From the Desk of the Chief Economist

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BNM Annual Report 2021

BNM REMAINS GUARDED

30 MARCH 2022

ECONOMIC RESEARCH

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ECONOMIC GROWTH IS UNDERPINNED BY REOPENING OF THE ECONOMY AND INTERNATIONAL BORDERS

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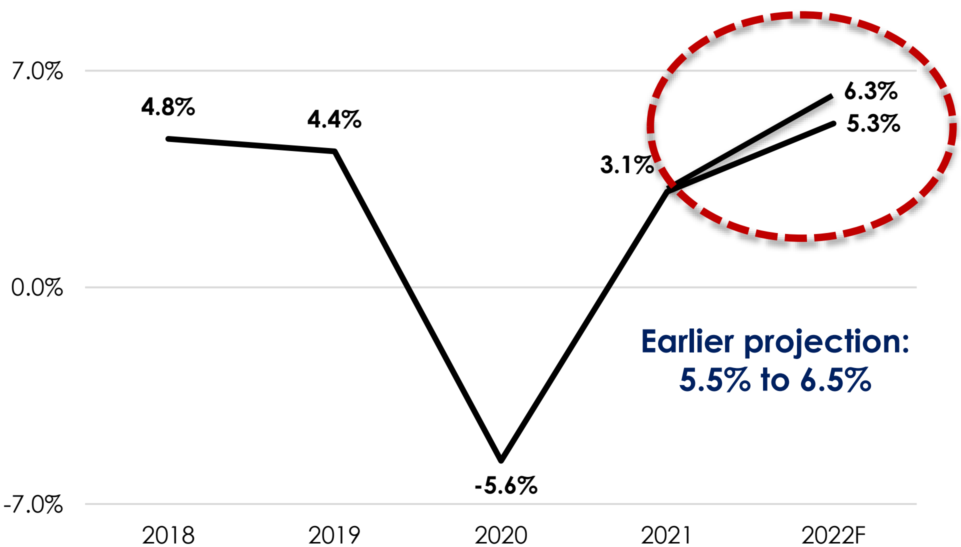
- ✓ Bank Negara Malaysia (BNM) has published its annual report for 2021 on 30 March 2022. The report concludes 2022 as a new turning point as many countries are progressing towards the endemic phase.
- ✓ Be that as it may, the recovery path remains foggy, especially on the heightened conflict between the Ukraine and Russia which continues to unfold.
- ✓ While the central bank is of the view that Malaysia is on track to gain recovery momentum in 2022, it has to be taken with a pinch of salt.
- ✓ The impact on the geopolitical war might weigh on global growth in 2022. Nevertheless, as a net commodity exporter, Malaysia could gain from the surge in crude oil and palm oil prices, making the country's economy to remain resilient.
- ✓ As such, the BNM has projected that the country's gross domestic product (GDP) would expand **between 5.3% and 6.3%** (Previously: 5.5% to 6.5%) in 2022 (2021: 3.1%) (Bank Islam – GDP 2022F: 5.5%).

Firmer recovery in Malaysia's GDP growth despite slightly below than earlier projection:



Sources: BNM Economic and Monetary Review 2021, CEIC

Key drivers for Malaysia's growth trajectory…

Continued expansion in external supported by tech upcycle

Lifting of containment measures and reopening of international borders amid high vaccination rates

Improvement in employment and prospects income

Continued access to targeted policy measures

Key challenges ahead…

- ✓ Emergence of severe, vaccine-resistant variants of concern (VOCs)
- ✓ Domestic policy uncertainty
- ✓ Weaker-than-expected global growth
- ✓ Further escalation in geopolitical conflicts
- ✓ Worsening supply disruptions and labour shortage
- ✓ Heightened financial market volatility leading to tightening financial conditions
- ✓ Higher-than-expected cost and price pressures weighing on business and household sentiments

AMONG THE KEY HIGHLIGHTS

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Ensuring safe and resilient payment services

- ✓ To enact the Consumer Credit Act (CCA) in 2022.
- ✓ It will strengthen regulatory arrangements for all consumer credit activities including "Buy Now Pay Later" (BNPL) schemes offered by non-bank operators.
- ✓ This will mitigate the risks that BNPL schemes may encourage consumers to spend beyond their means.

