社会经济研究中心

SOCIO-ECONOMIC RESEARCH CENTRE

SERC

Malaysian Timber Conference

How's the Global Economy Shaping Up ?

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Executive Director
25 July 2019

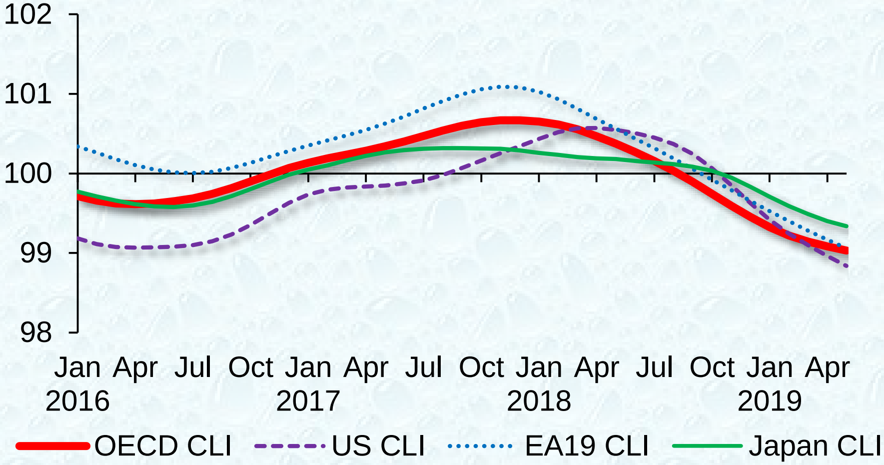
Section 1

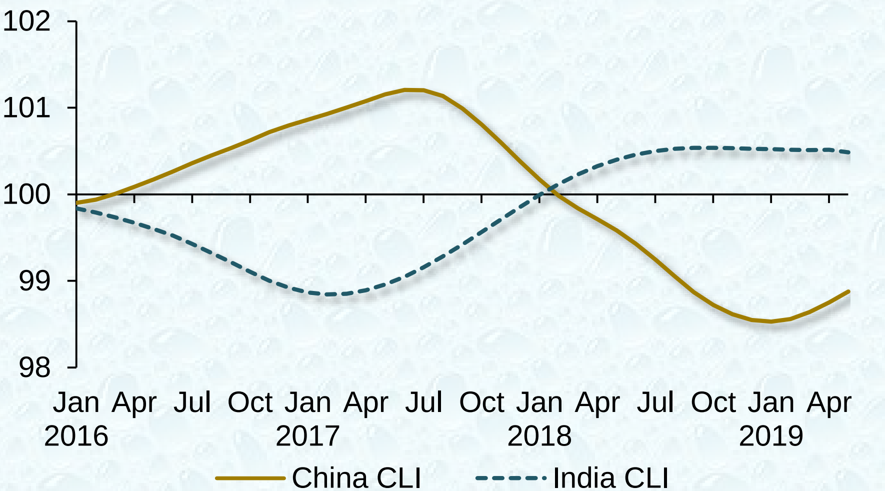
The World Economy

A synchronized slowdown

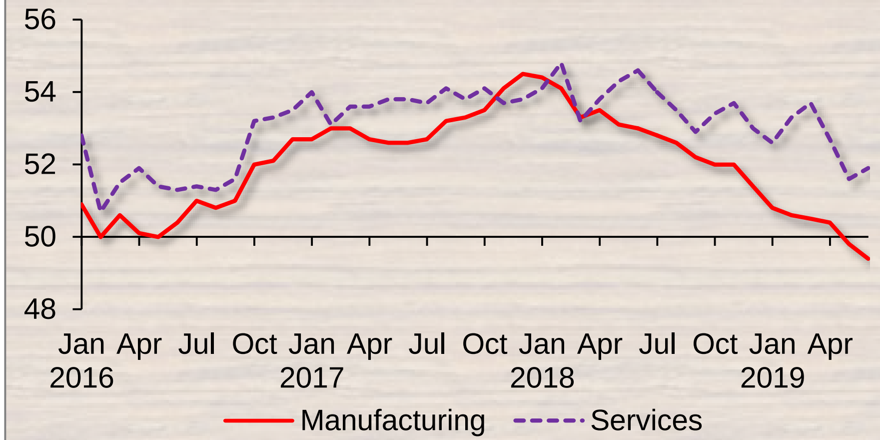
High frequency data pointing to slower global growth

Composite Leading Index (CLI)
A gauge of economic outlook
(Long-term average = 100)

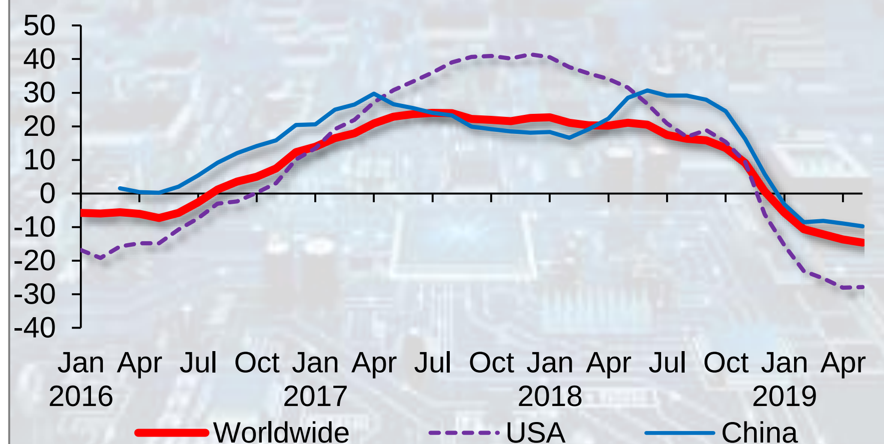




Global PMI for manufacturing and services
(50 = no change on prior month)



Global semiconductor sales
(%, 3-month moving average YoY)



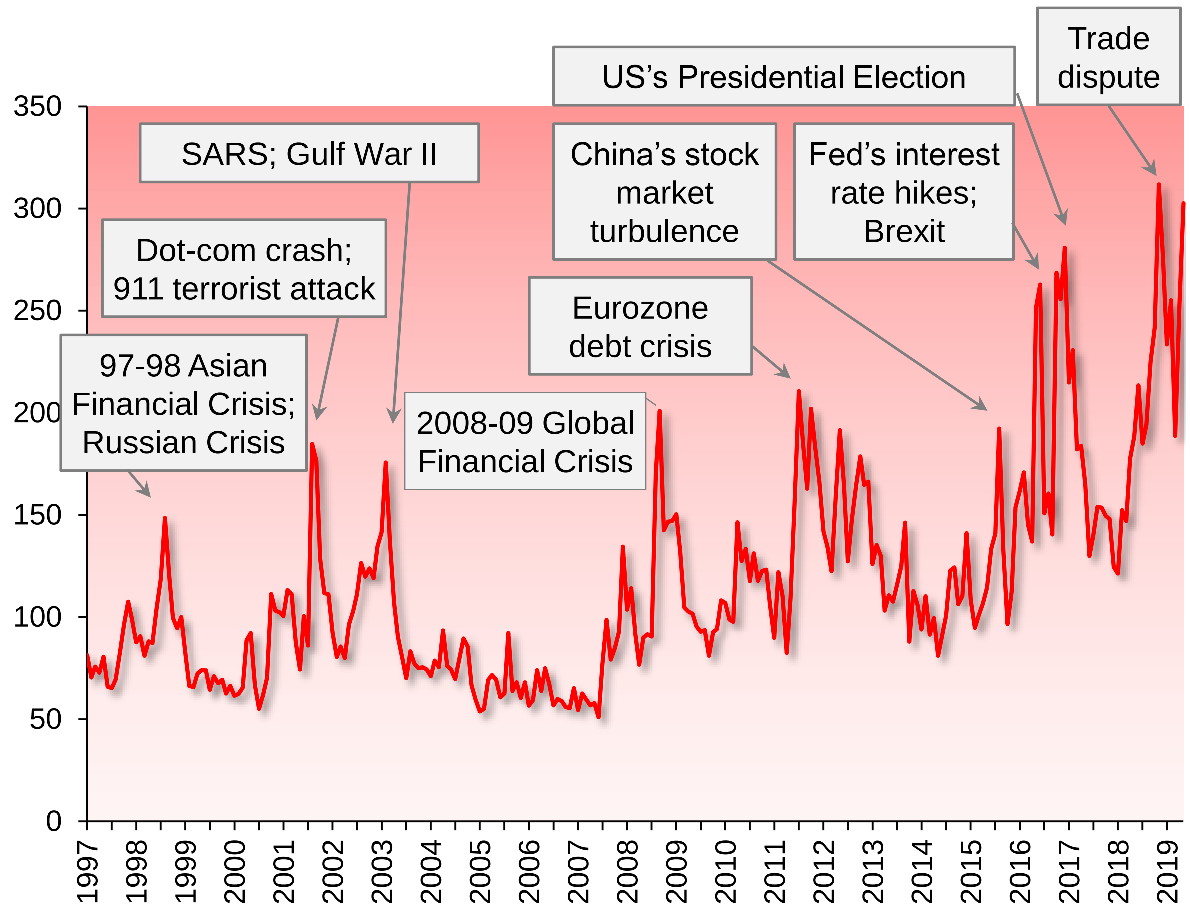
Source: OECD; Markit; SIA

Heightened uncertainties weighing on global growth

Uncertainties in the global economy have soared to their highest level in Nov 2018 and remained above the long-term average.

