# Malaysia Economic Outlook 2015

## Another hole in the belt and more pennies to pinch

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## Summary


- **Moderate growth in 2015** – high base effect, GST implementation and a general weak global economy means a more moderate growth of 5.1% in 2015 from an expected 5.8% in 2014. Main contributors to growth will be from construction and some exports demand from the USA. By year-end however, rebound in other major economies will help boost exports.

- **Consumption pullback** – Inflation will be pressured by cost-push factors, mainly the GST. However, lower oil prices will help mitigate the effect though overall consumption is expected to moderate for most of the year.

- **Fiscal consolidation** – less likely to see any form of fiscal consolidation next year as petrol is now on a managed float system. This will make it easier to hit the budget deficit target of 3.0%. However, there is some revenue threat from the oil & gas revenue due to sharply lower crude oil prices.

- **Inflation to stay above LT average –** inflation is expected to be above the long term average, likely to average around 4.0% in 2015 due to cost-push factors from the GST implementation.

- **BNM to play passive role –** the central bank is likely to be a passive observer in 2015 amidst growing divergence of central banks' policy globally. However, there is a possibility of a hike at the very end of the year if the economy rebounds significantly enough.

- **Ringgit to trade weaker** – due to the strength of the US$, USDMYR is to average weaker in 2015 (around 3.43 average). However, with global recovery and a rebound from GST effects, the ringgit ought to perform better by year-end.

- **Risk to growth** – there are worries about the effects of the GST being more severe than expected (*ala*. Japan) as it is riddled with uncertainties. The global economy may also take longer than expected to recovery, prolonging weak growth.

**Kenanga Research Malaysia Macroeconomic Forecast Summary**

| | 2013 | 2014F | 2015F | Remarks |
|---|---|---|---|---|
| **GDP** (%YoY) | 4.7 | 5.8 | 5.1 | Consumption spike in the 1Q15 but moderate growth for the next 6 to 9 months due to acclimatizing period of the GST. |
| **CPI** (Average %YoY) | 2.1 | 3.3 | 4.0 | Inflation continues to be influenced by cost-push factors mainly due to the GST and the weaker ringgit but partly mitigated by lower oil prices. |
| **OPR** (%) End-period | 3.00 | 3.25 | 3.25 | BNM to play a passive role in 2015 amidst rising policy divergence among central bankers globally – least likely to see any rate hike unless the economy rebounds faster than expected. |
| **USD/MYR** End-period | 3.17 | 3.49 | 3.38 | The possibility of a Fed rate hike, low oil prices means another year of volatile trading. The bullish Dollar means little reprieve for the Ringgit but should start to ease later in the year as other major economies, alongside with domestic economy starts to rebound. |

*Sources: Kenanga Research, E=Estimate, F=Estimate*

## Summary

**Slow start to the year.** Looking at the current situation of the global economy, the 1H15 is probably going to start on a rather modest note as stimulus measures in the Eurozone and Japan, and policy restructuring in China just starts to take hold. It will take some time before monetary and fiscal measures get absorbed into the economy and numbers begin to reflect on how effective those measures are. The USA will be the one exception, and looks to be starting the year on an optimistic mood. They will continue to be the main engine to global growth but the earlier part of the year. In the later half, other economies should begin to pick up, and good vibes to spill throughout the global economy.

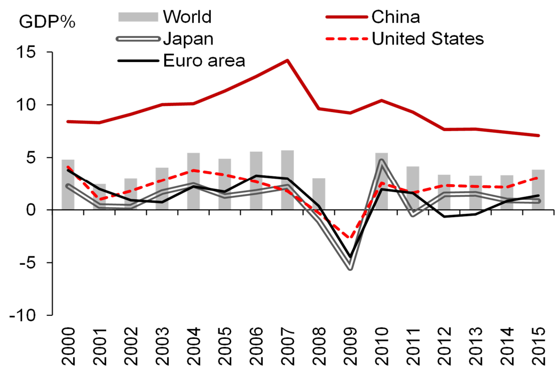
**Gradual rebound**. Malaysia's domestic economy on the other hand is expected to experience a relatively sharp spike in consumption in the 1Q15 as businesses and consumers prepare for the implementation of the GST. The following quarters however will see limited spending as the economy acclimatizes itself to the new tax system. Lower crude oil prices however, should help mitigate things, adding some extra spending money for consumers while cushioning the impact of the GST. By the end of the year, we should begin to see a rebound in aggregate demand as prices normalize. Export is also expected to perform better as the global economy rebounds.

Hence, for the whole of 2015, Malaysia's GDP is projected to grow at a slower pace of 5.1% from an estimated 5.8% in 2014.

