26 March 2020

THEMATIC

In this report:

Global Markets – Money financing for budget deficit

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Money financing for budget deficit

There are three major theses that we ought to know. First, the coronavirus-induced recession is expected to place both the global economy as well as the Malaysian economy into technical recession. It is causing both supply and demand shocks. In our view, the impact from this virus should taper by end 2Q2020. Normalisation of both the global and domestic economy should take place in 2H2020.

Next, the liquidity concern is more on the real economy as opposed to the financial institution which is far more regulated. These other economic sectors lack the same protection, especially businesses with limited cash in hand and are exposed to a high degree of leverage. The same goes to household debts. Although our banks may have the liquidity coverage ratio, things are moving so fast and in such a big way that it is almost impossible to rule out the possibility of a lack of liquidity proving to be problematic for some institutions. And also, the types of disruptions and whether these could occur not just in the real economy but also in banks are hard to know.

Plunging oil prices from the "twin" unexpected shocks i.e. the price war between Russia and Saudi, and the coronavirus impact resulted in a global recession. With the oil price dropping well below US$30 per barrel, it will reduce our oil revenue significantly. The estimated loss in oil revenue is between RM0.6 billion (at an average at US$60 per barrel) and RM12.6 billion (at an average at US$20 per barrel). Hence, pressure on the fiscal deficit/GDP would hover 3.6%–4.2%, pending the outlook of nominal GDP and expenditure.

Our strategy is focused on the need to stabilize the domestic economy which will then stabilize the markets. It should not be a situation of trying to stabilize the markets with the expectation that it will then stabilize the economy. This is where the government stimulus could play a role in providing much-needed relief to the affected economy and businesses as well as workers. Hence, fiscal stimulus is ultimately going to have to play a bigger role than monetary measures.

Given the limited flexibility of our fiscal policy, the government should look at "money creation" to finance the budget deficit. Through money creation, the government can mobilize resources to drive economic growth by financing the budget deficit. It will allow the government to spend as much as it wants with the aim of supporting the economy to its full capacity, boost private sector activities, reduce unemployment and finance major programmes like construction/infrastructure, healthcare and green initiatives. If the government spending creates a deficit, it is not a serious problem. It is because the government's deficit is by definition a surplus to the private sector.

There is no real risk to currency devaluation or economic chaos or fuelling inflation. According to our assessment, a 1% increase in money supply will improve the economic growth by 0.5%. At the same time, it supports the local currency with an appreciation of 0.6% against the dollar. Inflation is expected to rise by 0.25%.

In our view, the Stimulus Package 2 (SP2) should be more ambitious than the SP1 of RM20 billion in terms of reaching at a wider range of target groups and covers a broader range of economic activities. It must address six strategic issues: reducing unemployment and increasing job opportunities; easing the economic burden of the people, particularly those in vulnerable sections of society; supporting the private sector; undertaking capacity building for the future; supporting the SMEs; and supporting the informal business activities and those working in this sector. The focus should be on the transportation sector given the rising urbanisation, tourism, green initiatives, education, health, the halal sector, develop new technologies (particularly biotechnology), and upgrade human resource development (with an emphasis on private tertiary education).

A. Three major theses

1. Coronavirus-induced recession

- The last time global economy dipped into a recession was during the global financial crisis (GFC) of 2008 and 2009. Back then, Europe, Japan, and the US went into prolonged negative growth. China's GDP fell from 10% to 6%, somewhat implying a "recession".

- What is a recession? It is defined as a fall in economic activity i.e. GDP, income, employment, and output. There are two kinds of recessions i.e.: (1) driven by the adverse supply shock; and (2) due to adverse demand shock. In an environment where the global economy experiences adverse "supply shock", the fall in GDP is accompanied by an increase in prices. This happened during the 1970s oil shock that caused "stagflation". In 1974, oil prices tripled. It doubled again in 1980. During both events, the global economy fell into severe recessions.

- *The 1970s recession was the worst experienced since the 1930s global depression driven by the adverse supply shock*. The scenario during this period was different from the preceding and following decades. It was due to the absence of effective monetary policies. Both in the beginning and end of 1970s coincided with major shifts in monetary policy regimes.

- During the early 1970s, the monetary policy lost its anchor as it shifted towards a less restrictive regime following the collapse of Bretton Woods that led the world economy into an uncharted territory. Flexible exchange rates emerged. Unemployment became a big concern. Uncertainty became high. Policymaking entered a stage of experimentation and learning. Loosening monetary policy was viewed as the measure to address rising unemployment. The long post-war expansion appeared to have come to an end.

- However, the monetary policy anchor was re-established by Paul Volcker after 1979. Similar shifts in the monetary policy took place in many OECD countries at the same time. Monetary tightening instituted by Volcker represented a shift back towards a more stable regime. This time around, the monetary policy was reversed. The shift in policy was accepted at a slow pace. Inflation came down even as the economy went into a sharp recession in the early 1980s. There were no more outbreaks of stagflation since the 1970s despite witnessing several more oil price shocks thereafter.

- *Meanwhile, a good example of an adverse "demand shock" is the global financial crisis (GFC) of 2008 and 2009*. Housing prices tumbled. Many homeowners defaulted on their mortgages. There was a negative demand shock. People were cutting back on their spending because they did not have the money to spend. During the 2008 GFC, both the monetary and fiscal stimulus measures were employed. They came in handy as these policies gave people money to spend.

- Starting in the summer of 2007, the monetary authorities generally acted quickly. They adopted measures in respond to the demand by the financial institutions for higher access to central banks' liquidity via conventional monetary policies and interest rate reductions as well as the less conventional approaches such as quantitative easing. It was not until the second year of the crisis, starting in late 2008, that discretionary fiscal policy was used widely by countries which had the flexibility to do so. It is difficult to conclude that fiscal policy actions have been coordinated, but they are all pointed in the same direction. At least for the first two years, that made a huge difference and prevented the GFC of 2008 from becoming another Great Depression like the 1930s.

- *This time around, the global recession is a result of the coronavirus impact will be worse than the global recession of 2001 or 2008*. It is a combination of both adverse supply and demand shocks. The spreading of the virus in Europe and the US after hitting Asia has disrupted and dislocated the global economy, supply chains, shipping, total trade and markets. The impact from the virus is seen hurting the global economy on two prongs i.e. supply and demand shocks.

- Apart from the global supply chain and, shipping and total trade, disruption, the “sudden stop” to the economic activity through quarantines, event cancellations, and social distancing contributed to the downward revision alongside recent weeks of financial market chaos which adversely impacted supply. The production halt by companies is to curb the spreading of this virus to their employees.