- Lingering concerns and uncertainty about the **trade tensions**
- Uncertainty about the **Fed's plan on rate movements**
- 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

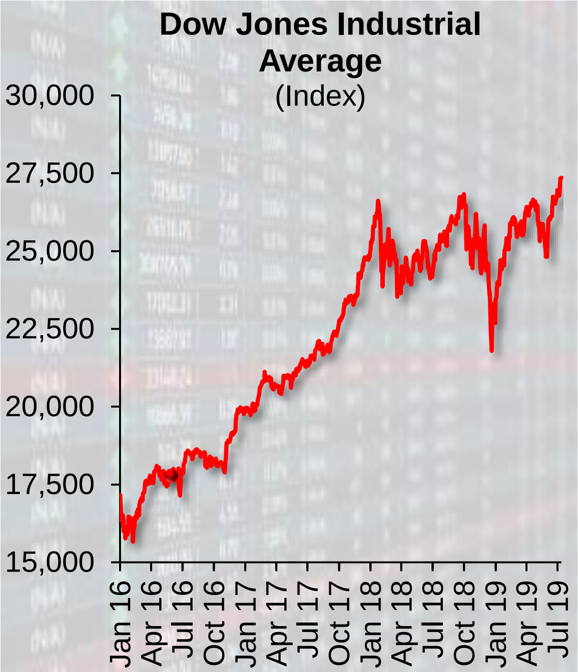
Monthly Global Economic Policy Uncertainty Index



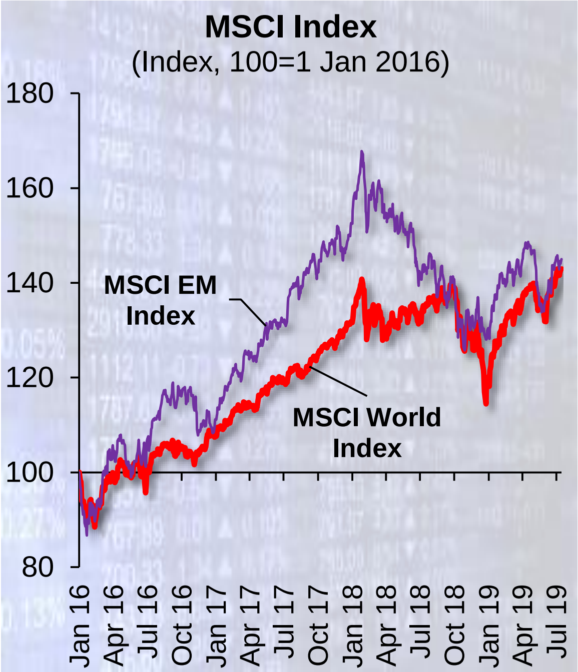
Source: Economic Policy Uncertainty

High financial market volatility

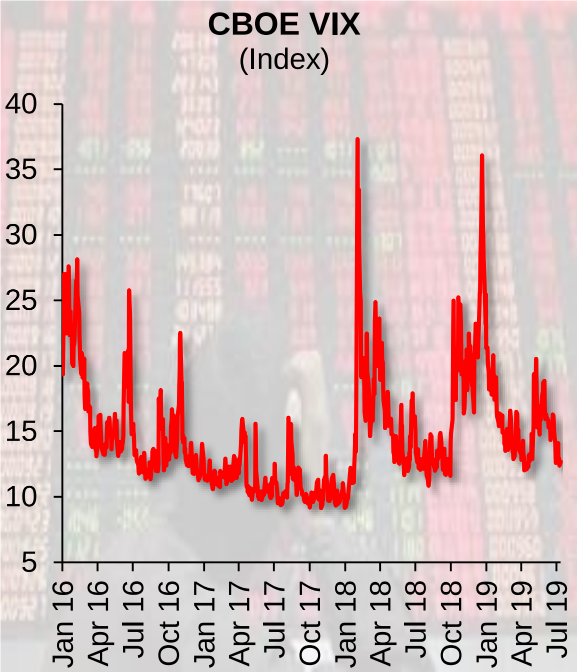
DJIA recharges new high again



Emerging markets' equities are more volatile to economic newsflow



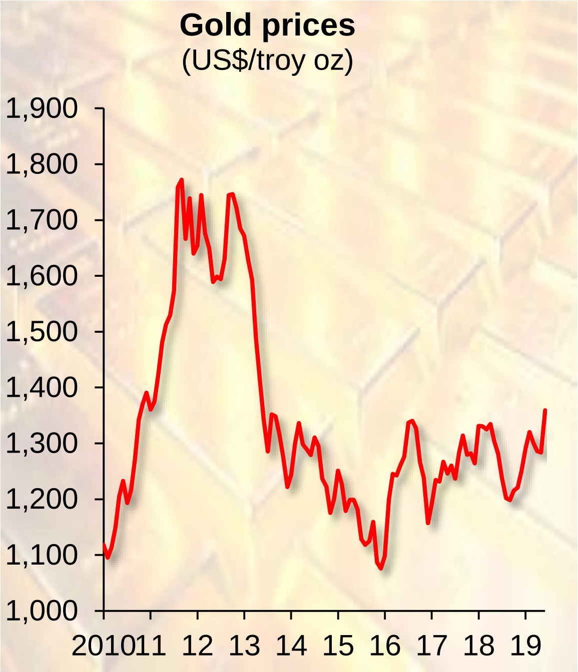
A spike of above 20-pts in 'Fear index' in May



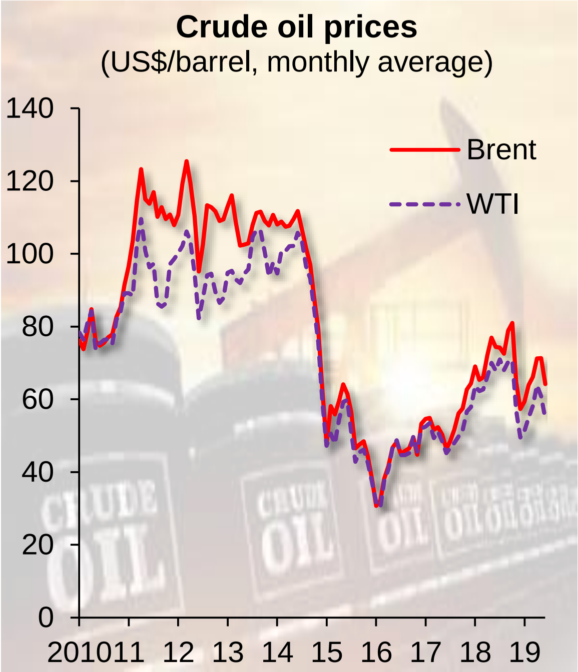
Source: WSJ; MSCI; CBOE

Gold as a safe haven; Volatile commodity prices

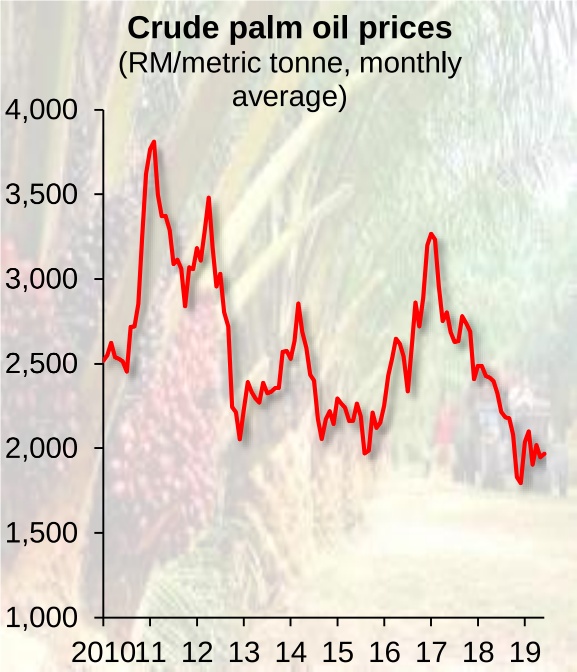
Gold prices are supported by strong demand and falling long-term real interest rate



Volatile crude oil prices: Supply cut continues; the US-Iran tensions; Hurricane Barry



CPO prices remain sluggish albeit reducing inventory

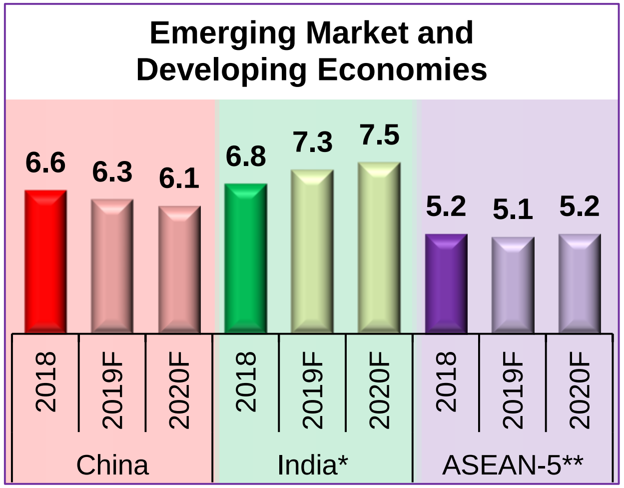


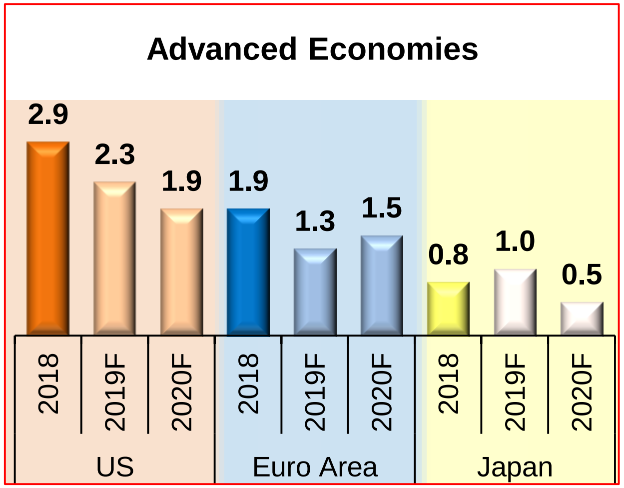
Source: World Bank; EIA; MPOB

A deepening trade war can slash global growth in 2020

The IMF has warned that the worsening trade tensions **could lower 2020's global growth estimates by 0.5%** from 3.6% (2019 estimate: 3.3%).

