Malaysia 4Q21 Economic Outlook

Transitioning to COVID-19 endemic phase

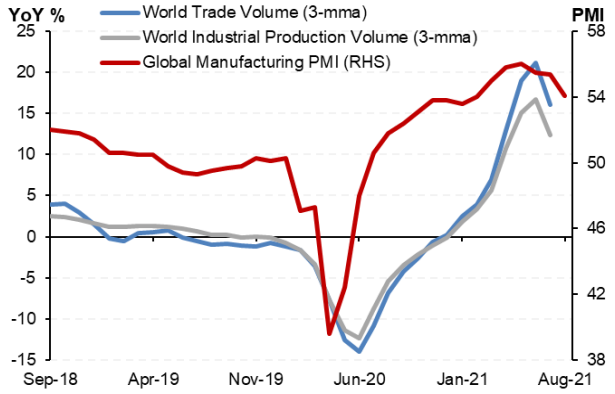
SUMMARY

- The global economic growth is expected to pick up in 4Q21, supported by the resumption of economic activities amid the progress of the COVID-19 vaccination rate and the relaxation of movement restrictions. This will be further supported by the ongoing stimulus measures among major economies and the release of pent-up demand.
- Major central banks are expected to continue raising policy rates and tapering asset purchasing as advanced economies register relatively strong recoveries and prolonged high inflation.
- US Treasury yields are expected to rise significantly, as the Fed starts tapering its bond purchases and as the US continues to chart a strong economic recovery. We project the 10Y UST yield to reach 1.80% by year-end.
- Brent crude oil prices are expected to remain elevated in the 4Q21 in tandem with the global economic recovery theme as demand is expected to improve while output restraint persists. Hence, we have revised the average Brent crude oil price forecast to range between USD65.0-70.0/bbl in 2021 (2020: USD43.0/bbl) from USD65.0/bbl.
- Despite the recovery optimism, the ongoing negative impacts of the COVID-19 pandemic and the current inequitable vaccine distribution poses a significant risk to global growth.
- As most restrictions on social and economic activities will gradually ease once 90.0% adults are fully-jabbed, we expect the government to unveil the new National Recovery Plan (NRP) standard operating procedures (SOPs) as early as the first week of October.
- In line with the gradual economic reopening and as Malaysia shifts to the endemic phase, GDP growth is expected to rebound by 2.8% in the 4Q21 (3Q21F: -1.4%) on broad-based improvement across sectors and components. The recovery is expected to resume from 3Q21 and going into 4Q21 with QoQ growth projected at 3.0% and 6.2%, respectively.
- Nonetheless, the 2H21 GDP growth is expected to be lower at 0.7%, compared to 7.1% growth in 1H21, largely reflecting the impact of movement restrictions in the 3Q21. **This brings the 2021 GDP forecast lower at 3.5% - 4.0% (point forecast: 3.7%) from earlier forecast of 5.0% - 6.0% (point forecast: 5.5%; BNM: 6.0% - 7.5%; 2020: -5.6%).**
- With a more stable economic outlook and a synchrounous global growth**, our preliminary forecast shows GDP growth would expand by 5.5% - 6.0% (point forecast: 5.7%) in 2022.**
- Fiscal deficit is forecast at 6.3% (MoF: 6.5%-7.0%; 2020: 6.2%) on the expectation of higher revenue contribution from the oil and gas sector along with the solid export activities. Likewise, we retain the federal government debt to GDP ratio at 64.5% (2020: 62.2%), but statutory debt is expected to hit the 60.0% limit.
- Amid continued economic uncertainty, strong USD dynamics and optimism surrounding the reopening of the domestic economy, the ringgit is expected to see-saw between gains and losses in the 4Q21. By the end of 2021, the USDMYR is projected to strengthen slightly at around the 4.18 level (2022F: 4.10).
- Foreign fund inflows into the domestic bond market will likely sustain going forward backed by a relative stability on the political front, further easing of lockdown restrictions, and the attractive yield differentials of local bonds. We project the 10Y MGS yield to rise to 3.60% by year-end.
- BNM is expected to keep the overnight policy rate (OPR) unchanged at 1.75% for the remainder of the year, as the local COVID-19 condition improves and lockdown measures continue to be relaxed.
- External and domestic downside risks remain, nonetheless, arising from the potential emergence of vaccine-resistant COVID-19 variants, China's Evergrande debt overhang situation, and Malaysia's COVID-19 uncertainty.

- **A resumption in global economic recovery is expected in the 4Q21 after the recovery pace in the 3Q21 was disrupted by the spread of the Delta variant.** Growth will be contributed by the advanced and developing economies on the back of gradual relaxation of COVID-19 movement restriction measures, supported by the progress of the ongoing vaccination.

  – The COVID-19 pandemic has impacted **global trade** volume in 3Q21 as countries around the world reimposed movement restrictions to curb the spread of the Delta strain. This is reflected in the global trade volume growth, which moderated to 9.8% in July (Jun: 15.8%), the slowest since February 2021. Similarly, expansion in global industrial production slowed to 8.6% (Jun: 11.9%), the lowest in four months. Meanwhile, the Global Manufacturing PMI showed weak expansion in the manufacturing sector in August, with the reading down to 54.1 (Jul: 55.4), the lowest since February 2022.

