

Economic Research

KDN No.: PP14787/11/2010(026023)

A Quick Note on 1Q2010 GDP



MALAYSIAN RATING CORPORATION BERHAD
(364803 V)

Vol.: ER/009/2010



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the last page of this report*

In a nutshell...

- The 1Q2010 GDP surprised on the upside when the economy grew significantly higher at 10.1% y-o-y after expanding 4.4% in the previous quarter. Strong economic growth was largely underpinned by continued expansion in domestic economic activities (5.4% in 1Q2010 vs. 2.8% in 4Q2009) as well as stronger external demand.
- On the demand side, private consumption expanded 5.1% in 1Q2010 (4Q2009: 1.6%) as the labour market emerged stronger from the previous slump, allowing income growth to resume after experiencing a sharp decline in 1Q2009. Nonetheless, the percentage-point (ppt) contribution to overall growth by private consumption is somewhat marginal at about 2.9ppt (or equivalent to one-third) of total growth. This signals that the recovery phase is still at an early stage. In the same vein, growth in investment activities continued to remain positive, albeit at a slower pace, owing to higher public investment as the revival in private investment appears to be modest.
- On the supply side, the star performer is obviously the manufacturing sector which grew at a double-digit clip of 16.9% against 4Q2009's 5.0% growth, underpinned by strong demand for electrical and electronics (E&E) goods. Output of E&E goods grew 37.2% after expanding marginally at 1.8% in the previous quarter, with greater regional demand for semiconductors and audio-visual products being the key catalyst for the stepped-up production of these goods. In the same vein, the services sector posted a healthy growth of 8.5% against 5.2% growth previously, led by higher value-added activities in the wholesale and retail trade which grew by 9.6% versus 3.6%. Other sectors such as construction, agriculture and mining all registered commendable growth in 1Q2010. Against such a backdrop, the BNM raised its overnight policy rate (OPR) by another 25 bps in the monetary policy committee (MPC) meeting to 2.50% after the rate's last increase by the same quantum on March 4. Despite that, the BNM remains cautious, particularly on issues relating to uncertainties stemming from recent developments in the international financial and economic environments.
- On that note, we project an upward bias in our current 2010 GDP forecast of 5.2%. But for now, we would like to see how the market evolves in the next one month or so in order to gauge the trend in capital flows which we believe would have a strong bearing on the real economy. As for the OPR, we opine that another hike of 25 basis points (bps) can be expected in the next MPC meeting as monetary policy continues to remain supportive of growth (given our neutral-rate estimate at around 3.5%).

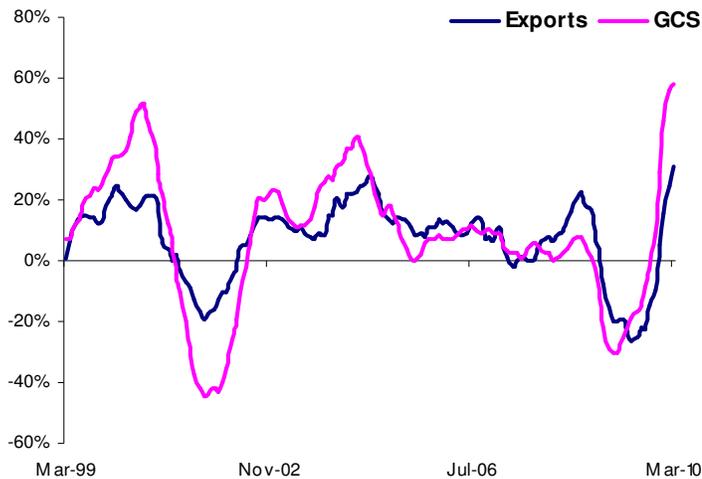
Table 1: Gross Domestic Product (GDP) Y-o-Y%

