25 November 2022

Malaysia 15th General Election

Upbeat near-term outlook as political impasse resolves and brings relief

SUMMARY

- After nearly a week of political uncertainty Datuk Seri Anwar Ibrahim has been appointment as Prime Minister and will lead a unity government with Pakatan Harapan, Barisan Nasional, Gabungan Parti Sarawak, Warisan, and Parti Bangsa Malaysia.
- Capital flows will likely return in the near-term following the positive political catalyst and easing global risk aversion, but downside risks remain from further US Fed rate hikes and a greater divergence in BNM-Fed policy rates.
- Ringgit is expected to be supported by optimism in the near-term following the political breakthrough and the Fed's less hawkish guidance. We revise the USDMYR year-end forecast slightly upwards to 4.54 from 4.57.
- Demand for bonds is expected to improve going forward, partly due to political developments, but mainly on lower global bond yields as markets anticipate a less hawkish Fed. We revise down our year-end 10Y MGS yield forecast to 4.25% from 4.40%.
- GDP growth forecast is expected to remain intact (2022F: 8.6%; 2021: 3.1%) on the back of resilient domestic demand aided by various policy support and increased tourist arrivals. We have also retained the 2023 GDP forecast at 4.3% amid an expected global growth slowdown and the normalisation of economic activities post-pandemic.
- BNM may hike its OPR by another 25 bps in January 2023 due to better-than-expected GDP growth in 2H22 and rising inflation, as reflected in the latest core inflation figure. Nonetheless, we expect BNM to stop its rate hike cycle if domestic demand signals a slowdown due to rising external risks.
- The unity government is expected to continue with expansionary fiscal policy in Budget 2023, on the possible continuation of populist measures such as the blanket fuel subsidy programme, while also embarking on various development projects to support the domestic economy from a potential growth slowdown.
- Government debt remains elevated but within manageable levels if the statutory debt ceiling of 65.0% is extended into 2023. However, rising debt service charges may need to be addressed with greater revenue collection in the near-term.

Overview

- **After almost a week since the 15th General Election (GE15) resulted in Malaysia's first hung parliament, Pakatan Harapan (PH) has garnered enough support to form a coalition government and Datuk Seri Anwar Ibrahim has been sworn in as the country's 10th Prime Minister**
  - GE15 resulted in an unprecedented hung parliament, as none of the major coalitions won enough seats to form a simple majority government. 112 seats were required, PH secured 82 seats, Perikatan Nasional (PN) performed considerably well and gained 73 seats, Barisan Nasional's (BN) call for an early election backfired and only garnered 30 seats, whilst the Borneo blocs of Gabungan Parti Sarawak (GPS) and Gabungan Rakyat Sabah (GRS) won 22 seats and 6 seats respectively.
  - On November 24, following five days of political uncertainty and negotiations, the Yang di-Pertuan Agong Sultan Abdullah Sultan Ahmad Shah decreed that Datuk Seri Anwar Ibrahim would be Malaysia's 10th Prime Minister. PH would form a unity government with BN, GPS, Warisan, and Parti Bangsa Malaysia (PBM) to secure 139 seats in parliament, well above the simple majority needed to pass most legislation, but still below the two-thirds supermajority of 147 seats required for constitutional amendments.

Table 1: 15th General Election Results

Party/Coalition	Seats Won	Popular Vote	Votes Share %
PH	82	5,894,096	38.0%
PN	73	4,667,429	30.1%
BN	30	3,456,762	22.3%
GPS	23	662,601	4.3%
GRS	6	194,324	1.3%
Warisan	3	281,732	1.8%
Independent	2	112,681	0.7%
PBM	1	16,437	0.1%
PKDM	1	52,054	0.3%

Source: Malaysian Election Commission, Straits Times, Kenanga Research

– Challenges remain for the new government and Prime Minister, who will have to navigate an increasingly bleak global economic outlook, slowing domestic economy, untested government coalition, and a divided Malaysian electorate. Pakatan Harapan's manifesto and promise of reforms will likely need to be reigned in and some compromises may need to be found in order to maintain the unity government. However, Anwar Ibrahim has pledged to focus on economic growth ahead of an expected slowdown, and the rising cost of living as inflationary pressures remain elevated.