Climate Change and Principle-based Taxonomy (CCPT) in the Financial Sector

- ✓ Overall economic losses from the December flood events last year were estimated to be at RM6.1 billion.
- ✓ With the erratic changes in climate patterns, mitigation and managing efforts together with sustainable practices are very important in the coming years.
- ✓ Beginning July 2022, financial institutions will start to report exposures in line with the CCPT to BNM, ensuring proper assessment and risks management moving forward.

Minimum Wage Policy

- ✓ The minimum wage increase to RM1,500 needs to be implemented in an orderly manner since there is uneven recovery across industries.
- ✓ This is crucial as the country is just emerging from the global pandemic.
- ✓ Hence, distortions in the job market should be minimised to prevent further inflationary pressures in the country.
- ✓ As such, small and large firms need a clear and transparent road map to plan their recovery path in light of such policy implementation.

Low Employees Provident Fund (EPF) savings

- ✓ Low EPF savings have underscored material longer-term risks to household stability. Approximately, 6.1 million EPF members have less than RM10,000 retirement savings while 3.6 million members have less than RM1,000 in their accounts. As such, further depletion of retirement funds would exacerbate households' financial vulnerability in the long run especially for household borrowers with financing tenures beyond working age and retirees.
- ✓ Nevertheless, labour market and social protection reforms from the government is anticipated to provide support in increasing income levels and household resilience in the long term.

MALAYSIA'S GDP IS PROJECTED TO EXPAND BETWEEN 5.3% AND 6.3% IN 2022, IMPROVING FROM A 3.1% GROWTH IN 2021

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Y-o-Y%	Share 2021	2017	2018	2019	2020	2021	2022F
GDP	**100.0%**	**5.8%**	**4.8%**	**4.4%**	**-5.6%**	**3.1%**	**5.3% - 6.3%**
By Expenditure:							
Domestic Demand (excluding stocks)	92.7%	6.5%	5.6%	4.3%	-5.8%	1.9%	7.2%
Private Sector	**74.3%**	**7.4%**	**7.1%**	**6.3%**	**-6.0%**	**2.0%**	**8.2%**
-Consumption	58.8%	6.9%	8.0%	7.7%	-4.3%	1.9%	9.0%
-Investment	15.6%	9.0%	4.3%	1.6%	-11.9%	2.6%	5.3%
Public Sector	**18.3%**	**3.5%**	**0.1%**	**-2.8%**	**-4.7%**	**1.6%**	**3.2%**
-Consumption	13.8%	5.7%	3.4%	1.8%	3.9%	6.6%	1.2%
-Investment	4.5%	0.3%	-5.0%	-10.7%	-21.3%	-11.4%	9.6%
Net Exports of Goods and Services	**6.0%**	**-3.9%**	**6.2%**	**11.2%**	**-13.0%**	**-5.8%**	**2.6%**
-Exports	69.2%	8.7%	1.9%	-1.0%	-8.9%	15.9%	4.8%
-Imports	63.2%	10.2%	1.5%	-2.4%	-8.4%	18.5%	5.1%
By Industry:							
Services	57.0%	6.3%	6.9%	6.2%	-5.5%	1.9%	6.9%
Manufacturing	24.3%	6.0%	5.0%	3.8%	-2.6%	9.5%	5.2%
Mining and Quarrying	6.7%	0.4%	-2.2%	-0.6%	-10.6%	0.7%	2.5%
Agriculture	7.2%	5.9%	0.1%	2.0%	-2.2%	-0.2%	1.5%
Construction	3.7%	6.7%	4.2%	0.4%	-19.4%	-5.2%	6.1%

Sources: BNM Economic and Monetary Review 2021, CEIC

BOTH ENGINES, DOMESTIC DEMAND AND NET EXPORTS WILL BE THE MAIN CATALYST FOR GROWTH

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1 PRIVATE CONSUMPTION

- Private consumption is anticipated to grow by 9.0% in 2022 (2021:1.9%), underpinned by the improvement in the labour market.
- Removal of restriction measures would encourage household spending while at the same time continuous online spending will further stimulate private consumption.
- Moreover, availability of persistent targeted policy measures and loan repayment assistance will spur overall spending.

