QUARTERLY ECONOMY TRACKER

(OCT-DEC 2020) & 2021 OUTLOOK

Socio-Economic Research Centre (SERC)

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QUARTERLY ECONOMY TRACKER (OCT-DEC 2020) & 2021 OUTLOOK

A. World Economic Situation and Prospects

GLOBAL ECONOMY IS HEALING; BUT DO NOT BE COMPLACENT

Goodbye 2020, an unprecedented year of a global health crisis-induced global recession. 2020 was an intense and volatile year as the unprecedented COVID-19 pandemic has ravaged across the globe, leaving a trail of massive socio-economic destruction and business damage. The ensuing Great Lockdown worldwide and devasting impact of pandemic has catalysed the most severe economic contraction since the Great Depression.

Recovery continues, albeit unevenly in 4Q 2020. Our tracking of high frequency economic data and indicators showed that though global economic recovery continues, its momentum has seemingly slowed in 4Q 2020. The COVID-19 infections are still high and rising rapidly in major advanced economies, especially in the US and Europe as well as in Asia. Renewed containment measures have restrained economic activity and reduced consumer confidence. Global PMI readings for manufacturing and services activity have eased in November and December. Global trade also increased at a slower pace.

Starting 2021 on cautious optimism. The starting of a mass vaccine distribution and immunisation process in advanced economies towards end-2020 gives way to hope and optimism of a stronger recovery as we head into 2021. Notwithstanding that the vaccination is undeniably good news for consumers and businesses, a widespread distribution of the vaccines is unlikely until (at the earliest) in 2H 2021 and 2022. Hence, a full recovery will therefore be expected in late 2H 2021 and 2022.

The US economic recovery will be supported by continued easy money and fiscal stimulus, including the proposed US$1.9 trillion COVID-19 stimulus package amid the dissipating impact of pandemic. Under the US President Biden's administration, economic growth would likely benefit from increased spending on infrastructure and social security as well as a less disruptive foreign trade policy. Renewed lockdown measures in several European countries, and potential hiccups in vaccinations roll-outs, the eurozone economy should recover, albeit moderately, supported by the EU funding, ultra-loose monetary policy and fiscal stimulus, and strengthening external demand. In Japan, sustained government spending will help to buoy domestic demand, supported by a revival in exports. China is set to rebound sharply due to strong pent-up in private consumption and higher exports.

But, the global economy is not yet completely out of the woods. We see four key risks that might derail the global recovery: (a) Amid the vaccination program, there remain concerns over the multiple waves of new virus strains mutation, which are difficult to control, requiring renewed national lockdowns in many countries; (b) Inadequate policy support due to the limitation of monetary policy and fiscal space; (c) While investors expect a more predictable US policy trajectory under Biden's administration, notably on trade and technology, in our view, it is too early to assess Biden's administration in recalibrating the US-China relationship, trade and technology conflicts between the US and China remain a risk; and (d) Geopolitical and political flashpoints.

B. Malaysia's Economic and Financial Conditions

CAUTIOUS OPTIMISM

The third wave of COVID-19 tempers the strength of domestic economic recovery in 4Q 2020. The year 2020 saw the Malaysian economy plunged into economic turmoil as the Movement Control Order (MCO) sent the already slowing economic growth trajectory into a heavy tail-spin in 1H 2020. Real GDP has suffered a historic sharp economic output decline of 17.1% yoy in 2Q 2020 before narrowing to a smaller contraction of 2.7% yoy in 3Q, thanks to the prompt economic stimulus recovery package of RM305 billion or 21.8% of GDP in 2020 to limit the economic and financial damages on households and businesses from the pandemic.

However, the emergence of a third wave of virus in late September, which resulted in high four digits new infection cases daily in recent weeks have tempered consumer and business sentiment in 4Q 2020 and in January 2021. It is estimated that the full-year 2020's GDP to decline by 5.8%. The unemployment rate has re-ticked higher to 4.8% in November (764,400 unemployed persons) and 4.7% in October after stabilizing at 4.6% for two months (Aug-Sep).

The economy has yet to be restored to a full capacity as the pandemic has disproportionately impacted the services sector versus the manufacturing sector due to social distancing measures and changes in consumer behaviour. The travel, tourism and aviation industry as well as retail sector will be slowly on the mend until the vaccine is distributed and at least 50% of population get vaccinated.

Emerging cautious optimism in 2021. We recognize that the shape of Malaysia's economic growth in 2021 is dependent on the development of infection rates and vaccination program, the effective implementation of Budget 2021's spending programs and cash assistance, consumer and business confidence as well as the economic performance of Malaysia's major trading partners.

The rapid virus spread and mounting strains on the healthcare system have left the Government with no choice to implement three stages of movement restrictions tiered according to the level of infection risk by states for a two-week period (13-26 January 2021): (i) MCO in Pulau Pinang, Selangor, Federal Territory (Kuala Lumpur, Putrajaya and Labuan), Melaka, Johor and Sabah; (ii) Conditional MCO (CMCO) in Pahang, Perak, Negeri Sembilan, Kedah, Terengganu and Kelantan; and (iii) Recovery MCO (Perlis and Sarawak). Starting from 22 January, all states in Malaysia, with the exception of Sarawak, were placed under MCO 2.0 until 18 February.

On 18 January, the Government rolled out Perlindungan Ekonomi dan Rakyat Malaysia (PERMAI) Assistance Package totalling RM15.0 billion, of which direct fiscal injection of RM6.6 billion was rolled to improve existing initiatives as well as accelerate the implementation of related initiatives as announced in previous stimulus packages and in the Budget 2021. This enhancement package is expected to provide some respite to particularly vulnerable households, self-employed, micro businesses and retailers.

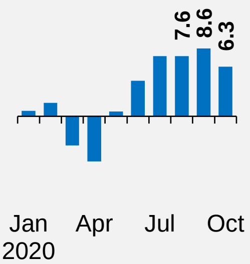
How our economy cope with these restrictions? The chances are that we will cope, but at a short-term cost, depending on the duration of MCO/CMCO. The cost will be even larger and a long-lasting impact for not doing good enough to balance the health risk prevention and supporting the economy.

The inter-state travel bans and prolonged MCO for nearly all states would result in some loss in output and demand. It is estimated that two weeks MCO and CMCO will reduce GDP growth by 0.5 percentage points. If we assume one-month MCO/CMCO, it will reduce our baseline estimate to 4.0% from 5.0% previously in 2021 (estimated -5.8% in 2020). We remain wary of the Budget 2021's implementation capacity risk as well as lingering policy and political risks.

For an upside scenario, 6.0% for 2021 on assumptions of the accelerated containment of virus spread and vaccination, supported by a more robust rebound in services with the resumption of international travel. It is also assumed that the effective implementation of the largest ever fiscal stimulus (total expenditure of RM322.5 billion) or -5.4% of GDP budget deficit enhances a faster domestic demand driven recovery.

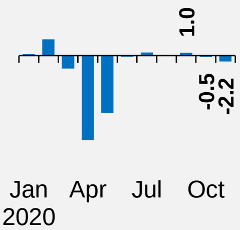
Malaysia's economic recovery tracker. A slew of economic indicators showed mixed performance, which collectively point to the economy will continue to heal, albeit unevenly as we move into 2021. Both the dated published data and anecdote evidence indicated that economic and business conditions are displaying disproportion recovery pace between different economic sectors, particularly following the reimplementation of CMCO/EMCO started in October 2020 to contain the third wave of COVID-19. The Recovery MCO has been extended to 31 March 2021.

Leading index (LI)
(%, YoY)



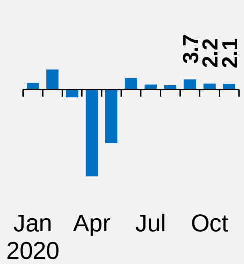
- The LI, a gauge of forward economic growth increased at a slower pace of 6.3% in Oct 2020, suggesting the continued economic recovery in early months of 2021

Industrial output
(%, YoY)



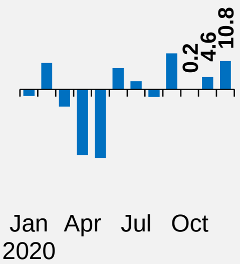
- Reverted to decline by 0.5% in Oct and 2.2% in Nov after three successive months of expansion
- Dragged by a double-digit contraction in the mining sector
- Manufacturing output growth moderated to 2.4% in Oct and 2.0% in Nov (3.1% in 3Q)

Manufacturing sales
(%, YoY)



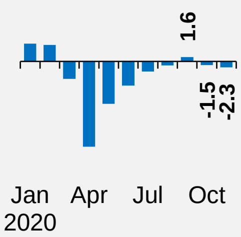
- Continued to expand, albeit slower at 2.2% in Oct and 2.1% in Nov (2.4% in 3Q)
- Helped by solid increases in overall food products, pharmaceutical products, rubber products, motor vehicles as well as electronics and optical products
- Partially offset by decreased sales in textiles and apparels, refined petroleum products and chemical products

Exports
(%, YoY)



- Expanded higher by 5.1% in 4Q (4.4% in 3Q)
- Supported by strong demand in electrical and electronic (E&E) products, rubber and rubber products as well as palm oil and palm-based products
- **For 2021, exports are projected to recover gradually by 3.3%** (-1.4% in 2020), supported by the gathering pace of economic recovery of Malaysia's major trading partners and higher commodity prices

Retail sales
(%, YoY)

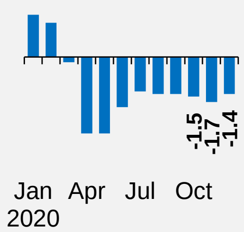


- Sales reverted to decline in Oct and Nov on re-implementation of CMCO in high infected areas
- The wholesale sector recorded a moderate decline (-0.7% in Nov and -0.9% in Oct vs. -4.2% in Sep)
- The resumption of domestic tourism helps to aid retail spending. However, closed borders to international travels remain a dampener on the travel, tourism and aviation industry
- Re-imposition of MCO in almost all states starting from either 13 or 22 Jan 2021 will further suppress the retail market

Unemployment rate
(%)

- The labour market condition still weak and slowly on the mend
- EIS's loss of employment registered a total of 107,024 in 2020, 267.0% higher than 2019. As of 17 Jan 2021, 4,956 employees have lost their jobs
- **The unemployment rate will gradually improve to an estimated 4.5% at end-Dec 2021** (End-Dec: estimated 4.8% in 2020), translating a near 720,000 unemployed persons, about 40% higher than near 510,000 unemployed persons pre-COVID-19

Headline annual inflation
(%)



- Ten consecutive months of deflation
- Inflation is expected to normalise into positive territory (between +1.0% and +1.5% in 2021) in tandem with the improved economic growth, higher crude oil prices and aided by the low base effect

Source: Department of Statistics, Malaysia

Fiscal spending needs to be effective and quick in terms of implementation and fund disbursement. The carry through spending effects from the RM305 billion direct and indirect fiscal injection, monetary and financial support will continue in 2021. On 18 January, RM15.0 billion Assistance Package was introduced to cope with MCO 2.0. The Budget 2021's total expenditure of RM322.5 billion will continue to play a pivotal role in sustaining domestic demand through the implementation of projects and programs under the RM69.0 billion development expenditure.

Monetary policy to stay accommodative. An easy monetary policy will remain in 2021 amid an arduous and uneven recovery scenario. As headline inflation is expected to increase at a moderate pace trajectory in 2021 and the labour market slack is unlikely to dissipate any time soon, we expect Bank Negara Malaysia to keep the current appropriate accommodative monetary policy stance for some time.

WORLD ECONOMIC SITUATION AND PROSPECTS

GLOBAL ECONOMY IS HEALING; BUT DO NOT BE COMPLACENT

The global economy will continue to heal. Amid the continued rise in new infection cases globally and renewed lockdown for some advanced economies, we are starting to see the light at the end of the tunnel as lighted up by the distribution of vaccines and immunisation process in the US and Europe in late 2020. **There is a growing sense of optimism of a global recovery in 2021.**

However, an effective and widespread distribution of the vaccines is unlikely until (at the earliest) in 2H 2021 and 2022. Hence, the pace and strength of recovery can still be uneven in advanced economies and emerging economies.

From a cyclical perspective, we see highly volatile growth figures in the first half of next year, due to the base effects of 2020. However, the growth performance will be way above potential as the recovery gains momentum in the second half-year of 2021, assuming a wider distribution and accelerated vaccination in 2H 2021.

Global economic recovery tracker. The incoming data showed some moderation in economic activity in 4Q 2020 as new cases continue to climb forcing some countries to reimpose new restrictions though it is less stringent as total lockdown.

Google Mobility data, which track footfall traffic from retail and entertainment hubs is considered a proxy for consumer spending. After an initial uptick, fewer people are visiting crowded locations as case counts rise in many countries. In late January, some moderation in the number of daily infection cases were observed.

a) The **OECD Composite leading indicators** (CLIs), a gauge of future economic growth showed stable growth ahead, albeit mixed results across different major economies: Stable growth in North America region and moderating growth in euro area.

b) **Global Purchasing Managers Index (PMI) for manufacturing and services** showed continued expansion. In December, manufacturing PMI remained at 53.8, backed by growing output and new orders while services PMI moderated a little to 51.8 on slower growth in business activities.

c) **Global trade volume and industrial production** showed that global recovery is on the right track. Both data are expected to trend back to expansionary territory in the coming months, whereby demand is gaining traction as economic activities were largely resumed. WTO expects world trade volume to rebound by 7.2% in 2021 from estimated -9.2% in 2020.

d) **Global semiconductor sales** remain intact (7.0% yoy in November, 5.9% in October vs. 5.2% in 3Q), underpinned by stronger sales in sensors and memory. The World Semiconductor Trade Statistics (WSTS) projects chips sales to grow further by 8.4% in 2021 from an estimated 5.1% in 2020, backed by a double-digit growth in memory and optoelectronics.

e) **Commodity prices have picked up**. Energy prices have edged higher in December 2020 fuelled by positive vaccines development. Brent crude oil prices rose to US$49.99 per barrel (bbl) in December from US$42.69/bbl in November. The OPEC+ has decided to ease production cut by 500,000 barrel per day (bpd) to 7.2 million bpd starting January 2021 from December's 7.7 million bpd while Saudi Arabia will voluntarily cut an additional 1 million bpd in Feb-Mar. The U.S. Energy Information Administration (EIA) projects that Brent crude oil prices to average at US$52.70/bbl in 2021 (US$41.69/bbl in 2020) in its monthly Short-Term Energy Outlook (STEO) in January.

