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BY CHERYL POO

Economists are pleased with Malaysia's economic progress and contained inflation, as evidenced by favourable data on the nation's second-quarter gross domestic product (GDP), based on advance estimates as well as June's Consumer Price Index (CPI) by the Department of Statistics Malaysia (DoSM).

It was a surprising result, considering that the country has seen a drop in purchasing power in recent years. People are feeling the pinch from the escalating cost of dining out, buying goods for daily use and, most recently, paying more for diesel (RM3.35 per litre since June 10, from RM2.15 per litre previously) as part of the fuel subsidy rationalisation. Companies are also feeling the heat as the heightened cost of doing business eats into profit margins.

June's inflation data came in unchanged for a second month last Wednesday at 2% year on year (y-o-y) — the highest since September 2023 but lower than the consensus of 2.2% y-o-y — in spite of the higher diesel price. This suggests that the upward pressure remains manageable and businesses are buoyed by the various targeted incentives afforded by Putrajaya to selected and eligible industry players.

Non-food inflation moderated to 1.9% y-o-y in June, compared with 2% y-o-y in May. Meanwhile, transport inflation rose to 1.2% y-o-y, representing a three-month high as the higher diesel price kicked in.

"The cost of living remains high, so price pressures remain high. People are not feeling good about this as things are expensive. Moving forward into the second half, cost pressures for businesses are expected to intensify. Bank Negara Malaysia is watching closely, even if a rate change is not on the cards for now. But should the central bank revise the interest rate, it would probably be in 2025, depending on how the economy shapes up during the second half," Lee Heng Guie, executive director of the Associated Chinese Chambers of Commerce and Industry of Malaysia's Socio-Economic Research Centre (SERC), tells *The Edge*.

UOB Malaysia senior economist Julia Goh concurs that the need to increase the interest rate remains to be seen as the authorities will need to monitor the collective pass-through effects from the subsidy rationalisation, Employees Provident Fund (EPF) withdrawals, wage hikes and the price-setting behaviour of businesses.

"The subdued June CPI print suggests that the government's price mitigation and anti-profiteering measures are helping curb excessive price increases of items in the CPI basket, where in June, out of 573 items monitored, 59.2% or 339 items recorded price increases. This compared with 57.8% or 331 items in May. And of the 573 items in June, 325 items registered a price increase of less than or equal to 10%. In fact, only 14 items recorded increases of more than 10%," Goh says.

So far, UOB and Kenanga Investment Bank Bhd have reduced their 2024 inflation forecasts — to 2% (from 2.6%) and 2.2% (from 2.7%) respectively.

Where economic growth is concerned, the economists whom *The Edge* spoke to last week expressed their satisfaction over DoSM's forecast of 5.8% GDP expansion for 2Q2024, up from 4.2% in 1Q2024. That's an estimated RM400.3 billion in economic growth, 0.73% higher than RM397.4 billion in the first quarter.

"The 2QGDP advance estimate surprised even the highest forecast. Growth momentum in the first two quarters has been robust, reinforced by domestic and external trade factors, which are rising in tandem," notes MARC Ratings Bhd chief economist Dr Ray Choy.

It is worth noting that Malaysia's trade has continued its upward trajectory to record an 8.7% y-o-y expansion in June to RM237.81 billion, according to the Ministry of Investment, Trade and Industry. Exports registered the third consecutive month of growth, increasing 1.7% to RM126.05 billion, while imports jumped 17.8% to RM111.76 billion.

Meanwhile, the unemployment rate of 3.3% in May, unchanged from April, continued its downward trend, with the number of jobless people falling 0.05% to 566,100 (from 566,400 the previous month) and 3.16% lower from the 584,600 persons recorded a year earlier.

These are some of the indications that inform Choy that Malaysia's economy is entering a period of sustained growth, rather than a reliance on a post-pandemic rebound and other base effects.

"This is evidenced by sustained growth in services and consumption-related GDP, which has maintained above 4% each quarter since mid-2023," he says.

"Producer prices also increased to 1.4% y-o-y in May, a notable improvement from [a position of near] disinflation during the whole of 2023. Thus, this reflects a recuperation from a period of excess capacity in the economy, rather than excessive growth," explains Choy.

He also points out that the manufacturing sector's quarterly GDP has turned around, from the near zero position for most of 2023 to the 1.9% rise in 1Q2024 coupled with higher exports and a strong electrical and electronics sector. "There has also been a sharper rebound in construction, mining and quarrying, which were previously laggard sectors and these are very encouraging signs. The positive news surrounding foreign direct investment (FDI) inflows has further translated into a 9.6% rise in gross fixed capital formation (GFCF) in 1Q2024, which is a rebound and is very high by historical standards.

