

ECONOMIC REVIEW

OCTOBER 2007

KDN : PP5028/1/2008

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MALAYSIA: LEADING INDEX POINTING TO HIGHER GROWTH IN 2008

Introduction

The Malaysian economy remains resilient. Despite the deceleration in the US economy, Malaysia is on track to achieve another 6 per cent growth this year. Efforts to strengthen the domestic economy by boosting private consumption and investment as well as public investment have resulted in soft de-coupling between the US and the Malaysian economy. Combined with stimulative macroeconomic policies, these efforts have alleviated the drag on the gross domestic product (GDP) growth arising from the present weak export.

In the first half of 2007, the economy has already turned in 5.6 per cent growth, supported by a stronger pickup in domestic demand (Table 1). In particular, private consumption was strong due to significant increases in income, strong and sustained prices for primary commodities and stable and low interest rates. Public investment has risen as well with the implementation of high-impact development projects under the Ninth Malaysia Plan. Private investment also has remained strong, boosted partly by the high capacity utilisation in the manufacturing sector.

Table 1
Malaysia: GDP by Aggregate Demand (in 2000 prices)

	Annual change (%)	
	2006	1H 2007
Aggregate Domestic Demand	7.0	9.8
Consumption	6.6	10.4
Private sector	7.1	10.8
Public sector	5.0	8.8
Gross Fixed Capital Formation	7.9	8.1
Exports of Goods and Services	7.4	2.5
Imports of Goods and Services	8.6	2.4
GDP	5.9	5.6

Source: Department of Statistics, Malaysia, Gross Domestic Product Second Quarter 2007.

Outlook for 2008

While the Malaysian economy is expected to remain strong in 2007, the outlook for 2008 is challenged by the external uncertainties and risks arising from the high global oil prices, high global inflationary pressures and deceleration in the US economy. Issues related to the crisis in the US sub-prime housing markets have yet to be resolved. Also, the resulted credit squeeze and credit tightening arising from the sub-prime issues is expected to linger in the

US and European economies longer than expected.

To gauge the prospects of the Malaysian economy in 2008, we examine the recent trend of Malaysia's Leading Index (LI), published by the Department of Statistics, Malaysia. Despite its limitation, the LI is a useful tool to predict future economic activity and direction, in particular a turnaround point in the economy. Briefly, the LI measures the aggregate economic behaviour of selected leading variables. It tells the likely direction of the economy in the next six to nine months: A rising trend of the LI signals economic expansion ahead and vice versa.

The Leading Index is a composite index, consisting of several key economic variables tested for their significance as a leading indicator. These variables include money supply, Bursa Malaysia Industrial Index and total trade with major trading partners. The variables are in Table 2.

Table 2
Malaysia: Leading Index Components

1. Real Money Supply, M1
2. Bursa Malaysia Industrial Index
3. Real Total Traded: Eight Major Trading Partners
4. CPI for Services, Growth Rate (Inverted)
5. Industrial Material Price Index, Growth Rate
6. Ratio of Price to Unit Labour Cost, Manufacturing
7. Number of Housing Permits Approved
8. Number of New Companies Registered

Source: Department of Statistics, Malaysia, Leading, Coincident and Lagging Indices July 2007.

Leading Index Trend

The LI for the period from January 2006 to June 2007 is shown in Graph 1. In absolute terms, the LI (2000=100) rose consistently from 138.5 in January 2006 to 153 in July 2007. In the first half of this year, the LI rose by 4 per cent from 147.1 in January to 153 in July.

