QUARTERLY ECONOMY TRACKER

(2019 Fourth Quarter & 2020 OUTLOOK)

Socio-Economic Research Centre (SERC)

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Socio-Economic Research Centre (SERC)

Executive Director

Mr. Lee Heng Guie - *hglee@acccimserc.com*

Senior Researcher

Mr. Lee Soon Thye - *stlee@acccimserc.com*

Researcher

Mr. Goh Kong Jun - *kjgoh@acccimserc.com*

Ms. Look Yuen Kei - *yklook@acccimserc.com*

QUARTERLY ECONOMY TRACKER (OCT-DEC 2019 & 2020 OUTLOOK)

World Economic Situation and Prospects

2019's global growth the slowest pace since 2009. The global economy has been dogged by many disruptors and uncertainties since 2018, which had experienced a synchronised slowdown in 2H 2018. Global economic growth is expected to fall to 3.0% in 2019, the slowest pace since 2008-2009 Global Financial Crisis and decelerated from a 3.8% pace seen in 2017. Both the US and China economies have slowed, largely inflicted by more than 19 months long trade dispute amid slowing investment.

Watching for inflection points in 2020. The 2020 macro environment is expected to remain either somewhat stable or improve gradually as global central banks' unusual late-cycle interest rate cuts and easing trade tensions helped to uplift sentiment though uncertainties over trade still linger.

Market and investors will be looking for an inflection point(s) to ascertain whether some stabilisation in global growth is on the horizon, paving the way for a convincing growth recovery.

The base case scenario for the global economy is a trade-war retreat or a material de-escalation of the trade tensions, and this will help to reduce the uncertainty and probably acts to spur global growth and market sentiment. The prospects of a "phase one" US-China trade deal and lower US interest rates have eased the tight liquidity condition and enhanced borrowing conditions to support consumer spending under a firm labour market condition. The effectiveness of coordinated global central banks' monetary easing and quantitative easing (QE) as well as China's massive policy stimulus would set the scene for stronger global growth in early 2020.

The inflection points to watch in 2020 are: (i) The signing of "phase one" partial trade deal between the US and China scheduled on 15 January should be a positive step to lay the foundation for future negotiations. More importantly, it is hope that more concrete agreements than less will ensue leading to a roll back of other tariffs in stages. Effective implementation and enforcement are the key; (ii) President Trump confronts one dilemma going into the 2020 amid public impeachment hearing. Without striking a clear deal approaching the 2020 US Presidential elections, there's a rising risk that tariffs will remain effect throughout 2020. A pause in the escalation of the trade tensions would help a slowing US economy to bounce back in an election year; and (iii) Low, zero and negative interest rates have become the new normal. What if an ultra-dovish monetary stimulus fails to work? The Fed has signalled that policymakers saw no need to boost the economy further anytime soon. Amid the fiscal limitation and high public debt level, fiscal policy has to be reinstated as the main tool for managing business cycles and supporting economic growth had monetary policy reached its limits?

The US and China economy in focus. The US economy is expected to cruise along albeit slower at 1.9% in 2020 as the fiscal card through tax cuts in 2018 has ebbed amid the support of low interest rate. The US President Trump seeking re-election, facing impeachment proceedings at home, and with the election looming, needs to boost US activities. Strong jobs growth should keep the consumer spending resilient. China's economy is in the midst of a structural slowdown as the country transitions away from its credit-intensive growth model. In the Eurozone, a gradual pick-up in growth is envisaged, driven by resilient domestic demand and progress on Brexit, albeit facing the risk from trade conflicts. Japan's economic growth is likely to slow notably, largely as the sales tax hike will restrain private consumption amid positive spillovers from the 2020 Olympics and low unemployment.

Broad-based central banks' easing bias remains. What's next for the central banks in 2020? Monetary easing bias remains amid receding recession fears. Future monetary actions will be data dependent and if growth ebbs below the trend pace, that could cause the policy makers to ease interest rate again. The Fed is likely to pause future rate actions for a while, at least into the first half of 2020. Bank of Japan (BOJ), European Central Bank (ECB) and most emerging markets' central banks are expected to keep either negative or low interest rates for greater part of 2020.

Main macro risks for 2020 stemming from trade war. A partial "phase one" trade deal between the US and China is expected to allow gradual negotiation progress to be made over the course of 2020. The key risk is re-escalation of the trade war. Though the US economy is on a solid footing, lingering uncertainties surrounding the on-going trade negotiations as well as the looming 2020 Presidential elections remain a key downside risk. Uncertainty about economic and trade policy, particularly if there is a close presidential race, may weigh on business and household decisions in 2020. Political and geopolitical risks will linger and have the potential to quickly shift investors' sentiment.

Malaysia's Economic and Financial Conditions

Malaysia's economic growth at 4.6% in 2019. Despite facing with many disruptors and uncertainties, particularly a prolonged trade conflicts between the US and China inflicted damage on global economy and trade since 2018, the Malaysian economy has withstood headwinds to grow by 4.6% in the first nine months of 2019. Nevertheless, growth momentum had moderated from an annual rate of 4.9% in 2Q 2019 to 4.4% in 3Q as domestic demand cooled (to 3.5% in 3Q 2019 from 4.6% in 2Q 2019 and 6.8% in 3Q 2018). Adding to growth pressure was continued sluggishness in exports, which had contracted by 2.1% in Jan-Nov. For the full-year of 2019, GDP growth is estimated to increase by 4.6%, which is a shade lower than 4.7% in 2018 but 1.1 percentage points lower than 5.7% in 2017.

GDP growth seen slowing to 4.5% in 2020. Weighing on cautious global growth estimates of 3.2%-3.4% in 2020 (IMF's estimated 3.0% in 2019), the Malaysian economy is expected to grow by 4.5% in 2020. Domestic demand, especially private consumption will be calling the shots, albeit slower as there remains considerable uncertainty about private investment. The 2020 Budget's 4.3% increase in development expenditure to RM56.0 billion in 2020 should help to provide partial support to the domestic economy. What matters most is to execute effectively the Budget's programmes and initiatives; and to disburse the funds timely for the implementation of projects.

Consumer spending to normalise on cautious sentiment. Private consumption is estimated to pace slower to 6.7% in 2020 from estimated 7.2% in 2019, which is normalised towards its long-term growth of 7.0% per annum in 2011-2018. The estimated rise in unemployment rate of 3.3%-3.4% and moderate salary increment (between 4.5%-5.0%) and bonus pay-out and still-high consumer debt are expected to see some pullback in discretionary spending. Nevertheless, RM5.0 billion cost of living aid would provide partial buffer to targeted low- and middle-income households and individuals. The Government has deferred the implementation of the targeted fuel subsidy scheme, which is slated to roll out on 1 January 2020.

Strong revival in private investment growth is needed. The biggest challenges facing the Malaysian economy is the fast slowing growth of private investment. The growth rate has been losing steam in recent quarters to 0.9% in the first nine months of 2019 and likely to end the year much lower at 0.8% (4.3% in 2018 and 9.0% in 2017), the slowest pace in nine years after contracting by 7.4% in 2009. For 2020, we expect private investment to remain cautiously weak, growing by 2.2% as investors stay on side lines on wary about external environment and broader domestic political development, including the leadership transition and policy uncertainties.

Growth in private investment has remained weak primarily due to concerns related to uncertain external environment, challenging domestic business condition, regulatory challenges as well as the lack of policies clarity continue to weigh on investors' confidence.

The danger is that the persistent pull back on capital spending would take much of the steam out of the economy going forward and undermine capital formation. There are also worries that weak business investment and challenging economic conditions could constrain companies' ability to continue hiring more workers, and undermine consumer spending.

Exports to recover gradually. Dampened by slowing global demand, especially for electronics and electrical products and also disrupted by a prolonged trade conflicts between the US and China, exports contracted by 2.1% in Jan-Nov. We expect exports to recover gradually in 2020 with an estimated positive 2.0% growth as against a decline of 1.5%-2.0% in 2019. The expected improvement in exports will be supported by (a) easing trade tensions will help to stabilise global trade; (b) the deployment of 5G will be the main factor propelling a moderate recovery in the semiconductor sector, especially the wireless technology industry; and (c) higher commodity and crude oil prices.

Inflation expectations will be higher in 2020 as fuelled by a managed floating of fuel prices on a gradual basis, a planned upward adjustment in water tariffs nationwide, higher minimum wage as well as higher private medical consultation fees. We expect the Government to eventually implement the targeted fuel subsidy scheme, which is originally planned for implementation on 1 Jan 2020. Overall headline inflation, as measured by Consumer Price Index (CPI) is estimated to increase by 2.0% in 2020, markedly higher from estimated 0.7% in 2019.

Bank Negara Malaysia keeps its monetary option open. While the economy will get some fiscal spending boost from 2020 Budget, but if global growth fails to stabilise or trade conflict uncertainties remain entrenched, monetary policy may need to reinforce and secure growth amid contained inflation expectations. Bank Negara Malaysia is expected to keep door open to modest monetary easing, probably 25 basis points cut in the overnight policy rate to 2.75% by 1H 2020 if the economy slows materially to say, around 4.0%.

Weighing on tailwinds for the ringgit. The ringgit ended the year 2019 at RM4.0925 per US dollar, a small appreciation of 1.1% from end-2018 (RM4.1385). The phase one trade deal between the US and China has aided to improve investors' sentiment as well as alleviate downward pressure on global economic and trade conditions. Fading recession risk and easing trade tension serve as a tailwind for open and trade-dependent Asian economies, including Malaysia while boosting the prospects of exports rebound. Still, any negative surprises from a trade truce negotiation, commodity prices volatility and geopolitical uncertainties could influence the ringgit's outlook. Domestic macroeconomic conditions, fiscal outlook and current account position of the balance of payment remain the primary drivers of the ringgit's performance. In 1Q 2020, all eyes are on the FTSE Russell's review on Malaysia's bonds' inclusion in its World Government Bond Index (WGBI), the US Treasury's next review of Malaysia in the Monitoring List on currency practices and domestic macroeconomic policies.

GLOBAL ECONOMY SEEN STABILISING BUT RISKS ABOUND

A roller-coaster ride in 2019. The global economy, which had experienced a synchronised slowdown in 2H 2018 continued into 2019 on a roller-coaster ride driven by bouts of financial market volatility, the US-China's tensions on both the trade and technology fronts, never-ending Brexit drama and much of a concern over the slowing US economy and China's ongoing economic growth slowdown.

Throughout 2019, a slew of high frequency economic indicators and financial barometers were flashing RED signal, indicating continued weak global growth trajectory ahead as both manufacturing and services sectors' momentum have slipped from the expansionary path.

Global central banks, led by the US Federal Reserve have moved into a convergence of policy interest rate cuts and liquidity provisions to provide insurance against on-going global risks on the domestic economy. The global growth slowdown currently underway is expected to be disinflationary.

In its October's releases, the International Monetary Fund (IMF) had lowered its estimates of 2019's global growth for the fifth time to 3.0% and to 3.4% in 2020 for the fourth time, citing unresolved trade barriers, heightened geopolitical tensions, included Brexit-related risks, abrupt shift in risk sentiment and expose to financial vulnerabilities, which had built up over the years under a prolonged period of low interest rates and easier credit conditions as well as the risks from climate change would affect the projected growth rate.

In addition, the risk of proliferation of global debt is rising and investors were warned on its domino effect if it collapses. As at end-Jun 2019, total credit of non-financial sector to world GDP has reached 242.3%, increasing from 231.4% as at end-Sep 2018. Advanced economies had recorded a credit to GDP ratio of 272.3% while that of emerging economies climbed back to a record high of 194.3%. China had recorded a new high of corporate loans default of about US$18.6 billion in 2019.

Table 1: Real GDP growth (% YoY)

	2017	2018	2019 Q1	2019 Q2	2019 Q3	2019*e* (IMF)	2019*e* (WB)	2020*f* (IMF)	2020*f* (WB)
United States	2.4	2.9	2.7	2.3	2.1	2.4	2.3	2.1	1.8
Euro Area	2.5	1.9	1.4	1.2	1.2	1.2	1.1	1.4	1.0
China	6.8	6.6	6.4	6.2	6.0	6.1	6.1	5.8	5.9
Japan	2.2	0.3	0.8	0.9	1.7	0.9	1.1	0.5	0.7
India	7.2	6.8	5.8	5.0	4.5	6.1	5.0	7.0	5.8
Malaysia	5.7	4.7	4.5	4.9	4.4	4.5	4.6	4.5	4.5
Singapore	3.7	3.1	1.1	0.2	0.5	0.5	-	1.0	-
Indonesia	5.1	5.2	5.1	5.0	5.0	5.0	5.0	5.1	5.1
Thailand	4.0	4.1	2.8	2.3	2.4	2.9	2.5	3.0	2.7
Philippines	6.7	6.2	5.6	5.5	6.2	5.7	5.8	6.2	6.1
Vietnam	6.8	7.1	6.8	6.7	7.3	6.5	6.8	6.5	6.5

Note: *Annual GDP for India is on fiscal year basis.*
Source: *Officials (unadjusted data except quarterly GDP for Euro Area); IMF (World Economic Outlook (WEO), Oct 2019); World Bank (Global Economic Prospects, Jan 2020; East Asia and Pacific Economic Update, Oct 2019; South Asia Economic Focus, Fall 2019)*

Looking for growth stabilisation in 2020. The 2020 macro environment is expected to remain either somewhat stable or improve gradually as global central banks' unusual late-cycle interest rate cuts and easing trade tensions helped to uplift sentiment though uncertainties over trade still linger. High frequency global indicators such as purchasing managers' index for manufacturing and services have shown tentative signs of recovery.