Real GDP Growth (%)





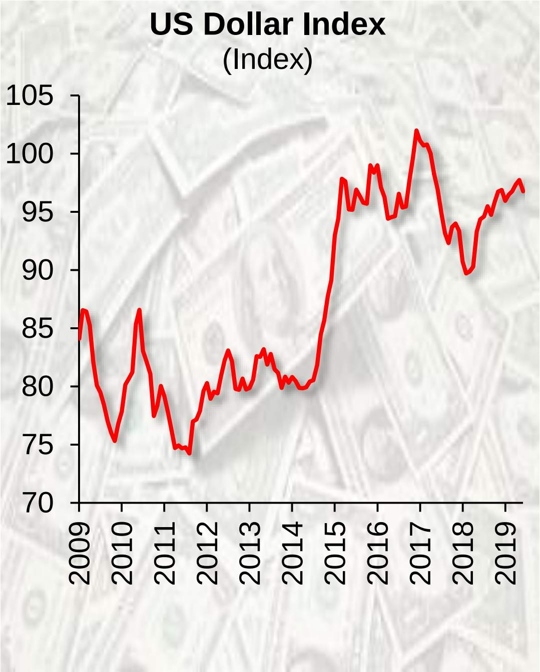
Source: Officials; IMF (WEO, April 2019)

* *Annual GDP for India is on fiscal year basis*

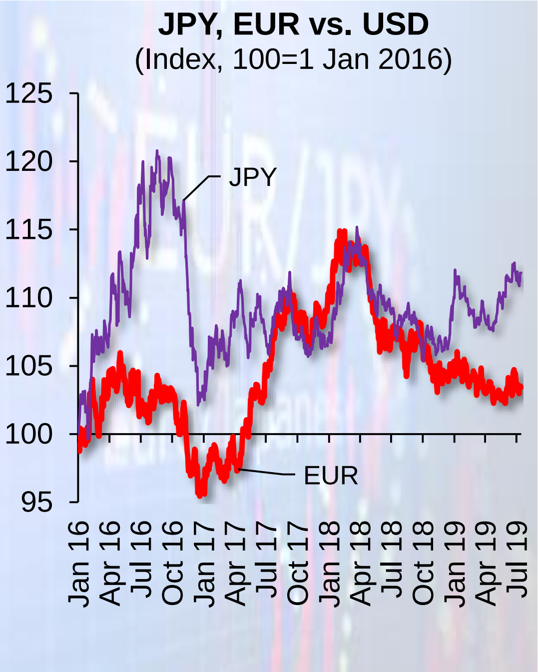
** *ASEAN-5: Malaysia, Indonesia, Philippines, Thailand, Vietnam*

Foreign exchange market – relieve pressure for regional currencies

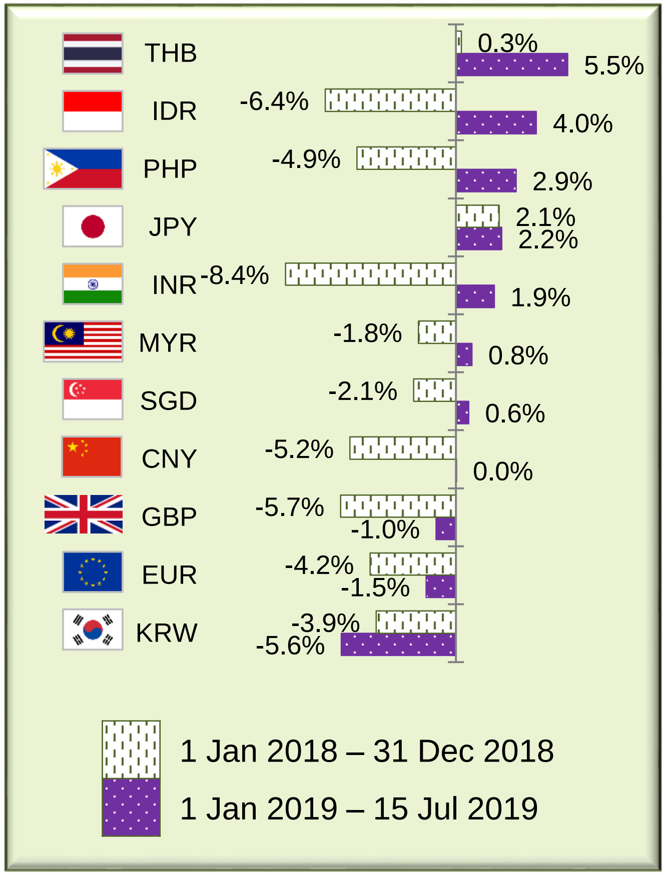
The US dollar index trend



Japanese yen, euro vs. the US dollar



Major and emerging market currencies against the USD



Source: WSJ; BNM (cross rate)

Why it takes time to cool down the US-China trade frictions?

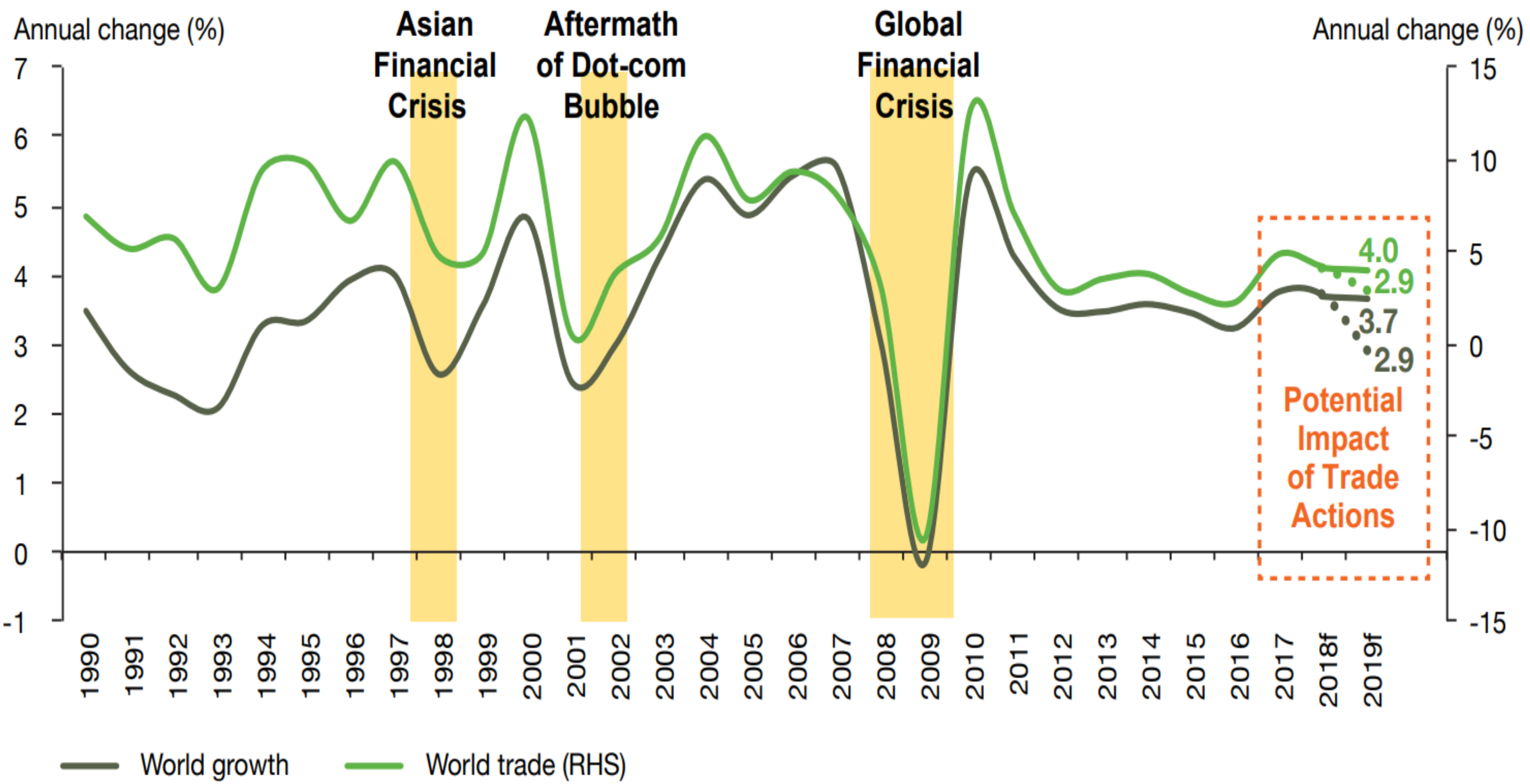
NO AGREEMENT ON FUNDAMENTAL ISSUES

- *Pressing on China to **come clean and show more transparency on heavy subsidization** of targeted state-owned enterprises, companies and industries;*
- *Take more **effective measures to strengthen protection of intellectual property rights** (IPRs) in legislation, the justice system and law enforcement;*
- *Strengthen the **weak copyright enforcement**. The US companies are forced to transfer technologies to Chinese counterparts as a condition of doing business in the country.*

TOO MANY STICKS AND NOT ENOUGH CARROTS

- **The US has behaved high handedly** in threatening tariffs.
- **Too many sticks and not enough carrots** to find a middle-path in the reconciliation of the trade disputes.
- **China prefers soft and non-confrontational approach.** Ultimately, China does not want to appear to be folding to pressure from the US when it already faces significant and likely non-negotiable tariffs.

