



From the Desk  
of the  
**Chief Economist**

**BANK ISLAM**

# **ECONOMIC OUTLOOK 2H2022: BETWEEN ROCK AND HARD PLACE**

**18 JULY 2022**

**ECONOMIC RESEARCH**

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## **The U.S. Federal Reserve (Fed) is in for an aggressive tightening**

- ✓ Minutes from the Fed June's meeting made it clear that officials are eager to move rates up even when the economy shows early signs of slowing and recession fears mount.
- ✓ In fact, the 9.1% jump in the inflation during June (May: 8.6%) signals a big rate move might well be in store for the next Federal Open Market Committee (FOMC) meeting on 26-27 July as the Fed is determined to choke off rapid inflation.

## **International Monetary Fund (IMF) trimmed the U.S. growth forecast**

- ✓ The growth forecast for the U.S. economy was downgraded to 2.3% (previous estimation: 2.9%) for 2022 and 1.0% (previous estimation: 1.7%) for 2023 due to soaring inflation.
- ✓ The recovery growth of economy from the pandemic took a further plunge with the Russia-Ukraine war, spiking fuel and food prices, as well as stoking inflation to 40-year high.
- ✓ Hence, avoiding recession could be a challenge as the Fed has been aggressively hiking the Federal Fund Rate (FFR).

## **Higher OPR is anticipated during 2H2022**

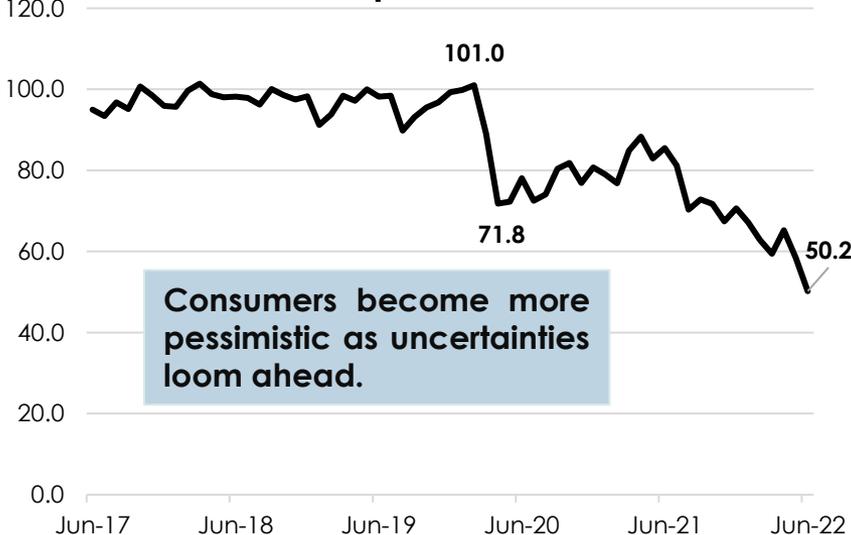
- ✓ Following positive developments surrounding Malaysia's economy, Bank Negara Malaysia (BNM) decided to raise the Overnight Policy Rate (OPR) by 25 basis points (bps) in July, a similar quantum during May's meeting.
- ✓ Further adjustment in the OPR is needed as conditions which required the historically low OPR of 1.75% are receding.



# GLOBAL & DOMESTIC ECONOMY IN A GLANCE

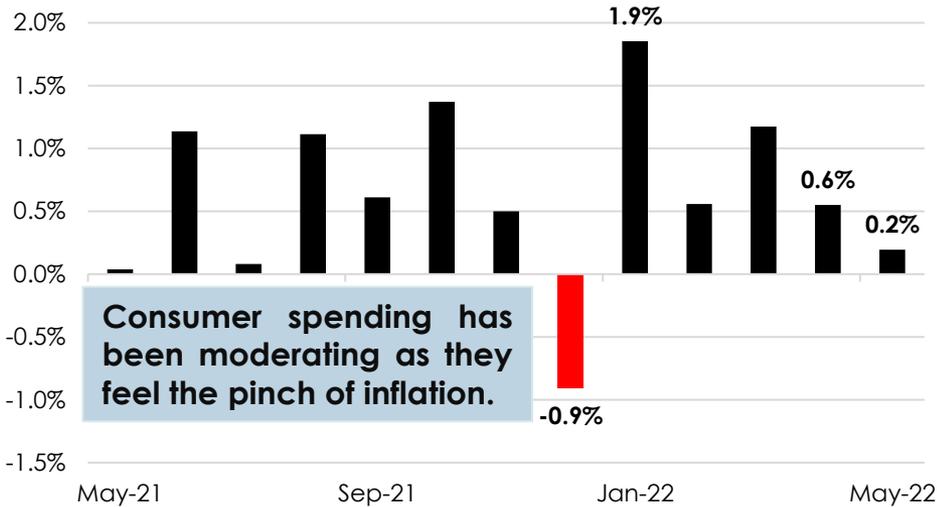
# THE U.S. ECONOMY IN BRIEF – CONSUMER SPENDING EDGES LOWER WHILE LABOUR MARKET REMAINS TIGHT.

**Consumer Sentiment Index (CSI), points**



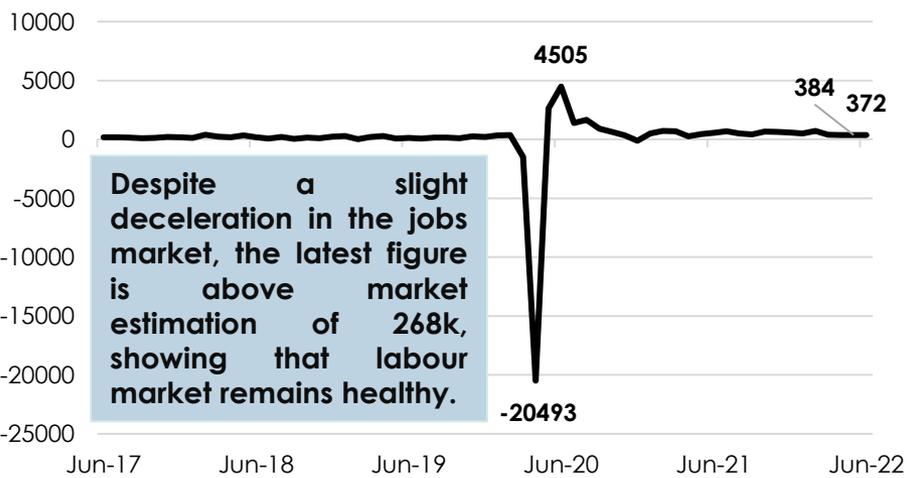
Consumers become more pessimistic as uncertainties loom ahead.

