ECONOMIC REPORT | Malaysia's Economic Outlook 2020

13 April 2020

MALAYSIA: CHALLENGING GLOBAL AND DOMESTIC ENVIRONMENT LIMIT EXPANSION

Another MCO extension, further slowdown expected in 2020. The Malaysian government announced another two weeks extension of the Movement Control Order (MCO) last Friday. Although we foresee Malaysian economy to continue expanding in 2020, it will be significantly moderated. In light of the MCO extension and the likelihood of some restrictions to remain in place even after the MCO ends, we are again revising our GDP growth forecast for 2020 to 1% from 2.7% previously. As comparison the GDP expanded 4.3%yoy in 2019. Besides the impact from the MCO, external trade performance will be another factor. More countries worldwide are imposing at least partial lockdowns. These restrictions will adversely affect private consumption and investment along with external trade performances. Hence, the 1H20 data is anticipated to be more precarious than before. Nevertheless, we expect a recovery in 2H20 as fears from Covid-19 wanes. The economic growth in overall will be influenced by various internal and external factors including disruption in global production and consumption following Covid-19, recession fears, global financial stability, oil price war, inflationary pressure and labor market performance. We remain cautious that if the pandemic lasts until year end, the economy will contract.

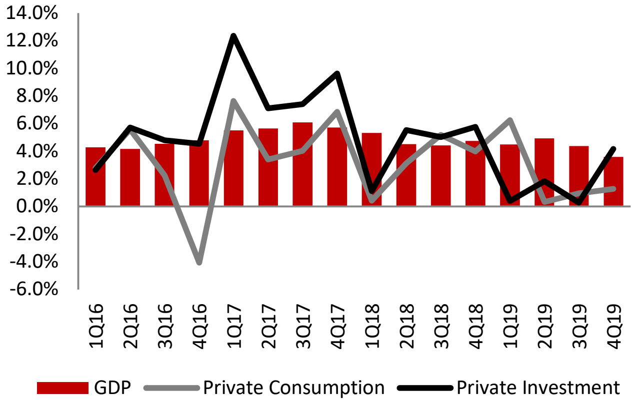
Modest private consumption. Household spending will be supported by low inflationary pressure, OPR cuts and huge economic stimulus package particularly through Rakyat-centric measures. Significant measures announced in PRIHATIN Economic Stimulus Package (ESP) including six months' moratorium on individual loan payments, reduction in EPF contribution rate, EPF Account 2 withdrawal and one-off cash assistance, among others will result in an increase of disposable income for employees. However, household expenditures are likely to be affected by ongoing Covid-19 especially with MCO. Consumption will be limited as Rakyat stays home during MCO and substantial increase in unemployment in badly affected sectors such as hotel and aviation. In addition, consumption is seen to be under continuous pressure for a period of time after the MCO as unemployed Rakyat might take a while to penetrate the labor market again, considerable numbers of employees are expected to continue working from home and individuals putting their vacation plans on hold due to fear of reactivation of Covid-19. Hence, we foresee private consumption to grow at a softer pace of 5.0%yoy in 2020 (2019: 7.6%yoy). Similarly, services sector will experience a slowdown, growing at 3.1%yoy (2019: 6.1%yoy) dragged down by weak tourism activities especially with the call-off of Visit Malaysia 2020 due to Covid-19.

Sentiment push investment down. Private investment is expected to plunge by -6.0%yoy (2019: 1.5%yoy) weighing by weak demand and business sentiments. Covid-19 is disrupting global supply chain resulting from lower Chinese and Asian factory output. Furthermore, the pandemic has now spread widely to other parts of the world including the Europe and the US with more countries imposing lockdowns to inhibit the further spread of the virus. This has also put China's commitment to the US-China phase one trade deal at stake. Political instability will also have their own impact on it. All these are deteriorating investors' confidence and halt business expansion or investment which will take more time to be restored despite lower interest rate and significant stimulus such as six months' moratorium on businesses loan payments and Special Relief Facility Fund for SMEs. In line, Malaysian weak import, particularly of capital goods, suggests that manufacturers are still pessimistic on the future demand for their products hence are more cautious on business expansion decisions. Meanwhile, construction activities are projected to fall by tepid pace of -0.6%yoy after stagnated in 2019 as many projects would be delayed. Mega projects including MRT2, LRT3 and Pan Borneo highway would cushion the impact however likely to be materialized towards the end of the year.

