



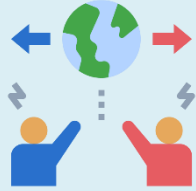
社会经济研究中心
**SOCIO-ECONOMIC
RESEARCH CENTRE**

**Opus Asset Management/Abbas Investment Management
2023 Outlook: Ready For Reset**

**A Fundamental Reset for Malaysia:
Are We On The Right Track?**

**Lee Heng Guie
Executive Director
14 March 2023**

A “Delicate” moment for the global economy



“CONFLICT”

Geopolitical tensions between China and the US as well as fragmentation

- Globalization is facing perhaps its biggest trial since the establishment of the Bretton Woods system.
- The world is at risk of a more permanent fragmentation of the global economy into geopolitical blocs with distinct technology standards, cross-border payment systems, and reserve currencies.



“COSTS”

Inflation, business costs, credit cost (higher interest rate)

- The Great interest rates reset - Recessionary risks, but crisis unlikely.
- Monetary tightening, higher cost of credit, cost-of-living crisis and high uncertainty will undoubtedly dent growth in 2023.
- Tight global financial conditions worsen debt stress; and financial insolvency for some distressed banks.



“CLIMATE”

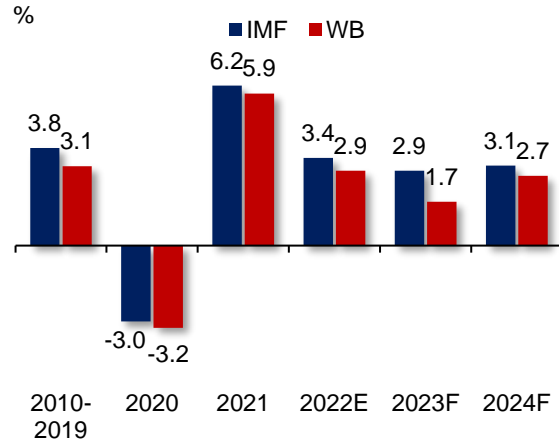
The existential threat of climate change

- Global public-private partnership to address global challenges - demographics, migration, cyber-risks and, of course, the existential threat of climate change. No country can solve alone.
- Innovation and technology to reduce greenhouse gas emissions.
- Solar wind, tidal power, small modular nuclear, batteries, EVs and power grid applications together have good scope to lead of the next productivity boom.

Global recession fears receded, but headwinds still persist

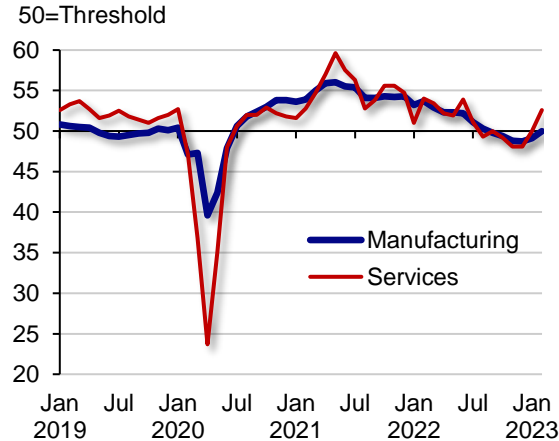
2023: Weaker global economic growth

Global growth estimates



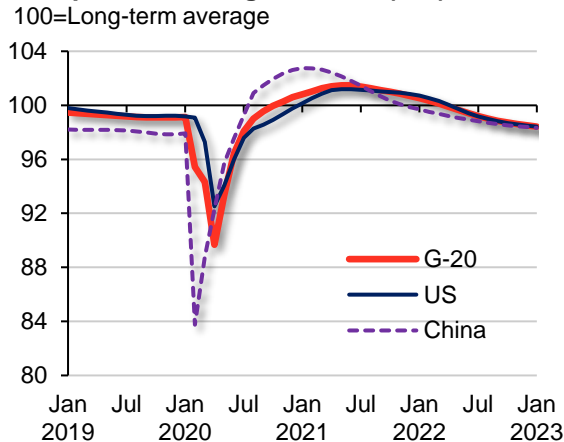
Manufacturing & services activities appears stabilising

Global PMI for manufacturing & services



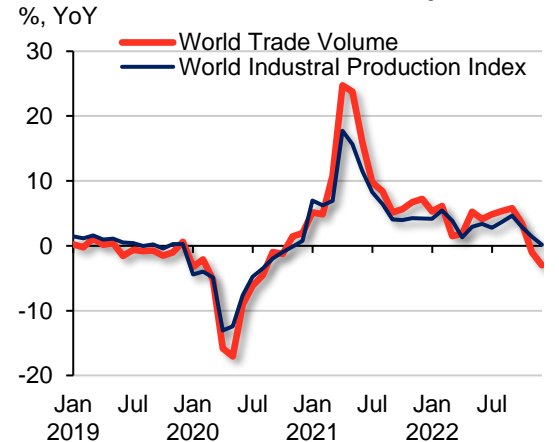
CLI for G-20 remained below long-term average

Composite Leading Indicator (CLI)



WTO: World trade remains subdued in 2023 (1.0% vs. 3.5% in 2022E)

World trade volume & industrial production



Global economy: Slightly less gloomy but headwinds persist

- A “mild and shallow” recession in the US
- China’s reopening eases global recession risk
- Global inflation may have peaked but pressures continue
- Central banks’ subtle monetary shift, not pivot to rate cuts

Upside risks

- 📈 Strong labour market conditions and wage growth
- 📈 China’s consumers release strong pent-up demand
- 📈 Pause in global monetary tightening amid concerns of financial contagion and cooling of inflation

Downside risks

- 📉 Escalation in Russia’s war in Ukraine
- 📉 Higher-than-expected interest rate level
- 📉 Tighter global financing conditions worsen debt distress
- 📉 Significant assets repricing on worse than expected economic slowdown
- 📉 Deepening geopolitical fragmentation

Source: International Monetary Fund (IMF); World Bank (WB); S&P Global; Organisation for Economic Co-operation and Development (OECD); CPB Netherlands

What it will take for the Fed to ease up? Will the financial tremors muddle the Fed's inflation fight?



Better balance between labour supply and demand



Slowing aggregate demand



Easing supply chain disruptions



Reduction in the breadth of inflation



Stable inflation expectations

What data shows?



The labour market shows no fresh signs of deterioration with minimal job layoffs (US jobless rate at 3.6% in Feb 2023).



Consumer spending increased by the most (1.8% mom in Jan 2023) in nearly two years amid a surge in wage gains.



Inflation slowed slightly to 6.4% in Jan 2023 (6.5% in Dec 2022), with the 'most important' measures remaining elevated



No disinflation

What did Jerome Powell say?
“interest rates are ‘likely to be higher’ than previously anticipated”

“the current trend shows that the Fed’s inflation-fighting job is not over”

Market consensus of the Fed funds rate in 2023:

- Between 5.25%-5.50%
- A slim chance of going to 6.0%



Malaysia will slow (growth normalisation) in 2023



“CONSUMPTION”

Can private consumption hold the fort?

- Waning consumption driven factors
- Rebuild savings



“CONFIDENCE”

Confidence, NOT hope

- Can Malaysia reform for better?
- Can the Government restore investors' confidence?
- Not “OPTICS” but real changes though the pace of reforms may be incremental



“COSTS”

Inflation, business costs, high debt and higher interest rate

- Cost of living pressures reduce disposable income
- Increased business costs dampens profit margin
- Prices pressures persist – targeted subsidy rationalisation to kick in gradually

The Great Reset for Malaysia – Address structural issues



Low productivity and technology adoption

- Malaysia's labour productivity grew moderately by 1.4% pa in 2011-2021 vs. Singapore (2.5%); Thailand (2.5%), Vietnam (5.0%) and Philippines (3.5%)



Talent and skilled manpower shortages; high youth unemployment

- As at 4Q 2022:
 - Skilled workers (27.9%)
 - Semi-skilled (59.4%)
 - Low-skilled (12.7%)
- Youth (aged 15-24) unemployment rate at 11.8% (331k persons) at December 2022, but still higher than pre-pandemic (2019:10.4%)



Low wages; dependency on foreign workers

- Median monthly wages grew by 2.5% pa in 2016-2021 to RM2,250
- Share of compensation of employees (CE) to GDP in 2021 at 34.8% vs. South Korea (47.9%); Australia (47.7%); Singapore (39.4%); and the Philippines (36.7%)
- As at end-2022, 1.46 million foreign workers (9.2% of total employment)



Uneven strength of private investment

- Private investment growth stagnated (4.9% pa in 2021-2022 vs. 4.8% pa in 2015-2019)
- Private investment share to GDP at 15.4% in 2022 vs. average 17.0% of GDP in 2015-2019
- FDI average RM53.6 billion per year in 2020-2022 vs. RM41.1 billion in 2015-2019

The Great Reset for Malaysia – Address structural issues (cont.)



