MALAYSIA

ECONOMIC RECOVERY BARELY DESTABILISED

After a modest growth in 2021, Malaysia's economy is set to recover more strongly in 2022. It will be supported by firm domestic demand, an expansionary fiscal policy and the reopening of Malaysia's borders to tourists. The country is an exporter of commodities – mainly oil and palm oil – and should benefit from higher international prices, without being directly affected by the conflict in Ukraine. Thanks to the additional revenue from higher oil prices, the government should be able to take on most of the burden of higher inflation to prevent problems for households whose finances have already been weakened by the 2020 crisis. Another key uncertainty regarding economic growth is how long and how severe Chinese lockdowns will be, since they could drag down Malaysian exports.

ECONOMIC GROWTH ACCELERATING IN 2022

In 2021, real GDP growth was only 3.1%, after a contraction of 5.6% in 2020. At constant prices, Malaysia's GDP ended last year still 2.7% lower than its pre-Covid level. The modest rebound in 2021 was mainly due to the various waves of the pandemic during the year, which badly affected domestic demand.

In 2022, economic output should rebound substantially. It will be supported by robust domestic demand, driven by i) higher public-sector investment, ii) a reduction in Covid-19 restrictions (with 80% of the population fully vaccinated in early April 2022), iii) a stronger labour market, which is still weaker than it was in 2019 but has improved significantly since the end of 2021, and iv) Malaysia's reopening to tourists from 1 April 2022 (income from tourism averaged 6% of GDP before the pandemic). Malaysia should also benefit from higher commodity prices, especially if the government limits the negative impact on households.

The main commodities exported by Malaysia (hydrocarbons and palm oil) account for 19% of its total exports. Higher global prices resulting from the conflict in Ukraine and the sanctions imposed on Russia will generate a windfall for exporters and the government. According to an AMRO study, a 10% rise in oil prices boosts Malaysia's economic growth by 0.4 points.

On the downside, however, constraints arising from the conflict in Ukraine have already lowered business confidence, with the manufacturing sector PMI falling to 49.6 in March.

The conflict's direct impact on the Malaysian economy will be extremely limited, because trade and financial links with Ukraine and Russia are weak: Ukraine accounts for only 0.06% of Malaysia's exports and Russia only 0.3%.

However, Malaysia will be indirectly affected by further disruption to global supply chains, particularly in the semiconductors market, which accounts for almost 22% of its exports. Palladium and neon, both of which are essential in chipmaking, are produced mainly in Russia and Ukraine.

In addition, the resurgence of Covid-19 in China in March and April has resulted in lockdowns: in early April, regions representing more than 60% of China's GDP were affected by restrictions of varying severity. This situation is likely to drag down Malaysia's exports (15.5% of which are to China) and further disrupt global supply chains.

Moreover, although exporting companies and the government are likely to benefit from higher commodity prices, this will not be the case for consumers. In particular, there are concerns about how higher food prices will affect households that were hit hardest by the 2020 crisis. Malaysia's poverty rate rose from 5.6% in 2019 to 8.4% in 2020. As of February 2022, the labour market had still not regained its pre-crisis position, with an unemployment rate of 4.1% vs. 3.3% in 2019. In addition, nominal wage growth in the private sector was only 0.4% following a 2.4% decline in 2020, and this is not enough to allow households to deal with this new inflationary shock.

FORECASTS

	2019	2020	2021e	2022e	2023e
Real GDP growth, %	4.4	-5.6	3.1	5.8	5.9
Inflation, CPI, year average, %	0.9	-1.2	2.5	2.9	2.3
General Gov. balance / GDP, %	-3.4	-6.2	-6.4	-5.4	-4.5
General Gov. debt / GDP, %	52.4	62.1	63.5	61.2	58.9
Current account balance / GDP, %	3.5	4.2	3.5	4.1	4.0
External debt / GDP, %	62.6	67.6	69.3	71.5	73.0
Forex reserves, USD bn	100	100	104	106	109
Forex reserves, in months of imports	5.7	6.2	5.7	5.6	5.7

TABLE 1

e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CONSUMER PRICE INDEX

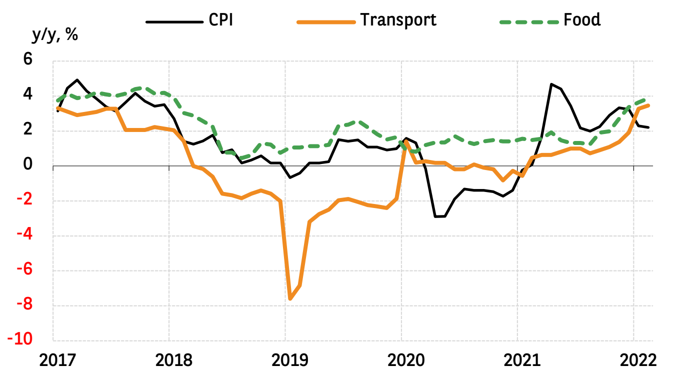

CHART 1

SOURCE: CEIC

GOVERNMENT LIKELY TO LIMIT THE IMPACT OF INFLATION

In February 2022, overall inflation remained low at only 2.2% y/y. However, food and transport prices have been rising since the end of 2021.

