26 September 2022

Malaysia 4Q22 & 2023 Economic Outlook

Securing growth recovery amid rising external headwinds

SUMMARY

- Global growth slowdown appears to be imminent as we approach 4Q22 and will likely spillover into 2023, on the back of the looming energy crisis in Europe amid a prolonged Russia-Ukraine war, an expected recession in the US as a result of aggressive Federal Reserve rate hikes to tame soaring inflation, and the uncertainty of China's zero-COVID policy.
- Global inflationary pressures may persist in 4Q22 before gradually subsiding in 2023 due to potential supply chain normalisation and back-to-back global central banks rate hikes.
- Major central banks are expected to continue tightening aggressively for the rest of the year before easing off in the 1H23, whilst the US Fed Funds Rate is expected to top at least 4.5% by the end of this year.
- US Treasury (UST) yields may keep rising for the rest of the year, with the 10Y UST projected to peak at 3.80% towards the end of 4Q22 and then decline from 2Q23 onwards, settling at 3.00% by end-2023.
- Due to rising geopolitical and financial market uncertainty and a weaker global economic outlook, we revised 2022 Brent crude oil prices down to USD100.0/bbl (2021: USD70.9/bbl) from the previous forecast of USD110.0/bbl. The price is expected to fall further in 2023 to USD90.0/bbl but would likely be supported by potential output cut led by OPEC+ alliance.
- Malaysia's economy is projected to grow at a slower pace in the 4Q22 (2.5%; 3Q22F: 10.9%) following two quarters of sharp growth expansion and as the low base effect dissipates. Nevertheless, growth recovery remains intact, with QoQ growth to rebound and expand going into 2023. Against this backdrop, we upgrade the 2022 GDP growth forecast range to 6.5% - 7.0% from 5.5% - 6.0% (2021: 3.1%) and project growth to slow to 4.0% - 4.5% in 2023, in line with an expected global growth slowdown.
- Malaysia's headline inflation is expected to average at 3.3% in 2022 due to the higher costs of imported inputs. In 2023, the potential implementation of a tiered fuel pricing system may push the CPI higher to an average of 4.2%.
- BNM may continue to hike the OPR by another 25 bps in November, however, the hawkish momentum may subside in 2023 due to the expectation of slowing global economic growth.
- The ringgit may continue to struggle for direction in 4Q22 due to persistent USD strength. Nevertheless, we maintain our neutral-to-partially bullish stance and forecast the ringgit to trade at 4.44 by the end of 4Q22 and at 4.30 by the end of 2023, partly due to the pro-ringgit catalysts.
- Foreign demand for Malaysian bonds may remain pressured in 4Q22, before charting a recovery in 1H23 as global risk sentiment may improve after major central banks complete their tightening cycles.
- Domestic yields are expected to be steered higher by rising global bond yields in 4Q22 before trending lower from 2Q23 onwards. The 10Y MGS yield is projected to rise to 4.35% by end-2022 and then to decline to 4.05% by end-2023, after global central banks finish tightening and as UST yields rapidly decline.
- Fiscal policy stance to remain expansionary in 4Q22, with room to embark on larger spending amid an increase in revenue collection. Nevertheless, the deficit is expected to reduce to 5.7% in 2022 (MoF: 6.0%; 2021: 6.4%) backed by higher nominal GDP growth and may fall further to 4.6% in 2023, on the back of a normalisation in economic activities, the withdrawal of pandemic-related support, and as the government pivots toward fiscal consolidation.
- Federal government debt is expected to decline to 62.0% by end-2022 before edging higher to 62.3% in 2023, whilst statutory debt will likely remain under the 65.0% limit in the long-term.
- We expect the 15th General Election to be held before year's end with a high probability that parliament will be dissolved in October 2022, as the ruling government seeks a greater mandate and prepares the country for a potential growth slowdown in 2023.
- Expect mild volatility in financial markets following the dissolution of parliament, and sustained weakness if there is a change in government or an immediate rebound if the political status quo remains.
- External risks to Malaysia's recovery remain, from ongoing concerns about China's zero-COVID policy, a recession in the US and Europe, as well as worsening geopolitical tensions that could weigh on global economic recovery.

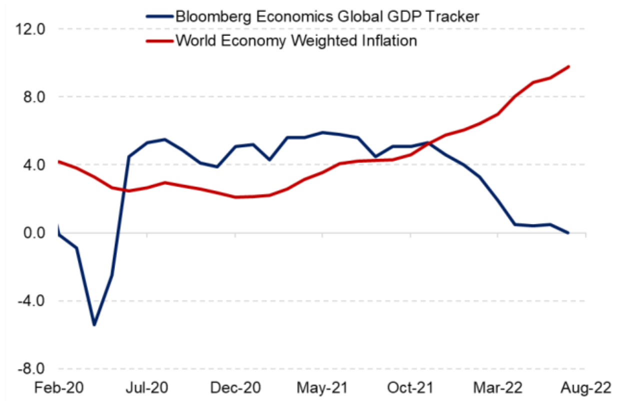
Global Macro Outlook – 4Q22 and 2023

- **After enduring the impact of the COVID-19 pandemic and facing the brunt of a long-drawn-out Russia-Ukraine war, the global economy confronts rising risk of a recession that may begin in the 4Q22 and possibly spill over into 2023**

  – **Growth:** Slowdown expected with rising risk of recession amid persistent downside risks.

