ECONOMICS

Malaysia

BNM Annual Report 2015

No major surprise

Bank Negara Malaysia (BNM) released its Annual Report 2015. There was no major surprise as the real GDP growth forecast was earlier revised to 4.0%-4.5% from 4.0%-5.0% previously following the Budget 2016 recalibration on 28 Jan 2016. The next key item on BNM calendar of event is PM's announcement of the successor to the retiring Governor Tan Sri Dr Zeti Aziz.

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Key Highlights & Takeaways…

Detailing the earlier revised real GDP growth forecast. The expected slower economic growth this year largely reflects the moderation in domestic demand (2016E: 4.0%; 2015: 5.1%) on deceleration in private consumption (2016E: 5.1%; 2015: 6.0%), public consumption (2016E: 2.0%; 2015: 4.3%) and private investment (2016E: 5.5%; 2015: 6.4%) which offset the projected rebound in public investment (2016E: 1.1%; 2015: -1.0%). At the same time, BNM sees firmer growth this year for the exports (2016E: 3.2%; 2015: 0.7%) and imports (2016E: 3.4%; 2015: 1.3%) of goods and services.

Monetary policy stance is currently appropriate according to BNM, suggesting no imminent change in the Overnight Policy Rate (OPR) despite the current trend of monetary policy easing and stimulus globally.

MYR to remain volatile despite recent gains. USDMYR breached 4.00 mark to close at 3.9930 yesterday. The last time USDMYR closed at sub-4.00 was on 11 Aug 2015 at 3.9735. YTD, MYR has appreciated 7.5% against USD (2015: -18.5%). Nonetheless, BNM expect MYR to stay volatile and noted that MYR's volatility has increased and remain elevated since Sep 2014.

The composition of Malaysian Government bonds' foreign investors was revealed for the first time. As at Jan 2016, 44% of non-resident holdings of Malaysian Government bonds were by asset managers, followed by central banks / governments (29%), pension funds (13%), banks (10%), insurance companies (1%), nominees / custodians (1%) and others (1%). From now on, such data will be published on quarterly basis.

Downside risks and upside surprises. Downside risks include China; volatility in key commodity prices; swings in liquidity and capital flows; and spillover from uncertainty and volatility in global economic and financial markets onto regional and domestic economies, financial markets, currencies. Meanwhile, possible upside surprises include better than expected growth in US, EU and China as well as commodity prices benefiting Malaysia's diversified exports and faster than expected turn around in consumer sentiment leading to them loosening their purse to result in stronger than projected private consumption growth.

SEE PAGE 9 FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS

Details on key official macroeconomic forecasts

BNM Annual Report 2015 provides details on the official real GDP growth forecast that was earlier revised to 4.0%-4.5% from 4.0%-4.5% - but minus the details – following the Budget 2016 recalibration announced on 28 Jan 2016 that was due to the lowering of the official crude oil price assumption to USD30-35/bbl versus USD48/bbl used for the original Budget 2016 tabled at the Parliament in Oct 2015.

Malaysia: Real GDP

% chg	ACTUAL		MAYBANK KE	OFFICIAL	
	2014	2015	2016E	2016E Revised	2016E Previous
Real GDP	**6.0**	**5.0**	**4.3**	**4.0-4.5**	**4.0-4.5**
Manufacturing	6.2	4.9	4.3	4.1	4.3
Services	6.5	5.1	5.0	4.4	5.4
Agriculture	2.1	1.0	(0.5)	(0.3)	1.3
Mining	3.3	4.7	1.0	3.5	4.0
Construction	11.8	8.2	7.3	7.9	8.4
Domestic Demand	5.9	5.1	4.0	4.3	5.5
Private Consumption	7.0	6.0	5.1	5.1	6.4
Public Consumption	4.4	4.3	(0.8)	2.0	3.0
Gross Fixed Capital Formation	4.8	3.7	4.2	3.9	5.1
Private Investment	11.0	6.4	4.9	5.5	6.7
Public Investment	(4.9)	(1.0)	2.8	1.1	2.3
Net External Demand	12.8	(3.7)	(2.2)	1.1	(4.4)
Exports of Goods & Services	5.1	0.7	2.4	3.2	0.9
Imports of Goods & Services	4.2	1.3	3.1	3.4	1.5