**Personal Consumption Expenditure (PCE), m-o-m%**



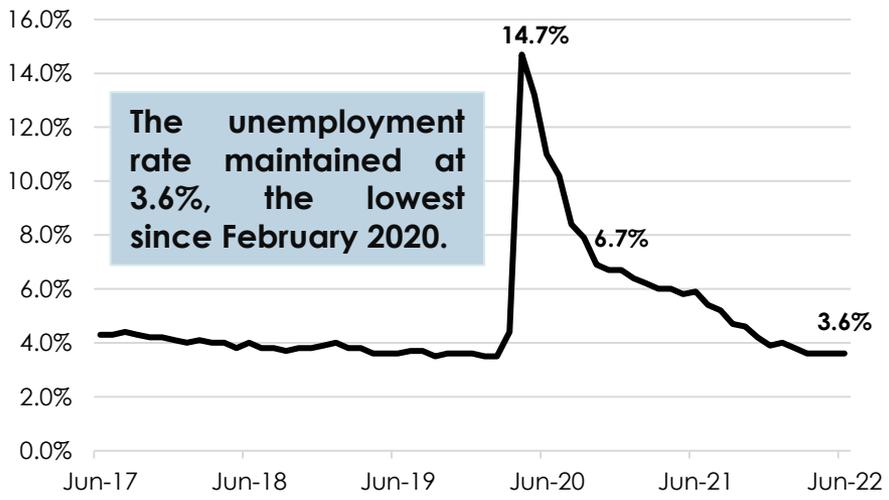
Consumer spending has been moderating as they feel the pinch of inflation.

**Nonfarm Payrolls, m-o-m changes ('000)**



Despite a slight deceleration in the jobs market, the latest figure is above market estimation of 268k, showing that labour market remains healthy.

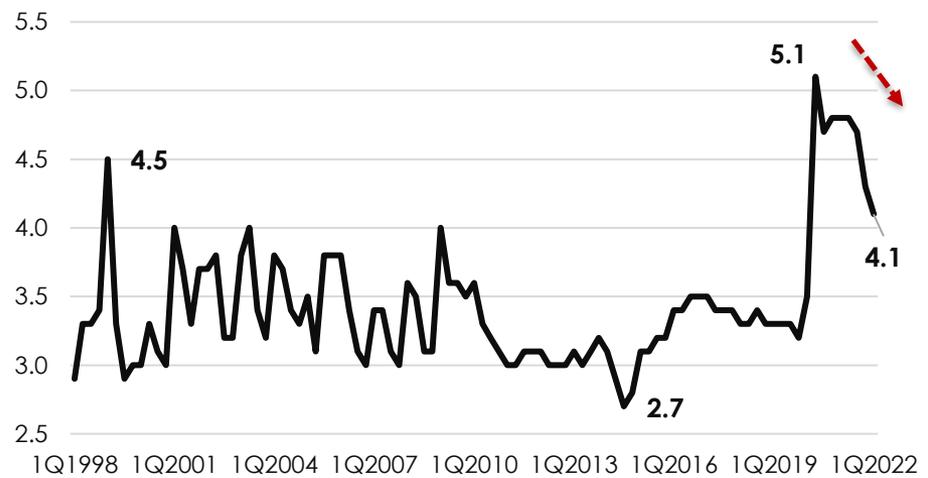
**Unemployment Rate (UR), %**



The unemployment rate maintained at 3.6%, the lowest since February 2020.

# MALAYSIA'S LABOUR MARKET MOMENTUM ESCALATED DURING 1H2022. IT IS EXPECTED TO STRENGTHEN IN 2H2022 AMID FIRMER DOMESTIC DEMAND.