Prices of non-energy commodities remained on a solid uptrend. **Crude palm oil prices** surged higher to RM3,620.50 per metric tonne (mt) in December 2020 bringing to an average of RM2,685.50/mt in 2020, an increase of 29.2% from RM2,079.00/mt in 2019, underpinned by a lower production and lowest stock level in December 2020 since 2007 as well as improved demand. The price level will remain well above RM3,000/mt for some time before production picking up or stock levels in both Malaysia and importers' countries return to a comfortable level.

What might derail the global recovery? 2021 could be a year of optimism. In the aftermath of the US President Election and the welcome news of vaccine distribution and immunisation towards end-2020, there is emerging optimism about a strong global recovery. The Governments' continued fiscal stimulus, including cash assistance and central banks' ultra-easy monetary policy are expected to secure a sustained economic and business recovery.

But, the global economy is not yet completely out of the woods. We see four key risks that might derail the global recovery: (a) Amid the starting of vaccines program, there remain concerns about the multiple waves of new virus strains mutation, which are difficult to control, requiring renewed national lockdowns in many countries; (b) Inadequate policy support due to the limitation of monetary policy and fiscal space as well as high debt for some countries; (c) While investors expect a more predictable US policy trajectory under Biden's administration, notably on trade and technology, in our view, it is too early to assess Biden's administration in recalibrating the US-China relationship, trade and technology conflict between the United States and China remains a risk; and (d) Geopolitical and political flashpoints.

Table 1: Real GDP growth (% YoY)

	2018	2019	2020	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2020*e* (IMF)	2020*e* (WB)	2021*f* (IMF)	2021*f* (WB)
World	3.5	2.8	-	-	-	-	-	-3.4	-4.3	5.5	4.0
United States	3.0	2.2	-3.5	0.3	-9.0	-2.8	-2.5	N/A	N/A	5.1	3.5
Euro Area	1.9	1.3	-	-3.2	-14.7	-4.3	-	-7.2	-7.4	4.2	3.6
China	6.7	6.1	2.3	-6.8	3.2	4.9	6.5	N/A	N/A	8.1	7.9
Japan	0.6	0.3	-	-2.0	-10.3	-5.7	-	-5.1	-5.3	3.1	2.5
India	6.1	4.2	-	3.1	-23.9	-7.5	-	-8.0	-9.6	11.5	5.4
Malaysia	4.8	4.3	-	0.7	-17.1	-2.7	-	-5.8	-5.8	7.0	6.7
Singapore	3.4	0.7	-5.8	-0.2	-13.4	-5.6	-3.8	N/A	N/A	N/A	N/A
Indonesia	5.2	5.0	-	3.0	-5.3	-3.5	-	-1.9	-2.2	4.8	4.4
Thailand	4.2	2.4	-	-2.0	-12.1	-6.4	-	-6.6	-6.5	2.7	4.0
Philippines	6.3	6.0	-9.5	-0.7	-16.9	-11.4	-8.3	N/A	N/A	6.6	5.9
Vietnam	7.1	7.0	2.9	3.7	0.4	2.6	4.5	N/A	N/A	N/A	6.7

Note: World GDP growth for 2018 and 2019 by IMF; Annual GDP for India is on fiscal year basis; N/A = Not applicable or not available

Source: Officials (unadjusted data except quarterly GDP for Euro Area); IMF (World Economic Outlook (WEO) Update, Jan 2021); World Bank (Global Economic Prospects, Jan 2021)

Monetary accommodation remains. Central bankers are unlikely to pull the monetary brake until there is a sign of a more secured economic recovery globally. The premature withdrawal of interest rate easing would risk tempering the pace of recovery. The normalisation of interest rates in major advanced economies, if any probably starting late 2021 or 2022 will be on a measured pace.

The Federal Reserve has pledged to keep borrowing costs near zero percent for at least the next three years, while indicating it will increase bond purchases by US$120 billion (comprising US$80 billion Treasury securities and US$40 billion agency mortgage-backed securities) a month until inflation runs above its 2% target.

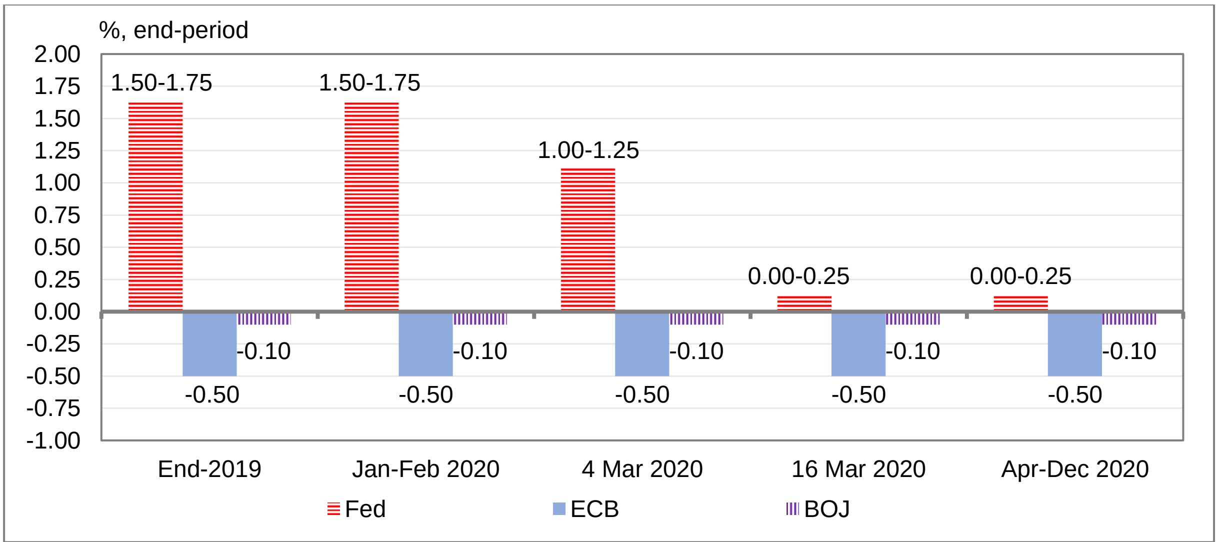
We expect central banks in emerging Asia to either maintain or ease their monetary policies further, taking advantage of easier global monetary setting and low domestic inflation. Core inflation is either low and stable, or declining for some emerging economies.

Table 2: Policy rate (%)

End-period of	2008	2009	2010	2011	2012	2016	2017	2018	2019	2020	2021*f*
US, Fed Federal Funds Rate	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.50-0.75	1.25-1.50	2.25-2.50	1.50-1.75	0.00-0.25	0.00-0.25
Euro Area, ECB Deposit Facility	2.00	0.25	0.25	0.25	0.00	-0.40	-0.40	-0.40	-0.50	-0.50	-0.50
Japan, BOJ Short-term Policy I/R	0.10	0.10	0.00-0.10	0.00-0.10	0.00-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
China, PBC 1-Year Loan Prime Rate	5.31	5.31	5.81	6.56	6.00	4.35	4.35	4.35	4.15	3.85	3.85
India, RBI Policy Repo Rate (LAF)	6.50	4.75	6.25	8.50	8.00	6.25	6.00	6.50	5.15	4.00	4.00
Korea, BOK Base Rate	3.00	2.00	2.50	3.25	2.75	1.25	1.50	1.75	1.25	0.50	0.50
Malaysia, BNM Overnight Policy Rate	3.25	2.00	2.75	3.00	3.00	3.00	3.00	3.25	3.00	1.75	1.75
Indonesia, BI 7-Day RR Rate	9.25	6.50	6.50	6.50	5.75	4.75	4.25	6.00	5.00	3.75	3.75
Thailand, BOT 1-Day Repurchase Rate	2.75	1.25	2.00	3.25	2.75	1.50	1.50	1.75	1.25	0.50	0.50
Philippines, BSP Overnight RR Facility	5.50	4.00	4.00	4.50	3.50	3.00	3.00	4.75	4.00	2.00	2.00

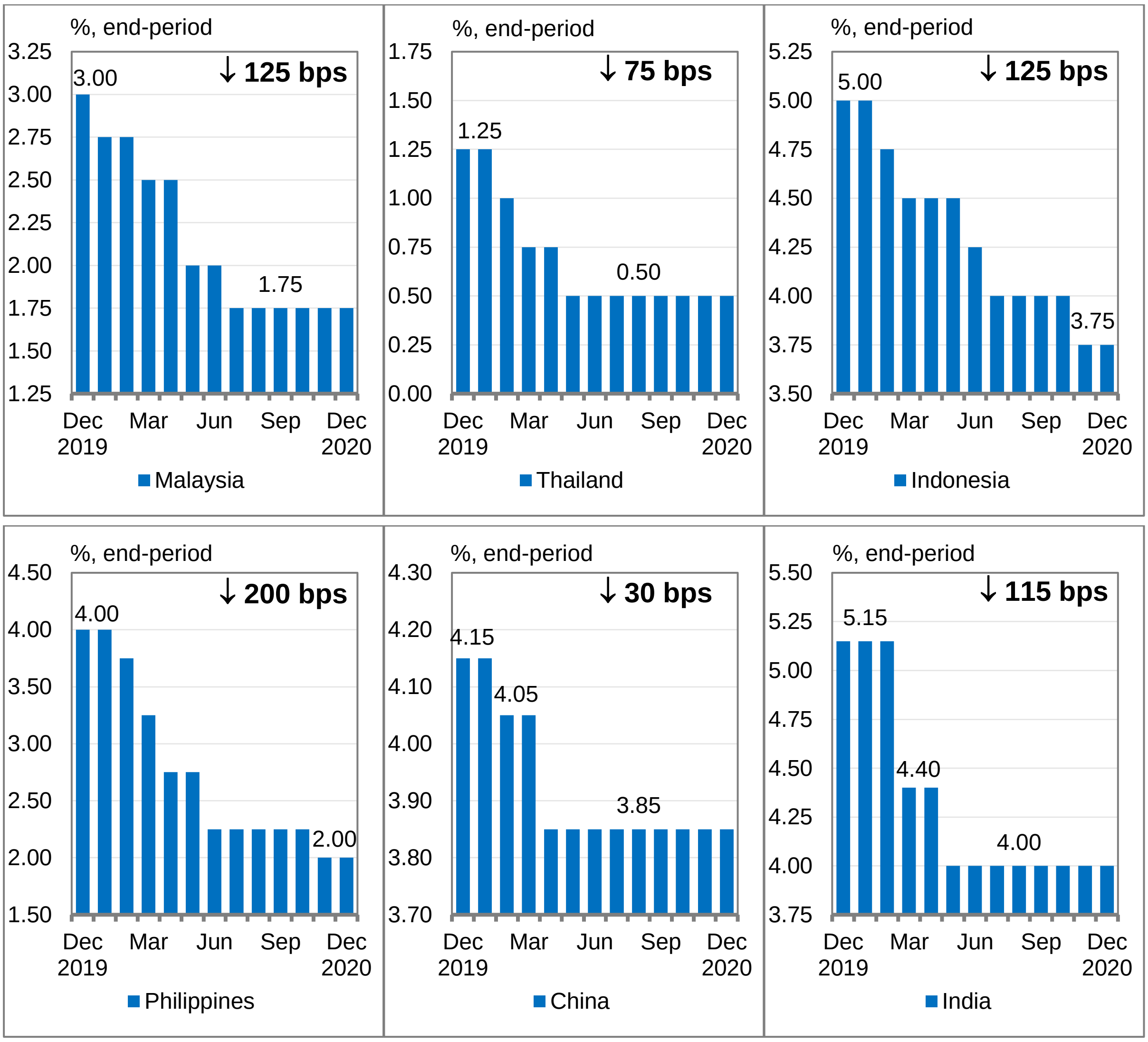
Source: Officials; SERC

Figure 1: Policy rate movements of major central banks in 2020



Source: Federal Reserve (Fed); European Central Bank (ECB); Bank of Japan (BOJ)

Figure 2: Policy rate movements of selected regional central banks in 2020



Source: *Bank Negara Malaysia; Bank of Thailand; Bank Indonesia; Bangko Sentral ng Pilipinas; People's Bank of China; Reserve Bank of India*

CURRENT AND FORWARD INDICATORS

Figure 3: CLIs show a mixed performance across major economies

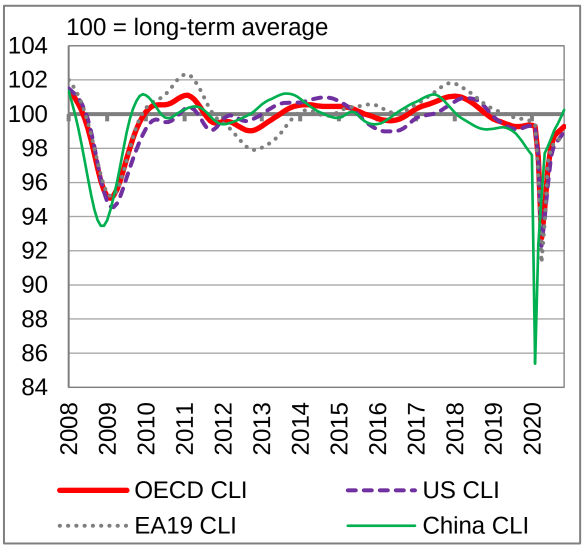
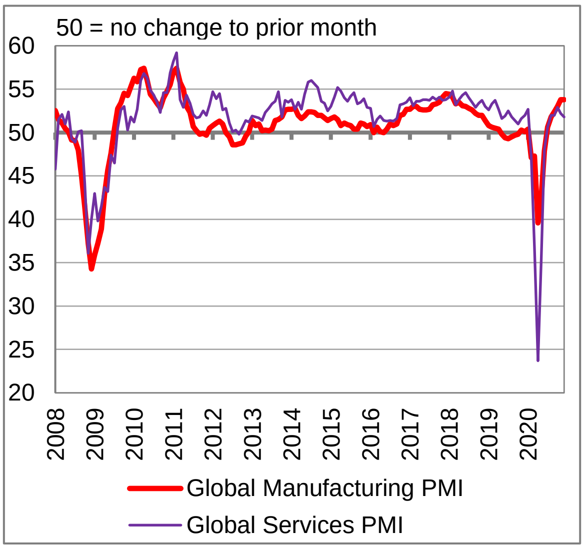


