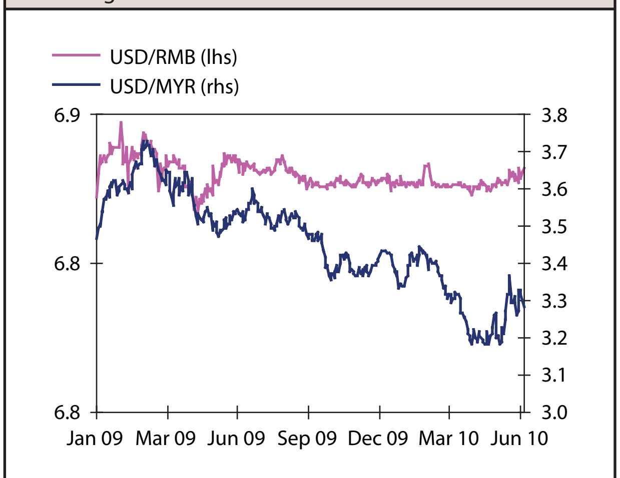
Malaysia

UOB Economic Projections	2008	2009	2010F	2011F
GDP	4.7	-1.7	6.1	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	16.5	16.8	15.9
Fiscal balance (FY, % of GDP)	-4.8	-7.0	-5.3	-4.5

- *On the back of our assumption that the RMB will appreciate by around 0.8% until year-end and factoring in uncertainties in the European markets, we could see USD/MYR at 3.18 by end-2010. That means MYR appreciation of 7.6% against USD for the year.*
- *BNM has hiked its Overnight Policy Rate (OPR) by a total of 50bps at two monetary policy meetings in March and May. Other than the expected spike in the inflation rate in 2H10, the improving domestic economic conditions augur well with another rate increase this year. We expect another 25bps rate hike in 3Q10 to bring the OPR to a neutral rate of around 2.75% before the central bank pauses for the rest of the year.*
- *Following the robust 1Q10 data, we have lifted our full-year growth forecast for Malaysia to 6.1% from 4.9%. This is in line with the government's forecast of 6.0% growth for 2010. The quarterly y/y GDP growth rate is likely to ease in the next three quarters as the base effect wanes off.*

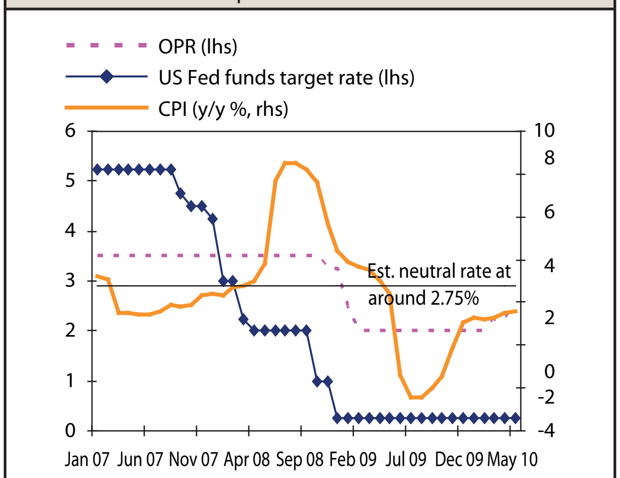
USD/MYR bounced higher after touching its 2-year low of 3.1810 in late-April, largely mirroring other USD/Asian pairs. However, despite the market turmoil triggered by the European debt woes, the MYR has remained positive against USD ytd throughout 2Q10. Expectation that Bank Negara will pause in its monetary normalization soon is unlikely to have much implication for the MYR but USD/RMB, which was largely flat since the start of the year, will probably drive the MYR for the months ahead as the PBoC formally announced its intention to resume its RMB exchange rate reform. However, any move by the PBoC is likely to be on a measured pace which means substantial gains in the MYR will not be sustainable especially since the currency has probably moved ahead of the other Asian currencies so far this year. On the back of our assumption that the RMB will appreciate by around 0.8% until year-end and factoring in uncertainties in the European markets, we could see USD/MYR at 3.18 by end-2010. That means MYR appreciation of 7.6% against USD for the year.

RMB is likely to drive MYR in 2H10 after remaining steady against USD since the Global Financial Crisis