    ▪ While the rest of the world slowly transitions into the endemic phase, COVID-19 continues to wreak havoc in China. The country holds fast to its zero-COVID policy to curb the outbreak, which is sending it into a potentially sharp slowdown this year. Chinese officials dropped its key economic growth target of around 5.5% this year, likely due to an increasingly unattainable target to achieve in 2H22 as it only charted 2.5% growth in 1H22. A slowdown in China is expected to cap the growth of Asian economies with strong trade ties and that heavily rely on China's economic performance. Nevertheless, upside bias to growth remains, lingering around China's future policy on its COVID-19 management and a rebound in its real estate sector.

Graph 1: Global Indicators



Source: Bloomberg, Kenanga Research

    ▪ The Russia-Ukraine conflict continues to elevate commodity prices, leading to supply disruption, global food crisis, and accelerating inflation. This has resulted in tighter financial conditions and an increased risk of stagflation in some countries. While the Russia-Ukraine crisis seems far from Southeast Asia, the impact of the crisis is now imminent in Europe, which is currently facing an energy crisis and soaring inflation due to its decision to partially ban Russian oil imports by the end of this year. The situation is expected to worsen as winter approaches and if Russia continues to halt gas deliveries via the Nord Stream pipeline indefinitely.

    ▪ Acceleration in global monetary policy tightening led by the US Fed, amid soaring inflation, may undermine global growth recovery via tighter financial conditions, with a larger impact on emerging and developing economies still recovering from the health crisis. The World Bank recently emphasised the risk of a global recession in 2023, as central banks simultaneously hike interest rates in response to inflation. Similarly, the IMF recently flagged a further global economic slowdown in 3Q22 amid high inflation, supply chain disruptions, and tighter financial market conditions.

  – **Inflation:** Expected to remain elevated in 4Q22 before gradually easing in 2023 amid expectations of a better balance between supply and demand.

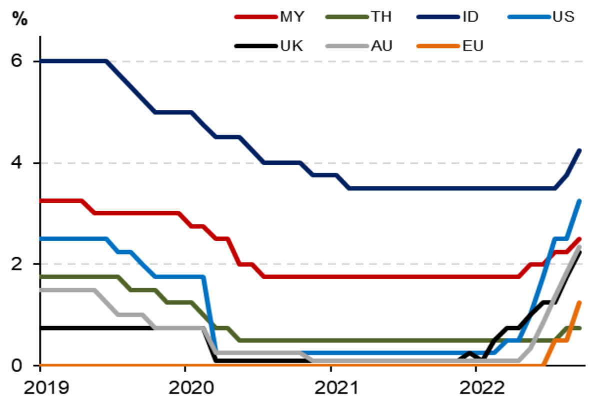
    ▪ In August, annual headline inflation rate in the US (8.3%; Jul: 8.5%) and UK (9.9%; Jul: 10.1%) eased marginally due to a fall in gasoline prices. However, underlying price pressures as measured by core inflation continued to trend higher, highlighting that inflation may continue to remain high and would not return to the 2.0% inflation target anytime soon, despite global central banks' aggressive rate hikes. In the near term, the Russia-Ukraine war may continue to push food prices higher due to the slow pace of grain and fertiliser exports from Russia. On top of that, electricity bills may continue to climb as the indefinite shutdown of the Nord Stream 1 pipeline continues to exacerbate Europe's energy crisis. Moving into 2H23, prices may start to taper off, mainly due to a potential normalisation in global supply chains, coupled with back-to-back interest rate hikes by major central banks. Nevertheless, it is to note that the current combination of high inflation and slow economic growth raises the risk of a stagflationary episode.

  – **Monetary Policy:** Major central banks will likely remain on aggressive tightening paths for the rest of the year, but most are expected to slow their pace by 1H23.

    ▪ The Fed's latest 75 basis points (bps) rate hike and Jerome Powell's strong hawkish remarks have reinforced the central bank's commitment to reign in persistently high price pressures. Peak inflation seems to have been delayed following hotter-than-expected data in August, leading to markets pricing in a higher and earlier terminal rate, with Fed Funds futures indicating around a 66.0% chance that the rate will top at 4.75% by February 2023. Nonetheless, we reckon that US inflation may yet peak in the coming months as fuel prices have retreated of late and wage growth plateaued in August, which may allow the Fed to slightly ease the pace of rate hikes and complete its tightening cycle by the end of this year. We see the Federal Funds Rate (FFR) raised by 75 bps in November and a 50.0% chance of a 50 bps or 75 bps hike in December, which would leave the terminal rate at 4.5% or 4.75% by the end-2022. Thereafter, we expect the Fed to keep the rate unchanged for most of 2023 before potentially cutting it at the end of the year, primarily dependant on the easing of inflationary pressures and the severity of a US recession.

- Elsewhere, the European Central Bank will likely maintain its aggressive rate hikes into 1Q23 to curb record-high inflation levels, raising the policy rate to 2.0% or higher, despite the strong probability of the Euro Zone tipping into a recession. Similarly, the Bank of England is expected to keep its pace and may be required to raise the policy rate to higher than 3.0% following Prime Minister Liz Truss' large fiscal spending package, aimed to ease rising living costs in the UK. Bank Indonesia and Bank of Thailand have finally joined regional peers to commence their tightening cycles in August, and are expected to raise rates well beyond their long-term neutral rates of 5.0% and 1.75% respectively, to tame inflation and keep pace with the Fed.

