QUARTERLY ECONOMY TRACKER

(JUL-SEP 2020)

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. Teo Xinqi - *xqteo@acccimserc.com*

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A. World Economic Situation and Prospects

RECOVERY IS UNDERWAY; RISKS STILL PREVALENT

Global recovery is underway amid growing coronavirus cases. The global economy is slowly emerging from the devastating impact of the COVID-19 pandemic shock, thanks to the massive policy responses amid lingering concerns about rapidly rising infected cases and the availability of vaccines. The spike of cases in some countries in Europe and Asian have prompted fears of renewed lockdowns or stricter movement restrictions. Unlike during the first episode of virus infection, this time, governments are more well prepared to cope with it while protecting the economy.

The path of virus containment and vaccines availability hold the key. Barring unexpected major shocks, growth prospects for the global economy will critically dependent on the virus' future containment path, and ongoing policy initiatives to revitalise and ensure a sustainable recovery. The pace and strength of recovery in advanced and emerging countries will remain uneven in 2H 2020 and 2021, depending on the different economic and health protection approaches.

Uneven pace of recovery across advanced and emerging economies. Amid rising coronavirus cases and the risk of re-lockdown, our tracking of global high frequency data has indicated that global economic activities are starting to stabilise and recover gradually (or V-shaped for some data) after hitting a trough, i.e. worst economic slump in 2Q 2020, largely due to "sudden stop" of business and economic activities because of the Great Lockdown worldwide.

The US economy has started to improve as reflected in the payroll numbers and retail spending amid investors' anxiety about the Presidential Election on 3 November. In the eurozone, available data spells caution for a strong recovery in 3Q on concerns about rising new infections and the tightening of restrictions in several countries. A fairly mild rebound is expected for Japan due to subdued growth in both manufacturing and services. China is the only major economy likely to register positive growth this year, benefiting from a reopening of the global economy and robust demand for health products.

Targeted fiscal transfers and aided are still needed; interest rate stays low for years. With the economic activities still operating below pre-pandemic levels, targeted fiscal transfers and aided are still needed to support the sectors that would take a longer time to recover, and these include the aviation industry, travel and tourism, small businesses and the vulnerable households.

While fiscal stimulus holds the key, the economy also needs low interest rates and targeted financial facilities to support households and businesses. We believe that Governments and central banks worldwide remain committed to deploy all tools at their disposal to ensure a strong and sustainable economic revival in 2021-2022.

Top five risks that may temper the global recovery: Given that the global economy is at an early stage of recovery, it remains susceptible to shocks and events that may undermine investors' confidence and cause a shift in market sentiment. The US Presidential Election on 3 November is the key upcoming event and the main political uncertainty until year-end. The five key risks are: (a) **New lockdowns to control a sharp spike in infection cases** (a second wave or a third wave) may threaten the global recovery; the longer-than-expected vaccines availability would dampen confidence; (b) **Premature withdrawal of fiscal stimulus and monetary accommodation**. Central banks are expected to remain in accommodative mode for some time. Fiscal stimulus is still needed as a reduction of public-sector demand would trigger a renewed contraction of the economy; (c) **A sudden reversal of investors' positive optimism towards the stock markets** on worries about the worsening economic outlook, could trigger sharp capital outflows and the tightening of global financial conditions; (d) **Lingering uncertainties about the US-China's tensions on trade and technology as well as political relations**; and (e) **Geopolitical events**, including political events.

B. Malaysia's Economic and Financial Conditions

HARNESSING THE RECOVERY PATH TO THE NEXT NORMAL

The worst of economic contraction in 2Q 2020 is behind us. Malaysia's real GDP contracted sharply by 17.1% yoy in the second quarter of 2020 (+0.7% in 1Q), the deepest one quarter slump in Malaysia's economic history on record. What had caused a RM1.5 trillion economy came to a screeching halt in 2Q was "sudden stop" in economic and business activities due to the Movement Control Order (MCO).

In layman terms, the sharp decline in GDP means that total market value of goods and services produced and consumed by domestic residents (Government, households and businesses) declined by RM69.1 billion or RM759.1 million per day during the period April-June to RM301.9 billion in 2Q 2020 compared to RM371.0 billion in 2Q 2019.

With the exception of a near flattish growth in the agriculture sector, other economic sectors fell sharply, with the services sector leading the pack to contract substantially by 16.2% yoy in 2Q 2020 (+3.1% in 1Q), followed by manufacturing (-18.3% vs. +1.5% in 1Q).

The movement restrictions during the MCO, loss of employment and income also took a heavy toll on domestic demand. Amid buffered by cash transfers and financial relief such as loan moratorium, private consumption had collapsed to -18.5% yoy in 2Q from +6.7% in 1Q while private investment contracted further by 26.4% in 2Q (-2.3% in 1Q) as investors halted capital spending on worries about the severity of COVID-19 pandemic impact on domestic economy. The external sector also shattered as reflected in a plunge in real exports (-21.7% in 2Q vs. -7.1% in 1Q) due to the supply chain disruptions and curtailed in global demand. Real imports too declined sharply by 19.7% in 2Q (-2.5% in 1Q), a reflection of a sharp retrenchment in domestic demand.

Economic indicators show signs of recovery, albeit unevenly. SERC concurs with Bank Negara Malaysia's assessment that the "shock" pandemic economic contraction has hit a trough in 2Q and the stabilisation has started to trickle in since June, raising cautiously optimism that real GDP will show a much more moderate pace of decline or positive growth in 3Q and 4Q 2020 respectively. The risk to our expectations lies in the virus development following the recent spike in new infection cases, prompting the implementation of Targeted Enhanced Movement Control Order (TEMCO) in some areas in Sabah.

We caution that an occurrence of a third wave of coronavirus would temper the hopeful of an economic improvement in 2H 2020. **SERC estimates the economy to decline by 4.0%, a revision from -3.0% previously (vs. BNM's revised estimates of between -3.5% and -5.5%) in 2020. For 2021, we expect a decent rebound in economic growth to 5.0% on the assumption of a stronger growth upturn in 2H 2021 (vs. BNM's projections between 5.5% and 8.0%).** We err on the conservative side as the pace and strength of recovery is critically dependent on the path of virus and vaccines development as well as a sustained revival of private sector's growth.

Malaysia's economic recovery tracker. Brutal numbers in March, April and May have turned around to show either shallower declines on an annual comparison basis or positive month-on-month growth in high frequency factual data in June, July and August. Anecdotal evidence and our channel checks indicate mixed consumer spending and business sentiment on the ground.

We reckon that uneven pace of recovery is seen as travel and tourism, aviation industry as well as small businesses would take some time to recover. While the bouncing back of domestic in-bound tourists provides some support to tourism sector, a delay re-opening of borders to international travellers means that a full-fledged revival is only expected in late 2021 or 2022. The recovery path of the aviation industry will go beyond 2022.

Some businesses' capacity was permanently destroyed (closing down of businesses or capacity reduced due to social distancing (such as in restaurants and hotels, etc.). Overall productivity growth is dampened by a reduction in labour participation rate due to massive job cuts.

With the emerging of incipient signs of stabilisation and green shoots, albeit unevenly, the economy is looking to improve gradually in the third quarter onwards and provides a meaningful rebound in 2021 to contrast with the unprecedented slump in 2Q 2020.

a) **Malaysia's leading index**, which gauges future economic direction registered **an annual increase for three consecutive months** (7.7% yoy in July; 4.6% in June and 0.6% in May), indicating a bright prospect of economic recovery towards early 2021.

b) The Department of Statistics of Malaysia (DOSM)'s compiled **monthly GDP** suggested that economic activity has picked up somewhat as the rate of economic decline has narrowed substantially to -3.2% yoy in June from -19.5% in May and -28.6% in April.

   The manufacturing sector has rebounded to increase by 4.5% in June (vs. -18.3% in 2Q 2020), followed by a double-digit 11% increase in agriculture output (+1.0% in 2Q). On somewhat cautiously positive signs, the declines in output have narrowed sharply in the construction sector (-12.7% in June vs. -44.5% in 2Q 2020); mining and quarrying sector (-16.4% in June vs. -20.0% in 2Q); and service sector (-6.0% in June vs. -16.2% in 2Q).

c) **Industrial output**, a proxy of overall economy has turned around to a positive growth (1.2% in July from -17.9% in 2Q), with the manufacturing sector growing by 2.9% in July for two consecutive months (4.7% in June).

d) **Manufacturing sales**' contraction, which had hit the bottom in 2Q, have gradually recouped lost ground. It increased by 1.9% in July and 4.2% in June as against -20.4% in May and -33.0% in April.

e) **Exports** have reverted to decline by 2.9% in August after recorded two successive months of positive growth in June (8.0%) and July (3.1%) vs. -26.0% in May and -24.9% in April. The main supports of exports were electronics and electrical products, palm oil, optical and scientific equipment, furniture and rubber gloves.

   With our major trading partners, especially China and the US economy and some regional economies are mending gradually amid the recent surge in infection cases in some countries, reigniting fears of the re-imposition of lockdown or stricter movement restrictions, we expect exports to slowly on the mend. With exports declined by 5.8% in the first eight months of 2020, we have revised **2020's exports estimate to decline by 5.0%** from -11.2% previously in 2020 (2019: -0.8%).

f) **Retail sales** have declined by a smaller magnitude of 3.8% in July (-9.2% in June vs. -32.4% in April and -16.1% in May respectively).

g) **Jobless rate continued to ease for two consecutive months** (4.7% in July and 4.9% in June) from a record high of 5.3% in May. This has translated into a reduction of 81,000 persons to 745,100 unemployed persons in July compared to 826,100 unemployed persons in May. Another encouraging development is **the Employment Insurance System (EIS) has reported lower number of employment losses** to 6,561 persons for 1-27 September, 9,261 persons in August and 16,660 persons in July from the peak of 18,579 persons in June.

   Given that the unemployment rate is a lagging indicator, it takes some time for the number of unemployed persons returning to pre-pandemic level of an average 500,000 persons.

h) **Domestic inbound tourists** have seen coming back as reflected in a gradual improvement in hotels' occupancy rates averaging 45.4% in August (35.4% in July) compared to between 8.3% and 16.4% in Apr-Jun. Hotels' occupancy rates in Pahang are 75.1%-82.8%; Perak (54.7%-60.4%); Terengganu (64.9%-54.0%); PD (70%-80%); Penang around 48%-49% and Ipoh (50%) in July-Aug.

Deflation rate will narrow further. The decline in the Consumer Price Index (CPI) – deflation remains stable in August (-1.4% yoy vs. -1.3% in July and -2.6% in 2Q), thanks to smaller magnitude of declines in prices of transport, clothing and footwear and non-essential items, especially household-related products. In Jan-Aug, CPI declined by 1.0%.

The deflationary pressure will continue to ease in the months ahead to low single-digit levels, assuming no major oil price shock that could cause a sharp fall in fuel prices of the CPI basket. Food prices, especially vegetables saw price increases due to monsoon season-induced supply disruption. We now estimate **headline inflation to decline by 1.0% in 2020 and will increase by 1.0%-1.5% in 2021**, reflecting a gradual improvement in domestic demand amid the prevalence of spare capacity.

Bank Negara Malaysia takes a pause in its rate-cutting. Bank Negara Malaysia (BNM) has kept the overnight policy rate (OPR) unchanged at 1.75% after frontloading a cumulative reduction of 125 basis points (bps). The pause in interest rate cut is deemed appropriate, allowing the central bank to assess the impact of successive rate reductions while keeping some ammunition to buffer against the threat of tempering the tempo of economic growth traction.

We believe that a cumulative 150 basis points reduction in the OPR since May 2019 together with other financial assistance and relief measures are expected to provide much needed stimulus to the economy. Targeted fiscal stimulus and aided are still essential to support domestic demand.

As alluded by BNM, given the outlook for growth and inflation, the Monetary Policy Committee (MPC) considers the stance of monetary policy to be appropriate and accommodative. We believe that BNM remains committed to utilise all policy tools to ensure a sustainable path of economic recovery.

The 2021 Budget on 6 November calls for targeted fiscal expansionary stance. BNM's monetary policy and liquidity measures will remain supportive in the foreseeable future. Therefore, fiscal policy will be the key policy variable going forward to support domestic demand.

Amid early signs of recovery, fiscal support measures must be renewed periodically and still needed to support the sectors that would take a longer time to recover, and these include the aviation industry, travel and tourism, small businesses and the vulnerable households and employees.

It's not about only getting the right macro and growth narrative; the implementation of impactful policies must remain squarely in focus. Bank Negara Malaysia still has some policy levers and has done what it can in terms of frontloading interest rates cut to a historical low and implementing an unprecedented array of financial facilities, financing relief and liquidity injection programs.

It’s now up to the Federal Government to flex its fiscal spending power. How much budget deficit spending and debt it willing to commit in the tabling of 2021 Budget on 6 November 2020?

With the Federal Government’s direct debt ceiling raised by 5% from 55% of total GDP presently to 60%, allowing it to borrow between RM70 billion and RM75 billion based on total nominal GDP value of RM1.4-1.5 trillion.

We expect the **Federal Government to plan a budget deficit of 5.5%-6.0% of GDP for 2021** (estimated 6.0%-6.5% of GDP in 2020).

The 2021 Budget expenditure programs and measures should be targeted and prioritized to help the nation reset, revitalise and recover from the pandemic crisis.

a) Protect the vulnerable B40 households and affected sectors of society, boost purchasing power, revitalise domestic and foreign investment and create more jobs as well as improve income.

b) Priority programs and initiatives to accelerate the adoption of digital technologies, to expand healthcare, industrial development, agriculture and entrepreneurship as well as the empowerment of women and youth. Micro-economic policies that promoting small enterprises, self-employment, multiple-skills, productivity, innovation and creativity must be explored in these challenging times.

Fiscal measures and programs can be considered to support domestic demand, especially speeding up the implementation of small and mid-sized projects; on-going and new public infrastructure projects; targeted cash assistance for the most vulnerable group; e-spending voucher; local travel cum shop discount vouchers to support domestic tourism and retail sector; tax holiday for individuals; co-sharing of wage scheme to help hiring of fresh graduates and unemployed; start-ups capital grant to incentivise youth entrepreneurship; facilitation support programs for e-commerce and digitalisation; and encourage agro-food and agriculture entrepreneurship.

GLOBAL ECONOMY – RECOVERY IS UNDERWAY; RISKS STILL PREVALENT

A global recovery is emerging though the path ahead still full of uncertainty. The global economy is slowly emerging from the worst of economic slump, thanks to a gradual resumption of business and economic activities post re-opening of economy after the Great Lockdown. The initial rebound, albeit unevenly for some sectors reflects the lifting of severe restrictions to contain the virus, but **the pace and strength of recovery is critically dependent on the future path of virus and vaccines development, which is anticipated to be available in 2021**.

