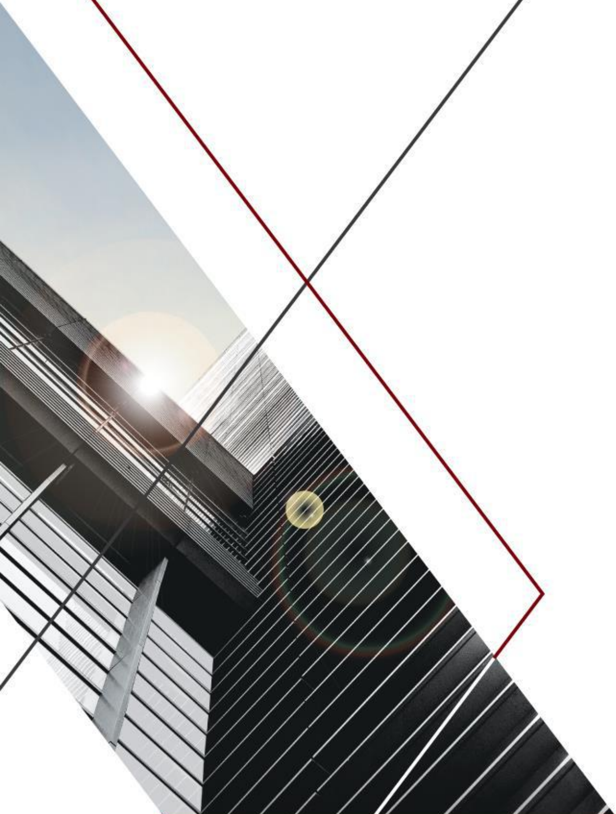


CIMB GROUP

CIMB Group

Economic Outlook of Malaysia

Dr Donald Hanna

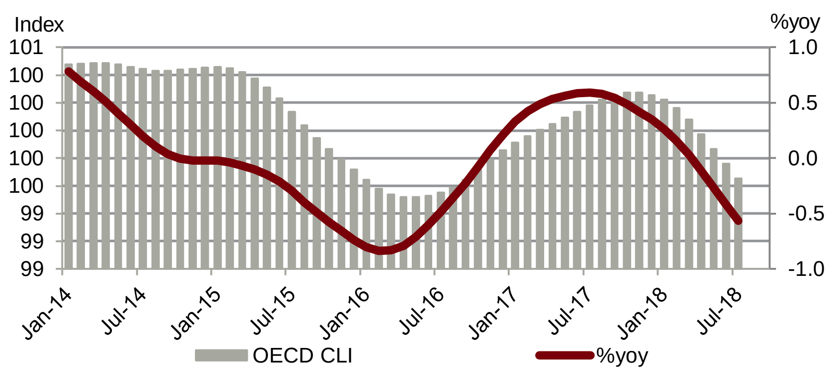
24 September 2018

FORWARD Together

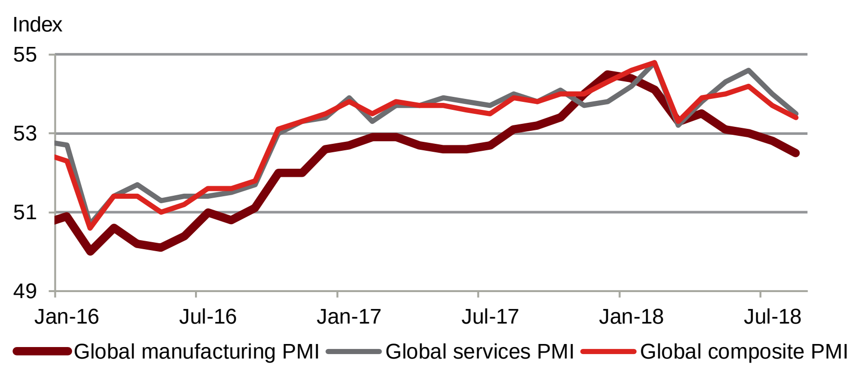
Globally, economic expansion is moderating and deeper trade war looms in the horizon

The IMF global simulation shows a GDP growth decline in emerging Asia (dominated by China) of 0.3 pp each year over the next three from this level of trade disruption

