QUARTERLY ECONOMY TRACKER

(OCT-DEC 2017)

Socio-Economic Research Centre (SERC)

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Executive Summary

A. GLOBAL ENVIRONMENT

- **Global growth continues rising.** The global growth outlook remains positive. The sustained improvement in global trade and manufacturing reinforces the strength of domestic demand in advanced economies. Confidence indicators continued improving, buoyed by unrelenting rallying in global equity markets and the confirmation of historic tax reforms in the US as well as tentative positive progress of the UK Brexit negotiations. The International Monetary Fund (IMF) estimated global growth to increase by 3.7% in 2018 (3.6% in 2017).
- **Advanced economies going steady.** The US economic expansion is increasingly broad based across sectors, powered by a tightening labour market. The economic recovery since the 2007-2009 recession is now in its eighth year and showing little signs of fatigue. Growth in the eurozone continues to expand solidly, albeit mixed between some economies while Japan's economy grew for the seventh straight quarter in 3Q17, its longest expansion since 2001, backed by rising business investment and a recovery in exports. China's economic restructuring growth still steadying though the authorities would continue to rein in credit growth and control debt without hurting the growth.
- **Global liquidity conditions will tighten gradually.** Going into 2018 and beyond, global financial conditions will tighten further as the Fed continues its forward guidance of measured pace of interest rate hikes and continued shrinking of balance sheet. A gradual reversal of ultra-monetary stimulus is not expected to pose a major drag or shock to asset values.
- **Keep a close watch on inflation.** Another closely watch indicators are headline and core inflation in advanced economies. They are seemingly looking benign or even falling in some months, and are still not hitting the central banks' target of annual inflation rate of 2.0%. While the positive supply shocks via technological innovations, low commodity prices and slack capacity had helped to ease inflation pressure, but the inflation will eventually catch up if the output gap narrows and the slack in product and labour markets diminish as the economy strengthens and demand gets stronger.
- **Global economic risks in 2018.** One potential shock that has received much attention relates to the pace of the Fed's monetary tightening if the risk of inflation is underestimated in months ahead. Rich asset valuations raise the likelihood of a market correction should there is a policy misstep or a protracted period of policy uncertainty, which could dampen growth and investors' confidence. And looming in the financial stability risk is a mountain of non-financial debt that makes markets nervous and increases the system's vulnerability to destabilizing shocks. Other key risks are the on-going Brexit negotiations, inward-looking policies that hinder global trade and market reforms. Rising geopolitical tensions can also weigh on market confidence and economic growth.

B. MALAYSIA'S ECONOMIC PERFORMANCE AND OUTLOOK

- **2017 ends on a strong footing.** The Malaysian economy delivered a strong momentum to grow by 5.9% in the first nine months of 2017 as both domestic demand and exports revved up. With a continued expansion of estimated 5.6-5.8% in 4Q17, the full-year GDP growth will end the year at 5.8-6.0%, the strongest in two years (4.2% in 2016 and 5.0% in 2015). Economic growth outlook for 2018 is now projected to rise by 5.1%, with domestic demand still taking the lead, albeit slower. The strong double-digit exports growth and export levels will normalize and grow at a slower pace (estimated 7.5% in 2018 vs. 19.8% in 2017) as the high base effect kicks in and also the waning effect of favourable exchange rate valuation due to the gradual strengthening of the ringgit.
- **Consumer spending remains intact.** By and large, the continued economic growth will be supported by domestic demand, thanks to still easy financial conditions and mildly expansionary budget. Despite coping with high cost of living, increasing prices of goods and services as well as high consumer debt (84.6% of GDP at end-Sep 2017), consumer spending has defied gravity as it grew by around 7.0% in 2017 and will likely to increase by 6.5% in 2018. The 2018 Budget measures such as RM6.8 billion cash handouts, RM3.0 billion of special payments to 2.3 million public servants and retirees, and RM1.5 billion tax savings from a 2% pts cut in personal income tax rate are expected to help spending power. Both middle-income 40 (M40) and top 20 high income (T20) households make up 75% of total private consumption.
- **Private investment expansion continues, albeit slower.** Private investment has finally moved out of a couple of quarters of low single-digit growth trap to expand by an estimated 8.3% in 2018 (estimated 9.0% in 2017). The drivers of investment are manufacturing and services. That said, with the 14th General Election must be held by June 2018, lingering uncertainties and concerns about the election outcome and policy changes may weigh on businesses' sentiment and thinking.
- **A broad-based expansion of economic sectors.** All economic sectors are projected to grow, albeit at slower pace in 2018. The services, manufacturing and construction sectors will continue to lead. The drivers of services are steady domestic spending, higher tourist arrivals, logistic services and financial services. The manufacturing sector's output will be underpinned by export-oriented industries (demand for electronics and electrical products, refined petroleum and wood products) and domestic-market oriented such as construction-related building materials, food products and transport equipment. The on-going civil engineering infrastructure projects such as ECRL, MRT SSP line, Electrified Double Track Gemas-Johore Bahru, SPE, Pan Borneo Highway, etc. will largely sustain the growth of construction sector. While the construction of residential and affordable housing programs should continue, growth of commercial and retail space development will slow due to property overhang.
- **Global demand to keep exports in positive trajectory.** With a strong double-digit pace of 20.4% in the first eleven months of 2017, exports are estimated to grow by 19.8% for the full-year, the fastest pace more than two decades since 1998 (29.7%). The robust exports were due to higher demand for a broad range of products, firmer commodity prices as well as favourable exchange rate valuation effects. Firmer global growth coupled with positive leads of global semiconductor industry, exports are estimated to grow by 7.5% in 2018. At this rate, it is still credible as it will be growing from a high base in 2017. In addition, the waning effect of exchange rate valuation will contribute to a moderate pace of annual growth.

- **Headline inflation will slow amid fuel still a wild card.** Amid the fuel prices variability, headline inflation moderated to 3.4% yoy in November (3.7% in October; 3.8% in 3Q). With inflation is estimated to rise to 3.6% in December, the full-year inflation will average 3.9% in 2017. We expect headline inflation to increase 3.0-3.5% in 2018, partly aided by a high base effect. Fuel prices remain a wild card and we assume global oil price of about US$60-65 per barrel (US$54 in 2017).

- **Private consumption and investment indicators continued to paint mixed performance.** Passenger car sales declined by an average of 4.5% yoy for four consecutive months between Aug-Nov, wiping off positive gains in the first half of 2017. Consumption credit and outstanding balance of credit cards are growing steadily. Commercial vehicles sales increased by 4.7% in Oct-Nov 2017 while imports of intermediate and capital goods extended their strong growth in Jan-Nov 2017. Household loan growth inched up slowly in recent months to 5.2% at end-Nov. In contrast, business loan growth eased sharply to a 15-month low of 2.3% in November.

- **BNM is getting prepared to hike interest rate in 2018.** Bank Negara Malaysia has signalled its readiness to review the current degree of monetary accommodation (overnight policy rate of 3.00%) given the stronger economic prospects. Our baseline call is 25 basis points hike for a start. The market must prepare for further rise in rates to a neutral level that would not discourage consumption, economic activity and investment if the conditions (steady economic growth, demand-induced price pressure and narrowing yield gap) are met throughout the year 2018.

- **Steadying prospects for the ringgit amid headwinds.** After trashing by a cumulative of 31.8% against the US dollar in 2013-16, the ringgit has strengthened by 10.8% for the first time in 2017, partly thanks to the onshore ringgit stabilization measures, including the stoppable of offshore ringgit trading and export proceeds conversion rules. Foreign reserves have stabilized, albeit rising slowly. One should remain wary about the state of capital flows and exchange rate pressure triggered by the Fed's continuation of rate hikes and shrinking of its balance sheet. The impending GE14 could provide the ringgit with headwinds in the first half-year. On balance, still good economic and financial fundamentals are positive supportive of the ringgit, which is fundamentally undervalued. The ringgit is expected to be RM3.80-3.90 by end-2018.

GLOBAL GROWTH CONTINUES RISING

Global economy's momentum to continue in 2018. After exceeding expectations in 2017, the global economy is expected to carry forward its current momentum throughout 2018, thanks in part to accommodative monetary policy and fiscal stimulus. The global economy is fired on all cylinders, with the US, eurozone, Japan and China have simultaneously experiencing sturdy economic growth for the first time in 2017 since 2008-09 Global Financial Crisis, joined by the emerging economies.

The state of global liquidity conditions, albeit tighten gradually remained supportive of asset-prices. The growth catalysts are in place to ensure continued and broadening economic growth in 2018. Global trade has strengthened as manufacturing activity firmed up and investment growth bottomed out. The job market is doing better; wages and income growth has improved. Inflation risk is seemingly missing in the growth equation but will eventually rises up as the output gap narrows and demand expands. The International Monetary Fund (IMF) estimated global growth to increase by 3.7% in 2018 (3.6% in 2017).

The U.S. economy grew at its fastest pace in more than two years in the third quarter (3.2% annualised qoq vs. 3.1% in 2Q), powered by robust business spending, and is poised for what could be a modest lift next year from sweeping tax cuts passed by Congress. Eurozone's GDP growth of 0.6% qoq and 2.3% yoy in 3Q17 made 2017 the best year of growth since the Global Financial Crisis. A robust labour market recovery, growing export markets, an accommodative monetary stance, improving lending conditions and modest inflation are the tailwinds that the eurozone economy is experiencing. Japan's economy grew at a solid pace in 3Q17 (2.5% annualised qoq vs. 2.9% in 2Q), notching a seventh consecutive quarter of growth as exports helped compensate for underwhelming domestic demand.

Both China and India economies, which contributed more than 40% of global GDP are expected to deliver mixed performance. China's growth is estimated to moderate to 6.5% yoy in 2018 and 5.8% in 2022 from estimated 6.8% in 2017. The Chinese authorities are expected to push further major reforms affecting state-owned enterprises (SOE) and forced continued deleveraging, which would weigh on growth and could lead to more tolerance for the Chinese renminbi's depreciation. India's growth will strengthen from estimated 6.7% in 2017 to 7.4% in 2018 and 8.2% in 2022.

Current and forward indicators point to continued global momentum. The OECD Composite leading indicators continue to stay above the long-term average for six months in a row and is expected to keep on growing steadily. Global Purchasing Managers indices (PMI) for both manufacturing and services sectors were sustained in the fourth quarter, underpinned by expansion in output and new orders. The extension of the OPEC and allies' oil output cut deal through the end of 2018 is sending a strong signal that the oil market rebalancing could speed up in 2018. Oil prices have experienced a remarkable rise in recent months, in part buoyed by tension in Iran. In addition, continued trading activities and firm global demand for chips will sustain global trade and exports.

Global economic risks in 2018. Despite the expected continuing global economic expansion, one should not remain complacency as there are potential risks and uncertainties that could temper market confidence as well as affect growth and investment activity. Policy uncertainty will remain in 2018, and the risks include unexpected changes in monetary policies, the financial-sector uncertainty in major economies, as well as geopolitical turmoil. Pressures for protectionism are building up. Policy driven risks like Brexit's negotiation process, contractionary monetary policy in the US and the possible monetary shift in Japan and euro area will continue to stir market uncertainty. With the US stock market scaling new peaks amid the rich market valuations heighten fears of an imminent market correction should the market multiples do not supported by prospective corporate earnings.

Figure 1: Real GDP growth (% YoY)

	2015	2016	2017 1Q	2017 2Q	2017 3Q	2017*E* (IMF)	2017*E* (WB)	2018*f* (IMF)	2018*f* (WB)
United States	2.9	1.5	2.0	2.2	2.3	2.2	2.3	2.3	2.5
Euro Area	2.1	1.8	2.7	1.8	2.3	2.1	2.4	1.9	2.1
China	6.9	6.7	6.9	6.9	6.8	6.8	6.8	6.5	6.4
Japan	1.4	0.9	1.5	1.6	2.1	1.5	1.7	0.7	1.3
India[1]	8.0	7.1	6.1	5.7	6.3	6.7	6.7	7.4	7.3
Malaysia	5.0	4.2	5.6	5.8	6.2	5.5-6.0	5.8	5.0-5.5	5.2
Singapore	1.9	2.0	2.5	3.0	5.4	2.5	-	2.6	-
Indonesia	4.9	5.0	5.0	5.0	5.1	5.1	5.1	5.3	5.3
Thailand	2.9	3.2	3.3	3.8	4.3	3.7	3.5	3.5	3.6
Philippines	6.1	6.9	6.4	6.7	6.9	6.6	6.7	6.7	6.7
Vietnam	6.7	6.2	5.2	6.3	7.5	6.3	6.7	6.3	6.5

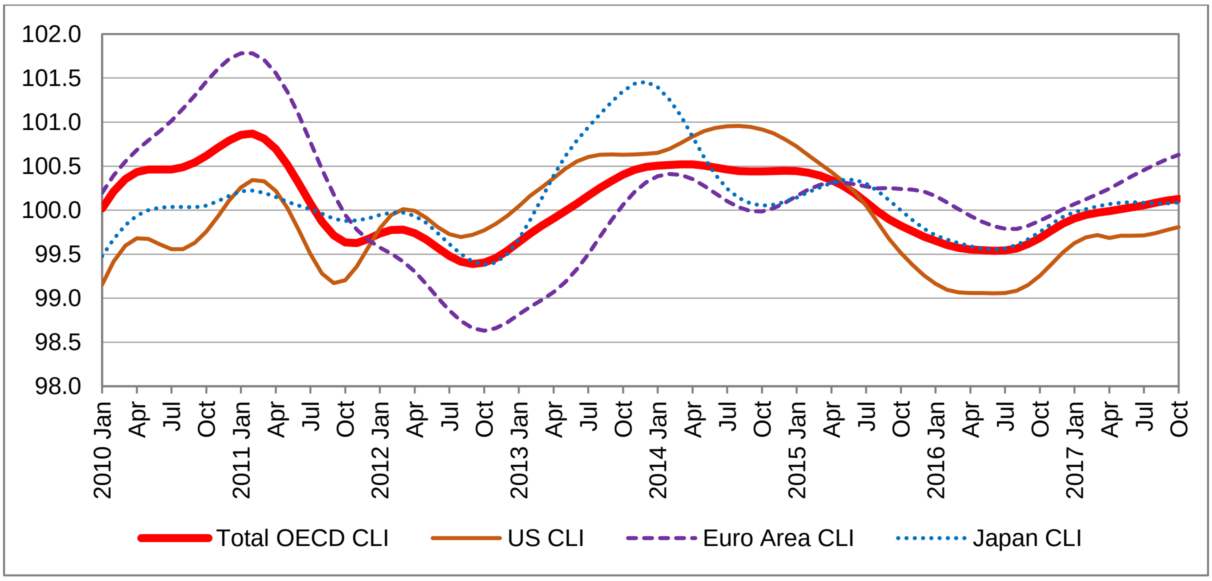
Source: Officials; IMF (World Economic Outlook, October 2017; Recent Article IV Consultations); World Bank (Global Economic Prospects, January 2018; East Asia and Pacific Economic Update, October 2017)

Note 1: Annual GDP for India is on fiscal year basis, as per reporting practice of the country.

A. SNAPSHOT REVIEW OF KEY GLOBAL ECONOMIC INDICATORS

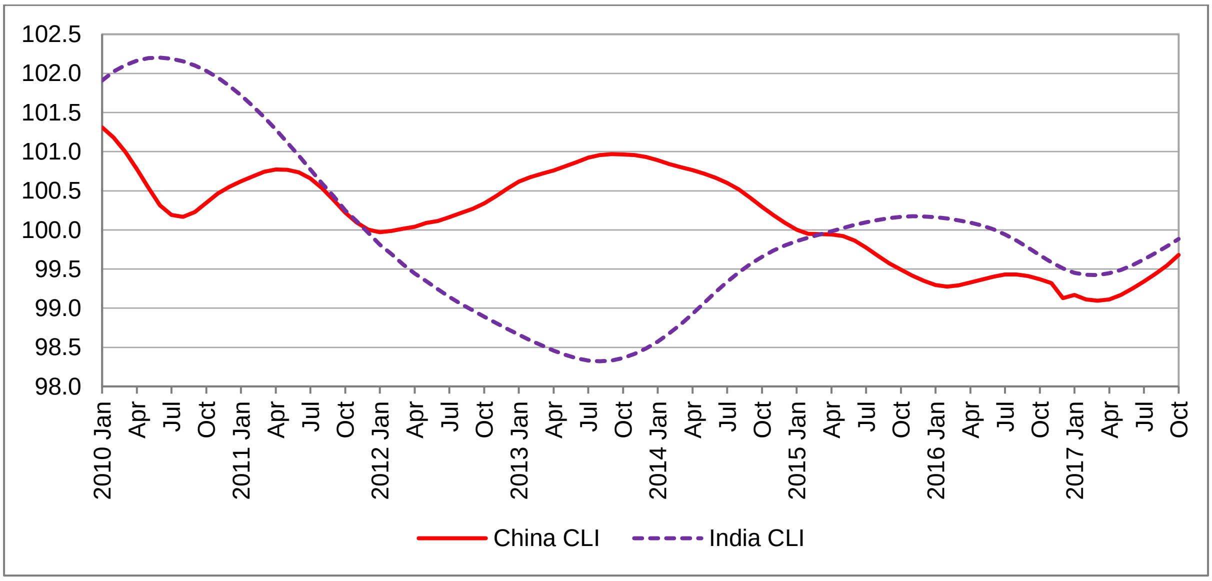
1) The **composite leading indicators (CLIs)** indicate continued stable growth momentum in the OECD area. The CLI index increased by an annual rate of 0.4% in October, staying above its long-term average for six consecutive months. Large emerging economies like Russia and India are showing stable growth while Brazil's growth is firming. China is expected to gain growth momentum.

Figure 2: OECD CLI stays above its long-term average for six consecutive months



Source: OECD

Figure 3: China shows sign of gaining growth momentum

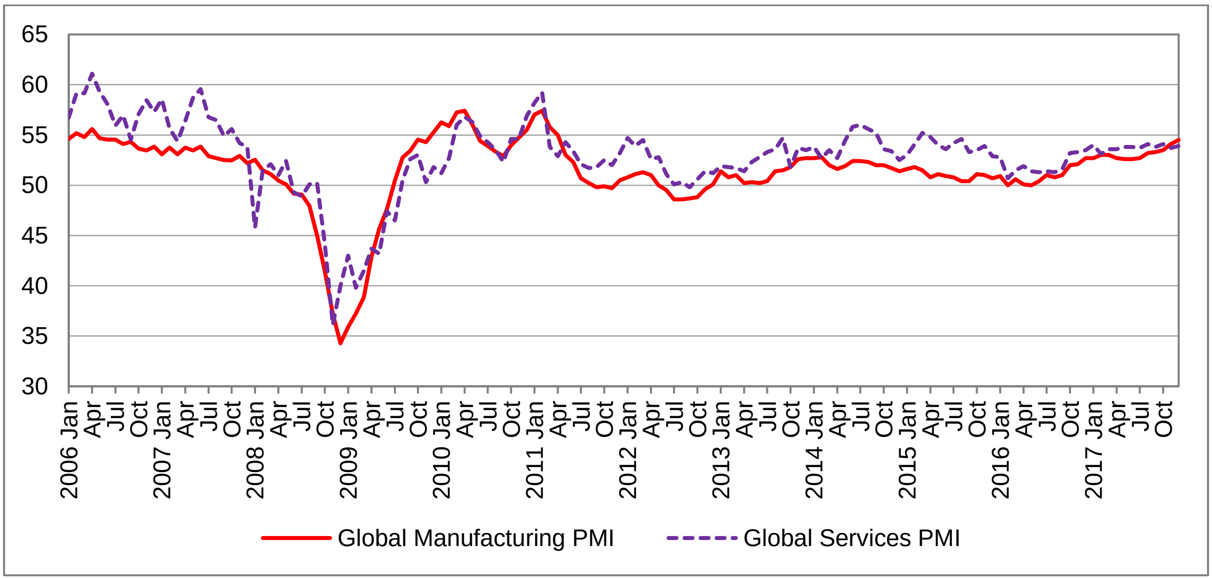


Source: OECD

2) The **global manufacturing PMI** ended 2017 at near seven-year high of 54.5, marking a 22-month of consecutive expansions (54.1 in November). The expansion in output and new orders accelerated to strong levels last seen since February 2011, leading to improved jobs growth and rising business optimism. This strong pace of performance set the base for a strong start in 2018.