Intensified trade tensions pose significant risks to global economy



Source: BNM; IMF

The spoils of trade war – Winners, Losers

Trade diversion in short-term. Trade diversion is one channel through which producers elsewhere are benefited. The decline in imports from China and the US appears to have been offset by an increase in imports from other countries.

Relocation/shifting of production bases. Laying the groundwork to benefit from the realignment of the global supply chains, particularly Vietnam (furniture and apparel), Thailand (automobiles) and Malaysia (LNG, palm oil). All three benefit in the information technology equipment and electronics manufacturing sectors.

But, ultimately, everyone will be a loser. Failure to resolve a full-blown trade differences and further escalation in other areas (such as the auto industry), which would cover several countries, could **further dent business and financial market sentiment**, **negatively impact emerging market bond spreads and currencies**, and **slow investment and trade**.

Higher trade barriers would **disrupt global supply chains; slow the spreading of new technologies, ultimately dampening global productivity and consumer welfare**.

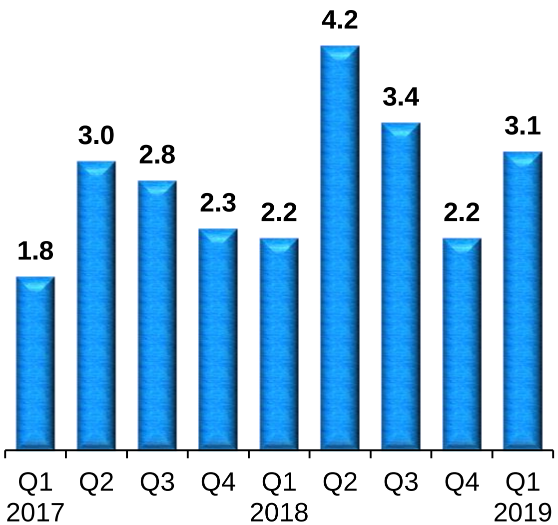
Businesses' profit margin will be eroded by higher taxes (import tariffs) and raw materials cost (due to supply chains disruption) if they have to absorb increased costs and unable to pass through onto consumers. **Tradable consumer goods** not only will be made **less affordable but inflation also will ensue** due to higher prices.

US – Fading fiscal stimulus holds the key

- Economic growth off the peak (2018: 2.9%; 2019E: 2.3%; 2020F: 1.9%). Downside risks are rising.
- A '**fiscal fade' and trade protectionism policy** is likely to dampen growth.
- The Fed's rate pausing and **is readying to cut interest rates** anytime soon. However, monetary policy affects the economy with unpredictable lags.

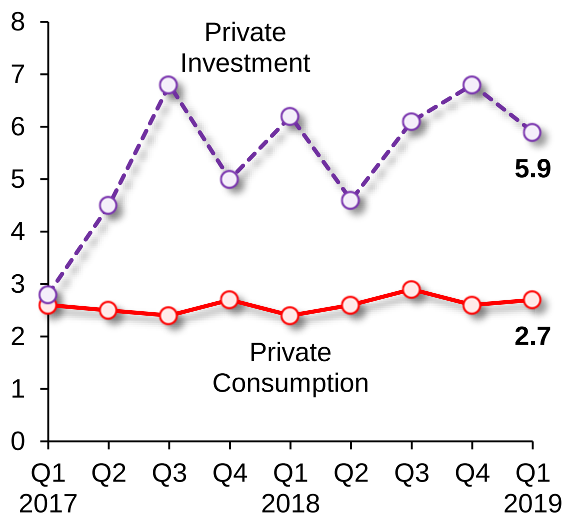
US economy still growing decently

Real GDP growth
(%, Annualized QoQ)



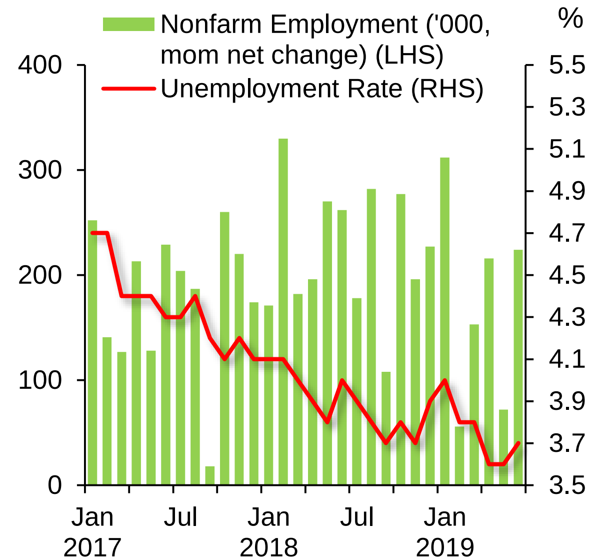
Can private investment sustain?

Real private sector growth
(%,YoY)



Job growth continues; jobless rate recorded 3.6% in Apr-May, lowest since 1969

Labour market condition

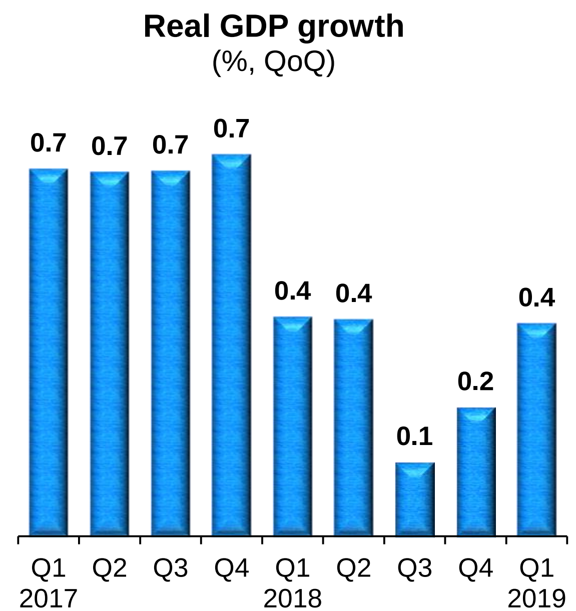


Source: US Bureau of Economic Analysis; US Bureau of Labor Statistics

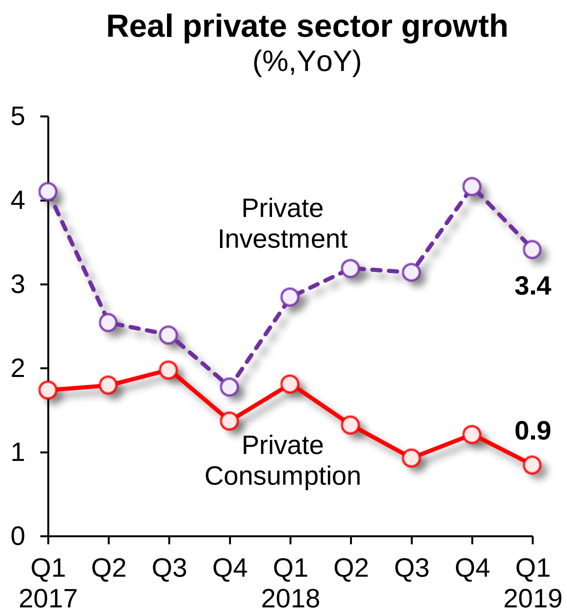
Eurozone – Gathering clouds of uncertainty

- Economic growth at slower pace (2018: 1.9%; 2019E: 1.3% and 2020F: 1.5%) on: (i) Weakening private consumption; (ii) Investment moderated in the wake of high external uncertainty; (iii) Challenging external trade landscape; and (iv) European politics skewing risks to the downside.
- The European Central Bank (ECB) will be prudent and stay put on rates until at least first half-year of 2020. **Prospect for more quantitative easing** (QE).

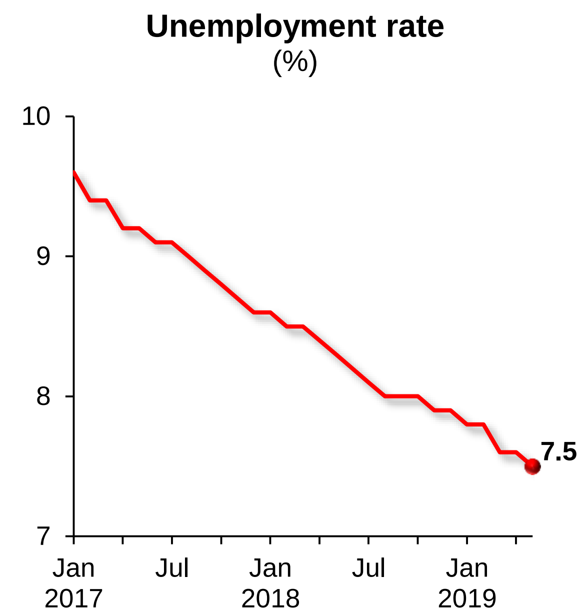
Euro area GDP expanded at a slightly higher pace …