The recent spike in infection cases in some advanced countries and regional economies have stirred fears of re-lockdown or stricter movement restrictions to contain the spreading of a second wave or third wave of virus. In this regard, policy makers have warned against premature optimism that the recovery is intact, and hence, both fiscal stimulus and monetary accommodation are essential to aid the recovery.

Global economic recovery tracker. Anecdotal evidence and factual facts suggest that a return to economic normality will take some time to restore back to pre-pandemic levels. This is particularly challenging for the labour market as the unemployment rate is a lagging indicator and job openings are still well below usual levels.

While household spending, which makes up the largest part of the economy in most countries, have seen making purchases but **confidence about the virus containment and vaccination are needed for a full recovery**. The same goes to a revival in private and business capital spending, which will see a sustained turnaround if businesses and investors are confident that the pandemic is under controlled to protect public health risk. The aviation industry, travel and tourism sector are most impacted by the travel restrictions.

While more discerning trends of stabilisation and recovery are expected in the months ahead, albeit an uneven pattern, we caution that the recovery path is risking of being knocked off course by any future re-tightening of movement restrictions.

a) **OECD leading indicators slow but off the lows.** The OECD's Composite Leading indicators, which tend to precede economic turning points by about six months, rose slightly in July and August after rebounding in May and June after economies have reopened. It signals that the pace of rebound in the world's leading economies still slow and remains below pre-crisis levels.

b) **Global PMIs show further rise.** The worldwide composite PMI readings for August (52.4), up from 51.0 in July, its highest since March 2019, indicating a further strengthening of global economic growth on continued recovery from the reopening of economy. New business inflows also accelerated and a renewed rise in backlogs of work. The improvement reflected faster rates of expansion across both manufacturing and service sectors. Factory output rose at the steepest rate for 28 months while service sector growth lagged behind, albeit registering the strongest expansion since January.

c) **Industrial production index's** rate of decline continues to narrow as companies and industries increased production to clear backlog orders and meet increased demand for electronics and technology applications and healthcare products as well as protective gears.

d) **Global trade volume** though continues to decline but at a smaller magnitude. Container shipping activity and volume are already back at decent levels, with ship movements in the America, Asia and Europe normalizing. Global trade is on course to recover as the world's leading economies, particularly China's exports have picked up while imports have declined smaller. Exports in some regional economies have also turned around to positive growth as the supply chain disruptions restored, backlog orders were filled and increases in demand for electronics as well as the strengthening of commodity prices.

Given that the global economy is at an early stage of recovery, it remains susceptible to shocks and events that may undermine investors' confidence and cause a shift in market sentiment. With the virus's infection cases spiking unstoppable globally and the availability of vaccines not seen in the near-term, the following top five risks that could derail the global economy or financial markets. The US Presidential Election on 3 November is the key upcoming event and the main political uncertainty until year-end.

a) **New lockdowns to control a sharp spike in infection cases** (a second wave or a third wave) may threaten the global recovery; a longer-than-expected vaccines availability would dampen the confidence of both consumers and businesses, which are needed for a full recovery;

b) **Premature withdrawal of fiscal stimulus and monetary accommodation.** Central banks are expected to remain in accommodative mode for some time. Fiscal stimulus is still needed as a reduction of public-sector demand would trigger a renewed contraction of the economy if private sector has not recovered to take up the slack;

c) **A sudden reversal of investors' positive optimism towards the stock markets** on worries about a delay in global recovery or worsening economic outlook, could trigger sharp capital outflows and the tightening of global financial conditions;

d) **Lingering uncertainties about the US-China tensions** on trade and technology as well as political relations; and

e) **Geopolitical events, including political events** that could lead to a reversal in investors' sentiment.

Table 1: Real GDP growth (% YoY)

	2018	2019	2020 Q1	2020 Q2	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	3.0	2.2	0.3	-9.0	-8.0	-6.1	4.5	4.0
Euro Area	1.8	1.3	-3.2	-14.7	-10.2	-9.1	6.0	4.5
China	6.7	6.1	-6.8	3.2	1.0	2.0	8.2	7.9
Japan	0.3	0.7	-1.8	-9.9	-5.8	-6.1	2.4	2.5
India	6.1	4.2	3.1	-23.9	-4.5	-3.2	6.0	3.1
Malaysia	4.8	4.3	0.7	-17.1	-3.8	-4.9	6.3	6.3
Singapore	3.4	0.7	-0.3	-13.2	-	-	-	-
Indonesia	5.2	5.0	3.0	-5.3	-0.3	-1.6	6.1	4.4
Thailand	4.2	2.4	-2.0	-12.2	-7.7	-8.3	5.0	4.9
Philippines	6.3	6.0	-0.7	-16.5	-3.6	-6.9	6.8	5.3
Vietnam	7.1	7.0	3.7	0.4	-	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; East Asia and Pacific Economic Update, Oct 2020)

Monetary accommodation remains. Given the current uneven recovery backdrop and worsening pandemic situation globally, central banks are expected to remain in accommodative mode for several years to come. We expect the central banks to remain committed in using all tools to aid the economy.

The premature withdrawal of interest rate easing would risk tempering the pace of recovery. The normalisation of interest rates in major advanced economies, if any, probably starting late 2021 or in 2022 will be on a measured pace.

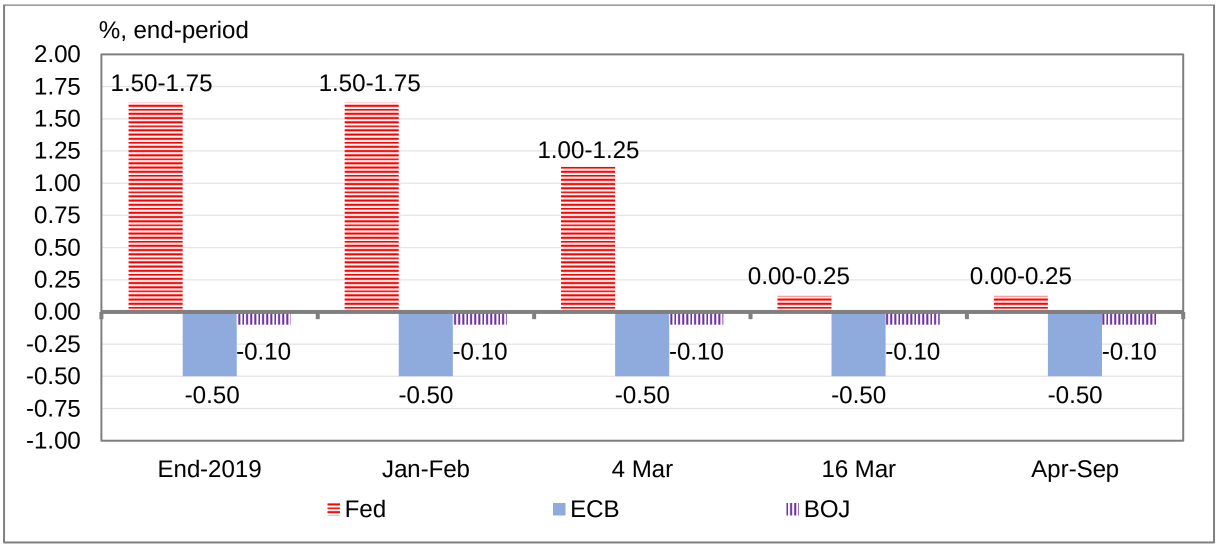
The Federal Reserve has announced a new approach to "average inflation targeting", which will be more inclined to allow inflation to run higher than the standard 2% target before hiking interest rates. The move means the Fed will be less inclined to hike interest rates when the unemployment rate falls, so long as inflation does not creep up as well. This could keep rates lower for a longer while. In its September's projection, the Fed expects to keep the current policy rate at least until 2023 where the Board expects inflation will reach their targeted 2% by that time.

Table 2: Policy rate (%)

End-period of	2008	2009	2010	2011	2012	2016	2017	2018	2019	2020 (Sep)	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	4.00	3.75
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

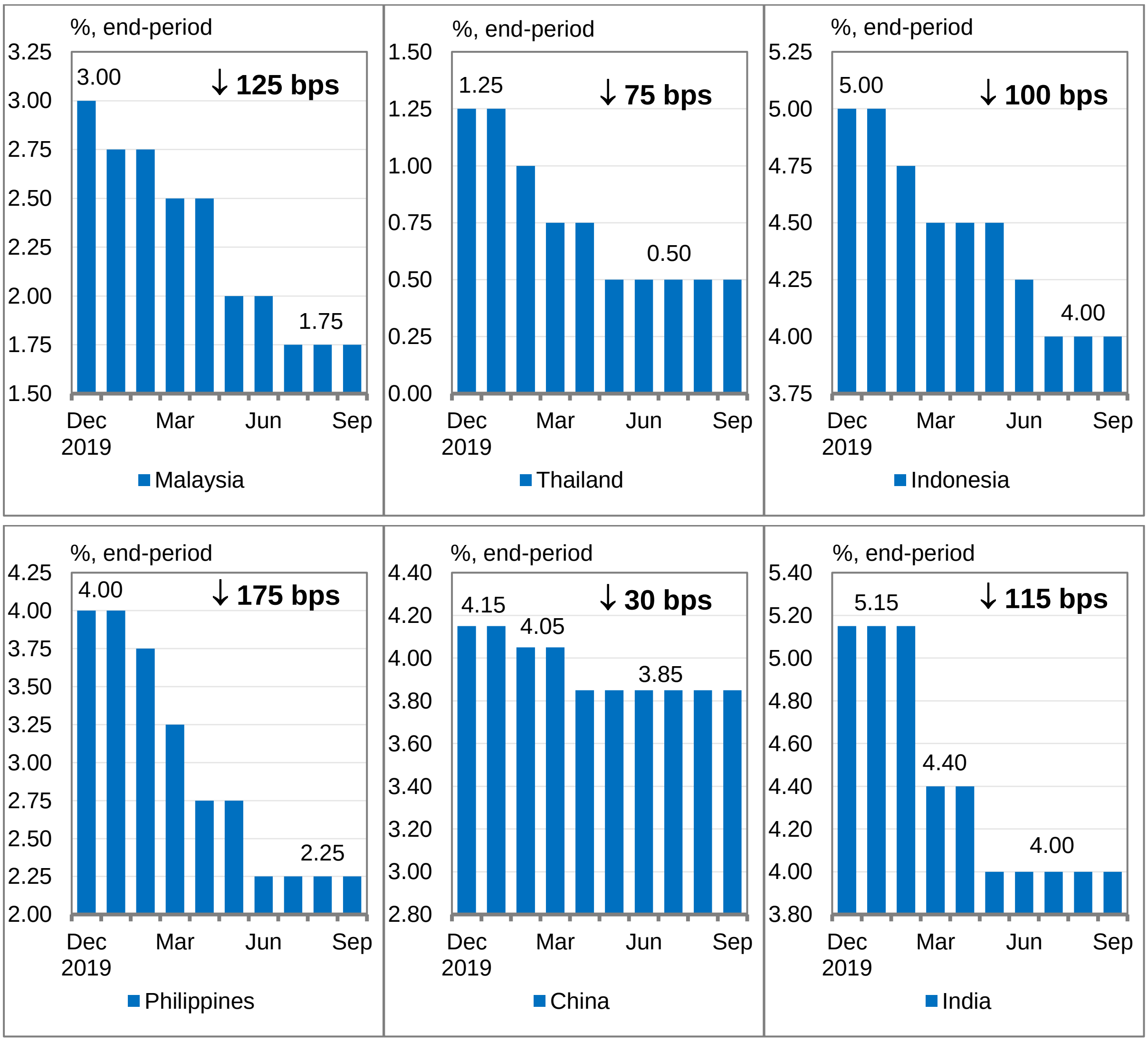
Source: Officials; SERC

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



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

CURRENT AND FORWARD INDICATORS

A slew of high frequency data suggests that the decline in growth of the global economy has reached the bottom in 2Q 2020, with activity now being set for a recovery over the coming months. The recent spike in virus infection cases globally reignites fear of the possibility of future lockdowns. The path ahead still highly uncertain. Confidence about virus containment and the availability of vaccines are needed for a full recovery.

a) The **OECD Composite leading indicators** (CLIs), a gauge of future economic growth for August continued to strengthen from the COVID-19 crisis lows, the pace of recovery has slowed and CLIs remain below the levels recorded prior to the initial COVID-19 outbreak.

b) **Global Purchasing Managers Index (PMI) for manufacturing and services** have recovered to improve gradually, with the index staying above an expansionary track in July and August, backed by an improving consumer demand on easing unemployment.

c) **Global trade volume and industrial production** declined by a smaller magnitude as the reopening of economy has eased both supply and demand shocks.

d) **Global semiconductor sales** continued to expand steadily for six consecutive months since February with uneven pace among the regions.

e) **Average Brent crude oil prices** have edged higher for the period 1 Jul-28 Sep (US$42.99/bbl vs. US$29.70/bbl in 2Q), taking to an average of US$41.16/bbl as of 28 Sep 2020. The oil market is expected to revive gradually on continued weak global demand relative to inventory amid the continued output cut by OPEC+ members. The U.S. Energy Information Administration (EIA) projects that Brent crude oil prices to average at US$41.90/bbl in 2020 and will climb higher to US$49.07/bbl in 2021 in its monthly Short-Term Energy Outlook in September.

f) **Crude palm oil prices** continued to firm, underpinned by an improving demand and a reduction in stocks. CPO prices averaged RM2,545.50/mt in Jan-Sep 2020. CPO prices are expected to average RM2,500-RM2,600/mt in 2020 and RM2,400-RM2,500/mt in 2021 respectively.

