



From the Desk
of the
Chief Economist

BANK ISLAM

IMPACT OF MCO 2.0 ON THE ECONOMY AND FINANCIAL MARKETS

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ECONOMIC RESEARCH

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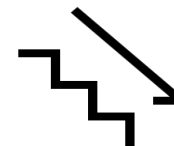


Revision in our 2021 GDP growth estimates

- ✓ Last year, we forecasted that the GDP in 2021 will grow by 7.3%. The estimates were then revised to 5.0% prior to the MCO announcement considering the surge in Covid-19 cases. With the MCO now in place, we have further revised downwards our 2021 GDP growth to 4.0%.

RECOVERY

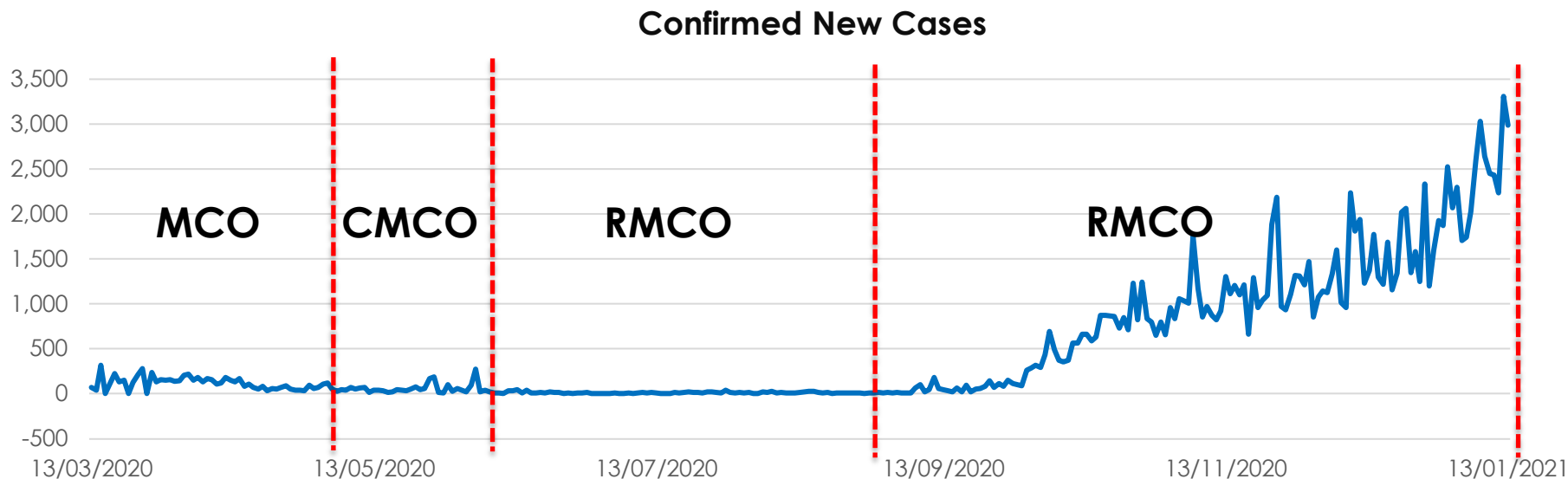
- ✓ The recovery in 2021 mostly attributed by lower base in 2020 and therefore does not really reflect a real economic growth amid higher number of infections cases.



Why we revised our GDP forecast?

- ✓ Uncontrolled number of Covid-19 infections as daily cases continued to surge with its highest at 3,337 individuals infected on 14 January.
- ✓ MCO has been imposed in 7 states in Malaysia, which contributed for about 68.1% to Malaysia's GDP in 2019. Meanwhile, an MCO is imposed in Sarawak covering districts of Sibul, Kanowit and Selangau only.
- ✓ A state of emergency was also announced but is anticipated to have minimal impact towards the economy as federal and state government machinery continue to operate as normal.





Source: CEIC

Statistics on the first day of the latest MCO

Covid-19 cumulative cases:
144,518

Covid-19 Deaths:
563

Recovered Covid-19 patients:
111,578

- ✓ As at 13 January 2021, the first day where renewed movement restrictions took effect, Malaysia reported 2,985 new Covid-19 cases, which brought the total number of infected individuals to 144,518 persons.
- ✓ A drastic approach has to be taken in the form of MCO as Malaysians are struggling to contain the virus infections within communities.
- ✓ The Ministry of Health has projected that the daily new cases could surpass 5,000 cases by April and 8,000 cases by May if the authorities do not move to implement the MCO to curb the spread of the virus.