Graph 2: Selected Central Banks Policy Rates

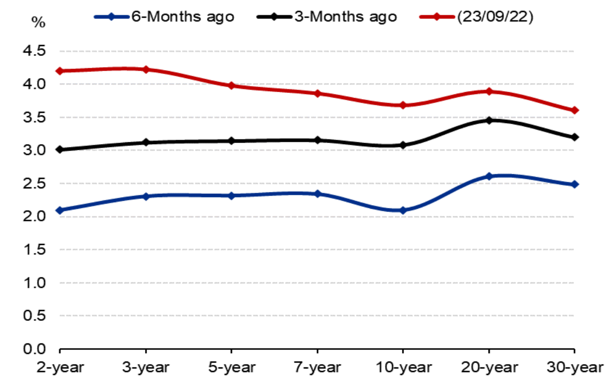


Source: Bloomberg, Kenanga Research

– **US Treasuries:** Yields will likely remain on an uptrend amid the Fed's strong hawkish stance and market expectations of a higher and earlier terminal FFR, even as US recession risks have heightened. As such, we have raised our end-2022 target for the 10Y UST to 3.80% from 3.40% previously (2021: 1.51%), whilst our end-2023 forecast remains at 3.00%.

- We expect UST yields to continue rising and reach a peak towards the end of 4Q22 as the Fed may conclude its very aggressive tightening cycle and the FFR reaches a terminal rate of 4.5% or 4.75%. Afterward, yields may begin to trend lower, especially in 2H23 as the market begins to anticipate Fed rate cuts in the face of a US recession and potentially improved inflation conditions. Furthermore, we expect short-term yields to decline at a faster pace when the Fed ceases rate hikes, thereby flattening the yield curve and ending the 10Y-2Y UST inversion in 2H23.
- Bond prices and bond market liquidity are also expected to be weighed by the Fed's continued quantitative tightening, which accelerated in September to wind down USD95.0b worth of Fed assets monthly compared to the USD47.5b a month pace that began in June. The MOVE Index, which measures Treasury market volatility, indicates that volatility remains elevated and is comparable to that of July this year. As such, we expect heightened volatility to persist as liquidity conditions remain strained until at least 1Q23 when the Fed settles its tightening cycle.

Graph 3: UST Yield Curves

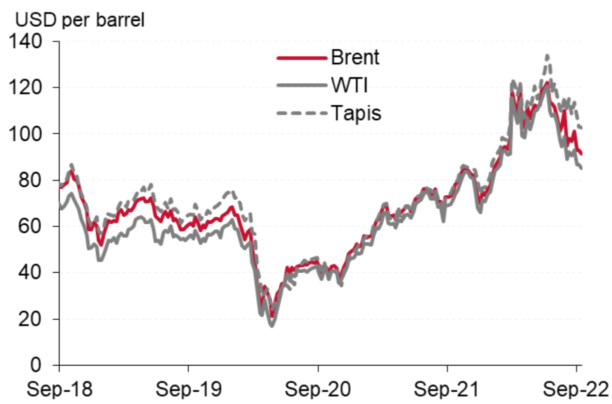


Source: Bloomberg, Kenanga Research

- **Crude oil prices:** Expected to remain volatile in the remaining quarter and going into 2023.

– Brent crude oil price is expected to remain volatile, trading between USD90.0/barrel (bbl) to USD100.0/bbl

Graph 4: Crude Oil Price Trend (USD/bbl)



Source: CEIC, Kenanga Research

in the remaining quarter, amid uncertainty around the Russia-Ukraine conflict and demand outlook, as the world braces for an economic slowdown. In its September Short-Term Energy Outlook forecast, the US Energy Information Administration (EIA) expects crude oil prices to average USD98.0/bbl in 4Q22 and further down to USD97.0/bbl in 2023, as it projects crude oil demand to rise moderately by 2.0m bbl/day in 2023 from an average of 2.1m bbl/day in 2022. Nevertheless, we expect the OPEC+ alliance to continue its supply restraint as a countermeasure to the falling demand outlook, thereby supporting elevated prices. Meanwhile, a potential economic reopening in China, possibly going into 2023, would remain the major catalyst for prices going forward. Against this backdrop, we have revised down the average Brent crude oil price forecast to USD100.0/bbl for 2022 and USD90.0/bbl for 2023 from the previous estimates of USD110.0/bbl (2021: USD70.9/bbl).

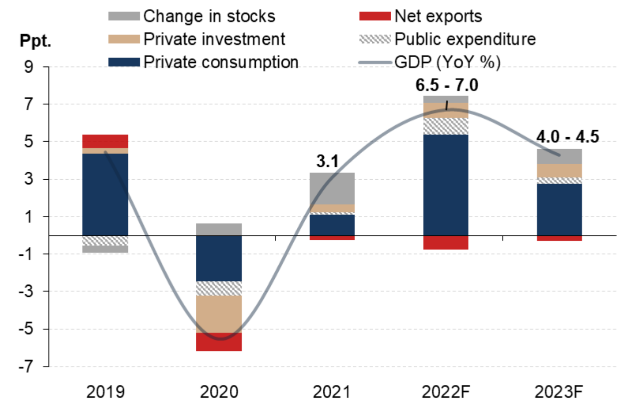
Domestic Macro Outlook – 4Q22 and 2023

- **Domestic growth to sustain as the nation transitions to endemicity, with the complete removal of pandemic restrictions, but rising inflation threat, tighter monetary policy, and global economic uncertainty may limit potential growth bias**

  – **GDP:** Growth to moderate in the 4Q22 but recovery going into 2023 to remain intact.