   The PMI reading for **global services sector** improved to 53.9 in December (53.7 in November), the highest point since 2Q15, taking the fourth quarter's average index to be the same level as in 3Q17. New business improved at a faster pace though the positive sentiment slipped to a 15-month low.

Figure 4: Global PMI for manufacturing and services sectors trending higher



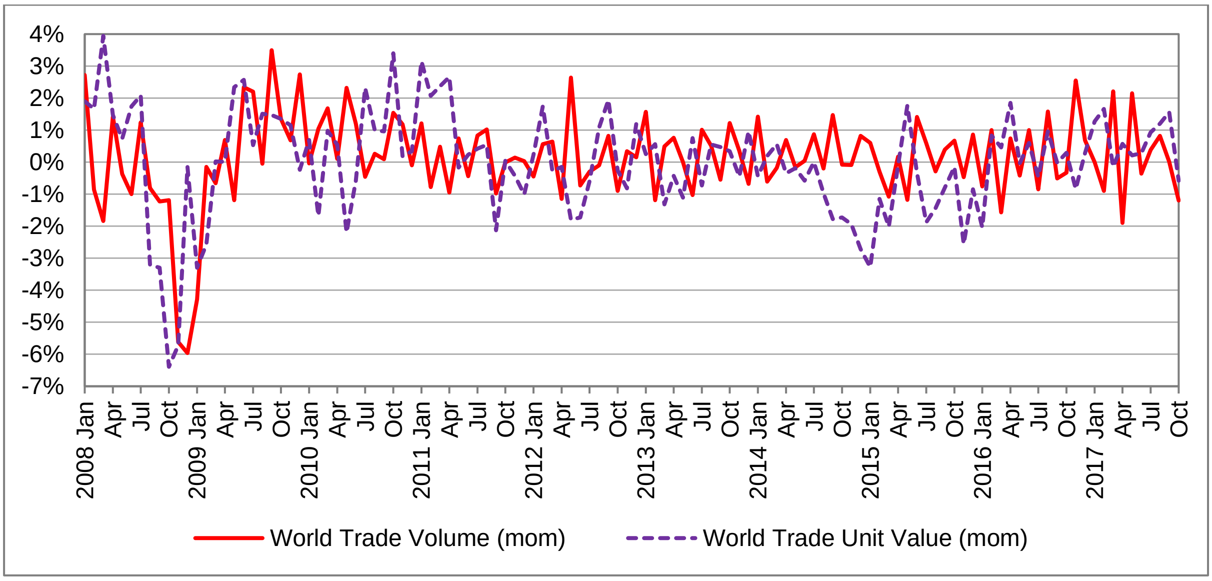
Source: Markit

3) **World trade volume** dropped by 1.2% mom in October after a stagnant growth in September (+1.4% qoq in 3Q). Both export and import volumes contracted by 1.9% mom and 0.5% respectively in October (+1.2% qoq and +1.6% respectively in 3Q). Nevertheless, world trade volume had registered unbroken growth since February 2016.

   In 3Q17, all regions recorded positive growth except Eastern Europe/CIS (-0.5% qoq). For advanced economies, Japan grew at the fastest pace (1.9%), followed by euro area (1.2%) and the United States (0.4%). For emerging economies, emerging Asia led the race with a 2.2% growth and Latin America came in second (1.9%) while Africa and Middle East only edged up 0.1%.

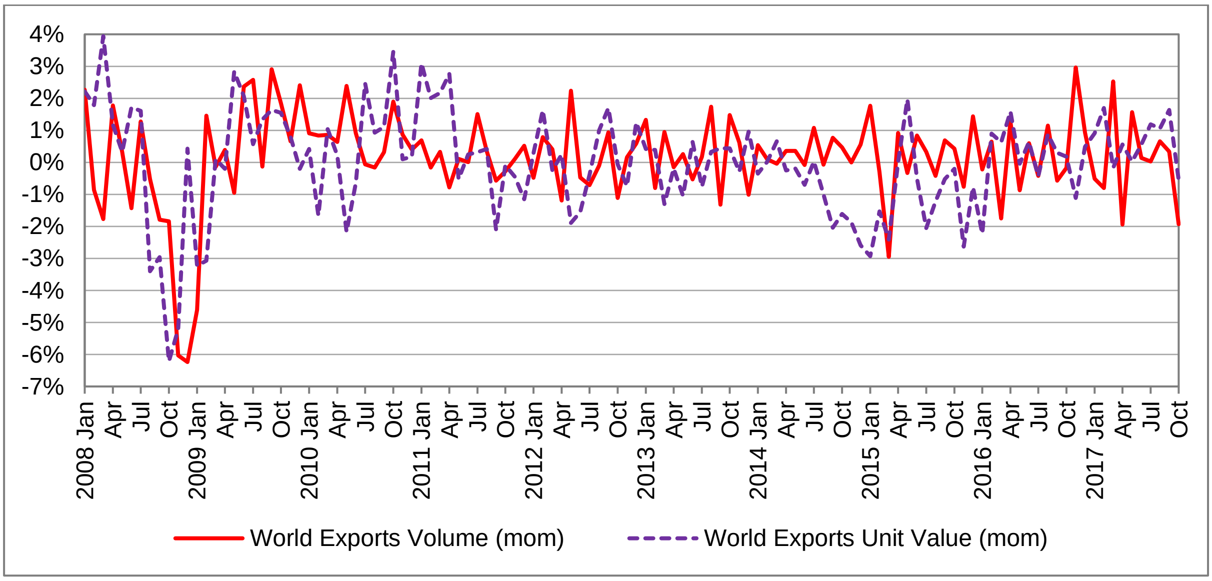
   The WTO's latest World Trade Outlook Indicator (WTOI) suggests that global merchandise trade growth will likely moderate in 4Q17 with a reading of 102.2 (102.6 in 3Q). By component, the indices of export orders, container shipping and air freight remained above the medium-term trend though pointing to an easing growth. Electronic components and agriculture raw materials showed rising trend. Automobile production and sales seem to be bottoming out after falling below trend since the beginning of the year.

Figure 5: World trade volume contracted by more than 1% for the second time in 2017



Source: CPB Netherlands Bureau for Economic Policy Analysis

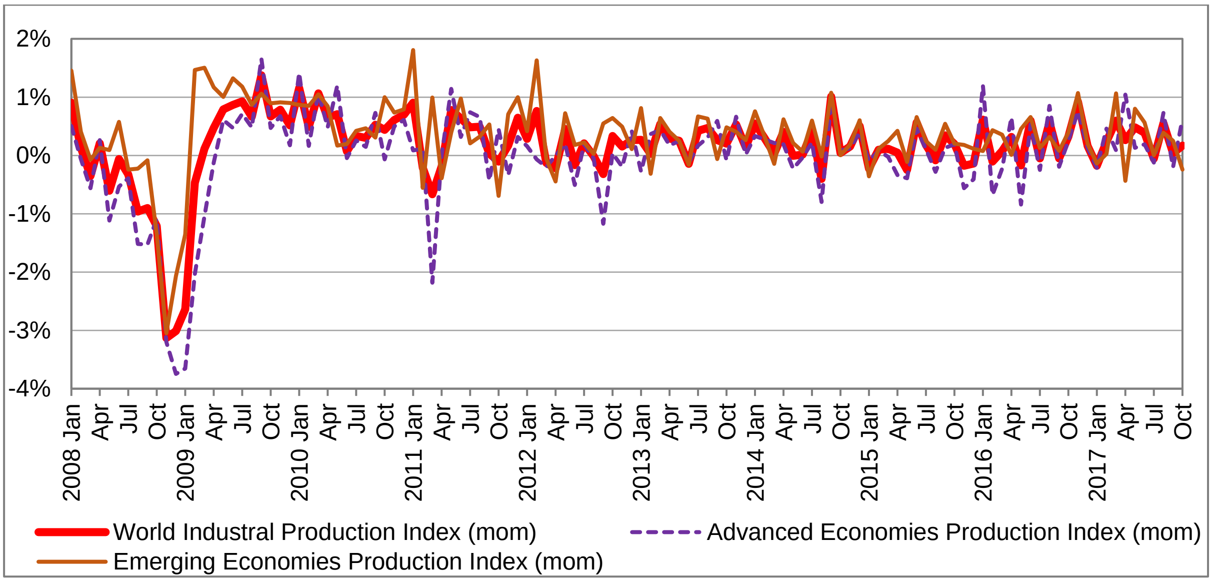
Figure 6: World exports volume reverted to decline after five consecutive of growth



Source: CPB Netherlands Bureau for Economic Policy Analysis

4) **World industrial production** gained 0.2% mom in October 2017 from a nearly stagnant growth in September (0.7% qoq in 3Q). Industrial output showed mixed results in both advanced (+0.6% mom in October and -0.2% in September) and emerging economies (-0.2% in October and +0.3% in September). In advanced economies, the US grew the fastest by 1.2%, followed by Japan (0.4%), Euro Area (0.1%) and other advanced economies (0.6%). The sub-regions of emerging economies which recorded contractions were Latin America (-0.7%), Central and Eastern Europe (-0.3%) and emerging Asia (-0.2%). On an annual basis, advanced economies grew by 3.7% yoy while emerging economies up 3.6%.

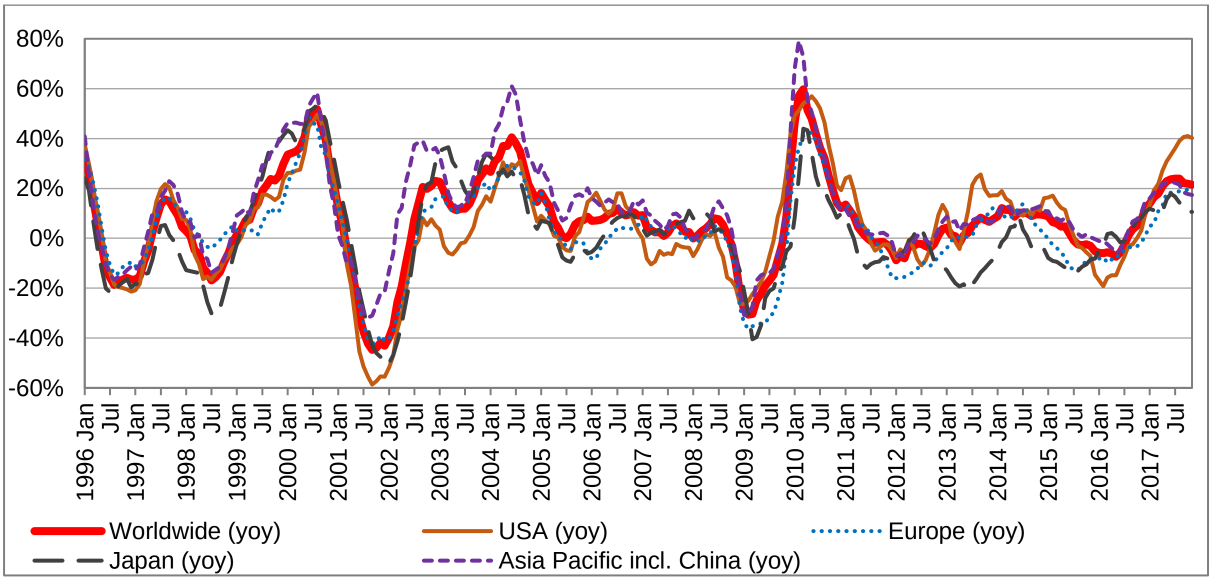
Figure 7: World industrial production continues to fluctuate



Source: CPB Netherlands Bureau for Economic Policy Analysis

5) **Global sales of semiconductors** continued to expand at strong double-digit growth of 21.5% yoy to US$37.7 million in November 2017 (21.9% in October and 23.3% in 3Q), marking a 16-month of consecutive growth. On a cumulative basis, total semiconductor sales rose by 20.9% to US$367.1 million in Jan-Nov 2017, looking set to achieve a full year sales of US$400 million. By region, sales in Americas region led the buoyant chip sales with a strong 40.2% growth in November, followed by Europe (18.8%), China (18.5%), Asia Pacific/All Other excluding-China and Japan (16.2%) and Japan (10.6%). All regions recorded double-digit growth since April 2017. The last time we had seen strong double-digit sales growth was in Feb-Oct 2010. On a monthly basis, global chip sales growth also expanded firmly for nine consecutive months.

Figure 8: Robust global semiconductor sales growth led by the US market



Source: Semiconductor Industry Association (SIA)

The **World Semiconductor Trade Statistics** (WSTS) revised upward its projection of semiconductor sales for 2017 for the fifth time, to rise by 20.6% to US$409 billion (1.1% in 2016). Higher growth estimated across all the regions: Americas (31.9%, share: 21.2%); Asia Pacific (18.9%; share: 60.6%), Europe (16.3%; share: 9.3%) and Japan (12.6%; share: 8.9%). Gartner also expects a 19.7% growth in semiconductor sales in 2017, indicating that memory will continue to lead the market higher while non-optical sensors, analog, discretes and image sensors are projected to grow over 10% in 2017. The upward revision supported by other semiconductor forecasters, i.e. IC Insights (22.0%), Semiconductor Intelligence (21.0%) and IHS Markit (21.0%) in their latest projection.

However, Semiconductor Intelligence, WSTS and Gartner expect semiconductor sales growth will moderate to 12.0%, 7.0% and 4.0% respectively in 2018. Gartner forecasts the market will decline by 1% in 2019 due to an increase supply in the memory market.

6) **Global oil price**, as benchmarked by Brent crude, which averaged US$49.55 per barrel in 2Q (US$53.59 per barrel in 1Q17), inched higher to US$52.10 in 3Q and US$61.40 in 4Q. This brings the full-year oil price average to US$54.12, an increase of 24% from US$43.64 in 2016. The Brent oil price started the year 2018 on a strong note, hovering between US$66.65 and US$68.73 in the first five trading days of 2018.

Both OPEC and non-OPEC countries agreed to extend the crude oil supply cut from end-March 2018 to end-2018. Two large oil exporters, Saudi Arabia and Russia are committed to 1.8 million barrel cut per day though Russia has expressed concern on the extension may trigger more shale oil production from the US, which is not participated in the production cut practice. In October, both OPEC and the non-OPEC groups managed to reach the oil production cutback target together for the first time with 104% and 105% compliance respectively. A majority of the nations have fully complied or reached at least 80% on average during the first ten months of 2017.

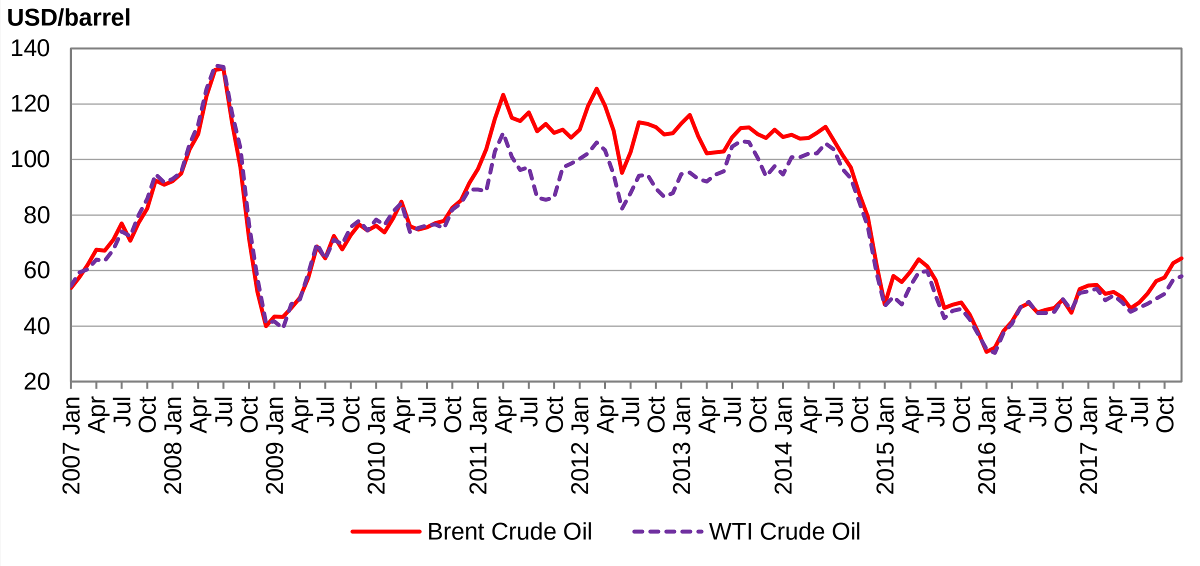
Investors are more optimistic that the oil market will further tighten next year and support higher oil prices, but rising U.S. shale production will likely cap any significant price gains. Expectations are that global economic growth will support solid oil demand growth. Potential geopolitical tensions in the Middle East mostly with the Saudi-Iran issues and the Iraq-Kurdistan standoff may take more barrels off the market.

There remain three potential risks in the markets that could temper the strength of oil prices: The risk of a sharp correction in the stock market that causes a sharp retracement of commodity prices; non-compliance by both OPEC and non OPEC members on the oil output cut; and increased production by the US shale producers.

OPEC estimated that the world oil demand to increase by 1.51 million barrel per day (mb/d) to 98.45 mb/d in 2018 (96.94 mb/d in 2017 and 95.42 mb/d in 2016), with higher demand mainly coming from China (+0.41 mb/d to 12.67 mb/d), India (+0.19 mb/d to 4.65 mb/d) and the United States (+0.18 mb/d to 20.42mb/d). They collectively accounted for 38.3% of the total projected oil demand.

The average Brent crude oil prices in 2018 are estimated at US$60-65 as against the US Energy Information Administration (EIA)'s projection of US$57.26. Petroleum Nasional Berhad (Petronas) projected that the oil price will be hovering between US$50-60 over the medium-term (2018-2020).

Figure 9: Brent crude oil price trending higher on supply cut and geopolitical tension



Source: US Energy Information Administration

US – TAX REFORM LIFTS GROWTH PROSPECT

The U.S. economy grew at its fastest pace in more than two years in 3Q17at an annual rate of 3.2% qoq (3.1% in 2Q), powered by robust business spending (7.3% vs. 3.9% in 2Q) while consumer spending eased to 2.2% in 3Q from 3.3% in 2Q.

Data on retail sales suggests consumer spending accelerated in October and November, supported by steady wage gains and household savings. Sales of retail trade and food services jumped by 6.4% mom to US$499.1 billion in November (4.9% in October and 3.8% in 3Q), the highest increase since February 2016, mainly helped by automotive sales. E-commerce retail sales has been growing at double-digit since 4Q09 had recorded 15.5% growth in 3Q17.

Employment situation seems to have recovered from the Hurricane effect. A total of 611,000 jobs were created in 4Q17, marking the best quarter since 3Q17 with employment gains in healthcare, construction and manufacturing sectors. Unemployment rate stood firm at 4.1% for third consecutive month. Average hourly pay-out increased by 2.5% yoy to US$26.63 in December (2.4% in November).

Industrial production index increased further by 3.4% yoy in November (2.9% in October and average 1.7% in 3Q), supported by a stable growth of 2.4% in manufacturing sector while the mining output jumped 9.4% after stabilising post the Hurricane Nate. Manufacturing ISM ended higher (59.7% in December vs. 58.2% in November). The non-manufacturing ISM though slowed to 55.9% in December (57.4% in November), it has been expanding for 96th consecutive month.

