OCBC Bank

ECONOMIC OUTLOOK IN 2022

MEDIA STATEMENT
BY SELENA LING, CHIEF ECONOMIST, OCBC BANK

Kuala Lumpur, 20 January 2022 – While 2021 has been a roller-coaster ride, as vaccines preluded a positive start to the year, the green shoots came under heavy rain showers in the form of the Delta variant before persistent elevated inflationary prints prompted the frontloading of hawkish central bank expectations. Of course, this was before the latest Omicron variant landed on many shores, prompting market swings as investors attempted to ascertain the health and economic implications. The rain clouds may be gathering even though it is not clear if it will be a passing shower or a persistent thunderstorm. While there is still uncertainty attached to the Omicron variant at this juncture, more importantly some themes remain familiar and are likely to sustain into the new year, and these include the long tail of Covid mutations, complex US-China bilateral relations, and global supply chain bottlenecks contributing to inflation.

US equity markets had a good run in 2021 until the new Covid variants emerged. While the FOMC did a relatively good job of guiding market that a taper was forthcoming, nevertheless, the tenacity of elevated inflation may have caught them by surprise and prompted the shift in rhetoric from "transitory" to "persistent" inflation. The different risk events contributing to the global supply

Selena Ling, Chief Economist, OCBC Bank

chain bottlenecks was partly to blame, but rising commodity prices including crude oil, also put the heat on corporate profits and increasingly also translating to the rising prices paid by end-consumers. For now, consumers remain relatively willing to spend amid the labour market recovery and as pandemic fatigue wears on. That said, hopes of Covid turning endemic with the ramp up in vaccination rates has proved somewhat premature, as the necessity of booster shots and ongoing tightening of some restriction measures in many economies globally testify.

The combination of both improving demand and continued global supply chain bottlenecks are posing a near perfect inflation storm. Once elevated inflation persists into 1H22, it is no longer a matter of low base effects from 2020. In fact, the continued tightening of Covid restriction measures and border controls due to first Delta and now Omicron (and potentially more Greek alphabets variants to come), suggests that there will be no immediate panacea to inflation, short of another global recession, albeit this would be the feared "stagflation" scenario. Other mitigating factors of course could include OPEC+ ramping up oil supplies, international borders re-opening quickly to allow freer flow of goods and workers again (which looks unlikely for now with Omicron) and/or China ramping up policy stimulus to offset its growth slowdown, as evidenced by the January 17th cuts in its 1-year MLF rate and the 7-day reverse repo rate.

Major central banks which were initially reluctant to withdraw monetary policy accommodation prematurely for fear of undermining the nascent recovery have subsequently turned more confident that inflation would stay structurally higher due to supply side factors, including efforts to combat climate change, and hence have embarked on tapering asset purchases and/or hiking interest rates.

The sea-change, however, can be noted in the major shift in the FOMC December meeting. With sticky inflation as the new diagnosis now, what are the monetary doctors prescribing to cure it? First, the Fed thinks the economy should wean itself off the existing medication of quantitative

easing. The tapering pace will thus be doubled, from $15bn to now $30bn a month – ending the liquidity injection by March, rather than June 2022 as originally signalled. Thereafter, going by the median dot plot, it is expecting three rate hikes in 2022. Indeed, two FOMC members think that four hikes are warranted. As a sign of how concerned they are of inflation now, the 2023 median rate projection has shifted to 1.6%, signalling three more hikes for that year too.

A more hawkish FOMC would undoubtedly create new headwinds for financial markets that are priced close to perfection. Note that even the IMF has urged the Fed to speed up monetary policy tightening amid mounting inflation fears, but warned that Emerging Market economies should prepare for Fed tightening. While the extent to which the Fed will end up carrying out the playbook that it had sketched will ultimately be depending on data, the new reality of a tighter global liquidity landscape will be something that the global economy and emerging markets will have to contend with in the coming months.

Set against such a backdrop, Malaysia's economy is hoping for a reset and a better year in 2022.

For the past two years, the ebbs and flows of the pandemic virulence have been a key determinant for the growth outturn of many economies around the world, including Malaysia's. While a high vaccination rate should put Malaysia in a better position to fight any pandemic bout this year, the unpredictability of it all may continue to weigh on investment and consumption activities.

Nonetheless, on the back of supportive exports outlook, we expect growth to pick up from what is likely to be 3.2% in 2021 to 5.0% this year. While that is an encouraging pick up in momentum, the pace of uptick may not be as smooth as the official forecasts. The government is pencilling in growth of 5.5-6.5% in 2022, which strikes us as being rather optimistic, especially given the lingering structural headwinds facing consumption recovery.

