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2024 ECONOMIC OUTLOOK: RIDING OUT THE STORM

- Economists were primarily pessimistic about the global economic outlook in early 2023 due to the global monetary tightening, which started in mid-2022. Macroeconomic forecasters, including the major multilateral development banks (MDBs) such as the International Monetary Fund (IMF), World Bank (WB), the Organisation for Economic Co-operation and Development (OECD) and the Asian Development Bank (ADB), downgraded their global outlook for 2023. However, the resilience of the labour market in facing high interest rates, in particular in the United States (U.S.), proved most, if not all, forecasters wrong. The global economy muddled through the year of restrictive environment, although there were instances that could have brought the global financial system to its knees. Relevant monetary authorities were quick to capitalise on the lessons from the 2008 Global Financial Crisis to avoid such a crisis, circumventing supposedly the epicentre of the next global recession. The global economy stands firm to date, thanks to the record-breaking stimulus packages introduced during the pandemic to cushion the deleterious impact of global lockdowns.

- Interestingly, the pessimism continues to 2024 as the macroeconomic forecasters are still edgy about the impact of a higher-for-longer global interest rates environment, as if disinflation doesn't matter. Many expect major global central banks to start cutting rates starting 2Q2024, reigniting the narrative of central bankers longing for an eventual "soft landing" that may or may not happen in 2024. At the very least, global interest rate tightening has ended, albeit not officially. At the point of writing, we are not seeing any early signs for central banks to plan on pivoting just yet as the labour markets around the world remain tight and/or resilient to tight monetary conditions and elevated commodity prices. Nevertheless, most MDBs are pointing growth in many parts of the world to head southward. Alas, only time will tell.

- The same sentiment cannot be said for Southeast Asia. The IMF and ADB are projecting all ASEAN member states to record stronger growth in 2024 than a year ago, owing to a marginal "rebound" from 2023. GDP growth in many Southeast Asian economies in 2023 is expected to come in lower than projected earlier due to the external pressure on trade and unfavourable foreign exchange terms. The tide may turn in 2024. As trade and investments head to their long-term trends, the region may grow strongly this year sans a global recession.

- As the fifth largest economy in ASEAN, Malaysia also stands to gain from the recovery in global trade and strong tourist arrivals in 2024. We expect the country to record firmer growth this year, in consensus with MDBs' projections, at 4.7%. The overnight policy rate (OPR) is expected to stay pat at 3.0%, which we believe is the new post-crisis rate, resting at 25bps lower than in the pre-pandemic era. As inflation will likely remain "low-ish" in 2024, the government finds this an opportune avenue to introduce various reform measures covering electricity tariffs, taxes relating to the goods and services trade and subsidy rationalisation. These measures will eventually put inflation higher than it should in 2024. We believe the Anwar administration faces zero to little political threat to undertake these measures, but discontent may well surface, denoting a thriving democratic environment. Despite the head-on policy plan running in the second year of the current political cycle, we do not view this as ground-breaking to overturn the fiscal pressures plaguing the government for some time. Whether these measures would move the needle or otherwise, we believe every baby step is a step towards tackling the bigger picture. Malaysia cannot afford to ignore incoming megatrends such as population ageing, climate change and AI-led technological advancements.

PART ONE: THE GLOBAL ECONOMY

	IMF (Oct'23)		WB (Jan'24)		OECD (Nov'23)		ADB (Dec'23)	
	2023	2024	2023	2024	2023	2024	2023	2024
World	3.0	2.9	2.6	2.4	2.9	2.7	-	-
Advanced Economies/OECD	1.5	1.4	1.5	1.2	1.7	1.4	-	-
U.S.	2.1	1.5	2.5	1.6	2.4	1.5	-	-
Euro Area	0.7	1.2	0.4	0.7	0.6	0.9	-	-
EMDEs	4.0	4.0	4.0	3.9	-	-	-	-
China	5.0	4.2	5.2	4.5	5.2	4.7	5.2	4.5
India	6.3	6.3	6.3	6.4	6.3	6.1	6.7	6.7
Note: These forecasts reflect different reporting times								

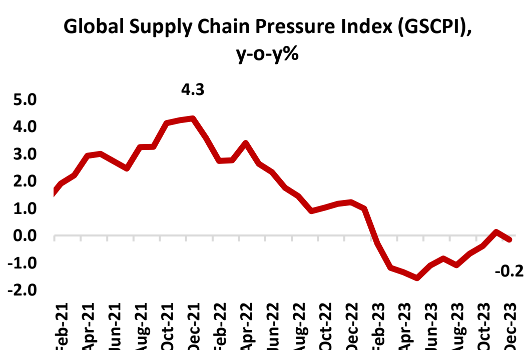
Sources: IMF, WB, OECD, ADB, Bank Islam

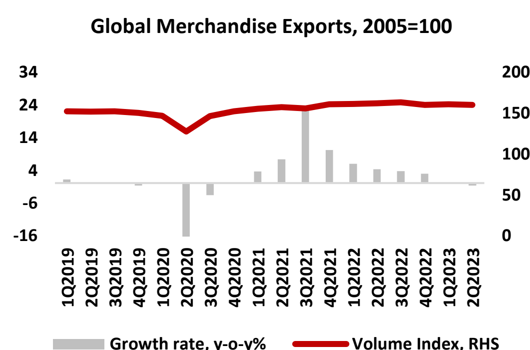
- The IMF forecasts the world economy to grow by 3.0% in 2023 before easing to 2.9% in 2024. Meanwhile, the OECD expects global growth of 2.9% in 2023 and 2.7% in 2024. WB holds the most bearish view, projecting the 2023 growth to clock in at 2.6% and 2.4% for 2024. Global growth in 2023 was driven by the resilient performance of the U.S. economy, beating early expectations of a hard landing amid tight labour market conditions. To a lesser extent, many emerging markets and developing economies (EMDEs) have displayed sound resilience in the face of external headwinds, supported by their domestic strengths.

- Another focal support for global growth in 2023 is expanding the services sector, especially tourism-related industries, as demand for services-oriented economies rose due to pandemic savings and pent-up spending. The fast recovery of the services sector had offset the worst of the manufacturing sector's slowdown. Despite central banks adopting tight monetary policies to curb the high inflation, tighter credit conditions did little to hinder growth. Solid labour market conditions have provided the buffer to support spending, albeit making the fight against inflation tougher for some economies.

- However, both MDBs project lower growth rates for 2024 compared to 2023. It seemed that the catch-up game with growth is on borrowed time. Whilst consumer spending largely managed to evade the high interest rates environment, data from the IMF shows that household savings in advanced economies are diminishing. Due to the tight financial conditions, weakness in economies due to lower business and firm demand would be exacerbated by the slowing household demand.

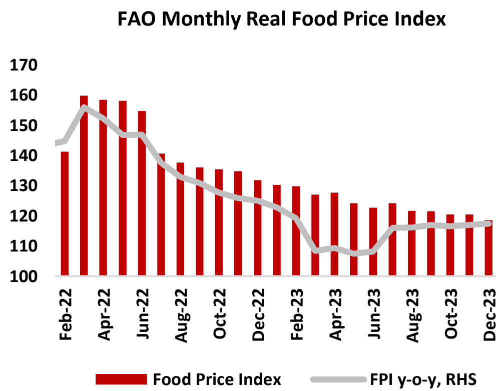
- Global supply chain pressures in recent months have been climbing, breaching past the negative territory in November before slipping in December 2023. Contrary to the rising demand for services, demand for manufacturing output remained weak in 2023 as the global merchandise exports eased, recording contractions for the first two quarters of 2023.

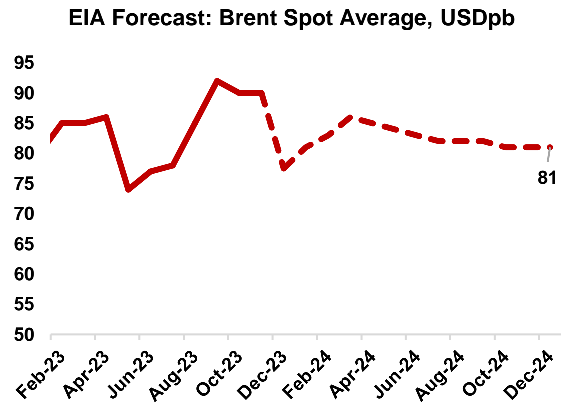




Sources: N.Y. Federal Reserve, United Nations Conference on Trade and Development (UNCTAD), Bank Islam

- The Food Price Index (FPI), as reported by the Food and Agriculture Organization (FAO), has been declining since March 2022 before tapering off in recent months. However, underlying price pressures persist despite the disinflation in many countries, meaning interest rates would have to stay higher-for-longer. Additionally, commodity prices face a volatile year in 2024 should the geopolitical tensions escalate further, sending shocks through the global supply chain and triggering inflation again. The Energy Information Administration (EIA) forecasts energy prices to linger between 81-85 U.S. Dollar (USD) per barrel (pb) throughout 2024.





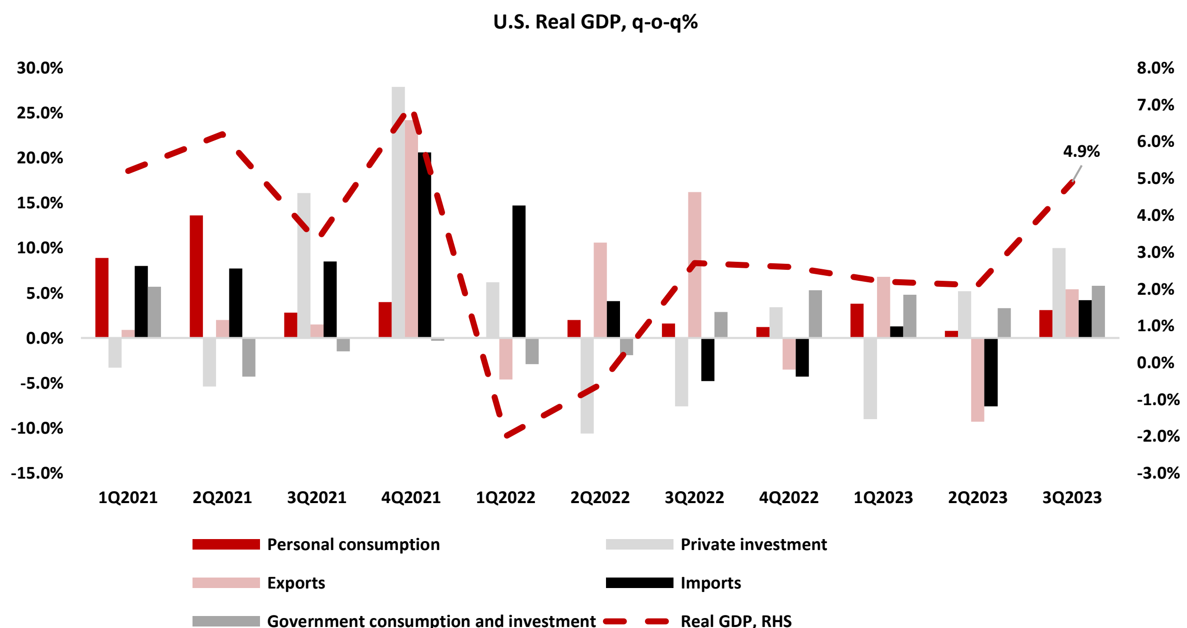
Sources: FAO, EIA, Bank Islam

PART TWO: MAJOR ECONOMIES

The United States: Growth defied expectations but unlikely to continue

- The U.S. economy – one of the major economies – had an unpredictable and mixed theme in 2023, leading to both uncertainty and pessimism from the market. Despite the breakneck rate hikes from the Federal Reserve (Fed), which began in March 2022, the country's economy remained resilient, with many ascribing it to excess savings amassed during the pandemic. This was all thanks to the strong consumer spending, representing around 70.0% of the U.S. GDP.

