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Danajamin Business Budget Forum

Malaysia’s Economic Outlook: 2019 and Beyond

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11 September 2019

Key Messages

HEIGHTENING GLOBAL UNCERTAINTIES

MALAYSIA ECONOMIC OUTLOOK REMAINS CAUTIOUS

2020 BUDGET: EXPANSIONARY STANCE ON THE CARDS

Section 1

The World Economy

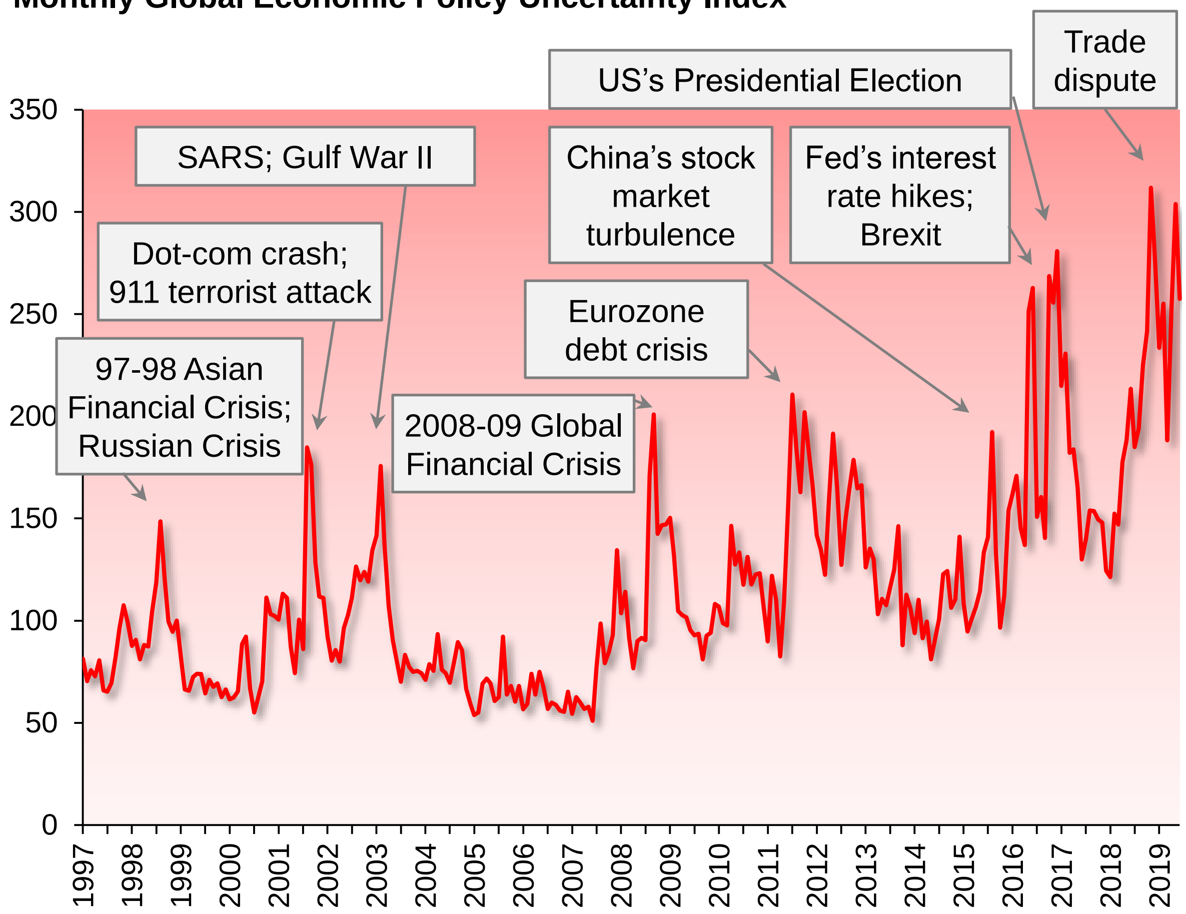
A synchronized slowdown amid global recession fears

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** (Middle-east and North Korea) and **political** risks (Brexit)

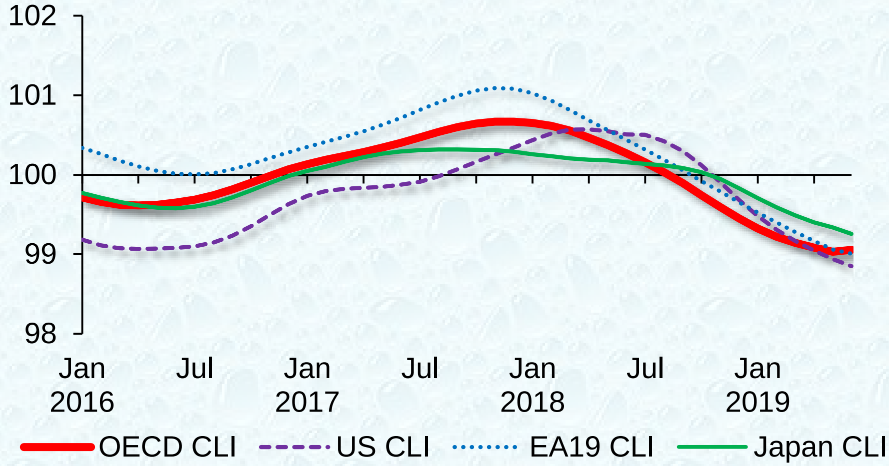
Monthly Global Economic Policy Uncertainty Index

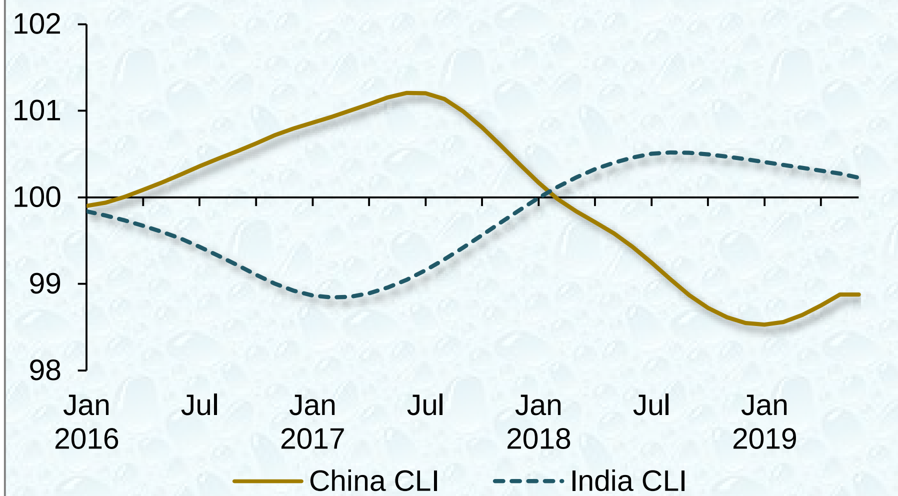


Source: Economic Policy Uncertainty

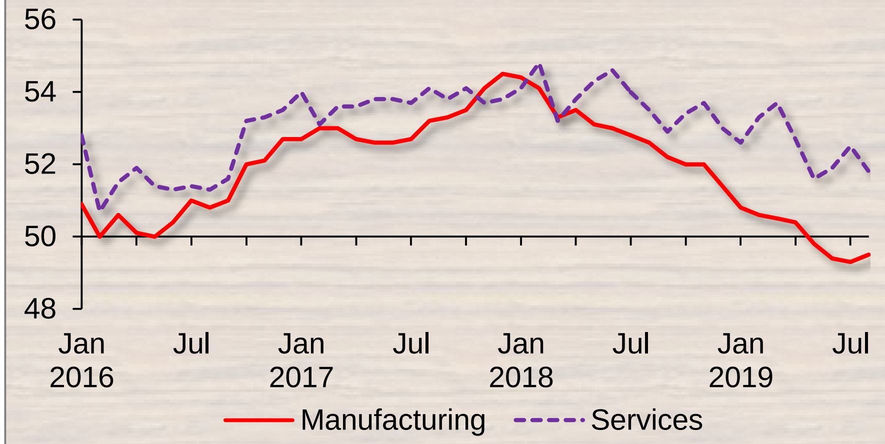
High frequency data pointing to slower global growth

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

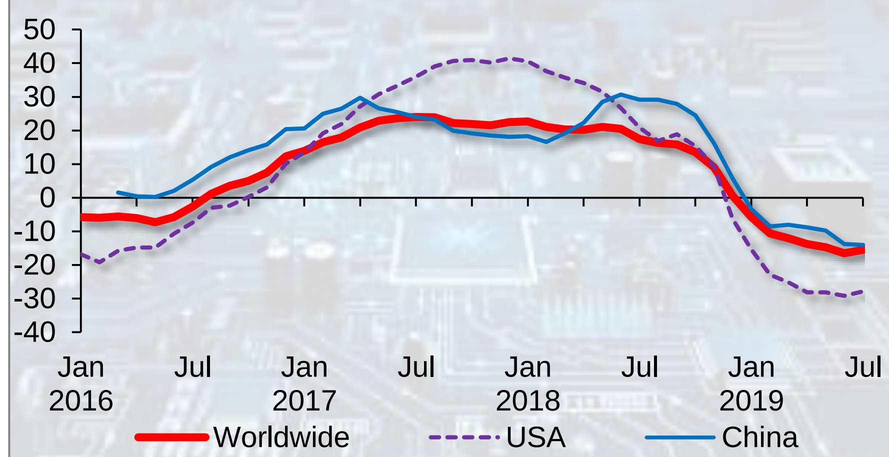




Global PMI for manufacturing and services
(50 = no change on prior month)



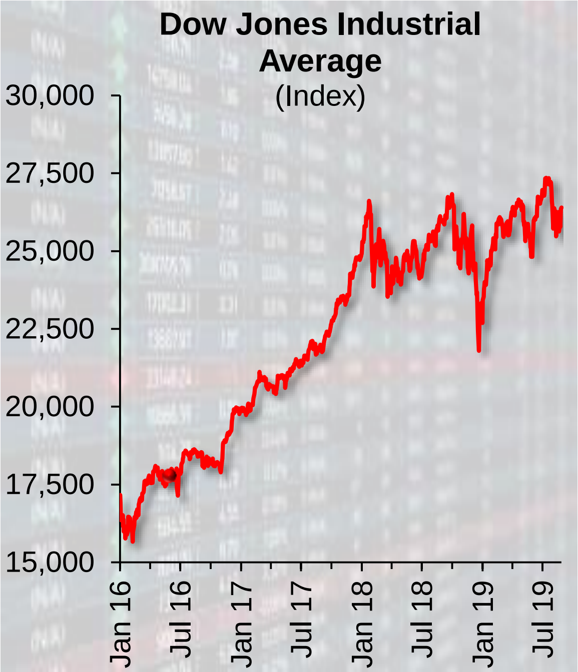
Global semiconductor sales
(%, 3-month moving average YoY)



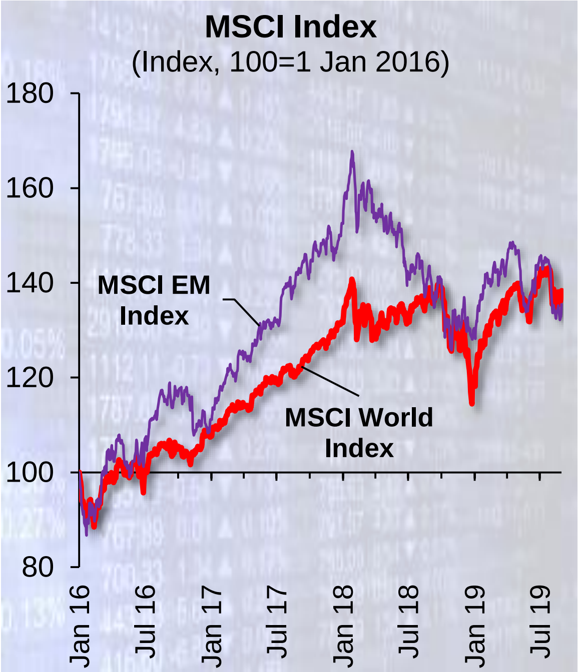
Source: OECD; Markit; SIA

Brace for high financial market volatility

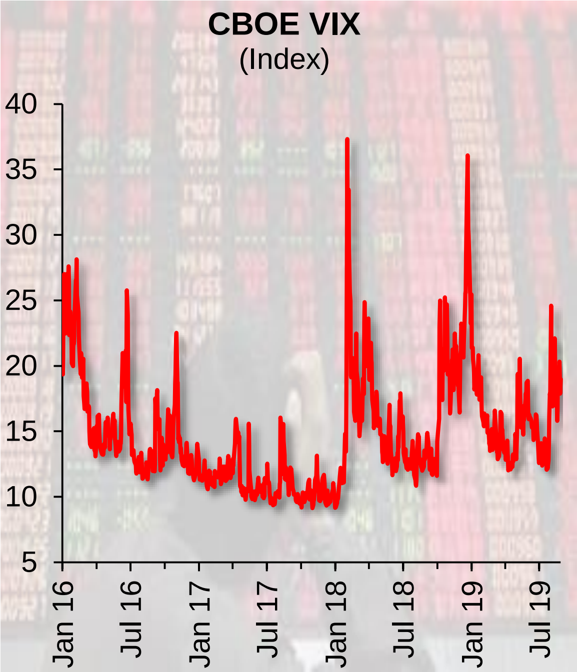
DJIA fluctuates amid uncertainty on the progress of trade talks



Emerging markets' equities are more volatile to economic newsflow



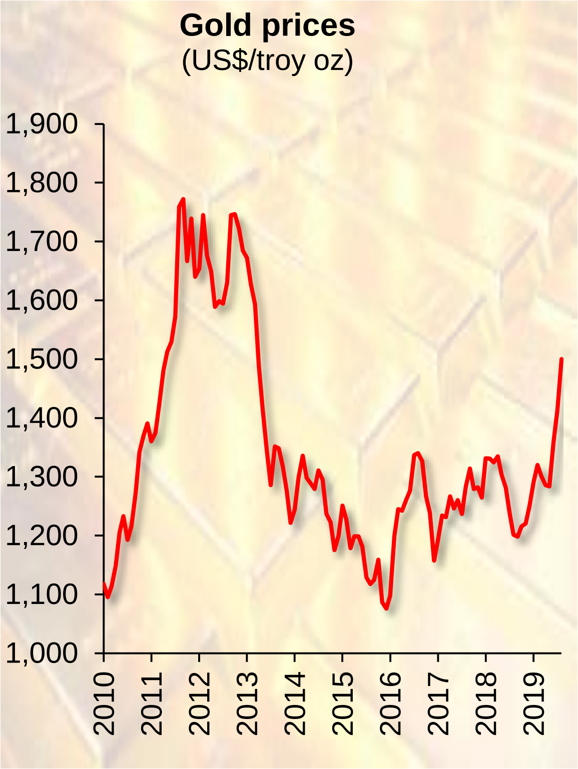
Recent global trade tensions and economic uncertainties spiked up 'Fear index' to above 20-pts



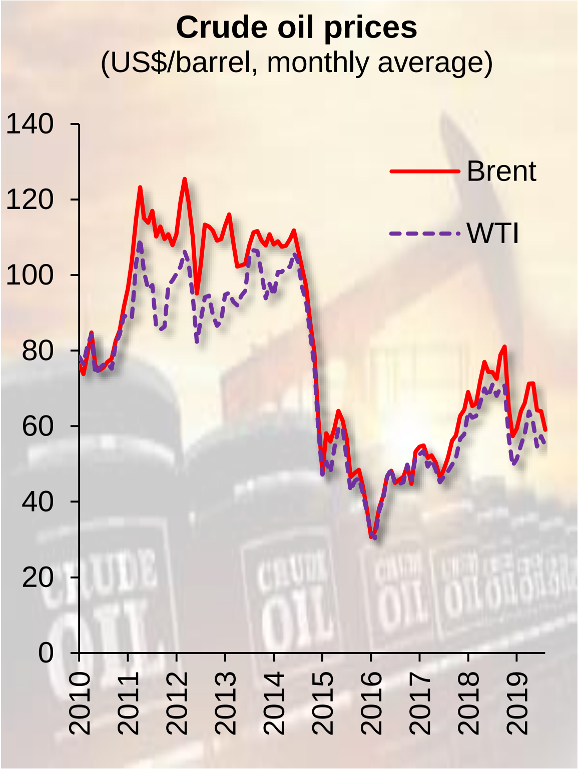
Source: WSJ; MSCI; CBOE

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

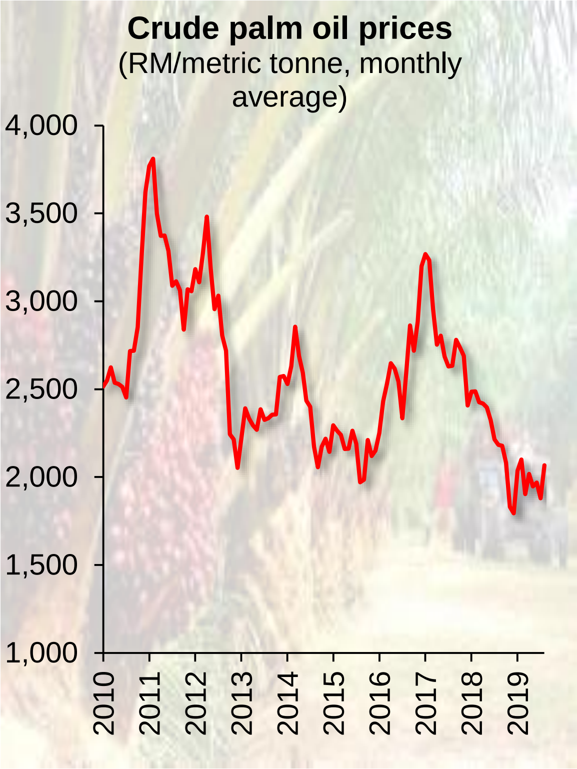
Gold prices rise on strong demand and falling long-term real interest rate



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



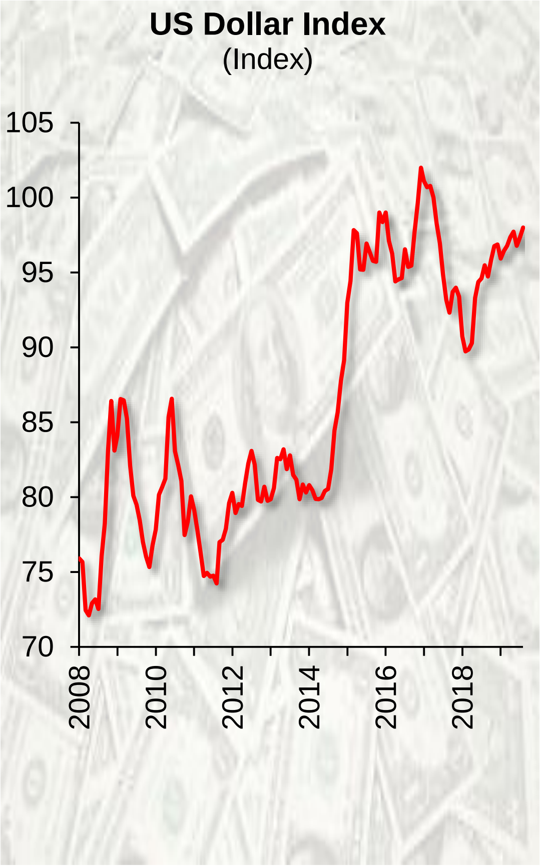
CPO prices yet to recover strongly amid a reduction in inventory



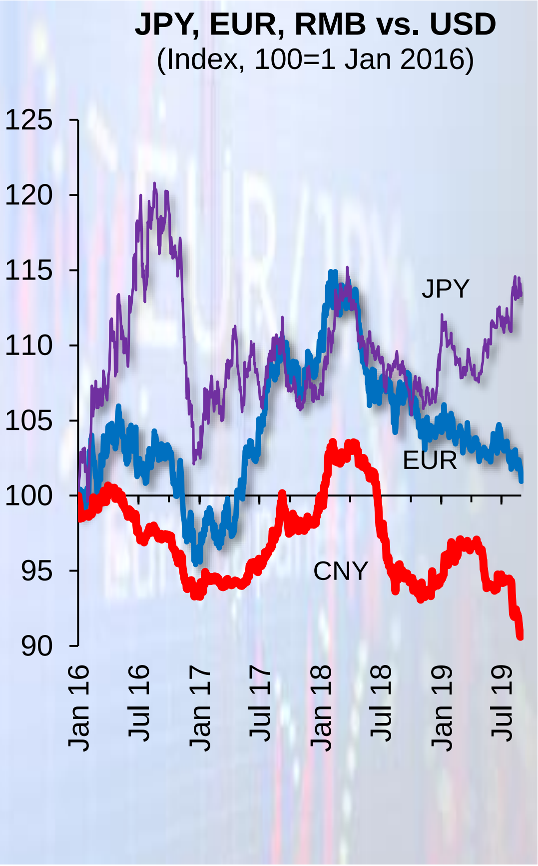
Source: World Bank; EIA; MPOB

Foreign exchange market – currency tensions

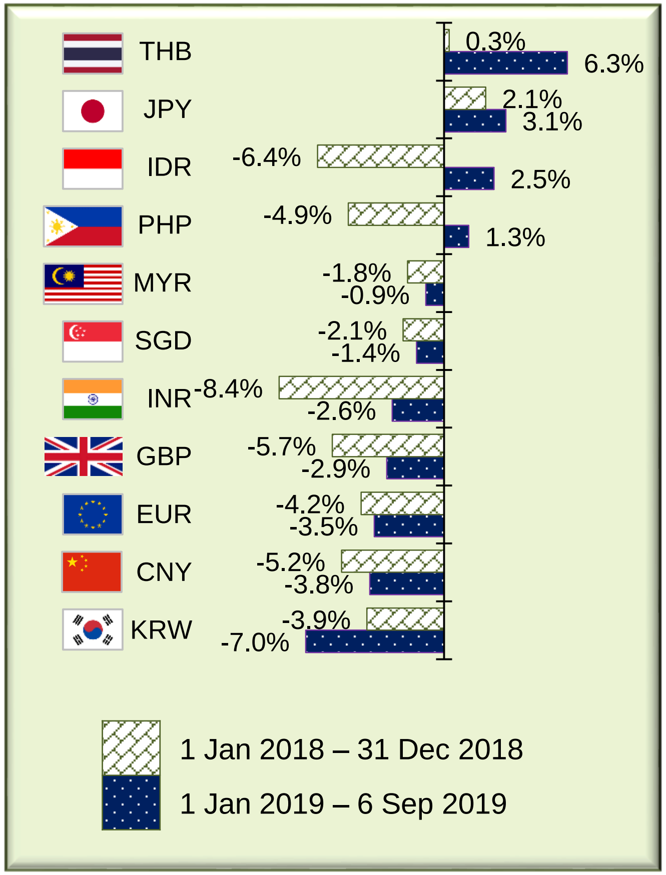
The US dollar index still firming up amid the Fed's dovish stance



RMB's weakness flares currency tensions



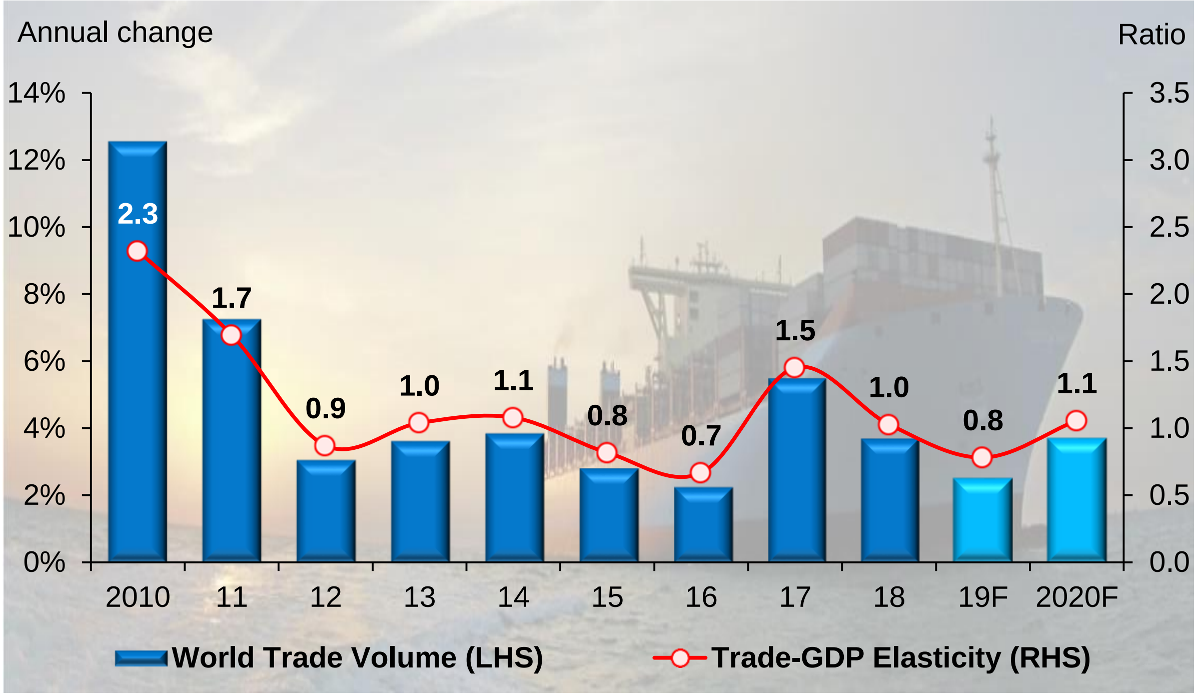
Major and emerging market currencies against the USD

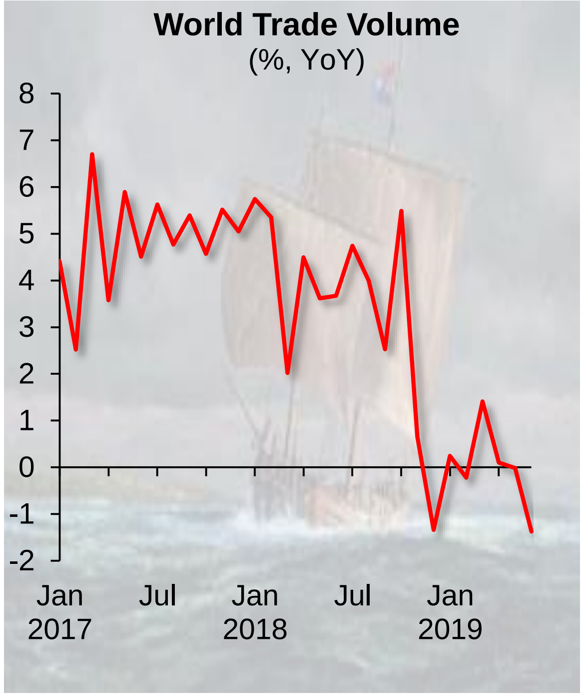


Source: WSJ; BNM (cross rate)

Global trade weakness continues

- The **WTO** slashed this year's **global trade growth** forecast to **2.6**% (vs. IMF's second round downward revision to 2.5% from 3.4% and 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 higher to 1.1x in 2020.

