社会经济研究中心

SOCIO-ECONOMIC RESEARCH CENTRE

BRACING FOR A NEW NORMAL GROWTH

Investing in Interesting Times

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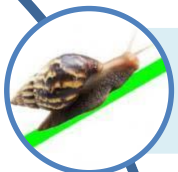
Executive Director, SERC

21 August 2019

Agenda



A SYNCHRONIZED GLOBAL SLOWDOWN

ZERO INTEREST RATE A NEW NORMAL AGAIN

BRACE FOR A RECESSION ?

CAN MALAYSIA WEATHER THE STORM?

Section 1

The World Economy

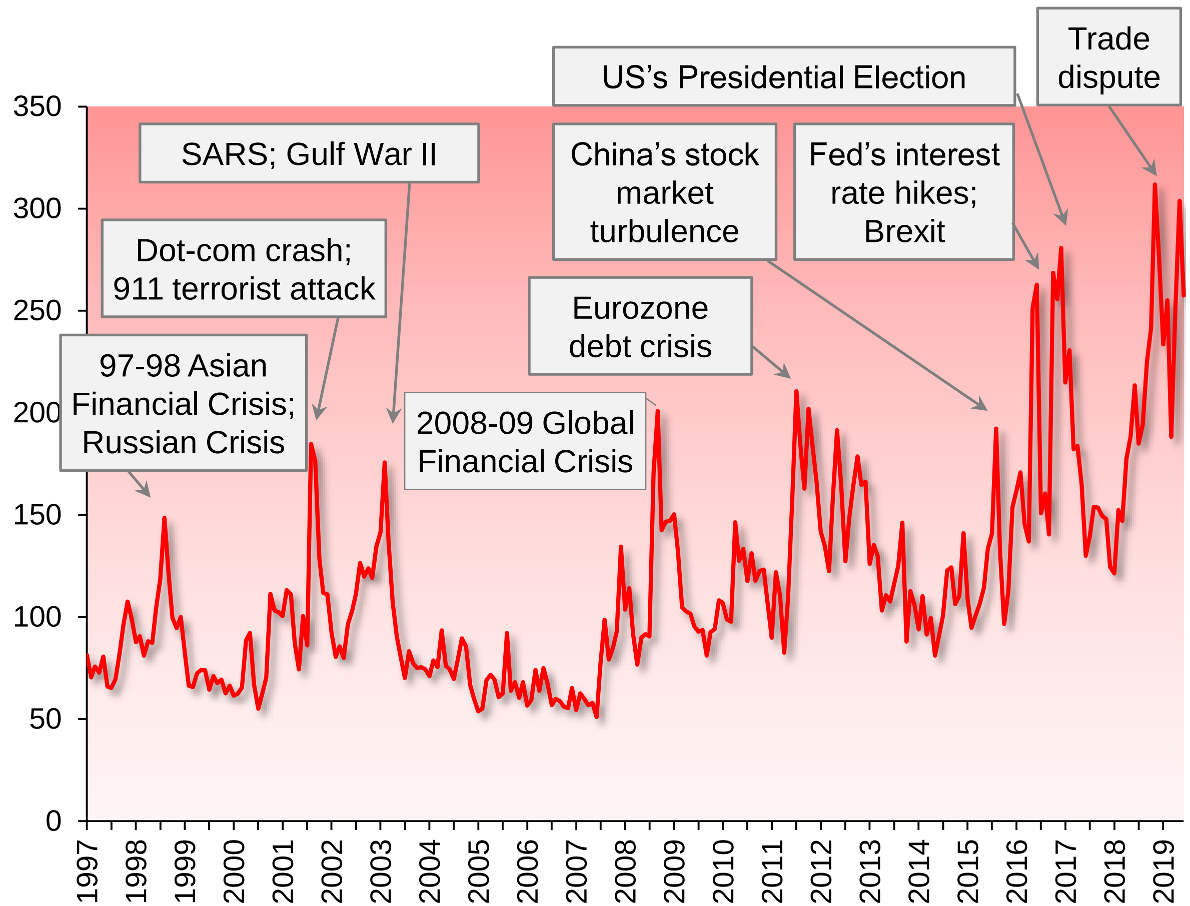
A synchronized slowdown amid global recession fears

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.

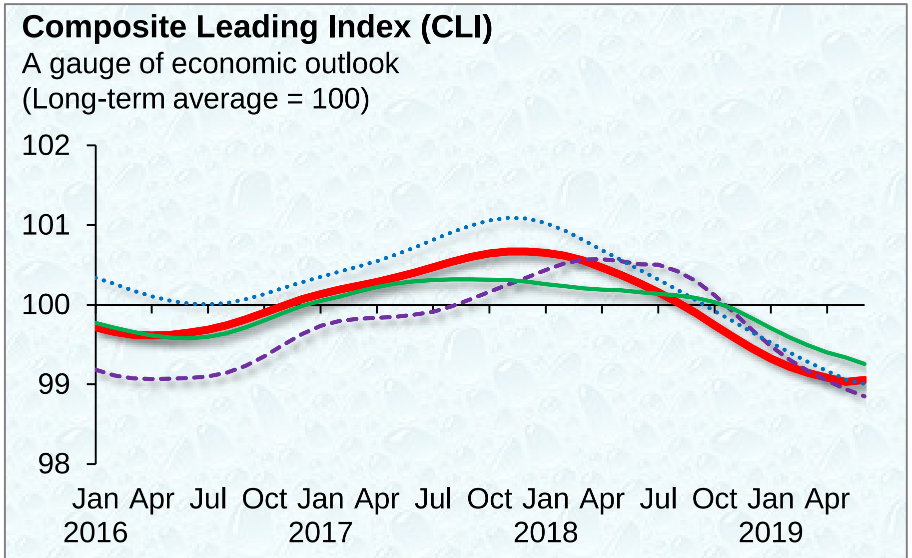
- Heightening uncertainty about the **trade tensions**
- **Global race to monetary bottom; plunging bond yields**
- Concerns about **global recession risk, the US** and **China economy**
- **Currency tensions** flared up, inflicted by the Chinese Renminbi's weakness
- Wide swings in **crude oil prices**
- **Geopolitical** and **political** risks

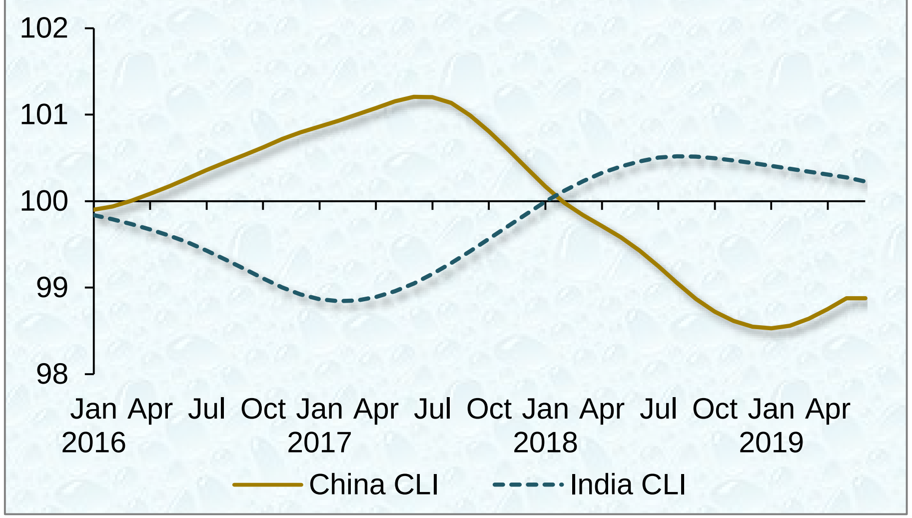
Monthly Global Economic Policy Uncertainty Index

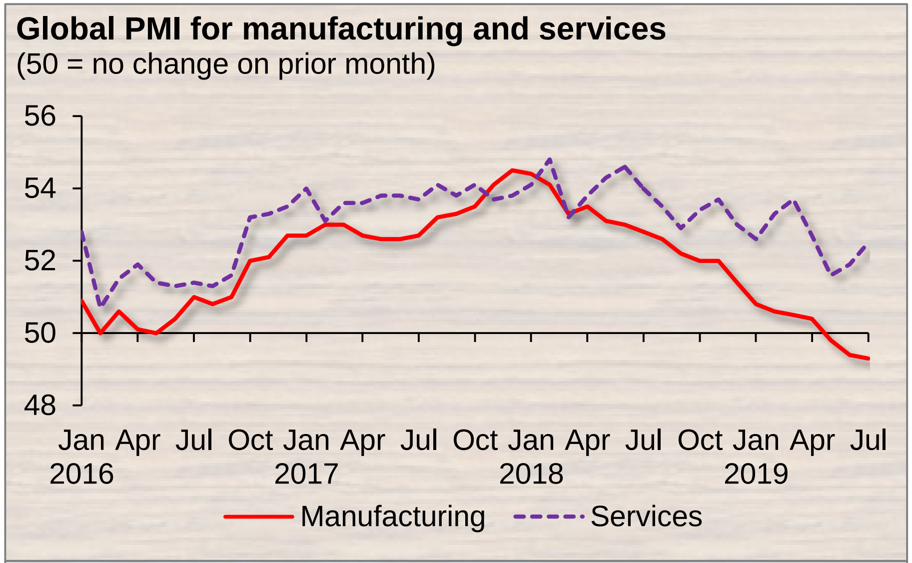


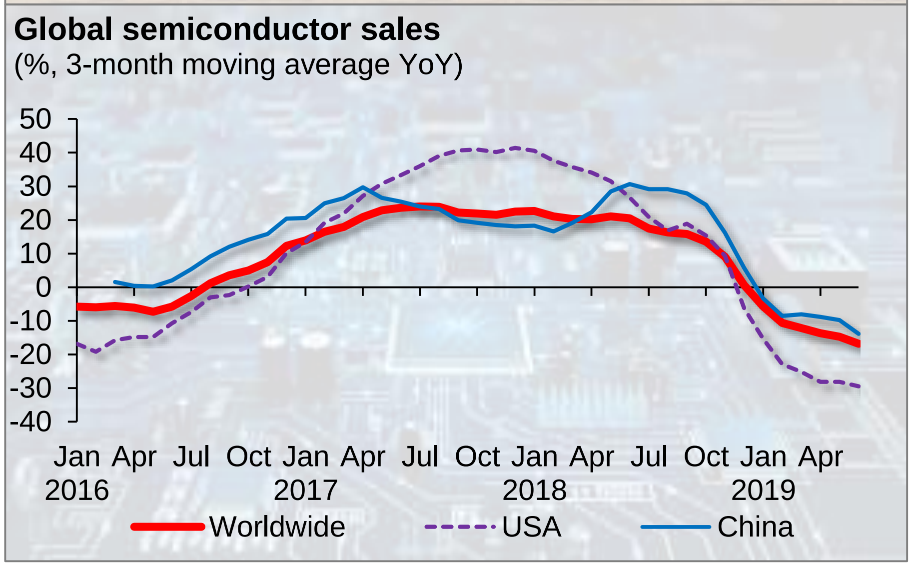
Source: Economic Policy Uncertainty

High frequency data pointing to slower global growth





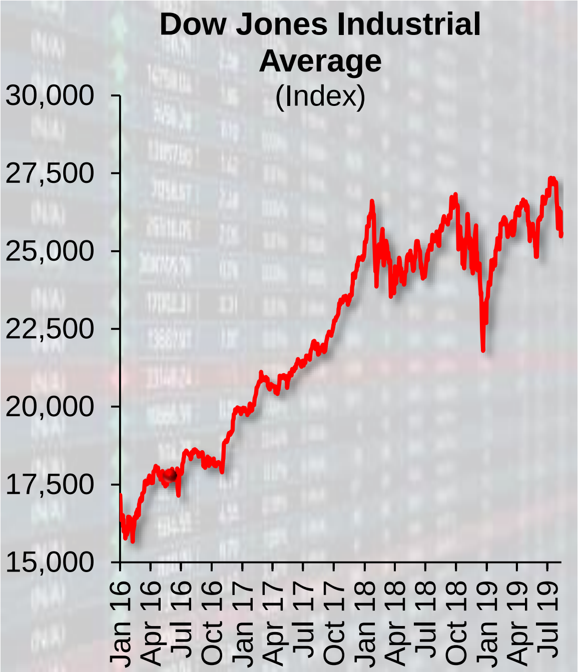




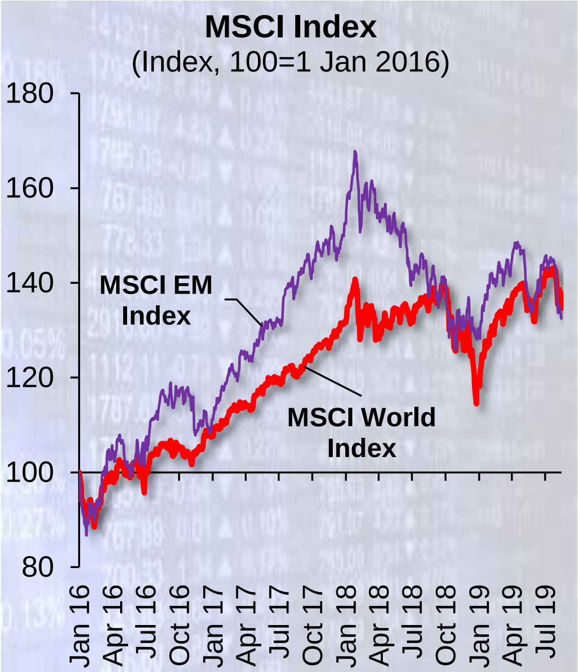
Source: OECD; Markit; SIA

Brace for high financial market volatility

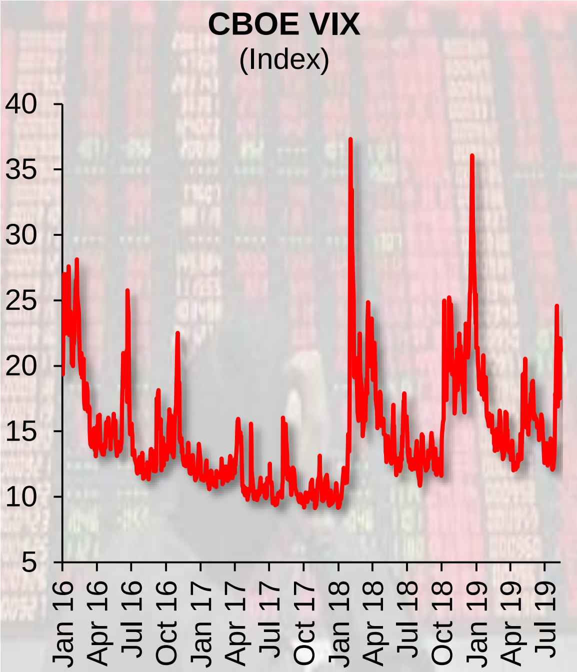
DJIA retreated from recent highs amid global recession fears



Emerging markets' equities are more volatile to economic newsflow



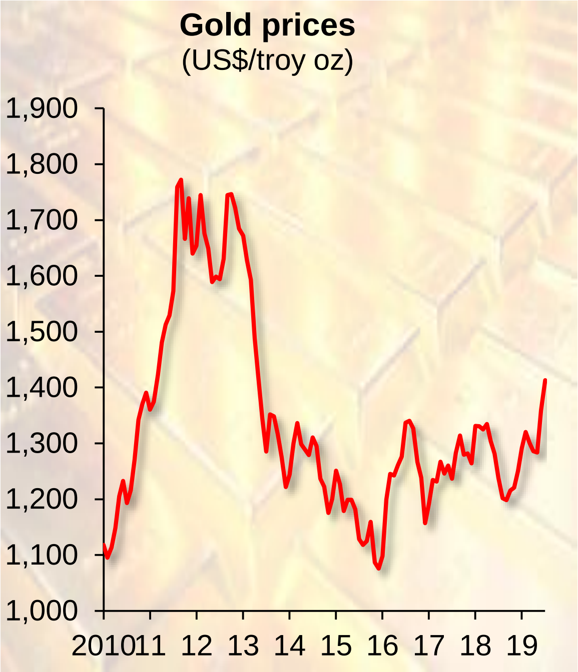
Recent global tensions spiked up 'Fear index' to above 20-pts



