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Malaysia Business Forecast Report Q4 2014

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Abstracts

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Core Views

Malaysia's economy continues to post strong domestic demand-led expansion, and we remain confident that the ongoing reform efforts and the economic transformation programme will continue to support strong medium-term growth. We forecast real GDP to grow by 4.5% in 2014, slightly below consensus estimates of 5.1%, as we expect weakening Chinese import demand and cooling domestic liquidity conditions to undermine external and domestic demand respectively. Malaysia's fiscal deficit came in at 3.9% of GDP in 2013, the lowest level since 2007, thanks to large subsidy reductions. We expect the deficit to narrow further in 2014 to 3.6% of GDP, and believe that the government's aim of returning the country to a long-overdue budget balance by 2020 is very much on track. BNM held its benchmark interest rate at 3.0% at its May monetary policy meeting, in line with broad-based expectations for no change in borrowing costs. Consensus expectations, however, are heavily biased in favour of a H214 hike, which we do not expect to see. While we acknowledge that consumer price inflation is slightly elevated, coming in at 3.5% y-o-y in March, making real interest rates negative, more forward-looking indicators suggest that inflationary pressures will subside over the coming months and quarters.

A bullish technical picture, cheap valuations, rising real interest rates and strong real GDP growth should all contribute to an appreciating ringgit over the coming quarters. We continue to forecast the ringgit to appreciate to MYR3.1100/USD by end-2014 and MYR2.9500/ USD by end-2015. Given our broad-based bullish view on the US dollar, though, we continue to see MYR gains being greatest against non-USD developed market FX.

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The debate over the possible introduction of Hudud law in Malaysia's Kelantan state continues to rage on, stoking tensions between political parties as well as Muslim and non-Muslim voters. The Hudud debate is likely to see the politicisation of Islam rise over the coming years in the lead up to the general election in 2018 as the ruling UMNO (United Malays National Organisation) and opposition PAS (Pan-Malaysian Islamic Party) compete for the Muslim vote.

Major Forecast Changes

We have not made any significant changes to our forecasts since the Q314 Business Forecast Report. We continue to see real GDP growth easing yet remaining strong, waning inflationary pressures, a narrowing current account deficit, further fiscal consolidation, and a strengthening currency over the coming quarters.

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liquidity conditions to undermine external and domestic demand respectively.

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Budget On Track To Meet Targets

Malaysia's fiscal deficit came in at 3.9% of GDP in 2013, the lowest level since 2007, thanks to large subsidy reductions. We expect the deficit to narrow further in 2014 to 3.6% of GDP, and believe that the government's aim of returning the country to a long-overdue budget balance by 2020 is very much on track.

Table: Fiscal Policy

Monetary Policy

BNM Holds, More Of The Same To Come

Bank Negara Malaysia's decision to hold fire on interest rate hikes at its May meeting was in line with expectations, and we maintain that rate hikes will be put off until 2015. Collapsing money supply growth and a stabilising property market support our view, while bond yields are showing signs of topping out, which would suggests broad-based expectations of a H214 hike will not be forthcoming.

Table: Monetary Policy

Exchange Rate Policy

MYR: No End In Sight To Bull Market

A bullish technical picture, cheap valuations, rising real interest rates and strong real GDP growth should all contribute to an appreciating ringgit over the coming quarters. We continue to forecast the ringgit to appreciate to MYR3.1100/USD by end-2014 and MYR2.9500/USD by end-2015. Given our broad-based bullish view on the US dollar, though, we continue to see MYR gains being greatest against non-USD developed market FX.

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Taking Further Steps To Support Export Growth

The Malaysian government continues to take steps forward to improve the country's business environment, and in particular to increase openness to international trade. Malaysia is one of the most open economies in the world, both in terms of exports as a share of GDP, and its 'market orientation' component in our Business Environment Ratings. We believe continued progress on this front bodes well for real GDP growth over the coming years.

Table: Current Account

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The Malaysian Economy To 2023
Productivity Gains To Support 4.0% Real Growth
Owing to strong demographic trends, a continually improving business environment, and further ASEAN economic integration, we see
Malaysian real GDP seeing a compound annual average growth rate of 4.0% (8.3% in nominal US dollar terms) over the next decade.
While this is slightly below the 4.3% (10.5% in nominal US dollar terms) rate seen over the past decade, this largely reflects lower
growth in the working age population, while labour productivity growth is set to rise. The lofty level of household debt, and uncertainty
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