PART 01 CAPITAL MARKET REVIEW AND OUTLOOK

OVERVIEW

The world experienced an unparalleled public health emergency in 2020, triggering an economic shock across economies globally. Against this backdrop, the Malaysian capital market witnessed significant volatility but continued to remain orderly. More importantly, the domestic capital market continued to play its vital role in financing economic activity and intermediating savings despite the challenging environment. In terms of performance, both the domestic equity and bond markets registered encouraging returns for the year, with the former experiencing a notable shift in sentiments towards smaller to mid-cap companies, especially in the healthcare and technology sectors. Going forward, the Malaysian economy is expected to rebound in 2021, in tandem with a recovery in global demand. Although the domestic capital market will continue to be influenced by key global developments, it is expected to remain resilient and orderly, underpinned by Malaysia's strong macroeconomic fundamentals, ample domestic liquidity and supportive policy environment.

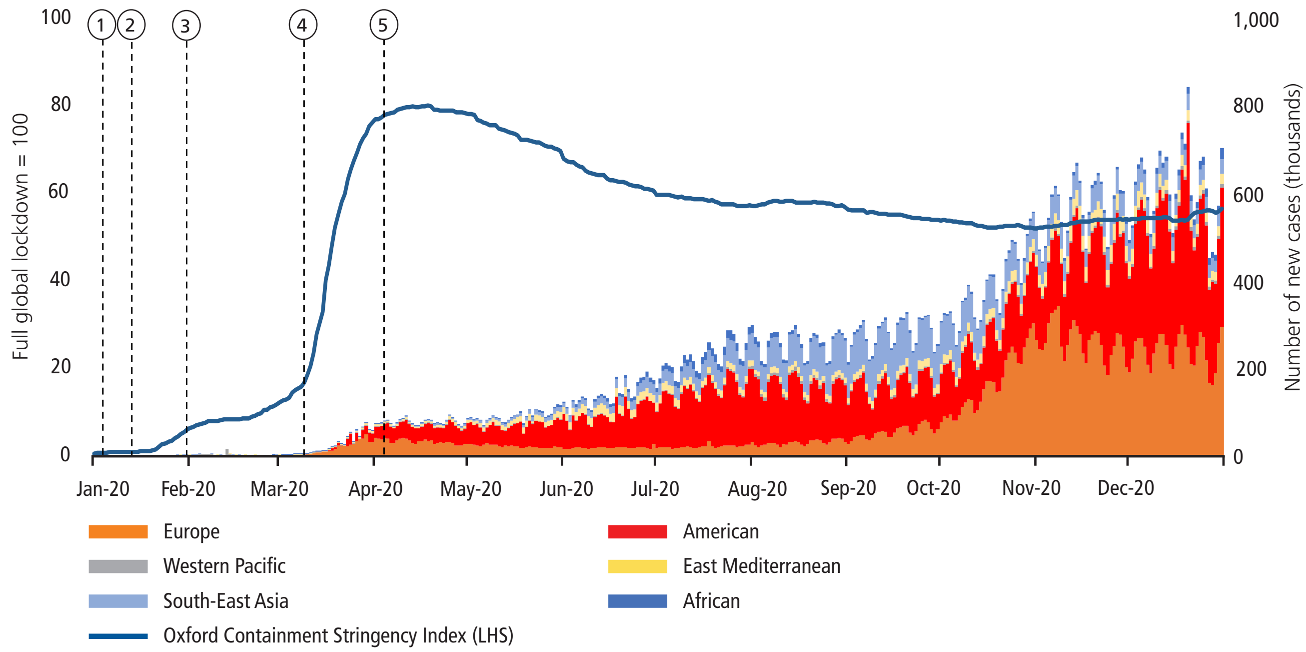
GLOBAL DEVELOPMENTS IN 2020

The global economy experienced one of the largest shocks in modern history in 2020. The emergence and rapid spread of COVID-19 at the beginning of the year threatened to overwhelm public health systems, contending with rising infection rates and death tolls in many parts of the world. To avert a public health disaster, governments in both advanced and emerging economies implemented strong containment measures, triggering concurrent supply and demand shocks across the globe.