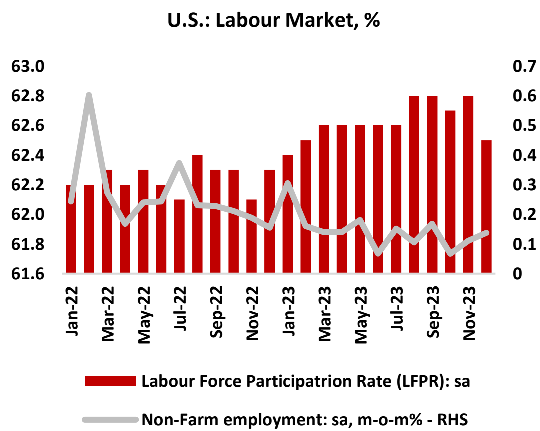
- Though the Bureau of Economic Analysis' (BEA) 3Q2023 third estimate expanded at 4.9%, slightly below 5.2% recorded in the second estimate, still it marked the strongest growth since 4Q2021. Moreover, such growth was ahead of China – the long engine of global growth – and other advanced countries such as the European Union (E.U.), the United Kingdom (U.K.), and Japan, among others. With that, the economy seems to end the year remarkably better than early forecasts.

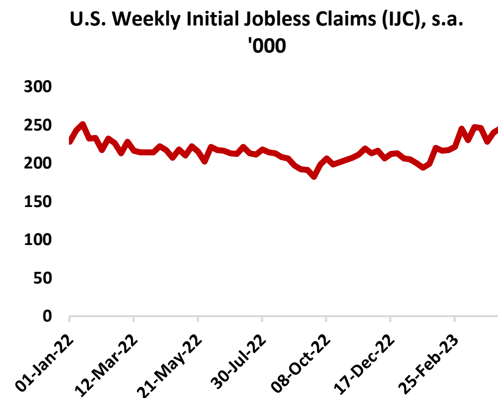


Sources: BEA, Bank Islam

- The broader question is, how long will such a feat last? Will the consumers keep spending en masse? Will the job market remain as hot as it did in 2023? As the U.S. economy achieved its soft landing in 2023, there is a reasonable chance that growth would continue in 2024, albeit at a slower pace due to the high interest rates, a slowdown in the world's top two economies and the never-ending geopolitical war, particularly in Ukraine and Middle east that could potentially worsen the global financial outlook.

- Also, both IMF and OECD are looking at the same projection, estimating that the U.S. real GDP growth will come in at 1.5% in 2024, lower than 2.1% and 2.4%, respectively, in 2023. Meanwhile, WB foresees that the country's growth performance in 2024 will grow at 1.6% in 2024 after recording a 2.5% expansion last year.



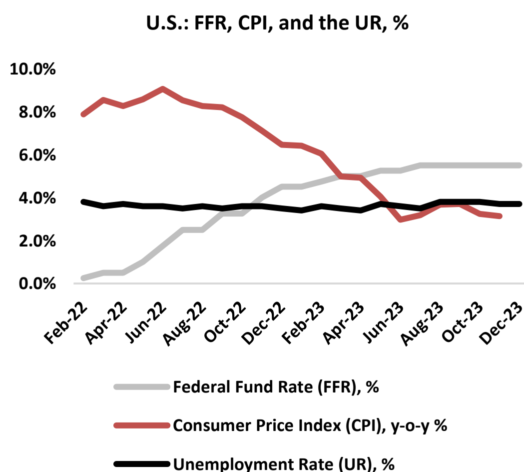


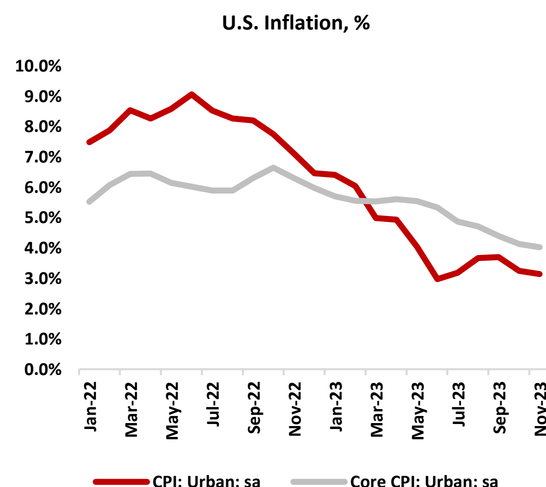
Sources: BEA, U.S. Bureau of Labor Statistics, Bank Islam

- On the inflation front, consistent disinflation is evident when the latest figure slowed to 3.1% in November (October: 3.2%). As such, we believe that could have prompted the Fed to leave the federal funds rate (FFR) steady at 5.25%-5.50% in its final policy decision of 2023 for the third straight time. While the price pressure has come down meaningfully, there is further to go as the Personal Consumption Expenditures (PCE) – the Fed's preferred inflation indicator (November: 2.6% vs. October: 2.9%) – is still far from the long-term 2.0% objective.

- Despite progress on taming inflation, the battle would continue, and if the hike is not needed, the higher-for-longer stance could remain on the card into the year. The latest Social Economic Projections (SEPs) expect three rate cuts in 2024 after almost two years of aggressive rate hikes. In other words, the desired benchmark rate would not be so low that it ushers in inflation, yet not so high that it could tip the economy into a recession.

- Last but not least, the U.S. economic platform will be a centrepiece of the 2024 presidential poll, as former President Trump's tax cuts are set to expire by the end of 2025, with its focus on the country's willingness to conduct fiscal consolidation. Meanwhile, U.S.-China relations remain an important agenda and a key geopolitical risk for market participants to navigate.





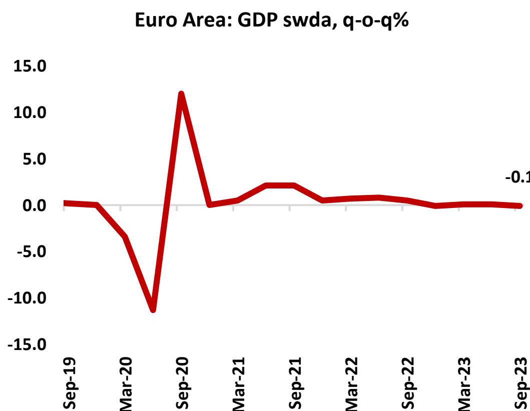
Sources: BEA, U.S. Bureau of Labor Statistics, Bank Islam

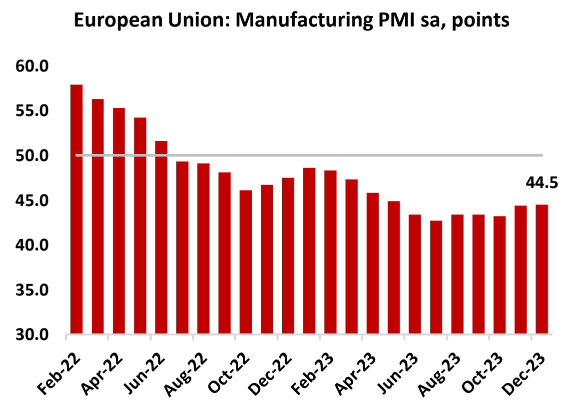
Euro Area: Slower growth but on the right note

- All MDBs remained cautious about the Euro Area's growth next year in light of the economy struggling to stay afloat in 2023. IMF expects the region to grow at 0.7% in 2023 and 1.2% in 2024, revising their earlier forecast of 0.9% and 1.5%, respectively. Meanwhile, the OECD penned in a growth of 0.6% this year before ticking up slightly to 0.9% in 2024. The most bearish of all three, WB projects the economy to grow at 0.4% in 2023 before expanding in 2024 by 0.7%.

- In the past year, the fight against elevated inflation has dragged on growth following the European Central Bank (ECB) hiking the interest rates by a total of 450 bps since June 2022. Worries surrounded the aggressive monetary policy path as the tighter financial conditions would cause a fall in demand and spending. True to expectations, the Euro Area contracted by 0.1% on a quarterly basis in 3Q2023 from a minor growth of 0.1% in the previous quarter.

- Sentiments in the region largely remained weak, as evidenced the eighteenth straight of contraction in manufacturing Purchasing Managers' Index (PMI). The contraction in business activities was attributable to weakening demand for manufacturing and services output. Moving forward, ECB officials have pointed to the rates having reached their peak, but they may remain high level for a longer time. Coupled with the realised lagged impact from the past hikes, cautious sentiments will set the tone in 2024, and growth will likely weaken.

