Economic Research

MARC

MARC Ratings Berhad
202001041436 (1397757-W)

MARC Research | **19 January 2022**

2022 Economic Outlook

NORMALISATION AMID RISING DOWNSIDE RISKS

Firdaos Rosli
+603-2717 2936
firdaos@marc.com.my

Quah Boon Huat
+603-2717 2931
boonhuat@marc.com.my

Summary

GLOBAL ECONOMY

- Once again, the emergence of another COVID-19 variant – Omicron – in late November 2021 rattled the global economy. It sent shivers to the spine of global markets, and sentiments surrounding global growth in 2022 may end up being no different than how it was a year ago. As it stands, all multilateral development banks' (MDBs) projections suggest dissipating low-base effects in 2022. But some estimates did not anticipate the impact of the new variant on the global economy, thus tilting the risks downwards. We believe that governments will only resort to, unless they must, mild mobility restrictions to curb the spread of Omicron or subsequent COVID-19 variants considering high vaccination rates globally. Besides, the advent of pharmaceutical interventions of late has helped to reduce the risk of governments resorting to strict mobility restrictions in 2022.

MAJOR ECONOMIES

- The US economy is expected to fare well in 2022, albeit not as great as projected earlier. We also believe that despite the rising daily COVID-19 cases in recent weeks, the Biden administration will not resort to strict mobility restrictions that would risk policy normalisation in the coming months. Besides, US President Biden's Build Back Better (3B) plan would stall if the US economy took a beating amid Omicron's spread.

- Although China has done tremendously well in combatting COVID-19, the year 2022 will be the litmus test to China's "zero-COVID" policy amid a slowing growth momentum. In 2022, the Chinese economy will grow between 5.1% to 5.6%, the unemployment rate will remain below 4%, but inflation will pick up amid supply pressures. That said, the silver lining to growth in 2022 will be China's participation in the Regional Comprehensive Economic Partnership (RCEP) which will boost exports to other signatory member countries.

- The European Central Bank (ECB) expects the gross domestic product (GDP) growth of the Euro area to return to the pre-pandemic level as early as 1Q2022, supported by FY2022 projections of 4.2% following a rebound of 5.1% in 2021. The inflation rate of all items, excluding tobacco, was at its highest since the formation of the monetary union at 5.0% in December 2021. Hence, we believe that despite the Euro area's high debt-to-GDP ratio, ECB will remain its accommodative stance to allow fiscal policy to do much of the heavy lifting in pursuing growth in 2022. There are key elections to look for in France, Portugal and Italy in the year as well.

ASEAN

- Following a strong rebound from -5.4% in 2020 to 7.2% (based on advance estimates) in 2021, the Singaporean government expects the economy to expand at a slower pace of between 3.0% and 5.0% in 2022. Similar to other major economies globally, the waning favourable low base effects contribute to the slowing growth while inflationary pressures have been building up as a significant threat to growth this year. A tighter monetary policy is expected amid the spread of the Omicron.

- Unlike growth forecasts of many global economies, MDBs believe that Indonesia will record a higher growth in 2022 than a year earlier. In 2021, its inflation rate was below Bank Indonesia (BI)'s lower bound target of 2%, unemployment remained high while household debt-to-GDP declined, suggesting a weak demand to rebound from the pandemic year. In 2022, we believe that the Indonesian economy is poised for stronger growth, but sluggish private consumption and commodity-dependent trade dynamics may challenge existing forecasts.

- For 2022, the Bank of Thailand (BOT) expects the Thai economy to expand by 3.4% (FY2021(e): 0.9%) on the back of increased domestic spending and gradual improvements in foreign tourist arrivals. We foresee downside risks to growth in 2022 amid the Omicron. We could likely see the economy contracting again in 2022 if the Omicron leads to new stringent containment measures and border closures. Meanwhile, BOT maintains its key interest rate at its record low of 0.50% but not for much longer amid inflation pressures.

- Asian Development Bank (ADB) latest forecasts a big jump in Viet Nam's GDP growth in 2022 of 6.5% versus 2% in 2021. The economy has been gradually reopened following rapid vaccination rollout since mid-2021. We think that Viet Nam is in good stead towards stronger growth, despite the Omicron, as its labour market is still robust. Its good-run trade surplus prospects are waning, but its strong trade linkages via RCEP and other major economies may bolster growth in 2022.

MALAYSIA

- As it stands, the International Monetary Fund (IMF) and ADB forecast the Malaysian economy to fare better in 2022 than a year earlier. However, in its January 2022 estimates, the World Bank expects Malaysia's growth in 2022 to come in higher at 5.8%. We believe Malaysia is on a good run to a firmer growth at 5.5%, but headwinds hinge heavily on pandemic-related uncertainties and scarring effects.

- Our 2022 forecast sits at the bottom of the government's growth range of 5.5% and 6.5%. As all states are now in the final phase of the National Recovery Plan (NRP), we assume that further lockdowns, if any, and COVID-19 resurgences will not hinder Malaysia's economic reopening. We see growth primarily driven by a rebound in domestic demand, thanks to rising private consumption and a gradually improving labour market. We expect the government to continue assisting vulnerable households, which will help support consumer spending to some extent.

- For 2022, we expect private investment growth to come in at 6.7% (2021E: 5.0%), and the unemployment rate will likely improve to 4.2% in 2022 (2021E: 4.6%). Subsidies and price control mechanisms will keep inflation at bay (2022F: 2.2%; 2021E: 2.5%).

- There is a slight chance Malaysia could face a monetary policy decision dilemma in 2022. Suppose the Omicron or other COVID-19 iterations rage on in 2022 as much as Delta did in 2021, or even more. And suppose global supply chain shocks cause inflation to surge even higher while hampering domestic recovery. If the worst comes to the worst, we expect Bank Negara Malaysia (BNM) to clamp down on inflation to maintain price stability and risk choking off growth. In any case, we expect BNM to start normalising monetary policy in 2H2022 against the backdrop of a gradually recovering economy by raising the overnight policy rate (OPR) by 25 basis points.

- If strong growth remains an issue, fiscal vulnerabilities will rise further as fiscal policy remains the primary tool to catalyse growth in 2022. With the emergence of Omicron, we think it is unlikely that the government will be able to meet its fiscal deficit target of 6.0% of GDP this year (2021E: 6.5%). Malaysia's relatively deep domestic savings pool and the small share of foreign currency-denominated debt provide some relief in the issue of debt sustainability for now. We see more negative rating pressure ahead if existing debt-to-GDP and debt-service matrices hold for the mid-to-long term.

GLOBAL ECONOMY: LOW BASE DISSIPATING

Another variant of concern

In late November 2021, the world was shaken by yet another COVID-19 discovery, labelled as a "variant of concern" by the World Health Organisation. Since then, several countries worldwide have reported confirmed cases of the Omicron, including in Malaysia.

The return of mobility restrictions

Countries were initially hesitant to reimpose travel restrictions. As the number of cases soared, countries in the northern hemisphere eventually resorted to mobility restrictions, thus suffocating recovery as the global economy entered the festive season. What was supposed to be a recovery year in 2021 turned into a dramatic turn of events, and sentiments surrounding the global economy had continued to face pressure.

Keeping up with the dynamics

The global economy's projections necessitate a more frequent update to keep up with the rapidly changing dynamics of mobility restrictions. As it stands, not all MDB's forecasts anticipated the spread of Omicron or any iterations of COVID-19 following Delta.

Dissipating low base effects

The International Monetary Fund (IMF)'s October 2021 projections expect the global economy to grow slower in 2022 at 4.9% compared with 5.9% in 2021. Mirroring the trend of previous years, growth in the emerging markets (EMs) will come in at 5.1% versus 4.5% in advanced economies. Spain (6.4%) and the US (5.2%) will lead the pack among advanced economies, whereas large EMs, namely China and India, will grow at 5.6% and 8.5%, respectively.

Pessimistic World Bank's forecast

At the time of writing, the World Bank's projections appear to be somewhat more pessimistic than the IMF's. The former's January 2022 forecast for the global economy is 4.1%, which is 0.2% lower than its June 2021's numbers. Advanced economies are expected to grow at 3.8%, whereas the emerging markets and developing economies (EMDEs) will record 4.6%.