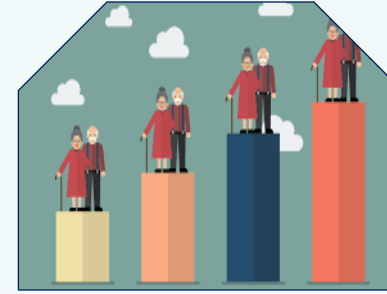
Limited fiscal space; high debt and liabilities

- 26th consecutive year of deficit
- Federal Government's direct debt stood at RM1.08 trillion (60.4% of GDP) at end-Dec 2022; and is projected to be around 62% of GDP by end-2023
- Debt and liabilities (80.6% of GDP in 2022)



High household debt; low savings buffer

- Household debt at 84.5% of GDP as at 1H 2022
- 76% of households have savings less than three months of living expenses



Ageing population; demographic dividends

- In 2022, more than 7% of the population are aged 65 and above, meeting the conventional international definition of an “aging society”
- Higher economic and fiscal implications – healthcare, community services, potential decline GDP, and decline in tax revenue



Retirement savings crisis

- 6.67 million or 51.5% of EPF members younger than 55 had less than RM10,000 in their accounts as of end-2022, up from 6.08 million a year ago

The Malaysian economy has risen above pre-pandemic level, albeit slower in 2023

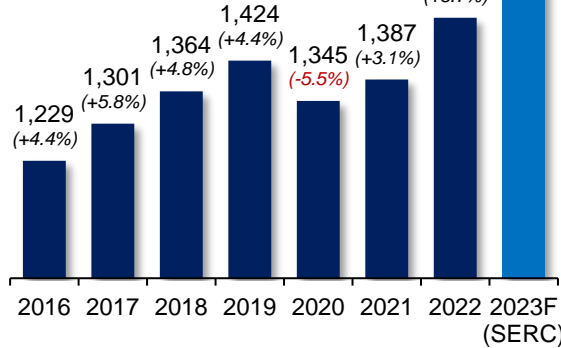
The Malaysian economy has bounced back but headwinds persist

Gross Domestic Product

RM billion (2015=100)

2010-19 Avg: 5.4% pa

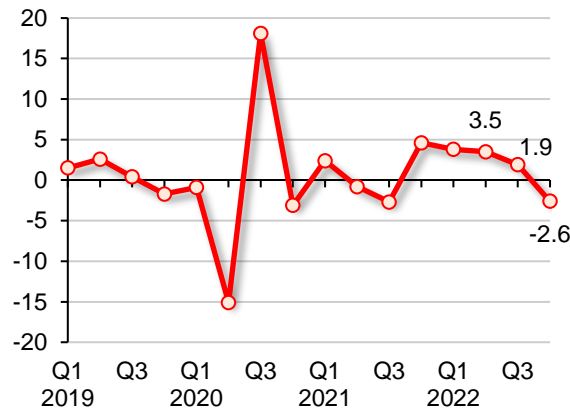
2015-19 Avg: 4.9%pa



However, the growth momentum has moderated in recent quarters

GDP growth

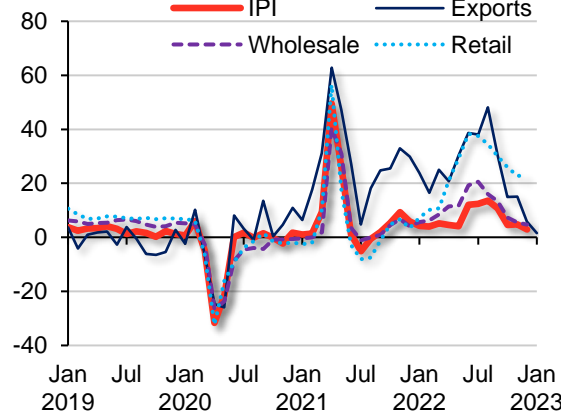
%, QoQ, seasonally adjusted



High frequency data showed either normalisation or deceleration growth

IPI; Exports; Wholesale; Retail growth

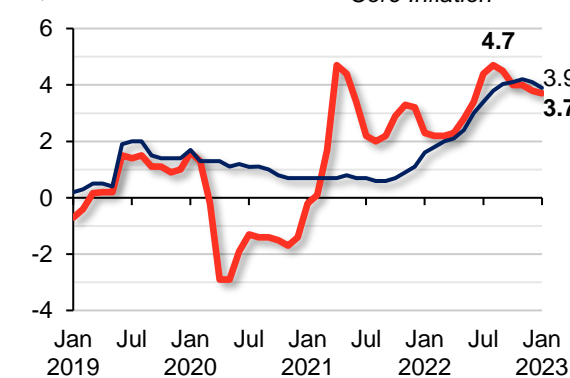
%, YoY



Headline inflation has peaked but price pressures continue to linger, especially core inflation

Inflation

%, YoY



The Malaysian economy

- The economy would continue to grow, albeit slower in 2023 (2023E: 4.1% real GDP growth vs. 8.7% in 2022)
- “Normalisation” of private consumption
- Weaker exports and softening commodity prices

Upside risks

- ➊ Continued recovery in labour market and better income prospects
- ➋ On-going and new public infrastructure projects
- ➌ Higher tourism activity

Downside risks

- ➍ Slower global growth; slumping exports
- ➎ Cost pressures (cost of living and business costs)
- ➏ Lag impact of higher domestic interest rates

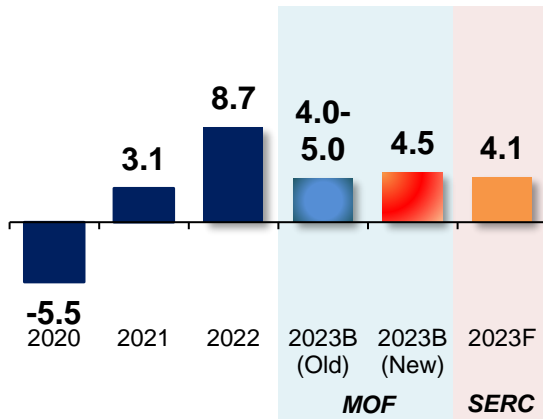
Source: Department of Statistics, Malaysia (DOSM)

Domestic demand will drive the economy in 2023

Real GDP growth will slow in 2023

...

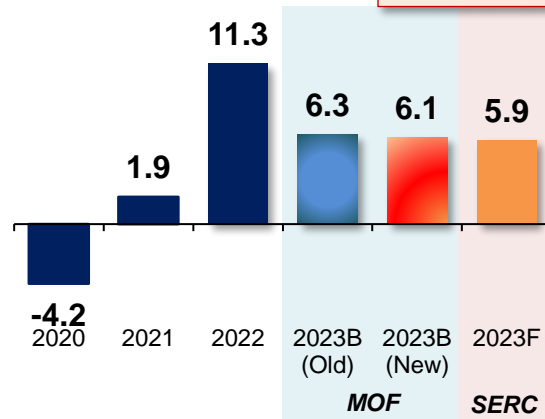
Real GDP



... supported by income and job growth ...