Grim stance on mining sector. Volatility in commodity prices are influencing the performance of commodity-based sectors particularly of mining sector. Crude oil prices have already moved downward starting this year due to the Covid-19 which led to softer demand. Saudi Arabia made it even worse with massive discounts on its official selling price and production ramp-up following the breakdown of talks with Russia, causing Brent crude oil price to currently hover below USD 30pb level. At this price level, Malaysian government's coffer will be affected. Potential supply glut and dismal demand mainly from the hard-hit aviation sector globally could pressure prices further. The opening of PFLNG 2 in 2Q20 would be a positive news however believed to be inadequate to compensate the overall impact of oil price war to the overall mining sector performance. We foresee mining sector to contract further by -2.8%yoy (2019: -1.5%yoy). Meanwhile, agriculture sector is expected to experience slight drop in growth at -0.5%yoy despite higher average price estimated for CPO at RM2,450mt (2019: RM2079mt). Pressure will be more on the demand side, from India, China and the EU.

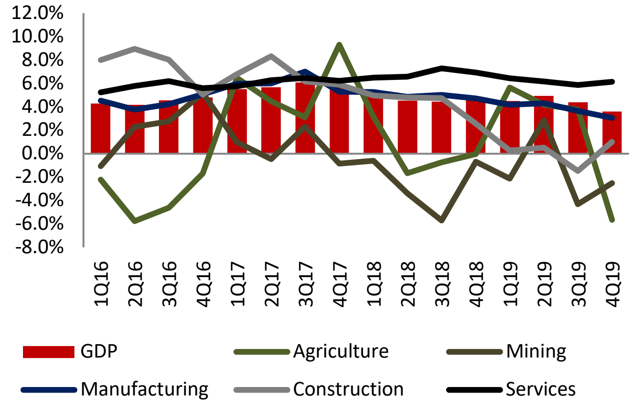
Government will be the saviour. Government expenditure are anticipated to cushion the adverse impact to Malaysian economy. The ESP announced by government to combat threats from Covid-19 to the economy which comprise one-off cash assistance, digital vouchers, energy discounts, special allowances to front-liners and wage subsidy would increase government consumption. Therefore, we foresee public consumption to expand higher by 6.0%yoy (2019: 2%yoy). Meanwhile, government investment is expected to recover marginally with softer negative growth of -9.7%yoy (2019: -10.8%yoy) due to mega projects. However, the fiscal space is likely to be somehow limited by lower oil prices. Furthermore, government's priority in combating the spread of Covid-19 might delay other public investment activities.

Chart 11: GDP vs Private Sector (YoY%)



Source: CEIC, MIDFR

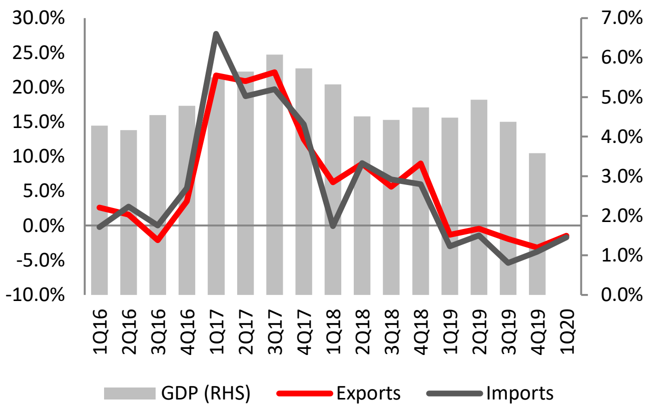
Chart 12: GDP by Supply-Side (YoY%)