Sources: Dept. of Statistics, BNM(Annual Report 2015, Budget 2016 Recalibration, MoF Economic Report 2015/2016), Maybank KE

Malaysia: Other Key Economic Indicators

	ACTUAL		MAYBANK KE	OFFICIAL	
	2015	2016 To-Date	2016E	2016E Revised	2016E Previous
Gross Exports (% chg)	1.9	(2.8) (Jan)	3.4	2.4	1.4
Gross Imports (% chg)	0.4	3.3 (Jan)	3.9	4.9	3.3
Trade Balance (RMb)	94.6	5.4 (Jan)	93.8	79.5	73.2
Current Account Balance (RMb)	34.0	-	31.8	19.1	11.3
Current Account Balance (% of GDP)	2.9	-	2.6	1.6	0.5-1.5
Fiscal Balance (% of GDP)	(3.2)	-	(3.1)	(3.2)	(3.1)
Inflation Rate (CPI, %)	2.1	3.5 (Jan)	3.0-3.5	2.5-3.5	2.0-3.0
Overnight Policy Rate (% p.a., end-period)	3.25	3.25	3.00-3.25	-	-
Exchange Rate (RM/USD, end-period)	4.39	3.99 (23 Mar)	4.10	-	-
Exchange Rate (RM/USD, average)	3.91	4.21	4.15	4.30	4.22
Unemployment Rate (%)	3.1	-	3.3-3.4	3.3-3.5	2.9
Crude Oil (USD/bbl, Brent average)	52	34	35	30-35	48
Crude Palm Oil (RM/tonne, average)	2,139	2,396	2,300	2,300	2,300

Sources: Bloomberg, Dept. of Statistics, BNM Annual Report 2015, Budget 2016 Recalibration, MoF Economic Report 2015/2016, EPU, Maybank KE, Maybank FX Research

The narratives on growth are broadly in-line with our and street views. The expected slower economic growth this year largely reflects the moderation in domestic demand (2016E: 4.0%; 2015: 5.1%) on deceleration in private consumption (2016E: 5.1%; 2015: 6.0%), public consumption (2016E: 2.0%; 2015: 4.3%) and private investment (2016E: 5.5%; 2015: 6.4%) which offset the projected rebound in public investment (2016E: 1.1%; 2015: -1.0%). At the same time, BNM sees firmer growth this year for the exports (2016E: 3.2%; 2015: 0.7%) and imports (2016E: 3.4%; 2015: 1.3%) of goods and services.

Consumers and businesses are still adjusting to policies and uncertainties, hence the slower growth in consumer spending against its long-term average and less buoyant business investment growth compared with the past five years (2011-2015: 12.2% p.a.).

GST effect on consumer spending still lingers with added headwinds from faster inflation rate (2016E: 2.5%-3.5%; 2015: 2.1%) due to impact of on-going subsidy rationalization; recent hikes in administered prices, namely in transportation costs such as intra-city highway toll rates and rail fares; as well as higher costs of imported finished goods, intermediate products and raw materials due to the MYR factor.

In addition, there is also the somewhat softer job market condition as unemployment rate is expected to rise (2016: 3.3%-3.5%; 2015: 3.2%) and wage growth to ease (2016E: 5.5%; 2016: 5.7%), based on the Malaysian Employers Federation (MEF) annual salary growth survey.

Offsetting these moderating effect on consumer spending are measures to boost disposable income and ease cost of living pressures, namely the 3 percentage points cut in employees' contribution to the Employees Provident Fund (EPF); the increases in Minimum Wage and civil servant salary effective 1 July 2016; as well as higher Bantuan Rakyat 1Malaysia (BR1M) cash transfers (2016: MYR5.9b; 2015: MYR5.2b) and additional personal income tax relief of RMYR2,000 for the lower income groups.