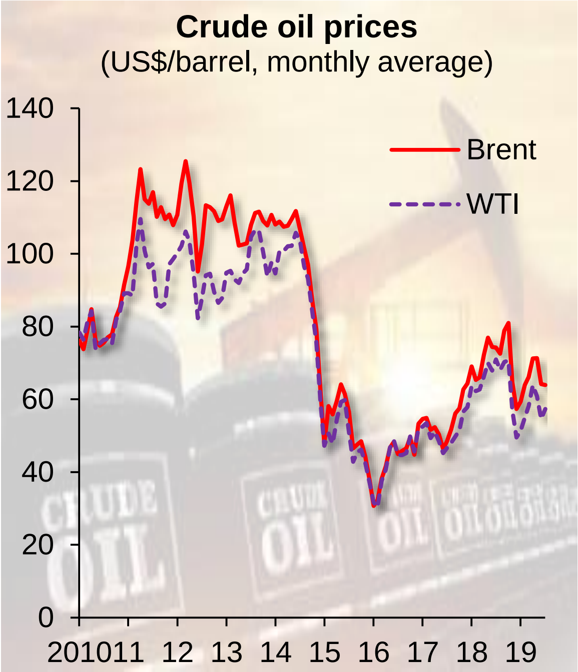
Source: WSJ; MSCI; CBOE

Gold a safe haven (a six-year high) ; Volatile commodity prices

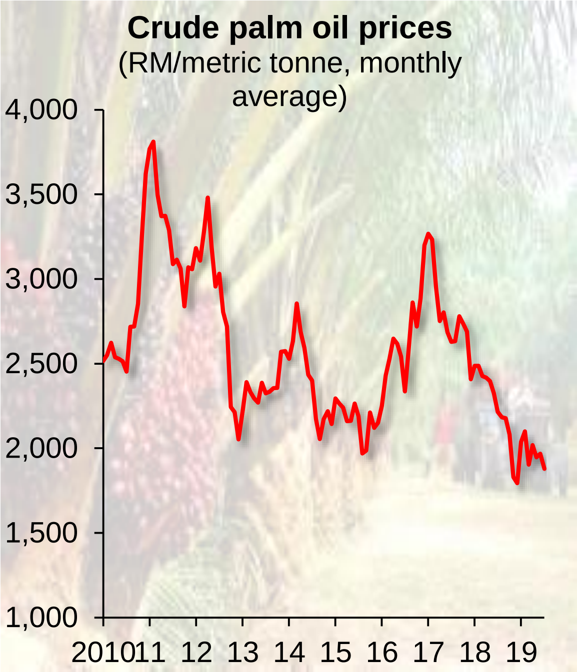
Gold prices are supported by strong demand and falling long-term real interest rate



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



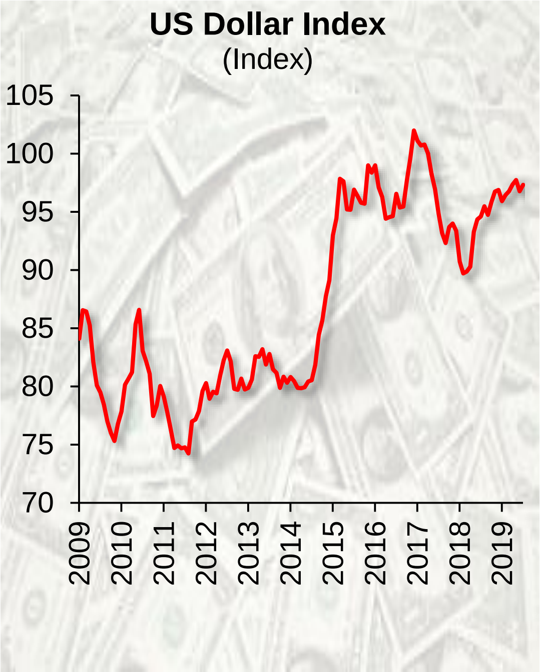
CPO prices remain low amid a reduction in inventory



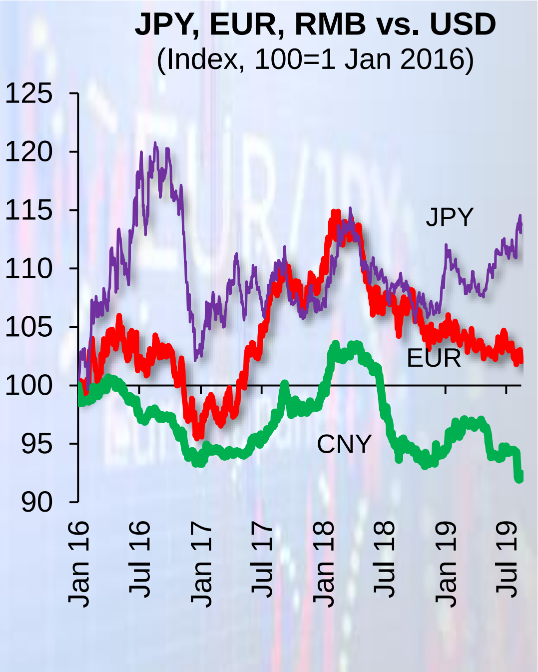
Source: World Bank; EIA; MPOB

Foreign exchange market – currency tensions

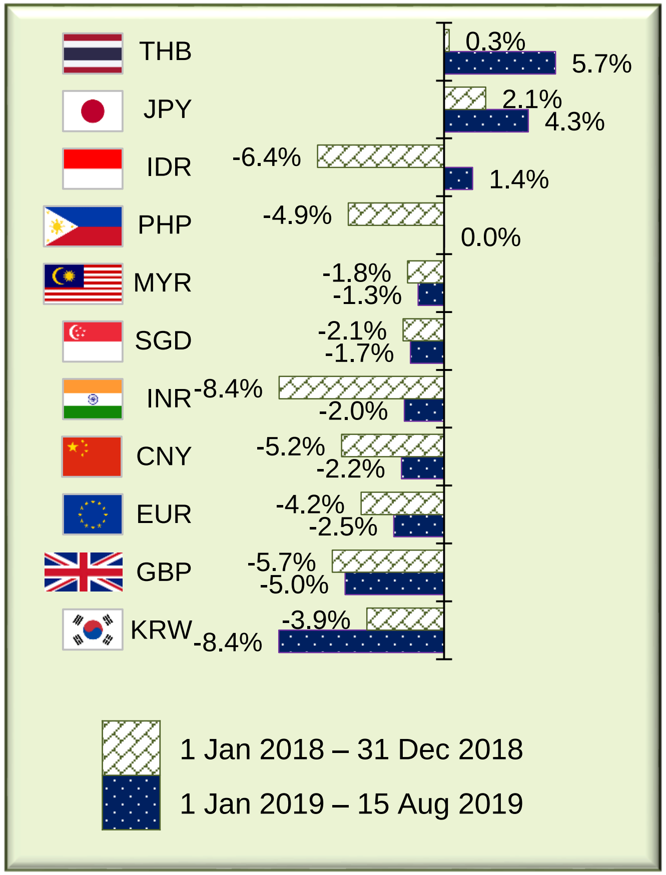
The US dollar index still firming up amid the Fed's dovish stance



RMB's weakness flares currency tensions



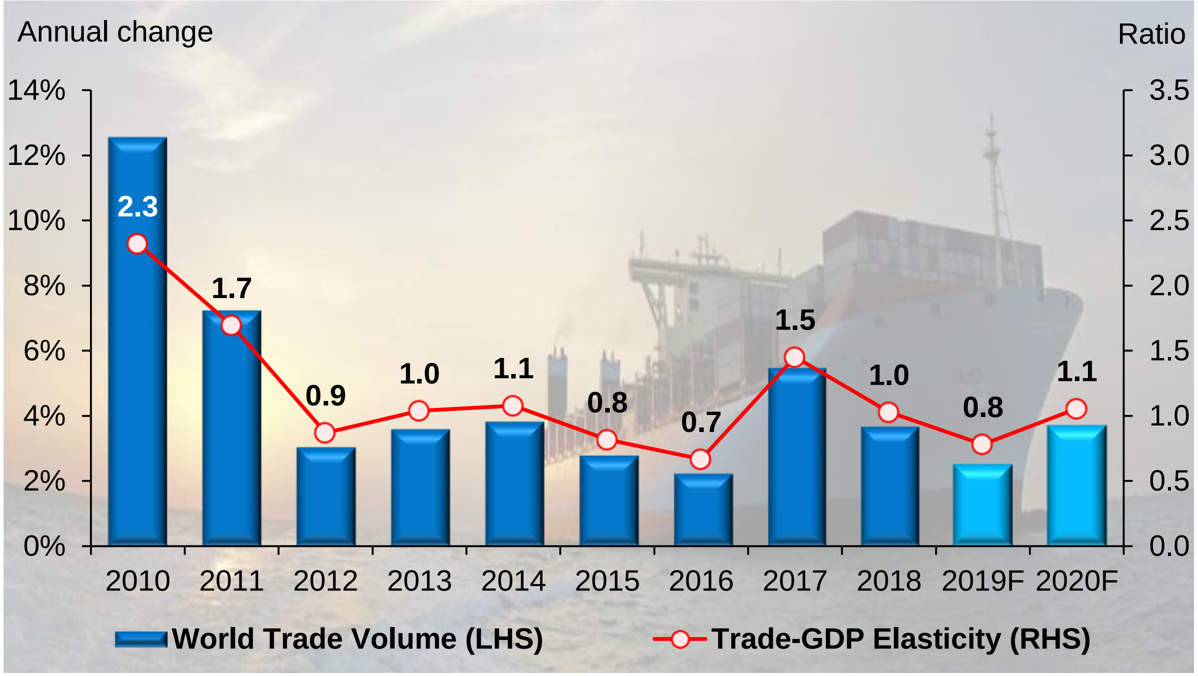
Major and emerging market currencies against the USD

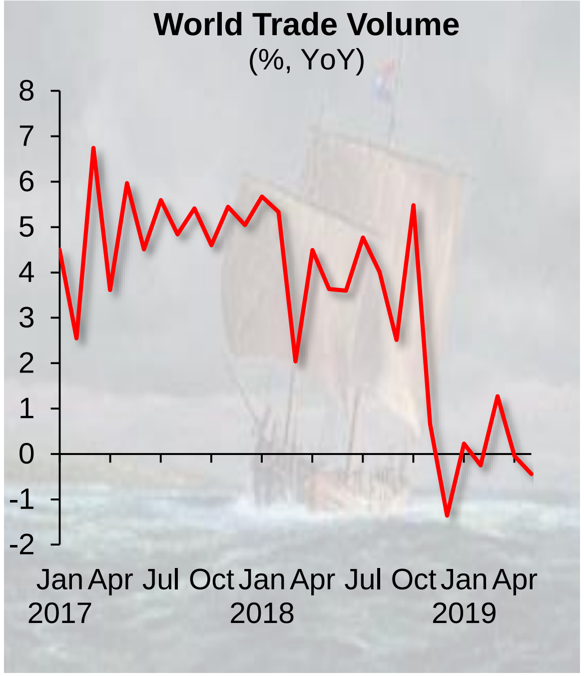


Source: WSJ; BNM (cross rate)

Global trade weakness continues

- The **WTO** slashed this year's **global trade growth** forecast to **2.6**% (vs. IMF's marked down revision to 2.5% from 3.4%; 3.7% previously (3.0% in 2018). It expects trade growth to rebound by 3.0% (vs. IMF's 3.7%) 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 decline further to 0.8x in 2019 before ticking up to 1.1x in 2020.

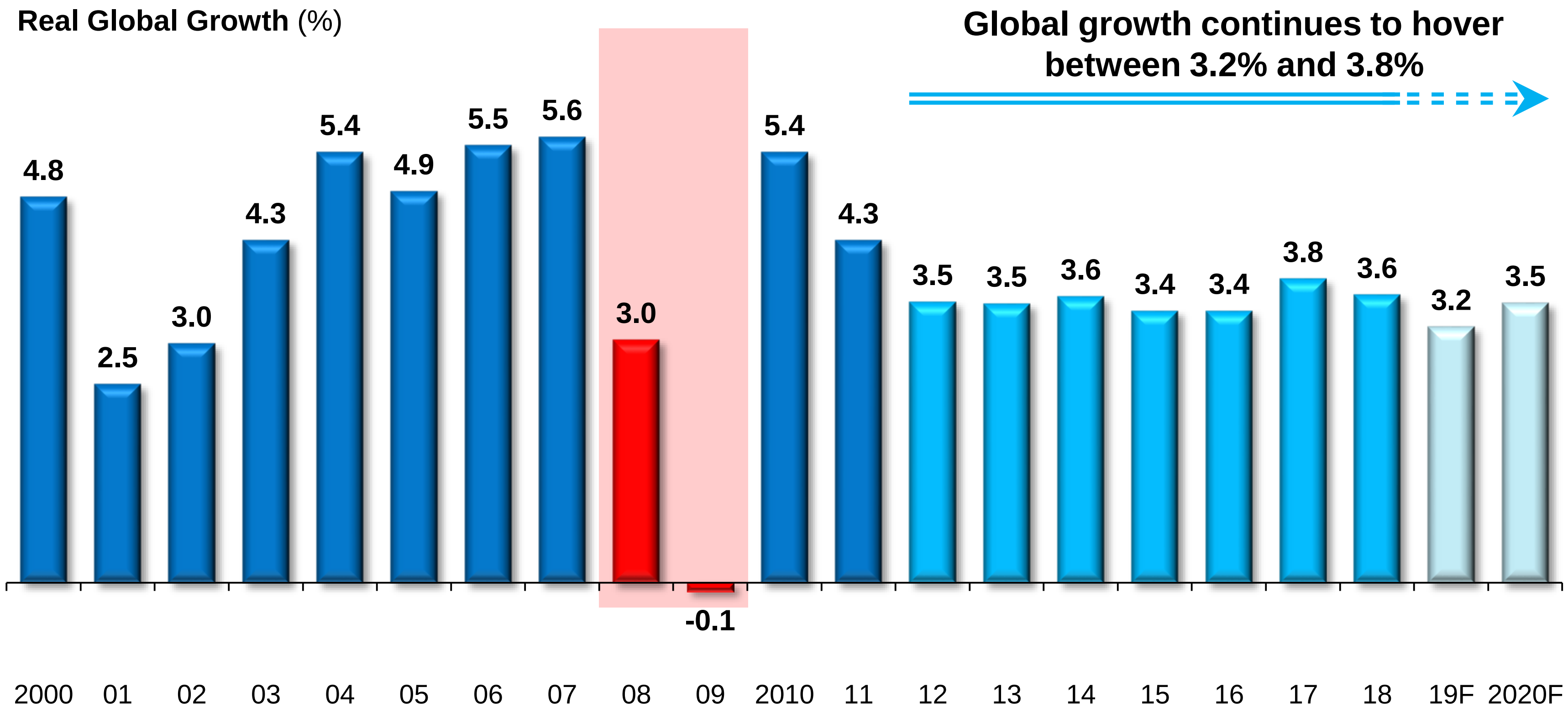




Source: IMF; SERC's computation; CPB Netherlands

Global growth is decelerating in synchronisation

- Three 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% to **3.2%**); **World Bank** (from 3.0% to **2.9%**); and **OECD** (from 3.5% to **3.3%**).
- The IMF has warned that worsening trade tensions could **lower 2020's global growth estimate to 3.1%**. (Note: A global recession occurs when GDP is 3% or less. According to IMF's definition, **a drop in global output** must coincide with a **weakening of other macroeconomic indicators (trade, capital flows, and employment**).

