

## **INSAP ECONOMIC REPORT**

### **Malaysia's Economic Outlook in a Changing Economic Landscape for 2024**

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#### **Executive Summary**

The global economic landscape is fraught with uncertainties and challenges, with the dynamics between the United States and China playing a pivotal role. This report delves into the economic outlook of these two powerhouses and their impacts on the world while scrutinizing Malaysia's economic development and business forecast for 2024. In the United States, fluctuations in inflation and interest rates are under scrutiny, alongside predictions of macroeconomic statistics. Meanwhile, China's economic trajectory is examined, providing insights into its recovery and prospects.

Shifting our focus to Malaysia, the report explores the patterns of economic growth and the critical domestic drivers influencing its economic landscape. Factors such as the Overnight Policy Rate, international reserves, exchange rates, property markets, and financial stability are analysed to provide a comprehensive understanding of the nation's economic health. The report extends its gaze to 2024, outlining Malaysia's economic outlook through expenditure components. Final consumption expenditure, gross fixed capital formation, and the dynamics of exports and imports are dissected to project the nation's economic trajectory. However, looming concerns cast shadows on Malaysia's economic horizon. Anticipated economic slowdown, persistent financial headwinds, the impact of taxes on inflation, and the development of artificial intelligence pose challenges. Moreover, geopolitical factors such as the reshaping of diplomacy in presidential elections and rising tensions between China and Taiwan create an environment of uncertainty.

In conclusion, this report serves as a guide, navigating the intricate web of global economic dynamics, dissecting key trends, and providing insights into potential challenges and opportunities that lie ahead for Malaysia in 2024. The interconnectedness of nations and the delicate balance of economic forces underscore the need for strategic foresight and adaptability in the face of a rapidly evolving global landscape.

## Table of Contents

<b>1.0 Introduction</b>	4
1.1 Navigating Uncertainties and Challenges Globally	4
<b>2.0 USA and China Economic Outlook</b>	6
2.1.1 Inflation and Interest Rate in the United States of America	6
2.1.2 Prediction of Macroeconomic Statistics	7
2.2 China’s Economy	8
<b>3.0 Overall Economic Development in Malaysia</b>	11
3.1 The Pattern of Economic Growth	11
3.2 Domestic Drivers	12
3.2.1 Overnight Policy Rate (OPR)	12
3.2.2 International Reserves	13
3.2.3 International Reserves, Imports and Short-term External Debt	14
3.2.4 The Fluctuation of Exchange Rate between Malaysia and its Major Trading Partners	15
3.2.5 Property Market	17
3.2.6 Money Supply and Financial Stability	17
3.2.7 Federal Government Debt: Classification by Currency and Remaining Maturity	18
<b>4.0 Malaysia Business Forecast 2024: Malaysian Economic Outlook through Expenditure Components</b>	20
4.1 Final Consumption Expenditure	20
4.2 Gross Fixed Capital Formation (GFCF)	21
4.3 Exports and Imports of Goods and Services	22
<b>5.0 2024 Economic Outlook: 10 Concerns for the Malaysian Economy</b>	25
5.1 Anticipated Economic Slowdown in 2024: Impact of Broader Aggregate Demand Factors and Fading Post-Pandemic Tailwinds	25
5.2 Financial headwinds to growth are expected to persist	25
5.3 The Effect of Taxes on Inflation, Consumption and Economic Growth	26
5.4 The Development of Artificial Intelligence (AI) and Smart Industries	26
5.5 Crowding-out Effect of the Government Debt	27
5.6 China’s Economy will Recover Slowly	27
5.7 The US Dollar will Depreciate against Some Major Currencies	28
5.8 Reshaping Diplomacy in Presidential Elections: A Potential Change of Diplomatic Relations with the U.S. and China	28
5.9 Rising Tensions China between Taiwan: A Long-term Unpredictable Time Bomb	29
5.10 Beyond Borders: Geopolitical Risks in 2024 and Beyond	20
<b>6.0 Conclusion</b>	31
<b>References</b>	<b>32</b>

## Figures

Figure 1A: World Output (Annual percent change) - 2000-2019 by International Monetary Fund	5
Figure 1B: World Output (Annual percent change) - 2000-2019 by World Bank	5
Figure 2: USA Inflation Rate and Fed Rate, 2016M1-2023M9	6
Figure 3A: Real GDP Growth Rate	8
Figure 3B: Inflation Rate	8
Figure 3C: Population	8
Figure 3D: Unemployment Rate	8
Figure 4A: GDP Demand Components of China	9
Figure 4B: Consumer Confidence Index	9
Figure 5: China's Real Estate Market Losing Momentum	10
Figure 6: World Output (Annual percent change) - 2000-2019 by World Bank	11
Figure 7: Overnight Policy Rate (OPR), May 2004 – November 2023	13
Figure 8: House Price Indicator, 2016Q1 – 2023Q3	17
Figure 9: Final Consumption Expenditure in Malaysia: 2016Q1-2023Q3	20
Figure 10: Gross Fixed Capital Formation in Malaysia: 2016Q1-2023Q3	21
Figure 11A: External Trade in Malaysia	22
Figure 11B: Exports and Imports of Goods and Services	23

## Table

Table 1.1A: Summary of World Output (Annual percent change) - International Monetary Fund (IMF)	4
Table 1.1B: Summary of World Output (Annual percent change) - World Bank	5
Table 2: US Economic Outlook and Forecast	7
Table 3: China Economic Outlook	8
Table 4: International Reserves (RM million)	14
Table 5: International Reserves to Imports and Short-term External Debt Ratios	14
Table 6A: The Fluctuation of the Exchange Rate between Malaysia and its Major Trading Partners: Feb 2017-Dec 2019 (Pre-COVID-19 Period) (month change, percent)	15
Table 6B: The Fluctuation of the Exchange Rate between Malaysia and its Major Trading Partners: Jan 2020 - Dec 2023 (During and Post COVID-19 Periods) (month change, percent)	16
Table 7: Monetary Aggregates: M1, M2 and M3 and Their Growth Rate	18
Table 8A: Federal Government Debt: Classification by Currency and Remaining Maturity (RM million)	19
Table 8B: Federal Government Debt: Classification by Currency and Remaining Maturity (Growth Rate (%))	19
Table 8C: Outstanding Federal Government Debt by Remaining Maturity (RM million) as of 2023 Quarter 3	19
Table 9: Average Growth Rate of the Exports and Imports of Goods and Services: A Comparison between Pre- and Post-COVID-19 Pandemic Periods	23

## 1.0 Introduction

### 1.1 Navigating Uncertainties and Challenges Globally

More than three years since the world grappled with the economic fallout of the COVID-19 pandemic, the global economy continues its journey towards recovery. Despite an initial robust rebound, the pace of this recovery has moderated, revealing persistent challenges and widening growth divergences across regions.

According to the World Economic Outlook released by the International Monetary Fund (IMF) in October 2023, a baseline forecast indicates a deceleration in global growth. Projections suggest a slowdown from 3.5 percent in 2022 to 3.0 percent in 2023, further dipping to 2.9 percent in 2024 (Table 1.1A). In contrast, a more cautious outlook emerges from the World Bank's projections. The global growth trajectory, which exhibited a 3.1 percent expansion in 2022, is anticipated to encounter substantial deceleration. The World Bank's pessimistic estimation anticipates a slowdown to 2.1 percent in 2023, with a marginal uptick to 2.4 percent in 2024 (Table 1.1B).

**Table 1.1A: Summary of World Output (Annual percent change) - International Monetary Fund (IMF)**

	2020	2021	2022	2023	2024	2028f
<b>World</b>	<b>-2.8</b>	<b>6.3</b>	<b>3.5</b>	<b>3</b>	<b>2.9</b>	<b>3.1</b>
<b>Advanced Economies</b>	<b>-4.2</b>	<b>5.6</b>	<b>2.6</b>	<b>1.5</b>	<b>1.4</b>	<b>1.7</b>
United States	-2.8	5.9	2.1	2.1	1.5	2.1
Euro Area	-6.1	5.6	3.3	0.7	1.2	1.3
Japan	-4.2	2.2	1	2	1	0.4
Other Advanced Economies	-4.1	6	3.1	1.5	1.8	2
<b>Emerging Market and Developing Economies</b>	<b>-1.8</b>	<b>6.9</b>	<b>4.1</b>	<b>4</b>	<b>4</b>	<b>3.9</b>
Emerging and Developing Asia	-0.5	7.5	4.5	5.2	4.8	4.5
Emerging and Developing Europe	-1.6	7.3	0.8	2.4	2.2	2.4
Latin America and the Caribbean	-7	73	4.1	2.3	2.3	2.5
Middle East and Central Asia	-2.6	4.3	5.6	2	3.4	3.7
Sub-Saharan Africa	-1.6	4.7	4	3.3	4	4.3

Source: International Monetary Fund (IMF).

Note: f = forecast.

Notably, these estimated growth rates fall below the historical average of 3.78 percent and 3.08 percent recorded for the period from 2000 to 2019 by IMF and World Bank, respectively (Figures 1A and 1B).

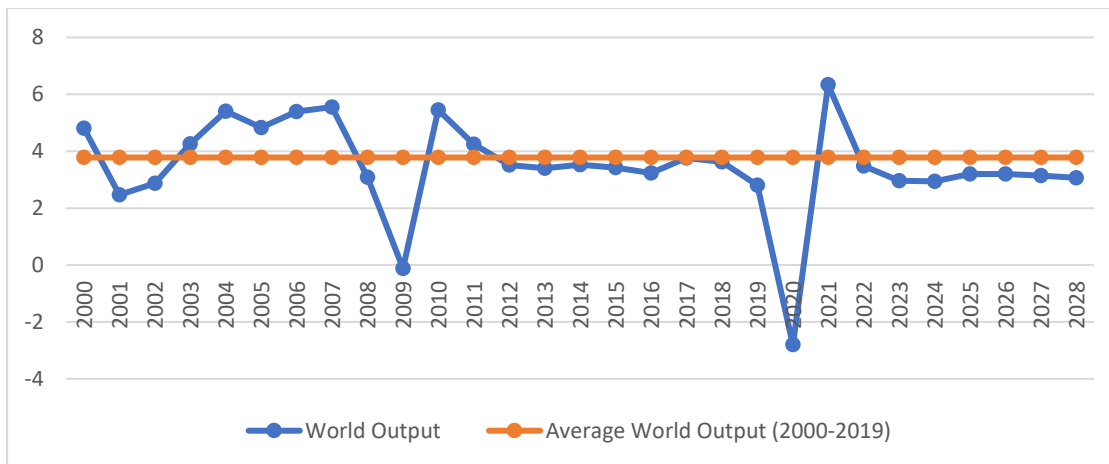
**Table 1.1B: Summary of World Output (Annual percent change) - World Bank**

	2020	2021	2022e	2023f	2024f	2025f
<b>World</b>	<b>-3.1</b>	<b>6.0</b>	<b>3.1</b>	<b>2.1</b>	<b>2.4</b>	<b>3.0</b>
<b>Advanced Economies</b>	<b>-4.3</b>	<b>5.4</b>	<b>2.6</b>	<b>0.7</b>	<b>1.2</b>	<b>2.2</b>
United States	-2.8	5.9	2.1	1.1	0.8	2.3
Euro area	-6.1	5.4	3.5	0.4	1.3	2.3
Japan	-4.3	2.2	1.0	0.8	0.7	0.6
Latin America and the Caribbean	-6.2	6.9	3.7	1.5	2.0	2.6
Middle East and North Africa	-3.8	3.8	5.9	2.2	3.3	3.0
South Asia	-4.1	8.3	6.0	5.9	5.1	6.4
Sub-Saharan Africa	-2.0	4.4	3.7	3.2	3.9	4.0

Source: World Bank.