Non-OECD member countries are expected to perform better

The OECD's December 2021 projections point to a global economic growth of 4.5%, nearer to that of the World Bank's. G20 countries are expected to grow at 4.7% in 2022 versus 5.9% a year earlier. Meanwhile, OECD member countries are expected to expand by 3.9% compared with non-OECD countries at 4.9% in 2022.

ADB expects developing Asia to grow at 5%

The Asian Development Bank (ADB)'s Outlook Supplement in December 2021 projects that developing Asia will record 5.3% growth, which is a mere 0.1% deviation slower than its previous forecast in September 2021. The bank noted China's slowing growth in 2022, marked by supply disruptions, of 5.3%. On the other hand, India is slated to record a strong performance in 2022, with GDP growth to come in at 7.5%. Southeast Asia is expected to perform better in 2022 at 5.1% than in 2021 (3.0%).

Table 1: Global real GDP projections by international agencies

	IMF		World Bank		OECD		ADB	
	2021	2022	2021	2022	2021	2022	2021	2022
World	5.9	4.9	5.5	4.1	5.6	4.5	-	-
Advanced Economies	5.2	4.5	5.0	3.8	-	-	-	-
US	6.0	5.2	5.6	3.7	5.6	3.9	5.5	3.9
Euro Area	5.0	4.3	5.2	4.2	5.2	4.3	4.8	4.5
EMDEs	6.4	5.1	6.3	4.6	-	-	-	-
China	8.0	5.6	8.0	5.1	8.1	5.1	8.0	5.3
India	9.5	8.5	8.3	8.7	9.4	8.1	9.7	7.5

Sources: IMF, World Bank, OECD, ADB
Note: These forecasts reflect different reporting times

Table 2: ASEAN real GDP projections by international agencies

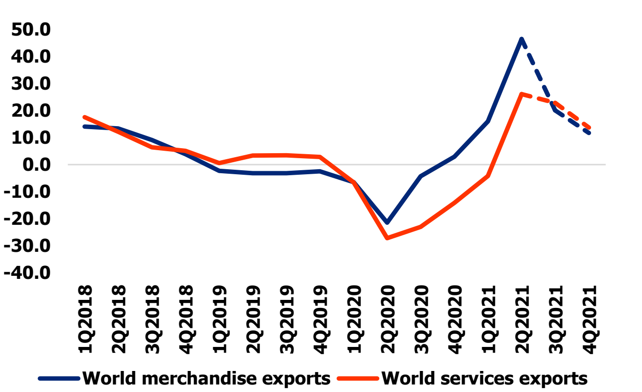
	IMF		World Bank		ADB	
	2021	2022	2021	2022	2021	2022
ASEAN-5	2.9*	5.8*	-	-	3.0	5.1
Malaysia	3.5	6.0	6.0	4.2	3.8	5.9
Indonesia	3.2	5.9	4.4	5.0	3.5	5.0
Philippines	3.2	6.3	4.7	5.9	5.1	6.0
Singapore	6.0	3.2	-	-	6.9	4.1
Thailand	1.0	4.5	2.2	5.1	1.0	4.0
Viet Nam	3.8	6.6	6.6	6.5	2.0	6.5

Sources: IMF, World Bank, ADB
**Including only Indonesia, Malaysia, Philippines, Thailand, and Vietnam*

Mobility curbs to put some pressure on aggregate demand and oil prices

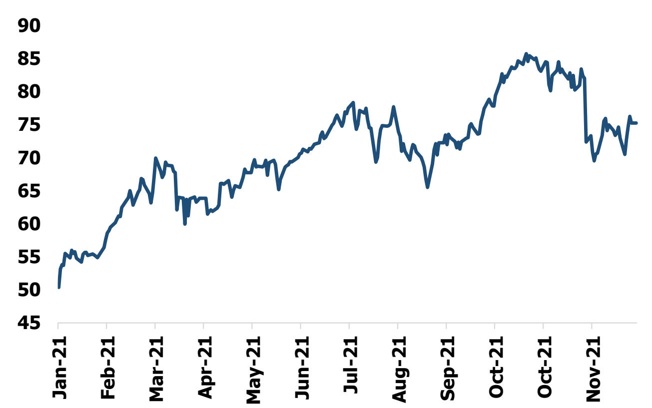
Brent crude is trending circa USD84 per barrel at the time of writing. In 2022, the International Energy Agency (IEA) expects the average Brent crude oil price to come in at USD79.40 per barrel. In contrast, the US Energy Information Agency (EIA) assumes an average of USD70 per barrel. The tightening of movement restrictions at the global scale will inevitably suppress the aggregate demand and oil prices but not at the level seen in 2020.

Chart 1: World merchandise and services exports (% y-o-y)



Sources: UNCTAD, MARC Ratings

Chart 2: Brent crude oil prices (USD per barrel)



Sources: US Energy Information Administration, MARC Ratings

Omicron's focus – transmissibility over severity

Policymakers appear to focus on transmissibility, rather than the severity of Omicron, to err on the side of caution. As a knee-jerk reaction, countries may choose to deploy similar non-pharmaceutical intervention policies as seen in 2020 and 2021. This scenario will thwart recovery and exacerbate the ongoing inflationary pressures amid acute supply constraints. The probability of deploying lockdowns is high, but only if the present pharmaceutical intervention is inadequate or too slow in removing the health risks associated with the latest variant. In any case, we believe that the global economy will gradually recover in 2022, but post-lockdown externalities will linger and become a more prominent policy issue in the year.

Global merchandise trade to experience double-digit rebound

The United Nations Conference on Trade and Development (UNCTAD)'s Handbook of Statistics 2021, released in early December 2021, expects a double-digit rebound in global merchandise trade in 2021 at 22.4% versus a contraction of 7.4% in 2020. While global merchandise trade has already surpassed pre-pandemic levels in 2021, services trade is still trending below the said benchmark despite growing at 13.6% in the year. Uneven global recovery means that global trade will continue to remain uncertain in 2022 amid headwinds in pandemic response and limited elbow room for further stimulus.

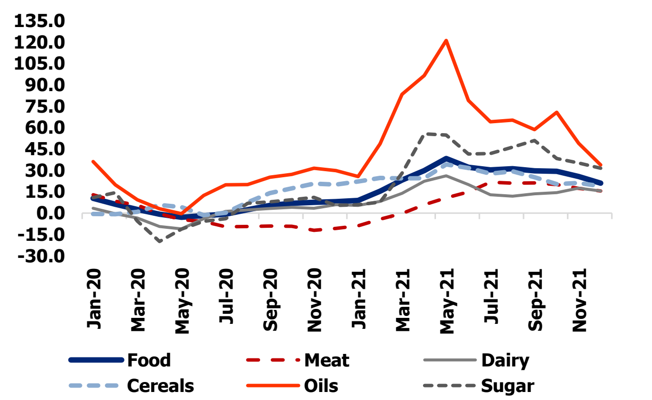
Soaring inflation

According to World Bank data, world inflation trended downwards from 2.4% in 2018 to 1.9% in 2020 amid global trade tensions and the pandemic. In recent months, rapid vaccination rollout and economic reopening have sent inflation soaring to multi-decade highs, prompting global central banks to become increasingly hawkish by the day. However, rising global food inflation deserves closer attention than headline inflation alone. In its early December 2021 release, the Food and Agriculture Organization of the United Nations (FAO) noted that The FAO Food Price Index (FFPI) has been increasing since May 2020. November 2021's FFPI was at its highest level in more than a decade, while all food indices inch higher on a month-to-month basis. Meanwhile, Oil Price Index trended higher than others amid higher commodity prices during the same period.

