ALLIANCEDBS RESEARCH

Economic Focus

Riding on Madani Economy Framework

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- **Sustained domestic demand to more than offset external headwinds**
- **Strategic initiatives under 12MP Mid-Term Review to drive strong economic growth**
- **Budget 2024 to be tabled in Oct 2023 to uplift economy**

No respite from external challenges but the worst could be over

External weakness continues to affect Malaysia's economy as Jul 2023 manufacturing industrial production dipped 0.2% and exports registered y-o-y contraction for five months consecutively. This has been largely anticipated given the aggressive monetary tightening globally to cool down inflation. Nevertheless, China's economic recovery could accelerate after a raft of stimulus measures being introduced recently which could help improve our exports performance. The recent rebound in commodity prices due to increased imports from China also bodes well for our external trade. Meanwhile, the global technology downcycle may have bottomed in view of the fifth straight successive m-o-m increase in global semiconductor shipments, potentially lifting our E&E exports towards late-2023.

Sustained strength in household spending

Amidst a relatively weak external environment, Malaysia's economy continues to take comfort from its resilient domestic demand, underpinned by healthy household spending as wages and employment continue to increase. The record high labour participation rate of 70.1% in Jul 2023 is an added booster to further sustain our strength in private consumption (60% of Malaysia's economy) despite the high base effects in 2022. Unemployment rate remains on a downward trajectory on a m-o-m basis, indicating a robust employment market. This comes at an opportune time for Malaysia to resolve its fair share of challenges such as subdued sentiment, low wages and high living cost which the Malaysian government remains committed to tackle.

Economic reform for a progressive Malaysia

The 12th Malaysia Plan Mid-Term Review has turned out to be the cornerstone of the government's reform initiatives as fiscal sustainability and subsidies retargeting have been highlighted as among the 17 key focus areas. Details for broadening the revenue base and retargeting of subsidies such as electricity and petrol are expected to be included in the Budget 2024 to be tabled in Oct 2023. In addition, more incentives related to the implementation of the National Energy Transition Roadmap (NETR) and the New Industrial Master Plan (NIMP) 2030 are likely to be introduced as the government strives to enhance economic competitiveness, drive digitalisation and achieve net zero agenda. More importantly, Budget 2024 is expected to contain a development expenditure of >RM90bn (vs ~RM84bn in 2023 excluding 1MDB payment) while the budget deficit should inch below 4.5% (vs 5% in 2023).

Domestic demand to underpin economic resilience

Despite the external challenges, we remain cautiously optimistic of the growth prospects of Malaysia and expect a healthy 2023 GDP growth of 4.1%. Private consumption continues to be the key growth driver, underpinned by robust labour market and strong economic and social activities, especially the tourism-related activities. On the other hand, Malaysia's diversified export base and deep integration into global supply chain will ensure our trade resilience. Key downside risks will be weaker-than-expected global growth outlook and volatile global financial conditions.

Weakening growth momentum expected

Malaysia registered a relatively weaker 2Q23 GDP growth of 2.9%, taking 1H GDP growth to 4.2% which was in line with our expectation. For 2Q23, growth momentum has understandably moderated given the impressive recovery last year, but healthy expansion was observed in domestic demand (+4.5% y-o-y), only to be dragged by a slowdown in net exports (-3.7% y-o-y) amid a global technology downcycle.

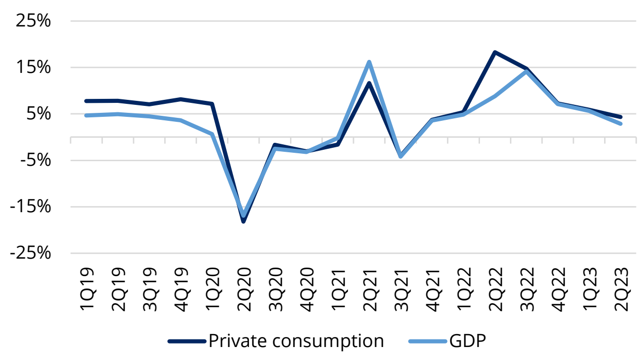
Admittedly, a widely anticipated external weakness has spilt over to Malaysia's economy, dragging our manufacturing sector which contributes ~24% of our GDP. As external trade remains comparatively weak, economic growth is likely to remain subdued in 3Q23. Nevertheless, the external challenges are expected to be more than offset by resilient domestic demand given the robust labour market as unemployment rate dipped to 3.4% in Jul 2023.