# Global outlook

**Here's hoping for the better.** Following the 3Q14 GDP growth and a multitude of economic data results, numerous central banks and international monetary bodies slashed growth forecasts for 2014. A rebound from major economies fell disappointingly short of expectations that global GDP is forecasted by the IMF to expand by 3.3% in 2014, down from 3.7% they had estimated earlier in the year. As a result of this and a weak outlook moving forward, even the 2015 forecast has had to be slashed, to 3.85% from 4.0%. The Eurozone seems to have stuttered to a halt, Japan's economy looks to be sliding backwards and China's growth is at a five-year low.

**Graph 1: IMF Growth Forecasts (2014 & 2015)**

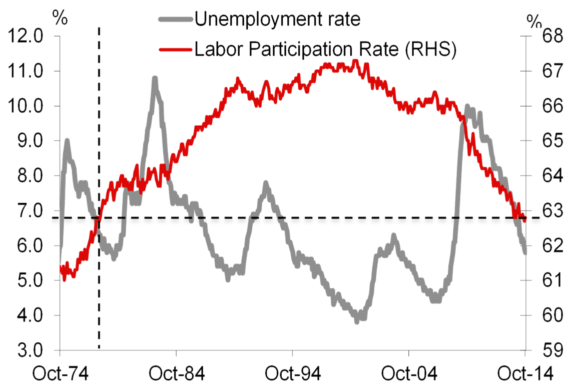



*Source: IMF, Bloomberg, Kenanga Research*

**The strength of the USA.** But not all hope is lost. The USA continues to go against the receding tide, becoming the primary engine driving global growth. Jobless rate is at a 6-year low of 5.8% and employment increased by at least 200,000 for the 10th straight month, the longest stretch since the 19-month stretch in 1994/1995. To add icing to the jobs cake, the kind of jobs, which had previously been boosted by part-time work, has switched back to full-time employment. Outside the jobs market, other sectors of the US economy have also performed steadily well throughout the year, though momentum has tapered somewhat towards year-end. Factory orders fell for a 3rd straight month in October and CEOs are more bearish on capital spending. However, manufacturing sentiment remains optimistic, as do consumer spending, construction, services and home sales. All these tend to point to the possibility of the US Fed embarking on rate normalization sooner rather than later.

However, there are arguments against a rate hike too soon. Labour force participation rate, particularly prime-age workers (25 – 54), has yet to recover even half of its loss since the peak prior to the recession. Real wages is still historically quite weak and inflation rate remains below the Fed's target of 2.0% and inching slower than hoped. Nonetheless, in the longer term, these issues may change for the better and we could see a rate hike in the 2H15, alongside some rebound from other major economies.

**Graph 2: US Labour Participation & Unemployment rate**




*Source: US Labor Dept, Bloomberg, Kenanga Research*

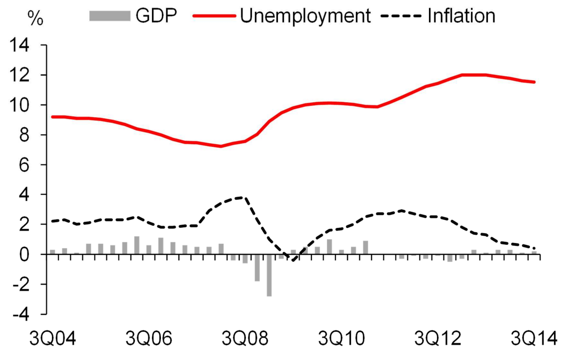
**Graph 3: US Sales and Construction performance**


*Source: US Census Bureau, Bloomberg, Kenanga Research*

**The European economic peril.** Europe has been struggling and trudging and plodding through year after year after year. The Eurozone only just managed to keep out of recession as the two largest economies – Germany and France managed to record a growth. There is little to celebrate however. Overall inflation in the region fell to 0.3% in November, far below the 2.0% target. France's unemployment rate is at 2013 peak of 10.4% and Germany's private sector grew at the slowest pace in 17th months, according Markit's composite PMI. The IMF now sees a 30% chance of the Eurozone slipping into deflation over the next year, and nearly 40% probability the area could enter recession. The chances of the former to happen could be higher given the continued slide in crude oil prices.

There is mounting pressure on the ECB to act more. The interest rate cut back in September did little to boost the economy. However, morale in the Eurozone did improve on the prospect of further stimulus measures. The European Union has drawn up a list of nearly 2000 projects worth €13 trillion to revive growth and increase jobs. Additionally, the ECB is expected to embark on more asset purchase programmes next year. The 2H15 should be seeing better prospects for the region as the stimulus packages and investment projects kick into gear proper.