Market and investors will be looking for an inflection point(s) to ascertain whether some stabilisation in global growth is on the horizon, paving the way for a convincing growth recovery.

The base case scenario for the global economy is a trade war retreat or a material de-escalation of the trade tensions, and this will help to reduce the uncertainty and probably acts to spur global growth and market sentiment. The prospects of a "phase one" US-China trade deal and lower US interest rates have eased the tight liquidity condition and enhanced borrowing conditions to support consumer spending under a firm labour market condition. The effectiveness of coordinated global central banks' monetary easing and quantitative easing (QE) as well as China's massive policy stimulus would set the scene for stronger global growth in early 2020.

In the near-term, the signing of the phase one interim trade deal on 15 Jan 2020 is viewed as a positive step to lay the foundations for future negotiations.

A phased rollback of trade tariffs indicates that both sides are willing to work out an interim solution palatable to both countries while adopting non-confrontational and consensus approach to reconcile the more complicated parts of the trade conflicts.

More importantly, it is hoped that more concrete agreements than less will ensue following the first phase and also contentious areas of conflicts related to the technology transfer, subsides given to the Chinese state-owned enterprises, granting more access to the US companies, cyber security as well as intellectual property rights be substantially addressed in the subsequent phases of the trade deals.

If the US and China can settle their differences and the trade war ceasefire holds, the global growth and US economy may be turning the corner. Nevertheless, another inflection point to watch is that the US Presidential elections and if the impeachment process against incumbent President Trump is any guide, the noise level is likely to remain elevated in 2020.

Central banks mind the step. Broad-based central banks' easing bias remains for the US Federal Reserve (Fed) and European Central Bank (ECB) as well as emerging markets' central banks.

Stepping back, the Fed's mid-cycle rate adjustment (or monetary easing) has been even more substantial that just three rate cuts by 75 basis points (bps) to 1.50-1.75% currently given that the central bank thought it would be raising rates in 2019.

The Fed has a lot to juggle, considering the slowing US economy will hit the button more as the fiscal stimulus fades (US$1.5 trillion tax cut package and a US$300 billion rise in fiscal spending were introduced in 2017). The Fed is expected to pause for one and two quarters in 2020, waiting to see the impact of previous rate cuts.

The ECB has restarted the asset purchase programmes (APP) since November. Bank of Japan (BOJ) indicated that the BOJ will not hesitate to further ease its already negative policy rate if inflation target is under threat.

In emerging markets, the Reserve Bank of India (RBI) has slashed policy rate for the fifth time in 2019, resulting in a cumulative reduction of 135 bps for the year. In 4Q 2019, Bank Indonesia (BI) tightened its policy rate for the fourth consecutive month while both South Korea's and Thailand's central bank have their second rate cut to 1.25% respectively. Meanwhile, The People's Bank of China applied 1-year loan prime rate (LPR) as its new benchmarking rate and has lowered the rate since August to 4.15% amid lowered 7-day medium-term lending facility (MLF) for the first time since 2015 to 2.50% and 1-year MLF for the first time since 2016 to 3.25%. In addition, it lowered reserve requirement ratio for the eighth time since early 2018 in January 2020, injecting fresh stimulus into the economy.

In 2020, emerging central banks' future interest rate move will be data dependent, weighing on the impact of previous interest rate cuts on the domestic economy as there is a response lag of up to 18 months for the rate changes to take full effect.

Table 2: Policy rate (%)

End-period of	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020*f*
US, Fed Federal Funds Rate	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	1.50-1.75	1.50-1.75
Euro Area, ECB Deposit Facility	0.25	0.00	0.00	-0.20	-0.30	-0.40	-0.40	-0.40	-0.50	-0.50
Japan, BOJ Short-term Policy I/R	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	6.56	6.00	6.00	5.60	4.35	4.35	4.35	4.35	4.15	4.15
India, RBI Policy Repo Rate (LAF)	8.50	8.00	7.75	8.00	6.75	6.25	6.00	6.50	5.15	4.65
Korea, BOK Base Rate	3.25	2.75	2.50	2.00	1.50	1.25	1.50	1.75	1.25	1.25
Malaysia, BNM Overnight Policy Rate	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 RR Rate	6.50	5.75	7.50	7.75	7.50	4.75	4.25	6.00	5.00	4.50
Thailand, BOT 1-Day Repurchase Rate	3.25	2.75	2.25	2.00	1.50	1.50	1.50	1.75	1.25	1.25
Philippines, BSP Overnight RR Facility	4.50	3.50	3.50	4.00	4.00	3.00	3.00	4.75	4.00	3.50

Source: Officials; SERC
Note: China applied 1-year loan prime rate (LPR) as its new benchmarking rate

CURRENT AND FORWARD INDICATORS

High frequency indicators suggest some tentative signs of stabilisation and recovery amid continued wary about the status of trade negotiations between the US and China, with the phase one partial trade deal will be signed on 15 Jan 2020. The US's trade disputes with other trading partners, including Europe remains on the watch list.

The **World Trade Organization** (WTO) had lowered its projection of world merchandise trade volume growth to 1.2% in 2019 (from 2.6%, 3.7% and 4.0% previously) and expects it to accelerate higher to 2.7% in 2020, albeit revised lower from 3.0% previously. The Purchasing Managers' Index (PMI) for manufacturing has crawled back to an expansion level (above 50-pt mark) in November after experiencing six months of contraction while PMI for services continued to moderate.

The **World Semiconductor Trade Statistics** (WSTS) expects global semiconductor sales to turn around from a sharp decline of 12.8% in 2019 to a positive growth of 5.9% in 2020, propelled by the deployment of 5G, which will bring renewed growth in the wireless industry. Optoelectronics will contribute to the highest growth followed by logic.

Figure 1: CLIs point to continuing below-trend growth in most major economies

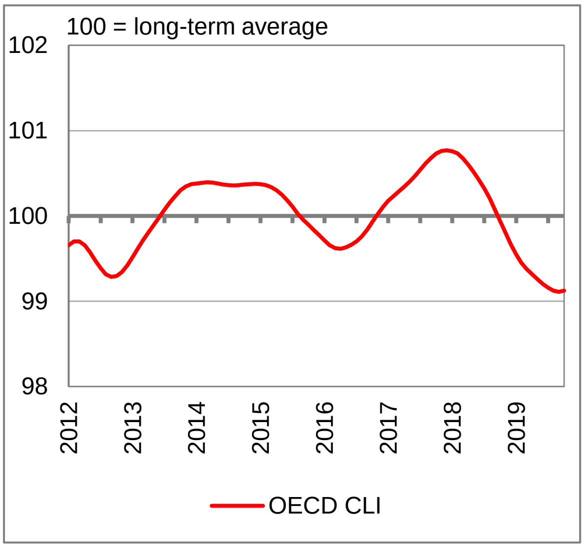


Figure 2: Global Manufacturing PMI edges back to expansion territory in November

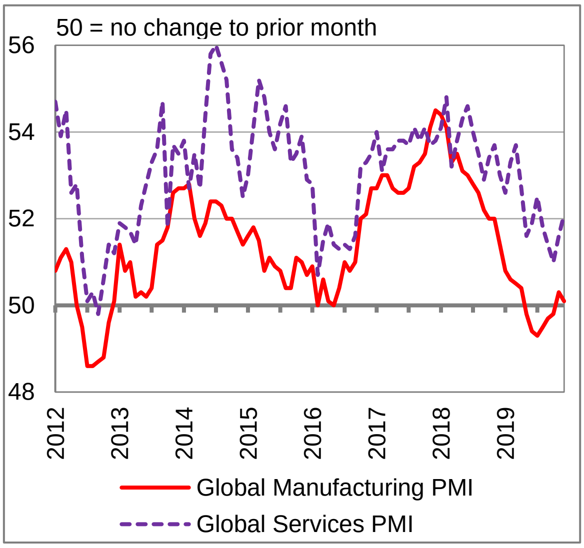


Figure 3: Still languishing world trade volume and industrial production, albeit narrower

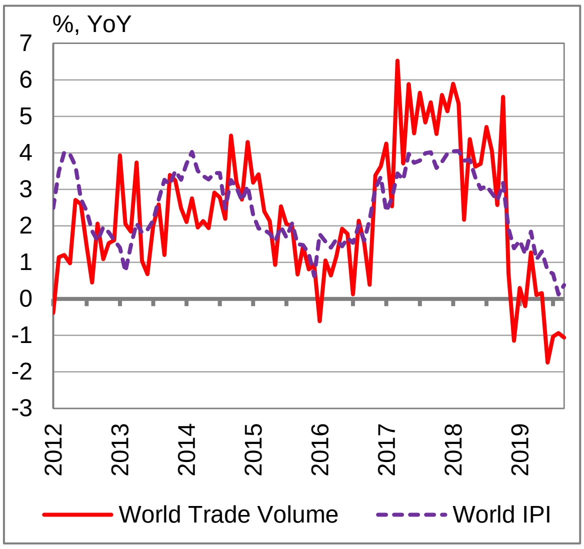
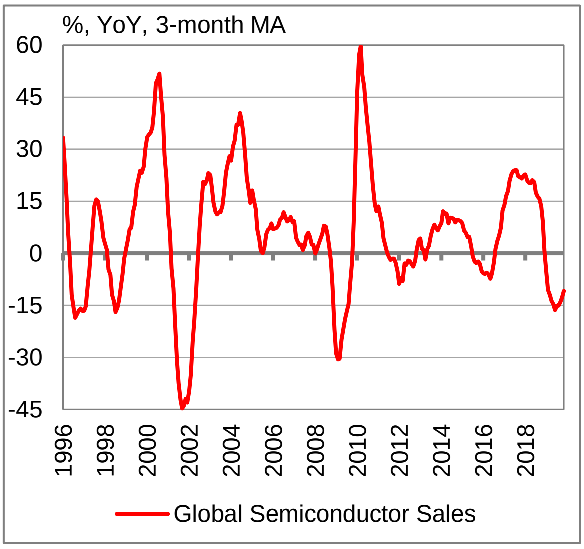


Figure 4: Semiconductor sales growth seems bottoming-out



Source: OECD; Markit; CPB Netherlands Bureau for Economic Policy Analysis; Semiconductor Industry Association (SIA)

OECD business confidence weakened further to the lowest level since 2009, dragged by restless trade conflicts between the US and its major trading partners as well as global economic slowdown. Similarly, **OECD consumer confidence** also trending down.

The receding trade war and fading fears of global recession risk are expected to inject positive sentiment to businesses and consumers. That said, any negative surprises from the trade truce negotiations and geopolitical uncertainties could dampen investors' confidence as well as derail the recovery of global growth.

Figure 5: OECD Business Confidence Index plunged to seven-year low in Oct

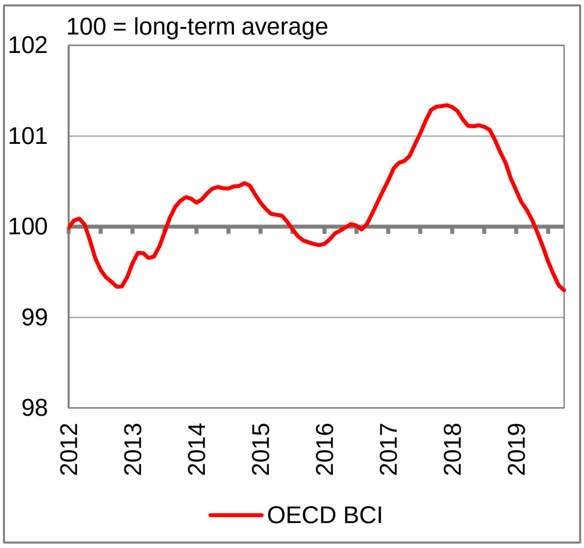
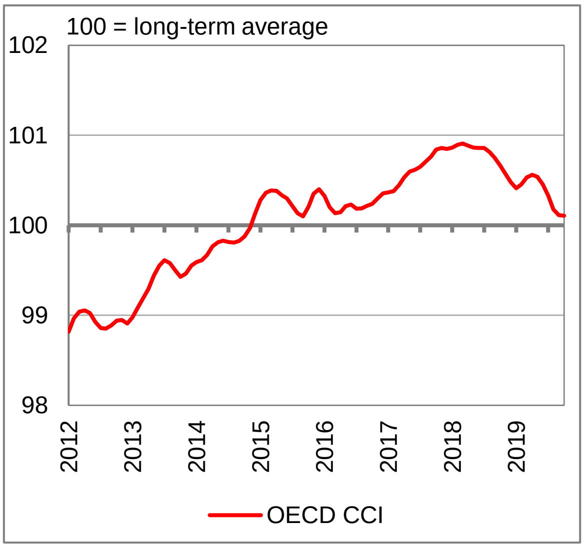


Figure 6: OECD Consumer Confidence Index trending south



Source: OECD

Crude oil prices softened by 9.7% to an average US$64.28 per barrel (bbl) for Brent crude in 2019 compared to an average of US$71.19/bbl in 2018 despite OPEC+ countries' compliance with the production cut. OPEC+ countries in its 7th Ministerial Meeting have decided to deepen crude oil supply cut by an additional 503,000 barrels per day (bpd) to 1.7 million bpd effective 1 Jan 2020, mainly led by Saudi Arabia (167,000 bpd) and Russia (70,000 bpd). Amid the expected rising inventories, the US Energy Information Administration (EIA) forecasts Brent crude oil prices to average US$60.51/bbl in 2020.

As geopolitical tensions mount between the US and Iran, oil prices spiked in early January. Brent crude oil, the global benchmark, reached a 6-month high of more than US$70 a barrel immediately after the killing of Iranian General. Iran partially houses one of the world's most important oil chokepoints, the Strait of Hormuz, which is located between Oman and Iran. Approximately 21 million barrels of oil per day, or 21% of global petroleum consumption, flow through the strait every day, according to EIA.