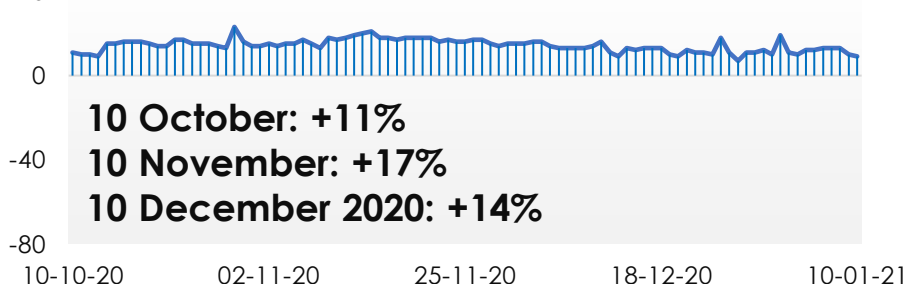
AMID HIGHER NUMBER OF INFECTIONS SINCE OCTOBER LAST YEAR, PEOPLE PREFER TO STAY AT HOME

Residential, %

+9%

compared to baseline

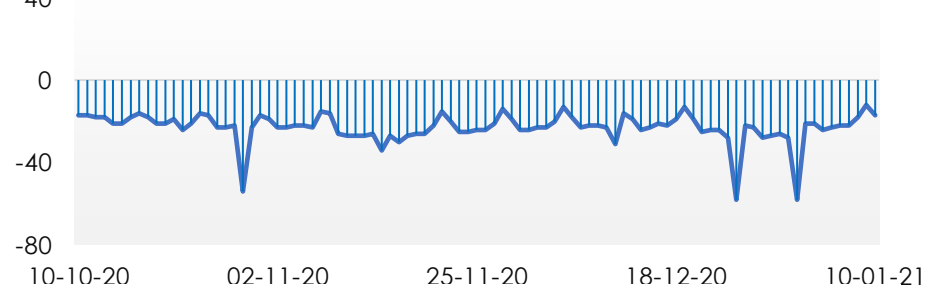
People are staying at home



Workplaces, %

-17%

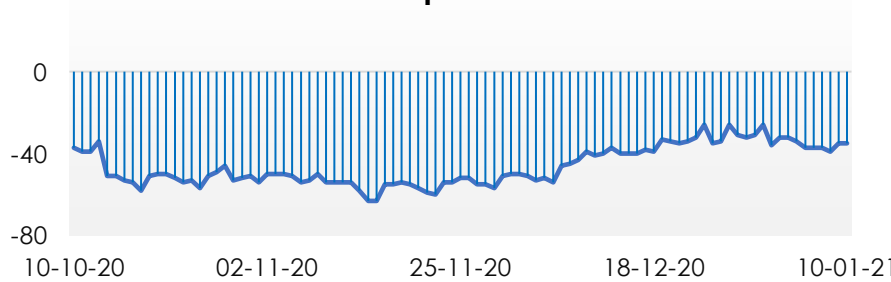
compared to baseline



Public Transport, %

-35%

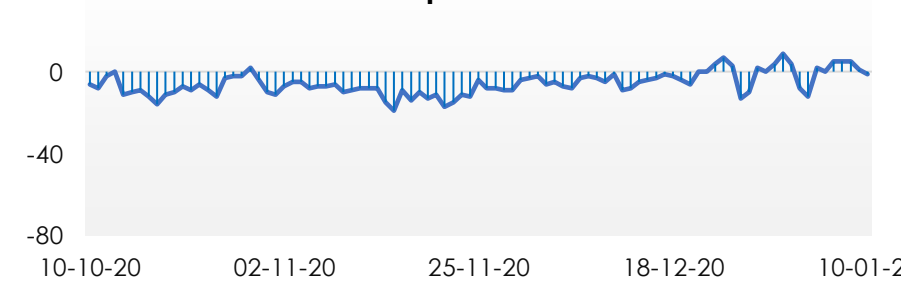
compared to baseline



Supermarket and Pharmacy, %

-1%

compared to baseline



Baseline 0 indicated no movement, while any number level above 0 means people are at specific places (workplaces, residential areas) and any number below 0 would mean otherwise.