Graph 1: Global Indicators



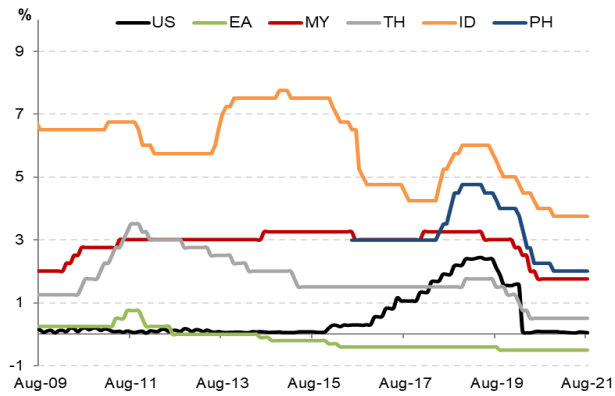
Source: CEIC, CPB Netherlands Bureau for Economic Policy Analysis

    - Nonetheless, the downtrend is expected to be temporary, with 4Q21 to chart a rebound in expansion due to the economic reopening in most advanced and developing economies as a result of the effective containment measures and higher vaccinated population. This will be further bolstered by an acceleration in the rollout of 5G-driven technology upcycle, and unleashed pent-up demand supported by the ongoing fiscal and monetary policies.

  – **Major central banks** are expected to continue the normalisation of monetary policy, as advanced economies register relatively strong recoveries and prolonged high inflation.

    - Despite the impact of a resurgent COVID-19, driven by the spread of the Delta variant, developed economies have been able to sustain their recovery momentum. Furthermore, the high inflation that beset advanced economies was less than transitory, with US headline inflation registering 5.3% and the EU recording its highest inflation rate in a decade of 3.0% in August. These factors, along with relatively successful vaccination programmes and COVID-19 cases appearing to have peaked, have led several major central banks to begin their rate hike cycles, and will likely continue to further tighten policy measures in the near-term. Among others, the central banks of South Korea, Iceland, and Norway have recently raised their key policy rates by at least 25 basis points (bps), whilst indicating that they may increase rates again before the end of the year. Some developing economies have also embarked on policy tightening, with Brazil drastically increasing rates by 100.0bps in order to stem surging inflation. However, ASEAN nations continue to hold their policy rates despite being at the epicentre of a new wave of COVID-19 over the last six months and will likely maintain this stance until the end of the year.

Graph 2: Policy Rates



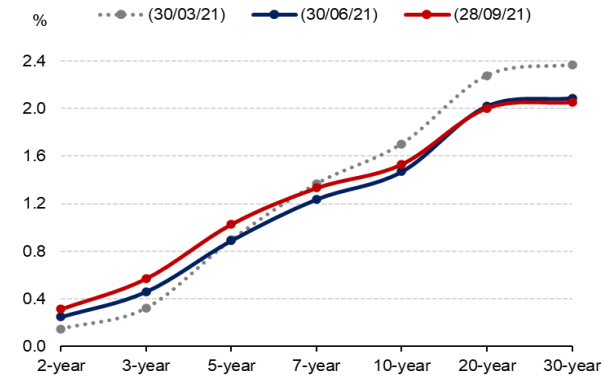
Source: CEIC, Bloomberg, Kenanga Research

    - The US Federal Reserve (Fed) has indicated that they would soon taper their USD120.0b monthly asset purchases, with Chairman Jerome Powell stating the announcement could be made as early as November. The Fed communicated a slightly more hawkish tone in their recent FOMC meeting, highlighting that the US recovery momentum remained intact and high inflation remained. Additionally, the updated dot plot indicated a growing preference to start raising the policy rate once in 2022, as opposed to the previous projection that rate hikes would only begin in 2023. Furthermore, the hawkish tilt and scaling back of bond purchases reflects a global trend, in which the European Central Bank (ECB) and the Bank of England (BOE) have also announced that they would soon reduce bond purchases and are prepared to raise policy rates if needed, to prevent persistently high inflation.

– **United States Treasury (UST) yields** are expected to rise significantly in 4Q21, primarily driven by the Fed tapering its bond purchases, and as the US continues to chart a strong economic recovery as COVID-19 cases recede. We project the 10Y UST yield to reach 1.80% by year-end.

  - Contrary to our earlier expectations, UST yields remained relatively low for the majority of 3Q21 with the 10Y UST averaging 1.31% (2Q21: 1.58%), largely due to renewed risk-off sentiment as the Delta variant spread globally. However, towards the end of September, Treasury yields gained robust upward momentum following a slightly hawkish FOMC statement that hinted at a tapering announcement in November and a rising number of Fed members pencilling in an earlier rate hike in 2022.

Graph 3: UST Yield Curve Comparison



Source: Bloomberg, Kenanga Research

  - In 4Q21, we expect UST yields to trend higher, driven by the potential tapering announcement in November and its commencement in December, as well as supported by solid US growth recovery and persistently high inflation. Nevertheless, we reckon the tapering impact will be less severe than the 2013 taper tantrum, which saw the 10Y UST rise to 3.028% by January 2014. In this case, the Fed appears to be better in managing market expectations and clearly communicating that tapering would not immediately start the rate hike cycle, with monetary policy to remain accommodative. As such, tapering would likely raise UST yields gradually towards the end of the year. However, yields are at risk of surging should the unresolved US debt ceiling issue lead to the US government defaulting on its debt by mid-October. This unprecedented default, however unlikely, would be catastrophic for US bonds and the resulting sell-off would heavily impact global financial markets.