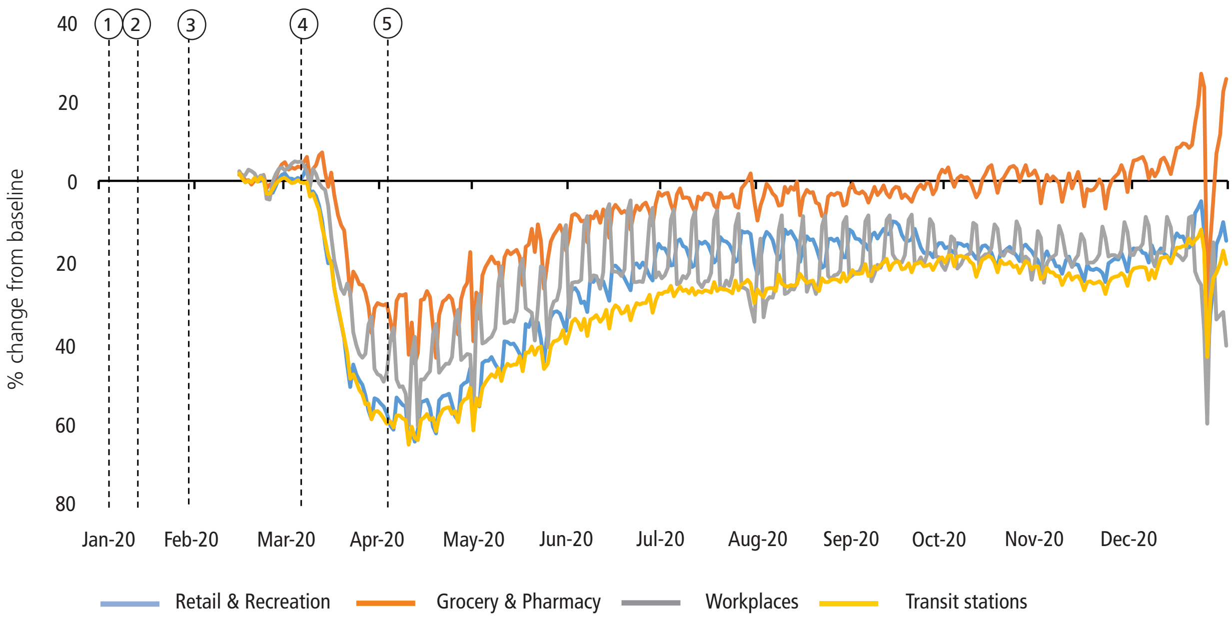
CHART 1

Strict worldwide containment measures contributed to concurrent supply and demand shocks, which led to the sharp decline in economic activity

Daily new COVID-19 cases by region vs Oxford Containment Stringency Index[1]



Google COVID-19 Community Mobility Report - Global Aggregate[2]



Note: Vertical dashed line indicates; 1) China informed WHO on the cluster of viral pneumonia of unknown cause in Wuhan; 2) First recorded case outside China in Thailand; 3) WHO declared coronavirus as Public Health Emergency of International Concern; 4) WHO declared COVID-19 as pandemic; 5) WHO reported more than 1 million cases worldwide, tenfold increase in less than a month.

1 Simple average of Containment Stringency Index for all countries covered by Blavatnik School of Government, University of Oxford.

2 Simple average across all countries covered by Google COVID-19 Community Mobility Reports; Index shows change in mobility relative to baseline corresponding to the median value of the same day during the five-week period between 3 January and 6 February 2020.

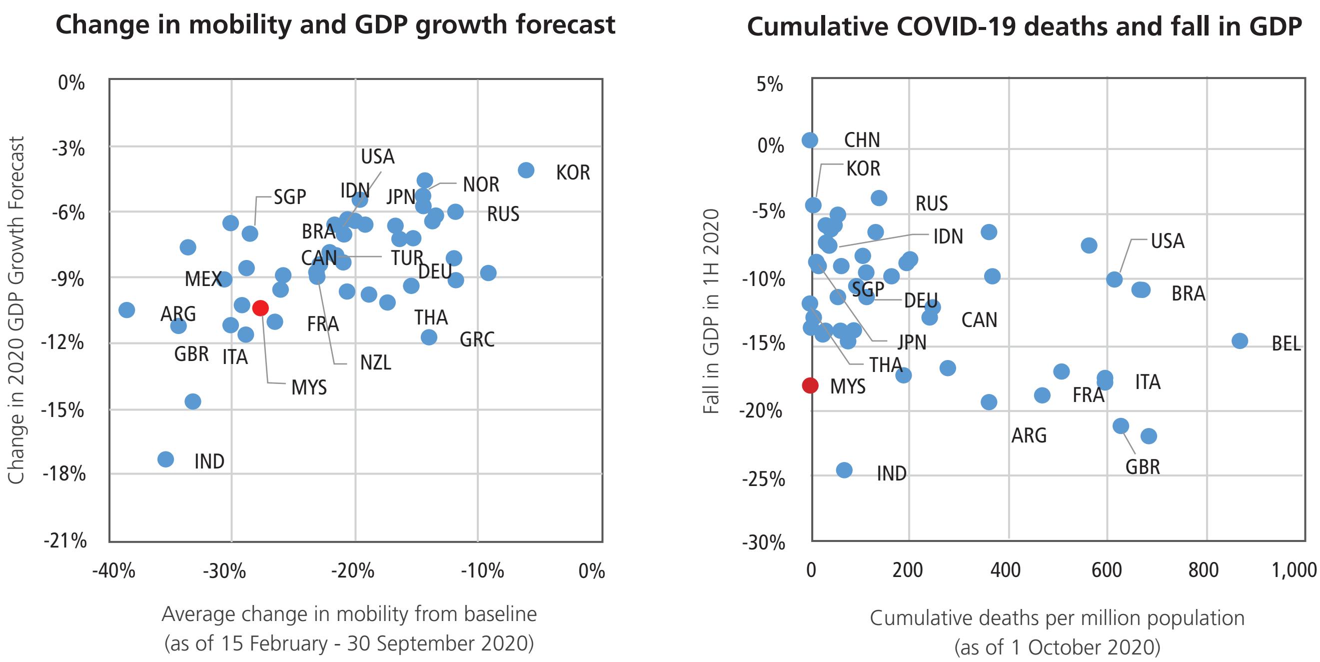
Source: CEIC; Oxford COVID-19 Government Response Tracker, Blavatnik School of Government; Google COVID-19 Community Mobility Report; SC's calculations

