

Malaysia Business Forecast Report Q2 2014

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Abstracts

Core Views

The Malaysian economy is likely to expand at an average of 4.2% over the next five years (2014-2018). Although this is by no means spectacular given that growth has averaged 5.0% over the last decade, we note that this is largely due to the rebalancing of the Malaysian economy towards domestic demand. We expect private sector investment to be a major source of growth for the economy, with GFCF as a share of nominal GDP rising steadily from around 25.6% in 2012 to 28.8% by 2017.

We view the newly announced fiscal budget as a major step in getting the government's finances back in order. We forecast Malaysia's budget deficit to narrow from an estimated 4.9% of GDP in 2013 to 1.0% by 2018, with the bulk of the reduction coming from 2015 onwards due to the implementation of the Goods and Services Tax (GST).

We expect inflationary pressures in 2014 to be kept in check by a host of factors including cooling money supply growth, declining global grain prices, and subdued regional economic growth. Unless, we see a sharp rebound in grain prices over the coming months (not our core view), we believe that food price inflationary pressures will be capped in 2014.

Major Forecast Changes

We have revised our average headline consumer price inflation (CPI) forecast to 2.9% for 2014 (up from 2.5% previously). This is to reflect the one-off impact of the electricity price hike implemented by the government in January.

Key Risks To Outlook

Malaysia's economic outlook remains vulnerable to external shocks. This is compounded by increased public spending on welfare subsidies in recent years. We caution that the government's failure to address its fiscal imbalances after the general election risks triggering a wave of downgrades by rating agencies on its debt. Such a scenario would likely result in higher debt servicing costs as investors demand higher yields, further complicating efforts to cut public spending going forward.

Contents

Executive Summary
Core Views
Major Forecast Changes
Key Risks To Outlook

CHAPTER 1: POLITICAL OUTLOOK

SWOT Analysis

BMI Political Risk Ratings

Domestic Politics

Sweeping Victory For Incumbents To Pave The Way For Reforms

A sweeping victory for Prime Minister Najib Razak's political allies within the United Malays National Organisation (UMNO) following the latest party election suggests that we could see further progress on fiscal reforms in 2014. We have also upgraded Malaysia's shortterm political risk rating (STPR) to reflect our view of increased policy continuity on the back of the vote outcome.

Table: POLITICAL OVERVIEW

Long-Term Political Outlook

Race Relations Still Cloud The Horizon

Malaysia's ethnic diversity will continue to influence domestic politics, and the rise of a stronger opposition presents myriad possibilities in the political arena over the longer term.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Private Sector Investment In Oil And Gas A Boon For The Economy

We believe that the Malaysian government's push to boost private sector investment in the oil and gas sector will be highly positive for the economy. We expect investment in the oil and gas sector to not only attract greater foreign direct investment (FDI) inflows into downstream industries and other related sectors, but also to generate high-skilled jobs that could potentially reverse the exodus of skilled workers from Malaysia into neighbouring countries.

Table: ECONOMIC ACTIVITY

Monetary Policy

Price Hikes Not A Concern For BNM

We maintain our view that policy-driven spikes in headline consumer price inflation (CPI) are likely to be transitory in nature, and not a reflection of underlying price pressures in the economy. We expect inflationary pressures to be kept in check by cooling money supply growth, declining global grain prices, and subdued regional economic growth. In terms of monetary policy, we see Bank Negara Malaysia (BNM) keeping its policy rate on hold at 3.00% throughout 2014.

Table: MONETARY POLICY

Exchange Rate Forecast

MYR: On A Mild Appreciatory Trend

Table: CURRENCY FORECAST

Table: CURRENT ACCOUNT

Fiscal Policy

2014 Budget: A Step In The Right Direction

We view the newly-announced budget for 2014 as a decisive step by Malaysian policymakers to bring the country's fiscal accounts back in order. Crucially, we expect the implementation of the 6.0% GST, which will take effect in April 2015, to play a major role in boosting tax revenues. We forecast the budget deficit to narrow from 4.9% of GDP in 2013 to 1.0% by 2017.

Table: Highlights Of The 2014 Budget

Table: FISCAL POLICY

CHAPTER 3: 10-YEAR FORECAST

The Malaysian Economy to 2023

Investment-Driven Growth In The 2010s

We expect Malaysia to register a long-term average growth rate of 4.1% between 2013 and 2022, driven by stronger private consumption owing to rising wealth levels and boosted by higher investment growth in earlier years. A greater reliance on domestic demand should see the external sector playing a smaller role in contributing to overall economic expansion.

Table: Long-Term Macroeconomic Forecasts

CHAPTER 4: BUSINESS ENVIRONMENT

SWOT Analysis

BMI Business Environment Risk Ratings

Business Environment Outlook

Table: BMI Business And Operation Risk Ratings

Table: BMI Legal Framework Rating
Infrastructure

Table: Labour Force Quality

Table: ASIA – ANNUAL FDI INFLOWS

Table: Trade And Investment Ratings

Market Orientation

Table: Top Export Destinations (US\$m)

Operational Risk

CHAPTER 5: KEY SECTORS

Autos

BMI Industry View

Table: Autos Production, 2010-2017

Table: Autos Sales, 2010-2017

Food

Table: Food Consumption Indicators – Historical Data & Forecasts, 2011-2017

Drink

Table: Hot Drinks Value/Volume Sales – Historical Data & Forecasts, 2010-2017

Table: Mass Grocery Retail Sales By Format – Historical Data & Forecasts, 2010-2017

Other Key Sectors

Table: Oil and Gas Sector Key Indicators

Table: Pharma Sector Key Indicators

Table: Freight Key Indicators

Table: Defence and Security Sector Key Indicators

Table: Infrastructure Sector Key Indicators

Table: Telecoms Sector Key Indicators

CHAPTER 6: BMI GLOBAL ASSUMPTIONS

Global Outlook

Momentum To Continue In H114

Table: Global Assumptions

Table: Developed States, Real GDP Growth, %

Table: BMI VERSUS BLOOMBERG CONSENSUS REAL GDP GROWTH
FORECASTS, %

Table: Emerging Markets, Real GDP Growth, %

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