الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

IIRA Reaffirms Sovereign Ratings of Malaysia

Manama, May 23, 2022 –The Islamic International Rating Agency (IIRA) has maintained the long term and short term foreign currency ratings of Malaysia (or 'the Country') 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, with 'Stable' outlook.

Ratings assigned to Malaysia (or 'the country') are strengthened by a sustained, positive current account balance, continued strong growth potential and a stable investment climate supported by well-developed physical and social infrastructure and credible institutions. A healthy financial sector provides overall economic stability to the country. As a member nation of the Association of Southeast Asian Nations (ASEAN), Malaysia maintains strong trade and diplomatic relations with regional and global economies. Key concerns are rising government debt levels caused by prevailing strain on fiscal position, precipitated chiefly by the pandemic. With improved prospects of economic recovery, we expect fiscal consolidation to commence from the current year, decelerating the pace of debt accumulation.

The economy begun its recovery on an upbeat note in H1'21, however was interrupted by refreshed mobility restrictions mid-year, affecting business pick up later in the year. Slower than expected growth of 3.1% was registered for the full year 2021, despite additional allocation in lieu of government stimulus packages. With vaccination campaigns having largely achieved success, improved economic offtake is anticipated for 2022. The considerable uncertainty cast by the prevailing geopolitical conflict between Russia and Ukraine has negative implications for global growth forecast, inflation, and volatility in currency and financial markets. Given low trade with Russia and a relatively neutral geopolitical position, Malaysia may yet be able to avert any significant economic fallouts; yet its growth forecasts may fall below expectation of 5.1% at the outset of the year, to 4% presently.

To support the economy, Bank Negara Malaysia (BNM) reduced the policy rate to 1.75% in 2020, with a slight increase of 0.25% to 2.0% in May 2022. While headline inflation had trended up, it has remained largely in line with historical average in 2021. Upward trend in commodity prices, exacerbated by the Russia-Ukraine conflict, may cause domestic inflation to head north, although it has remained steady till March 2022; interest rates are expected to also trend higher, in line with major economic systems globally. Malaysian Ringgit has shown strength over the years, having depreciated against the USD by a relatively moderate 3.9% during 2021, but is currently faced with pressures given uncertainty over global interest rate outlook and the prevailing investor sentiment to continue to seek safe havens.

A consistently strong surplus in current account is a key strength of the economy. Moreover, the trade basket is robust with reliance on consumption imports being minimal and an expanding component of technology driven exports. With some global recovery in 2021, Malaysia's trade also posted growth, driven by continued momentum in electrical and electronics (E&E) exports. However, with an increasing deficit in the services balance as well as secondary and primary income account, current account surplus fell to a still robust 3.8% of GDP and slightly higher than its past 5 year average (2016-2021 average: 3.0%; 2020: 4.2% of GDP). Malaysia's commodity exports are likely to be driven up by higher prices. Demand pull is also likely to sustain for E&E exports, with Malaysia to benefit from its relatively diffused position in the Russia –Ukraine crisis.

At 6.4%, fiscal deficit grew over prior year with the impact of COVID-19 Fund expenditures and despite an uptick in tax collection. Although expenditures remain high, we expect some improvement in fiscal position over the current year, gradually tapering off to pre-pandemic levels over three years.

Relief packages offered through fiscal measures have impacted the fiscal position, raising financing requirements, and causing federal government debt to increase by 11.3%. In GDP terms, the Federal Government debt has reached 63.4%, while statutory debt at 59.7% as at end-2021 which remains within the increased statutory limit of 65% of GDP. Debt level is likely to increase further but given anticipated growth in GDP, debt is likely to remain range-bound around 66% of GDP, while statutory debt is to remain under the limit at end-2022. External debt also posted growth of 11.7% during 2021 to reach 69.3% of GDP. As of end-2021, international foreign currency reserves cover about 123.5% of short term external debt and in addition to the current account surplus amount to 50.5% of total external debt.

The financial sector has shown strength over the years, supported by diversity and strong fundamentals, having grown despite tough conditions, amid COVID-19. BNM took a number of initiatives in 2020 and further in 2021 to support the economy through the financial sector. The banking sector remains well capitalized with sufficient buffers and strong asset quality. While there may be some increase in non-performance this year, the risk to banking health is not material, given asset performance data thus far. Profitability indicators, while inching lower over the last two years, indicate efficiency and a sound balance sheet.

Indicators for Future Change in Ratings

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

- Underperformance of the fiscal position vis-à-vis budget or a delayed fiscal recovery,
- Federal government debt materially breaching the current statutory limit of 65% of GDP.

Ratings maybe upgraded if:

- Fiscal outperformance is significantly above targets, allowing for moderation in government debt to GDP,
- 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.