Headline inflation edged higher to 2.2% yoy for November 2017 (2.0% in October), mainly lifted by the prices of gasoline and fuel oil. The core inflation, i.e. all items less food and energy eased a little to 1.7% in November (1.8% in October). Year to date, the headline and core inflation rates averaged at 2.1% and 1.9% respectively. The Federal Reserve expects inflation rate to stabilize around its target of 2% in the medium term.

The most radical overhaul of the US tax code containing US$1.5 trillion in tax cuts was signed into legislation by President Trump. The tax reform includes reducing individual tax rate in various tax brackets with the cap of 37% (from 39.6% in previous), tax cut for corporations from 35% to 21%, nearly double of standard deduction and higher child tax credit as well as the introduction of repatriation tax of 8% for illiquid assets and 15.5% for cash and cash equivalents. The new tax comes effect in 2018.

Figure 10: Highest US GDP growth for the past two years

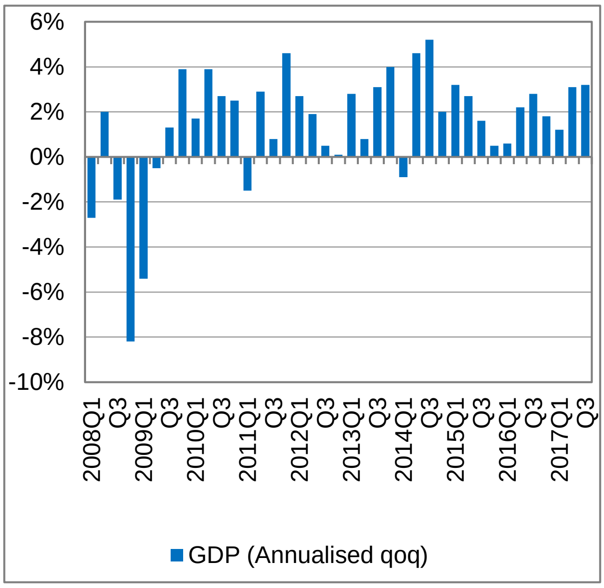


Figure 11: Accelerating investment; moderating consumption

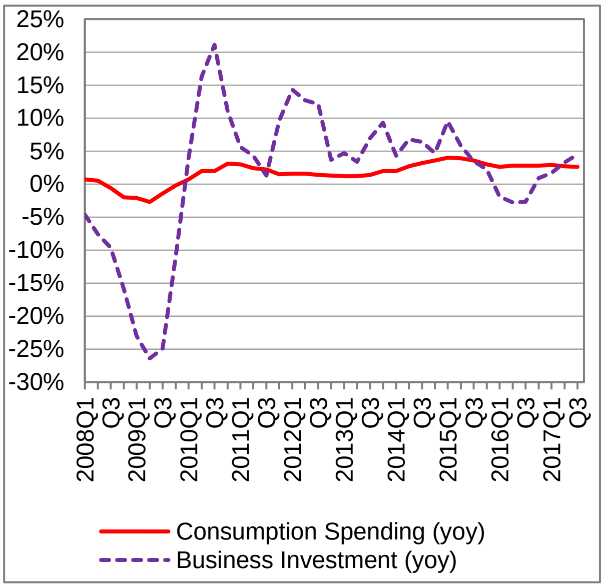


Figure 12: Manufacturing PMI remains strong

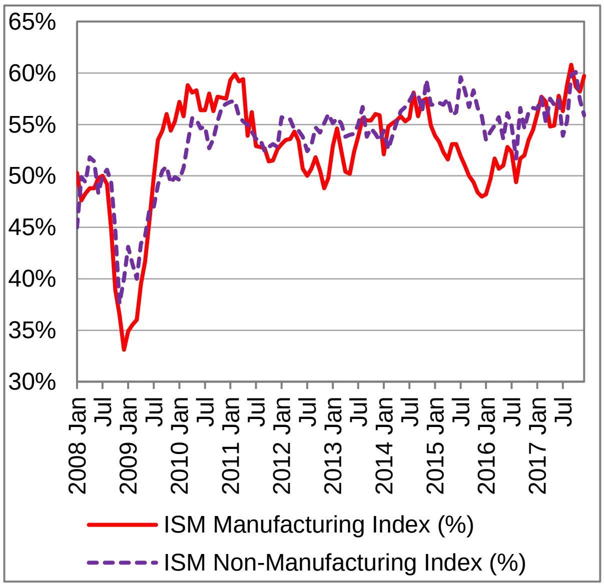


Figure 13: Robust growth of industrial production and retail sales

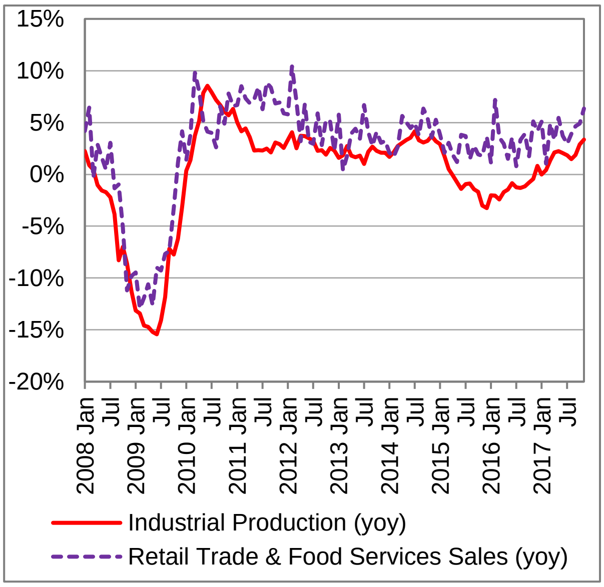


Figure 14: Job gains continue despite Hurricane effect

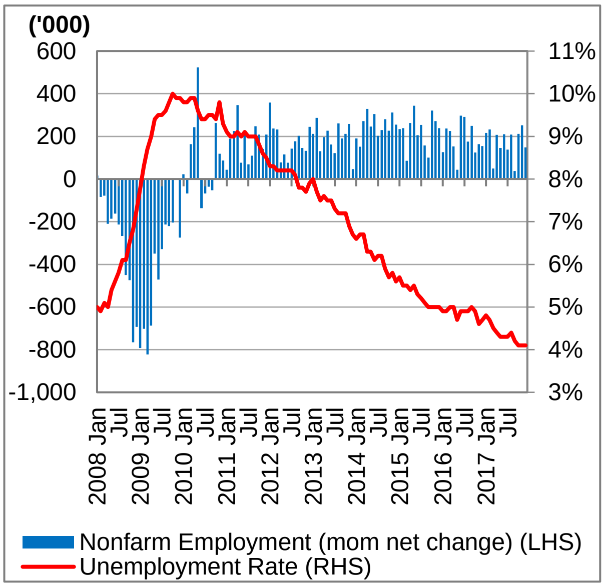
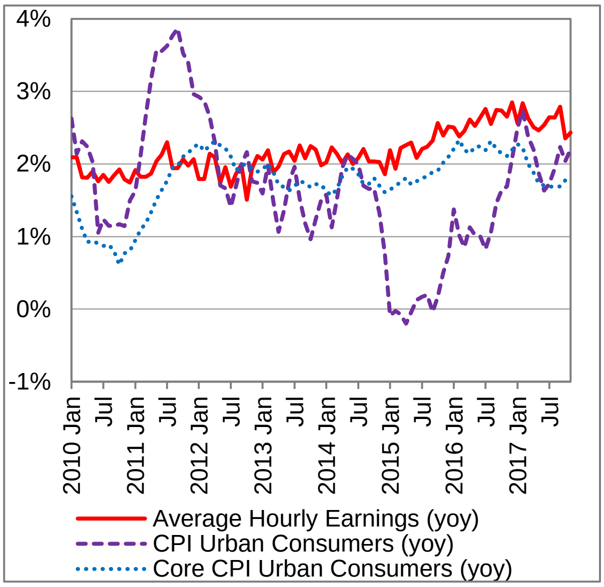


Figure 15: Headline inflation is picking up above 2%



Source: US Bureau of Economic Analysis; Institute for Supply Management; Federal Reserve System; US Census Bureau; US Bureau of Labor Statistics

EUROZONE – FAVOURABLE OUTLOOK

The eurozone economy continued to roar ahead in 3Q17 (0.6% qoq and 2.5% yoy vs. 0.7% and 2.3% yoy in 2Q), the fastest pace of growth in over a decade, largely boosted by a booming domestic demand. Private consumption was supported by the continued strengthening of labour market while high business investment spurred fixed investment. The external sector turned more supportive to growth in 3Q as export growth despite an erosion in competitiveness due to a strong euro.

The economic sentiment indicator (ESI) has reached 116.0 pts in December, the highest level since October 2000, of which the consumer confidence indicator turned positive for the first time in November since February 2001.

Manufacturing PMI brushed up a new record in December 2017 (60.6 vs. 60.1 in November), underpinned by strong expansion in output, new orders and employment. Services activity also expanded strongly (PMI reading of 56.6 in December vs. 56.2 in November).

In October 2017, industrial production expanded further by 3.7% yoy (3.4% in September), lifted by rising production of durable and non-durable consumer goods, intermediate goods and capital goods. Retail trade volume growth slowed to 2.8% in November and 0.4% in October from a 2-year high of 4.1% in September. On the job market, unemployment rate continues its moderation trend to 8.7% in November, which last seen in January 2009.

The inflation rate in November climbed to 1.5% (1.4% in October and 1.5% in September), mainly brought up by fuels for transport (+0.21 ppt). Without the energy factor, the inflation remains stable at 1.2% since June except September.

Figure 16: Stable growths in Eurozone economy

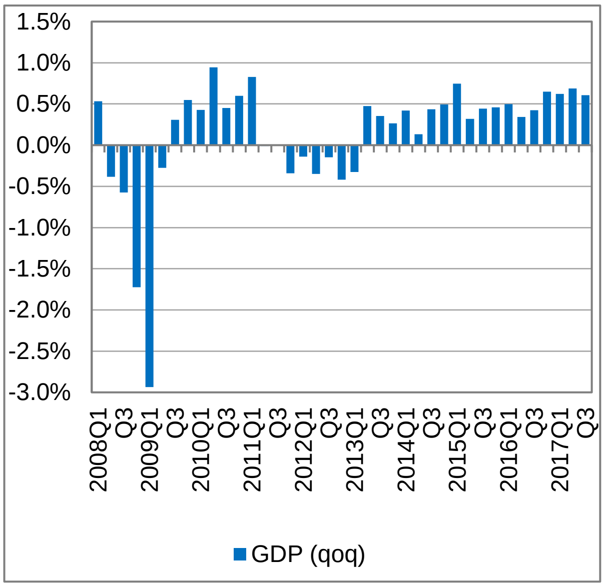


Figure 17: Domestic-driven growth

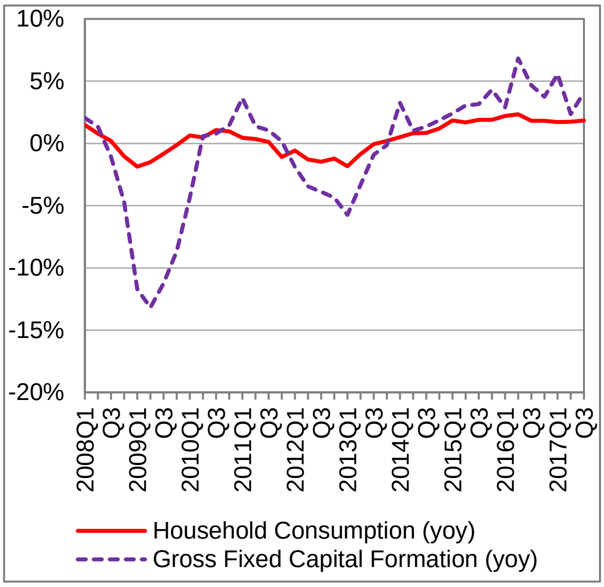


Figure 18: Firm positive outlook for manufacturing sector

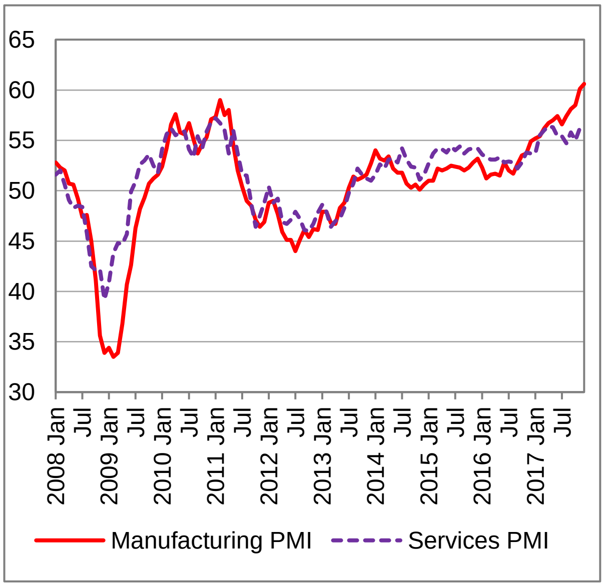


Figure 19: Expanding industrial production; softening retail volume

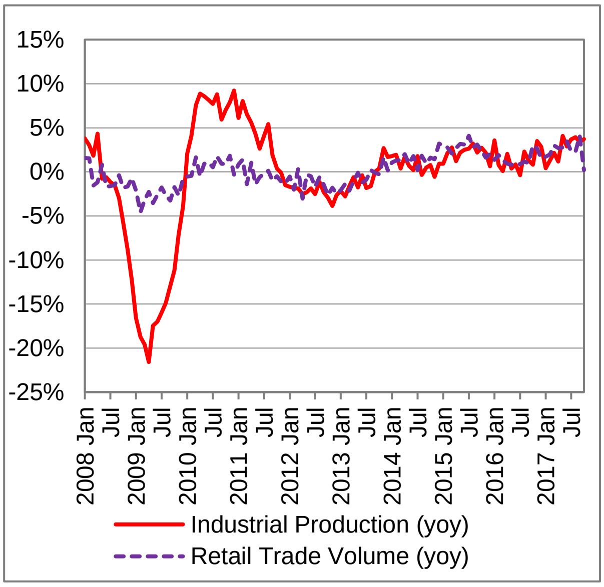


Figure 20: Lowest unemployment rate since Jan 2009

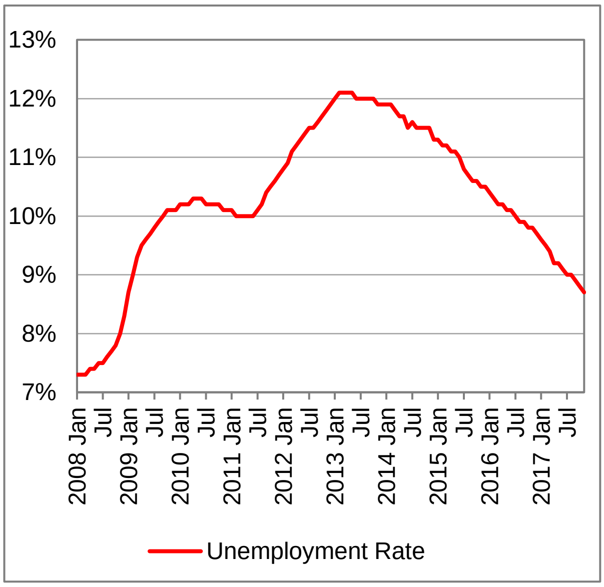
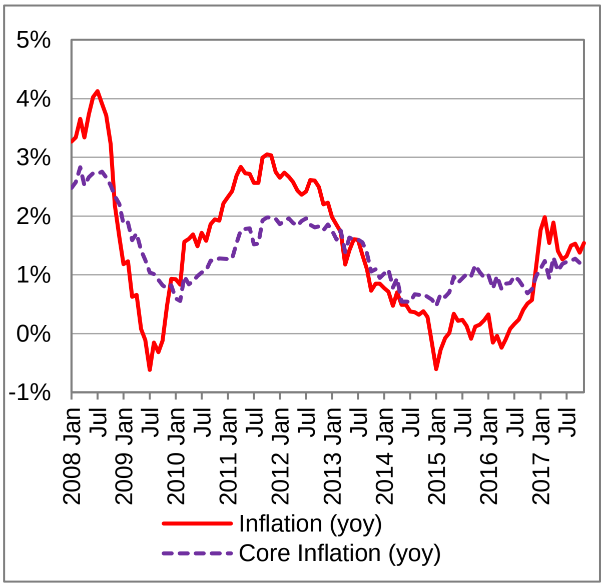


Figure 21: Inflation rate is stable in the second half-year



Source: Eurostat; Markit

JAPAN – PUSHING TAX REFORM TO BOOST SPENDING

The economy grew an annualised 2.5% qoq in 3Q17 (2.9% in 2Q), marking seven straight quarters of growth and the longest stretch on record. While export growth is driving corporate profits and business investment, wage gains and consumer spending remained lacklustre.

In efforts to stimulate household spending and uplift the economy out of protracted years of sticky deflationary pressures, the Government unveiled a tax reform plan on 14 December, which includes measures to lower taxes for firms that increase wages by 3%. The tax relief will be only for three years. The healthy pace of growth seems carried through into 4Q17 as supported by sustained global demand. In addition, the projects related to 2020 Olympic Games in Tokyo are believed to continue lifting investment activities.

Overall economic indicators are on the upside. While general business sentiments are positive for large and medium enterprises, small enterprises were adversely affected. Even though core machinery orders (a leading indicator of capital spending over a three- to six-month period) turned around from a decline of 8.1% mom in September to 5.0% in October, the overall fourth quarter is estimated to fall by 3.5% qoq. On another positive note, manufacturing PMI reached a 46-month high at 54.0 in December (53.6 in November). The services PMI stays above the threshold for fifteen consecutive months by registering 51.1 in December.

Exports, which has been growing at double-digit for five months since July 2017 had recorded an increase of 16.2% yoy for November (14.0% in October and 15.1% in 3Q). Industrial production recorded a second strongest growth for the year at 5.9% in October and preliminary November data shows a further growth of 3.7%. Retail sales growth bounced back to 2.2% in preliminary November data (-0.2% in October and 2.3% in September).

Unemployment rate improved further to 2.7% in November, after holding steadily at 2.8% for five months and is the best unemployment rate since November 1993. Inflation rate increased higher in November (0.6% yoy vs. 0.2% in October), driven by higher prices of fuel and utilities, medical care as well as transportation and communication. Core inflation (all items, less food (less alcoholic beverages) and energy) ticked up to 0.1% in November after remained flat for three months.

Shinzo Abe has been re-elected as Prime Minister of Japan after winning the election with strong majority. To re-cap, Abe has planned for a national sales tax hike to 10% in 2019 so as to fund higher allocation for child care and education. This could potentially general price level higher prior to the implementation.