Private investment growth is moderating amid the uncertain operating environment, cautious business sentiment, sector-specific factors and policy changes, especially that on labour market. Lower commodity prices affect capital expenditure in the upstream mining sector – specifically the oil & gas sector in reaction to the earlier slump in crude oil price. Businesses also have to adjust to higher costs reflecting impact of subsidy rationalization (e.g. increase in gas prices) and hikes foreign workers' levies and in Minimum Wage. The slower growth projection is on implementation of on-going and new investment projects in manufacturing and services sector, mainly reflecting capacity expansion in export-oriented manufacturing industries like E&E and petrochemicals, and in services industries like tourism, transportation, healthcare and telecommunications, on top of automation to increase cost and operating efficiency as well as productivity.

Budget 2016 recalibration affect mainly Government consumption expenditure, on account of the lower operating expenditure than originally budgeted, especially outlays on supply and services, although BNM expects it to still expand albeit at slower pace on continued expansion in emoluments.

Public investment is forecast to rebound this year after two years of contractions. This is despite the Federal Government lowering its development expenditure allocation under the recalibrated Budget 2016 as the revised development expenditure budget is still higher than the actual spending in 2015. Furthermore, total public sector fixed asset investment will also be driven by public corporations' capex, especially in key infrastructure projects in sectors like public transportation, utilities and downstream oil and gas.

Malaysia: Budget Details (MYRb)

	2015 Estimate	2016 Original	2016 Revised	2016 Revised
Crude oil price assumption	*USD52/bbl*	*USD48/bbl*	*USD35/bbl*	*USD30/bbl*
Revenues (R)	219.1	225.7	217.9	216.3
Expenditure (OE + GDE)	257.8	265.2	257.2	255.7
Operating Expenditure (OE)	217.0	215.2	211.2	210.7
Current Budget Balance (R-OE)	2.1	10.4	6.7	5.6
Gross Development Expenditure (GDE)	40.8	50.0	46.0	45.0
Loans Recoveries (LR)	(1.5)	(0.8)	(0.8)	(0.8)
Net Development Expenditure (NDE=GDE+LR)	39.3	49.2	45.2	44.2
Overall Budget Balance (R-OE-NDE)	(37.2)	(38.8)	(38.5)	(38.7)
% of GDP	(3.2)	(3.1)	(3.1)	(3.1)

Source: MoF

Net external demand (2016E: 1.1%; 2015: -3.7%) is going to be accretive to GDP growth on firmer growth in exports and imports of goods and services, assuming the pick up in global economic growth as per the latest IMF projection (2016E: 3.4%; 2015: 3.1%).

Trade surplus, while sustained, will be narrower (2016E: +MYR79.5b; 2015: +94.6b) despite faster growth in both gross exports (2016E: 2.4%; 2015: 1.9%) and gross imports (2016E: 4.9%; 2015: 0.4%) as the former trails the latter. Gross export growth this year will be driven by manufacturing exports (2016E: 5.6%; 2015: 6.5%) amid continued drop the exports of agriculture (2016E: -3.8%; 2015: -2.7%) and minerals (2016E: -17.0%; 2015: -20.6%). The expansion in gross imports will be broad-based as all components are projected to rise after a mixed performance last year i.e. intermediate goods (2016E: 4.7%; 2015: -2.3%), capital goods (2016E: 8.9%; 2015: 0.0%) and consumption goods (2016E: 3.0%; 2015: 24.1%).

In tandem with the projected sustained but narrower trade surplus, current account surplus is also forecast to be maintained but smaller (2016E: +MYR19.1b or 1.6% of GDP; 2015: +MYR34.0b or 2.9% of GDP). Meanwhile, the services account of the current account balance is projected to post a smaller deficit (2016E: -MYR19.2b; 2015: -MYR20.5b), premised on improvement in tourist arrivals and spending, particularly with the easing of travel requirements for tourist from China as well as the introduction of e-Visa for tourists form selected countries. However, the income account is expected to register larger deficit (2016E: -MYR61.1b; 2015: -MYR54.4b) as profits from Malaysian companies' overseas investment are expected to be lower, mainly due to lower oil & gas companies' income which account for over one-third of Malaysia's investment income abroad. In addition, outward remittances by foreign workers in Malaysia are expected to be higher.