Figure 7: Crude oil prices moved within a small range in 2H 2019

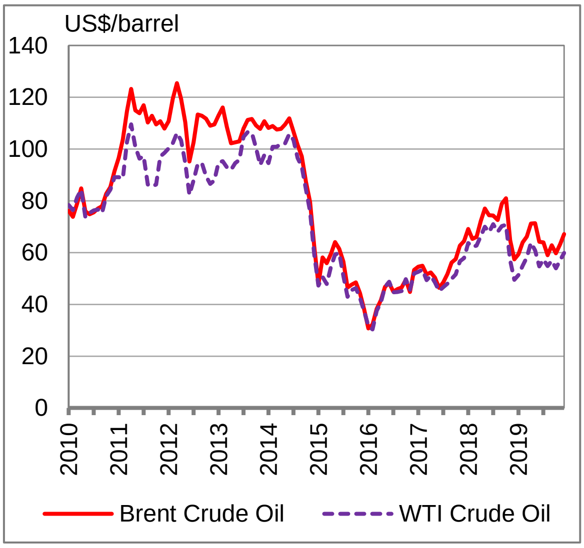
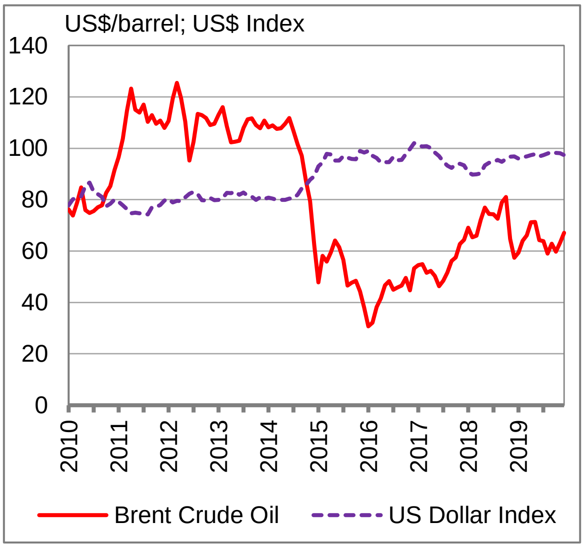


Figure 8: Brent crude oil price vs. the US dollar index



Source: US Energy Information Administration (EIA); The Wall Street Journal

CPO prices rallied since end-Oct 2019, driven by declining stocks and the adoption of higher weightage of palm oil for biodiesel in both Malaysia (B20) and Indonesia (B30). As at end-2019, CPO price of RM3,025.50/metric tonne (mt) marked an increase of 42.8% from RM1,970.50/mt at end-2018. Overall, CPO prices averaged RM2,079.00/mt in 2019 (2018: RM2,232.50/mt). CPO prices were traded at an average of RM3,060.50/mt in the period of 1-9 January 2020.

In 2019, Malaysia has exported 18.5 million tonnes of palm oil, mainly to India and China, which was 12.0% higher than previous year. Higher palm oil exports to both countries were due to (a) the agreement of higher purchases from China; and (b) lower tariffs from India in Jan-Aug 2019, leading to a decline of palm oil stocks in Malaysia, from 3.2 million tonnes as at end-2018 to 2.3 million tonnes as at end-Nov 2019.

Going into 2020, Malaysia has cut CPO export duty by 0.5%-1.5% to boost the shipment of palm oil. Nevertheless, India's uncertain tariff policy on the importation of palm oil and phasing out of palm oil for biodiesel in Europe remain a downside risk to palm oil demand.

Figure 9: Commodity prices sustained in 2H 2019

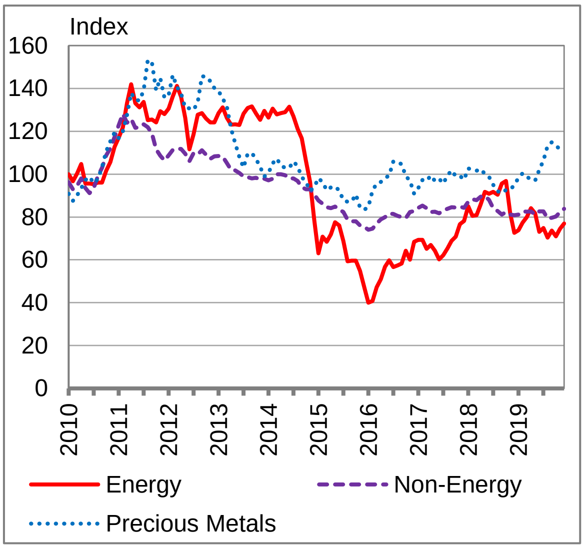
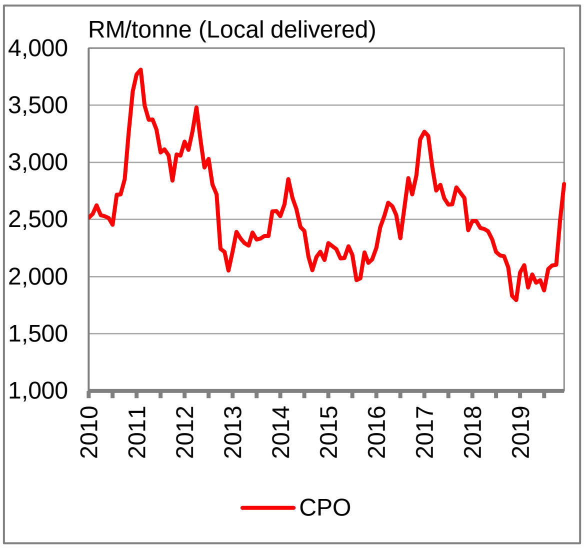


Figure 10: CPO prices surged since end-Oct on declining stocks



Source: World Bank; Malaysian Palm Oil Board (MPOB)

ECONOMIC DEVELOPMENTS IN ADVANCED ECONOMIES AND CHINA

The United States: Resilient consumer spending on strong labour market has helped to support the US economy to sustain 2.1% annualised qoq in 3Q 2019 (2.0% in 2Q and 3.1% in 1Q). However, both net external sector and private investment have dragged economic growth for two consecutive quarters. While the jobless rate has strengthened to a half-century low of 3.5% in Nov-Dec 2019, December's ISM Manufacturing has been staying below 50-pt threshold for five straight months since August whereas services PMI remains on expansionary track. Industrial production contracted for three consecutive months for the first time since August 2016. The interest rate cuts and liquidity provisions as well as continued consumer spending are expected to keep the US economy growing, albeit slower amid close tracking on the progress of a trade truce with China. The upcoming US Presidential elections will likely suppress investment.

Figure 11: ISM Manufacturing Index remained below 50-pt threshold for five consecutive months in Dec

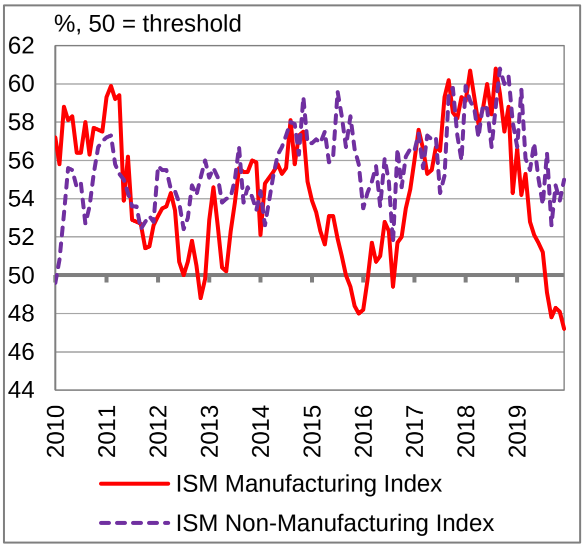


Figure 12: Industrial production contracted for three straight months in Nov

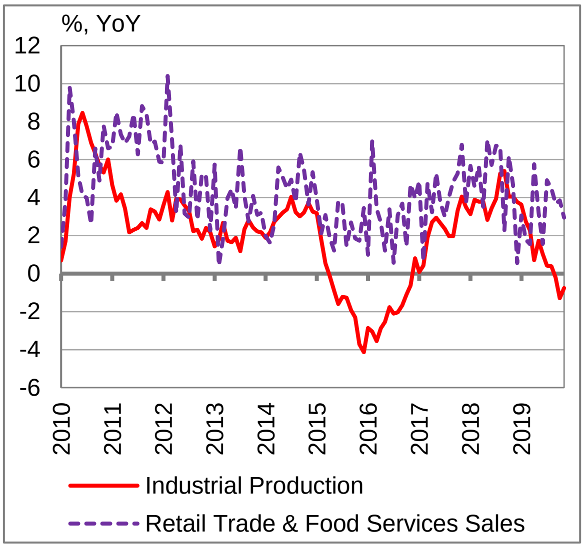


Figure 13: Unemployment rate dips to the lowest record level since 1969

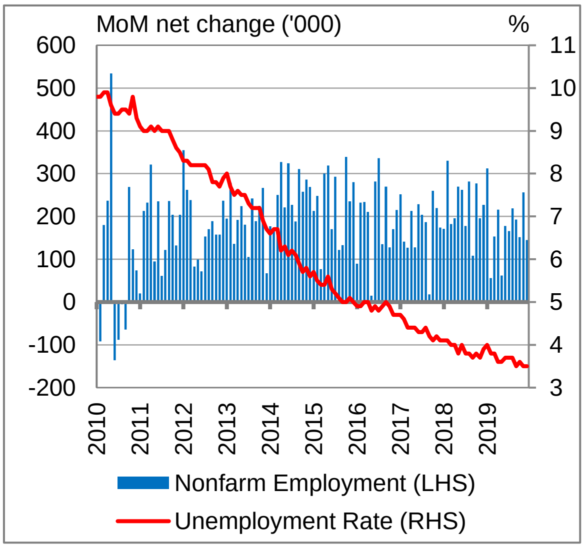
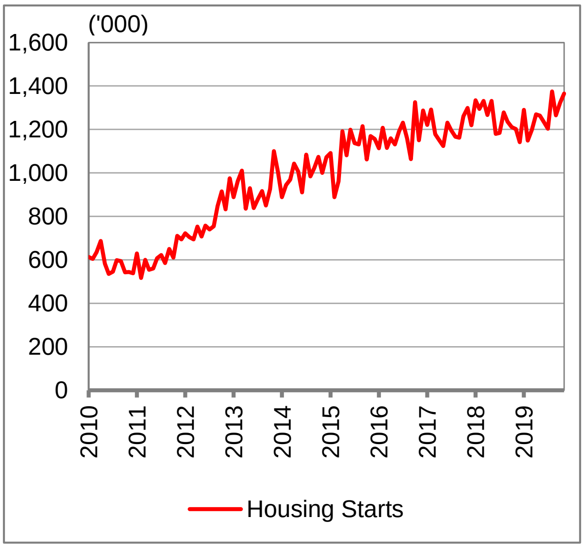


Figure 14: Housing starts continue to trend higher on lower mortgage rate



Source: Institute for Supply Management (ISM); Federal Reserve System; US Census Bureau; US Bureau of Labor Statistics

Euro area: Growth in Eurozone expanded mildly by 0.2% qoq in 3Q, the same level as in previous quarter, continuously dragged by poor performance of the external sector. Industrial production has been contracting for past twelve months, registering a decline of 2.2% yoy in October. Inflation rate stood at 1.2% on average in 2019, much lower compared to 1.8% in 2018, leading the ECB to maintain or lower its policy rate from the present level. On the political front, political uncertainty in Italy and Spain coupled with Brexit negotiations and a possible resurgence in global trade tensions cloud the outlook in Eurozone.

