ECONOMIC BRIEF
Issue #1 February 2020

INSTITUTE OF STRATEGIC ANALYSIS & POLICY RESEARCH

The Impact of the Coronavirus 2019-nCoV on the Malaysian Economy

Qarrem Kassim

Summary

On the eve of the Chinese New Year celebrations, a new strain of virus known as the Novel Coronavirus (2019-nCoV) believed to have originated from a bat in the Hubei province stormed international headlines, triggering fears of a pandemic outbreak much like the SARS crisis of 2003. No less worrying was that the virus seemed to have appeared in Wuhan, the geo-demographic centre of Mainland China and a central transportation hub for hundreds of millions of Chinese citizens.

Reactions were extreme with Wuhan city quickly succumbing to a state of lockdown and all international flights and transport lines were restricted. Within hours, international stock markets reacted sharply, triggered by a spike in investor uncertainty about China's economic performance this year and a massive institutional sell-off ensued resulting in an overall 9% drop in Chinese shares. Notwithstanding this, fears of China's economic vibrance this year coming to a halt has triggered oil prices to collapse, to a low of US$52 per barrel, to the detriment of oil producing nations such as Malaysia.

Economic Impact on China

It cannot be overstated the impact of the Wuhan lockdown as being one of the most important cities in China. The coronavirus outbreak is expected to have a considerable impact on China's economy, as the city of Wuhan, a city of 11 million people and the epicentre of the outbreak is a transportation and logistics hub for the whole mainland and supplies inputs to the domestic and international supply chain has been on lockdown since the beginning of the outbreak.

Wuhan is also a big manufacturing hub in China, it has over 500 factories that produce car parts, pharmaceuticals, optical equipment and steel products while China's third largest car manufacturer, Dongfen is also based in Wuhan. It also has one of the largest student populations in China. Therefore, the impact from a lockdown on the province cannot be disregarded, with predictions of more provincial lockdowns to come as the virus spreads to other provinces and territories.

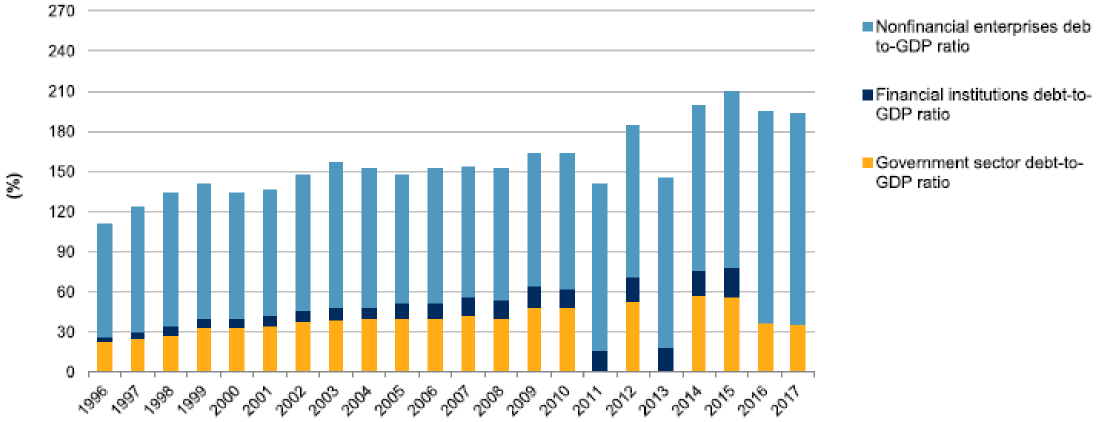
According to Capital Economics, logistics and transportation has been significantly damaged by the outbreak, with rail passenger numbers on the first day of the lunar new year 42% lower than the equivalent day in 2019 while road passengers were 25% lower, in contrast, the declines in May 2003, the peak month of the SARS outbreak, were 57% and 45% respectively.

An estimated 5 million people left the transportation nexus city of Wuhan before the Chinese New Year holidays, with travel times lasting for only a few hours to travel from one major city to the next which makes it particularly difficult in containing the spread of the virus.

As part of the lockdown, the government has advised people to stay indoors, severely hampering individual participation and engagement in economic activity. As such, shops have remained closed, inventories are overhung and businesses are closed until further notice.

