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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

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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.

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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.

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