ALLIANCEDBS RESEARCH

Economic Focus

2025 outlook: Rejuvenating the economy

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- **Strong underlying fundamentals cement position of strength in the face of rising external uncertainties and trade protectionism**
- **2025 ASEAN chairmanship underpins a strong year of robust economic activities with extensive trade collaborations as positive spillover**
- **We are upbeat on 2025 growth prospects and expect 4.7% GDP growth**

Domestic economy firing on all cylinders

Our conviction of a second economic take-off under the Madani Economic Framework remains firm. 9M2024 GDP growth came in at 5.2%, on track to achieve the government's revised projection of 4.8%-5.3% (from 4%-5%) in 2024 while 2025 growth projection was guided at 4.5%-5.5%, indicating a sustained growth trajectory. Robust labor market with low unemployment rate of 3.2% and historic high labour force participation rate will ensure resilient and steady domestic consumption. Meanwhile, the long-overdue surge in investment activities backed by record high approved investments in 2021-2023 underlines the robust prospects of investment upcycle in Malaysia which will accelerate the economic take-off envisaged by the government to be a paradigm shift for Malaysia.

ASEAN chairmanship to propel Malaysia to greater heights

With Malaysia assuming the ASEAN chair in 2025, key regional agenda such as climate change, trade facilitation, green transition and digital economy could be prioritized, dovetailing with Malaysia's strategic developments and flagship projects under the New Energy Transition Roadmap (NETR) and New Industrial Master Plan (NIMP) 2030. The Johor-Singapore special economic zone (JS-SEZ) – the first cross-border SEZ in ASEAN – is also expected to see more progress with both Malaysia and Singapore ironing out relevant issues including incentives, cross-border movement and human capital. In addition, more than 300 ASEAN-related summits, high-level meetings and technical workshops collectively will be held throughout the year in Malaysia which will provide a strong fillip to domestic consumption. As Malaysia seizes the opportunity to wield its influence to strengthen the ASEAN economic bloc with better regional integration in 2025, this may enhance overall economic resilience amidst rising trade protectionism and external uncertainties.

Fiscal reforms offer fleeting pains, but lasting gains

Budget 2025 showcases the government's commitment to pursue fiscal consolidation and rebuild fiscal buffer for long-term sustainability. Notably, targeted subsidy for petrol is expected to be implemented in mid-2025 which could save RM8bn (from RM20bn subsidy bill) from the top 15% consumers. Monthly minimum wage will be raised by 13% to RM1.7k from RM1.5k and various income tax reliefs on healthcare, education and insurance have been increased/extended which will ensure household disposable income remains intact. More importantly, 2025 budget deficit will fall to the lowest since 2019 at 3.8% (vs 4.3% in 2024), as the government is committed to achieve its medium-term deficit target of 3%.

All stars aligned

We are optimistic of Malaysia's economic outlook, and project 2025 GDP growth to come in at a stellar 4.7% which is in line with the government's forecast. Fundamentals remain strong as Malaysia's economy continues to take comfort from its resilient domestic demand, underpinned by sustained household spending. Key downside risks include slower-than-expected recovery in external demand and heightened geopolitical tensions.

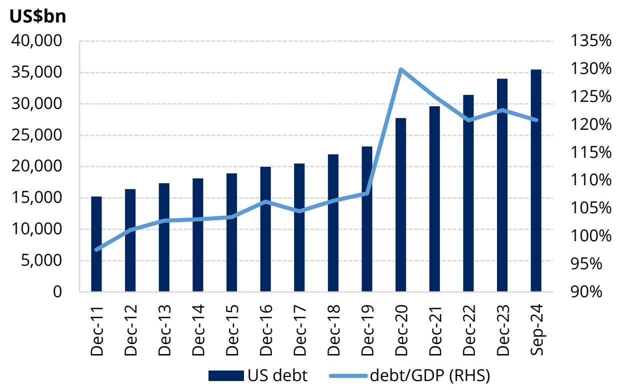
Potentially disruptive trade policies from the US

As the US welcomes its new president in 2025 with Republican control in both the Senate and the House of Representatives, financial markets have priced in a more robust US economic outlook with pro-growth policies under the new administration. Nevertheless, significant tax cuts, regulatory easing and punitive trade tariff are most likely to result in elevated inflationary pressures which may limit the Federal Reserve's ability to continue with its monetary easing.

The US president-elect has recently indicated that he will impose a 25% tariff on goods from Mexico and Canada, along with a 10% tariff on imports from China, signalling his strong intent to deliver on his election promise despite these three countries being US largest importing countries. It remains to be seen if the US economy will remain resilient with more trade protectionism which may in turn invite retaliations from its trading partners.

Depending on the extent of protectionist trade measures imposed by the US, this potential trade conflicts have serious and widespread repercussions for global trade as the ensuing global supply chain recalibration may intensify, potentially drawing trade and investments to Asian countries such as ASEAN and India. Nevertheless, global economy will be more susceptible to disruptions from US trade policies with more downside risks to global growth, despite the relatively healthy condition so far during the monetary tightening cycle.

US rising debt



Source: AllianceDBS, Bloomberg Finance L.P.

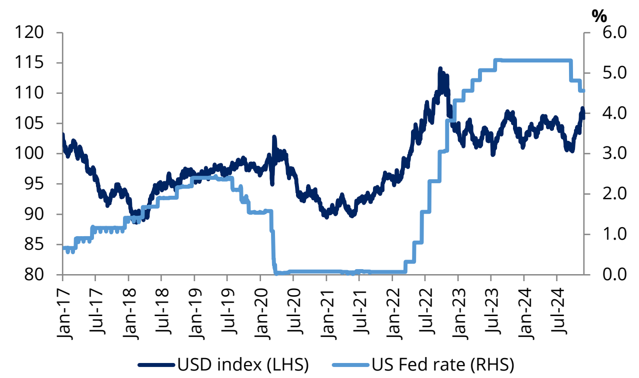
While stronger growth and inflation expectations have been anticipated under the incoming Trump administration as reflected in the elevated treasury yields, concerns of larger fiscal deficits will be a key concern for financial markets. In 2024, US fiscal deficit came in at 6.4% of GDP (vs 6.2% in 2023), bringing its gross federal debt to 123% of GDP, which is very close to its historical high incurred during the COVID-19 pandemic in 2020.

The Congressional Budget Office has projected US budget deficit to hover around 6%-7% over the next 10 years which will continue to add on the huge debt pile of the US government. Without a clear path to fiscal discipline, treasury yields are likely to remain at elevated levels as reflected in the rising term premium.

The Fed started its monetary easing cycle in Sep 2024 when it slashed the benchmark rates by 50 bps amid a slowing labour market and softening inflation. It then continued to cut rates by 25 bps each in subsequent two meetings in Nov 2024 and Dec 2024. The latest Summary of Economic Projects in Dec 2024 indicates that the rates could be cut by an additional 50 bps in 2025 to 3.7 5%-4.0% by end-2025, a much slower easing compared to its Sep 2024 projection of 100 bps cut.