Economic momentum continues to dampen



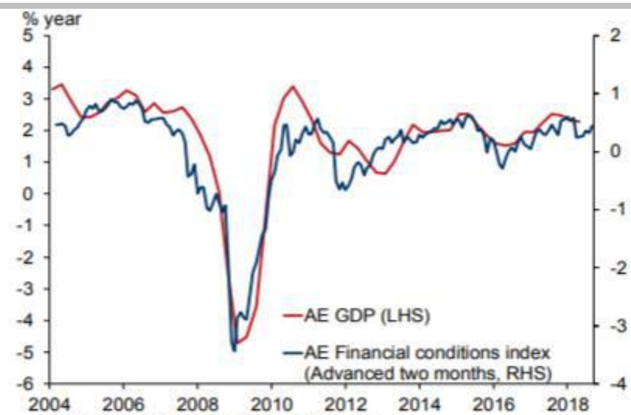
Latest PMI data slipped, reversing rises in 2Q



Global trade boom looks to be over and points to downside risks

Source : Oxford Economics/Nederland CPB

Financial conditions have tightened but not to an alarming extent



Source : Oxford Economics/Haver Analytics

CIMB GROUP

Comparison of fiscal and external balances (current vs eve of AFC)

- **Main challenges on MIST bond markets are: (1) ongoing risk-aversion away from EM financial markets; and (2) continued FOMC hike trajectory which risks widening bond spreads between MIST and US rates.**
- **Hence, amidst the continued Fed tightening, risk aversion from EM markets has prompted monetary tightening in select EM countries including Indonesia in recent months as these countries pre-emptively moved against a sharper weakening of their currencies. Monetary tightening resulted in surging bond yields (again in particular case, Indonesia) even though their currencies may have well been saved from further and severe depreciation.**
- **Contagion similar to the 1997/98 or 2007/08 crises is not a driving factor for EM Asia, in particular MIST markets. Economic conditions and risk profiles of MIST remain highly differentiated and generally robust compared to weaker EM counterparts such as Turkey, South Africa and Argentina.**

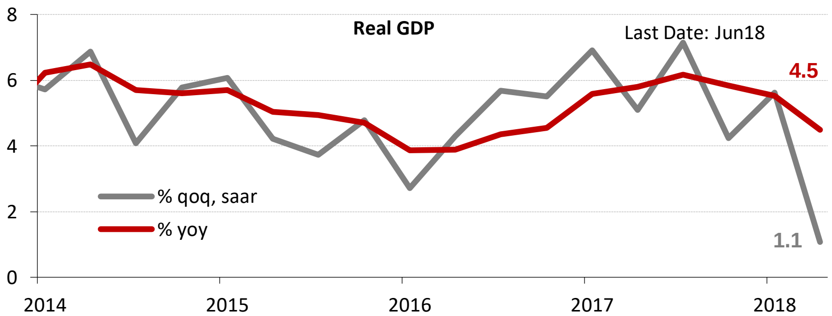
All values expressed as percentages (%)	Malaysia		Indonesia		Singapore		Thailand		Philippines	
	Q1 2018	Q1 1997	Q1 2018	Q1 1997	Q1 2018	Q1 1997	Q1 2018	Q1 1997	Q1 2018	Q1 1997
Fiscal Deficit as a % of GDP	-2.26	0.87	-2.45	1.27	4.10	-7.07	-2.37	-3.59	-3.89	-0.11
Current Account Balance as a % of GDP	4.36	-3.79	-2.70	-3.27	18.64	13.09	11.60	-4.64	-0.27	-4.37
Real Effective Exchange Rate %Δ YoY	2.13	10.62	-6.99	8.86	6.60	-1.73	1.66	5.27	-11.68	7.20
Domestic Credit as a % of GDP	145.12	157.37	47.04	57.91	145.32	66.39	163.40	169.21	68.08	76.73
Domestic Credit %ΔYoY	0.02	15.63	-0.61	9.44	6.44	7.52	-1.39	19.83	4.40	20.87
External Debt as a % of GDP	59.89	33.78	34.11	45.31	428.88	N/A	2.26	11.07	24.05	49.63
Government Debt as a % of GDP	51.36	30.61	29.01	20.23	118.18	71.85	32.29	3.75	43.93	46.30
Δ average 10-year govt bond yields vs US counterpart	1.20	0.21	3.67	12.42	-1.47	-3.50	-1.19	4.19	3.46	13.20

Source: National Statistical Institutes of ASEAN countries.

