Economic Research

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Despite external headwinds, MARC Ratings projects 3.9% 1Q2022 GDP growth amid accelerating economic recovery

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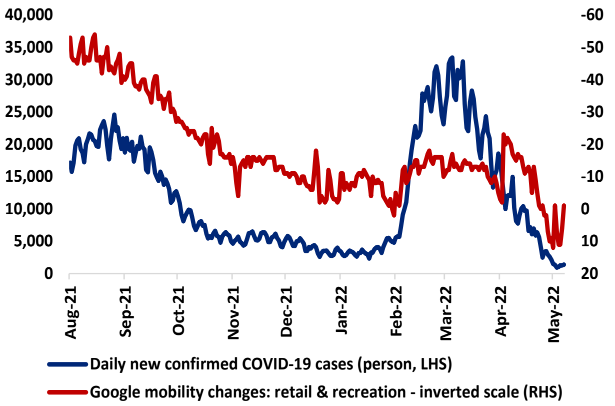
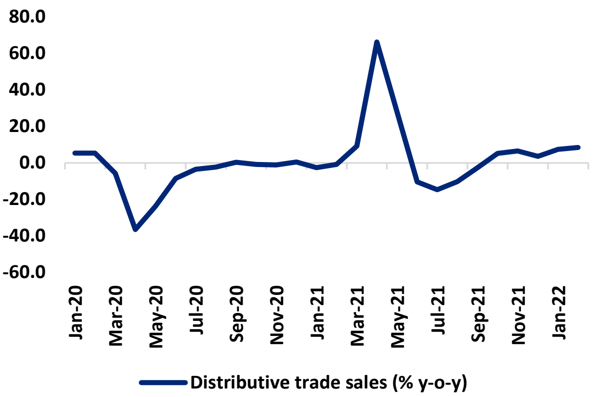
Chart 1: Daily new COVID-19 cases and footfalls to retail and recreation



Sources: CEIC, MARC Ratings

Chart 2: Distributive trade sales



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

- Partial indicators suggest that Malaysia's economic recovery remains on track and the momentum may have picked up slightly in 1Q2022. The spike of positive COVID-19 cases in mid-1Q2022 seems to have limited impact on consumption. The distributive trade sales have recorded a hefty growth of 8.0% y-o-y on average in the first two months of 2022 compared with 5.1% in 4Q2021, while the unemployment rate is declining gradually, coming in at 4.1% in 1Q2022 (4Q2021: 4.3%). However, 1Q2022 growth would have been much higher sans a slowdown in industrial production (4.5% y-o-y on average in 1Q2022 versus 7.0% recorded in 4Q2021). On balance, we still project firmer real GDP growth of 3.9% y-o-y in 1Q2022 compared with 3.6% recorded in 4Q2021.

- Looking forward, we anticipate growth to strengthen further throughout the next two quarters, accentuated by favourable base effects, supportive fiscal policies, the reopening of international borders and the lifting of other pandemic-related restrictions. The growth in domestic demand appears clear and imminent. We foresee considerable private consumption growth in the coming months with pent-up demand and income support. Continued strength in the labour market supports this notion as we predict a lower unemployment rate at 4.0% for 2022 (2021: 4.6%). In addition, Google Mobility data show footfalls in retail and recreation have returned to pre-pandemic levels since the end of April 2022, indicating an ameliorating overall sentiment amid a higher propensity to consume.

- Despite this optimistic viewpoint, we cannot discount the main threats to growth; these are not expected to dissipate anytime soon. Output growth will remain below potential amid the ongoing supply-side disruptions, which have led to higher input prices, labour shortages and a rapidly changing external outlook. Our headline inflation projection has been revised upwards to 2.7% for 2022 (2021: 2.5%), reflecting the intense supply-side inflationary pressures in the coming months despite active government intervention. Furthermore, the rising living and borrowing costs would act as speed bumps to consumer demand, though government measures such as price controls, the special Employees Provident Fund (EPF) withdrawal and the increase in minimum wage could cushion households against it.

