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ECONOMIC REVIEW | 2024 National Account

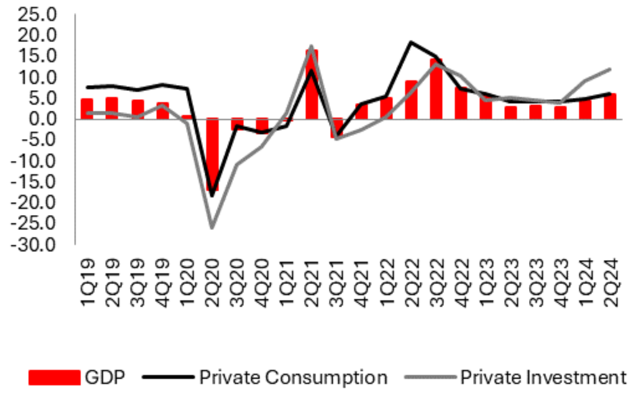
Malaysia's Economy to Grow at +5.0% in 2024 With More Encouraging Domestic Spending and Export Recovery

- *Domestic demand key driver for growth. The GDP data in 2QCY24 indicated that the domestic demand has been the key driver for growth. This was underpinned by stronger consumption expenditures which rose +6.0%yoy (1QCY24: +4.7%yoy). Given the healthy labour market, the positive income growth is expected to support consumer spending this year.*
- *Export recovery to support growth this year. The recovery in exports has persisted into 2QCY24, with real exports growing faster at 8.4%yoy (1QCY24: +5.2%yoy). We expect the recovery will continue in 2HCY24 with a more solid improvement in the E&E exports and continued demand for other commodities such as palm oil, LNG, petroleum products and other manufactured goods.*
- *More rooms for ringgit to appreciate and reach RM4.23 by year-end. The market priced in the Fed will slash its policy rate at the upcoming FOMC meeting in Sep-24. Considering narrowing of interest differentials as BNM is expected to keep OPR unchanged at 3.00% throughout 2024, we revise our ringgit outlook with a steeper appreciation of +8.6% to RM4.23 by year-end (end-2023: RM4.594).*
- *Revise upward 2024 GDP growth forecast to +5.0%. Taking into account the recent data, we revised our 2024 GDP growth forecast higher to +5.0% from +4.7% previously (2023: +3.6%). We foresee the positive outlook for domestic spending and export recovery will continue in 2HCY24.*

Domestic demand key driver for growth. The GDP data in 2QCY24 indicated that the domestic demand has been the key driver for growth. This was underpinned by stronger consumption expenditures which rose +6.0%yoy (1QCY24: +4.7%yoy), the fastest growth in 5 quarters. Given the healthy labour market, where we expect the unemployment rate to remain low at 3.3% this year, the positive income growth is expected to support consumer spending this year. We also foresee the recovery in the tourism sector, as reflected by the higher arrivals of foreign tourists, will support the domestic consumption spending which will benefit sectors such as accommodation, transport services, F&B services, and retail trade. This also explained why the services sector also grew faster at +5.9%yoy in 2QCY24, even stronger than the advance estimate of +5.6%yoy. The cash assistance from the government and the flexibility of EPF Account 3 will also help to support consumer spending, cushioning the possible inflationary effect from subsidy rationalization and other policy changes. On that note, we project private consumption will grow faster at +5.4% in 2024 (2023: +4.7%).

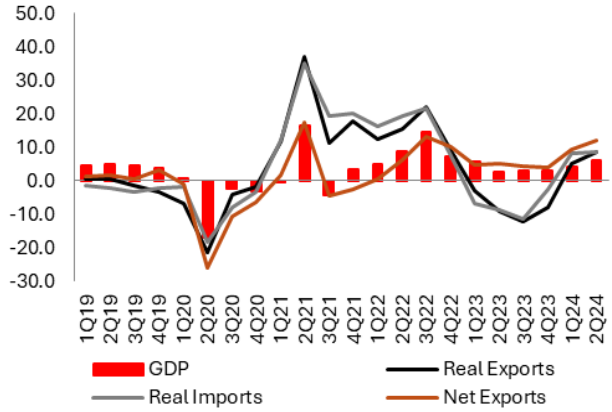
Export recovery to support growth this year. The recovery in exports has persisted into 2QCY24, with real exports growing faster at 8.4%yoy (1QCY24: +5.2%yoy). This was supported by stronger growth in goods exports (+5.5%yoy; 1QCY24: +1.0%yoy) and sustained double-digit growth in services exports (+24.6%yoy; 1QCY24: +33.8%yoy). We expect this trend will continue in 2HCY24 with a more solid improvement in the E&E exports and continued demand for other commodities such as palm oil, LNG, petroleum products and other manufactured goods. Although growth of real imports also accelerated to +8.7%yoy in 2QCY24 (1QCY24: +8.0%yoy), the improved performance in real exports explained the turnaround in net exports which contributed positively albeit a small +0.1ppt to the +5.9%yoy GDP growth during the quarter (1QCY24: -1.4ppt). Despite concerns and uncertainties on the final demand and the ongoing geopolitical conflicts, we foresee further recovery in exports in 2HCY24 will support Malaysia's GDP to grow stronger in 2024.