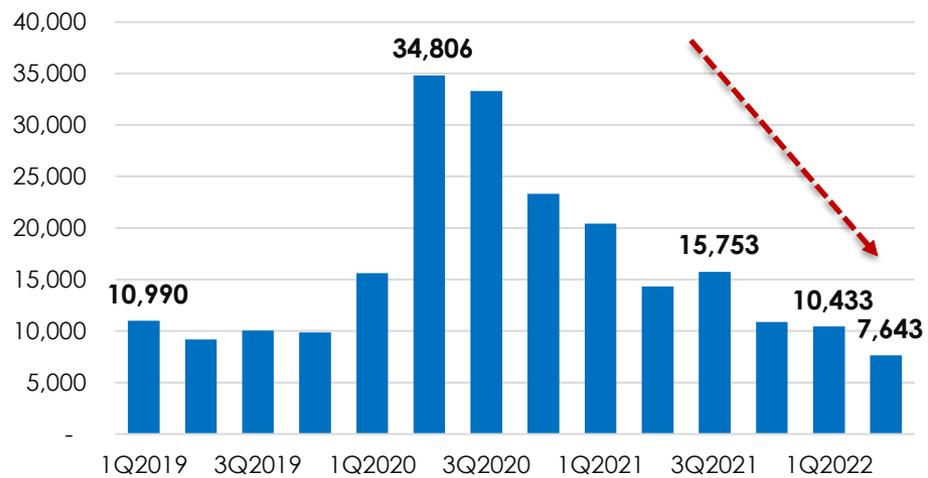
### UR by Quarter, %



### UR by Month, %



### Loss of Employment (LOE) by SOCSO

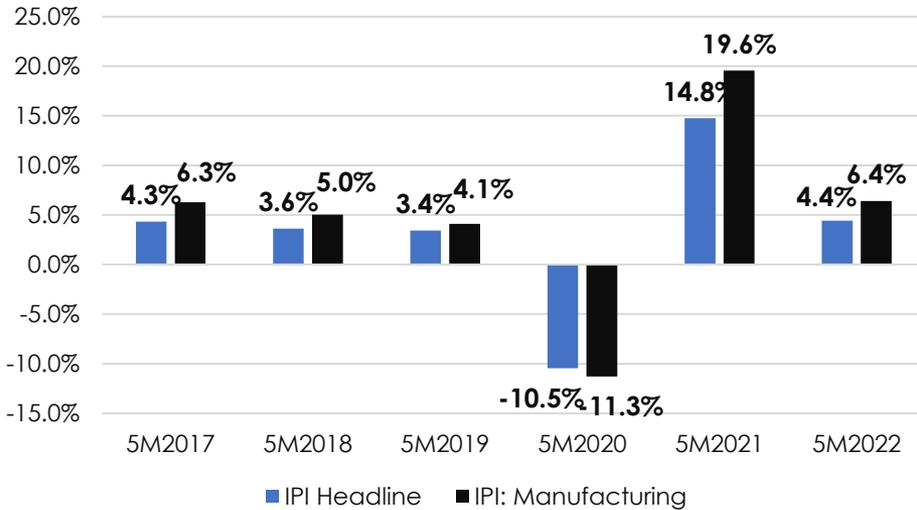


LOE	2019	2020	2021	2022
January	4,998	5,778	8,334	4,556
February	2,848	4,562	6,296	2,785
March	3,144	5,262	5,788	3,092
April	3,571	6,143	4,963	3,029
May	3,137	10,084	3,727	2,172
June	2,478	18,579	5,621	2,442
July	3,999	16,660	6,012	n/a
August	2,907	9,261	4,326	n/a
September	3,132	7,388	5,415	n/a
October	3,418	7,416	4,399	n/a
November	3,468	9,086	3,308	n/a
December	2,984	6,805	3,171	n/a
<b>Total</b>	<b>40,084</b>	<b>107,024</b>	<b>61,360</b>	n/a
<b>1H Figure</b>	<b>20,176</b>	<b>50,408</b>	<b>34,729</b>	<b>18,076</b>

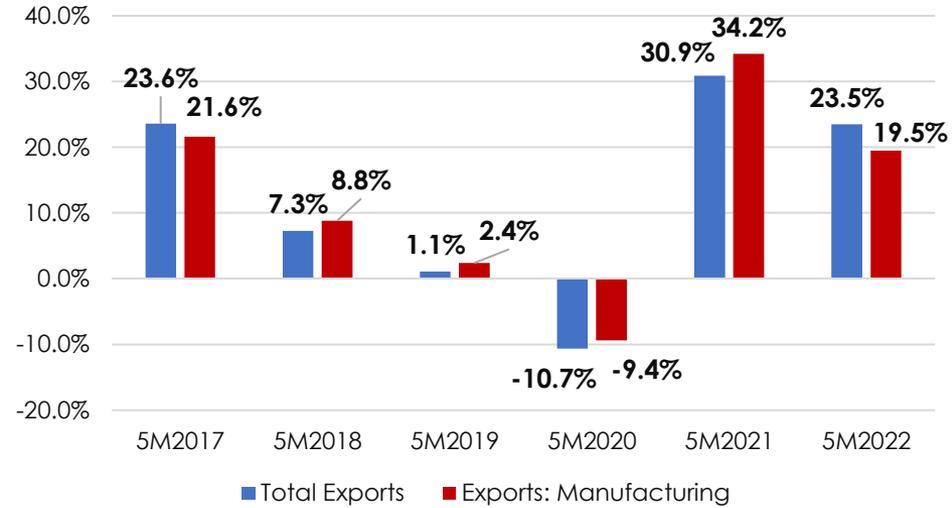
Sources: CEIC, SOCSO

# MANUFACTURING SECTOR CONTINUED TO SUPPORT DOMESTIC ECONOMIC GROWTH. NONETHELESS, SUPPLY CHAIN DISRUPTION ISSUES PERSIST.

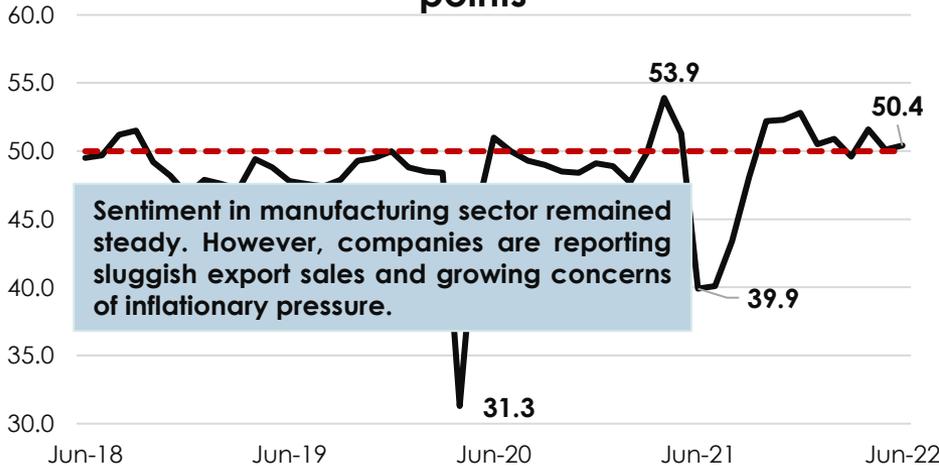
### Industrial Production Index (IPI), y-o-y%



