MALAYSIA

SOLID ACTIVITY, BUT SOME WEAKNESSES MUST BE MONITORED

In Malaysia, economic growth remained robust in 2023 even if it decelerated due to unfavourable base effects. Domestic demand was the principal driver, whereas exports contracted substantially. The outlook for 2024 remains positive and economic growth is expected to recover slightly. The main areas of concern are the developments on the property market and in the construction sector (which contains a large number of the most fragile companies), the consolidation of public finances (which is still happening very gradually) and the evolution of external accounts. Even though Malaysia has a large number of selling points that may attract international investors looking to relocate some of their manufacturing plants outside China, it is facing stiff competition from other ASEAN countries, such as Vietnam.

BELOW TARGET REAL GDP GROWTH

According to the initial estimates from the Malaysian Statistical Institute, real GDP growth stood at 3.8% in 2023 (compared to 8.7% in 2022), which is 0.2 pp below the low end of the government forecast (between 4% and 5%). Domestic demand was the principal driver, while net exports made a negative contribution.

Growth is expected to recover slightly in 2024 but downside risks remain high, in particular due to the expected world economic slowdown. The Malaysian economy is still highly vulnerable to an external shock (Singapore, China and the United States are its top three export partners) and dependent on the global electronics market. In November, the industrial production of electrical and electronic products declined for the sixth consecutive month (-6.8% y/y). The strong labour-market performance and the easing of inflationary pressures should continue to shore up domestic demand in 2024. At the end of 2023, the unemployment rate stabilised at 3.3% (compared to 3.7% a year earlier), while the labour participation rate hit an all-time high of 70.1%. At the same time, real wages continued to grow (+1.3% in Q3 2023) thanks to rising nominal wages and falling inflation. In December 2023, headline inflation was still contained to just +1.5% y/y while core inflation (excluding food and energy) decelerated slightly to +1.9% y/y, below its long-term average (2% over the 2011-2019 period). Inflationary pressures could accelerate in 2024 due to the reduction in food and energy subsidies, but they do not pose a risk to growth.

The risks to the Malaysian economy are still moderate. The first area to monitor worth mentioning is the property market. In fact, sales volumes declined in the second half of 2023 and prices rose by just 0.1% y/y in Q3 2023 (compared to an average of 4.6% in the first half of 2023). The second area to monitor, in connection with the first, relates to the financial positions of households and companies (particularly in the construction sector), as their level of debt is high. Household debt rose again in 2023, standing at 81.9% of GDP in Q2 (after falling to 81% of GDP at the end of 2022). Even though their assets still covered 2.1 times the value of their debt in mid-2023, downward pressures on the property market must be closely monitored, given their level of debt. Furthermore, despite the fact that, according to the Bank for International Settlements (BIS), corporate debt fell to 88.6% of GDP (compared to 95.5% of GDP in Q2 2022), their ability to meet their payments has slightly eroded. Margins fell with rising production costs (the costs of imported products remained relatively high due to the depreciation of the ringgit). The interest coverage ratio fell, but it generally remained very comfortable. Median pre-tax profits still covered interest expenses 5.5 times in mid-2023, compared to 6.5 times at the end of 2022 (with the minimum coverage ratio set at 2). Nevertheless, the Bank Negara of Malaysia (BNM) estimates that 26% of companies had an interest coverage ratio below the prudential threshold (which is 5.7 pp more than over the 2015–2019 period), with this proportion standing at 41.1% for companies in the construction sector.

The final two areas of concern are related to the performance ofpublic finance and pressures on external accounts.

FORECASTS

	2021	2022	2023e	2024e	2025e
Real GDP growth, %	3.1	8.7	3.8	4.3	4.8
Inflation, CPI, year average, %	2.5	3.4	2.5	2.8	2.4
General gov. balance / GDP, %	-6.4	-5.6	-5.0	-4.4	-3.9
General gov. debt / GDP, %	63.3	60.3	63.8	63.9	63.4
Current account balance / GDP, %	3.9	3.1	2.1	2.6	2.9
External debt / GDP, %	70.0	63.9	69.0	67.6	68.0
Forex reserves, USD bn	104	103	101	103	104
Forex reserves, in months of imports	5.7	4.6	4.5	4.5	4.6

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

MALAYSIA: INFLATION UNDER CONTROL

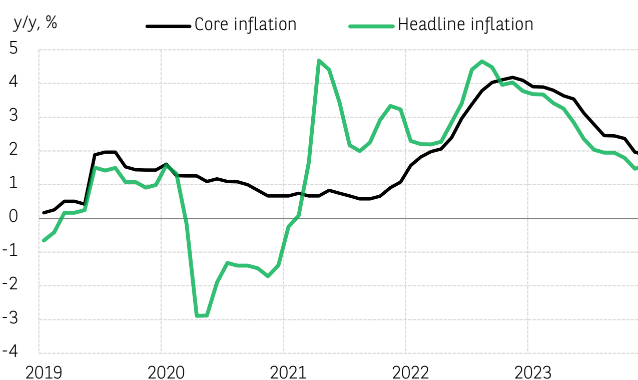

CHART 1 SOURCE: CEIC, BNM, BNP PARIBAS

A MODEST CONSOLIDATION OF PUBLIC FINANCES

The government has limited room for manoeuvre in order to support economic growth. The country's fiscal base, which is already modest, shrank in 2023 and is expected to continue falling in 2024, due to declining oil-related revenues.

The government is still not planning to reintroduce the goods and services tax, which would, however, increase the tax base and reduce its dependence on oil revenues.

