QUARTERLY ECONOMY TRACKER

(APR-JUN 2020)

Socio-Economic Research Centre (SERC)

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A. World Economic Situation and Prospects

NAVIGATING UNCHARTERED WATERS

Navigating unchartered waters. Governments and central banks worldwide have unleashed unprecedented fiscal and monetary stimulus as well as other financial supports to limit job and income losses and "do whatever it takes" to tackle the pandemic and limit the economic damage. Amid lingering virus concerns and the availability of vaccine, there's growing sense global economic recovery will be slow, depending on the effectiveness of countermeasures and policies to forestall the worse economic and financial outcomes, and to reduce contagion as well as support household and business recovery.

IMF cuts further global outlook for 2020. The International Monetary Fund (IMF) again downgraded its already pessimistic outlook for the global economy, lowering this year's GDP estimate to a larger decline of 4.9% from -3.0% predicted in April. The coronavirus impact and lockdown have had more economic damages in 1H 2020 than anticipated. A further decline in consumption, more job losses and the risk of a fresh wave of bankruptcies have heightened concerns about the path and shape of recovery. It expects global growth to recover by 5.4% in 2021.

Reopening from the Great Lockdown. Now that governments worldwide have eased economic restrictions, mobility and activity in the US and Europe are starting to restart, albeit slowly as consumers and businesses will engage in more social distancing in a new normal. There are a lot of concerns about an occurrence of a second wave of coronavirus. High frequency indicators have showed mixed performance though we anticipate a more severe economic output contraction will hit the peak in 2Q 2020. There are three key areas that should serve as reliable indicators to ascertain a sustained economic revival: (a) Consumer sentiment and spending; (b) Unemployment and wage growth; and (c) Purchasing Managers' Index (PMI) for manufacturing and services.

Global interest rates to stay low for years. With the path forward for the global economy remains highly uncertain and subject to downside risks, long and short-term interest rates in the US and eurozone will likely staying low for some time until their coronavirus pandemic decimated economies getting back on a solid state of recovery. Interest rate normalisation, including the unwinding of central banks' balance sheet expansion, if any will start at small steps, at the earliest in late 2021 or early 2022. The Fed has convinced markets that interest rates will stay low for a long time as it outlined two possible scenarios for the US economy: (a) Baseline forecast calls for an improvement in the second half-year and beyond; (b) Under a more pessimistic view, a second wave of the virus damages the economy around year-end.

A number of risks that bear close watching: (a) A longer-than-expected global recovery due to the possible risk of a second wave of coronavirus; (b) Permanently demand and output destruction due to massive jobs and income losses as well as rising businesses' bankruptcies; (c) Lingering uncertainty concerning the US-China's trade conflicts; (d) Continued tightening of global financial conditions, rising bond yields could stall global economic recovery; and (e) Volatile movements in crude oil and commodity prices.

B. Malaysia's Economic and Financial Conditions

GETTING THE ECONOMY BACK ON TRACK

Malaysia reopens economy. After nearly three months hiatus due to the coronavirus, a full-fledge economic restart has begun in May-June. A RM35.0 billion PENJANA Short-term Economic Recovery Plan was rolled out, which is primarily aimed at protecting jobs and helping businesses recover from the adverse impact of the coronavirus pandemic. In total, PRIHATIN Economic Stimulus Package and PENJANA amounted to RM295.0 billion or 21.1% of GDP in 2020. It is estimated that these packages will contribute 3.0-4.0 percentage points to overall GDP growth.

The deepest shock to economic activity will be concentrated in 2Q. We expect the large economic contraction estimated at 11.5% yoy to hit the peak in 2Q 2020 (+0.7% in 1Q), reflecting the full impact of Movement Control Order (MCO) in April and a gradual reopening in May-June. Exports have plunged by 25.5% yoy in May and 23.8% yoy in April. Retail sales and wholesale slumped by between 32.4% and 27.6% in April. Car sales have crawled back slowly in May and strongly on a month-on-month basis in June. Consumer spending and businesses are slowly on the mend. A smaller magnitude of GDP decline (-3.4%) is expected in 3Q before reverting to +2.2% in 4Q. Overall, **SERC estimates 2020's GDP to decline by 3.0%** (4.3% in 2019) **and will recover by 5.5% in 2021**.

Post COVID-19 and MCO recovery track. High frequency data and indicators (industrial production, exports, manufacturing sales, retail and wholesale) have declined sharply in April and May, which are in line with our assessment that the worst economic contraction will hit the peak in 2Q.

Our recent channel checks indicated that a slow pick-up in business and economic activities post MCO though 15 million employees (98.8% of total workforce) have returned to workplace:

a) **Overall manufacturing capacity rate** is currently running at 70%-80% and 90%-100% for some high demand industries (gloves, electronics) while wearing apparels remained low at 30%-50%;

b) **Footfall in major shopping malls** are about 50%-70% while sales are up to 40%. About 10% retail outlets in some mid-tier malls have closed down (out of business);

c) **Hotels' average occupancy rates** still low at below 30%, albeit has increased from below 20% previously. Allowing interstate travel, a pick-up in inbound tourism and the anticipated removal of cross borders' restriction via "Travel Bubble" among green zones' countries are expected to help revitalise the hardest hit tourism and hospitality sector, albeit gradually. We expect a firmer revival in 2H 2021, at the earliest; and

d) The resumption of **construction activities** has been slowed. It is hoped that all construction sites would be fully restored in the months ahead. During the sites' inspection conducted between 22 June and 1 July, about 9%-29% of construction sites have not started operations while 56%-82% have complied with Standard Operation Procedures (SOP).

Severe hit to the labour market would dent consumer spending. As widely expected, steep decline in activity comes with a catastrophic hit to labour market conditions, especially during the MCO.

a) **Unemployment rate** spiked to 5.0% (778,800 persons) in April, the highest since 1990. We expect the jobless rate to rise further to 5.5%-6.5% in the months ahead before stabilising towards end-year.

b) **The Employment Insurance System (EIS) reported 53,952 employment loss in Jan-4 Jul 2020**, with 23% in manufacturing sector, 15% in accommodation and food and beverages industry and 14% in wholesale and retail services. Professionals, managers, executives and technicians made up 58% of total employment loss while workers' earning monthly wage below RM3,000 made up 62% of the total.

c) **A total of 2.5 million employees have received wage subsidy** and **about 200,000 employees were placed under the Employment Retention Program (ERP)** receiving a 6-month wage subsidy on no paid leave.

It's essential to track whether the inevitable increases in wage subsidy and employment retention will see a decline as sectors have reopened because people are returning to work or because they are losing their jobs definitively.

While the loss in income due to layoffs (temporary or permanent) would dent consumer spending, a raft of financial assistance and cashflow relief measures (Bantuan Prihatin Nasional, EPF's i-Lestari, loans moratorium, etc.) are expected to ease income and financial pressure to continue spending on discretionary items. Overall, **SERC expects private consumption to slow to 1.5% in 2020** (6.7% in 1Q 2020; 7.6% in 2019 and 8.0% in 2018; an average growth of 7.1% pa in 2005-2017).

Exports contraction to narrow in 2H 2020. Exports, which had grown by 1.1% yoy in 1Q, reversed to contract sharply by 23.8% in April and 25.5% in May, reflecting notable declines in electrical and electronics, petroleum products, chemicals, and LNG as well as palm oil.

Global trade outlook remains dim, with the World Trade Organization (WTO) now saying that 2020 could see the worst collapse in international trade since the Great Depression. The WTO's optimistic scenario saw a 13% drop in the volume of international in 2020 (2009 GFC: -12%) while its pessimistic scenario sees a plunge by as much as 32% this year.

With a gradual reopening of our major trading partners, especially the US and Europe and regional economies, including a lifting of lockdown in China in early April along with the lifting of domestic MCO in stages since May are expected to mend the sluggish exports demand at a measured pace. For now, **we maintain our estimated exports decline of 11.2% in 2020** (2019: -1.7%).

Deflation (not broad-based decline in prices) trend will last longer. Headline inflation, as measured by the Consumer Price Index (CPI), declined by -2.9% yoy in both April and May (+0.9% in 1Q), due to continued declines in prices of transport, utilities, clothing and footwear and non-essential items, especially household-related products and services.

In Jan-May 2020, 27.3% of goods in the CPI basket saw decreases in prices. Core inflation, which excludes most volatile items (such as fresh food and administered prices (petrol) and services), still staying above 1.0%. Though fuel prices have increased month-on-month in May-Jun, the annual rate of decline will persist, albeit narrower throughout 2H 2020.

Malaysia is expected to experience sustained months of deflation, which may last longer this time round when compared to the previous episode of deflation (Jan-Nov 2009). As long as there is no broad-based decline in prices for a sustained period, says at least more than a year, it is a lesser concern about a deflation.

That said, the decrease in overall CPI will narrow in the months ahead and not all main groups will register decreases in prices. Electricity discounts for domestic users will be extended by another three months to end-Dec 2020 from Apr-Sep. Any price increases will likely to be at moderate pace as capped by the presence of slack capacity. **Our estimated headline inflation is between -0.5% and -1.0% in 2020**.

There were ups and downs in the main groups of overall CPI basket, depending on demand and supply conditions, policy-induced (as in the case of 100% sales tax exemption on CKD motor vehicles and 50% exemption on imported passenger cars as well as electricity discounts), demand shock (fuel prices), etc. Volatile crude oil prices remain a wild card.

Accommodative interest rates to support recovery. Bank Negara Malaysia (BNM) slashed the overnight policy rate (OPR) further by 25 basis points (bps) to a record low of 1.75% on 7 July, keeping some ammunition for buffer should the threat to economic growth accelerate.

Further rate cuts underscore the need to provide additional stimulus to safeguard economic activities, which have begun to recover from the trough in the second quarter. This is to ensure that a firmer recovery amid the expiry of loan moratorium in September.

BNM will continue to monitor economic conditions and credit market, and provide additional support and appropriate financial measures if necessary, which may not be confined to further cut in interest rates for now. Fiscal policy may be useful in speeding recovery from a deep recession and reducing the burden on monetary policy.

A cumulative reduction of 150 bps in OPR since May 2019 (YTD: 125 bps) as well as RM295.0 billion PRIHATIN and PENJANA economic stimulus packages (fiscal, monetary, financial assistance and credit measures) have helped to limit economic damage of the COVID-19 and lift financial sentiment, which in turn supports a gradual economic recovery.

Since May, most economic sectors and businesses have gradually reopened from a lockdown amid the compliance of SOP, paving the way for the resumption of activities. Amid a restoration of confidence and continued wary about the coronavirus, consumer spending is slowly on the mend.

GLOBAL ECONOMY – NAVIGATING UNCHARTED WATERS

Coronavirus infections on the rise calls for continued high vigilance. Fears of a second wave of virus in the US grows as new infection cases surged the most in recent days post reopening of the economy. Globally, total infections have surpassed 10 million cases and caused more than 500,000 deaths as of late-June, and the virus is still spreading at a worrying speed. Nevertheless, it is comforting that many countries have managed to flatten the infection curve and passed the peak of infection. Most have reopened their economies in phases to avoid a more severe impact to the economic fundamentals. The ongoing containment and protective measures such as social distancing in a new normal environment will continue to somewhat restraint a much-needed economic recovery.

Not out of woods yet. The economic damage will be much steeper-than-expected in 1H 2020. We continue to expect a protracted and uneven global recovery beginning in the second half-year as it emerges from the devastating impact of the COVID-19 pandemic amid infected cases still rising rapidly globally.

High frequency data (Purchasing Managers' Index (PMI) for manufacturing and services, exports, industrial production) and leading indicators of economic activity are in line with our assessment that the deepest output slump from the coronavirus crisis and strict lockdown will be concentrated in 2Q.

We expect some incipient signs of stabilisation and narrowing magnitude of declines on the way in the third quarter. But, global financial market volatility will remain on worries that a second wave of coronavirus could derail global economic and stock market recovery, with many anxious about further lockdowns being put in place as a result.

IMF cuts 2020's global growth sharply. The International Monetary Fund (IMF) again **cut its global economic forecast for 2020 from -3.0% previously to -4.9%**, citing that the COVID-19 pandemic has had a more negative impact on global activity in the first half-year of 2020 than anticipated. The recovery is projected to be more gradual than previously expected. The severe downturn is expected to hit bottom in the second quarter this year and then start to recover gradually. **In 2021, global growth is expected to rebound to a 5.4% growth rate**, revised lower from 5.8% forecast previously. The recovery is expected to be "sluggish".

Disconnect between stock market and economy. It is obvious that the huge disconnect between financial markets and real economy raises questions about the sustainability of stock markets' rally, if not for the abundant and cheap liquidity boost provided by central banks.

The onset of COVID–19 pandemic-inflicted economic crises necessitated the imposition of extraordinary measures by governments and central banks worldwide to stem a deep global recession.

As a result of interest rate cuts to near zero, a balance sheet expansion of over US$6 trillion, including asset purchases, FX swap lines, and credit and liquidity facilities, global financial conditions have eased significantly over the past few months. These monetary stimuli have helped to provide a floor to cap the slump in equity market, which saw stock prices rebounded sharply from the recent lows.

A V-shaped stock market recovery. The strong rebound in global equity markets (V-shaped) recovery in recent weeks seems to indicate investors are looking through the current adverse economic conditions.

Divergence between global equity markets and their underlying economies appears untenable and counterintuitive. Investors seem to be betting that lasting strong monetary and financial support from central banks will sustain a quick economic recovery even as economic data point to a deeper-than-expected downturn in 2020.

Rock-bottom interest rates with the sloshing of global liquidity have flowed into equity markets as capital has nowhere else to go. Stock prices are rising despite weak economy and depressed corporate earnings with the exception of healthcare products and technology-based industries. With bond's yields do not looking terribly attractive right now, money flows still favouring equity.

But, not a V-shaped for the global economy. It would take at least six months for global economic downturn to stabilise initially and gradually recovering. Global growth potential was crippled by the destroyed capacity or decreased capacity due to social distancing and supply chain disruptions; massive job cuts and income losses; a general decline in productivity; and reduced investment/capital spending on sluggish economic and investment prospects.

The duration and pace of global economic recovery depends on a quick restoration of confidence and sentiment as consumers and businesses emerge from the COVID-19; how they are adjusting and coping with the new normal environment; and the effectiveness of monetary and fiscal measures to revive spending and business activities.

