by
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Covid-19: How much economic pain can Malaysia endure?

The onslaught of trade tensions and sustained supply disruptions in the commodities sector as well as a continued decline in public investment have weighed down Malaysia's GDP growth in the fourth quarter of 2019, slowing markedly to 3.6% yoy from 4.4% in 3Q19, bringing the full-year growth to 4.3% in 2019 (4.7% in 2018).

This misses the government's target of 4.7% and also marks the slowest quarterly and annual growth since 3Q09 during the 2008-09 global financial crisis.

The slower than expected 4Q GDP number raises concerns whether Malaysia's economic and financial fundamentals are strong enough to withstand the headwinds from China's highly contagious Covid-19 outbreak, at least in 1H20, in the hope that the outbreak will likely subside and stabilise in early 2Q.

With increasing anxieties and wariness about the potential economic and business disruptions on the domestic economy, investors' confidence and consumer sentiment, it raises questions about the government's capacity for embracing and countering the fallout from the outbreak, especially when both the global and China's economies are on slowing growth trajectory.

Looking at Malaysia's 4Q19 GDP numbers, private consumption remained the primary growth driver, still growing resiliently by 8.0% yoy in 4Q, higher than 7.0% yoy in 3Q19. Though private investment gained traction to 4.2% in 4Q (0.3% in 3Q), cautious investors' sentiments about the virus' impact would slow private investment in 1H20.

Public investment declined by a smaller rate of 7.7% in 4Q from -14.1% in 3Q but a small turnaround is expected in 2020 as reflected by the higher budgeted development expenditure as well as that of non-financial public enterprises on 5G infrastructure, solar energy and affordable housing.

The external sector remains a drag on the economy as gross exports declined by a larger 3.3% in 4Q compared to -1.9% in 3Q while imports' contraction also widened to -1.8% in 4Q from -0.2% in 3Q, reflecting weakening imports of intermediate and capital goods. This is in tandem with the moderate industrial production and exports contraction as well as moderate private investment. The US-China trade tensions and cautious investors' sentiment as well as the lack of policy clarity and direction are also partly responsible for the performance of exports and private investment.

Seen in this light, the negative transmission effects from the Covid-19 outbreak in China is a test of Malaysia's economic endurance.

Why does China matter to the world and to Malaysia in particular? By the numbers, China's contribution to the world economy is much bigger now and deeply connected through global supply chains and connectivity when compared with the SARS outbreak in 2003. China has contributed 15.8% of the world's GDP in 2018 (2003: 4.3%) and 11.7% of total trade (2003: 5.3%).

China remains an important trade, economic and investment partner of Malaysia. It was Malaysia's largest trading partner (17.2% of Malaysia's total external trade); largest exporter (14.2% of total exports) and largest importer (20.7% of total imports) in 2019.

China was ranked as the 10th largest foreign investor in Malaysia. At end-September 2019, China's FDI outstanding stock stood at RM18.3 bil or 2.7% of Malaysia's outstanding FDI. China's share of Malaysia's tourism receipts more than tripled to RM12.3 bil or 14.6% of total receipts in 2018. Three million Chinese made up 11.4% of total tourist arrivals in Malaysia in 2018. In Jan-Sept 2019, Chinese tourist arrivals increased by 5.7% to 2.4 million or 12.0% of total tourist arrivals to rank as Malaysia's third largest tourist arrivals.

China's significance to Malaysia

CHINA (% share of Malaysia)	2003	2018
Total trade (RM bil)	53.4 (7.5%)	314.5 (16.7%)
Total exports (RM bil)	25.8 (6.5%)	139.1 (13.9%)
Total imports (RM bil)	27.6 (8.7%)	175.4 (19.9%)
Tourist arrivals from China (mil persons)	0.4 (4.0%)	2.9 (11.4%)
Tourist receipts from China (RM bil)	0.9 (4.2%)	12.3 (14.6%)
Gross direct investment from China (RM bil)		4.0 (2.8%)
FDI stock from China (RM bil)		17.0 (2.7%)
Gross direct investment to China (RM bil)		1.7 (2.6%)
ODI stock to China (RM bil)		9.6 (2.0%)

SOURCES: STATISTICS DEPARTMENT, TOURISM MALAYSIA

How bad can it get?

Malaysia must be prepared to brace for an economic fallout from the Covid-19 outbreak via trade and services. It is certainly expecting a notable impact on its economy, business and consumer confidence this year, especially as the situation is expected to persist for some time.

The Covid-19 outbreak is a bane to Malaysia's services and tourism-related sectors especially as 2020 is Visit Malaysia Year (VMY). The government targets 30 million tourists and RM100 bil foreign exchange earnings or 6.2% of GDP. We are setting a target of 3.48 million Chinese tourists in 2020. Non-China tourists would refrain from travelling to this region for fear of virus infection, at least in 1Q20 until the number of infections subsides and the situation stabilises.

Reduced travel if prolonged, along with cautious Malaysian households' sentiment, would have a severe effect on transportation, including the airline, travel, tourism and hospitality sectors. The domestic services subsectors such as wholesale, retail, hotel and restaurants as well as transport and communications will be the main casualties. They have a combined share of 22.3% of GDP.

During the SARS outbreak in 2003, Malaysia's overall services sector had suffered two consecutive quarters of a sharp slowdown or contraction, with pronounced declines in wholesale and retail sub-sectors (+2.5% yoy in 1Q03 and -2.4% in 2Q03), hotels and restaurants (+5.7% in 1Q and -8.0% in 2Q), as well as transport and storage (+2.3% in 1Q and -5.9% in 2Q). Chinese tourists dropped sharply from 2.9 million in 1Q03 to 1.7 million in 2Q03 before rebounding to 2.5 million in 3Q03.

This time round, the drag from the anticipated slowdown in the services sector on the domestic economy will be more pronounced given its share of GDP (56.7% in 2018 vs 50.5% in 2003) and moderate growth in manufacturing, mining and agriculture as well as a gradual recovery in exports. The domestic economy is largely depending on private consumption (57.0% of GDP) amid still-sluggish private investment and public spending.

Overall, it is estimated that a 1% lower economic growth for China and a 1% decline in Malaysia's tourism receipts (which accounted for 5.8% of GDP in 2018) could together potentially shave 0.5 to 1.0 percentage point off SERC's (Socio-Economic Research Centre) baseline GDP growth estimate of 4.5% for 2020 to 3.5%-4.0%.

Malaysia's first quarter (Jan-March) GDP growth of 2020 would be the hardest-hit given the intensity of Covid-19 on China's economy with its consequent impact on the domestic services sector on the anticipated decline in Chinese tourist arrivals as well as the supply chain disruptions in manufacturing. A sustained higher GDP growth is envisaged in 2H20 as the temporary disruptions from the Covid-19 outbreak recedes and stabilises in 2Q.

Another spillover effect could be in the form of periodic gyrations in financial markets. Equity markets' volatility across the region has edged higher while the ringgit has depreciated against the US dollar, which is not surprising given the tendency to co-move with the Chinese renminbi. It must be cautioned that prolonged volatility in equity markets could lead to broader risk aversion, and could lead to a tightening of financial conditions.

The government's stimulus package, including financial assistance, is designed to help ease the economic pains for businesses and industries affected by the Covid-19 outbreak. However, the speed of funds disbursement and implementation must be rapid and impactful to ensure the intended outcomes of cushioning the short-term impact. As well, the provision of financial assistance and relief funds to the affected sectors and companies by both the government and banks must be effective. FocusM

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