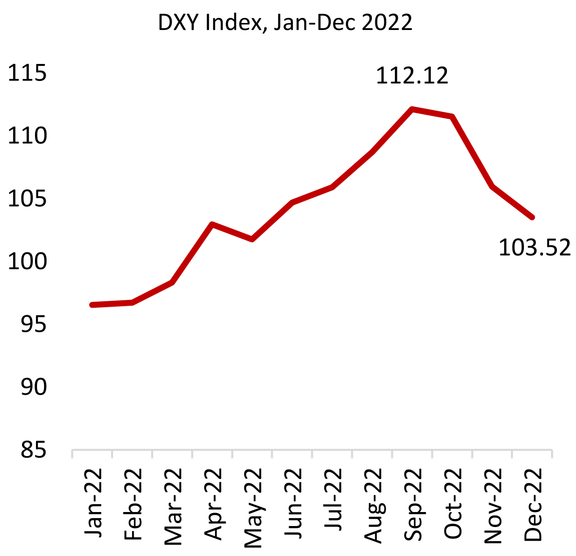
Firdaos Rosli | Chief Economist | firdaos@bankislam.com.my
Nor Jannah Abdullah | Economic Analyst | norjannah@bankislam.com.my
Raja Adibah Raja Hasnan | Economic Analyst | radibah@bankislam.com.my

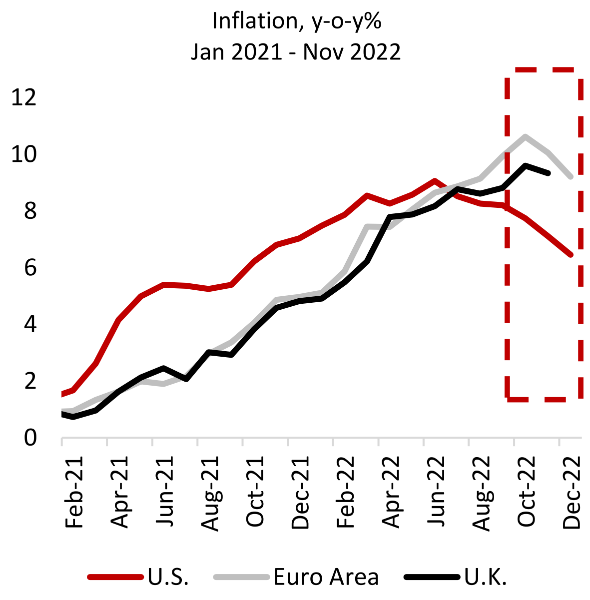
2023 ECONOMIC OUTLOOK: WHEN PRICES ARE ENTRENCHED

- The year 2022 left us with unprecedented events unseen in decades. Global inflation amid uneven post-pandemic recovery, synchronised aggressive monetary tightening, and a military conflict in Europe have led to growth headwinds in 2022. All major market indices, except FTSE100, ended lower versus a year earlier. Bond yields trended higher amid rapid policy normalisation, leading to an inflationary spike. The global economy is expected to fare lower in 2022 than a year earlier. Thus, 2023 will witness its challenges, but only with 2022 growth headwinds to spill over, at least in the first half of the new year.

- Despite the gloomy outlook, we see green shoots ahead in 2023. To name a few, China's economic reopening, declining US Dollar Index (DXY), peaked inflation and, to some degree, the softening of aggressive monetary stance by major central banks. We will see terminal rates in many parts of the world, including Malaysia. Labour market recovery is well on-track, although the unemployment rate in the United Kingdom (UK) and the European Union (EU) have recovered to their pre-pandemic levels much earlier than in other parts of the world.

- As a small and open economy, Malaysia cannot exclude itself from the rapid global changes. The overall sentiment remains low amid expectations of a hard landing in 2023, but it is not all doom and gloom for Malaysia. We opine that the new government will steer the Malaysian economy through a global slowdown, circumventing a recession in 2023.





Sources: Investing.com, BLS, Eurostat, ONS, Bank Islam

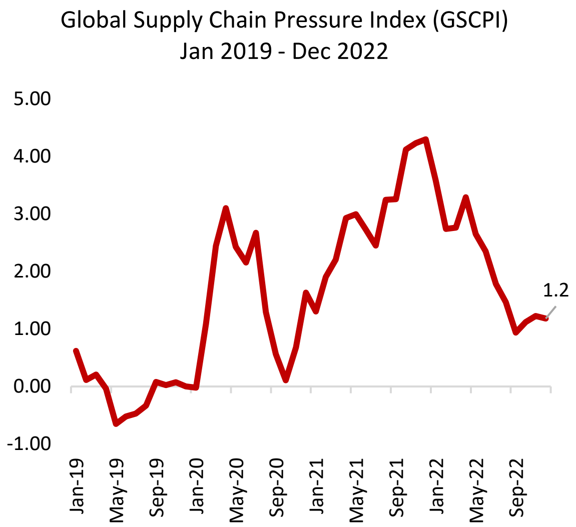
PART ONE:
THE GLOBAL ECONOMY: MODERATING GROWTH, ELEVATED PRICES

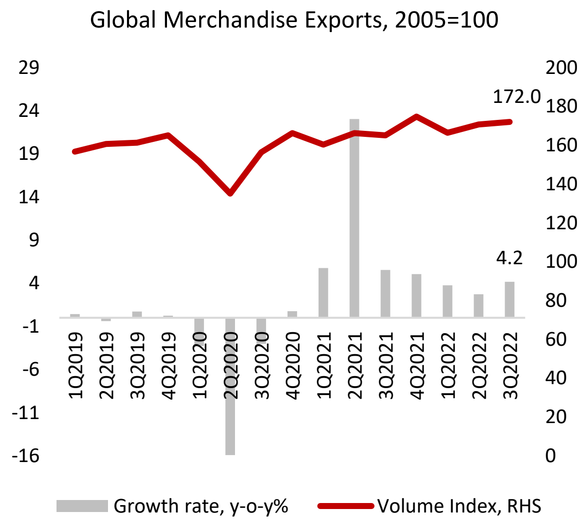
	IMF (Oct'22)		World Bank (Jan'23)		OECD (Nov'22)		ADB (Dec'22)	
	2022	2023	2022	2023	2022	2023	2022	2023
World	3.2	2.7	2.9	1.7	3.1	2.2	-	-
Advanced Economies/OECD	2.4	1.1	2.5	0.5	2.8	0.8	-	-
U.S.	1.6	1.0	1.9	0.5	1.8	0.5	-	-
Euro Area	3.1	0.5	3.3	0.0	3.3	0.5	-	-
EMDEs	3.7	3.7	3.4	3.4	-	-	-	-
China	3.2	4.4	2.7	4.3	3.3	4.6	3.0	4.3
India	6.8	6.1	6.9	6.6	6.6	5.7	7.0	7.2
Note: These forecasts reflect different reporting times								

Sources: IMF, World Bank, OECD, ADB, Bank Islam

- All multilateral development banks (MDBs) are projecting lower growth rates globally for the second year. The International Monetary Fund (IMF) has cut its growth projections from 3.2% in 2022 to 2.7% in 2023, weighed by the ongoing cost-of-living crisis, the prolonged tight financial conditions, the Russia-Ukraine military conflict, and the lingering effects of the pandemic. The Organisation for Economic Co-operation and Development (OECD) expects growth in 2023 at 2.2% versus 3.1% in 2022. The World Bank's January 2023 global growth projection is the most bearish among the said MDBs, with 2022 growth to come in at 2.9% and 1.7% for 2023. The varying estimates reflect the differing reporting times of the said MDBs.

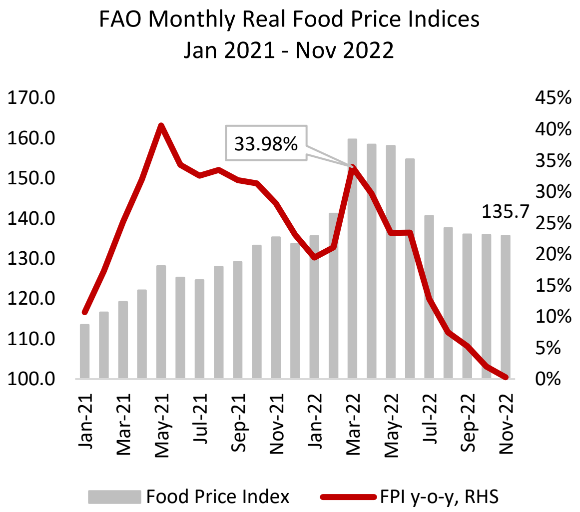
- Global trade was healthy in 2022, although plagued with supply chain constraints. Global merchandise export growth is decelerating despite a decreasing supply chain pressure. We expect the global supply chain pressure index to ease further amid China's economic reopening, but trade in 2023 may be weighed on by lower overall demand.

