BNM Economic & Monetary Review 2023

Silver lining on the horizon despite many external uncertainties in 2024

Summary

- Bank Negara Malaysia (BNM) forecasts a GDP growth of 4.0% to 5.0% in 2024 (2023: 3.7%), matching with the Ministry of Finance (MoF) projection of 4.0% - 5.0% and aligning with our in-house forecast of 4.5% - 5.0%.
- BNM projects continuous growth, fuelled by a resilient domestic demand backed by better labour market conditions, targeted government support, and progress in multi-year government projects. However, external headwinds continue to present risk to the economy.
- BNM projects current account (CA) surplus to widen to 1.8% - 2.8% (KIBB: 2.3%; 2023: 1.2% of GDP), thanks to the ongoing recovery in exports and tourist arrivals. We concur with BNM's assessment, holding a positive outlook for the domestic capital market, which could attract foreign inflows and further increase the CA surplus.
- BNM is committed to a policy that promote economic growth while keeping inflation in check. It believes that managed costs and limited might ease inflation, though it notes potential upside risks to price increase. Given the stronger GDP growth outlook and expected price stability, we predict BNM keep the overnight policy rate (OPR) unchanged at 3.00% throughout 2024.
- An improved global risk outlook, especially with a possible Federal Reserve policy pivot from June onwards, could strengthen the ringgit in 2H24. While short-term actions by BNM and the government might stabilise the ringgit, long-term structural reforms are crucial to ensure its return to a fair value. Additionally, a rise in foreign portfolio inflows would support our expectation that the ringgit would strengthen towards our end-2024 USDMYR forecast of 4.42.
- It's worth noting that BNM emphasise tackling structural issues to improve workforce flexibility, suggesting reforms in skill alignment, upskilling, and creation of high-skilled jobs. Collaborative efforts among government, industry, and educational sectors are encouraged. Our 2024 unemployment forecast remains at 3.2%, a tad lower than BNM's 3.3%, indicating stable labour conditions and strong hiring in line with a positive economic outlook.

- **BNM is projecting Malaysia's GDP growth to expand between 4.0% to 5.0% in 2024 (2023: 3.7%), after missing its target in 2023**
  - The latest BNM GDP growth projection aligns closely with forecasts by the Ministry of Finance (4.0% – 5.0%), IMF (4.3%) and World Bank (4.3%), as well as Bloomberg's median consensus estimate (4.3%). This also aligns with our in-house forecast of 4.5% - 5.0% growth. While it is similar to the growth target set for 2023, the consistency across these forecasts, despite a broader projection range reflecting ongoing domestic and global uncertainties, underscores a cautious optimism. BNM attributes projected growth mainly to strong domestic demand and an export recovery, while acknowledging persistent downside risks.
  - BNM notes the growth outlook faces downside risks, both domestically and externally. This includes weaker-than-expected global growth and heightened geopolitical tensions that could affect Malaysia's trade. Additionally, adverse weather conditions and extended maintenance of oil and gas (O&G) fields may adversely impact commodity production and growth prospects. Meanwhile, the anticipated subsidy rationalisation might slow growth, but targeted government assistance could partially offset its effect.

