Economic Research

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

MARC

MALAYSIAN RATING CORPORATION BERHAD
(364803-V)

A Quick Note on 2Q2010 GDP

Vol.: ER/015/2010

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19 August 2010

Malaysia | A Quick Note on 2Q2010 GDP

In a nutshell…

- The 2Q2010 GDP came in higher than expected at 8.9% (consensus: 8.4%, MARC estimate: 8.2%) driven by healthy domestic demand activities. Despite the strong outturn, economic growth has moderated from the 10.1% expansion recorded in 1Q2010 as the external sector weakened in the quarter under review. Real export growth decelerated from 19.3% to 13.8% following lower demand from key trading partners, namely the US, the Eurozone, Japan and China.

- Private consumption posted a robust 7.9% expansion in 2Q2010 (1Q2010: 5.1%) underpinned by stable labour-market conditions and income growth. Thanks to easy access to credit, as evidenced by the strong growth in household loans in the past few months, consumer spending will likely be sustained in 2H2010. However, concerns over higher prices following the rationalisation of fuel subsidies in July could potentially limit the pace of spending increases going forward.

- Investment activities are shaping up well at this juncture, with gross fixed capital formation (GFCF) growing at a double-digit pace of 12.9% (1Q2010: 5.4%). According to Bank Negara Malaysia (BNM), investments were driven by both the private and public sectors. Specifically, the government's development expenditure on education and transportation benefited the economy significantly.

- On the supply side, the manufacturing sector expanded by 15.9% in 2Q2010 (1Q2010: 17.0%), sustained by higher domestic-oriented industries as external demand took a breather in the quarter under review. The services sector continued to grow, albeit at a slower pace of 7.3% (1Q2010: 8.5%), supported mainly by the strong performance of the wholesale and retail trade, finance and insurance, and transport and storage sub-sectors.

- Growth prospects in 2H2010 remain favourable, judging by the momentum in domestic demand. Nevertheless, this period will be more challenging, as the low-base effect of last year wears off while risks of slower external demand increase, as evidenced by the Organisation of Economic Cooperation and Development (OECD) Composite Leading Index (CLI) which grew at a more moderate pace of 6.7% in June after hitting its cyclical peak of 10.3% in February and March this year. As such, we opine that the BNM has strong reasons to stand pat with regards to the overnight policy rate (OPR) maneuvering.

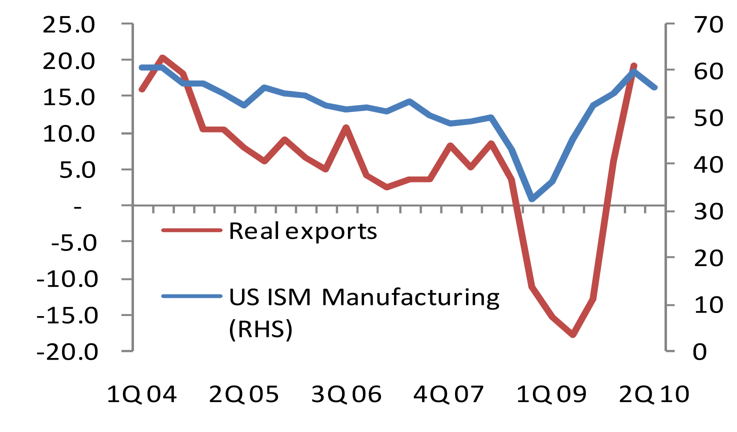
Table 1: Malaysia's Gross Domestic Product (GDP) – quarterly and half-yearly comparisons

