10 QUESTIONS FOR BANK NEGARA ON THE 2021 GDP GROWTH FORECAST

Dr Ong Kian Ming
BSc (LSE), MPhil (Cantab), PhD (Duke),
and REFSA Economics Team

INTRODUCTION

Bank Negara Malaysia (BNM) published its Economic and Monetary review on April 1st, and forecasts GDP growth ranging from 6.0% to 7.5% for 2021. This constitutes a significant downward revision of the lower bound that the Ministry of Finance (MoF) used for Budget 2021 (6.0% vs 6.5%).

However, the basis for this estimate is not very clear. Interestingly, the review often highlights the many possible downside risks. With this in mind, we examine the assumptions and forecasts underlying the growth estimate in this paper, and then proceed to propose 10 questions meant to probe the validity of the forecast. Overall, our concern is that there is significantly more downside risk than even acknowledged in the report, and that GDP growth in 2021 may therefore turn out to be significantly lower than forecast. If this is indeed the case, then government policy should be significantly adjusted in order to firstly, limit the possible downsides, and secondly, to lessen the impact of any possible downside risks. As the adage goes, "***if we fail to prepare, we prepare to fail***". And we cannot afford to fail given that the economic consequences of the possible downside risks will be severe especially to the B40 community and small and medium enterprises (SMEs).

SUMMARY OF ASSUMPTIONS

BNM's Economic and Monetary review forecasts a GDP growth rate of between 6.0% and 7.5%. This forecast is underpinned by a number of assumptions, summarised below:

Improving external demand and increase in exports
A marked improvement in global economic conditions seems to be the most important assumption. With the vaccine roll-out making progress in many countries, especially the US and China, global consumption, aided by pent-up demand, is expected to increase markedly in 2021.

Improvement in manufacturing production and investments and mining
This is related to overall improvements in the global economy, particularly the increase in consumption, which should help the E&E industry, while primary resources production and exports should be buoyed by the rise in oil price and other commodities.

Improvement in labour market conditions
BNM expects significant improvement in labour market conditions, along with increases in employment and rises in wages. This should then lead to a restoration of domestic aggregate demand and consumption.

Increase in public consumption and investment (Development Expenditure)
After a significant drop in public investment in 2020, this is expected to reverse in 2021. Public consumption meanwhile is expected to remain elevated, primarily because of continuing measures related to the pandemic, in particular the vaccine roll-out.

Increase in private investment (specifically Gross Fixed Capital Formation)
Unsurprisingly, Gross Fixed Capital Formation (GFCF) dropped sharply in 2020, but it is notable that it decreased in 2019 also. The expectation is that there will be pent-up "demand" for investment projects here too, which should materialise over 2021.

Domestically, continuing relaxation of MCO restrictions and vaccine roll-out
Another key underlying assumption is that the pandemic will remain under control until sufficient levels of vaccination have been achieved, so that there will be no need for MCO measures, and the attendant economic consequences.