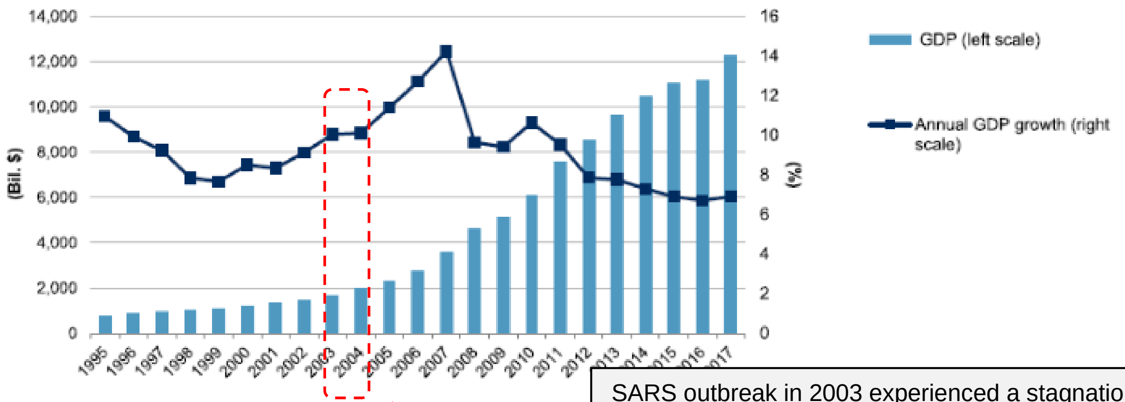
The sales of inventory and working capital requirements of businesses are becoming strained, with China's slowing GDP growth and lacklustre economic performance -due to the ongoing US trade war- have placed a strain on the bottom line of many domestic companies resulting in Chinese private debt levels reaching record levels.

Leverage Ratios In China (1996-2017)



Note: Missing values for the government sector (2011, 2013) and financial institutions (2016, 2017) are due to lack of data availability. Source: WIND.

China's GDP Growth Rate



Source: World Bank.

SARS outbreak in 2003 experienced a stagnation of % Change in GDP growth and a decline in the Shanghai Stock Exchange Composite Index (SSECI) from April to October 2003.

Source: tradingeconomics.com

The coronavirus outbreak is reminiscent of the SARS epidemic in April 2003, which caused shockwaves in the international marketplace, with the SSECI experiencing a decline from April to October 2003 and knocked China's annual GDP growth to 9.1% in the second quarter of 2003 from 11.1% in the previous 3-month period, as the government imposed travel restrictions.

It should be noted however, that the impact from the SARS outbreak occurred at a time when China was not yet as intrinsically linked to the global supply chain as it is today, thus an apple-to-apple comparison between SARS and 2019-nCoV is not possible as the Chinese economy is now over 4 times larger than during the SARS outbreak. Damage to the Chinese economy due to SARS costed an estimated USD$40Bil, however with the Chinese economy significantly larger than it was in 2003, the overall impact of the coronavirus may be much more far-reaching in comparison.

One of the most noticeable difference was that the symptoms of the SARS virus was easily spotted and its spread could be relatively easily stopped whereas the 2019-nCoV does not exhibit the same noticeable symptoms and can be difficult to detect in an individual. In addition, the impact from SARS was limited to several provinces notably Guangzhou and Beijing however, the coronavirus has been confirmed to have spread to all Chinese provinces, and sets the stage for a nationwide outbreak which is unable be contained easily.

Impact on China's GDP

The impact on the Chinese economy may be much more severe than in 2003 as over half (53.1%) of China's national economy consisted of the services sector, whereas services in 2003 made up less than a third of the Chinese economy. The importance of the services sector is worthwhile to flag out, as the Chinese New Year is the largest and busiest season for sales as shops and offices close from the outbreak. According to the official Chinese figures, Chinese restaurants, small vendors and retailers typically record revenues in excess of RMB1Tril in revenues during that 7-day period.

In addition, box office figures during the lunar new year hit rock bottom, resulting from a temporary closure of Disneyland Shanghai and Hong Kong as well as nearly 70,000 movie theatres nationally accounting for 33% of global box office sales. According to The Hollywood Reporter, if the closure does not stop in the short term, there could be a USD$1 to USD$2Bill loss worldwide. For scale, according to official Chinese data, over 40 million people are employed in the retail sector and another 7 million are employed in the hotel and luxury sector, which may result in a number of job losses and higher unemployment figures.

However, despite reorienting economic contribution from an export-led to a consumption-led model, the Chinese economic model still heavily relies on a positive external trade surplus to ensure sustainability. A drop in Chinese economic output will end up affecting its ability to generate GDP growth. Thus, a drop in the GDP growth rate constitutes a more than likely occurrence for this economic year. Estimates vary on how much GDP will be lower this year, Goldman Sachs predicts that the coronavirus will knock GDP growth down to 5.5% from 6.1% in 2019.

