MICPA MALAYSIA

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MICPA-MARC MALAYSIA ECONOMIC OUTLOOK 2021

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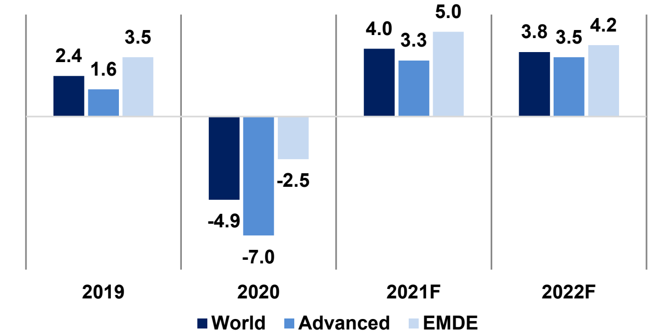
Published: March 2021

Global

Global growth is anticipated to rebound in 2021 but it will moderate in the following year. While the global public health and economic crisis continues to abate, uncertainties — including that related to the rollout of the vaccine — abound and continue to weigh down on global prospects.

Chart 1: Global real GDP growth (% y-o-y)



Source: World Bank

Photo by Daniel Schludi, Jaykala Toney, Layurel and Michael Evans on Unsplash

- The World Bank's baseline forecast sees global growth coming in at 4.0% in 2021. For 2022, it expects global growth to remain moderate at 3.8%. As for the Emerging Markets and Developing Economies (EMDE), it expects 5.0% in 2021 and 4.2% in 2022. Advanced economies are projected to see growth coming in at 3.3% in 2021 and 3.5% in 2022. In essence, EMDE will steer the global economic recovery following the pandemic.

- The rollout of the vaccine has rekindled hopes for the global economy and business and consumer confidence are expected to rise. We see this optimism reflected in the rising global manufacturing purchasing managers' index (PMI) and the recent rally in global financial markets.

- Notwithstanding rising optimism, a study estimated that the world would need seven years to reach herd immunity at the current pace of vaccination. This should come as no surprise given challenges that include inequitable vaccine access and vaccine hesitancy. Social distancing measures will likely remain for a while, thus choking activity.

- Effective policies will continue to play a prominent role in supporting the economic recovery and given this, fiscal deficits and public debt continue to rise. Most central banks have also pledged to remain accommodative in their monetary policy stance. This implies that low interest rates and quantitative easing will remain for a while.

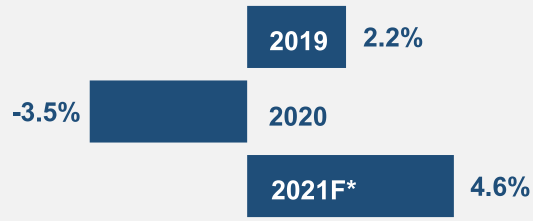
United States (US)

The US Congressional Budget Office (CBO) foresees the US economy staging a strong 4.6% bounce in 2021 from a 3.5% contraction in 2020. The rosy forecast considers the USD900 billion stimulus package passed in December 2020 and a faster resumption of business activity amid the slowdown in COVID-19 cases. A string of upbeat US economic data such as manufacturing PMI and non-farm payrolls released in March 2021 suggest that the economy is gaining momentum.

The new US President, Joe Biden, has revitalised hopes for a better US outlook. President Biden has signed executive orders that include a federal mask mandate and put in place a vaccination strategy. Additionally, the USD1.9 trillion coronavirus stimulus package received congressional approval that includes USD1,400 cheques, jobless aid, and funds for state and local governments to mitigate the impact of the pandemic.

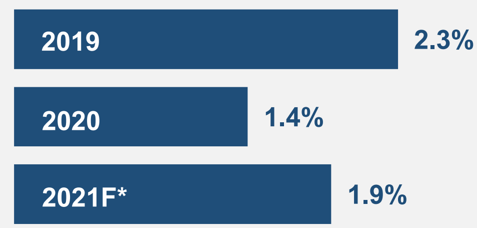
Despite rising optimism for a growth recovery, the US Federal Reserve (Fed) will likely maintain its ultra-accommodative monetary policy through 2021. With the unemployment rate still elevated from pre-pandemic levels, the Fed has signaled that tapering is premature for the time being.

