TheStar

Setting the stage for next year

PETALING JAYA: While the economy is expected to be on a better footing in the fourth quarter (Q4), the prolonged movement restrictions are expected to substantially weigh on economic output this year and well into 2022.

This output gap, said RAM Rating Services Bhd (RAM Ratings), is largely due to the uneven pace of recovery across sectors and from the possible lasting economic scarring.

Early signs of scarring have already manifested in some labour market indicators, including rising under-employment and graduate unemployment, which may have consequences on future potential growth if prolonged.

Notably, most parties are expecting a stronger recovery in Q4, boosted by the rapid pace of vaccinations and the reopening of more economic sectors.

The government is targetting to have all adults fully vaccinated by October.

However, businesses will need time to recoup losses and re-establish their operations, which will delay a full ramp-up in output as well as growth plans.

Additionally, certain precautions would likely still be in place, potentially capping the extent of revival for certain sectors.

Bank Negara has forecast a full-year gross domestic product (GDP) growth for 2021 at between 3% and 4%, lower than its previous forecast of between 6% and 7.5%, after taking into account the reimposition of nationwide containment measures in June.

RAM Ratings, meanwhile, is expecting the GDP to rebound to 3.8% this year.

The credit rating agency is looking at a stronger growth of 7% to 8% in 2022, albeit largely due to the still low base effects from 2021, where the economy is envisaged to still be operating below its long-term rate of around 4.5% to 5% for the second consecutive year.

“Our preliminary growth forecast of 7% to 8% in 2022 reflects a relatively strong post-pandemic recovery, where most economic sectors would open largely uninhibited by restrictions.

“Nevertheless, we do not expect conditions to fully normalise in 2022,” RAM Ratings said in its latest Economic Update report.

Despite the growth rebound expected next year, it said overall output level is estimated to remain below its pre-pandemic potential and this may continue over the next one to two years, as the decline in investment and capacity building during the pandemic years will hurt economic output for the next few years.

“Due to the severe fallout, output and progress that could have been generated had it not been for the pandemic, have been forgone completely,” it explained.

Given that demand conditions may take a while to fully recover, the negative output gap is expected to persist in 2022, albeit narrower than in 2021.

“We estimate that the domestic economy, in aggregate, would operate 5% below its potential output in 2022.

“In the interim, accommodative policies are crucial to limit the potential permanent scarring from the economic fallout caused by prolonged lockdowns.”

This may translate into approximately RM75bil to RM85bil less than what it would have been if the economy had trended along its long-term growth path.

It estimated that an additional RM35bil to RM40bil, or 2% to 2.4% of GDP, in direct fiscal support measures would be required to bridge the projected output gap.

RAM Ratings pointed to a similar experience during the Global Financial Crisis in 2009, where it took about four to five years for overall output to recover to pre-crisis levels.

Amidst softer domestic demand, exports have remained a bright spot for the economy. RAM Ratings is projecting a rebound to 11.1% in 2021 (2020: -8.9%), fuelled by robust global demand and the current semiconductor supercycle, moving ahead.

According to the Statistics Department, Malaysia’s exports in July 2021 rose 5%, supported by both domestic exports and re-exports. Domestic exports, which were valued at RM76.6bil, expanded 5.9% year-on-year (y-o-y).

However, MIDF Research noted that Malaysia’s total trade grew at a slower pace of 13% y-o-y in July, attributable mainly to weaker exports (-7.7% month-on-month).

“Compared to July last year, exports moderated sharply to 5% y-o-y (June 2021: +27.2% y-o-y), faster than our expectation as we anticipated the impact of the temporary closure of factories during the month would have a significant impact on the export performance.

“While there was a slowdown in exports to major trading partners, especially to China and the United States, but thanks to Malaysia’s diversified export products, the single-digit growth in exports was supported mainly by increased exports of petroleum products, chemicals and chemical products, and palm-oil products,” it said.

It expects demand for electrical and electronics and rubber products to remain robust, but the ongoing lockdown and supply bottlenecks could have a near-term impact on production.

Despite the slowdown in total trade and the weaker export performance in July, MIDF said the momentum of business and trade activity should pick up following the relaxation of restrictions and reopening of business activities since mid-July 2021.

The vast difference in vaccine coverage between developed countries and the rest of the world will continue to impact the speed of economic recovery and supply chain disruption risks. This, added RAM Ratings, had the potential to impact Malaysia's export demand and supply of production inputs around the world.

"However, we note that Malaysia's key export partners are those with high vaccination rates, cushioning the impact for our exports," it said.

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