Socio-Economic Research Centre

Quarterly Economy Tracker

Apr-Jun 2021

Malaysia's Recovery Path: Realistic vs. Hopeful

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MALAYSIA'S QUARTERLY ECONOMY TRACKER (APR-JUN 2021)

A. World Economic Situation and Prospects

GLOBAL RECOVERY CONTINUES AMID PANDMEMIC FAR FROM OVER

- **Global recovery continues amid the COVID-19 pandemic still weighs.** Global economic prospects continue to improve. The global economy remains on track for a strong but uneven recovery in 2021 as the pandemic weighs.

  The continued divergence in the recovery pace across major advanced and developing countries is attributable to a varying pace of the vaccines' rollout and vaccination. Major economies, led by the US set to register strong growth (6.4% annualised qoq or 0.4% yoy in 1Q 2021), and China's growth momentum too continues to charge ahead (12.7% yoy in 1H 2021), backed by revived consumer spending and exports. In Asia, many economies, including some countries in ASEAN are showing a different speed of recovery due to on-going fast spreading of new variant amid a slow pace of vaccination.

- **Global economic indicators still looking positive, albeit easing off from the high.** So far, so good. Most advanced economies have reopened their economy as the vaccination rates accelerate. Global PMIs indicated that global economy expanded at a solid rate again in June, albeit slowed slightly, led by the service sector while manufacturing also continued to expand strongly. Global trade and industrial continued to rebound not only in sectors related to the COVID-19 (e.g., semiconductors, pharmaceuticals, communication and office equipment) but also increased for most other sectors, such as commodities, minerals and agro-food. Higher prices of commodities also helped to raise export earnings.

- **Markets' focus on inflation and the timing of interest rate normalisation.** With the continued strength of growth rebound in the US economy, along with the inflation spikes and expectations, albeit perceived to be transitory in nature, due to the low base effects and supply bottlenecks, may eventually force the Fed starting to signpost tapering of asset purchases and eventually raise the short-term interest rates. We expect the Fed to commence tapering in late 2021, with the second half of 2022 the likely timing for the first interest rate hike, but on a measured pace.

- **Downside risks to outlook remain.** The outlook is subject to considerable uncertainties. A more persistent pandemic as new more contagious variants are spreading fast, but the existing vaccines are not ineffective against these new variants. Stagflation risk (high inflation and low economic growth), a wave of corporate bankruptcies and financial stress, the prolonged sluggishness in labour market and renewed weakening consumer spending. Premature aggressive monetary withdrawal, including interest rate normalisation could result in tighter global liquidity conditions and asset prices volatility.

B. Malaysia's Economic and Financial Conditions

THE RECOVERY PATH DISRUPTED AS LOCKDOWN AND RISING INFECTIONS BITE

- **Malaysia's recovery path suffers a temporary setback in 2Q and early 3Q 2021.** The Malaysian economy recovery, which saw real GDP's contraction narrowed from -3.1% yoy in 2H 2020 to -0.5% in 1Q 2021, hit a speedbump in June-3Q 2021 as the worsening virus resurgence forcing the reimposition of lockdown and stricter containment measures led to fresh concerns about the risk of stalling the recovery path in 2H 2021.

  Starting on 1 June 2021, the Government has implemented a nationwide full lockdown (FMCO) under Phase 1 of the National Recovery Plan (NRP) to curb rising infections amid the slow vaccination rates. At this point of writing, movement restrictions remain in most states while six states in Peninsular Malaysia (Perlis, Pulau Pinang, Perak, Kelantan, Terengganu, and Pahang) and Sabah have moved into Phase 2 of the NRP, which has allowed more economic sectors and higher manpower capacity in the positive list of reopening.

- **Deeper and longer economic scarring effects.** The lockdown and restricted containment measures have taken a heavy economic toll on domestic demand and business activities via a cutback in demand, supply disruptions, reduced income, weakened consumer sentiment and restricted mobility.

  The bulk of the revenue losses or zero revenue were not only limited to the pandemic-exposed sectors, like retail, restaurants and accommodation, the export-oriented industries too were disrupted by a limited manpower capacity. The most devastating sectors are tourism and travel, which have had endured a prolonged business slump since last year, will take a longer time to heal and rebuild their business sustainability until we achieve at least 50% of population having a completed two doses of vaccination and the lifting of inter-district-state travel ban and reopening of international borders to tourists.

- **Maintained 2021's GDP growth estimate at 4.0%, subject to downside risk.** Our GDP growth estimate of 4.0% for this year is under threat, depending on the future path of virus containment, the pace of vaccination rate as well as how long it takes moving to Phase 2, 3 and 4 of the National Recovery Plan for the reopening of more economic and social sectors.

  PEMERKASA+ and PEMULIH packages provide a temporary relief to households and businesses. But, the worsening pandemic condition and persistent movement restrictions have had a long-lasting impact on businesses and also dented the already impaired balance sheets of the underserved as well as vulnerable, low and middle-income households.

  The lockdown in June has punctuated the low-base effect aided annual comparison in 2Q 2021. July and August are important months to watch as the high level of vaccination rates will offer a glimpse of hope for a fast transition into phases 3 and 4, allowing more economic sectors in the positive list and also social sectors to start operations accordingly. As the point of writing, it is observed that the pace of vaccination has accelerated in June-July, with 14.3% of total population (4.7 million persons) have completed two doses as of 19 July 2021.

  We expect continued recovery in 4Q 2021 as a restoration of consumer spending will be supported by the progress of vaccination, and the containment of virus spread. Amid some pent-up demand, the continued cash aid and loan moratorium help to provide a temporary cash flow relief but a weak recovery in the labour market remains a drag on consumer spending. Lingering political uncertainty remains a drag on investors' confidence.

- **Exports still going strong.** In the first five months of 2021, exports have bounced back strongly to grow by 31.1% yoy, partly aided by low-base effect last year (due to the lockdown induced demand and supply disruptions), and the improvement in global demand of electronics and electrical products, rubber products, chemical products, metal products as well as higher prices of commodities and crude oil have had helped to lift exports higher.

  We expect the renewed lockdown in June and July with a 60% manpower capacity for the export-oriented industries, manufacturing sector and plantation would hamper the delivery of exports shipment, and may result in the cancellation of future orders as the buyers are concerned whether their orders can be fulfilled without interruption.

  Amid a divergent recovery between advanced and regional economies, **exports are expected to grow by 15.8%, with stronger 1H (estimated 26.7% yoy) before slowing to estimated 6.6% yoy in 2H 2021** as the low base effect dissipates. Global demand of electronics will be sustained by increasing usage of digitalisation, data solutions and applications, as well as the 5G development. Palm oil and crude oil prices are expected to hold at steady level, underpinned by firm global demand.

  The Government needs to quickly ratify Regional Comprehensive Economic Partnership (RCEP) as well as provides trade and investment facilitation to the Malaysian companies, manufacturers and exporters to sell more in the international markets within the 15-member RCEP market and 11-member CPTPP bloc respectively.

- **Inflation spiked in 2Q on low base effect.** The Consumer Price Index (CPI) increased by 4.4% yoy in May (4.7% in April and 0.5% in 1Q), bringing the CPI growth to 2.1% in Jan-May 2021, due to the lower base effect last year. The transport index recorded the most significant growth at 26.0%, followed by housing, water, electricity, gas and other fuels (3.2%), furnishings, household equipment and routine household maintenance (2.1%), and food and non-alcoholic beverages (1.5%).

  Headline inflation is expected to moderate to below 4.0% in the near-term as low base effect dissipates. Underlying inflation, as measured by core inflation (0.7% in Jan-May 2021), is expected to remain subdued amid continued spare capacity in the economy. Crude oil prices remain a wild card. Without the continued fuel price subsidy for RON95, headline inflation would have increased much higher. **SERC estimates inflation to increase by 3.0%-4.0% in 2021** (-1.2% in 2020).

- **Data driven monetary policy**. The current appropriate and accommodative stance of monetary policy, supported by fiscal and financial relief measures (such as loan moratorium, EPF withdrawals, and cash payments) are expected to cushion the prolonged pandemic impact on businesses and households.

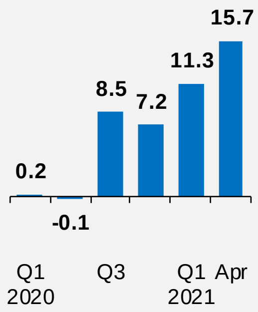
  During this pandemic and lockdown as well as restricted movements-induced supply and demand disruptions, monetary policy has its limitation relative to a quick and timely fiscal stimulus. Hence, further lowering of interest rate may not be effective to spur consumption and investment demand. Households' cautious sentiment, worried about rising infections, restricted mobility as well as concerned about job security and income prospects due to the disrupted economic recovery, causing cautious discretionary spending. Businesses adopt a wait-and-see investment stance until more clarity amid lingering political uncertainty.

We reckon that a reduction in interest rate can provide partial cash flow relief for borrowers but direct cash flow assistance, such as cash handouts to targeted households and automatic loan repayment moratorium would be handier. With the current restricted movements likely to be a temporary one, it is appropriate to reserve the monetary arsenal (a historic low interest rate) for future shocks. Hence, we expect BNM to keep the overnight policy rate (OPR) steady at 1.75% by end-2021.

We expect Bank Negara Malaysia (BNM) to continue closely monitor developments surrounding the pandemic, including the incoming data and information to ascertain that the economic recovery is not stalled and derailed in the quarters ahead. The central bank also weighs on domestic inflation expectations, and also the implications on exchange rate and capital flows arising from the Fed's tapering of bonds purchase and the eventual increase in interest rate in 2022-2023.

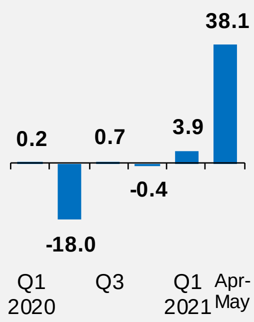
SNAPSHOTS OF MALAYSIA'S ECONOMIC RECOVERY TRACKER

Leading index (LI)
(%, YoY)



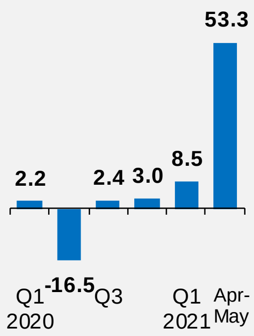
- Apr's LI, a gauge of forward economic growth anticipates a favourable economic performance ahead if the pandemic eases in 2H 2021.
- Jun-Jul's leading index will be dampened by the lockdown and restricted containment measures.

Industrial output
(%, YoY)



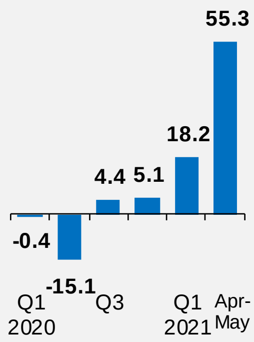
- Industrial output growth soared on solid manufacturing output expansion and also low base effect.
- Higher output growth in export-oriented industries while uneven performance seen in domestic-market oriented industries.
- Crude petroleum output remained sluggish.

Manufacturing sales
(%, YoY)



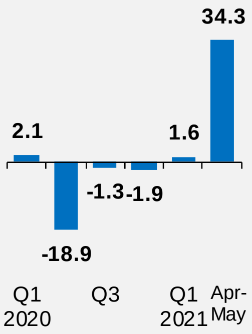
- Manufacturing sales expanded robustly in most sub-sectors, particularly transport equipment, electrical and electronic products, as well as rubber and plastic products.
- The lockdown starting Jun is expected to dampen the growth momentum given limited sectors to operate with capping manpower capacity.

Exports
(%, YoY)



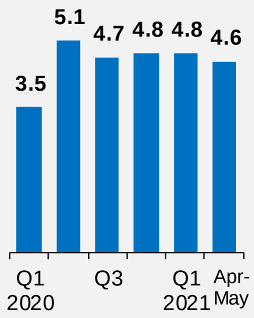
- Strong external demand came from electrical and electronic (E&E) products, rubber and rubber products as well as palm oil and palm-based products.
- Limited and restricted operations for some export sectors under FMCO and EMCO will affect production and exports.

Retail sales
(%, YoY)



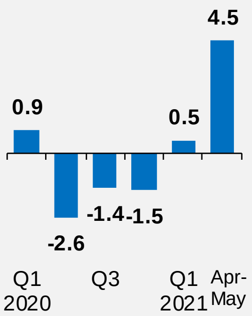
- Cautious sentiment, reduced income, job losses and restricted mobility would dampen consumer spending.
- Going into 3Q-4Q 2021, it is hoped that higher vaccination rates and containment of infections leading to the normalcy of economic and social activities, including inter-state travel and a gradual reopening of the international borders would help to lift retail sales.