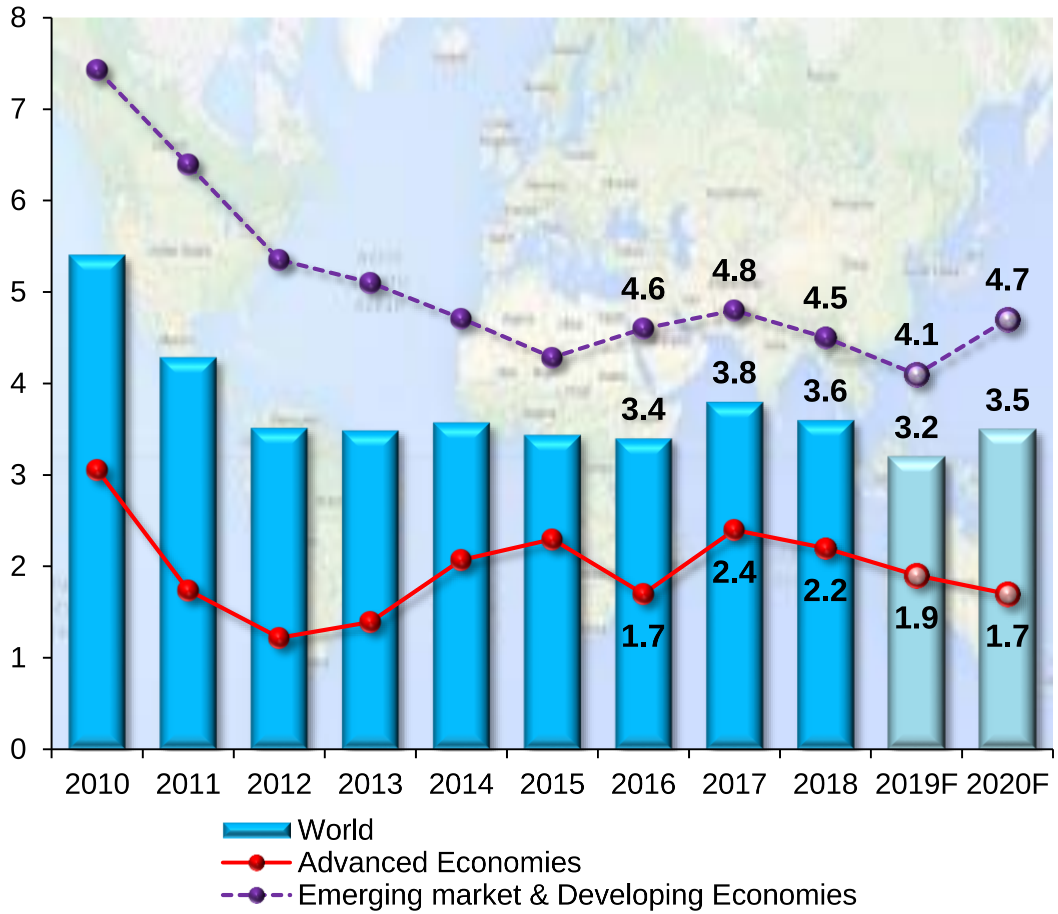


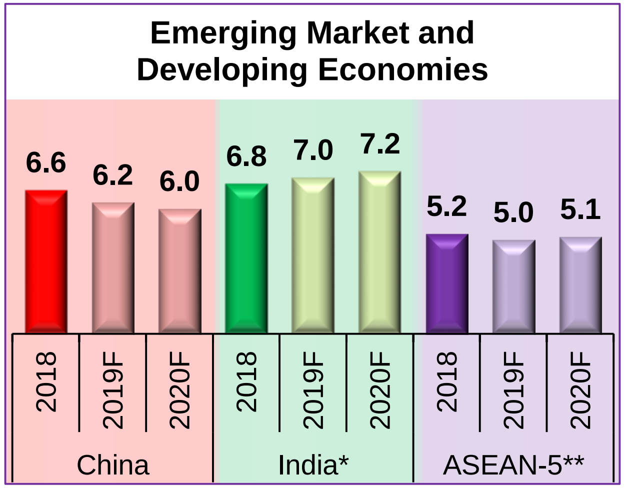
Source: IMF (WEO update, July 2019)

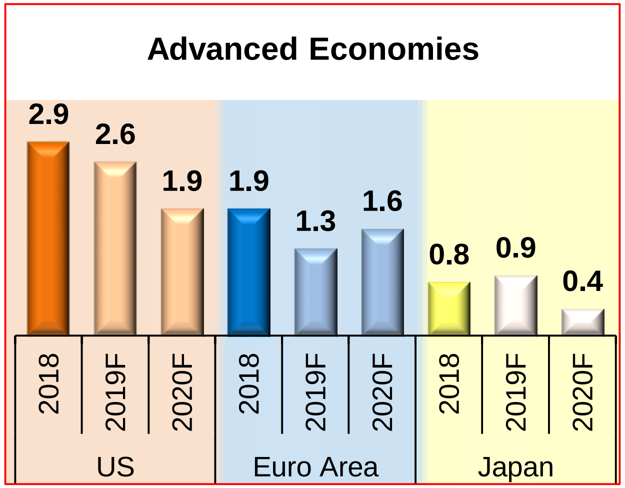
Deepening trade wars can slash global growth in 2020

Downside risks: Further trade and technology tensions; Abrupt shifts in risk sentiment; Disinflationary pressure; and Geopolitical tensions in the Persian Gulf.

Real GDP Growth (%)





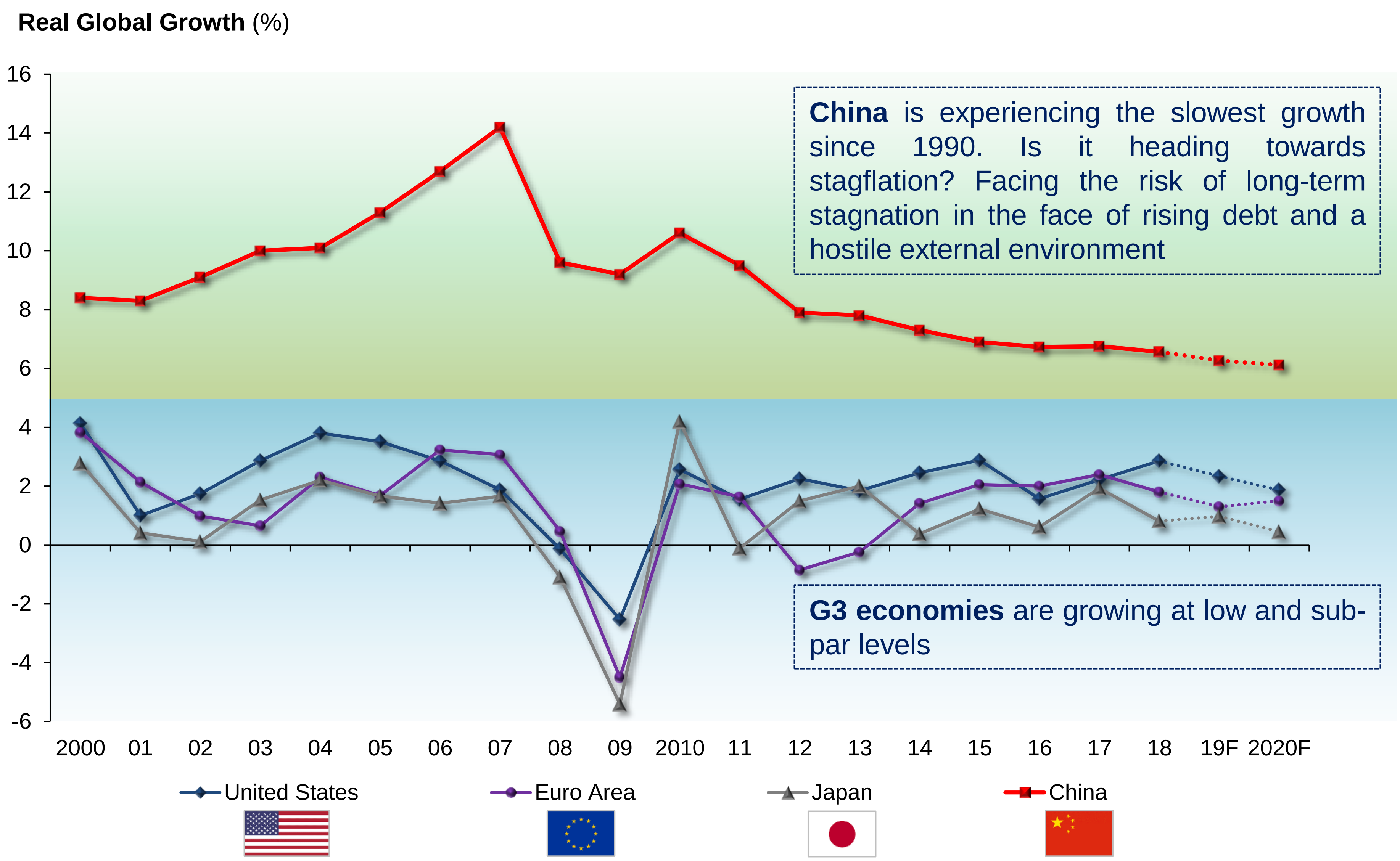


* *Annual GDP for India is on fiscal year basis*

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

Source: Officials; IMF (WEO Update, July 2019)

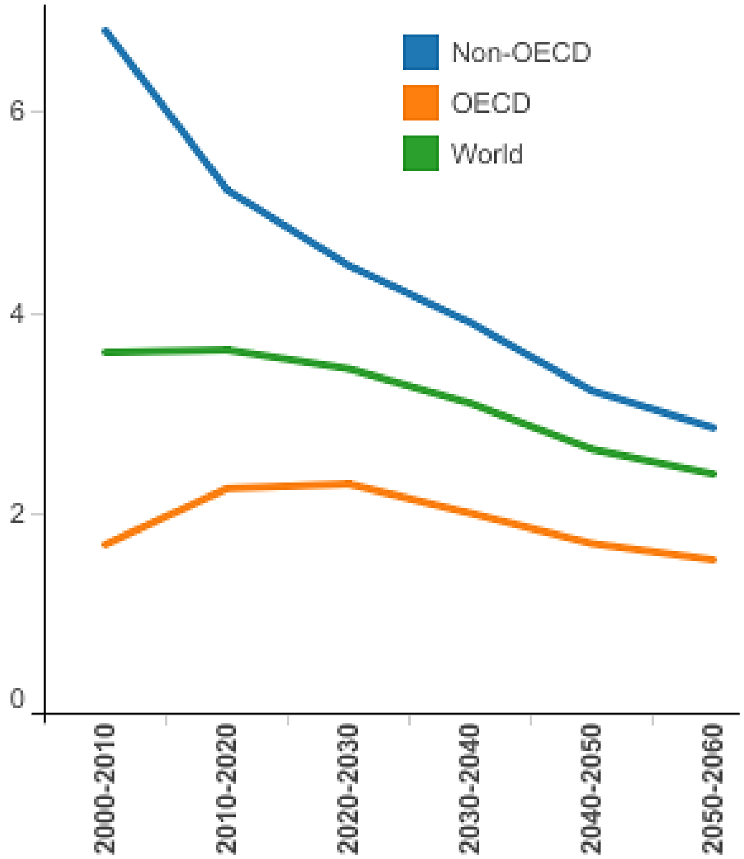
G3 economies and China are slowing



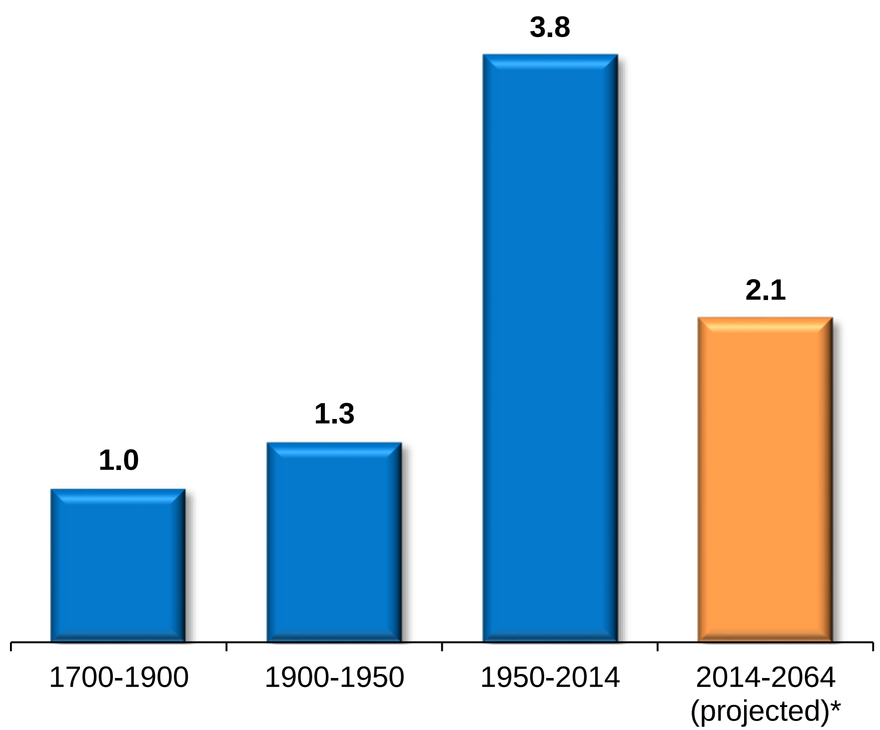
Source: IMF (WEO update, July 2019)

The world economy will slide back towards 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