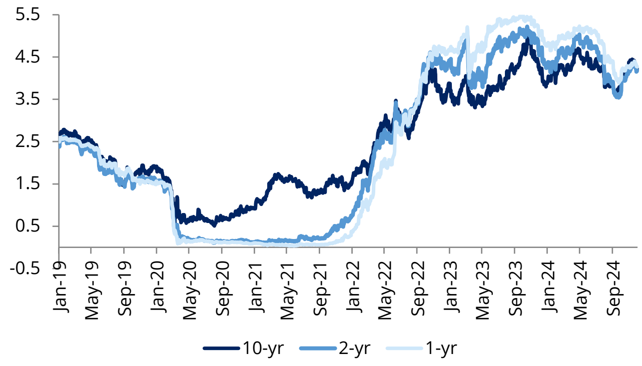
Based on Fed fund futures, the market is only pricing in 25bps cut in 2025, possibly due to inflation concerns of Trump's policies . While the disinflation trend in the US has worked in favour of the Fed to combat inflation after its aggressive monetary tightening over the past three years, the new administration under Trump may alter the dynamics as financial markets continue to speculate on him delivering on his election campaign promises. The pace of interest rate cuts in 2025 remains highly debatable going by the volatile swings in the financial markets in 2024. The interest rate outlook can fluctuate wildly within a short span of a few months, underlining the difficulty in making accurate projections of its future trajectory.

Beginning of Fed rate cuts



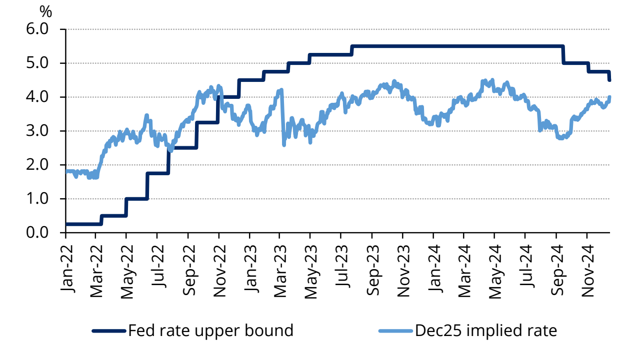
Source: AllianceDBS, Bloomberg Finance L.P.

US Treasury yields remain elevated



Source: AllianceDBS, Bloomberg Finance L.P.

Fed funds futures price in measured rate cut in 2025



Source: AllianceDBS, Bloomberg Finance L.P.

IMF's world economic outlook projections

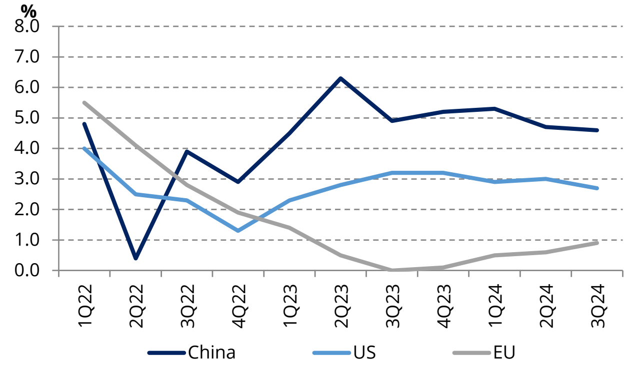
Region, country	Oct 2024			Oct 2023	
	2023	2024	2025	2023	2024
World	3.3	3.2	3.2	3.0	2.9
US	2.9	2.8	2.2	2.1	1.5
UK	0.3	1.1	1.5	0.5	0.6
Euro area	0.4	0.8	1.2	0.7	1.2
China	5.2	4.8	4.5	5.0	4.2
India	8.2	7.0	6.5	6.3	6.3
Japan	1.7	0.3	1.1	2.0	1.0
Emerging & developing economies	4.4	4.2	4.2	4.0	4.0

Source: AllianceDBS, IMF

Based on the World Economic Outlook Oct 2024 by the International Monetary Fund (IMF), global economic growth is expected remain stable at 3.2% for both 2024 and 2025. Notably, the US remains a key growth driver for advanced economies while emerging Asia such as China and India is expected to bolster global growth with their substantial public investment. Meanwhile, global headline inflation has largely subsided, thanks to the overall moderation in goods prices though services price inflation remains elevated in many countries.

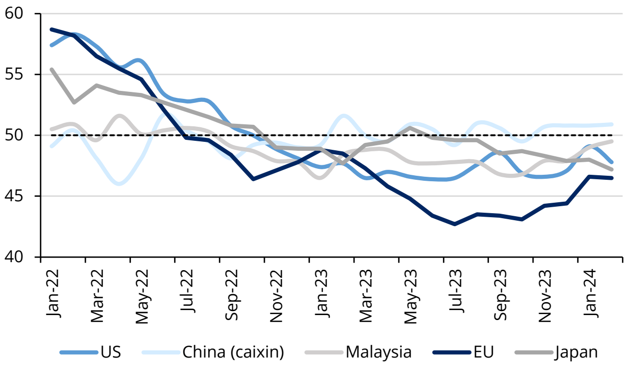
Compared to a year ago, IMF's economic projections indicate that global economic growth momentum has been rather resilient despite the aggressive interest rate hikes undertaken by global monetary authorities. As central bankers begin to undertake monetary easing, global outlook may continue to remain stable, though risks are tilted to the downside amid elevated policy uncertainty.

Y-o-y GDP growth for major economies



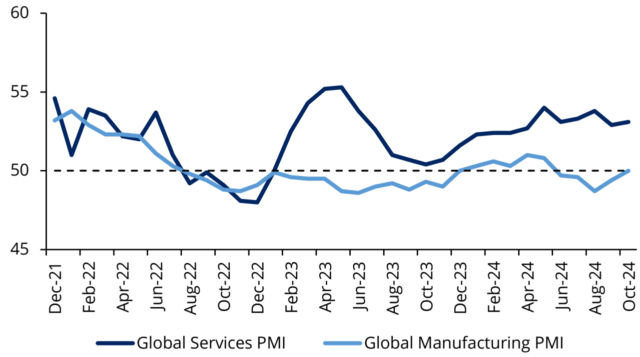
Source: AllianceDBS, Bloomberg Finance L.P.

Manufacturing PMI



Source: AllianceDBS, Bloomberg Finance L.P.

Global PMI



Source: AllianceDBS, Bloomberg Finance L.P.

Meanwhile, China's growth trajectory in 2025 will be closely monitored by market participants as it remains vigilant on the impact of expected US tariff hikes on its exports. China has stepped up efforts to spur investment and consumption in recent months to boost domestic demand.

In Oct 2024, China introduced a slew of more-aggressive-than-expected stimulus measures aimed at boosting the economy and equity markets. The broad stimulus package injects RMB1 trillion of liquidity via reserve requirement ratio cut, lowers borrowing costs and loosens downpayment requirement for second-home buyers. For the equity markets, RMB800bn of liquidity injection is provided with more support measures in the pipeline.

