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Economic Analysis for 2021 and Forecasts

By Qarrem Kassim

Summary

Though the world has bid their collective goodbyes to a turbulent 2020, it is unfortunately not good riddance, as we continue to live under the shadow of its legacy. The past year has been an unmitigated disaster for much of the world for myriad reasons, exposing previously unacknowledged realities, frailties and vulnerabilities in the global economic and financial systems.

Various institutions and expert analysts however paint a rosier picture for Malaysia's economic performance in 2021 compared to 2020. Most notably, the Ministry of Finance (MOF) projects a 6.5-7.5% growth rate, however whether such scenarios are truly reflective of the year's economic reality remains to be seen; indeed, the uncertainties seen in 2021 may very well persist into the next year and beyond.

It should be noted however that the main theme among all analyst forecasts is highly contingent on the effectiveness of both the vaccine and public measures designed to help mitigate the COVID-19 crisis which currently threatens to overwhelm the healthcare sector. In addition, economic disruption events which include among others, a return to mass lockdown restrictions, internal travel bans and disruptions in logistical supply chains can have adverse impacts to the economy, especially in service and export-oriented economies such as Malaysia.

In this brief, we will be examining what the experts are forecasting. However, one thing is for certain, economic forecasts for 2021 will invariably be the most uncertain of this generation, as economic projections in 2021 become dependent upon many variables which industry experts have little to no control over, such as the timing of possible economic disruptions and the severity of its impacts.

In essence, economic forecasts and estimates at the start of 2021 will likely be the result of educated guesswork and speculation dependent on factors which economists have very limited forecasting power over.

Key Takeaways

- Economic growth in 2021 is set to outperform 2020's performance, with estimates varying between 6.0%-7.5% being the most likely. This is however dependent on the depth and severity of economic restrictions throughout 2021.

- Private consumption growth in 2021 is crucial to Malaysia's economic recovery, a prolonged Movement Control Order in the 1Q2021 will likely derail the momentum in economic performance experienced during the 4Q2020, lowering estimates for 1Q2021 and severely impacting private consumption growth. The recovery in private sector consumption is however highly dependent on the success of the vaccine and how quickly businesses can resume normal operations.

- Consumer price inflation is more uncertain as it depends on both the speed of the economic recovery and effectiveness of the mass vaccination program. Core inflation however is poised to be remain stable as the demand for basic foodstuffs and necessities can be met with little resistance from international trade restrictions compared to the export restrictions faced in 2020.

- Labour market conditions are set to be more optimistic than the prior year as border restrictions on foreign workers open up opportunities in the manufacturing and services sector for local workers to fill. In that regard, we are unlikely to experience the scathing impact from the first round of restrictions in 2020, which resulted in an official unemployment rate of 5.3% in May 2020.

- Private investment is set to recover; however, it will be difficult to offset the losses incurred to the sector from the prior year. Moreover, in terms of investment, the government is set to take on a more active role in pursuing more infrastructure projects and development in transport and internet connectivity, creating positive spill over effects in manufacturing, employment and income growth.

- Malaysia's international trade performance is set to perform better in 2021, as more sectors within manufacturing are allowed to operate under new restrictions as compared to the prior year. The growth in global demand for telecommunication devices and electronics is set to boost Malaysia's position as a key manufacturing hub for electronics and electricals, which may constitute up to 40% of all exports.

- Increased demand in healthcare services globally will boost Malaysia's production and export of rubber gloves, which effectively doubled during the prior year. However, palm oil exports are more uncertain for 2021 as a resumption of trade with India has been met with an increase in India's import tariffs amid increasing United States (US) scrutiny over palm oil producers.

- The international price of oil (Brent) is set to recover gradually as more countries are slowly relax travel and border restrictions, global manufacturing recovers and an improvement in key advanced economies such as China, the US and India. The increase in the international price of crude bodes well for the Malaysian government who rely on the sale of oil to supplement fiscal revenue, giving more firepower for additional stimulus if need be.

- The political uncertainty that Malaysia faces has caused international investors to remain cautious, despite a temporary respite from a declared state of emergency. Most notably, should snap elections be expected soon, many private investors and multinational companies would hold off plans for expansion and reduce their holdings of Malaysian equities for the year.

Key Drivers of Economic Performance in 2021 and Analysis

From the ashes of the dismal economic performance in 2020, where the COVID-19 pandemic caused mass disruption and uncertainty across all economic sectors, the Malaysian economy in 2021 is set to outperform the prior year due to the lower base year estimates, general societal normalization of the pandemic and increased awareness and naturalization of various Standard Operating Procedures (SOPs) for business operations.

Economic growth in 2021 will rely on an increased effort in restoring consumer confidence and promoting fiscal consolidation, given that many businesses had exhausted much of their cash reserves to continue operations in compliance with the SOPs set by the government.

It is noteworthy that much of the economic activity in 2020 was propelled by private investment into precautionary anti-viral equipment such as temperature checkers, hand sanitizers and facemasks in all commercial outlets, which had invariably become a necessity rather than a choice for most businesses, reflected in a sharp rise in share prices in commercial glovemakers and the healthcare-product sectors.

This in mind, it helps to maintain a clear and firm grasp and understanding of the key economic drivers going into the new fiscal year, how these drivers can impact the economy and what the government can do to smoothen the transition into a more robust and shock-resilient economy.

Effectiveness of the Vaccine

Perhaps unsurprisingly, the main economic driver among all economies -not limited to Malaysia- is the overall effectiveness of the coronavirus vaccine, its geographical delivery, rollout coverage and how quickly nations are able to adapt and reopen segments of the economy affected during the past year. In many instances, the COVID-

19 vaccine had been described as an "economic silver bullet" to the pandemic, despite the fast-tracking of the vaccine and doubts surrounding its effectiveness against the virus.

Despite the uncertainty surrounding the vaccine, recent preliminary empirical evidence from Israel (which currently has the highest proportion of immunized individuals relative to the population at over 20%), suggests that COVID-19 infection rates had plummeted by 33% after receiving the first dose of the Pfizer vaccine[1] and by 50%, 14 days after the second dose was administered[2]. Though such preliminary data is in its infancy and is far from being a sufficient population study, the early results seem promising. Thus, if a reliable vaccine is effectively and quickly rolled out, the impact to Gross Domestic Product (GDP) may be tremendous, potentially allowing for a return to a pre-pandemic growth path.

It should be noted that even if the vaccine rollout in March is proven to work effectively, it's quite likely that current SOPs for commercial establishments may yet persist into the foreseeable future, until infection rates are brought fully to heel or until such time that the government declares the pandemic to be officially over. This scenario presents several challenges and opportunities for businesses in varying sectors. Importantly, these SOPs act as a higher fixed and quasi-fixed (such as maintenance) cost barrier for SMEs to establish itself and serves as an added cost to expansion, primarily affecting the hospitality and retail sectors.

However, the relatively inelastic demand of medical equipment in the near term will spur growth in the maintenance of both the software and hardware components connected with such items, increasing short and medium-term semi-skilled employment and incomes. In particular, an increased buying of equipment will translate into higher demand growth in semi-conductors and intermediate equipment sectors required in the production of such goods.

Nevertheless, reports of the vaccine being less effective against new, more contagious strains of the COVID virus[3] may present key challenges in combatting the spread of the pandemic and will hamper government efforts in gradually liberalising key segments of the economy such as tourism and air travel. Despite this, Dr Anthony Fauci of the United States (US) National Institute of Allergies and Infectious Diseases opined that the rollout of the vaccine can provide more benefit than harm in giving the human body a relatively stronger level of protection against the worst outcomes. (ibid)

Therefore, should the newer and more infectious strains of COVID arrive onto Malaysia's shores, even after the mass immunization program, it is likely that some level of economic restrictions may still apply with the severity of these restrictions commensurate with the overall level of risk to the public.

From a health economics perspective, vaccines are viewed from three overarching dimensions, namely, 1) Gains in overall health, 2) Healthcare cost savings and 3) Healthcare-related productivity gains. However, as the vaccination plan has yet to be rolled out and is still in its infancy in much of the developed world, such economic estimates are not yet quantitatively known, however government policymakers should keep abreast of such measurements when attempting to maximize the potential benefits of the planned vaccination program.

In terms of overall health gains, we look to the opportunity cost of vaccination as opposed to non-vaccination, measured as the actual number of cases of diseases and deaths prevented using a specific vaccine. For example, research shows that seasonal flu vaccinations in Europe have prevented an estimated 2.1 million cases, 65,600 hospitalizations and 37,200 deaths from occurring annually[4].

Secondly, healthcare cost savings are associated with the savings allowed by the government/ private individual as a result of preventing illness and future hospitalization costs. For example, studies from the US showed that the

[1] Israel Vaccine Data Suggests Decrease in Covid-19 Infection Rate After First Dose, 14 Jan 2021, Wall Street Journal
[2] Initial Israeli data: First Pfizer shot curbs infections by 50% after 14 days, The Times of Israel
[3] Dr. Fauci says new data shows Covid vaccines appear to be less effective against some new strains, 21 Jan 2021 CNBC
[4] Annual public health and economic benefits of seasonal influenza vaccination: a European estimate, BMC Public Health Journal, August 2014, Preaud

diphtheria, tetanus and pertussis (DTP) vaccine has resulted in savings of up to USD23.6bil, projecting that an estimated USD24 was saved for every one USD spent on the vaccine[5].

Lastly, healthcare-related productivity gains refer to productivity time savings of working individuals who would have otherwise been struck with sickness, avoiding the need for healthcare. For instance, when a working parent's child contracts a vaccine-preventable illness, this leads to an absence from work by the parent who may need to take days off to tend to and care for the child. Such adverse effects become more magnified the lower the household is on the income scale, especially in a middle-income country such as Malaysia where social security programs are often insufficient to meet the needs of low-income families.

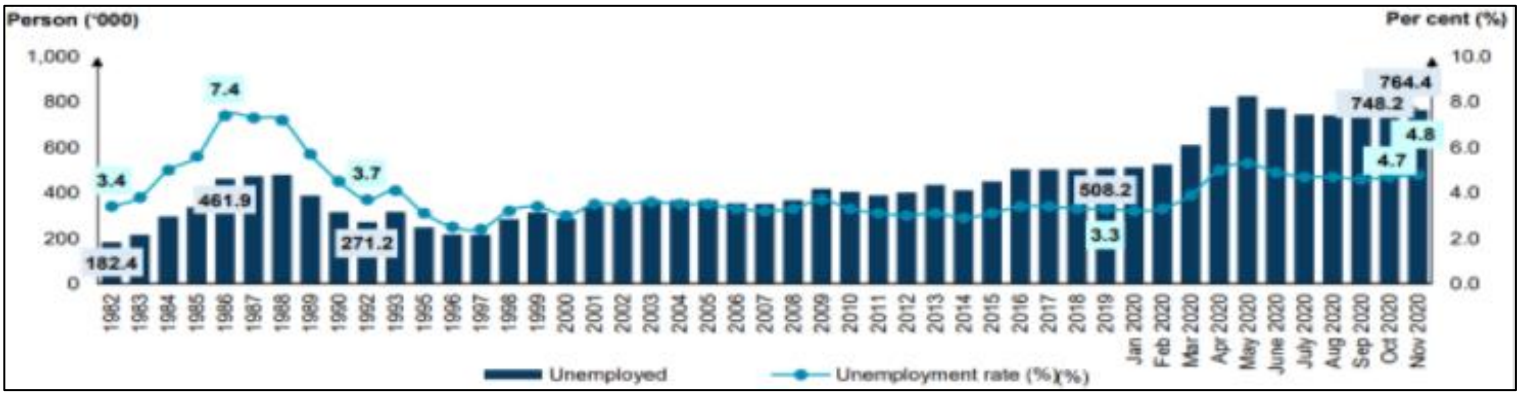
Employment Prospects and Labour Market Growth

A major factor in determining the health of the economy in 2021 is the pace at which employment and incomes can recover from the prior year. Though the labour market has shown signs of recovery since the second and third quarters of 2020 as MCO measures were gradually loosened, improvements in the nominal employment rate had been insufficient to restore conditions back to pre-pandemic levels, given the massive decline in labour-intensive sectors such as tourism and retail which employed up to 23% of the total workforce prior to the pandemic[6].