Table 1: Real GDP Growth

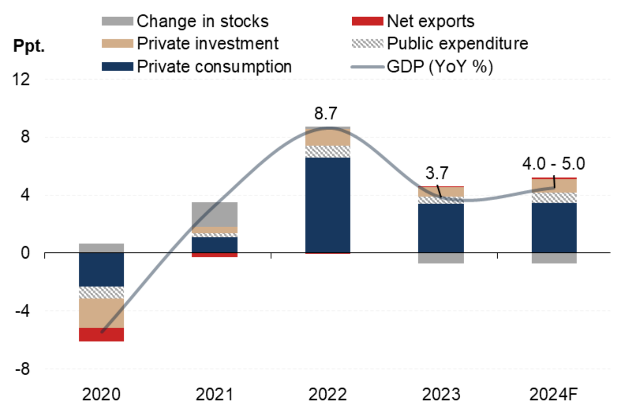
YoY %	2023	KIBB 2024F	MoF 2024F	BNM 2024F
By Sector				
Agriculture	0.7	1.6	1.2	-0.5
Mining	1.0	2.0	2.7	3.5
Manufacturing	0.7	4.5	4.2	3.5
Construction	6.1	3.9	6.8	6.7
Services	5.3	5.4	5.6	5.5
Real GDP	**3.7**	**4.5 – 5.0**	**4.0 – 5.0**	**4.0 – 5.0**
By Expenditure				
Consumption	4.6	5.2	5.1	5.2
Public	3.9	2.1	2.6	3.2
Private	4.7	5.8	5.7	5.7
Investment	5.5	5.7	6.1	6.2
Public	8.6	6.1	8.3	6.2
Private	4.6	5.6	5.4	6.1
Public Spending	5.1	3.1	4.1	4.0
Private Spending	4.7	5.8	5.6	5.8
Aggregate Demand	4.8	5.3	4.8	4.6
Exports	-7.9	4.3	4.1	4.0
Imports	-7.6	4.5	3.9	4.1
Net exports	-11.3	5.4	5.5	2.1
Real GDP	**3.7**	**4.5 – 5.0**	**4.0 – 5.0**	**4.0 – 5.0**

Source: BNM, Dept. of Statistics, Kenanga Research

However, BNM also pointed a few potential upside risks, including increased spillover from the tech upcycle, increased tourism activity, and quicker execution of investment projects.

- **Firmer domestic demand and improvement in external demand to support the overall growth trajectory**
  - Domestic demand (5.4%; 2023: 4.8%): Sustained expansion and remains the anchor of the domestic growth
    - Private spending (5.8%; 2023: 4.7%): BNM projects further expansion led by expansion in private consumption (5.7%; 2023: 4.7%) above the long-term average 2014-2023 of 5.2%. Firmer projection is largely due to the improvement in labour market conditions amid a lower unemployment rate outlook (BNM: 3.3%; KIBB: 3.2%; 2023: 3.4%) and rising wages in the manufacturing and services sectors, alongside government measures. Similarly, private investment is projected to chart a solid expansion (6.1%; 2023: 4.6%) amid the realisation of new and ongoing investment projects, thanks to higher approved investment last year totalling RM330.0b (2022: RM268.0b). According to BNM, the realisation is concentrated in the E&E products and information & communications (ICT) sub-sectors. Notably, the average manufacturing sector investment realisation rate from 2021 to 2023 is 74.0%. Overall, we view that BNM's positive outlook is also backed by improved political stability and a clear policy direction from the government, supported by a various major national master plan. Most importantly, it requires swift, effective action and thorough follow-up.

Graph 1: GDP by Expenditure (BNM Forecast)

