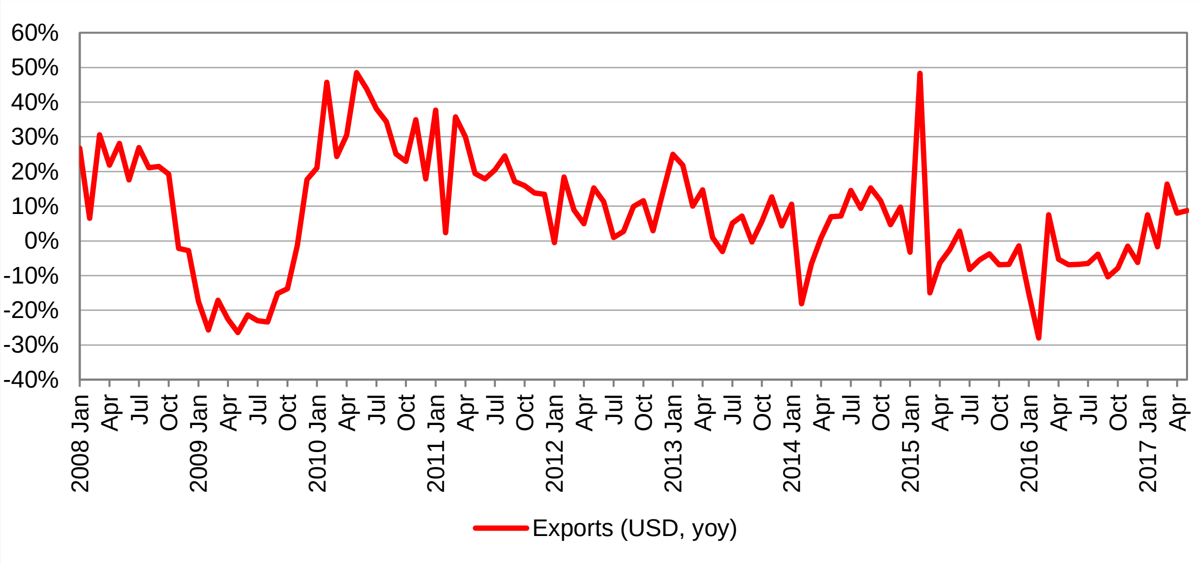
The government sets a lower economic growth target of 6.5% for 2017 compared to last year's range of 6.5% to 6.7%.

House prices in 70 large- and medium-sized cities rose 0.7% mom in May, same rate as in April. The sale price of newly-constructed residential buildings increased in 56 cities (58 in April), declined in 9 cities and was unchanged in 5. Annual average growth in house prices slipped from 9.6% in April to 9.5% in May.

Exports up 8.7% yoy in May (8.0% in April) as resilient global demand drove a third straight monthly increase. Imports also grew 14.8% (11.9% in April). The trade surplus widened to US$40.8 billion from US$38.0 billion in April. With exports remain a bright spot, this helps the overall economy though China's growth driver has been relying on domestic demand in recent years.

The biggest risk to China's trade prospects is the US inward-looking policy against its major trading partners, which were blamed for the huge trade imbalances disfavour the US. China's large trade surplus with the US has been a prime focus of the Trump administration, with more than 40% of the U.S. trade deficit in goods was with China. Both countries agreed to a 100-day plan for trade talks aimed at boosting US exports and reducing China's trade surplus with the United States.

Figure 16: Exports growth on recovery



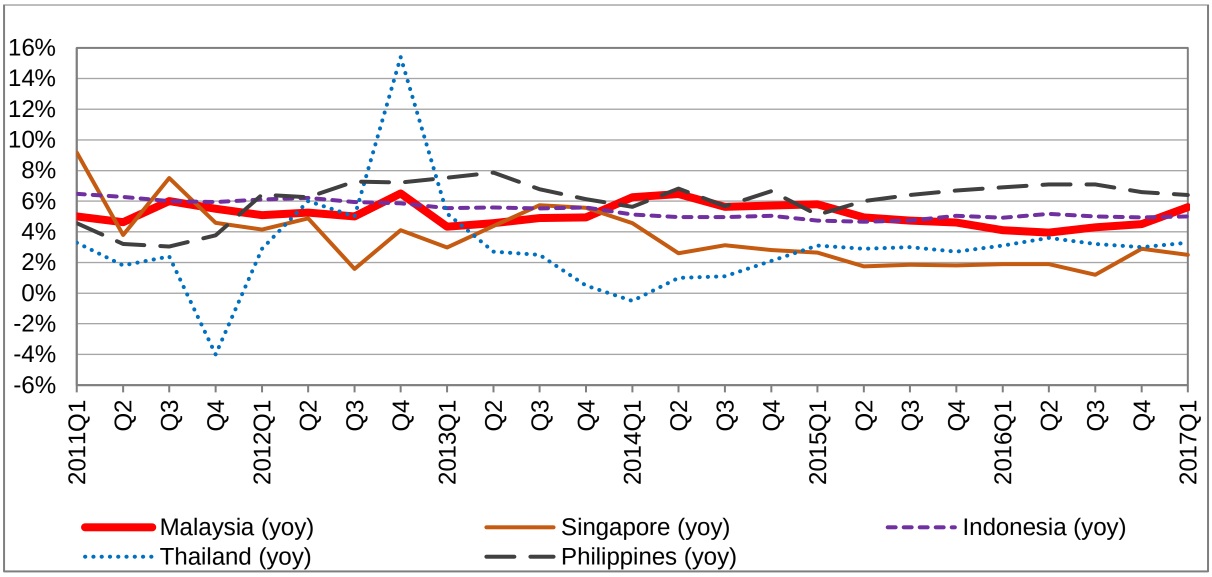
Source: National Bureau of Statistics of China

ASEAN-5 ECONOMIES' KEY ECONOMIC DATA TRACKER

Broadly, ASEAN-5 economies' (Malaysia, Singapore, Indonesia, Thailand and Philippines) continued to expand in 1Q17, largely thanks to strong exports and steady pace of domestic demand. With the exception of Singapore and Philippines, economic growth has picked up in Malaysia, Indonesia and Thailand.

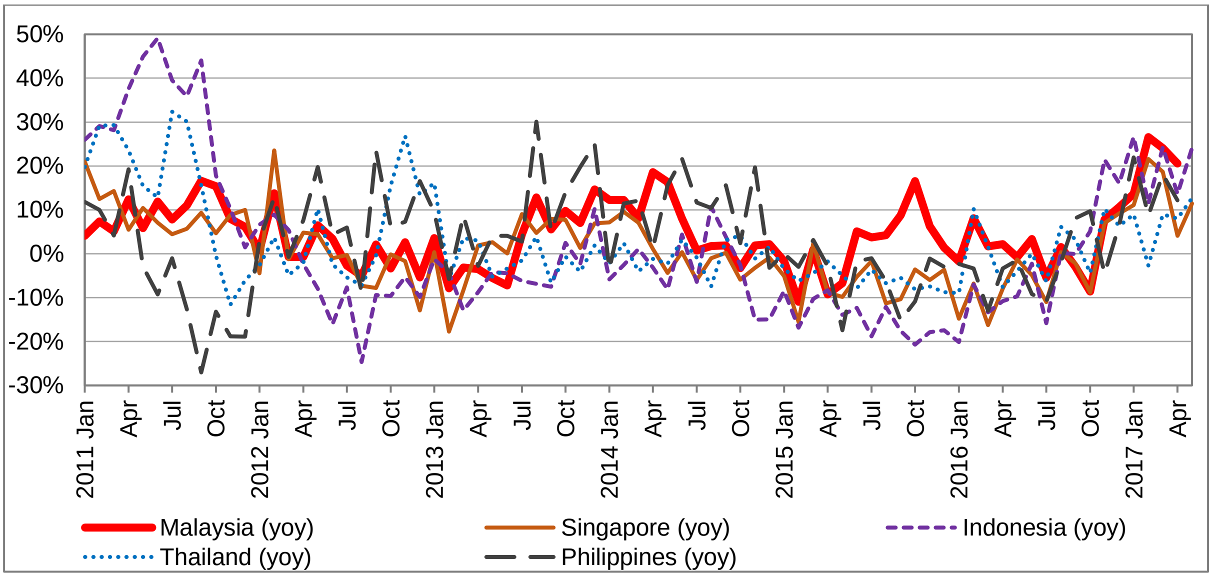
The incoming economic data and indicators point to continued expansion of real economic activities, albeit moderately in ASEAN-5. Both exports and industrial production seen growing at a slower pace going into the second quarter. Except Singapore and Thailand, the CPI readings for Malaysia, Indonesia and Philippines remained elevated though Malaysia and Philippines have ebbed from the peak. Regional currencies have moved higher against the US dollar, thanks to a pause in the dollar's strength as investors' earlier enthusiasm for a stronger US dollar driven by the Trump administration's policies fizzled out. In addition, lingering uncertainties surrounding political troubles in the White House also pared the dollar strength expectations further.

