Economic commentary

09/11/2018

Week Ahead Asia-Pacific Economic Preview

- **Thailand, Indonesia and the Philippines decide on interest rates**
- **Japan, Malaysia and Hong Kong Q3 GDP**
- **China data updates, including lending, investment and factory output**
- **Special focus on Malaysia's Budget**

Next week continues to see third quarter GDP updates for a number of countries in Asia, including Japan, Malaysia and Hong Kong. Several regional central banks also set monetary policy, while China will release a clutch of economic data that will offer further clues as to the health of the economy after Caixin PMI surveys indicated waning growth momentum.

Other data highlights for Asia include trade numbers for Singapore and Indonesia, as well as India's inflation and trade balance figure, plus South Korea's job data.

Elsewhere, GDP data are published for the Euro area and Germany, alongside UK data updates to employment, wage, inflation and retail sales plus US inflation, industrial production and retail sales data.

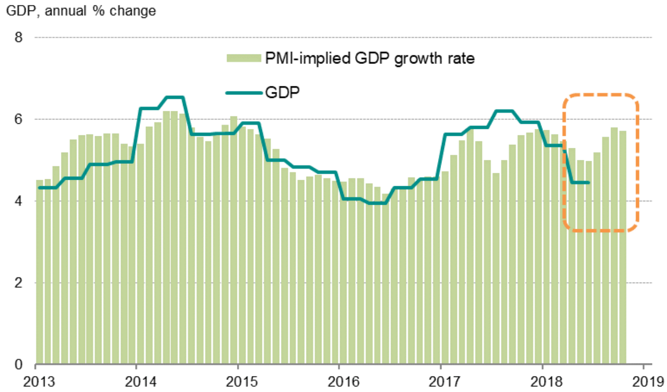
Our special focus this week reviews Malaysia's recent Budget.

China data updates

The economic calendar in China next week is a busy one. With recent focus on funding to the private sector, updates to lending data, such as new yuan loans and total social financing, will be keenly watched by analysts. Other data highlights, including fixed asset investment, foreign direct investment, industrial production and retail sales figures will provide insights into the health of the Chinese economy at the start of the fourth quarter and give clues as to whether the pace of expansion looks set to continue to wane in the fourth quarter after slipping to 6.5% in the third quarter.

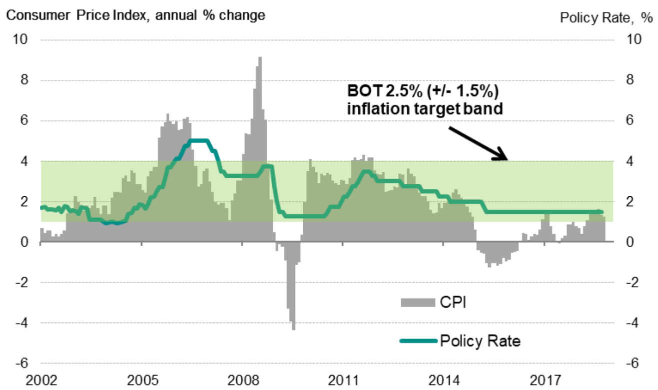
Recent Caixin PMI surveys fired clear warning shots about the negative impact of the US-China trade dispute on economic activity. October data indicated the slowest pace of growth in business activity for over two years, with the survey showing an increasing number of survey participants (particularly in manufacturing) expressing concerns about ongoing trade tensions.