Post COVID-19 recovery tracking, the following three indicators must be closely monitored to show the strength of recovery: (a) Consumer sentiment and spending; (b) Unemployment and wage growth; and (c) Global Purchasing Managers' Index (PMI) for manufacturing and services.

Can global stock market rally be sustainable? Global stock markets are currently at the first stage rebound supported by aplenty liquidity. The game changer is whether the pandemic is brought under control and vaccination (probably in 2021) so that the economy can be revitalised and get back on track, and continues to reinforce investors' optimism on the stock market, backed by sustainable corporate earnings.

During the 1929 Great Depression and 2008-2009 Global Financial Crisis (GFC), global stock markets also experienced short-term rebound after governments and central banks launched massive fiscal, monetary and financial support or bailout measures, yet as the real economy showed no signs of improvement, the market eventually crushed again. Investors have to be convinced that the economic recovery is real to support future corporate earnings.

Developments that could trigger a reversal in riskier assets' prices. We caution that a number of developments and policy risks that could cause shifts in market expectations and changing investors' sentiment which, in turn, trigger a decline in riskier assets' prices and reverse the current market's rally.

a) **A protracted and deeper recession as anticipated by investors.** This could stem from a second wave of infections, compelling more restricted movements and containment measures;

b) **Investors pare down expectations and lower optimism** about the central banks' continued liquidity support;

c) **Investors reassess their appetite and pricing of risk** on worse-than-expected corporate earnings. Assets' repricing could result in a sharp tightening in financial conditions, causing stock market volatility;

d) **Renewed trade tensions between the US and China**;

e) **The US Presidential Election outcome in November** and potential policies' ramifications; and

f) **Geopolitical tensions** could lead to a reversal in investors' sentiment.

Two possible outcomes: The first outcome is that the stock market is right and the real economy catches up. Another possible outcome is that the stock market updates its expectations and starts to fall again.

Table 1: Real GDP growth (% YoY)

	2018	2019	2020 Q1	2020*f* (IMF)	2020*f* (WB)	2021*f* (IMF)	2021*f* (WB)
World	3.6	2.9	-	-4.9	-5.2	5.4	4.2
United States	2.9	2.3	0.3	-8.0	-6.1	4.5	4.0
Euro Area	1.9	1.2	-3.1	-10.2	-9.1	6.0	4.5
China	6.7	6.1	-6.8	1.0	1.0	8.2	6.9
Japan	0.3	0.7	-1.7	-5.8	-6.1	2.4	2.5
India	6.1	4.2	3.1	-4.5	-3.2	6.0	3.1
Malaysia	4.8	4.3	0.7	-3.8	-3.1	6.3	6.9
Singapore	3.4	0.7	-0.7	-	-	-	-
Indonesia	5.2	5.0	3.0	-0.3	0.0	6.1	4.8
Thailand	4.2	2.4	-1.8	-7.7	-5.0	5.0	4.1
Philippines	6.3	6.0	-0.2	-3.6	-1.9	6.8	6.2
Vietnam	7.1	7.0	3.7	-	2.8	-	6.8

Note: World GDP growth for 2018 and 2019 by IMF; Annual GDP for India is on fiscal year basis.
Source: Officials (unadjusted data except quarterly GDP for Euro Area); IMF (World Economic Outlook (WEO) Update, Jun 2020); World Bank (Global Economic Prospects, Jun 2020)

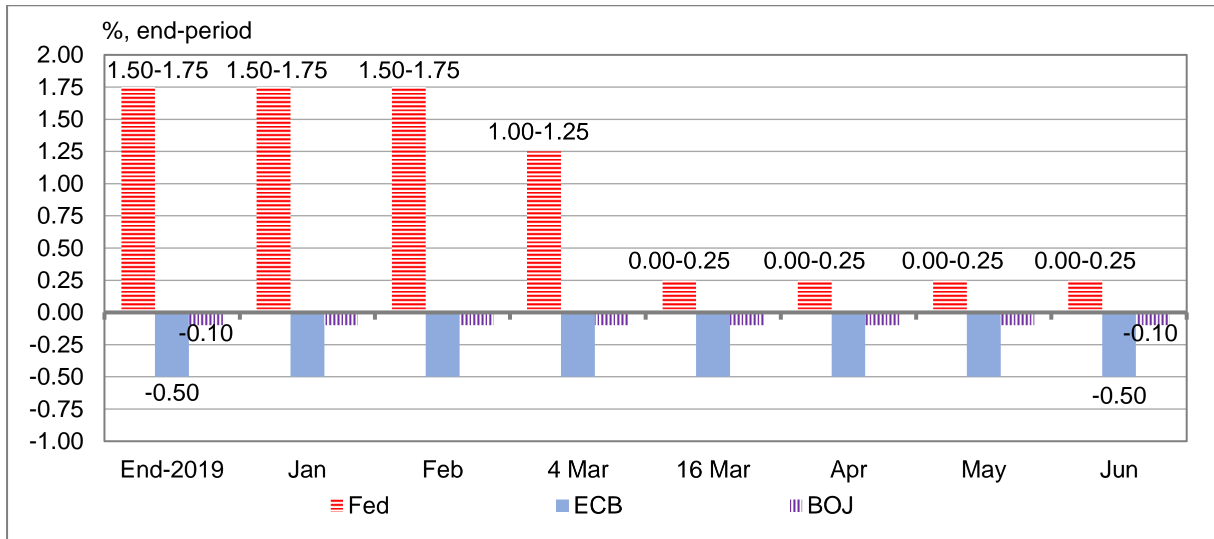
Profoundly low interest rates are here to stay. Global central banks have utilised a full range of monetary policy tools and financial measures to limit economic damage and ease financial stress on households and businesses. The tight global liquidity conditions were eased and stocks prices have rebounded strongly from the slump when the coronavirus pandemic accelerated.

Post COVID-19 stabilisation and recovery phase, we expect depressing effect on interest rates will likely to linger for a longer while until the global recovery is firmly entrenched. In our view, interest rates normalisation and unwinding of quantitative easing and purchases of securities will be carried on a measured pace, probably at the earliest in late 2021 or early 2022.

a) Those market participants **FOR** an eventual rise in interest rate argue that higher fiscal deficit and debt could cause concerns about fiscal sustainability, and lead to higher inflation. This will push nominal and real interest rates back up to pre-pandemic levels.

b) Those market participants **AGAINST** higher interest rate rationalise that larger private sector's saving glut and implicit or explicit nominal yield curve control by central banks will keep low interest rates longer.

Figure 1: Policy rate movements of major central banks in 2020



Source: Federal Reserve (Fed); European Central Bank (ECB); Bank of Japan (BOJ)

Figure 2: Policy rate movements of selected regional central banks in 2020

%, end-period
3.00
↓ 125 bps
1.75
Dec Jan Feb Mar Apr May Jun Jul
2019 2020
Malaysia

%, end-period
1.25
↓ 75 bps
0.50
Dec Jan Feb Mar Apr May Jun
2019 2020
Thailand

%, end-period
5.00
↓ 75 bps
4.25
Dec Jan Feb Mar Apr May Jun
2019 2020
Indonesia

%, end-period
4.00
↓ 175 bps
2.25
Dec Jan Feb Mar Apr May Jun
2019 2020
Philippines

%, end-period
4.15
↓ 30 bps
4.05
3.85
Dec Jan Feb Mar Apr May Jun
2019 2020
China

%, end-period
5.15
↓ 115 bps
4.40
4.00
Dec Jan Feb Mar Apr May Jun
2019 2020
India

Source: Bank Negara Malaysia; Bank of Thailand; Bank Indonesia; Bangko Sentral ng Pilipinas; People's Bank of China; Reserve Bank of India

Table 2: Policy rate (%)

End-period of	2008	2009	2010	2011	2012	2016	2017	2018	2019	2020 (Jun/ Jul)	2020e
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	0.50-0.75	1.25-1.50	2.25-2.50	1.50-1.75	0.00-0.25	0.00-0.25
Euro Area, ECB Deposit Facility	2.00	0.25	0.25	0.25	0.00	-0.40	-0.40	-0.40	-0.50	-0.50	-0.50
Japan, BOJ Short-term Policy I/R	0.10	0.10	0.00-0.10	0.00-0.10	0.00-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
China, PBC 1-Year Loan Prime Rate	5.31	5.31	5.81	6.56	6.00	4.35	4.35	4.35	4.15	3.85	3.85
India, RBI Policy Repo Rate (LAF)	6.50	4.75	6.25	8.50	8.00	6.25	6.00	6.50	5.15	4.00	3.50
Korea, BOK Base Rate	3.00	2.00	2.50	3.25	2.75	1.25	1.50	1.75	1.25	0.50	0.50
Malaysia, BNM Overnight Policy Rate	3.25	2.00	2.75	3.00	3.00	3.00	3.00	3.25	3.00	1.75	1.75
Indonesia, BI 7-Day RR Rate	9.25	6.50	6.50	6.50	5.75	4.75	4.25	6.00	5.00	4.25	4.00
Thailand, BOT 1-Day Repurchase Rate	2.75	1.25	2.00	3.25	2.75	1.50	1.50	1.75	1.25	0.50	0.50
Philippines, BSP Overnight RR Facility	5.50	4.00	4.00	4.50	3.50	3.00	3.00	4.75	4.00	2.25	2.25

Source: Officials; SERC

CURRENT AND FORWARD INDICATORS

High frequency data (Purchasing Managers' Index (PMI) for manufacturing and services, exports, industrial production) **and leading indicators of economic activit**y **are in line with our assessment that the deepest slump of economic activity** from the coronavirus crisis and strict lockdown **will be concentrated in 2Q**.

Incipient signs of turning points are likely on the way in 3Q as global demand improves gradually on more resumption of economic and business activities. We must be mindful that a firmer recovery will take some time, probably in 2021 when the vaccine is found and widely available.

Global trade activity is expected to remain sluggish throughout the year. Succumbed to the virus impact and associated lockdown measures, the World Trade Organisation (WTO) expects world merchandise trade volume to decline by a strong double-digit of 18.5% yoy in 2Q 2020 (-3.0% in 1Q). It estimates that the world trade will decline by 12.9%-31.9% in 2020 before reverting to a growth of 21.3%-24.0% in 2021. It must be cautioned that international trade will be further tempered if there is a prolonged pandemic impact or a second wave of coronavirus outbreak, which could compel re-lockdown measures. The countries on the watch list include the United States, Brazil, India and Indonesia.

There is a silver lining in the semiconductor industry. The **World Semiconductor Trade Statistics (WSTS)** projects a 3.3% growth in semiconductor sales in 2020 though lower from 5.9% previously (-12.0% in 2019). By component, the growth will be helped by an increase in integrated circuits, particularly memory, logic and micro. By region, positive growth is expected to come from Americas and Asia Pacific. Nonetheless, the industry's growth prospect for this year is somewhat less sanguine as international institutions are expecting a diverse range of estimates between -11.7% and 7.6%.

Figure 3: CLIs yet to signal any solid turning points

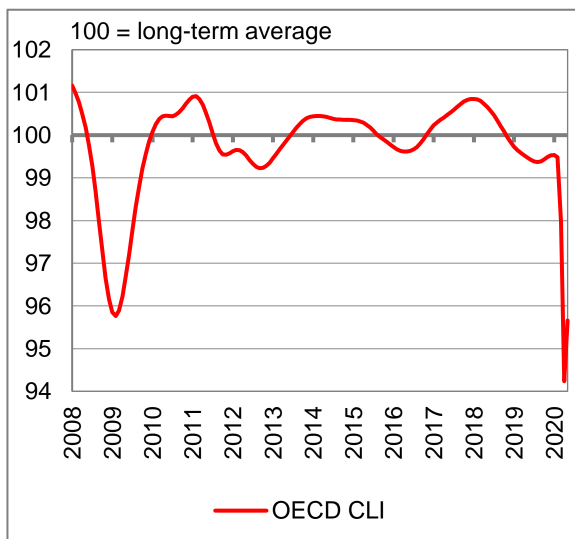


Figure 4: Both global PMI for manufacturing and services remained in contraction territory, albeit smaller

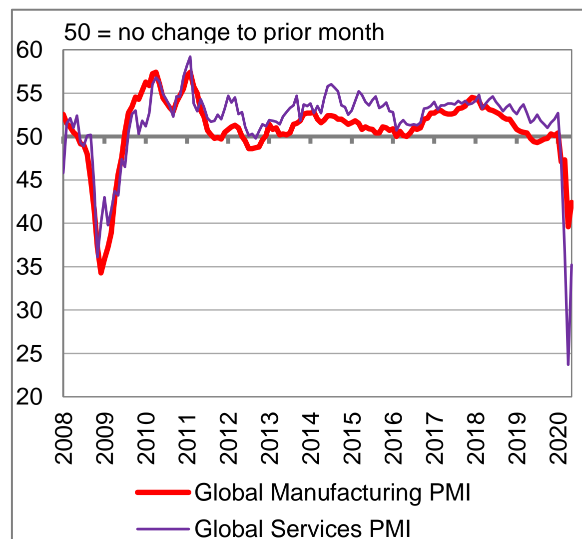


Figure 5: Slumping world trade volume and industrial production

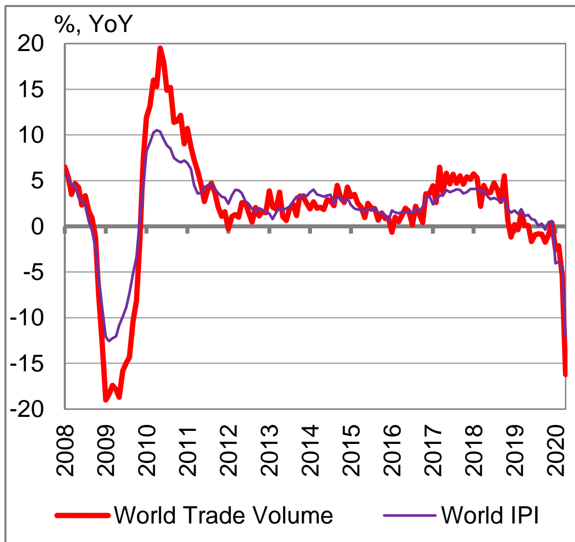
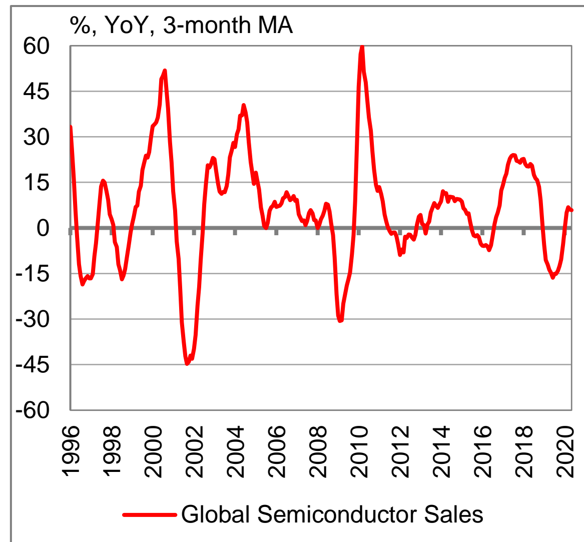


Figure 6: Semiconductor growth provides a glimpse of hope



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

OECD business confidence and **consumer confidence** continued plunging to the lowest level since 2009, dragged by the impact of coronavirus and lockdown. With the opening of economic sectors worldwide, consumers and business sentiments are expected to restore at measured pace amid still wary about the virus. Hence, it is vital to practise social distancing and wear masks to contain new infection cases. Consumers will start purchasing big-ticket items such as motor vehicles and consumer durables while businesses committing to capital spending when their confidence levels are being restored, supported by fiscal policy and monetary measures.