Figure 17: Real GDP growth trend



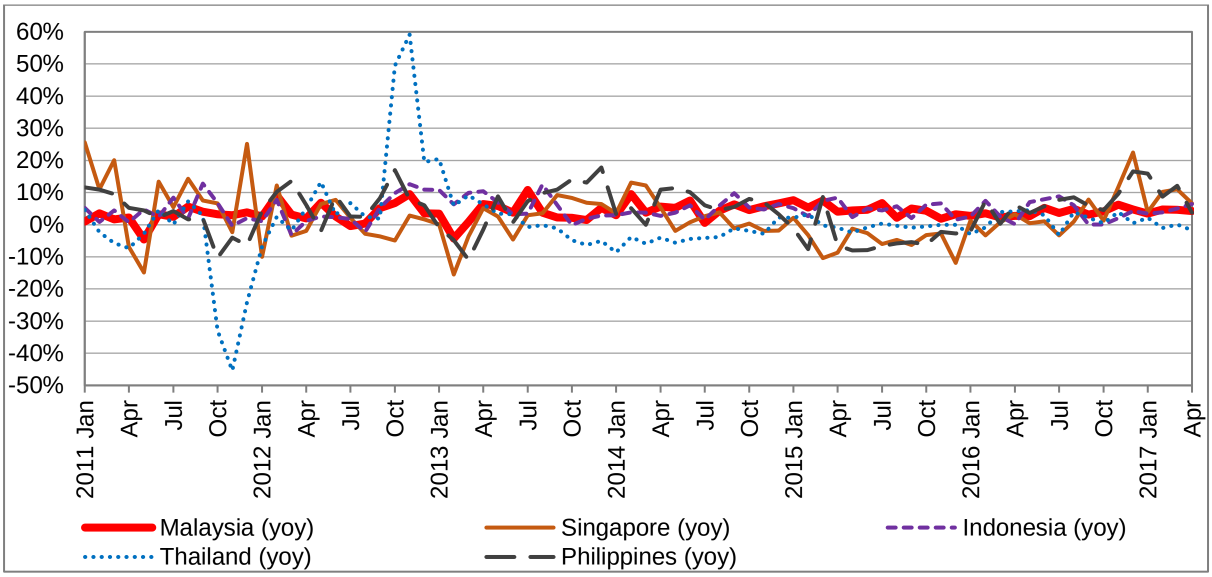
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; National Economic and Social Development Board, Thailand; Philippine Statistics Authority

Figure 18: Export growth trend



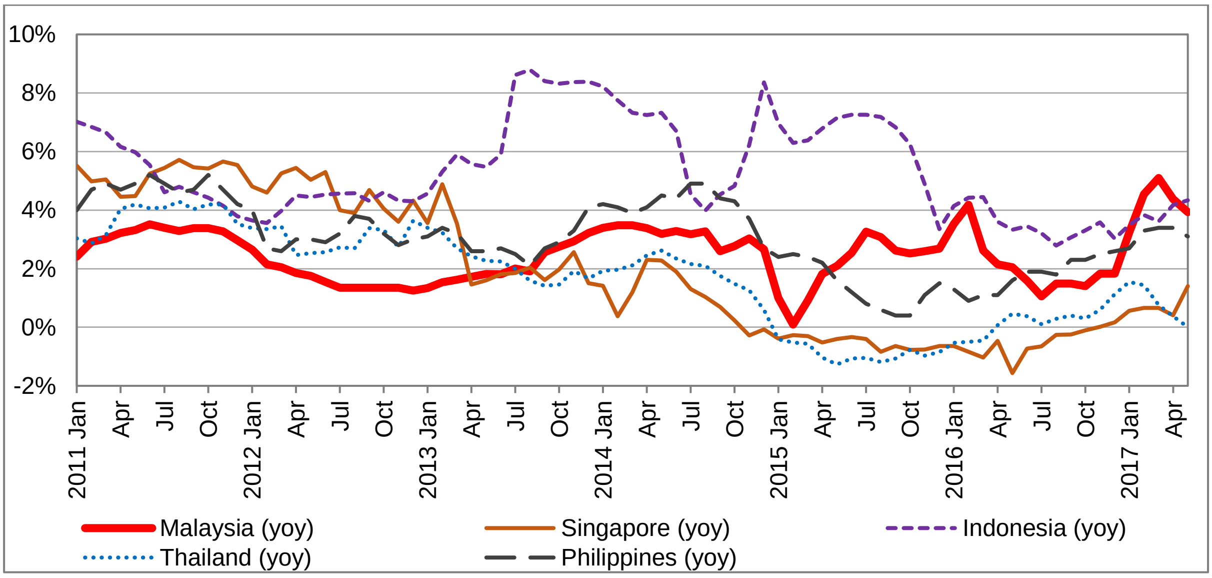
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Bank of Thailand; Philippine Statistics Authority

Figure 19: Industrial production growth trend



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

Figure 20: Inflation trend



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

B. GLOBAL MONETARY POLICY TRACKER

Recent policy statement and guidance from global central banks have stirred expectations that a synchronised restrictive monetary policy is on the cards. Global bonds sold off as investors bet on the hawkish tones from central banks signalling an end to easy-money era going forward.

The Federal Reserve's rate hike of 25bps to 1.00-1.25% in June marks the fourth round of increases since Dec 2015. The Fed has demonstrated consistency in its forward guidance of a gradual hiking of interest rates, keeping pace with the Fed's dual mandate of sustaining employment and ensuring stable prices. The Fed officials viewed recent softer inflation data as primarily reflecting transitory factors.

The increased interest rate reflects the Fed's confidence on the US economic expansion path despite the recent weak economic and inflation readings, citing the firm labour market condition.

Moving into the second half of the year, market will be focussing on the Fed's plan to pare back the US$4.3 trillion balance sheet it amassed during the crisis. Nearly all policymakers indicated that as long as the economy and the path of the federal funds rate evolved as currently expected, it likely would be appropriate to begin reducing the Federal Reserve's securities holdings this year.

The Fed expects to implement its balance sheet normalisation this year, initially trimming reinvestments in treasury securities by US$6 billion per month and mortgage backed securities by US$4 billion. The reduction will be expanding on a quarterly basis until it reaches US$30bn per month for US Treasuries and US$20bn per month in mortgage backed securities.

The Fed still on course for the third rate hike this year. We expect the Fed to raise rates by another 25bps to 1.25-1.50% by end-2017 (0.50-0.75% at end-2016).

The European Central Bank (ECB) indicated that risks to growth outlook is broadly balanced. The central bank has also tweaked its forward guidance on taking interest rates below their record levels if warranted. It now says rates will only stay at their present lows (-0.40%) should inflation continue to undershoot, signalling a policy shifts toward tightening when the condition permits. The ECB's QE programme could however still be expanded beyond its €60bn a month "if necessary". Its monthly asset purchases will continue to total €60bn a month and to run until at least December 2017.

Despite an improving economic outlook, Bank of Japan's (BoJ) Governor Haruhiko Kuroda affirmed that the time to start on exit strategy is when the bank achieved the 2% inflation objective.

Most regional central banks are expected to maintain a wait and see monetary approach, weighing on the strength of domestic economy, inflation trajectory and the path of the US interest rates.

Figure 21: Policy rate (%)

End-period of	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 Jun	2017e
US, Federal Funds Rate	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.25-0.50	0.50-0.75	1.00-1.25	1.25-1.50
Euro Area, ECB (Deposit Facility)	2.00	0.25	0.25	0.25	0.00	0.00	-0.20	-0.30	-0.40	-0.40	-0.40
Japan, BOJ Policy Rate	0.10	0.10	0.00-0.10	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
China, PBOC 1-year Benchmark Loan I/R	5.31	5.31	5.81	6.56	6.00	6.00	5.60	4.35	4.35	4.35	4.60
India, RBI Policy Repo Rate	6.50	4.75	6.25	8.50	8.00	7.75	8.00	6.75	6.25	6.25	6.00
Korea, BOK Base Rate	3.00	2.00	2.50	3.25	2.75	2.50	2.00	1.50	1.25	1.25	1.25
Malaysia, BNM O/N Policy Rate	3.25	2.00	2.75	3.00	3.00	3.00	3.25	3.25	3.00	3.00	3.00
Indonesia, BI 7-Day RR Rate	9.25	6.50	6.50	6.50	5.75	7.50	7.75	7.50	4.75	4.75	4.75
Thailand, BOT 1-Day Repurchase Rate	2.75	1.25	2.00	3.25	2.75	2.25	2.00	1.50	1.50	1.50	1.50
Philippines, BSP O/N RR Rate	5.50	4.00	4.00	4.50	3.50	3.50	4.00	4.00	3.00	3.00	3.00

Source: Officials; SERC

C. MALAYSIA ECONOMY ON TRACK FOR CONTINUED GROWTH

A strong start for the year. The Malaysian economy grew stronger-than-expected in 1Q17 (5.6% yoy vs. 4.5% in 4Q16), thanks to strengthening domestic demand (7.7% vs. 3.2% in 4Q16) and higher exports (9.8% vs. 2.2% in 4Q16) though net trade shave off 1.2% pts from 1Q17's GDP growth due to much stronger imports (12.9%).

Surprisingly resilient consumer spending, private investment picks up. Defying expectations, consumer spending displayed resilience to grow by 6.6% in 1Q17, higher than 6.1% in 4Q16 despite grappling with high cost of living and inflation. The cash handouts estimated RM2.6bn during the first phase of payment in February came in handy. Private investment staged a strong comeback to expand by a double-digit rate of 12.9% in 1Q17 (4.9% in 4Q16) after slowing and stuck in a low growth range in previous quarters. Higher capital spending was boosted by a few large manufacturing investment and lumpy purchases of transport equipment.

All economic sectors register positive growth. The services sector sustained a higher growth of 5.8% in 1Q17 (5.5% in 4Q16), thanks to resilient domestic demand as reflected in retail trade (7.8%), motor vehicles sales (3.5%), transport and storage (6.1%), communication (8.2%), finance (3.9%), real estate and business services (7.3%), government services (5.1%) and other services (5.4%). Manufacturing growth expanded stronger (5.6% vs. 4.7% in 4Q16), driven by better demand for electronics while continued demand for food-related products and rebound in motor vehicle sales helped to hold overall output of domestic-market oriented industries. Construction sector's growth of 6.5% in 1Q17 (5.1% in 4Q16) was lifted by the expansion of civil engineering projects in the petrochemical, power plant and transportation segments. The agriculture sector turned around to grow by 8.3% (-2.5% in 4Q16), thanks to rebound in crude palm oil output (1Q17: 17.7%; 4Q16: -7.2%) on the diminished impact of El Nino and higher rubber production (1Q17: 23.5%; 4Q16: 1.1%). Mining output moderated to 1.6% from 5.0% in 4Q16 on lower crude oil production as Malaysia committed 20,000 barrels per day cut in crude oil, in compliance with the OPEC's oil output cuts deal.

2017 GDP growth estimate revised higher. Given stronger-than-expected 5.6% growth in 1Q17, we have raised our 2017's GDP estimate to 5.0% from 4.3%. This implies that 1Q's growth will not be sustainable and the growth trajectory is expected to moderate going into the remaining three quarters on the normalisation of exports and production. In particular, the weak exchange rate valuation effects on exports will taper in 2H17.

