Economic Research

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Malaysia's 4Q2017 GDP: Another Quarter of Strong Performance

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Our take

- According to the Department of Statistics, Malaysia's economy registered another impressive gross domestic (GDP) growth performance of 5.9% in 4Q2017, in line with the market consensus (MARC's estimate: 5.8%). The growth was, once again, contributed largely by the strength in domestic demand and sustained growth in external trade performance. In particular, private consumption remained robust, expanding by 7.0%, slightly higher than its trend growth while private investment growth continued to accelerate, expanding by 9.2% compared to its trough of 2.1% expansion in 1Q2016.

- Overall, Malaysia recorded a higher-than-expected GDP growth of 5.9% in 2017, its strongest since 2010 (2016: 4.2%). The growth is also stronger than most ASEAN-5 countries save for the Philippines in 2017 (Indonesia: 5.1%; Singapore: 3.6%, Thailand (estimate): 3.8%; the Philippines: 6.7%). Malaysia's overall 2017 GDP growth also beats its average growth recorded in the period of 2011-2016 by 0.8 percentage point, the most among ASEAN-5 countries (refer to Chart 2).

- Externally, stronger global economic growth in 2017 has led to continued trade expansion which ultimately benefits export-dependent economies such as Malaysia. MARC anticipates that GDP growth in major advanced economies had surpassed their 2011-2016 averages (refer to Chart 1) with the euro zone economy strengthening the most. China's economic growth, which rebounded in 2017 from its 26-year low to 6.9%, played a critical role in driving up bullish sentiment in global commodity prices. This has benefitted Asian exporters at large.

- Global trade performance played a critical role in energising Malaysia's overall growth although domestic demand contributed significantly to headline growth in 2017. Notably, export performance rebounded strongly since the beginning of 2017. In USD terms, it expanded by a double-digit pace since July 2017, in line with global exports that increased by 13.0%. Among demand-side growth components, Malaysia's export growth in 2017 had surpassed its 2011-2016 average growth by 8.0 percentage points, higher than other components such as private consumption and private investment (private consumption: + 0.1 percentage point; private investment: -1.6 percentage points)

- The surge in exports were in tandem with the sharp rebound in the prices of crude oil and other major commodities. Brent crude oil prices surged to USD67 per barrel as at end December 2017, up from its trough of USD28 per barrel in January 2016. Global crude oil prices have benefitted from, among other things, the production cut by the Organisation of Petroleum Exporting Countries (OPEC), a softer US dollar (USD) and higher-than-expected demand resulting from a stronger global economy. As a result, Malaysia's exports of petroleum and petroleum products have gained by an average 34.0% between January and December 2017. Similarly, exports of LNG and crude, and processed palm oil rose by an average 29.0% and 17.0% respectively during the same period.

- On the domestic side, investments have recovered after growth slowed to 2.7% in 2016. Major infrastructure projects such as the extension lines of the LRT and MRT (LRT3 and MRT2), Menara PNB 118, The Exchange 106 and Pan-Borneo Highway have generally boosted investment in the economy. The positive sentiment towards investment is also evidenced by corporate bond issuances which surged to RM123 billion in 2017, the highest since 2012. MARC expects the positive momentum in investment to persist in 2018 and estimates that private investments would grow by 7.3% this year.

- Private consumption has been surprisingly resilient in 2017 despite consumers having to face higher costs of living. Overall growth in private consumption climbed to 7.0% in 2017, topping its six-year growth trend of 6.9%. It also contributed about 62.9% overall headline growth. Private consumption growth has rebounded since hitting its trough in 3Q2015. The improvement in overall private consumption growth is in line with Malaysia's labour market which has recovered since beginning of 2017.

- Going forward, MARC foresees a respectable global trade expansion to prevail in 2018 in view of a meaningful recovery of major economies such as the US and euro zone. We anticipate the US economy to post another strong growth of circa 2.3%-2.8% in 2018 (2017: 2.3%) on the back of a healthy labour market and stronger capital spending. The jobless rate continued to be below the level of Non-accelerating Inflation Rate of Unemployment (NAIRU) at 4.1% in January 2018. Relatively strong crude oil prices of between USD60-USD70 per barrel and rising LNG prices will continue to support commodity exports for Malaysia although palm oil prices have languished by about 29.0% since its 2017 peak of RM3,348 per tonne. All these augur well for the Malaysian economy, whose trade remains above 100% of GDP.