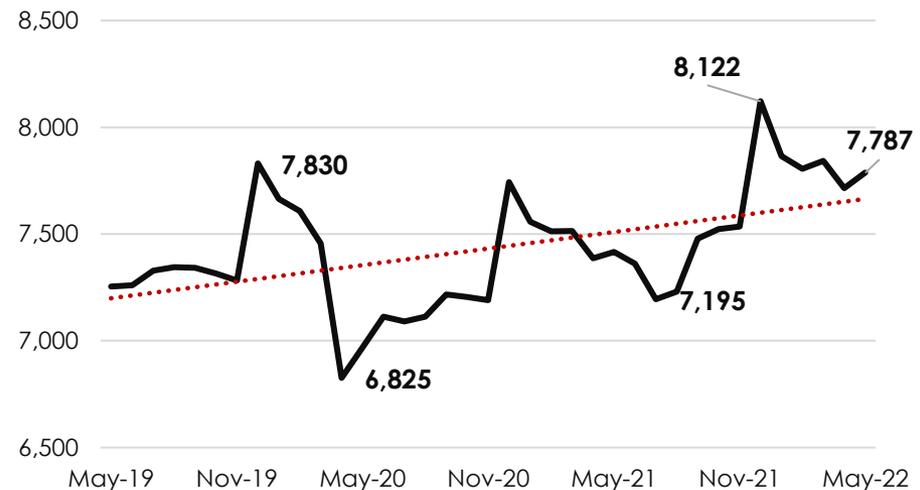
### Exports, y-o-y%



### S&P Global Malaysia Manufacturing Purchasing Manager's Index (PMI), points

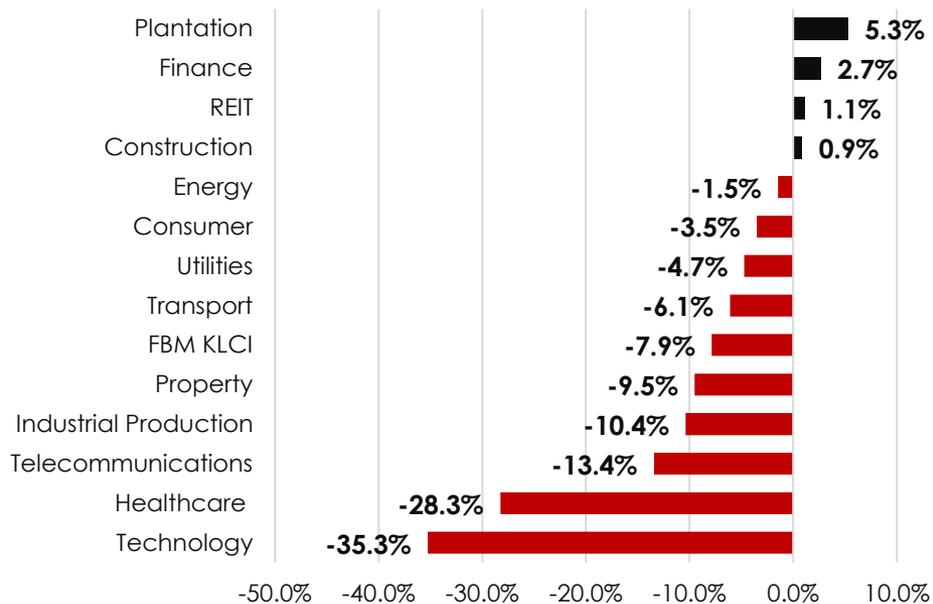


### Manufacturing Sector Payroll, RM Million

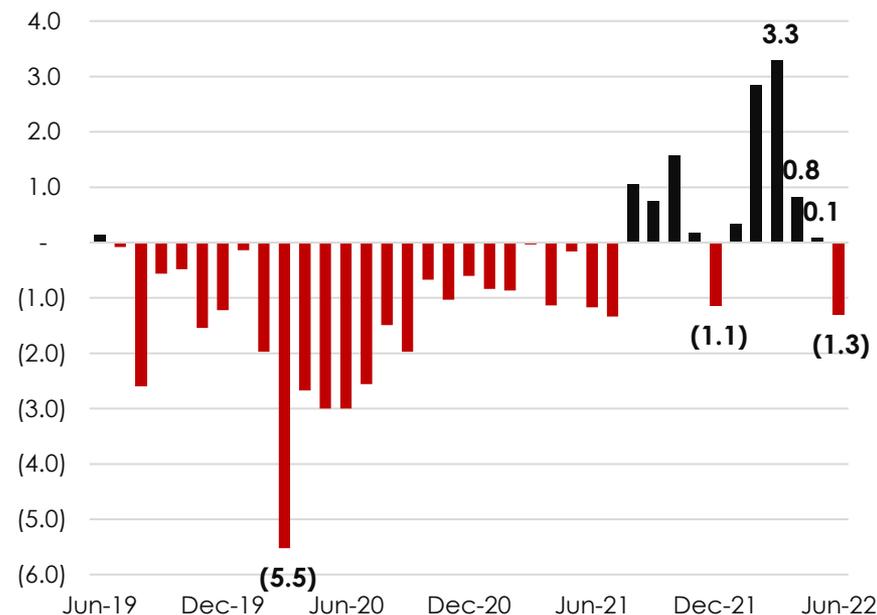


# DOMESTIC EQUITY MARKET PERFORMANCES WERE AFFECTED DURING 2Q2022, DRIVEN BY THE U.S. INTEREST RATE DEVELOPMENT.

## Bursa Malaysia Sectoral YTD Performance as of June 2022



## Monthly Foreign Net Inflow/Outflow in Malaysia's Equity Market, RM Billion

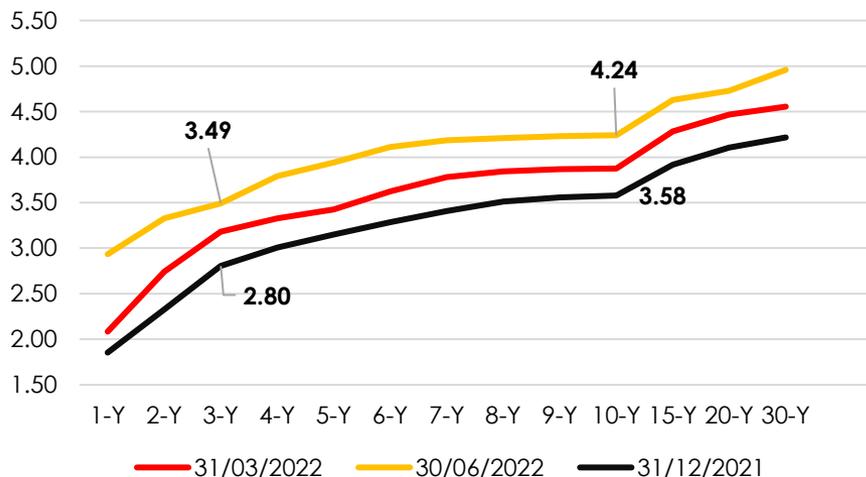


Sources: Bursa, Bank Islam

- ✓ The FBM KLCI dropped by 7.9% on a year-to-date (YTD) basis, predominantly driven by external headwinds, as well as earning and margin stresses. However, Crude Palm Oil (CPO) and Oil & Gas (O&G) players have been benefiting from strong commodity prices.
- ✓ Meanwhile, **foreign investors turned to be net sellers in June at 1.3 billion after 5 straight months as net buyers.** Notwithstanding that, cumulative foreign flows from January to June was still positive at RM6.1 billion as compared to RM3.2 billion net outflows during the same corresponding period last year.
- ✓ Moving forward, we foresee that the ongoing uncertainties in the global market amid aggressive interest rate hike among major central banks may prompt further fund outflows from Malaysia.

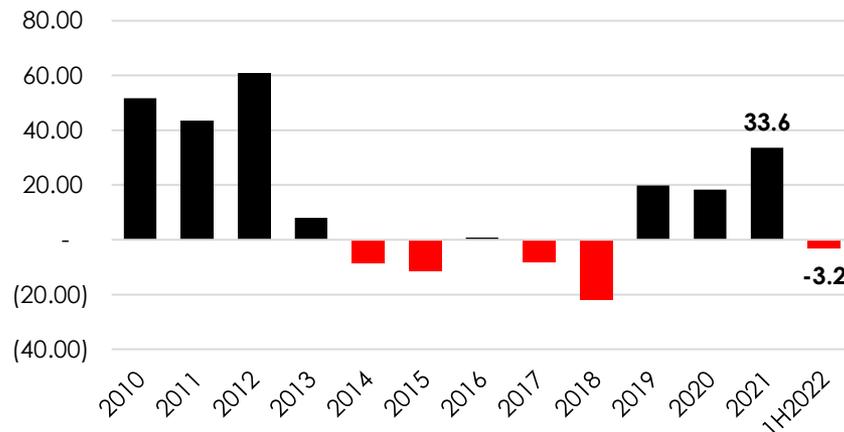
# FIXED INCOME – FOREIGN DEMAND WAS PRESSURED BY WEAK GLOBAL SENTIMENT.

