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KICK-OFF CONFERENCE
THE MID-TERM REVIEW OF RMK-12:

MALAYSIAN ECONOMIC INSIGHTS

The Everly Putrajaya

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Agenda

1. Key takeaways
2. Where are we now?
3. Regional comparison

KEY TAKEAWAYS

1. **Since the unveiling of RMK-12, the political, social and economic landscape has changed drastically.** None foresaw the deleterious effects of uneven post-pandemic economic recovery where global inflation reached a level unseen in decades. Most countries resort to monetary policy to rebalance their economies, Malaysia turbo-boosts subsidies amid higher petroleum-related revenues. The country is blessed with ample ammunition to combat the raging inflation, but it is costly on various fronts. Although there are attempts at reducing the fallout on the government's fiscal position (i.e. targeted subsidies), we should shelve the idea for now until the mechanism becomes clearer.

2. **As such, the mid-term review (MTR) of the RMK-12 discussion should consider Malaysia's strategic positioning amid regional competition.** Things are changing, but not all are within our control. It is virtually impossible to achieve a high-income nation status while maintaining high growth rates. Economic development is a journey/process, not a destination.

3. **We should not view the MTR in isolation, as we cannot afford to "rebuild" a better Malaysia with a blunt tool.** We applaud the end of the post-GE15 political deadlock and acknowledge that the coalition is premised on an untested formula. Judging from Prime Minister Anwar's recent statements, we believe that his administration intends to keep the government's purse strings as tight as possible amid a global slowdown in 2023. This will become contentious because austerity cannot be the answer to moderating growth. We must invest for the future. The problem is, that GE15 pushed all contested parties to the edge amid a divisive electoral outcome. We anticipate constant politicking from all sides in light of the upcoming by- and state elections, aided by media democratisation. While his decades-long struggle to assume premiership is finally over, the difficult task has just started.

Section 1

WHERE ARE WE NOW?

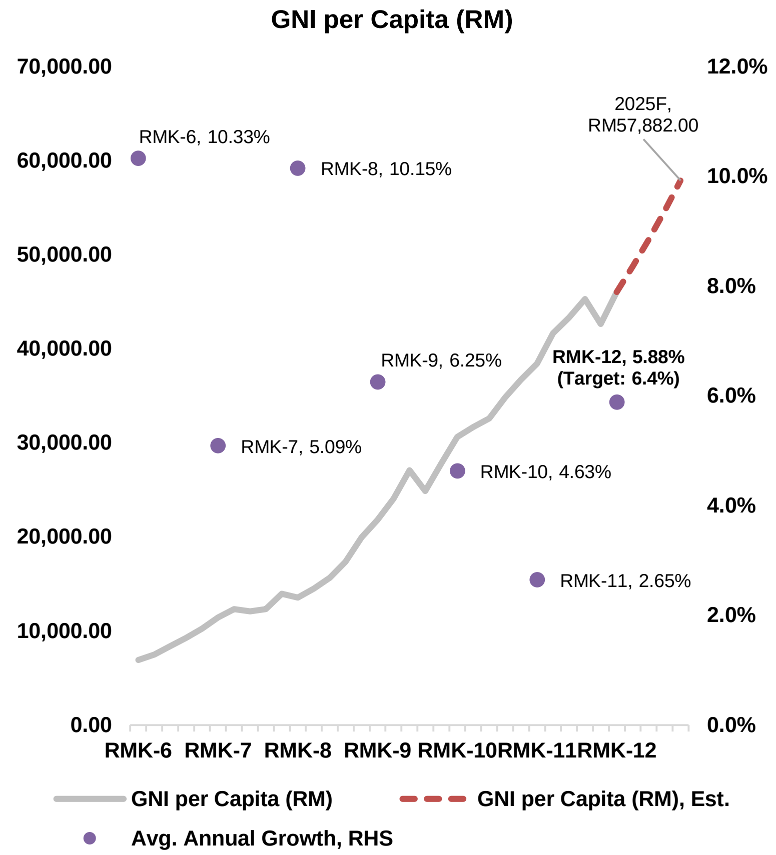
Selected RMK-12 macroeconomic targets

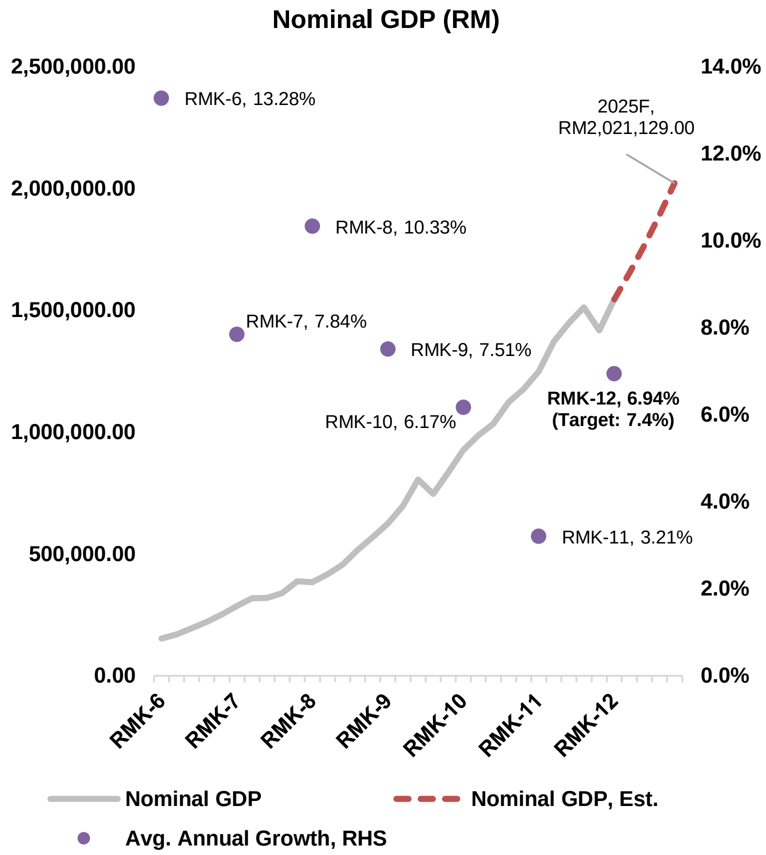
Item	RM Million				Average Annual Growth Rate (%)
	Target	Actual			RMK-12
	2025	2020	2021	9M2022	2021-2025
Private Expenditure	**1,598,578**	**1,011,165**	**1,031,536**	**857,798**	**8.1**
Consumption	1,308,310	800,514	815,388	676,348	8.7
Investment	290,268	210,651	216,148	181,450	5.5
Public Expenditure	**316,324**	**251,750**	**253,369**	**180,061**	**4.1**
Consumption	228,147	181,228	190,813	138,833	4.4
Investment	88,177	70,522	62,556	41,228	3.5
Net Exports	**106,495**	**87,070**	**83,472**	**50,733**	**3.1**
Exports of Goods and Services	1,192,185	830,157	958,334	801,015	6.5
Imports of Goods and Services	1,085,690	743,087	874,862	750,282	6.9
Gross Domestic Product	**2,021,129**	**1,345,145**	**1,386,739**	**1,110,095**	**7.4**
Gross National Income	**1,979,868**	**1,389,480**	**1,503,821**	**1,268,804**	**7.4**
GNI Per Capita RM	57,882	45,738	49,763	53,379	6.4
Inflation (%)	2.7	-1.1	2.5	3.2	2.7
Unemployment (%)	4.0	4.5	4.6	3.9	N/A

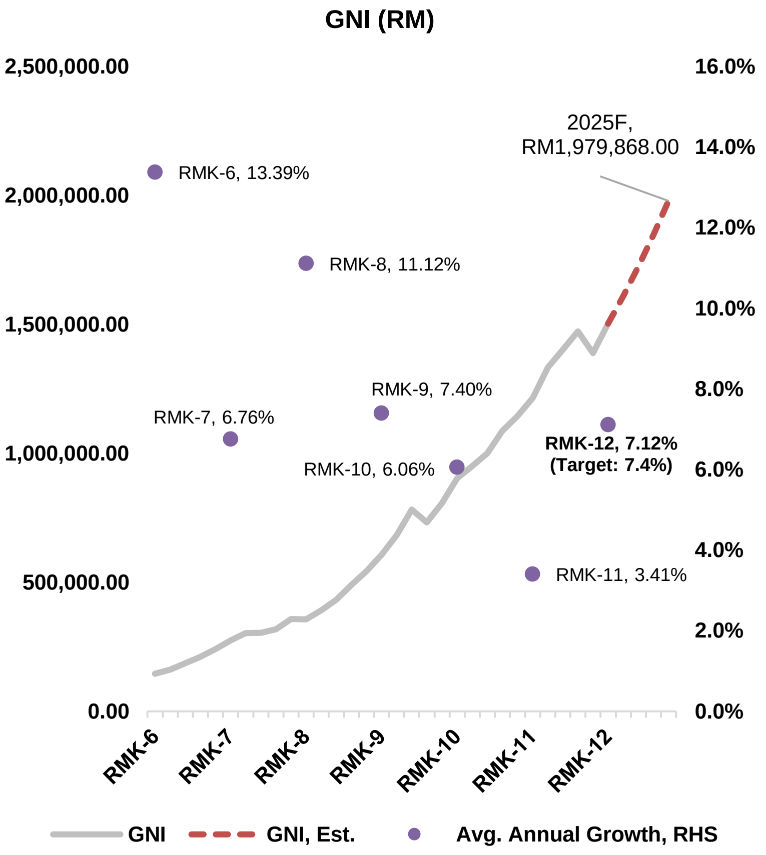
Sources: EPU, DOSM, Bank Islam

- Achieving macroeconomic targets is only one facet of development planning. In the past, Malaysia **rarely** meets all its initial RMK targets due to the evolving political and economic circumstances. It gets more complicated as globalisation and crises intensify over time. The mid-term review intends to realign macroeconomic targets and the ever-changing environment.
- There is still a long way to go in meeting RMK-12 targets. The new **administration must learn the ropes quickly enough** as the coming year will prove challenging amid an uneven post-pandemic economic recovery at the global scale. Let alone preparing the country towards the ageing nation status by 2030.
- This presentation attempts to **assess** the Malaysian economy through the rear-view mirror with hopes that the new government can power through the country amid increasingly unpredictable global and domestic economic environments.
- Important questions:
  - how far along are we?
  - What is happening around us? More importantly, ASEAN.
  - What variables are within our control and what can we do about them?
  - If we can do something about it, should we?