– **Crude oil prices** are expected to remain elevated in the 4Q21 driven by higher demand and output restraint

  - As of September 30, Brent crude oil average price rose to USD68.0/bbl (2020 average: USD43.2/bbl), a 57.3% higher than last year. On quarterly basis, it grew 6.0% QoQ (2Q21: 12.7%) to USD73.2/bbl (2Q21: USD69.1/bbl). Higher oil price during the 3Q21 was associated with supply disruptions in Mexico and severe storm hitting the US Gulf Coast which likely to be temporary as production resume.

  - On September 1, OPEC+ agreed to increase their collective crude production by 400,000 b/d in October, sticking to their easing plans as global economic growth remains on a trajectory on the back of the wider vaccination and as many economies begin to reopen. However, uncertainty remains over the path of the pandemic and the unabated surge in COVID-19 cases as economic activities resume, relaxation of SOPs and potentially new variant emerges. Another key point to be closely monitored will be Iran's potential return, as the Iranian Foreign Minister recently signalled nuclear talks to resume 'very soon'.

Graph 4: Crude Oil Price Trend (USD/barrel)

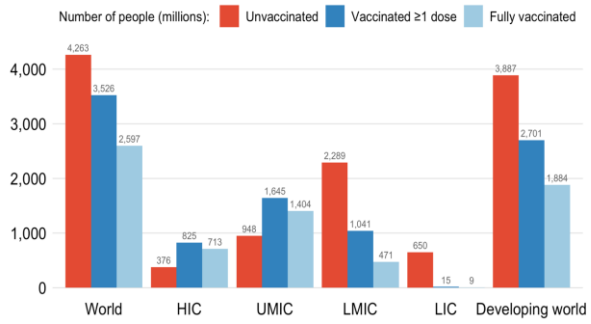
Source: Bloomberg, Kenanga Research

  - Against this backdrop, the oil price is expected to remain elevated in the 4Q21 and going into 2022, driven largely by the global recovery theme due to various policy measures and aggressive inoculation campaigns. This would likely support the Brent crude oil price to remain above USD70.0/bbl during the final quarter. Hence, we raise the 2021 estimate to average USD65.0-70.0/bbl (2020: USD43.2/bbl) from the previous forecast of USD65.0/bbl. In comparison, the US Energy Information Administration (EIA) via its September Short Term Energy Outlook (STEO) has revised its average price projection to USD68.6/bbl for 2021 from USD68.7/bbl and USD66.0/bbl in 2022, with the price averaging at USD71.0/bbl during 4Q21.

– **Even though the number of global COVID-19 cases and deaths has begun to decline again in September, there continue to be huge disparities in vaccination rates by income group**

- As of September 29, there are now more than 234.0m COVID-19 cases and 4.7m deaths (mortality rate: 2.0%) worldwide. Declining trends in both COVID-19 cases and deaths have been observed globally; per 1.0m people, there are now around 57 new cases (end-Aug: 82) and around 0.99 death (end-Aug: 1.22) recorded on a 7-day average. By income group, high (HIC) and upper middle (UMIC) income countries recorded more than 73.0% of the total global COVID-19 cases, while low-income countries (LIC) only reported a mere 0.6%. The main reason for this could be limited testing due to lack of quality COVID-19 rapid tests and inadequate medical facilities, making it harder to trace and contain the virus.

Graph 5: Distribution of World Population by Vaccination Status



Source: Our World in Data. Updated: 2021-09-29. Latest: pandem-ic.com.

Note: Acronyms: high (HIC), upper-middle (UMIC), lower-middle (LMIC) & low-income (LIC) countries. Developing world: UMIC, LMIC and LIC. Numbers reflect latest available data, which may be dated. As of today, we count a total of 0.0 million doses globally that are undocumented about their contribution to full or partial vaccination.

- On the global vaccination progress, more than 45.0% of the world population have received at least one vaccine shot and almost 34.0% are fully-vaccinated. Out of the total 4.3b unvaccinated people, more than 53.0% are from lower-middle income countries (LMIC). To highlight, there is clear evidence of vaccine inequalities as only 2.6% of the population in LIC and 31.1% in LMIC had received at least one vaccine dose compared to 63.4% in UMIC and 68.5% in HIC. To put things into context, more than half (51.8%) of the world population are from LIC and LMIC. According to the Economist Intelligence Unit, the world economy could lose USD2.3t due to delayed vaccinations. Moving forward, this situation is expected to improve as the global COVID-19 summit held on September 22 has highlighted one major theme intended to narrow the equity gaps which is "vaccinate the world by enhancing equitable access to vaccines and getting shots in arms."

