MALAYSIA

NORMALISATION AFTER THE STRONG REBOUND IN 2022

Malaysia's economy held up well in 2022. Economic growth may have exceeded 8% and public finances strengthened thanks to the sharp rise in oil revenues. Furthermore, although external accounts weakened due to capital outflows and increased imports, the current account balance remained in surplus and the ringgit depreciated moderately against the dollar over the year as a whole. The outlook for 2023 is less favourable. Economic growth is expected to decelerate given the monetary tightening and the global economic slowdown. Public finance risks are still contained even though debt remains above pre-crisis levels. The new government should present its 2023 budget in parliament at the end of February. Its budgetary strategy should be in line with that of the previous government. The main question is whether the goods and services tax should be reintroduced or not.

SIGNIFICANT SLOWDOWN IN GROWTH IN 2023

Over the first three quarters of 2022, real GDP growth reached 9.3%, supported by the dynamism of domestic demand and a positive contribution from net exports in the third quarter.

Economic activity was particularly dynamic in the construction and services sector. The increase in subsidies on energy and food prices helped limit the impact of rising international prices on household purchasing power. In addition, the return of tourists, the upturn in the labour market and the increase in minimum wages boosted domestic demand. Although the number of tourists remains 37% lower than pre-COVID-19, it has multiplied by more than 3.2 since the borders reopened in April 2022.

Similarly, although still more fragile than before the crisis, the labour market has strengthened significantly over the past twelve months. Employment rose by 3.6% in the third quarter of 2022 and the unemployment rate fell to 3.7% in October, 0.7pp less than at the same time last year. The labour participation rate continued to rise, reaching 69.7% in October. Wage increases continued, particularly in the services sector (+8.7% in Q3-2022), the main job creation sector.

Economic growth probably slowed significantly in the fourth quarter of 2022. Since September 2022, economic activity indicators have showed a slowdown in retail sales and industrial production. Business confidence deteriorated significantly in conjunction with rising production costs. In addition, exports gradually declined after reaching a high point in August and this movement is not expected to reverse in the first quarter of 2023 due to the resurgence of the COVID epidemic in China. Nevertheless, despite the slowdown in activity in the fourth quarter, economic growth may have exceeded 8% over 2022 as a whole.

Growth forecasts for 2023 are much less favourable. They have been revised downwards by the World Bank and the Asian Development Bank since September. The Malaysian economy is much more exposed to the international environment than other Asian countries, and the risks of recession in Europe and the United States are high. Furthermore, domestic monetary tightening should weigh on domestic demand. Over the past twelve months, interest rates deflated by the core inflation (excluding fuel and food prices) have increased by 210 basis points.

Under these conditions, real GDP growth is unlikely to exceed 4-4.5% unless activity in China recovers more rapidly than expected.

CONSOLIDATION OF PUBLIC FINANCES

Public finances strengthened during 2022. Although still above the pre-crisis level, the federal government deficit and debt have decreased and are expected to stand at 5.3% and 62% of GDP respectively over the year as a whole. On the other hand, some structural weakenesses remain: the fiscal base remains relatively narrow (revenues should barely exceed 15% of GDP this year) and the proportion of rigid expenditure remains high (the cost of interest payments, retirement and emoluments accounts for 41% of total expenditure).

Over the first eleven months, the budget deficit fell by 28% compared to the same period last year (-0.7 GDP points) to 5.2% of GDP. This consolidation results from a sharp increase in government revenues (+29.5%) while the increase in expenditure was more modest (+11.1%)

FORECASTS

	2020	2021	2022e	2023e	2024e
Real GDP growth, %	-5.5	3.1	8.0	4.0	4.8
Inflation, CPI, year average, %	-1.2	2.5	3.4	3.0	2.0
General Gov. balance / GDP, %	-6.2	-6.4	-5.3	-5.2	-4.6
General Gov. debt / GDP, %	62.1	63.5	62.0	63.0	63.5
Current account balance / GDP, %	4.2	3.8	2.0	1.5	2.2
External debt / GDP, %	67.6	70.0	67.5	65.0	62.5
Forex reserves, USD bn	100	104	98	100	104
Forex reserves, in months of imports	6.2	5.7	4.9	5.0	5.4

TABLE 1

e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

MALAYSIA: PUBLIC FINANCES

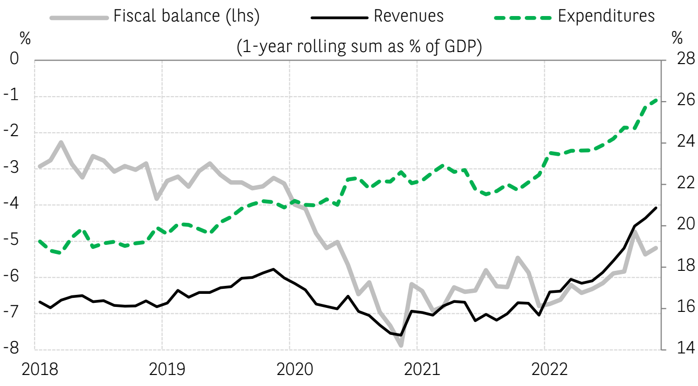

CHART 1

SOURCE: BNM, BNP PARIBAS

despite the significant increase in subsidies (multiplied by almost 1.6). This increase in revenue can be explained both by the strong recovery in economic activity and by the soaring oil prices. In fact, over the first three quarters of 2022, revenues from petroleum activities reached levels not seen since 2014 and accounted for 27.3% of total government receipts. Indeed, according to the latest forecasts from the Ministry of Finance, the dividends paid by Petronas alone should reach MYR50 billion (i.e. more than 17% of total revenues for the year) without taking into account direct taxes from companies in the oil sector (7% of total income) and indirect taxes on sales of oil products. The increase in budgetary revenues for 2022 will therefore only be temporary unless the new government decides to reintroduce the tax on goods and services, which was abolished in 2018. Such a project had been contemplated by the former government but was not voted on before the dissolution of parliament.