How far along are we?







Sources: DOSM, Bank Islam

- Short answer: Still a long way to go.
- Long answer: It all depends on how **<u>quickly</u>** we can bring both the demand and supply sides of the economy back to their pre-pandemic levels. Furthermore, growth headwinds are likely to manifest externally rather than internally.
- Assuming annual inflation to average **<u>2.7%</u>**, the real GDP growth for the remaining period of RMK-12 (2022-2025) should be **<u>at least 4.24%</u>**. *(Note: Bank Islam GDP growth projections: FY2022: 8.1%, FY2023: 4.5%, FY2024: 4.7% and FY2025: 4.5%).*

Can we keep inflation circa 2.7% during the RMK-12 period?

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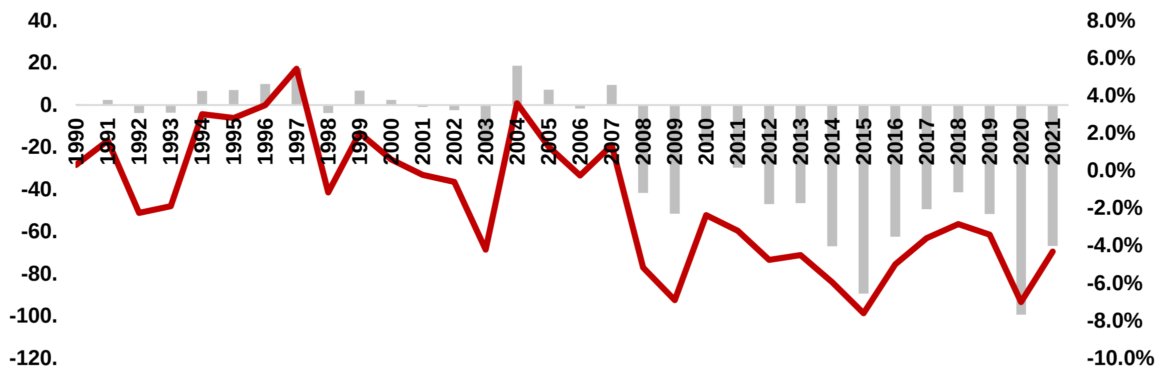
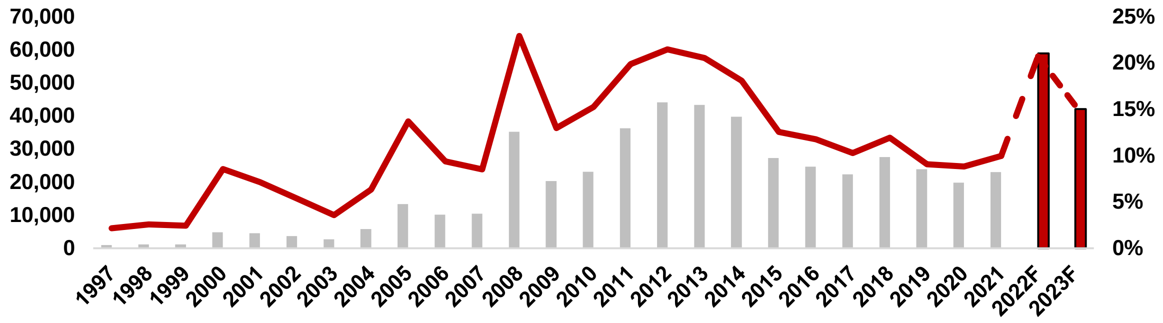
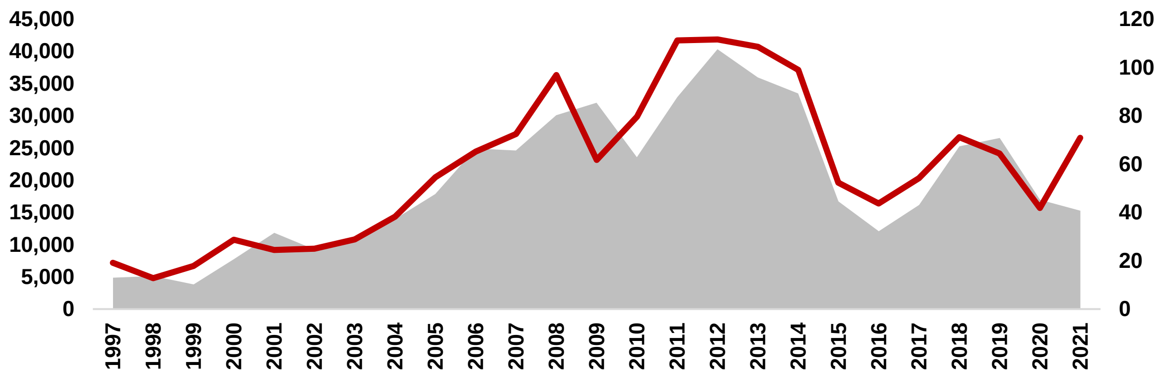
Fiscal Position, 1990-2021



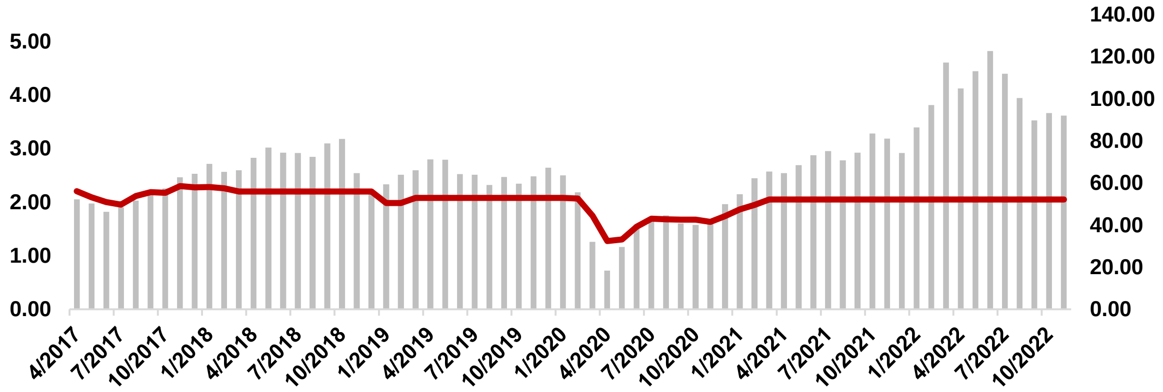
OPEX: Subsidies (RM mil)



PITA and Non-Tax Petroleum Royalty incomes vs. Brent Crude, 94% correlation



RON95 vs Brent Crude, 52% correlation



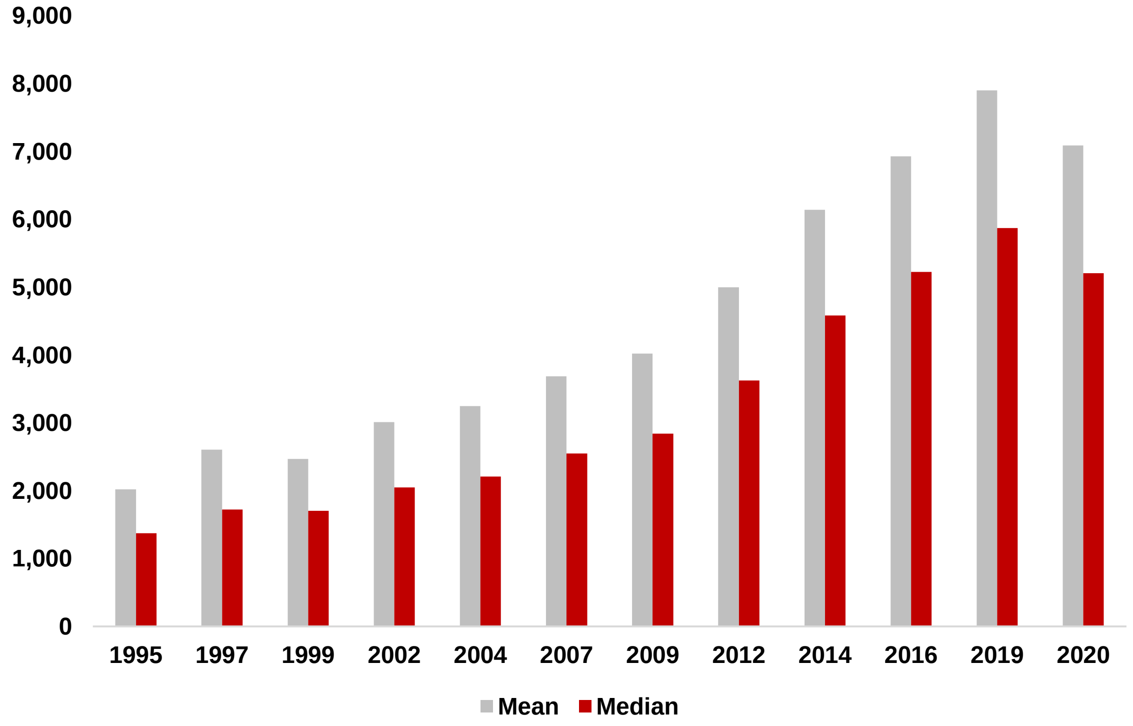
Sources: IMF, Bank Islam

- Malaysia's fiscal balance has been relatively **stable** post-GFC. The short-lived Goods and Services Tax (GST) breathed new life into the country's fiscal position. Regrettably, the repeal of GST in 2018 **forces** the government to rely increasingly on oil revenues to sustain its growth rates.

