社会经济研究中心

SOCIO-ECONOMIC RESEARCH CENTRE

BRACING FOR A NEW NORMAL GROWTH

Slow growth and low interest rate

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16 April 2019

Section 1

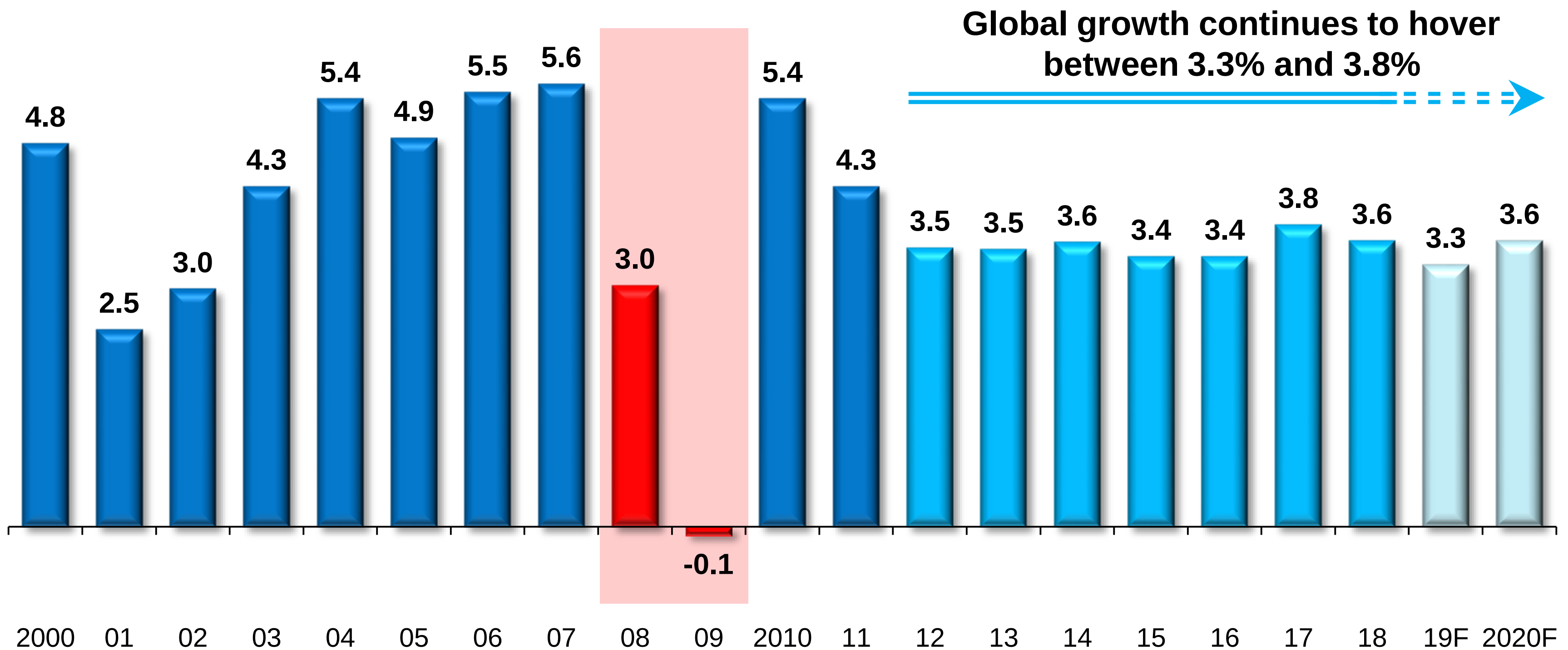
The World Economy –

A synchronized slowdown

Global growth is decelerating in synchronisation

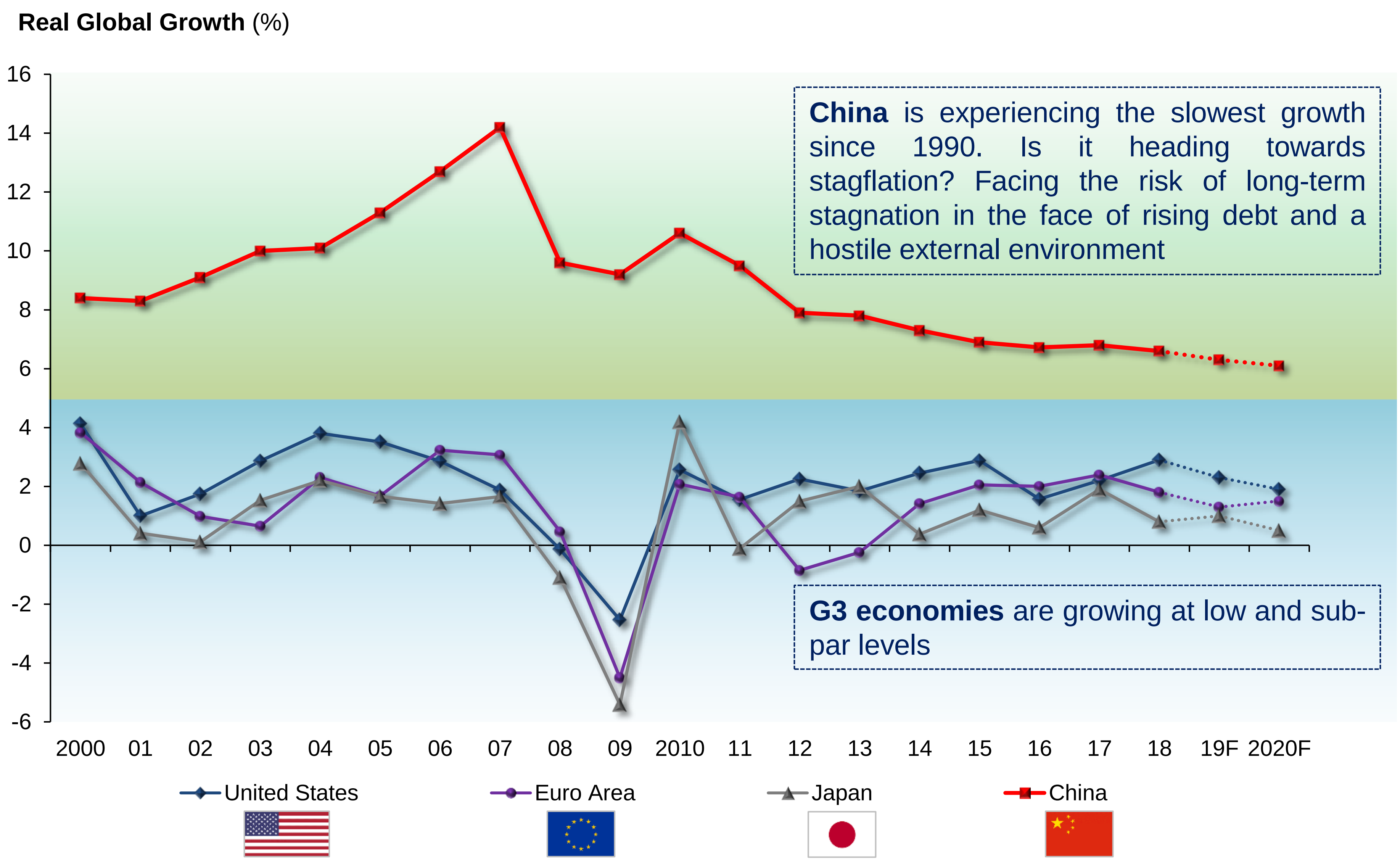
- The International Institutions (IMF, WB and OECD) have concurrently marked down 2019's global growth estimates
- **IMF** (from 3.7% to 3.5% to **3.3%**), **World Bank** (from 3.0% to **2.9%**) and **OECD** (from 3.5% to **3.3%**)

Real Global Growth (%)



Source: IMF World Economic Outlook (April 2019)

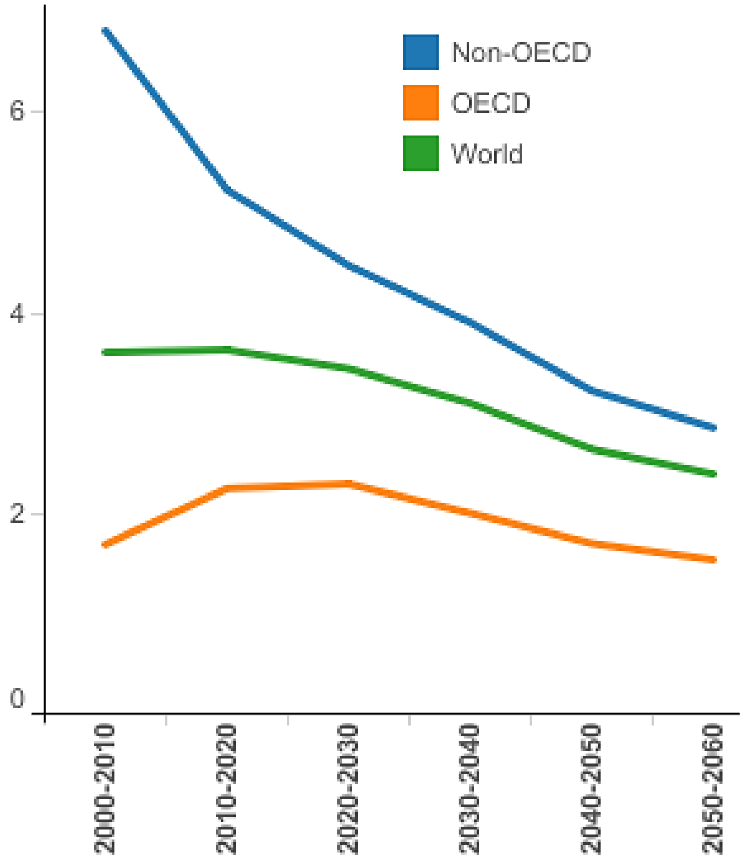
G3 economies and China are SLOWING



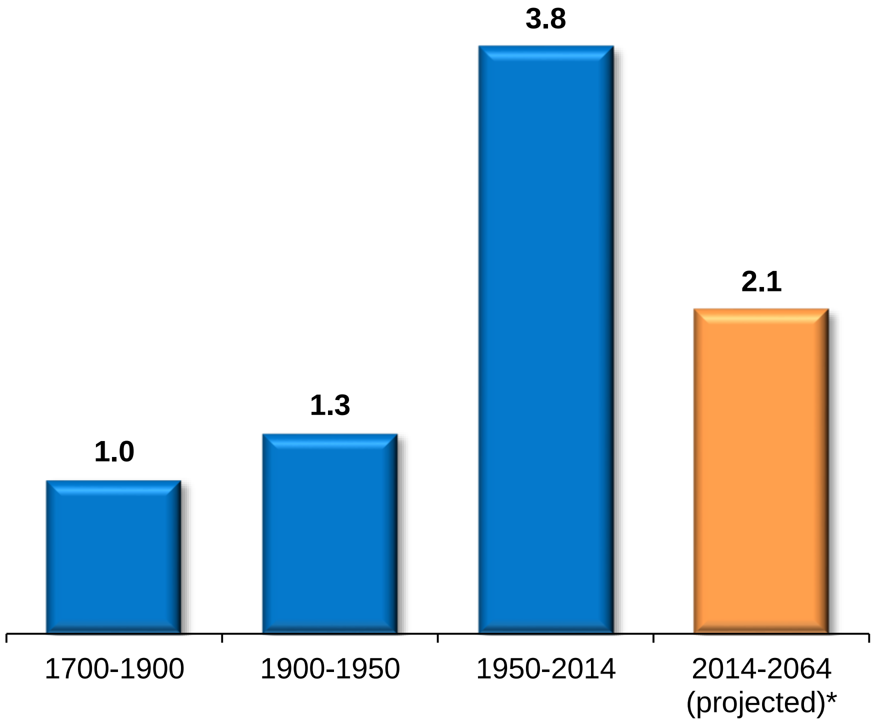
Source: IMF

The world economy will slide back toward its RELATIVELY SLUGGISH LONG-TERM GROWTH RATE

Global economy growth will slow from 3.6% in 2010-2020 to 2.4% in 2050-2060
% average annual rate