### MGS Yield Curve, %



Sources: Bank Islam and CEIC

### Foreign Fund Flows in Bond Market, RM Billion



- ✓ **The Malaysian Government Securities (MGS) yields have surged between 66 bps and 79 bps during 1H2022**, mirroring the U.S. treasury (UST) yields movement amid monetary tightening cycle in the U.S.
- ✓ However, the MGS yields were lower during early of July.
- ✓ This could signal that the investors are seeking for safe-haven assets amid worries over recession risks in the developed markets (the U.S. & Europe).
- ✓ Following this, we foresee that the **3-Y, 5-Y and 10-Y MGS yields to trend lower to settle at 3.89%, 4.30% and 4.57% due to global risk aversion.**

- ✓ Foreign investors have pulled a RM4.1 billion fund from local bond market in June after acquiring a total of RM0.5 billion during May.
- ✓ It was the largest foreign outflows in over 2-years as demand was weighed by the U.S. Fed's aggressive tightening.
- ✓ Following this, the cumulative foreign fund have turned net outflows to RM3.2 billion during 1H2022 compared to RM14.8 billion net inflows in 1H2021.
- ✓ Looking forward, we anticipate that **the foreign fund outflows to persist in 2H2022 on the back of rising uncertainties from aggressive rate hike by the major central banks. The inversion of UST yield curves have reinforced the pessimistic view.**

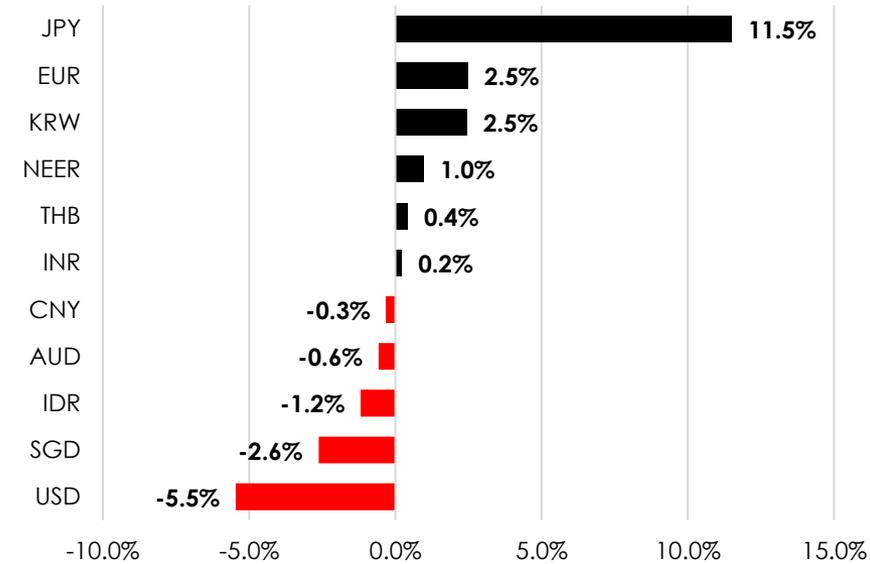
# RINGGIT REMAINS ON DOWNWARD TREND AMID HAWKISH OUTLOOK FROM THE U.S. FED.

**USDMYR**



Source: Investing.com

**MYR Against Regional Currencies, YTD Gain% (As at 30 June 2022)**



- ✓ On a YTD basis, the USDMYR has depreciated by 5.5%, attributable to various factors which led to the weaker local note.
- ✓ The main compelling reason is the aggressive monetary tightening policy by the Fed in view of the country's inflation which skyrocketed to 40-year high.
- ✓ This has put a downward pressure towards emerging currencies including the Ringgit despite the latest rating revision by S&P from negative to stable for Malaysia's outlook on 27 June.
- ✓ Following this, the BNM appears to be intervening the foreign exchange market as reflected by the fall in the international reserve assets (June: USD109.0 billion vs. May: USD112.8 billion).
- ✓ Hence, Ringgit to remain volatile in the near-term following headwinds from the external front.

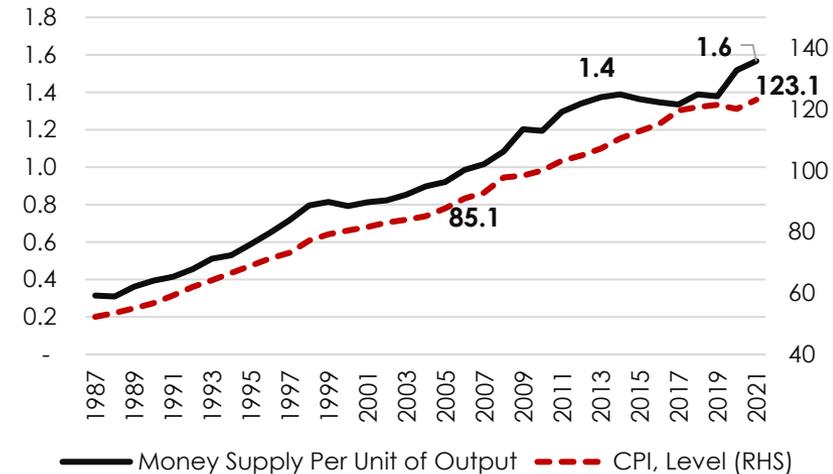


# WHAT TO LOOK FOR IN 2H2022?

# GLOBAL INTEREST RATE – DEMAND-PULLED INFLATION HAS BECOME PREVALENT. RAISING THE BENCHMARK RATE IS EXPECTED TO BE THE MAIN ANTIDOTES.