Figure 3: CLIs signal moderating pace of growth

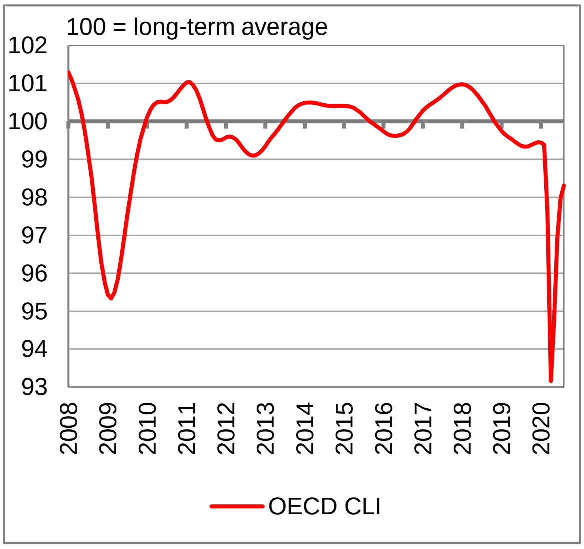
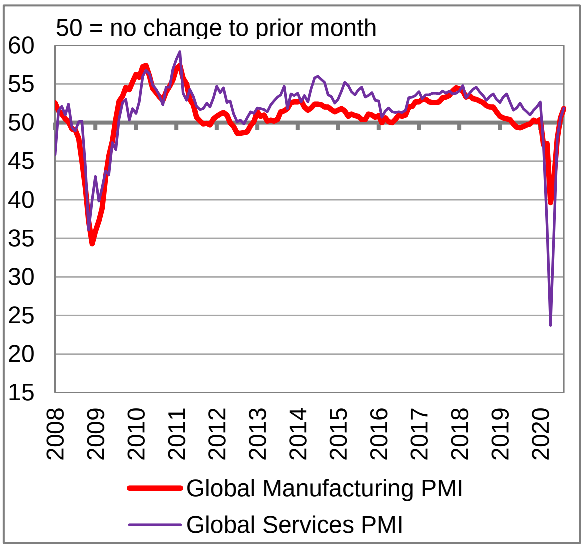


Figure 4: Growth of global output and new orders accelerate



Source: OECD; Markit

Figure 5: World trade volume and industrial production growth are recovering from the slump

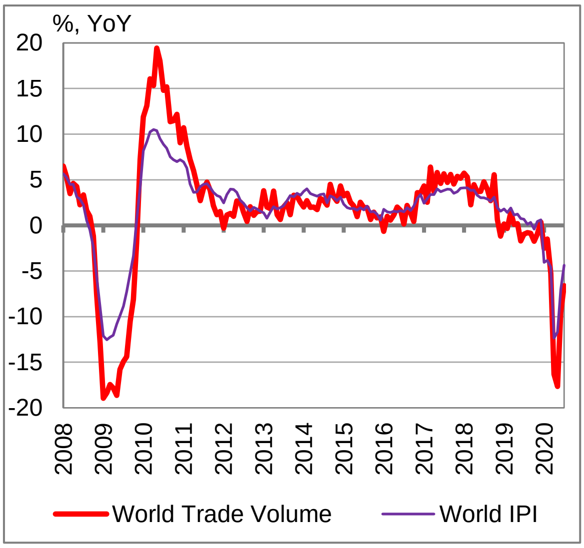
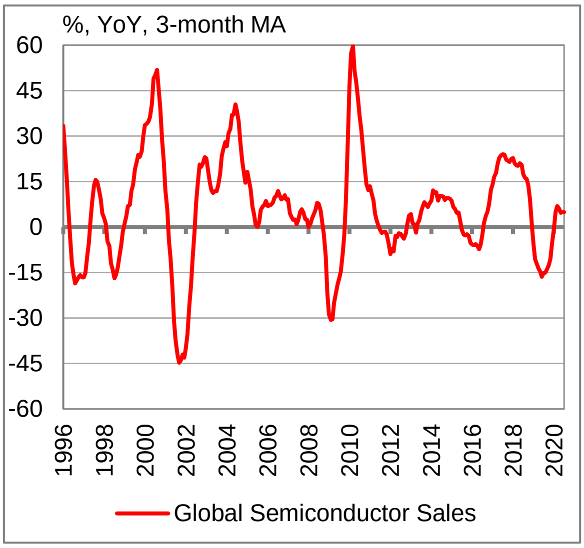


Figure 6: Global semiconductor sales growth remains broadly stable



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

Figure 7: OECD Business Confidence Index indicates a revival in confidence

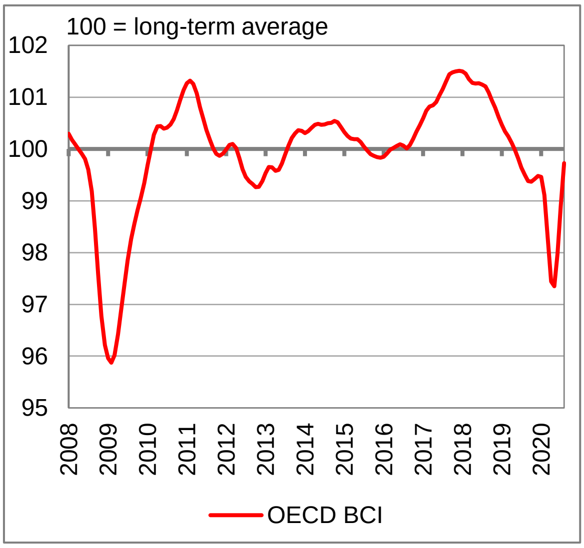
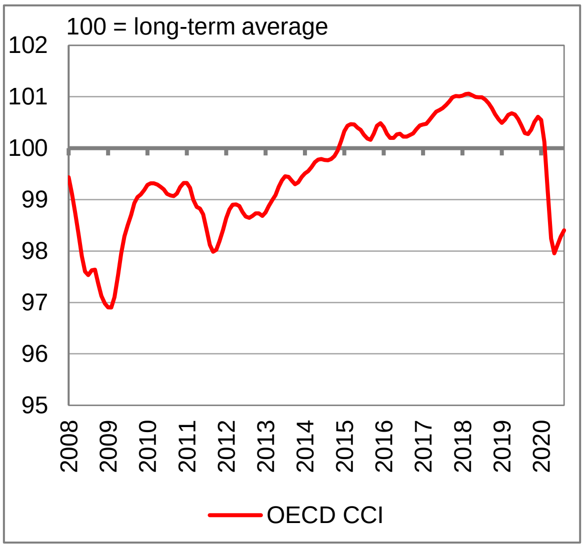


Figure 8: OECD Consumer Confidence Index suggests still cautious sentiment



Source: OECD

Figure 9: Crude oil prices remained broadly stable since July

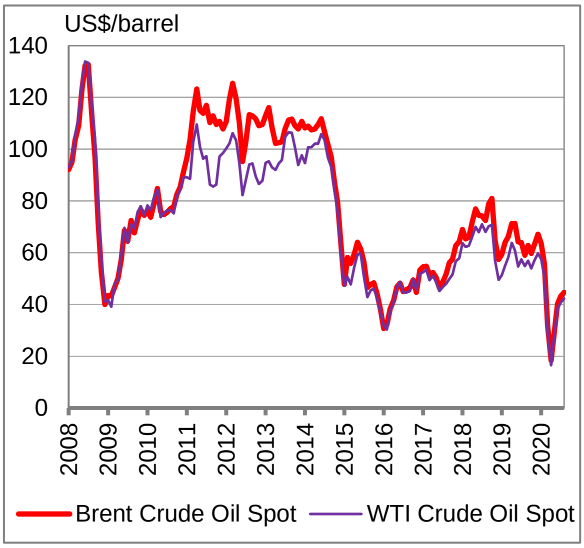
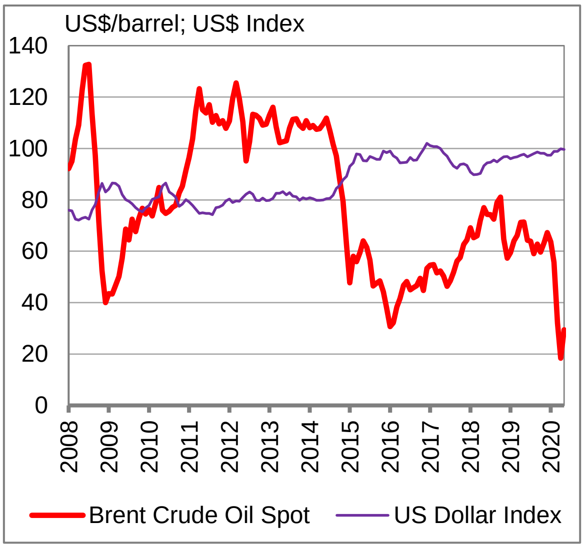


Figure 10: Brent crude oil price vs. the US dollar index



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

Figure 11: Prices of safe haven products continue to increase strongly

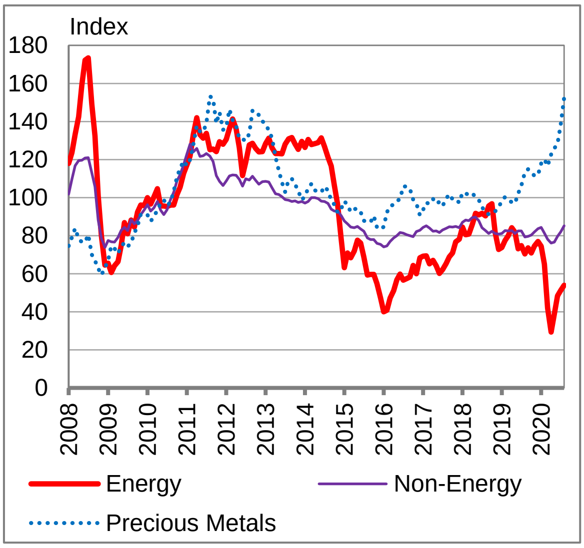
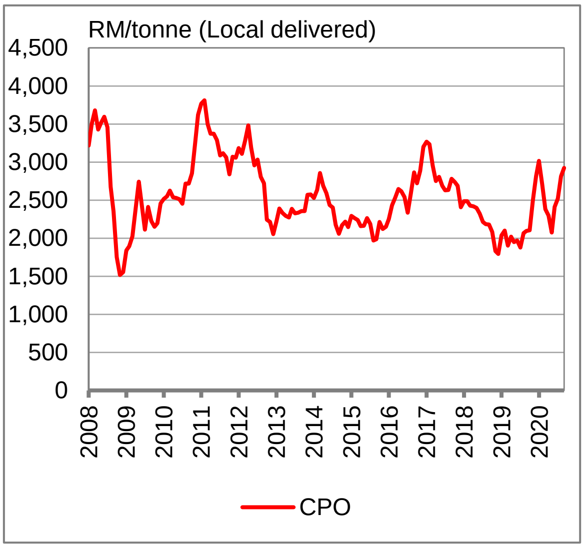


Figure 12: CPO prices surged in 3Q



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

ECONOMIC DEVELOPMENTS IN MAJOR ECONOMIES

The United States: After suffering its worst period ever in the second quarter, with GDP falling a historic 31.4% annualised qoq in 2Q 2020 (-5.0% in 1Q), the US economy has shown "marked improvement" as printed in recent high frequency data. But the path ahead remains "highly uncertain" as the continued rising number of new infection cases has raised the possibility of future lockdowns or stricter movements. Though the jobs and households' spending have rebounded since the economy cratered during the Great Lockdown, said it still remains far from where it was. The US Presidential Election on 3 November remains a political development risk. On 1 October, the US House of Representatives has approved a US$2.2 trillion Democratic plan to provide more economic relief from the coronavirus pandemic.

Figure 13: ISM manufacturing and non-manufacturing PMI showed expansion for the third successive month in Aug

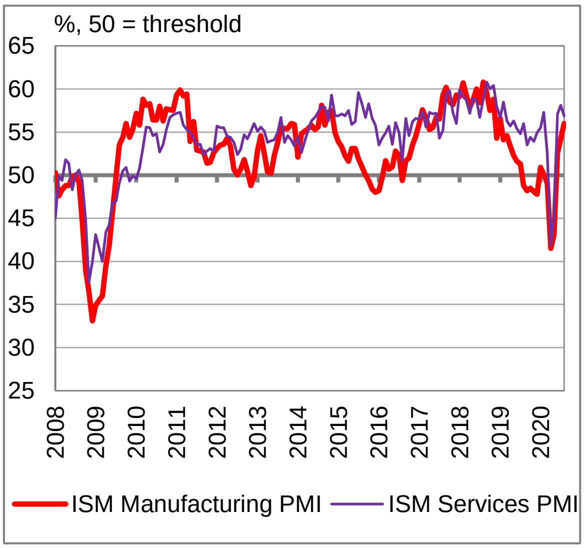


Figure 14: Industrial production contraction narrows further in August; marginal growth seen in retail trade

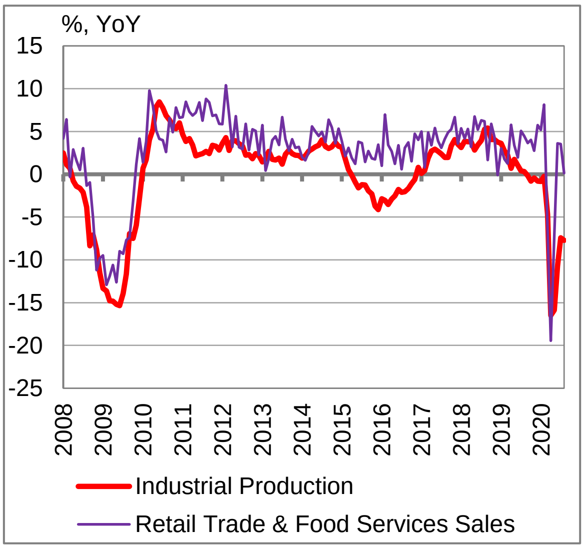


Figure 15: Unemployment rate crawled back to a single-digit of 8.4% in Aug

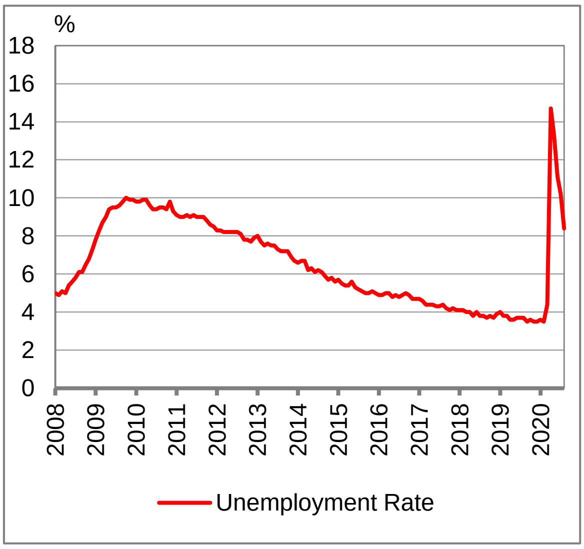
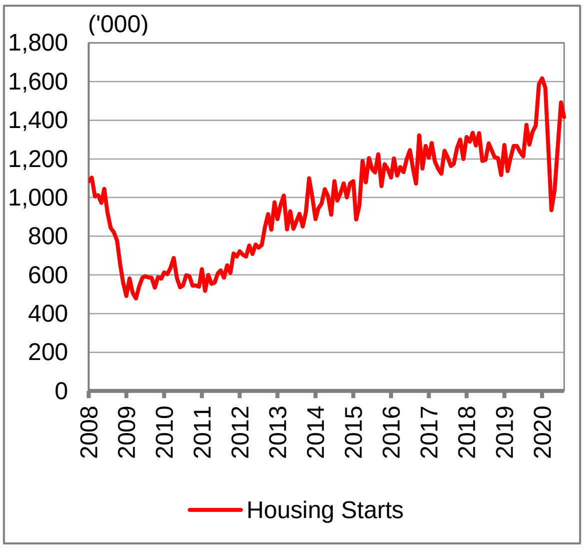


Figure 16: Housing starts regained lost ground after reaching bottom in Apr



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

Euro area: The bag of economic data showed a mixed performance with the improved consumer spending underpinning the retail sector to lead the recovery while the industrial sector and exports are lagging behind. There are also clear divergences between countries, both in terms of virus containment and the pace of the economic recovery, with Spain on one side suffering badly while Germany outperforming the rest of the euro area.