Figure 15: Manufacturing PMI remained in contraction territory since Feb 2019

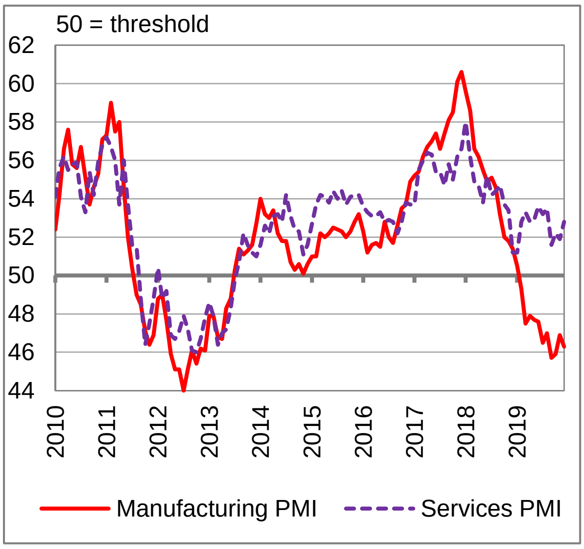


Figure 16: Industrial production contracted for twelve consecutive months

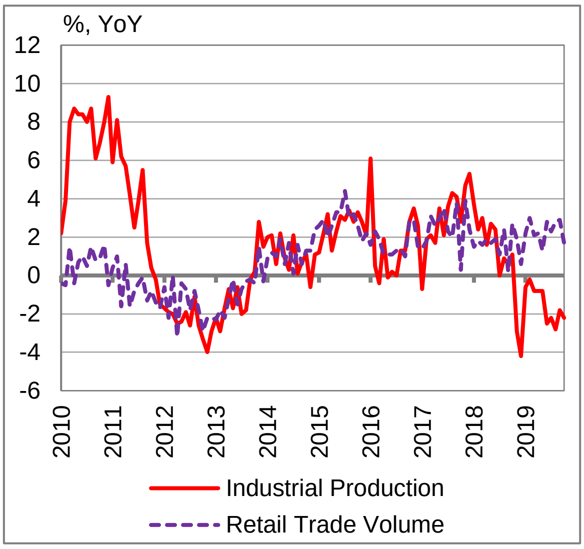


Figure 17: Headline inflation rate stays persistently low

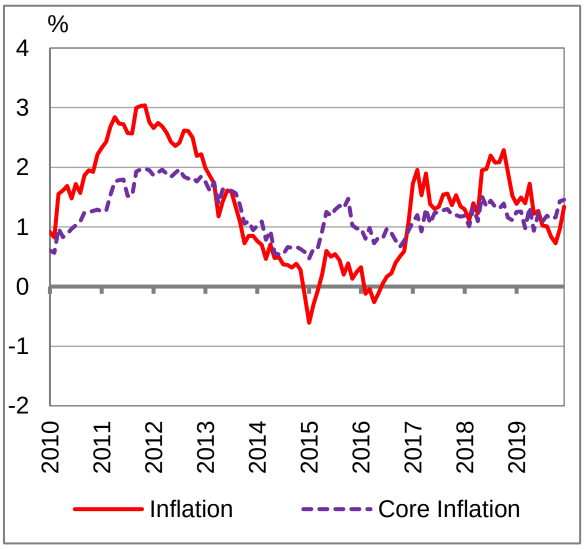
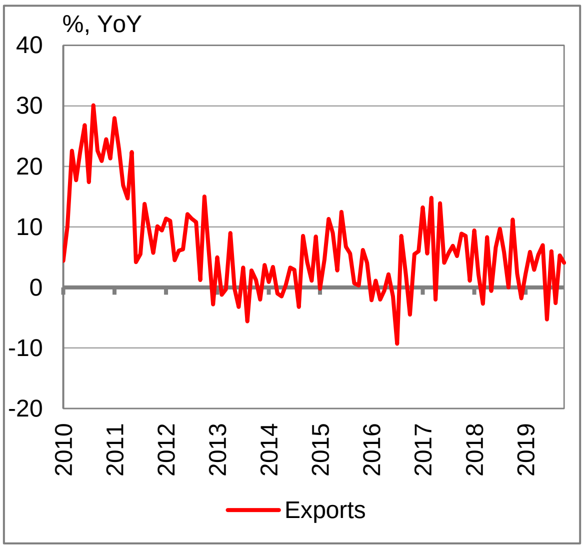


Figure 18: Eurozone's export growth remained volatile



Source: Markit; Eurostat

Japan: The economy expanded by a mere 0.1% qoq in 3Q while incoming data suggests unfavourable growth ahead. Tankan survey – a gauge of economic sentiment by businesses has been flat for two consecutive quarters whilst core machinery orders declined by 6.0% mom in October. The external sector has been muted since end-2018. Both industrial production and retail sales growth have contracted by 7.7% yoy and 7.0% yoy respectively in October. The latter was affected by an increase of consumption tax rate from 8% to 10%. Notwithstanding the consumption tax hike in October, headline inflation remains stubbornly low at 0.2% in October and 0.5% in November respectively. To boost the economy, the Government recently has announced a US$120 billion spending package, around 20% of which will be spent from December 2019 to March 2020, and the rest from April 2020 to March 2021.

Figure 19: Tankan survey suggests flat growth ahead

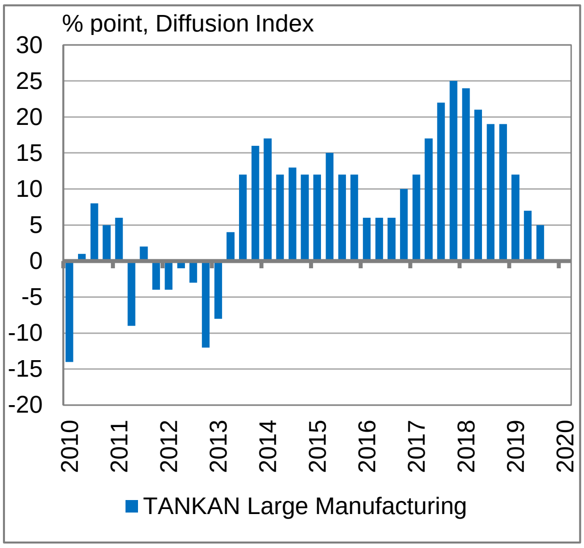


Figure 20: Both industrial production and retail sales growth contacted in Oct

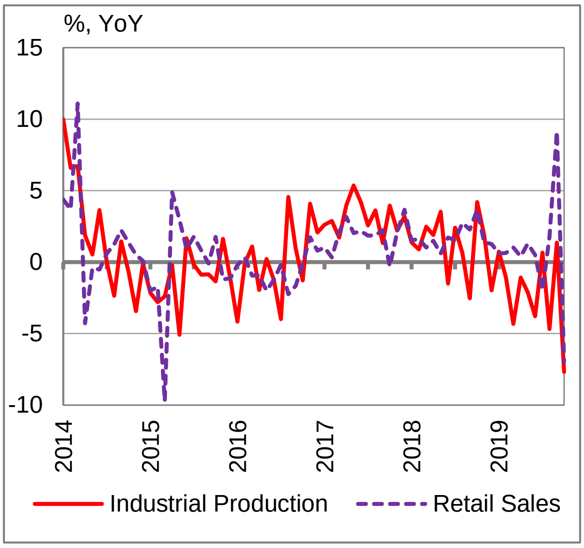


Figure 21: Headline inflation did not rise as much as in 2014 when consumption tax was hiked

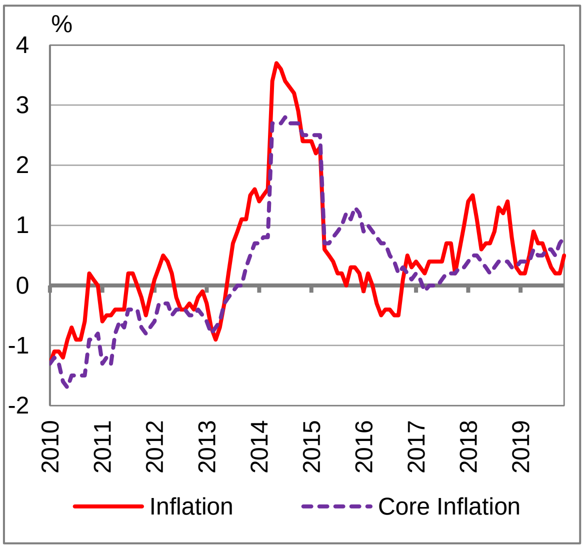
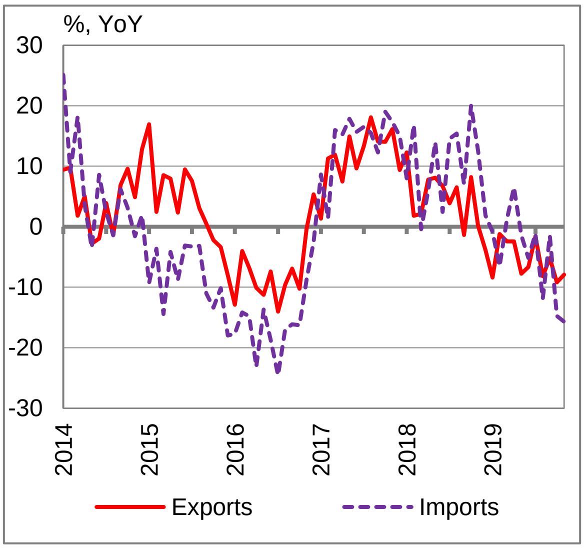


Figure 22: Exports contracted for twelve consecutive months in Nov



Source: Bank of Japan (BOJ); Ministry of Economy, Trade and Industry (METI), Japan; Japan Customs; Statistics Bureau, Japan

China: Driven by the restless trade conflicts with the US and continued rebalancing of its economic structure, China economy expanded by 6.0% yoy in 3Q (6.2% in 2Q and 6.4% in 1Q), the weakest pace in nearly three decades. Overall, monetary easing and targeted fiscal stimulus continued to support the economy.

High frequency data indicates moderating growth ahead. The external sector remains moderate while both industrial production and retail sales saw higher growth in November. The main silver lining has been a rebound in the manufacturing PMI to expansionary territory since November. Inflation rate has printed a nearly eight-year high of 4.5% in November and December due to high increase in food prices, particularly various livestock meats, vegetables and eggs, and are expected to remain elevated. However, given that the producer price index is declining, the PBOC is facing a conundrum in setting its monetary policy. In addition, a ballooned corporate debt level of 154.5% as at June 2019 remains a concern, especially several large companies have defaulted an increasing amount of debt.

Figure 23: Manufacturing PMI edged back to an expansion track in Nov

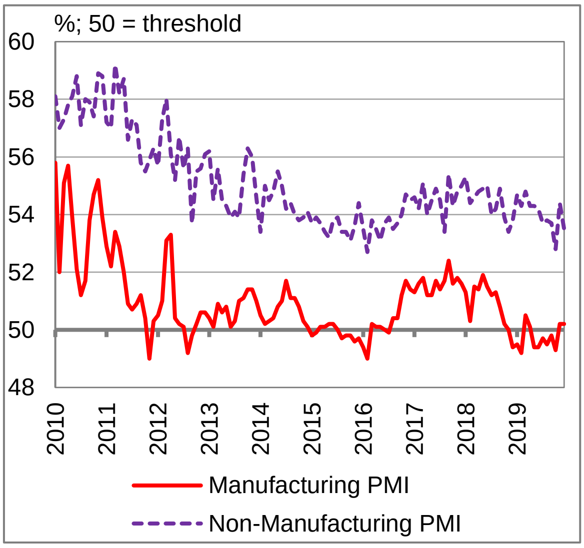


Figure 24: Industrial production and retail sales growth picked up in Nov

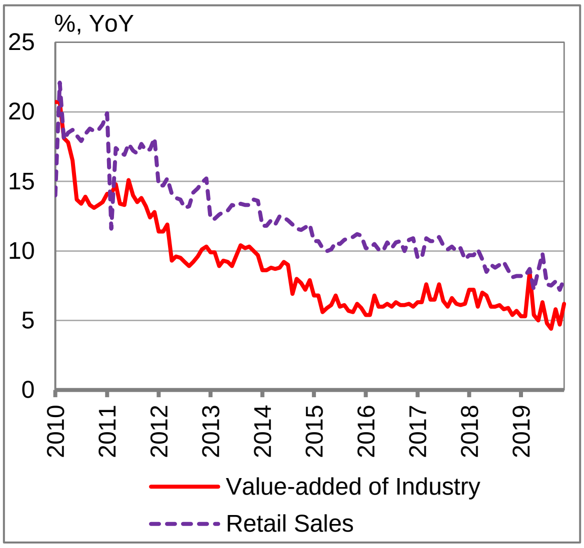


Figure 25: Inflation rate on the rise due to high increase in food prices

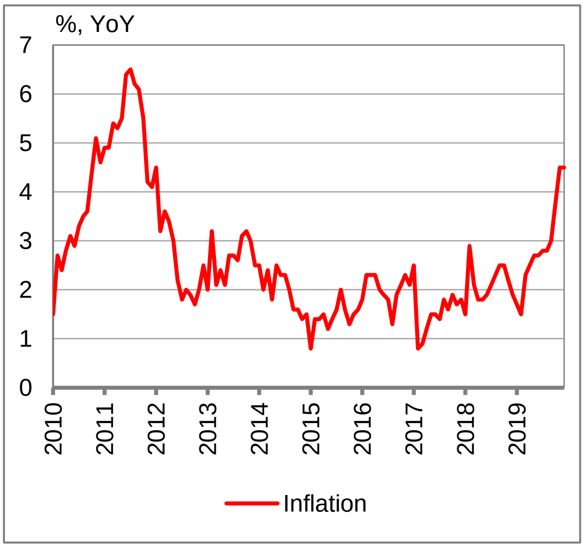
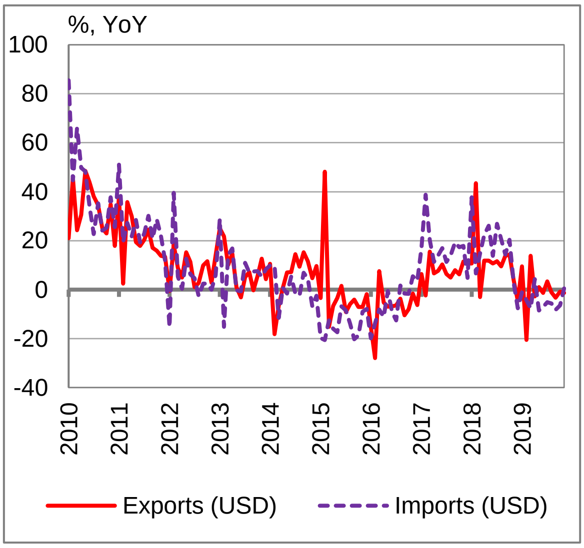


