From the Desk of the Chief Economist

BANK ISLAM

ECONOMIC OUTLOOK FOR 2H2021: DEALING WITH THE AFTERMATH

12 JULY 2021

ECONOMIC RESEARCH

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TABLE OF CONTENT

OVERVIEW

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- ✓ **Sustainable economic recovery hinges upon the vaccination program** – While the economic stimulus has been sizeable and forthcoming, convincing recovery will be predicated on how soon the economy can be reopened. This will be primarily dependent on the timely achievement of the so-called herd immunity which slated to be reached by end of the year.

- ✓ **Global trade is expected to support economic growth with some caveat** – The recovery in global trade has been stronger amid higher demand conditions despite facing constraints in the global value chain. For instance, China's exports surged by 40.2% year-on-year (y-o-y) during 5M2021 from a 8.0% contraction in the same period last year. However, the slight decline in the J.P. Morgan Global Manufacturing Purchasing Manager's Index (PMI) to 55.0 points in June (May: 56.0 points) suggests that the global trade momentum could easily turn slower.

- ✓ **Gradual decline in Covid-19 infections globally** – Global Covid-19 cases continued to drop, though many countries are still struggling with sparse vaccine supply, the spread of new variants and health systems being on the brink of collapse. Thus far, the number of daily infections fell to 421,893 on 1 July 2021 from 751,891 cases on 1 January this year. Be that as it may, the numbers are still high and continue to climb in some countries such as Russia, UK and Australia, fuelled by the highly contagious Delta variant. Apart from that, higher infections were recorded particularly in developing economies amid unequal vaccine deployment.

- ✓ **The U.S. is on the cusp of monetary policy normalization** – The steady vaccination pace in the U.S. and strong policy support have led the U.S. Federal Reserve (Fed) to bring forward the time frame on when it is expected to raise the Federal Funds Rate (FFR). Apart from that, the Fed officials indicated that rate hikes could come as soon as 2023 after saying in March that it saw no increases until at least 2024. This may also jive well with the market expectations that the Fed will begin cutting back its aggressive assets purchasing programme (Treasury securities: USD80.0 billion and Mortgage-back securities: USD40.0 billion) beginning in 2022.

OVERVIEW (CONT'D)

- ✓ **Government fiscal support** – Malaysia's government has broadened the fiscal responses to mitigate the severe impacts caused by the Covid-19. Since 2020, Malaysia has issued seven stimulus packages *(refer slide 10)* worth RM530.0 billion in total which includes RM83.0 billion of direct fiscal injections. Recently, on 28 June 2021, Malaysia's government unveiled a new economic stimulus package named "PEMULIH" worth RM150.0 billion in an attempt to mitigate the impacts of continued lockdowns, allowing people to cope with financial difficulties. Apart from that, the National Recovery Plan (NRP), a four-phase exit strategy from the Covid-19 crisis could shed some light on how conditions of the movement restrictions would be gradually lifted in Malaysia.

- ✓ **Herd immunity likely to be reached by year-end in Malaysia –** Meanwhile, the Malaysian government is planning to ramp up the daily vaccination doses to the tune of 300.0k to 400.0k per day on average starting in August from the current average of 150.0k to 200.0k doses per day. Should the plan materialise, Malaysia may be able to vaccinate 80.0% of the country's population to reach herd immunity by the end of 2021. As of late, the number of daily vaccination doses administered in the country has been encouraging, reaching 291,217 doses on 11 July 2021.

- ✓ **The case for higher OPR next year is building up** - Assuming that herd immunity is reached by year-end in Malaysia with relaxations being probably eased, the pace of economic recovery will be well supported by strong consumer spending. The country's M1 (currency in circulation plus demand deposits) money supply growth has been increasing by a double-digit growth since May last year (May 2021: 15.1% y-o-y vs. April 2021: 18.3%). This suggests that there is an abundance of cash in the hands of the general population. As such, consumer spending is expected to make a strong comeback next year. Therefore, a higher overnight policy rate (OPR) would make a compelling case in 2022.

GLOBAL ECONOMIC PROJECTION & MALAYSIA'S ECONOMIC SNAPSHOT

GLOBAL OUTPUT PROJECTION IN 2021

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Projection made in June 2021:
5.6%
Projection made in January 2021:
4.1%

- ✓ The World Bank has revised up its global output growth to 5.6% in 2021, 1.5 percentage points (ppts) higher than the previous forecast, largely on strong rebounds from a few major economies.
- ✓ Apart from that, the steady but highly uneven global vaccination trends and the gradual relaxation of pandemic-control measures in many countries are expected to support the growth.

OECD BETTER POLICIES FOR BETTER LIVES

Projection made in May 2021:
5.8%
Projection made in December 2020:
4.2%

- ✓ Global GDP is estimated to rebound by 5.8% in 2021, helped by the government stimulus–led upturn in the U.S.
- ✓ In many advanced economies, government stimulus is helping to boost demand and businesses are adapting better to the restrictions to stop the spread of the virus.

INTERNATIONAL MONETARY FUND

Projection made in April 2021:
6.0%
Projection made in January 2021:
5.5%

- ✓ The global economy is forecasted to grow at 6.0% in 2021, reflecting additional fiscal support in a few large economies and the anticipated vaccine-powered recovery in the second half of the year.
- ✓ Be that as it may, high uncertainty still surrounds the global outlook as future developments will depend on the path of the health crisis.

Source: Official websites

MALAYSIA: GDP PROJECTION IN 2021

2021F: 4.2%

- ✓ The extent of fluidity has been extremely evident. This has led to multiple revisions in our GDP forecast.
- ✓ Early in January this year, we estimated that Malaysia's GDP would expand by 5.0% in 2021, anticipating that the economic recovery would make a smooth sailing in light of the vaccination rollout.
- ✓ Little that we know the implementation of MCO 2.0 effective from 13 January 2021, leading to the downward revision to our GDP forecast to 4.0%.
- ✓ As the economy is gradually improving and the government has started the vaccination program since February, we decided to revise up our base estimates for the GDP growth in 2021 to 5.0% in April.
- ✓ And most recently, we have adjusted our GDP projection downwards to 4.2% with the following assumptions:

1. MCO 4.0 will last for two months until end of July.
2. Labour market continues to be affected which will lead to lower consumption expenditures.
3. Inability of manufacturers to fulfill orders due to working capacity constraints.

BANK NEGARA MALAYSIA

2021F: 6.0% – 7.5%

"The forecast is expected to be revised downwards in mid-August" - MOF

WORLD BANK GROUP

Projection made in June 2021:
4.5%
Projection made in March 2021:
6.0%

- ✓ Flare-up in Covid-19 infections.
- ✓ Slower-than-expected vaccine rollout.

Projection made in April 2021:
6.5%
Projection made in January 2021:
7.0%

Still high Covid-19 infection cases would put a lid on growth prospects.

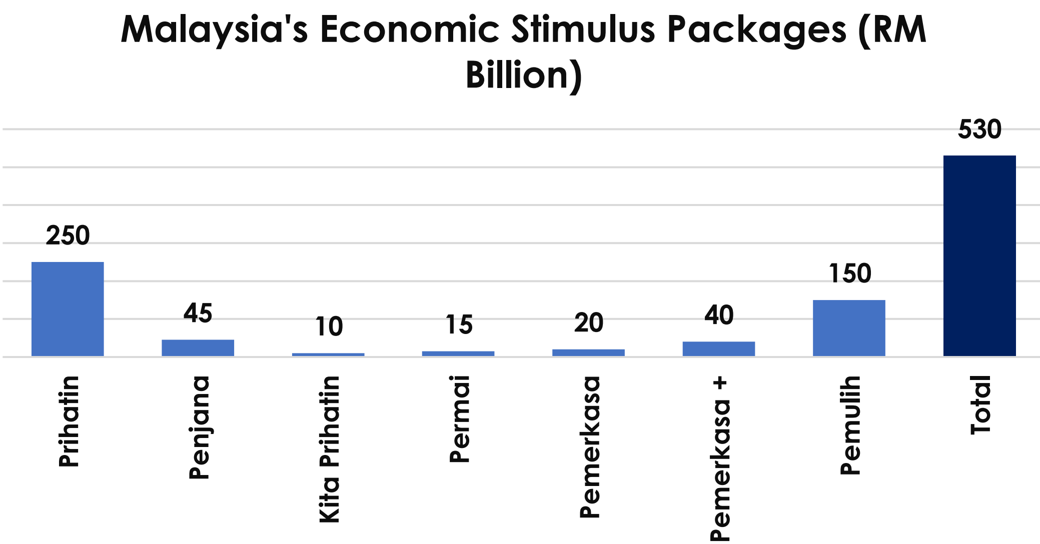
Sources: World Bank, IMF, BNM, Bank Islam

LATEST PERFORMANCE ON MALAYSIA'S ECONOMY

Variables	Remarks
Gross Domestic Product (GDP)	Malaysia's GDP contracted by 0.5% y-o-y in 1Q2021, though at a softer pace as compared to the previous quarter of -3.4%. This marks the fourth consecutive quarter of decline since 2Q2020 due to the Movement Control Order (MCO) 2.0 in January and February this year.
Trade Balance	Total exports recovered by 31.1% during 5M2021 after falling by 10.8% in the same period last year. This was mainly attributed by the Manufacturing (5M2021: 34.3% vs. 5M2020: -9.4%) and Agriculture (5M2021: 31.8% vs. 5M2020: -9.9%) sectors. Similarly, total imports improved by 20.1% in 5M2021 from a 7.5% contraction in 5M2020. As such, the trade surplus balance widened to RM92.8 billion during 5M2021 (5M2020: RM43.7 billion).
Industrial Production Index (IPI)	IPI rebounded by 14.9% y-o-y in 5M2021 (5M2020: -10.8%) driven by better performance in Manufacturing sector which grew by 19.6% during 5M2021 (5M2020: -11.3%). This was due to robust external demand for electrical & electronics (E&E) products (5M2021: 21.6% vs. 5M2020: -8.5%).
Consumer Price Index (CPI)	Inflation rate surged by 2.1% in 5M2021 from a 0.6% decline in the same period last year. Meanwhile, core inflation softened by 0.7% in 5M2021 (5M2020: 1.3%). This indicates that the costs pressure could be transitory amid a lower base effect from last year and is expected to subside further in the next few months.
Manufacturing Purchasing Manager's Index (PMI)	Manufacturing PMI dropped to 39.9 points in June from 51.3 points in May. This was the lowest figure reported since April last year as rising number of infection cases had led to the implementation of stricter containment measures and dampened demand in both domestic and external markets.
Labour Market	UR declined to 4.5% in May from 4.6% in the previous month. It was the lowest jobless rate since March last year, as the number of unemployed persons fell by 11.9% y-o-y to 728.1k in May (April: 742.7k), while employment rose by 3.2% y-o-y to 15.37 million in May (April: 15.35 million). Apart from that, according to the data from SOCSO, the loss of employment (LOE) declined to 34,729 during 6M2021, lower than the 50,408 recorded in the same period last year.

Sources: BNM, DOSM, CEIC

STIMULUS PACKAGE – WORTH OF RM530 BILLION



2021

18 Jan 2021

PERMAI (RM15 Billion)

3 main goals:
1. Combat the Covid-19 outbreak
2. Safeguard welfare of people
3. Support business continuity

17 Mar 2021

PEMERKASA (RM20 Billion)

Comprises a total of 20 strategic initiatives that aims to boost economic growth, support businesses and provide targeted assistance to the people and sectors that are still affected by the pandemic.