Figure 22: Real GDP by economic sector (% YoY)

Economic Sector [% share to GDP in 2017*]	**2014**	**2015**	**2016**	**2017 1Q**	**2017*f* (BNM)**	**2017*e* (SERC)**
Agriculture [8.0%]	2.0	1.3	-5.1	8.3	4.0	5.0
Mining & Quarrying [8.7%]	3.3	5.3	2.2	1.6	2.7	1.3
Manufacturing [22.9%]	6.1	4.9	4.4	5.6	4.3	5.7
Construction [4.7%]	11.7	8.2	7.4	6.5	8.0	8.3
Services [54.4%]	6.6	5.1	5.6	5.8	4.9	5.2
Overall GDP	**6.0**	**5.0**	**4.2**	**5.6**	**4.3-4.8**	**5.0**

Source: Department of Statistics, Malaysia; Bank Negara Malaysia (Annual Report 2016); SERC
** % Share to GDP of 2017f from BNM*

Current and forward indicators remain positive. Exports continued to expand strongly, albeit slower at 20.6% in April (24.1% in 1Q17), partly lifted by a low base effect. Industrial production rose 4.2% in April while loan growth held steadily. Imports of consumption goods pulled back sharply in April. Consumer sentiment improved but not so upbeat while business sentiments rebounded strongly.

The Malaysian Retail Chain Association (MRCA) expects retail sales to grow by about 4.5% this year, largely boosted by tourists spending. Despite the improvement in sentiment, households and businesses generally felt that the strong headline GDP number did not filter down to the man in the street and had varied impact on sectors. While businesses involved in the export sector benefitted from the weak ringgit and buoyant global demand, there were mixed impact on domestic sectors.

Private investment indicators suggest continued expansion of capital. Imports of capital and intermediate goods still growing, albeit at slower pace of 14.8% and 29.2% respectively in April (42.0% and 27.8% respectively in 1Q17). In the near-term, lingering uncertainties ahead of the General Election (GE14) as well as about how the Trump's economic policies shaping up are expected to cause some cautiousness among investors. Private investment prospects in the medium-term should be well supported by a flurry of mega infrastructure related projects, namely public transport, rail, ports and real estate development.

Figure 23: Real GDP by demand component (% YoY)

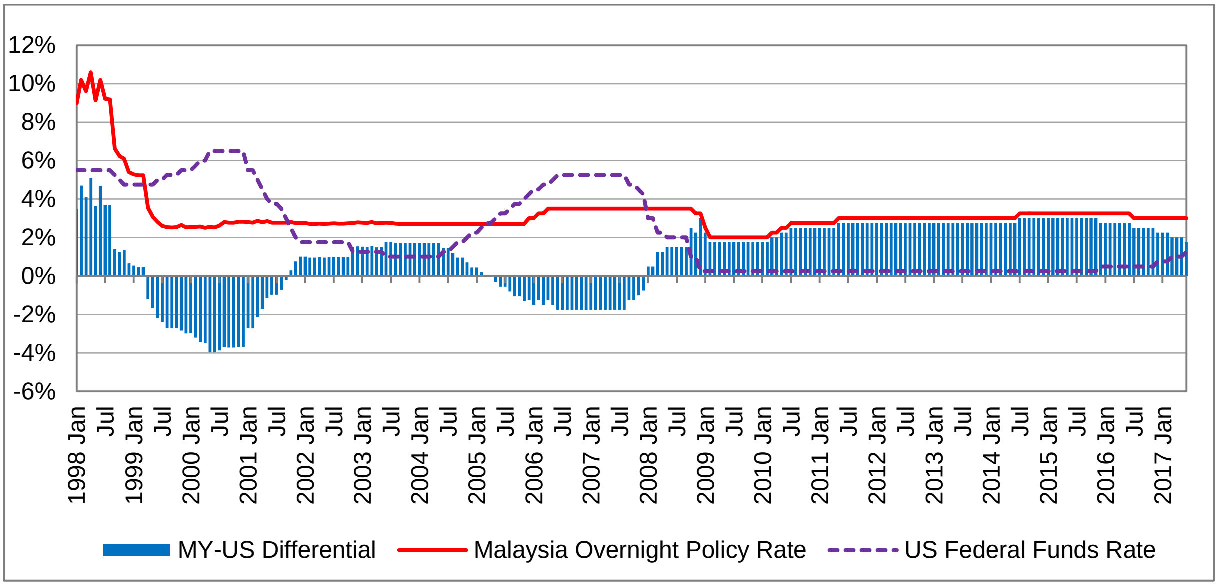
Demand Component [% share to GDP in 2017*]	**2014**	**2015**	**2016**	**2017 1Q**	**2017*f* (BNM)**	**2017*e* (SERC)**
Private Consumption [54.0%]	7.0	6.0	6.0	6.6	6.0	6.2
Public Consumption [12.5%]	4.3	4.4	0.9	7.5	-0.2	6.3
Private Investment [16.8%]	11.1	6.3	4.3	12.9	4.1	8.9
Public Investment [8.3%]	-4.7	-1.1	-0.5	3.2	1.5	2.8
Exports of Goods and Services [68.4%]	5.0	0.3	1.1	9.8	2.2	7.9
Imports of Goods and Services [60.3%]	4.0	0.8	1.1	12.9	1.8	10.2
Overall GDP	**6.0**	**5.0**	**4.2**	**5.6**	**4.3-4.8**	**5.0**

Source: Department of Statistics, Malaysia; Bank Negara Malaysia (Annual Report 2016); SERC
** % Share to GDP of 2017f from BNM*

Headline inflation to increase at moderate pace in 2H17. After hitting an 8-yr high of 5.1% yoy in March, headline inflation ebbed to 3.9% yoy in May (4.4% in April and 4.3% in 1Q17), thanks to moderating transport prices. With the volatile crude oil prices remain a wild card, we expect inflation to hover between 4.1-4.3% in 2Q17 assuming stable oil prices in the range of US$50-55/bbl. We estimate inflation to 3.5-4.0% this year, in line with BNM's inflation outlook of 3.0-4.0% in 2017 (2.1% in 2016).

Bank Negara Malaysia's policy rate remains status quo. Bank Negara Malaysia (BNM) is expected to keep the policy rate unchanged at 3.00% for the rest of the year though the domestic economy is gaining momentum amid cost-induced inflation pressures. BNM reaffirmed that the demand-pull inflation is not apparent as reflected in moderate core inflation (which excludes volatile fuel prices) of 2.6% in May. Nevertheless, we think the central bank should prepare the groundwork for a gradual rise in interest rates in 2018 if the economy continues to strengthen.

Figure 24: Malaysia-US's interest rate differentials



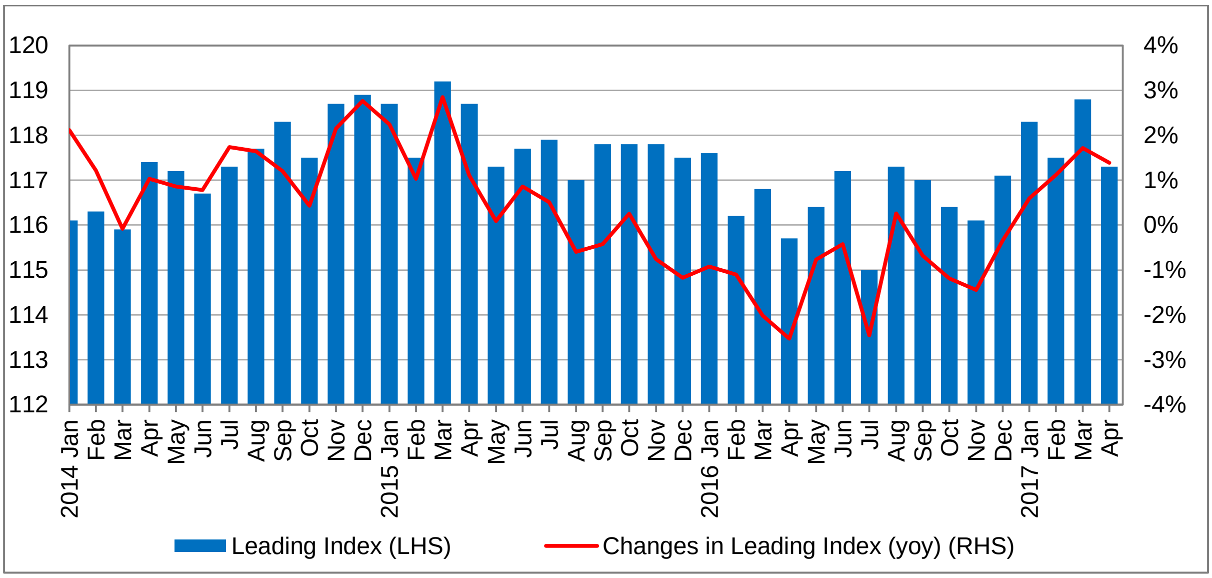
Source: Bank Negara Malaysia; Federal Reserve

REVIEW OF KEY ECONOMIC AND FINANCIAL INDICATORS

High frequency data such as **exports, industrial production, manufacturing sales, services and loans** extended by the banking system suggest that the economic growth momentum would continue, albeit at a moderate pace when compared to 1Q. Headline inflation has ebbed in April and May though prices paid by consumers have not come down. Given stronger-than-expected 1Q's GDP growth, we have raised our real GDP growth estimate to 5.0% for this year and 4.9% for 2018 (4.6% previously).

1. The **leading index (LI)** moderated to 1.4% yoy in April from 1.7% in March, mainly dragged by declines in real imports of other basic precious and other non-ferrous metal (-0.6% mom), number of housing units approved (-0.6%) as well as number of new companies registered (-0.4%). However, the fourth consecutive growth of expansion indicates that the economy will continue expanding in four to six months ahead.