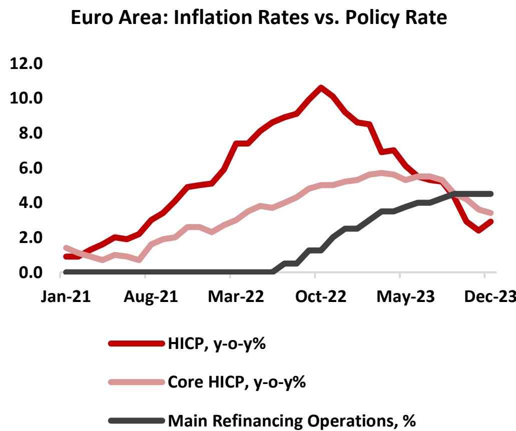


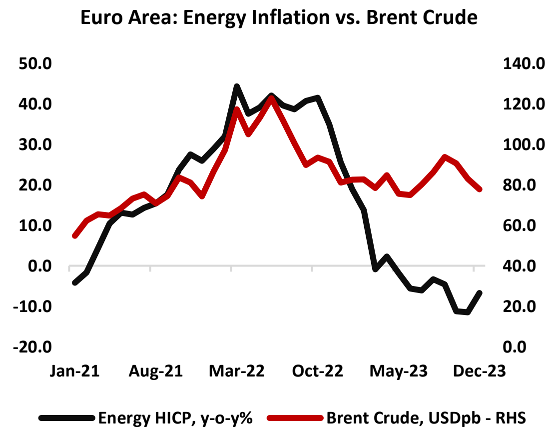


Sources: Eurostat, S&P Global, Bank Islam

- Concerns about inflation could flare up again should the geopolitical conflicts escalate further, triggering global energy price volatility. The inflation trend in the region is yet in an imbalance where the slightest shock could unravel the progress made thus far. While the headline inflation has been easing in the previous months, December 2023 saw an uptick to 2.9% from 2.4% in November. Core inflation also remains persistent, at 3.4% in December (November: 3.6%), as risks stemming from underlying price pressures loom.

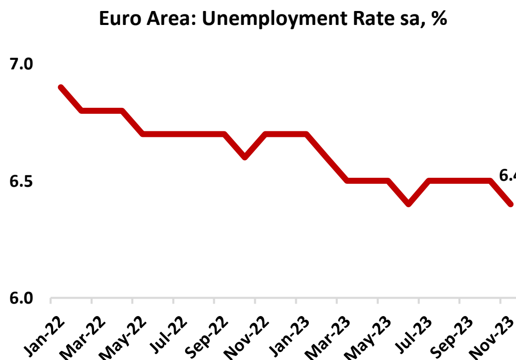
- Historically, we have observed that inflation in the Euro Area was mainly driven by the pass-through of price movement instead of labour market tightness. However, in recent months, there has been a divergence in the movement of both, which pointed to the sufficiently restrictive nature of the monetary policy. As such, we believe that the ECB will hold rates higher-for-longer to curb inflation down to the target of 2.0% successfully.

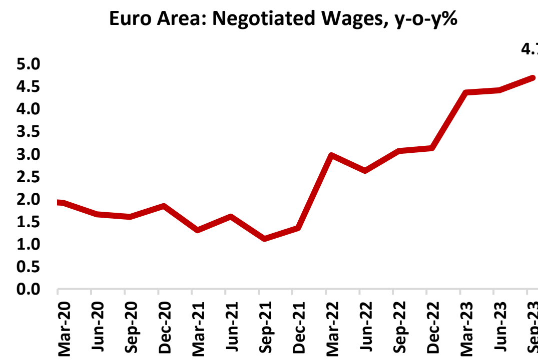




Sources: Eurostat, ECB, EIA, Bank Islam

- Despite the moderating economy, the labour market remained tight as the unemployment rate thus far in 2023 has been ranging 6.4% to 6.7% with latest figure in December coming in at 6.4%. Job vacancy rates have also declined in recent quarters as businesses and firms are reported to employ more labour to prepare for an economic rebound. Should the economy increase more than expected, the labour market would provide a much-needed catalyst for expanding output and activities.





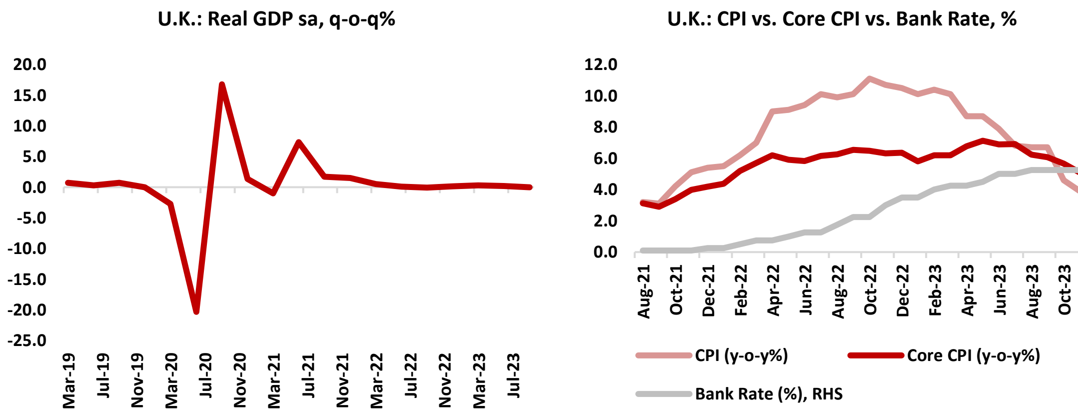
Sources: Eurostat, ECB, Bank Islam

UK: Growth to be weighed down by higher-for-longer interest rates and sticky inflation

- The U.K.'s outlook remains gloomy against persistent and elevated inflation, a high interest rate environment, and fiscal consolidation efforts. Both the IMF and OECD expect the economy to grow at 0.5% in 2023 before expanding at 0.6% and 0.7% in 2024, respectively. Moving forward, we expect the aforementioned risks will plague the economy, and respite for the bleak outlook will stem from the demand side amid wage improvement and further inflation easing.

- In a year of aggressive monetary policy being dealt with by major central banks around the world before tapering out towards the end of the year, the same path was taken by the Bank of England (BoE) with a total of 175 bps rate hikes since the beginning of 2023 till the last hike in its August 2023 meeting. However, unlike its peers who have seen inflation cooling to a more manageable level, the U.K.'s inflation burns hot. November's inflation print stands at 3.9% (October: 4.6%), whilst core inflation trends higher at 5.1% (October: 5.7%).

- Despite coming down from a historical high of 11.1% in October 2022, it is apparent that the BoE still have a long way to go in cinching inflation to its desired target of 2.0%. However, the road will be long and winded as the effects of the tighter credit conditions weigh on the economy. The central bank believes the rate will remain elevated until at least the third quarter of 2024, and growth will likely be flat. Thus far, the economy has stagnated in 3Q2023, down from an expansion of 0.2% in 2Q2023.

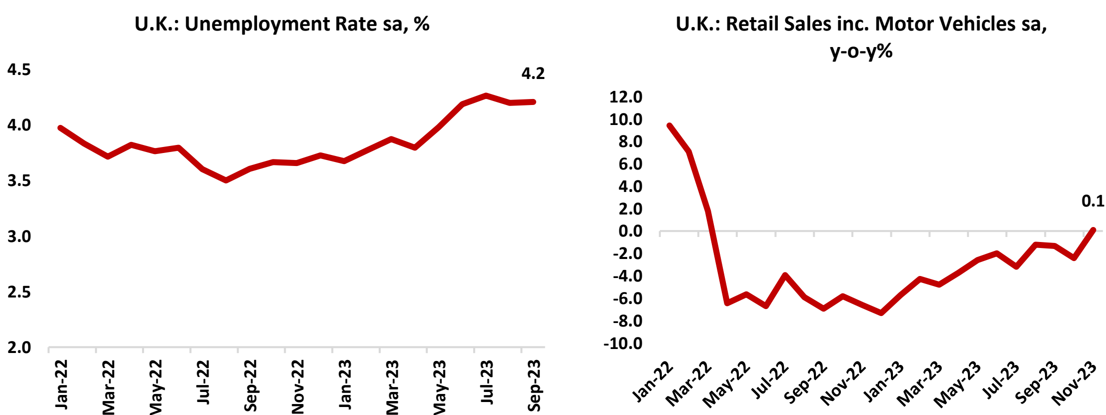


Sources: Office for National Statistics (ONS), BoE, Bank Islam

- Furthermore, the U.K. government is plagued by the question of debt consolidation following the inflation-linked net public sector debt surging to more than 100.0% of GDP – the highest level seen since 1961. The tighter fiscal space and higher borrowing costs put the economy in danger should another price shock occur.

- In light of the loosening job market, the higher-for-longer stance heading into 2024 points to the economy struggling to gain momentum. The latest data as of September shows that the unemployment rate had stayed flat at 4.2% from the previous month. This scenario could persist in the coming months as the claimant counts for unemployment rose to 4.0% in all three months to November.

- Despite the tighter financial conditions and persistent inflation, retail sales continued to recover, albeit at a slower pace, after trending in the negative territory since April 2022, with the latest data rising by 0.1% in November (October: -2.4%). On the other hand, business confidence remained weak as business owners scaled back their buying and production activities on lower demand. Contraction in the manufacturing PMI persists in December at 46.2 points (November: 47.2).

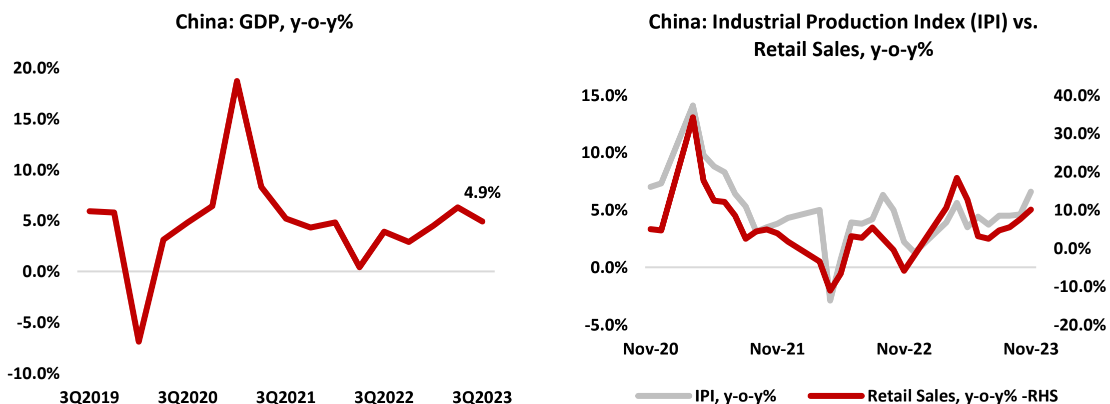


Sources: ONS, Bank Islam

China: For better or for worse?

- It is unusual to witness the U.S. economy's growth rate to match China's. The world's second-largest economy has a solid start to the year after emerging from the pandemic. However, certain economic indicators showed that the economic recovery lost steam from April onwards due to weak consumer spending, a persistent real estate slump, and muted global demand for manufactured products.