Figure 7: OECD Business Confidence Index

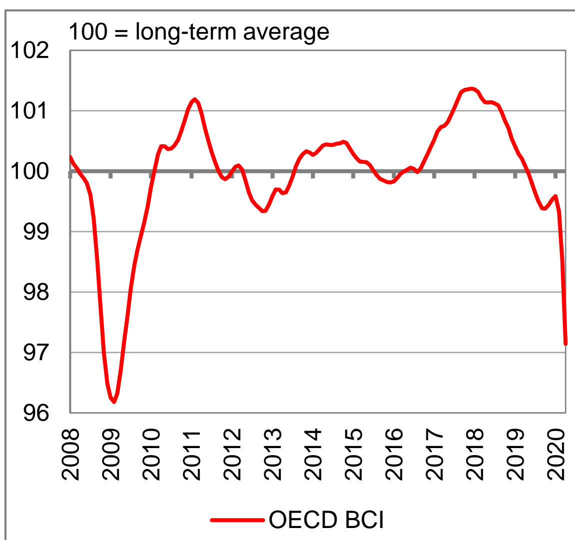
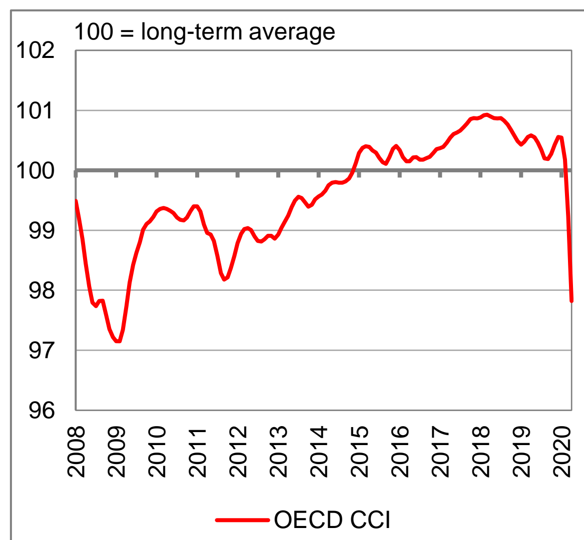


Figure 8: OECD Consumer Confidence Index



Source: OECD

Crude oil prices bounced back strongly. The unprecedented coronavirus crisis has led to a big slash of global demand for crude oil as economic and business activities halted during the Great Lockdown. Brent crude oil spot price level has fallen to a single digit of US$9.12 per barrel (bbl) as of 21 April while WTI crude oil futures prices settled at negative level.

In early June's meeting, OPEC+ members have agreed to comply with April's decision (further supply cuts at different levels till April 2022) and several members have initiated to have extra voluntarily output adjustment to curb supply. This has helped to revive Brent crude oil spot prices to US$29.38/bbl in May and further to US$41.58/bbl as of 29 June. But, the price level still lower compared to US$67.77/bbl as at 31 December 2019. Year-to-date (Jan - 29 June), Brent crude oil spot prices averaged at US$40.22/bbl.

Weak global demand and a gradual economic recovery will continue to weigh down the price supports effect of the supply cuts. In its July's Short-Term Energy Outlook (STEO), the U.S. Energy Information Administration (EIA) projects that Brent crude oil prices to average at US$40.50/bbl in 2020 and will climb higher to US$49.70/bbl in 2021.

Figure 9: Crude oil prices registered a strong rebound from the lows

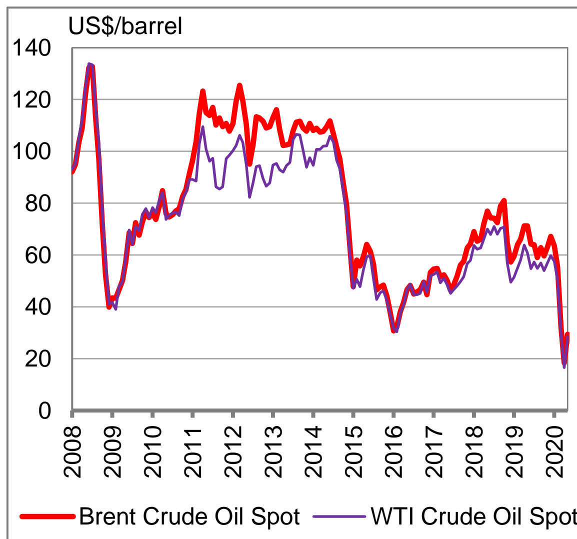
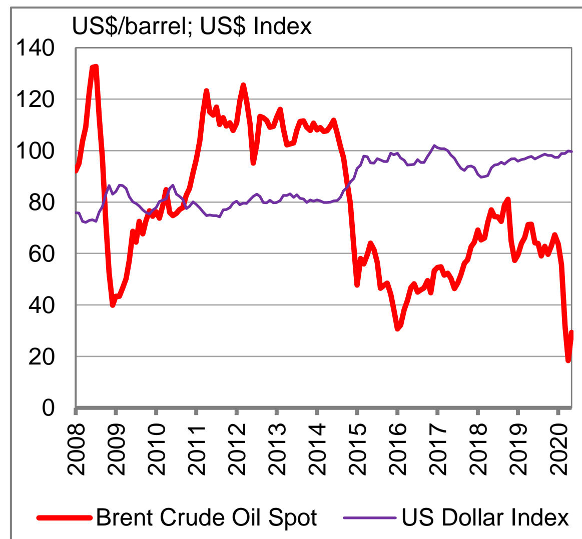


Figure 10: Brent crude oil price vs. the US dollar index



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

Crude palm oil (CPO) prices moderated for a number of months after reaching its peak in January 2020. Following increases in production in April, CPO stocks have accumulated higher. Sustained export volume helped to lift CPO price higher to RM2,411.50 per tonne in June. CPO price averaged RM2,433.50 per tonne in Jan-Jun 2020, an increase of 17.1% compared to RM2,079.00/tonne in the corresponding period of 2019.

Prices of most commodities have softened since the beginning of this year on weaker global demand due to the pandemic-inflicted recession. In contrary, **gold** – a safe haven asset to hedge against economic uncertainty and future inflation risk continues to spur high demand. Gold prices have jumped by 23.2% to US$1,732 per troy oz in June compared to an average price of US$1,392 per troy oz in 2019.

Figure 11: Commodities prices continue to soften, except safe haven products like gold

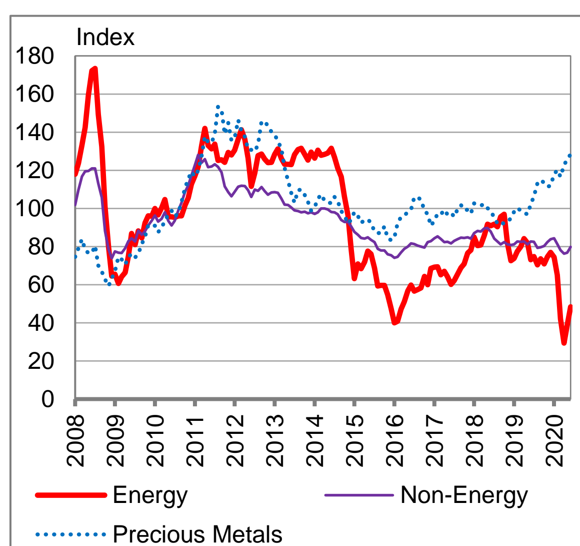
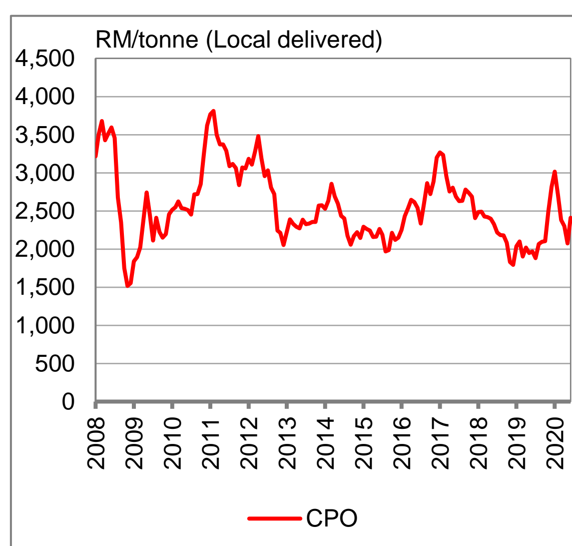


Figure 12: CPO prices picked up in June



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

ECONOMIC DEVELOPMENTS IN MAJOR ECONOMIES

The United States: The US economy shrank by 5.0% annualised qoq in 1Q 2020 (+2.1% in 3Q and 4Q 2019 respectively), dragged by a contraction in private sector (both consumption and investment) and external demand.

The Great Lockdown has constrained social, economic and business activities, which dampened consumption and services sector while global supply chain disruptions has hit investment and export sectors badly.

Both retail trade and industrial production growth have plunged below the level recorded during the 2008-2009 GFC, of which the latter has contracted for nine consecutive months since September 2019.

Jobless rate shot up to double-digit rates in April (14.7%) and May (13.3%) during the lockdown, the highest since data available in 1948 and more than 20 million of job losses recorded in April alone. In June, the unemployment rate has improved to 11.1% but remains elevated. It remains to be seen whether the improvement will sustain in the months ahead amid a strong surge in new infection cases in late June and early July, fuelling fears of more layoffs if businesses' revival were dampened and delayed. Multiple state governments, primarily in the south, have reinstituted lockdown policies due to an increase in the number of confirmed cases of COVID-19.

If the COVID-19 outbreak prolongs or out of control, the economic recovery will take a longer while or even a protracted economic contraction.

Figure 13: ISM manufacturing and non-manufacturing PMI bounced back to expansion territory in June

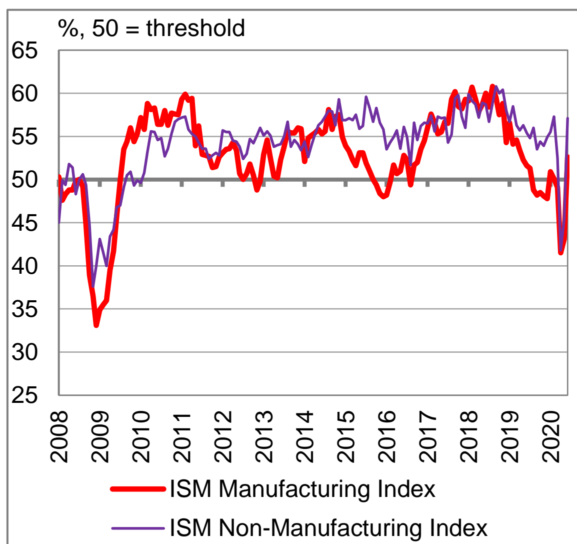


Figure 14: Industrial production contracted for nine straight months in May

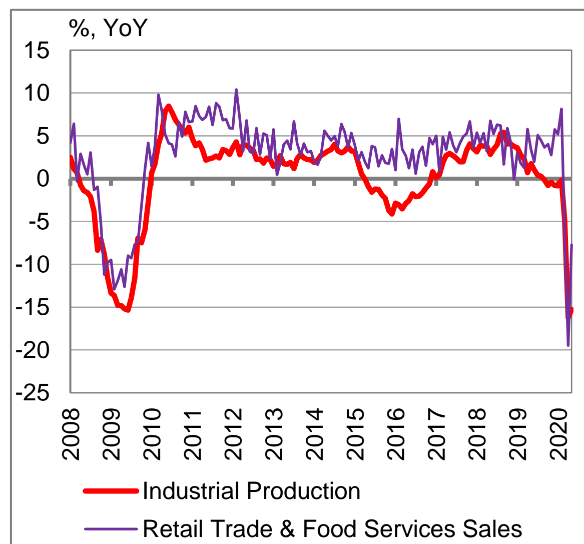


Figure 15: Unemployment rate stood at historical high of 14.7% in April, 13.3% in May and 11.1% in June

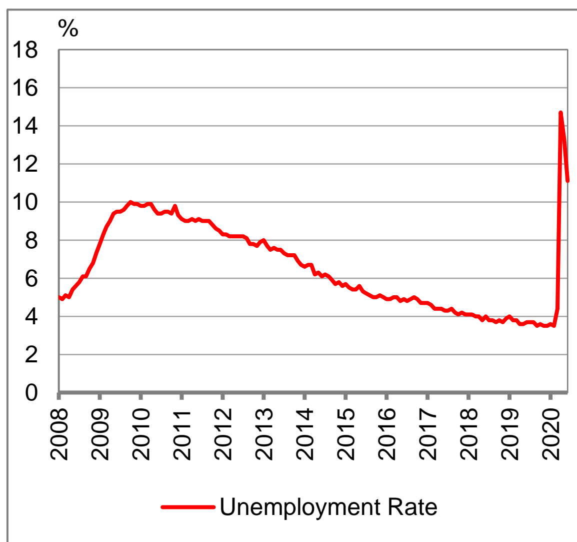
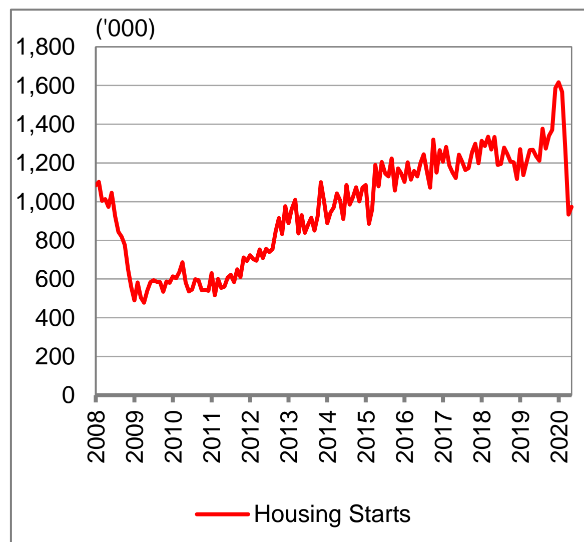


Figure 16: Housing starts declined drastically after hitting a peak in January



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

Euro area: With major member countries suffering high number of infection cases before brought under control and have reopened in May, all aspects of economic activities in the Euro area are impacted severely. Real GDP recorded a 3.6% qoq of contraction in 1Q 2020, the sharpest decline on record. With the exception of food retailing, most of the other sub-sectors in retail trade and industrial components have experienced a large double-digit of contraction, weighed down by the COVID-19 containment measures. The containment measures are now gradually being lifted, hoping to soften the blow to economy in the third quarter. The ECB has warned that deteriorating fiscal metrics has placed already-highly indebted countries such as Italy and Spain on rising risks of debt sustainability.

