



IIRA Reaffirms Sovereign Ratings of Malaysia

Manama, January 10, 2019 –The Islamic International Rating Agency (IIRA) has maintained the long term and short term foreign currency ratings of Malaysia (or ‘the Country’) at ‘A / A1’ (Single A / Single A One) and local currency ratings at ‘A+ / A1’ (Single A Plus / Single A One), on the international scale, and ‘AAA (my) / A1+ (my)’ (Triple A / Single A One Plus) on the national scale, with ‘Stable’ outlook.

Ratings assigned to Malaysia are reflective of largely stable macroeconomic indicators, a well-developed physical and social infrastructure and its strategic location in the ASEAN region. Stable monetary policy and a healthy financial sector have contributed to overall macroeconomic stability. On the heels of political change in May 2018, Malaysia has experienced a significant shift in its tax and subsidy regime. While the net effect of tax policy changes on government revenues is not likely to be substantial in 2018, higher expenditure expectations are likely to widen the fiscal deficit to 3.7% of GDP during 2018, up from a deficit of 3% in prior year.

Malaysia’s economy features a high trade to GDP ratio, sustained flow of foreign direct investments and a gradually increasing scale of external debt. Volatility in portfolio flows, given ongoing normalization of policy rates in the US may affect financial account negatively. While the country’s current account has remained in surplus over the last several years, the balance has generally demonstrated narrowing in recent years and particularly in the last two quarters of 2018. Malaysia’s significant external linkages, global economic trends by way of rising trade protectionism, ongoing Fed rate hikes and geopolitical risks, will continue to have a bearing on the economic environment in Malaysia, and as such may be viewed as constraining factors in our rating assessment.

Following a year of strong economic growth of 5.9% in 2017, the average pace moderated to 4.7% growth during Q1-Q3’2018, led by decline in net exports and despite continued strong domestic demand. Overall the economic sentiment remained positive reflected also in a largely stable Ringgit. Headline inflation declined significantly to 1.2% during Q1-Q3’2018 primarily led by Goods and Services tax (GST) zerorisation, onwards of June’2018. With implementation of sales and services tax (SST) since September 2018, we may expect some reversal in inflation during Q4’2018. Overnight policy rate (OPR) increased to 3.25% from 3.00% in January 2018, with no further changes in the rest of the year. The latest increase in policy rate by the US Fed as recently, as in December 2018, marked a cumulative increase of 100bps in the current year and as such would continue to lead to upward pressure on emerging market policy rates.

Malaysia’s consistent current account surplus is a reflection of strong goods exports. The balance of payments is further supported by surplus in financial account in recent years, with consistent direct investment inflows, albeit some volatility in portfolio inflows. Current account balance has narrowed to around 2.2% of GNI during Q1-Q3’2018 and is expected to remain around this level for full year 2018. In line with monetary tightening in US, portfolio outflows of RM 40.9b were observed during H1’2018, which was supported by higher ‘other investment account’ inflows, leaving financial account with a strong surplus during Q1-Q3’2018. The financial account surplus is expected to normalize in H2’2018.

Malaysia has been investing heavily on infrastructure projects which put pressure not only on its expenditure base, but also on external account owing to increased imports. Under the new leadership, some of the major infrastructure projects including projects under Belt and Road Initiative (BRI) are under reassessment. This may take some pressure off expenditures and the import bill, in the near term.

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External debt grew by around 10.7% on YoY basis increasing to USD 228.9b or 66.2% of GDP as at end-Q3'2018 (Q3'2017: USD 206.8b and 65% of GDP). A sizable portion of external debt is ringgit denominated and held by non-resident investors. In the backdrop of an increasingly competitive global investment market, off-shore ringgit denominated debt declined. On the other hand banking sector borrowings increased with higher foreign currency placements from foreign parent entities, and as local institutions shored up their foreign currency liquidity buffers. Debt Coverage ratio remained sufficient, albeit slightly lower at 48.9% (end-2017: 51.2%).

Malaysia has a stable and diversified financial sector. With a healthy distribution of conventional and Islamic banks, the sector has demonstrated consistent strength, with sufficient capacity to provide credit to a growing economy, and no significant imminent risks. It is further supported by healthy capitalization indicators, improving profitability and sound asset quality. Household financing, while still high, declined to 83.8% of GDP as of H1'2018, and is supported by reasonably low levels of debt servicing ratios, continued income growth and low unemployment.

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