This simultaneous introduction of strict containment measures worldwide resulted in a sudden stop in economic activity through March and April 2020, which led to a substantial downgrade in growth expectations. The International Monetary Fund (IMF), in June 2020, forecasted a global gross domestic product (GDP) contraction of -4.9% for the year 2020, down by 8.2 percentage points from its January 2020 forecast and certainly worse than the -0.1% contraction in 2009. Unlike previous economic crises where the financial sector had typically been the catalyst, this downturn began from a health policy-induced crisis in the real economy.

Based on the assessment of the IMF then, more than 85% of global economies would record sub-zero growth in 2020, significantly more than during the Global Financial Crisis (GFC) in 2007-2009, leading to the worst peacetime contraction in global output since the Great Depression of the 1930s. Although some countries initially suffered larger economic contractions due to more stringent containment measures, those that were unable to manage the pandemic eventually suffered greater economic pain, recovering more slowly and recording more deaths over time.

CHART 2

Economic activity fell more where containment measures were stronger; countries that were unable to control their outbreaks suffered the most economic pain



Source: Google COVID-19 Community Mobility Report; IMF World Economic Outlook Database, October 2019 and October 2020; OECD database; WHO COVID-19 Dashboard; SC's calculations

Global financial markets were affected by the sharp worsening of the growth outlook and heightened uncertainties surrounding the pandemic. This resulted in a significant increase in volatility and led to a subsequent sell-off across a wide range of assets amid worsening global financial conditions. Ongoing US-China tensions also added to the volatility in global financial markets especially in 2H 2020.