In terms of price level, muted headline inflation was dragged by a large decrease in energy price whereas core inflation is broadly stable. Overall, the Euro area is expected to be hit hardest among major advanced economies in 2020.

Figure 17: Services PMI dropped to a shocking low of 12.0 in April before improving markedly in May-Jun

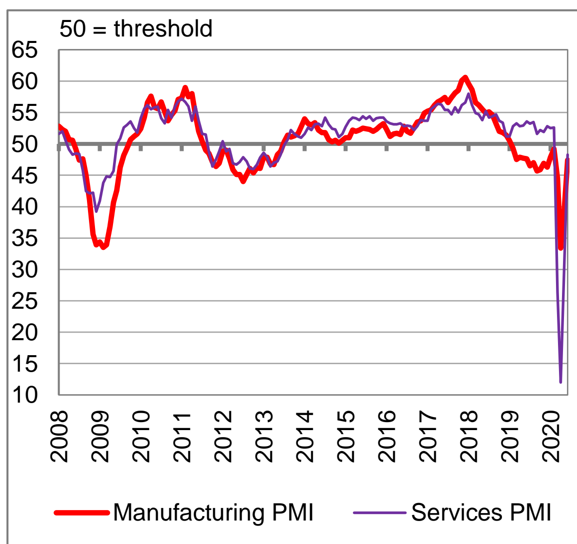


Figure 18: Broad-based contraction in industrial production and retail trade volume

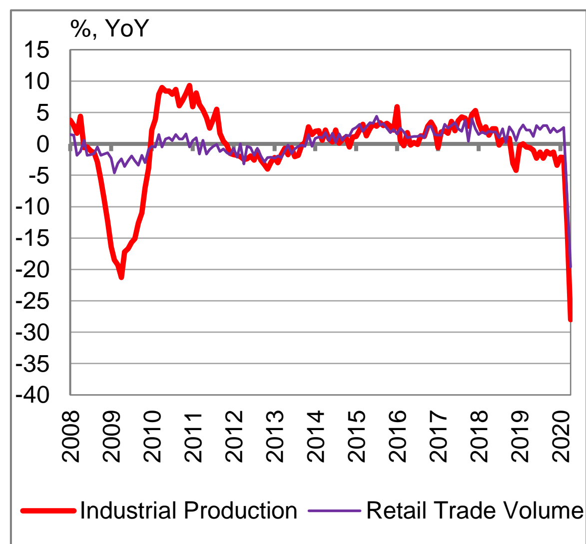


Figure 19: Core inflation remains stable

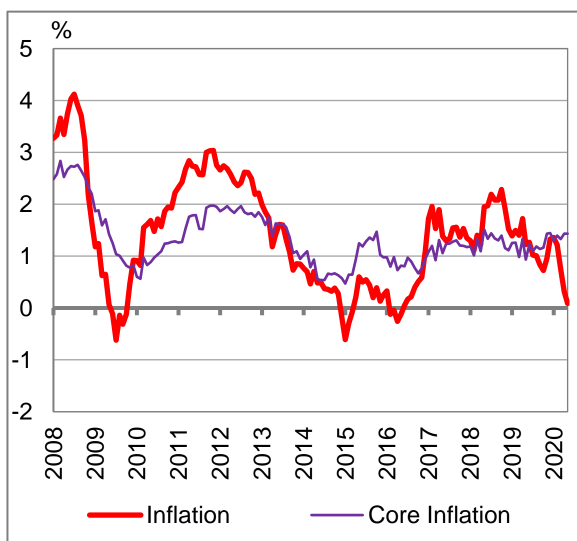
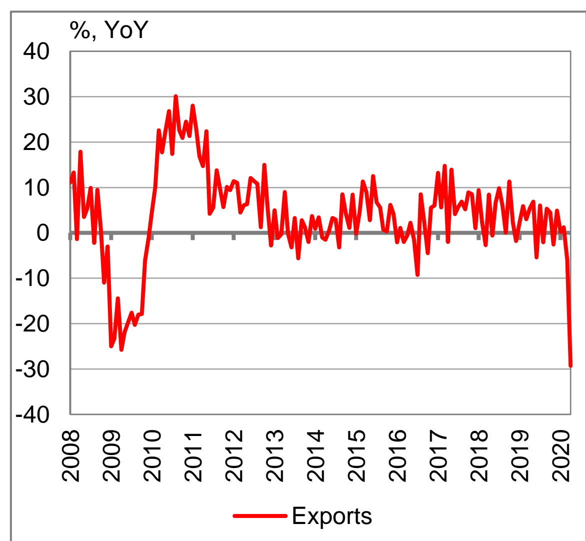


Figure 20: COVID-19 containment measures continue to impact export performance



Source: Markit; Eurostat

Japan: The economy contracted further by 0.6% qoq in 1Q 2020 (-1.9% in 4Q 2019). Both economic and business conditions are likely to deteriorate ahead. The IMF forecasts that Japanese economy will shrink by 5.8% this year, worse than the 2008-2009 GFC.

TANKAN survey shows that businesses are more pessimistic in the second and third quarters, reflecting poor global demand due to the impact of COVID-19. Both industrial production and retail sales growth contracted sharply by 25.9% yoy and 12.3% respectively in May (-15.0% and -13.9% in April respectively). Exports slumped by 21.9% in April and 28.3% in May, mainly dragged by machinery and transport equipment. Given the postponement of 2020 Tokyo Olympics to 2021, which is the key engine growth of services sector, the 234 trillion yen (US$2.18 trillion or about 40% of GDP) stimulus package is expected to revitalize local economic activities as well as to ease the financial burden on businesses and households.

Figure 21: Large manufacturers expect an unfavourable outlook

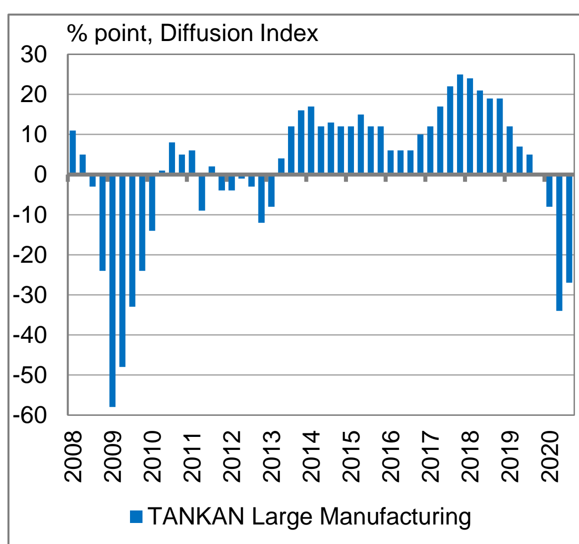


Figure 22: Lowest industrial output growth since 2009; lowest retail sales growth since 1998

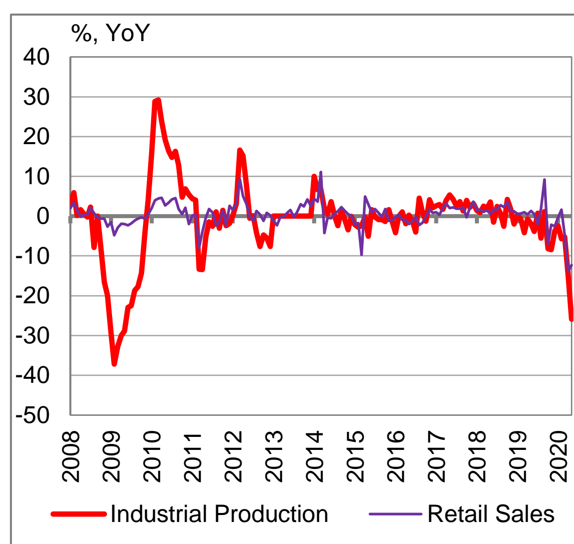


Figure 23: BOJ continues to aim for a 2% inflation target

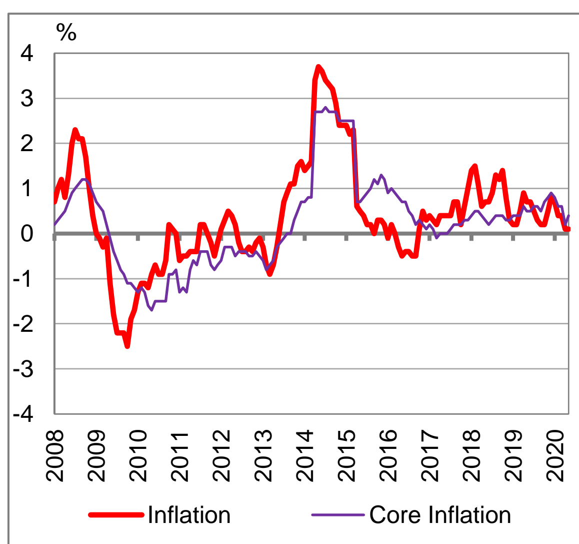
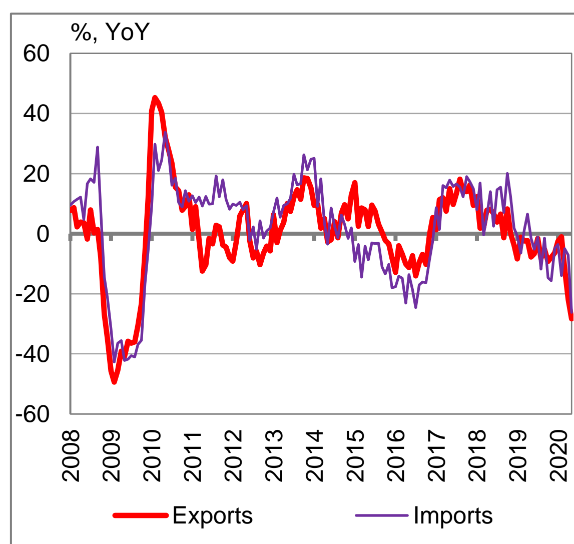


Figure 24: Export growth fell by sharpest pace since 2009



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

China: China's economy shrank by 6.8% yoy in 1Q 2020 (+6.0% in 4Q 2019), the first contraction in 28 years due to the COVID-19 outbreak and restless trade conflicts with the US. The IMF expects the economy to grow by 1.0% in 2020 and 6.9% in 2021.

Most economic activities slumped shockingly in February due to total lockdown and has rebounded rapidly since March, albeit at different magnitudes. Industrial production continues to grow in April and May while retail sales' contraction has narrowed. Manufacturing PMI and non-manufacturing PMI have stayed above 50-pt threshold (expansion) since March. However, the external trade sector remained subdued. The policy makers continue to support the economy via a mix of monetary easing and targeted fiscal stimulus measures.