Unemployment rate
(%)



- The unemployment rate has hovered between 4.5% and 4.9% since Jun 2020 to May 2021, after easing from 5.3% in May 2020.
- However, the labour market conditions will be dampened by the implementation of more restricted containment measures.
- The Employment Insurance System (EIS)'s loss of employment registered a total of 35,493 as of 2 July 2021 (107,024 in 2020).

Headline inflation
(%, YoY)



- Headline inflation turned to positive growth starting Feb and has increased by 4.7% in Apr and 4.4% in May, the highest level since Mar 2017.
- The sharp spike in CPI was attributable to lower base effect in electricity tariff and petrol prices as well as cost-driven increases in households' items.
- The supply bottlenecks and rising prices of raw materials would eventually feed onto consumer inflation if the producers unable to absorb increased cost of production.
- We estimate headline inflation to increase by 3.0%-4.0% in 2021 (-1.2% in 2020).

Source: Department of Statistics, Malaysia

WORLD ECONOMIC SITUATION AND PROSPECTS

GLOBAL RECOVERY CONTINUES AMID PANDEMIC FAR FROM OVER

Global recovery continues in 2Q 2021, albeit divergence in major advanced and developing economies. We continue to see the divergence in recovery paths due to a different speed of vaccinations between advanced and emerging as well as developing economies, the latter grouping was somewhat hindered by an inequitable vaccine distribution. It is a critical time now for many countries in Southeast Asia as they are in a tight race between the speed of new variants generation of the virus and the speed of vaccination.

While the advanced economies are returning to normalcy faster than their peers in emerging and developing economies, no time for complacency in getting more people vaccinated given the dramatically spreading of new mutated variants.

The comfort news is that the vaccination is somewhat effective against the new variant. The world data for the COVID-19 countries showed that upon reaching a certain threshold of vaccination, it provides a mitigation to ensure that people do not fall sickly and hospitalised from the virus infection.

Both the US and China economies continued to lead the global recovery, followed by still moderate recovery in euro area and Japan, albeit unevenly amid the continued roll out of various stimulus packages and measures.

Global economic recovery tracker. High frequency global economic indicators and data continued to show decent reading of economic and business data as well as trade flows.

a) The **OECD composite leading indicators** (CLIs), which is designed to anticipate turning points in economic activity relative to trend, showed a sustained growth expansion in the OECD area as a whole, including the United States, Japan, Canada, euro area, Russia and China.

b) **Global Purchasing Managers Index (PMI) for manufacturing and services** continued their expansion trail since July 2020. June's PMI of 56.5 (58.5 in May) was among the best registered over the past 15 years. Companies benefited from rising intakes of new orders, including increased new export business.

c) **Global trade volume and industrial production** have surpassed the pre-pandemic level and continued the expansion starting 2021, riding on the global recovery track and robust demand, especially semiconductors, minerals and commodities. We expect continued uptrend in the second half-year of 2021 given a wider vaccination coverage, followed by more easing of containment measures.

d) **Global semiconductor sales remained intact**. Sales have expanded at a robust growth of 26.2% yoy in May (21.8% in April and 17.8% in March), underpinned by across-the-board increases in all regions and product categories. Underpinned by the technology upcycle and 5G development, the World Semiconductor Trade Statistics (WSTS) revised its projection of semiconductor sales to grow by 19.7% from 10.9% in 2021 and 8.8% from 5.1% in 2022 (6.8% in 2020).

e) **Commodity prices trended up substantially.** Energy commodity prices continued their strong price rally in June, with both WIT and Brent crude oil prices breaching US$70 per barrel (bbl), nearly 50% higher from December 2020. Firmed global demand relative to a tight supply market are expected to keep crude oil prices steady amid the development of potential supply increases by OPEC+. The U.S. Energy Information Administration (EIA) projects that Brent crude oil price to average US$68.78/bbl in 2021 (65.0% higher than US$41.69/bbl in 2020) in its monthly Short-Term Energy Outlook (STEO) in July.

Prices of non-energy commodities eased a little in June 2021 from nearly 10-year high in May. Crude palm oil (CPO) prices off the peak from all-time high in May (average RM4,572 per metric tonne (mt)) to average RM3,830.50/mt in June.

Table 1: Real GDP growth (% YoY)

	2019	2020	2021 Q1	2021*f* (IMF)	2021*f* (WB)	2021*f* (IMF)	2021*f* (WB)
World	2.8	-3.3	N/A	6.0	5.6	4.4	4.3
United States	2.2	-3.5	0.4	6.4	6.8	3.5	4.2
Euro Area	1.3	-6.5	-1.3	4.4	4.2	3.8	4.4
China	6.1	2.3	18.3	8.4	8.5	5.6	5.4
Japan	0.0	-4.7	-1.6	3.3	2.9	2.5	2.6
India	4.0	-7.3	1.6	12.5	8.3	6.9	7.5
Malaysia	44	-5.6	-0.5	6.5	6.0	6.0	4.2
Singapore	1.3	-5.4	1.3	5.2	N/A	3.2	N/A
Indonesia	5.0	-2.1	-0.7	4.3	4.4	5.8	5.0
Thailand	2.3	-6.1	-2.6	2.6	2.2	5.6	5.1
Philippines	6.1	-9.6	-4.2	6.9	4.7	6.5	5.9
Vietnam	7.0	2.9	4.5	6.5	6.6	7.2	6.5

Note: World GDP growth for 2019 and 2020 by IMF; Annual GDP for India is on fiscal year basis; N/A = Not applicable or not available

Source: Officials (unadjusted data except quarterly GDP for Euro Area); IMF (World Economic Outlook (WEO), Apr 2021); World Bank (Global Economic Prospects, Jun 2021)

Still accommodative monetary policy amid inflation risk. Amid the continued strength of global recovery, especially in the US and China, the stance of monetary policy remains highly accommodative to ensure a durable global recovery path. High inflation risk, albeit perceived to be a transitory in nature due to low base effect and supply bottleneck have stirred market expectations that the central banks would change its monetary course when the economic recovery is secured to keep the inflation expectations at bay.

Following the US Federal Reserve's somewhat hawkish assessment in its June's projection, there is growing expectations that the Fed's tapering of bonds purchase may start sooner than expected, followed by the eventual interest rate increases in 2022-2023.

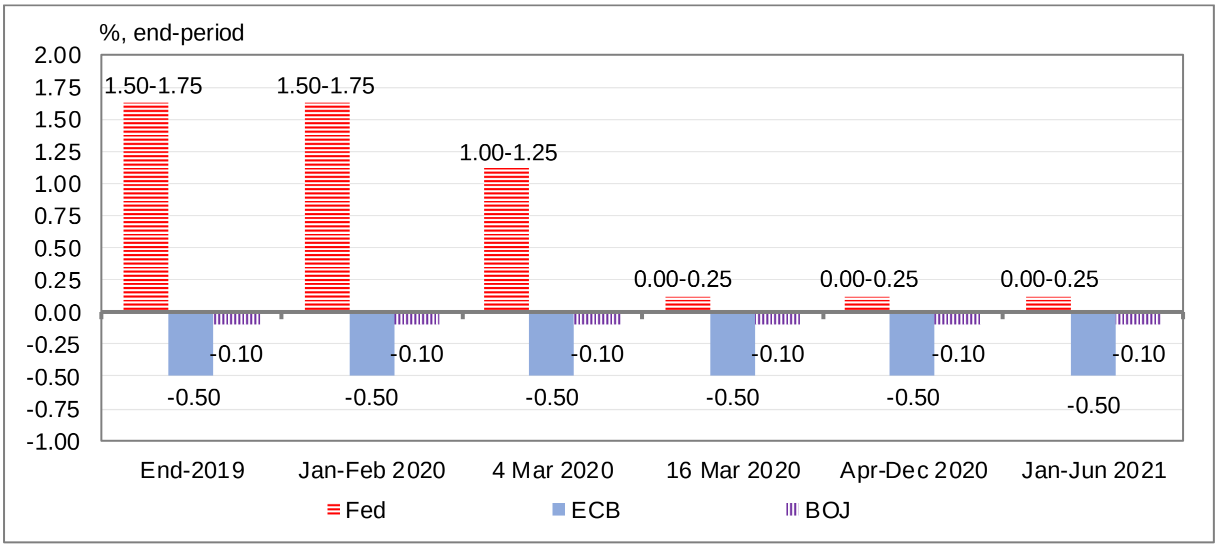
Central banks in Asia have been keeping their policy rate steady for now while keeping a close watch on the recovery strength amid a fresh wave of rising new variant infections. The People's Bank of China (PBOC) cut the reserve requirement ratio (RRR) for all banks by 50 basis points (bps), effective from 15 July, a move seen to underpin its post-COVID economic recovery that is starting to lose momentum as the favourable low-base effects wane. Despite helped by surging exports, pent-up COVID demand has now peaked and that growth rates will start to moderate in the second half of the year, weighed down by weakening exports and surging raw material prices that hurt smaller firms.

Table 2: Policy rate (%)

End-period of	2008	2009	2010	2011	2012	2016	2017	2018	2019	2020	2021 (Jun/ Jul)	2021f
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	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	-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	-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	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	4.00	4.00
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	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	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	3.75	3.50	3.50
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	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	2.00	2.00	2.00