Monetary policy tightening prospect

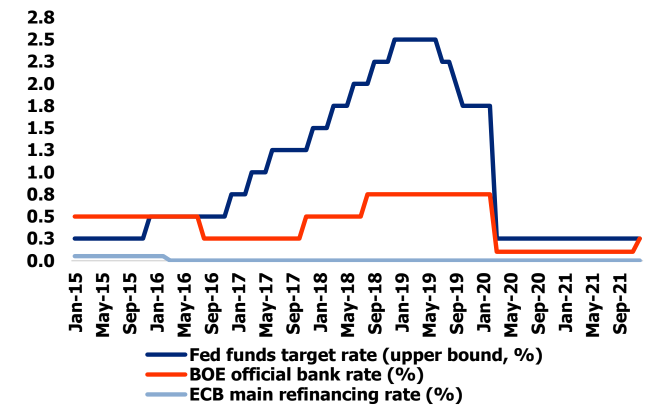
Ultra-loose monetary policy will not stay for much longer. On 16 December 2021, the Bank of England became the first major central bank to raise interest rates from 0.1% to 0.25%, the first of such hike in more than three years. While the US Federal Reserve slows down its bond-buying programme and prepares for its first rate hike since the pandemic started, other major central banks, apart from the European Central Bank, are actively positioning for tightening as early as 1Q2022. Although the end of COVID-19 is nowhere in sight, global central banks have little option but to place the economy highest on its agenda in 2022.

Chart 3: FAO monthly real food prices (% y-o-y)



Sources: FAO, MARC Ratings

Chart 4: Major central banks' policy rates



Sources: Respective central banks

MAJOR ECONOMIES

United States (US): Great expectations

US economy to continue performing well

The US economy is expected to fare well in 2022, albeit not as great as projected earlier. The latest publications by the IMF and the World Bank expect the US economy to record real GDP growth in 2022 at 5.2% and 3.7%, respectively. The OECD and ADB expect the US's growth in 2022 to come in at 3.7% and 3.9%, respectively. While we take note of the differences in projections amid different modelling and the timing of publication, we concur with the projections that the US economy will continue to perform relatively well despite supply chain headwinds.

Vaccinations led to US' labour market recovery

The number of new COVID-19 cases was declining in the lead up to Joe Biden's swearing-in ceremony on January 20, 2021, and the number of daily vaccinations per million people in the US started to rise rapidly thereafter. This allowed the new Administration to rebuild the economy soon after cabinet formation. Both jobless claims and the unemployment rate continued to trend lower, which in turn saw the economy create 1.3 million new jobs, the fastest job growth on record by any past US President in the first 100 days. However, coupled with base effects, the rapid recovery has consequently led to inflation soaring to a level unseen since 1982.

Less likely to reimpose another lockdown

The number of daily new COVID-19 cases has been trending upwards since late-October 2021 and is likely to continue in the coming weeks due to the Omicron. However, we see low probability of another lockdown in the coming months amid The Fed's moves to initiate a liftoff.

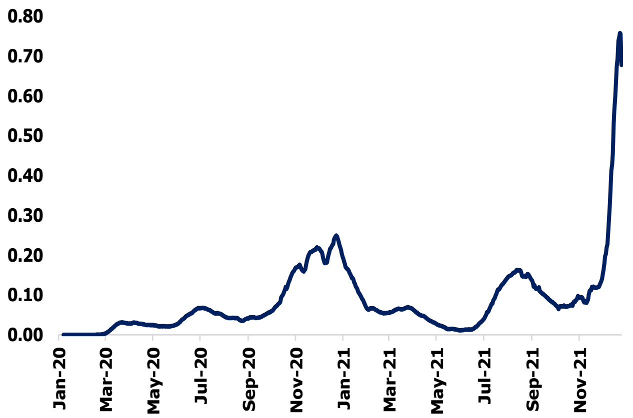
Build Back Better will proceed

The Build Back Better framework has seen its fair share of wins and losses. While it could be argued that the three plans – The American Rescue Plan, Jobs Plan, and Families Plan – did not or have yet to achieve what they initially set to do, US President Joe Biden has managed to muddle his plans through amid a highly polarised and divided political realm. While the Biden administration attempts to create the biggest investment and innovation in the US since World War II, we think that his subsequent plans, most notably the Build Back Better Act, will eventually proceed in 2022 but not without resistance from the conservatives.

The Fed's hawkish move

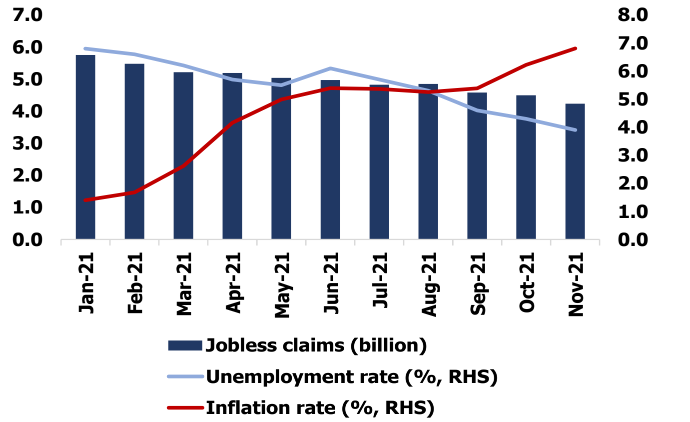
Surging inflation has prompted members of the Federal Open Market Committee (FOMC) to become increasingly hawkish over the past months. The US Federal Reserve "dot-plot" in June 2021 suggested that FOMC members were in favour of holding the fund rate steady until after 2022. However, its December 2021 meeting's diagram suggests three rate hikes in 2022 are highly likely. The Fed has already begun the bond purchases tapering and is expected to end by 1Q2022, which means a rate hike will commence in 2Q2022, if not earlier. While this is indeed an indication that the US economy is overheating rapidly following the pandemic, the same cannot be said for EMs due to the heightened risk of capital flight. All eyes are on the possible impact of the Omicron spread in the US, which may delay the economy's move towards a more robust recovery path.

Chart 5: US' daily COVID-19 cases (million, 7-day moving average)



Sources: CEIC, MARC Ratings

Chart 6: US' jobless claims, unemployment and inflation rates



Sources: US Bureau of Labor Statistics, US Department of Labor, MARC Ratings

China: Slowly but surely

Zero-COVID policy slows everything down

In 2021, the authorities' "zero-COVID" policy worked tremendously well, notwithstanding intermittent spikes in daily new COVID-19 cases that were well below levels seen in 2020. Even with China's population size of over 1.4 billion people, the number of new COVID-19 cases trended extremely low at double-digit throughout most of 2021. New daily COVID-19-related deaths were nil in most months of the year. New COVID-19 cases are dominated mainly by imported cases, suggesting that the situation on the ground is controlled yet very effective in combatting the spread of the virus.

Chinese economy is expected to grow at 5.4% in 2022

The Chinese economy was the only major economy that "escaped" contraction in 2020. For 2021, an eight per cent GDP growth is well within reach despite supply-side disruptions and regulatory crackdowns, most notably in the second half of the year. In 2022, however, the IMF forecast China to record GDP growth of 5.6%, with the unemployment rate to remain low at 3.7%. The World Bank estimates the Chinese economy to grow at 5.1% in 2022, which is 0.3% lower than its June 2021 estimates. Latest projections by OECD and ADB forecast that China will grow at 5.1% and 5.3%, respectively, in 2022.

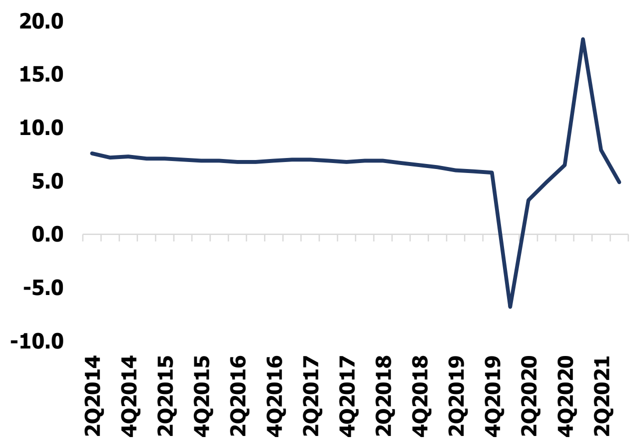
Uptrend in PPI but low trend in CPI

Although China's producer price index (PPI) growth has continued to trend high at double-digits since 4Q2021 amid the rise in energy and raw material prices, consumer prices have remained relatively low. The country's unemployment rate will stay low and stable throughout 2022 at below 4%.