The Chinese government may follow up with more fiscal easing measures to further revitalise the ailing economy given the global easing cycle. In fact, the government has promised stronger fiscal policy in 2025 with a higher budget deficit of 4% to support domestic economy, which may in turn keep external trade activities healthy for the Asian region. We believe that the China's commitment to spur the economy should not be underestimated as financial stability is of utmost importance to the government.

This is especially so when trade relations between the US and China are unlikely to improve as the US continues to introduce export curbs and sanctions against China on advanced technology. China remains committed to huge investments to pivot away from US technology and it is vigorously promoting the localization of its tech industry to reduce reliance on foreign technologies and products under the Made in China 2025 framework in response to increasingly stringent restrictions from the US government.

Key risks to global economy in 2025 include slower-than-expected growth in trade activities and heightened geopolitical conflicts that have remained unabated. The global trend of de-globalisation has continued to gain traction as businesses seek to ensure supply chain security by adopting "China + 1 strategy" which has also offered opportunities for emerging countries to tap into large foreign investments.

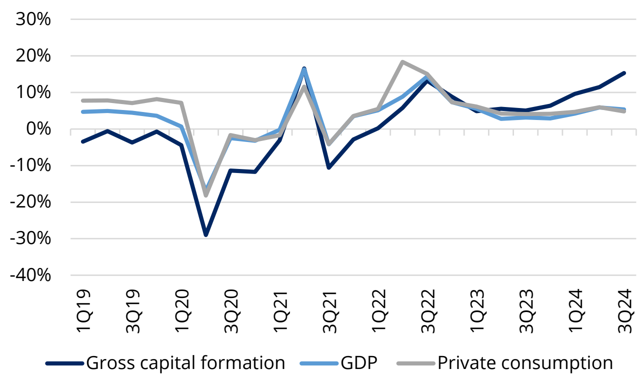
Madani Economy delivers stellar performance

Malaysia's economy in 2024 has come in stronger than expected on the back of firm domestic demand, driven by sustained strength in household spending and revitalized investment activities. 9M2024 GDP growth came in at 5.2%, on track to achieve the government's revised projection of 4.8%-5.3% (from 4%-5%) while 2025 growth projection was guided at 4.5%-5.5%, indicating a sustained growth trajectory.

We believe Malaysia's economy is coming from a position of strength in 2025 as domestic demand is likely to strengthen further with sustained consumer spending and stronger investment activities. Its strong fundamentals and diversified economic structure, coupled with renewed government focus to spur higher economic growth will help ensure Malaysia's growth trajectory remains firmly on the uptrend.

We expect Malaysia to register a firm GDP growth of 4.7% in 2025 after a healthy growth of 5.1% expected for 2024. This is also in line with the government's 2025 GDP growth projection. Private consumption, accounting for 60% of our economy, will continue to deliver satisfactory performance for Malaysia's economy, underpinned by robust labour market and strong economic and social activities, especially tourism-related activities.

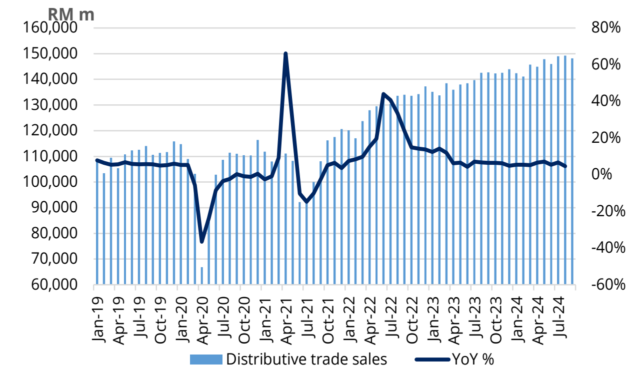
Malaysia's GDP growth



Source: AllianceDBS, CEIC

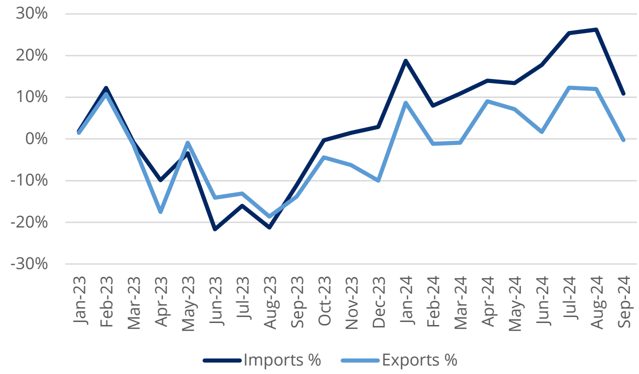
Meanwhile, private investment is expected to benefit from improved external environment and positive response to the NETR and NIMP 2030 while the government continues with its expansionary fiscal policy to drive economic growth. 3Q24 capital expenditure surged to a multi-year high growth of 15.3%, signifying the positive impact arising from record-high approved investments in 2021-2023 and various government-led strategic developments under national blueprints. This underlines the robust prospects of investment upcycle in Malaysia which will continue to provide further tailwinds in the near term.

Monthly wholesale & retail sales



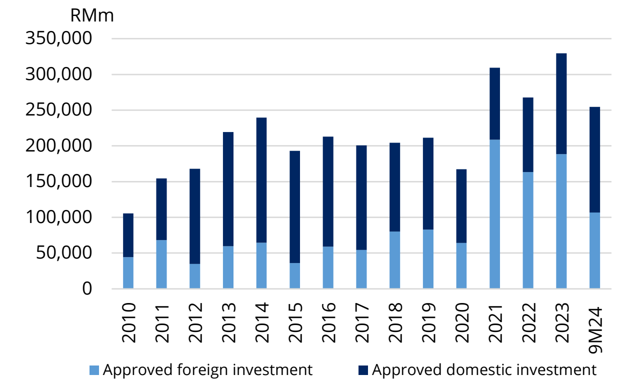
Source: AllianceDBS, CEIC

High imports on rising investments and higher trade



Source: AllianceDBS, CEIC

Record high approved investments continue in 2024



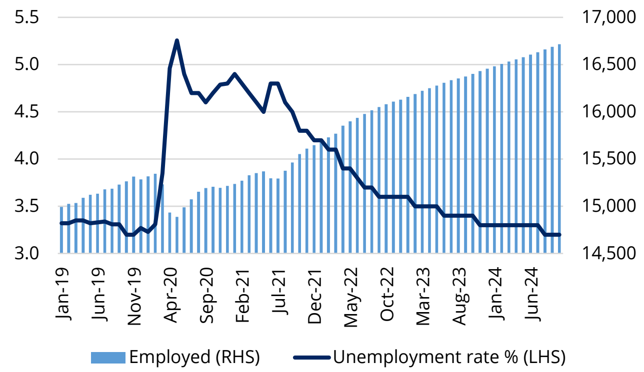
Source: AllianceDBS, CEIC

Tight labour market condition

Malaysia's economic growth momentum will continue to be underpinned by the robust employment market which has been growing from strength to strength. Malaysia's unemployment rate in Oct 2024 came in at 3.2%, compared to 4.2% in Jan 2022. Notably, we are encouraged by the continuous growth in employment market outpacing the growth in labour force, lifting the labour participation rate to a record high of 70.5% in Oct 2024. This will certainly bode well for the economic outlook in 2025 given that domestic demand forms the bulk of our economy.