We believe the resilient household spending is likely to continue, in tandem with the continued recovery in the labour market. Meanwhile, the implementation of new and existing investment projects under the NETR and the NIMP 2030 are expected to have a positive impact to economic growth as more investment are expected from both domestic and foreign investors.

In addition, inbound tourist arrivals are expected to recover over the course of 2023 after the gradual pace of recovery in 1H23. As international passenger traffic has only reached ~75% of pre-pandemic level, there is still more room for improvement which will help contribute to domestic expenditure.

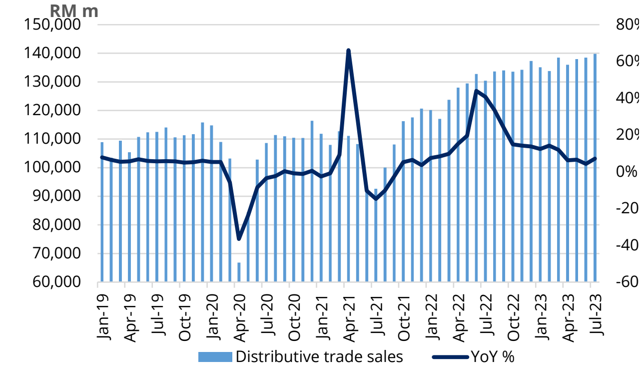
We expect Malaysia to register a healthy GDP growth of 4.1% in 2023 after an impressive growth of 8.1% expected for 2022. This is also in line with the government's 2023 GDP growth projection of 4%-5%.

Malaysia's GDP growth



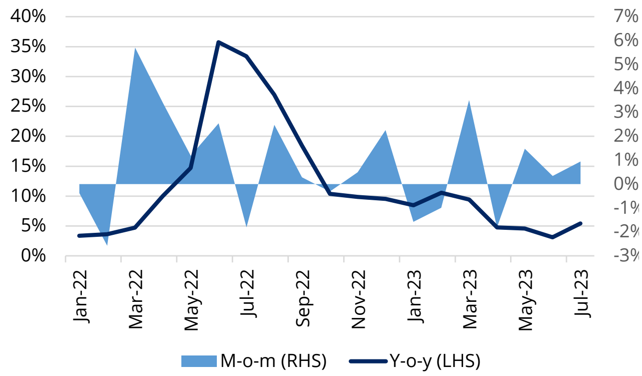
Source: AllianceDBS, CEIC

Monthly wholesale & retail sales



Source: AllianceDBS, CEIC

Distributive trade sales on healthy growth trend



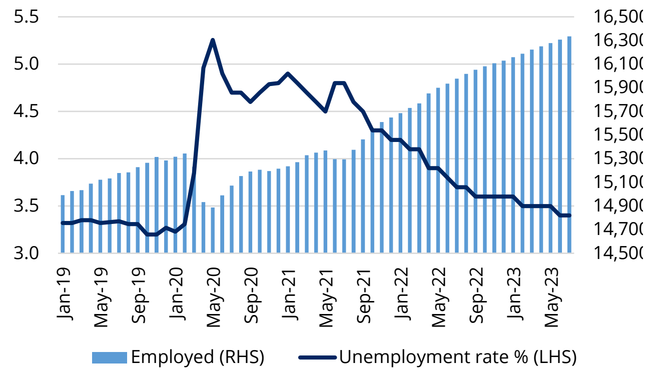
Source: AllianceDBS, CEIC

Robust labour market condition

Malaysia's economic growth momentum will continue to be underpinned by the robust employment market which has been growing from strength to strength. Malaysia's unemployment rate in Jul 2023 came in at 3.4%, compared to 4.2% in Jan 2022. Notably, we are encouraged by the continuous growth in employment market outpacing the growth in labour force, lifting the labour participation rate to a record high of 70% in Jul 2023. This will certainly bode well for the economic outlook in 2023 given that domestic demand forms the bulk of our economy.