	2Q 09	3Q 09	4Q 09	1Q 10	2Q 10	1H 2009	1H 2010
GDP	**-3.9%**	**-1.2%**	**4.4%**	**10.1%**	**8.9%**	**-5.1%**	**9.5%**
Demand side							
Domestic Demand	-2.2%	0.1%	2.8%	5.3%	9.0%	-2.7%	7.2%
Consumption Expenditure	0.6%	2.9%	1.4%	5.3%	7.7%	0.2%	6.5%
Private Consumption	0.3%	1.3%	1.6%	5.1%	7.9%	-0.2%	6.5%
Public Consumption	1.5%	9.4%	0.7%	6.3%	6.8%	1.5%	6.6%
GFCF	-9.6%	-7.9%	8.2%	5.4%	12.9%	-10.4%	9.4%
Exports	-17.9%	-12.9%	6.0%	19.3%	13.8%	-16.7%	16.5%
Imports	-19.4%	-13.2%	7.0%	27.5%	21.9%	-21.1%	24.5%
Supply side							
Agriculture	0.3%	-0.4%	5.9%	6.8%	2.4%	-2.0%	4.5%
Mining and Quarrying	-3.5%	-3.6%	-2.8%	2.1%	1.9%	-4.4%	2.0%
Manufacturing	-14.5%	-8.6%	5.0%	17.0%	15.9%	-16.2%	16.4%
Construction	4.4%	7.9%	9.3%	8.7%	4.1%	2.9%	6.3%
Services	1.7%	3.4%	5.2%	8.5%	7.3%	0.8%	7.9%

Source: CEIC

The 2Q2010 GDP – Dissecting the numbers

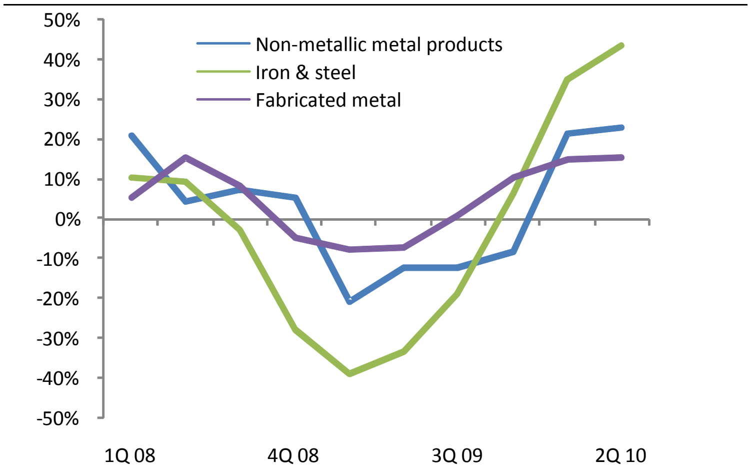
Chart 1: Real exports vs. US ISM Manufacturing



Sources: CEIC & Bloomberg

- Real exports in 2Q2010 came in at 13.8%, moderating from 19.3% registered in the previous quarter. Such a modest expansion suggests that Malaysia's external sector has started to feel the pinch of slower demand from key trading partners such as the US, the Eurozone, Japan and China.
- The global economy has been weaker in recent months. In the US, manufacturing activities appear to be shifting into lower gear, based on the ISM manufacturing index which fell from 59.6 points in 1Q2010 to 56.2 in the quarter under review.
- The US outlook for 2H2010 remains somewhat murky, with the Federal Reserve now looking at a lower growth rate of between 3.0% and 3.5% in 2010, from its previous estimate of between 3.2% and 3.6%.