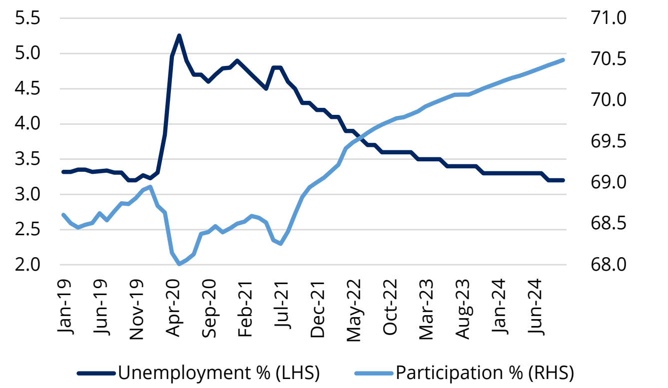
Going by the healthy growth momentum of Malaysia's economy in 2024, the robust labour market condition will ensure that the growing working-age population is met with higher employment opportunities. We believe Malaysia's unemployment rate will continue to decline towards 3.1%
by end of 2025.

Strong labour market



Source: AllianceDBS, CEIC

Favourable labour market dynamics

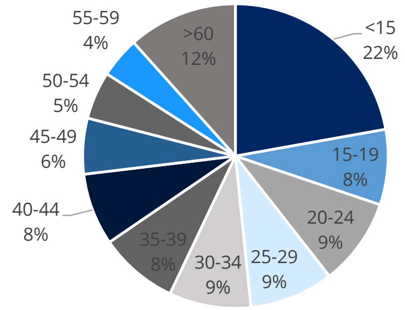


Source: AllianceDBS, CEIC

We believe this healthy strength in the employment market is a key growth pillar that will continue to sustain Malaysia's economic growth as the country enjoys the demographic dividend. The median age of Malaysia's population is relatively young at 31 years, underpinning the healthy growth in our labour force.

According to the Department of Statistics Malaysia, Malaysia's population is expected to grow by 2% to 34.1m in 2024, similar to the growth pace in 2023. The healthy growth projection in 2024 is largely due to the sharp increase of non-citizens from to 3.4m (3m in 2023, 2.5m in 2022), in line with the reopening of national borders starting from Apr 2022 and the implementation of the employment recalibration program 2.0 since Jan 2023.

Malaysia's 2024 demographic breakdown by age



Source: AllianceDBS, CEIC

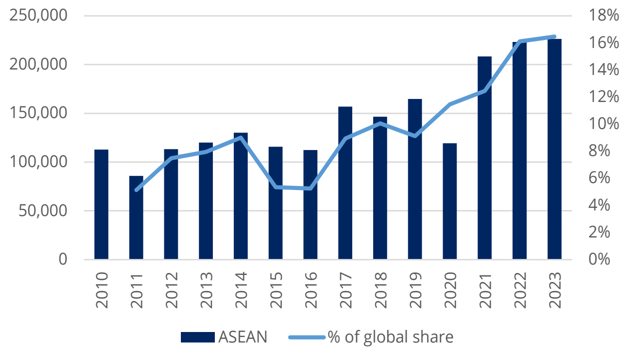
As the Malaysian government continues to advance its economic transformation agenda by attracting more quality investment to Malaysia, international migration especially skilled labour force could further lift the overall employment market in Malaysia. According to the 12MP Mid-Term Review (MTR), Malaysia's population is projected to grow by 4.9% in 2023-2025, implying annual growth rate of 1.6%. This could be in tandem with the various investment programs undertaken by the government.

Time to shine as ASEAN chair in 2025

2025 will be a significant year for Malaysia as it will be hosting the ASEAN chairmanship after 10 years. It comes as at a crucial time as the world is at a crossroads, especially with the incessant US-China conflicts and the rise of far-right politics as well as general retreat from democratic centralism which have all contributed to renewed uncertainties. This structural shift has made ASEAN, a traditionally non-aligned bloc, a rising economic hotspot. ASEAN has largely benefitted from the geopolitical landscape with increasing share of goods trade as well as marked increase in foreign direct investments due to supply chain diversification under "China + 1" strategy.

ASEAN has consistently proven its resilience and appeal as a leading destination for FDI despite the overall decline in global FDI flows. The shifting patterns and priorities in global FDI, particularly the growing focus on digital and renewable energy are also strongly manifest in the region. More importantly, ASEAN's rising prominence as a major hub for global supply chain underscores its competitive advantage in positioning itself as a critical partner for multinational companies to navigate a changing world order.

Rising FDI inflow into ASEAN



Source: AllianceDBS, UNCTAD

Malaysia, under the leadership of Prime Minister Anwar Ibrahim since Nov 2022, has continued to focus on rebuilding and restructuring its economy with the inception of Madani Economy Framework in Jul 2023 as the overarching principle to propel Malaysia's goals to achieve a progressive, inclusive and dynamic economy. Subsequently, the NETR and the NIMP 2030 were rolled out, both of which have the lofty ambitions of lifting Malaysia's economic competitiveness and elevating the overall socioeconomic status of the people.