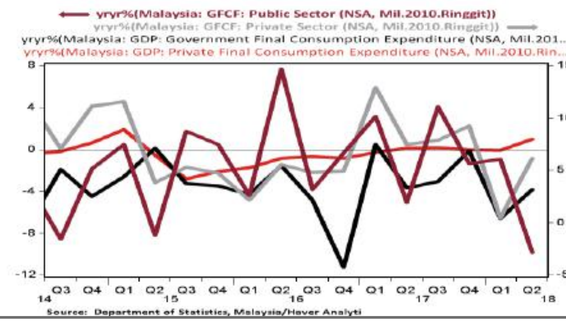
Malaysia: Slower economic activity in the horizon

- **BNM will likely keep the Overnight Policy Rate (OPR) unchanged for an extended period. Unless inflation remains weak, room for BNM to loosen monetary policy to stimulate demand is constrained by the uptrend in US interest rates and lower market tolerance for deteriorating current accounts.**
- **Fiscal options to stimulate the economy are limited amid budgetary constraints, placing greater urgency for policy clarity and accelerate meaningful reforms to unleash productivity growth.**

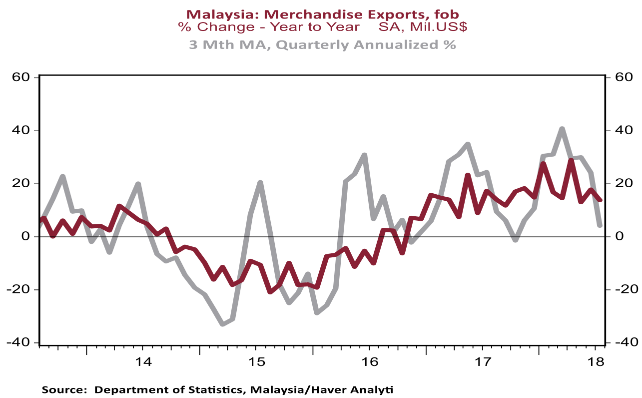
Growth begins to slow



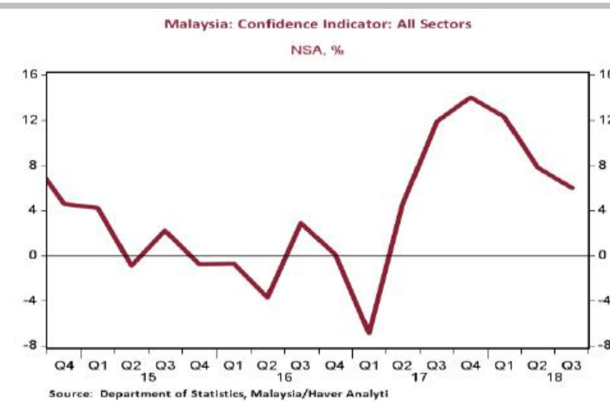
Contraction in public investments offset by gains in total consumption



Exports growth easing



Confidence indicators edges lower



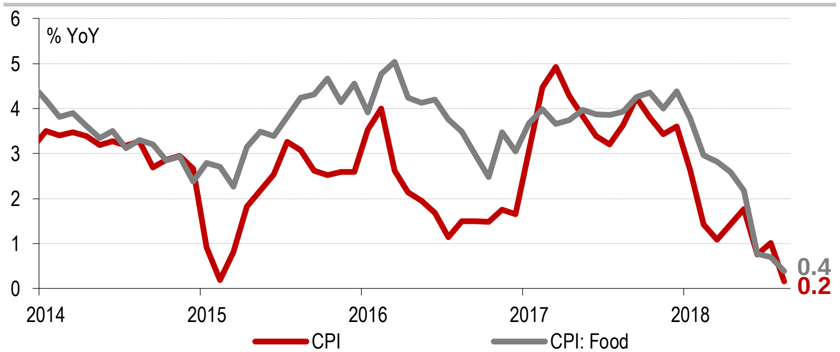
Source: Department of Statistics, CIMB Research.