31 May 2021

PEMERKASA PLUS (RM40 Billion)

3 main goals:
1. Healthcare capacity
2. People’s welfare
3. Business continuity

28 June 2021

PEMULIH (RM150 Billion)

3 main focuses:
1. People’s welfare
2. Supporting business
3. Improving vaccination

Source: Prime Minister’s Office of Malaysia Official Website

VACCINATION PROGRESS IN MALAYSIA

VACCINATION – PACE OF MALAYSIA'S VACCINATION EFFORTS

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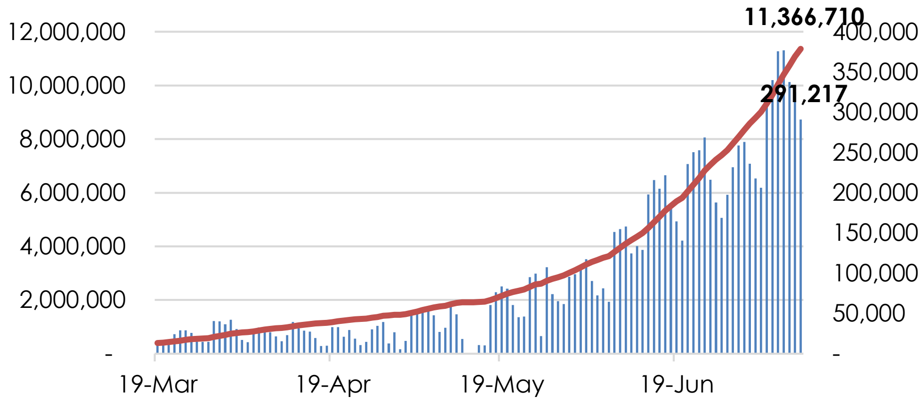
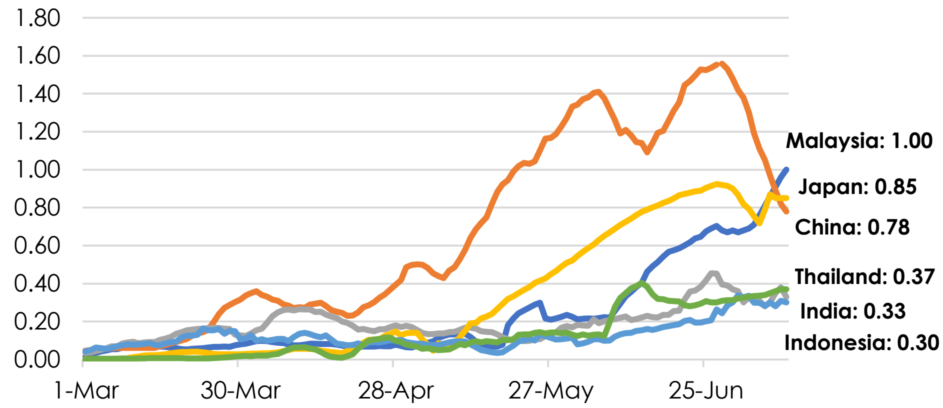
Vaccination Doses Administered in Malaysia



Source: CEIC
Note: As at 11 July 2021

Daily Vaccination Doses Administered Per 100 People



Source: Our World In Data
Note: As at 10 July 2021

- ✓ Malaysia's vaccination programme which commenced on 24 February 2021 has shown a steady progress with 10.8% of the total population or 3.5 million people having received both doses as at 11 July 2021.
- ✓ Moreover, the pace of vaccination efforts has increased as of late. For instance, the average daily number of doses administered in June had reached 169.2k doses per day compared to 50.3k doses per day in May.
- ✓ In comparison with other Asian peers, Malaysia is faring well as the daily vaccination doses per 100 people stood at 1.00 on 10 July 2021, better than countries such as Japan, India, Thailand, China and Indonesia.

Percentage of Malaysia's Population That Have Been Fully Vaccinated

Malaysia's Population	32,750,000
Number of People Fully Vaccinated With Two Doses	3,526,676
Percentage of Malaysian Population Vaccinated With Two Doses	10.8%
Percentage of Adult Malaysian Population With Two Doses	15.1%

Sources: DOSM, Covid-19 Immunisation Task Force (CITF)
Note: As at 11 July 2021

VACCINATION – PATHWAY TO REACH 80.0% OF POPULATION BY YEAR-END

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Malaysia's Targeted Vaccination Doses To Vaccinate 80.0% Of The Population*

Month	Average Daily Doses Administered/Expect To Be Administered ('000)	Total Doses Administered (1st And 2nd Dose) (million)	Cumulative Doses Administerd (1st and 2nd Dose) As At Month-End (million) (A)	Number Of Doses Required To Vaccinate Malaysia's Total Population (B)	Percentage Of Population Vaccinated (With At Least The First Dose) (A÷B)
24 February 2021 to 30 June 2021	63.8	8.1	8.1	65.5	12.4%
Jul-21	389.6	12.1	20.2	65.5	30.8%
Aug-21	433.8	13.4	33.6	65.5	51.3%
Sep-21	209.9	6.3	39.9	65.5	60.9%
Oct-21	215.3	6.7	46.6	65.5	71.1%
Nov-21	130.6	3.9	50.5	65.5	77.1%
Dec-21	80.7	2.5	53.0	65.5	80.9%

Sources: DOSM, National Covid-19 Immunisation Programme

- ✓ According to Department of Statistics of Malaysia (DOSM), Malaysia's population is estimated to be at 32.75 million in 1Q2021 (1Q2020: 32.62 million). As such, there will be 65.5 million doses needed to vaccinate the whole population since each person would require two shots to be inoculated.
- ✓ Herd immunity is deemed to be at 80.0% of population to be fully vaccinated. That would mean 52.4 million doses will be required to reach the said target.
- ✓ Referring to the table above, 8.1 million doses (first dose: 5.8 million, second dose 2.3 million) have already been administered in Malaysia from 24 February 2021 to 30 June 2021. The total doses that are anticipated to be administered in 2H2021 is expected to peak in August at an average of 433.8k doses before declining thereafter.
- ✓ More importantly, the calculations in the table suggest that a total of 53.0 million vaccine doses are forecasted to be administered in Malaysia by the end of December. This translates to 80.9% of Malaysia's population that will be vaccinated with at least the first dose, indicating that Malaysia will likely obtain herd immunity by year-end.

*https://www.thestar.com.my/news/nation/2021/06/21/daily-vaccinations-to-hit-peak-in-august-says-khairy

VACCINATION – DRIVERS FOR VACCINATION EFFORTS IN MALAYSIA

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- ✓ We understand that the number of vaccination centres nationwide have been increased to accommodate the vaccination efforts in the country.
- ✓ For instance, manufacturing workers will be vaccinated under the Public-Private Partnership Covid-19 Industry Immunisation Programme between July and September at 49 designated industry vaccination centres. Therefore, this could prevent further infections at factories while enabling working capacity to be gradually increased later on. With that, the impact from bottleneck supply chain issues could be mitigated.
- ✓ Other notable vaccination centres include the Bukit Jalil National Stadium which has a capacity to administer 10,000 vaccines per day and has started operations since 21 June 2021.
- ✓ In total, there are currently 714 vaccination centres (excluding mobile and outreach vaccination exercises) across the country with a total maximum daily capacity of 256.0k doses.
- ✓ Looking forward, the government will plan to set up more vaccination centres as supplies come into the country.

Current Operating Vaccination Centres In Malaysia

No.	Types Of Vaccination Centres	Total	Maximum Daily Capacity Of Doses
1	Public Vaccination Centres under Ministry of Health (MOH)	139	21,191
2	Public Vaccination Centres not under MOH	223	144,870
3	Mega Vaccination Centres	5	34,000
4	AstraZeneca Vaccination Centres	8	34,400
5	Higher Educational Institution Vaccination Centres	5	7,600
6	Drive-through Vaccination Centres	4	1,600
7	Vaccination Centres under General Practitioner	273	3,821
8	Vaccination Centres under Private Hospitals	57	8,541
	Total	**714**	**256,023**

Source: Slides by Minister of Science, Technology and Innovation, Khairy Jamaluddin at The Oxford and Cambridge Society Malaysia's "The Path to Herd Immunity" session.

VACCINATION – WHEN CAN WE EXPECT ECONOMY TO FULLY REOPEN UNDER THE NATIONAL RECOVERY PLAN

Malaysia's National Recovery Plan

PHASE 1
July 2021

- ✓ Only essential services allowed to operate normally with adherence to standard operating procedures (SOPs).
- ✓ Certain exempted manufacturing sectors to operate at 60.0% and 10.0% working capacity.

To enter Phase 2:
- <4,000 daily Covid-19 cases
- Moderate ICU capacity
- 10.0% of population vaccinated with 2nd dose

PHASE 2
Mid-July to August 2021

- ✓ Operating capacity of manufacturing sectors to be increased to 80.0% from 60.0% previously
- ✓ Social sectors remain closed.

To enter Phase 3:
- <2,000 daily Covid-19 cases
- Comfortable ICU capacity
- 40.0% of population vaccinated with 2nd dose

PHASE 3:
September to October 2021

- ✓ All manufacturing sectors and economic sectors allowed to operate except those that are deemed high risk.
- ✓ Fully vaccinated industries can operate at full capacity.
- ✓ Some social activities allowed to resume.

To enter Phase 4:
- <500 daily Covid-19 cases
- Safe and secure ICU capacity
- 60.0% of population vaccinated with 2nd dose

PHASE 4:
November to December 2021

- ✓ All economic and majority of social sectors allowed to resume.
- ✓ Interstate travel and domestic tourism allowed subject to SOPs.

Source: National Recovery Plan

- ✓ We gathered that the dosing interval for the AstraZeneca vaccine has been shortened from 12 weeks to 9 weeks. In addition, the Sinovac vaccine which is being administered for the third phase of the National Covid-19 Immunisation Programme also has a short dosing interval of three weeks, Henceforth, the pace for people to receive their second dose will be faster. This will expedite the process to reach the threshold of fully vaccinating 60.0% of the population.
- ✓ However, this will also depend on the intensive care unit (ICU) capacity and daily number of Covid-19 cases. With vaccination efforts being ramped up, the number of Covid-19 patients hospitalized could be reduced as vaccinated individuals are likely to face less severe symptoms if infected.

VACCINATION – MALAYSIA'S VACCINE PORTFOLIO

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Malaysia's Vaccine Portfolio

Manufacturer	Doses	Population Coverage
COVAX (World Health Organisation) -AstraZeneca -Janssen (Johnson & Johnson -Novavax	6.4 million (1 or 2 doses per person)	10.0% (3.2 million people)
Pfizer/BioNTech (Comirnaty –BNTI62b2)	44.8 million (2 doses per person)	70.0% (22.4 million people)
AstraZeneca University of Oxford (AZDI222)	6.4 million (2 doses per person)	10.0% (3,2 million people)
Sinovac Biotech Ltd/Pharmaniaga Sdn Bhd (CoronaVac)	12.0 million (2 doses per person)	18.8% (6.0 million people)
CanSino Biologics Inc/Solution Biologics Sdn Bhd (AD5-nCOV)	3.5 million (1 dose per person)	10.9% (3.5 million people)
Total	**73.1 million**	**117.0%**
*Subject to National Pharmaceutical Regulatory Agency Approval: Gamaleya (Sputnik V)/Duopharma Biotech Bhd	6.4 million (2 doses per person)	10.0% (3.2 million people)

Source: National Covid-19 Immunisation Programme

Malaysia's Population: 32.75 million

Total Doses Needed To Vaccinate Malaysia's Population: 65.5 million doses*

Source: DOSM
Note:* Assume that majority of vaccines require a 2 dose for each person

- ✓ Assuming that 65.5 million doses are required to fully vaccinate Malaysia's population, the number of vaccines that have been approved by the government is more than enough at 73.1 million.
- ✓ Therefore, there are ample supplies of vaccination for everyone in the country.

