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THEMATIC

In this report:

Strategy 2022 – Stronger global comeback; moderate in Malaysia

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1. Recap for 2021: *A look at 2022 while reflecting on lessons of 2021*

- **Global economy has staged a swift recovery supported by the stimulus measures**
- **2021 GDP projected at 4.8% (previously was 5.3%)**
- **Malaysia's GDP is expected to grow at 3.4% (previously was 5.5% -6.0%)**
- **Downgrade to Malaysia's GDP was due to the "open and close" approach.**

- The global economy has staged a swift recovery compared to past recessions despite the Covid-19 pandemic outburst in March 2020 that fuelled the depth of recession in 1H2020 followed by unexpected setbacks of the Delta variant in 2022.

- Massive fiscal and monetary stimulus packages as well as non-monetary measures, added with the rapid development of effective vaccines helped paved the way to reopen the economy. It has somewhat prevented the 2020 recession from devolving into a long period of lacklustre economic growth. Following a global economic contraction of 3.3% in 2020, it is expected to grow by 4.8% in 2021.

- Malaysia's GDP, which shrank by 5.6% in 2020, the worst since the 1997 Asian financial crisis, is now projected to grow by 3.4% in 2021, a downgrade from our initial projection of 5.5%–6.0%.

- Our downgrade on Malaysia's GDP growth was due to the impact from the Delta variant that led to the imposition of MCO 3.0. Lockdowns were imposed to manage the ongoing pandemic wave. The restrictions cut activities in the services sector, resulting in sizeable job losses and affected the domestic economy.

- The economy suffered from the "open and close approach", although daily losses in each MCO were decreasing as projected by the Finance Ministry (MCO 1.0: RM2.4 billion; MCO 2.0: RM600 million; and MCO 3.0: RM200 million). The government had to spend an enormous amount on every phase of the MCO to stabilize the economy through a series of stimulus packages worth a total RM530 billion.

- Concerns on the risk of downgrading, deteriorating sentiments, foreign investors remaining net sellers in the equity market and foreign investments pulling out from the country lingered with political uncertainties adding to the risks. Issues relating to the implementation of the policies, poor coordination and confusing SoPs weighed on the economy and overall confidence.

- Nonetheless, the economy started to show signs of rebounding following the reopening of the economy and a successful nationwide vaccination programme. The RM530 billion stimulus measures gave economic growth a much needed boost.

- Also, the domestic economy was buffered to a large degree by exports. Exports have been expanding for 15 consecutive months, chalking up yearly expansion since September 2020 while trade has been growing at double digits for the 10th straight month.

- Exports earnings crossed the RM2.0 trillion mark for the first time during the period from January until November 2021, rising 24.6% y/y to RM2.01 trillion. Electronics and electrical products, refined petroleum, manufactures of metal, chemicals, and chemical-related products as well as palm oil and related goods were the key export drivers. Firm commodity prices also played supporting role in driving the exports value higher.

- The economy also benefitted from the 51.5% y/y jump in approved FDIs. Until September 2021, the total amount of approved FDIs stood at RM177.8 billion in the manufacturing, services and primary sectors. Meanwhile, manufacturing health gained momentum following the relaxation of MCO 3.0 as reflected by the headline IHS Markit Manufacturing Purchasing Managers' Index (PMI) which read at 52.8 in December 2021 from a low of 39.9 in June.

2. Global: Entering 2022 on a strong footing following a surprisingly swift pandemic recovery

- **Global economy enters 2022 on a strong footing supported by the stimulus measures**
- **But recovery will remain uneven due to large differences in vaccination rates between countries**
- **And there is a marked variation of inflation**
- **Global GDP is expected to grow at 4.5%.**

- Global GDP is growing stronger than anticipated in 2021. Extraordinary support from governments and central banks around the globe provided the uplift. Continued vaccine rollouts and a gradual resumption of economic activities provided the added impetus to growth, which is projected to expand by 4.5% in 2022.

- However, the global recovery in 2022 remains uneven. Countries are emerging from the crisis with different challenges, often reflecting their pre-Covid 19 strengths and weaknesses, and their policy approaches during the pandemic. Even in countries where output and employment have recovered to their pre-pandemic levels, the recovery is not complete, with jobs and incomes still short of the levels expected before the pandemic.

- The imbalance is also due to large differences in vaccination rates between countries. Renewed outbreaks of the virus are forcing some countries to restrict activities, resulting in bottlenecks, thus adding to supply shortages. And there is a marked variation in the outlook for inflation which has risen sharply in the US and some emerging market economies but remains relatively low in many other advanced economies, particularly in the euro area.

- A rapid increase in demand as economies reopen has pushed up prices in key commodities such as oil and metals as well as food, which has a stronger effect on inflation in emerging markets. The disruption to supply chains caused by the pandemic has exacerbated cost pressures. At the same time, shipping costs have skyrocketed.

3. *Global: Challenges in 2022*

- **Omicron, new variants, and more lockdown.**
- **Macro focus of the recovery has shifted to inflation.**
- **Volatile global financial market.**
- **Emerging Market Economies (EMEs) risk falling into a crisis.**
- **Global supply chains issues to remain in 2022.**
- **China risk hitting the wall in 2022.**

A) **Omicron, new variants and potential lockdowns:** New Covid-19 variants are likely to continue emerging and spreading until there is a breakthrough in research on the virus. For now, vaccinations seem to provide the best protection. To date, about 60% of the world's population have received at least one dose of the Covid vaccines.

Vaccines is not just a selfless act but a rational one. Until the entire world population is vaccinated, we remain vulnerable to new variants emerging and some of these could be more dangerous than Omicron.

Viruses "tend to become milder" as they evolve. But this may not be the case always, especially with future Covid variants. They can be more contagious but milder in terms of symptoms. If this is the case, it would help the global economy get back on track to the pre-pandemic normal, which means higher household spending on services. Again, there is no certainty.