CIMB GROUP

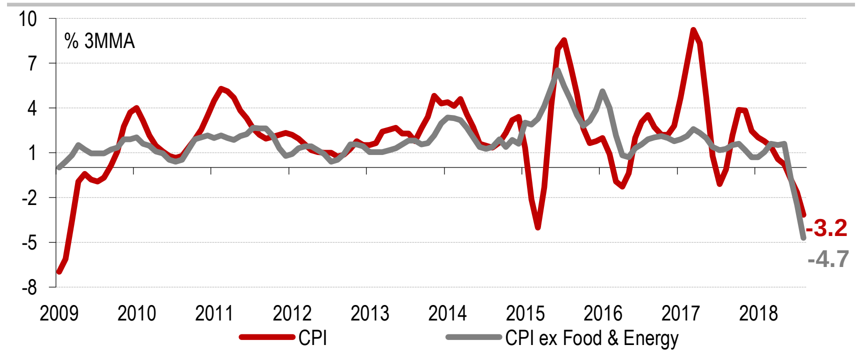
Malaysia: Inflation bottoming out

- The GST cut created a base effect that temporarily lowered inflation.
- Anticipated inflation pick up from Sep onwards will be muted by (1) the narrower coverage of CPI basket under SST vs. GST, (2) government enforcement to clamp down on indiscriminate price hikes, (3) fixed retail RON95 and diesel prices, (4) lower sugar prices in Sep, (5) reactivation of the National Cost of Living Action Council, (6) postponement of container tariffs hikes to Mar 2019, and (7) continued efforts to reduce household costs, particularly in broadband services, transport and utilities (water and power).

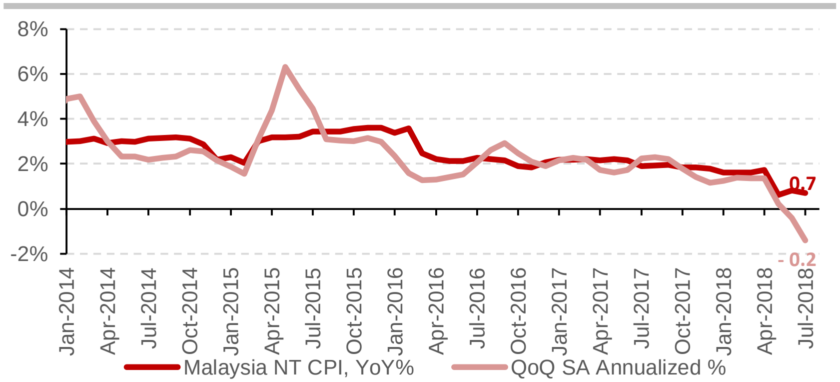
Headline inflation drifts lower, likely reaching a turning point before SST kicks in



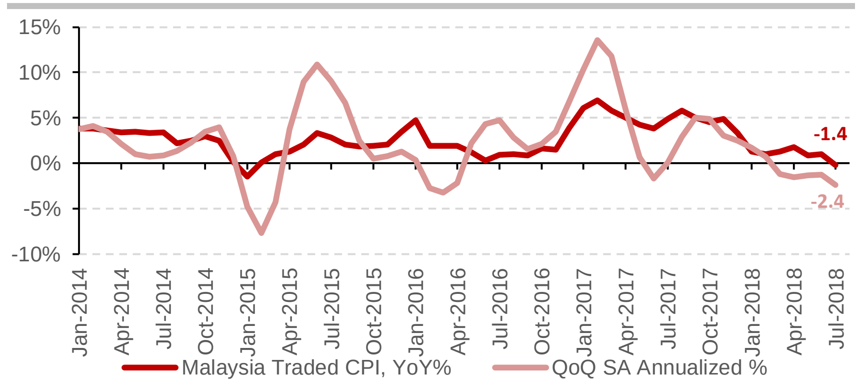
Sequential core data slipped into deflation as GST holiday curbed prices



Non traded goods dynamics not supportive of a rate hike



Traded goods inflation inching lower as well

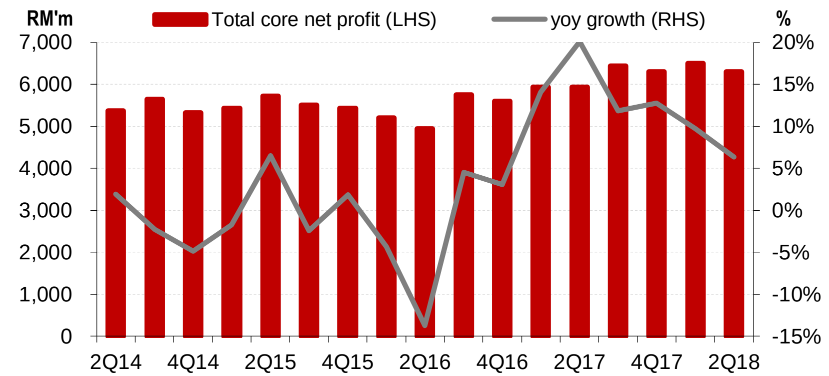


Source: Department of Statistics, CIMB Research.

