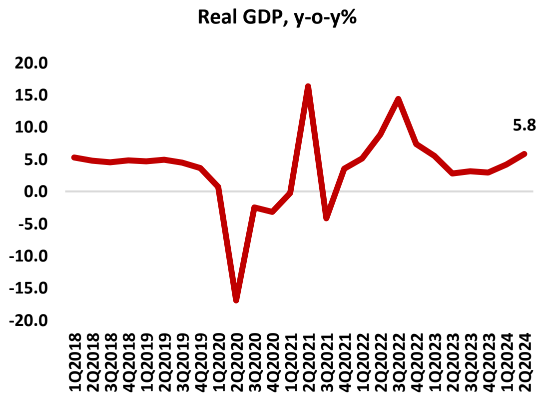
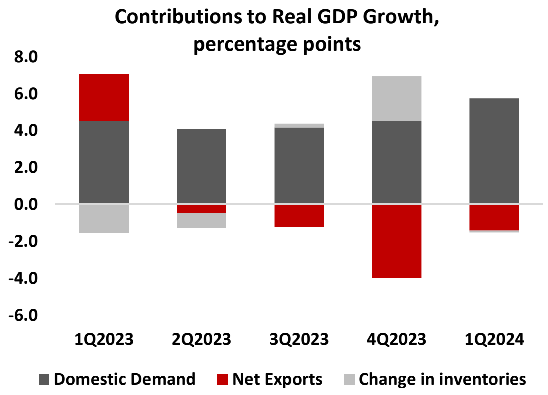
Imran Nurginias Ibrahim | Chief Economist | imran@bimbsec.com.my
Lee Si Xin | Economic Analyst | sxlee@bankislam.com.my
Nor Lyana Zainal Abidin | Economic Analyst | nlyanaz@bankislam.com.my
Khayrin Farzana Fazli | Economic Analyst | kfarzana@bankislam.com.my
Amiratul Husna | Economic Analyst | amira.husna@bimbsec.com.my

2H2024 ECONOMIC OUTLOOK: STEADY BUT SLIGHT MODERATION

- Malaysia's growth momentum thus far has aligned with our expectations at the start of the year. GDP growth in 2Q2024 is estimated to have accelerated to 5.8% y-o-y, up from 4.2% in 1Q2024, bringing overall growth in 1H2024 to 5.0% (1H2023: 4.1%). This robust performance is driven by resilient household consumption, a vibrant tourism sector, rising investments, and a pick-up in exports. While there is an upside risk to our current full-year growth forecast of 4.7% for 2024, growth is expected to moderate slightly in 2H2024 due to a more challenging global economic backdrop, including anticipated slowdowns in the U.S. and China, which could affect business and consumer sentiments. Our forecast remains within the official projection range of 4.0% to 5.0%.

- Moving into 2H2024, growth will remain supported by steady domestic demand, although at a moderated pace, as concerns about rising costs weigh on spending. This moderation will be tempered by a modest improvement in net exports, which have been the main drag on growth since 2Q2023, amid the global semiconductor recovery. Nevertheless, the outlook remains subject to several downside risks, largely stemming from global developments. With the U.S. presidential election approaching, there is potential for intensified U.S.-China trade tensions and resulting fragmentation, which could exacerbate the global slowdown.

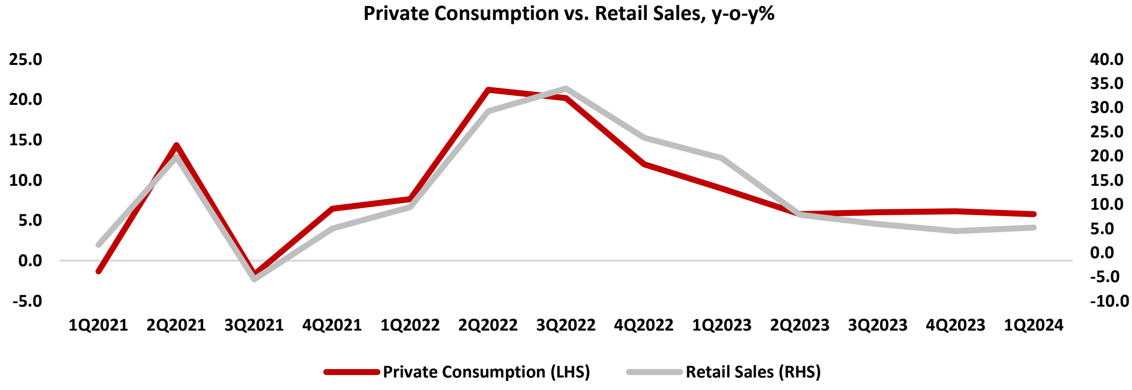




Sources: Department of Statistics Malaysia (DOSM), Bank Negara Malaysia (BNM), CEIC Data, Bank Islam

