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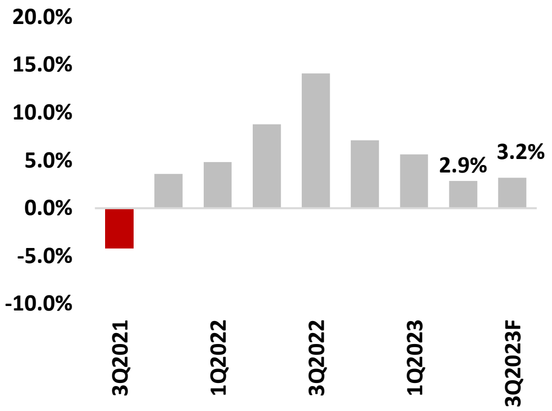
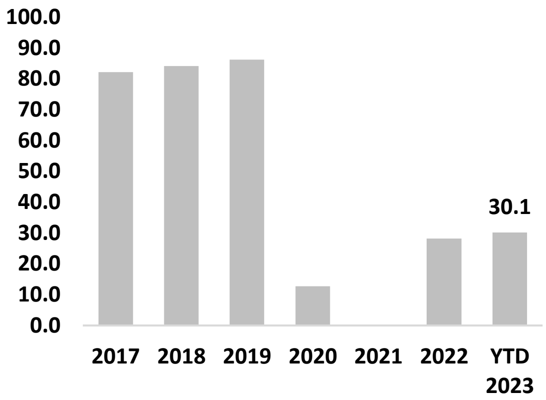
GDP 3Q2023 PREVIEW: RESILIENT DOMESTIC DEMAND AMID FRAGILE EXTERNAL ENVIRONMENT





Sources: Department of Statistics Malaysia (DOSM), Bank Islam

- **We expect GDP growth to be slightly higher in 3Q2023 at 3.2%, a tad lower than the official advance estimate of 3.3%, amid resilient domestic demand despite external headwinds.** We foresee that the better-than-expected growth was bolstered by none other than private consumption – the main driver of economic growth following the small uptick in labour productivity y-o-y during the quarter (3Q2023: 0.6% vs. 2Q2023: 0.0%). This is aligned with the labour force participation rate, which remains high at 70.1% in 3Q2023 (2Q2023: 70.0%). Distributive trade sales came in stronger from 5.7% in 2Q2023 to 6.8% in 3Q2023. Be that as it may, we posit that consumer spending is limited in view of moderation wages in both manufacturing (3Q2023: 3.0% vs. 2Q2023: 3.6%) and services (3Q2023: 3.6% vs. 2Q2023: 3.9%) sectors. While inflation has been easing since the start of the year, we believe that such spending is capped by the weakening of the Ringgit, which coincides with a smaller contraction in the individual's saving deposit (3Q2023: -5.9% vs. 2Q2023: -8.4%) due to imported-related items.

- **Sluggish external demand to put a cap on growth, with exports plummeting by 15.2% in 3Q2023 (2Q2023: -11.1%).** Of note, Malaysia's trade with its major trading partners continued trending in the red but recovering, denoted by the exports to the U.S. (3Q2023: -6.0% vs. 2Q2023: -10.5%), European Union (3Q2023: -6.3% vs. 2Q2023: -20.3%) and China (3Q2023: -11.5% vs. 2Q2023: -9.2%). We believe that the ebbing external trade is due to the fragile global economy amid high global interest rates environment, geopolitical tensions and property woes in China. Thus, trade surplus shrank by 9.1% in 3Q2023 (2Q2023: -9.2%), which will likely stifle the net exports figure. Additionally, the manufacturing Industrial Production Index (IPI) (3Q2023: -0.1% vs. 2Q2023: +0.1%) slipped into the negative territory while the manufacturing Purchasing Managers' Index (PMI) continued to be in the contraction zone for the last 14 months.

- **Should the present macroeconomic environment persists, we posit that 4Q2023 will record the lowest quarterly performance this year in the mid-2% y-o-y.** The anticipated slowdown is due to the higher-for-longer interest rate narratives by major central banks and dampened global demand, dragging down exports to trend in the negative for longer. Of note, exports had contracted in the double digits for the past two quarters (3Q2023: -15.2% vs. 2Q2023: -11.1%). Domestically, we foresee the downtrend in private consumption (2Q2023: 4.3% vs. 1Q2023: 5.9%) to persist well into the last quarter due to moderating wages, as seen in the slowdown in loan growth.

- **Given the abovementioned scenario, we are keeping our full-year 2023 GDP growth projection unchanged at 3.7% for now,** which is slightly lower than the official forecast of circa 4.0%. This would represent a slowdown from the 8.7% expansion recorded in 2022, partly reflecting the dissipating favorable base effects. While trade contribution is set to slow given the external challenges, with the weakness in ringgit dragging the terms of trade lower further, domestic demand will remain resilient, supported by the improving labour market conditions and the easing of inflation. We expect unemployment to gradually return to pre-pandemic level, declining to 3.4% in 2023 from 3.8% in 2022. We also foresee the inflation to slow to 2.7% in 2023 from 3.3% in 2022 due in part to the high base effects and the easing of supply-chain constraints.