Growth is set to slow dramatically
GDP growth (%), CAGR

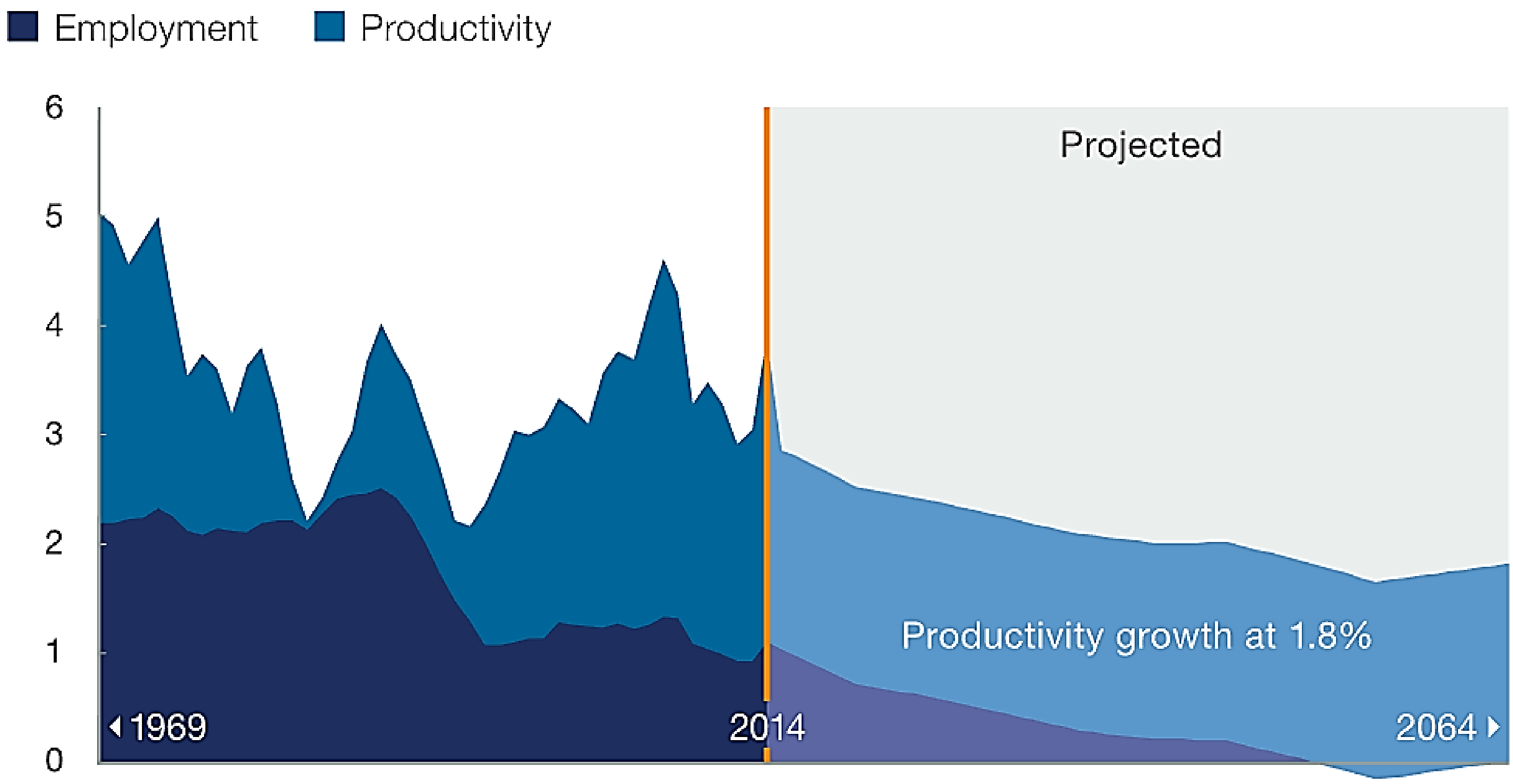


** Assuming 1.8% productivity growth, equal to average for 1964-2014*

Source: OECD Economic Policy Papers; McKinsey Global Institute

SLOWER POPULATION GROWTH and LONGER LIFE EXPECTANCY are limiting growth in the working-age population. Slowing employment growth; PRODUCTIVITY must pick up the slack

Labour's contribution to GDP growth (%), rolling 5-year periods, CAGR



Source: McKinsey Global Institute

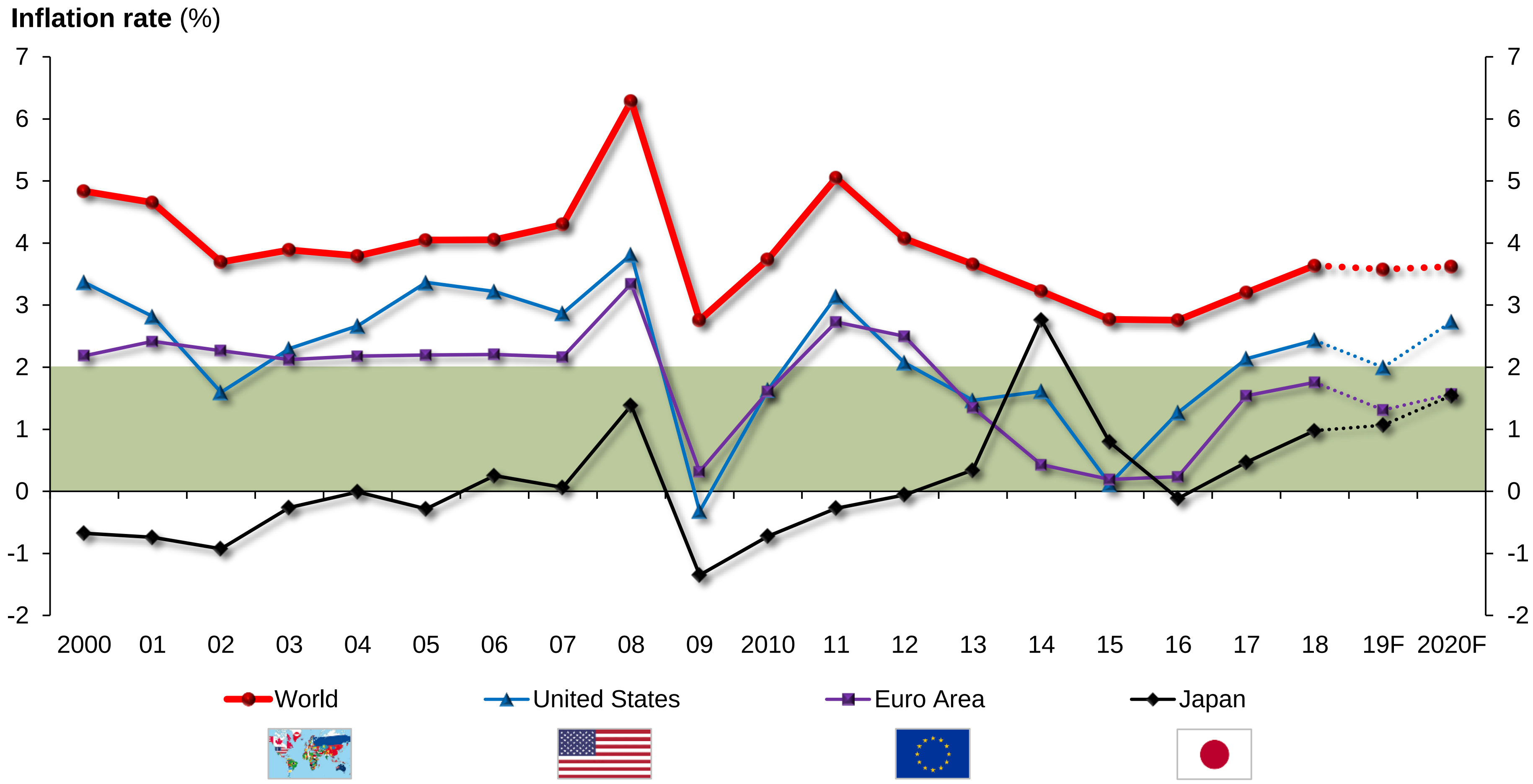
Section 2

Inflation & Interest Rate –

Inflation or deflation?

INFLATION stubbornly low, but subject to upward pressures

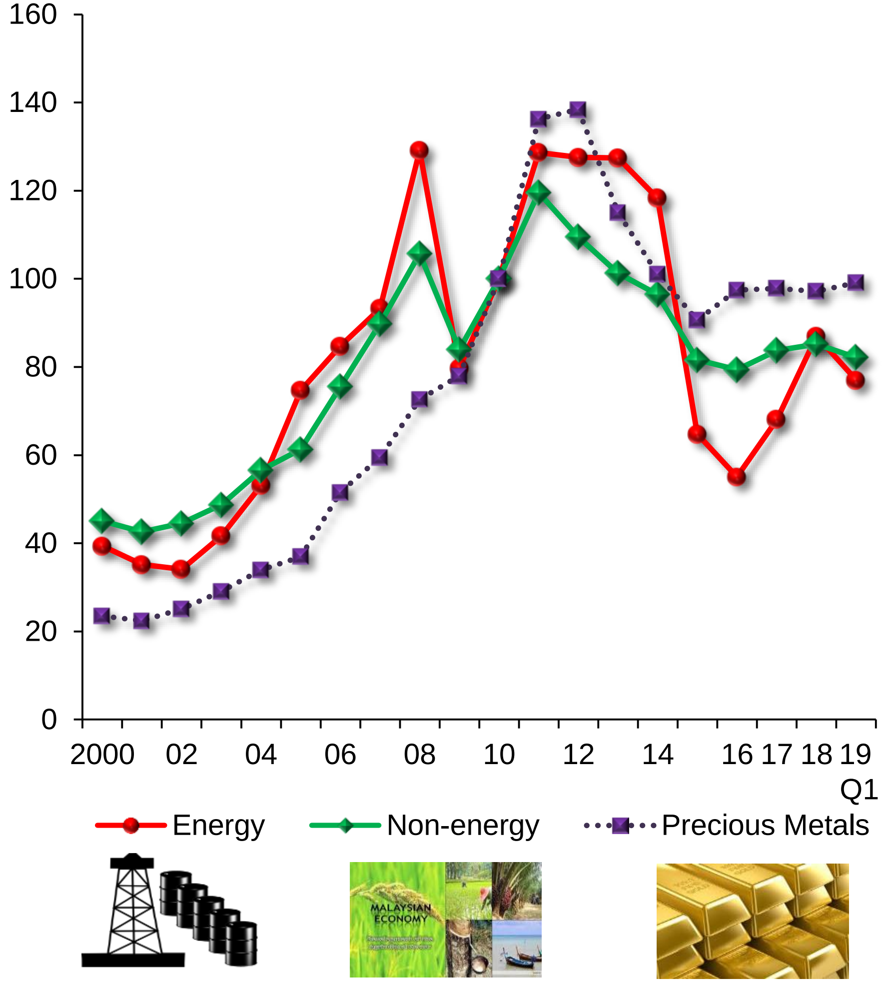
- Inflation rates in the US, euro zone and Japan are dropping below central bank targets of 2% inflation rate



Source: IMF

VOLATILE ENERGY PRICES remain a wild card

Commodity Price Index
(2010=100)



Source: World Bank

- Brent crude oil prices have climbed back more than 30% to US$68/bbl as at end-Mar 2019 (US$51/bbl as at end-2018).
- Factors underpinning the movement in prices: (a) OPEC and its allies' compliance of cutting crude oil supply by 1.2 million barrel per day in Jan-Jun 2019; (b) Trade war fears subside; (c) Increasing shale oil production from the US; and (d) Syria and Middle East tensions pose bigger risk for oil prices in the near-term.
- The US EIA expects Brent crude oil price to average at US$65/bbl in 2019 (2018: US$71/bbl).

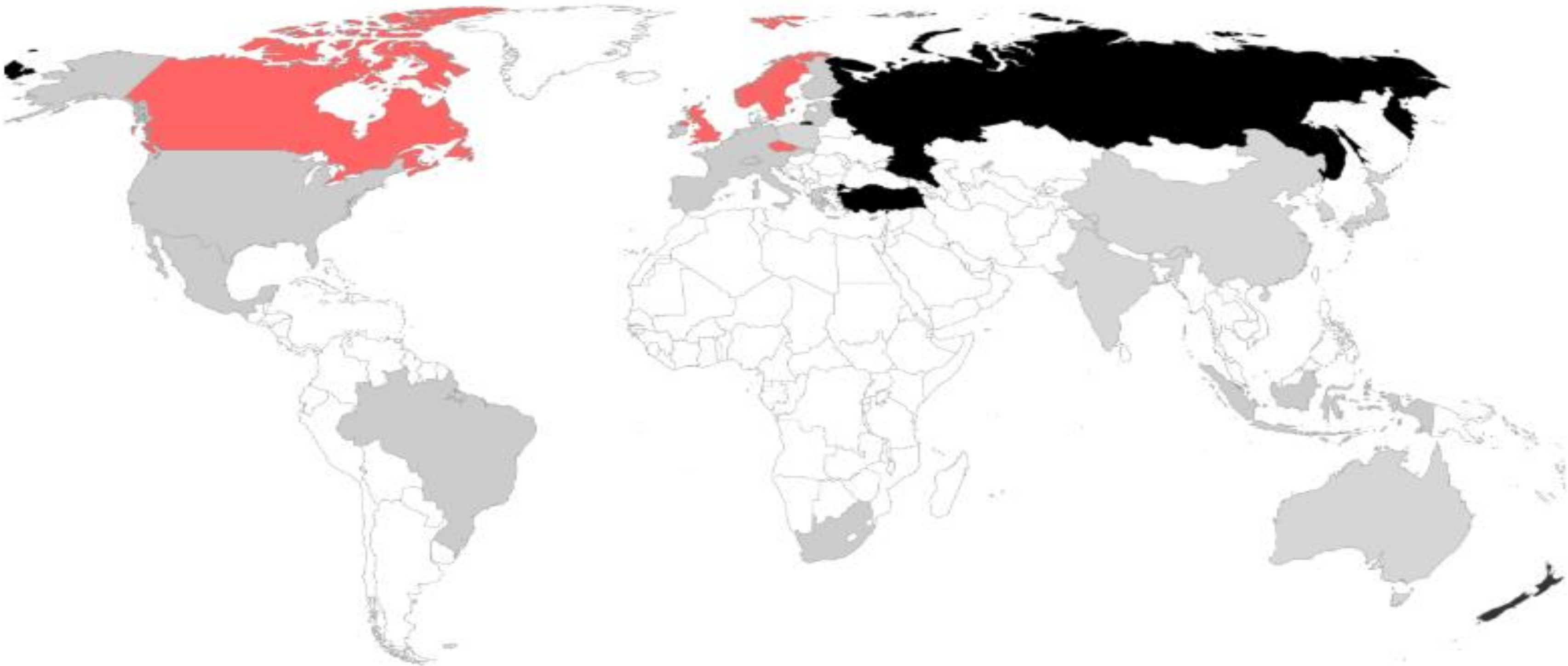
Global central bankers under pressure to RETHINK how aggressive they can be hiking interest rates