Economic rebalancing efforts will intensify in 2022

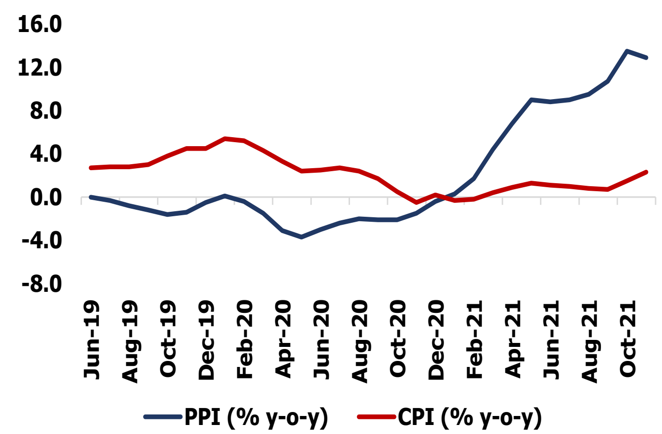
In recent months, the authorities' regulatory crackdowns appeared to be deliberate, and consonant with China's Dual Circulation Strategy unveiled in 2020. As mentioned earlier, the slowing down of y-o-y GDP growth in 3Q2021 (4.9% versus 7.9% in 2Q2021) was primarily internally driven with the rebalancing of short-term growth for long-term gains in sight. As such, we think that China's economic rebalancing efforts will intensify in 2022, as it prepares for the eventual application to join the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) – a plurilateral trade agreement of 11 Asia-Pacific Economic Cooperation (APEC) member economies. Reforms relating to high-quality trade issues, such as state-owned enterprises, intellectual property rights, labour, and environmental standards, amongst others, will take centre stage. At the same time, short-term growth is slowing for now. In any case, the growth of trade with its regional trading partners will be healthy following the Regional Comprehensive Economic Partnership (RCEP) 's entry-into-force starting January 1, 2022.

Chart 7: China's real GDP growth (% y-o-y)



Sources: CEIC, MARC Ratings

Chart 8: China's prices growth



Sources: CEIC, MARC Ratings

Euro Area: Dovish, still?

ECB highlighted the need for monetary accommodation in 2022

The European Central Bank (ECB) expects the GDP growth of the Euro area to return to pre-pandemic levels as early as 1Q2022, supported by FY2022 projections of 4.2% following a rebound of 5.1% in 2021. The OECD is also projecting somewhat similar economic growth at 4.3% in 2022. Notwithstanding the rosy picture of the Euro area in the coming year, the ECB on December 16, 2021 highlighted that monetary accommodation is still needed to support the economy, but a "step-by-step" asset purchases reduction will be more apparent in the quarters to come.

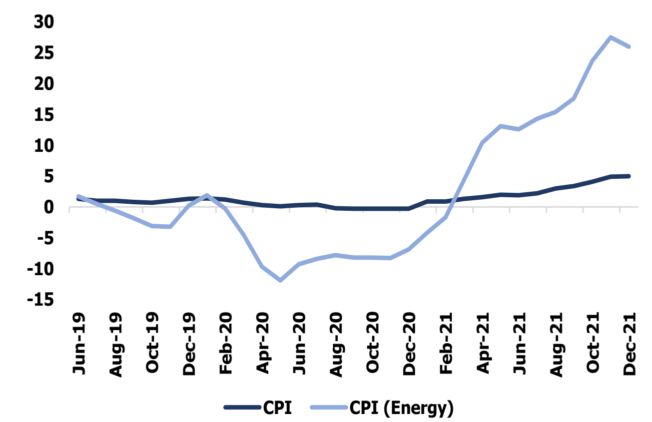
Record-breaking inflation

The inflation rate of all items, excluding tobacco, has been on a rollercoaster ride in the past year. It went down to the lowest since the 2008/2009 Global Financial Crisis of -0.48% in December 2020 and up to 5% in December 2021, the highest since the formation of the monetary union. Much of this was due to rapid rise energy prices, coupled with a strong labour market performance as the unemployment rate continued to fall since 3Q2020. However, consumer confidence fell by 8.3% in December 2021 as the Omicron pushed daily COVID-19 cases at a record-breaking pace since the pandemic started. Besides, the Euro area's growth in 2022 may not only face headwinds from high inflation and Omicron, it may in fact also be compounded by EU-China trade and political tensions in eastern Europe.

Euro Area press for higher growth rates

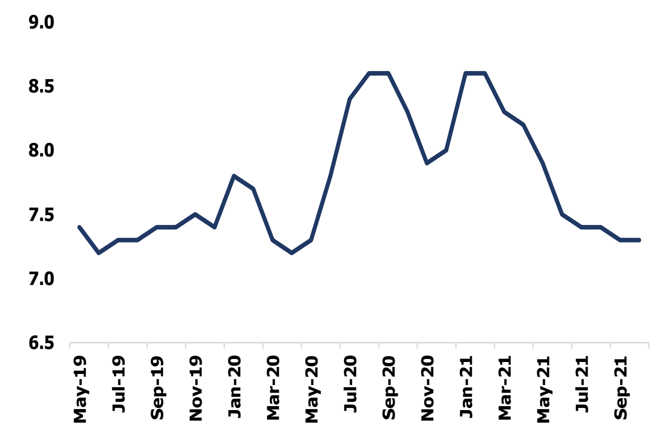
The Euro area recorded a debt-to-GDP ratio of 98.3% in 2Q2021, a slight dip from 100% in the previous quarter. It appears that the Euro area is no longer interested in pursuing austerity measures to address the rising public debt but to press for higher growth rates instead. The Multiannual Financial Framework 2021-2027 and NextGenerationEU funds amount to a total of €2.018 trillion in stimulus; it will be interesting to see how they progress in the coming years. Besides, the political scene in the region will continue to evolve following newly sworn-in German chancellor Olaf Scholz. France and Portugal will face major elections, while the Italian parliament will vote for a new President in 2022.

Chart 9: Euro Area's Consumer Price Index (% y-o-y)



Sources: Eurostat, MARC Ratings

Chart 10: Euro Area's unemployment rate (% y-o-y)



Sources: Eurostat, MARC Ratings

ASEAN

Singapore: More tightening in 2022

Singapore grew by 7.2% in 2021 (MTI's advance estimates)

According to the Ministry of Trade and Industry's (MTI) advance estimates, Singapore's 4Q2021 GDP expanded by 5.9% y-o-y, which was lower than the previous quarter's 7.1% expansion. For full year 2021, the Singapore economy is estimated to grow by 7.2%, a significant jump from 2020's contraction of 5.4%.

Omicron resulted in lower than estimate 4Q2021 GDP

The last quarter's slower GDP growth pace had been expected. Besides the emergence of the Omicron that had played havoc with plans to relax entry restrictions for multiple countries and ease some domestic controls, the economy had also been facing waning favourable low base effects. Singapore's full year 2021 GDP growth pace would be the fastest in over a decade, and as such, will more likely than not prove to be unsustainable going into 2022. Besides the expected impact of rising global daily cases of Omicron infections pushing back global demand, we see global trade normalising.

Merchandise trade to slow down in 2022

As it is, forecasts by the World Trade Organization (WTO) show merchandise trade volume growth will slow down to 4.7% in 2022 from last year's expected 10.8%. Against this backdrop, it is likely that Singapore's services sector will start play a larger part in leading growth as domestic demand momentum, just like external demand conditions, continues to improve.

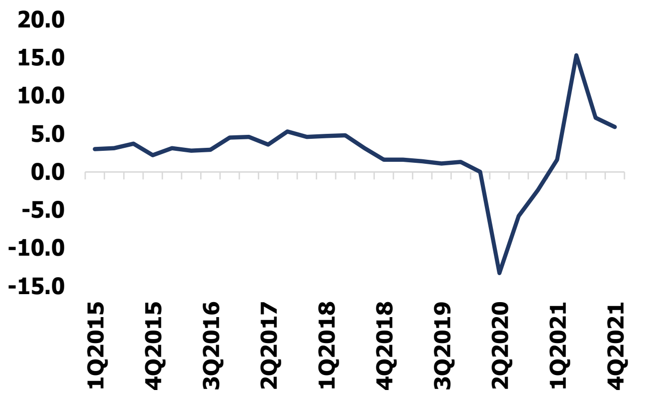
Stable and resilient recovery expected by the Singapore's government

Meanwhile, the government expects the economy to expand at a slower pace of between 3.0% and 5.0% in 2022. While the expected GDP growth pace may be slower, indications are that the government expects the recovery to be stable and resilient. And with the economy gradually reviving from the COVID-19 crisis, the government has, among other things, indicated that it will have to start moving on its planned Goods and Services Tax (GST) hike in Budget 2022.