- At the same time, there is an adverse demand shock. Consumers are unable to spend on the usual purchases of goods and services due to the lack of availability and loss of confidence. With more people being retrenched, consumers decided to cut back on their spending as they did not have the money to spend.

- While the policy response will provide downside protection, the underlying damage from both the virus attack and tighter financial conditions will deliver a material shock to the global economy. For instance, the manufacturing sector is already in recession due to the trade war. It is now further impacted from the virus, especially auto industries due to the impact on auto parts manufacturing; transportation industry like airlines and shipping companies; and semiconductor. Services which supported the 2019 global growth are also impacted from the spread of this virus, especially tourism and tourism-related business activities as well as organizers of trade fairs, exhibitions and congresses.

- Uncertainties remain high as there are no clear numbers for now. The difference this time is the speed of decline and the comprehensive economic hit caused by an unpredictable health scare that resulted in an “economic stoppage”. This is unlike the financial crisis. Assuming the virus impact softens by end 2Q2020 with an economic rebound in the 2H2020, that should see the global GDP only fall into a “technical recession”. Global GDP should contract by 1.1% in 1H2020 and improve by +1.9% in 2H2020 as the global business reopens, supported with strong demand. If the virus impact continues into 3Q2020, the global GDP should contract by 0.4%.

Looking at ‘technical’ recession in Malaysia

- Underpinned by the ongoing external headwinds and domestic challenges, the Malaysian economy is expected to fall into a *technical recession in 2020*. Even prior to the outbreak of the coronavirus, the manufacturing sector has been in recession, impacted by the trade tension between the US and China. Overall business and consumer confidence were softening. Businesses were affected by the slow implementation, lack of clarity on the policies, policy consistency issues, poor engagement between the authorities and business, and domestic political noises. Loans grew much slower than the GDP.

- Following the outbreak of the coronavirus, it led to a severe disruption of global supply chain and shipping as well as total trade. The PH government unveiled a RM20 billion stimulus package to support the economic growth, projected to grow at a slower pace between 3.2% and 4.2% which is higher than our base case projection of 2.5%–3.0%. Fiscal deficit was revised upwards to 3.4% of GDP from previously 3.2% of GDP under Budget 2020.

- However, the domestic economy is expected to contract in 1Q2020 by -2.8% – the first contraction since 3Q2009. The adverse impact is expected to be felt across all the economic activities following a "partial" lockdown by the new government in view of the increasing severity of the virus impact.

- For instance, the already in recession manufacturing activities due to the trade tension and domestic noises will continue suffer from the supply chain and shipping as well as total trade. Our major trading partners such as the US and China are poised to be in recession in 1H2020. Likewise, the Eurozone and Japan. The E&E sector will continue to be impacted by the global semiconductor downcycle. Falling oil and commodity prices plus financial market volatility will weigh on the domestic economic performance.

- Underpinned by external headwinds and domestic challenges, the domestic economy is expected to report a negative growth in 2Q2020, estimated at -1.8%. Meanwhile, normalisation of the domestic economy is more likely to take place in 2H2020, just like the global economy. Coordinated efforts by the global economy, including Malaysia, to support growth through monetary and fiscal stimulus measures should start yielding positive results. And by which time, the "partial" or "total" lockdown would have been lifted as the virus impact eases globally. Our full-year GDP growth for Malaysia is 0.4% with the downside at -1.1%.

Technical recession in US, China, Eurozone & Japan

- The *US economy is assured of a recession* — at least two consecutive quarters of negative GDP — with output falling by 0.3% in 1Q and 15% in 2Q which will be the biggest quarterly contraction on record. Even with monetary support from the Fed's rate cut close to zero and 0.25%, and buying of US$700bil in Treasury and mortgage-backed securities as it attempts to head off a severe slowdown and fiscal policy turning sharply with stimulus of around US$2.0 trillion, these shutdowns and rising public anxiety about the virus are likely to lead to a sharp deterioration in economic activities for the rest of March and throughout April. GDP should grow by 3.5% in 3Q2020 and 5.5% in 4Q2020. That should bring the economy for the full year to -1.6% from 2.1% in 2019 and improve to 2.2% in 2021 and 1.9% in 2022. Much will also depend on a number of factors, including governmental response. Uncertainties around all these numbers are much greater than usual.

- *The falling GDP in China is virtually unprecedented*. But this time around, the data could be worse than most previous hypothetical "hard-landing" scenarios. The Chinese economy is expected to contract in 1Q2020 – the first such contraction since the end of the Cultural Revolution in 1976. The shock to the economy from the virus impact should see 1Q2020 GDP contracting by 8%. Our full-year GDP growth is now at 3.5%.

- But the question is whether China will admit its economy shrank by such a huge amount in 1Q2020, given their tendency to report predictable and steady growth no matter what happens. So, it will not be surprising if China reports a contraction of 2%–3% in 1Q2020 and maintain a full-year growth of around 5%. More so, the Chinese economy is likely to ride on the good news whereby the daily number of new coronavirus cases has been falling sharply. It should pave the way for a marked economic recovery in 2Q2020.

- However, the recovery could be delayed if the pandemic is not brought under control globally over the next few months. The interruptions to the economic activities seen in China are on a scale and speed rarely seen other than during periods of military conflict, natural disasters or financial crises. While there is a huge uncertainty, the risk is that it will shortly see these abrupt interruptions happening simultaneously across all major economies as the global pandemic spreads.

- The rapid spread of the virus outside China has prompted sharp declines in travel and tourism, and the cancellation of business and leisure events worldwide as "social distancing" takes hold. Some of the large advanced countries like Italy, Spain and France have engaged in aggressive official lockdown response just like China. Their GDP will see huge declines in the coming months. The delayed impact of supply-chain disruptions and lower Chinese demand on the rest of the world will continue to be felt profoundly for some time, particularly in the rest of Asia and the Eurozone.

- *The Eurozone will also be in recession in 2020.* The Eurozone GDP could contract by 1.8% and 18% over the 1Q and 2Q respectively. For the full year, the GDP will contract by 1.8% and rebound to 3.5% in 2021. Germany would reduce its economic activity by 1.9% in 2020 and grow in 2021 by 3.6%. France will shrink by 1.0% in 2020 and grow 3% in 2021, while Italy will fall by 4.0% this year and rise by 3.0% in 2020. The ECB has announced the €750 billion Pandemic Emergency Purchase Programme which will be conducted until the end of 2020. Even before the coronavirus outbreak, dark clouds were gathering over the Eurozone economy. Italy was in the eye of the storm with the risk of falling into stagnation that can be worse than anything Japan has seen. Demographic, structural headwinds and limited appetite for reform are likely to lower the region's potential growth rate to less than 1% from the annual average of 1.4% in the previous decade.