Chart 1: GDP vs Private Sector (YoY%)



Source: Macrobond, MIDFR

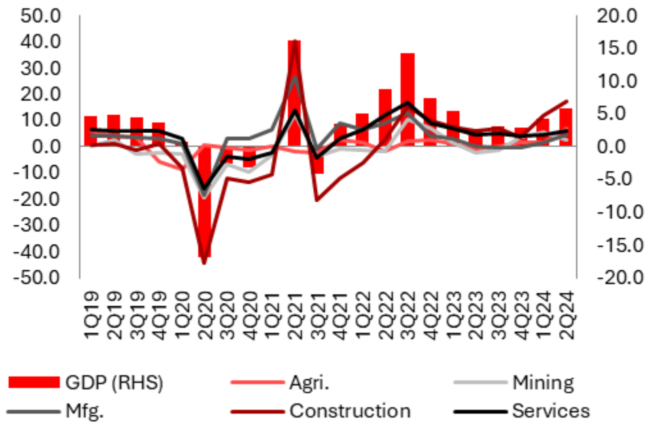
Chart 2: GDP vs External Trade (YoY%)



Source: Macrobond, MIDFR

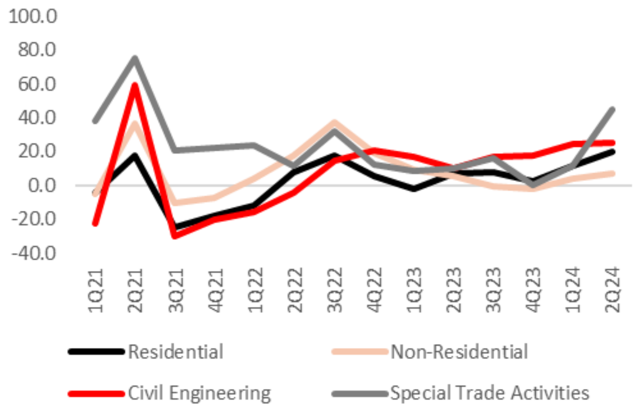
More encouraging domestic business activities. In line with the recovery in external trade, the manufacturing sector growth picked up to +4.7%yoy in 2QCY24 (1QCY24: +1.9%yoy), which was the fastest growth in 7 quarters. We project production activities will continue to grow in the coming periods as firms will increase its production to cope with growing demand, from both the domestic and foreign markets. We tweak our growth forecast for the manufacturing sector higher to +4.4% (previous forecast: +4.0%), pricing in a relatively more encouraging demand outlook. Meanwhile, progress in infrastructure projects, such as railway and highway projects under the 12th Malaysia Plan, will support continued growth in the construction, which continued to grow robustly at +17.3%yoy in 2QCY24. Moreover, construction in the residential sector is also contributing to the construction sector growth as the increased number of housing units approved suggests more houses will be built on the back of increasing demand. We now predict construction will grow stronger at +9.8% in 2024, stronger than our earlier projection of +5.2% (2023: +6.1%). In addition, we also upgrade the growth outlook for the agriculture sector to +2.9% (previous: +1.5%) factoring in a better outlook for oil palm production due to improved supply condition. Meanwhile, the mining sector will grow at +3.5% (2023: +0.5%), which would be mainly driven by increased production of natural gas underpinned by growing external demand.

