MALAYSIAN ECONOMIC OUTLOOK

2nd Quarter 2023

MALAYSIAN INSTITUTE OF ECONOMIC RESEARCH

MALAYSIAN ECONOMY ON A STABLE COURSE

INTRODUCTION

This has been a stable quarter for Malaysia following the dramatic political, geopolitical, and economic upheavals of the previous three years. Stable growth, stable employment, reducing inflation, and small but consistent depreciation in the ringgit spell positive indications for the Malaysian economy.

However, the government must not be complacent, as businesses and consumers report reducing confidence and concerns for the future. Encouraging spending domestically, as well as further attracting investment from abroad, must remain big priorities for the Malaysian government, as can be seen already with many of the policy announcements made.

THE MALAYSIAN CONTEXT

The Madani government has continued with its policies focusing on wealth creation and supporting the poorest people, although dramatic policy announcements have been fewer and further between this quarter as there was no full budget tabling. Announcements include tax-free sales of electric vehicles; reduced prices on cement for developers building affordable housing; a review of the Malaysia My Second Home initiative following arguments from some people that the current requirements are too strict; and a one-off allowance of RM 300 for over 1.3 million civil servants.

A major surprise announcement at the beginning of the quarter was the decision of Bank Negara Malaysia to raise the base interest rate from 2.75% to 3%. This was not predicted by economists as 2022 had already seen multiple hikes in the rate, and may be surprising given the major investment plans of the government. However, the increase in the rate should also be understood in the context of getting inflation under control, which remains high but dropping. Nonetheless, the central bank must be careful to monitor the impact of the increased interest rate on spending, and act if consumption drops concerningly as the BCI and CSI results might suggest.

ECONOMIC GROWTH

Overall the Malaysian economy saw year-on-year growth of 5.6% in Q1 2023. This is higher than the figure for Q1 2022 (4.8%) but lower than the overall figure for 2022 (8.7%). This lower result is unsurprising and predicted: as Covid-19 restrictions eased throughout 2022, this encouraged more spending, which has now reduced as the post-restrictions 'honeymoon period' has largely ended and people are returning to more 'normal' consumption patterns.

Notably, private consumption and private investment have both grown more slowly in Q1 2023, while public investment has grown slightly faster, most likely a result of spending commitments made during the election and under the Madani government. Somewhat surprisingly, public consumption has actually decreased by 2.2% year-on-year. Perhaps the most notable change is that, having seen very large growth in both imports and exports in previous years, the first quarter of 2023 has seen decreases in both. The pattern of import growth superseding export growth has also reversed: imports decreased 6.5% year-on-year in Q1 2023, compared to a decrease of 3.3% for exports, resulting in a slight reduction in the balance of payments deficit.

In 2022, growth was most pronounced in manufacturing (8.1%) and services (10.9%). 2023 has seen an increase in growth in the construction sector (5.0% to 7.4%), but reductions in both manufacturing (down to 3.2%) and services (down to 7.3%). As construction makes up a far smaller proportion of the overall economy, it is unsurprising to see a downturn in growth overall. These figures still represent a very healthy growth for the Malaysian economy, way ahead of IMF forecasts for 2023 both worldwide (2.8%) and among the ASEAN-5 (4.5%); but whether they form a continuous downward trend should be monitored carefully.

Forecasts for the Malaysian economy in 2023 range from 4.0% to 5.0%, and so Malaysia has outperformed in the first quarter. However, given shrinking consumer sentiments and business confidence, as detailed in the next section, it remains to be seen whether the rest of the year will see slower growth. Nonetheless, this start to the year should be encouraging for the Malaysian government and for the rakyat.

CONSUMER SENTIMENTS AND BUSINESS CONDITIONS

The Consumer Sentiments Index and Business Conditions Index have shown disappointing results for this quarter; seemingly, the largely positive statistics reflected in the remainder of this outlook are not being felt by consumers and businesses, or perhaps, they are fearful about what the economy holds for them in the future.

Business conditions have hit a low of 82.4 this quarter, down a huge 13 percentage points quarter-on-quarter and 13.8 points year-on-year. Meanwhile, consumer sentiments have decreased markedly quarter-on-quarter to 90.8 (a drop of 8.4 points), albeit a slight improvement year-on-year from 86.0. In the case of business conditions, it is the lowest result seen since before the Covid-19 pandemic began.

The components of the indices also raise concerning results. In the case of business conditions, businesses are reporting that sales and orders are dropping *both* domestically and for exports (possibly a reflection of the cost of living crises being felt in many countries, especially developed countries); production volume is declining while inventories have been growing due to reduced orders. For consumer sentiments, consumers reported reduced current finances (possibly due to higher-than-desired inflation) *as well as* concerns about future finances. As a result, consumers are reducing their spending plans, which will only serve to exacerbate the reduced orders and production for businesses.

While the overall macro figures for the economy are largely good, the government should be very mindful of these indices from businesses and consumers. If these results hold in future quarters, the positive figures for growth could easily turn the other way.