| | 1Q 2009 | 2Q 2009 | 3Q 2009 | 4Q 2009 | 1Q 2010 |
|-------------------------|--------------|--------------|--------------|-------------|--------------|
| Demand Side | | | | | |
| GDP | -6.2% | -3.9% | -1.2% | 4.4% | 10.1% |
| Domestic Demand | -3.1% | -2.2% | 0.1% | 2.8% | 5.4% |
| Consumption Expenditure | -0.3% | 0.6% | 2.9% | 1.4% | 5.4% |
| Private Consumption | -0.6% | 0.3% | 1.3% | 1.6% | 5.1% |
| Public Consumption | 1.6% | 1.5% | 9.4% | 0.7% | 6.3% |
| GFCF | -11.2% | -9.6% | -7.9% | 8.2% | 5.4% |
| Exports | -15.5% | -17.9% | -12.9% | 6.0% | 19.3% |
| Imports | -23.0% | -19.4% | -13.2% | 7.0% | 27.5% |
| Supply Side | | | | | |
| Agriculture | -4.4% | 0.3% | -0.4% | 5.9% | 6.8% |
| Mining and Quarrying | -5.2% | -3.5% | -3.6% | -2.8% | 2.1% |
| Manufacturing | -17.9% | -14.5% | -8.6% | 5.0% | 16.9% |
| Construction | 1.2% | 4.4% | 7.9% | 9.3% | 8.7% |
| Services | -0.2% | 1.7% | 3.4% | 5.2% | 8.5% |