Figure 25: Manufacturing PMI rebounded quickly to a mild expansionary track

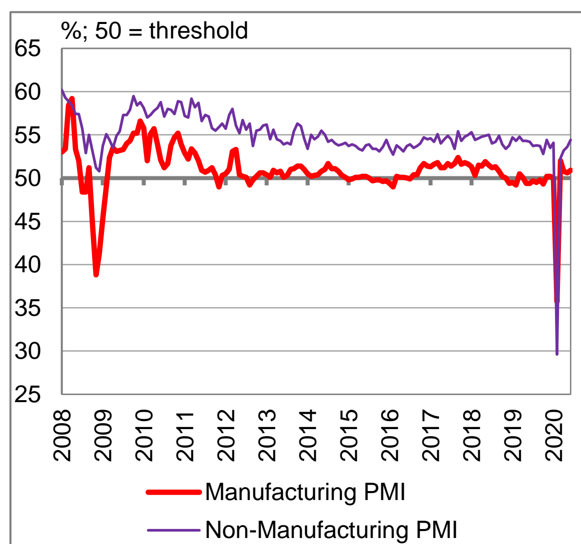


Figure 26: Retail sales growth contracted for five straight months since January 2020

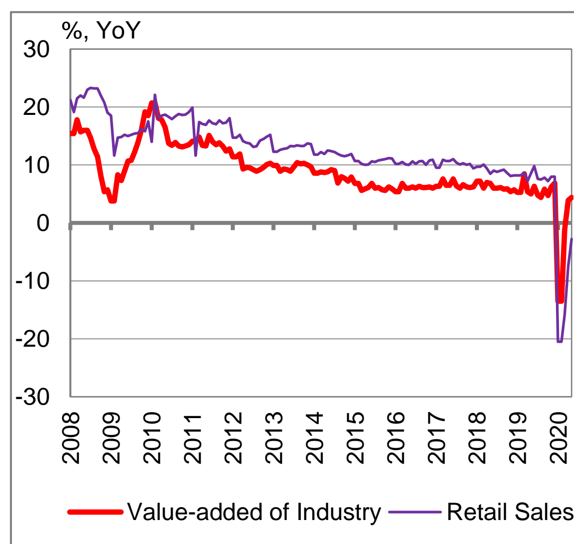


Figure 27: Fixed assets investment growth remained subdued

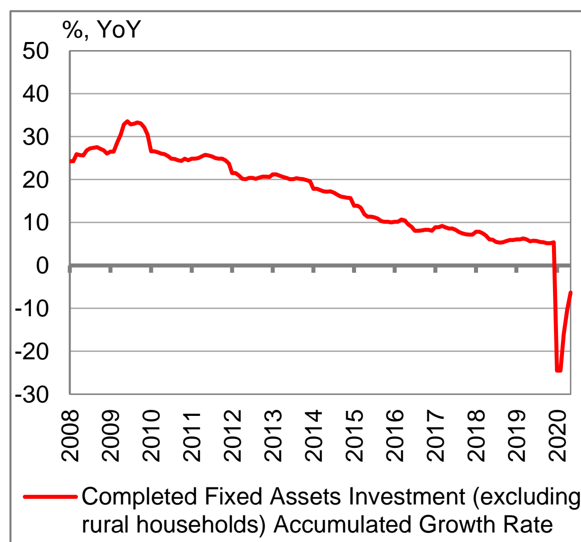
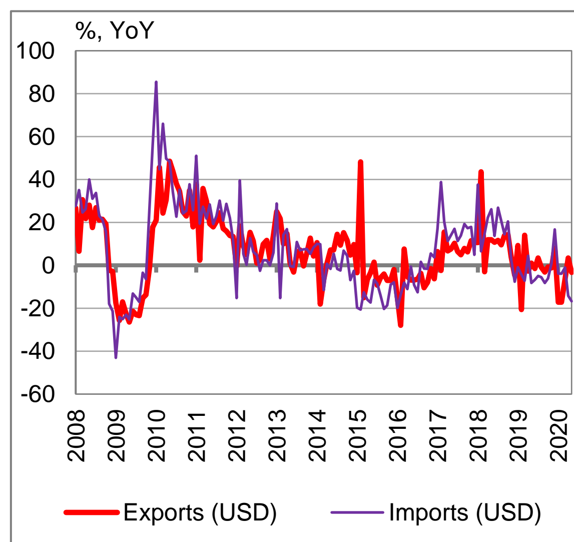


Figure 28: Weak external demand induced poor exports

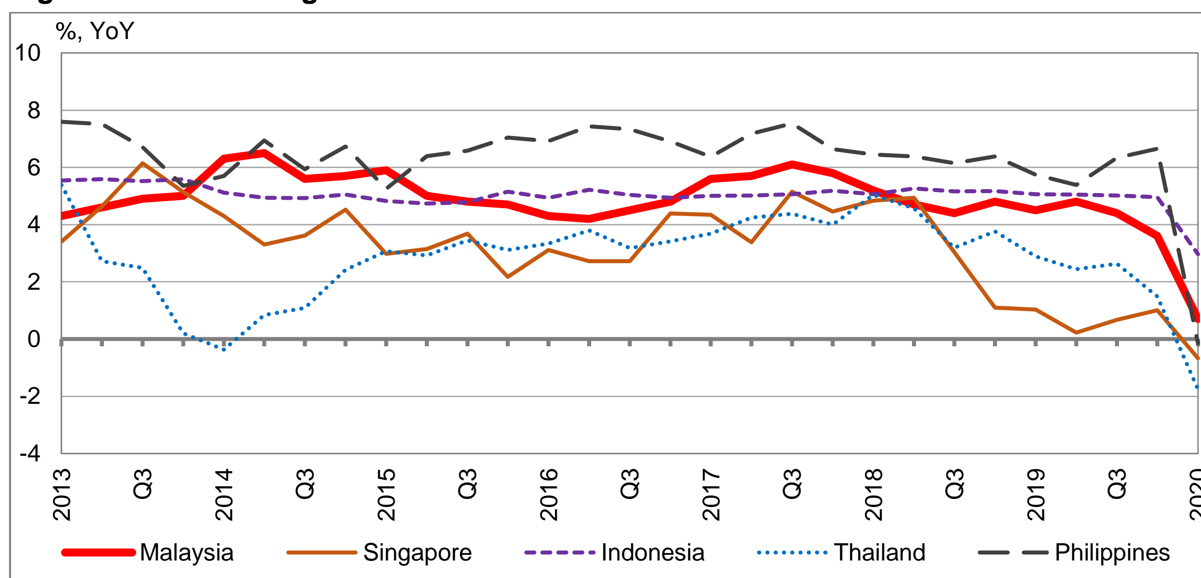


Source: National Bureau of Statistics of China; General Administration of Customs, China

ASEAN-5 ECONOMIES' KEY ECONOMIC DATA TRACKER

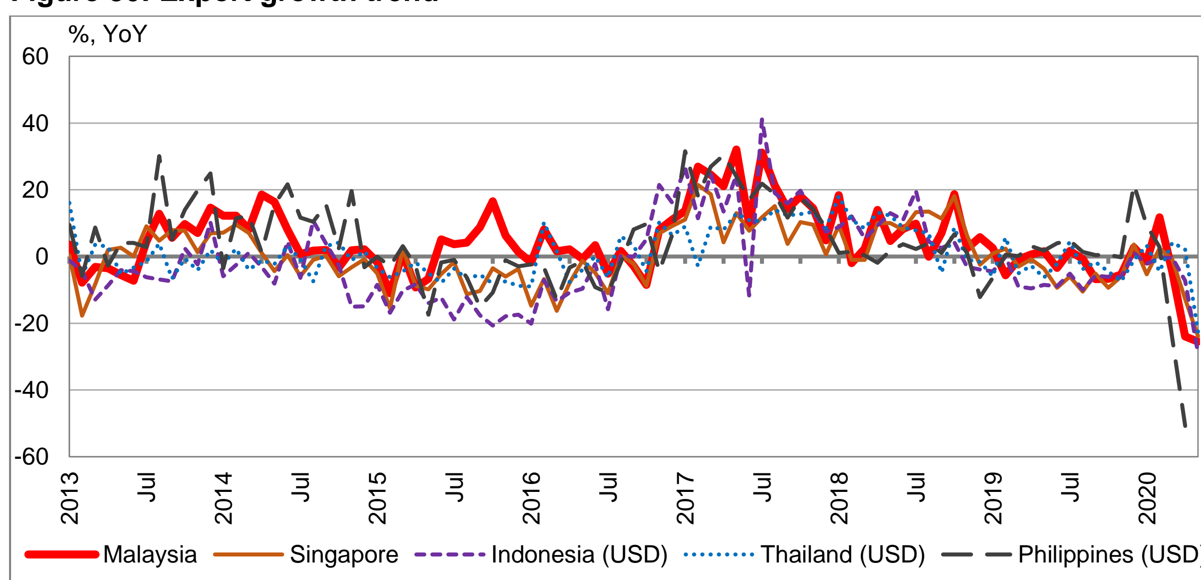
ASEAN-5 economies (Malaysia, Singapore, Indonesia, Thailand and the Philippines) showed a synchronised economic contraction or slowdown, albeit at an uneven pace in 1Q 2020, Given these economies' high trade dependent and deeply integration with the global supply chains, exports and industrial production amongst ASEAN-5 have registered strong double-digit contractions owing to the impact of varying degree of lockdown, supply chain disruptions and collapsing demand. Despite these economies have reopened, global demand is expected to remain weak. The economic prospects of ASEAN-5 would depend on the effectiveness of fiscal and monetary stimuli as well as the recovery pace of their major trading partners.

Figure 29: Real GDP growth trend



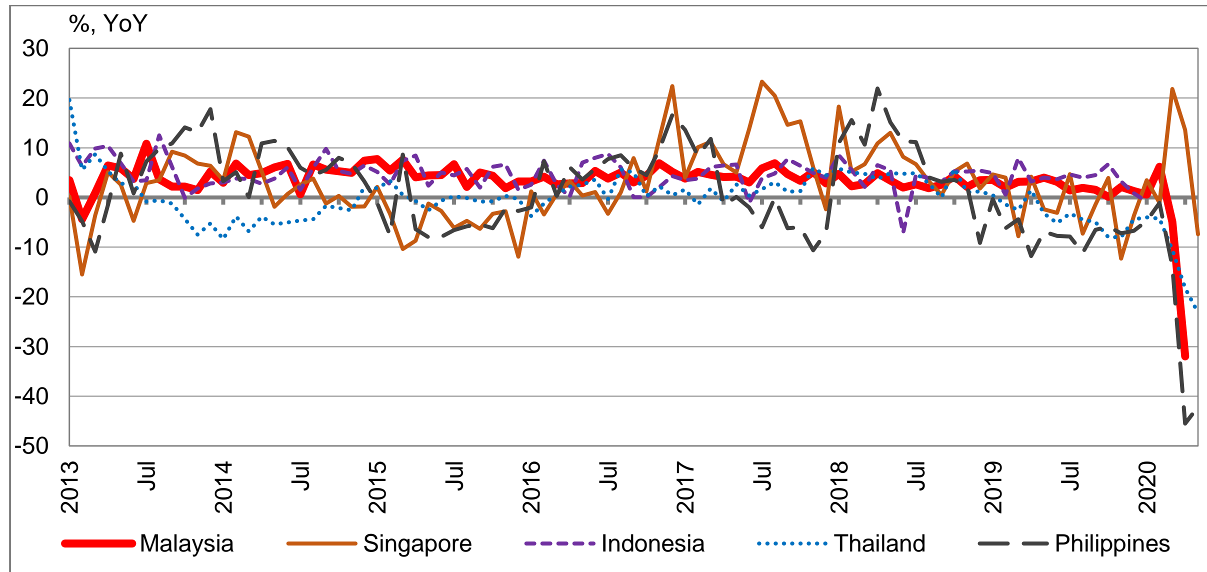
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; National Economic and Social Development Board, Thailand; Philippine Statistics Authority

Figure 30: Export growth trend



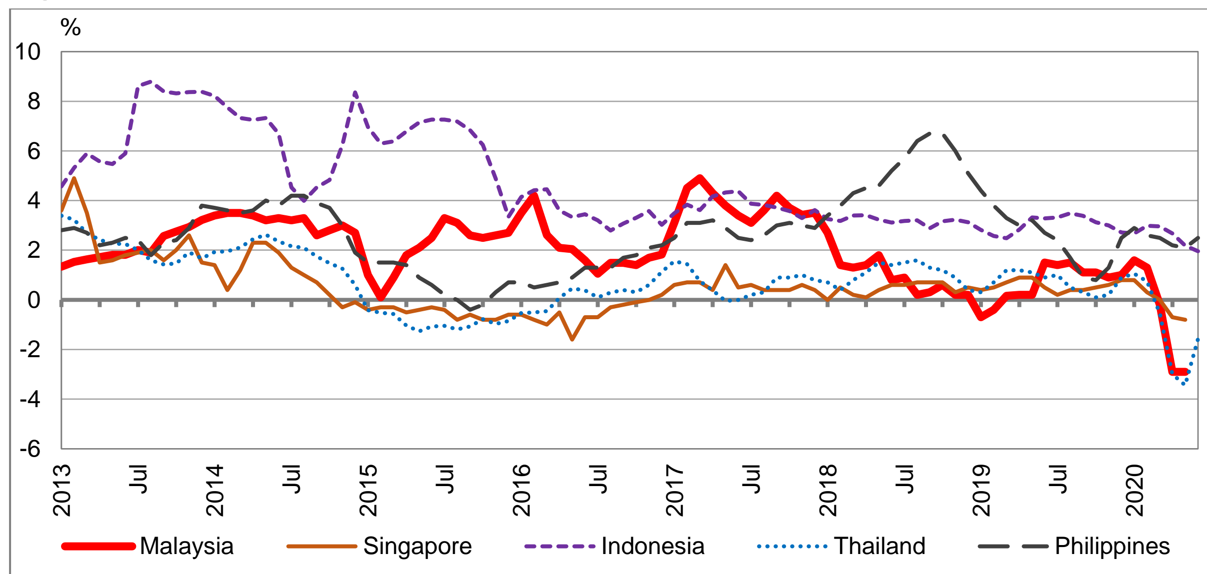
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Bank of Thailand; Philippine Statistics Authority

Figure 31: Industrial production growth trend



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

Figure 32: 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

GETTING THE ECONOMY BACK ON TRACK

From RESTART to RECOVERY. As we move into the fourth phase (Recovery) of 6Rs (Resolve, Resilience, Restart, Recovery, Revitalise and Reform) in navigating through an unprecedented pandemic triggered economic crisis, PENJANA Short-Term Economic Recovery Plan was rolled out to stabilise and revitalise domestic economic and business conditions.

In all, the combined **RM260.0 billion PRIHATIN Economic Stimulus Package and RM35.0 billion PENJANA amounted to RM295.0 billion or 21.1% of GDP**. **Direct fiscal injection** is **totalled RM45.0 billion (3.2% of GDP)**, which comprises RM35.0 billion from PRIHATIN and RM10.0 billion from PENJANA.

Higher fiscal deficit-GDP ratio of about 6.0% in 2020. The fiscal deficit is expected to march higher to about 6.0% of GDP in 2020 (-3.4% in 2019). The financing of deficit will source largely from domestic borrowing. As at end-March 2020, Federal Government's debt stood at RM823.8 billion (estimated 58.8% of GDP), has exceeded self-imposed administrative limit of 55% of GDP. Hence, there is a need to seek for Parliament's approval to relax these binding fiscal limits during the crisis period to allow funding for the fiscal stimulus and also for the forthcoming tabling of 2021 Budget on 6 November. The statutory limit was last revised higher to 45% (from 40%) effective June 2008 and to 55.0% effective June 2009.