The Bloomberg Central Bank Outlook

How 23 major central banks will change monetary policy by the end of 2019

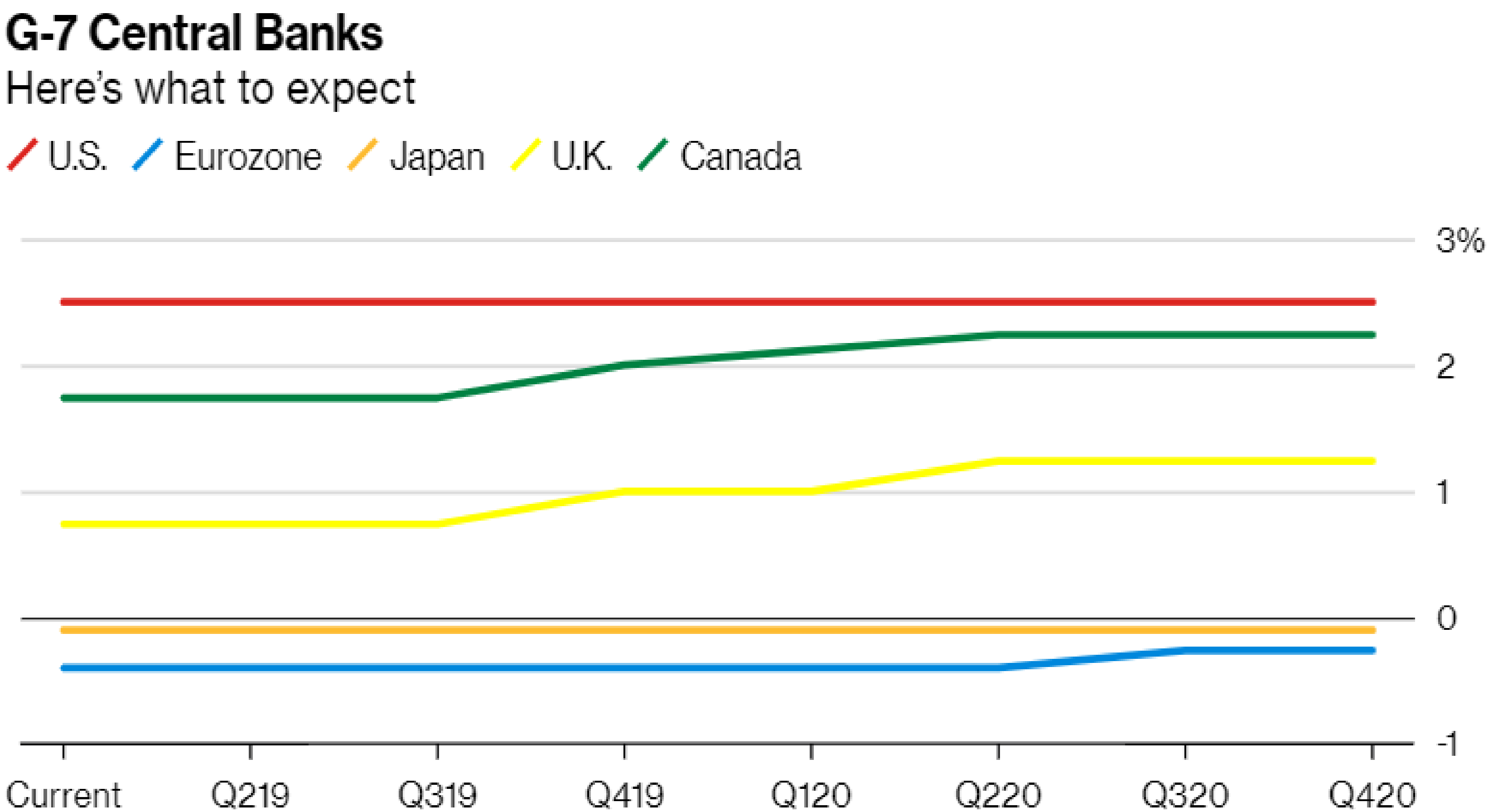
Projected interest-rate change

● Decrease ● No change ● Increase



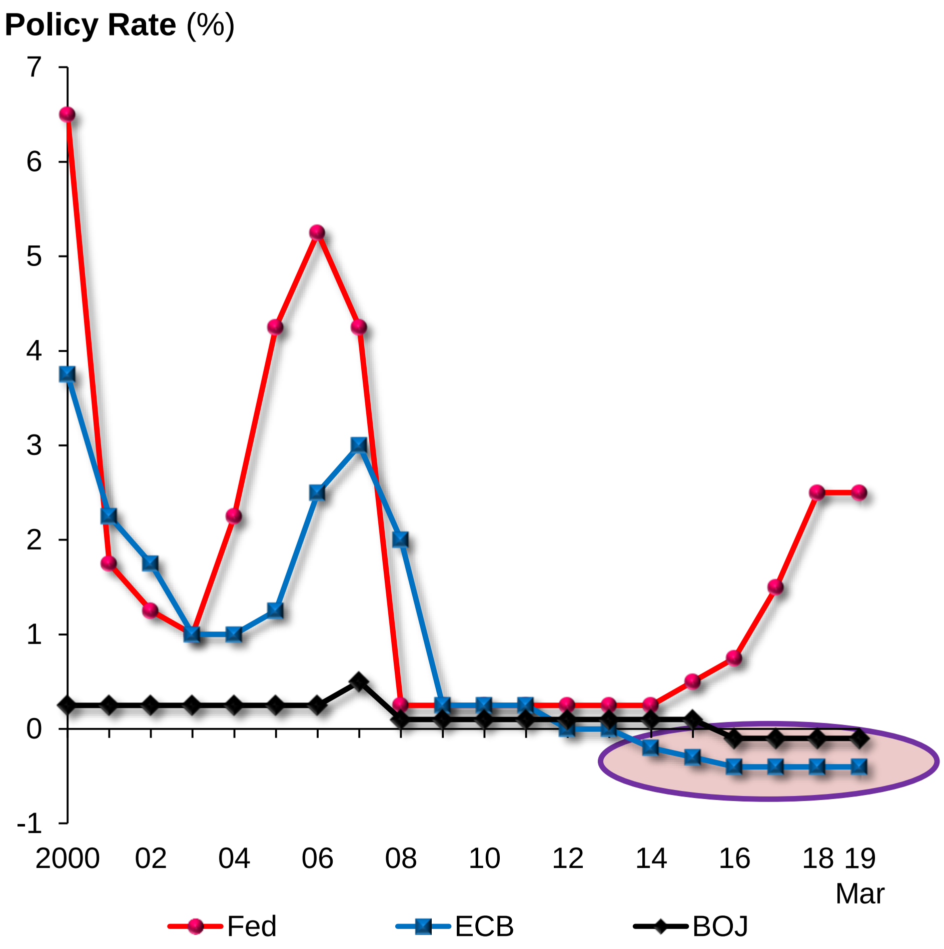
Note: Based on median estimate of latest monthly or quarterly survey, where available, or of most recent collected forecasts. All interest rate and forecast data are as of April 3, 2019.
Sources: Central banks, Bloomberg surveys

Will the US & Europe mirror the experience of Japan: SLOW-GROWING, STUBBORNLY LOW INFLATION AND LOW INTEREST RATES?



Source: Bloomberg surveys

Global central banks on PAUSING OR EASING MODE

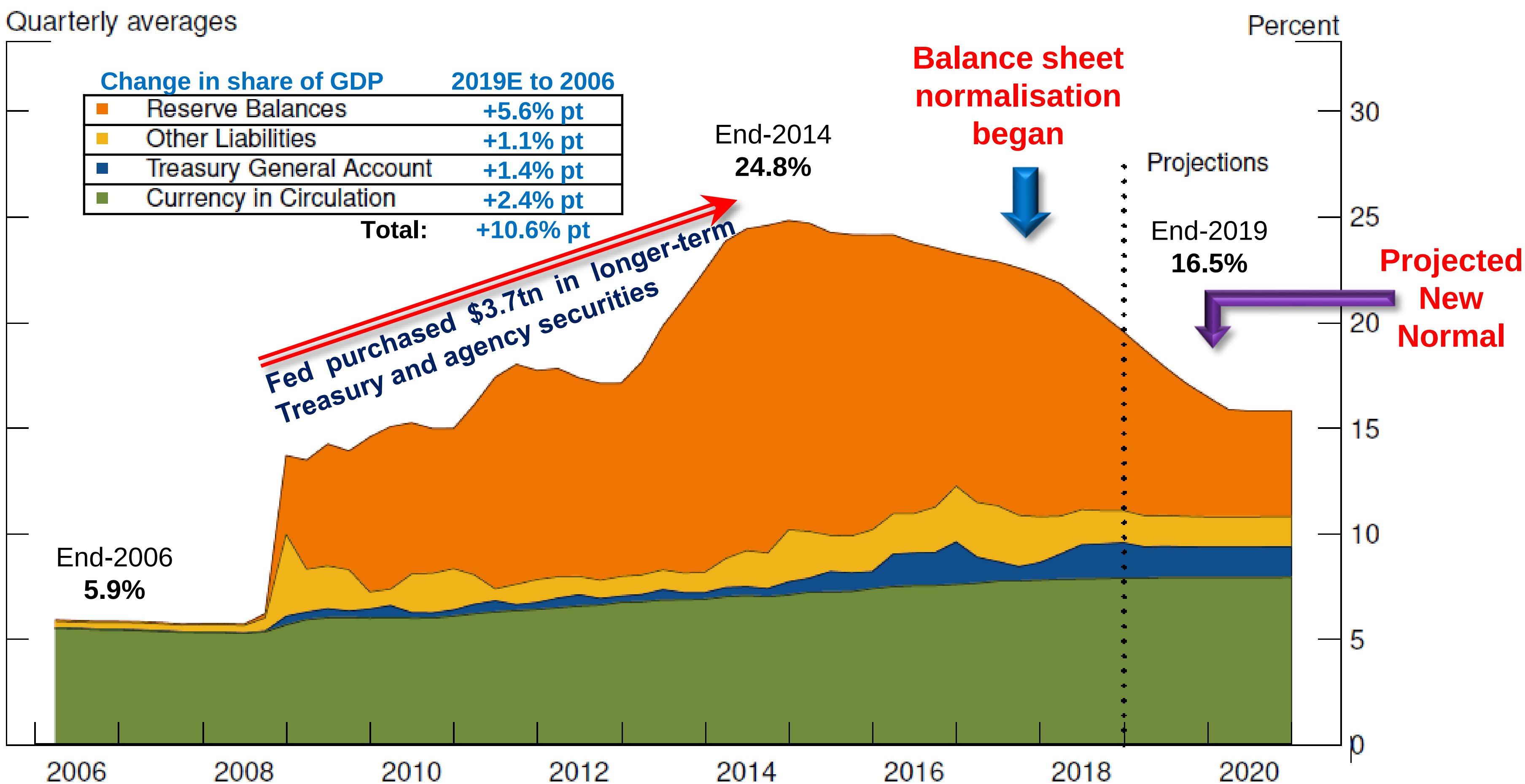


- The **Fed** indicates that **no more rate hikes** will be coming this year. It will also **complete its balance sheet roll-off program at end-September**.
- The **European Central Bank** (ECB) pledges to maintain its key interest rates at least through the end of 2019 and also provides fresh loans facility to stimulate bank lending in the face of weakening growth and external risks.
- **Bank of Japan** (BOJ) is expected to **continue with its stimulus program** in order to achieve the Bank's inflation target in a stable manner for an extended period of time as price pressures remain subdued.

Source: Fed; ECB; BOJ
Note: Interest rate on deposit facility applied as ECB's policy rate

The Fed steps toward an early exit from its balance sheet reduction; heading towards a NEW NORMAL LEVEL

Federal Reserve Liabilities as a share of GDP



Source: The Federal Reserve

Section 3

Risks to Global Growth –

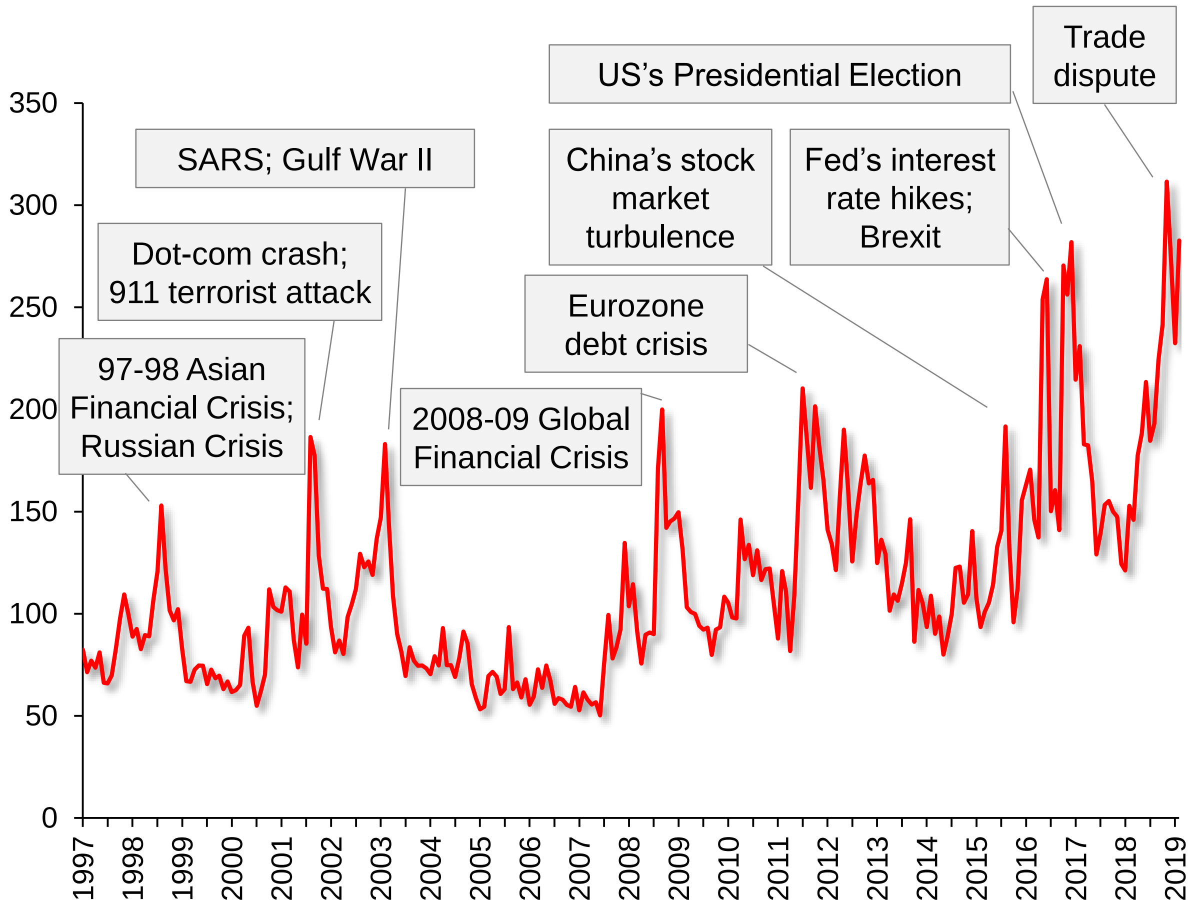
Is the next financial crisis looming?

