Economic Research

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MALAYSIAN RATING CORPORATION BERHAD
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Economic Growth 2012 – Founded On Investment

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2012 In Review

4Q2012 GDP – Well above expectations

- Malaysia's 4Q2012 GDP growth came in well above expectations, in fact almost beyond the range of market estimates, and certainly beyond our own. Real gross domestic product (GDP) expanded 6.4% in 4Q2012 year-on-year (y-o-y) compared to our forecast of between 5.4%-5.9%, primarily driven by sustained domestic demand and high investment growth. For the full year 2012, real GDP growth hit 5.6%, well above the government's revised forecast of 4.5%-5.0% made last year.

- Private consumption grew 6.1% (3Q2012: 8.5%) over 4Q2011, while private investment zoomed 20.2% (3Q: 22.9%). Public sector expenditure meanwhile showed marginal growth of 1.1% (3Q: 2.3%), but public investment continue to expand strongly by 11.1% (3Q: 22.4%).

- Consumption expenditure was supported by somewhat stronger wage growth, high employment rates, and government efforts to cap increases in living costs – lower average commodity prices also helped. Investment spending on the other hand has been substantially boosted by major infrastructure and property projects, not least of which was the MYRapid Transit(MRT) and Refinery and Petrochemical Integrated Development (RAPID) project under the Economic Transformation Programme (ETP). Investment expenditure was about evenly divided between structures and machinery & equipment, but the former category showed continued strong growth at 25.0% over 4Q2011, while growth in the latter category slowed to 7.6% from 22.3% in 3Q2012.

- The external sector provided little support with exports showing a slower pace of decrease in 4Q2012 to -1.5% (3Q: -3.0%), while imports also decreased by -0.9% (3Q: 4.4%) resulting in an actual increase in the level of net exports compared to 3Q2012, although growth remained negative relative to 4Q2011. Continued weakness in Europe, recession in Japan and an uneven recovery in the United States (US) moderated demand from advanced economies, while China probably hit a cyclical bottom in 2H2012. External demand as such was weak in 4Q2012 although not as weak as was feared.

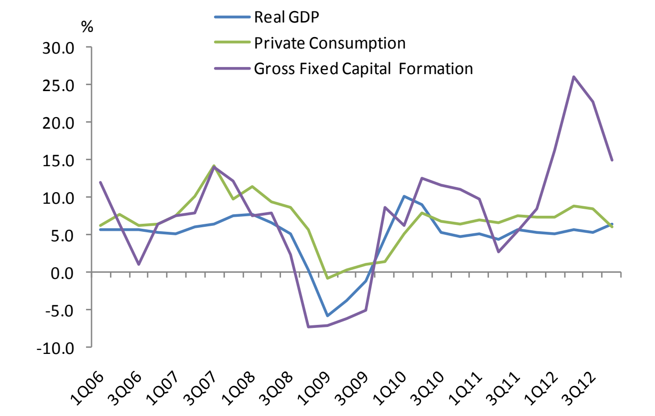
- On the supply side, growth was broad based with all major sectors registering increases. Looking at the detailed data, the only subsectors that posted declines werethe textile manufacturing and forestry and logging activities. The construction sector posted the strongest growth, hitting 18.1% on the year (3Q2012: 18.3%), not surprising given the spate of major projects and related private sector property investment over the year.

- The manufacturing sector showed surprising strength, accelerating to 5.8% in 4Q2012 after slowing to 3.3% in 3Q2012, the fastest rate of growth in two years. The key contributor here was in the transport equipment and other manufacturessub-sector, which grew by 10.7% (3Q: 4.2%). Spillover effects from increased constructions probably helped support domestic-oriented manufacturing the most during the period.

- The mining sector also posted a solid contribution, growing by 4.3% and breaking a long string of disappointing growth numbers going back to the 2Q2007. Higher mining output also helped contribute to the stronger manufacturing numbers, by providing a bigger supply of inputs for refining and processing.

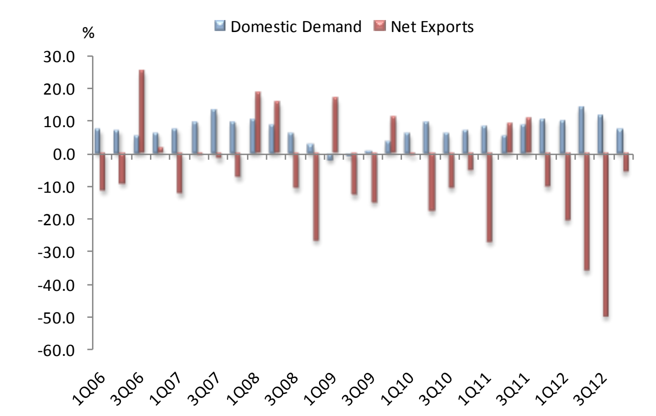
- The services sector on the other hand maintained a solid pace of growth at 6.3% (3Q2012: 7.0%), largely driven by stronger provision of government and financial services. Insurance services also grew at a blistering 22.8% pace.

