Economic Research

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MALAYSIAN RATING CORPORATION BERHAD
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Economic Viewpoint:

Near-term outlook improves;

Long-term growth needs a boost

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We see, we analyse, we revise…

- The continued acceleration in the growth of the overall industrial production index (IPI) by 12.7% in January 2010 (Dec 2009: +7.5%) as well as the manufacturing index by 16.4% (Dec 2009: +10.7%) suggests that the upward momentum of Malaysia's industrial activity remains intact and will likely lead to a higher-than-expected expansion in the manufacturing sector. The robust 19.8% growth in electricity output also strengthens our belief that the near-term macro outlook has improved for the better. Coupled with the recent upsurge in exports in January by 37.0% - the second consecutive month of positive growth - we opine that the overall economic growth prospects for 2010 have become more favourable.

- At the same time, the 4Q2009 GDP came in well above market expectations, clocking in at 4.5% growth (consensus: +3.4%), with some components registering blistering expansion, e.g. the construction sector surged by 9.2% while investment soared by 8.2%. The real strength in terms of contribution to GDP was – to our surprise – investment. This is reflected by its 1.6-percentage-point contribution to overall growth, which in our opinion was largely driven by the public-sector component as the private sector's contribution remained lackluster due to a continuation of risk aversion, albeit at a more moderate level than in the preceding quarters.

- With the current momentum in external demand and domestic economic activity likely to be sustained in 1H2010, we would not be surprised if 1H2010 GDP averages more than 6%, akin to the recovery pattern seen during 2H2002. This is based on the assumption that following the sharp turnaround in the economies of emerging countries such as China and India in 2H2009, growth will remain robust and at the same time, domestic demand will continue to benefit from the stronger growth in investments.

- Notwithstanding these factors, domestic economic forces are quite different during this cycle compared to the previous up cycles. For one thing, the strength in private consumption, as evident in its contribution to GDP growth at 0.9-percentage points (less than a quarter of the headline number) was below its historical average. This is in contrast to 2Q2002 where private consumption contributed 1.6-percentage points out of 4.7% growth. Similarly, in 1H2005 when the headline growth averaged 4.9%, private consumption's contribution was higher at an average of 3.9-percentage points, more than half of the economic expansion. Our guess is that the continued impact of higher consumer prices in 2008 explains the less-than-robust pattern in private consumption in this cycle.

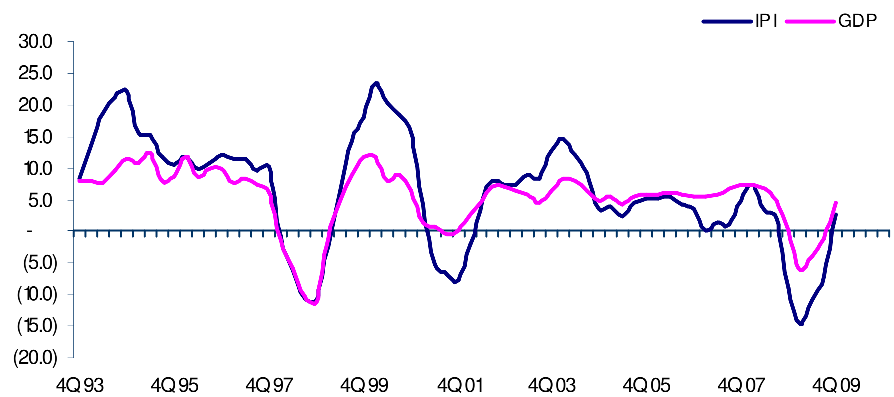
- What is heartening, however, is the level of investment which, based on the aggregate basis (private plus public sector), rebounded sharply and helped boost the headline growth in 4Q2009. This is in sharp contrast to the recovery phases in 2Q1999 and 2Q2002 when total investments' contributions to GDP growth were negative. In 2Q1999 and 2Q2002, total investments took off 2.8- and 0.5-percentage points from growth respectively. We anticipate that the government will continue to spur domestic investment activities to support the economy until the global economy shows signs of sustained growth in 2011.

- Although the improvements in global trade, especially in emerging economies like China and India, have been positive, global economic conditions have yet to revert to pre-crisis levels. Euro economies are struggling to address their fiscal woes and debt problems which we think will continue to cause jitters in the financial markets. While Japan has received a boost from a sharp turnaround in its external sector, political issues and public debt problems linger, affecting its macro stability in the medium term. The US, on the other hand, is making a comeback in its headline growth, but again, the thorny issue of its weak labour market is not providing enough assurance for a sustainable expansion in 2H2010.