Figure 4: Global manufacturing and services activities are expanding steadily



Source: OECD; Markit

Figure 5: World trade volume and industrial production growth on the recovery track

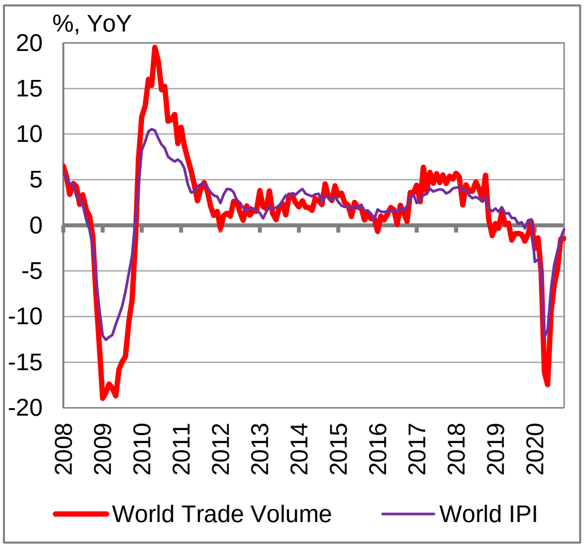
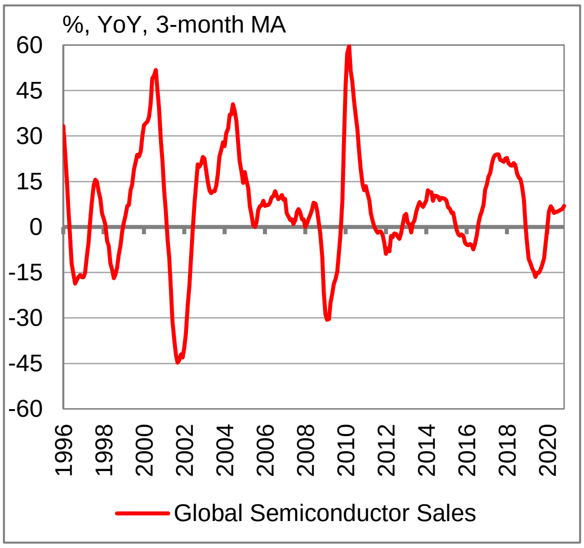


Figure 6: Global semiconductor sales growth continued expanding



Source: CPB Netherlands Bureau for Economic Policy Analysis; Semiconductor Industry Association (SIA)

Figure 7: OECD Business Confidence Index

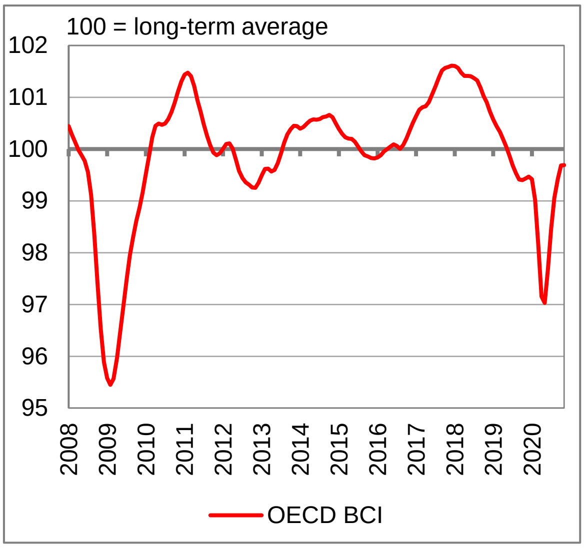
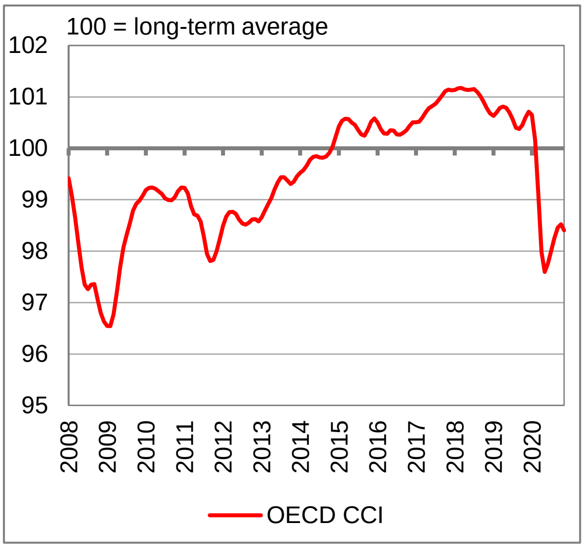


Figure 8: OECD Consumer Confidence Index



Source: OECD

Figure 9: Crude oil prices climb higher, backed by better demand prospects

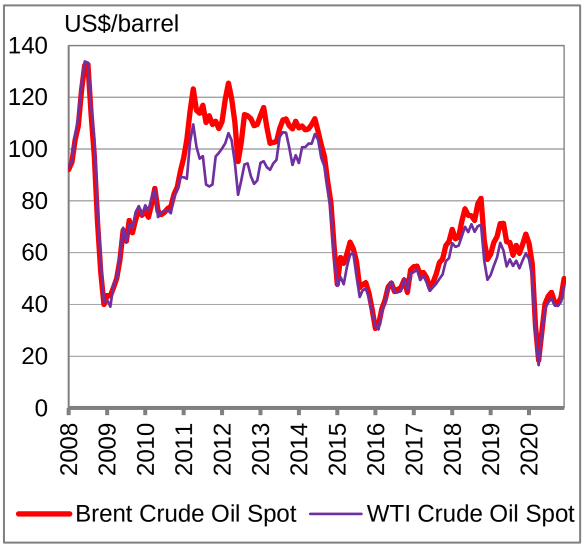
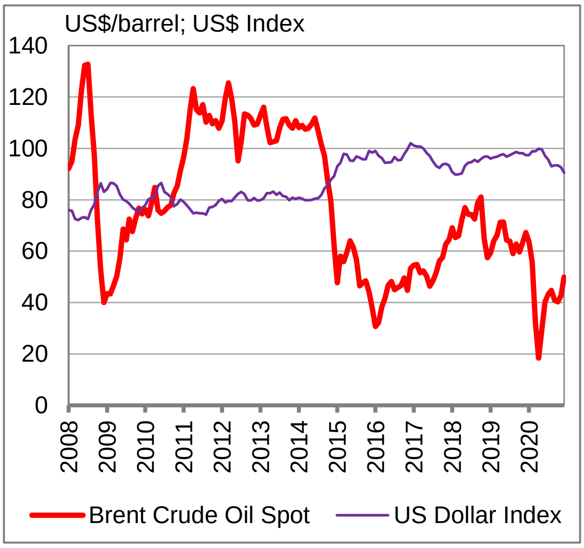


Figure 10: Brent crude oil price vs. the US dollar index



Source: US Energy Information Administration (EIA); The Wall Street Journal

Figure 11: Prices of non-energy commodities on a solid uptrend

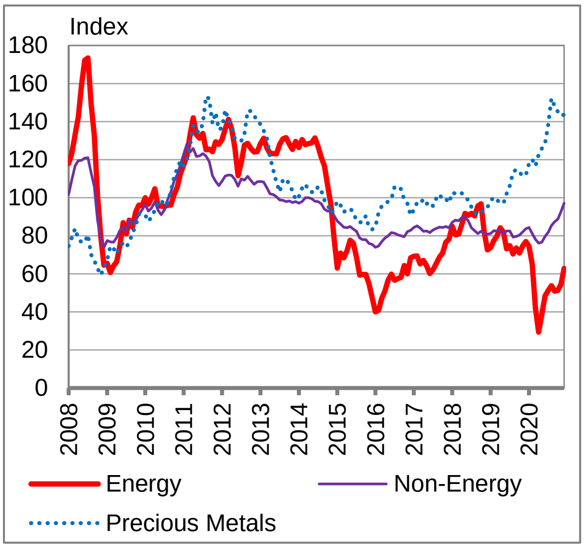
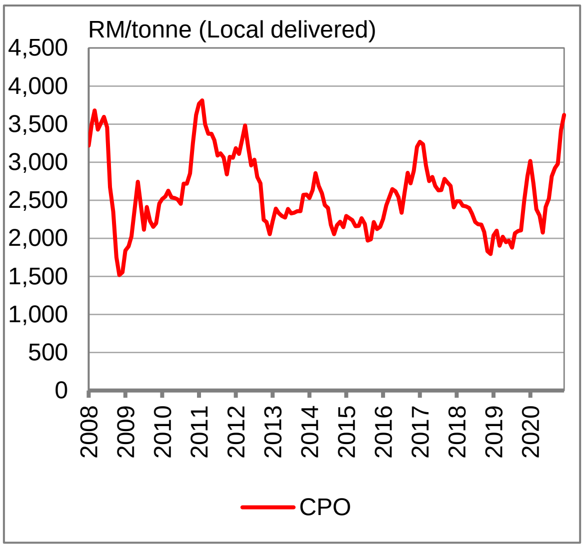


Figure 12: CPO prices test to hit record high



Source: World Bank; Malaysian Palm Oil Board (MPOB)

ECONOMIC DEVELOPMENTS IN MAJOR ECONOMIES

The United States: The US political turmoil comes to an end following President-elect Biden's victory in the US Presidential Election. All eyes are on Biden administration's future path of policy changes and challenges after the inauguration ceremony on 20 January 2021. The pace of the recovery in economic activity and employment has moderated in recent months, with weakness concentrated in the sectors most adversely affected by the pandemic. Backed by the mass vaccination program, the US economic growth is likely to benefit from increased spending on infrastructure and social security as well as a less disruptive foreign trade policy. The US-China's trade and technology conflict remains a wild card.

Figure 13: ISM manufacturing and services PMI continued to charge ahead

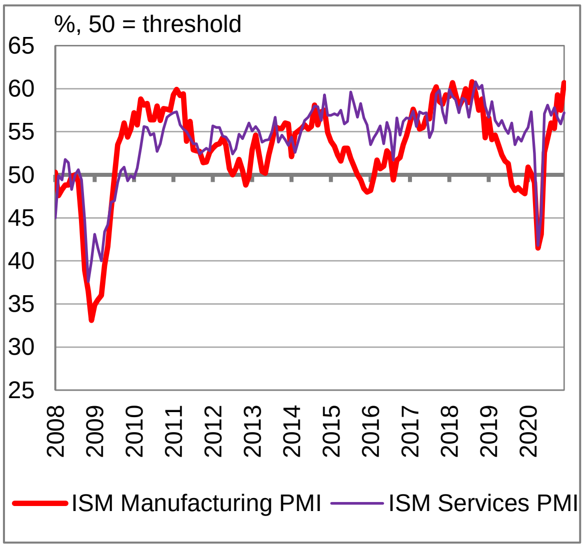


Figure 14: Industrial production contracted for 16 consecutive months, albeit continued improvements

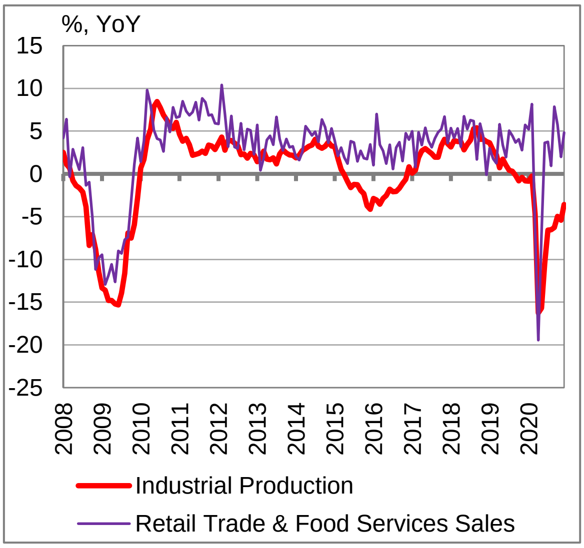


Figure 15: Unemployment rate moderated to 6.7% in Nov-Dec 2020

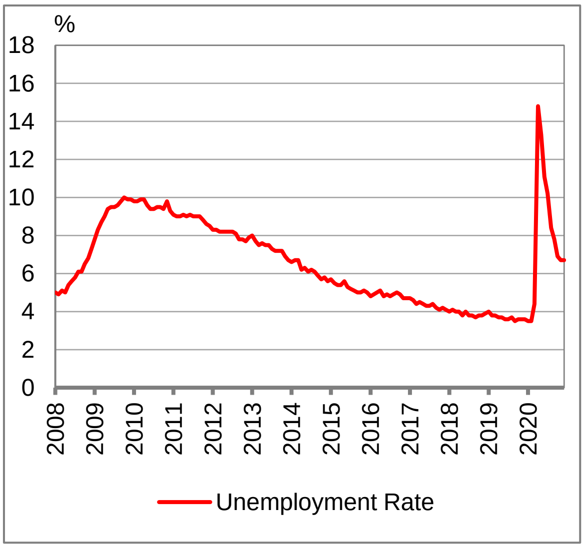
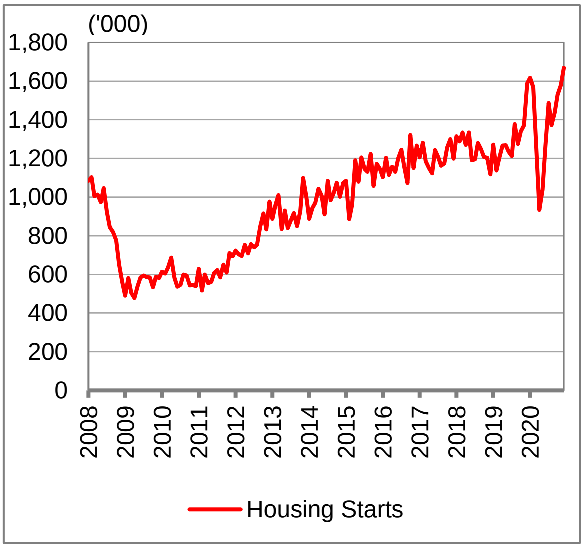


Figure 16: Housing starts in Dec 2020 rose to the highest since Sep 2006



Source: Institute for Supply Management (ISM); Federal Reserve System; US Census Bureau; US Bureau of Labor Statistics

Euro area: Despite making a comeback in 3Q 2020, the re-implementation of targeted containment measures in various countries have hurdled the recovery momentum in 4Q. It is likely to see a clear W-curve in the eurozone. The EU funding, ultra-loose monetary and fiscal stances will continue to provide support for the recovery, albeit gradually. Britain's split from the European Union took full effect as the year 2021 began but leaving uncertainties given a close connection between the United Kingdom and most of eurozone members.