Figure 22: Japan's economy grows qoq for seven consecutive quarters

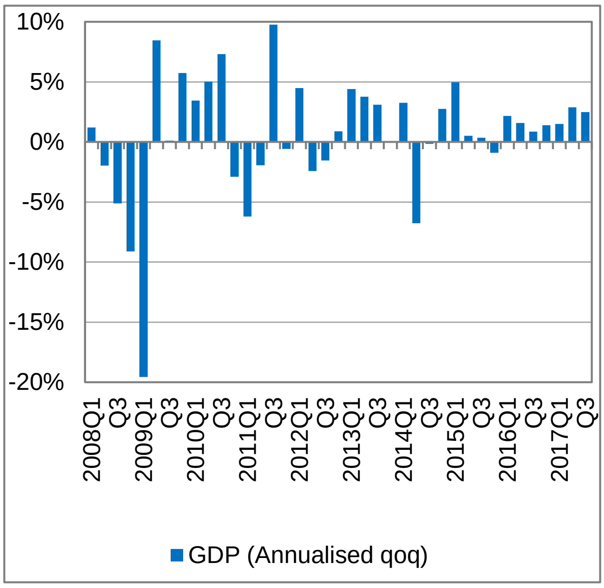


Figure 23: Private consumption softens in the third quarter

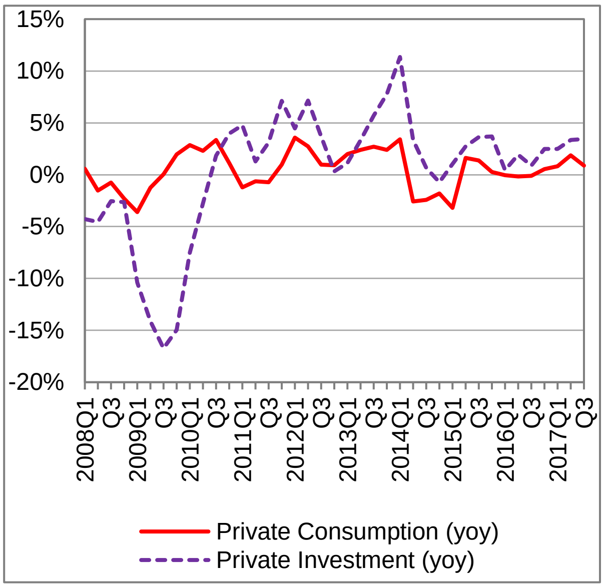


Figure 24: Strong industrial output while retail sales weaken

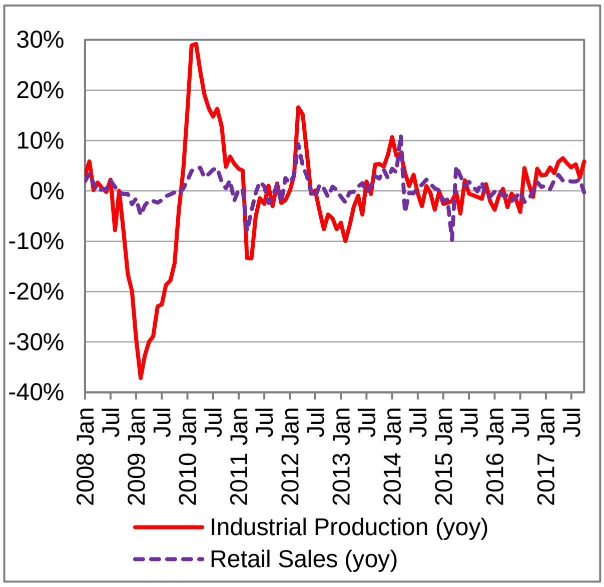


Figure 25: Exports on a firm growth

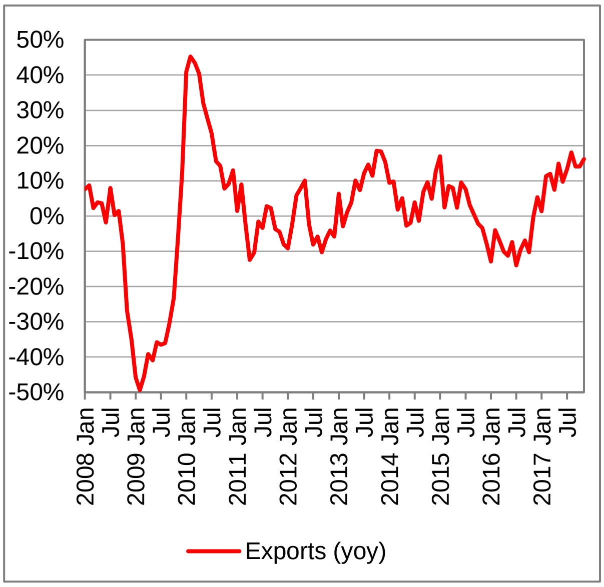


Figure 26: Unemployment rate at its best since November 1993

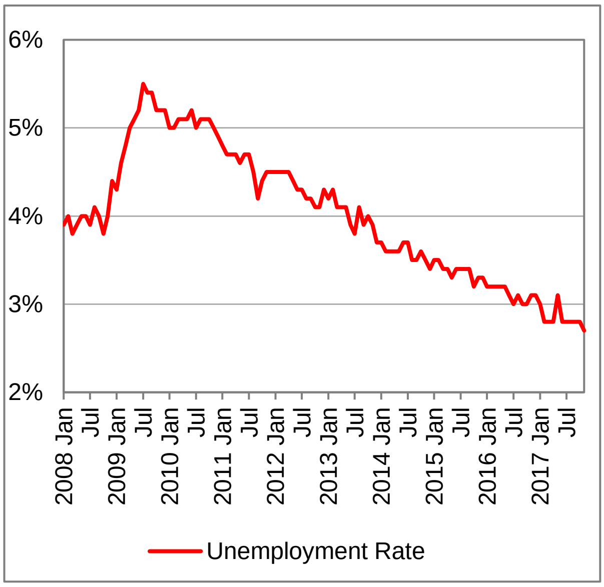
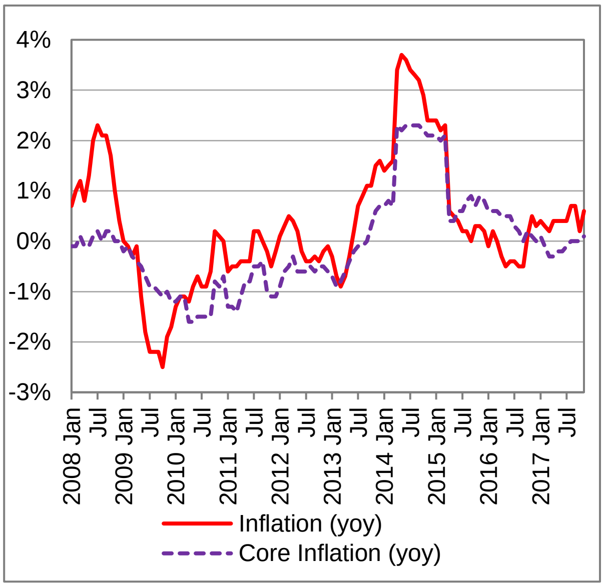


Figure 27: Inflation rate remains low



Source: Economic and Social Research Institute; Ministry of Economy, Trade and Industry, Japan; Japan Customs; Statistics Bureau, Japan

CHINA – SOFT-LANDING TO A NEW NORMAL GROWTH

China's economic growth moderated marginally to 6.8% yoy in 3Q17 (6.9% in 2Q and 1Q) but still way above the full-year target of 6.5%. The tertiary industry remains as the largest contributor with a 50.0% and also the primary driver of growth, growing by 8.0% in 3Q (7.6% in 2Q). The gradual growth moderation underscores China's economic restructuring remains firmly on the path of a more sustainable growth trajectory amid the strong commitment to control the debt and maintain financial stability. The economic growth rate has been hovering between 6.7-6.9% over the past nine quarters.

China manufacturing PMI continues to maintain at its average level for the year 2017 at 51.6% in December, underpinned by steady growth in production and new orders. The non-manufacturing sector continued to expand since February 2010, of which PMI readings for the services industry stood at 53.4% and 63.9% for the construction industry.

Other lead indicators appear to suggest that economic momentum has lost some steam in 4Q17. Investment growth decelerated further in November due to a cooling property market; industrial production remained weak amid the government's campaign to improve air quality. In contrast, retail sales grew higher by 10.2% in November (10.0% in October). Online retail sales hit RMB6.4 trillion in the first 11 months of 2017, marking a 32.4% growth (26.2% in Jan-Nov 2016). Sales of physical goods accounted for 76.4%, growing by 27.6% while non-physical goods expanded 50.7% during the same period.

China's property cooling measures seem effective to curb the increasing housing prices over the past few months. There were 11 medium and large-sized cities experienced decline in housing prices on an annual basis in November, resulting in an average growth of price index slowed to 5.4% as compared to the double-digit growth in the beginning of the year.

The Beijing authorities continue to stress that they will contain financial leverage and seek to ensure that the financial sector effectively supports the real economy to reduce major risks such as soaring corporate debt.

Figure 28: Steadying economic growth

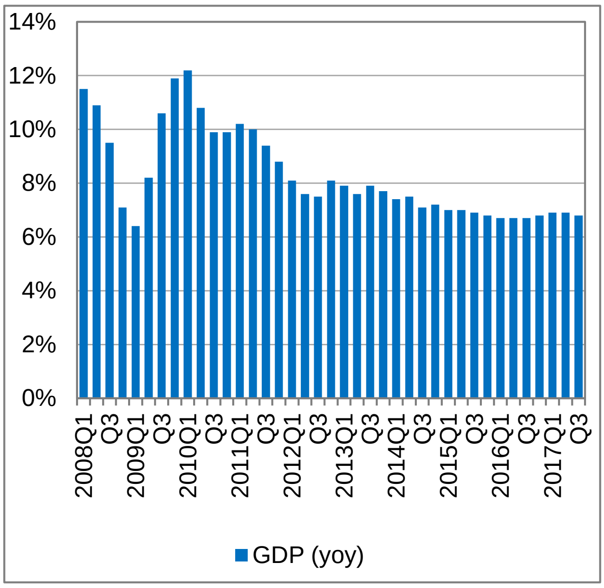


Figure 29: Retail sales growth hovering between 10.0-11.0% since March

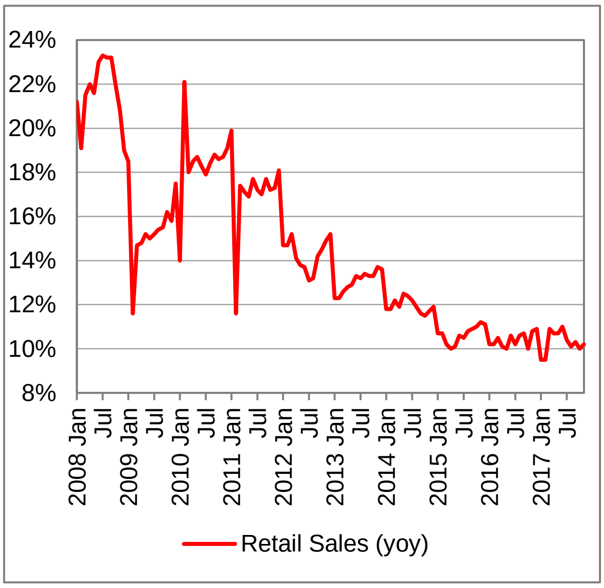


Figure 30: PMI readings suggest stable expansion

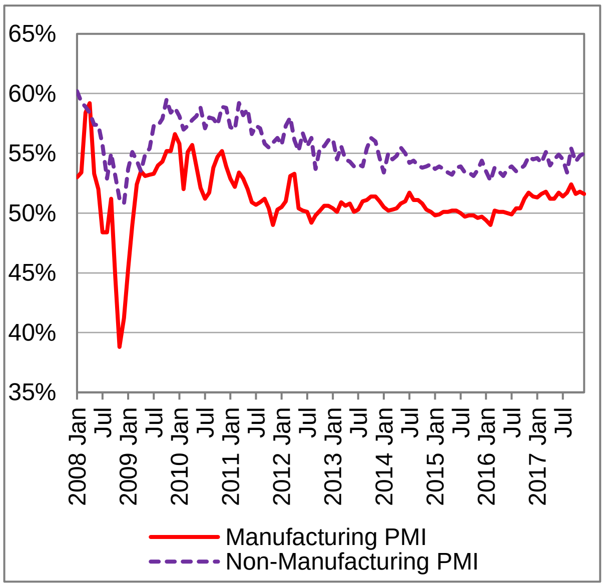


Figure 31: Industrial production growth fluctuates less since January 2015

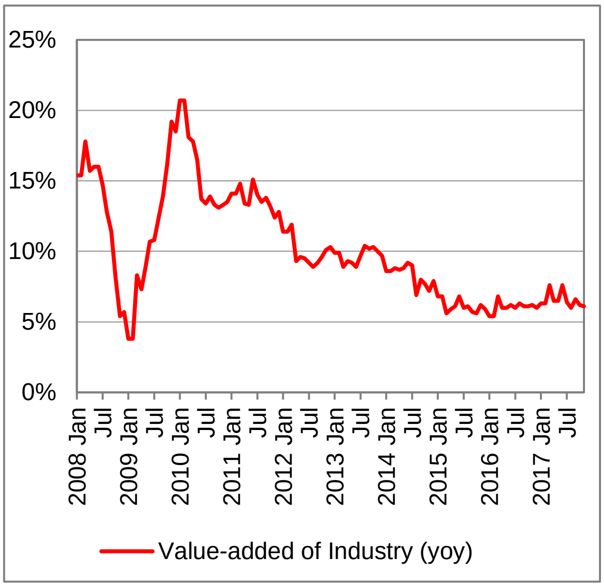


Figure 32: Fixed assets investment continued to grow at slower pace

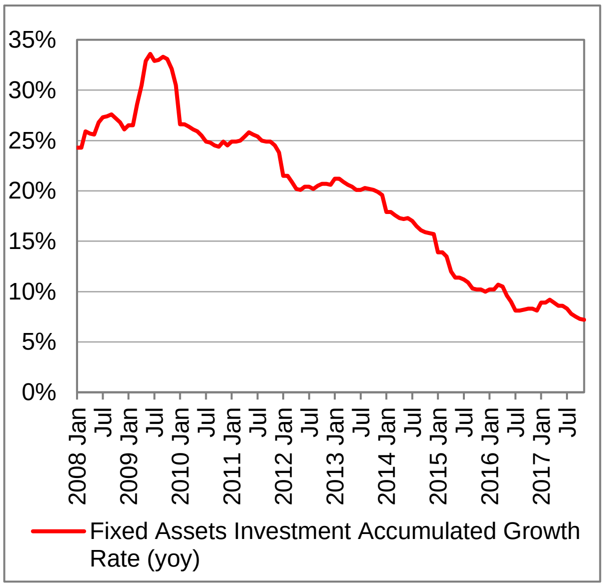
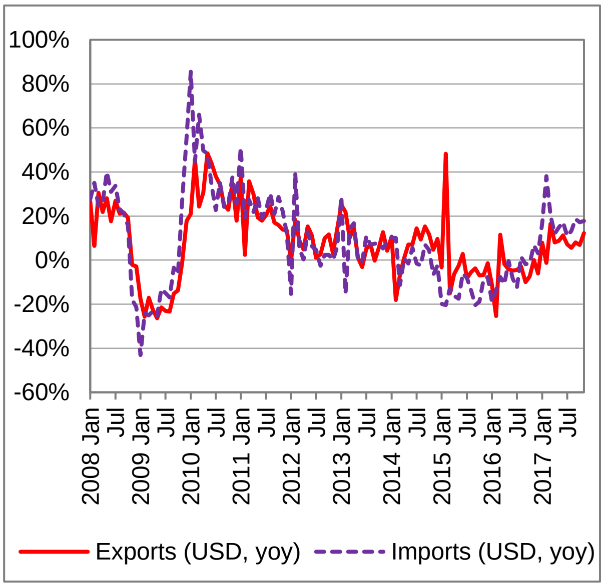


Figure 33: Stronger imports relative to exports for fifteen months



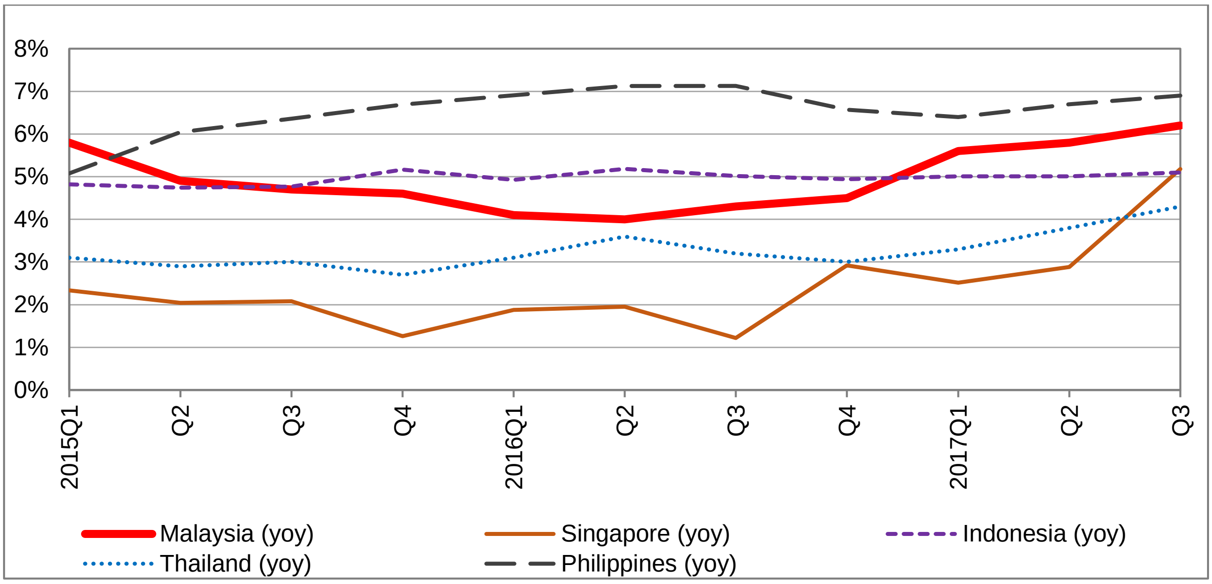
Source: National Bureau of Statistics of China

ASEAN-5 ECONOMIES' KEY ECONOMIC DATA TRACKER

Following overall growth expansion in 2Q17, ASEAN-5 countries (Malaysia, Singapore, Indonesia, Thailand and Philippines) continued to grow at faster pace in 3Q. All five countries recorded the strongest economic growth over past four quarters, particularly Singapore achieved a 15-quarter high of 5.4% yoy in 3Q17. For the full-year 2017, Singapore's advanced estimate of GDP growth was 3.5%, which is much higher than the previous two years (2.0% in 2016 and 1.9% in 2015).

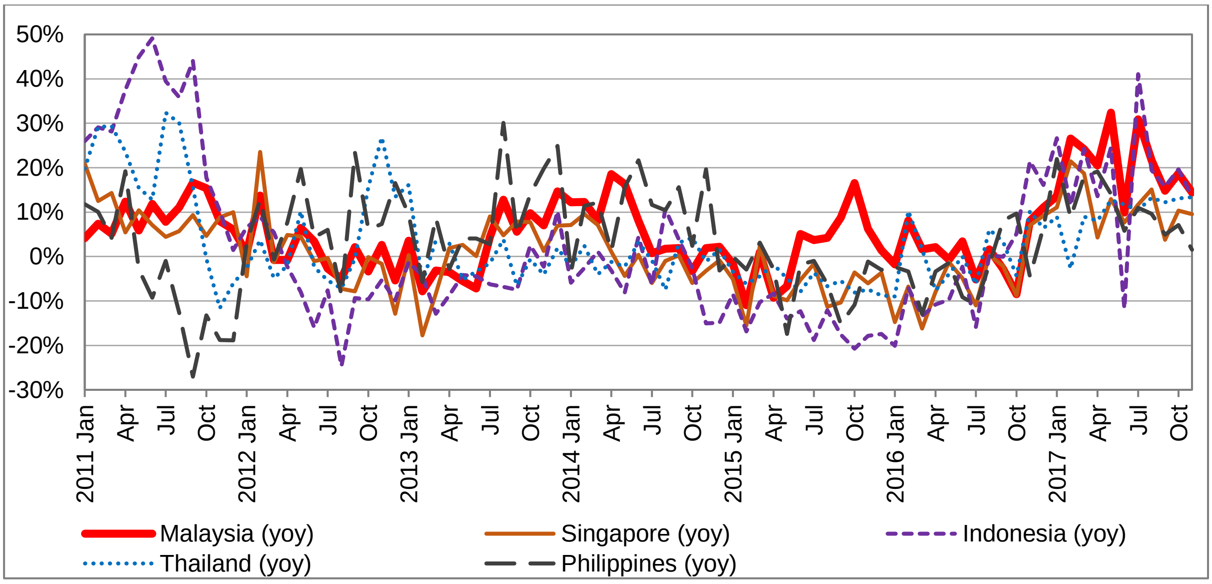
Both exports and industrial production growth are trending slower in the second half-year. Headline inflation did not fluctuate substantially but will likely to move higher slowly on increasing oil prices.