… but private consumption growth momentum eases



Unemployment rate continues to improve

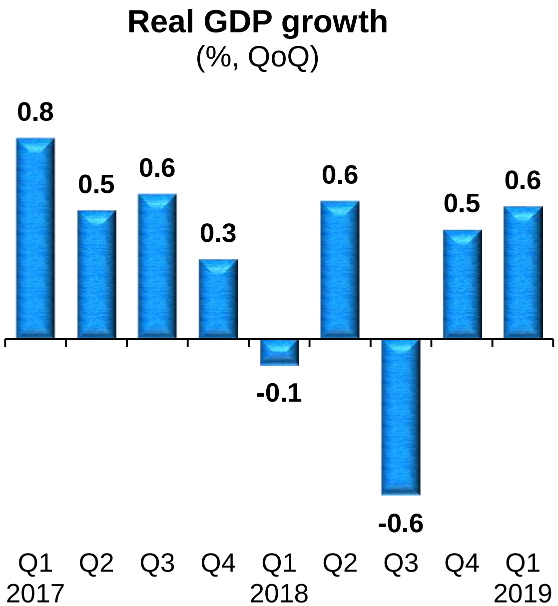


Source: Eurostat

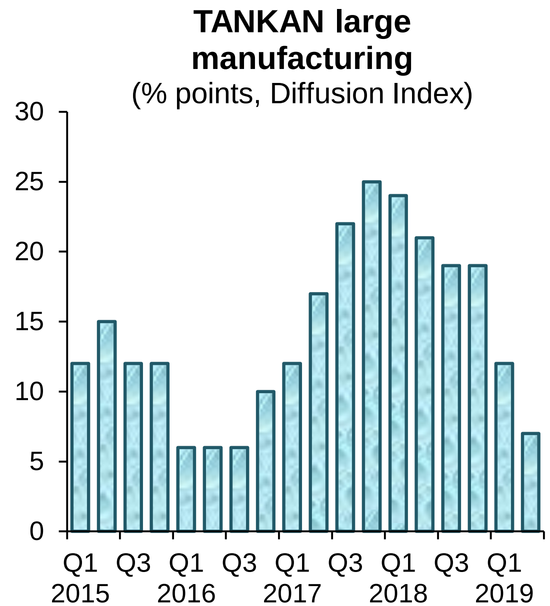
Japan – Growth should remain volatile

- Continued slowing economic growth (2018: 0.8%; 2019E: 1.0% and 2020F: 0.5%).
- Trade war squeezes exports; upcoming consumption tax hike dampens consumption and a slowdown in corporate investment and public spending.
- Market eyes stimulus to shore up the flagging economy.

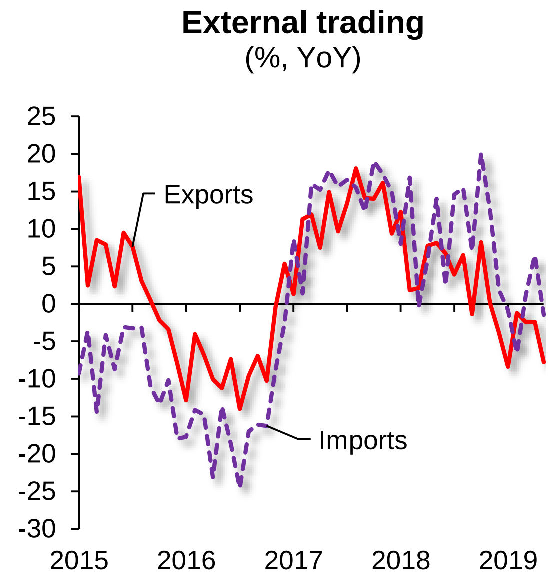
Unexpected growth spurt in 1Q19



Tankan sentiment survey



Import growth outpaced that of exports



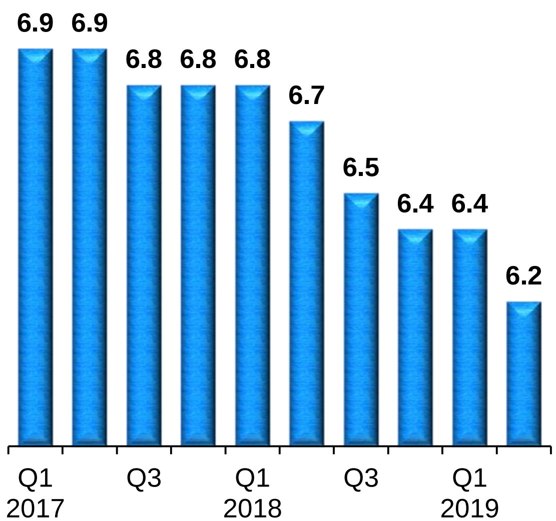
Source: Economic and Social Research Institute; Bank of Japan; Japan Customs

China – Walking on a tightrope

- Economic growth slowed to 6.2% in 2Q19, the weakest pace in 27 years, prompting more stimulus.
- Monetary and fiscal support to ensure the economy stay on track (2018: 6.6%; 2019E: 6.3%; 2020F: 6.1%).
- Ongoing structural reforms, trade disputes amid monetary easing and fiscal support.

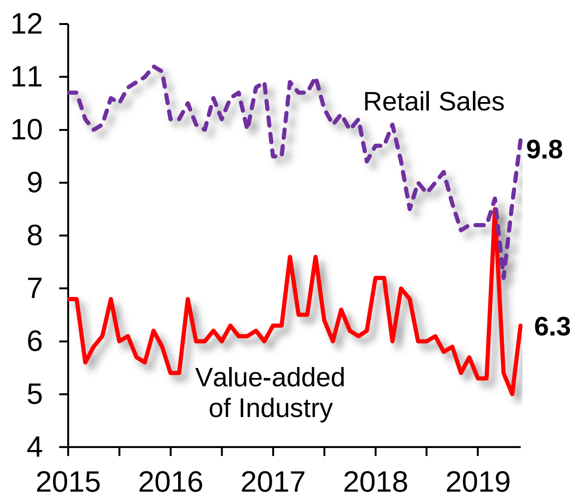
China economy continues to slow, but not on a hard landing

Real GDP growth
(%, YoY)



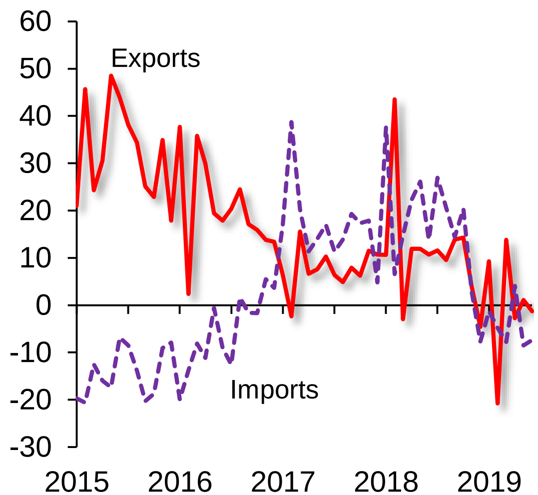
Both industrial output and retail sales growth rebounded in June

Economic activity
(%, YoY)



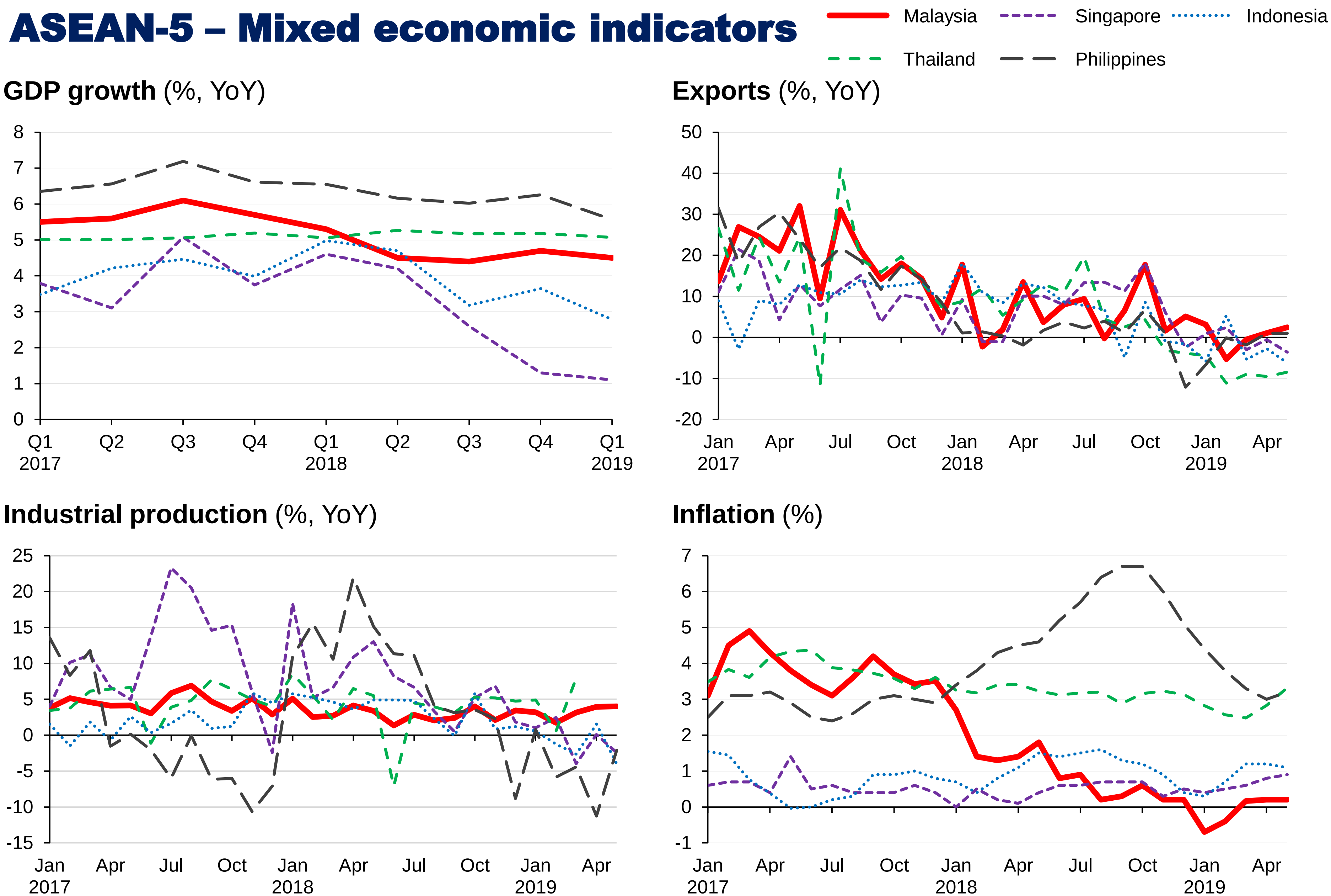
Volatile export growth correlates with the trade spat progress