Figure 17: Services PMI fell back to contractionary track for four months since Sep 2020

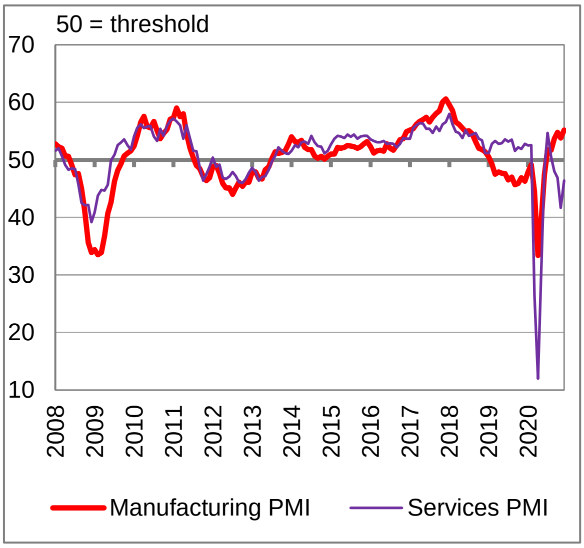


Figure 18: Retail trade contracted again in Nov 2020; industrial output growth on recovery track

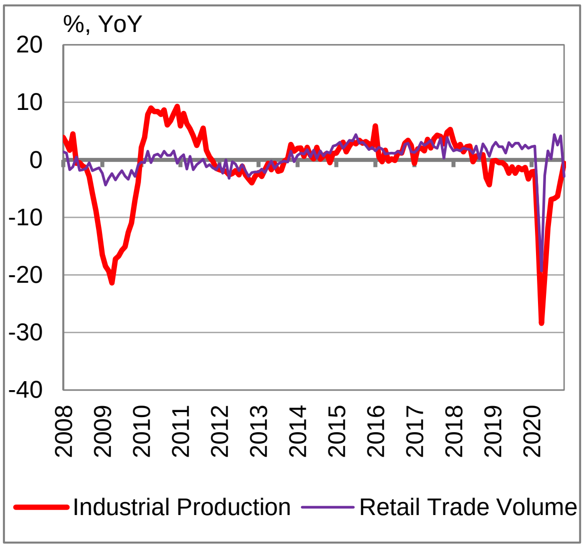


Figure 19: Deflation for five consecutive months in Dec 2020

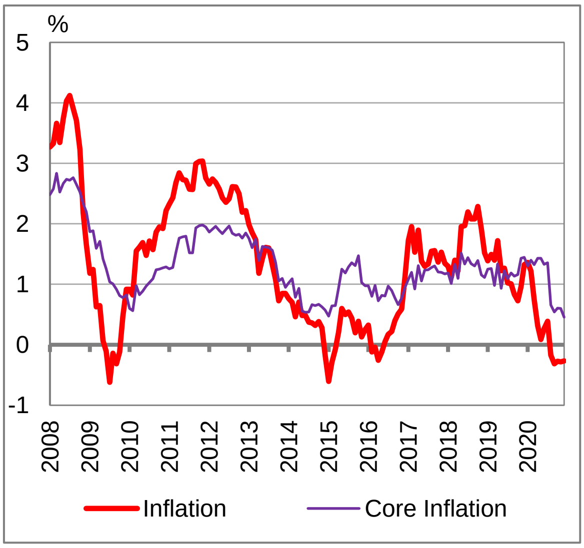
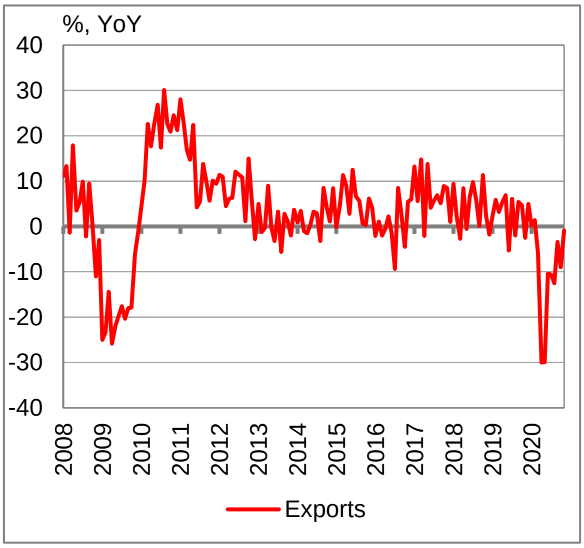


Figure 20: Months of export contraction are ending soon



Source: Markit; Eurostat

Japan: The Japanese economy rebounded by 5.3% qoq in 3Q 2020 after three continuous contractions on a quarterly basis since 4Q 2019. The incoming data suggests a recovery is on the way, with industrial output turning around in recent months. The external demand growth has turned to positive after two years of contraction. The signing of RCEP and its eventual implementation is expected to give some optimism prospects. Both fiscal and monetary policies are expected to remain loose to support the economy for some time.

Figure 21: TANKAN indicates that manufacturing activities are gradually recovering

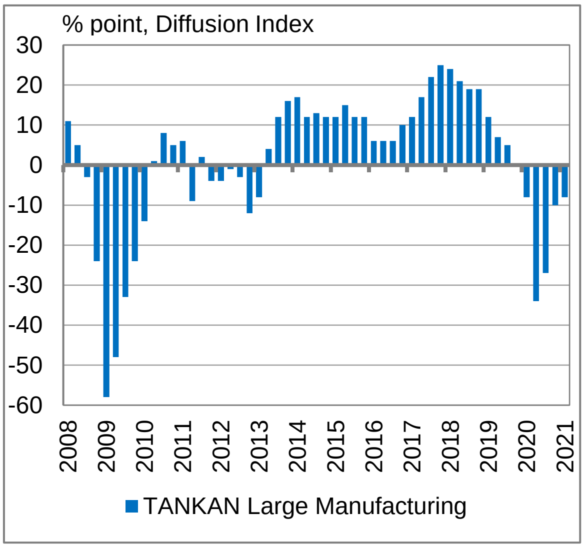


Figure 22: Industrial output continued to recover; uneven retail sales performance

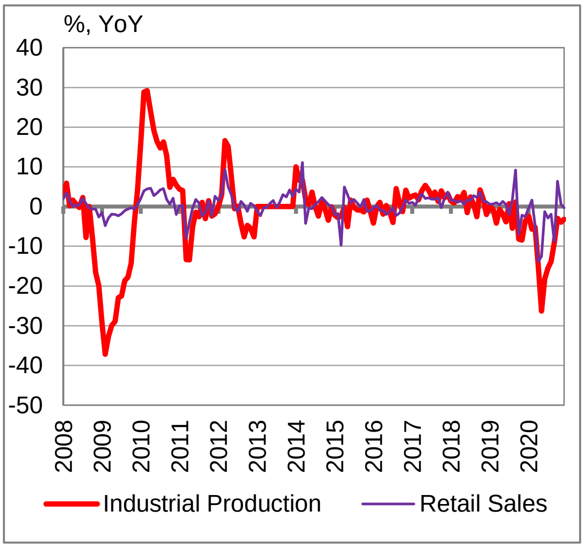


Figure 23: Deflation set in Oct 2020, last seen in September 2016

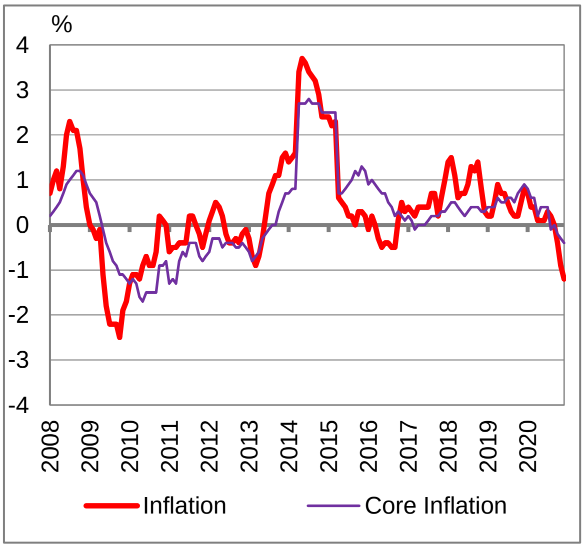
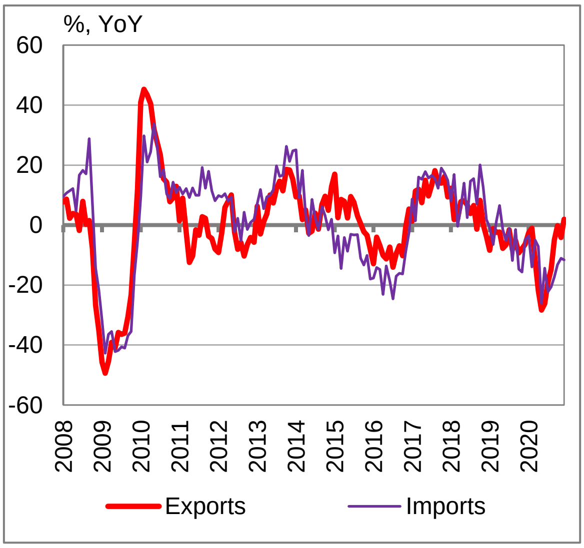


Figure 24: Exports returned to black in Dec 2020 after 24 months of contraction



Source: Bank of Japan (BOJ); Ministry of Economy, Trade and Industry (METI), Japan; Japan Customs; Statistics Bureau, Japan

China: Chinese economy has recovered rapidly from the COVID-19 pandemic impact as it gained traction to a strong growth of 6.5% yoy in 4Q 2020 (4.9% yoy in 3Q and 3.2% in 2Q), thanks to a strong revival in consumer spending, industrial production and external demand. For the full-year, China's GDP rose 2.3% in 2020. In November, manufacturing PMI printed the highest reading since September 2017, whereas non-manufacturing PMI recorded its best since June 2012. Both PMI slipped a little in December but still signalling solid growth ahead. Industrial profit also registered a 2.4% growth in Jan-Nov 2020, mainly contributed by the manufacturing sector. Notably, China's exports rose robustly by 18.1% yoy with a record high export value in December (20.6% in November and 10.9% in October), supported by E&E products, plastic products, optical products, furniture, etc. Besides, the price level edged back to a marginal growth in December after slipping into deflation in November for the first time in eleven years due to lower food and fuel prices.

Figure 25: PMI signals continued growth ahead

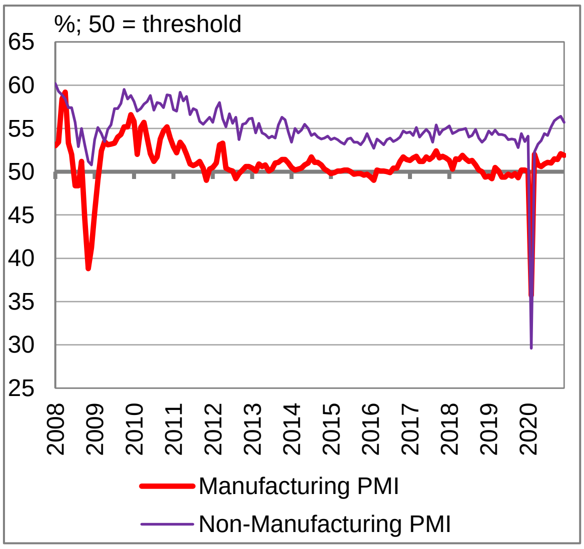


Figure 26: Both industrial output and retail sales were growing at solid pace

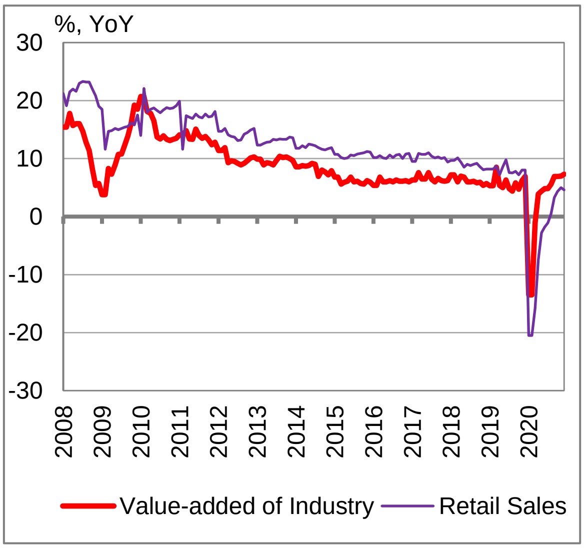


Figure 27: Fixed assets investment grew by 2.9% in 2020, driven by state-owned and state holding enterprises