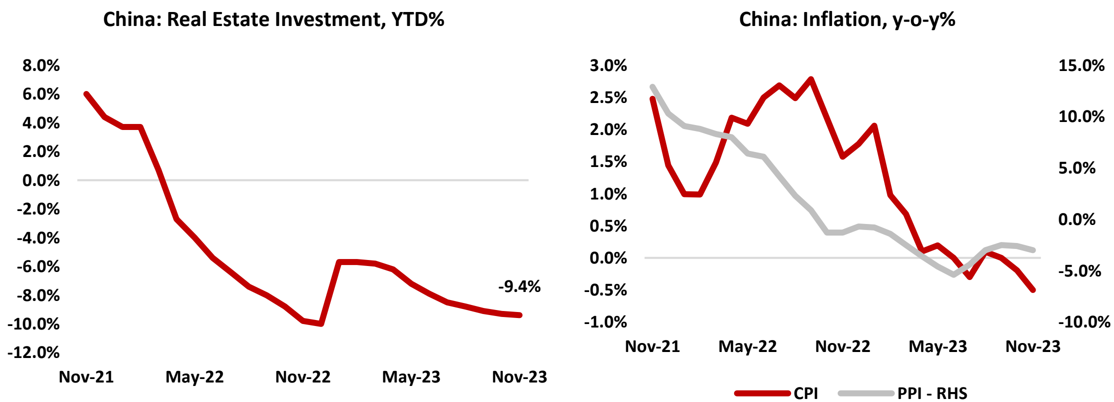
- Through November, industrial output number beat market expectations (Act: 6.6% vs Est: 5.6%). The latest reading was probably due to the low base effect in 2022 when COVID-19 curbs disrupted consumers and businesses. Additionally, the retail sales grew slower than projected during the said month (Act: 10.1% vs. Est: 12.5%), highlighting the threat posed by weak consumer demand to the world's second-largest economy.



Sources: National Bureau of Statistics, Bank Islam

- The gloomy outlook is pressured by Moody's cut to China's credit outlook, which went from stable to negative, adding unnecessary salt to the wound. The rating agency sees China's ability to repay its government borrowing could be challenged due to its stagnant growth and the ongoing property crisis. We do not believe that is the case. With that, they expect the GDP to grow by just 4.0% in 2024 and 2025 and average 3.8% between 2026 and 2030.

- Besides that, China is the only major economy dealing with falling prices for much of the year, contrasting with other countries where the focus is on taming inflation instead. The latest data showed that consumer prices dropped to 0.5% in November, steeper than the previous month (October: -0.2%) – marking the fastest decline in the CPI since November 2020. Likewise, the Producer Price Index (PPI) declined to 3.0% during the month (October: -2.6%), suggesting the factory-gate cost has been mired in deflation territory for 14 consecutive months since October 2022.



Sources: National Bureau of Statistics, Bank Islam

- In the latest development, the IMF recently raised its forecast for China's GDP growth to 5.4% in 2023 from its previous forecast of 5.0% in October. Similarly, in November, the OECD predicted that China's GDP would grow by 5.2% in 2023. However, the world's second-largest economy is expected to see growth of around 4.6%-4.7% in 2024, according to the said international organisations.

- Despite that, it is foreseen that the country's growth is still making headway, partly due to the step-up policies supported by the government, which looks set to remain flowing into 2024. At the same time, the annual Central Economic Work Conference (CEWC), held on December 11-12, ended with a strong commitment by top officials to focus more on economic growth in 2024.

- The country is poised to achieve its GDP target of 5.0% in 2023, considering that its economy grew 5.2% y-o-y in the first three quarters. We posit that should the plans for the said policies materialise, it's full speed ahead for the economic recovery next year, with GDP potentially surpassing 5.0%. This will, in turn, brush off Western pessimism over the Chinese economic outlook.

PART THREE: SOUTHEAST ASIA

	IMF (Oct'23)*		WB (Jan'24)		ADB (Dec'23)**	
	2023	2024	2023	2024	2023	2024
ASEAN	4.2	4.5	-	-	4.3	4.7
Malaysia	4.0	4.3	3.9	4.3	4.2	4.6
Indonesia	5.0	5.0	5.0	4.9	5.0	5.0
Philippines	5.3	5.9	5.6	5.8	5.7	6.2
Singapore	-	-	-	-	1.0	2.5
Thailand	2.7	3.2	2.5	3.2	2.5	3.3
Viet Nam	4.7	5.8	4.7	5.5	5.2	6.0

**ASEAN-5*
***including Timor-Leste*

Sources: IMF, WB, ADB, Bank Islam

- ADB has revised its ASEAN (including Timor-Leste) economic outlook lower from its earlier projections to 4.3% in 2023 and 4.7% in 2024 from 4.6% and 4.8%, respectively. Similarly, the IMF lowered forecast from July's figures, expecting the region to grow by 4.2% in 2023 before expanding by 4.6% in 2024.

- The updated growth projections for 2023 reflect the weaker-than-expected performance of the region's manufacturing sector, namely from Malaysia, Thailand and Vietnam. Although poised for growth, the three countries are plagued by softening external demand throughout the year, which caused the downbeat momentum in their trade performance. Conversely, growth projections for Singapore, Indonesia, and the Philippines have been maintained amid solid economic expansion thus far.

- GDP growth for the region in 2024 will be driven by the rebound in the tourism sector alongside better trade performance. International tourists and regional visitors travelling between the ASEAN countries are expected to spur the tourism and travel-related industries. The higher volume of arrivals will undoubtedly result in higher consumer spending. It could also trigger a rise in investments to achieve tourism targets as the outlook for the sector improves. Furthermore, stabilising advanced economies in other parts of the world will help lift the outlook for ASEAN countries. We believe that a rebound in the technology sector is imminent, and demand for electrical and electronics (E&E) exports will rise, supporting the growth of this region.

Indonesia: General election to carve the nation's future

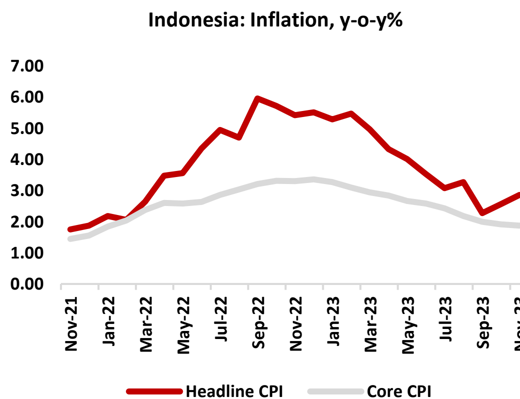
- Indonesia's economy moderated slightly to 5.05% for the cumulative three quarters of 2023, compared to 5.41% in 2022. Indonesia's growth is expected to remain robust in 2024, boosted by domestic consumption and upcoming election spending. IMF and ADB project Indonesia's economy to expand at 5.00% in 2024, which will follow the expected robust growth of 5.00% in 2023.

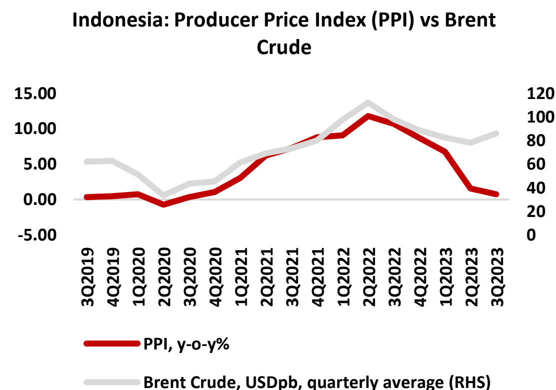
- Investments and public spending will gain ground later in line with ongoing reforms and new government projects amid the possible policy changes after the presidential election, which will be held on February 14, 2024. The external position will face challenges from slower trade, with the exports having been in negative territory for six consecutive months. Still, the situation is expected to improve on the back of an easing monetary policy environment.

Sources: Statistics Indonesia, Bank Islam

- Indonesia's 2024 general election is pivotal for the world's third-largest democracy. With President Joko Widodo ineligible for a third term, the race is shaping up to be a tightly contested battle between three major contenders. The 2024 election promises to be a closely watched event, with implications for Indonesia's domestic politics and the wider region. The next president's choice will shape the country's direction on issues such as foreign policy, trade, and international cooperation.

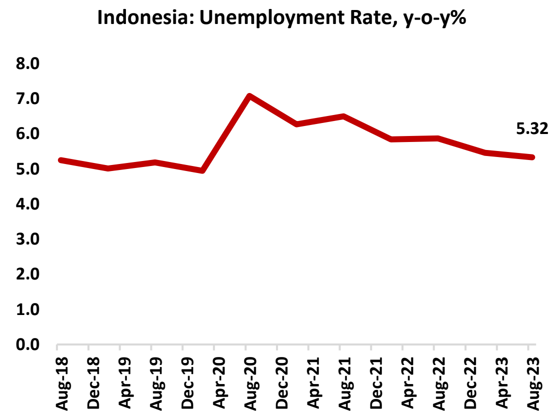
- Inflation is projected to fall further to an average of 3.20% in 2024 (2023: 3.69%). It is expected to stay within Bank Indonesia's (BI) inflation target, supported by softening commodity prices and domestic demand normalisation. The central bank has revised its target to the range of 1.5% to 3.5% in 2024 from 2.0% to 4.0% in 2023. However, higher spending during the February 2024 elections might create temporary inflationary spikes.





Sources: Statistics Indonesia, IMF, Bank Islam

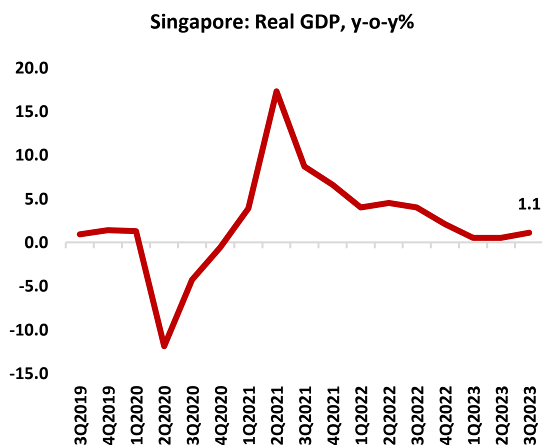
- The fiscal stance will be conservative, focusing on revenue gains to manage the deficit. The budget deficit is expected to remain manageable at around 2.28% of GDP in 2023, thanks to rising tax reforms and is projected to hover at approximately 2.29% of GDP based on Budget 2024. Tourist arrivals rebounded to 10.41 million for the first eleven months of 2023, and the government foresees that it will hit 11.0 million for the full year 2023, albeit still lower than the pre-pandemic era. Additionally, the government predicts 14.0 million tourist arrivals in 2024. The unemployment rate is on a downtrend, with the latest print at 5.32% in August 2023 (February 2023: 5.45%). The revival of the tourism sector will lend a hand in buoying Indonesia's labour market.