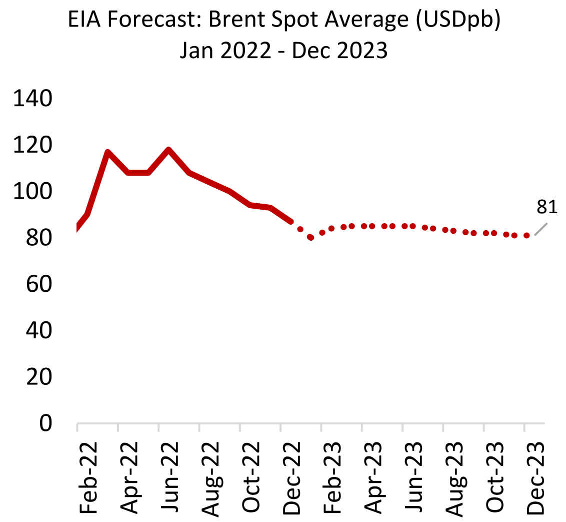




Sources: N.Y. Federal Reserve, UNCTAD, Bank Islam

- It is safe to conclude that inflation peaked in 2022 but will remain elevated in 2023. According to the Food and Agriculture Organisation of the United Nations (FAO), its Food Price Index has declined since 2Q2022. It appears that the FPI is plateauing and will remain so long as the Russia-Ukraine military conflict and the elevated global oil prices persist. The United States (US)'s Energy Information Administration (EIA) expects energy prices to be flat between USD88-93 per barrel throughout 2023.





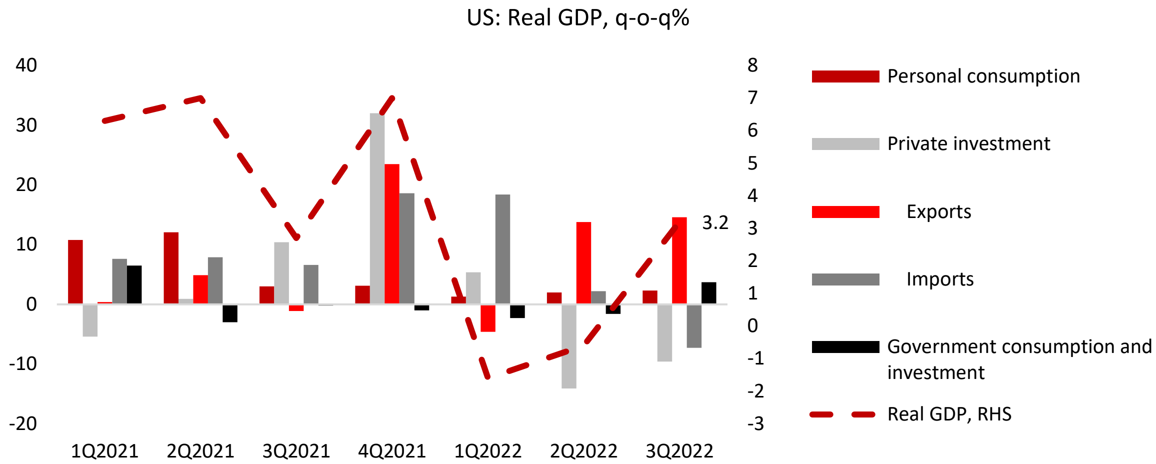
Sources: FAO, EIA, Bank Islam

PART TWO:
MAJOR ECONOMIES – THE US, EU, AND CHINA

THE UNITED STATES: MORE HIKES, MORE PAIN?

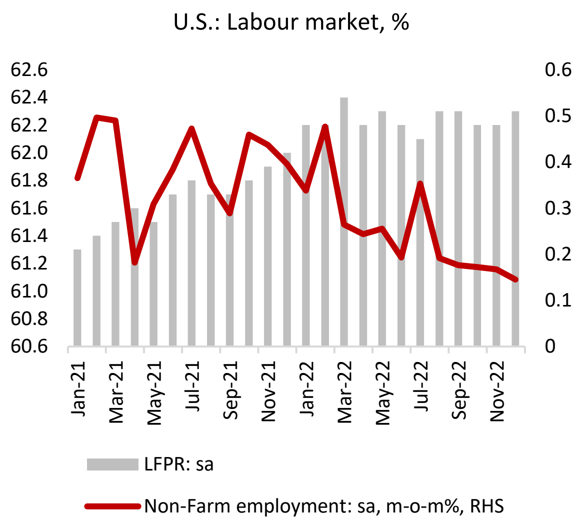
- The latest IMF estimates suggest that the US real GDP growth will come at 1.0% in 2023, lower than 1.6% in 2022. World Bank appears to be more optimistic about the country's growth performance in 2022 (1.9%) but much less than IMF's projection in 2023 (0.5%). Meanwhile, OECD believes that the country will grow at 1.8% in 2022 compared to 0.5% in 2023. These early estimates suggest that the US economy may successfully achieve a soft landing after all, averting a full-blown recession in 2023.

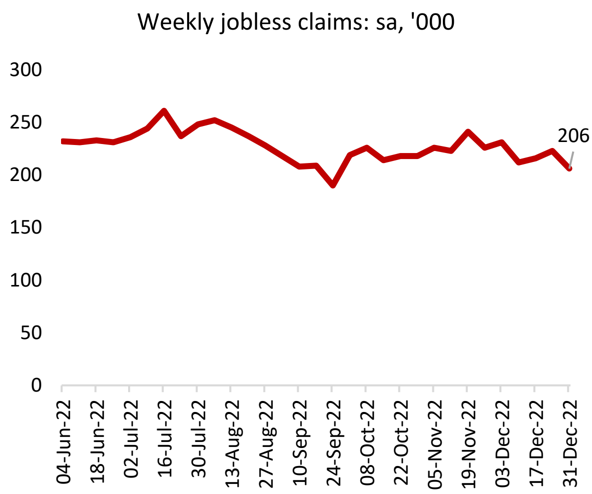
- In fact, the US economy appears "unperturbed" by the US Federal Reserve (Fed)'s successive/aggressive rate hikes throughout 2022. Private consumption growth remains solid so far, growing from quarter to quarter and is supported by higher public consumption and gross investment. The Bureau of Economic Analysis (BEA)'s 3Q2022 third estimate was higher than its previous two estimates. However, it appears that private investments are moderating in line with higher borrowing costs, particularly in the private housing market.



Sources: BEA, Bank Islam

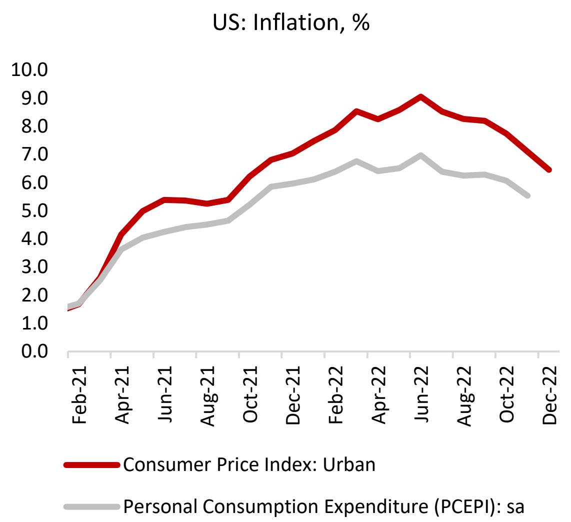
- Conversely, there are signs of moderating labour market in the country. Its labour force participation rate (LFPR) (December: 62.3%) is recovering but still trending below the pre-pandemic levels. The non-farm payroll (NFP) is trending in the positive territory but is declining steadily throughout 2022. The US economy ended the year with a three-month low in the weekly initial jobless claims of 206,000. As the Fed's rate hike cycle continues in 2023, we should expect the country's labour market to cool as the domestic economy eventually responds to higher interest rates.

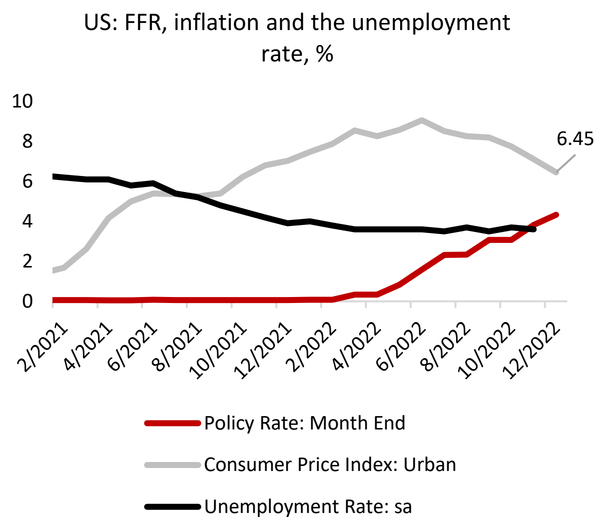




Sources: BEA, Bank Islam

- US inflation peaked in June 2022 and is cooling steadily throughout 2H2022. Fed Chair Jerome Powell sidestepped analysts' calls to intervene early, thus putting the central bank way behind the curve in taming inflation. As a result, the Fed had to tighten aggressively with four consecutive 75 bps rate hikes from June to November 2022. It is unknown whether the US has effectively "reached" its terminal rate, as inflation has already been downtrend since July 2022. The Fed is at risk of over-tightening if its rate hikes cycle continues as is. In any case, the December 2022 FOMC meeting pointed out that most members expect the Federal Funds Rate (FFR) to reach 5.00-5.25% in 2023.