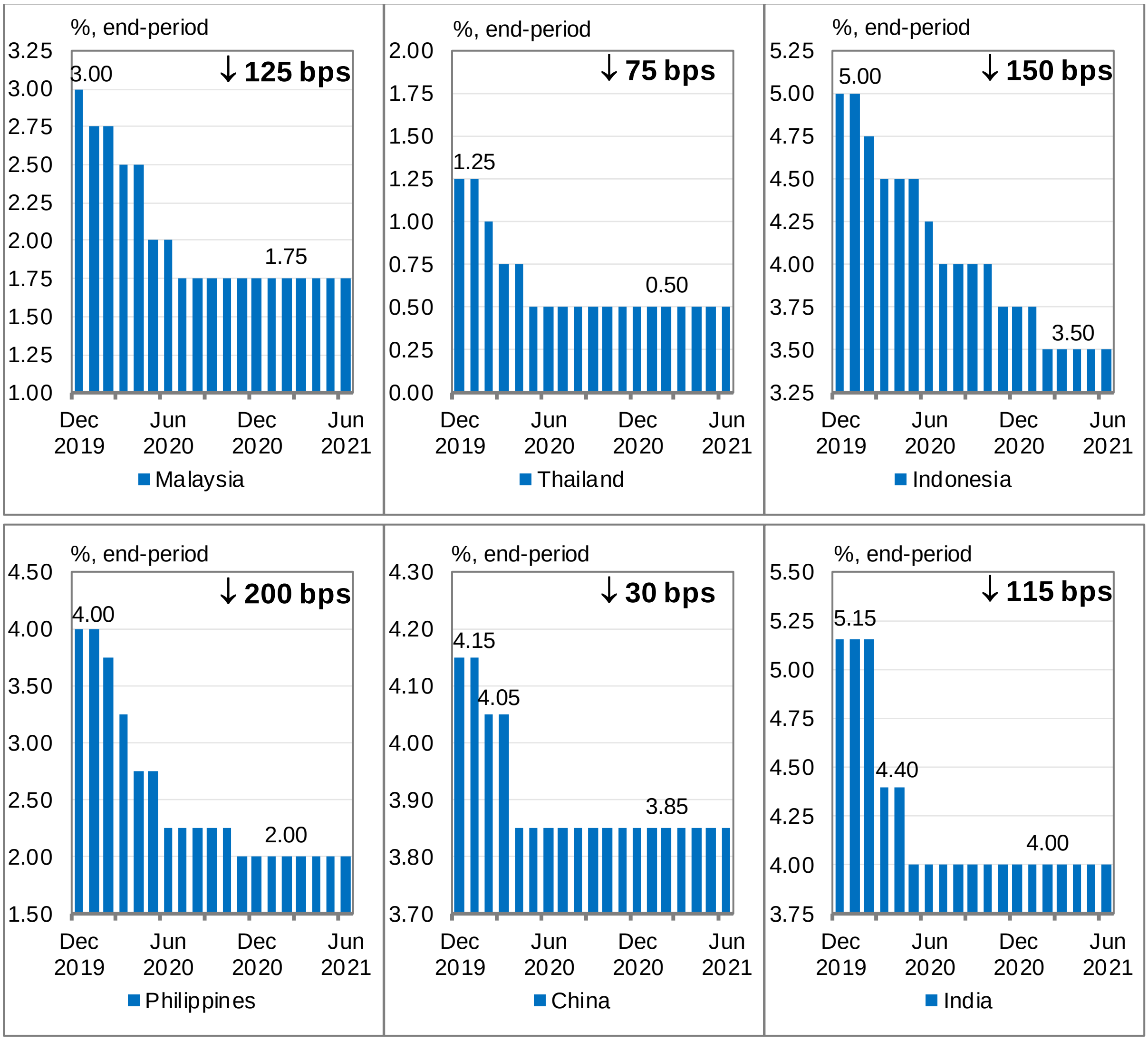
Source: Officials; SERC

Figure 1: Policy rate movements of major central banks



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

Figure 2: Policy rate movements of selected regional central banks



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

Figure 3: CLIs continue to increase at a steady pace

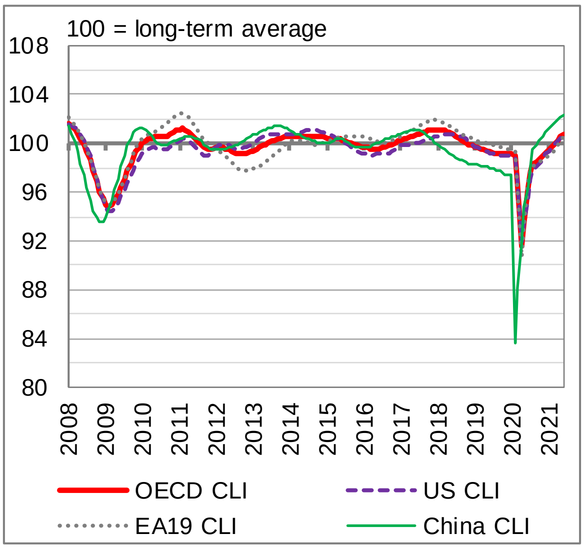
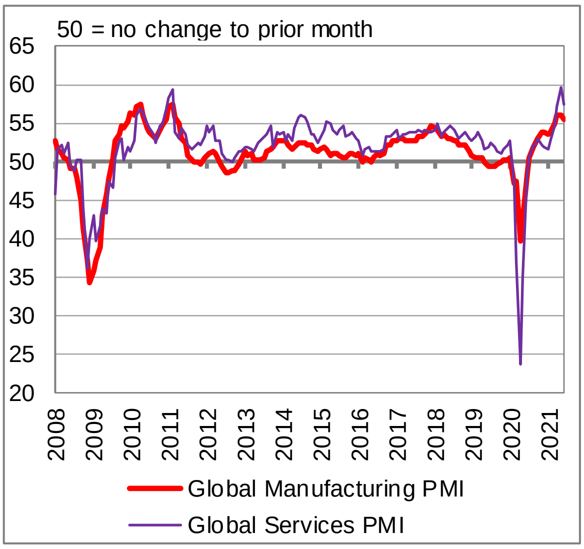


Figure 4: Still solid global manufacturing and services growth ahead



Source: OECD; Markit

Figure 5: Strong uptrend in world trade volume and industrial output

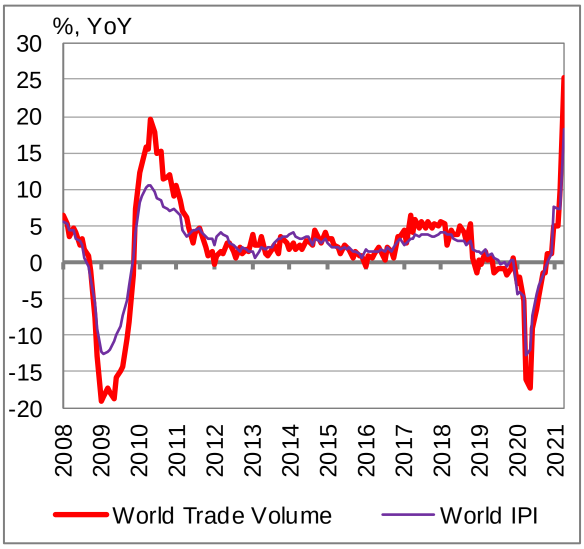
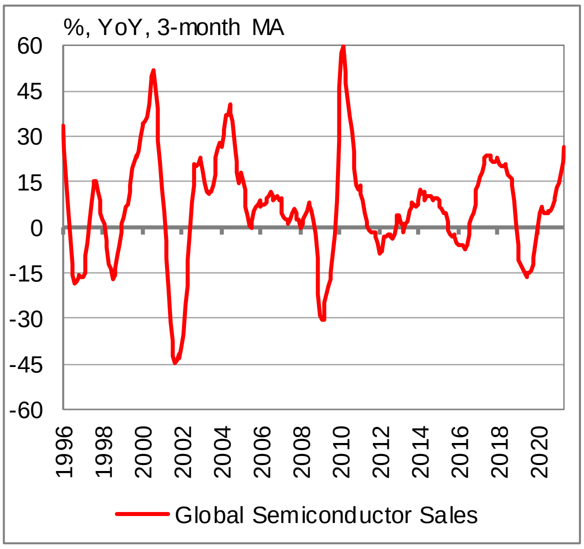


Figure 6: Robust demand of global semiconductor



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

Figure 7: OECD Business Confidence Index

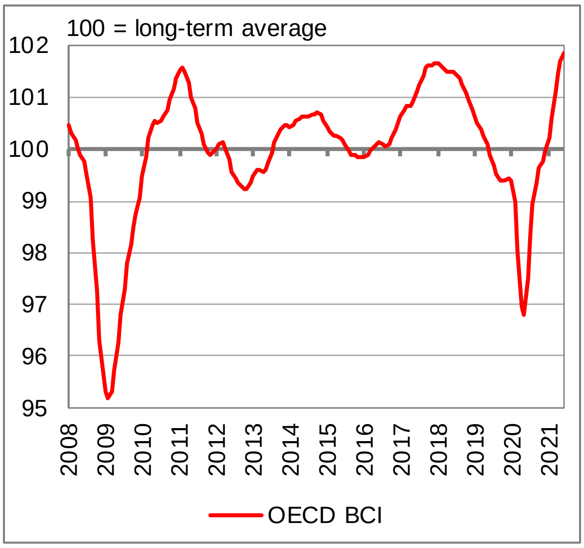
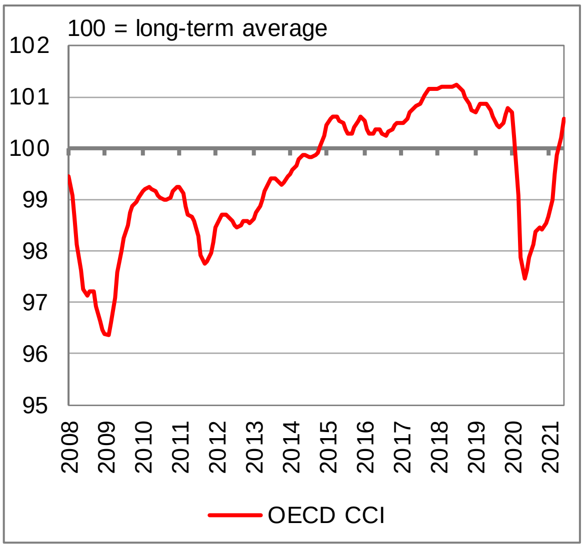


Figure 8: OECD Consumer Confidence Index



Source: OECD

Figure 9: Crude oil prices breached US$70/bbl in Jun 2021

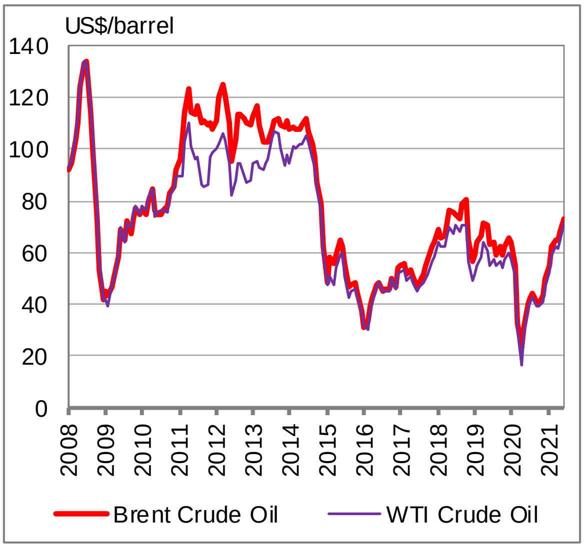
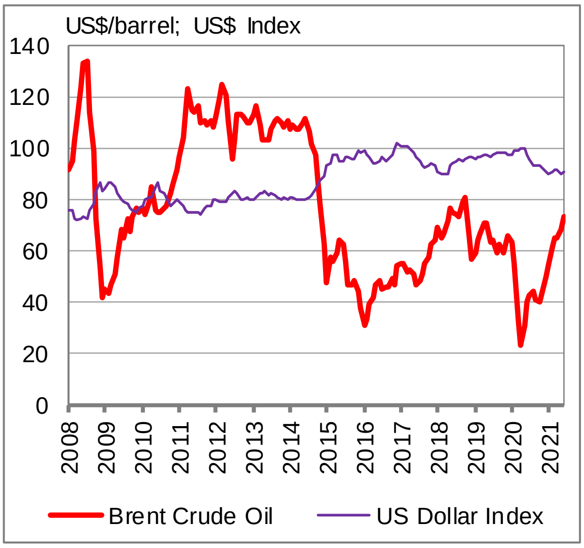


Figure 10: Brent crude oil price vs. the US dollar index



Source: World Bank; The Wall Street Journal

Figure 11: Commodities prices on a solid uptrend

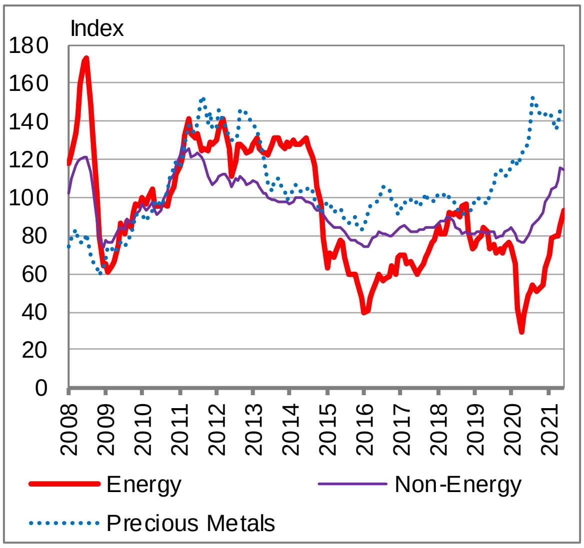
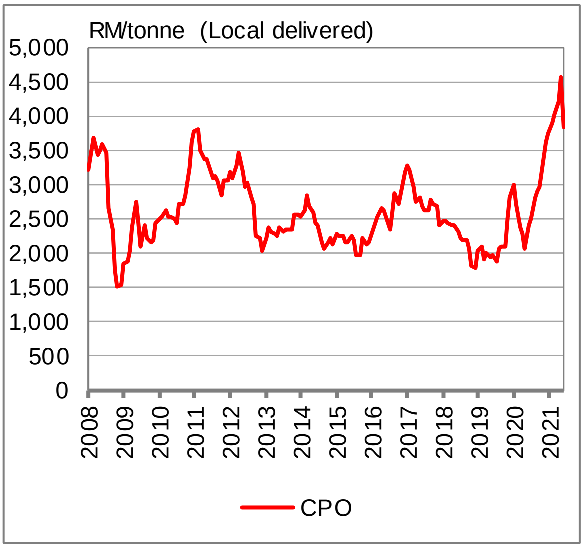


Figure 12: CPO prices eased in Jun after hitting all-time high in May 2021



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

ECONOMIC DEVELOPMENTS IN MAJOR ECONOMIES

The United States: The US economy soared to an annualised 6.4% qoq in 1Q 2021 (0.4% yoy vs. 4.3% qoq and -2.4% yoy in 4Q 2020), buoyed by stimulus checks, increased fixed residential and non-residential investment as well as government spending. Biden's aggressive fiscal stimuli helped to fuel economic engine and consumers' sentiments. A wider coverage of vaccination (nearly 50% of total population have completed two doses as at end-June), steady improvement in the labour market condition, and continued wage growth should keep the US economy going, albeit slower in 2H 2021 as post COVID-19 pent up demand wanes. The IMF expects the US economy to expand by 6.4% this year, highest since 1984. High inflation risk and the Fed's tapering of bonds purchase and the normalisation of interest rate are attendant risks to the growth outlook.