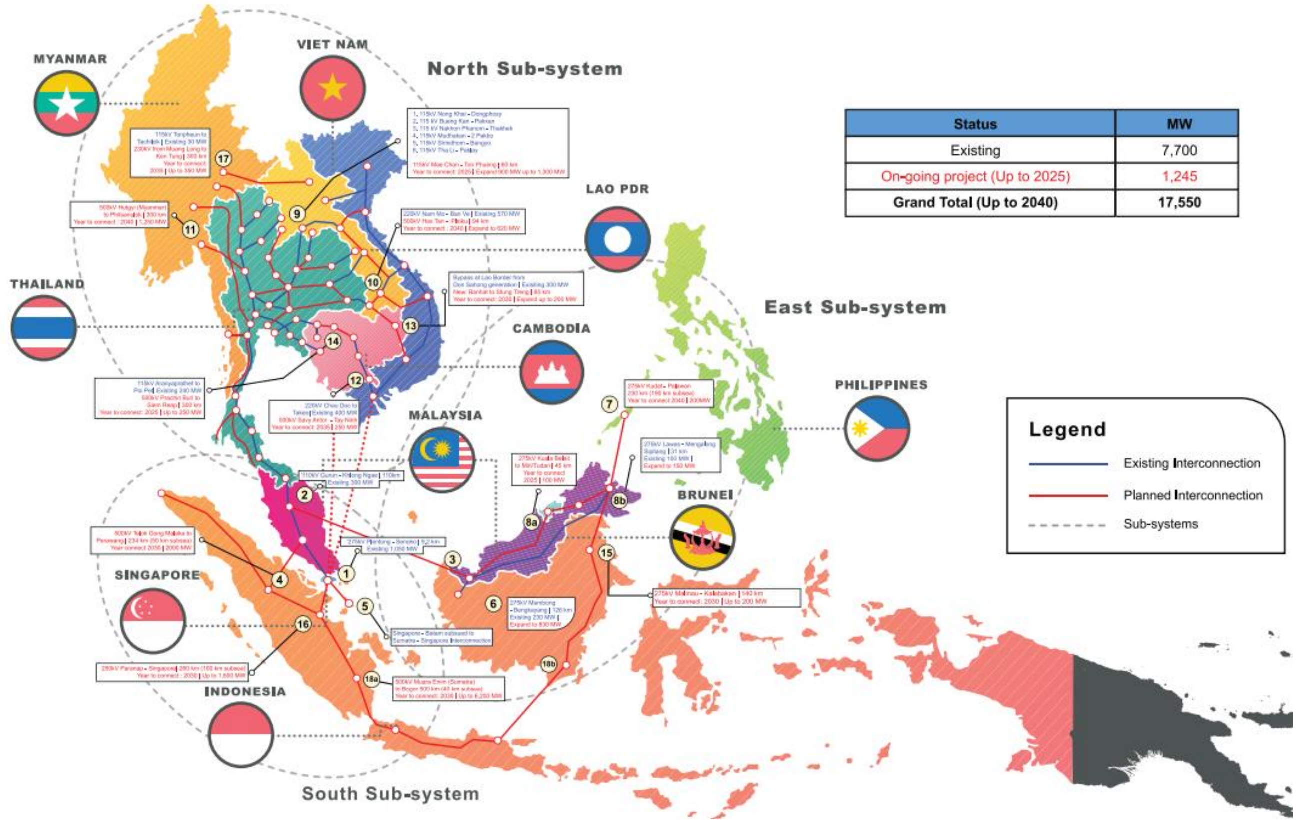
The concerted efforts by the Madani government to accelerate Malaysia's economic growth trajectory has started to bear fruits in 2024 with the higher-than-expected GDP. With Malaysia's economy firing on all cylinders and the government embarking on fiscal reforms, we believe ASEAN chairmanship in 2025 comes at an opportune time for Malaysia to further propel its second economic take-off toward a high-income nation, regaining its former lustre of an Asian Tiger economy.

Key regional agenda such as climate change, trade collaboration, green transition and digital economy could be prioritized, dovetailing with Malaysia's strategic developments and flagship projects under the NETR and NIMP 2030. In addition, various summits, high-level meetings and technical workshops in excess of 300 sessions collectively will be held throughout the year in Malaysia which will provide a strong fillip to domestic consumption. As Malaysia seizes the opportunity to wield its influence to strengthen the ASEAN economic bloc with better regional integration in 2025, this may enhance overall economic resilience amidst rising trade protectionism and external uncertainties.

We believe the ASEAN Power Grid (APG) is a key matter that is likely to be championed by Malaysia in 2025 as the world continues to pursue the green transition. The APG is an initiative to construct a regional power interconnection to integrate the region's power grid system. Malaysia has made notable strides in advancing the net zero carbon emission agenda with various flagship projects under the NETR which is backed by RM61bn investment for phase 1, exceeding the initial target of RM25bn.

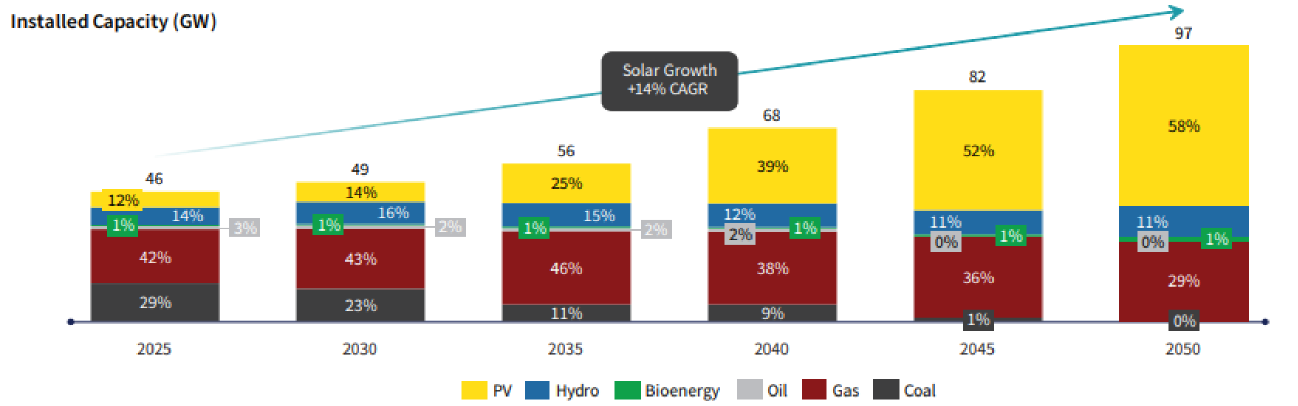
We are encouraged with the successful launch of several key solar energy programs such as the large-scale solar (LSS) projects, net energy metering (NEM) scheme, corporate green power programme (CGPP) and the latest being corporate renewable energy supply scheme (CRESS) which are all increasing the energy mix of renewable energy. Particularly, CRESS will allow third-party access for the sales of renewable energy through the national grid via a predetermined system access charge, marking a significant milestone in liberalising Malaysia's energy market which is also a critical building block for the APG.

ASEAN Power Grid map



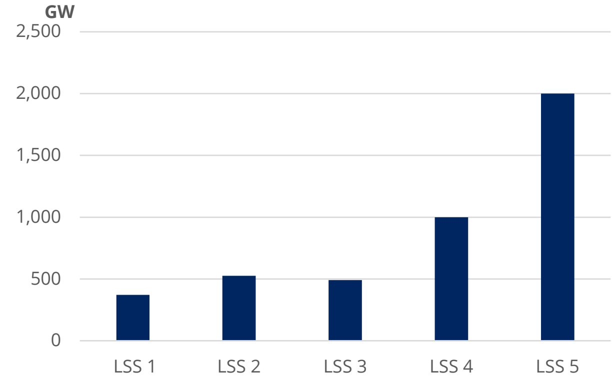
Source: ASEAN Energy

Malaysia' projected power system installed capacity mix



Source: Ministry of Economy

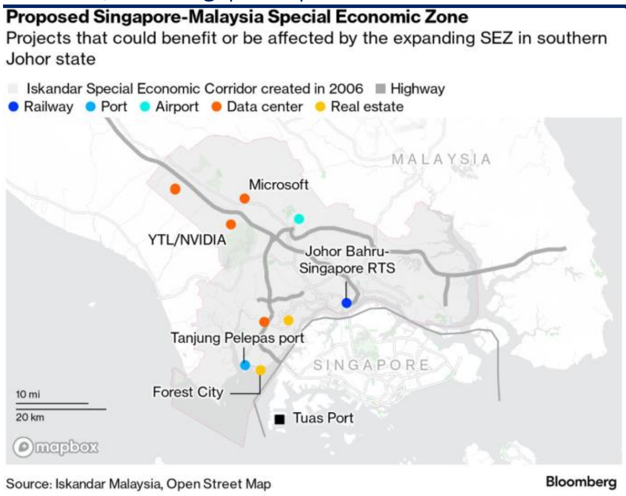
Aggressive expansion for solar power in Malaysia



Source: AllianceDBS, Energy Commission

Meanwhile, the Johor-Singapore special economic zone (JS-SEZ) could be featured prominently as the first cross border SEZ in ASEAN in 2025. With the signing of a joint agreement on the JS-SEZ scheduled during the 11th Malaysia-Singapore Leaders Retreat in Jan 2025, we expect further progress in 2025 with both Malaysia and Singapore ironing out relevant issues including incentives, cross-border movement and human capital. Malaysia and Singapore have continued to enjoy warm bilateral relations under both countries' new leadership, and this has set the foundation for both parties to jointly undertake more win-win initiatives under the JS-SEZ which could possibly thrive for the next 10 years.