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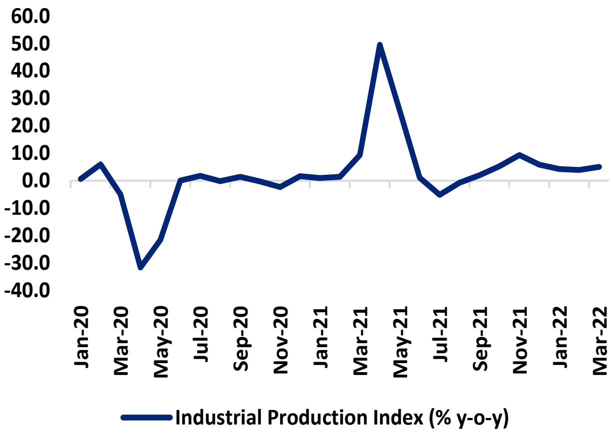
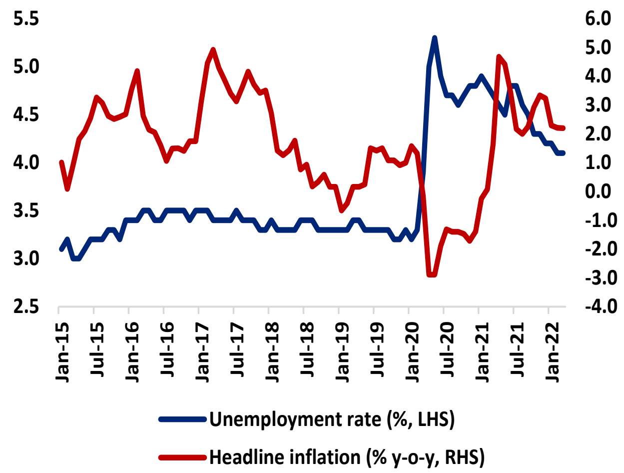
Chart 3: Industrial production



Sources: DOSM, CEIC, MARC Ratings

Chart 4: Unemployment rate and inflation



Sources: CEIC, MARC Ratings

- On the external front, the weaker prospects of major economies are also a concern, with the International Monetary Fund downgrading its global growth forecast by 0.8 percentage points to 3.6% in 2022 (2021E: 6.1%). On the one hand, prolonged and heightened geopolitical tensions, China's economic slowdown, and the US Federal Reserve's aggressive monetary tightening prospects will add to a potent mix of downside risks to Malaysia's overall trade and national output performance. But on the other hand, sharp upward adjustments in commodity prices, if sustained, will provide some relief to exports.

- Bank Negara Malaysia (BNM) decided to raise its key policy rate — the Overnight Policy Rate (OPR) — by 25bps to 2.00% on May 11, 2022, marking its first rate hike since January 2018. BNM had kept its OPR at the historical low of 1.75% since July 2020 to support the economy following the pandemic-induced recession. The hawkish pivot came about as the BNM felt that "the unprecedented conditions that necessitate such actions have since abated". We perceive the rate hike as a defence against significant capital outflows and ringgit depreciation amid the higher interest rates in the US. It will also help keep inflation in check as demand improves.

- We opine that a second interest rate hike by BNM in 2H2022 is highly probable. Upon closer examination of the latest Monetary Policy Statement (MPS), there is an increasing number of positive words such as "firmer", "strengthen" and "improve", implying BNM's growing confidence in the domestic economy's near-term prospects. Nevertheless, we expect that the eventual normalisation of monetary policy will be gradual, as reiterated in the MPS, to ensure sustainable economic recovery.

- For policy normalisation to be well-measured, the unemployment rate (March 2022: 4.1%) should decline significantly in the coming months. For a developing economy such as Malaysia, raising the OPR amid an elevated unemployment rate could be challenging from the standpoints of wage growth, the government's fiscal position and social stability. Therefore, we expect fiscal policy to correspond with the rising interest rate environment through higher government spending or improvements in investment prospects in the coming months.

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