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Malaysia: GDP and CPI Data Suggest Steady Interest Rate

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4Q06 GDP in Line with Expectation

The Malaysian economy grew 5.7%y/y in 4Q06 (3Q: 5.8%), in line with market's and our expectation. The slower exports growth in 4Q was mitigated by firm private consumption and improving fixed investment which contributed to the bulk of the economic growth in the quarter. On the industry basis, the services and agriculture sectors were the main growth drivers while manufacturing expansion moderated due to weaker demand for electronics. Indications of broadening growth base with the construction sector recording growth of 0.6%y/y in 4Q after 10 consecutive quarters of contraction, also supports a more positive outlook going forward. Overall, the economy expanded by 5.9% in 2006, up from 5.2% in 2005.

We expect higher government and private consumer spending to underpin growth in 2007. The government is likely to accelerate the implementation of the ninth Malaysia Plan projects and the development of the South Johor Economic Region (SJER) as well as other public spending ahead of an imminent election in the later part of 2008. Higher private consumption should continue to exert downward pressure on net exports growth this year especially if the external demand is forecast to moderate. Given the improvement in domestic sentiment, we have upped our GDP growth forecast for Malaysia to 5.5% this year from 5.2% previously. This is still below the official growth forecast of 6.0% this year.

Monetary Policy to Remain Steady in Months Ahead

The BNM has maintained its view that the current interest rate level balances medium-term growth and inflation outlook at the Feb 26 monetary policy meeting, which suggests that it would probably hold the overnight policy rate (OPR) at 3.50% for a while. Not withstanding the heavy flooding at some parts of the country and the 15-60% increase in toll charges for some highways around KL in January, inflationary pressure in Malaysia is still contained. Jan CPI was up 3.2%y/y (Dec: 3.1%), with prices rising 0.5% over Dec 06. As global energy prices ease to manageable levels, we continue to forecast full-year headline CPI at 2.6% which is significantly lower than the average 3.6% in 2006.

The benign inflation outlook suggests the BNM has no need to raise interest rates further despite the lesser-than-expected tightening in the current cycle. Positive growth outlook also means that there is no urgency to cut rates in the near-term to spur domestic demand. As a result, we are maintaining our forecast for the OPR to remain at 3.50% in the first three quarters of this year while a 25bps cut is likely in 4Q07 as the Fed eases its monetary policy.

4Q06 Growth Supported by Private Consumption and Investment

	1Q06	2Q06	3Q06	4Q06		2006
		y/y % chg		y/y % chg	Ppt Cont	y/y % chg
GDP	5.9	6.2	5.8	5.7	5.7	5.9
Consumption	6.8	7.3	8.2	6.7	4.7	7.2
Public	3.8	7.2	13.0	6.9	1.3	7.9
Private	7.5	7.3	6.8	6.6	3.4	7.0
GFCF	11.4	7.6	3.5	9.8	2.5	7.9
Change in stocks (as % of GDP)	1.7	2.4	-1.5	-5.2	-2.5	-0.7
Exports	5.9	4.9	10.5	4.1	5.0	5.9
Imports	10.8	7.7	7.4	3.5	4.0	7.2
Net Exports	-35.5	-30.9	72.2	12.7	1.0	-5.0

Source: CEIC, UOB