Although employment had improved gradually, recording a positive performance of 71,300 new jobs generated, the increase was marginal at 0.5% which is much lower than the annual growth rate of the labour force of 1.5%. Despite the marginal increase in employment, the labour force participation rate had fallen considerably, from 66.6% in November 2019 to 65.1% in November 2020 indicating drastically lower confidence among jobseekers about their employment prospects[7].

Further, the mass closure of business operations and cost-cutting measures as a result of the MCO have weakened the aggregate demand side of the economy as incomes decline, contributing to the massive slowdown in employment opportunities compared to the pre-pandemic period. This had caused a massive spike in unemployed people, shooting up 50.4% following the imposition of the MCO, culminating in an unemployment rate of 4.8% or 764,400 people in November 2020.

Unemployed Persons and Unemployment Rate%
1982 – Nov 2020



Source: Department of Statistics Malaysia (DOSM)

The negative impacts of the pandemic were likewise highly reflected in other labour market indicators. Job vacancies declined significantly in the last month of 2020, as of 18 December 2020, it was reported that the number of jobseekers reached 145,466 persons while there were only 41,638 job vacancies according to PERKESO (ibid). This situation was further amplified as an unexpected flood disaster had occurred in the few east coast states, namely, Pahang and Terengganu, as well as Sabah and Sarawak.

[5] Vaccination: the cornerstone of an efficient healthcare system, Journal of Market Access and Health Policy, Remy, 2015
[6] Employment in the Tourism Industries, 2017, DOSM
[7] Employed persons and employment-to-population ratio, January 2018 - August 2020, DOSM

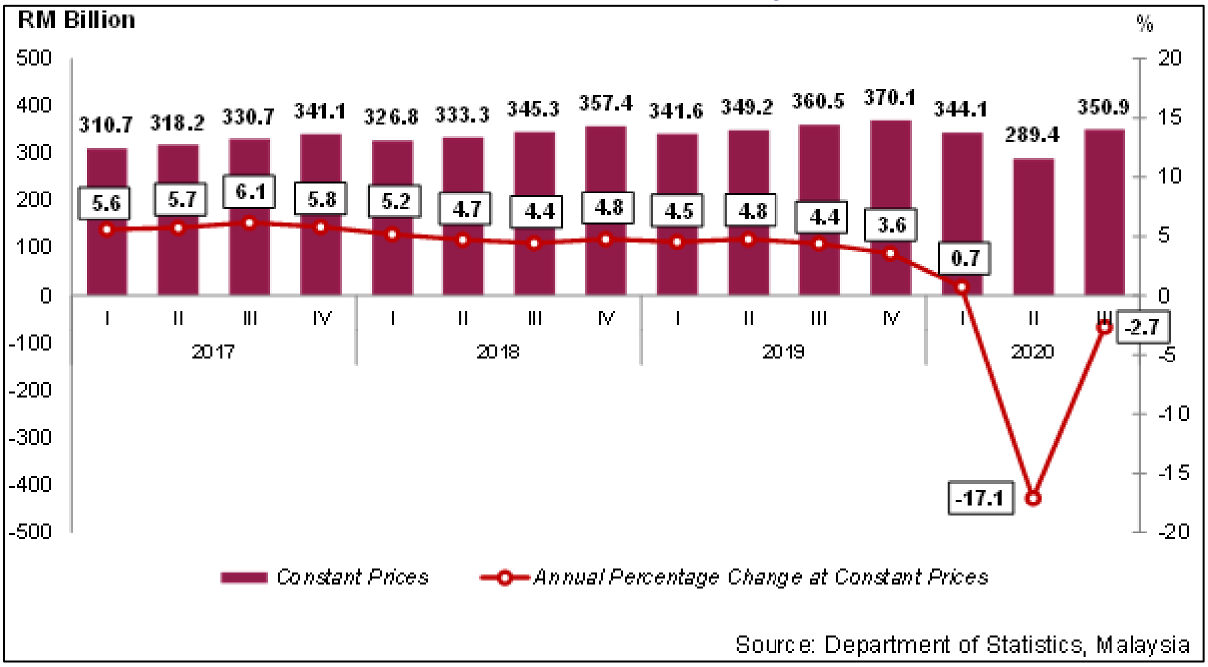
Nevertheless, according to the Ministry of Finance (MOF), total employed persons in Malaysia is expected to reach 15.1 million people, expanding further to 15.3 million in 2021. This is anticipated to be supported by stronger domestic demand amid a gradual recovery in economic growth. The ministry estimates that in 2021 that the rise in the number of employed people will be largely supported by better performance in the manufacturing, services and construction sectors, comprising a total of 88% in total employment in 2021 or 13.7 million people[8].

Nevertheless, despite the expected rebound in the labour market in 2021 in line with an expected recovery in global economic conditions, low inflation and the revival of major infrastructure projects, there are severe downside risks to growth outlook arising from the recent resurgence of COVID-19 cases and the recent reimposition of the Movement Control Order (MCO) in 2021, commonly referred to as the ongoing MCO2.0, the duration of the imposition of containment measures domestically and externally. In addition, unforeseen geopolitical tensions between the US and China still remain, as well as volatility in financial and commodity markets may dampen the pace of the recovery.

Effects of Domestic Demand and Private Investment Growth

According to the Department of Statistics Malaysia (DOSM), domestic demand is expected to contract by 3% in 2020, with private and public consumption declining by 3.2% and 2.1% respectively. This decline is most evident during the first half of 2020 (1H2020) where domestic demand contracted significantly by 7.7% on a Year-on-Year (YoY%) basis amid restricted movement and economic restrictions designed to contain the spread of the pandemic. This can be seen evidently in the negative YoY% growth rates in GDP value added during the second (2Q2020) and third quarters (3Q2020) of 2020 as GDP value-added growth, income growth and domestic consumption growth are closely and positively corelated with one other.

GDP Value Added and YoY% Change



Nevertheless, the announcement of various stimulus packages and the gradual easing on economic restrictions during the second half of the year are expected to partially restore business and consumer confidence. Hence, total domestic demand is anticipated to rebound to 1.5% during the period.

Private consumption in particular is expected to pick up on the back of various government measures aimed at providing support to households and businesses. These measures include a moratorium on loan repayments, temporary optional reduction in employee contributions to the Employees Provident Fund (EPF) and discounts on

[8] Macroeconomic Outlook, Labour Market Conditions, Ministry of Finance 2021 Economic Outlook

electricity bills and record low interest rates. As a result of these measures, private consumption is expected to rebound marginally by 4.2% in the 2H2020, cushioning the overall fall in consumption activity (ibid).

	Share (%)	Change (%)		
	2020	2019	2020	2021
Domestic Demand	**95.5%**	**4.3%**	**-3.0%**	**6.9%**
Private Expenditure	**76.6%**	**6.2%**	**-3.2%**	**7.0%**
Consumption	61.1%	7.6%	-0.7%	7.1%
Investment	15.5%	1.6%	-11.7%	6.7%
Public Expenditure	**18.9%**	**-2.8%**	**-2.1%**	**6.7%**
Consumption	13.0%	2.0%	1.6%	2.0%
Investment	6.0%	-10.8%	-9.3%	16.9%
External Sector	**5.5%**	**9.7%**	**-24.9%**	**4.1%**
Export	47.8%	-1.3%	-13.4%	8.7%
Import	42.3%	-2.5%	-11.9%	9.2%
Total	**100.0%**	**4.3%**	**-4.5%**	**6.9%**

Source: Department of Statistics Malaysia, Ministry of Finance
Note: Figures may not add up due to rounding

In 2021 however, the outlook for domestic consumption is more uncertain. Despite rosy, higher-than-average growth estimates from both the MOF and other external institutions such as the IMF[9] and the Fitch Ratings agency[10], it is uncertain whether a projected increase in private consumption will materialize due to a reimposition of a prolonged MCO.

The MCO2.0 imposed on the 14th January 2021 has certainly caused much anxiety in the consumer market, and speculation is rife as to when these restrictions will be eased. Despite this, a temporary state of emergency until August 2021 that had been called by the government will offer some respite to the political uncertainty that plagues Malaysian market sentiments.

Despite these uncertainties however, it is likely that private consumption will experience a considerable improvement from the prior year, as exports start to improve due to the improvements of other key import nations, low interest rates, an extension of tax relief on stamp duties on housing, electronics and tourism activities as well as measures to boost incomes, such as the wage subsidy program and cash aid programs like Bantuan Prihatin Nasional (BPN) under the PERMAI stimulus package.

However, concerns arise as to whether the efficiency of these measures would maximize its impact on consumer behaviour as consumers are largely prevented from reaping these benefits as long as interstate movement, economic and air travel restrictions remain in place. Therefore, we are of the opinion that though private consumption is set to increase, it may not reflect the high growth estimates published by these institutions. However, as the consumer market shifts rapidly towards digitization, e-commerce and 5G technologies as a result of the pandemic, we may see a muted impact from these economic and movement restrictions on economic growth.

On this note, private investment is expected to contract 11.7% according to the DOSM, after a decline of 15.2% in the 1H2020, this was due mainly to weak demand and tight liquidity among businesses as MCO restrictions forced them to close down for weeks following the MCO amid mass uncertainty in the financial markets. Nevertheless, recent measures to revitalize businesses including the establishment of funds to support digitization, especially for SMEs as well as tax incentives to attract foreign direct investment (FDI) and cash assistance to sustain businesses is expected to bode well for private investment growth in 2021, estimated to rebound at a growth rate of 6.7%.

Effects and Economic Consequences on Small and Medium Enterprises (SMEs)

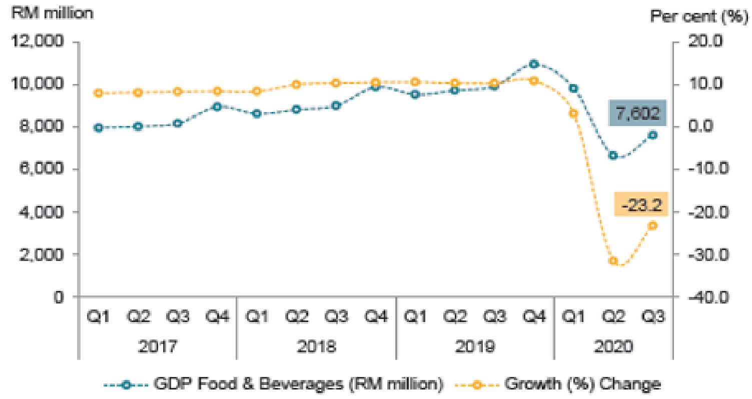
A critical component to understanding the consequences to Malaysia's economy involves a thorough understanding of SMEs. This is because SMEs play an integral part in Malaysia's society and forms a vital component of its economic activity, contributing to nearly 89% of total GDP and provides jobs to more than 7 million workers or 48.4% of the entire workforce (DOSM, 2019).