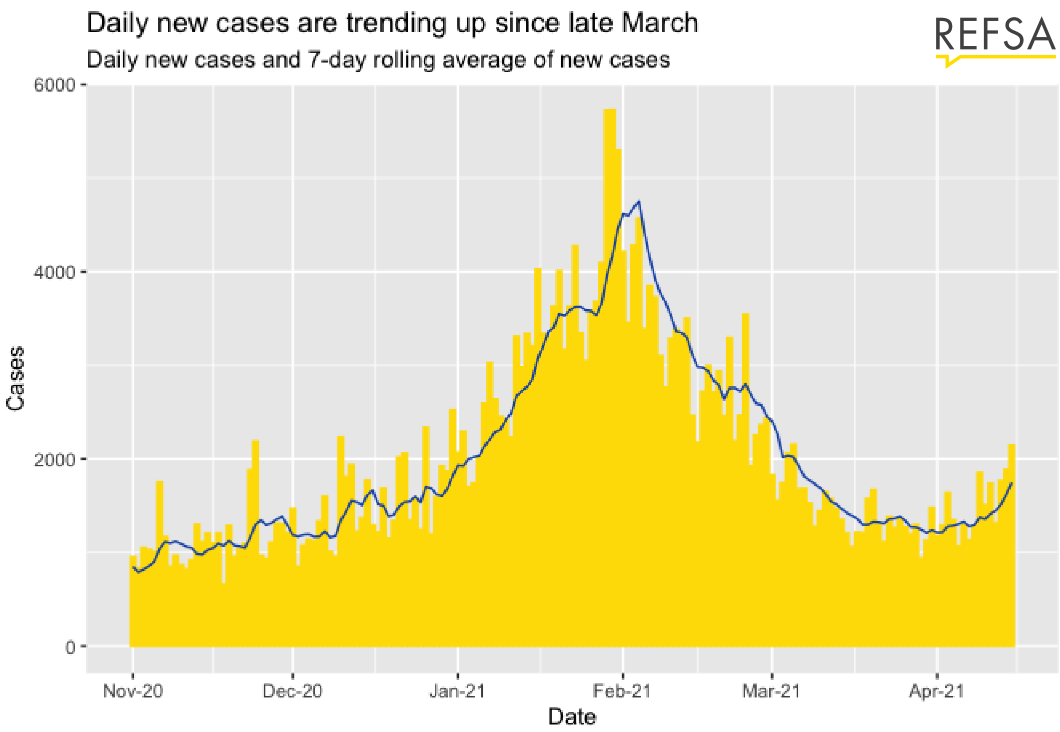
10 QUESTIONS FOR BANK NEGARA

The assumptions highlighted above triggered the following 10 questions. It is straightforward to see that BNM's assumptions are relatively optimistic, and that there are very significant downside risks. To be fair, BNM highlights those in the review, but it is worth looking at them more closely. In particular, recent data points signal that some of these risks are already materialising, and overall GDP growth will suffer as a result.

1. Is the pandemic evolving in a favourable direction?

Despite progress made since January, the trend of new and active cases over the last few days shows signs of rising again. At the time of writing, on the 17th of April, 2021, the number of cases have exceeded 2000 for three consecutive days (2148, 2551, 2331 respectively).

At the same time, vaccinations have only reached a small percentage of the population so far, and there is considerable vaccine hesitancy, which translates to a low amount of registrations. This shows that herd immunity is a long way off, and the danger of a new "wave" of infections still looms.

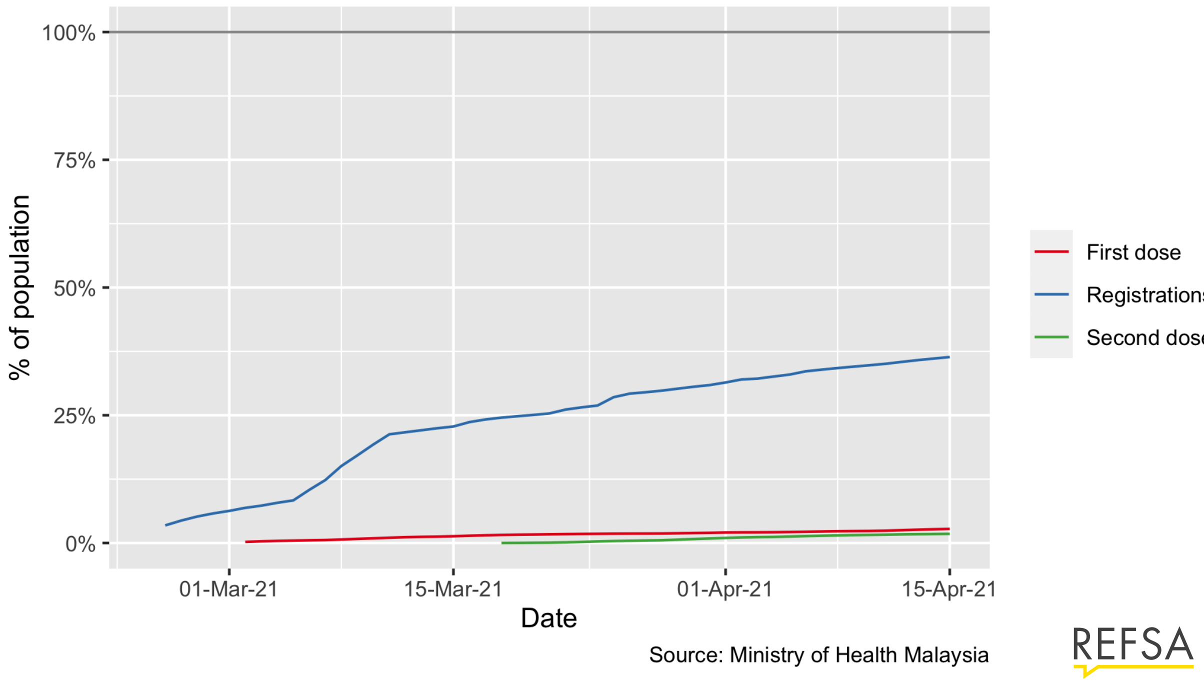


Source: Our World in Data.