Source: CEIC, MIDFR

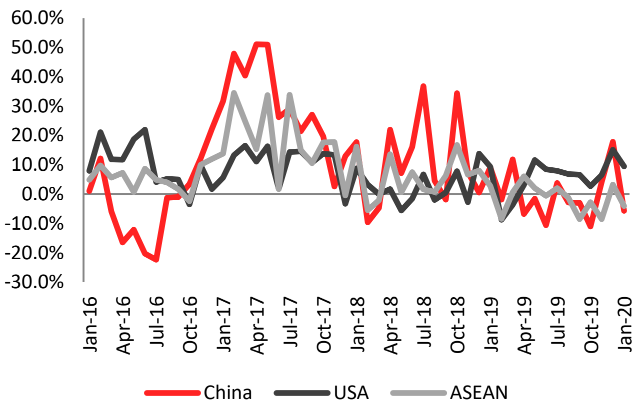
Covid-19 and trade war threaten external trade performance. Impact of Covid-19 emerged as the top risk to global trade flows now. This includes Malaysia as China is our largest trading partner. The threat to foreign trade has increased even more with the pandemic spreading rapidly to Europe and the US. MCO in Malaysia and also in a number of key countries have a negative knock-on effect to export and import activities as most businesses shut down temporarily. Furthermore, delayed investment decisions may be chipping away some impetus in trade. Hence, we forecast both exports and imports growth to contract further in 2020 at -7.2%yoy (2019: -1.7%yoy) and -6.7%yoy (-3.5%yoy) respectively. Uncertainties to global trade flows will remain even when Covid-19 is contained. This was due to the fact that existing tariffs imposed between China and US are still largely in place regardless of the phase one trade deal. The US presidential election and protectionism possibly resurfacing during the election campaign. Besides that, Green Deal by the EU, Saudi-Russia oil war and Malaysia-India spat will also affect Malaysian exports.

Chart 13: External Trade vs GDP, (YoY%)



Source: CEIC, MIDFR

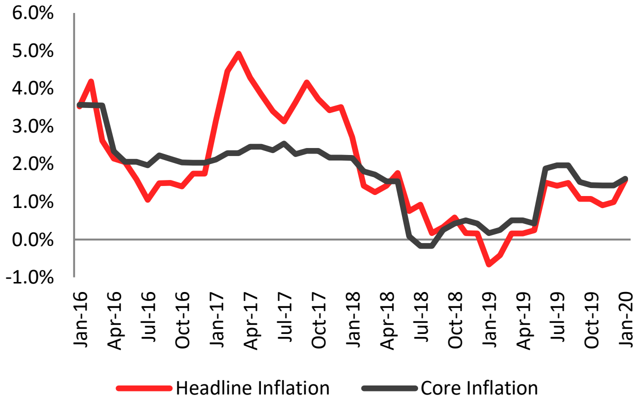
Chart 14: Exports Growth (YoY%) by Major Destination



Source: CEIC, MIDFR

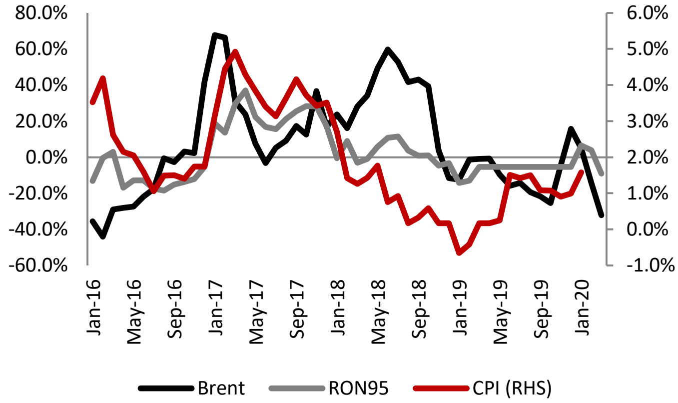
Low inflationary pressure. The recent oil war has caused a nose-dive movement in global crude oil prices with Brent's price currently hovering below USD 30pb. We foresee Brent crude oil price for 2020 to average at USD 41pb (2019: USD 64.3pb). At this level, we could see further reduction in RON95 prices, far below level seen in 2019. In addition, toll rates for all PLUS highways are reduced by 18% starting Feb-20. As transport is the third biggest component in overall CPI basket, we opine these to have a significant impact to overall inflation. Furthermore, we do not foresee any major demand-pull inflation due to the Covid-19. Purchases of big ticket items such as houses and cars could be dampened as consumers change spending pattern from discretionary to necessity. Some upward pressure could be expected in food component through imported inflation as Malaysia is a net importer of food and weaker Ringgit will result in the items to be more expensive. We foresee inflation to moderate further to 0.5%yoy (2019: 0.7%yoy).