Private Consumption Is Expected To Moderate But Well-Supported

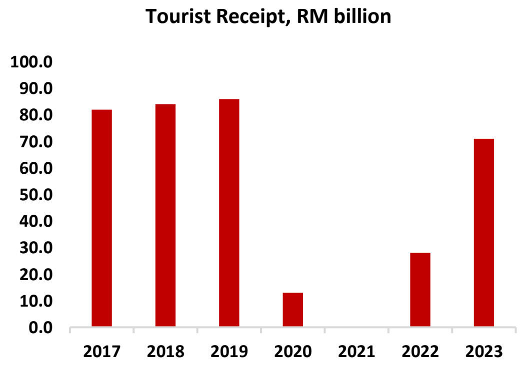
- The government's ongoing economic reforms, especially regarding fuel subsidies, are likely to make consumers more cautious in managing their finances. Private consumption is expected to moderate due to subsidy rationalization but will be bolstered by government cash transfers, EPF Account 3 withdrawals, and a salary increase for civil servants, supporting small-ticket purchases. Additionally, a rise in tourist arrivals and the upcoming civil servant salary hikes are projected to further enhance consumer spending in the coming quarters.



Sources: DOSM, CEIC Data, Bank Islam

Tourism Industry Poised To Exceed Pre-Pandemic Levels

- Malaysia's tourism industry is set to exceed 2019 pre-pandemic levels, driven by strategic airline partnerships and the 'Visit Malaysia 2026' roadmap. This year is poised to be a landmark for the sector, with record-breaking economic contributions, employment, and domestic spending. Tourism Malaysia is enhancing collaborations to attract global travellers and convert transit passengers at Kuala Lumpur International Airport into tourists, unlocking the nation's full tourism potential. In 2023, the tourism industry supported the services sector with a stronger-than-expected revival, surpassing the official target of 19.1 million arrivals by reaching over 20.1 million tourists (2022: 10.1 million persons). Singapore led with an impressive 8.3 million visitors. Additionally, total tourist receipts amounted to RM71.3 billion, surpassing the RM28.2 billion recorded in 2022.



Sources: Ministry of Finance (MoF), Tourism Malaysia, Bank Islam

Investment To Maintain Positive Momentum

- Investment is expected to maintain positive momentum in the second half of 2024, supported by the remaining 40% of development expenditure (DE) and rising demand for data centres and industrial facilities. The diesel subsidy rationalization is expected to boost the government's fiscal capacity, accelerating key infrastructure projects such as the East Coast Rail Link (ECRL), Phase 1B of the Pan-Borneo Highway, the Penang Light Rail Transit (LRT) project, LRT3 station reinstatements, flood mitigation plan, Penang Airport expansion and the Johor – Singapore Special Economic Zone (SEZ). Furthermore, we expect sustaining private sector flows to be led by data centres (DCs) where the pipeline continues to be strong, driven by competitive land and energy costs. However, investment growth may be constrained due to limited fiscal space, high debt-to-GDP nearing 65%, tight financial conditions, and geopolitical tensions affecting investor confidence.

- We believe the New Industrial Master Plan (NIMP) 2030 and the National Energy Transition Roadmap (NETR) will continue to drive growth and attract investments in the second half of 2024. The NIMP 2030 is anticipated to boost the FDI inflow by effectively implementing reforms, including opening service sectors that are more restricted in Malaysia compared to other countries. Meanwhile, the investment commitments for the flagship NETR projects have reached RM60.7 billion, surpassing the initial RM25 billion target. The effective implementation of the NETR is expected to boost national GDP, create job opportunities, improve socioeconomic status, and ensure energy security and environmental sustainability.

Trade To Accelerate Further Following Rebound In Electrical & Electronics (E&E) Exports

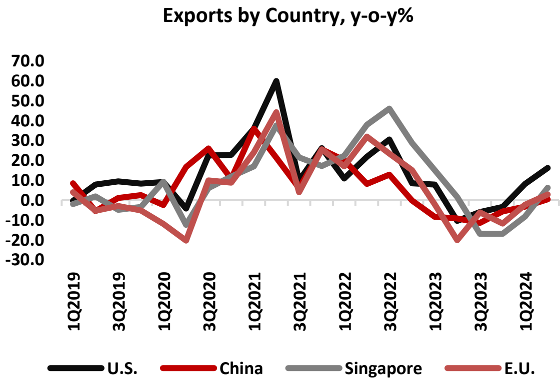
- Malaysia's trade has been on an upbeat momentum in 1H2024 with imports hitting double digit yearly growth for five months during the period while exports had rebounded last year's slump, where it trended in the red for ten straight months. During the second quarter, imports surged by 15.0% from 12.5% in 1Q2024 while exports accelerated by 5.8% (1Q2024: 2.0%).

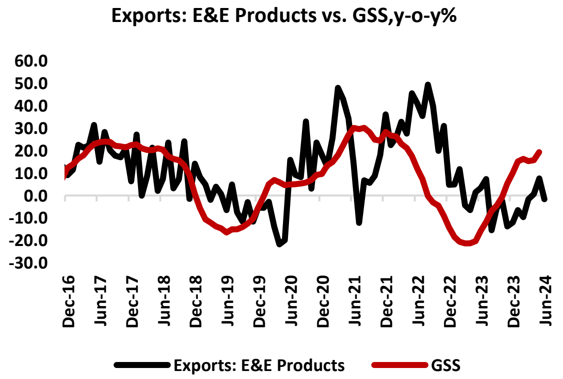
- Reflective of the ongoing infrastructure development projects, strong expansions are observed in related imports, namely the industrial transport equipment, primary and processed industrial supplies, as well as capital goods. As such, we believe the continued strength of the construction sector will bolster imports growth, alongside the resilient domestic demand.