Heightened UNCERTAINTIES weighing on global growth

Uncertainties in the global economy have soared to their highest level in Nov 2018.

- Lingering concerns and uncertainty about the **trade tensions**
- Uncertainty about the **Fed's future rate hikes**
- Concerns about **slowing global growth, the US** and **China economy**
- Induced **volatility in global financial markets**, including exchange rates in emerging markets
- Wide swings in **crude oil prices**
- **Geopolitical** and **political** risks

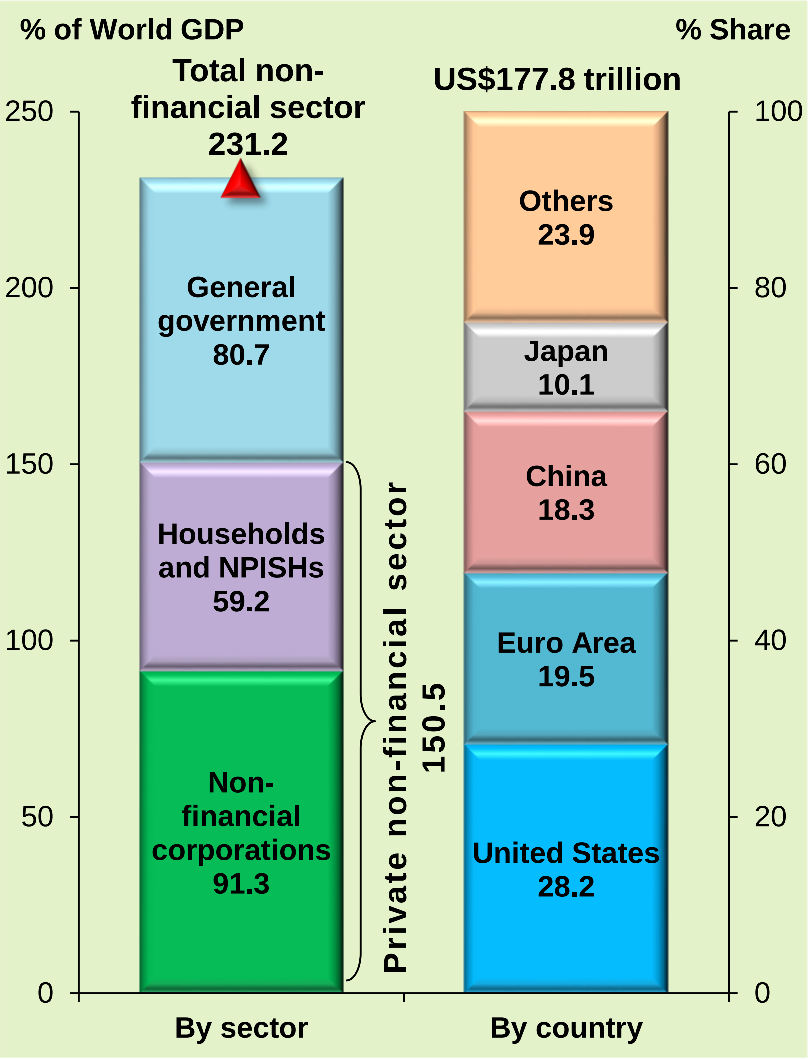
Monthly Global Economic Policy Uncertainty Index



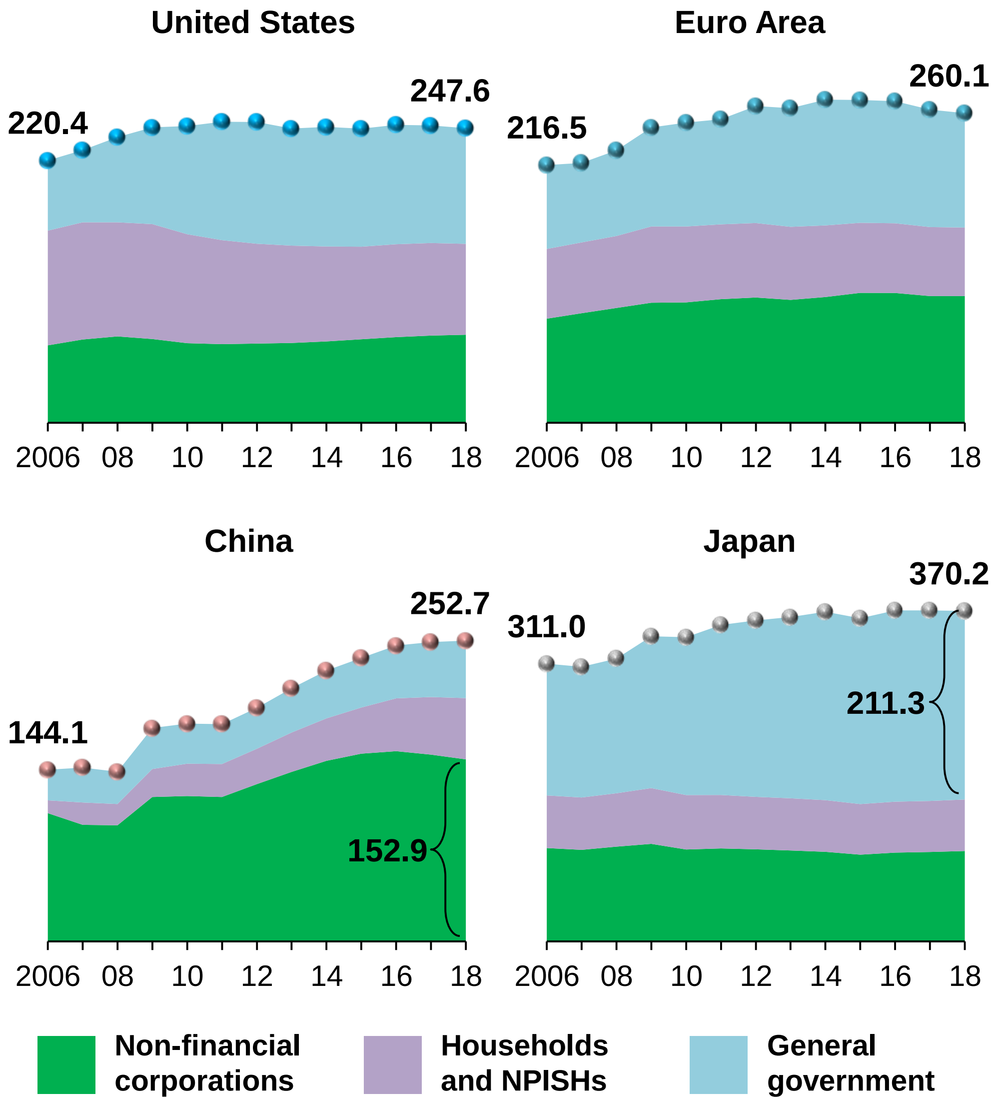
Source: Economic Policy Uncertainty

Global debt stood at 231.2% of world GDP as at end-Sep 2018

As at Sep 2018:



Debt as % of GDP



Source: BIS
Note: 2018 data as at end-Sep 2018

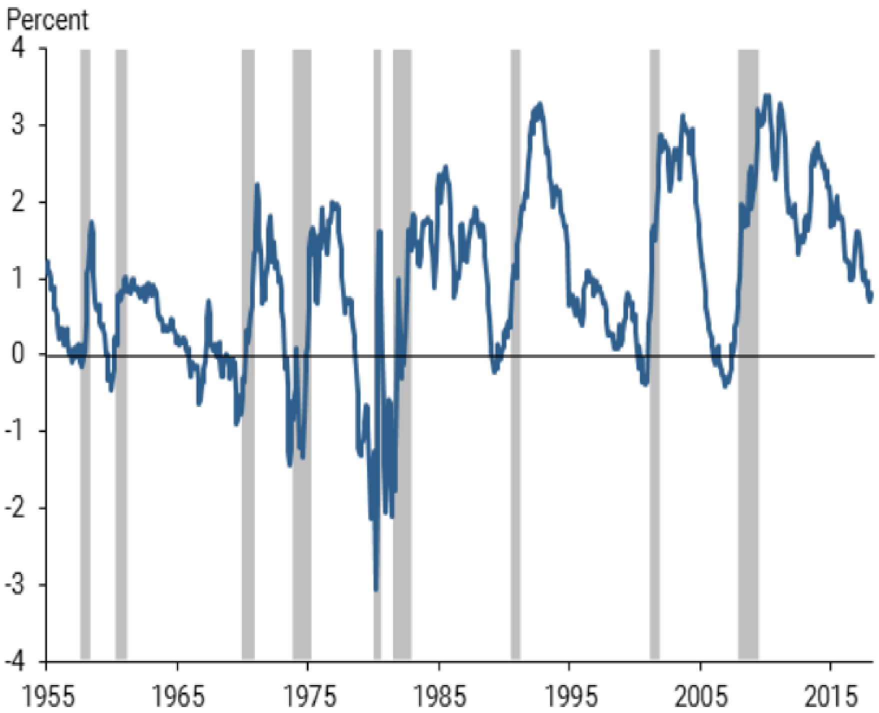
U.S. curve INVERTS for first time since 2007 – A reliable predictor of recession (Has happened ahead each of the past seven recessions)

Source: Bloomberg

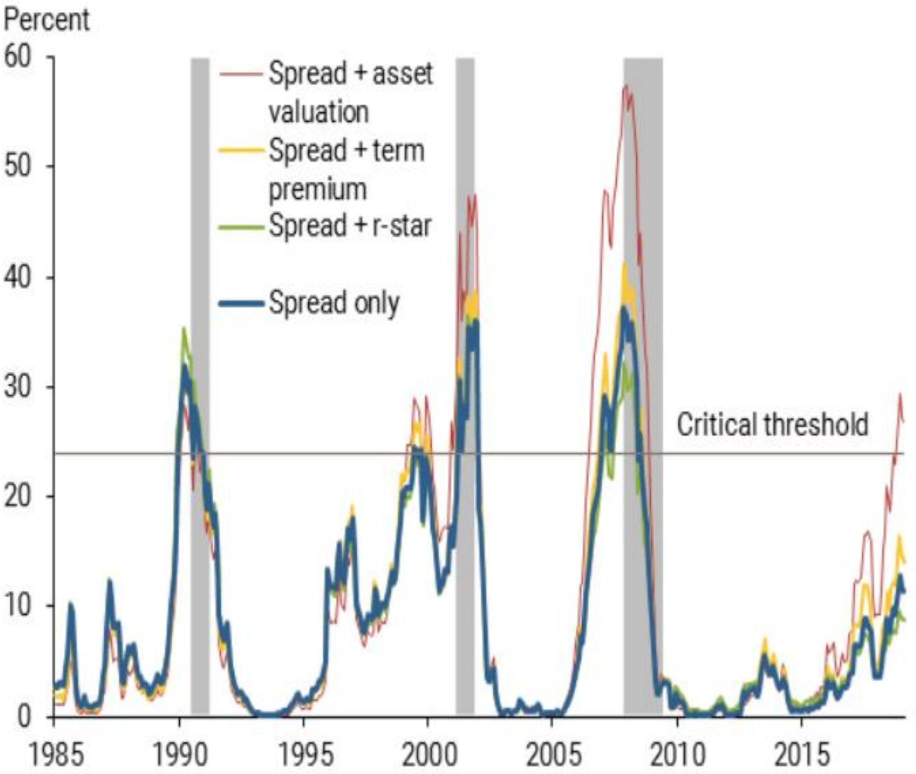
Every **RECESSION** over this period was preceded by an **INVERSION OF THE YIELD CURVE** that is, an episode with a negative term spread.

A simple rule of thumb that **PREDICTS A RECESSION WITHIN TWO YEARS WHEN THE TERM SPREAD IS NEGATIVE** has correctly signalled all **NINE RECESSIONS** since 1955 and had only one false positive in the mid-1960s

The term spread and recessions



Estimated probabilities of recession based om term spread



Source: Federal Reserve Bank of San Francisco.

