

Executive Summary

Economic and Financial Developments in 2019

The global economy and global trade expanded by 2.9% and 1.0%, respectively in 2019 (2018: 3.6% and 3.7%, respectively), amid protracted and unresolved trade tensions which exacerbated the cyclical downturn in global manufacturing and investment activities. Heightened risk aversion in financial markets led to sustained demand for safe haven assets, exchange rate volatility as well as capital flow reversals from emerging market economies (EMEs). Amid this challenging global economic environment and domestic supply disruptions, the Malaysian economy expanded by 4.3% in 2019, supported by resilient private sector spending. Headline CPI inflation was lower at 0.7% (2018: 1.0%), while underlying inflation remained relatively stable (2019: 1.5%; 2018: 1.6%). The Monetary Policy Committee (MPC) meeting in May 2019 decided to reduce the OPR from 3.25% to 3.00% in order to preserve the degree of monetary accommodativeness, thus ensuring a conducive monetary environment for continued growth amid price stability. In addition, the Statutory Reserve Requirement (SRR) ratio was reduced from 3.50% to 3.00% in November 2019, which further supported the efficient functioning of the domestic financial markets.

Outlook and Policy in 2020

The global economy is projected to register negative growth in 2020, due mainly to the significant economic repercussions arising from the unprecedented coronavirus disease (COVID-19) pandemic. The IMF is expecting the global economy to undergo a recession in 2020 that is at least as bad as the GFC, with a projected recovery in 2021. Growth prospects for advanced countries and EMEs will be weak, with advanced economies in particular expected to experience a contraction in growth.

Measures implemented to contain the rapid spread of COVID-19, including broad-based travel restrictions, enforced business closures and restrictions on social activities, will suppress private sector activity globally. Nonetheless, the unprecedented nature and scale of fiscal and monetary policy intervention across economies is expected to cushion the economic disruptions caused by COVID-19. These measures will support a gradual normalisation in economic activities upon the successful containment of the pandemic.

Risks to global growth are tilted to the downside, mainly reflecting the significant uncertainties surrounding the COVID-19 pandemic. The extent of the economic impact arising from this pandemic would be contingent on the severity and duration of the outbreak in various economies and the corresponding measures undertaken to contain this global health crisis. The weakness in the real economy could be further weighed down by a prolonged tightening of global financial conditions.

Against this highly challenging global economic outlook, Malaysia's GDP growth is projected to be between -2.0 to 0.5% in 2020 (2019: 4.3%). The domestic economy will be impacted by the necessary global and domestic actions taken to contain the outbreak. Of significance, tourism-related sectors are expected to be affected by broad-based travel restrictions and travel risk aversion, while production disruptions in the global supply chain will weigh on the manufacturing sector and exports. The implementation and subsequent extension of the Movement Control Order (MCO), while critical, will dampen economic activity following the suspension of operations by non-essential service providers and lower operating capacity of manufacturing firms. Beyond the MCO period, reduced social and recreational activities until the pandemic is fully controlled globally and domestically will continue to dampen consumption and investment activity. Apart from the pandemic, the domestic economy will also

be affected by the sharp decline and volatile shifts in crude oil prices and continued supply disruption in the commodities sector. Unfavourable weather conditions and maintenance works will weigh on the production of oil palm, crude oil and natural gas.

Given the significant headwinds to growth arising from COVID-19, the Government and Bank Negara Malaysia have introduced large countercyclical policy measures to mitigate the economic impact of the pandemic. Two economic stimulus packages amounting to RM250 billion were introduced to provide immediate relief to affected households and businesses. These packages also include loan guarantees and an automatic 6-month moratorium on loan repayments for individuals and small and medium enterprises (SMEs). The economic stimulus measures were complemented by two consecutive Overnight Policy Rate (OPR) reductions early this year and measures to provide additional liquidity in the banking system.

Private consumption is expected to be dampened by weak labour market conditions, mobility restrictions and subdued sentiments. Nonetheless, policy measures introduced in the two economic stimulus packages, including cash transfers to vulnerable households, flexibility to withdraw from EPF savings and the moratorium on loan repayments will increase disposable income and improve cash flow for households. In addition to supporting household spending, these broad-based measures will facilitate a gradual recovery in private consumption as labour market conditions eventually stabilise following the projected improvement in global and domestic economic activities.

Domestic growth prospects are expected to improve towards the end of the year, in line with the projected recovery in global demand and amid continued support from policy measures. Recovering external demand will lift growth in the export-oriented sectors. Consumer sentiments are also expected to gradually improve following the easing of travel restrictions and resumption of tourism activities as risks from the pandemic subside. In addition, the anticipated recovery from supply disruptions in the commodities sector and higher public sector expenditure will support the gradual improvement in the Malaysian economy in the latter part of the year. Public sector spending will be underpinned by the continuation of large-scale transport-related projects by public corporations and the implementation of more small-scale projects worth RM4 billion by the Federal Government.

Overall risks to the domestic growth outlook are tilted to the downside, mainly due to the risk of a prolonged and wider spread of COVID-19 and its effects on the global and domestic economy. Domestic growth also remains susceptible to a recurrence of commodities supply shocks and continued low commodity prices which could pose additional risks to production in the commodities sector, exports and income growth. In addition, heightened financial market volatility due to ongoing external uncertainties may lead to tighter domestic financial market conditions. The baseline growth projection could, however, be lifted by a stronger-than-expected impact from the various stimulus measures by the Federal Government and additional measures implemented by several state governments.

Headline inflation is forecasted to average within the range of -1.5 to 0.5% in 2020 (2019: 0.7%), mainly reflecting significantly lower global oil and commodity prices. Without the direct downward impact from lower global oil prices, underlying inflation, as measured by core inflation, is projected to remain positive, averaging between 0.8 to 1.3%. This reflects subdued demand pressures, expectations for a negative output gap this year, as well as weak labour market conditions.

Monetary policy in 2020 will focus on providing support to domestic economic growth in an environment of subdued price pressures. The OPR was reduced in January and March 2020 by a total of 50 basis points to 2.50% to provide a more accommodative monetary environment to support economic growth amid price stability. The Statutory Reserve Requirement (SRR) ratio was also reduced further by 100 basis points in March 2020 along with the granting of flexibility to Principal Dealers to recognise Malaysian Government Securities (MGS) and Malaysian Government Investment Issues (MGI) for SRR compliance, releasing an additional liquidity of RM30 billion into the banking system. In addition, the Bank undertook measures to ensure continued financial intermediation including providing additional funds for SMEs, amounting to a total allocation of RM13.1 billion under the BNM's Fund for SMEs and improving features of the funds. These measures, together with lower borrowing costs for the private sector, will reinforce support to financing activity. Monetary policy will continue to take into account the continuously evolving balance of risks surrounding the outlook for growth and inflation.