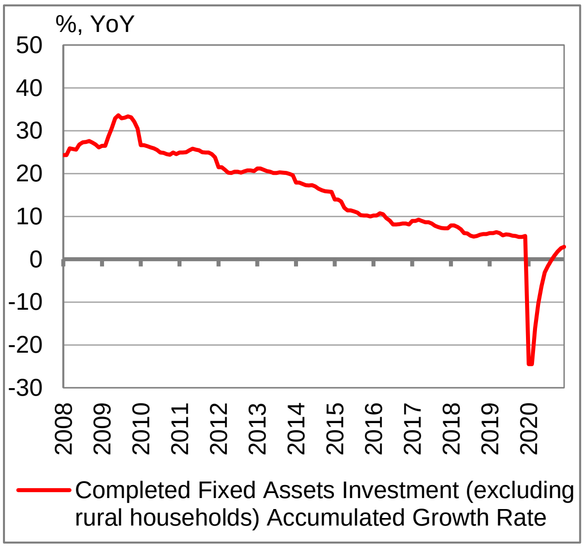
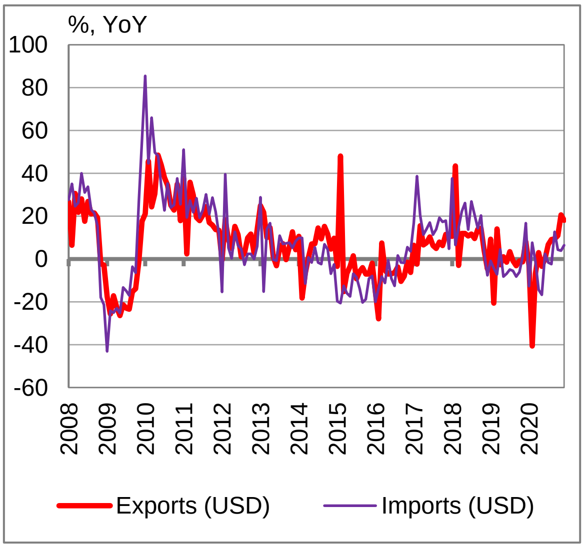


Figure 28: Exports had expanded by strong double-digit growth in Oct-Dec 2020

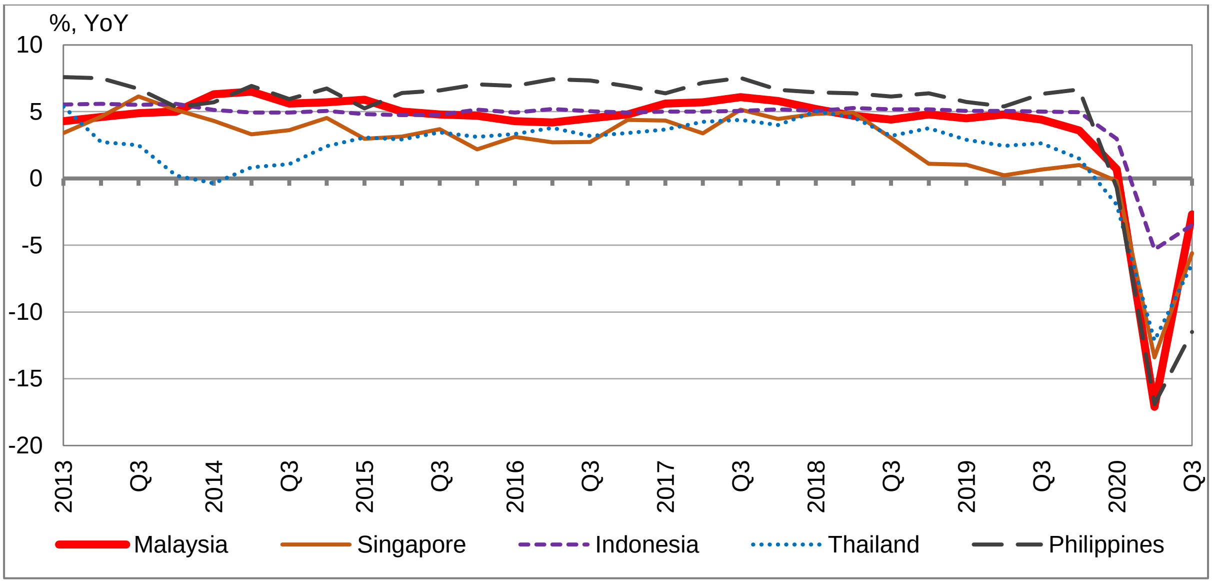


Source: National Bureau of Statistics of China; General Administration of Customs, China

ASEAN-5 ECONOMIES' KEY ECONOMIC DATA TRACKER

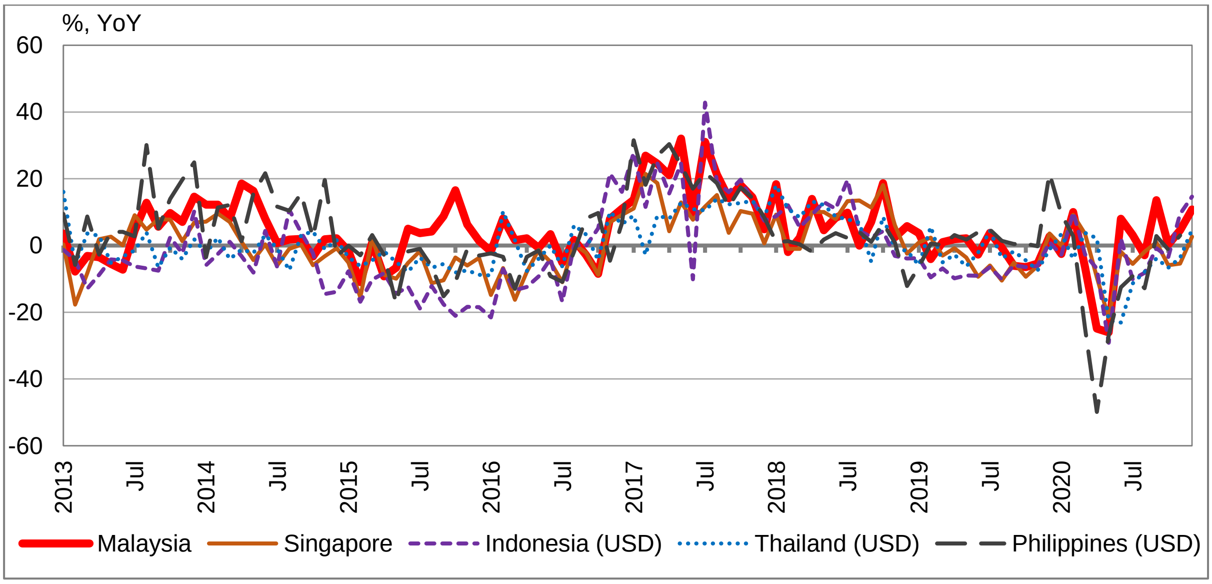
ASEAN-5 economies (Malaysia, Singapore, Indonesia, Thailand and the Philippines) rebounded unevenly in 3Q 2020 as the movement restrictions were removed. Nevertheless, the pace and strength of recovery remains uncertain, depending on the containment of virus spread and development of vaccination program. The incoming data continued to show a mixed performance in these economies. Global demand is picking up and hence, would benefit these export-oriented economies.

Figure 29: Real GDP growth trend



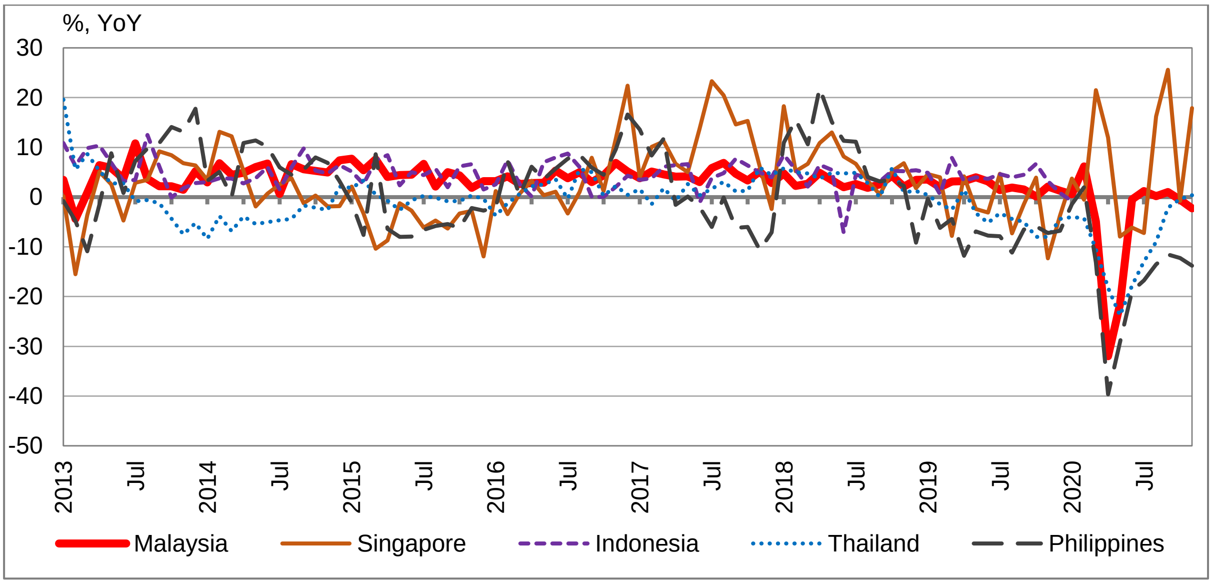
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; National Economic and Social Development Board, Thailand; Philippine Statistics Authority

Figure 30: Export growth trend



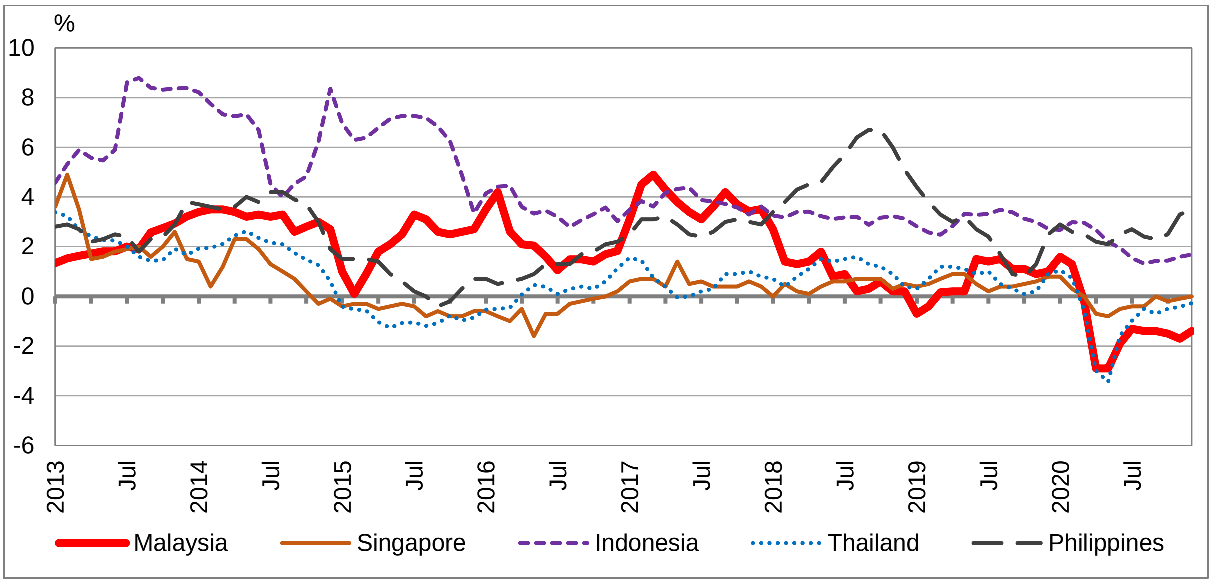
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Bank of Thailand; Philippine Statistics Authority

Figure 31: Industrial production growth trend



Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Office of Industrial Economics, Thailand; Philippine Statistics Authority

Figure 32: Inflation trend



Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Bank Indonesia; Ministry of Commerce, Thailand; Philippine Statistics Authority

MALAYSIA'S ECONOMIC AND FINANCIAL CONDITIONS

CAUTIOUS OPTIMISM

The economy is gradually on the mend in 2H 2020. The Malaysian economy has suffered a record economic output decline of 17.1% yoy in 2Q 2020 (+0.7% in 1Q), due to the Movement Control Order (MCO)-induced "sudden stop" in business and economic activities. Following the reopening of economy on the Conditional CMO (CMCO) in different stages, the economy is gradually on the mend to register a smaller decline of 2.7% in 3Q, aided by the transitory positive effects from various cash handouts and financial relief measures as well as interest rate cuts to mitigate the pandemic impact on households and businesses.

But, the recovery pace in 4Q has been tempered by the resurgence in COVID-19 cases since late September 2020 and the resumption of CMCO and Enhanced MCO (EMCO). Sectors that have been the worst impacted by the pandemic, namely travel, hospitality and aviation sectors, have continued to struggle as the borders have generally remained closed to tourists and international travels. Assuming a slower pace of improvement in the fourth quarter, we estimate the full-year GDP to decline by 5.8% in 2020.

Cautious optimism in 2021. In tandem with the projected global economic recovery in 2021 (IMF estimates global growth of 5.5% in 2021 vs. estimated -3.5% in 2020), along with the distribution of vaccines and immunisation process, there is a growing sense of optimism that better domestic economic growth in 2021.

The rapid virus spread and mounting strains on the healthcare system have left the Government with no choice to implement three stages of movement restrictions according to the level of infection risk by states for a two-week period (13-26 January 2021): (i) MCO in Pulau Pinang, Selangor, Federal Territory (Kuala Lumpur, Putrajaya and Labuan), Melaka, Johor and Sabah; (ii) Conditional MCO (CMCO) in Pahang, Perak, Negeri Sembilan, Kedah, Terengganu and Kelantan; and (iii) Recovery MCO (Perlis and Sarawak). Starting from 22 January, all states in Malaysia, with the exception of Sarawak, were placed under MCO till 18 February.

