MEDIA STATEMENT
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Malaysian Domestic Economy Remains Robust Despite Downgrading Of GDP Forecast


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Kuala Lumpur, 24 June 2013 - Global growth prospects for 2013 have been shaded down since the start of the year, amid concerns of a more subdued recovery in the US and Chinese economies, despite risks of a systemic financial market meltdown having subsided. Global GDP growth is likely to average around 3-3.5% this year, which is not much of an improvement compared to 2012 and, more importantly, still some distance away from the 4.8% average in the 5-year period before the onset of the 2008 Great Financial Crisis. Malaysia's growth prospects have also come under pressure, with Q1 performance missing market expectations. Therefore, we have also downgraded our 2013 GDP forecast for the Malaysian economy to 5.0% yoy from 5.4% previously.

The path of recovery looks to be more divergent than ever among the developed economies. While financial markets have stabilised in the Eurozone and risks of another sovereign default in the region are significantly lower compared to six months ago, the real economy remains in the doldrums, with record high unemployment still weighing on any probability of a quick turnaround story. Encouragingly though, Eurozone officials seemed to be slightly less aggressive in pushing for tight fiscal austerity measures to be adopted in the peripheral member countries, and this should provide some near-term support for the region as a whole.

The picture is brighter in both the US and Japan. Sustained recovery in the US housing market has continued to bolster both consumer confidence and domestic spending in the economy, offsetting the drag created by the automatic budget cuts that kicked in earlier this year. The US job market has shown an improvement, with nonfarm payrolls returning to pre-2008 levels while the unemployment level has also recovered to early 2009 levels. However, financial markets are now speculating about the possibility for the US Federal Reserve to taper its Quantitative Easing (QE3) programme before the end of the year, as part of its exit strategy from its very accommodative monetary policy stance. In Japan, while the 3-arrow Abenomics is not in full throttle as yet, early signs from the economy have been positive particularly considering the authorities' strong commitment to sustain its aggressive monetary expansion to reach their 2% inflation target.

For China, however, views remain very divided amidst mixed economic signals. The new leadership has signalled its comfort with a slower growth environment, which suggests that aggressive stimulus measures are unwarranted. As the global economy adjusts to a Chinese economy that will grow around the 7-8 percent handle instead of the pre-crisis double-digit, the region will also have to taper its expectations for China to be the key demand engine in the near-term. What is encouraging is that the Chinese government has shown its commitment to market-based reform, especially reforms in the areas of taxation, financial system, investment, resource pricing, social security and urbanization.

In Malaysia, the domestic economy has remained robust so far this year. Investment growth continued to be strong, at 13.2% yoy in Q1 2013, supported by strong growth in both private and public investment at 10.9% yoy and 17.3% yoy. Despite earlier concerns that political uncertainties might have weighed on investment growth in the country, the Q1 GDP data indicated that Malaysia's longer-term growth potential has been the more important driving factor of domestic growth. The government's commitment to deliver the targets embedded in the Economic Transformation Program remains firmly in place, and we expect the frontloading of infrastructure projects to sustain economic growth towards the year-end. This is also evident from the fact that monthly data of capital good imports continue to suggest sustained demand for infrastructure-related goods. It is also imperative to note that the spillover impact from Malaysia's investment growth (since 2012) would continue be the underlying support for private consumption, whose growth is likely to sustain at more than 7.5% this year.

Not surprisingly, export growth remains lacklustre so far in H1 2013 as demand for manufacturing exports remained weak. In addition, global commodity prices have hit another soft patch in Q2 2013. Malaysia's trade balance hit a 16-year low of MYR 0.9bn in April 2013, highlighting the sharp divergence between the domestic vis-a-vis the external economic momentum. We expect the drag from export growth to persist in H2 2013, given that a significant turnaround in global economy is still unlikely to occur while pressure on global commodity prices may persist especially if concerns over China's growth prospects continue to persist going forward.

Inflationary pressures have ticked up in H1 2013 but at a slower pace from what we had expected earlier this year. A combination of low base effects, rising prices and supply-side pressures from rising wages is likely to mean that inflation will inch back towards 3% at the year-end, although this is still within the official comfort zone. Coupled with the fact that growth momentum has slowed this year, we expect the authorities to maintain its benchmark OPR steady for the rest of the year. That said, it is interesting to note that financial conditions have continued to tighten in the Malaysian economy, driven largely by the relative outperformance of the MYR since the latter half of last year. The implicit tolerance of a strong MYR has been partly driven by the need to support domestic demand, particularly to bolster investment growth in the economy. This means that there is some potential room for the authorities to provide some monetary stimulus on the currency front, particularly considering the downside risks to growth stemming from the lacklustre external demand.

Specifically on the direction of the MYR itself, the possibility of a widespread USD strength amidst the anticipated QE3 tapering by the US Fed is likely to be the dominant factor that will dictate global currency markets towards the year-end. Market movements may remain volatile as policy uncertainties loom at this juncture, as already witnessed in the first 2 weeks of June. Considering the fact that the QE3 tapering prospect is highly dependent on data from the US in the coming couple of months, financial markets could remain on tenterhooks until there is greater clarity as to the Fed's exit strategy. Of late, we have been penciling in a widespread USD strength in our FX forecasts and at this juncture, we think that the USD-MYR may remain supported above 3.1000 at year-end.

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