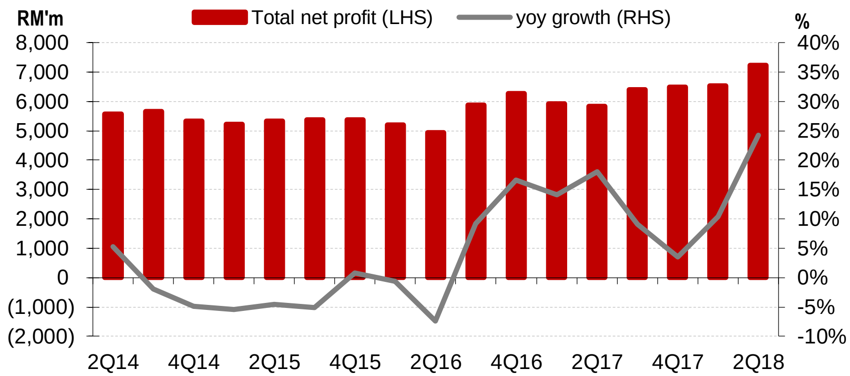
Financial Services: Hampered growth

- A negative surprise in banks' 2Q18 financial results, with a 1.5% yoy drop in operating revenue.
- Net interest income slid 3.1% under the pressure of margin contraction arising from stiff competition for deposits. In light of lower revenues, banks' 2Q18 net profit growth was primarily supported by a 36.2% yoy plunge in loan loss provisioning (LLP) and 3.3% yoy drop in overheads.

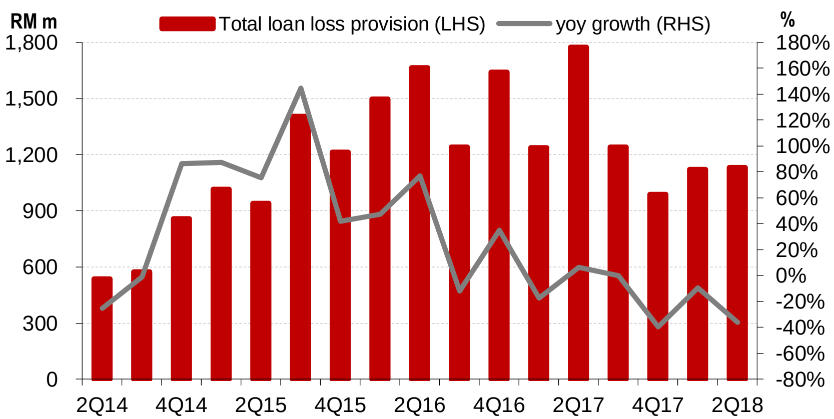
2Q18 core net profit growth slowed; second consecutive quarter of deceleration



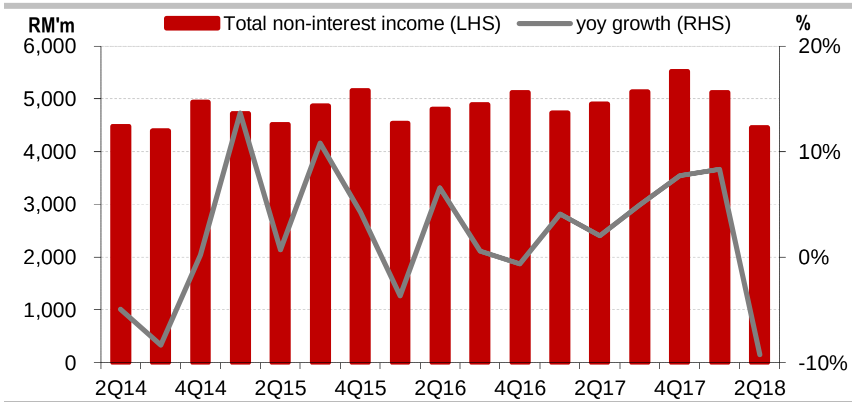
A spike in local publicly listed banks' 2Q18 reported net profits are due to one-off gains for CIMB



Lower loan loss provisioning the key 2Q18 earnings driver



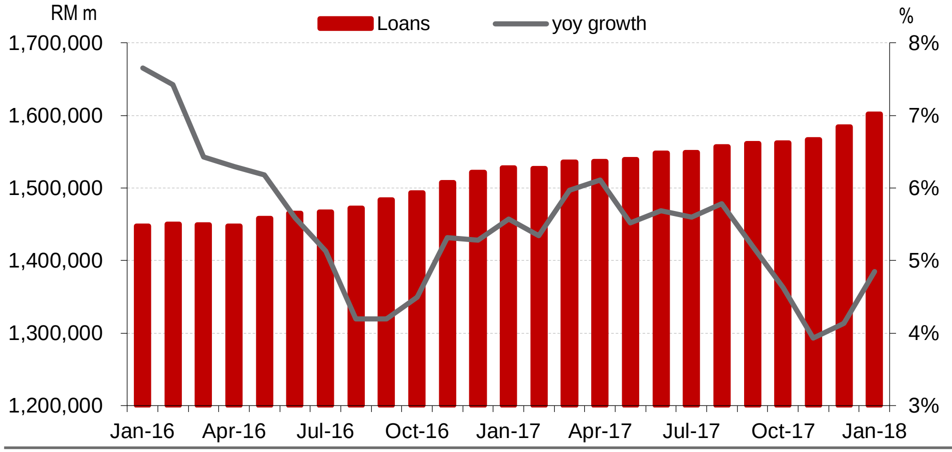
Net interest income drops despite improvements in loan growth and Jan 18 rate hike