The debt-to-GDP ratio should not be a cause for alarm in the current moment from a historical perspective as we had far higher debt to GDP ratio between 60.1% of GDP and 93.1% of GDP during the period 1982-1991. But, the Government has to carefully balance the need of having higher binding fiscal limits against the potential erosion of fiscal institution's credibility in maintaining sound fiscal management.

A debt-to-GDP ratio of 60% is quite often noted as a prudential limit, suggesting that crossing this limit will threaten fiscal sustainability. Nevertheless, the limit cannot be interpreted as being the optimal level of public debt, taking into consideration the future growth and revenue path as well as the capacity to repay during the possibility of adverse shocks.

When the economy has recovered, **the only way to avoid adding to the debt pile is to consolidate and reduce budget deficits by boosting taxes or cutting public spending**, including to rationalise the exponential growth in operating expenditure (emoluments, pension payment, supplies and services).

What have we achieved so far from PRIHATIN? The PRIHATIN has helped to blunt the blow of coronavirus on households and businesses, especially in easing cashflow burden whilst protecting jobs.

a) A survey by the Department of Statistics, Malaysia (DOSM) revealed that **96.8% of Malaysians have benefitted from PRIHATIN**.

b) **68.2% received three forms of assistance, 13.9% received two and 17.9% received only one**. A total 70.1% of respondents felt the stimulus package was effective as it reduced financial burdens during the MCO period.

c) **2.7 million jobs have been saved via Wage Subsidy Programme (WSP) (2.5 million) and Employment Retention Programme (0.2 million)**; more than **10 million individuals' cash flow burden was eased** via Bantuan Prihatin Nasional (BPN), loans moratorium and EPF's i-Lestari; and various financial assistance and loans moratorium have supported **more than 800,000 businesses and micro SMEs**.

Post COVID-19 economic recovery is likely to be gradual one. As the economy emerges from the pandemic, it is reasonable to expect domestic consumption and business capital spending to mend gradually, accompanied by a restoration of consumer confidence and business sentiment.

A significant rebound (V-shaped) in domestic stock market from the lows could well serve as a barometer that investors are feeling somewhat sanguine about the prospect of domestic economic recovery. The jury is still out.

Businesses still coping with 3Cs (Cash flow, Costs and Credit). Many businesses, especially SMEs and micro enterprises are still struggling not only coping with immediate challenges (slow demand, supply disruptions, cash flow problem and high operating costs) but also structural challenges (due to consumer protocols, social distancing, Standard Operating Procedures (SOP), intense competition in online business / e-commerce) that threaten their survival. The **three main challenges** faced by businesses were (i) **salary payment (76.6%)**; (ii) **no customer (65.5%)**; and (iii) **rental payment (61.4%)**.

Restoring confidence key to reviving economy. While external environment still matters, restoring domestic consumer and investor confidence will be the key to uplift domestic economic recovery. This must be anchored on keeping clear and consistent communication flows of the government's economic stabilisation and stimulation policies, backed by macro-economic and political stability.

The deepest shock to economic activity will be concentrated in 2Q. High frequency data (exports, industrial output, services, manufacturing sales, selected consumption and investment indicators) are in line with our assessment that the sharpest fall in economic and business activities will be concentrated in 2Q. With almost all economic sectors restarting since May, including sub-tourism sectors such as entertainment and theme parks reopening in July, it is expected that some gradual improvement in economic activities, which have begun to recover from the trough in 2Q and continued into 3Q and beyond.

Maintain 2020's GDP estimate at -3.0%. We expect the large economic contraction estimated at 11.5% yoy to hit the peak in 2Q 2020 (+0.7% in 1Q), reflecting the full impact of Movement Control Order (MCO) in April and a gradual reopening in May-June. Exports have recorded double-digit contractions of 25.5% yoy in May and 23.8% yoy in April. Retail sales and wholesale declined sharply by 32.4% and 27.6% in April. While only 141 motor vehicles were sold in April, demand for some mid-price range cars have seen crawling back decently in May and June on a month-month basis. Consumer spending and businesses are slowly on the mend. A smaller magnitude of GDP decline (-3.4%) is expected in 3Q before reverting to +2.2% in 4Q. Overall, **SERC estimates 2020's GDP to decline by 3.0%** (4.3% in 2019) and **will recover by 5.5% in 2021**.

Recovery in trade far from sight as global outlook dims. Both exports and imports contracted sharply by 24.7% and 19.2% respectively in Apr-May (1.1% and 1.3% respectively in 1Q). The exports retrenchment was due to lockdown in our major trading partners, which have restricted their consumer spending, supply chain disruptions and also the effect of lower commodity prices. The exports decline was broad-based by major items and markets. Imports contraction were across-the-board: intermediate, capital and consumption goods.

We expect the contraction in exports to continue throughout the year, with second quarter registering the worst magnitude as global demand remains depressed by measures to curb the ongoing coronavirus outbreak. The magnitude of declines will narrow markedly going into 2H 2020, thanks to some improvement in global demand following the lifting of the Great Lockdown in major advanced economies starting May. Though China was the first to lift the lockdown in April, Malaysia's export growth to China's market has been growing moderately by 4.2% and 4.5% in April and May respectively.

The outlook for global trade still grim. The World Trade Organisation (WTO)'s optimistic scenario saw a 13% drop in the volume of international trade in 2020. The last such drop was in 2009, when trade volumes fell by 12% during the Global Financial Crisis. WTO's pessimistic scenario sees the volume of global trade dropping by as much as 32% this year.

SERC estimates exports to contract by 11.2% this year (-1.7% in 2019). Some silver lining are seen coming from the semiconductor industry. According to McKinsey's report in April, the semiconductor market is expected to show a decline between 5% and 15% in 2020, with the impact varying significantly between end-user segments. While automotive and wireless communication segments are likely to decline steeply (10%-25%) and industrial to register moderate decline (1%-10%), demand from the wireline communication and 5G testing equipment segment will see a positive growth due to factors such as increased broadband usage, higher demand for cloud services, video streaming, etc. Continued consolidation of crude oil markets though prices have recovered from the lows and a weak crude palm oil price environment would restrain agriculture and mining exports earnings.

Deflation trend (not broad-based decline in prices) will last longer. Headline inflation, as measured by the Consumer Price Index (CPI), which declined by 2.9% yoy in both April and May (+0.9% in 1Q), due to continued declines in prices of transport, utilities, clothing and footwear, and non-essential items, especially household-related products and services. 27.3% of goods in the CPI basket saw decrease in prices in Jan-May 2020. Core inflation, which excludes most volatile items such as fresh food and administered prices (such as petrol) and services, still staying above 1.0%. Though fuel prices have increased month-on-month in May-Jun, the annual rate of decline will persist, albeit narrower throughout 2H 2020.

Malaysia is expected to experience sustained months of deflation, which may last longer this time round when compared to the previous episode of deflation (Jan-Nov 2009). As long as there is no broad-based decline in prices for a sustained period, says at least more than a year, it is a lesser concern about a deflation.

That said, the decrease in overall CPI will narrow in the months ahead and not all main groups will register decreases in prices. Electricity discounts have been extended by another three months to end-December 2020 from Apr-Sep. Any price increases will likely to be at moderate pace as capped by the presence of slack capacity. **Our estimated headline inflation is between -0.5% and -1.0% in 2020.**

There were ups and downs in the main groups of overall CPI basket, depending on demand and supply conditions, policy-induced (as in the case of 100% sales tax exemption on CKD motor vehicles and 50% exemption on imported cars as well as electricity tariff discounts) and demand shock (fuel prices), etc.

Accommodative interest rates to support recovery. Bank Negara Malaysia (BNM) slashed the overnight policy rate (OPR) further by 25 basis points (bps) to a record low of 1.75% on 7 July, keeping ammunition for buffer should the threat to economic growth accelerate.

Further rate cuts underscore the need to provide additional stimulus to safeguard economic activities, which have begun to recover from the trough in the second quarter. This is to ensure that a firmer recovery amid the expiry of loan moratorium in September.

BNM will continue to monitor economic conditions and credit market, and provide additional support and appropriate financial measures if necessary, which may not be confined to further cut in interest rates for now. Fiscal policy may be useful in speeding recovery from a deep recession and reducing the burden on monetary policy.

In a normal environment, lower interest rates will spur household expenditures on consumer durables as well as ease debt-service payments on existing loans and free up some cash, which really matters for highly leveraged borrowers and the B40 households. The same is true for small and medium enterprises, whose cash flow will be lifted by lower debt-service payments. It will also be cheaper for them to borrow for working capital or expansion.

But this does not mean purse strings will be loosened instantly in a low-interest rate environment. The responsiveness of consumers and businesses will be influenced by factors like income growth, employment stability as well as perception about economic and investment prospects.

Consumers also tend to spend if they are confident that Government's policies can revive economic growth timely. So, if uncertainties prevail, there will be a tendency for people to hoard cash even at record-low interest rates.

A cumulative reduction of 150 basis points (bps) in OPR since May 2019 (YTD: 125 bps) as well as RM295.0 billion PRIHATIN and PENJANA economic stimulus packages (fiscal, financial, and credit measures) have helped to limit the economic damage of the COVID-19 and lift financial sentiment, which in turn supports a gradual economic recovery.

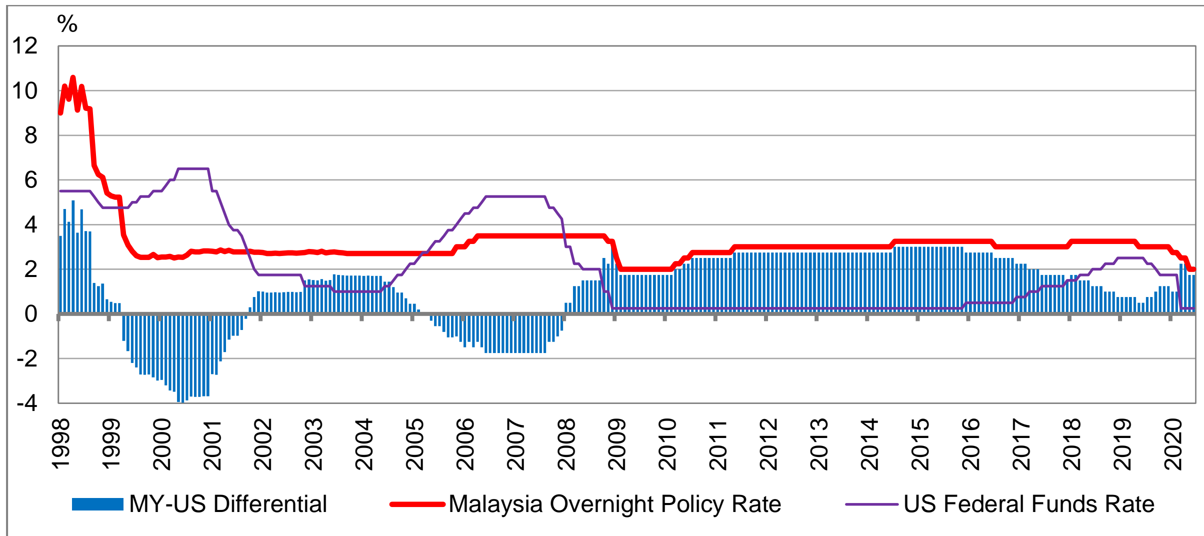
Since May, most economic sectors and businesses have gradually reopened from a lockdown amid the compliance of SOP, paving the way for the resumption of activities. Amid a restoration of confidence and continued wary about the coronavirus, consumer spending is slowly on the mend.

Table 3: Real GDP growth (% YoY)

Economic Sector [% share to GDP in 2019]	**2018**	**2019**	**2020 Q1**	**2020*e* (BNM)**	**2020*e* (SERC)**
By kind of economic activity					
Agriculture [7.1%]	0.1	2.0	-8.7	-2.9	-3.0
Mining & Quarrying [7.1%]	-2.2	-2.0	-2.0	-4.2	-3.8
Manufacturing [22.3%]	5.0	3.8	1.5	-8.6	-8.0
Construction [4.7%]	4.2	0.1	-7.9	-1.9	-1.0
Services [57.7%]	6.8	6.	3.1	2.3	-0.8
By type of expenditure					
Private Consumption [58.7%]	8.0	7.6	6.7	4.2	2.5
Public Consumption [12.2%]	3.2	2.0	5.0	5.9	5.4
Private Investment [16.8%]	4.3	1.6	-2.3	-9.7	-11.4
Public Investment [6.3%]	-5.0	-10.8	-11.3	-7.5	-6.9
Exports of Goods and Services [63.7%]	1.9	-1.3	-7.1	-13.6	-13.1
Imports of Goods and Services [56.7%]	1.5	-2.5	-2.5	-11.9	-12.8
Overall GDP	**4.8**	**4.3**	**0.7**	**-2.0 to +0.5**	**-3.0**

Source: Department of Statistics, Malaysia; Bank Negara Malaysia (Economic and Monetary Review 2019); SERC

Figure 33: Malaysia-US's interest rate differentials



Source: Bank Negara Malaysia; Federal Reserve

REVIEW OF KEY ECONOMIC AND FINANCIAL INDICATORS

Leading indicators and Industrial production

Leading indicators (LIs) anticipate that the economy will remain in contraction trajectory in the coming months. In fact, LIs have displayed some negative signals after October 2019, where the economy has begun to slow down due to global trade tension and the contraction in LI got worsen following an outbreak of the COVID-19 pandemic.

Industrial production has started to contract since March (-4.9% yoy in March and -32.0% in April) following the implementation of Movement Control Order (MCO) on 18 March. Non-essential sectors' operations were halted while essential sectors were allowed to operate around halved-capacity, causing the Industrial Production Index (IPI) to plunge by 32.0% in April (0.4% in 1Q 2020). Manufacturing output declined sharply by 37.2% in April, reflecting the full impact of MCO.

Following the reopening of economic sectors in stages starting in May, we expect both industrial and manufacturing production to improve gradually with a smaller magnitude of decline in 3Q and may revert to small positive growth in 4Q 2020.