- Domestically, consumer spending growth will likely sustain above 7.0% in 2018, as favourable labour market conditions prevail in the near term. A stronger ringgit in 2018 will also act as a boost for consumer spending going forward. As for investment, the continuation of major infrastructure projects will likely support its growth. This, however, could be partially offset by rising interest rates in 2018.

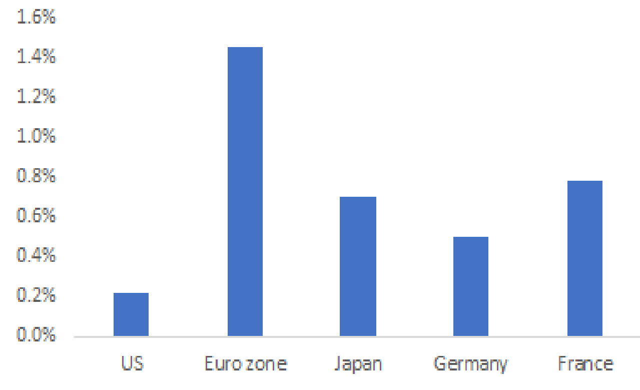
- The ringgit will likely remain relatively strong against the greenback as portfolio investors move capital into Malaysian shores to take advantage of the stronger economic growth in 2018. Inflows are anticipated to rise due to a synchronised recovery in the region. In addition, the fact that the ringgit had depreciated immensely on a real effective exchange rate (REER) basis by almost 16.0% after crude oil prices collapsed in 2014 provides an opportunity for investors to gain from an expected appreciation in the near term.

- With the economic outlook improving, the government will be afforded significant breathing space as it continues with efforts to strengthen sovereign credit metrics that are of concern to rating agencies. The efforts should continue to focus on reducing budget deficits, government debt and contingent liabilities, household debt, as well as further reducing energy subsidies. In containing budget deficits, we believe that the government will continue to contain operating expenditure (opex) while sustaining the amount spent for development purposes. Opex has grown by 5.5% on a CAGR basis between 2010-2017, down from 13.4% between 2001-2008.

- Notwithstanding the better global economic outlook as synchronised global growth gains further traction, there will be challenges ahead. Firstly, financial market volatility has risen as a result of rising interest rates in the US. Although the risk would affect both the equity and bond markets, concerns over a possible sharp bond market correction is critical considering a large holding of Malaysian bonds by foreigners (i.e. 46.0% of MGS outstanding held by foreigners in January 2018). A rapid outflow of capital, if it happens, could affect the ringgit's prospects in 2018.

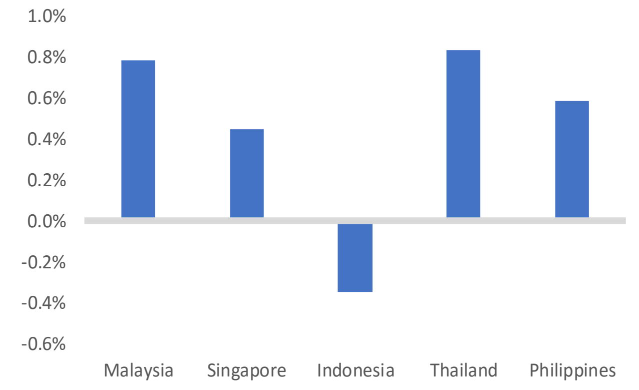
- Secondly, although bond yields are generally expected to slowly climb at a leisurely pace in 2018, an unexpected and sustained increase in bond yields would affect investment environment. More importantly, from a macro perspective, it could lead to higher government debt service charges which are already expected to increase to around RM31 billion in 2018. Under Malaysia's administrative fiscal rule, federal government debt service charges as a percentage of revenue should be kept below 15.0%. In the latest Economic Report, the Ministry of Finance (MoF) is already projecting debt service charges to rise to 13.1% of revenue in 2017, up from 9.8% in 2010.

