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A Quick Note on 3Q2010 GDP

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Malaysia | A Quick Note on 3Q2010 GDP

In a nutshell…

- As expected, growth in Malaysia's gross domestic product (GDP) decelerated to 5.3% in 3Q2010 (median forecast: 5.9%) after moderating from 10.1% in 1Q2010 to 8.9% in 2Q2010. This deceleration came as no surprise, considering that the Malaysian economy has recovered from the 2009 recession and it is also not unusual to witness modest growth after the economy's phenomenal expansion of 9.5% in 1H2010. For the first nine months of the year, the economy grew by 8.0% (9M2009: -3.7%).

- The softening external sector appears to have been the main catalyst of the slowdown in growth. Indeed, real exports registered a modest growth of 6.6% in 3Q2010, owing to lower demand for electrical and electronic (E&E) products which recorded a moderated single-digit growth of 3.9% in the quarter, after growing at a double-digit pace in the several preceding quarters. The latest global chip sales forecast by the Semiconductor Industry Association (SIA) – a good proxy for Malaysia's E&E exports' future performance – suggests that worldwide chip sales growth in 2011 and 2012 could come in at 6.0% and 3.4% respectively, after the estimated 32.8% expansion in 2010. Hence, we opine that E&E exports growth will likely settle on a lower trajectory following such softening in global demand.

- Other demand components, such as private consumption, also recorded slower growth of 7.1% (2Q2010: 7.9%). Despite the Malaysian Institute of Economic Research (MIER) Consumer Sentiment Index (CSI) increasing 5.4 points quarter-on-quarter (q-o-q) to stand at 115.8, a ten-quarter high, consumers appear reluctant to spend in a big way. This is attributed to concerns about high living costs that have caused consumers to become increasingly prudent in their spending. Indeed, 81% of respondents in a recent MIER survey expect prices to increase in the coming months, especially in urban areas. Meanwhile, on the supply side, manufacturing-sector growth took a breather, registering at 7.5% (from the 16.0% recorded in 2Q2010) on the back of slower overseas demand, while the services sector also reported marginal growth of 5.4% (2Q2010: 7.3%).

- Given such prevailing conditions, we maintain our 2010 economic growth forecast of 6.8%, while for 2011, we opine that GDP will grow at a modest pace of 5.0%, as global demand is softening alongside slower growth in the world's advanced economies. A still-high unemployment rate in the United States (US) (hovering precariously around the 10% mark), combined with ongoing concerns about euro-zone countries' public finances (with the latest being Ireland's), could crimp Asia's exports significantly. Hence, we expect the overnight policy rate (OPR) to stand pat at 2.75% in 1H2011 as the central bank will increasingly become data-dependent, causing the rate-normalisation process to greatly hinge upon external-sector performance.

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Table 1: GDP components' year-on-year (y-o-y) growth rates

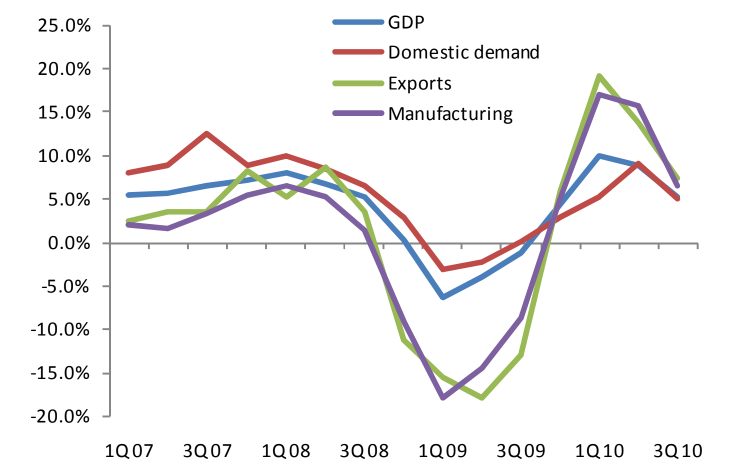
Demand side	3Q09	4Q09	1Q10	2Q10	3Q10	9M2010	9M2009
GDP	-1.2%	4.4%	10.1%	8.9%	5.3%	8.0%	-3.7%
Domestic Demand	0.1%	2.8%	5.3%	9.0%	5.0%	6.4%	-1.7%
Consumption Expenditure	2.9%	1.4%	5.3%	7.7%	3.5%	5.4%	1.1%
Private Consumption	1.3%	1.6%	5.1%	7.9%	7.1%	6.7%	0.4%
Public Consumption	9.4%	0.7%	6.3%	6.9%	-10.2%	0.2%	4.4%
Gross Fixed Capital Formation	-7.9%	8.2%	5.4%	12.9%	9.8%	9.5%	-9.5%
Exports	-12.9%	6.0%	19.3%	13.8%	6.6%	12.9%	-15.4%
Imports	-13.2%	7.0%	27.5%	21.9%	11.0%	19.4%	-18.3%

