Economists:
Lynette Lee
Toh Wei Liang

Strategic Credit & Economic Analytics
SMEBank-SCEA@smebank.com.my
(603) 2615 2020

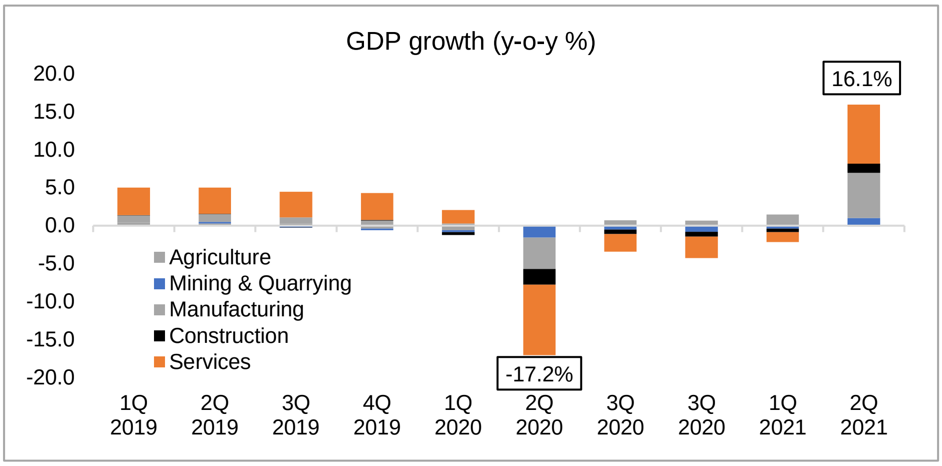
After months of political bickering and talks of no confidence vote, Tan Sri Muhyiddin Yassin had resigned from his position as Prime Minister last month. On August 21, Datuk Seri Ismail Sabri Yaakob was sworn in as our country's 9th Prime Minister. While some investors may take a "wait and see approach" amid changes at the helm of the Malaysian government, the reappointment of the majority of the Cabinet members were viewed positively.

This ensures policy continuity and consistency, especially for the upcoming 12th Malaysia Plan and Budget 2022 that are originally planned for 20th September and 29th October, respectively. Current economic policies, recovery plans and vaccination progress are not expected to be derailed. Although the new government may face an uphill task in terms of managing a drained economy coming out of a pandemic-led slowdown, recovery is around the corner considering the accelerated vaccination rate. As at end-August, 60% of Malaysia's adult population or close to 14.9 million people have been fully vaccinated while 78% or 19.6 million have received at least one dose of vaccine. With the commendable progress of vaccination, the nation should achieve herd immunity by 4Q 2021. This encouraging development is expected to drive positive sentiment among businesses and consumers.

An inaugural Pre-Budget Statement was published by the Ministry of Finance on 31 August 2021, to increase transparency in drafting of the country's annual budget. This is consistent with international best practices and in line with the proposed framework in enacting the Fiscal Responsibility Act. The re-appointment of Tengku Datuk Seri Zafrul Abdul Aziz as Finance Minister provides reassurance on policy continuity and clarity on the country's fiscal policy direction. The expansionary Budget 2022 will likely focus on:

1) rebuilding the resilience of the public health system
2) enhancing digital and technological infrastructure, from the education perspective and business sector
3) accelerating transition towards IR4.0 with higher level of productivity based on automated technology and higher human capital capabilities
4) further strengthening the sustainability agenda

On the economic front, after four consecutive quarters of economic contraction, Malaysia's GDP grew by a stellar 16.1% y-o-y in the April to June quarter (2Q 2021) owed to a low base effect – the economy contracted sharply at 17.2% during the same period last year. Strong trade activity is also a bright spot in the Malaysian economy amid the upcycle in global tech and rising demand for commodities as countries gradually reopen.



On a quarter-to-quarter (q-o-q) perspective, the economy clocked in at -2% weighed by tighter containment measures in June compared to the preceding January to March quarter (1Q: 2.7% q-o-q). For the remainder of 2021, we are expecting 3Q to clock in a mild contraction before rebounding in 4Q. This is in line with Bank Negara Malaysia (BNM)'s GDP forecast of 3 – 4% this year. Gradually, the government has begun to allow more economic activities for states across the country, even those that are under Phase 1 of the National Recovery Plan. Looser restrictions for fully vaccinated people with strict adherence to standard operating procedures such as dine-ins, re-opening of retail outlets and inter-district travels beyond 10km should prop up growth in the services industry in 2H 2021. The resumption of infrastructure projects with high multiplier effects and higher operating capacity for the construction and manufacturing industries should also lend support to economic recovery. According to the Construction Industrial Board, only 16% of the construction sector was operational during MCO 3.0.

The prolonged lockdown and business restrictions during several MCOs had dried up SMEs' cash reserves and impeded revenue generation activities. Business owners had to rationalise their manpower to contain fixed costs, albeit the government's wage subsidy programme under various stimulus packages that could in part alleviate the brunt of job cuts. In 2020, SMEs employment declined by 65,000 persons. Most surviving businesses have scaled down their operations and we foresee this situation to last until 2022. Nonetheless, we are confident that SMEs are resilient and will regain their footing as the economy gradually re-opens. The relaxation of movement controls is viewed positively as SMEs in the food and beverages and tourism industries would stand to benefit. SME Bank has been and is always ready to provide financing facilities to help businesses with their liquidity needs.

While the full return of mobility to pre-pandemic levels is unlikely this year, the ease of restrictions over the next few months should increase utilisation of domestic spare capacity, including a tighter labour market, to support underlying growth trend. We expect to see continued divergence in the recovery paths across businesses and economic sectors, with manufacturing and services sectors i.e. wholesale and retail trade, ICT, finance & insurance, and transport & storage taking the lead.

While the external economy and domestic vaccination programme is paving the way towards a stronger growth trajectory next year, renewed external uncertainties such as tapering of the US Federal Reserve's quantitative easing programme and slowdown in China's economy could dampen near-term recovery momentum, weighing on the prospects of Malaysia's export sector. Domestic downside risks include emergence of new Covid-19 variants that could impinge on the health system capacity and compel the government to extend movement restriction measures. The temporary pause in factory activities of several local semiconductor players, due to Covid-19 outbreaks, has contributed to global chip shortages. Corresponding to IMF and World Bank's GDP growth projection of 5% - 6% for 2022, our estimate is broadly similar where economic activities are likely to be above 2019 levels but below its potential output until 2023 – when economic conditions are envisaged to fully normalise.