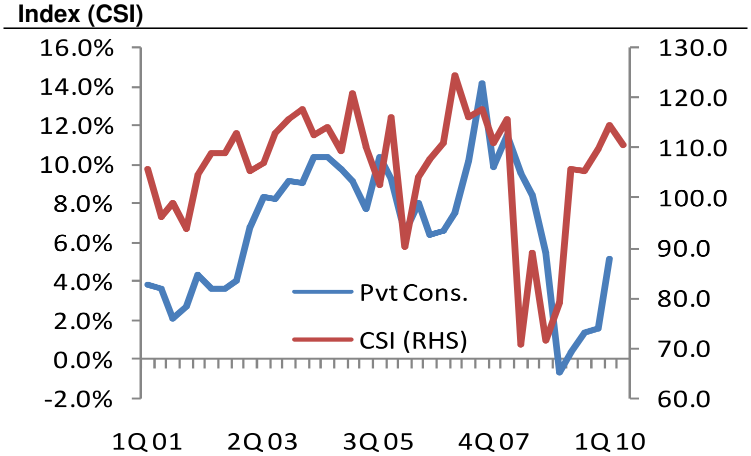
Chart 2: Construction-related output



Source: CEIC

- Notwithstanding the external developments, activities in the domestic economy continued to increase at a healthy clip, with domestic demand growing at 9.0% in 2Q2010.
- On the supply side, the manufacturing and services sectors were the obvious key drivers, growing at 15.9% and 7.3% in 2Q2010 respectively. The construction sector grew by 4.1% (1Q2010: 8.7%) owing to strong growth of non-residential sub-sectors such as office space, schools and government quarters.
- Looking at Chart 2, production of non-metallic metal products, iron and steel and fabricated metal are on a high note, with all products posting double-digit growth rates, signaling higher input demand by businesses, especially the construction players.

Chart 3: Private consumption vs. MIER's Consumer Sentiment Index (CSI)

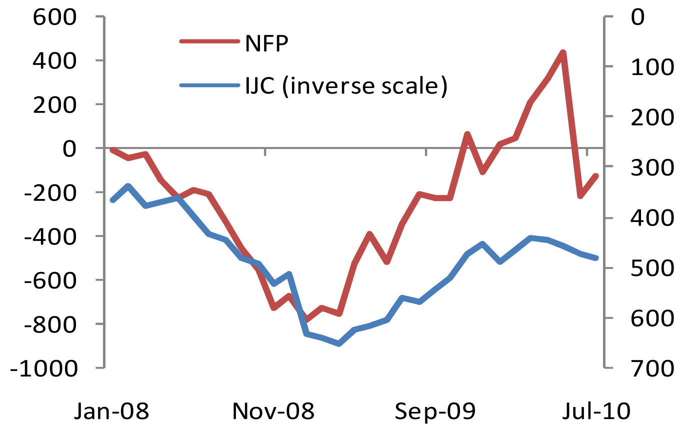


Source: CEIC

- In the same vein, the pace of consumer spending accelerated in 2Q2010. Private consumption grew by 7.9% in 2Q2010 (1Q: 5.1%) following stable labour-market conditions, rising wages and easy credit extended by banks to the household sector in the past several months.
- However, the recent decline in the Malaysian Institute of Economic Research's Consumer Sentiment Index (CSI) from 114.2 in 1Q2010 to 110.4 in 2Q2010 suggests that consumers are wary about the repercussions of the government's subsidy rationalisation plan, which was proposed by the Performance Management and Delivery Unit (PEMANDU) in May this year.

Softening external demand

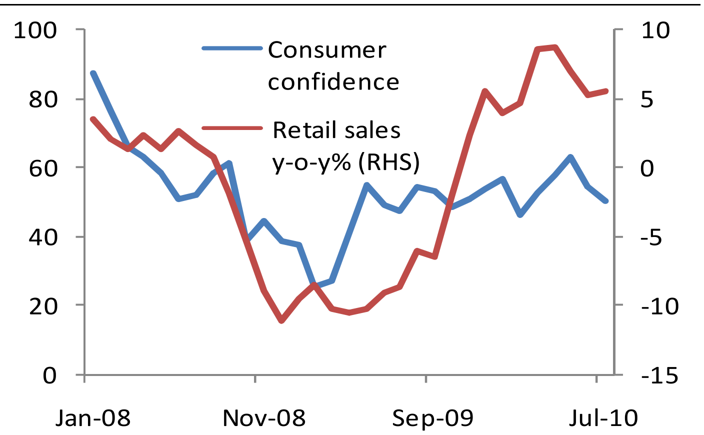
Chart 4: US labour market – initial jobless claims (IJC) vs. non-farm payroll (NFP)



Source: Bloomberg

- The lukewarm recovery in the US labour market can be observed in the number of people collecting jobless benefits. The recent uptick in initial jobless claims (IJC) signals that more US citizens are claiming such benefits as fewer jobs are available to them. The IJC figure is hovering at 482,000 as of July 2010.
- Similarly, the pace of job creation has been quite halfhearted, with the latest non-farm payroll (NFP) measure declining for the second consecutive month in July, falling by 131,000.
- The unemployment rate remains stubbornly high at 9.5% in July. Similarly, the alternative measure of unemployment stood unchanged at 16.5%.