Figure 13: Both PMIs for manufacturing and services indicate firmly expansion

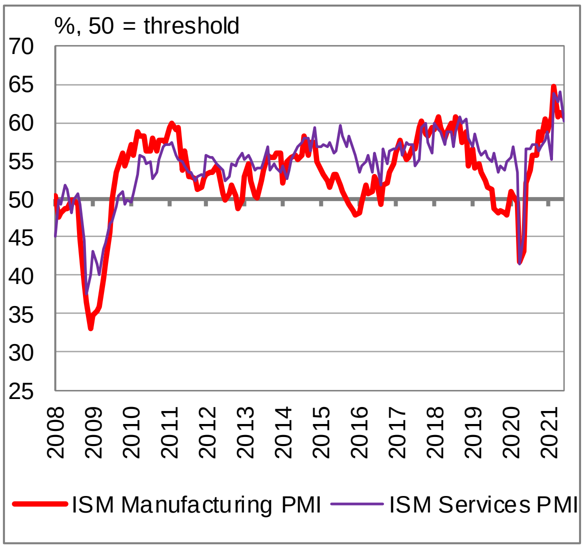


Figure 14: Higher industrial output to meet strong retail spending

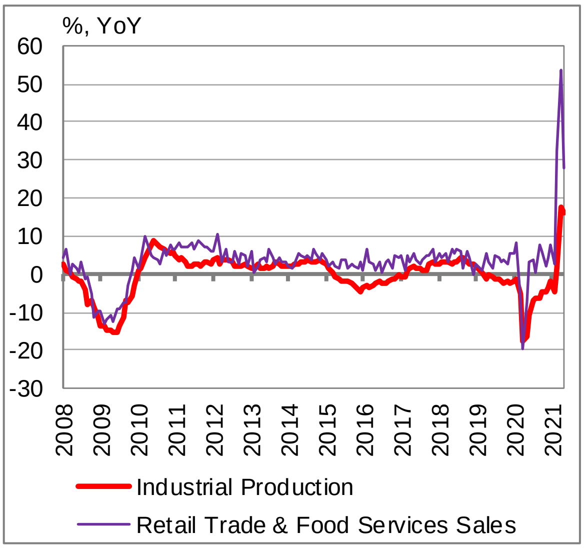


Figure 15: Jobless rate ticked higher in Jun though more employment created

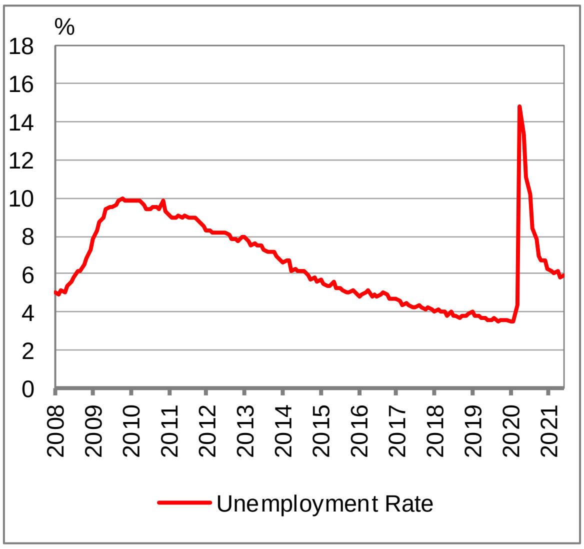
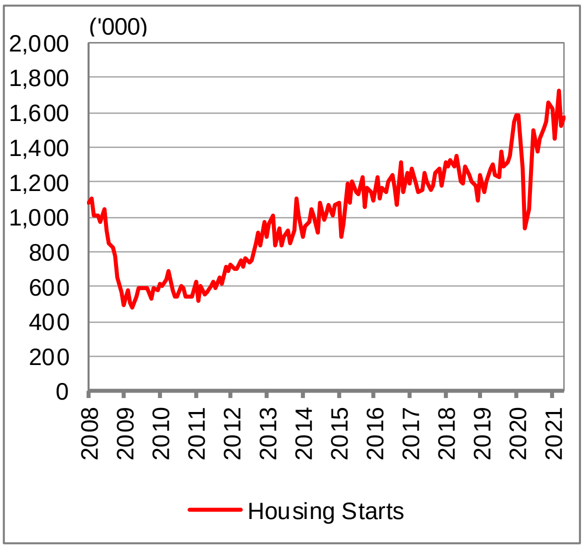


Figure 16: Housing starts continued its upward trend, albeit somewhat volatile



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

Euro area: The euro area fell into another technical recession as GDP contracted by 0.3% qoq (or -1.3% yoy) in 1Q 2021 and 0.6% qoq (or -4.7% yoy) in 4Q 2020, dragged by unfavourable private consumption activities. The €672.5 billion Recovery and Resilience Facility (RRF) is a key instrument to support reforms and investments undertaken by its Member States. High frequency data suggest that the economic performance will turn around in 2H 2021 as both manufacturing and services PMI accelerated in the second quarter. Industrial production and retail sales were doing well, though helped by an extremely low base effect.

Figure 17: Both PMI readings are climbing higher in the second quarter

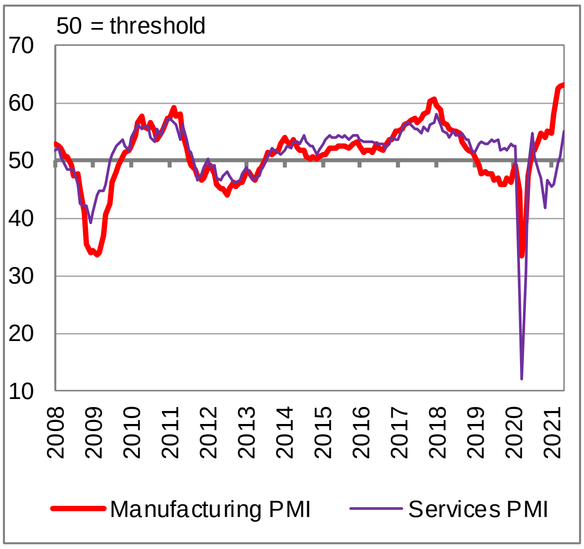


Figure 18: Real economic activities have performed well

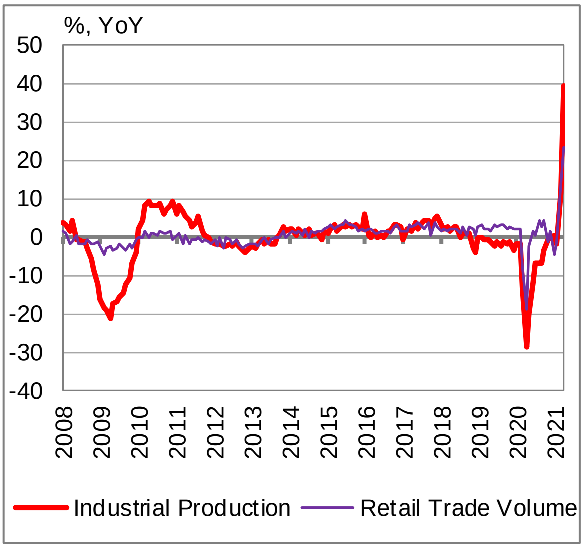


Figure 19: Headline inflation is soaring high, mainly due to rising energy prices

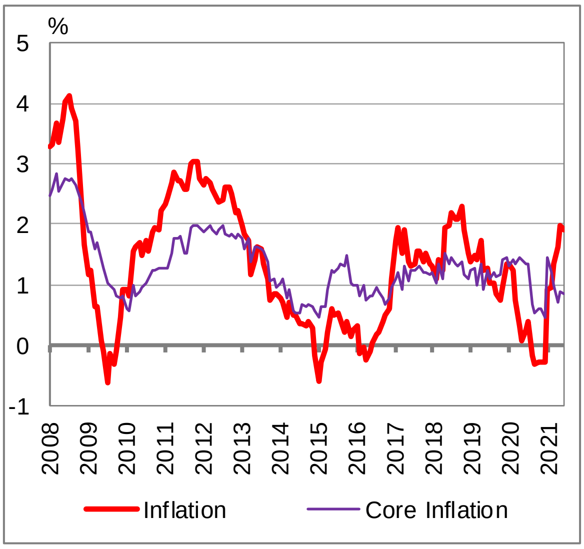
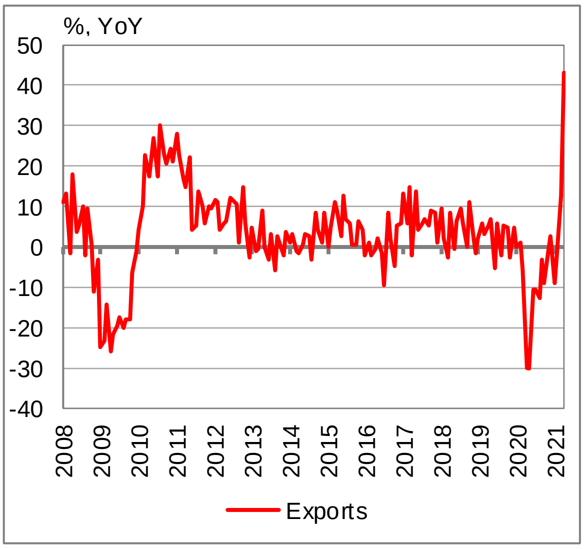


Figure 20: Exports regained losing ground on stronger global demand



Source: Markit; Eurostat

Japan: The Japanese economy contracted by 1.0% qoq (-1.6% yoy) in 1Q 2021 after two consecutive quarters of growth in the second half-year of 2020. The economic prospects remained uncertain before clear indicators appearing. Both industrial output and retail sales have yet returning to pre-pandemic level, whereby strong growth in Apr-May was largely due to low base effect. Price level remained subdued. The July's Tokyo Olympics without spectators would have almost negligible economic spillover effects on domestic economy and business despite having poured in billions of spending in the Olympics related infrastructure and preparations.

Figure 21: TANKAN indicates that manufacturers remain optimistic in 2021

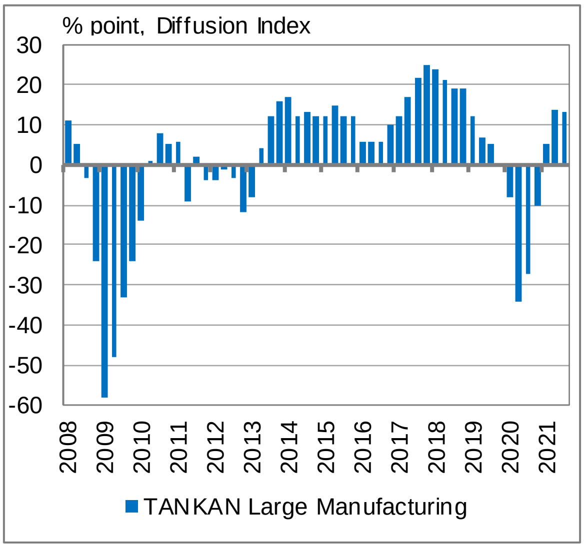


Figure 22: Both industrial production and retail sales have yet returning to normalcy

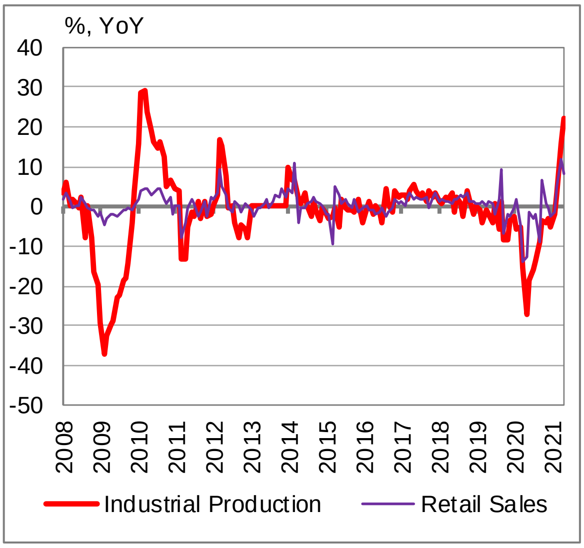


Figure 23: Deflation for the eighth consecutive month. Core inflation was in deflationary territory for two months