Source: CEIC

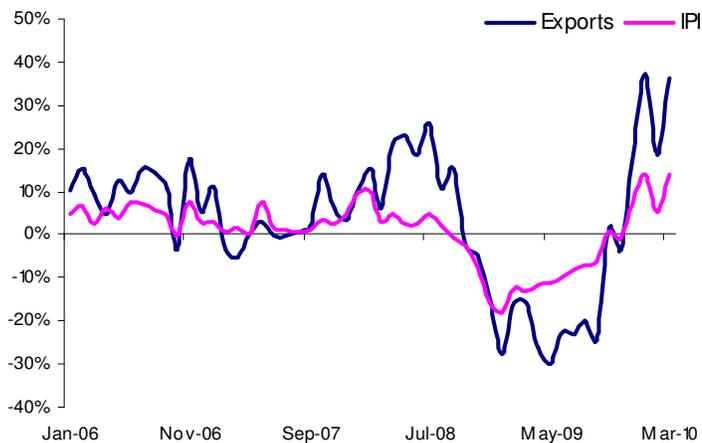
External demand is running high

Chart 1: Global chip sales (GCS) vs. Malaysia's exports



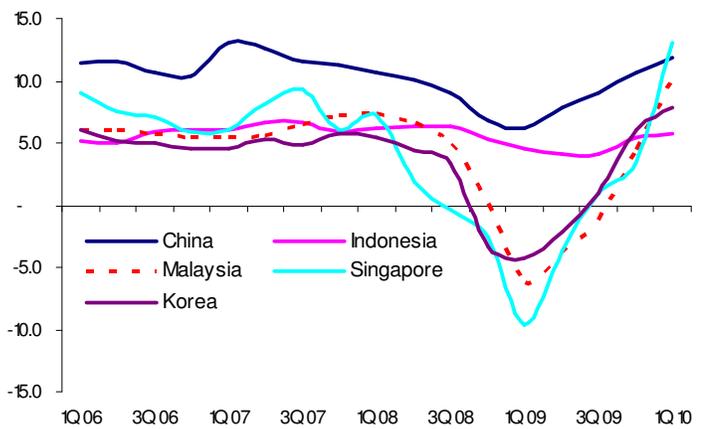
Source: CEIC

Chart 2: Malaysia's exports vs. IPI



Source: CEIC

Chart 3: Asia's quarterly GDP performance



Source: Bloomberg

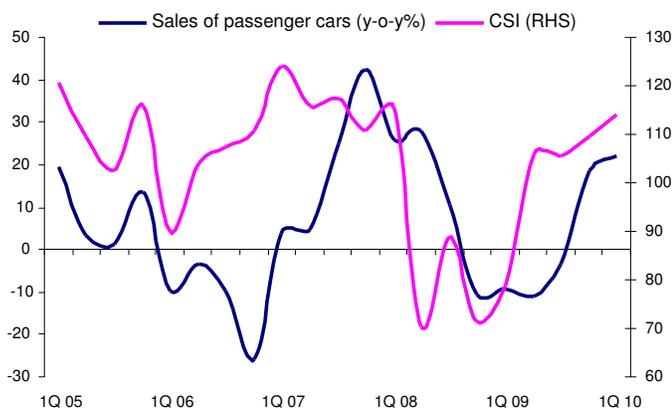
- The global economic recovery appears to be on track with real exports posting a 16.9% growth (4Q2009: 5.0%), led by higher overseas sales of E&E goods as well as commodities, suggesting global consumers are no longer tightening their purse strings.
- The prospects of economic growth going forward are improving markedly, with the International Monetary Fund (IMF) in its latest April 2010 forecast indicating that the world economy is likely to grow by 4.2% in 2010. This is 30 bps higher than its initial forecast in January 2010.
- Even more heartening is the forecast for the US. The world's largest economy is expected to post a 3.1% growth in 2010, a 40 bps increase from January's forecast. Should this forecast materialise, it would have an important bearing on Malaysia's economy, given the close relationship between the US and our economy (particularly post-1997/98 Asian Financial Crisis).

- The manufacturing sector was the immediate beneficiary of the rebound in global demand, with total output expanding 16.9% in 1Q2010. Further breakdowns showed that export-oriented industries expanded 14.6% (4Q2009: 4.1%) while domestic-oriented industries grew by 17.6% (4Q2009: 5.5%).
- Manufacturing workers are now scrambling to assemble finished goods in view of rising orders. As a result, the pace of hiring, particularly for the production line, has intensified.
- Indeed, the number of new vacancies in the manufacturing sector grew at a phenomenal 227% y-o-y rate (or by 180,081 units) in 1Q2010. Similarly, the amount of wages and salaries paid to manufacturing workers were also higher at 15.1% in 1Q2010 vs. -8.8% registered in the same period last year.

- Clearly, Asian economies have grown quite remarkably, thanks to the respective governments' timely and effective policy responses.
- Top of this list is Singapore with its 1Q2010 GDP growth of 13.1% y-o-y (4Q2009: 3.5%), followed by China (11.9% in 1Q2010 vs. 10.7% in 4Q2009) and Korea (7.8% in 1Q2010 vs. 6.0% in 4Q2009).
- Malaysia's 10.1% growth in 1Q2010 was comparatively commendable after the 4.4% expansion registered in the previous quarter. Nonetheless, we believe that 2H2010's performance will be more critical in light of the worrisome sovereign-debt crisis in Europe as well as the high-base factor registered in 2H2009 that could easily undermine the current growth momentum.

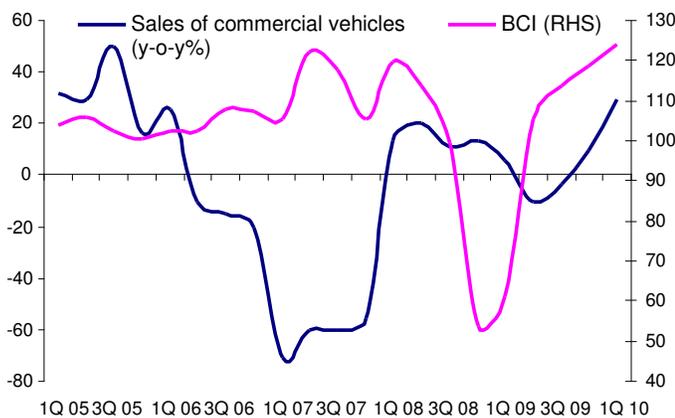
Domestic activities are booming, too...