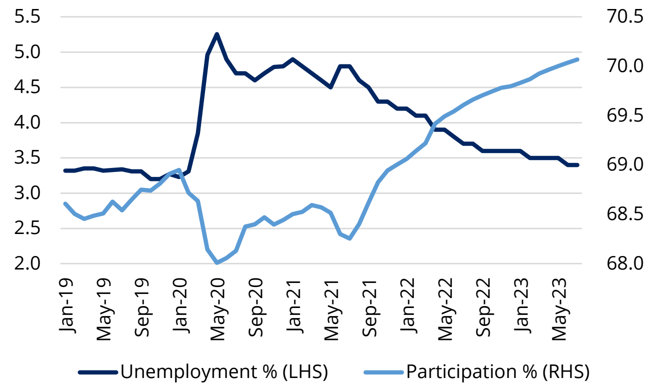
Going by the healthy growth momentum of Malaysia's economy in 2023, the robust labour market condition will ensure that the growing working-age population is met with higher employment opportunities. We believe Malaysia's unemployment rate will continue to decline towards pre-pandemic level of 3.3% by end of 2023.

Strong labour market



Source: AllianceDBS, CEIC

Favourable labour market dynamics

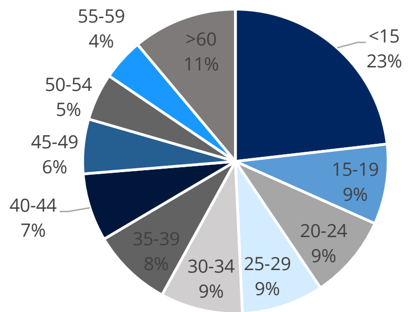


Source: AllianceDBS, CEIC

We believe this healthy strength in the employment market is a key growth pillar that will continue to sustain Malaysia's economic growth as the country enjoys the demographic dividend. The median age of Malaysia's population is relatively young at 30.7 years, underpinning the healthy growth in our labour force.

According to the Department of Statistics Malaysia, Malaysia's population is expected to grow by 2.1% to 33.4m in 2023, compared to 0.4% growth to 32.7m in 2022. The astounding growth projection in 2023 is largely due to the sharp increase of non-citizens from 2.5m to 3m, in line with the reopening of national borders starting from Apr 2022 and the implementation of the employment recalibration program 2.0 since Jan 2023.

Malaysia's 2022 demographic breakdown by age



Source: AllianceDBS, CEIC

As the Malaysian government continues to advance its economic transformation agenda by attracting more quality investment to Malaysia, international migration especially skilled labour force could further lift the overall employment market in Malaysia. According to the 12MP Mid-Term Review (MTR), Malaysia's population is projected to grow by 4.9% in 2023-2025, implying annual growth rate of 1.6%. This could be in tandem with the various investment programs undertaken by the government.

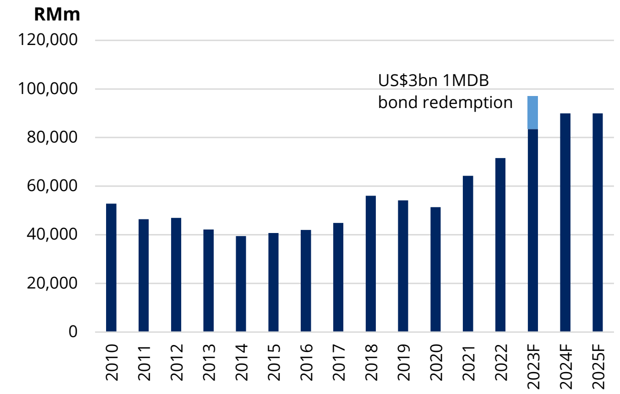
Madani Economy sets the tone for reform

The government has been unveiling several key policies over the past three months, starting with the introduction of Madani Economy Framework in Jul 2023 which serves as a guiding principle over the next 10 years to propel Malaysia's goals to achieve a progressive, inclusive and dynamic economy. Since then, the NETR and the NIMP 2030 have been rolled out, both of which have the lofty ambitions of lifting Malaysia's economic competitiveness and elevating the overall socioeconomic status of the people.