2 PUBLIC CONSUMPTION

- Public consumption is forecasted to expand moderately by 1.2% in 2022 (2021: 6.6%) amid softer growth in emoluments and contraction in supplies and services expenditure.
- However, the growth will be underpinned by pandemic-related spending such as purchases of medical supplies and procurement of vaccines and booster doses.

3 GROSS FIXED CAPITAL FORMATION (GFCF)

- GFCF is expected to rebound by 6.3% in 2022 (2021: -0.9%) amid rising capital spending by both private and public sectors, especially in machinery and equipment (M&E).
- Private investment is forecasted to improve further by 5.3% (2021: 2.6%), anchored by the continued growing global demand and realization of new and ongoing investments.
- Public investment, which is expected to grow by 9.6% (2021: -11.4%), will be supported by major infrastructure projects such as Light Rail Transit Line 3 (LRT3), East Coast Rail Link (ECRL) and Pan Borneo Highway.

4 NET EXPORTS

- Net exports are expected to accelerate after experiencing two consecutive years of contraction.
- This will be underpinned by strong global demand for electrical & electronics (E&E) products, improvement in commodity production, as well as higher prices of crude oil, liquefied natural gas (LNG) and crude palm oil (CPO) that provide further support to Malaysia's exports.
- Improvement in labour supply availability would also help to support exports of agricultural products as procurement of foreign labours would likely to be addressed in the near term.

Source: BNM Economic and Monetary Review 2021

ALL ECONOMIC SECTORS ARE EXPECTED TO GROW IN 2022

SERVICES

- Services sector is expected to grow by 6.9% in 2022 (2021: 1.9%), anchored by the consumer and tourism-related subsectors due to the upliftment in containment measures and reopening of international boarders.
- As such, greater mobility is foreseen and this will provide further impetus to consumer spending.

AGRICULTURE

- Agriculture sector is forecasted to rebound by 1.5% in 2022, (2021: -0.2%) underpinned by higher oil palm production as labour supply is expected to gradually improve.
- Additionally, livestock and other agriculture subsectors will continue to expand, supported by rising domestic demand.

CONSTRUCTION

- Construction sector is anticipated to recover significantly by 6.1% in 2022 (2021: -5.2%) following resumption of construction activities across subsectors.
- Implementation of small-scale projects under the 2022 Budget will underpin growth in civil engineering and special trade subsectors.

MANUFACTURING

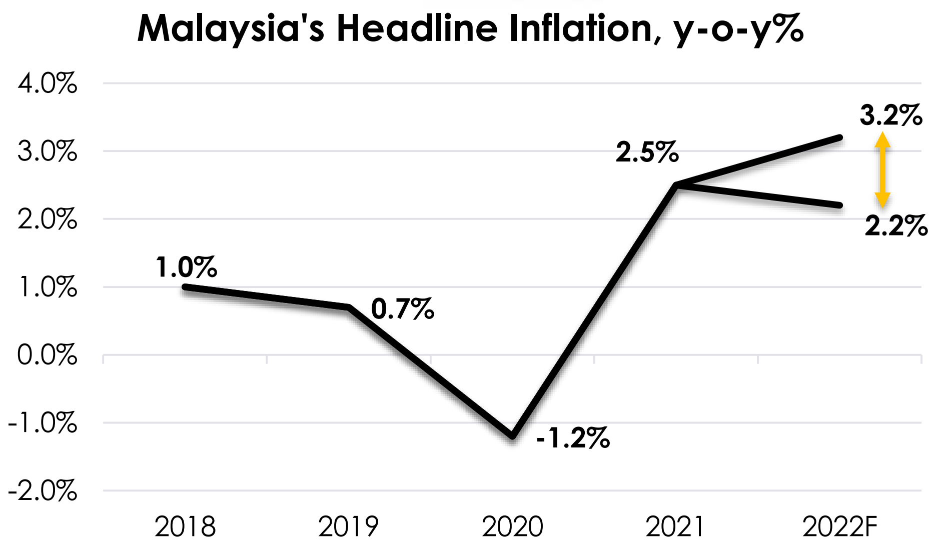
- Manufacturing sector is projected to record a softer growth of 5.2% this year (2021: 9.5%).
- Continued global demand for E&E products will benefit the sector, supported by ongoing expansions in domestic production capacity.
- Despite strong external and domestic demand, labour shortages and supply chain issues will continue to hamper production in certain manufacturing subsectors.