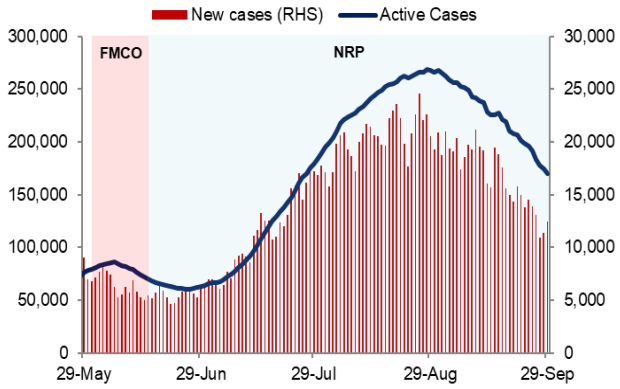
Macro Outlook – 4Q21 and 2H21

- **Malaysia's COVID-19 endgame: A delicate balancing act between health and the economy as the country prepares to shift from pandemic to endemic phase**

  – Despite tightened SOPs and accelerated vaccination rollout, Malaysia's daily COVID-19 infections nearly quadrupled to 24,599 cases (peak: August 26) from 6,276 cases (end-June), mainly due to the emergence of delta variant with a combination of widespread community transmission (ineffective find, test, trace, isolate and support system (FTTIS)) and airborne spread. However, cases and positivity rate have been showing signs of declining in the past few days, with a 7-day average of 12,717 and 9.6%, respectively. It is to note that the number of active cases has fallen to 169,718 from its peak of 268,551. Out of the total active cases, more than 80.0% are under home quarantine (level 1 and 2 patients) and only around 0.5% are in the intensive care unit. Moving forward, the domestic COVID-19 situation will depend on the effectiveness of the government's reopening strategies.

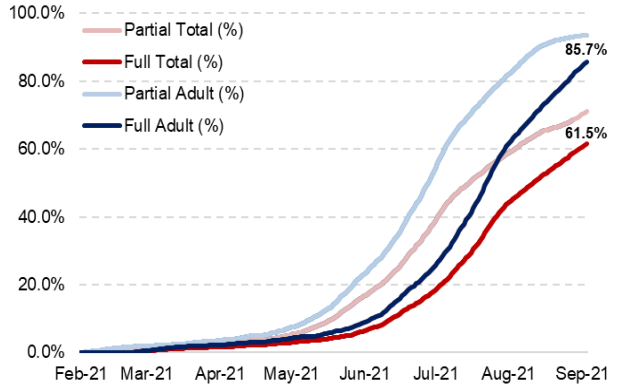
  – In the early phase of the National Recovery Plan, less than 5.0% of the population are fully-vaccinated against COVID-19, even after more than three months since the vaccination programme kicked off on February 24. Fast forward, as of September 29, more than 43.3m doses of COVID-19 vaccines have been administered in Malaysia. In all, a total of 23,273,902 (71.5%) Malaysians have received at least one vaccine shot and

Graph 6: Malaysia COVID-19 Pandemic Trend



Source: Kenanga Research, MoH

Graph 7: Malaysia COVID-19 Vaccination Rate



Source: Kenanga Research, JKJAV

out of that total, almost 62.0% are fully-vaccinated. The pace of vaccination rollout in Malaysia has been slowing down in September as almost all of the registered adult has received at least one dose of the vaccine. However, as the country has started vaccinating those from 12 to 17 years old, the pace is likely to pick up again until we reach the glass ceiling of roughly 80.0% vaccinated population. To highlight, more than 94.0% of the adult population have received at least one dose of the COVID-19 vaccine and it is estimated that more than 90.0% of those above 18 years old will be fully-vaccinated as early as October 6. Hence, the government may lay out its reopening strategies as early as next week, where most social and economic sectors will be allowed to operate under a new loosened SOPs. It is to note that the government have announced plans for booster shots and the third dose of the COVID-19 vaccine.

- **The domestic economy is expected to rebound in the final quarter amid gradual economic reopening under the National Recovery Plan (NRP) after likely being mildly impacted by the movement restrictions in the 3Q21**
  - **We have revised 2021 GDP growth earlier at 3.5% - 4.0% (point forecast: 3.7%; BNM: 3.0% - 4.0%; 2020: -5.6%) from 4.0% - 5.0%,** following the extended movement restrictions and delay in the reopening of the economy amid surging COVID-19 cases and fears over the highly contagious Delta strain. 3Q21 GDP growth is expected to fall by 1.4% (previously: -2.0% - 0.5%), reflecting the impact of movement restrictions on the services sector and private spending. Nonetheless, we expect growth to rebound by 2.8% in 4Q21, bringing the 2H21 growth at 0.7% (1H21: 7.1%). The pace of recovery is expected to resume from 3Q21 and going into 4Q21, with QoQ growth projected at 3.0% and 6.2%, respectively.
  - In 4Q21, the economy is expected to improve broadly across sectors and components. By sector, growth will remain supported by the manufacturing sector, particularly the export-driven industry, given the expected improvement in global trade activities following the reopening of the economy. Export growth is expected to remain strong despite the threat of the Delta wave and supply chain issues, as major trading partners continue to chart solid economic recoveries amid ongoing stimulus measures, while global oil prices remain high, and the technology upcycle continues. This is evidenced by the latest exports growth, which rebounded by 18.4% in August (Jul: 5.0%), partly due to the base effect. Therefore, we project a solid expansion in the manufacturing sector at 4.5% (3Q21F: 2.1%), contributing 1.1 percentage points (ppts) to 4Q21 GDP growth. Likewise, the services sector is expected to rebound by 2.6% (3Q21: -2.2%) and contributing 1.5 ppts to 4Q21 growth on the back of relaxation in movement restrictions and expected reopening of most economic activities in the 4Q21 as Malaysia shift to the endemic phase. On the demand side, both value-added private and public expenditure is projected to grow by 8.4% in 4Q21, contributing a total of 7.9 ppts to 4Q21 GDP growth. Most of this will be attributable to an estimated 9.5% growth (5.5 ppts) of private consumption backed by the unleashing of pent-up demand. Overall, aggregate demand is projected to rebound by 8.4%, contributing 7.9 ppts to 4Q21 GDP growth. With a more stable economic outlook and a synchronous global growth, barring the unforeseen**, our preliminary forecast shows GDP growth would expand by 5.5% - 6.0% (point forecast: 5.7%) in 2022.**