- *Japan risks falling into the worst recession*. The 1Q GDP is expected to fall by 2.8% after posting a 7.1% contraction October–December as a result of higher consumption tax at 10% from 8% which has dented consumer spending. The situation could worsen with the Summer Tokyo Olympics postponed to 2021. The BoJ is seen to be running short of policy tools to further boost the economy after years of massive monetary easing. The PM is now forced to turn to state coffers for budgetary stimulus. It could match the April 2009 stimulus size of 57 trillion yen (US$513 billion) emergency plan to shield the economy from negative fallouts. It should be over and above the already introduced policy packages worth more than 1 trillion yen to fight the coronavirus, in addition to the 26 trillion yen stimulus launched in December to address shocks from the 1 October tax hike. The latest measures will likely be financed under a supplementary budget for fiscal 2020 with the government issuing new debt.

2. Liquidity concern is more on real economy than financial institutions

- Today, the global economy is struggling with the coronavirus pandemic and falling oil prices. Many countries' banks, companies and governments are scrambling to secure the dollar to service dollar-denominated debts due to a tight supply of the dollar in the markets outside the US, fuelling dollar-funding costs against other currencies.

- Liquidity swap lines are the main way to pipe dollars into the global financial system. It was first deployed in the 1960s. Dollar funding was between central banks who struggled to uphold the fixed exchange rates of the Bretton Woods system. Central banks credited with each other on a matching amount of currency. For instance, a Deutschmark credit for the Fed at the German's Bundesbank is offset by a dollar credit for the Germans in the US.

- And it is now the second time this century that the global economy experiences an acute shortage of dollar funding. The previous was during the 2008 GFC. But dollar shortage was confined to the banks of Europe and the US which fell within the comfort of the Fed. It happened not due to the shortage of official reserves, but as a result of shortage in the bank balance sheets. Europe's banks had huge exposure to the US subprime debt without having a depositor base in the US to match. To fund the loans, the banks borrowed dollars in wholesale money markets or swapped euros, Swiss francs and British pound. When the markets panicked, demand for the dollar outstripped supply causing the dollar funding to dry up. It raised the risk that the European banks will sell off their US investments, thus further accelerating the panic in US markets.

- But this time around, the coronavirus crisis is a global issue. It has again resulted in the dollar liquidity issue and raised eyebrows on the risk of a financial crisis driven by a dollar liquidity crunch. It is despite the Fed slashing interest rates to nearly zero, establishing a number of credit facilities in order to lend to businesses and consumers, encouraging banks to dip into their capital liquidity buffers and pledging an unlimited amount of bond purchases — all to boost the economy and guarantee businesses and banks on having enough cash in hand.

- The Fed also enhanced dollar liquidity swap line arrangements with the Bank of Canada, Bank of England, Bank of Japan, European Central Bank and Swiss National Bank which began on 23 March and last through at least until the end of April. The Fed broadened the swap lines for at least six months to further boost dollar funding to additional countries which include large emerging markets like Brazil and Mexico as well as European nations including Denmark and Sweden. The new swap lines would provide US$60bil each in dollar liquidity for the central banks of Australia, Brazil, South Korea, Mexico, Singapore and Sweden and US$30bil each for the central banks of Denmark, Norway and New Zealand.

- Despite the Fed's moves, there are concerns that a shortage of corporate debt and other types of liquidity could develop into a deeper crisis, especially with the coronavirus impacting the global economy with no signs of abating in the US, Europe and countries in Asia. Fortunately, banks are equipped with more capital and liquidity buffers after the 2008 GFC, thanks to the Dodd-Frank Act. Thus, they are better prepared to handle periods of financial stress.

Real concern on other economic sectors

- Although there have been efforts to improve the dollar liquidity plus global central banks including Bank Negara Malaysia (BNM) embarking on monetary stimulus measures, the real concern is on the other economic sectors. These other economic sectors lack the same protection, especially businesses with limited cash in hand and are exposed to a high degree of leverage. Businesses have been incentivized to pile on more debts due to low interest rates since the financial crisis. The same goes to household debts.

- As such, a liquidity crisis faced by businesses as well as households could result in a domino effect that would end up hurting banks. This is despite banks being better prepared for a downturn. It is hard to know how high the economic stress would reach in the financial institutions in today's scenario. Although banks may have the liquidity coverage ratio, things are moving so fast and in such a big way that it is almost impossible to rule out the possibility of a lack of liquidity proving problematic for some set of institutions.

- Also, the types of disruptions and whether they could occur not just in the real economy but also in banks are hard to know. If delinquencies were to rise as businesses and households struggle to make ends meet, banks would lose out on loan payments, which would threaten their business models. Banks and investors will have to carry that risk. For that reason, BNM must focus on ensuring liquidity within the system is plentiful so that banks could continue lending in a downturn.

- But the longer the economic fallout from the virus lasts, the more unknowns there are. As soon as there is some sort of distress impacting on the financial markets, what will happen is that there will be a natural shrinkage of credit availability. It is because everyone will want to have cash to weather the storm.

- The question is when will credit availability begin to be severe that it will cause constrictions in the marketplace. And with the severity of the coronavirus pandemic, it is going to test the solvency of small and large businesses as well as households.

- Hence, the key to the central bank is to be able to tell the difference between insolvency and illiquidity. And the epicentre here is businesses as well as households, and not the financial institutions who are being regulated by BNM. The challenges to BNM will be to determine which corporate entities need liquidity and which are insolvent. Also, the challenge of addressing the household debt.

3. Plunging oil prices from 'twin' unexpected shocks

- Global oil prices are plunging. The market had to deal with "twin" shocks i.e. the unexpected oil price war between producers Russia and Saudi Arabia, and demand destruction due to the coronavirus pandemic. The first shock comes following a disagreement between key Opec+ members, especially between Russia and Saudi. The second shock is the impact from the coronavirus outbreak resulting in governments having escalated lockdowns to curb the spread of the virus.

- As a result, the oil demand, which is estimated around 100mbpd, should fall. Assuming a 10% drop in global oil consumption, it will translate to an excess of 10mbpd. With the current production cut deal expiring 31 March, it will further push oil price down. There are strong possibilities for oil prices to fall into the teens of around US$15 per barrel in the short term amid disaster demand destruction, building global stocks and no production limits after April.