**Graph 4: Eurozone growth, unemployment and CPI**



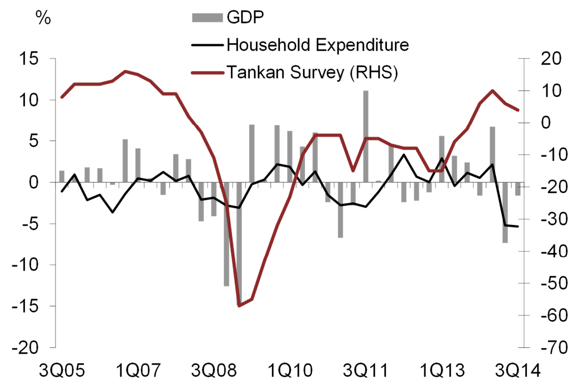

*Source: Eurostat, Bloomberg, Kenanga Research*

**Abenomics 2.0.** In the Far East, Japan posted another quarter of negative growth, effectively putting them into a technical recession. This prompted Prime Minister Shinzo Abe to dissolve parliament early (two whole years before the party needed to go to the polls) to seek a fresh mandate. The sweeping victory paved its way to secure the green light to continue on Abenomics reforms.

The election win means that the planned tax hike in 2015 is almost definitely going to be delayed after a slew of pessimistic numbers, from falling inflation rate (excluding the effect of April's tax hike – October's CPI was estimated at 0.9%, less than half of the BoJ's 2.0% target), weakening household spending (fell 0.4% in October - down for 7-months in a row), drop in inflation adjusted wages (fell 2.8% in October - 16th straight month of decline), just to name a few.  On the other hand, exports rose 9.6% in October, the most in 8 months, boosted by the weak yen, and demand from Asia and the US. Manufacturing as reported by the Purchasing Managers Index (PMI) has also remained expansionary for the 6th consecutive month.

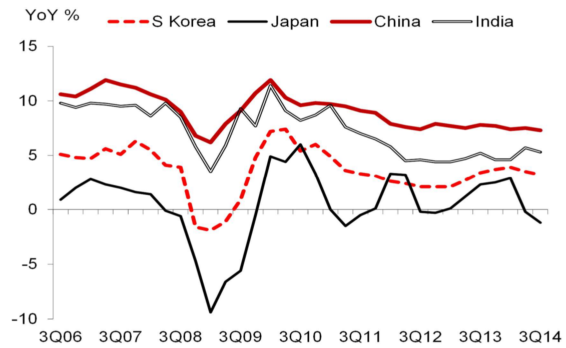
In 2015, we are likely to see more stimulus measures on top of the monetary stimulus programme of enlarging the monetary base to ¥80 trillion (from ¥60 trillion) announced by the BoJ at the end of October. Abenomics needs to go further than the 3 arrows (or further expand the 3rd arrow), as it was unable to sustain growth. We reckon that there's a possibility of structural reforms, which has not been emphasized strongly enough these last two years since the start of Abenomics. Supply-side reforms need to move forward faster lest we see another decade of stagflation.

**Graph 5: Japan in a recession**




*Source: BoJ, Bloomberg, Kenanga Research*

**Graph 6: China growth tapering**




*Source: Respective Central Banks, Bloomberg, Kenanga Research*

**China's new normal.** As for the middle kingdom, China will be going through a new phase in economic growth – or the 'new normal' as it's being called, a growth of around 7.0% being an acceptable level. There will be further economic and policy reforms in an effort to boost domestic demand, to steer away from overreliance on exports and to urbanize more of the country. To a point, they have managed to create a very powerful and strong economy. In purchasing parity terms as calculated by the IMF, China is now the world's biggest economy, overtaking the USA. In raw terms though, China is still more than US$6.5t lower than the USA.

Despite the economic might of China, the world can no longer expect the same pace of growth as before. The new normal will see a slower growth pace but deeper concentration on spurring the domestic economy. The People's Bank of China (PBOC) may embark on further easing policies to boost lending and the government is likely to pump in more stimulus into the system. They may also further loosen restriction on foreign investment, opening to other sectors from the current 79 sectors. At the same time, China is also likely to deepen their relationship with other countries, effectively increasing their economic influence.