Table 1: Malaysia GDP Growth (constant 2015 prices)

					Kenanga								BNM
YoY %	**2019**	**2Q20**	**3Q20**	**4Q20**	**1Q21**	**2Q21**	**3Q21F**	**4Q21F**	**1H21F**	**2H21F**	**2020**	**2021F**	**2021F**
By Sector													
Agriculture	2.0	0.9	-0.3	-1.0	0.2	-1.5	-5.0	3.1	-0.7	-1.3	-2.2	-1.0	
Mining	-0.6	-20.8	-7.8	-10.4	-5.0	13.9	4.8	3.4	3.5	4.1	-10.6	3.8	
Manufacturing	3.8	-18.3	3.3	3.0	6.6	26.6	2.1	4.5	15.8	3.3	-2.6	9.1	
Construction	0.4	-44.5	-12.3	-13.9	-10.4	40.3	-11.2	0.4	8.3	-5.5	-19.4	0.8	
Services	6.2	-16.2	-4.0	-4.8	-2.3	13.4	-2.2	2.6	4.8	0.2	-5.5	2.4	
Real GDP	**4.4**	**-17.2**	**-2.7**	**-3.4**	**-0.5**	**16.1**	**-1.4**	**2.8**	**7.1**	**0.7**	**-5.6**	**3.5 - 4.0**	**3.0 - 4.0**
By Expenditure													
Consumption	6.6	-15.1	-0.7	-2.3	-0.3	11.1	-3.4	9.1	4.8	2.9	-2.9	3.8	
Public	1.8	2.2	6.8	2.4	5.9	9.0	4.3	2.1	7.5	5.1	3.9	6.2	
Private	7.7	-18.5	-2.1	-3.5	-1.5	11.6	-4.5	9.5	4.3	2.4	-4.3	3.3	
Investment	-2.1	-29.0	-11.4	-11.8	-3.3	16.5	2.0	6.0	5.5	4.0	-14.5	4.7	
Public	-10.7	-40.1	-13.1	-20.4	-18.6	12.0	3.5	10.5	-6.9	7.5	-21.3	1.7	
Private	1.6	-26.1	-10.8	-6.6	1.3	17.4	1.5	3.7	8.8	2.5	-11.9	5.8	
Public Spending	-2.8	-11.1	0.1	-5.7	-1.5	9.7	2.5	8.4	3.8	5.8	-4.7	4.9	
Private Spending	6.3	-20.4	-4.0	-4.0	-0.9	13.0	-3.3	8.4	5.3	2.4	-6.0	3.8	
Aggregate Demand	4.3	-18.8	-3.3	-4.5	-1.0	12.3	-2.2	8.4	5.0	3.1	-5.8	4.0	
Exports	-1.0	-21.7	-4.9	-2.1	11.9	37.4	10.5	9.3	23.5	9.9	-8.9	16.2	
Imports	-2.4	-19.7	-7.9	-3.3	13.0	37.6	12.7	10.1	24.3	11.4	-8.4	17.5	
Net exports	11.2	-37.9	19.2	10.0	0.8	34.3	-3.6	2.8	15.6	-0.7	-13.0	5.6	
Real GDP	**4.4**	**-17.2**	**-2.7**	**-3.4**	**-0.5**	**16.1**	**-1.4**	**2.8**	**7.1**	**0.7**	**-5.6**	**3.5 - 4.0**	**3.0 - 4.0**

Source: Dept. of Statistics, Kenanga Research, F: forecast

– **Fiscal** expansionary will remain in the 4Q21 and 2022 driven by the ongoing stimulus support, expected higher statutory debt limit and the implementation of the 12th Malaysian Plan (12MP)

- As of July 2021, total government revenue expanded by 8.3% YoY to RM122.4b despite the prolonged movement restrictions and uncertainty over the pandemic. Meanwhile, expenditure increased by 4.5% YoY to RM187.9b. Consequently, the overall balance of federal government fiscal stands at a deficit of RM65.6b, or 1.9% lower than in the same period of 2020 (-RM66.8b). Though the pace of deficit in the overall balance has slowed down, the monthly average stands at -RM9.4b.