Figure 25: Leading index increased for four consecutive months albeit softer



Source: Department of Statistics, Malaysia

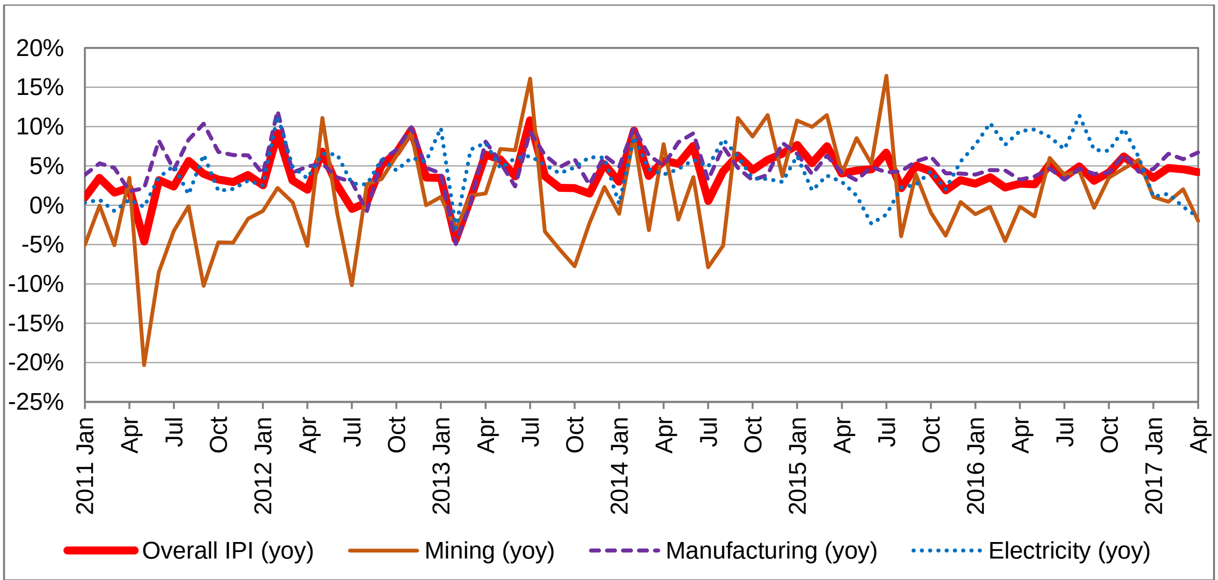
2. **Industrial production**, as measured by the Index of Industrial Production, rose at a slower rate of 4.2% yoy in April (4.6% in March; 4.3% in 1Q17), as higher manufacturing output (6.7% vs. 5.9% in March) was offset by declines in electricity (-1.5% vs. -0.2% in March) and mining (-2.0% vs. 2.0% in March).

   Higher **manufacturing output** was broad-based. Within domestic-market oriented industries, the sectors that showed continued expansion were food, beverages and tobacco (15.4% vs. March's 5.6%), transport equipment (5.0% vs. March's 6.2%), and non-metallic monetary products, basic metal and fabricated metal growth (4.3% vs. March's 4.0%). Export-oriented sectors were held up by electrical products and electronics (9.7% vs. March's 8.5%), textiles and apparel (6.4% vs. March's 7.0%), wood products and furniture (7.1% vs. March's 10.3%).

   The decline in **mining output** was due to lower extraction of crude petroleum oil and condensates (-6.6%). This reflected Petronas's reduction of oil output of 20,000 bpd in compliance with the OPEC and non-OPEC agreement on the oil output cuts deal. The oil output cuts deal is extended until March 2018.

   April's higher manufacturing output growth lends credence to continued steady economic growth estimated 5.0% in 2Q17, augmented by the services, agriculture and construction sectors. We expect the industrial output to grow by 4.5-4.8% in 2017 (3.8% in 2016), supported by higher expansion of manufacturing sector and electricity as well as moderate growth in mining output.

Figure 26: Overall industrial production growth lifted by manufacturing output



Source: Department of Statistics, Malaysia

3. The **external sector** continues to perform favourably in April as the trade surplus widened to RM8.8 billion from RM5.4 billion in March. Both exports and imports grew at double-digit rates, albeit slower when compared to March. Nevertheless, Malaysia's export growth is still leading many of its ASEAN peers.

   Exports expanded by 20.6% yoy in April (24.1% in March), partly aided by a low base effect and supported by higher demand for electrical products and electronics (22.2%; a share of 35.5% of total), petroleum products (5.4%; share 7.4%), chemicals (18.0%; share 7.4%), palm oil (26.1%; share 5.0%), manufactured metal (17.3%; share 4.5%), liquefied natural gas (LNG) (50.2%; share 4.4%), crude petroleum (65.7%; share 3.2%), rubber products (36.3%; share 3.1%), and optical and scientific equipment (10.5%; share 3.5%).

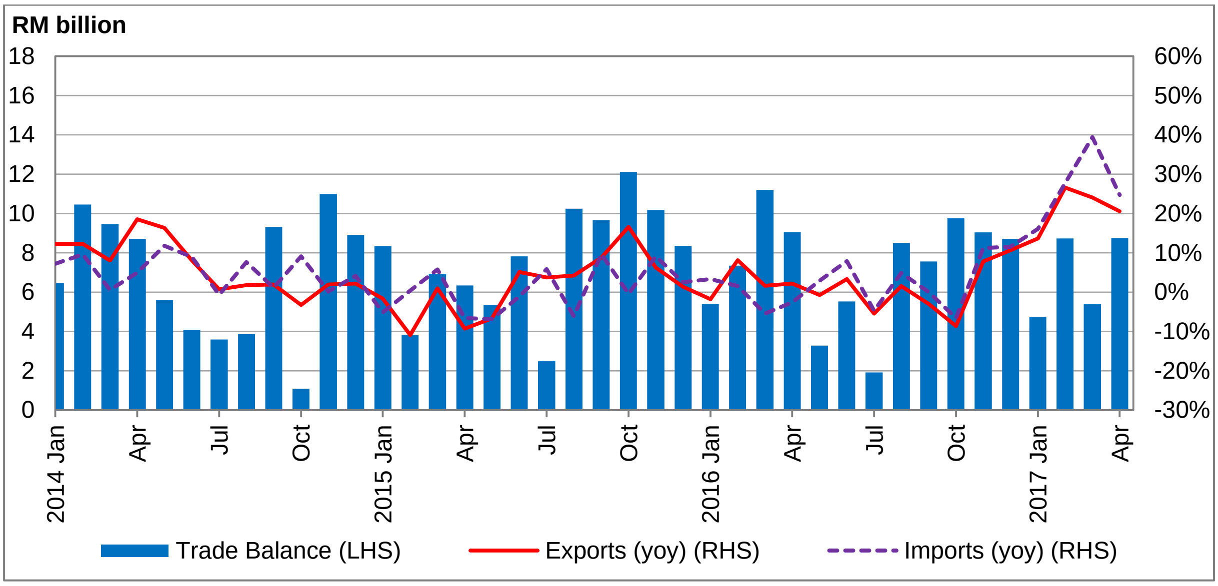
In terms of export markets, exports were broadening to advanced economies, namely the US (11. 0% growth; 10.0% share of total exports), Japan (44.7%; 8.6% share), EU (26.5%; 10.1% share). Exports to China surged 50.6% to account for 13.7% share of total Malaysia's exports while growth to ASEAN grew 14.9% (28.6% share).

Imports also paced slower to 24.7% yoy in April (39.4% in March; 27.7% in 1Q17) lifted by intermediate imports (29.2%), capital imports (14.8%) and imported consumer goods (1.0%).

While we expect exports expansion to continue, but the disappearing of favourable base effects as well as exchange rate valuation should take some heat from the annual growth of exports, particularly going into 2H17. The export drivers remain intact and these include still expanding global manufacturing activity and firm global semiconductor sales. The volatile crude oil prices could be a dampener. The potential drag from the protectionism mindset in advanced economies and China's recovery strength should be closely monitored.

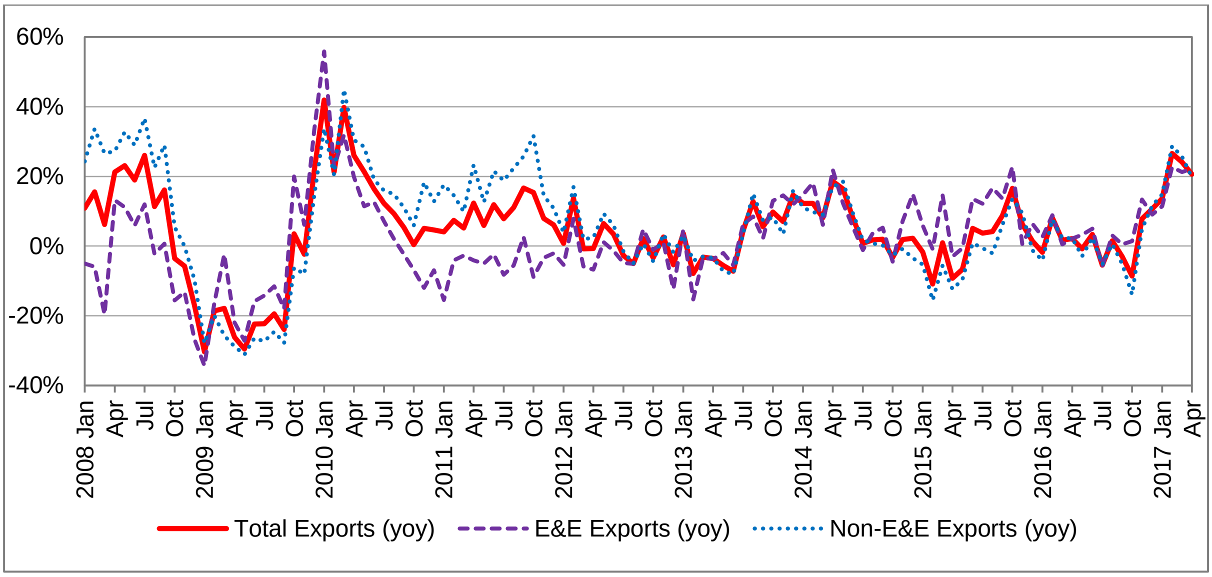
Backed by a strong 21.2% growth in Jan-Apr 2017, we have revised higher our full year's export growth estimate to 14.5% (1.1% in 2016).