Source: CEIC, UOB

We expect another 25bps rate hike in 3Q10 before the BNM pauses to take stock



Source: CEIC, UOB

Malaysia

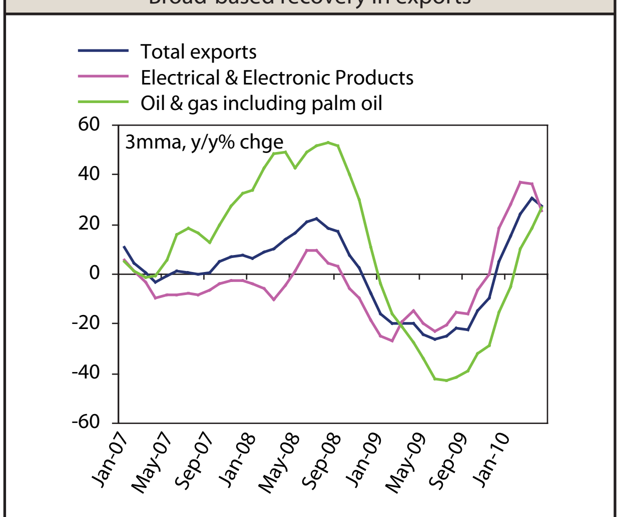
Inflation rate to accelerate in 2H10

On the inflation front, risks are well-contained with CPI rising by an average of 1.3%y/y in January-April. The stable inflation rate is also helped in part by the firm MYR. Nonetheless, the inflation rate is likely to accelerate substantially in 2H10 as a result of the base effect given that prices fell during 2H09. This should push the headline inflation to above 2%y/y by the beginning of 3Q10. Another risk stems from the government's plans to rationalize its subsidies, which is one of the highlights in the 10th Malaysia Plan (2011-2015). For this year, RON 95 price could be raised by 15sen/litre which represents 8.3% hike. The electricity tariff is also set to increase but the government estimated that around 56% of consumers will not be affected. Our full-year inflation forecast of 2.3% has factored in the impact of increase in administered prices although the timing of the increase has yet to be finalized.

Interest rate hike cycle: Nearing a pause

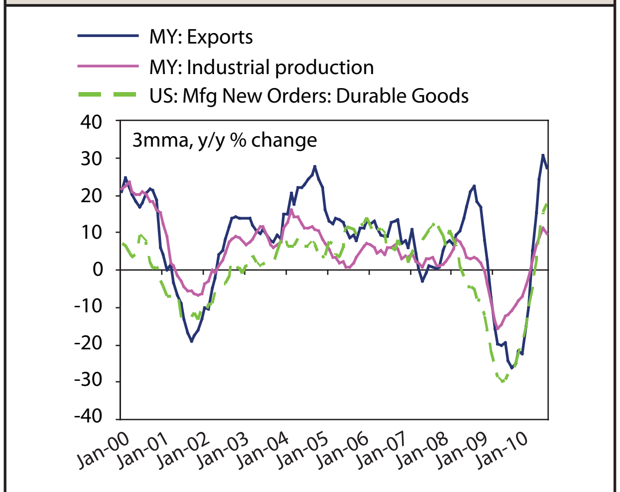
BNM has hiked its Overnight Policy Rate (OPR) by a total of 50bps at two monetary policy meetings in March and May. Other than the expected spike in the inflation rate in 2H10, the improving domestic economic conditions augur well with another rate increase this year. We expect another 25bps rate hike in 3Q10 to bring the OPR to a neutral rate of around 2.75% before the central bank pauses for the rest of the year. This would recover half of the 150bps rate cut during the financial crisis. There are two meetings (8 July and 2 September) scheduled in 3Q10. There is also a possibility that the central bank could push back further rate increase to November if we encounter market hiccups around the date of the monetary policy decision in July and September.

Broad-based recovery in exports



Source: CEIC, UOB

Exports and industrial production remain supported



Source: CEIC, UOB

Strong growth in 1Q10

Malaysia's 1Q10 GDP growth surged to 10.1%y/y from 4.4% in 4Q09. The GDP growth has rebounded strongly since the three consecutive quarters of y/y contraction in 1Q-3Q of 2009. This was partly driven by the low base effect. In 1Q10, the bulk of the headline growth was contributed by sharply lower inventory contraction as manufacturers became more optimistic about the growth outlook. Private consumption was also firmer, accounting for 2.9ppt of the growth rate in the quarter. As an indication of improving business sentiment, fixed investment rose for the second consecutive quarter, up 5.4%y/y in 1Q10. The strong exports performance in the quarter was led mainly by demand from China and other parts of Asia. However, net exports fell in 1Q10 as the imports recovery was sharper than exports.

Buoyant US manufacturing industries' durable goods orders which has a close correlation with Malaysia's exports and industrial output growth suggests that the country's manufacturing sector will remain firm in 2Q10. Beyond that, the softening European demand could start to be a drag on Malaysia's exports. The EU-16 market account for around 10% of Malaysia's exports, which is similar to that for US. Besides that, the rebound in private consumption and investment will help to offset the easing fiscal support in the coming quarters. For this year at least, we do not expect a significant dampening effect from the government's subsidy rationalization.

Following the robust 1Q10 data, we have lifted our full-year growth forecast for Malaysia to 6.1% from 4.9%. This is in line with the government's forecast of 6.0% growth for 2010. The quarterly y/y GDP growth rate is likely to ease in the next three quarters as the base effect wanes off.

Malaysia

Growth jumped to double-digit in 1Q10						
	2009	2Q09	3Q09	4Q09	1Q10	
	y/y % chge					ppt cont
GDP	-1.7	-3.9	-1.2	4.4	10.1	10.1
Consumption	1.2	0.6	2.9	1.4	5.4	3.6
Public	3.1	1.5	9.4	0.7	6.3	0.8
Private	0.7	0.3	1.3	1.6	5.1	2.9
GFCF	-5.6	-9.6	-7.9	8.2	5.4	1.1
Change in stocks (as % of GDP)	-2.7	-1.3	-0.2	-0.2	-1.8	8.0
Net exports	5.0	-6.7	-10.3	-4.7	-12.9	-2.7
Exports	-10.4	-17.9	-12.9	6.0	19.3	20.1
Imports	-12.3	-19.4	-13.2	7.0	27.5	22.8
Source: CEIC, UOB						