  - GDP growth is projected to moderate in 4Q22 (2.5%; 3Q22F: 10.9%), as a low base effect recorded last year dissipates but is still backed by strong domestic demand. So far, the removal of COVID restrictions, as well as the reopening of borders, cash transfers, and EPF withdrawals, have outpaced the persistent downside risks to growth. These risks include a political risk premium with a general election on the horizon, rising inflationary threat, ongoing supply chain disruptions caused by geopolitical tensions, China's zero-COVID policy, and the impact of climate change. Primarily, growth would largely be supported by private consumption amid improvement in income prospects, a relatively lower unemployment rate, and higher tourist arrivals with a further resumption of international tourism. Overall, GDP growth is expected to settle at 6.5% in 2H22 (1H22: 6.9%), bringing 2022's full-year growth higher to 6.5% - 7.0% (consensus: 6.9%; 2021: 3.1%) compared to our previous forecast range of 5.5% - 6.0%.

Graph 5: GDP Growth Trend



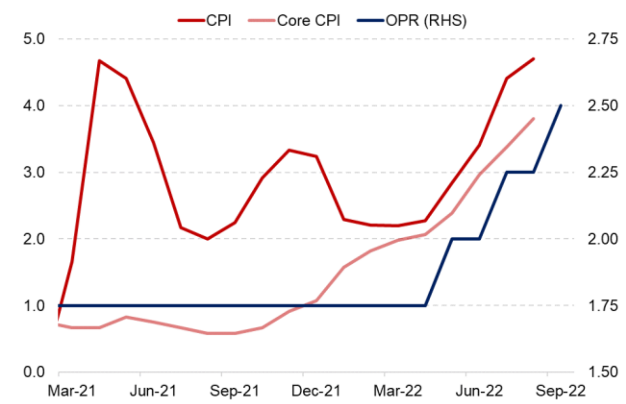
Source: CEIC, Kenanga Research

  - Moving forward, however, we retain the 2023 GDP growth projection of 4.0% - 4.5%, considering the imminent prospect of a global growth slowdown, brought about by an acceleration in the global monetary policy tightening cycle and as the domestic economy normalises as it gradually enters the post-pandemic phase.

  – **Inflation:** An increase in tourism-led spending and costs of imported inputs may continue to push prices higher in the next few months. In 2023, despite expectations of moderating price pressures, the headline consumer price index (CPI) may continue to accelerate due to the potential implementation of a new fuel pricing mechanism.

  - After a sudden spike in prices in July (4.4%; Jun: 3.4%), the domestic inflation rate may continue to hover around the 4.5 - 5.0% level in the near-term, before easing to an average of 3.6% in the 4Q22, due to the high base effect from last year, Bank Negara Malaysia's (BNM) monetary policy normalisation, and the government's record high subsidy bill. However, price of core goods is expected to rise further due to the tourism-pull inflation and higher input costs amid a weaker ringgit. As such, we maintain our 2022 inflation forecast at 3.3% (2021: 2.5%).

Graph 6: Malaysia Inflation Rate and BNM OPR



Source: CEIC, Kenanga Research

  - The improvement in the global supply chain due to China's potential reopening and labour market recovery, coupled with tighter financial conditions and a stronger local note, may bring the core inflation back down to average around 1.0 – 2.0% in 2023. Nevertheless, due to the expectation that the government may introduce a tiered fuel pricing system as early as January 2023 to reduce subsidy leakages, the headline CPI may increase further to an average of 4.2% in 2023. In an alternative scenario, if the government continues to provide fuel subsidy at current prices, headline inflation may subside to around the 2.3-2.5% level in 2023.

– **Monetary Policy:** While the tightening bias may remain intact until 4Q22, the hawkish momentum is likely to subside in 2023.

  - To realign with the global policy rate trend, the BNM may continue to increase the OPR for the fourth consecutive time in November, bringing it to 2.75%. The rate hike is necessary to curb upward pressure on demand amid a gradual improvement in the domestic labour market. However, in 2023, we are only assigning a 50.0% probability for another 25 bps OPR hike due to the expectation of slowing domestic economic growth and growing global recessionary risk due to the Fed's back-to-back jumbo rate hikes and Europe's energy crisis.

– **Ringgit:** The persistent strength of the USD index (DXY) may continue to exert pressure on the local note, however pro-ringgit catalysts may help to support the local note to trade around the 4.44 level in 4Q22 and around 4.30 in 2023.

  - After depreciating above the 4.50 level against the USD for the first time since January 1998 on September 7, the ringgit is likely to struggle for direction in the next few months, as the DXY is expected to remain elevated around the 108.0 – 112.0 level due to the market's cautious sentiment. The ringgit is also susceptible to changes in the global economic landscape and Malaysia's political sentiment. Given the potential of an early general election, China's possible invasion of Taiwan, and bets of another super-sized Fed rate hike post-Sep FOMC meeting, the local note may continue to be pressured around the current level. However, favourable domestic economic prospects amid strong tourism activity, yuan's potential strengthening post-Chinese Communist Party congress (October 16), USD seasonal weakness, and elevated commodity prices may help the ringgit to recoup some losses. Hence, our USDMYR end-2022 forecast has been revised upwards to 4.44 from 4.35.