VACCINATION – DECLINE IN VACCINE HESITANCY SEEN IN HIGH REGISTRATION NUMBERS

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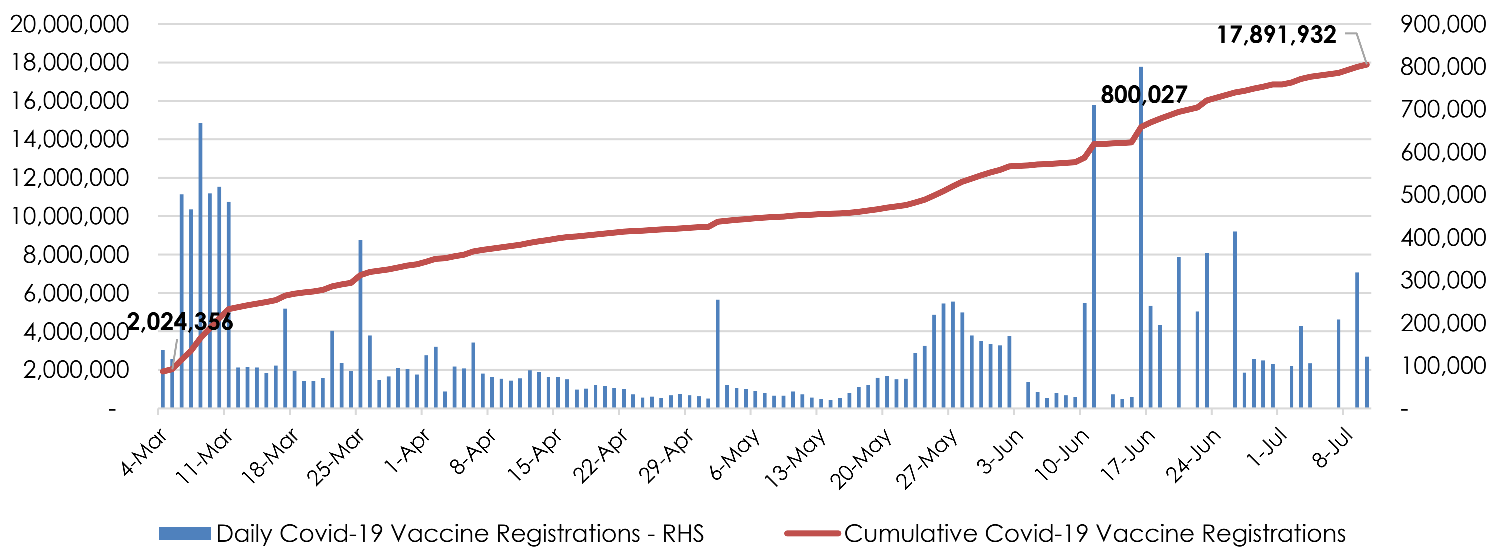
- ✓ Vaccine hesitancy appeared to be high when the vaccination campaign was rolled out in late February this year, as many people were concerned on the side effects of the vaccination.
- ✓ When the AstraZeneca voluntary opt-in vaccination programme was launched in May, surprisingly all 268,000 slots were filled. Even during the second batch of the said programme, all slots for 1,240,000 doses were fully booked within an hour.
- ✓ This signifies that vaccine hesitancy is waning and people are more aware of the importance of being vaccinated.
- ✓ Looking at the vaccine registration trends in Malaysia, the number of people who have registered for the vaccine reached 17.9 million on 10 July 2021 compared to just 1.9 million on 4 March 2021.
- ✓ It is no doubt that the increased willingness of people to be vaccinated will help smoothen the journey to reach herd immunity.

Covid-19 Vaccine Registrations in Malaysia



Source: CEIC
Note: As at 10 July 2021

VACCINATION – EFFICACY OF CURRENT VACCINES TOWARDS THE DELTA VARIANT

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- ✓ Global daily Covid-19 cases have witnessed a decline to reach 458,355 cases on 9 July from 751,891 cases on 1 January this year.
- ✓ However, some parts of the world such as Europe together with the U.K have experienced a recent spike in daily global cases.
- ✓ For instance, the daily global Covid-19 cases in the Europe was hovering in the range of 56,000 to 72,000 in late June before surging as high to 100,801 cases on 8 July.

Number Of Daily Covid-19 Cases

Date	Global	U.S.	Europe	U.K.	Indonesia	Malaysia
1-Jan-21	751,891	237,337	307,029	70,797	8,072	2,068
25-Jun-21	447,854	14,239	62,166	16,702	18,872	5,812
26-Jun-21	404,041	15,239	61,161	15,296	21,095	5,803
[illegible]	[illegible]	[illegible]	62,051	17,943	21,342	5,586
[illegible]	[illegible]	[illegible]	56,117	14,623	20,694	5,218
[illegible]	[illegible]	[illegible]	63,683	22,644	20,467	6,437
[illegible]	[illegible]	[illegible]	72,093	20,223	21,807	6,276
1-Jul-21	[illegible]	[illegible]	84,387	25,606	24,836	6,988
2-Jul-21	416,909	10,959	89,285	27,556	25,830	6,982
3-Jul-21	435,572	18,156	90,099	26,706	27,913	6,658
4-Jul-21	423,324	16,123	87,920	24,447	27,233	6,045
5-Jul-21	383,636	5,372	79,615	23,818	29,745	6,387
6-Jul-21	336,458	3,180	77,837	27,100	31,189	7,654
7-Jul-21	378,572	5,614	93,184	28,334	34,379	7,097
8-Jul-21	490,673	36,990	100,801	32,048	38,391	8,868
9-Jul-21	458,355	22,569	97,491	31,977	38,124	9,180

Many countries saw a spike in daily cases towards the end of June after a declining trend was observed.

Source: CEIC
Note: Updated as at 9 July 2021

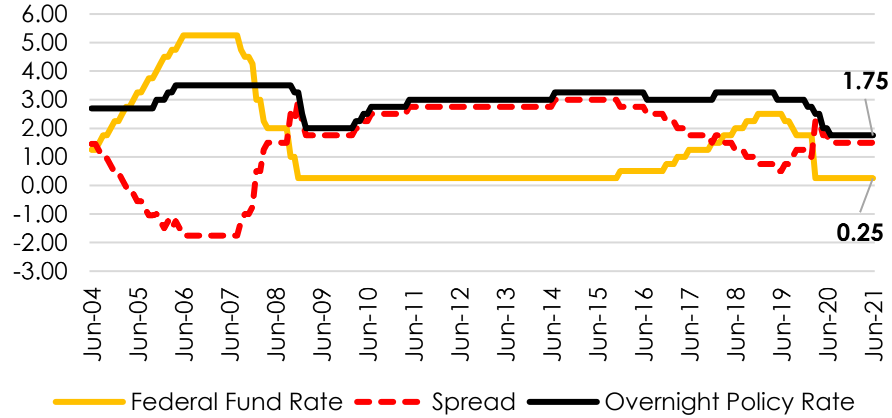
- ✓ Similarly, Indonesia's daily covid 19 cases has breached 30,000 cases on 6 July amid the emergence of the delta variant.
- ✓ On the domestic front, Malaysia's daily Covid-19 cases remains high at above 5,000 during the final week of June. We gathered that Malaysia has so far detected 40 cases related to the delta variant as at 5 July 2021.
- ✓ The European Medicines Agency's (EMA) on 1 July said that the **Covid-19 vaccines approved in the European Union offered protection against all Covid-19 variants, including the delta variant, but called for active monitoring by vaccine manufacturers to stay alert. The respective vaccines authorized in the EU include Pfizer/BioNTech and Johnson & Johnson which are under Malaysia's vaccine portfolio.**
- ✓ On further scrutiny, vaccines made by AstraZeneca and the Pfizer/BioNTech offer high protection of more than 90.0% against hospitalization from the Delta variant according to a study by Public Health England (PHE).
- ✓ Therefore, the current types of vaccine in Malaysia will prevent further spread of the virus from the delta variant.

ARE THERE ANY SIGNS OF MONETARY POLICY TIGHTENING?

ARE THERE ANY SIGNS OF MONETARY POLICY TIGHTENING? – WHY WE THINK INFLATION IS TRANSITORY

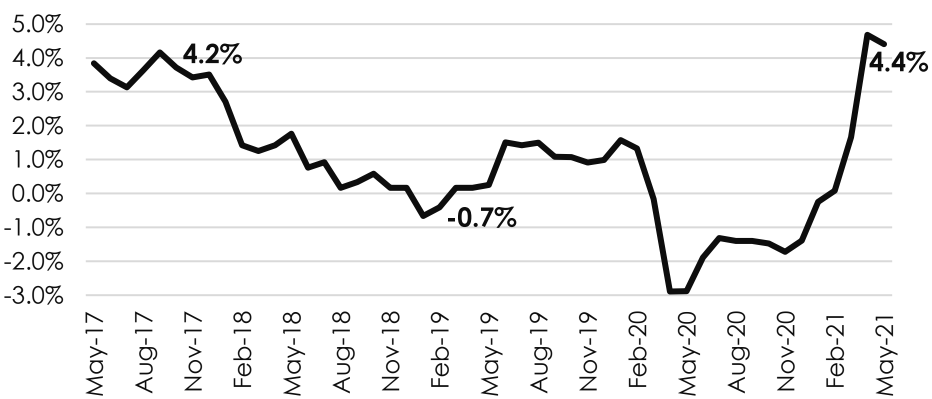
- ✓ Latest monetary policy developments showed that the U.S. had indicated that rate hikes are likely to occur earlier than expected in 2023. The Fed in March this year had earlier guided that a rate hike may occur in 2024.
- ✓ The Fed cited that the reason for bringing forward the time frame for higher interest rates was due to encouraging vaccination rates in the U.S. which will lead to better economic growth.
- ✓ As such, this may shorten the journey to reach the Fed's long-term inflation target of 2.0%.

Overnight Policy Rate(OPR) vs. Federal Fund Rate (FFR)



Source: CEIC

Malaysia's Headline Inflation, y-o-y%



Source: CEIC

- ✓ Notwithstanding this, we opine that the latest projection by the Fed on the timing of rate hikes will not induce BNM to tighten the monetary policy fairly soon. This is despite the inflation rate reaching 4.4% in May this year (April: 4.7%), a level not seen since March 2017.
- ✓ This is because we opine that inflationary pressures in Malaysia are expected to remain transitory in nature. Our opinion is based on factors such as: **1) dissipating low base effects particularly on fuel prices and 2) normalization in the supply and demand dynamics.**

ARE THERE ANY SIGNS OF MONETARY POLICY TIGHTENING? – WHY WE THINK INFLATION IS TRANSITORY (CONT'D)

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- ✓ On further scrutiny, the latest rise in Malaysia's CPI in May by 4.4% (April: 4.7%) was boosted by the cost for the Fuels & Lubricants For Personal Transport Equipment which rose strongly by 56.1% in May but moderated from the 59.2% growth recorded in April.
- ✓ Latest data shows that the double-digit y-o-y increases for average fuel prices of RON95, RON97 and Diesel remain prevalent in June. However, this represents a moderation compared to the preceding month.
- ✓ This indicates that the low base factor for fuel price should wear off as retail prices for RON95, RON97 and Diesel were gradually on the rise in 2H2020.
- ✓ In early July this year, the deal to increase oil production by 2.0 million barrels per day from August to December this year which did not go through due to the disagreement by the United Arab Emirates (UAE) during the OPEC's latest meeting. Therefore, a tightness in oil supply can be expected.
- ✓ Nevertheless, global jet fuel demand will remain tepid this year as international borders of Asian countries remain largely closed. This is seen through the scheduled airline capacity in Asia which was 37.5% lower in late June this year compared to late January last year before the pandemic struck.

Year-on-year changes (%) in average fuel prices

Month	Price (RM per litre)			Year-on-year change (%)		
	RON95	RON97	Diesel	RON95	RON97	Diesel
Apr-21	2.05	2.55	2.15	60.8%	61.9%	44.2%
May-21	2.05	2.60	2.15	57.1%	62.1%	48.3%
Jun-21	2.05	2.65	2.15	32.8%	43.8%	25.5%

Source: CEIC

Scheduled Airline Capacity In Asia

Region	Scheduled Airline Capacity In Late January 2020	Scheduled Airline Capacity In Late June 2021	% Change In Scheduled Airline Capacity
North East Asia	25,178,594	19,416,602	-22.9%
South East Asia	10,866,623	3,583,244	-67.0%
South Asia	5,160,958	2,650,316	-48.6%
Central Asia	344,740	336,848	-2.3%
Total	**41,550,915**	**25,987,010**	**-37.5%**

Source: Official Aviation Guide

- ✓ Therefore, upward pressure on Brent crude oil price could be contained going forward.
- ✓ Overall, we are confident that the OPEC will resolve the UAE-Saudi spat by probably going ahead with the deal and discuss a new UAE baseline as part of a new deal.