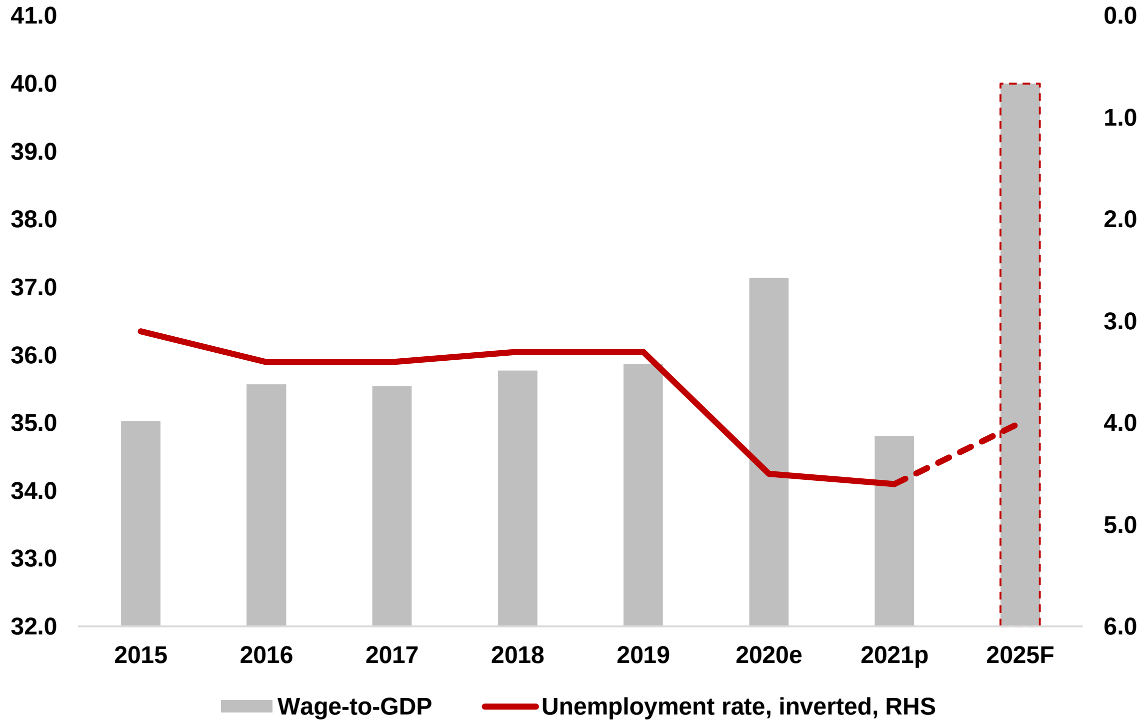
- The expansion of Malaysia's social protection system and subsidies is **straining** the government's operating expenditure sans tax reforms.
- The capping of RON95 since 2018 does not help.
- The idea of targeted subsidies may result in **higher inflation**.

We expect subsidies to continue until wages return to pre-pandemic trajectory

Monthly Gross Income (RM), 1995-2020



Wage-to-GDP and the unemployment rate, %



Sources: DOSM, Bank Islam

- Lockdowns hurt **all** economic actors, albeit at varying degrees. The mean and median incomes dropped amid the spike in the unemployment rate following MCO1.0.
- Wage-to-GDP in 2021 returned to around pre-2015 levels, **erasing all economic progress achieved in the last six years**.
- We view the recent decline in the unemployment rate as favourable to the prospects of labour market recovery. It will surely push incomes closer to the pre-pandemic levels, if not higher.
- As prices remain relatively the same during the pandemic, rising incomes/declining unemployment rate will be **inflationary**. Existing subsidies will likely continue in the near term, thus making targeted subsidies idea harder rather than easier.

Inflation is still relatively benign versus other countries. But at what cost?

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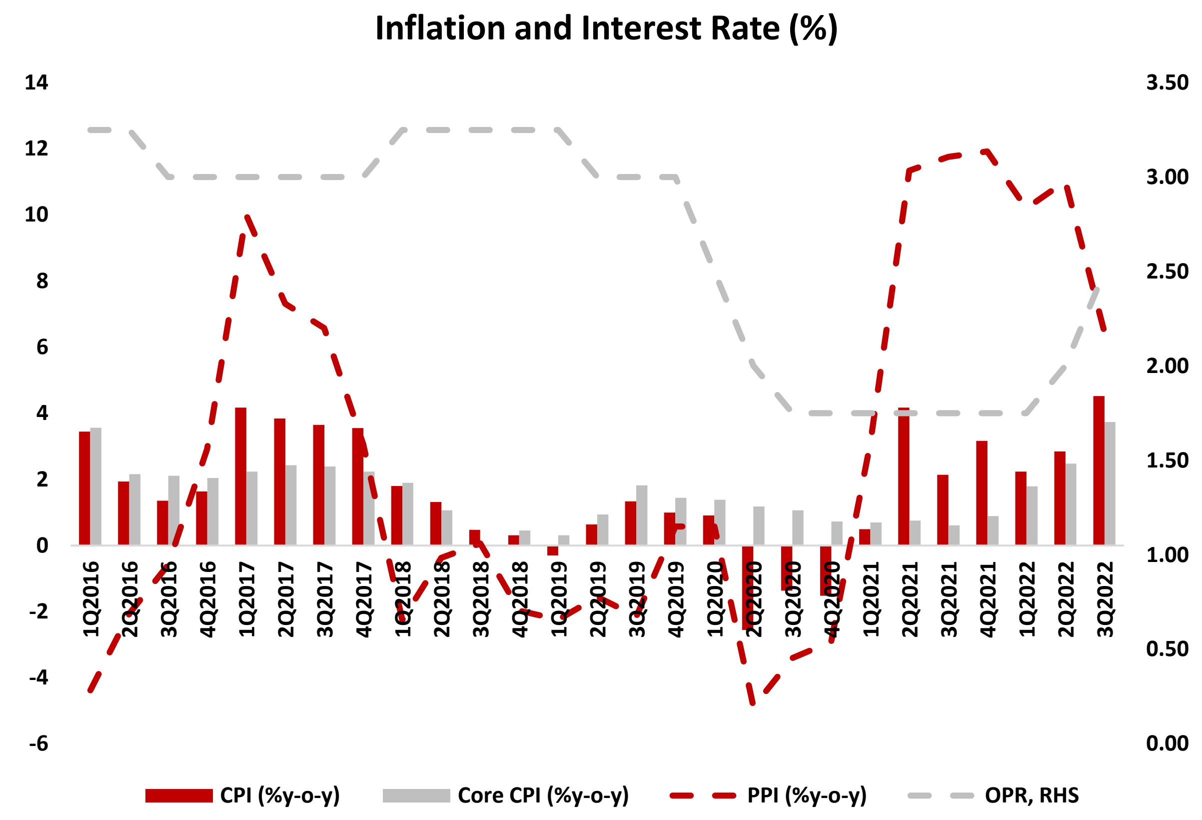

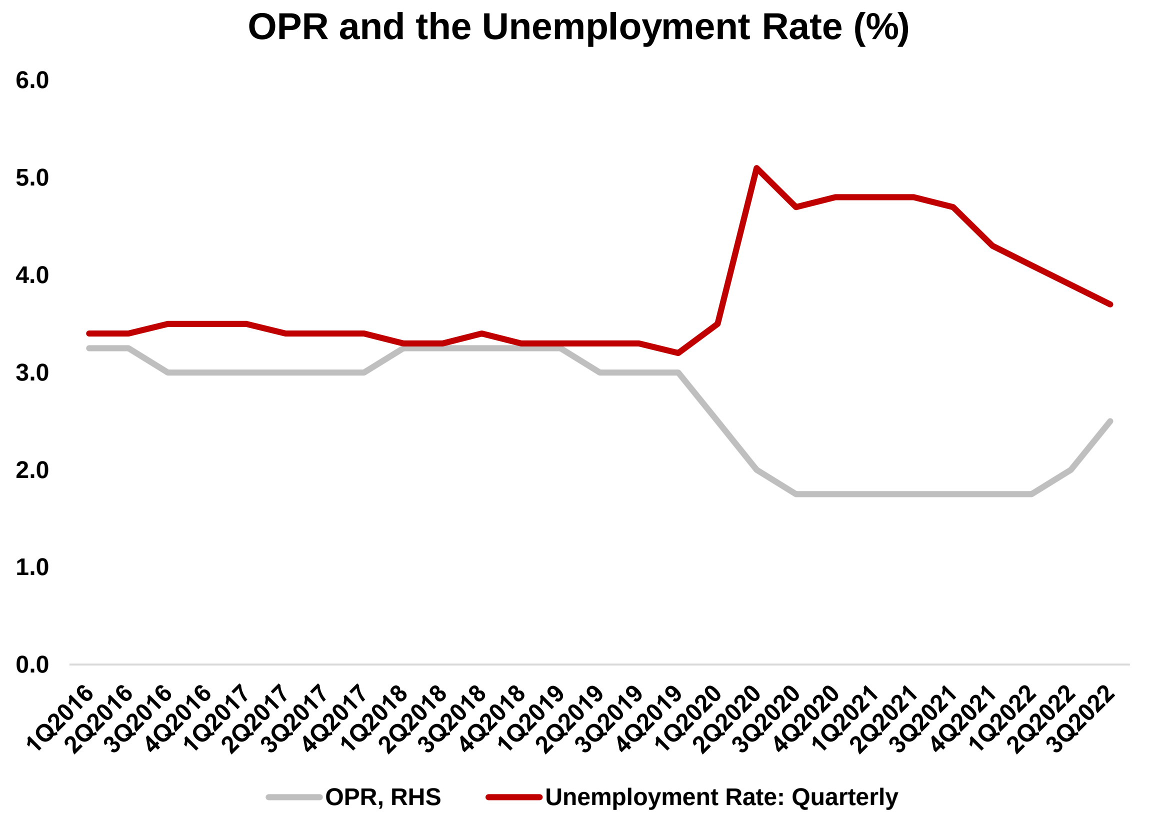

Sources: DOSM, Bank Negara, Bank Islam

- The government is able to increase subsidies amid higher petroleum-related revenues. We believe that **inflation has peaked**, although prices remain elevated still.
- Inflation in Malaysia is primarily **supply-driven**. PPI is highly volatile versus CPI and Core CPI.

- As the economy recovers, so is monetary policy.
- Unlike in many parts of the world, inflation gives limited clues to Malaysia's monetary policy direction. Labour market recovery means the OPR should progressively return to its new terminal level.
- OPR correlates more strongly with the unemployment rate than inflation (-91%).

Are we investing enough for the future?