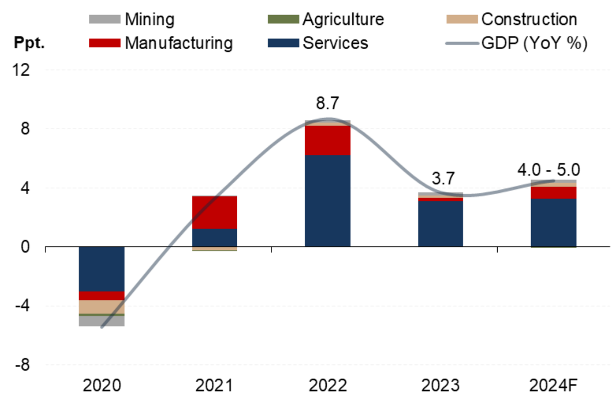


Source: BNM, Dept. of Statistics, Kenanga Research

    - Public spending (4.0%; 2023: 5.1%): BNM sees slower public spending growth but still above house forecast (3.1%). Public consumption is projected to expand moderately (3.2%; 2023: 3.9%) due to the government's commitment to improve the efficiency of spending. Nevertheless, growth will be supported by emoluments spending driven by annual salary increments and new hirings. Similarly, public investment is expected to moderate (6.2%; 2023: 8.6%), but a tad above house forecast (6.1%). This is due to the progress of ongoing large-scale infrastructure projects and catalytic investments, driven by government and public corporations.
  - Net exports (2.1%; 2023: -11.3%): A growth rebound is expected amid higher global trade activities, technology upcycle and higher commodity prices
    - Exports (4.0%; 2023: -7.9%): BNM expects value added exports to rebound in tandem with a higher global trade activity, recovery in global technology cycle and higher commodity prices. This will be driven by higher demand for manufactured products (4.7%; 2023: -6.7%) which account for 85.0% of Malaysia's total exports. Additionally, commodities exports are also expected to rebound by 6.5% (2023: -16.2%) following a sharp decline last year, backed by higher crude palm oil prices and higher production of O&G. Overall, BNM expects gross exports to rebound by 5.0% (2023: -8.0%), but below house forecast of 9.4%.
    - Imports (4.1%; 2023: -7.6%): Value-added imports are projected to rebound in tandem with higher exports and improving domestic demand. This will be a broad-based expansion with the expansion of intermediate imports driven by the rebound of manufactured exports, and imports of consumption and capital goods to be supported by higher consumption and investment activities. Overall, BNM projects gross imports to rebound by 5.4%, following a contraction of 6.4% in the preceding year.
- **A broad-based expansion across economic sectors led by services and manufacturing sectors**
  - Services (5.5%; 2023: 5.3%): This is primarily due to improvement in the business-related subsectors. Growth will be supported by the recovery in external demand, ongoing construction projects, the rollout and expansion of 5G network coverage as well increased subscriptions. Additionally, consumer-related subsectors are also set to benefit from a further recovery in tourism and resilient household spending, supported by favourable labour market conditions and 30-day visa-free travel for China and India nationals. Notably, BNM's growth projection sits between MoF (5.3%) and our (5.6%) forecasts.
  - The manufacturing sector is expected to expand by 3.5% (2023: 0.7%), driven by the recovery in the export-oriented industries and sustained growth in the domestic-oriented cluster. BNM expect E&E production to rebound modestly

in 1H24, with a stronger recovery in 2H24, in line with house expectations. This is largely in anticipation of an upswing in the global technology cycle, backed by improving external demand. Similarly, steady expansion is expected in the primary-related cluster amid improving upstream supply together with higher production in the major oil refineries in Johor. For the consumer-related cluster, BNM expects continued recovery in tourism activities to support growth, while the construction-related cluster benefits from the progress of multi-year government investment projects.

Graph 2: GDP by Industry (BNM Forecast)



Source: BNM, Dept. of Statistics, Kenanga Research

– Agriculture (-0.5%; 2023: 0.7%): BNM projects the sector to contract mainly due to dry weather conditions linked to El Nino and lower oil palm production. However, higher productivity will be backed by the continuous training of migrant workers to support output in oil palm production. In addition, the impact of El Nino is also expected to affect other agriculture subsectors. In comparison, we are still maintaining positive growth projection for this sector (1.6%) as we expect higher allocation in the Budget 2024 worth RM6.17b (2023: RM5.39b) or a 14.4% increase to boost the agriculture sector.