What is certain is that lockdowns and Covid caution would impact household spending and dampen the global economy. A rebalancing of spending could boost global growth to 5.0% from the base forecast of 4.5%. But the prospects of global economy recovery may not be so bright. A more contagious and deadly variant could drag economies. A three-month return of the tough 2021 restrictions could see 2022 growth slow to 4.0%.

B) **Macro focus of the recovery has shifted to inflation:** The initial view was that there would be a modest and temporary rise in inflation in early 2021. But as economies reopened, events turned out differently. Price pressures remained persistent.

And the debate is now whether inflation is transitory and will gradually ease, or whether it is persistent and requires an earlier-than-planned policy response. What certain though is that the Inflation concerns are becoming more worrying. Central banks across emerging and advanced economies are starting to raise rates and remove accommodative policies.

In EMs, inflation and expectations continued to rise due to energy prices. For instance, the central banks of Brazil, Chile, Colombia, Mexico, Russia, Poland, and South Africa all hiked rates in their most recent meetings. More hikes are expected in 2022 with the exception of Turkey, which is the sole country to lower interest rates. Central banks in advanced countries have begun to tighten as well. Monetary authorities in Norway, South Korea and New Zealand have increased rates, with the US, Australia, England, and Sweden tapering asset purchases.

Inflation pressures from oil and supply chains, which have been driving inflation dynamics in many countries, showed some early signs of easing, paving the way for the transitory view. Oil prices are likely to ease with the combination of higher US shale output and the likelihood of a deal with Iran in 2022. While this may cushion the risk of oil price inflation, higher oil prices could still cause strains for oil consumers.

On supply chains, the Baltic Exchange Dry Index has fallen by around one-half since early October. It has somewhat eased logistics costs. But there is limited room for a clearing of backlogs output in high-demand sectors such as microchips until 1H2022.

Disruptions can still take place pending the outcome of the new variants impact. Omicron is just one potential cause. Wages are rising and could climb higher in some countries like the US. Meanwhile, tensions between Russia and Ukraine could send gas prices surging. Climate change would bring more disruptive weather events and food prices may continue to rise. Another major miss on inflation target is possible.

C) **Volatile global financial market:** Should the pandemic ease in 2022, global central banks would raise interest rates or cut back on their multitrillion-dollar quantitative easing bond-buying stimulus programmes to address inflation.

The US Fed is now expected to raise its borrowing costs three - four times in 2022 (our initial view was two times) and continue until it reaches 2.50% - 2.75%. If the Fed delivers three hikes in 2022 and continue to raise rates until it touches 2.5%, pushing Treasury yields up and credit spreads wider, it could result in a recession in early 2023.

The Fed appears to be in an “unenviable position” of between “persistently high inflation rate and persistently overvalued financial markets”. And its lift-off could mean a crash landing for emerging markets. Higher US rates typically boost the dollar and trigger capital outflows — and sometimes currency crises — in developing economies. In 2013 and 2018 it was Argentina, South Africa and Turkey that suffered the most. Brazil and Egypt were in the same fate too.

The Bank of England (BOE) is also expected to raise interest rates in 2022, perhaps two or three times, having raised its main interest rate to 0.25% at its December meeting as we had expected despite concerns over Omicron.

Inflation is expected to stay elevated in the short term although it could be on decreasing trend through the year. However, one could be strongly underestimating what higher power prices could do to inflation, corporate earnings and growth across the global economy. Europe is vulnerable. Power outages and “industrial dislocation” in China could cause fresh supply chain chaos, all pointing towards higher inflation.

Chaos to global financial markets may also come from policy mistake, a disorderly energy transition that would result to a surge in selected commodity prices, and a nasty variant escaping vaccine protection.

D) **Emerging Market economies (EMEs) risk falling into a crisis:** The pandemic caused a heavy toll on emerging-market economies. (EME) They suffered from deep economic recessions, high unemployment rates and soaring budget deficits as well as public debt. Their easy access to global capital market allowed them to mask the considerable extent to which these countries’ public finances have been impaired. An estimated US$1.5 trillion had been poured into this region by investors over the past 18 months in search for yields despite the deteriorated economic fundamentals.

These flows were adequate to keep the EMs afloat and avoid seeking IMF’s assistance. But such happy tone could end in 2022 for some countries when the ample global liquidity ends as major central banks roll back their cheap monetary policy to curb inflation. The Fed, which have started to taper, is now looking at potentially three - four rate hikes in 2022. Continuous hikes are seen until borrowing cost reaches 2.50%.

Besides, much also depends on the outcome of Omicron or new variants. A more contagious but milder variant may not affect the global economy as severely and it could still get back on track to the pre-pandemic normal where households could see higher spending on services. But this remains uncertain. Any lockdown would slow down global economy, including EMEs.

Higher interest rates or slower global growth would create global financial market volatility. The risk is higher for those that have enjoyed the ultra-low interest rates and hold the view that the global economy will continue to grow indefinitely at a satisfactory rate. When these bubbles burst, EMEs will have to brace themselves for a huge capital outflow. This can precipitate a wave of EME debt crises.

The Fed's rolling back of the ultra-cheap monetary policy could mean a hard landing for EMEs. Higher US rates tend to boost the USD and trigger capital outflows, and sometimes currency crises.

E) **Global supply chain issues to remain in 2022.** As some bottlenecks ease, others are just starting. The onset of Omicron and potential new variants could lead to new shutdowns, sending another blow to the barely recovered global supply chains. Issues of shortages are many, affecting consumers and businesses around the world. And the supply chain crises prompted by the Covid-19 pandemic could last for many more months and even up to two years.

An outbreak of Covid-19 in the Chinese manufacturing hub of Zhejiang, home to the world's largest cargo port Ningbo-Zhoushan, led to thousands being quarantined under China's strict zero-Covid policy. Workers have been urged not to travel home "unnecessarily" for the upcoming Lunar New Year festival in February. The strict zero-Covid policy suggests risks of further supply chain disruptions going forward.

