

2011 Malaysian Economic Outlook: Growth Assured Amid Headwinds

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In a nutshell



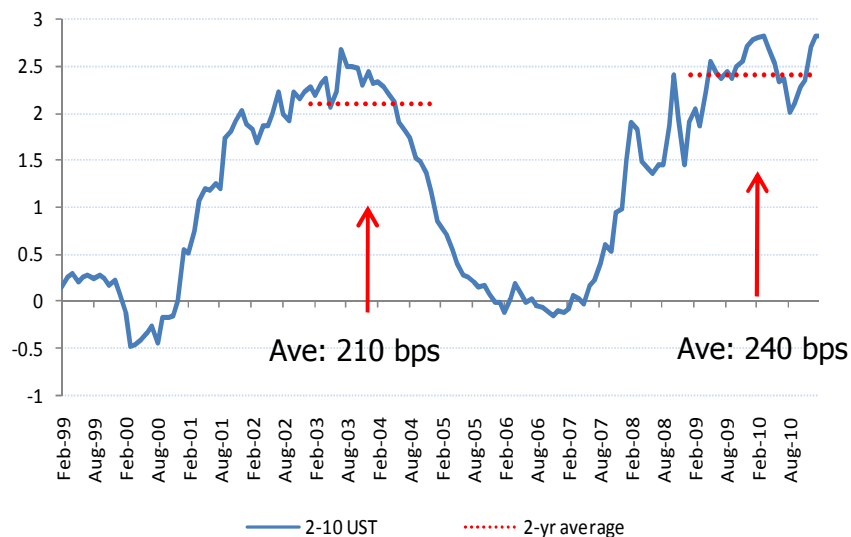
- The US economy is emitting more positive signs, judging by leading indicators in the financial market (yield gaps and corporate bond spread). In January 2011, unemployment showed the sharpest two-month decline since 1958. It declined further to 8.9% in February.
- European countries are still embroiled in the sovereign debt crisis. The European Central Bank hinted that it may raise rates in the next meeting; mixed feelings.
- Asian economies remain strong, fueled by the twin engines of China and India. World growth rate was revised upwards by the International Monetary Fund (IMF). Most notable improvement was the outlook of the US economy.
- Malaysia's growth momentum is decelerating, with slowing global demand and the waning of the base effect.
- Among the important issues for the Malaysian economy are: (1) effect of higher prices on consumers; (2) effect of possible monetary tightening measures, if policymakers react; (3) effect of a possible sudden reversal in capital flows; and (4) effect of surging oil prices on the economy.

US – light at the end of the tunnel?

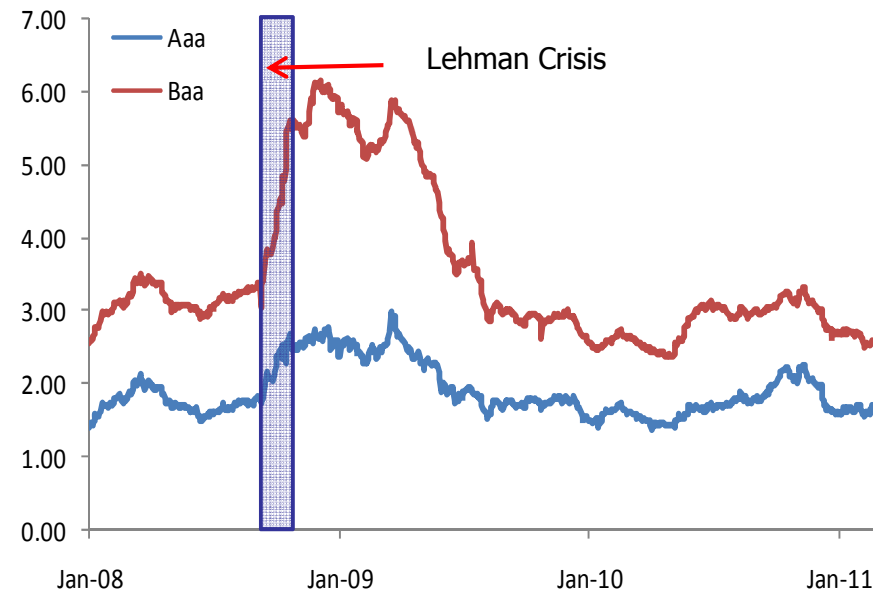


- The yield gap of 2-10 US Treasuries (UST) jumped to 290 basis points (bps) in February 2011, the most since February 2010; while 30-year yield stood at 4.75%, the highest since April 2010. The average gap between 2009-2010 was 240 bps, higher than the average between 2003-2004 prior to the boom.
- The corporate bond spread shrank, suggesting that perception of risk has declined for both high- and low-rated corporate bonds.

2-10 yield gap of UST



Corporate bond spread



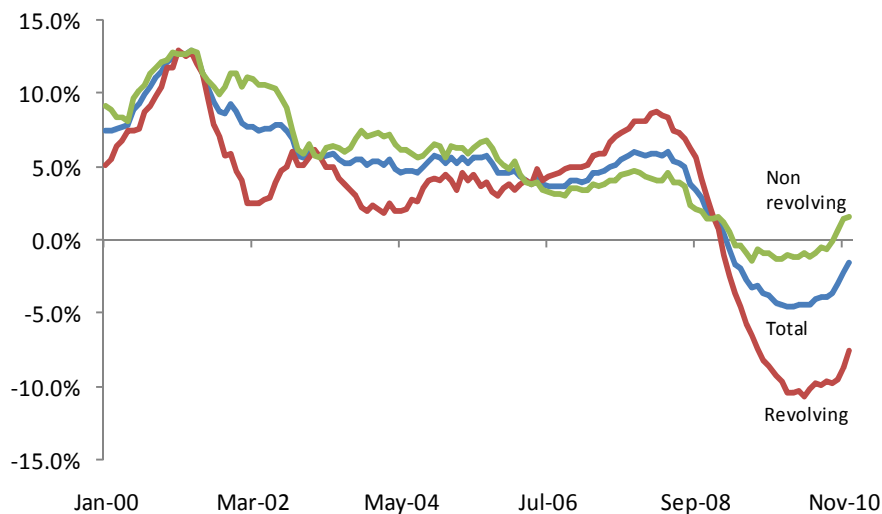
Source: Bloomberg

US – light at the end of the tunnel?