- The drop in oil prices will have serious implications on both the economy and geopolitical consequences, namely in the Gulf area. A decline in oil prices could see several net oil-exporting countries managing, to some extent, by initially running substantial and higher fiscal deficits. The challenge on these economies will emerge when their GDP growth continues to face downside risk compared to the rest of the world. More so, if spot crude oil prices fall well below their fiscal and external breakeven prices (Tables 1 & 2) as it will heighten the challenge on their fiscal and current account positions. Particularly, major oil producers with currency pegs to the US dollar or other tightly managed exchange rate arrangements like Iran, Iraq, Nigeria, Saudi Arabia, the GCC countries and Venezuela.

- Also, monetary policies will be constrained in commodity-exporting countries, especially those with more flexible exchange rates. As the currencies of these countries depreciate fast, it will add inflationary pressure. At the same time, it limits the room for monetary policy easing in response to addressing a slower growth. What could happen is a divergence in monetary policies. The global monetary policy is now on an easing trend to address the coronavirus impact. However, such monetary easing may not take place globally, should the oil prices continue to drop, especially in commodity-exporting countries.

- The impact of the drop in oil prices on global GDP should be assessed based on supply and demand. Estimates showed that for every 10% drop in oil prices as a result of supply shocks, it will raise the global GDP by 0.1% to 0.2%. Meanwhile, if the drop in oil prices is due to weaker demand, it will lower the global GDP by 0.2%–0.3%. Hence if the current weak oil price is due to higher supply (50%) and weaker demand (50%), the net impact on the global GDP is a slight drop of 0.1%.

- Furthermore, financial strain will emerge as a result of the drop in oil prices, particularly in countries with foreign currency exposures. Although the share of major oil-exporting countries in relation to the global economy is small, around 15% of global GDP based on purchasing power parity, the negative spillovers on those countries with close trade and/or financial links can be impactful. It can weigh down the already weakening global confidence as a result of the virus impact and hence global economic activities.

Pressure on Malaysia's fiscal deficit

- Our domestic economic reliance on oil revenue leaves the economy vulnerable to global commodity markets. Contribution of oil revenue to total revenue is projected at 20.7% based on Budget 2020. The projected oil price i.e. Brent per barrel was US$62 per barrel. On that account, the fiscal deficit/GDP is expected to drop to 3.2% in 2020 from 3.4% in 2019.

- Following the outbreak of the coronavirus, the PH government unveiled a RM20 billion stimulus package in a move to support the affected industries and the economic growth from sliding. As a result, the fiscal deficit/GDP was revised upwards to 3.4% for 2020.

- And the new challenge is the sharp drop in the oil prices arising from the price war between Russia and Saudi Arabia, added with the coronavirus, induced a global recession. That led to oil price now to below US$30 per barrel. Such a plunge in oil prices would add pressure on the revised fiscal deficit/GDP of 3.4%.

- With the drop in oil price to around US$25 per barrel, it would result in a shortfall in oil revenue amounting to RM11.1 billion. It is based on the view that for every US$1 per barrel drop in oil price, it will reduce the oil revenue by RM300 million. Estimated loss in oil revenue is between RM0.6 billion (at an average at US$60 per barrel) and RM12.6 billion (at an average at US$20 per barrel) (Table 3). Hence, the pressure is on the fiscal deficit/GDP to hover between 3.6% and 4.2%, pending the outlook of nominal GDP and expenditure.

B. Strategy: Need to stabilize economy which will stabilize markets

- Unlike the 2008 financial crisis that originated from the financial sector, the current economic turmoil experienced by both the world and Malaysia came completely outside the financial sector. It came from the virus impact that is directly harming areas of the economy like tourism and tourism-related activities, and other areas of economic activities like manufacturing, construction, mining and agriculture following the lockdown. It has also affected businesses in the informal sector. The job market is impacted by retrenchments and many workers going on unpaid leave in many sectors.

- It is important to take note that the demand shocks can be addressed through monetary and fiscal policies. As for the supply shocks, it is the microeconomics that plays a more crucial role. But the trouble in today's situation is that we are experiencing both. And with policymakers still trying to figure out the best measures, the result will be a lot of volatility in the markets because people do not know what they are doing.

- Since the cause of this crisis differs, then the treatment should also differ. In this situation, there is an urgent need to stabilize the domestic economy which in turn will help to stabilize the markets. It should not be a situation of trying to stabilize the markets with the expectation that it will then stabilize the economy. That is where the role of government stimulus could come in to provide much-needed relief to affected economic and business as well as workers. Hence, fiscal stimulus is ultimately going to have to play the bigger role than monetary measures.

- A stimulus package combined with the monetary measures should help to shorten the duration of the crisis. A combination of what BNM is doing and fiscal policy will probably provide the certainty and the confidence that the markets need to look at this as a short-term issue. However, it could become a longer-term problem if the virus crisis remains protracted.

- Monetary actions should help to get ahead of some of the issues such as liquidity and solvency. By committing to essentially monetary stimulus, it helps to safeguard the financial system by doing whatever is necessary. It should be "micro-targeted" toward specific sectors. And in a way, the monetary policy might be the right way to go at that, like loan programmes for specific sectors of the economy.

And time to look at money financing for budget deficit

- On the fiscal front, given the limited flexibility, resources could be mobilised through money financing of the budget deficit. Upwards pressure on the current 3.4% fiscal deficit/GDP comes from the drop in oil revenue and slower economic growth due to the virus impact. The risk of the fiscal deficit/GDP surpassing 4% is high.

- Given the limited flexibility of the fiscal policy, added with a weak economy and low inflation environment, money creation which is now called as "money financing" of budget deficit while under the old or earlier terms is referred to as "deficit financing" is an appropriate way to support the economy. Printing of money to raise government's revenue is called "seigniorage". However, some believe that "printing money" to solve our economic problems is a bad idea. But it is important to take note that the money created is truly from "printing" and not from taxpayers.

- Our view is that money creation is a useful tool. Through money creation, the government can mobilize resources to drive the economic growth by financing the budget deficit. It will allow the government to spend as much as it wants with the aim of supporting the economy to its full capacity, boost private sector activities, reduce unemployment and finance major programs like construction/infrastructure, healthcare and green. Even if the government spending does create a deficit, it is not a serious problem. It is because the government's deficit is by definition a surplus to the private sector.