Source: Ng, Winson. 2018. Sector Note: Banks stutter with lower revenue in 2Q18. CIMB Research. Published on September 14, 2018
Note: The sample of banks covered in this segment includes only local listed financial institutions.

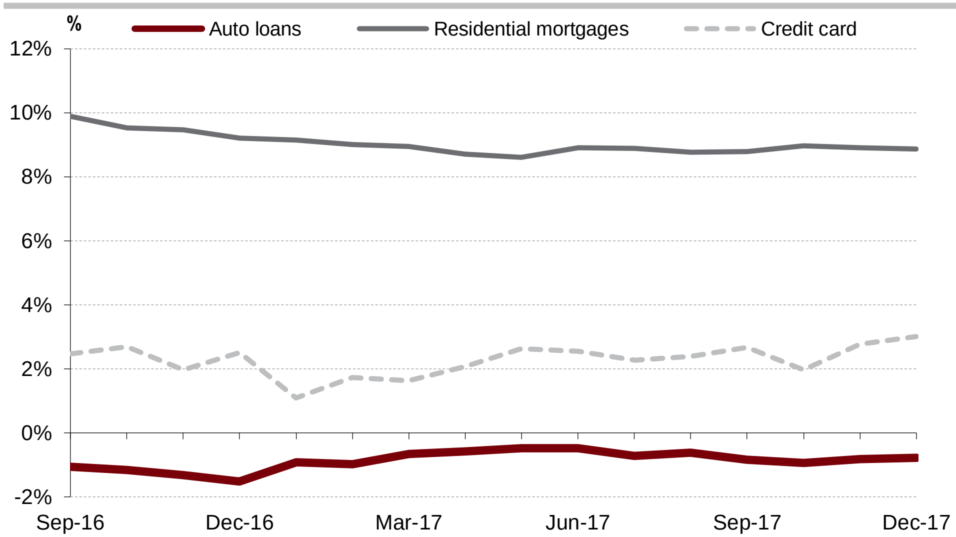
Financial Services: Divergent loan growth trends

Improvement in loan growth driven mainly from the business loan segment



- **Loan growth improvements mainly came from the business loan segment.**
- **The two major types of business loans recorded relatively stronger yoy growth at end-Jun 18 (vs. at end-Mar 18):**
  - **3.8% yoy growth for manufacturing loans at end-Jun 18 vs 0.4% at end-Mar 18.**
  - **Doubling of the growth in general commerce loans to 4.1% yoy at end-Jun 18 from 2% yoy at end-Mar 18.**

Consumer loans growth to moderate September onwards



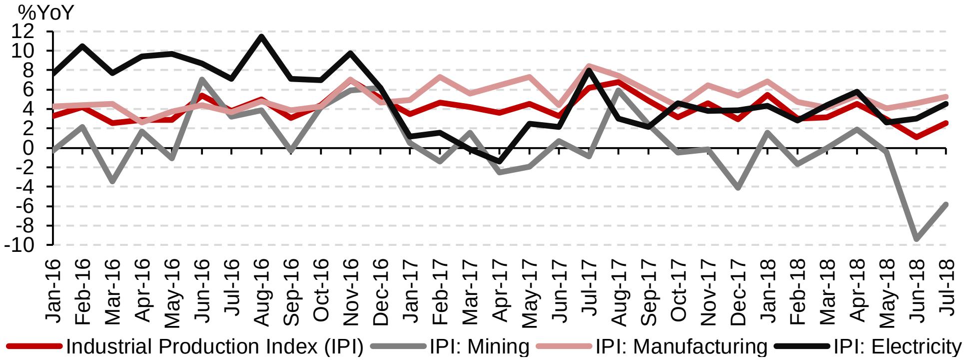
- **Loan growth will soften as auto sales and consumer spending eases with the introduction of SST.**
- **Momentum for household loans picked up marginally; 5.8% yoy at end-Jun 18 vs 5.6% yoy at end-Mar 18:**
  - **Moderation of the growth in residential mortgages at 8.3% yoy at end-Jun 18 vs 8.9% yoy at end-Mar 18.**
  - **Auto loans declined further at end-Jun 18 by 1.2% yoy.**
  - **Personal loans improved from 5.4% yoy at end-Mar 18 to 6.9% yoy at end-Jun 18.**