On 18 January, the Government rolled out Perlindungan Ekonomi dan Rakyat Malaysia (PERMAI) Assistance Package totalling RM15.0 billion, of which direct fiscal injection of RM6.6 billion was rolled to improve existing initiatives as well as accelerate the implementation of related initiatives as announced in previous stimulus packages and in the Budget 2021. This enhancement package is expected to provide some respite to particularly vulnerable households, self-employed, micro businesses and retailers.

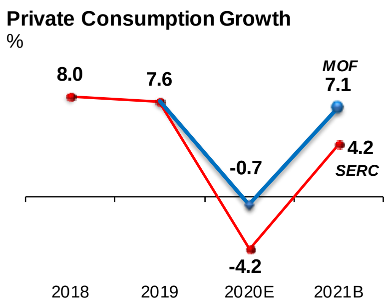
How our economy cope with these restrictions? The chances are that we will cope, but at a short-term cost, depending on the duration of MCO/CMCO. The cost will be even larger and a long-lasting impact for not doing good enough to balance the health risk prevention and supporting the economy.

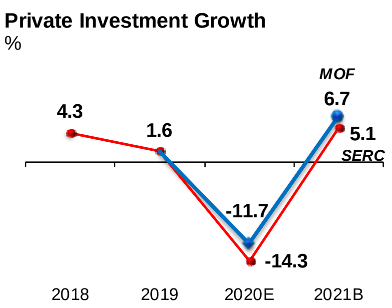
Base and upside scenario. We recognize that the shape of Malaysia's economic growth in 2021 is dependent on the development of infection cases and vaccination program, the effective implementation of Budget 2021's spending programs and cash assistance, consumer and business confidence as well as the economic performance of Malaysia's major trading partners.

a) **Our base case scenario of real GDP growth is cut to 4.0% for 2021 from 5.0% previously**, assuming the inter-state travel bans and prolonged MCO for nearly all states would result in some loss in output and demand. It is estimated that two weeks MCO and CMCO will reduce GDP growth by 0.5 percentage points. If we assume one-month MCO/CMCO, it will reduce our baseline estimate to 4.0% from 5.0% previously in 2021 (estimated -5.8% in 2020). We remain wary of the Budget 2021's implementation capacity risk as well as lingering policy and political risks.

b) **For an upside scenario, 6.0% for 2021 on assumptions of the accelerated containment of virus spread and vaccination, supported by a more robust rebound in services with the resumption of international travel.** It is also assumed that the effective implementation of the largest ever fiscal stimulus (total expenditure of RM322.5 billion) or -5.4% of GDP budget deficit enhances a faster domestic demand driven recovery.

Touchpoints of SERC's 2021 economic outlook: Domestic demand and sectoral performance





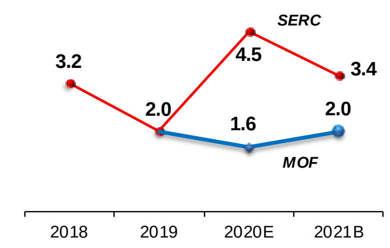
Private Consumption

- Continued cash transfers, loan moratorium, EPF's monthly withdrawal, etc. are expected to cushion consumer spending.
- **In 2021**, **a rebound in private consumption (+4.2%)**, supported by higher disposable income, improved export earnings, low interest rate and the extension of financial relief. The vaccination program will lift sentiments.
- **Risks**: **Prolonged worsening virus infection condition, slow and uneven job recovery, households rebuild savings.**

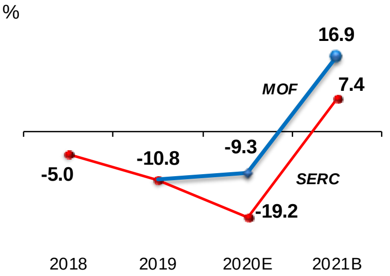
Private Investment

- After slumping by 14.3% in 2020 (1H 2020: -15.2%), **private investment is expected to turn around by 5.1% in 2021**, lifted by various investment supportive and tax incentives to facilitate business operations and revive private investment activities. The spill-over effects from the Budget's capital investment also helps to support investment.
- SERC **cautions about the timely implementation of public projects; quick disbursement of funds as well as ensuring stable political environment to boost investors' confidence**.

Public Consumption Growth
%



Public Investment Growth
%



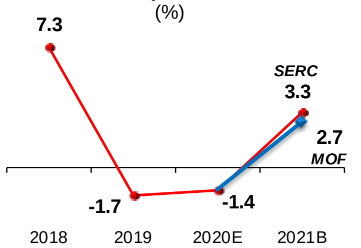
Public Consumption

- Public consumption is expected **to expand by 3.4% in 2021**, lower than 4.5% growth in 2020.
- This reflects the continued improvement in public delivery services and optimising spending.
- **Emoluments**, the largest component of operating expenditure (35.7% share) **is estimated to increase by 2.3% to RM84.5 billion in 2021**, mainly for the provision of annual salary increments for civil servants.

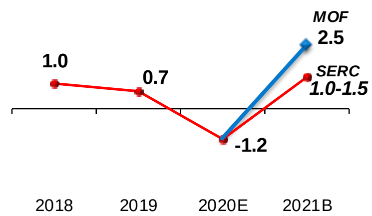
Public Investment

- **Public investment is projected to expand by 7.4% in 2021** (estimated -19.2% in 2020).
- Factors underpinning the robust public investment are higher development of RM69 billion in 2021; the implementation of small-scale projects, infrastructure, the National Fiberalisation and Connectivity Plan (NDCP). Major projects: Airport expansion, construction of hospitals, MRT2, LRT3, RTS, Pan Borneo Highway, Klang Valley Double Track Phase 1, and capital spending by public corporations.
- SERC **warns the risk of projects' implementation delay**.

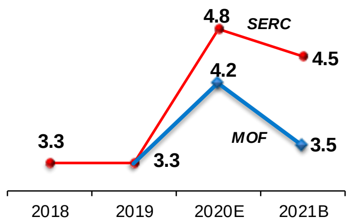
Gross Exports Growth
(%)



Inflation Rate
(%)



Unemployment Rate
(%)



Gross Export

2021F: 3.3%

2020: -1.4%

- **Gross exports** are expected **to rebound by 3.3% in 2021**, benefitting from the recovery in global trade and supply chains.
- The gathering pace of economic recovery of Malaysia's major trading partners in 2H 2020 and 2021 would help to lift export growth and support the economy.

Inflation Rate

2021F: 1.0-1.5%

2020: -1.2%

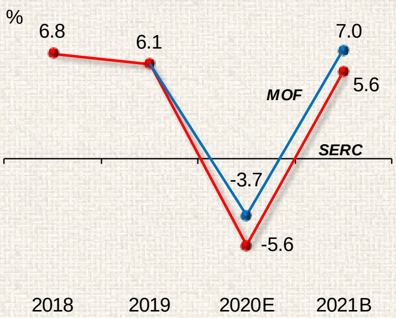
- **Inflation is expected to normalise between 1.0% and 1.5% in 2021** in tandem with better economic growth and higher crude oil prices.
- **Benign inflationary pressure allows continued monetary accommodation** to support stronger economic revival.

Unemployment Rate

2021F: 4.5%

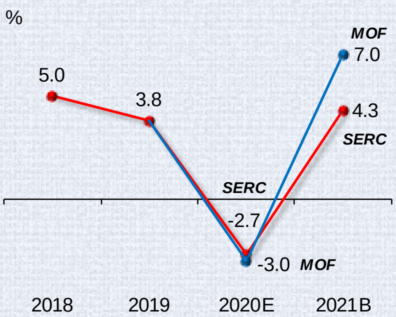
End-Dec 2020E: 4.8%

- **Labour market is expected to recover gradually in 2021**, in tandem with better economic growth and a turnaround in investment activities.
- SERC **cautions that the unemployment is a lagging indicator and may take a longer while returning to pre-pandemic levels (3.3%-3.4%)**.



Services

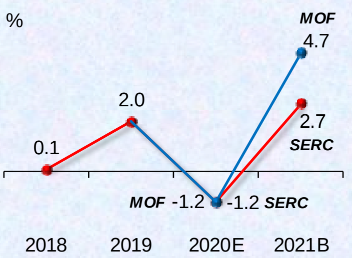
- **The sector is projected to contract by 5.6% in 2020** before rebounding by 5.6% in 2021.
- Higher disposable income and e-commerce will boost demand for retail and wholesale segments (food, motor vehicles).
- Information and communication subsector will be supported by the 5G spectrum network, the expansion of digitalization and e-learning.
- The finance and insurance will improve, thanks to the normalization of loan repayment and increased loan demand.



Manufacturing

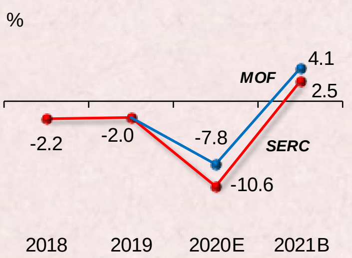
- **The sector is forecast to expand by 4.3% in 2021**, a marked turnaround from a decline of 2.7% in 2020.
- The E&E segment will accelerate with the digital transformation and virtual business communication, which spur demand for wireless technology, memory and micro chips.
- Demand of consumer-related products will benefit from improved disposable income. Major infrastructure and affordable housing projects will support construction related products.

Agriculture



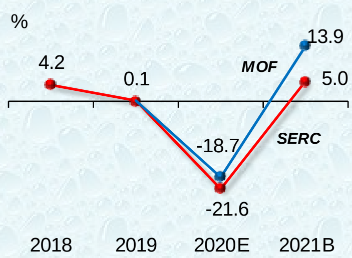
- **The sector is anticipated to rebound by 2.7% in 2021** (-1.2% in 2020).
- Higher production of palm oil and rubber as well as increased production of livestock and other agriculture and fishing.
- Prices estimates for CPO: RM2,550/metric tonne; rubber (SMR20): RM5.50/kg

Mining and Quarrying



- The sector, which is estimated to contract by 10.6% in 2020, **is projected to turn around by 2.5% in 2021**.
- Supported by a recovery in global demand for crude oil and liquefied natural gas (LNG).
- Brent crude price is expected to average US$45-50/bbl in 2021 (US$42/bbl in 2020).

Construction



- After crashing by 21.6% in 2020, **the sector is set to rebound by 5.0% in 2021** on account of the acceleration and revival of major infrastructure projects and affordable housing projects.
- MRT2, LRT3, West Coast Expressway, Bayan Lepas Light Rail Transit, Pan Borneo and Coastal Highways in Sarawak. Utility projects include the Langat 2 Water Treatment Plant, Baleh Hydroelectric Dam and Sarawak Water Supply Grid Programme (Phase I).

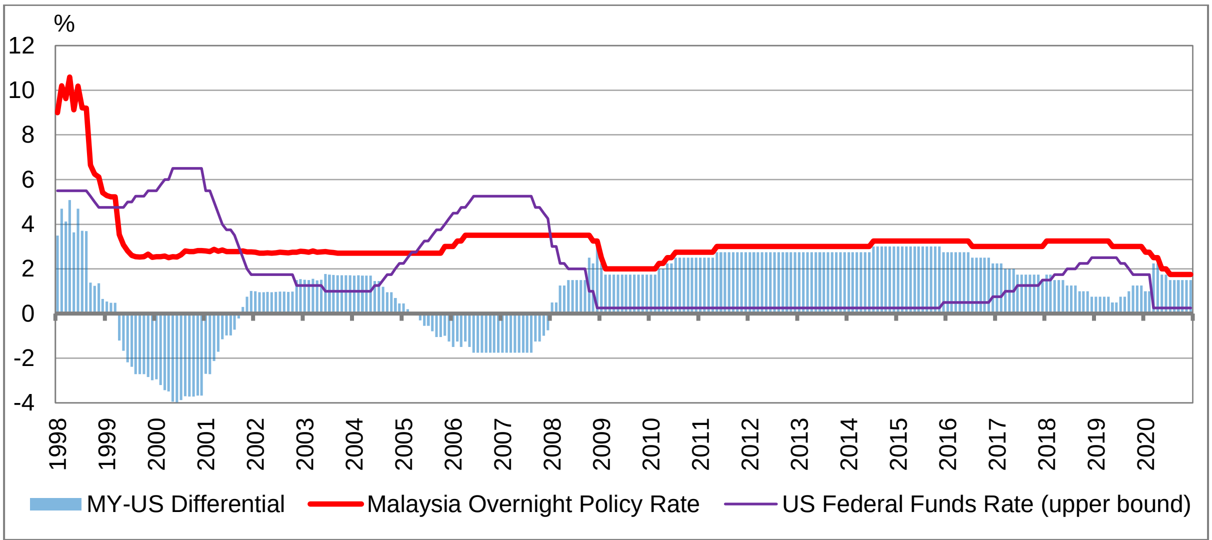
Source: Department of Statistics, Malaysia; Ministry of Finance; SERC

Table 3: Real GDP growth (% YoY)

Economic Sector [% share to GDP in 2019]	**2019**	**2020 Q1**	**2020 Q2**	**2020 Q3**	**2020 (Jan-Sep)**	**2020*e* (SERC)**	**2021*f* (SERC)**
By kind of economic activity							
Agriculture [7.1%]	2.0	-8.7	1.0	0.7	-2.7	-1.2	2.7
Mining & Quarrying [7.1%]	-2.0	-2.0	-20.0	-6.8	-9.7	-10.6	2.5
Manufacturing [22.3%]	3.8	1.5	-18.3	3.3	-4.6	-2.7	4.3
Construction [4.7%]	0.1	-7.9	-44.5	-12.4	-21.3	-21.6	5.0
Services [57.7%]	6.1	3.1	-16.2	-4.0	-5.8	-5.6	5.6
By type of expenditure							
Private Consumption [58.7%]	7.6	6.7	-18.5	-2.1	-4.6	-4.2	4.2
Public Consumption [12.2%]	2.0	5.0	2.3	6.9	4.8	4.5	3.4
Private Investment [16.8%]	1.6	-2.3	-26.4	-9.3	-13.2	-14.3	5.1
Public Investment [6.3%]	-10.8	-11.3	-38.7	-18.6	-22.3	-19.2	7.4
Exports of Goods and Services [63.7%]	-1.3	-7.1	-21.7	-4.7	-11.1	-9.0	3.9
Imports of Goods and Services [56.7%]	-2.5	-2.5	-19.7	-7.8	-10.1	-9.0	5.9
Overall GDP	**4.3**	**0.7**	**-17.1**	**-2.7**	**-6.4**	**-5.8**	**4.0**

Source: Department of Statistics, Malaysia; Bank Negara Malaysia; SERC

Figure 33: Malaysia-US's interest rate differentials



Source: Bank Negara Malaysia; Federal Reserve

REVIEW OF KEY ECONOMIC AND FINANCIAL INDICATORS

Leading indicators and Industrial production

Malaysia's leading indicators (LIs) have been registering a sustained improvement since June, indicating continued recovery path ahead. However, LI growth has moderated in October and November, raising concerns that the recovery may not be as strong as anticipated previously, due to the re-implementation of CMCO. Moving forward, the reimplementation of MCO starting mid-January is expected to dent the overall recovery pace.