Chart 1: Real GDP growth on demand side (% y-o-y)



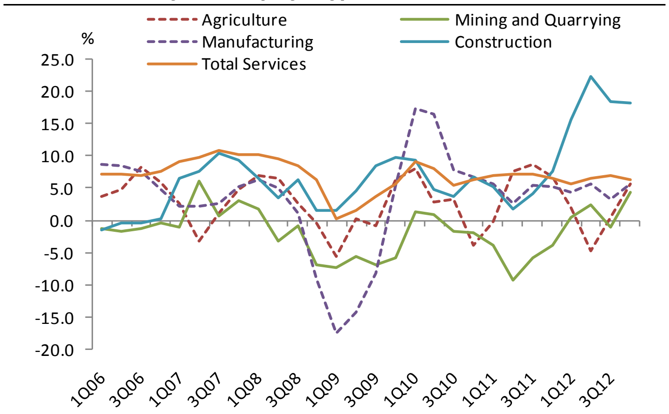
Source: CEIC, MARC Economic Research.

Chart 2: Domestic demand and net exports growth (% y-o-y)



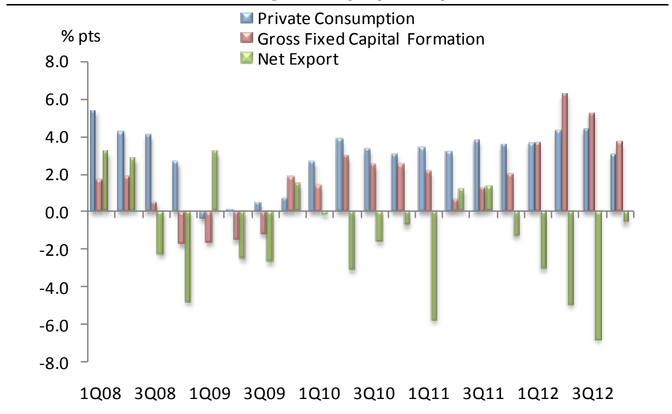
Source: CEIC, MARC Economic Research.

Chart 3: GDP by sector (% y-o-y)



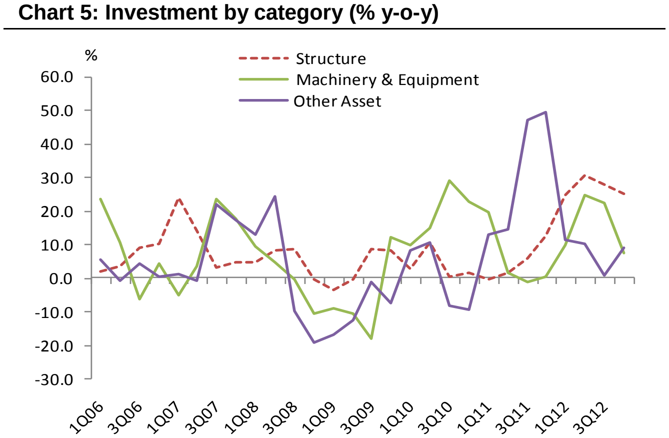
Source: CEIC, MARC Economic Research.

Chart 4: Contribution to growth (% points)



Source: CEIC, MARC Economic Research.

Chart 5: Investment by category (% y-o-y)



Source: CEIC, Bloomberg, MARC Economic Research.

Chart 6: Real exports and real imports growth (% y-o-y)

Source: CEIC, MARC Economic Research.

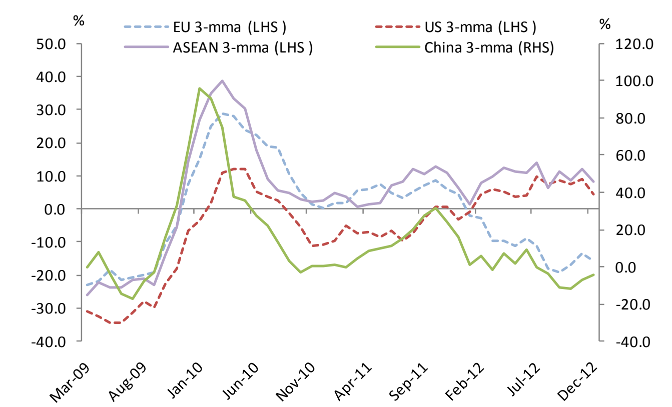
Updating the 2013 Outlook

Growth – upward surprise may continue

- With growth surprising on the upside for 4Q2012, the case for sustained growth in 2013 has gotten stronger. Malaysia's growth will continue to hinge on the global economic performance, where there are some signs of improvement. Although troubles in Europe continue to see disappointing numbers, US growth may continue to strengthen, while the bottoming out of China's economic performance in the latter half of 2012 looks to provide some stability to the external environment going forward.