- Meanwhile, in line with our expectations, the Global Semiconductor Sales (GSS) upcycle was a boon to our exports. Exports of E&E – which consistently makes up the largest share of Malaysia's exports – finally rebounded by 2.1% in 2Q2024 after trending in the contractionary zone for the past four quarters.

- Moving into 2H2024, we remain optimistic that trade will improve further, backed by the global economic stabilisation and the technology upcycle. In its June report, the World Semiconductor Trade Statistics (WSTS) projects the global semiconductor industry to grow by 16.0% in 2024 as global demand for technology and electric vehicles (EV) increases. As such, we believe demand for Malaysia's E&E exports will rise, which in turn will be a positive driver for exports growth.

- Downside risks to trade are the 1) moderating global demand, stemming from persistent elevated interest rate environments and slower than expected growth in advanced economies; and 2) escalation of trade tensions between U.S. and China.





Sources: DOSM, Bank Islam

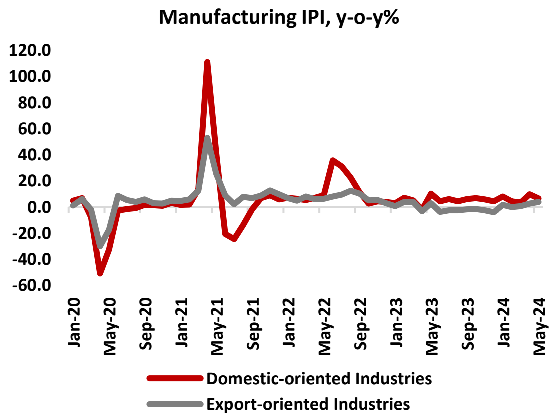
Manufacturing Sector To Rise In Tandem With Upbeat Trade Performance

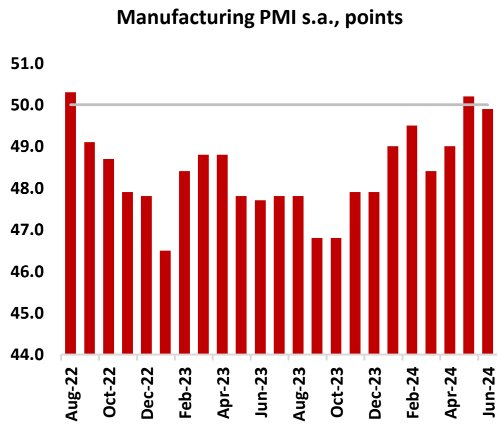
- The manufacturing sector growth had picked up from the rocky performance last year with the manufacturing Industrial Production Index (IPI) surging by 3.6% during 5M2024 (5M2023: 1.9%). Such performance was driven by the recovering global demand as well as the resilient domestic demand.

- Thus far, Malaysia's export-oriented output had expanded to the highest level since November 2022 (May: 3.7% vs. Apr: 2.6%), backed by the strong recovery of the Manufacture of computer, electronics and optical products, reflecting the rising global technology demand. Parallel to the rebound of trade, we believe the factory activities will ramp up further in 2H2024 as external demand strengthens.

- Domestically, resilient household consumption played a pivotal role in supporting the sector with the domestic-oriented output trending in the positive territory throughout the first half (May: 6.4% vs. Apr: 9.5%). In May, the manufacture of motor vehicles, trailers, and semi-trailers recorded a double-digit growth of 10.3%, backed by fulfilment of new and backlogged orders amid solid motor vehicles sales.

- However, we foresee domestic demand to moderate in 2H2024 due to higher costs of living as well as the fuel subsidy rationalisation. Household spending will be dragged as the higher transportation costs weighs on the households' financial abilities, and consequently, production for domestic-oriented output will experience a slowdown. Moreover, the Manufacturing Purchasing Managers' Index (PMI) slipped back in the red in June (49.9 points vs. May: 50.2 points) as business firms are reported to scale back their purchasing activities and production following increases in input costs.





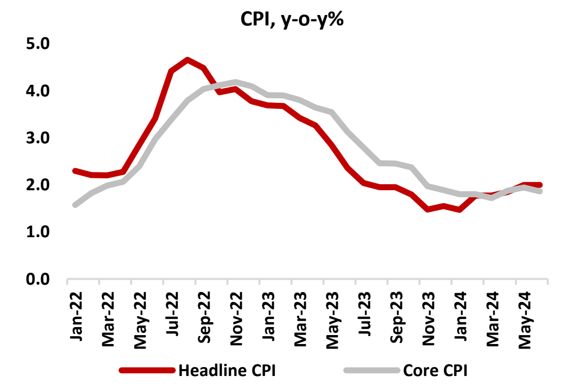
Sources: DOSM, S&P Global, Bank Islam

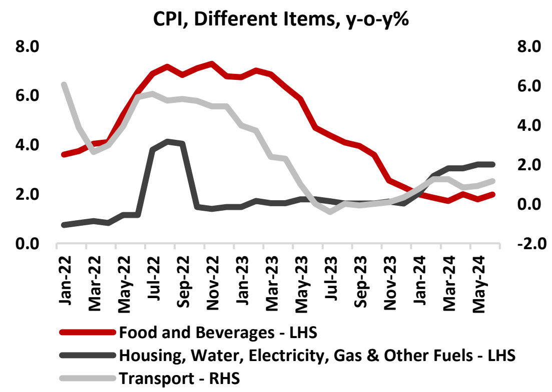
Downside Potential To Our 2024 Inflation Forecast