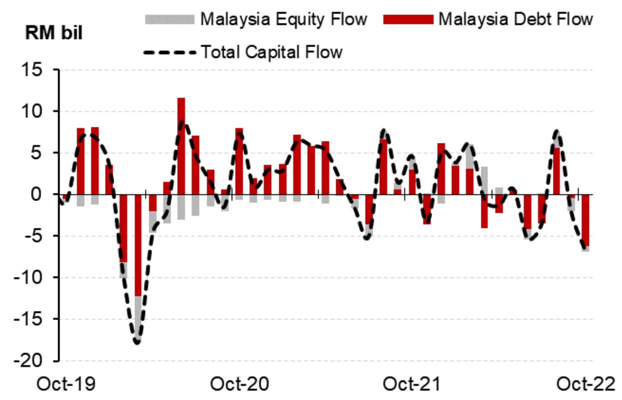
Economic Impact

- **Capital flows: May improve going forward, buoyed by the new unity government and easing global risk-aversion**

  – November may see the return of foreign portfolio inflows for both the equity and bond markets following the resolution of the hung parliament and the formation of a coalition government. This comes off the back of very strong foreign selling from both markets in October (-RM6.9b; Sep: -RM2.1b), recording its largest net capital outflow since the early days of the COVID-19 pandemic in March 2020 (-RM17.8b). Likewise, foreign selling likely continued early in November ahead of GE15 and intensified immediately after the hung parliament result, but this will likely be outweighed by renewed foreign demand in the near-term.

  – Going forward, we expect modest capital inflows as foreign investors return amid the onset of domestic political stability and improving global risk sentiment. Markets have also begun to expect a less hawkish US Fed, especially after the latest FOMC minutes confirmed that most Fed officials were in favour of slowing the pace of rate hikes, which has curtailed global risk-aversion. In 2023, there remains a risk of outflows in 1Q23 given the widening divergence between BNM and Fed policy rates, with the Fed Funds Rate potentially reaching 5.0% whilst the OPR is expected to top at only 3.0%. However, we reckon the outlook will brighten from 2Q23 onwards, as we expect a stronger return of risk-on sentiment and capital inflows, when most major central banks complete their tightening cycles and as the Fed potentially signals rate cuts towards the end of the year due to a widely anticipated US recession.

Graph 1: Net Foreign Capital Flows

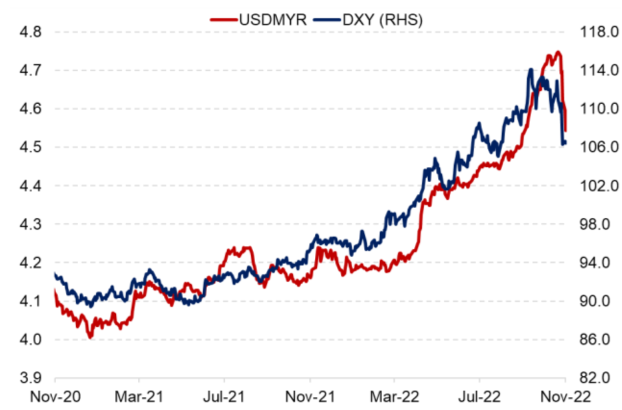


Source: BNM, Kenanga Research

- **Ringgit: To benefit from optimism following the political breakthrough and dovish US Fed pivot**

  – The recent appreciation of the ringgit against the USD to below the 4.60 level due to the US Fed minutes, signals a slowdown in rate hikes is expected to be short-lived as geopolitical uncertainties, coupled with rising recessionary risk, may stop the USD index from sliding further and prompt it to trade around the 106.0-110.0 level in the next few months. Nevertheless, we have revised our USDMYR end-2022 forecast slightly upwards to **4.54** from 4.57 against the USD due to a facade of political stability, which is expected to encourage the modest return of capital inflows. This, coupled with the Fed's less hawkish guidance and USD seasonal weakness, may help to prop up the local note in December. However, moving into 1Q23, the ringgit is expected to weaken to around the **4.64** level due to the increasing divergence between BNM-Fed policy rates. Afterwards, the local note may gain some ground and appreciate against the USD due to Prime Minister Anwar Ibrahim's expected pro investor policies, together with the Fed's potential pivot, and China's reopening in 2H23. Hence, we have also revised our end-2023 ringgit forecast to **4.26** from 4.39 previously.