Other highlights & key takeaways…

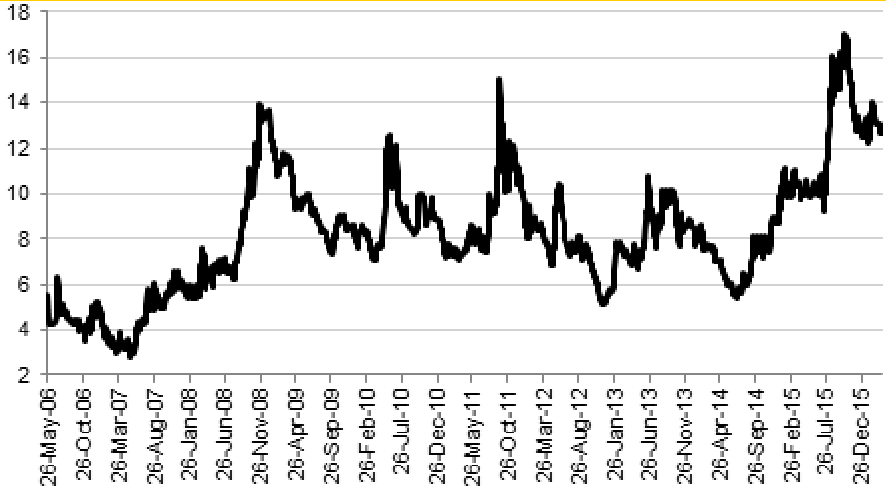
Monetary policy stance is currently appropriate according to BNM, suggesting no imminent change in the Overnight Policy Rate (OPR) despite the current trend of monetary policy easing and stimulus globally. At the same time, BNM is not expected to reverse the macroprudential and banking measures put in place previously to deal with the household debt issue, despite the fact that reference to the risk of financial imbalances has been removed from the Monetray Policy Statement (MPS). While the 3.25% OPR is currently seen as accommodative and supportive of economic activities, the latest Monetary Policy Statement (MPS) sounded "dovish" in our opinion, thus leaving the option open for OPR adjustment if needs be. We are penciling in a range forecast of 3.00%-3.25% for OPR this year. A 25bps OPR cut in 2H 2016 is possible if growth threatens to slip below what we believe to be BNM's comfort zone of 4%-6%. Latest inflation rate of 3.5% YoY as of Jan 2016 is over what we deemed to be BNM's tolerance range of 2%-3%. Therefore OPR decision will ultimately be dependent on data that influence and determined the balance of risk between growth and inflation.

MYR to remain volatile despite recent appreciation. USDMYR breached 4.00 mark to close at 3.9930 yesterday. The last time USDMYR closed at sub-4.00 was on 11 Aug 2015 at 3.9735. YTD, MYR has appreciated 7.5% against USD (2015: -18.5%). Nonetheless, BNM expect MYR to stay volatile and noted that MYR's volatility has increased since Sep 2014 and remain elevated vis-à-vis pre-Global Financial Crisis (GFC) period and during GFC, Eurozone Sovereign Debt Crisis and Taper Tantrum. The official forecast for average USDMYR is 4.30 vs our expectation of 4.15 (2016 YTD: 4.21). Presently, our FX Research is also expecting a volatile path for USDMYR, looking at it to be at 4.10 at end-1Q 2016, 4.25 at end-2Q 2016, 3.90 at end-3Q 2015 and 4.10 at end-4Q 2015.

USDMYR

Source: Bloomberg

Average of USDMYR 1 to 12 Months Implied Volatility



Source: Bloomberg

GST collection was "good", according to BNM without mentioning any specific figure or for what period. Together with the current crude oil price level that is above the official forecast of USD30-35/bbl - if sustained, and the rollbacks in deadweight expenditures like subsidies, these augur well for the country's fiscal position, especially in terms of delivering continued fiscal consolidation. To recap, despite the Budget 2016 recalibration, the Government is sticking to its budget deficit target of -3.1% of GDP.