Figure 27: Exports growth moderated yet still strong



Source: Department of Statistics, Malaysia

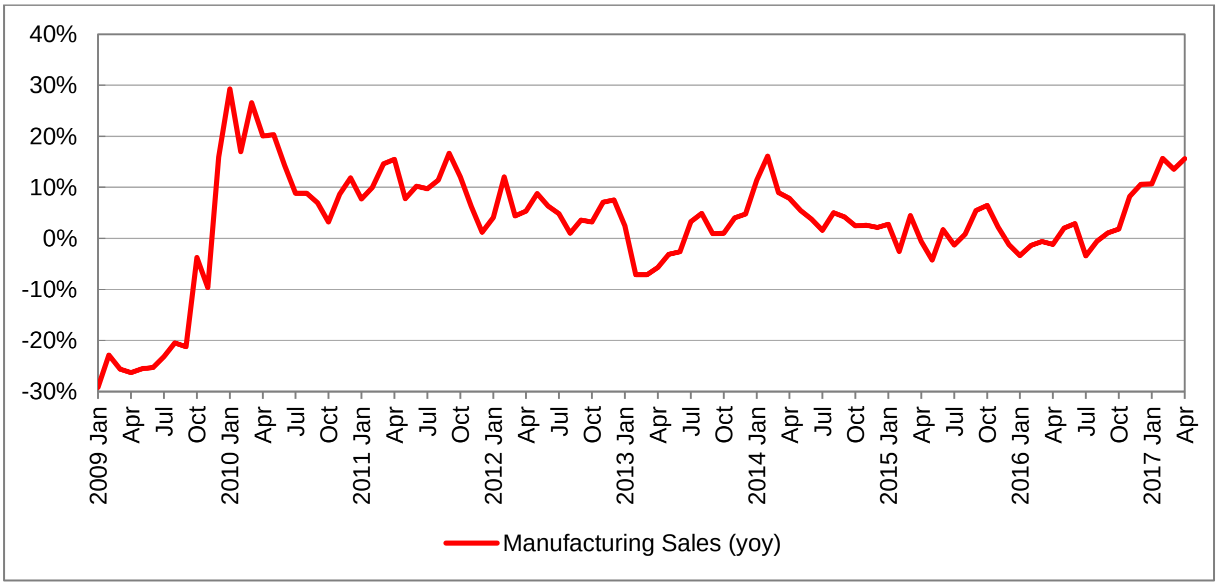
Figure 28: Exports driven by all sectors



Source: Department of Statistics, Malaysia

4. Total **sales value of the manufacturing sector** rose higher by 15.6% yoy to RM60.5 billion in April (13.6% in March), marking five consecutive months of double-digit growth since December 2016. The significant annual increase was due to increases in electrical products and electronics (17.3%), petroleum, chemical, rubber and plastic products (18.2%) and non-metallic mineral products, basic metal and fabricated metal (12.3%). They jointly contributed 80.1% to the total sales value.

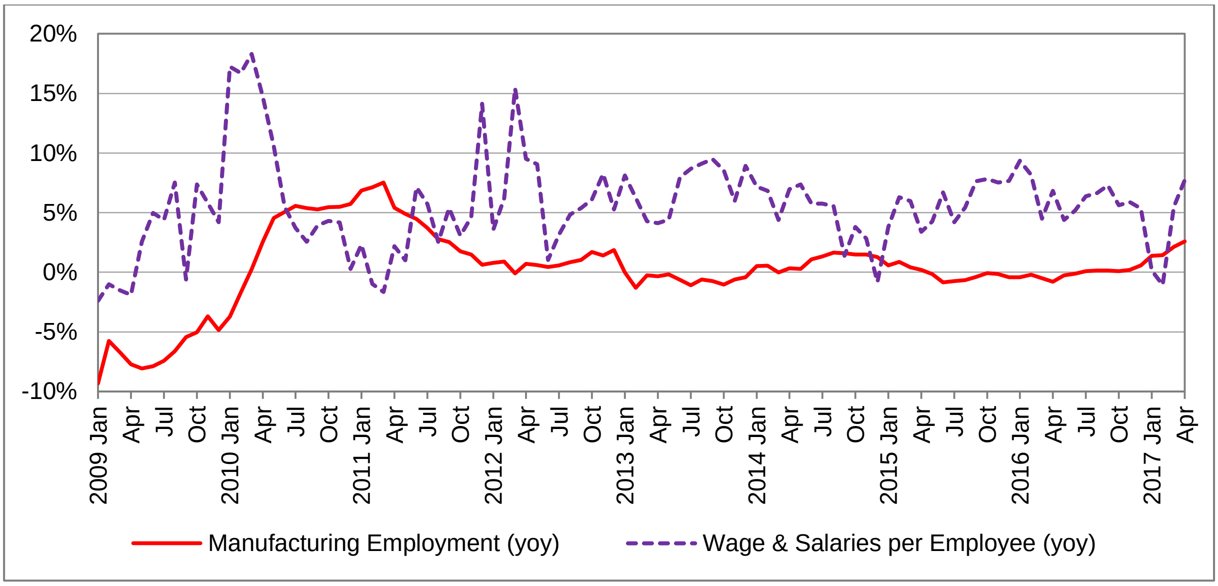
Figure 29: Double-digit manufacturing sales growth for five consecutive months



Source: Department of Statistics, Malaysia

Total number of employees employed in the manufacturing sector increased 2.6% yoy to 1,047,310 persons at end-April (2.1% in March), marking the highest increase since August 2011. The average sales value per employee, a measurement of labour productivity increased by 12.7%. Total salaries and wages paid rose 10.5% yoy in April, higher than 7.8% recorded in March while the wage per employee grew 7.7% to RM3,315.

Figure 30: Highest manufacturing employment growth since August 2011

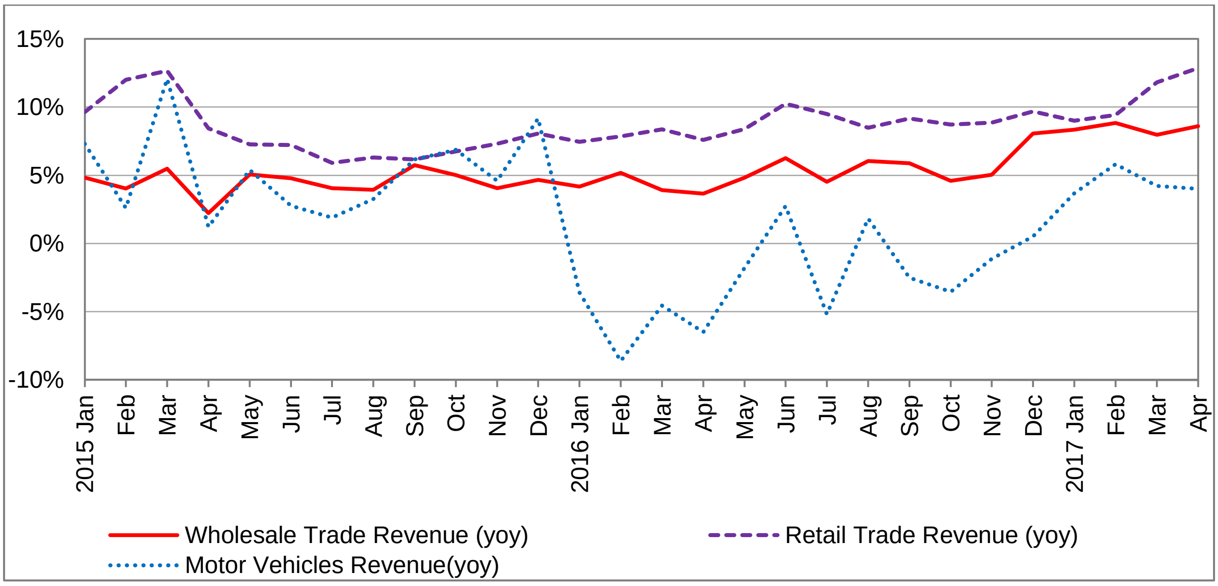


Source: Department of Statistics, Malaysia

5. The **services sector** recorded an 8.3% yoy increase in sales value to RM375.3 billion in 1Q17 (5.5% in 4Q16), the highest growth since 2Q14, mainly thanks to a rise of 8.5% growth or RM281.4 billion in the distributive trade.

   Distributive trade which consists wholesale, retail and motor vehicle, grew higher by 9.6% yoy in April 2017 (8.9% in March and 8.7% in February respectively). The **wholesale and retail sector** up 8.6% and 12.9% respectively while motor vehicle sales eased to 4.0%.

Figure 31: Wholesale and retail trades grow higher



Source: Department of Statistics, Malaysia

All other sub sectors within services sector also registered positive sales growth in 1Q17, including professional (17.6% yoy), private education (8.5%), arts, entertainment & recreation (8.3%), information and communication (7.9%), food and beverages (6.9%), real estate agent (6.4%), private health (6.4%), transportation and storage (6.2%) and accommodation (1.6%).

The number of persons employed in services sector rose 2.5% yoy to 3.6 million persons in 1Q17 (2.5% in 4Q16). Total salaries and wages paid increased 5.1% to total RM22.9 billion in 1Q17, representing the highest growth since 1Q15. Productivity growth jumped 5.6%, the largest increase since 3Q14.

Despite rising by 1.8% in March, **tourist arrivals** dropped by 0.5% yoy in 1Q17, dragged by lower arrivals in February (-2.3%) and January (-1.1%). Among the top ten tourist arrivals by destination, China was the only country outside ASEAN that registered positive growth of 7.5% yoy to 551,378 persons in the first quarter. With total tourist arrivals of 6.6 million in 1Q17, the target of 31.8 million tourist arrivals in 2017 looks achievable, helped by the 29th SEA Games and 9th ASEAN Para Games in the third quarter.

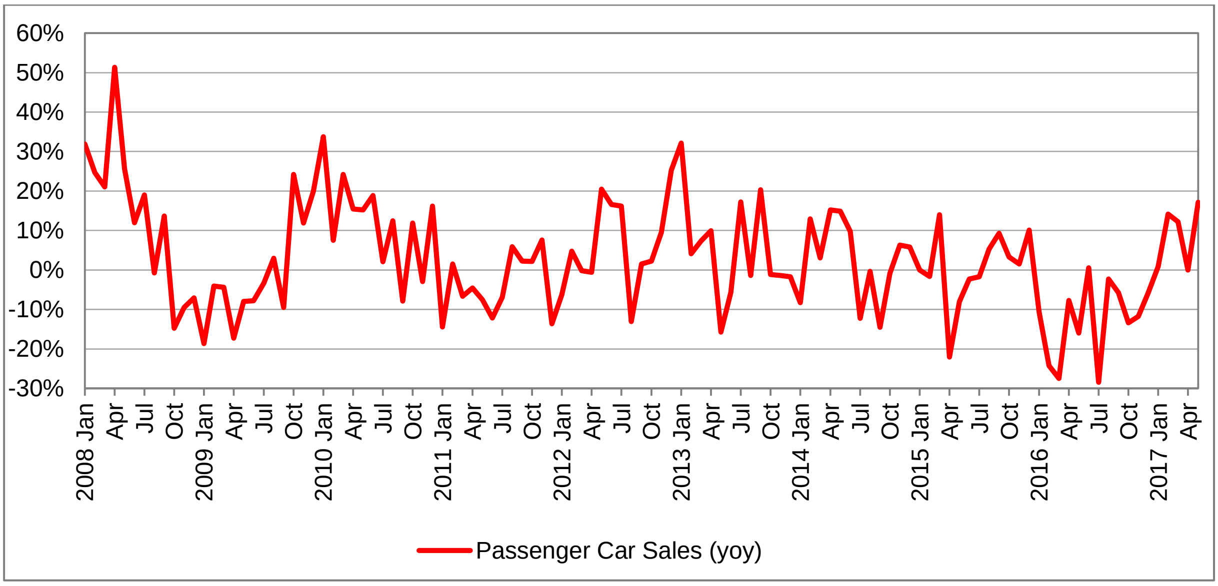
6. **Private consumption indicators showed mixed performance**. Households have displayed their spending resilience in 1Q17 despite coping with high cost-induced inflation pressures and rising cost of living. MIER's consumer sentiment index (CSI) up 6.8 points to 76.6 in 1Q17 (69.8 in 4Q16) but remains below 100-point optimism threshold since 3Q14. The reasons cited for the improvement were stable income, improved financial and job expectations as well as worries over rising prices moderating. While households looking to up their shopping plans, some cautiousness remain.