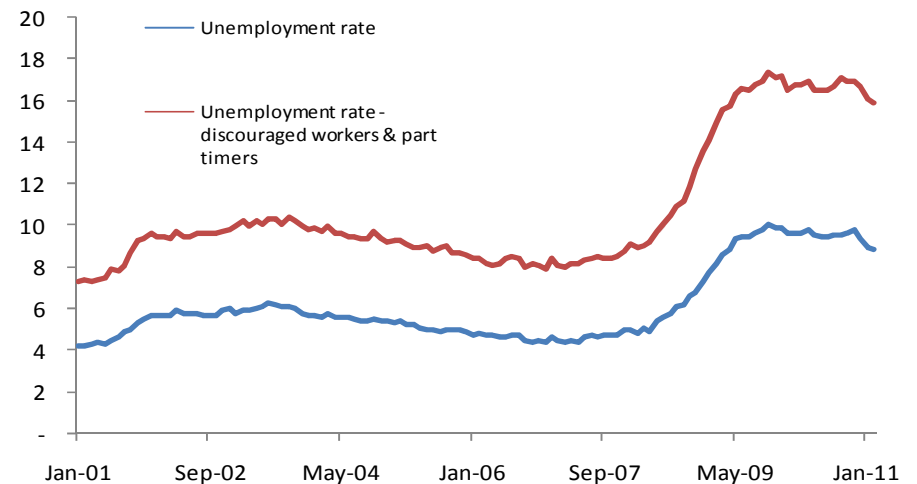


- Access to credit has improved, while the US monetary policy stance remains accommodative. Non-revolving credit (including auto loans) has registered three consecutive months of positive growth.
- The declining unemployment rate should benefit consumer spending going forward.

Consumer credit growth (y-o-y%)



Unemployment rate (%)



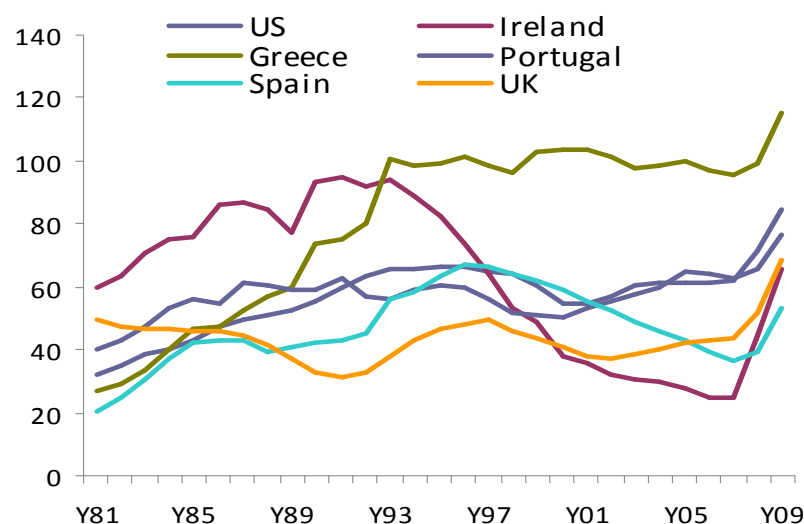
Sources: Federal Reserve & Bureau of Labour Statistics

G3 economies – European problems



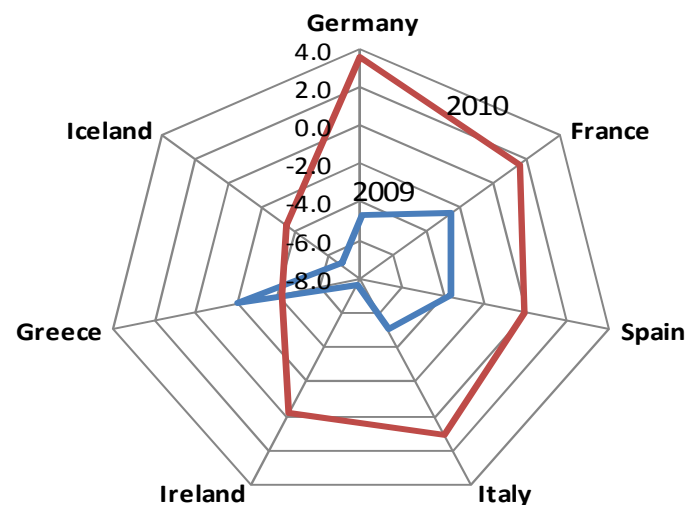
- Astronomical levels of budget deficits and sovereign debts in European countries will prevent a smooth recovery of advanced economies.
- Despite that, the economy grew 1.7% in 2010 after falling by 4.1% previously. But growth was rather uneven among members.

Government debt-to-GDP ratio (%)



Sources: IMF & Eurostat

GDP growth in 2009 and 2010 (%)



Global economic outlook by the IMF



- Overall growth forecast was revised upwards in January 2011, with the US having been upgraded the most among G3 economies (+0.7 percentage points).
- Prospects of Asian economies remain encouraging as the twin growth engines of China and India continue to be strong.

	Year over Year					
	2009	2010	Projections		Difference from October 2010 WEO Projections	
			2011	2012	2011	2012
World Output ¹	-0.6	5.0	4.4	4.5	0.2	0.0
Advanced Economies	-3.4	3.0	2.5	2.5	0.3	-0.1
United States	-2.6	2.8	3.0	2.7	0.7	-0.3
Euro Area	-4.1	1.8	1.5	1.7	0.0	-0.1
Germany	-4.7	3.6	2.2	2.0	0.2	0.0
France	-2.5	1.6	1.6	1.8	0.0	0.0
Italy	-5.0	1.0	1.0	1.3	0.0	-0.1
Spain	-3.7	-0.2	0.6	1.5	-0.1	-0.3
Japan	-6.3	4.3	1.6	1.8	0.1	-0.2
United Kingdom	-4.9	1.7	2.0	2.3	0.0	0.0
Canada	-2.5	2.9	2.3	2.7	-0.4	0.0
Other Advanced Economies	-1.2	5.6	3.8	3.7	0.1	0.0
Newly Industrialized Asian Economies	-0.9	8.2	4.7	4.3	0.2	-0.1