Figure 26: External trade remained lacklustre

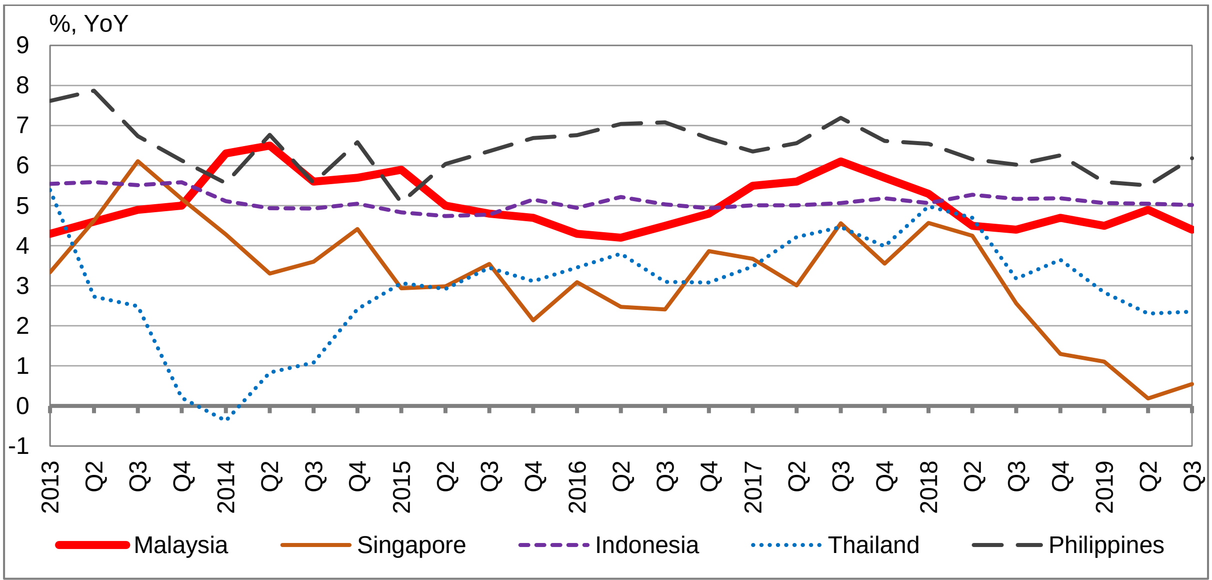


Source: National Bureau of Statistics of China; General Administration of Customs, China

ASEAN-5 ECONOMIES' KEY ECONOMIC DATA TRACKER

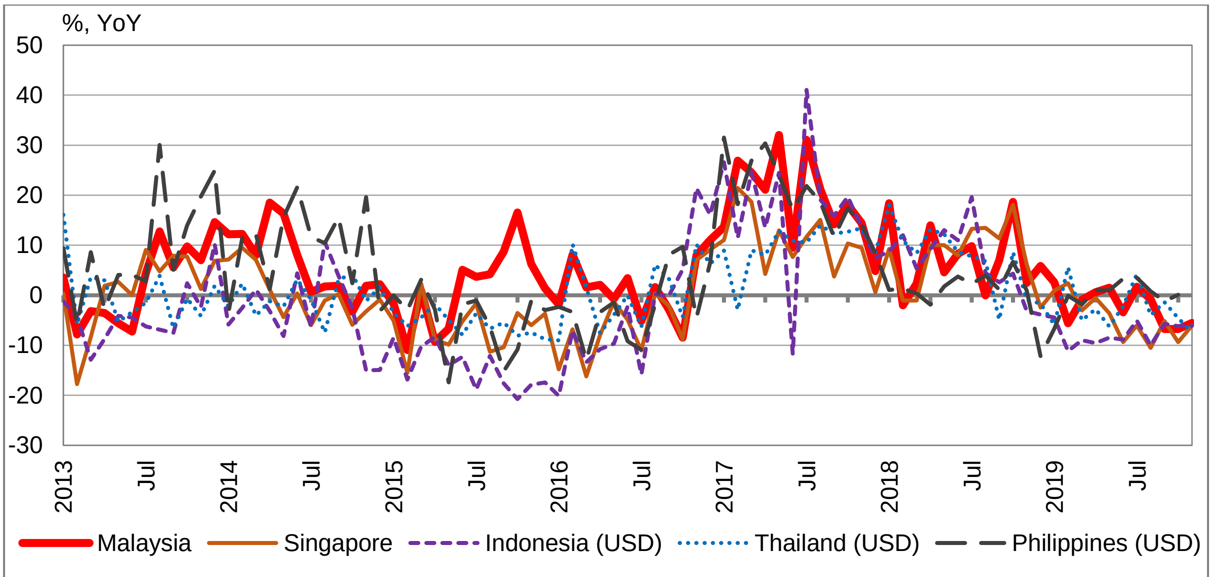
ASEAN-5 economies (Malaysia, Singapore, Indonesia, Thailand and the Philippines) continued to display mixed economic performance in 3Q. While Philippines, Singapore and Thailand registered further expansion, Malaysia's economic growth slowed down in 3Q whilst Indonesia sustained at the same level as in 2Q. Exports of five economies were generally contracting, blamed on the trade conflicts between the US and China as well as slowing global growth. Industrial production growth also showed a mixed trend. Inflation rate was generally lower in 4Q compared to 3Q. Overall, the IMF expects the growth of ASEAN-5 remains broadly stable in 2020.

Figure 27: Real GDP growth trend



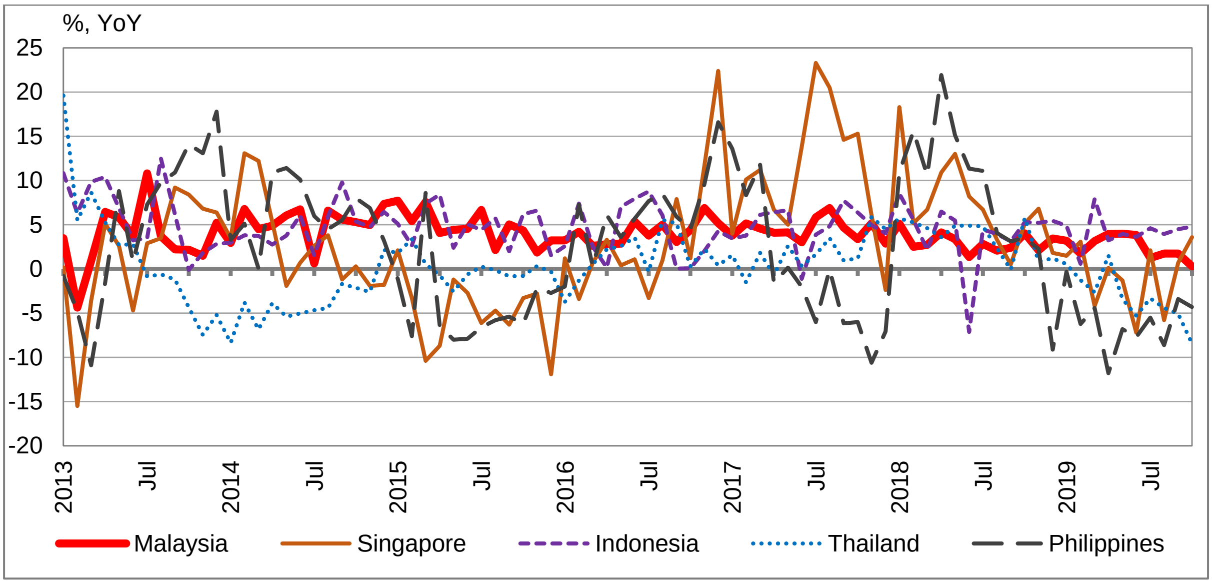
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; National Economic and Social Development Board, Thailand; Philippine Statistics Authority

Figure 28: Export growth trend



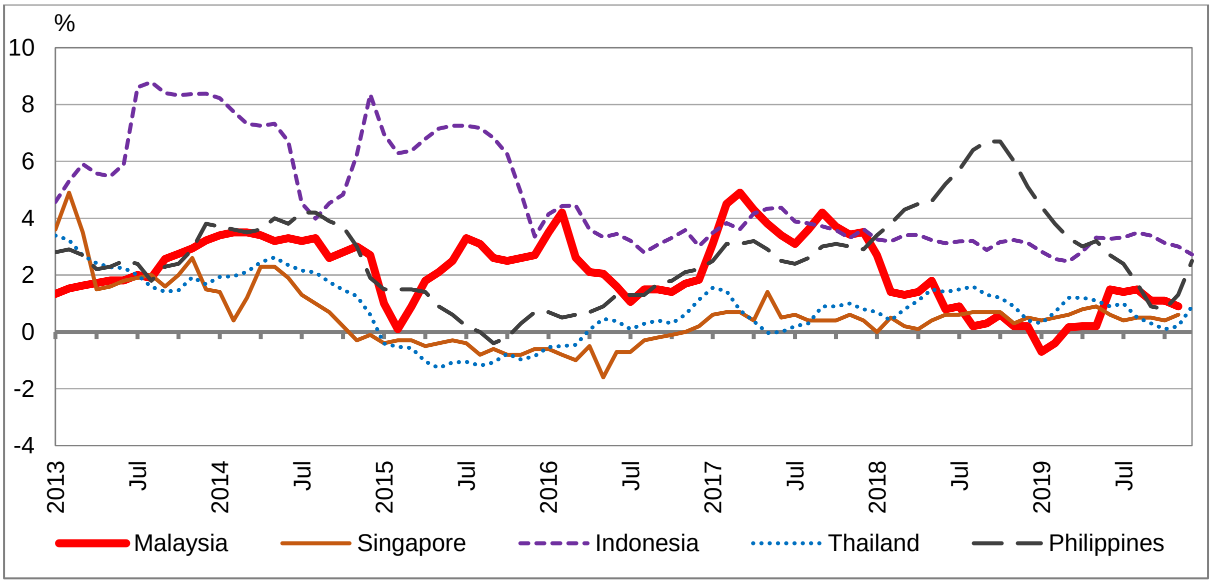
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Bank of Thailand; Philippine Statistics Authority

Figure 29: Industrial production growth trend



Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Office of Industrial Economics, Thailand; Philippine Statistics Authority

Figure 30: Inflation trend



Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Bank Indonesia; Ministry of Commerce, Thailand; Philippine Statistics Authority

MALAYSIA'S ECONOMIC AND FINANCIAL CONDITIONS

GDP growth moderated in 3Q19. After picking up to 4.9% in 2Q 2019 (4.5% in 1Q), Malaysia's economic growth relapses to print a slower growth rate of 4.4% yoy in the third quarter (Jul-Sep) as weakening domestic demand and exports contraction weighed on the growth. In the first nine months (Jan-Sep) this year, the Malaysian economy grew by 4.6%. With the continued drag from sluggish exports and slowing domestic demand, we estimate real GDP growth to sustain at 4.2%-4.4% in 4Q, taking the full-year growth to 4.6% in 2019 (4.7% in 2018).

Dragged by a contraction in public investment, albeit smaller, subdued private investment as well as slackening external sector, resilient private consumption growth remains the primary leg to hold up the economy. By sector, manufacturing activities slowed down significantly while mining output reverted to contraction after making a turnaround from six consecutive quarters of contraction. Construction sector contracted for the first time since 2006, driven by persistently high overhang in both residential and non-residential properties.

2020's GDP growth expected to expand by 4.5%. Weighing on cautious global growth estimates of 3.2%-3.4% in 2020 (IMF's estimated 3.0% in 2019) as well as lingering wary about domestic leadership and policies transition, the **Malaysian economy is expected to grow by 4.5% in 2020** (estimated 4.6% in 2019).

Domestic demand, especially private consumption will be calling the shots, albeit slower as there remains considerable uncertainty about private investment. The catalysts are the revival of several mega civil engineering projects as well as tourism activities related to the Visit Malaysia Year (VMY) 2020 and the hosting of Asia-Pacific Economic Cooperation (APEC).

The 2020 Budget's 4.3% increase in development expenditure to RM56.0 billion in 2020 should help to provide partial support to the domestic economy. What matters most is to execute effectively the Budget's programmes and initiatives; and to disburse the funds timely for the implementation of projects.

Consumer stays on spending streak, continued helping to hold up the economy, albeit slower. Household consumption paced slower to 7.0% in 3Q from 7.7% in 1H19 though still matched the average growth of 7.0% per annum in 2011-2018. Private consumption growth will continue in 4Q19 and in 2020, underpinned by festive spending, healthy labour market conditions, albeit a rise in jobless rate as well as moderate wage growth. Passenger cars have enjoyed robust sales in Sep-Nov, partly thanks to low base effect.

The Cost of Living Aid (BSH) of RM5 billion for targeted households and individuals will be continued in 2020, with the first phase of payment totalling RM1.0 billion to 3.8 million households starting 20 Jan 2020, minimum wages in 56 major cities also increased to RM1,200 starting 2020. The Malaysian Employers Federation (MEF) in its survey indicated that the average salary increments for executives in 2020 is 5.00% (5.15% in 2019) and 5.01% for non-executives (4.96% in 2019). **For 2020**, SERC expects **private consumption to increase by 6.7%** (estimated 7.2% in 2019).

Subdued private investment remains a drag. Another big disappointment was a sluggish 0.3% growth in private investment in 3Q (1.8% in 2Q and 0.4% in 1Q), taking the cumulative growth to only 0.9% in the first nine months of this year. This marks second successive year of sharp moderation in private investment since 2017 (9.0%) and 4.3% in 2018.

Weighed down by weak sentiments, businesses have responded to external uncertainties, including the trade hostility development, persistent weakness in the property segment as well as domestic political uncertainty. MIER's Business Conditions Index (BCI) fell to decade-low in 3Q, sales orders and capacity utilisation level dropped further. Businesses continue to keep cautious stance as indicated in ACCCIM Malaysia's Business and Economic Conditions Survey (M-BECS). Private investment indicators such as imports of intermediate goods and capital goods continue to shrink, adding concerns to the vitality of private investment. By type of assets, capital spending on machinery and equipment declined by 6.4% in Jan-Sep 2019 while imports of capital goods contracted sharply by 11.5% in the same period. SERC estimates **private investment to grow by a mere 0.8% in 2019 and will improve slightly to 2.2% in 2020** (4.3% in 2018).