US real GDP growth:



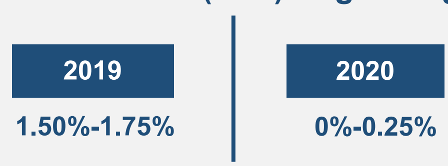
**Forecast by CBO*

US inflation rate:



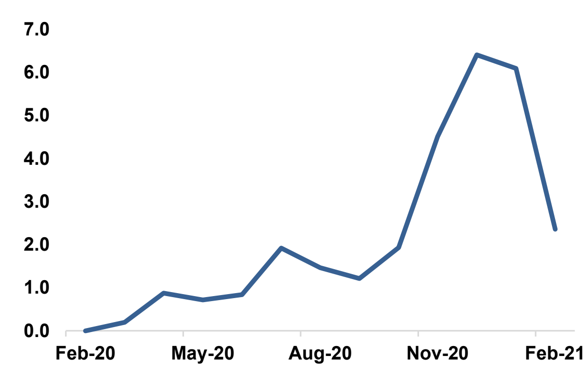
**Forecast by CBO*

Fed fund rate (FFR) target range:



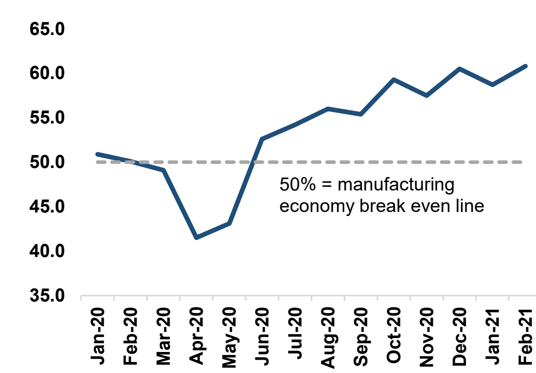
Sources: US Bureau of Labour Statistics, the Fed, CEIC

Chart 2: US monthly confirmed new COVID-19 cases (million)



Source: CEIC

Chart 3: US Institute of Supply Management (ISM) manufacturing PMI (%)



Source: ISM

China

China real GDP growth:

2019	6.1%
2020	2.3%
2021F*	8.1%

Forecast by International Monetary Fund (IMF)

China inflation rate:

2019	2.9%
2020	2.5%
2021F*	2.7%

Forecast by IMF

China 1-year loan prime rate:

2019	2020
4.15%	3.85%

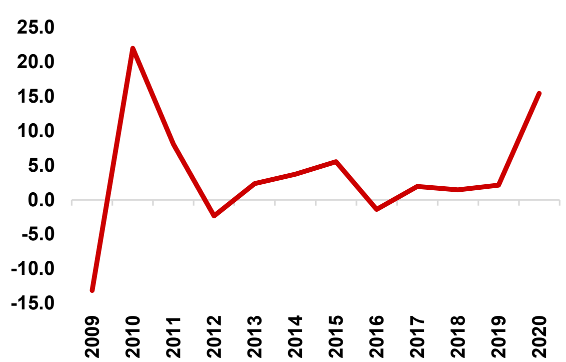
Source: National Bureau of Statistics of China, People's Bank of China (PBoC)

China set an economic growth target of more than 6% for 2021. In 2020, China bucked the global recession, growing by 2.3%, the fastest among the G20 economies. This can be attributed to swift and tough action to contain the COVID-19 pandemic, which helped the country recover quickly and get its manufacturing capacity up and running even as supply chains in other countries remained in a state of disarray. The rise in business investment in 2020 will likely continue this year.

Despite strong performance, growth is still subject to downside risks, particularly from the persistent trade tensions with the US and possibility of a pandemic resurgence. The Biden administration has said that the US will use "all available tools" to fight China's unfair trade practices. These may include collaboration with partners and allies to safeguard the liberal world order.