Figure 17: Both manufacturing and services PMI returned to the expansion territory in Jul-Aug

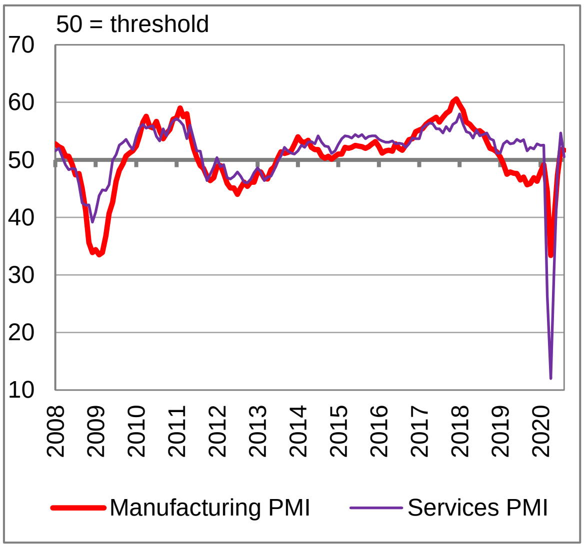


Figure 18: Retail trade expanded mildly; industrial production remained sluggish, albeit narrower magnitude of declines

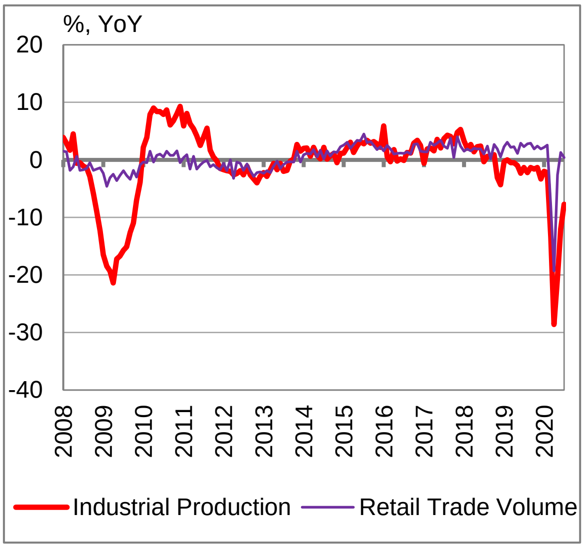


Figure 19: First deflation since May 2016

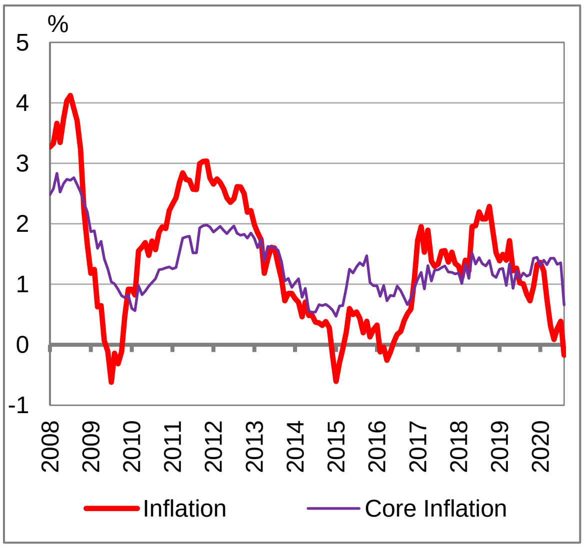
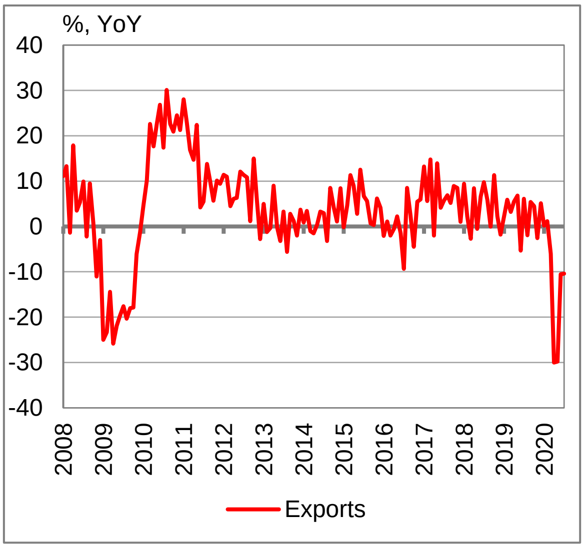


Figure 20: Exports have yet to recover though declined smaller



Source: Markit; Eurostat

Japan: The Japan economy, which had slumped in 2Q (-7.9% qoq vs. -0.6% in 1Q) has seen some moderate rebound in the incoming data. PMIs for both manufacturing and services were still subdued while exports also have not recovered. Meanwhile, in the political sphere, new Japanese Prime Minister Yoshihide Suga's priority is to lift the economy out of the pandemic crisis and is determined to host Tokyo Olympics in 2021 after the game was postponed this year due to the COVID-19 global outbreak. No significant changes in economic policy are expected in the short term.

Figure 21: TANKAN indicates a mild rebound in manufacturing activities ahead

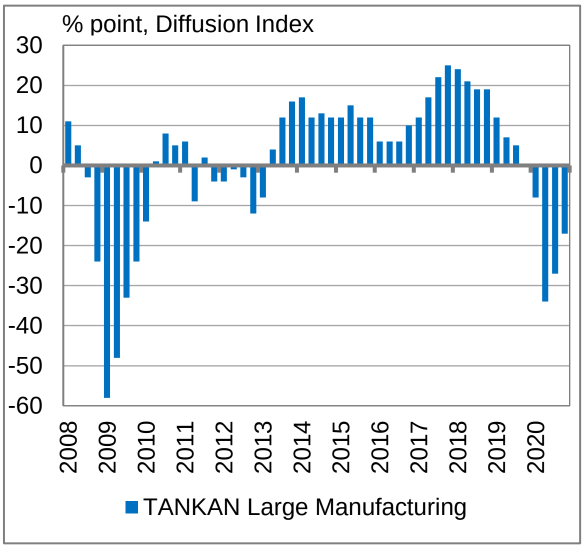


Figure 22: Industrial output growth still declining double-digits

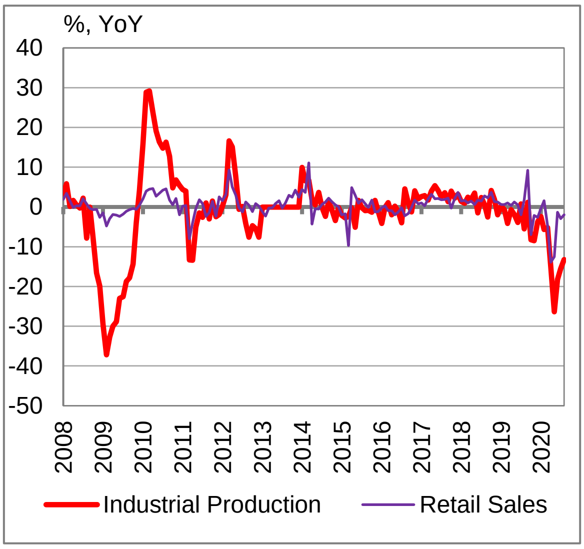


Figure 23: Inflation rate remains muted

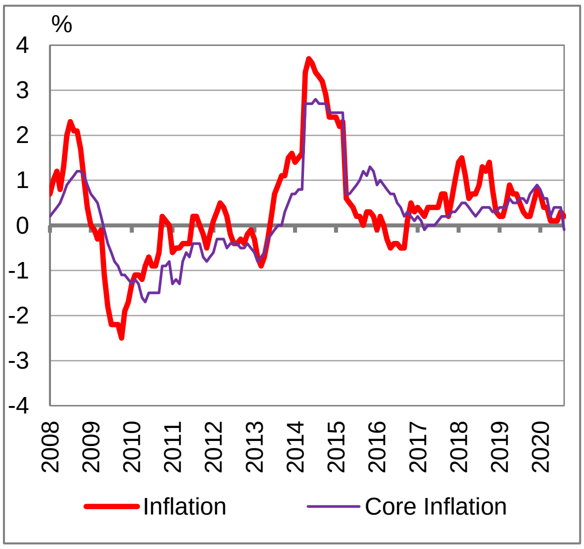
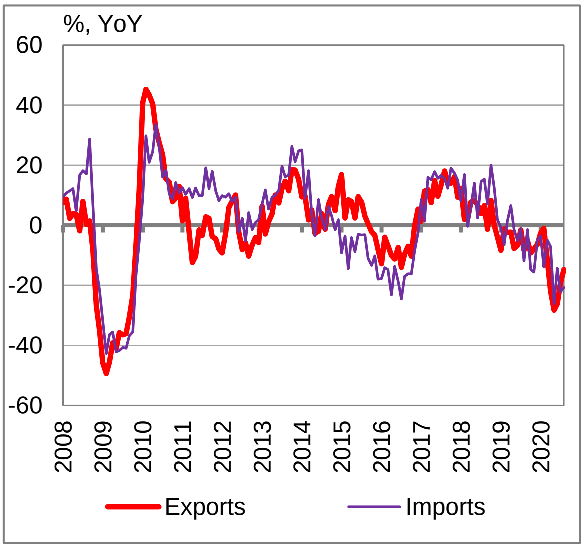


Figure 24: Exports continued to contract since Dec 2018



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

China: Being "First in, First out" from the pandemic, China, is the only major economy recorded a positive growth in 2Q (3.2% yoy vs. -6.8% in 1Q). Its economic recovery remains remarkably strong though there is a clear divergence between the industrial sector, which has fully recovered while the retail sector is lagging behind and yet to restore its full strength. The external trade also on the mend.

Figure 25: The rebound in PMIs indicate manufacturing and services are gaining traction

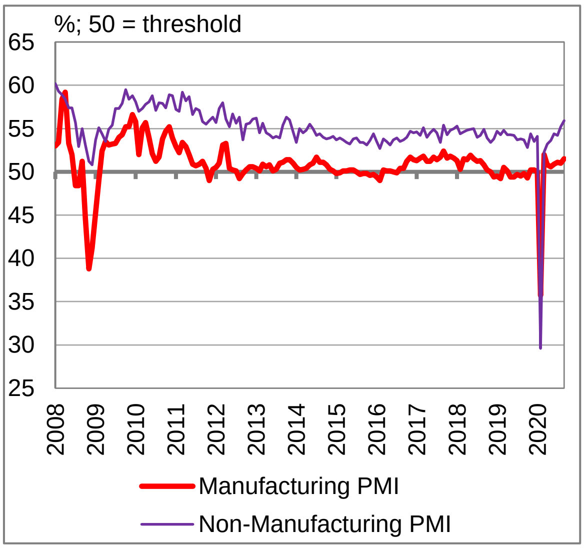


Figure 26: Industrial output regained lost ground while retail sales growth edged back to positive track

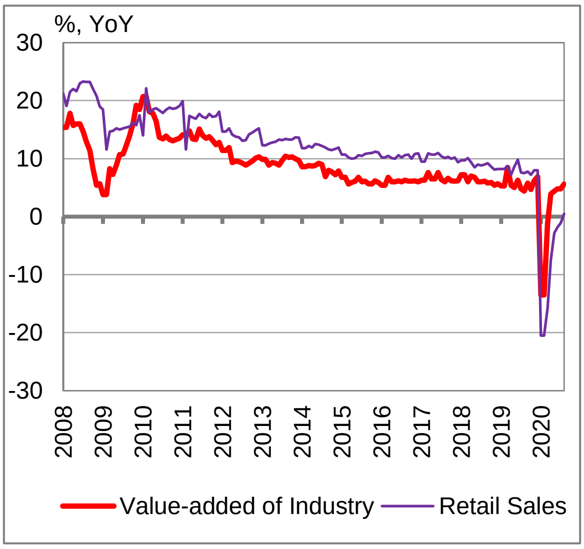


Figure 27: Fixed assets investment growth set back to near null from a sharp contraction

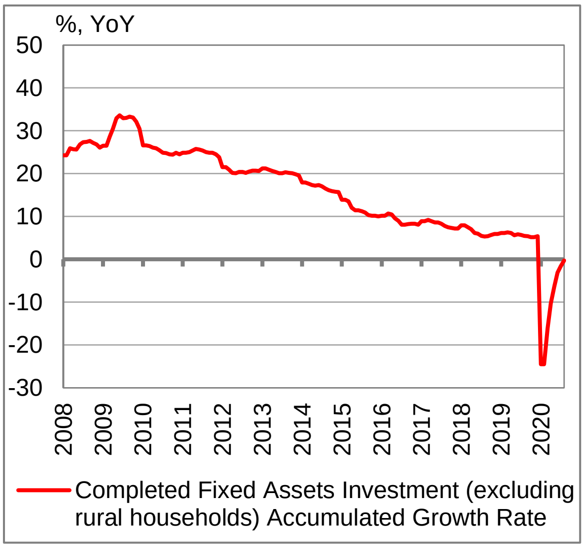
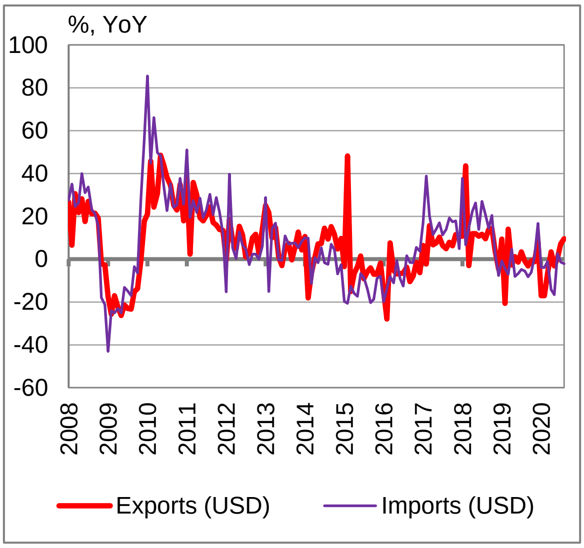