Note: e = estimate (actual data for commodity prices); f = forecast.

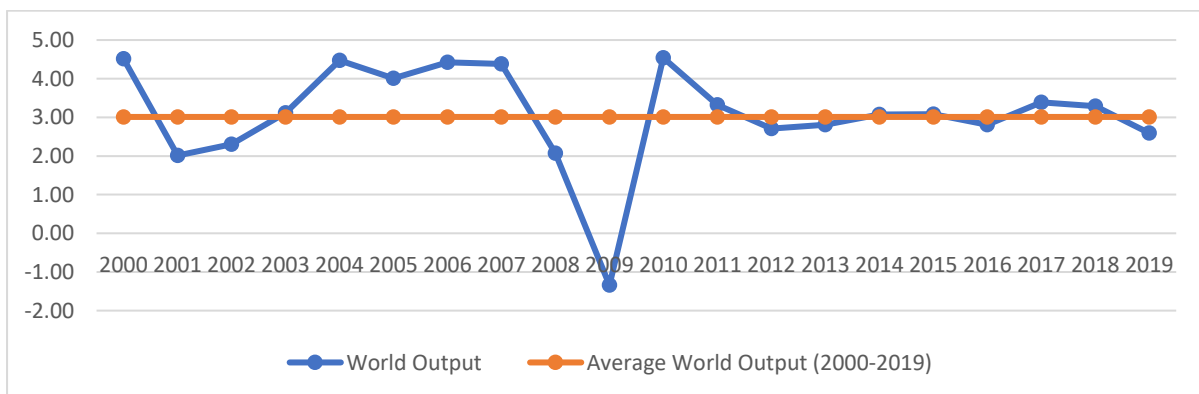
**Figure 1A: World Output (Annual percent change) - 2000-2019 by International Monetary Fund**



Source: International Monetary Fund (IMF).

Note: The growth rate from 2023 to 2028 is estimated by IMF.

**Figure 1B: World Output (Annual percent change) - 2000-2019 by World Bank**



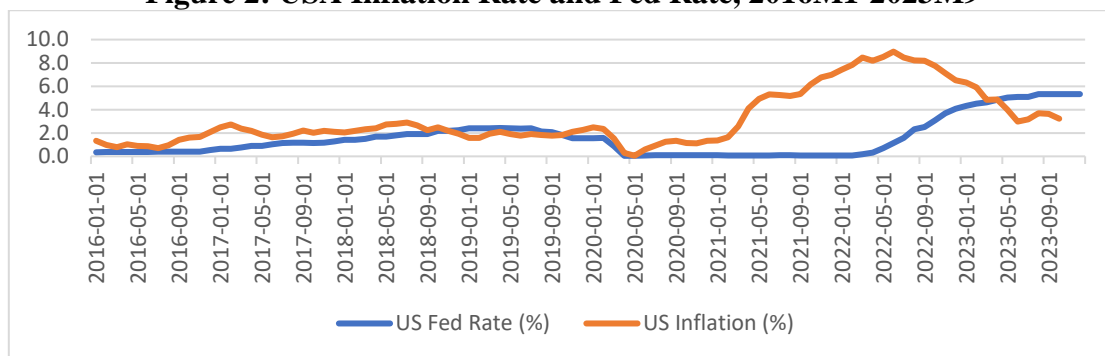
Source: World Bank.

These divergent forecasts underscore the prevailing uncertainties in the global economic landscape. While the IMF signals a moderation in growth, the World Bank takes a more cautious stance, emphasizing the potential headwinds and challenges that could impede economic expansion. This analysis delves into the multifaceted landscape shaped by the long-term consequences of the COVID-19 pandemic. However, the healing process is not solely influenced by the pandemic; rather, it is intertwined with a complex web of geopolitical issues. For example, the Russia-Ukraine War, the Israel-Palestine Conflict, tensions in the South China Sea and the Korean Peninsula, and the spectre of geo-economic fragmentation contribute to a landscape marked by uncertainties. These factors collectively pose hurdles to the recovery, necessitating a nuanced understanding of their implications for global economic stability. In this context, the report explores the interconnected dynamics of these challenges and underscores the importance of international cooperation to navigate the complexities and uncertainties that persist in the global economic landscape.

## 2.0 USA and China Economic Outlook

### 2.1.1 Inflation and Interest Rate in the United States of America

**Figure 2: USA Inflation Rate and Fed Rate, 2016M1-2023M9**



Source: Federal Reserve Bank of St. Louis, <https://fred.stlouisfed.org>

The Fed rate began at a low point in 2016 and gradually increased over the years (Figure 2). A significant drop was observed in early 2020 and subsequent to 2021, reaching near-zero levels in response to the economic effects of the COVID-19 pandemic. This drastic reduction aimed to stimulate economic activity and support financial markets during the pandemic-induced economic downturn.

From 2022 onward, there was a sharp increase in the Fed rate, reflecting the central bank's response to inflationary pressures and the broader goal of economic normalisation. This adjustment in the Fed rate indicates the Federal Reserve's commitment to managing inflation while transitioning the economy to a more sustainable and balanced state. The shift in the Fed rate serves as a key tool in the central bank's efforts to find a balance between fostering economic growth and upholding price stability.

Inflation remained relatively moderate from 2016 to early 2020, fluctuating within the target range set by the Federal Reserve. A notable drop in inflation occurred in mid-2020, reflecting the economic downturn caused by the pandemic. Post-2020, however, there was a significant uptick in inflation, reaching elevated levels in 2021 and peaking at around 9% in June 2022. Inflation rates remained elevated into 2023, indicating persistent inflationary pressures.

The upward trend of the Fed Rate from 2022 suggests a cautious approach by the Federal Reserve to manage inflation while supporting economic growth. The Federal Reserve continues to monitor and respond to economic conditions and inflationary pressure to achieve its dual mandate of price stability and maximum employment. However, it's worth noting that the Federal Reserve revealed its implicit intention to reduce the Fed Rate in early 2024. This strategic move may indicate a proactive stance aimed at addressing economic challenges and maintaining a balanced approach to monetary policy.

### 2.1.2 Prediction of Macroeconomic Statistics

**Table 2: US Economic Outlook and Forecast**

	2023Q3	2023Q4e	2024Q1e	2024Q2e	2024Q3e	2024Q4e
Real GDP	5.2	2	1.2	0.5	0.5	0.8
Real consumer spending	4	2.3	1.3	0.3	0.3	1.1
CORE PCE prices	2.3	2.1	2.4	2.4	2.4	2.3
Unemployment rate	3.7	3.8	4	4.1	4.3	4.4
Feds funds target	5.5	5.5	5.5	5.25	4.75	4.25

Source: Bureau of Economic Analysis, Bureau of Labour Statistics, Federal Reserve, J.P. Morgan forecasts. e=estimate.

#### Real GDP growth

A noticeable deceleration in US real GDP growth is estimated, decreasing from a robust 5.2% in 2023Q3 to 0.8% by 2024Q4 (Table 2). This downward trend signifies a significant shift from rapid economic expansion to a more moderate growth trajectory. The deceleration is attributed to factors such as the saturation of pent-up demand, global economic conditions, and adjustments to fiscal and monetary policies. Moreover, the initial strong rebound in the GDP growth rate and consumer spending can be attributed to the post-pandemic recovery. However, as the economy stabilises, growth rates are predicted to moderately expand.

#### Real Consumer Spending

Consumer spending growth follows a similar pattern as real GDP growth, slowing down from 4% in 2023Q3 to 1.1% in 2024Q4. The moderation in consumer spending suggests a more cautious approach by individuals, possibly influenced by factors such as higher inflation, increased interest rates, or elevated unemployment rates.

#### Core Prices

Core PCE prices remain relatively stable, hovering around 2.3% - 2.4% throughout the forecast period. While inflation is projected to persist. The stability in core prices suggests that it may not escalate into a significant concern. However, policymakers need to monitor and manage inflationary pressures and interest rates to maintain economic stability without stifling economic growth.

#### Unemployment Rate

The unemployment rate is expected to increase gradually from 3.7% in 2023Q3 to 4.4% in 2024Q4. The rise in the unemployment rate may indicate challenges in the labour market or a

natural adjustment phase. It could be influenced by factors such as technological disruptions, industry shifts, or adjustments to economic policies.

### Federal Funds Target Rate

The Federal Reserve is projected to reduce the federal funds target rate, from 5.5% in 2023Q3 to 4.25% in 2024Q4. The Federal Reserve’s decision to lower the federal funds target rate indicates a proactive approach to support economic activity by managing inflation expectations and stimulating economic activity.

### 2.2 China’s Economy

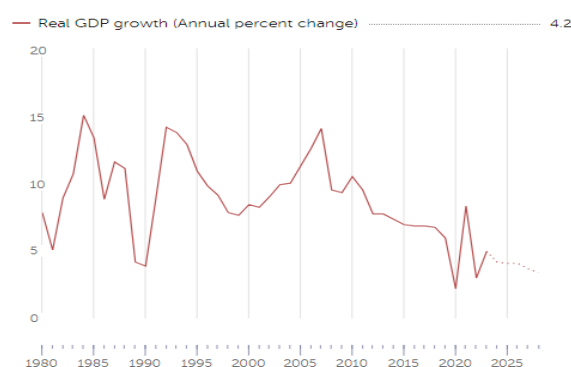
According to the report released by the World Bank (December 2023), economic activity in China has experienced a notable increase in 2023, however, the recovery remains fragile. It is predicted that real GDP growth suggests a rebound to 5.2 percent in the year 2023 (Table 3). Although growth momentum is expected to stabilise, the short-term outlook is clouded by ongoing weaknesses in the real estate sector and a persistently subdued external demand. China’s growth is estimated to decrease to 4.5 and 4.3 percent in 2024 and 2025, respectively. This prediction is not only considering the short-term headwinds but also acknowledges the increasing structural constraints to growth. These include elevated levels of unemployment rate, population ageing and a low population growth rate, and persistent economic imbalances (Table 3).

**Table 3: China Economic Outlook**

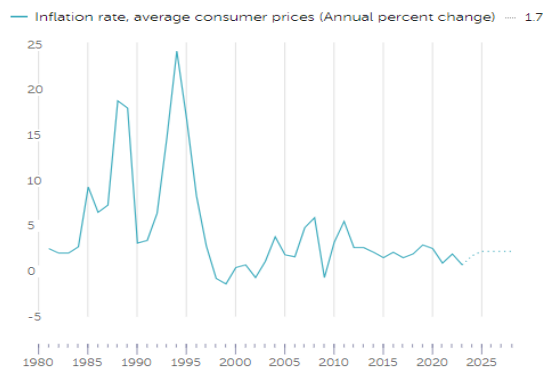
	2020	2021	2022	2023f	2024f	2025f
Real GDP growth (%)	2.2	8.4	3	5.2	4.5	4.3
Consumer Price Index (% change, average)	2.5	0.9	2	0.5	1.6	2.1
Current account balance (% of GDP)	1.7	2	2.2	1.5	0.7	0.3
Consolidated fiscal balance (% of GDP)	-8.5	-4	-6.4	-6.5	-6.4	-4.2

Source: World Economic Outlook, October 2023, International Monetary Fund (IMF).