Private Consumption

Share of GDP in 2023B: 61.2%

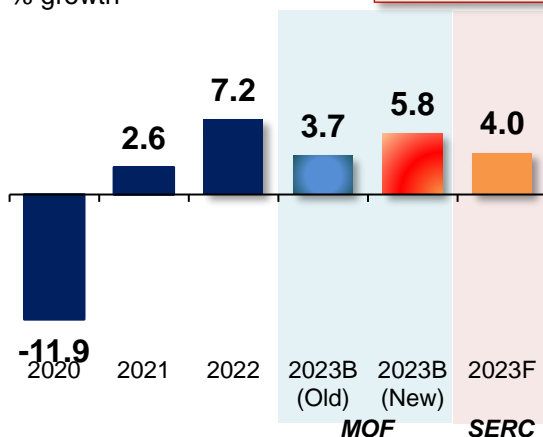


... and moderate growth in private investment and public investment

Private Investment

% growth

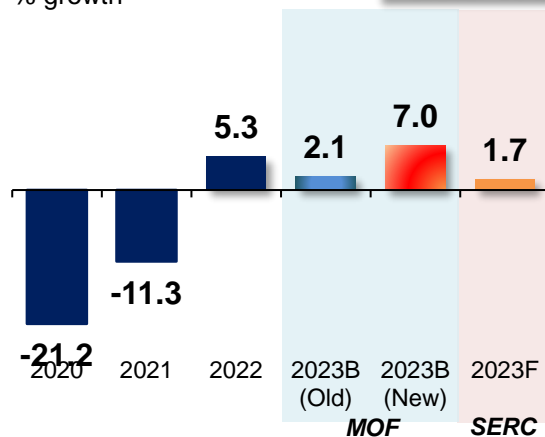
Share of GDP in 2023B: 15.6%



Public Investment

% growth

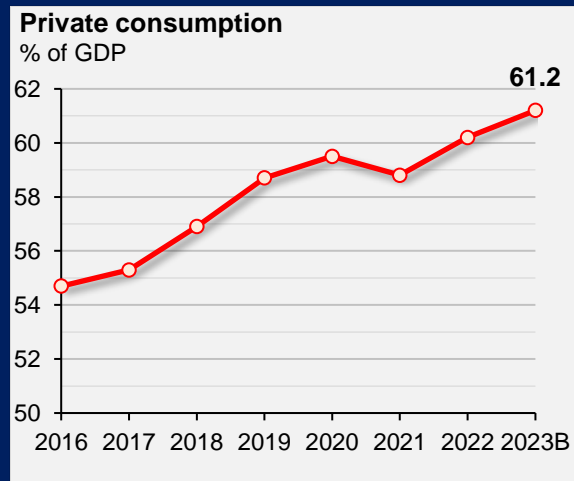
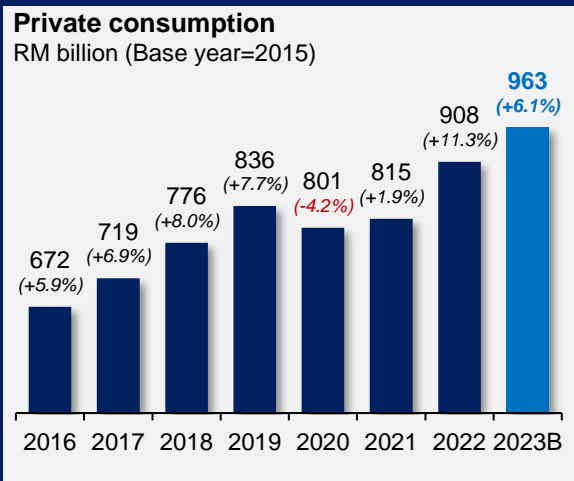
Share of GDP in 2023B: 4.5%



Source: DOSM; MOF

- The economy is expected to normalise to an **approximately 4.5% growth in 2023** (2022:8.7%). This is supported by domestic demand while exports will slow markedly. Risks to growth remain (Prolonged geopolitical conflict, climate-related disasters, rising cost of living and the lag impact of higher interest rates).
- Stable labour market conditions and sustained economic and social activities, particularly in tourism-related sectors following the reopening of China's international border is expected to support **private consumption growth**, albeit at a **moderate pace of 6.1% in 2023** (11.3% in 2022).
- **Private investment is anticipated to increase by 5.8% in 2023**, mainly in the manufacturing and services sectors following the Government's efforts to enhance good governance, reduce business costs, and facilitate faster investment approvals.

Can private consumption (61.2% of GDP) hold the fort in 2023?



Private Sector Wages

Annual change (%)



Waning support factors

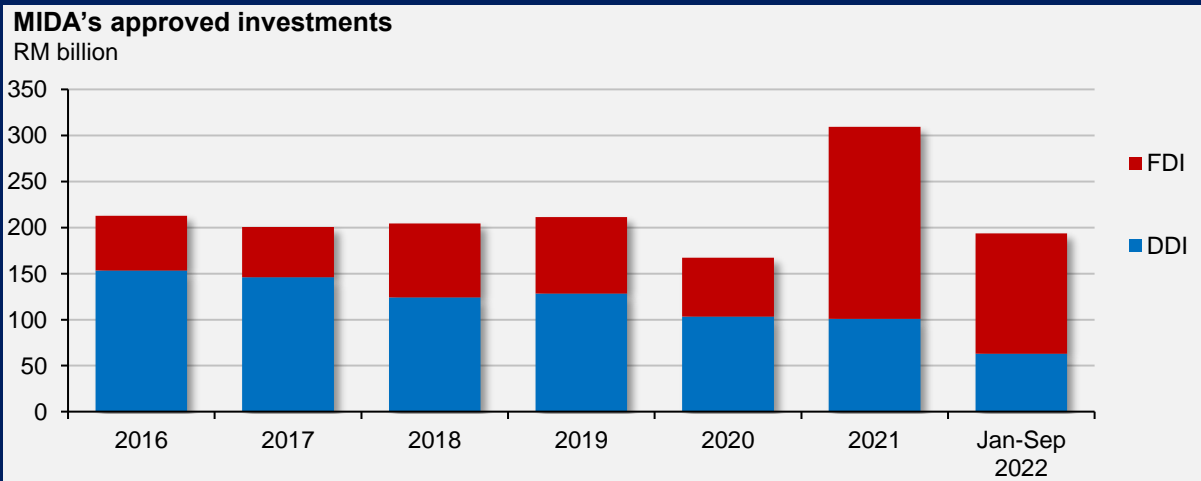
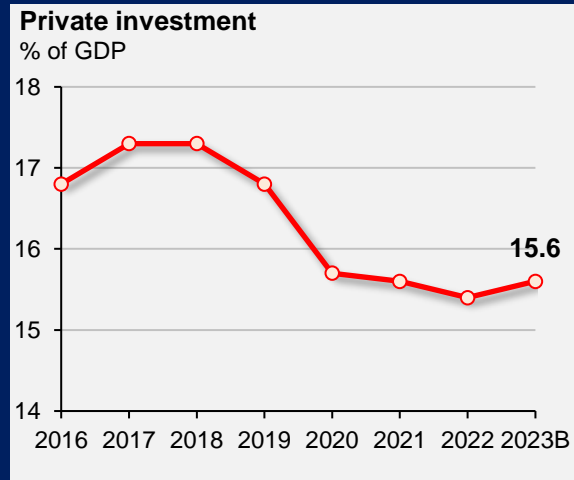
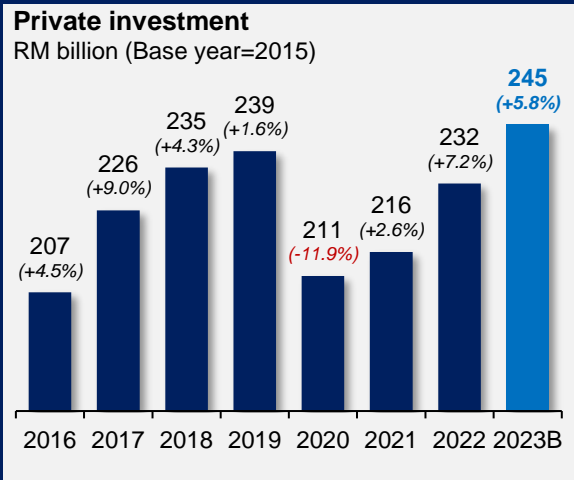
- **Pent-up demand:** Normalisation of spending; and waning effect of the EPF withdrawals.
- **Reduced spending power:** Inflation and cost of living pressures as well as the weakening Ringgit.
- **Credit:** High household debt burden (81.9% of GDP), tighter lending conditions; and the lag impact of higher interest rate.

Mitigating factors

- Stable unemployment rate (2023E: 3.5%-3.7%; 3.6% in 2022) and improved wages.
- Anticipated boost from a revival of China's tourist arrivals.
- Continued cash handouts and special payment for civil servants.
- A 2 percentage points reduction in personal income tax rate for chargeable income exceeding RM35,000 to RM100,000 (tax savings between RM300 and RM1,300) for 2.4 million tax payers, releasing RM900 million (net from tax adjustments for higher income earners); e-wallet for 2 million youth @ RM200 each, releasing RM400 million.
- Subsidies on electricity tariffs, petrol, diesel, LPG, chicken, eggs, etc. **BUT, not for long – targeted subsidy is on the way!**

Source: DOSM; MOF; BNM

Private investment has yet returning to pre-pandemic level



(Why) Is Private investment Weak?

- Business investment is not just a key determinant of long-term growth, but also a highly cyclical component of aggregate demand.
- Uncertainty about the future state of the economy and a lack of profitable investment opportunities.
- A stronger recovery of investment would seem to depend on a reduction in economic uncertainty and expectations of stronger future growth.