The recent evolution of the number of daily new cases shows that there is a real risk of a fourth wave, also acknowledged by Senior Minister Ismail Sabri.[1]

Moreover, vaccine registrations and inoculations are relatively sluggish, as shown in the chart below. Some two months after registrations opened up, only about 36% of the population is registered,[2] 2.8% has received a first dose, and 1.8% a second dose.[3]

Vaccination registration is sluggish and vaccine roll-out starting slow
Percentage of population who registered for vaccine and received at least one dose



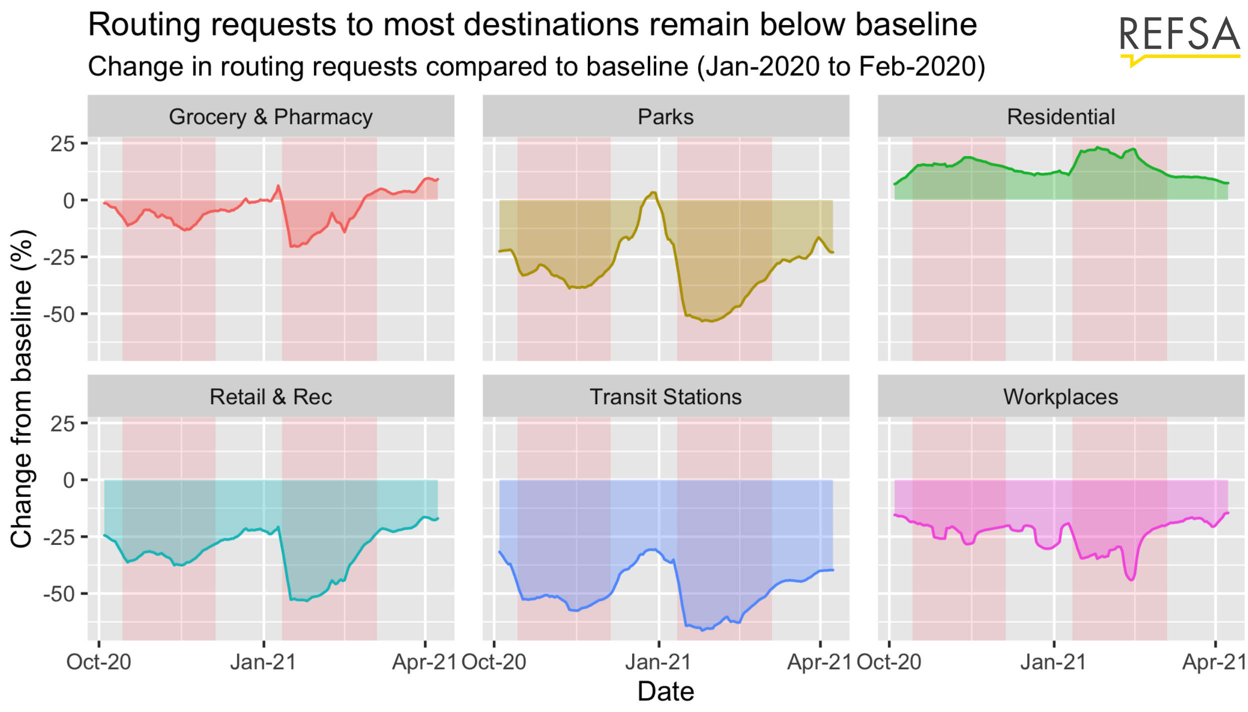
Overall, up to April 15th, slightly more than 1.1m doses of vaccine have been administered, which translates to a daily rate of approximate 28,000 per day. Ramping this up to 160,000 jabs per day as targeted by Vaccine Minister Khairy Jamaluddin[4] looks set to be a significant challenge, and it is unclear whether sufficient funds have been allocated for it.

Beyond the logistical issues, news reports of the EU and the US pausing the roll-out of the AstraZeneca and Johnson & Johnson vaccines are likely to increase vaccine hesitancy, making it less likely that the timetable for herd immunity will be met.