Potential Johor-Singapore Special Economic Zone



Source: Bloomberg

ASEAN has also emerged as a data centre hotspot as the rapid growth in the digital economy is driving demand, with increasing reliance on cloud services. In Malaysia, the green lane pathway set up by Tenaga Nasional in 2023 to fast-track power supply application for data centre operators has yielded significant success as 1.1GW of data centre capacity has been completed in the 9M2024, compared to just 0.6GW at the beginning of 2024. As at Sep 2024, 14 data centre projects with a collective capacity of 3GW are either under construction or in the pipeline which will bring the total data centre capacity in Malaysia to 4.7GB over the next few years.

Asia's largest data centre markets in 1H24

Rank	Geography	Capacity (MW)
1	China (mainland)	6,515
2	India	4,336
3	Japan	4,059
4	Australia	3,278
5	Malaysia	3,108
6	South Korea	1,727
7	Singapore	1,334
8	Hong Kong, China	1,127
9	Indonesia	1,046
10	Thailand	467

**Including operational, under construction and planned*

Source: AllianceDBS, Cushman & Wakefield

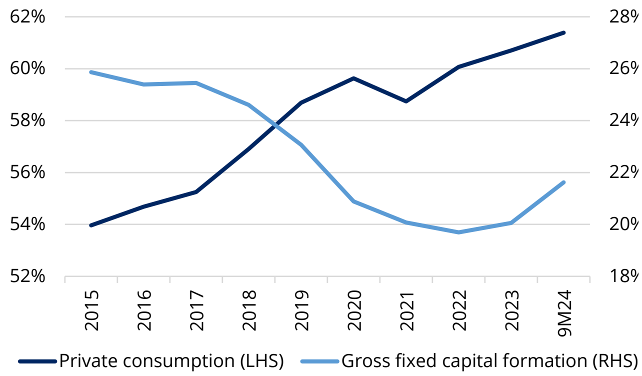
As ASEAN is still in the infancy stage of digital transformation, Malaysia's strategic move to position itself as a regional hub of data centre bodes well for the country. The surging demand for hyperscale data centres is fuelled by the growing adoption of AI technologies, including machine learning, deep learning, natural language processing, and Large Language Models. Malaysia's abundant affordable land and excellent fibre connectivity make it an ideal location for these large-scale facilities.

Indeed, Malaysia has witnessed a significant increase in digital investment. The Malaysian government has revealed recently that the country's digital investment surged to RM66bn in 1H24, compared to RM46bn for the full year of 2023, resulting in the creation of 24,498 new jobs which is aligned with the Madani Economy Framework to provide high-skilled, high-income employment.

Investment renaissance in Malaysia

Thanks to the concreted efforts by the federal government to boost economic growth under the Madani Economy Framework, investment-driven spending is set to be a new growth driver for Malaysia in 2025. The implementation of the strategic developments and flagship projects under the NETR and NIMP 2030 will accelerate the economic take-off envisaged by the government to be a paradigm shift for Malaysia. In addition, the realisation of record-high approved investments from foreign investors in 2021-2023 will ensure the economy remains on a healthy growth trajectory in 2025.

GDP share of consumption vs investment



Source: AllianceDBS, BNM, CEIC

Indeed, the proactive strategy adopted by the government to revitalize the domestic economy has started to bear results as 9M24 capital expenditure surged to a multi-year high growth of 12.1%. The positive impact arising from record-high approved investments in 2021-2023 and various government-led strategic developments under national blueprints is expected to provide further tailwinds in the subsequent quarters.

More importantly, after achieving record high approved investments in 2021-2023, the winning streak has continued unabated in 2024 with the figures rising 11% y-o-y to RM255bn in 9M2024, outpacing the government's full-year target of 5%. This signifies the strong confidence that foreign investors have in Malaysia, a traditionally non-aligned country which is expected to benefit from the US-China tensions, indirectly helping to uplift Malaysia's industrial capabilities and boost its value-adding exports

The NIMP 2030 particularly is poised to enhance the competitiveness of Malaysia's manufacturing industry, leveraging on the global trend of "China + 1" strategy for industrial value chain diversification. In fact, the heightened US-China trade tensions have benefitted not only Malaysia but the entire ASEAN as a whole given the attractive value proposition offered.

In addition, the government has launched the National Semiconductor Strategy in May 2024 with a government allocation of RM25bn which is aimed at further advancing the development of semiconductor ecosystem, moving up the value chain to capture a larger share of global investments. Therefore, it is no surprise that globally renowned technology giants such as Infineon AG, Nvidia, Microsoft and Google have all committed to step up their investments in Malaysia which will help to cement Malaysia's global position as one of the world's key semiconductor hubs.

Meanwhile, the government is also committed to revive economic growth by undertaking various large-scale infrastructure projects which will create positive spillover effects to the local businesses. Some of the major projects that will continue in 2025 include RM10bn Penang LRT, RM3bn flood mitigation projects, RM 9.7bn Pan Borneo Sabah phase 1B and RM7.4bn Sarawak-Sabah Link Road 2. We believe there will be more progress on the RM45bn MRT 3 in 2025
which will be an added impetus for Malaysia's economy. All these come on top of the existing mega projects including the likes of RM50bn ECRL and RM3.7bn Johor-Singapore RTS which have progressed well so far.

Some of the major government projects

Project	Investment RMbn	Timeline
MRT 3	45.0	from 2025
Penang LRT	10.0	2025-2030
Flood mitigation	3.0	2025
Pan Borneo Sabah phase 1B	9.7	2025
Sarawak-Sabah Link Road 2	7.4	2025
LRT 3 expansion	5.3	2024-2025
ECRL	50.0	2018-2027
Johor-SG RTS	3.7	2021-2026
My Digital 5G	16.5	2021-2031
Pan Borneo Sabah phase 1A	16.0	2016-2025

Source: AllianceDBS, MOF

Slowly but surely in implementing fiscal reforms

Budget 2025 entails a record high expenditure of RM421bn which 3.3% higher than the revised Budget 2024 estimate of RM407.5bn as Malaysia strives to achieve its socioeconomic goals under the Madani Economy Framework. 2025 development expenditure is expected to remain unchanged y-o-y while operating expenditure is projected to increase by 4.2% which is slower than the projected revenue growth of 5.5% in 2025.