- Hence, we expect the deficit in the overall balance of the government fiscal balance sheet to remain by year-end as the government continues to spend to support the economic recovery. Of note, Bantuan Prihatin Rakyat (BPR) Fasa 3, Geran Khas Prihatin (GKP 4.0), and Bantuan Khas COVID-19 (BKC), will be distributed to the people and businesses between September and December this year. This will be further bolstered by the 12MP as the government gear up for development spending going forward. Nonetheless, we retain our fiscal deficit forecast at 6.3% (MoF revised: 6.5-7.0%; 2020: 6.2%) as we expect higher Brent crude oil price and strong trade activities to support government revenue this year.

Table 2: Federal Government Fiscal Outlook

	Global Financial Crisis				MoF Original	MoF Revised	KIBB	
RM billion	**2008**	**2009**	**2019**	**2020**	**2021F**	**2021F**	**2021F**	**2022F**
Revenue	**159.8**	**158.6**	**264.4**	**225.1**	**236.9**	**N/A**	**221.0**	**240.5**
Gross Expenditure	**196.3**	**206.6**	**317.5**	**314.0**	**322.5**	**314.8**	**317.3**	**354.0**
Net Expenditure	**195.4**	**206.1**	**315.9**	**315.2**	**321.7**	**314.0**	**316.4**	**353.1**
Operating Expenditure	153.5	157.1	263.3	224.6	236.5	219.6	220.5	240.0
Gross Development Expenditure	42.8	49.5	54.2	51.4	69.0	68.2	69.8	69.0
Loan Recoveries	-1.0	-0.5	-1.6	1.3	-0.8	-0.8	-0.9	-0.9
COVID-19 Fund				38.0	17.0	27.0	27.0	45.0
Overall Balance	**-35.6**	**-47.4**	**-51.5**	**-87.6**	**-84.8**	**N/A**	**-95.4**	**-112.6**
% of GDP	-4.6	-6.7	-3.4	-6.2	-6.0	-6.5 - 7.0	-6.3	-6.9
Federal Government Debt (% of GDP)	39.8	50.8	52.5	62.2	58.5	N/A	64.5	66.9
Real GDP Growth (%)	**4.8**	**-1.5**	**4.4**	**-5.6**	**6.5 - 7.5**	**3.0 - 4.0***	**3.5 - 4.0**	**5.5 - 6.0**
Average Brent Price (USD/barrel)	97.7	64.1	64.6	43.2	42.0	N/A	65.0 – 70.0	60.0 – 65.0

Source: MoF, Kenanga Research

- Meanwhile, we maintain the federal government debt forecast at 64.5% of GDP (2020: 62.2%), mainly to reflect the impact of slower economic growth recovery. In addition, the statutory debt is expected to reach its limit of 60.0% in the near term, given the higher borrowing pace year-to-date. According to the latest data, the government raised RM88.8b of new statutory debt within just eight months of this year, or 10.4% higher than the end of 2020 level, partly to finance its development spending and the additional economic stimulus amid lower revenue. Consequently, there is RM4.2b left for new borrowing before reaching the 60.0% statutory limit. Nonetheless, the government proposal to lift the statutory limit to 65.0% in October is estimated to allow RM75.5b additional space for new borrowing.

Table 3: Federal Government Debt Headroom

		RM bil		
		latest	**limit**	**balance**
Offshore borrowing	3Q21	33.6	35.0	1.4
Malaysian Treasury Bills (MTB)	Aug-21	8.0	10.0	2.0
Statutory (MGS, MGII, MITB)	Aug-21	902.0	906.3	4.2
Statutory (% of GDP)	Aug-21	59.7%	60.0%	0.3%
Total:		**943.6**	**951.3**	**7.6**

Source: BNM, CEIC, Kenanga Research

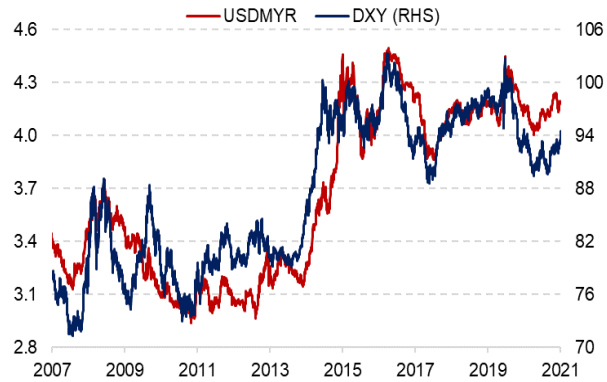
– **Ringgit:** In 4Q21, the USDMYR pair is expected to continue to trade in a volatile manner on the back of lingering COVID-19 uncertainty, Fed taper announcement in November, China's Evergrande crisis and unpredictable global oil market. Hence, the ringgit is expected to trade in between 4.15-4.20 before closing the quarter at around the 4.18 level.

- The weakness in the ringgit in 3Q21 was mainly due to improved greenback's performance as evidenced by a rise of more than 1.9% on average in the USD index (DXY), driven by better-than-expected US economic data readings

and a surprisingly hawkish Fed. Despite higher Brent crude oil prices, US-China optimism, 12MP and improving domestic COVID-19 situation, the local note struggled to gain momentum amid the global risk-off environment.