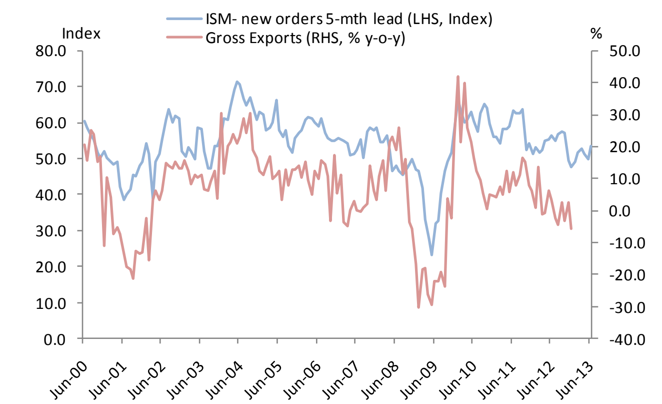
- Semiconductor sales are expected to rebound by only 4.5% (according to the estimates by World Semiconductor Trade Statistics) and palm oil prices expected to move within the range of RM2,200 and RM2,600per tonne next year. As such, we anticipate that Malaysian real exports will post a mediocre growth of 4.0% in 2013.

Chart 7: Export growth to major markets (% y-o-y)



Source: BNM, CEIC, MARC Economic Research.

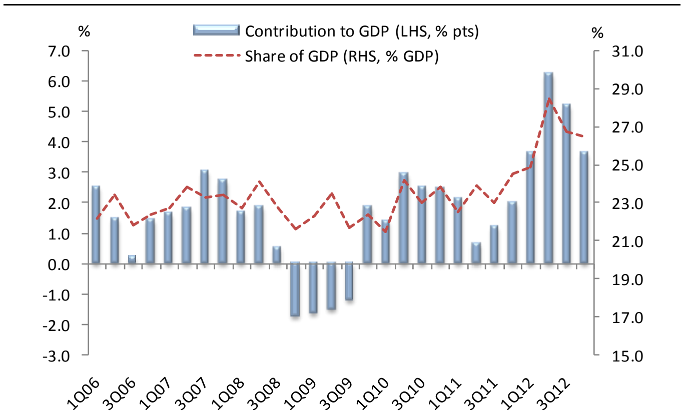
Chart 8: Exports growth and ISM New Orders Index



Source: CEIC, ISM, MARC Economic Research.

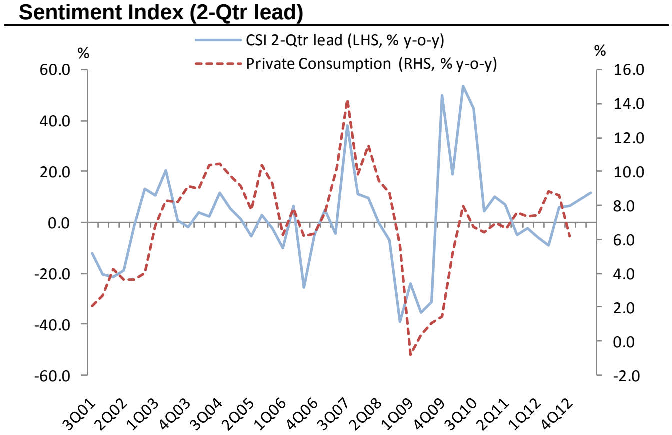
- Domestic demand on the other hand will likely stay resilient amidst rising contributions from private investment and private consumption, with the former expected to register a growth rate of 14.0% in 2013 on the back of major ongoing public projects such as the MRT, the LRT extension, and RAPID. The Malaysian Institute of Economic Research (MIER) Consumer Sentiment Index which hit a 6-year high in the 4Q2012 provides a clear sign that private consumption growth will remain relatively elevated in 2013.

Chart 9: Contributions of investments to headline growth and its share in GDP



Source: CEIC, MARC Economic Research.