Chart 3: GDP by Supply Side (YoY%)



Source: Macrobond, MIDFR

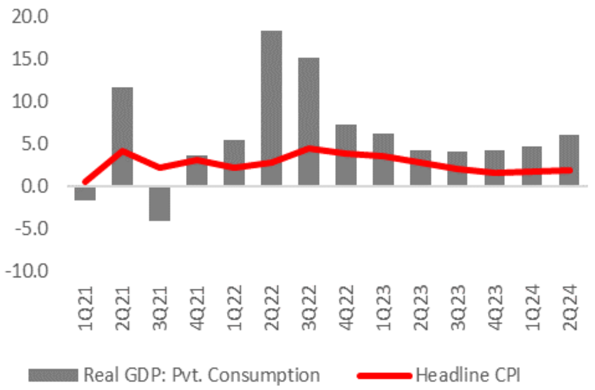
Chart 4: Construction Works Done by Segment (YoY%)



Source: Macrobond, MIDFR

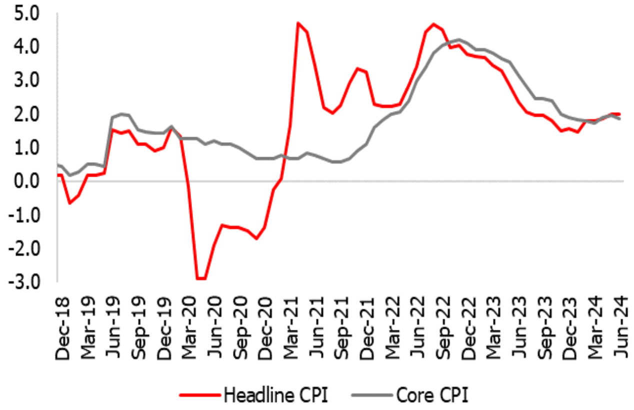
Inflation to increase to remain under control. Although we maintain our inflation forecast for the year at +2.7% (2023: +2.5%), so far inflation has been under control. The effect from the diesel subsidiy rationalization and other policy changes, such as SST rate hike and tariff changes, have been rather limited. This can be reflected in inflation hovering around +2.0%yoy in 2QCY24, slightly higher than +1.7%yoy in 1QCY24. Nevertheless, we anticipate the level of inflation will be higher in 2HCY24, factoring further subsidy rationalization in the latter part of the year. While we expect inflation this year will be generally a cost-push inflation due to changes on the supply side, we opine there will be some upward pressures from underlying demand as given the growing domestic spending, which we expect to continue in the second half of 2024. On the other hand, if the planned targeted subsidy for RON95 were to be pushed to next year, this will present a downside revision to our inflation forecast, which will be positive for the domestic consumption outlook. With inflation to be manageable and more influenced by the supply factors, we expect BNM to keep the current monetary policy setting and therefore keeping OPR unchanged at 3.00% in 2024.

Chart 5: CPI: Private Consumption vs. Headline CPI (YoY%)



Source: Macrobond, MIDFR

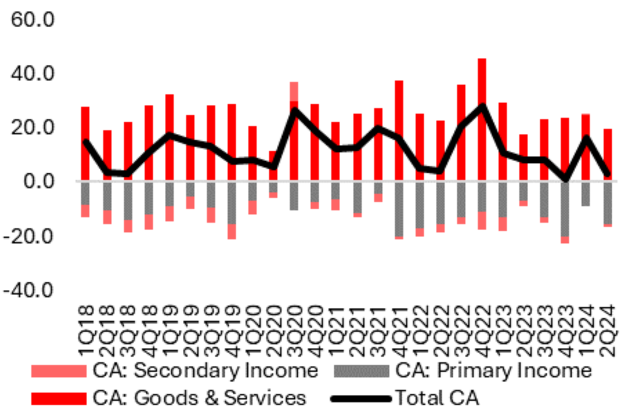
Chart 6: CPI: Headline vs. Core Inflation (YoY%)



Source: Macrobond, MIDFR

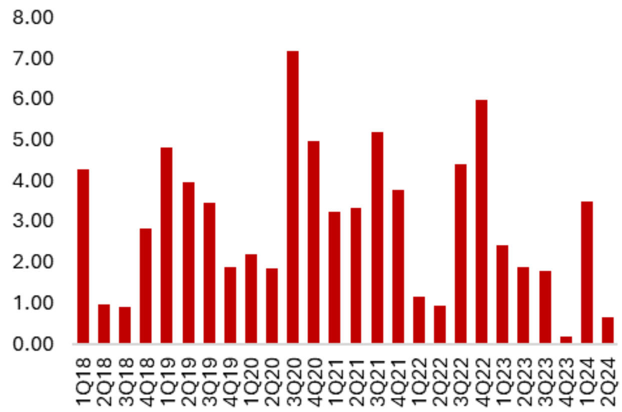
Revise down current account surplus to +2.3% of GDP. In view of the lower current account (CA) balance which fell to +0.6% of GDP in 2QCY24, we adjust our forecast for CA balance to only improve to +2.3% of GDP in 2024 (2023: +1.5%). While export recovery will be the key factor that will contribute to higher surplus in the trade of goods, import growth has also been stronger than expected in line with the more encouraging domestic economic condition. Moreover, we noticed the movement in the CA balance was also weighed down by deficts in the primary and secondary income accounts, which also explained the lower CA surplus in 2QCY24. We believe these factors will continue to influence the improvement in CA balance in the latter part of the year.

