الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & FINANCIAL SECTOR OVERVIEW

Malaysia

April, 2021

TRUST . TRANSPARENCY . INDEPENDENCE

ECONOMIC OVERVIEW

Table 1: Malaysia- Key Economic Indicator				
Amounts in USD 'b, unless otherwise stated	**2017**	**2018**	**2019**	**2020**
Population (million)	32.00	32.38	32.5	32.7
GDP per capita (USD)	9,452	10,424	10,558	9,766
GDP - constant prices growth rate (%)	5.8%	4.8%	4.3%	-5.6%
Inflation (CPI Year End, %)	3.7%	1.0%	0.7%	-1.4%
Unemployment Rate (%)	3.4%	3.3%	3.3%	4.8%
Current Account Balance as % of GDP	2.8%	2.1%	3.4%	4.4%
Fiscal Balance as % of GDP	-3.0%	-3.7%	-3.4%	-6.2%
Gross External debt (USD'b)	215.45	223.4	228.3	235.6
External debt as % of GDP	65.0%	63.9%	62.6%	67.7%
Gross International Reserves (USD'b)	102.1	101.4	103.6	108.6**
*Source: BNM Statistical Bulletin. ** As of Jan 29, 2021, ^ Sept 2020*				

As a diversified economy, Malaysia is driven by a vibrant private sector with sustained low inflation and interest rates and low unemployment. As COVID-19 brought on recessionary conditions globally, the world economy is estimated tohave shrunk by 4.3%[1] during 2020, accompanied by a 9.2%[2] fall in international trade. Malaysia's economy posted a contraction of 5.6% for the year (2019: growth of 4.3%) causing GDP per capita to decline significantly to 9,766 in 2020 from 10,558 in 2019.

While forecasts emerging for 2021 are promising, at 4.0%[3] anticipated growth in global GDP, emergence of the second wave of COVID-19 caused are-impositionof lockdowns in several countries, including Malaysia, depressing initial growth forecasts for 2021. The first phase of COVID vaccinationhas commenced in the country, with front line workers, senior citizens, chronically ill and people with disabilities to be covered. The government plans to vaccinate at least 80% of the population by February 2022 under the National Immunization Program. Moreover, resurgence in commodity prices, particularly oil price surge in the early part of the current year may support the growth prognosis for Malaysia at 5.5%, weaker than the official initial projection at 7%. IIRA expects a rebound in basic sectors of the economy from 2022 onwards and expects long-term repression of tourism related businesses, particularly hotels and aviation, as well as commercial real estate. Expectations of Malaysia's economic recovery are dependent on effective, efficient and timely implementation of the vaccination program. Prolonged pandemic state, mutant strains, delays in mass inoculations and uneven geographic distribution, pose downside risks.

Having a share of 80.1% in aggregate domestic demand, private sector is a key driver of economic growth. Private consumption has remained the major component forming 63.4% of aggregate domestic demand with private investment being 16.7% in 2020. Both private consumption and investment declined sharply by -4.3% and -11.9%, respectively, in 2020. As the country went under an MCO (Movement Control Order) in March of last year, followed by a series of extensions, private sector shrunk by -6.0%, with Q2'2020 posting significant contraction of -20.5%. Some recovery of losses was evident in subsequent quarters, while remaining depressed on a year on year basis. Public sector, contributing 18.7% of GDP, posted similar trends, while net exports at 6.5% of GDP fell steeply in the first two quarters and made strong gains in H2'20, with overall annual decline being still significant at 2.3%.

On the supply side, broad-based decline was evident in a range of economic sectors, with construction being the most severely affected, having shrunk by -19.4% (2019: 0.1%) in 2020. Ata share of around 58%, services sector contracted by -5.5% (2019: 6.1%), followed by manufacturing contracting by-2.6% during 2020 (2019: 3.8%), despite significant improvement in H2'2020, led by the E&E sub-sector.

The government has taken a number of initiatives to support the economy announcing an RM 250bn (USD 58.8bn) stimulus package early in 2020, being about 20% of GDP. The initiatives target health spending, temporary tax and social security relief, rural infrastructure spending, electricity discounts, wage subsidies to help employers retain workers and

[1] *Source: World Bank – January 2021 report*
[2] *As per World Trade Organization report of October 2020,*
[3] *Source: World Bank – January 2021 report*

giving working capital loan guarantees for all COVID-19 affected businesses, among others. Also in this regard, a COVID-19 fund has been established to be allocated over 3 years till 2022.