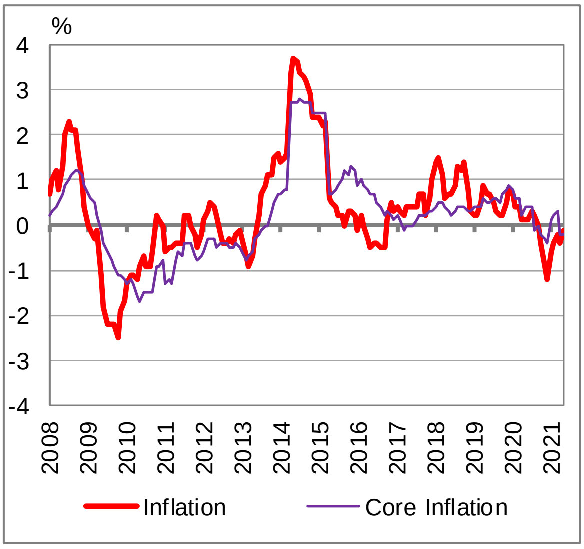
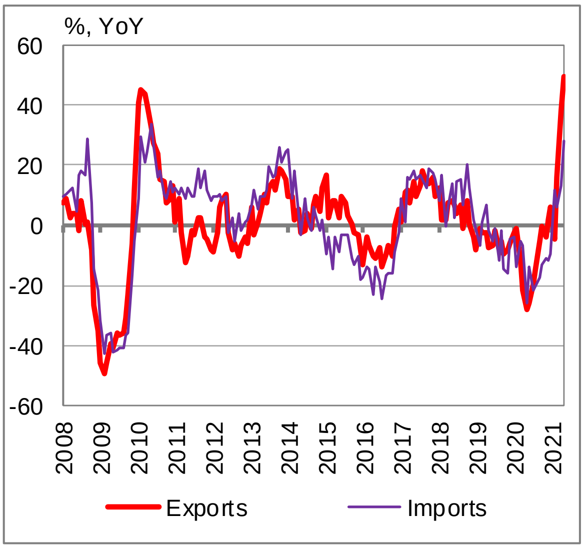


Figure 24: Exports remained volatile; incurred trade deficit for second time in May 2021



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

China: The Chinese economy continued to expand further by 7.9% yoy in 2Q 2021 after posting a double-digit growth of 18.3% yoy in 1Q 2021 (+6.5% in 4Q 2020; +2.3% in 2020), well above its pre-pandemic level. Incoming data seemingly show the growth has moderated in 2H 2021 as the pent-up demand post COVID19 has peaked; waning low-base effect and weakening exports. The Beijing authorities remain confident to achieve the 6% GDP growth target. The People's Bank of China (PBOC) cut the reserve requirement ratio (RRR) for all banks by 50 basis points (bps), effective from 15 July, a move seen to underpin its post-COVID economic recovery through providing liquidity to support smaller firms.

Figure 25: Both PMI readings signalled continued expansion, albeit moderately

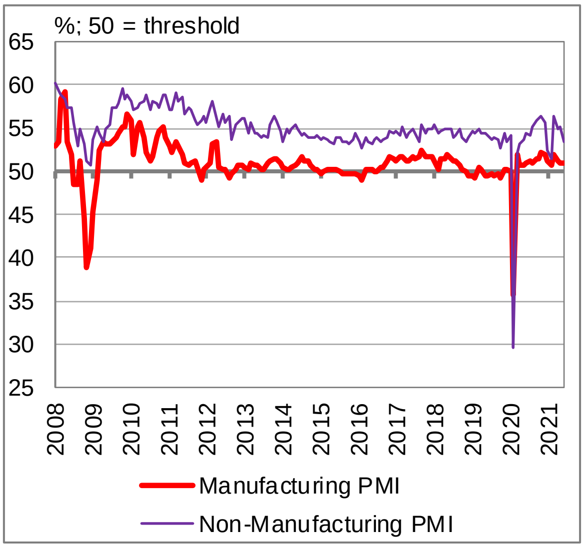


Figure 26: Both industrial output and retail sales growth have pulled back as the low-base effect normalises

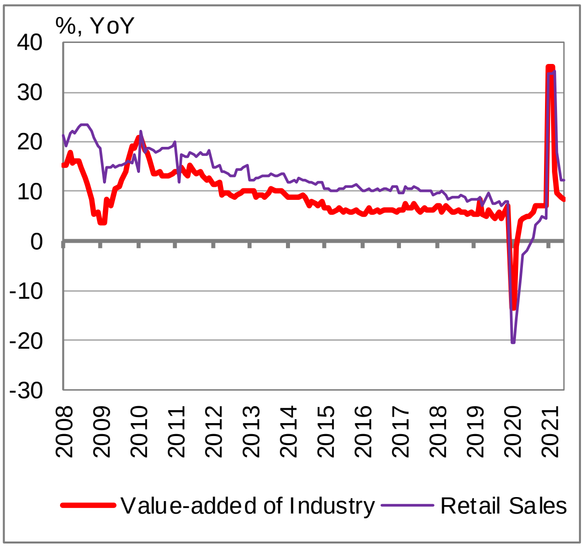


Figure 27: Fixed assets investment mainly came from the manufacturing sector and real estate industry

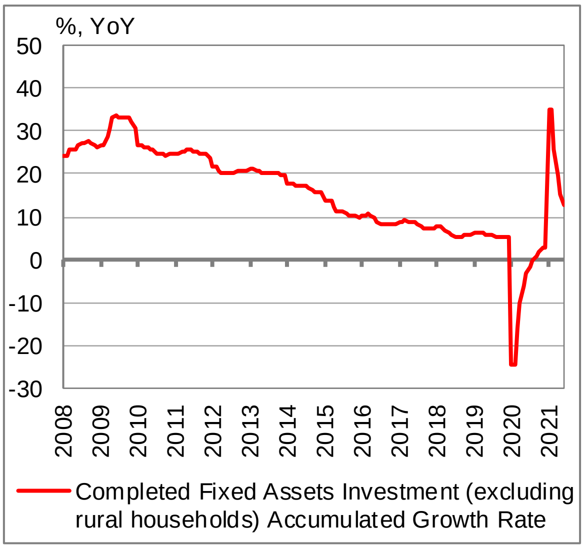
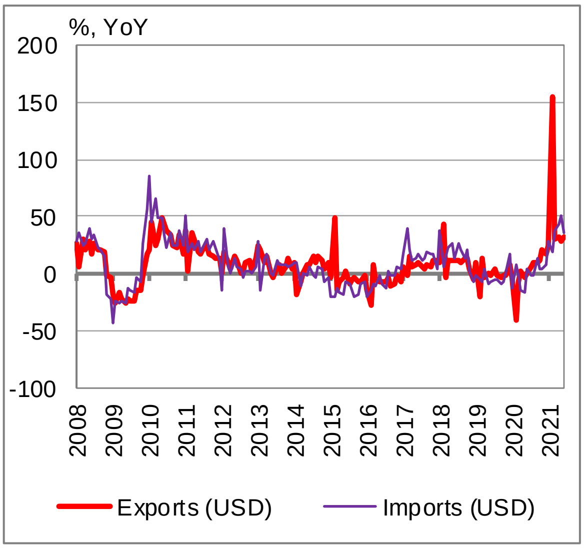


Figure 28: Exports sustained at around US$250 billion per month in Jan-May 2021

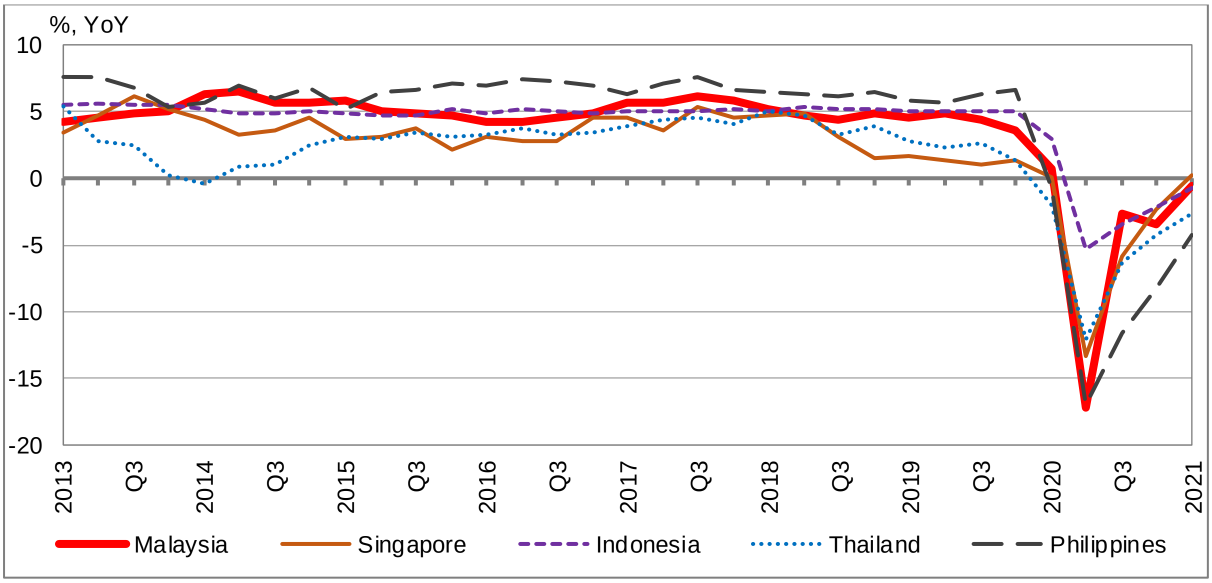


Source: National Bureau of Statistics of China; General Administration of Customs, China

ASEAN-5 ECONOMIES' KEY ECONOMIC DATA TRACKER

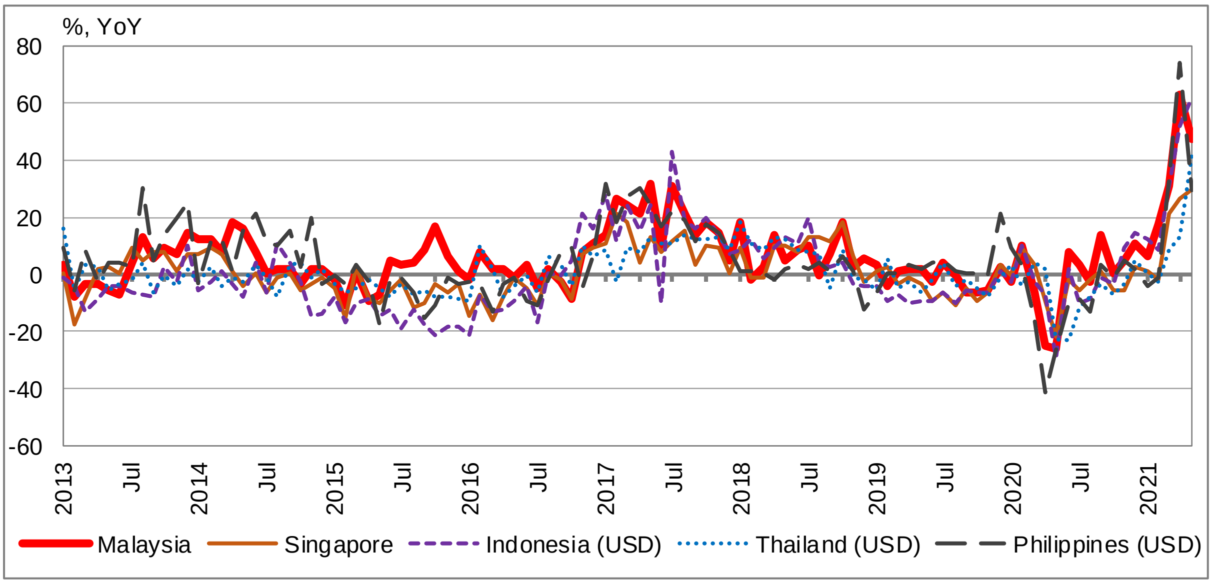
ASEAN-5 economies (Malaysia, Singapore, Indonesia, Thailand and the Philippines), with the exception of Singapore have not returned to the expansionary mode in 1Q 2021. Given the resurgence of COVID-19 caseloads and re-imposition of containment measures, the recovery paths in some countries have been disrupted in 2Q and 3Q. The exports engine will continue to support their economy, with global demand coming largely from electronics and electrical products, commodities as well as oil and gas products. Domestic retail and travel as well as tourism sectors remained weak, depending on the level of infections and pace of vaccination as well as less restrictive reopening of international travel.