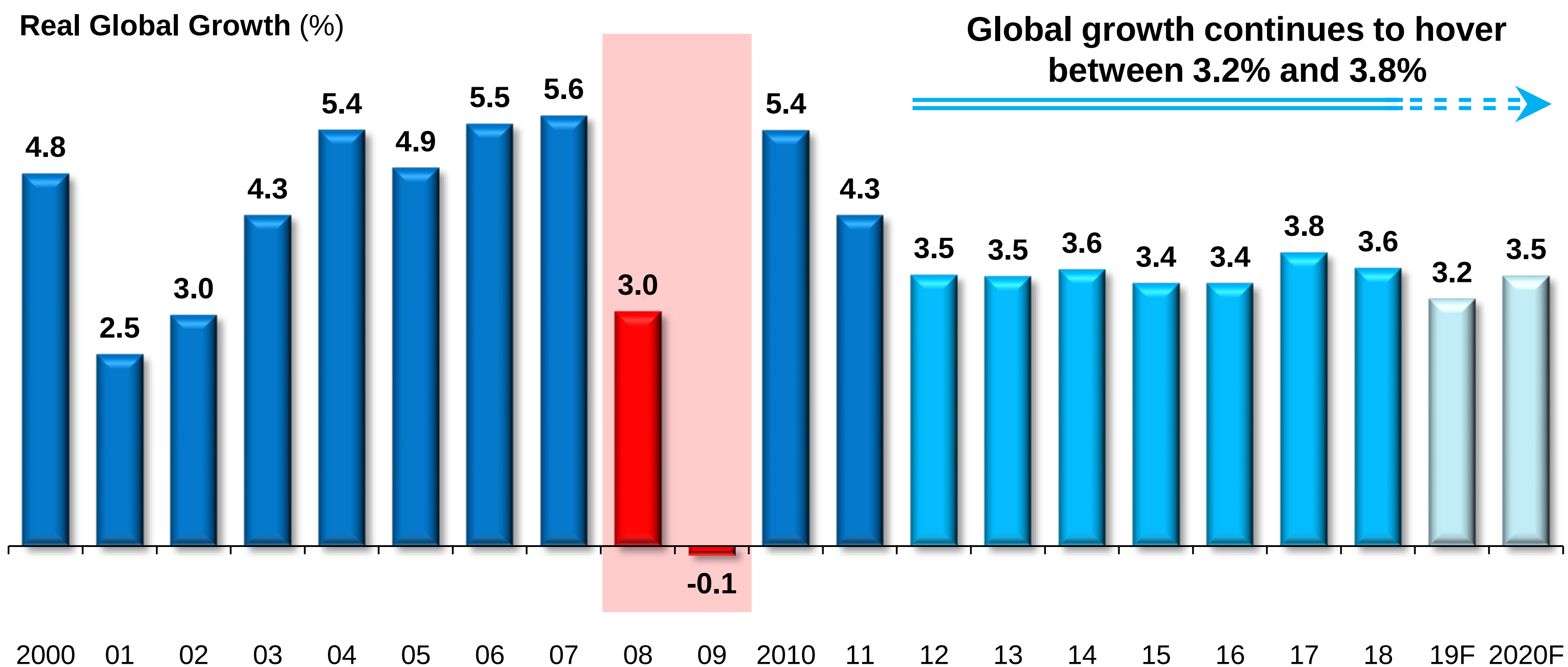




Source: IMF; SERC's computation; CPB Netherlands

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 2.9% to 2.7% to **2.6%**); and **OECD** (from 3.5% to 3.3% to **3.2%**).
- 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***).

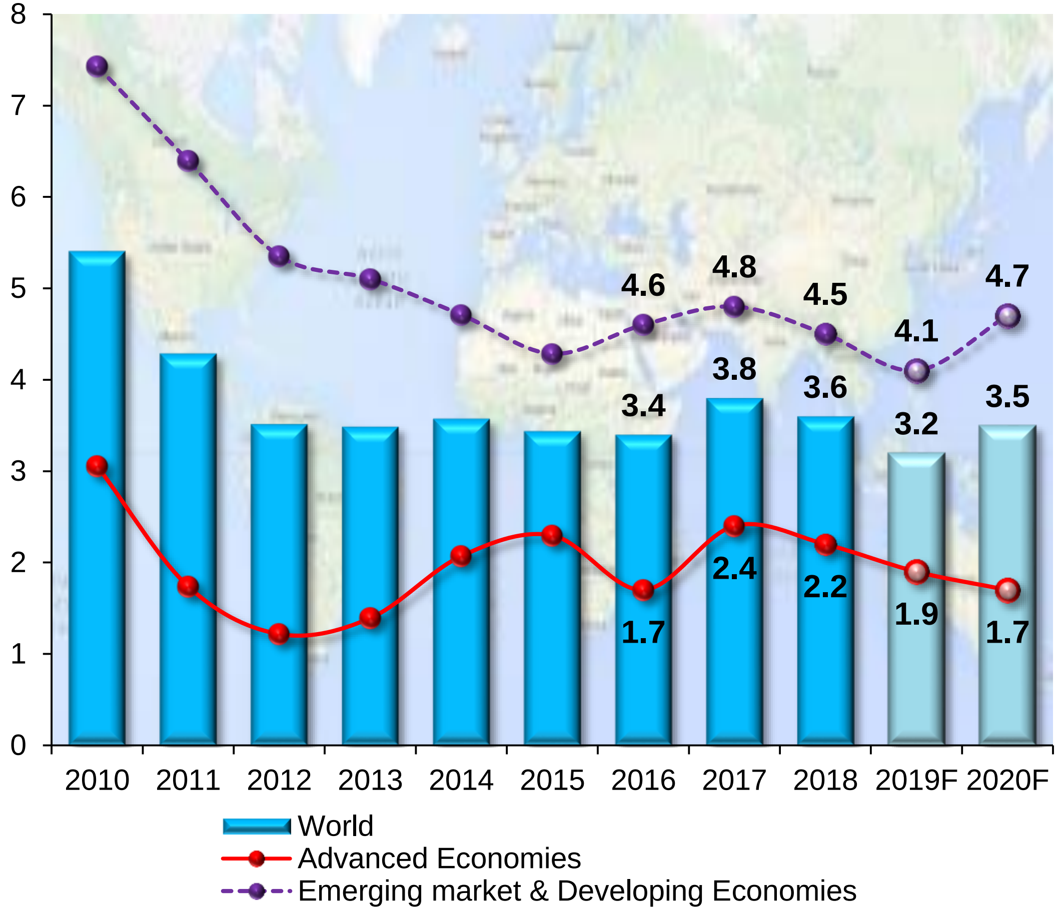


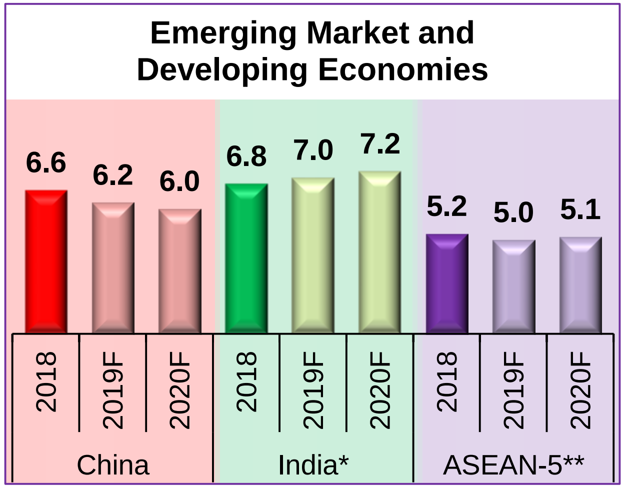
Source: IMF (WEO update, July 2019)

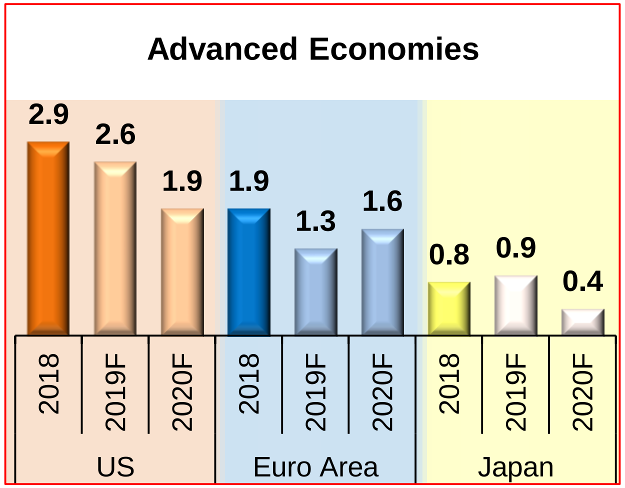
Deepening trade wars can slash global growth in 2020

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)

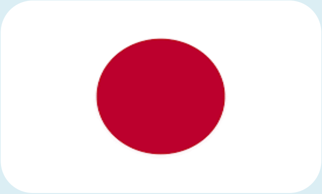
Economic outlook: US, Euro area, Japan and China

2019E: 2.6%; 2020F: 1.9%

- At least 30% recession risk
- Resilient consumer spending
- Trade dispute
- Fading fiscal stimulus

2019E: 1.3%; 2020F: 1.6%

- Lingering weakness in industrial sector
- Weaker global growth
- Geopolitical concerns and political risk
- Hard Brexit



2019E: 0.9%; 2020F: 0.4%

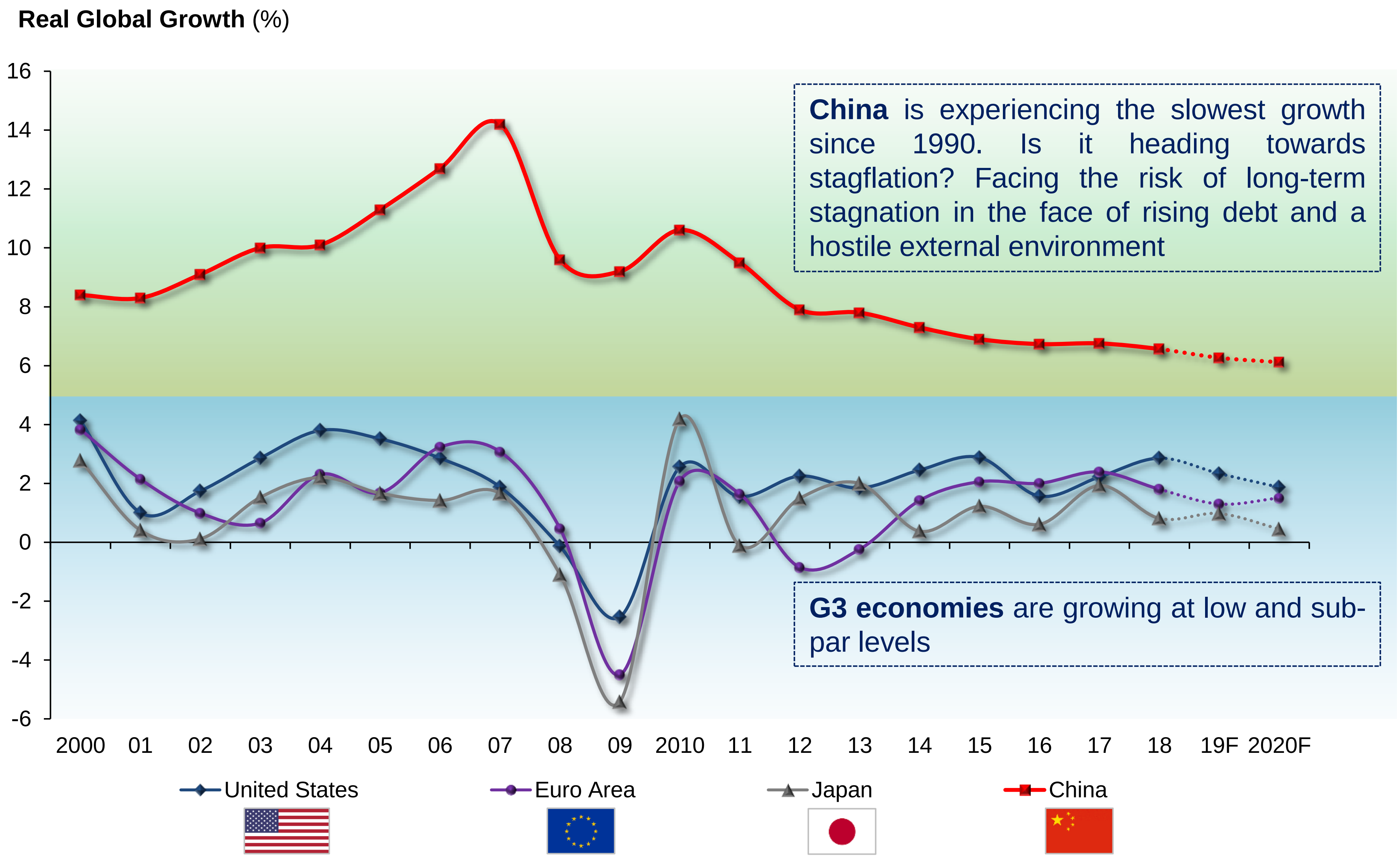
- Consumption tax hike (10%)
- Construction works related to the 2020 Tokyo Olympic
- Subdued global demand
- Trade tensions with South Korea

2019E: 6.2%; 2020F: 6.0%

- 2Q's GDP growth (6.2%) the slowest in 27 years
- Ongoing economic structural reforms
- Trade disputes
- Monetary easing and fiscal support

Source: IMF (WEO Update, July 2019)

G3 economies and China are slowing



Source: IMF (WEO Update, July 2019)

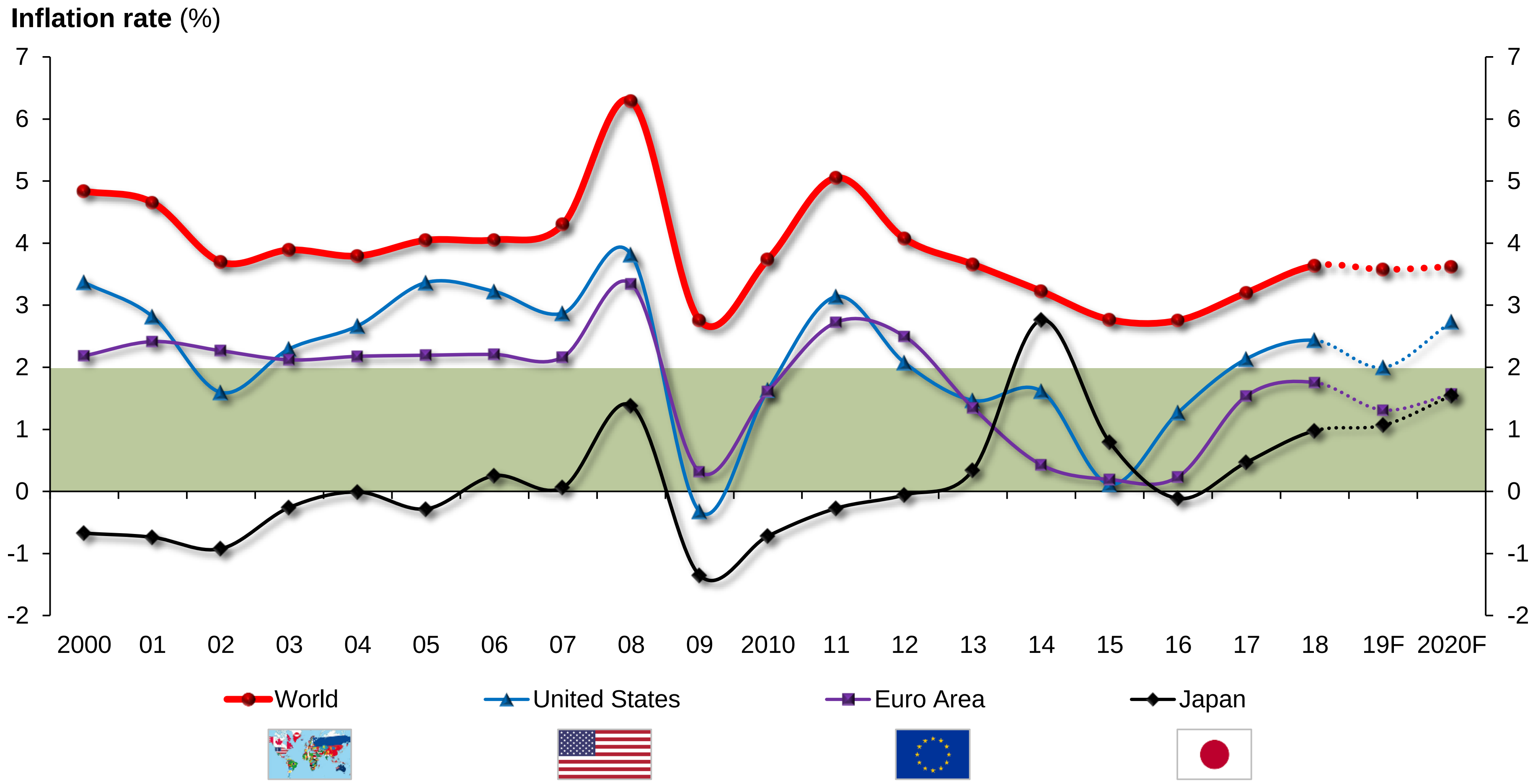
Section 2

Inflation & Interest Rate

Inflation or deflation?

Inflation stubbornly low, but subject to upward pressures

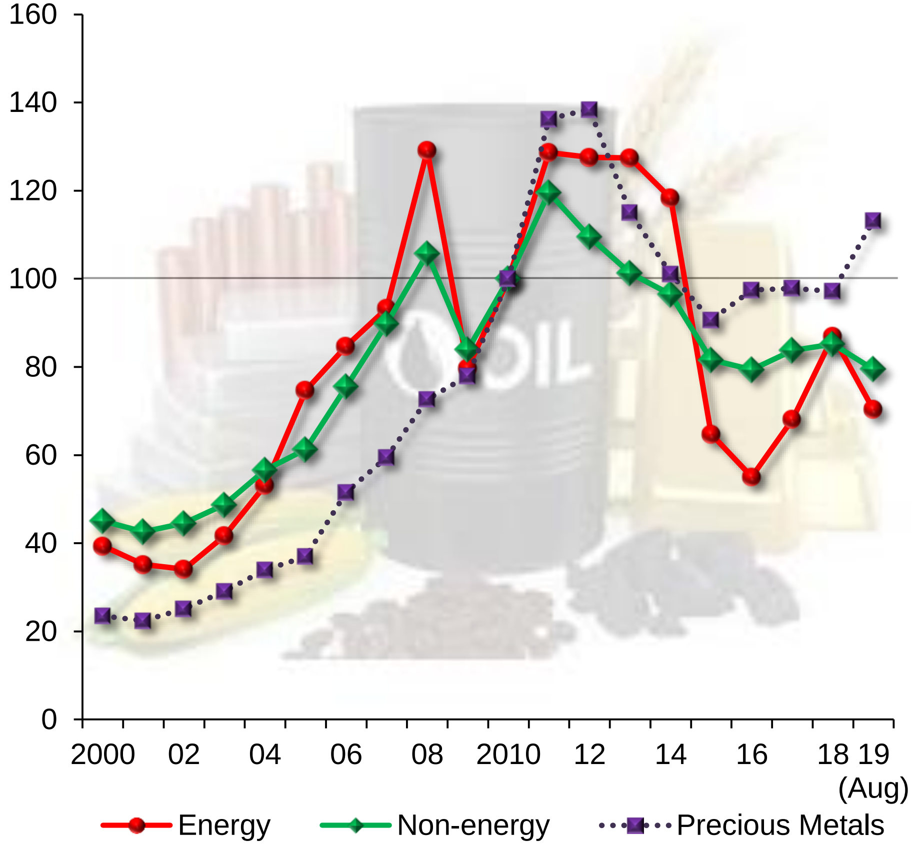
- Inflation rates in the US, euro zone and Japan are dropping below central bank targets of 2% inflation rate.



Source: IMF (WEO, April 2019)

Volatile energy prices remain a wild card

Commodity Price Index
(2010=100)

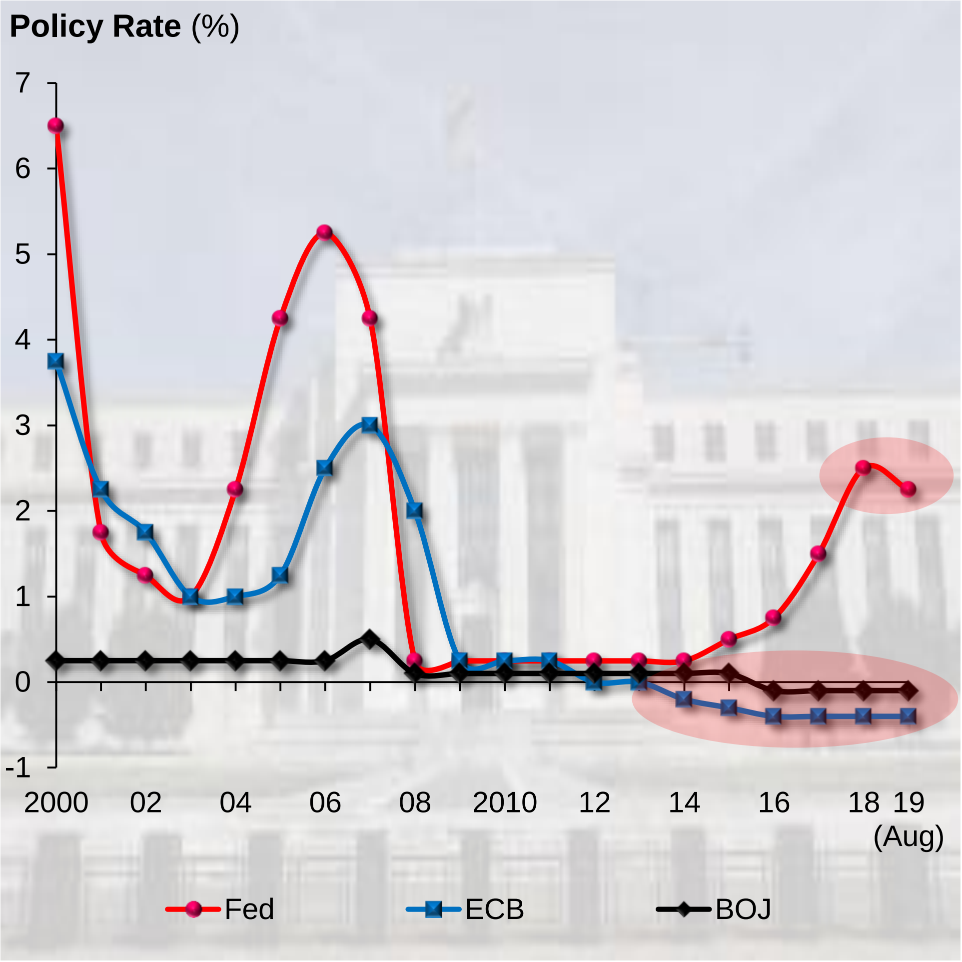


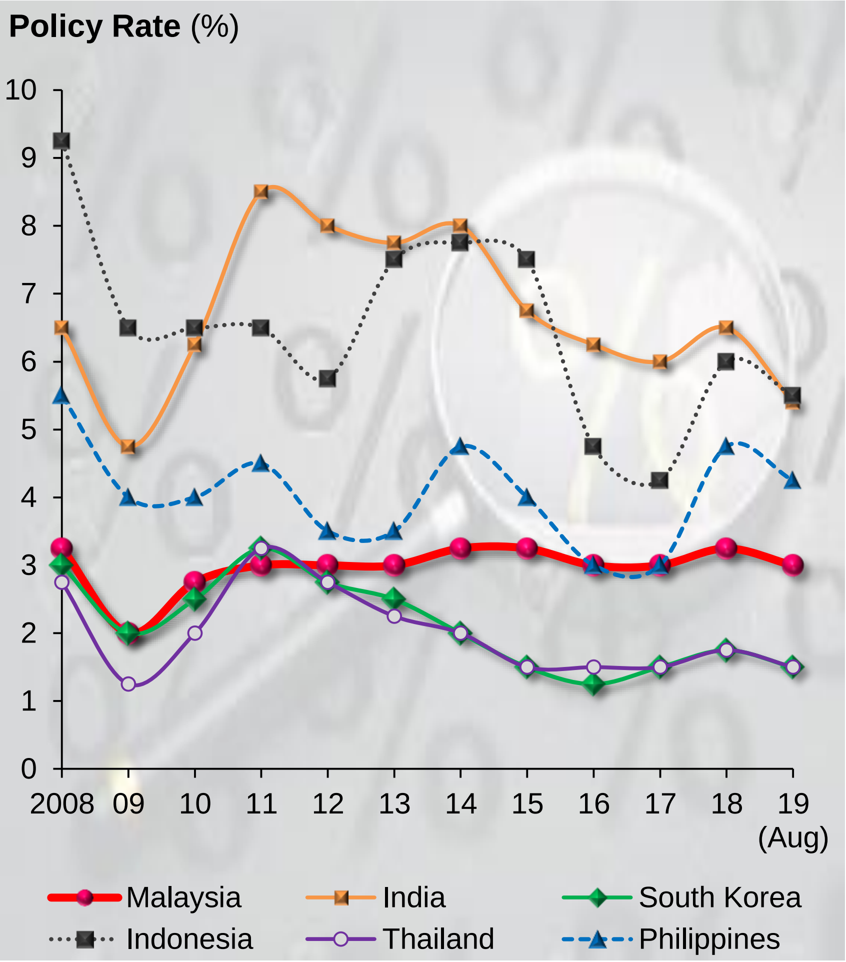
Source: World Bank

- **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$58/bbl as of 3 Sep. YTD (Jan to 3 Sep), **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 and production recovery of conventional crude from Hurricane Barry in the US; and (d) the US-Iran tensions.

Global central banks race interest rate to bottom

- Low or negative interest rate is a new normal again?





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

Snapshot of selected central banks' policy rate

End-period of	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019 (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	5.50	5.50
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

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

Section 3

The US-China Trade Spat So Far

Protracted, Intensified, Uncertainty

Will the trade war cause recession?