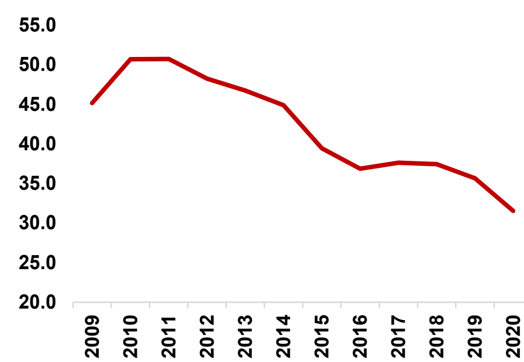
To mitigate external risks, the Chinese government has introduced a "dual circulation" strategy, which aims to shift the demand focus from external to domestic, in their 14th five-year plan. With this strategy, the government expects the Chinese economy to strike a good balance between being self-reliance and external trade.

Chart 4: Foreign direct investment (FDI) inflows to China (% y-o-y)



Sources: United Nations Conference on Trade and Development (UNCTAD), CEIC

Chart 5: China's trade to GDP (%)



Source: CEIC

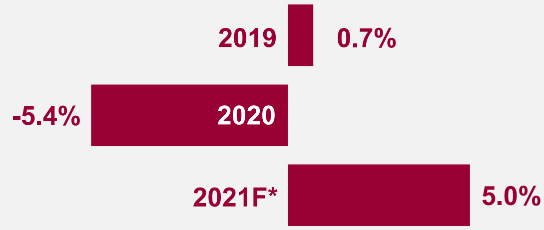
Singapore

The government anticipates the country's real GDP growth pace to rebound in 2021 to between 4.0% and 6.0% (2020: -5.4%). This is premised on the expectation of a gradual recovery throughout the year with vaccination underway. Among the first batch of countries to roll out mass inoculations, Singapore leads the region in terms of per capita vaccination rate.

The outlook, however, remains uneven across sectors. Trade-related sectors such as manufacturing and shipping will benefit from the pickup in external demand. Semiconductors, for example, benefited due to the 5G rollout and rising demand for self-driving cars. In contrast, the services sector, particularly travel and hospitality will remain sluggish amid travel restrictions and constraints associated with social distancing measures.

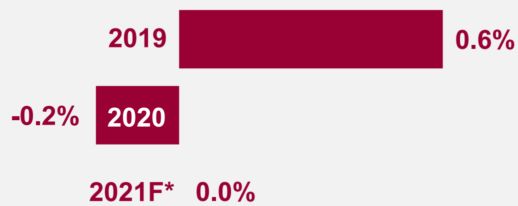
Singapore's fiscal policy is expected to remain expansionary going forward, albeit at lower magnitude. According to the Budget 2021, the overall budget balance is projected to see a much smaller deficit of 2.2% of GDP in FY2021, compared with a deficit of 13.9% in FY2020. Of note, the government will allocate SGD24 billion over the next three years to help businesses transition to a post-pandemic environment.

Singapore real GDP growth:



Median forecast by Singapore's government

Singapore inflation rate:

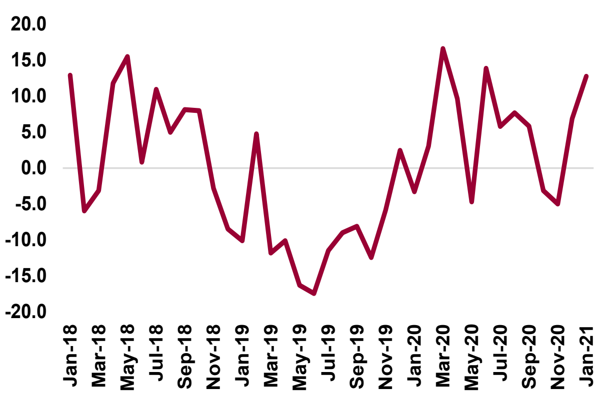


Median forecast by Singapore's government

SGD against USD (period-end):

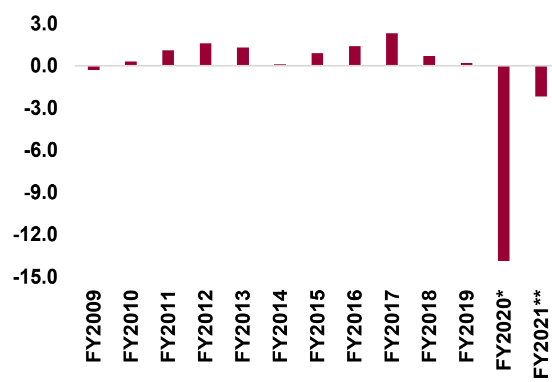
Sources: The Singapore Department of Statistics, Monetary Authority Singapore (MAS)

