BNM Economic & Monetary Review 2020

2021 GDP forecast range widened downwards, paints a cautiously optimistic picture

Summary

- Bank Negara Malaysia (BNM) depicted a cautiously optimistic tone, by widening its GDP forecast range towards the downside (6.0-7.5%) vis-à-vis MoF's forecast (6.5-7.5%) and noting that the balance of risks remain tilted to the downside. However, BNM is still relatively sanguine compared to market's GDP consensus of 5.5% (KIBB: 4.5%).
- BNM expects a broad-based recovery across the demand and supply side, led by a rebound in private sector expenditure and the services sector. This is in line with our view of a continued global economic recovery bolstered by the technology upcycle, vaccination drive, less stringent movement restrictions and extended fiscal measures.
- As for the CA balance, BNM projects a continued surplus as the goods surplus is expected to increase due to higher commodity prices. We echoed BNM's view and expect that the CA balance will also continue to be supported by global vaccine rollout and higher exports of E&E and rubber gloves.
- In line with our house expectations for the overnight policy rate (OPR) and inflation, BNM is committed to maintaining an accommodative monetary policy in order to ensure sustainable economic recovery, even whilst expecting modest inflation pressure with headline inflation project to average between 2.5% - 4.0%.
- Moving forward, while the medium term performance of the ringgit is expected to reflect Malaysia's economic fundamentals, uncertainties surrounding the COVID-19 pandemic and economic prospects will continue to affect the ringgit in the near term. We concur with the BNM's view and maintain our end-2021 USDMYR forecast at 3.95.

- **The BNM widened its 2021 GDP forecast range towards the downside (6.0-7.5%) when the Ministry of Finance reinstated its forecast of 6.5-7.5% barely a week ago (2020: -5.6%), depicting a cautiously optimistic tone**
  - International institutions' forecasts (IMF: 6.5%; World Bank: 6.0%) came in at the lower-end of the BNM's forecast range, while our in house and consensus views are relatively less sanguine (consensus: 5.5%; KIBB: 4.5%).
  - BNM pencilled in a gradual and uneven recovery, with herd immunity of COVID-19 expected to be achieved in the 1Q22, international borders remain closed in 2021 and a highly targeted movement control order.
  - It cautioned that the balance of risks remain tilted to the downside, with growth trajectory facing the risk from a resurgence of COVID-19 cases, slow inoculation progress, low vaccine efficacy, a shock in domestic commodity production and heightened financial market volatility.
- **The growth rebound is broadly based, steered by the domestic demand, specifically private sector expenditure**
  - Domestic demand (7.4%; KIBB: 5.1%; 2020: -5.7%):
    - Private spending (7.4%; KIBB: 4.8%; 2020: -6.0%): consumption activities to be buoyed by improvement in consumer sentiment and labour market conditions, following less stringent mobility restrictions and the rollout of COVID-19 vaccine this year. Mirroring our view, the BNM sees the extended fiscal measures positively, contributing to a higher disposable income. Tracking a similar path, investment is also poised to rise on external demand recovery, construction of mega infrastructure projects, development of the digital economy and various incentives announced under the 2021 Budget.