External trading (USD)
(%, YoY)



Source: National Bureau of Statistics of China

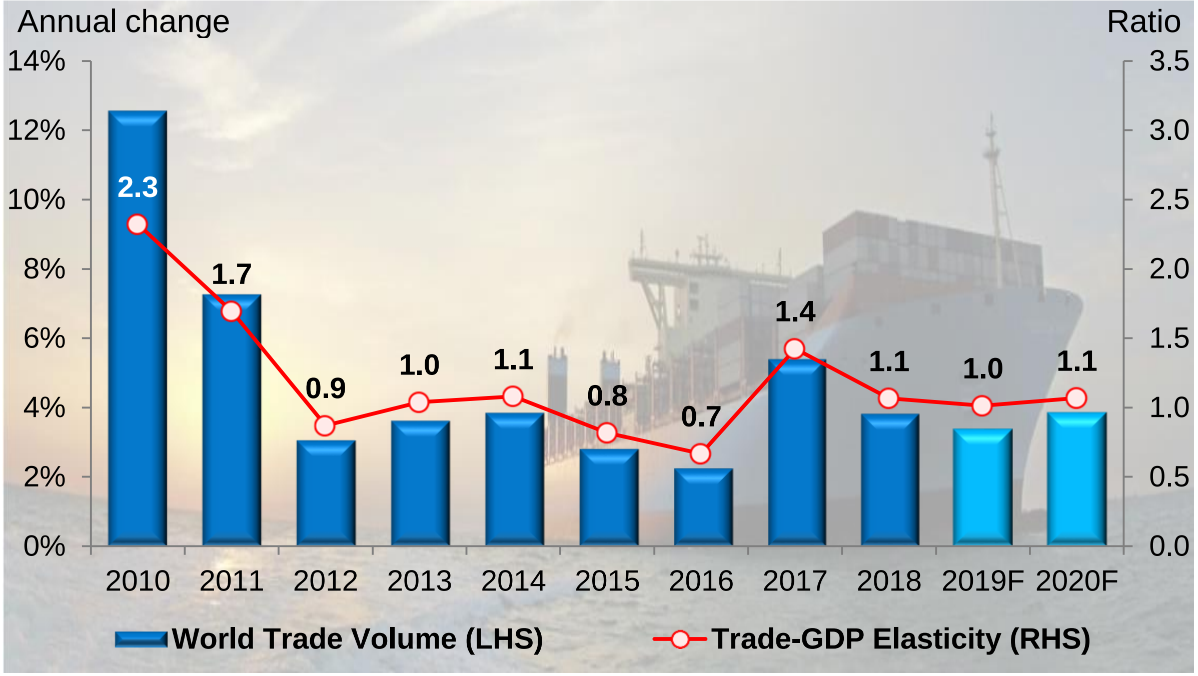
ASEAN-5 – Mixed economic indicators

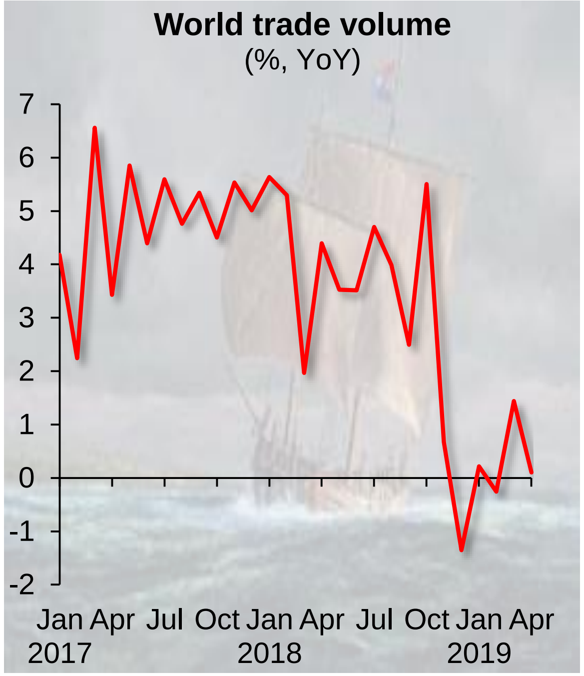


Source: Officials; Note: ASEAN-5=Malaysia, Singapore, Thailand, Indonesia, Philippines

WTO indicator suggests trade weakness ahead

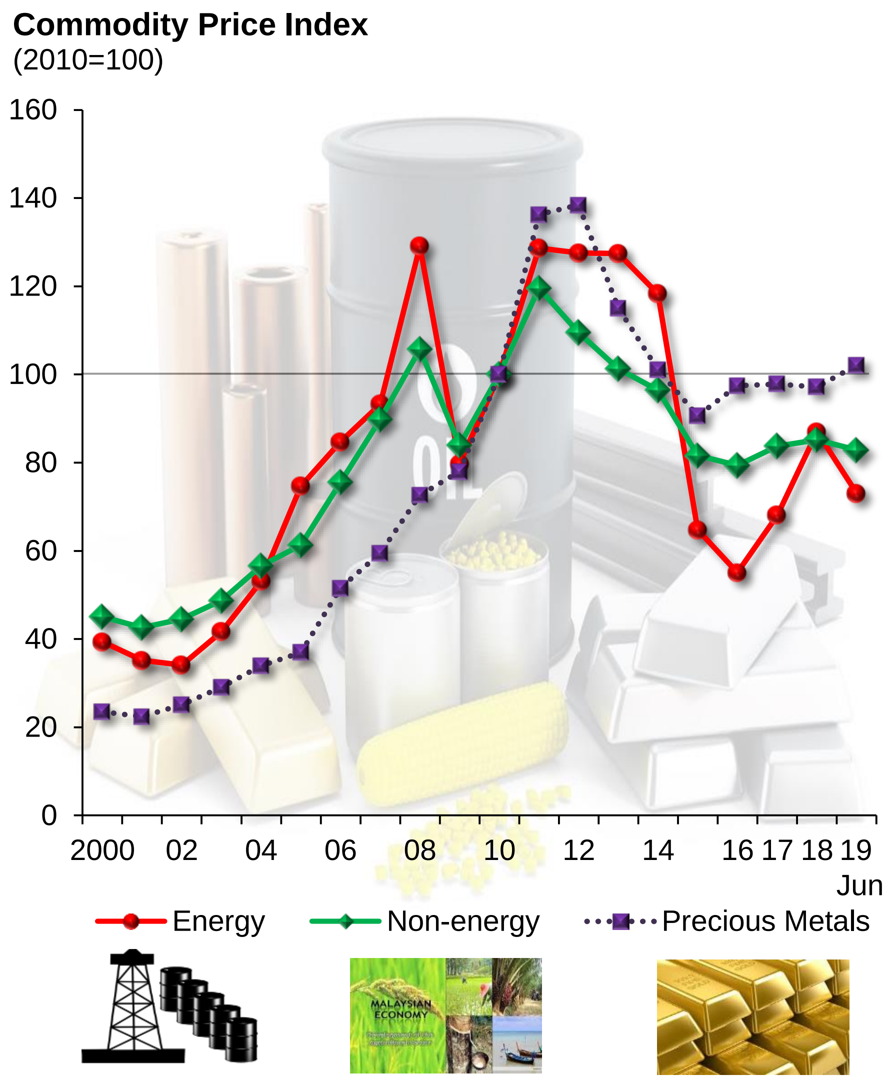
- The **WTO** slashed this year's global trade growth forecast to 2.6% (vs. IMF's 3.4%) from 3.7% previously (3.0% in 2018). It expects trade growth to rebound by 3.0% (vs. IMF's 3.9%) in 2020.
- **Heightened trade tensions** pose a material risk to investment and trade via further denting business and financial market sentiments, slowing investment and growth.
- **Trade to GDP ratio** is expected to slip further to 1.0x in 2019 before ticking up to 1.1x in 2020.