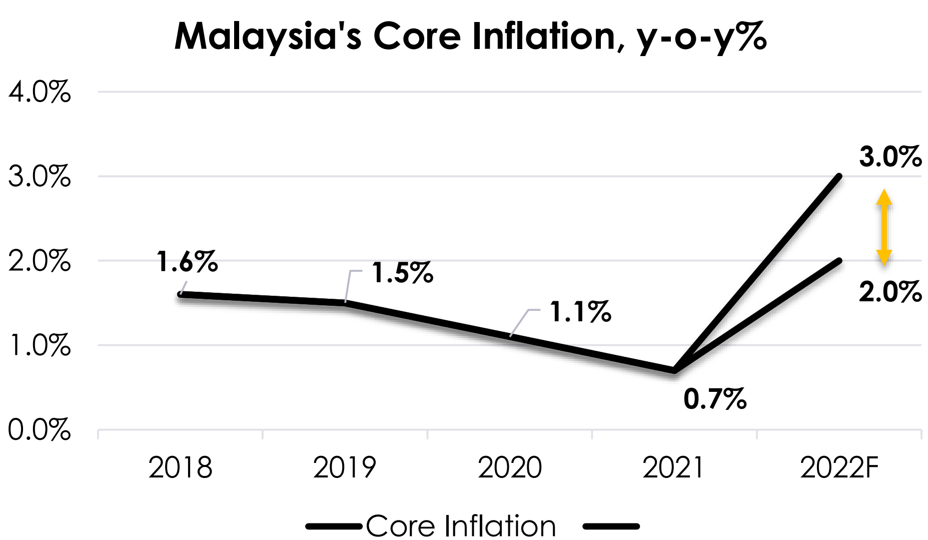
MINING & QUARRYING

- Mining sector is expected to expand by 2.5% this year (2021: 0.7%).
- This is due to operationalisation of new facilities such as Pegaga gas project in Sarawak and continued production from PFLNG2 facility.
- Higher oil production is expected following the end of Organisation of the Petroleum Exporting Countries Plus (OPEC+) oil output cut agreement by 2H2022.

Source: BNM Economic and Monetary Review 2021

THE FOG OF INFLATION IN 2022





Source: BNM Economic and Monetary Review 2021

Inflation rate is likely to remain at an elevated level in 2022 mainly besieged by:
- ✓ Sustained demand pressures
- ✓ Soaring energy and commodity prices
- ✓ Prolonged global supply chain disruptions

- Additionally, ongoing Russia-Ukraine war has exacerbated price pressures and hastened global inflation outlook murkier. Higher input cost could be passed on end consumers and elevates the cost of living.
- Following this, the BNM has projected that inflation would range around 2.2% - 3.2% this year (2021: 2.5%).
- Meanwhile, the core inflation is likely to rise between 2.0% and 3.0% in 2022 from 0.7% in 2021.

Having said that, the rising inflationary environment in the country could be contained by:

Continued spare capacity in the economy

Policy interventions such as price ceilings

Relatively less severe disruptions, reflecting factors such as proximity to global manufacturing hub