The worst delays are still on the US west coast where ships were waiting up to four weeks to unload due to the lack of workers on land. Ports at Los Angeles and Long Beach — which together make the biggest gateway for ocean trade in the US — saw record numbers of ships waiting for berths to offload their goods. In the UK's biggest container port, Port of Felixstowe, the dockside remained clogged with containers waiting to be emptied. Driver shortages were being felt all over the world with port infrastructure failed to keep pace with the container vessels.

Then, there is the human factor. Technological advancement may have reshaped manufacturing. But the production and delivery still rely heavily on people. Huge layoffs in production due to lockdowns caused labour shortages when demand picked up. Vietnam saw a mass exodus of workers from industrial hubs to rural areas, which could not easily be reversed.

Although consumer demand is expected to eventually self-regulate towards normalisation, inventories have picked up in some cases, and fine-tuning could take years. Without production capacity increases and investments in port infrastructure, the normalization of supply bottlenecks could be delayed beyond 2022 as demand will remain above potential.

And while shipping congestion could soften in 2H2022 as capacity increases with stronger global orders for new container ships, the cost of shipping would remain elevated. Going into 2022, spot prices for container shipping are 10 times of pre-pandemic levels at around US$15,000 per 40-foot container, and the average value of goods in containers traveling from China to the US is US$50,000.

While we hope that lockdowns will be a thing of the past outside China, there remains all kinds of movement restrictions in place, including workers with in-demand skills. Months of shipping backlogs, labour shortages and geopolitical tensions, remain disconcerted. It would create a chaotic "ripple effect" around the world with ships locked into tight deadlines and a glut of containers in some ports in the US and Europe, but not enough in ports throughout Asia. The global supply chains still face tremendous pressure. It will take up to mid-2024 to get back to "normal".

F) **China risks hitting the wall in 2022.** The local economy experienced major disruptions through 2021 due to the ongoing China-US trade war, Covid-19 restrictions and power shortages.

While China may continue to suffer from the ongoing trade war and possible Covid-19 resurgences, new issues are likely to rise to the forefront of economic problems in 2022. They are namely the real estate downturn and inflation, as well as bringing about common prosperity.

Real estate developers suffered in 2021 from increased financial restrictions. Some developers like Evergrande defaulted on debt repayments. Commercial sales and real estate investment growth slowed down. Debts among property developers continue to pose a barrier to achieving financial health in this sector in 2022.

And the question is to what extent the China's real estate default will impact the financial sector and investors. The government eased financial terms to reduce fallout. The central bank lowered the loan prime rate and reserve requirement ratio to increase bank lending to creditworthy customers. But the China government is unlikely to carry out direct bailouts of indebted developers. It has also encouraged banks to help healthy developers acquire distressed developers' projects.

"Producer price inflation" rose in 2021 to an average 10.1% for the first eleven months due to high commodity prices, transportation bottlenecks and labour as well as energy shortages. Supply chain disruptions would continue into 2022 but may ease in 2H2022 if the interruptions from Covid-19 and surge in demand stabilizes. Power shortages due to emissions restrictions would be reset in 2022. Production plans are likely to be adjusted.

But producers have started to pass through the higher costs to consumers, resulting in a slight rise in consumer price inflation. Increases in food prices resulted in higher CPI. And rising demand ahead of the Chinese New Year would lead to higher CPI to some extent in January. Besides, inflation in US and Europe would transmit to China through rising import prices. Therefore, although CPI remains much lower than PPI, CPI is likely to rise in 2022.

Meanwhile, President Xi Jinping continued to underscore the importance of "common prosperity", which involves cultivating a quality and more egalitarian economic development. Also, China steered in a slew of regulations in 2021, some of which are to crack down on monopolistic firms and their anti-consumer practices. Wealthy individuals and firms must donate to charity to reduce economic inequality ahead of further government regulations. More regulations to control excessive and "unfair" economic gains and policies to reduce inequality may come into effect. The drive for common prosperity will continue in 2022. The question is how this will be translated into specific policies. It remains somewhat unclear.

China's focus is on "economic stability" in 2022. Hence, the government needs to be cautious in introducing policies that have an economic tightening effect. The Chinese GDP is projected at 5.0% for 2022, much slower than China's average in previous decades. And the economy growth will be shored up by investing into fixed assets. Infrastructure investment will comprise a large part of this. It could be financed through the issuance of special bonds to partly finance fiscal spending.

The Beijing's Winter Olympics, scheduled to be held in February, could stimulate the economy to some degree. New technology industries like new energy vehicles and industrial robots will continue to provide a source of economic growth. Technologies that help China to move closer to carbon neutrality will also provide growth support.

But sluggish consumer spending could continue to drag the economy. This is worrying as businesses and investors are betting on consumer spending as they expect China's middle class spending power to grow in coming years. A weakening demand would not sustain the economic development due to the negative impact of the pandemic on people's incomes. How consumption recovers in 2022 will have a significant impact on the economy. China needs to find new ways of boosting consumption in order to maintain the momentum of its economic development.

