

## Malaysia

UOB Economics Projections	2008	2009	2010F	2011F
GDP	4.6	-1.7	4.9	5.1
CPI (average, y/y)	5.4	0.6	2.3	3.6
Unemployment (end-4Q)	3.1	3.5	3.3	3.1
Current account (% of GDP)	17.5	16.7	16.6	15.9
Fiscal balance (FY, % of GDP)	-4.8	-7.4	-5.6	-4.5

- *Although China is expected to keep a tight rein on the USD/RMB in the near-term, there is still some scope for USD/MYR to trend lower to around 3.15 in the short-term. This level was last seen in 2Q08 and note that the USD/RMB was higher then. While the earlier-than-expected rate normalisation in Malaysia would continue to support MYR in the near-term, this advantage will diminish by 4Q10 when most other Asian central banks start to hike interest rates.*
- *The postponement of fuel subsidy restructuring in Malaysia meant that inflation rate could be potentially lower than expected and thus reduces the incentive for BNM to tighten rates aggressively in 2010.*
- *For the outstanding four policy meetings before the end of the year, we expect Bank Negara to proceed to raise interest rates by only another 50bps at its meetings in May and July to bring the OPR to 2.75% this year.*
- *We expect domestic demand to continue to underpin the growth recovery in Malaysia this year. Our 2010 GDP growth forecast remains unchanged at 4.9% with the y/y growth rate likely to peak in 1Q10 and moderate in the next three quarters. However, Malaysia's full-year growth could come in at the top of BNM's forecast range of 4.5%-5.5% should the current momentum be sustained.*

Improving risk sentiment and more hawkish central bank policy bolstered the MYR which rose 4.6% against USD in 1Q10. The MYR was the best performing currency in Asia during the quarter. Although China is expected to keep a tight rein on the USD/RMB in the near-term, there is still some scope for USD/MYR to trend lower to around 3.15 in the short-term. This level was last seen in 2Q08 and note that the USD/RMB was higher then. While the earlier-than-expected rate normalisation in Malaysia would continue to support MYR in 2Q10, this advantage will diminish by 4Q10 when most other Asian central banks start to hike interest rates. We expect Bank Negara to continue its rate hike into the next two meetings before pausing in September and November. Going forward, a move by US Federal Reserve to raise its target rate, possibly in the later part of this year, could see MYR reverse some of its gains against the USD. We are expecting the USD/MYR to end the year at around 3.20.

### **Benign Inflation Did Not Stop BNM From Normalising Rates**

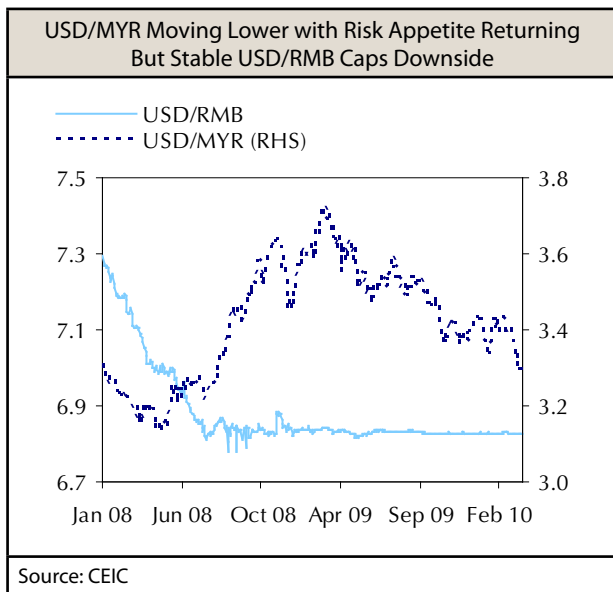
Headline inflation in the country has underperformed our expectation with January and February inflation rate averaging just 1.3%/y. Despite the benign domestic inflation outlook, Bank Negara hiked its benchmark

Overnight Policy Rate (OPR) by 25bps to 2.25% in March, making it the first central bank in Asia outside Australia to start normalising interest rates.

The move in March was a close call as the central bank dropped hints of a rate hike, yet domestic inflation and asset prices appeared to be relatively well-contained. The hike was made on the back of expected improvements in economic growth and moderate inflation, and was aimed at pre-empting imbalances in the market. The low base in 2H09 will result in higher inflation rates in the second half of the year and we foresee it trending above 2% y/y in 2Q10. For the full year, inflation will average around 2.3% vs 0.6% in 2009. The central bank forecast headline inflation at 2.0%-2.5% for 2010. This incorporates the probability of some increase in administered prices. Nonetheless, the country has already said that it will be shelving plans to restructure the fuel subsidy which was originally intended to take effect in May in order to lower Malaysia's subsidy costs. This meant potentially lower-than-expected inflation rate for the whole of the year and thus reduces the incentive for BNM to tighten rates aggressively in 2010. Although the government highlighted the review of its subsidies and consultation on GST implementation in its New Economic Model (NEM), there was no timeline given.

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Even as the BNM moved earlier than we have expected, the central bank's quantum of rate normalisation will likely be more moderate compared with other Asian countries where interest rates were slashed more deeply during the financial crisis. For the outstanding four policy meetings before the end of the year, we expect the central bank to proceed to raise interest rates by only another 50bps at its meetings in May and July to bring the OPR to 2.75% this year.