- By financing the budget deficit through printing money, it will increase the money supply. When money supply is increased in times of recession/depression when both productive capacity and labour are lying idle due to poor demand, the price level is unlikely to rise much. The effects of increasing money supply will support stronger output or income. The increase in real income, given the rate of taxation, will bring about an increase in revenue from taxation which will help reduce budget deficit in the short run.

- Also, higher government spending through money creation will not generate inflation provided the economy experiences excess capacity or high levels of unemployed labour. It is only when the economy experiences physical or natural constraints on its productivity like full employment or capacity, then inflation will kick in because supply fails to meet demand. Printing money to raise revenue for financing the budget deficit which causes inflation is like an inflation tax. This is because the government is able to get resources through printed money which causes inflation and reduces the real value of the holdings of money by the public. Hence, governments can control inflation by spending less or withdrawing money from the economy through taxes.

- According to our assessment, a 1% increase in money supply will improve the economic growth by 0.5%. At the same time, it supports the local currency with an appreciation of 0.6% against the dollar. Impact on inflation is about 0.25%. Hence, money creation does not automatically cause economic chaos or devalue the currency or fuel inflation.

- In our view, the Stimulus Package 2 (SP2) should be more ambitious than SP1 of RM20 billion in terms of reaching at a wider range of target groups and covers a broader range of economic activities. It must address six strategic issues: reducing unemployment and increasing job opportunities; easing the economic burden of the people, particularly those in vulnerable sections of society; supporting the private sector; undertaking capacity building for the future; supporting the SMEs; and supporting the informal business activities and those working in this sector.

- Given the concerns over fund allocations, the SP2 should seriously look at adopting the "money financing" for the fiscal deficit strategy. Money created through this mechanism could be channelled to:

  1. Promote private sector confidence and ensure that this sector does not collapse due to the deepening of the crisis. This can be carried out in a variety of ways, including direct financial assistance, incentive packages, and mega-projects that require private sector participation and small and medium enterprises (SMEs);
  2. Focus on the growing the informal sector by providing direct financial assistance, incentive packages;
  3. Compensating individuals whose welfare has been adversely affected due to the current crisis, and focus on those who work in the informal sector, paid daily or contract;
  4. Reduce unemployment and create job opportunities by providing incentives to companies that employ those who have been laid off;
  5. Provide entrepreneurial skills and financial assistances for those who intend to venture into "micro" businesses or informal business activities;
  6. There is a need to facilitate with the proper financial functioning of the private sector during times of crisis and hence, there must be measures to enable companies to raise funds in the capital market with greater ease;
  7. Companies relying on foreign workers should be exempted from levy payments to the Human Resource Development Fund for a period of six months; and

8. Focus on the transportation sector given the rising urbanisation, tourism, green initiatives , education, health, the halal sector, develop new technologies (particularly biotechnology), and upgrade human resource development (with an emphasis on private tertiary education).

- The SP2 should also look at: (1) extending all housing loans for government servants by an additional 5 years; (2) increasing the loan amount for certain categories of government servants to buy property or car; (3) making it easier for foreigners and foreign companies to buy commercial real estate valued at RM500,000 or more without seeking the approval of the Foreign Investment Committee; and (4) extending the business operations of hypermarkets/retail businesses until 11pm on weekdays and 1am on weekends while hypermarkets in shopping complexes can apply to operate on a 24-hour basis.

Appendix 1

Table 1 Breakeven for Fiscal Deficit

Countries	Fiscal Breakeven Oil Price (US$/bbl)
Algeria	92.3
Bahrain	93.0
Iran	124.4
Iraq	59.0
Kuwait	49.7
Libya	79.0
Oman	85.9
Qatar	45.4
Saudi Arabia	78.3
UAE	68.0

Source: IMF/AmBank Research

Table 2: Breakeven for Current Account

Countries	External (Current Account) Breakeven Oil Price (US$/bbl)
Algeria	75
Bahrain	77.8
Iran	52.4
Iraq	59.4
Kuwait	49.6
Libya	67.7
Oman	69.6
Qatar	51.2
Saudi Arabia	58.1
UAE	42.4

Source: IMF/AmBank Research

Table 3: Malaysia Oil Revenue Sensitivity Analysis

Oil Price ($/barrel)	Revenue Loss (RM bil)
60.0	-0.6
55.0	-2.1
50.0	-3.6
45.0	-5.1
40.0	-6.6
35.0	-8.1
30.0	-9.6
25.0	-11.1
20.0	-12.6

Source: AmBank Research

Table 4: Interest Rate Movement (%)

	Dec-19	Jan-20	Feb-20	Mar-20	Cumulative Rate Cut (bps)
Australia	0.75	0.75	0.75	0.50	25
China	4.15	4.15	4.05	4.05	10
EU	-0.50	-0.50	-0.50	-0.50	-
Iceland	3.00	3.00	2.75	1.75	125
India	5.15	5.15	5.15	5.15	-
Indonesia	5.00	5.00	5.00	4.50	50
Japan	-0.10	-0.10	-0.10	-0.10	-
Malaysia	3.00	2.75	2.50	2.50	50
New Zealand	1.00	1.00	1.00	0.25	75
Philippines	4.50	4.50	4.25	3.25	125
South Korea	1.25	1.25	1.25	0.75	50
Thailand	1.25	1.25	1.00	0.75	50
Turkey	12.00	11.25	10.75	9.75	225
UK	0.75	0.75	0.75	0.25	50
US	1.50 – 1.75	1.50 – 1.75	1.50 – 1.75	0.00 - 0.25	150
Vietnam	4.00	4.00	4.00	4.00	-

Source: CEIC/AmBank Research; Note: EU = Deposit Facility Rate; China: 1-year Loan Prime Rate

Table 5: Reserve Requirement Ratio (%)

	Dec-19	Jan-20	Feb-20	Mar-20	Cumulative Rate Cut (bps)
China	13.00	12.50	12.50	nm	50 - 100
India	4.00	4.00	4.00	nm	-
Indonesia	12.00	12.00	12.00	12.00	-
Japan	0.79	0.79	0.79	nm	-
Malaysia	3.00	3.00	3.00	2.00	100
Philippines	14.00	14.00	14.00	12.00	200
South Korea	7.00	7.00	7.00	nm	-
Thailand	1.00	1.00	1.00	nm	-
Turkey	7.00	7.00	7.00	nm	-
US	10.00	10.00	10.00	nm	-