Industrial production reverted to decline by 0.5% yoy in October and 2.2% in November (+0.8% in 3Q), dragged by a larger contraction of mining output (-10.6% in October and -15.4% in November for crude oil extraction and natural gas production) and softer manufacturing activities, which saw a contraction in output of food products, refined petroleum products and chemical products. Pharmaceutical products, rubber gloves, electrical and electronic (E&E) products as well as passenger cars continued to register strong growth. The heavy-weighted E&E segment has outperformed since June (ranging 7.1%-13.2% in Jun-Nov), outpaced the average growth of 6.0% in 2016-2019.

Figure 34: The annual growth of leading index indicates the recovery is on track, albeit unevenly

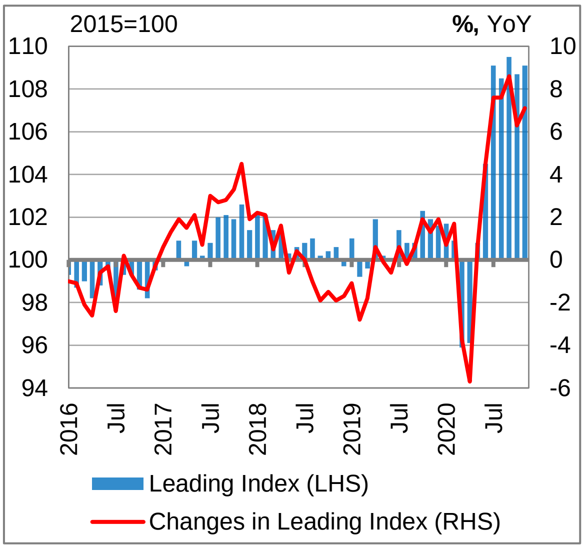
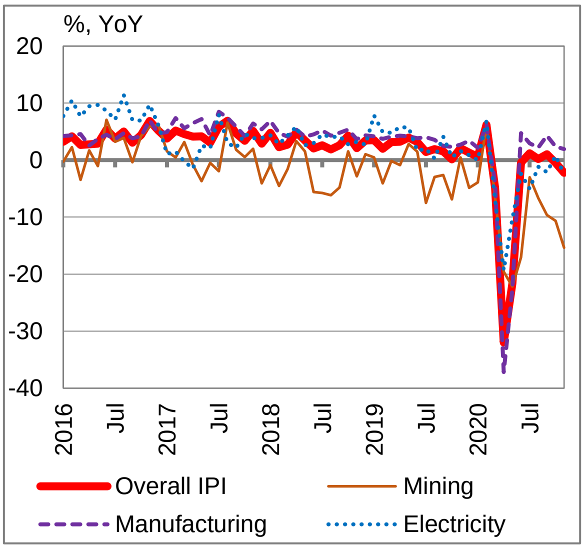


Figure 35: Industrial production declined in Oct-Nov 2020 after three months of increase in Jul-Sep



Source: Department of Statistics, Malaysia

Exports and Distributive trade

Exports expanded by 10.8% yoy in December, marking the fourth consecutive month of growth (4.6% in November, 0.2% in October and 13.6% in September). The positive growth was mainly boosted by increased shipments to our major trading partners (US, Singapore, China, EU, Hong Kong and Japan). Manufactured goods and agriculture sector contributed to the expansion, thanks to increases in electrical and electronic (E&E) products, palm oil and palm-based products as well as rubber and rubber products.

Retail sales declined by 2.3% in November and 1.5% in October (-1.3% in 3Q) with sales declining in all types of specialised stores, except specialised store for food, beverages and tobacco. This was partly dampened by the re-implementation of CMCO in several states and areas, which have resulted in movement restrictions and weak consumer confidence. The re-imposition of large-scale MCO and CMCO in January 2021 is expected to dampen the retail sector. Sales of passenger cars continued, albeit slower (1.2% in November; 2.2% in October and 6.1% in 3Q), thanks to the sales tax exemption and launching of new models. The SST exemption has been extended to June 2021.

Figure 36: Trade surplus widens on still-weak imports

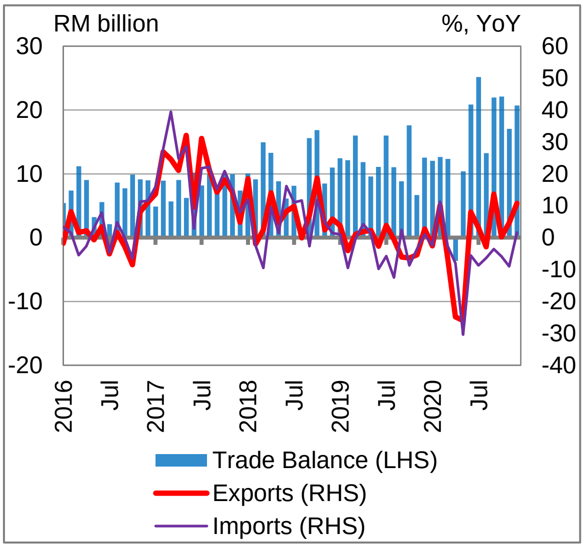
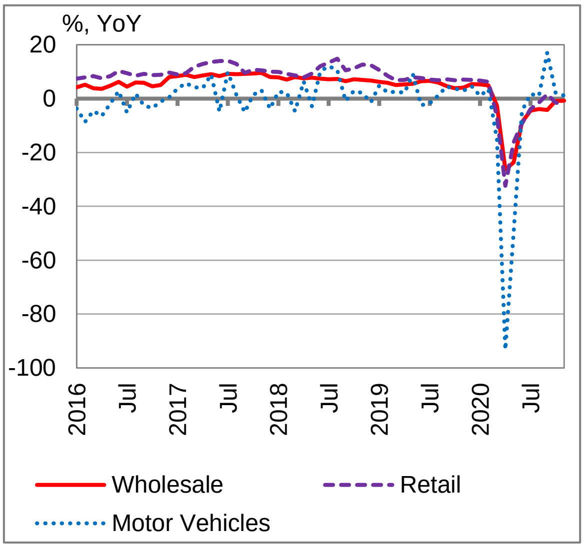


Figure 37: Motor vehicles demand still intact; wholesale and retail sectors remained fragile



Source: Department of Statistics, Malaysia

Private consumption indicators

Selected **private consumption indicators** signalling cautious consumer sentiments and household spending as reflected in MIER's Consumer Sentiments Index (CSI), which stood below the 100-pt threshold. While spending on essential items and car purchases continued, overall retail sales have not fully recovered as the fast-rising number of infection cases have dented consumer sentiment.

The number of unemployed persons remained elevated at around 764,400 persons in November 2020 compared to around 520,000 persons before the pandemic. According to the "MEF Salary Surveys for Executives and Non-Executives", 36% of respondents have yet to decide their recruitment policy in 2021 and approximately 20% of respondents have frozen recruitment. Following the expiry of automatic loan moratorium in September, individual borrowers have started to repay their loan facilities and hence, leaving with fewer cash on hand.

Figure 38: Selected private consumption indicators

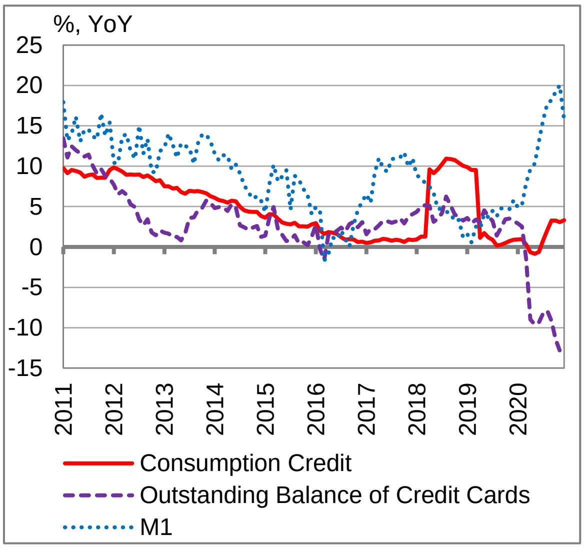
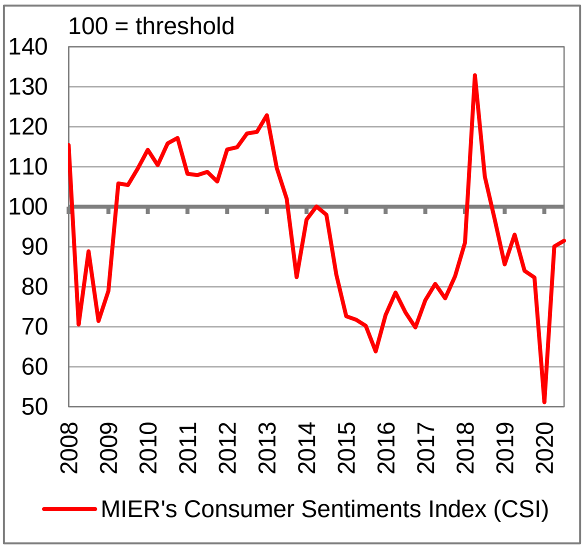


Figure 39: MIER's Consumer Sentiments Index (CSI)



Note: Loan data for April 2018 onwards have been revised to include MBSB Bank Berhad.
Source: Bank Negara Malaysia; Malaysian Institute of Economic Research

Private investment indicators

Selected **private investment indicators** showed a mixed performance: Sales of commercial vehicles have picked up strongly in 2H 2020, but imports of investment and intermediate goods remained weak, indicating a bleak investment outlook ahead. MIER's Business Conditions Index (BCI) remained weak in 3Q, albeit not as worse as in 2Q. A sustained turnaround in business sentiments in the near future hinges on the accelerated containment in the virus spread and vaccination; improved domestic economic outlook and easing concerns about political situation.

During 3Q 2020, MIDA has approved RM29.7 billion of manufacturing investment, of which basic metal products accounted for RM14.1 billion, bringing total approved manufacturing investment to RM65.3 billion in Jan-Sep 2020, which was 16.6% higher than the same period in 2019. However, both primary and services sector recorded a big decline of 73.5% yoy to RM1.7 billion and 51.8% to RM42.8 billion respectively in Jan-Sep 2020. Overall, total approved investment in Jan-Sep declined by 27.3% to RM109.8 billion in the first nine months of 2020.

Figure 40: Selected private investment indicators

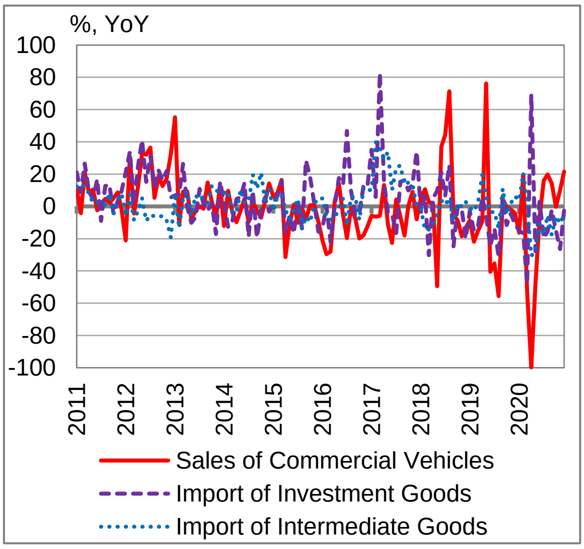
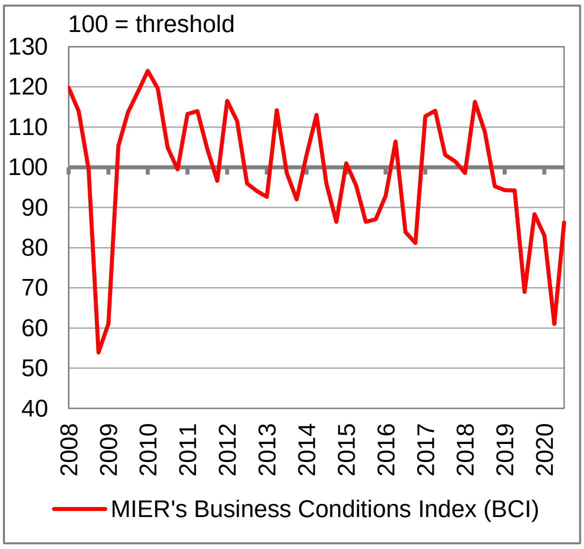


Figure 41: MIER's Business Conditions Index (BCI)



Source: Bank Negara Malaysia; Malaysian Institute of Economic Research

Price indicators

Overall **price level**, as measured by the Consumer Price Index (CPI) continued to decline by a smaller magnitude of 1.4% yoy in December (-1.7% yoy in November) for the tenth consecutive month, attributed to lower fuel prices and electricity tariff discount. For the full-year, CPI declined by 1.2% in 2020. Food prices have been increasing steadily since March 2020. 61.5% of the sub-categories recorded higher price increases while lower prices were seen in 32.7% of the sub-categories. Core inflation, which measures the underlying inflation excluding volatile fuel and food prices, trending down to 0.7% in Nov-Dec, the lowest reading since May 2019, mainly caused by lower rental increases.