It therefore makes it difficult for China (due to the loss of economic output and income) to fulfil its purchase orders from the US under the phase one trade agreement, ie. committed purchases of US agricultural goods over USD200bil over what was purchased in 2017 and throws into question whether domestic demand from China can support increased purchases from the US. Therefore, a lot depends on how the US will react to this loss of domestic demand, whether they will adopt a softer timeline and work with their Chinese counterparts or continue to play hardball, will crucially define the pace of trade negotiations in the near future.

In response, authorities in China have tried to prevent a massive selloff of shares by releasing RMB 1.2 trillion of extra liquidity into the financial system to buy over securities from investors seeking to sell. The Chinese central bank, the Peoples Bank of China also announced greater monetary and credit support facilities for hospitals and medical research institutions fighting the Wuhan outbreak. If the Chinese economy is unable to sustain a 6% GDP growth this year, it will also be a political disaster for the government as this would be the first time since opening up the economy that they have not managed to double the size of the economy compared to ten years prior.

The government may be forced to introduce a large fiscal stimulus package and looser monetary policies to boost economic growth after the coronavirus contagion has been successfully contained. In such a case, China may enter into deficit spending, increasing its leverage position, forcing the Chinese government to rethink its economic policy for the year. Therefore, the true extent of the new coronavirus outbreak to the marketplace is not yet fully understood and greatly depends on the reaction of the Chinese central bank and fiscal institutions, but will certainly exacerbate the precarious position of the Chinese economy.

In the event that Chinese goods are restricted due to the fear of contamination such as exposed workers in the ports or assembly workers, the impact on China will likely be much more far-reaching than originally thought, throwing a spanner in the recent trade negotiations with the US and triggering an emergency in international trade relations. Both domestic and international supply chains will be affected, and will require time for firms to reorient elsewhere in the event of a ban on Chinese imports.

Coronavirus impact on Malaysia

Malaysia is set to be one of the hardest hit economies from the viral outbreak as a nation with close ties to China with large investments such as the ECRL and Malacca Gateway projects in place. Malaysia's retail space is also highly dependent on Chinese tourism (the third largest group after Singapore and Indonesia) which accounted for RM12.2Bil or 14.5% of total foreign spending receipts.

The coronavirus outbreak in China and global emergency call from the WHO places pressure on the Malaysian government to restrict flights from China who account for the vast majority of foreign tourist visits. This is a major setback to Malaysia's tourism target of 3.2 million Chinese and 30 million visits this year.

For reference, according to data from Tourism Malaysia, in 2018, Malaysia had a total of 25.8Mil tourist arrivals of which China accounted for 2.9Mil (11%), China also accounted for RM12.2Bil or 14.5% of total foreign spending receipts. According to government officials, in 2019, the tourism sector contributed 15% to Malaysia's GDP. A decline in the tourism industry is thus a more than likely downside risk for the economy in the first half of 2020.

Aviation companies such as AirAsia and Malindo Air have temporarily suspended all flights to and from Wuhan following the outbreak. Despite this however, Tourism, Arts and Culture Minister Datuk Mohamaddin Ketapi had reportedly dismissed concerns of a temporary ban on Chinese tourists from Wuhan and Hubei to contain the outbreak of the Coronavirus would impact the government's target of 30 million tourist arrivals for Visit Malaysia 2020. As he said that the suspension would have "minimal impact" to the targeted number of tourists.

Allianz Bank Chief Economist Manokaran Mottain has predicted that in a scenario where the virus is contained during a 3-month period, the impact to GDP growth will be cut by 0.1% from the forecast 4.5% growth rate this year. However, in the scenario that the restrictions continue for another 6 or 9 months, similar to the SARS outbreak, a cut of 0.1% to forecasted GDP growth will be very small, and the true impact to GDP can be much higher. Further, he states that the Malaysian economy is already growing at the lowest gear and the ideal growth range should not be lower than 4% GDP growth. A growth rate lower than 4% will be extremely unhealthy for Malaysia's economy.

The impact to Malaysia's trade can be potentially disrupted, as Malaysia's exports to China accounted for 14% of total exports in 2018. If current restrictions on travel and curfews continue, it will have a negative impact on economic activity, reducing the demand for goods and services and in turn affecting the amount of goods China imports from Malaysia.