The US-China tit-for-tat trade spat – Key timeline

7 Feb 2018: Implemented 'global safeguard tariffs' – a 30% tariff on all solar panel imports, except for those from Canada and a 20% tariff on washing machine imports

1 First Stage

- **Effective 6 Jul 2018:** The US imposed tariffs on US$34bn worth of China's imports, and retaliated by China with same amount
- **Effective 23 Aug 2018:** The US slapped tariffs on US$16bn worth of China goods, and China also countered with same amount

2 Second Stage

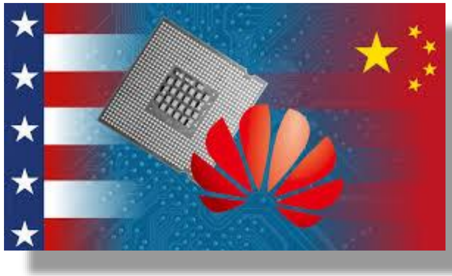
- **Effective 24 Sep 2018:** The US imposed 10% tariffs on additional US$200bn worth of China's products
- China retaliated by imposing 5-10% tariffs on additional US$60bn worth of US's products

3 Third Stage

- **Effective 10 May 2019:** The US tariffs on US$200bn of China's products increased to 25% from 10%
- **Effective 1 Jun 2019:** China imposed 5-25% tariffs (from 5-10% previously) on US$60bn of US's products

The US-China tit-for-tat trade spat – Key timeline (cont.)

From Trade to Tech war



- **15 May 2019:** President Trump issued an executive order to block Chinese telecom giant Huawei Technologies Co. and other foreign communications firms from doing business in the US. The US Commerce Department granted 90 days of relief for certain US broadband companies using Huawei equipment.
- **31 May 2019:** China's Ministry of Commerce said that it will publish a list of businesses or individuals deemed to have violated market rules or taken 'discriminatory measures'.

4 Fourth Stage

- President Trump and Xi Jinping met at G-20 Summit in Osaka and agreed to restart the trade negotiations.
- Nevertheless, the US has implemented a 15% tariffs on about US$125bn of China's products, **effective 1 Sep 2019**, and China retaliated on some US products worth US$75bn, includes a 5% on US's crude oil.
- Another round of US tariffs on China's products is set to go on **15 Dec 2019**, particularly on laptops and smartphones, hit a total of US$300bn of China's products in this stage.

The US-China's trade numbers at a glance

Total Exports in 2018: US$1,664bn
- To China: US$120bn (Share: 7.2%)

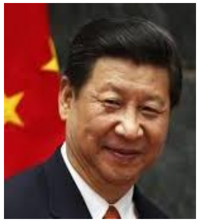
Total Imports in 2018: US$2,543bn
- From China: US$540bn (Share: 21.2%)

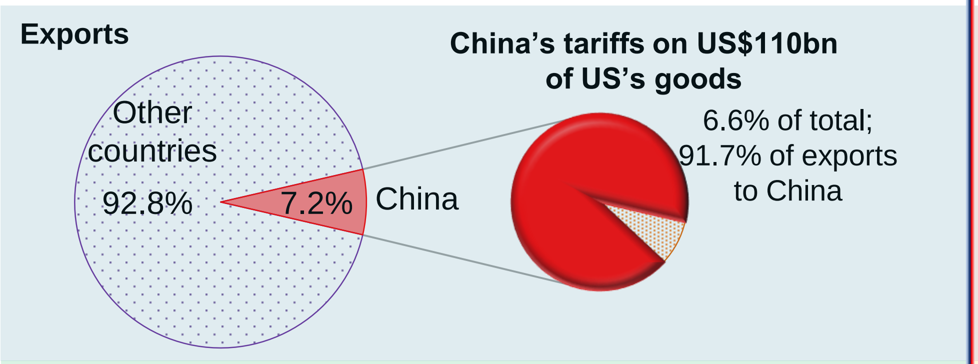
Trade deficit with China: US$419bn

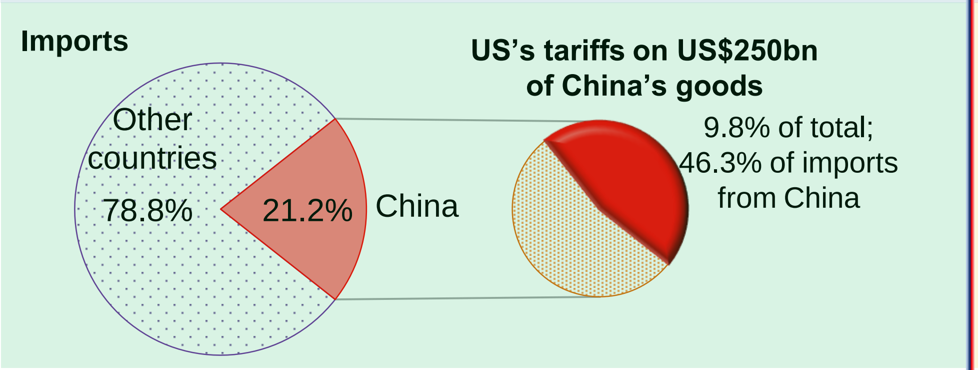
Total Exports in 2018: US$2,487bn
- To US: US$478bn (Share: 19.2%)

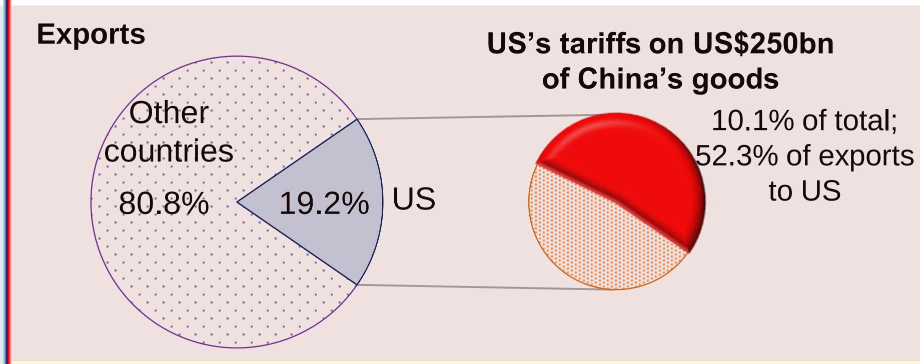
Total Imports in 2018: US$2,136bn
- From US: US$155bn (Share: 7.3%)

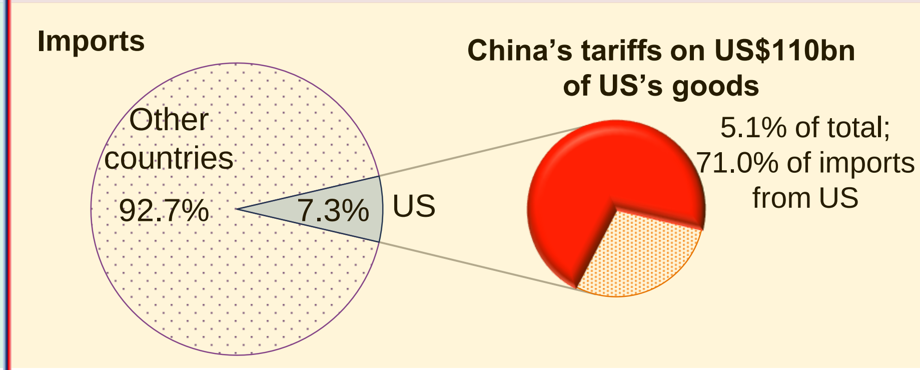
Trade surplus with US: US$323bn







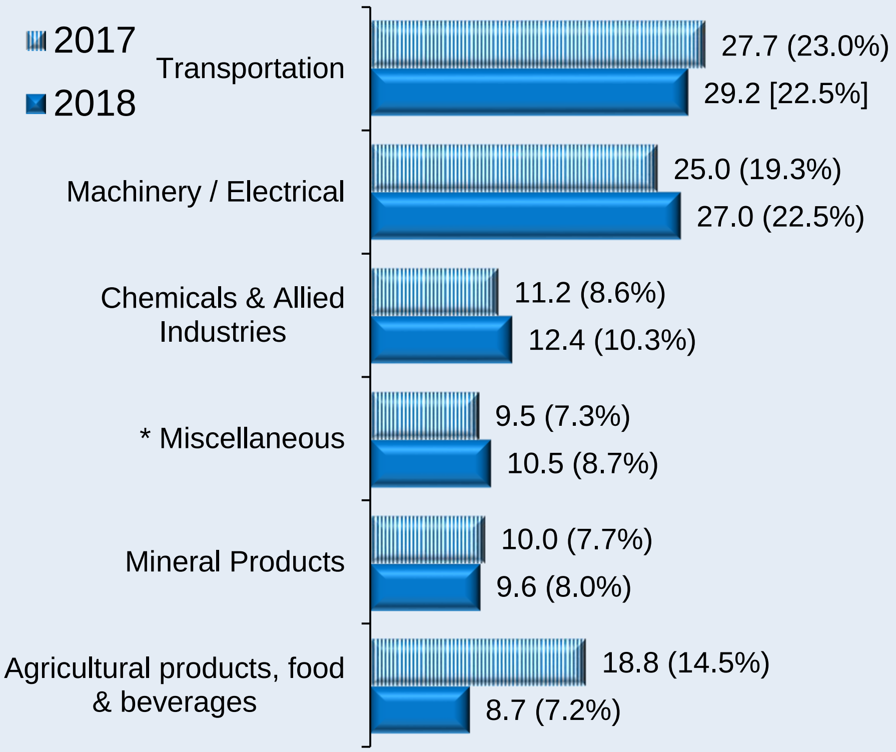




Source: US Census Bureau; China Customs

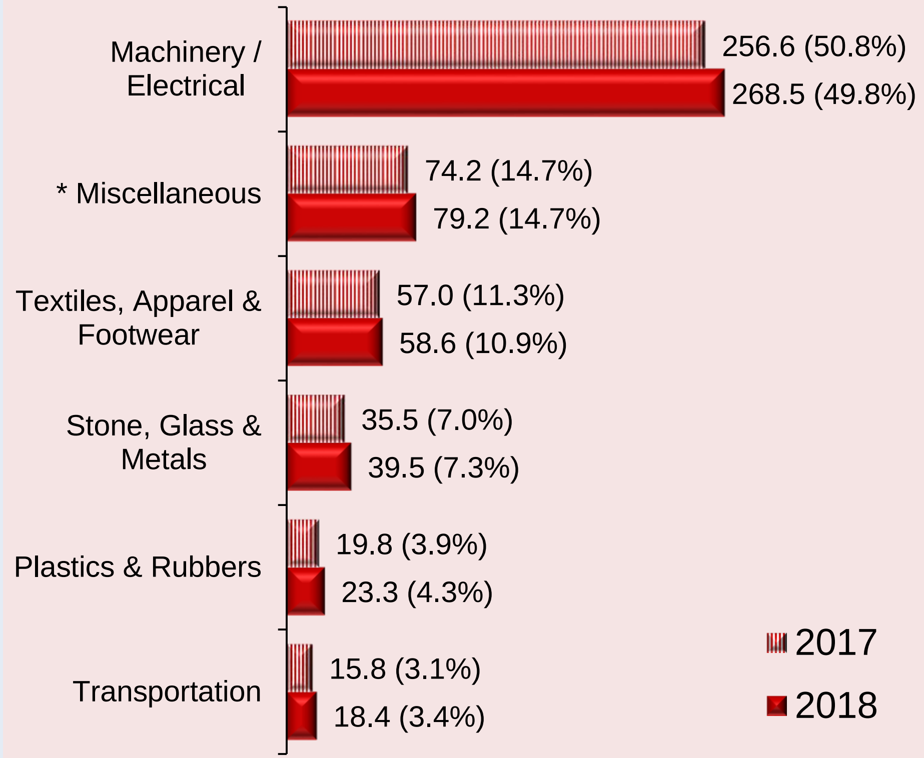
The industries most at risk in the US-China trade war

The US industries most at risk in a trade war with China
Leading export categories by HS code
United States to China in 2017 and 2018 (US$ billion)



** Miscellaneous mainly are optical & scientific equipment*

The Chinese industries most at risk in a trade war with US
Leading export categories by HS code
China to United States in 2017 and 2018 (US$ billion)



** Miscellaneous mainly are furniture & parts, toys, games & sport equipment, optic & medical instruments*

Source: US Census Bureau
Figure in parenthesis indicates % share of gross exports

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

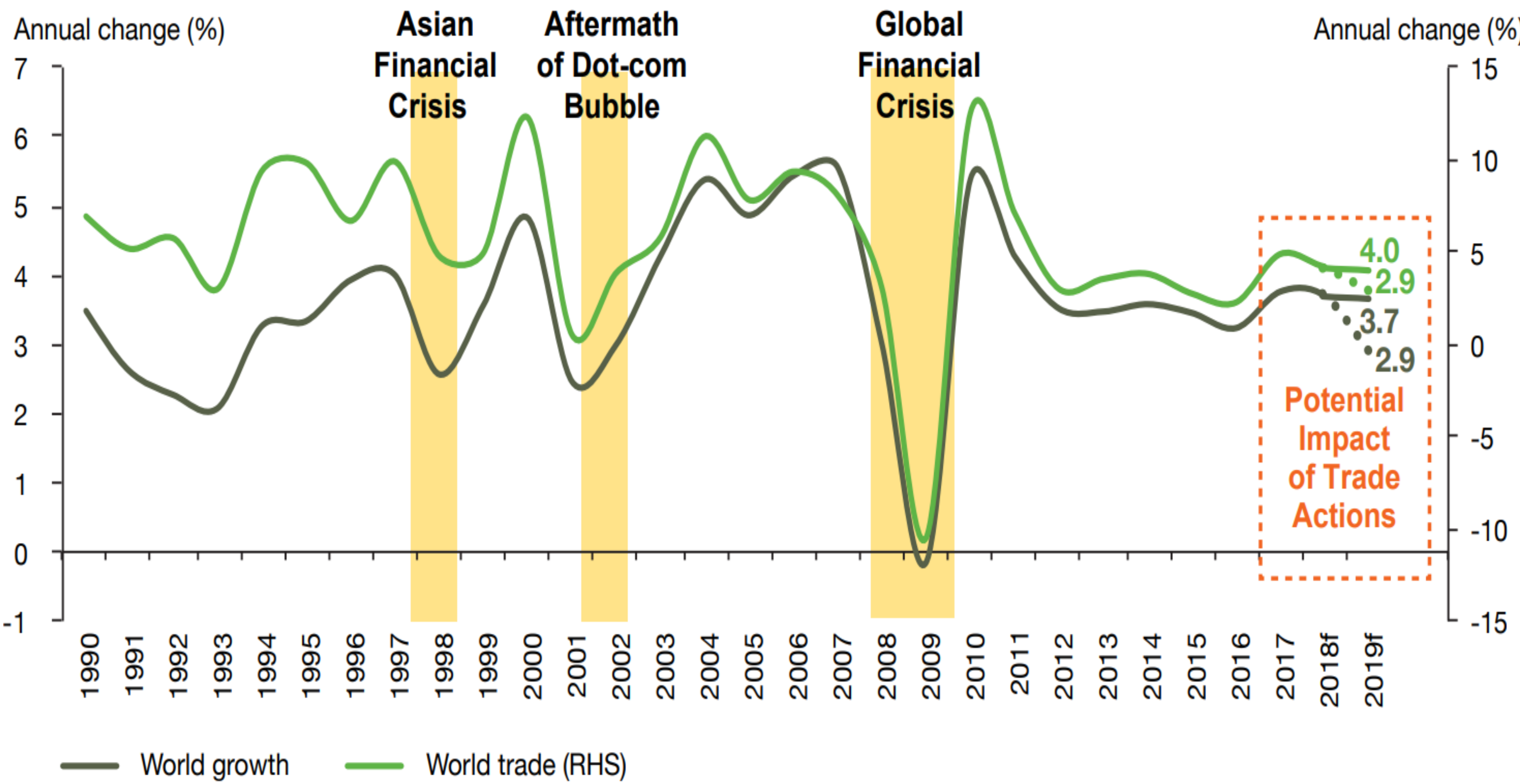
NO AGREEMENT ON FUNDAMENTAL ISSUES

- *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 highhandedly** 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.

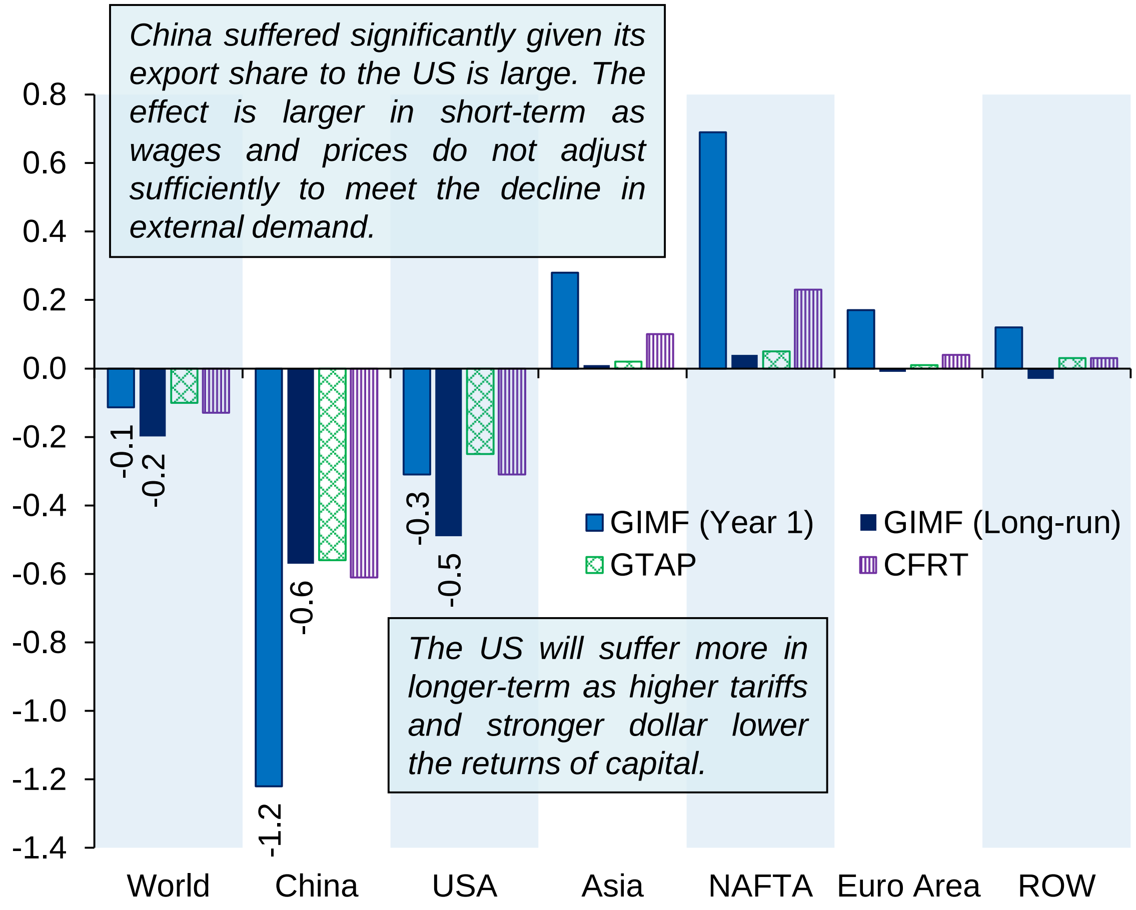
But, ultimately, everyone will be a loser. Failure to resolve a full-blown trade differences and further escalation in other areas (such as the auto industry), which would cover several countries, could **further dent business and financial market sentiment**, **negatively impact emerging market bond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

IMF's diagnosis: Short-term gains, long-term pains

Impact on real GDP from 25% increase in tariffs affecting all the US-China trade *(% point change from baseline)*



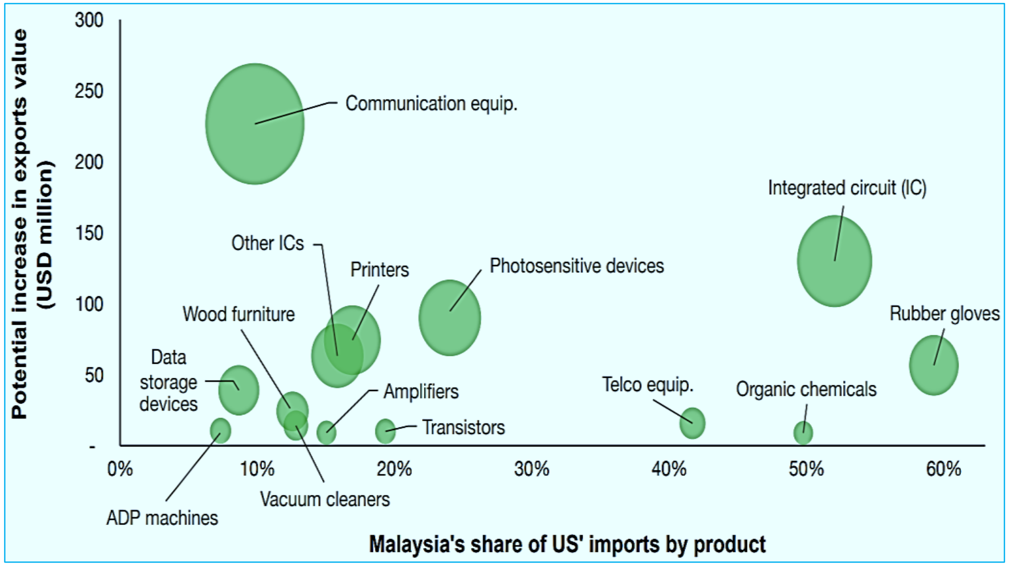
Source: IMF
Note:
GIMF = Global Integrated Monetary and Fiscal model; GTAP = Global Trade Analysis Project;
CFRT = Caliendo and others (2017) model

- **Short-term**: Asia (excl. China), Mexico and Canada will benefit the most from the spillover effect. However, these effects will fade over the long-run.
- The tariffs have a net negative impact on global GDP growth, the effect will become larger over time.
- It may be a trigger point to tip the vulnerable economies into greater recessionary risk.

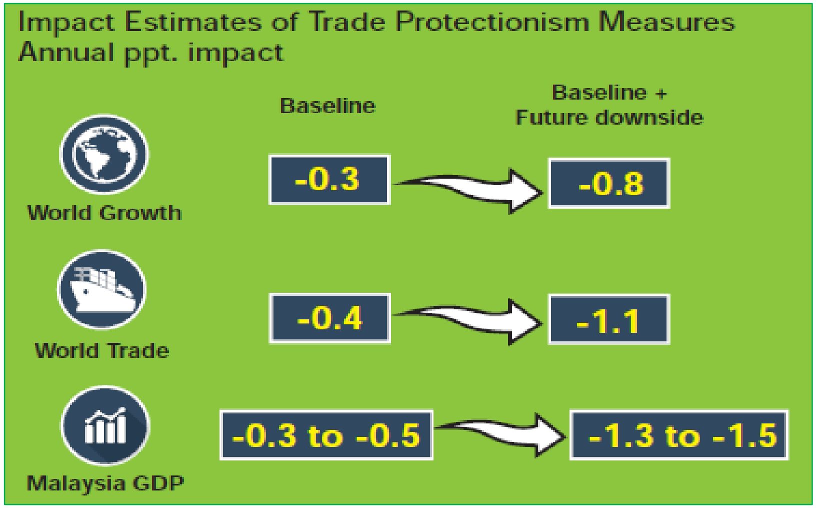
Malaysia stands to benefit from production substitution

- ACCCIM's Malaysia Business and Economic Conditions Survey (ACCCIM M-BECS): 62.3% of the respondents' supply chains were not disrupted by the US-China trade dispute in general. Nearly three quarters of the respondents indicated that no impact on their sales while **23.1% foresees adverse impact if the trade conflict prolongs and deepens**.
- Products that Malaysia would likely gain from are mostly in the **electronics and electrical products such as electrical machines, electronic integrated circuits** and **semiconductors for solar panels cells, palm oil** and **LNG**.
- But, **substitutability of affected products, manufacturing capacity and firms' value proposition.**

Malaysia's exports to the US: Potential gain from trade substitution



Source: ITC Trade Map; Global Trade Atlas; BNM
Note: Bubble size reflects potential value of gain. For clarity, chart only illustrates US import products in which at least 5% of those imports are sourced from Malaysia.



BNM: A potential gain of 0.1% pt in GDP growth from trade diversion → Net: -1.2% pt to -1.4% pt

What the Government should do?

- **Enhance economic resilience**; well-positioned to benefit and mitigate disruption risks from the trade war disruption.
- **Leverage on our endowments and strategic location** not only as a production centre but as a trans-shipment hub in ASEAN.

Provide some form of **exports credit scheme** to domestic SMEs; **reduce import duties on raw materials**; **assist in exploring new export markets**

Provide attractive incentives to conglomerates and MNCs to **establish their principal hub** in Malaysia

Widen and deepen the trade relationships by actively participate in multi- and bi-lateral trade agreements **with new markets** such as Middle-east, Africa and Asia Pacific

Provide clarity on Malaysia's stance concerning **ongoing negotiations for CPTPP** and **expedite the completion of RCEP**

Draw up actionable plans to **stimulate higher domestic investments** and **attract more quality foreign direct investments** (such as ease cost of doing business and regulatory requirements, review of investment incentives etc)

Diversify more trading activities with European Union (EU), revisit the Malaysia-European Union Free Trade Agreement (MEUFTA) negotiation or accelerate the proposed ASEAN-EU FTA

What the companies should do?