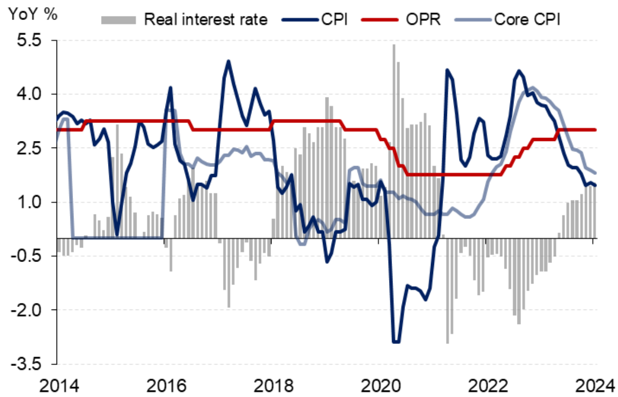
– Mining and Quarrying (3.5%; 2023: 1.0%): BNM project growth to expand at a faster pace attributable to higher production in O&G fields led by O&G fields in Sarawak. Notably, BNM's projection surpasses house (2.0%) and MoF (2.7%) forecasts.

– Construction (6.7%; 2023: 6.1%): Further expansion is expected due to sustained activities in civil engineering, special trade, and residential subsectors. This growth will be fuelled by infrastructure projects and initiatives outlined in Budget 2024, New Industrial Master Plan (NIMP) 2030, and National Energy Transition Roadmap (NETR). Additionally, new housing launches are expected to drive growth in the residential subsector, backed by increasing housing demand. Nevertheless, we project a slower growth (3.9%) as we remain cautious about the impact of upcoming subsidy rationalisation and the rising cost of living which could result in slower demand for residential subsectors.

- **BNM will ensure that monetary policy continues to support sustainable economic growth while maintaining a backdrop of price stability**

– Having completed its policy normalisation cycle in May 2023, the BNM now prioritises maintaining a policy stance that supports economic growth while managing risks to inflation. The central bank acknowledges that its projections for moderating inflation and improved economic growth in 2024 are subject to several risks. These risks include domestic policy decisions, financial market developments, external demand fluctuations, and global commodity price movements. The BNM reiterates that the Monetary Policy Committee (MPC) will closely monitor how these factors impact inflation dynamics and demand conditions. Given the current uncertainties, the MPC remains vigilant, assessing ongoing developments and their potential effects on the balance of risks surrounding domestic inflation and growth.

Graph 3: BNM OPR and Inflationary Trend



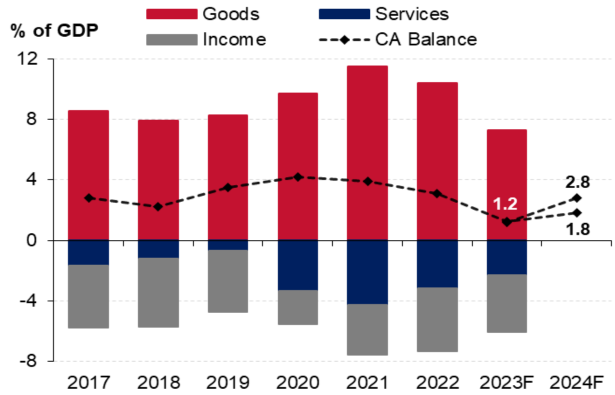
Source: Dept. of Statistics, Bloomberg, Kenanga Research

– The BNM may find itself inadvertently on autopilot throughout the year as, at the current juncture, the OPR at 3.00% ensures price stability while bolstering domestic economic growth. Despite our projection of a higher headline inflation rate of 2.7% YoY this year, unchanged monetary policy settings would still yield a positive real interest rate of approximately 0.3%. Given our forecast of a stronger GDP growth of 4.5% - 5.0% in 2024, propelled by strong domestic demand and a continued expansion in the manufacturing sector, there seems little cause for the BNM to adjust the OPR during the year. Nevertheless, we acknowledge potential upside risks to prices and downside risks to growth that could alter this outlook.