This point is fundamental, since the vaccine roll-out is the government's pre-eminent strategy to address the pandemic. All hopes hinge on a fast, comprehensive roll-out, which will then allow the economy to open up and restore our economic growth back to normal. By extension, any delay or setback in the vaccination programme translates to a direct impact to the economy. Overall, the level of uncertainty on the evolution of the pandemic remains high enough to affect consumption and investment decisions.

2. Is it possible for the economy to recover while the pandemic is not under control?

Controlling the pandemic and loosening the restrictions put in place are fundamental to the economic recovery, globally and domestically. However, even removing the restrictions entirely does not mean that activity immediately returns to pre-pandemic levels. As long as there is an elevated risk of infection, some sectors will have to contend with subdued activity, in particular the retail, entertainment, live performances and the significant travel and tourism sector, just to name a few. This is plainly visible in the mobility data released by Google, in which all categories except "Residential" and just recently "Grocery & Pharmacy" show a lower number of visits than before the pandemic, even when the MCO restrictions were at their loosest.



Shaded areas indicate MCO/CMCO restrictions.
Source: Google Covid-19 Community Mobility Reports.

The fact is that it is not only the physical distancing and other MCO measures that keep customers away, it is also the fear of infection itself. As long as there is no clear pathway to bringing the pandemic under control, an economic recovery will remain elusive.

3. Is there any progress on putting in place a comprehensive "Find, Test, Trace, Isolate & Support (FTTIS)" system, and avoid the blunt instrument of lockdown?

A useful framework which follows a "Find, Test, Trace, Isolate and Support (FTTIS)" has been discussed and designed at a fine-grained level in other countries.[5] This framework can be used in a targeted fashion to control the spread of the virus and subsequently bring the number of positive cases down.

Such a system is essential to avoid blunt restrictions that significantly affect the recovery. By now, the government and health authorities should have a wealth of data available through MySejahtera to manage new clusters or outbreaks in a more targeted manner. In addition to localised lockdowns, there is now also the option of targeted vaccinations in affected areas, which increases the appeal of this approach. Unfortunately, it seems no progress has been made on putting in place a comprehensive test and trace system. Because of this, the government will have little choice but to resort to the blunt instrument of generalised movement restrictions to keep cases in check, which has and will cost the economy dearly.

4. How much positive spillover effects can Malaysia expect from improving global conditions?

BNM's forecast is primarily predicated on a robust pick-up in global demand, helping Malaysian exports. For now, the developed economies are making progress in the vaccine roll-out and there is optimism, reflected in strikingly more optimistic forecasts than six months ago, especially for advanced economies.[6]

However, the risk of the pandemic has not completely receded, as can be seen in Europe especially, but also in parts of the US. Moreover, in light of these optimistic predictions, largely due to the unprecedented amount of government support, advanced economies may choose to start withdrawing this support too early. This could choke off their recovery, and also cause turbulent financial conditions for emerging markets. As to Malaysia's largest trading partner in 2019, China, the most recent manufacturing PMI figures were weaker than expected,[7] highlighting downside risk there as well.