- Both Malaysia's headline and core inflation remained modest in the first half of 2024, averaging 1.8% (1H2023: 3.2% and 3.6%, respectively), despite pressure on the ringgit and several policy changes. The policy changes included an adjustment in water tariffs for domestic users in February, a 2.0% increase in the Services Tax rate in March, and the rationalisation of diesel subsidies beginning on June 10. The relatively contained inflation rate was largely due to the high base effect from the previous year and a global trend of disinflation.

- The Inflation trajectory in 2H2024 will depend on whether the RON95 subsidy rationalisation is implemented and if so, its magnitude. Given petrol's heavier weight of 5.5% in the Consumer Price Index (CPI) basket, compared to diesel's 0.2%, the impact of the RON95 retail price adjustment on inflation is expected to be more pronounced. According to our simulation, headline inflation could surge above 4.0% if the RON95 retail price is increased by more than a half, similar to the scale of the hike in diesel retail prices following its subsidy rationalisation.

- However, given the increasing likelihood that the government will delay the RON95 subsidy rationalisation until next year, there is potential for a downward revision of our current inflation forecast of 2.7% for this year. Nonetheless, we expect that inflation will remain within Bank Negara Malaysia's (BNM) projected range of 2.0% to 3.5%.





Sources: DOSM, CEIC Data, Bank Islam

Rate Pause Of OPR Is Likely At Least Through 2024

- With robust growth and relatively stable inflation, BNM has been on hold since the Monetary Policy Committee (MPC) last raised the Overnight Policy Rate (OPR) to 3.00% in May 2023. This OPR level, which matches the pre-pandemic level, reflects BNM's view that the current monetary policy stance remains supportive of the economy.

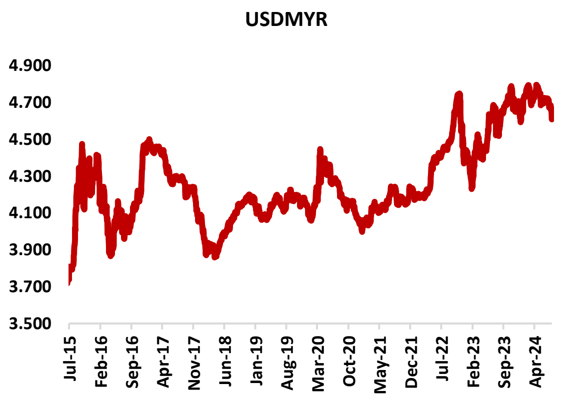
- There are two remaining MPC meetings for the year, one in September and another in November. We opine that BNM will continue to pursue a policy stance supportive of the economy and keep the OPR unchanged through at least 2024. Our expectation that Malaysia's inflation this year will fall within BNM's projected range of 2.0% to 3.5% underpins our view that the necessity for further rate hikes by BNM has diminished. Whether any upside risks to inflation, such as the potential implementation of RON95 subsidy rationalisation, will prompt a monetary response will depend on the persistence of price pressures.

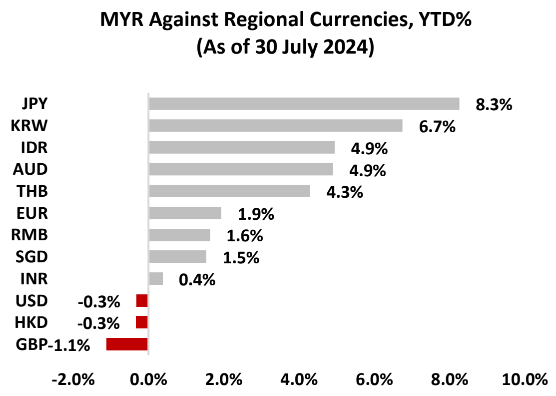
- We also believe that BNM is unlikely to rush into cutting the OPR, as growth and labour market conditions are expected to remain healthy in the near term. Even with two rate cuts anticipated from the U.S. Federal Reserve (Fed) in 2H2024, the interest rate differential with the U.S., currently at an all-time low of -233 basis points, will remain negative throughout the year.

Ringgit on Track to Rebound in 2H2024

- There had been no reprieve for the local note after the dismal 2023 performance as Ringgit remained under pressure against the USD throughout 1H2024, hitting the YTD high on RM4.794 on April 17. The persistent weakness of the local note presents the conundrum – why? After all, the country's solid economic growth surprised markets during the first quarter (Act: 4.2% vs. Est: 3.9%) and official estimates point to a better growth of 5.8% in 2Q2024.