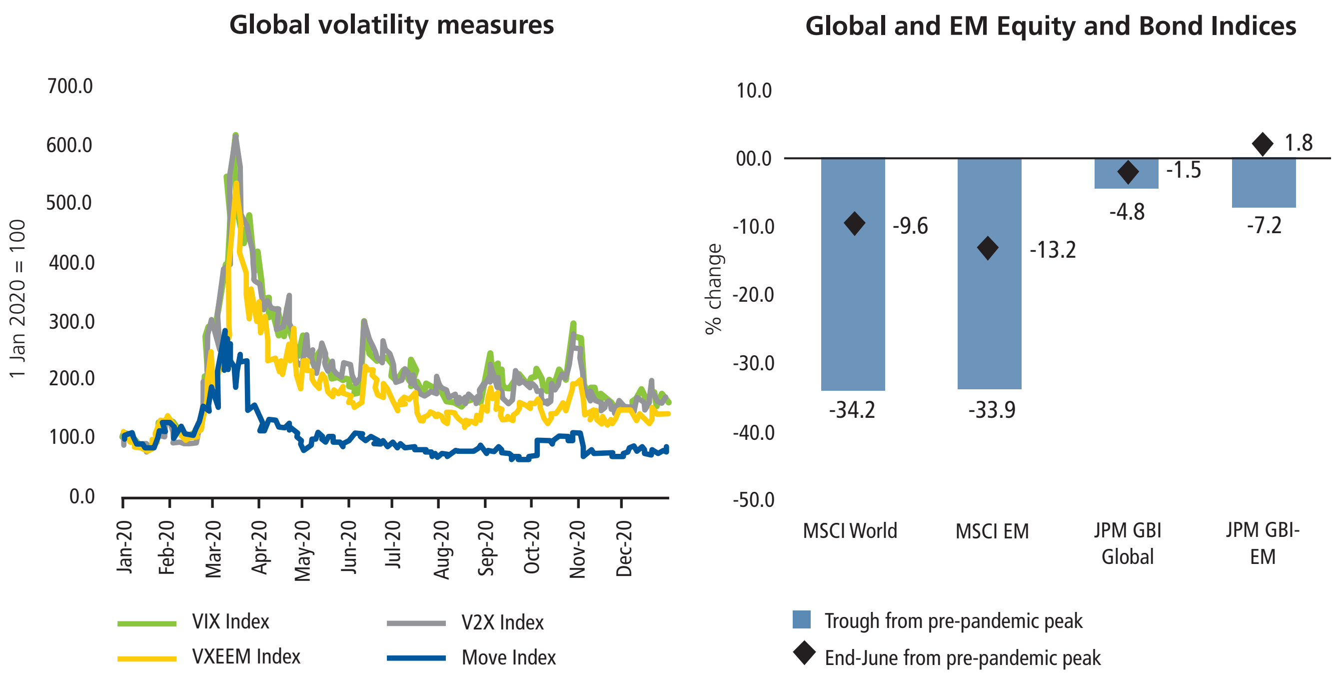
The initial flight to safe-haven assets eventually turned into a hunt for cash in mid-March 2020, culminating in a simultaneous fall in equity prices and a spike in bond yields. Gold prices surged on continued safe-haven flows, while other commodities declined on weakened demand prospects. To this effect, Brent crude oil touched an 18-year low in early March 2020, exacerbated by the temporary breakdown of the Organisation of the Petroleum Exporting Countries+ (OPEC+) coalition. The US benchmark West Texas Intermediate (WTI) near-term oil futures even witnessed a brief dip into negative territory in April 2020 due to the supply overhang.

In addition to the toll on health and decline in domestic economic activity, emerging market economies (EMEs) had to contend with the loss of economic activity from weakened foreign demand, sharp falls in commodity prices and reduction in capital flows.

As such, outflow pressures intensified considerably even as financing needs increased. The Institute of International Finance (IIF) estimated that US$80 billion of capital was withdrawn from EMEs in March 2020 alone, the largest single month of capital outflows on record.

CHART 3

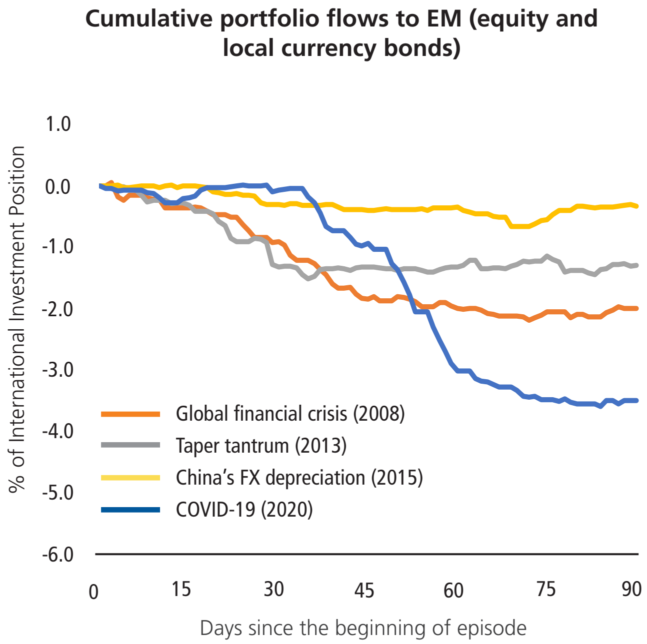
Implied volatility in financial markets surged to a record, while equity and bond markets significantly fell during the height of the COVID-19 crisis

