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QUICK TAKE: BNM ANNUAL REPORT 2022

BANK ISLAM'S CURRENT GDP FORECAST FALLS IN THE MIDPOINT OF BNM'S

Table 1: Real GDP by expenditure components

Growth, y-o-y%	2020	2021	2022	2023F BNM	2023F Bank Islam
Aggregate domestic demand (excluding stocks)	-5.5	1.7	9.2	5.4	5.2
Private Consumption	-4.2	1.9	11.3	6.1	6.2
Private Investment	-11.9	2.6	7.2	5.8	3.5
Public Consumption	5.0	5.3	3.9	1.3	1.6
Public Investment	-21.2	-11.3	5.3	7.0	6.6
Net Exports	-13.7	-4.1	-1.8	9.7	11.0
Exports of goods and services	-8.6	15.4	12.8	2.7	4.7
Imports of goods and services	-7.9	17.7	14.2	2.1	4.2
Real GDP	**-5.5**	**3.1**	**8.7**	**4.0-5.0**	**4.5**

Sources: BNM, Bank Islam

- **Overall, our 2023 outlook on Malaysian economic growth is within the range estimated by the BNM, specifically at 4.5%.** Undoubtedly, slower growth is inevitable for this year following the challenging global environment. Nevertheless, we remain upbeat that such growth will be supported by resilient private consumption, which is expected to record a gain of 6.2%, buoyed by an improved labour market and continuous government measures weighs in on the domestic demand, thus boosting our economic growth.

- **Our GDP outlook is bolstered by our optimistic projection on the net exports at 11.0% against BNM's 9.7% growth**. We believe there could be potential spill over effects from the ratification of mega trade deals, namely the Regional Comprehensive Economic Partnership (RCEP) and Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which could support the country's trade performance. While we generally share the same view as BNM on public consumption and investment, we are less optimistic about the momentum of private investment than BNM's projection. We foresee the private investment growth to pick up by 3.5% in 2023, less than BNM's forecast of 5.8%. This is mainly due to uncertainties in the global financial market, the central banks' monetary policy path outlook and the elevated global oil prices, which can impact sentiments negatively and, thus, influence investment habits.

- **We share BNM's view that the growth risks outlook is "fairly balanced", with downside risks stemming from external developments while upside risks primarily derived from the country's sound macroeconomic fundamentals.** The recent global banking crisis in the advanced economies compounds the already anticipated slower global economic growth, affecting public sentiment in our domestic economy. Though we foresee that household spending squeeze looms amid elevated price levels, the better-than-expected labour market conditions, stronger pick-up in tourism activities, and implementation of multi-year investment projects could help to lift the overall domestic growth outlook. That said, we remain optimistic that Malaysia is not at risk of a recession this year sans a major global supply shock.

GDP by Economic Sector, y-o-y%	2020	2021	2022	2023F	
				BNM	Bank Islam
Agriculture	-2.4%	-0.2%	0.1%	0.7%	1.1%
Mining & Quarrying	-9.7%	0.3%	3.4%	2.0%	1.7%
Manufacturing	-2.7%	9.5%	8.1%	4.0%	4.2%
Construction	-19.3%	-5.2%	5.0%	6.3%	5.2%
Services	-5.4%	1.9%	10.9%	5.0%	4.9%
Real GDP	**-5.5%**	**3.1%**	**8.7%**	**4.0%-5.0%**	**4.5%**

Sources: BNM, Bank Islam

- **Modest growth is expected across all economic sectors, powered by tourism-related industries amid China's reopening news.** BNM expects that the services sector will remain the engine of growth in the wake of the resumption of international tourism activities alongside higher tourist arrivals from China. However, the growth projection for services is halved to 5.0% in 2023 from 10.9% in 2022 (Bank Islam: 4.9%) in tandem with the moderation in global growth and demand normalisation. Similarly, the manufacturing sector, the second largest component in GDP, will soften to 4.0% (2022: 8.1%), slightly lower than our forecast of 4.2% amid the easing supply chain pressure. Be that as it may, the challenging external headwinds, subdued international trade activities, and semiconductor downcycle will continue to pose risks to manufacturing performance this year. Meanwhile, BNM believes the construction sector will outpace growth in 2023, rising by 6.3%. The latest projection is higher compared to our forecast of 5.2% this year. However, it remains supportive amid the implementation of large-scale projects which will drive the civil engineering subsector. As for mining & quarrying and agriculture sectors, BNM foresees these sectors to record marginal growth of 2.0% (Bank Islam: 1.7%) and 0.7% (Bank Islam: 1.1%), accordingly this year.