** Term spread is calculated as the difference between the ten-year and one-year Treasury yields*

Section 4

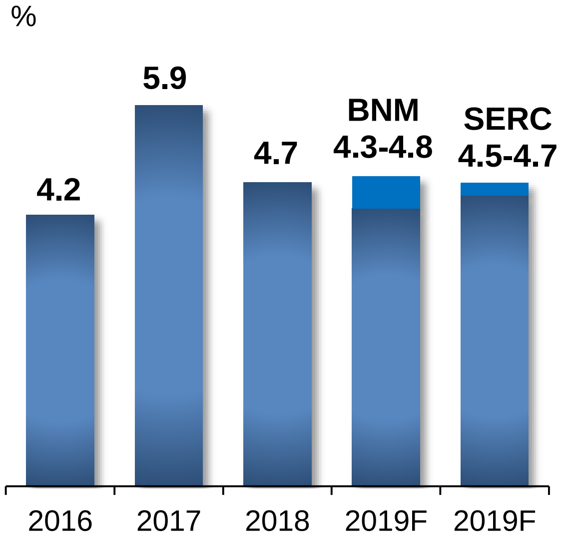
The Malaysian Economy –

Where are we now?

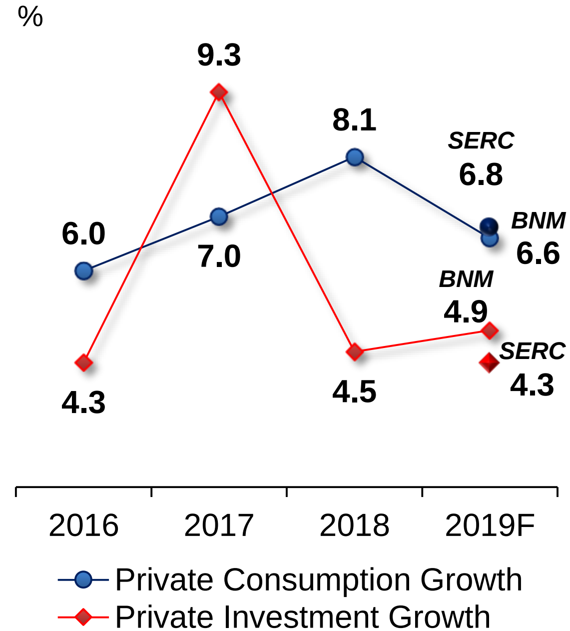
Malaysia's GDP growth is SUSTAINED albeit slower in 2019

- **SERC's GDP growth estimate is between 4.5-4.7%** for this year, keeping a close watch on the state of global economy, the outcome of the US-China trade talks and the strength of domestic demand.
- **Preliminary GDP estimate in 1Q 2019 (4.2%)** vs. 4.7% in 4Q 2018

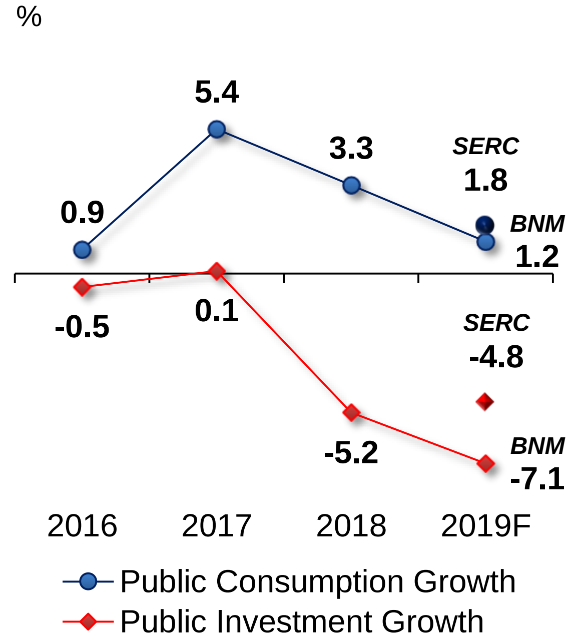
Real GDP growth driven by domestic demand expansion



Private sector remains the growth anchor



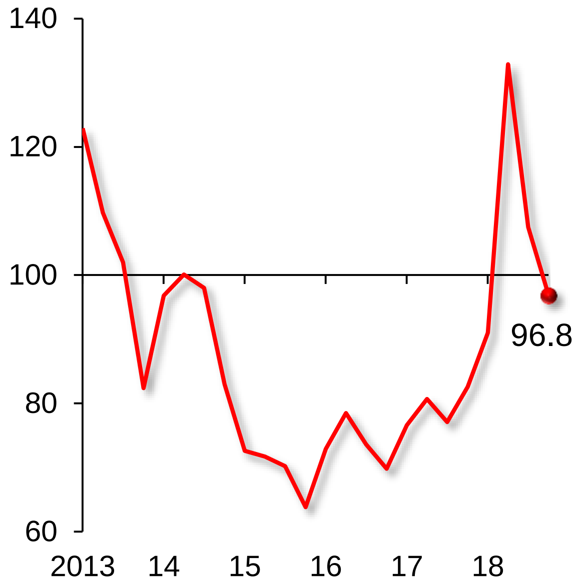
Public sector spending remains a drag



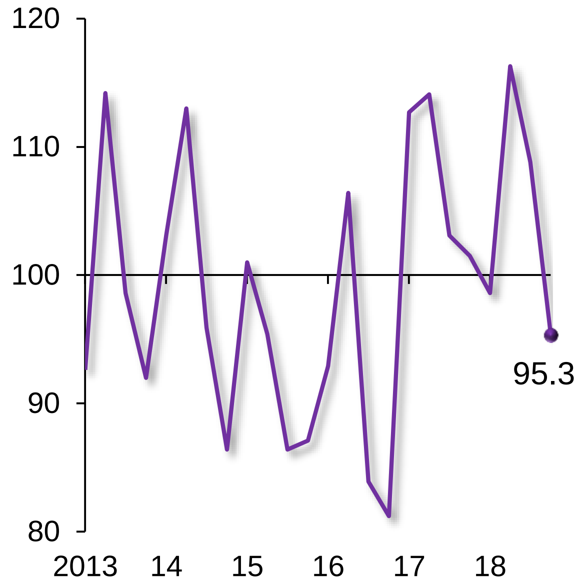
Source: DOSM; BNM; SERC

Weakening CONSUMER SENTIMENT and BUSINESS CONFIDENCE

MIER's Consumer Sentiments Index (CSI)

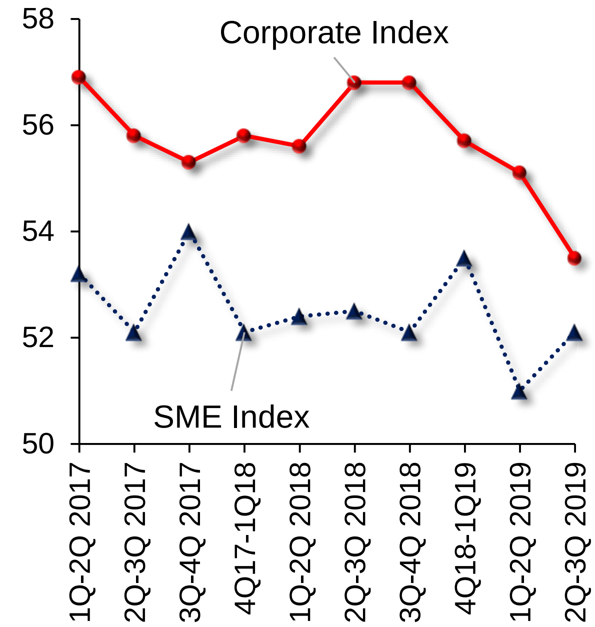


MIER's Business Conditions Index (BCI)



RAM Business Confidence Index

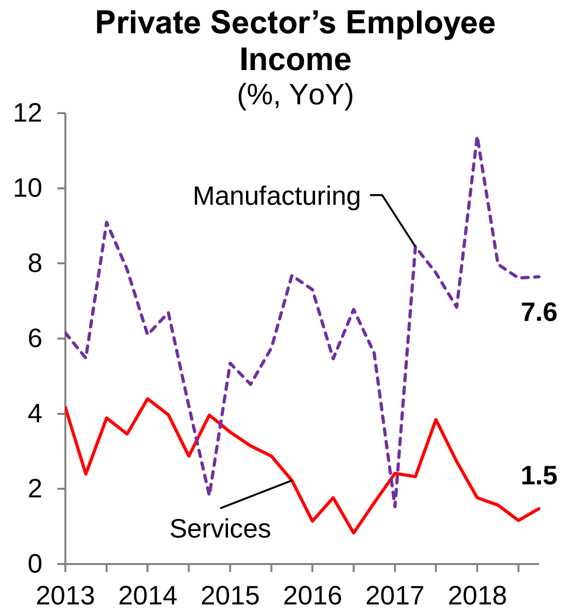
50 = Neutral benchmark

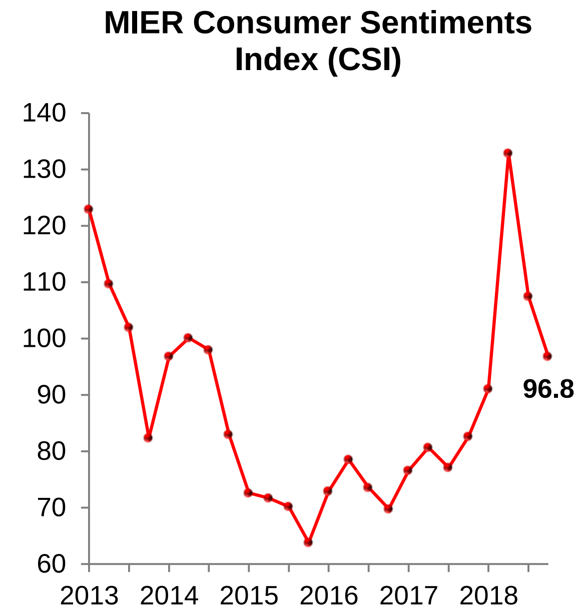


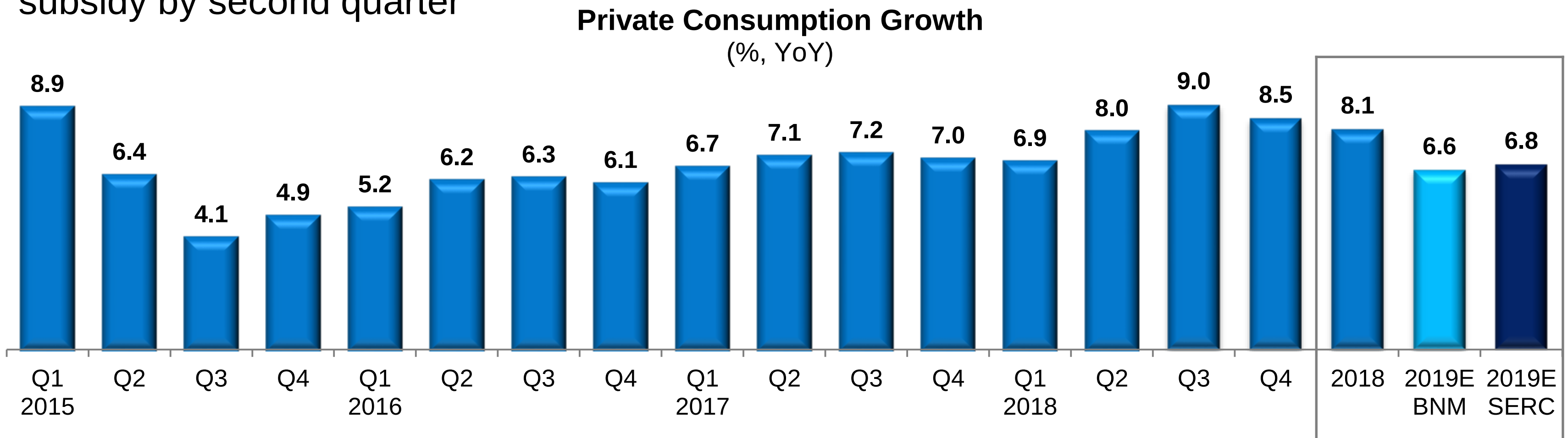
Source: MIER; RAM

CONSUMER SPENDING to slow but still firm

- **FUNDAMENTAL DRIVERS**: Income growth and healthy labour market conditions
- Household spending **NORMALIZED** post 3-month zerorised GST tax holiday (Jun-Aug 2018) and the reintroduction of **SST** in Sep 2018
- Potential **DAMPENING FACTORS**: Review of fuel subsidy by second quarter





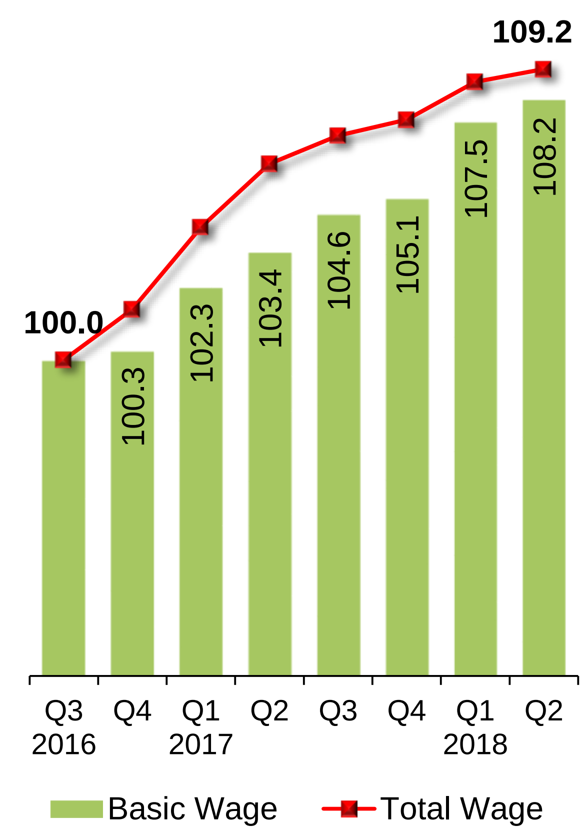


Source: DOSM; MIER

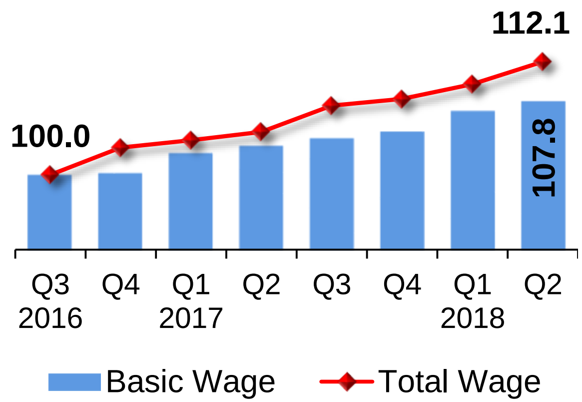
Wages in MANUFACTURING & SERVICES sector increased, albeit less uniformly

- W.e.f. Jan 2019, minimum wage increased by 10.0% and 19.6% to RM1,100 per month from RM1,000 in Peninsular Malaysia and RM920 in East Malaysia respectively.

