

Macroeconomic Outlook

Highlights

- Global growth to improve in 2021, but at an uneven pace across countries.
- Growth outlook of the Malaysian economy affected by the re-imposition of nationwide containment measures.
- Headline inflation is projected to moderate in the near term as the base effect dissipates.

Continued divergence in global economic outlook in 2021

In their July World Economic Outlook, the IMF kept its projection of global growth in 2021 unchanged, compared to the April World Economic Outlook, at 6.0%. While the overall global growth outlook remained unchanged, there were offsetting revisions between advanced economies (AEs), which were revised upwards, and emerging market economies (EMEs) which were revised downwards. This reflects pandemic developments especially with regards to vaccination rates, differences in the extent of policy support and availability of policy space.

With higher vaccination rates, AEs are expected to be able to manage resurgences in COVID-19 infections with relatively lighter containment measures. This, along with improvement in domestic demand, will support the recovery momentum for AEs in the second half of 2021.

For EMEs, the risk of disruptions in domestic activity due to containment measures amidst COVID-19 resurgences is higher, due to the slower rate of vaccination. In addition, there is less policy space in EMEs, which will limit the degree of accommodation from policy to offset any shocks due to a resurgence of COVID-19.

The balance of risk remains tilted to the downside, with COVID-19 related risks remaining the key source of downside risk. The key risk concerns the spread of new variants of concern that could lead to the resumption of containment measures to preserve healthcare capacity, amid lower effectiveness of vaccines against newer variants. Nevertheless, upside risks to growth could come from faster-than-expected vaccination progress in EMEs and further fiscal stimulus, particularly in AEs.

The pace of recovery of the Malaysian economy dampened by resurgence of COVID-19 cases

The Malaysian economy was on track for a broad recovery in 2021 as compared to last year. However, the resurgence of COVID-19 cases has necessitated the re-imposition of nationwide containment measures, which would weigh on growth. Nevertheless, the impact will be partially mitigated by continued allowances for essential economic sectors to operate, higher adaptability to remote work, as well as increased automation and digitalisation. Growth will continue to be supported by policy measures, which will provide cash flow support, particularly for affected households and businesses. Going forward, the economic recovery will be underpinned by higher external demand and gradual improvement in domestic demand. The rapid progress of the nationwide vaccination programme will allow economic sectors to be gradually reopened and provide some lift to household and business sentiments.

Against this backdrop, for 2021, the Malaysian economy is projected to expand within the range of 3.0 – 4.0%, although the pace of recovery will be uneven across sectors. The recovery is expected to accelerate going into 2022, supported by

normalisation of economic activities as well as the positive spillovers from continued improvement in external demand.

The balance of risks remains tilted to the downside, arising mainly from pandemic-related factors, such as delay in the easing of containment measures or imposition of tighter containment measures, and a weaker-than-expected global growth recovery.

Headline inflation is projected to moderate in the near term

In line with earlier assessments, headline inflation spiked in the second quarter of 2021 due mainly to the base effect from fuel prices. This spike is transitory and headline inflation is expected to moderate in the near term as this base effect dissipates.

For 2021 as a whole, headline inflation is projected to average between 2.0% and 3.0%.¹² While there remain cost pressures from global commodity prices and idiosyncratic supply disruptions, these pressures are assessed to be temporary. Underlying inflation, as measured by core inflation, is expected to remain subdued, averaging between 0.5% and 1.5% in 2021, amid continued spare capacity in the economy.

¹² This range takes into account that headline inflation is expected to average close to the lower bound of the previous forecast range.

Malaysia's 2021 Growth Outlook: Baseline and Scenarios

Several major developments related to the COVID-19 pandemic have taken place since the Bank published its 2021 growth forecast of 6.0 – 7.5% during the release of the Economic and Monetary Review 2020 in March this year. As domestic COVID-19 cases were at manageable levels early this year, the Government announced the adoption of targeted interventions based on localities and cluster locations to contain localised outbreaks. However, the rapid resurgence of cases around May 2021 led to the implementation of blanket containment measures, notably the Full Movement Control Order (FMCO) on 1st June 2021¹. This will dampen the earlier projected growth prospects.

This article discusses the baseline and alternative scenarios for the economic outlook, premised primarily on plausible developments of the COVID-19 epidemic and their implications on the Malaysian economy.