MODERATING CONSUMER INFLATION

Consumer Inflation, y-o-y

Food and Non-Alcoholic Beverages, y-o-y
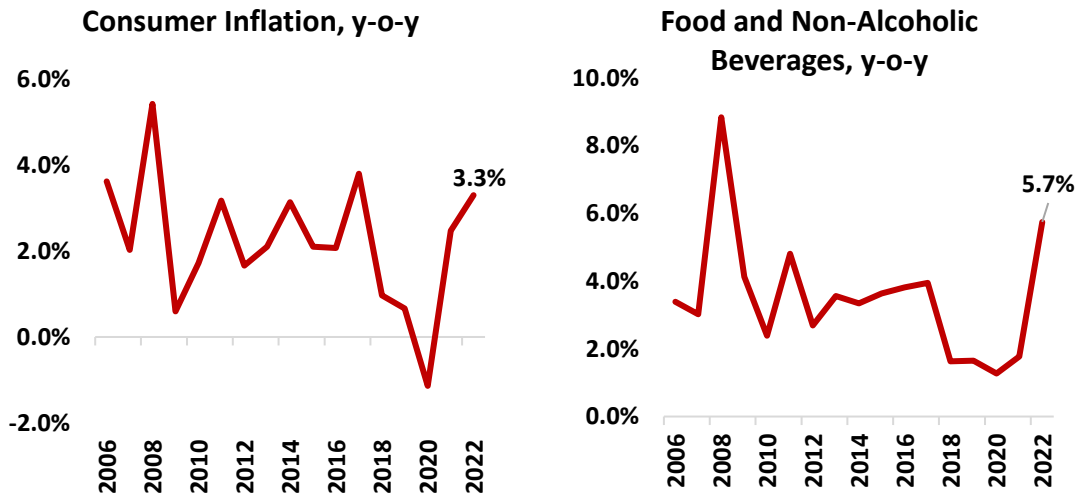
Sources: BNM, Bank Islam

- **We foresee that headline inflation will come in at 3.0% in 2023.** Our inflation forecast falls within the BNM's projection range between 2.8% and 3.8% on the back of lower global commodity prices coupled with improvement in supply chain disruption. Nonetheless, food prices will remain elevated following continued recovery in the labour market, strong domestic demand, the possibility of further subsidy rationalisation, and unfavourable FX, which has led to higher imported food products. Our inflation outlook, however, has yet to incorporate the impact of subsidy rationalisation slated for 2H2023.

WE SENSE RESISTANCE TO FURTHER NORMALISE RATES IN 2023

Unemployment Rate, %

3M Klibor-OPR Gap, bps
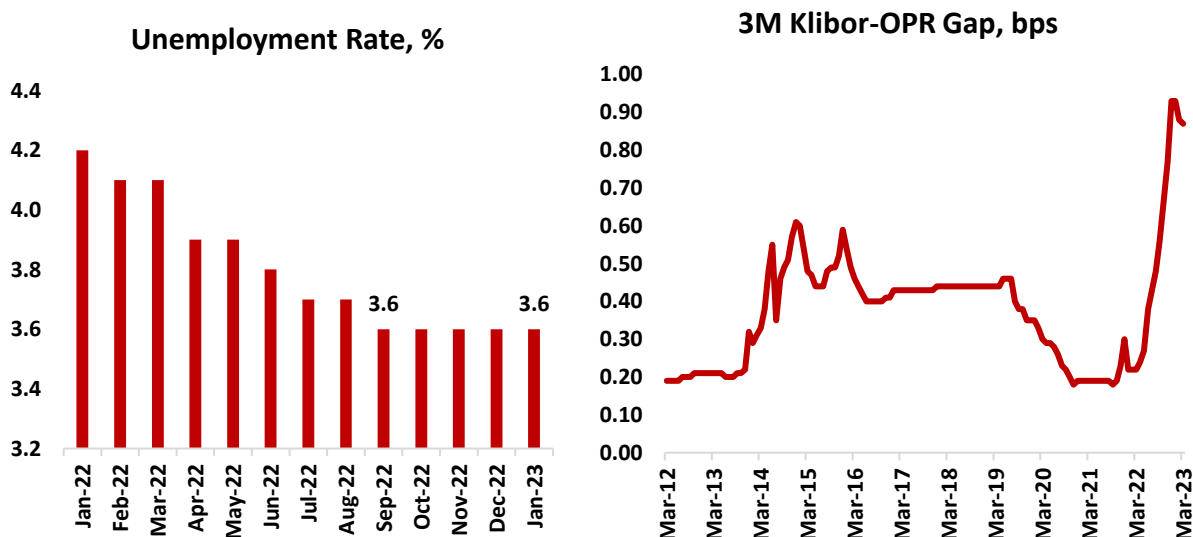
Sources: BNM, Bank Islam