Chart 15: CPI: Headline vs Core (YoY%)



Source: CEIC, MIDFR

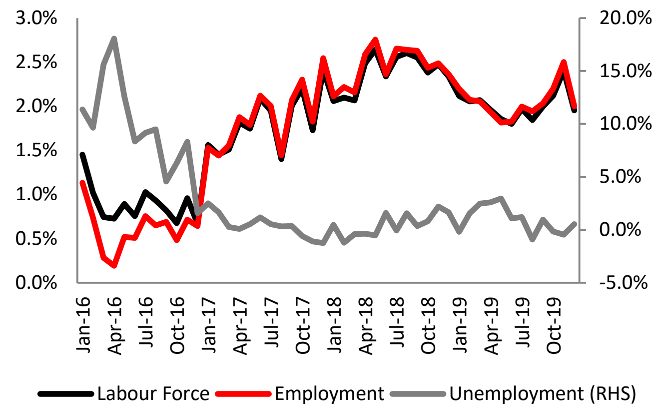
Chart 16: CPI vs Crude & Retail Fuel Prices (YoY%)



Source: CEIC, MIDFR

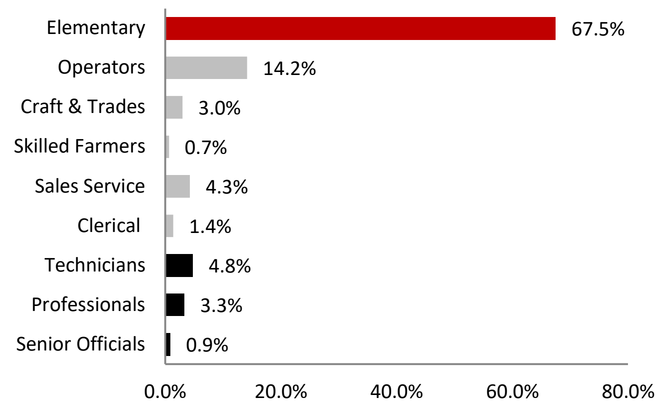
Full employment state to continue. Malaysia's unemployment rate will maintain under state of full employment in 2020 but with an upward tick to 3.8% (2019: 3.3%). Unemployment growth is expected to shoot up following layoffs in hard-hit sectors. Slowdown in both domestic and global economies which weaken exports and consumption will affect employment opportunities particularly in services and manufacturing sectors. Services sector has the largest share of total employment in the country at circa 60% followed by manufacturing sector (20%). The Wage Subsidy Programme in ESP would provide some relief but are viewed to be less significant in retrenchment for companies especially SMEs who faced huge drop in revenue. Employment plays a significant role to boost private consumption and investment which subsequently facilitate economic growth.