[9] IMF projects Malaysia's GDP to grow by 7% in 2021, The Edge Markets
[10] Malaysia's 2021 Growth, Monetary and Fiscal Outlooks Likely Derailed, Fitch Solutions

In addition, it accounts for more than 98% of total business establishments, primarily in the services sector comprising an estimated 89.2% of all SMEs, with 5.3% in manufacturing and 4.3% in construction. Within the services sector however, there is a severe subsector-imbalance, most notably, between 2015 and 2019, the share of SMEs GDP and employment to the Food and Beverage (F&B) sector accounted for 89% and 79% respectively, showing that the subsector has a disproportionately larger impact on SME development and employment. The surge of the COVID-19 infection rate and the subsequent MCO, Recovery MCO and Conditional MCO have placed immeasurable strain on the performance of the food and beverage industry in 2020, resulting in an unprecedented slump in overall economic activity.

In 2Q2020, Malaysia's F&B industry YoY% GDP contracted by a record 31.5% and a further contraction of 23.2% in 3Q2020. To continue operations, more and more establishments are moving precipitously toward a digitization of business, such as through e-commerce and online delivery platforms, despite many SMEs unable to afford high quality digital infrastructure. Though there are government grants available for SMEs to participate in digital platforms, issues such as a lack of stable internet connectivity (especially in rural areas) and awareness of these programs continue to hinder its effectiveness[11]. The relative lack of digitization will continue to be a thorn in the side of the recovery of SMEs, potentially affecting positive growth estimates for 2021.

The Value-added and Growth of SME Food and Beverage Subsector to Malaysia's GDP (2017-2020)



Source: Department of Statistics Malaysia

Therefore, it can be said that the performance of the F&B industry disproportionately affects many other facets of the economy, such as a higher-than-average contribution to employment, contribution to small businesses in the upstream supply chain such as distributors and wholesale suppliers, covering the education, rental, utilities and other expenses for many families.

Most worryingly, as food and beverage-based SMEs tend mainly to employ youth workers, the negative impact to youth unemployment may be relatively higher than other industries. Thus, it is likely that the problems of youth idleness and unemployment may face a significantly more uphill task as players in the F&B industry are being challenged to pay for non-wage operational costs, such as rental, utilities and other fixed operating costs. This has resulted in many SMEs failing to cover for basic operating expenses due to a lack of cashflow liquidity, resulting in many SMEs opting for a temporary or permanent closure of operations[12].

Unlike conventional office jobs, where most of the work can be done through computerization, restaurants and eateries face significant constraints as their work is almost exclusively done on-site, such as preparing and serving food to customers. Therefore, taking a sustained approach to boosting online platform usage among SMEs in the F&B line is imperative in the current scenario. Aside from sit-in dining, the catering industry within F&B face the most daunting challenge as most events, meetings, seminars are temporarily prohibited and until these restrictions are lifted, there is scant little in the way of policy to help this sector.

Among all SMEs however, surveys by SME Corp. Malaysia reveal that only 34% of registered SMEs were able to continue operations as essential services providers. In addition, the majority of polled SMEs had to undertake various alternative measures to continue operating, including negotiating with employees on cuts to salaries and benefits (37%), retrenchment of employees (34%), limiting business trips (33%) and working from home (33%).

[11] Still lacking the digital factor, October 2020, The Star
[12] Malaysian Economic Statistics Review, Volume 1/2021

The survey also indicated that for SMEs to regain their pre-pandemic growth momentum, assistance other than commercial loans were necessary. These include more accessible soft loan programs, a deduction of corporate and business taxes, advice on restructuring and business remodelling and easier access to online commercial platforms. In addition, among all the incentives put in place by the government, the wage subsidy program, the six-month automatic loan moratorium, free internet services and the special relief facility initiative were the most impactful measures[13].

According to the respondents, 69% of SMEs are anticipated to rebound within a year, while the rest would require over a year to stabilise its income[14]. Nonetheless, most SMEs report that the most pertinent challenge is in restoring consumer demand, increasing the level of capital liquidity, normalisation of the supply chain and difficulties in adhering to often conflicting and unclear SOPs.

Due to the drastic fall in the price of crude oil and a significant decline in domestic consumption in 2020, much of the 2021 recovery effort may rely heavily on the success of the economic rebound of SMEs, employing nearly half of the workforce, this segment of the economy may very well prove to be the "make or break" factor that signals better economic performance in 2021.

However, as employment opportunities for the youth dry up disproportionately in the short and medium-term under the tremendous strain of the 2021 MCO currently ongoing, youth spending will be negatively affected and their savings rate likely to increase even amidst record low interest rates. Despite more industries being liberalized during the most recent MCO, it is undeniable that many SMEs are likely to suffer short-term anxiety in cash flow liquidity, especially among petty traders and the self-employed, leading to drastically lower performance for private consumption in the calculation of 2021 GDP estimates.

Net Exports, Commodity Prices and the International Price of Oil

As Malaysia has positioned itself as a key trading and manufacturing nation in South East Asia, the performance of its exports in 2021 is of the utmost importance in determining the pace of the post-pandemic recovery effort. Therefore, it is necessary to examine baseline 2020 export performance relative to 2019 to better conceptualize the 2021 recovery phase and where the impetus for GDP growth will derive from.

Recent export figures released in late January 2021[15] reveal that the lifting of economic restrictions had resulted in a much stronger 4Q2020 performance compared to the third and fourth quarters of 2020, with headline exports for December expanding YoY% by 10.8% to RM95.7bil.

Meanwhile, imports for the year had suffered overall, from RM849.4bil in 2019 to RM796.2bil, or a decrease of about 6.2% YoY%. Despite this, December's import figures noted a 1.6% increase from December 2019, indicating a slight recovery in import demand when exclusively accounting for the month. However, much of this uptick in import demand may be due to depressed demand factors during the year and the seasonal effect of year-end sales to make up for lost revenue during the year. In addition, the sustained decline in import statistics is indicative of a weakening of the domestic market as incomes fall and the demand for imports shrink.

[13] SME Corp survey: Penjana able to assist SMEs in Malaysia in achieving quick recovery, August 2020, The Star
[14] Survey: 69% Of SMEs Anticipate Business Recovery Within 3-12 Months, RinggitPlus.com
[15] Malaysia External Trade Statistics Bulletin, December 2020, DOSM

2019	Value RM'bil		
	Exports	Imports	Net Exports
Jan	86.3	73.9	12.4
Feb	67.7	55.6	12.1
Mar	85.7	69.7	16.0
Apr	86.2	74.4	11.9
May	84.7	75.1	9.6
Jun	76.7	65.6	11.1
Jul	89.8	73.8	16.0
Aug	81.5	70.5	11.1
Sep	78.3	69.4	8.8
Oct	90.9	73.3	17.6
Nov	81.0	74.3	6.7
Dec	86.4	73.9	12.6
Total 2019	**995.1**	**849.4**	**145.7**

2020	Value RM'bil		
	Exports	Imports	Net Exports
Jan	84.1	72.1	12.0
Feb	74.5	61.8	12.6
Mar	80.1	67.8	12.3
Apr	64.8	68.4	-3.6
May	62.7	52.3	10.4
Jun	82.8	62.0	20.9
Jul	92.6	67.4	25.2
Aug	79.1	65.9	13.2
Sep	88.9	67.0	22.0
Oct	91.1	68.9	22.1
Nov	84.7	67.6	17.1
Dec	95.7	75.0	20.7
Total 2020	**981.0**	**796.2**	**184.8**

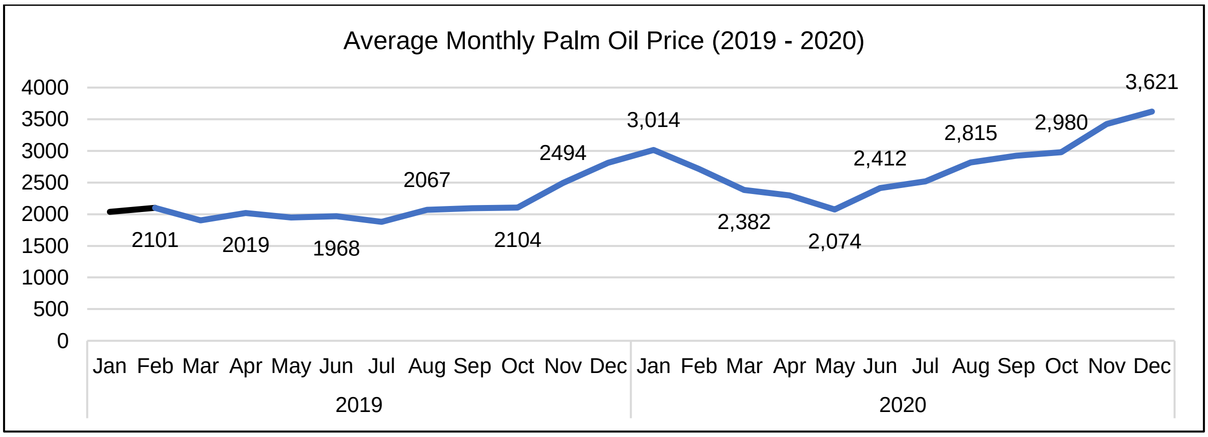
	Annual Change %		
	Exports	Imports	Net Exports
Jan	-2.6%	-2.5%	-3.1%
Feb	10.0%	11.3%	4.2%
Mar	-6.5%	-2.7%	-23.0%
Apr	-24.9%	-8.0%	-130.6%
May	-26.0%	-30.4%	8.6%
Jun	8.0%	-5.6%	88.5%
Jul	3.1%	-8.7%	57.8%
Aug	-2.9%	-6.5%	19.6%
Sep	13.6%	-3.6%	149.1%
Oct	0.2%	-5.9%	25.9%
Nov	4.6%	-9.0%	154.9%
Dec	10.8%	1.6%	64.8%
Total	**-1.4%**	**-6.3%**	**26.9%**

Source: DOSM, Matrade

Among Malaysia's exports in 2020, it can be broken down into several key components, namely, in electronics and electricals (E&E), crude palm oil and palm oil products, petroleum and rubber products. Notably, the export of manufactured products had experienced a remarkable recovery in growth, making up 85.6% of total exports in December 2020, registering a double-digit YoY% growth rate of 12.4% to RM81.9bil, consisting mainly of E&E, rubber gloves and metal manufactures.

In particular, the export of E&E products experienced the fastest growth in the 2H2020, rising 3.5% from 2019 to RM386.1bil. This was spearheaded by higher exports of integrated circuits, transmission apparatus and voice and video transference parts to support work from home (WFH) policies globally. Indeed, a deeper look show that parts and accessories for computers and telecommunication devices rose sharply by 27.8% and 150.6% respectively as nations around the world adopt WFH office policies. Aside from this, the export of rubber products showed a 68.9% increase from 2019, notably, rubber glove exports showed a significant boost in 2020, doubling its number from 2019 to meet the increased demand from healthcare facilities globally.

Due to the relatively positive short and medium-term global economic outlook for 2021, as major economies start to improve their national incomes amid a general normalization of WFH policies globally, this will likely translate to better growth performance in E&E exports going forward. In addition, the near-term demand for rubber gloves is set to remain high in the coming few years as the higher global demand for healthcare workers continue to keep upward pressure on rubber globe exports. However, this is set to decline in the medium to long term as vaccines are rolled out during the year. Naturally, this is dependent on the effectiveness of the vaccine and how quickly they can be dispensed to the general population.