**Figure 3A: Real GDP Growth Rate**

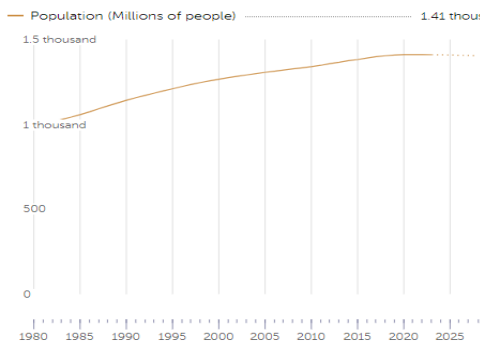


**Figure 3B: Inflation Rate**

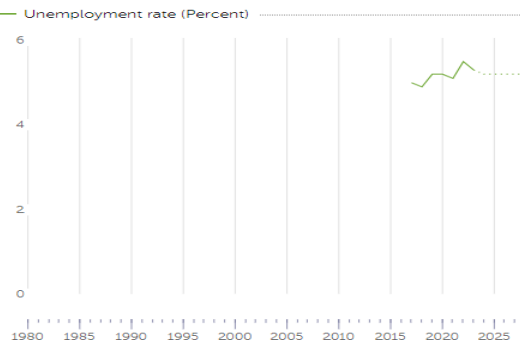


Source: International Monetary Fund (IMF) Data Mapper, October 2023.

**Figure 3C: Population**



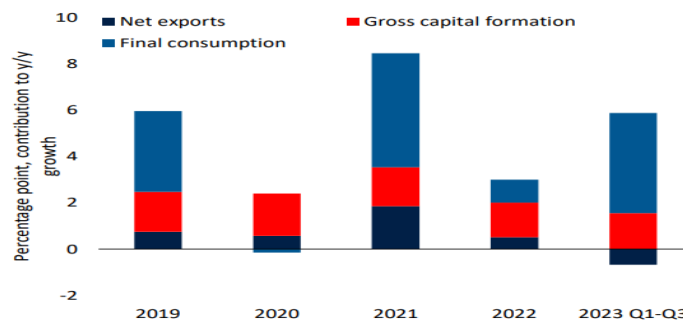
**Figure 3D: Unemployment Rate**



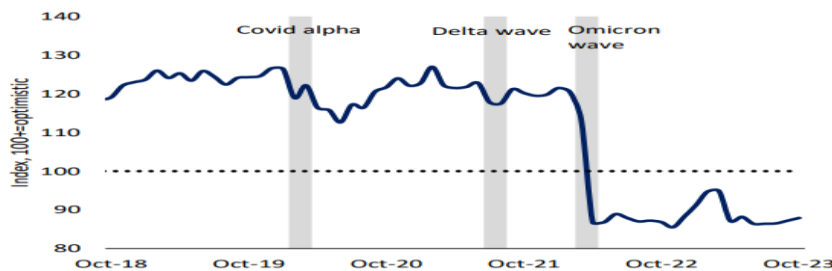
Source: World Bank (2023)

Looking at Figure 4A, for example, it is found that the GDP growth of China is supported by its consumption compared to exports and gross capital. However, the recovery from the pandemic appears to be fragile, as indicated by a weakened consumer confidence index, resulting from a few factors such as pandemic resurgence, inflation concerns, employment challenges, global economic conditions, trade tensions, and geopolitical events (Figure 4B). When confidence is low, consumers are likely to be more cautious in their spending, which can retard economic growth. Hence, businesses should adapt their strategies to capitalise on consumer demand, especially in sectors like retail, e-commerce, luxury goods, and services. Indeed, in the first three quarters of 2023, imports of goods and services are more than the exports of goods and services which causes a deficit in the trade balance.

**Figure 4A: GDP Demand Components of China**



**Figure 4B: Consumer Confidence Index**



Sources: Haver Analytics; and IMF staff calculations. Cited from IMF, World Economic Outlook, October 2023.

### Size of Top Income Bands and Middle-Class Expansion

China is projected to increase the size of its top income bands by approximately 200 million people during the course of this decade (InterChina, 2023). This significant expansion indicates a growing affluent consumer base, presenting opportunities for businesses targeting higher-income demographics. China already boasts a substantial upper-middle-class and above segment, comprising 270 million people, including 6 million USD millionaires. The projection indicates a significant expansion, with this number expected to grow to 470 million by 2030. This growth signifies the increasing purchasing power and consumption potential of the middle and upper classes.

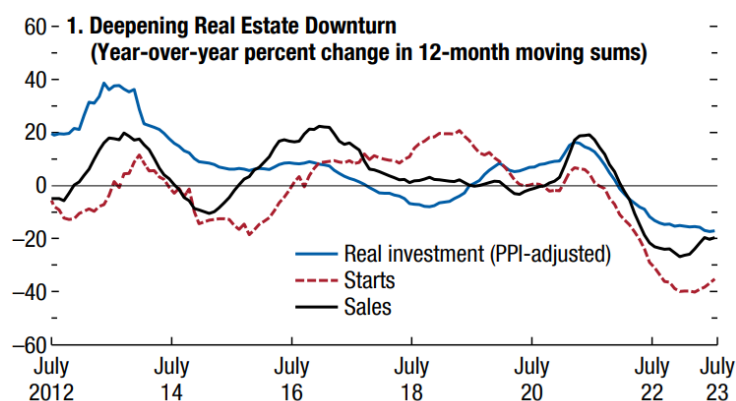
The expansion of top-income bands and the significant growth in the middle class present vast business opportunities. Companies that cater to the preferences and demands of affluent and middle-class consumers are likely to thrive in the Chinese market.

### China’s Real Estate Market

As depicted in Figure 5, several indicators, including real investment, new housing projects, and housing sales, point to weaknesses in the property sector in China. This crisis is emerging as a pivotal factor hampering overall economic growth. For example, Country Garden, the largest property developer in China and a significant recipient of government support, is currently experiencing pronounced liquidity challenges. In China, the pandemic-induced deceleration in 2022, coupled with the crisis in the property sector, has led to substantial output losses of approximately 4.2 percent compared to pre-pandemic projections (InterChina, 2023).

Property developers, in general, are grappling with significant funding constraints, which hinder their ability to complete presold homes. This, in turn, has a cascading effect on home buyer confidence, exacerbating the downturn in the property sector. The challenges faced by major players like Country Garden underscore the broader concerns within the Chinese property market, indicating a complex and challenging situation that requires careful attention and strategic intervention.

**Figure 5: China’s Real Estate Market Losing Momentum**



Sources: Haver Analytics; and IMF staff calculations. Cited from IMF, World Economic Outlook, October 2023.

### **Urbanisation Impact**

Urbanisation in China is a pivotal driver of economic development. With urbanisation standing at 65% in 2022 and projected to peak at 82% in 2045, the country is set to experience two more decades of significant internal migration (InterChina, 2023). This migration, particularly from rural to urban areas, will expand the urban workforce and contribute to the growth of consumer markets. Businesses should strategically position themselves in urban centres, particularly smaller cities connected to city clusters, to leverage the growing urban workforce and expand consumer markets. Understanding regional preferences and trends will be key to success.

### **Population Trends**

China's total population has peaked at approximately 1.4 billion and is expected to decline in the coming years. The low birth rate in China is leading the country towards an ageing society, similar to the demographic trajectory experienced by Japan (InterChina, 2023). Businesses should consider the implications of an ageing population, adjusting product and service offerings to meet the needs of an older demographic. Healthcare, retirement planning, and leisure industries targeting seniors may see increased demand.

### **Long-Term Economic Development: 2035 and 2049 Targets**

China has set ambitious long-term economic development targets for 2035 and 2049. To achieve these goals, the emphasis will be on driving growth through consumption. The government is likely to transfer a higher share of national income to households over time, aligning to foster a consumer-driven economy. Even with lower GDP growth rates of 4%-5%, China's annual growth increment is expected to surpass that of any other country in the world. This highlights the country's substantial economic influence and resilience (InterChina, 2023).

In conclusion, China's market dynamics present a mix of opportunities and challenges, with a growing affluent class, urbanisation trends, and demographic shifts shaping the economic landscape. Strategic planning and adaptability will be crucial for businesses aiming to thrive in this evolving market.

## **3.0 Overall Economic Development in Malaysia**

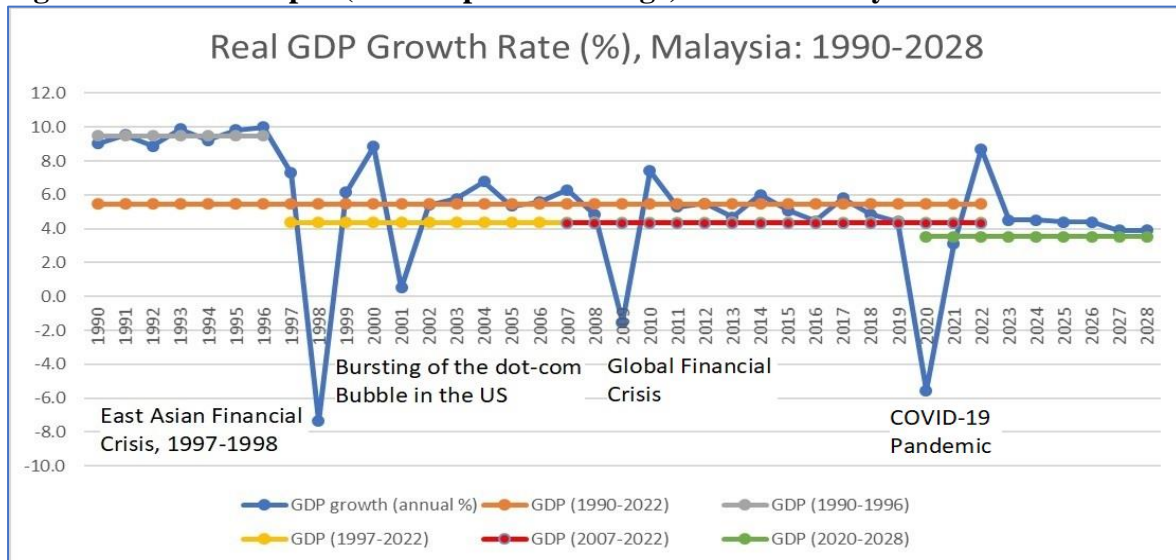
### **3.1 The Pattern of Economic Growth**

The year 2024 dawns upon Malaysia with a cautiously optimistic outlook. After navigating the headwinds of a global slowdown in 2023, the Malaysian economy is poised for moderate growth, projected to range between 4.3% and 5.5% by various institutions like the International Monetary Fund (IMF), World Bank, RAM Ratings, and the Ministry of Finance, Malaysia.