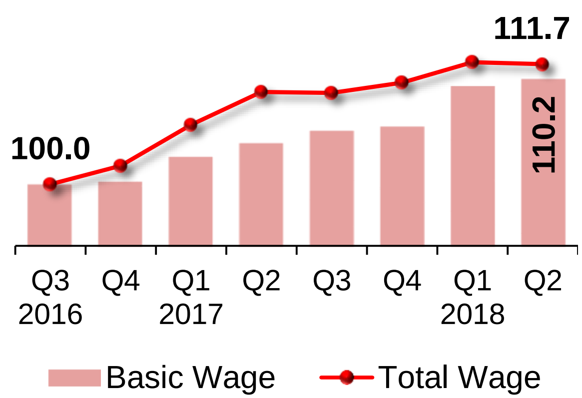
National Wage Index
(3Q16=100)



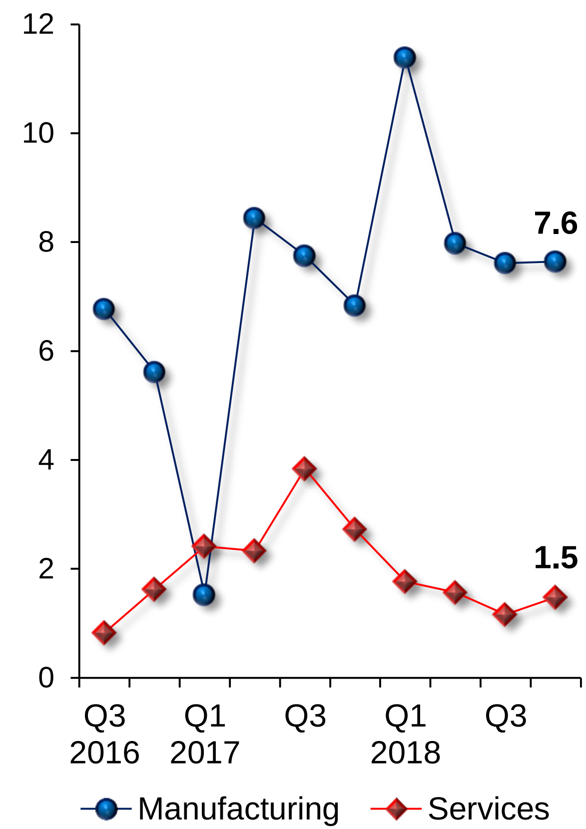
Manufacturing



Services



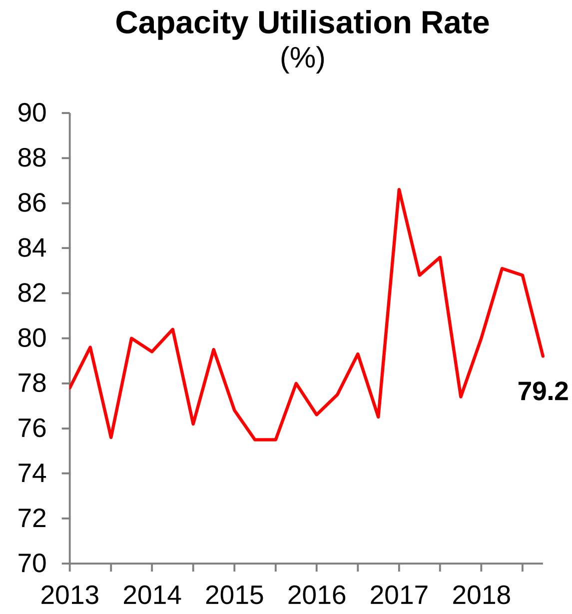
Average wage growth per employee

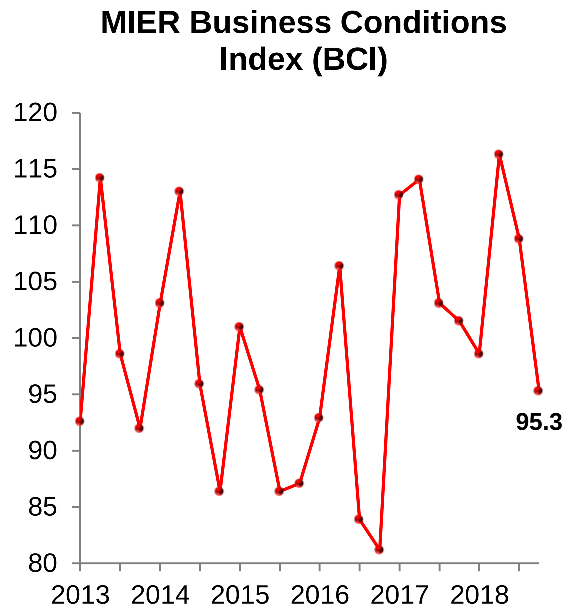


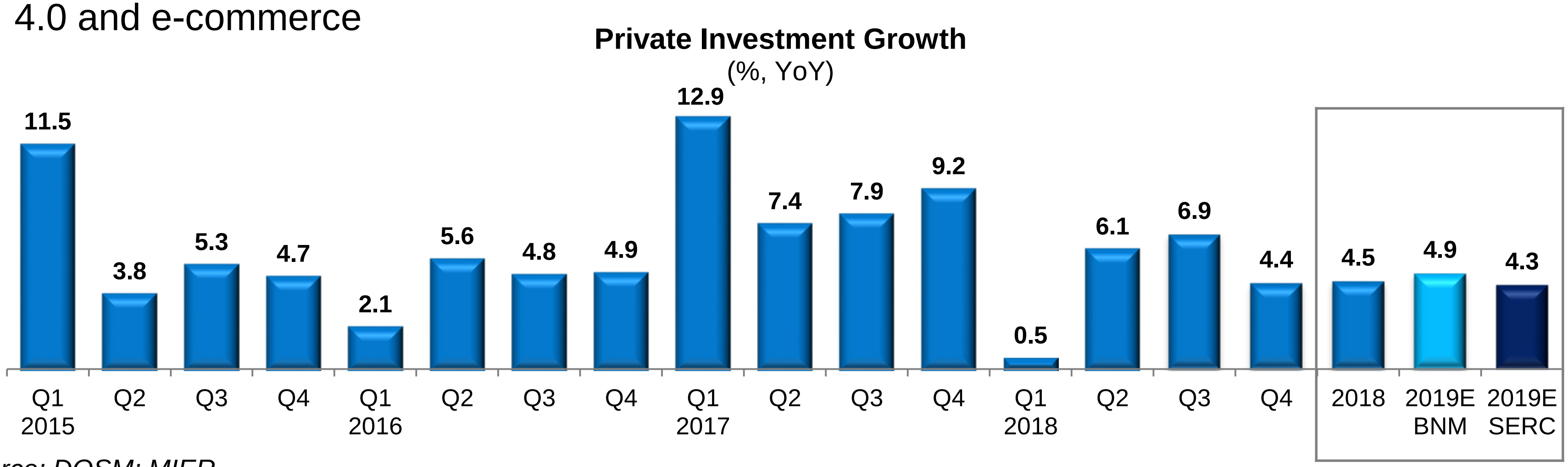
Source: ILMIA; DOSM

Private investment remains CAUTIOUS

- Private investment growth SLOWED to 4.5% in 2018 from 9.3% in 2017 (10.5% pa in 2011-17)
- **CAUTIOUS** about external environment; new government's policy implications
- 2019 Budget to **BOOST** private investment in tourism, manufacturing, IR 4.0 and e-commerce