Source: IMF; SERC's computation; CPB Netherlands

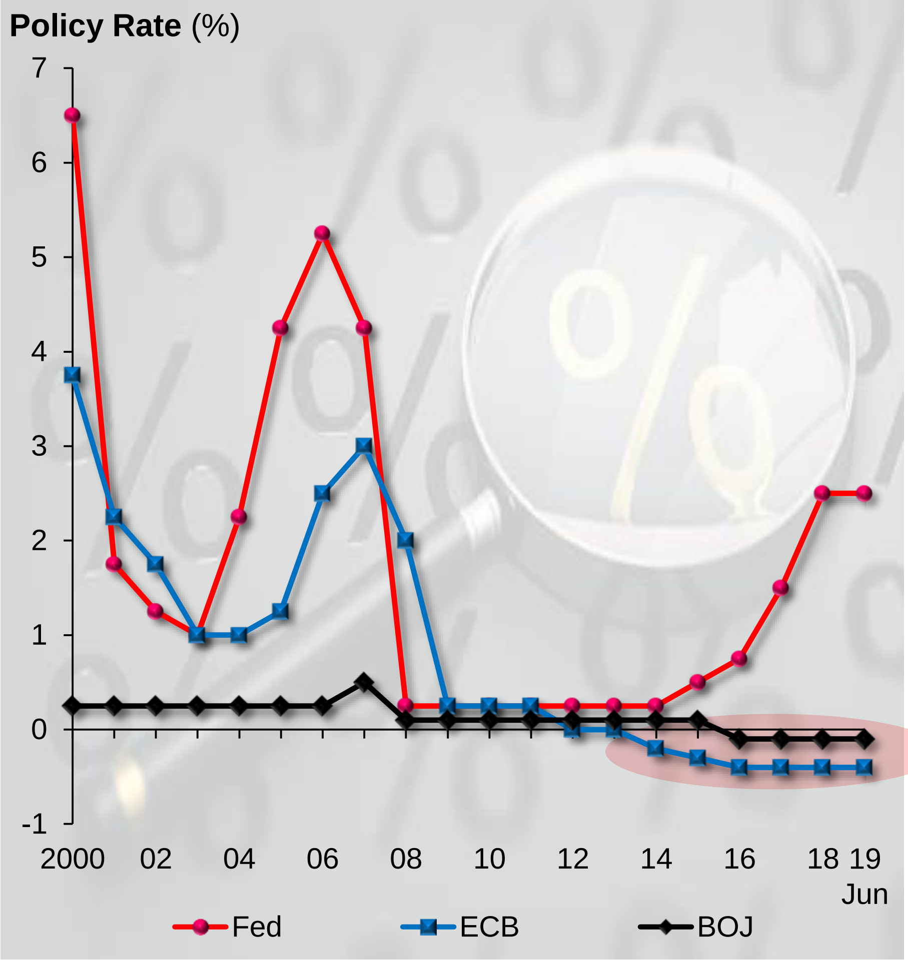
Volatile energy prices remain a wild card



Source: World Bank

- **Brent crude oil prices** have climbed more than 30% to average US$71/bbl in May 2019 before reverted to US$65/bbl on 8 July 2019 (US$51/bbl as at end-2018). YTD (Jan to 8 Jul), Brent crude oil prices average at US$66/bbl.
- The US EIA expects Brent crude oil price to average US$66.51/bbl in 2019 and US$67.00/bbl in 2020 (2018: average US$71.19/bbl).
- Factors affecting the near-term movement of prices: (a) Will OPEC+ able to comply the crude oil supply cut in 2H 2019?; (b) Resolution of the trade war?; (c) Increasing shale oil production in the US vs. Hurricane Barry; and (d) the US-Iran tensions.

Global central banks on pausing or easing mode



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

- The **Fed turned dovish** and signalled rate cut(s) this year, as early as in late-July. The market also expects **an early completion of the balance sheet roll-off program**, which slated at end-September previously.
- The **European Central Bank** (ECB) pledges to (i) **maintain its key interest rates at least through the first half-year of 2020**; (ii) continue to fully reinvest the principal payments from maturing securities "for an extended period of time"; and (iii) setting the interest rate for new series of quarterly targeted longer-term refinancing operations (TLTRO III) at 10 bps above average rate.
- **Bank of Japan** (BOJ) is expected to **keep the policy rate till at least spring 2020** and **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.

Snapshot of selected central banks' policy rate

End-period of	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019 (Jun)	2019*E*
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	0.00-0.25	0.00-0.25	0.25-0.50	0.50-0.75	1.25-1.50	2.25-2.50	2.25-2.50	1.75-2.00
Euro Area, ECB Deposit Facility	2.00	0.25	0.25	0.25	0.00	0.00	-0.20	-0.30	-0.40	-0.40	-0.40	-0.40	-0.40
Japan, BOJ Short-term Policy Interest Rate	0.10	0.10	0.00-0.10	0.00-0.10	0.00-0.10	0.00-0.10	0.00-0.10	0.00-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
China, PBC 1-year Benchmark Loan I/R	5.31	5.31	5.81	6.56	6.00	6.00	5.60	4.35	4.35	4.35	4.35	4.35	4.35
India, RBI Policy Repo Rate (LAF)	6.50	4.75	6.25	8.50	8.00	7.75	8.00	6.75	6.25	6.00	6.50	5.75	5.50
South Korea, BOK Base Rate	3.00	2.00	2.50	3.25	2.75	2.50	2.00	1.50	1.25	1.50	1.75	1.75	1.50
Malaysia, BNM Overnight Policy Rate	3.25	2.00	2.75	3.00	3.00	3.00	3.25	3.25	3.00	3.00	3.25	3.00	3.00
Indonesia, BI 7-Day Reverse Repo Rate	9.25	6.50	6.50	6.50	5.75	7.50	7.75	7.50	4.75	4.25	6.00	6.00	5.50-5.75
Thailand, BOT 1-Day Repurchase Rate	2.75	1.25	2.00	3.25	2.75	2.25	2.00	1.50	1.50	1.50	1.75	1.75	1.75
Philippines, BSP Overnight RR Facility	5.50	4.00	4.00	4.50	3.50	3.50	4.00	4.00	3.00	3.00	4.75	4.50	4.50

Source: Officials
Note: Selected central banks' benchmark policy rate have changed over the coverage period

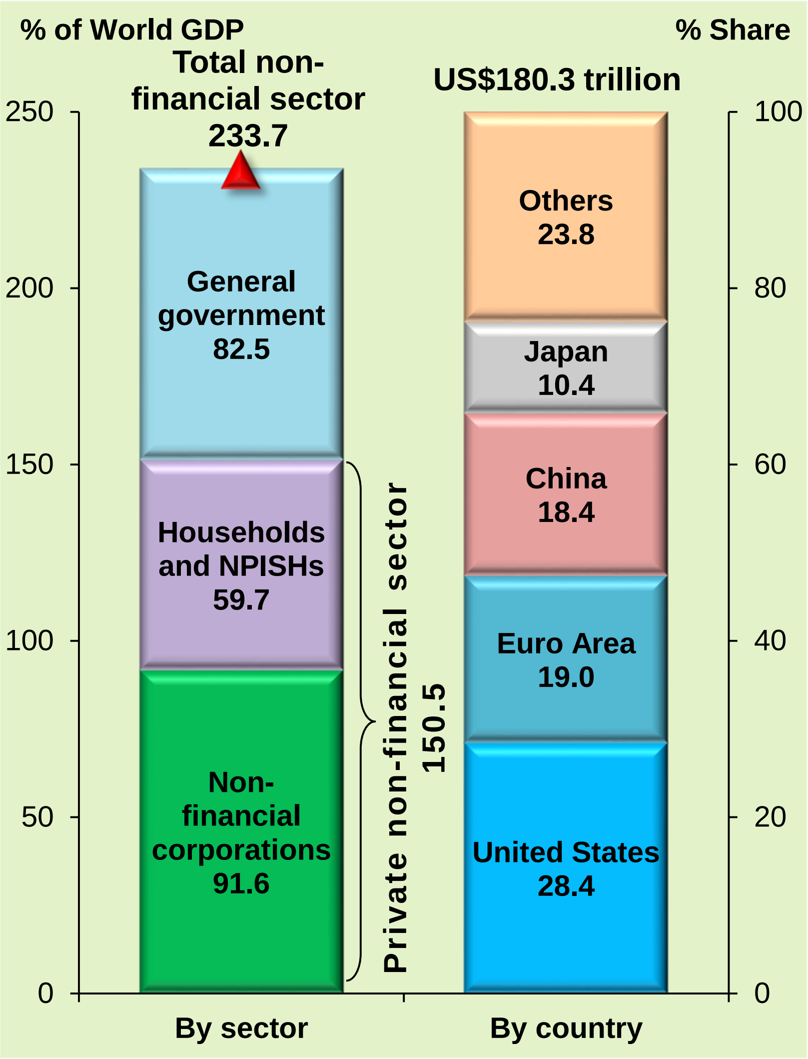
Section 2

Risks to Global Growth

Is the next financial crisis looming?