Graph 2: USDMYR & DXY Index

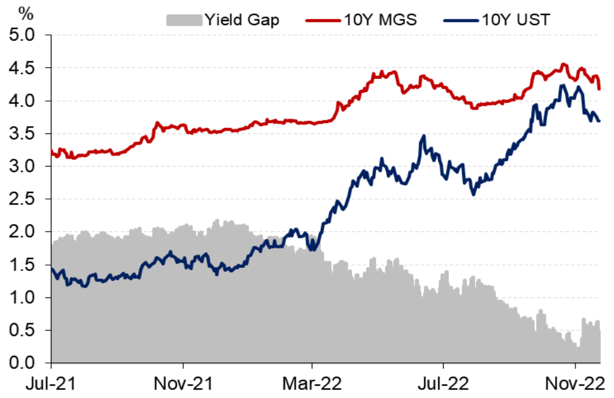


Source: Bloomberg, Kenanga Research

- **Bonds: Demand to improve on positive political catalyst and plunging global bond yields**

  – We have revised down our end-2022 10Y MGS yield forecast to **4.25%** from 4.40% previously, partly due to the near-term bounce expected from the formation of the new government, but still predominantly steered by lower global bond yields. Domestic yields have tracked plummeting US Treasury yields following the latest FOMC minutes as markets price in a potential Fed pivot. However, we reckon there will be a minor correction leading up to the next Fed meeting, as another 50 bps rate hike is widely expected, which may cause domestic yields to settle slightly higher by the end of the year. For 2023, we continue to expect yields to trend significantly lower, in line with expectations of falling global bond yields, a strong return of foreign capital inflows, and the end of most major central banks' tightening cycles. Accordingly, we have revised down our 10Y MGS yield target for end-2023 to **3.90%** from 4.05% previously.

Graph 3: 10Y MGS and US Treasury (UST)

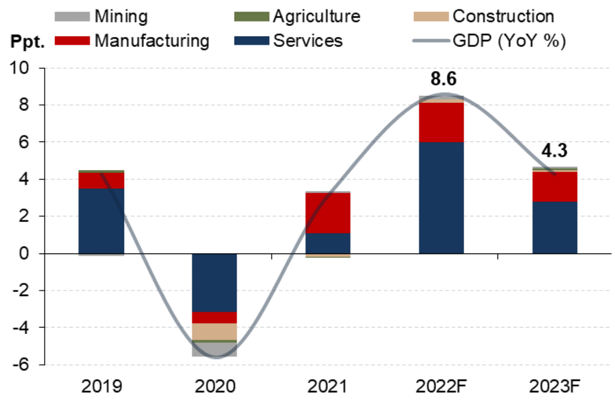


Source: Bloomberg, Kenanga Research

- **GDP: 2022 GDP growth to remain intact with momentum to subside going into 2023**

  – The expected impact of the new government on GDP growth outlook is neutral. We reckon the PH-led government will remain supportive of private consumption via a sustained cash transfer programme, especially to targeted income groups, namely the lower and middle-income earners. Since private consumption constitutes around 57.9% of GDP in 2021, any increase in the cash transfer or future policy uplifting household income, such as higher minimum wages and hiring incentives, would have a significant impact on consumption growth. This would partially offset the expected slowdown in public spending amid fiscal constraints, as well as slower exports due to the global economic downturn amid heightened recessionary risk in several major countries. Hence, we have retained our 2022 GDP growth forecast of **8.6%** (2021: 3.1%) following the better-than-expected 3Q22 GDP growth, with growth projected to moderate to **4.3%** in 2023.