Policy rates	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22*
<b>Advanced countries</b>							
US (Fed Fund Rate)	0.25	0.25	0.50	0.50	1.00	1.75	1.75
Japan (Policy Balance Rate)	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
Euro Zone (Main Refinancing Rate)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
UK (Bank Rate)	0.25	0.50	0.75	0.75	1.00	1.25	1.25
Canada (ON Lending Rate)	0.25	0.25	0.50	1.00	1.00	1.50	2.50
<b>Latin America</b>							
Mexico (ON Rate)	5.50	6.00	6.50	6.50	7.00	7.75	7.75
Brazil (Selic Rate)	9.25	10.75	11.75	11.75	12.75	13.25	13.25
Argentina (LELIQ 7D Notes Rate)	40.00	42.50	44.50	47.00	49.00	52.00	52.00
<b>Eastern Europe</b>							
Russia (Key Rate)	8.50	9.50	20.00	14.00	11.00	9.50	9.50
Ukraine (Discount Rate)	10.00	10.00	10.00	10.00	10.00	25.00	25.00
Turkey (1W Repo Rate)	14.00	14.00	14.00	14.00	14.00	14.00	14.00
<b>Asia</b>							
China (1Y Loan Prime Rate)	3.70	3.70	3.70	3.70	3.70	3.70	3.70
India (Repo Rate)	4.00	4.00	4.00	4.00	4.40	4.90	4.90
Indonesia (7D Repo Rate)	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Thailand (1D Repo Rate)	0.50	0.50	0.50	0.50	0.50	0.50	0.50
South Korea (Base Rate)	1.25	1.25	1.25	1.50	1.75	1.75	2.25
Philippines (O/N Lending Rate)	2.00	2.00	2.00	2.00	2.25	2.50	3.25
Australia (Cash Rate)	0.10	0.10	0.10	0.10	0.35	0.85	1.35
New Zealand (Cash Rate)	0.75	1.00	1.00	1.50	2.00	2.00	2.50
Malaysia (OPR)	1.75	1.75	1.75	1.75	2.00	2.00	2.25

Malaysia: Money Supply/Output vs. CPI



Sources: CEIC, Bank Islam

- ✓ Judging from the Money Supply per Unit of Output, the amount of liquidity in the system has been quite abundance.
- ✓ The economic stimulus during pandemic amounting to RM530.0 billion may have started to deliver its impact when the economy starts to reopen again in October last year.
- ✓ This has led demand-pulled inflation to be increasingly visible and the best to address such inflationary pressures is by way of removing the excess liquidity in the system.
- ✓ In other words, raising the OPR.

- ✓ Latest, Bangko Sentral ng Pilipinas (BSP) had raised its key rate by 75 bps to 3.25% on 14 July, a surprise move ahead of the policy meeting scheduled on 18 August.
- ✓ The Governor Felipe Medalla stated that the central bank is ready to take necessary actions to control the broadening inflationary pressure (June: 6.1% vs. May: 5.4%) in the country.

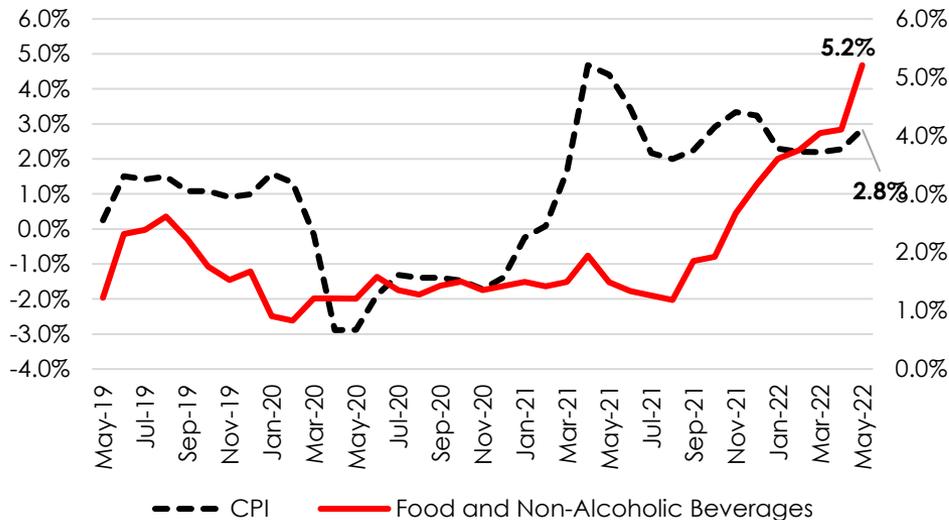
Source: Bloomberg  
\*As at 18 July 2022

Interest Rate Hike

Interest Rate Cut

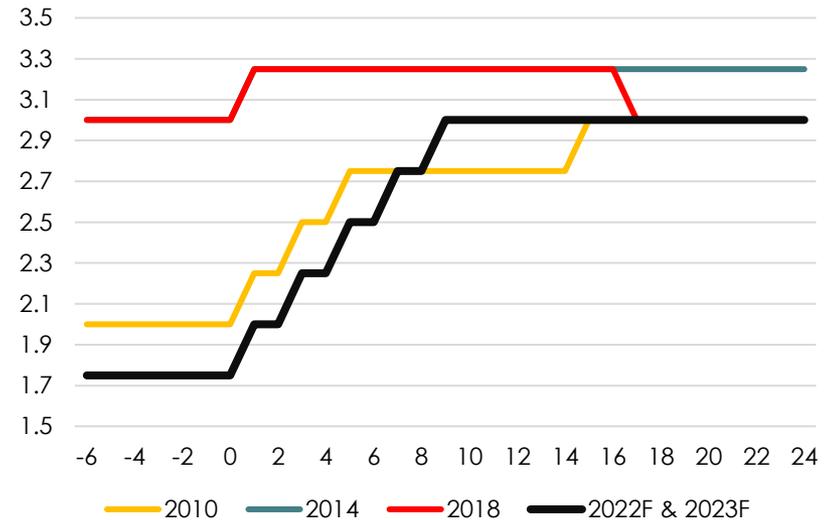
# HEADLINE INFLATION WILL CONTINUE TO TREND UPWARD IN 2H2022 WHILE THE BNM HAS STARTED ITS MONETARY NORMALISATION CYCLE.