- **CA balance is projected to maintain a surplus, albeit higher, fuelled by the recovery in export growth and increased tourist arrivals and spending**

  – BNM anticipates that CA of the balance of payments will register a higher surplus of 1.8% -- 2.8% of GDP in 2024, compared to 1.2% in 2023. This upward trend is expected to be propelled by an increased surplus in the goods account and a reduced deficit in the services account. The goods account is forecasted to achieve a significantly higher surplus, reaching RM163.8b (2023: RM132.9b). This surge is attributed to the recovery in export growth (5.0%; 2023: -8.0%), which offsets the rebound in imports growth (5.4%; 2023: -6.4%). Meanwhile, the services account is projected to incur a smaller deficit of RM40.9b (2023: -RM41.9b), reflecting a further recovery in the travel account as tourist arrivals continue to increase towards to pre-pandemic levels. However, the overall services account will remain in deficit due to Malaysia's ongoing reliance on foreign services, particularly in the transportation segment. The primary income account is expected to record a higher deficit of RM68.3b (2023: -RM55.1b) due to continued income payment accrued by foreign investors in Malaysia amid improving export earnings. Meanwhile, the secondary income account is projected to persist in deficit at RM13.2b, driven by ongoing outward remittances by foreign workers.

Graph 4: Current Account Trend (% of GDP)



Source: Dept. of Statistics, Kenanga Research

  – We concur with the BNM's assessment that the rebound in exports, fuelled by the global technology upswing, coupled with the stimulation of robust tourism activity through the government's charter flight matching grant incentive and Malaysia's visa-free policy, are poised to elevate the current account (CA) surplus in 2024. Moreover, the potential for a stronger ringgit against major currencies (i.e., USD and EUR) could enhance the value of earnings from foreign investments upon conversion into the domestic currency. This could alleviate the pressure from continued investment income accrued by foreign investors in Malaysia, thereby supporting the CA surplus. Furthermore, government initiatives aimed at attracting investment, in tandem with the improving prospects of the domestic capital market, hold the potential to amplify foreign inflows and further strengthen the CA surplus with house projection to widen to 2.3% in 2024.

- **Although both headline and core inflation are expected to moderate due to contained cost and limited demand pressures, upside risks from both domestic and global factors may continue to push prices higher**

  – The BNM expects headline inflation to remain moderate due to contained cost pressures amid easing global supply conditions. The impact of exchange rate depreciation and tax changes is anticipated to be manageable, with only marginal effects. However, domestic policy uncertainties, particularly regarding the implementation of fuel subsidy rationalisation, have resulted in a wide forecast range of 2.0% - 3.5% for 2024 (2023: 2.5%). Core inflation is also expected to moderate to an average of 2.0% - 3.0% (2023: 3.0%) due to continued expansion in domestic demand and anticipated wage increases. Nevertheless, limited demand pressures and stable near-term sentiment regarding economic conditions may temper upward price pressures.

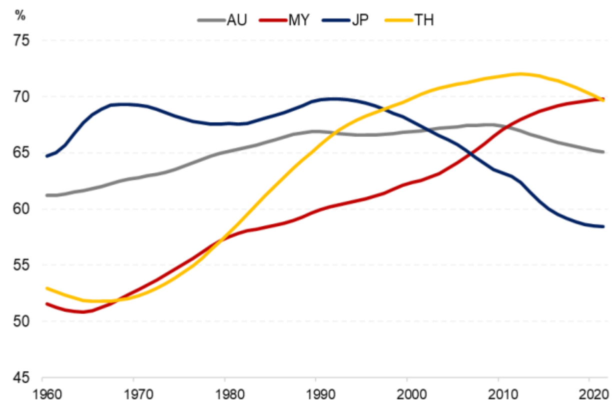
  – House forecast for the 2023 headline CPI lies in the middle of the BNM's projection at 2.7%. This is based on both global and domestic factors, including the threat of global food insecurity exacerbated by extreme weather conditions, climate change, and geopolitical conflicts, which may lead to increased food prices. Additionally, the rationalisation of RON95 fuel subsidies in 2H24 and the anticipated rise in tourism activity contribute to this projection. Regarding underlying inflation, we anticipate core prices to average around 2.0% this year, the lower-end target of BNM, due to our outlook for a stronger ringgit and limited pass-through from wage growth increases.