Meanwhile, the 12MP MTR 2021-2025 has been tabled in the Parliament recently which serves as a comprehensive policy document that strives to address major economic challenges of Malaysia, namely disparity in development and income, limited fiscal space and slow structural transition of the economy over 2023-2025. The 12MP MTR details its 17 "Big Bolds" initiatives that shape the main strategies accordingly, incorporating governance and institutional reforms, fiscal sustainability and socioeconomic upliftment.

Among the salient highlights of the 12MP MTR include an upward revision of GDP target to 5%-6% from 4.5%-5.5% as 2021-2022 GDP growth outperformed on low base in 2020 due to the COVID-19 pandemic. The government is also committed to allocate development expenditure of at least RM90bn per annum for 2023-2025, an indication that existing and new investment projects will continue to strengthen our economic growth.

Rising development expenditure



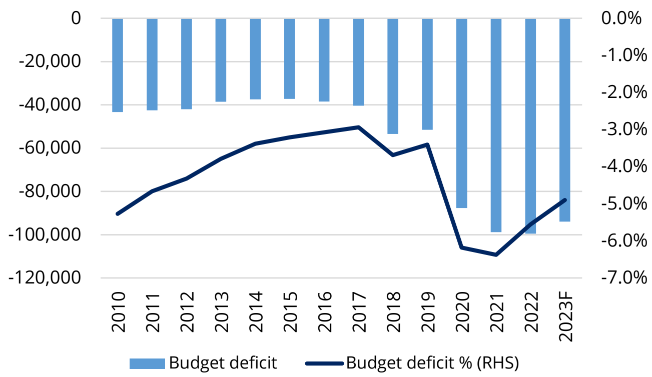
Source: AllianceDBS, BNM, Ministry of Economy

12MP MTR will focus on infrastructure spending as some major projects such as Johor BRT, Subang and Penang airport expansions, new phases of Sabah Pan Borneo Highway and Sarawak-Sabah Link Road, Trans Borneo Highway, as well as expansion of North-South Expressway and Senai-Desaru Expressway. All these developments involve investments that are supportive of economic development.

Fiscal sustainability has often been cited as a key concern for Malaysia given the fast-rising federal debt on persistent budget deficit throughout the years. The 12MP MTR has specifically touched on subsidies retargeting given ballooning subsidy budget is not sustainable for the government. The implementation of subsidies retargeting via a single database marks a critical milestone for the government to address the issue of high subsidy.

PADU (Pangkalan Data Utama), a new single database integrating all databases will be used as the main reference for socioeconomic assistance that includes poverty alleviation and targeted subsidy programs. The central database is set to go on trial in Nov 2023 before being rolled out in early 2024, ensuring the right target groups benefit from assistance. According to the Ministry of Finance, RM50.8bn was spent on petrol, diesel and LPG subsidies in 2022, of which 35% or RM17bn benefitted the T20 high-income group. Assuming half of the subsidy for the T20 is saved by the government, this could easily shave off 0.4% budget deficit.

Consolidating budget deficit



Source: AllianceDBS, BNM, Ministry of Economy

In addition to subsidy retargeting, broadening tax revenue base is also the key focus of the federal government under the 12MP MTR. Electronic invoicing and repurposing excess fund from government agencies are some of the measures will be implemented. Introduction of new taxes could also be on the cards as reported by the media quoting remarks from top government officials. Given the commitment to further improve budget management, the budget deficit target of 3.5%-3% in 2025 may not be too farfetched if the promised initiatives do take place.

Madani Economy Framework to gear up economic growth

We expect more concrete details related to the 12MP MTR to be revealed in Budget 2024 which will be tabled on 13 Oct 2023. A narrower budget deficit with higher development expenditure to boost economic growth will certainly be a significant confidence booster to the financial market as this indicates great development potential for Malaysia under prudent fiscal management.