2023 Budget's action plan

- Attracting & facilitating meaningful investment - empower PEMUDAH; expediting approvals.
- **Strengthening Investment Ecosystem** - New Industrial Masterplan 2030 (expect to roll out in September 2023); upgrading local talent to meet industry requirements - TVET to pioneer new form of PPP; matching grants; trainers and training module.

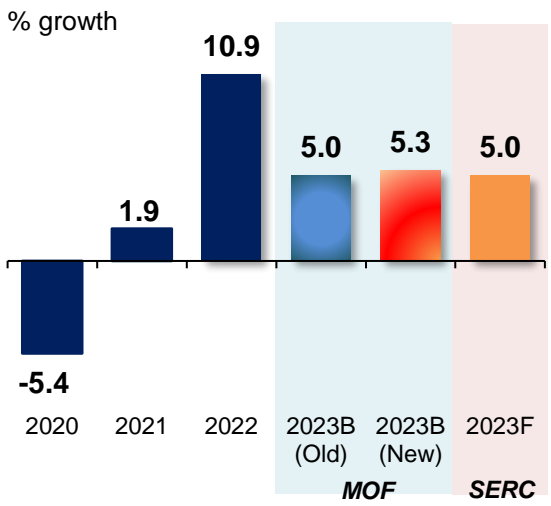
Potential and impactful investment

- EV, Green and sustainability (renewable energy, reuse manufacturing, smart agriculture, hydrogen & carbon sequestration), bio-tech and medical tech, telcos and transportation.
- **Multi-stakeholders approach to facilitate private investment.**

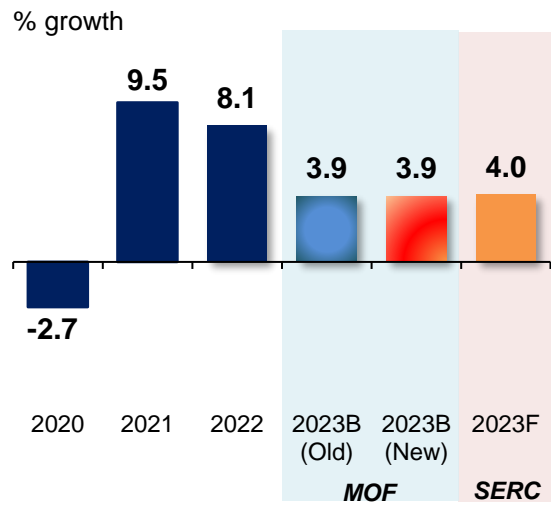
Source: DOSM; MOF; MIDA

Almost all sectors will slow in 2023

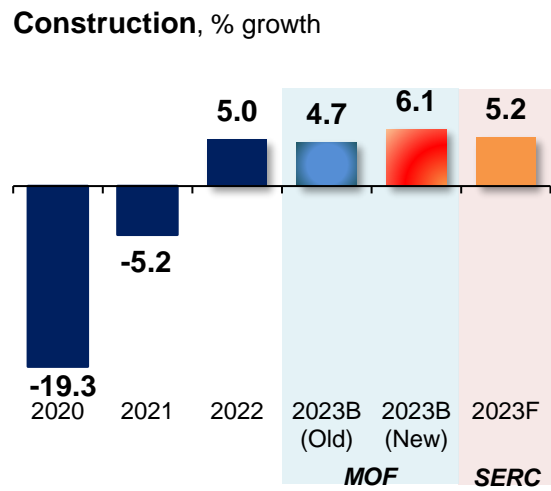
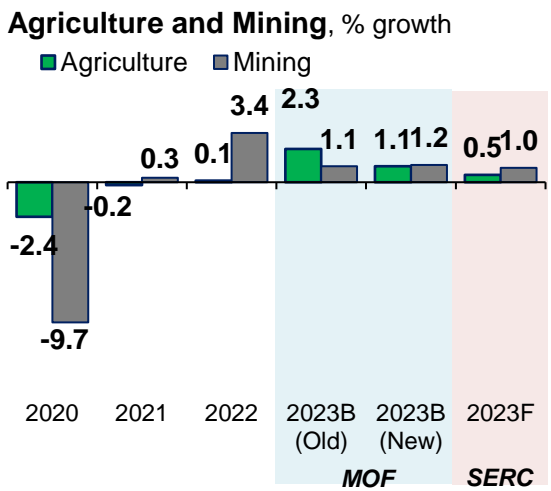
Services sector (58.7% of total GDP)



Manufacturing (24.1%)



Agriculture (6.4%); Mining (6.2%); and Construction (3.6%)



Source: DOSM; MOF

Note: % in parenthesis refers to share of GDP in 2023B (New)

Services

- Driven by the **wholesale and retail trade** (wider usage of e-commerce and rapid transition to digitalization); **real estate and business services** (higher demand for professional services, particularly engineering, legal and accounting); **information and communication** (wider digital adoption).

Manufacturing

- Supported by expansion in all subsectors across both export- and domestic oriented industries despite moderating economic activities.

Agriculture

- Improvement in oil palm (higher CPO output due to improved labour supply), livestock and fishing (concerted efforts to strengthen food security) subsectors.

Mining

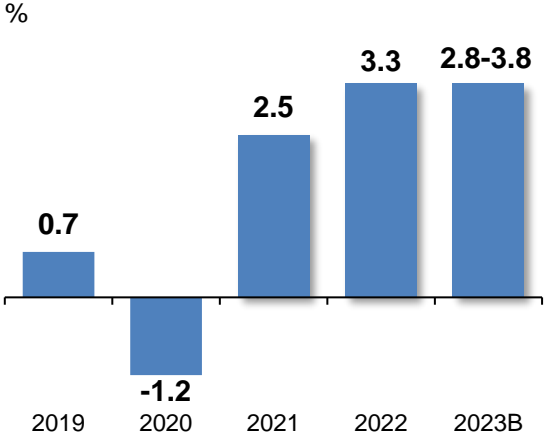
- Higher natural gas output (completion of new pipeline projects in Sarawak); higher demand from major trading partners; new demand from domestic industrial and petrochemical segment.

Construction

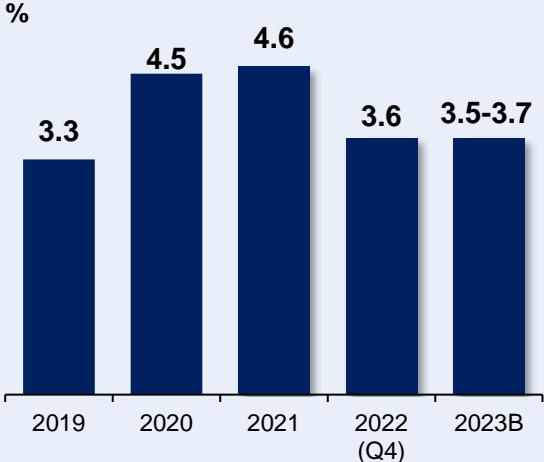
- The implementation of new projects such as upgrading the Klang Valley Double Track (KVDT) Phase 2 and the acceleration of ongoing infrastructure projects, which include East Coast Rail Link (ECRL) and Light Rail Transit Line 3 (LRT3) and fifth-generation cellular network (5G) rollout.