Graph 4: Growth Outlook by Sector (KIBB forecast)

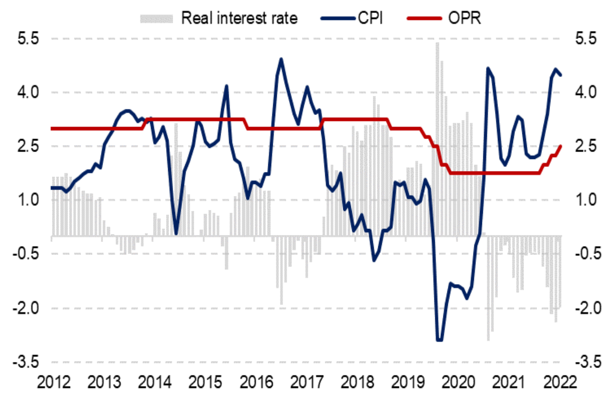


Source: Ministry of Finance, CEIC Data, Kenanga Research

- **OPR: BNM may hike another 25 bps in January 2023, bringing an end to its tightening cycle**

  – With GDP growth expected to remain resilient and underpinned by strong domestic demand, possibly beating the official forecast of 6.5% - 7.0% for 2022, we expect the Bank Negara Malaysia (BNM) to continue its monetary policy tightening cycle with another 25 bps hike in its upcoming Monetary Policy Committee (MPC) meeting slated on 18-19 January 2023, bringing the policy rate to 3.00%, which would match its long term neutral rate. While the MPC reiterated in the previous meeting that it was not on any pre-set course, we still believe the central bank may want to frontload the rate hikes gradually up to 1Q23 to combat inflationary pressure as reflected in recent the core inflation print (Sep: 4.0%; Aug: 3.8%). The inflationary pressure is also expected to be driven by the continued increase in tourist arrivals, wage growth, higher minimum wages, and tight labour market conditions. Nevertheless, we do not rule out

Graph 5: CPI vs OPR trend



Source: BNM, CEIC, Kenanga Research

the possibility that BNM may stop its policy rate normalisation if domestic demand signals a slowdown, amid the impact of monetary policy tightening and gradual withdrawal of some government policy support post-pandemic.

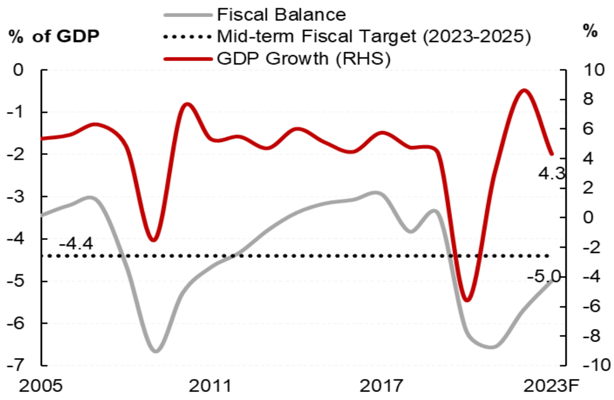
- **Inflation: No impact on inflation outlook in the near term due to continued policy support**

  – For 2022, we have retained our headline inflation forecast at **3.3%** (YTD: 3.2%; 2021: 2.5%) as prices may trend lower to 3.7% in 4Q22 (3Q22: 4.5%), mainly due to the high base effect and falling commodity prices. Moving forward, the expectations of lower input cost amid abating supply chain disruptions, as well as weaker consumer demand due to tighter financial conditions and a weakening economic landscape, may bring core inflation back down to average around the 1.5-2.5% level in 2023, prompting the BNM to put the brakes on its rate-tightening run. Headline CPI is projected to subside to around the 2.5% level in 2023 from our previous forecast of 4.2%, as the new government may continue to provide fuel subsidies at current prices and introduce other price control measures to ease the burden on vulnerable households and businesses.