GDP revision under 12MP MTR

Demand side	2022 share	11th MP 2016-2020	12th MP Initial	Revise	2021-2022	2023-2025
Private Consumption	60%	4.8%	5.8%	6.2%	6.4%	6.1%
Private Investment	15%	1.2%	3.8%	5.8%	4.9%	6.4%
Public Consumption	13%	3.1%	3.7%	3.2%	5.5%	1.7%
Public Investment	4%	-7.9%	2.6%	1.0%	-3.3%	3.9%
Net exports	5%	-0.3%	3.1%	1.0%	-2.5%	3.4%
	GDP	2.7%	4.5%-5.5%	5.0%-6.0%	5.9%	5.0%-5.5%

Supply side	2022 share	11th MP 2016-2020	12th MP Initial	Revise	2021-2022	2023-2025
Services	58%	3.8%	5.2%	6.0%	6.5%	5.7%
Manufacturing	24%	3.2%	5.7%	6.4%	8.8%	4.9%
Agriculture	7%	0.3%	3.8%	1.6%	0.0%	2.7%
Mining	6%	-2.1%	2.6%	2.6%	1.8%	3.1%
Construction	4%	-0.6%	4.2%	3.9%	-0.2%	6.7%
	GDP	2.7%	4.5%-5.5%	5.0%-6.0%	5.9%	5.0%-5.5%

Source: AllianceDBS, BNM, Ministry of Economy

Federal government's financial projection

Federal Government Finance (RMm)	**Initial 2021-2025**	**Revised 2021-2025**	**2021**	**2022**	**Budget 2023**	**12MP MTR 2023-2025**	**average p.a.**
Revenue	1,227,816	1,432,941	233,752	294,357	291,500	904,832	306,666
Operating expenditure	1,231,517	1,425,376	231,515	292,693	289,140	901,168	306,014
Current balance	(3,701)	7,565	2,237	1,664	2,360	3,665	653
Gross Development expenditure	400,200	400,207	64,257	71,574	97,000	264,376	83,688
Less: Loan recovery	3,100	5,176	990	1,407	700	2,779	1,040
Net Development expenditure	397,100	395,031	63,267	70,167	96,300	261,597	82,649
COVID-19 fund	47,000	68,690	37,711	30,979			
Overall balance/(deficit)	**(447,801)**	**(456,156)**	**(98,741)**	**(99,482)**	**(93,940)**	**(257,932)**	**(81,996)**
% of GDP	**(3.5) - (3)**	**(3.5) - (3)**	**(6.4)**	**(5.6)**	**(5.0)**	**(3.5) - (3)**	

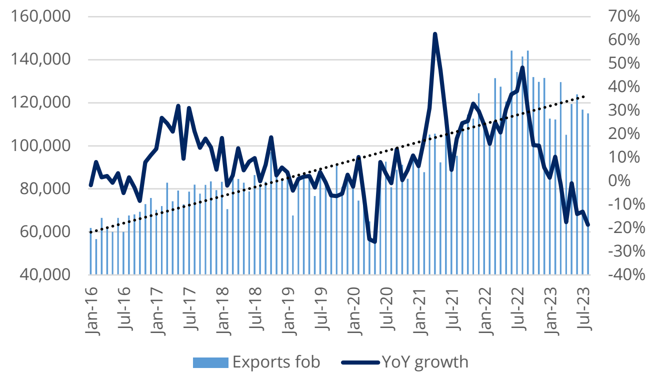
Source: AllianceDBS, BNM, Ministry of Economy

External weakness

Slow trade activities have continued unabated as demand weakness lingers on and China's economic recovery has been lacklustre so far. Malaysia exports have not been spared by the sluggish trade as monthly exports have been seeing contraction on a y-o-y basis for six months consecutively. Slowdown is apparent across key export items including E&E, petrochemicals and commodities which collectively account for more than 60% of Malaysia exports. The higher-for-longer narrative for interest rate development in developed economies suggests that demand will remain relatively subdued in the near term.