Figure 34: Real GDP growth trend



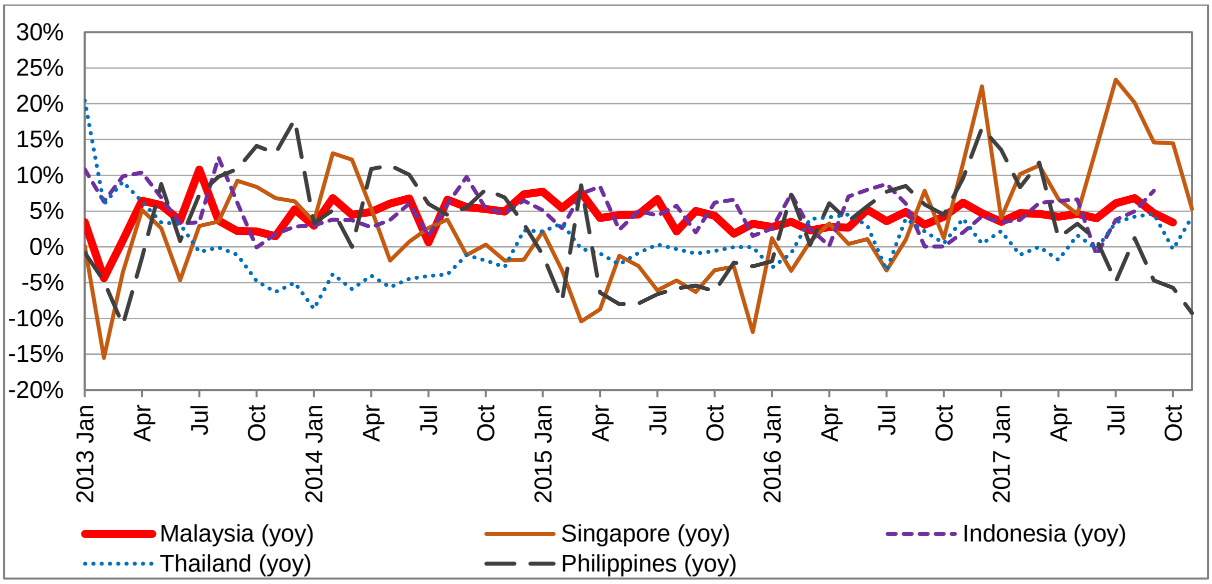
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; National Economic and Social Development Board, Thailand; Philippine Statistics Authority

Figure 35: Export growth trend



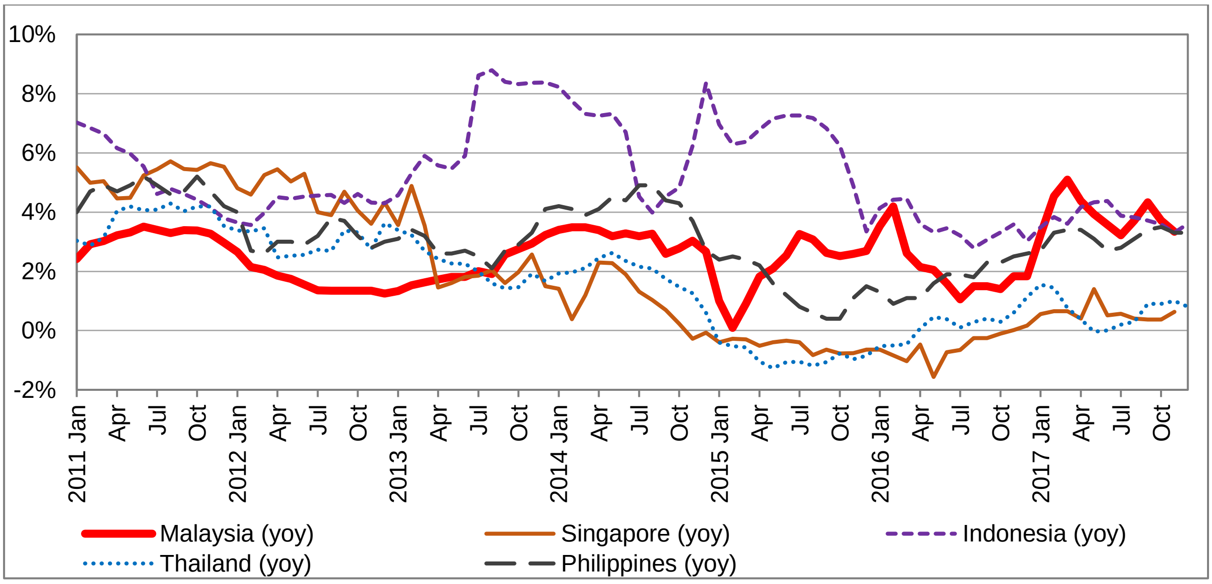
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Bank of Thailand; Philippine Statistics Authority

Figure 36: Industrial production growth trend



Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Office of Industrial Economics, Thailand; Philippine Statistics Authority

Figure 37: Inflation trend



Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Bank Indonesia; Ministry of Commerce, Thailand; Philippine Statistics Authority

B. GLOBAL MONETARY POLICY TRACKER

The US Federal Open Market Committee (FOMC) ended the 2017 by raising the federal funds rate by another 25 basis points (bps) to 1.25-1.50%, supported by continued strengthening of the economy and labour market. Since December 2015, the Fed had hiked rates by a cumulative of five times at 25 bps each. Based on the FOMC participants' assessments, the federal funds rate is projected to increase for another three times or 75 bps in 2018 to the range of 2.00-2.25%, moving towards the longer-run target of 2.75-3.00%.

The Fed's balance sheet normalization, which was initiated from October 2017 will be enhanced from January 2018 by reducing the reinvestment of US$12 billion per month for maturing Treasury securities and US$8 billion per month for holdings of agency debt and mortgage-backed securities, making up to a total of US$20 billion per month in 1Q18. The normalization process will be continued by increasing US$10 billion every quarter until it reaches US$50 billion per month in October 2018.

FOMC continues to expect gradual adjustments of the monetary policy, moderate expansion in economy and strong labour market conditions. The inflation rate is expected to remain somewhat below the longer-run objective of 2% in the near term.

Jerome Powell will succeed the current Federal Reserve Chairwoman Janet Yellen when her term expires in February 2018. Powell has pledged to continue with the current Fed's approaches by gradually raising the interest rates so long as the economic growth remains healthy.

The Bank of Japan will continue pursuing an ultra-loose monetary policy going forward to achieve its target in the foreseeable future. While the European Central Bank (ECB) kept the policy rate unchanged, the net asset purchases under the asset purchase programme (APP) will be cutting half to €30 billion per month starting from January 2018 and is expected to end in September 2018. Nevertheless, the ECB stated that they will increase the amount and/or extend the duration if the economic outlook is less favourable, or ending the APP earlier if there is sustained inflation adjustment with its inflation aim.

In Asia, South Korea raised its policy rate by 25 bps to 1.50% at end-November on solid domestic economic growth. The Hong Kong Monetary Authority (HKMA) raised the base rate charged through its overnight discount window by 25 bps to 1.75% as Hong Kong tracks Fed rate moves because its currency is pegged to the US dollar. The People's Bank of China lifted its 7-day and 28-day reverse repurchase agreements as well as the medium-term lending facility (MLF) by 5 bps each after Fed's rate hike announcement in December. This marks the first rate hike since March, which seen as an attempt to limit the outflows of capital without harming economic growth. China's 14-day reverse repurchase rate also hiked by 5 bps on 18 December 2017.

Figure 38: Policy rate (%)

End-period of	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018*F*
US, Federal Funds Rate	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.25-0.50	0.50-0.75	1.25-1.50	2.00-2.25
Euro Area, ECB (Deposit Facility)	2.00	0.25	0.25	0.25	0.00	0.00	-0.20	-0.30	-0.40	-0.40	0.00
Japan, BOJ Policy Rate	0.10	0.10	0.00-0.10	0.00-0.10	0.00-0.10	0.00-0.10	0.00-0.10	0.00-0.10	-0.10	-0.10	0.00-0.10
China, PBOC 1-year Benchmark Loan I/R	5.31	5.31	5.81	6.56	6.00	6.00	5.60	4.35	4.35	4.35	4.85
India, RBI Policy Repo Rate	6.50	4.75	6.25	8.50	8.00	7.75	8.00	6.75	6.25	6.00	6.00
Korea, BOK Base Rate	3.00	2.00	2.50	3.25	2.75	2.50	2.00	1.50	1.25	1.50	1.25
Malaysia, BNM O/N Policy Rate	3.25	2.00	2.75	3.00	3.00	3.00	3.25	3.25	3.00	3.00	3.25-3.50
Indonesia, BI 7-Day RR Rate	9.25	6.50	6.50	6.50	5.75	7.50	7.75	7.50	4.75	4.25	4.25
Thailand, BOT 1-Day Repurchase Rate	2.75	1.25	2.00	3.25	2.75	2.25	2.00	1.50	1.50	1.50	1.50
Philippines, BSP O/N RR Rate	5.50	4.00	4.00	4.50	3.50	3.50	4.00	4.00	3.00	3.00	3.00

Source: Officials; SERC

C. MALAYSIA: SEEKING SUSTAINABLE GROWTH

2017 ends on a strong footing. The Malaysian economy delivered a strong momentum to grow by 5.9% in the first nine months of 2017 as both domestic demand and exports revved up. With a continued expansion of estimated 5.6-5.8% in 4Q17, the full-year GDP growth will end the year at 5.8-6.0%, the strongest in two years (4.2% in 2016 and 5.0% in 2015). Economic growth outlook for 2018 is now projected to rise by 5.1%, with domestic demand still taking the lead, albeit slower. The strong double-digit exports growth and export levels will normalize and grow at a slower pace (estimated 7.5% in 2018 vs. 19.8% in 2017) as the high base effect kicks in and also the waning effect of favourable exchange rate valuation due to a gradual strengthening of the Ringgit.

National Budget 2018 was tabled on 27 October 2017 with a fiscal deficit of RM39.8 billion or 2.8% of the projected GDP (-3.0% of GDP in 2017), marking 21 successive years of deficit since 1998. Federal revenue is estimated to increase by 6.4% to RM239.9 billion in 2018 with contributions from corporate income tax (share: 30.3%), GST (share: 18.3%) and individual income tax (share: 13.4%). Operating expenditure and gross development expenditure are budgeted at RM234.3 billion and RM46.0 billion respectively. Some of the key measures include selected cuts in individual income tax rate, historical high allocation for agricultural sector, promoting medical tourism and various infrastructure projects.

Consumer spending remains intact. By and large, the continued economic growth will be supported by domestic demand, thanks to still easy financial conditions and mildly expansionary budget. Despite coping with high cost of living, increasing prices of goods and services as well as high consumer debt (84.6% of GDP at end-Sep 2017), consumer spending has defied gravity as it grew by around 7.0% in 2017 and will likely to increase by 6.5% in 2018. The 2018 Budget measures such as RM6.8 billion cash handouts, RM3.0 billion of special payments to 2.3 million public servants and retirees, and RM1.5 billion tax savings from a 2% pts cut in personal income tax rate are expected to help spending power. Both middle-income 40 (M40) and top 20 high income (T20) households make up 75% of total private consumption.

Private investment expansion continues, albeit slower. Private investment has moved out of a couple of quarters of low single-digit growth trap to expand by an estimated 8.3% in 2018 (estimated 9.0% in 2017). The implementation of ongoing and new major public infrastructure and connectivity projects (rail, ports, highways and High Speed Rail) ahead are expected to keep up the investment momentum of both public and private sectors over the medium term.

While managing rising cost pressures and new regulatory changes, the small and medium-sized enterprises should leverage on the Budget's funding programs and credit facilities, including the establishment of Digital Free Trade Zone (DFTZ) to raise technological capability, expand into the borderless marketplace, explore business and investment opportunities. In the near-term, lingering uncertainties ahead of the 14th General Election, which has to be called by June 2018 would weigh down investors' sentiment. What investors really look for is policy continuity, uniformity and certainty to ensure investors' friendly investment and business environment, backed by a transparent, ease of compliance and less cumbersome regulations.

In the year ahead, Malaysian businesses will have to brace themselves for higher operating costs with the implementation of the Employer Mandatory Commitment (EMC), which was postponed for implementation in 2017 (Under the EMC, the employers would be disallowed from deducting the levy from the wages of their workers) and the Employment Insurance System (EIS), and higher gas prices. Other related costs in the cards are the electricity tariffs adjustment, probable review of new minimum wage in 2018 and new foreign workers' levy structure in 2019.

Manufacturing and services sectors remain as the key economic drivers. Manufacturing and services sectors expanded further by 7.0% and 6.6% respectively in 3Q (5.8% and 6.1% respectively in 1H). The former was supported by the E&E and optical products as well as petroleum, chemical, rubber and plastic products while the services sector was mainly lifted by the wholesale and retail as well as the information and communication sector. Agricultural output has moderated to 4.1% (7.1% in 1H) and construction activity also slowed down to 6.1% (7.4% in 1H). However, mining output seen an improvement of 3.1% (0.9% in 1H).

A broad-based expansion of economic sectors. All economic sectors are projected to grow, albeit at slower pace in 2018. The services, manufacturing and construction sectors will continue to lead. The drivers of services are steady domestic spending, logistic services and financial services. The manufacturing sector's output will be underpinned by export-oriented industries (demand for electronics and electrical products, refined petroleum and wood products) and domestic-market oriented such as construction-related building materials, food products and transport equipment. The on-going civil engineering infrastructure projects such as East Coast Rail Line (ECRL), MRT Sungai Buloh-Serdang-Putrajaya (SSP) line, Electrified Double-Track Gemas-Johore Bahru, Setiawangsa-Pantai Expressway (SPE), Pan Borneo Highway, etc. will largely sustain the growth of construction sector. While the construction of residential and affordable housing programs should continue, growth of commercial and retail space development will slow due to property overhang.

Global demand to keep exports in positive trajectory. With a strong double-digit pace of 20.4% in the first eleven months of 2017, exports are estimated to grow by 19.8% for the full-year, the fastest pace in more than two decades since 1998 (29.7%). Robust exports were due to higher demand for a broad range of products, firmer commodity prices as well as exchange rate valuation effects. Firmer global growth coupled with positive leads of global semiconductor industry, exports are estimated to grow by 7.5% in 2018. At this rate, it is still credible as it will be growing from a high base in 2017. In addition, the waning effect of exchange rate valuation also contributed to a moderate pace of annual growth.

Private consumption and investment indicators continued to paint mixed performance. Passenger car sales declined by an average of 4.5% yoy for four consecutive months between August and November, erasing positive gains in the first half of 2017. Consumption credit and outstanding balance of credit cards are growing steadily. Commercial vehicles sales increased by 4.7%% in Oct-Nov 2017 while imports of intermediate and capital goods extended their strong growth in Jan-Nov 2017. Household loan growth inched up slowly in recent months to 5.2% at end-Nov. In contrast, business loan growth eased sharply to a 15-month low of 2.3% in November.

Headline inflation will slow amid fuel still a wild card. Amid the fuel prices variability, headline inflation has moderated to 3.4% yoy in November (3.7% in October; 3.8% in 3Q). With inflation is estimated to rise to 3.6% in December, the full-year inflation will average at 3.9% in 2017. We expect headline inflation to increase 3.0-3.5% in 2018, partly aided by a high base effect. Fuel prices remain a wild card and we assume global oil price of about US$60-65 per barrel. Other factors that could put pressure on inflation are increases in airport passenger service charges and higher utility costs following the rise in natural gas tariff w.e.f. Jan 2018. The strengthening of ringgit against the US dollar to 10.8% in 2017, if persisted on a sustained basis offers a ray of hope for Malaysians to enjoy the positive impact of a strong ringgit. But, the pass-through exchange rate effect comes with a time lag and as always, one should expect some price stickiness and slow transmission.

BNM is getting prepared to hike interest rate in 2018. Bank Negara Malaysia has signalled its readiness to review the current degree of monetary accommodation (overnight policy rate of 3.00%) given stronger economic prospects. Our baseline call is 25 basis points hike for a start. The market must prepare for further rise in rates to a neutral level that would not discourage consumption, economic activity and investment if the following conditions are met throughout the year 2018: 1) If the global growth and domestic economy continues to sustain at strong levels, supported by domestic demand; 2) To anchor inflation expectations should headline and core inflation continue to remain at elevated levels as oil prices remain a wild card. BNM needs to stay ahead of the inflation curve; and 3) To balance the yield gaps should the Fed hike rates aggressively.

Steadying prospects for ringgit amid headwinds. After trashing by a cumulative of 31.8% against the US dollar in 2013-16, the ringgit has strengthened by 10.8% for the first time in 2017, partly thanks to the onshore ringgit stabilization measures, including the stoppable of offshore ringgit trading and export proceeds conversion rules. Foreign reserves have stabilized, albeit rising slowly. One should remain wary about the state of capital flows and exchange rate pressure triggered by the Fed's continuation of rate hikes and shrinking of its balance sheet. The impending GE14 could provide the ringgit with headwinds in the first half-year. On balance, still good economic and financial fundamentals are positive supportive of the ringgit, which is fundamentally undervalued. The ringgit is expected to be RM3.80-3.90 by end-2018.

Medium-and long-term challenges to sustain growth. While the welcome cyclical global activity upturn and sustained domestic demand provides an opportunity for Malaysia to carry forward its current growth momentum, there are medium- and long-term challenges that could limit potential for much faster growth.

Policy focus on qualitative growth factors, namely supportive tax policies and regulatory environment, growth inclusiveness, stronger productivity growth, further enhancement of technological capacity and labour skills, digitalization as well as the driving of e-commerce growth would help to sustain quality growth and provide better conditions for businesses to thrive over the medium-term.

Monetary, financial and credit policies should continue to remain growth-supportive. Setting right fiscal priorities matter. Future fiscal stance should continue to prioritize social and economic expenditure and transfer to foster a balance and inclusive growth so as the benefits of economic growth can reach out to all.