It is noteworthy that the relatively stronger revenue growth comes on the back of a robust economic outlook and tax revenue broadening measures though PETRONAS dividend will be maintained at RM32bn in 2025. Meanwhile, 2025 budget deficit will fall to the lowest since 2019 at 3.8% (vs 4.3% in 2024). As at Dec 2023, government debt accounted for ~64% of our gross domestic product (GDP), and it is likely to hover around the same level by end-2024 and 2025.

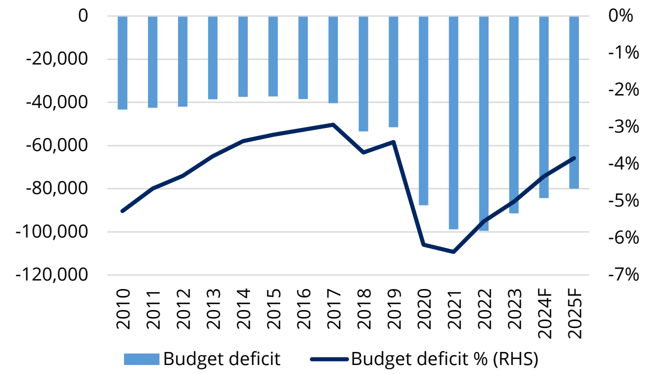
Budget 2025 continues to deliver on the government's reform initiatives to broaden tax revenue and implement targeted subsidy rationalisation. Notably, targeted subsidy for petrol is expected to be implemented in mid-2025 which could save RM8bn from the top 15% income earners and foreign consumers. Nevertheless, allocation for direct cash assistance under Sumbangan Tunai Rahmah and Sumbangan Asas Rumah programs will be boosted by 30% to RM13bn (vs RM10bn in 2024), benefitting 9m recipients.

In addition, various income tax reliefs on healthcare, education and insurance have been increased/extended to mitigate the impact of rising living cost. More importantly, monthly minimum wage will be raised by 13% to RM1.7k from RM1.5k which will come in handy for low-income earners. For revenue base expansion, some of the new taxes include a 2% tax on dividend income and expansion of the sale and services tax. In short, the government has clearly showcased its commitment toward fiscal sustainability which will bode well for Malaysia's long-term development.

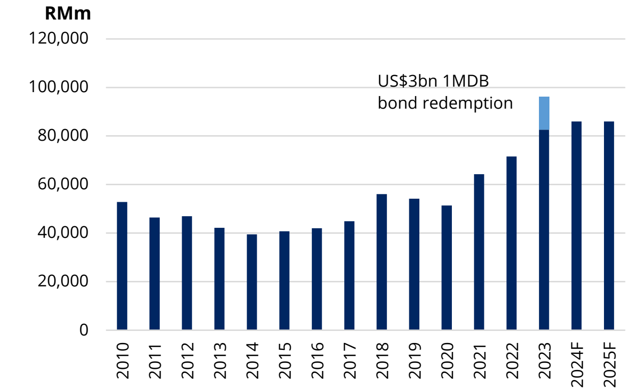
We are encouraged by the government's commitment to embark on fiscal discipline especially on petrol subsidy rationalisation in 2025 which has been delayed by a year. Despite the slower timeline, it comes on the heels of diesel, water and electricity subsidy rationalisation which have all taken place in 2024. There are all difficult and bold moves that require significant political will given the potential backlash from the public as subsidies are very much ingrained in Malaysian society for decades.

While the risk of subsidy rationalisation affecting consumer sentiment is real, inflation has remained benign in 2024, thanks to the declining commodity prices as well as government's financial assistance to low-income households. We believe the prudent approach of rationalising subsidies while providing financial aids to those in need will remain in place in 2025. In addition, the implementation of a higher minimum wage in tandem with the positive economic outlook will help to ensure Malaysians' purchasing income remains intact.

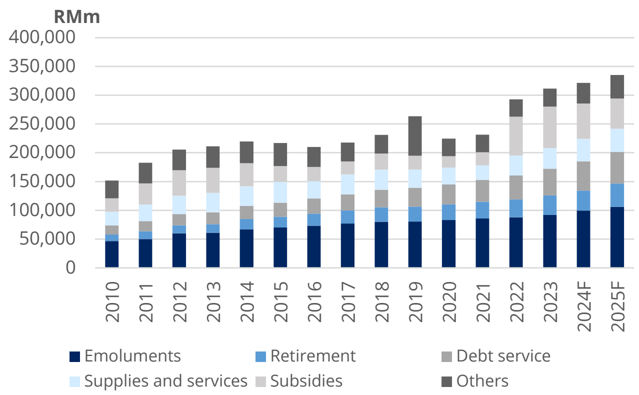
Consolidating budget deficit



Prioritizing development expenditure in 2025



Fiscal reforms to improve operating expenses



Source: AllianceDBS, BNM, Ministry of Economy

Resilient external trade

The anticipated recovery in external trade since early 2024 has now come into realisation as Malaysia's 9M2024 exports and imports rose 5% and 16% respectively. We believe the prospects for external trade in 2025 should remain resilient as Malaysia benefits from the global technology upcycle given our entrenched position in the global semiconductor supply chain, especially in the packaging, assembly, and testing services.

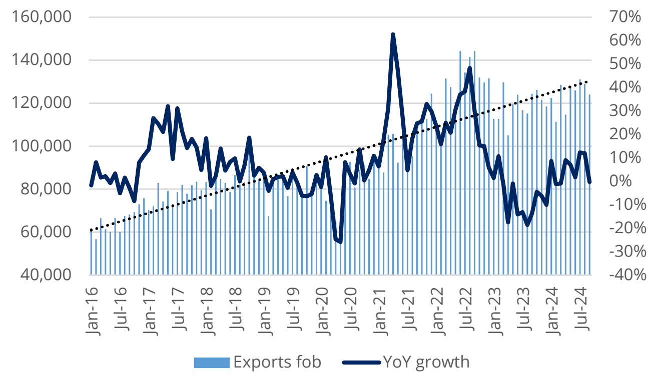
While the domestic E&E industry has been hit by the volatile currency movement in 3Q24 given the dramatic appreciation of MYR, the outlook of the global tech cycle remains promising given the relentless capital spending by multinational companies. The improving trend of global semiconductor shipments as well as positive trade data among key Asian trading hubs will continue to spill over to Malaysia given our deep integration with the global supply chain. The de-globalisation trend, especially in the technology sector, will also result in more capital spending as countries rush to ensure supply security.

In addition, continued recovery in tourist arrivals which stood at c.97% of pre-pandemic levels in 3Q24 will also contribute to better exports, supported by higher flight connectivity and visa exemptions. Meanwhile, Malaysia's strategic push to leverage on the global trend of "China + 1" industrial value chain diversification has been reflected in the record high approved investments in 2021-2023, helping to uplift Malaysia's industrial capabilities and boost its value-adding exports.