- **Fiscal deficit: Fiscal consolidation unlikely in the new Budget 2023**

  – The fiscal stance is expected to remain expansionary in 2023, given the expected continuation of populist measures such as the blanket fuel subsidy in a bid to protect the people from rising inflationary pressures. Besides, there is no clear indication in PH and BN manifestos that they would embark on fiscal reforms, particularly on tax issues, which raises the question of how the administration would finance its fiscal spending going forward. In addition, given that there will be several state elections in 2023, any policy shift towards fiscal tightening may not yet be favoured by the ruling party. Therefore, we have revised our fiscal deficit forecast slightly for 2023 to **5.0%** of GDP (2022F: 5.7%) from the previous forecast of 4.9%, also taking into consideration the expectation of slower GDP growth next year amid a global growth slowdown. Moving forward, we still expect the federal government to improve its fiscal position by reintroducing Goods and Service Tax (GST) in the medium term or once the economy is on a solid recovery path, in order to reduce its debt and move away from being dependant on oil & gas related revenue. This would suggest that the re-implementation of the GST would likely be in 2024.

Graph 6: Federal Government Fiscal Balance



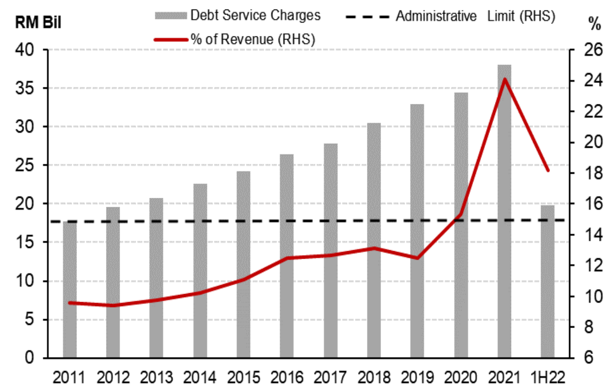
Source: Bloomberg, Kenanga Research

- **Debt management: Government debt remains manageable, but rising debt service charges should be addressed**

  – Federal government debt remains relatively high, having increased to RM1.07t by end-September and projected to rise to RM1.10t by the end of the year, which would be about 61.1% of GDP based on our estimates (2021: 59.9% of GDP). Meanwhile, statutory debt (MGS, GII, MITB) stands at 57.5% of GDP as of end-October, still well below the 65.0% threshold under the amended Act 830 (Temporary Measures for Government Financing). However, this statutory limit will expire by the end of this year and will require a prompt extension by the new government. Otherwise, the debt ceiling will revert to 55.0%, leading to a breach of the limit going into 2023 and severely impacting the government's ability to fund its fiscal deficit. With that said, despite the expected expansionary fiscal stance, statutory debt is projected to remain under the 65.0% next year and within manageable levels.

  – On the other hand, debt service charges (DSC) may need to be addressed having increased to RM19.8b in 1H22 (1H21: RM18.4b), and with the DSC-to-revenue ratio currently at 18.2%, remaining above the administrative limit of 15.0%. However, the new government has not explicitly laid out plans for fiscal consolidation or higher tax collection, which may keep the DSC-to-revenue ratio above the administrative limit in the medium-term.