Chart 4: Passenger-car sales (y-o-y%) vs. Consumer Sentiment Index (CSI)



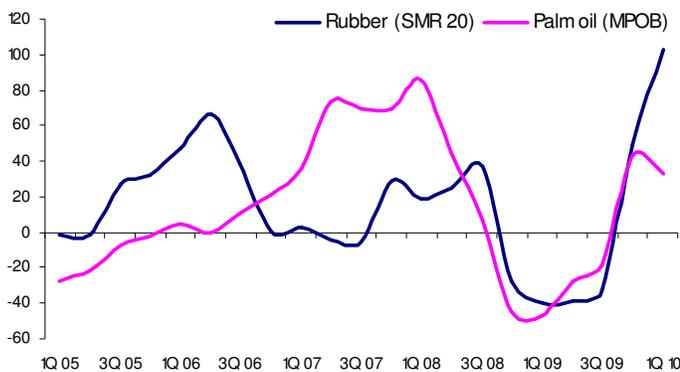
Sources: BNM & CEIC

Chart 5: Commercial-vehicle sales (y-o-y%) vs. Business Condition Index (BCI)



Sources: BNM & CEIC

Chart 6: Commodity price increases (y-o-y%)



Source: BNM

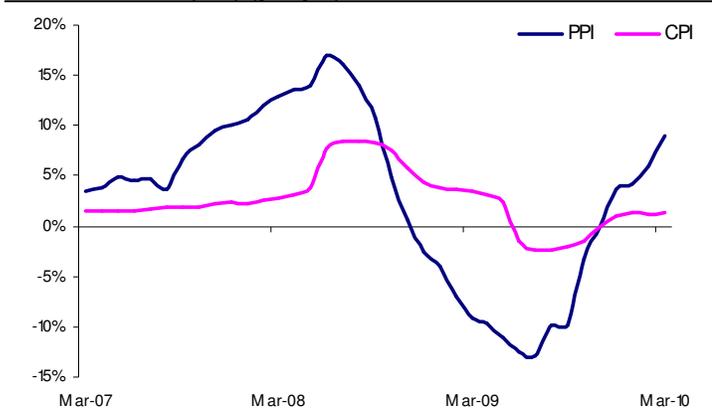
- Consumer spending is on firmer ground with sentiment indices suggesting that households are increasingly optimistic about the present economic situation. In 1Q2010, private consumption expanded by 5.1% versus 1.6% previously.
- Among the items commonly purchased by consumers are vehicles. In this regard, sales of passenger cars rose 22.0% y-o-y in 1Q2010 (4Q2009: 18.5%), with stunning sales growth recorded by such manufacturers as Proton (29.5%), Perodua (24.4%), Toyota (22.0%) and Nissan (20.8%). In the same vein, the Consumer Sentiment Index (CSI) edged up to 114.2 points in 1Q2010 (4Q2009: 109.6) as households become more optimistic about their current state of finances.
- With the labour market remaining healthy, we think that consumers are able to sustain their current spending behaviour in the following quarters.

- Investment activities intensified moderately at 5.4% after rising 8.2%, with the catalyst being the continued public-investment spending, while private investment recorded a moderate expansion from improving domestic production and exports, leading to higher capacity utilisation and business sentiment.
- Thus far, the two common measures for private investment have rebounded from 2009's slump, with sales of commercial vehicles jumping close to 30% in 1Q2010 and the BCI remaining above 100 points in the past four quarters (the latest number was 63 points higher from the same period in 2009).
- Investment activities are likely to register respectable growth rates going forward in light of the relatively low interest-rate environment as well as the ongoing governmental infrastructure projects.

- Consumers in rural areas are also benefiting from the global economic recovery, as the rising demand for commodities have caused palm-oil and rubber prices to post a sharp upturn in the quarter under review.
- On a y-o-y basis, rubber prices rose by a whopping 102.8% in 1Q2010 following higher demand from rubber-glove makers. However, the palm-oil price appreciation appears to be taking a breather, rising by 33.0% in 1Q2010 against 43.1% in 4Q2009. Hence, the present economic recovery is quite broad-based.