Chart 6: Singapore non-oil domestic exports (% y-o-y)



Sources: The Singapore Department of Statistics, MARC Research

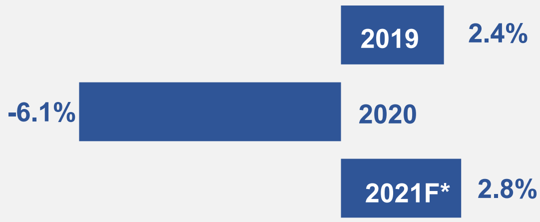
Chart 7: Singapore fiscal balance (% of GDP)



**estimate; **budgeted*
Source: Ministry of Finance Singapore

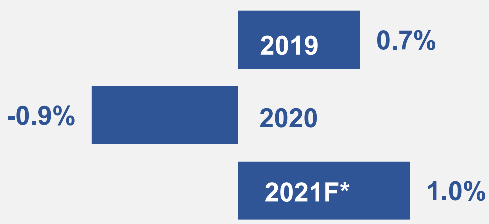
Thailand

Thailand real GDP growth:



**Forecast by the Ministry of Finance, Thailand*

Thailand inflation rate:



**Forecast by Bank of Thailand (BOT)*

BOT's benchmark 1-day bilateral repurchase rate:

2019	2020
1.25%	0.50%

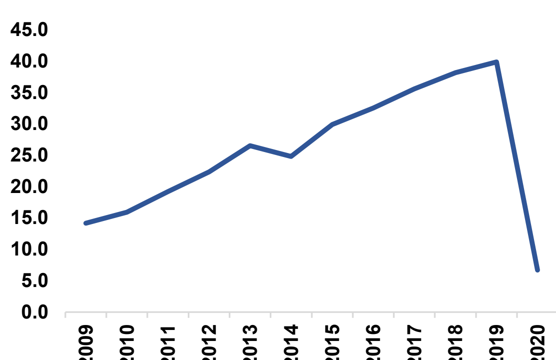
Sources: National Statistical Office of Thailand, BOT

On January 27, the finance ministry downgraded its 2021 real GDP growth forecast to 2.8% from 4.5%. The downgrade was triggered by the resurgence of COVID-19 cases both domestically and externally. The slower-than-expected lifting of travel restrictions has hit the tourism sector hard. The government predicts foreign arrivals to come in at five million for 2021, down 25% from 2020 and significantly lower than the eight million projected earlier.

The renewed wave of COVID-19 infections has prompted a series of fiscal response, including aid packages totalling almost THB250 billion so far this year. While the stimulus measures should support economic recovery moving forward, the actual fiscal impact remains unclear. The government remains open to more fiscal measures if needed, though policy space is narrowing as public debt has risen to near the legal ceiling.

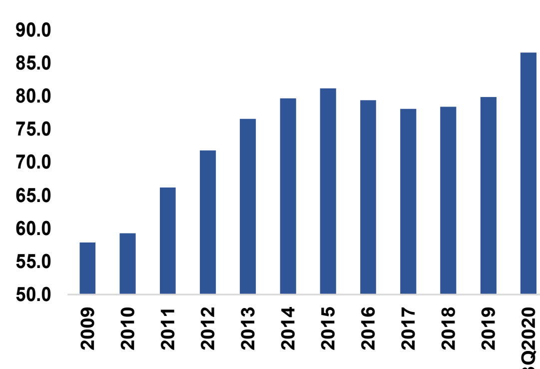
We expect consumer spending, aided by fiscal support for affected households and record low interest rates, to continue improving. However, elevated household debt (end-3Q2020: 87% of GDP) could pose a major threat to private consumption growth. Meanwhile, we see exports returning as another growth driver given improving external demand though the strength of its rebound will likely be capped by a strong THB.