ARE THERE ANY SIGNS OF MONETARY POLICY TIGHTENING? – WHY WE THINK INFLATION IS TRANSITORY (CONT'D)

BANK ISLAM

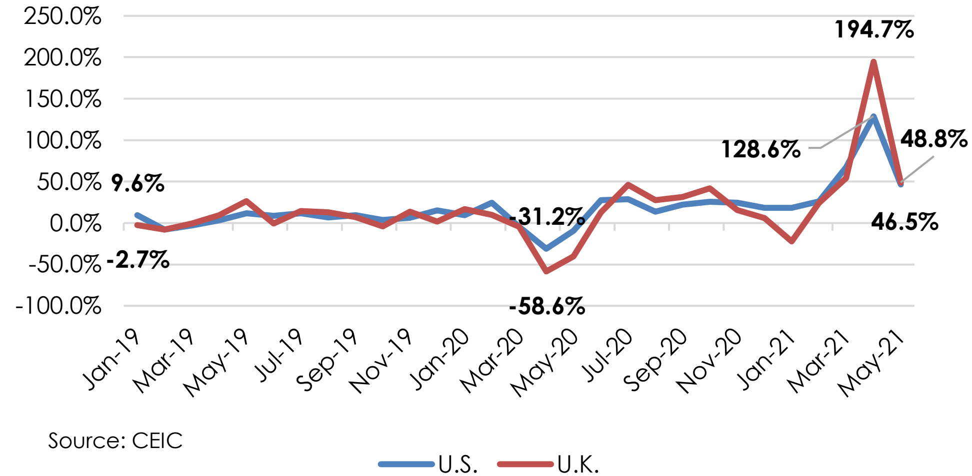
- ✓ External demand has been strong especially from countries that have fared well in handling the pandemic such as the U.S. and the U.K.
- ✓ This is evident from Malaysia's exports to the U.S. and the U.K. which grew by 46.5% (April: 128.6%) and 48.8% (April: 194.7%) in May this year respectively.
- ✓ However, a concern lingers regarding the latest full-scale lockdown which entails a limit on working capacity by industries. In addition, the enhanced movement control order (EMCO) in certain parts of Selangor and Kuala Lumpur restricts certain industries from operating such as rubber glove factories which operate mainly in Klang, an area affected by the EMCO.
- ✓ Restrictions on working capacity may result in supply chain bottlenecks if external demand exceeds domestic supply. This would later lead to upwards pressure on prices of goods by manufacturers.

Location Of Rubber Glove Manufacturing Plants

Company	Location of Production Plant	Area under EMCO
Hartalega	Kawasan Perindustrian Tanjung, Sepang, Selangor	Yes
Top Glove	Meru, Klang, Selangor	Yes
Supermax	Meru, Klang, Selangor	Yes
Kossan	Meru, Klang, Selangor	Yes

Source: Various

Growth In Malaysia's Exports To The U.S. & The U.K., y-o-y%



Source: CEIC

- ✓ Notwithstanding the bottleneck issues, we posit that the supply and demand dynamics will likely normalize later in 2H2021.The reason being is that the ramp up in vaccinations for factory workers will pave way for higher working capacities as outlined under the NRP.
- ✓ In fact, states such as Kelantan, Pahang, Perlis, Perak, Terengganu and Penang have entered Phase 2 of the NRP. With this, business activities can slowly resume and contribute to the country's economic output.
- ✓ As a result, this will enable them to catch up with demand and subsequently tame inflationary pressures coming from supply and demand imbalance.

ARE THERE ANY SIGNS OF MONETARY POLICY TIGHTENING? - OPR VS. NEUTRAL RATE

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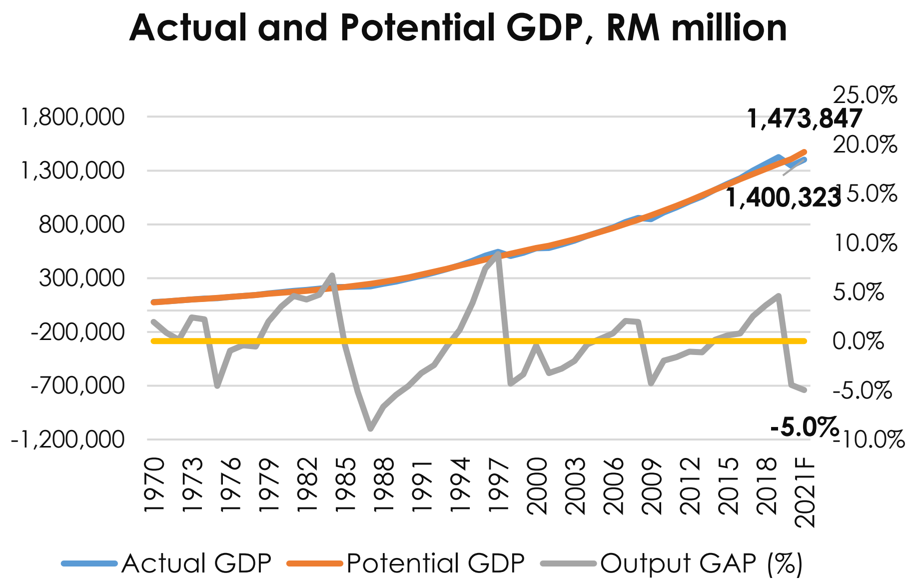
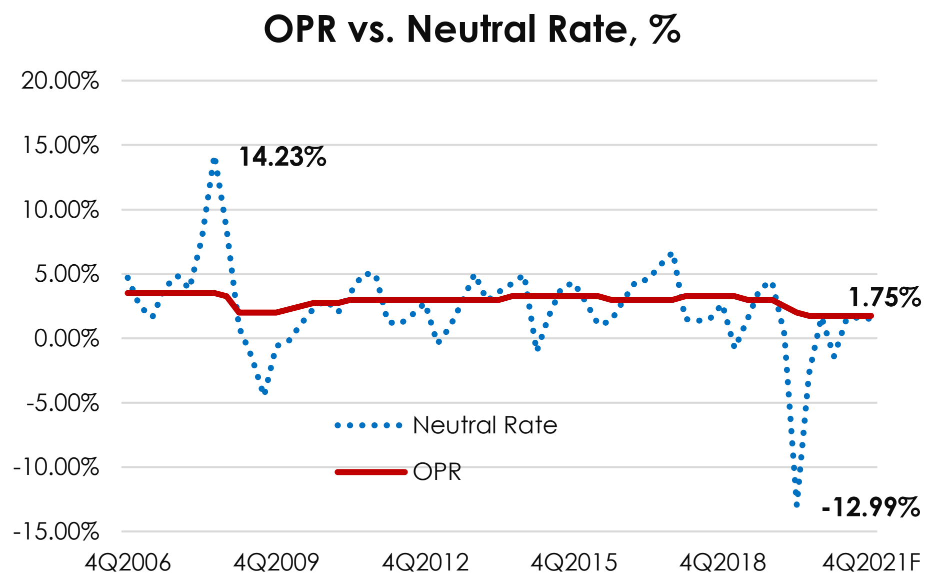




Sources: Bloomberg, CEIC, Bank Islam

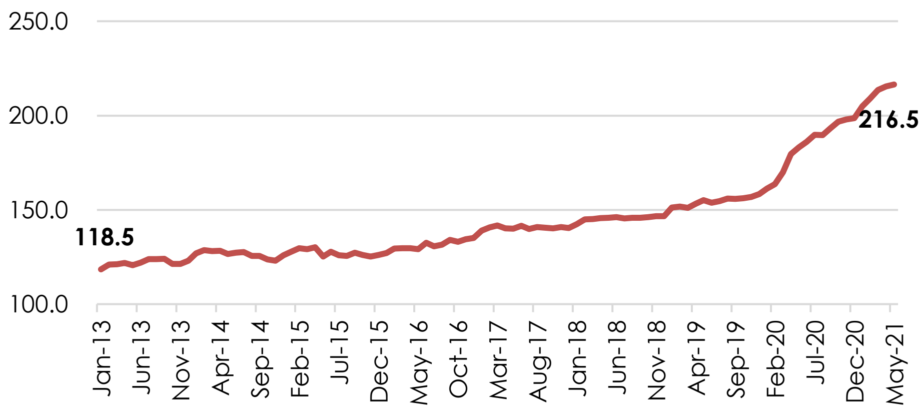
- ✓ While the Malaysian economy is expected to record a 4.2% growth this year after falling into recession in 2020 (2020 GDP: -5.6%), we opine that the country's output gap (the difference between actual and potential GDP) is estimated to be around -5.0%. This would mean the available resources (labour, capital & total factor productivity) have not been fully utilized. In short, the economy is still fragile and requires support from the government.
- ✓ Combined with the transitory nature of inflation, the case for keeping the OPR low is strong. Moreover, the country is still grappling with high Covid-19 infections. The latest tally showed new cases had reached 8,574 cases on 12 July, after reaching a record high of 9,353 cases on 10 July.
- ✓ Our estimates also showed that the Taylor's neutral rate (a rate that is neither expansionary nor contractionary) is hovering between 1.50% and 1.60% in 2021. Judging from this, BNM may want to cut the OPR by 25 basis points if the decision is solely on ruled-based monetary policy.
- ✓ However, the expansionary fiscal policy alongside with robust external demand would mean BNM can afford to keep the OPR steady at 1.75% throughout the year, at least for now.

ARE THERE ANY SIGNS OF MONETARY POLICY TIGHTENING? – WHEN WILL BNM TIGHTEN ITS BELT?

BANK ISLAM

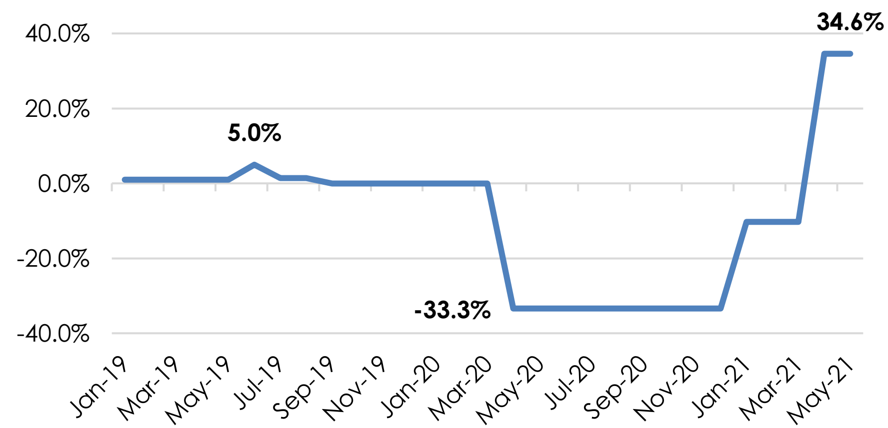
- ✓ As mentioned earlier, our estimates indicate that the aim to vaccinate 80.0% of Malaysia's population by year end is possible. Once this goal is reached, a full reopening of the social and economic sectors is something that can be reasonably expected.
- ✓ We opine that the reopening of the economy will be accompanied by a strong propensity to consume. This can be seen from the number of deposits held by individuals in the country's banking system which stood at RM216.5 billion in May this year (April: RM215.5 billion) compared to RM170.0 billion when the pandemic outbreak occurred in March last year.
- ✓ Apart from that, the cost of electricity is poised to be higher in 2022 as electricity bill discounts will likely not be granted next year (compared to now from 1 July to 30 September) as factories and businesses are expected to resume operations on a larger scale, consuming more electricity. Recall that the CPI for Electricity grew markedly by 34.6% in May 2021(April 2021: 34.6%) amid the absence of electricity bill discounts that were previously offered from April to December 2020.
- ✓ Therefore, a higher OPR in 2022 would be more plausible once the herd immunity is achieved, allowing the reopening of the economy to be more consistent. Perhaps, the demand-pulled inflation could be more prevalent next year, necessitating BNM to raise the OPR in order to anchor the inflation expectation.

