Malaysia

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Happily Wrong

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Malaysia's growth momentum is stronger than we had thought

- Even as we saw signs that exports uptick would help to cushion the blow of the Jan-Feb MCO on the economy in Q1, we might have been too pessimistic when it comes to the strength of the private consumption recovery. As it turns out, Malaysia's economy shrank by just 0.5% against the 1.9% contraction that we had anticipated, boosted by consumption strength.
- As the country is unfortunately entering another period of MCO restrictions now, the fact the economy could still perform respectably in Q1 despite the MCO back then too gives us stronger hope that Q2 performance might hold up relatively well too. Indeed, we are revising our GDP forecast upwards rather than downwards; from 5.4% to 6.0% for the full-year 2021 because of the encouraging momentum in consumption and exports.
- We must throw in a big caveat here, however. We are assuming that economic activities can remain open despite the MCO. If the virus resurgence cannot be curtailed and that factories and shops must be shut to flatten the curve, then such numbers will automatically look lofty. Overall, tackling this virus looks increasingly like running a marathon. It is a good thing that Malaysia's economic stamina is a lot more robust than we thought.

They told us so

The central bank has been saying it for a while, and so has the Finance Minister: that Malaysia can achieve growth of 6.0-7.5% this year. For a while, we kept staring at our spreadsheet and wonder how that scenario could possibly pan out – and thought to ourselves that a full-year growth of 5.4% looks a lot more plausible to us.

As it turns out, we had underestimated the growth momentum of the economy in Q1. As it transpired, even as we calculated that the degree of economic contraction in Q1 will be less pronounced than the 3.4% yoy shrinkage seen in Q4 last year, we were too conservative. Rather than contracting at 1.9% yoy, the Q1 GDP growth came in at -0.5% yoy, besting market expectations of -0.9% yoy, as well. On a seasonally adjusted basis, the economy grew at a nice clip of 2.7% qoq, compared to -1.5% in Q4 last year.

What contributed to the strength? The most immediately clear answer is exports. After languishing in negative territory for the whole 2020, the segment roared back to positive growth in Q1, posting growth of 11.9% yoy. Here, the base effect from last year's subpar performance obviously helps. But, the underlying recovery in demand for Malaysia's exports, in the semiconductor-boosted E&E sector, in particular, has been evident from the monthly exports prints during the period, as well.

It helps, of course, that unlike the MCO of 2020, the restriction orders at the start of this year left the manufacturing sector ran their production lines as much as possible. While there were initial scares revolving a few virus contagion clusters in a number of factories, Malaysia managed to strike the right balance between keeping much of the economy running even as it put a tight lid on social interactions to curb the transmissions.

Mulling over MCO

That is the formula that it has again been compelled to use, as it steps into yet another round of MCO. While there were some hopes earlier that a nationwide blanket MCO could be avoided, and restriction orders could be applied to only specific hot zones, the continued uptick in cases has rendered that approach unworkable.

Indeed, just last night, the PM has announced a blanket MCO from May 12 to June 7. Crucially, however, similar to the MCO of a few months ago, factories can still operate. Hence, even though ultimate exports prints will depend on end-demand (which still looks strong for now in the major destinations of US and China), at least the supply side should be an issue as of now.

Still. even though the MCO should leave the exports sector largely untouched, wouldn't it have impacted private consumption and investment because of confidence hit? That's what we thought.

As it turns out, while the negative impact is there, the degree has been less than anticipated. Household consumption grew by -1.5% yoy in Q1, compared to -3.5% in Q4 2020 (and a much heftier -18.5% yoy in Q2 2020 during the first MCO). Hence while, consumption did weigh on overall GDP growth, subtracting 0.87ppt from the headline, the outturn is better than the 2ppt that it shaved off from the headline GDP growth rate in Q4.

A relatively better employment condition helped spending during the period. For one, even though unemployment rate did pick up to 4.9% in Jan 2021, from 4.8% the month before due to MCO, it has since declined to 4.7% in March. Again, compared to the shock effect back in Q2 last year, whereby joblessness rate picked up to 5.3%, employment is on steadier ground now, not least because economic activities remain open.

Hence, as we try to surmise what the impact of the latest MCO announcement will be on Q2 growth, it is encouraging to note that Q1 was not as badly hit as we had thought. Indeed, for Q2, the base effect will help a lot as well. Hence, taking the view that the new MCO will not impact exports activities much and would only have a more curtailed effect on private consumption, we think that growth may come in at 19.0% yoy in Q2. Together with the relative uptick in Q1's print, it would thus take our full-year forecast to 6.0% from 5.4% previously.

The show must go on

Where are the danger zones to the economy? They are aplenty, to be sure, but the ongoing virus resurgence will remain front-and-centre of our risk factors.

For one, there remains an uncomfortable probability, however small at this point, that the MCO might just be extended to cover at least some economic activities due to any hypothetical upsurge in industrial zones or commercial areas. That risk may be especially pronounced since Malaysia's vaccination drive has not picked up enough speed at a time when its inoculation rate remains behind its peers such as Singapore and Indonesia.

Given the tricky nature of the current pandemic wave, with its potentially higher transmissibility, that scenario cannot be discounted altogether – and would present a heavy double whammy on growth. Not only could exports be curtailed because of enforced factory shutdowns, but its resultant hit on employment outlook would put a dent on consumer confidence as well.

Even as we should continue to stay wide-eyed about such downside risks, we should also acknowledge the reality that the Malaysian economy has adapted quite considerably to the challenges posed by the pandemic and restriction orders.

Hence, overall, from the monetary policy perspective, we think there is an even higher chance now that Bank Negara would continue to adopt a wait-and-see stance and leave its OPR unchanged at 1.75% for the rest of the year.

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