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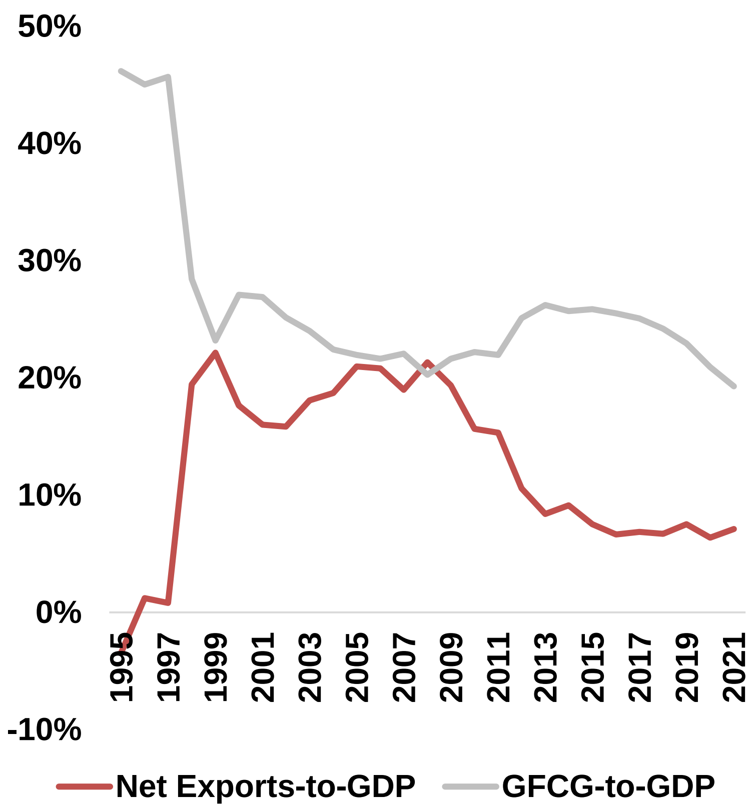
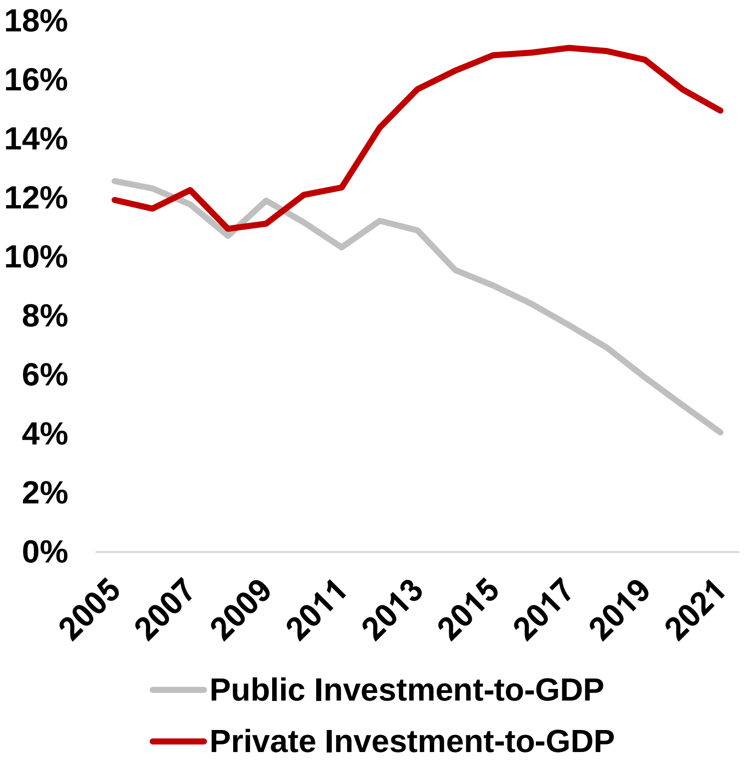
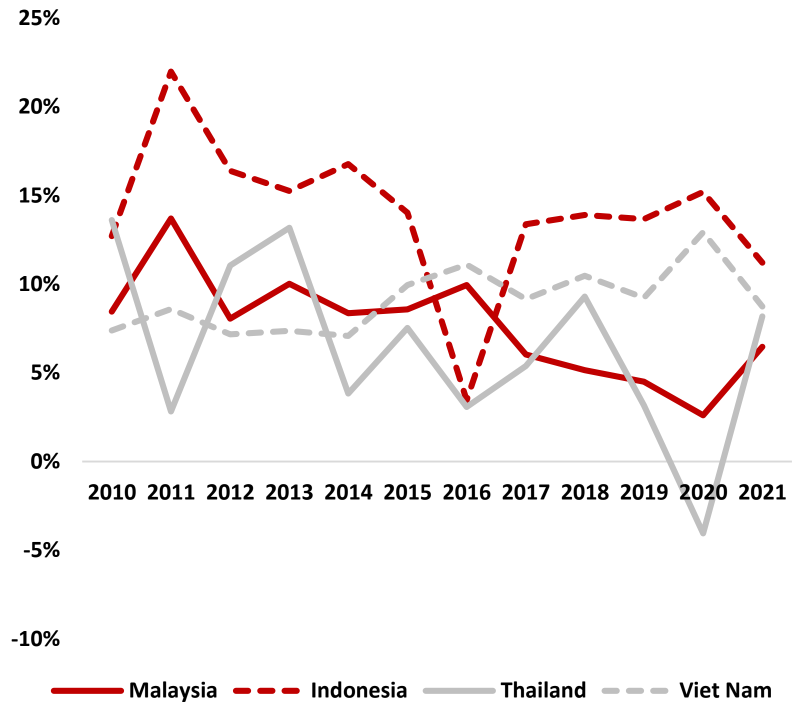
Investments and Net Exports



Public vs Private investments to GDP



Flows of Inward Foreign Direct Investment (FDI) to selected ASEAN Countries (% share)



Sources: DOSM, ASEANstats, Bank Islam

- Malaysia's prosperity today is a result of high investment levels pre-Asian Financial Crisis. The global economy today is unlike what it was in the past, so we should **refrain** from romantising our past glories and move forward.
- To sustain future growth rates, we should be wary about the **declining net exports-to-GDP and investments**.
- The rising income is a factor, so **technological upgrading is key** to pushing investments higher in the coming years.
- Public investments take a back seat as the economy gets larger.
- We are, however, **bullish** about Malaysia's investment prospects amid the on-going megaprojects (e.g. ECRL, Pan-Borneo Highway and MRT3) and the ratification of CPTPP.
- Although FDI in Malaysia is still healthy, **the share of investments relative to Malaysia's neighbours is steadily declining**.

Debt and debt service charges are climbing steadily since GFC. But at what cost?

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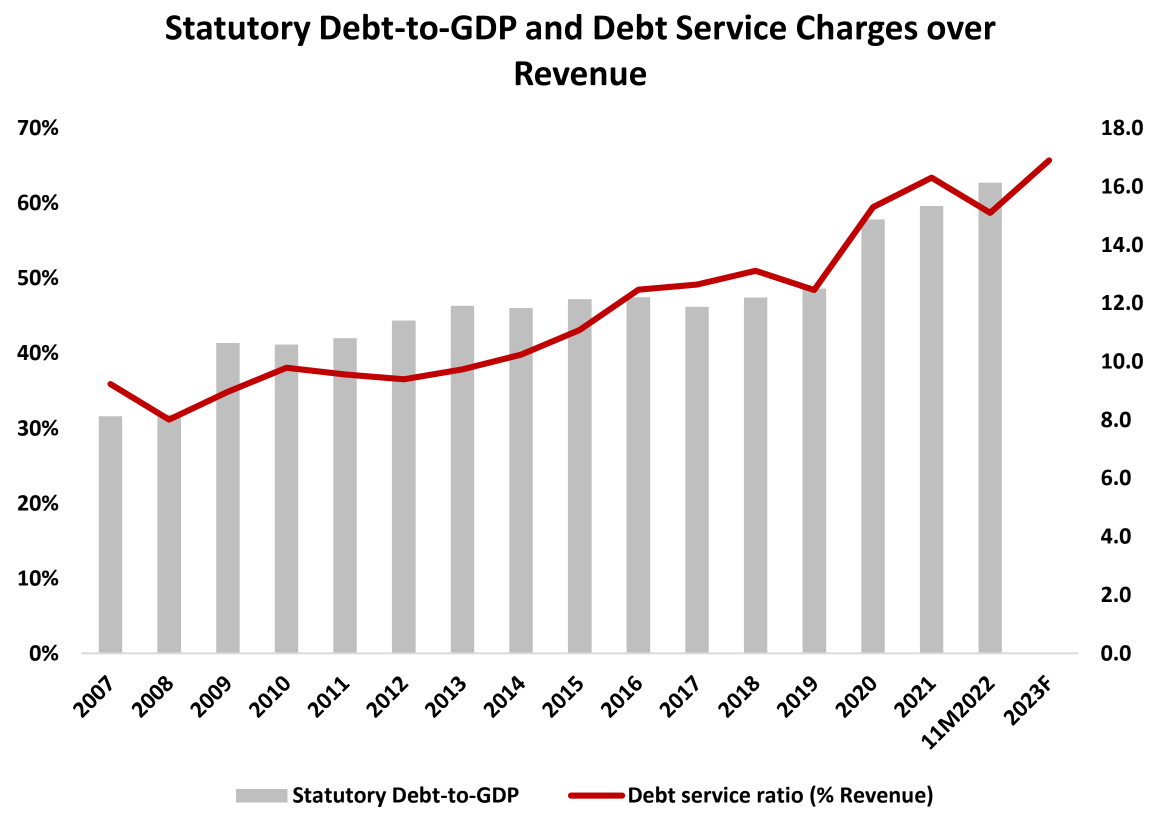
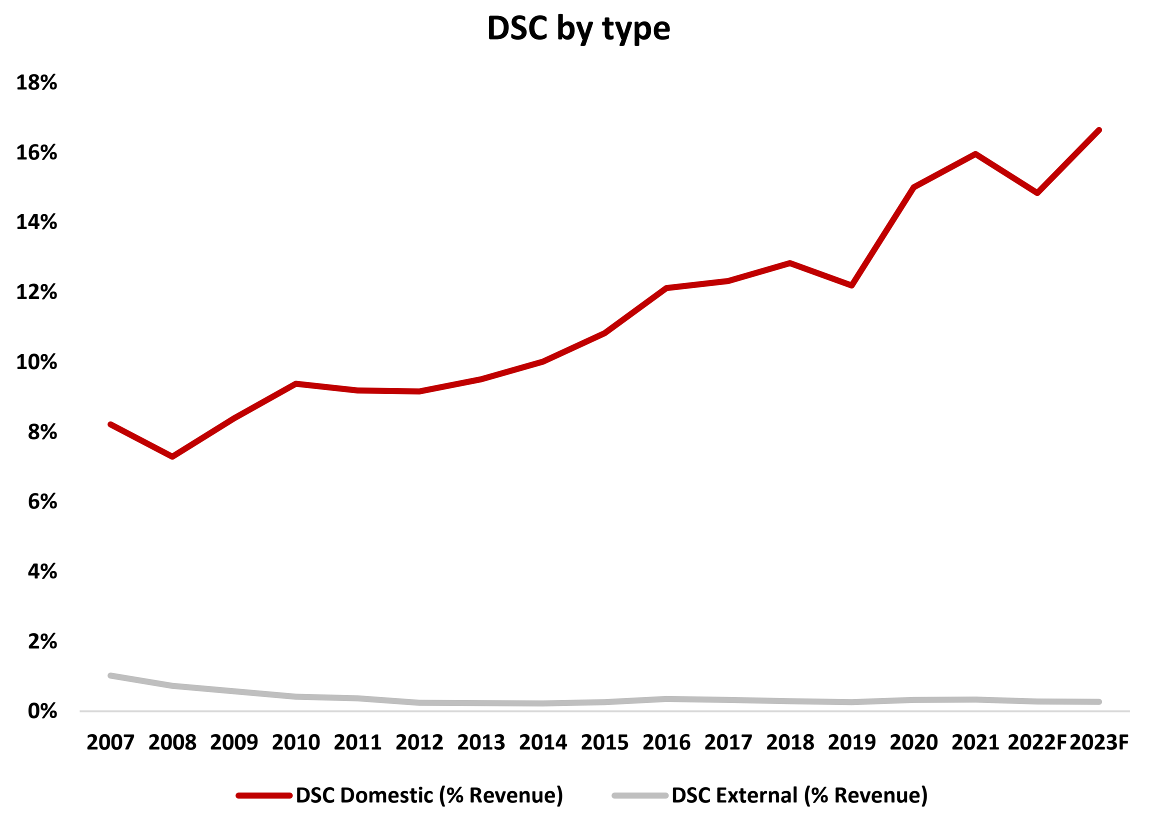