The lockdowns and slower demand have strained labour market conditions, despite strong government support. Unemployment rate increased sharply from 3.3% as of Dec'2019 to 5.1% as of Jun1'2020, before moderating to 4.8% by December 2020. As economic activity picked some momentum during H2'2020, labour market conditions improved with job recovery, lower job losses and higher placement rates of employees in new jobs. Labour conditions are expected to further improve, with the economy likely to revert to its long-term unemployment rate of about 3%by end2021.

Headline inflation has remained moderate since 2017 at 1.0% during 2018 and further down to 0.7% during 2019. As demand slid significantly in the aftermath of the pandemic, deflation set inat -1.4% during 2020; lower retail fuel prices and tiered electricity rebate were key drivers. Core inflation also moderated to 0.7% (2019: 1.4%) mainly due to lower rental, communication and accommodation inflation. We expect inflationary trendsin the current year, pushed up by commodity price resurgence, particularly in the hydrocarbon segment. Core drivers of inflation are likely to rise relatively gradually.

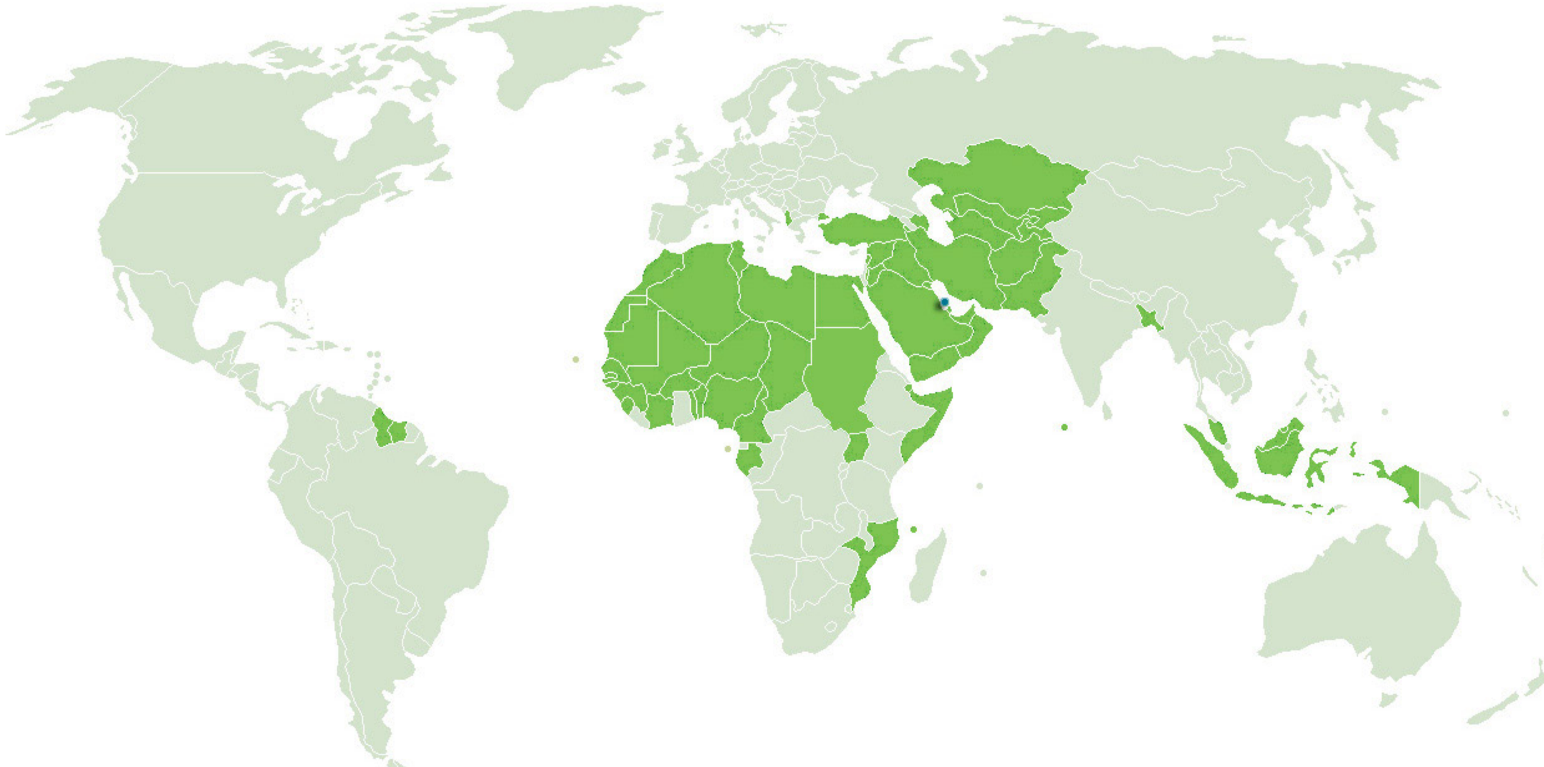
To support the economy, BNM has continued its accommodative monetary policy, with policy rate declining from 3.0% in January 2020 to a record-low 1.75% in July 2020, and held steady since. The decline in interest rate was also driven by the Federal Reserve's rate cut to zero percent in response to the global crisis, as Central banks around the world sought to buffer economic slide through monetary policy easing. Ringgit (MYR) remained largely stable against USD with around 2.0% appreciation during 2020, owing mostly to weakness in the USD against major currencies. MYR lost some value against Euro having depreciated by 7.0% during 2020, largely materializing in H1'20 and holding mostly stable thereafter. However, trends reversed in 2021, more specifically, as USD strengthened against all Asian currencies on the back of sustained reduction in COVID cases, with Ringgit losing 3.1% against USD during Jan-March, 2021, with 2.3% of the depreciation coming in recent weeks.