- The focal point here is the widened interest rate differentials between Malaysia's OPR and U.S.' Federal Funds Rate (FFR), dimming the shine of the local note to investors. Furthermore, the U.S. economy had proven to be more resilient than expected while inflation was stickier than anticipated, prompting a more hawkish Fed during the period. In between markets' constant repricing of the monetary policy path and decisions to hold the rates well into the third quarter, the bullish view of the USD had investors flocking towards the greenback.



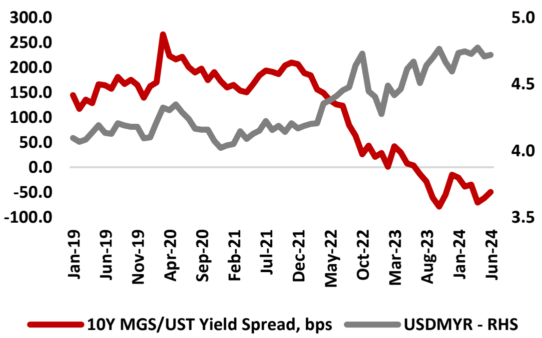


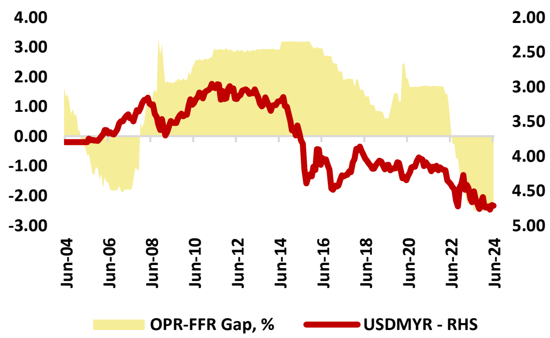
Sources: DOSM, BNM, Bank Islam

- Nevertheless, in a year of surprises, we posit that the local note will is in for a revival in 2H2024 due to domestic and external developments. On the external front, U.S. rate cut cycle is closing in as latest data shows inflation easing further towards to the targeted 2.0%. Furthermore, the job market is losing steam as businesses grapple with the elevated interest rates, posing a risk to one half of the Fed's dual mandate which is maximising employment. Such developments are pressuring the Fed to initiate policy easing to preserve economic growth whilst achieving price stability. Currently, markets remain firm on their expectations of the first FFR cut to happen in September whilst pricing in another cut before year end, which provides support to the local note.

- Looking on the domestic side, we believe that Malaysia's strong economic fundamentals poses as a buffer to the drags, holding the wheel steady in the rocky sea of unexpected shocks. Furthermore, Malaysia has had a great run thus far with foreign direct investments returning to the local market. Investor sentiments are lifted by the multiple development projects in the pipeline and Malaysia's prospects in the renewable energy (RE) and technology sectors, making us more appealing than our counterparts.

- Additionally, the government's commitment to fiscal consolidation and policy reforms are other impetus to drive investor confidence higher, making the local note more attractive. Therefore, we anticipate that the local note to rebound against the USD, ending at RM4.45 in 2024, barring external shocks. However, risks to the outlook remain from the U.S. presidential election, high-for-longer FFR and the escalating geopolitical tensions; one of which is the U.S.-China trade tensions, threatening to disrupt the global supply chain.





Sources: DOSM, BNM, Bank Islam

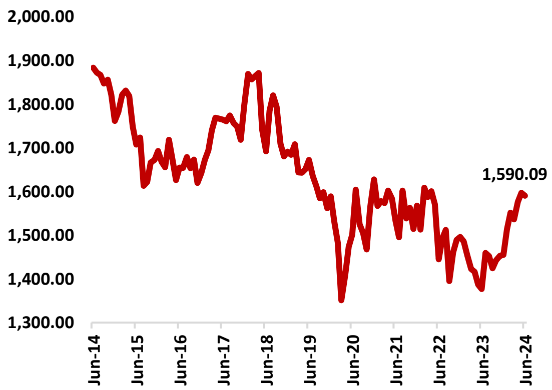
Capital Markets

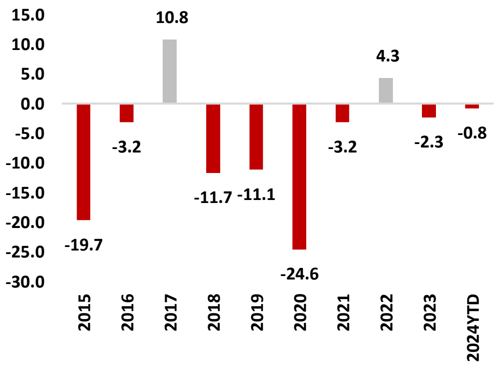
Uptick Expected for Domestic Equities

- The FBM KLCI benchmark index rose by 9.3% in 1H2024 and we posit that the local equity index to thrive in 2H2024. The uplift will be buoyed by several development projects in the pipeline, undervalued ringgit and the solid footing of the Malaysian economy. On the external front, China's expected economic recovery and a shift towards more dovish monetary policies by major central banks in 2H2024 would lend a hand to equity market performance.

- Nevertheless, the downside risks remain including the uncertainty about the U.S. Federal Reserve's interest rate plans, the possibility of increased geopolitical tensions, upcoming elections in various countries, and domestic policy changes in Malaysia, such as the subsidy rationalization program.