Keenly aware of the **shifts in global trade flows** brought about by the current disruptions from the trade conflicts

Rejig supply chains; look for suppliers from other origins, which is a "huge cost" as pricing is very different

Continue to **diversify into other sectors and markets**, so that business will never "held ransom" by the fortunes of any single sector or market

Continue to **upgrade business capabilities** and **worker skills**

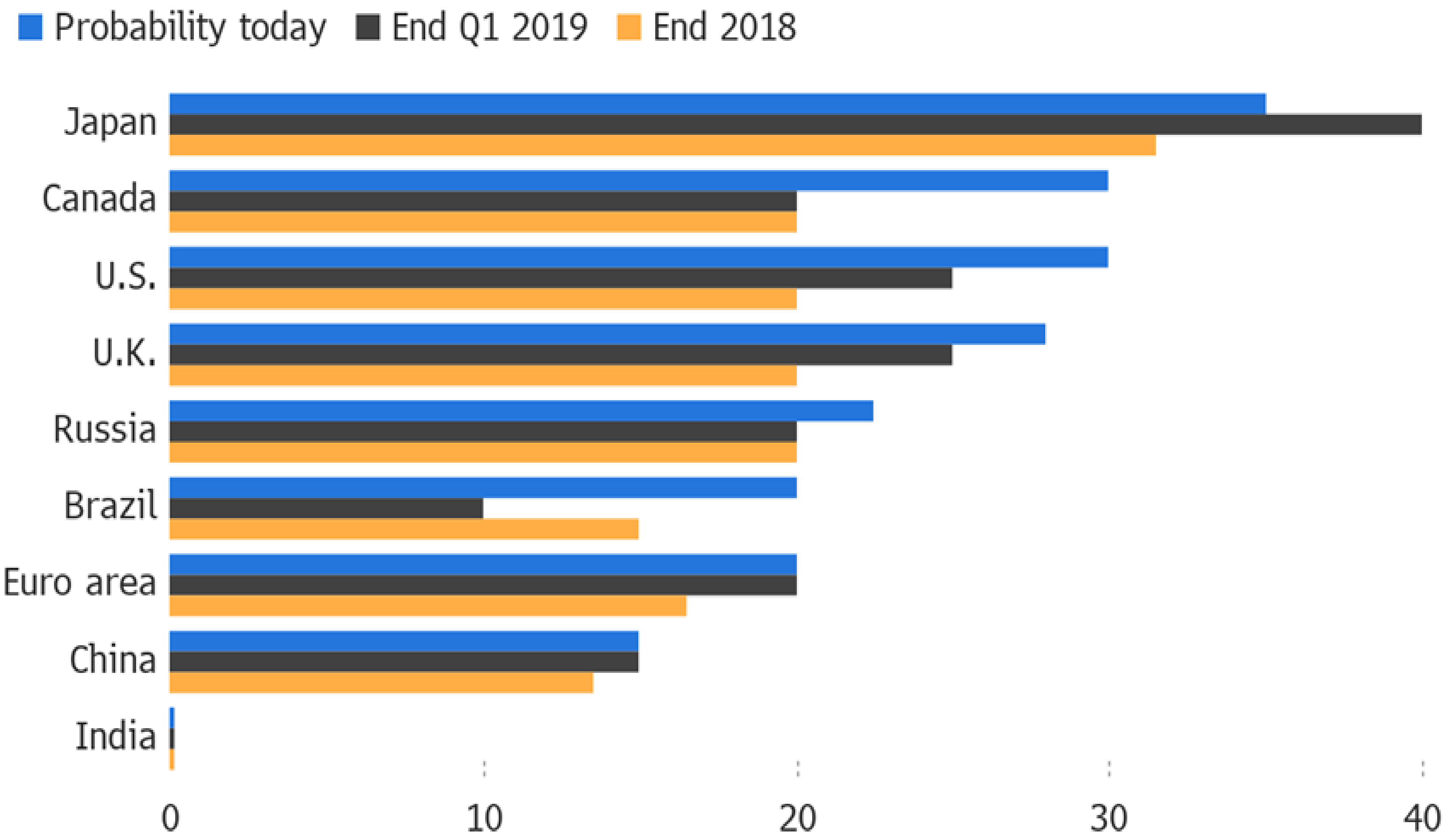
Section 4

Global Recession Risk

Recession odds at 40-50%

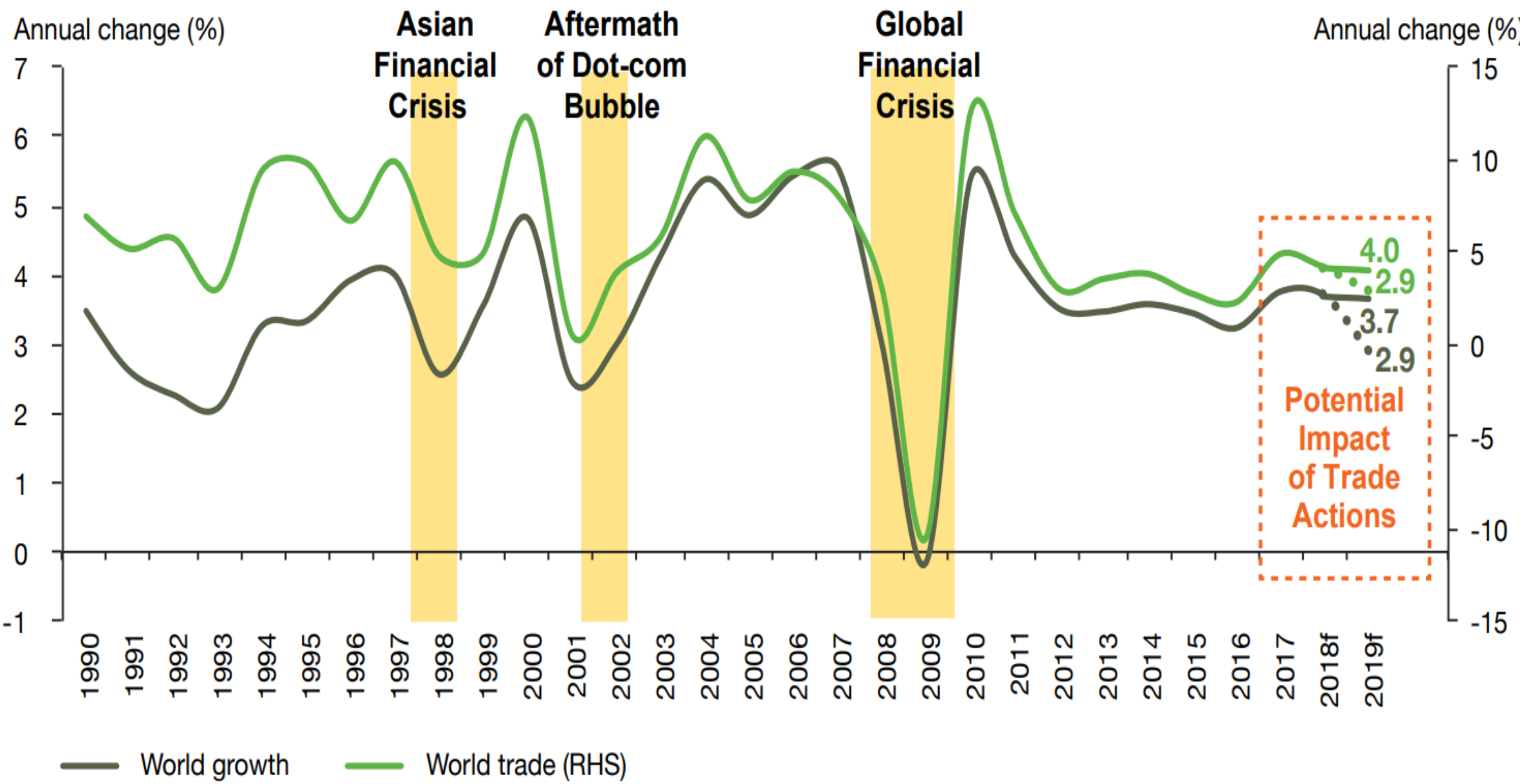
Recession risk on the rise

The risk of recession has increased in most of the world's biggest economies



Source: Bloomberg surveys, median probability of a recession in the next 12 months

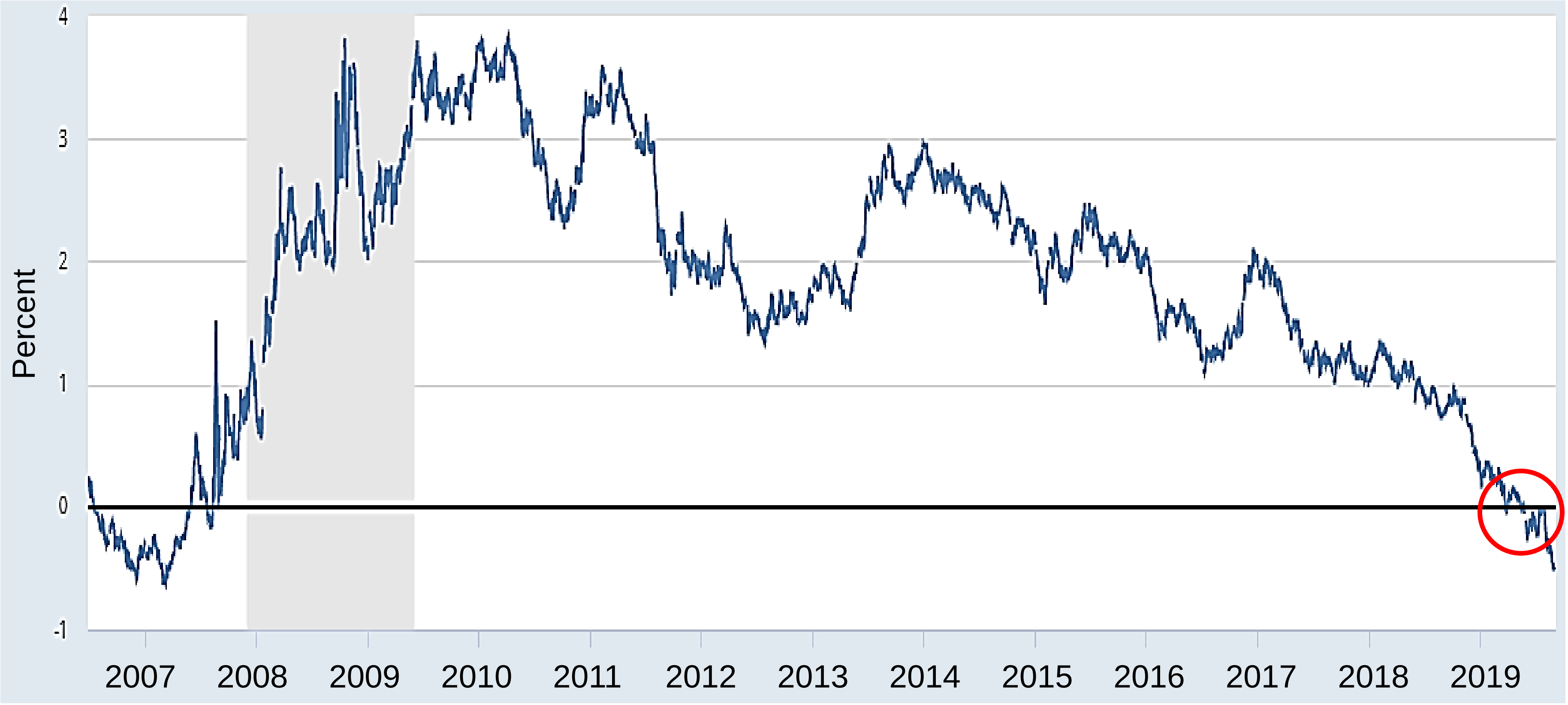
Intensified trade tensions pose significant risks to global economy



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)

10-Year Treasury Constant Maturity Minus 3-Month Treasury Constant Maturity

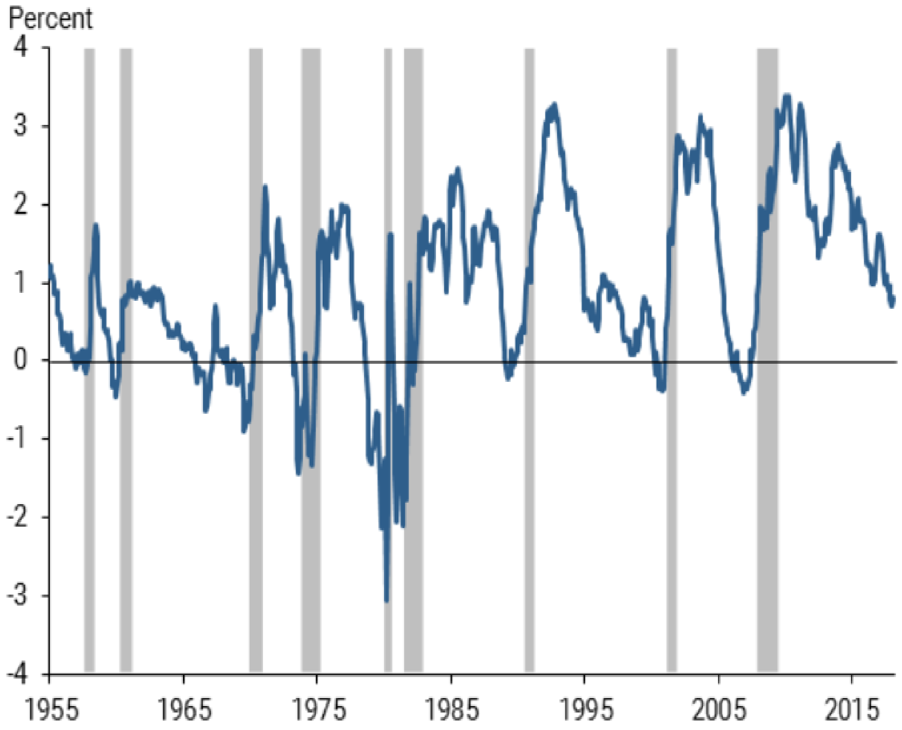


Note: Shaded area indicates US recessions
Source: Federal Reserve Bank of St. Louis

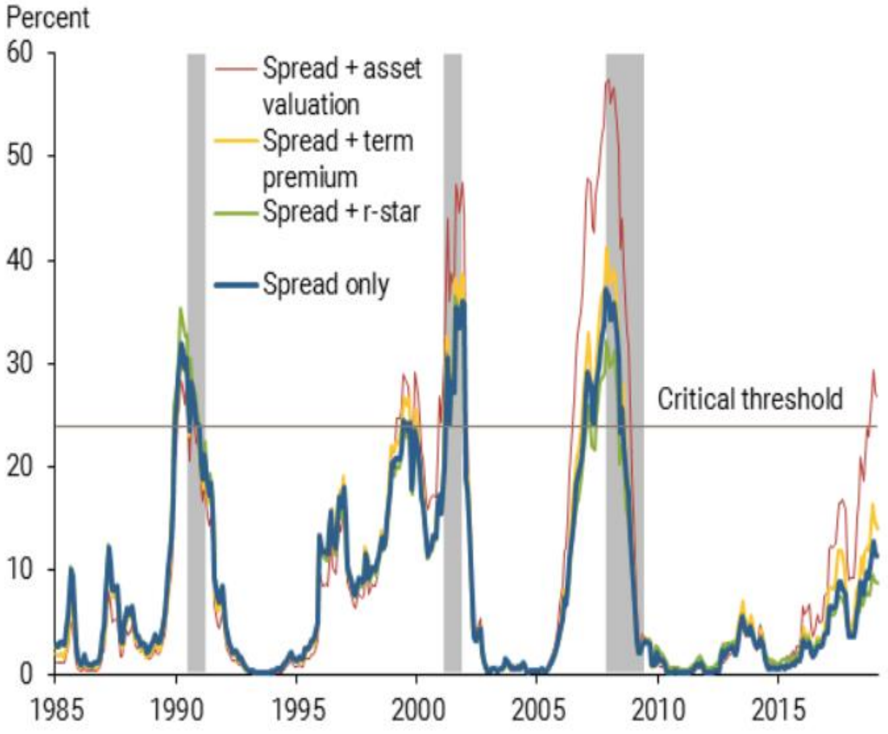
Every **RECESSION** over this period was preceded by an **INVERSION OF THE YIELD CURVE** that is, an episode with a negative term spread.

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

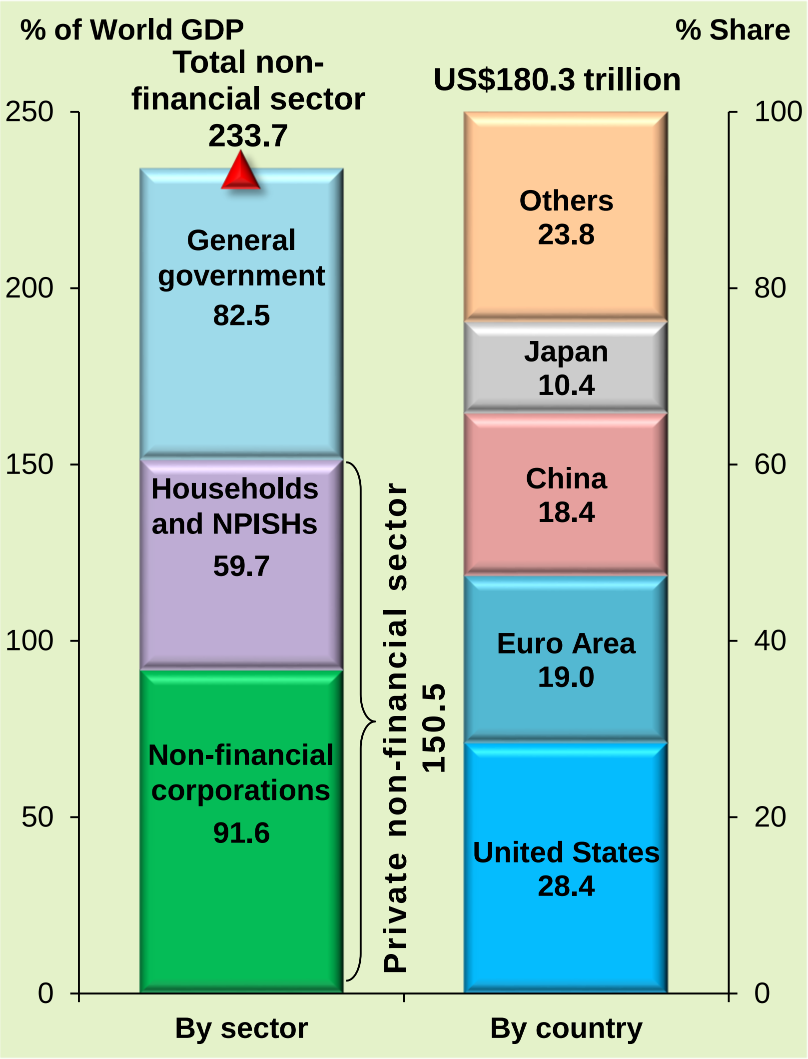


Source: Federal Reserve Bank of San Francisco

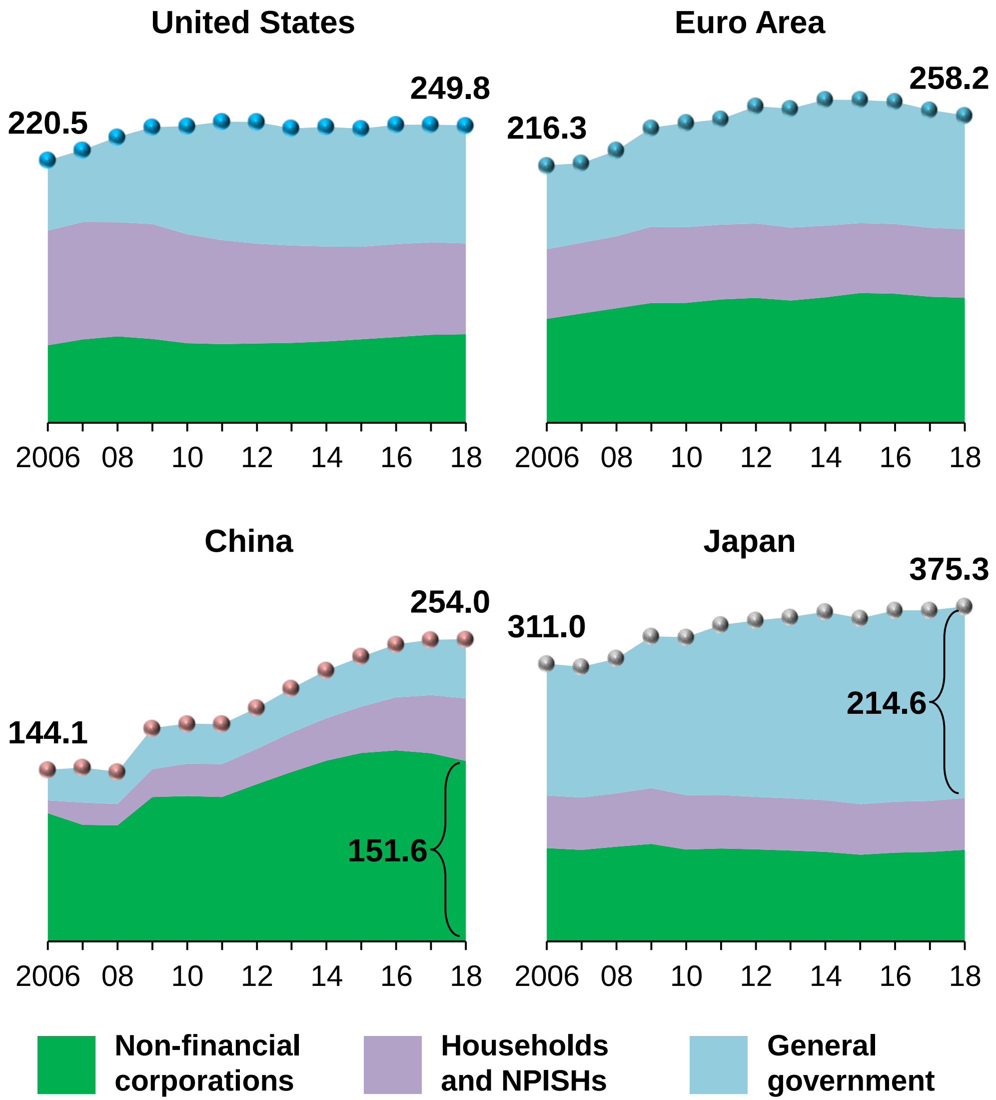
** Term spread is calculated as the difference between the ten-year and one-year Treasury yields*

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

As at Dec 2018:

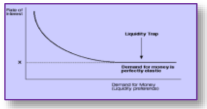


Debt as % of GDP



Source: BIS

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%-2.50 compared to 5.25% in September 2007.
- In **Euro Area 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.

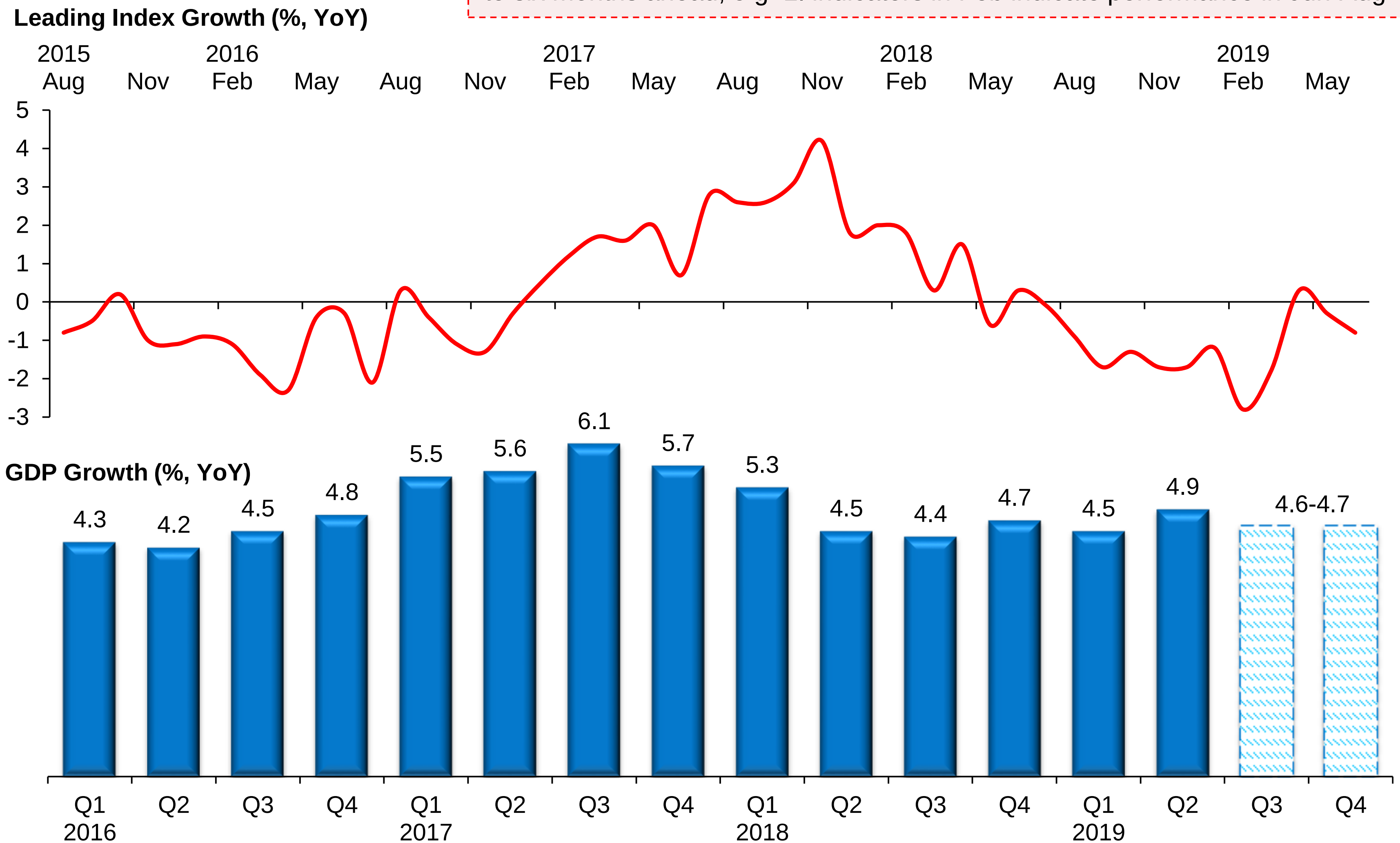
Section 5

The Malaysian Economy

What the economic indicators say?

Malaysia's leading index indicates softening economic growth

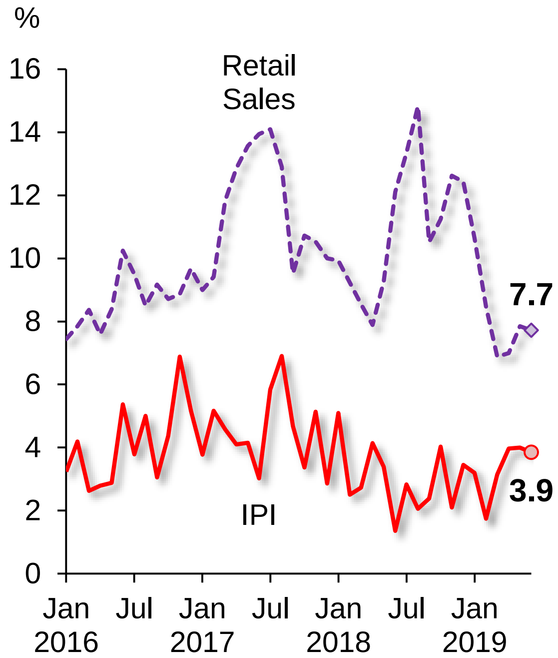
The Leading Index (LI) indicators anticipates the overall economic activity in four to six months ahead, e.g. LI indicators in Feb indicate performance in Jun-Aug.