According to the Harvard Atlas of Economic Complexity, the majority (over 40%) of Malaysia's export goods to China were electronic and integrated circuits in 2017, comprising almost 23% of our total exports and makes up the largest category of manufactured goods. A decline in the Chinese import market will have severe ramifications on this sector, and many items in this category are exported to China as components for other manufactures of goods are locked within the global supply chain. A sustained closure of factories and economic slowdown above three months will impact the level of Chinese purchase orders from Malaysian components manufacturers as companies reposition their supply chain.

It should be noted that according to Statista.com, in 2018, 592,000 people were employed in this sector, making up nearly 4% of the total workforce of 15.3 million and comprised 25.1% of the manufacturing sector workforce in 2017 according to the latest estimates by the DOSM.

Malaysia's education sector may also feel the impact of the coronavirus outbreak as students from mainland China remain in quarantine rendering them unable to travel for further studies. Government estimates for 2017 place education services contributing RM17.6Bil to GDP in total where college and university education made up 60% of gross value output with international Chinese student making up the second-largest international student community at 14.5 million students after Bangladesh. An impact to the student population thus poses a major downside risk to the education sector in Malaysia.

Stock Market Performance

The local bourse KLSE slipped dramatically from 1,591.81 index points on the 17th January 2020 just before news broke on the nCoV outbreak to 1521.95 index points, its lowest on 3rd Feb 2020.

Source: Yahoo Finance

The drop in the KLSE index coincided with a general sell-off globally as investors feared an extensive economic impact from the coronavirus outbreak, stock on Bursa Malaysia were affected across the board with decliners outnumbering gainers by four-to-one.

In the local stock exchange, tourism-related stocks slumped, with MAHB falling as much as 6.73% to RM6.37, the lowest since January 2017. Commodities such as palm and crude oil saw major sell-offs amid concerns of an economic slowdown in the second largest economy in the world.

Palm oil futures fell as much as 10% on the 28th January, the highest fall since 2008 on mounting fears that a fast-spreading coronavirus will impact Chinese demand amid a diplomatic spat with India. After 3 months of steady gains, palm oil prices have since declined 15.6% in January. Palm oil exports are set to fall 5.2% during the period between 1 Jan and 25th Jan compared with the same period last month, cargo surveyor Amspec Malaysia said. On the positive side, the ringgit fell by 0.5% against the US Dollar, making Malaysian palm oil cheaper for holders of foreign currency.

Bucking the trend however were glovemakers, medical supplies and healthcare-related stocks who dominated the list of top gainers. Among them were Adventa (+47.1%), Supermax (+15.5%), Top Glove (+8.3%), Kossan (+5.47%) and Hartalega (+3.65%). Among healthcare-related stocks, IHH healthcare Bhd recorded gains of 1.73% to close at RM5.89 while Pharmaniaga Bhd was up 5.29% to RM2.19 and KPJ Healthcare Bhd rose 5.15% to RM1.02.

According to Dennis Low, president of the Malaysian Rubber Glove Manufacturers Association, local glove makers had received an urgent request from Chinese importers for more medical gloves and its members had ramped up production to meet this request. If the coronavirus outbreak became a pandemic, rubber glove demand could reach astronomical levels noting that medical glove consumption grew by 17% during the H1N1 crisis.

Rakuten Trade Sdn Bhd president of research Vincent Lau said that FBM KLCI's performance would continue to be driven by technology, rubber, plantation and energy stocks in the near-term as technology-related stocks have continued to do well as demand was high for chips and components for Apple, triggering Apple suppliers to ramp up production amid the lockdown in Wuhan.

He also added that the FBM KLCI is largely dependent on the performance of the banking sector which have been underperforming in recent times as they have been impacted by lower interest rates and compressed margins, weighing on the overall market sentiment as banking stocks account for almost 30% of the total market capitalization volume.

There is also uncertainty in the market as investors were unsure on the state of government infrastructure projects, in particular, contracts that are set to be awarded.

Sunway University economics professor Dr. Yeah Kim Leng said that uncertainties over the extent, duration and severity of the coronavirus outbreak in China had spooked emerging markets and has the potential to slow the Chinese economy with negative spillovers to the global economy, adversely affecting emerging markets who are dependent on Chinese import demand, tourist spending and investment activities.

He added that a prolonged outbreak will increase risk aversion and dampen the attractiveness of our market to foreign investors seeking higher returns compared to developed markets. However as soon as the vaccine is developed, the tourism trend before the outbreak is likely to continue.