## Growth Prospects

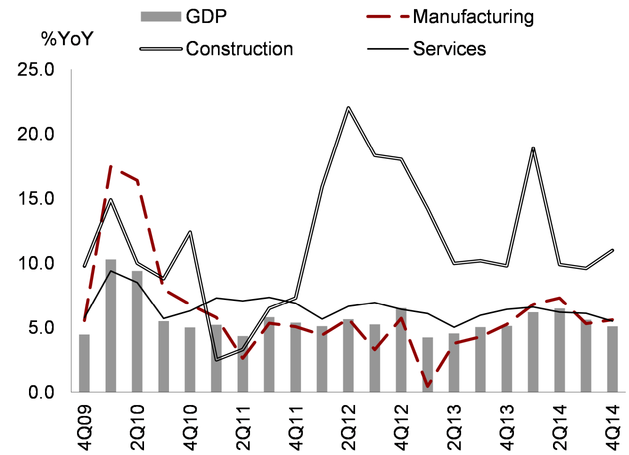
### 4Q14 Overview

**External demand hit the brakes.** So far, the final quartile of the year started off on a rather weak note. Overseas demand (with the exception of the USA) has been tepid and exports is estimated to moderate further in comparison to earlier in the year. In addition to that, it will also be faced with a very high base effect, pulling down any potential upside to growth. Hopefully though, the weakness of the Ringgit will bring about some respite for exporters towards the year-end, and we are looking at the exports component of the GDP to grow at a moderate pace of 1.5% compared to 2.8% in the 3Q14. This would add 1.4 percentage points (ppts) to the GDP.

**Manufacturing for the locals.** Manufacturing is however, estimated to improve further to 5.6% in the 4Q14 following a 5.3% growth in 3Q14. This is largely being pulled by production for local consumption (on expected consumer boost for year-end and goods for use in construction) as well as continuously strong performance of E&E manufacturing for exports. This should add 1.4 ppts to the GDP (3Q14: 1.3%).

**Festivity boost for spending.** At the same time, in anticipation of the year-end festivities and early preparation of the GST, consumer spending is expected to improve. This is when the weakness of the Ringgit is to our disadvantage. It will end up mitigating the impact of better consumption (imports more expensive), hence why are looking at the same level of growth in consumption (3.6%) as in the 3Q14.

Graph 7: GDP - Supply side growth trend




*Source: Department of Statistics, Kenanga Research*

**Construction spurring onwards.** The construction sector will continue to remain robust and following announcements in the 2015 Budget, the 4Q14 is projected to see a double-digit growth of 11.0% (3Q14: 9.7%) even after considering the high-base effect. A similar situation is expected from investment, which is predicted to expand by 12.0% in the 4Q14 from 1.1% in the 3Q14. This will boost aggregate demand to 7.1% from 4.8% as previously seen.

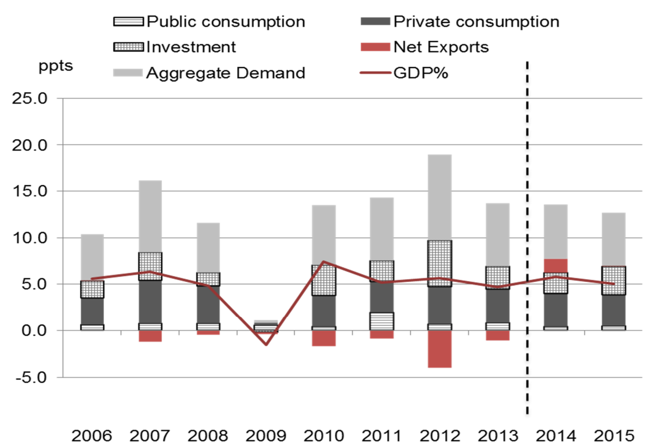
To sum, the 4Q14 is estimated to decelerate further to 5.1% from 5.6% in the preceding quarter. This would bring the average growth for the 2H14 to 5.3% much lower than the 6.3% registered in the 1H14. All in all, this will bring about an average growth of 5.8% for the whole of 2014 (2013: 4.7%), highest since 2010.

## Outlook 2015 – Uncertainties Abound

**Challenging year ahead**. Growth in 2015 will be faced with many challenges, largely due to the effects of uncertainties coming about from the implementation of the Goods and Services Tax (GST). Demand from the external sector is also expected to be less than sanguine as major economies – namely the Eurozone, Japan and China face difficult times supporting their economies. The 1H15 will also be faced with a high base effect as the 1H14 had exceeded expectations.

**Meek consumption**. The consumer spending in the 1Q15 is anticipated to ride high ahead of the GST simply for fear of price increases and uncertainties. However, a sharp pull back is expected once the new tax system is implemented. Inflationary pressures will bring down overall consumption for the year. However, lower oil prices should help to add some extra disposable income to consumers, therefore partly mitigating the GST effects. We are looking at consumption to moderate to 5.6% in 2015 from 6.1% estimated in 2014. This is projected to contribute 3.9 percentage points (ppts) to the overall GDP, compared to 4.0 ppts estimated in 2014.

