Economic Research

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MALAYSIA: 1Q2020 GDP Performance

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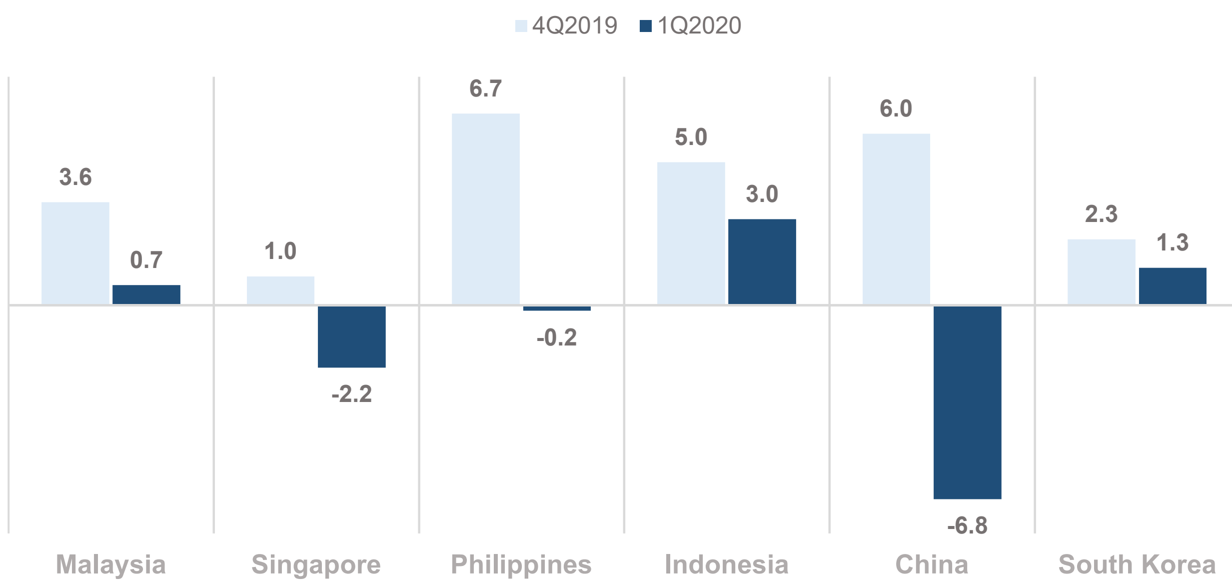
Real GDP by expenditure (% y-o-y)

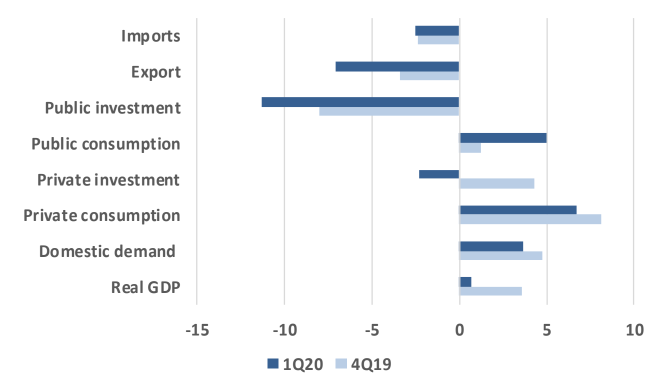
	4Q2019	1Q2020
Real GDP	3.6	0.7
Domestic demand	4.8	3.7
Private consumption	8.1	6.7
Public consumption	1.2	5.0
Private investment	4.3	-2.3
Public investment	-8.0	-11.3
Export	-3.4	-7.1
Import	-2.4	-2.5

Real GDP growth of regional economies (% y-o-y)