Source: Google Mobility Report

- ✓ Malaysian government has signed an early agreement with the Covax facility provider Pfizer and AstraZeneca, for the procurement of Covid-19 vaccine. The vaccine supply would reach a total of 40.0% of the population.
- ✓ Meanwhile, National Pharmaceutical Regulatory Agency (NPRA) has approved the administration of the Covid-19 vaccine developed by Pfizer, and the first batch vaccine is expected to be delivered by the end of February 2021.



- ✓ Aside from that, the government is already in the final phase of discussions with Sinovac, Cansino and Gamaleya in order to boost vaccine supply to reach 80.0% of the population or 26.5 million people.
 - ✓ However, Malaysia will only go ahead with procurement if it satisfies the safety and efficacy standards of local regulators after clinical trials found that it was only 50.4% effective at preventing symptomatic infections.
- ✓ Despite the government has approved vaccine by Pfizer-BioNTech vaccine, the grueling distribution process requires an historically low storage temperature requirement of minus 70 degrees Celsius as mentioned earlier will pose major challenges for Malaysia's vaccination campaign.
 - ✓ Upon delivery to the respective vaccination centres or sites, the Pfizer-BioNTech vaccine, once thawed, must be used quickly as it can only be kept for five days at normal fridge temperature of two to eight degrees Celsius.
 - ✓ Therefore, it will require enormous transportation resources and vast policy coordination to fulfil different storage and logistics protocols.

SCENARIO ANALYSIS ON IMPACT OF STATE OF EMERGENCY AND MCO ON 2021 GDP GROWTH

GDP Breakdown By States

State	Contribution to GDP in 2019	Quarterly Output loss in 2Q2020 (RM Million)	Weekly Output Loss in 2Q2020 (RM Million)
Selangor*	24.2%	14,457.8	1,204.8
Kuala Lumpur*	16.4%	9,797.9	816.5
Sarawak	9.6%	5,735.3	477.9
Johor*	9.4%	5,615.8	468.0
Pulau Pinang*	6.7%	4,002.8	333.6
Sabah*	6.0%	3,584.6	298.7
Perak	5.3%	3,166.4	263.9
Pahang	4.1%	2,449.5	204.1
Negeri Sembilan	3.4%	2,031.3	169.3
Kedah	3.3%	1,971.5	164.3
Melaka*	3.1%	1,852.0	154.3
Terengganu	2.5%	1,493.6	124.5
Kelantan*	1.8%	1,075.4	89.6
Labuan*	0.5%	298.7	24.9
Perlis	0.4%	239.0	19.9
Supra State**	3.3%	1,971.5	164.3
Total	100.0%	59,743.0	4,978.6

Sources: CEIC, DOSM, Bank Islam estimates

* States under MCO

** Supra State covers production activities that are beyond the centre of predominant economic interest for any state

Estimated Output Loss During MCO

Year	Estimated Total Output Loss (RM Million)
2 weeks MCO impact in 2021F	6,780.8
1 month MCO impact in 2021F	13,561.7
2 month MCO impact in 2021F	27,123.3

MCO Impact on 2021 GDP Growth Estimates

Year	Gross Domestic Product (RM Million)	Annual Growth (y-o-y)
2019	1,421,454.0	4.3%
2020E	1,343,274.0	-5.5%
2021F (estimated in 2020)	1,441,333.0	7.3%
2021F (revised Jan 2021 prior to MCO)	1,410,437.7	5.0%
2 weeks MCO impact in 2021F	1,403,656.9	4.5%
1 month MCO impact in 2021F	1,396,876.1	4.0%
2 month MCO impact in 2021F	1,383,314.4	3.0%

- ✓ We envisage that the negative impact of the latest MCO towards our 2021 GDP growth estimates to be softer compared to the first MCO in March 2020.
 - ✓ The reason being is that only 7 states (Federal Territories of Kuala Lumpur and Labuan, Selangor, Pulau Pinang, Sabah, Johor, Melaka and Kelantan) are under a full MCO compared to the year before where the MCO was nationwide.
 - ✓ Moreover, businesses such as eateries and retail outlets are more prepared as the initial MCO have prompted them to utilise digital platforms to carry out business operations.
- ✓ To estimate the impact of the state of emergency and latest MCO, we use the weekly output loss calculated in 2Q2020 for the 7 states involved.
 - ✓ The reason for not using the output loss in 1Q2020 for the 7 states involved is that the MCO came into effect at the tail-end of the said quarter. Therefore, using the weekly output loss derived from 2Q2020 is a more conservative approach in our view.
 - ✓ Our analysis indicates that a two-week MCO in the 7 states will only lead to a 0.5 ppts reduction in our 2021 GDP growth estimate. It is highly likely that the MCO may be extended to a month due to the number of daily Covid-19 infections remaining high. As such, we are revising our base estimates for the GDP growth in 2021 to 4.0%.