Malaysia's economic development in 2024 is poised to navigate a path influenced by domestic and international factors. With a legacy of robust economic fundamentals, the nation continues to recalibrate its growth strategies in the face of evolving global dynamics. Key sectors, including manufacturing, services, and technology, are expected to play pivotal roles in steering the economy forward.

The analysis of Malaysia's GDP growth rate spanning from 1990 to 2022 and/or 2028 reveals several noteworthy trends and patterns (Figure 6), with implications for the country's economic trajectory as follows.

**Figure 6: World Output (Annual percent change) - 2000-2019 by World Bank**



Source: World Development Indicators, World Bank.

### Golden Period of Growth (1990-2006)

The observation of a sustained period of peak economic growth from 1990 to 1996, devoid of major crises, is indicative of the success of Malaysia’s globalisation policies during this era. The average growth rate is recorded at 9.5 percent.

### Long-Term Growth Benchmark

The calculation of the average growth rate at 5.5 percent from 1990 to 2022 provides a useful benchmark for assessing the long-term growth trajectory of the country. This figure serves as a reference point for evaluating the success of economic policies and initiatives aimed at sustaining growth over extended periods.

### Impact of External Crises

The identification of four major external crises – the East Asian Financial Crisis (1997-1998), the Dot-com Bubble Burst (2001), the Global Financial Crisis (2007-2008), and the COVID-19 Pandemic (2019-2020) - underscores the vulnerability of Malaysia’s economy to external shocks.

### Post-Crisis Growth Challenges and Economic Recovery

The revelation that GDP growth rates tend to dip below pre-crisis levels after major external shocks is a critical insight. The subsequent decline in average growth rates post-East Asian Financial Crisis (4.4 percent, 1997-2022), Global Financial Crisis (4.3 percent, 2007-2022), and COVID-19 Pandemic (2.1 percent, 2020-2022) underscores the challenges faced by Malaysia in recovering from such downturns.

The declining trend in growth rates post-crisis, coupled with the indication that the Malaysian economy is still grappling with the economic recovery stage, suggests persistent challenges in achieving robust and sustained growth. This suggests that the Malaysian growth rate is declining following significant external crises and continues to face challenges in the economic recovery stage.

### World Bank’s Growth Projections with the Diminishing Growth Rate

The World Bank’s estimate of a 4.5 percent growth rate in 2023 and 2024, followed by a declining pattern to 3.9 percent in 2028, raises concerns about the overall economic outlook. A critical examination of the factors influencing the World Bank’s projections, such as global economic trends, domestic policy dynamics, and externalities, would provide a more nuanced understanding of the forecast.

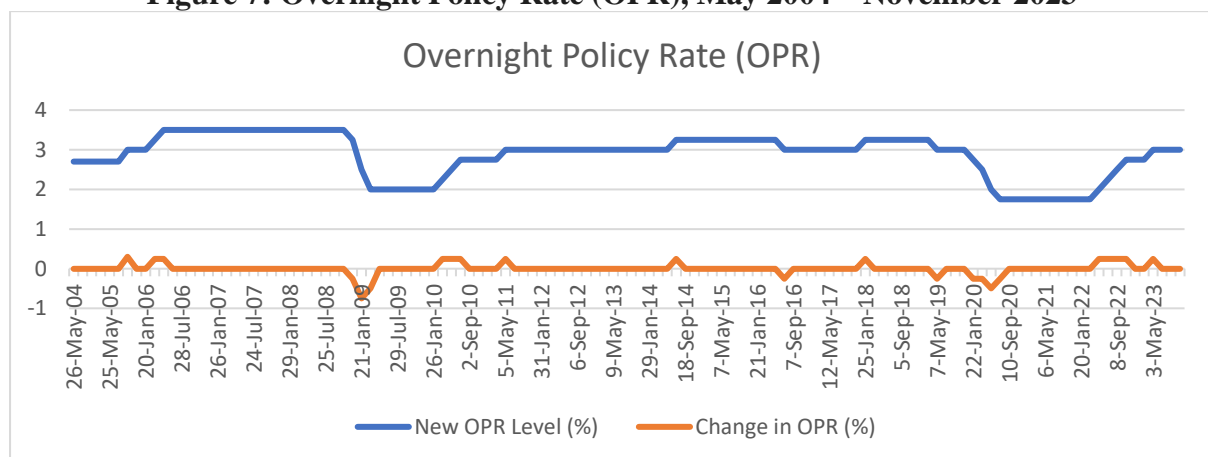
### 3.2 Domestic Drivers

#### 3.2.1 Overnight Policy Rate (OPR)

As shown in Figure 7, the OPR remained stable at 2.7% from May 2004 to November 2005. A notable increase to 3% occurred in November 2005, signalling a change in monetary policy. Subsequently, the OPR underwent several adjustments, reaching a peak of 3.5% in April 2006. The rise in interest rates aimed to cool down an overheating economy, prevent asset bubbles, and curb excessive risk-taking in the financial sector. However, from October 2008 to February 2009, a series of reductions in the OPR (from 3.5 percent to 2.0 percent) reflected a response to economic challenges during the Global Financial Crisis, stimulating economic activity and mitigating the crisis’s impact.

Similarly, an OPR reduction occurred from January 2020 (2.75 percent) to July 2020, with the OPR reaching its lowest point of 1.75% amid the COVID-19 pandemic, followed by subsequent stability. Despite the OPR’s increase from 2 percent in May 2022 to 3 percent in May 2023 and persisting at the same rate, the increase is mainly due to adjustments aligning with a series of Federal Reserve rate hikes by the United States. This was aimed at curbing extremely high inflation, even though it led to a period of economic contraction. Consequently, the Bank Negara Malaysia (BNM) raised interest rates to stabilise the exchange rate, enhance export competitiveness, and minimise foreign capital outflows or attract more foreign capital inflows.

**Figure 7: Overnight Policy Rate (OPR), May 2004 – November 2023**



Source: Bank Negara Malaysia (BNM), Malaysia.

Considering the current economic growth, inflation, and monetary policy goals internally, as well as the U.S. Federal Reserve’s intention to further reduce its Fed rate, it is predicted that BNM will maintain the current OPR of 3 percent in the first quarter of 2024 and may decrease it by 25 to 50 percentage points if the U.S. Federal Reserve lowers its rate. Lowering the OPR

is crucial for the central bank to stimulate economic activities, especially borrowing and spending in the financial market. This, in turn, will encourage investment, consumption, and overall economic growth.

### 3.2.2 International Reserves

The trend in gross international reserves reveals a consistent increase from 1990 to November 2023, indicating a positive accumulation of reserves in Malaysia (Table 4). The substantial growth from RM27,044.8 million in 1990 to RM527,156.8 million in November 2023 reflects a proactive approach to building reserves. This robust increase is a positive sign of the country's capacity to meet external obligations and withstand economic shocks.

It is noteworthy that the gold and foreign exchange category exhibits a steady rise, aligning with the overall growth in gross international reserves. This category constitutes more than 93 percent of the total international reserves. The stability in asset values within this category serves the purpose of diversifying reserves and mitigating risks associated with currency fluctuations. Contrastingly, the percentage of external liabilities to international reserves fluctuates but generally remains below 1% over the observed period. This suggests that, on the whole, the country's reserves are sufficient to cover its external liabilities.

**Table 4: International Reserves (RM million)**

	Gross international reserves	Gold and foreign exchange		External liabilities		Net international reserves
1990	27,044.8	25,886.2	95.72%	19.7	0.07%	27,025.1
1995	63,796.1	61,681.8	96.69%	26.6	0.04%	63,769.5
2000	109,090.5	105,360.9	96.58%	23.7	0.02%	109,066.8
2005	265,262.7	263,328.0	99.27%	22.5	0.01%	265,240.2
2010	328,670.5	320,774.4	97.60%	21.4	0.01%	328,649.1
2015	409,126.0	398,178.3	97.32%	30.2	0.01%	409,095.8
2016	423,930.2	415,506.4	98.01%	55.9	0.01%	423,874.3
2017	414,651.2	406,797.9	98.11%	59.8	0.01%	414,591.4
2018	419,572.1	411,042.4	97.97%	60.6	0.01%	419,511.5
2019	424,089.5	414,843.8	97.82%	57.2	0.01%	424,032.3
2020	432,373.8	421,775.2	97.55%	61.1	0.01%	432,312.6
2021	486,848.4	455,789.0	93.62%	58.2	0.01%	486,790.2
2022	503,330.7	471,957.1	93.77%	58.3	0.01%	503,272.5
2023 Nov	527,156.8	494,146.2	93.74%	62.4	0.01%	527,094.4

Source: Bank Negara Malaysia (BNM), Malaysia.

### 3.2.3 International Reserves, Imports and Short-term External Debt

The data provided in Table 5 reports two indicators for assessing the stability of the country's international reserve position, namely the International Reserve to Imports of Goods and Services Ratio (months) and the International Reserve to Short-term External Debt Ratio (time). The trend in the International Reserve to Imports of Goods and Services Ratio shows a relatively stable situation from October 2017 to October 2022, fluctuating between 5.1 and 8.4 months (in other words, the international reserves are sufficient to finance 5.1 and 8.4 months

of retained imports). The significant drop from 8.1 months in October 2021 to 5.1 months in October 2022 raises serious concerns. A substantial reduction in this ratio may signal increased vulnerability to external shocks and potential challenges in covering import costs resulting from the exchange rate fluctuation (or depreciation), external shocks, and/or changes in global economic conditions.

**Table 5: International Reserves to Imports and Short-term External Debt Ratios**

	<b>International Reserve to Imports of Goods and Services Ratio (months)</b>	<b>International Reserve to Short-term External Debt Ratio (time)</b>
Oct-17	7.6	1.1
Oct-18	7.5	1.0
Oct-19	7.6	1.1
Oct-20	8.4	1.2
Oct-21	8.1	1.2
Oct-22	5.1	1.0
Oct-23	5.3	1.0

Source: Quarterly Bulletin, Bank Negara Malaysia

On the other hand, the International Reserve to Short-term External Debt Ratio appears relatively consistent from 2017 to 2023, moving between 1.0 and 1.2. A ratio above 1.0 indicates that the international reserves are sufficient to cover its short-term external debt obligations. Despite the decline in the International Reserve to Imports of Goods and Services Ratio in October 2022, the Short-term External Debt Ratio remains steady at 1.0. This could be a positive sign, indicating that short-term debt obligations are still manageable.

The statistics show a potential vulnerability in the country's external position, as evidenced by the significant drop in the International Reserve to Imports of Goods and Services Ratio in October 2022. Policymakers should closely monitor and identify the factors contributing to the significant drop to ensure economic resilience. The stability in the International Reserve to Short-term External Debt Ratio is a positive sign but warrants continued scrutiny, especially considering the external challenges posed by the declining reserves.

### 3.2.4 The Fluctuation of Exchange rate between Malaysia and its Major Trading Partners

Tables 6A and 6B present descriptive statistics for currency fluctuations between the Malaysian Ringgit and its major trading partners during two distinct periods: February 2017 to December 2019 (Pre-COVID-19 Period) and January 2020 to December 2023 (During and Post COVID-19 Periods).