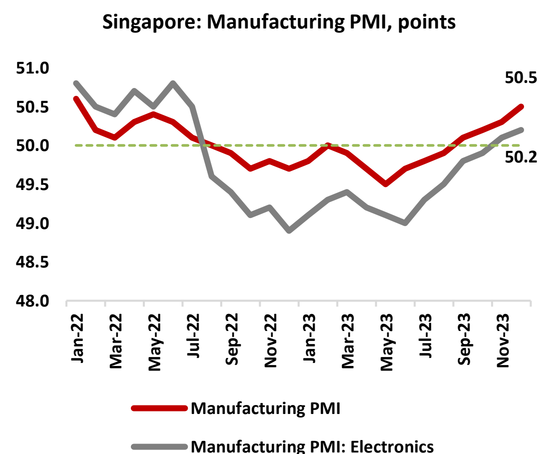


Sources: Statistics Indonesia, Bank Islam

Singapore: Policy in focus amid the forthcoming leadership transition

- The Singapore government projects the city-state's economy to expand by about 1.0% in 2023 and between 1.0% and 3.0% in 2024. The trade-dependent economy's growth in 2023 is constrained by the subdued external demand amid persistent inflation and tighter financial conditions globally. In contrast, a modest improvement is anticipated in 2024, premised on a continued recovery in international travel and a turnaround in the manufacturing activities led by the electronics sector. There have been signs that Singapore's manufacturing sector is slowly picking up, with the manufacturing PMI continuing to climb in the expansion territory since September 2023. In the meantime, Singapore's non-oil domestic exports rebounded in November 2023, marking a reversal after 13 consecutive months of contraction. However, the magnitude of the turnaround remains uncertain, given the heightened risks of global economic slowdown and geopolitical tensions.





Sources: Singstats, CEIC Data, Bank Islam

- Leadership transition to the 4G team led by the current Deputy Prime Minister Lawrence Wong could take place in 2024 as Prime Minister Lee Hsien Long said in his speech on 5 November 2023 that he will pass the baton by November 2024 "if all goes well". The leadership transition will not be later than Singapore's next general election, which has to be held by November 2025. We opine that the forthcoming transition will be smooth, fostering continuity in the government agenda as preparations have been underway with the 4G team increasingly involved in policy-setting. One way of this is by leading the Forward Singapore (Forward S.G.) exercise, initiated in June 2022, aiming to review and refresh the city-state's social compact and set a roadmap for the next decade and beyond. A total of seven policy shifts are outlined in the report concluding the Forward S.G. exercise released in October 2023, and the details of the related initiatives will be announced in the upcoming Budget 2024, which is scheduled to be released in February 2024. Given this, the Budget 2024 will likely be expansionary.

- The Monetary Authority of Singapore (MAS) has announced that it would increase the number of scheduled policy reviews from two to four beginning in 2024, underscoring the need to ensure timely monetary policy communication amid the still uncertain outlook. We expect the MAS to maintain the prevailing rate of appreciation of its Singapore dollar nominal effective exchange rate (SGD NEER) policy band before the Fed's rate cuts prompt it to reduce the slope of the policy band.

PART FOUR:
MALAYSIA IN 2024: A BETTER OUTLOOK, KEEP A LOOKOUT FOR CLOUDY DAYS

- After a bumpy 2023, we expect Malaysia's economy to hold up well in 2024. For now, we believe that the government's expectation for 2023 full-year GDP growth of around 4.0% is achievable, partly helped by the faster-than-expected recovery in the tourism sector. As for 2024, we anticipate growth of up to 4.7%, aligning with the official projection range of 4.0% and 5.0%.

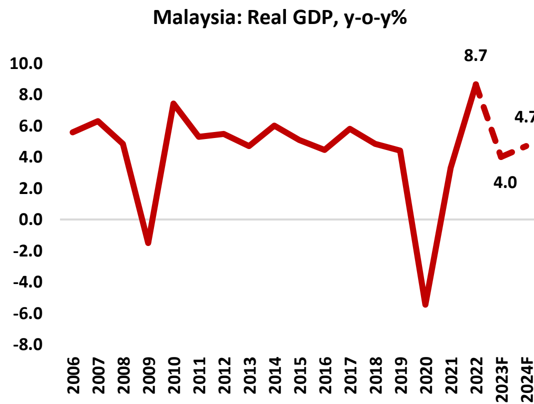
- Growth in 2024 will remain supported by still-robust domestic demand, although at a slightly moderated pace. The net exports, which have been the main drag to growth in 2023, are bound to improve and even become a positive contributor in the coming quarters. Nevertheless, there are downside risks to our projections, and they mainly stem from external developments. Global growth could slow more sharply than expected, and the intensifying geopolitical tensions and the resulting fragmentation could amplify the slowdown.

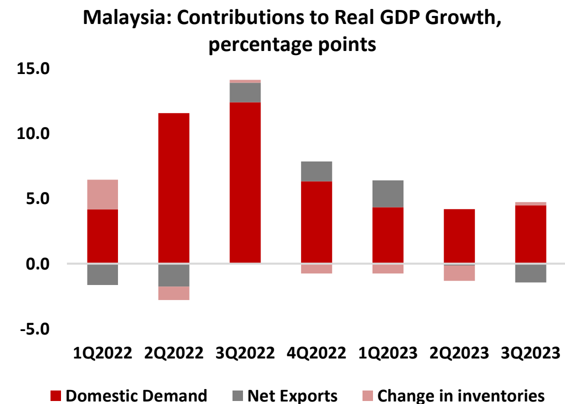
- Among the components of domestic demand, private consumption, which accounts for the largest part of GDP (3Q2023: 62.1%), has been and will continue to be the key growth driver. Resilient labour market conditions, subdued inflation and the government's cash transfers should see the strength of consumer spending persist into 2024, albeit at a softening pace as pent-up demand from the pandemic falters.

- We posit that the 2.0% increase in the Service Tax rate from 6.0% to 8.0% and the subsidy rationalisation programme, expected to take effect from 2H2024 onwards, could potentially reduce households' disposable income and, thus, constrain consumption growth. The impact will depend on the implementation, as the government is finalising the exemption list from the Service Tax rate hike and has reassured that the subsidy rationalisation will be gradual. The much-anticipated progressive wage policy, which focuses on lifting wages of workers earning less than RM5,000 a month and is scheduled to be piloted in June 2024, could provide some cushion to the impact.

- The investment will likely sustain its positive momentum in the coming quarters with the ongoing infrastructure projects and construction developments in the pipeline. These include the East Coast Rail Link (ECRL), the Pan-Borneo Highway, the Penang Light Rail Transit (LRT) project, the resumption of the construction proposal of five previously cancelled LRT3 stations and the Johor – Singapore Special Economic Zone (SEZ). However, the pace of investment growth will likely be tempered by limited fiscal room with government debt-to-GDP approaching the debt ceiling of 65.0%, still-tight financial conditions and geopolitical tensions that could undermine investor confidence.

- We believe the New Industrial Master Plan (NIMP) 2030 and the National Energy Transition Roadmap (NETR) will enhance growth and attract investments through a sectoral approach. The NIMP 2030 aims to expedite the transformation of industries in Malaysia, focusing on high-impact industries. Meanwhile, the NETR should create the country's pathway in adhering to the Paris Agreement and economic restructuring into renewable energy, which has seen an increased investor interest in recent years. According to UNCTAD's World Investment Report 2023, renewable energy investments have nearly tripled since adopting the Paris Agreement 2015. Nevertheless, the successful implementation of these plans hinges on various factors, such as efficient and timely regulatory frameworks and effective stakeholder engagement.



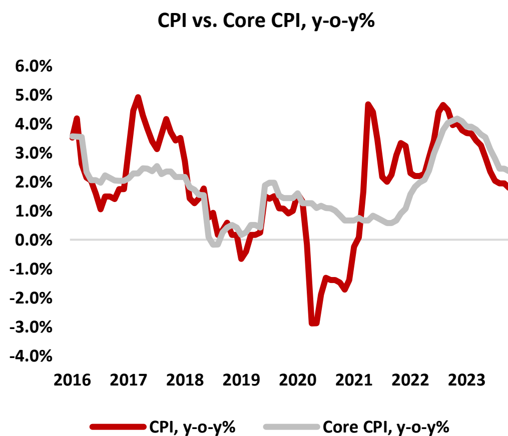


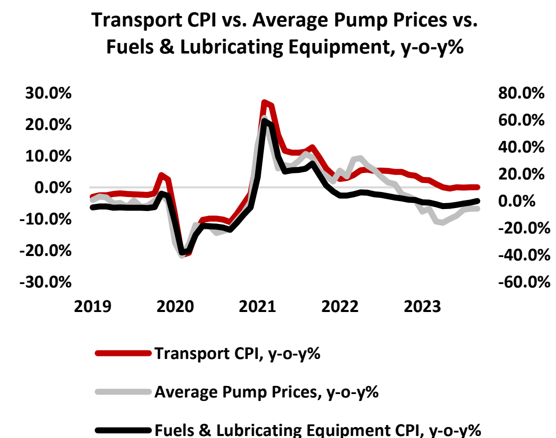
Sources: Department of Statistics Malaysia (DOSM), Bank Islam

Targeted subsidies would impose an upside risk to the inflation outlook in 2024

- Of late, Malaysia's inflation print has been gradually easing since the start of 2023, with the latest print coming in at its lowest in more than two years (November: 1.5%). This is partly due to the moderation in food price pressures and stability in global commodity prices after three years of market volatility caused by the war, adverse weather, rising energy, and input costs.

- Given the above statement, we foresee the inflation will remain modest. Be that as it may, the inflation outlook is subject to planned domestic policies implemented by the government – the 2.0% increase in Service Tax rate from 6.0% to 8.0% with effect from March 1, 2024, and the targeted fuel subsidy programme to be introduced in 2H2024. This is especially given the contribution of Transport (sub-index of CPI) and Fuels & Lubricating & Equipment (part of transport sub-index) at 14.60% and 8.50%, respectively. On balance, we expect the inflation rate to average 2.7% in 2024, slightly higher than 2.5% in 2023.