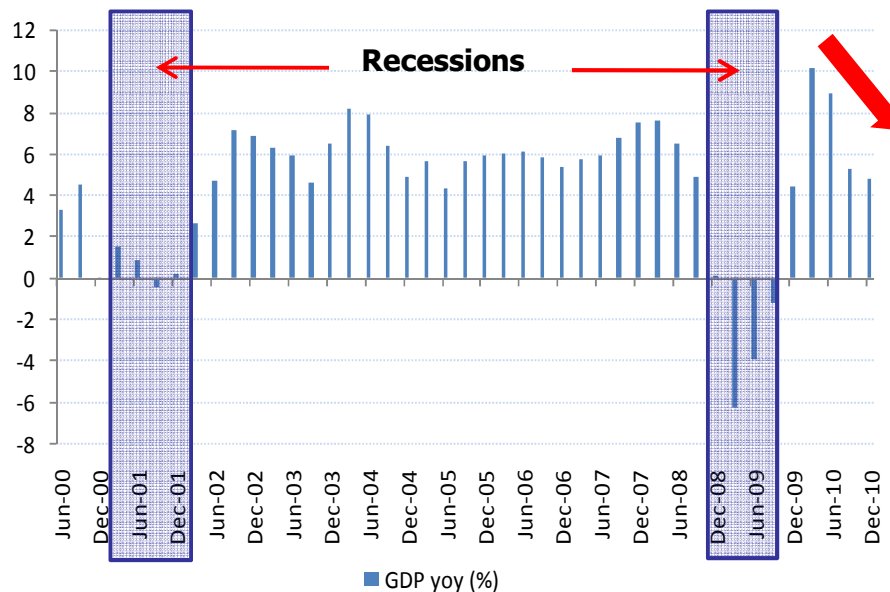
Source: IMF

Back home – growth is also moderating



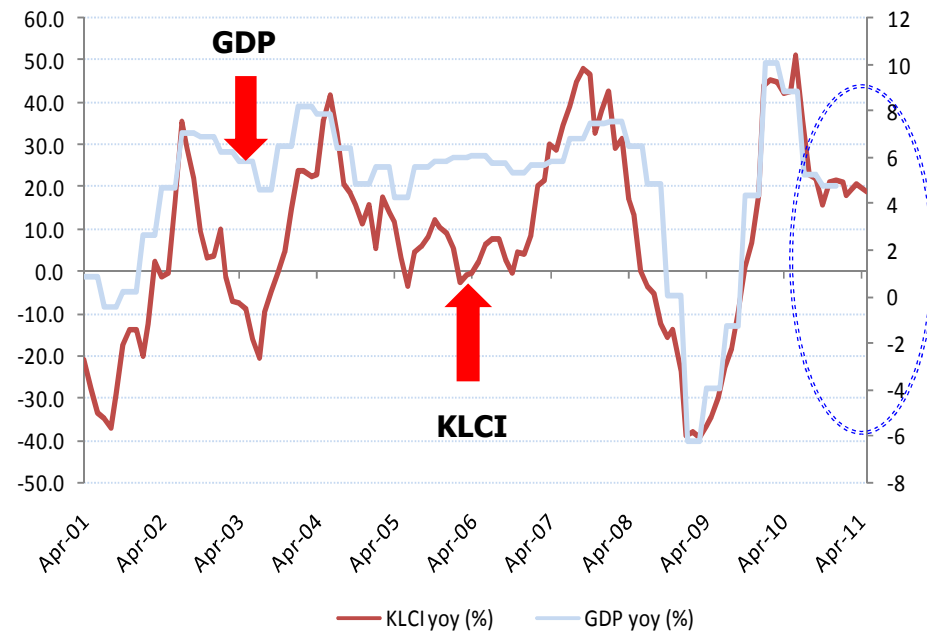
- Following a sharp recovery in 2010, Malaysia's economic growth moderated in the last three quarters as weaker global demand weighed on the performance of its external sector.
- Leading indicators are pointing to softer growth in the next few quarters.

Malaysia's quarterly GDP growth



Source: CEIC

KLCI (four-month lead) and GDP growth (y-o-y%)

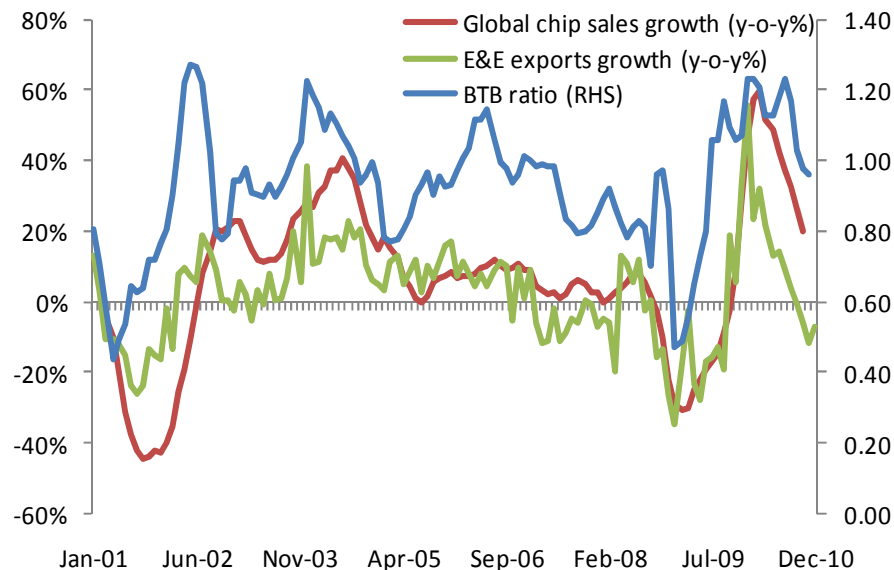


Back home – growth is also moderating



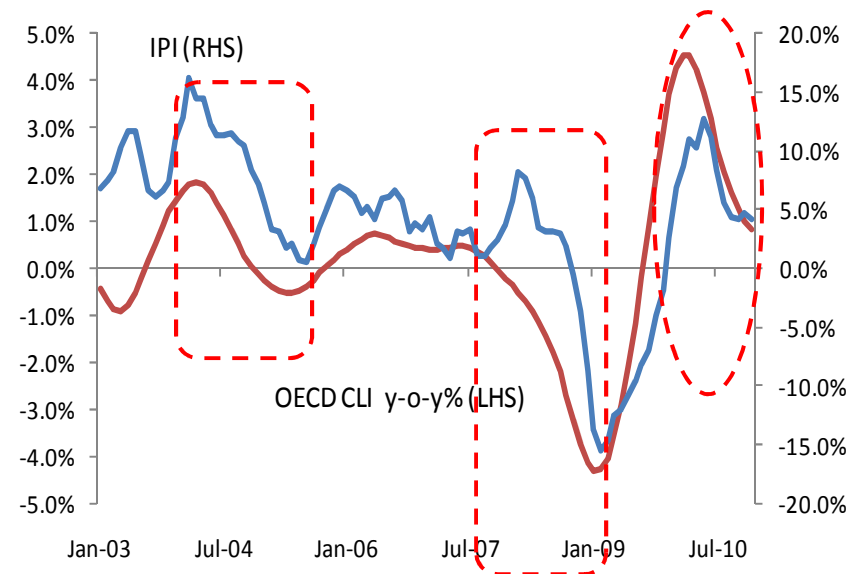
- The major reason for the expected slower growth in 2011 is the weaker external trade (smaller net exports) due to waning global demand (particularly for E&E products).
- Global chip sales are expected to grow by 6.0% and 3.4% in 2011 and 2012 respectively, down from the estimated 32.8% in 2010.