High uncertainty surrounding the path of the COVID-19 pandemic remains a key challenge to Malaysia's near-term economic prospects

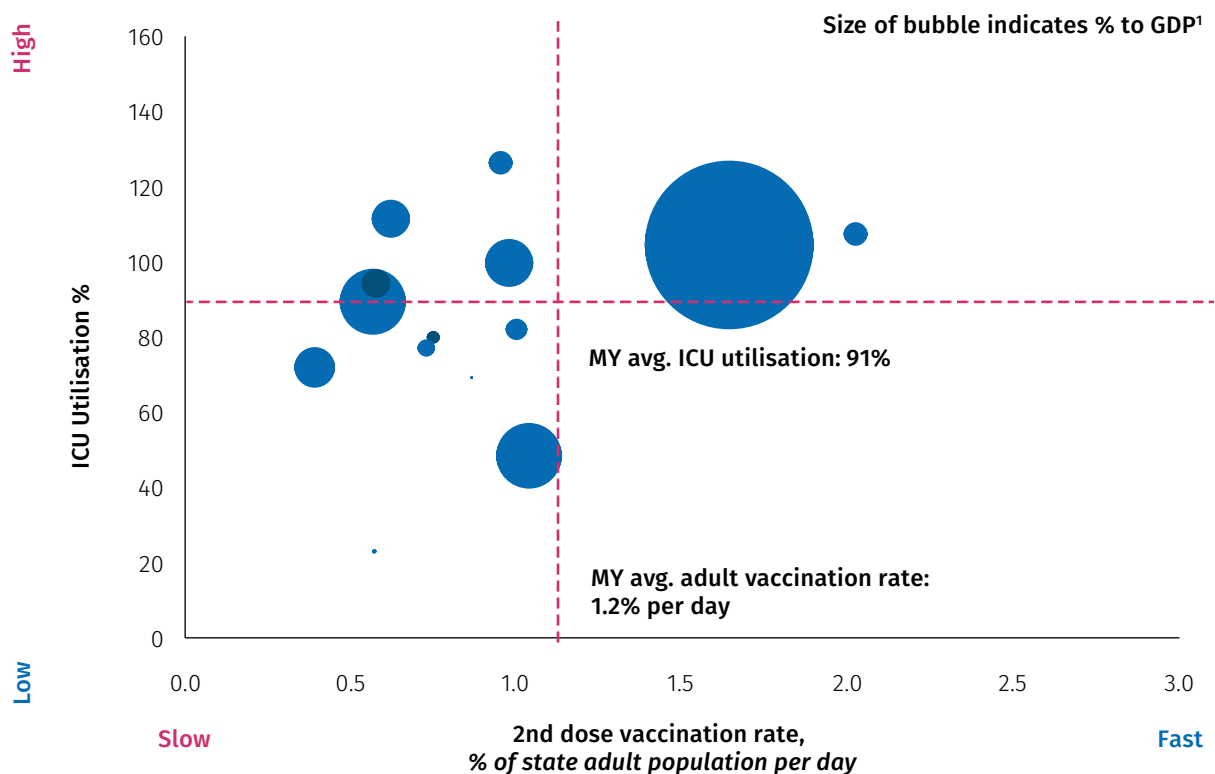
The Malaysian economy has rebounded since the trough in 2Q 2020 following the imposition of strict containment measures and the synchronised global recessions. While the domestic economy is expected to continue on its recovery trajectory in 2021, there are several uncertainties which could affect the pace of the recovery and Malaysia's current baseline growth projection. First, the course of the outbreak. Since early-2021, Malaysia has experienced several bouts of recoveries and resurgences. Second, the pace of the vaccination rollout under the National Immunisation Programme across states and the effectiveness of the vaccination programme, which will be reflected in each state's hospital capacity. Third, policy uncertainty and progress of major infrastructure projects given the containment measures.

Given that states are currently in different phases of the FMCO and have varying degrees of vaccination rates as well as ICU utilisation (Chart 1), they are expected to transition to the next phase at differing times (Chart 2). Several key assumptions are made in the baseline and scenario projections. First, states which have progressed to a more relaxed phase will not revert to a stringent phase². Second, fast vaccination rates leading to lower ICU utilisation is expected to accelerate the relaxation of containment measures. However, in states with already high ICU utilisation rates, the transition to the next phase may take a longer time due to an expected lag before ICU capacity is released. Third, slow vaccination rates would lead to a longer period in the current phase. These factors will affect the duration of phases assumed under the baseline and scenario projections.

¹ The National Recovery Plan (NRP), which outlines the implementation of the FMCO, is a four-phase exit strategy from the COVID-19 epidemic in Malaysia, which allows for a safe reopening of the economy based on three indicators, namely daily symptomatic hospital admission cases, healthcare capacity and vaccination rate. The first phase is the most stringent with strict restrictions on sectors allowed to operate and community mobility, followed by gradual relaxations across the second, third and fourth phase (Source: Speech by YAB Prime Minister "Pelan Pemulihan Negara: Peralihan Fasa PKP Secara Berperingkat", 15 June 2021 and "Kemudahan-Kemudahan Bagi Individu Yang Telah Menerima Vaksinasi Lengkap", 8 August 2021).