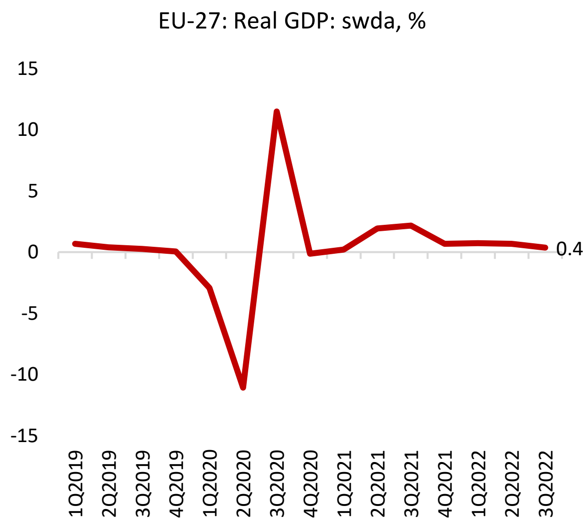


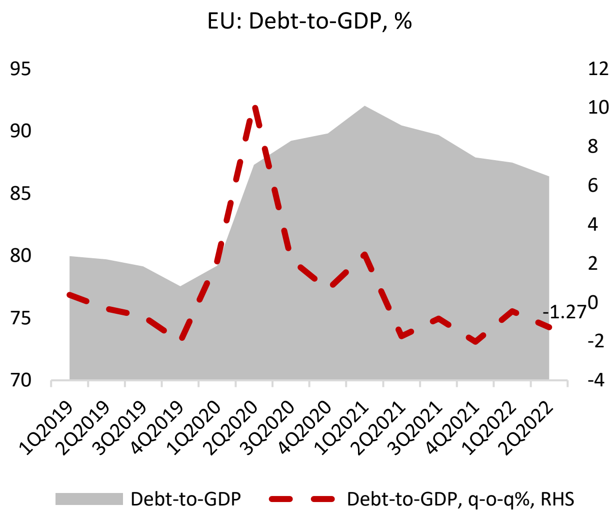
Sources: BEA, BLS, Bank Islam

THE EURO AREA: WHAT STAGFLATION?

- All MDBs are pessimistic about the Euro Area's growth prospects in the near term. IMF and OECD expect the region's 2023 real GDP growth to come in at 0.5% in 2023, marking a significant drop in growth from 3.1-3.3% in 2022. World Bank believes the region will record growth at 3.3% in 2022 but flat at 0.0% in 2023.

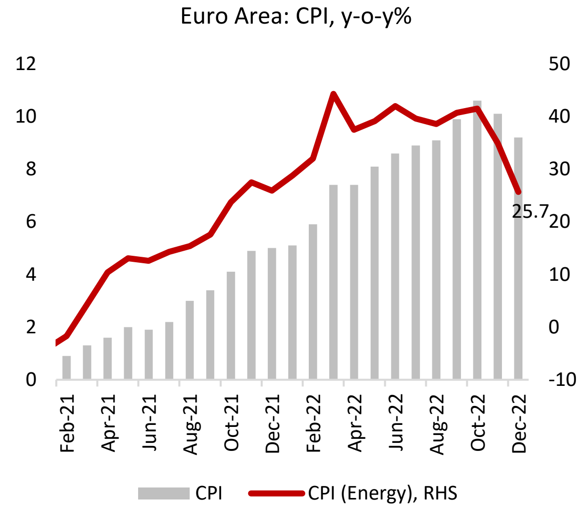
- Many economists believe that the Euro Area will experience a period of stagflation amid elevated energy prices. This contrasts with reality, where the region's q-o-q real GDP growth remains positive despite supply-side headwinds. Debt-to-GDP is also on a decline every quarter. While we foresee limited rebound opportunities in 2023, the region may not suffer from stagflation amid decisive policy intervention and plateauing energy prices.

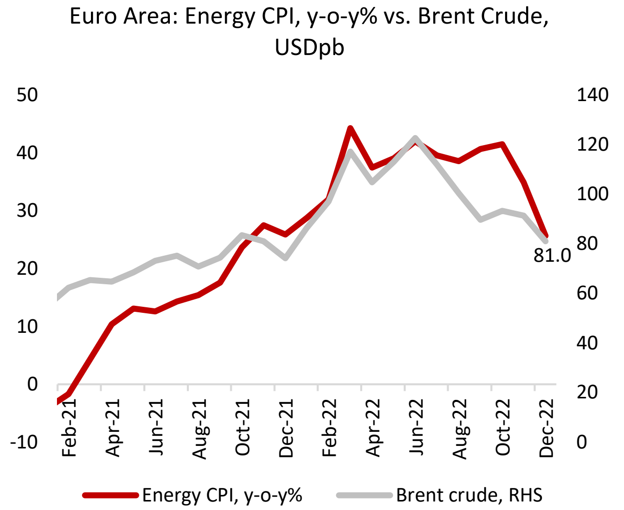




Sources: Eurostat, CEIC, Bank Islam

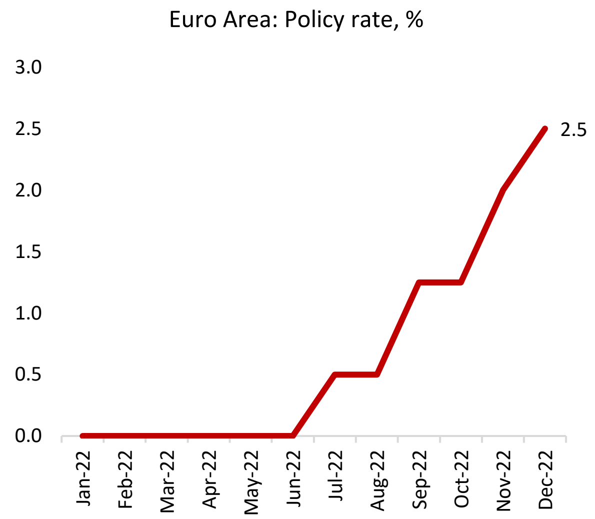
- As global oil prices retreated amid global recessionary fears, so did inflation in the Euro area. In December 2022, the region's inflation rate fell to a single digit for the first time in two months. Falling inflation came as no surprise as energy prices have fallen in recent months.

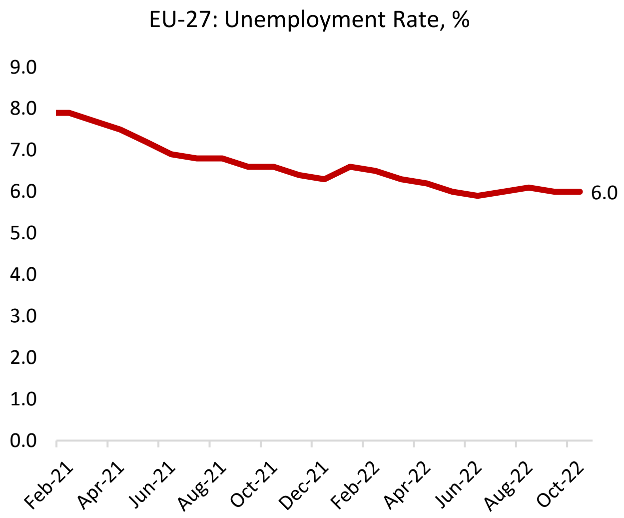




Sources: Eurostat, Bank Islam

- The European Central Bank (ECB) took a bold move by hiking its policy rate by a whopping 250 bps throughout 2H2022. The central bank has kept its interest rate at 0.0% since 2016, intending to support growth amid the region's high sovereign debt levels. As stated earlier, the region's labour market has returned to the pre-pandemic level in 3Q2021, which was among the fastest globally. Despite the optimistic macroeconomic performance thus far, the Euro Area is well exposed to global event risk in 2023. A small shock is all it takes to push the region off the edge into a recession.