Global chip sales and Malaysia's E&E exports



Sources: SIA & CEIC

IPI and OECD composite leading indicators

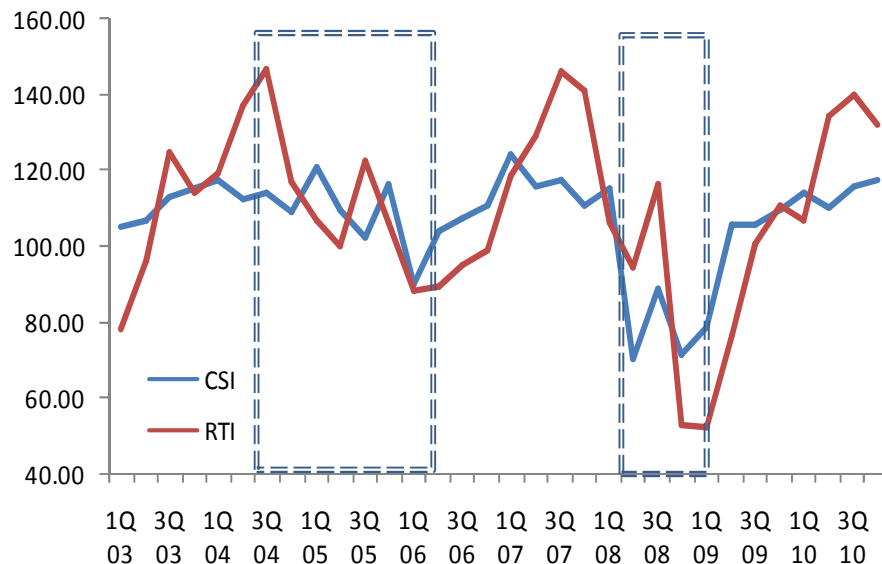


Issue 1 – How do consumers react to higher prices?

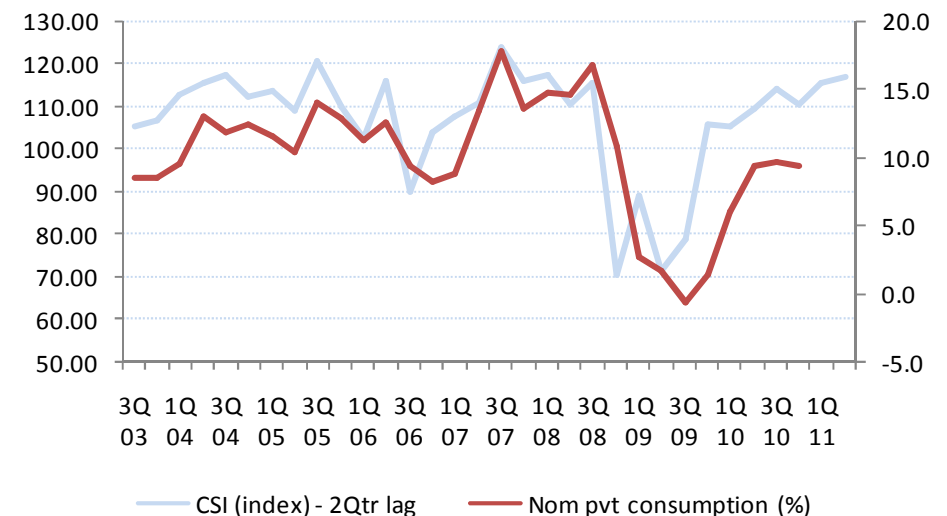


- Although the consumer price index (CPI) remained below 3%, higher pump prices will dampen consumer spending, putting pressure on private consumption, as evidenced by the fall in the retail trade index (RTI).
- Over the years, actual private consumption has had a strong correlation with the consumer sentiment index (CSI), with a two-quarter lag.

Consumers' reaction to hikes in pump prices



CSI normally leads actual private spending by two quarters



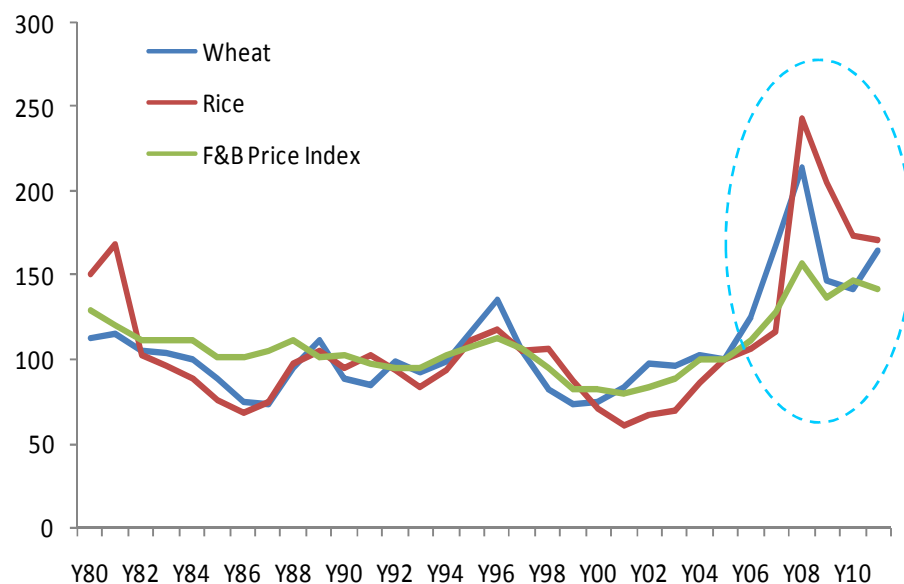
Source: CEIC

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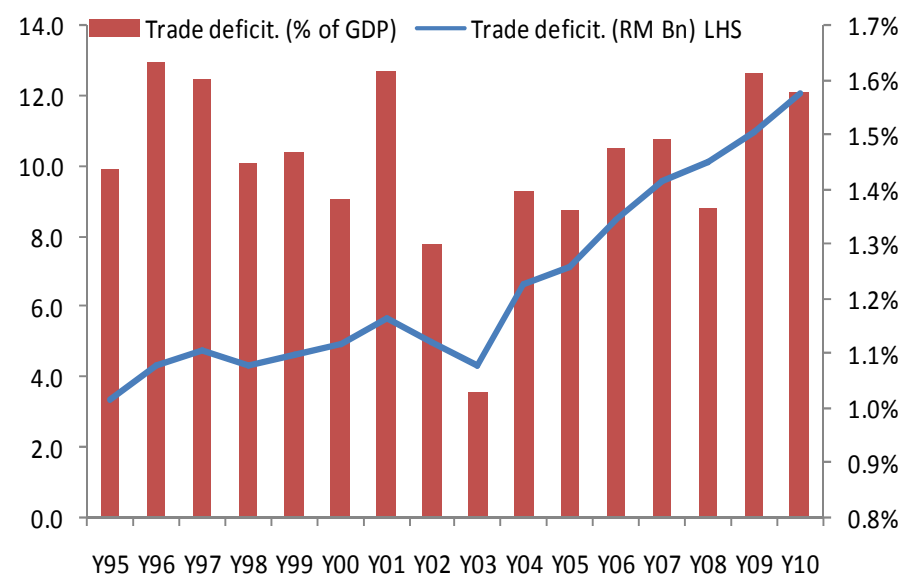
- Food prices have increased exponentially since 2005, and the Food and Agriculture Organization of the United Nations (FAO) predicted no near-term respite for consumers as price increases are not likely to decelerate in the near future.
- Malaysia's trade deficit in foodstuff has risen over the years.