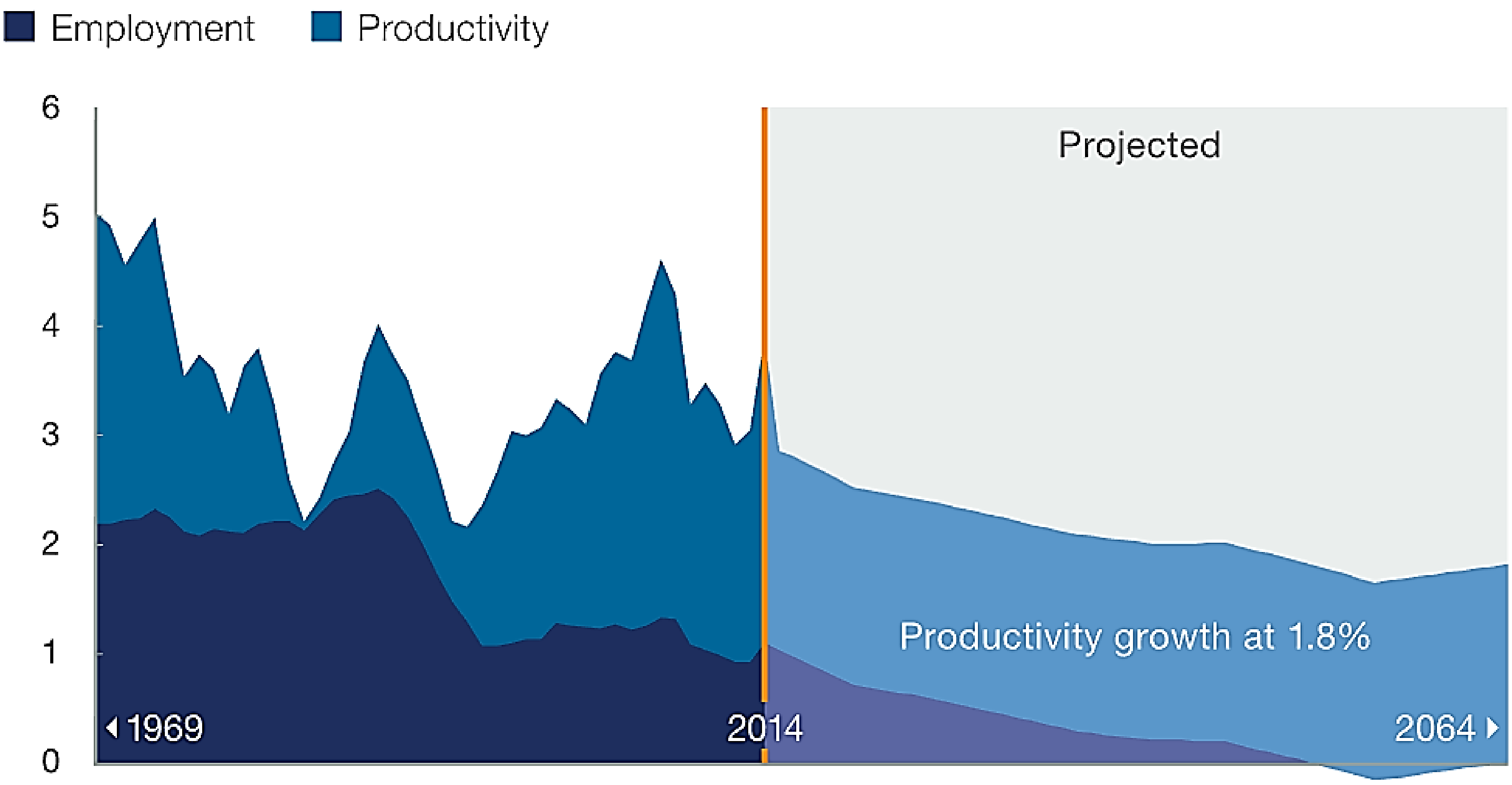


** Assuming 1.8% productivity growth, equal to average for 1964-2014*

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

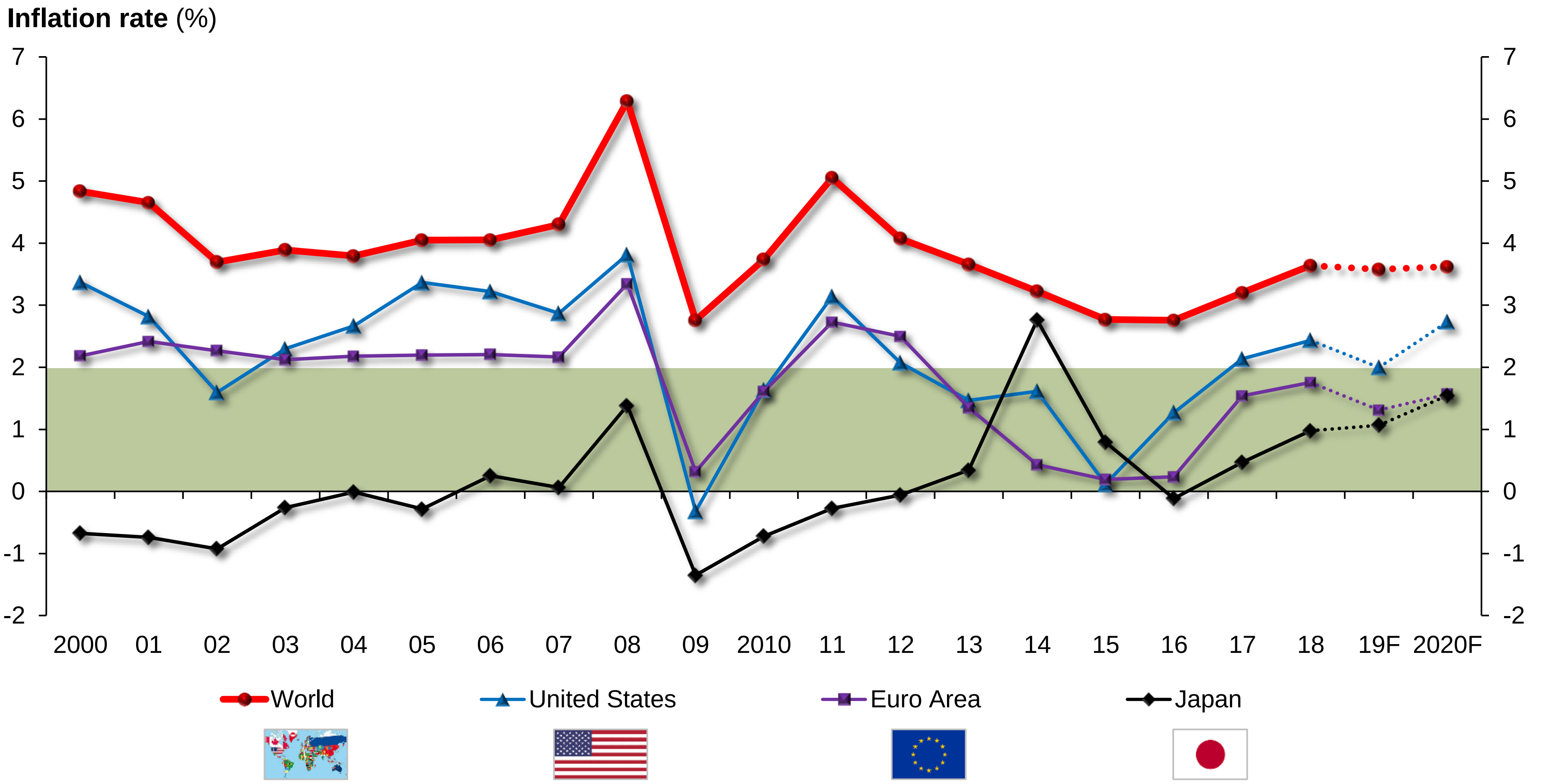
Section 2

Inflation & Interest Rate

Inflation or deflation?

Inflation stubbornly low, but subject to upward pressures

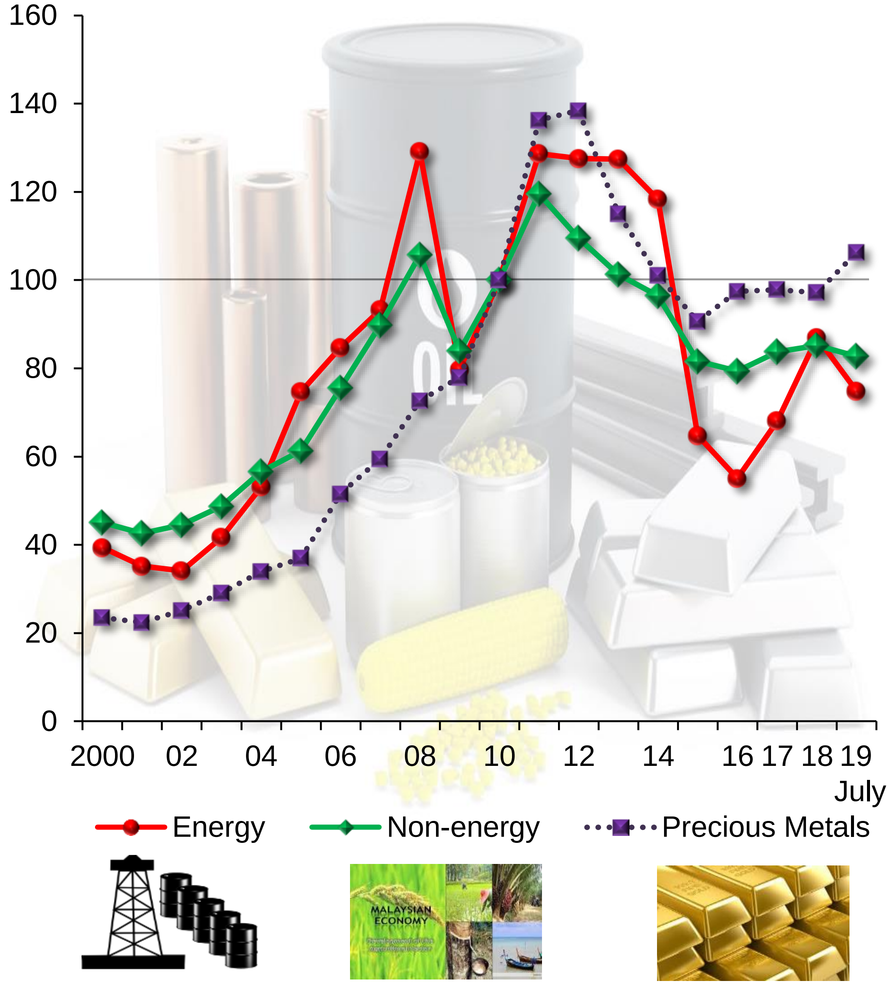
- Inflation rates in the US, euro zone and Japan are dropping below central bank targets of 2% inflation rate.



Source: IMF (WEO, April 2019)

Volatile energy prices remain a wild card

Commodity Price Index
(2010=100)

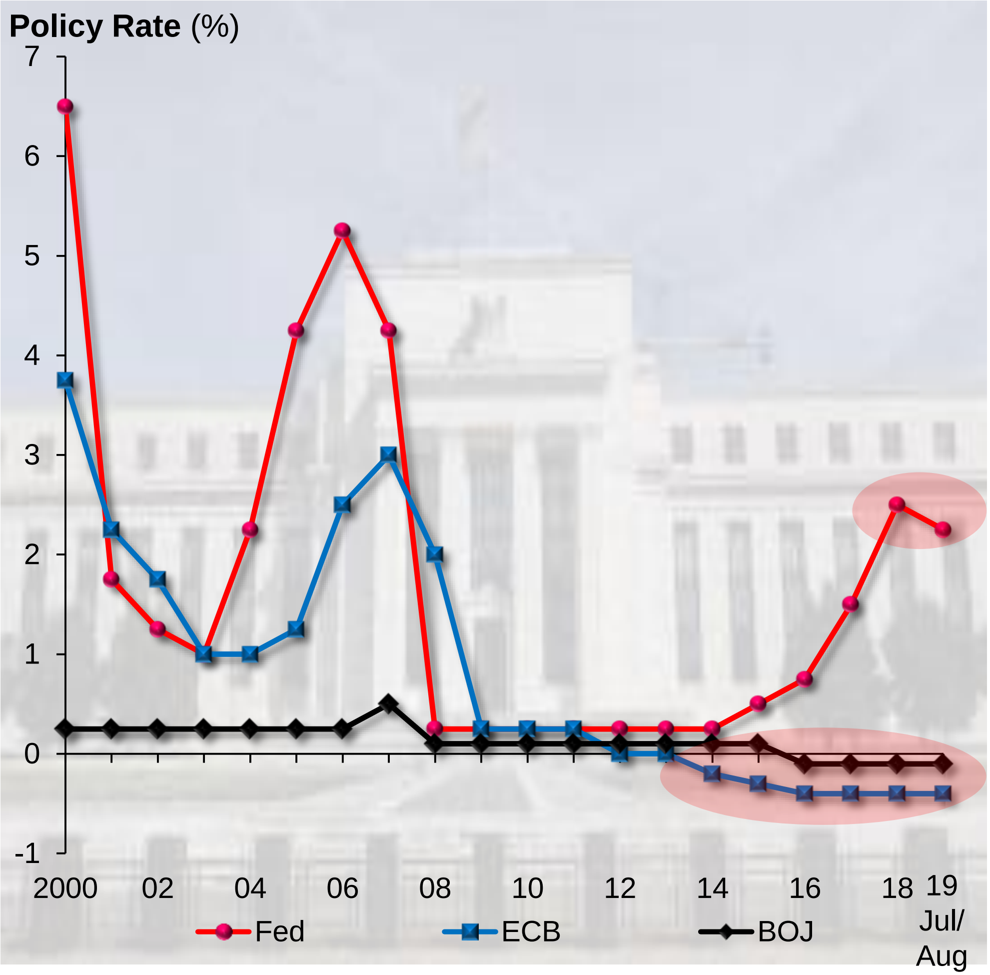


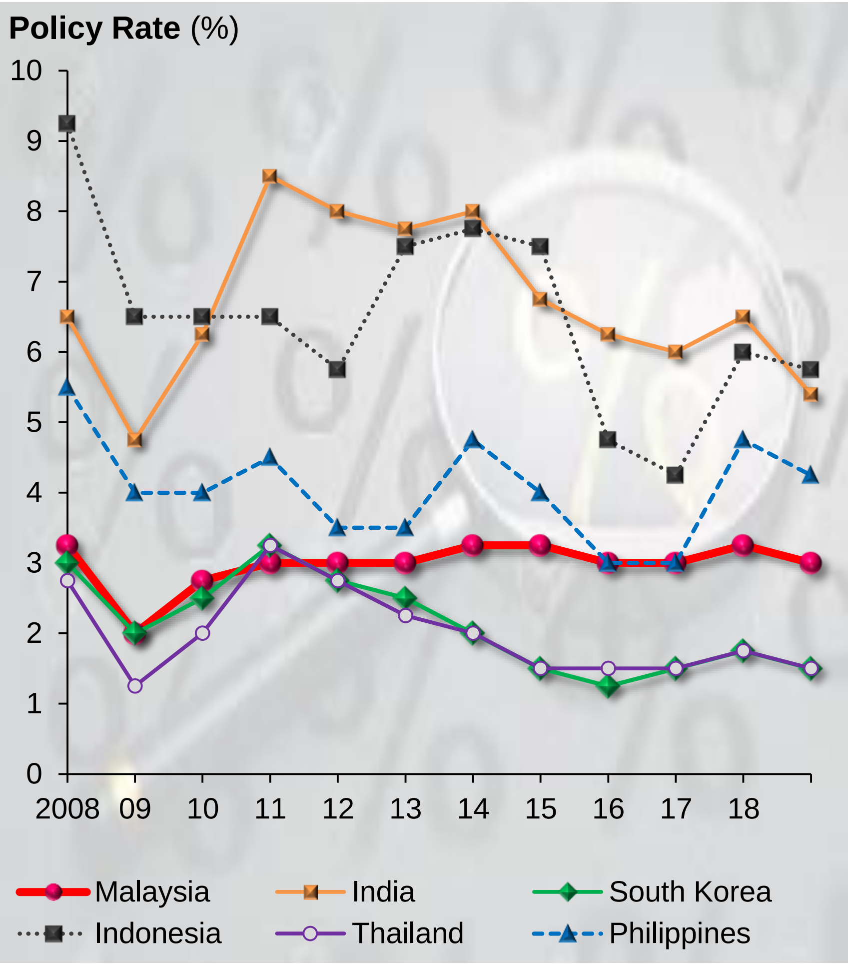
Source: World Bank

- **Brent crude oil prices** have climbed more than 30% to average US$71/bbl in May 2019 (US$51/bbl as at end-2018) before reverting to US$57/bbl as of 12 Aug. YTD (Jan to 12 Aug), **Brent crude oil prices average at US$65/bbl**.
- The US EIA expects Brent crude oil price to average US$65.15/bbl in 2019 and US$65.00/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 race interest rate to bottom