We foresee additional monetary tightening in 2022

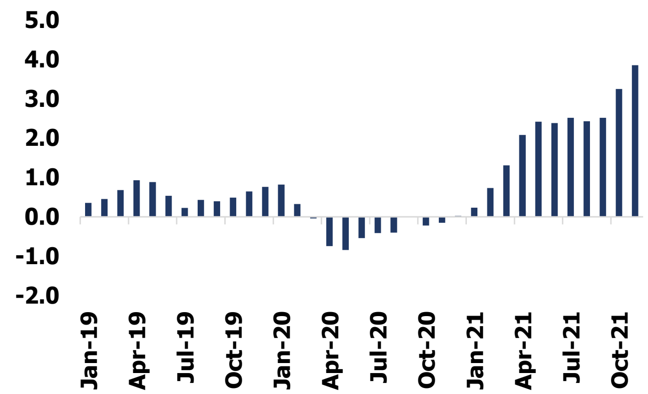
It is evident that inflation is being perceived, and rightly so, as a major threat to growth. The Monetary Authority of Singapore (MAS) had unexpectedly tightened monetary policy at its October 2021 meeting amid rising inflationary pressures driven by supply constraints and the global economic recovery. We see Singapore's headline inflation for November, which had risen by 3.8%, the fastest since February 2013, further feeding into the fear that rising consumer prices could threaten growth. It is thus very likely that the Singapore central bank, following in the footsteps of some major central banks, will further tighten monetary policy at its next monetary policy meeting in April 2022.

Chart 11: Singapore's real GDP growth (% y-o-y)



Sources: MTI, MARC Ratings

Chart 12: Singapore's Consumer Price Index (% y-o-y)



Sources: CEIC, MARC Ratings

Indonesia: Rupiah will be under pressure

Indonesian economy is on track towards a sturdier recovery

The ADB expects Southeast Asia's only G20 member to record a higher GDP growth pace of 5.0% in 2022 versus an estimated 3.5% in 2021. This projection falls fittingly within Bank Indonesia (BI)'s 2022 real GDP growth projection of between 4.7% to 5.5% but lower than Anggaran Pendapatan dan Belanja Negara (APBN)'s estimate of 5.2%. However, the IMF's October 2022 projections expect the economy to grow even higher than other estimates at 5.9% in 2022. These projections suggest that the Indonesian economy is on track towards a sturdier recovery, but the recent first case of locally transmitted Omicron may pose significant challenges to growth in 2022.

Inflation trending below 2% since 2H2020

Unlike most major economies, Indonesia seemed to have "escaped" the brunt of high prices following the global economy's rebound. Its headline inflation has been trending below 2% since 2H2020, well below the 3% inflation target set by BI, while the producer's price index (PPI) trends circa 2% throughout 2021. Nevertheless, the unemployment rate has remained elevated since 2022, which stood at 6.49% in August 2021.

Low impact from capital flight

Similar to other countries globally, Indonesia's debt-to-GDP remains elevated at 41.02% as of 3Q2021. It should be noted that its sovereign debt is increasingly becoming domestic-driven since the Global Financial Crisis. Amid falling foreign bond holdings since June 2019, we expect low impact from capital flight if it was to happen.

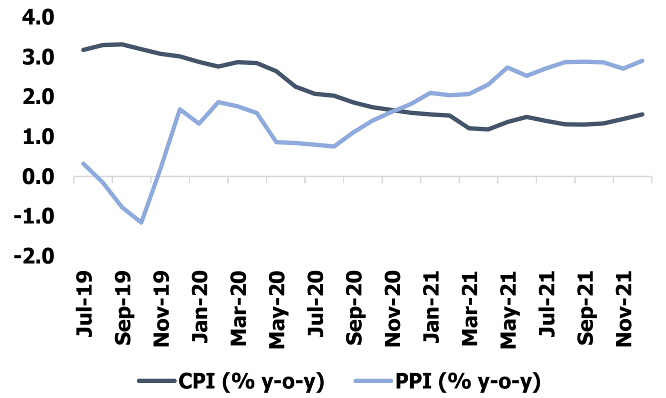
Downtrend in private consumption and household debt-to-GDP may hinder growth

The economy's weakening private consumption and declining household debt-to-GDP may pose challenges to growth in 2022. Although net exports appear to have been bolstering growth in the past months, high commodity prices may not favour Indonesia much longer. This is because the impending US monetary tightening will lead to a stronger greenback and consequently a weaker Rupiah.

"Recover Together, Recover Stronger"

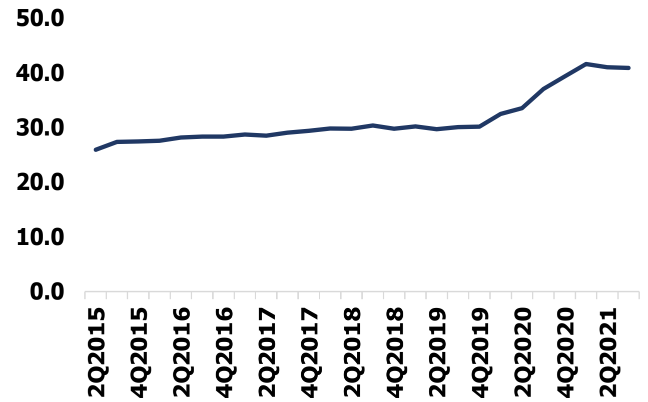
President Joko Widodo will play host in the next G20 Summit in October 2022. With the theme "Recover Together, Recover Stronger", Indonesia is expected to address the glaring recovery gaps among countries, in particular issues relating to the harmful effects of vaccine nationalism, unequal domestic fiscal space, and the lack of critical infrastructures and health capacities to rollout a timely inoculation process.

Chart 13: Indonesia's Producer Price Index (PPI) and Consumer Price Index (CPI)



Sources: Central Bureau of Statistics, CEIC, MARC Ratings

Chart 14: Indonesia's government debt as % of nominal GDP



Sources: CEIC, MARC Ratings

Thailand: Slow recovery momentum

Thailand's economy estimated to be on recovery path in 2022

According to its central bank's latest estimate, Thailand's GDP growth will come in at 0.9% in 2021, up from a contraction of 6.1% in the previous year. For 2022, it expects the economy to expand by 3.4% on the back of domestic spending and gradually improving foreign tourist arrivals. On the supply side of the economy, it expects the various business sectors to recover in line with the improvement of economic activities.

Omicron will be the downside to recovery

While there may be early signs that tourist-reliant Thailand is on the verge of a recovery, we see growth risks heavily skewed to the downside because of COVID-19. We see the Omicron's global surge muting Thailand's recovery and keeping it from achieving its pre-pandemic long-term growth trajectory for longer. In 3Q2021, economic activity had slowed down severely after a major surge in the number of daily infections, even before the emergence of Omicron. As a result, GDP had contracted by 0.3% y-o-y, a significant fall from the previous quarter's expansion of 7.6%.

Border reopening will boost 2022's GDP growth

For the vital tourism sector, the impact has been severe. With Omicron, we think it is optimistic to suggest that the broader reopening of borders to vaccinated foreign visitors on November 1, 2021 – which the government subsequently tightened – will significantly boost GDP growth in 2022. Foreign tourist arrivals, based on the World Bank's 2022 and 2023 projections, will come in at around 7 million and 20 million; notably, these projections are far below 2019's 39.7 million.