Figure 39: Real GDP by economic sector (% YoY)

Economic Sector [% share to GDP in 2017]*	**2015**	**2016**	**2017 1Q**	**2017 2Q**	**2017 3Q**	**2017*E* (MOF)**	**2017*E* (SERC)**	**2018*F* (MOF)**	**2018*F* (SERC)**
Agriculture [8.1%]	1.3	-5.1	8.3	5.9	4.1	6.0	5.5	6.0	3.8
Mining & Quarrying [8.4%]	5.3	2.2	1.6	0.2	3.1	1.0	1.7	1.0	1.5
Manufacturing [23.0%]	4.9	4.4	5.6	6.0	7.0	5.7	6.3	5.7	5.5
Construction [4.6%]	8.2	7.4	6.5	8.3	6.1	8.0	7.2	8.0	8.0
Services [54.5%]	5.1	5.6	5.8	6.3	6.6	5.9	6.1	5.9	5.6
Overall GDP	**5.0**	**4.2**	**5.6**	**5.8**	**6.2**	**5.2-5.7**	**5.8-6.0**	**5.0-5.5**	**5.1**

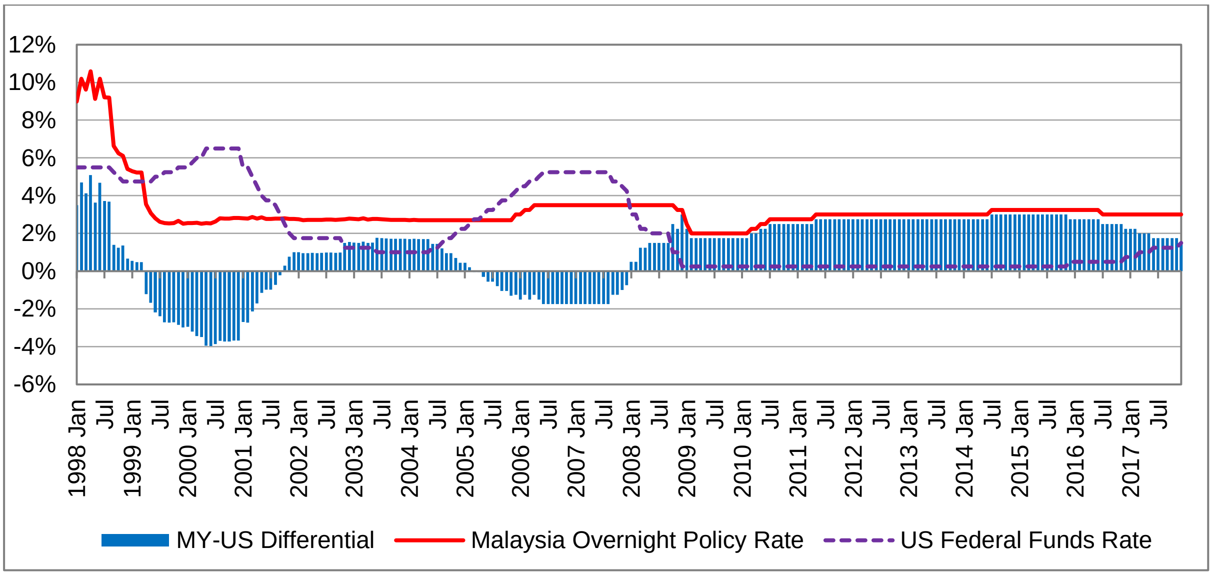
Source: Department of Statistics, Malaysia; Ministry of Finance, Malaysia; SERC
** % share to GDP in 2017 as estimated by MOF*

Figure 40: Real GDP by demand component (% YoY)

Demand Component [% share to GDP in 2017]*	2015	2016	2017 1Q	2017 2Q	2017 3Q	2017*E* (MOF)	2017*E* (SERC)	2018*F* (MOF)	2018*F* (SERC)
Private Consumption [53.9%]	6.0	6.0	6.6	7.1	7.2	6.9	7.0	6.8	6.5
Public Consumption [12.7%]	4.4	0.9	7.5	3.3	4.2	2.7	4.9	1.3	4.0
Private Investment [17.5%]	6.3	4.3	12.9	7.4	7.9	9.3	9.0	8.9	8.3
Public Investment [8.4%]	-1.1	-0.5	3.2	-5.0	4.1	3.7	1.0	-3.1	0.5
Exports of Goods and Services [72.2%]	0.3	1.1	9.8	9.6	11.8	8.0	9.9	2.3	6.8
Imports of Goods and Services [64.7%]	0.8	1.1	12.9	10.7	13.4	9.9	11.7	2.5	7.8
Overall GDP	**5.0**	**4.2**	**5.6**	**5.8**	**6.2**	**5.2-5.7**	**5.8-6.0**	**5.0-5.5**	**5.1**

Source: Department of Statistics, Malaysia; Ministry of Finance, Malaysia; SERC
** % share to GDP in 2017 as estimated by MOF*

Figure 41: Malaysia-US's interest rate differentials are narrowing



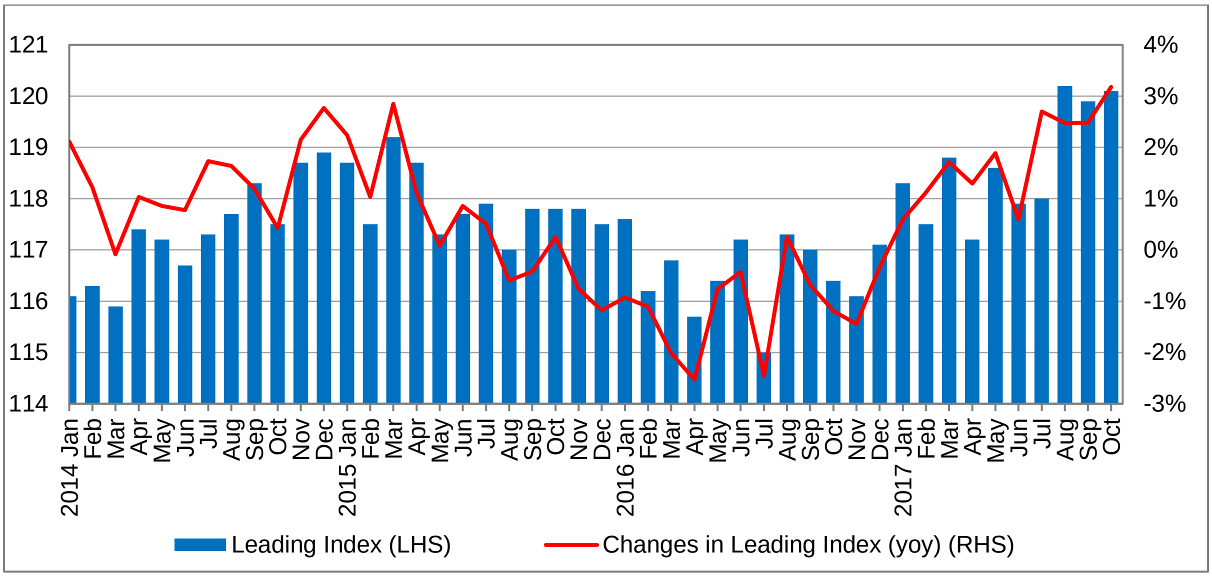
Source: Bank Negara Malaysia; Federal Reserve

REVIEW OF KEY ECONOMIC AND FINANCIAL INDICATORS

High frequency data such as **exports, industrial production, manufacturing sales, services and loans** extended by the banking system suggests that the economic growth momentum would continue, albeit at a moderate pace in 4Q17. Private consumption and investment showed mixed performance along with uneven indicators in various sectors, the economy is expected to grow steadily at 5.1% in 2018 (estimated 5.8-6.0% in 2017).

1. The **leading index (LI)**, which gauges the forward economic performance, grew higher by 3.2% yoy in October compared to an average of 2.6% in 3Q (1.3% in 2Q and 1.1% in 1Q). The leading index growth has been staying in positive trajectory since January 2017, a reflection of higher than expected GDP growth in the first three quarters. On month-to-month basis, LI rose by 0.2%, mainly induced by higher M1 supply (+0.4%) and the number of new companies registered (+0.3%).

Figure 42: Leading index increased at faster pace



Source: Department of Statistics, Malaysia

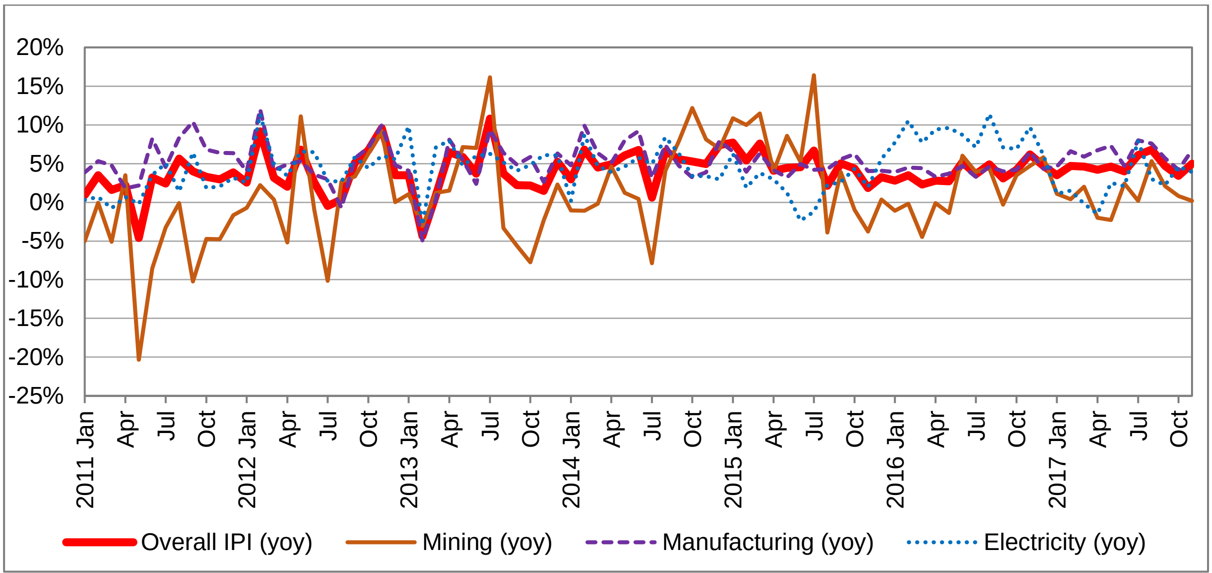
2. **Industrial production** growth improved to increase by 5.0% yoy in November (3.4% in October and 5.8% in 3Q), lifted by a strong growth of 6.7% in manufacturing sector (4.2% in October and 7.1% in 3Q). However, it was dragged by slower growth in mining (0.2% in November vs. 0.8% in October and 2.5% in 3Q) and electricity production (3.9% in November vs. 4.6% in October and 4.3% in 3Q).

   The major **manufacturing** sub-sectors registered mixed growth: electrical and electronic products (6.9% in November vs. 5.9% in October and 8.5% in 3Q), petroleum products (9.4% in November vs. 0.7% in October and 6.1% in 3Q), chemical and chemical products (7.5% in November vs. 1.8% in October and 4.0% in 3Q), construction-related products (4.6% in November vs. 4.8% in October and 6.4% in 3Q) as well as food, beverages and tobacco (8.2% in November vs. 7.0% in October and 12.0% in 3Q).

   Mining output softened mainly due to a flattish output of natural gas (1.4% in October and 7.9% in 3Q). With Malaysia's participation in oil production cut agreement by reducing 20,000 barrel per day, crude oil output has declined by 2.3% in Jan-Nov 2017. Malaysia has agreed to extend the oil output cut by another 20,000 barrel per day until end-2018.

   Industrial production is expected to grow by an average growth of 4.6% in 2017 (3.8% in 2016). For 2018, both manufacturing and electricity sectors will underpin the industrial output growth of 4.5-5.0% despite continued decline in mining output.

Figure 43: Industrial production continues to grow steadily in 4Q17



Source: Department of Statistics, Malaysia

3. The **external sector** has been expanding firmly since November 2016. In the first eleven months of 2017, total trade value jumped 20.8% yoy, a markedly improvement from a mere 0.6% a year ago. Though imports expanded at a faster pace of 21.2% relative to exports (20.4%), higher exports base has strengthened the trade balance by an accumulation of RM90.0 billion during Jan-Nov 2017 (a surplus of RM79.2 billion in Jan-Nov 2016).

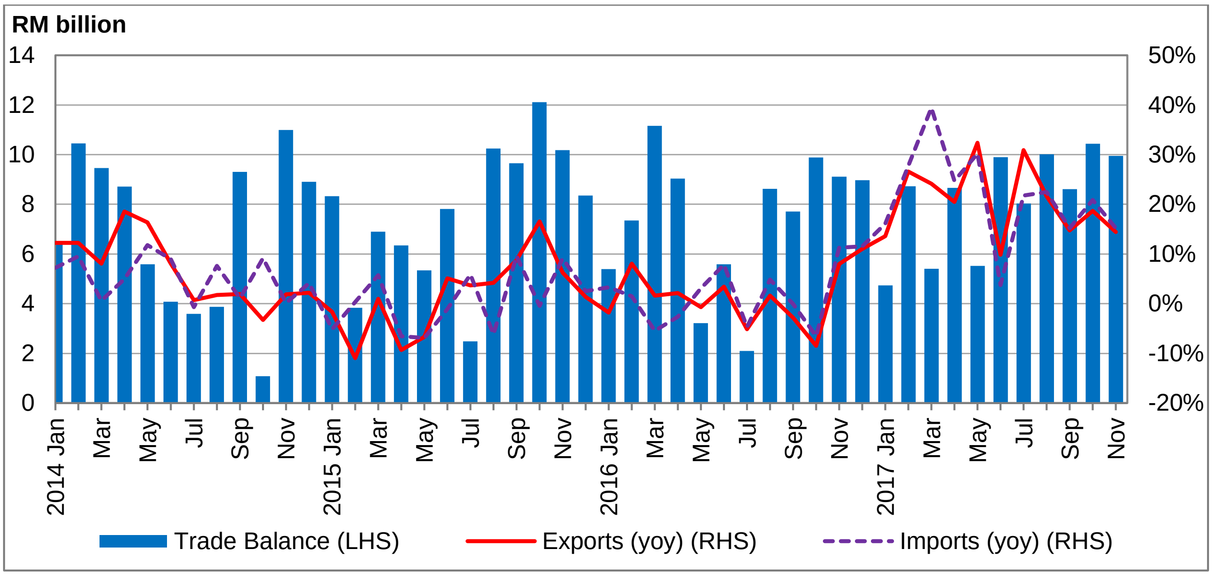
   In November, **exports** growth moderated to 14.4% yoy (18.7% in October and 22.1% in 3Q), but it is still commendable due to having high base from the previous year. The main contributors came from electrical and electronic products (+21.0% or RM5.5 billion to RM31.7 billion; 38.0% export share), followed by liquefied natural gas (+7.5% or RM243.7 million to RM3.5 billion; 4.2% export share), timber and timber based products (+11.5% or RM217.6 million to RM2.1 billion; 2.5% export share) as well as palm oil and palm oil based products (+2.7% or RM176.4 million to RM6.8 billion; 8.2% export share).

   However, crude petroleum exports (5.3% export share) contracted 3.1% to RM2.4 billion due to a 23.8% decline in export volume, albeit higher average unit value of 27.2%. Natural rubber exports also fell by 5.7% to RM313.3 million on a 12.9% decline in export volume despite higher average unit value of 8.3%. Malaysia, Indonesia and Thailand as the major natural rubber exporters have come to an agreement to withhold 350,000 tonnes of natural rubber exports till March in order to support the price of natural rubber.

   For the first eleven months of 2017, China remained as Malaysia's largest trading partner (16.3% of total share), leading the source of imports with 19.6% share while the top export destination is Singapore (14.6% share). On a positive note, total trade deficit from China and South Korea have been reducing to RM35.4 billion and RM8.5 billion respectively in Jan-Nov 2017 (RM39.6 billion and RM13.5 billion trade deficit respectively during Jan-Nov 2016).

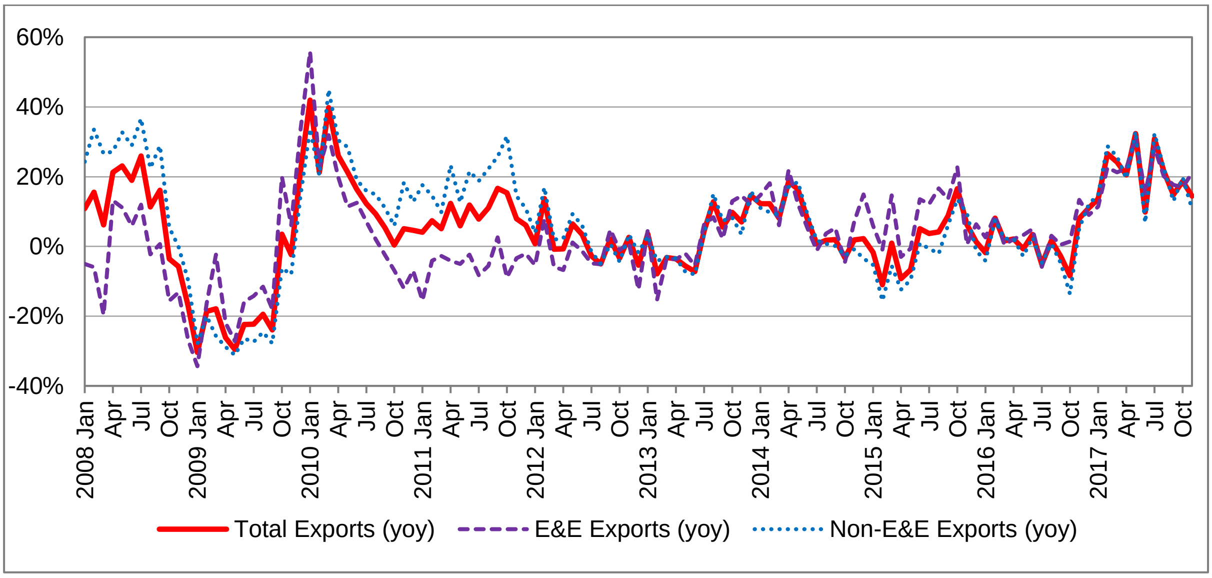
   With a strong double-digit pace of 20.4% in Jan-Nov 2017, exports are estimated to grow by 19.8% in 2017, the fastest pace since 2004 (21.0%). Supported by continued global demand, especially for semiconductors and also firming commodity prices, including crude oil, exports growth is estimated to expand by 7.5% in 2018. The high base effect in 2017 and waning exchange rate valuations will cause a moderate pace of export growth.

Figure 44: Exports is moderating but still encouraging



Source: Department of Statistics, Malaysia

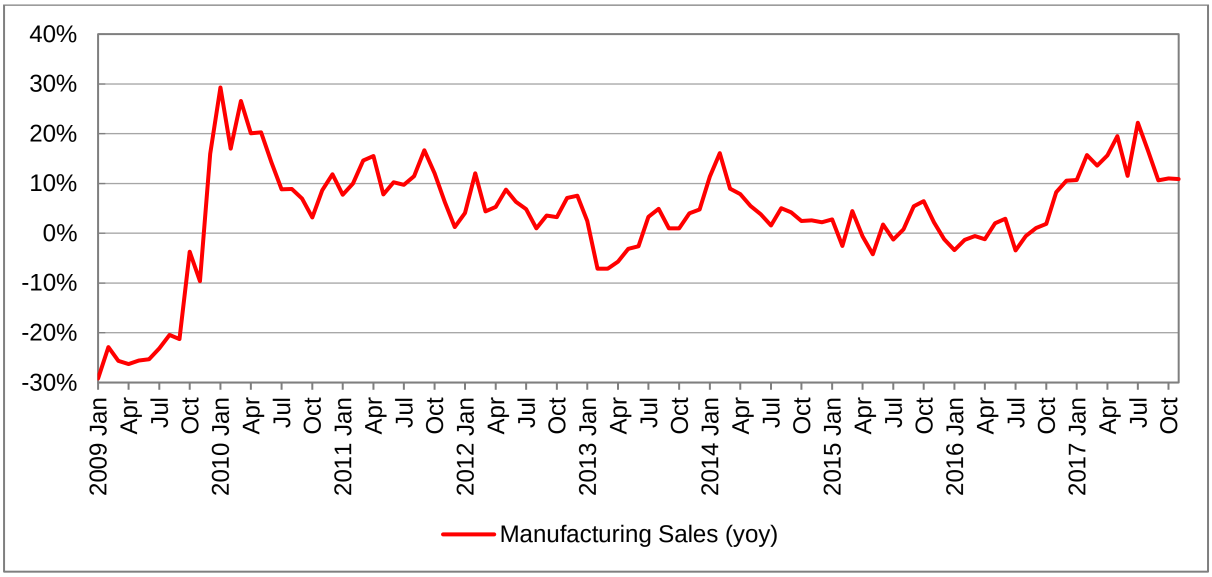
Figure 45: E&E products still carrying favourable outlook



Source: Department of Statistics, Malaysia

4. Total **sales value of manufacturing sector** pulled back from the peak in July (22.2% yoy) to grow by 10.9% in November, though it has been in an expansion mode for fifteenth consecutive month. Labour productivity, measured by average sales per employee, which has been growing since July 2016, continues to increase by 8.4% yoy to RM63,186 in November. Three major product groups with a collective share of 79.7% increased substantially: electrical and electronic products (+8.8%), petroleum, chemical, rubber and plastic products (+17.8%) and non-metallic mineral products, basic metal and fabricated metal products (+4.8%). In Jan-Nov 2017, total manufacturing sales value expanded by 14.2%.