**Table 6A: The Fluctuation of Exchange Rate between Malaysia and its Major Trading Partners: Feb 2017-Dec 2019 (Pre-COVID-19 Period) (month change, percent)**

	<b>USD</b>	<b>GBP</b>	<b>EUR</b>	<b>JPY100</b>	<b>CNY</b>	<b>SGD</b>	<b>THB100</b>
Mean	-0.22	-0.07	-0.08	-0.08	-0.26	-0.07	0.26
Median	-0.14	-0.25	-0.22	-0.27	-0.16	-0.07	0.16
Standard Deviation	1.38	1.67	1.32	1.64	1.10	0.96	1.41
Skewness	-0.55	0.33	0.28	0.54	-0.48	-0.52	0.22

Range	5.73	8.82	4.84	7.56	4.99	4.06	5.63
Observations (months)	34	34	34	34	34	34	34

	<b>PHP100</b>	<b>IDR100</b>	<b>BND</b>	<b>VND100</b>	<b>KHR100</b>	<b>MMK100</b>
Mean	-0.27	-0.33	-0.07	-0.29	-0.27	-0.47
Median	-0.34	-0.34	-0.11	-0.26	-0.14	-0.22
Standard Deviation	1.65	1.69	1.07	1.26	1.47	1.58
Skewness	-1.24	1.96	-0.48	-0.42	-0.39	-1.11
Range	9.25	9.75	4.48	5.62	5.38	8.09
Observations (months)	34	34	34	34	34	34

Source: Bank Negara Malaysia.

Notes:

1. USD: United States Dollar; GBP: British Pound Sterling; EUR: Euro; JPY100: 100 Japanese Yen, CNY: Chinese Yuan Renminbi; SGD: Singapore Dollar; THB100: 100 Thai Baht; PHP100: 100 Philippine Pesos; IDR100: 100 Indonesian Rupiah; BND: Brunei Dollar; VND100: 100 Vietnamese Dong; KHR100: 100 Cambodian Riel; MMK100: 100 Myanmar Kyat.
2. Positive (Negative) values indicate an increase (decrease) in the exchange rate. This means that a positive value indicates a depreciation of ringgit Malaysia against foreign currency.

Referring to Table 6A, it is noteworthy that, on average, most foreign currencies (except the Thai Baht) experienced depreciation against the Malaysian Ringgit in the pre-pandemic period. Notably, the USD, GBP, EUR, JPY, CNY, SGD, THB, and VND exhibited relatively high standard deviations, indicating a higher risk of fluctuation or volatility in their exchange rates against the ringgit. This heightened volatility is further underscored by the negative skewness observed in the majority of foreign currencies. This suggests that there were periods during which these currencies significantly depreciated against the ringgit, potentially influenced by economic or geopolitical events such as robust exports, substantial capital inflows, and other relevant factors.

Surprisingly, there has been a significant shift in the appreciation behaviour of the Malaysian Ringgit against other foreign currencies from 2020 onwards (during and post-COVID-19 Periods), as highlighted in Table 6B. Notably, except for three currencies (JPY, THB, and MMK), the mean values of most currencies now exhibit a positive sign, signalling an appreciation of these currencies against the Malaysian Ringgit. The most notable average appreciation against the ringgit is observed for the Brunei Dollar (BND) and the Singapore Dollar (SGD), followed closely by the US Dollar (USD). This shift in trend suggests a noteworthy alteration in the dynamics of currency relationships.

This change in appreciation dynamics during and post the COVID-19 pandemic periods can be attributed to several influential factors. These include a low GDP growth rate, interest rate differentials favouring the United States over Malaysia leading to substantial foreign capital outflows, political uncertainty, and the prevailing weak global economic conditions. These factors collectively contribute to the observed significant depreciation of the Malaysian Ringgit against a majority of foreign currencies during this time frame.

**Table 6B: The Fluctuation of Exchange Rate between Malaysia and its Major Trading Partners: Jan 2020 - Dec 2023 (During and Post COVID-19 Periods) (month change, percent)**

	USD	GBP	EUR	JPY100	CNY	SGD	THB100
Mean	0.26	0.20	0.22	-0.29	0.20	0.29	-0.03
Median	0.52	0.36	-0.26	-0.19	0.27	0.18	0.33
Standard Deviation	2.05	2.04	1.73	2.08	1.25	1.12	1.68
Skewness	-0.24	0.22	0.35	-0.20	-0.42	0.09	-0.48
Range	11.28	8.89	6.07	9.48	6.27	6.11	6.96
Observations (months)	48	48	48	48	48	48	48

	PHP100	IDR100	BND	VND100	KHR100	MMK100
Mean	0.07	0.06	0.29	0.15	0.25	-0.43
Median	-0.04	0.34	0.14	0.00	0.19	0.40
Standard Deviation	1.71	2.75	1.12	1.84	2.12	3.48
Skewness	-0.01	-0.61	0.11	-0.34	0.42	-1.04
Range	8.00	19.67	6.12	9.11	12.66	16.92
Observations (months)	48	48	48	48	48	48

Source: Bank Negara Malaysia.

Notes:

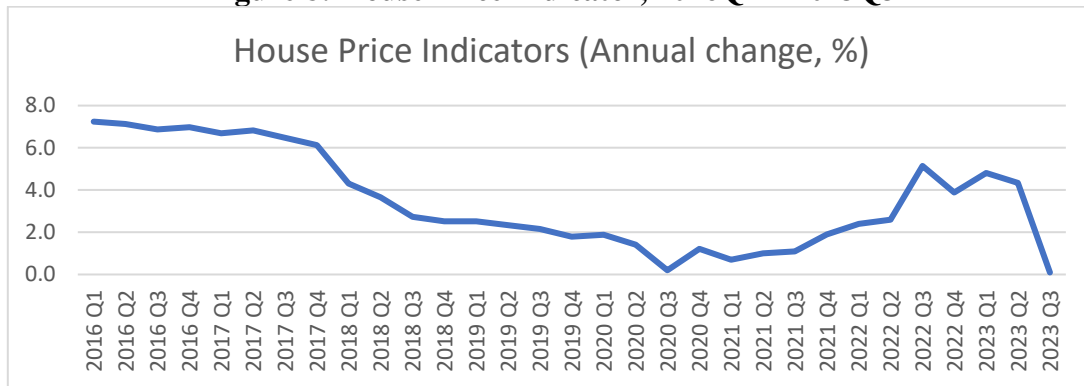
1. USD: United States Dollar; GBP: British Pound Sterling; EUR: Euro; JPY100: 100 Japanese Yen, CNY: Chinese Yuan Renminbi; SGD: Singapore Dollar; THB100: 100 Thai Baht; PHP100: 100 Philippine Pesos; IDR100: 100 Indonesian Rupiah; BND: Brunei Dollar; VND100: 100 Vietnamese Dong; KHR100: 100 Cambodian Riel; MMK100: 100 Myanmar Kyat.
2. Positive (Negative) values indicate an increase (decrease) in the exchange rate. This means that a positive value indicates a depreciation of ringgit Malaysia against foreign currency.

### 3.2.5 Property Market

Figure 8 exhibits the House Price Indicators (quarterly change) from 2016 Q1 to 2023 Q3 in the property market. The indicator has shown fluctuations over the years, showing a dynamic housing market development and changes. There is a general declining trend in house price indicators from 2016 to 2020, with a significant decrease in 2018 and 2019, resulting from the economic uncertainties and disruptions although it is happening before the COVID-19 pandemic. There is an uncommon drop in house prices in 2023Q3 (0.1%). This anomaly could be influenced by specific market conditions, policy changes, or other external factors, such as weak market demand, relatively high-interest rates, consumer confidence or other market stimuli.

The main challenge to consumer confidence is heavily influenced by the situation in the property sector. Some reforms in the property market are already in place, and the possibility of a stimulus package for entry-level houses is on the horizon. Hence, the recovery speed of the property markets from the pandemic remains fragile and uncertain.

**Figure 8: House Price Indicator, 2016Q1 – 2023Q3**



Source: Department of Valuation and Property Services, National Property Information Centre (NAPIC), Bank Negara Malaysia.

### 3.2.6 Money Supply and Financial Stability

Table 7 provides statistics on the aggregate money supply (M1, M2, M3), their growth rates, and the ratios between M1/M3 and M2/M3 for the period of 2013-November 2023. Over the years, there has been a general upward trend in the money supply, reflecting economic expansion. Growth rates for M1, M2, and M3 are consistently positive from 2014 to 2023 (Jan-Nov), indicating an overall expansion of the money supply and an increase in liquidity in the financial system within the range of 4%-6% except in both 2020 (15.71%) and 2021 (10.43) due to the COVID-19 pandemic. The M1/M3 ratio ranges from approximately 22% to 27%, suggesting a relatively stable proportion of liquid assets (M1) to the total money supply (M3). On the other hand, the M2/M3 ratio remains constant at approximately 98%-99% over the period, indicating a stable monetary environment and a well-functioning financial system with a proportionate distribution of liquid and near-money assets. It also suggests a more balanced composition of liquid assets within the broader money supply and a precautionary approach taken by the Central Bank of Malaysia in monitoring the stability of the financial market.

While the growth rates are positive and decreasing from 2022, it's essential to consider the broader economic context, inflationary pressures, interest rate, exchange rate and other factors influencing the money supply. While it is predicted that the stability of the financial system and market will continue and grow healthily in 2024, a comprehensive analysis should involve comparing them to the challenging economic context (nationally and internationally) and examining other relevant indicators for the simultaneous analysis.

**Table 7: Monetary Aggregates: M1, M2 and M3 and Their Growth Rate**

	RM Million			Growth Rate (%)			Percentage	
	M1	M2	M3	M1	M2	M3	M1/M3 Ratio	M1-M3 Ratio
2013	327,596.0	1,436,451.9	1,452,317.1	-	-	-	22.56	98.91
2014	346,415.9	1,544,160.0	1,557,612.3	5.74	7.50	7.25	22.24	99.14
2015	360,502.9	1,595,853.8	1,603,938.0	4.07	3.35	2.97	22.48	99.50
2016	380,860.6	1,647,269.5	1,655,225.0	5.65	3.22	3.20	23.01	99.52
2017	422,820.0	1,730,466.1	1,736,444.7	11.02	5.05	4.91	24.35	99.66
2018	427,720.5	1,885,094.2	1,894,517.2	1.16	8.94	9.10	22.58	99.50
2019	452,559.5	1,950,567.9	1,961,553.9	5.81	3.47	3.54	23.07	99.44
2020	523,662.9	2,037,481.1	2,040,993.9	15.71	4.46	4.05	25.66	99.83

2021	578,301.9	2,165,807.0	2,171,798.7	10.43	6.30	6.41	26.63	99.72
2022	602,972.1	2,258,295.0	2,265,666.8	4.27	4.27	4.32	26.61	99.67
2023 Nov	624,652.1	2,351,567.6	2,361,524.1	3.60	4.13	4.23	26.45	99.58

Source: Monthly Statistical Bulletin, Bank Negara Malaysia.

M1: Currency, demand deposits, and other liquid assets.

M2: M1 + savings accounts, time deposits, and other near-money assets.

M3: M2 + large time deposits, institutional money market funds, and other larger liquid assets.

M1/M3 Ratio: The ratio of M1 to M3, indicates the proportion of liquid assets to the total money supply.