- Foreign investment in the local stock market remained negative, albeit at a smaller magnitude as it logged three months of foreign outflows out of the first six months of 2024. As of 1H2024, Bursa recorded cumulative net foreign outflows of RM0.8 billion relative to the net foreign outflows of RM4.2 billion of the same period in the previous year.





Sources: Bursa Malaysia, Bank Islam

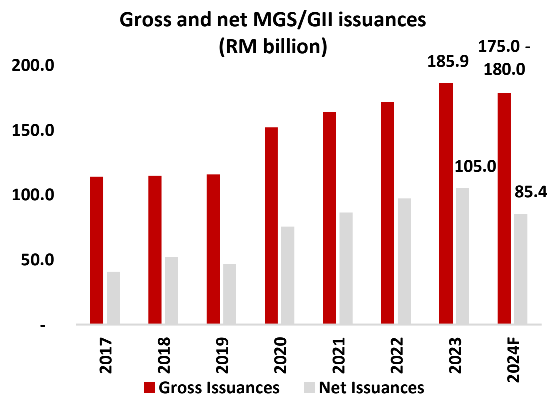
Fixed Income

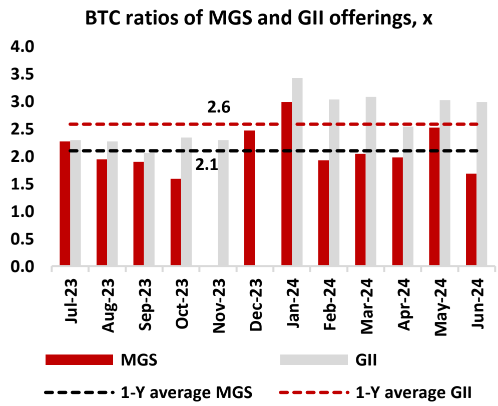
Lower Debt Issuances amid Fiscal Consolidation

- Total gross issuances of Malaysian Government Securities (MGS) and Government Investment Issues (GII) reduced slightly by 1.1% in 1H2024 to RM94.5 billion (MGS: RM55.0 billion, GII: RM54.5 billion) compared to RM95.5 billion raised in the corresponding period in the previous year. Of the total, RM76.5 billion were raised through 19 public offerings while the remaining RM18.0 billion were raised via private placements. Based on the 2024 auction calendar, there are 18 remaining public auctions scheduled in 2H2024, consisting of nine that will be issued via MGS, while the rest will be from GII issuances.

- Public offerings for local government bonds continued to garner vigorous demand during the first half of the year with all papers oversubscribed. As of 1H2024, on average, investors recorded a robust bid-to-cover (BTC) ratio of 2.2x for MGS (1H2023: 2.0x). Similarly, GII also saw healthy demand with a BTC of 3.0x (1H2023: 2.2x). Overall, the average BTC ratio stood at 2.6x in 1H2024, higher relative to 2.1x in 1H2023. The BTC values above 2.0x reflect strong demand from local institutional investors.

- We maintain our forecast that the gross MGS/GII issuance will amount in the range of RM175.0 to RM180.0 billion in 2024 (2023: RM185.9 billion) based on the upcoming MGS/GII maturities of RM53.5 billion in 2H2024, matured amount of RM39.5 billion in 1H2024 and the government's projected fiscal deficit of RM85.4 billion in Budget 2024 (2023: -RM93.2 billion) amid the ongoing fiscal consolidation.





Sources: BNM, Bank Islam

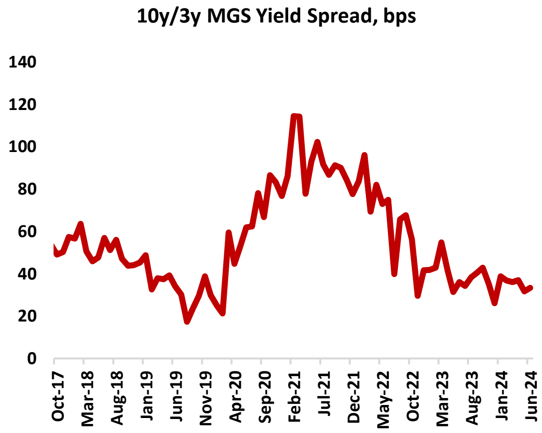
The Trajectory of Local Bond Yields to be Influenced by U.S. Future Interest Rate Path

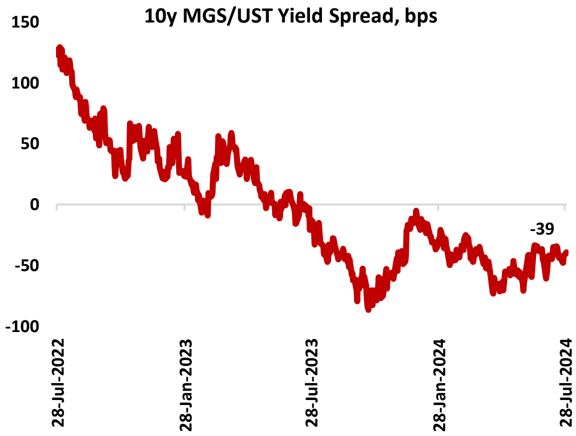
- From the period of January to June 2024, MGS yields ticked higher in the range of 1bp and 13bps for all maturities with selling pressures were mostly heavy at the belly of the curve. The high-for-longer stance by the Fed dragged the bond yields upwards.