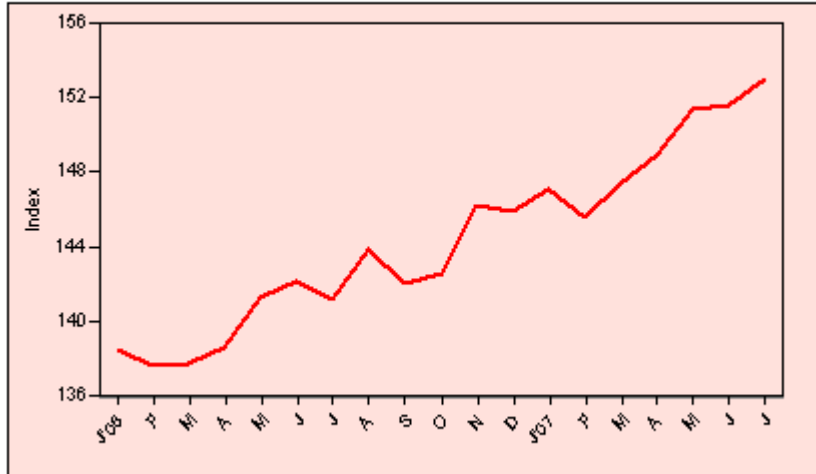
The annual growth of the LI was also high as shown in Table 3. In fact, the annual growth of the LI rose from an average of 4.5 per cent per month in the first half of 2006 to 5.7 per cent in the second half of the year. The growth in the LI picked up to 7.2 per cent per month in the period from January to July of 2007. The increasing trend and higher growth of the LI in 2007 indicates that the Malaysian economy will continue to remain strong and healthy in 2008.

To gauge whether there is any sign of impending economic slowdown ahead, we use the Coincident Index and the Lagging Index, also published by the Department of Statistics, Malaysia. While the series are of limited use individually, we construct the ratios of the Coincident Index to the Lagging Index to provide clues to the likely direction of the economy: Steady and rising ratios of the Coincident to the Lagging Index signal economic expansion ahead and vice versa.

The ratios of the Coincident Index to the Lagging Index from January 2006 to July 2007 are shown in Graph 2. While the ratios have softened in 2007 from its peak in January, they

remained high: In fact, the ratios of the Coincident Index to the Lagging Index were significantly higher in 2007 compared to that of 2006 due to higher growth in the Coincident Index compared to that of the Lagging Index. The high ratios of the Coincident Index to the Lagging Index indicate that the Malaysian economy will remain on an expansionary mode with GDP growth is likely to be higher in 2008 than that of 2007.

Graph 1
Malaysia: Leading Index, 2006-2007



Source: Department of Statistics, Malaysia, Leading, Coincident and Lagging Indices July 2007.

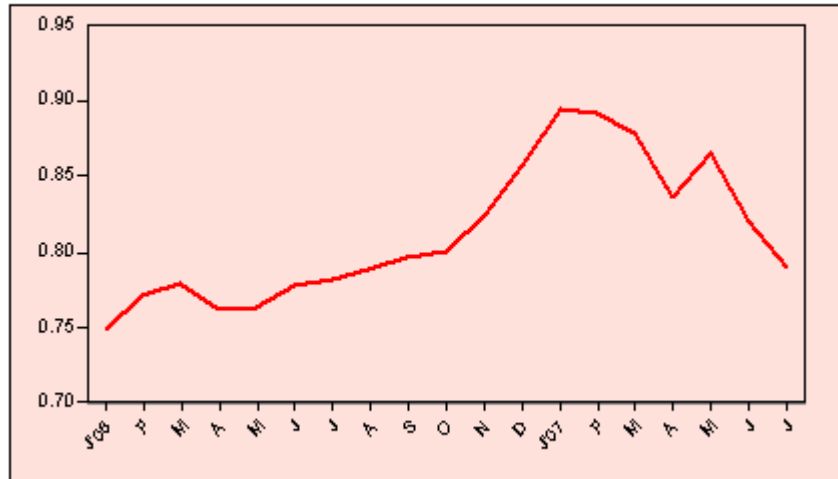
Table 3
Malaysia: Leading Index, 2006-2007

	Growth Rates (%)	
2006	January	5.2
	February	3.2
	March	2.6
	April	3.3
	May	6.4
	June	6.4
	July	4.1
	August	7.1
	September	3.7
	October	4.0
	November	8.5
	December	6.8
2007	January	7.4
	February	4.6
	March	5.8
	April	6.7
	May	8.9
	June	8.0
	July	8.8

Source: Department of Statistics, Malaysia, Leading, Coincident and Lagging Indices July 2007.

Graph 2

Malaysia: Ratio of Coincident Index to Lagging Index, 2006-2007



Source: Department of Statistics, Malaysia, Leading, Coincident and Lagging Indices July 2007.

Conclusion

The increasing trend and steady growth in the LI and the ratio of the Coincident Index to Lagging Index in 2007 indicates that the Malaysian economy will continue to remain strong and healthy in 2008. From the high and rising growth in the LI, it is not unreasonable to expect a higher GDP growth in 2008 compared to that of 2007



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