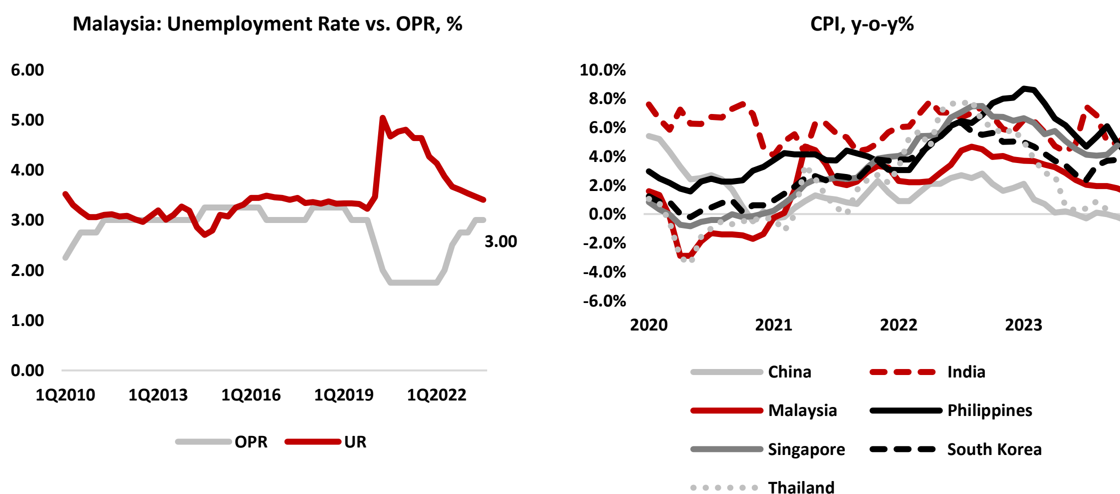
Sources: DOSM, BNM, Bank Islam

A lengthy key rate pause of OPR is likely throughout 2024

- As expected, the Bank Negara Malaysia (BNM) held its key rate steady at 3.00% in the final meeting of the Monetary Policy Committee (MPC) on November 1-2, given the easing inflation trend in Malaysia. This marked the third straight meeting of rate pause by the BNM, which started the July 5-6 meeting earlier.

- While the inflation reading is on a downward trending, the core inflation is still trending higher than the headline inflation. Yet, the current rate is not as acute as in other countries as it is relatively low compared to other regional countries, partly due to the subsidies and price mechanisms controlled by the government. As such, the BNM's hike window has lapsed with the easing of inflation, as the BNM acknowledged.

- The MPC has scheduled six meetings in 2024 between 23 January and 6 November. Though we have emphasised the strong correlation between the OPR and the labour market, rather than the inflation rate, we foresee the continued sluggish growth in the unemployment rate as of now might prompt the OPR to remain at 3.00% by the end of 2024, or even longer unless there are unforeseen adverse developments to the economy with a surprise upside of the labour market to return to its pre-pandemic level. Even with the Fed's rate cuts anticipated in 2024, we expect the interest rate differential vis-a-vis the U.S., which is currently at an all-time low of -2.33%, will remain negative throughout the year. This suggests no immediate urgency for BNM to follow suit.

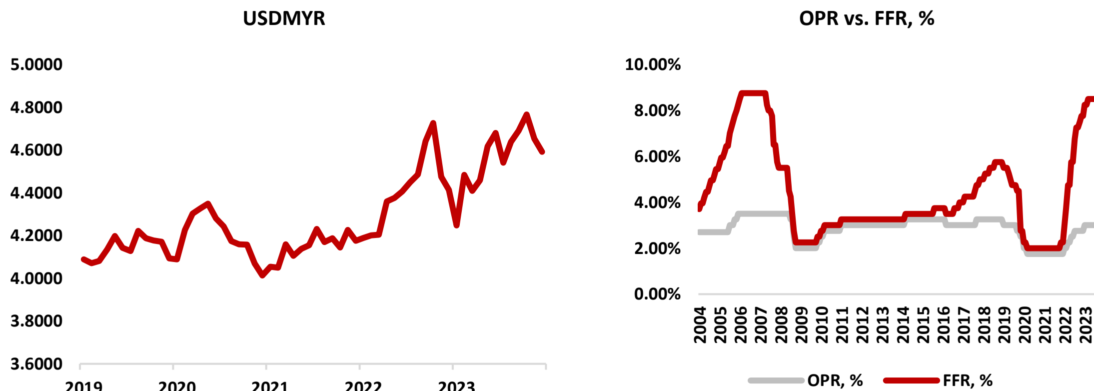


Sources: BNM, DOSM, Bank Islam

Ringgit is poised to gain losses in 2024

- There is no doubt that 2023 was not a good year for the Ringgit. While inflation is not something to worry about since the headline readings continued to cool down, our country has to deal with the persistent weaknesses in the local note. In mid-October, Ringgit plunged to an all-time low against the USD, making it the second-worst performer in Asia after the Japanese Yen (JPY).

- The focal point here is the widening interest rate differential between the country's OPR and the U.S. FFR, which is the leading pressure that holds the local note down. Additionally, the continued resilience of the U.S. economy prompted the higher-for-longer stance, prompting the strong demand for USD. This includes when there is an increasing concern over the potential escalation of geopolitical tensions in the Middle East, which started in early October this year.



Sources: DOSM, BNM, Bank Islam

- Despite external front hurdles, the local note is anticipated to ride into 2024 on an optimistic note after the U.S. Fed signalled three rate cuts in the said year during its 2023 final policy decision on December 12-13. While this could lend some to the Ringgit, we believe a weakening USD would not happen overnight, which will cap significant gains in Asian currencies.

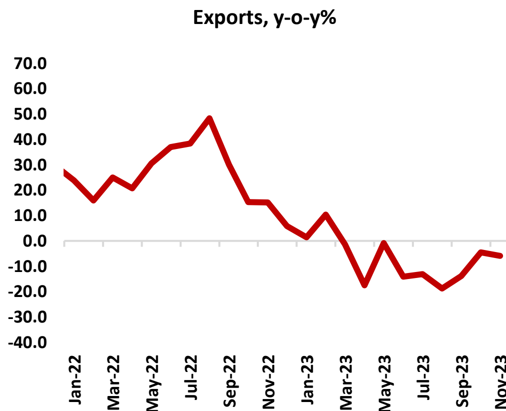
- After all, we believe domestic factors that respond well to unexpected shocks still represent a strong card that can support the local note even though the country's performance is influenced mainly by the U.S.' monetary policy stance and China's ongoing performance.

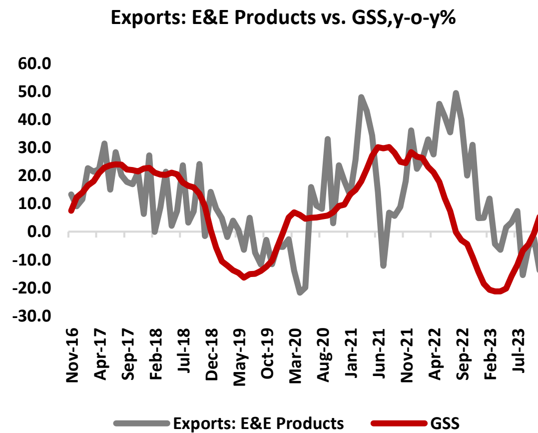
- With that, we posit that the government's push for fiscal consolidation in managing the country's finances could give some confidence to the investors, hence making the local note attractive. Additionally, our domestic-oriented factors have remained resilient and solid for the past three quarters, which could help the Ringgit rebound soon. We anticipate that the local note could improve further against the USD, ending at RM4.45 in 2024, barring external shocks.

Global Semiconductor Sales (GSS) is in for a revival – Good news for Malaysia's E&E exports

- We posit that foreign trade will recover in 2024 amid waning external headwinds as the global financial markets move towards equilibrium. Trade has shown signs of improvement in recent months, with imports recording a small growth following eight months in the contraction zone while exports declined at a smaller margin.

- We expect the GSS upcycle in the coming months as the recent figures have been improving but are still trending in negative territory. The World Semiconductor Trade Statistics (WSTS) anticipate a growth of 13.1% in 2024 for the global semiconductor industry, with all markets rebounding from 2023's downcycle. The revival is attributable to the depleting inventories of related manufacturing sectors and higher technological and electric vehicle (E.V.) demand. Reflective of the upcycle, we believe Malaysia's trade performance would stand to benefit as demand for E&E products – which consistently makes up the majority of Malaysia's exports – strengthened.





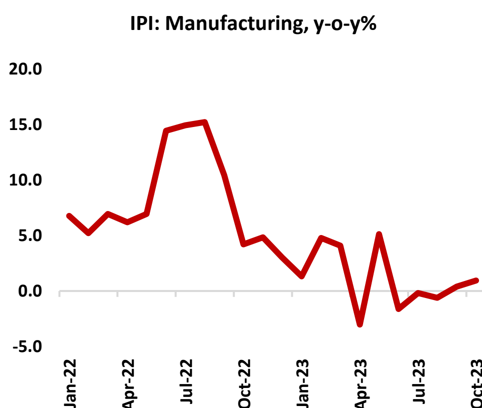
Sources: DOSM, Semiconductor Industry Association, Bank Islam

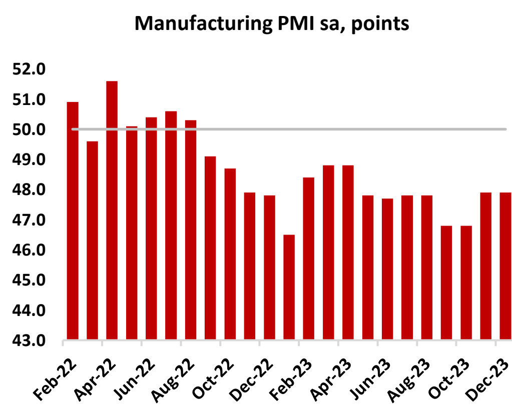
Imminent the manufacturing sector recovery

- 10M2023 factory activities experienced sluggish growth, with the Industrial Production Index (IPI) rising by only 1.0% y-o-y (10M2022: 7.3%). As economies worldwide face growth challenges in the face of high inflation and restrictive policy stances, global demand for Malaysian exports weakened and led to a broad-based slowdown in production. Manufacturing IPI rose by only 0.9% y-o-y in October (September: 0.4%), a muted performance compared to previous years. Business owners had also scaled back their buying activities, as evidenced by the the sixteen-mont contraction of the manufacturing PMI.

