Dr. Mohd Afzanizam Abdul Rashid | Chief Economist | 03-2088 8075 | afzanizam@bankislam.com.my
Shafiz Jamaluddin | Economic Analyst| 03-2088 8399 | shafiz@bankislam.com.my
Nor Jannah Abdullah | Economic Analyst | 03-2782 1417 | norjannah@bankislam.com.my
Nurrizque Addelina Zamanhuri | YLP Trainee | 03-2088 8753 | naddelina@bankislam.com.my

BNM Annual Report for 2019 – It's getting chilly…and…eerie.

Growing fears of recession

The Bank Negara Malaysia (BNM) has released its annual report for 2019 yesterday. During our Video Conferencing with the Governor and her team, the feeling was uncertain and hopeful. It remains unknown as to when Covid-19 would peak and whether the Movement Control Order (MCO) could be extended. However, according to BNM, the economic forecast has taken into account of MCO period which could be stretched beyond the present dateline. At the same time, the BNM believes that the economic stimulus package amounting to RM250 billion would add 2.8 percentage points to GDP. The Governor also indicated that the BNM forecast is very conservative. It is based on lower Marginal Propensity to Consume (MPC) despite various measures on cash transfers. As for the loan moratorium, the BNM assume a 100% take-up rate for B40, 80% for M40 while 0% for the T20. As for the infrastructure projects, the central bank only focuses on the small projects to be imputed in their model.

Having said that, **the BNM has projected Malaysia's Gross Domestic Product (GDP) would range between -2.0% and 0.5% for 2020 (Bank Islam: -1.5%). Yes, the economy is expected to be in recession this year.** The last time Malaysian economy went into recession was in 2009 when GDP contracted by 1.5% due to Global Financial Crisis (GFC). **This time, it will be Global Health Crisis (GHC).**

The Covid-19 pandemic has spread across the globe and daily cases are soaring. This has curtailed the economic activities in a significant way following lockdowns measures and social distancing practices. In light of this, the International Monetary Fund (IMF) on 27 March has announced that the global output will contract in 2020 following a sudden stop in economic activities. Echoing such tone, the World Bank, on 30 March, has also indicated that the prospect of a global financial shock and recession would hurt the developing economies in the East Asia and the Pacific (EAP).

As at 2 April 2020, there were 896,450 confirmed cases and 45,526 deaths reported by the World Health Organization (WHO), in which 813,726 confirmed cases and 42,199 deaths recorded outside China's jurisdiction. The epicentre now is in the US, registering 187,302 cases and 3,846 number of deaths. This was followed by Italy and Spain, recording 110,574 and 102,136 confirmed cases with 13,157 and 9,053 deaths respectively. These countries are in the "accelerated phase" as shown by their respective steep curves (Refer Chart 2). Meanwhile, China and South Korea have succeeded in flattening the curve with South Korea taking quick measures before new cases spike up without implementing any lockdowns. South Korea "unique" measures should be set as an exemplary model as they used mass diagnostic testing to contain the spread which requires massive resources of equipment. China on the other hand took the extraordinary step of locking down most of its cities inside the Hubei province to prevent explosive outbreak outside of Wuhan region.

Meanwhile, confirmed cases in Malaysia are quite alarming too. The number of new cases has surpassed 3,000 (2 April 2020: 3,116 cases) and various places have been earmarked as the hot spot. According to the report by the Malaysian Institute of Economic Research (MIER), the ongoing virus spread could potentially peak on 12 April, two days prior to the Movement Control Order (MCO) would end. The research institute also expect the recovery rate would reach 100% by end of May 2020. However, such predictions could prove futile as the number of new cases do not seems to slow down materially amid the strict MCO implementation.