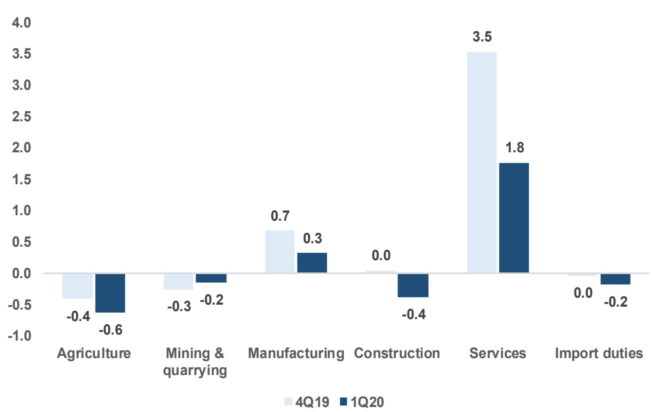
The Malaysian economy in 1Q2020

Chart 1: Real GDP growth (% y-o-y) by expenditure



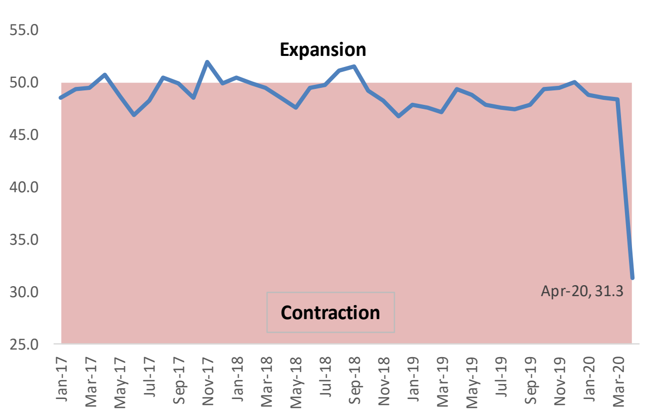
Sources: Department of Statistics Malaysia (DOSM)

Chart 2: Contributions to GDP (percentage points)



Sources: DOSM, MARC Economic Research

Chart 3: Malaysia's PMI

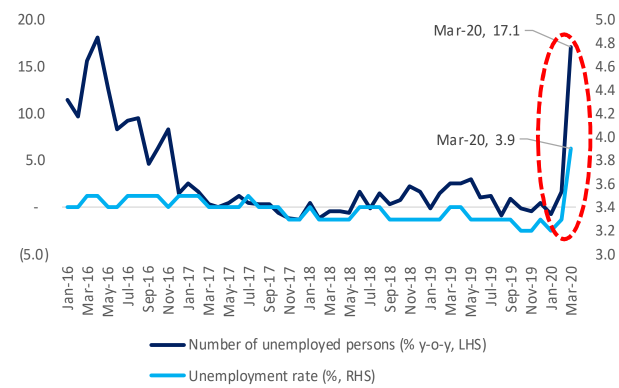


Source: Bloomberg

- The Malaysian economy decelerated sharply at an inflation-adjusted pace of 0.7% y-o-y in 1Q2020 (4Q2019: 3.6%), the weakest growth since 4Q2009. According to Bank Negara Malaysia (BNM), growth moderated due to decreases in both public and private investments as well as net exports. The economy was, nevertheless, supported by public and private consumption.
- On the supply side, a broad-based slowdown was seen across sectors. The services sector, which made up about 58.4% of real GDP, grew at a softer pace of 3.1% (4Q2019: 6.2%). The modest expansion came on the back of a significant moderation to 1.3% in service sales (4Q2019: 7.9%) following a drop in sales of transportation and storage, accommodation as well as arts, entertainment and recreation.
- Similarly, the manufacturing sector's growth slowed to 1.5% (4Q2019: 3.0%). This is in line with the lacklustre purchasing managers' index (PMI), which has remained in a contractionary mode for the past six quarters, as the COVID-19 pandemic badly impacted demand and restricted non-essential firms' operating capacities.
- The mining and quarrying sector was also not spared from the economic slack. In 1Q2020, the sector contracted, albeit at a slower pace, to -2.0% (4Q2019: -3.4%). This is evident by a shallower dip in the industrial production index (IPI) of -1.5% (4Q2019: -3.4%), owing to an increase in the extraction of natural gas.
- Meanwhile, the construction sector declined by 7.9% (4Q2019: 1.0%), the sharpest drop since 2Q1999 as project rollouts and property sales were dragged by the weak market sentiment. Likewise, the agricultural sector also suffered a deeper contraction of 8.7% (4Q2019: -5.7%) mainly due to the decline in oil palm production (-22.0%).
- The overall deceleration of the domestic economy was in tandem with the sluggish global economic performance as countries struggled to keep their economies running while containing the COVID-19 pandemic. Based on Bloomberg's global GDP tracker, the world economy is estimated to have eased by 1.1% in 1Q2020 (4Q2019: 3.2%), the slowest growth in two decades, amid the "worst economic downturn since the Great Depression".