Sources: Eurostat, CEIC, Bank Islam

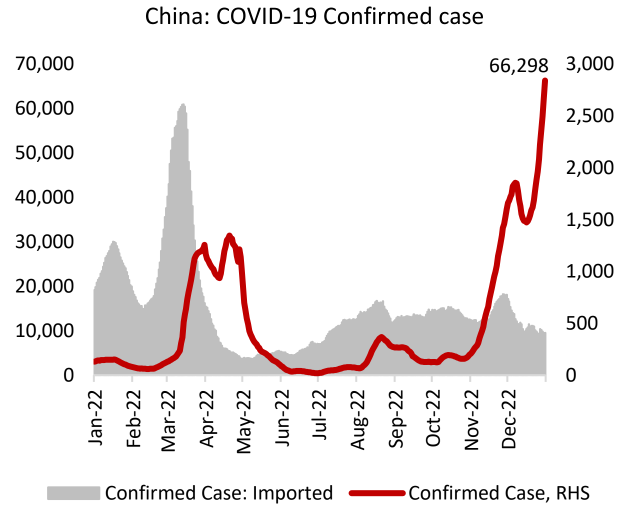
CHINA: BETTER LATE THAN NEVER

- ADB expects the People's Republic of China (China)'s growth to rise to 3.0% in 2022 and 4.3% in 2023. IMF, World Bank and OECD project the country to record real GDP growth of 3.2%, 2.7% and 3.3% in 2022, respectively. In 2023, all MDBs expect China's growth to accelerate to 4.3-4.6%. As far as 2023 global growth is concerned, all eyes are on China to support global growth in the new year.

- As the only major economy to avoid a COVID-19 recession in 2020, China narrowly escaped contraction in 2Q2022. Its zero-COVID strategy took a toll on the economy as the authorities pushed for intermittent lockdowns in major cities, particularly in Shanghai. After almost three years of lockdown, China reopened its economy in December 2022.

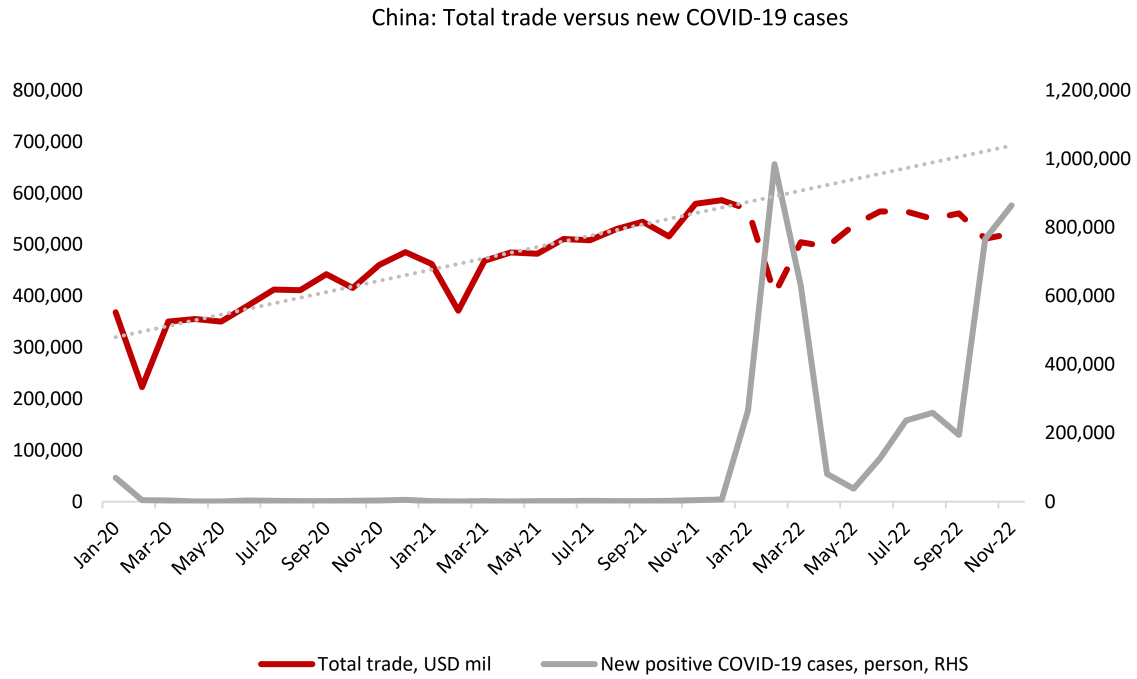
- Economic reopening is positive for China's overall economic outlook in 2023. However, the move has caused an uncontrolled spike in positive COVID-19 cases throughout the country. Most of these cases are locally transmitted. At the point of writing, the number of positive COVID-19 cases is spiralling upwards and has yet to peak, causing countries to put up travel barriers for China-inbound travellers. That said, we believe that the outbreak will begin to subside in the coming weeks.

- The recent spike in positive COVID-19 cases did not stop the Chinese from celebrating the world's largest annual human migration – the "Chunyun" or the Spring Festival travel rush. Xinhua News Agency, China's official state news agency, recently reported that the government expects the travel rush to record a massive 2.1 billion passenger trips for the lunar new year.



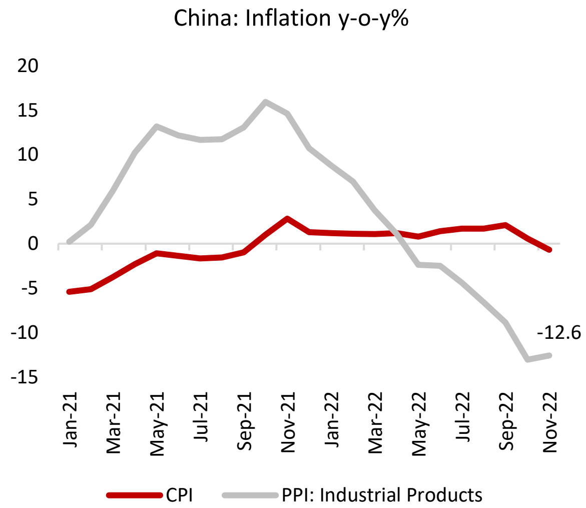
Sources: National Health Commission, CEIC, Bank Islam

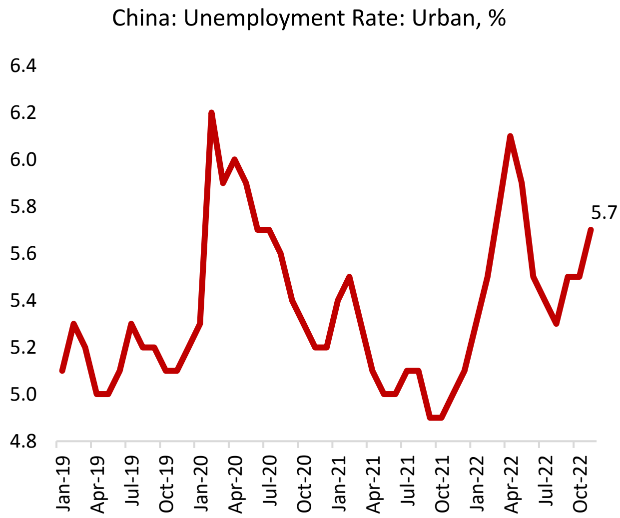
- Owing to China's zero-covid strategy, the country's total trade trended below the recovery trajectory amid intermittent spikes in positive COVID-19 cases throughout 2022. Considering China is the world's most populous country with a higher urbanisation rate than India (China: 63%, India: 35%), one could argue that such a strategy was economically harmful but necessary to "flatten the curve". The probability of a global recession in 2023 might be higher if China's zero-COVID strategy was to continue for another year.



Sources: General Administration of Customs, Johns Hopkins University, Bank Islam

- Unlike other major economies, China did not suffer from high inflation due to the coordinated COVID-19 prevention and control weighed on growth. Although the country's unemployment rate briefly recovered in 2021, the rate spiked due to lockdowns in major cities such as Shanghai, Guangzhou and Shenzhen. As a result, China's CPI y-o-y growth trended below 2.0% throughout 2022 except in September 2022 amid higher demand during the holiday season. PPI peaked in October 2021 and declined throughout 2022 as well. We expect an uptick in China's inflation in 2023 amid higher domestic demand while energy prices remain elevated.





Sources: National Bureau of Statistics, Bank Islam

PART THREE: SOUTHEAST ASIA

	IMF (Oct'22)*		World Bank (Jan'23)		ADB (Dec'22)**	
	2022	2023	2022	2023	2022	2023
ASEAN	5.3	4.9	-	-	5.5	4.7
Malaysia	5.4	4.4	7.8	4.0	7.3	4.3
Indonesia	5.3	5.0	5.2	4.8	5.4	4.8
Philippines	6.5	5.0	7.2	5.4	7.4	6.0
Singapore	3.0	2.3	-	-	3.3	2.3
Thailand	2.8	3.7	3.4	3.6	3.2	4.0
Vietnam	7.0	6.2	7.2	6.3	7.5	6.3

**ASEAN-5*
*** including Timor-Leste*

Sources: IMF, World Bank, ADB, Bank Islam

- MDBs such as IMF and ADB project the Southeast Asian region's growth to moderate alongside the global economy. The former estimates that the region will grow at 4.9% in 2023 compared to 5.3% a year earlier. The latter, however, expects global moderating growth in 2023 to be more impactful to Southeast Asia, where growth in 2023 will come in lower at 4.7% versus 5.5% in 2022. Despite growth headwinds from major economies, the region is poised to become one of the world's fastest-growing regions in 2023.