   The labour market shows a moderate recovery as the **unemployment rate** eased slightly to 3.4% in April and March after holding steady at 3.5% from December 2016. The country's jobless rate rose from 3.1% in 2015 to 3.4% in 2016, and labour participation rate fell to 67.7% from 67.9%. There were 5,549 job terminations reported in the 1Q17, among them only 957 were under the voluntary separation scheme (VSS). The layoffs either forced or voluntary were evident in the oil and gas, banking and manufacturing sectors. In terms of youth unemployment, the number of unemployed youth dropped slightly to 273,400 in 2016 (273,600 in 2015) despite the total unemployed person increased by 53,800 compared to a year ago.

   After rising by 8.9% yoy in 1Q17, **sales of passenger cars** declined marginally to 37,741 units in April, due to the lapsing of some induced factors, including a rush for deliveries by companies having a financial year ending March 31 as well as changes in the SUV/4×4 excise duty structure, which was later reversed to its original rate. However, car sales rebounded strongly to grow by 17.1% to 45,139 units in May, marking the highest monthly increase since September 2013. In 5M17, total passenger car sales increased 8.8% to 210,410 units.

   While the local automotive industry remains challenging, we expect total car sales to register a modest upturn of 1-2% increase this year (-13.0% in 2016), the first decline in four years. This is in line with the Malaysian Motor Association (MAA), which expects total passenger cars sale to rise by 1.4% to 522,000 units in 2017 (514,545 units in 2016).

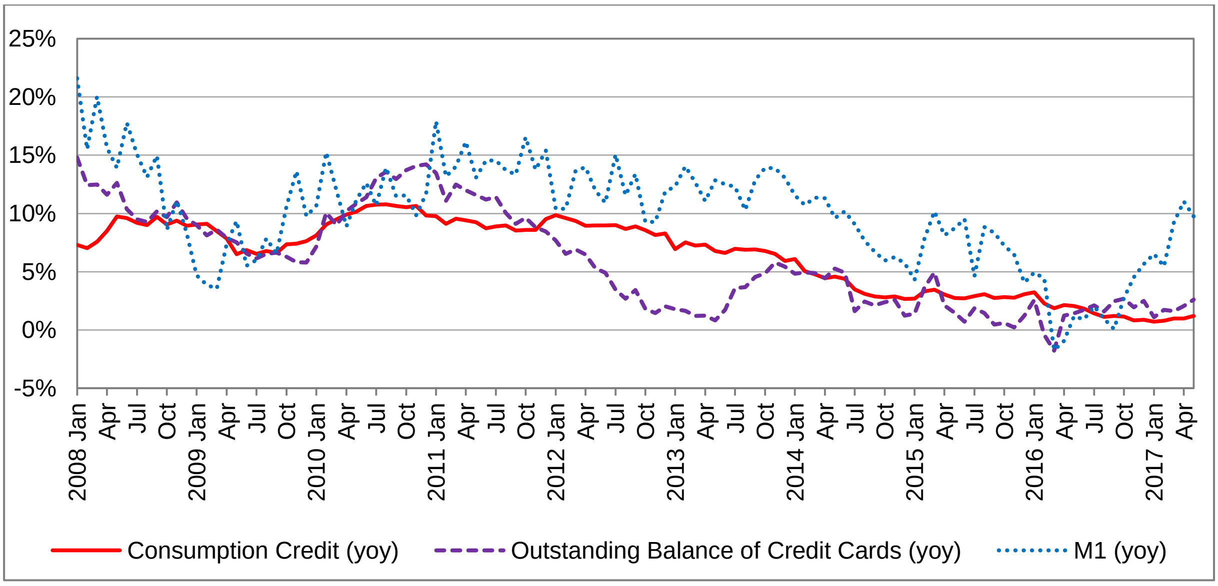
Figure 32: Passenger car sales growing towards the target



Source: Bank Negara Malaysia

Loans extended by banks for the purpose of **consumption credit** remained stable at 1.0% yoy in April (0.8% in 1Q17) while **imports of consumption goods** growth pulled back sharply to 1.0% in April (14.1% in March; 4.0% in 1Q), reflecting uneven pace of spending on imported consumer durables, partly due to the weakening ringgit.

Figure 33: Consumer sentiment remains cautious despite some optimism spotted



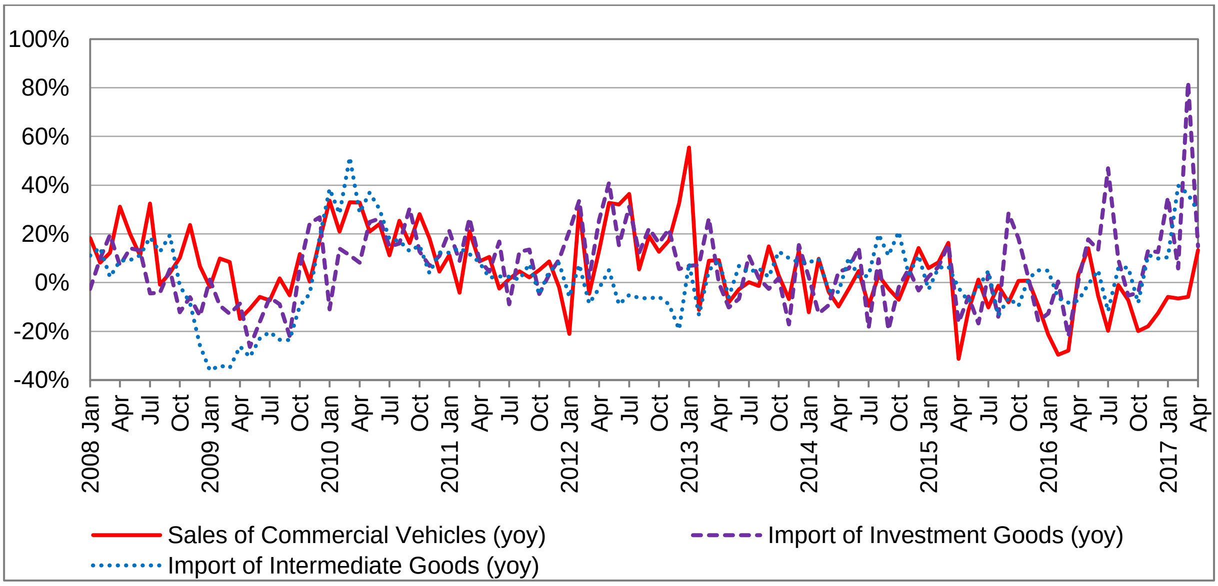
Source: Bank Negara Malaysia

Even though private consumption growth surprises on the upside in 1Q17 (6.6% vs. 6.1% in 4Q16), the strength of consumer spending hinges critically on how consumers view the state of economy, job and income prospects as well as inflation expectations. Rural households' spending depends on the prices of commodities such as rubber, which had slowed further to 18.9% in May (25.1% in April and 93.7% in 1Q17) and for palm oil higher at 7.5% in May (3.7% in April vs. 30.0% in 1Q17). Spending on big-ticket items such as passenger car jumped 17.1% in May. **Private consumption growth** is now expecting to grow by 6.2% in 2017 and 6.0 % in 2018 respectively (6.0% in 2016), slowing from an average growth of 7.1% in 2011-15.

7. **Private investment indicators** painted a mixed picture, indicating that the strong private investment growth (12.9% in 1Q17) may not repeat in 2Q. Imports of **capital goods** and **intermediate goods** moderated to 14.8% in April (82.4% in March; 42.0% in 1Q17) and to 29.2% in April (36.3% in March; 27.8% in 1Q17) respectively. **Business loan** growth eased to 6.1% in May from 7.5% in April. MIER's Business Conditions Index climbed above benchmark to read 112.7 points in 1Q17, up from 81.2 points in 4Q16, supported by the picked up in local and export orders as well as fast-moving sales.

   In the near-term, lingering uncertainty associated with the General Election 14 (GE14) may temper investors' sentiment. Nevertheless, we continue to see better prospects for private investment over the medium-term, backed by the on-going implementation and new infrastructure projects related to rail and ports projects. Real estate development projects and continued investment in manufacturing and services also are prime catalysts. We have revised **private investment growth** estimates to 8.9% in 2017 (4.1% previously) and 7.8% in 2018 respectively (4.4% in 2016).