Source: CEIC/AmBank Research; Note: China SRR = Big Banks

Table 6: Global Stimulus Package

Country	Stimulus Package		Monetary Stimulus	
	Amount	Remarks	Policy Rate (%)	Others
US	US$ 1.8tril	Republicans expected unveil a stimulus package worth about US$1.8tril which would include direct payments to individuals and families (on average about US$3,000 for a family of 4), expanded unemployment benefits and a massive loan program to tide over small business	0.00 - 0.25	(1) Cutting interest rates by 150bps
				(2) restarting quantitative easing, which will include US$500bil in Treasury purchases and a further US$200bil in mortgage-backed securities
				(3) restarting a commercial paper funding facility for US corporates
				(4) introducing swap lines to nine major central banks
				(5) allowing banks and broker-dealers that trade directly with the Fed to borrow cash secured against some stocks and higher-rated bonds
UK	£330bil of guarantees	(1) Workers whose jobs are at risk will see up to 80% of their wages paid by the gov	0.10	(1) Slashed interest rates by 65bps to a record low of -0.10% and boost its QE target by additional 200bil to a target of 645bil pound;
		(2) Companies will get a £30bil tax holiday for one quarter (Value Add Tax)		(2) Introduce a new Term Funding scheme with additional incentives for Small and Medium-sized Enterprises (TFSME), financed by the issuance of central bank reserves.
		(3) Renters and self-employed will receive help from the gov		
EU			-0.50	(1) The ECB kept policy rates unchanged
				(2) Launched an € 750bil (US$820bil) pandemic emergency debt-buying program. That came on top of 120 billion euros in additional asset purchases agreed previously
				(3) Measures to pump more liquidity into the financial system and to subsidize long-term loans for banks.

Country	Stimulus Package		Monetary Stimulus	
	Amount	Remarks	Policy Rate (%)	Others
Italy	€25bil	New measures includes ranging from suspending tax payments to helping cover layoffs to mortgage relief		"Less significant banks" have been given more wiggle room on bad debts and capital requirements
Spain	€200bil	(1) €117bil will be coming from public sector - largest stimulus package in history (2) The package includes a moratorium on mortgage payments for peope adversely affected (3) The gov will stop evictions and guarantee water, electricity and internet to vulnerable households (4) Up to €100 mil of the package will be used to guarantee liquidity for Spanish business (5) All self-employed workers who lose business due to Covid-19 will receive special help (6) €30mil was pleged to researchers trying to develop a vaccines		
Japan	¥2.03tril	(1) Package includes support for SMEs (2) Subsidies for parents who need to take time off work (3) Funding for development of virus vaccines and test kits and for extra production of protective masks (4) The gov is looking into another ¥30 trillion stimulus package	-0.10	(1) Raise ETF annual purchase target by doubling to ¥12tril (US$112bil) (2) Introduce new lending program that to extend one-year - zero rate loans to financial institution
China	CNY500bil		4.05	(1) CNY100 billion (US$14.28 billion) was injected into the market via the medium-term lending facility (MLF); (2) Cuts SRR by 50-100bps to release another CNY550bil (3) Slashed one-year prime loan rate by 10bps to 4.05%

Country	Stimulus Package		Monetary Stimulus	
	Amount	Remarks	Policy Rate (%)	Others
South Korea	₩11.7tril (US$9.8bil)	(1) Injection is a supplementary budget (2) Some ₩2.3 trillion will be allocated to medical institutions and fund quarantine efforts (3) Another ₩3.0 trillion going to SME businesses struggling to pay wages to their workers, and child care subsidies. (4) Loans will be made on relaxed terms to affected exporters while people who have lost their jobs will be re-trained.	0.75	(1) Bank of Korea slashed interest rates by 50bps to 0.75% (2) Established direct swap lines with the Fed
Australia	A$83.6bil	(1) Supporting business investment - A$3.9bil (2) Providing cash flow assistance to help SMEs to stay in business and keep their employees in jobs - A$9.0bil includes cash flow suport; 50% wage subsidy for apprentice (3) Targeted support for the most severely affected sectors, regions and communities - A$4.8bil one-off cash transfer (A$750); (4) Household stimulus payments	0.25	(1) Cut rates by 50bps to 0.25% (2) Announcement of Quantitative Easing (QE). The 3Y Government bond yield would be targeted at around 0.25% through asset purchase in the secondary market across the yield curve and in government bonds and semi-government securities (3) Introduction of a term funding facility aimed at supporting SMEs. This is a 3Y facility for deposit-taking institutions at a fixed rate of 0.25% equivalent in size to 3% of outstanding credit, and at least A$ 90 bil.
New Zealand	NZ$12.1bil (4% of GDP)	Includes covering wages for people who are required to self isolate but cannot work from home; bolstering healthcare sector; more money for low-income families; and changes to business tax	0.25	(1) QE up to NZ$30 billion (US$17 billion) worth of government bonds; (2) Slashed interest rates by 75bps

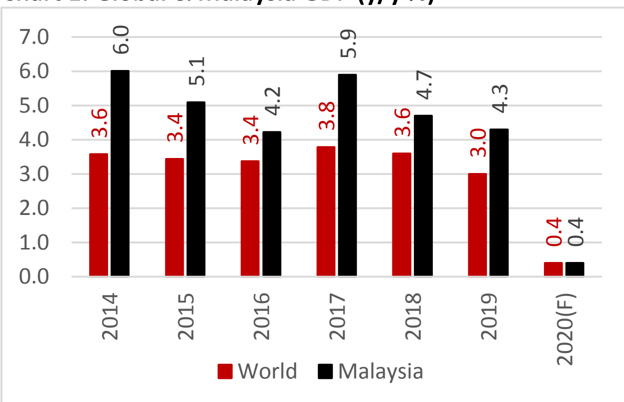
Country	Stimulus Package		Monetary Stimulus	
	Amount	Remarks	Policy Rate (%)	Others
Singapore	S$6.4bil	S$4bil to help business cash flow; S$1.6bil for care and support package; and $800mil for front-line agencies		
Indonesia	IDR10.3tril (US$727mil)	(1) Includes exemption of income tax for workers in the mfg sector for 6 months (2) 30% deduction of corporate tax for six months (3) Restructuring for SME loans	4.5	(1) Bank of Indonesia slashed interest rates by 50bps to 4.5%. (2) Holding daily repurchase and foreign-exchange swap auctions to bolster liquidity
Thailand	THB400bil (US$12.7bil)	(1) Package include soft loans, a fund, and tax benefit for those affected (2) No cash handouts for low income earners	0.75	(1) BOT cut rate by 25bps to a record low of 0.75% (2) Plans to inject THBt 100bil liquidity to support financial market
Hong Kong	HK$120bil	(1) Low-interest loan with 100% guarantee provided by the government, to a ceiling of HK$2 million (2) Profits tax reduction of 100% on the first HK$20,000, waiving of business registration fees, extending subsidies on electricity and water and sewage bills. (3) A payment of HK$10,000 to each permanent resident (above 18 years)	0.86	(1) Hong Kong's central bank cut rates (2) Reducing the level of capital buffers it requires financial institutions to hold to 1% from 2% of their risk-weighted assets
Vietnam	VND27tril	(1) Includes tax break, delayed tax payments and reduction in land lease fee (2) The government aimed to speed up state spending on infrastructure projects	4.00	