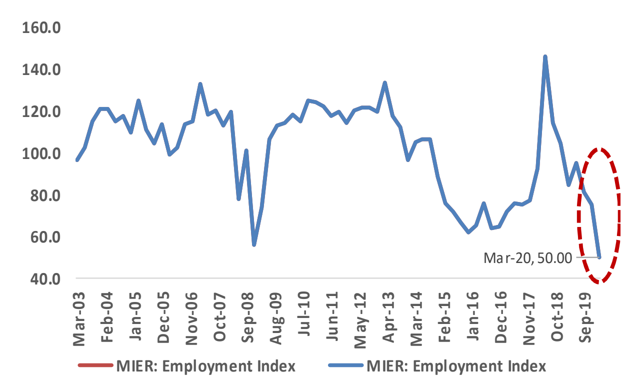
The Malaysian economy in 1Q2020

Chart 4: Malaysia's labour market conditions



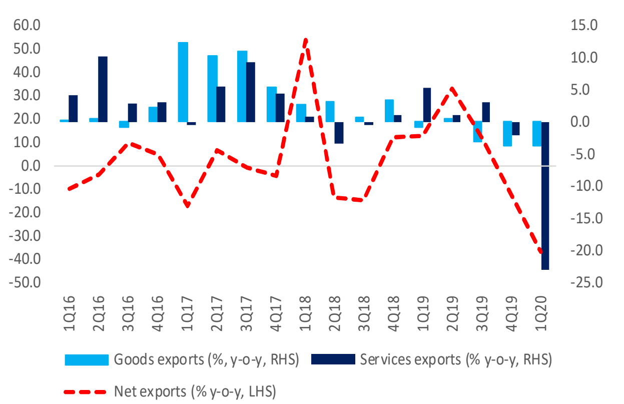
Source: DOSM

Chart 5: MIER's Employment Index



Source: MIER

Chart 6: Goods and services exports (%)



Source: DOSM

- Private consumption was weighed down by the Movement Control Order (MCO), which began towards end-1Q2020 as consumers cut back on discretionary spending and stocked up on essential goods. Retail sales, for example, rose by a meagre 2.1% (4Q2019: 6.9%) due to a decline in automotive fuel, household equipment, cultural and recreation goods whereas sales of food and beverages was somewhat resilient.

- The cautious consumer sentiment was also a result of the deterioration of the labour market. In March 2020, the unemployment rate rose to more than its nine-year high of 3.9% while the number of unemployed persons jumped to a double-digit pace of 17.1%. In addition, the MCO has also negatively affected the informal economy. According to a survey conducted by the DOSM from March 23 to 31, 2020, almost 50% of self-employed Malaysians are out of work while those who are still working saw a 95% drop in income after the MCO was imposed.

- During the quarter, headline inflation averaged at 0.9% (4Q2019: 1.0%), mainly due to the lapse in the remaining impact from the Sales and Services Tax (SST) implementation and lower retail pump prices, which stemmed from the global crude oil price collapse that started in mid-March 2020. In 1Q2020, Brent crude oil price averaged at USD51 per barrel (4Q2019: USD62 per barrel).

- On the external front, net exports continued to shrink with a double-digit growth of 37.0% (4Q2019: -12.4%) as the fall in export growth surpassed that of import. The whopping drop in net export growth was due to a large decline in service exports, which collapsed by 23.1% (4Q2019: -2.2%). Goods exports, on the other hand, fell at a much slower pace of 3.8% (4Q2019: -3.7%) and represented a greater share of total exports at 86.1% (4Q2019: 83.7%) as demand for petroleum as well as electrical and electronic (E&E) products remained strong.