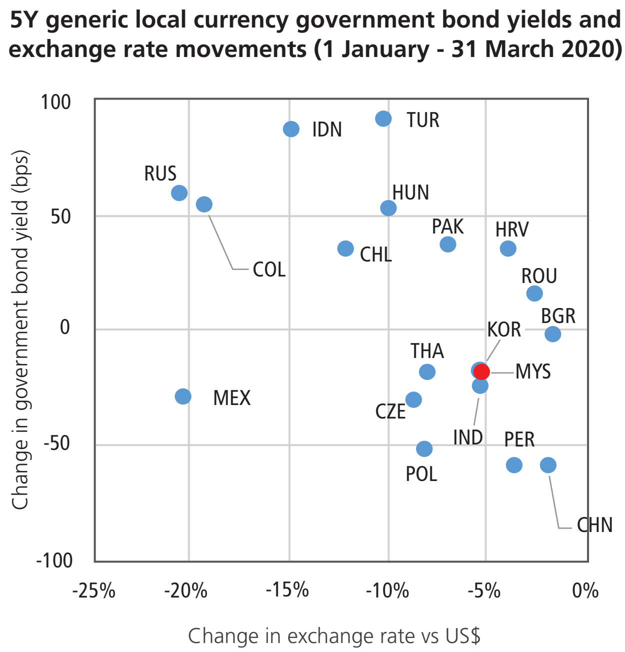


Source: Thomson Reuters Datastream; SC's calculations

CHART 4

Emerging market economies experienced unprecedented portfolio outflows, leading to sharp depreciation of their respective currencies



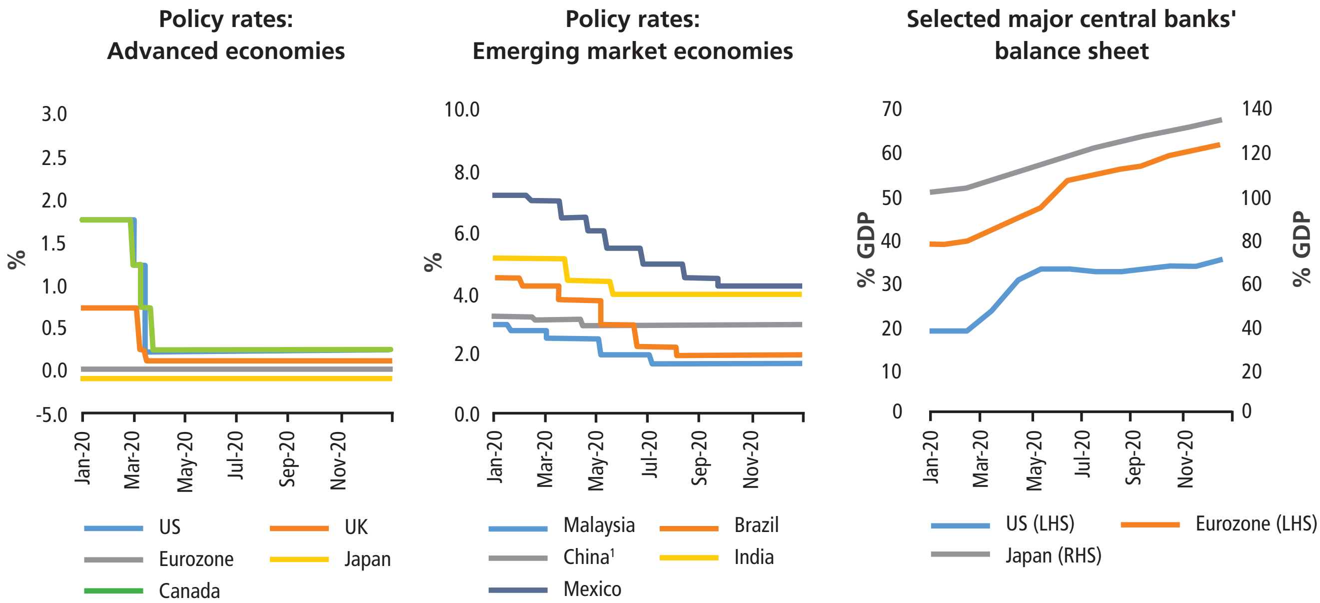


Source: The Institute of International Finance (IIF); IMF; Bloomberg; SC's calculations

Given the shock's unprecedented scale, the policy responses were swift and aggressive across both advanced economies (AEs) and EMEs, well beyond those adopted during the GFC. Central banks reacted promptly both in terms of speed and scale, cutting benchmark interest rates to record lows and implementing unconventional monetary policy measures. Some central banks also chose to provide direct financial lifelines to vulnerable groups, either via direct debt purchases or by providing backstops to banks via funding-for-lending initiatives, especially for small and medium enterprises (SMEs). Despite having lesser room to manoeuvre, central banks in EMEs also reacted in a similar fashion, cutting policy rates aggressively, and in some countries, embarking on asset purchase programmes for the first time.

CHART 5

Central banks reacted swiftly alongside the utilisation of unconventional monetary policy measures



Note:
1 Medium-term lending facility rate, one-year.