Country	Stimulus Package		Monetary Stimulus	
	Amount	Remarks	Policy Rate (%)	Others
Malaysia	RM61.5bil	(1) RM2bil for immediate implementation of small infrastructure repair and upgrading projects	2.50	(1) SRR reduced to 2.00%
		(2) Financial aid of RM600/month for workers earning RM4K/month or less who are forced to take unpaid leave for 6-months		(2) OPR reduced by 50bps to 2.50%
		(3) Providing a discount on monthly electricity bills for hotels, travel agencies, airlines, shopping malls, convention and exhibition centres will help reduce the cost		(3) BNM announced 6-month loan moratorium for affected SMEs and individuals
		(4) Flexible pension fund withdrawal; & Bring forward BSH to March 2020 and provide additional one-off RM100 cash transfer in May 2020		(4) BNM's RM2bil Special Relief Fund (SRF) for SME working capital loans; Bank Simpanan Nasional RM300mil microcredit facility: BNM's RM1bil Agrofood facility for working capital and capex
		(5) Comprehensive fiscal stimulus will be announced on **30 March**		

Source: Various sources/AmBank Research

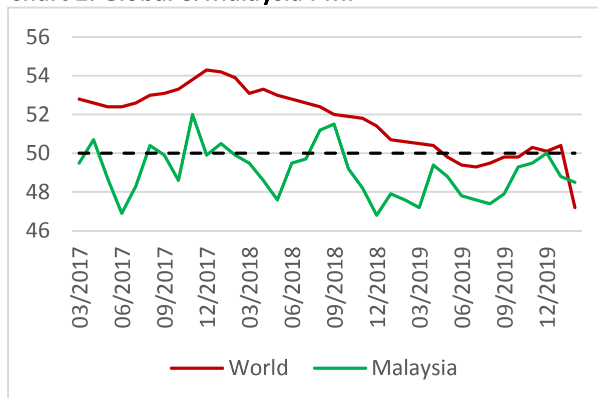
Appendix 2

Chart 1: Global & Malaysia GDP (y/y %)



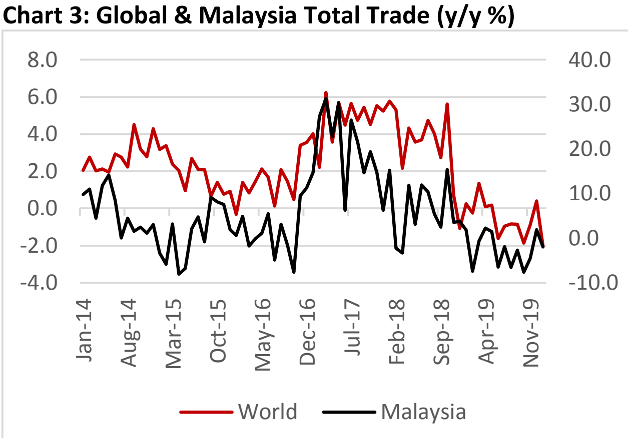
Source: CEIC/AmBank Research

Chart 2: Global & Malaysia PMI



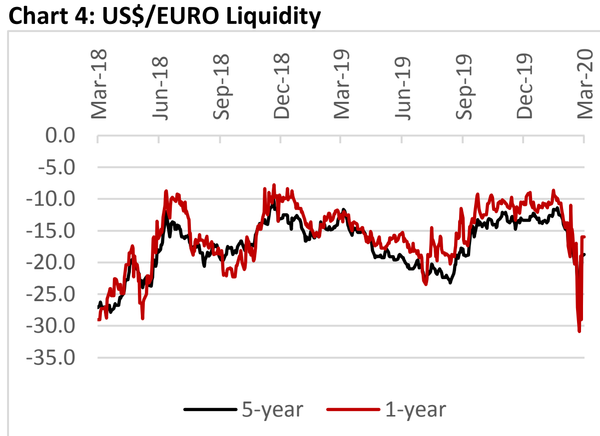
Source: CEIC/AmBank Research

Chart 3: Global & Malaysia Total Trade (y/y %)