MONETARY POLICY: FACILITATING A SUSTAINABLE ECONOMIC RECOVERY WHILE PRESERVING PRICE STABILITY

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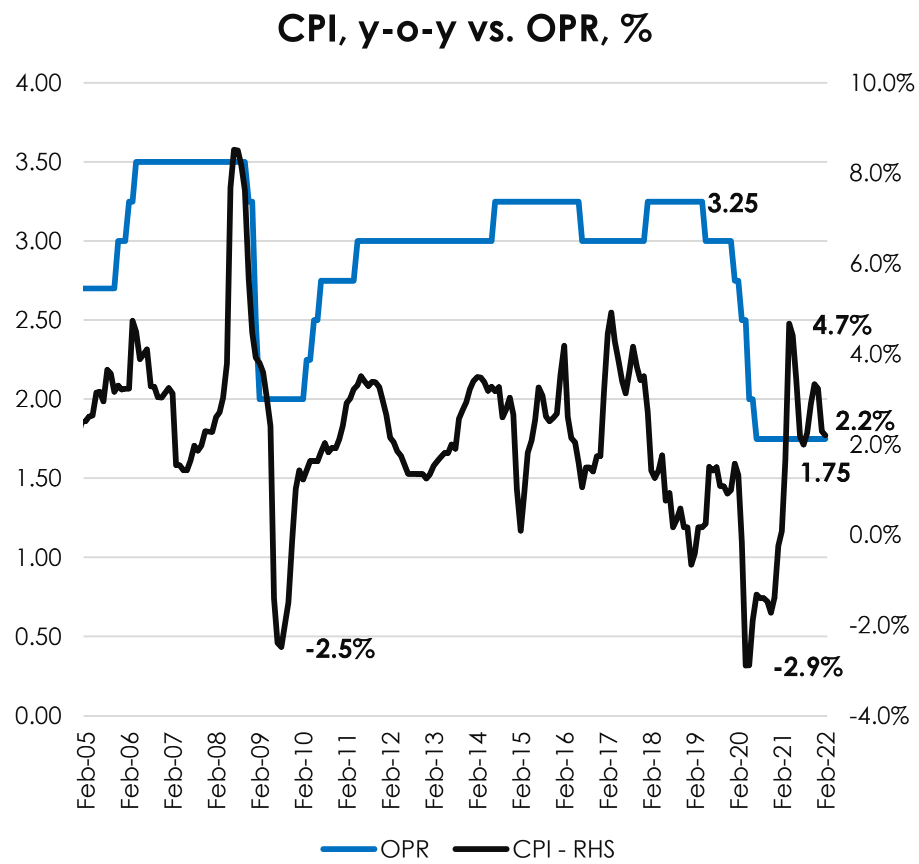
- ✓ To recall, the inflation rate is expected to range between 2.2% and 3.2% in 2022 (2021: 2.5%). Despite that, the upside risks remain visible due to the cost-push factors.
- ✓ Subsequently, the case for higher overnight policy rate (OPR) in 2022 is building up. As such, we are pencilling in that BNM will start to raise the OPR by 25 basis points (bps) in the 2H2022 to anchor the inflation expectations.
- ✓ However, BNM will continue to monitor the outlook for growth and inflation, while assessing the risks for maintaining a low interest rate for a prolonged period.
- ✓ The BNM has also indicated a reviewing on monetary policy framework to ensure continuous effectiveness in shaping the economic and financial landscape moving forward.
- ✓ Nonetheless, there was no timeline given for such review.