- Zero interest rate is a new normal again





Source: Fed; ECB; BOJ, Official central banks

Note: Interest rate on deposit facility applied as ECB's policy rate

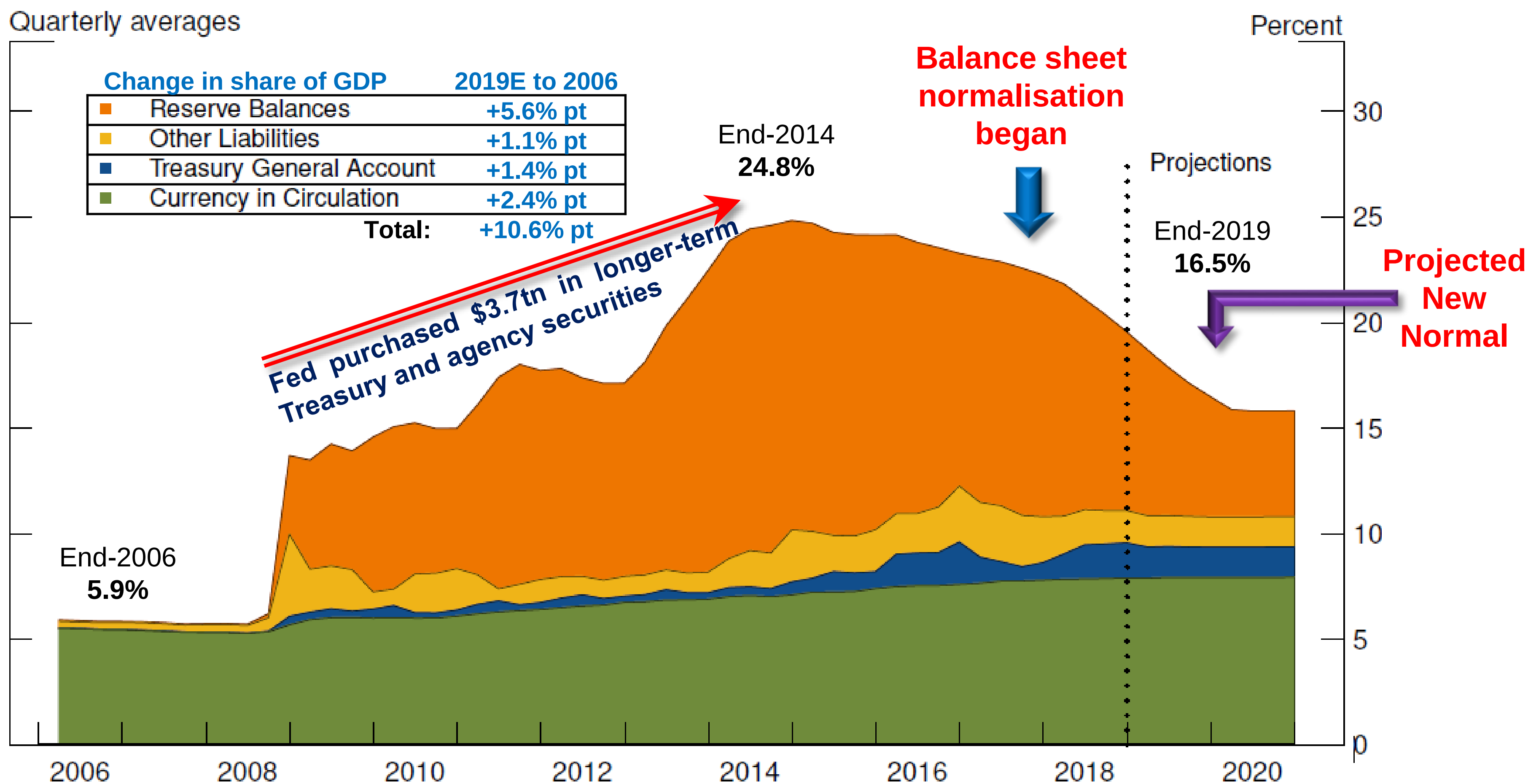
Snapshot of selected central banks' policy rate

End-period of	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019 (Jul/Aug)	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 ↑	2.00-2.25 ↓	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 ↑	5.40 ↓	5.40
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 ↑	1.50 ↓	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 ↓	2.75-3.00
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 ↑	5.75 ↓	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 ↑	1.50 ↓	1.50
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 ↑	4.25 ↓	4.25

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

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

Demographic developments - An important cause of the long-term movement in global interest rates

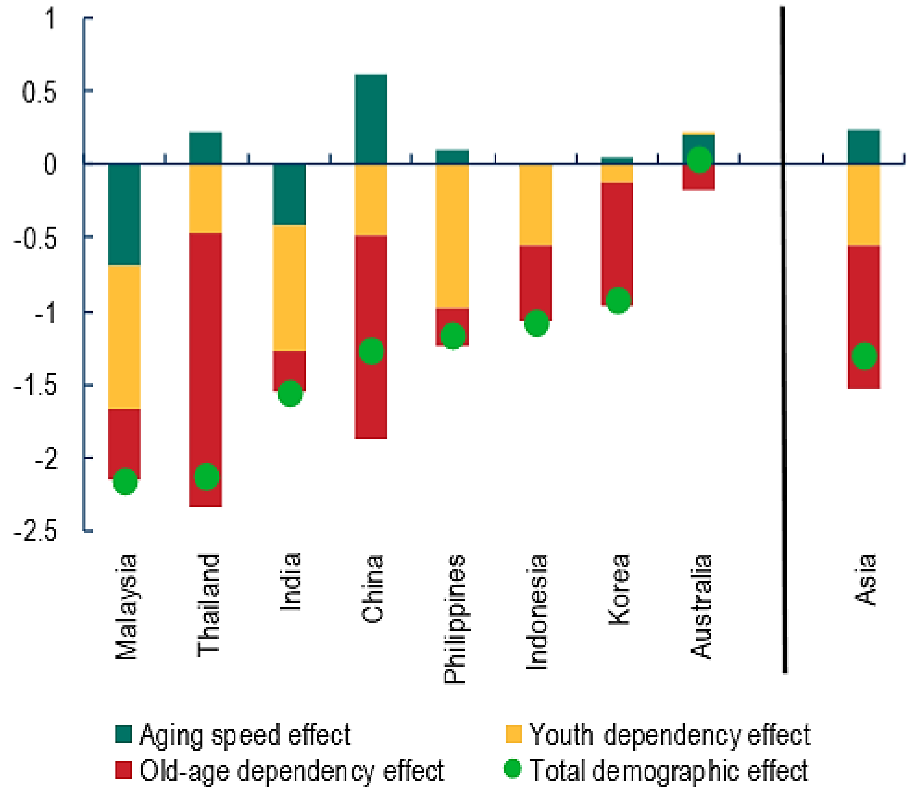
- Since 2008-09 Global Financial Crisis (GFC), long-term bond yields have declined significantly in advanced economies and Asia.
- Both conventional and unconventional monetary policies are an important force behind these low real rates.
- However, **structural factors** are also at play (adverse **demographic** developments, **a falling price of investment, lower productivity growth, savings glut, scarcity of safe assets** and **increasing wealth** and **income inequality)**
- **Demographics** affects economic activity (**incomes, savings, and investment**) through which affects **financial markets and interest rates**

	Savings	Investment	Interest Rates
 Youth Dependency	↓	↑	↑
 Old-Age Dependency	↓	↓	Ambiguous
 Aging Speed	↑	↓	↓

Demographic developments - an important cause of the long-term movement in global interest rates

- Overall, the results suggest that **demographic trends could put downward pressure on interest rates by about 1 to 2 percentage points in the next decade**, all else being equal
- The impact depends on three factors: the **degree of economic openness, the state of aging, and the speed of aging.**
- For **post-dividend countries** (Korea and Thailand), rising old age dependency is expected to depress interest rates.
- For **early-dividend countries** (India, Philippines and Malaysia), aging speed and falling youth dependency is projected to reduce or drive down interest rates.

Selected Asia: Impact of demographics on 10-yr Real Interest Rates
(Percentage points, cumulative change between 2020 and 2030**)**

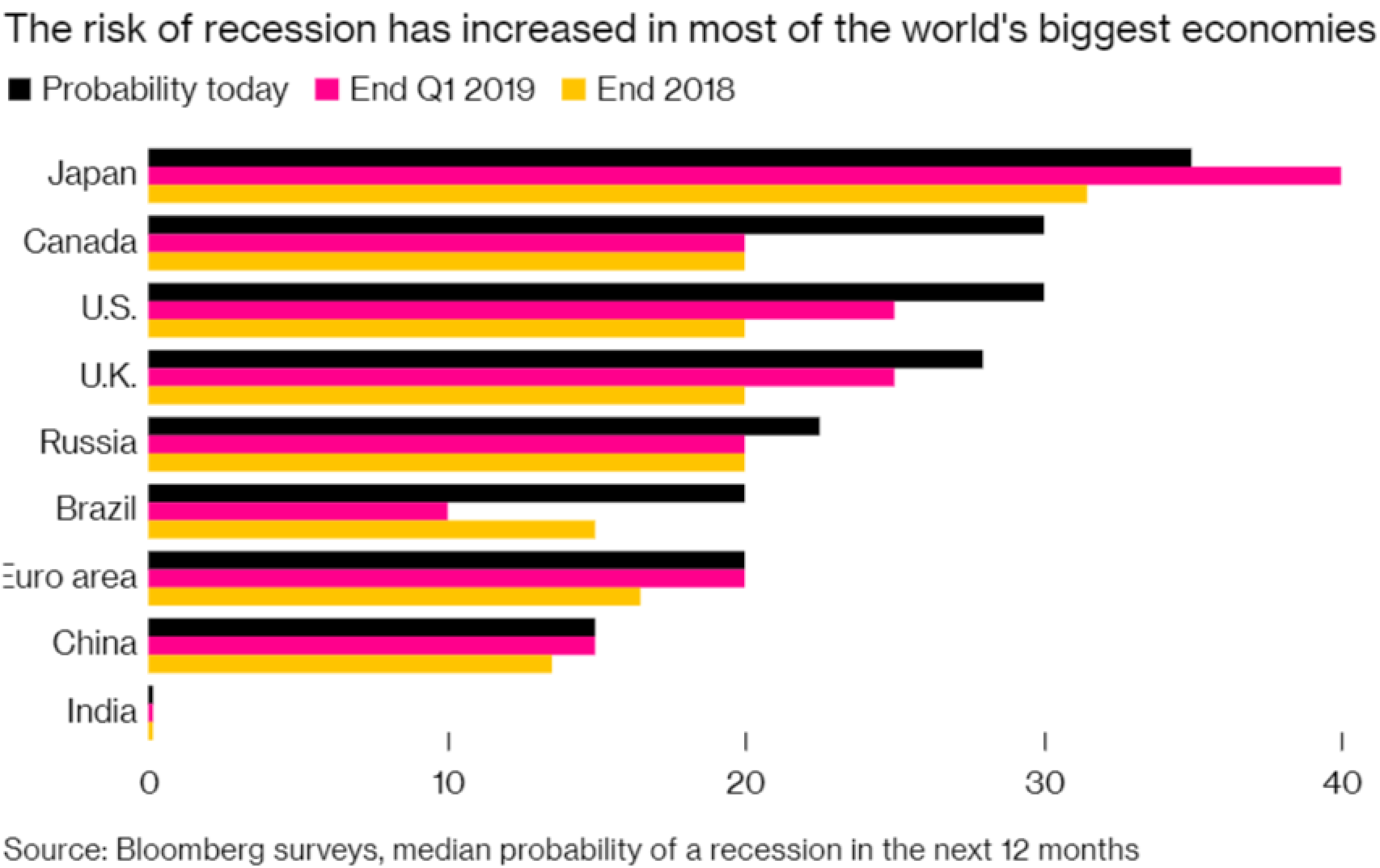


Source: IMF staff projections.
Note: The figure for Asia reflects the nominal GDP-weighted average.

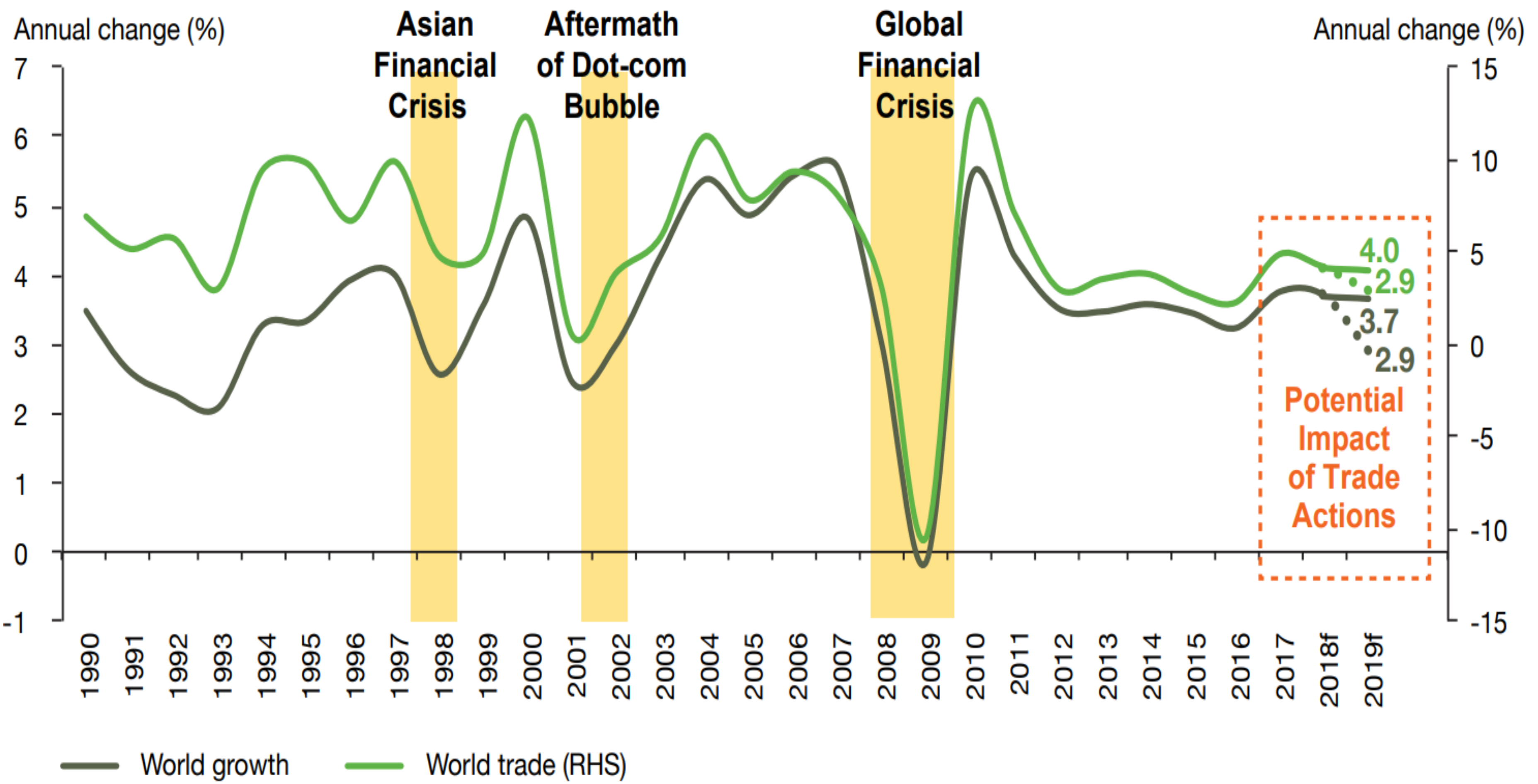
Section 3

Global Recession Risk

Recession risk on the rise



Intensified trade tensions pose significant risks to global economy



Source: BNM; IMF

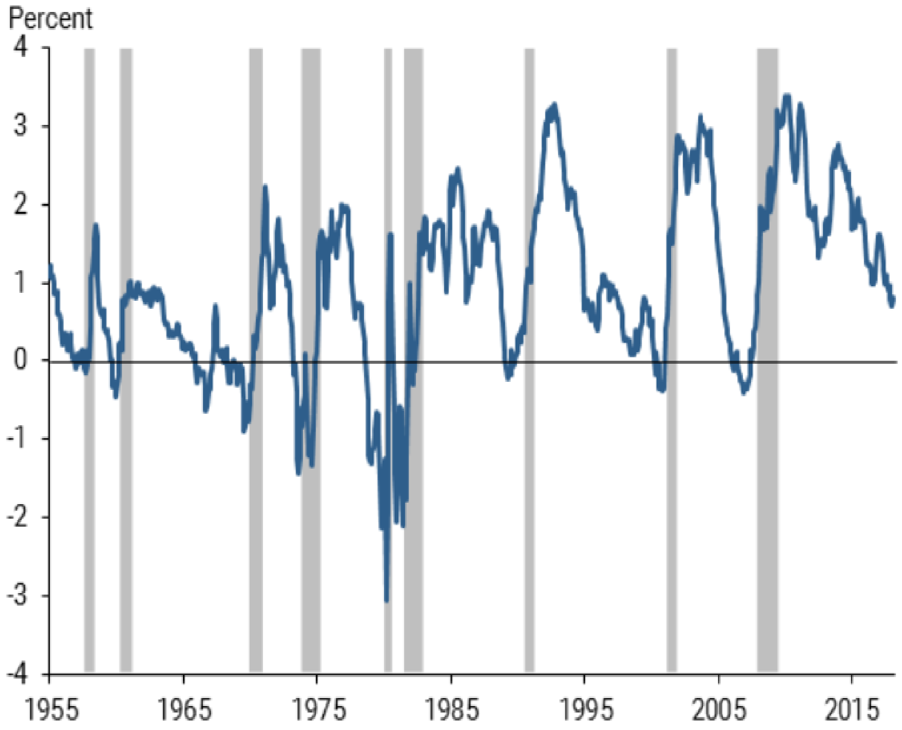
U.S. curve INVERTS for first time since 2007 – A reliable predictor of recession (Has happened ahead each of the past seven recessions)