FBM KLCI Index



Source: Bloomberg
Note: As at 13 January 2021

Earnings Growth Trajectory of the FBM KLCI

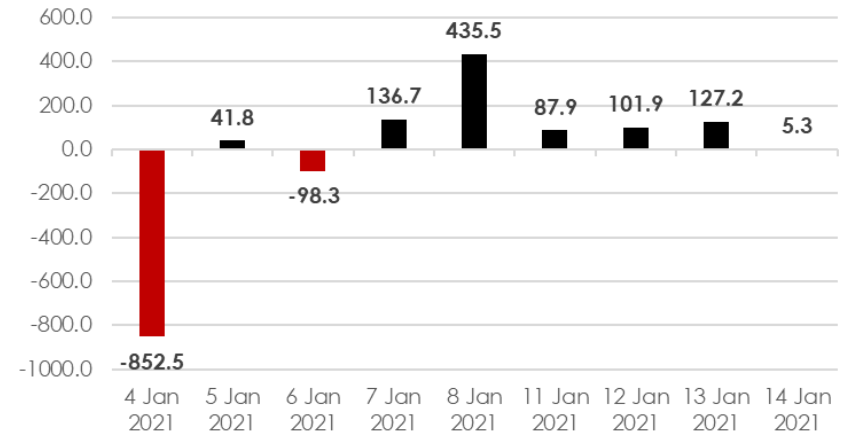
Year	Earnings Per Share (EPS) of FBM KLCI	Year-on-year (y-o-y) EPS Growth
2021E	114.5	62.7%
2020	70.4	-21.5%
2019	89.7	13.0%
2018	79.3	-26.5%
2017	107.9	9.8%
2016	98.3	4.4%
2015	94.2	-13.0%

Source: Bloomberg

- ✓ Bursa recorded a 1.0% loss on Monday, 11 January 2021 when the market closed at 5pm ahead of the Prime Minister's announcement at 6pm on the same day. The local bourse retreated further by 0.3% to settle at 1,612.0 points on the next day as a state of emergency was declared before jumping by 1.5% on the day after. This indicates that the drop in the FBM KLCI index was a knee-jerk reaction following the announcement of the MCO and state of emergency.
- ✓ In comparison with the market movements during the first MCO in March 2020, the FBM KLCI closed at 1,280.6 points on 16 March 2020 prior the announcement was made on the same day before declining more to reach as low as 1,219.7 points three days later, translating into a 4.8% drop during that interval.
- ✓ Therefore, the drop in the local bourse following the announcement of the latest MCO was not as severe as the first one. The reason being that businesses and consumers have experienced the MCO before, making them more prepared to face it.
- ✓ Aside from that, the proclamation of the state of emergency until 1 August 2021 by the Yang di-Pertuan Agong entails a suspension of the parliament, ending political moves to force an early general election in the meantime. This indirectly limits the current volatile political situation in the country.
- ✓ We are projecting a year-end target of 1,715 points (previously estimated at 1,750 points) for the FBM KLCI index in 2021. This is pegged to a forward PE of 15.0x which is -1.50 SD lower than the five-year historical average to reflect the expected earnings recovery which may be capped by the threat of the new Covid-19 variant.