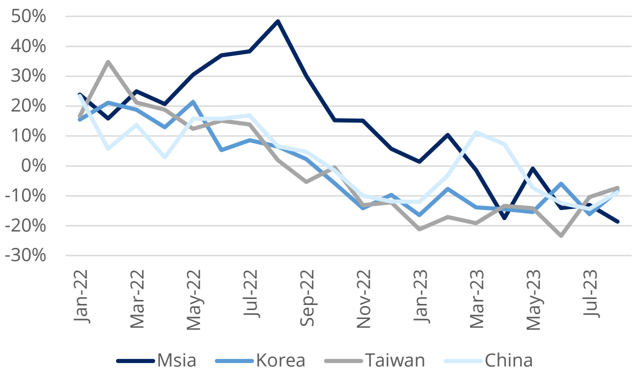
Amid all the doom and gloom, China has started to show signs of stabilizing as export growth decline is narrowing, consumption is performing better than expected and investment growth is stabilizing. As the government has been introducing a slew of stimulus measures, China's economic recovery may gather pace in 4Q23. As its largest trading partner, Malaysia will certainly benefit from a strong growth in China.

Moderating monthly exports



Source: AllianceDBS, CEIC

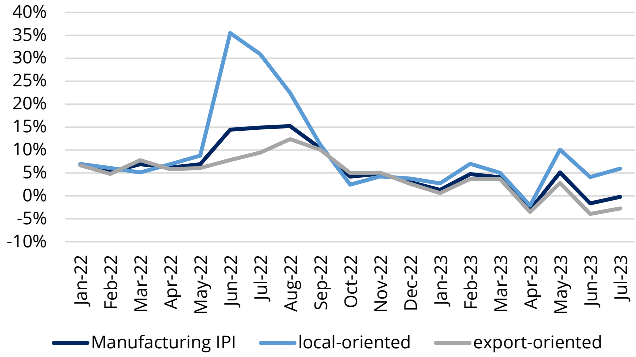
Malaysia's declining exports in line with key Asian exporters



Source: AllianceDBS, CEIC

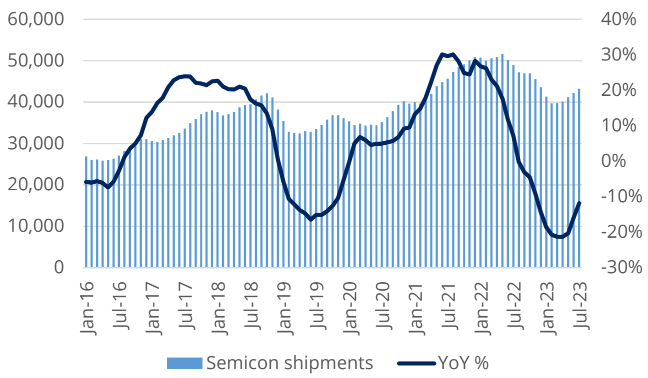
The demand weakness has been reflected in the sluggish manufacturing production which remained in contraction in Jun-Jul 2023. The decline was largely underpinned by export-oriented manufacturers given weaker demand arising from inventory de-stocking. To a certain extent, the relatively subdued export-oriented manufacturing activities will be offset by domestic-oriented industries given our resilient demand locally.

Local-oriented industries' production holding up well



Source: AllianceDBS, CEIC

Global semiconductor shipments



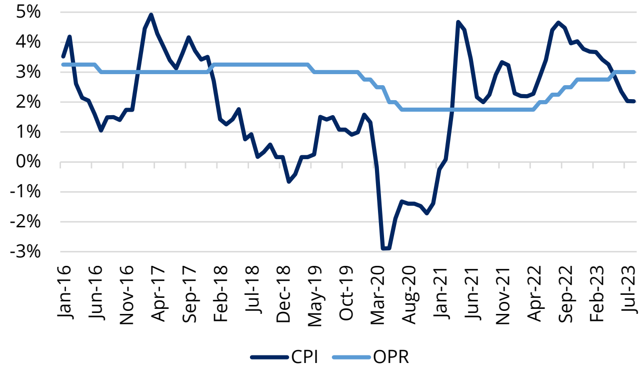
Source: AllianceDBS, SIA, CEIC

As we progress toward 2024, there is a possibility that the global technology downcycle may have bottomed out given the narrowing decline in global semiconductor shipments. E&E accounts for ~40% of Malaysia's exports and it has a deep integration with the global supply chain which makes it vulnerable to the global trend. After enduring a deceleration for much of 2023, the prospect of Malaysia's resilient E&E sector may be better going forward.