Chart 8: Thailand tourist arrivals (million)



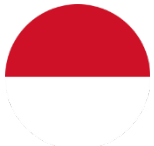
Sources: Thailand's Ministry of Tourism and Sports, CEIC

Chart 9: Thailand household debt (% of GDP)



Source: BOT

Indonesia

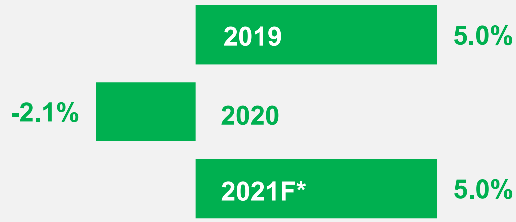


The Indonesian government projects 2021 real GDP to expand by between 4.5% and 5.5% (2020: -2.1%). Given that Indonesia is still grappling with the largest pandemic outbreak in the region, the normalisation of economic activity will depend to a large extent on how the pandemic pans out. Indonesia began its vaccination drive in January 2021. It aims of inoculate 70% of its population or 181.5 million by early 2022. However, there are massive challenges ahead given its large geographic size and poor infrastructure.

Recent economic indicators paint a mixed picture. Consumer confidence, which had been improving, stalled in January 2021 amid the implementation of pandemic containment measures. Household consumption will thus likely continue to face a restrained recovery going forward. Meanwhile, manufacturing PMI eased slightly – though it remained expansion territory – in February due to supply disruptions caused by flooding and the pandemic resurgence.

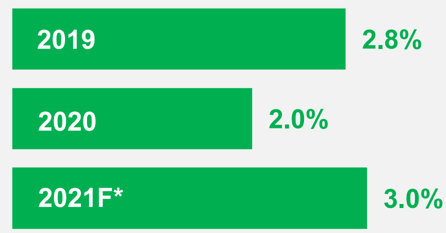
On the monetary front, Bank Indonesia (BI) has indicated that policy space has become more limited. It had in February cut its main policy rate by 25 bps to a new record low of 3.5%. Given this development and the recent spike in yields that could impact IDR stability, it is expected to pause its easing cycle in the near-term.

Indonesia real GDP growth:



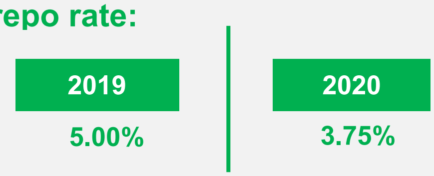
*Median forecast by the Indonesian government

Indonesia inflation rate:



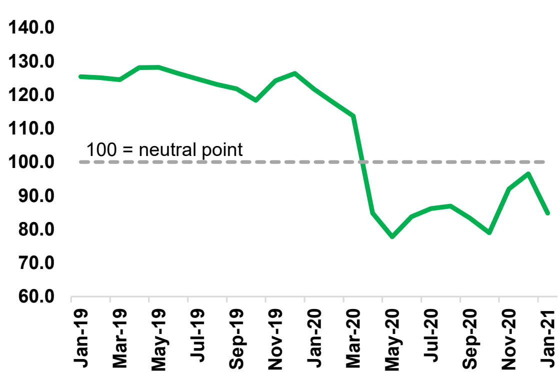
*Median forecast by BI

BI's benchmark 7-day reverse repo rate:



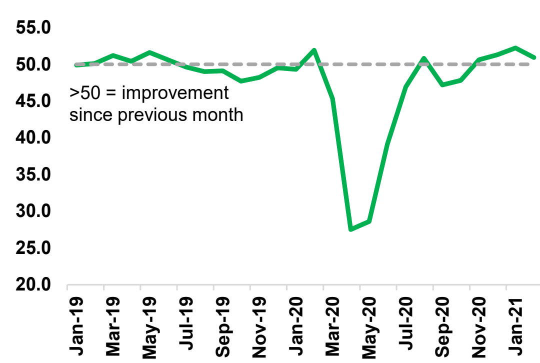
Source: Statistics Indonesia, BI

Chart 10: Indonesia consumer confidence index



Sources: BI, CEIC

Chart 11: Indonesia manufacturing PMI



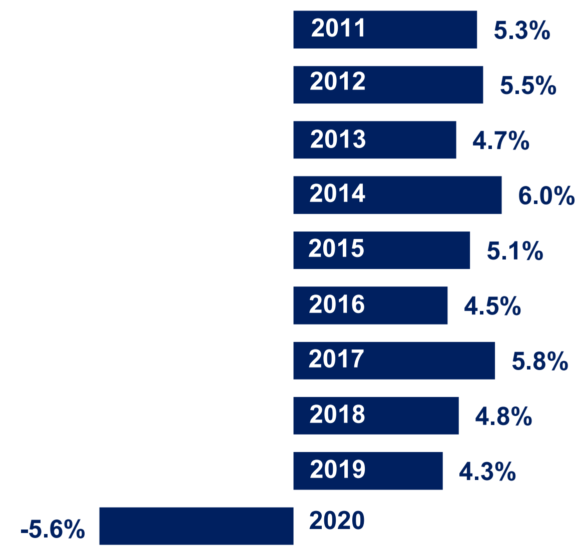
Source: CEIC

Malaysia

Real GDP will rebound in 2021 though the magnitude would depend on how the pandemic situation pans out. The projected economic recovery follows a deep contraction of 5.6% in 2020 and mainly reflects low base effects.

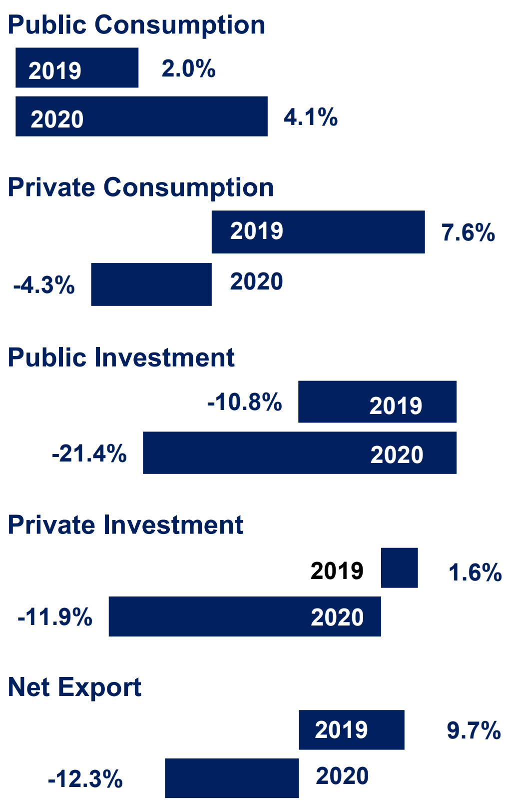
Note that the country is still reeling from the scarring effects of the pandemic. However, downside risks to growth going forward will likely dissipate with the kickstarting of the National Immunisation Plan (NIP) in February. Under the NIP, the government hopes to vaccinate 80% of the adult population by February 2022. An effective rollout should bolster sentiment as we expect it to sharply reduce the possibility of further stringent lockdowns down the road.

Annual real GDP growth:



Source: Department of Statistics Malaysia (DOSM)

GDP components:



Source: DOSM

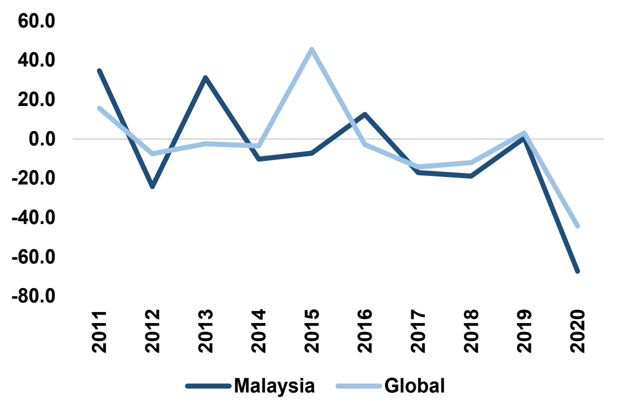
A recovery to pre-pandemic economic activity will likely take a while. Incorporating our expectation that positive growth will return by 2Q2021, we are projecting a growth pace of 5.6% for full year 2021. The strength of the recovery will vary across different sectors given that some, e.g., tourism, have been hit harder than others.