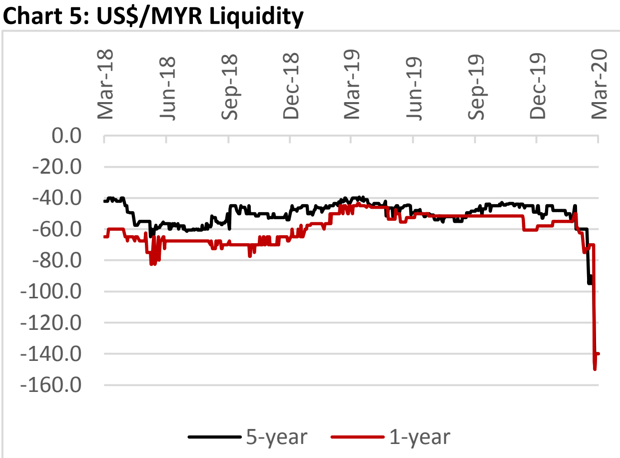
Source: CEIC/AmBank Research

Chart 4: US$/EURO Liquidity



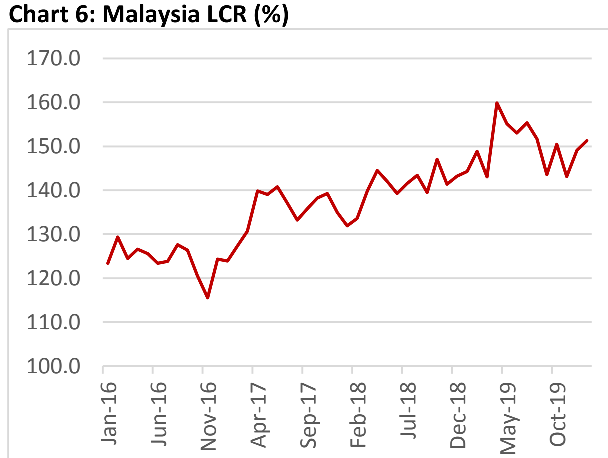
Source: Bloomberg/AmBank Research

Chart 5: US$/MYR Liquidity



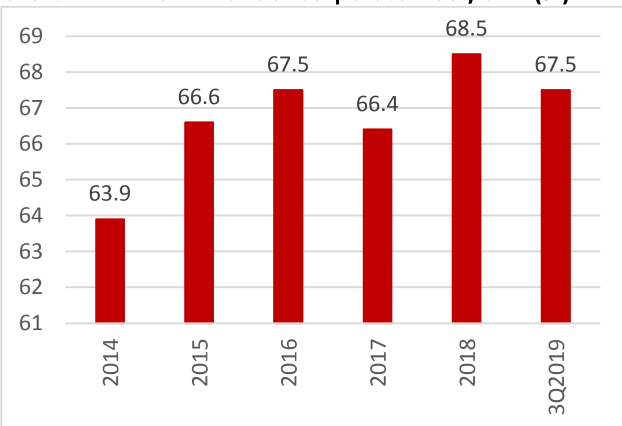
Source: Bloomberg/AmBank Research

Chart 6: Malaysia LCR (%)



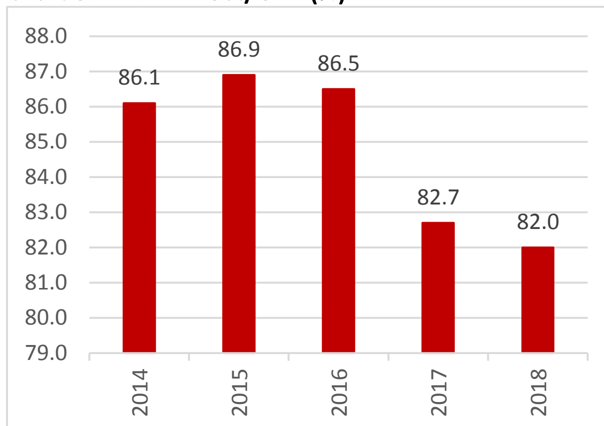
Source: CEIC/AmBank Research

Chart 7: MY Non-Financial Corporate Debt/GDP (%)



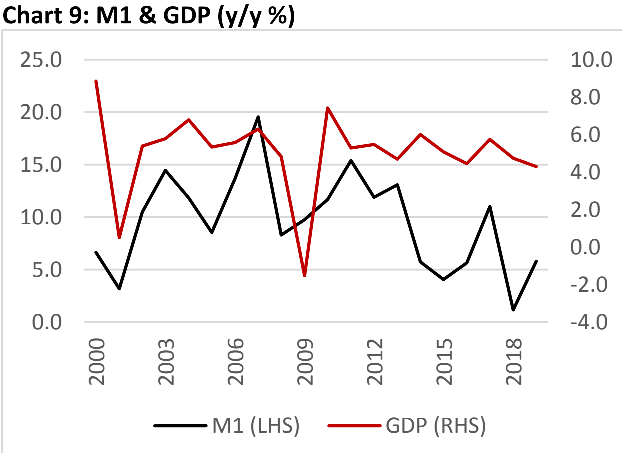
Source: BIS/AmBank Research

Chart 8: MY: HH Debt/GDP (%)



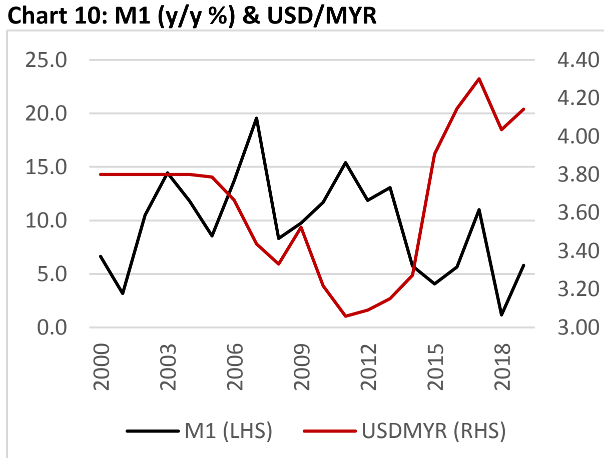
Source: CEIC/AmBank Research

Chart 9: M1 & GDP (y/y %)



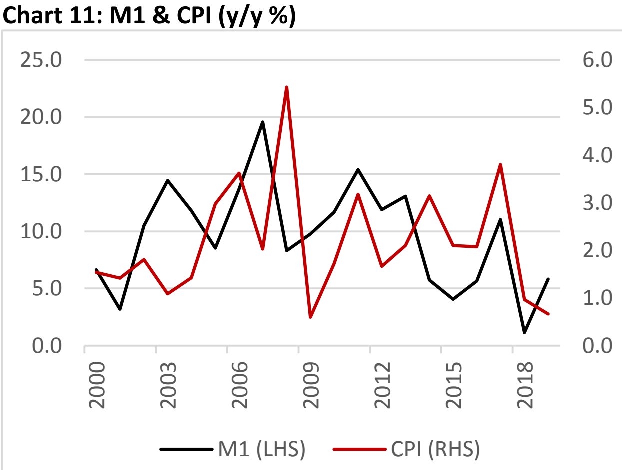
Source: CEIC/AmBank Research

Chart 10: M1 (y/y %) & USD/MYR



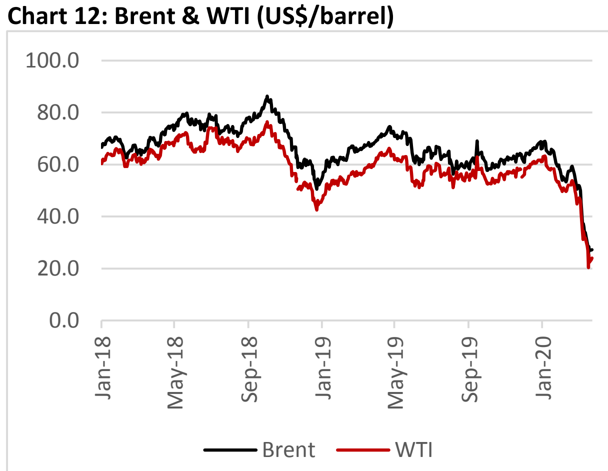
Source: CEIC/AmBank Research

Chart 11: M1 & CPI (y/y %)



Source: CEIC/AmBank Research

Chart 12: Brent & WTI (US$/barrel)



Source: CEIC/AmBank Research

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