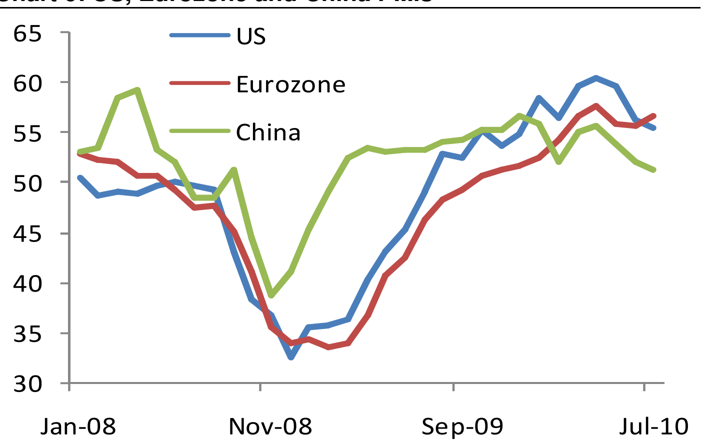
Chart 5: US consumer confidence vs. retail sales



Source: Bloomberg

- Given the weak labour market, US consumers are tightening their purse strings, refraining from spending in a big way. This is evidenced by the growth in retail sales which now lingers in the region of 5.2% - 5.5% in June and July, down from 8.5% - 8.7% between March and April this year.
- On the same note, consumer confidence somewhat lost ground, with the index falling to 50.4 in July from this year's high of 62.7 registered in March.
- Against such a backdrop, two-thirds of the US' strength which is personal consumption expenditure (PCE) is being compromised, and the latest release showed that spending among consumers moderated to 1.6% in 2Q2010 from 1.9% previously.

Chart 6: US, Eurozone and China PMIs

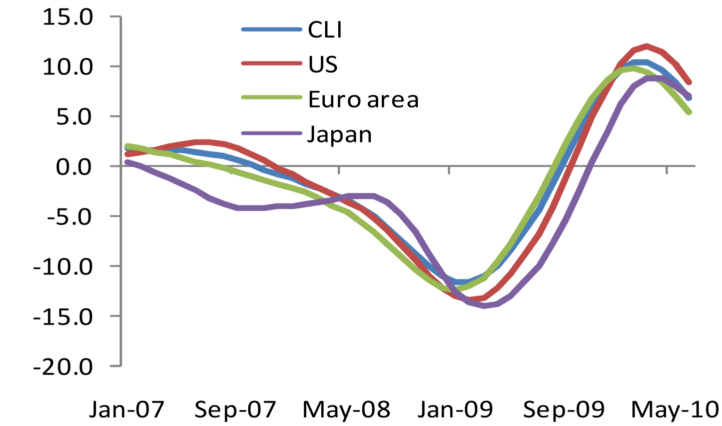


Source: Bloomberg

- Presently, businesses are becoming less optimistic about what is in store in 2H2010. Purchasing managers' indices (PMIs) across the globe imply that manufacturing activities will likely decelerate, dampening the pace of hiring in the sector.
- This could help explain why the recovery in the labour market has been slow, especially in the US. Rising risk aversion may cause businesses to hold back expansion plans and capital expenditure.
- This can be seen from the US non-residential investment component which has moderated from 7.8% in 1Q2010 to 4.5% in 2Q2010.