M2/M3 Ratio: The ratio of M2 to M3, represents the broader money supply relative to the total.

### 3.2.7 Federal Government Debt: Classification by Currency and Remaining Maturity

Tables 8A to C present the federal government debt by currency and remaining maturity from 2016 to 2023Q3. The total federal government debt has consistently increased from 2016 to Q3 2023, reaching RM 1,156 billion. The primary denomination is in ringgit Malaysia (domestic debt), with USD being the second most significant currency. Although there are fluctuations, the overall pattern shows a rise in debt across all currency denominations. Looking at the growth rates of the federal government debt, it is found that double-digit growth rates in total debt started from 2020 onwards, which demonstrates a substantial increase in debts. However, most of the debts (domestic and foreign debts) have a long-term debt structure, which has a maturity period of more than 5 years.

The burgeoning national debt poses significant challenges and economic implications for the Malaysian government. With a determined objective to trim the budget deficit to 3.5% of GDP by 2025, however, achieving this target appears formidable in light of the economic circumstances in 2014. Even though more than 95% of the debts are incurred domestically, which significantly reduces the bankruptcy risk, high-interest payments can exert a significant financial burden on the government's budget, potentially limiting resources available for other essential services and investments. In addition, increased debt service costs may lead to a 'crowding out' effect, where government spending on interest payments reduces funds available for productive investments in some fundamental infrastructures. It is crucial to monitor debt management strategies and ensure they align with economic goals and sustainability targets, especially considering the expected increase in total debt due to the growth rate of the economy in 2024.

**Table 8A: Federal Government Debt: Classification by Currency and Remaining Maturity (RM million)**

RM million equivalent	RM	USD	Yen	Others	Total
2016	624,822 (96.35%)	17,389 (2.68%)	5,909 (0.91%)	356	648,475
2017	665,572 (96.90%)	15,686 (2.28%)	5,286 (0.77%)	293	686,837
2018	719,545 (97.10%)	15,974 (2.16%)	5,286 (0.71%)	243	741,049
2019	764,233 (96.37%)	15,777 (1.99%)	12,794 (1.61%)	194	792,998
2020	851,284 (96.79%)	15,280 (1.74%)	12,840 (1.46%)	156	879,560
2021	950,084 (96.97%)	17,923 (1.83%)	11,689 (1.19%)	118	979,814

2022	1,050,078 (97.27%)	18,891 (1.75%)	10,537 (0.98%)	85	1,079,591
2023Q3	1,126,658 (97.41%)	20,203 (1.75%)	9,736 (0.84%)	72	1,156,668

Source: Monthly Statistical Bulletin, Bank Negara Malaysia.

Figures in parentheses indicate the proportion of debt relative to various currencies.  
The total debt shown excludes the debt guaranteed by the federal government.

**Table 8B: Federal Government Debt: Classification by Currency and Remaining Maturity (Growth Rate (%))**

	<i>RM</i>	<i>USD</i>	<i>Yen</i>	<i>Others</i>	<i>Total</i>
2016	2.59	12.59	5.30	-15.68	2.84
2017	6.52	-9.80	-10.54	-17.52	5.92
2018	8.11	1.84	0.00	-17.06	7.89
2019	6.21	-1.24	142.04	-20.30	7.01
2020	11.39	-3.15	0.36	-19.59	10.92
2021	11.61	17.30	-8.96	-24.36	11.40
2022	10.52	5.40	-9.86	-27.97	10.18
2023Q3	7.29	6.94	-7.60	-15.75	7.14

Source: Monthly Statistical Bulletin, Bank Negara Malaysia.

**Table 8C: Outstanding Federal Government Debt by Remaining Maturity (RM million) as of 2023 Quarter 3**

	<b>Total</b>	<b>Up to 1 year</b>	<b>&gt;1 - 3 years</b>	<b>&gt;3 - 5 years</b>	<b>&gt;5 years</b>
RM-denominated	1,126,658	118,520	180,416	166,570	661,152
Foreign-currency	30,010	236	9,653	403	19,718
Jumlah/Total	1,156,668	118,756	190,069	166,973	680,870

Source: Monthly Statistical Bulletin, Bank Negara Malaysia.

#### 4.0 Malaysia Business Forecast 2024: Malaysian Economic Outlook through Expenditure Components

The national income identity, expressed as  $GDP = C + I + G + EX - IM$ , provides a comprehensive framework for understanding the dynamics of the Malaysian economy through its expenditure components, where:

GDP = Gross domestic product (national output)

C = Private sector consumption

I = Investment

G = Public sector consumption

EX = Exports

IM = Imports

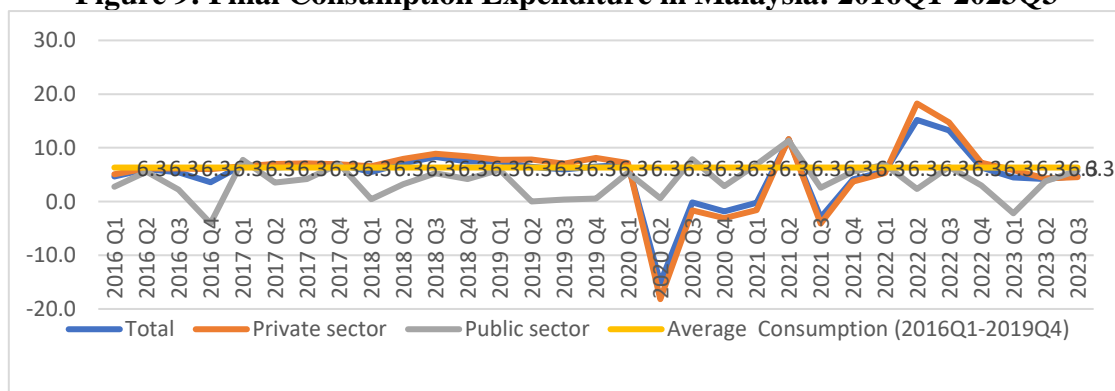
##### 4.1 Final Consumption Expenditure

Figure 9 illustrates the quarterly consumption trends for total, private sector, and public sector consumption spanning from 2016Q1 to 2023Q3. Total consumption exhibits fluctuating

patterns across quarters, marked by periods of robust growth (2016Q2, 2018Q3, 2022Q2) and contractions in 2020Q2 during the COVID-19 pandemic. The sharp contractions in 2020Q2, followed by a partial recovery in Q3, underscore the immediate and severe impact of the pandemic on consumption patterns. Subsequent quarters in 2020 demonstrate a gradual rebound, indicating the resilience and adaptability of the economy. However, a dip in 2023Q1 raises questions about the sustainability of the recovery resulting from consumption contributions. It is observed that the overall consumption growth level significantly decreases after 2022Q4.

The private sector has consistently outpaced the public sector in growth, except for the pandemic period from 2020Q1 to 2022Q1. This pattern underscores the significant role played by private consumption in driving economic expansion. The dominance of private sector consumption is notable in the pre-pandemic period. However, there has been a reverse change observed from 2020 Q1 onwards. The public sector consumption generally lags behind private consumption, partly due to government budget constraints. However, it is crucial to note that during the pandemic, the public sector played a pivotal role in stimulating economic growth, demonstrating an average growth rate of 5 percent for the period spanning from 2020Q1 to 2022Q4.

**Figure 9: Final Consumption Expenditure in Malaysia: 2016Q1-2023Q3**



Source: Bank Negara Malaysia, Monthly Statistical Bulletin.

The consistently averaged consumption of 6.3 over the period from 2016 Q1 to 2019 Q4 suggests a certain degree of stability in overall consumption during this pre-pandemic period. However, it is noteworthy that the average growth rates (2020Q1-2023Q3) differ between the private and public sectors, with figures of 3.6% and 4.6%, respectively. This discrepancy indicates that the role of the private sector as compared to the public sector in contributing to GDP has been diminishing from 2020 Q1 onwards. It suggests that the consumption levels have not fully recovered to their pre-pandemic levels. Despite signs of a rebound in certain quarters, the persistent effects of the COVID-19 pandemic are discernible in the overall observation. The observation that the consumption levels have not fully returned to their pre-pandemic levels raises concerns about the sustainability of the recovery.

It is expected that private consumption may grow moderately in 2024, primarily due to the anticipated implementation of several taxes that are expected to further dampen economic consumption. For example, the charging and levying of a 10 percent sales tax on Low-Value Goods will take effect on 1 January 2024. Additionally, there will be an 8 percent sales and

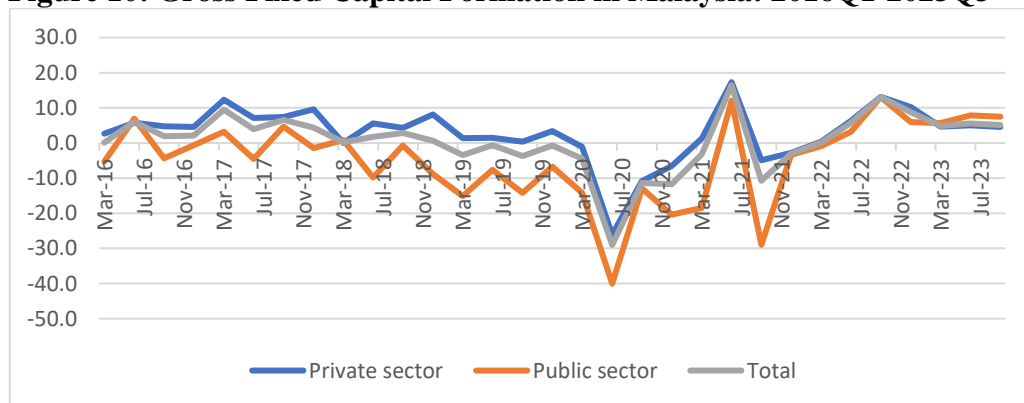
service tax (SST) imposed on traditional and complementary medicine services, effective from 1 March 2024.

## 4.2 Gross Fixed Capital Formation (GFCF)

Gross Fixed Capital Formation (GFCF) is a key component of the Gross Domestic Product (GDP) by expenditure approach. It measures the total value of all investments in fixed assets within an economy over a specific period, such as buildings, machinery, equipment, and infrastructure. GFCF is an important indicator of a country’s investment in expanding or maintaining its physical capital.

Figure 10 presents quarterly growth rates of gross fixed capital formation (GFCF) for the private sector, public sector, and the total economy, along with average growth rates for both sectors. The data illustrates fluctuations in the growth rates of these capital formations across different quarters. Notably, the average growth rate for the private sector remains consistently positive at 4.9% for the entire period (2016Q1-2023Q3), indicating resilience and its role as a driving force for economic expansion.

**Figure 10: Gross Fixed Capital Formation in Malaysia: 2016Q1-2023Q3**



Source: Bank Negara Malaysia, Monthly Statistical Bulletin.

Conversely, the public sector exhibits a consistently negative average growth rate of -4.0%, signalling persistent contraction challenges. This suggests the need for a closer examination of fiscal policies and public investments. In the most recent quarters of 2023, both private and public sectors show positive growth although the growth rates have slightly declined after July 2022. Hence, the expectation is that the growth of domestic capital or investment in 2024 may not be sufficient to generate significant economic spillover effects.