Supply side	3Q09	4Q09	1Q10	2Q10	3Q10	9M2010	9M2009
GDP	-1.2%	4.4%	10.1%	8.9%	5.3%	8.0%	-3.7%
Agriculture	-0.4%	5.9%	6.8%	2.4%	2.7%	3.8%	-1.4%
Mining and Quarrying	-3.6%	-2.8%	2.1%	1.1%	-1.0%	0.7%	-4.1%
Manufacturing	-8.6%	5.0%	17.0%	16.0%	7.5%	13.3%	-13.7%
Construction	7.9%	9.3%	8.7%	4.1%	2.8%	5.0%	4.7%
Services	3.4%	5.2%	8.5%	7.3%	5.4%	7.0%	1.7%

Source: Bank Negara Malaysia (BNM), CEIC & MARC Economic Research

3Q2010 GDP – On further scrutiny

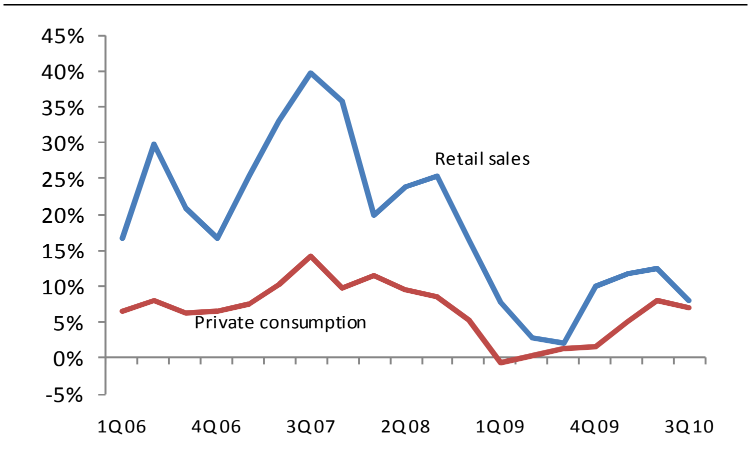
Chart 1: GDP and its main components



Source: CEIC

- GDP grew 5.3% in 3Q2010, a moderated expansion from the 8.9% growth recorded in the preceding quarter, owing to slower external demand (growth in real exports slowed to a single-digit pace of 6.6% from 2Q2010's 13.8%).
- On a similar note, domestic demand grew at a moderate pace of 5.0% as investment and consumption activities took a breather in 3Q2010 - total investment and consumption expanded (albeit moderately) at 9.8% (2Q2010: 12.9%) and 3.5% (2Q2010: 7.7%) respectively.
- According to the BNM, investment was largely driven by private capital spending to support domestic production activities amid the presently high level of capacity utilisation and positive business sentiment.

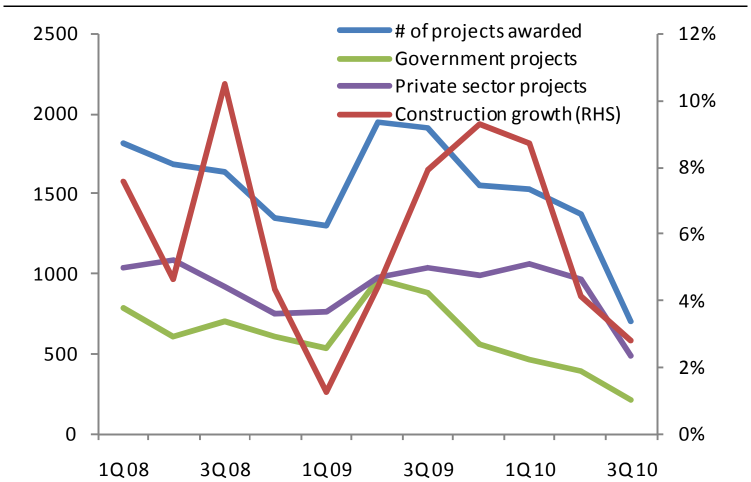
Chart 2: Private consumption vs. retail sales