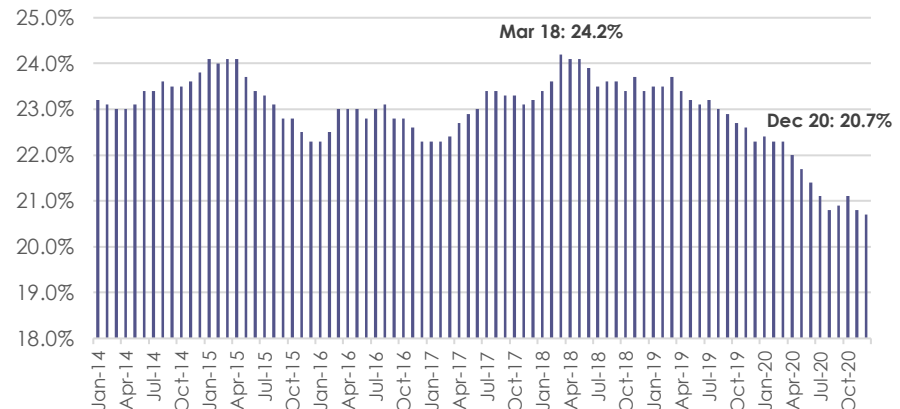
- ✓ Bursa had a bad start for the year as international investors dumped RM852.5 million net on the first trading day of the year.
- ✓ Nevertheless, offshore funds have been net buyers for six straight trading days, from 7 January 2021 to 13 January 2021.
- ✓ The Prime Minister made the announcement of the MCO at 6pm on Monday, 11 January 2021 and foreign investors still entered Bursa at a tune of RM101.9 million net of local equities on the day after.
- ✓ Meanwhile, the foreign ownership in terms of percentage of Bursa Malaysia's market capitalization stood at 20.7% in December 2020 compared to 22.4% in January 2020. This is in conformity with the foreign net outflow of RM24.6 billion recorded in 2020. In fact, Bursa Malaysia has experienced foreign net outflows for three consecutive years.
- ✓ While the latest bout of foreign net inflows is still too early to gauge whether or not it is sustainable moving forward, the current trend is perhaps a good starting point for foreign funds to slowly stage a return to Bursa Malaysia.
- ✓ The suspension of parliament prohibits any general elections to be held as highlighted earlier. Therefore, this could ease the current political turbulence that Malaysia is facing. Policy makers will have ample time to redirect their efforts towards ensuring the nation's economic recovery.

Daily Foreign Net Inflow/Outflow (RM Million)



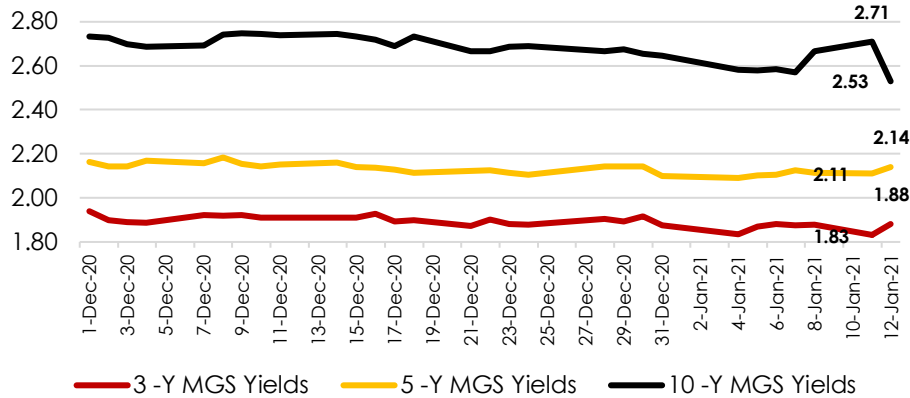
Source: Bursa Malaysia

Securities Market Foreign Ownership In Terms of Percentage of Bursa Malaysia's Market Capitalisation



Source: Bursa Malaysia

Malaysian Government Securities Yields (%)