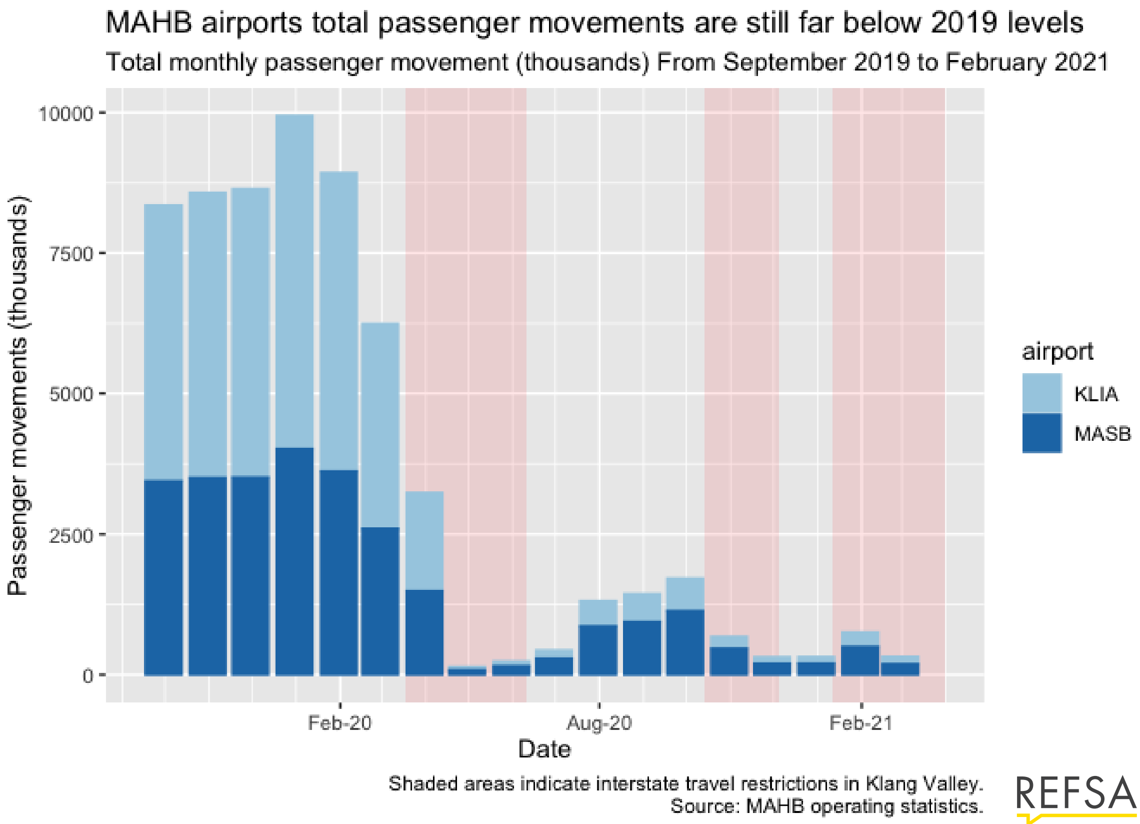
Indeed, the World Bank has been cautious in its GDP projections for 2021, having downgraded its forecast for global GDP growth this year from 4.2% in June 2020 to 4.0% as of January 2021. Recovery is expected to be slower for the advanced economies in particular, which is forecast to grow 0.6% slower than previously projected. Meanwhile, for East Asia and the Pacific, there has been a 0.8% upward revision in 2021 GDP projections, but most of this gain is expected to be seen in China.[8]

5. Where will export growth come from?

Looking at specific sectors, the largest contributor to overall goods exported at 29.5% of total merchandise exports is electrical machinery and equipment. Enjoying a relatively strong 2020, the sector generated RM296 billion in exports last year, a 5.3% increase annually relative to 2019.[9] This was driven to an extent by higher demand for electronic integrated circuits as part of work-from-home initiatives.[10] For 2021, the upside may start to run its course depending on global lockdown measures moving forward. In addition, this sector might be affected by specific issues, such as the worldwide microchip shortage, again preventing it from reaching its full output potential.

Oil and gas and palm oil, two of the other major export contributors, are sensitive to the global economic conditions, which brings us back to the points highlighted in the previous question. Palm oil export growth is premised on crude palm oil prices remaining high as well as economic recovery in the two biggest importers of Malaysian palm oil,[11] namely China (which is likely according to World Bank projections) and India (less likely because of the extent of the pandemic there).

BNM also highlights the tourism sector, which is expected to recover with the loosening of restrictions, albeit not to pre-pandemic levels. Recent data from airport operator MAHB however shows that passenger traffic is still virtually non-existent[12]. This is not surprising considering that international arrivals are still prohibited and that the Klang Valley, with a population of 7.6m, has been subject to interstate travel restrictions since the beginning of the year. Given that travel and tourism accounted for 15.9% of GDP in 2019,[13] this bodes ill for 2021's GDP growth rate overall.



