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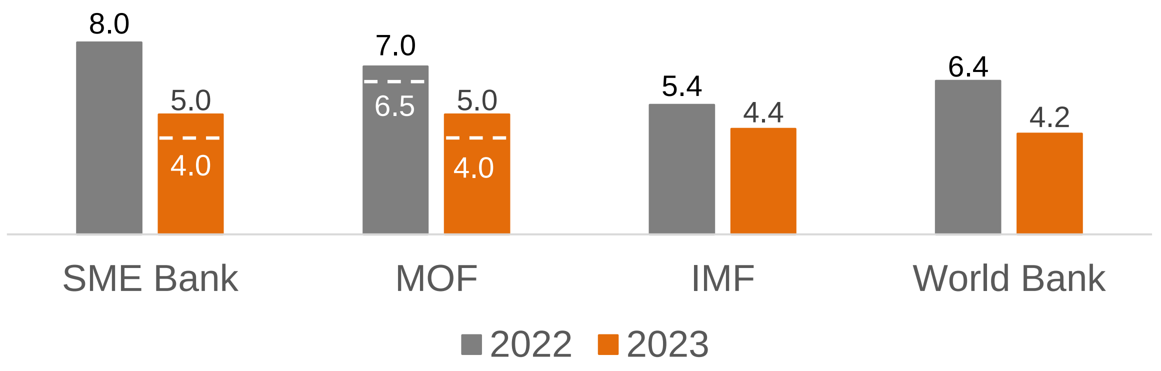
Malaysia clocked in a robust economic performance for the first 9 months of 2022, as reflected by its Gross Domestic Product (GDP) growth of 9.3% YoY. While **SME Bank expects growth performance of around 8% YoY** this year, the **momentum might not be sustained moving forward as headwinds** becomes more evident. We foresee **the economy to continue growing in 2023 albeit at a moderating pace of 4% - 5%,** supported by still resilient domestic demand, tight labour market and the prospect of China's economic relaxation. The forecast is in line with government's projection and international bodies such as International Monetary Fund (IMF) and World Bank (*refer Figure 1*).

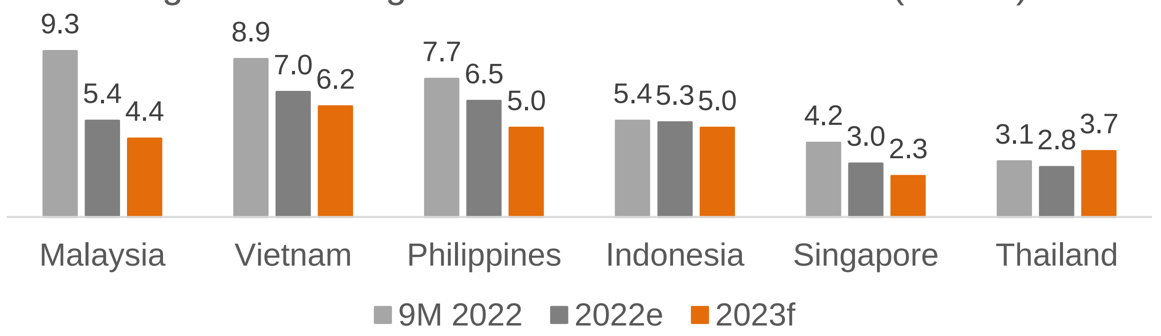
Figure 1: GDP Growth Forecasts (% YoY)



--- indicates lower range of forecast.
Source: IMF World Economic Outlook (Oct 2022), World Bank East Asia & the Pacific Economic Update (Sep 2022), Ministry of Finance (MOF) Malaysia

Thus far, Malaysia's economy has been performing better than peers in the Association of Southeast Asian Nations (ASEAN) 6 *(refer Figure 2)*. For 2023, all ASEAN-6 members are projected to experience a slowdown in growth except Thailand – supported by recovery in the tourism sector and continuous fiscal stimulus. In Malaysia, some important indicators such as the Purchasing Managers' Index, industrial production and retail sales are already trending downward in recent months, broadly in line with regional peers.

Figure 2: GDP growth in ASEAN-6 countries (% YoY)



e = estimate; f = forecast.
Source: IMF World Economic Outlook (Oct 2022)

The slowdown foreseen next year is mainly **stemming from external factors**. High food prices globally and severe energy crisis in Europe resulting from the Russia-Ukraine conflict remains a critical risk to the global economic stability. IMF forecasts some major economies (e.g. the US, Europe) to experience a significant slowdown if not a contraction in 2023. Global slowdown in demand, alongside persistent inflationary pressures, aggressive tightening of monetary conditions, sharp appreciation of the US dollar, climate change risks and China's zero-Covid policy pose significant challenges to emerging market including Malaysia.

Domestically, there are some considerable uncertainties as well. Notable and broad-based price pressures and monetary policy tightening will likely dampen consumer spending. **Targeted fuel subsidy that is expected to be introduced in 2023** might bode well with the Government's Fiscal Responsibility Act but could also be detrimental to the economy, depending on its rollout mechanism. Under the managed float mechanism for RON95 and diesel when it was first implemented in Dec 2014, RON95 was priced at RM2.30 per litre (Brent price averaged ± USD57 per barrel). In comparison, current (Dec 2022) price of RON95 is subsidised at RM2.05 when Brent is hovering around USD80 per barrel (YTD average: USD100 per barrel). Complete removal of fuel subsidy at this price level could result in a huge jump in inflation. Recently, relevant ministries under the new government have been instructed to swiftly formulate and develop suitable measures to implement targeted subsidies by taking into consideration the interests of consumers and the industries. Hence, we expect more details to be gradually announced early next year. **Our 2023 in-house forecast for Brent crude oil remain high at an average of USD85 – USD95 per barrel while we foresee inflation to range between 3.0% - 4.0%.**

Micro, Small and Medium Enterprises (MSMEs) is unlikely to escape the ripple effects from the moderation in GDP growth as it accounts for 97.4% of overall establishments in Malaysia. While they can still leverage on the ongoing recovery story, we may also see some MSMEs **holding back expansion plans but requiring additional financing for working capital instead**, in anticipation of a more challenging year ahead. Moreover, MSMEs which are in a tight cashflow situation may find it **difficult to operate in a higher cost/ interest rate environment**. We expect **two rate hikes of 25bps each in 1H 2023, bringing the OPR to 3.25% in 2023.** Other factors such as **environmental, social and governance (ESG), and low carbon requirements add to higher costs** as firms may require an overhaul to the existing plants and processes. Nonetheless, ESG should be seen as an investment for long-term growth benefits as it allows MSMEs to tap into new markets and gain better access to funding.

Nonetheless, there are **some upsides to growth next year**. The newly elected government will continue to monitor global developments as well as implement appropriate policies and structural reforms to strengthen the economy. The government has also pledged to prioritise addressing the rising cost of living which could restore consumers' confidence. Malaysia's diversified economy, alongside its resilient domestic demand should cushion against potential external shocks. The recovery in subsectors such as tourism and education will continue to pick up in 2023 amid spare capacity, providing more support to economic growth.

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