Graph 8: Demand Side & Contribution to Growth Trend




*Source: Department of Statistics, Kenanga Research*

**Table 1: GDP Growth Trend and Forecast – (% YoY)**

| | 2013 | 2Q13 | 3Q13 | 4Q13 | 1Q14 | 2Q14 | 3Q14 | 4Q14 (Kenanga Forecast) | 1H14 (Kenanga Forecast) | 2H14 (Kenanga Forecast) | 2014 (Kenanga Forecast) | 2015 (Kenanga Forecast) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **By Sector** | | | | | | | | | | | | |
| Agriculture | 2.1 | 0.3 | 2.0 | 0.2 | 2.3 | 7.1 | 4.0 | 2.6 | 4.6 | 3.3 | 3.9 | 3.2 |
| Mining | 0.7 | 4.4 | 1.4 | -1.2 | -0.8 | 2.1 | 1.4 | 0.5 | 0.6 | 1.0 | 0.8 | 2.0 |
| Manufacturing | 3.5 | 3.8 | 4.3 | 5.2 | 6.8 | 7.3 | 5.3 | 5.6 | 7.1 | 5.5 | 6.3 | 5.0 |
| Construction | 10.9 | 10.0 | 10.2 | 9.8 | 18.9 | 9.9 | 9.7 | 11.0 | 14.3 | 10.3 | 12.2 | 9.6 |
| Services | 5.9 | 5.0 | 6.0 | 6.4 | 6.6 | 6.2 | 6.7 | 5.5 | 6.4 | 5.8 | 6.1 | 5.5 |
| **Real GDP** | **4.7** | **4.5** | **5.0** | **5.1** | **6.2** | **6.5** | **5.6** | **5.1** | **6.3** | **5.3** | **5.8** | **5.1** |
| **By Aggregate Demand** | | | | | | | | | | | | |
| Consumption | 7.0 | 7.8 | 8.0 | 6.8 | 8.0 | 5.2 | 6.4 | 5.2 | 6.5 | 5.8 | 6.1 | 5.6 |
| Public | 6.3 | 11.9 | 7.8 | 5.2 | 12.3 | -0.5 | 5.2 | -0.5 | 5.3 | 1.9 | 3.4 | 2.1 |
| Private | 7.2 | 6.8 | 8.0 | 7.4 | 7.1 | 6.5 | 6.7 | 7.1 | 6.8 | 6.9 | 6.9 | 6.1 |
| Investment | 8.5 | 5.9 | 9.4 | 6.5 | 6.3 | 7.2 | 1.1 | 12.0 | 6.8 | 6.5 | 6.6 | 5.8 |
| Aggregate Demand | 7.4 | 7.2 | 8.4 | 6.7 | 7.5 | 5.8 | 4.8 | 7.1 | 6.6 | 6.0 | 6.3 | 5.7 |
| Exports | 0.6 | -4.4 | 4.6 | 5.7 | 7.9 | 8.8 | 2.8 | 1.5 | 8.3 | 2.2 | 5.1 | 4.5 |
| Imports | 2.0 | -1.3 | 4.2 | 7.1 | 7.1 | 3.9 | 2.2 | 2.3 | 5.5 | 2.2 | 3.8 | 5.3 |
| **Real GDP** | **4.7** | **4.5** | **5.0** | **5.1** | **6.2** | **6.5** | **5.6** | **5.1** | **6.3** | **5.3** | **5.8** | **5.1** |

*Source: Dept. of Statistics, Kenanga Research*

**Moderate investment.** Overall investment is also predicted to moderate next year, partly due to a high base effect. There will also be some companies who may choose to sit back and ride out the normalization period of the GST. The weak ringgit will also make imports of capital equipment for expansion more expensive. At least for next year, we do not expect the Overnight Policy Rate (OPR) to increase (at least not until the very end of the year – and only if economic rebound is significant enough) making it one less variable to worry about. In a nutshell, we are looking at overall investment to expand by 6.1% in 2015 compared to 6.9% expected this year. Nonetheless, the percentage point contribution to growth is expected to remain the same as this year, at 1.8 ppts.

**Better exports but only later in the year**. Though the weaker ringgit should be advantageous for exporters and export-oriented sectors, weak demand from major economies will drag down production capacity. Similarly, neighbouring countries have also felt a weakening of their currencies, keeping competition as stiff as ever – making it hard for Malaysia to take advantage of the weaker currency. As with major consumers, Japan, one of Malaysia's closest trade partners, will be facing an uphill climb out of recession, and the Eurozone still struggles to keep the threat of deflation at bay. Trade with China, though expected to somewhat recover compared to this year, won't be as robust as they continue to go through policy and economic restructuring. The USA alone will not be able to pull exports forward. Therefore, we are looking at exports growth to moderate to 4.5%, down from 5.1% expected this year. Its percentage point contribution to GDP will lessen to 3.0 from 4.6.

**Manufacturing to be mild**. Reflecting slowing exports, the manufacturing sector will also face the same setbacks. On the domestic side, with the exception of manufacturing geared towards the construction sector, manufacturing for home use will feel the effects of smaller spending as consumers and businesses ride out the normalization period of higher prices on account of the GST. We are looking at the manufacturing sector to expand by just 5.0% in 2015, compared to 6.3% projected for 2014, with lesser percentage point contribution of 1.3 from 1.5 ppts.