Malaysia PMI-implied GDP growth



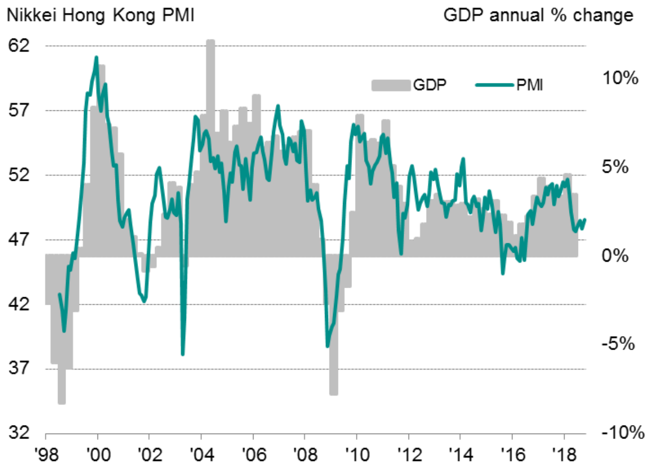
Sources: IHS Markit, Nikkei, DoS

Thailand inflation and monetary policy



Sources: Ministry of Commerce, Bank of Thailand

Hong Kong GDP and the PMI



Sources: IHS Markit, Nikkei, Datastream

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Monetary policy

Central banks in Thailand, Indonesia and the Philippines meanwhile meet to set interest rates. While the consensus is for Thailand to maintain policy rates steady, there are increasing expectations of a rate hike. The Bank of Thailand has been building a case for policy normalisation to create policy space and reduce risks to financial stability. Two of the seven Monetary Policy Committee members voted for a hike in the September meeting, up from one in August. The current policy rate of 1.5% has been in place for three-and-a-half years.

Indonesia is expected to hold its monetary policy steady for a second time this month. Bank Indonesia has appeared less hawkish in recent rhetoric, policymakers clearly remain concerned that the rupiah is vulnerable to financial market volatility ahead of a widely expected Fed hike in December and recent turmoil in emerging markets. The latest PMI data pointed to softer demand conditions in the manufacturing sector at the start of the fourth quarter.

Asia GDP updates

Next week also sees the release of third quarter GDP estimates for Japan, Hong Kong and Malaysia.

Third quarter GDP is expected to shrink 0.3% in Japan, according to a Reuters poll, linked to a series of natural disasters and a slowdown in global demand. However, in a sign the downturn will prove transitory, PMI surveys indicated a rebound in growth at the start of the fourth quarter, partially supported by post-typhoon demand. October PMI data also showed the first increase in export sales for five months.

In Malaysia, market expectations are for economic growth to accelerate to 5.2% in the third quarter, up from 4.5% in the second quarter. PMI surveys (as early as September) suggested a stronger third quarter. The PMI Output Index, which exhibits a near-80% correlation with GDP growth, indicated an annual GDP growth of around 5.6% in the three months to September, although the latest PMI data have sent some warning signals regarding the health of the Malaysian manufacturing sector.

In Hong Kong, the Nikkei PMI indicates that slower growth in China and waning global trade flows are likely to have curbed GDP growth compared to the 3.5% annual rate of expansion seen in the second quarter. Recent PMI readings have been indicative of the annual growth rate slipping closer to 2%.

Monday 12 November

Singapore retail sales (Sep)

Japan machine tool orders (Oct)

India industrial production (Sep) and inflation (Oct)

Italy industrial production (Sep)

Tuesday 13 November

Australia business confidence (Oct)

Germany inflation (final, Oct)

China new yuan loans, total social financing and money supply (Oct)

UK jobless rate and average earnings (Sep)

Euro area and Germany ZEW surveys (Nov)

Brazil retail sales (Sep)

Russia GDP (preliminary, Q3)

Wednesday 14 November

South Korea unemployment rate (Oct)

Australia consumer confidence (Nov) and wage price index (Q3)

Japan GDP (preliminary, Q3)

China fixed asset investment, FDI, industrial production and retail sales (Oct)

India wholesale inflation (Oct)

Thailand interest rate decision

Germany GDP (flash, Q3)

France and Spain inflation (final, Oct)

UK inflation (Oct)

Euro area GDP (2nd est, Q3) and industrial production (Sep)

US inflation (Oct)

Thursday 15 November

Australia employment change and jobless rate (Oct)

China house price index (Oct)

Indonesia trade (Oct)

Indonesia and Philippines interest rate decision

India trade balance (Oct)

UK retail sales (Oct)

Euro area trade balance (Sep)

US retail sales (Oct) and business inventories (Sep)

US export and import prices (Oct)

Friday 16 November

Singapore trade (Oct)

Malaysia and Hong Kong GDP (Q3)

Euro area and Italy inflation (final, Oct)

US industrial production (Oct)

Special Focus

Malaysia's Budget for 2019:
a sound framework for medium term economic growth and fiscal consolidation

By Rajiv Biswas, Asia-Pacific Chief Economist, IHS Markit

We review the first budget of the Pakatan Harapan coalition government, which was announced on 2nd November. The Budget estimate is that the Malaysian economy will achieve GDP growth of 4.8% in 2018, edging higher to 4.9% in 2019, buoyed by domestic demand, which will help to offset a tightening of public expenditure.