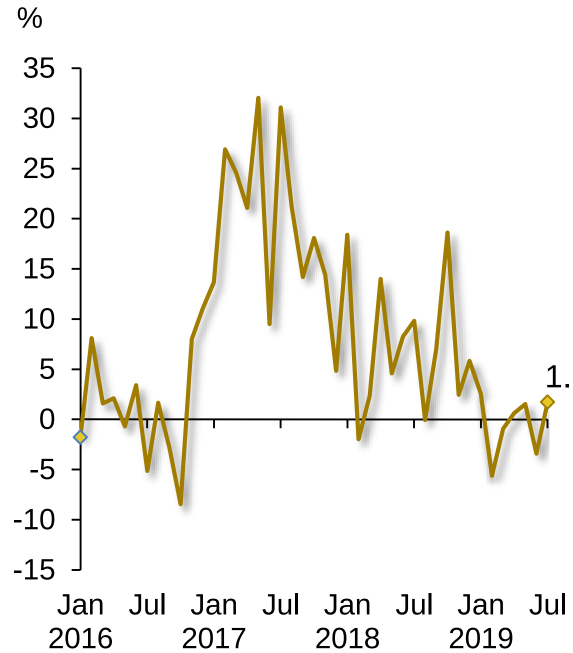
Source: DOSM; BNM

High frequency indicators suggest continued expansion; albeit slower

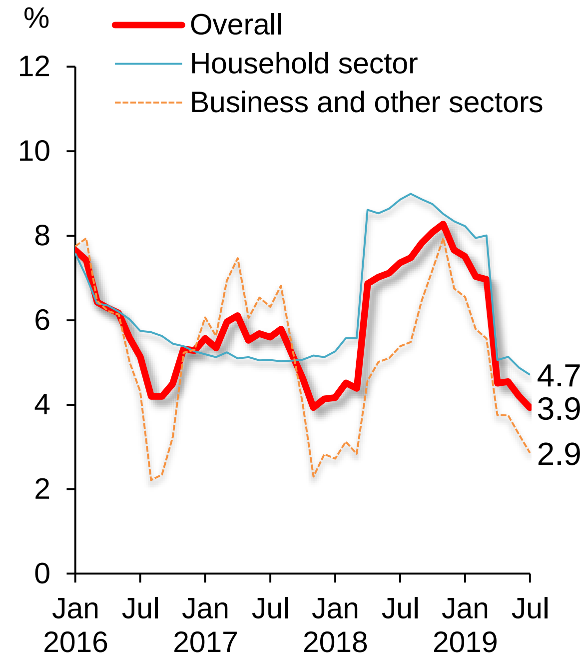
IPI growth sustained; retail sales growth moderated significantly



Exports declined by 0.4% yoy in the first seven months of 2019



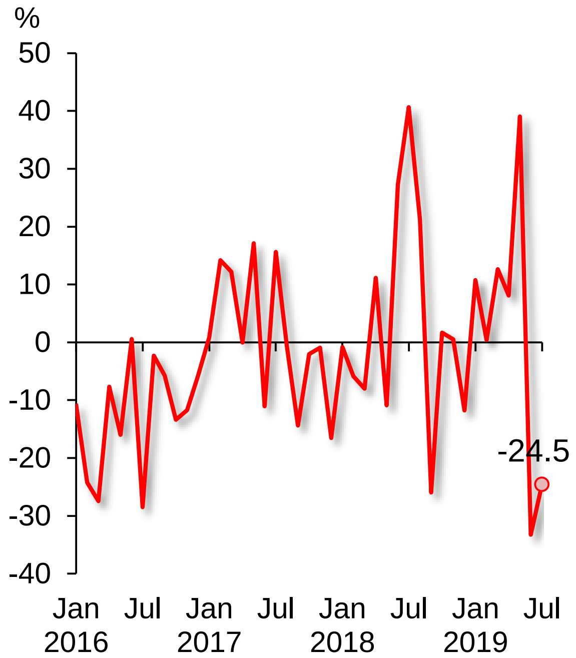
Overall loan growth continued to moderate



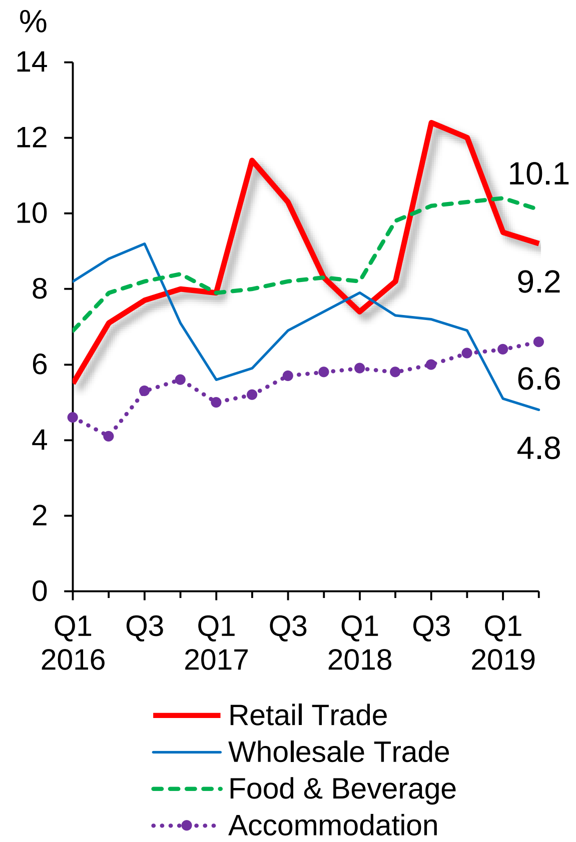
Note: Loan data for April 2018 onwards have been revised to include MBSB Bank Berhad.
Source: DOSM; BNM

Private consumption indicators

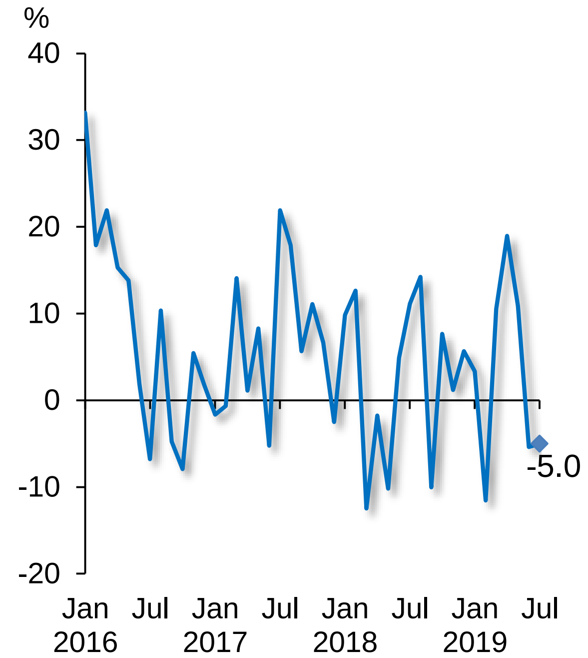
Passenger car sales declined due to high base (zero-rated GST) last year



Growth of wholesale, retail, restaurant and hotels



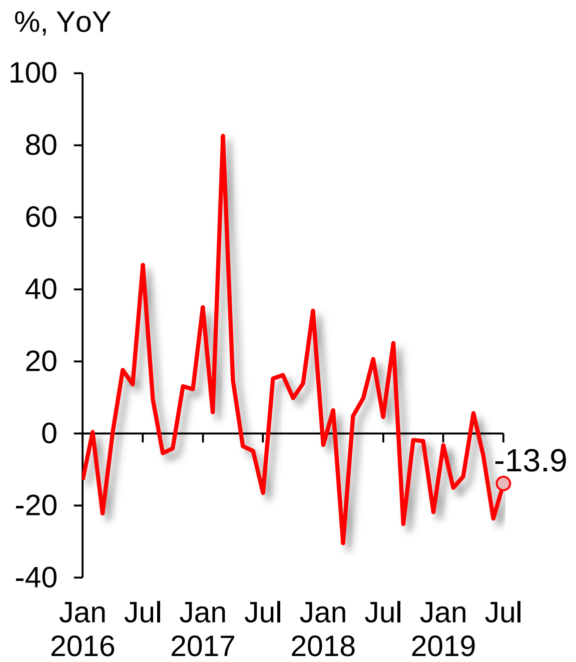
Imports of consumption goods



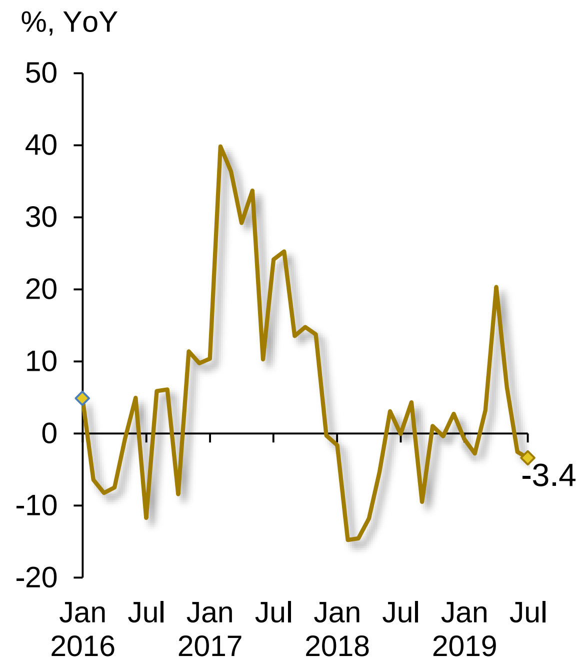
Note: Loan data for April 2018 onwards have been revised to include MBSB Bank Berhad.
Source: DOSM; BNM

Private investment indicators

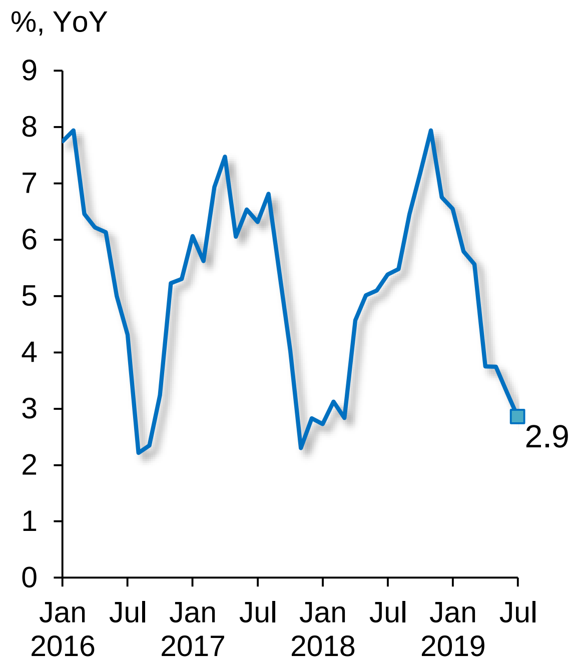
Imports of capital goods



Imports of intermediate goods



Loans extended for businesses and other sectors

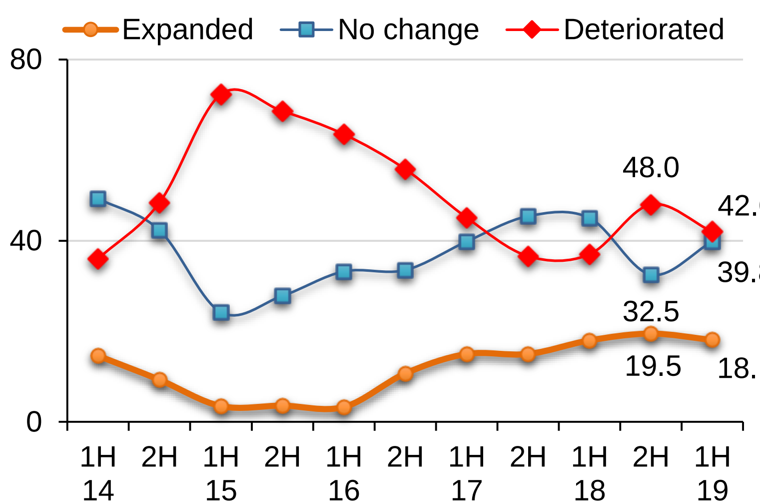


Note: Loan data for April 2018 onwards have been revised to include MBSB Bank Berhad.
Source: DOSM; BNM

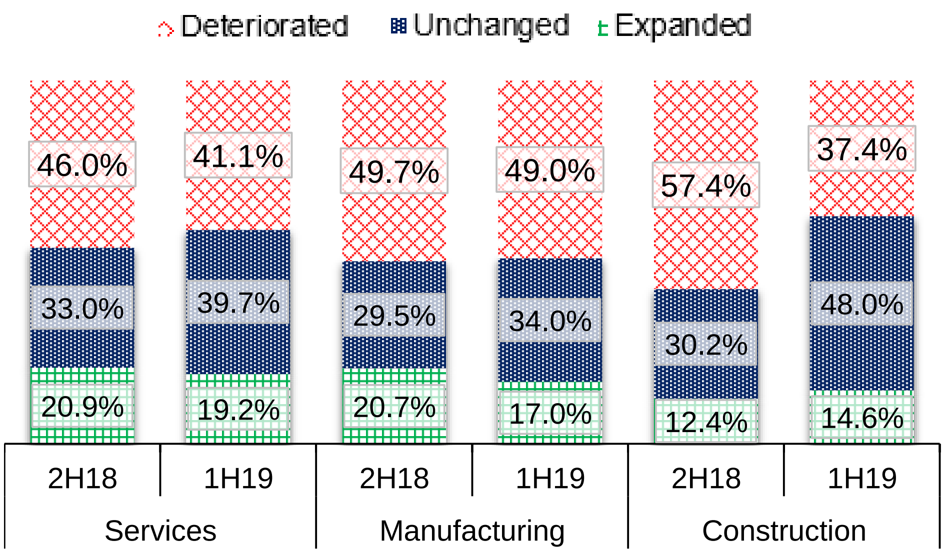
ACCCIM's M-BECS: Business conditions "Deteriorated" albeit at lower percentage in 1H 2019

- **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

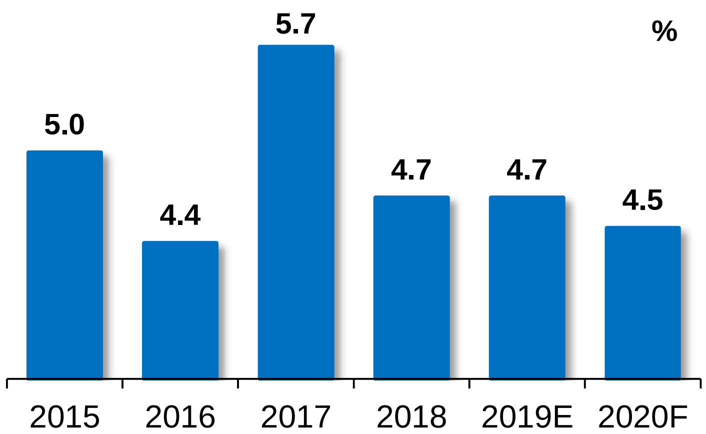


Source: ACCCIM

Economic conditions and prospects

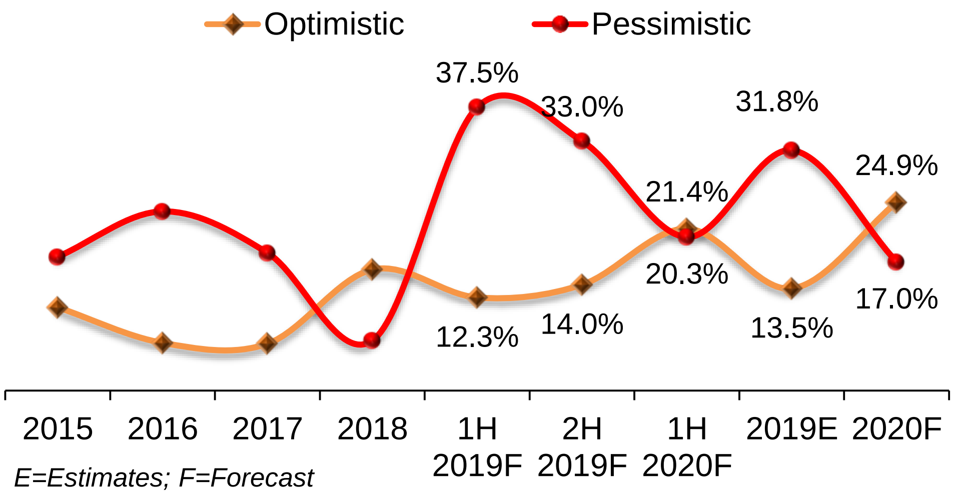
- **Maintain cautiousness about the economy in 2H 2019**. 53.0% respondents were "neutral"; 33.0% having "pessimistic" views, which is 3.4% points higher in the previous survey when asked about their expectations for 2H 2019.
- Businesses expect **domestic economy to remain challenging in** 2019. 31.8% 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's real GDP growth to moderate in 2020



Source: DOSM; ACCCIM; SERC

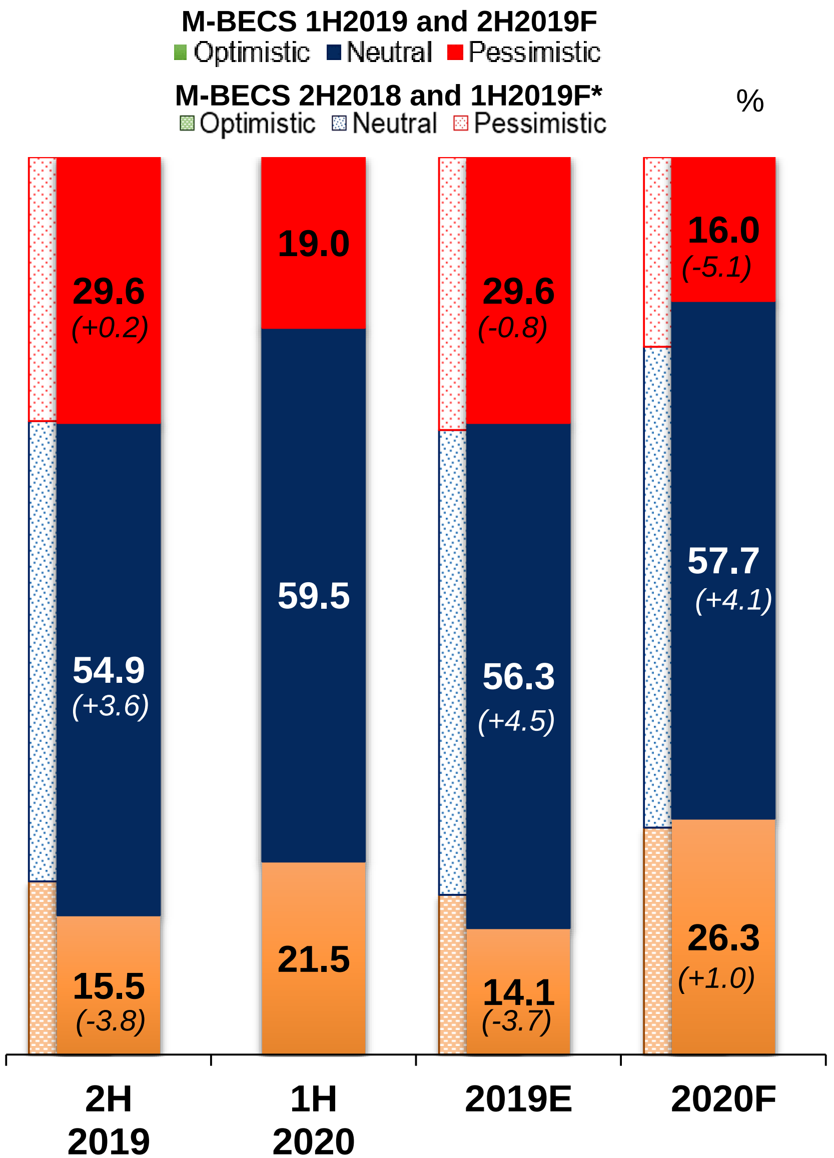
Respondents cautiously optimistic about 2020's economic condition



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%).

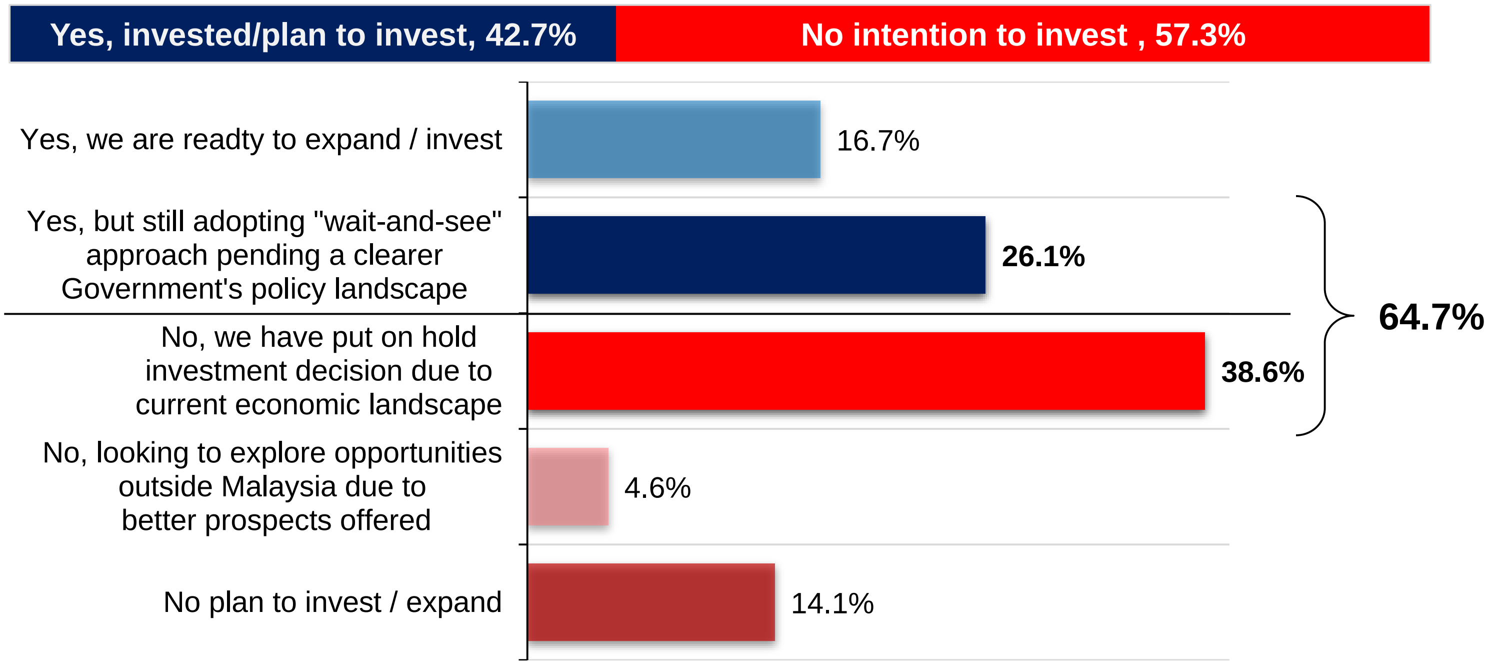


E=Estimates; F=Forecast
• denotes data obtained from previous survey.
Figure in parenthesis denotes changes in % of respondents from previous survey
Source: ACCCIM

Cautious investment stance

- **42.7%** of respondents indicated that they **either have invested or plan to invest** in Malaysia over **next 12-24 months** while **57.3%** indicated that they **have no intention** to invest.
- It can be inferred that **64.7% of respondents** will likely to **revisit their investment decisions,** hinging on the ensuing developments in the scenario of economic and policy landscape.

Business's investment planning in Malaysia over next 12-24 months



Source: ACCCIM

Section 6

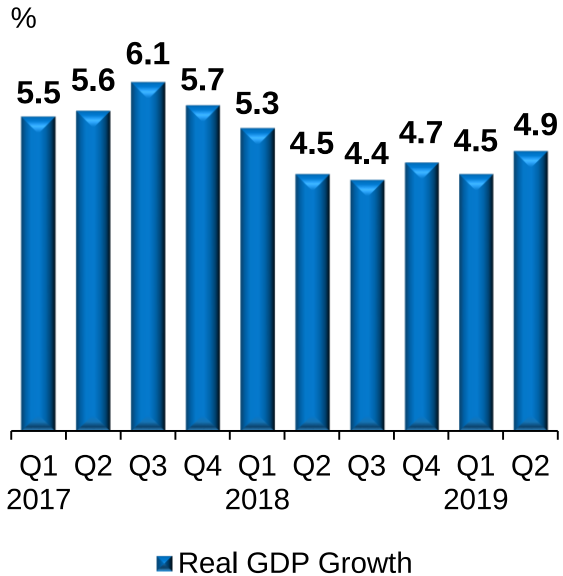
The Malaysian Economy

Present, Prospects and Challenges

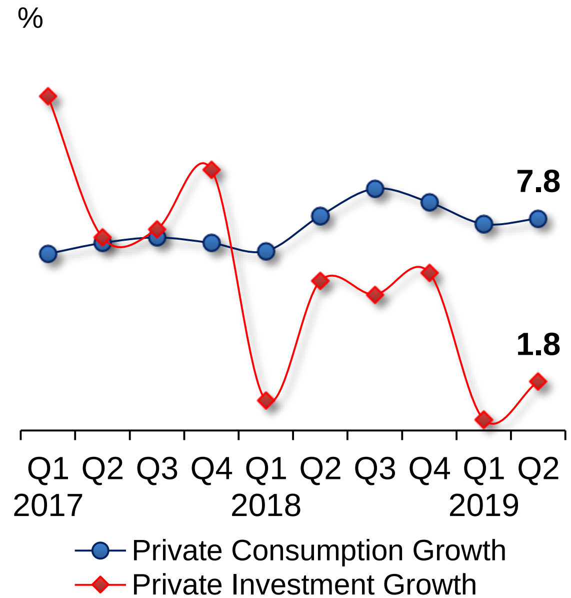
Malaysia's GDP growth: 4.7% in 2019 and 4.5% in 2020F

- **Higher real GDP growth in 2Q19 (4.9% yoy vs. 4.5% in 1Q19)**, underpinned by resilient consumer spending and a rebound in mining output.
- **SERC maintains GDP growth estimate at 4.7% in 2019.** Looking ahead, GDP growth is expected to grow by between 4.6% and 4.7% in 2H 2019. For 2020, real GDP is projected to expand by 4.5%.
- **Downside risks remain**: Global recession risk, the escalation of the US-China trade tensions, slowing domestic demand.