Figure 42: Deflation will start to normalise in Jan 2021 on low-base effect, economic recovery and higher fuel prices

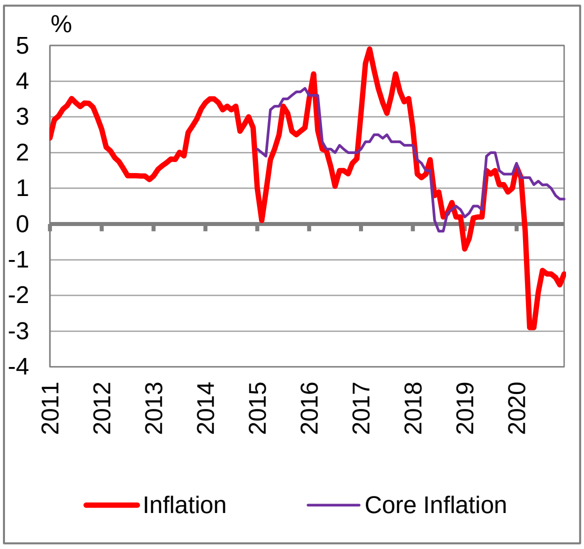
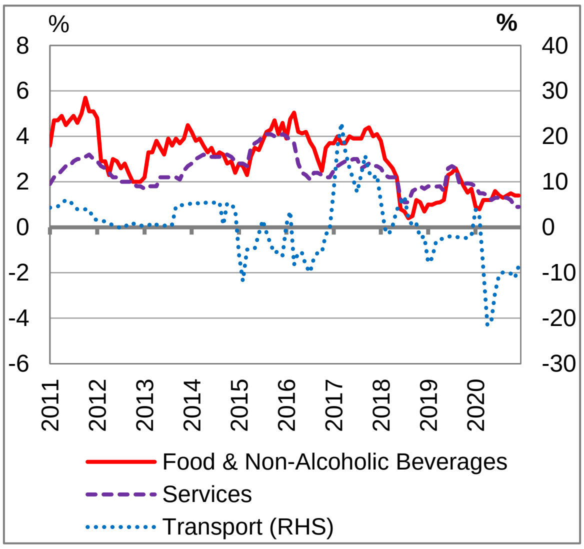


Figure 43: Transport prices (mainly fuel prices) will normalise and increase on yoy comparison starting March 2021



Source: Department of Statistics, Malaysia

Banking loan indicators

Banking system's outstanding loan growth moderated to 3.4% yoy in December (between 4.3% and 4.5% in Jul-Oct 2020), dragged by contracted loan demand for working capital as well as softened demand of residential property and non-residential property. Purchase of passenger cars helped to cushion some impact. Loan repayment started to pick up since October on the expiry of automatic loan moratorium in September, which was replaced by a targeted loan repayment assistance. Banks' excess capital buffers gained a little from RM123.7 billion as at end-September 2020 to RM125.1 billion as at end-November 2020. Impaired loans in December 2020 continued to increase to its highest since March 2011, registered a ratio of 1.6% to total loans. Nevertheless, banks have set a higher provision of 1.7% to total outstanding loans as a precaution against future credit losses.

Figure 44: Outstanding loan growth by type

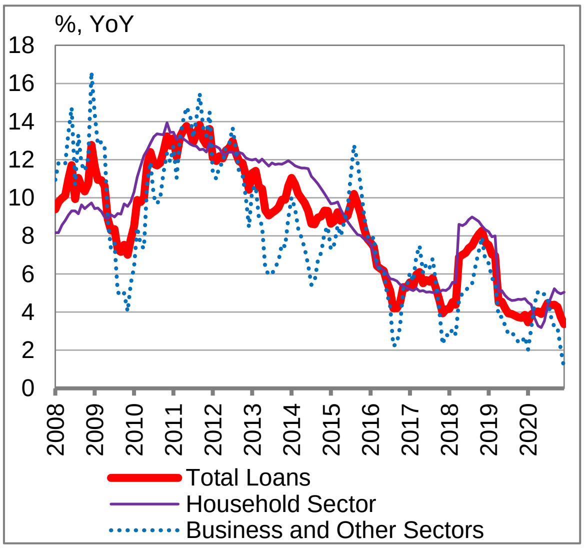


Figure 45: Loan applications growth

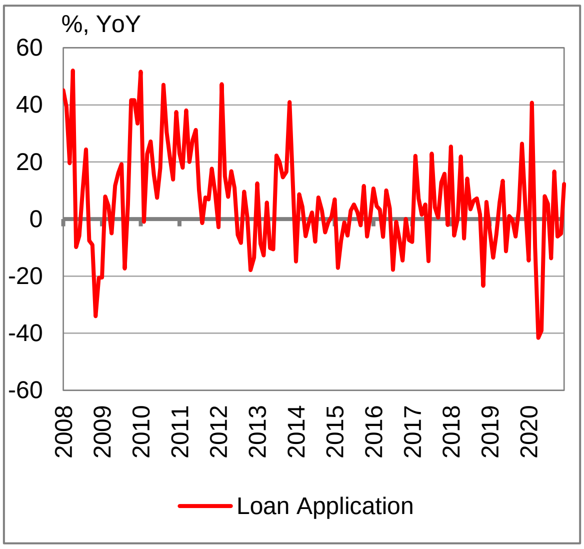


Figure 46: Loan approvals growth

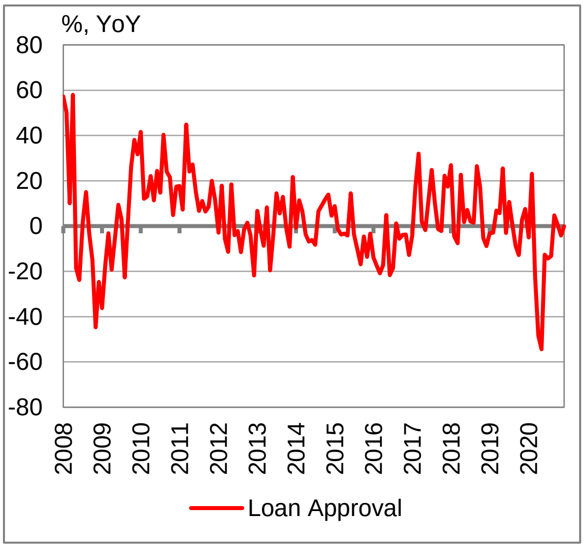
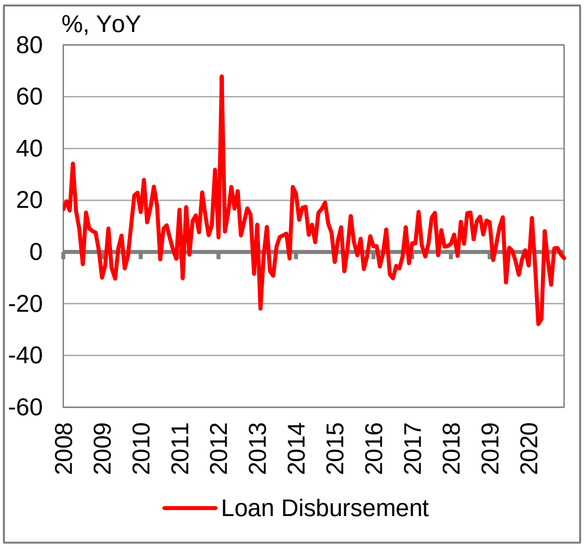


Figure 47: Loan disbursements growth



Note: Loan data for April 2018 onwards have been revised to include MBSB Bank Berhad.
Source: Bank Negara Malaysia

Financial indicators

Foreign reserves accumulation, which has accounted for the quarterly foreign exchange revaluation changes, amounted to US$107.6 billion as at end-2020, the highest level since May 2018. The reserves position is sufficient to finance 8.6 months of retained imports and is 1.2 times total short-term external debt.

Foreign investors have been net sold the Malaysian equities for 18 consecutive months, with RM24.8 billion worth of shares sold throughout the year 2020. Nonetheless, FTSE Bursa Malaysia KLCI closed higher to 1,627.21 as at end-2020, 38.45 points higher than 1,588.76 as at end-2019.

In contrast, foreign investors continued to accumulate the Malaysian Government Securities (MGS) since May 2020, led to a cumulative net purchase of RM30.1 billion of MGS during the period May-Dec 2020, holding a 40.6% share of MGS as at end-2020. In terms of overall ringgit-denominated debt securities, foreign investors made net purchase of RM37.1 billion in May-Dec 2020, holding a 13.9% share of total ringgit-denominated debt securities in Malaysia as at end-2020, the highest level since May 2018.

The ringgit continued to outperform the greenback since end-October and closed the year 2020 by appreciating 2.0% against the US dollar at RM4.0130 per US$ (end-Dec 2019: RM4.0925 per US$). Compared to end-2019, the ringgit has performed unevenly against other major and regional currencies: Appreciated against Indian rupee (+4.8%), Indonesian rupiah (+3.1%), Thai baht (+2.1%), Vietnamese dong (1.7%) and Singapore dollar (+0.1%); depreciated against euro (-7.0%), Chinese renminbi (-4.5%), South Korean won (-4.3%), Philippine peso (-3.4%), Japanese yen (-3.2%) and pound sterling (-1.7%). **The ringgit is likely to trade between RM3.95-4.00 per US dollar at end-2021.**

Figure 48: Foreign reserves accumulated US$4.0 billion in 2020

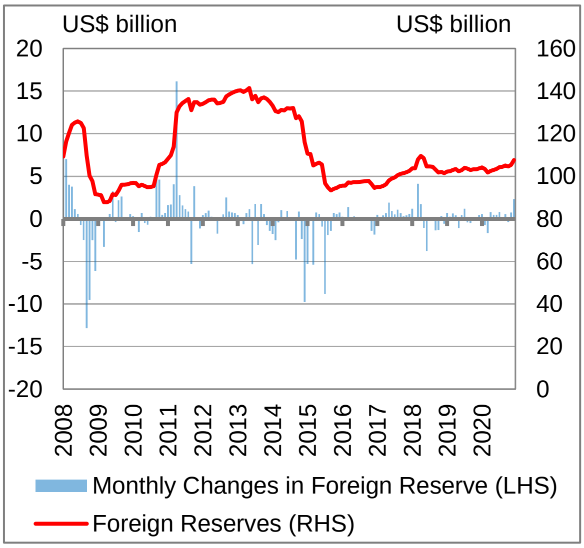


Figure 49: Ringgit's effective exchange rate (EER)

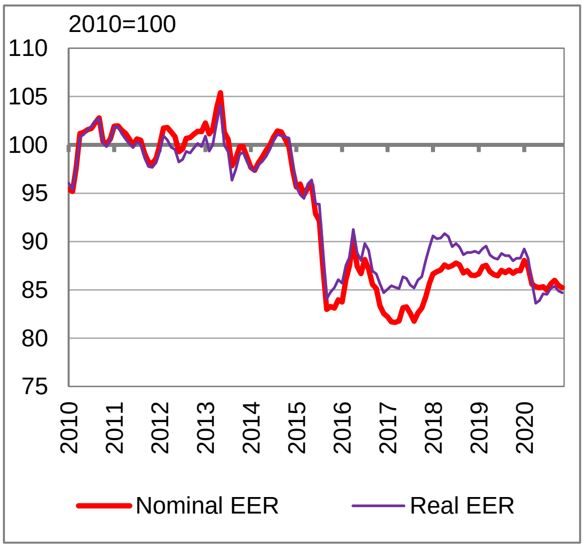


Figure 50: Ringgit against major foreign currencies

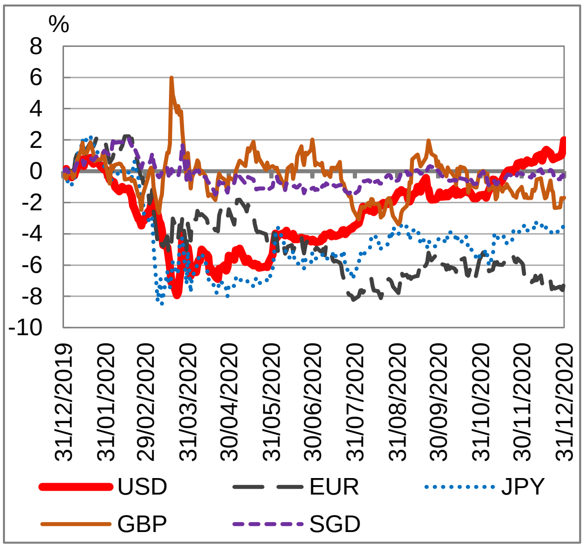
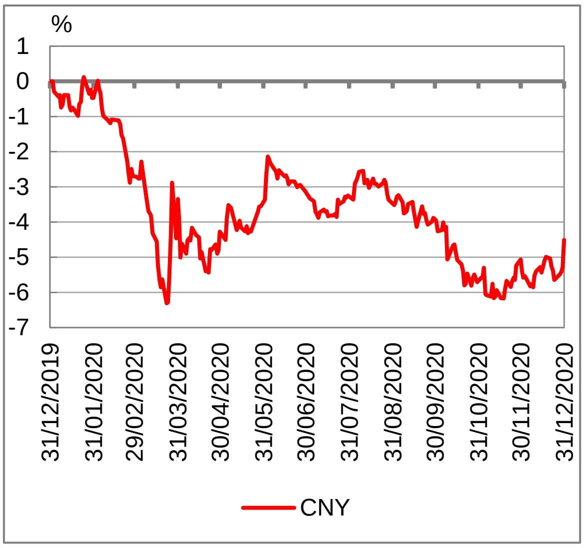


Figure 51: Ringgit against Chinese renminbi



Source: Bank Negara Malaysia; Bank for International Settlements

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