Economic outlook

The Pakatan Harapan (PH) coalition government led by Prime Minister Dr. Mahathir bin Mohamad announced its first budget on 2 November 2018. According to the economic forecast for the Malaysian economy announced in the Budget, GDP growth is projected to moderate from 5.7% in 2017 to 4.8% in 2018, edging up to 4.9% in 2019.

The near-term economic outlook is expected to be underpinned by strong growth in domestic demand, which is expected to grow at an annual pace of 4.8% in 2019, similar to the 5.0% rate expected for 2018.

A key growth engine is projected to be private consumption, forecast to grow by 6.8% in 2019, after a 7.2% expansion in 2018. Private investment growth is projected to strengthen from 4.5% in 2018 to 5.0% in 2019. However public spending is expected to act as a drag on growth, contracting by 0.9% in 2019 after a marginal 0.1% expansion in 2018. While public consumption is expected to grow at a modest pace of 1.8% in 2019, public investment is projected to contact by 5.4% in 2019, after a decline of 1.5% in 2018.

Medium term fiscal implications

Due to the significant reforms to indirect taxation announced soon after the incoming government took office in May 2018, considerable focus has been placed on the implications for the medium term fiscal outlook in the Budget. The withdrawal of the Goods and Services Tax (GST), that was announced by the new government in May and implemented in June, is estimated in the Budget to have resulted in a revenue shortfall of Ringgit 21 billion for 2018.

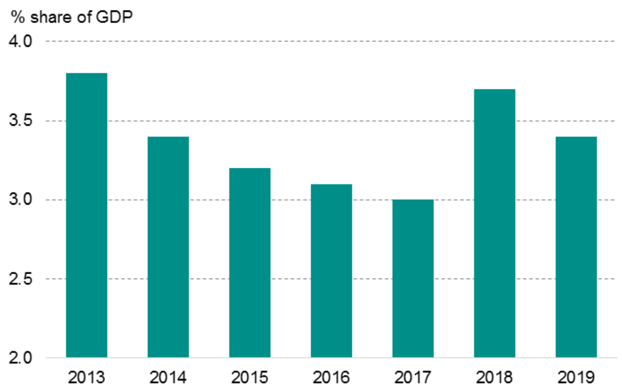
However, the Budget estimates that the Sales and Service Tax that was introduced in September 2018 together with higher dividend and oil-related revenue will generate Ringgit 14.5 billion in additional revenue, resulting in a net shortfall of Ringgit 6.5 billion. This will be largely met by around Ringgit 6.3 billion of expenditure savings.

The incoming government has reviewed the fiscal position to take into account additional tax refunds, off-budget commitments and additional expenditure for items such as major infrastructure projects. As a result of this review, the fiscal deficit for 2018 has been revised up from 2.8% to 3.7%.

The government projects that the fiscal deficit will be reduced to 3.4% in 2019. During the 2019 fiscal year, the government has announced that it will settle Ringgit 37 billion in outstanding tax refunds of which Ringgit 19 billion are due in relation to the GST. The government's fiscal position will be boosted by a one-off special dividend of Ringgit 30 billion from Petronas.

Over the medium-term outlook, fiscal consolidation is projected to continue, with the fiscal deficit projected to moderate. Key economic assumptions for the Medium Term Fiscal Framework from 2019 – 2021 are that real GDP growth will average around 4.5% to 5.5% per year, while the crude oil price will be in a range of USD 60 to USD 70.

Malaysian Fiscal Deficit 2013-2019



Source: Malaysian Budget 2019.

Government debt burden

The Budget estimates that Malaysian federal government debt was 50.7% of GDP in mid-2017, and had remained stable at that level by mid-2018. However, after taking into account committed government guarantees, 1MDB net debt and other liabilities, the total federal government debt and liabilities are estimated to have amounted to 80.3% of GDP in mid-2017, but then declined to 74.5% of GDP by mid-2018 due to a significant reduction in other government liabilities, such as public-private partnership obligations.