Demand Deposits Of Individuals In The Banking System (RM Billion)



Source: CEIC

CPI Growth of Electricity, %



Source: CEIC

MALAYSIA'S FISCAL SPACE

STIMULUS PACKAGES WERE ANNOUNCED TO COMBAT THE PANDEMIC

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Stimulus Package	Total Amount		Direct Fiscal Injection	
	RM billion	% of 2020 GDP	RM billion	% of 2020 GDP
PRIHATIN	250.0	17.6%	25.0	1.8%
PRIHATIN SMEs	10.0	0.7%	10.0	0.7%
PENJANA	35.0	2.5%	10.0	0.7%
KITA PRIHATIN	10.0	0.7%	10.0	0.7%
PERMAI	15.0	1.1%	2.0	0.1%
PEMERKASA	20.0	1.4%	11.0	0.8%
PEMERKASA PLUS	40.0	2.8%	5.0	0.4%
PEMULIH	150.0	10.6%	10.0	0.7%
Total	**530.0**	**37.4%**	**83.0**	**5.9%**

Sources: PMO's Announcement, MOF's Malaysian Economy 1Q2021

- ✓ According to the government's narrative, the fiscal space appears to be constrained following the series of stimulus packages that the government had announced in order to mitigate the detrimental impacts from the Covid-19 crisis.
- ✓ The latest stimulus package was announced on 28 June, known as Pemulih package amounting to RM150.0 billion (10.6% of GDP) with a direct fiscal injection of RM10.0 billion (0.7% of GDP), following the implementation of the full scale lockdown beginning on 1 June.

- ✓ We understand that S&P Global Ratings (S&P) has affirmed Malaysia's foreign currency and local currency long-term issuer ratings at A- and A, respectively, with a negative outlook. The affirmation is testament to the country's strong external position, monetary policy flexibility, recognised track record of supporting sustainable economic growth, as well as economic resilience during times of uncertainty.
- ✓ Nevertheless, the risk of a rating downgrade could not be disregarded especially if there is a weaker commitment to fiscal consolidation or if the economic growth suffers a deeper or more prolonged downturn than expected.

IS THE FISCAL SPACE "LIMITED"?

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- ✓ Despite various of aid packages being announced, we view that Malaysia may still have ample fiscal space to cushion the impact from the pandemic.
- ✓ Recall that the government has lifted up the self-imposed statutory limit from 55.0% to 60.0% last year, allowing more flexibility in the fiscal space to cushion the detrimental impacts from the Covid-19 pandemic.
- ✓ As at the end of March this year, the federal government's debt-to-GDP ratio stood at RM917.5 billion or 58.5% of the GDP from 56.4% at the end of December 2020.
- ✓ On the other hand, the outstanding debt for MGS, MGII & MITB was at 54.6% of the GDP which was lower compared to self-imposed statutory limit of 60.0%.
- ✓ Judging from this, we believe that the government still has room for fiscal expansion based on a study done by the Bank for International Settlements (BIS)**.
- ✓ It shows that the threshold for government debt before it becomes a drag on the economy is around 85.0% of the total GDP.
- ✓ Our estimation shows that raising the limit by another 5 percentage points (ppts) to 65.0% would allow an additional RM102.4 billion worth of fiscal space for the government to manoeuvre.

Federal Government Debt Legislative Limit

Act	Statutory Limit	Outstanding End March 2021
Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020	Domestic debt ceiling (MGS, MGII, MITB) not exceeding 60.0% of GDP	RM856.7 billion 54.6% of GDP
External Loans Act 1963	Offshore borrowing ceiling not exceeding RM35.0 billion	RM28.2 billion
Treasury Bills (Local) Act 1946	MTB ceiling not exceeding RM10.0 billion	RM8.5 billion

Source: MOF
* nominal GDP was estimated from MOF's Malaysian Economy 1Q2021

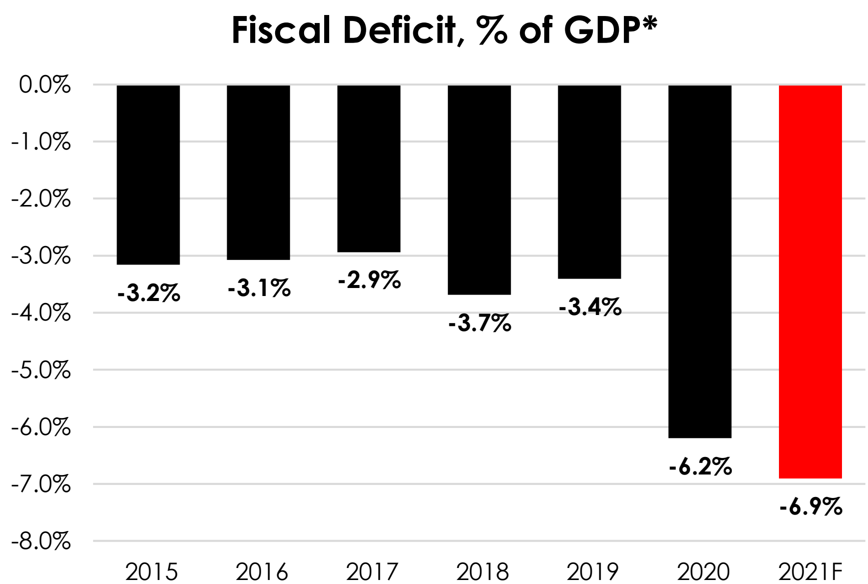
Estimation:

If the debt-to GDP ratio is raised to	RM Billion
60.0%	23.9
65.0%	102.4
70.0%	180.8
75.0%	259.3
80.0%	337.7
85.0%	416.2

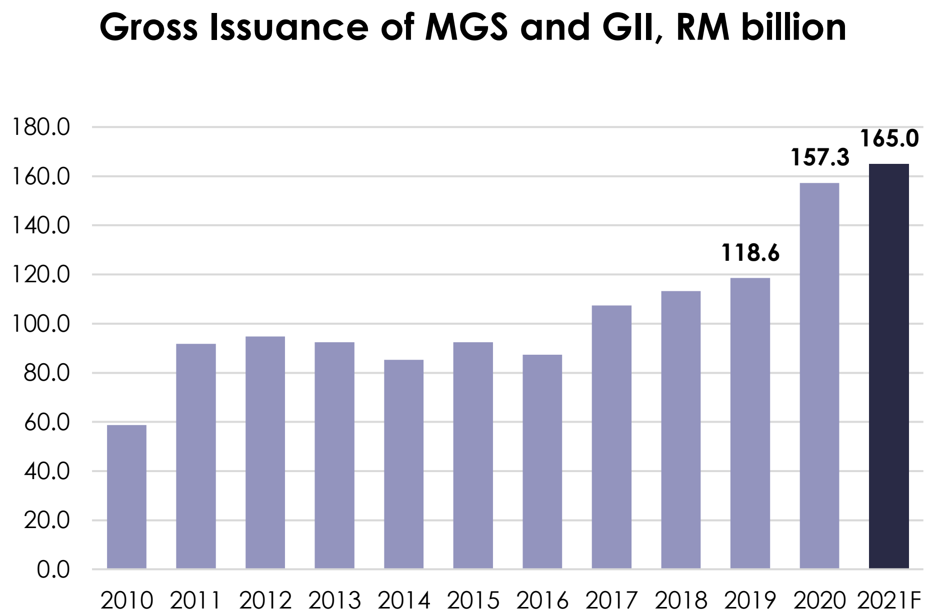
Sources: Bank Islam, MOF, CEIC

** https://www.bis.org/publ/othp16.pdf

FISCAL DEFICITS TO WIDEN TO 6.9% OF GDP THIS YEAR



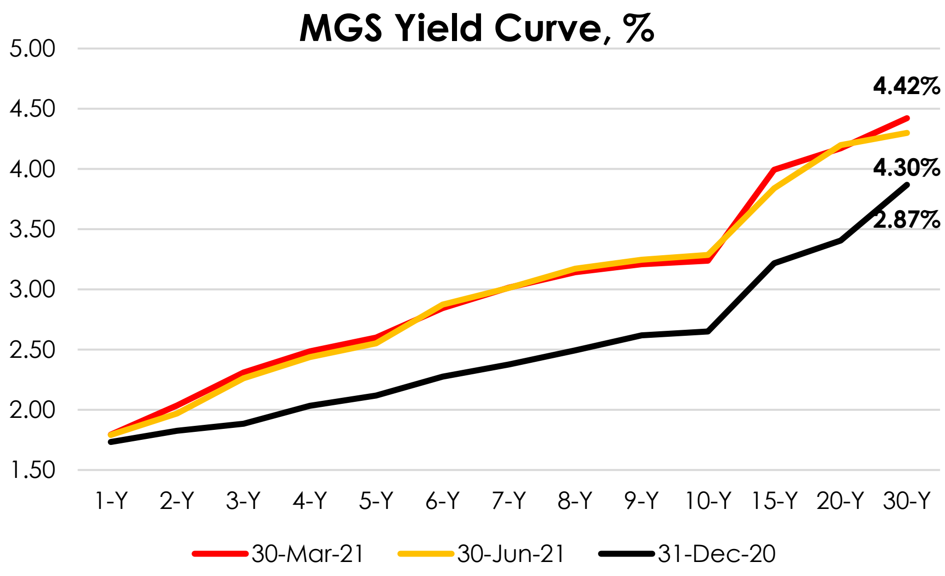
Sources: CEIC, Bank Islam
* nominal GDP was estimated from MOF's Malaysian Economy 1Q2021



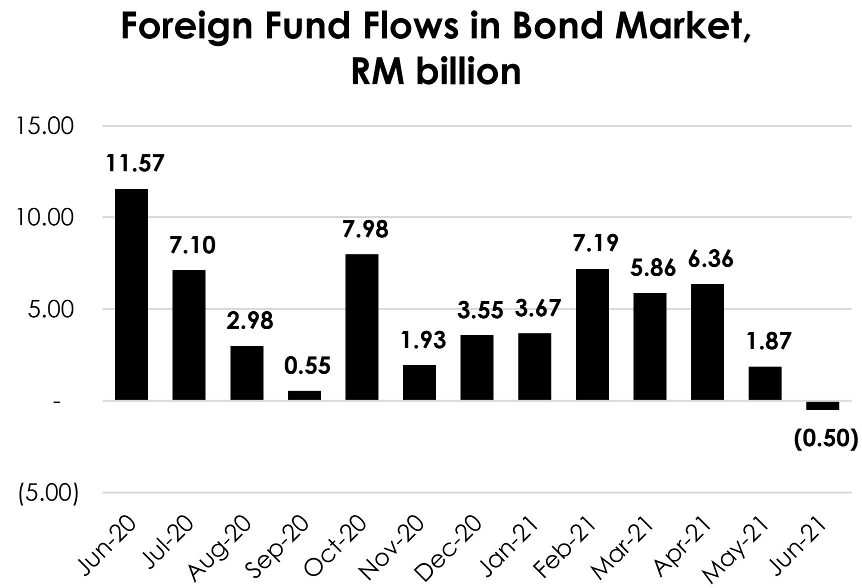
Sources: CEIC, Bank Islam

- ✓ Taking into account of the aforementioned matters, we believe that the fiscal deficit for 2021 is likely **to widen to 6.9% of GDP with overall balance of –RM107.8 billion** amid the announcement of the stimulus packages. This was in tandem with the government's latest fiscal revision to 6.5%-7.0% from 6.0% projection made in May 2021.
- ✓ The fiscal target of 6.9% is based on our assumption that crude oil will average at USD65.0 per barrel this year which is higher from the Government's conservative projection of USD40.0 per barrel.
- ✓ In light of this, Malaysia's petroleum revenue is anticipated to increase by RM7.5 billion to RM45.3 billion this year, offsetting higher Government expenditure.
- ✓ Following this, the **debt-to GDP ratio is expected to rise to 63.3%** this year with **gross issuance of MGS and GII to go up to RM165.0 billion** this year from RM157.3 billion in 2020.

BOND YIELDS ARE LIKELY TO PICK UP



Source: CEIC



Source: CEIC

- ✓ As for the bond market, foreign investors sold RM0.5 billion worth of bonds in June (May: RM1.9 billion) after recording foreign net inflows for 13 consecutive months while the level of foreign holdings on the MGS was slightly lower at 40.4% in June from to 41.1% in May. Nevertheless, non-resident investors remained as net buyers on a cumulative basis, registering a RM24.5 billion net inflow in 1H2021 (1H2020: -RM5.8 billion).
- ✓ Looking forward, we anticipate that the bond yields will increase gradually post FOMC meeting as the Fed has shifted to a hawkish stance following upbeat economic activities in the U.S.
- ✓ On top of that, concerns over higher supply, as well as rising inflationary risk could exert downward pressure on the bond's price in the medium term.
- ✓ In light of this, yields of the 3-Y MGS, 5-Y MGS and 10-Y MGS are likely to close at 2.43%, 2.68% and 3.42% by the end of 2021.

