Navigating a challenging 2020: Certainty in direction needed

by
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Effective implementation of the 2020 Budget is crucial in rescuing the economy

Despite facing many disruptors and uncertainties, particularly the prolonged Sino-US trade conflict which has inflicted damage on global economy and trade since 2018, the Malaysian economy has withstood the headwinds to grow by 4.6% in the first nine months of 2019.

Nevertheless, the growth momentum had moderated from an annual rate of 4.9% in 2Q19 to 4.4% in 3Q as domestic demand cooled (to 3.5% in 3Q19 from 4.6% in 2Q19 and 6.8% in 3Q18).

Adding to the growth pressure was continued sluggishness in exports, which had contracted by 1.8% in Jan-Oct. For full-year 2019, GDP growth is estimated to increase by 4.6%, which is a shade lower than 4.7% in 2018 but 1.1 percentage points lower than 5.7% in 2017.

What lies ahead for Malaysia in 2020? Being a small, open and trade-oriented economy (2018: total exports made up 69.3% of total GDP; total trade, 130.2% of total GDP), an uneven state of the global economy and unwarranted volatility in the financial markets do not bode well for Malaysia via trade and financial channels.

The global economy has been dogged by many uncertainties since 2018. Going into 2020, the market and investors will be looking for inflection points to ascertain whether some stabilisation in global growth is on the horizon, paving the way for a convincing growth recovery.

The inflection points to watch in 2020 are:

1 The sign-off of a phase-one partial trade deal between the US and China should be a positive step to lay the foundation for future negotiations. More importantly, it is hoped that more concrete agreements than less will ensue, leading to a rollback of other tariffs in stages. Effective implementation and enforcement are the key.

2 President Donald Trump confronts a dilemma going into the 2020 US presidential election amid a public hearing to impeach him. Without striking a clear deal approaching the election, there's a rising risk that tariffs will remain in effect throughout 2020. A pause in the escalation would help a slowing US economy bounce back in an election year.

3 Low, zero and minus interest rates have become the new normal. What if an ultra-dovish monetary stimulus fails to work? The US Federal Reserve Board has signalled that policymakers see no need to boost the economy further anytime soon. Amid the fiscal limitation and high public debt level, fiscal policy has to be reinstated as the main tool for managing business cycles and supporting economic growth, but has monetary policy reached its limits?

Alternative scenario

The alternative scenario for the global economy is a trade-war retreat, as this will help to reduce uncertainty and probably act to spur global growth and market sentiment. The effectiveness of coordinated global central banks' monetary easing and quantitative easing (QE) as well as China's massive policy stimulus would set the scene for stronger global growth in early 2020.

Weighing on cautious global growth estimates of 3.2%-3.3% in 2020 (estimated 3.1% in 2019), the Malaysian economy is expected to grow by 4.5% in 2020. Domestic demand, especially private consumption, will be calling the shots, albeit slower as there remains considerable uncertainty about private investment.

The 2020 Budget's 4.3% increase in development expenditure to RM56 bil in 2020 should help to provide partial support to the domestic economy. What matters most is to execute effectively the Budget's programmes and initiatives; and to disburse the funds in a timely manner for the implementation of projects.

With a highly cautious export outlook for 2020 (estimated 2.0% growth against a decline of 1%-1.5% in 2019) remaining a drag on the domestic economy, household spending should continue to be the primary driver of Malaysia's economic growth.

Private consumption is estimated to pace slower to 6.7% in 2020 from an estimated 7.2% in 2019, which is normalised towards its long-term growth of 7.0% a year in 2011-2018. Underpinning private consumption are steady labour market conditions (estimated unemployment rate of 3.3%-3.4%) and continued wage growth (4.5%) as well as the RM5 bil cost of living aid to targeted households and individuals.

One of the biggest challenges facing the Malaysian economy is the rapidly slowing growth of private investment. The growth rate has been losing steam in recent quarters to 0.9% in the first nine months of 2019 and likely to end the year much lower at 0.8% (4.3% in 2018 and 9.0% in 2017), the slowest pace in nine years after contracting by 7.4% in 2009.

For 2020, we expect private investment to remain cautiously weak, growing by 2.2% as investors stay on the sidelines wary of broader political developments, including the leadership transition and policy uncertainties.

Growth in private investment has remained weak, primarily due to concerns related to the uncertain external environment, challenging domestic business condition, regulatory challenges as well as the lack of policies' clarity, and these continue to weigh on investors' confidence.

In Jan-Sept 2019, total approved investment in services, manufacturing and primary sectors grew moderately by 4.4% to RM149 bil. Though approved FDI rose (+6.5% to RM82.7 bil) in Jan-Sept 2019, domestic investment approvals saw a much slower pace of 2.9% to RM82.7 bil in the same period. It takes at least 16-18 months for 60%-70% of total approved investment to be realisable over the medium-term.

Hence, it is domestic private investment that forms the bulk of private investment (at least 55% of the total), and unless this accelerates, the investment cycle will not see a convincing expansion and thereby exert downward pressure on the economy.

Further, the overhang in both residential and commercial properties has impacted private investment in these sectors. For several sectors, such as telecommunication, pharmaceutical, power, automotive, banking and the sharing economy, there have been regulatory changes, including technological and digitalisation disruptions that have impacted or could impact the performance of these sectors.

It is positive that the 2020 Budget is making available RM1 bil in customised packaged incentives to attract investments from Fortune 500 and global unicorn companies in high technology, manufacturing, creative and new economic sectors.

Seeking certainty

Businesses and investors are seeking certainty in the country's direction, policy and regulations. Reviving investor confidence should be a priority. The economic development policies and benefits of policy interventions aimed at sustaining quality economic growth and reviving investor sentiment need to be clearly spelt out, especially in terms of employment and income generation outcomes.

Inflation expectations will be higher in 2020 fuelled by a managed float of fuel prices on a gradual basis starting Jan 1, 2020, a planned upward adjustment in water tariffs nationwide, higher minimum wage as well as higher private medical consultation fees. Headline inflation, as measured by the Consumer Price Index (CPI), is estimated to increase by 2.0% in 2020, markedly higher from an estimated 0.7% in 2019.

While the economy will get some fiscal spending boost from the 2020 Budget, if global growth fails to stabilise or trade conflict uncertainties remain entrenched, monetary policy may need to reinforce and secure growth amid contained inflation expectations. Bank Negara Malaysia is expected to keep the door open to modest monetary easing, probably a 25-basis point cut in the overnight policy rate to 2.75% by 1H20 if the economy slows materially to say, around 4.0%.

What can buffer Malaysia against external shocks? Malaysia is in a position of strength to face headwinds. It has still-sound economic and financial fundamentals supported by facilitative policies and an accommodative monetary policy; well-diversified trade and economic sectors; and sources of FDI. This helps to reduce vulnerability and the risks inflicted by a particular sector and industry.

A targeted gradual fiscal consolidation path is appropriate while continuing to protect growth-enhancing spending.

The financial sector is well capitalised to cope with most shocks. As at September 2019, banks' liquidity buffers exceeded regulatory levels with strong loan quality amid an uptick in aggregate non-performing loans (NPLs) to 1.6% of gross loans since March (1.5%) and sizeable provisions (88.8% to total impaired loans). The liquidity coverage ratio (LCR) is well above the required level (100% starting 2019) at 143.6%.

A flexible exchange rate is essential continue to play the role of shock absorber and remains the first line of defence against external shocks in the context of protracted uncertainty in global economic and financial conditions. This is backed by adequate international reserves and sustained current account surplus. FocusM

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