In terms of expenditure, over the first three quarters of 2022, the cost of interest payments compared to revenue, although still higher than the pre-crisis level, fell to 14% compared with over 16% in 2021.

The budget for 2023 is expected to be presented on 24 February by the new Prime Minister Anwar Ibrahim (also Minister of Finance). The budget initially presented in October by the former government provided for a reduction of the deficit from 5.8% of GDP in 2022 to 5.5% of GDP. Although the new government is expected to further consolidate its public finances, it has however announced that it does not wish to increase tax pressure and that it will continue its efforts to support growth. In particular, it wants to focus more on subsidies for the most disadvantaged households. In addition, capital expenditure should continue to rise in order to compensate for infrastructure failures, particularly in road and rail transport.

In Q3 2022, debt stood at 61.6% of GDP. Although it remains high, refinancing risks are contained. Debt is almost exclusively denominated in local currency (at 97.2%) and held mainly by domestic investors (77.6%).

TEMPORARY STRESS ON EXTERNAL LIQUIDITY DESPITE THE CURRENT ACCOUNT SURPLUS

Malaysia has a structural current account surplus. Although falling significantly during 2022, it remained in positive territory and should stay there in 2023.

In 2022, Malaysia benefited from the rise in the prices of exported commodities (palm oil, hydrocarbons). However, the increase in exports over the first three quarters of the year (+2.2 GDP points) was offset by the increase in imports (+4.2 GDP points), particularly in food products and durable consumer goods against a backdrop of a sharp acceleration in domestic demand. Thus, despite the increase in tourism revenues, the current account surplus decreased by 2.3 GDP points compared to the same period last year to just 1.6% of GDP. In the fourth quarter, the drop in imports caused by the economic slowdown and the turnaround in the price of commodities will compensate for the contraction in exports generated in particular by the sharp slowdown in activity in China. Over 2022 as a whole, the current account surplus should therefore stand at 2% of GDP compared with 3.8% in 2021.

In terms of the financial account, like other South Asian countries, Malaysia was not spared by capital outflows generated by the sharp rise in US policy rates. They reached the equivalent of 1.9% over the first three quarters of 2022.

MALAYSIA: TRADE

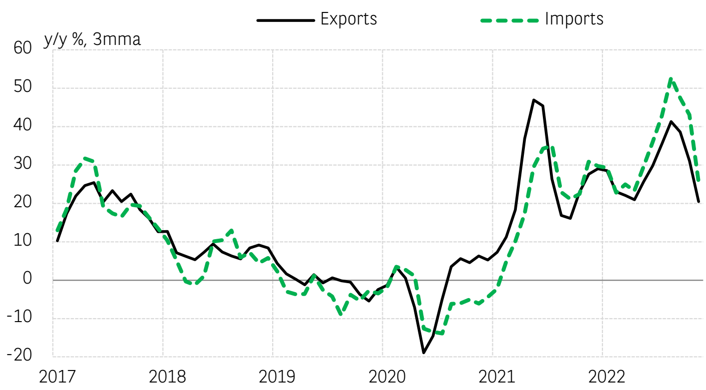

CHART 2

SOURCE: BNM, BNP PARIBAS

The proportion of equities held by foreign investors fell 0.7 points over the past twelve months to just 13.7% in December 2022. The same applies to bonds. On the domestic bond market, foreign investors only hold 12.7% of the bonds (-0.8pp in one year).

Against this backdrop, to contain the depreciation of the ringgit against the dollar, the central bank intervened on the exchange markets, thus generating a drop in foreign exchange reserves of USD10.4 billion between January and October 2022. Since November, downward pressures on external accounts have eased. The ringgit strengthened against the dollar to end the year down only 4.6% and foreign exchange reserves rose once again to USD98 billion at the end of November 2022, the equivalent of 4.9 months of goods and services imports.

The ratio of external debt to GDP remains high, but it fell to 67% of GDP in Q3 2022, despite the rise in the nominal value of debt. The share of external debt denominated in foreign currency remains high (67.8% of total debt) but the risks of revaluation caused by the depreciation of the ringgit remain moderate. In fact, according to the central bank, 67.6% of foreign currency debt is subject to strict currency hedging rules. Furthermore, 14.2% of external debt corresponds to intra-company debt and 11.1% to «commercial» debt naturally covered by export transactions abroad.

The downward trend in the prices of certain commodities (palm oil from the end of April and oil since June), as well as the resurgence of the COVID-19 epidemic in China and the expected recession in advanced countries, are all factors that will weigh on the country's exports in 2023. However, the current account balance is expected to remain in surplus due to the slowdown in imports.

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Completed on 9 January 2023