Graph 7: USDMYR and DXY Trend

Source: Bloomberg, Kenanga Research

  - Moving forward, the ringgit may roller coaster between gains and losses and trade around the 4.40 – 4.50 in 1H23, before strengthening to around 4.30 by end-2023. In the first few months of 2023, the widening gap between the Fed and BNM policy rate may push investors away, pressuring the ringgit. However, in 2H23, the Fed's potential rate cuts and China's full-reopening prospects are seen to support the ringgit. On top of that, being one of the most undervalued currency (on a Real Effective Exchange Rate basis), Malaysia's strong fundamentals and a potential increase in the MGS-UST yield premium may continue to attract foreign funds into the country, further strengthening the local note.

– **Bond Market:** Foreign demand for Malaysian bonds may remain pressured in 4Q22, before charting a recovery in 1H23 as global risk sentiment improves. With that said, we maintain our end-2022 forecast for the 10Y MGS at 4.35% and our end-2023 target at 4.05%.

  - The Malaysian bond market may still record foreign outflows in the near-term, primarily due to a resurgence in global risk-aversion as the Fed maintains its aggressive tightening stance, and partly due to falling MGS-UST yield differentials. However, we reckon that bond flows may improve towards the end of 4Q22 on fewer government bond maturities and as the pace of Fed hikes may ease slightly. In 1H23, we reckon that foreign demand for Malaysian bonds will rebound on improving global risk sentiment as domestic bonds remain relatively attractive compared to other regional market bonds, especially with China keeping monetary policy accommodative. Local bonds are well positioned to attract foreign investors given Malaysia's robust

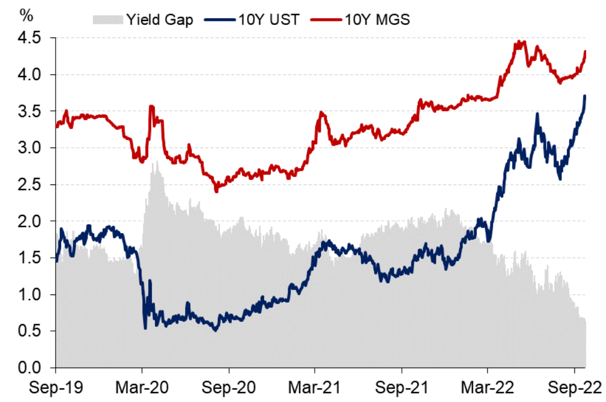
Table 1: 10Y MGS and UST Forecasts*

	Q4-22F	Q1-23F	Q2-23F	Q3-22F	Q4-23F
MGS	4.35	4.35	4.20	4.15	4.05
UST	3.80	3.80	3.55	3.25	3.00

*Source: Kenanga Research, *End of period* recovery, solid macroeconomic fundamentals, and positive yield differentials against developed market bonds, with only Indonesian bonds possessing more appealing yields.

- Domestic yields may continue to be partly steered by rising global bond yields in 4Q22, as BNM and other central banks remain on a tightening path. With that said, we believe that Malaysian bonds have become less sensitive to global bond yields, with correlations against developed market bonds on a downtrend, and the market appearing to have already priced in BNM's forthcoming rate hikes. As such, we expect the 10Y MGS yield to peak in 4Q22 at only 4.35% and to begin falling from 2Q23 onwards to 4.05% by end-2023, after global central banks complete their tightening cycles and as UST yields rapidly decline, on expectations of Fed rate cuts and a US recession.

Graph 8: 10Y MGS-UST Yields and Yield Gap

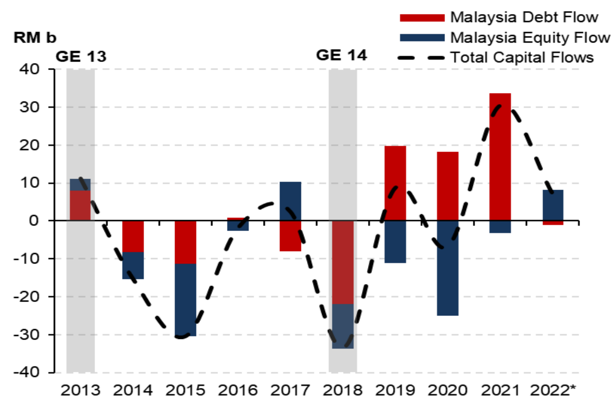


Source: Bloomberg, Kenanga Research

15th General Election (GE) Preview

- **An increasing probability of an earlier 15th General Election, in a bid to secure a strong mandate amid rising global economic uncertainty**
  - **Timeline:** Rising global and domestic economic uncertainties may compel the current government to call for an earlier election before the previously anticipated date (mid-2023). To note, the five-year government mandate will expire in July 2023 and the 15th Malaysian GE must be held within 60 days (September 2023) of the dissolution of parliament. At this current juncture, we reckon that the government may dissolve the parliament as early as the second week of October 2022, right after the tabling of Budget 2023. After the dissolution, we expect that the caretaker government may announce the date of the election to be on either the first or second week of November 2022. Alternatively, due to the year-end monsoon season, there is also a possibility that the election may be called in the first week of March 2023 instead.
  - **Key challenges and strategies**: Whether there will be a new government coalition or the status quo remains post-GE15 result, we expect the next leadership will need to deal with several key economic issues within its first one-year tenure in the administration. This includes addressing the fiscal deficit and elevated government debt, youth unemployment and a mismatch in job placement, rising cost of living, relatively low-income growth, and achieving higher potential GDP growth amid the rising risk of a global economic slowdown in 2023.
  - **Impact on financial markets**: We expect mild volatility in the financial markets following the dissolution of parliament and leading up to election day. Afterwards, both the bond and equity markets could potentially strengthen if the political leadership remains status quo, as investors will likely be encouraged by expectations of policy continuity. On the other hand, if the government changes, we expect the financial markets to face considerable pressure and possibly record a sharp increase in foreign capital outflows, particularly for the equity market.
    - Looking at the 14th General Election on May 9, 2018 and the unprecedented change in government, the FBMKLCI fell by 3.8% about a month following the surprise election results. It also triggered RM5.6b worth of foreign fund outflows in May, the largest in almost five years. This was mirrored by a broad bond sell-off that saw the 10Y MGS yield rise by 11.0 bps a month later and RM12.9b of bond outflows in May. However, the bond market began to chart a strong recovery thereafter, with bond yields and foreign flows returning to pre-election levels after two months. Meanwhile, the FBMKLCI remained relatively weak and the equity market continued to register foreign capital outflows until recently. In contrast, both the bond and equity markets strengthened