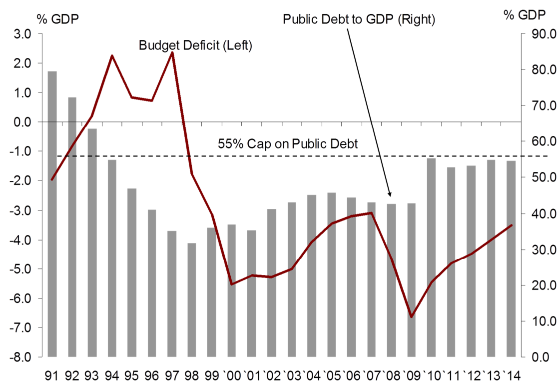
**Construction to remain bullish**. The construction sector is expected to remain robust for years to come as the nation strives towards a developed nation status by the year 2020, largely driven by infrastructure spending. For 2015, there will be significant development spending for public transportation (MRT2, LRT3, electric busses for selected urban areas), highways and high speed rail, more affordable housing, hospitals and schools, just to name a few. However, growth will be faced with a high base effect, making it difficult to sustain higher growth. Nevertheless, expansion should remain in the high single digit of 9.6% in 2015, from 12.2% estimated for 2014.

**Better year-end.** Though most of the year is expected to grow rather meekly, the end of the year is expected to perform better. Advanced economies ought to see a growth rebound as stimulus measures take hold proper and spread throughout the economy. The pace of the recovery is anyone's guess but if Abenomics succeeds in postponing the tax hike, and they are more successful in structural reforms, as with China as well, the two nations will in all likelihood pull Malaysia's (and the region's) growth alongside them. The situation in the Eurozone is a bit harder to predict due to the structure of the region but we should finally see some reprieve once stimulus measures spread throughout its economy. With congress finally able to agree on a budget, the USA will remain the main engine of growth next year. All in all, the 2H15 is expected to perform better compared to the 1H15, backed by improving exports and continued investment spending.

## Fiscal Policy

**Lower oil – good or bad?** The recent removal of petrol subsidy is expected to have a positive impact on the fiscal balance in 2015. Rating agencies and monetary bodies have commended the move, which is expected to save the government around RM20b. Though there was no better time to rid of petrol subsidies that at a moment of plunging global oil prices, the situation is both a boon and a bane.

**Graph 9: Fiscal Deficit vs Public Debt Trend (% of GDP)**




*Source: Department of Statistics, Kenanga Research*

**Shrinking O&G revenue.** According to Petronas, around RM68b of the government's revenue is expected to be derived from oil & gas this year and that figure is estimated to plunge to RM43b in 2015. Even then, that is if oil prices average around US$75 per barrel (pb). Benchmark Crude has already slipped below US$70pb and with OPEC keeping supply as it is, the US churning out nearly 9 million barrels per day (mbpd), and Saudi Arabia cutting prices of oil bound for Asia and the US, it's possible that oil prices may hover low for some time yet. We are looking at crude prices to average at $70pb in 2015.

**Other sources of income.** But one has to remember that government coffers aren't entirely dependent on oil revenue. Though the percentage of revenue has been between 20% - 40% in the last decade, prior to that, revenue barely skimmed 20%. In addition to that, dividend pay-out could always be increased when needed, as the government wholly owns Petronas. At the height of the financial crises, whence oil prices had dipped below US$50pb, dividend pay-out was at an all-time high of RM30b, of which was channelled back into the economy to cushion the impact of the crises. Following that, through incentive programmes such as the Economic

Transformation Programme (ETP), there are now wider sources of income that even with lesser revenue from oil and gas, we do not think it will affect budget deficit target significantly. Furthermore, revenue made from the implementation of the Goods and Services Tax (GST) should help to partly mitigate revenue loss from the oil & gas sector. The MoF estimates that RM21.7b will be gained from the GST.

**Lower inflation means better for pockets.** That being said, the Prime Minister mentioned in the 2015 Budget that a significant amount of gain from the GST would be channelled back to the economy via the BR1M, to cushion the impact of higher prices from the new tax system. On the flipside though, the lower oil prices – which will also lead to lower commodity prices, and with any luck reduce cost of doing business, will be able to keep overall inflation on the lower end of 4.0% - 5.0% expected next year (we are looking at 4.0% average). A relatively lower inflation courtesy of lower fuel prices means more disposable income for households and larger savings for corporates would boost aggregate demand. This would increase tax profits, which will help the government to achieve the fiscal deficit target of 3.0% of GDP in 2015, from 3.5% estimated in 2014.