  – We agree with the BNM's assessment that the inflation outlook remains highly dependent on the adjustment to blanket fuel subsidies, which could potentially lead to a sharp spike in headline numbers. However, given our projection of a stable Brent crude oil price of around USD84.0/barrel (BNM assumption: USD80.0-90.0/barrel) and an anticipated floating price for RON95 between RM3.10 - RM3.20, it is more likely that consumer prices will remain below 3.0% in 2024.

- **BNM continue to implement various strategies aim to ensure the ringgit fairly reflects its economic fundamentals**
  - The BNM contends that the current level of the ringgit is undervalued, particularly in light of Malaysia's positive growth prospects. Looking ahead, as major central banks begin to reduce rates, the yield differential between advanced and emerging economies is expected to narrow. This shift in risk perception may favour the MYR as investors rebalance their portfolios. Additionally, sustained confidence from global investors on future growth prospect and the steady progress of key infrastructure projects as well as major national master plan could attract capital inflows, thereby stabilising the ringgit. Joint initiatives between the government and the BNM aimed at promoting the repatriation and conversion of foreign investment income by GLCs and GLICs, along with the conversion of export proceeds by resident exporters, may further bolster the ringgit. Furthermore, advocating for increased usage of the local currency in settling export or import payments is also seen as a measure to strengthen the ringgit.
  - Anticipation of foreign inflows in 2H24, driven by an improvement in global risk sentiment following a potential Fed rate cut in June, coupled with broad USD weakness, may contribute to boosting the ringgit to trade at 4.42 by end-2024. As the Fed initiates rate cuts, investors seeking to maintain their returns might redirect their funds towards stable, high-quality, and high-yielding emerging market debt, particularly in countries where central banks are not expected to lower rates, such as Malaysia. However, as highlighted by the BNM, beyond the short-term measures aimed at strengthening the ringgit, the government's structural reforms to ensure fiscal sustainability, new growth areas, improving transportation connectivity along with enhancing labour productivity remain crucial in attracting investors. Effective implementation of the Madani policies is imperative to avoid negative rating actions or downgrades and to appeal to foreign investors, leveraging Malaysia's relatively higher credit rating and lower the implied probability of default compared to its ASEAN-5 counterparts.

- **Policy reforms are needed to address the challenges in the labour market**
  - In its box article "The Case for Labour Market Reforms in Malaysia: Challenges and Opportunities, BNM highlighted the significance of minimising the effects of structural issues and the concurrent trends that impede the growth and workforce agility. BNM touched on the commendable difference in the unemployment rate of 5.1% in 2Q20 which have returned to the pre-pandemic level at 3.3% at the end of 2023.
  - Despite the steady recovery in the unemployment rate, the central bank reminded us on the worrisome underemployment rate mainly for high-skilled related which has increased from the average of 33.8% (2018-2019) to the average of 38.4%. The drivers behind the rise would be the low vacancy for high-skilled jobs and the mismatch on the skills possessed by candidates. The mismatch between fresh graduates entering the workforce and the creation of high-skilled jobs is notable, despite rising demand. This gap is exacerbated by graduates possessing skills that do not align with available high-skilled positions, largely due to their level of education surpassing job requirements. The issue is further compounded by underqualified candidates for these high-skilled roles.

Graph 5: Working-age population (% of total population)



Source: World Bank, Kenanga Research

  - BNM drew attention to ongoing worrisome trends, including the adoption of advanced technology such as automation and generative artificial intelligence, which could potentially displace 4.5m jobs by 2030. Additionally, supply chain reconfiguration poses a risk of job displacement, especially if nearshoring or reshoring is adopted. Transitioning to a green economy is not a quick process for Malaysia, as it requires the development of new skills and training among workers. Lastly, the concerning increase in the ageing population will ultimately reduce the working-age population share of the total population from 70.0% in 2023 to 66.0% by 2050.
  - BNM introduces several labour market policy reforms to progressively create a resilient and sustainable workforce. Firstly, upskilling candidates to become more holistic individuals through improvements in education and comprehensive training would equip job candidates with important fundamental skills, whether cognitive or aptitude-based. An autonomous training system that allows working individuals to undergo training courses without supervision from employers is also a wise initiative for an agile and upskilled workforce.