What to expect going forward

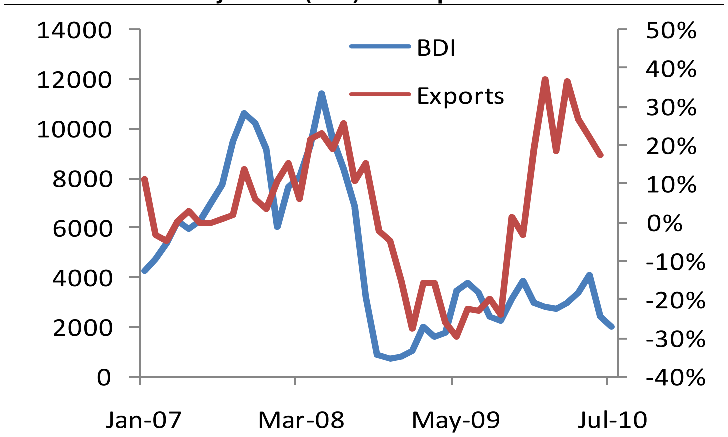
Chart 7: The OECD Composite Leading Indicator



Source: OECD

- The OECD Composite Leading Indicator experienced a consecutive decline since April 2010 - it dropped to 6.7% in June after hitting its cyclical peak of 10.3% in February and March, suggesting economic expansion will likely be a rather modest one in 2H2010.
- Almost all OECD member countries experienced this declining trend in June, with the US, Euro area and Japan dropping to 8.3%, 5.3% and 6.9% respectively (May: 10.0%, 6.9% and 8.0%). Such a trend is also extended to non-OECD members such as China and India, whose indices fell to 15.8% and 9.4% respectively (May: 17.5% and 10.7%).
- Hence, Malaysia's external sector could potentially be fraught with challenges in 2H2010.

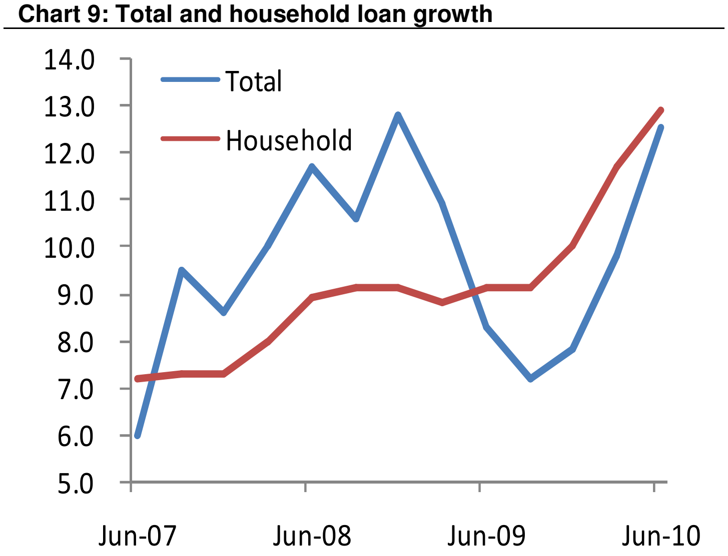
Chart 8: Baltic Dry Index (BDI) vs. Exports



Sources: CEIC & Bloomberg

- The Baltic Dry Index (BDI), which tracks worldwide international shipping prices of various dry bulk cargos, has been declining over the past two months.
- Based on the news flow, the fall in the BDI can be explained by the increasing number of vessels coming onstream, especially from China.
- Closer inspection of Chart 8 would reveal that the BDI has some form of predictive ability for Malaysia's export performance going forward. Hence, one should be cautious on export growth in 2H2010 in light of the lethargic BDI readings in recent months.

Chart 9: Total and household loan growth



Source: BNM

- We believe domestic demand will likely remain resilient for the rest of 2010. Easy access to credit through aggressive lending activities by banks will keep consumers on the High Street, ensuring private consumption remains robust. In addition, government spending will continue to support the construction sector, as evidenced by the implementation of several infrastructure projects such as additional highways, the double-tracking railway project, the Low-Cost Carrier Terminal (LCCT), and gas pipelines.
- Notwithstanding that, we remain concerned over the possibility of a sustained high level of household debt, which may lead to rising bad debts if not properly monitored.
- Combined with weaker growth prospects in 2H2010 as well as the high level of indebtedness among consumers, we believe the overnight policy rate (OPR) will remain at 2.75% for the rest of the year. Accordingly, we maintain our GDP growth forecast for the whole of 2010 at 6.8%.

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Published and Printed by:

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