While domestic investments are critical, attracting foreign direct investment (FDI) can complement and diversify the sources of investment. This diversification can be particularly beneficial during economic downturns or when domestic investment alone may not meet the growth targets. FDI always brings with it not just capital transfer but also expertise, technology, and management practices, which contribute to the development of local industries and enhance competitiveness.

Margin pressure for businesses, especially MNCs, is expected due to a few determinants such as excess capacity and deflationary pressures, which may lead to challenges in maintaining

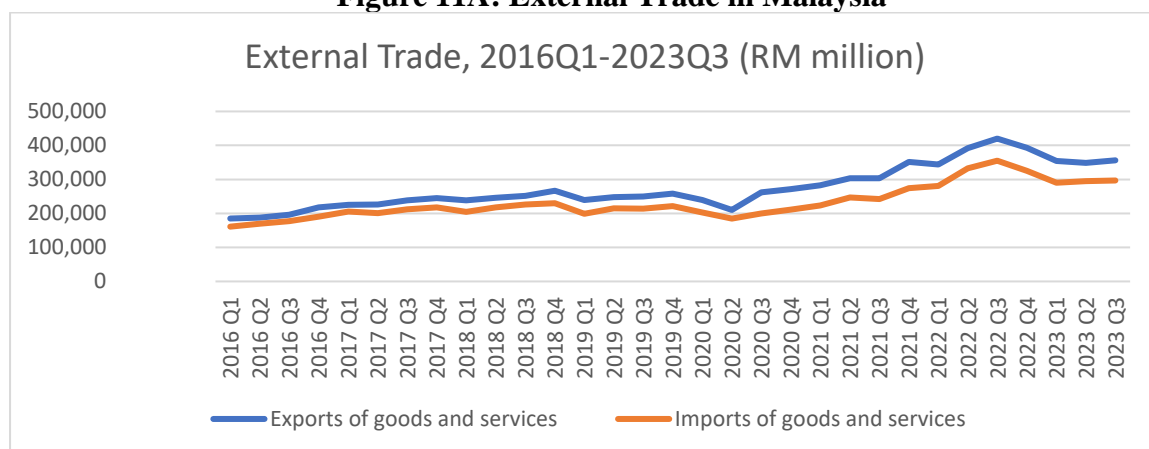
reasonable profit margins. For MNCs, the possibility of imported inflation and a potential shift to cost-driven customers may impact their market strategies.

Achieving sustainable investment growth requires a delicate balance between encouraging domestic investments and attracting foreign direct investment (FDI). It is important to have a business-friendly environment and policies such as streamlined regulations and bureaucracy, tax incentives and subsidies for micro, small and medium enterprises (MSME), labour market reforms and investing in infrastructure development.

### 4.3 Exports and Imports of Goods and Services

Figure 11A presents the quarterly values for exports and imports of goods and services. Both exports and imports have shown a general upward trend over the quarters, indicating a positive growth trajectory. There are some observable cyclical patterns, with periodic peaks and troughs, which may reflect changes in consumer and business spending and economic conditions globally. There is a substantial increase in exports and imports during 2021, with a continuation of this trend into 2022. The surge during this period could be attributed to the global economic recovery and increased demand. The trade balance in 2022 appears to favour imports, as the values are notably higher than exports in most quarters. Policymakers may need to assess the reasons behind this imbalance, which could be a result of international economic trends, geopolitical events, and the trade policies of major trading partners.

**Figure 11A: External Trade in Malaysia**



Source: Department of Statistics, Malaysia, and Authors' calculations.

Even though the overall trend of both exports and imports is increasing from 2016Q1 to 2023Q3, with some downward fluctuations, it is noticeable that the growth rates of both exports and imports have experienced significant changes in their patterns, particularly during and after the COVID-19 pandemic period.

**Figure 11B: Exports and Imports of Goods and Services**



Source: Department of Statistics, Malaysia, and Authors' calculations.

**Table 9: Average Growth Rate of the Exports and Imports of Goods and Services: A Comparison between Pre- and Post-COVID-19 Pandemic Periods**

	<b>Growth Rate (%)</b>	<b>Trade Imbalance (Exports – Imports)</b>
<b>Entire Period</b>		
Average Exports of goods and services (2016Q1- 2023Q3)	3.90	-0.50
Average Imports of goods and services (2016Q1- 2023Q3)	4.40	
<b>Pre-COVID-19 Pandemic Period</b>		
Average Exports of goods and services (2016Q1-2019Q4)	2.80	+0.10
Average Imports of goods and services (2016Q1-2019Q4)	2.70	
<b>During and Post COVID-19 Pandemic Periods</b>		
Average Exports of goods and services (2020Q1- 2023Q3)	5.10	-1.00
Average Imports of goods and services (2020Q1- 2023Q3)	6.10	

Source: Department of Statistics, Malaysia, and Authors' calculations. The negative value of the trade imbalance indicates the diminishing of trade surplus, or vice versa.

During the entire period (2016Q1-2023Q3), as reported in Table 9, the average growth rate for exports stands at 3.90%, while the average growth rate for imports is slightly higher at 4.40%. Examining the pre-pandemic period (2016Q1 to 2019Q4), the average growth rate for exports was 2.80%, higher than the average growth rate for imports, which was 2.70%. However, in the pandemic and post-pandemic periods (2020Q1-2023Q3), the average growth rate for exports is 5.1%, lower than the average growth rate for imports at 6.1%.

The higher average growth rate for imports compared to exports during the overall and post-pandemic period raises serious concerns about increasing trade imbalances. Policymakers should carefully consider the implications of this changing pattern of growth rates for overall

economic health, trade balance, international reserves and the long-term sustainability of external trade. Addressing the trade imbalance may require strategic interventions to promote export growth, enhance competitiveness, and ensure a more sustainable and balanced trade profile.

## **5.0 2024 Economic Outlook: 10 Concerns for the Malaysian Economy**

### **5.1 Anticipated Economic Slowdown in 2024: Impact of Broader Aggregate Demand Factors and Fading Post-Pandemic Tailwinds**

We anticipate that real GDP growth will tread the line between slight expansion and contraction for much of the next year (or called as soft landing). As the post-pandemic tailwinds fade, their contribution to economic growth diminishes. The initial rebound from pandemic-induced disruptions may no longer provide the same level of momentum. Therefore, it is predicted a below-trend, approximately 3.9%-4.2%, pace of expansion in 2024.

Among the major components of GDP, private sector expenditure is expected to increase at a more modest pace next year, while public sector expenditure might shift from being a positive contributor in 2023 to a modest drag—unless there is a special additional budget allocation to support public spending and, subsequently, positively promote economic growth. Notable drops in business investment and external trade activities in 2023 have set the stage for improved performance in 2024, even though the outlook remains muted amid higher interest rates (3%). The strength observed in the services sector in 2023 is likely to soften.

### **5.2 Financial headwinds to growth are expected to persist**

The confluence of two critical factors is poised to shape the economic landscape in 2024. Firstly, the delayed repercussions of elevated interest rates will begin to manifest, exerting pressure on the debt servicing capacity of businesses and individuals alike. Secondly, the diminishing influence of COVID-19-related support measures will further exacerbate this financial strain. As higher interest rates ripple through the economy, the burden on debt servicing capacity is expected to intensify. This is particularly pertinent given the already precarious financial situations that many entities find themselves in. The collective impact is projected to translate into a discernible uptick in non-performing loans (NPLs), particularly within certain financial institutions.

The culmination of these factors is expected to cast a shadow on credit growth. Business investments are likely to experience a deceleration as firms confront difficulties in securing the necessary funding for expansion and innovation. Similarly, consumers, facing tighter credit conditions, are anticipated to exhibit a more conservative approach to spending. Collectively, these factors are expected to act as a drag on economic growth, impeding the overall recovery and expansion of the economy.

### **5.3 The Effect of Taxes on Inflation, Consumption and Economic Growth**

Introducing a 10 percent sales tax on Low-Value Goods and a 8 percent sales and service tax (SST) imposed on traditional and complementary medicine services can have some significant implications for the inflation rate, consumption level, and overall economic growth. Higher taxes or widening the tax coverage can lead to increased costs for businesses and consumers as it directly affects the prices of goods and services and contributes to cost-push inflation domestically. As a result, it will contribute to demand-pull inflation by decreasing aggregate demand. Reduced consumption will impact businesses, leading to lower profits and decreased investment. This, in turn, will affect employment and wage growth, further influencing consumer spending and economic growth.

Low-income families typically spend a larger proportion of their income on essential goods and services, including low-value goods or household necessities. A 10% sales tax on these items would represent a larger percentage of their overall spending, potentially placing a disproportionate burden on their finances. For example, if a family spends RM100 per week on essential low-value goods, the sales tax would incur an additional RM10 to their weekly expenses. Hence, the tax may affect the affordability of these basic items for low-income families, potentially compromising their standard of living, seeking cheaper or low-quality alternatives to cope with the increased cost of goods, and inadequate access to nutritious food may impact the well-being of individuals (especially children) in the low-income and medium-income households. Policymakers would need to carefully consider the social and economic implications and implement measures to ensure the tax system is fair and does not unduly burden those with lower incomes.

It is believed that the re-implementation of the Goods and Services Tax (GST) at a lower rate is much better and more efficient than raising the tax rate and increasing the coverage of the Sales and Services Tax (SST). It is generally well-known that GST is a more inclusive, transparent, and equitable tax system with a broader tax base covering goods and services and a self-policing mechanism. Even though GST was implemented in April 2015 but abolished in 2018, the collected taxes amounted to RM37.9 billion in 2015, RM59.3 billion in 2016, RM67 billion in 2017, and RM36.7 billion in 2018 before it was abolished that year (The Star, 09 Mar 2023). The lower revenue collection from SST and frequent revision of higher SST rates and/or wider coverage may pose challenges for future public spending and development, inflationary pressure, a conducive investment environment, as well as growth prospects.

Even though the effect on long-term growth prospects depends on how the government utilises the additional tax revenue, if the additional tax revenues are used to fund productive investments or reduce budget deficits, it may have positive effects in the long run. However, if the additional revenue is not used efficiently, it could hinder growth prospects.

### **5.4 The Development of Artificial Intelligence (AI) and Smart Industries**

Technological advancements in AI have heightened its significance in national security and geopolitical competition. While the United States currently leads in this domain, several countries are poised to accelerate their efforts in distinctive ways. Notably, China aims to achieve self-sufficiency in AI through continued research investments, and the United

Kingdom seeks to foster innovation, maintaining its position as the third-largest recipient of global AI investment.

While Malaysia has an AI master plan under its New Industrial Master Plan 2030 (NIMP 2030) to leverage AI for economic development, it is imperative for the government to actively pursue increased AI investment and foster innovation across sectors, transforming them into smart industries. EY's findings (2023, p. 8) indicate that only 8% of organisations currently utilise AI for innovation, emphasizing the opportunity for companies to innovate on products and business models with government encouragement. Establishing robust AI governance and regulatory frameworks is essential to ensure compliance with existing regulations and instil confidence among regulators and stakeholders. Noteworthy frameworks include the AI Principles adopted by the OECD and G20 in 2019 and the recent Bletchley Declaration.

