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## IIRA Reaffirms Sovereign Ratings of Malaysia

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**Manama, March 20, 2020** – 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 / A One) and local currency ratings at ‘A+/ A1’ (Single A Plus/ A One), on the international scale, and ‘AAA (my)/ A1+ (my)’ (Triple A/ A One Plus) on the national scale, with ‘Stable’ outlook.

Ratings assigned to Malaysia are reflective of sustained demand driven growth, a well-developed physical and social infrastructure and the country’s strategic location in Association of South East Asian Nations (ASEAN), enabling strong relations with regional and global economies. Low inflation, a stable monetary policy, and a robust financial sector continue to provide overall economic stability to the country. External balance reflects a healthy position with a strong current account surplus, despite volatility in portfolio flows. A high external demand component in GDP exposes the country to risks from rising trade protectionism, global interest rate trends and geopolitical developments, in addition to global growth outlook, which has taken a knock down as per recent estimates. Further in this regard, the COVID - 19 which has been officially declared a global pandemic by the World Health Organization (WHO), has direct implications on global growth, as well as international trade and tourism. Given its high trade to GDP, strong foreign investment links and historically robust tourism inflows, we estimate external risks to Malaysia to be particularly elevated, and may be viewed as a constraining factor in our rating assessment.

Malaysia continued on its path of continuous growth and stability in 2019, which affirms diversification and resilience of the economy. However, it has paced lower at 4.3% (2018: 4.7%), given the notably slackened growth in Q4’2019. Global health risks are expected to precipitate a further slowdown in 2020. While, the materialization of any such adverse trends depends on the length and severity of the ongoing crisis, recent measures taken to mitigate its economic impact, with an RM 20b economic finance package are seen to be proactive, and support IIRA’s GDP forecast of 3.6% for 2020. The package will however strain the fiscal account which is forecasted to weaken to a deficit of 3.4% and above initially budgeted target of 3.2%, thereby interrupting the planned trajectory of gradual fiscal consolidation. The year 2021 is expected to witness a resumption of the improving trend in the fiscal balance, as the effects of the enhanced costs, level off. Both upside and downside risks remain pertinent, given the uncertainty regarding the length and spread of the outbreak, in addition to the jurisdictions affected and the possible displacement of economic opportunity amongst countries. As such, this remains an evolving situation and merits a reassessment when the prevailing global uncertainty tapers down.

Inflation forecasts are muted in the absence of any significant demand pressures in addition to specific policy decisions such as the postponement of the implementation of the fuel subsidy program, measures taken to contain food prices and the sharp fall in oil prices. While having remained on course in terms of inflation targets, an accommodative monetary policy stance has been adopted in recent periods. Following global trends, Bank Negara Malaysia (BNM) cut its policy rate in May 2019 and further to 2.75% in January 2020, followed by a recent cut in March 2020. Ringgit remained largely stable with a slight appreciation of 1.1% against USD during 2019. However, a significant fall in the local currency was observed amid the on-going COVID-19 crisis, as the USD gained strength. Given the headwinds to demand forces, the BNM’s accommodative monetary policy stance is likely to continue in the early part of the current year, with the possibility of further cuts during the year, and precipitated by two further cuts in Fed rate this month, with the latter cited as an emergency action.

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Stronger surplus in the goods balance and lower deficit in the services balance led to a higher current account surplus of 3.3% of GDP during 2019 (2018: 2.1% of GDP). As global trade tensions continued, trade volumes shrunk during the year however, fall in imports exceeded the decline in exports. After posting a surplus during 2018, financial account entered a deficit during 2019 largely because of larger outflows in the portfolio account. Despite expectations of a fall in prices of major commodities in 2020, Malaysia's current account balance may post a wider trade balance, driven by expectations of significantly subdued imports. Tourism receipts are also likely to fall substantially for the better part of the year, albeit expected to resume the upward trajectory in 2021.

External debt has increased by 3.5% during 2019 increasing in GDP relative terms to 66.6%. There are significant foreign holdings in the local bond markets, given Malaysia's standing as one of the largest domestic markets in the region after Japan and South Korea. The high intercompany debt component of MNCs and banks, is noteworthy. At 41.4% of total external debt, short-term debt is high although covered by international reserves. A consistent current account surplus also mitigates risks associated from a relatively high debt to GDP indicator. Moderation in the government's debt burden may be expected in the medium term, with the setup of a Debt Management Office in early 2019.

The financial sector growth moderated in 2019 with maintained strong capitalization buffers, healthy earnings generation capacity and low degree of asset impairment. Household financing remained high at 82.4% of GDP as of Q3'2019, and despite recent slight increase in impairment within the segment, it remains largely healthy, supported by sophisticated underwriting standards and superior risk management practices.

Indicators for Future Change in Ratings:

IIRA has reaffirmed the ratings with a 'Stable' outlook based on the above mentioned factors. Ratings may be upgraded if:

- a. Growth rate is achieved and appears sustainable at long-term GDP growth potential of 5.0%,
- b. Significant progress is made in ongoing efforts towards fiscal consolidation with an average fiscal deficit falling sustainably to under 2.5% of GDP
- c. Inflation outlook remains steady at below 2.5%

Ratings may be viewed to be under downward pressure in case of:

- a. Fiscal deficit widening to 3.8% of GDP and adverse expectations on recovery
- b. Adverse trends in the balance of payments, given pressure on exports, tourism receipts, or slowdown in investment inflows
- c. Material deterioration in banking sector indicators

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