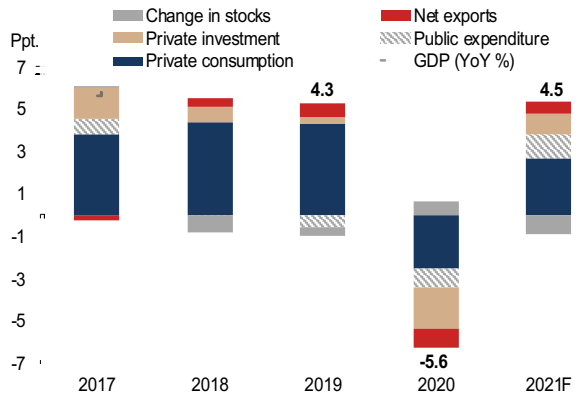
Table 1: Real GDP Growth

YoY %	2020	KIBB 2021F	BNM 2021F
By Sector			
Agriculture	-2.2	2.4	4.2
Mining	-10.0	3.5	3.1
Manufacturing	-2.6	6.0	8.8
Construction	-19.4	4.1	13.4
Services	-5.5	4.2	6.6
Real GDP	-5.6	4.5	6.0 – 7.5
By Expenditure			
Consumption	-2.9	4.1	0.0
Public	4.1	2.3	4.4
Private	-4.3	4.5	8.0
Investment	-14.5	8.7	7.8
Public	-21.4	16.7	15.2
Private	-11.9	6.1	5.4
Public Spending	-4.6	6.3	7.4
Private Spending	-6.0	4.8	7.4
Aggregate Demand	-5.7	5.1	7.4
Exports	-8.8	9.0	13.1
Imports	-8.3	9.1	14.1
Net exports	-12.3	8.6	4.8
Real GDP	-5.6	4.5	6.0 – 7.5

Source: BNM, Dept. of Statistics, Kenanga Research

- Of note, household debt-to-GDP ratio rose to 93.3% in 2H20 (1H20: 87.5%), with the household debt increasing to RM1,320.6b in 2H20 (1H20: RM1,265.9b), indicating normalisation to pre-crisis levels following the relaxation of strict movement control restrictions. Growth was mainly driven by car and housing loans, with a boost coming from personal financing as well. BNM suggests that the rise in household debt-to-GDP is not worrying as there is no significant evidence that households have begun rapidly deleveraging following the initial impact of the COVID-19 pandemic. BNM stressed that lending continued to be supported by good underwriting standards, with stable overall median debt service ratios for outstanding loans at 35.0% and newly-approved loans at 43.0%.

Graph 1: GDP by Expenditure



Source: Dept. of Statistics, Kenanga Research

- Public spending (7.4%; KIBB: 6.3%; 2020: -4.6%): matching our view, BNM foresees a double-digit expansion in public investment amid further progress in infrastructure projects (ECRL, MRT2, and Pan Borneo Highway) and an acceleration in digitisation initiatives. In contrast to our expectation, BNM projects a faster growth in public consumption underscored by the vaccine procurement and logistics costs.

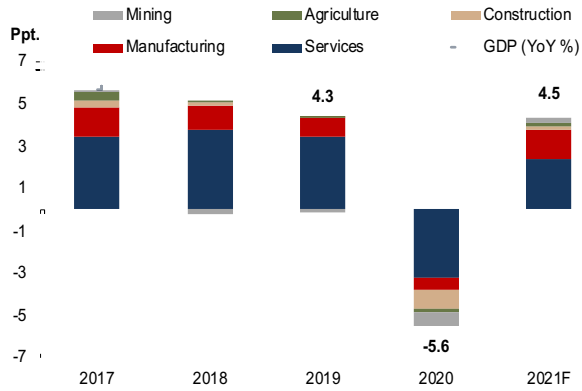
– Net exports (4.8%; KIBB: 8.6%; 2020: -12.3%):

- Exports (13.1%; KIBB: 9.0%; 2020: -8.8%): underpinned by increased demand from major trading partners, the technology upcycle and rising commodity prices. Lending further support are expansion in E&E and gas production facilities, as well as prolonged demand for COVID-related products such as glove and personal protective equipment.
- Imports (14.1%; KIBB: 9.1%; 2020: -8.3%): with stronger domestic demand and a surge in export-oriented manufacturing activities, imports are forecasted to mark a turnaround, especially in the intermediate goods segment.

- **A recovery is projected across all sectors, against the backdrop of stronger foreign demand**

– Services (6.6%; KIBB: 4.2%; 2020: -5.5%): BNM expects a strong pick up in the information and communication, finance and insurance sub-sectors due to higher demand for digital solutions to boost the sector's recovery. However, the reimposition of the MCO 2.0 in 1Q21 and the year-long international border closure will continue to weigh on activities in the wholesale and retail sub-sector as well as tourism-related industries. We concur with the view as the services sector will continue to struggle with measures to contain the virus until the nation achieves herd immunity.