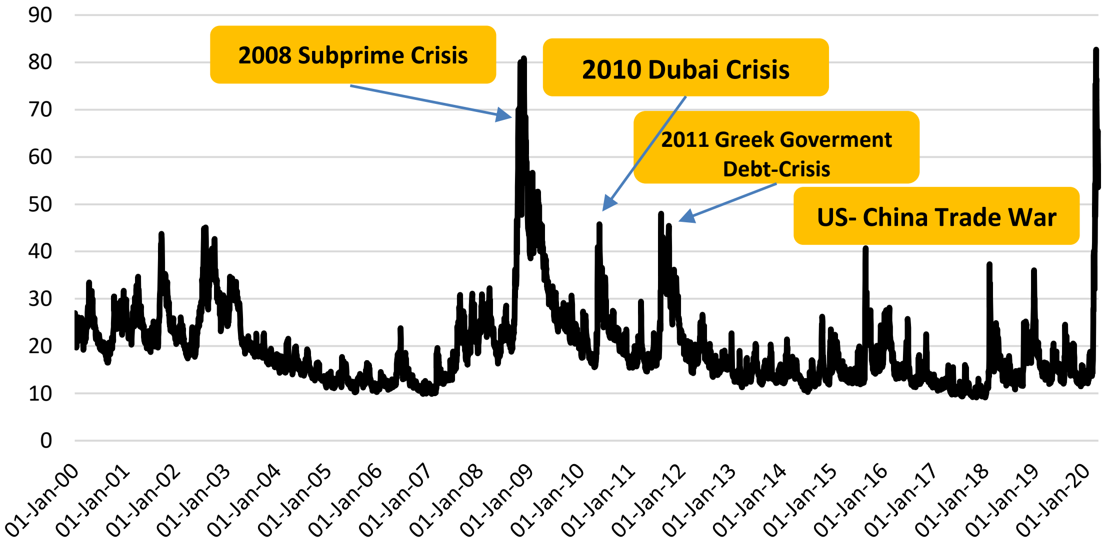
Following this, the BNM is of the view that the domestic demand, which is the pillar of Malaysia's growth (accounted for 94.1% of total GDP) is expected to grow at a moderate pace of 1.1% in 2020 from 4.3% in 2019. This was attributed by softer expansion in private consumption of 4.2% from 7.6% recorded previously, driven by weak labour market condition, as well as mobility restrictions. Meanwhile, the private and public investment are projected to fall by 9.7% (2019: 1.5%) and 7.5% (2019: -10.8%) respectively in 2020, dragging the overall performance. However, the public consumption is set to post a higher growth of 5.9% in 2020 as compared to 2.0% in 2019 following the implementation of fiscal stimulus package. On the other hand, the real exports and imports are likely to deteriorate significantly by 13.6% (2019: -1.1%) and 11.9% (2019: -2.3%) respectively. The lockdown measures implemented in major economies are expected to weigh heavily on Malaysia's international trade, leading to the 27.0% contraction in net exports this year.

Table 1: BNM's 2020 GDP Forecast

y-o-y%	% Share (2019p)	2018	2019	2020F	Long Term Average
GDP	**100.0%**	**4.7%**	**4.3%**	**-2.0% to 0.5%**	**5.1%**
Domestic Demand	**94.1%**	**5.5%**	**4.3%**	**1.1%**	**6.4%**
Private Consumption	58.8%	8.0%	7.6%	4.2%	7.1%
Private Investment	16.8%	4.3%	1.5%	-9.7%	8.9%
Public Consumption	12.2%	3.3%	2.0%	5.9%	5.1%
Public Investment	6.3%	-5.0%	-10.8%	-7.5%	-0.2%
Net Exports of Goods and Services	**7.3%**	**11.4%**	**8.9%**	**-27.0%**	**-1.5%**
Exports	64.0%	2.2%	-1.1%	-13.6%	2.1%
Imports	56.7%	1.3%	-2.3%	-11.9%	2.9%
By industry					
Services	57.7%	6.8%	6.1%	2.3%	6.2%
Manufacturing	22.3%	5.0%	3.8%	-8.6%	4.8%
Mining & Quarrying	7.1%	-2.6%	-1.5%	-4.2%	0.6%
Agriculture	7.1%	0.1%	1.8%	-2.9%	1.9%
Construction	4.7%	4.2%	0.1%	-1.9%	8.0%

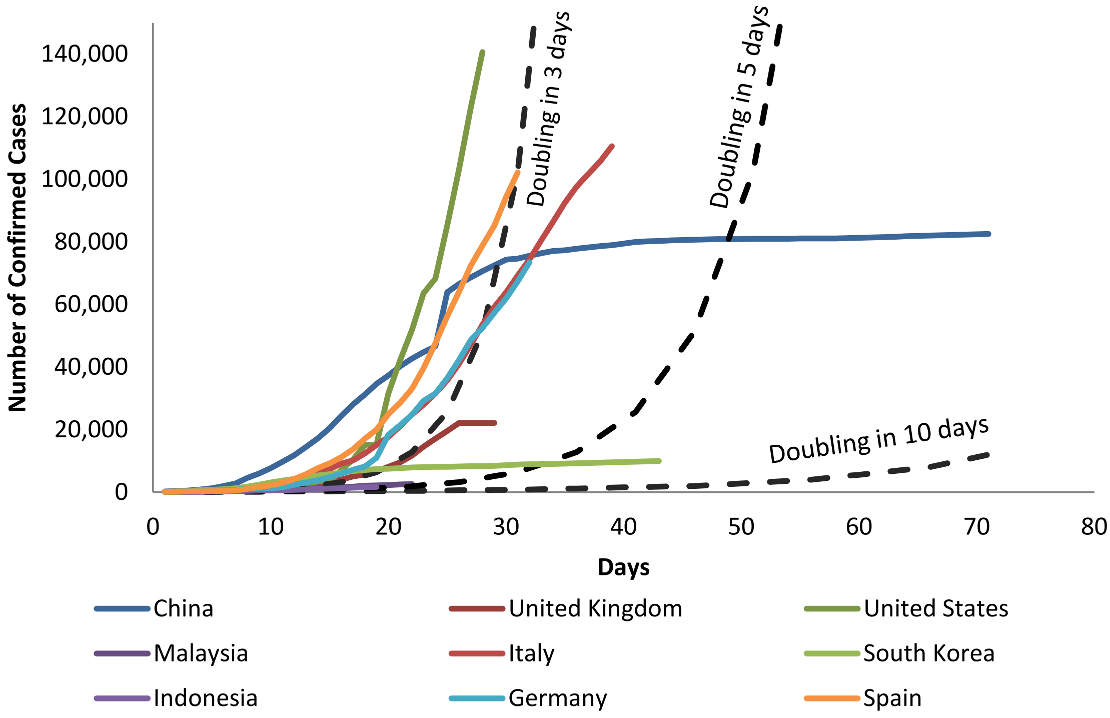
Source: BNM Economic & Monetary and Financial Stability Review