- To create more high-skilled jobs, technological improvements and adoption are needed, especially among SME's. Additionally, the adoption of advanced technology can drive productivity growth, making firms more attractive to investors. Redesigning immigration policies is necessary to reduce the country's dependency on foreign workers, especially for low-wage and low-skill jobs, ensuring alignment with development needs. Meanwhile, attracting high-skilled foreign talents for high-skilled jobs is advisable to foster knowledge transfer, especially to local workers.

- Adjusting the minimum wage of graduates according to their skill level would ensure that workers are fairly compensated for their labour. Lastly, for social protection aspects, flexibility in the labour market, especially in work arrangement and gig work needs to be introduced, especially in the informal sectors. Social protection plans like EPF and SOCSO can pave the way for greater penetration of social insurance.

- We are in sync with BNM regarding the necessity of implementing labour market reforms to mitigate the impacts of structural issues and the ongoing trends that could impede the establishment of future-ready workforce. As for the reforms proposed, we would like to include the need to form and enhance a collaborative relationship between the government, the industry and educational institutions. This collaboration is essential to ensure that education and training programs are aligned with the evolving skill requirements of industries, as outlined in the 257,052 job vacancies posted (as of February 2024) on MYFutureJobs. Notably, semi and low-skilled positions currently dominate the vacancies, accounting for a 64.5% total share, while BNM report that overall employment remains primarily concentrated in semi-skilled segments, with more than 70.0% of the jobs in the agriculture, construction and manufacturing sectors are in the semi-skilled category. Overall, we maintain our 2024 unemployment rate forecast at 3.2% versus 3.3% by the BNM. The positive view is mainly driven by the stable labour market conditions and robust hiring in 2024 as reflected in the sustained employment growth in the recent month amid positive economic outlook.

Table 2: Forecast and Assumptions

	2015	2016	2017	2018	2019	2020	2021	2022	2023	KIBB 2024F	BNM 2024F
Real GDP (%YoY)	5.0	4.2	5.9	4.7	4.4	-5.6	3.1	8.7	3.7	**4.5-5.0**	**4.0-5.0**
Consumer Price Index (avg.)	2.1	2.1	3.7	1.0	0.7	-1.2	2.5	3.3	2.5	**2.7**	**2.0-3.5**
Current Account Balance (% of GDP)	3.0	2.4	2.8	2.1	3.4	4.4	3.8	3.1	1.2	**2.3**	**1.8-2.8**
Fiscal Balance (% of GDP)	-3.2	-3.1	-3.0	-3.4	-3.4	-6.2	-6.5	-5.5	-5.0	**-4.5**	**NA**
Unemployment Rate (%)	3.2	3.3	3.4	3.4	3.3	4.5	4.6	3.8	3.5	**3.2**	**3.3**
Manufacturing Output (%YoY)	4.8	4.3	6.0	5.0	3.8	-2.7	9.5	8.1	0.7	**4.6**	**3.5**
Exports of Goods (%YoY)	1.6	1.2	18.8	7.3	-0.8	-1.1	26.1	25.0	-8.0	**9.4**	**5.0**
Overnight Policy Rate (end-period)	3.25	3.00	3.00	3.25	3.00	1.75	1.75	2.75	2.75	**3.00**	**N/A**
USDMYR (end-period)	4.29	4.49	4.05	4.13	4.09	4.02	4.17	4.40	4.11	**4.42**	**NA**

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

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