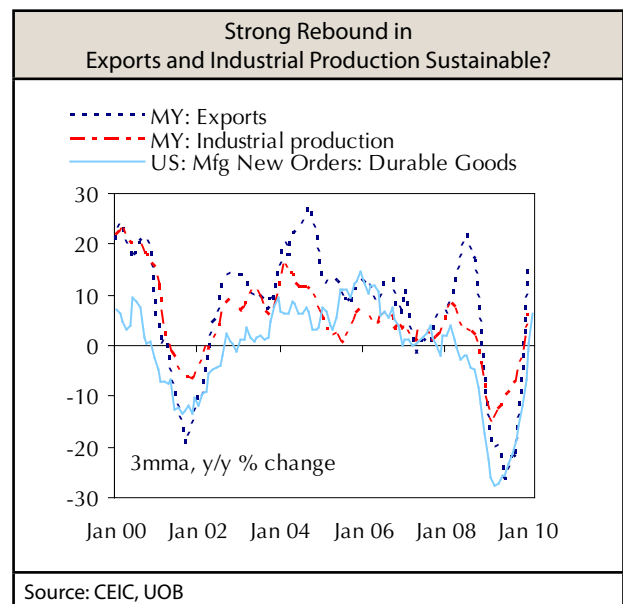
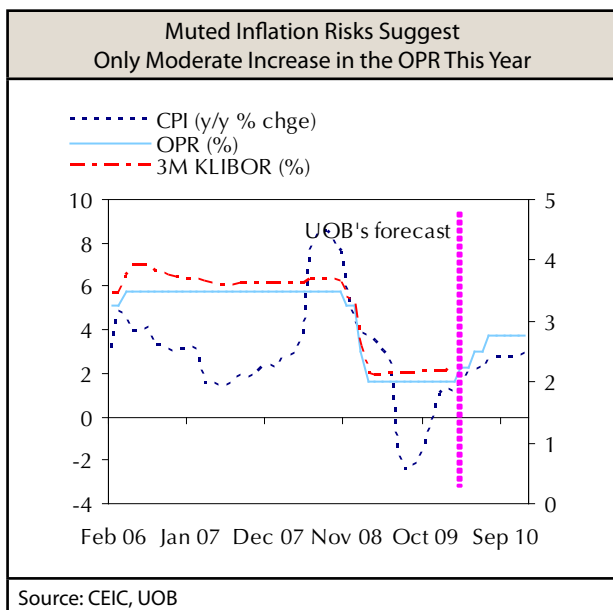
## Economic Outlook

The Malaysian economy sustained positive growth momentum for the third consecutive quarter in 4Q09. This was led by firm domestic demand, particularly from the increased in public sector spending. On a y/y basis, the

economy turned in a better-than-expected growth of 4.5% in 4Q09 after three preceding quarters of contraction. This brought the full year GDP contraction to -1.7% in 2009.

The buoyant industrial production and export data in the beginning of the year is expected to continue into the coming months. Malaysia's industrial production growth rebounded to 12.7%/y/y in January from 2.4% in 4Q09 and is likely to remain firm at least in the first half of the year due to a low base in the same period a year ago, even though the pace could ease somewhat to single-digit growth rate in the months ahead. Similarly, exports surged by 27.6%/y/y in the first two months this year vs 5.1%/y/y in 4Q09 and the double-digit expansion could be sustained until around 3Q10, aided also by the recovery in palm prices. As the recent surge in the industrial output and export growth were driven by low base effect and global inventory adjustment process, we would be careful about reading too much into the positive numbers. We are closely watching the nominal exports value which have recovered to 2007 levels. The slow improvement in external demand, particularly as US unemployment rate remains at prohibitably high levels, will be a key drag on the global recovery and therefore the prospects for export-dependent Asia. As such, we expect domestic demand to continue to underpin the growth recovery in Malaysia this year. Despite a lower planned budget deficit for this year, the implementation of projects under the second stimulus package will likely keep up public spending. The country's budget deficit is expected to narrow sharply to around 5.6% of GDP in 2010 from an estimated 7.4% in 2009.

In its annual report, Bank Negara has upgraded its 2010



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GDP growth forecast for Malaysia to 4.5%-5.5% from 2.0%-3.0%. Our forecast remains unchanged at 4.9% with the y/y growth rate likely to peak in 1Q10 and moderate in the next three quarters. However, Malaysia's full-year growth could come in at the top of BNM's forecast range should the current momentum be sustained. Going forward, the government's New Economic Model (NEM) which involved

divestments of government holdings in listed companies and a review of the affirmative action policies to focus on boosting income of the lowest 40% of households in Malaysia will help to rejuvenate the economy, but the success of which still lies in the implementation of the NEM. This will be closely watched when the country announces its 5-year economic plan starting in 2011.

Marked Recovery in 4Q09 GDP						
	2009	1Q09	2Q09	3Q09	4Q09	4Q09
	y/y % change					ppt cont
GDP	-1.7	-6.2	-3.9	-1.2	4.5	4.5
Consumption	1.4	-0.2	0.6	3.3	1.6	1.2
Public	3.7	2.1	1.0	10.9	1.3	0.2
Private	0.8	-0.7	0.5	1.5	1.7	0.9
GFCF	-5.5	-10.8	-9.6	-7.9	8.2	1.6
Change in stocks (as % of GDP)	-4.0	-12.3	-3.5	-1.1	-0.1	0.8
Net Exports	8.4	39.1	-0.7	-16.9	11.4	0.9
Exports	-10.1	-15.2	-17.3	-13.4	7.3	7.9
Imports	-12.5	-23.5	-19.7	-12.9	6.9	7.0

Source: CEIC, UOB