Graph 9: Foreign Capital Flows



*Source: BNM, Kenanga Research, *YTD*

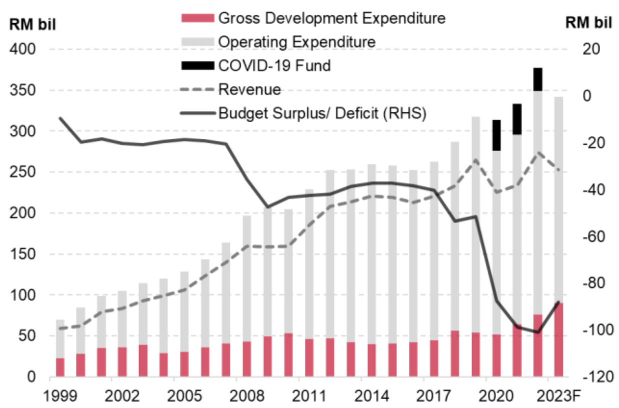
following the 13th General Election (May 2013) as the outcome was mostly within expectations, and investors were likely buoyed by the prospect of policy stability for another five years.

2023 Pre-budget Outlook

- **Government to continue with expansionary fiscal policy under the upcoming Budget 2023, to be tabled on the October 7, albeit narrowing in line with post-pandemic fiscal consolidation**

  - **Budget 2023:** In line with the budget theme of "Strengthening Recovery, Facilitating Reforms Towards Sustainable Socio-Economic Resilience of *Keluarga Malaysia*" the government is expected to balance the budget between supporting economic growth, improving people's wellbeing through targeted measures, and embark on fiscal consolidation to strengthen its fiscal position. The fiscal deficit for 2023 is projected to narrow further to 4.6% of GDP (2022F: -5.7%; 2021: -6.4%) as the economy returns to normalisation post-pandemic, and on the withdrawal of pandemic related support given that the country is no longer prone to recessionary risk.

Graph 10: Federal Government Finances



Source: Bloomberg, Kenanga Research

  - **Revenue:** Government revenue is expected to fall in 2023 due to the absence of special dividends from Petronas and *Cukai Makmur*, amid lower commodity prices as the world braces for economic slowdown and with the rising threat of inflation. Revenue is expected to shrink to RM253.0b in 2023 (13.3% of GDP), lower than the RM274.0b or 15.5% of GDP estimated for 2022 (versus Ministry of Finance (MoF) 2022 forecast: RM234.0b). The bulk of the revenue is expected to be contributed by higher direct and indirect taxes as the economy recovers post-pandemic and is boosted by the resumption of SST for new vehicles after March 2023. Nevertheless, we do not discount the probability of higher non-tax revenue, specifically higher dividends from Petronas for next year, on the expectation that crude oil prices remain elevated. On the prospect of reintroducing the Goods and Services Tax (GST), we opine that the best time to implement it will be as soon as 2H23 or as soon as new leadership takes over after the general election, as inflation may start to ease due to the dissipation of a low base effect. This will allow the government to raise its revenue and implement significant development projects to lift the country's economy while enhancing its fiscal position in the medium term.

  - **Expenditure:** The government may propose a lower spending plan amounting to RM342.0b in 2023 (2022F: RM377.0b), underpinned by a notable decrease in the operating expenditure (OE) (RM252.0b; 2022F: RM273.0b) and the absence of the COVID-19 fund. On the other hand, gross development expenditure is expected to increase to a record high of RM90.0b (2022F: RM72.0b) due to the continuation of high-multiplier infrastructure projects, mainly the Pan Borneo Highway, East Coast Rail Link and mass rapid transit, coupled with a potential revival of the KL-Singapore high-speed rail and Bandar Malaysia projects. On top of that, in an effort to ease rising cost of living and boost spending, the government may provide direct assistance in the form of cash handouts (i.e. *Bantuan Keluarga Malaysia*, e-wallet transfer), travel and merchandise coupons and bonuses for civil servants. Furthermore, an additional fund may also be allocated for the maintenance of federal roads. The government may also focus on improving food-related supply chains, strengthening the public health system, restoring small and medium enterprise competitiveness, adoption of automation and digital technology, intensifying domestic tourism, as well as promoting green growth and sustainable development.