6. Where are the signs that labour conditions are improving?

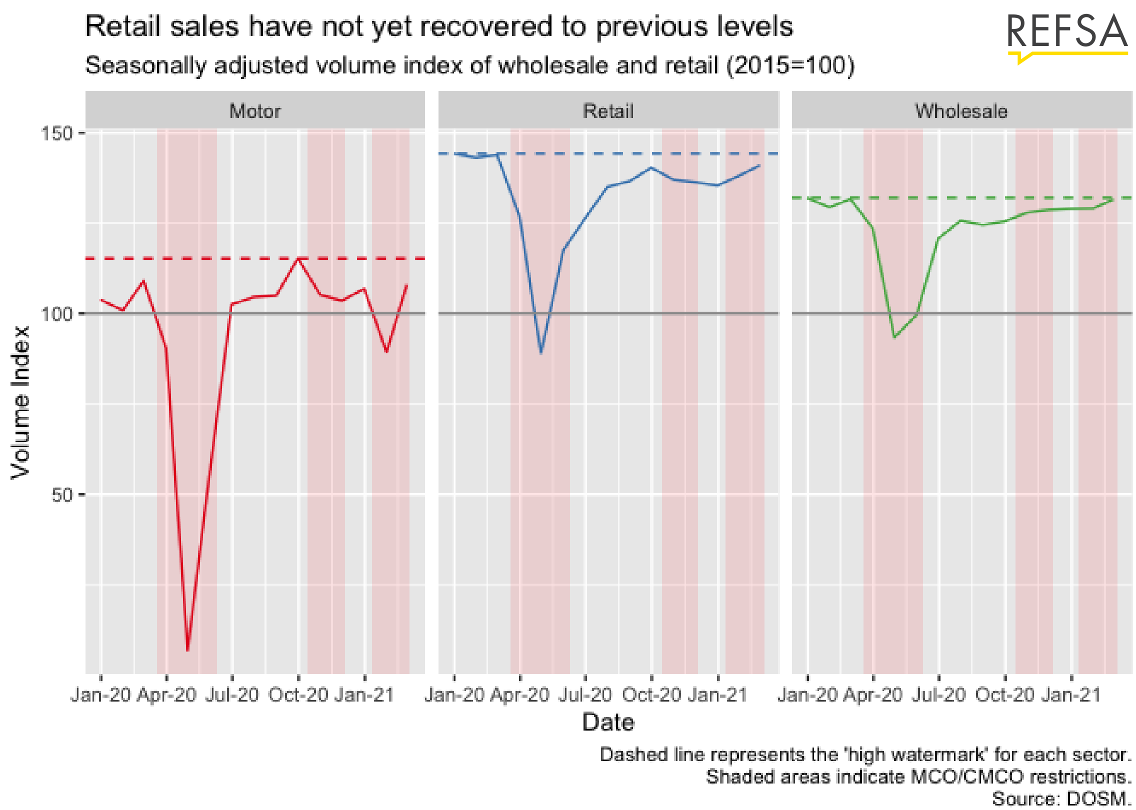
An improvement in the labour market, with higher job creation, lower unemployment and higher wages, is another important factor in BNM's assessment. However, the most recent labour market data does not show any significant improvement compared to last year. Malaysia's unemployment rate is exhibiting hysteresis, standing at 4.8% as of February 2021, with no change recorded since April 2020 just after the implementation of the first MCO. Among unemployed people, there is still considerable pessimism about their prospects: February 2021 saw an increase of 3.8% in the number of inactively unemployed people believing there was no employment available relative to January.[14] Underemployment also remains high and persistent, with time-related underemployment accounting for 2.4% of the employed workforce in Q4 2020, a 0.4% point increase from the previous quarter.[15] Anecdotally, there is no evidence of large employers looking to recruit heavily.

At the same time, it seems overly optimistic to anticipate a rebound in the salary of employees, many of whom experienced salary cuts in 2020, especially given the continued uncertainty over the number of COVID-19 positive cases and uncertainties in the political and economic landscape.

With no visible improvement to date, the runway for an increase in employment, wages and therefore private consumption in 2021 is shortening.

7. Where are the green shoots of the recovery?

Echoing the mobility data highlighted in question 2, seasonally-adjusted retail trade data available for the first two months of 2021 shows that this sector has not yet recovered to the previous highs, recorded in December 2019.[16] As long as some measure of MCO restrictions remains in place, especially in the Klang Valley, it seems likely that the sector will remain subdued, and any pent-up demand will only materialise when the pandemic is under control.



In addition, the decrease in the amount of direct government fiscal injections and non-direct liquidity injections (for example, the blanket loan moratorium) from 2020 to 2021 such as the Bantuan Prihatin Nasional (BPN), the expiry of the blanket loan moratorium in 2020, the decrease in the amount paid out via the Wage Subsidy Programme (WSP) will take away liquidity from consumers and firms and hence decrease overall spending. Even though the government allowed for the withdrawal of personal EPF funds from Account 1 via the I-Sinar programme (to replace the much stricter I-Lestari programme), the net effect is still negative for 2021 compared to 2020. (The blanket loan moratorium would have released RM100b in liquidity compared to about RM60b for the I-Sinar programme)