Moving forward, stock market movements will depend on how quick Chinese authorities are able to contain the outbreak and exhibit signs of a recovery.

Stimulus Policy

Azmin Ali, the current Economic Affairs Minister has posited that a stimulus package is being considered if the outbreak and lockdown persists over a long period of time and negatively impacts the Malaysian economy. Among the sectors expected to feel the impact are tourism, aviation, transportation, education, manufacturing and construction sectors. No further details were provided regarding the stimulus package.

The stimulus package should therefore consider supporting affected industries to allow short term working capital to continue at a sustainable level of operations until after the outbreak has been contained and restrictions on travel lifted.

Comparatively, in 2003, several stimulus policy measures were implemented amidst the uncertainty from the SARS outbreak amid a slowing global economy and record oil prices resulting from the Iraq war. These measures comprised both expansionary fiscal and monetary policy to boost the economy.

Fiscal package: On the 21st may 2003, the government announced a RM7.3Bil (2% of GDP) stimulus package comprising 90 measures designed to provide short term relief to affected sectors, aid consumer sentiment and sustaining economic activity.

Monetary easing: On the same day as the above, BNM had cut its OPR by 50 basis points from 5.0% to 4.5%, its first reduction in 20 months.

In addition, economic package measures sought to benefit affected sectors such as tourism & travel, hotel operations, transportation and retail sectors. A summary of the relief measure is illustrated below:

Industry Beneficiaries	Measures
Tourism	- RM1Bill special relief guaranteed facility
Hotel operations	- 5% temporary discount on utility bills - HRDF levy of 5% government tax fund exemption - Exemption of import duties and tax on televisions and video equipment
Travel agencies	- Suspension of income tax payments - Exemption of HRDF levy
Taxi operators	- One-time reduction of road taxes by 50%
Retail and transportation	- Reduction of employee EPF contribution by 2%
Duty free retailers in Malaysian airports	- 50% cut in rental rates for retailers operating in premises owned by MAHB

Source: BNM

Impact on Growth and the Fiscal Balance Sheet

The measures taken to combat the SARS epidemic came too late in Q203 and the domestic economy was not able to fully avert the impact of the outbreak. However, we expect authorities in 2020 to monitor the impact of the coronavirus outbreak diligently and be more proactive in taking the necessary measures to support the economy before the outbreak weighs down on local demand.

On monetary policy, there is a possibility that Bank Negara may cut the OPE further by 25 basis points to 2.50% at the next Monetary Policy Committee meeting in March 2020 to stave off a slowing economy. BNM had recently on the 22nd January 2020 cut the OPR by 25 basis points to 2.75% - the lowest since 2011 - as a pre-emptive measure to improve GDP growth amid a slowdown, coming as a surprise to many economists who expected the Monetary Policy Committee to maintain the OPE rate at 3.0%.

On the fiscal side, measures introduced in 2003 had been proven effective during the crisis and its effects are immediately felt. Hence, it would not be impossible for the government to consider similar measures such as rebates in utility bills, reduction in the tax rate for hotels, restaurants, retailers and taxi services sectors and so on. In addition, a special relief fund similar to 2003 may work to ensure that the affected industries would have sufficient working capital to sustain critical operations during this outbreak.

A stimulus package similar to 2003 may cost the government an estimated RM5bil to RM10bil adding to the current government deficit forecast of RM51.7bil for 2020. Assuming no change to fiscal revenue and expenditure growth, the fiscal deficit may widen to at least 3.5% of GDP in 2020 (based on a nominal GDP forecast of RM1.6Tril this year. (Assuming an official GDP growth target of 4.8%) and would pose a challenge for the government to maintain its promised fiscal deficit target of 3.2% of GDP, reducing the deficit by 0.2% from 2019 at 3.4% of GDP.

Given that revenue growth this year is projected to contract by 7.1%, the fiscal deficit would need to be largely supported by debt financing, raising the debt-to-GDP ratio further. Based on official figures, government debt had reached a record of RM804Bill or 57.2% at the end of September 2019, above the 55% self-imposed debt ceiling.

Overall, we assume that the possible measures taken by government authorities would help soften the adverse spillover from the nCoV outbreak. Assuming that the outbreak does not result in a full-blown epidemic and the death toll does not reach critical levels, it would be prudent to revise the GDP growth forecast down to 4.3% this year (Based on an average of reported sources ie. Malaysian Ratings Agency Corp Bhd: 4.3%, World Bank: 4.5%, ICEAW: 4.0%, Kenanga Investment Bank: 4.3%)

//END