Figure 29: Real GDP growth trend



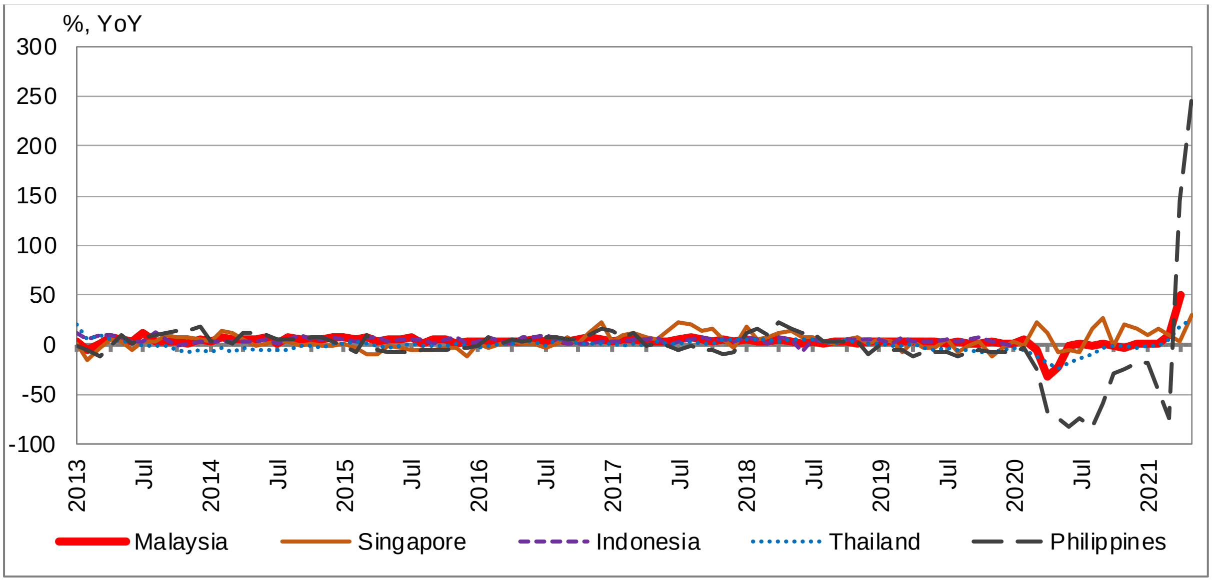
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; National Economic and Social Development Board, Thailand; Philippine Statistics Authority

Figure 30: Export growth trend



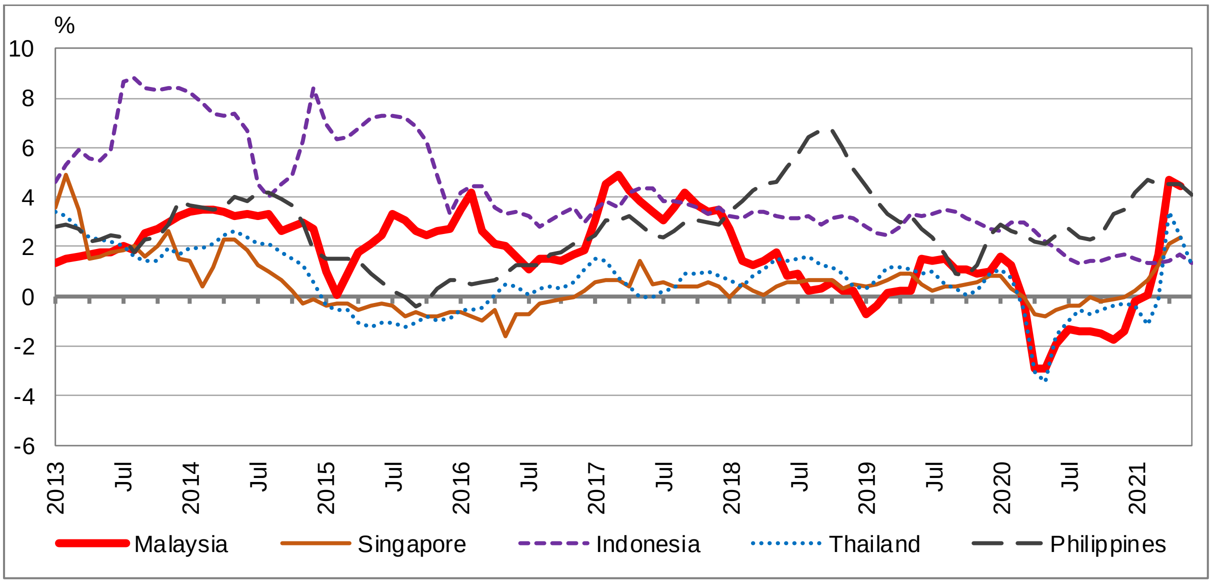
Source: Department of Statistics, Malaysia; Singapore Department of Statistics; Statistics Indonesia; Bank of Thailand; Philippine Statistics Authority

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

THE RECOVERY PATH DISRUPTED AS LOCKDOWN AND INFECTIONS BITE

Prolonged lockdown dampened the recovery path. A nationwide Full Movement Control Order (FMCO) starting in June, followed by four phases of the National Recovery Plan starting in July, which saw some key states placed under the Enhanced MCO until 16 July, have severely disrupted the recovery path.

Real GDP is expected to rebound to positive growth on annual basis in 2Q 2021 (-0.5% yoy in 1Q), aided largely the low base effect in 2Q 2020 due to stricter lockdowns between mid-Mar and early May. Growth in 2H 2021 is critically depending on the level of vaccination and easing of containment measures.

Speedy vaccination is the only hope. A three-pronged strategy: Speeding up vaccination, testing-tracing and insolation is important to help build health protection and return to normalcy.

Domestic demand is dented. The lockdown, reduced income, job losses, and worried about high infection rates are expected to reduce discretionary consumer spending in June and early 3Q until the pandemic conditions subside with the projected higher vaccination rates between 40%-60% in Phase 3 and 4.

Private investment remains cautious. We expect a continued divergent of private investment growth between the export-oriented industries and domestic-market sectors. The export-oriented manufacturing sectors, especially electronics and electrical products, rubber products, chemical products would incur increased capital spending. Domestic sectors, particularly the travel, tourism, retail, accommodation and property sectors may halt all their expansion plan, holding back to wait for better clarity until they repair and rebuild the impaired balance sheet.

Exports remained the key growth engine. Amid facing the limited manpower capacity-induced production and supply chain disruptions, exports are expected to remain strong estimated 15.8% in 2021 (-1.4% in 2020), albeit slower in 2H 2021 due to the disappearing of low base effect. This will be supported by demand of electronics and electrical products, chemical products, health care products, and palm oil, aided by higher commodities prices.

Headline inflation remains elevated but will moderate in 2H 2021 as low base effect wanes. The current surge in headline inflation (0.5% in 1Q and 4.5% in Apr-May) was due to a combination of low base effect, fuel prices and some cost-push factors. Higher producer price index and rising cost of raw materials as well as the supply bottleneck also may eventually pass through onto consumer inflation if they cannot fully absorb increased cost of production. **Overall headline inflation is estimated to increase by 3.0%-4.0% in 2021** (-1.2% in 2020).

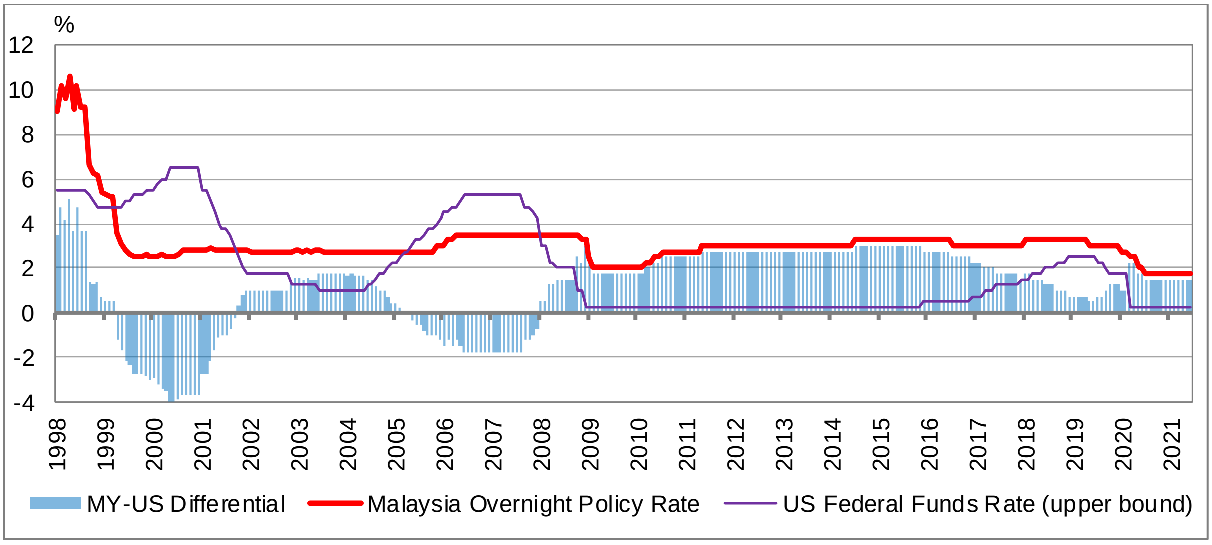
SERC maintains its GDP growth estimates of 4.0%, subject to downside risk due to the continued deeper and lasting economic scarring effects from the movement restrictions and restricted inter-state travel. The prolonged restricted containment measures as well as a potential snag in the on-going improvement of vaccination program are risks to the growth outlook in 2H 2021. The accelerated pace of the vaccination rates in June and July boasts hopes for the transition to Phase 3 and 4 sooner than expected, allowing the reopening of more economic and social sectors as well as returning to more normalcy.

Table 3: Real GDP growth (% YoY)

Economic Sector [% share to GDP in 2020]	**2019**	**2020**	**2021 Q1**	**2021*e* (BNM)**	**2021*e* (SERC)**
By kind of economic activity					
Agriculture [7.4%]	2.0	-2.2	0.4	4.2	2.7
Mining & Quarrying [6.8%]	-0.6	-10.6	-5.0	3.1	2.5
Manufacturing [23.0%]	3.8	-2.6	6.6	8.8	4.3
Construction [4.0%]	0.4	-19.4	-10.4	13.4	5.0
Services [57.7%]	6.2	-5.5	-2.3	6.6	5.6
By type of expenditure					
Private Consumption [59.5%]	7.6	-4.3	-1.5	8.0	4.2
Public Consumption [13.4%]	1.8	3.9	5.9	4.4	3.4
Private Investment [15.7%]	1.6	-11.9	1.3	5.4	5.1
Public Investment [5.2%]	-10.7	-21.3	-18.6	15.2	7.4
Exports of Goods and Services [61.6%]	-1.0	-8.9	11.9	13.1	3.9
Imports of Goods and Services [55.1%]	-2.4	-8.4	13.0	14.1	5.9
Overall GDP	**4.4**	**-5.6**	**-0.5**	**6.0-7.5**	**4.0**

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), a gauge of economic performance in the next four to six months, anticipated a favourable economic performance ahead if the pandemic condition eases. The growth rate of smoothed leading index, which is used to predict the direction of economic movements in the near future remained positive. Nevertheless, a nationwide full MCO in June, and various wide-scale EMCO in July is expected to dent the recovery pace.

Industrial production expanded robustly by 50.1% yoy in April and 26.0% in May (3.9% in 1Q 2021), aided largely by the low base effect. Strong output expansion in export-oriented industries while uneven performance seen in domestic-market oriented manufacturing industries. Crude petroleum output remained sluggish. Owing to the 60% manpower capacity during the FMCO and EMCO starting June, this would dampen the production and exports of those industries that are allowed to operate.

Figure 34: Apr's improved leading index was supported by positive contributions of all components amid low base effect

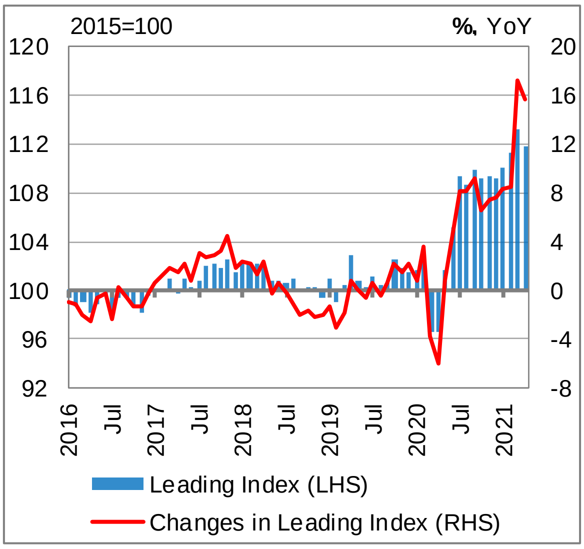
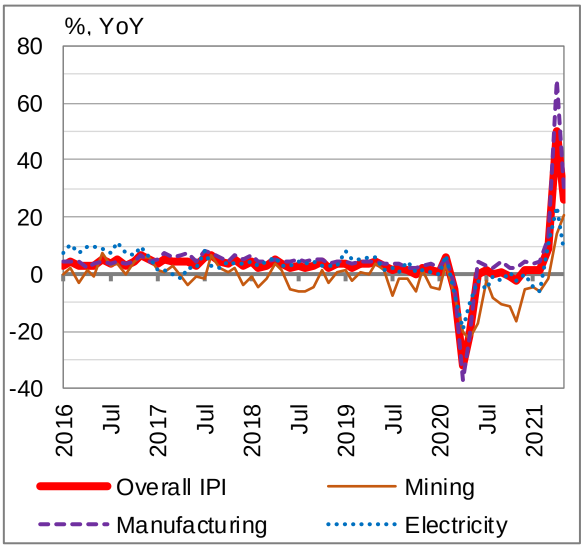


Figure 35: Industrial production growth soared, driven by robust manufacturing output and low base effect



Source: Department of Statistics, Malaysia

Exports and Distributive trade

Export's buoyancy remained intact, supported by solid global demand, thanks to continued recovery in major advanced economies and some regional economies. Export's value breached RM100 billion per month in Mar-Apr 2021 before moderating to RM92.3 billion in May. The major contributors of exports in May (47.3% yoy vs. 63.0% in April and 18.2% in 1Q 2021) were electrical and electronic products, palm oil and palm-based products, refined petroleum products, liquefied natural gas, timber and timber-based products, and crude petroleum.