Figure 34: Leading index declined further by 5.5% in April

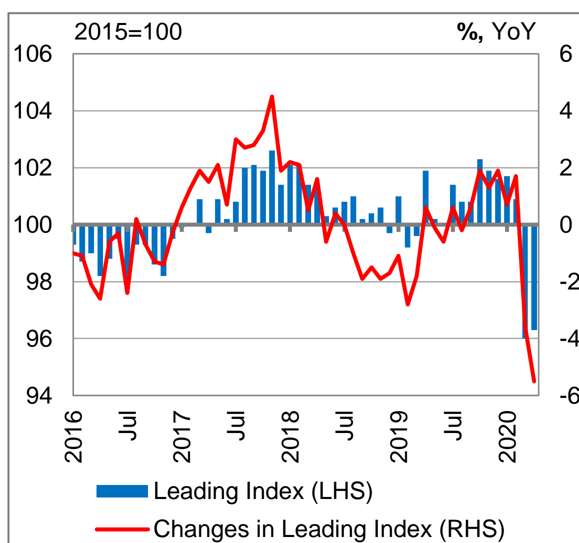
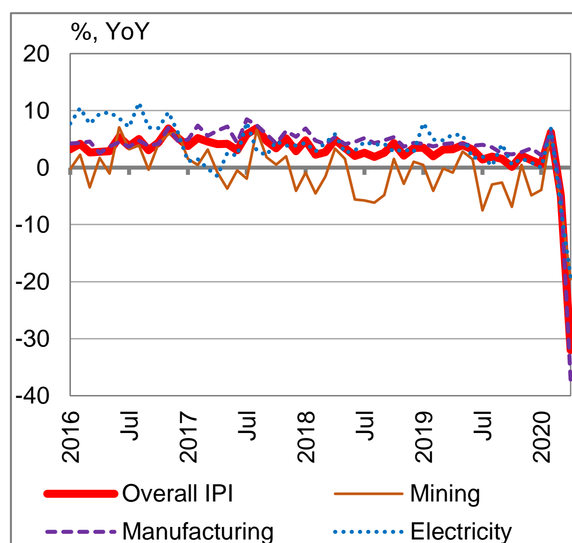


Figure 35: Industrial production nose-dived 32.0% in April as the full effect of MCO kicks in



Source: Department of Statistics, Malaysia

Exports and Distributive trade

Limited production capacity for essential sectors during the MCO period coupled with weak global demand had taken a heavy toll on **exports**, which have slumped to a ten-year low of 25.5% yoy in May (-23.9% in April and -4.7% in March). Trade balance recorded the first ever deficit in April, which last seen in October 1997. In the months ahead, exports are expected to contract further, albeit at narrower magnitude, depending on the recovery pace of our major trading partners.

Retail sales have declined substantially by 32.4% in April (-6.6% in March), where increases in sales were mainly generated from food stalls, grocery market and pharmacies only. Our channel checks indicated that footfall in major shopping malls are around 50%-70% and sales are up to 40% compared to pre-MCO. Along with inter-state travel, the opening of cinema and entertainment centres and parks as well as a gradual return of domestic inbound tourism, we expect retail spending to improve, backed by a revival of confidence.

Motor vehicles sales have plunged by 92.5% in April as the MCO has halted sales at the dealers' show room and also Road Transport Department (JPJ) to register new cars. As economic sectors have reopened in phases starting May, and coupled with tax incentives (Jun-Dec 2020) to boost passenger cars sales, motor vehicle sales growth are expected to rebound moderately in the months ahead. Some mid-price range cars have enjoyed good monthly sales in June.

Figure 36: COVID-19 sinks international trade in Apr-May

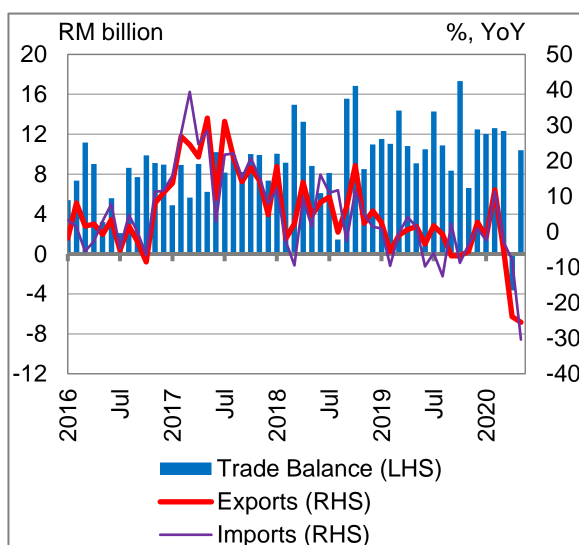
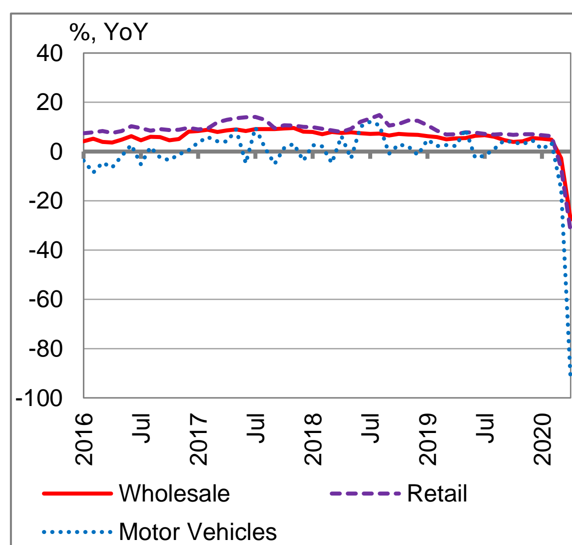


Figure 37: Dismal month for motor vehicles sales in April



Source: Department of Statistics, Malaysia

Private consumption indicators

Despite the lifting of movement restriction amid the practicing of social distancing and protective measures, consumers are generally still cautious in spending and wary about the virus. Consumer sentiments are extremely weak as revealed by MIER's Consumer Sentiments Index (CSI), which saw a plunge of 31.2 points to a 32-year low of 51.1 in 1Q 2020, as households worry about the near-term outlook.

Passenger car sales have declined almost 100% in April (-99.7% yoy to 131 units) and have picked up to 20,456 units or -63.4% in May. Helped by the tax incentives and some pre-incentive discounts, car manufacturers and distributors have received decent bookings in June with both Perodua and Proton reporting best monthly car sales for this year.

Tourism-related consumption would take some time to regain its lost ground (number of tourist arrivals dropped by 36.8% in 1Q 2020) amid the reopening of tourism sub-sectors, including entertainment parks. We expect the implementation of "Bubble Travel" amongst Green zones' countries would help to revive some extent of tourism-related spending.

The labour market conditions have turned sluggish in recent months. The number of unemployed persons increased by 261,800 to 778,800 in April 2020 from 517,000 in end-2019. Unemployment rate has jumped to 5.0% in April (3.9% in March and 3.3% in February).

As reported by PERKESO, 53,952 persons have claimed unemployment benefits as of 4 July 2020 (40,084 in Jan-Dec 2019). Nevertheless, the wage subsidy program (which has extended to six months from three months previously) and employment retention scheme come in handy to help employers preserve employment. As of 6 July, 310,622 employers were approved for the wage subsidy programme, benefitted 2.5 million employees.

It's essential to track whether the inevitable increases in wage subsidy and employment retention will see a decline as sectors have reopened because people are returning to work or because they are losing their jobs definitively.

Figure 38: Selected private consumption indicators

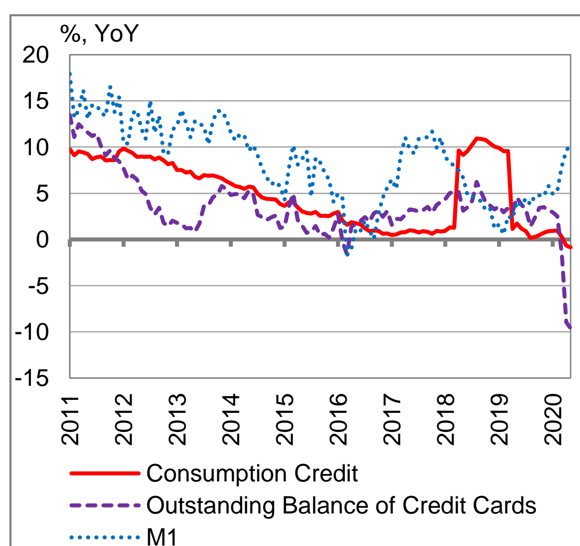
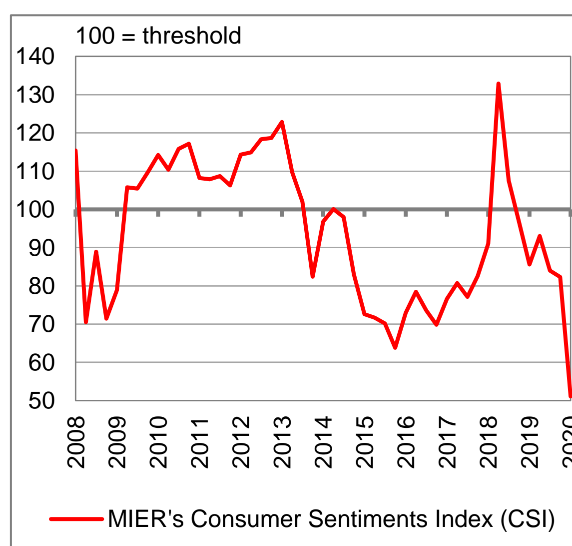


Figure 39: MIER's Consumer Sentiments Index (CSI) plunges to a 32-year low in 1Q 2020



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

Private investment indicators

Businesses remained pessimistic about economic and investment outlook as reflected in MIER's Business Conditions Index (BCI). Businesses, especially SMEs are still challenged by cash flow problem, credit cost and high operating costs though a raft of wage subsidy program, loans moratorium, soft loans and credit facilities as well as utilities discounts have helped to relieve and ease their financial burden. Imports of investment goods and intermediate goods have declined sharply by 27.8% yoy respectively in May (+68.9% and -30.6% in April respectively), indicating an unfavourable investment outlook ahead.

Private investment has declined by 2.3% yoy in 1Q 2020 (+4.3% in 4Q19) dogged by weakening economic and investment prospects. We expect private investment to contract by 11.4% in 2020 (+1.5% in 2019) as investors weighing on the COVID-19 induced economic and investment challenges, continued wary of broader political developments, including the leadership transition and policy uncertainties.

Figure 40: Selected private investment indicators

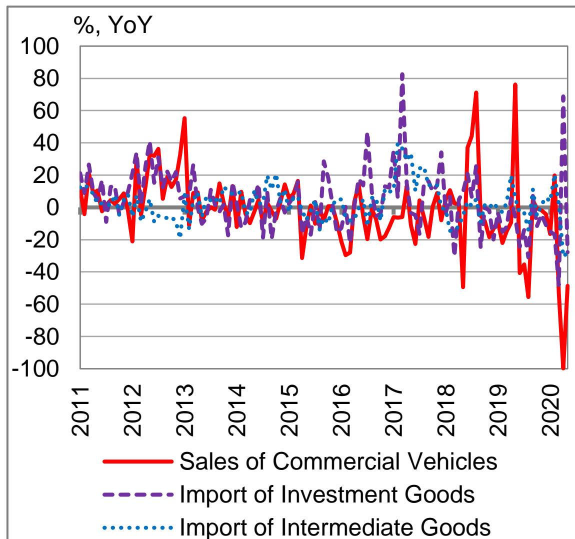


Figure 41: MIER's Business Conditions Index (BCI)

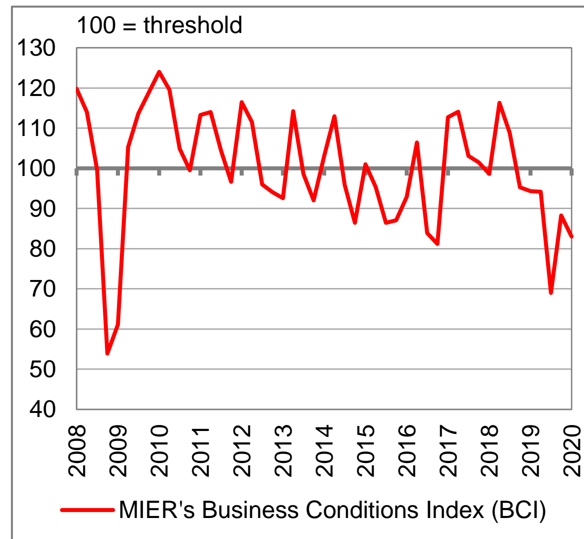
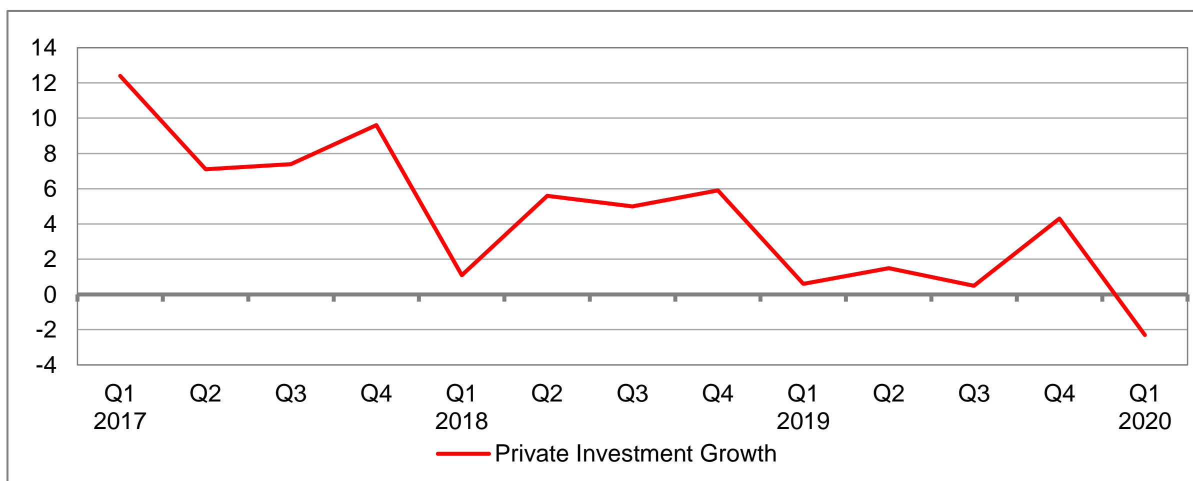


Figure 42: Private investment has been trending down in recent years



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

Price indicators

Headline inflation, as measured by the Consumer Price Index (CPI) declined by 2.9% yoy in both April and May 2020, mainly due to lower petrol prices and discount on electricity bills. The average prices of RON95 petrol were RM1.27/litre in April and RM1.30/litre in May, 37.5%-38.9% lower compared to RM2.08/litre in Apr-May 2019. Electricity tariff discounts are about 33.3% cheaper and have been extended by another three months to end-December from April to September. Another distortionary factor was 18% discount on highway toll starting February 2020. In contrary, increasing prices for precious stones like gold has acted as the lifting factor for inflation.