- The ringgit is expected to continue experiencing a roller-coaster ride in 4Q21 amid continued economic uncertainty as Malaysia enters the endemic phase of COVID-19. In October, the ringgit may gather some strength and appreciate against the USD due to the optimism surrounding the reopening of the Malaysia economy and the tabling of Budget 2021. The local note's direction will be mainly influenced by external factor as the Fed is highly expected to announce a reduction in its USD120.0b/month asset purchases in November and may start to cut purchases by USD15.0b/month as early as December. As the tapering news may drive the US 10-year treasury yield and DXY higher, the ringgit is likely to remain under downward pressure towards the end of the year before staging a rebound in 2022 at around 4.10.

Graph 8: USDMYR and DXY trend



Source: Bloomberg, Kenanga Research

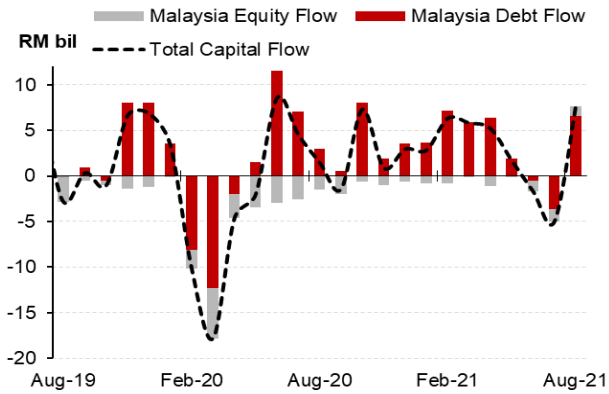
– **Bond Market:** Foreign fund inflows into the domestic bond market will likely sustain in 4Q21, on the back of improved domestic political stability, further easing of lockdown restrictions, and the attractive yield differentials of local bonds, but may be capped by the Fed's expected tapering announcement. We project the 10Y MGS yield to rise to 3.60% by year-end.

- After two consecutive months of selling, foreign investors turned net buyers of Malaysian debt in August, with inflows reaching a 10-month high of RM6.6b, more than offsetting the previous months' outflows (Jul: -RM3.6b; Jun: -RM0.5b). The rebound in demand was driven by improving political stability, after a period of heightened volatility that culminated in the resignation of Tan Sri Muhyiddin Yassin as Prime Minister, as well as the gradual easing of restriction measures after a resurgence in COVID-19 cases saw the nation placed under extended lockdown.

- We expect foreign demand for domestic bonds to sustain in 4Q21, given that falling COVID-19 cases and strong vaccination rates will likely see lockdown measures eased further in the near-term. This will also be supported by a new phase of relative domestic political stability, which has already led to the publication of the 12MP and will see the tabling of Budget 2022 on October 29. Furthermore, Malaysian bonds remain attractive due to its high yield differentials against developed market bonds. However, inflows may be partly tempered by the Fed's expected announcement of tapering in November, with global demand for bonds already showing signs of pressure. Nonetheless, we do not expect tapering to impact the bond market as heavily as in 2014, rather, reduced inflows will likely be seen gradually over the tapering period until mid-2022.

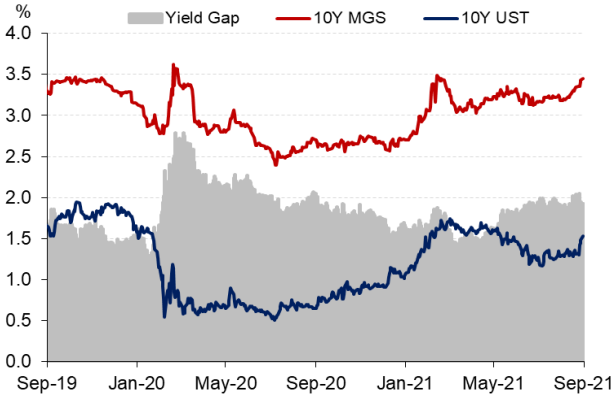
- The 10Y MGS yield trended lower-than-expected in 3Q21 at an average of 3.23% (2Q21: 3.18%), tracking similarly low UST yields for most of this period, and was also weighed down by Malaysia's worsening COVID-19 condition, which led to prolonged restriction measures. Nevertheless, domestic yields began to climb in September as lockdown measures were gradually eased and have trended higher following the recent US FOMC meeting. In 4Q21, we

Graph 9: Net Foreign Capital Flows



Source: BNM, Kenanga Research

Graph 10: 10Y MGS-UST Yields and Yield Gap



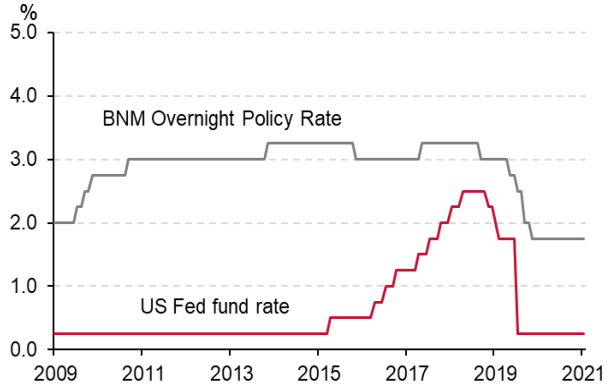
Source: Bloomberg, Kenanga Research

expect yields to increase further, primarily lifted by UST yield movements, driven by the Fed's expected tapering announcement. Additionally, an uptrend in domestic yields should be backed by the improving COVID-19 situation and a full economic reopening before year's end.