Source: Ng, Winson. 2018. Sector Note: Banks stutter with lower revenue in 2Q18. CIMB Research. Published on September 14, 2018
Note: The sample of banks covered in this segment includes only local listed financial institutions

Manufacturing: Uncertain times ahead

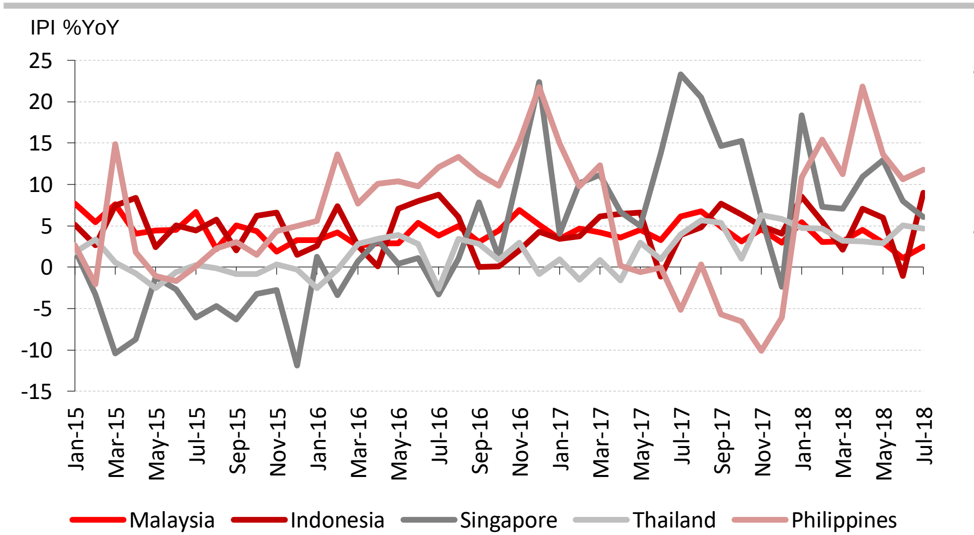
Supply disruptions in agriculture and mining are expected to linger for the rest of the year while the manufacturing outlook is clouded by external headwinds

Manufacturing outlook remains uncertain, clouded by the US-China trade war



- **Industrial activity experienced minor recovery in Jul after Jun's drop.**
- **Front-loaded consumption supported local industries, particularly car production, but the momentum is expected to fade after the SST takes effect on 1 Sep.**
- **Optimism of continued tailwinds for manufacturing is tempered by stagnating new export orders and rising inventories.**

Uncertainties in trade landscape would impact economies of the entire region



- **The looming escalation is likely to entangle other trade partners, including Malaysia, due to the broadening of tariffs to tradables that extend across the Asian manufacturing supply chain.**
- **Although Malaysia's manufacturing PMI drifted higher in Aug (51.2 vs. 49.7 in Jul) to a 9-month high, the accompanying survey revealed pockets of concerns, including stagnating export sales, unease over the external outlook due to trade tensions, and potential setbacks to exporter competitiveness.**

Source: CEIC Data, CIMB Research.

Manufacturing: Trade war spill overs could prove costly for Malaysia, a major trading partner of China

All Chinese exports containing Malaysian inputs are at risk from the fallout of the trade war

- **All Chinese exports that contain Malaysian inputs. could be adversely affected, imposing negative knock-on effects upstream in the supply chain.**
- **The difficulty in assessing the impacts of the trade war is trade off between the degree of redirection out of China and into Malaysia vs redirection elsewhere and reduction in trade activity itself.**
- **An IMF global simulation shows a GDP growth decline in emerging Asia (dominated by China) of 0.3 pp each year over the next three from this level of trade disruption.**
- **Suppliers could avoid the tariffs by sourcing/shifting production outside China. The later move creates some offset for ASEAN as a likely beneficiary of such moves. However, they are unlikely, to be large enough to offset the drag.**
- **The IMF's work does not account for the complexities of global supply chains and the likely higher prices that will ensue, since substituting for non-Chinese/non-US suppliers would be difficult.**

Source: Department of Statistics, CIMB Research.