- BNM is likely to keep interest rates steady at 3.00% for all of 2024, promoting economic stability and potentially preventing borrowing costs from rising. Based on the CME Fedwatch, the market foresees 75bp interest rate cuts by the Fed in 2H2024. Meanwhile, the recent FOMC's dot-plot suggested that the Fed is looking at one rate cut for the rest of this year. Consequently, the 10y MGS/UST yield spread remained in the negative territory as the interest rates differential between OPR and FFR remained negative.

- The Malaysian government's focus on reducing the budget deficit as outlined in Budget 2024 could lead to less government borrowing, lowering government bond supply and potentially lowering bond yields. A robust Malaysian economy is likely to attract greater investor interest, possibly contributing to a decrease bond yield.

- On the other hand, the subsidies rationalisation measures by the government are expected to raise concerns on inflation. Thus, dragging upwards the bond yields as investors are looking to hedge their returns from inflation.





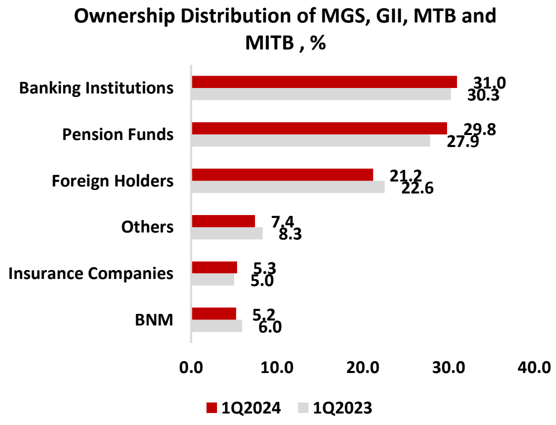
Sources: BNM, Bank Islam

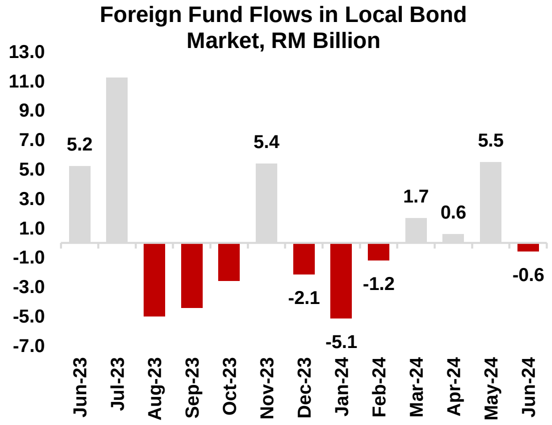
Bond Ownership and Foreign Holdings.

- In 1Q2024, banking institutions retained their positions as the largest holders of local government bonds at 31.0% of total outstanding and followed closely by the pension funds with a share of 29.8% of total outstanding. Other domestic institutional investors were also supporting the demand for local government bond market particularly Development Financial Institutions, BNM and insurance companies.

- On foreign holdings, for 1H2024, the local bond market posted cumulative net foreign inflows of RM0.9 billion, significantly lower relative to the inflows of RM21.2 billion logged in the same period in 2023. However, the share of foreign holdings in MGS and GII slumped to 21.6% in June 2024 (December 2023: 22.5%). Overall, the total foreign shareholdings in the local bond market remained tepid at 13.1% of total outstanding in June 2024.

- The upcoming U.S. election adds to the existing uncertainties of the Fed’s interest rate path, geopolitical tensions and China’s economic recovery pace and government policies. Thus, the investment flowing into emerging markets like Malaysia will remain volatile in the coming months.