Sources: Bloomberg, Bank Negara Malaysia
 Note: As at 12 January 2021

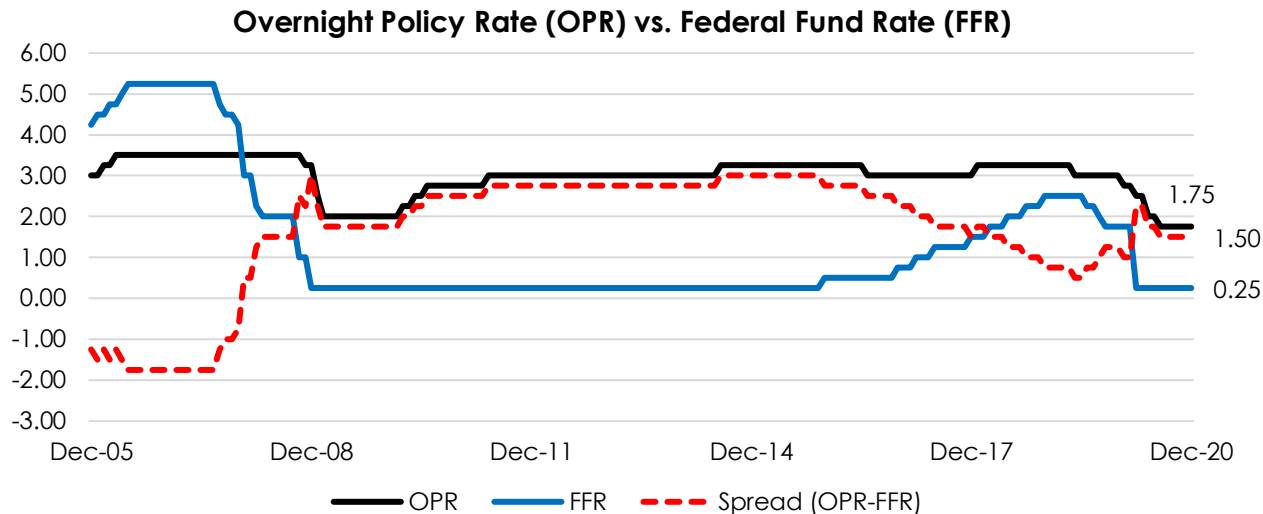
USDMYR



Sources: CEIC, DOSM
 Note: As at 13 January 2021

- ✓ In terms of MGS yields, 3-Y MGS and 5-Y MGS yields were higher on 12 January 2021, a day after the MCO announcement, reaching 1.88% (11 January 2021: 1.83%) and 2.14% (11 January 2021: 2.11%) respectively. In contrast, the 10-Y MGS yields declined to 2.53% on 12 January 2021 from 2.71% on the previous day.
- ✓ The rise in yields of 3-Y and 5-Y MGS is in line with the higher buying interest in the equity market indicated by the foreign net inflow of RM101.9 million net on 12 January 2021.
- ✓ Notwithstanding this, any increased volatility in the markets exerted by the Covid-19 pandemic especially due to possible delays in vaccine distribution, investors could turn back to the safe-haven assets such as the bond market. As a result of the influx of investors in the bond market, yields of MGS will face downward pressure.
- ✓ Turning to the foreign exchange market, the Ringgit appreciated by 1.8% against the US Dollar in 2020, settling at 4.020 on 31 December 2020, the strongest level since 25 June 2018.
- ✓ Meanwhile, the fluidity of the domestic political landscape has led to some depreciation in the Ringgit against the US Dollar. Thus far in 2021, the Ringgit has depreciated by 0.5% against the greenback as at 13 January 2021.
- ✓ On further scrutiny, the Ringgit weakened slightly by 0.1% against the greenback a day after the MCO announcement but later rebounded by 0.3% on 13 January 2021 as investors digested the declaration of the state of emergency.
- ✓ Looking ahead, any further downgrade in the nation's credit rating would pose downward pressure on the Ringgit.

- ✓ Finance Minister Datuk Seri Tengku Zafrul Abdul Aziz mentioned that the government could roll out more fiscal stimulus to keep the country's economic recovery on track amid the latest MCO. Aside from that, the minister noted that there is sufficient domestic liquidity to support any additional fiscal stimulus to support lives, livelihoods and businesses, if necessary.
- ✓ However, one important matter to take into consideration in structuring policies is the country's credit rating. Recall that the government has rolled out stimulus packages worth RM305.0 billion in 2020 in response to the Covid-19 crisis and a record federal budget valued at RM322.5 billion for this year.
- ✓ As such, the government will have to manage the fiscal deficit or otherwise another rating downgrade will happen.
- ✓ With that in mind, there is a high likelihood that the country will lean more towards the monetary support whereby the **overnight policy rate (OPR) would be reduced between 25 to 50 basis points this year** as the reimposition of the MCO will likely have significant bearing on human mobility. Therefore, we are expecting a cut in the OPR from 1.75% to 1.50% by Bank Negara Malaysia in the upcoming Monetary Policy Committee meeting on 20 January 2021.



