



# Hope On The Horizon

While Malaysia's declining second-quarter numbers have caused some concern over growth prospects, there are some good things going for it.

I HAVE to admit I was previously concerned about prospects for the global and Malaysian economy for next year. No, not because I thought things were crumbling. A five-odd-percent growth for Malaysia is still decent compared with that of some regional countries. At the same time, the United States economy would still be an important locomotive for global growth.

What I was more concerned about was the pace at which things were moving. The global semiconductor cycle, for instance, was not recovering as fast as I initially thought it was. At the same time, I felt the US economy might start to feel the pinch from Alan Greenspan's decision to continuously hike up rates to the so-called 'neutral' level.

The Euro economy was also not worth looking at. On top of that, oil-sensitive economies were (and are still) struggling to cope with the impact of escalating oil prices. Thailand, for instance, is only looking at a mediocre growth rate of 3.5% as high diesel prices dent consumer spending.

Malaysia's private consumption, a major pillar of the economy, is slowly softening, as evidenced from statistics revealed by the Malaysian Institute of Economic Research (MIER) and the Mastercard Master Index. Exports remain resilient, but with slow recovery from the major economies, Malaysia's external trade performance might not be something we could shout about.

With this kind of environment prevailing, I thought Malaysia would not be able to do much but wait for a more robust global recovery to materialise, hopefully by the end of the year.

Of late, however, more positive

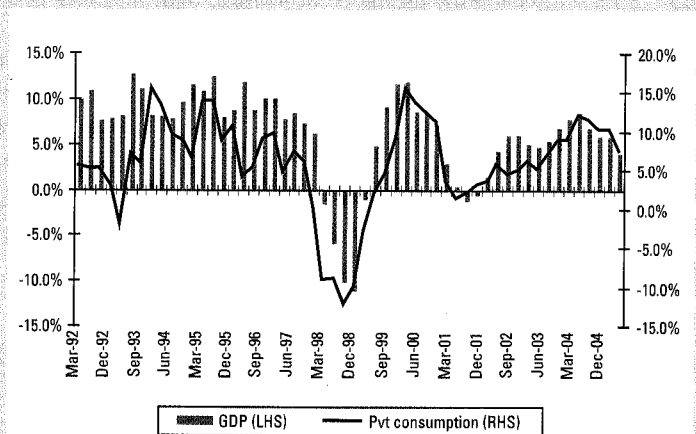
signs have emerged on the horizon. There are now more reasons to be upbeat about the economy. No doubt oil prices remain a major threat as a persistent rise would spoil the party for next year. But that aside, things look rather favourable.

First, the US economy seems to be still resilient despite experiencing a series of interest rate hikes. While some macro indicators are suggesting softer economic conditions a year from now, current numbers indicate strong third-quarter growth.

Accordingly, growth expectations for the quarter have been revised upward to 3.7%, although the impact of Hurricane Katrina, which hit the US, may pull the number slightly lower.

The reason for the optimism is none other than the strength of American consumer spending. A study indicates that since the early 1980s, average growth in the US was strongest during its period of interest rate

MALAYSIA'S ANNUAL GDP AND PRIVATE CONSUMPTION GROWTH



Source: CEIC

hikes – at a rate of 4.5%. A year later, when the hikes stopped, the economy softened to less than 3%.

American consumers should be thanked for doing their job of lifting global growth at a time when other engines are sputtering. While petrol prices are heading towards the US\$3 per gallon level following a sharp rise in crude oil prices – due to demand-supply dynamics and disruption brought about by Hurricane Katrina – consumers are cashing in on high residential property prices.

For instance, the median price of existing homes actually rose 15% in June on an annual basis. That gives Americans additional pocket money to continue spending on durable and non-durable goods.

At the same time, while the Euro 12 economy has not really risen above its current condition, things may not get any worse – except if oil prices keep escalating. With the US economy set to remain strong in the short term, Euro's exports will likely reap the benefit, especially when the euro keeps sliding against the greenback.

Some macro numbers also look promising. For instance, Italy's GDP accelerated 0.7% quarter-on-quarter (q-o-q) in the second quarter, the fastest pace in four years, due to accelerated exports, compared with a 0.5% q-o-q contraction in the first three months. Spain's GDP also surged 0.9% q-o-q and the Netherlands economy expanded 1.2% q-o-q. On the whole, the region grew 0.3% q-o-q.

As for Malaysia, it is understandable that some people are quite sceptical about its prospects for next year, especially after seeing the second-quarter GDP numbers, when growth skidded to 4.1% from 5.7% recorded earlier.

The manufacturing sector grew at a much slower pace of 3.2%, compared with 5.7% in the first quarter. On the demand side, private consumption, a major pillar of the economy, expanded at a single-digit pace of 7.4%, its first since the first quarter of last year.

Not surprisingly, a recent survey of 17 economists by Bloomberg showed their GDP growth forecast for 2005 being reduced to 5% from an initial estimate of 5.4%.

There are however some bright spots in the report. First, total investment (gross fixed capital investment) has unexpectedly grown by 6.7%, way beyond its average of 2%-3% in the past few quarters. The revival in private investment will indeed be a major catalyst for the Malaysian economy.

Second, the budget deficit stood at merely RM0.1 billion in the first half, compared with the over RM17 billion shortfall projected for the whole of this year. That would mean the Government will be able to spend quite a bit in the second half, utilising the rest of its

development allocation made in last year's Budget.

Third, Bank Negara Malaysia (BNM) remains firm about maintaining a stable and low interest rate regime to promote economic growth. That's good news for private consumption as consumers are relying on cheap borrowing costs.

Another major reason for being more optimistic about prospects for the local economy by next year's end is the stability of the ringgit vis-à-vis other currencies. Although there was initial speculation that the ringgit might strengthen significantly following its departure from the fixed exchange rate regime on July 21, no such thing has happened.

BNM has openly voiced its intention to see a stable ringgit, as currency volatility would only disrupt Malaysia's financial market. A sharp appreciation, for instance, would cause foreign investors to dump Malaysian stocks and bonds as they seek to take advantage of foreign exchange gains.

But with minimum fluctuation of the local currency, they are forced to remain invested in Malaysia, at least for the time being.

This is due to the fact that although they currently see a limited movement in the value of the ringgit, they believe the currency's appreciation is still insufficient. In fact, most of them believe a slow and steady appreciation will take place in the next one year.

The ringgit's slow appreciation also helps the country in another way – its exports. In a period of volatile global demand, an undervalued currency will definitely be a plus point for the export sector. At RM3.70-RM3.80 to the US dollar, the ringgit might still be slightly undervalued – meaning it can still help boost Malaysia's trade performance, or at the very least buffer the drop in the country's economic growth should global demand stumble.

At the same time, an expected recovery in the global economic cycle by the year's end or early next year would be a windfall for a major exporter and an open economy like Malaysia.

A major caveat to the outlook painted above is no other than the escalating oil prices. Crude oil prices, which initially rose on the back of anticipation of higher global demand, recently skyrocketed following a supply shock caused by Hurricane Katrina.

Should the price volatility persist, global consumer confidence will get hit and this would translate to higher interest rates for some countries and slower overall economic growth. If such a scenario unfolds, prospects for an acceleration in global recovery would likely be delayed. **mb**

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