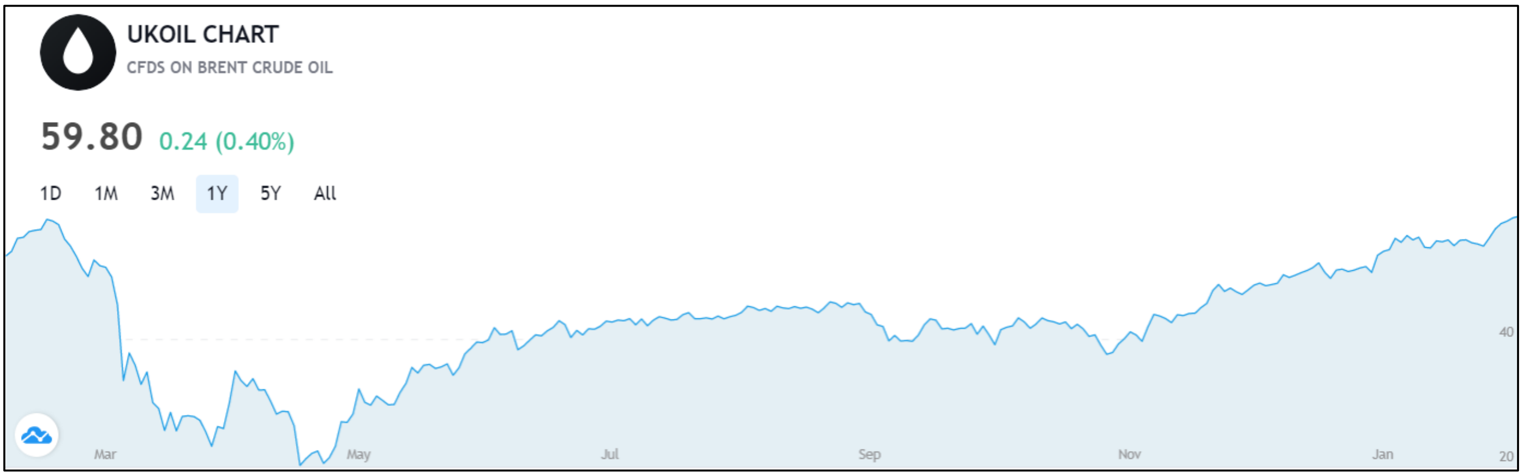
Source: Malaysian Palm Oil Board

In the export of palm oil and its downstream products, the normalisation of trade with India continues to have a positive effect on palm oil exports[16]. According to the DOSM, the export of palm oil had improved considerably during 2020, increasing YoY% by 18.4% to RM52.3bil for the year as the economies of China and India improve for the foreseeable future. This is likely to have a continued strengthening effect on the price of crude palm oil, which has increased considerably in the 2H2020.

However, it should be noted that Malaysia may be facing strong headwind from key importer India who had recently introduced a higher import excise tax on edible oils[17], primarily to shore up its own palm oil sector. This also serves to erode the relative competitive advantage that palm oil has over sunflower and soybean oil imports, which could cut shipments from Indian importers from March onward as current futures purchase orders are fulfilled.

The decrease in the price of crude oil over the year 2020 has been severe to the Malaysian market as Malaysia relies heavily on proceeds from crude oil sales to supplement government revenue, which contributed an average of 20% over the past several years[18].

The export of petroleum and petroleum products and liquified natural gas (LNG) have declined YoY% by 13.4% and 32.1% respectively in 2020, reflecting the drastic decrease in global oil demand as WFH, social distancing policies and global travel and border restrictions are imposed, severely reducing the amount of people travelling for both work and tourism. However, as these policies are gradually lifted, the short to medium-term outlook for hydrocarbons is set to improve gradually going into 2021, with the IMF predicting an average 2021 oil price of USD50.03 per barrel from an average of USD41.3 per barrel in 2020.



Source: TradingView.com

It is important to note the role that the international price of crude oil plays, having a direct impact to the Malaysian economy. History shows that Malaysia's current account balance and GDP growth rates are directly and positively correlated with average oil prices due to the government's reliance on oil to supplement its fiscal revenue. Government estimates suggest that for every USD1 increase in the price of crude oil, it adds RM300mil to government revenue collection. In addition, according to Standard Chartered Global Research, a 10% rise in global oil prices is correlated with an increase of Malaysia's current account balance by 0.3% of GDP[19].

Therefore, in the context of Malaysia's economic health, the performance of crude oil is crucial as it allows the Malaysian government to continue funding its social programs and COVID-19 stimulus packages while reducing its reliance on taxpayers and debt financing for the necessary liquidity.

[16] Malaysia-India trade ties on the upswing, says group, July 2020, The Star
[17] India's tax hike on crude palm oil imports could cut shipments, Feb 2020, The Star
[18] Malaysia's slick politics of oil, Bridget Welsh and Calvin Cheng, Malaysia Kini
[19] Malaysia's economy more diversified than thought, June 2018, The Star

Malaysia's Political Stability and Impact on Foreign Investment

In the economic mainstream, political stability and economic performance are deeply interconnected. Political uncertainty within an unstable social environment may decrease investor confidence and in turn the pace of economic development, as investors search for safer havens to store and grow their wealth. In addition, the rise of fringe and extremist parties may increase the risk of the introduction of anti-market policies in the pursuit of their ideological or religious agendas. Such policy agendas which used to belong to the fringes of political discourse have become more mainstream in recent years, much to the fear of investors in hospitality, entertainment and consumer goods.

Despite the political situation being a tenuous one, it is still above regional peers like Indonesia and Thailand, that have been rocked by massive street protest movements in the 4Q2020. However, the situation is one more based on uncertainty given that the long-ruling Barisan Nasional (BN) coalition was displaced by the Pakatan Harapan (PH) coalition in 2018 was itself displaced by the Perikatan Nasional (PN) coalition in February 2020. Given the massive ideological differences between PN component parties, it presents a risk to both race relations and institutional reforms in Malaysia.

As both the government and the opposition are in weak positions, rumours and speculation about further changes in government is rife, with the possibility of snap elections being called in 2021 after the lifting of the state of emergency will continue to cloud the political environment in Malaysia. This lack of political cohesion will likely take up a significant portion of the political capital of the ruling government. It is precisely the lack of any strong political player that allows for a great degree of political manoeuvring among the different parties and personalities which may likely continue even after a snap election.

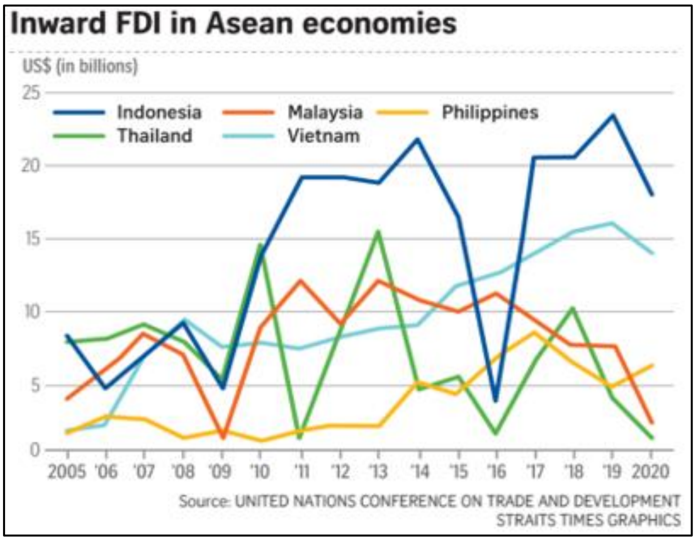
Even within key leadership figures, including UMNO president Ahmad Zahidi and former president, Najib Razak, who are still involved with criminal proceedings linked to their role in the 1MDB scandal, the potential for interference within the judiciary will likely be strongly opposed by both Prime Minister Muhyiddin Yassin and Anwar Ibrahim's respective coalitions.

While the larger parties in parliament generally have more leverage in general, the Malay-exclusive UMNO and its former ally PAS have been active in trying to combine their political size and influence into the executive arm of government, leading to fears of more antagonistic inter-race relations.

This has likewise prompted fears of an encroachment of Islamic radicalism within the executive branch of government, leading to fears among both Malaysian and international investors with the implementation of socially regressive policies such as gender segregation in public spaces, including separate queues for men and women in shopping centres -as is currently enforced in the state of Kelantan, the banning of the sale and production of alcohol and the prohibition of gambling which could lead to a boiling over of racial tensions, exacerbate capital flight and drive away international investors.

Indeed, according to the United Nations Conference on Trade and Development (UNCTAD), Malaysia's foreign direct investment (FDI) fell by 68% from 2019, amounting to a paltry USD2.5bil (RM10.1bil) compared to its regional ASEAN neighbours who lost 31% on average[20], with the exception of the Philippines, who rose 29% YoY from 2019. Experts opined that the bulk of the blame had to do with the unclear and populist economic policies set by the Muhyiddin administration and a dampening of the investment climate amid an uncertain political situation.

[20] Foreign investment in Malaysia plunges as investors flee, Feb 2021, UNCTAD



Currently, there is a temporary relief from political uncertainty due to the declaration of a state of emergency. However, this is unlikely to provide any permanent relief to the damp investment climate as growing concerns of economic nationalism, racial tensions and religiously-motivated social policy continue to weigh on investor confidence.

It is worthy to note that foreign investments rely heavily on clear, transparent, stable, inclusive and efficient policies. Therefore, by simply offering tax incentives and free long-term land usage are largely insufficient to maximize the inflow of foreign capital investment. Rather, the government needs to focus on minimizing day-to-day inefficiency and uncertainties as well as polishing up guidelines and rules on businesses.

The excuse that companies are not investing in Malaysia due to problems with global business confidence does not hold water as it can be seen that in the latter half of 2020, technology stocks in the United States have been soaring past pre-COVID levels and are heavily investing in expanding their productive capabilities. Companies such as Tesla, Amazon and Google have been flocking to neighbouring Indonesia as the nation is poised to become a more attractive investment destination than Malaysia due to a relatively more stable and friendly business and political climate combined with a larger consumer and e-commerce market.[21]

Forecasts and INSAP Analysis

The economy during the past year had performed dismally, with the MOF estimating that the economy as a whole contracted by 4.5% in its tabling of budget 2021, while other institutions such as Standard Chartered estimate a 5.8% decline in real GDP in 2020[22]. Despite this, there are a number of financial institutions that have provided their estimates for the year. Notably, these estimates take into account a large base year effect, giving a higher-than-normal GDP growth estimate for the first succeeding year. In other words, the low GDP components in 2020 may add a boost to Year-on-Year (YoY) GDP growth estimates for 2021.

The Ministry of Finance Malaysia

The MOF in its tabling of the 2021 budget had provided their own estimates for next year's growth performance. In their view, overall real GDP is set to grow by 6.5% to 7.5%[23], aided by a well-diversified production economy and improvements in external demand, lending their assumptions to a short (1-year) disruption caused by the global pandemic, indicating an optimistic view of the economic recovery phase.

The ministry thus assumes a general improvement in nominal exports at 8.8% compared to 2020, while such estimates may seem optimistic, it is in fact 0.7% lower compared to nominal 2019 export figures. Meanwhile, total imports are set to rise faster than exports, indicating an increase in overall domestic consumption on the back of an improved national income scenario. In addition, they anticipate improvements in domestic consumption resulting from the positive spill over effects from the economic stimulus packages in 2020 and 2021.