Global wheat, rice and F&B price indices (2005 = 100)



Sources: IMF and CEIC

Malaysia's trade deficit in foodstuff

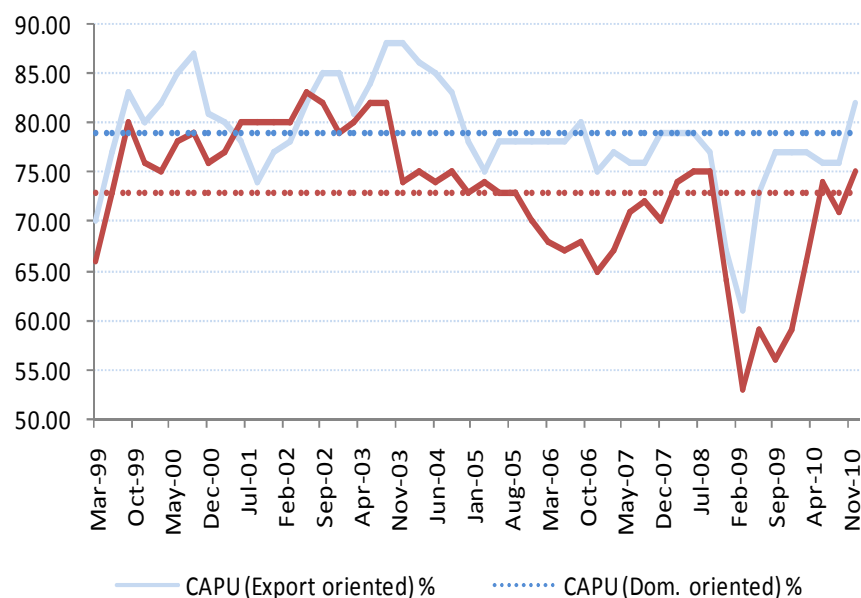


Issue 2 – How is monetary policy responding to higher prices?



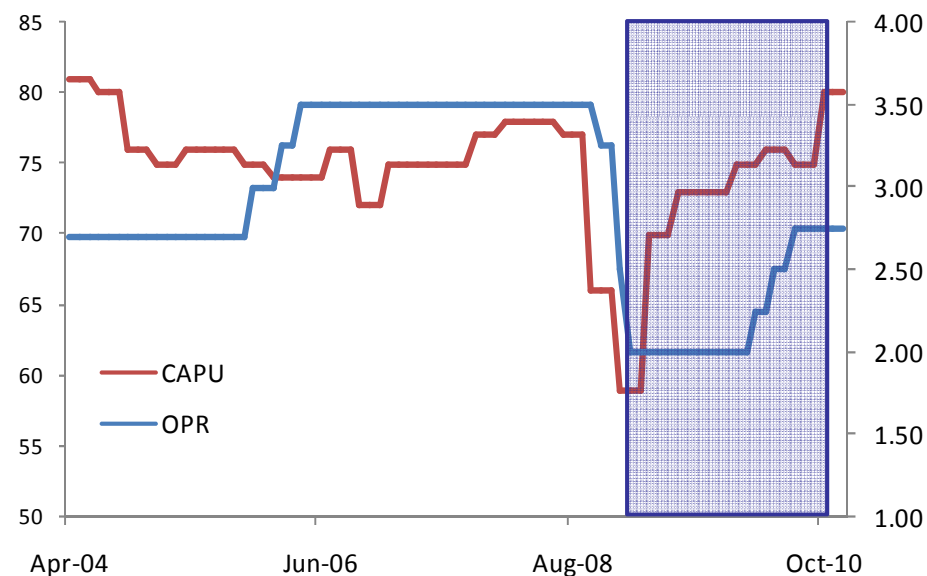
- Capacity utilisation (CAPU) rates in domestic- and export-oriented industries have surged above their long-term averages, pointing to a higher risk of demand-pull influences.
- The overnight policy rate (OPR) is normally raised in response to rising CAPU to prevent a “second round” effect.

CAPU of domestic- and export-oriented industries (%)



Source: CEIC

CAPU and OPR (%)