Sources: Bloomberg, Bank Negara Malaysia

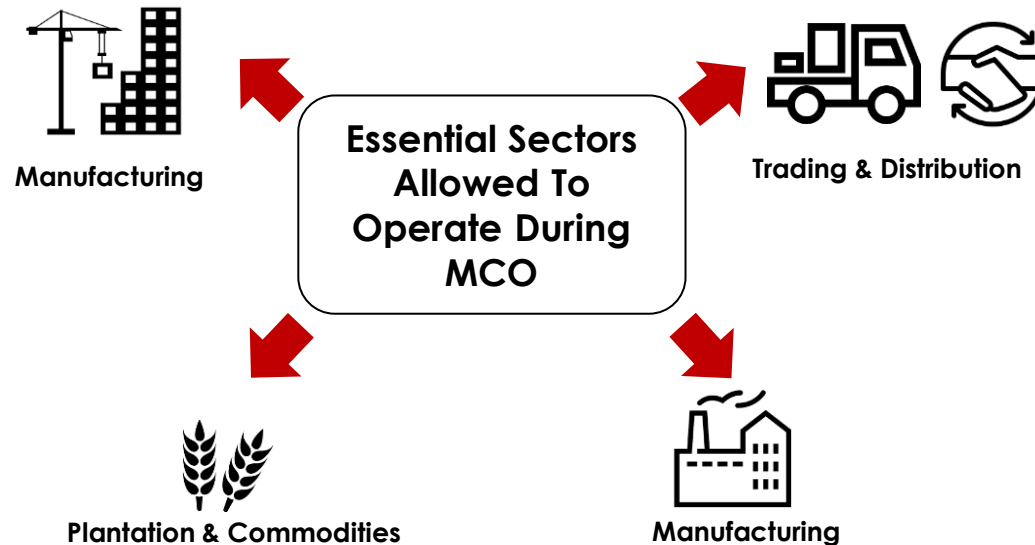
IMPACT OF MCO ON MACRO AND FINANCIAL MARKETS

Macro Economic Variable	2020	Previous forecast of 2021	2021 Forecast after considering MCO	Remarks
GDP	-5.5%	7.3%	4.0%	GDP was envisaged to grow by 7.3% initially. Taking into account of high number of Covid-19 cases, GDP was then expected to only grow by 5.0% prior to the MCO announcement. With MCO likely to be extended to one month, we envisage that GDP will grow by 4.0% in 2021.
FBM KLCI Index	1,627 points	1,750 points	1,715 points	The expected corporate earnings recovery may be capped by the threat of the new Covid-19 variant.
MGS 3-Y Yields	1.88%	2.44%	2.11%	A prolonged period of high Covid-19 infection rates may cause investors to increase their exposure in safe-haven assets such as the bond market. Consequently, an influx of investors into the bond market will push bond prices higher and lower the bond yields.
MGS 5-Y Yields	2.10%	2.63%	2.31%	
MGS 10-Y Yields	2.65%	3.10%	2.76%	
USDMYR	RM4.02	RM4.10	RM3.98	Ringgit is expected to see some speed bumps ahead due to the resurgence in Covid-19 cases but may regain strength from the infrastructure commodity boosting element of the US stimulus package. The additional oil output cuts by Saudi Arabia will likely support oil prices which also bodes well for the Ringgit.
OPR	1.75%	1.75%	1.50%	The country would have to manage manage the fiscal deficit or otherwise another rating downgrade will happen. Therefore, Bank Negara Malaysia could lean more towards monetary support by having lower policy rates.

Sources: Bloomberg, Bank Negara, Bank Islam estimates

Note: USDMYR, FBM KLCI Index, 3-Y,5-Y and 10-Y MGS Yields are year-end figures

- ✓ All in all, the disruptive impact of the new MCO on economic activities should be comparatively less severe than the earlier one as (a rather broad swath of) sectors deemed essential such as manufacturing, construction, services, trade & distribution and plantation & commodities will be allowed to continue operating subject to the approved standard operating procedures (SOPs). Meanwhile, on the demand side, re-imposition of physical movement restrictions (particularly the ban on cross-district travels) would adversely impact both the level, as well as the variety of consumption activities but by a smaller magnitude.
- ✓ We remain cautiously optimistic for 2021 as the situation is expected to be improve albeit with some short-term pitfalls. Anticipation of a slow economic recovery this year will be driven by domestic demand and supported by government spending especially with the highest development expenditure in history.
- ✓ Nevertheless, we are aware of the short-term downside risks such as the resurgence in Covid-19 new cases globally combined with fluid political landscape.



Source: Prime Minister's Office

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A cityscape at sunset with a pink bar at the bottom. The sky is filled with soft, golden light and scattered clouds. The city buildings are silhouetted against the bright sky, and a highway with traffic is visible in the foreground. A solid pink bar runs along the bottom edge of the image.

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