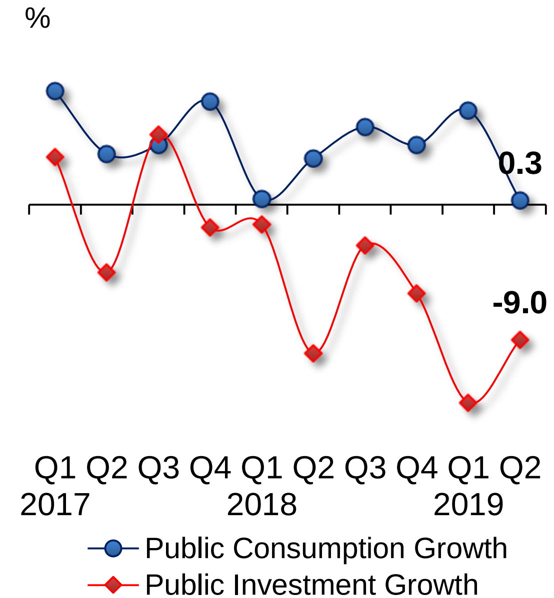
Malaysia bucks regional economies to record higher GDP growth in 2Q19



Consumer resilience remains; cautious private investment



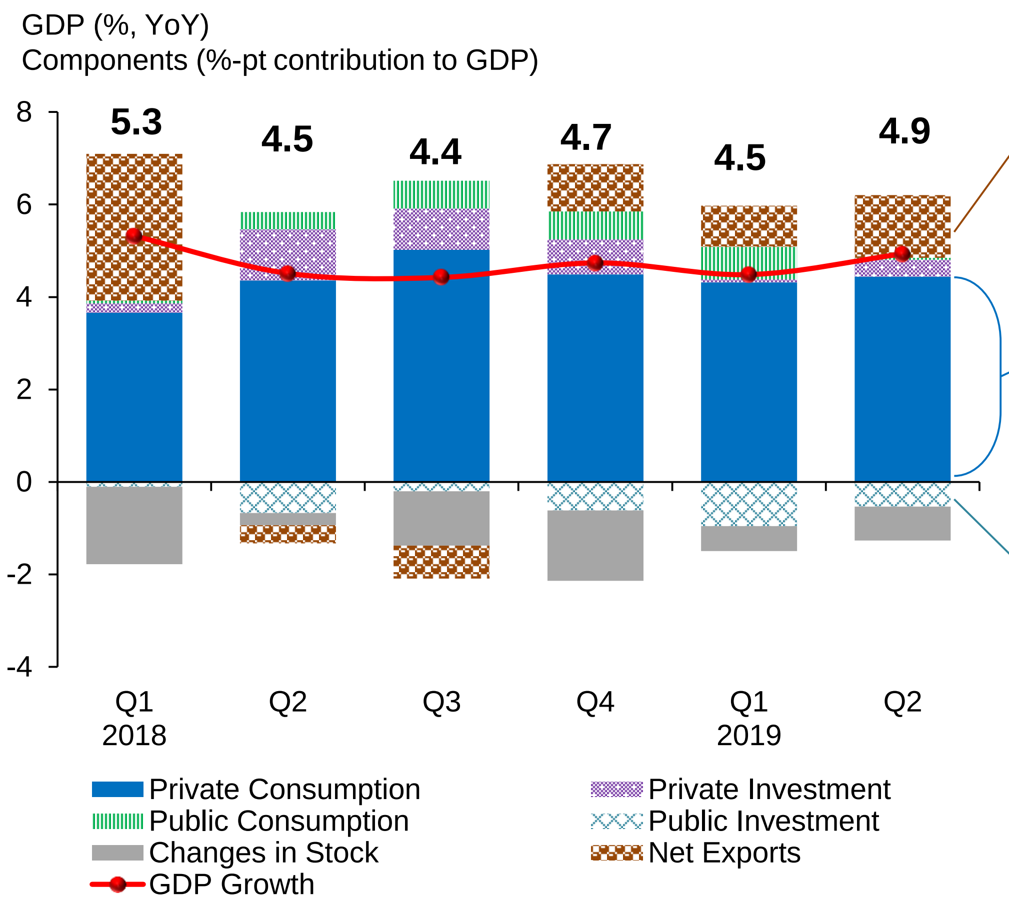
Public sector spending continued to contract, albeit narrower



Source: DOSM

Private sector spending remained the key driver of growth

- Private consumption is holding the fort



Higher net export's point contribution due to imports compression

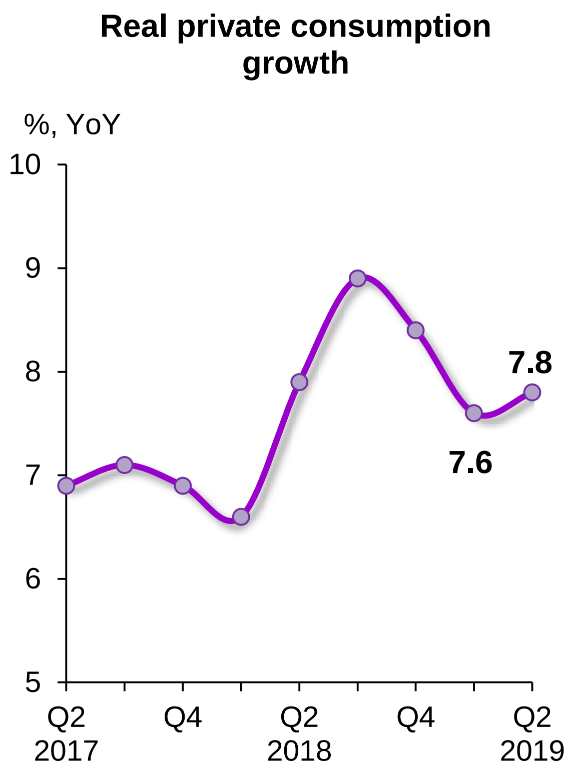
Sustained strong expansion in household spending while private investment remains weak

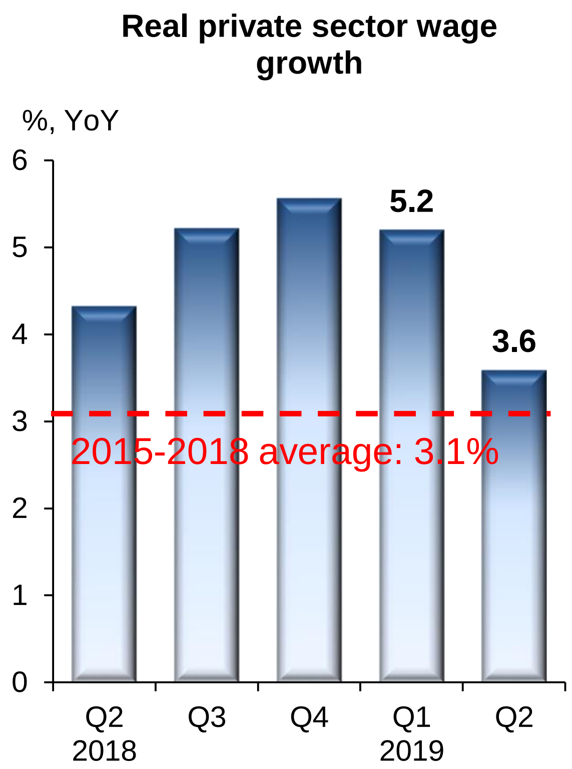
Continued contraction in capital outlays by public corporations

Figure indicates quarterly GDP growth
Source: DOSM

Still-strong consumer spending amid cautious sentiment

- Household spending propping up the economy, underpinned by above-average real wage growth and consumption-enhanced measures.





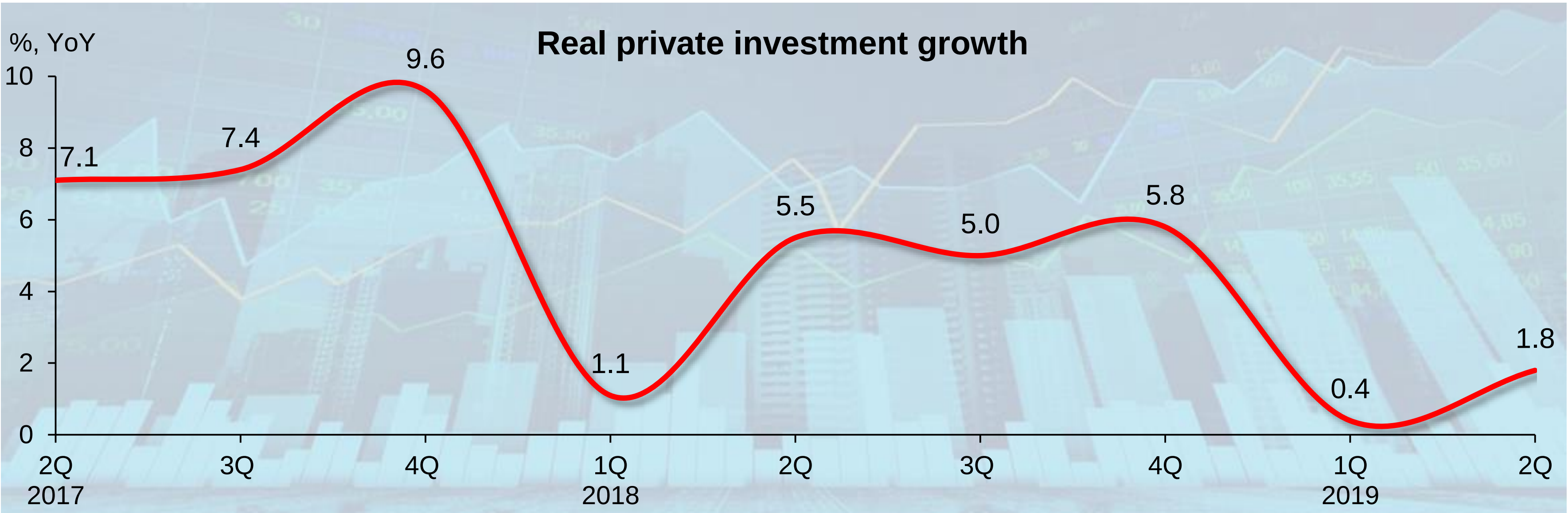
Consumer spending likely to moderate to 6.7% in 2020 (estimated 7.2% in 2019) on cautious discretionary spending amid stable employment and moderate wage growth.

Note: Real private sector wages are derived from the nominal salaries and wages data, published in the Monthly Manufacturing Statistics and Quarterly Services Statistics by the Department of Statistics, Malaysia (covering 62.9% of total employment). The nominal private sector wages are then deflated by the consumer price index (CPI).

Source: DOSM; BNM

Slackening private investment growth is worrying

- Private investment's momentum had moderated from 12.1% pa in 2011-15 to 5.9% pa in 2016-18. It expanded by 1.3% in 1H 2019.



➢ **Downside risks remain**:

Heightened global uncertainty, slower global growth and trade hostilities

Domestic policy uncertainties; persistent weakness in the property segment, especially residential and commercial properties

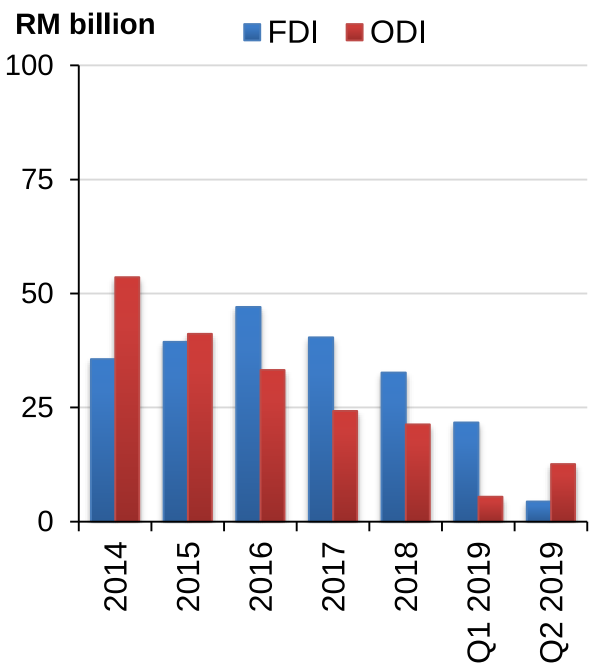
Source: DOSM

Foreign approved investment jump but domestic down sharply

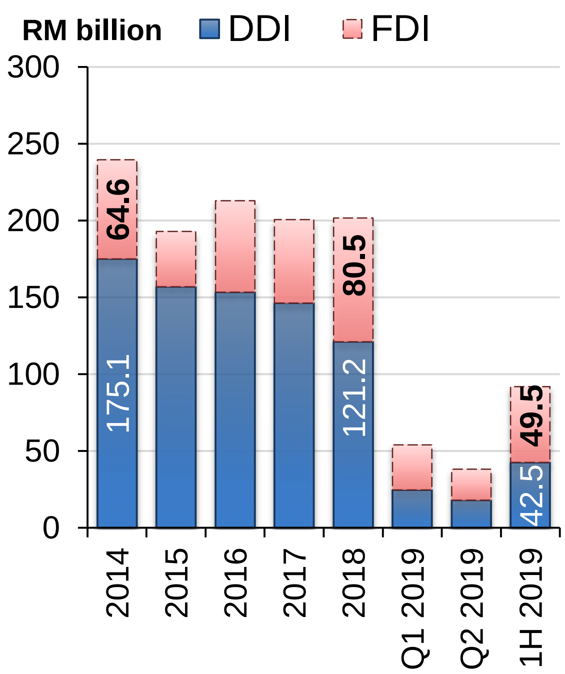
- In 1H 2019, foreign investments approved in the manufacturing, services and primary sectors increased by 97.2% yoy to RM49.5bn (RM25.1bn in 1H 2018).

- Approved domestic investments declined by 29.6% to RM42.5bn in 1H 2019, contributing 46.2% of total approvals.

ODI surpassed FDI in 2Q19



Overall approved investment seen lower in 2019



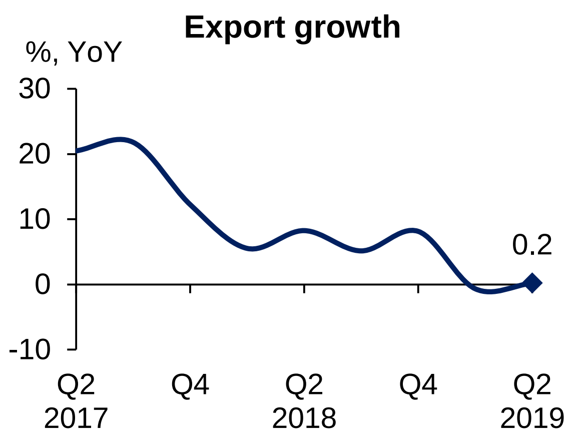
Top foreign sources in manufacturing sector were: The USA (RM11.7bn); China (RM4.8bn); Singapore (RM3.1bn); Japan (RM2.1bn) and the British Virgin Islands (RM1.4bn).

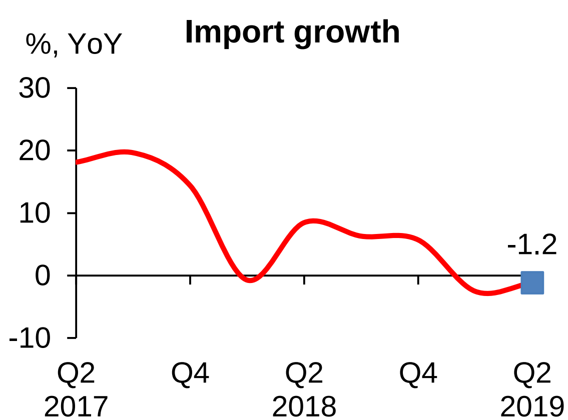
China's Longi Technology to produce monocrystalline solar cell; Advance Energy Industries; On Semiconductors and Plexus Manufacturing; Micron Technology and Jabil Circuit from US; China's XSD International Paper

Source: DOSM; BNM

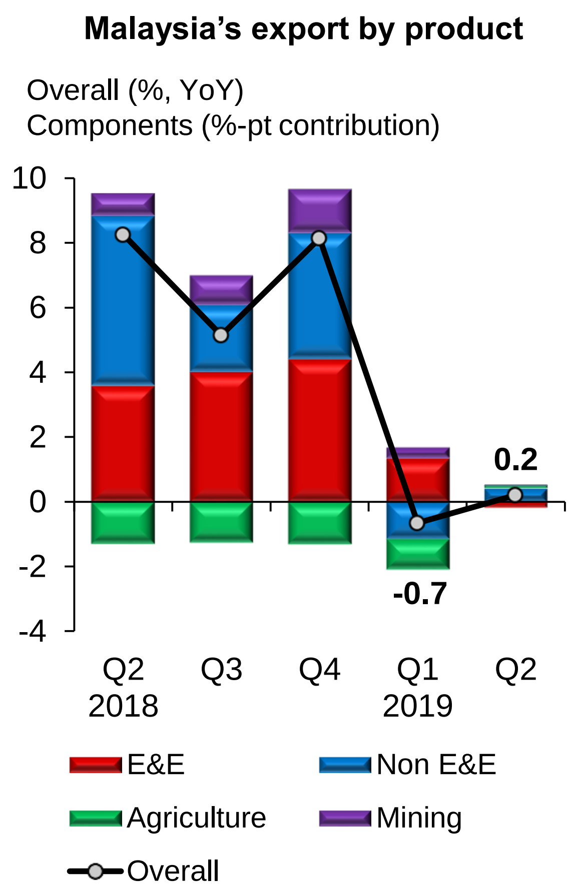
Exports hostage to slowing global growth & trade tensions

Lethargic exports growth

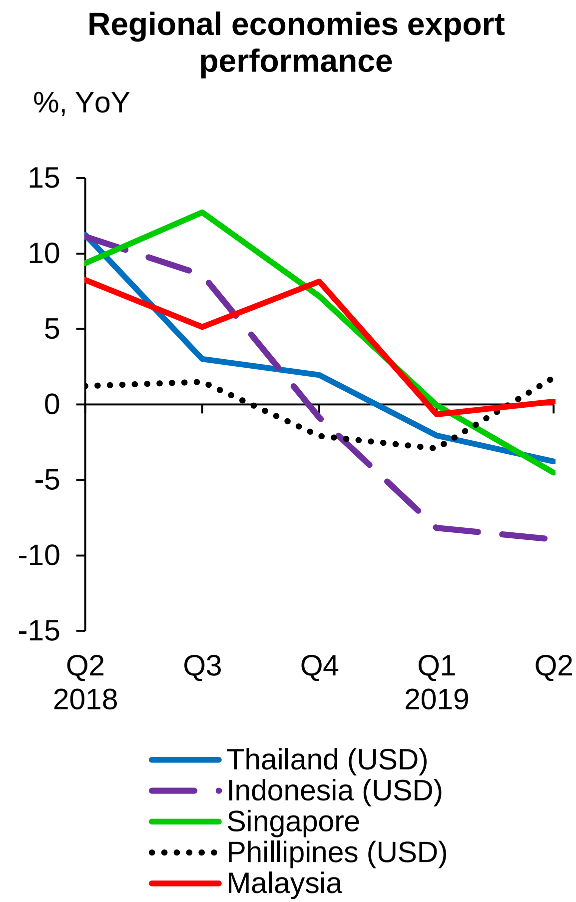




Diversified exports helped mitigate impact of weaker E&E export growth

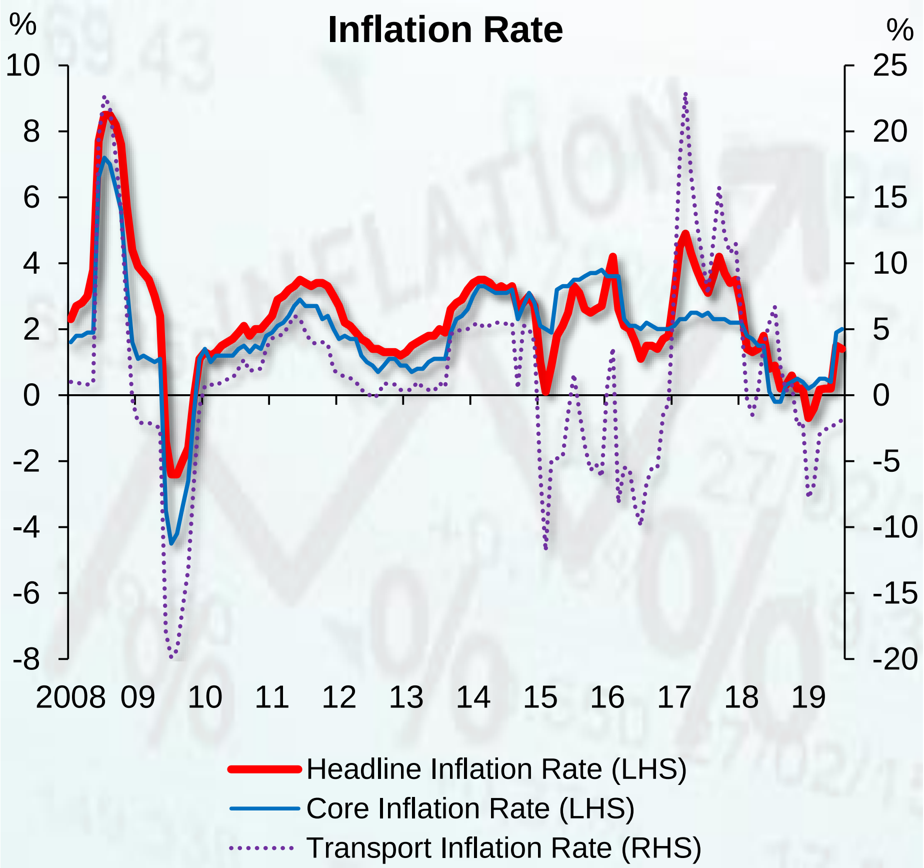


Malaysia's exports compared to regional economies



Note: Mineral products data taken is the data of mining products
Source: DOSM; Officials

Inflation has returned to positive trajectory



- **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.

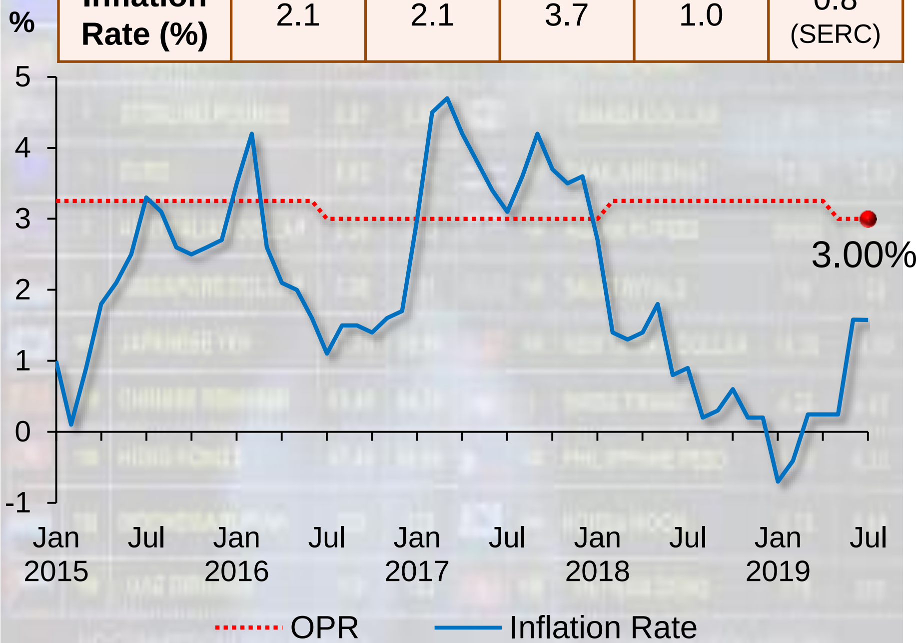
Note: Core inflation in 2008-2014 excludes food and non-alcoholic beverages only.
Source: BNM; DOSM

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.