What to expect going forward

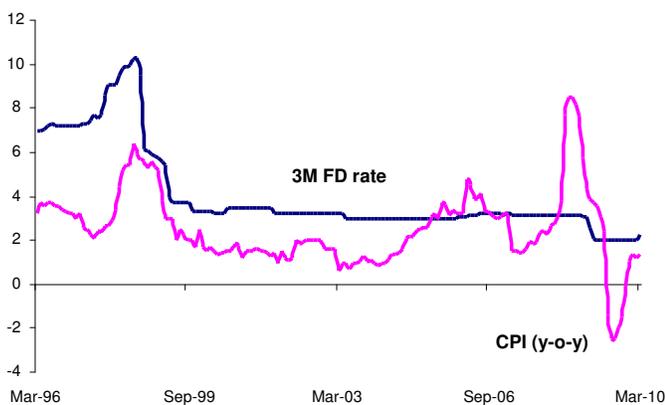
Chart 7: Consumer price index (CPI) vs. Producer price index (PPI) (y-o-y%)



- With economic recovery comes the inevitable creeping-up of prices, especially of food items. This is particularly true in the Malaysian context with the government now seeking to reduce or abolish altogether the subsidies on essential food items such as rice, bread and sugar.
- In January 2010, the government raised sugar prices by 20 sen, resulting in the sweetener being priced at RM1.65 and RM1.75 per kilo in Peninsular Malaysia and Sabah and Sarawak respectively.
- So far, the CPI trend is rather tame with its latest reading at 1.3% y-o-y in March versus its long-term average of 3.7%. However, prices at the producer level (as evidenced by the PPI) are indicating that the burden of price increases would soon be passed on to consumers, given its current reading of 9.0% in March.

Sources: BNM & CEIC

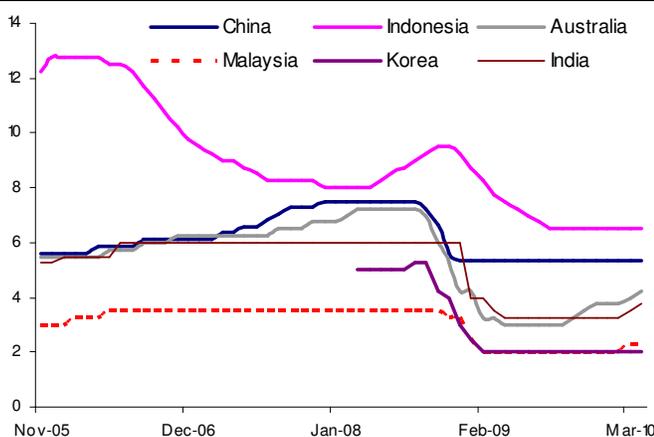
Chart 8: Inflation and 3-month fixed-deposit rates (FD)



- As the inflation rate continued to march higher (albeit at a still-moderate pace), the gap between the 3-month FD rate and the CPI is quickly narrowing. If left unattended, depositors risk earning negative returns from their savings.
- The BNM had likely taken cognisance of and reacted to this when it raised the OPR by another 25 bps on May 13, the second time this year, to ensure that savings returns are well protected. The interest-rate hikes were also undertaken to maintain stability in the banking system's liquidity.
- Inflationary pressures have regained strength of late, but explicitly, the cost factor appears to be the dominant factor determining the overall inflation trend. However, to some extent, we believe that demand-pull inflation has made a fair contribution to the overall inflation dynamics, although the extent of which remains unclear given that the economy is coming from a low base last year.

Sources: BNM & CEIC

Chart 9: Policy rates across Asia



- The BNM has earned the distinctive recognition of being one of the region's frontrunners in monetary tightening. The latest hike of 25bps on May 13 indicates that while the central bank is confident of economic recovery being on solid ground, it is also seeking to prevent financial imbalances and inflation from rearing their ugly heads in time to come.
- In contrast, Bank of Indonesia (BI) and Bank of Korea (BOK) opted to maintain their policy rates in May. The resulting interest-rate differential favouring Malaysia enables us to maintain our MYR call at RM3.20 – RM3.30 in the face of European sovereign-debt concerns.
- We are not ruling out a possible revision to our growth target of 5.2% for 2010. But for now, we would like to see how the market evolves in the next one month or so in order to gauge the trend in capital flows which we believe would have a strong bearing on the real economy.

Source: Bloomberg

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Published and Printed by:

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