- Southeast Asia's growth is led by the performance of the top three of its most populous economies: Indonesia, the Philippines and Vietnam. These economies account for about 72% of the region's total population, where 41% of its population resides in Indonesia. Around 23% of Southeast Asians live on Java Island alone.

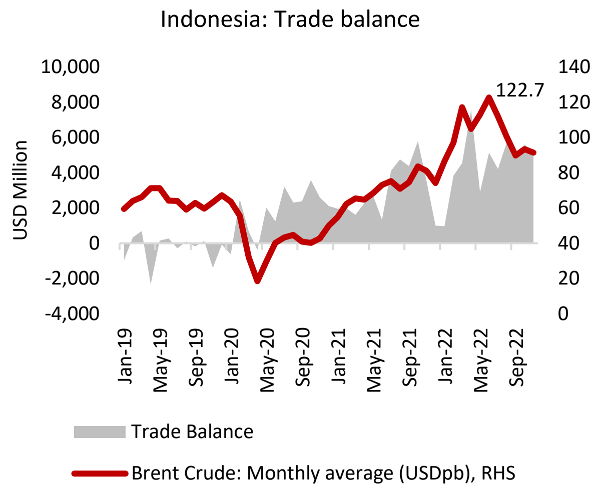
- Southeast Asian economies are laden with trade agreements other than their single market and production base. The world's largest free trade agreement – the Regional Comprehensive Economic Partnership (RCEP) – came into effect on 1 January 2022. The agreement came into effect later for Malaysia (18 March 2022) and Indonesia as the latest economy to ratify the agreement on 2 January 2023. Myanmar and the Philippines have yet to ratify the agreement. Meanwhile, the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) is another mega trade pact consisting of four ASEAN economies: Brunei, Malaysia, Singapore and Vietnam. Brunei is the only ASEAN signatory yet to complete its ratification process.

INDONESIA: OILED UP BY TRADE AND ASEAN CHAIRMANSHIP IN 2023

- IMF expects Indonesia to grow at 5.0% in 2023, somewhat slower than in 2022 (5.3%). World Bank appears to be more pessimistic, with the country's real GDP growth expected to rise at 4.8% in 2023. For the record, World Bank holds a similar view to ADB about Indonesia’s growth projection in 2023.

- Despite supply-side pressures, Indonesia's quarterly growth has been on an uptrend since 4Q2021. In 3Q2022, the country's y-o-y growth came in at 5.7% or 1.8% on a q-o-q basis. Much of this was due to net exports with y-o-y growth of 17.6% and gross fixed capital formation of 4.96%.

- Indonesia's trade sector benefits from higher global energy demand, where its net exports in mineral fuels and lubricants improved from USD662.0 million in April 2021 to USD2.9 billion in October 2022. Other energy-related commodities, such as coal, pushed Indonesia's trade higher. The country's trade prospect in 2023 appears resilient, but its non-energy sector may decline amid moderating global demand.

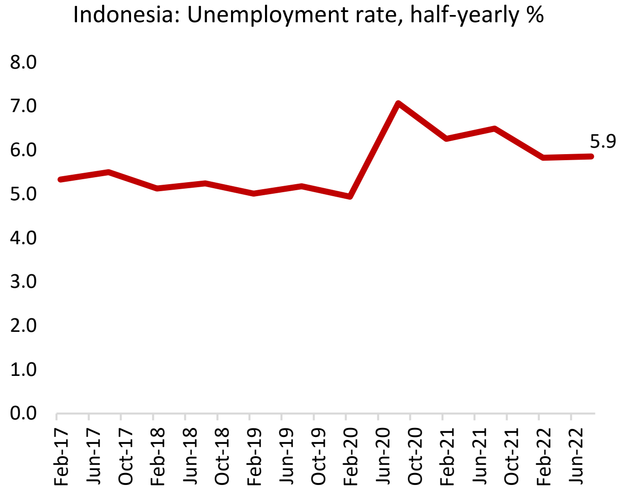


Sources: Central Bureau of Statistics (BPS), EIA, Bank Islam

- Bank Indonesia (BI), through a Memorandum of Understanding with the government, set its inflation target of 3.0% for 2022 and 2023. For 2024, the target is 2.5%. Inflation trended higher than the target rate starting in 2Q2022 and peaked in September 2022 at 6.0%, bringing the annual inflation rate to 4.2%. Core inflation has also trended higher since August 2022, with no signs of abatement. Indonesian producers are facing higher input prices amid higher global oil prices and unfavourable exchange rates against US Dollar. We believe the country's PPI will continue to trend higher amid elevated global oil prices throughout 2023.

Sources: BPS, B.I., OPEC, Bank Islam

- Indonesia's tourism sector accounts for around 5% of its GDP. Similar to other regional economies, the country's tourist arrivals have yet to return to pre-pandemic levels due to the low China-inbound arrivals. For context, China-inbound arrivals into Indonesia peaked at 2.14 million in 2018 but declined to 54,713 arrivals from China in 2021. Its unemployment rate remains high (20 February: 4.9%, 22 August: 5.9%) amid the anaemic tourism sector. However, we believe that regional countries, including Indonesia, will eventually profit from China's economic reopening in 2023.



Sources: BPS, EIA, Bank Islam

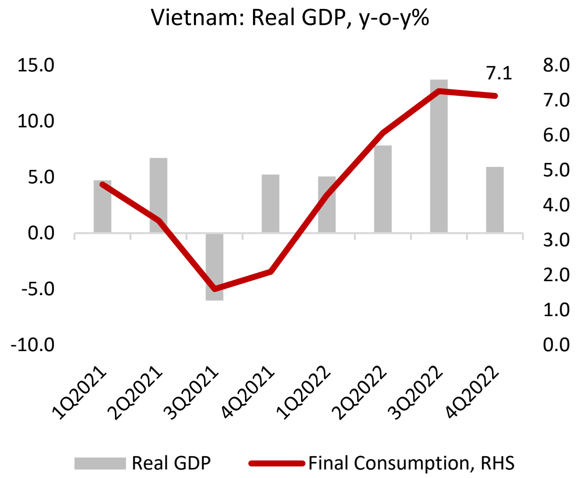
- Indonesia assumes the chairmanship of ASEAN in 2023, and expectations are mounting for Southeast Asia's largest economy. The country's ASEAN chairmanship in the past had been nothing short but influential. To recap, Indonesia's chairmanship in 2003 endorsed the Bali Concord II as the framework for the ASEAN Community. In 2011, it rallied ASEAN+6 members (i.e., Australia, New Zealand, India, Japan, Republic of Korea and China) to commence RCEP's negotiations.

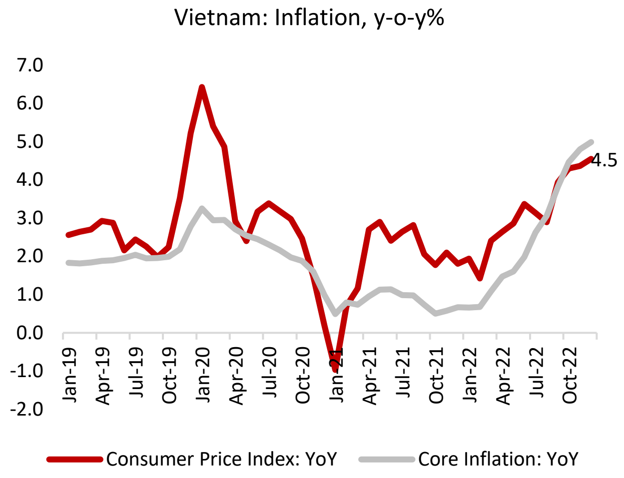
VIETNAM: SOLID 2022 PERFORMANCE AMID RISING INFLATION

- Dubbed "the darling of ASEAN", Vietnam is expected to record real GDP growth of 6.2% in 2023 as per IMF's latest estimates. World Bank projects the economy's 2023 growth to come in at 6.3% as ADB. For the record, Vietnam's official FY2022 growth came in much higher than all MDBs' estimates at 8.02%.

- Vietnam's recent economic performance has been influenced by its private consumption growth. Its 3Q2022 performance peaked at 13.7% amid base effects but moderated to 5.9% in 4Q2022 as private consumption moderated in the said quarter.

- The country's inflation rate in 2022 was 3.15%, which fell below the State Bank of Vietnam (SBV)'s target of 4%. Vietnam's CPI started creeping up in 2Q2022 and trended higher after that. Core inflation y-o-y growth has been trending higher than the headline from October to December 2022, driven by the unfavourable exchange rate against the US dollar. We expect inflation to continue to be contentious for the economy in 2023, as its inflation rate has yet to peak.



