OCBC TREASURY RESEARCH

Regional Snapshot

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Steadier State

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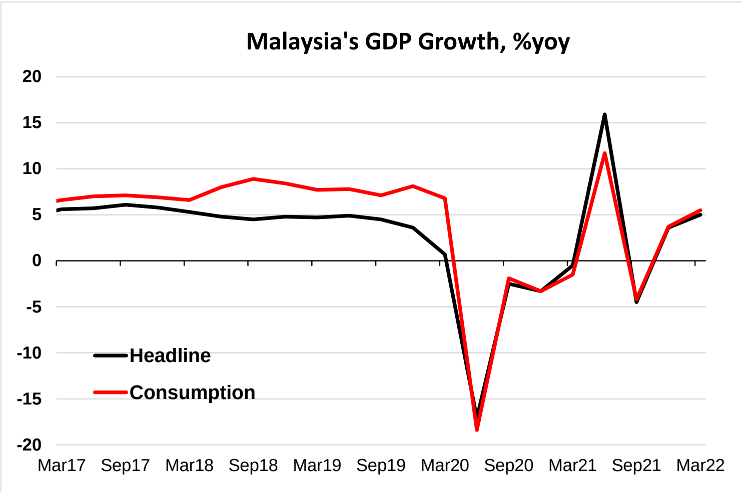
Malaysia's economy strengthened markedly in Q1

- Malaysia reported Q1 GDP growth rate of 5.0% yoy, coming ahead of the 4% and the 3% that the market and we had expected, respectively. While exports helped, the key factor in the outperformance was the recovery in the domestic consumption, bolstered by labour market normalization.
- Such a strong showing for domestic growth driver is encouraging, although the effect on the balance of payments deserves a closer watch in an environment of global volatility. Partly because of stronger imports to fulfil the domestic needs, the current account surplus has thinned to 0.7% of GDP.
- Overall, the robust GDP print is in line with the tightening stance that Bank Negara has just adopted this week, even if it has not shifted our thinking that it may still opt for a pause in the July meeting and only hike again in September in view of its pledge to tighten in a "measured and gradual" way.

Firmer at Five

In its decision to hike the OPR by 25bps unexpectedly just two days ago, Malaysia's central bank noted that, as shown by "the latest indicators," the economy is "on a firmer footing." It is perhaps not too much of a stretch to think that the Q1 GDP number, which came in at a higher-than-expected 5.0% yoy, had contributed to such a confident policy move.

Looking at the details, private consumption appears to be driving the bulk of the strong performance, growing at 5.5% yoy in Q1 this year compared to 3.7% yoy in the previous quarter. Indeed, in the note accompanying the GDP release, the BNM stated that the growth print "was mainly supported by improving domestic demand as economic activity continued to normalise with the easing of containment measures."



Source: OCBC, Bloomberg.

An improvement in the labour market provided one of the major tailwinds to the domestic demand recovery, it seems. The country's unemployment rate has drifted down to 4.1% as of March this year, compared to 5.1% at the worst stage of the pandemic in 2020.

The fact that wages are starting to recover more markedly amid the supportive domestic demand pick-up would have featured into BNM's calculations this week that led to the rate increase, as well. Going by its data, wages for the services sector has picked up the most sharply, at 5% yoy, in Q1. The fact that the sector that was most beleaguered by the pandemic lockdowns is now seeing an uptick showcases how the Malaysian economy is stepping into the endemic stage of the Covid-19 crisis, as well.

Overall, the uptick in domestic demand, together with signs that the labour market and wages are recovering, would have undoubtedly contributed to BNM's rate hike decision this week, especially to its expectation that the underlying core inflation may pick up to a range of 2.0-3.0%.

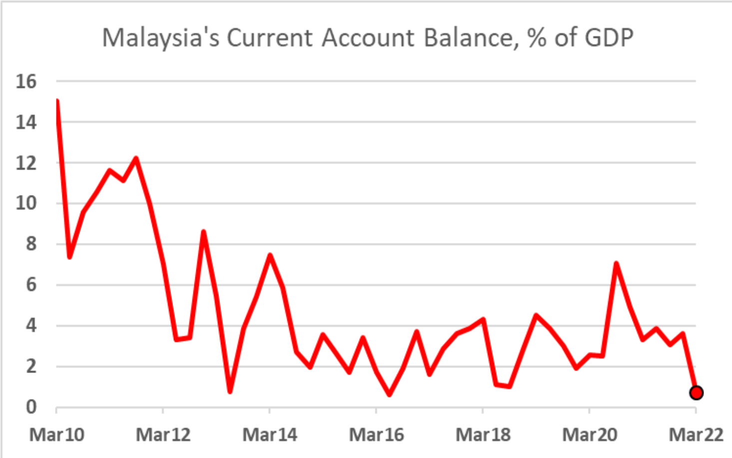
Going forward, even as the strength in the Q1 data is comforting, the potential headwinds posed by a slowdown in the major economies are likely to present tougher times for the Malaysian economy. As fortunate as it is to enjoy a domestic demand uplift, the exports component cannot be ignored, on its own and on account of how it feeds to the overall economy through employment recovery, especially.

Hence, even though our forecast for the full-year GDP growth would naturally go up to account for the upside surprise in Q1, the outturn for the later parts of the year looks less promising than before. Hence, in net terms, we now see the full-year 2022 growth at 5.7% yoy, a measured uptick from 5.4% before.

Indeed, even as a recovery in growth momentum is something we usually pine for, especially after the challenging pandemic period, we should nonetheless be cognizant of the inherent risks when growth rates start to pick up quickly. Here, apart from the risk of inflation that has been much talked about, the potential for current account dip presents another area to look out for.

As a case in point, Malaysia's current account balance dipped to 0.7% of GDP in Q1, compared to 3.6% in Q4 last year. This marks the thinnest current account buffer since Q2 2016 and comes at a time when investors would pay greater attention to the metric. While Malaysia's current account should stay in the surplus territory, the fact that the cushion has gotten thinner could translate to more susceptibility to more volatile capital flows.

To that end, it is worth noting that part of the reason why the current account surplus has been reduced is the uptick in goods imports to satiate the uptick in domestic needs, even as Malaysia's hefty exports continue to provide some counterbalancing buffer. Elsewhere, it is notable as well that the debit portion of the primary income component – which typically comprises items such as dividend repatriation of foreign investors – has been higher than usual at this time of the year. At MYR35.5bn in Q1, this segment is sizably higher than the MYR22.4bn average for the first quarters of 2019-2021, for instance.



Source: OCBC, Bloomberg.

To be clear, this is not to say that the thinning current account surplus is an issue, especially when the country's financial account remains healthy in part due to favourable net FDI outturn. It is just that a moderate pace of recovery might well suit the economy better at this stage not just in terms of containing the inflation risk but also any potential strain on the current account.

In starting to step away from the historically low level of policy rate, BNM might indeed be trying to achieve just that Goldilocks scenario. As mentioned in our report earlier this week "Why Wait?", we see the potential for further tightening in that respect, with the central bank likely to take a gingerly approach by pausing in July before hiking in September.

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