Chart 17: Labour Market Key Indicators (YoY%)



Source: CEIC, MIDFR

Chart 18: Share of Job Vacancies by Type (%)

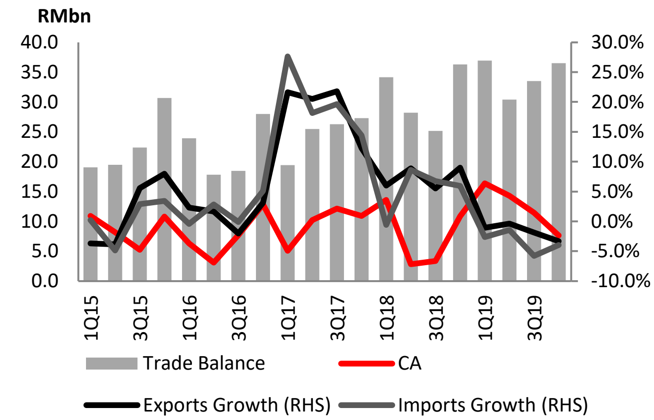


Source: CEIC, MIDFR

End-2020 Ringgit target at RM4.25 against the USD. In the immediate term, the Covid-19 pandemic is a downside risk to the Ringgit as it results in global supply chain disruption and induces a flight to safety. Recently, nosedive movement in oil prices due to the oil price war between Saudi Arabia, Russia and the US has caused Ringgit to breach the USD/MYR4.40 level. Other downside risks will be the review by FTSE Russell of Malaysia's position in its FTSE World Government Bond Index (WGBI) watch list, lower interest rates resulting from OPR cuts, and moving towards the end of this year, the potential re-election of President Trump may boost the green back. Despite all this, we are sanguine on the oil production cut deal among world's major oil-producers nations and that the Covid-19 will be contained. Based on available data on Covid-19, we foresee the effects of the fears will wane in 2H20 given that recovery rate is on improving trend. Factoring all that, we foresee Ringgit at USD/RM4.25 (2019: USD/RM4.09) by year-end of 2020 and average at USD/RM4.22 (2019: USD/MYR4.14).

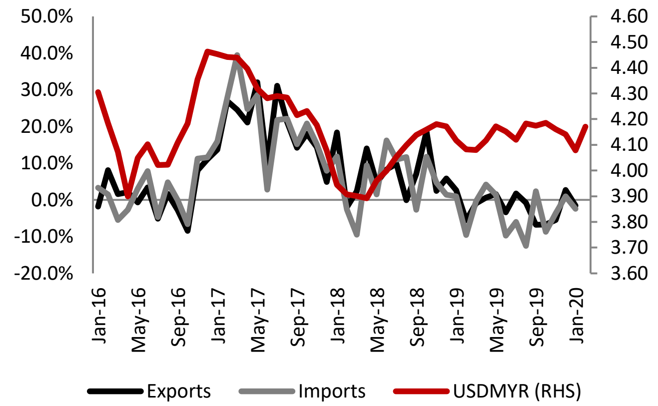
Lower current account surplus to GDP expected in 2020. Via the channel of trade surplus supported by diversified export products and markets, we opine a continuous surplus in current account for 2020. However, we foresee a lower current account surplus of 2.0% of the GDP compared to 3.3% in 2019 due to falling net exports and that tourism and manufacturing activities will be attenuated by Covid-19. As the net exporter of oil, the recent oil price war will also contribute to the narrowing current account surplus.

Chart 19: Current Account Balance vs External Trade



Source: CEIC, MIDFR

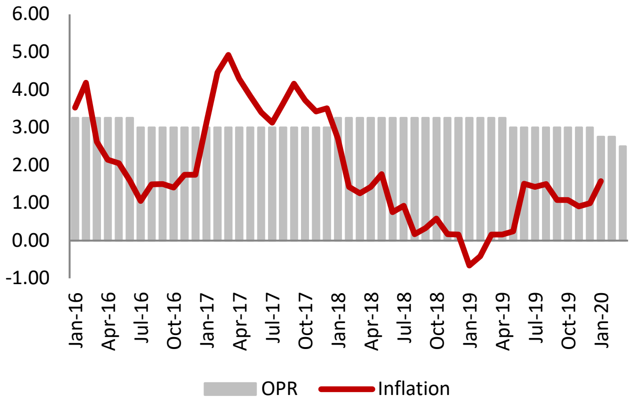
Chart 20: Exports & Imports (YoY%) vs USDMYR