Private consumption will remain the growth engine, partly supported by policy stimulus including the cumulative 125-bps cut in the overnight policy rate (OPR) in 2020 and additional cash handouts to vulnerable groups. It is notable that Google mobility data show increasing foot traffic to recreation and retail outlets since the relaxation of Movement Control Order (MCO) 2.0.

Trade will take cue from the stronger external demand as the global economy reopens further. The World Trade Organization (WTO) projects a 7.2% rise in global merchandise trade volume in 2021, compared with a 9.2% decline in 2020. Malaysia's exports will likely be driven by the global electronics upturn as well as higher crude oil and palm oil prices.

Going forward, headwinds likely to prevent a faster recovery in investment activities include uncertainties surrounding the COVID-19 pandemic, the rollout of the vaccine and political developments.

Chart 12: Global and Malaysia's FDI inflows (% y-o-y)

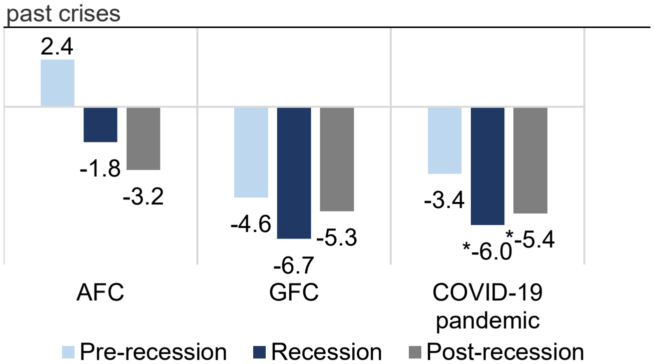


Source: UNCTAD

Chart 13: Brent crude oil prices (USD per barrel)

Source: CEIC

Chart 14: Malaysia's fiscal balance as % of GDP during the past crises



**Forecast by Ministry of Finance (MOF) Malaysia*
Source: CEIC

- **Prospects for FDI to remain challenging as firms delay major investment decisions.** The UNCTAD is projecting a decline of between 5% and 10% in global FDI flows for 2021. Meanwhile, a World Bank survey found that almost 40% of affiliates of multinational enterprises (MNEs) expect their parent companies to invest less in their host countries. The implication is grim for countries such as Malaysia where FDI inflows are a key determinant of growth capacity via capital formation.

- **US-China trade tensions offer potential opportunities for Malaysia from shifting supply chains.** According to official Malaysian statistics, there is rising FDI interest from both the US and China. We expect the government's soon-to-be-announced Twelfth Malaysia Plan (2021-2025) to include new policy measures to improve Malaysia's attractiveness as an investment destination and seize opportunities triggered by trade and investment diversions.

- **The rally in crude oil prices is positive for Malaysia's growth and fiscal outlook.** Brent crude has rebounded as the global energy demand improves. Brent crude has been trading above USD60 per barrel since early February 2021, significantly up from the trough of USD9 in April 2020. We expect global crude oil prices to remain well supported by improving global demand as the worldwide economic opening continues. There will also be support from the supply side as production cuts by the Organisation of the Petroleum Exporting Countries (OPEC) and its allies should lead to further oil inventory drawdowns throughout 2021.

- **With the economic damage inflicted by the pandemic, more debt-led fiscal support will likely become necessary, even with the rollout of the vaccine.** Given this strong possibility, Malaysia's fiscal deficit will likely come in marginally higher than Budget 2021's estimated 5.4% of GDP and debt will remain elevated. Going forward, this will pose a growing challenge to government efforts to balance fiscal prudence with growth and development.

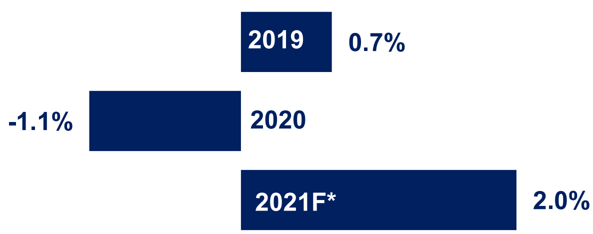
- **Labour market recovery will likely be protracted and uneven.** We expect the process of re-absorbing dropouts from the labour force during the pandemic while taking care of new young graduates to be long-drawn. As such, the unemployment rate will remain elevated at 4.0% in 2021 (2020: 4.5%).