Opinion

- The sharpest moderation in Malaysia's real GDP growth since 2009 has been expected in view of the extreme downward pressure from both global and domestic economies in 1Q2020. Growth performance is in line with other countries such as Singapore (-2.2%), the Philippines (-0.2%) and South Korea (-1.3%). Advanced economies have also not been spared from the slowdown (the US at 0.3%; eurozone at -3.3%).

- The first quarter performance will likely be followed by a contraction in GDP in the subsequent quarter as domestic demand — both private consumption and investment — has been affected by the global lockdown since late March. We expect growth in 2Q2020 to be 2.5 to 3.5 percentage points lower than the 1Q2020 reading.

- The economy was essentially supported by consumer spending in 1Q2020, which contributed more than 500% to headline GDP growth. Other components — investments and net trade — knocked off a few percentage points from growth. This means, going forward, if private consumption falters due to the rising number of the unemployed in subsequent quarters, the economy will likely weaken materially in 2020.

- Investments had already weakened (public investment: -11.3%; private investments: -2.3%) and were not able to cushion the downward pressure in 2020. The declining investment momentum is partly reflected in the amount of corporate bond issuance which has slowed to barely RM22 billion in 1Q2020, down by 17% year-on-year. Should this pace continue throughout the year, the amount of corporate bond issuance will likely fall back to the RM80 billion and RM90 billion range, a level last seen in 2014-2016. Going forward, we foresee a high likelihood of further weakness in private investment due to the new normal business environment which will threaten the GDP growth trajectory for the rest of the year.

- Global investment decisions relating to foreign direct investment (FDI) flows post COVID-19 will be critical in determining the trend of capital formation in many FDI-dependent countries such as Malaysia. Even before COVID- 19, Malaysia's net FDIs had been on a declining trend, down by 30% from its recent peak of RM47 billion in 2016. In the manufacturing sector, net FDI inflows shrank by 49% during the period while those in the mining and quarrying (O&G) sector dropped by 57% from its peak in 2014.

- While Malaysia has introduced various initiatives and benefitted from investments associated with the development of the global supply chain, the country is trailing behind other economies in the region; apart from Indonesia, Malaysia is the only ASEAN-5 country that saw net FDI inflows as a percentage of GDP shrinking between 2014 and 2018 (from 3.1% to 2.4%). On the other hand, during the period, FDI inflows into Thailand rose to 2.7% from 1.2% of GDP, Singapore's was up to 22.5% from 21.8% of GDP, and the Philippines' climbed to 3.0% from 2.0% of GDP.

- With the current new normal business setting and decision making, the future investment landscape will largely determine the trend of Malaysia's FDIs going forward and shape the recovery pattern of the economy. In short, the V-, U- or other recovery patterns will, to a large extent, depend on how the global investment climate pans out in the near future.

- This, however, does not imply that a material pick up in growth is not possible in 2021. A rebound in GDP growth above Malaysia's long-term potential could happen in 2021 given its low-base in 2020. In addition, pent-up demand could spike private consumption in 2H2020 if concerns over the COVID-19 pandemic start to fizzle. The only question is the sustainability of its post-recovery growth.

- External factors will depend on how major economies unfold in the near term. Of importance is China's economic development post-COVID-19. One economic indicator worth watching is its commodity demand for crude oil and liquefied natural gas (LNG). Such developments will provide hints on how global crude oil prices will behave in the next one year.

- The global crude oil market is crucial for the outlook of the Malaysian economy. Studies have shown that for every USD1 increase in Brent oil price: (1) Malaysia's real GDP tends to rise by RM650 million; and (2) the fiscal revenue will improve by RM340 million. As such, a meaningful and sustainable rebound in global crude oil prices will change the outlook of the Malaysian economy going forward.

- We maintain our real GDP growth projections for 2020 at between -1.5% and -3.5%. We foresee a likelihood of a GDP contraction of between 2.0% and 3.0% in 2Q2020 although a minor improvement could take place in 2H2020. In 2Q2020, GDP growth will continue to be dented by: (1) negative trade performance; (2) slumping business conditions; and (3) lacklustre consumer spending growth.