Overall, headline inflation has declined by 2.0% during the MCO (Mar-May 2020). Nevertheless, it is not a broad-based deflation as the underlying inflation, as measured by core inflation is still staying above 1.0%. The number of CPI items that recorded monthly price increases was higher in May (Share of CPI items with monthly price increases – 36% in May vs. 10% in April and 29% in March (average in 2010-2018: 46%) suggesting some normalisation of price pressures.

Figure 43: Deflation in April and May with disinflation in non-volatile consumer basket

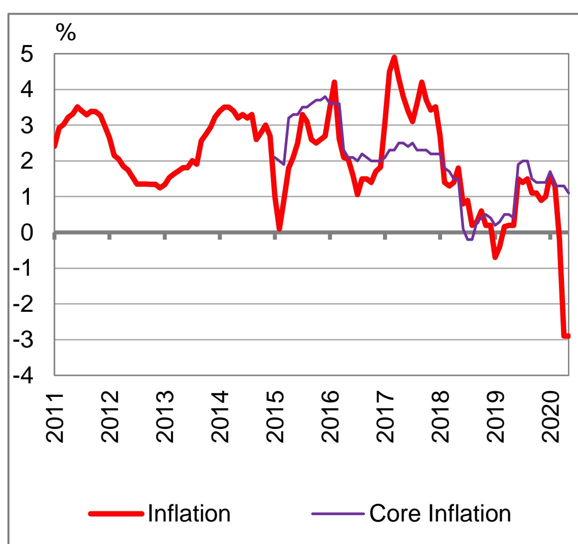
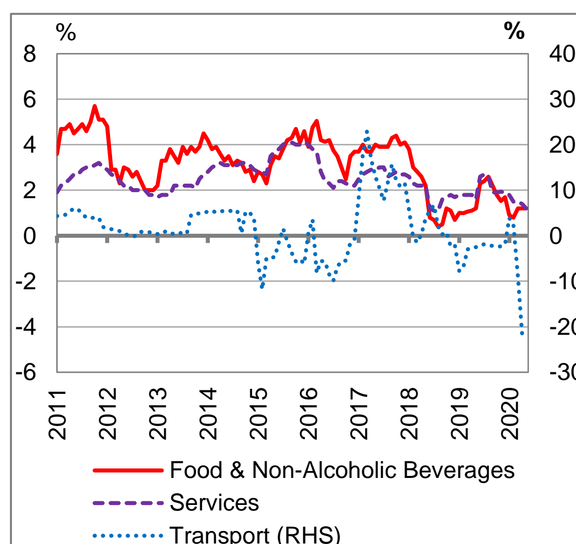


Figure 44: Transportation prices dropped over 20% in April and May, mainly due to lower petrol prices



Source: Department of Statistics, Malaysia

Banking loan indicators

Banking system's outstanding loan growth was sustained at 3.9% in May (4.0% in April), supported by stable growth in household loans (3.2% in May and 3.3% in April) and business loan (4.5% in May and 4.7% in April). This was partly thanks to loan moratorium granted for April-September, which led to a large decline in loan repayments (-29.2% in April and -22.3% in May). Loan applications, approvals and disbursement have been declining in March-May 2020, reflecting the constraints of activities during the MCO.

Outstanding loan growth is expected to edge higher in Jun-Sep as economic activities are recovering amid still subdued loan repayments. The exemption of sales tax on passenger car and stamp duty on property under the Home Ownership Campaign (HOC) in the second half-year will encourage greater consumers' lending activities.

Figure 45: Outstanding loan growth remains stable

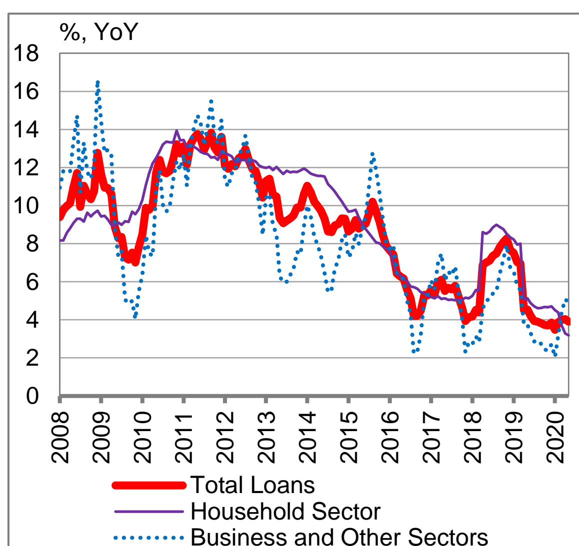


Figure 46: Loan applications growth

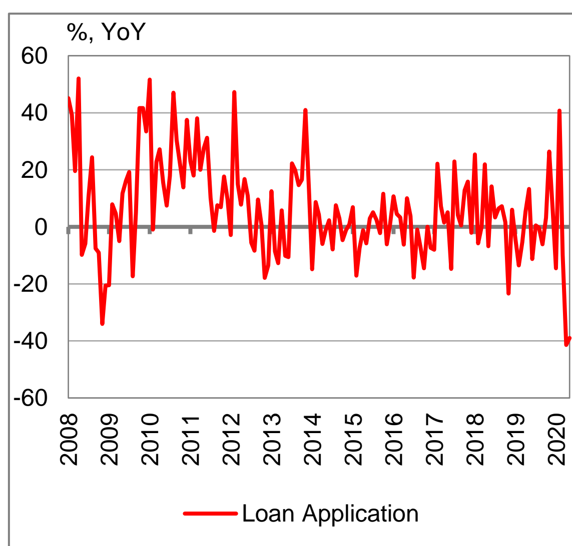


Figure 47: Loan approvals growth

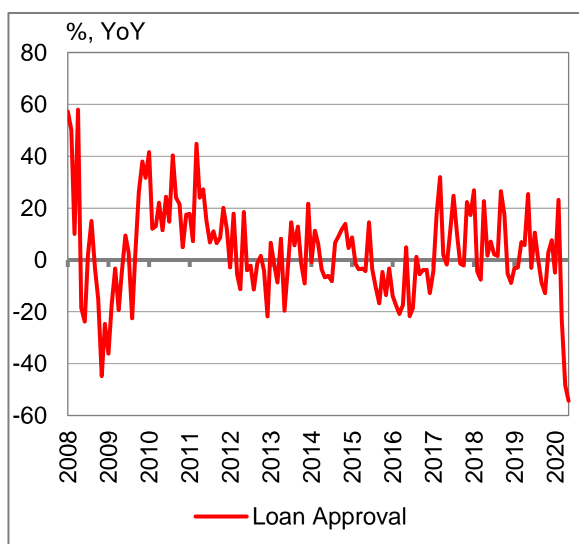
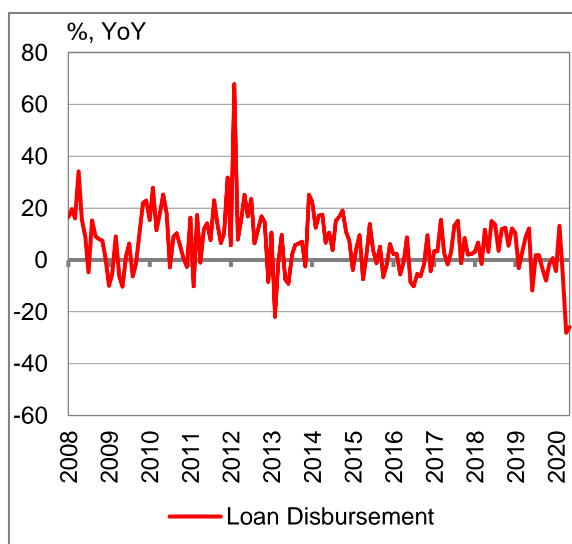


Figure 48: Loan disbursements growth



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

Financial indicators

Foreign reserves amounted to US$103.4 billion as at end-June 2020, an improvement from US$101.7 billion as at end-March but still below US$103.6 billion as at end-2019. The reserves position is sufficient to finance 8.3 months of retained imports and is 1.1 times total short-term external debt.

Faced with lingering global uncertainty and domestic political concerns, foreign investors have been selling Malaysian equities for twelve straight months since July 2019. In the first half-year of 2020, foreigners net sold RM16.4 billion of shares. As such, foreign holdings of Malaysia equities reduced to 22.3% as at March 2020. In terms of debt market, after selling a large amount (RM20.0 billion in Feb-Apr 2020) of Malaysian Government Securities (MGS), foreign investors have made a comeback by net purchased RM9.7 billion of MGS in May-Jun (RM1.9 billion in May and RM7.8 billion in June), resulting in 37.3% ownership of the MGS (41.6% as at end-2019).

The ringgit has generally performing weaker against a basket of currencies. As at 30 June, the ringgit has depreciated by 4.4% against the greenback at RM4.2800 per US dollar vs. RM4.0925 per US dollar as at end-2019. Compared to other major and regional currencies in the same period, the ringgit also depreciated against Philippine peso (6.1%), Japanese yen (5.2%), Hong Kong dollar (4.8%), euro (4.7%), Chinese renminbi (3.1%), Australian dollar (2.7%), Indonesian rupiah (1.7%), Thai baht (1.2%), Singapore dollar (1.1%), South Korean won (1.0%). **The ringgit is likely to trade between RM4.30 per US dollar at end-2020.**

Figure 49: Gradual improvements in foreign reserves

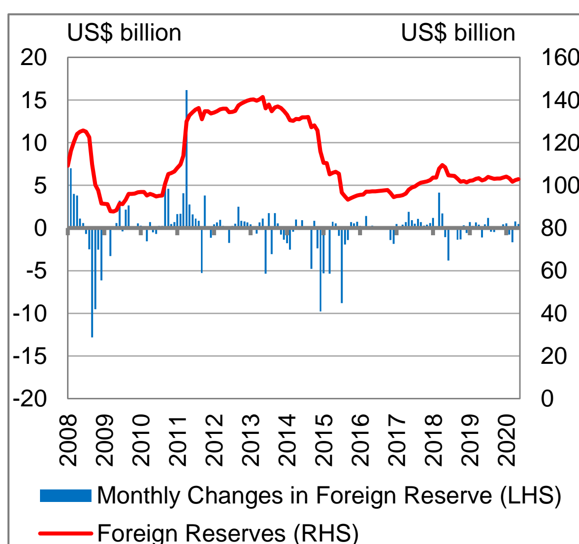


Figure 50: Ringgit's effective exchange rate (EER)

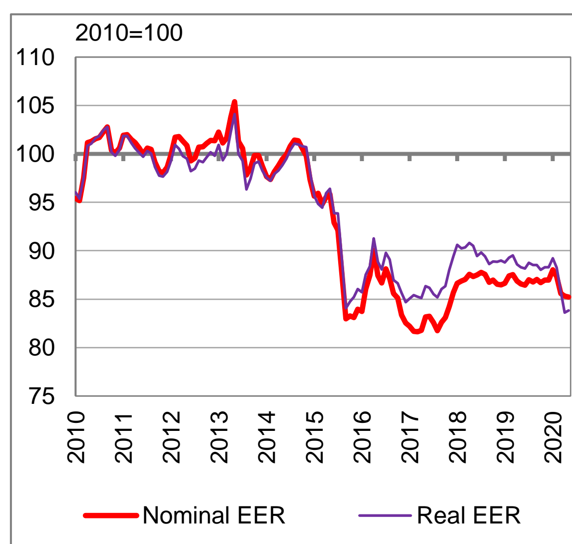


Figure 51: Ringgit against major foreign currencies

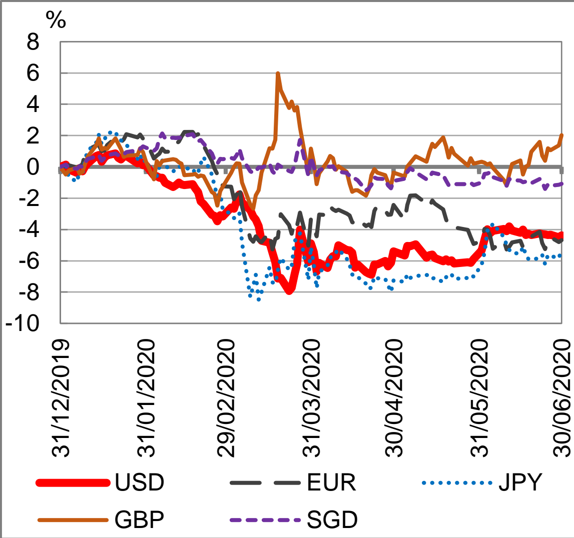
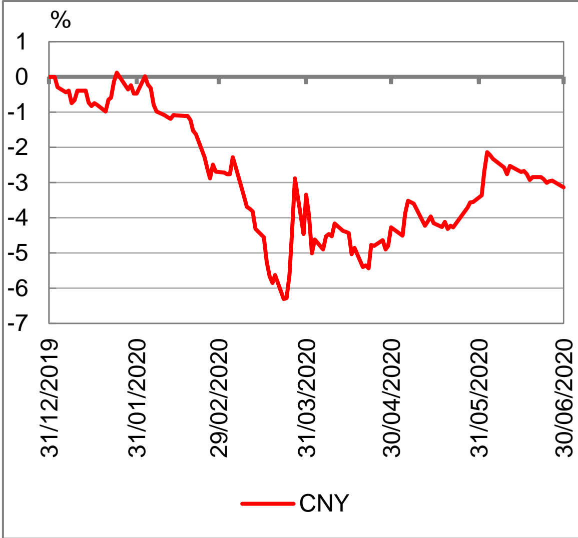


Figure 52: Ringgit against Chinese renminbi



Source: Bank Negara Malaysia; Bank for International Settlements

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