Sources: FAST Bank Negara, Bank Islam

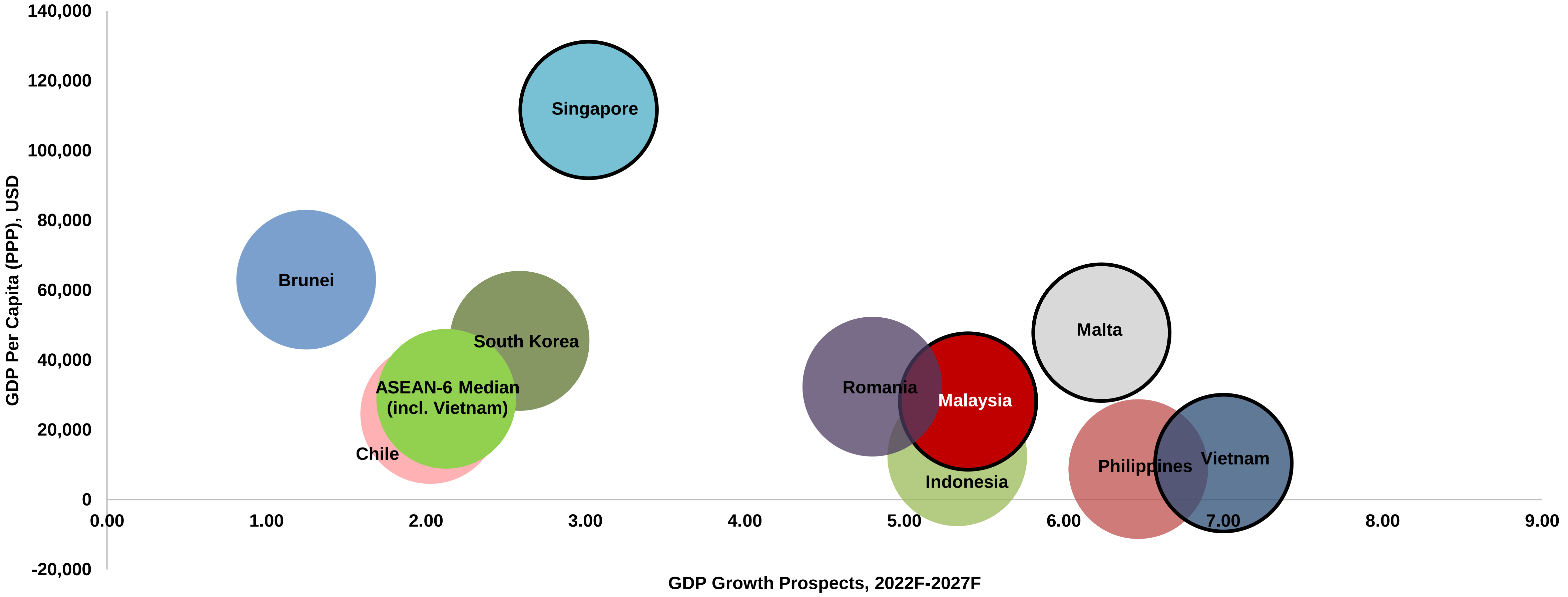
- The previous administration raised the debt ceiling twice, now standing at 65%, amid the pandemic-induced spending.
- **Debt-led spending means the government could get around reforming/improving the taxation system**.
- As a result, revenue growth **does not correspond** to Malaysia's growing economic size.

- The steady increase in DSC is due to the large issuances of RM-denominated debt.
- Low foreign-currency-denominated debt **decreases** Malaysia's sensitivity to global risk factors.

Section 2

REGIONAL COMPARISON

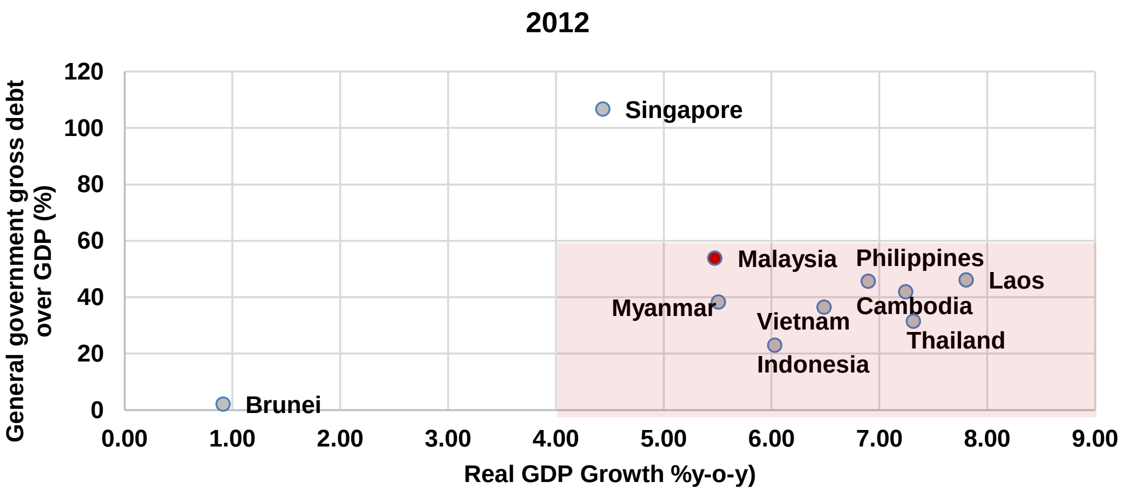
Malaysia's growth prospect is higher than ASEAN-6 median, but rising incomes remain a challenge to expand its economy