4. *Malaysia: Moderate outlook with room for revision*

- **Economy is expected to grow around 5.4% in 2022 following a slower growth of 3.4% in 2021**
- **Besides low base, growth drives in 2022 will come from private consumption, domestic driven private investment, implementation of approved FDIs (manufacturing and services) and public expenditure**
- **Exports and firm commodity prices will continue to support growth. Rectification of RCEP would also boost economic growth.**

- Following a challenging 2021 that led to our downgrade of the economic growth to 3.5% from 6.0%, the economy is expected to rebound in 2022. Growth in 2022 is projected at 5.4% as the base case, with the upside at 6.0% and downside risk at 3.5%.
- Notwithstanding the low base of 2021, 2022's growth momentum is supported by the positive impetus of high Covid-19 vaccination coverage and the ongoing booster rollout. This has resulted in less restrictive measures since July 2021 that saw the reopening of most economic activities without the risk of further lockdowns.
- Domestic demand would benefit from private consumption through higher household income, improved job market, higher minimum wage and continued direct cash assistance by the government to targeted groups (9.6 million recipients) and a special payment to civil servants and retirees (2.3 million recipients).
- Private investment will remain the growth engine. It would benefit from the government's effort to promote quality investment (innovation-based, high-technology, knowledge-intensive and high value-add industries), fiscal injection, business capex expansion driven by a more optimistic outlook (higher imports – capital, intermediate and consumption), and the implementation of approved FDIs in the manufacturing and services sectors due to a better global and domestic environment.
- Exports would continue to support the economy in 2022. Ratification of RCEP would support growth both domestic and export led business activities. Electronics and related goods are poised to remain robust, as the global shortage of semiconductors continued to power demand. Trade will be supported by rubber products, chemicals and chemical products, manufactures of metal, machinery, equipment and parts, petroleum products, palm oil and palm oil-based agriculture products. Malaysia is also investing to become a regional logistics hub and building advanced manufacturing capabilities. Also, firm commodity prices will add value.
- The overall macro policy would remain pro-growth supported by an expansionary Budget 2022 with measures and incentives being introduced for the people, and stimulus measures of RM530 billion, plus the rollout of the 12MP. Should the economic sectors i.e. manufacturing, construction and services continue to outperform expectations in the coming months, which will provide a further uplift to the economy.

5. *Malaysia: Challenges in 2022*

- **Lingering risk of Covid-19**
- **Rising living cost**
- **Rolling back domestic relief measures and policy changes**
- **Lower-than-expected growth projection**
- **Liquidity threat and global financial market volatility**
- **China's economy is on a long-term deceleration.**

A) Lingering risk of Covid-19. Omicron and the fear of new variants remain. Although the economic impact could be fading from the new variants, the risk of another lockdown or restrictive measures remain very much in the minds of businesses and consumers.

Both the global economy and financial markets will remain volatile to Omicron or new variants though they may not cause severe illness. The latest variant saw some countries embarking on restrictive measures, especially those with zero-Covid policy like China.

Another round of a three-month lockdown like the MCO 3.0 in Malaysia would certainly have a seriously detrimental impact on the economy. Coming from a low base, should there be a lockdown or stringent restrictive measures, the risk of downgrading of 2022 GDP's growth target is high. Overall confidence will erode as many businesses and households are still scrambling to survive. The severity of the impact on the economy depends on the restrictive measures. GDP growth could be sliced between 1% and 3%.

B) Rising living cost. Global supply chains disruptions are poised to remain for an extended period in 2022. This would continue to add upwards pressure on prices. Soft and hard commodities' prices that increased substantially in 2021 will continue to add pressure. Likewise, logistic and shipping costs that skyrocketed. Other factors like labour shortages, higher input costs, climate change and natural disasters will also fuel price pressures.

Added with the view that the OPR would be raised in 2H2022 by 25 basis points from the current 1.50%, it would raise the borrowing cost. The rollback of the some of the stimulus measures i.e. moratorium, will have an impact on households who needed the facility.

All these would mean that the cost and environment of doing business in 2022 across many industries remain challenging. The question now is transfer pricing. How much can the affected businesses transfer price to consumers? Can the consumers absorb the additional cost?

Much would depend on the ability of businesses to absorb the rising costs. Having said that, it appears that transfer pricing to the consumers is inevitable.

In 2020, we reported an additional 12.5% of households with income less than RM2,500. Looking at the M40 group with income of RM4,850–RM10,959, about 20% have dropped to the B40 group. The rich or those in the T20 group were also affected from this pandemic where 12.8% has slipped to the M40 group. And the number of poor households rose to 639,800 in 2020 from 405,400 households in 2019.

The average cost of living for a family of four is around RM9,000 to RM9,500 a month while for a single person RM4,000 to RM4,500 a month. In terms of the minimum wage in Malaysia, it is only RM1,200 for workers in the peninsula and RM1,100 in Sabah and Sarawak.

In this current environment that is impacted severely by the pandemic and now hurt by the recent floods, the already affected household spending power would be further dampened. The risk of rising bankruptcies and delinquencies, non-performing loans, and greater levels of borrowing from "money lenders" would apply downwards pressure on the economy via weaker domestic spending and business activities.

C) Rolling back of domestic relief measures and policy changes. Proposed policy changes that include tax would have both transitory and permanent supply and demand effects. They would also impact the market sentiment on individuals, companies and investors.

The one-off 33% prosperity tax rate on chargeable corporate income exceeding RM100 million could result in a downside risk to corporate earnings in 2022 and reduce dividend payments due to the higher taxes. This is amidst businesses are still facing the challenge of managing rising cost pressures even as they are healing.

It is envisaged that relief measures and assistance (such as rental tax rebate, electricity discount, levy discount, and freeze statutory contribution rate, etc.) will be discounted in 2022. The proposed higher minimum wage and multi-tier levy going forward will add onto operating costs.

D) Lower-than-expected growth projection. A lower-than-expected growth projection in 2022 would raise eyebrows on the overall economic performance. Such an event would put the country on the radar of rating agencies for a potential downgrade.

Banks would come under pressure. Rating agency S&P has placed banks as "negative", citing downside systemic risks are on the rise. Lockdown, rampant pandemic waves, repeated moratoriums on loan repayment and political uncertainties would raise the downside risk to the recovery of the banking system.

Also, banks face the rising risk in the competitive environment due to negative government intervention. The risk of the other rating agencies following S&P cannot be ruled out. A slower-than-expected growth could dampen the ability to achieve the fiscal deficit target of 6% of GDP in 2022 from -6.5% of GDP in 2021. Tax collections could get hurt when the economy performed below expectations.