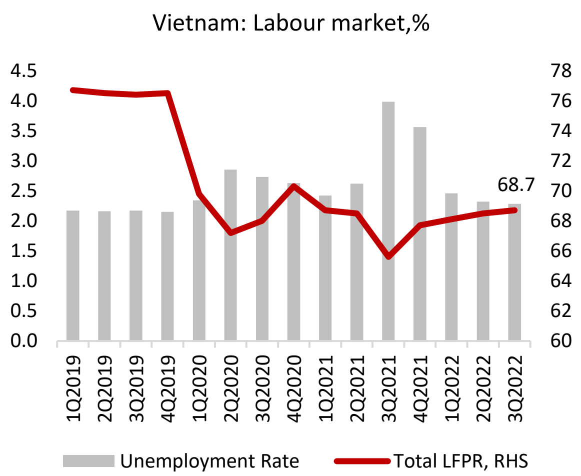


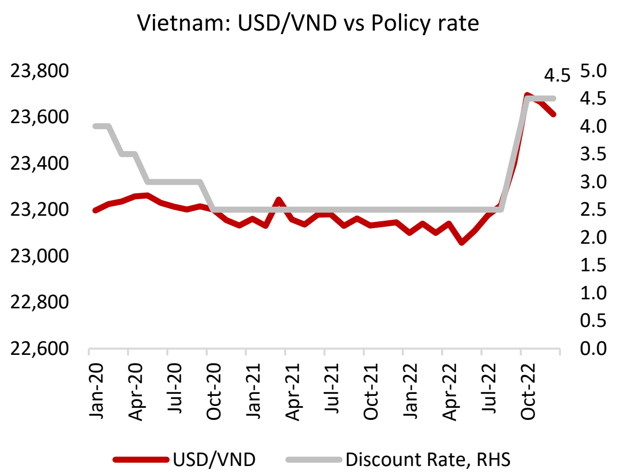
Sources: General Statistics Office of Vietnam (GSO), Bank Islam

- Vietnam's economy suffered from the spike in positive COVID-19 cases in 3Q2021, which brought its real GDP contracted to its lowest in decades at -6.03%. The unemployment rate spiked from 2.62% in 2Q2021 to 3.98% in 3Q2021. The authorities then boosted its vaccination programme, which peaked at 17,000 doses per million people in late November 2021.

- The economy showed significant gains as COVID-19-related barriers were gradually removed. Its unemployment rate declined and more so following the reduction of quarantine requirements for fully vaccinated international arrivals in 1Q2022. However, LFPR has yet to return to its pre-pandemic levels as the services industry, particularly tourism, is still performing below its long-run capacity. Vietnam stands to gain from tourist arrivals from China amid the end of the latter's zero-COVID strategy. For the record, Vietnam received 5.8 million tourists from China in 2019, compared to only 124,896 arrivals in 2022.

- SBV kept its discount rate unchanged at historic lows throughout 2021 to August 2022 at 2.5%. In September 2022, the central bank raised its interest rate by 100bps and another 100bps a month later, bringing the discount rate to the end of the year at 4.5%. In 2023, we believe that the movement of its monetary policy objective will continue to take cues from USD/VND movements.





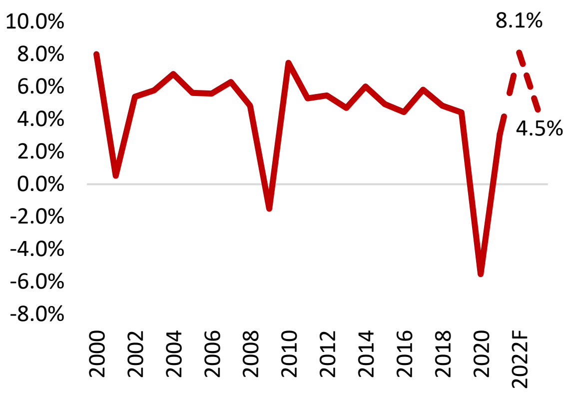
Sources: GSO, SBV, Bank Islam

PART FOUR:
MALAYSIA IN 2023: GROWTH TO MODERATE STEEPER THAN OTHERS IN THE REGION

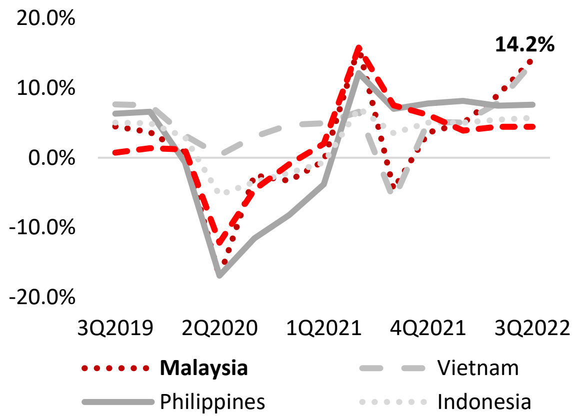
- IMF projects Malaysia's growth at 5.4% in 2022 and 4.4% in 2023. ABD appears to be more optimistic about Malaysia's FY2022 growth, with 7.3% and 4.3% in 2023. World Bank's latest forecast suggests that growth will come in at 7.8% in 2022, but it will decelerate to 4.0% in 2023.

- That said, we expect Malaysia's FY2022 to come in at 8.1%, exceeding the official projections of the range between 6.5%-7.0%. Our higher 2022 growth estimate aligns with the stronger-than-expected 3Q2022 performance, which saw Malaysia's growth outpacing its ASEAN neighbours. However, growth headwinds abound in 2023, and we believe that Malaysia's real GDP growth to moderate to 4.5%, steeper than others in the region.

Malaysia: Real GDP growth



Quarterly GDP ASEAN countries' performance



Sources: CEIC, DOSM, Bank Islam

Inflation peaked in 2022, but prices will remain elevated in 2023

- Malaysia's CPI prints were generally stronger-than-expected at 3.3% during 11M2022 (11M2021: 2.4%) amid a combination of factors, including unsettling Russia-Ukraine military conflict and the surge in commodity prices and a strong greenback. Supply chain bottlenecks amid the uneven global economic reopening did not help. We believe that inflation may have peaked in August 2022 at 4.7%. However, prices will likely remain elevated on the back of prolonged geopolitical tensions and persistently high commodity prices.

- In 2H2023, the CPI y-o-y% would decelerate amid base effects. The stronger Ringgit outlook may aid the downtrend, bringing inflation even lower. We forecast the headline inflation to average 3.0% in 2023 (2022F: 3.4%) under the assumption that the government maintains the current fuel subsidy. However, inflation will inevitably trend higher than our baseline if the government proceeds with subsidy rationalisation in 2023 amid higher retail oil prices. We posit that CPI will increase by 0.42% above the baseline for every 10 cents increase in RON95.

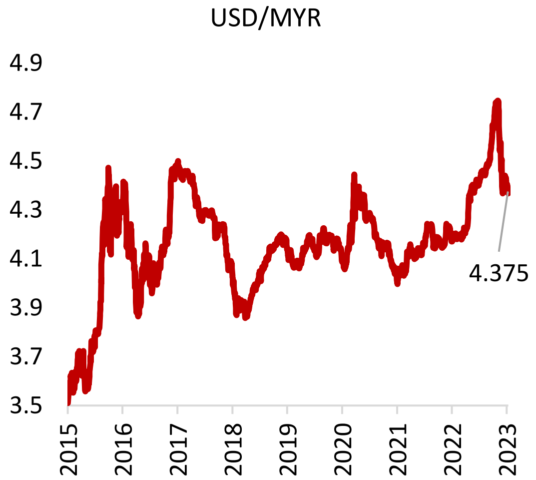
Ringgit is expected to fare better in 2023

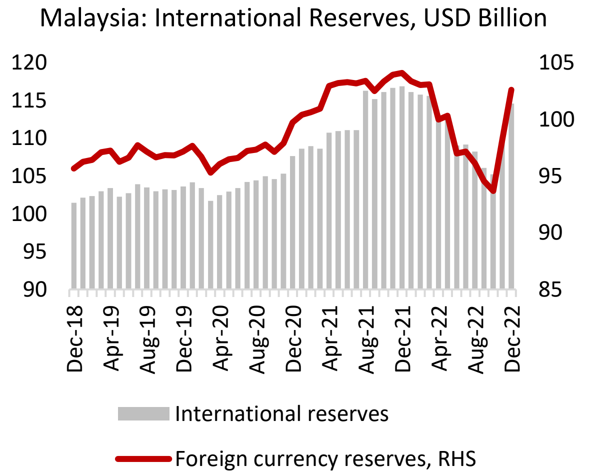
- It has been a roller coaster ride for the Ringgit in 2022. This time last year, Ringgit's outlook was largely positive when the local note ended at RM4.17 on its first trading day of the year. Alas, the USD/MYR reached its historic high at RM4.7465 on 4 November 2022 following the US aggressive monetary tightening. Ringgit ended 5.5% lower at the end of 2022.

- Aside from betting on the Fed rate hikes, the local note was pressured by the widening interest rate and yield gaps between Malaysia and the US. Throughout 2022, the Fed raised its policy rate by 425 bps since March versus a merely 100 bps increase in the OPR. This scenario resulted in the FFR range, now at 4.25%-4.50%, being higher than OPR at 2.75% in 2022.