- Moving forward, we believe that global economic stabilisation in 2024 could lead to a recovery in trade and, thus, spur our factory activities. Higher salaries and wages (October: 3.4% vs September: 3.2%) and increased employment (October: 2.5% vs. September: 2.4%) in Malaysia's manufacturing sector would provide much-needed impetus for productivity growth and subsequent expansion.

- On the flipside, domestic demand had proved resilient in driving growth. This rings true as domestic-oriented industries have carried the manufacturing sector thus far. In October 2023, the manufacture of motor vehicles, trailers, and semi-trailers recorded a double-digit growth of 10.6% (September: 2.6%), backed new orders, and fulfilled backlogged orders. The rising demand for motor vehicles has led to a surge in sales volume in the latest quarter (November: 9.6% vs. October: 21.0%). We believe domestic demand will continue to play a pivotal role in supporting the sector's growth in 2024.





Sources: DOSM, CEIC, Bank Islam

Tourism sector's better-than-expected rebound, thanks to Singapore

- Malaysia's tourism sector has embarked on a road of recovery following the heavy hit dealt by the COVID-19 outbreak. The recovery was attributable to tourists satisfying their pent-up spending needs and the shift in consumer behaviour post-pandemic, leading to a surge in incoming visitors in 2023. As of September 2023, Malaysia recorded more than 14.4 million international tourist arrivals and is on track to achieve the target of 18.0 million. The total tourist receipts for the same period amounted to RM49.3 billion, a sharp increase from the FY2022 figure of RM28.2 billion.

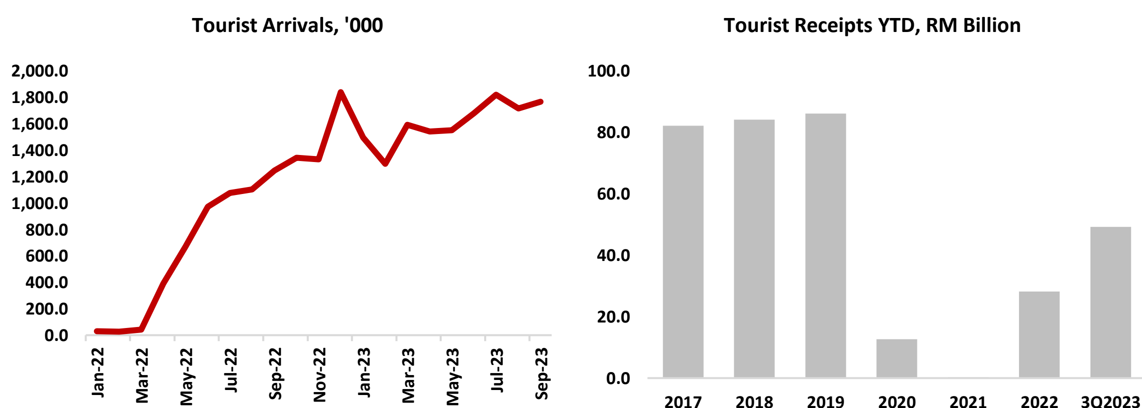
- Although tourist arrivals at the beginning of 2023 were slower than expected despite China's much-anticipated exit from the Zero-Covid policy, the arrivals had gained traction from our regional peers, with Singapore, Indonesia and Thailand topping the list. Meanwhile, domestic tourism had also bloomed, with 156.6 million domestic visitors recorded for 9M2023, with a total expenditure of RM61.2 billion.

- We believe that the sector will expand further in 2024 with higher recorded arrivals of tourists, aided by the developments in digital technology, roles of private investments and measures by the government to support the industry.

- In Budget 2024, RM150.0 million was allocated for developing and maintaining tourism infrastructure. Special provisions were also made for targeted tourism support facilities such as the Central Spine Road and Tioman Airport to enhance accessibility to more tourist spots. The government will also provide flight charter matching grants to increase connectivity and offer prospective tourists a broader range of travel options. RM300.0 million will revitalise the promotions of Malaysia's tourism industry through physical and virtual advertising campaigns and activities starting this year in preparation for the Visit Malaysia Year 2026 programme.

- Furthermore, the government announced visa-free travel for up to 30 days for visitors from China and India, reducing travel costs and easing the process for visitors from these countries. If not extended, the visa waiver would be available until the end of 2024, which points to higher tourist arrivals. However, competition will also be challenging as ASEAN countries have relaxed their Chinese visitors' entry requirements.

- Another initiative to be highlighted is the entertainment tax, revised downwards to 10% from 25% for international acts, while local acts are fully exempted. This move could draw more foreign artists to perform in Malaysia, and subsequently, more consumers would opt to travel here for such entertainment, especially from neighbouring countries.

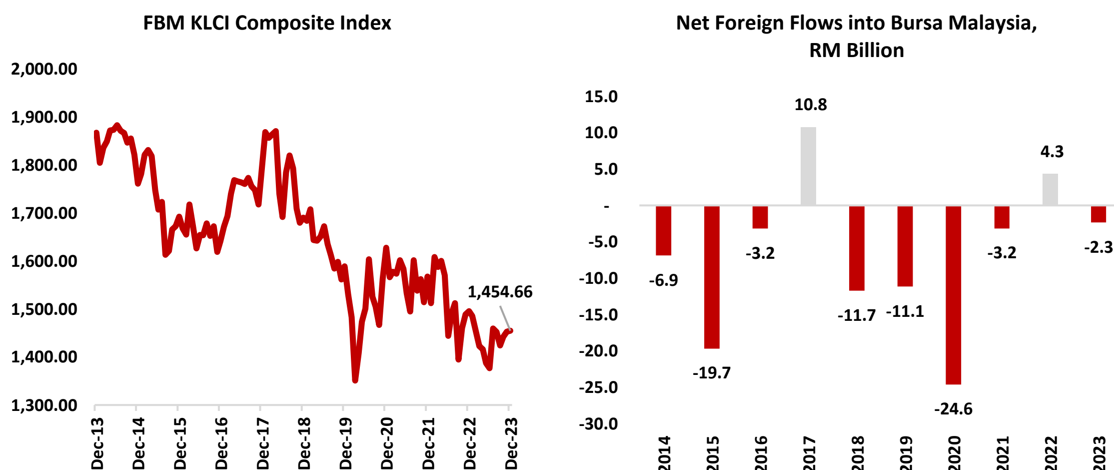


Sources: Ministry of Finance (MoF), Tourism Malaysia, Bank Islam

Capital Markets - Local equity market to fare better in 2024

- The FBM KLCI benchmark index is expected to pull off better in 2024. The local equity market, weighed down by banking stocks, will be uplifted by factors of a less hostile monetary environment, easing inflation, and improving external trade. Additionally, the aggressive U.S. Fed interest rate hikes are expected to slow down or end in 2024. This could reduce pressure on global equity markets and increase investment in emerging markets like Malaysia.

- Local equity market foreign fund flows continued to dwindle as it logged seven months of foreign outflows this year. In 2023, Bursa recorded cumulative net foreign outflows of RM2.3 billion. Malaysia's economy is expected to remain resilient in 2024, with expectations of improvements in external demand and an uptick in tourist arrivals, which could further support the local stock market.



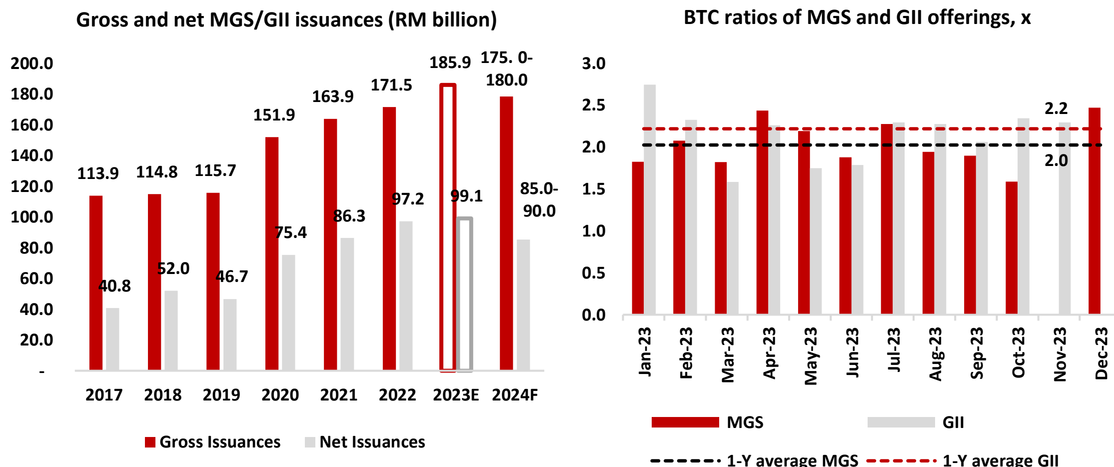
Sources: Bursa Malaysia, Bank Islam

Fixed Income - Fiscal consolidation to cap debt issuances

- BNM has concluded the issuances of Malaysian Government Securities (MGS) and Government Investment Issues (GII) amounted to RM185.9 billion in 2023 (2022: RM171.5 billion). The redemption of MGS/GII in 2023 of RM86.8 billion surpassed the previous year's RM74.3 billion. Thus, net issuances of MGS/GII in 2023 topped RM99.1 billion, slightly higher than RM97.2 billion in 2022.

- Despite the higher issuances, public offerings for local government bonds attained robust demand during the year. On average, GII garnered higher demand with a bid-to-cover (BTC) of 2.2x compared to MGS, with a BTC of 2.0x in 2023. Overall, the average BTC ratio stood at 2.1x in 2023, a tad lower than 2.2x in 2022. The BTC values above 2.0x reflect strong demand from local institutional investors.

- We foresee that the gross MGS/GII issuance will amount in the range of RM175.0 to RM180.0 billion in 2024 (2023: RM185.9 billion). This is based on the upcoming MGS/GII maturities of RM93.0 billion in 2024 and the government's projected fiscal deficit of RM85.4 billion in Budget 2024 (2023: -RM93.2 billion) amid the ongoing fiscal consolidation.