Chart 1: Chicago Board Options Exchange Volatility Index (VIX)



Source: Bloomberg
*as at 1 April 2020

Chart 2: Trajectories by country on confirmed cases



Source: CEIC and London Business School

Inflation rate is expected to be very low

The inflationary pressure will remain low this year as Consumer Price Index (CPI) is forecasted to hover between -1.5% and 0.5% in 2020. The downward pressure on inflation was primarily driven by the crash in global oil and commodity prices, dragging down the main component in the headline inflation. As of 3 April, the fuel price for RON95 has plummeted to RM1.38 per litre (3 January: RM2.08) while Diesel stood at RM1.68 per litre (3 January: RM2.18). Demand condition is also weak as the Output Gap (the difference between actual and potential GDP) is expected to be in negative territory. However, the Core Inflation which excludes Food & Non-Alcoholic Beverages and Transport is expected to remain positive, averaging between 0.8% and 1.3%. This signals product prices other than food and fuel are likely to rise albeit at moderate pace. Against such backdrop, the BNM has the policy to prescribe additional monetary easing as inflation is not a threat at the moment. The focus now is how to revive the economic growth amidst Covid-19 outbreak. However, the main priority is health. There will always be trade-off in every decision. In this case, the economy will be worse off whereby there would be further disruption to activities should MCO period would be extended.

Our view

So it's official now. The BNM is expecting the Malaysian economy to be in recession in 2020 following the GHC engulfing the forecast scenario. Their baseline on GDP forecast of -2.0% to 0.5% saw a significant decline in the net exports which would likely to contract by 27.0% in 2020. This clearly indicates that Malaysia such an open economy will be susceptible to volatility in the external demand. The steep decline in Purchasing Manager's Index (PMI) globally, as well as the recent sharp rise in the US initial jobless claims registering more than 6 million claims last week suggest that the global economy may not be so kind to us. The Covid-19 outbreak and the subsequent implementation of MCO have inflicted major restraint to economic activities as businesses and households are not able to transact as per normal. Obviously, the economy is operating below its potential level and the BNM has clearly indicated that the Output Gap will be negative this year. As such, there will be excess capacity in the economy which would take a while for it to be cleared. In the meantime, policy supports via cash transfers alongside with loan moratorium, loan guarantee, lower utility costs and income tax deferments for households and businesses should be able to cushion the impact. Going forward, prospects for global growth will be depending on how soon the pandemic can be contained and stopped. Therefore, policy response would be aligned to such scenario whereby the main priority is to ensure healthcare system and infrastructures are able to cope with sudden surge in demand. The MCO and social distancing will undoubtedly affect economic activities. So, the focus would be to address the loss of income, job security and maintained stable cash flows among households and businesses.

Is the economic forecast too rosy? Well, it's difficult to tell as human emotion tends to gyrate especially during period of uncertainty. Flashing back to the era of Global Financial Crisis (GFC), everyone was talking about the collapse of financial system following the toxic assets being held by the banks and insurance companies. Credit crunch ensues and banks have cancelled their loan facility to various players during the disastrous time. Yes, granted the current crisis is different. But, at least, the fiscal and monetary authorities are doing the right thing and, in our case, the BNM is willing to prescribe policies which are quite unconventional to a large degree. Subject to the evolving economic outlook, we believe the BNM would stand ready to cut the Overnight Policy Rate (OPR) by 50 basis points to 2.00% in order to ensure the monetary policy will remain supportive to economic growth. Similarly, the Statutory Reserve Requirement (SRR) could be reduced by another 100 basis points to 1.00% with a view to provide additional liquidity in the financial system and to reduce the cost of funds among the financial institutions.