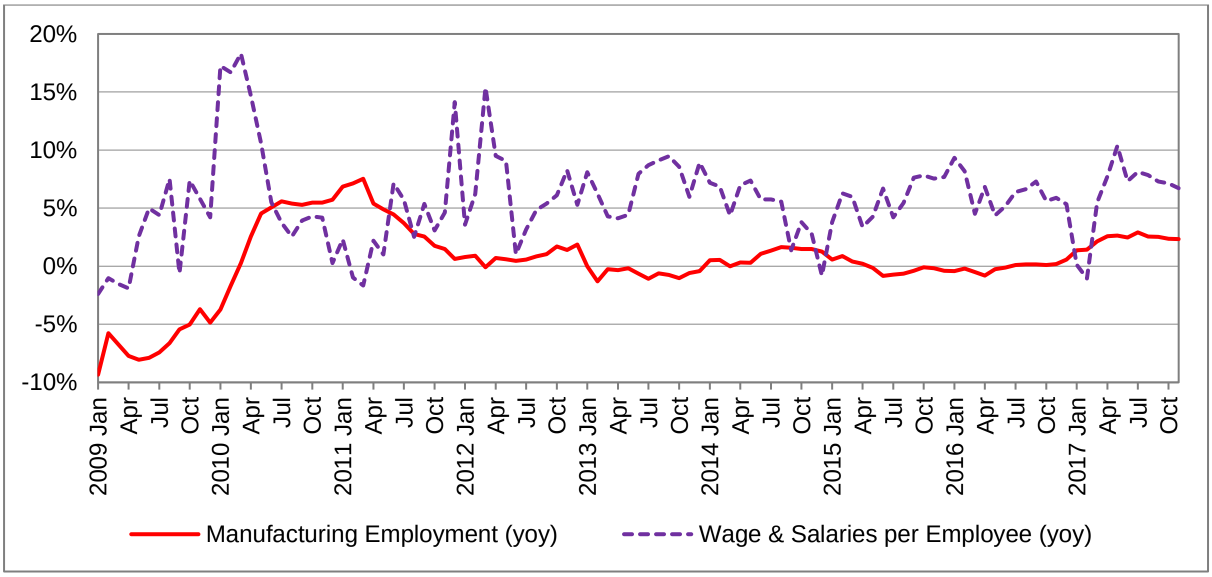
Figure 46: Manufacturing sales held strongly, albeit moderated from the peak



Source: Department of Statistics, Malaysia

Total **number of employees** employed in the manufacturing sector increased by 2.3% yoy to 1,054,705 persons as at end-November (2.4% in October and 2.5% yoy in 3Q), representing a largest manufacturing workforce since January 2008. On an annual basis, average wage and salaries per employee increased steadily by 6.7% to RM3,347 in November, but lower in terms of absolute value compared to RM3,362 in October and RM3,392 in September.

Figure 47: Manufacturing employment and pay-out growth are moderating

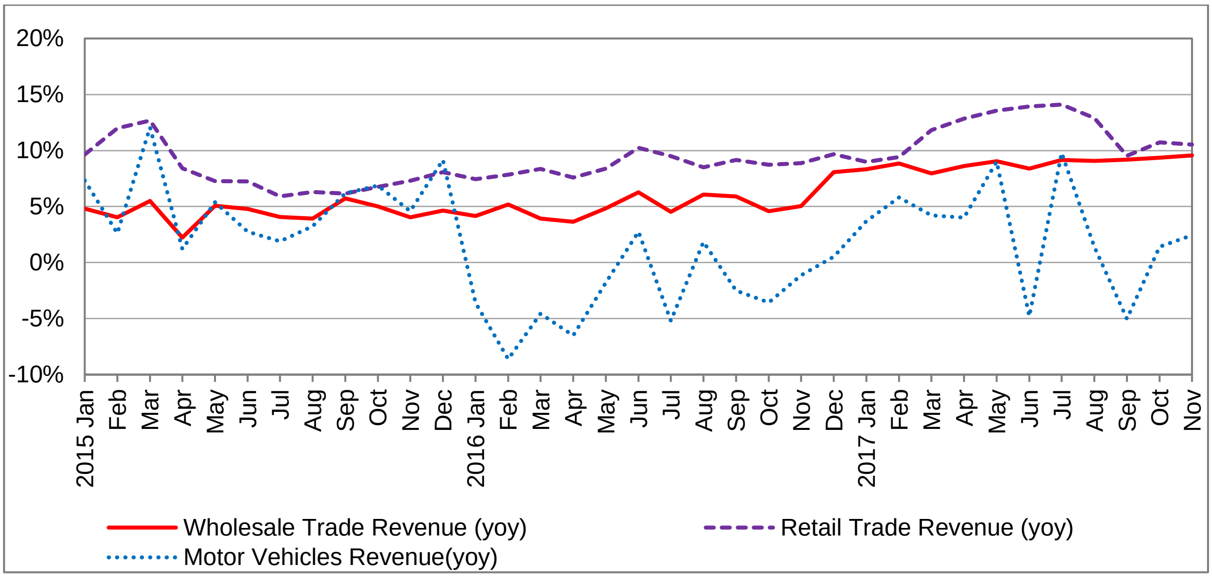


Source: Department of Statistics, Malaysia

5. The **services sector** gained higher revenue of RM387.8 billion in 3Q, representing a 9.3% yoy growth (9.4% in 2Q). The bulk of revenue sources are from distributive trade (75.3%), followed by information and communication (7.5%), transportation and storage (6.9%), food and beverages (3.7%) while other sub-sectors collectively contributed the remaining 6.6%.

   Distributive trade sales value increased by 9.0% yoy to RM98.1 billion in October 2017 (9.3% in 3Q). Wholesale sector grew higher by 9.5% (9.2% in September) while retail sector is picking up again after two months of moderation (10.9% in October vs. 9.5% in September). Motor vehicle sales continue to fluctuate, registering a 1.3% growth in October (-5.0% in September).

Figure 48: Robust sales growth in wholesale and retail sectors



Source: Department of Statistics, Malaysia

   All the sub-services sectors are posting positive sales growth in 3Q, of which the significant growth registered in professional (14.6% yoy), real estate agent (10.8%), information and communication (10.3%), food and beverages (10.2%), and private education (10.1%).

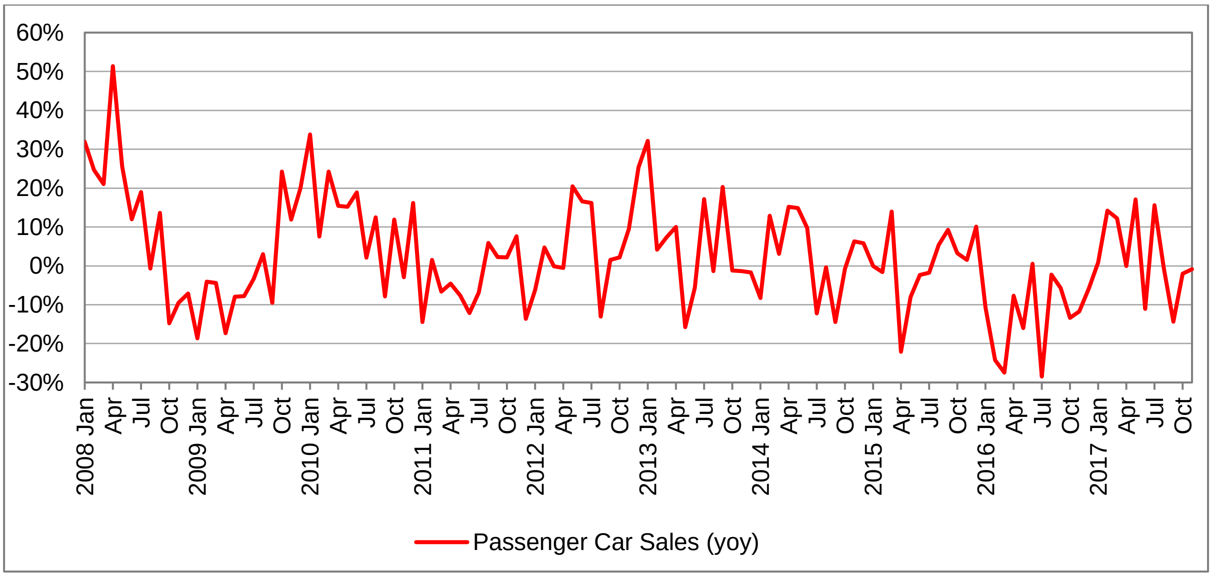
   There were 3,583,613 employees employed in services sector in the 3Q, an increase of 2.4% yoy but declined by 0.5% qoq when compared to 2Q17. Retail sector took up 29.1% of the services workforce, followed by food and beverages sector (22.2%) and wholesale sector (12.5%). Employee productivity improved by 6.7% (5.8% in 2Q), with the highest productivity growth reflected in wholesale, information and communication, motor vehicle, and arts, entertainment and recreation. The sector's employees that received higher salaries were in information and communication sector (RM5,627), professional sector (RM4,142) and wholesale sector (RM3,175).

6. **Private consumption indicators showed mixed performance**. General consumer sentiment remains weak as **MIER's consumer sentiment index** (CSI) slipped to 77.1 for 3Q from 80.7 in 2Q. The last time it stood above the 100-pt threshold was in 2Q14. However, weak consumer sentiment did not necessarily translate into weak consumer spending. Private consumption growth sustained its strong resilience of 7.2% in 3Q (7.1% in 2Q and 6.6% in 1Q). **Unemployment rate** improved to 3.3% in November after remained stable at 3.4% in October for three straight months. The number of unemployed persons have been reducing greatly every month from 519,000 in July to 505,100 in November (508,800 in October, 514,500 in September and 516,900 in August). Nevertheless, with the higher cost of employing, including the paying of foreign worker levy by employer, newly implemented employee insurance scheme (EIS) and potential increase of minimum wage in the second half of 2018, the Malaysian Employers Federation (MEF) expects a retrenchment of 50,000 workers in 2018.

   Passenger car sales declined for four consecutive months since August, totally wiped out positive gains in the first half-year. With 466,603 passenger cars sold for the period of Jan-Nov 2017, at least 55,397 units must be sold in December to achieve the yearly target of 522,000. **Consumption credit** has returned to an average annual growth of 0.9% in November (0.6% in October and average 0.8% in 3Q) and **outstanding balance of credit cards** paced higher to 2.8% in November (2.0% in October). **Imports of consumption goods** increased by 6.6% in November, mainly contributed by processed food & beverages (+15.7% or RM247.2 million) and durables goods (+11.3% or RM84.7 million).

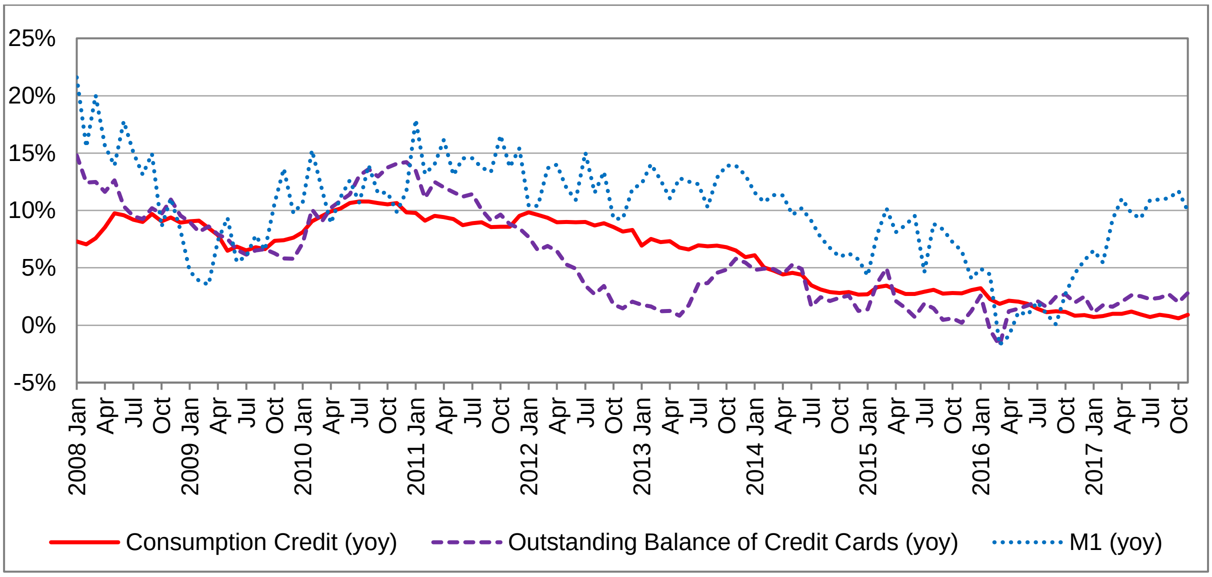
   Private consumption growth is estimated to grow by 7.0% in 2017. With the improved wage growth, continued cash hand-out (BR1M to be distributed in February, June and August in 2018), higher bonus for civil servants, tax cut savings for M40 households and stronger ringgit, private consumption growth is estimated to increase by 6.5% in 2018 (6.0% in 2016).

Figure 49: Passenger car sales declined in the second half-year



Source: Bank Negara Malaysia

Figure 50: Private consumption indicators suggest a stable outlook



Source: Bank Negara Malaysia

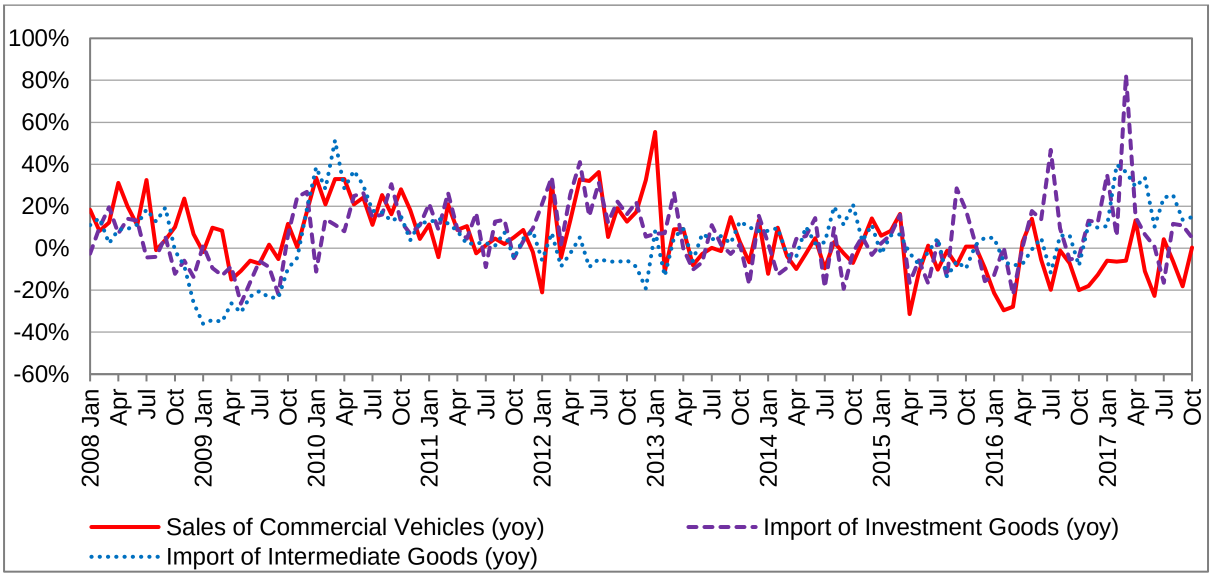
7. **Private investment indicators** showed uneven trend, but generally have strengthened compared to a year ago. Private investment gained growth traction in 3Q17 (7.9% yoy vs. 7.4% in 2Q) and will likely to improve further in 4Q. **MIER business condition index (BCI)** weakened to 103.1 in 3Q as a result of poor manufacturing sales, slowdown in production as well as lower domestic and export orders. However, there were higher expectations for export sales and production level in 4Q.

   Commercial car sales appear to pick up moderately in 4Q17, with sales rising 0.3% yoy in October and 9.0% in November respectively after experiencing sluggish sales in the first nine months of 2017. The industry is unlikely to achieve its yearly target of 68,000 in 2017 as there were only 55,304 commercial vehicles sold in Jan-Nov. Imports of **capital goods** grew by 12.2% or RM1.1 billion in November 2017 (5.1% in October) while imports of **intermediate goods** also increased by 13.8% or RM4.9 billion due to increased processed industrial supplies (+15.4% or RM2.1 billion) and parts & accessories of capital goods which except transport equipment (+14.4% or RM1.8 billion).

   Business loan growth moderated to 2.3% in November (4.0% in October and 6.2% in 3Q), the lowest level since August 2016. This was mainly due to a smaller growth in manufacturing sector (0.5% vs. 3.2% in October and 4.2% in 3Q) and declines in financing, insurance and business services (-2.2% vs. -0.9% in October and +3.6% in 3Q).

   While the General Election 14 (GE14) is around the corner, it is expected that the private investment activity may be dampened prior to the election and will start to roll-out post-election. Construction awards for several mega projects, including highway and railway are also in the pipeline this year. Overall, private investment growth is estimated to increase by 9.0% in 2017 and 8.3% in 2018 (4.3% in 2016).

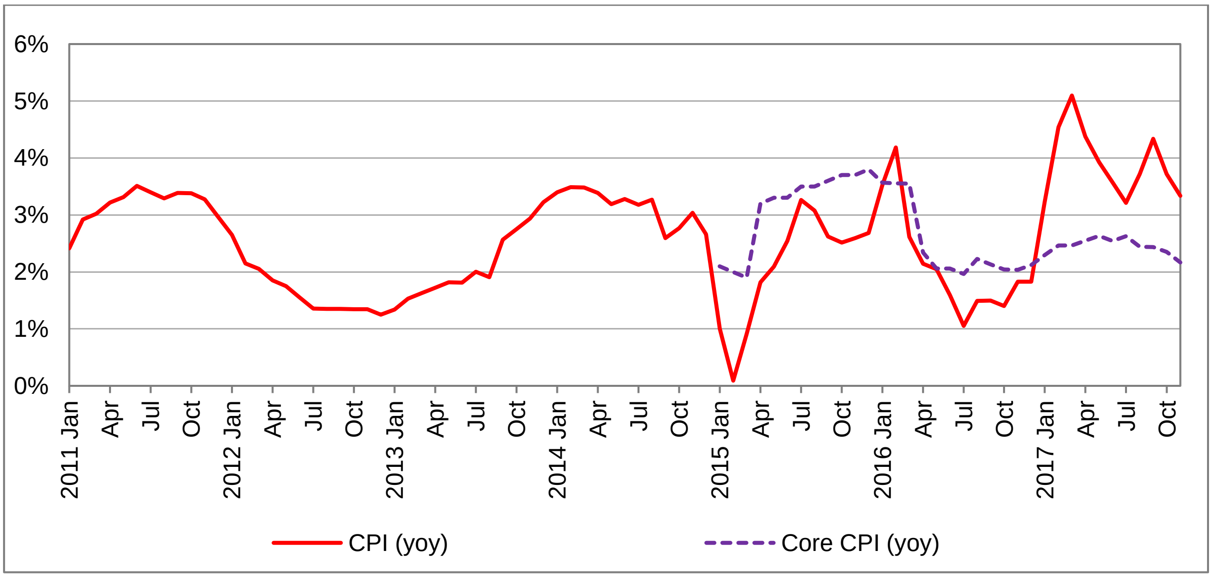
Figure 51: Uneven private investment indicators



Source: Bank Negara Malaysia

8. **Headline inflation**, as measured by the Consumer Price Index (CPI) continues to moderate to 3.4% in November (3.7% in October and 3.8% in 3Q). Core inflation, which excludes volatile items such as fresh food and administered prices of goods and services also slipped to 2.2% in November (2.3% in October), staying below its 11-month average of 2.5%.