Moderating loans growth momentum

Following Bank Negara Malaysia's interest rate hike by 25 bps to 3.0% in May 2023, the central bank has paused for the past two meetings. As the OPR has reverted to its pre-pandemic level, we believe that the BNM will remain with this slightly accommodative interest rate for the rest of 2023 as the current monetary policy remains conducive to sustainable economic growth amid price stability.

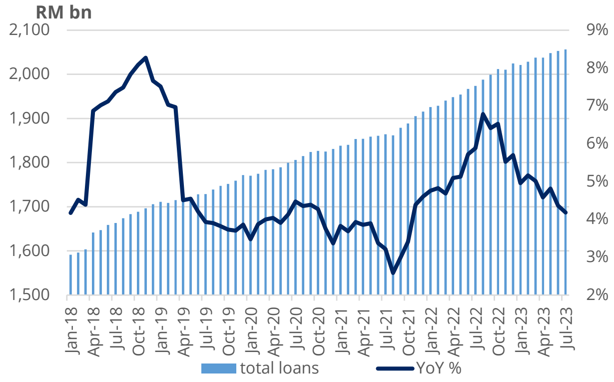
Interest rate vs inflation



Source: AllianceDBS, DOSM, CEIC

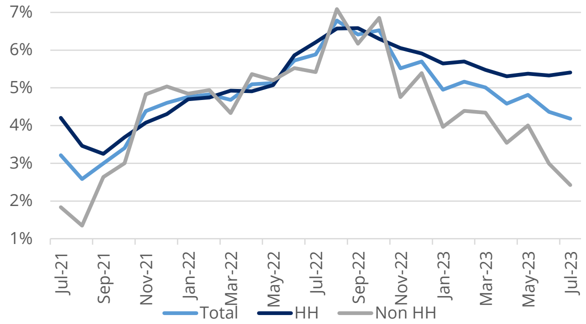
Our headline inflation has been moderating over the course of 2023, in tandem with the easing momentum of price increases which is expected to continue for the remainder of 2023. This has also resulted in positive real rates after staying negative for the past two years. Going forward, inflation outlook will be largely swayed by the global commodity price developments as well as the implementation of subsidy rationalisation in 2024.

Robust banking system loans growth



Source: AllianceDBS, BNM

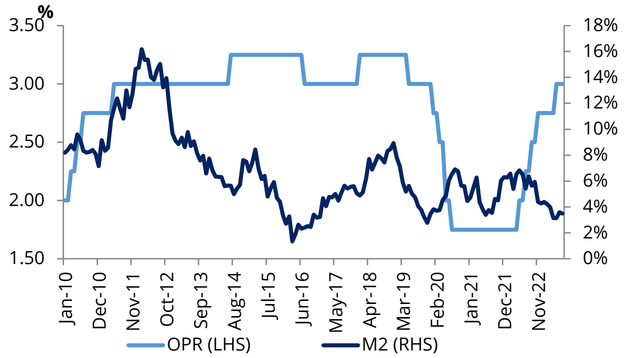
Resilient household loans growth



Source: AllianceDBS, BNM

Reflecting the relatively slower economic growth momentum, Malaysia's banking system has also recorded moderating loans growth which stood at 4.2% in Jul 2023, compared to 5.7% in Dec 2022. This is largely attributable to weaker demand from non-household sectors, possibly due to higher financing rates and uncertainties arising from global developments. On the other hand, household loans growth remained firm at 5.4%, in tandem with resilient domestic expenditure. This diverging scenario may persist in the near term as businesses assess the macroeconomic environment before committing to new loans.

Normalising liquidity condition in the economy



Source: AllianceDBS, BNM

Meanwhile, M2 money supply continues to grow at a healthy level of mid-single digit despite the consecutive interest rate hikes due to the lag effects of monetary policy on the economy. Therefore, it is likely that the domestic liquidity remains sufficient, with continued orderly functioning of the financial market. Household spending will continue to be underpinned by improvements labour market conditions and income prospects.

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