We remain vulnerable to both the external environment and domestic challenges in terms of policy implementation and their progress, and enticing FDIs (which are highly competitive) and the rate implementation of the approved projects. Under such circumstances, it would dent the current revenue targets. Oil-related revenue is based on a crude oil price assumption of US$66/barrel in 2022 as against the current level of US$70/barrel.

E) Liquidity threat and global financial market volatility. Global liquidity is estimated at US$170–172 trillion. Since the 2008 global financial crisis, both the US and China have been the main liquidity providers. Since China's global footprint is small, what matters more is the US action in global markets, especially during this pandemic crisis.

The US dollar's importance is reflected in the global funding and the extension of support lines between central banks to provide access to facilities backed by the USD during the pandemic Estimations suggest that these actions led to a spike of around 60% of the central banks' balance sheet size to more than US$30 trillion that has fuelled about a 30% rise in global liquidity since early 2020.

But these figures were still overshadowed by a huge debt pile that now exceeds an eye-watering US$300 trillion that will burden the global GDP by three times.

If we take the average debt maturity of five years, it shows a US$60 trillion annual refinancing. That would require balance sheet capacity which is liquidity. More liquidity requires more debt as collateral. And more debt needs more liquidity for refinancing. Policymakers seem to be stuck in this cycle. The low interest rates that encourage more borrowing have now shifted to quantitative tightening.

Consider the policy responses to the 2008, 2010, 2019 and 2020 market sell-offs, and the support given through the colourfully dubbed "Greenspan, Bernanke and Yellen Puts", after successive Fed chairs. We now need a "Powell Put" which is an inevitable remedy for the next stock market sell-off.

The Fed's tapering and monetary tightening will induce tighter liquidity conditions. Such global financial volatility could spill over to Malaysia's shores via financial channels and a weaker ringgit against the US dollar. Also, the risk from EMs could ring the alarms of a contagion effect into this region and may knock on our doors. It appears that the future growth of global liquidity has seemingly become institutionalised by these debt burdens.

F) **China's economy is on a long-term deceleration**. China has acknowledged that its economy is experiencing a three-cornered headwind i.e. contracting demand, supply shocks and weakening expectations. This has caused the government to inject liquidity and adopt monetary easing to steer for a soft landing.

The economy is struggling with real estate woes and fallout from Covid-19 lockdowns. China's zero-Covid target means no compromise on lockdowns. This would certainly cause supply disruptions, impact the labour market and consumer spending. With the risk of new variants and the global spread of the Omicron variant, the threat of a sharp economic slowdown in 2022 is clearly present.

While Beijing will attempt to stop the Evergrande debt fiasco's contagion in its tracks, the situation is still likely to cause a further marked slowdown for China's property and construction sector, which could dampen demand for mineral and commodities like iron ore, oil and palm oil.

With our projection of 5.0% GDP growth in 2022, which is a pullback from an estimated 7.1% in 2021, our estimates showed that for every 1% change in the Chinese GDP growth, the impact on our GDP is 0.3–0.5 percentage point.

6. *Central banks' outlook: Rates on the uptrend*

- **Inflationary pressure will be the 'buzz word' in 2022**
- **Policy rate hikes will be on the lips of central bankers**
- **Questions will be 'how much' and the timing.**

- 2021 ended just like how it started – with the Covid-19 pandemic as the key concern for everyone. And the rapid spread of Omicron led to the reintroduction of social and travel restrictions in several countries. Worries are that it will dampen economic activities: spending, manufacturing and distribution. Fears of new variants emerging would result in restrictive measures to prevent another wave of infections.

- As the immediate outlook becomes more uncertain, central banks would find it difficult to outline a path to the next stage of global economic recovery. The key fear for financial markets prior to the emergence of Omicron is inflation, and this will remain as 2022 gets under way. Inflation is expected to stay elevated in 1H2022.

- The risk is that these higher levels of inflation will get baked into the ongoing wage and price behaviour. Besides, any further Covid-19 related disruptions to supply chains further support the upside risks on inflation.

- Rising inflation allows global interest rates to be repriced upwards. For a start, we have raised our call on Fed to raise rates from 2 times in 2022 to now 3 –4 times. That would take the federal funds policy rate to at least 0.75%–1.00%, still low by historical standards. The hikes are likely to take place in March, June and September. Any fourth hike could materialise in December. We expect the Fed to continue hiking in 2023 and 2024 until it settles at 2.50%–2.75%. It will be a clear break from the very accommodative rates we have had since the beginning of 2020.

- For the Bank of England, following a 25bps rate hike in December 2021 to bring the borrowing cost to 0.25%, expectations are that there will be another 2–3 rate hikes in 2022. This would mean borrowing costs should settle at 0.75%–1.00%. The first hike will likely be in February and the second in May. Much will depend on the outcome of Omicron and any new variants. The third hike could happen in November.

- The ECB is more likely raise the interest rate sometime early 2023. This will take place after it ends the remaining bond purchases by the end of 2022. However, the possibility for a rate hike in 2022 cannot be ruled out. If inflation remains elevated, we can expect the ECB to bring forward the rate hike cycle to late 3Q or 4Q 2022.

- BNM is likely to normalise its policy rate and raise the OPR in 2022. We now expect BNM to revise upwards the policy rate by 1–2 times in 2022 in a move to keep the interest rate differential between the US and Malaysia at around 175–225bps. This suggests that borrowing costs could settle between 1.75% and 2.00%. The first hikes could come in July, and possibly another in November. We expect BNM to continue raising the rate in 2023 and 2024 until it settles at 3.00%–3.50%.