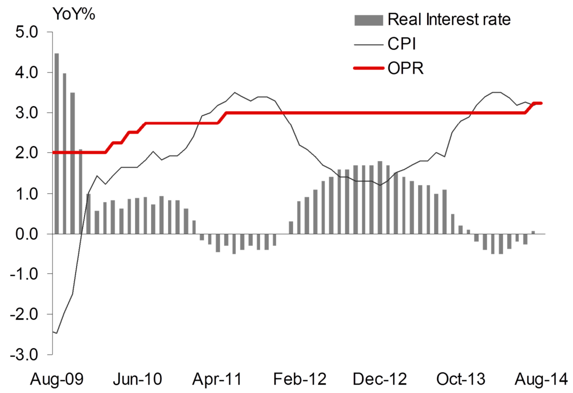
## Monetary Policy

**Central banks going different directions.** There is a huge divergence of monetary policy between major central banks – the US Federal Reserve (Fed) and the Bank of England (BoE) is expected to return to normalize rates whilst the European Central Bank (ECB), the Bank of Japan (BoJ) and the People's Bank of China (PBOC) is projected to ease policies further. Bank Negara Malaysia's (BNM) policy is likely to remain unchanged, as they're likely to remain a passive observer next year. They have briefly already leant towards a tightening mode this year when they increased the OPR by 25 basis points (bps) in July. Only a major external shock such as a recessionary threat or uncontrollable inflation will alter its policy mode.

**Inflationary pressures remain.** Though inflation is expected to average between 4.0% to 5.0%; we are looking at the lower end – towards 4.0% on lower oil prices (2014 estimate: 3.1%), inflationary pressures remain cost-push that an increase in the interest rate will do little to mute prices. It will be another year of prudent spending to ride out the normalization of prices.

**OPR to likely stay pat.** A hike in the Overnight Policy Rate (OPR) is possible towards the end of the 2H15, to follow suit if and when the Fed raises rates. This is also on the condition that the domestic economy has rebounded enough following an anticipated slower growth in 2015 – the impact from the implementation of the GST, and weak global demand.

**Graph 10: Malaysia Real iRates ticked up to positive**

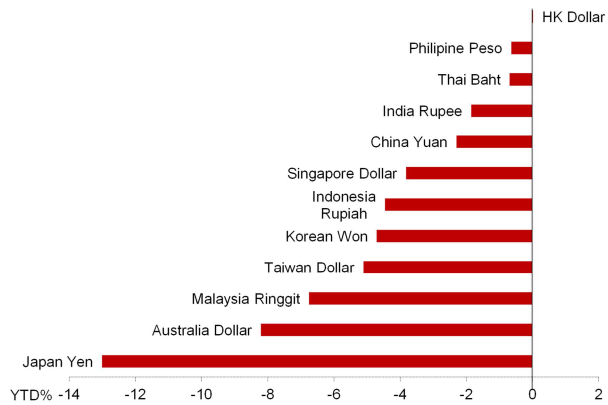



*Source: Bank Negara Malaysia, Dept of Statistics, Kenanga Research*

## Ringgit outlook

**The battering of the Ringgit.** Compared to neighbouring currencies, the Malaysian ringgit has been taking rather severe battering of late. This is also due to the country's stronger dependence on oil revenue, which gives the perception of the country's finances being under threat. However, perception differs from reality. Malaysia is in actuality a net oil importer when it comes to refined petroleum (which is what effects petrol prices) so, lower oil prices is largely good for the overall economy. It's agreed that the current situation is more due to the strength of the US$ and not the weakness of the Ringgit. Based on the current trend, the Ringgit will probably end the year at around 3.47 to the dollar and average about 3.26 for the whole of 2014.

**Graph 11: YtD Performance of Regional Currencies vs US$**




*Source: BNM, Bloomberg, Kenanga Research*

**Weak ST, better LT**. For next year, a narrowing current account surplus on weaker exports and the higher possibility of the US Federal Reserve will put pressure on global currencies, especially those from Emerging Economies, the Ringgit not being an exception. In the short term, we're likely to see similar levels as currently. The implementation of the GST and the low oil prices will add further uncertainties to the Ringgit, keeping it weak. But as the year progresses and other major currencies slowly start to gain straight again, once stimulus measures start to take hold, and Malaysia starts to normalize with the GST, the ringgit should gain some foothold. We are looking at the Ringgit to average around 3.43 vis-à-vis the US dollar and end the year on a stronger note of 3.38.

## Risk to growth

**Prolonged recession.** It is quite possible that Japan may be faced with a prolonged recession despite the planned tax hike being postponed. Structural reforms may take a longer time to implement and the people may be reluctant to change the way things work (changing labour laws and practices for example), making it difficult for the economy to rebound. Abenomics need to do more to change the economy, making sure to target as many aspects of the economy and lift the spirits of the Japanese people. If anything, Japan needs to be able to regain competitive edge once more, especially against neighbouring Asia.