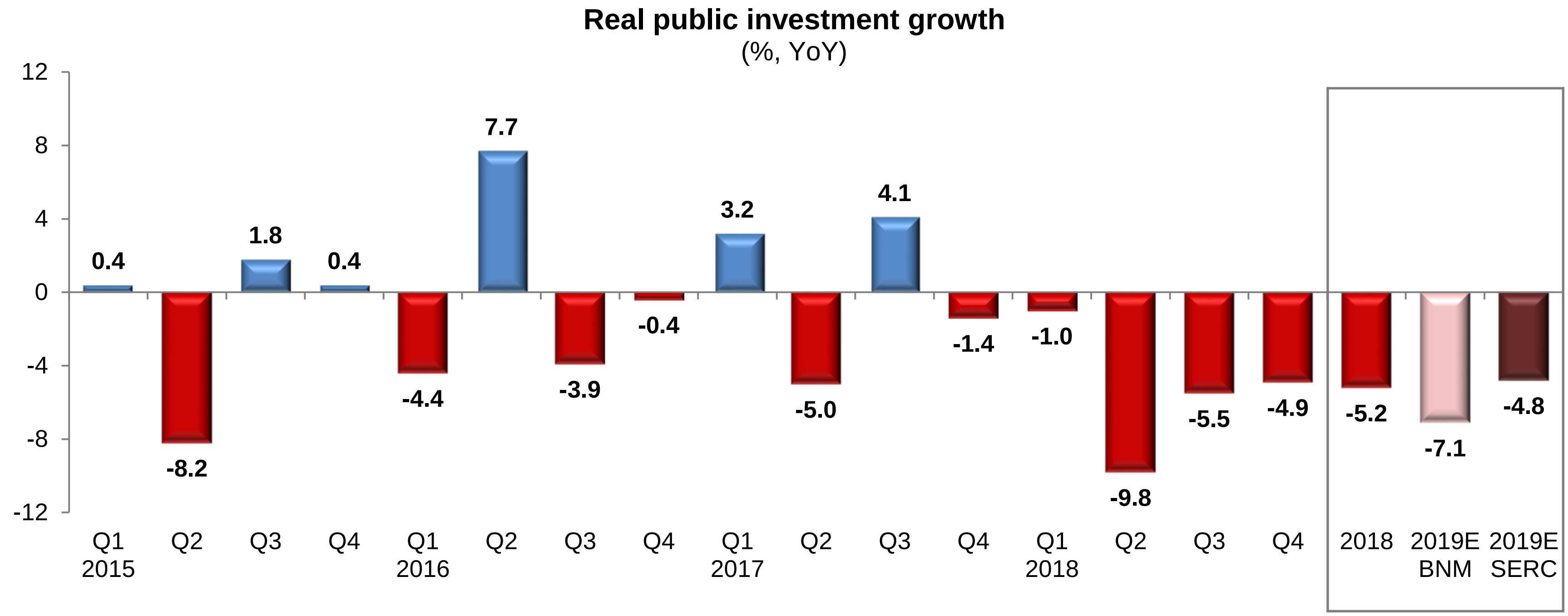




Source: DOSM; MIER

Public investment remains a DRAG ahead

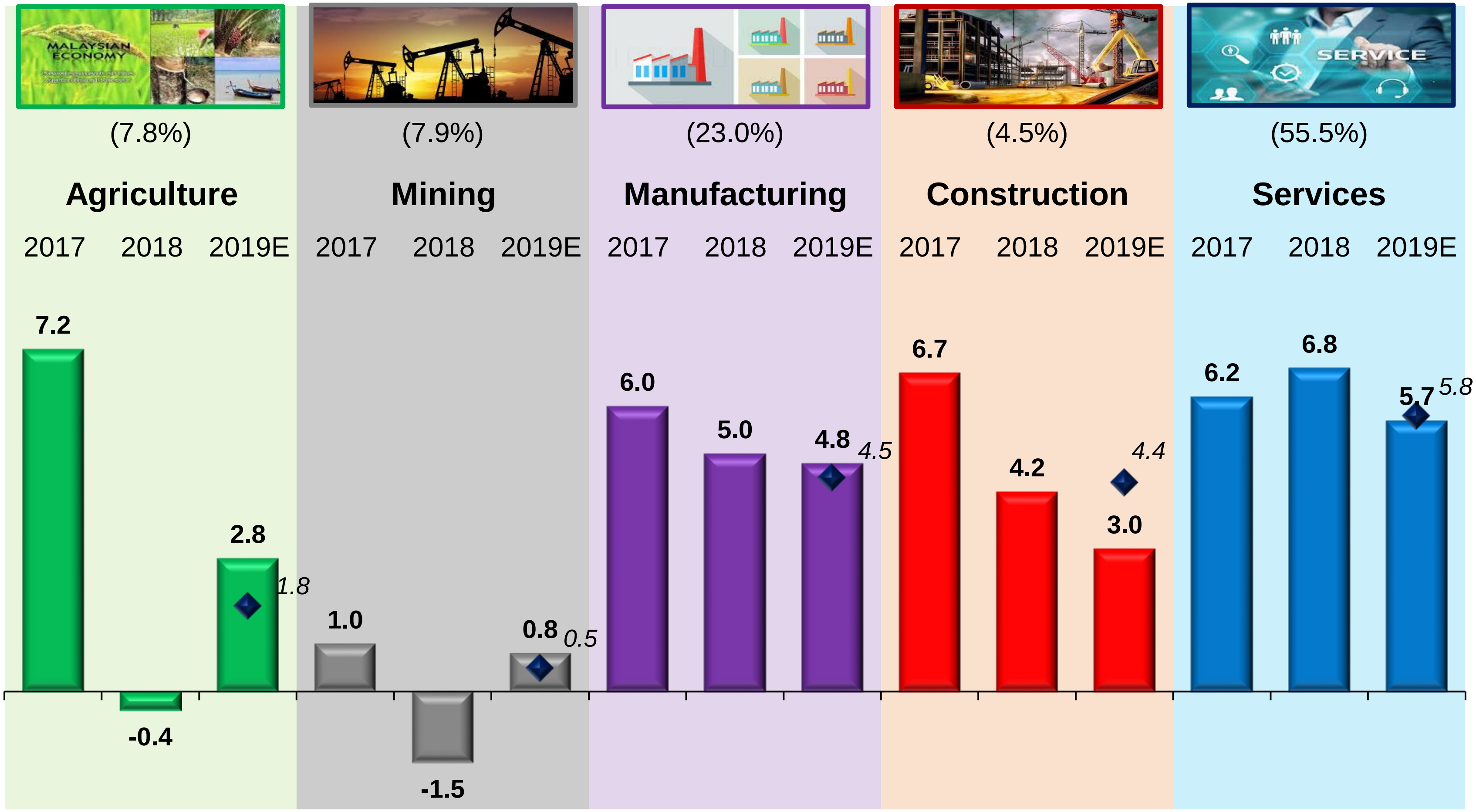
- **PUBLIC INVESTMENT GROWH CONTRACTED** for five straight quarters and expected to contract further in 2019
- Rationalisation of development expenditure means moderate public investment growth



Source: DOSM

A BROAD-BASED EXPANSION is expected in 2019

Sectoral performance (%)

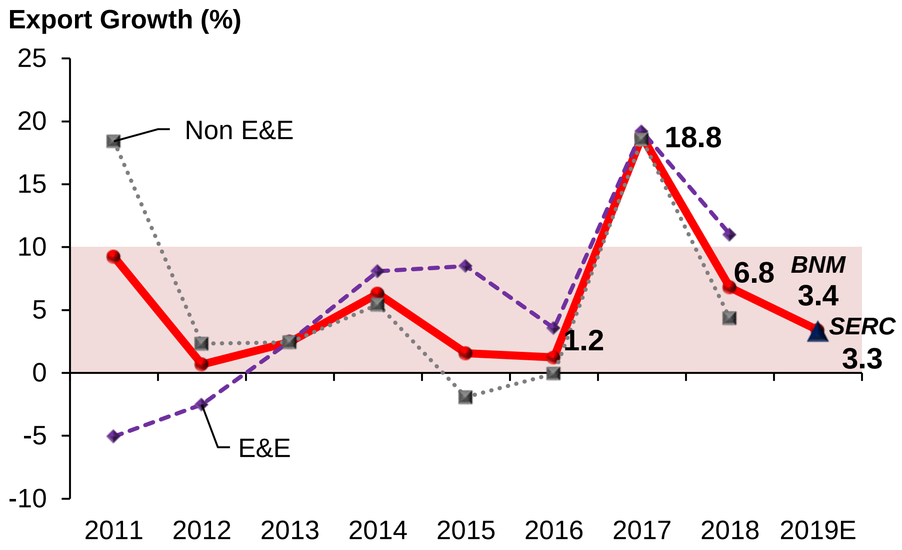


Note: Figure in parenthesis denotes share of GDP in 2018; Figure in italic style with marker denotes SERC's estimates for 2019

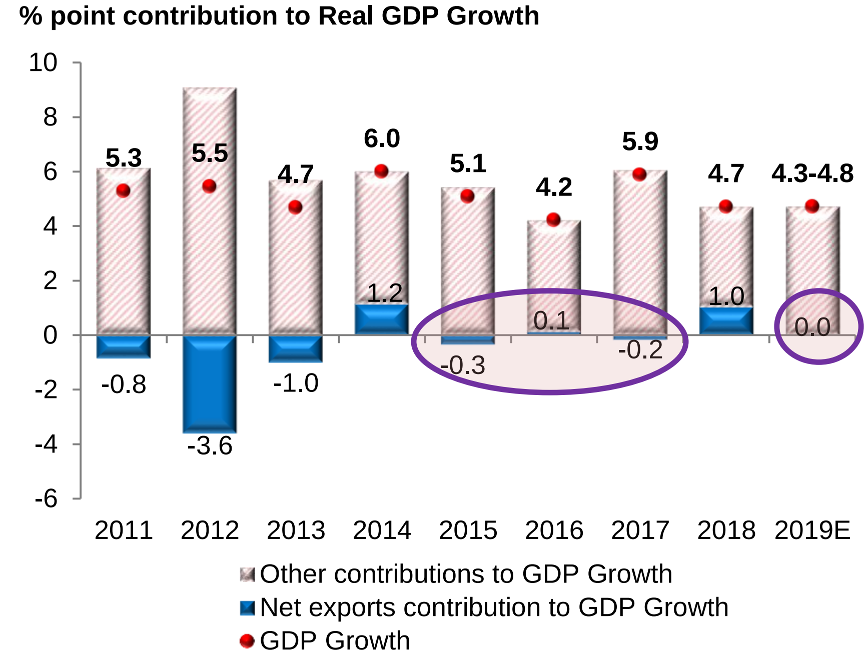
Source: DOSM; BNM; SERC

Muted contributions from the EXTERNAL SECTOR

Except for 18.8% in 2017, exports have been trapped in low growth trajectory

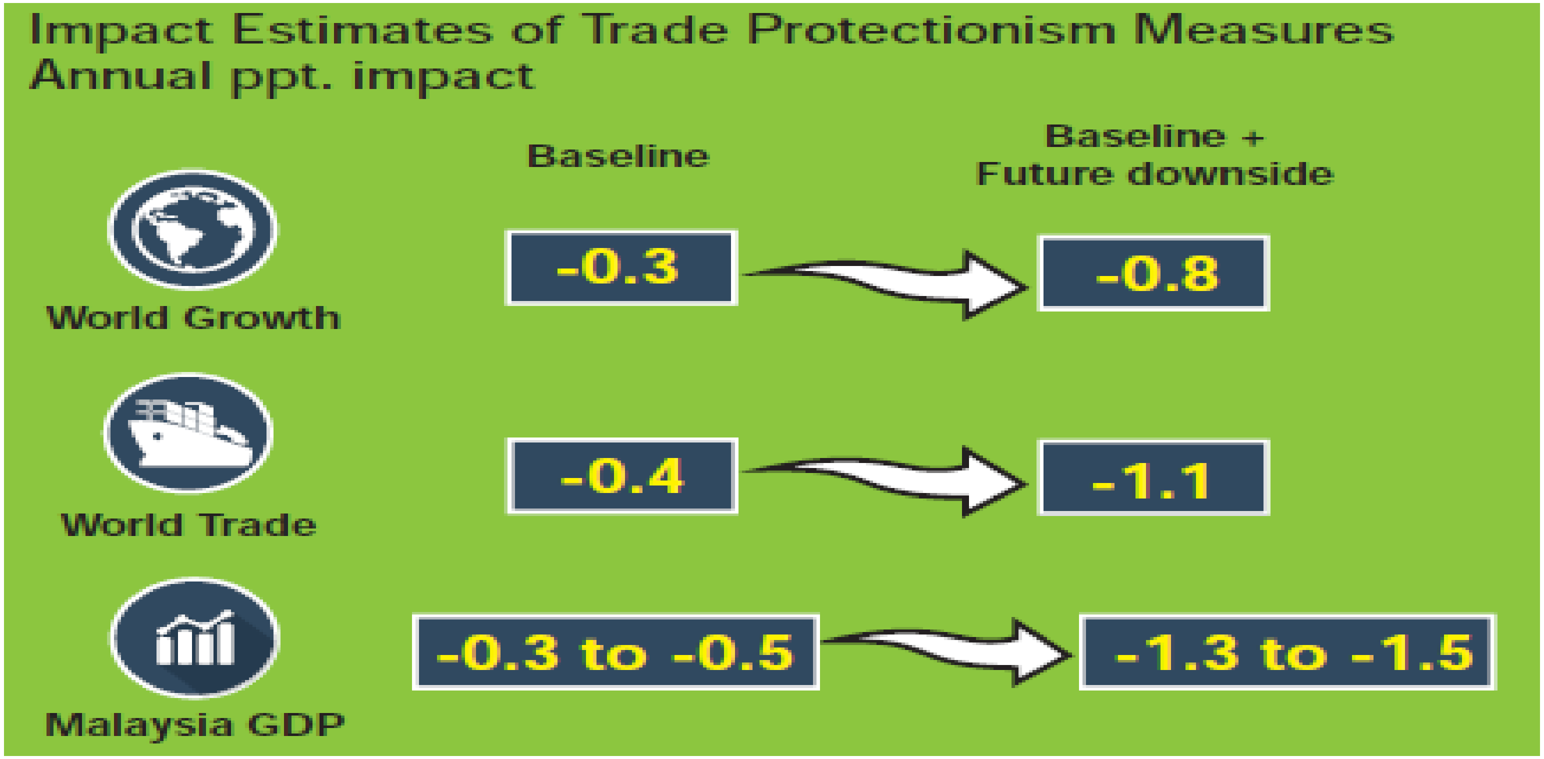


Net external sector generally been a drag on GDP growth



Source: DOSM; BNM; SERC

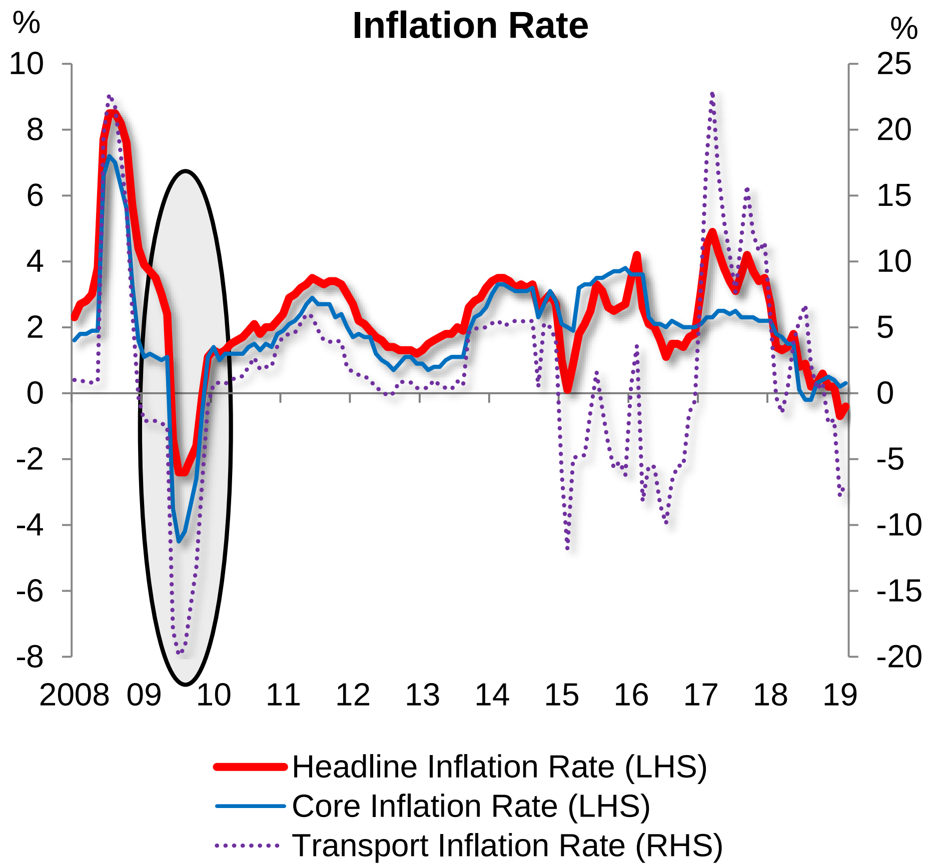
Further ESCALATION in trade tensions to have significant impact on GDP



- Overall, the impact of bilateral trade tensions on Malaysia's export performance is largely dependent on the **substitutability of the affected products**, **manufacturing capacity constraints** and Malaysian **firms' value proposition**.