Property and Construction: Supply and demand issues leading to overheated markets

Residential property market's momentum easing, with greater supply and lower price growth

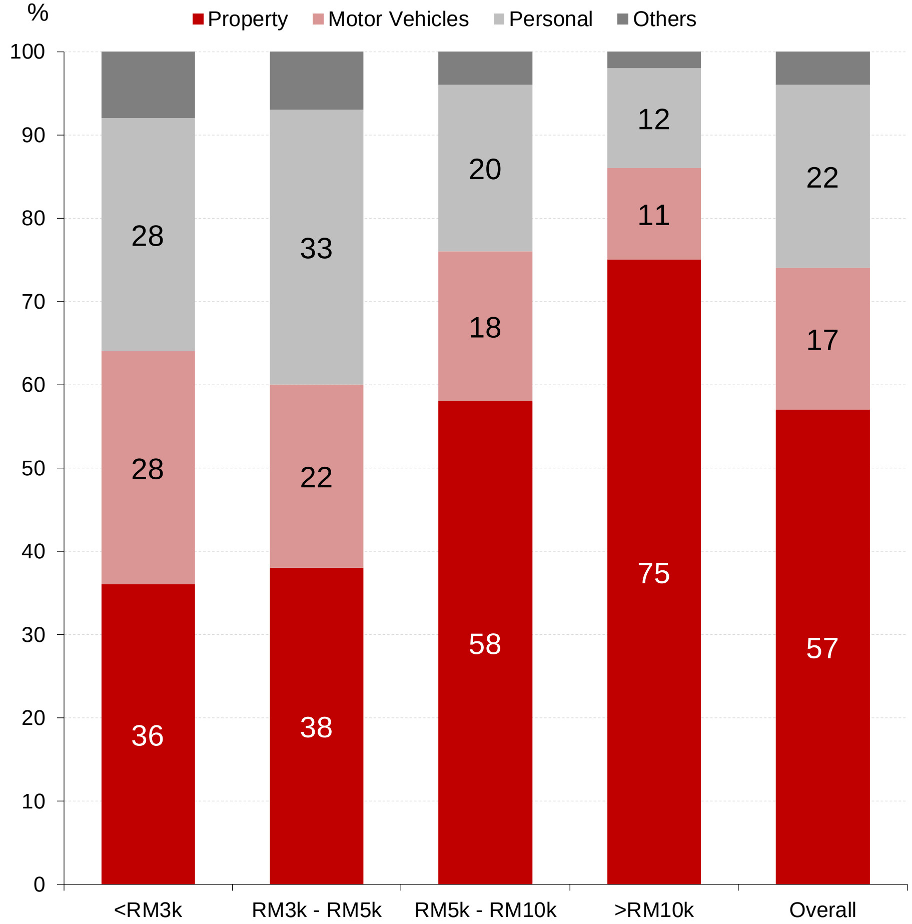
- **Supply-demand imbalances in the property market have increased since 2015.**
- **BNM reports that the large number of unsold properties is due to the mismatch between the prices of new launches and households' affordability.**
- **Unsold residential properties are at a decade-high, with the majority of unsold units being in the above RM250,000 price category**
- **Between 2014-16, there was an average supply of 114,000 new houses, markedly lower than the formation of 154,000 new households. The undersupply of affordable homes is also exacerbated by the fact that recent housing launches were skewed towards the higher-end property segment, which are out of reach for many Malaysians. The supply-demand mismatch, together with the societal preference towards homeownership instead of renting, has exerted further upward pressure on house prices.**

Source: Bank Negara Malaysia. 2017. Box Article: Imbalances in the Property Market. BNM Quarterly Bulletin 3Q17

Property and Construction: Affordability a major issue in the housing market

Spending constraints results in elevated household debt; Lower income growth not providing sufficient demand

Household debt by purpose and income group, 2016



- **Despite recent income gains, the financial position of households has not improved significantly, as a sizeable portion of household income is directed to service debt obligations.**
- **Fundamentally, household income growth has also not kept up with the rise in house prices. Between 2007-16, average house prices increased by 10%, but income only grew at an average of 8%.**
- **BNM's estimates that based on the median household income of RM5,228, the maximum affordable house price in Malaysia is estimated to be RM282,000. However, actual median house price was 11% higher at RM313,000.**

Source: Bank Negara Malaysia. 2018. Box Article: Divergence in Economic Performance and Public Sentiments. BNM Quarterly Bulletin 2Q18