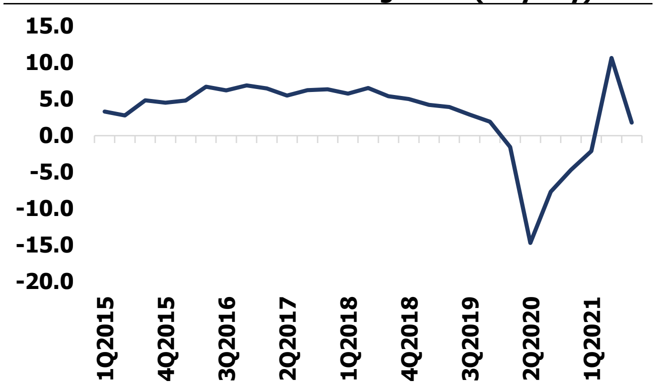
Growth likely to contract

It is likely that we could see the economy contracting again in 2022 if the Omicron leads to new stringent containment measures and border closures. In any case, the central bank's forecast of a 3.4% GDP growth pace in 2022 – even if it bears out – will neither take the economy back to its pre-pandemic level nor erase its negative output gap.

Inflation will be subject to upside risks

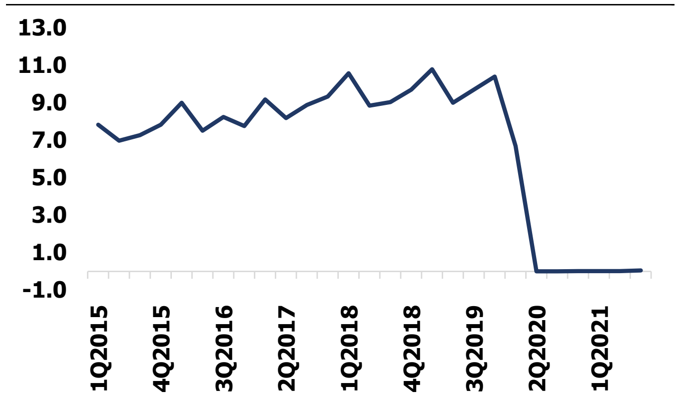
The central bank had on December 22, 2021, kept its key interest rate – the one-day repurchase rate – at its record low of 0.50%, unchanged since May 2020 after three cuts earlier that year. It expects inflation for 2022 to come in well within its 1.0%–3.0% target at 1.7% (2021E: 1.2%). Given global inflationary pressure, however, headline inflation will be subjected to upside risks and could dampen an already slow recovery momentum.

Chart 15: Thailand's real GDP growth (% y-o-y)



Sources: Office of the National Economic and Social Development Council, MARC Ratings

Chart 16: Thailand's number of international tourists



Sources: Bank of Thailand, MARC Ratings

Viet Nam: All eyes on trade prospects

Poised for stronger growth in 2022

The ADB forecasts a big jump in Viet Nam's GDP growth in 2022 at 6.5%. The one-party state economy in 2021 suffered a beating when the spread of the Delta heavily disrupted supply. The COVID-19 Stringency Index was elevated from 2H2021 and remained so to date. ADB had to downgrade Viet Nam's growth estimates in 2021 from 3.8% to 2% in 2021. The country ramped up its vaccination rates dramatically since mid-2021 amid the raging spread of Delta. At the point of writing, 57% of its total population are fully vaccinated, while 19% of them are awaiting their second dose. In total, the country is only three percentage points shy of Malaysia's share of vaccinated people, and we think that Viet Nam is poised for much stronger growth in 2022 despite the emergence of Omicron.

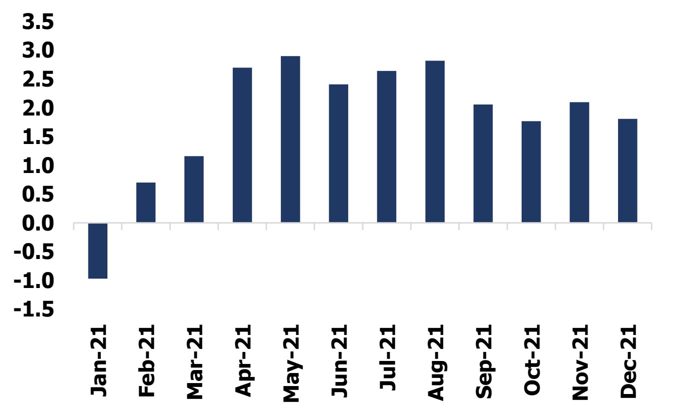
Improving trade performance

Although Viet Nam began to lose steam in sustaining its good-run of trade surplus since 4Q2020, its trade performance has been recovering fast since 2H2021 as the economy gradually reopens. Exports have picked up considerably since, so have imports but somewhat speedier amid supply bottlenecks. Owing to low aggregate demand, inflation is trending way below its target of 4% (December 2021: 1.8%), while core inflation came in at 0.67% y-o-y in December 2021. The labour market is still relatively robust. Although the recent lockdown did push the unemployment rate higher, it did not breach the 4% mark by any means. The average monthly salary in USD has been declining amid mobility restrictions.

On track for recovery

In 2022, we believe that Viet Nam will rebound well, so long as the economy does not suffer from mobility restrictions, as seen during mid-2021. The Vietnamese economy has been gradually reopening since August 2021, but the Omicron may present itself as a major headwind to growth in 2022. Otherwise, coupled with a broader trade linkage following the Regional Comprehensive Economic Partnership (RCEP) 's entry-into-force on January 1, 2022, trade will support Viet Nam's growth in the short as well as in the long run.

Chart 17: Viet Nam's Consumer Price Index (% y-o-y)



Sources: General Statistics Office, MARC Ratings

Chart 18: Viet Nam's trade balance (% of GDP)

Sources: General Statistics Office, MARC Ratings

MALAYSIA: Down on the upside

Variants of concern pushing up downside risks

W-shaped recovery

We are cautiously optimistic about Malaysia's growth recovery prospects given the pandemic-related uncertainties and scarring effects. With the vaccination rate rising and economy reopening, business and consumer sentiment should continue to improve. It is notable that the latest GDP data (3Q2021: -3.6%) on a q-o-q seasonally adjusted basis appears to be marking the turning point of the second trough of the "W" in a W-shaped recovery.

We forecast GDP to come in at 5.5%

The government expects GDP growth pace in 2022 to come in at between 5.5% and 6.5%, thanks in part to support from its proposed record high Budget 2022 allocation of RM332.1 billion. Our GDP growth forecast, in line with the government's forecasted range, comes in at exactly its lower bound of 5.5%. With this, the economy should expand to larger than what it was in 2019.

Growth driven largely by rebound in domestic demand

Developments related to the pandemic continue to be a key determining factor of the economy's growth trajectory. Our 2022 forecast assumes that Malaysia's economic reopening is not hindered by further lockdowns and COVID-19 resurgences. We see growth to be driven largely by a rebound in domestic demand, thanks to rising private consumption and a gradually improving labour market. We expect the government to continue assisting vulnerable households, which will help support consumer spending to some extent.

Investment and unemployment rate will likely improve

Investment activity should pick up as investors' confidence improve. For 2022, we expect private investment growth to come in at 6.7% (2021E: 5.0%). In line with this, the unemployment rate will likely improve to 4.2% in 2022 (2021E: 4.6%) and help provide some welcome boost to economic sentiment.

Twelfth Malaysia Plan

At least for now, we expect government efforts to remain focused on economic recovery and returning GDP growth pace to its pre-crisis trend. We think Malaysia's economic resetting, as laid out in the Twelfth Malaysia Plan (12MP), will likely come into serious play only after the recovery is firmly on track.

Low-base effects

With the focus on economic recovery, any economic reset to reinvigorate the economy will likely only take place further down the road. It is notable that public investment has been in persistent decline over the last four years (2021E: -4.7%). Against this backdrop, we should not be too excited by the expected 5.8% rise in 2022 because it reflects favourable low-base effects.

Inflationary pressure to remain in 2022

Meanwhile, CPI-based inflation has been rising. In November, it accelerated to 3.3% (October: 2.9%), driven largely by low base effects and the 12.7% increase in the Transport group. We expect it to surge further in the months ahead, driven by double digit-increases in PPI (November: 12.6%). Given that it is a politically sensitive issue, however, we expect the government to resort to subsidies and price control mechanisms to keep inflation at bay (2022F: 2.2%; 2021E: 2.5%).