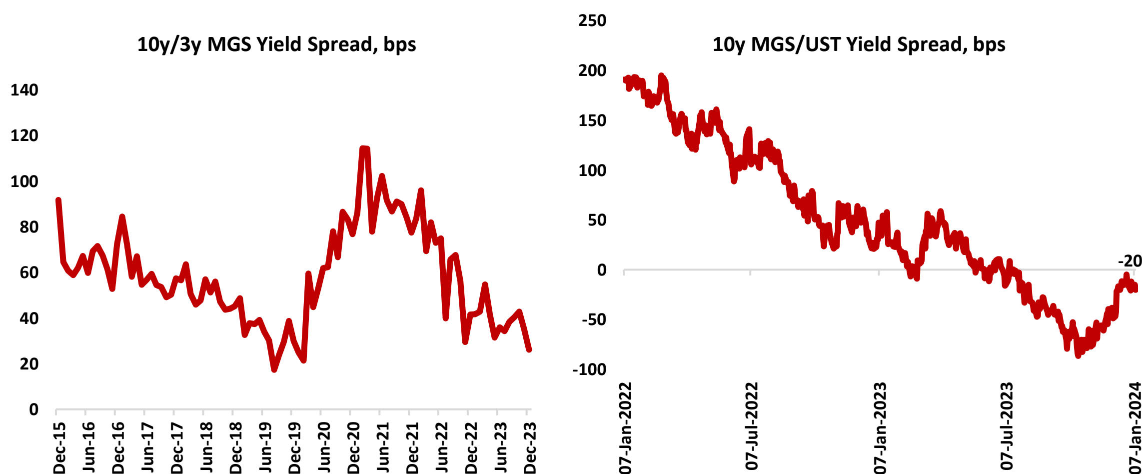
Sources: BNM, Bank Islam

Dovish pivot by U.S. Fed set to pare bond yields

- MGS yields inched lower between 16bps and 36bps for all. Buying interest skewed towards the longer-term notes resulted in a flatter MGS yield curve portrayed by the narrowing of the 10y/3y MGS yield spread, which reduced to 26bps at the end of December 2023 from 42bps at the end of December 2022. In addition, the 10y MGS/UST yield spread remained in the negative territory albeit at a lower magnitude as the Fed has propagated a dovish tone in December's Federal Reserve Open Market Committee (FOMC) meeting.

- BNM is expected to hold the OPR at 3.00% throughout 2024, providing stability and potentially keeping yields in check. The Malaysian government's commitment to narrowing the fiscal deficit, as outlined in Budget 2024, could reduce bond issuance and ease upward pressure on yields. A resilient Malaysian economy could attract greater investor interest and support lower bond yields.

- Despite dipping in recent months, inflation remains a concern. The government's planned subsidy rationalisation and higher service tax in 2024 could push inflation back up, increasing bond yield. A weakening ringgit would put upward pressure on bond yields as investors demand higher returns to compensate for currency risk.



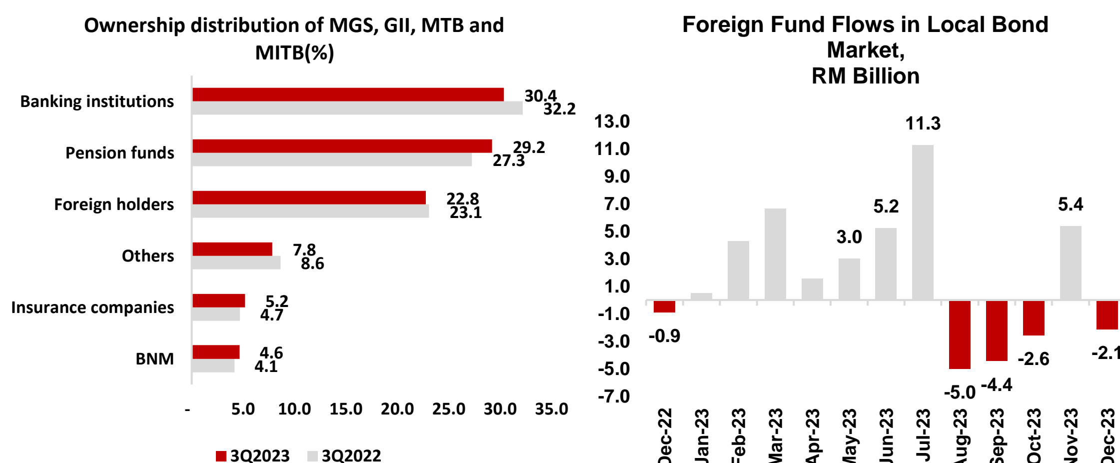
Sources: BNM, Bank Islam

Bond ownership and foreign holdings

- In 3Q2023, banking institutions held the largest share of local government bonds at 30.4% of the total outstanding, followed closely by pension funds with a share of 29.2% of the total outstanding. Other domestic institutional investors were also buoying demand for local government bond markets, particularly Development Financial Institutions, BNM, and insurance companies.

- On foreign holdings, the local bond market posted cumulative net foreign inflows of RM23.7 billion in 2023, significantly higher relative to the outflows of RM9.8 billion logged in 2022. The local bonds market recorded net foreign inflows in all months except for net foreign outflows, which amounted to RM14.1 billion from August to October 2023 and December 2023 as the yield-seeking investors reaped the benefits of higher U.S. Treasury (UST) yields on the expectations of higher-for-longer rates during the said period. Nevertheless, the share of foreign holdings in MGS and GII remained relatively robust at 22.5% in December 2023 (December 2022: 22.4%).

- The outlook of foreign inflows into Malaysia's bond market is mixed, buoyed by the country's strong economic fundamentals and attractive yields. The prospects for the Fed to cut interest rates in 2024 will give an edge on local yields to entice demand for Malaysian bonds. However, the monetary policy landscape by major central banks and geopolitical tensions will exert further challenges and uncertainties in the market.

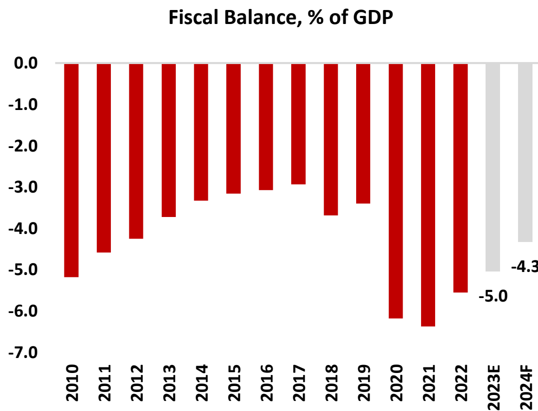


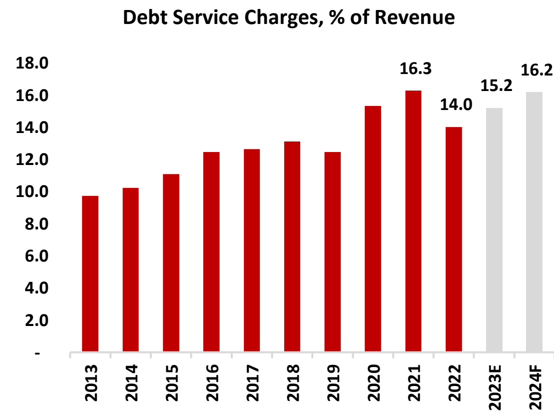
Sources: BNM, Bank Islam

Public Finance – a long and winding road amid consolidation

- With the government reaffirming its commitment to fiscal consolidation in the Budget 2024, we see a relatively more restrictive public spending climate going forward. In Budget 2024, the government foresees the fiscal deficit to slide to 4.3% in 2024 relative to 5.0% in 2023, derived from the estimated 6.7% nominal GDP growth, lower expenditures and slightly higher revenue. This aligns with the government's mid-term vision of a 3.5% average deficit from 2024 to 2026. However, achieving this depends on strategic spending cuts and increased revenue generation, which unforeseen fluctuations in the economic landscape may impact.

- Debt service charges (DSC) are expected to reach 16.2% of revenue in 2024 (2023E: 15.2%), higher than the 15.0% of revenue administrative limit amid a lower fiscal deficit. The tepid movement in tax revenue-to-GDP of 12.3% in 2024 (2023E: 12.4%) projected in Budget 2024 will challenge debt affordability, given the limited revenue space. Additionally, the expected moderation in economic growth in 2024 does not help easing the DSC figure.





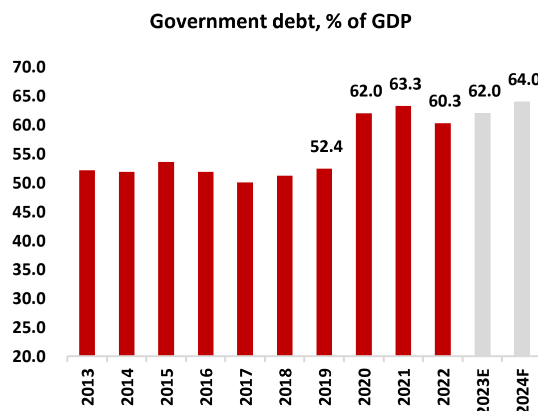
Sources: MOF, BNM, Bank Islam

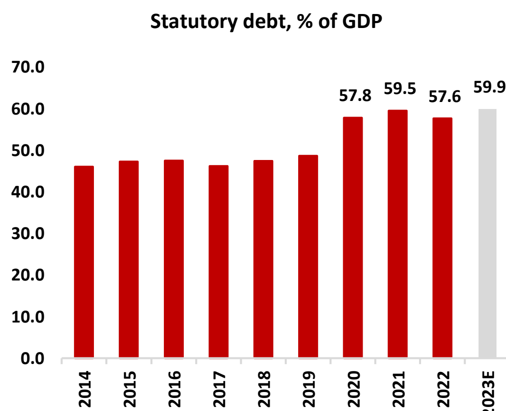
Elevated debt and liabilities exposure

- The debt-to-GDP ratio is projected to rise to 64.0% in 2024, marginally higher than the 62.0% expected in 2023. On the other hand, statutory debt-to-GDP (MGS, GII and MITB) stood at 60.7% as of November 2023 (2022: 57.6%). Albeit the statutory debt-to-GDP has yet to reach the statutory debt ceiling of 65.0%, there is limited space for government debt issuances in 2024.

- In terms of debt and liabilities exposures, which consist of Federal Government debt, committed guarantees and other liabilities, namely financial commitment from public-private-partnership (PPP) and private finance initiatives (PFI) projects, total debt and liabilities exposures were 81.6% of GDP as of end-June 2023 (2022: 80.7%). According to the Fiscal Responsibility Act, government financing via contingent liability should come in less than 25% of GDP. In addition, the stress tests conducted by the MoF indicated that the crystallisation of contingent liabilities could see total federal government debt hitting 82.8% of GDP in 2024.

- The saving grace in debt space is the percentage of government debt denominated in foreign currency, which stood at only 2.6% of the total debt outstanding as of 3Q2023, imparting low foreign exchange risks. Hence, foreign exchange vulnerabilities to major central banks' policy changes are reduced.





Sources: MOF, BNM, Bank Islam