Figure 52: Both headline and core inflation stay lower than year-to-month average

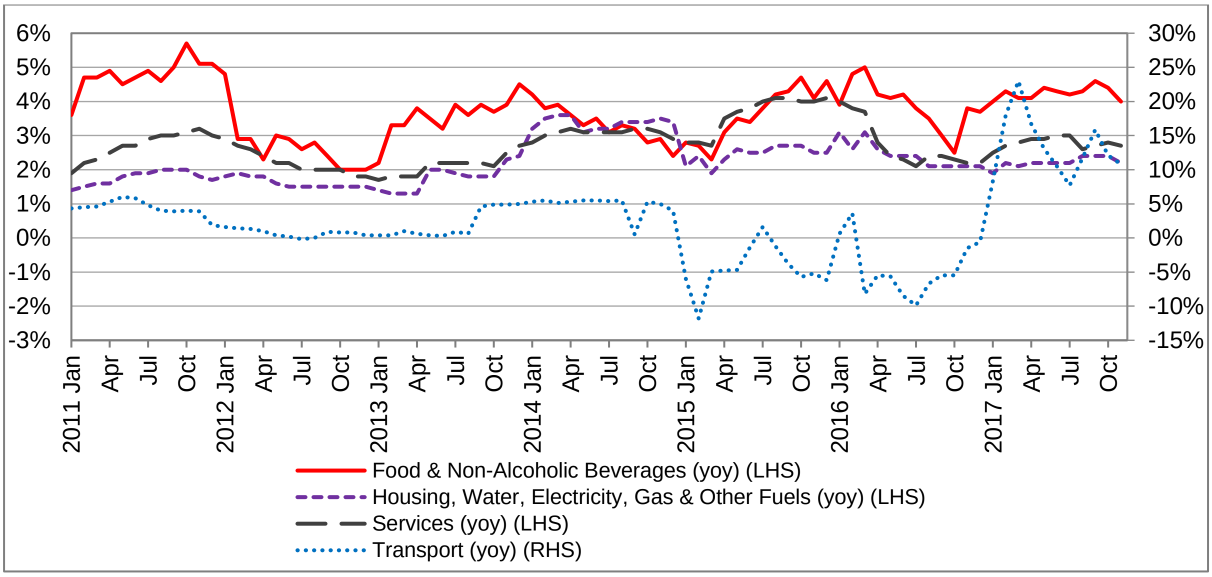


Source: Department of Statistics, Malaysia

Prices of three components that carry the largest weight in CPI basket posted slower increase: (i) Food & non-alcoholic beverages (4.0% in November vs. 4.4% each in October and 3Q respectively), thanks to the phasing out of cooking oil price increase in November 2016. Prices of fish & seafood and food away from home remained high; (ii) Housing, water, electricity, gas & other fuels (a share of 23.8%) eased to 2.2% (2.4% in October); and (iii) Transport prices moderated further to 10.8% in November (12.1% in October and 15.9% in September). The price differentials for RON95 in November 2016 and 2017 have narrowed to 35 sen per litre compared with 38 sen between October 2016 and 2017, and 49 sen between September 2016 and 2017. The narrowing of differential in annual petrol prices helped to soften the increase in transport prices as the fuels & lubricants for personal transport equipment accounted for 7.8% of the CPI basket.

The ringgit's appreciation may aid to moderate the inflationary pressure but the crude oil prices remain a wild card to influence the transport prices as well as other associated costs. The average inflation rate for 2017 is estimated at 3.9% and will moderate to 3.0-3.5% in 2018 (2.1% in 2016), partly aided by high base.

Figure 53: Prices of major components are rising at a slower magnitude



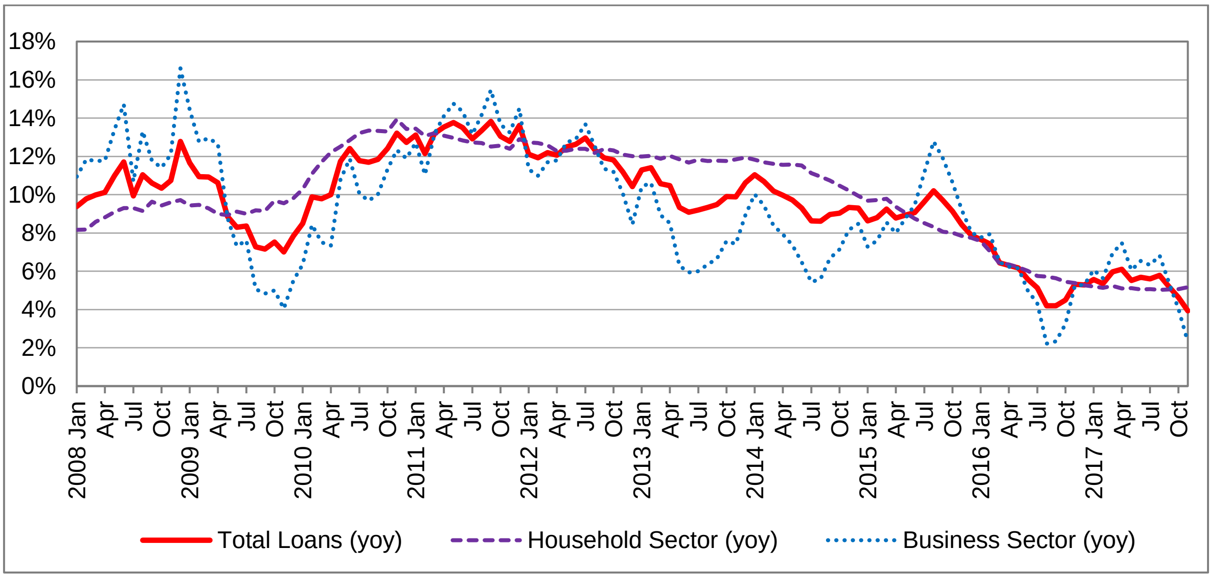
Source: Department of Statistics, Malaysia

9. All **loan indicators** registered positive growth in November after showing some mixed direction in September and October. **Household loan** growth inched to 5.2% yoy in November (5.1% in October and 5.0% in 3Q). In contrast, **business loan** growth eased sharply to a 15-month low of 2.3% in November (4.0% in October and 6.2% in 3Q), mainly due to a smaller growth in manufacturing sector (0.5% vs. 3.2% in October and 4.2% in 3Q) and declines in financing, insurance and business services (-2.2% vs. -0.9% in October and +3.6% in 3Q). As a result, total loan outstanding growth weakened to a new low of 3.9% in November (4.6% in October and 5.5% in 3Q).

Loan applications have been increasing for five consecutive months, expanded further by 15.8% in November (12.8% in October and 8.5% in 3Q). In terms of loan purposes, strong applications were reflected in the purchase of residential and non-residential property as well as for working capital. Increasing demand for personal loans in recent months warrant close monitoring – whether for investment or consumption purpose. Loan applications for the purchase of passenger vehicles have declined for four months in a row, indicating weak buying sentiment.

Loan approvals turned around to increase strongly by 22.3% in November (-2.2% in October), mainly for the purchase of transport vehicle, residential property, and securities, as well as personal loan and construction sector. Loans approved for the purchase of non-residential property declined sharply by 19.2%, resulting in a cumulative decline of 4.9% in Jan-Nov. This reflects the consolidation of commercial and retail sector due to the oversupply or overpricing of commercial lots. **Loan disbursements** slowed markedly to 1.8% in November (8.4% in October), supported by higher disbursements to the household (+14.0%) while disbursement to business sector contracted by 2.6%. Lower disbursements were for finance, insurance and business activities.

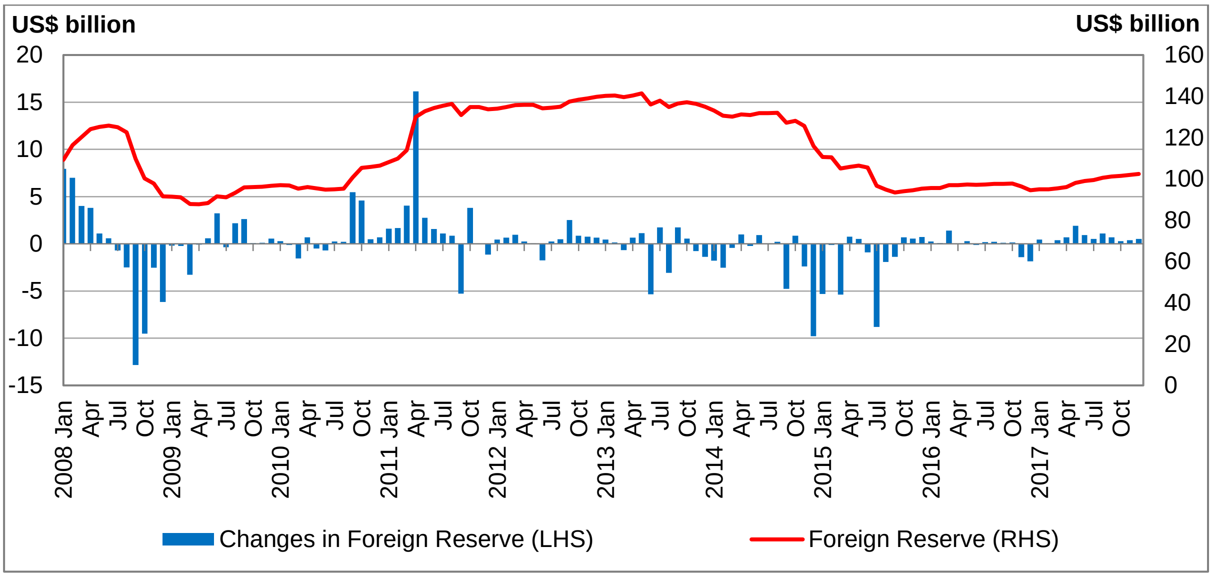
Figure 54: Business loan growth eased sharply



Source: Bank Negara Malaysia

10. **Bank Negara Malaysia's holdings of foreign exchange** continues to accumulate gradually in recent months, reaching US$102.4 billion as at end 2017, representing an overall increase of US$7.9 billion from US$94.5 billion as at end 2016. Foreign reserves accumulation were supported by the larger trade surplus and continued inflows of FDI. The reserves position is sufficient to finance 7.2 months of retained imports and is 1.1 times the short-term external debt.

Figure 55: Foreign reserves expand steadily



Source: Bank Negara Malaysia

Net **portfolio investment** outflows continued in 3Q (-RM5.1 billion vs. +RM16.0 billion in 2Q and –RM31.9 billion in 1Q), bringing total cumulative net outflows to RM20.9 billion in Jan-Sept 2017. The outflows registered in many regions, including North America, South-east Asia, North-east Asia, Oceania and other regions except Europe. Indications are that net portfolio investment will continue to register outflow in 4Q17 as investors rebalanced their portfolio holdings.

Foreigners reverted to net buying position in equity market in December 2017 after selling shares in August-November. The net buying of RM0.9 billion in December has helped to lift the FTSE Bursa Malaysia KLCI to reach 1796.81 at its end-year closing, an increase of 155.08 pts or 9.4% compared to 1641.73 at end-2016.

For the year 2017 as a whole, foreigners bought Malaysian stocks on a net buying value of RM10.6 billion. In debt market, foreign holding of Malaysia's ringgit-denominated bonds has been reduced to RM206.7 billion or 16.0% of the total as at end-2017 (RM214.7 billion or 18.3% as at end-2016). The share of foreign holdings of Malaysian government bonds have lowered to 28.0% (30.7% as at end-2016), of which there is RM164.4 billion or 45.1% of MGS as at end-2017 (47.1% as at end-2016).

In the early weeks of January 2018, foreign interests in domestic equities have returned as the sustained buying was driven by an upcoming general election (GE) and the strengthening of the ringgit. Gains in the local equity market were also buoyed by the spillover effects from the strong performance of US Wall Street.

In the first nine months of 2017, a total of 3,886 projects were with a total investment value of RM113.5 billion, which is weaker when compared to 5,143 projects worth RM212.8 billion approved in 2016. Of the total approvals in 2017, RM30.1 billion or 26.5% share were foreign-owned. Among the largest manufacturing investment sources, Switzerland came in top (RM2.4 billion), followed by Netherlands (RM2.0 billion) and Singapore (RM1.8 billion). Surprisingly, China, which was the largest foreign investor in 2016 did not make it on the list of major foreign investors in 2017. Nevertheless, Malaysia was ranked 4th under China's Going Global Investment Index in 2017, a big leap from 20th position in 2015.

After trashing by a cumulative of 31.8% against the US dollar in 2013-16, the ringgit gained 10.8% against the US dollar in 2017, with significant gains came from second half of the year (6.1% vs. 4.5% in 1H17). Being a laggard currency in the region, the ringgit had caught up its appreciation against most of the peer currencies in the second half-year, particularly in 4Q17.

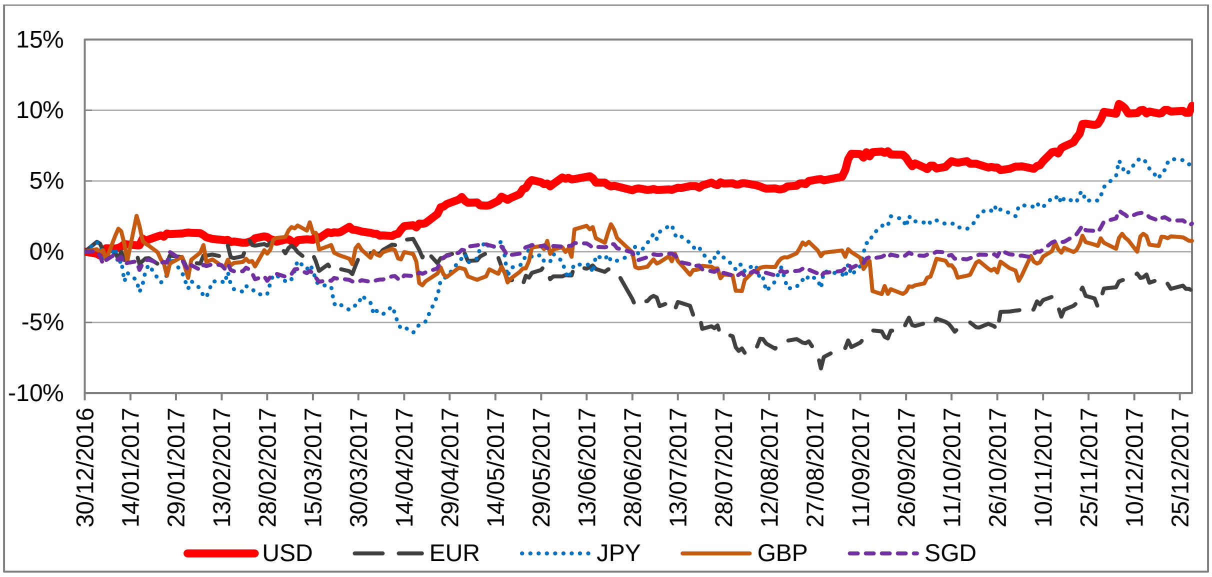
The ringgit strength was partly attributed to the onshore ringgit stabilization measures, including the stoppable of offshore ringgit trading and export proceeds conversion rules. Foreign reserves have stabilized, albeit rising slowly. Strong buying interests on the ringgit was also buoyed by better-than-expected economic growth, expanding current account surplus, rising oil prices and potential interest rate hike in 1Q18.

The ringgit has appreciated against major and regional foreign currencies in 2017: Indonesian rupiah (11.7%), Hong Kong dollar (11.7%), Philippine peso (11.4%), Vietnamese dong (10.7%), Japanese yen (6.6%), Indian rupee (4.2%), Chinese renminbi (3.9%), Brunei dollar (2.9%), Australian dollar (2.4%), Singapore dollar (2.4%), New Taiwan dollar (1.8%), Thai baht (0.9%) and pound sterling (0.8%). However, the ringgit weakened 2.6% against euro and 1.8% against South Korean won. In terms of real effective exchange rate (REER), ringgit gained 4.2% against the currency basket for the first eleven months of 2017 and the full-year rate is expected to be higher.

There remain headwinds for the ringgit. One should remain wary about the state of capital flows and exchange rate pressure triggered by the Fed's continuation of rate hikes and shrinking of its balance sheet. The impending GE14 could provide the ringgit with headwinds in the first half-year. On balance, still good economic and financial fundamentals are positive supportive of the ringgit, which is fundamentally undervalued. The ringgit is expected to be RM3.80-3.90 by end-2018 (End-2017: RM4.0475; End-2016: RM4.4860).

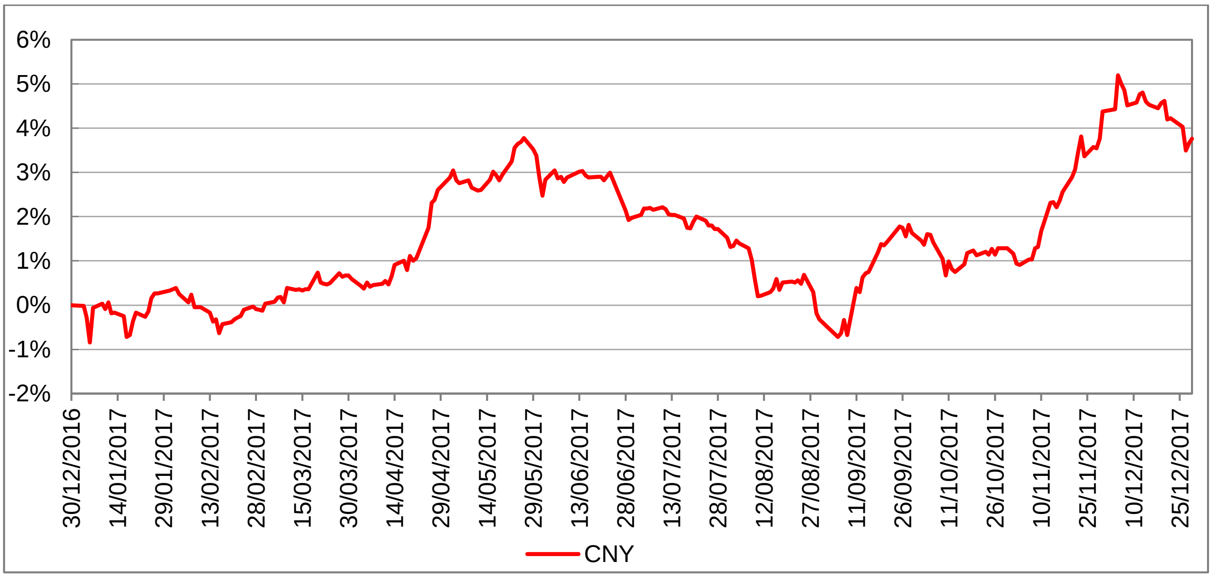
Bank Negara Malaysia continues to work with regional central banks to enhance bilateral currency settlement arrangement. BNM, Bank Indonesia (BI) and Bank of Thailand (BOT) launched the local currency settlement framework between BNM and BI, BNM and BOT, and BI and BOT, a move to promote a wider use of local currencies to facilitate and boost trade and investment in these countries. The three frameworks become operational from 2 January 2018. Businesses which engaged in trading of goods and services among these three countries and investors will be benefited as they have greater efficiency in accessing these three currencies for settlement of trade and direct investments with direct quote by the respective appointed banks.

Figure 56: Ringgit appreciated strongly especially the last quarter



Source: Bank Negara Malaysia

Figure 57: Ringgit gained 3.9% against CNY for the year 2017



Source: Bank Negara Malaysia

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