Source: CEIC

- In 3Q2010, private consumption growth moderated to 7.1% from the 7.9% expansion in the preceding quarter, in tandem with lower retail sales in the quarter. While consumption experienced a slowdown, we believe this was not driven by lower income, given that labour-market conditions remained healthy (the unemployment rate fell further to 3.1% in September from February 2009's high of 4.1%).
- In addition, consumer sentiment remained robust, with 80% of respondents in a 3Q2010 MIER survey indicating that their income levels had either improved or stabilised, up from 77% in the previous survey.
- However, consumers are likely tightening their purse strings as the clouds of gloom over the economy's future have yet to be fully lifted and living costs continue on their upward trajectory, largely unabated by the prevailing economic uncertainty.

Chart 3: Number of projects awarded vs. construction output

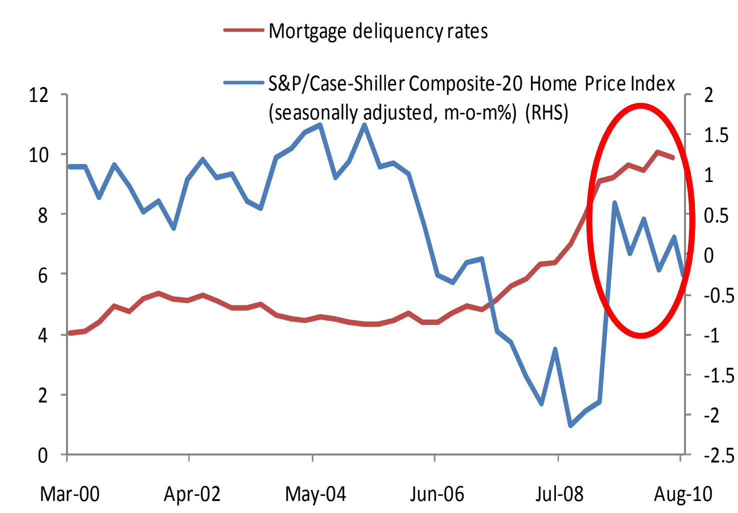


Sources: CEIC & Construction Industry Development Board of Malaysia

- Construction-sector activity grew modestly at 2.8% in 3Q2010. Looking at the number of projects awarded in the quarter (702 in 3Q2010 vs. 1,307 in 2Q2010), one could deduce that the sector's growth will likely decelerate should the present trend of fewer projects awarded continue into the next quarter. This is particularly true, as the gap between the time of awarding projects and actually commencing construction is approximately three months.
- The government's development spending stood at about RM19.4 billion in 1H2010, representing 36% of total development expenditure slated for the year, suggesting that the government is behind schedule in implementing development projects. This can have adverse repercussions on construction growth. Indeed, urgent attention should thus be given to address this issue, especially in light of the sector's crucial role in creating multiplier effects in other industries like manufacturing, financial services and professional services.

The external sector – deteriorating in condition

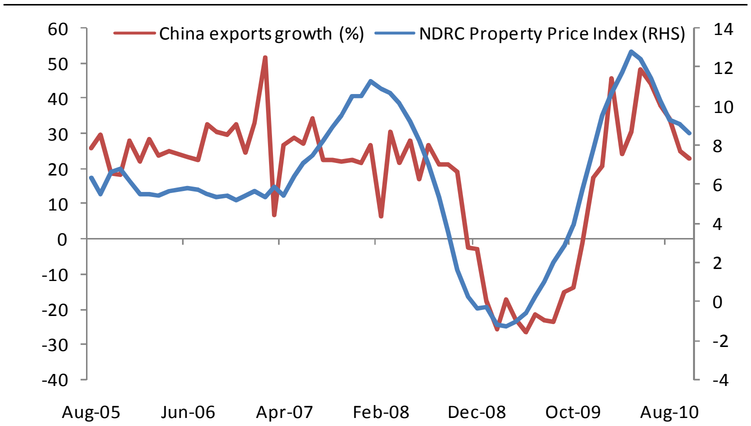
Chart 4: US mortgage delinquency rates vs. S&P/Case-Shiller composite-20 home price index (seasonally adjusted, m-o-m%)



Source: Bloomberg

- The US housing market has yet to experience a meaningful recovery from the recent recession that was dubbed the worst since the Great Depression, as evidenced by the S&P Case-Shiller home-price index measuring prices in 20 cities that fell a seasonally adjusted 0.3% month-on-month (m-o-m) in August, the second straight decline and the largest since April 2009. On a y-o-y basis, the index rose 1.7%, the smallest gain since February. The index remains 28% below its peak in July 2006.
- Amidst weak labour-market conditions, mortgage delinquency rates have accordingly been on the rise since the beginning of the recession, hitting a seasonally adjusted high of 10.06% in 1Q2010 before falling slightly in 3Q2010 to 9.13% of all loans outstanding.
- With job and income growth likely to remain suppressed, the US housing sector, a crucial contributor to economic growth, will possibly remain in the doldrums, crimping demand and by extension, Malaysia's export sector and GDP growth.