Sources: BNM, Bank Islam

Public Finance

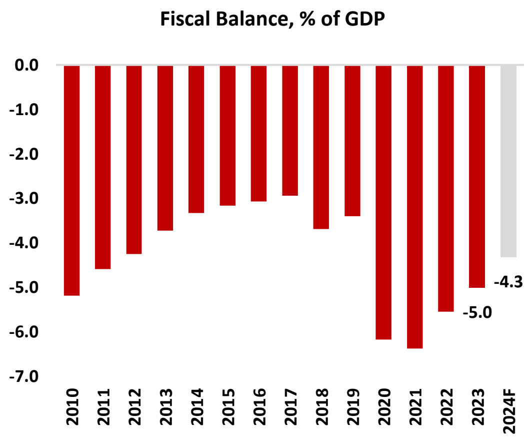
Fiscal Reform Underway

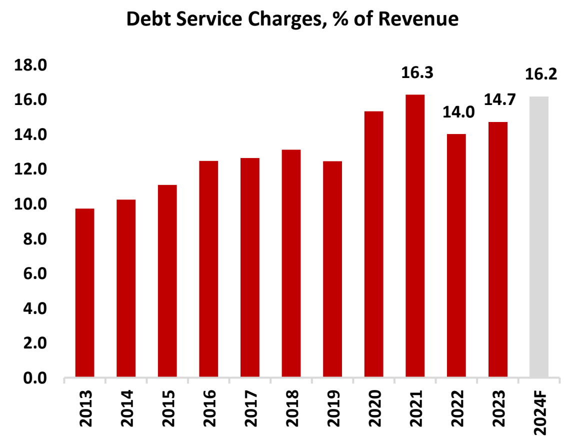
- For 2024, the Ministry of Finance is looking at trimming the fiscal deficit to 4.3% of GDP (2023: 5.0%) on the back of smaller fiscal deficit and projected GDP growth in the range of 4.0% to 5.0% in 2024. While the Budget 2024's introduction of a higher service tax rate from 6% to 8% and broadened its scope, we anticipate a minimal impact on overall revenue. Although the service tax rate increased and its base expanded, SST revenue is projected to grow modestly to RM35.8 billion in 2024. Given the narrow tax base, these changes are unlikely to accelerate revenue growth.

- In Budget 2024, the government stated its commitment on reducing government spending, leading to tighter public purse strings going forward with subsidies rationalisation on the card. Subsidies and social assistance component accounted for 25.0% of the government's operating expenditure (OPEX) in 2023. The government foresees that the expenditure of the component to edge lower at 17.4% of OPEX in 2024 with the diesel subsidy rationalisation taking effect from June 10, 2024. The government has allocated RM50.0 million to disburse monthly diesel subsidies of RM200 for eligible individuals, small farmers and commodity smallholders under the Budi Madani initiative.

- Another major chunk of the government spending is emolument with a 29.5% share of OPEX in 2023. In Budget 2024, the government foresees the magnitude to be edge slightly higher at 31.5% of OPEX. However, the civil servant salary revision which was announced on May 1 would involve an allocation of over RM10.0 billion with a salary hike of more than 13.0% starting December and granular details to be announced in Budget 2025.

- The pace of fiscal consolidation momentum is expected to accelerate, as evidenced by the MoF's fiscal deficit projection of 3.5% of GDP in the Medium-Term Fiscal Framework (MTFF 2024-2026), compared with 4.1% in MTFF 2023-2025. The reductions in fiscal deficit are mainly driven by lower total expenditures which are expected to edge down to 19.1% of GDP (2023: 22.3%) On the contrary, the government expects revenue-to-GDP to decline to 15.6% in the medium-term (2023: 17.3%).





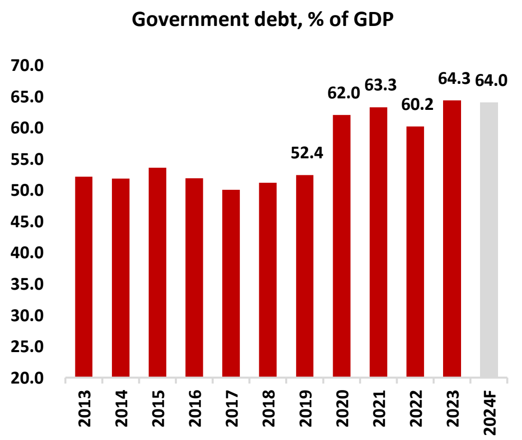
Sources: MOF, BNM, Bank Islam

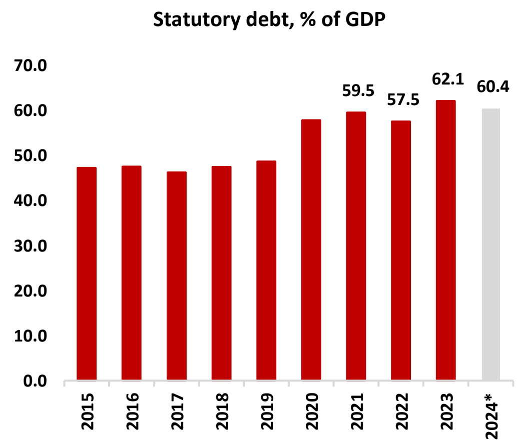
Fiscal Consolidation in tandem with Lower Debt Level Target

- The ratio of debt-to-GDP is expected to hover at 64.0% in 2024, slightly lower than 64.3% in 2023. The government reiterated that the current medium goal is to lower the debt level to 60.0%. Looking closer, the statutory debt-to-GDP (MGS, GII and MITB) stood at 60.4% as of June 2024 (2023: 62.1%). The statutory debt-to-GDP ratio has yet to breach the statutory debt ceiling of 65.0% and the fiscal consolidation effort will result in lower government debt issuances in 2024.

- Nevertheless, we opine that the element of economic growth is also prominent in enhancing the debt ratios in addition to the tapering of government debt issuances. Debt service charges (DSC) is projected to reach 16.2% of revenue in 2024 (2023: 14.7%), towering the 15.0% of revenue administrative limit driven by the still high interest rate environment. The tepid movement in tax revenue-to-GDP of 12.3% in 2024 (2023: 12.6%) projected in Budget 2024 will provide a challenge on debt affordability given the limited revenue space.

- In contrast, the government has a low risk of currency fluctuations because only 2.5% of its debt is denominated in foreign currency as of 1Q2024. Thus, it will have minimal impact by the changes in interest rates by other countries' central banks.





*Sources: MOF, BNM, Bank Islam. * as of 1H 2024*