Chart 7: Current Account Balance (RM b)



Source: Macrobond, MIDFR

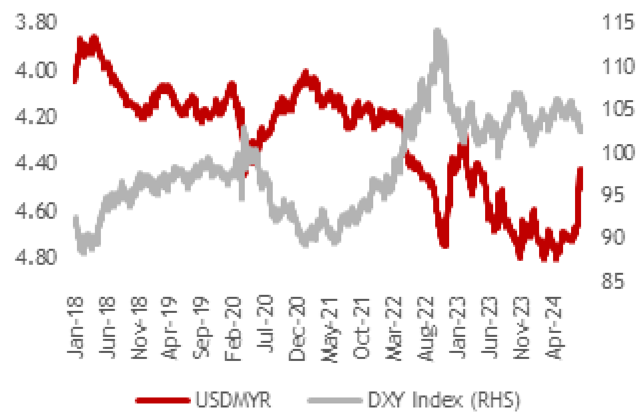
Chart 8: Ratio of Current Account Balance to GDP (%)



Source: Macrobond, MIDFR

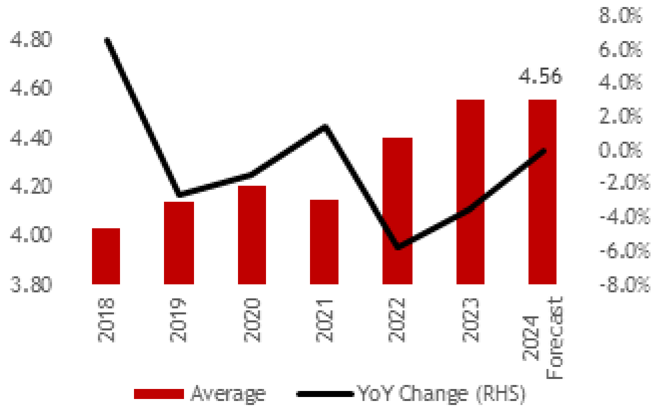
More rooms for ringgit to appreciate and reach RM4.23 by year-end. The market has priced in the Fed to slash its policy rate at the upcoming FOMC meeting in Sep-24, with at least a -25bps cut. We believe that there could be more rate cuts in 4QCY24 if the US inflation eases further and closer to the Fed's 2% target. Considering narrowing of interest differentials as BNM is expected to keep OPR unchanged at 3.00% throughout 2024, we revise our ringgit outlook anticipating a steeper appreciation of +8.6% to RM4.23 by year-end (end-2023: RM4.594). We also anticipate continued inflows of foreign funds into domestic equity and bond markets will also support for ringgit to strengthen in the latter part of the year. Furthermore, the ringgit is fundamentally supported more robust growth in the domestic economy and a recovery in the external trade, which we foresee will continue in 2HCY24. Despite the delayed appreciation of the ringgit, which faced challenges and weakened against the US dollar in 1HCY24, we anticipate the local currency will average around RM4.56 for the whole year, virtually unchanged compared to the prior year's level. However, we believe there are possible downside risks, which could cause ringgit to weaken, among others are a further delay in the Fed's policy easing and risk of a weaker global growth, which could result in risk-off sentiment and encourage higher demand for the dollar.