2023 Budget: Inflation, jobless rate and commodity prices forecast

Inflation

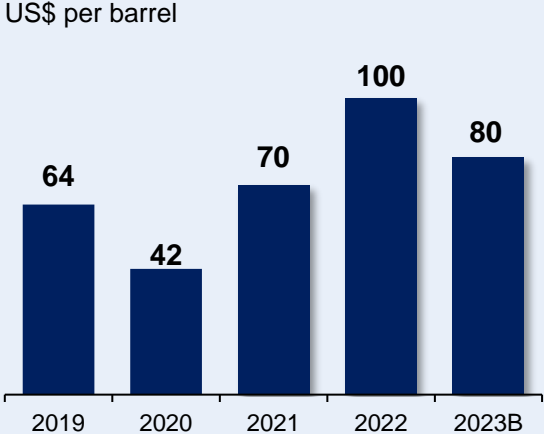


Unemployment rate

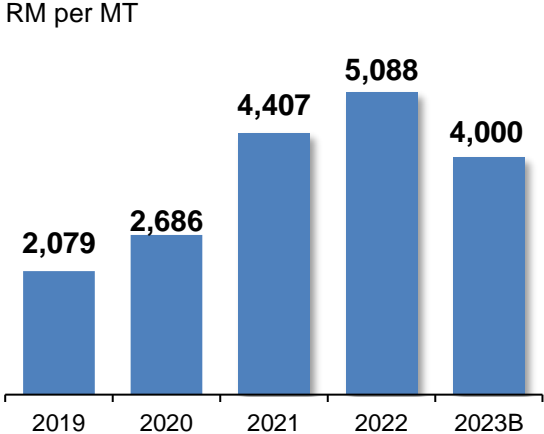


Price pressures remain amid softening commodity prices

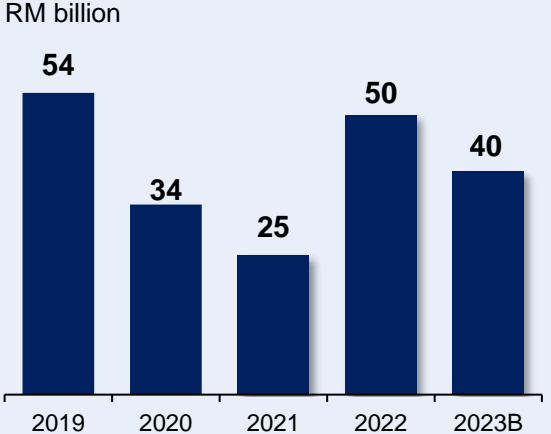
Brent crude prices



Crude palm oil prices



PETRONAS dividend



Source: DOSM; MOF; World Bank; MPOB

Upside and Downside risks to Malaysia's growth prospects in 2023

UPSIDE RISK



Fiscal support for **inflation** and **cost of living**



Efforts in **mitigating the downside risks**



Strong improvement in **tourism sector**



Continued **improvement in the labour market**



DOWNSIDE RISK



Inflationary pressure



Climate-related disasters



Prolonged geopolitical conflict



Rising recessionary risk

Backdrop for the preparation of the 2023 Budget



STILL CHALLENGING GLOBAL OUTLOOK

2023 global growth to slow to 1.7% from 3.0% expected six months ago, as the potential sharp and long-lasting slowdown of advanced economies will hit developing countries hard with heavy debt burdens and weak investment.

JAN 2023, World Bank

Global inflation will fall in 2023 and 2024 amid subpar economic growth, with 2.9% in 2023. Downside risks include potential escalation in the Russia-Ukraine war, tighter global financing costs and further geopolitical fragmentation.

JAN 2023, IMF



SLOWING ECONOMIC GROWTH MOMENTUM

Malaysia's real GDP growth % YoY

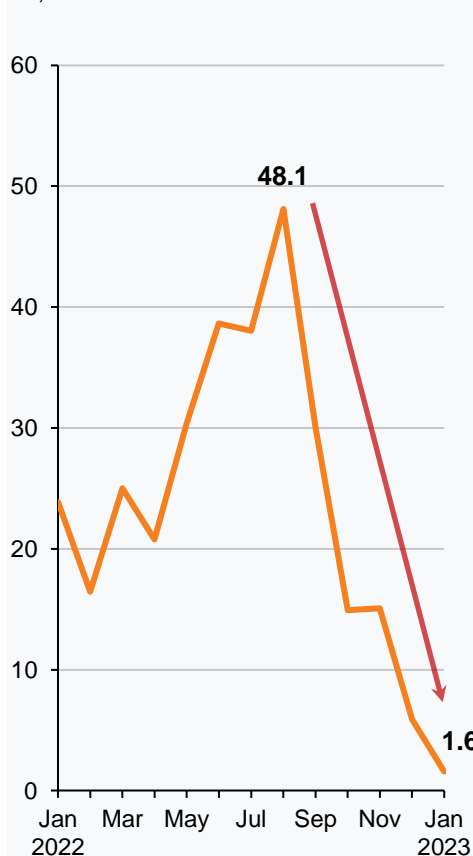


Monthly GDP % YoY



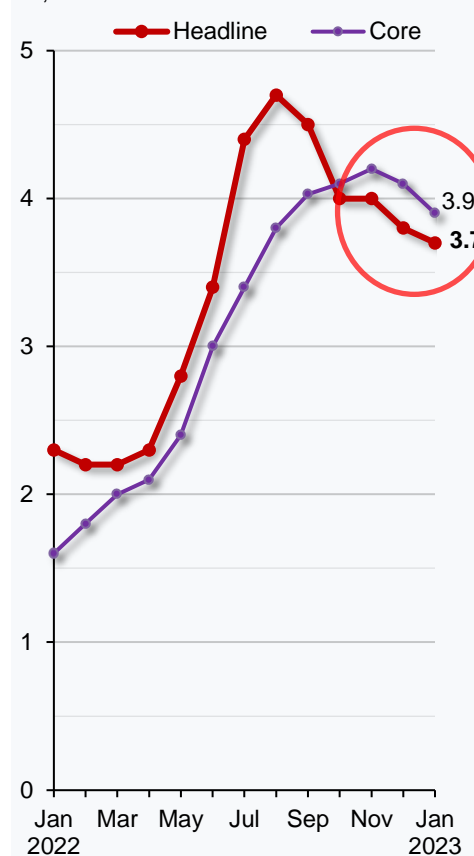
EXPORTS DECELERATE SHARPLY

Export growth % YoY



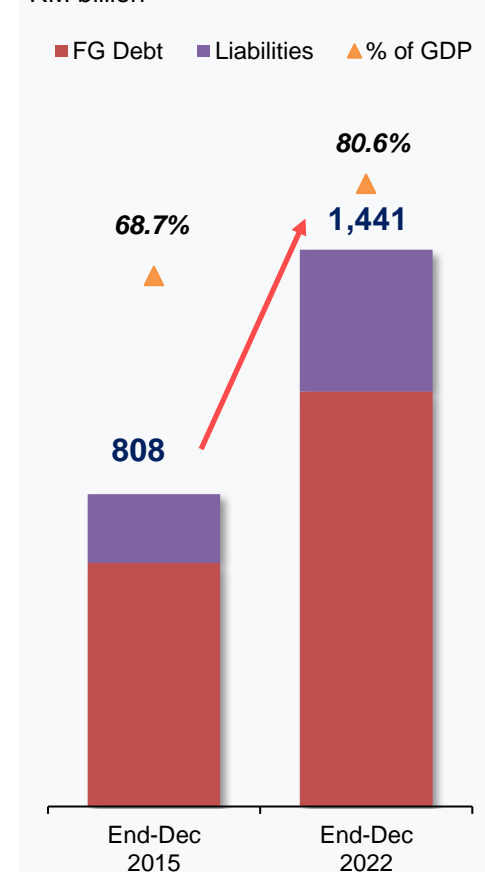
INFLATION PRESSURES REMAIN ELEVATED

Headline and core inflation % YoY



UNPRECEDENTED HIGH LEVEL OF DEBT AND LIABILITIES

Debt and liabilities RM billion



Note: Liabilities in 2015 cover government guarantee only.

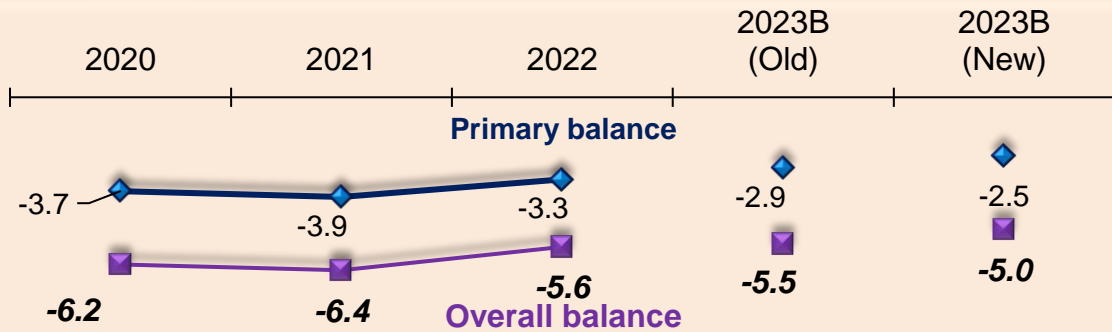
Budget: Developing Malaysia MADANI

The Budget and the Economy

26th consecutive year of budget deficit since 1998

Federal Government's Overall Fiscal Balance

Overall deficit



Note: Primary balance excludes debt service charges.

