1Q performance — a precursor of things to come?

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The deceleration of Malaysia's first quarter gross domestic product (GDP) growth to 4.2% did not come as a surprise. Expectations were rife for growth to come in at around the 4% mark, based on market consensus. Most indicators (trade, industrial production, consumer and business sentiments, to name but a few) were on a downward trend amid global headwinds. Other regional economies are also seeing moderation in the pace of their growth — Indonesia's GDP growth slowed to 4.9% while Singapore's slipped to 1.8%, as reported recently.

As always, different groups reacted differently to the statistics released by Bank Negara Malaysia. For the government, the pace of growth will have important repercussions on its fiscal position and planned expenditure for 2016. Slower growth means lower revenue and with crude oil prices remaining below the long-term average (albeit having recovered somewhat from the recent low in January), revenue growth will remain subpar at best, if not negative. Last year, revenue contracted for the first time since the global financial crisis in 2009. Consequently, any revenue that can be generated should be properly utilised, while expenditure items will have to be carefully planned so as not to create larger government deficits that could ring the alarm bells of international rating agencies.

For Malaysia, revenues and expenditures have tended to move in tandem over the years. And the government is aware that its revenue collection has averaged circa 24% of GDP in recent years, lower than its single-A sovereign-rated peers (median of about 38% of GDP). But the good thing is that Malaysia's total expenditures are also lower than its rating peers, at about 23% of GDP (compared with the median single-A average of 39% of GDP). Given the moderation in GDP growth and revenue collection this year, the RM9 billion cut in expenditures announced during the recalibration of Budget 2016 will likely be strictly implemented, even if crude oil prices continue to recover. This is to ensure that the deficit target will not be derailed.

As for economists, Bank Negara's statistics are fuelling the debate on whether monetary policy should be made more accommodative to support the economy, which is seemingly decelerating to below its potential growth this year. One camp argues that the central bank's monetary stance can be loosened as the policy rate stands at just 25 basis points below its historical high and has remained there for some time, although other central banks in the region have softened their stance amid global economic headwinds. Moreover, Malaysia's fiscal space is considerably limited due to lingering budget deficits, so a helping hand from the monetary side would come in handy. Another camp, however, argues that the possible benefits arising from a more accommodative monetary stance are too minimal, as experienced by other countries. In other words, the impact of looser monetary policy alone is decidedly limited. In fact, lowering interest rates could exacerbate certain imbalances (such as the currently high household debt) and will not provide the much-needed boost to growth.

But one bright spot in the first quarter, as far as economists are concerned, is the recovery in nominal GDP growth, which suggests that the economy is no longer deflating. In fact, since the second half of 2015, nominal GDP growth has exceeded real GDP growth. This is contrary to the situation in the first half of 2015 when nominal growth trailed real growth, signifying a general decline in prices due to the weak economic momentum.

In business circles, the debate is on whether the government should come up with extra measures at the upcoming Budget 2017 to improve near-term business conditions. Businesses have been facing twin pressures from rising costs and weaker demand. Capital spending has been scaled down to protect margins. Based on the quarterly surveys by the Malaysian Institute of Economic Research, business sentiment has continued to wane due to global and domestic economic uncertainties.

As for consumers, nothing matters more than their financial conditions as they need to make ends meet. Hence, many tend to ignore the intimidating economic jargon bandied about in the media and focus instead on the state of their finances. What is more pressing to them is how their finances are going to be. Slower economic growth spells greater uncertainty for businesses and the labour market. For instance, the recent uptick in the unemployment rate to 3.5% in April, above its long-term average of 3.2%, signals some weakness in the labour market that is putting consumers on alert. Thus, going forward, they would likely apply the brakes on unnecessary spending and start to save more for rainy days.

Consumers will also keep a close watch on general prices as they are aware of the ever-rising cost of living. Indeed, some are wondering why food prices in Malaysia are generally higher than in advanced countries. Based on the Consumer Price Index breakdown, food prices have risen by an average of 3.7% per annum in the past five years compared with, say, the UK, Australia or the US, which experienced average increases of only 0.5%, 0.5% and 1.8% respectively in the same period. From consumers' point of view, it does not matter if the economy is supported by fiscal or monetary measures. Of overarching importance is a decent economic performance that provides jobs and enables business owners to support their operations and their families.

Notwithstanding this, it is interesting to note that consumers have remained rather unperturbed by economic uncertainties in recent quarters. This is reflected in consumer spending growth, which has rebounded from the recent low of 4.1% in the third quarter of 2014 to more than 5% in the first quarter of this year. Perhaps the labour market deterioration is still confined to certain sectors such as oil and gas and a small portion of services. In addition, access to credit from financial institutions, while having been tightened somewhat, is still supporting consumer spending at this juncture.

Against this backdrop, Budget 2017 will be closely watched by both the business community and consumers. It will be quite challenging for the government to support the two groups at times like this. But again, too deep of a cut in expenditures to prevent a marginal increase in budget deficits may not be the answer. E

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