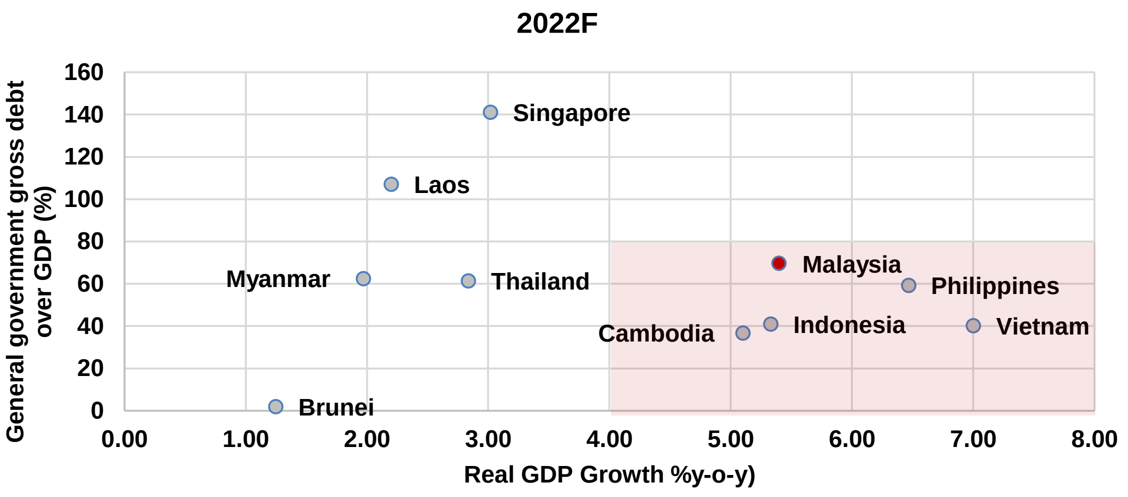


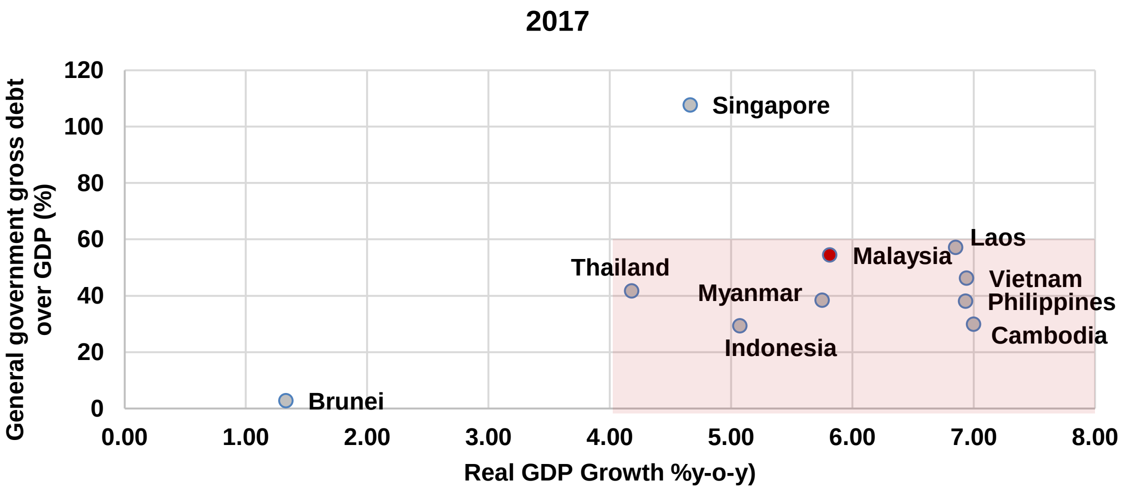
Sources: IMF, Bank Islam

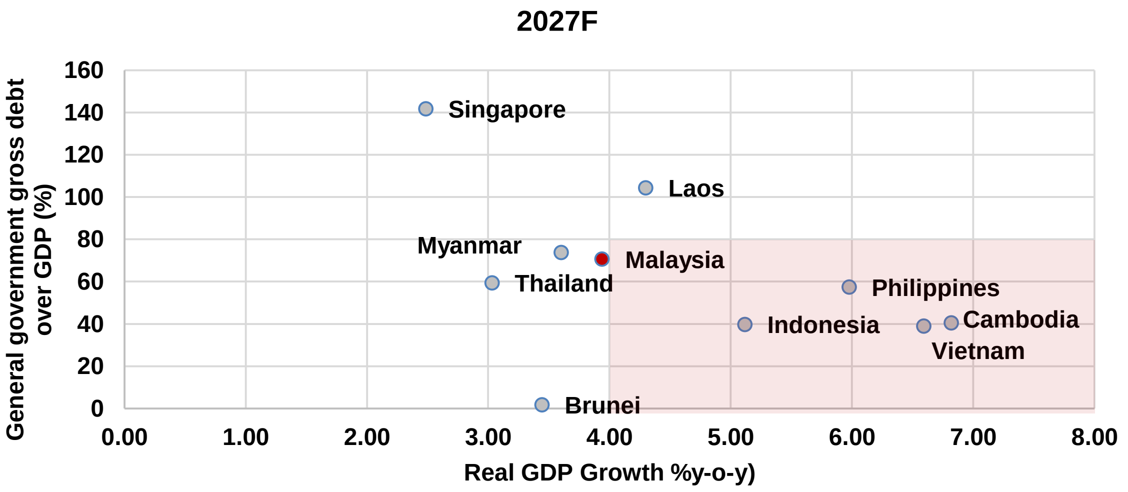
- While Malaysia is unable to sustain its past high growth rates, the country is still within a pack of high-growth countries.
- What makes Malaysia unique is its **well-diversified economy relative to its high-growth peers**, but it **can no longer play in the low-wage gallery** amid its small population size compared to Indonesia, the Philippines and Vietnam.
- There is a **tendency** for Malaysia to move to the left side of the quadrant (i.e. high-income, low growth rates) as it pursues its high-income nation status. As such, in order to remain competitive, Malaysia should **decide** which side of the quadrant represents its national interests best.

Malaysia's rising debt level does not seem to yield higher growth rates. The low-right quadrant is where we want to be.









Sources: IMF, Bank Islam

- Prior to the pandemic, Malaysia's debt-growth nexus was still favourable but close to the desired limit.
- Malaysia can maintain its performance relative to other ASEAN countries despite debt/pandemic-induced spending. However, IMF estimates show that the country's **future growth rates may moderate** vs its elevated debt level.

Malaysia appears to suffer greatly from a crisis relative to its neighbours.

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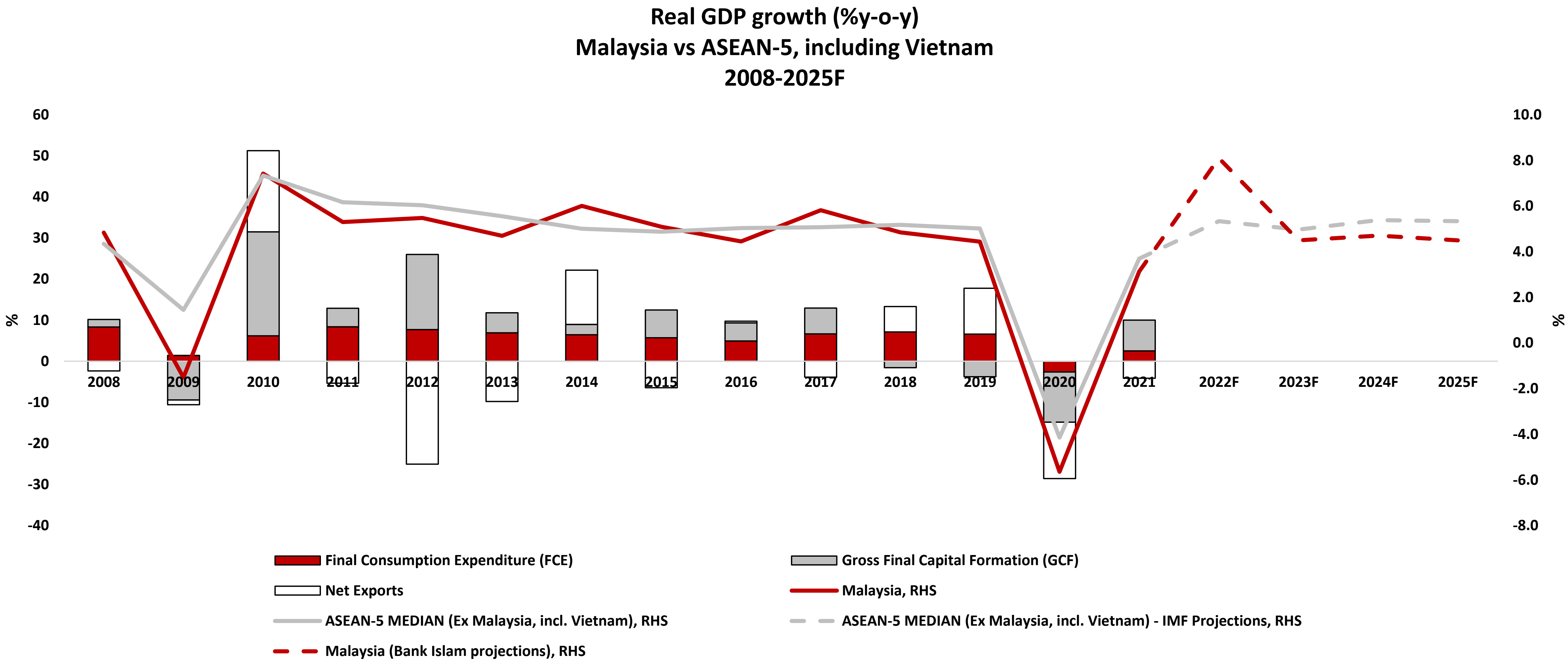
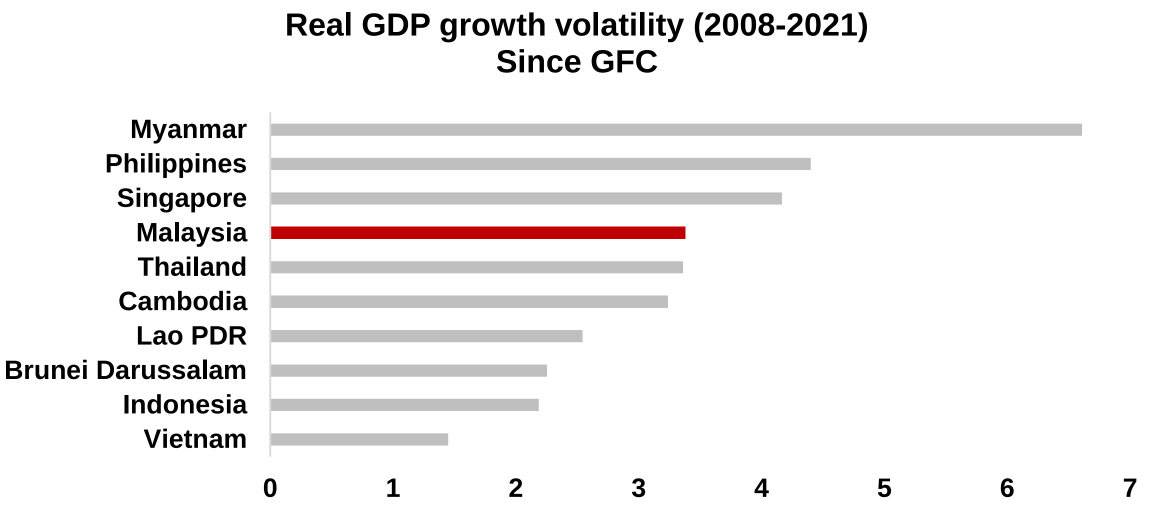
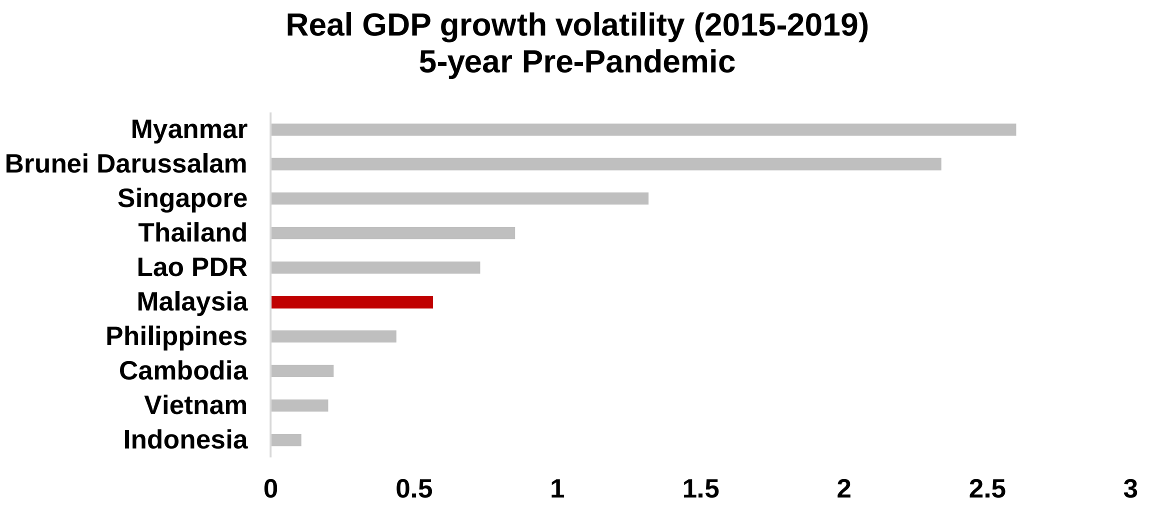