Exports to rebound in 2020. Malaysia's exports fell by 2.1% yoy in Jan-Nov 2019, blamed on the slowing global demand as well as a prolonged trade hostility between the US and China. While Malaysian companies benefited from trade diversion, overall net impact on exports were negative, leading to four consecutive months of contraction in Aug-Nov. Exports of electronics and electrical products declined by 2.0% in Jan-Nov, palm oil down by 4.3% due to lower prices. SERC estimates **exports to decline by 1.5%-2.0% in 2019 and will recover gradually by 2.0% growth in 2020**.

Headline inflation stays low in 2019 but will pick up in 2020. In Jan-Nov 2019, headline inflation, as measured by Consumer Price Index (CPI) averaged to increase by 0.6% yoy and is expected to average 0.7% for the full-year of 2019. Core inflation remains healthy at 1.4%-1.5% in Sep-Nov. Inflation expectations will be higher in 2020 as fuelled by a managed floating of fuel prices on a gradual basis, a planned upward adjustment in water tariffs nationwide, higher minimum wage as well as higher private medical consultation fees. We expect the Government to eventually implement the targeted fuel subsidy scheme, which is originally planned for implementation on 1 Jan 2020. Overall **headline inflation is estimated to increase by 2.0% in 2020**, markedly higher from estimated 0.7% in 2019.

Bank Negara Malaysia keeps its monetary option open. While the economy will get some fiscal spending boost from 2020 Budget, but if global growth fails to stabilise or trade conflict uncertainties remain entrenched, monetary policy may need to reinforce and secure growth amid contained inflation expectations. Bank Negara Malaysia is expected to keep door open to modest monetary easing, probably 25 basis points cut in the overnight policy rate to 2.75% by 1H 2020 if the economy slows materially to say, around 4.0%.

Weighing on tailwinds for the ringgit. The ringgit ended the year 2019 at RM4.0925 per US dollar, a small appreciation of 1.1% from end-2018 (RM4.1385). The phase one trade deal between the US and China has aided to improve investor sentiment as well as alleviate downward pressure on global economic and trade conditions. Fading recession risk and easing trade tension serve as a tailwind for open and trade-dependent Asian economies, including Malaysia while boosting the prospects of exports rebound. Still, any negative surprises from a trade truce negotiation, commodity prices volatility and geopolitical uncertainties could influence the ringgit's outlook. Domestic macroeconomic conditions, fiscal outlook and current account position of the balance of payment remain the primary drivers of the ringgit's performance. In 1Q 2020, all eyes are on the FTSE Russell's review on Malaysia's bonds' inclusion in its World Government Bond Index (WGBI), the US Treasury's next review of Malaysia in the Monitoring List on currency practices and domestic macroeconomic policies.

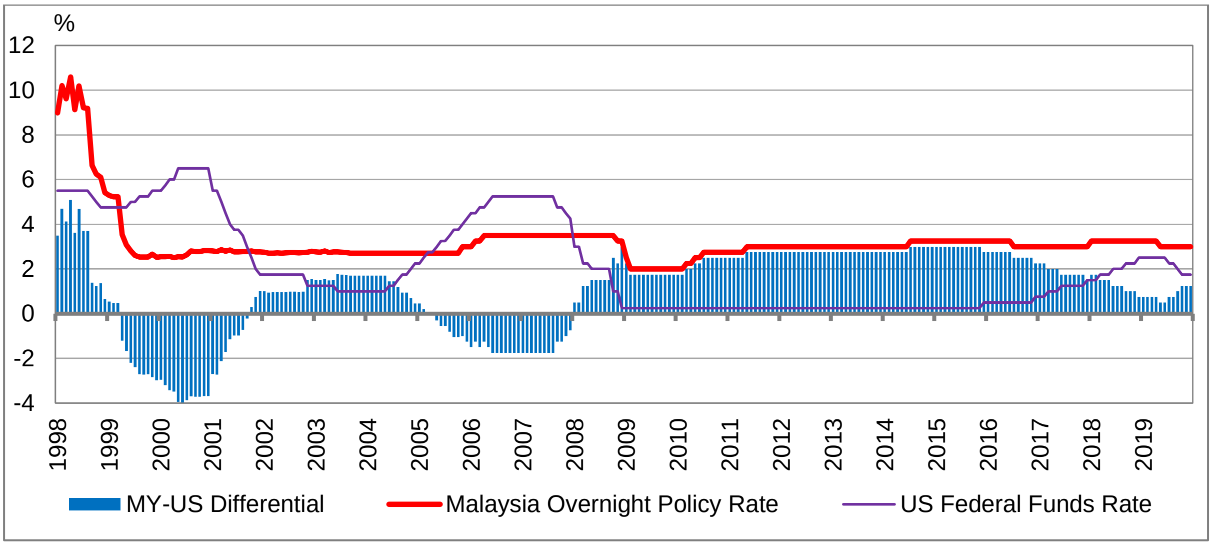
Throughout the year 2019, the ringgit has appreciated against South Korean won (5.1%), euro (3.2%), Indian rupee (3.2%), Chinese renminbi (2.6%) and US dollar (1.1%), but depreciated against Thai baht (7.2%), Indonesian rupiah (3.1%), Philippine peso (2.5%), pound sterling (2.2%), Japanese yen (0.5%) and Singapore dollar (0.2%). The ringgit will be likely trade around RM4.00-RM4.05 at end-2020.

Table 3: Real GDP growth (% YoY)

Economic Sector [% share to GDP in 2018]	2018	2019 Q1	2019 Q2	2019 Q3	2019*e* (MOF)	2019*e* (SERC)	2020*f* (MOF)	2020*f* (SERC)
By economic sector								
Agriculture [7.3%]	0.1	5.6	4.2	3.7	4.3	4.4	3.4	2.5
Mining & Quarrying [7.6%]	-2.6	-2.1	2.9	-4.3	0.6	0.5	0.3	0.8
Manufacturing [22.4%]	5.0	4.2	4.3	3.6	4.0	4.0	4.1	3.9
Construction [4.9%]	4.2	0.3	0.5	-1.5	1.7	0.8	3.7	1.5
Services [56.7%]	6.8	6.4	6.1	5.9	6.1	6.1	6.2	6.0
By expenditure approach								
Private Consumption [57.0%]	8.0	7.6	7.8	7.0	6.8	7.2	6.9	6.7
Public Consumption [12.5%]	3.3	6.3	0.3	1.0	2.0	2.7	1.5	2.0
Private Investment [17.3%]	4.3	0.4	1.8	0.3	1.5	0.8	2.1	2.2
Public Investment [7.4%]	-5.0	-13.2	-9.0	-14.1	-8.1	-8.9	-0.6	-1.0
Exports of Goods and Services [67.6%]	2.2	0.1	0.1	-1.4	-0.4	-0.7	1.4	1.2
Imports of Goods and Services [60.6%]	1.3	-1.4	-2.1	-3.3	-2.1	-1.6	1.9	1.0
Overall GDP	**4.7**	**4.5**	**4.9**	**4.4**	**4.7**	**4.6**	**4.8**	**4.5**

Source: Department of Statistics, Malaysia; Ministry of Finance (Economic Outlook 2020); SERC

Figure 31: Malaysia-US's interest rate differentials



Source: Bank Negara Malaysia; Federal Reserve

REVIEW OF KEY ECONOMIC AND FINANCIAL INDICATORS

Leading indicators and Industrial production

October's leading indicators suggest somewhat improving economic growth, albeit cautiously going into 2020. Nevertheless, a slew of incoming data seemingly shows that economic momentum continued to remain moderate in 4Q 2019. Industrial production picked up moderately to grow by 2.0% yoy in November (0.3% in October), thanks to a marginal turnaround in mining output (0.5% in November from -5.8% in October), still moderate growth in the manufacturing sector and electricity output. The mining sector outlook remains gloomy as it was reported that the crude oil production has yet to recover to its full capacity following the completion of maintenance works at the Gumusut-Kakap oilfield. In 2020, Malaysia will be cutting an additional 5,000 barrels of crude oil production per day, leading to a total cut of 20,000 barrels per day though Malaysia has not been meeting the target most of the time. Output growth in the manufacturing sector grew by 2.5% in November and 2.2% in October respectively (3.4% in 3Q and 4.1% in 2Q), where the latter marking the lowest growth since March 2013. This was mainly brought down by poor performance in food products, electrical and electronic products, petroleum, chemical, rubber and plastic products.

Figure 32: Leading index moves higher in Oct

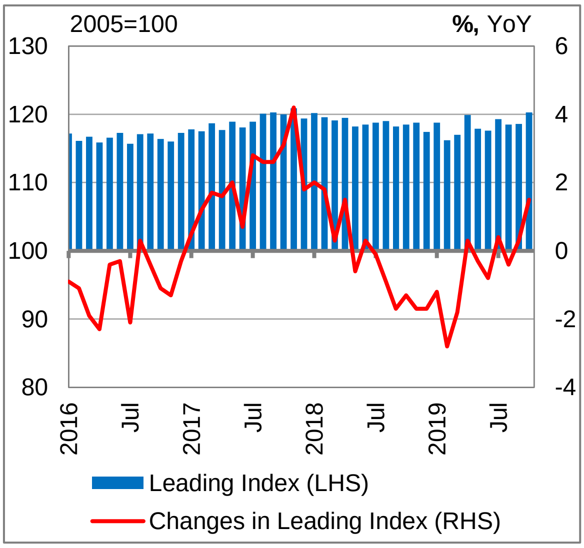
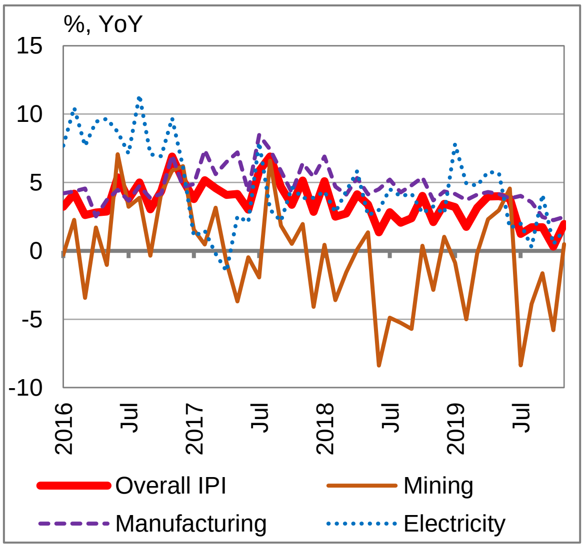


Figure 33: Overall IPI growth nearly muted in Oct



Source: Department of Statistics, Malaysia

Exports; Manufacturing sales and Distributive trade

Exports fell by 5.5% in November for fourth consecutive month (-6.7% in October), bringing an overall 2.1% decline in Jan-Nov 2019. This goes to show that the positive trade divergence effect has been fully offset by negative spillover effects from a prolonged trade tensions that had significantly dampened global trade and disrupted the supply chains. Manufacturing sales growth slowed to a three-year low in November 2019 (2.3% vs. 5.2% in Jan-Oct). Retail sales growth sustained at 7.0% in November (6.8% in October) while wholesale trade growth edged higher to 4.3% in November (3.9% in October vs. 5.7% in both 3Q and 2Q). The moderating growth in wholesale trade could have a negative feedback loop on retail sales.

Figure 34: Trade balance struck a record-high in Oct …

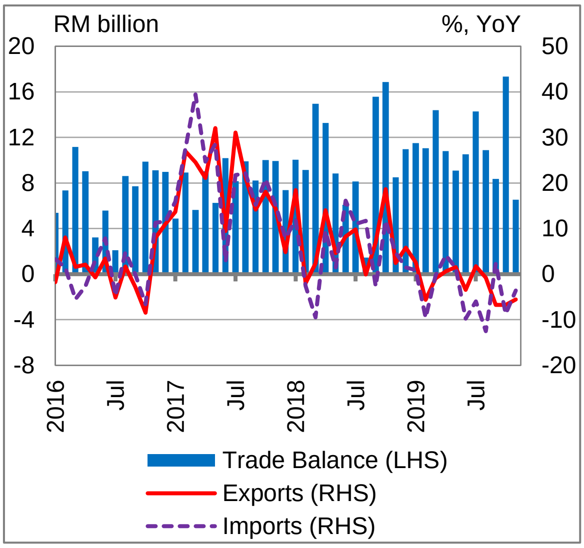


Figure 35: … led by a larger decline in imports compared to exports

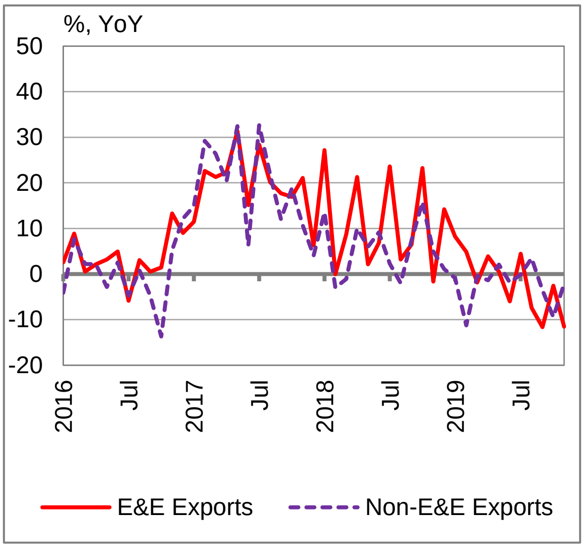


Figure 36: Lowest manufacturing sales growth since Oct 2016

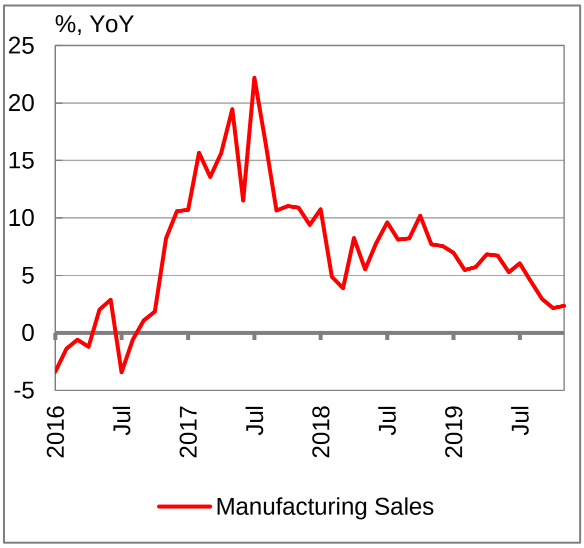
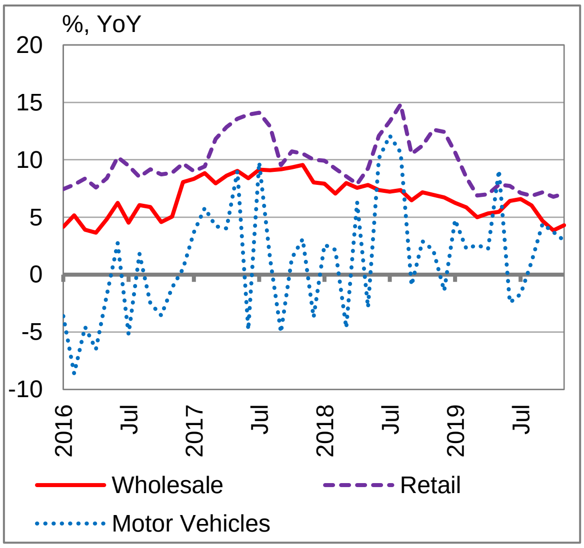