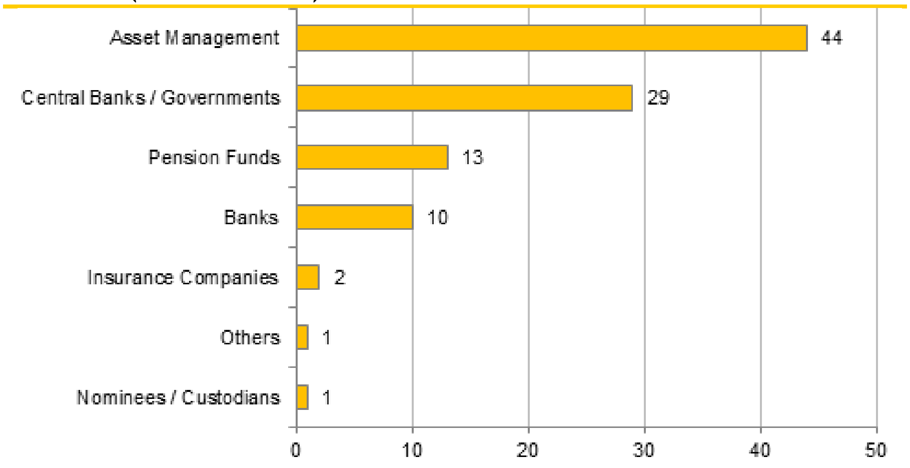
External balance sheet positions are manageable. On the asset side, BNM highlighted that while there has been a drop in external reserves throughout last year, it has stabilized and inched up so far this year. Furthermore, the official external reserves accounts for 25% of Malaysia's external assets totaling USD384.1b as of 2015, down from 59% (of USD118.74b total) in 2005, whereas the banks and non-bank corporates' external assets made up 75% of the country's external assets last year, up from 41% in 2005. This shift reflects liberalization of foreign exchange rules and means private sector have their own foreign exchange resources to meet their obligations.

The external debt structure are healthy in view of:

- Contained risks of currency fluctuations as 36% of the total MYR833.7b external debt are MYR-denominated and held by non-residents.
- External debt denominated in foreign currencies are lower now at 41.8% of GDP vs 60% of GDP back in 1998.
- Limited rollover risks as 57.8% are of mid-term to long-term tenures.
- Short-term external debt is mostly covered by short-term external assets. As at 2015, the former was MYR324.8b while the latter is MYR262b i.e. 80% cover
- Low debt service ratio of 22.6%.

Finally, data on the composition of foreign holders of Malaysian Government bonds. At the BNM Annual Report briefing, this was provided for the first time as per the chart below. As at Jan 2016, 44% of non-resident holdings of Malaysian Government bonds were by asset managers, followed by central banks / governments (29%), pension funds (13%), banks (10%), insurance companies (1%), nominees / custodians (1%) and others (1%). From now on, such data will be published on quarterly basis.

Composition of Foreign Holders of Malaysian Government Bonds as at end-Jan 2016 (% share of total)



Source: BNM

Four key downside risks to outlook mentioned in the Annual Report.

- **China's growth outlook** amid the challenges and vulnerabilities facing the necessary rebalancing in the transition to a more sustainable growth and development, such as high indebtedness and industrial excess capacity. China's rising importance in the global economy and extensive trade and financial linkages means a "harder/hard landing" will have significant spillover effects globally.

- **Uncertainty and volatility in key commodity prices** will affect the growth of commodity-exporting countries and disinflationary pressures in other economies.

- **Global financial market volatility and swings in liquidity and capital flows** impacting financial conditions and growth prospects. The volatility in financial markets and capital flows were evident the past two years as markets and investors react to monetary policy shifts in the advanced economies, reflecting the underlying fragility in the current phase of global growth cycle and the overall financial risk-taking driven by search for returns and yields.

- **Spillover from uncertainty and volatility in global economic and financial markets onto Asia's economies, financial markets, currencies.**

Meanwhile, possible upside surprises include better than expected growth in US, EU and China as well as commodity prices benefiting Malaysia's diversified exports and faster than expected turn around in consumer sentiment leading to them loosening their purse to result in stronger than projected private consumption growth.

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