  - **Debt and bond issuance**: For 2023, we expect federal government debt to edge higher to 62.3% of GDP (2022F: 62.0%; 2021: 63.5%), on a projected fiscal deficit of RM88.0b. To note, as of September 2022, the government has issued RM66.5b worth of new statutory debt, and considering the debt ceiling of 65.0%, there is still significant fiscal space of RM160.7b before reaching the statutory limit this year. Moreover, we expect statutory debt to remain well under the 65.0% limit in 2023.

Table 2: Federal Government Debt Headroom

			RM bil	
		Latest	limit	Balance
Offshore borrowing	2Q22	29.4	35.0	5.6
Malaysian Treasury Bills (MTB)	Sep-22	8.5	10.0	1.5
Statutory (MGS, MGII, MITB)	Sep-22	988.3	1149.0	160.7
Statutory (% of GDP)	Sep-22	55.9%	65.0%	9.1%
Total:		**1,026.2**	**1,194.0**	**167.8**

Source: BNM, CEIC, Kenanga Research

- Given our lower fiscal deficit projection in 2023, the government is expected to require less debt issuance to fund the budget and expenditure. We estimate a gross issuance of RM170.0b worth of government bonds next year, taking into account the RM88.0b deficit forecast and RM80.9b worth of MGS, GII, and SPK scheduled to mature. This would also be equal to our 2022 forecast of RM170.0b MGS and GII gross issuance (2021: RM163.2b), of which the government has raised RM123.5b as of mid-September from 26 auctions, with 10 more auctions remaining for the year.

Downside Risks

- **Malaysia's recovery momentum remains sensitive to several external risks** besides a global economic slowdown. Namely, China's zero-COVID policy and COVID-19 virus permutations as well as new variants remain a persistent concern, whilst geopolitical tensions could worsen and possibly derail a speedier global economic recovery
  - China's zero-COVID policy and its approach towards managing the pandemic would be a major game changer for global growth. Though there is no clear timeline on when China will relax its zero-COVID policy, we expect that any major shift in policy may happen after October when China's ruling Communist Party holds its congress from October 16, with Xi Jinping expected to secure a third leadership term. Besides, President Xi Jinping has started his first foreign trips since the pandemic hit in 2020, making a first overseas trip to Kazakhstan before travelling to Uzbekistan for a regional summit. Nevertheless, the probability for the zero-COVID policy to extend into 2023 remains high as the country recently locked down the cities of Chengdu and Shenzhen following multiple outbreaks.
  - In recent weeks, the growth of new COVID-19 and monkeypox cases across the globe have been abating. Despite the recent slowdown, there is still a possibility of future waves of infection, especially for COVID-19, as the Omicron variant continues to mutate and change. This constantly raises uncertainty surrounding our near-term economic outlook.
  - The Russia-Ukraine war has escalated following Ukraine's successful counter-offensive and Russia's subsequent "partial mobilisation", throwing more troops and financial support towards the war effort. As such, it looks increasingly likely that the conflict will drag on into 2023 and could worsen the coming recession in Europe. Meanwhile, the tensions between China and Taiwan may intensify over the next year, as China's continued presence across the Taiwan strait runs the risk of developing into an open conflict, which would adversely impact regional neighbours. A war in the Taiwan strait would also worsen supply-chain disruptions that already weigh on global growth and aggravate inflationary pressures.

Table 3: Forecast and Assumptions

	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F
Real GDP (%YoY)	6.0	5.0	4.2	5.9	4.7	4.4	-5.6	3.1	**6.5 – 7.0 (6.7)**	**4.0 – 4.5 (4.3)**
Consumer Price Index (avg.)	3.2	2.1	2.1	3.7	1.0	0.7	-1.2	2.5	**3.3**	**4.2**
Current Account Balance (% of GDP)	4.4	3.0	2.4	2.8	2.1	3.4	4.4	3.8	**3.9**	**3.4**
Fiscal Balance (% of GDP)	-3.4	-3.2	-3.1	-3.0	-3.4	-3.4	-6.2	-6.4	**-5.7**	**-4.6**
Unemployment Rate (%)	2.9	3.2	3.3	3.4	3.4	3.3	4.5	4.6	**3.9**	**3.4**
Manufacturing Output (%YoY)	6.1	4.8	4.3	6.0	5.0	3.8	-2.7	9.5	**7.7**	**4.5**
Exports of Goods (%YoY)	6.4	1.6	1.2	18.8	7.3	-0.8	-1.1	26.1	**27.0**	**5.8**
Overnight Policy Rate (end-period)	3.25	3.25	3.00	3.00	3.25	3.00	1.75	1.75	**2.75**	**3.00**
USDMYR (end-period)	3.50	4.29	4.49	4.05	4.13	4.09	4.02	4.17	**4.44**	**4.30**
Palm oil (RM/tonne, avg.)	2,384	2,166	2,649	2,791	2,235	2,244	2,767	4,407	**4,500**	**4,000**
Crude oil (Brent) (USDD/bbl, avg.)	99.5	53.6	45.1	54.8	71.6	64.1	43.2	70.9	**100.0**	**90.0**

Source: MoF, BNM, Bloomberg, Kenanga Research, F = Forecast

Table 4: Malaysia GDP Growth (constant 2015 prices) and Contribution to Growth By Sector (Supply) and Expenditure (Demand)