8. Will the government be able to increase public investment?

While the final breakdown between in government spending between operational and development expenditure has not been finalised, it is likely that the regular development spending on infrastructure and other construction projects would have been significantly affected in 2020. Most of the direct fiscal stimulus announced by the government in 2020 were direct fiscal injections to individuals and families (through policies such as the BPN and to firms (through the Wage Subsidy Programme). Given that the government and the public's attention was on COVID-19 related issues and policies, it should not be surprising that the tendering and awarding for regular infrastructure projects, such as the building of schools, roads and other public infrastructure would have been given lesser priority in 2020. The expectation of the government and perhaps, of BNM, is that the development expenditure that was neglected in 2020 would be aggressively executed in 2021.

Is there any reason to believe these projects will be mobilised faster in 2021 than in 2020? Anecdotal evidence from informal discussions with a few Bumiputera contractors who rely mostly on government related construction projects indicates that many tender for projects have been issued but the actual awarding of contracts have been few and far between.[17]

In addition, some of the large scale infrastructure projects have a long lead-time before they can be executed. For example, we should not expect a big project like MRT3 to start construction in 2021, given the long and complicated tender process.

9. Are the conditions right for private investment to flourish?

A bounce back in Gross Fixed Capital Formation (GFCF) and private investment is another important contributor to the overall growth rate forecast. GFCF fell by RM47.7 billion from RM328.4 billion in 2019 to RM280.7 billion in 2020, or a fall of 14.5%. While we can expect some level of recovery from this drastic fall in 2020, what are the factors which will convince the private sector to increase their investment spending in 2021, especially given continued uncertainties with the COVID situation and also the continued political uncertainty?

For example, it is quite clear that the number of new housing project launches will be very limited in 2021. With the exception of certain sectors such as the glove industry and the E&E industry, there is very little reason to see why investment in additional capacity, for example, will suddenly take a big leap in 2021 after the significant fall in 2020. There are more reasons to be pessimistic than to be optimistic.

10. What policies are in place to manage the end of the pandemic and start to build back better?

If we are to follow the reasoning of the report, the conclusion is that the pandemic will be practically over in a few months, which raises the question of how the government will start winding down the various support programmes, such as the loan moratorium, loan guarantees, tax breaks etc. The pandemic has also highlighted a host of structural reforms that are necessary, implementation of which cannot start soon enough. Business and consumers should get early visibility of these policies so they can adequately prepare, and so that uncertainty overall is reduced. However, the report offers no insight whatsoever, especially in those areas under the remit of the Bank, for example on the grant of digital banking licenses, stimulating "green" lending or social impact bonds, etc. Having a clear framework in these areas, all important potential contributors to future-proof growth, is a prerequisite to unlock innovation and investment.

CONCLUSION

Working through the assumptions of the report and the questions they generated, it is clear that there is an even chance we may be in for another difficult year in 2021. From this perspective it would seem reasonable to revise the forecast growth rates for 2021 downward, at least the lower bound of the estimate. Publishing overly optimistic forecasts is not without consequence. At a first order, they may lead the government to withdraw fiscal support too soon, as happened in developed economies after the global financial crisis. Beyond that, they may also become complacent in terms of managing the pandemic, and could choose not to address existing structural weaknesses in the economy. After the horrendous economic performance in 2020, this is something we can ill afford. Rather than taking this unique opportunity to "***build Malaysia back better***", we are seeing the total opposite, which is haphazard decision making and confusing policies, leaving the public wondering if it bears repeating that "***if we fail to prepare, we prepare to fail***" and failure is something which the B40 community and the SMEs can ill afford, especially after the suffering they have gone through in 2020.

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17. Dr. Ong Kian Ming, in his capacity as Member of Parliament for Bangi, and in the execution of a development expenditure related project in his constituency, spoke to a contractor, a landscape architect and a quantity surveyor and the feedback was consistent – tenders were going out but awarding of contracts were few and far between.

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Dr. Ong is the former Deputy Minister of International Trade and Industry (MITI), Malaysia and the current Member of Parliament (MP) for Bangi.

REFSA Economics Team: Jaideep Singh, Morgan Loh, Faiz Mustafa, Frederik Paulus

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Research For Social Advancement

Level 5, Block A,
Wenworth Building,
Jalan Yew, Off Jalan Pudu,
55100 KL

(03) **9285 5808**

www.**refsa**.org

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