[21] Indonesia's Digital Economy Attracts Investments from US Tech Giants, ASEAN Briefing
[22] Steady but lacklustre growth for Malaysia in 2020: Standard Chartered, The New Straits Times
[23] Economic Outlook 2021, Key Data and Forecast, Ministry of Finance Malaysia

A summary of 2021 economic growth estimates by the MOF during the tabling of Budget 2021 is shown below:

Real GDP Estimates (Constant 2015 Prices)

RM ('Mil)	2019	2020	2021	% Change (2021-2020)	% Change (2021-2019)
GDP (Current Prices)	**1,421,454**	**1,357,731**	**1,450,830**	**6.9%**	**2.1%**
Components of GDP:					
Consumption	**1,016,572**	**1,017,686**	**1,083,381**	**6.5%**	**6.6%**
Public	166,237	169,582	169,974	0.2%	2.2%
Private	850,336	848,104	913,407	7.7%	7.4%
Investment	**326,356**	**290,126**	**314,748**	**8.5%**	**-3.6%**
Public	88,799	80,694	92,833	15.0%	4.5%
Private	237,557	209,433	221,915	6.0%	-6.6%
Net Exports	**105,772**	**76,027**	**76,296**	**0.4%**	**-27.9%**
Exports	927,081	794,291	847,760	6.7%	-8.6%
Imports	821,309	718,264	771,464	7.4%	-6.1%
Changes in Inventory	**- 27,246**	**- 26,109**	**- 23,595**	**-9.6%**	**-13.4%**
Total	**1,421,454**	**1,357,731**	**1,450,830**	**6.9%**	**2.1%**

Source: Ministry of Finance Malaysia

From the estimates shown, it can be seen that the MOF have optimistic projections for 2021, notably, GDP component forecasts predict higher consumption growth from the private sector at 7.7%%, edging out 2019 even after accounting for inflation. Such optimism in consumption may be thought to have been induced by income spill over effects from the PENJANA economic stimulus packages introduced in the second and third quarters of 2020, though it is debatable whether these positive spill overs caused by cash transfers can persist into the following year given that gross savings had reduced by 11% in 2020, suggesting that many have dipped into their prior savings to sustain their consumption.

Therefore, the projected increase in private consumption denotes either an expansion of government stimulus in 2021, greater investment in infrastructure, profoundly better external conditions or a planned future loosening of monetary policy. If such events do not occur in the current year, it is possible that private consumption as it is currently projected may in fact be overestimated as it optimistically shoots past pre-COVID levels of economic performance.

Another element worthy to note is the relative decline in the rate of increase in public-led consumption, or public procurement in GDP forecasts, where in 2019 and 2020, public consumption accounted for 16.5% during the two years, whereas in 2021, public consumption is expected to make up only 15.7% of total consumption, increasing nominally in line with a commonly-used inflation estimation metric of 2% per annum. This indicates that the government has no plans to increase government operational expenditure in the near term, keeping their rate of increase relatively flat for the post-pandemic recovery process.

However, it is evident that government-led investment projects will experience a large increase from 2020 at a real rate of 15% indicating an expansion of public infrastructure projects as a share of total investments for the current year, increasing from 27% of total investment in 2019 to 29% in 2021. However, it should be noted that the relative increase in the governments share of total investment is largely affected by the declining rate of private gross fixed capital formation (GFCF) in recent years, usually an indicator of slower private investment and a decline in foreign direct investment (FDI) even after accounting for inflation. Despite this, MOF projections for private GFCF in 2021 are still 6% higher than 2020 but lower compared to 2019, indicating a slower post-pandemic recovery in private investment relative to pre-pandemic conditions.

In terms of foreign trade, the performance of gross exports is set to improve in 2021 compared to 2020, growing by 6.7% in real GDP owing to better economic performance forecasted in traditional export markets. Despite this, it is far from its pre-pandemic performance, showing an 8.6% contraction compared to 2019. Imports however are expected to grow 7.4% in 2021 compared to 2020, indicating a deteriorating rate of capital accumulation and foreign exchange earnings forecasted over the year, the relative increase in imports being the result of a quick recovery in private domestic consumption and increased government expenditure forecasted. Due to the mismatch in exports relative to imports, net exports are estimated to perform worse than 2020, growing 0.4% in 2021 compared to 2020 but contracting 27.9% in real terms in 2021 compared to 2019.

Real GDP Estimates (Constant 2015 Prices)

RM ('Mil)	2019	2020	2021	% Change (2021-2020)	% Change (2021-2019)
GDP (constant 2015 prices)	**1,421,454**	**1,357,731**	**1,450,830**	**6.9%**	**2.1%**
By Sector:					
Agriculture	101,549	100,344	105,086	4.7%	3.5%
Mining and quarrying	101,438	93,568	97,404	4.1%	-4.0%
Manufacturing	316,320	306,845	328,215	7.0%	3.8%
Construction	66,266	53,859	61,340	13.9%	-7.4%
Services	820,069	789,379	844,554	7.0%	3.0%
Import duties	15,812	13,736	14,231	3.6%	-10.0%
National Income and Expenditure					
Gross National Income	1,398,921	1,344,443	1,427,963	6.2%	2.1%
Per Capita Income	43,177	41,114	43,141	4.9%	-0.1%
Unemployment Rate %	3.3%	4.2%	3.5%	-0.7%	0.2%

Source: Ministry of Finance Malaysia

It can be seen that several sectors stand out as being poised for a quick and supra-normal recovery from the pandemic, even edging out their performance in 2019. Among the sectors in this description are agriculture, manufacturing and services; these estimates could however be overvalued, especially given the uncertainty of the effects from the pandemic, where it is more likely that unless the vaccines are proven to be wildly effective in containing the virus and economic restrictions are loosened, we would not see a drastic across-the-board normalization to pre-pandemic levels of economic performance until after 2021.

Agriculture Sector

Among all economic sectors, the services and agriculture sectors are set to experience the largest level of growth, and by MOF estimates even better than pre-COVID 2019 levels on an inflation-adjusted basis. It is interesting to note that agriculture-based GDP had fallen relatively slightly in 2020 compared to other sectors of the economy, indicative of more inelastic demand trends in the face of negative shocks in income. However, it is likely that sub-categories within food production in the agriculture sector may have experienced a higher level of internal change as short-term necessities such as rice and eggs experience greater levels of consumer demand than more income elastic high-end agricultural goods such as lamb, beef and high-end fruit products.

Most notably, the expected increase in the performance of agriculture is backed by an increased external demand for Malaysian palm oil as economic conditions in China and India, two of the world's largest importers of the commodity are expected to improve over the near term. Further, it can be seen that the most serious contractions in the 1Q2020 (QoQ%: -22.0%)[24] in agricultural output was due much in part due to supply shocks from the disruptions in palm oil logistics as a result of the first Movement Control Order (MCO) lockdown. However, it should be noted that even before the pandemic, dry weather and cutbacks in fertilizer had constricted supply in 2019.

As business Standard Operating Procedures (SOPs) begin to be normalized by producers, the palm oil sector is expected to rebound following improvements in the export market. In addition, according to the Council of Palm Oil Producing Countries (CPOPC), crude palm oil (CPO) prices are expected to remain stable in the medium term[25] in line with the expected recovery in tourism, biodiesel and food and beverage sectors in key export markets. In addition, the rubber sub-sector is expected to improve following increases in the global demand for medical products[26].

[24] Malaysia Economic Performance First Quarter 2020, Press Release, Department of Statistics Malaysia
[25] Palm Oil Supply and Demand Outlook Report 2021, CPOPC
[26] Global rubber glove shortage to last beyond March 2022, The Malay Mail

Services Sector

The services sector suffered the largest contraction in 2020 (YoY%: -3.7%) due to the imposition of worldwide travel bans, domestic movement restrictions and quarantines which seriously hampered tourism-related subsectors and airlines. In addition, among the hardest hit sub-sectors were the wholesale, retail, accommodation, food and beverage, transportation, real estate and business services industries, with the only exception being the communication and information technology subsectors which recorded a significant expansion of revenue as online services expanded sharply during the MCO.

As economic activity starts to normalize and due to high base effect from 2020, it is likely that all subsectors are poised to record positive YoY% growth in 2021 compared to the prior year; the MOF projects an overall YoY% growth in services at 7% underpinned by stronger pent up consumer demand in 2021 as shops and usual business operations reopen.

Subsector	Share% (2020)	YoY% Growth		
		2019	2020e	2021f
Wholesale and Retail	28.8%	6.7%	-6.1%	8.5%
Finance and Insurance	11.8%	4.6%	-0.1%	5.5%
Information and Communications	11.4%	6.6%	6.4%	7.9%
Real Estate and Business Services	7.7%	7.8%	-11.6%	7.6%
Transportation and Storage	6.0%	6.8%	-11.9%	7.5%
Food and Beverage and Accommodation	5.5%	9.6%	-13.3%	10.7%
Utilities	4.9%	6.0%	1.7%	5.7%
Others	8.2%	5.5%	-8.1%	6.2%
Government Services	15.7%	3.7%	4.0%	3.7%
Services	**100.0%**	**6.1%**	**-3.7%**	**7.0%**

Source: Department of Statistics Malaysia, Ministry of Finance

The **Wholesale and Retail Trade** subsectors recorded a stunning contraction of 10.8% in the 1H2020 due mainly to disruptions in the domestic supply chains. The subsector however is expected to record a smaller decline in 2H2020 due to cash assistance programs, sales campaigns, car tax exemptions and the normalization of online platforms, helped much in part due to the stimulus packages announced throughout 2020 culminating in a YoY% growth rate of -6.1% for 2020. In 2021 however, the wholesale and retail sector is expected to record a YoY growth by 8.5% in 2021 according to MOF estimates as economic activity normalizes.

The **Finance and Insurance** subsector had contracted marginally in 2020, mostly due to the six-month loan moratorium amid a drastic slowdown in lending activities as other sectors of economy were forced into protracted restrictions. Nevertheless, the relatively better performance in this subsector was buoyed by an increase in life insurance subscriptions[27] as the effects of the pandemic place extra precautionary behaviour in consumers for potential healthcare needs, which partly cushioned a pronounced decline in this subsector. In addition, this behaviour is further demonstrated by the higher net impact of more expensive premiums amid lower claims during the year, as individuals become less cost-averse to higher healthcare premiums as fears of potential hospitalization or mortality due to COVID-19 grips the consumer market.

Though according to the MOF, the subsector is poised to make a steady rebound in 2021, estimated at a 5.5% growth rate, returning almost entirely back to pre-COVID levels, this estimate was performed on the assumption of a normalization of loan repayment as the moratorium is lifted. However, following the rollout of PERMAI, where a 3-month loan moratorium was extended on a targeted basis, the actual effect on this subsector's recovery may be more muted than what was estimated by the MOF. However, if the rollout of the vaccine proves to be effective in

[27] Life insurers record 14% jump in premiums collected from new policies last year, The Edge Markets

combating the spread of COVID-19, we could see a near return to pre-COVID levels of domestic consumption as pent-up consumer demand bursts onto the market, providing a short-term boost in lending activity. Meanwhile, the insurance segment is expected to grow steadily in 2021, especially in motor vehicle insurance as motor vehicles sales increase due to the effects of tax relief policies in the PERMAI and prior stimulus policies.