Figure 28: External demand picked up strongly

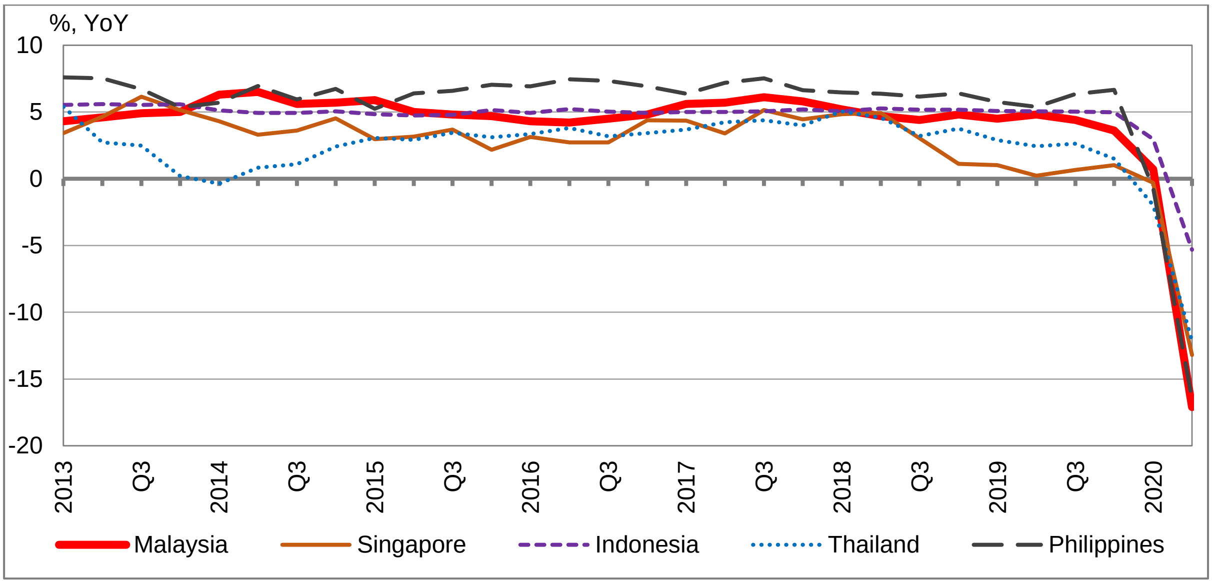


Source: National Bureau of Statistics of China; General Administration of Customs, China

ASEAN-5 ECONOMIES' KEY ECONOMIC DATA TRACKER

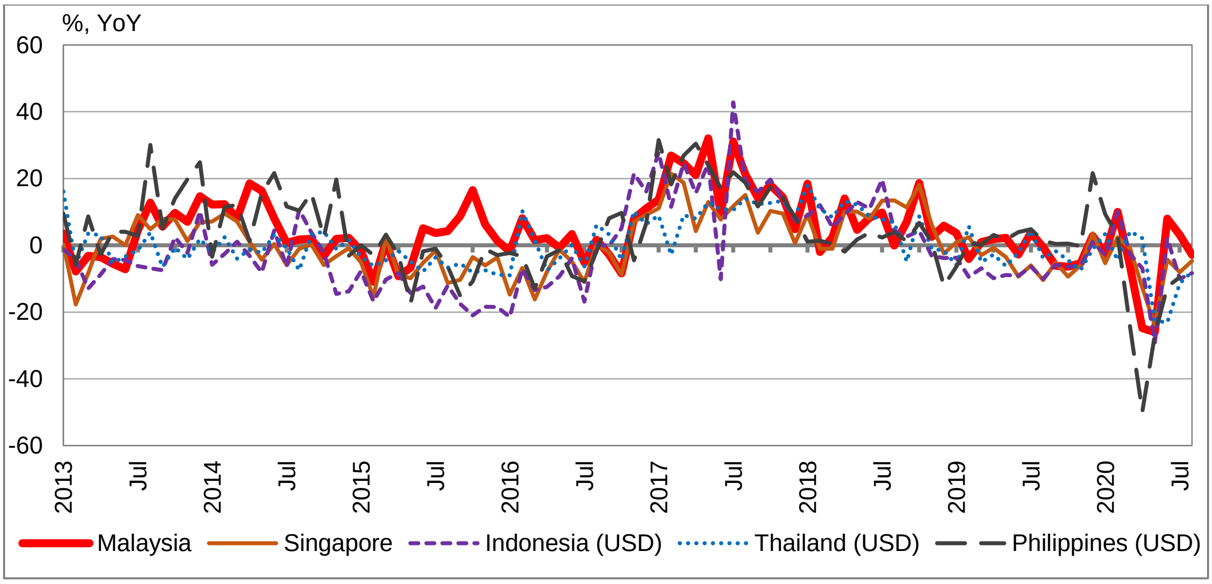
ASEAN-5 economies (Malaysia, Singapore, Indonesia, Thailand and the Philippines) contracted sharply in 2Q due to the impact of COVID-19 and containment measures. The incoming data showed a mixed performance in these economies; the recovery pace is seen gradually as there are downside risks stemming from increasing number of infection cases around the globe and regional countries.

Figure 29: Real GDP growth trend



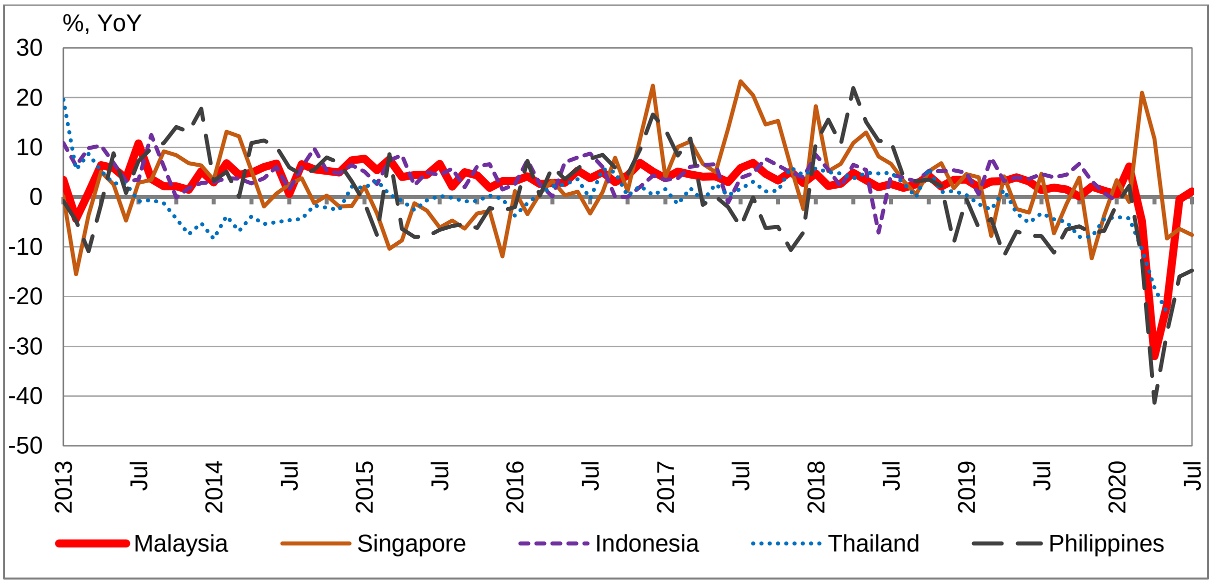
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; National Economic and Social Development Board, Thailand; Philippine Statistics Authority

Figure 30: Export growth trend



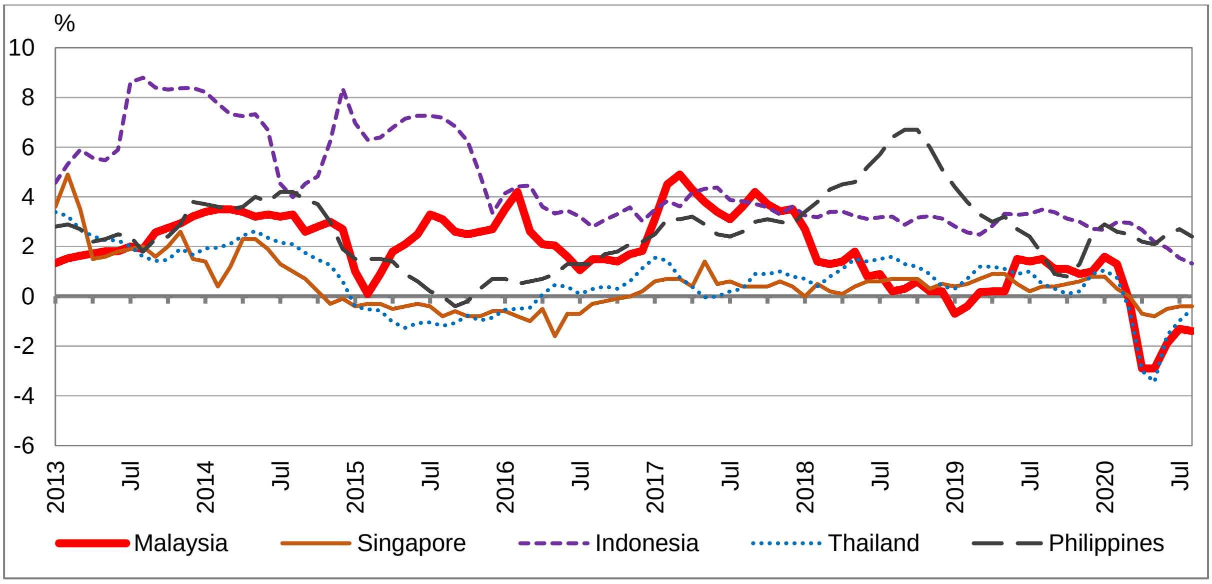
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Bank of Thailand; Philippine Statistics Authority

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

HARNESSING THE RECOVERY PATH TO THE NEXT NORMAL

The sharp economic contraction has bottomed out in 2Q 2020. After registering a record economic decline of 17.1% yoy in 2Q 2020 (+0.7% in 1Q), due to the Movement Control Order (MCO)-induced "sudden stop" in business and economic activities as well as demand retrenchment, high frequency data have indicated that the economic stabilisation has emerged, albeit unevenly, paving the way for a gradual recovery going into 2H 2020 and in 2021.

We caution that the pace and strength of economic recovery may be tempered by an occurrence of a third wave of virus spread and also critically dependent on the availability of vaccines. It is through both consumers and businesses having confidence on the containment of virus, a full recovery is assured.

We believe that the Government is better prepared this time round to deal with the virus while protecting the economy from severely impacted. The likely approach to be adopted is Targeted Enhanced MCO (TEMCO) at the infected areas rather than a total lockdown.

Continued fiscal support is essential. Malaysia's Recovery MCO (RMCO) has been extended from 1 September to 31 December 2020 with continued practising of social distancing measures, restricted travelling outside Malaysia and re-opening of borders to international tourists as well as bans on the business operation of entertainment centres and pubs, amongst others.

The RM305.0 billion or 21.8% of GDP PRIHATIN, PENJANA and KITA PRIHATIN economic stimulus and recovery packages, augmented by a 125 basis points (bps) reduction in the overnight policy rate (OPR) as well as other liquidity measures have had helped to stabilise and limit the inflicted economic and financial damages on households, businesses, industries and employees.

The Economic Stimulus Implementation and Coordination Unit Between National Agencies (LAKSANA) status update (between 5 June and 18 September) indicated that:

a) 2.7 million jobs have been saved via Wage Subsidy Programme;

b) 10.6 million individuals' cash flow burden was eased via cash transfers, loans moratorium and EPF's i-Lestari;

c) 22,925 SMEs have received various financial assistances.

Bantuan Prihatin Nasional (BPN)

- *Benefitted 10.6 million individuals & households*
- *Distributed RM11.2 billion*

As of 23 Sep

KWSP
EPF

EPF's i-Lestari

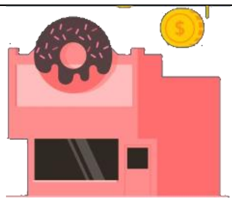
- *Benefitted 4.6 million individuals*
- *Withdrawal up to RM9.3 billion between April and August*

As of 18 Sep

KWSP contribution rate reduced from 11% to 7%

- *Benefitted 5.7 million EPF contributors*
- *Total reduction: RM1.9 billion*
- *1.9 million opt to maintain at 11%*

As of 5 Jun



SME Soft Loan Funds

- *Benefitted 22,925 SMEs*
- *Approved loan amounted to RM10.6 billion*

As of 18 Sep

PRIHATIN Special Grant (GKP)

- *Benefitted 545,000 micro enterprises*
- *Approved grant amounted to RM1.6 billion*

As of 13 Jul

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Loan Payment Moratorium

- *Total moratorium value is approximately RM93.4 billion*
- *RM32.7 billion benefitted business sector while RM60.7 billion for people*

As of 18 Sep

PERKESO

Wage Subsidy Programme

- *Benefitted more than 2.7 million employees**
- *RM11.9 billion in wage subsidies had been approved*

* *EIS's Vital Statistics*

As of 18 Sep

On 23 September 2020, the Government has rolled out RM10.0 billion KITA PRIHATIN comprises (i) RM7.0 billion Bantuan Prihatin Nasional (BPN) 2.0 targeting at B40 and M40 (households and single); local workers and micro-traders in various fields; (ii) RM2.4 billion Wage Subsidy Program 2.0, which will benefit 1.3 million employees; and (iii) RM600 million PRIHATIN Special Grant (GKP), which will benefit more than 200,000 micro-businesses who have missed the applications in May.

Bantuan Prihatin Nasional 2.0 (BPN 2.0)

- *RM7 billion to be allocated*
  - *RM1,000 to 3.7 million B40 households*
  - *RM500 to 3.8 million B40 singles*
  - *RM600 to almost 1.4 million M40 households*
  - *RM300 to 1.7 million M40 singles.*

Wage Subsidy Programme 2.0

- *Allocation of RM2.4 billion*
- *Expected to benefit 1.3 million employees*

PRIHATIN Special Grant (GKP)

- *Reopen applications in 1 Oct to 31 Oct*
- *Allocation of about RM600 million*
- *Expected to benefit more than 200,000 micro-businesses*

Signs of recovery are emerging, albeit unevenly. With the lifting of lockdown worldwide and reopening of domestic economy, the aggressive fiscal, monetary and financial relief as well as assistance facilities have had helped to ease the cashflow needs of households, individuals and businesses as they sail through this extraordinary shock in terms of the loss of employment or furlough, reduced income due to pay cut or no pay leave for households and employees. For businesses, especially micro-business, wage subsidy program, loans moratorium and soft loan facilities have softened the blow of pandemic inflicted demand shock on their operating cashflow while they slowly recouping the loss income and revenue.