Malaysia imports food – cereals, meat, fruit and vegetables – and fertiliser used in its domestic food production. Although cereal imports remain modest (0.6% of GDP in 2021), higher food prices arising from the conflict in Ukraine could push up inflation by an estimated 22 basis points (bp) in 2022, and rising fertiliser prices could also affect 2023 food prices. The elasticity of food prices to international prices is estimated to be 0.6, while food makes up 28.4% of consumer spending. However, for the poorest households, food accounts for 38.5% of spending. Food price inflation had already risen to 3.9% in February as opposed to 1.5% this time last year.

Higher oil prices could also push up domestic inflation by 60bp if they were passed on in full to consumers. So far, the government has kept prices of the main fuels (diesel and unleaded 95) unchanged to protect households worst affected by the Covid-19 crisis.

The increase in fiscal revenue arising from higher international oil prices could allow the government to bear the full brunt of that increase for consumers without weakening public finances. The government prepared its budget based on an average oil price of USD 67 per barrel. It was expecting to receive MYR 43.9 bn (2.7% of GDP) of oil revenue (in the form of direct and indirect taxes but also dividends paid by Petronas). With the oil price averaging USD 102 in the first three months of 2022, 52% higher than the figure included in the budget, oil revenue could amount to MYR 85 bn (5.2% of GDP), generating a surplus of MYR 41.1 bn compared with the initial budget. The government estimates that the additional cost of subsidies to keep the retail price of petrol unchanged would be MYR 17 bn relative to 2021. So even if it took on the entire burden of higher oil prices, the government would still have extra revenue equal to 1.4% of GDP compared with its forecast budget.

As a result, although no announcement has yet happened regarding food subsidies, it seems likely that the government will introduce support, at least for the most vulnerable households and especially since elections could take place in the second half of 2022. This follows the agreement reached by the government and opposition parties in September 2021 to ensure a certain level of political stability until July 2022.

EXTERNAL ACCOUNTS SUPPORTED BY HIGHER COMMODITY PRICES

Malaysia's balance of payments is solid. In 2021, for the second consecutive year, the country's net international investment position showed a credit balance equal to 5.9% of GDP. In February, forex reserves amounted to USD 103 bn, the equivalent of 4.9 months of goods and services imports.

Malaysia has a structural current account surplus. In 2021, that surplus fell slightly, by 0.7 points to 3.5% of GDP, due to a larger deficit in the services account (linked to the collapse in revenue from tourism), but the trade surplus was 11% of GDP. Malaysia benefited from the rise in commodity prices and the rebound in global trade. In addition, foreign direct investment accelerated sharply to equal 4.7% of GDP, vs. only 2.7% of GDP on average in the five years preceding the Covid-19 crisis.

CURRENT ACCOUNT BALANCE

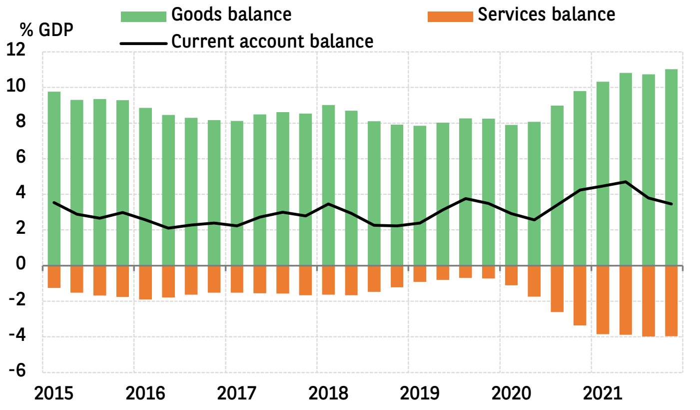

CHART 2

SOURCE: CEIC

Malaysia's external accounts should remain solid in 2022, supported by higher prices of exported commodities and by the reopening of the country's borders to tourists: the services account deficit was 4% of GDP in 2021 as opposed to only 1.4% on average between 2015 and 2019.

In the first two months of 2022, exports grew very quickly (by 20.2% seasonally adjusted), which helped increase the trade surplus. The sharpest rises were for fuel and animal and vegetable oils.

However, the current account balance does face some risk. The extent of the global inflation shock and the Covid-19 shock in China will drag down global demand. In addition, tourist numbers will be limited by the absence of Chinese tourists – who accounted for almost 18% of Malaysia's tourist income pre-Covid – and by the lower real incomes of consumers in all Asian countries (with ASEAN alone making up 50.8% of Malaysia's tourists).

Higher US interest rates could also result in capital outflows, especially if Malaysia's central bank maintains its loose monetary policy. Nevertheless, in February and March, Malaysia continued to see net portfolio investment inflows (according to IIF figures). Like most commodity exporters, Malaysia has benefited from an increase in investor confidence. As a result, and unlike most currencies of other ASEAN countries, the ringgit has been relatively stable against the dollar since the start of the year.

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