7. Fixed Income: Bonds could be in dilemma

- **Bond market is signalling that interest rates are on the uptrend**
- **But Omicron is a threat to that outlook and, of course if new variants emerge**
- **Hence, there could be a potential conundrum in the global bond market**
- **UST10 yield should peak around 2.00% in 1Q2022 and to go sharply higher in 2022 could be a challenge**
- **Tough for UST10 yields to touch 3.00% as it will be data dependent and a function of Fed's tone**
- **MGS10 yield is expected to hover around 3.90%–4.00% in 2022**
- **To breach 4%, it will depend on global markets (data & news) and domestic (data, BNM's tone & domestic noises).**

- The Fed is expected to hike rates and quickly reduce its purchases of government bonds. At this stage, it would be wise to expect USD interest rates to keep rising over the next couple of years until the federal funds rate reaches somewhere between 2.50% and 2.75%.
- Countries whose currencies are linked to the USD will come under pressure to raise rates to avoid a wide interest rate differential. This all leads to a potentially higher level of interest rates across the US and other economies, with the appropriate effects on economic growth.
- Yet Omicron is a threat to that outlook and, of course if new variants emerge. The risk of economic growth being seriously threatened by successive waves of the virus remains. And under such circumstances, the solution is not raising interest rates.
- And so, there could be a potential conundrum in the global bond market. And this is reflected in the current pricing. Short-term bond yields have risen to reflect the risk of monetary tightening. But the longer-term bond yields remain well within the ranges that have been in place in 2021.
- Besides, the rising trend of inflation is not expected to stay permanently. The bond yields seem to show a return to somewhat close to central banks' targets on a three-to-five-year horizon. And the real level of bond yields is very low – at minus 1 per cent in the US and minus 2 per cent in Germany.
- This could mean that nominal bond yields – represented by the US 10-year benchmark Treasury yield – have limited capacity to rise significantly in the short to medium term. Real yields rose modestly in past Fed tightening cycles. Only during the 2013 taper tantrum did we see yields rise aggressively. This time around, the Fed has been much clearer in intention to reduce asset purchases.
- The 10-year yield is important since it influences lending rates for mortgages and many other business and consumer loans. The bond market started off with a bang. It is getting kind of bounced back and forth between the downside risks to the economy from Covid and then bounce back to the economic stories, high inflation and the Fed is on track to raise rates.
- On the backdrop of the economic optimism and inflationary concerns, the UST10 yields would reach 2% in the 1Q2022. But after that spurt to 2%, for the yield to go sharply higher in 2022 could be a challenge. It will be data dependent and a function of the tone from the Fed. It would be tough for the yields to touch 3.00%. Thus, the yield should peak early in the year.

- In Asia, higher yields in some sectors may signal higher returns going forward. This can take place if investors decide to put behind the current problems in the China's property market. And with high yield market touching double-digit yields recently, the Asian credit markets could be an attractive play. It will continue to have generally low returns.
- BNM is also expected to chart the pathway for higher interest rates in 2H2022, with 1-2 rate hikes by 25 basis points on each hike. Economic growth momentum, rising inflation and addressing interest rates differential would be the major factors supporting for a rate hike.
- But the downside risk on the economic growth remains, coming from both external and domestic challenges. Thus, the local bond market would also be in some riddle just like the global bond markets.
- Nonetheless, the MGS10 year yields is expected to reach around 3.90% - 4.00% in 2022. And for the yields to move up higher than this level, much will depend on global markets flow driven by data and news as well as domestic events i.e. data dependent, BNM's tone and domestic noises.
- On equities, there could be several alternatives to seek decent investment returns. Much depends on the virus, short-term impact on economic growth and a need to factor in higher rates to take into consideration of valuation adjustment risk.
- But the key driver of returns is earnings. The earnings cycle is expected to remain strong globally. Returns from global equities is projected around 5%–10%. Stronger relative performance is expected from Europe compared to the US. In Asia, there is upside. It will be driven by China. The market was a lag in 2021.

8. Foreign Exchange: Ringgit is expected to stay weak in 1H2022 and pull back slightly in 2H2022

- **More downside risk on ringgit in 1H2022 driven by both the external and domestic factors**
- **Ringgit outlook against the USD in 1H2022 should be around 4.25, with an upside at 4.30**
- **We foresee slight pullback in 2H2022 driven by greater clarity on external and domestic fronts**
- **Local currency in 2H2022 would strengthen to around 4.20 levels/**

- The ringgit's outlook in 2022 continues to be challenged by a combination of external and internal factors. While the long-term trading range of the local currency is between RM3.80 and RM4.50 against the USD, there is more upside risk on the currency in 1H2022 and some pullback in the 2H2022.

- Selling pressure on the ringgit is expected in 1H2022 and that could see the ringgit reach the 4.25 levels and possibly touching 4.30. The upside risk would be driven by a combination of external and domestic factors.

- On the external front, it would be influenced by the strengthening of the USD itself on the back of a more hawkish tone by the Fed. Besides, we have the uncertainties on Omicron and the new variants' impact on the global economy that could result in an increase in demand for the USD as a safe-haven hedge. The outlook of the ringgit also depends on the direction of the Chinese yuan against the USD, global oil price movements and geopolitical issues such as the US mid-term election.

- On the local front, the focus will be on the authorities' ability to continue enhancing the economy and financial resilience to lift the strength of the ringgit against major foreign currencies. These will include maintaining a sustainable economic growth by rebuilding Malaysia's fiscal position in containing the debt level and enhancing the competitive investment climate. It is also vital to provide a clear, stable and certain policy landscape to attract the inflows of long-term capital and portfolio investment into domestic equity and bond markets. The government needs to also address the increasing financial strains on the households and businesses impacted from the pandemic and now post-floods. These steps are particularly important especially when the stimulus measures are rolled back.

- However, the upside risk on the ringgit could be contained with expectations that the domestic economy would remain open for the larger part of the year in 2022, supported by firm crude oil prices, a gradual weakening of the Chinese yuan, a more stable environment on the pandemic, and greater policy clarity, implementation and outcome. Expectations are that the local currency in 2H2022 will pull back from its weakening trend to hover around the 4.20 levels in 2H2022.