regulatory framework; (3) reinforcing comprehensive Shari'a governance framework; (4) improving liquidity management framework; (5) expanding outreach and market development; and (6) bolstering human capital and raising awareness.

With higher pace of deposit mobilization, Islamic banking assets in Pakistan posted significant 30% Y-o-Y growth (highest since 2012) to PKR4,269bn at end-2020, representing 17% share of overall banking sector assets (2019: 14.9%). Net financings- to- deposit ratio of the IBs has trended down on a timeline, having stood at 56.5% at Q1'21 from 61.2% at 2019, albeit remained higher than the overall banking industry (Q1'21: 45.2%; 2019: 51.7%). Despite SBP support policies, overall banking sector-wide financings decelerated during 2020, and thereby available liquidity was redirected towards investments; particularly in Government of Pakistan ("GoP") securities. On the contrary, IBs financings exhibited 15.9% Y-o-Y growth in 2020, in addition to surged channeling of liquidity into GoP securities. While generally there is still a deficit of Islamic liquidity instruments in the market, during 2020 GoP and public sector[13] Sukuk issuances witnessed an increase. Islamic banks' asset quality indicators in terms of NPFs-to-total financings improved to 3.5% at Q1'21 (2020: 3.2%; 2019: 4.3%), comparing favorably vis-à-vis overall industry (Q1'21: 9.3%; 2020: 9.2%; 2019: 8.6%). In view of Covid-19 impact, SBP decided to further defer the implementation of IFRS-9 until January 2022 instead of the ongoing year. However, from Q2'20 onwards IB provisions increased as some Islamic banks also target to implement the standa**rd in the ongoing year. This is** reflected in higher provisioning coverage at 82.2% at Q1'21 (2020: 82.4%) vis-à-vis 54% at end-2019. With this it may be notable that for IBs, net NPLs in relation to total capital substantially reduced in Q1'21 to 4.6% (2020: 4.2%; 2019: 14.6%). This also compares well vis-à-vis overall banking industry in Pakistan at Q1'21: 5.9% (2020: 5.3%). Nonetheless, non-performance in the banking sector may increase once the effect of deferments allowed by SBP due to Covid-19 wane. Profitability in terms of return ratios, for both overall banking sector and IB segment edged up in 2020 vis-à-vis prior year.

In June 2018, the SBP issued the revised Shari'a governance ("SG") framework for Islamic banking institutions. Further, during 2021, SBP issued 2 circulars regarding Shari'a Board members and Shari'a non-compliance risk management ("SCNR"), which shall be effective in July and September 2021, respectively. SBP issued a circular in Q1'21[14] on SG framework with amendment regarding Shari'a Board members (except resident members) who may serve up to 3 IBs in Pakistan. This is subject to IBs ensuring at-least 2 members (other than resident) not serving any other Islamic bank. Other circular[15] provides instructions to reinforce the best practices in SCNR. Guidelines for establishment of a full-fledged IB, IB subsidiary and branches of conventional banks was also updated in 2020.

[13] *Government related entity – Pakistan Energy Sukuk by Power Holding (Pvt.) Ltd.*
[14] *Circular letter February 2021*
[15] *Circular letter July 2021*



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