Graph 2: GDP by Industry



Source: Dept. of Statistics, Kenanga Research

– Manufacturing (8.8%; KIBB: 6.0%; 2020: -2.6%): BNM opines that the COVID-19 pandemic accelerates the structural change towards digitalisation, boosting demand for E&E and medical device products. Growth will also be supported by increased production of refined petroleum and petrochemical, and construction-related manufacturing sectors due to pick-up in infrastructure projects. The consumer-related manufacturing cluster is also expected to improve in line with the recovery and reopening of economic activity and expansion in the automotive cluster due to the extension of tax incentive for car sales. Higher growth forecast by BNM is in line with house view, supported by the global economic recovery theme.

– Construction (13.4%; KIBB: 4.1%; 2020: -19.4%): According to BNM, various infrastructure projects and resumption of activities across all subsectors are expected to support growth recovery in the construction sector. These include ongoing affordable housing projects, solar power projects, Jalinan Digital Negara (JENDELA), small-scale projects under the 2021 Budget, as well off-budget stimulus under PERMAI and PEMERKASA measures.

– Agriculture (4.2%; KIBB: 2.4%; 2020: -2.2%): Growth recovery is expected, underpinned by improving palm oil yields particularly towards the end of the year as a result of higher rainfall in early part of the year. Meanwhile, higher

natural rubber prices are expected to encourage tapping activities. In addition, growth in household spending will lead to a strong expansion in livestock production.

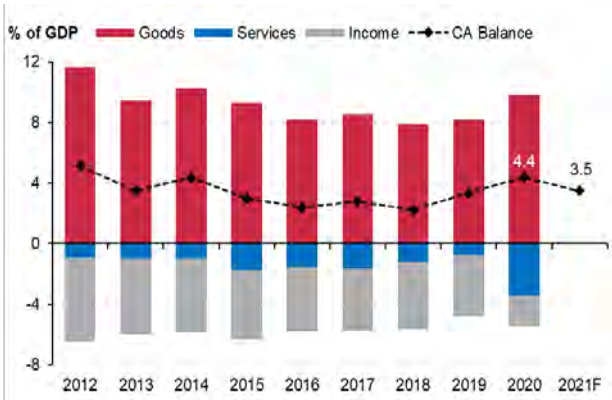
- Mining and Quarrying (3.1%; KIBB: 3.5%; 2020: -10.0%): BNM sees growth to recover in the 2H21 despite maintenance closures in the 1H21 following voluntary supply adjustments by PETRONAS. Growth will be supported by higher production of natural gas contributed by new gas fields as well as the ramp-up of the PFLNG2 facility in East Malaysia. Nonetheless, the house views that growth projection could be higher on anticipation of gradual pick-up in global crude oil demand and an increasingly higher supply drawdown rate.

- **Current account (CA) balance to remain in surplus, albeit lower at 2.5 – 3.5% of GDP (2020: 4.4% of GDP)**

  - BNM had predicted that the services exports would remain subdued, mainly due to lower travel receipts and higher payments for professional and technical services. However, the goods surplus is expected to increase as goods exports are seen to outpace the recovery in imports and benefit from higher commodity prices. Malaysia's exports and imports are projected to sharply rebound to 13.1% (2020: -8.8%) and 14.1% (2020: -8.3%), respectively.

  - This is in line with our in-house view by which the CA balance is forecasted to narrow slightly to 3.5% of GDP in 2021, underlined by sustained travel deficit as international borders will remain closed to foreign tourists until herd immunity is reached or until a vaccine passport system is developed. On the upside, CA balance will continue to be supported by higher goods trade surplus, due to the global vaccine rollout, strong external demand for E&E and rubber gloves, and rising commodity prices.

Graph 3: Current Account Trend (% of GDP)

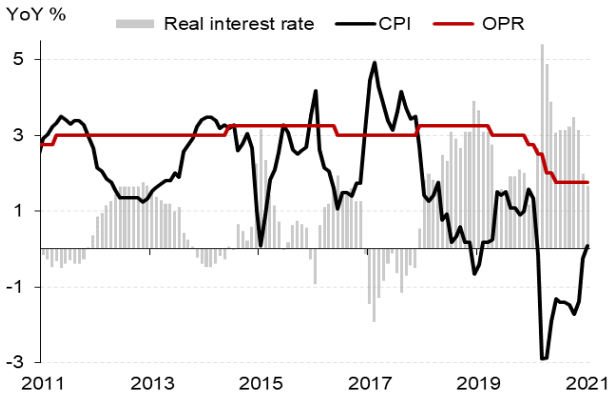


Source: Dept. of Statistics, Kenanga Research

- **Monetary policy to remain accommodative in order to support economic recovery amid modest inflation pressure**

