The pandemic induced supply shock has spread across the globe causing economic activity to come to an abrupt standstill, with global headwinds further compounded by fears of a worldwide recession. Bursa Malaysia, together with AmBank, had invited Dr Richard Record, World Bank Lead Economist for Malaysia, to discuss the implications of COVID-19 on Malaysia’s economic outlook. Key takeaways below.

- COVID-19 has now become a global pandemic, with the epicentre shifting from China to Europe and the US. As a result, countries have taken strict measures to restrict movements to mitigate the spread of the virus. This has a significant implication on trade as per the chart below. The emerging markets have also seen large capital outflows, dipping below GFC level (-2.1 points vs GFC’s -1.0 points).

- Commodity markets have experienced significant turbulence with energy prices seeing the sharpest declines, albeit partly due to the price war. Crude oil declined 40% MoM in March, while rice gained 10% MoM as households hoard food during the lockdown period. Agricultural products heavily used for industrial purposes such as sugar, cocoa and palm oil saw a decline in prices. Metal prices have declined as well.

- GDP and exports are expected to be negatively affected across the world. The World Bank’s base case sees a deviation from the trend rate for China’s GDP by -3.7%, developing countries by -2.5% and the world by -2.1%. However, on an amplified pandemic scenario, the negative impulse for China would be -4.3%, developing nations by around -4.0% and the world by -3.9%.
Additionally, the economic impact of the outbreak has been felt through the enactment of movement restrictions leading to limited economic activities since only essential activities are allowed to continue, and the restrictions have led to simultaneous domestic demand and supply shocks.

The severity of the economic downturn will depend on the management of the pandemic curve. Flattening the pandemic curve through public health measures, i.e. Movement Control Order (MCO) will prevent the virus from overwhelming the healthcare system. Macroeconomic measures are also needed to help flatten the recession curve.

Since January 2, the FBMKLCI has declined around 17%, and the MYR has depreciated nearly 7%. Early indicators are suggesting a sharp decline in economic activity as merchandise exports and imports started to decline since February. Large capital outflows were also seen in February and March.

Output contraction is expected this year with a baseline scenario of real GDP growth of -0.1% in 2020, followed by a strong recovery in 2021 with a real GDP growth of 6.4%. Private consumption is expected to be weak in 2020 but held up by public consumption. Industrials are expected to see a sharp decline as well. On a lower-case scenario, the World Bank expects a deeper real GDP growth contraction of 4.6% and a slower recovery of 4.1% in 2021, assuming a longer-lasting period to suppress the spread of COVID-19 and a slow period before growth starts to recover.

Some of the downside risks to this outlook include:
- A prolonged outbreak will lead to a more severe economic downturn
- The increasingly depleted fiscal space
- Political uncertainties that may arise

In response to the fiscal impact, the Malaysian government has enacted several rounds of stimulus packages totalling about 17% of GDP with direct fiscal injection of about 2.3% of GDP.

Government revenue is expected to fall in 2020. Current estimates show a marked shortfall of RM22.6 billion to RM29.4 billion in revenue for 2020 based on World Bank’s forecast. The bulk of the revenue decline is due to lower petroleum-related income.

World Bank expects the larger government spending combined with lower revenue would result in a wider fiscal deficit in 2020. Without any new revenue measures, the fiscal deficit could widen to 6.6% of GDP vs 4.9% of GDP with revenue measures.
Meanwhile, government debt is projected to exceed the self-imposed limit of 55% of GDP unless measures are taken to increase revenues or adjust Malaysia’s fiscal rules.

- While the overall size of Malaysia’s stimulus package is large, the actual fiscal injection is relatively modest. Most of the components of the stimulus package are off-budget. This is constrained by the government’s statutory limits on federal government debt.

- According to the Loan (Local) Act 1959, operating expenditure must be financed by revenue (not borrowing) and the statutory limit of federal government outstanding debt instruments must not exceed 55% of GDP.

- The World Bank presented three options to finance additional fiscal measures if a further stimulus is needed:
  - **Option 1**: Government could recalibrate selected items of non-core operating expenditure such as supplies and services, grants and non-COVID-19 related subsidies.
  - **Option 2**: Government could raise additional non-tax revenue to fund additional stimulus spending, which includes higher investment income from Government-Linked Companies (GLCs) and the sale of physical assets.
  - **Option 3**: Parliamentary intervention to temporarily lift the statutory limits governing public debt management.

- In conclusion, the World Bank thinks that Malaysia’s economy remains resilient, given its diverse economic structure, current account surplus, resilient financial sector institutions and its early response to the pandemic and strong healthcare institutions.

- However, additional measures will be needed to ensure a speedy recovery after the crisis. These measures should be designed to restore private confidence and revive private investments. Medium to long-term reforms is also needed to address critical gaps in human capital to boost productivity, increase competition in protected sectors as well as creating more private sector opportunities especially for women’s participation in the economy.