Source: Bloomberg

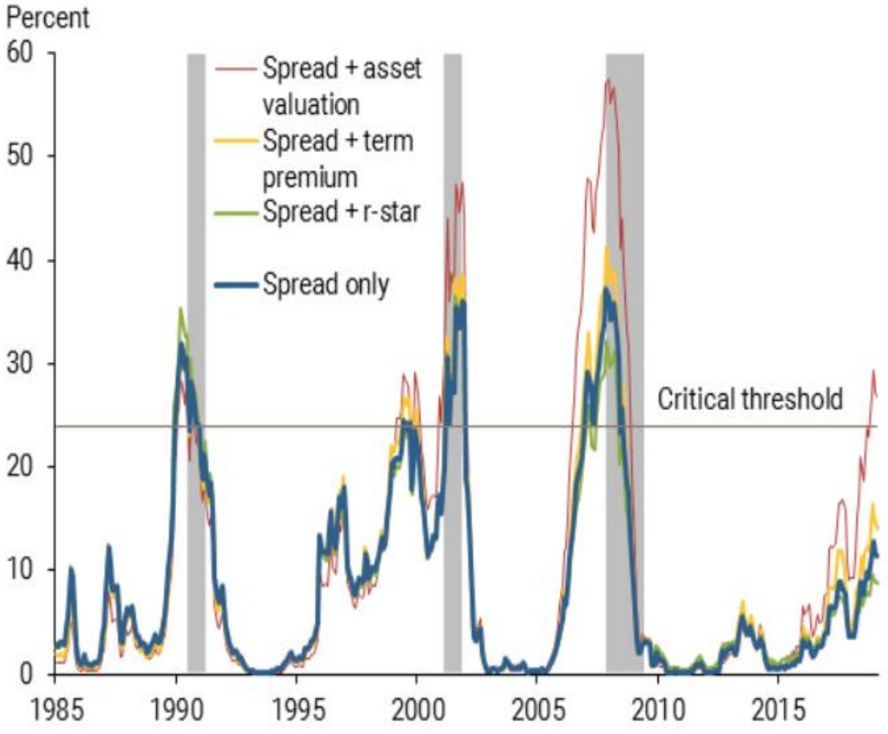
Every **RECESSION** over this period was preceded by an **INVERSION OF THE YIELD CURVE** that is, an episode with a negative term spread.

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

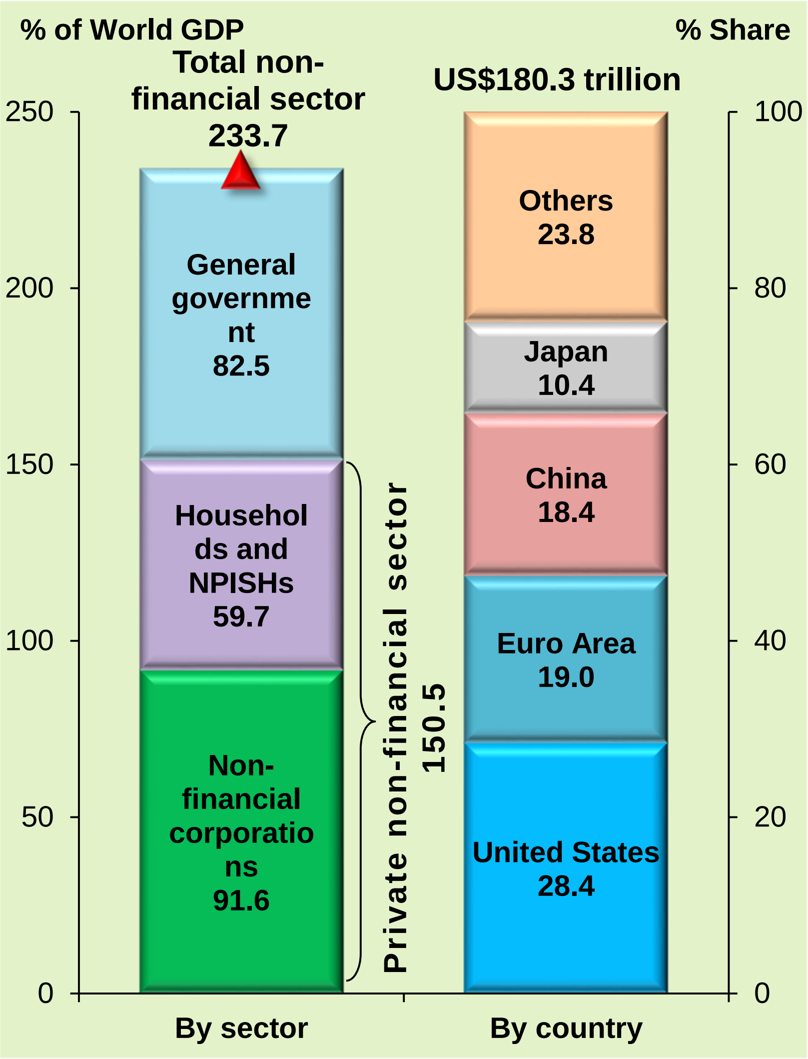


Source: Federal Reserve Bank of San Francisco

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

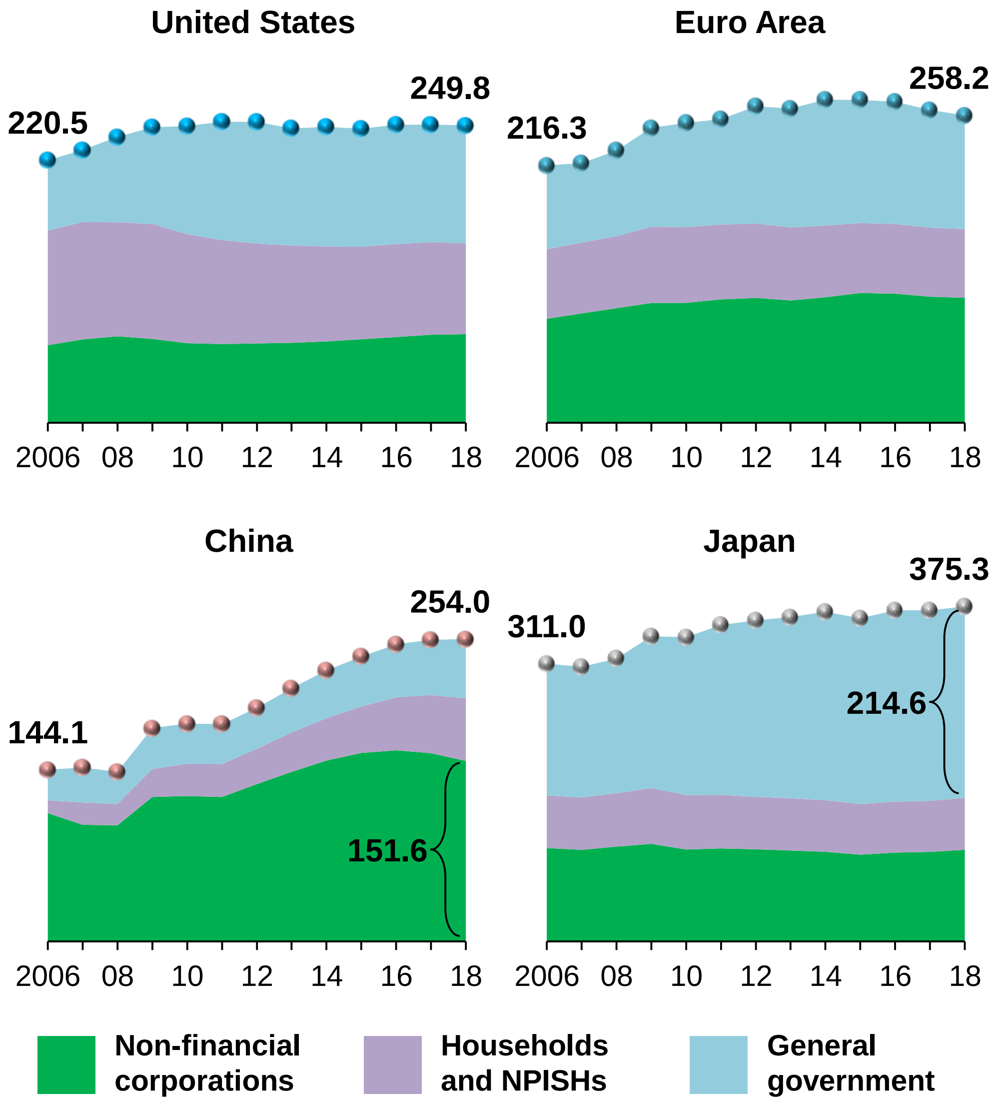
Global debt stood at 233.7% of world GDP as at end-Dec 2018

As at Dec 2018:

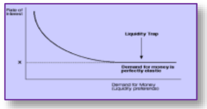


Source: BIS

Debt as % of GDP



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.

Section 4

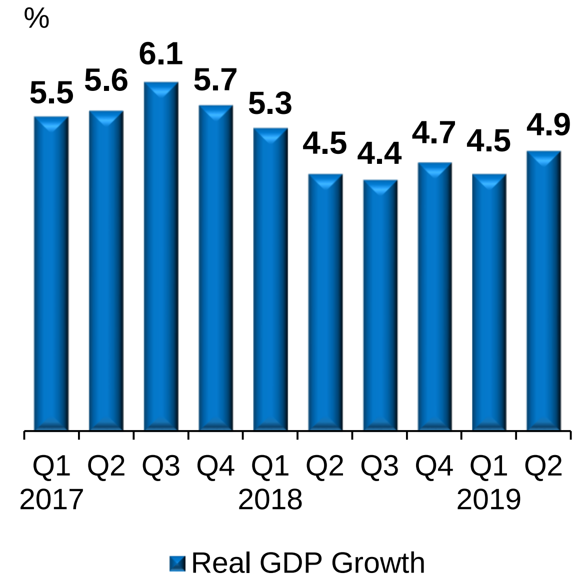
The Malaysian Economy

Can we weather the storm ahead?

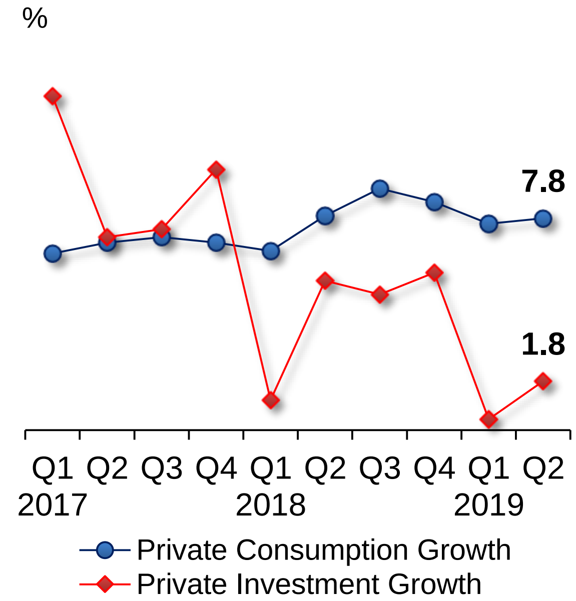
Malaysia's GDP growth to increase by 4.5-4.7% in 2019

- **Real GDP growth expanded higher in 2Q19 (4.9% yoy vs. 4.5% in 1Q19)**, underpinned by resilience consumer spending and a rebound in mining output**.**
- **SERC maintains GDP growth estimate at 4.5%-4.7% in 2019.** Looking ahead, GDP growth is expected to grow between 4.6% and 4.7% in 2H 2019.
- **Downside risks re**main: global recession risk, the escalation of the US-China trade tensions, slowing domestic demand.