**Europe falls into a deflation.** The situation in Europe is as precarious as ever. Despite Mario Draghi's best efforts, it may take far more than what has been done to address the situation in selected European countries. The ECB can only do so much but ultimately, respective countries need to address their own issues. It's imperative that focus should be on growth and not trying to adhere to budget cuts, exacerbating the employment issue further. Sentiment could end up slipping further, keeping the Eurozone in another year of gloom.

**Fed hike too soon.** Most are expecting the US Federal Reserve to begin on rate normalization in 2015. However, it's crucial that the Fed get the timing right. Too soon may have the opposite effect on the economy. It could also trigger sharp capital flows from emerging economies, threatening their currencies further. In addition to that, though the USA economy is generally performing well, the recent racial tensions and wealth gap issues is one that shouldn't be taken lightly. Labour conditions may be affected by continuous protests and weaknesses from it could bleed into other parts of the economy.

**Difficulties in China.** China's deepening economic restructuring should be done gradually so as to not shock the economic system. It's quite possible that the effects of said restructuring and urbanization plans take a toll on facets of the economy, which has been dependent on the old-school policies, leading to reduced productivity, employment woes and lack of investment. This may very well spread to other parts of the economy and ultimately, even spilling over to other parts of Asia.

**Oil drop.** Though falling oil prices is generally good for the economy, it effects on the oil & gas sectors may end up spreading to other parts of the economy, especially for countries whose economy has been largely oil dependent. We do not think that Malaysia is particularly at risk but the perception of it could batter the Ringgit even further. Though minute, the threat to government Budget is possible. Missing the 3.0% budget deficit target by a bigger than expected margin could be detrimental towards investor confidence.

**Severe GST effects.** The effects of the Good and Services tax could turn out to be more severe than expected. It is possible that Malaysia may end up mirroring Japan's domestic economy after their tax hike. Consumer spending may pull back too much, effecting businesses too harshly and threatening closures. Wages may also have a hard time keeping up with the increased cost of living. The recovery may take longer than expected, making it even harder for achieve a developed economy status by 2020.

**Kenanga Research Macroeconomic Forecast and Assumption 2014 - 2015**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014F | 2015F |
|---|---|---|---|---|---|---|---|---|
| Real GDP (%YoY) | **4.8** | **-1.5** | **7.2** | **5.1** | **5.6** | **4.7** | **5.8** | **5.1** |
| Consumer Price Index (avg.) | 5.4 | 0.6 | 1.7 | 3.2 | 1.7 | 2.1 | 3.1 | 4.0 |
| Current Account Balance (% of GNP) | **17.6** | **15.8** | **11.5** | **11.3** | **5.3** | **3.8** | **4.5** | **2.5** |
| Fiscal Balance (% of GDP) | -4.8 | -7.0 | -5.6 | -5.4 | -4.7 | -4.0 | -3.5 | -3.0 |
| Unemployment rate (% of working population) | **3.3** | **3.7** | **3.4** | **3.3** | **3.2** | **3.3** | **3.2** | **3.3** |
| Manufacturing output (%YoY) | 0.6 | -9.9 | 11.1 | 4.6 | 5.2 | 4.2 | 6.1 | 4.7 |
| Exports of goods (%YoY) | **9.6** | **-16.5** | **15.5** | **8.7** | **0.7** | **2.4** | **10.6** | **5.2** |
| Overnight Policy Rate (end period) | 3.25 | 2.00 | 2.75 | 3.00 | 3.00 | 3.00 | 3.25 | 3.25 |
| Exchange rate: Ringgit/US$ (avg.) | **3.3325** | **3.5189** | **3.2182** | **3.0595** | **3.0898** | **3.1678** | **3.2624** | **3.4321** |
| Exchange rate: Ringgit/US$ (end period) | 3.4640 | 3.4245 | 3.0835 | 3.1770 | 3.0583 | 3.1743 | 3.4732 | 3.3788 |
| Palm oil: RM/tonne (avg.) | **1,522** | **2,475** | **2,864** | **2,237** | **2,701** | **3,219** | **2,400** | **2,200** |
| Palm oil: RM/tonne (end-period) | 2,000 | 3,106 | 1,630 | 2,590 | 3,759 | 3,161 | 2,400 | 2,200 |
| Crude Oil (Brent)- US$/barrel (avg.) | **99.59** | **61.69** | **79.43** | **95.05** | **88.99** | **97.54** | **101.02** | **73.1** |
| Crude Oil (Brent)- US$/barrel (end-period) | 44.60 | 79.36 | 91.38 | 98.83 | 91.82 | 99.81 | 68.88 | 75.3 |

*Source: BNM, Ministry of Finance, Dept of Statistics, Bloomberg, CEIC, Kenanga Research*



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