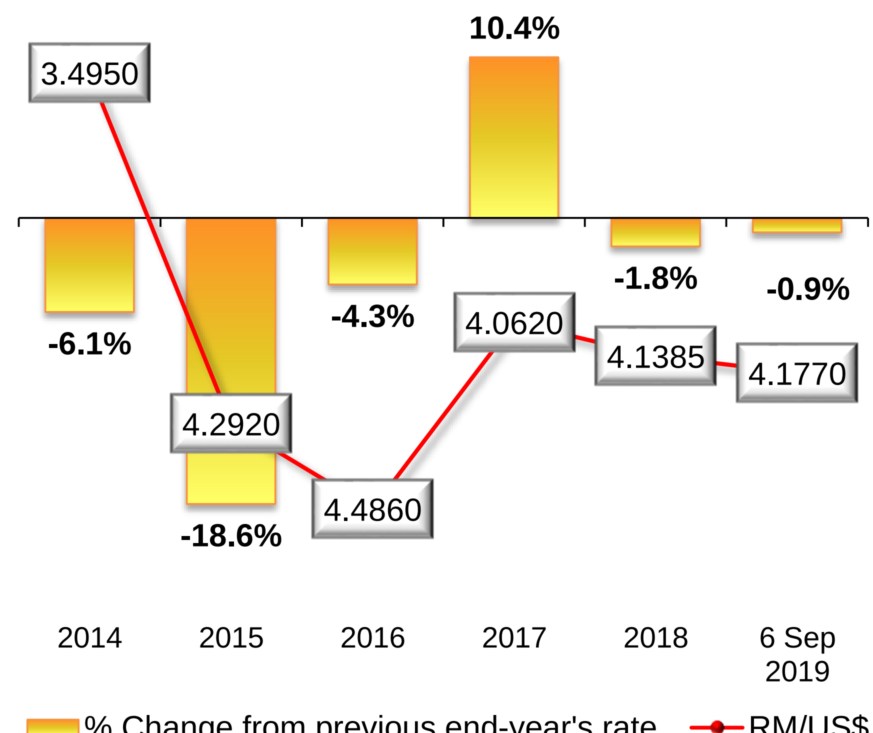
Inflation will rise in second half-year of 2019

Year	2015	2016	2017	2018	2019E
OPR (%)*	3.25	3.00	3.00	3.25	2.75-3.00
Inflation Rate (%)	2.1	2.1	3.7	1.0	0.8 (SERC)



* OPR as at end-year

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

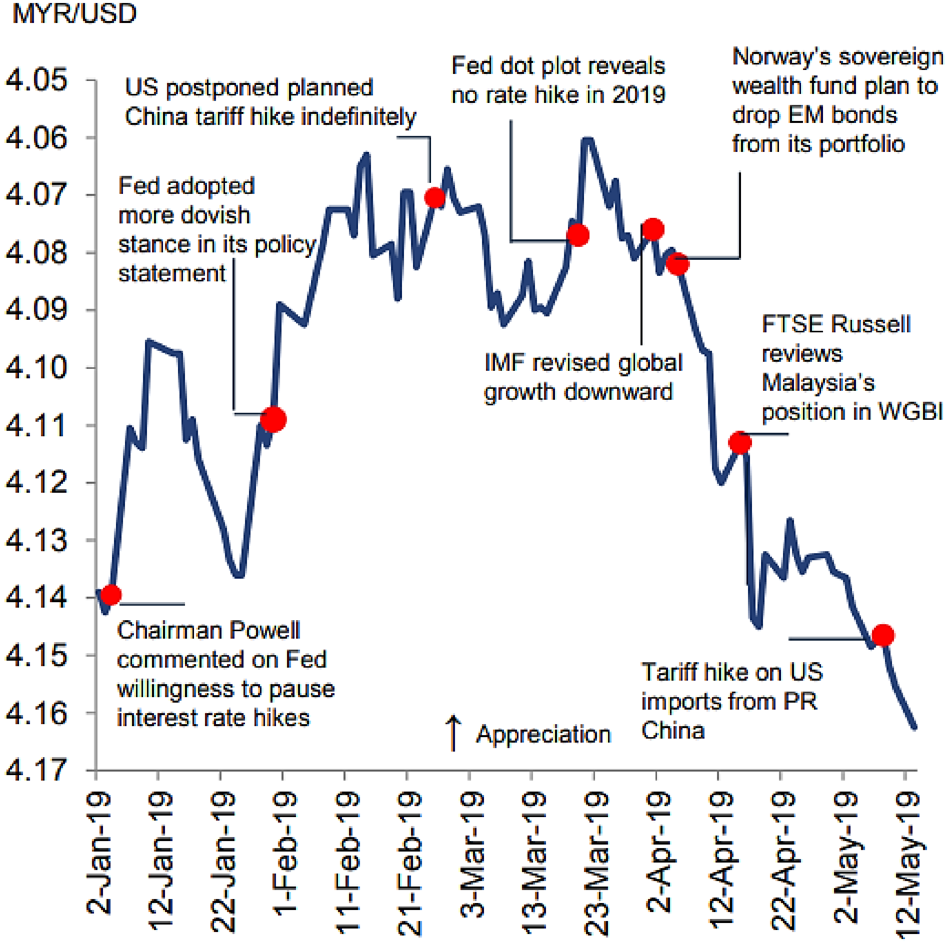


Note: Exchange rate (12:00 rate) as at end-period

Source: DOSM; BNM; SERC

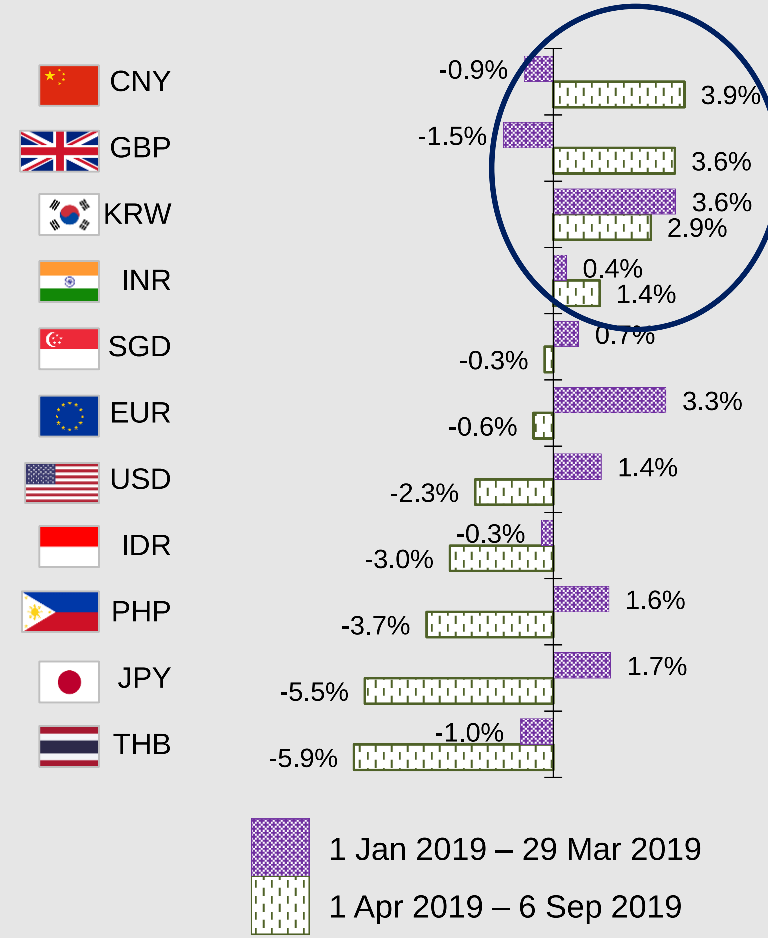
Ringgit's movements largely driven by external influences & cautious investors' sentiment

Movements of ringgit and global developments



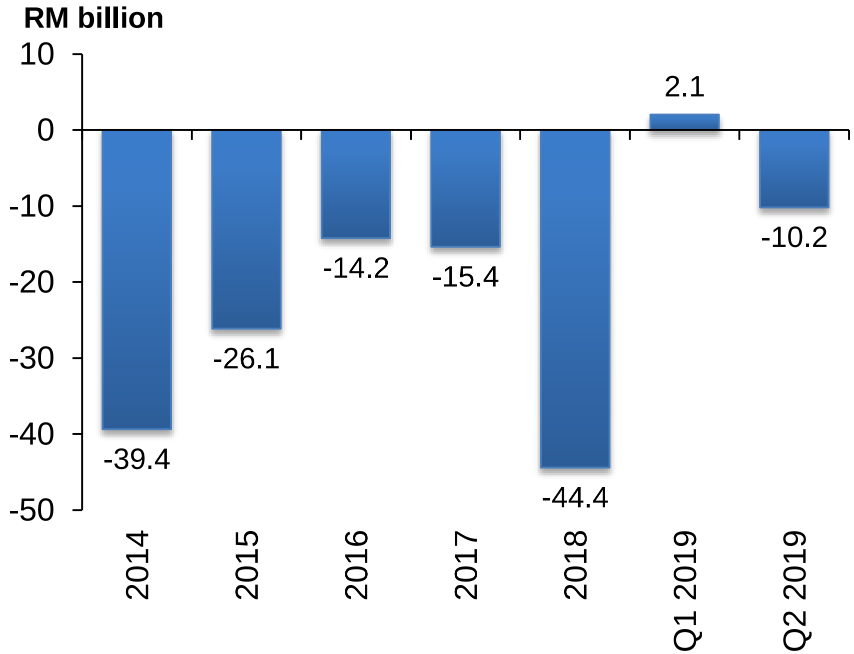
Source: BNM

Ringgit performance against selected major and regional currencies

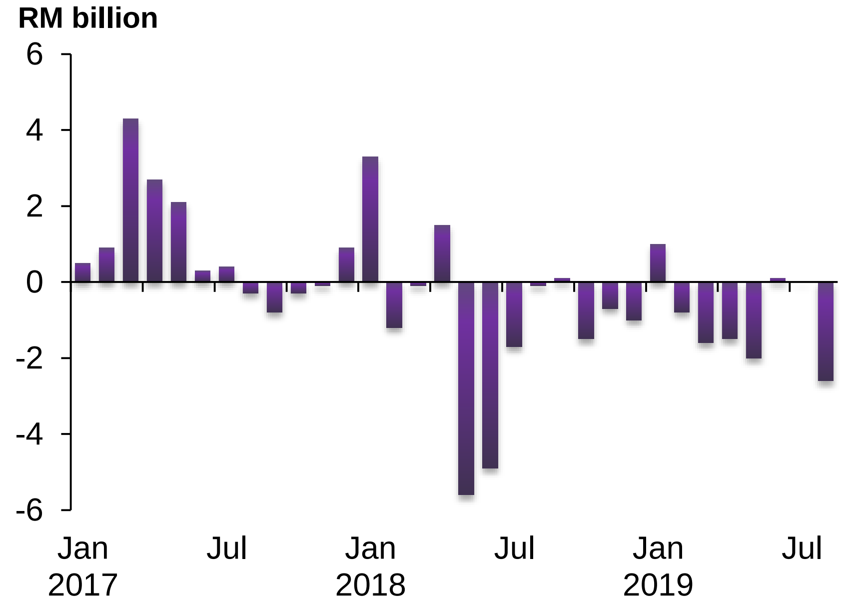


Volatility in portfolio investment flows would persist

Portfolio investment



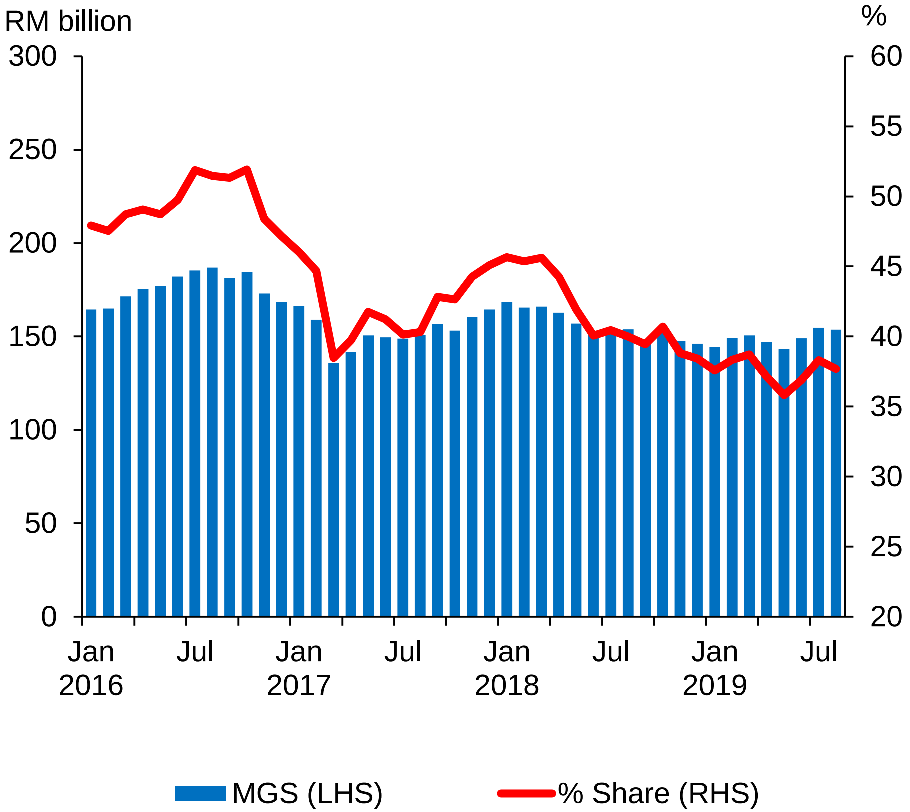
Foreigners' net buy/(sell) position of domestic equity market



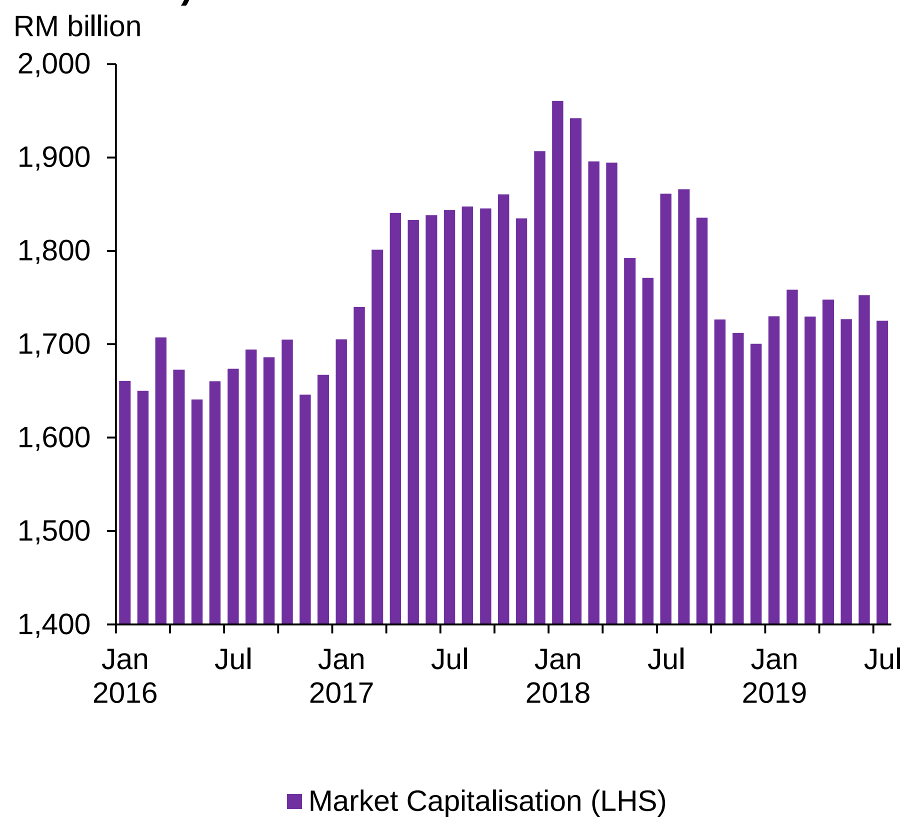
Source: DOSM; BNM

Further trimming of Malaysia bonds and equities

Foreign holdings of Malaysian Government Securities (MGS): 37.7% of total as at Aug 2019



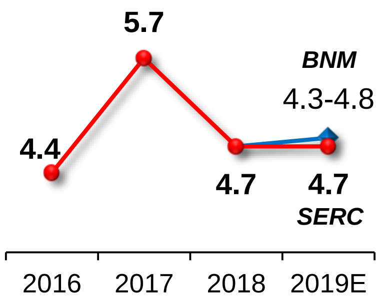
Equity market capitalisation has declined by RM200bn to RM1.7tn+ from the peak (Jan 18: RM1.9tn+)



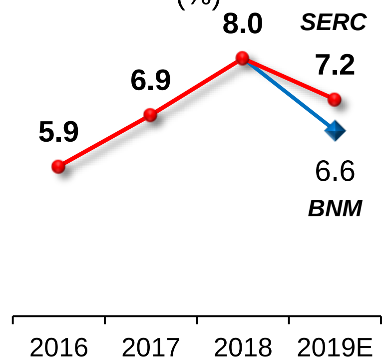
Source: BNM; Bursa

Malaysia's key economic indicators

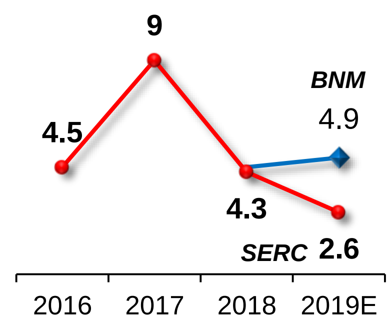
Real GDP Growth
(%)



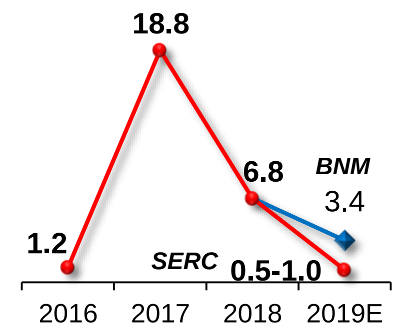
Private Consumption Growth
(%)



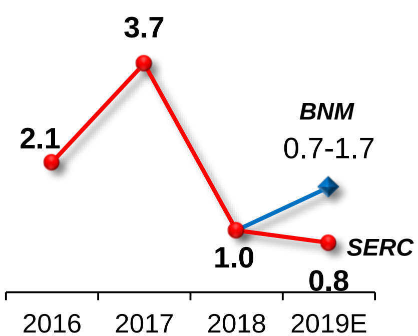
Private Investment Growth
(%)



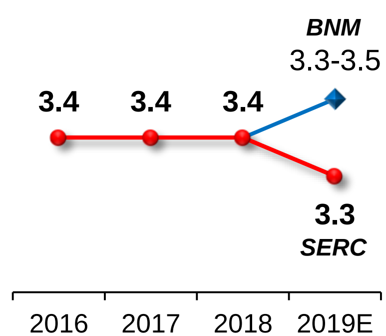
Gross Export Growth
(%)



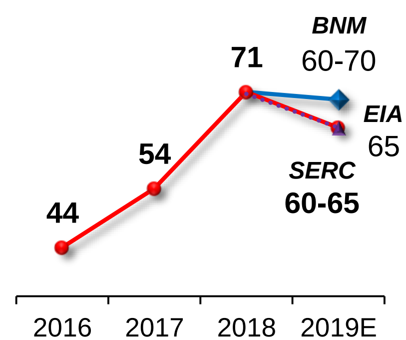
Inflation Rate
(%)



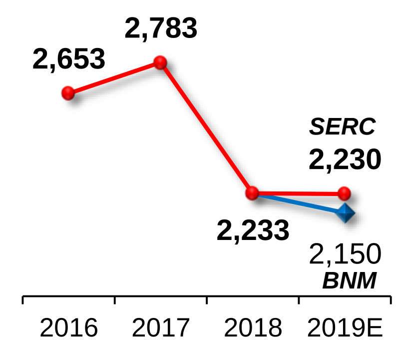
Unemployment Rate
(%)



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

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

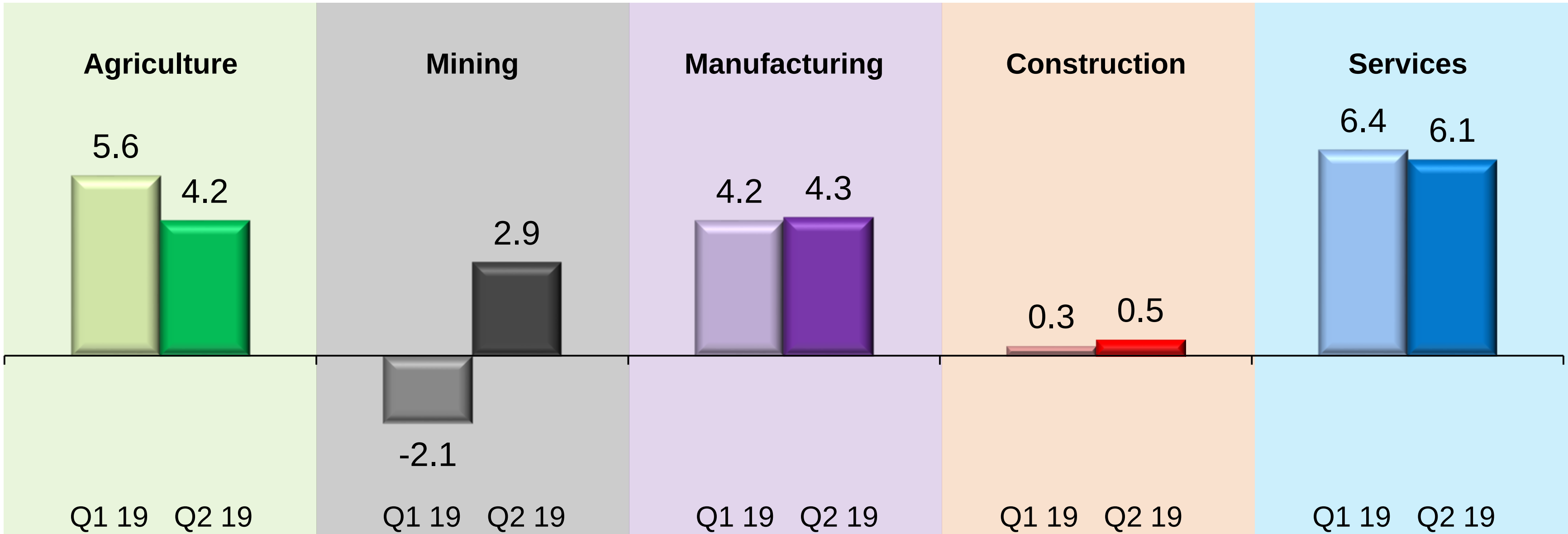
% growth, 2015=100	2017	2018	2019 Q1	2019 Q2	2019 1H	2019E (BNM)	2019E (SERC)	2020F (SERC)
GDP by demand component								
Private consumption (57.0%)	6.9	8.0	7.6	7.8	7.7	6.6	7.2	6.7
Private investment (17.3%)	9.0	4.3	0.4	1.8	1.2	4.9	1.3	3.5
Public consumption (12.5%)	5.5	3.3	6.3	0.3	3.2	1.2	2.7	2.0
Public investment (7.4%)	0.3	-5.0	-13.2	-9.0	-11.3	-7.1	-8.9	-1.0
Exports of goods and services (67.6%)	8.7	2.2	0.1	0.1	0.1	0.1	0.3	1.2
Imports of goods and services (60.6%)	10.2	1.3	-1.4	-2.1	-1.8	0.0	-1.6	1.0
GDP by economic sector								
Agriculture (7.3%)	5.7	0.1	5.6	4.2	4.9	2.8	4.6	2.0
Mining & quarrying (7.6%)	0.4	-2.6	-2.1	2.9	0.3	0.8	0.5	1.5
Manufacturing (22.4%)	6.0	5.0	4.2	4.3	4.2	4.8	4.4	3.9
Construction (4.9%)	6.7	4.2	0.3	0.5	0.4	3.0	0.8	1.5
Services (56.7%)	6.2	6.8	6.4	6.1	6.3	5.7	6.1	5.9
Overall GDP	**5.7**	**4.7**	**4.5**	**4.9**	**4.7**	**4.3-4.8**	**4.7**	**4.5**

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

Expansion across all economic sectors

- Growth supported by the recovery from commodity supply disruptions and improved performance in the manufacturing and construction sectors

%, YoY



Decline in **fishing and forestry segment** and weaker **natural rubber output** partially offset by continued recovery in palm oil yields

Recovery in natural gas output from supply disruptions in 2018

Better performance of the **domestic-oriented** industries

Improvements in the residential and **special trade** sub-sectors

Sustained growth in the retail and **wholesale trade sub-sector**

Source: DOSM; BNM

A broad-based expansion is expected in 2019E-2020F

Sectoral performance (%)

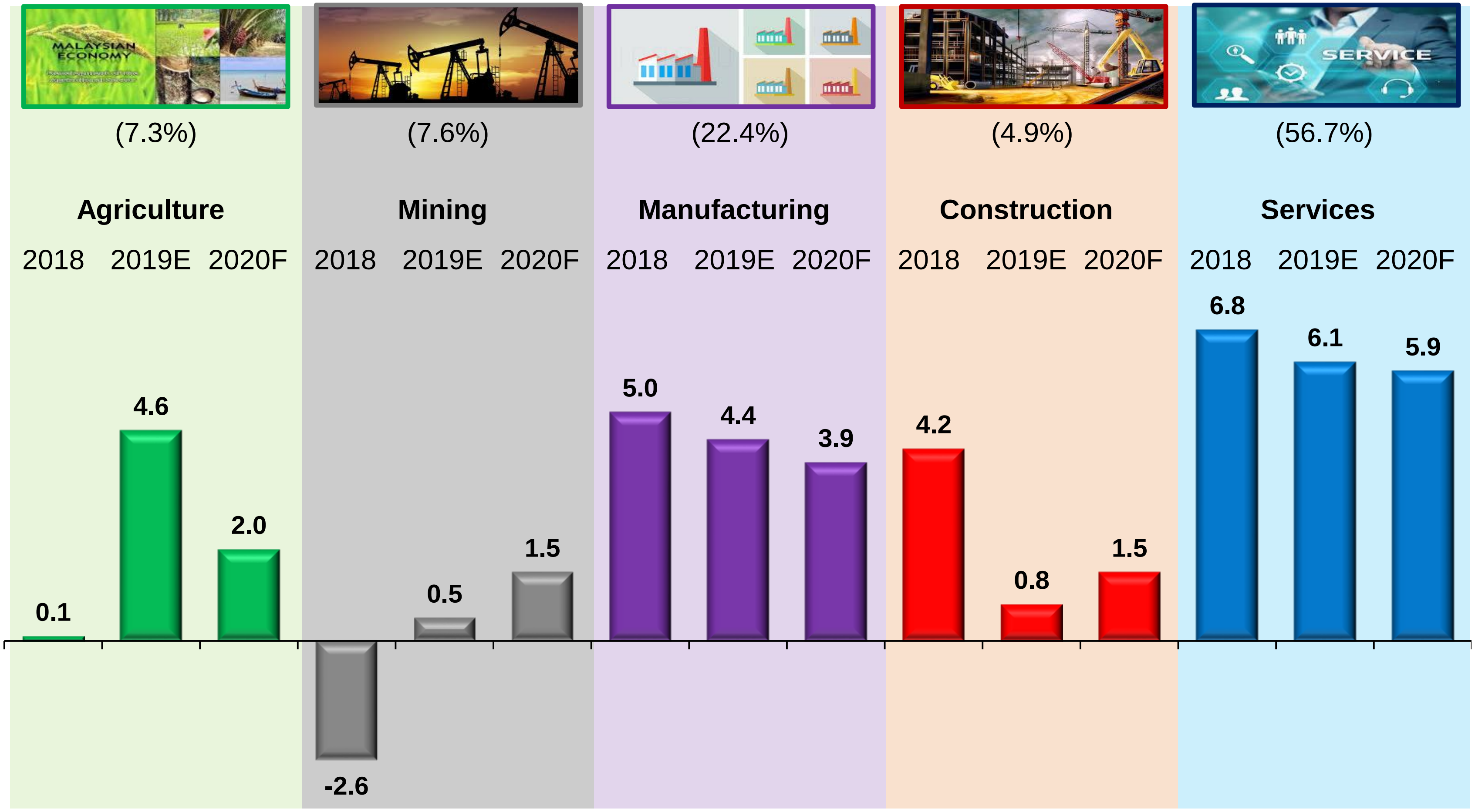


Figure in parenthesis indicates % share to GDP in 2018
Source: DOSM; BNM; SERC

Economic sectors' outlook in 2020

Services

2019E: 6.1%; 2020F: 5.9%

- Still dominant sector
- Domestic-demand driven services
- Wholesale and retail trade, communication and transportation

Manufacturing

2019E: 4.4%; 2020F: 3.9%

- Trade tensions dampen electronics and electrical products
- Domestic-market oriented industries grow moderately
- Food products and some construction related materials