9. Appendix

Table 1: Selected Countries' GDP

Countries	2020	2021	2022	2023	2024
United States	-3.4	5.5	4.0	2.5	2.3
Europe	-6.5	5.0	4.0	2.4	1.6
United Kingdom	-9.4	7.0	0.6	2.2	1.9
Japan	-4.5	1.9	2.3	1.2	1.0
China	2.2	7.1	5.0	4.9	4.8
Malaysia	-5.6	3.4	5.4	5.0	4.7

Source: AmBank Research

Table 2: Malaysia's GDP Supply Side

Supply Side	2020	2021	2022
Services	-5.5	3.0	6.5
Manufacturing	-2.6	7.0	5.5
Mining	-10.6	1.0	0.5
Agriculture	-2.2	-1.0	-1.5
Construction	-19.4	3.5	9.5

Source: MoF/CEIC/AmBank Research

Table 3: Malaysia's GDP Demand Side

Demand Side	2020	2021	2022
Real GDP	**-5.6**	**3.4**	**5.4**
Private Consumption	-4.3	3.6	7.5
Public Consumption	3.9	5.0	2.0
Private Investment	-21.3	4.0	5.5
Public Investment	-12.0	-1.0	12.0
Exports of Goods & Services	-8.9	15.5	10.0
Imports of Goods & Services	-8.4	16.5	10.5

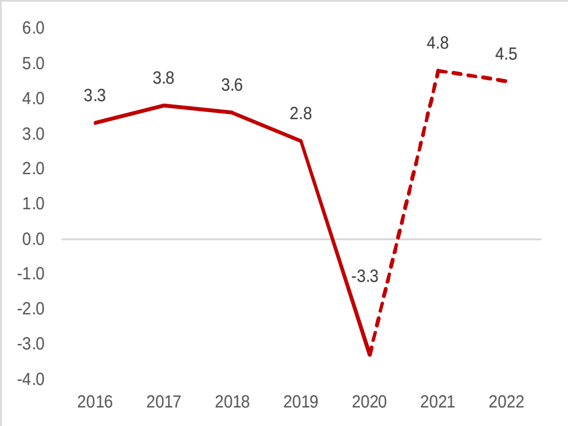
Source: MoF/AmBank Research

Table 4: Selected EME ranking

Countries	Current Account	External Debt	Govt Debt	Reserve Coverage	Real Policy Rate	Governance	Vulnerability Ranking
Saudi Arabia	3.8	5.0	29.7	327.0	0.2	0.1	4.5
Russia	4.4	8.7	17.9	359.2	-0.6	0.0	5.2
Taiwan	15.2	25.2	27.2	170.2	-1.5	1.6	6.0
Indonesia	-1.0	6.0	41.4	125.2	1.8	0.4	7.8
South Korea	4.2	13.2	51.3	99.0	-2.5	1.4	8.8
Thailand	2.1	15.2	58.0	251.3	-1.9	0.3	9.0
India	-1.4	9.4	90.6	190.7	-0.5	0.4	9.7
Peru	0.1	6.6	35.0	287.0	-4.3	-0.2	10.0
Mexico	-0.3	4.8	59.8	128.9	-1.5	-0.2	10.2
Mainland China	1.5	11.3	68.9	74.8	1.5	0.6	10.2
Philippines	-1.8	5.4	59.1	237.6	-2.6	0.1	10.5
Malaysia	3.7	33.7	70.7	118.3	-1.2	1.0	10.7
Chile	-2.2	9.7	34.4	84.0	-3.3	1.0	11.2
Poland	1.6	25.5	55.5	138.5	-6.3	0.4	11.7
South Africa	-0.9	16.4	68.8	75.2	-1.5	0.3	13.0
Columbia	-4.0	11.3	66.7	144.6	-2.1	0.0	13.0
Egypt	-3.7	4.3	91.4	58.2	2.0	-0.5	13.3
Brazil	-1.7	8.9	90.6	163.8	-2.9	-0.4	13.8
Turkey	-1.6	25.9	37.8	76.4	-3.9	0.0	14.7
Argentina	0.8	17.5	102.8	68.5	-14.1	-0.2	16.9

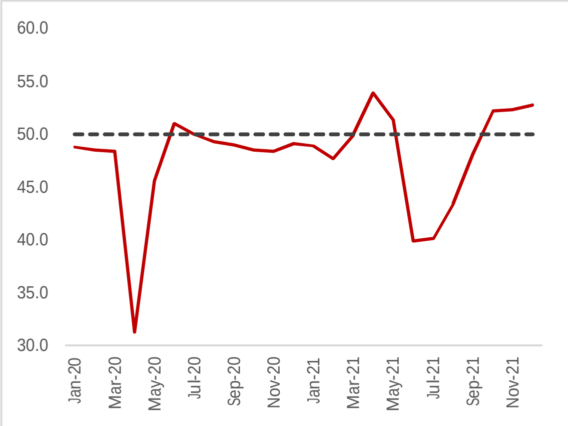
Source: Bloomberg/AmBank Research

Chart 1: Real global GDP growth (y/y %)