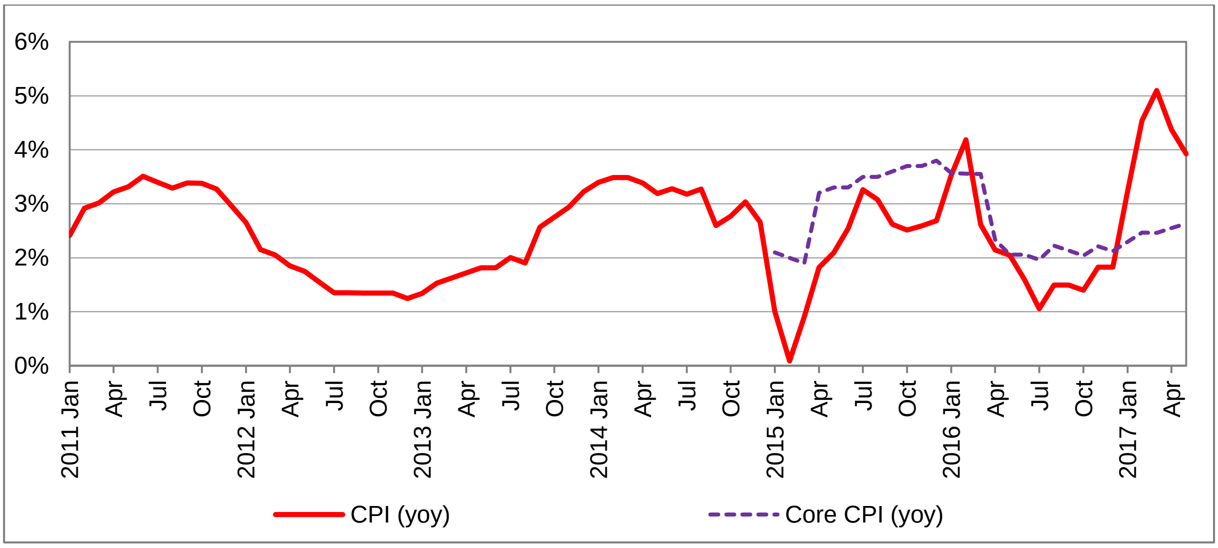
Figure 34: Private investment indicators show positive outcomes in April



Source: Bank Negara Malaysia

8. **Headline inflation** eased further to 3.9% yoy in May (4.4% in April, 5.1% in March and 4.5% in February). Core inflation (excludes volatile items) which reflects the demand-induced inflation increased higher to 2.6% in May, marked the largest inflation since March z016, mainly due to the higher food and non-alcoholic beverages prices.

Figure 35: Inflation eases on moderated transportation costs

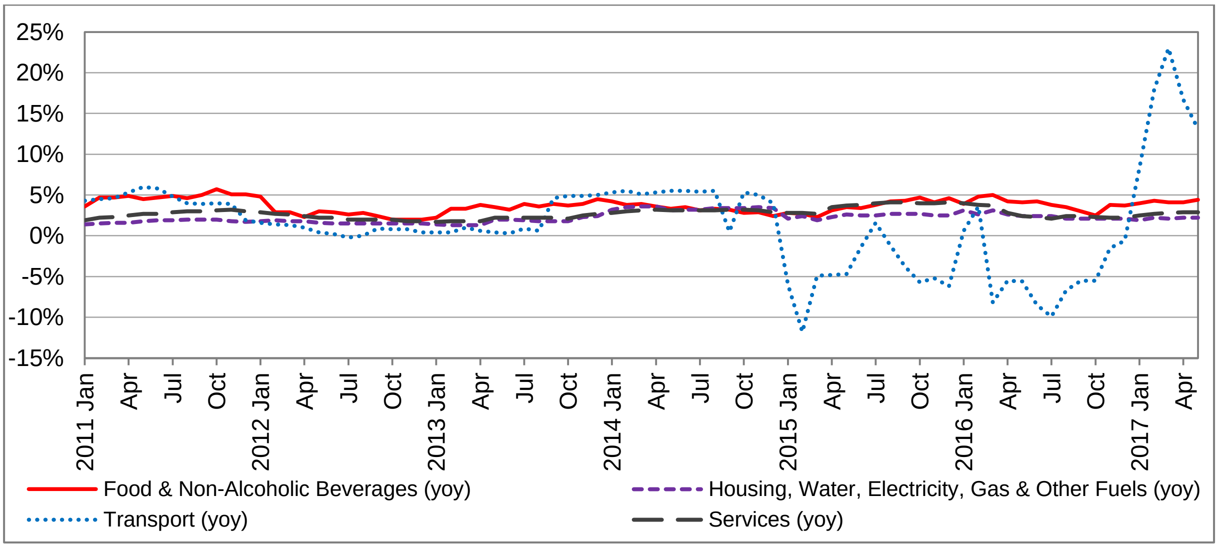


Source: Department of Statistics, Malaysia

Among the major groups which registered higher increases of prices were transport (13.1% vs. 16.7% in April), food & non-alcoholic beverages (4.4% vs.4.1% in April), recreation services & culture (2.9% vs. 3.0% in April) and health (2.9% vs. 2.8% in April). Food & non-alcoholic beverages, which make up 30.2% of CPI basket, showed price increases in oil and fats (38.9%), fish & seafood (4.1%) and meat (5.1%).

While the cost-push inflation has caused broader price increases, demand pressure inflicted by a wage-price spiral is not seen as core inflation increased moderately. Though the headline inflation reading will moderate in 2H17, the pace of price increases will depend on the volatile global crude oil prices. We estimate inflation to average 3.5-4.0% (2.1% in 2016).

Figure 36: Fuel prices moderated since the peak in March



Source: Department of Statistics, Malaysia

9. **Loan indicators** showed mixed performance in May. **Loan applications** continue to increase by 4.9% yoy (0.6% in April) while **loan approvals** and **disbursements** declined by 2.3% and 1.3% in May respectively (+0.3% and +2.5% in April respectively). Total **loan outstanding** also paced slower to 5.5% growth in May (6.1% in April and 6.0% in March).

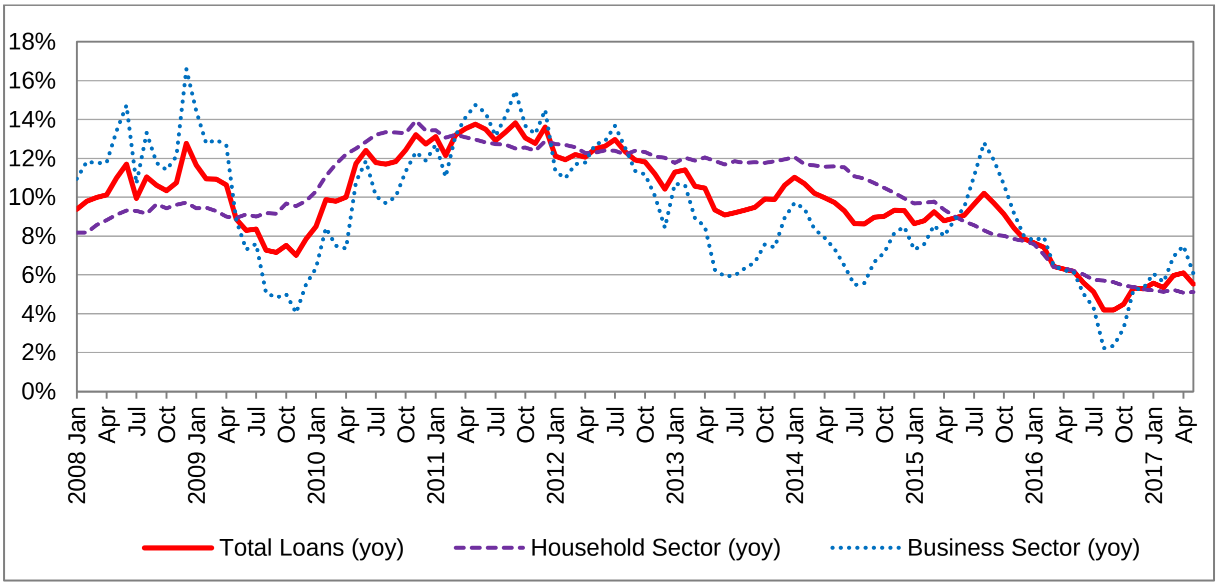
   Household loan growth held steady at 5.1% in May while **business loan** growth moderated to 6.1% (7.5% in April). The moderated business loan growth was due to the decrease of 11% in mining & quarrying sector as well as softened growth in real estate, financing, insurance & business services, and electricity, gas & water supply. In terms of purposes, loan increases were recorded in purchase of both residential and non-residential properties, personal use, credit card and construction.

   Loan applications increased across all the purposes except the purchase of fixed assets other than land & building (-76.9%) and working capital (-28.0%) in May. The purchase of residential and non-residential properties, which contributed a combine share of 40.6% of the total loan applications saw 20.2% and 19.2% increase in May respectively.

   Loan approvals reverted to decline by 2.3% in May from 0.3% in April and 28.9% in March respectively. Among the major declines were for working capital (-36.8%) and purchase of securities (-5.2%). Similarly, loan disbursements also contracted 1.3% in May (+2.5% in April and +15.6% in March). It was mainly pulled down by lower disbursement for working capital (-4.9%), which accounted for 59.0% of the total loan disbursements. Loan disbursements were sharply lower in the transport, storage & communication (-60.5%) and finance, insurance & business activities (-19.7%).

   We estimate the banking system's loans growth to rise by 5.0% this year compared to 5.3% in 2016, supported by moderate loans demand from both households and businesses.

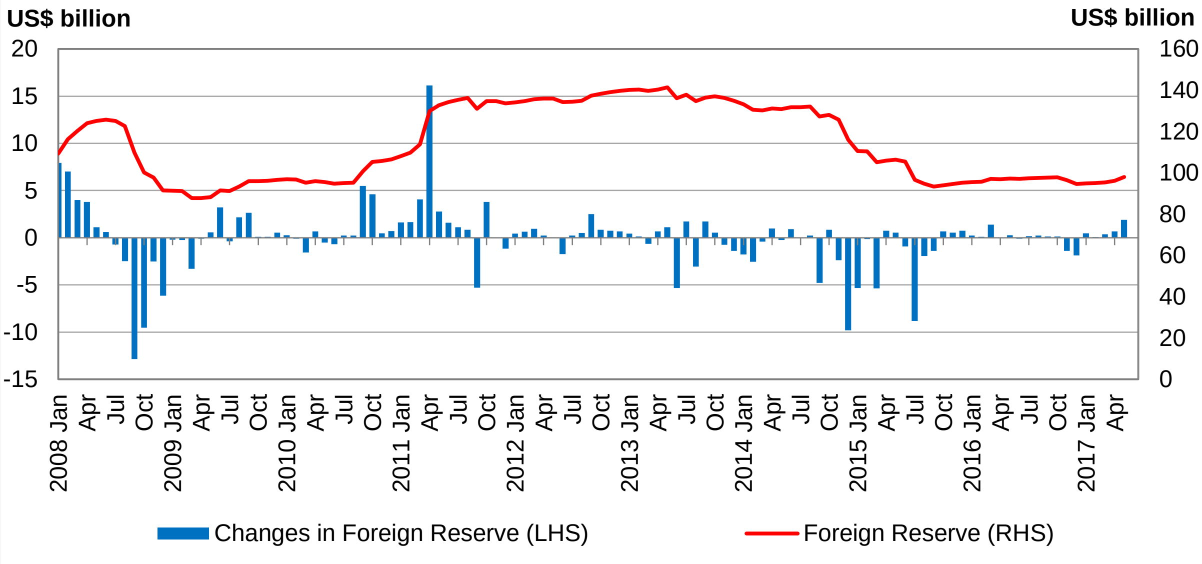
Figure 37: Household loan growth is getting stable



Source: Bank Negara Malaysia

10. **Bank Negara Malaysia's holdings of foreign exchange** continues to stabilise and rise gradually to US$98.7 billion as at 15 June 2017, marking an increase of US$4.2 billion from US$94.5 billion at end-December 2016. The level of reserves is sufficient to finance 8.2 months of retained imports and were 1.1 times the short-term external debt.