	KIBB									BNM
YoY %	**2021**	**1Q22**	**2Q22**	**3Q22F**	**4Q22F**	**1H22**	**2H22F**	**2022F**	**2023F**	**2022F**
By Sector										
Agriculture	-0.2	0.1	-2.4	-1.1	0.8	-1.2	-0.2	-0.7	1.1	1.8
Mining	0.3	-1.1	-0.5	2.0	1.7	-0.8	1.9	0.5	1.2	1.9
Manufacturing	9.5	6.6	9.1	9.9	5.4	7.9	7.6	7.7	4.5	5.2
Construction	-5.2	-6.2	2.4	4.9	0.9	-2.1	2.9	0.3	3.9	6.1
Services	1.9	6.5	12.0	14.0	1.5	9.2	7.4	8.3	4.7	6.8
Real GDP	**3.1**	**5.0**	**8.9**	**10.9**	**2.5**	**6.9**	**6.5**	**6.7**	**4.3**	**5.8**
								(6.5-7.0)	**(4.0-4.5)**	**(5.3-6.3)**
Ppt. Contribution										
Agriculture	0.0	0.0	-0.2	-0.1	0.1	-0.1	0.0	0.0	0.1	0.1
Mining	0.0	-0.1	0.0	0.1	0.1	-0.1	0.1	0.0	0.1	0.1
Manufacturing	2.2	1.6	2.2	2.4	1.3	1.9	1.9	1.9	1.1	1.3
Construction	-0.2	-0.2	0.1	0.2	0.0	-0.1	0.1	0.0	0.1	0.2
Services	1.1	3.7	6.8	7.9	0.9	5.2	4.2	4.7	2.7	3.9
Real GDP	**3.1**	**5.0**	**8.9**	**10.9**	**2.5**	**6.9**	**6.5**	**6.7**	**4.3**	**5.8**
								(6.5-7.0)	**(4.0-4.5)**	**(5.3-6.3)**
By Expenditure										
Consumption	2.5	5.7	15.3	8.0	4.4	10.3	6.1	8.1	4.1	7.5
Public	5.3	6.7	2.6	2.1	0.3	4.7	2.7	3.6	2.0	1.7
Private	1.9	5.5	18.3	9.7	4.3	11.5	6.9	9.1	4.6	8.8
Investment	-0.9	0.1	5.8	10.3	7.9	2.9	9.1	5.9	4.0	6.2
Public	-11.3	-0.9	3.2	21.7	11.5	1.0	15.1	9.1	2.3	9.3
Private	2.6	0.4	6.3	7.5	6.1	3.3	6.8	4.9	4.5	5.3
Public Spending	0.6	4.8	2.8	4.9	6.6	3.8	5.9	5.0	2.0	3.6
Private Spending	2.0	4.4	15.4	9.3	4.6	9.6	6.9	8.3	4.5	8.1
Domestic Demand	1.7	4.4	13.0	8.4	5.1	8.6	6.7	7.6	4.1	7.2
Exports	15.4	8.0	10.4	12.3	8.7	9.2	10.4	9.8	4.7	4.9
Imports	17.7	11.1	14.0	13.9	9.1	12.6	11.4	12.0	5.5	5.2
Net exports	-4.1	-26.5	-28.7	-5.7	5.1	-27.6	0.5	-12.8	-6.4	1.7
Real GDP	**3.1**	**5.0**	**8.9**	**10.9**	**2.5**	**6.9**	**6.5**	**6.7**	**4.3**	**5.8**
								(6.5-7.0)	**(4.0-4.5)**	**(5.3-6.3)**
Ppt. Contribution										
Consumption	1.8	4.2	10.4	6.0	3.2	7.3	4.5	5.9	3.0	5.4
Public	0.7	0.8	0.3	0.0	0.7	0.6	0.4	0.5	0.3	0.2
Private	1.1	3.3	10.1	5.9	2.5	6.7	4.1	5.4	2.7	5.2
Investment	-0.2	0.0	1.2	2.0	1.5	0.6	1.7	1.2	0.8	1.2
Public	-0.6	0.0	0.1	0.8	0.7	0.0	0.8	0.4	0.1	0.4
Private	0.4	0.1	1.1	1.2	0.7	0.6	0.9	0.8	0.7	0.8
Public Spending	0.1	0.8	0.5	0.9	1.4	0.6	1.2	0.9	0.4	0.7
Private Spending	1.5	3.4	11.2	7.1	3.2	7.3	5.1	6.1	3.4	6.0
Domestic Demand	1.6	4.2	11.7	7.9	4.7	7.9	6.2	7.1	3.8	6.7
Exports	9.5	5.4	7.5	8.3	6.0	6.5	7.1	6.8	3.3	3.4
Imports	9.8	6.9	9.2	8.7	5.6	8.1	7.1	7.6	3.6	3.3
Net exports	-0.3	-1.5	-1.7	-0.3	0.3	-1.6	0.0	-0.8	-0.3	0.1
Real GDP	**3.1**	**5.0**	**8.9**	**10.9**	**2.5**	**6.9**	**6.5**	**6.7**	**4.3**	**5.8**
								(6.5-7.0)	**(6.5-7.0)**	**(5.3-6.3)**

Source: DoSM, Kenanga Research, F: forecast, PPT: percentage point

For further information, please contact:

Wan Suhaimie Wan Mohd Saidie
Head of Economic Research
wansuhaimi@kenanga.com.my

Muhammad Saifuddin Sapuan
Economist
saifuddin.sapuan@kenanga.com.my

Afiq Asyraf Syazwan Abd. Rahim
Economist
afiqasyraf@kenanga.com.my

Zalman Basree
Economist
zalman@kenanga.com.my

Published and printed by:

KENANGA INVESTMENT BANK BERHAD (15678-H)
Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my