Chart 10: Private consumption and MIER: Consumer Sentiment Index (2-Qtr lead)



Source: CEIC, MARC Economic Research.

- Strength in private consumption is predicated on a stable labour market conditions and wage growth. Malaysia's unemployment rate averaged just 3.0% in 2012 (2011:3.1%), while growth in manufacturing wages averaged 6.4% (2011: 3.8%). Combined with government transfers and subsidies (e.g. BR1M 2.0), there is more than a firm foundation for solid private consumption growth, particularly in 1H2013. As such we foresee growth of 6.2% in 2013, slightly slower than this year's growth of 7.7%.

- Overall, taking into consideration domestic forces that may offset weaknesses in the external sector, we foresee another relatively resilient growth performance in 2013 with GDP growing at a 5.3% pace.

Table 1: GDP growth on the demand side

					MARC	MoF
Growth % y-o-y	**2009**	**2010**	**2011**	**2012**	**2013F**	**2013F**
GDP	-1.5	7.2	5.1	5.6	5.3	4.5 - 5.5
Domestic Demand	0.3	7.0	8.2	10.5	7.3	5.6
Private Consumption	0.6	6.6	7.1	7.7	6.2	5.7
Public Consumption	4.9	2.9	16.1	5.4	3.6	-1.2
Private Investment	-7.4	15.5	12.2	21.9	14.0	13.3
Public Investment	2.9	5.0	-0.3	18.2	6.3	4.2
Real Exports	-10.9	11.3	4.2	1.6	4.0	2.8
Real Imports	-12.7	15.6	6.2	4.0	6.4	3.6

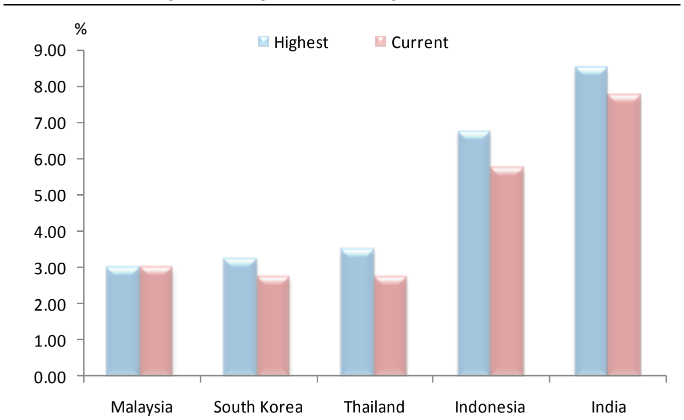
Source: CEIC, MoF, MARC Economic Research.

Interest rates not likely to budge

- Stronger growth notwithstanding,we continue to feel that monetary policy will remain unchanged with a slight upside bias. With domestic demand remaining robust and signs of improvement in the external sector, there are far less grounds for an interest rate cut, unlike in the rest of the region where growth has, with the exception of Thailand, been less than impressive. High capacity utilisation, strong credit growth and the need to rein in household debt are all mitigating factors against an easing of policy.

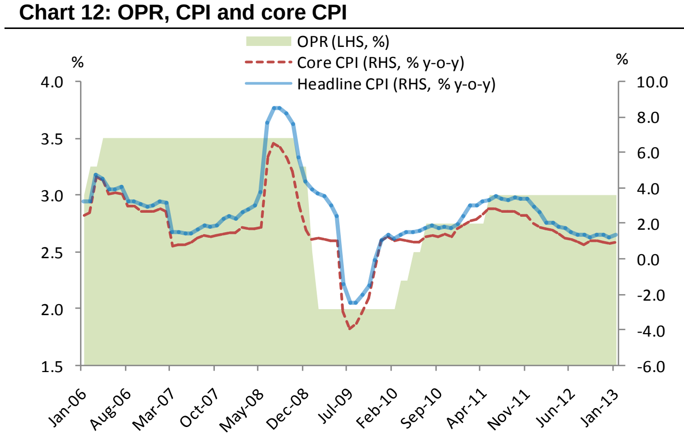
- Conversely, continued weakness in the external sector and damping down capital inflows argue against a too hasty "normalisation" of interest rates. We are of the view that if the US macro numbers improve materially and the financial market begins to discount the possibility of the US Federal Reserve lifting interest rates earlier than its plan in 2015, would there then be a possibility of an upward bias in the OPR. This would be especially true if China'sposts a stronger economic up-cycle and starts to increase their imports from other Asian countries.

Chart 11: Policy rates – peak of the cycle and current



Source: CEIC, MARC Economic Research.

Chart 12: OPR, CPI and core CPI



Source: BNM, CEIC, MARC Economic Research.

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