- We would like to caution that our primary concern is not the GDP level in 2010, which to some extent will benefit from the low base, but the overall growth trajectory in the next three years which could be affected by the shrinking proportion of private investments. This is reflected in the estimated potential GDP growth of approximately 4.3% to 4.5% (IMF estimates: 4.25% in the next three years).

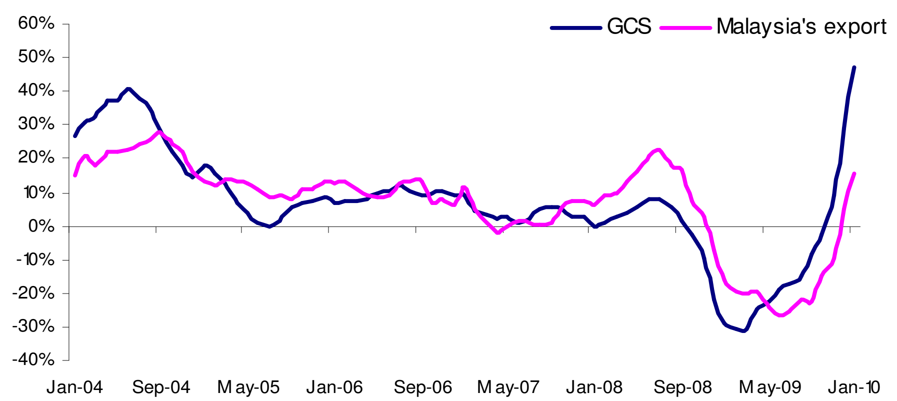
- Nevertheless, given the current momentum in global trade and other external factors, Malaysia's net exports will likely contribute positively to the headline growth this year. In addition, even if private consumption may turn out to be less robust this year than in the previous recovery cycles, a steady rebound in total investments underpinned by the government's efforts to boost domestic investment will ensure a respectable headline GDP growth in 2010. Against such a backdrop, we revise our GDP growth forecast for 2010 from 3.6% to 5.2%.

Chart 1: Malaysia's IPI and GDP growth y-o-y%



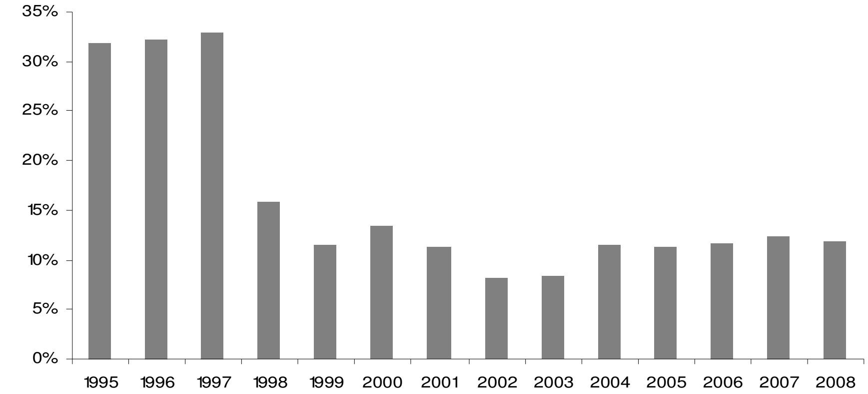
Source: CEIC

Chart 2: Malaysia's export and global chip sales (GCS) growth, 3MMA Y-o-Y%



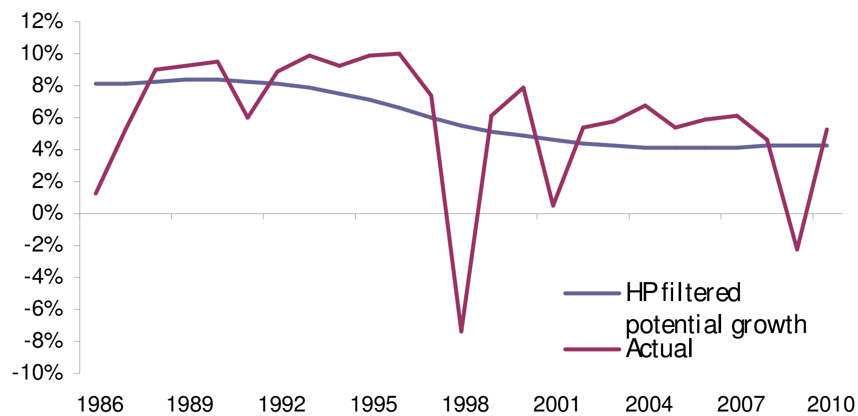
Sources: MARC Economic Research & US Semiconductor Industry Association (SIA)

Chart 3: Private investment as a percentage of GDP



Source: CEIC

Chart 4: Potential GDP and actual GDP growth



Source: MARC Economic Research

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