SERC concurs with Bank Negara Malaysia's assessment that the "shock" pandemic economic contraction has hit the trough in 2Q and the stabilisation has started to trickle in since June, raising cautiously optimism that real GDP will show a much more moderate pace of decline or positive growth in 3Q and 4Q 2020 respectively.

We caution that an occurrence of a third wave of coronavirus would temper the hopeful of an economic improvement in 2H 2020. **SERC estimates the economy to decline by 4.0%, a revision from -3.0% previously (vs. BNM's revised estimates between -3.5% and -5.5%) in 2020. For 2021, we expect a decent rebound in economic growth to 5.0% on the assumption of a stronger growth upturn in 2H 2021 (vs. BNM's projections between 5.5% and 8.0%).** We err on the conservative side as the pace and strength of recovery is critically dependent on the path of virus and vaccines development as well as a sustained revival of private sector's growth.

The brutal numbers in March, April and May have turned around to show either shallower declines on an annual comparison basis or positive month-on-month growth in high frequency factual data in June, July and August. Anecdotal evidence and our channel checks indicate mixed consumer spending and business sentiment on the ground.

We reckon that uneven pace of recovery is seen as travel and tourism, aviation industry as well as small businesses would take some time to recover. While the bouncing back of domestic in-bound tourists provides some support to tourism sector, a delay re-opening of borders to international travellers means that a full-fledged revival is only expected in late 2021 or 2022. The recovery path for the aviation sector will go beyond 2022.

Some businesses' capacity was permanently destroyed (closing down of businesses or capacity reduced due to social distancing (such as in restaurants and hotels, etc.). Overall productivity growth is dampened by a reduction in labour participation rate due to massive job cuts.

With the emerging of incipient signs of stabilisation and green shoots, albeit unevenly, the economy is looking to improve gradually in the third quarter onwards and provides a meaningful rebound to contrast with the unprecedented slump in 2Q.

a) **Malaysia's leading index**, which gauges future economic direction registered an annual increase for three consecutive months (7.7% yoy in July; 4.6% in June and 0.6% in May), indicating a bright prospect of economic recovery towards early 2021.

b) The Department of Statistics of Malaysia (DOSM)'s compiled **monthly GDP** suggested that economic activity has picked up somewhat as the rate of economic decline has narrowed substantially to 3.2% yoy in June from -19.5% in May and -28.6% in April.

   The manufacturing sector has rebounded to increase by 4.5% in June (vs. -18.3% in 2Q 2020), followed by a double-digit 11% increase in agriculture output (+1.0% in 2Q). On somewhat cautiously positive signs, the declines in output have narrowed sharply in the construction sector (-12.7% in June vs. -44.5% in 2Q 2020); mining and quarrying sector (-16.4% in June vs. -20.0% in 2Q); and service sector (-6.0% in June vs. -16.2% in 2Q).

c) **Industrial output**, a proxy of overall economy has turned around to a positive growth (1.2% in July from -17.9%% in 2Q), with the manufacturing sector growing by 2.9% in July for two consecutive months (4.7% in June).

d) **Manufacturing sales**' contraction, which had hit the bottom in 2Q, have gradually recouped lost ground. It increased by 1.9% in July and 4.2% in June as against -20.4% in May and -33.0% in April.

e) **Exports** have reverted to decline by 2.9% in August after recorded two successive months of positive growth in June (8.0%) and July (3.1% vs. -26.0% in May and -24.9% in April. The main supports of exports were electronics and electrical products, palm oil, optical and scientific equipment, furniture and rubber gloves.

   With our major trading partners, especially China and the US economy and some regional economies are mending gradually amid the recent surge in infection cases in some countries, reigniting fears of re-lockdown or stricter movement restrictions, we expect exports to slowly on the mend. With exports declined by 5.8% in the first eight months of 2020, we have revised **2020's exports estimate to decline by 5.0%** from -11.2% previously in 2020 (2019: -0.8%).

f) **Retail sales** have declined by a smaller magnitude of 3.8% in July (-9.2% in June vs. -32.4% in April and -16.1% in May respectively).

g) **Jobless rate** continued to ease for two consecutive months (4.7% in July and 4.9% in June) from a record high of 5.3% in May. This has translated into a reduction of 81,000 persons to 745,100 unemployed persons in July compared to 826,100 unemployed persons in May. Another encouraging data is the Employment Insurance System (EIS) has reported lower number of employment loss to 6,561 persons for 1-27 September, 9,261 persons in August and 16,660 persons in July from the peak of 18,579 persons in June.

h) **Domestic inbound tourists** have seen coming back as reflected in a gradual improvement in hotels' occupancy rates averaging 45.4% in August (35.4% in July) compared to between 8.3% and 16.4% in Apr-Jun. Hotels' occupancy rates in Pahang are 75.1%-82.8%; Perak (54.7%-60.4%); Terengganu (64.9%-54.0%); PD (70%-80%); Penang around 48%-49% and Ipoh (50%) in July-Aug.

Fiscal lever is needed to facilitate and sustain the recovery resilience. In times of an extraordinary economic crisis, fiscal deficit may not matter much as government's spending and fiscal assistance are needed to mitigate the profound economic damages.

Direct fiscal injection of RM55.0 billion or 3.9% of GDP (via PRIHATIN, PENJANA and KITA PRIHATIN), together with the original budget allocation for 2020, has pushed **2020's budget deficit to between 6.0% and 6.5% of GDP** given higher spending relative lower revenue collection.

The raising of the self-imposed statutory debt ceiling from 55% to 60% of GDP through 2022 gives the Federal Government the capacity to borrow an additional RM70.0 billion to RM75.0 billion, based on a nominal GDP value of between RM1.4 trillion and RM1.5 trillion. As at end-June, Federal Government's direct debt stood at RM854.1 billion or 53.2% of GDP.

A higher debt limit implies that the government is prepared to go for another year of targeted expansionary budget deficit for 2021 to revitalise and sustain the current signs of economic stabilisation as the worst economic contraction has hit the trough in 2Q 2020. Some of the RM55.0 billion allocation may be carried forward to 2021.

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 tax revenue or cutting public spending**, including to rationalise the exponential growth in operating expenditure (emoluments, pension payment, supplies and services).

The 2021 Budget on 6 November calls for targeted fiscal expansionary stance. BNM's monetary policy and liquidity measures will remain supportive in the foreseeable future. Therefore, fiscal policy will be the key policy variable going forward to support domestic demand.

Fiscal support measures must be renewed periodically and still needed to support the sectors that would take a longer time to recover, and these include the aviation industry, travel and tourism, small businesses and the vulnerable households and employees.

It's not about only getting the right macro and growth narrative; the implementation of impactful policies must remain squarely in focus. Bank Negara Malaysia still has some policy levers and has done what it can in terms of frontloading interest rates cut to a historical low and implementing an unprecedented array of financial facilities, financing relief and liquidity injection programs.

It's now up to the Federal Government to flex its fiscal spending power. How much budget deficit spending and debt it willing to commit in the tabling of 2021 Budget on 6 November 2020?

We expect the **Federal Government to plan a budget deficit of 5.5%-6.0% of GDP for 2021** (estimated 6.0%-6.5% of GDP in 2020).

SERC's proposed key measures and initiatives for 2021 Budget

The 2021 Budget is being formulated under the RMCO to revitalise and ensure that early signs of recovery are firmly entrenched amid concerns about an occurrence of a third wave of virus and uncertainty on the availability of vaccines.

The 2021 Budget expenditure programs and measures should be targeted and prioritized to help the nation to reset, revitalise and recover from the pandemic crisis.

a) Protect the vulnerable B40 households and affected sectors of society, boost purchasing power, revitalise domestic and foreign investment and create more jobs as well as improve income.

b) Priority programs and initiatives to accelerate the adoption of digital technologies, expand healthcare, industrial development, agriculture and entrepreneurship as well as the empowerment of women and youth. Micro-economic policies that promoting small enterprises, self-employment, multiple-skills, productivity, innovation and creativity, must be explored in these challenging times.

A. Spending on multiplier and productive capacity expansion projects/programs

1) **Expedite the implementation of small socio-economic and community projects as well as on-going and new public infrastructure projects** (such as MRT2, Pan

Borneo Highway, LRT3, Gemas-JB Double Track, ECRL, and Singapore-Johor Bahru RTS); and

2) **Focusing on investing in "new smart infrastructure"** used for high-tech, digitalisation and sustainable purposes (renewable energy, climate change, eco-green). These include, big data centres, 5G infrastructure, and charging stations for new energy vehicles (NEVs), solar energy, healthcare.

B. Sustaining consumer spending; financial assistance to targeted households

1) **Extension of a voluntary reduction in the EPF's employees' contribution rate** for 2021 and EPF's i-Lestari withdrawal of RM500 per month from Apr 2021to Dec 2021;
2) **Tax free holiday for individuals** (chargeable income of RM100,000 and RM150,000 below); or **Reduction in personal income tax rate for middle-income earners**;
3) **RM100 e-wallet spending voucher** for annual income below RM100,000. The on-line stores and participating merchants to provide a match in a form of discount vouchers, that have to be spent in a stipulated time;
4) **Allow personal tax relief for cost incurred in purchase of personal protective equipment (PPE)** Personal Kit, face mask, hand sanitizer and gloves; and
5) **Extension of RM30 public transport subsidy** for another year to December 2021.

C. Create jobs and skill enhancement. Continue to support jobs; create new ones; and to better flow workers to new opportunities

1) **Extend reskilling and upskilling programmes** to end-Dec 2021;
2) **Extend hiring and training as well as assistance for business** to end-Dec 2021;
3) **Promote job search through both public and private sectors' jobs portal**. Propose a screening to distinguish between people who may be relative job ready and those who have more substantial impediments to employment; and
4) **Encourage youth involvement in agro-food and agriculture industry** through high interest subsidy on agriculture loans and credit facilities; technical support on agricultural production.

D. Easing cost of doing business and reviving private investment

1) **Enhance a conducive investment climate**. Maintain a competitive tax structure and cost of doing business, transparent and liberal investment policies/guidelines;
2) Consider to **extend wage subsidy programme to end-June 2021**;
3) **A suspension of foreign workers levy in 2021 or a 50% reduction in foreign levy**;
4) **Extend the electricity tariffs discount**;
5) **Extend the special tax deduction on reduction of rental for another 6 months from Oct 2020 to end-Mar 2021.** This tax rental deduction is also eligible for rental payment reduction given to large companies' tenant;
6) **Review of company income tax rate**: (a) Reduce company income tax rate to 22% from 24% for corporates in YA 2021 and further to 20% for YA 2022; (b) Reduce company tax rate to 15% from 17% for SMEs in YA 2021; and (c) Provide tax rebate of 25% on corporate income tax payable up to RM15,000 to RM20,000 for YA 2020-2021; and

7) **Design a "Reconstruct, Resilience, Reimagine Package" for micro and SMEs**. The package comprises fiscal, monetary, financial, marketing, technology, digitalisation and automation, technical advisory, product and market development as well as human capital development.

E. Digitalisation and e-commerce

1) **Expedite the implementation of RM21.6 billion National Fiberisation and Connectivity Plan (NFCP)** to improve broadband quality and coverage, reduce broadband prices and provide Internet access across all spectrums of society;
2) **Provide double tax deductions for investment in upskilling and reskilling** of employees in ICT;
3) **Provide 100% capital allowance on purchase information and technology (ICT) equipment** for YA 2021 and 2022;
4) **Provide a double-tax deduction on developing e-commerce's website or mobile apps**;
5) **Soft grants for digital marketing and training services online**; incentives for employers to conduct online learning and e-learning;
6) **For Point-of-Sale terminal, no charge for the first 1,000 transactions; lower the merchant Discount Rate (MDR) to 0.1%**; Market Development Fund to fund the deployment of Point-of-Sale terminals; and
7) **Lower MDR rates charged by e-wallet**.

F. Sectors focus

Tourism sector

1) **Further extension of tax incentives for the tourism sector:** (a) Tourism tax and service tax exemption be extended from 1 July 2020 to 30 June 2021 to another one year from July 2021 to June 2022; (b) Increase income tax relief to RM2,000 from 1,000 for tourism expenses and extend the period of relief from 31 December 2021 to June 2022; and (c) Extend the period of deferment of tax instalment payment from 31 December 2020 to 31 December 2021;
2) **Assist the industry operators and tours agencies to adopt digital technologies and digital solutions** to create 'live remote' tourism and/or virtual tourism experiences;
3) **Continue to explore the implementation of the "Travel Bubbles"** and identify green zones in the region to help revive the return of international tourists; and
4) **Getting the industry prepared for the eventual border re-opening**. Travellers will need to be reassured on the safety of travelling to restore travellers' confidence and stimulating demand.
5) The government needs to **collaborate with the private sector to put in place new standards in terms of safety, hygiene, testing, and procedures**. These include the sharing of updated information within the business and provide clear communication about the guidelines on keeping the tourist destinations safe to visit; introduce safe and clean labels to reassure visitors that it is safe to travel in Malaysia.

Agriculture sector

1) The Federal Government, in collaboration with State governments to **open up more land for agricultural production**;
2) The Federal Government can consider to **set up KPI for State Governments to allocate 5,000 to 20,000 hectares of land each for agricultural purposes**, depending on the size of each state;
3) For commercial viability, **a 30-year period lease is the minimum period for reasonable investment return;** and
4) **Establish a land bank database for idle land** through the cooperation of Ministries and state land offices. These lands will be leased to farmers and corporation for agricultural ventures.