In 2023, the deficit is expected to remain high, albeit slightly lower than last year. It should hit 5% of GDP (compared to 5.6% of GDP in 2022), which is above the average recorded over the 2015-2019 period (3.3% of GDP). Total revenues are expected to fall by 0.1 pp to 16.3% of GDP, due to the sharp fall in commodity prices. On a positive note, the burden of interest payments on debt fell slightly, accounting for 13.7% of government revenues over the first three quarters of 2023, compared to 14.1% for the same period in the previous year.

In its 2024 budget, the government is setting out to reduce the deficit by 0.7 pp to 4.3% of GDP. However, this reduction is not reflective of a fully fledged structural consolidation.

On the revenue side, the main measure is the 2-pp rise in the service tax rate, which will be accompanied by measures to expand its base. The government also intends to introduce taxes on luxury goods and capital gains. However, these increases will not be enough to offset the expected drop in dividends received from the national oil company Petronas (-0.4% of GDP). According to government forecasts, revenues will fall to 15.5% of GDP, which is 0.7 pp below the average recorded over the 2018-2022 period.

On the expenditure side, a 0.9-pp cut is planned. The government intends to reduce subsidies (-0.6% of GDP), but the savings made will be used to finance targeted social spending for the most in need. In reality, the reduction in the deficit will essentially mirror the cuts to investment spending, which had risen sharply in 2023 as a result of paying 1MDB's debt. If this one-time expense is excluded, expenditure is expected to be relatively stable in 2024.

In 2023, government debt increased by 2.3 pp to hit 63.8% of GDP (compared to 52.4% of GDP at the end of 2019). However, the debt structure still does not pose a great deal of risk, as it is denominated in domestic currency and held by resident investors.

INCREASED PRESSURE ON THE RINGGIT

During 2023, downward pressures on the currencies of emerging countries, and in particular Asian countries, intensified due to the widening yield spreads between domestic and US bond prices. The Malaysian ringgit experienced one of the sharpest falls against the US dollar (-9.6%) out of all Asian currencies. In nominal and real effective terms, the ringgit depreciated by 3.9% and 4.7% respectively against the currencies of its main partners' countries. This muted depreciation was due to both the declining current account surplus (caused, in particular, by the plummeting trade surplus) and major net capital outflows.

Over the first three quarters of 2023, the trade balance declined by20.5% year-on-year. Exports suffered an even harder decline than imports. Malaysia was hamstrung by the falling demand for electrical products (36.3% of its total exports in 2022) and, in particular, integrated electronic circuits (22.2% of its exports), but also by the decline in prices of exported commodities (mineral fuels and vegetable oils accounted for 17.2% and 6.7% of its exports in 2022, respectively).

The decline in the services deficit, driven by the rise in tourism revenue (which is still 21.4% below its pre-COVID-19 level, however), was not enough to offset the shrinking trade surplus.

MALAYSIA: PRESSURES ON EXTERNAL ACCOUNTS

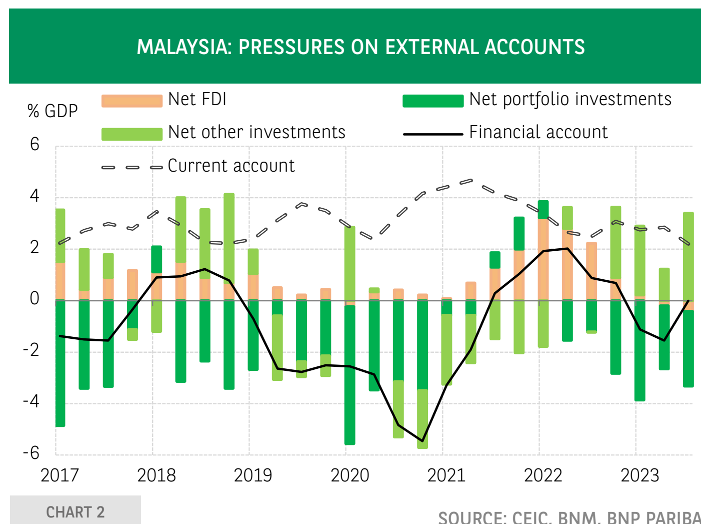

CHART 2 SOURCE: CEIC, BNM, BNP PARIBAS

The current account surplus fell to just 1.7% of GDP over the first three quarters. Even though a slight increase is expected in Q4 2023, it is unlikely to rise above 2.1% of GDP over 2023 as a whole (compared to 3.1% in 2022).

At the same time, net capital inflows plunged. Resident investments abroad increased, whereas non-resident investments in the country (both FDI and portfolio investments) fell.

Inward foreign direct investment decreased by 49% over the first three quarters of 2023 to 1.8% of GDP, which is low in comparison to the FDI inflows over the 2015-2019 period (3.1% of GDP on average). This fall is partially due to a correction after the sharp increase seen in 2021. However, it also mirrors a wider movement that affected many ASEAN countries (-16%, according to UNCTAD), driven by higher financing costs and weaker growth prospects.

However, some ASEAN countries, including Vietnam, saw their FDI inflows increase slightly. Therefore, there are grounds to question how much Malaysia could be challenged by Vietnam. According to national data from the Malaysian Investment Development Authority (MIDA), investment projects in Malaysia are currently still performing well, particularly in the electrical and electronics sector. Malaysia could benefit from some of the relocation of production plants in China in the integrated electronic circuits sector in particular. Malaysia has already capitalised on the trade tensions between China and the United States to increase its market share, which stood at 7.3% of global exports in 2022, compared to 6.3% over the 2017-2021 period.

Its external accounts are expected to recover in 2024, thanks to an expected recovery in demand for electrical and electronic products and an increase in net capital inflows driven by the anticipated decline in bond yields in developed countries. Foreign exchange reserves (down USD 1.7 billion in 2023) are expected to rise slightly to USD 102 billion, which is equivalent to 4.5 months of goods and services imports.

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