– **Monetary Policy:** We maintain our view that Bank Negara Malaysia (BNM) will keep the overnight policy rate (OPR) unchanged at 1.75% for the remainder of the year.

  - This takes into account the recent improvement of the local COVID-19 situation as daily cases consistently trend lower, and as the government is expected to continue relaxing lockdown measures in the near term amid high vaccination rates. Loosened movement restrictions will stimulate domestic demand going forward, and external demand already appears to be recovering after a heavier-than-expected downturn in July, which should improve Malaysia's economic outlook towards the end of the year and give BNM the space to maintain the policy rate.

Graph 11: BNM OPR vs. US Fed Fund Rate



Source: Bloomberg, Kenanga Research

  - Furthermore, as several major central banks have begun their rate hike cycle, amid sustained economic growth and heightened inflationary pressure, we reckon BNM may withhold from any further monetary easing. Given that the US Fed has increasingly indicated that it would begin raising its short-term rate in 2022, as opposed to 2023, we believe BNM may raise the OPR by mid-2022 in a preemptive move.

  - Nonetheless, slight downside risks remain as COVID-19 and the potential for new variants could reverse the country into strict lockdown measures, as well as financial market volatility as major central banks start to readjust their monetary policies. As such, we believe BNM still has room to lower both the OPR and the Statutory Reserve Requirement if required.

– Even though the economic performance in 4Q21 may improve sequentially from the 3Q21, the domestic economy will likely continue to face headwinds in the near term, arising from the potential emergence of vaccine-resistant COVID-19 variants, China's Evergrande debt crisis and the country's COVID-19 uncertainty

  - On August 30, the World Health Organization (WHO) has added a new COVID-19 variant called "Mu" (first detected in Colombia) into its variant of interest list. Quoting the WHO, "the variant contains genetic mutation that indicate natural immunity, current vaccines or monoclonal antibody treatments may not work as well against it as they do against the original ancestral virus." Even though further study is needed to confirm whether the strain is more resistant to the current vaccines or not, the abolishment of non-vaccination measures such as mask-wearing and social distancing may cause another wave of the pandemic and give rise to a potential vaccine-resistant variants, as most of the countries around the world are preparing to reopen their borders to the fully-vaccinated people.

  - On top of the already slowing China economy, the current Evergrande's debt crisis will be a significant roadblock on the country's road to recovery from the COVID-19 pandemic. Despite the fact that the Chinese government may offer a bailout to China's second-largest property developer, it is highly anticipated that it would not be anytime soon as Beijing is expected to wait and see how the situation plays out. The slowdown in China's economy and plummeting investor confidence due to the debt overhang situation may have knock-on effects on other emerging markets including Malaysia.

  - On the domestic front, the COVID-19 health crisis remains a key risk to the Malaysia growth outlook in the near future. Despite the improving COVID-19 situation and most of the population already fully-vaccinated against the virus, poor adherence to SOPs and weak implementation of the FTTIS system may cause an increase in the number of both breakthrough cases among the vaccinated and deaths among the unvaccinated once the government allows interstate-travel and more tourism activities.

Table 4: Forecast and Assumptions

	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Real GDP (%YoY)	4.7	6.0	5.0	4.2	5.9	4.7	4.4	**-5.6**	**3.5 – 4.0 (3.7)**	**5.5 – 6.0 (5.7)**
Consumer Price Index (avg.)	2.1	3.2	2.1	2.1	3.7	1.0	0.7	**-1.2**	**2.3**	**1.7**
Current Account Balance (% of GDP)	3.5	4.4	3.0	2.4	2.8	2.1	3.4	**4.4**	**3.7**	**4.1**
Fiscal Balance (% of GDP)	-3.8	-3.4	-3.2	-3.1	-3.0	-3.4	-3.4	**-6.2**	**-6.3**	**-6.9**
Unemployment Rate (%)	3.1	2.9	3.2	3.3	3.4	3.4	3.3	**4.5**	**4.5**	**3.7**
Manufacturing Output (%YoY)	4.2	6.1	4.8	4.3	6.0	5.0	3.8	**-2.6**	**9.1**	**6.5**
Exports of Goods (%YoY)	2.5	6.4	1.6	1.2	18.8	7.3	-0.8	**-1.4**	**16.7**	**6.9**
Overnight Policy Rate (end-period)	3.00	3.25	3.25	3.00	3.00	3.25	3.00	**1.75**	**1.75**	**2.00**
USDMYR (end-period)	3.28	3.50	4.29	4.49	4.05	4.13	4.09	**4.02**	**4.18**	**4.10**
Palm oil (RM/tonne, avg.)	2,371	2,384	2,166	2,649	2,791	2,235	2,244	**2,767**	**3,700**	**3,200**
Crude oil (Brent) (USDD/barrel, avg.)	108.7	99.5	53.6	45.1	54.8	71.6	64.1	**43.2**	**65.0 – 70.0**	**60.0 – 65.0**

Source: MoF, BNM, Bloomberg, Kenanga Research, F = Forecast

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