MEDIA STATEMENT
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A peek into 2013 – Reality (still) bites

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Kuala Lumpur, 20 November 2012 - The global economy is likely to be on a stronger footing in 2013, even if any improvement may prove to be limited and with plenty of downside risks weighing on global growth. According to the IMF, the global economy is likely to chalk a 3.6% expansion in 2013, just slightly above the 3.3% estimated for this year but below the 3.8% seen in 2011 or the 5.1% seen in 2010. On broad expectations, the world is still going to be highlighted by a lacklustre US economy, a struggling Eurozone and a still solid EM-Asia driven by the sustained growth that we continue to pencil in for China. Specifically for Malaysia, expect to see growth at 5.2% yoy in 2013, just a notch above our current estimate of 5.1%, as the economy is likely to remain strongly supported by its domestic demand.

A key assumption in our scenario is the ability of the US government to get a new deal to avoid the so-called fiscal cliff at the start of 2013. According to several estimates, including a projection done by the US Congressional Budget Office (CBO), the US economy will contract by 0.5% in 2013 if the fiscal cliff sets in. This is likely to drag the global economy into another recession, given the significant spillover effects from a contraction in the US economy to the global economy as a whole. At this juncture, we think that the risk to this scenario is still limited, as we expect the new US government to finalise a new deal even if this may happen only at the eleventh hour. While no sharp improvement is likely to be seen in the labour market, recent encouraging development from the US housing market is likely to support domestic sentiment in 2013 and provide a lift towards its economic recovery. That said, the ongoing deleveraging process still evident in both corporate USA and among US households is likely to mean that the economy would still grow at a pace that is just slightly lower than its long-term 2.5-3% trend.

In Europe, the uncertainties in the peripheral Eurozone countries are likely to remain the main drag to the region's growth prospect, especially since we have also seen several of the core EU economies ramping up their own austerity programmes. Several key elections will be held in the Eurozone next year, starting with Italy in April and Germany in September, both of which would have marked impacts on the respective economy's performance in 2013. Both Italy and Spain are likely to continue seeing negative growth next year, amidst the strict austerity measures that are aimed at boosting productive growth. Even Germany is likely to see growth hovering below 1%, as domestic consumption continues to get stifled by the poor outlook of regional economic growth.

As for China, despite increasing concerns of a possible hard-landing in the economy, we remain optimistic with regards to the Chinese growth prospects going into 2013. We have been seeing some encouraging signs that suggest a free-fall is likely to be avoided, particularly considering that China still has ample room for fiscal stimulus and that the new leaders are unlikely to shy from using this when necessary. Looking further ahead, with a large-scale urbanisation likely to take place in the country, we expect fiscal expenditure on infrastructure projects to remain strong going forward, providing the underlying support to domestic growth momentum. At this juncture, we think that China will post 8.1% growth in 2013.

Against this backdrop, we maintain our 2013 GDP growth forecast for Malaysia at 5.2% yoy (as compared to our current projection for 2012 GDP growth forecast at 5.1% yoy), although we have certainly turned more positive on our assessment of the economy at least in the 4-6 quarter horizon amidst what we see as strong positive momentum in private consumption growth, which has been increasingly a strong pillar in the country. It is important to note that we are unlikely to see investment growth running at above 20% yoy in 2013, but we still look for investment to expand by close to double-digit, at least in H1-2013, as the government is expected to continue ramping up the infrastructure overhaul, currently in progress.

On inflation, we note Malaysia's inflation has been among the lowest in Asia in 2012. One main reason is that the country has one of the longest lists of administered prices. Additionally, import prices have been trending down rather sharply this year, driven by a combination of base effects and the outperformance of the MYR earlier this year. The relatively low inflation trend currently witnessed in the economy continues to provide the authorities with some room to tweak its monetary policy, but we expect this option to only be explored in the case that we see stronger evidence of further slowdown in global demand, which would be contrary to our baseline scenario going into 2013. As it is, we are also of the opinion that inflation should return to about 3% in 2013 (from likely below 2% this year), a level that is more in sync with Malaysia's medium-term inflation trend.

The main risk to our projection is the possible slump of global demand, especially noting the fact that exports remain a main drag to Malaysia's growth in 2012. A quick look on Malaysia's recent growth drivers would clearly show that the external demand has continued to be a large drag to the economy, and in fact, we note that both in terms of nominal value and its contribution to GDP growth, net exports are at a record low in Q3 2012. Exports growth has been sluggish throughout the year, partly on the back of commodity price correction, and falling exports earnings will not only affect growth directly but will have negative spillover effects to households' spending behaviour. Additionally, we may see further pressure from the recent slump in CPO prices, which could be quite detrimental given that the commodity boom seen in the past several years has led to a spike in investment in palm oil related industries.

As for implication on the FX market, we note that global risk appetite remains fairly elevated despite the still gloomy global economic picture. This improvement in risk appetite has been partly caused by the injection of liquidity into the global financial system by the major central banks in the world, including the Fed, the BOJ and the ECB. With risk appetite back in the picture and some signs that global economic conditions have somewhat stabilised, we may see a broad "sell-USD" theme dominating global markets going forward although we remain very much cautious of headline news stemming from the Eurozone. Specifically for Asia, we note that Asian currencies have been implicitly supported by a pick up in portfolio inflows in recent months while the trade balance of the region remains in the surplus as a whole. This is exactly the case that we have been witnessing for Malaysia and we expect portfolio flows to remain largely supportive for the MYR in 2013, with our current forecast pencilling the USD-MYR at 2.9511 at the end of 2013.

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