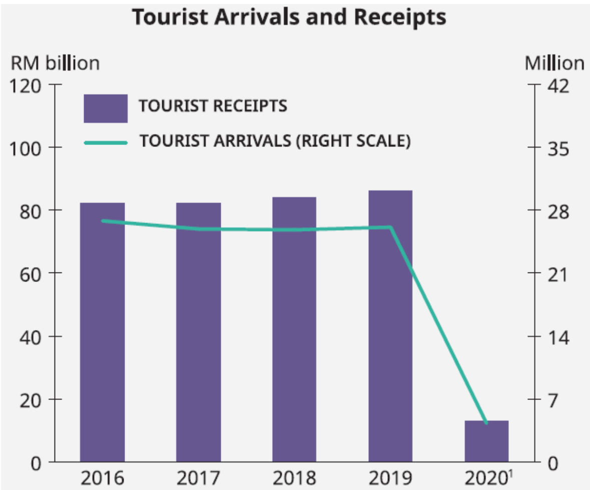
Perhaps most positively, the **Information and Communication** segment had recorded an impressive estimated YoY% growth rate of 6.4% in 2020, primarily supported by higher consumer usage of internet services, particularly from online transactions such as e-commerce, online entertainment such as Netflix, educational programming and work from home (WFH) activities. The subsector is projected to benefit greatly in 2020 due to various government initiatives, including a tax exemption of up to RM5,000 for information technology (IT) equipment to support WFH activities and an individual income tax relief of RM2,500 on the purchase of digital devices.

In 2021, the MOF projects this subsector to expand by 7.9% as the government begins its rollout of 5G cellular networks facilitating e-commerce and e-learning activities. In addition, the rollout of the National Connectivity Plan or JENDELA and the Fourth Industrial Revolution (4IR) policies introduced in the 4Q2020 is expected to enhance the productivity and competitiveness of the subsector. In our opinion, this target is moderately achievable given the breakneck growth of the sector over the past five years, most notably in e-commerce activity. However, it should be noted that to maximize the productivity growth in IT and software requires a higher level of local skilled labour and a persistent effort to bring high-skilled graduates from outside the Malaysian labour market.

The **Real Estate and Business Services** segment contracted by 11.6% during the year 2020, attributed mainly to the temporary suspension of construction activity during the MCO amid deferred construction projects and subdued business activity[28] due to the overall economic downturn in domestic consumption and retail demand. However, a projected 2021 recovery and resumption of large infrastructure projects in Budget 2021 will translate to a more pronounced economic rebound of 7.6%.

This is further buoyed by the continued exemption of Real Property Gains Tax (RPGT) under the government's stimulus packages, the stamp duty exemption of first-time homebuyers under the Home Ownership Campaign (HOC) and rent-to-own (RTO) schemes as well as other schemes under the Youth Housing Scheme (YHS) are expected to generate positive support to the subsector. In addition, as the consumer sentiment and demand in the real estate sector improve, we can expect higher demand for construction-related business services to be the main driver of the business services segment.

The **Transportation and Storage** subsector was one of the worst-hit segments during the year which contracted sharply by 24% in the 1H2020, as border closures and transport restrictions were imposed on the populace amid lower trade activity and fears of contagion among commuters.



Source: Department of Statistics

In addition, the closure of international borders drastically reduced tourism-related transport demand and spending in the sector at an estimated 79% drop between 2019 to 2020[29], severely hampering regular transport activities.

Though the lifting of inter-state travel bans and loosening of goods-to-port restrictions did improve the situation somewhat in the 2H2020, overall, the sector is expected to decline sharply through the year culminating in an overall YoY% growth rate of -11.9% in 2020.

In 2021 however, the subsector is expected to rebound by 7.5%, driven by land-based transportation following

[28] Growth for construction sector to recover in 2021, The Star
[29] 2020 was a bad year for tourism, but 2021 could be even worse, Focus Malaysia

the opening of new highways such as the Setiawangsa-Pantai Expressway, Damansara-Shah Alam Expressway and developments in the Pan-Borneo Highway[30]. Likewise, an anticipated loosening of international air travel -if the COVID-19 vaccine proves effective- is expected to recover the sector moderately due to improvements in domestic travel arrivals and cargo shipping. In addition, the anticipated improvement of global trade performance is likely to improve international maritime trading and shipping activity.

Most notably, the **Food and Beverage and Accommodation** segment is expected to improve YoY% in 2021 at 10.7% after experiencing a marked decline of 19.9% in 1H2020 and an overall YoY% growth rate of -13.3% in 2020 mainly due to the sluggish performance of the accommodation segment following the significant drop in tourist arrivals and domestic consumption of non-home food items.

The segment is expected to expand 10.7% in 2021 mainly backed by accommodation services through domestic tourism-related activity with the support of several government initiatives. These initiatives include a tax relief for consumers on tourism related services and the extension of the RM1,000 relief for domestic travel expenses. In addition, attractive packages coupled with promotions and campaigns such as the implementation of the reciprocal green lane and periodic commuting arrangement between Malaysia and Singapore for official cross-border travel for business and work purposes will help reinvigorate this segment. In addition, the government's effort to encourage more travel bubbles will bode well in helping to ensure the gradual recovery of this sector[31].

However, should the COVID-19 vaccine prove ineffective against combating the spread of the virus, we could see a return to further lockdowns and enhanced border restrictions, limiting the effectiveness of the recovery in the tourism segment. Meanwhile, though an increased demand for online food delivery services may cushion the fall in the Food and Beverage segment, it may not be sufficient to prevent major job losses and reduced operating margins. Further, the large undercurrent of informal microenterprises that exist within this segment will likely suffer the brunt of these restrictions the hardest, potentially impoverishing the livelihoods of many rural folk.

Manufacturing

As Malaysia is a recognised manufacturing hub for international businesses around the world, the importance of the sector for both export-led economic growth and foreign exchange earnings should not be understated. In the context of Malaysian manufacturing, on average nearly 70% of this economic sector is intended for value-added export, further emphasizing the size and scope of the impact of lockdown restrictions on the Malaysian economy.

Within export-oriented industries, the **electricals and electronics** (E&E) segment was the most severely affected as the sector makes up nearly 40% of all export-oriented production and 27.2% of all the entire nation's exports in 2019. During the year 2020, there was a sharp decline in the sector, as global demand decelerated rapidly amid a lockdown that prohibited the completion of international purchase orders and delayed the fulfilment of export orders. Among domestic-oriented industries, the sharp contraction in domestic demand likewise decelerated sharply as sluggish consumption growth was reported across most product sectors, with transportation equipment, non-metallic mineral products, basic metals and fabricated steel registering a double-digit contraction in 2020.

In terms of the percentage change in manufacturing output production, the month of April saw the most drastic decline, as the **Industrial Production Index contracted by 32% and a further 22% in May**[32]. Overall, the manufacturing sector contracted by 8.7% in the 1H2020 as nearly all industry operations were temporarily halted following supply chain disruptions from the MCO and subsequent lockdowns, nevertheless, this is expected to recover slightly in 2H2020, with the year 2020 estimated at an overall 3% YoY decline.

[30] Residents eager for shorter commutes via new highways, Free Malaysia Today
[31] Domestic tourism picking up after green travel bubble, says Nancy Shukri, Free Malaysia Today
[32] Malaysia's latest industrial output reading heralds sharp 2Q GDP contraction, The Edge Markets

Performance of Manufacturing Industry by Product Category	Share (%)		Change (%)	
	2019	2020	2019	2020
Export Oriented Industries	**69.2%**	**70.8%**	**3.6%**	**-3.5%**
Electronics and Electricals	**27.2%**	**28.3%**	**4.0%**	**-1.6%**
Electronics	15.1%	16.0%	3.7%	-0.2%
Electricals	12.1%	12.3%	4.4%	-3.4%
Primary-Industries	**42.0%**	**42.5%**	**3.4%**	**-4.7%**
Chemical and Chemical Products	12.8%	12.8%	2.3%	-5.7%
Petroleum Products	12.9%	12.1%	3.0%	-11.5%
Textiles, Apparel, Leather and Footwear	2.0%	1.7%	5.3%	-18.4%
Wood and Wood Products	3.2%	2.8%	4.8%	-16.0%
Rubber Products	3.0%	4.7%	8.0%	43.8%
Off-Estate Processing	5.1%	5.5%	2.2%	1.1%
Paper and Paper Products	3.0%	2.9%	4.6%	-8.0%
Domestic-Oriented Industries	**30.8%**	**29.2%**	**4.8%**	**-10.5%**
Construction-Related Industries	**13.7%**	**12.0%**	**4.3%**	**-17.3%**
Non-Metallic Mineral Products	4.4%	3.7%	4.7%	-20.3%
Basic Metals	3.4%	3.3%	3.8%	-9.0%
Fabricated Metal Products	5.9%	5.0%	4.3%	-19.7%
Consumer-Related Products	**17.1%**	**17.2%**	**5.2%**	**-5.2%**
Food Products	6.1%	6.7%	5.0%	4.8%
Transportation Equipment	6.6%	6.3%	7.2%	-9.3%
Beverages	1.0%	0.9%	3.4%	-18.3%
Tobacco Products	0.7%	0.6%	6.2%	-26.1%
Others	2.7%	2.7%	1.6%	-6.8%

Source: Department of Statistics Malaysia, Ministry of Finance

Manufacturing production estimates for 2020 provide a grim picture for manufacturing products, where estimates show an **across-the-board decline in all major sectors, with the exception of rubber products** (ie. rubber gloves) which reported a nearly 44% growth in the product segment.

Nevertheless, the manufacturing sector is expected to rebound by 7% in 2021, driven by a sustained improvement in global economic performance, with an improvement in exports to China in particular which made up 14.2% of Malaysia's total exports in 2019[33] as China's economy is forecasted to grow 8.1% in 2021 according to the IMF[34]. In addition, domestic-oriented industries are set to perform better in 2021 as overall consumption is expected to normalise gradually to pre-COVID-19 levels.

Further, the E&E segment is expected to see the largest improvement in performance in line with the digital transformation of WFH and virtual communication services as these avenues become more ubiquitous among global business practices. This in turn further supports higher global demand for integrated circuits, microchips and semi-conductors as technology companies in the United States (US) market continue to show strong market capitalization rates and fiscal performance – with the market capitalization of the US technology sector greater than the entire combined stock market of the EU[35].

It should be emphasized here that E&E exports to the US made up 36% of Malaysia's total exports to the US in 2018 while E&E exports made up 35% of total exports to China[36], indicating strong existing supply chain links form Malaysia to both US and Chinese producers.

Notwithstanding this, the production of both chemical and chemical products and rubber products are expected to increase due to stronger global demand for disinfectants, sanitizers and rubber gloves, as healthcare budgets globally are expected to experience an increase in public funding. According to The Economist, on a global level,

[33] China is Malaysia's main export market in 2019, 19 December 2020The Malaysian Reserve
[34] IMF lifts global growth forecast for 2021, still sees 'exceptional uncertainty', 26 January 2021, Reuters
[35] U.S. tech stocks are now worth more than the entire European stock market, 28 August 2020, CNBC
[36] Malaysia-US Trade Data, Atlas of Economic Complexity, Harvard University Trade Database

the average percentage of healthcare spending as a percentage of GDP will increase from 10.1% in 2019 to 10.4% in 2020, with the 2021 forward growth rate in public expenditure on healthcare estimated at 5.5% in US-dollar terms[37].

As the economy recovers due to the vaccine rollout and the lifting of economic restrictions, consumer-related products will benefit from higher short and medium-term household expenditure as disposable incomes improve. Meanwhile construction-related manufacturing is set to experience an improvement due to government investment into major infrastructure and affordable housing projects under Budget 2021.