Figure 37: Wholesale trade growth is moderating



Source: Department of Statistics, Malaysia

Private consumption indicators

MIER's Consumer Sentiment Index (CSI) dropped to 84.0 in 3Q 2019, the lowest reading since 4Q 2017. Amongst the reasons cited for dampening sentiments are less favourable finances; weak job outlook weighs on income expectations while low-income households, rural areas and eastern region most anxious about rising prices. Shopping plans are limited by flagging purchasing power.

Overall, labour market conditions remain supportive of households' spending, albeit slower. Joblessness was at 3.2% in October while overall private wages growth moderated to 3.8% in 3Q from 4.2% in 2Q, reflecting slower wage growth in the services sector (4.1% in 3Q; 4.4% in 2Q) and manufacturing sector (3.2% in 3Q; 3.9% in 2Q). Cooling wage growth could hold down spending gains in the months ahead.

Figure 38: Passenger car sales are likely to achieve the target of 534,000 set for 2019

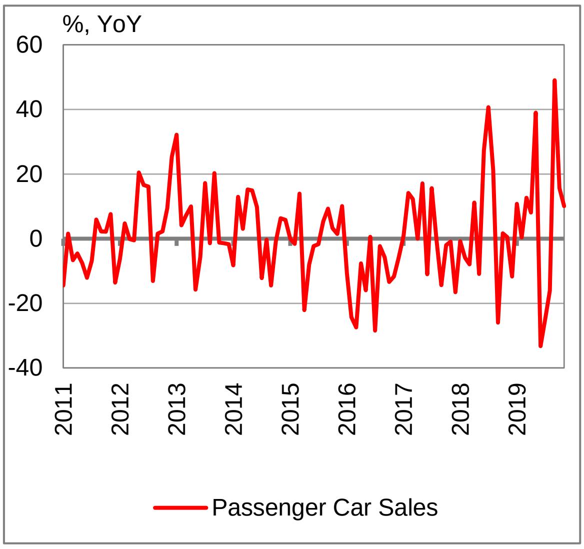


Figure 39: Selected private consumption indicators

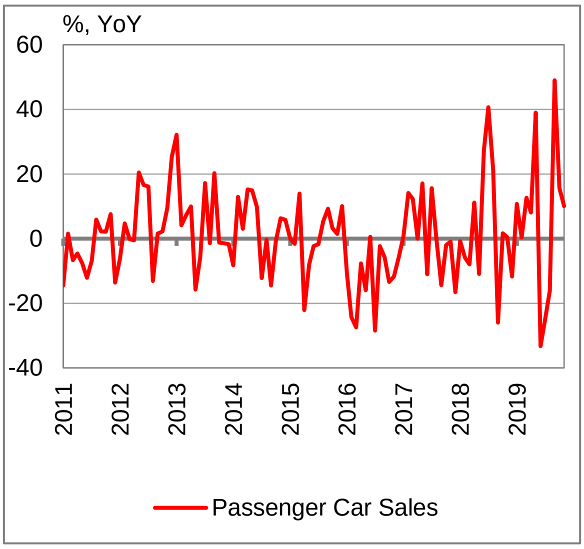


Figure 40: Employees received lower payout

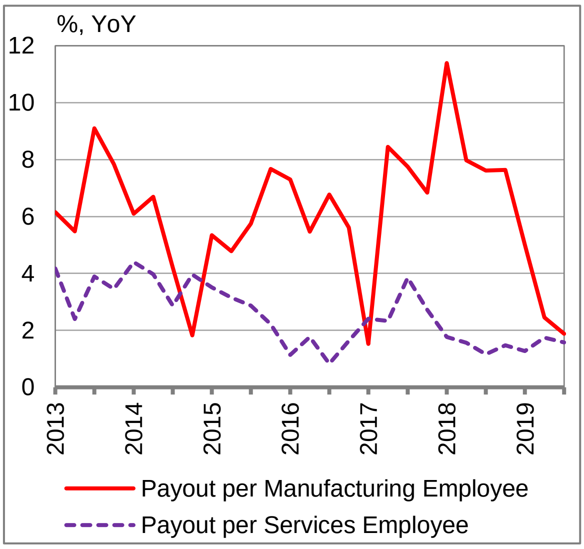
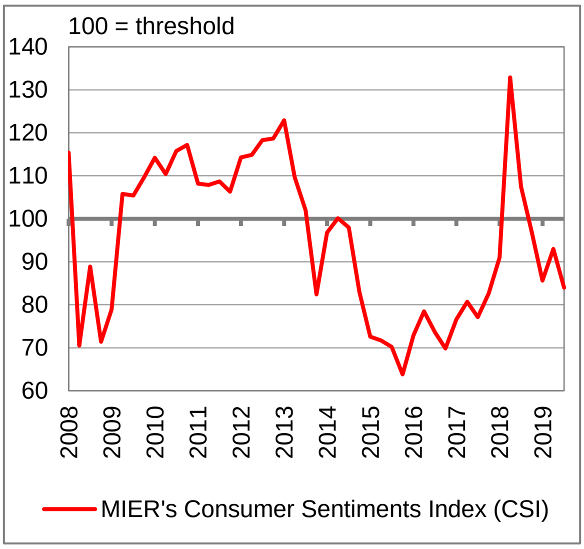


Figure 41: Consumer sentiment index continues to deteriorate



Note: Loan data for April 2018 onwards have been revised to include MBSB Bank Berhad.
Source: Department of Statistics, Malaysia; Malaysian Institute of Economic Research

Private investment indicators

Import growth of intermediate goods and investment goods continued to trend lower, suggesting still weak private investment prospects ahead. MIER's Business Confidence Index (BCI) revealed that businesses are at their worst conditions since 2008. Capacity utilization rate dropped to 72.0%, last seen in 1Q 2009. This is in line with ACCCIM's M-BECS which showed that Malaysian businesses maintained a cautious stance on business conditions in 2020.

Figure 42: Selected private investment indicators

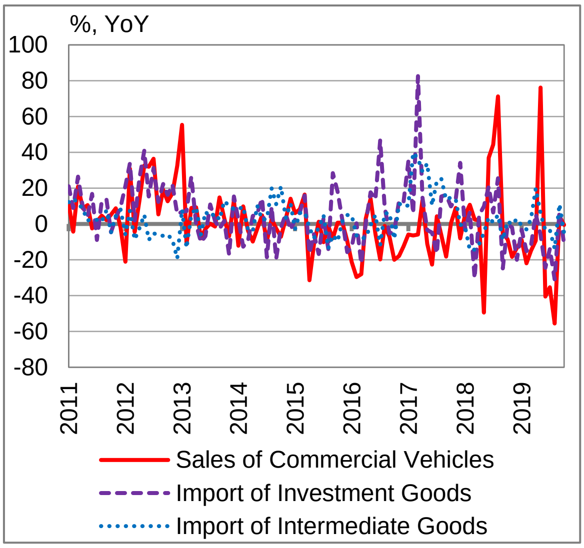


Figure 43: Subdued real private investment growth

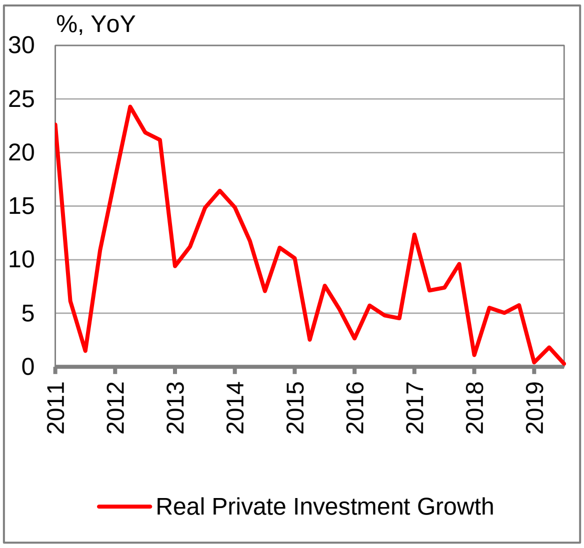


Figure 44: Capacity utilization rate dropped to ten-year low

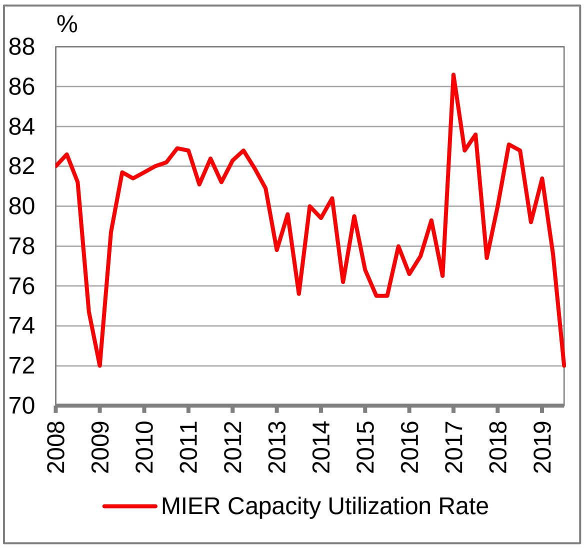
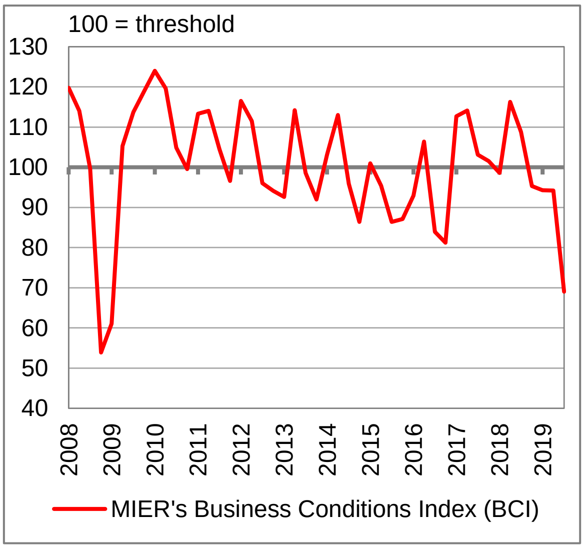


Figure 45: Businesses are losing confidence substantially



Source: Department of Statistics, Malaysia; Malaysian Institute of Economic Research

Price indicators

Post the lapsing effect of no consumption tax policy in Jun-Aug 2018, headline inflation as measured by the Consumer Price Index (CPI) has normalised on an annual comparison basis. Broadly, price levels have increased at a slower pace. Headline inflation increased 0.9% in November 2019 (1.1% in October and 1.3% in 3Q), mainly contributed by softening increase of food prices (1.5% in November, 1.8% in October and 2.4% in 3Q). Transport prices continued to decline, mainly due to lower pump price of RON95 (RM2.08 per litre since February 2019 vs. RM2.20 per litre in Mar-Dec 2018). Core inflation remains healthy at 1.4%-1.6% since June 2018 (excluding the effect of a change in consumption tax policy).

Inflation is expected to edge higher in 2020, reflecting a managed floating of fuel prices on a gradual basis, a planned upward adjustment in water tariffs nationwide, higher minimum wage as well as higher private medical consultation fees. We expect the Government to eventually implement the targeted fuel subsidy scheme, which is originally planned for implementation on 1 Jan 2020.

