ECONOMIC OUTLOOK 2021

MEDIA STATEMENT
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Kuala Lumpur, 18 January 2021 – 2020 was a watershed year for the global economy, financial markets and also life in general. With the havoc wreaked by the Covid-19 pandemic and the ensuing global lockdown, we saw the global supply chains were disrupted, most economic activities essentially ground to a halt and international travel also stalled abruptly. Many industries, especially in aviation and hospitality-related sectors were upended, firms and households were particularly hard hit through the sudden and sharp loss in orders and income respectively. The major economies including the United States and the Eurozone entered into a recession and even China saw GDP growth slow significantly. Global policymakers reacted promptly and aggressively with unprecedented stimulus to combat the Covid pandemic and the economic fall-out.

That said, with the roll-out of several Covid vaccines in various economies signal some light at the end of the tunnel. Nevertheless, the cost in terms of impacted lives and financial upheaval continue to rise with new resurgence of Covid infections and reinstatement of lockdowns in various countries including parts of Europe, Japan, and even Malaysia for that matter.

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Consequently, major central banks remain very cautious about withdrawal of policy accommodation. The US Federal Reserve has committed to keeping its zero interest rate policy out through 2023 and has pushed back on market speculation of any tapering of its bond purchase program this year. The recent softening of the US labour market towards the end of 2020 may also pressure the incoming Biden administration to do more in fiscal stimulus, which should aid the US economic recovery. Elsewhere, UK's Brexit from the EU and the fresh lockdowns in Europe suggest a still uncertain outlook.

Global growth is tipped to rebound in 2021, following a deep slump in 2020 that sets a very low base and was mitigated by unprecedented policy support. Moreover, a K-shaped recovery is apparent with uneven and uncertain sectoral outlooks – while manufacturing is faring better due to digitalization, AI, Internet of Things, cloud computing, demand for 5G products and solutions, and work-from-home arrangements, other sectors such as construction and domestic-oriented services may continue to face many challenges due to periodic lockdowns, enhanced social restrictions and tightening of various measures. The reconfiguration to enhance economic resilience and avoid over-reliance on single supplier and/or market also remains intact amid a choppy US-China relationship, even as market hopes that the incoming Biden administration would herald a de-escalation in bilateral tensions, at least in terms of trade tariffs and economic sanctions.

China, as the first-in-first-out of the Covid crisis, is tipped to expand by up to 9.2% on-year in 2021, following a very modest 2.0% in 2020. ASEAN economies are also expected to grow by around 5% this year, after a sharp contraction in 2020. Should the global and domestic roll-out of vaccination be smooth, growth momentum in the second half of 2021 may accelerate and bolster business and consumer confidence and prompt the gradual re-opening of international borders. However, it may be premature to assume there will not be hiccups along the recovery trajectory.

The reflation theme bears watching. The 10-year US Treasury bond yield has surged past the 1% handle while the 10-year breakeven inflation rate (the gap between the 10-year UST bond yield and Treasury inflation-protected securities) exceeded 2% for the first time since 2018. With OPEC+ extending its output quota and Saudi Arabia unilaterally cutting output, there may be upside risk to crude oil prices. While we do not expect runaway oil prices, nevertheless, reflation will likely accompany economic recovery.

For Malaysia, the dramatic turn of events recently – with the re-imposition of MCO, followed by a declaration of a state of emergency – would inadvertently challenge the nascent recovery that the economy has started to eke out. Already, even as growth surprised on the upside in Q3 2020, we had cautioned before that Q4 momentum might be more challenged. The latest events could see growth becoming more curtailed in Q1, in particular. Even as exports continued to show signs of benefiting from a recovery in demand in electronic goods, the domestic segment would likely to continue to be a drag – and potentially even more so now.

While the MCO restriction orders are not applied in a wholesale fashion across the country as per March-April 2020, the affected areas this time round are nonetheless the heavyweight regions, economically speaking. Together, the 5 states (Selangor, Penang, Johor, Melaka and Sabah) and KL command a hefty 67.7% of the economy. The hit to economic activities there would naturally challenge any hope for a robust uptick in the economy overall.

In particular, the still-elevated unemployment rate, which went up to 4.7% in October, having declined to 4.6% in September from the peak of 5.3% in March, is a reminder that a soft labour market outlook would continue to crimp consumption as it is – made all the more so now with the renewed risk of extended restriction measures.

While, as it stands, the MCO is slated to last only for two weeks, it may well be extended, unfortunately, unless the number of cases starts to come down dramatically in the coming week or so. Indeed, if it is any indication, the accompanying state of emergency is valid for a much longer period of all the way through to August 1st, even if it can technically be cut short if a consultative committee that is to be set up by the PM determines there is no longer any need for it.

All in all, we see downside risks to our 2021 GDP forecast. Previously at 6.0%, it is already relatively low compared to the 6.5-7.5% range targeted by the government and latest 6.8% consensus. However, the culmination of recent events and the distinct likelihood that the MCO may be extended beyond the current stipulated period of two weeks are likely to pressure Q1 growth further. Indeed, we see the risk that the economy will shrink on both a sequential and year-on-year basis in Q1, with growth rates of -0.6% qoq sa and -0.1% yoy, respectively. For the year as a whole, growth rate now is likely to be at 5.7% yoy in our new baseline thinking.

The softer growth outlook will bring some challenges to the authorities in terms of remedial measures. Already, even as we lauded the support coming from Budget 2021, especially in terms of developmental spending, we had cautioned against the relatively optimistic tax revenue assumption that is predicated on strong growth outturn.

Even though the emergency powers allow the government to potentially issue ordinances to temporarily supplant existing laws, including the one concerning the recently approved budget, the government may remain reluctant to undertake a ‘bazooka’-type fiscal largesse, given the external constraints imposed by market. Already, the December 4th downgrade by Fitch ratings agency serves as reminder of the limits of fiscal space that Malaysia may run into, especially given its relatively high stock of government debt.

With the relatively dim prospect of large-scale fiscal help, the onus is thus for monetary policy to shoulder the burden more considerably. When it left its OPR unchanged at 1.75% for the second time running in its last MPC meeting on November 3rd, Bank Negara still sounded quite sanguine on growth prospects. We expect that tone to have turned more downbeat by now in the face of recent events, however, and we see a heightened chance of a rate cut to 1.5% in the upcoming meeting on Jan 20th. Depending on how things pan out in the pandemic fight in the weeks thereafter, we might well see another rate to 1.25% in the March meeting as well.

Overall, we remain constructive of Malaysia's economic prospects and the eventual recovery in later part of 2021 – especially since its manufacturing sector is well-geared to partake in the global electronics recovery, for example – but the immediate months ahead would present some speed bumps.

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