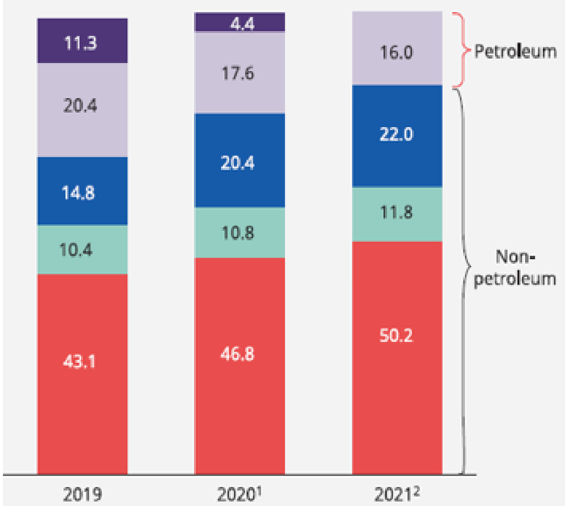
Mining and Quarrying

The mining and quarrying sector is expected to face a sharp decline of 7.8% in the year 2020, with the sector recording a double-digit contraction of 11% in the 1H2020, affected by the slump in global oil demand due to mass business closures and the reduction of international air travel and transport activities amid a sustained multi-national lockdown in response to the pandemic.

In Malaysia, the sector was particularly hit hard due to temporary shutdowns of several oil and gas facilities for maintenance, constricting production amid declining global demand. Domestically, the global collapse in oil demand caused an oversupply of crude oil, filling up storage space for the commodity and leaving the global brent crude oil price underwater at USD9.12 per barrel (pb) on 21 April 2020[38], before stabilizing at USD40pb.

Nevertheless, the sector is anticipated to recover to 4.1% YoY% growth, supported by an anticipated recovery in global oil demand and liquified natural gas (LNG). According to several oil price forecasts, this is supported by an expected recovery in 2021 to USD42pb and well on its way to recover to pre-pandemic price levels in the medium term. As of the December 2020 monthly average brent crude oil price, it averaged at USD50pb and is projected to average USD53pb in 2021, according to the US Energy Information Administration (EIA)[39].

Petroleum-Related and Non-Petroleum Revenue



Source: Ministry of Finance, Malaysia

The effects of the international oil price on Malaysia's economy are important as Malaysia relies much of its public finance revenue through the sale of crude oil, with the state-owned company Petronas being a major global player in the field. It is estimated that on average, petroleum sales account for 20% of Malaysia's total public revenue while accounting for over 60% of the state budgets of Kelantan and Terengganu, 41% in Sabah and 47% in Sarawak[40].

In the years 2020 and 2021 however, oil revenues as a percentage of total revenue are expected to shrink considerably from 2019 where it contributed 20.4% of all revenues and a further 11.3% in special Petronas dividends. In 2020, the share of oil revenue is estimated to shrink considerably to 17.6% of total revenues and 16% in 2021. Such a decline in public finances may restrict the government's flexibility in its fiscal space, forcing the government to borrow against future income to sustain current state expenditures.

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[37] Covid-19: the impact on healthcare expenditure, May 2020, The Economist
[38] Crude Oil Brent US Dollars Per Barrel, CountryEconomy.com
[39] Short-term Energy Outlook, 12 January 2021, US EIA
[40] Malaysia's slick politics of oil, Bridget Welsh and Calvin Cheng, Malaysia Kini

The World Bank Economic Outlook for Malaysia

In December 2020, the World Bank released its 2021 economic outlook for Malaysia[41], these estimates paint a positive picture for the near-term, with the economy expected to rebound by 6.7% in 2021. This rebound can be mostly attributed to a lower base in 2020 where many industries were eviscerated by the fallout of the pandemic and heavy government travel and economic restrictions.

In addition to this, a gradually improving net export position -crucial to the calculation and recovery of GDP- and the anticipated build up of pent-up demand in private consumption and investment when restrictions are gradually eased. It should be noted however that these estimates do not consider the most recent developments in early 1Q2020, particularly the declaration of a state of emergency and the reimposition of the Movement Control Order 2021 (MCO 2.0).

Regardless, these estimates are highly contingent upon the timing and effectiveness of the mass vaccination program. The institution estimates that with the first batch of vaccines expected to arrive in 1Q2020, the vaccination program will allow 20% of the Malaysian population to be vaccinated by the end of 2021. In a best-case scenario, where the vaccine is effective in combating the spread of the virus, the rollout is likely to boost consumer spending, business confidence and contribute to a gradual strengthening of private sector economic activity.

GDP growth and contribution to growth

Annual Growth, y/y, Percentage					Contribution to Annual GDP Growth (Percentage Point)				
	2019	2020f	2021f	2022f		2019	2020f	2021f	2022f
GDP	**4.3**	**-5.8**	**6.7**	**4.8**					
Domestic Demand (including stocks)	3.9	-5.1	6.6	4.8	Domestic Demand (including stocks)	3.7	-4.8	6.2	4.4
Private Consumption	7.6	-4.8	7.4	6.1	Private Consumption	4.3	-2.8	4.4	3.6
Public Consumption	2.0	3.7	2.1	1.5	Public Consumption	0.3	0.5	0.3	0.2
Gross Fixed Capital Formation	-2.1	-13.4	7.2	2.8	Gross Fixed Capital Formation	-0.5	-3.1	1.5	0.6
					Change in Stocks	-0.4	0.7	0.0	0.0
External Demand					External Demand				
Exports of Goods & Services	-1.3	-9.3	8.9	5.5	Exports of Goods & Services	-0.9	-6.0	5.5	3.4
Imports of Goods & Services	-2.5	-8.6	9.1	5.4	Imports of Goods & Services	-1.5	-4.9	5.0	3.0

Source: World Bank staff calculations and projections

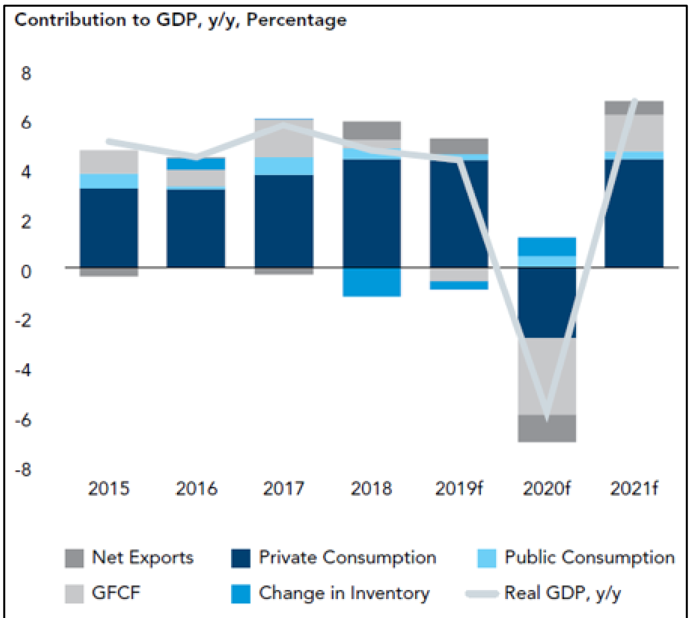
Compared to the MOF who predicted a 7.7% YoY growth rate for 2021, the World Bank estimates private consumption to rebound to 7.4% growth in 2021 on the back of a -4.8% growth rate in 2020. This estimate considers better pandemic management, an effective vaccination program, better labour market prospects and continued support from pandemic-related stimulus packages, including income tax deductions, reliefs, targeted loan repayment assistance and government cash transfers.

Meanwhile, public consumption is expected to continue to expand marginally over the near term, estimated at 2.1% in 2021 compared to 3.7% in 2020. The growth in public expenditure will mostly be supported by emoluments to public service employees.

[41] Malaysia Economic Monitor, December 2020, The World Bank

Private investment activities are expected to gradually gain momentum as GFCF is projected to grow YoY by 7.2% compared to a -13.4% in 2020. Due to the low base effect, a 7.3% growth is unlikely to regain the lost momentum from 2020 and recover to pre-pandemic levels. The GFCF growth is expected to be supported by an accommodative business policy such as investment tax incentives and additional cash aid to SMEs that is likely to spur new investments and capital goods growth. Nevertheless, the degree of this growth is especially conditional upon the strength of the balance sheets of private sector companies as well as the overall pace of the economic recovery.

In addition, public investment is expected to take a more active role given the expansionary 2021 budget for infrastructure projects such as the new double-track railway network and the Pan-Borneo Highway, as development expenditure is set to increase by 38% to RM69bil compared to RM50bil in 2020.



Source: The World Bank Economic Monitor

In terms of trade, exports will likely gain greater momentum on the back of recovering global demand in the absence of another wave of infections. Under this scenario, exports will likely experience a stronger pace of growth at 8.9% in 2021 compared to a -9.3% in 2020 as global demand recovers to pre-pandemic levels. Particularly, the relatively quick recovery in China, Malaysia's key and most important export partner will contribute to better overall improvement in the export of goods.

Meanwhile, YoY% import growth is projected to reach 9.1% from -8.6% in 2020, with the growth of intermediate and capital imports regaining lost momentum in 2020 due to an expected improvement in export and investment activity in the near and medium-term.

World Bank estimates for headline inflation is projected to increase moderately in 2021 with the average consumer price inflation rate to increase to 0.8% from an estimated -1.0% average rate for 2020. The core inflation rate is expected to be broadly contained in 2021 in the absence of immediate domestic cost pressures.

Despite the positive outlook from the World Bank, the estimates come with considerable downside risks to GDP growth. Notably, should there be any delays in the rollout of the vaccination program whether domestically or externally, it could lead to prolonged lockdowns in both Malaysia and other advanced economies, hampering domestic private consumption and investment growth and international trade respectively. The resulting uncertainty may continue to have greater spill over effects on both domestic and international financial markets.

Additionally, with the outcome of the vaccination program remaining uncertain in the near-term, the number of vulnerable households without adequate government support can increase, leading to further implementations of the MCO, placing drastically far-reaching adverse effects on businesses and employment, deteriorating the wellbeing and livelihoods of many vulnerable groups. These include people with little to no savings or assets to fall back upon, the large share of informal workers and self-employed among the Malaysian workforce who are not covered by existing social safety nets. This has acutely negative implications on the incomes and spending power of would-be consumers in the economy and severely hampers the optimisation of government-led recovery efforts.

Nevertheless, on the upside there are also opportunities for enhanced economic growth, predicated on the basis of a successful containment of the pandemic's spread and an effective rollout and implementation of the vaccination program. In such a scenario, this could lead to a faster-than-expected recovery in consumer demand. business sentiments and consequently, a more robust post-pandemic recovery in the domestic economy in 2021.