Mining

2019E: 0.5%;
2020F: 1.5%

- Moderate increase in natural gas and crude oil production

Agriculture

2019E: 4.6%;
2020F: 2.0%

- Moderate rise in palm oil output

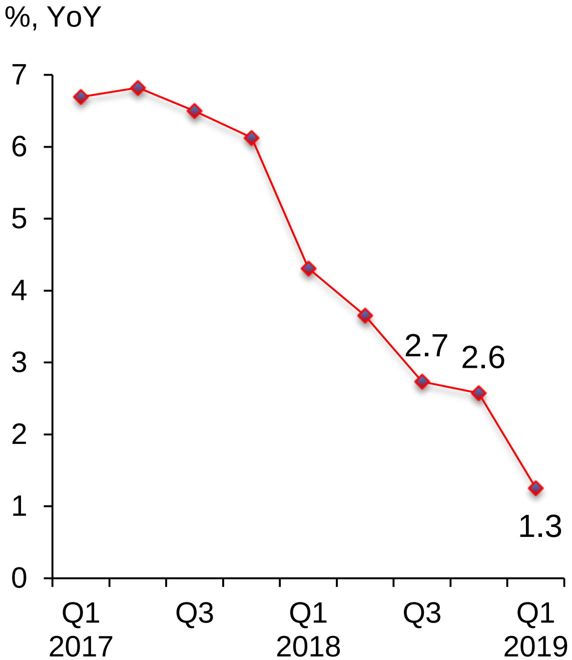
Construction

2019E: 0.8%; 2020F: 1.5%

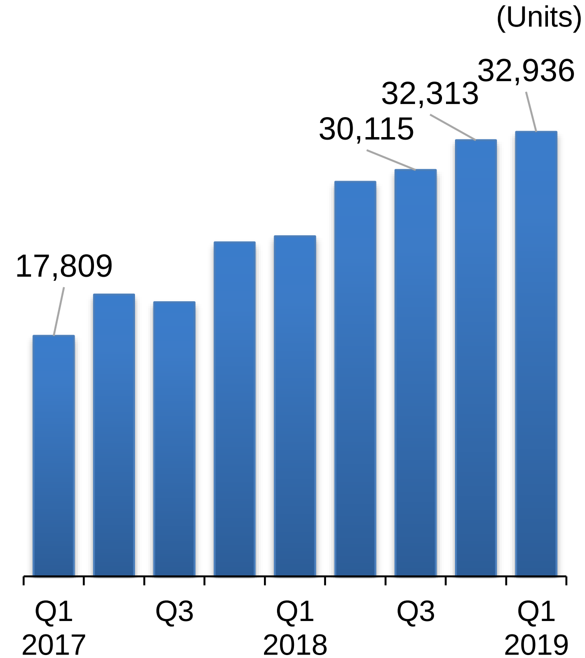
- Slow growth in civil engineering projects on near-completion of large projects amid the revival of ECRL and on-going public transportation projects.
- Property overhang in residential and commercial sector remains a drag

Property overhang continues to rise

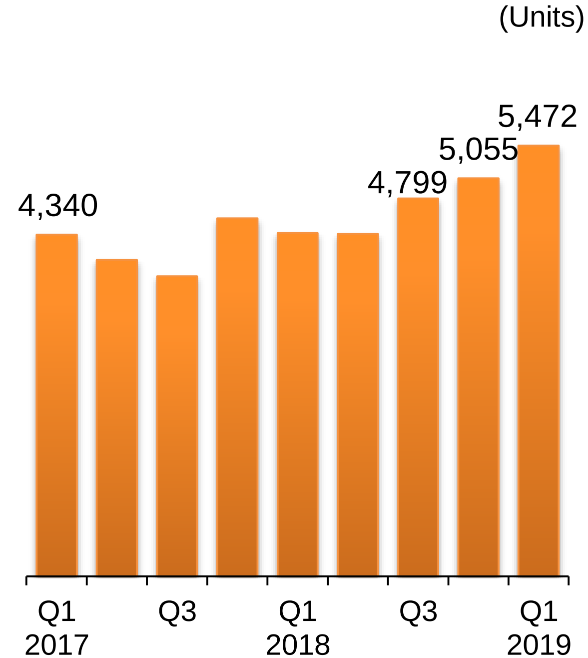
House price index slows further in 1Q19, marking seven consecutive quarters of easing



Overhang in residential properties surge new highs



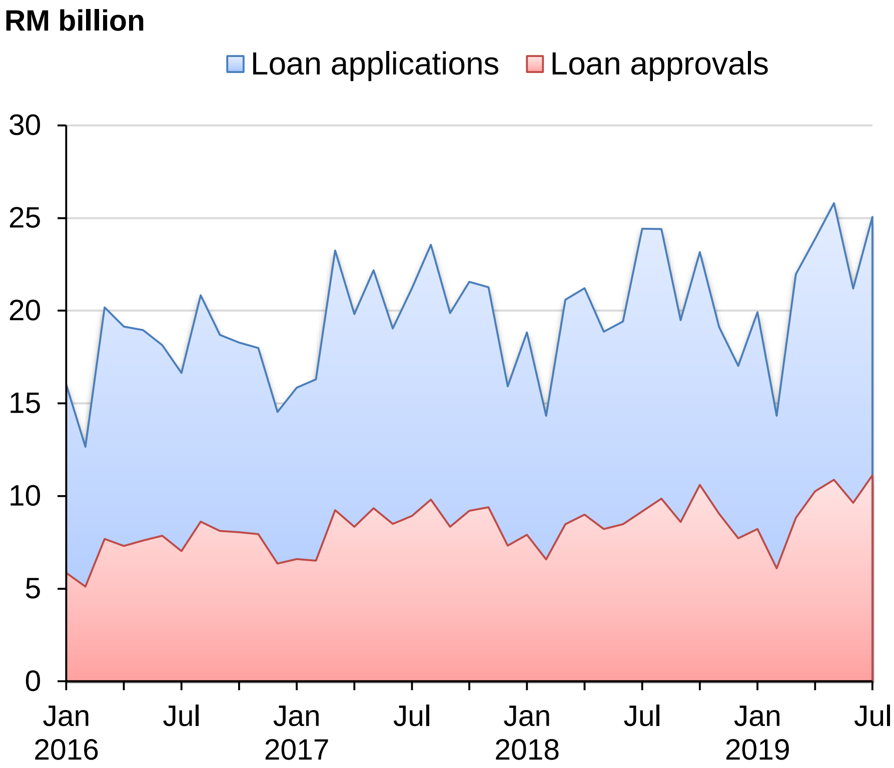
Further rise in overhang commercial properties



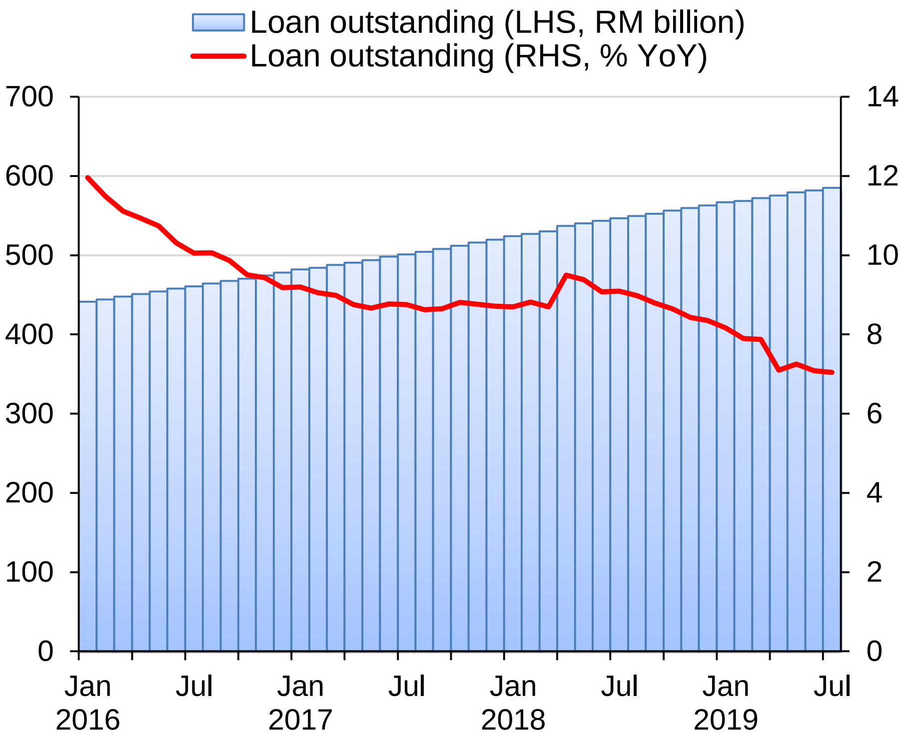
Note: Residential and commercial overhang properties data are excluding SOHO and service apartment.
Source: NAPIC

Home mortgage financing remained soft

Cautious loan approvals for property purchases

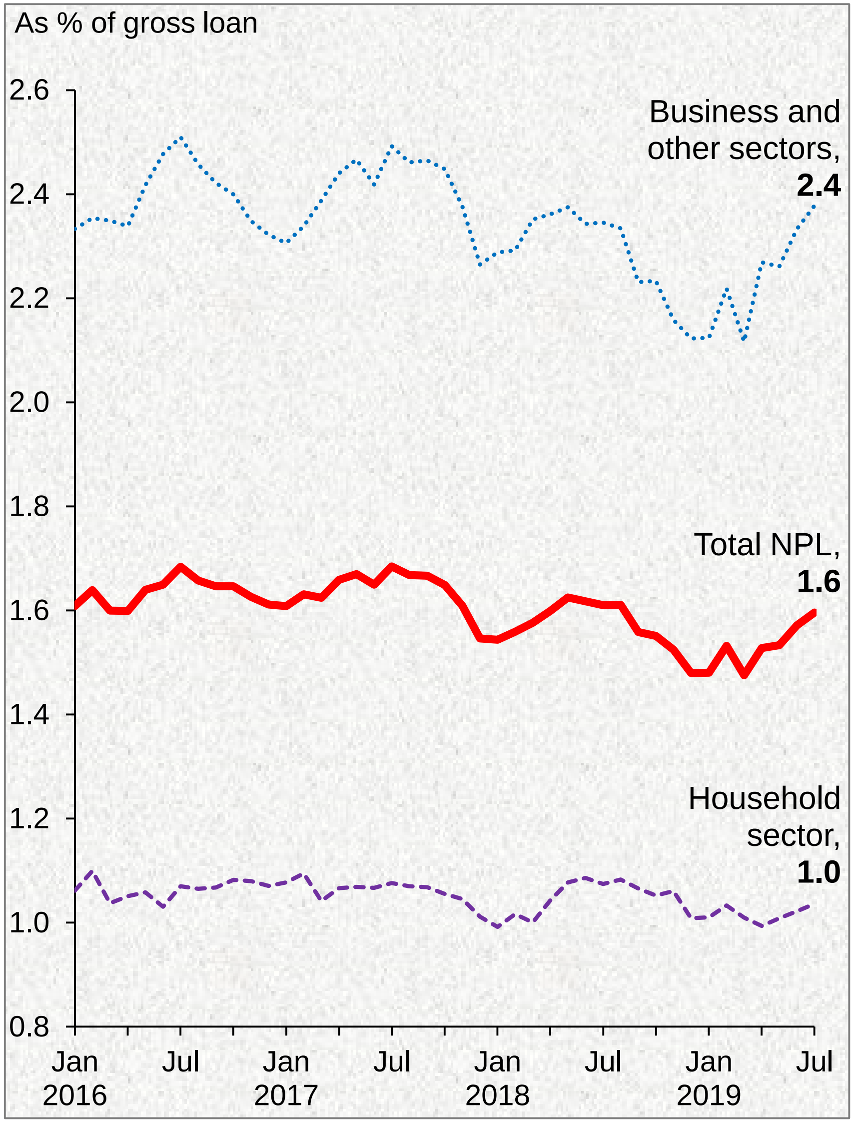


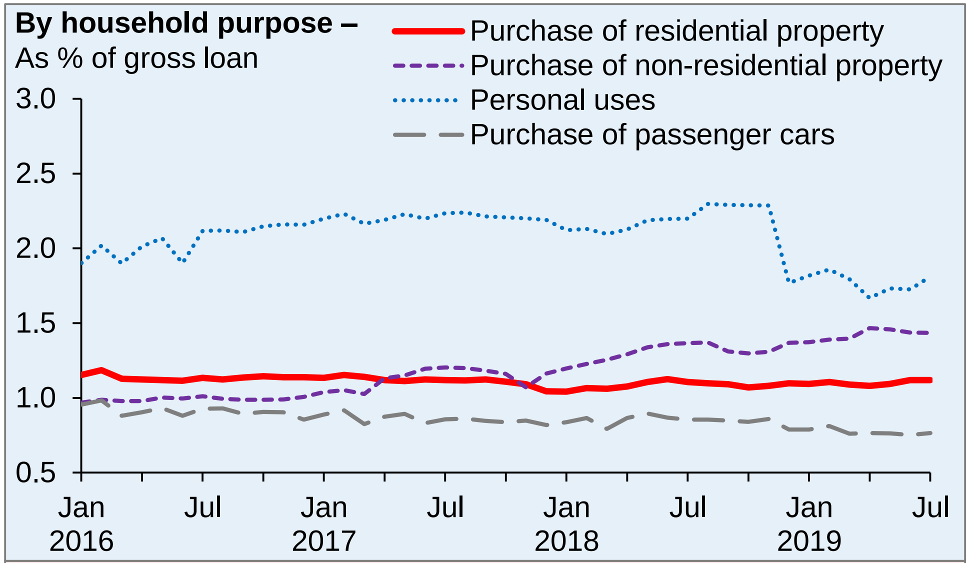
Housing loan outstanding growth continues to moderate in recent months

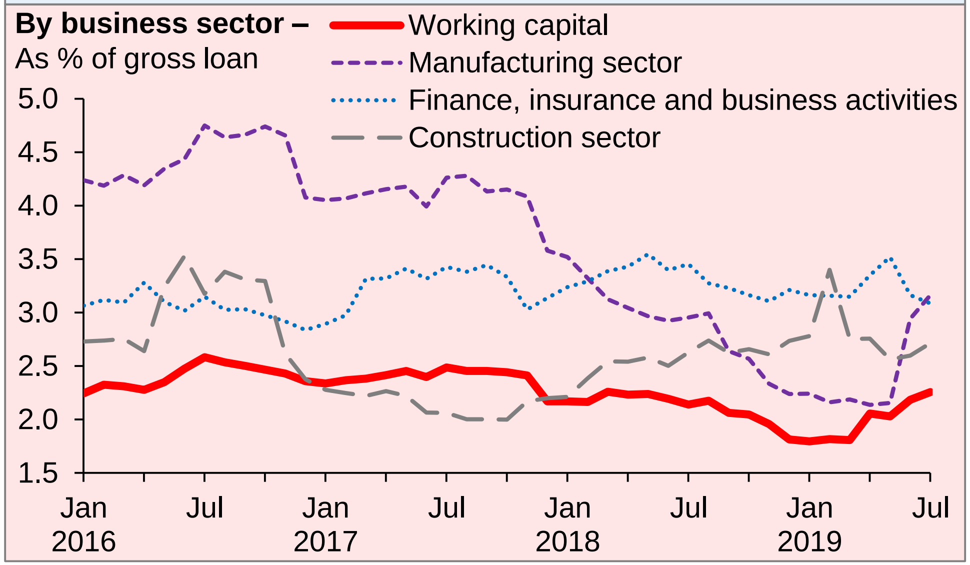


Note: Loan data for April 2018 onwards have been revised to include MBSB Bank Berhad.
Source: BNM

Non-performing loans (NPL) seen ticking up





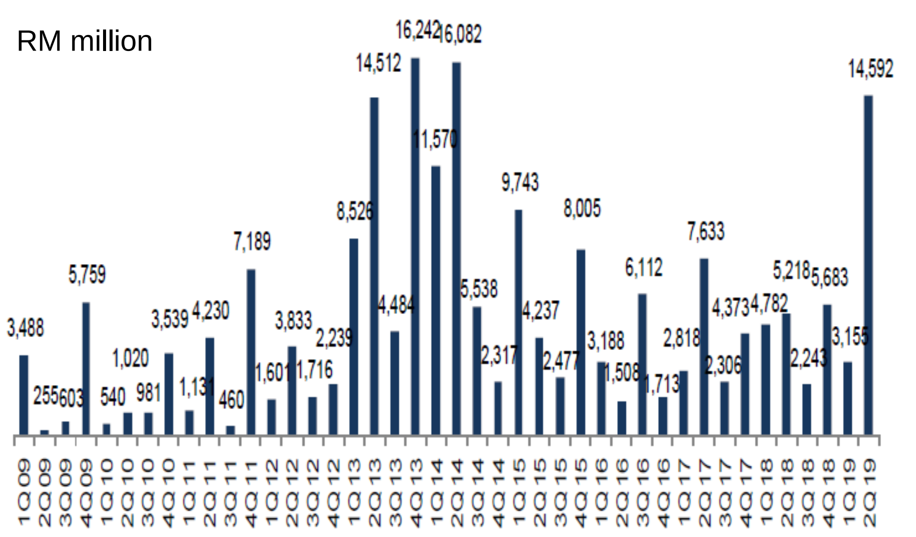


Note: Loan data for April 2018 onwards have been revised to include MBSB Bank Berhad.
Source: BNM

Oil and gas (O&G)– Breaking dawn, but cloud still exists

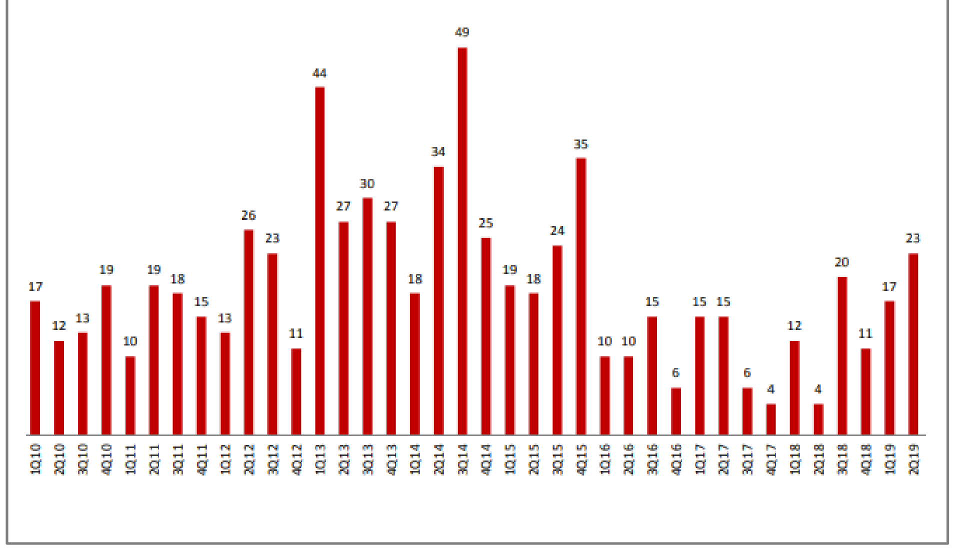
- **OPEC+** agreed to extend crude oil supply cut (1.2m bbl/day) till March 2020 and hence, provides a support to crude oil prices, albeit partially offset by increasing shale production from the US.
- **PETRONAS** has planned an upstream capex of RM32.0bn-RM34.0bn per year in 2019-2023 (with a ratio of 60:40 for domestic vs. overseas allocation), much higher than RM14.8bn-RM27.4bn per year in 2016-2018, albeit still lower than an average of RM54.3bn in 2014-2015.
- Many of the major contracts in key categories and its associated services are due for re-tendering in 2020-2021. This provides good opportunities for players to strategise on new technology offering and strategic partnerships. Decommissioning (which involves the safe plugging of the hole in the earth's surface and disposal of the equipment used in offshore oil production) presents next wave of opportunity for O&G. More than 20 platforms around Malaysia could be decommissioned in the next five years.

Domestic oil and gas contracts seen ticking up



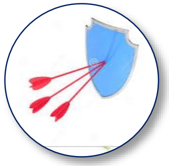
Source: Bloomberg; Affin Hwang

Number of oil and gas contracts announcements



Source: Kenanga Research; Bursa Malaysia

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 July 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 (91.0% to total impaired loans). Liquidity coverage ratio (LCR) is well-above the required level (100% starting 2019) at 155.4%.

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**

Section 7

2020 Budget on 11 Oct

Expansionary stance on the cards

2020 Budget: Pragmatic and responsive to external shocks

Focusing on appropriate budgetary stance and being prepared to be more expansionary is especially important during rising global economic uncertainties.

The Government's **fiscal policy can be calibrated to allow some room for an expansionary budget**, focussing on sectors, initiatives and measures that would protect growth-enhancing spending and investment.

A marginal reduction in the budget deficit to GDP ratio for 2020 (estimated -3.2% of GDP) from estimated 3.4% of GDP in 2019 is acceptable given the need to turn on spending taps under the threat of a bigger global economic slowdown and its spillover effect on domestic economy via both trade and financial transmissions.

The **2020 Budget policies must aim at strengthening economic resilience, sustaining domestic spending and investment, save jobs, create jobs and help viable companies staying afloat**.

It also prepares Malaysia to emerge stronger and enhance our capabilities and competitiveness for the long term.

2020 Budget: Proposed measures and initiatives

A. Sectoral Allocation

i. Allocate more budget for development expenditure, focusing on **education, utilities, ports, healthcare, housing, digital infrastructure, industrial development and SMEs**; and

ii. **Smart and green technology projects and climate change**, including flood mitigation, **renewable energy, public infrastructure, airports upgrading and ports projects**. Development of suburban nodes, roads and rail networks, drainage and sewerage networks, and public housing community, especially the low-cost flats and apartments rejuvenation.

By selected sub-sector	2017	2018E	2019B	2017	2018E	2019B	2017	2018E	2019B
	RM million			% YoY			% Share		
Agriculture and rural development	2,219	2,191	2,278	-23.5	-1.2	3.9	4.9	4.0	4.2
Energy and public utilities	2,475	3,379	4,589	-15.4	36.5	35.8	5.5	6.2	8.4
Trade and industry	3,800	6,686	5,721	-21.5	75.9	-14.4	8.5	12.2	10.5
Transport	10,429	15,501	13,388	33.2	48.6	-13.6	23.2	28.2	24.5
Environment	2,061	1,725	2,134	-12.1	-16.3	23.7	4.6	3.1	3.9
Education and Training	6,306	7,307	8,287	69.2	15.9	13.4	14.0	13.3	15.2
Health	1,470	1,897	2,257	-1.7	29.1	19.0	3.3	3.5	4.1
Housing	785	1,144	1,852	-64.9	45.8	44.4	1.7	2.1	3.0
Total Development Expenditure	**44,884**	**54,900**	**54,700**	**6.9**	**22.3**	**-0.4**	**100.0**	**100.0**	**100.0**

2020 Budget: Proposed measures and initiatives

B. Jobs Preservation and Creation

i. Provide **jobs credit for the employment of graduates and diploma students**; skills upgrading program; freeze of foreign workers' levy;

ii. Establish a **one-stop jobs bank and non-stop online marketplace** that are user-friendly to provide better search functions for job seekers. The online marketplace is to be equipped with individual learning portfolio portal to upskill their capabilities;

iii. Expand the **channels of job-matching servic**es through closer collaboration between academia, industry and private-sector employment agencies through focus on active job seekers, not passive job seekers;

iv. Introduce the **"Attach-Train-Employ" p**rogram by giving some form of incentives and tax rebates to incentivize private sector in providing job opportunities for fresh graduates; and

v. Introduce **New Enterprise incentive scheme** to support eligible job seeker, who is interested in starting and running a small business, and will get practical small business training, business mentoring and financial assistance from the scheme.

C. Uplifting Productivity and Manpower Development

i. Provide allocation for **Skill and Productivity Enhancement** through the revamping of Technical and Vocational Education and Training (TVET). Tax deductible training expenses should be given to private sector in manpower development;

ii. Introduce various measures such as **SkillsFuture and Workforce Skills Qualifications Fund** to ensure that Malaysians remain employable in the face of automation and digital disruption; and

iii. Introduce the **skills for education and employment program** for fresh graduates and college students to improve soft skills such as speaking, reading, writing or communication in the workplace.

2020 Budget: Proposed measures and initiatives

D. Revitalise Private Investment

i. Increase the **grant for technology, industrial deepening and R&D as well as automation** to facilitate SME in the adoption of IR 4.0.

ii. Extend **Reinvestment Allowance (RA**) indefinitely from the current qualifying period of 15 years of assessment.

iii. Enhance **Accelerated Capital Allowance** (ACA) for machinery and equipment.

iv. **A moratorium on hikes in foreign worker levy for next three years till 2021** to ease manpower cost of SMEs. In efforts to increase labour productivity and production efficiency, the **levies should be ploughed back into a Designated Industrial Revolution/Adjustment Fund** that provides financial support or technical assistance to firms to facilitate automation, mechanization and technological development.

v. Enhancement of **bank lending guarantee**, especially to SMEs through enhancing existing schemes on risk-sharing initiative.

vi. Enhancing **business cash-flow and cost of doing business** via a rebate in quick rent and assessment for industrial and commercial properties, business fees and licences; road tax rebate for taxi, buses and lorries.

2020 Budget: Proposed measures and initiatives

E. Enhancing Domestic Consumption

i. Supporting households, especially B40 and targeted vulnerable group via **direct cash assistance**;

ii. **House rental payments to be given a personal tax relief of up to RM4,000 annually**, mainly for M40 households. In the 2018 Budget, a 50% income tax exemption was given on rental income not exceeding RM2,000 per month for each residential home. This is to encourage landlords to reduce their rents but intrinsically rents are market driven based on the supply and demand;

iii. **Personal tax relief** on tuition fees (primary & secondary) up to RM2,000 annually;

iv. "**Buy Malaysian Products**" Campaign;

v. **Re-introduce tax relief for interest payments on housing loan up to RM10,000 per year**. The interest relief is only entitled for one unit of residential property for owner-occupied and not renting out;

vi. To **increase lifestyle tax relief** from RM2,500 to RM3,000 annually;

vii. To **revise personal tax relief** from current RM9,000 to RM10,000. The last revision was in 2010; and

viii. Increase the **tax relief for EPF's contribution and life insurance** premium to RM6,000 each.

2020 Budget: Proposed measures and initiatives

F. Easing Property Overhang Pressure

- The **persistent overhang in residential and commercial properties** require urgent attention and prompt policy intervention. In 1Q 2019, total overhang of residential properties remained high to increase by 30.7% to a new record of 32,936 units valued at RM20 billion. For commercial properties, the number of overhangs increased by 25.5% to 5,472 units in 1Q 2019 to value at RM4.5 billion.

- **Growth in Malaysia's House Price Index (HPI) has slowed for seven consecutive years**, from 13.4% in 2012 to 3.1% in 2018 (6.5% in 2017). In 1Q 2019, house price index eased further to 1.3%.

  i. **Review the threshold for the foreign purchase of properties**. Between 2012-2016, foreign purchases of properties only accounted for 0.3% (706 units) -1.0% (2.406 units) of total properties transacted;

  ii. **Review of RPGT, including the abolishment of 5% RPGT** on the disposal of property after the fifth year; and

  iii. **Extend the National Home Ownership Campaign (HOC)** until 31 December 2020, together with the stamp duty exemption.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