As such, we think the consumer price index (CPI) will continue to be under pressure throughout 2022. Average inflation in 2022 is expected to come in at 2.2% against the backdrop of gradual improvements in the labour market, continual supply constraints, and inefficient existing price control and anti-profiteering mechanisms. The latter will result in a reduction of supply in adhering to the ceiling price, thus prolonging shortages.

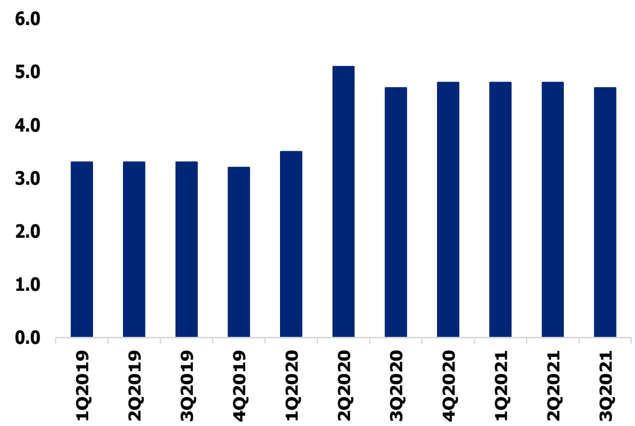
Omicron will be the headwinds to growth

On the external front, developments before the emergence of Omicron had been relatively positive. With its emergence, downside risks to both domestic and external outlooks should loom larger. We expect the World Trade Organisation (WTO) to downgrade its 2022 global merchandise trade volume forecast of 4.7% (2021E: 10.8%) down the road. Meanwhile, the IMF has indicated that it expects the Omicron to slow global economic recovery. Against this backdrop, we see Malaysia's real export and import growth moderating significantly to 1.4% (2021E: 14.4%) and 1.2% (2021E: 16.3%).

Chart 19: Malaysia's real GDP growth (% y-o-y)

Sources: Bank Negara Malaysia (BNM), MARC Ratings

Chart 20: Malaysia's unemployment rate (% y-o-y)



Sources: Department of Statistics Malaysia (DOSM), MARC Ratings

Table 3: Summary of Malaysia's main economic indicators

Growth (% y-o-y)	2015	2016	2017	2018	2019	2020	2021E	2022F
GDP	5.1	4.4	5.8	4.8	4.4	-5.6	3.3	5.5
Domestic Demand	5.1	4.3	6.5	5.5	4.3	-5.8	2.8	5.7
Private Consumption	6.0	5.9	6.9	8.0	7.7	-4.3	2.0	5.8
Public Consumption	4.5	1.1	5.7	3.2	1.8	3.9	6.5	4.3
Private Investment	6.3	4.5	9.0	4.3	1.6	-11.9	5.0	6.7
Public Investment	-1.1	-1.0	0.3	-5.0	-10.7	-21.3	-4.7	5.8
Real Exports	0.3	1.3	8.7	1.9	-1.0	-8.9	14.4	1.4
Real Imports	0.8	1.4	10.2	1.5	-2.4	-8.4	16.3	1.2
Net Exports	-3.7	0.4	-3.9	6.2	11.2	-13.0	-1.5	3.7
CPI	2.1	2.1	3.8	1.0	0.7	-1.1	2.5	2.2
Unemployment rate (%)	3.1	3.4	3.4	3.3	3.3	4.5	4.6	4.0

Sources: MARC Ratings

Monetary policy decision dilemma in 2022

OPR remain unchanged at 1.75% in 2021

At its eighth consecutive meeting on November 3, 2021, Bank Negara Malaysia's (BNM) Monetary Policy Committee (MPC) kept the overnight policy rate (OPR) unchanged at its historical low of 1.75%. With the economy still in recession, it is not surprising that monetary policy is being kept loose to support the economy and contain financial stability risks. It helped that inflation was still at relatively moderate levels.

Scenario of concerns

The central bank's monetary policy statements thus far have not provided any leads as to its future monetary policy moves. Its November 2021 monetary policy statement said that its main concerns "include a weaker-than-expected global growth, a worsening in supply chain disruptions, and the re-imposition of containment measures due to the impact of new COVID-19 variants of concern." While BNM's scenario of concerns for Malaysia is not unexpected, we think the sequence of events could turn complicated. For instance, there is a slight chance that BNM could face a monetary policy decision dilemma in 2022.

Price pressure to continue in 2022

For a start, we expect the combination of shocks – including supply chain bottlenecks and labour market frictions – to continue pressuring prices higher. As it is, several countries have already seen inflation rise to well above their monetary policy targets. On December 16, 2021, the Bank of England started its anti-inflation fight when it raised its benchmark interest rate to 0.25% from 0.10% after consumer prices rose by 5.1% in the previous month.

Interest rate tightening is likely

We think the answer is easy enough if consumer prices are surging on the back of robust and stable growth recovery. In such a situation, interest rate tightening is likely. Even then, it will be done very gradually for fear of tripping up economic recovery. Based on our outlook, at least for now, we expect BNM to increase the OPR by 25 basis points in 2H2022.

Monetary policy decision dilemma

But what if the emergence of other COVID-19 variants of concern triggers more supply side issues that cause inflation to spike to levels BNM find uncomfortable and, on top of that, dampen an already slower-than-expected recovery? Under this scenario, BNM would find itself between a rock and a hard place. If BNM tightens monetary policy to control inflation, it could depress demand and threaten economic recovery. But if it remains on the sidelines and keep policy loose to avoid stifling an already slower-than-expected recovery, inflation could feed into wage and price-setting. This could undermine medium-term price stability and spell more trouble ahead.

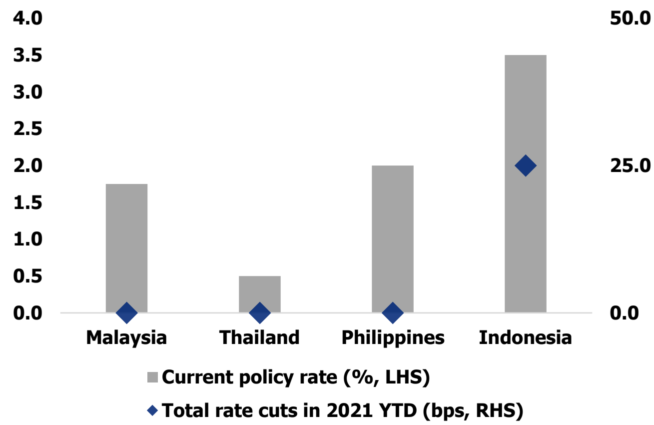
Higher macro-financial vulnerabilities

Given investors' spectrum of risk profiles, some could start giving Malaysia a wider berth. The country is after all already displaying significantly higher macro-financial vulnerabilities. We think the potential implications for the ringgit is obvious; it can only go one way, and that is to the south.

Selective intervention is crucial

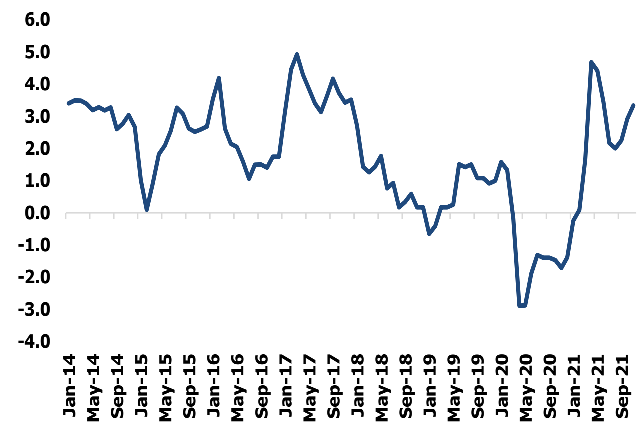
With regard to inflation, we expect the government, at least for now, to use subsidies, cash transfers and price control mechanisms if it spikes to above what BNM considers moderate, especially if recovery continues to struggle. It is important, though, to intervene selectively to slow down the rise of prices in specific items that are of the most concern.