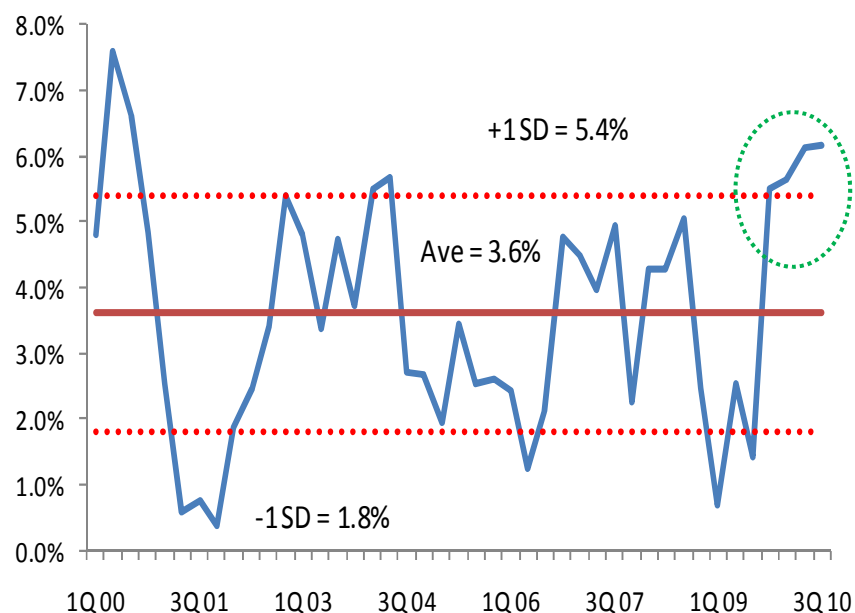


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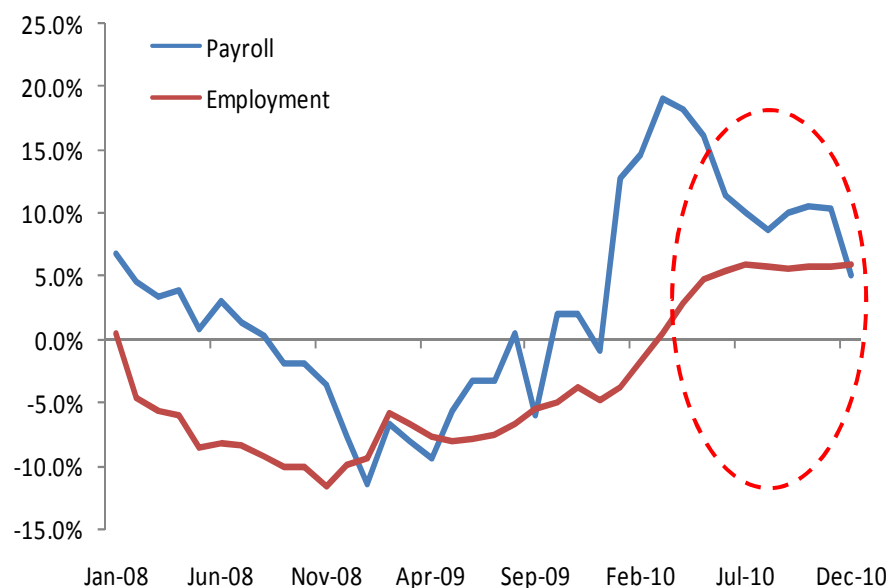
- The growth in Malaysia's house price index is currently above 1 standard deviation (SD) from its historical mean, but there is no emerging real property bubble.
- The growth in payroll and employment in the manufacturing sector has slightly moderated after recording sharp increases in the past one year.

Malaysia's house price index



Source: CEIC

Malaysia's manufacturing payroll and employment (y-o-y%)

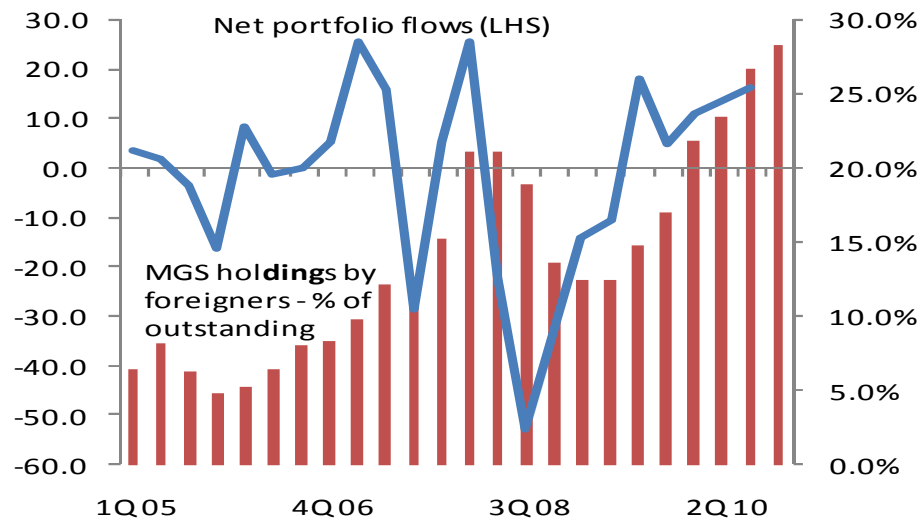


Issue 3 – inflows, inflows

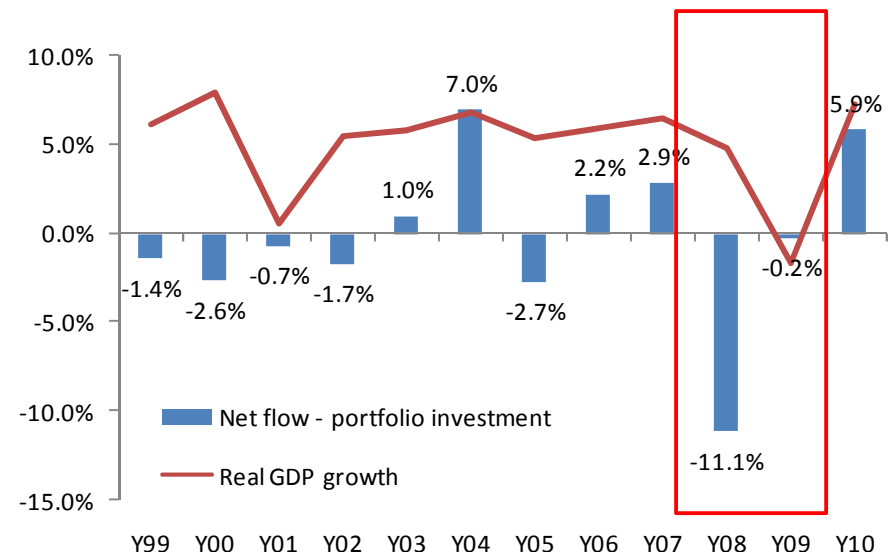


- Massive capital inflows are evidenced by the rallies in the local stock and bond markets. Malaysia's inflows have been largely characterised by portfolio investments.
- Experience suggests that large outflows can drastically affect both the financial market and the real economy.

Portfolio flows (RM Million)



