

## Malaysian Economy in 2012: Risks and Rewards?

**A**t Session Three of the *ISIS Praxis Seminar 2012*, **Dr Nungsari Ahmad Radhi** of *Khazanah Nasional* and **Mr Christian de Guzman** of *Moody's Singapore* discussed the outlook of the Malaysian economy in 2012. *ISIS Analyst Firdaos Rosli* reports.



(From left) Nungsari Ahmad Radhi, Larry Wong and Christian de Guzman

**Dr Nungsari Ahmad Radhi** said he believed the Malaysian economy will get worse before it gets better. *Khazanah Nasional*, the investment holding arm of the Malaysian government is particularly concerned about global economic developments in 2012 and is keeping an eye on external updates.

In 2012, trade, capital flows and equities are expected to decelerate faster than in late 2011. This in turn will affect investments, domestic consumption and the political scenario in Malaysia. Relative to the government's projected GDP growth of five to six per cent, *Khazanah's* 2012 growth figure is lower at around 4.5 to 5.0 per cent.

*Khazanah* has listed three critical factors that policymakers should consider for the next 12 months.

First, the impact of the Eurozone sovereign debt crisis on Malaysia. Malaysia will not be spared the effect of the Eurozone

sovereign debt crisis as the European banks' loans to Asia are higher than those of American banks. Generally, there is still much uncertainty in the Eurozone despite their leaders' reform pledges. Investors are still unsure about the magnitude of the crisis in relation to the European economy and the world as a whole. The economic projections for the next few months are expected to be gloomy as there is doubt about the ability of the European Central Bank to solve the EU's sovereign debt muddle.

Secondly, the Malaysian ruling party is expected to announce/undertake several popular decisions in gearing itself for the 13th General Elections expected in the first half of 2012. France, Russia, Taiwan and the United States will also hold their elections in 2012. As such, normalizing fiscal and monetary policies, as well as other structural reform initiatives will be delayed. Political competition will inevitably lead to irrational decisions that will hinder economic growth.

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Thirdly, the convergence of the Eurozone crisis, the possibility of an early election and the government's fiscal situation should also be taken into account. Despite greater discipline in restraining its deficit growth, in the 2012 Budget, the country's fiscal position is of major concern to investors, particularly when a massive portion of capital flows is in the debt market rather than in equities.

Malaysian government securities account for more than 40 per cent of the instruments in the debt market. Khazanah Nasional is concerned over the short and medium term consequences of any drastic changes in capital flows and their effect on sovereign ratings and the corporate cost of borrowing.

Malaysia's debt-to-GDP ratio is the highest in the region and the forecast for other aggregate numbers is still uncertain. As such, there is limited possibility of a stimulus package to counter-balance the global economic slowdown in 2012.

Malaysia's third quarter GDP was mostly driven by public consumption. Household debt remains high, at around 70 per cent of GDP, and public debt is in excess of 55 per cent of GDP.

However, all is not lost. Policymakers are comforted by the fact that emerging Asia will act largely as a catalyst to cushion the impact of a double dip crisis. China's attempt to rein in inflation and provide a soft landing for investors is beginning to bear fruit. However, the role of its

informal banking sector in boosting its SME capacity is a matter of concern.

The rise of domestic demand and private investments in Malaysia will lead the nation's growth prospects in 2012, meeting the challenges of a more globalised economy. Moody's Investor Service (hereafter Moody's) recently ranked Malaysia's economic strength as 'moderate' due to the nation's predictable GDP growth trend over the years relative to its regional peers. Institutional strength is also ranked as 'moderate' as the economy is hampered by transparency issues and a maturing domestic democracy, more noticeable since the March 2008 elections.

While Moody's is of the opinion that the Malaysian government's financial strength is high and relatively stable, the nation's sovereign debt has been increasing steadily since 1970 and has increased even more steeply since the 2008 crisis. Although the issue of high debt sustainability is in question, a low inflation rate and high domestic savings of around 35 per cent of GDP are deemed favourable.

The government's large deficits underscore the need for consolidation by broadening tax and subsidy reform. Presently, only a million Malaysians out of a 28 million population pay income tax and the government is expected to replace the sales and services tax with a more comprehensive Goods and Services Tax (GST).

In July 2010, the government's subsidy reform started with the removal of energy and sugar subsidies. The idea for subsidy rationalization was not only to reduce the government financial burden but also to readjust subsidies for targeted groups that are deeply affected by higher prices -- the bottom 40 per cent and middle-income groups who live in big cities.

Domestic politics continue to play a major role in the formulation of economic policies and are potentially capable of delaying reform



*Participants at the seminar*

initiatives. In light of an early general election, the implementation modality and timing of the GST and subsidy reform will prove to be a challenging task for the government of the day.

Unlike most of its regional peers, Malaysia's events risk is low. There is minimal risk from natural disasters, apart from seasonal flooding cases outside major industrial towns. Moody's regards Malaysia's corporate and banking sectors' financial event risk favourably; Malaysia's banking system was recently rated the fifth best in the Asia-Pacific region. Furthermore, exposure from the Eurozone is limited due to the low reliance on external sources of funding other than well-established UK-based banks such as HSBC and Standard Chartered.

Moody's believes that the Malaysian government will undertake further initiatives to become less reliant on external financing in order to limit exposure and vulnerability to external sentiments. While the probability of becoming the 'next Greece' is low, Malaysia's debt-to-GDP ratio has been climbing sharply over the last few years.

Apart from the points highlighted by both speakers, there are also other internal considerations that could shape Malaysia's economic outlook in 2012. Firstly, there is a slowing down of private investments in the country, not only due to external economic conditions, but also the lack of initiatives to

stimulate them further in Budget 2012. The Economic Transformation Programme projects may have spurred interest in domestic investments but a real push for structural reform is much needed as a booster to create a more favourable business climate and higher productivity-driven economic growth.

The implementation of the national minimum wage will be another point to consider in 2012. Companies in Malaysia tend to reward capital more than labour and as a result, the rise in the labour market does not get a commensurate return from the country's economic growth.

Malaysia's competitiveness should not be affected by the setting up of a national minimum wage. The implementation of the minimum wage has to be transparent to the public and investors in order to ensure that the wage agreed upon is at an effective level.

All in all, global headwinds against growth and exports will be the key risks in 2012. As the Malaysian economy is not spared from external shocks, 2012 will prove to be yet another uncertain year indeed.