SECTORAL OUTLOOK

SUMMARY OF SECTORAL CALLS

- ✓ We currently have 15 sectors under our observation.
- ✓ The rating changes which have been made are for the Oil & Gas and Telecommunication sector whereby we revised the ratings of both sectors from neutral to positive. We believe that opportunities lie for Oil & Gas companies to diversify their income in the Renewable Energy (RE) field.
- ✓ The upgrade for the rating of the Telecommunication was done on the basis that further consolidation in the sector could weed out the incompetent players while enhancing the quality of service to customers.

Positive	Neutral	Negative	Avoid
Healthcare	Power	Non-residential Property	Retail Space
Manufacturing Rubber Gloves	Construction		
Manufacturing Semiconductor	Residential Property		
Oil & Gas	Automotive		
Telecommunication	Plantation		
	Banking		
	Logistics		
	Education		

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Sector	Rating	Remarks
Oil and Gas	**Positive**	- Upgrade to positive call from neutral call. - Production activities in the oil and gas space have been gaining traction as of late. This can be seen through the total number of rigs worldwide which reached 1,325 rigs in June this year (May: 1,262 rigs) compared to 1,073 rigs in June last year. - Such trends in the oil rig count resonates well with the projection by the Organization of the Petroleum Exporting Countries (OPEC) for the world oil demand in 2021 to reach an average of 96.58 million barrels per day (bpd) (2020: 90.63 million bpd). - On the domestic front, Petronas is budgeting around RM40.0 billion to RM45.0 billion for capex spending in 2021, higher than the RM33.4 billion spent in 2020. A high portion of this capex will likely be directed more towards the upstream division compared to other divisions as there are no major announcements of further expansions in RAPID Pengerang projects beyond the sanctioned projects. - Meanwhile, the latest OPEC meeting in early July saw the United Arab Emirates (UAE) disagreeing on the baseline from which its production cuts are being calculated and wants it raised. The failure of the talks means that the expected increase in output by about 2.0 million barrels per day from August to December will not take place. While this will exert upwards pressure on Brent oil price, jet fuel demand is expected to stay low as international borders of Asian countries remain largely closed. The overall demand projected by the OPEC in 2021 of 96.58 million bpd is still lower than the 99.97 million bpd demand seen in 2019. - Therefore, we are forecasting Brent crude oil price to settle at USD65.52 per barrel by year-end (2020: USD51.80 per barrel) and remain mindful of the pockets of opportunities for local oil and gas players. Prospects in 2022 will be brighter as the world approaches herd immunity, stoking oil demand at a faster pace. - In relation to the shift of oil and gas (O&G) companies towards RE, we note that the average rate for large scale solar (LSS) projects in Malaysia has declined by more than half to RM0.2091/kWh in LSS4 from RM0.4131/kWh recorded in LSS1. The declining capacity generation rate will translate into lower investment returns. - Therefore, venturing into provision of RE services could be a better choice for O&G companies rather than being an asset owner in order to remain relevant in a world that aims to achieve net zero green house gas (GHG) emissions by 2050. As such, O&G companies are likely to take this pathway in the long run which may require a shift in its business model.

SECTORAL OUTLOOK (CONT'D)

Sector	Rating	Remarks
Logistics	**Neutral**	- Maintain neutral call. - The Malaysian Communications and Multimedia Commission (MCMC) has launched the National Accelerator Courier Plan (PAKEJ) programme in June this year. In brief, PAKEJ will serve as a benchmark for courier players to improve their quality of service that has been deteriorating with delivery times increasing from 2.1 days to 4.6 days during lockdown periods. - Key initiatives under PAKEJ include setting up a shared parcel network and sharing of postmen across different service providers. Such initiatives could help to expand network coverage and lower operating costs for courier industry players as labour costs involving postmen are a large fixed cost that has been hampering the profitability of courier players. - Courier companies such as Pos Malaysia remained in the red but saw its losses-after-tax narrow to RM46.8 million in 1Q2021 (1Q2020: -RM49.2 million), supported by robust courier volumes. Perhaps such initiatives mentioned above could help Pos Malaysia to contain its overhead costs better to achieve profit in subsequent years. - However, we believe that these initiatives will go through a gestation period before contributing positively in the long run. - Meanwhile, logistics companies involved in freighting services particularly air freight could continue to see some upside in demand. The reason being is that some ports in countries such as the U.S. have faced congestions amid increased demand for overseas goods. - Henceforth, shipper of goods would prefer air freight which is faster and has ample of capacity despite higher charges. - Latest data from Clive Data Services shows that the global air cargo volume in May 2021 was 41.0% y-o-y higher than the month of May 2020.

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Sector	Rating	Remarks
Manufacturing Rubber Gloves	**Positive**	- Maintain positive call. - The average selling price (ASP) per 1,000 gloves has peaked at around USD120.00 per 1,000 gloves in March this year and has been trending downwards to hover between USD75.00 and USD85.00 per 1,000 gloves recently. - Meanwhile, production disruptions are expected due to the full scale lockdown whereby manufacturing sectors including rubber glove manufacturers are allowed to operate at a 60.0% working capacity. - The latest enhanced movement control order (EMCO) which allows certain factories to operate (excluding rubber glove factories) will also impact production of rubber gloves as the majority of factories of major rubber glove makers are located in Klang which placed under the EMCO from 3 July to 16 July. Top Glove itself has 28 factories in Meru, Klang which have been shutdown to comply with the EMCO. - This will have a negative impact on production volumes, resulting in lower profit, as factories face the risk of not being able to fulfil orders. As a consequence, customers may seek elsewhere to obtain rubber glove supplies. - Apart from production disruptions, further allegations of mistreatment of foreign labour could also negatively impact demand for Malaysian rubber gloves. Top Glove's gloves are already banned from entering the U.S. and recent reports have also claimed that the U.S. Customs and Border Protection (CBP) would investigate both Hartalega and Supermax. - Nevertheless, such conditions serve as an opportunity for other rubber glove makers to fill up the void as demand for rubber gloves is expected to remain resilient at 420.0 billion pieces in 2021(2020: 360.0 billion pieces) according to the Malaysian Rubber Gloves Manufacturers Association (MARGMA). - Moreover, the demand from non-healthcare sectors such as food handling and industrials will continue to be sustained amid increased hygiene awareness around the globe.

SECTORAL OUTLOOK (CONT'D)

BANK ISLAM

Sector	Rating	Remarks
Automotive	**Neutral**	- Maintain neutral call. - Likewise, the Total Industry Volume (TIV) also regained momentum by growing at 99.7% in May (April: 38,000.0%) to reach 46,663 units (April: 57,912 units), partly due to the dissipating low base effect from last year when the first Movement Control Order (MCO) was in place. - On a cumulative basis, TIV was higher by 91.0% to reach 245,932 units in 5M2021 (5M2020: 128,790 units). - In the short to medium term, we foresee sales in July to be minimal as Malaysia is currently under the Phase 1 of the National Recovery Plan (NRP) which allows the automotive sector to operate at 10.0% working capacity. The latest EMCO will have a further adverse impact on the automotive sector as only certain factories (which does not include automotive factories) deemed essential are allowed to operate. - We expect sales to pick-up in the later months provided that the country gradually transitions into the remaining phases under the NRP in the later months whereby restrictions will be gradually relaxed. - This is due to the pent-up demand combined with consumers wanting to take advantage of the sales service tax (SST) exemption which expires by the end of the year. - Notwithstanding this, downside to the automotive sector would be the peoples' tendency to increase savings now in order to have a higher propensity to consume services from the social sector such as leisure once the economy fully reopens. As such, there is a possibility that the 570,000 units forecasted by the Malaysia Automotive Association for 2021 could not be achieved. - On a separate note, the higher level of parts localisation and cost optimisation adopted by automotive companies may cushion higher import costs from the fluctuation in exchange rates as they generally purchase components from overseas.

SECTORAL OUTLOOK (CONT'D)

Sector	Rating	Remarks
Banking	**Neutral**	- Maintain neutral call. - The financing activities grew by 3.89% y-o-y in May (April: 3.86%), slightly lower compared to 3.91% in the same period last year. - On the other hand, the average GIFR grew higher to 1.59% in 5M2021 from 1.55% in 5M2020, as both Household and Non-Household GIFR rose to 1.11% (5M2020: 1.06%) and 2.27% (5M2020: 2.22%) in 5M2021 respectively, suggesting that asset quality continued to deteriorate as the economy was impacted by the prolonged Covid-19 crisis in the nation. - The GIFR is expected to increase further alongside higher provisions this year in view of series of MCO extensions that will heavily weigh on the business conditions, as well higher unemployment rate that would dampen the consumer sector. - Nevertheless, the GIFR would remain below BNM's impairment projection of 2.9% for Adverse Scenario 1 (AS1) and 3.3% for AS2 by end of this year in view of 6-month blanket moratorium effective in July.
Power	**Neutral**	- Maintain neutral call. - Tenaga Nasional Berhad (TNB) total demand sales rebounded by 4.0% y-o-y in 1Q2021(4Q2020: -1.0% vs. 3Q2020: -3.0%) after declining for three straight quarters, suggesting that the ongoing movement restrictions have minimal impacts on demand for electricity. - The government has set a 31.0% RE target by 2025 and 40.0% in 2035. Consequently, carbon emissions from fossil fuels are expected to decline by 45.0% in 2025 and 60.0% in 2035. - Apart from that, KL City Mayor has imposed that all future development projects in Kuala Lumpur, be it commercial or residential, must comply with the 30.0% RE rule in an effort to reduce consumption in electricity. - Meanwhile, the Large Scale Solar 4 (LSS4) project bids are expected to start commercial operations by 2023 with each plant having a minimum operational period of 21 years. Therefore, the policy should bode well for the industry players.

Sector	Rating	Remarks
Telecommunication	**Positive**	- Upgrade to positive call from neutral call. - As the world continues to grapple with the pandemic, telcos continue to see an uptick in data usage. For instance, Telekom's number of Unifi customers jumped by 30.9% to hit a record high of 1,951.0k subscribers in 1Q2021 from 1,490.0k subscribers in 1Q2020. - Likewise, the revenue for the home fibre segment of Maxis recorded a 19.5% y-o-y increase to reach RM135.0 million in 1Q2021 (4Q2020: RM127.0 million), in line with the expansion in the number of customers in the said segment to a record high of 423.0k customers in 1Q2021 (4Q2020: 402.0k customers). - Wee opine that the advent of e-commerce partly led to the increase in data and internet usage as more people shopped online amid the movement restrictions. - We foresee such companies to benefit from the higher rollout of digital infrastructure under the MyDIGITAL initiative executed via the Malaysia Digital Economy Blueprint which aims to attract more international submarine cables landing in Malaysia to expand global connectivity. - Meanwhile, the establishment of Digital Nasional Berhad which is the special purpose vehicle responsible to build, own and operate 5G infrastructure in Malaysia will lead to a faster rollout of network and lower capex for mobile operators as it inhibits duplication of networks. - Consequently, mobile operators can concentrate solely on providing 5G services at a competitive rate.That being said, competition between mobile operators in the postpaid and prepaid realms will remain intense amid a never-ending tussle to defend and/or expand the subscriber base. - Henceforth, further consolidation within the telco industry is possible but nevertheless could lead to better quality of service for customers as it eliminate incompetent players. An example of a consolidation currently ongoing is the Celcom-Digi merger which will have a combined mobile customer base of 19.1 million users, surpassing Maxis' customer base of 11.3 million users based on customer statistics in 2020.