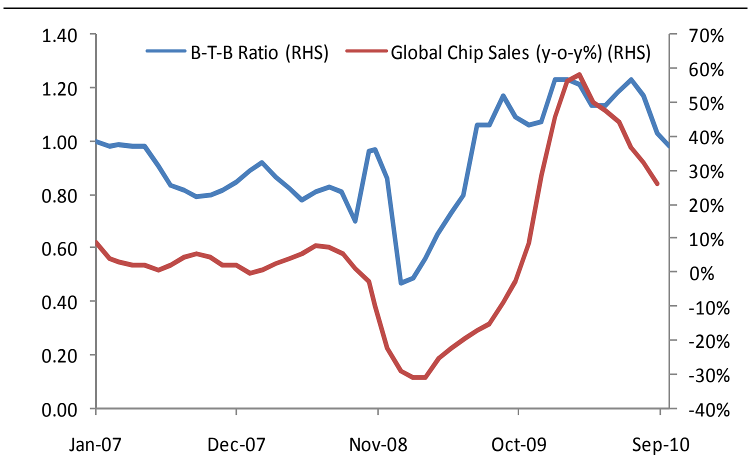
Chart 5: China exports growth vs. NDRC property price index



Source: Bloomberg

- China, Malaysia's key trading partner, is at present facing slower demand for its output due to the decelerating growth in the US and the austerity drive being implemented by euro-zone economies struggling with high public debts.
- As such, exports growth has been dampened in recent months since May, which no doubt would have some bearing on the labour market in terms of income and jobs growth.
- The property market, which closely tracks the health of the economy, accordingly suffered some deterioration, as evidenced by the National Development and Reform Commission's property price index which has been on the downtrend since April.

Chart 6: Global chip sales (y-o-y%) vs. book-to-bill ratio

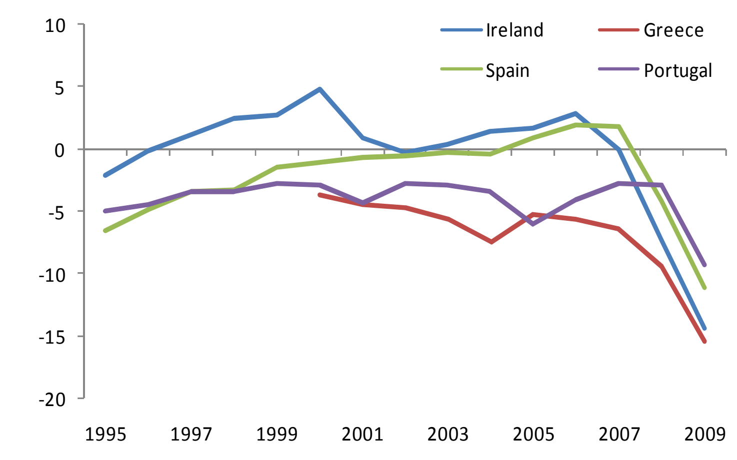


Sources: SIA, SEMI

- Global chip sales, as tracked by the SIA, have been on a freefall on a y-o-y basis since the high achieved in March 2010, as demand wavered for E&E goods in the face of economic uncertainty.
- The Semiconductor Equipment and Materials International (SEMI) book-to-bill (B-T-B) ratio has in the same manner demonstrated a declining trend since July 2010, portending some difficult times for the global E&E sector in the months ahead.
- With E&E products constituting a considerable share of Malaysia's exports, the nation's export-dominant economy looks set to also take a hit from the malaise in the sector, unless the economy's growth can be steadily and sufficiently fired by other "cylinders" such as private consumption and private investment.