The economy will grow at a slower pace of **4.5%** in 2023

Real GDP growth



-5.5%

2020

2021

3.1%

2022

8.7%

2023B (Old)

4.0%-5.0%

2023B (New)

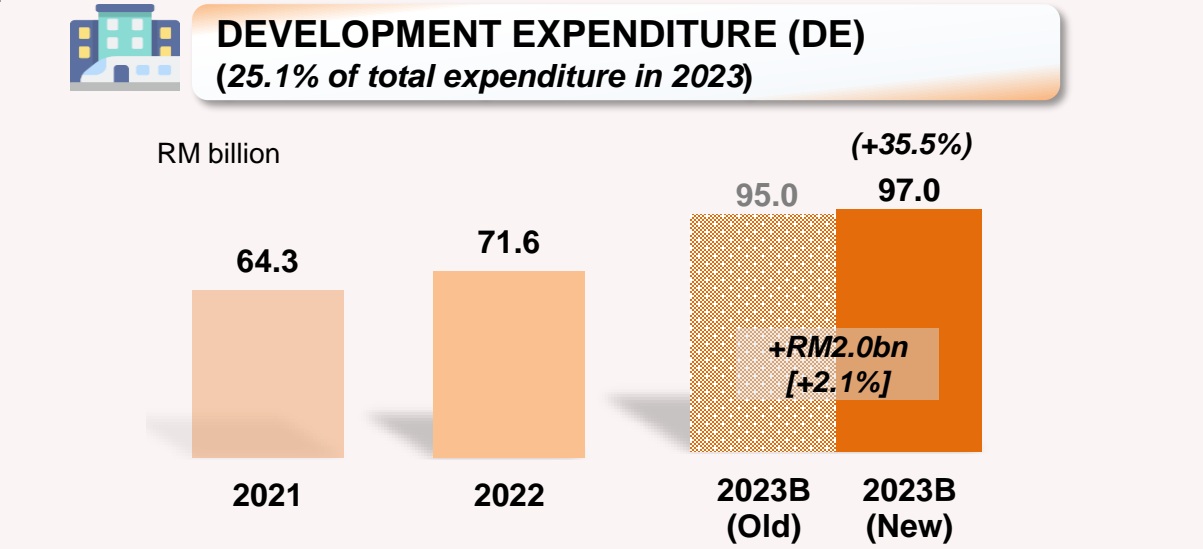
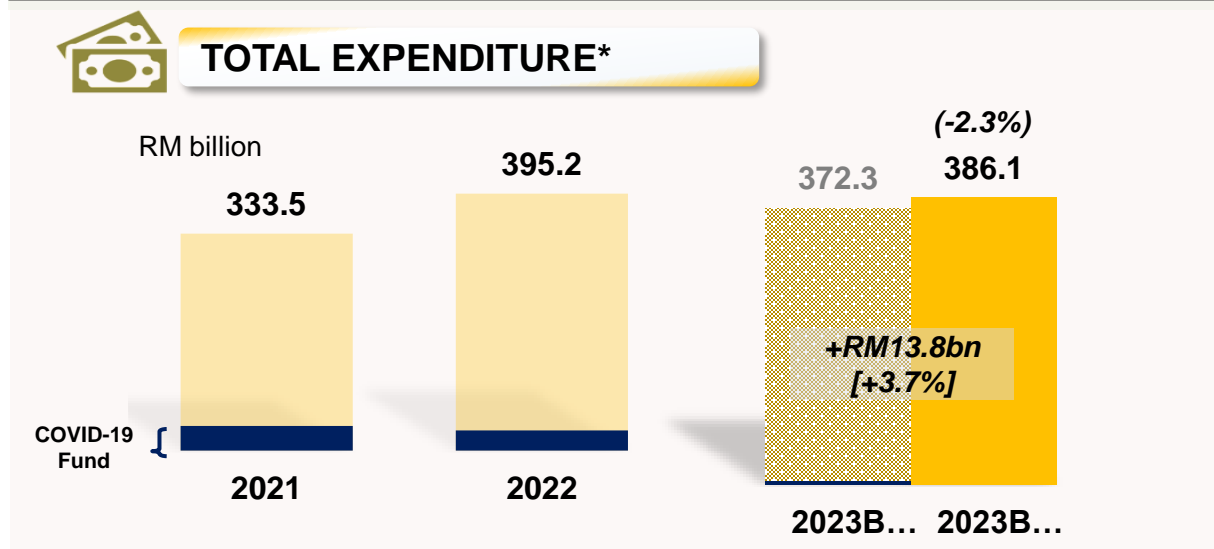
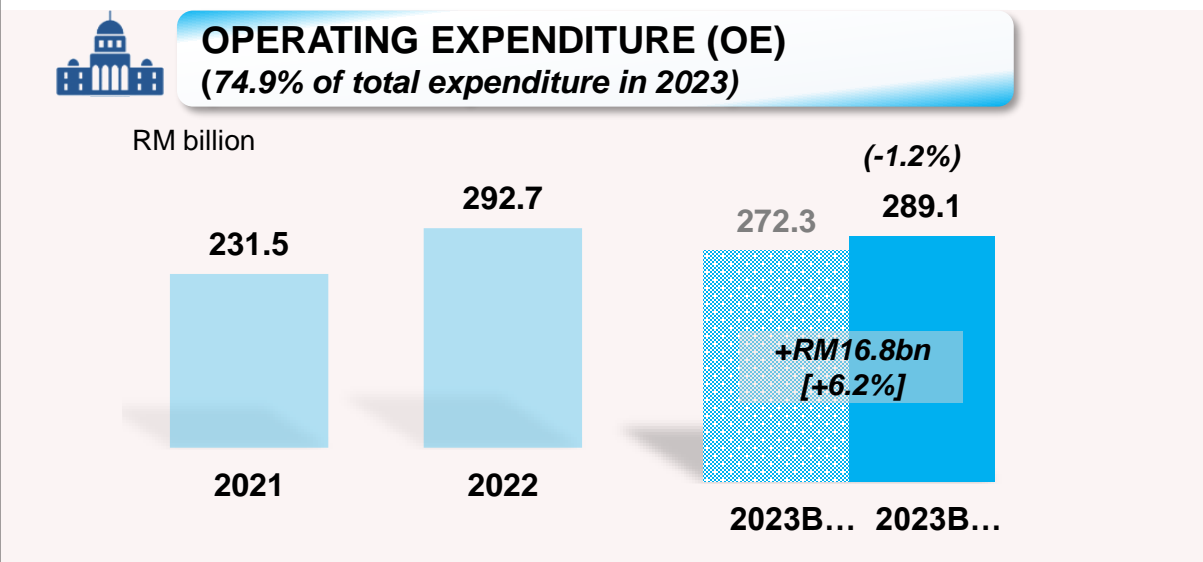
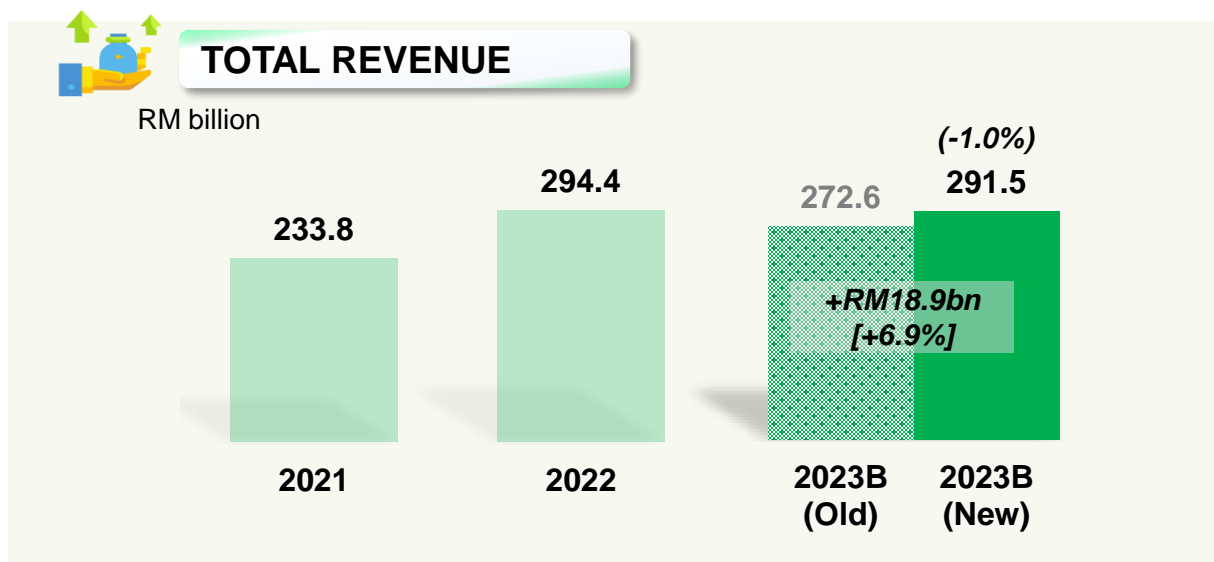
4.5%

SERC

2023F

4.1%

Budgetary operations snapshot



Source: MOF

* Includes the COVID-19 Fund: 2021 (RM37.7bn), 2022B (RM23.0bn), 2022E (RM28.8bn) and 2023B (Old) (RM5.0bn)

() indicates changes compared to 2022

[] indicates changes compared to old budget

Bloated subsidies – Transition to targeted subsidies

- **Subsidies and social assistance set a record high of RM67.4 billion in 2022.** These bloated subsidies continued to add pressure on the already-constrained fiscal balance sheet.
- As the blanket subsidies for petrol, diesel, water, and electricity also benefitting many of the M40 and T20 households, **it is fiscal prudence and equitable to move towards a targeted subsidy rationalisation scheme.**
- **Subsidies and social assistance are budgeted to remain substantial at RM58.6 billion (20.3% of total operating expenditure) in 2023** though it marks a decline of RM8.7 billion from RM67.4 billion in 2022.