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Sector	Rating	Remarks
Education	**Neutral**	- Maintain neutral call. - In 2020, the number of students enrolled in tertiary education dropped by 6.0% y-o-y to 1,244,098 persons from 1,323,449 persons in the preceding year. This is reflected by the Covid-19 situation which has delayed the student enrolment in their respective places. - Subsequently, the number of international students have declined by 3.8% (2020: 131,300 students vs. 2019: 136,497 students) due to the lockdown measures and border closures. - Though foreign students account for approximately 14.0% of the total enrolment in the private higher education institutions, the total revenue from foreign students contribute 40.0% of the private higher education sector. Should the situation persist for much longer, it is potentially catastrophic for private universities and colleges to remain viable given their dependency on the student fees. - Meanwhile, the y-o-y change in the cost of tertiary education has remained at 0.0% from June 2020 to May 2021.
Retail Space	**Avoid**	- Maintain avoid call. - The Covid-19 pandemic has definitely shocked the retail industry in which the malls' footfall traffic has been declining due to the mobility restrictions in an effort to contain the spread of the pandemic. - As such, in 1Q2021, the average occupancy rate (AOR) of shopping complexes recorded a lower growth of 77.6% y-o-y as compared to the same period last year (1Q2020: 79.4%). - About 80.0% of the Malaysia's population are active internet users with extremely high rates of mobile phone penetration. With the Covid-19 pandemic, many have switched from offline to online purchases as their primary shopping method. At the moment, Malaysia's top two e-commerce sites by traffic are marketplaces Shopee and Lazada, both recording close to 20.0 million visitors per month. - Even before the pandemic hit our shores, shopping malls, particularly retailers, were already feeling the pressure of e-commerce. While customer retention strategy is long overdue in addition to the effect, retailers in shopping malls are now forced to overhaul their strategy.

SECTORAL OUTLOOK (CONT'D)

Sector	Rating	Remarks
Healthcare	**Positive**	- Maintain positive call. - The Covid-19 pandemic has posed a great challenge to healthcare system as a result of its rapid spread. As such, healthcare awareness is rising among the public and preventive measures are widely adopted. - Apart from that, the total population in Malaysia has been growing from 28.6 million in 2010 to 32.7 million in 2020 with a 10-year CAGR of 1.4% per annum. The increasing in population growth could translate into increasing needs for medical treatments. - Malaysia's population in 1Q2021 is estimated to be 32.8 million, increasing by 0.6% y-o-y from 32.6 million in the same period last year. The percentage of population aged 65 years and above (old age) is expected to increase from 7.0% in 1Q2020 to 7.2% in 1Q2021. This would result in higher demand for healthcare services. - However, the occupancy rate in hospitals is expected to take a hit from lockdowns as Malaysia's healthcare sector would face lower volume of inpatients and outpatients due to Covid-19 fears. The stricter movement control measures and high Covid-19 cases would also affect elective patient volume during 3Q2021. Thus far, KPJ (1Q2021: 35.0% vs. 4Q2020: 48.0%) and IHH Healthcare (1Q2021: 43.0% vs. 4Q2020: 45.0%) recorded a lower occupancy rate due to the implementation of the MCO2.0. - In addition, there is also regulatory risk from potential new price controls on medicines in Malaysia to ensure that treatment costs in private hospitals do not increase arbitrarily, which may affect companies earnings and margins. - Nevertheless, the healthcare sector has a strong economic immunity: whereby medical treatments are not tied to the vagaries of the economic cycle. - The recovery post pandemic will depend on Malaysia's ability to achieve herd immunity of the population.

SECTORAL OUTLOOK (CONT'D)

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Sector	Rating	Remarks
Construction	**Neutral**	- Maintain neutral call. - Construction output contracted by 17.4%y-o-y in 1Q2021, extending the 12.7% fall in the previous quarter. This was mainly attributed by the decline in construction work done, plummeting by 10.5% in 1Q2021 (4Q2020: -14.2%). - On further scrutiny, Residential (1Q2021: -4.2% vs. 4Q2020: -10.9%), Non-Residential (1Q2021: -5.3% vs. 4Q2020: -6.3%) and Civil Engineering (1Q2021: -22.3% vs. 4Q2020: -25.0%) construction activities continued to drop albeit at a softer pace. - Progress on ECRL: the government reinstated Section C's (Mentakab, Pahang - Port Klang, Selangor) Northern alignment and revised the total project cost to RM50.0 billion from RM44.0 billion under the previous alignment. Thus far, construction works have been concentrated on Section A (Kota Bharu - Dungun) and Section B (Dungun - Mentakab). The Transport Ministry estimated that works for over 300 locations will commence by year-end for Section A and Section B. - Be that as it may, Selangor's state government still prefers the Southern alignment and would not approve land acquisition for the rail route on the basis that it will contradict the state's wishes. As such, it could affect overall progress on the ECRL project moving forward. - Downside risks for the sector: extended MCO could delay construction activities amid stringent standard operating procedures (SOPs) at work sites that could bring down productivity, many construction clusters, manpower distress, disruption on construction supply chains, as well as higher property overhang that will negatively affect property related construction.

SECTORAL OUTLOOK (CONT'D)

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Sector	Rating	Remarks
Residential Property	**Neutral**	- Maintain neutral call. - Risks: affordability issues, as well as a prolong slowdown in property sector. - Average house prices are still beyond affordable in 1Q2021P at RM432,220 , despite showing signs of gradual softening from RM434,013 in the previous quarter. In fact, average house prices are still higher compared to the same period last year at RM430,786. - The unsold units declined by 16.6% y-o-y to 102,753 units in 1Q2021(4Q2020: 114,275 units). - The breakdown - overhang (1Q2021: 27,468 units vs. 4Q2020: 29,565 units), under construction (1Q2021: 67,445 units vs. 4Q2020: 71,735 units) and not constructed (1Q2021: 7,840 units vs. 4Q2020: 12,975 units). - Be that as it may, affordability remains a pressing issue for home buyers especially when jobless rate is still above its pre-pandemic level. - Apart from that, we have seen a slowdown in property transactions, declining to 52,275 units or RM19.7 billion in 1Q2021 from 60,200 units or RM20.9 billion in the previous quarter. - Notwithstanding this, House Ownership Campaign (HOC) is extended until 31 December 2021. This would help to encourage home ownership among Malaysians and stimulate the national housing market. - Commendable sales performance recorded by main players amid attractive marketing packages: i) SP Setia (1Q2021: RM1.2 billion vs. 1Q2020: RM0.5 billion), ii) Mah Sing (1Q2021: RM400.0 million vs. 4Q2020: RM247.4 million).Sales target: i) SP Setia (2021E: RM3.8 billion vs. 2020: RM3.8 billion), ii) Mah Sing (2021E: RM1.6 billion vs. 2020: RM1.1 billion).

SECTORAL OUTLOOK (CONT'D)

Sector	Rating	Remarks
Non-residential Property – Shop units	**Negative**	- Maintain negative call. - The closure of physical stores due to the MCO and social distancing measures have led consumers to ramp up online shopping, supporting the e-commerce market growth in Malaysia. - As such, e-commerce space is likely to expand further in view of its efficiencies and favourable price differentials. - Apart from that, e-commerce adoption among merchants and businesses would help them to widen their reach across the country. - Online retail sales index, which portrays e-commerce activity in Malaysia averaged at about 31.4% last year could encourage more SMEs to pivot towards online sales. Thus far, the index still recorded a double-digit growth of 22.0% y-o-y in April this year (March: 18.3%), suggesting more consumers have been shifting to online shopping. - The unsold units for commercial property stood at 11,745 units in 1Q2021 from 12,490 units in the preceding quarter.

SECTORAL OUTLOOK (CONT'D)

Sector	Rating	Remarks
Manufacturing – Semiconductor	**Positive**	- Maintain positive call. - The Covid-19 outbreak has prompted a massive trend towards remote working while the advent of Internet of Thing (IoT) and Artificial Intelligence (AI) are driving the high-end application segment across the consumer electronics and automotive industries. - This was reflected in the continued increase in Global Semiconductor Sales (GSS) for 16 straight months since February last year (5.0%) while latest data recorded a double-digit growth at 26.2% y-o-y in May, higher from the 21.8% growth in April. - In light of this, the World Semiconductor Trade Statistics (WSTS) has forecasted the global semiconductor market to surge by 19.7% y-o-y in 2021 (2020:6.8%) before moderating by 8.8% in 2022. - All in all, we foresee that the gradual reopening of other countries will have a positive impact on the semiconductor industry in Malaysia in the long run. This will be further supported by the push towards digitalisation and the adoption of new technologies, fuelling chip demand. - Nevertheless, the Covid-19 outbreak in Taiwan has posed a threat to global semiconductor supply chain's reliance on a small number of key players. - As such, this could worsen global chip shortage amid the sudden surge in demand and knock back production activity as Taiwan's chipmaking industry is a crucial supplier. - Therefore, it would be a potential choke point for companies across a wide array of sectors, from consumer electronics, to server farms and the automotive industry across the world.

SECTORAL OUTLOOK (CONT'D)

Sector	Rating	Remarks
Plantation	**Neutral**	- Maintain neutral call. - For 5M2021, Malaysia's Crude Palm Oil (CPO) production continued to decline by 5.7% y-o-y albeit at a softer pace compared to -13.4% in 5M2020, providing upward pressure on CPO future price to RM3,782.00 per Metric Tonnes (MT) from RM2,379.00 per MT in June 2020. - Nevertheless, palm oil production is anticipated to pick up in 2H2021 on the back of seasonal factor and more conducive weather conditions. - According to the U.S. Department of Agriculture (USDA), the U.S.'s soybean harvested area for 2021 is estimated at 86.7 million hectares (ha), rising by 5.0% from 2020. - On top of that, soybean production in Brazil is projected to rise this year in light of higher soybean planted area to 40.3 million ha in 2021-2022 season (previous projection: 38.8 million ha). - Therefore, the increase in production of soybean to accommodate the strong demand from the biofuel sector will likely lead to a surplus in CPO, weighing on its price moving forward as soybean oil is traded at a premium against CPO. - On the other hand, India as the world's biggest vegetable oil buyer will cut the base import tax on CPO to 10.0% from 15.0% for the period between 30 June and 30 September this year. - The decision will have a positive development for CPO exports and upstream plantation companies in Malaysia. - Henceforth, the prospects for CPO is quite mixed at the moment.

KEY TAKEAWAYS

KEY TAKEAWAYS

- ✓ **The return to normalcy will be uneven** – Regionally, Asian countries including Malaysia together with its neighbours namely Thailand and Indonesia have been grappling with a spike in Covid-19 infections as of late. In contrast, Singapore will begin to relax dine-in restrictions while New York has lifted Covid-19 restrictions last month. Therefore, some countries will recover faster compared to others.

- ✓ **New variants are alarming** – While the globe carries on with vaccination efforts , more infectious Covid-19 variants are being discovered along the way with the latest ones being the Delta and Lambda variant. Notwithstanding this, latest researchers in the U.S. found that messenger ribonucleic acid (mRNA) Covid-19 vaccines are effective against the latest variants.

- ✓ **Political risks may continue to spook foreign investors away** – In addition to adverse impacts brought by the pandemic, the fluid political situation in Malaysia has somewhat deterred foreign investors from coming into Malaysia. The reason being is that it will give rise to the probability of economic or policy reforms being put on the backburner. In the long run, the formalisation of an elected government via a general election would address any doubt on legitimate leadership, and go a long way towards reversing the foreign outflows due to improved political stability.

- ✓ **Slowly but surely** - All in all, Malaysia's prospects for recovery is not all doom and gloom. Vaccination rates have been very encouraging with daily doses administered reaching above 300,000 doses. Therefore, the target to vaccinate 80.0% of the population by year-end will likely be within reach. Aside from that, states such as Kelantan, Pahang, Perlis, Perak, Terengganu and Penang have entered Phase 2 of the NRP. With this, business activities can slowly resume and contribute to the country's economic output.