Malaysia's medium-term outlook – growth to moderate

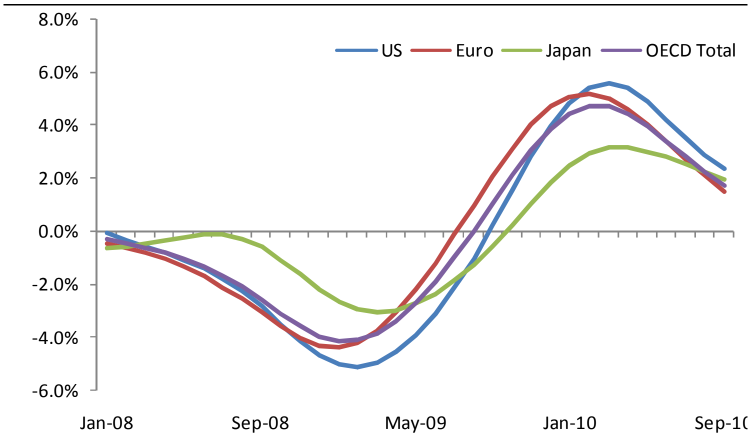
Chart 7: Public balances of selected euro-zone economies



Source: Eurostat

- Euro-zone economies, laden with burdensome welfare payments that have taken immense tolls on government finances, are now buckling under the weight of this system, recording unsustainable budget deficits for years.
- The euro is today facing downward pressure yet again as fears of public-debt woes spreading throughout the region have been reignited by debt-crippled Ireland formally applying for a massive European Union-International Monetary Fund loan last Sunday to stem capital flight from its foundering banks.
- Although some countries have commendably implemented austerity measures to address their deficits, such a resort inevitably detracts from demand, and certainly, exporting nations such as Malaysia have had demand for their output falter in recent months. This austerity drive, going forward, could potentially weigh on Malaysia's exports and growth.

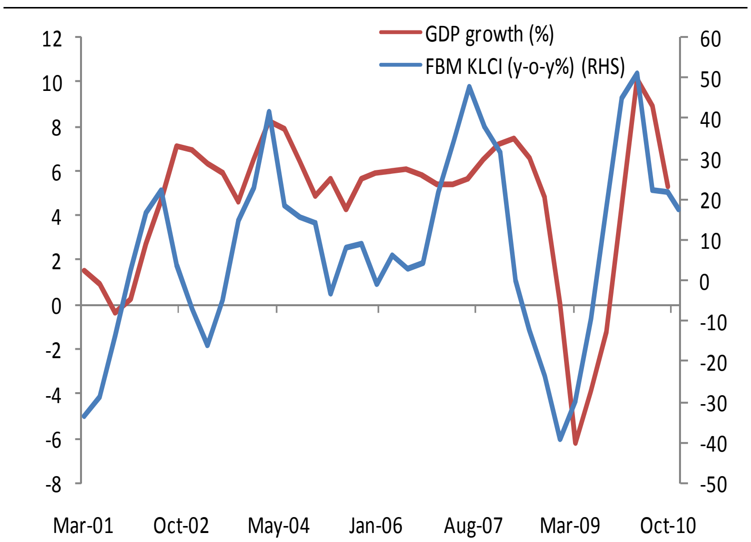
Chart 8: OECD composite leading indicators (y-o-y%)



Source: OECD

- The composite leading indicators (CLIs) produced by the Organisation for Economic Co-operation and Development (OECD) provide early signals of turning points (peaks and troughs) between expansions and slowdowns of economic activity, giving an indication of economies' performance going forward.
- The CLIs for the major economies of the US, euro zone, Japan and in the OECD grouping have been trending downwards since the beginning of the year, a foreboding indication that these economies will hit a soft patch in the near future.
- With Malaysia being one of the most open economies in the world, any hiccups in the global economic recovery will indubitably exert downward pressure on the domestic economy's growth profile.

Chart 9: FBM KLCI (y-o-y%) vs. GDP growth (%)



Source: Bloomberg

- The FTSE Bursa Malaysia Kuala Lumpur Composite Index (FBM KLCI), traditionally deemed a forward-looking indicator of the economy's growth in the next six months, has risen sharply since March 2009, attributed to, amongst others, the relatively stable growth prospects of the economy in the next few years following an expected steady improvement in private investment as well as resilient private consumption, prospects of a stronger property market and the general uptrend in the commodities market, particularly that of crude palm oil.
- However, the downside risks posed by the negative developments in the US, euro-zone economies and China as aforementioned are very real and indeed, we are already seeing the repercussions of these on output growth and the index's decline.
- The government's efforts to ramp up the economy's competitiveness via the Government Transformation Programme and the Economic Transformation Programme are thus to be lauded for their potential to spur domestic demand.

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