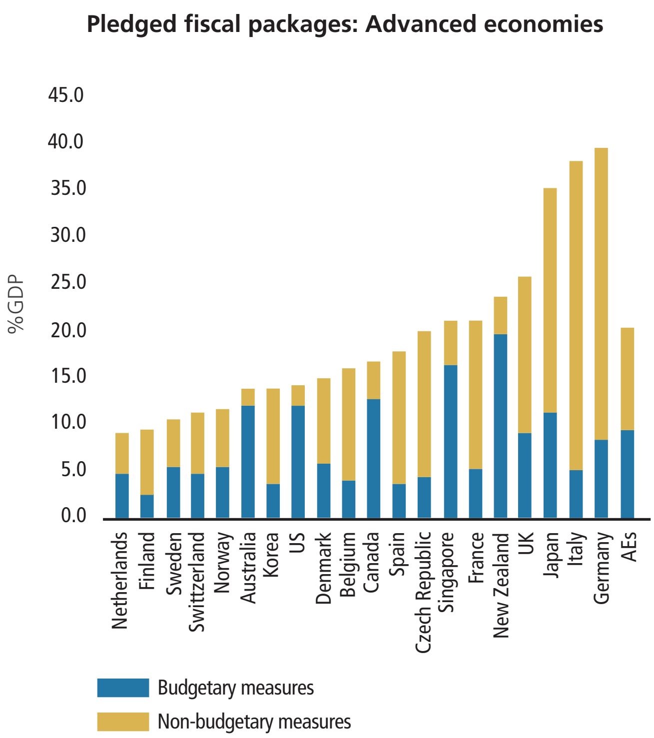
Source: Bloomberg; SC's calculations

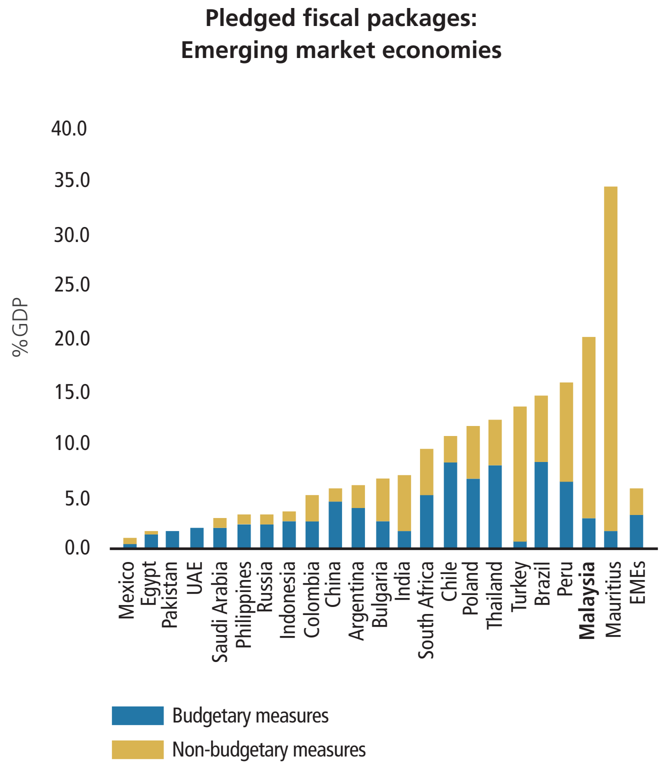
Likewise, fiscal authorities worldwide unveiled unprecedented amounts of stimulus packages, estimated at US$12 trillion as of September 2020 or close to 12% of GDP, according to the IMF.

The size and composition of fiscal support, however, varied vastly across countries. A continued decline in long-term interest rates aided by central banks' actions, especially in the AEs and large EMEs facilitated the massive fiscal response.

CHART 6

Fiscal authorities responded with large stimulus packages





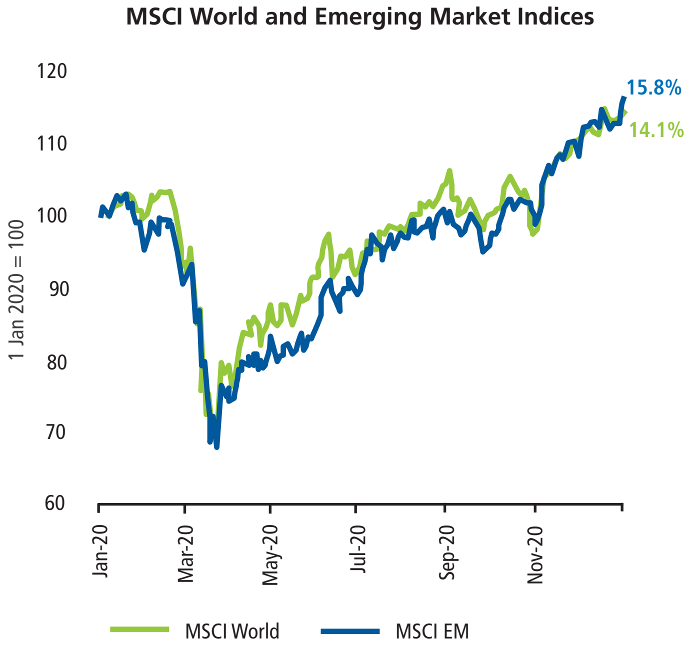
Source: IMF Global Fiscal Monitor, October 2020