To be sure, the reopening initiatives would give some boost to the economy. However, we remain watchful of the fact that the EPF withdrawal schemes that were an integral part of the stimulus packages have resulted in a cleaving out of savings for households that might take a while to rebuild, resulting in curtailed consumption growth in the coming years.

Indeed, the head of the EPF noted before that, out of a total membership of 15mn people, as many as 6.3mn do not even have MYR10,000 left in their Account 1 and 9.3mn members do not have that same amount in their Account 2 balances. In his words, "they've used their emergency funds." Given that under the EPF guidance, as much as MYR240,000 is said to be necessary for a basic retirement needs, the depleted balances for a considerable portion of Malaysians in their EPF accounts is an area of concern and may act as a drag on private consumption on the path towards recovery. Hence, as much as we agree and do hope that the worst is now over, we are of the view that the recovery pace may not be as robust as assumed by the government.

Against the backdrop of better outlook for economic recovery, we see Bank Negara refraining from any rate cut. After all, it kept its policy rate unchanged throughout the whole of 2021, despite the overt challenges posed by the pandemic and political crises of the period. Indeed, judging from its tone in the November 2021 MPC meeting, it might have started to lay the groundwork in preparation for greater expectation for the rate to move the other way: up.

There are aspects from the MPC statement that suggest that BNM is now anticipating the need to pre-empt any rise in market anticipation for policy rate hike in Malaysia. Most tellingly, BNM is keen to portray that inflation remains tame and not a big issue in Malaysia. Core inflation is expected to remain low at below 1% for this year, for instance, while headline inflation is "projected to remain moderate" moving into 2022. Even as it acknowledges that "core inflation is expected to edge upwards" as activities normalize, it is

seen to “remain benign given the continued spare capacity in the economy and slack in the labour market.”

To be sure, it did throw in caveats such as how “global commodity price developments” and “prolonged supply-related disruptions” might affect the inflation outlook. However, the underlying message that inflation is not a ‘biggie’ for Malaysia – and hence do not expect us to have to tighten our policy because of that – is hard to miss. Whether the inflation outturn is as subdued as it expects to be, the focus there suggests that the conversation has shifted considerably. While it was all about how growth would be okay despite near-term challenges – and hence there is no need to cut rate – it has evolved perceptibly to a heavier emphasis now on how inflation is still subdued – and how policy rate does not need to shift up.

To us, we continue to see a central bank that will be committed to supporting growth for as long as it can by keeping the policy rate anchored at the current low level. Inflation should remain broadly anchored as well given the lingering output gap. For instance, the unemployment rate remains relatively high at 4.3%. Even if it has come down from the peak of 5.3% last year, it remains well above the 3.3% pre-pandemic run rate, just one sign of how the impact of the pandemic on the labour market remains far from being resolved.

Hence, our baseline remains that BNM can and will leave its OPR unchanged at 1.75% throughout 2022. Such a view will require ‘cooperation’ from a few factors, naturally. Apart from the domestic inflation outturn, perhaps what matters more ultimately will be the global market sentiment. The chief risk is that the Fed fund rates outlook has shifted so quickly that the scenario of market ructions compelling EM central banks, including Malaysia’s, to raise rates to anchor sentiment can no longer be ruled out.

About OCBC Bank

OCBC Bank is the longest established Singapore bank, formed in 1932 from the merger of three local banks, the oldest of which was founded in 1912. It is now the second largest financial services group in Southeast Asia by assets and one of the world's most highly-rated banks, with Aa1 by Moody's and AA- by both Fitch and S&P. Recognised for its financial strength and stability, OCBC Bank is consistently ranked among the World's Top 50 Safest Banks by Global Finance and has been named Best Managed Bank in Singapore by The Asian Banker.

OCBC Bank and its subsidiaries offer a broad array of commercial banking, specialist financial and wealth management services, ranging from consumer, corporate, investment, private and transaction banking to treasury, insurance, asset management and stockbroking services.

OCBC Bank's key markets are Singapore, Malaysia, Indonesia and Greater China. It has more than 430 branches and representative offices in 19 countries and regions. These include over 210 branches and offices in Indonesia under subsidiary Bank OCBC NISP, and over 60 branches and offices in Mainland China, Hong Kong SAR and Macau SAR under OCBC Wing Hang.

OCBC Bank's private banking services are provided by its wholly-owned subsidiary Bank of Singapore, which operates on a unique open-architecture product platform to source for the best-in-class products to meet its clients' goals.

OCBC Bank's insurance subsidiary, Great Eastern Holdings, is the oldest and most established life insurance group in Singapore and Malaysia. Its asset management subsidiary, Lion Global Investors, is one of the largest private sector asset management companies in Southeast Asia.

OCBC Bank offers Islamic banking products and services in Malaysia through its wholly-owned subsidiary, OCBC Al-Amin Bank Berhad.

For more information, please visit www.ocbc.com.my