Graph 7: Debt Service Charges and % of Revenue



Source: BNM, Kenanga Research

Appendix 1: Pakatan Harapan Manifesto

Cost of living	- Reduce PLUS toll charges gradually, and ultimately eliminate tolls - More affordable homes for ownership, rental, low-to-medium cost, and transit housing - Structure a minimum wage policy plan to achieve the status of a high-income nation - Extend special allowance to those who have lost their jobs as contract workers - Continue the Bantuan Sara Hidup programme to help overcome cost of living
Healthcare	- Increase the public healthcare expenditure to 5% of GDP in 5 years - Build more clinics in high density areas and door-to-door testing in low-cost apartments - Solve contract doctors' conundrum - Expand the coverage of the MySalam programme to the M40 group - Attention on care economy agenda to tackle ageing population - Decriminalise suicide attempts - Increase mental health coverage, including in insurance schemes
Women	- Childcare subsidy for working women from the B40 and M40 categories - Amend Article 14(1)(b) to allow Malaysian mothers with foreign spouses who give birth overseas to confer citizenship on their children - Free sanitary pads and tampons at all schools and for women in the B40 category - Every bill presented in parliament will be guaranteed to possess gender inclusivity elements - Resume efforts for the National Strategic Plan in handling the causes of child marriages by 2025 - Every new-born will be given cash benefits that will be deposited monthly to the parents up to six years old
Foreign Direct Investment	- Streamline the business and commerce processes by reducing bureaucracy through continued facilitation by government agencies such as MIDA, Matrade, SME Corp, MPC and MIDF - Introduce more strategic funding to strengthen the capacity of Malaysian-owned companies to participate in direct domestic investments - Upgrade infrastructure at all industrial parks
Environment	- Table the Climate Change Act that will set carbon emissions and forest coverage targets by 2040 - RM1 billion funding to state governments as an incentive to ensure that forest reserves are not degazetted - Increase the percentage of marine protection areas to 30% by 2030 - Form the Transboundary Haze Act and reinforce a cooperation framework with neighbouring countries to implement pollution prevention law - Increase investments in renewable energy to achieve 50% target of the country's energy mix - Incentive for solar system installations at homes
SMEs and MSMEs	- Overcome labour shortage by streamlining the recruitment process for foreign workers - Set up a One Stop Digitalisation Centre to help MSMEs apply for digitalisation incentives to ensure digital transformation - Provide incentives or grants for productivity solutions, especially for MSMEs to increase capital utilisation efficiency - Increase allocation for venture capital financing on a periodic basis to encourage entrepreneurs in high-value technology fields to jump-start their operations
Sabah and Sarawak	- Gazette Free Trade Zones at Kota Kinabalu Industrial Park (KKIP), POIC Lahad Datu and Sipitang Oil & Gas Industrial Park (SOGIP) - Ensure 35% of parliament representatives are from Sabah and Sarawak - Handing over the administration of Sabah Electricity Sdn Bhd - Solve the issues of foreign influx in Sabah - Upgrade the POIC Lahad Datu port and Sepanggar port; building a Kudat port - Allocations to solve basic infrastructure problems in all industrial parks in Sabah
Food Security	- Eliminate cartels in the sectors of food and essential supplies to encourage competition - Work closely with suppliers to ensure sufficient food supply - Incentives to increase production of food and basic essentials - Tax cut for investments in the farming sector, both for companies and small-scale farmers - Enhance Young Agropreneur Programme and talent-matching programmes for youth who are interested in modern farming - Increase the use of technology in the agricultural sector by providing grants or accessible loans
Addressing Corruption	- Asset declaration for all ministers, MPs, senior civil servants, GLC chairman and close family members over 18 years old - Amendment of the Whistleblower Protection Act to allow misappropriation to be directly exposed to the media - Vetting of nomination for MACC chief commissioner to ensure a neutral candidate - Guarantee freedom of media - Establishing an ombudsman system to address issues of misconduct by politicians and civil servants - Review and repeal draconian provisions of acts, for example the Sedition Act 1948
Education	- Increase funds for the free breakfast programme - Reduce teachers' workload

	- Special allocations to assess students' basic competencies in reading, writing and arithmetic - PTPTN loan forgiveness programme for B40 households - Fair allocation of funds to all schools - Restructure early childhood education - Introduce more scholarships for the B40 - Guarantee freedom for youth to participate in activism
Tax Reform	- Tax exemptions for investments in the farming sector, whether for companies or small-scale farmers - Tax exemption incentives and financial assistance for employers that train and employ senior citizens - More export incentives to encourage international trade - 100% stamp duty exemption for first-time homeowners for properties below RM500,000 to cover subsale units