² "States transitioned to Phase Two NRP will not revert to Phase One", Bernama, 14 July 2021

C1 ICU Utilisation and Vaccination Rate by State



¹ Refers to share to GDP in 2020

Note: ICU utilisation and vaccination rates refer to the 7-day average between 3-9 Aug 2021

Source: COVID-19 Immunisation Task Force, Ministry of Health, Department of Statistics, Malaysia and Bank Negara Malaysia

C2 Assumed Baseline Transition Path for Varying Degrees of ICU Utilisation and Vaccination Rate

Current ICU utilisation	Current speed of vaccination rate	Assumed transition path
Low	Fast	Faster and earlier transition to Phase 4
Low	Slow	As vaccination rate improves, transition to subsequent phases is shorter
High	Fast	1. Gradual transition to the next phase as ICU utilisation stabilises and improves
High	Slow	2. As vaccination rate progresses and ICU utilisation improves, transition to subsequent phases will be swift

Source: COVID-19 Immunisation Task Force, Ministry of Health and Bank Negara Malaysia

The Malaysian economy is projected to grow at 3.0 – 4.0% in 2021 under the baseline forecast

The baseline projection has been revised from 6.0 – 7.5% previously to 3.0 – 4.0% in 2021 due mainly to the impact of the containment measures. However, Malaysia's growth is expected to remain on a recovery path, supported by stronger external demand, faster progress in vaccination rate and the continued targeted policy support for households and businesses. The outlook also assumes a reopening of all economic sectors nationwide, in which all states will transition into Phase 4 of the NRP by November this year³ (Chart 3). This is premised on the vaccination rate threshold under the NRP, with existing vaccines being effective against the prevailing variants, resulting in lower ICU utilisation.

Given the significant uncertainties surrounding the epidemic situation, the alternative scenarios elaborated below provide additional insights into the implications of COVID-19-related developments on Malaysia's 2021 growth.

A faster-than-expected reopening of the economy could lead to a stronger growth in 2021

A faster recovery scenario assumes a sooner-than-expected reopening of the economy and relaxations of mobility restrictions. Compared to the baseline, all states in Malaysia would transition into Phase 4 of the NRP earlier, which is by September 2021 (Chart 3). This assumes a faster rollout of the vaccination programme, following a ramp-up in vaccinations (including among youth). Similar to the baseline, current vaccines are assumed to be effective against prevailing variants, which eases the strain on the healthcare system.

With the earlier relaxation of containment measures, overall labour market conditions are projected to recover at a faster pace, with increased hiring and improvement in income growth. This contributes to a sooner-than-expected recovery in consumer confidence. When restrictions are eased, the effects from improved labour market conditions and sentiments will generate stronger-than-expected demand conditions. In particular, overall household savings has increased since last year, partly due to increased precautionary savings and households not being able to spend on discretionary items. These items include certain high-touch services such as restaurants, hotels and recreational activities. When restrictions are eased, the effects of potential pent-up demand could be realised as some households are now able to spend on these selected services, providing a positive lift to growth. For example, consumer spending improved in December 2020, following the easing of dine-in and interstate travel restrictions, as evidenced by a monthly growth of 4.6% in the Index of Retail Trade during the month (October-November 2020 average month-on-month growth: 1.0%) and a higher average hotel occupancy rate (36.2%; October-November 2020 average: 25.2%). In this faster recovery scenario, the Malaysian economy is expected to recover stronger in 2021.

³ Under the Phase 4 of the NRP, all economic sectors are allowed to operate with some restrictions for social activities. Interstate travel and domestic tourism will also be allowed, subject to strict Standard Operating Procedures (Source: Speech by YAB Prime Minister "Pelan Pemulihan Negara: Peralihan Fasa PKP Secara Berperingkat", 15 June 2021).

A prolonged health crisis could lead to a weaker growth outlook

A slower recovery scenario assumes a delayed reopening of the economy, on account of a delayed resolution of the epidemic as vaccination rates slow down, in part due to moderating vaccine take up. This leads to the majority of the total population being fully vaccinated only by early-2022 (Chart 3). Furthermore, the efficacy of existing vaccines is lower to new virus strains. These developments would lead to the healthcare system remaining burdened by elevated ICU utilisation, resulting in a delayed positive impact of vaccination progress on the health and economic crisis in Malaysia. Compared with the baseline, labour market conditions recover at a slower pace. In this slower recovery scenario, longer containment measures become necessary and are expected to weigh on economic activity.

C3

Assumptions on COVID-19 related parameters under baseline and scenarios

	Faster Recovery	Baseline	Slower recovery
Majority of total population being fully vaccinated	By end-October 2021	By end-2021	By early-2022
Efficacy of existing vaccines against prevailing variants	Effective	Effective	Lower efficacy to new virus strains
Containment measures nationwide	Relaxation of tight containment measures by September 2021	Relaxation of tight containment measures by November 2021	Prolonged tight containment measures until early-2022

Source: COVID-19 Immunisation Task Force, Ministry of Health and Bank Negara Malaysia

Uncertainty on factors underpinning the Malaysian economic outlook could lead to divergence in growth prospects

These alternative scenarios characterise the uncertainty in the Malaysian economic outlook arising from the evolution of the COVID-19 pandemic. The economic implications under the baseline and both scenarios serve as a guide for the 2021 growth prospects.