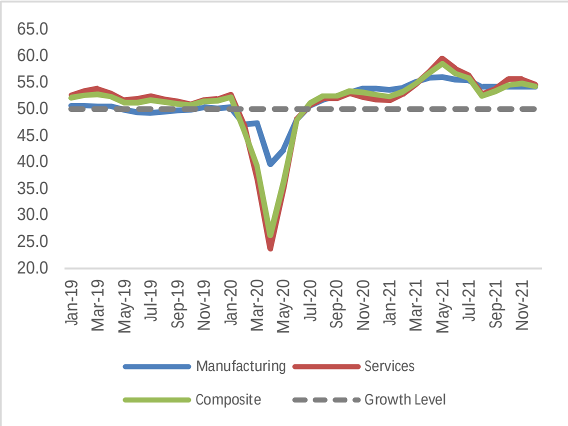
Source: CEIC/AmBank Research

Chart 2: Malaysia Markit PMI



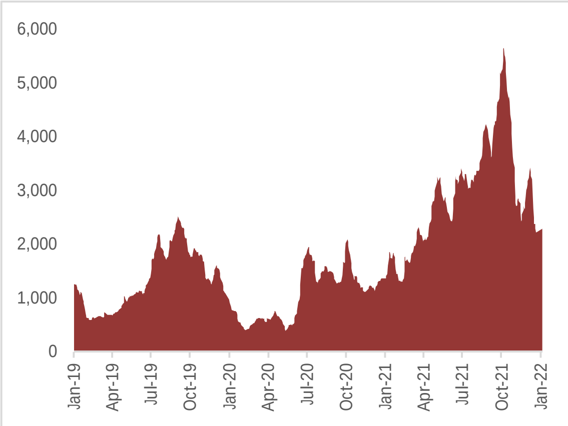
Source: IHS Markit/CEIC/AmBank Research

Chart 3: Global PMI



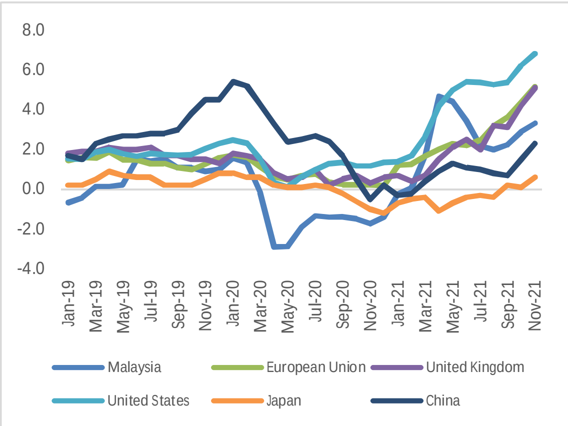
Source: IHS Markit/CEIC/AmBank Research

Chart 4: Baltic Exchange Dry Index



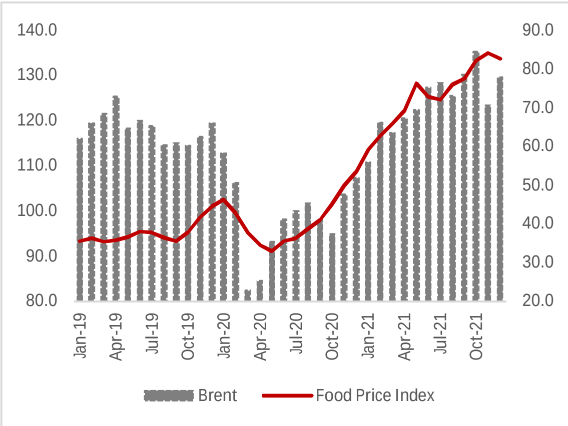
Source: Baltic Exchange Information/CEIC/AmBank Research

Chart 5: Selected Countries' Inflation



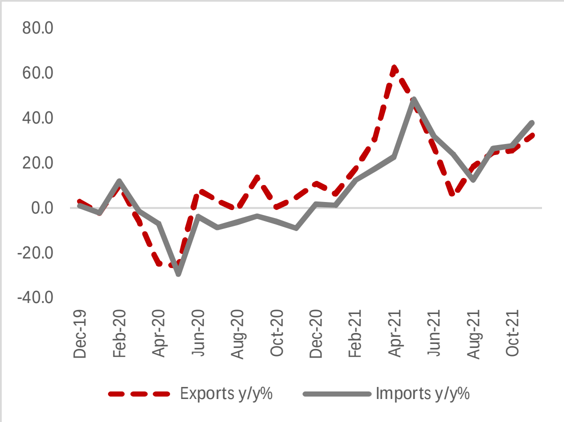
Source: CEIC/AmBank Research

Chart 6: Brent Price and Global Food Price Index



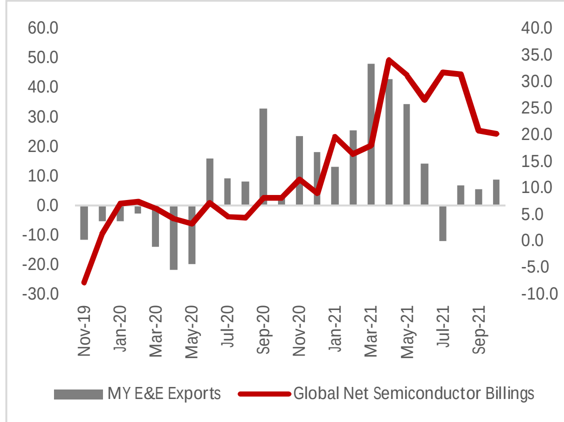
Source: FAO/Bloomberg/AmBank Research

Chart 7: Exports & Imports (y/y %)



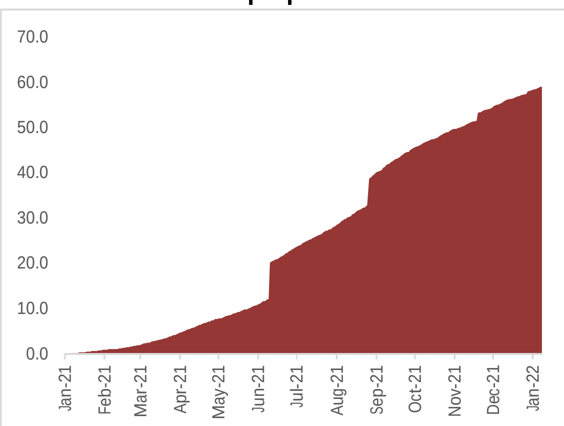
Source: CEIC/AmBank Research

Chart 8: E&E and Semiconductor Net Billings (sa y/y %)



Source: MIER/CEIC/AmBank Research

Chart 9: Vaccinated People per Hundred



Source: CEIC/AmBank Research

Chart 10: USD/MYR

Source: Bloomberg/AmBank Research

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