- To some degree, we believe that BNM was in a tight spot in supporting the Ringgit when the BNM international reserves were on a decline, tumbling below USD110.0 billion since June 2022. We posit that the "delay" in policy normalisation was caused by MCO 3.0, which caused Malaysia's unemployment rate to trend higher.

- Nevertheless, the Ringgit's weakness against US Dollar provided the necessary boost in foreign trade. Export growth surpassed imports for the first time in 2022 in November. We believe Malaysia's foreign trade outlook is positive in the immediate term.

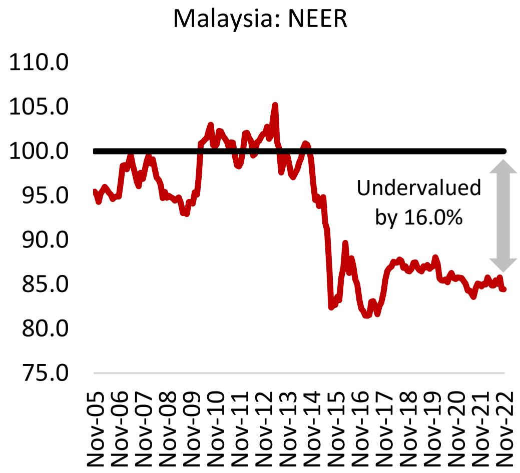


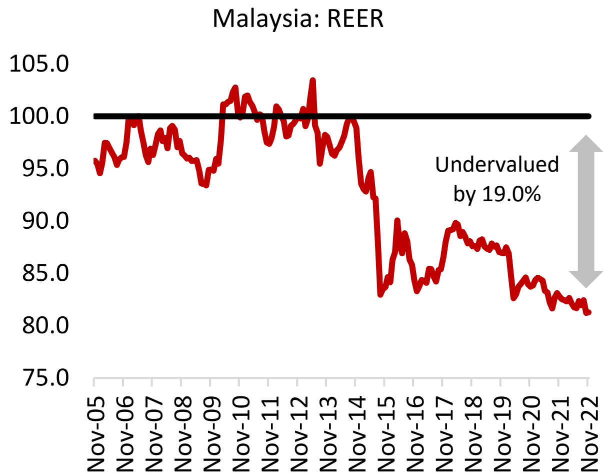


Sources: CEIC, DOSM, Bank Islam

- In 2023, we opine that the USD could be easing as the Fed scales down its rate hikes, gradually allowing the Ringgit to appreciate. Moreover, DXY has been trending lower since November this year, slipping below the 110.0 level. The Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) suggest that the Ringgit is undervalued by 16.0% and 19.0%, respectively, suggesting room for future appreciation.

- We note that 2023 headwinds, particularly the risk of a global economic slowdown, could limit the Ringgit's recovery trajectory. Political risk premium also plays a role. However, we remain optimistic that resilient domestic growth and the intensified China's economic reopening can support the local note. We expect the Ringgit to end the new year at RM4.28 (2022: RM4.40).





Sources: IMF, CEIC, Bank Islam

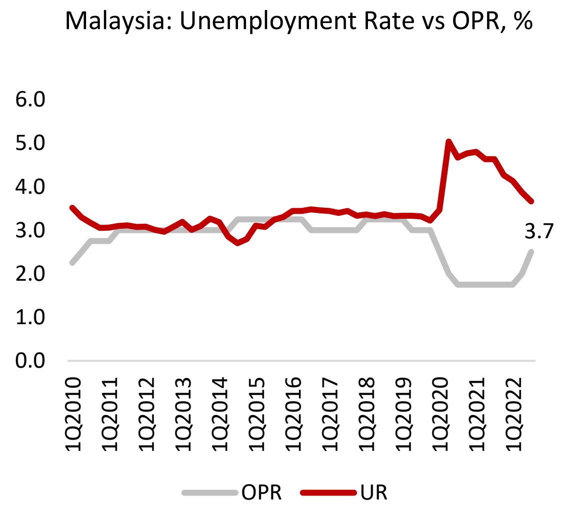
OPR to rise amid the decreasing degree of monetary accommodation

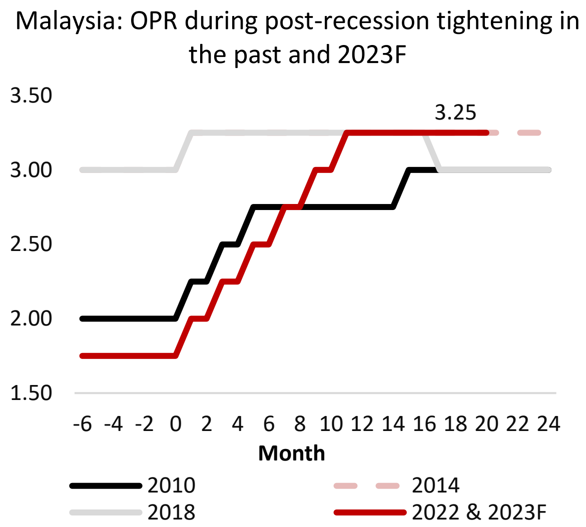
- BNM hiked the OPR by 100 bps in 2022, bringing the cumulative rate to 2.75% from a historic low of 1.75%. Malaysia's domestic growth in 2H2022 is expected to remain strong amid improvements in domestic demand and robust external demand.

- We believe that keeping the OPR low for too long could pose a macroeconomic imbalance amid excessive risk-taking activities. The consecutive hikes in OPR, notwithstanding the impact on the overall borrowing cost to the Malaysian economy, were meant to gradually remove the excessive monetary accommodation rather than to tame inflation. We noticed that the rate remained static despite the past volatility in the inflation rate. Gradual OPR increases also allow economic actors to adjust accordingly.

- Though inflation in Malaysia is still not as acute as in other countries, its upward momentum has picked up in 2H2022. Be that as it may, we believe that BNM will stick to its "gradual and measured" mantra to ensure an optimal level of sustainable economic growth and price stability.

- The Monetary Policy Committee (MPC) has scheduled six meetings in 2023 between 18 January and 2 November. We expect the OPR to increase by 50 bps during the 1Q2023 (January and March meeting) to its new terminal rate of 3.25%. BNM will subsequently pause, and the OPR will likely remain unchanged throughout 2H2023 sans global event risk.





Sources: BNM, CEIC, Bank Islam

Lower bond yields at higher OPR?

- The aggressive and synchronised global monetary tightening has induced the risk of a global recession in 2022, particularly amongst advanced countries. We see a challenging 1H2023; the weaker overall investor sentiment will attract capital inflows to the local bond market. However, central banks may loosen their monetary policy starting 2H2023 amid growth concerns. Following this, we forecast yields for 3-Y MGS, 5-Y MGS, and 10-Y MGS are likely to trend lower and settle at 3.00%, 3.40% and 3.65%, respectively, by the end of 2023. The foreign holding ratio improved to the pre-pandemic levels of around 40.0% for MGS.

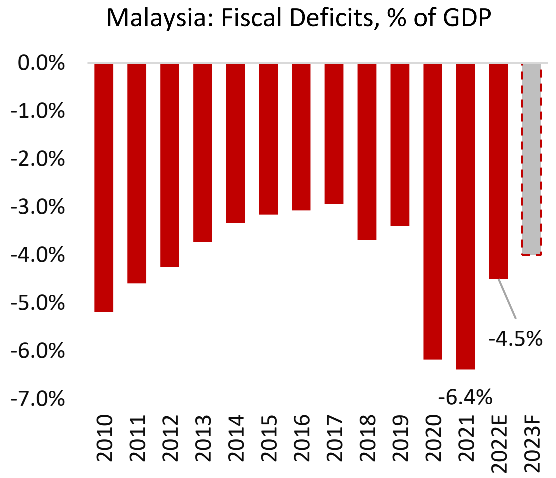
Higher MGS & GII Issuance to fund development expenditure (D.E.)

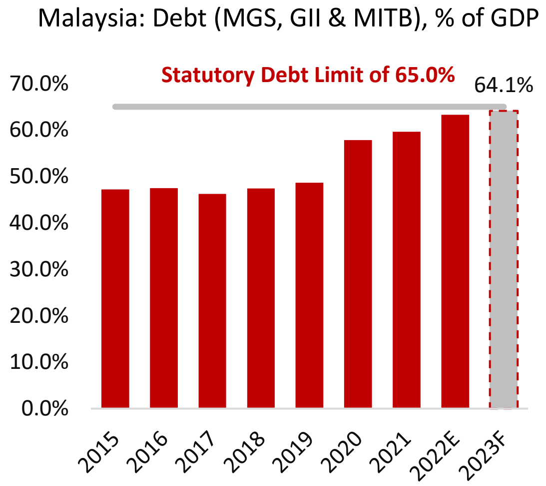
- We believe options to cut spending in 2023 are limited. With the anticipation of higher DE, we forecast the MGS & GII issuance to be higher at RM185.0 billion from an estimated RM175.0 billion in 2022. The redemption is expected to be RM83.3 billion (2022F: RM78.8 billion). In addition, a higher debt service charges ratio will likely follow suit, rising in tandem with a higher interest rate. Furthermore, we foresee the debt (MGS, GII & MITB) to GDP ratio to inch closer to the statutory debt limit (65%) at 64.1% in 2023 (2022F: 63.3%). As such, sustaining Malaysia's growth rates is critical.