Chart 1: Gap between growth rates in 2017 and their averages in 2011-2016 for selected advanced economies



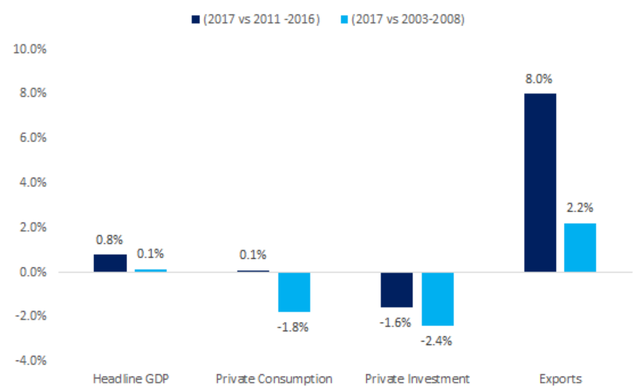
Source: Bloomberg, MARC Economic Research

Chart 2: Gap between growth rates in 2017 and their averages in 2011-2016 for ASEAN-5 economies



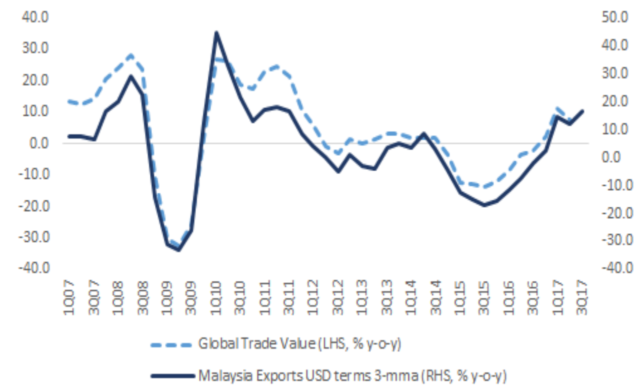
Source: DoSM, CEIC, Bloomberg, MARC Economic Research

Chart 3: Malaysia - Gap between growth rates of GDP components in 2017 and their averages 2011-2016/2003-2008



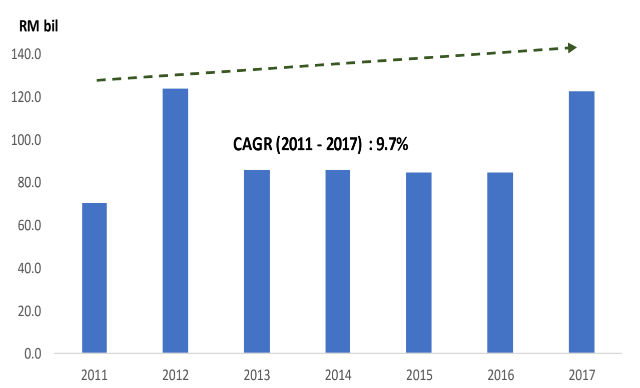
Source: DoSM, CEIC, MARC Economic Research

Chart 4: Global trade value and Malaysian exports in USD term



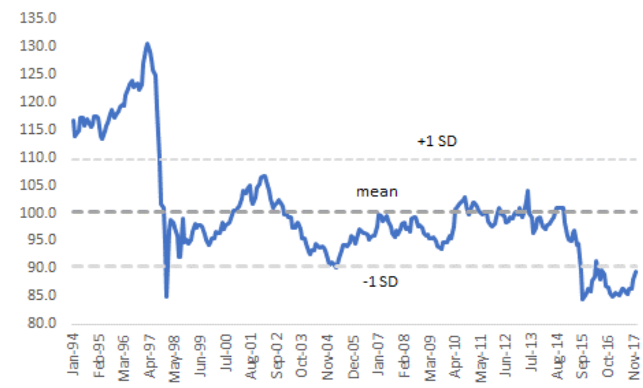
Source: WTO, MARC Economic Research

Chart 5: Malaysia – Total corporate bond issuances



Source: BPAM, MARC Economic Research

Chart 6: Malaysia - Real effective exchange rate



Source: BIS, MARC Economic Research

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