Chart 21: Policy rates in selected ASEAN countries



Sources: Respective central banks, MARC Ratings

Chart 22: Malaysia's inflation rates (% y-o-y)



Sources: CEIC, MARC Ratings

Fiscal vulnerabilities will rise further

Fiscal policy as the main tool to catalyse growth

As the impact of the pandemic has been multi-dimensional, fiscal policy, not monetary policy, will remain as the primary policy tool to support, boost, and sustain recovery and growth. Thus far, the government's stimulus packages have reached a total of RM530.0 billion (equivalent to 37.4% of GDP). Of this, RM87.6 billion (or 6.2% of GDP) constitute direct fiscal injection.

Long-lasting impact on fiscal position

We expect the pandemic's impact on the government's already stressed fiscal position to be long-lasting. For 2021, we estimate Malaysia's fiscal deficit to come in at 6.3% of GDP, higher than the government's target of 6.0%.

We expect more fiscal support going forward

Given that the economy remains in recession and that we are seeing the emergence of more variants of concern, we can expect more fiscal support going forward. We, however, expect fiscal support to come in smaller and in more targeted packages because of the government's increasingly constrained fiscal space.

Unlikely to meet 6.0% fiscal deficit target

The government had been preparing for more COVID-19 related spending even before the Omicron appeared. With the emergence of Omicron, we think it is unlikely that the government will be able to meet its fiscal deficit target of 6.0% of GDP this year (2021E: 6.5%).

Debt sustainability is not expected to be an issue

In anticipation of more relief spending, a majority of lawmakers in the lower house of parliament had voted in October to raise the statutory debt level to 65% of GDP until end-2022, from the current 60%. We do not expect debt sustainability to become an issue, at least for now. This is because of Malaysia's relatively deep domestic savings pool and the small share of foreign currency-denominated debt (2020: 3.3% of total).

Higher debt, higher debt service charges

While government debt may be sustainable, higher debt does mean higher debt service charges. This can restrain budget allocations for worthwhile expenditure. For 2022, the government estimates its debt service charges as a share of operating expenditure to rise to 18.5% (2021E: 17.8%; 2020: 15.4%).

Economic rebuilding and strengthening

Going forward, we expect Malaysia's economic rebuilding and strengthening to drag on in the post-pandemic period given the economic damage. As a result, it is unlikely that the government will revert the statutory debt level to 55% of GDP, despite the raise was supposedly a temporary move.

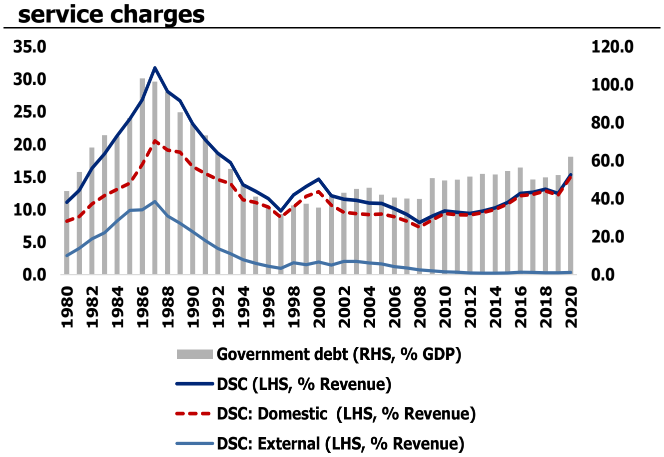
Negative rating pressure ahead

It is important to note that Malaysia entered the pandemic from a position of weakness. Even before the pandemic hit, Malaysia's public finances were already a source of negative sovereign credit rating pressure. Compared with its rating peers, Malaysia's debt-to-GDP was higher and debt-service burden heavier. With the pandemic, its fiscal and debt metrics have worsened considerably. We see more negative rating pressure ahead.

Government revenue reform

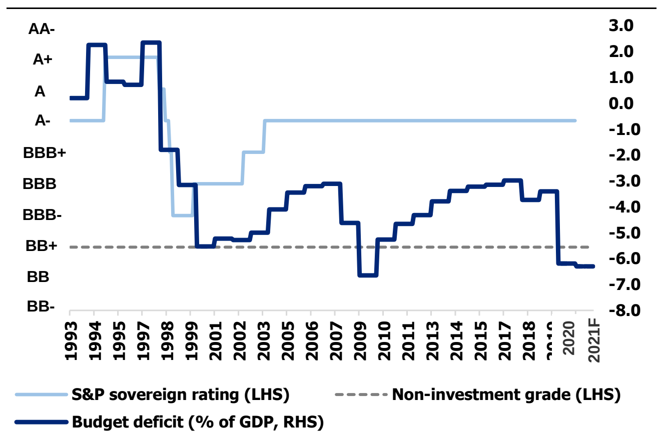
Meanwhile, Malaysia continues to suffer from a narrow revenue base, especially after the zero-rating of the Goods and Services Tax (GST) on June 1, 2018. It remains dependent on oil revenue despite efforts to diversify its revenue sources. Meanwhile, political uncertainty following the change of government in March 2020, and once more in August 2021, has proven detrimental to already patchy reform efforts. This, on top of the pandemic, has added to investors' concerns. On December 4, 2020, Fitch Ratings had downgraded Malaysia's sovereign rating to BBB+/stable from A-/negative. We expect other international credit rating agencies to follow suit if the country's economic and financial situation worsens further.

Chart 23: Malaysia's government debt and debt service charges



Sources: Ministry of Finance, MARC Ratings

Chart 24: Malaysia's fiscal deficit vs ratings



Source: MARC Ratings

Disclaimer

This report is strictly confidential and privileged and is intended solely for the information and benefit of the addressee or recipient. If you are not the intended recipient, and/or have received this report in error, please delete this report and do not copy, disseminate, distribute or disclose the content of this report to any other person.

Any opinion, analysis, observation, commentary and/or statement made by MARC Ratings are solely statements of opinion based on information obtained from issuers and/or other sources which MARC Ratings reasonably believes to be accurate and reliable to the greatest extent and therefore, shall not be taken as statements of fact under any circumstances. MARC Ratings does not and is in no position to independently audit or verify the truth, timeliness, completeness and accuracy of the information contained in the document and shall not be responsible for any error or omission or for the loss or damage caused by, resulting from or relating to the use of such information. NEITHER MARC RATINGS NOR ITS AFFILIATES, SUBSIDIARIES, DIRECTORS AND EMPLOYEES, GIVE ANY EXPRESS OR IMPLIED WARRANTY, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTY AS TO THE ACCURACY, COMPLETENESS OR TIMELINESS OF ANY INFORMATION CONTAINED HEREIN FOR ANY PARTICULAR PURPOSE. MARC Ratings will not defend, indemnify or hold harmless any user of this report against any claims, demands, damages, losses, proceedings, costs and/or expenses which the user may suffer or incur as a result of relying on this report in any way whatsoever.

This report is not a recommendation to buy, sell or hold any security and/or investment. Any user of this report should not rely solely on the credit rating and analysis contained in this report to make an investment decision in as much as it does not address non-credit risks, the adequacy of market price, suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security concerned.

MARC Ratings and its affiliates, subsidiaries and employees shall not be liable for any damage or loss arising from the use of and/or reliance on reports produced by MARC Ratings or any information contained therein. Anyone using and/or relying on MARC Ratings' reports and information contained therein solely assumes the risk in making use of and/or relying on such reports and all information contained therein and acknowledges that this disclaimer has been read and understood, and agrees to be bound by it.

Statement of Conflict of Interest

MARC Ratings, its researchers and analysts involved in preparing this report have not encountered and/or are not aware of any conflict of interest situation which might affect their judgement or impartiality when preparing this report. If MARC Ratings, its researchers or analysts finds that an actual or potential conflict of interest does exist, MARC Ratings shall as soon as reasonably practicable notify the user of this report.

Published and Printed by:

MARC Ratings Berhad 202001041436 (1397757-W)
19-07, Level 19, Q Sentral, 2A Jalan Stesen Sentral 2, Kuala Lumpur Sentral, 50470 KUALA LUMPUR
Tel.: +603 2717 2900 Fax: +603 2717 2920
Email: marc@marc.com.my Website: www.marc.com.my