Meanwhile, the apprehension of potential US trade protectionism under the Trump presidency may encourage traders to accelerate their shipments in the near term, though the impact of tariff hike for goods exported to the US remains unclear at this juncture. Most of the key exporting countries in Asia continue to register steady numbers over the past few months, thanks to the resilient global economy. The beginning of the Fed monetary-easing cycle may help to ensure external trade remains on a healthy trajectory as more central banks globally are expected to follow suit in pursuing an accommodative monetary policy.

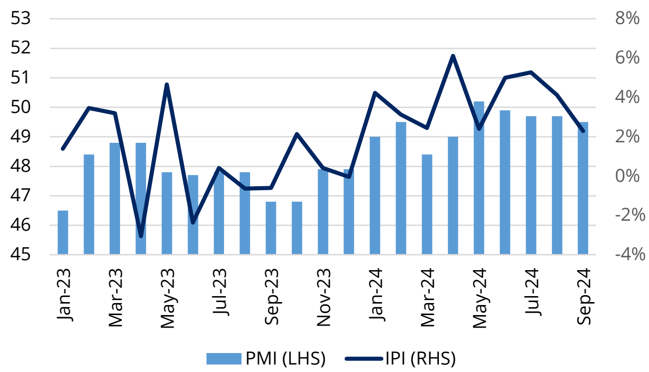
Therefore, we believe that the 2025 outlook for the manufacturing sector, contributing ~23% of GDP, is likely to remain healthy, in tandem with the improvement anticipated for overall economy. This is corroborated by positive data from the manufacturing PMI, industrial production as well as business confidence levels. In addition, the upticks in business loans since the end of 2023 lends further credence to our view that the manufacturing sector will continue its growth trajectory in 2025.

Malaysia's monthly exports growth is recovering



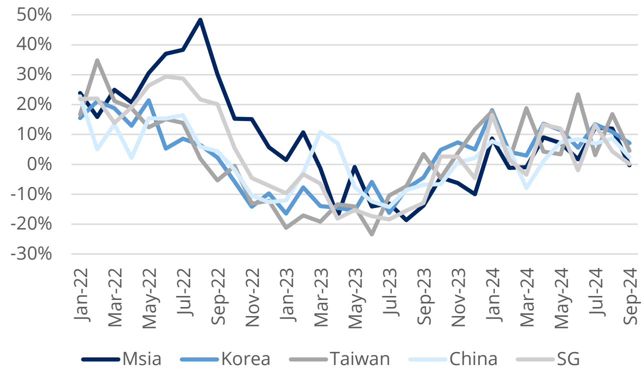
Source: AllianceDBS, CEIC

Industrial production remains healthy



Source: AllianceDBS, CEIC

Steady exports growth for key Asian exporters

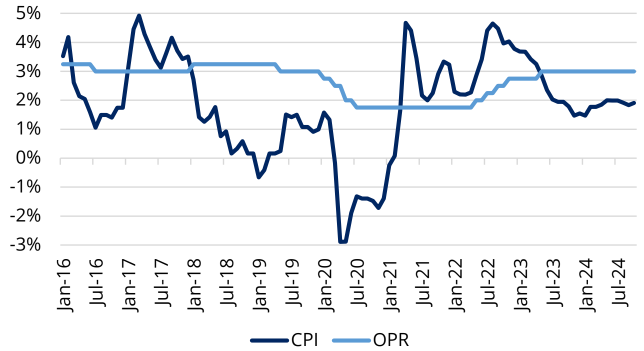


Source: AllianceDBS, CEIC

Heathy loans growth momentum

Despite the beginning of global monetary easing in 2024, Bank Negara Malaysia has been maintaining its current OPR rate of 3% which is similar to its pre-pandemic level. We believe that BNM will remain with this slightly accommodative interest rate in 2025 as the current monetary policy remains conducive to sustainable economic growth amid price stability.

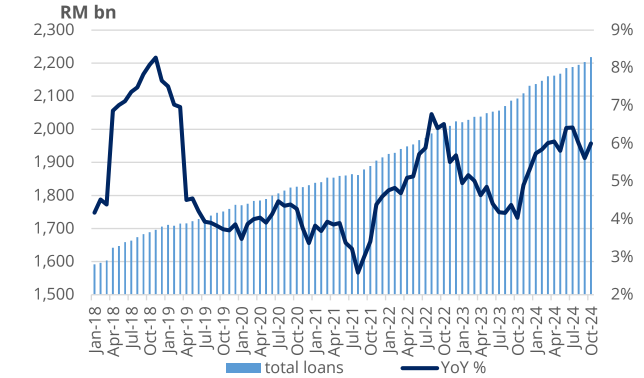
Interest rate vs inflation



Source: AllianceDBS, DOSM, CEIC

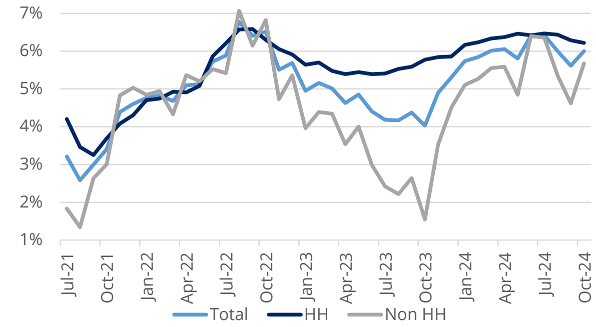
Our headline inflation has been moderating over the course of 2024, in tandem with the moderating trend of commodity prices due to demand concerns from major economies. Therefore, the positive real rates are likely to continue in the near term. Going forward, the outlook for inflation will be largely swayed by the global commodity price developments as well as the implementation of petrol subsidy rationalisation.

Banking system loans growth



Source: AllianceDBS, BNM

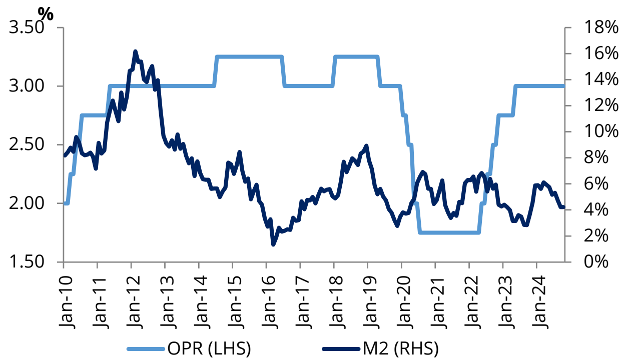
Loans growth remain at elevated levels



Source: AllianceDBS, BNM

Malaysia's banking system has been seeing improved credit demand in 2024 with Oct 2024 loans growth coming in at 6% (vs 4% in Oct 2023). Positively, business loans growth picked up in 2024, reflecting the growth momentum of Malaysia's overall economy. On the other hand, the positive landscape of the property sector continues to bolster the loans growth for the household segment.

Normalising liquidity condition in the economy



Source: AllianceDBS, BNM

Meanwhile, M2 money supply continues to grow at a healthy level of 4.2% in Oct 2024 (vs 3.6% in Oct 2023), as the domestic economy grows steadily. It is likely that the domestic liquidity remains robust, with continued orderly functioning of the financial market. Household spending will continue to be underpinned by improvements in labour market conditions and income prospects.

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