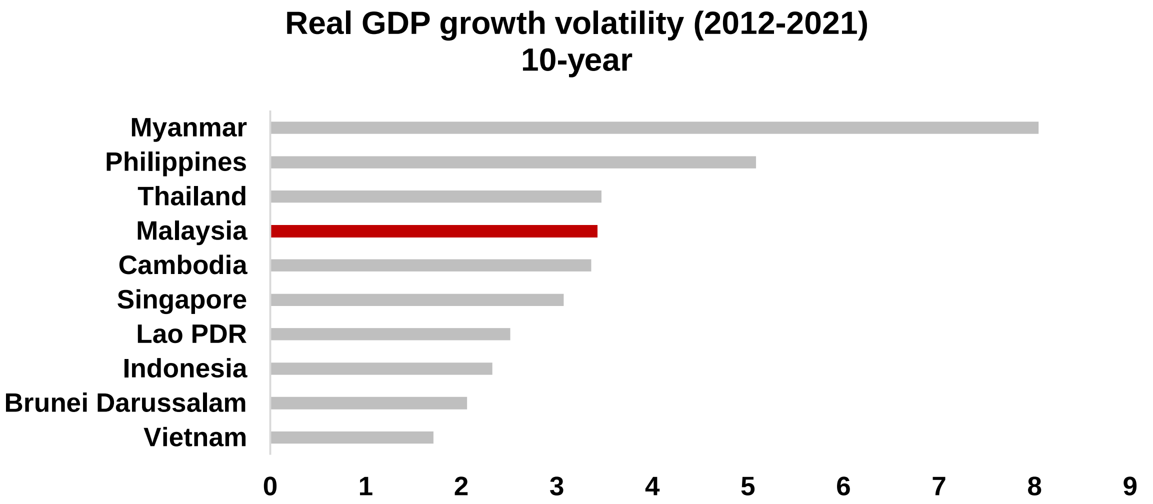
Sources: IMF, Bank Islam

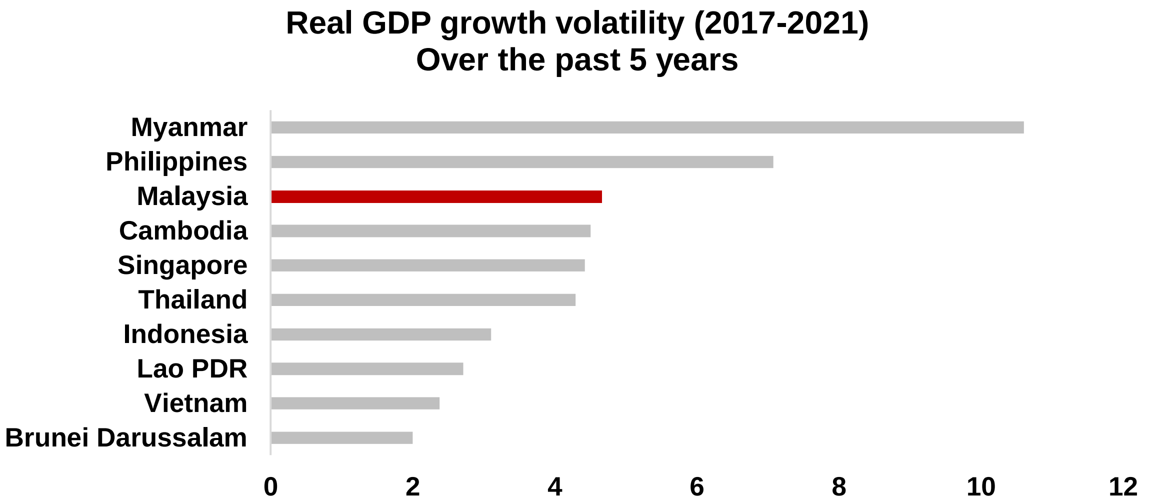
- For FY2022, Bank Islam expects Malaysia's real GDP growth to come in at **8.1%**. However, we foresee that growth will moderate in the coming years to **circa 4.5-4.7%** during the remaining period of RMK-12.

Malaysia should address its growth volatility amid the absence of revenue buffer





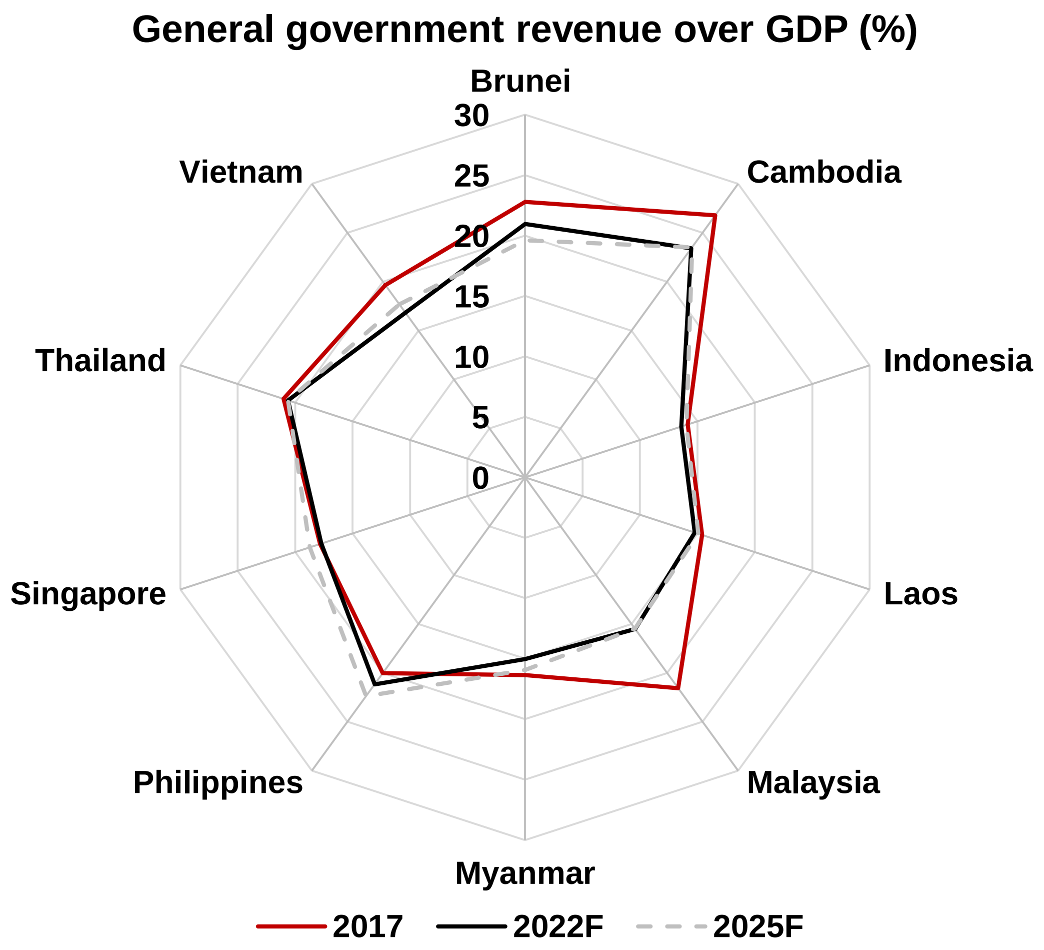




Sources: World Bank data, Bank Islam

- Malaysia's long-term growth volatility is **higher** than ASEAN median due to the lack of revenue buffer.
- The introduction of GST gave Malaysia the necessary fiscal support in times of crisis. **Following its repeal in 2018, Malaysia's growth rates became more volatile to changes in the economic landscape.**

Rising debt level at the expense of declining revenue-to-GDP



Sources: IMF, Bank Islam

- All other things being equal, Malaysia's **revenue-to-GDP will steadily decline over the RMK-12 period**.
- The IMF expects Malaysia's revenue-to-GDP in 2025 come in at 15.5% (RMK-12: 13.5%). The ratio may be the **lowest** in ASEAN after Laos (15.1%) and Indonesia (14.1%).

