Malaysia

A good structural story

- GDP contracted in q/q annualised terms in Q3 while growth eased relative to a year ago. (See Chart 1.) The slowdown may well continue for one or two more quarters. Final demand in the West will stay weak while the boost from inventories, which has lifted GDP since the end of 2009 (see Chart 2), has now largely come through. Electronics exports, in particular, are at risk of falling sharply from early 2011 once Christmas demand has worked through (see Chart 3), which will probably keep industrial output on its current weak track too. (See Chart 4.)

- Nevertheless, we still anticipate that the slowdown will come to an end during the first half of next year. We expect that GDP growth will be back up to Malaysia's trend pace of 5% pa, or will be stronger, by this time next year. The continued rapid expansion of intra-Asian trade should partly offset the weakness in the West. In addition, rising incomes, in tandem with a supportive fiscal stance (see Chart 5), should ensure that household spending keeps expanding at a reasonable pace, even though consumer debt levels are relatively high.

- In addition, Malaysia is tackling the fall off in foreign direct investment inflows through the so-called Economic Transformation Programme (ETP). The ETP over the period to 2020 has targeted investments totalling $444bn, which is equivalent to 160% of nominal GDP in 2010. Around 90% of this total is slated to come from the private sector, and some 70% of the latter will probably come from domestic companies. Projects to improve the transportation infrastructure will start from Q1 next year, perhaps with an eye to holding early elections in 2011.

- The government is also aiming to accelerate GDP growth through new reforms which deregulate the economy. However, an overhaul of the positive discrimination policies toward bumiputra groups still looks too politically contentious an issue to tackle. The commitment to change appears deep-rooted and we anticipate that there will some progress. But the risk is that the private sector does not buy into the reforms and the implementation of ETP projects is delayed.

- Consumer price inflation has stayed well-contained. (See Chart 6.) What's more, the roll-back of subsidies will stay gradual while there is still plenty of scope for more MYR appreciation, at least on a trade-weighted basis. (See Chart 7.)

- Nevertheless, the central bank will not want to be overly reliant on currency gains to keep inflation at bay. Accordingly, we expect that rate hikes will resume in Q1 and see rates climbing to the middle of a neutral range, which is 3-4%, by end-2011. (See Chart 8.)

TABLE 1: KEY FORECASTS

% y/y, unless stated

	Average 99 – 08	2009	Forecasts 2010	2011	2012
GDP	5.6	-1.7	7.5	5.5	6.2
Private cons'ptn	7.6	0.7	6.5	5.0	6.0
Total fixed invest.	7.0	-14.6	9.0	6.5	7.0
Consumer prices	2.4	0.6	1.8	2.5	2.5
Unemp. rate (%)(1)	3.4	3.7	3.4	3.2	3.2
Gen'l gov't bal(2)	-4.3	-7.0	-5.0	-4.0	-3.2
Current account(2)	13.0	16.5	14.0	13.0	10.0

(1) End of period (2) As % of GDP

Malaysia Charts

Chart 1: GDP

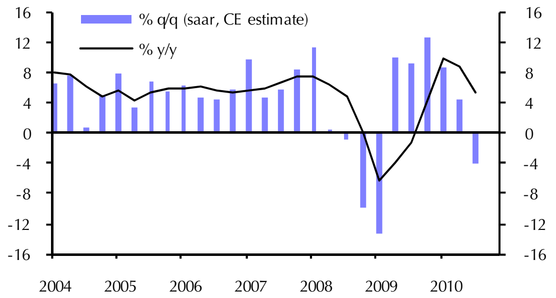


Chart 2: GDP by Expenditure (%-point annual contribution)

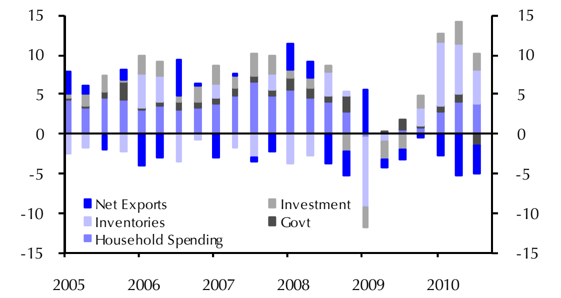


Chart 3: Malaysia Exports & Book-to-Bill Ratio (%)

