Bridge the financial divide with the west

Screenshot showing the MARC Malaysian Bond & Sukuk 2022 Virtual Conference in progress

'Bridge the financial divide with the West'

Malaysia needs to mind the gap or it will pay the price in form of more subsidies, says economist

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PETALING JAYA: The Malaysian government should bridge the economic and financial divide with the West through structural reform or the country will have to pay a higher price in terms of subsidies, according to MARC Ratings.

This will cause narrowing tax revenue to gross domestic product (GDP), thus putting pressure on fiscal finance and higher public finance, it said.

Its chief economist Firdaos Rosli said the gaps include wage-to-GDP, ringgit-US dollar, Federal Fund Rate-Overnight Policy Rate (FFR-OPR), bond capital flows and Malaysian Government Securities-US Treasury (MGS-UST) 10-year yield.

"Yesterday (Tuesday), the Statistics Department released its preliminary account of GDP by the income approach, in which Malaysia wage-to-GDP dropped from 37.1% in 2020 to 34.8% in 2021, going back to 2005 levels. The compensation of employees is lower than in 2015, wiping out the reforms undertaken by the government over the years.

"Private consumption share of GDP by expenditure remains the largest component of GDP. Therefore, we cannot discount the role of private consumption in Malaysia's economic recovery trajectory," Firdaos said at the MARC Malaysian Bond & Sukuk 2022 Virtual Conference yesterday.

Malaysia's inflation is kept artificially low compared with other countries in the region, which means consumers' disposable income is not going to be badly affected by rising prices. From the producers' perspective, there will not be a massive erosion in corporate earnings.

"However, as inflation goes up everywhere else but in Malaysia, demands go up everywhere else except in Malaysia, which means that other countries - perhaps more importantly, the West - will pursue wage demands. And eventually, if employers were to meet the demands, the wage gap between that country or that region and Malaysia will widen further. Because without inflation, your wages cannot grow.

"Inflation ran at 3.4% as of May 2022. The government is going all out to combat inflation. So we posit that the government may spend about 20% of the total expenditure on subsidies alone this year, and that is excluding emoluments, pension payments, debt service charges ... which can put a bit of strain on our fiscal balance," he explained.

Firdaos suggested that as consumer spending is rising, monetary policy should be proactive to avoid inflation to overshoot prematurely due to revenge spending. Currently, Malaysia's real interest rate is still negative, suggesting ample policy space for Bank Negara Malaysia (BNM) to increase the Overnight Policy Rate (OPR). However, he noted that not all regional banks have started normalising interest rates amid fear of disrupting economic rebound.

As the US dollar gets stronger amid a hawkish US Federal Reserve stance, the ringgit and the greenback have started to decouple despite higher global oil prices. Besides, the FFR and OPR gap and the yield gap are narrowing, which Firdaos said will eventually affect capital flows and ringgit movements.

"Due to economic scarring and slow economic recovery for Malaysia, we can expect more fiscal support to complement adjustments in monetary policy. So we think it is unlikely for the government to be able to meet its 6% fiscal target this year," remarked the economist.

MARC's primary bond market forecast for 2022 is for gross MGS/Government Investment Issue (GII) issuances to come in at RM170-RM180 billion. Meanwhile, corporate bond issuance will moderate slightly to RM200-210 billion, driven by robust economic recovery in the second half of this year.

"Nevertheless, the elevated level of government debt and the stretch of public finances following the pandemic will weaken the quasi-government debt issuances on top of the hawkish interest rate environment and we think that may impact rated issuances somehow albeit indirectly," Firdaos said.

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