Figure 46: Headline inflation rate remains moderate

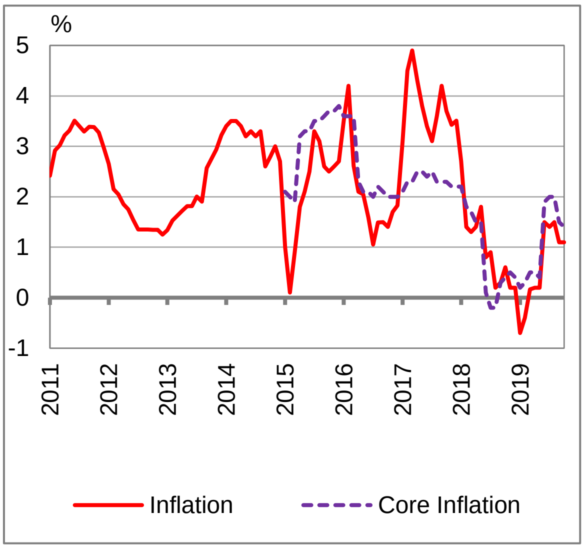
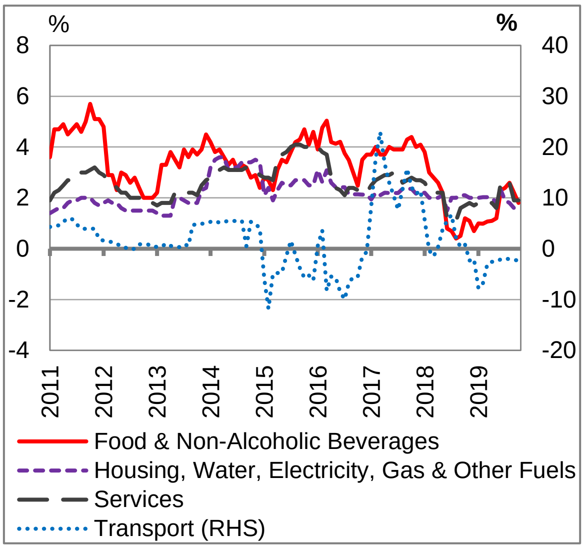


Figure 47: Major price components remained broadly stable



Source: Department of Statistics, Malaysia

Banking loan indicators

Growth of total outstanding loans extended by banking system eased to 3.7% yoy in both October and November 2019 (3.8% in September and 4.2% in June), mainly dragged by lower loan growth in business segment. This was seen in a sharp moderation in loan growth for working capital purposes (1.3% in both October and November vs. 1.6% in September and 2.3% in June). Household loan growth remained broadly stable at 4.6%-4.7% since July. Non-performing loans (NPLs) increased dramatically by 8.5% in November and 8.0% in October (7.4% in September and 1.2% in June), the highest rate of increase since April 2017. NPLs to gross loans ratio inched higher to 1.6% in November (1.5% at end-2018). Nevertheless, the provision of impaired loans stayed healthy at 89.4% and liquidity coverage ratio (LCR) was well above the 100% requirement at 143.0% in November.

Figure 48: Total outstanding loans growth continues to moderate

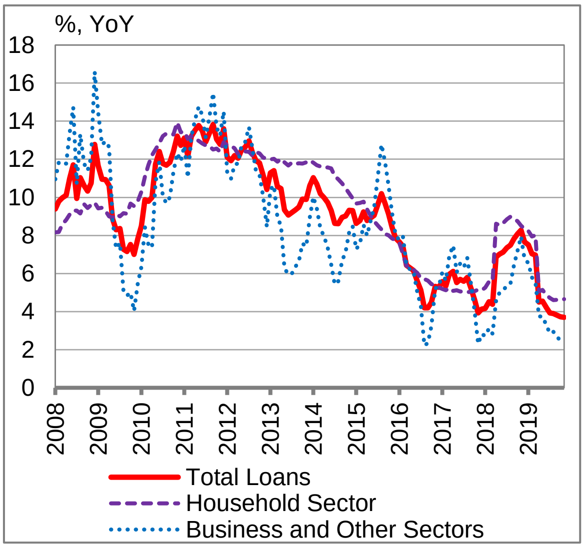


Figure 49: Loan applications growth

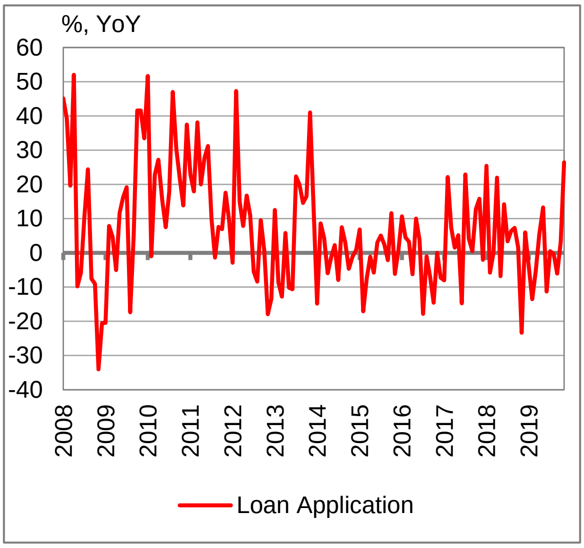


Figure 50: Loan approvals growth

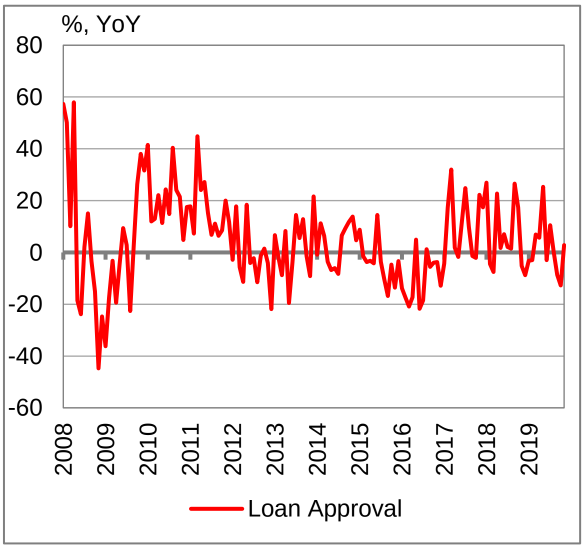
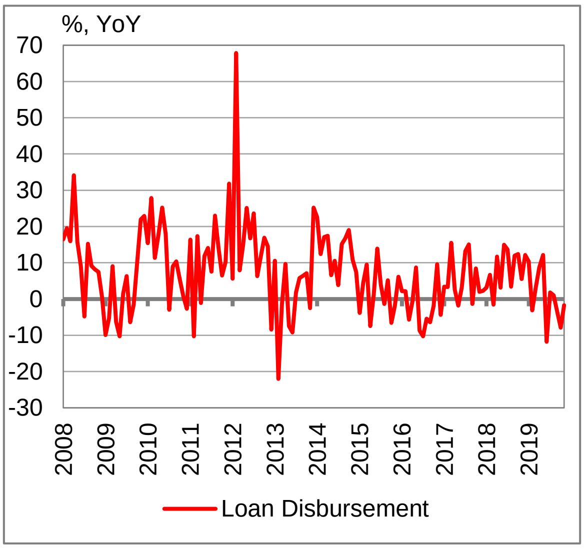


Figure 51: Loan disbursements growth



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

Financial indicators

Foreign reserves remained relatively stable throughout 2019 to reach US$103.6 billion as at end-2019. This is US$2.2 billion higher than the closing level of US$101.4 billion at end-2018. The reserves position is sufficient to finance 7.5 months of retained imports and is 1.1 times of total short-term external debt.

Malaysia's equity market continued to underperform in 2019 compared to regional peers for four consecutive years in general since 2016, reflecting weak corporate earnings, persistent foreign funds outflow, a lack of clarity on domestic economic policies as well as concerns about the global economy. FBMKLCI has fallen by 6.0% to 1588.76 as at end-2019 compared to 1690.58 as at end-2018 as foreign investors net sold domestic equities worth of RM11.0 billion for the full-year of 2019 (-RM11.7 billion in 2018). In early weeks of January 2020, foreign interests on domestic equities have returned, supported by improved sentiment following the US-China's trade truce.

Malaysia's government bonds continued to attract foreign portfolio inflows. Foreigners' net purchase of Malaysian government debt securities (MGS, GII, T-bills and Islamic T-bills) totalled RM20.7 billion for the year (net sold of RM20.5 billion in 2018), of which net purchases of RM15.9 billion were recorded in Nov-Dec. Foreign ownership of Malaysian Government Securities (MGS) crawled back above 40% in November to 41.6% as at end-2019, the highest level since May 2018. Amid some refinement of hedging measures and Bank Negara Malaysia's active engagement with foreign investors, Malaysian bonds have been retained in the FTSE Russell Fixed Income Watch List, leaving a potential downgrade from its Market Accessibility Level of 2 in World Government Bond Index (WGBI).

Throughout the year 2019, the ringgit has been moving in a tight range against a basket of currencies in 2H 2019, as reflected in the effective exchange rate compiled by Bank of International Settlements (BIS).

The key risk come from uncertain external risks, a review of US Treasury's Monitoring List on currency practices and domestic macroeconomic policies.

Figure 52: Foreign reserves remained stable amid continued capital outflows

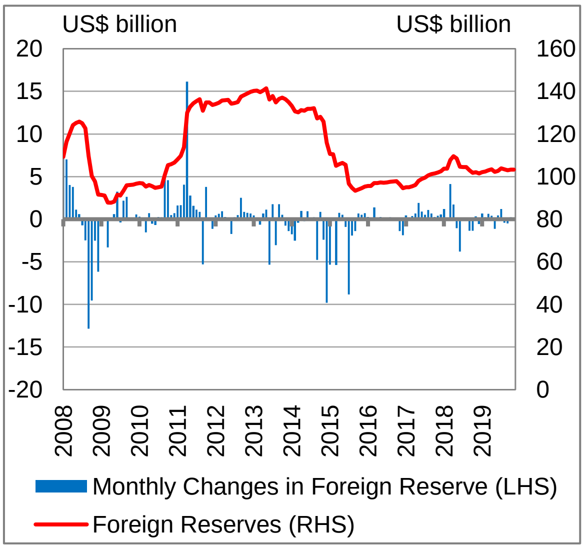


Figure 53: Ringgit's effective exchange rate (EER)

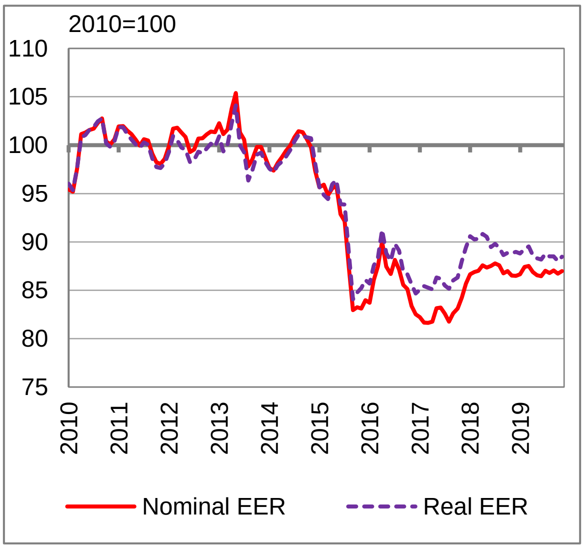


Figure 54: Ringgit against major foreign currencies

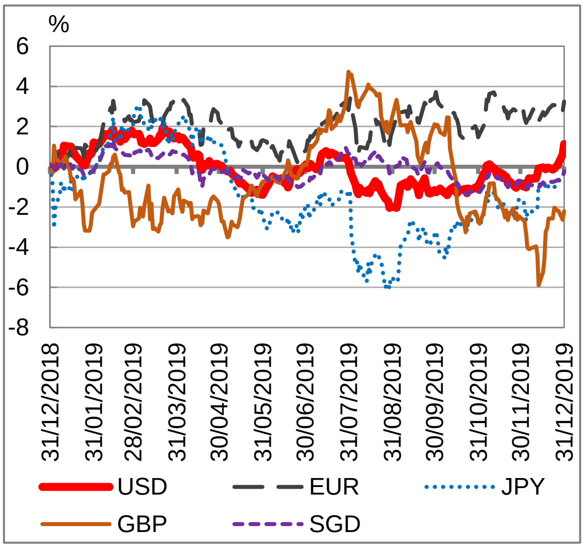
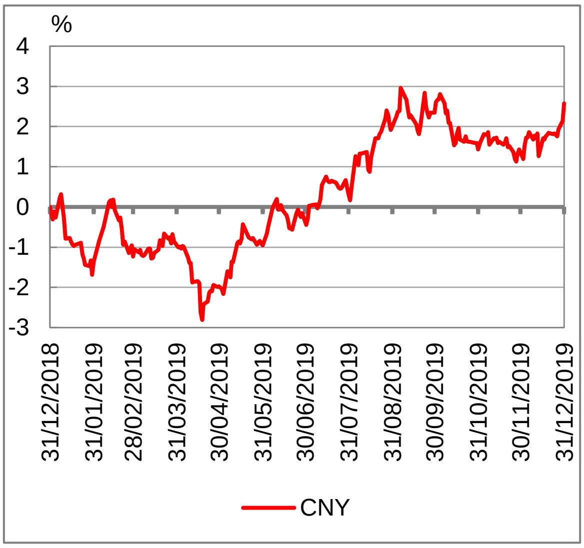


Figure 55: Ringgit against Chinese renminbi



Source: Bank Negara Malaysia; Bank for International Settlements

SOCIO-ECONOMIC RESEARCH CENTRE (SERC)
SERC SDN BHD (Company No.: 918837-W)

6th Floor, Wisma Chinese Chamber,
258, Jalan Ampang, 50450 Kuala Lumpur, Malaysia.
Tel: (603) 4260 3116 / 3119 Fax: (603) 4260 3118
Email: serc@acccimserc.com
Website: http://www.acccimserc.com