Figure 38: Foreign reserves rise steadily since end-December 2016



Source: Bank Negara Malaysia

Net **portfolio investment** outflows continued for three consecutive quarters (-RM31.8 billion in 1Q17; -RM19.1 billion in 4Q and -RM10.6 billion in 3Q16), weighed by lingering negative sentiment about BNM's NDF restrictions, the Fed's rate hike in March, the third time since December 2015, unsettling global oil prices and the reduction of Malaysia's weightage in the JP Morgan GBI-EM Index.

Foreign investors have been net sellers of Malaysia bonds for five successive months since November 2016 due to adverse reactions toward BNM's none-deliverable forward market (NDF) as well as global investors' rebalancing of portfolio following the rise in the US Treasuries yield post the Trump's victory.

Foreigners pared down their holdings of Malaysia government bonds, which saw it fell substantially by RM61.6 billion from RM218.4 billion at end-October 2016 to RM156.8 billion at end-March 2017. Of the total, foreign holdings of Malaysian Government Securities (MGS) reduced by RM37.1 billion from RM173.0 billion at end-November 2016 to RM135.9 billion at end-March 2017. As a result, foreign-owned of Malaysia government bonds fell from a peak of 36.3% of total at end-October 2016 to 25.6% at end-March 2017. Similarly, foreign shareholding of MGS also plunged sharply to 38.5% at end-March 2017 from 51.9% at end-Oct 2016.

In April-May, foreigners have returned to the bond market as attractive value investing emerged after five successive months of selling since November 2016. In April, foreigners owned a total worth of RM162.8 billion Malaysia government bonds (RM156.8 billion at end-March) and RM141.6 billion worth of MGS (RM135.9 billion at end-March). Though foreign shareholdings of Malaysia government bonds and MGS have increased to 26.3% and 39.7% respectively at end-April 2017, they are still below than the peak of 36.3% and 51.9% respectively at end-October 2016. Non-resident holdings of government bonds increased by RM8.8 billion to RM171.6 billion at end-May, with more than 70% into medium to longer term papers, accounting for 27.2% of the total outstanding as at end-May 2017.

While foreigners were net buyers of domestic equities amounting to RM10.8 billion in the first half of 2017, the pace of net buying has slowed to RM2.7 billion in April, RM2.1 billion in May and RM0.3 billion in June compared to RM4.3 billion in March.

Bank Negara Malaysia's onshore ringgit stabilization measures, including the requirements for exporters to convert at least 75% of their export proceeds into ringgit have increased the supply of dollars, which help buffer foreign reserves. Net foreign exchange conversion from exports amounted to US$1.4 billion during the period Dec 2016-Mar 2017. In May, Net FX conversion was US$1.1 billion.

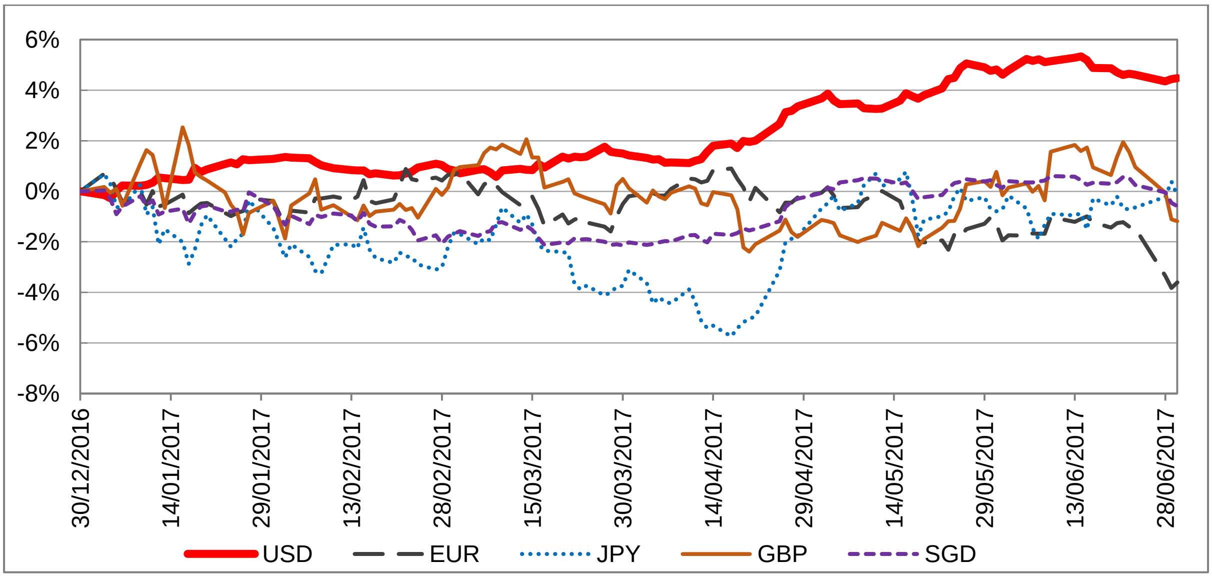
Bank Negara Malaysia also engaged in the US dollar swap ranging between a maturity of up to one month, 3 months and more than 3 months and up to one year totalling US$16.8 billion as of May to curb the depreciation pressure on ringgit, especially during the period of sustained selling of Malaysia bonds post the implementation of NDF restriction measure. The offer of US dollar via FX swaps is a different tool of FX intervention to calm the FX market without showing a sharp fall in BNM's spot reserve numbers. Going forward, the central bank will have to manage the tapering of the dollar swap on the foreign reserves stock when the swap duration matures though the reduction would be offset by net inflows of capital.

Going forward, we expect foreign reserves to rise moderately as there remain hurdles along the path of reserves accumulation: the anticipated gradual rise in the US interest rates; higher yields of the US Treasuries; maturing of outstanding Malaysian bonds (RM49.0 billion between July and November vs. RM18.3 billion between March and June 2017) as well as capital flows volatility associated with the Trump's economic policies.

During the period Jan-30 June 2017, the ringgit has strengthened by 4.5% against the US dollar, reflecting the pausing of the US strength, the positive impact of BNM's onshore ringgit market stabilisation measures as well as the inflows of portfolio investment.

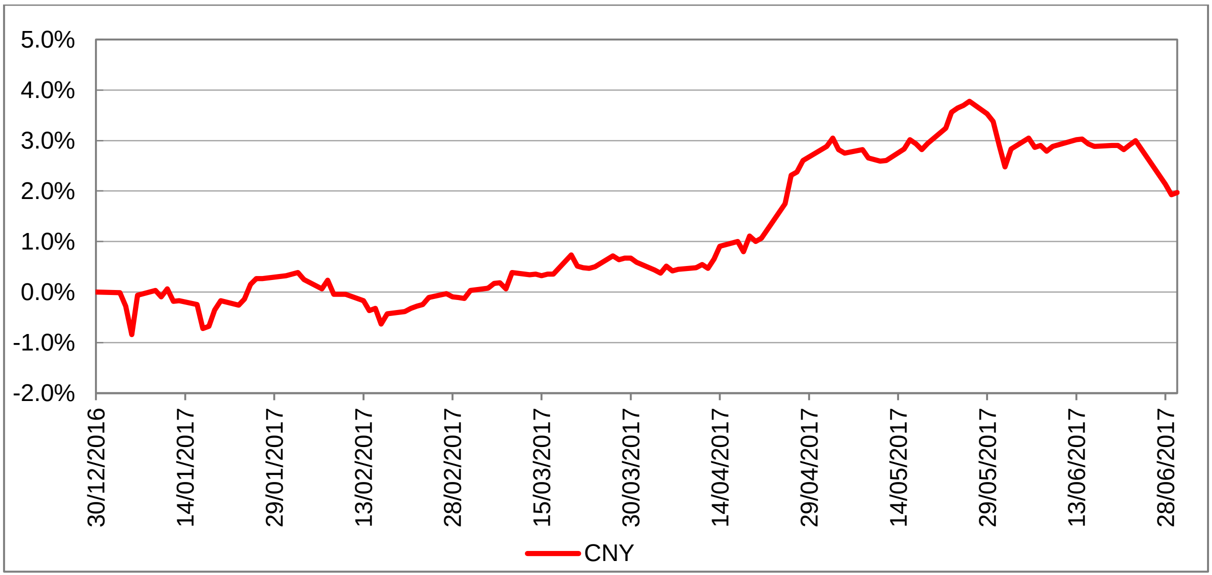
Against other global and regional currencies, the ringgit weakened 3.6% to euro, 1.2% to pound sterling, 0.9% to Thai baht, 0.6% each to Singapore dollar and Korean won, 0.4% to Indian rupee and 0.2% to Japanese yen, while strengthened 6.3% to Philippine peso, 3.4% to Indonesian rupiah and 2.0% to Chinese renminbi.

Figure 39: The ringgit appreciated against USD but weaker against others



Source: Bank Negara Malaysia

Figure 40: Ringgit appreciated against CNY but moderating recently



Source: Bank Negara Malaysia

According to the latest updates by Financial Markets Committee (7 June), the onshore foreign exchange market sustained a daily average volume of US$9.4 billion, of which trading volume for MYR currency pairs recorded a daily average of US$5.2 billion in May (April: US$9.9 billion and US$6.2 billion respectively). The exchange rate remains stable with USD/MYR 1-month implied volatility at an average of 5.0% this year. Average intraday movement recorded a daily average of 89 points while the bid-ask spread recorded an average of 26.4 basis points since end-April 2017.

The ringgit is expected to end the year 2017 at RM4.20-4.30 (End-2016: RM4.4860; End-2015: RM4.2935).

SOCIO-ECONOMIC RESEARCH CENTRE (SERC)
SERC SDN BHD (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