AI plays a crucial role in US-China relations, where the US and its allies employ export controls and investment restrictions to limit Chinese companies' access to advanced semiconductors essential for AI hardware. By establishing new "regulatory sandboxes" that enable companies to test AI applications in a conducive environment, the Malaysian government could attract more foreign companies, especially those from the US and China, to establish AI hubs in Malaysia. The year 2024 will witness intense competition in the innovation and regulation of AI and will be a key driver in the realignment of the global geopolitical landscape.

### **5.5 Crowding-out Effect of the Government Debt**

Looking at the overall economic environment, targeted subsidy strategies and the government's strategies to generate revenue in 2024, it is expected that the total debt level will increase to support its expenditures. Persistent high-interest payments relative to the GDP may raise concerns about the sustainability of the government's debt, potentially leading to credit rating downgrades and increased borrowing costs. High-interest payments can constrain the government's ability to implement expansionary fiscal policies, limiting its capacity to stimulate economic growth during economic downturns and lead to "crowding-out" effects and concerns.

The "crowding-out" effect refers to a situation where increased government borrowing and higher debt service costs lead to reduced funds available in the financial markets for private investment, particularly for small and medium-sized enterprises (SMEs). As the government borrows more money domestically, it increases the demand for credit in the financial markets. Higher demand for credit tends to drive up interest rates in compensating for the perceived increased risk associated with lending money when government debt levels are high. Higher interest rates can make borrowing more expensive for businesses, including SMEs as there is less capital available for private enterprises. Hence, the "crowding-out" effect of the government debt can hinder private sector investment, causing SMEs (being crucial contributors to employment and innovation) to maintain or expand their operations and leading to a slowdown in economic growth.

### **5.6 China's Economy will Recover Slowly**

China's economy is poised to benefit from a more accommodative policy stance, a gradual upswing in private-sector confidence, and the anticipated stabilisation of the housing

market downturn. It is believed that China's central bank is likely to maintain a lower interest rate environment and implement measures to increase the money supply. It is crucial to encourage borrowing and spending by businesses and consumers, thereby boosting economic activities. As a result, businesses are expected to become more optimistic about economic conditions with supportive government policies, a stabilizing macroeconomic environment, or improving market conditions. As confidence grows, businesses are more likely to increase investments, expand operations, and contribute to economic growth. In addition, the decline in the real estate sector is expected to decelerate after government interventions and property market policy adjustments in stabilising housing prices or demand. Once the housing market stabilises, it can have positive effects on consumer wealth, construction activity, and related industries, providing a lift to the broader economy. Therefore, the projection indicates that the annual real GDP growth in China is estimated to be 4.5% in 2024, a slight decrease from the anticipated 5.2% in 2023.

### **5.7 The US Dollar will Depreciate against Some Major Currencies**

It is expected that the US dollar will be depreciated by a relative slowing of US real economic growth, inflation and interest rate (Fed Rate). Several currencies such as the yen, euro, and the renminbi are expected to appreciate against the US dollar more strongly than many of its peers during 2024. The depreciation of the US dollar can be influenced by two main reasons. The first reason is that the US is predicted to experience a relative slowing of real economic growth in 2024 compared to other countries. International investors may seek higher returns elsewhere, reducing demand for the US dollar and leading to its depreciation. Another main reason is that, as the Federal Reserve (Fed) expects a lower inflation rate in 2024, it may lead the Fed to reduce its interest rates. The Fed typically uses interest rates to monitor inflation. A lower inflation rate and interest rate can make US assets less attractive to international investors, exerting downward pressure on the value of the US dollar.

### **5.8 Reshaping Diplomacy in Presidential Elections: A Potential Change of Diplomatic Relations with the U.S. and China**

2024 is an exceptionally busy year for elections. For example:

- Taiwan: Presidential election on January 13th, with significant implications for its relationship with the US and China.
- Pakistan: A cluster of elections in February, including the presidential and general elections.
- Indonesia: Presidential election on February 14th, crucial for the world's third-largest democracy.
- India: General elections due by May, potentially shaping the future of the world's largest democracy.
- European Union: European Parliament elections, affecting policies across the continent.
- United States: The presidential election on November 5th, along with all House and Senate seats up for grabs.

The U.S. presidential election on November 5, 2024, is anticipated to have a substantial impact on the U.S.-China relationship, potentially surpassing the dynamics observed during President Biden's term. While the identities of the Democratic and Republican nominees are yet to be

determined, their policy positions and past track records concerning China will significantly shape the nature of the potential shift. Regardless of the winning candidate, there is a belief that major policies related to trade, technology, human rights, and military presence in the region could contribute to heightened tensions with China, particularly in the South China Sea area. The outcome of the election is likely to play a crucial role in shaping the future trajectory of U.S.-China relations.

Besides, the upcoming January presidential election in Taiwan has significant implications for the island's relationship with China and the US, resulting from the complex interplay of internal politics, historical baggage, and geopolitical tensions. The core issue is how closely the elected president adheres to the "One China" policy, viewed by Beijing as the foundation for relations.

Democratic Progressive Party (DPP) Candidate, Lai Ching-te's Pro-US Stance: His experience as vice president and close ties to the US administration strengthen bilateral ties and solidify US security guarantees.

Kuomintang (KMT) Candidate, Hou Yu-ih's ambiguous approach: He always maintains the appearance of moderation and avoids clear positions on the issues related to both the US and China firmly.

The US seeks to deter Chinese aggression against Taiwan while upholding the "One China" policy. Any significant shift in Taiwan's stance could destabilise the delicate balance, and will shape its relationship with both the US and China, potentially impacting regional stability and international security.

## **5.9 Rising Tensions China between Taiwan: A Long-term Unpredictable Time Bomb**

While there has been no direct military intervention by China on Taiwan's territory, there have been some significant incidents recently involving the Chinese military near Taiwan. The following are the chronological events or incidents of the rising tensions between China and Taiwan and the potential for a serious military escalation in the future.

- April 2023: After Taiwan's President met with then-US Speaker Nancy Pelosi, China conducted "joint sword" drills, practising encirclement of Taiwan with its Shandong aircraft carrier participating.
- August 19, 2023: Following a visit by Taiwan's Vice President William Lai to the US, China launched large-scale military drills with air and sea forces surrounding Taiwan.
- September 2023: China conducted large-scale naval exercises near Taiwan, involving multiple warships and aircraft. This followed a period of intense air incursions in which Chinese planes crossed the median line on several occasions. These exercises were widely seen as a response to Taiwan's President Tsai Ing-wen's meeting with then-US Speaker Kevin McCarthy.
- December 7, 2023: Taiwan reported rare night-time activity by the Chinese military, with aircraft crossing the median line and operating close to the island. This night-time activity is unusual and potentially signifies increased alertness and readiness from China.<sup>22</sup>
- December 28, 2023: 12 Chinese military aircraft, including J-11 and Su-30 fighters, crossed the median line of the Taiwan Strait and flew in airspace north, centre, and southwest of Taiwan.

China maintained a near-constant presence of aircraft in Taiwan's air defence identification zone (ADIZ), often crossing the median line. This is a significant increase from previous years and serves as a constant reminder of China's military capabilities and willingness to assert its claims over Taiwan. It is believed that the Chinese military and the Ministry of National Defense have collected some military defence arrangements, military capabilities and information about Taiwan through these incidents.

In his New Year's address, President Xi Jinping reaffirmed his commitment to "reunification" with Taiwan, stressing its inevitability and hinting at the use of force as a potential option. As a result, Chinese officials have become more vocal in expressing their view of Taiwan as a breakaway province and an integral part of China. President Xi has a strong vision to unify Taiwan by revolving around the concept of "One Country, Two Systems" under Chinese rule while acknowledging some degree of autonomy for the island (similar to Hong Kong SAR). However, due to recent incidents or actions by Taiwan's government (a visit by Taiwan's Vice President William Lai to the US, a visit by then-US Speaker Nancy Pelosi to Taiwan, and Taiwan's President Tsai Ing-wen's meeting with then-US Speaker Kevin McCarthy), President Xi and his government have taken a more assertive and uncompromising tone, emphasizing the inevitability of unification and hinting at the possibility of using force if necessary. This hardening stance has raised concerns about the potential for increased military tensions and conflict across the Taiwan Strait and spillover to the neighbouring ASEAN countries.

If the "reunification" with Taiwan occurs through a military approach, then as the largest trade and investment partner to Malaysia and some ASEAN countries, the economic performance of Malaysia will be greatly affected as the US and its allies will very likely impose some restrictive measures against China such as:

- Military and defensive measures - enhancing military deployments to the South China Sea, arms and security assistance to Taiwan, imposing unprecedented economic and financial sanctions on China, targeting its leadership, banks, businesses, and energy sector.
- Diplomatic and political measures - isolating China diplomatically, condemning its aggression and supporting international efforts to hold it accountable.
- Economic and financial measures - restricted critical technology and equipment exports to China, disconnecting China's access to the SWIFT international payment system, and froze Chinese assets held within their jurisdictions, targeting oligarchs and individuals deemed close to the President's regime.

It is predicted that reunification with Taiwan is expected to occur in the next few years, very likely before President Xi's retirement.

### **5.10 Beyond Borders: Geopolitical Risks in 2024 and Beyond**

We are witnessing a trend towards de-globalisation, as countries focus on domestic interests and cultivate independent economic and technological spheres. This shift can lead to trade disputes, supply chain disruptions, and a reduction in international trade and investment. Among the ongoing geopolitical conflicts are heightened trade tensions between the US and China, the Russia-Ukraine War, territorial disputes in the South China Sea, tensions between China and Taiwan, and the Israeli-Palestinian conflict.

These geopolitical risks have disrupted global supply chains, created uncertainties in financial markets, distorted the availability and prices of critical commodities and goods,

and affected various stages of production and distribution globally. It is also evident that geopolitical tensions or conflicts between the US and China have been disrupting semiconductor production, causing shortages and affecting industries such as automotive, electronics, and telecommunications regionally and globally. What is even more concerning is the absence of immediate signs of resolution for these geopolitical conflicts, at least in the short and medium terms, potentially further destabilizing the international order.

## **6.0 Conclusion**

In 2024, Malaysia's economic landscape is forecasted to improve slightly, with consumer confidence gradually recovering. The acceptance of a new normal characterised by slower growth will contribute to this recovery. Most companies anticipate sales growth ranging from 5% to 20%, indicating optimism about increased economic activities. Nevertheless, businesses are likely to face challenges, primarily driven by margin pressures due to the weak aggregate demand nationally and internationally. Despite positive sales expectations, managing profit margins and cash flows will be a focal point for companies in 2024.

To address margin pressures and low demand for goods and services, businesses, including MNCs, are expected to reduce their investments or capital formation, but, they will focus on productivity gains and innovation. Efforts to enhance operational efficiency, explore new technologies, and streamline processes will be crucial for maintaining competitiveness and sustaining growth. Exports are less likely to be a major growth driver in 2024, given continuing geopolitical tensions and slow global markets. The global economic landscape, influenced by geopolitical factors and market dynamics, may limit the potential for robust export growth, especially to the USA and China.

In conclusion, while 2024 is anticipated to be a better year for the Malaysian economy, challenges persist, especially related to margin pressures, consumer confidence, and global economic uncertainties. Successful navigation through these challenges will require a combination of strategic reforms, targeted stimulus measures, and innovative approaches by businesses, both local and multinational.

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