Selected budgeted subsidy and assistance (RM billion)	2021	2022	2023	
			7 Oct 2022	24 Feb 2023
Major Cash Assistance (BAP, JKM, BKM)	8.6	9.5	11.1	11.1
Petrol, Diesel and LPG	11.1	50.8	23.6	25.6
Cooking Oil (COSS)	2.2	2.4	0.5	0.5
Electric	-	9.8	*	6.8
Poultry and Egg Prices	-	1.8	*	*
Other Consumption Subsidies	1.2	1.5	1.1	1.1
Others (education, transportation, agriculture)	14.3	15.6	18.7	18.7
Total	37.3	91.4*	55.0	63.8*

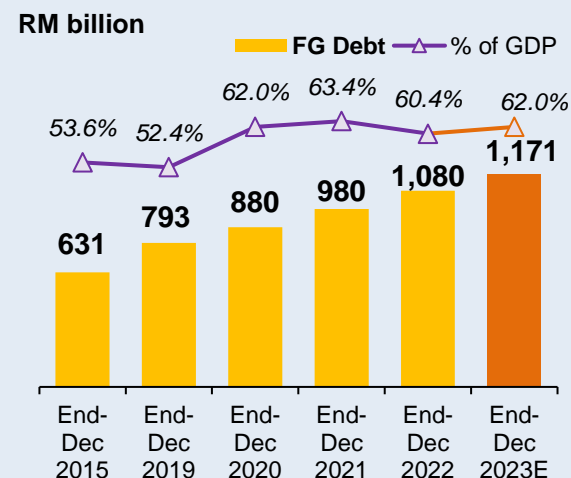
Note: The Government will continue subsidising prices of chicken eggs until June 2023 with total cost of RM1.28 billion.

* Discrepancies in total amount of "subsidies and social assistance" in operating expenditure were due to subsidies under the special COVID-19 Fund.

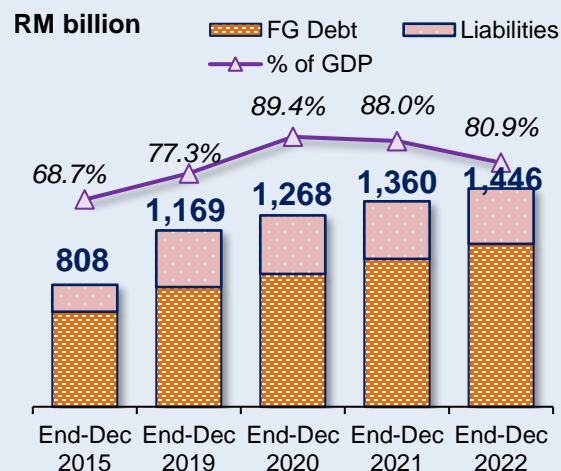
Source: Ministry of Finance (MOF)

We have to anchor expectations on sustainable fiscal and debt levels

Federal Government (FG)'s debt

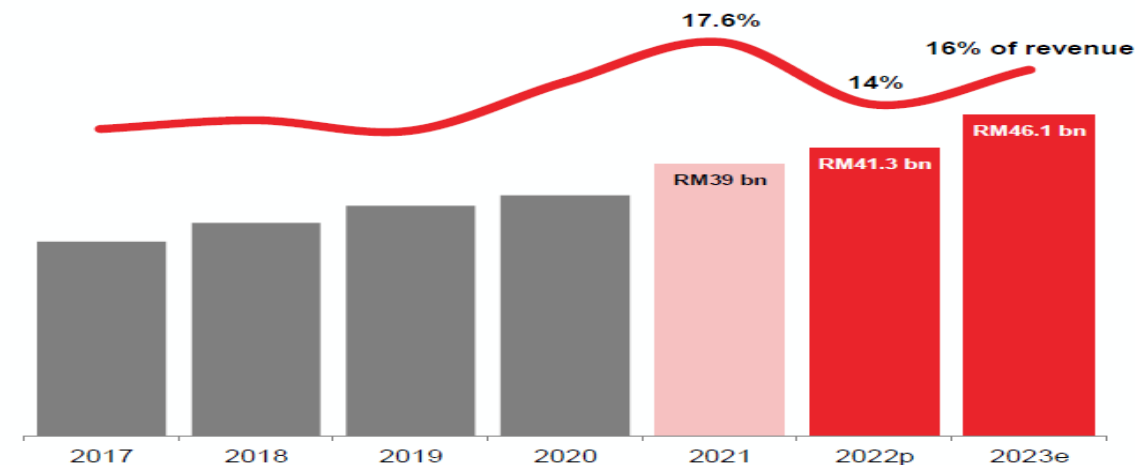


Debt and liabilities



Note: Liabilities in 2015 cover government guarantee only.

Malaysia's Debt Service Charges



Debt legislative guidelines

Act	Statutory Limit	End-Dec 2022
<ul style="list-style-type: none"> Loan (Local) Act 1959 [Act 637] Government Funding Act 1983 [Act 275] Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) (Amendment) Act 2021 [Act A1635] 	Outstanding MGS, MGII and MTIB not exceeding 65% of GDP	57.7% of GDP (RM1,032 million)
External Loans Act 1963 [Act 403]	Offshore borrowings not exceeding RM35 billion	RM29.5 billion
Treasury Bills (Local) Act 1946 [Act 188]	MTB not exceeding RM10 billion	RM9 billion

Source: BNM; MOF

- Compared to selected A-rated peers and regional economies, Malaysia ranked the sixth highest (worst) in 2021.
- In terms of debt service charges (DSC) to revenue ratio, Malaysia ranked the second highest at 16.3% in 2021.
- In Budget 2023, it is expected to rise to 15.8% of revenue (RM46.1 billion) in 2023 from 14.0% in 2022, which exceeds the 15% threshold in accordance with international best practices.**

What do people think about Budget 2023? Mixed feelings



Man in the street:

“It is a BORING budget”; “Why does it tax me so much?”; “More cash handout is needed”.



Bankers:

Well-being for rakyat; “No one is left behind”; sustain better economic prospects; ESG; prudent, targeted and inclusive approach; expansionary nature.



Industry/SMEs:

A fine balance; prudent but disappointed (no announcement of GST implementation); falls short on tax cuts (higher threshold of preferential rate for SMEs); concerned about Capital Gains Tax; Luxury goods tax



Economist/Market strategist

A balancing act; Taxing the rich; Wealth transfer; Neutral; From Peter to Paul.

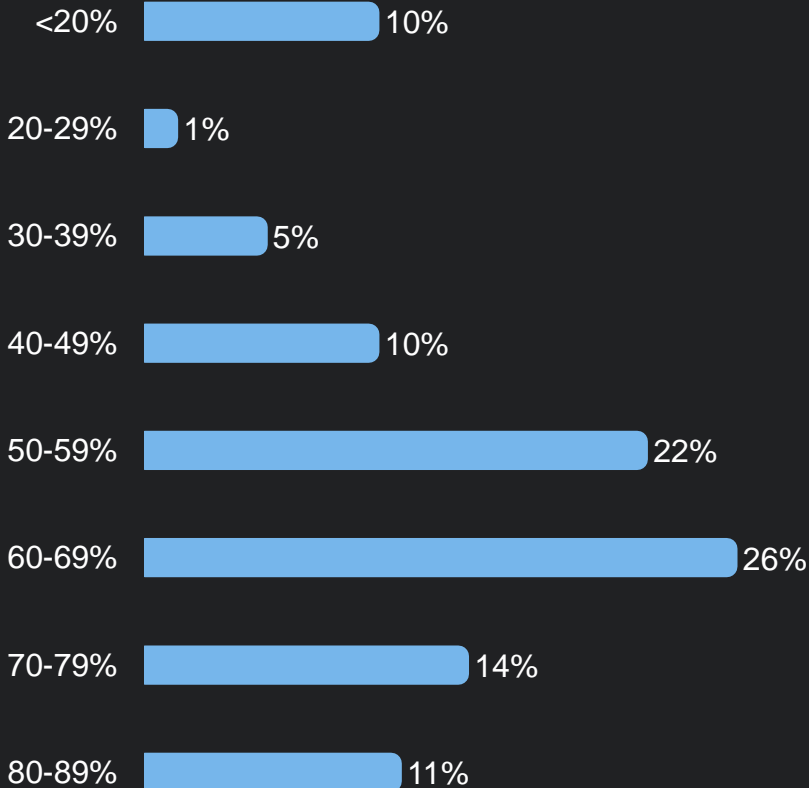


Construction and property sector:

Unfriendly budget; Understandable on a tight budget, but no non-financial incentives are provided; Affordable housing is a myth.