### Inflation, y-o-y%



Sources: CEIC, Bank Islam

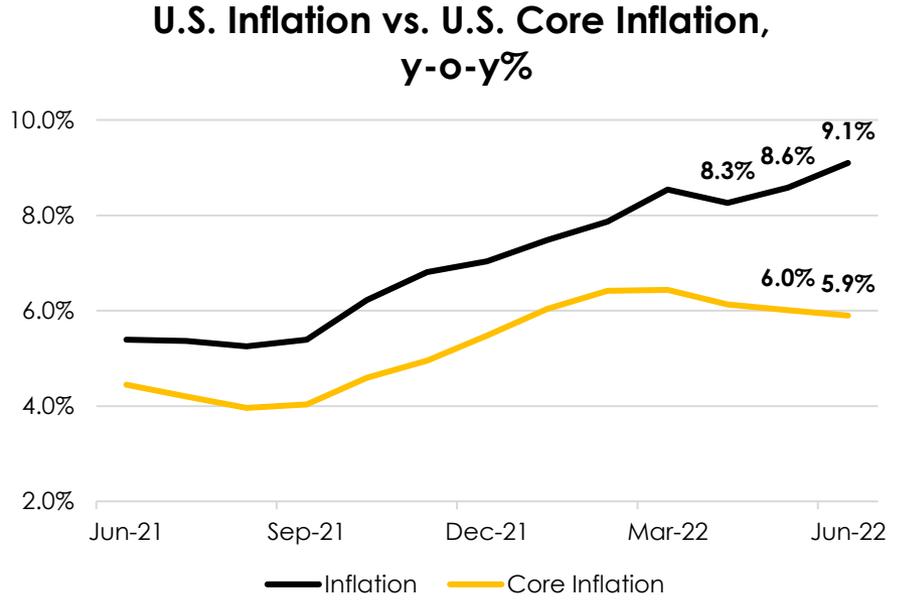
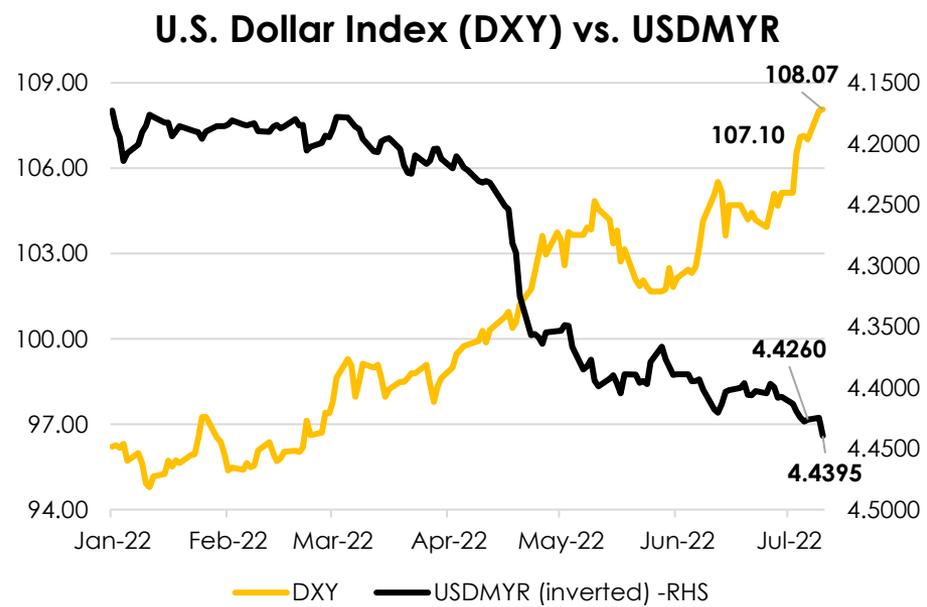
### OPR during post-recession tightening in the past, %



- ✓ Malaysia's headline inflation has been rising at a fast clip with the latest Consumer Price Index (CPI) rose by 2.8% in May y-o-y (April: 2.3%) on the back of higher food prices (May: 5.2% vs. April: 4.1%).
- ✓ Apart from that, inflationary pressure is rapidly building up due to pent up demand following border reopening, higher commodity prices, as well as the removal of cooking oil price subsidy alongside with new ceiling price for chicken.
- ✓ As such, we have revised the **headline inflation to increase by 3.5% in 2022 from the previous estimation of 2.8%.**

- ✓ The BNM's normalisation cycle is intended to withdraw the monetary support and to remove bulk of liquidity prescribed during Covid-19 crisis.
- ✓ Owing to positive economic development, we anticipate **that BNM to increase the OPR by 25 bps at each of two remaining meetings in September and November to reach 2.75% by end of 2022.**
- ✓ **We also do not rule out another back-to-back increase in January next year to 3.00%-3.25%.**

# RINGGIT IS MOVING CLOSER TO THE WEAKEST LEVEL SINCE MARCH 2020 AMID GROWING FEARS OF AGGRESSIVE INTEREST RATE HIKES AND GLOBAL RECESSION.

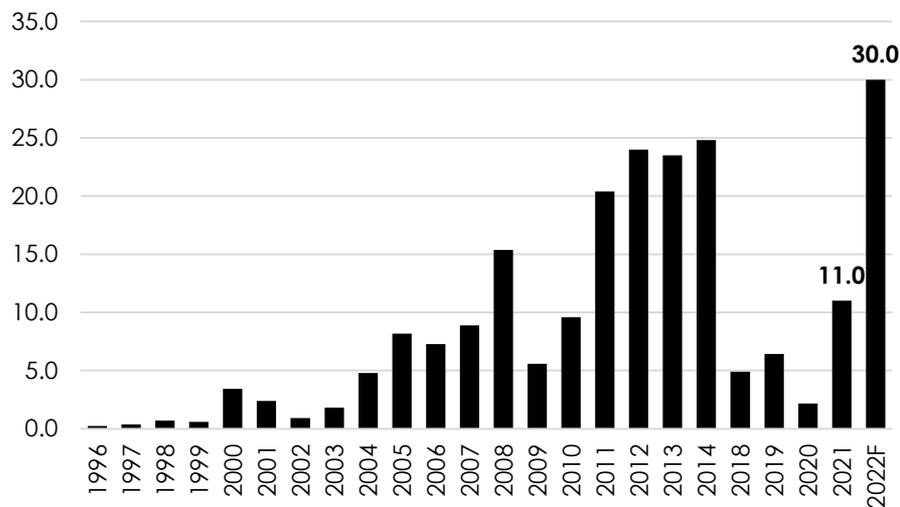


Sources: Bloomberg, CEIC

- ✓ Despite the recent decision of BNM's to increase the OPR to 2.25%, the value of Ringgit remains fairly weak at RM4.45 presently.
- ✓ The DXY has soared significantly, hitting 108.07 recently in July, the first time since October 2002 as further aggressive tightening from the Fed remains the key driver for USD strength.
- ✓ With another scorching inflation, this could raise the bet of full point rate hike for the upcoming Fed's meeting later this month.
- ✓ As a result, the recession fears have flared up, prompting investors to seek shelter in the safe-haven currencies for the time being.
- ✓ **Following this, we foresee the Ringgit could end the year at RM4.35 in 2022 from the previous projection of RM4.28.**