- **We believe that Malaysia's labour market recovery will trend sideways this year.** The unemployment rate declined from 4.2% in January 2022 to 3.6% a year later amid the full resumption of economic activities. In 2023, BNM anticipated that the rate would improve further to 3.5%, with more broad-based expansion in the income, thanks to the government's policy intervention. Yet, it is slightly higher than the pre-pandemic levels of 3.3%, so further upside to the OPR hinges more on wage growth. That said, we believe that limited collective bargaining space and the delay in implementing the new RM1,500 minimum wage level would limit the overall wage growth in the year.

- **As such, we posit that BNM could keep OPR flat at 2.75% until the year-end.** Recently, BNM decided to pause the OPR hike for the second time during its March meeting to allow the economy to adjust the 100bps hike delivered in 2022. We sense resistance to normalising rates further amid cautious global economic outlook and static domestic labour market conditions. While such a pause has eased the 3M Klibor-OPR gap to 87bps in March (February: 88bps), it remains elevated to a level unseen in decades.
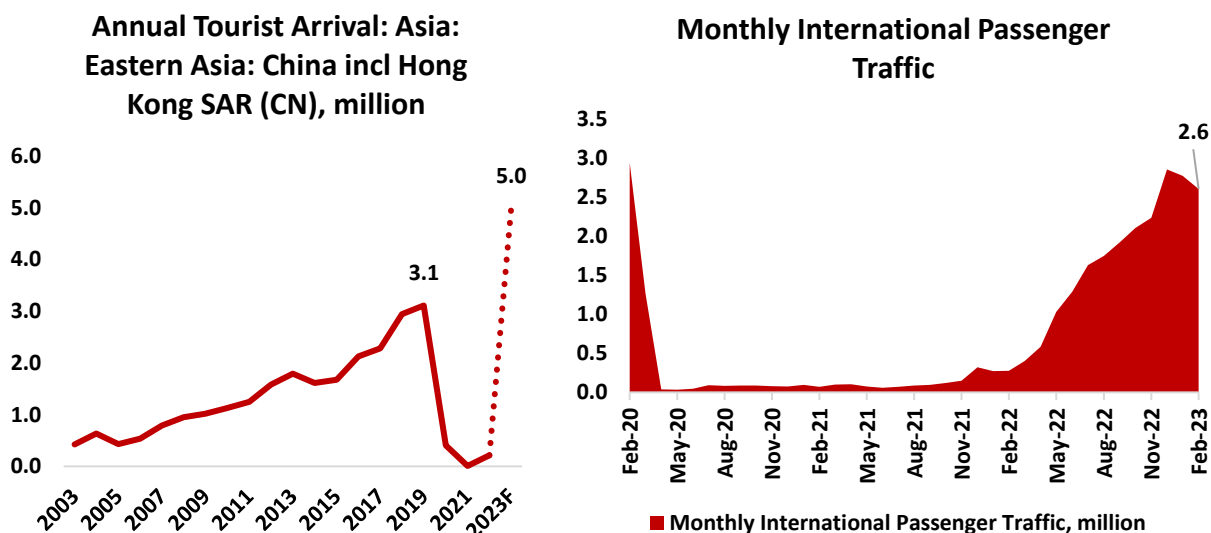
STRONG DOMESTIC DEMAND IS THE CATALYST FOR FINANCING GROWTH IN 2023

