MALAYSIA

AN ECONOMY HIGHLY VULNERABLE TO THE SLOWDOWN IN CHINA

Economic growth remains solid, but it is expected to slow down in 2025. Due to its very open economy, Malaysia is more vulnerable to the slowdown in China than India or Indonesia. In addition, tensions between the United States and China could make it more complicated to implement its New Industrial Master Plan, a key pillar in the country's efforts to revitalise growth. The authorities have limited room for manoeuvre in order to support the economy. The Central Bank of Malaysia is expected to leave its key interest rates unchanged over the next six months, unlike other central banks in Asia. Inflation risks are on the upside due to the abolition of energy subsidies and wage increases. In addition, fiscal consolidation, which began two years ago, is hurting investment spending.

EXPECTATIONS OF LOWER GROWTH

Malaysia is the emerging Asian country with the highest levels of income (2.5 times the GDP per capita of Indonesia and 1.6 times the GDP per capita of China and Thailand at purchasing power parity), but it has not yet entered the "high income" country category. It may never manage this if it does not successfully speed up the pace of its economic growth, which started to slow down well before the pandemic (from 5.8% over the 2010-2014 period to 4.9% over the 2015-2019 period). Unlike other Asian countries, such as India or Indonesia, Malaysia's growth is structurally more dependent on exports than domestic consumption. However, the country is facing foreign competition, particularly from Vietnam, which has seen its global market share increase over the last ten years, while its own share has virtually stagnated at 1.3%.

As a result, in order to stimulate growth, particularly in the manufacturing sector, the government has adopted the New Industrial Master Plan 2030 (NIMP 2030), which aims to increase its integration into global value chains, particularly in the microelectronics sectors, and to establish itself as a key player in high-value added green technologies. However, implementing this programme could be difficult given its limited fiscal room for manoeuvre. As things stand, according to the latest IMF forecasts, Malaysia's growth is set to slow over the next five years to 3.9% on average per year.

Over the first nine months of 2024, real GDP growth stood at 5.1% y/y (vs. 2.9% in 2023) and is expected to remain at this same level over the year as a whole (vs. 3.6% in 2023). Activity has been buoyed by dynamic household consumption, driven by the strong labour market (the unemployment rate fell to 3.2% in August, slightly below the level prior to the pandemic), wage increases (+5.6% y/y in June 2024 for the median wage), and control of inflationary pressures (1.8% y/y over the first nine months of the year). Investment accelerated and net exports started to make a positive contribution to growth again during the second quarter, due to, in particular, recovering exports of electrical and electronic products, reflecting the upturn in the global electronics cycle.

In 2025, growth is expected to slow. Fiscal policy will be more restrictive and household consumption is likely to slow down as the strong momentum in the labour market is expected to peter out. Growth is expected to stand at between 4% and 4.5% according to the Ministry of Finance's forecasts, which is higher than in Thailand but lower than the other ASEAN countries. The risks to growth remain on the upside. The country is vulnerable to a global economic slowdown, a commodity-price shock and a downturn in the electronics market all at the same time.

FORECASTS

	2021	2022	2023	2024e	2025e
Real GDP growth, %	3.3	8.9	3.6	5.1	4.5
Inflation, CPI, year average, %	2.5	3.4	2.5	2.0	2.8
General gov. balance / GDP, %	-6.4	-5.6	-5.0	-4.4	-3.9
General gov. debt / GDP, %	63.3	60.2	64.3	63.9	63.4
Current account balance / GDP, %	3.9	3.2	1.5	1.8	2.0
External debt / GDP, %	70.0	63.9	68.2	70.8	71.1
Forex reserves, USD bn	104	103	101	107	103
Forex reserves, in months of imports	5.7	4.6	4.5	4.9	4.8

TABLE 1 e: ESTIMATES & FORECASTS SOURCE: BNP PARIBAS ECONOMIC RESEARCH

MALAYSIA: EXPORT REBOUND (VOLUME)

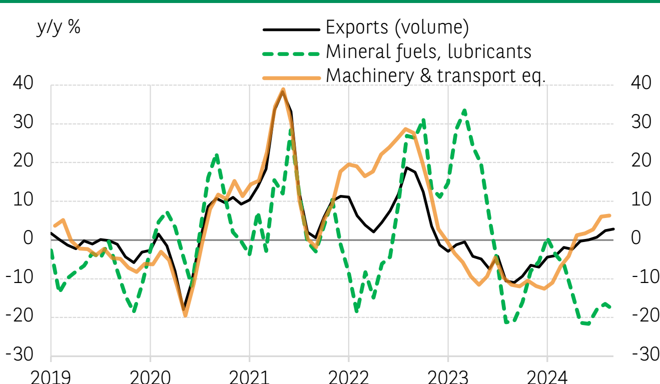

CHART 1 SOURCE: CEIC, BNM, BNP PARIBAS

NO MONETARY EASING IN SIGHT

Unlike other central banks in Asia, the Central Bank of Malaysia (*Bank Negara Malaysia*, BNM) has, for the time being, kept its key interest rates unchanged. It seems unlikely that it will relax its monetary policy over the next six months, as its growth is robust.

In addition, even though inflation is under control, risks are on the upside due to government policy changes. In its 2025 budget, the government stated that subsidies on petrol prices (RON 95) would be fully phased out by mid-2025. In addition, the wages of civil servants will be increased in December 2024 and January 2025 (with the total increase ranging from 7% to 15% depending on the pay grade), as well as the minimum wage for the private sector (+13.3%). This measure will buoy domestic demand but could increase inflation, which is set to stand at between 2% and 3.5% in 2025, according to the Ministry of Finance.