Retail sales continued to register between RM43 billion and RM47 billion per month between July 2020 and May 2021, about the same average sales value recorded in 2019. The worsening pandemic conditions since May 2021 has dampened the retail sector's recovery, which has been disrupted by the "stop-start" movement restrictions. Worse still, the travel, accommodation and aviation sectors, which are barely coming out of the slump, would be hit badly again. Despite the extension of sales tax exemption for passenger cars to December 2021, cautious buyers' sentiment and worried about job security and income would see moderate sales in 2H 2021 amid the closure of showrooms during Phase 1 of NRP.

Figure 36: Trade surplus surpasses RM10 billion per month for thirteen straight months

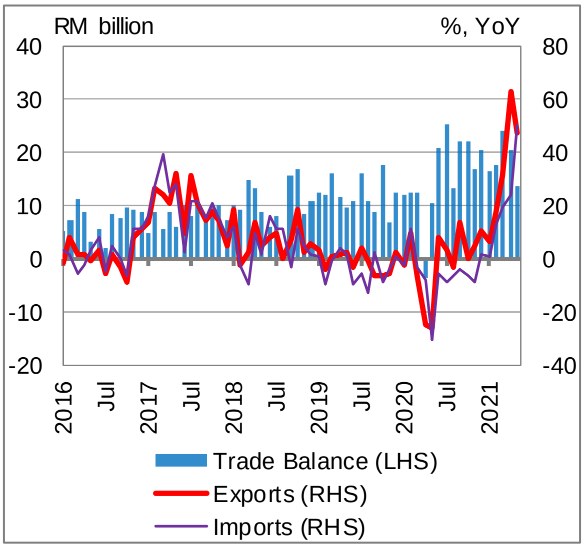
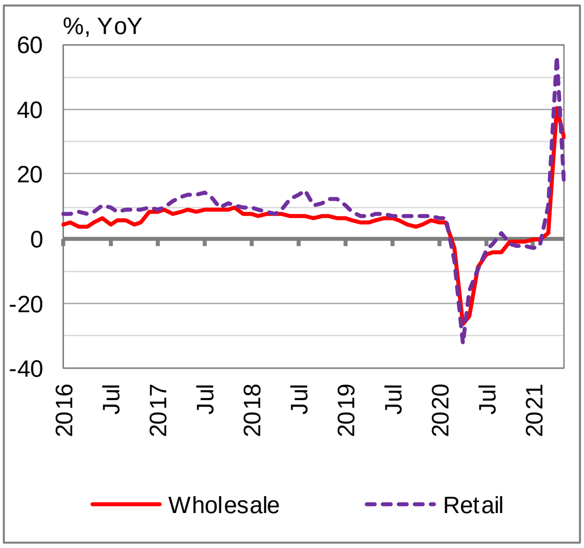


Figure 37: Distributive and retail trade would be dampened by rising COVID-19 caseloads



Source: Department of Statistics, Malaysia

Private consumption indicators

Selected **private consumption indicators** showed mixed consumer discretionary spending. Cautious sentiment, worried about rising infections and weak employment as well as income prospects are expected to damp consumers' pent-up demand. Individuals are still keeping high precautionary savings despite historically low fixed-deposit rates. Individuals' total fixed deposits and investment deposits slipped a little to RM487.0 billion at end-May 2021 from RM489.3 billion at end-December 2020 (RM494.8 billion as at end-December 2019). Saving deposits increased by 9.0% to RM216.5 at end-May 2021 from RM198.6 billion at end-December 2020 (RM158.5 billion at end-December 2019).

The jobless rate eased to 4.5% in May, best since the peak of 5.3% a year ago, though the number of unemployed persons still high at 728,100 persons, 40% higher than pre-pandemic level of around 520,000 persons. As of 2 July 2021, 35,493 employees lost their jobs as reported by the Employment Insurance System (EIS). The slow recovery and weak labour market conditions remain vulnerable to the prolonged pandemic and restricted mobility that weighed on business revenue and demand. As a result, companies and businesses have either slowed down the rehiring; frozen employment or retrenched their employees.

Figure 38: Selected private consumption indicators

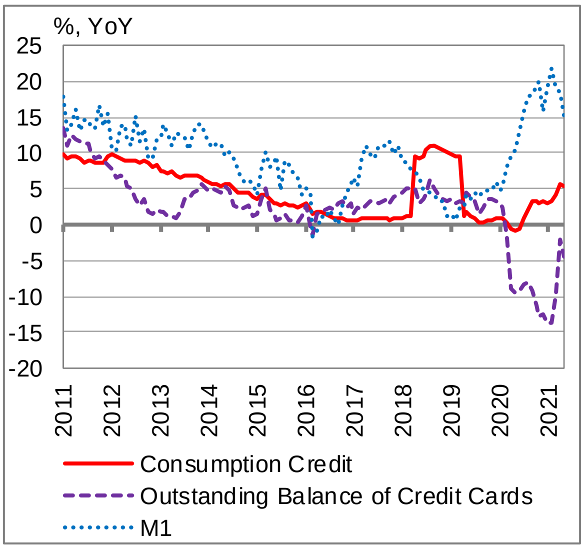
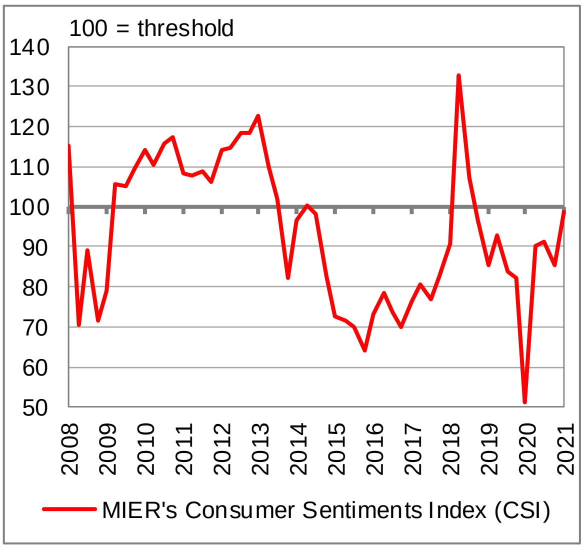


Figure 39: MIER's Consumer Sentiments Index (CSI)



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

Selected **private investment indicators** showed some positive signs, where both imports of investment goods and intermediate goods recorded higher growth in Mar-May 2021. These would translate into higher production and exports in the months ahead. The continued global recovery and improving progress of the national vaccination program have boosted business sentiments. However, the re-imposition of lockdown and restricted containment measures in June-July as well as the fast spreading of new virus variant have caused investors' pessimism.

In Jan-Mar 2021, MIDA's total approved investment jumped by 95.6% yoy to RM80.6 billion, of which RM58.8 billion came from the manufacturing sector, RM15.6 billion from the services sector and the remaining RM6.0 billion were in the primary sector.

Higher manufacturing investment in 1Q was boosted by a RM42.2 billion manufacturing of solar cells and solar modules project by Risen Energy Co Ltd for a period of 15 years from 2021 to 2035, generating 3,000 jobs. Another notable project is a copper foil producer for electric vehicle by SK Nexilis from South Korea.

By sector, electrical products and electronics was the main contributor (RM47.0 billion), followed by fabricated metal products (RM4.9 billion) and rubber products (RM3.3 billion).

Figure 40: Selected private investment indicators

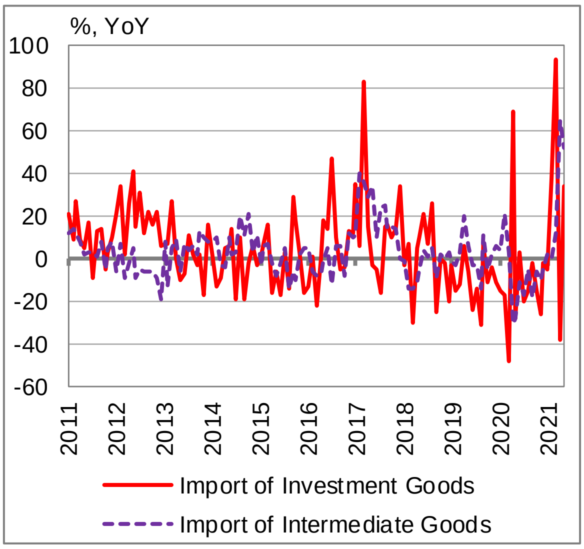
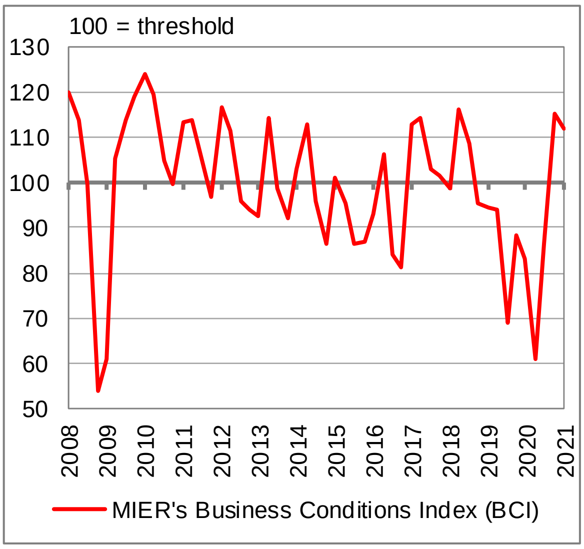


Figure 41: MIER's Business Conditions Index (BCI)



Source: Bank Negara Malaysia; Malaysian Institute of Economic Research

Price indicators

Headline inflation, as measured by the Consumer Price Index (CPI) increased higher by 4.7% yoy in April 2021 and 4.4% in May (0.5% in 1Q 2021), the highest annual price change since March 2017. This was due to a combination of an extremely low base, higher petrol prices as well as some cost-push prices of household items, such as furniture and furnishings.

In contrary, core inflation in May remained subdued at less than 1.0% for eight consecutive months since October 2020.

In the months ahead, headline inflation is expected to moderate further as the low base effect in fuel prices normalise (RON95: RM1.54/litre in June 2020, RM1.63-RM1.74/litre in Jul-Dec 2020 vs. RM2.05/litre currently). With producer prices climbing higher (an average growth of 11.3% in Apr-May and 3.0% in 1Q 2021), the increasing cost of raw materials and cost of production may eventually pass through onto consumer price inflation with a time lag, if the producers unable to fully absorb it. Overall, we maintain our headline inflation estimate of 3.0%-4.0% in 2021 (-1.2% in 2020).

Figure 42: Headline inflation shot up in Apr-May, but core inflation remains subdued

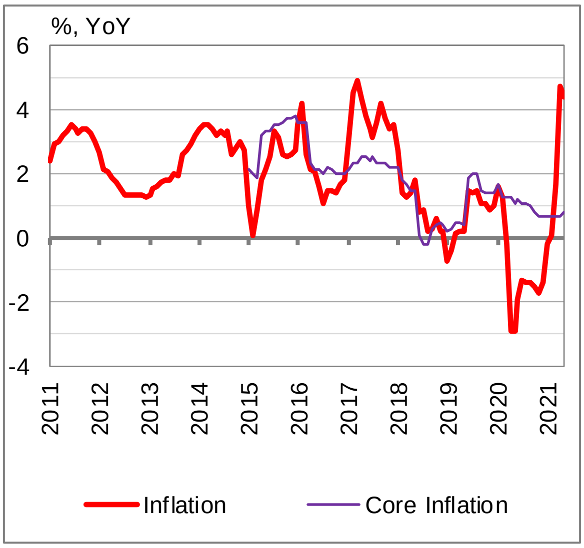
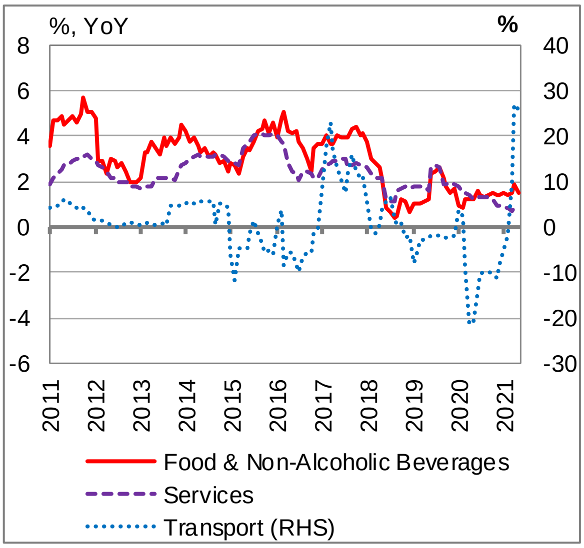


Figure 43: Food prices increased steadily while transport prices soared due to an extremely low base



Source: Department of Statistics, Malaysia

Banking loan indicators

Banking system's outstanding loan growth sustained at 3.9% yoy in May 2021 for three months in a row, with support coming from the household sector (6.1% in May vs. 5.7% in March), mainly for the purchase of passenger cars and still-high residential property loans. Business and other loans growth were subdued (0.9% in May vs. 1.4% in March), with slower demand in the construction sector and muted loan growth in the manufacturing sector. Contracted loan demand in agriculture, real estate, and transport and storage sectors.