"Hence, growth drivers in the second half include private-sector momentum as business operations accelerate following an initial period of heightened capital investments, coupled with continued tourism inflows sustaining consumption and services growth. Nonetheless, we need to remain cognisant of global geopolitics and the timing of interest rate cuts as key risk factors," Choy says, adding that the strength of Malaysia's economic growth amid contained inflation will give Bank Negara the upper hand or, rather, the flexibility to raise or maintain the interest rate.

"While the exchange rate is not a priority determinant in interest rate policy, any hawkish overtone by Bank Negara at this time when the US is expected to cut interest rates [soon] would distinctly reflect the strength of Malaysia's economy, sending a positive signal to the financial market — this will raise the propensity for the ringgit's appreciation," Choy says.

The majority of economists maintains that the government would need more time to refine the subsidy distribution and fuel price mechanisms, particularly for RON95, when its targeted rationalisation is expected to commence in 4Q2024.

"Subsidy rationalisation has led to higher inflation in utilities and fuel costs, although policymakers have taken calculated decisions to phase this in very cautiously.

"Historically, Malaysia has had much experience in comfortably adjusting to administered price increases such that they do not exceed 3% CPI for a sustained period," assures Choy, who is forecasting inflation for 2024 to be 2.5%.

He has raised his GDP forecast for 2024 to between 4.5% and 5%, from 4.2% previously, though it is subject to a recalibration following further details from the statistics department.

Similarly, UOB expects to revise upwards its 2024 GDP forecast when the actual 2Q GDP data is released next month.

Higher minimum wage, civil servants pay and multi-tier levy to add pressure

"On top of the expected wider implication of the subsidy rationalisation of petrol in 2H2024 compared with diesel, the central bank will be watching closely the market's reaction to three factors. First is the likely upward revision in the minimum wage due to employee pressure," says SERC's Lee.

"Second is the impending implementation of the multi-tier levy mechanism (MTLM), which will likely start next January as part of the Human Resources Ministry's intention to ensure job security for locals by limiting foreign worker hires.

"Third is the adjustment in civil servants' salaries. The central bank will be assessing their collective impact on the economy," Lee notes.

MARC's Choy explicates that while the increase in labour market costs will likely raise both cost-push and demand-pull inflation, the higher wages will be phased in gradually and would likely have different rates of increase in different segments of the civil service, with more details to be presented in Budget 2025.

He also expects the multi-tier levy on foreign workers to encourage the hiring of locals and promote automation, although the exact details of its implementation and timing in 2025 will depend on ongoing industry dialogue. "Consequently, labour market costs are unlikely to rise abruptly."

Attention on US presidential election, China's rate cut

Meanwhile, the economists will also be watching the outcome of the US presidential election in November and its impact on Malaysia.

On the one hand, Choy views the event positively since it sets the stage for increased US government spending and opportunities to review trade arrangements globally.

"US trade protectionism has the potential to redirect trade from China to Malaysia, although this may also subject Malaysia to greater scrutiny over supply chain sources and re-export destinations. The ongoing effect of US trade policy has culminated in the rise in Malaysia's FDI and this will likely sustain given multi-year business planning periods. Furthermore, the overlap of US post-election spending coupled with the likelihood of US interest rate cuts reinforce twin tailwinds for the global economy," he explains.

But less than ideal outcomes cannot be denied if policies of the new administration should cast downside risks for the region particularly if universal tariffs are introduced alongside potential export controls.

In addition, China's weak economy and potential drag on export recovery is another downside risk that the economists are watching for. Note that the world's second most powerful economy last Thursday notched up its effort to reinvigorate its slowing economy with a surprise cutting of its benchmark rate for one-year medium-term policy loans by 20 basis points (bps) to 2.3%; the rate on seven-day loans was reduced to 1.7% from 1.8% previously.

"With the weaker 2Q GDP and uneven recovery, we revised down our China GDP growth to 4.9%, slightly lower than the official target of 'around 5%'. We think there could be challenges to maintaining the growth momentum in the second half given the moderation in June's activity indicators, particularly retail sales," says UOB's Goh.

"Our exports have managed to pull up — 3.9% growth in 1H2024 — thanks to diversified export structure — benefiting from shipments to North America even though exports to China declined. Exports to Indonesia, Vietnam and Taiwan also recorded commendable growth," she adds.

"Thus far, the drivers and signs of further export recovery remain [intact], including that of global trade recovery, seventh month of improvement in Malaysia's intermediate imports, technology upcycle and firm commodity prices."