Halal industry

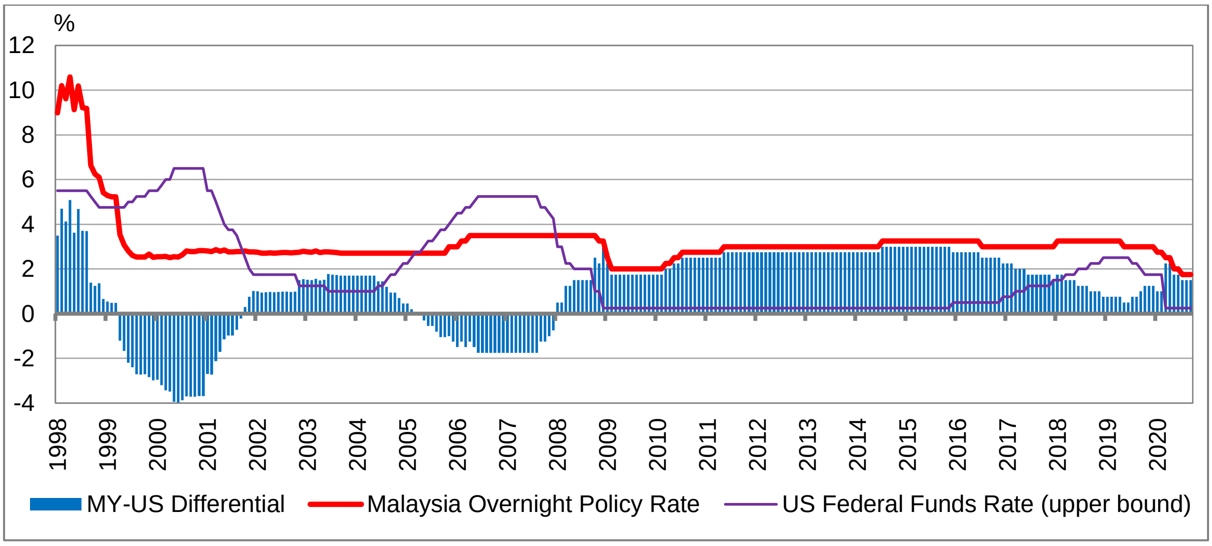
1) The Government must **disclose sufficient content of information** and **consistently update market players** about the development status of halal hub;
2) The Government needs to **improve monitoring mechanism for companies to comply with halal certification**;
3) The Islamic authorities in different states should **harmonise the regulations in micro perspective to avoid different standards in the certification's requirement**;
4) For renewal processes, the authorities should **design an easier procedure to quicken and streamline the approval processes** given that they are lacking of manpower to conduct site auditing;
5) The Islamic authorities should **have certain levels of commercial-oriented mindset to help businesses in obtaining halal certificate** instead of giving the perception of trying to set roadblock for getting the certification; and
6) The Government needs to **expedite the harmonization of halal certification with the Indonesian Government**.

Table 3: Real GDP growth (% YoY)

Economic Sector [% share to GDP in 2019]	2018	2019	2020 Q1	2020 Q2	2020 1H	2020*e* (SERC)	2021*f* (SERC)
By kind of economic activity							
Agriculture [7.1%]	0.1	2.0	-8.7	1.0	-3.9	-0.5	3.0
Mining & Quarrying [7.1%]	-2.2	-2.0	-2.0	-20.0	-11.0	-6.6	2.8
Manufacturing [22.3%]	5.0	3.8	1.5	-18.3	-8.7	-2.4	4.3
Construction [4.7%]	4.2	0.1	-7.9	-44.5	-25.9	-22.9	5.0
Services [57.7%]	6.8	6.1	3.1	-16.2	-6.7	-3.0	5.6
By type of expenditure							
Private Consumption [58.7%]	8.0	7.6	6.7	-18.5	-6.0	-4.2	4.4
Public Consumption [12.2%]	3.2	2.0	5.0	2.3	3.6	4.5	4.4
Private Investment [16.8%]	4.3	1.6	-2.3	-26.4	-15.2	-15.3	5.4
Public Investment [6.3%]	-5.0	-10.8	-11.3	-38.7	-24.2	-18.1	-10.3
Exports of Goods and Services [63.7%]	1.9	-1.3	-7.1	-21.7	-14.4	-5.5	3.3
Imports of Goods and Services [56.7%]	1.5	-2.5	-2.5	-19.7	-11.2	-6.1	3.4
Overall GDP	**4.8**	**4.3**	**0.7**	**-17.1**	**-8.3**	**-4.0**	**5.0**

Source: Department of Statistics, Malaysia; Bank Negara Malaysia; 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

Malaysia's leading indicators (LIs) have improved significantly in June and July, signalling a pick-up in economic growth towards year-end and in 2021.

Industrial production, which is a proxy of overall economy, has turned around to register moderate positive growth in July after contracting sharply in April and May due to "sudden stop" in activities because of the MCO. Manufacturing production also increased in July, albeit moderately for two months in a row while mining output continued to shrink at a narrower pace. In the months ahead, we expect both industrial production and manufacturing output to improve gradually with a higher rate of growth in 4Q 2020, supported by a firmer recovery in domestic and external demand.

Figure 34: Leading index surged higher in Jun-Jul

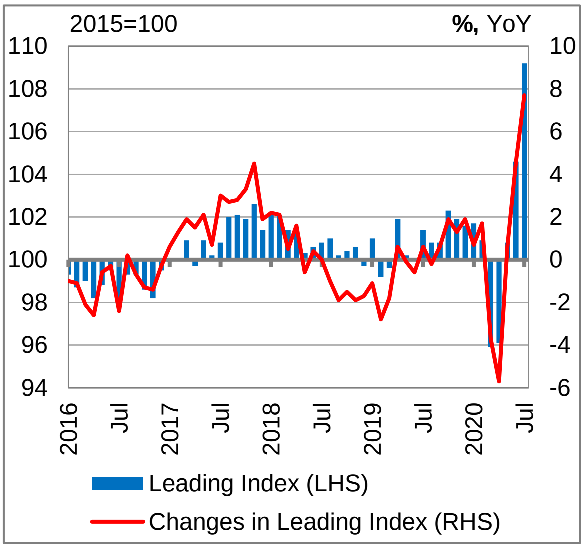
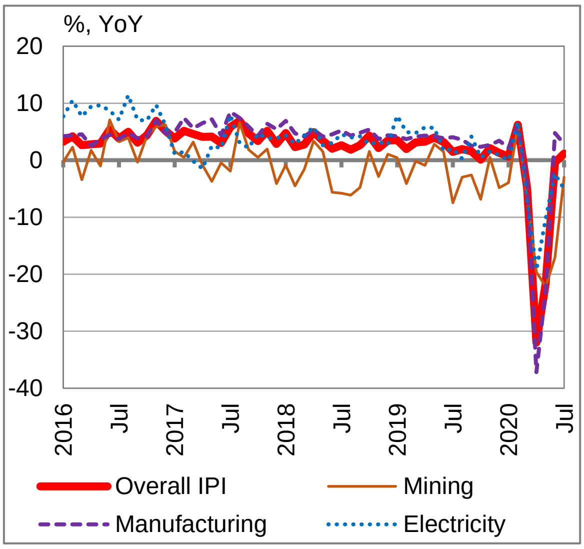


Figure 35: Industrial production growth returned to black, helped by the manufacturing sector



Source: Department of Statistics, Malaysia

Exports and Distributive trade

Exports have reverted to decline by 2.9% yoy in August after two months of expansion in July and June, reflecting the ebbing effect of backlog orders and the underlying exports level will be reflected in the months ahead. The export performance of electronic and electrical products remains intact. We expect continued uneven export trends as it is critically dependent on the recovery strength of Malaysia's major trading partners.

Retail sales have registered a smaller magnitude of decline in July (-3.8%) as against -18.9% in 2Q as household spending slowly returning amid cautious sentiment against the virus infection. A sustained improvement in the labour market condition and confidence about the virus containment would help to aid higher consumer spending

Figure 36: Overall export performance improved, albeit not a broad-based recovery

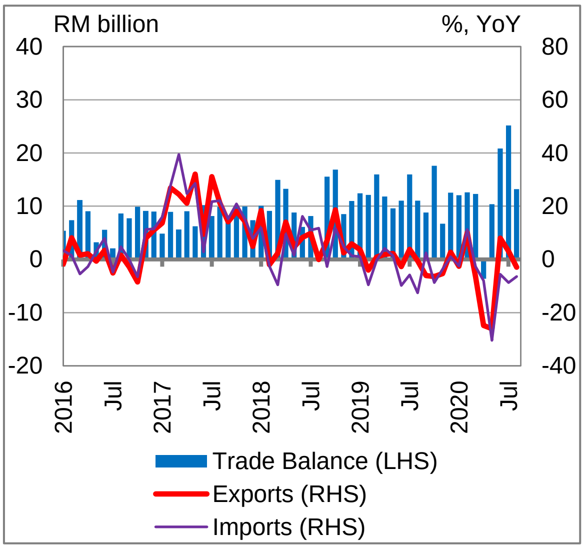
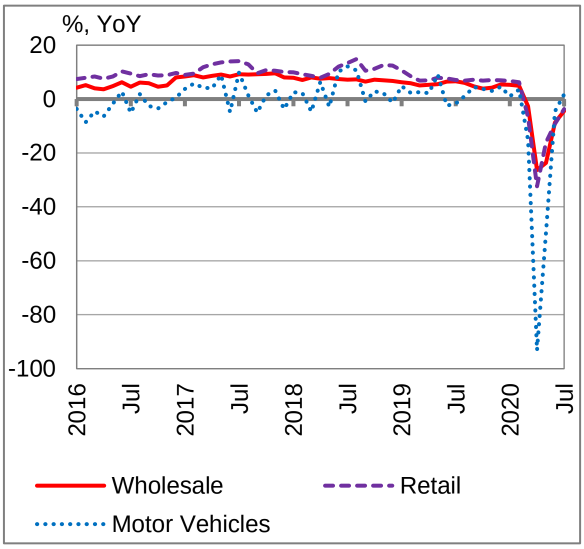


Figure 37: Distributive trade is rebounding, mainly driven by notable car sales performance



Source: Department of Statistics, Malaysia

Private consumption indicators

Our tracking of **selected private consumption indicators** shows a mixed performance. While consumer sentiment is inching away from the confidence optimum level, some positive signs of recovery in household spending since May as reflected in passenger car sales, sales of food and beverages and consumption credit. Amid worrying about rising number of infection cases, household spending is expected to grow gradually in tandem with better labour market conditions and sentiments. The end of automatic loan moratorium in September and transition towards a targeted loan repayment flexibility may temper the household loans demand.

Domestic inbound tourists have seen coming back as reflected in a gradual improvement in the hotels' occupancy rates averaging 45.4% in August (35.4% in July) compared to between 8.3% and 16.4% in Apr-Jun. The jobless rate has continued to ease for two months in a row (4.7% in July and 4.9% in June) from a record 5.3% in May. **The Employment Insurance System (EIS)** data has reported continued lower number of employment losses (6,561 during 1-27 September, 9,261 in August and 16,660 in July vs. 18,579 in June). The extension of wage subsidy till end-December 2020 would help to retain employment.

Figure 38: Selected private consumption indicators

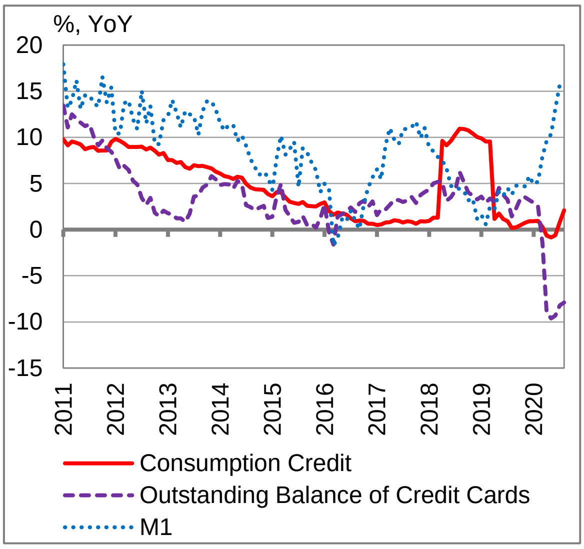
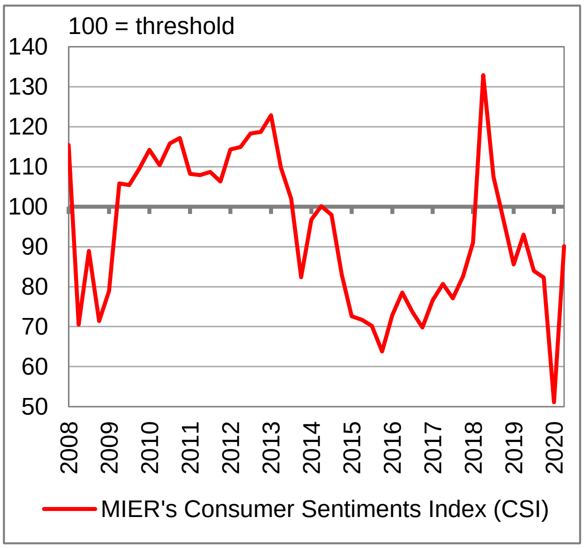


Figure 39: MIER's Consumer Sentiments Index (CSI)



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

Private investment has fallen sharply by 15.2% yoy in 1H 2020 (-26.4% in 2Q and -2.3% in 1Q) due to the MCO and businesses held back capital spending on bleak economic and business outlook. We expect a gradual restoration of investors' confidence and will resume some investment until a clearer macro condition emerges towards year-end.

MIER's Business Conditions Index (BCI) still remains in cautious territory. Businesses, especially SMEs still slowly repairing their balance sheet and rebuilding cash flow. The end of automatic loan moratorium and be replaced by a targeted loan repayment flexibility may cause some companies facing difficult adjustment. Imports of investment goods and intermediate goods continued to decline, indicating poor investment performance ahead.

Owing to the pandemic's impact on domestic and external economic conditions, the **approved domestic and foreign investors' investment in the manufacturing, services and primary** (agriculture, mining and plantations) declined by 38.4% yoy to RM64.8 billion in 1H 2020 from RM105.2 billion in 1H 2019. This was largely dragged down by a sharp decline in services sector (-54.1% to RM28.6 billion or 44.2% share of total approved investment), followed by primary sector (-92.2% to RM471 million or 0.7% of total) while approved manufacturing investment declined by 3.0% to RM35.7 billion or 55.1% of total approvals.

Besides uncertainty about the pace and strength of global and domestic economic recovery, investors are looking forward to the 2021 Budget for some form of catalysts to revive business sentiment.