CONTINUED FISCAL CONSOLIDATION

In the budget approved by Parliament in October, the government plans to continue its fiscal consolidation. Although still above its 2019 level, its fiscal deficit is expected to fall from 4.3% of GDP this year to 3.8% of GDP next year, and its primary deficit is expected to decrease by 0.5 pp to 1.2% of GDP. Its expected budget revenue is slightly down on this year (-0.1 pp to 16.1% of GDP) and is set to remain 2.4 percentage points (pp) below the 2019 level. The government refuses to reintroduce the tax on goods and services that had been abolished in 2018 and revenue from oil and gas activity is expected to fall. The reduction in public spending, thanks to the abolition of subsidies, will be used to reduce the fiscal deficit and not to increase investment spending, which will fall to 4.1% of GDP.

Federal debt is expected to remain stable at around 64% of GDP. Debt interest payments should absorb 15.6% of revenue. In the medium term, the government reaffirmed its commitment to bringing down the deficit and debt to 3% and 60% of GDP, respectively.

HIGH VULNERABILITY TO CHINA'S SLOWDOWN

Malaysia is vulnerable to the economic slowdown in China. According to estimates by the Malaysian bank UOB, a drop in Chinese growth of 1 pp would result in a fall in Malaysian growth of between 0.3 pp and 0.5 pp. The slowdown in China is being adversely felt through three channels: i) trade flows (the most prominent transmission channel) and commodity prices, ii) the influx of tourists, and, to a lesser extent, iii) foreign direct investment (FDI).

Malaysia is more integrated into global trade than other ASEAN countries, with exports accounting for 68.6% of GDP (on average over the last five years). In addition, it has become much more vulnerable to global economic cycles, as the concentration of its exports per product has increased since 2016. Apart from Hong Kong and Taiwan, Malaysia is the Asian country with the highest concentration per product. China is its main supplier and second largest export market (13.5% of its exports in 2023), behind Singapore but ahead of the United States. Malaysia mainly exports electrical and electronic products (38.4% of its exports), particularly to China (14.9% of the total), as well as hydrocarbons (which make up 10.5% of its exports to China). Although still modest, its market share in China has increased since 2017 (+1 pp to 4% of total Chinese imports), particularly on sales of electronic products (excluding parts), aluminium, copper and refined oil. However, unlike other Asian countries (such as Vietnam, Taiwan and South Korea), Malaysia has failed to capitalise on the trade frictions between China and the United States to increase its market share on American soil. Since 2017, its market share in the United States has actually fallen slightly, dropping by 0.1 pp to just 1.5% in 2023 (while Vietnam's market share has increased by 1.7 pp to 3.8%). Slower growth in China has already led to a drop in Malaysia's exports over the first nine months of 2024 (-1.9%), particularly its machinery and transport equipment exports (-10.4%).

MALAYSIA: EXPORTS BY COUNTRY

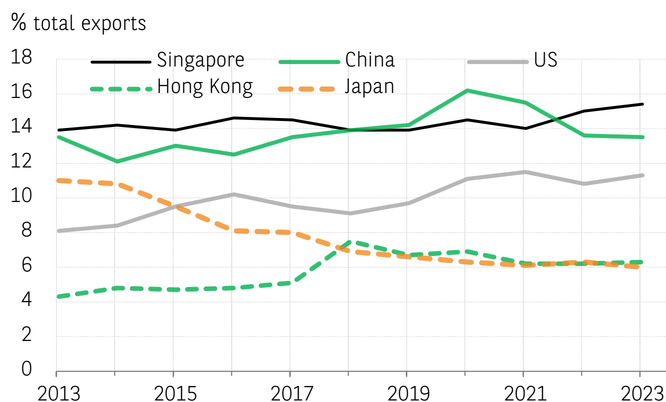

CHART 2 SOURCE: CEIC, BNM, BNP PARIBAS

If the economic slowdown in China was to continue, it could also result in falling commodity prices that would adversely affect not only Malaysia's external accounts, but also its public finances. Commodity exports accounted for 31.4% of its exports in 2023 and income from oil activity is still expected to account for nearly 16% of its fiscal revenue in 2025 (2.7% of GDP). At the end of October, the increase in metal prices in year-on-year terms continued (excluding nickel), but the international price of crude oil was almost 16% lower y/y. The fiscal slippage risks are still currently under control, as budgetary assumptions are fairly conservative (the Ministry of Finance forecasts an oil price of between USD 75 and USD 80 per barrel).

The second channel through which the slowdown in China could adversely affect Malaysia is tourism, with revenues standing at 6% of GDP before the pandemic. In 2019, Chinese tourists accounted for 18% of total tourism revenue, but, in 2023, this revenue was still 5.7 pp below pre-pandemic levels and no rebound is expected in the short term. Household confidence in China is still low and tourist arrivals fell sharply in September.

Finally, in relation to the investment channel, although Chinese FDI has been on the rise since 2021, it is still modest (3.7% of FDI received by the country in 2023) compared to investments from other Asian countries (FDI from Singapore, Hong Kong and Japan accounted for 21.3%, 10.9% and 9.9% of net FDI received by Malaysia in 2023, respectively) and the United States (11.5% of the total). In addition, although the Malaysian government is considering greater cooperation with other Asian economies, particularly with China under the NIMP 2030 plan, its plans could be constrained by geopolitical pressures between China and the United States. This is because the US government could ban its companies from investing in countries where China has businesses operating in order to circumvent restrictive measures.

Johanna Melka
johanna.melka@bnpparibas.com