INFLATION

Inflation continues on an encouraging slow but steady downward trend. Headline inflation is down to 2.8% in May 2023 (down from a peak of 4.7% in August 2022) while core inflation is down to 3.5% from a peak of 4.0% in September 2022. While these inflation figures remain above the ideal figure - and certainly below the low inflation levels seen over the Covid period - their reduction is encouraging in reducing price pressures on Malaysians, especially low-income households. Compared to persistent and sticky high inflation in many parts of the world, Malaysian inflation is not of great cause for concern, although of course the same downward trend must continue to reach a stable level.

As in previous quarters, while inflation is reducing across the board, it remains higher on some products than others. In particular, inflation on food and non-alcoholic drinks remains highest at 5.9% (albeit down from a 7.3% peak in November last year), as well as restaurants and hotels inflation which remains at 6.7%, only slightly down from a peak of 7.0%, in spite of the helping hand of Menu Rahmah introduced across many restaurants to offer low-cost meals. Interestingly, communications inflation has actually decreased, reaching a deflationary peak of -3.7% in May 2023.

LABOUR FORCE

Having seen higher than average unemployment over the Covid period (at a rate of 4.9% in January 2021), labour force participation has now largely stabilised to an equilibrium rate. The last quarter has nonetheless seen a small increase from 69.9% to 70.0% (as of May 2023), demonstrating the strength of the economy as it stands.

The unemployment rate of 3.5% for April and May 2023 is well within the forecast for the year 2023 from the Ministry of Finance (3.5-3.7%). The unemployment rate should reach the upper end of the range if businesses continue to lack confidence as suggested by the Business Confidence Index for this quarter.

TRADE AND INDUSTRY

Growth in the Industrial Production Index remains positive but low on average, with an average for January to May 2023 of 2.0% - down quite significantly from a peak in Q3 2022 with an average of 12.3%. April 2023 saw a drop in the IPI and in all of its divisions, notably a 4.9% drop in the mining division; however, May 2023 saw a bounceback, with 4.7% growth in the IPI and growth in all three divisions.

FISCAL EXPENDITURE

Government revenue has increased slightly year-on-year, with RM 76.2 bil for Q1 2023 compared to RM 62.8 bil for Q1 2022. Combined with stable expenditure, this results in a slightly reduced overall deficit of RM 16.7 bil for the first quarter of 2023, reduced from a deficit of RM 23.8 bil for Q1 2022. This is encouraging given the high deficits run in 2021 and 2022 as a result of the Covid-19 pandemic and various economic challenges. However, continuing to reduce the deficit with the ultimate goal of a balanced budget should remain on the government's agenda whenever possible.

One element of easing for the government's spending was the removal of Covid-19 related spending: Q1 2023 was the first quarter where such funding fell to zero, having cost a total of RM 31 bil over 2022 in spite of significant easing of Covid restrictions over the course of the year. This has nonetheless been counteracted by an increase in net development expenditure from RM 16.6 bil (Q1 2022) to RM 26.3 bil (Q1 2023), most likely as a result of increased government spending to help ease some of the post-Covid economic shocks.

FOREIGN EXCHANGE

The ringgit continues its pattern of persistent weakening against other currencies. The average daily NEER against a basket of foreign currencies throughout Q2 2023 was at 95.21 (using the start of 2021 as the base rate of 100), a reduction quarter-on-quarter (from 96.72) and year-on-year (from 97.66). Most currencies have been subject to a decline against the US dollar, more due to the strengthening of the greenback rather than any inherent weakness.

This result is also reflected when comparing the ringgit with other Asian currencies. All five currencies included in the data - the Chinese yuan, the Japanese yen, the Thai baht, the Malaysian ringgit, and the Singaporean dollar - have seen depreciation over the period, largely due to the strength of the US dollar. However, with a decrease of 2.9% on the average for Q2 2023 compared to Q1 2023, the ringgit showed the second strongest depreciation (after the Japanese yen on 3.5%). It is surprising, however, that the consistent depreciation of the ringgit over more than two years has not led to any noticeable pattern of improvement in the balance of trade.

CONCLUSION

Given the cost of living crises facing many countries across the world, one could look at these figures from Malaysia with a great sense of relief. While growth has decreased compared to 2022 – an unsurprising result - it still remains well ahead of the world's developed economies and even ahead of other ASEAN countries. Inflation, while still higher than ideal, is clearly reducing, while unemployment remains low and stable. Meanwhile, while exports are unfortunately dropping due to reduced spending in other countries, stable depreciation of the ringgit is preventing them from falling as dramatically as they might otherwise.

The most concerning results should not be those at the current time, but those predicting what is to come in the following months: in particular, concerns from consumers and businesses about reducing income and consequent changes in spending plans. The government must work to increase consumer and business confidence so as to maintain some happy economic growth, albeit not at quite the same levels that were seen in 2022.