Source: CEIC

LABOUR MARKET IS EXPECTED TO IMPROVE AS ECONOMIC ACTIVITY PICKS UP

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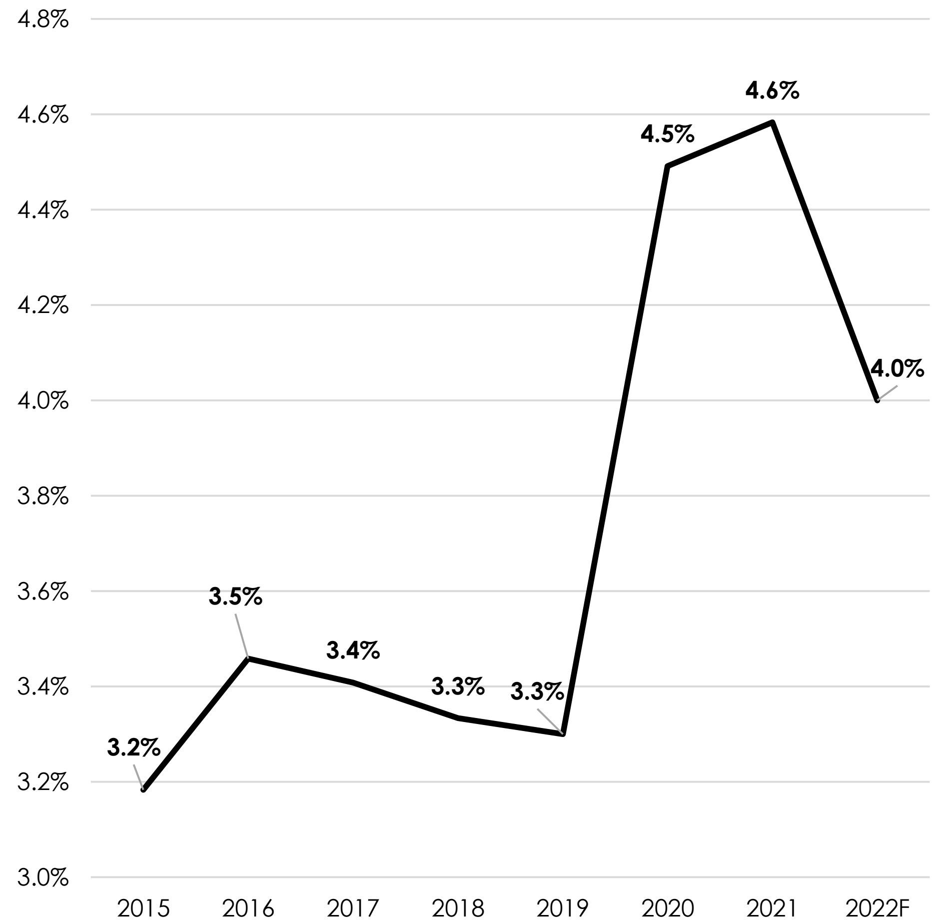
- ✓ The year 2022 will see Malaysia getting back on track with further improvement in the labour market.
- ✓ This is in view of a moderate recovery in the labour market last year after experiencing significant disruptions in 2020.
- ✓ For 2022, BNM is of the view that the unemployment rate will decline to 4.0% (2021: 4.6%) as economic growth is expected to gain further momentum.
- ✓ Such view is supported by targeted measures to boost labour demand, facilitate reskilling and upskilling, as well as reduction in labour market frictions.
- ✓ Therefore, higher income growth and sustaining employment creation will support the household spending (2022F: 9.0% vs. 2021: 1.9%) during the said year.

Malaysia's Unemployment Rate, %

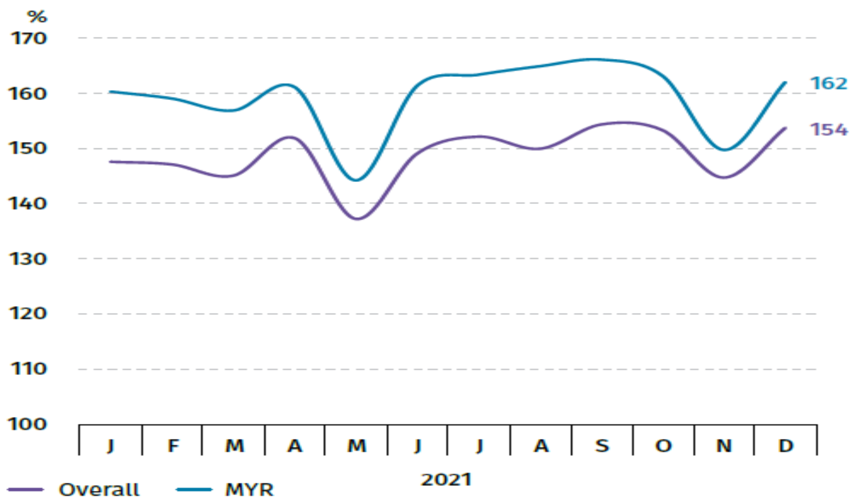


Note: The slight increase in the unemployment rate in 2021 is mainly due to a faster growth in labour force relative to employment, following the re-entry of workers into the labour force during the year.