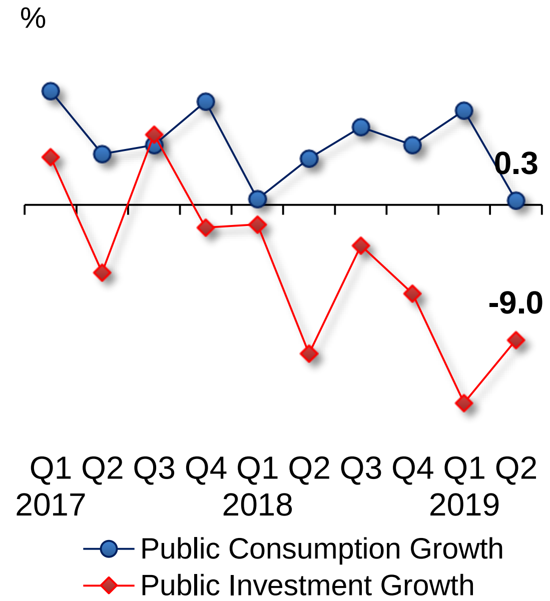
Malaysia bucks regional economies to record higher GDP growth in 2Q19



Consumer resilience remains, private investment cautious



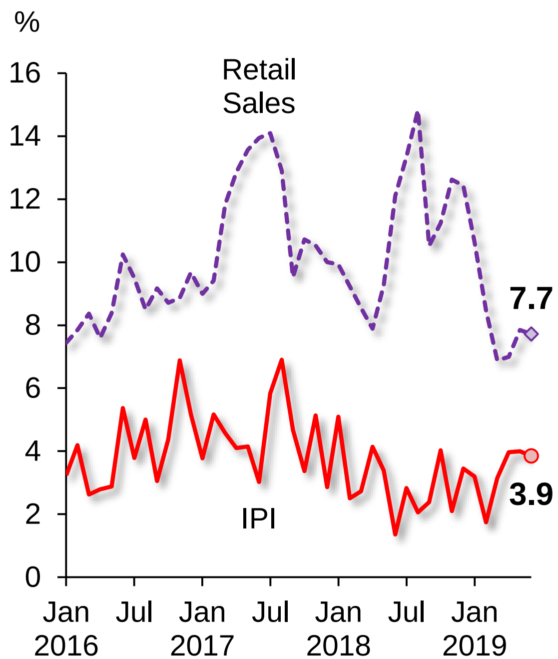
Public sector spending continued to contract



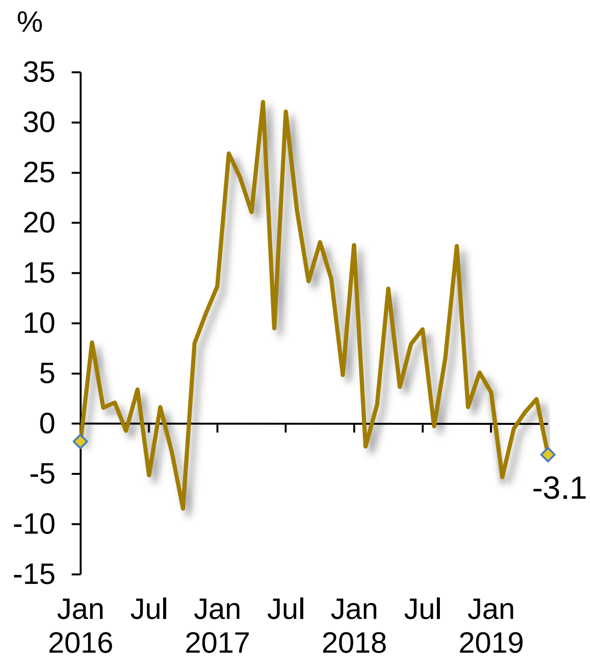
Source: DOSM

High frequency indicators suggest continued expansion; albeit slower

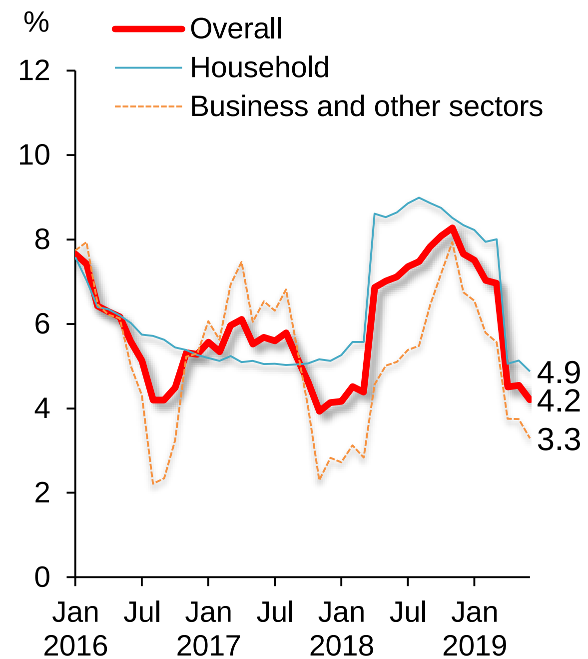
IPI growth sustained; retail sales growth moderated significantly



Exports declined by 0.2% yoy in the first half-year of 2019



Overall loan growth continued to moderate



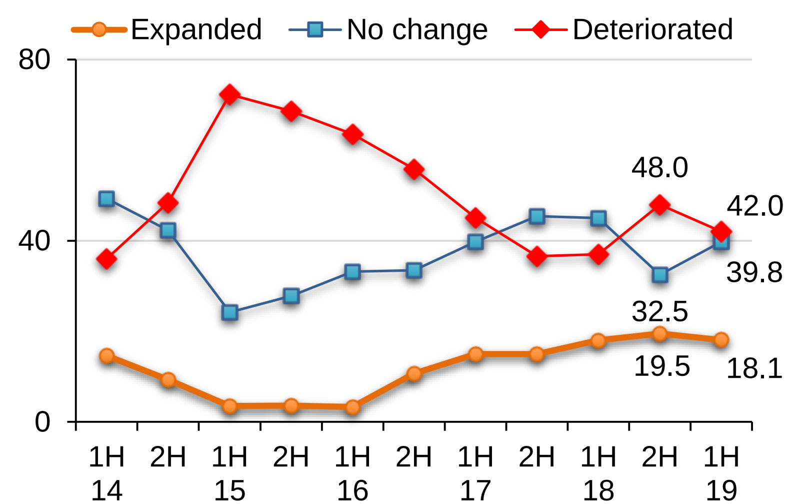
Source: DOSM; BNM

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

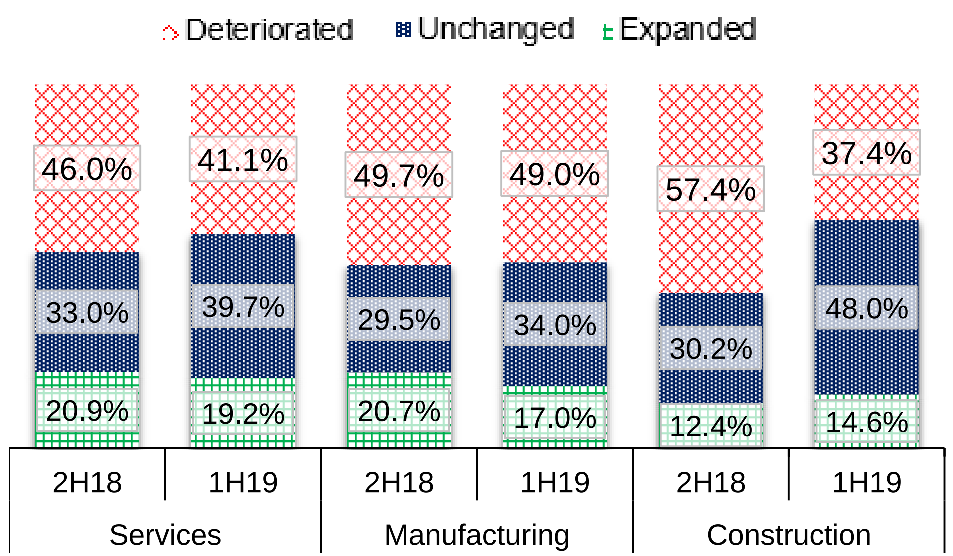
ACCCIM's M-BECS: Business conditions "Deteriorated" albeit at lower percentage in 1H 2019

- **Manufacturing sector** (49.0% of respondents) – Lingering concerns about a slowing global economy, a protracted trade tensions as well as slower domestic economic growth
- **Service sector** (41.1%) – Resilient consumer spending and demand for services related to trade and transportation as well as communications
- **Construction sector** (37.4%) – Revival of the mega projects (e.g. ECRL, Bandar Malaysia) has somewhat improved the business sentiment

Malaysia's business condition deteriorated in 1H 2019



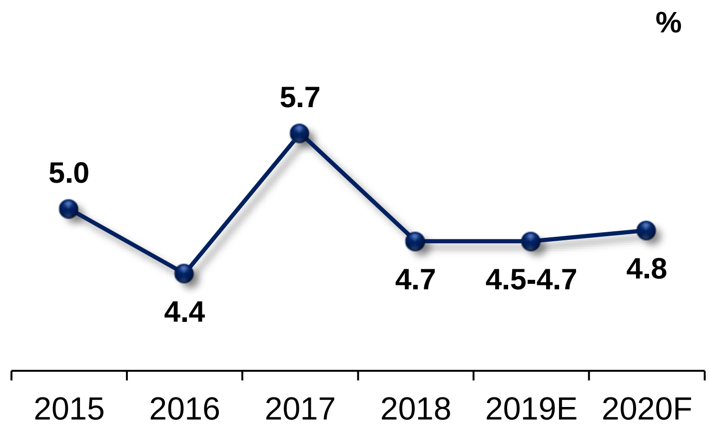
Manufacturing has highest share of pessimism



Economic Conditions and Prospects

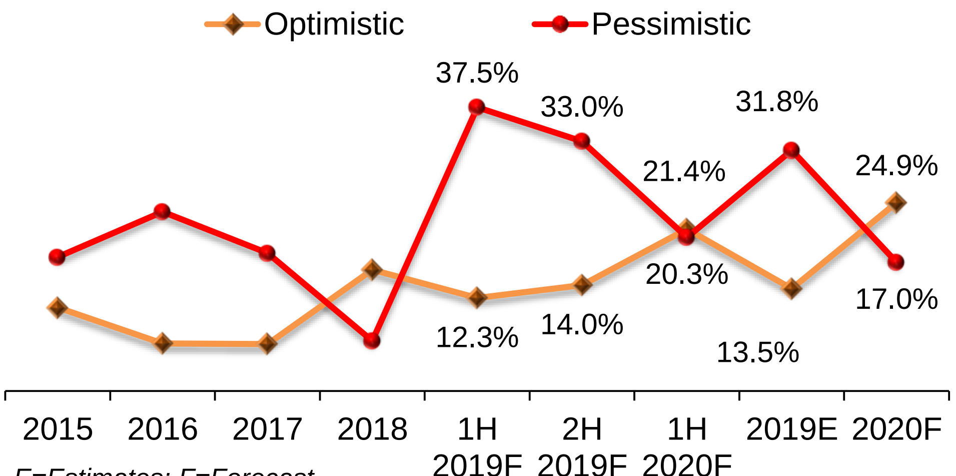
- **Maintain cautiousness about the economy in 2H 2019**. 53.0% respondents were “neutral”; 33.0% having “pessimistic” views, which is 3.4% points higher in the previous survey when asked about their expectations for 2H 2019.
- Businesses expect **domestic economy to remain challenging in** 2019. 31.8% rated “pessimistic” and only 13.5% of respondents were “optimistic”.
- Businesses are **cautiously positive on economy in 1H 2020** as reflected in a higher percentage of optimistic views (21.4% from 14.0% in 2H 2019) while pessimism sentiment was 12.7% points lower (20.3% in 1H 2020 vs. 33.0% in 2H 2019).

Malaysia real GDP growth projected to expand steadily in 2020



Source: DOSM; SERC’s estimates

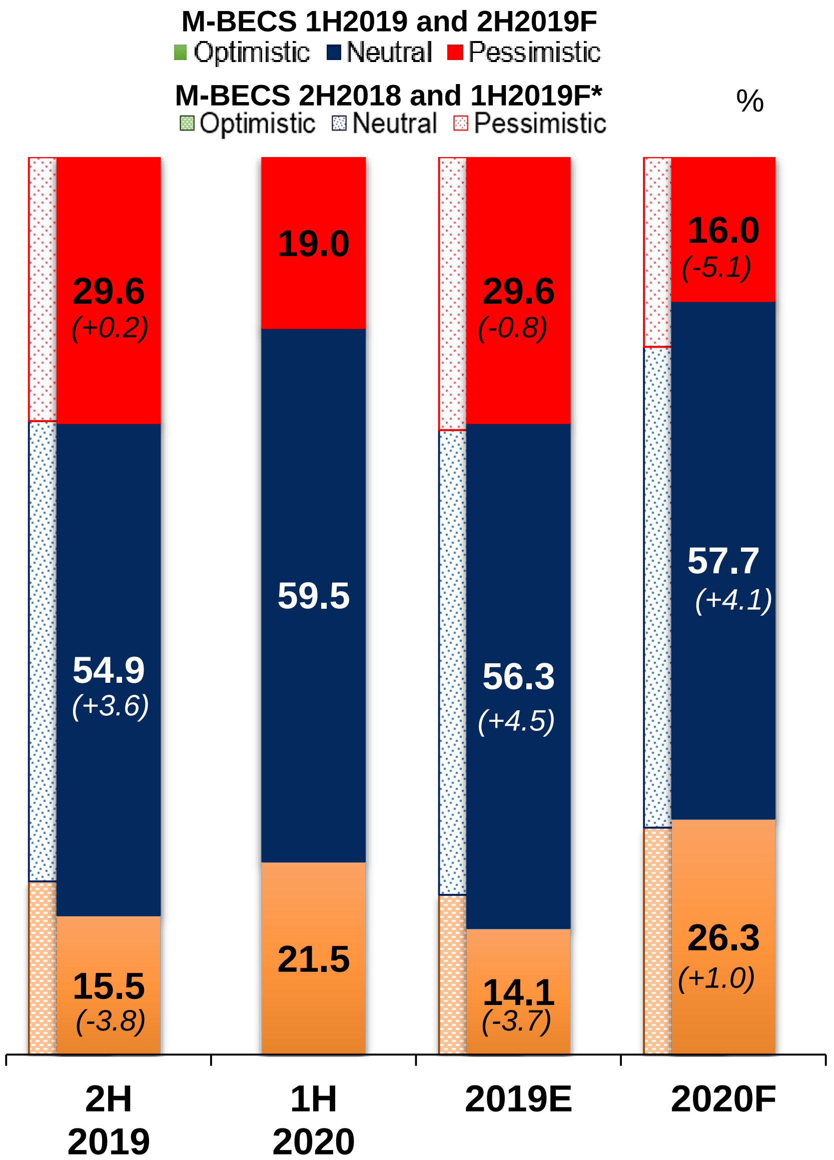
Respondents view 2020’s economic condition optimistically



E=Estimates; F=Forecast
1H2019F was obtained from previous survey

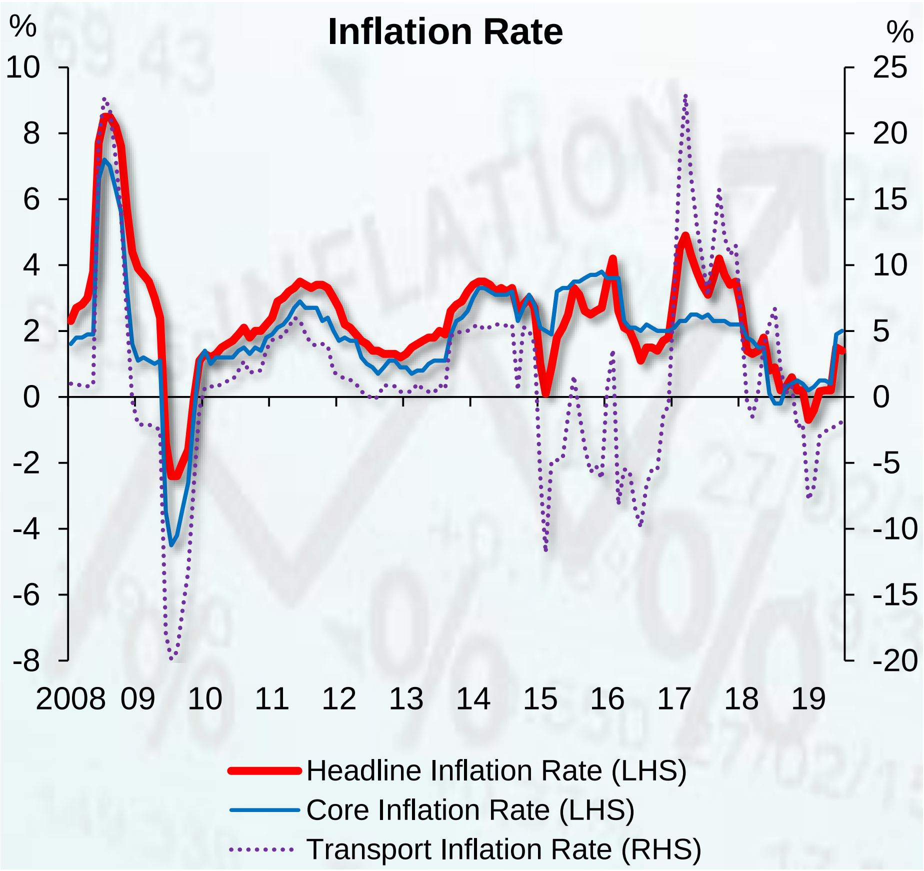
Business Conditions and Prospects

- Malaysian businesses are **keeping a cautious stance** on business conditions in 2H 2019 compared to 1H 2019.
- For the full-year of 2019, only 14.1% of respondents tagged overall business conditions as "optimistic".
- However, a shift in pessimism from 2H 2019 to 1H 2020 as there were lesser respondents having pessimistic views (19.0% in 1H 2020 vs. 29.6% in 2H 2019).
- Respondents are more positive about 2020's business prospects with a higher percentage of respondents (26.3%) compared to 2019 (14.1%).