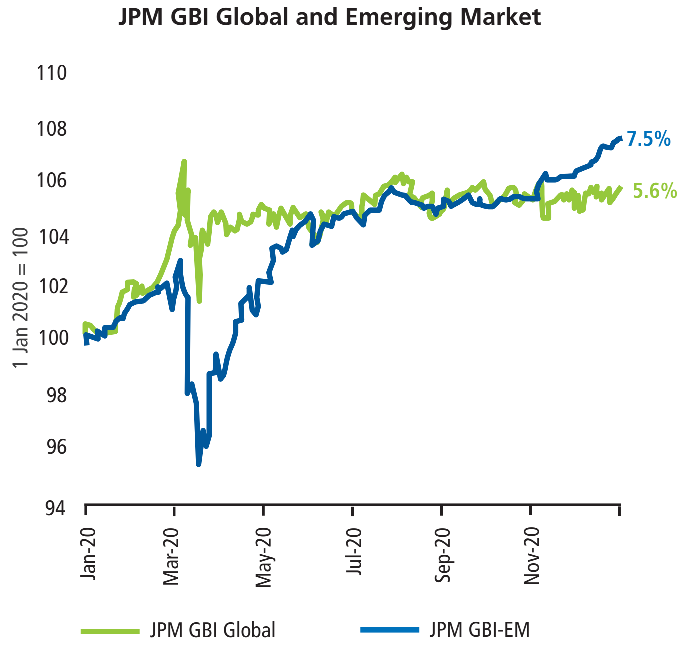
These supportive global policy actions alongside the resumption of economic activities with the easing of lockdowns in April-May 2020, although remaining uneven, contributed to broadly easier global financial conditions and improved investor confidence. Despite occasional escalations in US-China tensions, financial market volatility subsequently declined, accompanied by a surge in asset prices. Equity prices ended the year at historical highs, especially in AEs despite differentiated performance across countries and sectors. MSCI World increased by 67.9% from a low of 1,602.11 points on 23 March 2020 to end the year 14.1% higher at 2,690.04 points (2019: 25.2%). Meanwhile, MSCI EM rose by 70.3% to 1,291.26 points on 31 December 2020 from its low on 23 March 2020, an increase by 15.8% from a year earlier (2019: 15.4%).

Similarly, bond yields were significantly lower from their peaks in March 2020, while credit spreads continued to tighten. JP Morgan Government Bond Index (GBI) rose 5.6% from the beginning of year 2020 (2019: 6.1%), while GBI EM gained 12.5% from its low on 19 March 2020, an increase by 7.5% from a year earlier (2019: 12.9%).

CHART 7

Global equities and bonds rebounded swiftly despite continued volatility throughout the year