  - BNM acknowledges that an accommodative monetary policy stance will be needed through 2021 given the uneven pace of recovery and the downside risks to economic outlook. This is in line with our house view that BNM will keep the OPR unchanged at 1.75% for the remainder of the year, particularly given the recent relaxation of COVID-19 restrictions, Malaysia's continuing vaccination drive and the additional RM20.0b PEMERKASA stimulus package. However, we believe that BNM still has room to cut the OPR by at least 25 basis points, should COVID-19 infections rise significantly leading to the reintroduction of lockdown restrictions thereby weakening the pace of economic recovery.

Graph 4: BNM OPR and Inflationary Trend



Source: Dept. of Statistics, Bloomberg, Kenanga Research

  - Headline inflation is projected to average higher between 2.5% - 4.0% (2020: -1.2%), largely due to an expected increase in global oil prices and the upcoming expiry of local electricity bill discounts. On the other hand, core inflation is forecasted to average between 0.5% - 1.5% (2020: 1.1%), remaining relatively subdued due to enduring spare capacity in the economy.

  - We agree with BNM's view that headline inflation will rise in the coming months on the back of higher commodity prices, with our house forecast of 1.8%. We reckon inflation will gather pace throughout 2021 as Malaysia's inoculation campaign is expected to lift consumer confidence and boost consumption in 2H21. Nevertheless, we believe that downside risks remain, as some COVID-19 restrictions are still in place and the domestic labour market remains weak.

- **Ringgit's direction to be influenced by COVID-19 situation and domestic economic fundamentals**
  - In the immediate term, the movement of the USDMYR will continue to be driven by the uncertainties surrounding the COVID-19 pandemic and economic prospects. Moving forward, the MYR's performance will likely reflect Malaysia's economic fundamentals as the global economy starts to recover. Due to the excessive volatility in the currency markets, BNM remains cognisant, managing the risks through their two-way foreign exchange interventions. In line with this, exchange rate flexibility will continue to act as a shock absorber from any adverse spillovers caused by the external shocks to the domestic economy.
  - Despite improving domestic COVID-19 situation and higher Brent crude oil price (YTD average: USD61.3/barrel; 2020 average: USD43.2/barrel), we expect the USDMYR to remain under pressure and trade in a range of 4.10-4.20 in the near term amid the spike in global bond yields. However, in the medium term, the positive outlook of the National COVID-19 immunisation program and Malaysia's continuous fiscal and monetary measures is seen to boost the country's nascent economic recovery, prompting the MYR to trade higher against the safe-haven USD. Therefore, we maintain our end-2021 USDMYR forecast at 3.95 (average: 4.00).

Table 2: Summary of Key Economic Indicators

	2015	2016	2017	2018	2019	2020	KIBB 2021F	BNM 2021F
Unemployment Rate (%)	3.1	3.4	3.4	3.3	3.3	4.5	4.0	4.6
Real GDP (% YoY)	5.0	4.2	5.9	4.8	4.3	-5.6	4.5	6.0 – 7.5
Nominal Gross National Income (% YoY)	5.2	6.2	9.7	4.7	5.2	-5.5	5.1	9.8
CPI (% YoY)	2.1	2.1	3.7	1.0	0.7	-1.2	1.8	2.5 – 4.0
Brent Crude Price (USD/barrel)	53.6	45.1	54.8	71.6	64.1	43.2	60.0	52.0 – 62.0
Current Account Balance (RM bil)	35.2	29.9	38.3	32.3	50.9	62.1	52.1	44.3
Current Account Balance (*% of GDP*)	*3.0*	*2.4*	*2.8*	*2.2*	*3.4*	*4.4*	*3.5*	*2.5 – 3.5*

Sources: BNM, Dept. of Statistics, Kenanga Research
F: forecast

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Published and printed by:

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PP7004/02/2013(031762)