- The fiscal support entailing wage subsidies and employment retention programmes to mitigate the impact of the pandemic is extensive. However, it will be a challenge to try to recover all jobs lost in hard-hit sectors such as tourism, retail, and food and beverages.

Unemployment rate

*Forecast by MARC Research
Source: DOSM

Inflation

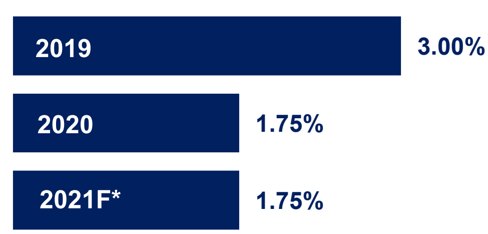


*Forecast by MARC Research
Source: DOSM

- **Inflation expected to return by 1Q2021 after a year of negative readings.** We expect headline consumer prices (CPI) in 2021 to average around 2.0% (2020: -1.1%), thanks largely owing to the low base effect. Demand-pull inflation will gradually recoup lost ground but remains constrained by anaemic labour market conditions. We do not anticipate fuel prices to pose a significant inflationary threat as the government will cap it at or below the ceiling price.

- **Bank Negara Malaysia (BNM) will continue to keep the OPR at its historical low of 1.75%.** With growth prospects expected to gradually recover amid elevated uncertainties, we do not foresee any further rate adjustments on the table, at least for the time being. Note that with inflation returning, the real interest rate is expected to fall going forward. In any case, BNM's recent monetary policy statement gave no indication that it is in any hurry to adjust its policy setting.

OPR

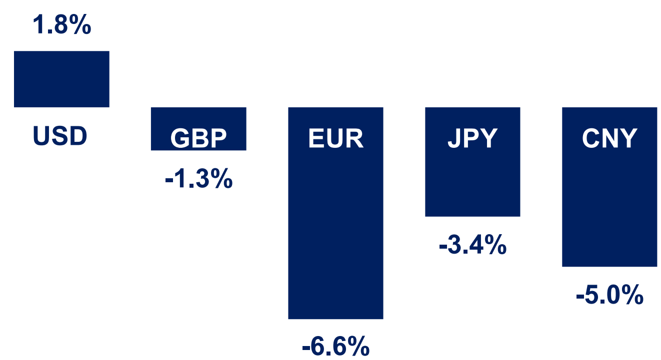


*Forecast by MARC Research
Source: BNM

- **Against the US dollar, the ringgit will likely remain supported.** Support for the ringgit expected to come from, among others: (a) prospects of a weaker US dollar on the back of wider twin deficits and relatively low interest rates; (b) consistent economic recovery in Malaysia; and (c) steady global crude oil prices. The real effective exchange rate (REER), currently at one standard deviation below its 10-year mean, suggests more upside for the ringgit.

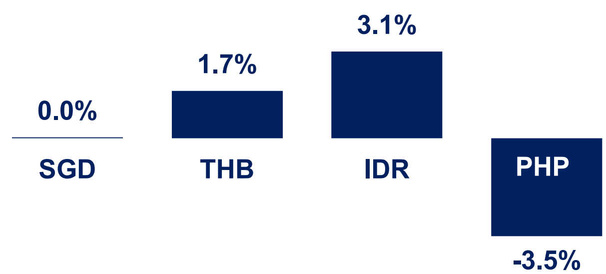
- Going forward, ringgit volatility will likely persist on concerns that include a) higher fiscal deficit and debt; b) the possible exclusion of Malaysian government bonds from the FTSE Russel Global Bond Index from March 2021, and c) rising political uncertainty potentially culminating with the holding of a general election in 2021.

Ringgit against selected major currencies in 2020



Sources: BNM, MARC Research

Ringgit against other ASEAN-5 currencies in 2020



Sources: BNM, MARC Research

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Published by:

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