Financing Growth, y-o-y%

Gross Impaired Financing Ratio (GIFR), %
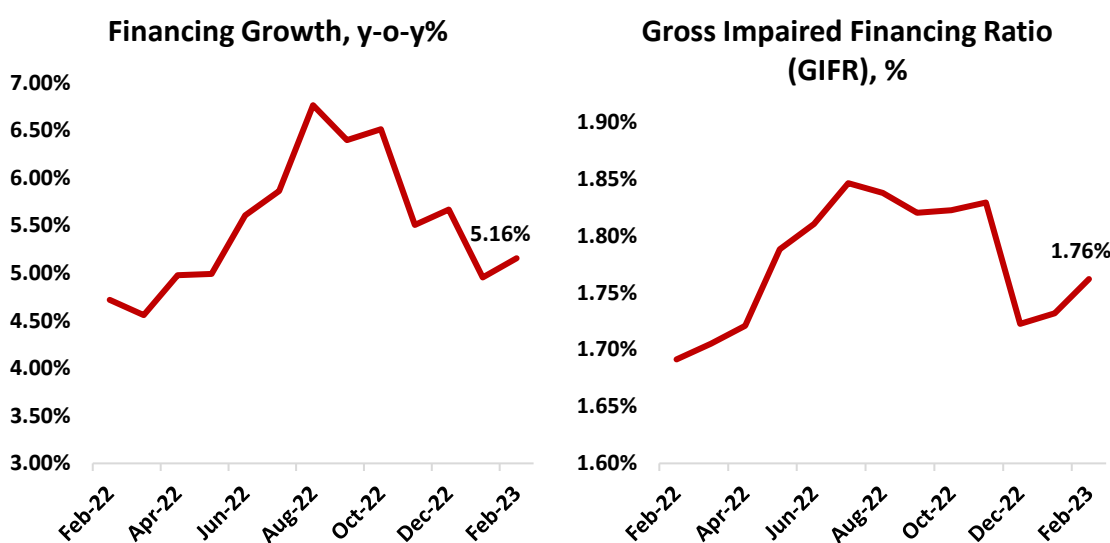
Sources: BNM, Bank Islam

- **Total financing activities for 2022 (5.7%) have improved near pre-COVID-9 levels at an average of 6.2% (2015-2019) and the trend is expected to persist this year given strong labour market and firm demand conditions.** However, impairment for the total banking system under Adverse Scenario 1 (AS1) and Adverse Scenario 2 (AS2) is projected to be higher at 4.1% and 3.9%, respectively, in 2023. The anticipation of weaker asset quality will mainly come from households earning below RM5,000 per month as they will be severely affected during the economic downturn, given their narrow financial buffers.

CHINA'S REOPENING IS A DOUBLE-EDGED SWORD

Annual Tourist Arrival: Asia: Eastern Asia: China incl Hong Kong SAR (CN), million

Monthly International Passenger Traffic

■ Monthly International Passenger Traffic, million

Sources: Tourism Malaysia, Malaysia Airport Holdings Berhad (MAHB)

- **We concur with BNM that Malaysia could benefit from China's economic reopening, thus providing a much-needed boost to Malaysia's tourism and private education sectors.** Chinese tourist arrival into Malaysia will likely grow and recover towards the pre-pandemic levels, following an upward trend recorded throughout 2022. Although the Ministry of Tourism, Arts and Culture Ministry is bullish about its 5.0 million Chinese tourist target in 2023, we are pessimistic about such a prospect considering the threats to the global economy and connectivity constraints.

- **We think connectivity constraints will be a downside to the tourism sector.** We take note of the lack of direct international flights between Malaysia and Tier 2 Chinese cities as of 1Q2023, which may dampen the immediate-term positive outlook of Malaysia's tourism sector. The untimeliness of official tourism data makes it harder to pinpoint the tentative impact of China's economic reopening on Malaysia's economy. While we remain sanguine that China's reopening is positive for Malaysia, we do not discount that the strong upside of China's rebound could lead to an upturn in demand following an upsurge in consumer spending, which in turn, creates an inflationary environment, especially in the restaurant and hotel related industries.