Chart 9: USDMYR vs Dollar Index



Source: Bloomberg, MIDFR

Chart 10: USDMYR Yearly Average and %YoY Average Change



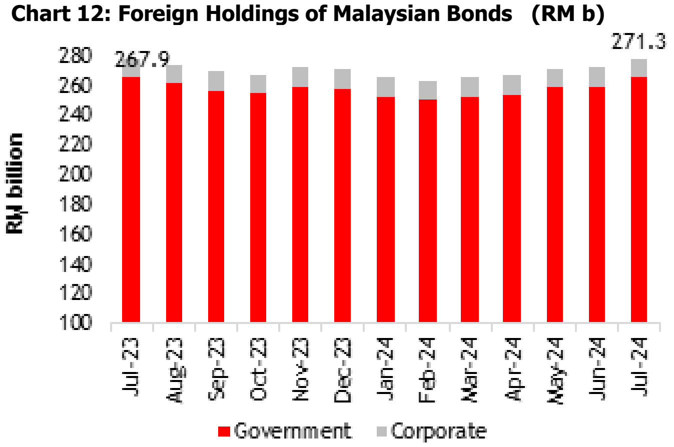
Source: Bloomberg, MIDFR

10-year MGS yield is expected to decline to 3.60%. We have seen respectable foreign fund inflow into the domestic bond market as of the 7MCY24 at RM8.7b. The expected narrowing of FFR-OPR differentials is expected to drive a faster inflow into the domestic bond market, driving the benchmark 10-year MGS yield to a projected decline by -13bps and to end the year at 3.60% (end-2023: 3.73%). We foresee the 10-year MGS to average around 3.80% for 2024, -6bps lower than 2023's average of 3.86%. Overall, we foresee the Fed's rate cuts will rekindle the appetite for riskier assets, benefitting emerging markets including Malaysia's debt market. Additionally, the government's commitment to strengthen fiscal's position also echoes positive sentiment for Malaysia's bond market.

Chart 11: 10y MGS vs 10y UST Yields (%)

Source: Bloomberg, MIDFR

Chart 12: Foreign Holdings of Malaysian Bonds (RM b)



Source: Bloomberg, MIDFR

Revise upward 2024 GDP growth forecast to +5.0%. Taking into account the recent data, we revised our 2024 GDP growth forecast higher to +5.0% from +4.7% previously (2023: +3.6%). We foresee the positive outlook for domestic spending to continue, both by businesses and consumers given the more encouraging domestic economic condition. As we mentioned before, we anticipate the recovery in exports will continue as we expect continued improvements in the E&E trade continuing into the latter part of the year. On the downside risks, we are still cautious that weaker demand from major countries, namely the USA and China, and the escalation in geopolitical and trade tensions could hurt external trade outlook. On the domestic front, we are monitoring closely the adverse effect on domestic demand from possible re-acceleration in domestic inflation, which may be triggered by the planned policy changes by the government and other supply shocks.

(YoY%) Unless Stated Otherwise	2020	2021	2022	2023	2024f
Real GDP	(5.5)	3.3	8.9	3.6	5.0
Govt. Consumption	4.1	5.8	5.1	3.3	4.5
Private Consumption	(3.9)	1.8	11.3	4.7	5.4
Gross Fixed Capital Formation	(14.4)	(0.7)	6.8	5.5	9.4
Govt. Investment	(21.2)	(11.0)	5.3	8.6	9.5
Private Investment	(11.9)	2.8	7.2	4.6	11.2
Exports of goods & services;	(8.6)	18.5	14.5	(8.1)	7.5
Goods Exports	(0.7)	21.4	11.0	(12.7)	4.5
Services Exports	(47.8)	(8.2)	58.3	33.0	24.6
Imports of goods & services;	(7.9)	21.2	16.0	(7.4)	8.9
Goods Imports	(3.6)	23.8	14.4	(11.7)	9.0
Services Imports	(25.3)	7.7	25.7	15.8	8.3
Net Exports	(13.7)	(4.0)	(1.5)	(16.2)	(12.0)
Agriculture etc.	(2.4)	(0.3)	1.3	0.7	2.9
Mining & Quarrying	(9.7)	0.9	3.5	0.5	3.5
Manufacturing	(2.7)	9.5	8.1	0.7	4.4
Construction	(19.3)	(5.2)	5.1	6.1	9.8
Services	(5.2)	2.2	11.0	5.1	5.4
Exports of Goods (f.o.b)	(1.1)	26.1	24.9	(8.0)	5.2
Imports of Goods (c.i.f)	(5.8)	23.3	31.0	(6.4)	11.2
Headline CPI Inflation (%)	(1.1)	2.5	3.4	2.5	2.7
Current Account, % of GDP	4.1	3.9	3.0	1.5	2.3
Fiscal Balance, % of GDP	(6.2)	(6.4)	(5.6)	(5.0)	(4.7)
Federal Government Debt, % of GDP	62.0	63.2	60.3	61.9	62.2
Unemployment Rate (%)	4.48	4.58	3.82	3.43	3.30
Brent Crude Oil (Avg), USD per barrel	41.6	71.5	102.0	82.2	84.0
Crude Palm Oil (Avg), MYR per tonne	2,775	4,486	5,262	3,813	3,800
USD/MYR (Avg)	4.20	4.14	4.40	4.56	4.56
USD/MYR (End-period)	4.02	4.17	4.35	4.59	4.23
MGS 10-Yr Yield (Avg)	2.84	3.23	4.07	3.86	3.80
MGS 10-Yr Yield (End-period)	2.65	3.59	4.04	3.73	3.60
Overnight Policy Rate (%)	1.75	1.75	2.75	3.00	3.00

Source: Macrobond, DOSM, MIDFR

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