Sources: BNM Economic and Monetary Review 2021, CEIC

THE BANKING INDUSTRY REMAINS RESILIENT AMID ROBUST CREDIT UNDERWRITING STANDARD

Banking System - Liquidity Coverage Ratio (LCR)

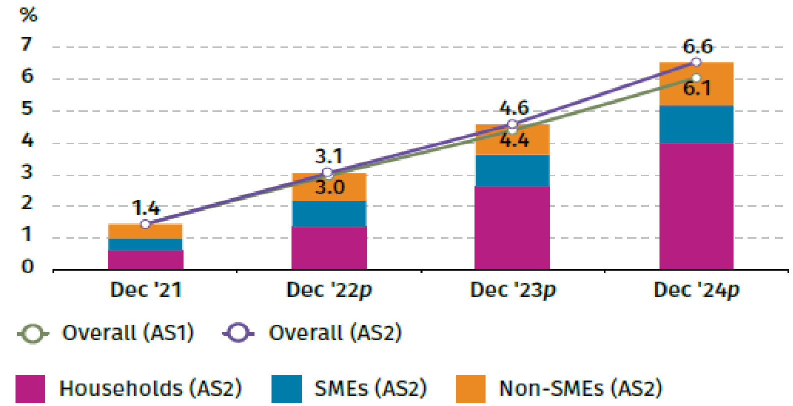


Source: BNM's FSR 2H2021

Note: 1. MYR LCR is calculated based on HQLA and expected net cash outflows denominated in ringgit.
2. Overall LCR is calculated based on HQLA and expected net cash outflows denominated in all currencies.

- ✓ Bank's intermediation activities remained supportive with aggregate Net Stable Funding Ratio (NSFR) stood at 116.2% as of December 2021 (December 2020: 116.0%) which was higher than minimum NSFR requirement of 100.0%.
- ✓ Additionally, the LCR remained well above 150.0% (2021: 153.8% vs. 2020: 148.2%), suggesting the liquidity remained healthy despite being hit by the economic fallout from Covid-19 last year.
- ✓ This also shows that the support measures for household and business, including the extension of loan repayment moratoria had limited impacts on bank's liquidity.

Banking System - Impaired Loans Ratio Under Adverse Scenarios 1 (AS1) and 2 (AS2)



Source: BNM's FSR 2H2021

- ✓ The banking's Gross Impaired Financing Ratio (GIFR) remained low at 1.4% in 2021 (2020: 1.6%) mainly contributed by regularisation of financing repayment by business and individuals alongside write-offs by several banks in 2H2021.
- ✓ However, the BNM's stress test shows that banking sector impairment is expected to be higher by end of 2022, **rising to 3.1% and 3.0% under AS1 and AS2 respectively (2021 GIFR: 1.4%)**. This was mainly weighed by thinner financial buffer among household borrowers earning less than RM5,000 which made up largest share of total borrowers projected to default.
- ✓ Hence, the banks will remain vigilant in their credit risk assessment amid fluid economic environment.

- ✓ The further improvement in labour market conditions as reflected by the lower projection in the unemployment rate from 4.6% in 2021 to 4.0% in 2022 is likely to strengthen the recovery process this year. This will be manifested via an above trend growth in consumer spending along with higher private investment activities.
- ✓ On top of that, a healthy global demand would continue to support Malaysia's external sector. This is in tandem with the anticipation of higher surplus in the current account balance of RM75.8 billion or 4.2% to 4.7% of GDP in 2022 (2021: RM53.5 or 3.5% of GDP).
- ✓ However, the military conflict in Ukraine and Russia remains extremely fluid as it may affect Malaysian economy via global supply chains disruption and guarded sentiments among the businesses.
- ✓ On domestic front, higher input costs in light of rising commodity prices are projected to exert inflationary pressures on goods and services. However, economic policies such as price ceiling and subsidies would help to contain the rise in general prices.
- ✓ All in all, a slightly lower projection for Malaysia's GDP growth ranging between 5.3% and 6.3% (earlier projection: 5.5% to 6.5%) suggests that the BNM remained wary on the state of global recovery. Judging from their lists of downside risks, the emergence of new Covid-19 variant that has high resistance towards vaccines remain their biggest concern. Therefore, the prevailing economic condition remains highly fluid and policies would need to be agile enough in order to account for the uncertainties.

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