Source: BNM

"Technical" base-induced DEFLATION is transitory



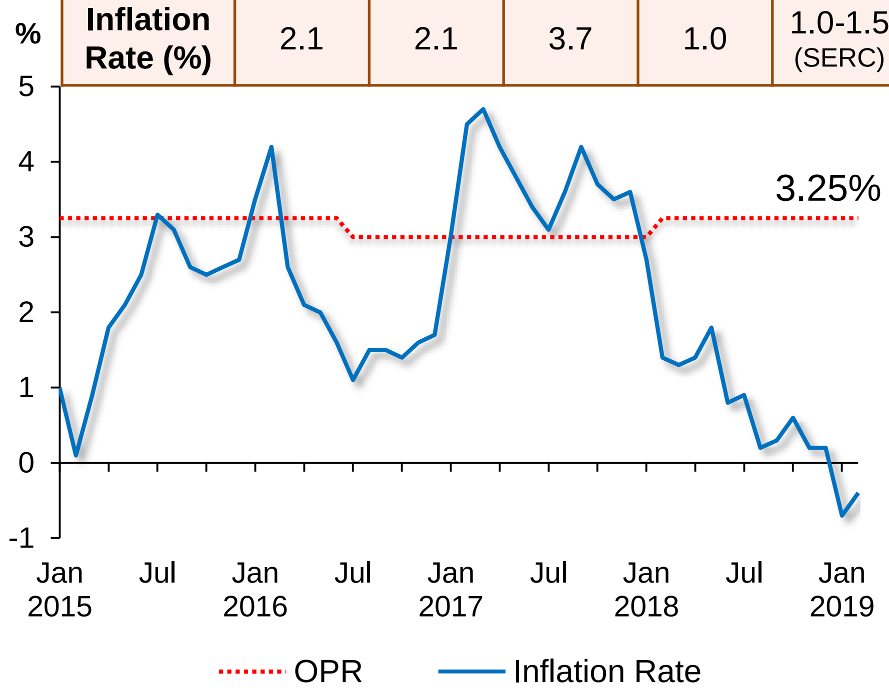
- BNM expects **HEADLINE INFLATION** to **average between 0.7-1.7% in 2019 (SERC: 1.0-1.5%)** (1.0% in 2018) due to some cost pass-through from domestic cost factors.
- **DOMESTIC COST FACTORS**: the lapse in consumption tax policy (the ending of 3-month zerorised GST tax holidays and reintroduction of SST); increase in minimum wage and higher electricity surcharges for businesses; potential increase in food prices. However, global oil prices remain a wild card.
- **First deflation** (-0.7% yoy in Jan 2019 and -0.4% in Feb 2019) since end-2009. It is merely a technical deflation due to the decline in fuel prices and the replacement of GST with SST.

Source: BNM; DOSM
Note: Core inflation in 2008-2014 excludes food and non-alcoholic beverages only.

MONETARY SPACE has some room; FISCAL LEVER is limited

Inflation will rise moderately in 2019

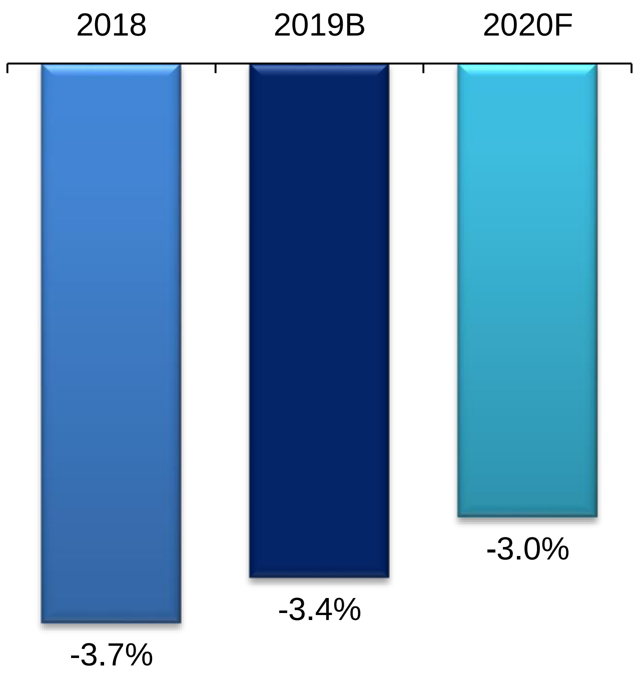
Year	2015	2016	2017	2018	2019E
OPR (%)*	3.25	3.00	3.00	3.25	3.00
Inflation Rate (%)	2.1	2.1	3.7	1.0	1.0-1.5 (SERC)



* OPR as at end-year

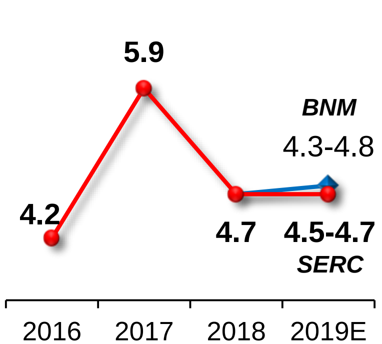
Source: DOSM; BNM; SERC

Reset fiscal deficit path (2018-2020F)

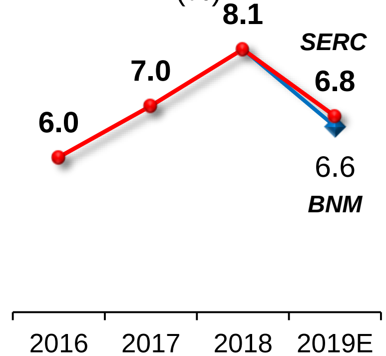


Malaysia's key ECONOMIC INDICATORS

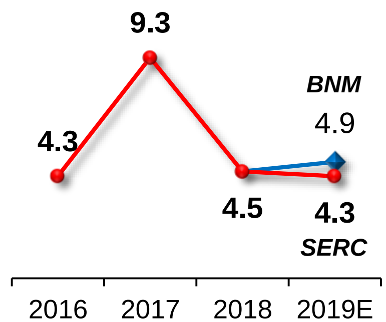
Real GDP Growth
(%)



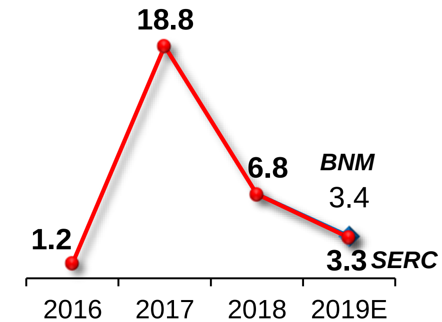
Private Consumption Growth
(%)



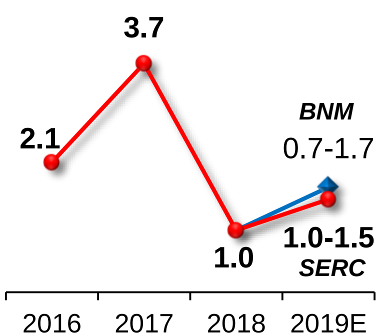
Private Investment Growth
(%)



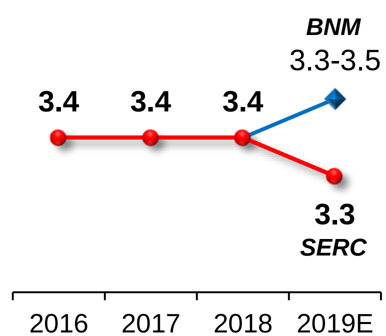
Gross Export Growth
(%)



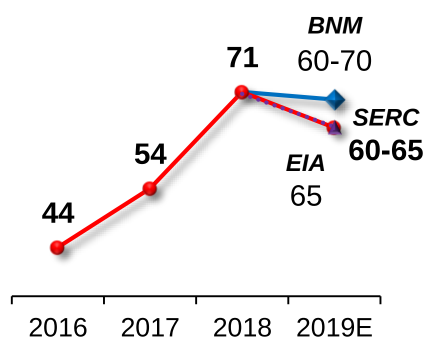
Inflation Rate
(%)



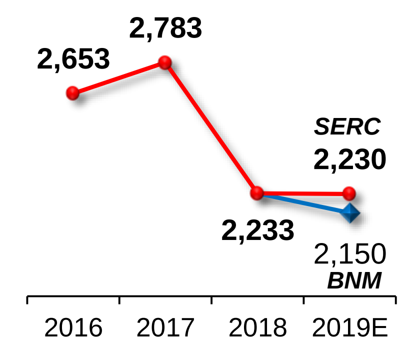
Unemployment Rate
(%)



Brent Crude Oil Prices
(US$/barrel)



Crude Palm Oil Prices
(RM/metric tonne)

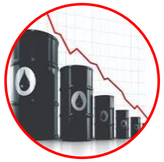


Source: DOSM; EIA; MPOB; BNM; SERC

DOWNSIDE RISKS to 2019's economic growth projection

UNRESOLVED TRADE TENSIONS between the US and China and a slower-than-expected global growth will affect Malaysia via the trade and investment channel

The **UNCERTAIN PACE OF THE MONETARY POLICY NORMALISATION IN THE US** could heighten financial market volatility across emerging market economies, leading to volatile two-way capital flows and currency fluctuations



VOLATILITY IN THE GLOBAL OIL PRICE could also affect export performance and mining sector investment

On the domestic front, a **RE-OCCURRENCE OF THE COMMODITY SUPPLY DISRUPTION**, partly from unanticipated weather patterns, could affect the recovery in the mining and agriculture sectors

OVERSUPPLY SITUATION in the PROPERTY MARKET could dampen activity in the construction sector

Section 5

What can the government do to power economic growth?

Structural reforms as cure

Key ISSUES and CHALLENGES facing Malaysia

1. **SLOWING PRODUCTIVITY GROWTH & IMPEDIMENTS**: Technology adoption, industrial structure, talent and skills gap, over-dependence on low-skilled foreign workers (Semi- and low-skilled workers: 72.5% of total employment in 2017; foreign workers: 15.5%)
2. **BURDENSOME REGULATORY** and **COMPLIANCE COSTS**: Inconsistent interpretation and application of regulations, the complex and lengthy licensing application processes have resulted in high costs and delays
3. **QUALITY INVESTMENT**: Lower investment of ICT equipment (from 26.0% in 2010 to 22.2% in 2017). Many industries are still in the low-end to mid-range of the value chain as well as lower innovative capacity
4. **VALUE ADDED SECTORAL OUTPUT**: (a) **Services sector** – dominated by traditional services subsectors while technology-driven modern services subsectors have stagnated; (b) **Manufacturing sector** – premature deindustrialization; high value added; and (c) **Agriculture sector** – less on agro-based industries; leverage on technology
5. **LIMITED FISCAL SPACE**: Federal revenue has not kept pace with the economic growth and meet high committed expenditure. Tax buoyancy dropped from 2.2 in 2011 to 0.5 in 2017
6. **HIGH RATES OF YOUTH & GRADUATES UNEMPLOYMENT** (unemployment rate of 10.8% in 2017) due to labour market mismatches, limited job creation and inadequate supply of industry-ready graduates

A multifaceted approach to ADVANCING future economic growth trajectory

1. **DISCARD THE “BUSINESS AS USUAL” MINDSET**. A new mindset and attitude as well as behavioral changes
2. **INVESTMENT POLICIES AND FRAMEWORK CONDITIONS** must be right and conducive. **EQUAL OPPORTUNITIES FOR ALL** and based on the smart Public-Private partnership
3. Process of **CREATIVE DESTRUCTION** to optimize resources and sharing of growth and economic dividends
4. **DOMESTIC DIRECT INVESTMENT (DDI) initiatives** must be strongly promoted and facilitated along with foreign direct investment (FDI)
5. **DOMESTIC SMEs** must be competitive (cost, quality and delivery) and connected to global supply chains
6. The **GOVERNMENT’S BUSINESS IS NOT IN BUSINESS. GLCS MUST BE OPENED TO A LEVEL PLAYING FIELD** to compete with the private sector
7. **COMPENSATION OF EMPLOYEES (CE**) have to be improved if it is matched by the rise in productivity gains and commensurate with the skills set. Malaysia’s **CE to GDP ratio** increased from 33.9% in 2013 to **35.2% in 2017** was lower than Australia (47.3%), South Korea (44.4%) and Singapore (42.4%). The **target is to raise it to 38% by 2020**.

STRUCTURAL REFORMS to uplift growth potential

STRUCTURAL REFORMS are necessary to restore **ECONOMIC DYNAMISM**, ensure **SUSTAINABLE** and sustain **COMPETITIVE** growth in the long term

BIG-BANG versus **GRADUALISM** comes with adjustment costs

Fiscal Reform

Labour Market and Wage Reform

Market and Investment Liberalisation

GLCs Reform

Social Safety Net

STRONG POLITICAL WILL
AVOIDING DISRUPTIVE BIG-BANG CHANGES

Fiscal and Debt Reconstruction

- **Sustainable** revenue base (tax less on employment and business income; more on consumption)
- Plugging **tax leakages**; shadow economy (2017: 22.9% of GDP (RM298 billion); tax gap is about 20% vs 10-15% in developed economies
- **Tax reform** (Fair, Effective and Simpler)
- **Expenditure rationalization** (targeted subsidy; pension reform)
- Active **debt** and **responsible budget management** (Zero-based budgeting; accrual accounting)

Labour Market and Wage Reform

- Boosting productivity through **reskilling and training**
- **Performance-driven** wage system; labour flexibility
- **Technical and Vocational Education Training** (TVET)
- Spurring **innovation**; ecosystem for **creation**
- **Phase reduction of reliance** on foreign workers
- **Living wage** and linked with productivity

Market and Investment Liberalisation

- **Equal and inclusive** opportunities for **ALL**
- **'Schumpeterian creative destruction'**
- Targeted programs for **SMEs**
- Review **current incentives** (time bound)

GLCs Reform

- **Leaner,** responsive and less intrusive
- **Functions to be systematically** reviewed
- **Transparency**, better **governance & accountability**
- Subjected to **Parliamentary oversight**
- **Optimization of resources** and mandates for real competition

Social Safety Net

- Targeted **most vulnerable and needy households**
- **Conditionally social assistance system** – income enhancement, employability and empowerment; **Exit program** to wean off from subsidy mentality
- **Pension** and **healthcare** reform (ageing population)

社会经济研究中心

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谢 谢
THANK YOU

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