Figure 40: Selected private investment indicators

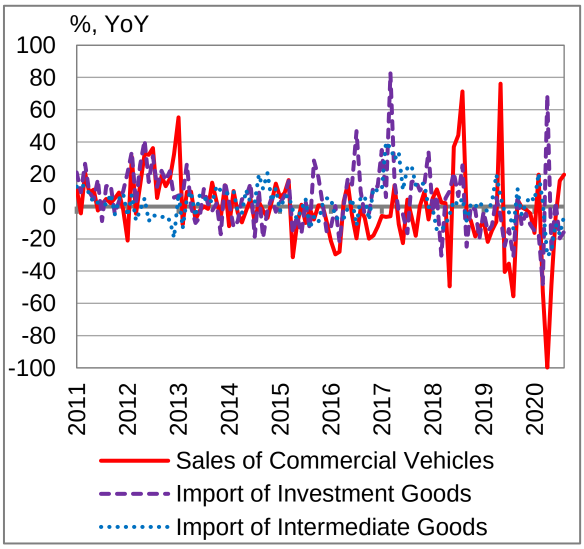
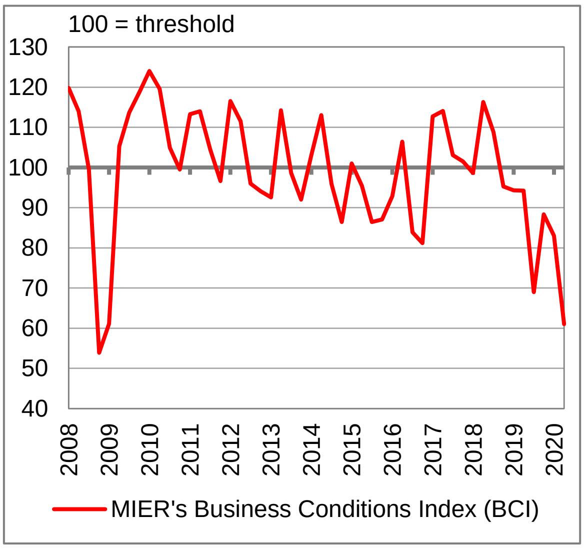


Figure 41: MIER's Business Conditions Index (BCI)



Source: Bank Negara Malaysia; Malaysian Institute of Economic Research

Price indicators

Deflation rate, means a decline in price as measured by the Consumer Price Index (CPI) has remained relatively stable to decline by 1.4% yoy in September (-1.3% in August), marking narrower declines compared to -2.6% in 2Q. The ebbing price declines in transportation (fuel prices) aided a smaller drop in overall prices. Food prices continued to increase. Core inflation, which excludes volatile fuel and food prices, increased by 1.1%-1.2% in May-Aug, marking the underlying inflation continues to remain, albeit at subdued pace.

We expect the deflation to ease in the months ahead to end the year at **an average decline of 1.0% in 2020** as the decline in transport prices ebb on a technical base effect. **Headline inflation is expected to increase by 1.0%-1.5% in 2021**, reflecting a gradual recovery in domestic demand.

Figure 42: Deflation trend set in since March but has eased in recent months

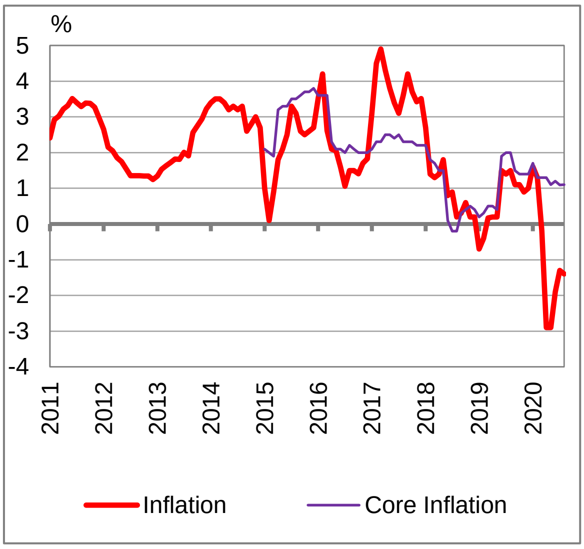
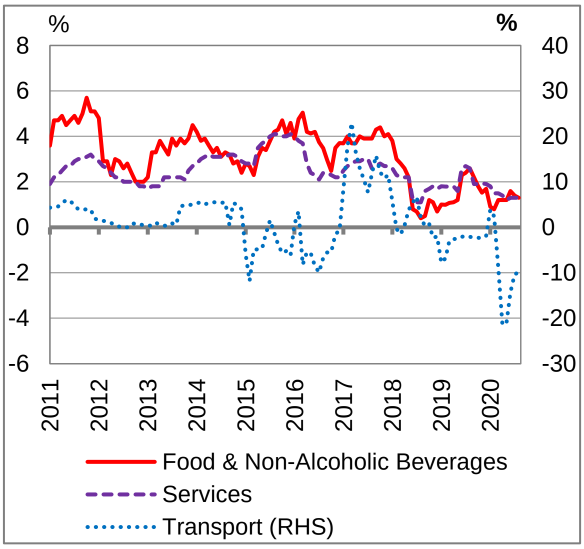


Figure 43: … led by lower fuel prices and electricity discounts



Source: Department of Statistics, Malaysia

Banking loan indicators

Banking system's outstanding loan growth increased by 4.4% yoy in August 2020 (4.5% in July vs. 4.1% in June), mainly supported by households' loan demand, particularly for the purchased of passenger cars and residential property. Outstanding business loan growth moderated to 3.3% in August from 3.9% in July on lower disbursement for working capital. The ending of automatic loan moratorium in September and be replaced by a targeted loan repayment flexibility may result in uneven pace of loan demand in the months ahead.

Figure 44: Outstanding loan growth by type

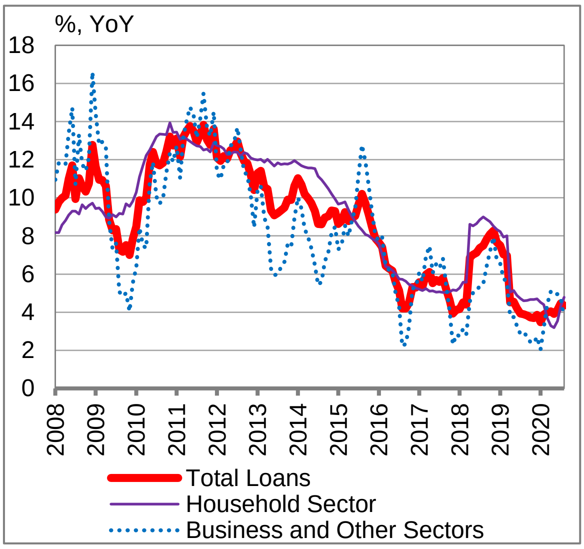


Figure 45: Loan applications growth

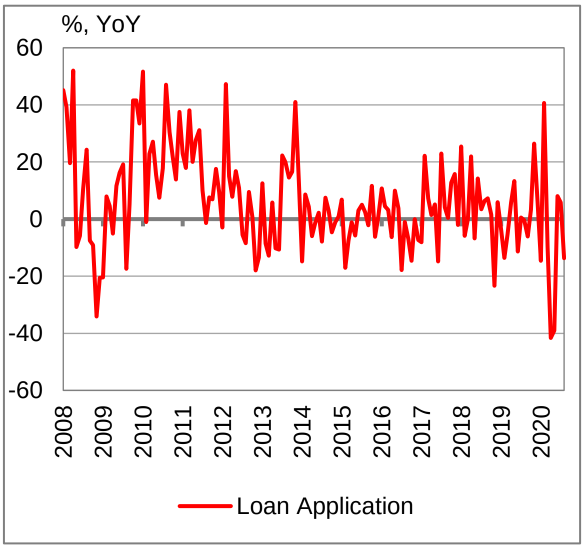


Figure 46: Loan approvals growth

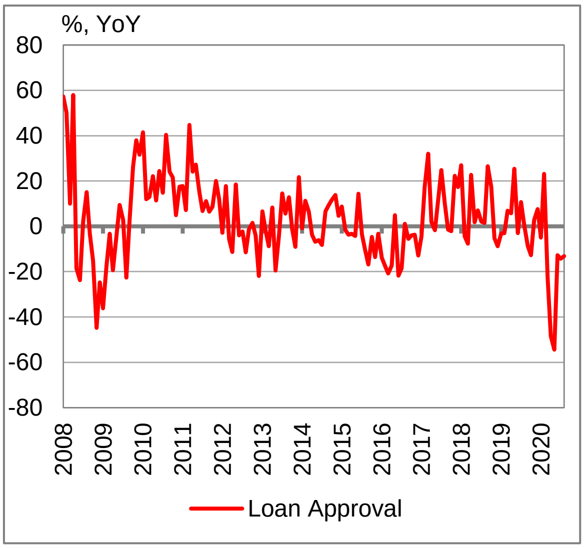
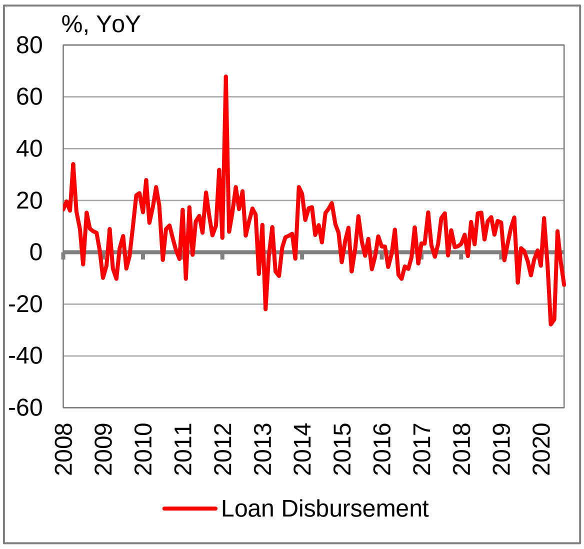


Figure 47: Loan disbursements growth



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

Financial indicators

Foreign reserves accumulation amounted to US$104.8 billion as at 15 September 2020, the highest since May 2018. The reserves position is sufficient to finance 8.7 months of retained imports and is 1.1 times total short-term external debt.

Foreign investors continued to reduce the holdings of Malaysian equities to 21.4% as at end-June 2020 from 22.3% as at end-2019 and net sold RM22.2 billion of shares in the first nine months of 2020. In contrast, foreign investors have continued to accumulate Malaysian Government Securities (MGS) since May 2020 for four straight months, resulted in a net purchase of RM20.6 billion of MGS during the period May-Aug 2020, with holding 39.2% share of MGS as at end-August 2020.

The ringgit has gained some strength against the US dollar since August but performed unevenly against other major and regional currencies. Compared to end-2019, the ringgit has depreciated against Philippine peso (-6.0%), euro (-6.0%), Japanese yen (-4.4%), Chinese renminbi (-3.9%), the US dollar (-1.6%) and South Korean won (-0.4%) while appreciated against Indonesian rupiah (+5.7%), Thai baht (+4.3%), Indian rupee (+1.9%) and pound sterling (+0.6%) as at end-September 2020. **The ringgit is likely to trade between RM4.10-4.15 per US dollar at end-2020.**

Figure 48: Foreign reserves position continue to improve since Mar

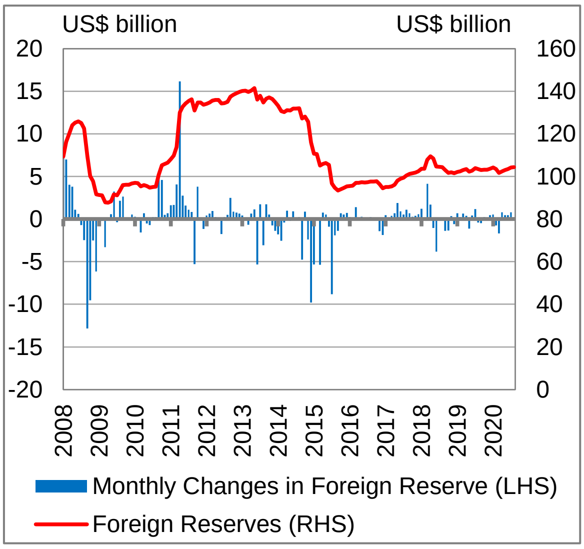


Figure 49: Ringgit's effective exchange rate (EER)

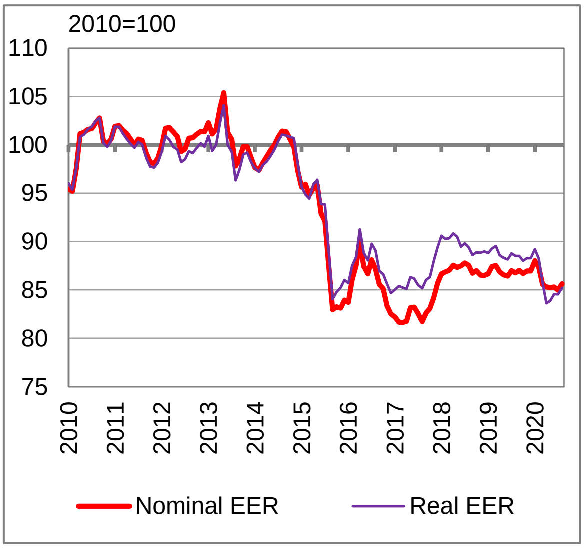


Figure 50: Ringgit against major foreign currencies

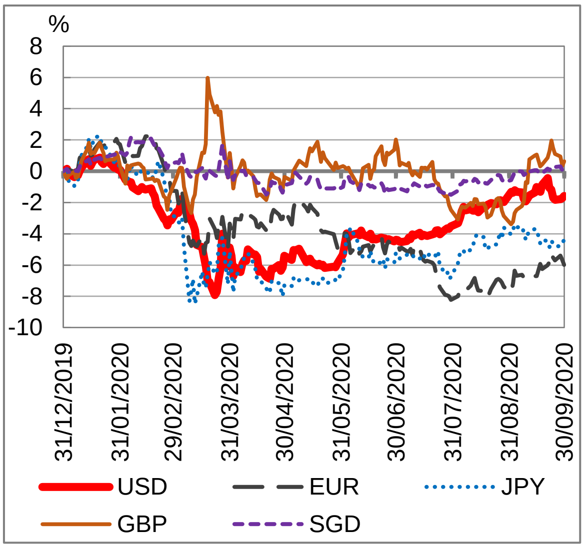
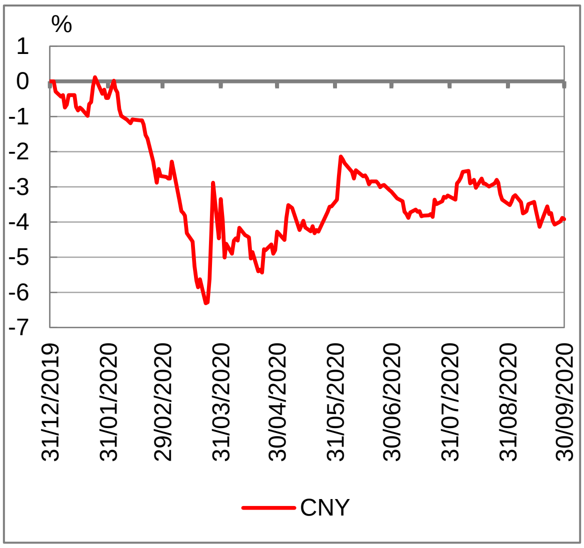


Figure 51: Ringgit against Chinese renminbi



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.coms