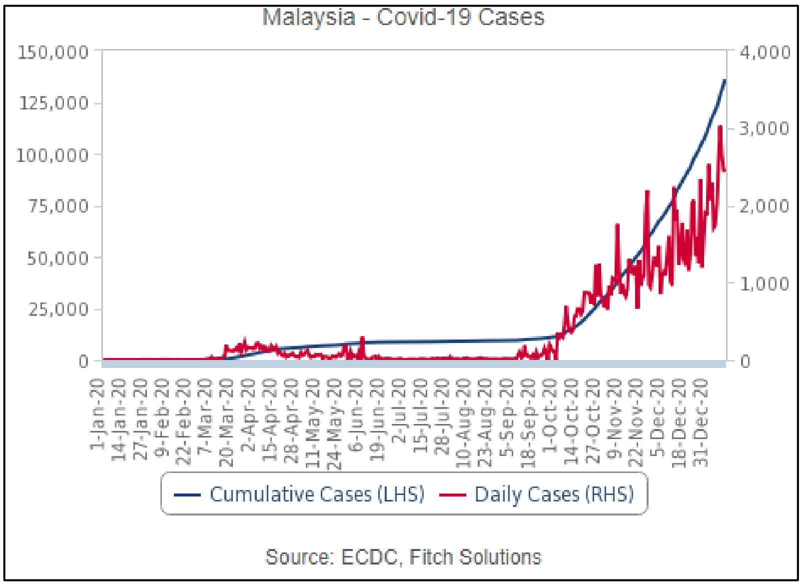
The successful implementation of the vaccination program at both national and international levels will undoubtedly contribute to a greater resumption in economic activity amid sharper upward momentum in international trade and investment.

The Imposition of the 2021 Movement Control Order (MCO)

On the 13th January 2021, faced with a resurgence of the COVID-19 pandemic amid record-breaking levels of new infection rates and deaths resulting from more infectious and deadlier strains, the Malaysian government had decided to reimpose the MCO (MCO 2.0) and furthermore declared a state of emergency across the nation. In an instant, what was previously estimated as a boon for Malaysian export and commerce compared to a disastrous 2020 had once again returned to uncertainty amid fears of a slowdown in domestic consumption and the return to sub-par income and job market growth.

The prior estimates of 6.5% - 7.5% in 2021 GDP growth from the Ministry of Finance[42] and a 6.7% growth from the World Bank are thus facing increasing downside risks and may potentially have to be re-examined the further the emergency and movement restrictions persist. The scale of the impact is further magnified due to the fact that the hardest and most punitive MCO restrictions were imposed on the most economically dynamic parts of the country, particularly in the Federal Territories, Sabah, Selangor, Penang, Johor and Malacca, who collectively constitute roughly two thirds (~66%) of Malaysia's overall GDP and nearly 60% of the nation's population.

The MCO which imposed an inter-state travel ban was followed with a declaration of a state of emergency that is set to last until 1st August 2021 (or earlier if authorities succeed in flattening the infection curve). The state of emergency had alarmed investors, evidenced by a sharp dip in the stock market of 1.07% shortly after being announced[43]. However, this move would augur well for near-term political stability, as the political uncertainty that had persisted for much of the past year and still continues to plague investor confidence is temporarily removed.



Source: ECDC, Fitch Solutions

Despite the lull in short-term uncertainty, it is likely that a protracted lockdown in the 2021 MCO will invariably affect overall consumption growth in the economy. Importantly, given the seriousness of the third wave of infection and added to the fact that the outbreak is now far worse than the initial outbreak in the first quarter of 2020, **we do not believe that these lockdown measures will be limited to a two-week timeframe ending on January 26 but instead may be further prolonged until after Chinese New Year (CNY)**. Indeed, if the government hastens to

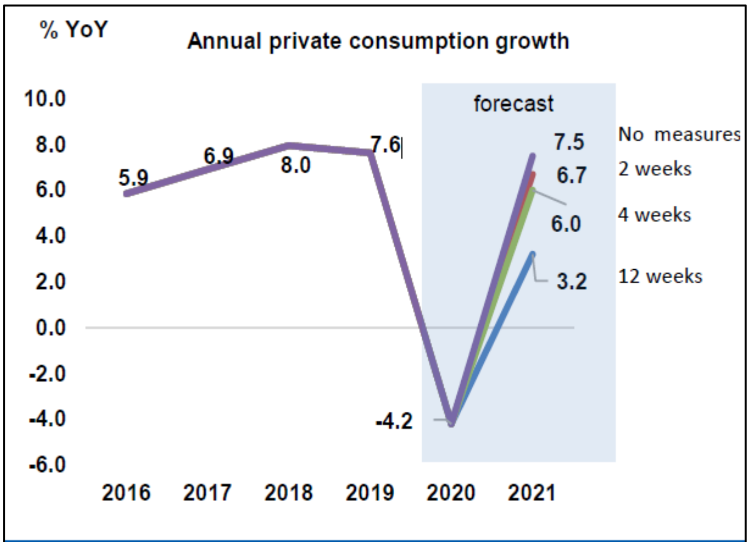
[42] Malaysia's economy to expand 6.5-7.5 pct in 2021, Bernama News
[43] Bursa slips on state of emergency to contain pandemic, The Star

re-open the economy prematurely after two weeks without the outbreak brought under control, the problem of mass infection rates may spiral out of control with economic consequences being delayed or even worsened in time.

Analysts at MIDF Research have reported that it estimates the impact of a two-week MCO could lower GDP growth by 0.7% to 0.9% this year, resulting in an overall reduction from their current Year-on-Year (YoY) GDP projection of 7.0% to 6.2%[44].

Meanwhile, CGS-CIMB Research estimates that daily economic losses due to the two-week lockdown at RM750mil, higher than the RM200mil incurred under the prior Conditional MCO (CMCO) due to its proximity to CNY. It should be noted that this is significantly less onerous than the RM2.4bil incurred each day from the first lockdown imposed from March to May 2020 as there is now more clarity and flexibility on which industries are allowed to operate under the restrictions. Considering these factors, the institution expects a 0.7% (or RM10bil) reduction in their full-year GDP growth forecast for each fortnightly lockdown (ibid).

Further, RHB investment bank's Global Economics and Market Strategy research arm had opined that the effect of the MCO 2.0 would introduce severe downside risks to economic growth, particularly on their YoY% private consumption growth forecasts of 7.5%[45]. The research arm had made significant strides by performing a scenario analysis on YoY% private consumption growth as seen in the chart below.



Source: CEIC, RHB Economics & Market Strategy
Note: 2, 4, and 12 weeks represent time period of MCO 2.0

As seen in the chart, the firm had set their original prediction for 2021 private consumption growth at 7.5%, in a two-week MCO, this could pull private consumption growth down by 0.8% to 6.7% and down 1.5% to 6.0% if the MCO were to continue for 4 weeks.

In the unlikely event that the punitive MCO 2.0 is carried on for 12 weeks, or 3 months, private consumption growth in this scenario would plummet considerably to 3.2%, dealing a massive blow to Malaysia's prospects of economic recovery.

According to the research firm, the MCO 2.0 will have severe repercussions on 1Q2020 economic growth, particularly because of government economic restrictions during important CNY festivities where consumption had historically been high during this period. This weakness will spill over on 1H2021 economic growth estimates the longer these restrictions are in place. However, there are some upsides to this MCO as compared to the previous year, as the MCO in the prior year had allowed as little as 10 sectors that were considered essential services while during the current round, there is a much wider scope of essential services with 37 sectors allowed to operate.

Most glaringly, the research firm had estimated a loss of private consumption of RM3bil per week while under the MCO 2.0 assuming that no further counter-cyclical economic policies are introduced in the near-term. As a result, they have revised their 7.5% growth in private consumption at the start of the year to a more conservative figure of 6.0% - 6.7%.

The relative optimism compared to the prior year MCO is also due to the fact that consumers have adapted to the new operating environment through engaging in more online purchases, while the sharp rise in the official

[44] MCO 2.0 to drag Malaysia's GDP growth by 0.7 to 0.9 percentage point this year, say analysts, The Edge
[45] Malaysia: MCO 2.0 Induces Downside Risk to Growth & Markets, Global Economics and Market Strategy, Jan 2021, RHB

unemployment rate as seen in May 2020 at 5.3% is unlikely to be repeated in the current year since border closures have led to a tighter labour market in some sectors, with vacancies available for Malaysian workers. In addition, the recent PERMAI stimulus package had included several cash transfer programs to both SMEs and individuals which could induce an income effect (extra goods and services bought due to higher incomes) among consumers, which were mostly absent in 1H2020.

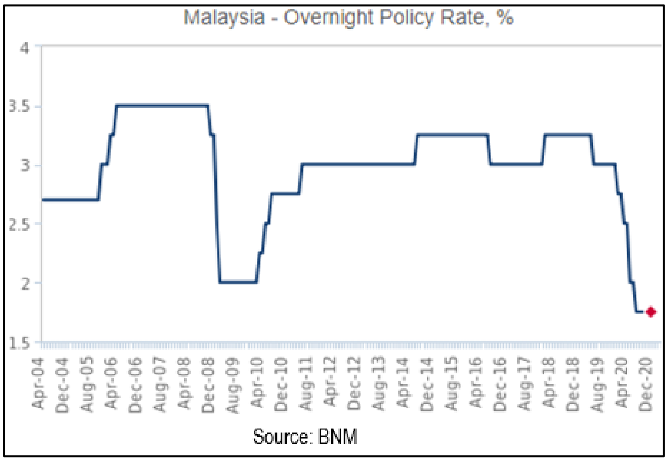
Adding to this, according to a Kenanga economic forecast[46], a protracted MCO has reduced their overall 2021 GDP growth estimates by 2.2%, where subsequent to the reimposition of the MCO, the base case scenario for 2021 GDP growth had been revised downwards to 3.9% from an initial 6.1% (translating into a RM29bil reduction in real 2021 GDP growth from their initial estimates). Despite this pessimistic view, the analyst opined that in his best-case scenario, a 5.4% growth in GDP is achievable but that even this would be exceptionally difficult given the medium-tern political and investment climate Malaysia faces.

Possible Interest Rate Interventions

Given the substantial downside economic risk to the Malaysian economy at the start of the year, there is a chance that Bank Negara Malaysia (BNM) will cut the Overnight Policy Rate (OPR) further from the prevailing rate of 1.75% as monetary policy is loosened to address the slowdown in economic growth. However, with interest rates now at historic lows since the 1997 Asian Financial Crisis, BNM may otherwise opt for nonconventional options to smoothen and encourage liquidity and lending in the credit market without directly affecting interest rates.

However, during the Monetary Policy Committee (MPC) in January 2021, it is understood that due to the expansionary RM15bil stimulus package under PERMAI, BNM had less pressure to cut the overnight policy rate (OPR) and instead opted for a wait-and-see approach to the economy. This is due to the fact that PERMAI had the ability to support short-term consumption through direct cash transfers and wage subsidies. Additionally, the mechanism for an effective rate cut is likely to be severely muted even if the OPR was reduced, as banks are more reluctant to lend capital to the private sector given the variety of credit relief and moratoria in place[47].

However, this does not negate the possibility that we may see a cut in the OPR during the 1H2021 if the PERMAI stimulus package is unable to restore consumer confidence under a worst-case scenario of a prolonged extension of economic and movement restrictions.



However, despite the possibility, monetary policymakers may likewise wish to avoid forcing the economy into a liquidity trap, a dangerous monetary situation where a further loosening of monetary policy proves ineffective in stimulating consumption as banks are reluctant to lend capital; and where individuals in an economy choose to save rather than spend whilst interest rates are already at record lows.

However, it should be noted that if the vaccine rollout is proven to be more effective than policymakers expect, moreover coupled with a successful curb on new infection rates, a gradual recovery in overall inflation and higher than expected GDP growth, BNM may instead see it fit to raise the benchmark OPR toward the 2%-3% range so as to avoid future liquidity traps and give itself more ammunition against future economic slowdowns.

46 Wan Suhaimie Wan Mohd Saidie, Head of Economic Research, Kenanga Investment Bank, 14/01/2021, "The Emergency, The MCO and The Malaysian Economy"
47 Less pressure for BNM to cut rate at 2021's first MPC meeting, say economists, The Edge Markets