E=Estimates; F=Forecast
• denotes data obtained from previous survey.
Figure in parenthesis denotes changes in % of respondents from previous survey

Inflation has returned to positive trajectory



Source: BNM; DOSM

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

- Headline inflation normalises to 1.5% yoy and 1.4% in June and July respectively after a year of either low or negative rate due to the change of consumption tax policy. Inflation up 0.3% in Jan-July.
- Core inflation remained healthy and ticked higher to 2.0% in July (1.9% in June), indicating continued domestic demand.
- SERC expects **headline inflation to average 0.8% in 2019** due to some cost pass-through from domestic cost factors. These include:
  - Lapse in consumption tax policy;
  - Increase in prices of soft drinks due to soda tax;
  - Increase in minimum wage;
  - Higher electricity surcharges for businesses; and
  - Potential higher increase in food prices.

Should BNM cut rate further?

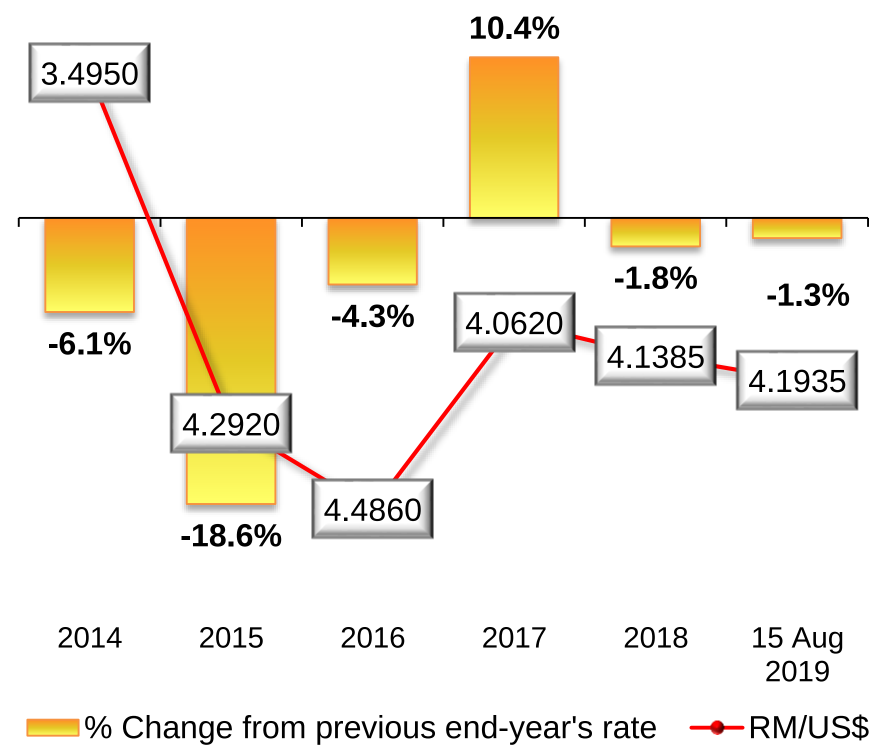
- BNM cut the overnight policy rate by 25 bps to 3.00% in May.
- Reserve monetary arsenal while continue to assess the impact of rate cut on domestic demand.

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

Ringgit outlook at RM4.15-RM4.20 per US dollar

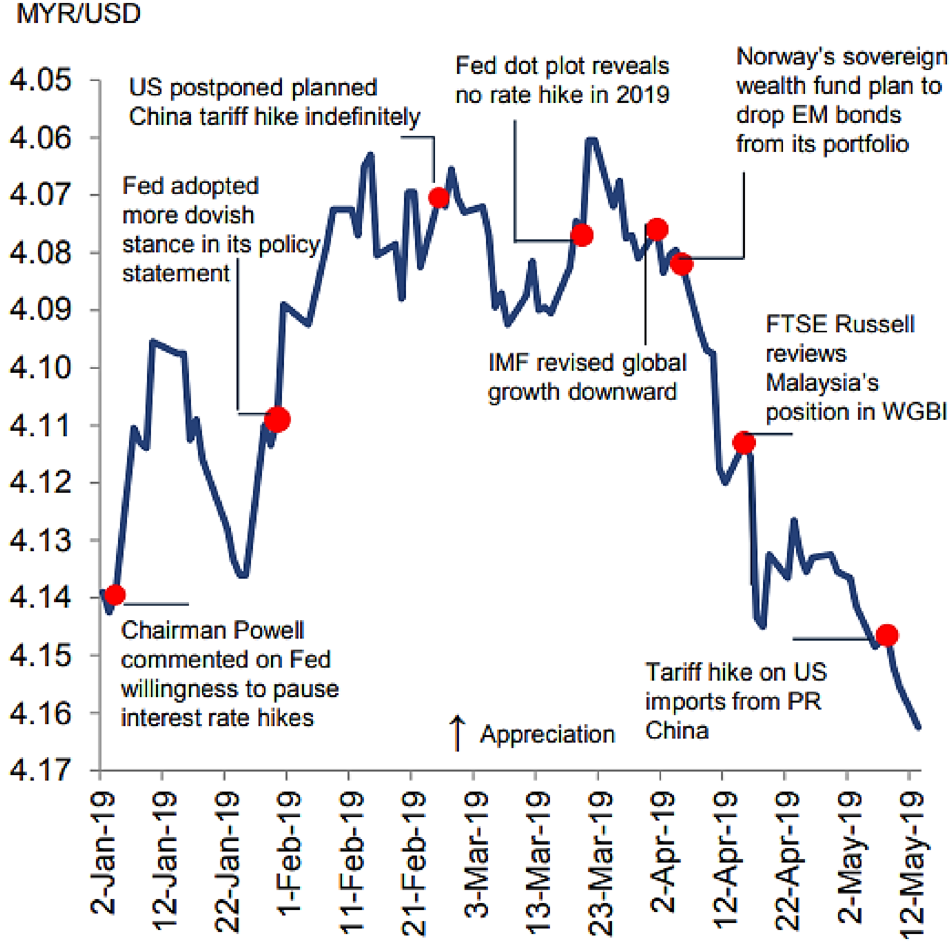


Note: Exchange rate (12:00 rate) as at end-period

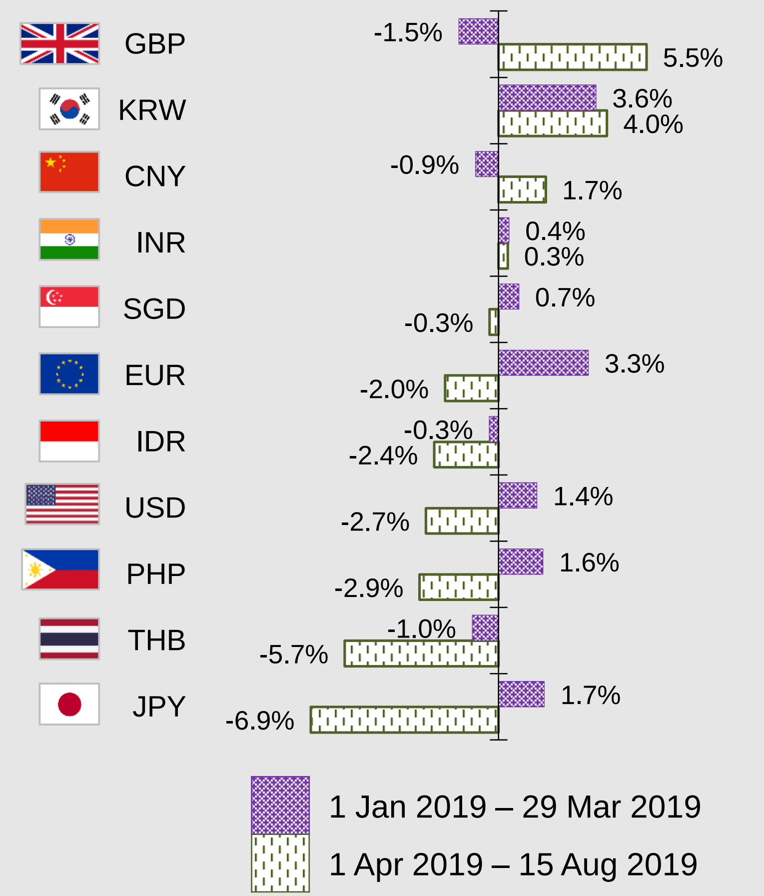
Source: DOSM; BNM; SERC

Ringgit's movements largely driven by external influences & cautious sentiment

Movements of ringgit and global developments



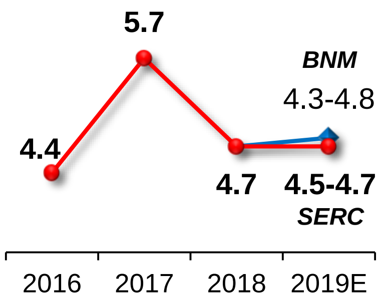
Ringgit performance against selected major and regional currencies



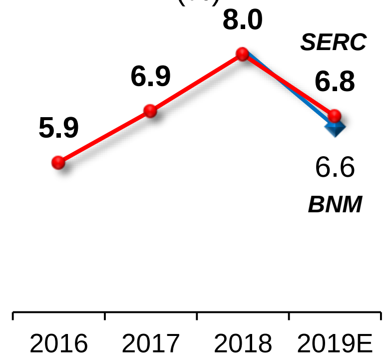
Source: BNM

Malaysia’s key economic indicators

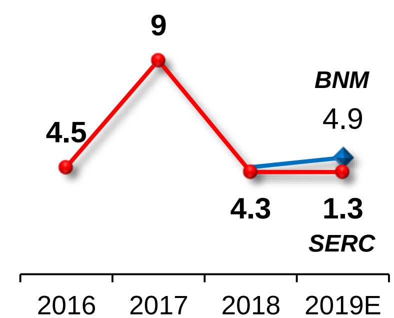
Real GDP Growth
(%)



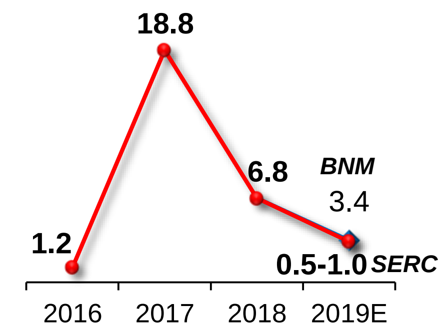
Private Consumption Growth
(%)



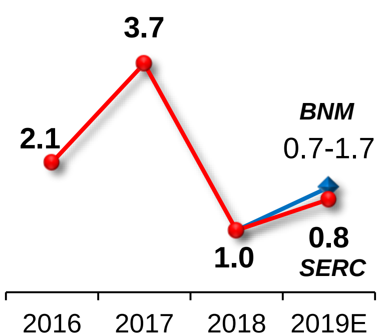
Private Investment Growth
(%)



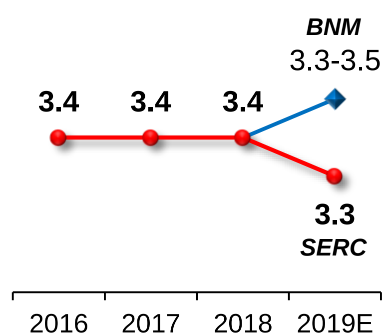
Gross Export Growth
(%)



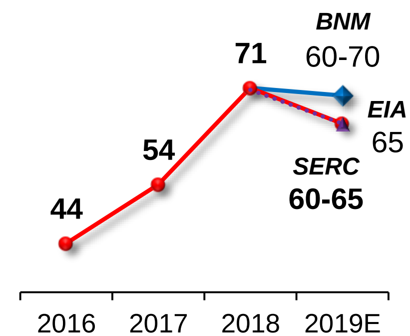
Inflation Rate
(%)



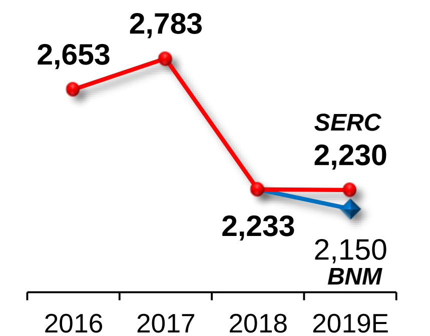
Unemployment Rate
(%)



Brent Crude Oil Prices
(US$/barrel)



Crude Palm Oil Prices
(RM/metric tonne)



Source: DOSM; EIA; MPOB; BNM; SERC

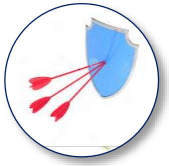
Sources of GDP growth: DEMAND and SUPPLY side

- **Positive drivers**: Continued expansion in services and manufacturing; recovery in agriculture and mining output
- **Negative drivers**: Weak investment activities and consolidation of public spending

% growth, 2015=100	**2016**	**2017**	**2018**	**2019 Q1**	**2019 Q2**	**2019 1H**	**2019E (BNM)**	**2019E (SERC)**
GDP by demand component								
Private consumption (57.0%)	5.9	6.9	8.0	7.6	7.8	7.7	6.6	7.2
Private investment (17.3%)	4.5	9.0	4.3	0.4	1.8	1.2	4.9	1.3
Public consumption (12.5%)	1.1	5.5	3.3	6.3	0.3	3.2	1.2	2.7
Public investment (7.4%)	-1.0	0.3	-5.0	-13.2	-9.0	-11.3	-7.1	--8.9
Exports of goods and services (67.6%)	1.3	8.7	2.2	0.1	0.1	0.1	0.1	0.3
Imports of goods and services (60.6%)	1.4	10.2	1.3	-1.4	-2.1	-1.8	0.0	-1.6
GDP by economic sector								
Agriculture (7.3%)	-3.7	5.7	0.1	5.6	4.2	4.9	2.8	4.6
Mining & quarrying (7.6%)	2.2	0.4	-2.6	-2.1	2.9	0.3	0.8	0.5
Manufacturing (22.4%)	4.4	6.0	5.0	4.2	4.3	4.2	4.8	4.4
Construction (4.9%)	7.4	6.7	4.2	0.3	0.5	0.4	3.0	0.8
Services (56.7%)	5.7	6.2	6.8	6.4	6.1	6.3	5.7	6.1
Overall GDP	**4.4**	**5.7**	**4.7**	**4.5**	**4.9**	**4.7**	**4.3-4.8**	**4.5-4.7**

Source: DOSM; BNM; SERC
Figure in parenthesis indicates % share to GDP in 2018

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 June 2019, banks' liquidity buffers exceeded regulatory levels with strong loan quality (aggregate non-performing loans (NPLs) at 1.6% of gross loans) and sizeable provisions (91.1% to total impaired loans). Liquidity coverage ratio (LCR) is well-above the required level (100% starting 2019) at 153%.

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**.

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**

社会经济研究中心

SOCIO-ECONOMIC RESEARCH CENTRE

SERC

谢 谢

THANK YOU

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