Economic size and incomes matter

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Ranking	Country	2012 GDP (current US$ Mil)
1	Indonesia	917,869.91
2	Thailand	397,558.22
3	Malaysia	314,443.15
4	Singapore	295,087.22
5	Philippines	261,920.51
6	Vietnam	195,592.47
7	Myanmar	58,318.68
8	Brunei Darussalam	19,047.94
9	Cambodia	14,054.44
10	Lao PDR	10,192.85

Ranking	Country	2012 GDP per capita, PPP (current $)
1	Brunei Darussalam	88,246.00
2	Singapore	82,065.00
3	Malaysia	22,985.80
4	Thailand	14,871.00
5	Indonesia	9,713.90
6	Vietnam	6,329.60
7	Philippines	6,296.80
8	Lao PDR	4,841.60
9	Myanmar	3,547.10
10	Cambodia	2,868.70

Ranking	Country	2021 GDP (current US$ Mil)
1	Indonesia	1,186,092.99
2	Thailand	505,981.66
3	Singapore	396,986.90
4	Philippines	394,086.42
5	Malaysia	372,701.36
6	Vietnam	362,637.52
7	Myanmar	65,067.81
8	Cambodia	26,961.06
9	Lao PDR	18,827.15
10	Brunei Darussalam	14,006.57

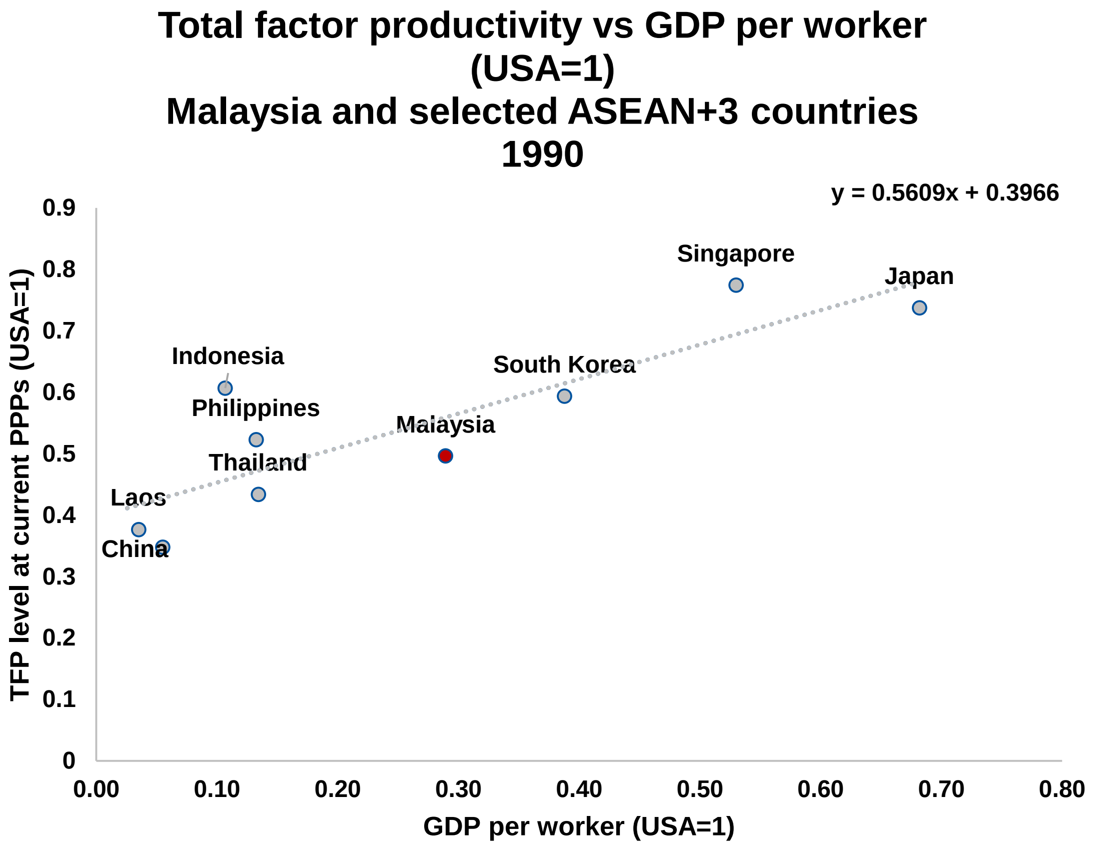
Ranking	Country	2021 GDP per capita, PPP (current $)
1	Singapore	116,486.50
2	Brunei Darussalam	66,619.90
3	Malaysia	29,617.30
4	Thailand	19,209.50
5	Indonesia	12,904.30
6	Vietnam	11,553.10
7	Philippines	9,119.70
8	Lao PDR	8,674.00
9	Cambodia	4,683.00
10	Myanmar	4,344.90

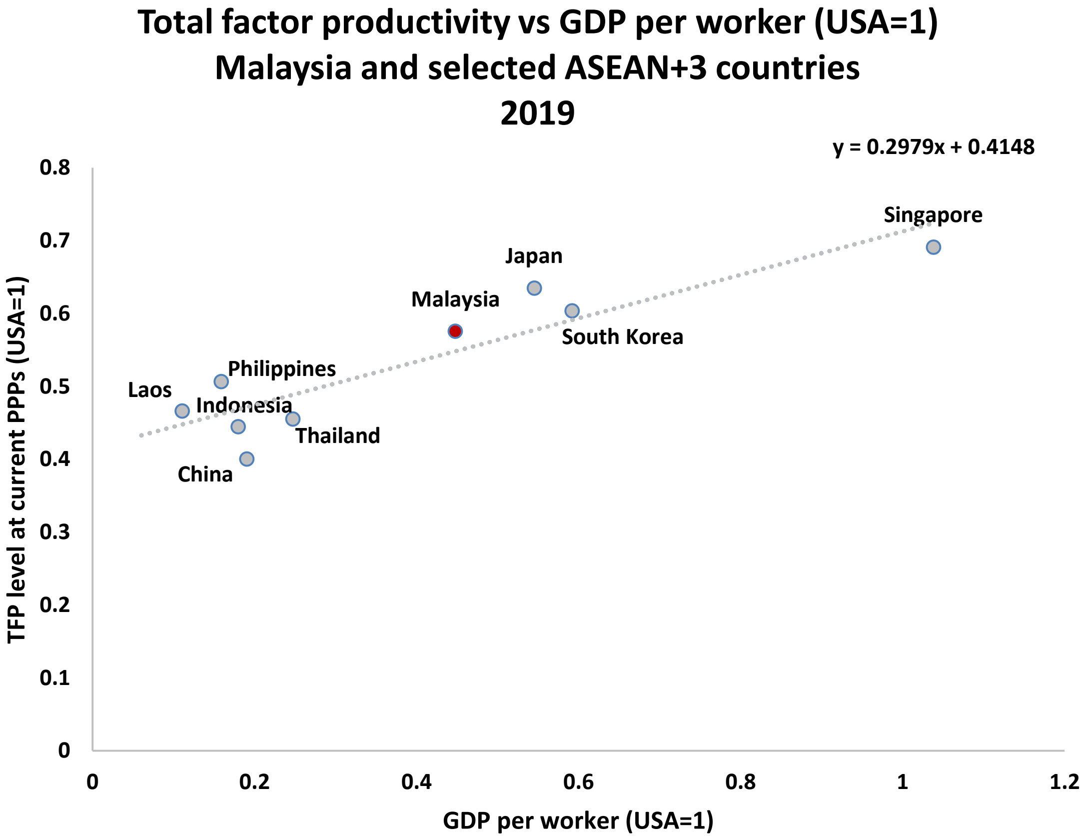
Sources: World Bank data, Bank Islam

- Over the past decade, Singapore and Philippines have **surpassed** Malaysia due to the latter's moderating growth rates.

- Malaysia is still ranked 3rd in the region from the income perspective.
- The GDP per capita of smaller countries, e.g. Vietnam (6.9%) and Laos (6.7%), **has been rising faster** than Malaysia's (2.9%) in the past decade.

Economic convergence: What is happening around us matters, too.



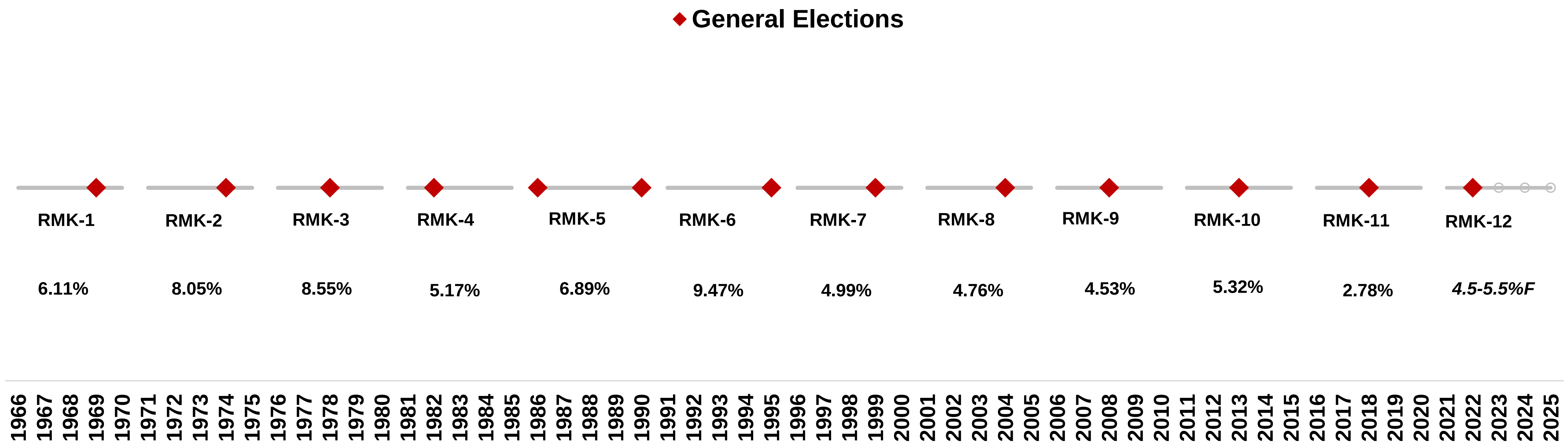


Sources: Penn World Table, Bank Islam

- Thanks to the 1971's New Economic Policy, Malaysia's wealth increased by 1990, although some countries appear to have leapfrogged closer to the US' level of development.
- As countries become more competitive, South Korea was closing in on Singapore and Japan.

- Despite various attempts to develop its economy, Malaysia has **<u>yet to surpass the halfway mark</u>** in terms of GDP per worker vis-à-vis the US.
- Meanwhile, **<u>South Korea has already overtaken Japan</u>** a year prior to the pandemic.

Should the new administration realign the political and economic cycles together?



Sources: SPR, DOSM, Bank Islam

- Looking back, Malaysia's **growth rates peaked** when the political and economic cycles were aligned (RMK-5 and RMK-6). The government then had all it took to push the Malaysian economy to a higher level.
- Considering that the new administration is new and untested, it is sensible to "reset" the targets to match its policy objectives. This is, obviously, ideal but worthy of debate.
- Having contested elections brings about contested policy objectives. Once the political mandate is secured, the victor/government has the upper hand in formulating and driving policies in line with their political ideology.
- The end of the post-GE15 political stalemate is **positive** on many levels. However, ideological differences across the political spectrum are apparent despite the government formation. We believe political white noise will continue – irrespective of the government's majority in the Dewan Rakyat – as the country will witness state-level elections by mid-2023. The democratisation of the media is not helping anyone but only the loudest. As such, we view the government as still **fragile sans a registered/unified political coalition**.

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