- BNM's further accommodative stance through its recent additional Overnight Policy Rate (OPR) cut by 50bps (to 2.0%) is commendable and able to provide some cushion to the struggling economy. However, given that monetary arsenals have its own limitations, we see less likelihood of further rate cuts for the rest of the year. Reductions in borrowing cost will not likely induce lending significantly if borrowers still face difficulties in getting access to credits.

- It is noteworthy that during recessions, lending by financial institutions normally contract as they undertake measures to protect their bottom lines. For instance, during the 2009 recession, monthly loan approvals for businesses in the banking system contracted by an average 28% between mid-2008 and mid-2009.

- The crux of the matter remains the flow of credit to businesses which is often hindered by banks' lending criteria and guidelines. The need to safeguard banks' credit profile while at the same time continue to infuse capital to businesses to help them survive represents a difficult balancing act at this juncture. Certainly, some sacrifice is needed to ensure profitable businesses continue to survive.

Appendix I: Tables

Table 1: Real GDP growth by expenditure (% y-o-y)

Growth (% y-o-y)	2019					2020
	1Q	2Q	3Q	4Q	Year	1Q
GDP	4.6	4.8	4.4	3.6	4.3	0.7
Domestic Demand	4.5	4.5	3.5	4.8	4.3	3.7
Private Consumption	7.7	7.8	7.0	8.1	7.6	6.7
Public Consumption	6.3	0.3	1.0	1.2	2.0	5.0
Private Investment	0.6	1.5	0.4	4.3	1.6	-2.3
Public Investment	-13.7	-7.8	-14.6	-8.0	-10.8	-11.3
Exports	0.1	0.5	-2.1	-3.4	-1.3	-7.1
Imports	-1.6	-2.3	-3.5	-2.4	-2.5	-2.5

Source: DOSM

Table 2: Contributions to real GDP growth by expenditure (percentage points)

Growth (% y-o-y)	2019					2020
	1Q	2Q	3Q	4Q	Year	1Q
Domestic Demand	4.2	4.3	3.3	4.5	4.1	3.4
Private Consumption	4.3	4.4	4.1	4.5	4.3	3.9
Public Consumption	0.7	0.0	0.1	0.2	0.3	0.6
Private Investment	0.1	0.3	0.1	0.6	0.3	-0.4
Public Investment	-1.0	-0.5	-1.0	-0.7	-0.8	-0.7
Net exports	1.0	1.8	1.4	-0.9	0.6	-3.2

Sources: DOSM, MARC Economic Research

Table 3: Real GDP growth by economic activity (% y-o-y)

Growth (% y-o-y)	2019					2020
	1Q	2Q	3Q	4Q	Year	1Q
GDP	4.6	4.8	4.4	3.6	4.3	0.7
Agriculture	5.8	4.3	4.0	-5.7	2.0	-8.7
Mining & quarrying	-1.5	0.9	-4.1	-3.4	-2.0	-2.0
Manufacturing	4.1	4.3	3.6	3.0	3.8	1.5
Construction	0.4	0.5	-1.4	1.0	0.1	-7.9
Services	6.4	6.1	5.8	6.2	6.1	3.1
Import duties	-19.3	-4.3	34.7	-3.3	-1.2	-16.0

Source: DOSM

Table 4: Contributions to real GDP growth by economic activity (percentage points)

Growth (% y-o-y)	2019					2020
	1Q	2Q	3Q	4Q	Year	1Q
Agriculture	0.4	0.3	0.3	-0.4	0.1	-0.6
Mining & quarrying	-0.1	0.1	-0.3	-0.3	-0.2	-0.2
Manufacturing	0.9	1.0	0.8	0.7	0.8	0.3
Construction	0.0	0.0	-0.1	0.0	0.0	-0.4
Services	3.6	3.5	3.3	3.5	3.5	1.8
Import duties	-0.3	-0.1	0.3	0.0	0.0	-0.2

Sources: DOSM, MARC Economic Research

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