How did you score the Budget 2023?

Anonymous Pool
Source: Independent



Can the 2023 Budget deliver?

Medium-Term Fiscal Framework (MTFF) 2023-2025

- **Fiscal deficit will reduce to 5.0% of GDP in 2023** (-5.6% of GDP in 2022). It is targeted to reach 3.2% of GDP in 2025
- **Statutory debt to GDP ratio at 65% of GDP**
- **Federal Government debt** (2022: RM1.08 trillion or 60.4% of GDP; 2023E: RM1.17 trillion or 62.0% of GDP)
- **FG debt and liabilities** (2022: 1.45 trillion or 80.9% of GDP; 2021: RM1.36 trillion or 88.0% of GDP)
- **Subsidies and social assistance** (2023B: RM58.6 billion or 20.1% of Federal revenue)

The implications

- Persistent high deficits and growing debt can trigger investors' concern towards fiscal solvency.
- Too much debt and liabilities impair the government's fiscal sustainability but also its ability to service debt.
- A credible fiscal reduction plan to transit gradually from fiscal imbalances to more sustainable levels is clearly needed.
- Must not succumbed to fiscal fatigue – longer and more painful adjustment.

Action plans

(a) Legislative guidelines

- **Fiscal Responsibility Act (FRA)** – transparent, and accountable management
- **Government Procurement Act (GPA)** – specific legislation governs the government procurement process: (a) To stem the prevalence of operational mismanagement; (b) Unchecked variations in project cost and specifications; (c) Lack of timeliness of payment schedules; and (d) Lack of enforced oversight in our procurement system.

(b) Revenue enhancement

- **Taxing the rich** – increase in marginal tax rate (0.5-1.0 percentage points) for chargeable income exceeding RM100,000 to RM1 million
- **Luxury goods tax**
- **Voluntary Disclosure program** – a penalty remission of 100% from 1 June 2023 to 31 May 2024
- **Capital Gains Tax (CGT)** on the disposal of unlisted shares by corporate shareholders in 2024

Can the Budget deliver? (cont.)

(c) Expenditure rationalisation

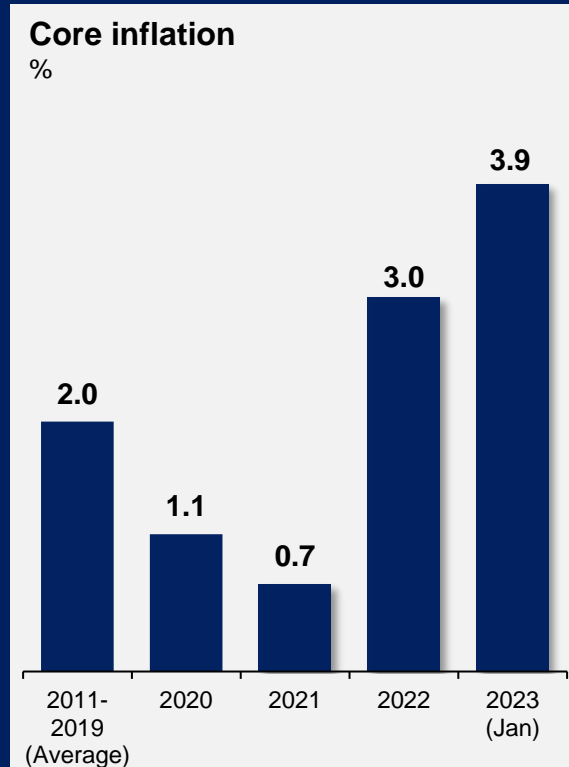
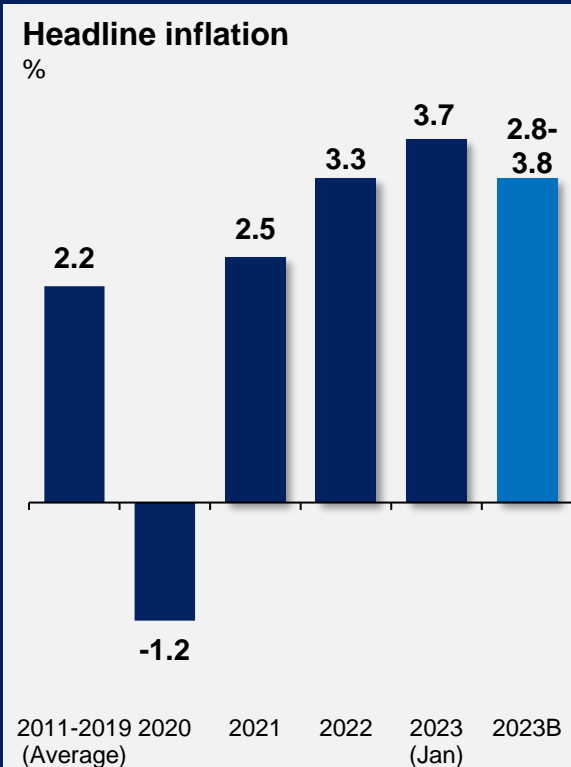
- Gradual implementation of subsidy rationalisation
- Explore the option of defined contribution for pension
- Plugging wastage, leakages and corruption
- Open tender



Bolder tax reform: Trade-offs and Priorities

- Bolder tax reform can be challenging - it produces winners and losers
- No one size fits all approach – depending on circumstances and priorities
- **Strong political leadership and public buy-in is essential**
- Timing can also matter
- GST is a broader, fairer and equitable tax – cover the informal sector
- Capital Gains Tax (CGT) – impact on capital market; capital flight and disincentive to wealth creation
- Environment-related and health taxes; pollution and fossil fuel taxes; carbon taxes and pricing schemes are growing in popularity
- But their effectiveness can be enhanced via strengthened design and implementation, and quality monitoring, reporting, and verification
- Taxes on alcohol, tobacco, and sugar-sweetened beverages
- Subsidies rationalisation – 3 Cs (Credible, Comprehensive and Communication)
- Sticks and carrots to incentivize tax compliance
- People are sometimes reluctant to pay their taxes, fearing that these revenue collection will be squandered

Headline inflation has receded, but renewed price pressures remain



Drivers of inflation

- Continued cost pressures (wage cost, electricity tariffs, amended Employment Act)
- Subsidy rationalisation (timing of implementation keep BNM on guard)
- Partly driven by demand pressures due to sustained consumption and spending
- Impact of the weakening Ringgit

Offsetting factors

- Softening commodity and energy prices
- Normalisation of consumer spending
- Lag impact of higher interest rate

Source: DOSM; MOF

Is it time for a pause in interest rate hikes?

What is the balance of risks between growth and inflation?

- Intermittent pause allows BNM to assess the lag impact of previous rate hikes on the economy, which takes about 12-14 months.
- More data points with some confirmation of how the economy is doing and also the risk of inflation.
- BNM does not expect the economy in recession.
- The balance of risk to the inflation outlook remains tilted to the upside.
- Demand pressures on prices also come into play due to sustained consumption and spending.
- Changes in the subsidy policy.

- Bank Negara Malaysia faces a **difficult communication balancing act** in coming months.
- The challenge is not only **how to communicate the temporary pause** while domestic economic growth still growing amid inflation risk is still elevated, but also to **convince markets that BNM is still assessing the balance of risks between growth and inflation outlook.**
- The central bank is **still looking to normalise its interest rate.**

MPC (9 March 2023)

- **The MPC remains vigilant to cost factors, including those arising from financial market developments, that could affect the inflation outlook**



社会经济研究中心
**SOCIO-ECONOMIC
RESEARCH CENTRE**

THANK YOU

Address : 6th Floor, Wisma Chinese Chamber,
258, Jalan Ampang, 50450 Kuala Lumpur, Malaysia.
Tel : 603 - 4260 3116 / 3119
Fax : 603 - 4260 3118
Email : serc@accimserc.com
Website : <https://www.accimserc.com>