- With the domestic recovery still uneven among the sectors, the new government will likely keep a somewhat accommodative fiscal stance in 2023. In view of a narrowing revenue base and high operating expenditure (OE) and DE., it will be challenging to repair Malaysia's fiscal position amid a slower economic growth rate.

Fiscal Deficits to linger around 4.0.0%-4.5% in 2023

- Malaysia's fiscal deficit narrowed to 3.9% of GDP during 9M2022, cushioned by better-than-expected 3Q2022 GDP performance (3Q2022: 14.2% vs 2Q2022: 8.9%). Going into 2023, as Malaysia's economic fundamentals are likely to remain solid, we anticipate its fiscal deficit to improve slightly to between 4.0% and 4.5% of total GDP in 2023 (2022F: 4.5%).



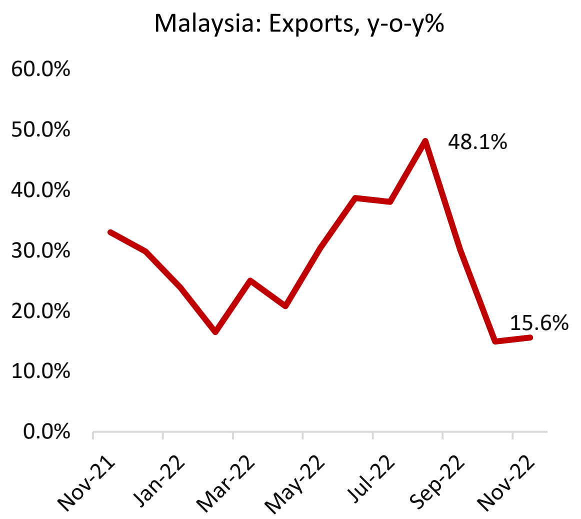


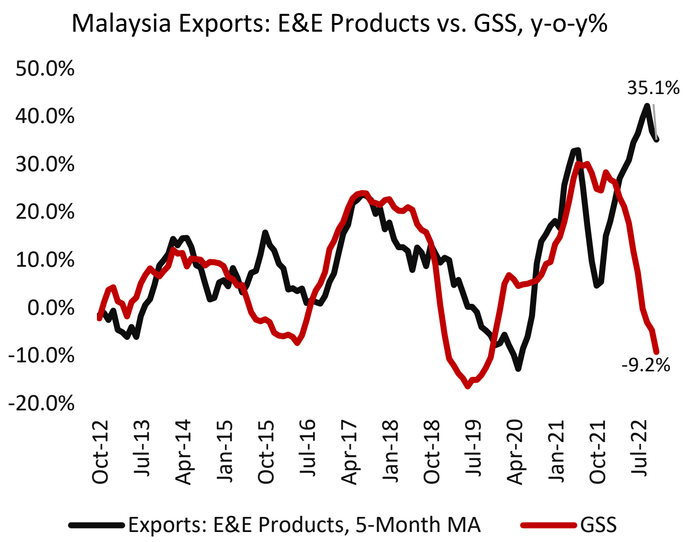
Sources: MOF, CEIC, Bank Islam

Softer foreign trade is inevitable

- We believe challenges stemming from the external demand will be a primary risk of a slowdown in export growth and Malaysia's economic outlook in 2023. Signs of softer foreign trade are already emerging, taking cues from the contraction in Malaysia Purchasing Manager's Index (PMI) alongside Global Semiconductor Sales (GSS) downcycle, which remained negative for four consecutive months. The latest PMI in October 2022 showed that manufacturing activities contracted for four straight months since September (December: 47.8 points vs November: 47.9 points) amid waning demand. Furthermore, there are reports that some business owners have scaled back their buying and production activities. Malaysia's E&E trade which has been the bedrock of export growth could take a toll this year as weakness spreads amongst major economies.

- There is a silver lining to the conundrum, though. On 30 September 2022, Malaysia ratified CPTPP, which came into force on 29 November 2022. The ratification marked Malaysia's decade-long struggle to improve its trade prospects. Under the trade agreement, Malaysia will gain access to three new export markets: Canada, Peru and Mexico. The high-quality agreement covers strict rules and discipline on Malaysia’s key reform areas such as state-owned enterprises, government procurement, environment, intellectual property rights, labour issues and Bumiputera-related policies. We believe such high standards will improve Malaysia’s overall doing-business environment versus its other regional partners who are not signatories of CPTPP.





Sources: DOSM, CEIC, Bank Islam

KEY EVENTS IN 2023

1. The re-tabling of Budget 2023

- All eyes are on the re-tabling of Budget 2023, scheduled on 24 February 2023. We hope the new budget will focus on the government's Medium-Term Revenue Strategy (MTRS), Public Expenditure Review, and Fiscal Responsibility Act. This will, in turn, elucidate the new government's fiscal priorities, in particular, the reintroduction of the Goods and Services Tax (GST) and subsidy rationalisation efforts. We believe these reform measures are inflationary in the immediate term.

- We posit that the government will relook at its global oil price assumption in formulating the new budget. While it is assumed that the global oil price to remain elevated, averaging at USD90.0 per barrel in 2023, it is now hovering between USD80.0 to USD85.0 per barrel at the time of writing. It would trend lower amid anticipation of decelerating global growth. While the GST is unlikely to return in 2023, ongoing revenue-side reform is paramount in Budget 2023. We are of the view that the global oil price assumption would be key in the budget design, considering lower petroleum-related revenue and a narrow tax base.

2. Mid-term Review of 12th Malaysia Plan (MTR 12MP)

- The new Budget 2023 should align with the 12MP, which requires the government to outline its medium-term policy objectives over the next five years. National interest is of the highest priority. Such a review is meant to monitor the progress made under the 12MP and to identify any changes needed to attain the initial targets.

- In reality, it's a tall order to meet all of its initial masterplan targets amid evolving political and economic circumstances. Reviewing the 12MP will be highly complex, considering the lack of a common policy framework among the government's coalition and parties. As such, policy and political uncertainties will remain high.

3. Domestic political landscape and state elections in 2023

- After decades of single coalition rule, Malaysia was forced into a multi-coalitional formula resulting from the 2020 political crisis dubbed the "Sheraton Move". The fragile coalition ruled for only two years and five months, with its leadership changing hands twice in March 2020 and August 2021. Following the 15th General Elections (GE15) held on 19 November 2022, the multi-coalitional setup remains where the Prime Minister's party is not the largest component member of the ruling coalition.

- Having said that, the current government commands a comfortable two-thirds majority in the Dewan Rakyat. We believe that Prime Minister Anwar Ibrahim's consolidatory persona is key in bringing a positive balance to the fragile multi-coalitional formula.

- We expect the six states (namely Kedah, Penang, Selangor, Negeri Sembilan, Kelantan and Terengganu) will hold their state polls in 2Q2023. Considering that the current government has yet to stand the test of time, the elections are going to be as contentious as GE15. Unless the current political setup heads for formal registration, we believe the political landscape is relatively stable but exposed to many fault lines.

BANK ISLAM'S FORECAST

Growth (% y-o-y)	2019	2020	2021	*2022F*	*2023F*
GDP (Demand Side)	4.4%	-5.5%	3.1%	*8.1%*	*4.5%*
Domestic Demand	4.3%	-5.5%	1.7%	*9.4%*	*5.7%*
Private Consumption	7.7%	-4.2%	1.9%	*12.4%*	*11.4%*
Private Investment	1.6%	-11.9%	2.6%	*6.2%*	*-24.0%*
Public Consumption	1.5%	5.0%	5.3%	*3.2%*	*8.7%*
Public Investment	-10.7%	-21.2%	-11.3%	*1.1%*	*20.2%*
Exports	-1.0%	-8.6%	15.4%	*13.8%*	*7.2%*
Imports	-2.4%	-7.9%	17.7%	*16.6%*	*7.0%*
Net Exports	11.2%	-13.7%	-4.1%	*-15.3%*	*11.4%*

Variables	2019	2020	2021	*2022F*	*2023F*
CPI, y-o-y%	0.7%	-1.1%	2.5%	*3.4%*	*3.0%*
Unemployment Rate, %	3.3%	4.5%	4.6%	*3.8%*	*3.5%*
USDMYR	RM4.09	RM4.02	RM4.17	*RM4.40*	*RM4.28*
Brent, USD/barrel	66.00	51.80	77.78	*85.91*	*91.00*
OPR, %	3.00%	1.75%	1.75%	*2.75%*	*3.25%*

Sources: DOSM, Bank Islam