Portfolio flows - historical experience



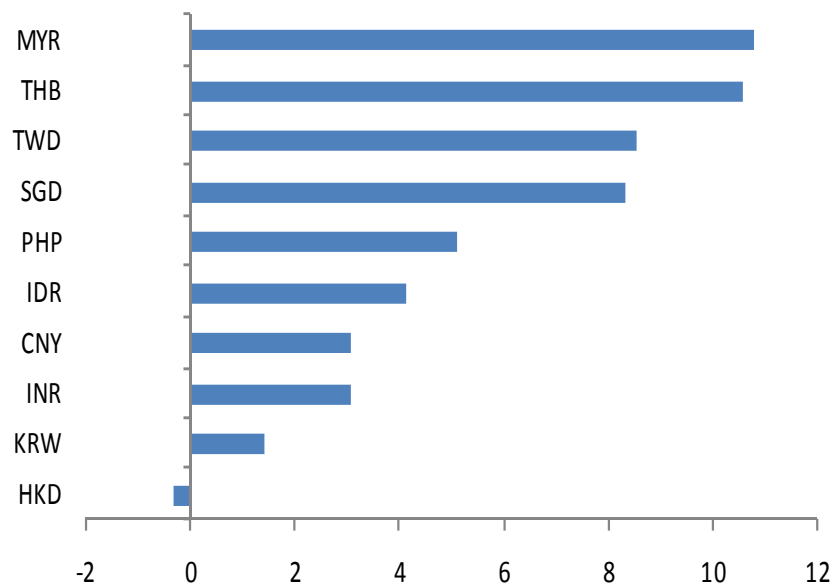
Sources: CEIC & MARC Economic Research

Issue 3 – inflows, inflows



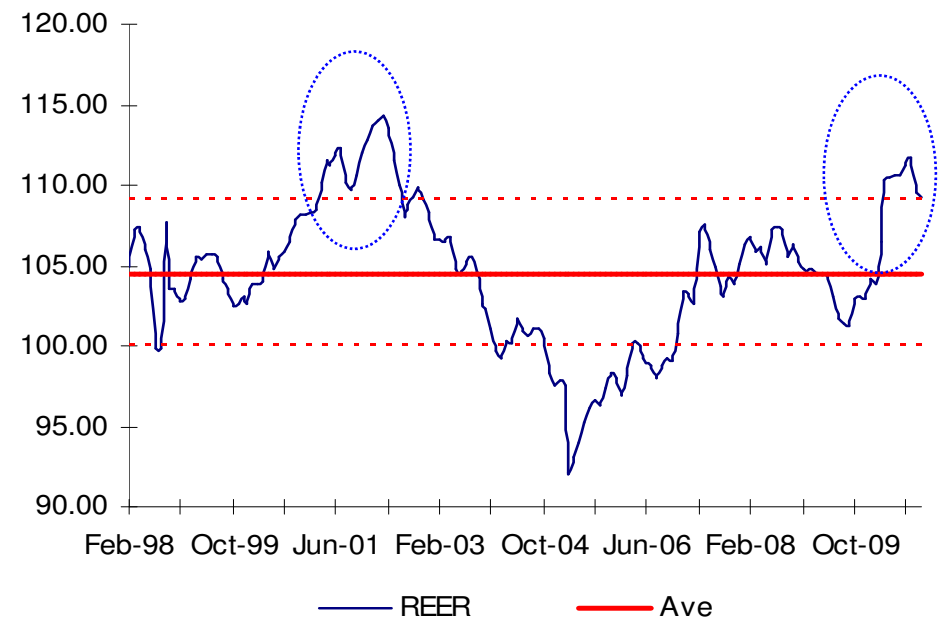
- Amount of capital inflows into Asia (including Malaysia) is exerting upward pressure on Asian currencies, including the ringgit.
- Malaysia's real effective exchange rate (REER) is currently above 1SD from its mean. Any sudden reversal in flows will affect the ringgit's performance.

Currency movements in 2010



Source: Bloomberg

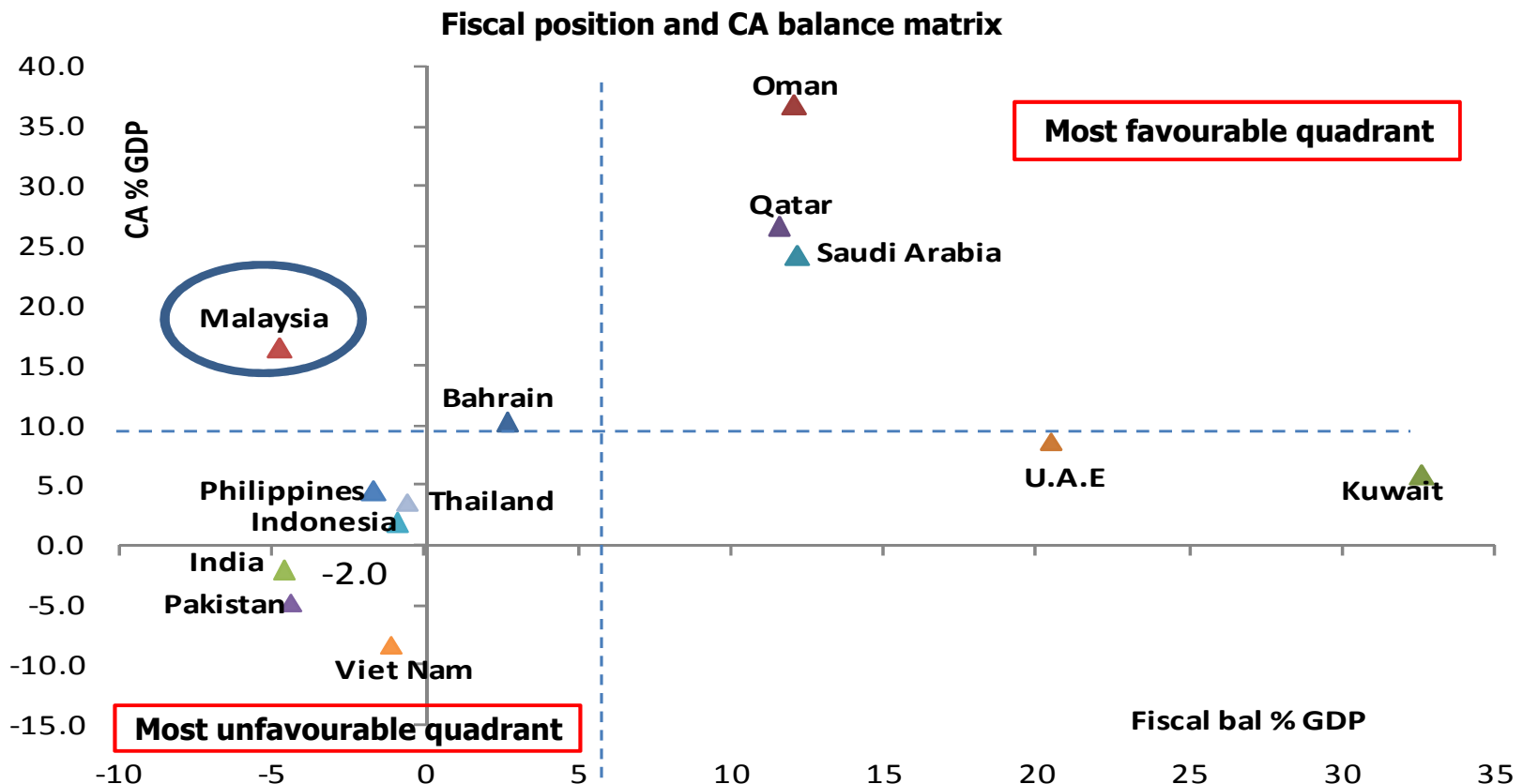
Malaysia's REER



Issue 4 – government finances



- The fiscal and current account (CA) balance matrix shows that Malaysia is in a less favourable quadrant, and is comparable to India and Pakistan. However, its CA position is more favourable than many Asian countries.