COVID-19 NEW DAILY INFECTIONS – ADVANCED ECONOMIES

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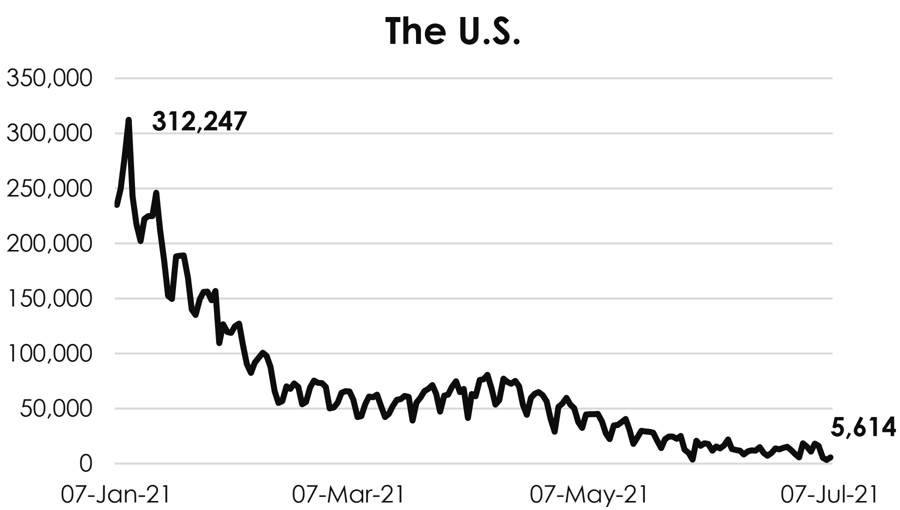
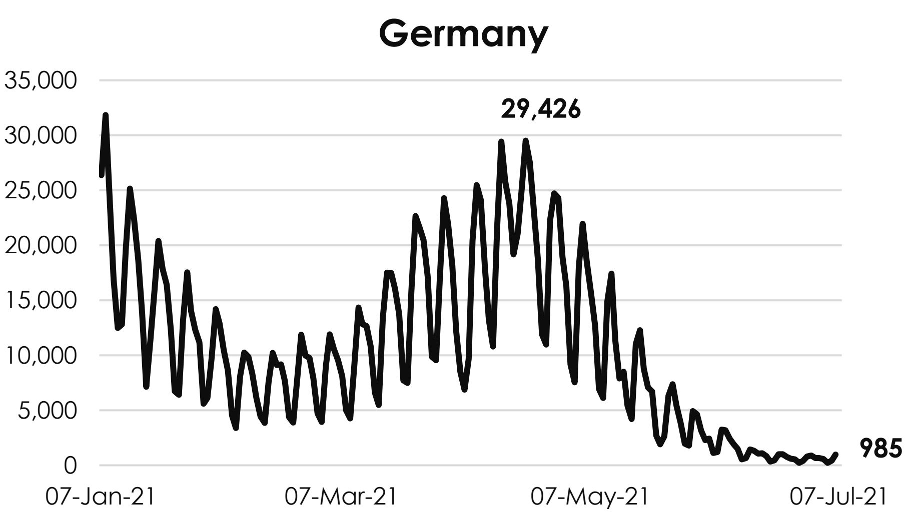
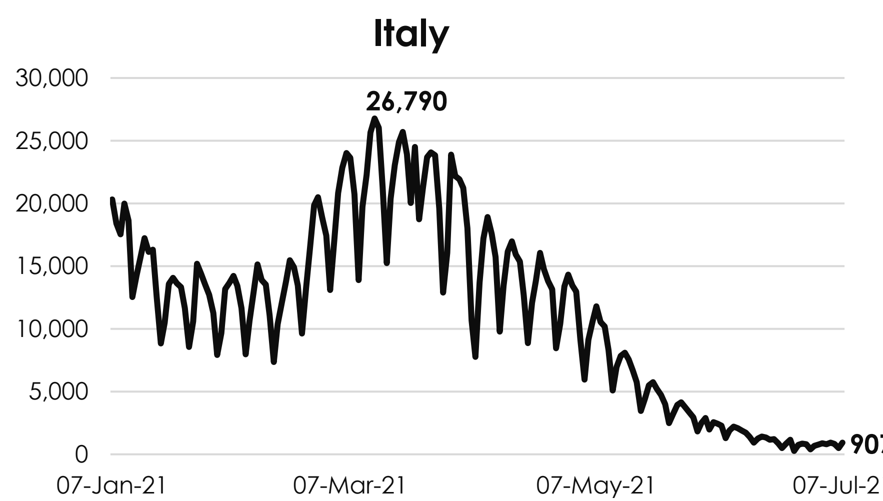
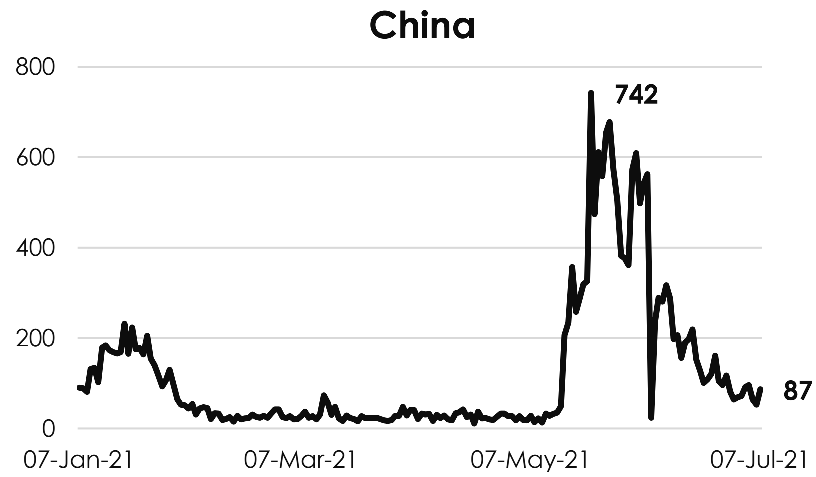


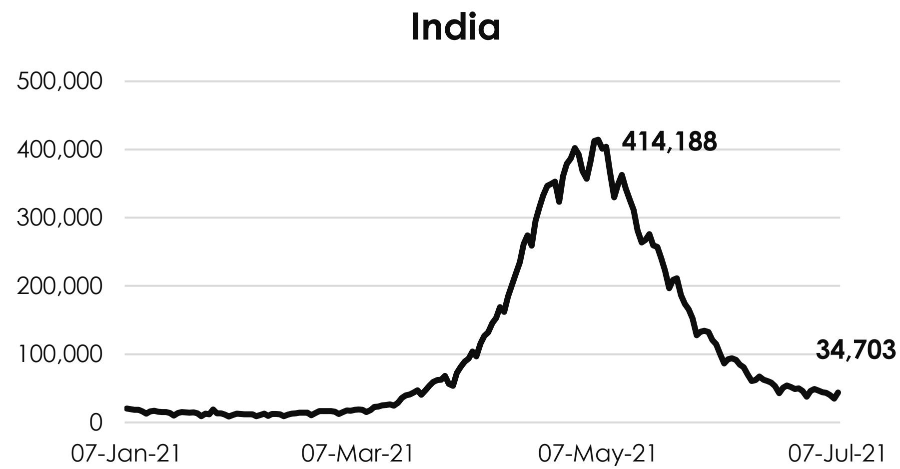


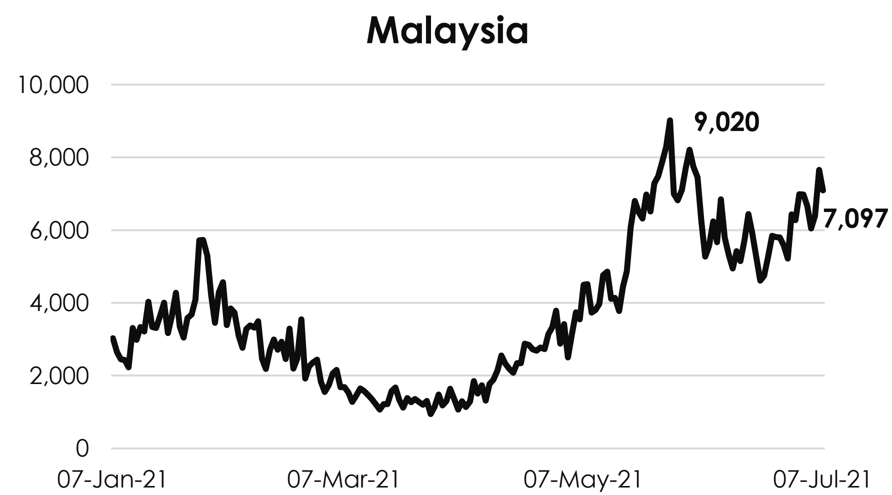


Source: CEIC

COVID-19 NEW DAILY INFECTIONS – ASIAN COUNTRIES







Source: CEIC

OUR FORECASTS FOR 2021

OUR FORECAST FOR 2021

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✓ Taking into consideration of the latest domestic and global developments, below is our latest forecast for the macro economic variables (MEVs).

Variables	2019	2020	2021F
GDP	4.4%	-5.6%	4.2%
FBM KLCI year-end target	1,589 points	1,627 points	1,610 points
OPR	3.00%	1.75%	1.75%
USDMYR	RM4.09	RM4.02	RM4.11
CPI	0.7%	-1.1%	2.5%
CPO	RM3,026 MT	RM3,788 MT	RM3,436 MT
BRENT	USD66.00/bbl.	USD51.80/bbl.	USD65.52/bbl.

Source: Economic Research, Bank Islam
Note: FBM KLCI, USDMYR, CPO and Brent are year-end figures

✓ Following the series of MCO extensions, the government is likely to cut Malaysia's GDP growth for this year to around 4.0% from current 6.0%-7.5% expansion. This is not far from our in-house estimates of 4.2% GDP growth for 2021.

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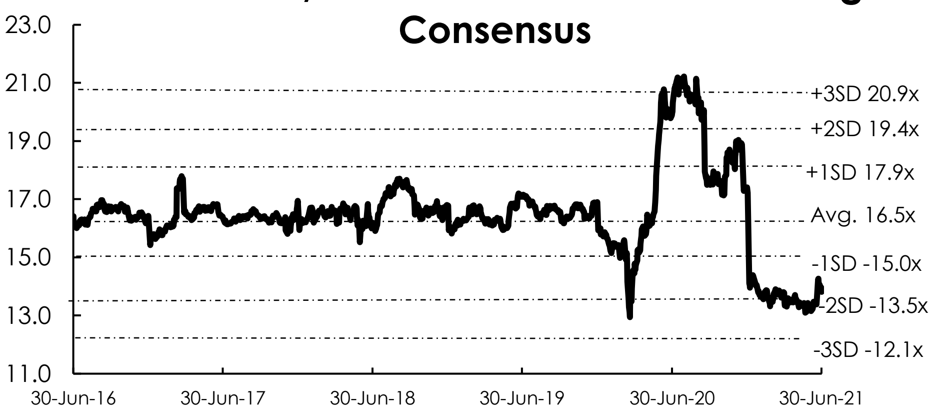
- ✓ A major revision was also made for the year-end FBM KLCI target whereby we are forecasting the **FBM KLCI index to settle at 1,610 points at year-end for 2021 (2020 year-end: 1,627 points) from 1,715 points previously.**
- ✓ The reason for the revision is to incorporate the lower consensus forecasted FBM KLCI index earnings per share (EPS) integer of 111.0 compared to 118.3 before the full scale lockdown came into place. The downward revision in FBM KLCI index EPS integer consensus was likely due to the full-scale lockdown together with the latest EMCO in certain parts of Selangor and Kuala Lumpur may temper earnings and valuation prospects in the near term.
- ✓ This FBM KLCI EPS integer of 111.0 is then multiplied with a forward PER target of 14.5x which is roughly -1.25 SD lower than the 5-year historical average. We ascribe such forward PER target as we remain cognizant of the risks of the Delta variant which may lengthen the path to recovery in the wake of better corporate earnings this year. In addition, any prolonged political uncertainty will likely drag investor sentiment.

FBM KLCI P/E Band based on 2021 Earnings Consensus



Source: Bloomberg

EPS Integer Of The FBM KLCI Index

Year	Earnings Per Share (EPS) Integer of FBM KLCI	Year-on-year (y-o-y) EPS Growth
2022F	109.4	-1.5%
2021E	111.0	55.9%
2020	71.2	-20.6%
2019	89.7	13.0%
2018	79.3	-26.5%
2017	107.9	9.8%
2016	98.3	4.4%
2015	94.2	-13.0%

Source: Bloomberg

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