Source: The Edge Markets

Appendix 2: Barisan Nasional Manifesto

Cost of living	- Eradicate absolute poverty via Assistive Basic Income scheme; automatic credit to households with a monthly income below RM2,208 by 2025 - Employment Retention Fund (ERF) - to safeguard against immediate layoffs during economic crises and national emergencies - Provide more job opportunities and maintain unemployment rate below 4.0% - Allocate RM10 million per year to provide travel vouchers to the disabled via e-hailing services
Healthcare	- Double the annual allocation to RM77 billion from RM36 billion (5% of GDP) by 2027 - Build more specialist hospitals for infectious diseases and mental health - Increase speciality and sub-speciality training opportunities in private hospitals
Women	- Establish the Women's Economic Development Bank - Establish the first Women's Public Specialist Hospital (HAWA) specialising in women's health issues - Build the first Women's Public University - Build the National Women's Economic Development Corporation - Establish the Women's Leadership Academy at public universities - National subsidy scheme for mammogram tests and cervical cancer screening - Amend the Federal Constitution on citizenship rights for children born abroad to Malaysian women with foreign spouses
Foreign Direct Investment	- Introduce a Migrant Worker Policy that upholds human security - A comprehensive reform of immigration laws and regulations by introducing various types of visas to attract investors, talents and skilled workers - Implement various strategies and free trade negotiations between Malaysia and various regional, developing and developed countries
Environment	- Stricter environmental laws, including a fine up to RM10 million for offenders - Tighter laws for mining and quarrying activities - Remove approved permits (APs) for electric vehicles (EVs) - All public transport services and official government vehicles to be environmentally friendly by 2030 - Special funds for victims affected by natural disasters - All government projects to comply with ESG principles and benchmarks - Renewable energy to represent 30% of total electricity generation by 2030 - Increase Malaysia's forest coverage to 60% of the land surface (currently at 54%)
SMEs and MSMEs	- Set limits on GLS investment and involvement in certain industries to prevent crowding out opportunities for private companies - Providing credit vouchers of a maximum of RM10,000 per year to SME employers for training activities - Enact Dependent Contractor Act to protect the rights, welfare and income of gig workers and other non-formal workers
Sabah and Sarawak	- Sabah and Sarawak as the new national security hub - Sabah and Sarawak as the new economic giants of the country - Promote local cultures in education by encouraging the use of the mother tongue for children at Community Learning Centres in Sabah and Sarawak - Revive the east-west public ferry service (Feri Malaysia) that connects Peninsular Malaysia with Sabah and Sarawak - To appoint two deputy prime ministers, one each from Sabah and Sarawak
Food Security	- Remove approved permits (APs) for agro-food imports, especially products that have no domestic production - Set up six new food valleys across the country - Subsidise 50% of the financing of skills training in the field of agriculture, fishery, animal, husbandry and enterprises in rural areas

	- Cooperate with state governments to permanently gazette agricultural areas such as paddy fields and grazing land to prevent a change of status to municipal, industrial and settlement areas - Nurture a young generation of 5,500 modern farmers under the age of 40 within a period of five years, through a special training programme/ academy in collaboration with the industry - Mandate that 10% of GLS farms should be designated for food production
Addressing Corruption	- Explore the devolution of power from the federal to the state government to increase efficiency - Separate the roles and functions of the Attorney-General and Public Prosecutor to eliminate conflict of interest - Vetting key national positions such as MACC chief commissioner, EC chairman and Bank Negara governor to eliminate conflicts of interest - Explore the use of blockchain technology to create a single and integrated identification system - Ensure Malaysian Institute of Integrity (Institut Integriti Malaysia) remains as an independent agency to enhance the capabilities and competencies of the public and private sectors on matters pertaining to governance
Education	- Free early childhood care and education for children six years and below - Introduce coding, creative thinking and languages such as Mandarin, Tamil and other ethnic languages in all schools - Special programme for students affected during the Covid-19 pandemic - Textbook-free schools and free laptops for B40 students - 5G internet and public WiFi at all schools within 18 months - Promote teaching as a preferred and highly prestigious profession - Free higher education for all individuals from B40 families - Offer 100% PTPTN loan to M40 and below
Tax Reform	- Tax cut for companies that uphold gender and ethnic diversity in management - Tax cut up to RM5,000 per year for companies that provide employees training - 2% income tax cut targeted at the M40 group (RM50k - RM100k) - Tax cut for companies that introduce flexible working hours for working mothers - Full income tax exemptions for five years for women who return to the workforce after a career break

Source: The Edge Markets

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