Source: CEIC, MIDFR

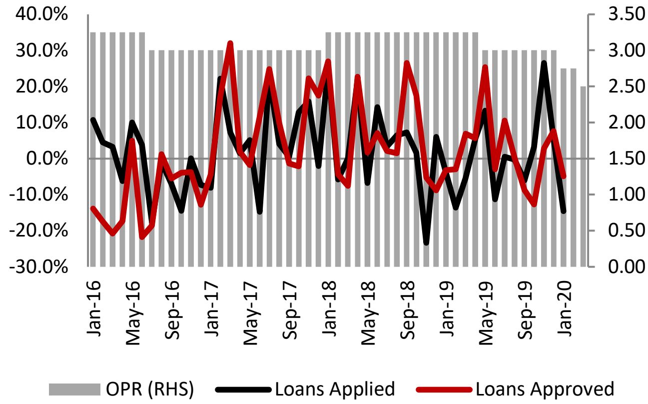
Two more OPR cuts. BNM has cut its OPR twice for a total of 50bp so far this year due to intensifying impact from Covid-19. Such easing monetary policy is need along with expansionary fiscal policy to support Malaysia's economic growth especially via private consumption and investment. We view downside risks to the economy include Covid-19, global trade tensions, political instability and the US presidential election to remain. In addition, Fed cut its policy rate by 100bps to 0-0.25% (the levels it hovered for years during and after GFC) in a second emergency move after the first one on 3rd March. Since there will be more pressure from both domestic and external fronts, BNM could undertake two more rate cuts by 25bp each for this year.

Chart 21: Monetary Policy (%) vs CPI (YoY%)



Source: CEIC, MIDFR

Chart 22: OPR (%) vs Loans Growth (YoY%)



Source: CEIC, MIDFR

Table 1: MIDF Research Macroeconomic Forecast Figures for 2020 (%)

(YoY%) Unless Stated Otherwise	**2016**	**2017**	**2018**	**2019**	**2020f**
Real GDP	4.4	5.7	4.7	4.3	1.0
Govt. Consumption	1.6	5.5	3.2	2.0	6.0
Private Consumption	5.8	6.8	7.9	7.6	5.0
Govt. Investment	(0.8)	0.5	(5.0)	(10.8)	(9.7)
Private Investment	4.4	9.1	4.4	1.5	(6.0)
Exports of goods & services	1.3	8.8	2.2	(1.1)	(9.4)
Imports of goods & services	1.5	10.3	1.3	(2.3)	(8.0)
Net Exports	0.3	(3.9)	14.6	8.9	(20.5)
Agriculture etc.	(3.6)	5.8	0.2	1.8	(0.5)
Mining & Quarrying	2.3	0.5	(2.6)	(1.5)	(2.8)
Manufacturing	4.4	6.1	5.0	3.8	(3.4)
Construction	7.5	6.8	4.3	0.0	(0.6)
Services	5.7	6.2	6.8	6.1	3.1
Exports of Goods (f.o.b)	1.2	18.8	7.3	(1.7)	(7.2)
Imports of Goods (c.i.f)	1.9	19.7	5.2	(3.5)	(6.7)
Trade Balance	88.1	98.5	123.8	137.3	123.0
Consumer Price Index	2.1	3.8	1.0	0.7	0.5
Current Account - %of GDP	2.4	2.8	2.1	3.6	2.0
Fiscal Balance - % of GDP	(3.2)	(3.1)	(3.7)	(3.5)	(5.9)
Federal Government Debt - % of GDP	51.9	50.1	51.2	52.5	56.1
End of Unless States Otherwise	**2016**	**2017**	**2018**	**2019**	**2020f**
Brent Crude Oil (Avg)	46.0	55.7	70.0	64.3	41.0
Crude Palm Oil (Avg)	2,630	2,690	2,320	2,079	2,450
USD/MYR (Avg)	4.14	4.30	4.00	4.14	4.22
USD/MYR	4.46	4.08	4.10	4.09	4.25
Overnight Policy Rate (%)	3.00	3.00	3.25	3.00	2.00

Source: MIDFR

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