Overall gross and net impaired loans ratios remained broadly stable at 1.6% and 1.0% in May respectively while total provisions set aside against potential credit losses stood at 1.8% of total banking system loans. Despite a marginal decline in capital ratios, banks' excess capital buffers remained strong at RM119.9 billion at end-May 2021 (RM123 billion in December 2020).

Figure 44: Outstanding loan growth by type

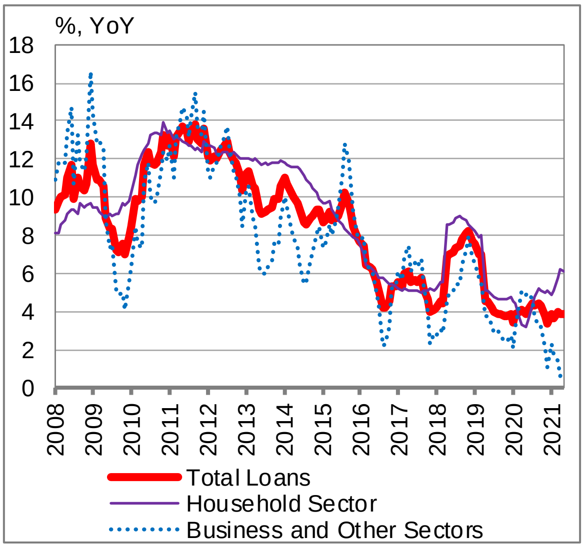


Figure 45: Loan applications growth

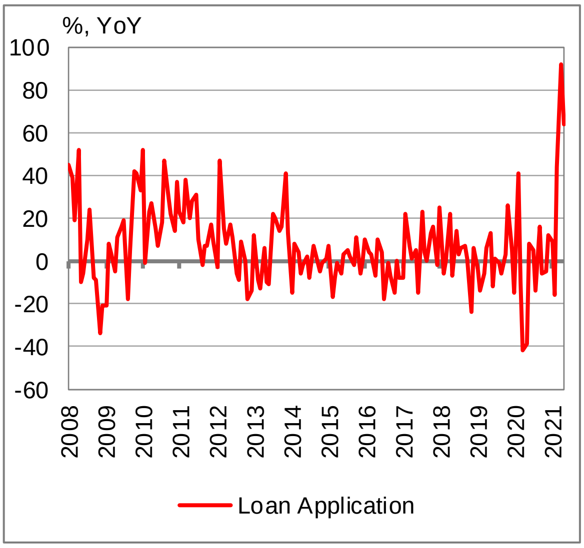


Figure 46: Loan approvals growth

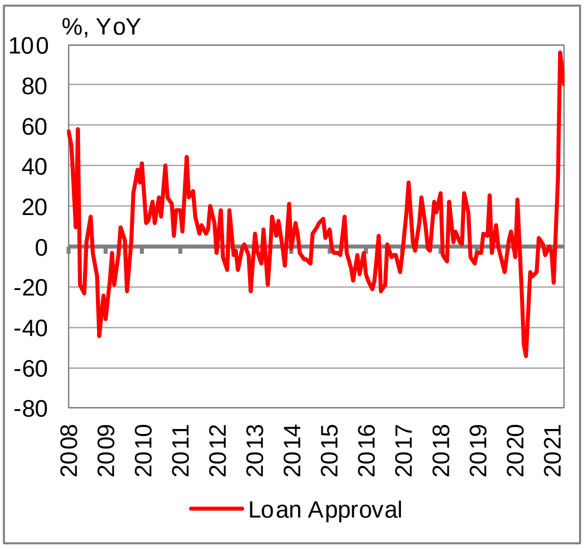
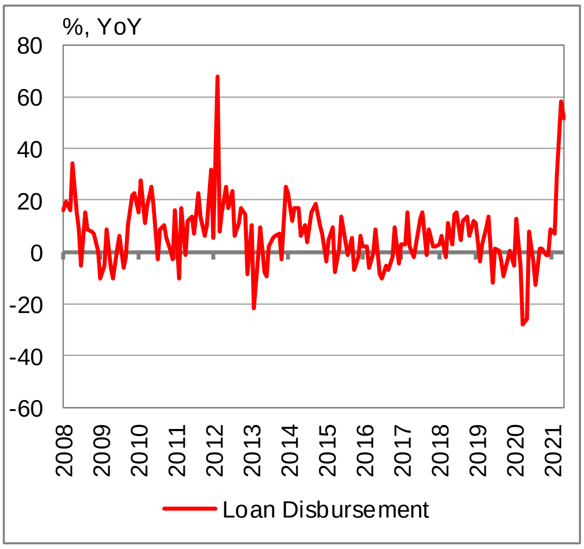


Figure 47: Loan disbursements growth



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

Financial indicators

Foreign reserves accumulation continues to reach US$111.1 billion at end-June 2021 after taking into account the quarterly foreign exchange revaluation changes. It is the best level since December 2014. The reserves position is sufficient to finance 8.2 months of retained imports and is 1.1 times total short-term external debt.

As at end-June 2021, FTSE Bursa Malaysia KLCI eased further to 1,532.63 (1,573.51 as at end-March 2021 and 1,627.21 as at end-December 2020). Foreign investors continue to dispose domestic equities for 24 continuous months, amounting to net sold of RM35.3 billion since July 2019.

In terms of debt market, foreign investors sustained their accumulation of the Malaysian Government Securities (MGS) for fourteen months since May 2020, albeit much smaller net purchase in June at merely RM0.4 billion. As at end-June 2021, foreign holdings of the Malaysian Government Securities eased to 40.4% from 41.1% in May. In Jan-Jun 2021, foreign investors made a net purchase of a RM14.8 billion of MGS and RM6.0 billion of Malaysian Government Investment Issues (MGII).

The ringgit depreciated by 3.4% to RM4.1543 against the greenback as at end-June 2021 from RM4.0130 as at end-December 2020 (RM4.1465 as at end-March 2021). Overall, the ringgit is weaker against a basket of weighted currencies as measured by effective exchange rate. In Jan-Jun 2021, the ringgit has depreciated against the Pound sterling (-5.0%), Chinese renminbi (-4.5%), Vietnamese dong (-3.3%), Indian rupee (-2.0%), Philippine peso (-2.0%), Singapore dollar (-1.8%), Australian dollar (-1.1%), and euro (-0.2%), while appreciated against Thai baht (3.4%), Japanese yen (3.4%), and South Korean won (0.5%), whereas unchanged against Indonesian rupiah. **SERC expects the ringgit to settle at RM4.2000 per US dollar at end-2021.**

Figure 48: Foreign reserves position has returned to the level last seen in December 2014

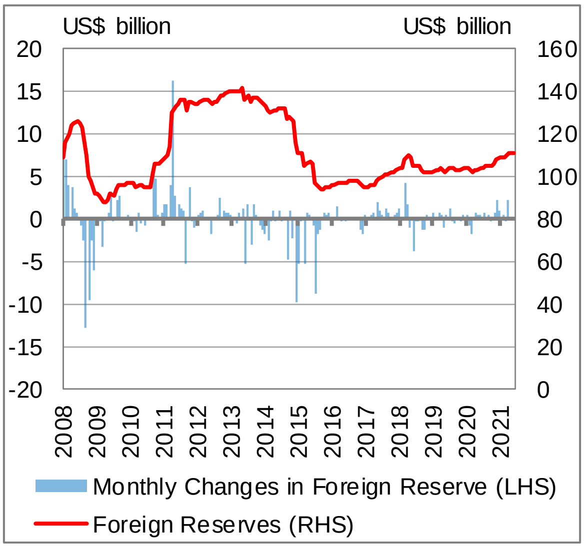


Figure 49: Ringgit's Effective Exchange Rate (EER)

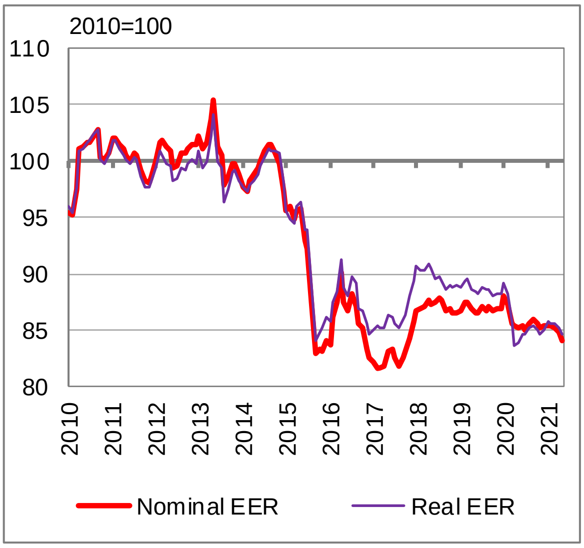


Figure 50: Ringgit against major foreign currencies

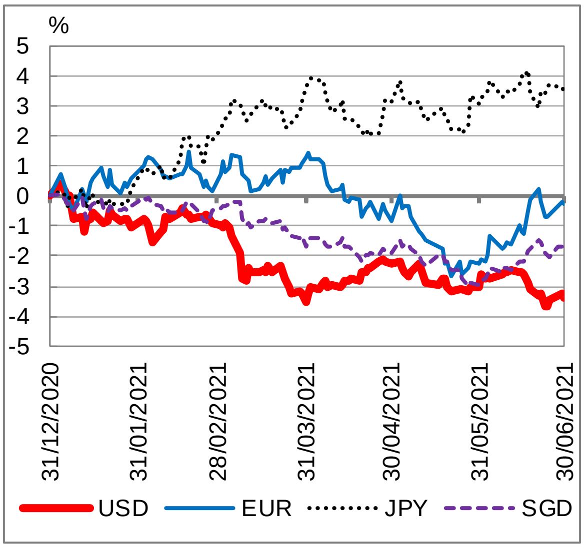
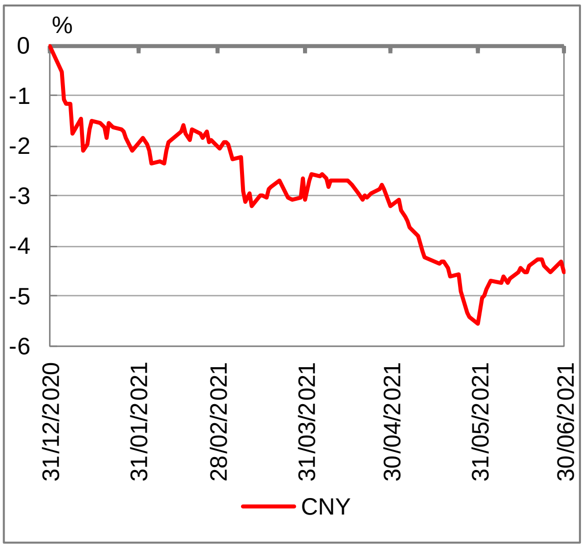


Figure 51: Ringgit against Chinese renminbi



Source: Bank Negara Malaysia; Bank for International Settlements

The Associated Chinese Chambers of Commerce and Industry of Malaysia (ACCCIM)'s Socio-Economic Research Centre (SERC Sdn. Bhd.) was established as an independent and non-profit think tank on 19 October 2010. Officiated by YAB Prime Minister on 28 April 2011, SERC is funded by ACCCIM SERC Trust.

SERC is tasked with carrying out in-depth research and analysis on a wide range of economic, business and social issues in support of the formulation of public policies to shape Malaysia's national socio-economic and industrial development agenda.

The organization will identify and explore issues and future trends that impact domestic economic and business environments. It will also focus on sharing knowledge and promoting public understanding of socio-economic issues of national importance.

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