# THE CHALLENGES THAT LIE AHEAD.

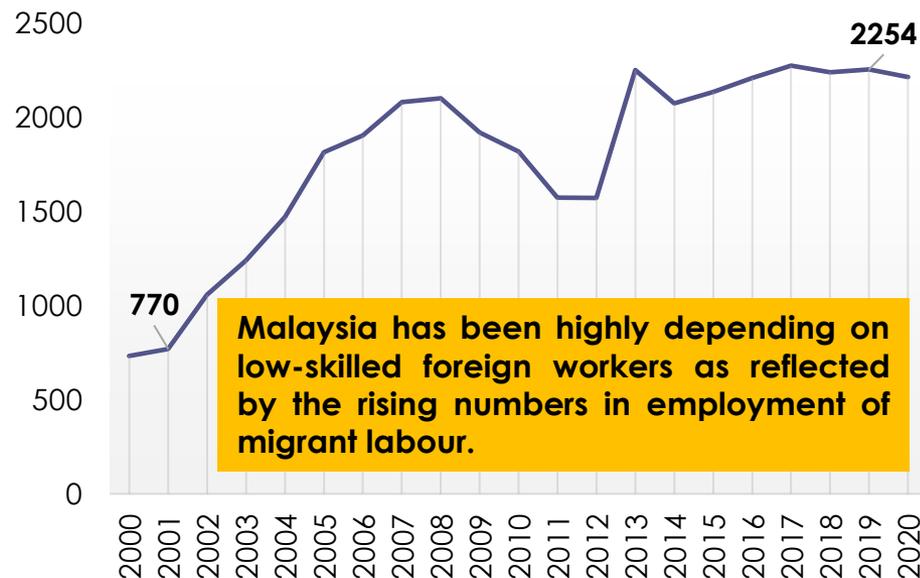
### Malaysia's Fuel Subsidy, RM Billion



Sources: CEIC, MOF

- ✓ **Potential subsidies removal** - Fuel subsidy this year is expected to reach RM30.0 billion from previous estimation of RM28.0 billion. Following this, **the policy makers might want to review the subsidy programme as the current subsidy mechanism is not sustainable and depleting Malaysia's fiscal coffer.** In fact, the government has announced the removal of subsidy for bottled cooking oil alongside with the new ceiling price for chicken due to rising raw materials prices. Hence, more targeted subsidy system moving forward is anticipated for the long-term plan by the government.

### Foreign Workers ('000 persons)



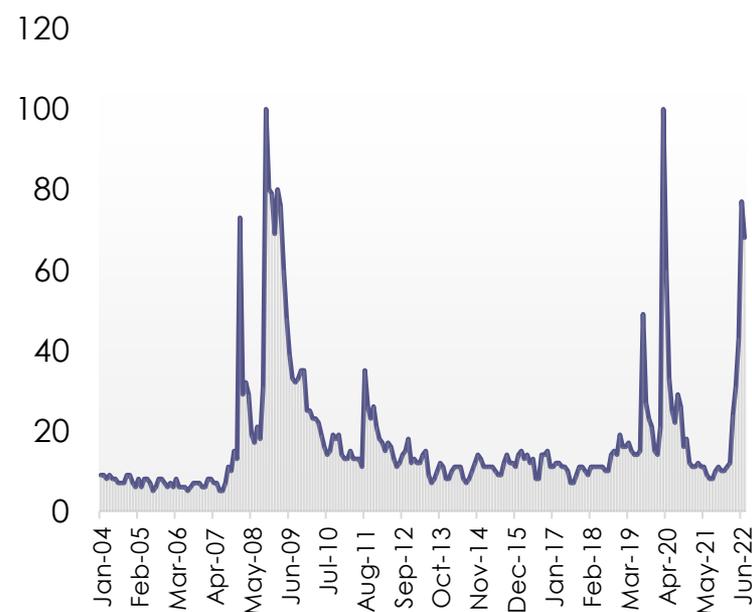
**Malaysia has been highly depending on low-skilled foreign workers as reflected by the rising numbers in employment of migrant labour.**

Source: BNM

- ✓ **Malaysia's economic sector will face productivity issues amid pockets of labour shortages in certain industries** – Thus far, Indonesia's temporary ban on labour supply to Malaysia is expected to dampen domestic activities. Consequently, it would prolong the labour shortages issue in Malaysia. For instance, the delay in arrival of foreign workers in palm oil industry will disrupt the harvesting activities in plantation sector with upcoming peak production period during 2H2022. As such, the government has to take proactive approach towards solving the labour shortage issue in all sectors and look for other alternatives to boost economic activities in 2022.

- ✓ **Inflation rate has become pervasive in the U.S.** – The ongoing elevated inflation rate has led the Fed to be more aggressive in their monetary tightening process. The Fed Chairman has also indicated that the unintended outcome – recession – could happen. Based on the Google search activity, the “R” word has gained prominence in the public domain. This could have an impact on market sentiments as investors would continue to seek shelter against economic uncertainties.
- ✓ **Malaysia’s GDP to grow by 5.5% in 2022** – Domestic economic indicators have been pointing to a stronger performance, thanks to reopening of international border. Apart from that, the past policy supports may have driven up the domestic spending activities during the 1H2022. As such, we are maintaining our GDP estimate for 2022 at 5.5% this year.

Google Search Activity For  
“Recession” Since 2004



Source: Google

- ✓ **BNM will remain measured and steady in OPR hike** – The BNM is adamant to remove the monetary support as the country’s economy has normalized. However, the pace of policy support removal is likely to be measured and gradual.
- ✓ **The downside risks to economic outlook is tilted on the downside** – The unresolved Russia-Ukraine war coupled with China’s commitment to its Zero Covid Strategy (ZCS) have contributed other headwinds for economic growth. The inversion of US Treasury yield curve have also raised the odds for the recession in the U.S. economy. Expect risk-off sentiments to prevail in the immediate terms.

# OUR FORECAST FOR 2022 AND 2023

Variables	2021	2022F	2023F
GDP	3.1%	5.5%	4.5%
FBM KLCI year-end target	1,567.50 points	1,550.0 points	1,650.0 points
OPR	1.75%	2.75%	3.25%
USDMYR	RM4.17	RM4.35	RM4.30
CPI	2.5%	3.5%	2.2%
CPO	RM5,180 MT	RM4,300 MT	RM4,200 MT
BRENT	USD77.78 bbl.	USD100.0 bbl.	USD88.01 bbl.

Source: Bank Islam  
 FBM KLCI USDMYR, Brent Crude and CPO are end of the year forecasts

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An aerial photograph of a city skyline at sunset, with a prominent pink bar at the bottom. The sky is filled with soft, golden light and scattered clouds. The city features numerous high-rise buildings, with a particularly tall, slender skyscraper on the left. A highway with traffic is visible in the foreground, winding through the city. The overall mood is warm and serene.

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