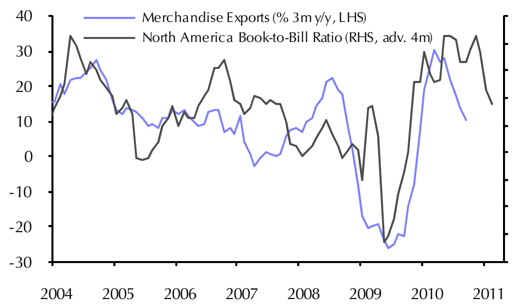


Chart 4: Exports & Production (% 3m/3m)

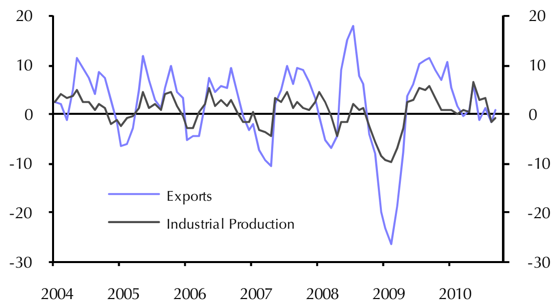


Chart 5: Government Budget (% of GDP)

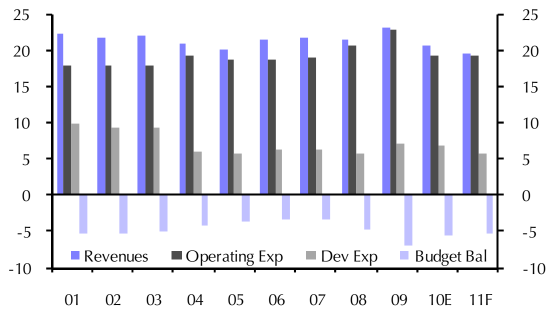


Chart 6: Consumer Prices

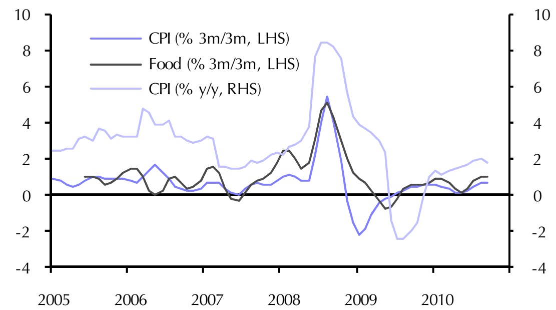


Chart 7: Exchange Rate

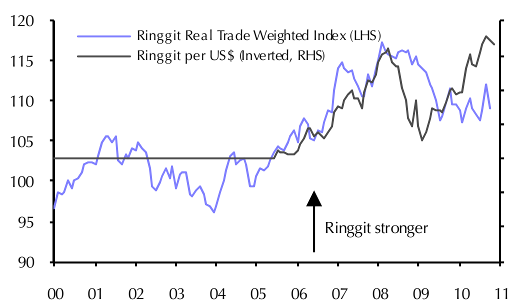
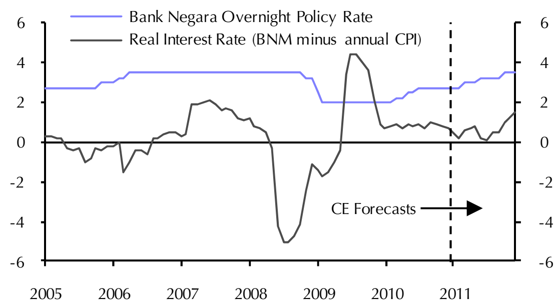


Chart 8: Policy Rate & Real Interest Rate (%)



Sources – Thomson Datastream, Bloomberg, CEIC, Capital Economics