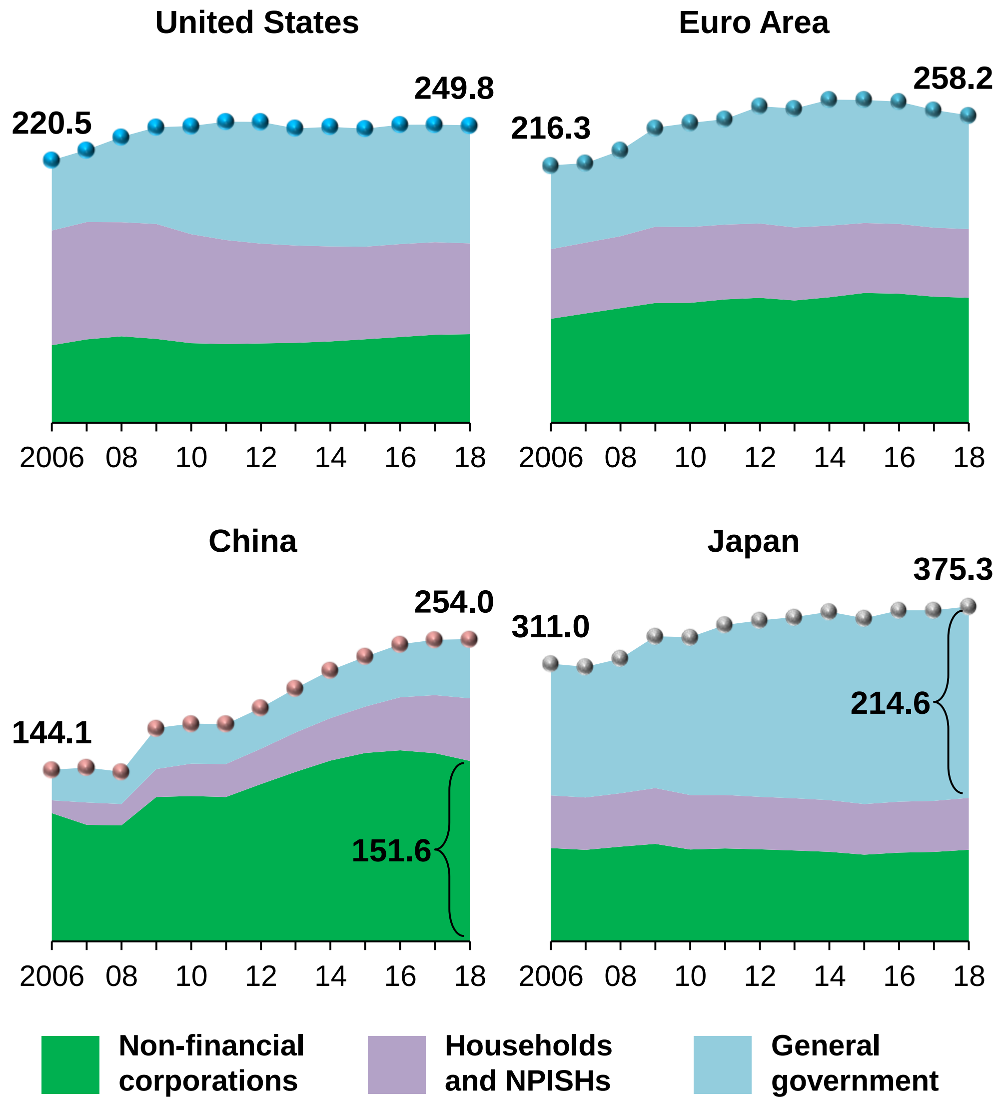
Global debt stood at 233.7% of world GDP as at end-Dec 2018

As at Dec 2018:



Source: BIS

Debt as % of GDP



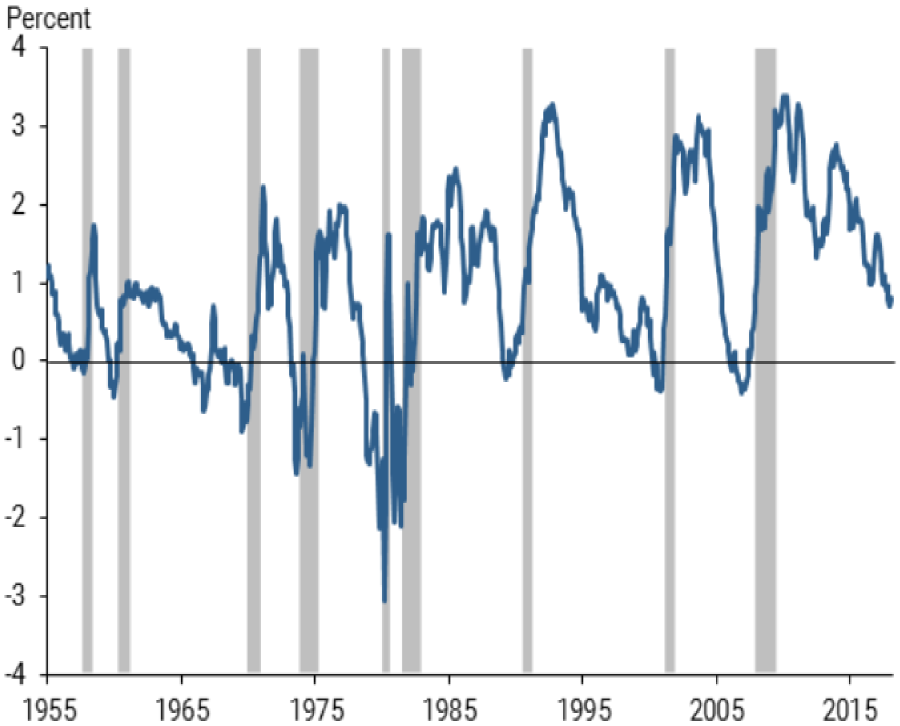
U.S. curve INVERTS for first time since 2007 – A reliable predictor of recession (Has happened ahead each of the past seven recessions)

Source: Bloomberg

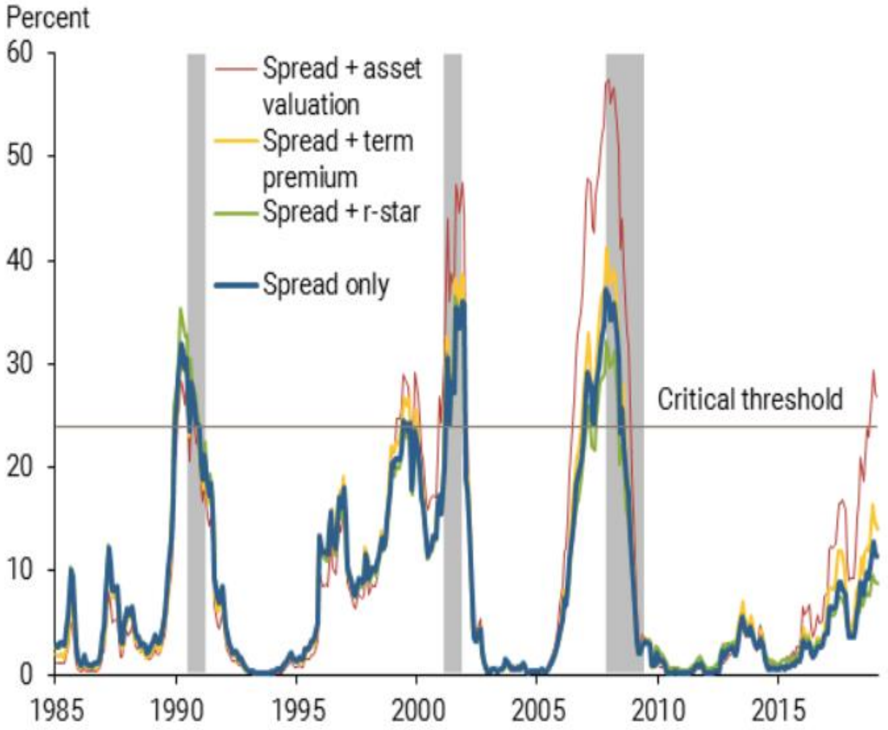
Every **RECESSION** over this period was preceded by an **INVERSION OF THE YIELD CURVE** that is, an episode with a negative term spread.

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



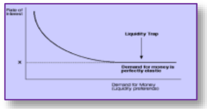
Estimated probabilities of recession based on term spread



Source: Federal Reserve Bank of San Francisco

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

Do Governments have policy tools to avert a financial crisis or global recession? A severe enough shock could usher in a global recession, even if central banks respond rapidly.



Policy tools are limited. Interest rates are very low and it gives the central banks very limited room to cut interest rates.

- Today, the **Fed** is starting with a benchmark policy rate of 2.25-2.5%, compared to 5.25% in September 2007.
- In **Europe and Japan**, central banks are already in negative-rate territory, and will face limits on how much further below the zero bound they can go.

Printing money (**Quantitative easing** (QE))? With bloated balance sheets from successive rounds of QE, central banks would face similar constraints if they were to return to large-scale asset purchases.

There's so much divide across the political spectrum, it may be difficult to put together a strong enough **government spending fiscal response**.

On the fiscal side, most advanced economies have **even higher deficits and more public debt** today than before the 2008-09 GFC, leaving little room for stimulus spending.

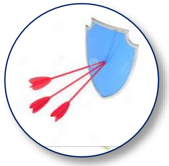
Malaysia: A priority for action, now more than ever

- The rise of global complexity and competition and uncertainty about its future as well as digitalisation acceleration will fundamentally reshape global economic and business landscape.
- Being a small and highly open economy, Malaysia remains vulnerable to external trade or financial shocks.
- Domestically, the Government must continue and has the political will to **enhance economic resilience and implement coordinated policy reforms** to ensure medium-term growth sustainability. Delays or resistance to the reform agenda could undermine confidence, leading to lower investment and growth.
- **Effective and well-designed structural reforms** are key to shaping Malaysia's future. Structural reforms are needed to boost the country's growth potential, raise productivity and investment as well as reduce the cost of doing business.

Priority should be given to

1. Formulate an **appropriate incentive framework** based upon a clear, transparent and predictable business and investment climate
2. Improving **education**, strengthen **manpower training and skillset of workforce**
3. Accelerating **innovation and technology** adoption
4. Move up further the **value chain and integrate in global supply chains**

What can buffer Malaysia against external shocks?



Malaysia is in a position of strength to face headwinds. Still-sound economic and financial fundamentals supported by facilitative policies and accommodative monetary policy.

A well-diversified trade, economic sectors and sources of foreign direct investments. This helps to reduce vulnerability and risks inflicted by a particular sector and industry as well as country.

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 May 2019, banks' liquidity buffers exceeded regulatory levels with strong loan quality (aggregate non-performing loans (NPLs) at 1.5% of gross loans) and sizeable provisions (91.7% to total impaired loans). Liquidity coverage ratio (LCR) is well-above the required level (100% starting 2019) at 155.2%.

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**.

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