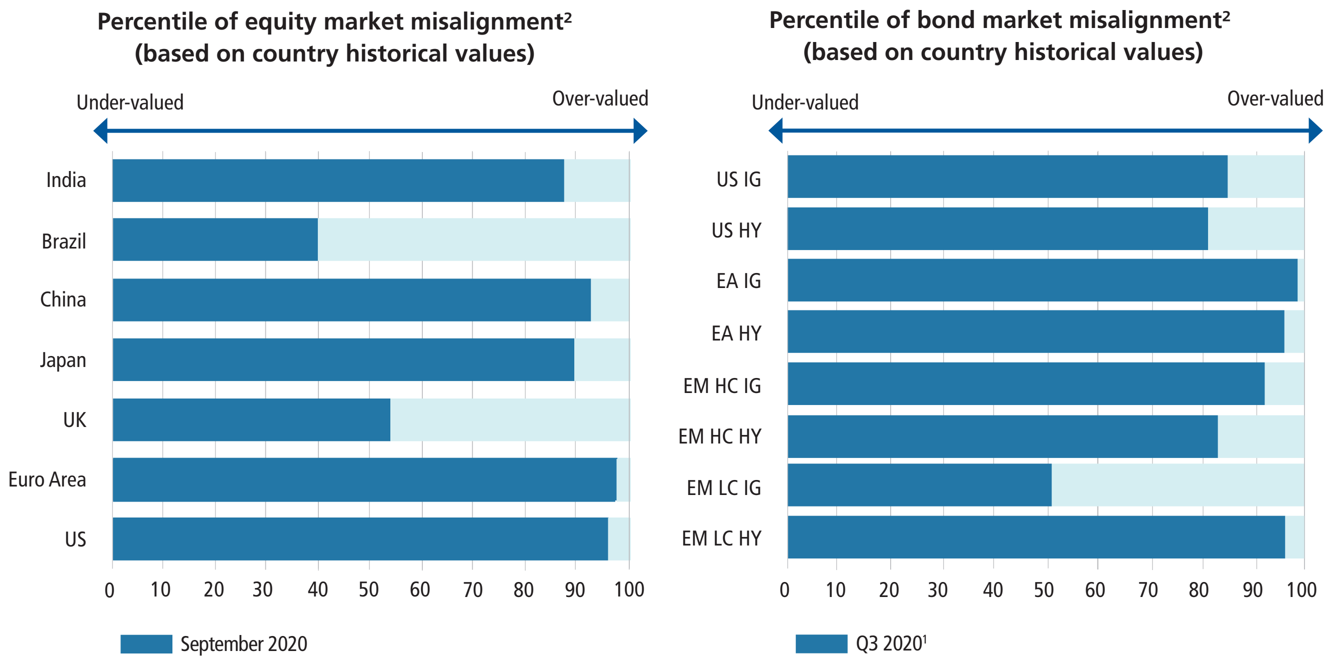


Source: Thomson Reuters Datastream; SC's calculations

A stream of moderately positive economic indicators, news on vaccine development progress and the outcome of the US presidential election further buoyed performance in global financial markets towards the end of 2020. The IMF in its World Economic Outlook (WEO) published in January 2021 expected a shallower recession of -3.5% in 2020 (October WEO: -4.4%), amid stronger-than-expected growth in 2H 2020, robust policy support and a stronger recovery in China offsetting weakness in EMEs. Nevertheless, the IMF notes that this remains the world's worst peacetime contraction since the Great Depression in the 1930s. While asset prices continued to improve, the recovery in economic activity continues to be highly uneven and incomplete across most economies. In particular, evidence points to some disconnect between financial markets and the real economy, with risk asset valuations in some economies, especially in AEs, being highly stretched despite subdued economic prospects. Such conditions suggest higher financial vulnerability against the sudden repricing of risk, which could undermine the economic recovery process.

CHART 8

Global financial assets continued to rise despite subdued economic recovery



Notes:

1 Data up till 29 September 2020.

2 Misalignment is the difference between market- and IMF model-based values scaled by the standard deviation of weekly equity returns and monthly changes in bond spreads. High/low percentiles of market misalignment indicate the extent of overvaluation/undervaluation as compared to the country's historical values.

US - United States; EA - Euro Area; EM - Emerging Markets; HC - Hard Currency; LC - Local Currency; IG - Investment Grade; HY - High Yield.

Source: IMF Global Financial Stability Report, October 2020

MALAYSIAN CAPITAL MARKET DEVELOPMENTS IN 2020

The Malaysian economy was not exempt from the adversity stemming from the COVID-19 pandemic in 2020. The rapidly rising number of infections domestically, alongside mounting cases abroad required the government to implement a full Movement Control Order (MCO) on 18 March 2020, closing national and state borders to contain the spread of the virus outbreak. These containment measures affected both the supply and demand side of the economy, causing a sharp decline in economic activity. Real GDP contracted by 17.1% y-o-y in Q2 2020, with growth seen to have troughed in April, during which most economic activities came to a standstill due to the MCO.

This has resulted in full year decline of -5.6% in 2020, a larger decline than the -1.5% contraction witnessed in 2009 during the GFC.

Against the backdrop of challenging economic conditions, domestic policy responses have been swift. Bank Negara Malaysia (BNM) promptly cut the Overnight Policy Rate (OPR) by a cumulative 125 basis points (bps) between January and July 2020, while reducing the Statutory Reserve Requirement (SRR) by 100 bps and relaxing its compliance in March 2020. Likewise, the government unveiled a sum of RM305 billion in stimulus via *Prihatin Rakyat* Economic Stimulus Packages (*Prihatin*, *Prihatin PKS Tambahan*, *Kita Prihatin*) and the National Economic Recovery Plan (*PENJANA*), of which RM45 billion was directly injected by the government under the COVID-19 Relief Fund.