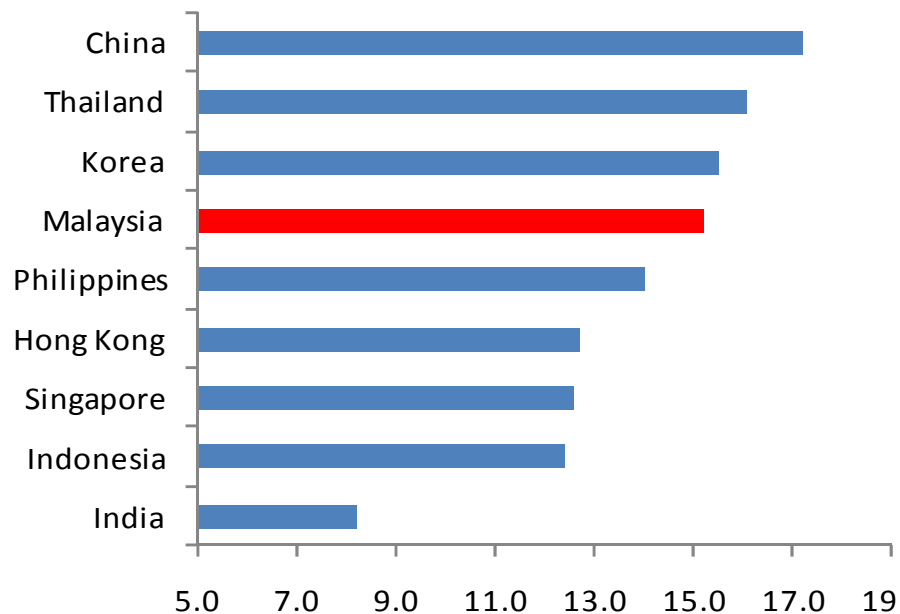
Source: CEIC

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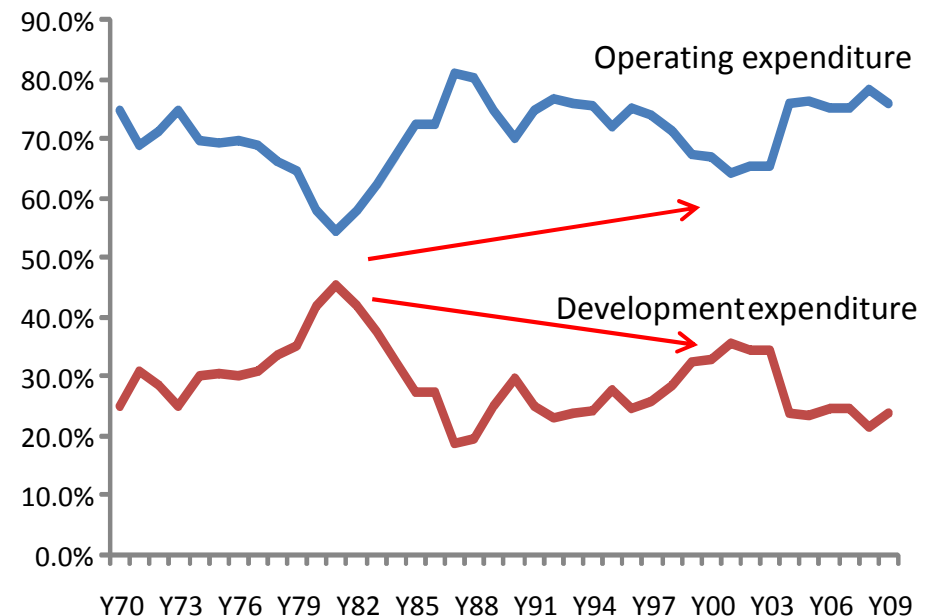


- Revenues are not a problem for Malaysia as the country's tax-to-GDP ratio is one of the highest in the region.
- However, operating expenditure (emoluments, subsidies, supply & services) has risen over the years.

Tax-to-GDP ratio (%)



Malaysia's operating and development expenditure as a % of total expenditure



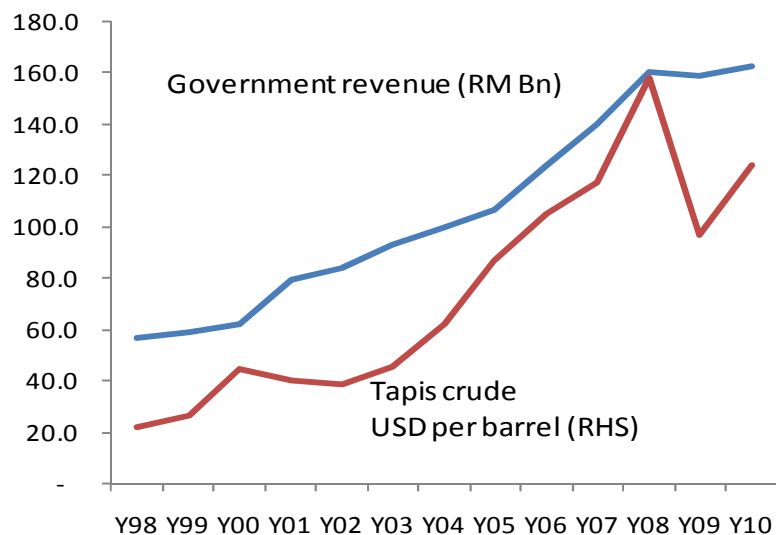
Sources: ADB & CEIC

Issue 4 – government finances

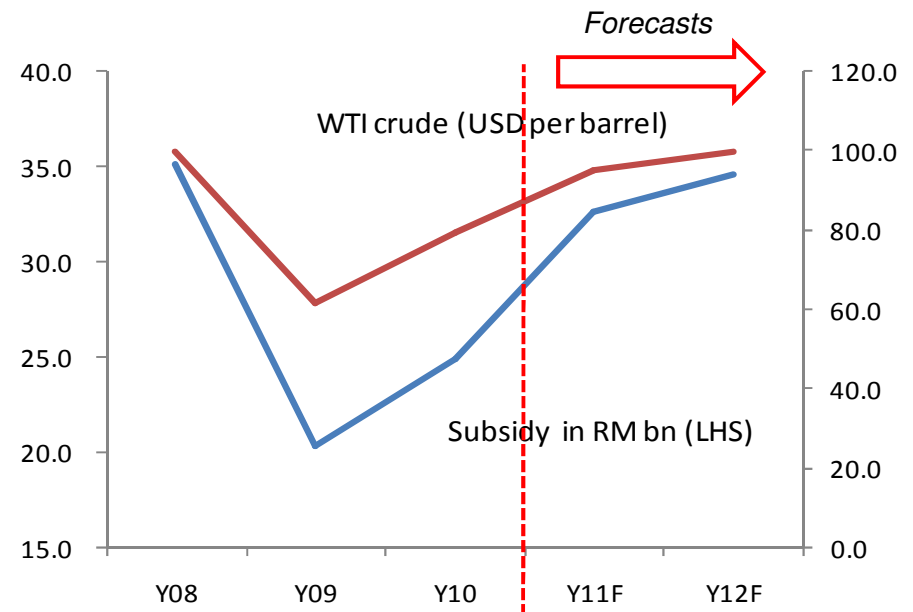


- The rise in oil prices will result in higher revenues, but at the same time would increase the government's subsidy bill.
- The government has to contend with the trade-off between restoring the budget balance and safeguarding the people's welfare.

Government revenue vs. price of Tapis crude



Total subsidy vs. price of West Texas Intermediate (WTI) crude



Sources: IMF & CEIC

A faint, grayscale background image of a large conference room with a long table and several chairs arranged around it.

Thank You