The PH government has moved swiftly on its election campaign promise to review large infrastructure projects. A key concern for the Malaysian government is the high level of government debt that would be incurred due to these infrastructure megaprojects.

The new administration has estimated that government debt has reached Ringgit 1.087 trillion, making controlling further escalation in government debt a key priority. The new Malaysian Finance Minister Lim Guan Eng stated on 24th May that the government's estimate of Malaysian government debt included official federal government debt of Ringgit 687 billion, or 50.8% of GDP, plus around Ringgit 199 billion of contingent liabilities relating to government guarantees for state-owned enterprises, equivalent to 14.6% of GDP. In addition, government payments for public-private partnerships amount to an estimated Ringgit 201 billion, or 14.9% of GDP.

In order to prevent a sharp escalation of government debt, a number of infrastructure megaprojects were placed under review. The Singapore-Kuala Lumpur High Speed Rail project will be suspended for a period of two years. A Belt and Road Initiative megaproject that has also been suspended is the East Coast Rail Link (ECRL) megaproject, a bilateral project agreed between Malaysia and China under China's Belt and Road Initiative, with the latest estimated total cost being around Ringgit 81 billion. The ECRL project construction is 85% financed by the Export-Import Bank of China with a loan at a 3.25% interest rate.

In addition, the Trans-Sabah Gas Pipeline project and the Multi-Product Pipeline project, which were both being built by China Petroleum Pipeline Bureau, have been cancelled. The two pipeline projects have a combined project value of Ringgit 11.1 billion. A suspension order for all contracts related to the two pipeline projects as well as the ECRL project was issued on 3rd July by the Malaysian Ministry of Finance.

Outlook

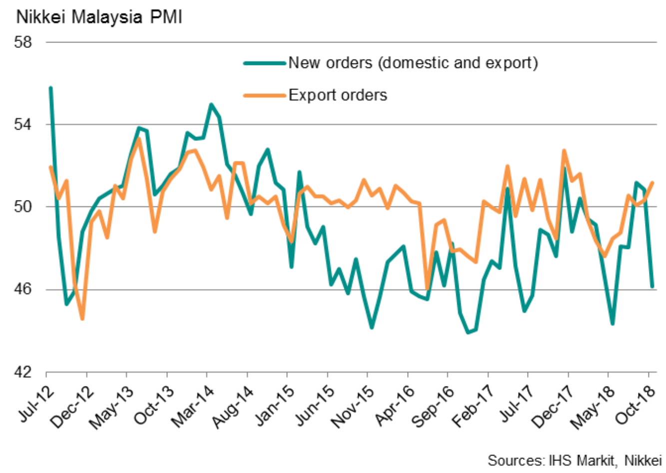
The first budget of the incoming PH coalition government has delivered a roadmap for fiscal transparency with a commitment to medium term fiscal consolidation. The near-term growth outlook is projected to remain resilient, according to the Budget, underpinned by continued strong expansion in domestic demand. Manufacturing sector growth in 2018 is estimated at 4.9%, with sustained expansion at a pace of 4.7% in 2019. The services sector is expected to remain strong, growing at a pace of 6.3% in 2018 and 5.9% in 2019.

However, there are a number of key downside risks to the economic outlook for 2019, notably the effects of the US-China trade war as well as the impact of further US Fed rate hikes on Asian financial markets and currencies. A downside risk to the economic outlook may also come from a slowdown in domestic construction sector activity due to the impact of reduced public infrastructure spending and weaker residential construction spending.

Overall, Budget 2019 sets a sound framework for medium term economic growth and fiscal consolidation.

Malaysia PMI

View also our monthly PMI surveys, conducted by IHS Markit on behalf of Nikkei, for regular updates on economy trends in Malaysia. The latest survey data brought news of the economy struggling as demand eased noticeably in October as a result of the recently-implemented Sales & Services Tax (SST). However, new business from overseas increased at the sharpest pace in nine months. The US and other countries in South East Asia were mentioned as destinations for new export orders.



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Contact for further APAC commentary:
Rajiv.Biswas@ihsmarkit.com or Bernard.Aw@ihsmarkit.com.

Editor and contact for European and US PMI commentary:
chris.williamson@ihsmarkit.com

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