الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

IIRA Maintains Sovereign Ratings of Malaysia

Manama, August 04, 2023 – The Islamic International Rating Agency (IIRA) has reaffirmed the long term and short term foreign currency ratings of Malaysia at 'A / A1' (Single A / Single A One) and local currency ratings at 'A+/ A1' (Single A Plus/ Single A One), on the international scale, and 'AAA (my)/ A1+ (my)' (Triple A/ Single A One Plus) on the national scale. Meanwhile, the outlook on the ratings remains 'Stable'.

Ratings of Malaysia are supported by a sustained current account surplus and the rapid recovery in the economy following the pandemic, which is indicative of its resilience. Improving labor market conditions and downtrend in inflation in recent periods, are further positive trends. Adequate buffers and robust performance mark the banking sector profile. On the fiscal front, the budget deficit has been relatively high, but on a downtrend in line with recovery in the economy; favorable trends are likely to continue with further revenue mobilization measures being taken. Federal government debt to GDP is forecasted to increase further in 2023 to around 62%. Tighter than expected monetary policy adopted by major central banks and associated slowdown in global economy & trade could dampen growth and export performance of Malaysia, as well as precipitating outflows through the capital account.

After registering superior GDP growth of 8.7% in 2022, IIRA projects Malaysia to grow at around 4.2%, as base effects kick in. Goods exports are likely to moderate on account of the slowdown in global demand, although partly balanced by resilient domestic demand. Improving employment and income levels as well as ongoing implementation of multi-year projects would support consumption and investment activity. Household income will be supported by various government policies including, but not limited to, implementation of higher minimum wage by small businesses, revision in individual income tax rates, and cash transfers.

Following its peak in Q3'22, headline inflation moderated in Q4'22, to average 3.3% for 2022, well above the 2021 average of 2.5%. In the current year, inflation retreated to 2.8% in Q2'23 driven by easing commodity prices globally, easing of supply-related disruptions as well as the lagged impact of the rate hikes by BNM. The Central Bank implemented 4 consecutive rate hikes of 25bps each starting from May 2022 to dampen inflationary pressures, and then paused to allow its effects to kick in. In May 2023, BNM hiked the rates once again by 25bps to 3.0% noting that the risks to inflation were still to the upside. For the rest of the ongoing year, IIRA expects the continuation of moderation of headline inflation and does not expect further rates hikes as inflation eases, domestic demand decelerates, and subsidy rationalization by the Government is postponed to 2024.

For 2022, fiscal revenues were supported by strong economic activity and higher crude oil prices which was partially offset by a higher subsidy cushion to mitigate the impact of increasing cost of living on the population. Consequently, the budget deficit remained largely maintained from the prior year at RM99.5bn (2021: RM98.7bn) and corresponded to 5.6% of GDP vis-à-vis 6.4% in 2021. Meanwhile, the federal government debt fell slightly as a reflection of base effects reaching 60.3% of GDP vis-a-vis 63.3% in 2021.

Increase in non-petroleum related revenue as a result of continuous initiatives to diversify tax base, and the consequently declining reliance on oil-based income, is a positive trend. The Budget for 2023 projects a deficit to GDP ratio at 5%. The Government will continue its fiscal consolidation plan to achieve deficit target of below 3% in the medium term within the next 10 years as announced in the MADANI Economic Framework. This is in line with the IIRA projection that the budget balance is likely to be achieved at the primary level by 2027. Continuously rising debt will continue to put pressure, particularly over the next two years in a high interest rate environment with the weight of debt service charges in total fiscal expenses forecasted to rise around 2pps in the year 2023.

In the year 2022, the current account surplus has contracted to RM55.1bn from RM60.2bn for 2021 despite improvement in services deficit and offset by strong import demand and outflows from primary income due to higher income accrued to foreign investors. Consequently, and compounded with base effects, the current account surplus fell to 3.1% of GDP from 3.9% in 2021 and 3.3% average for 2018-2020 period. For the ongoing year, export performance will be impacted by slowing global demand and the down cycle for global semiconductor industry in particular, as well as lower commodity prices. On the other hand, the expected reversal of the travel account to surplus will be supportive for the current account, forecast at 3% of GDP.

Performance of the banking sector improved in 2022 with better profitability, liquidity, and asset quality. As of March 2023, sector capital adequacy ratio of 18.6% (2022: 19.0%, 2021: 19.2%) and liquidity coverage ratio of 157% (2022: 153%, 2021: 153.4%) indicate sustained buffers. The financial strength of the insurers and takaful operators is evidenced by a capital adequacy ratio of 225% (2021: 221%) which remains comfortably above the regulatory minimum of 130% and continues to exceed thresholds even under extreme stress scenarios.

On the ESG front, Malaysia’s performance with respect to World Bank Governance Indicators depicted improvement over a timeline, with strongest scores achieved in government effectiveness and regulatory quality. Commitment to enact Fiscal Responsibility Act (FRA), projected to be tabled in October 2023, and Government Procurement Act (GPA) is illustrative of fiscal reform initiatives being taken to enhance transparency and accountability.

Gradual implementation of Carbon Border Adjustment Mechanism in European Union, starting from October 2023, is expected to affect 0.5% of Malaysia’s exports in its first phase. Almost all of the oil palm planted areas (over 97%) have obtained Malaysia Sustainable Palm Oil certification and the Government has been engaging with EU and UK authorities for the recognition of this certification. Given the significance of palm-based products within export mix, which constituted around 9% of total exports in 2022, there could be downside risk to export potential in case negotiations with EU and UK authorities with respect to certification, do not meet success, or the process takes longer than expected.

Indicators for Future Change in Ratings

Ratings may be viewed to be under downward pressure in case of:

- Reversal in the currently improving trends in fiscal position in terms of the fiscal deficit exceeding expectations by a significant margin,
- Federal government debt materially breaching the current statutory limit of 65% of GDP.

Ratings maybe upgraded if:

- Fiscal performance is superior to targets with faster than expected convergence of the primary deficit towards balance,
- Continued robust performance on the external account, improving reserve coverage above 65% of external debt.

For further information on this rating announcement, please contact IIRA at iira@iirating.com.