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In this report:

Malaysia – Managing the downgrade risk

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Malaysia

Managing the downgrade risk

The increasing possibility of a further upwards revision on Malaysia's current public debt ceiling from 60% to 65% and a downgrade to the economic growth could raise the prospect of future rating downgrades by any one of the international rating agencies.

The downward pressure on Malaysia's ratings could emerge over the next 12 to 24 months if the economic growth suffers a deeper or more prolonged downturn than expected, or if a weaker commitment to fiscal consolidation is evident. Both situations could result in a faster accumulation of net general government debt. This could be indicated by a change in net general government debt surpassing 4% on a sustained basis, net indebtedness crossing 80% of GDP, or interest paid by the general government exceeding 15% of revenue.

However, a downwards revision could be mitigated by a healthy external position, monetary policy flexibility and sustainable economic growth. Instead, an upward pressure on the ratings would emerge if prospects for fiscal consolidation were to improve significantly, particularly through measures that broaden the currently narrow revenue base, pointing to a sustained decline in the government debt burden and improvement in debt affordability.

- In contrast to our earlier expectation that Malaysia's economic growth would recover in 2021, and projected to expand by 5.5 %–6.0% (BNM: 6.0%–7.5%), we now believe that such view does not hold water anymore. Once again as the Covid-19 pandemic rears its ugly head in June in what is viewed as the "third wave", the country found itself in a lockdown that was extended into July with some states put under the enhanced movement control order (EMCO). Such move has added pressure both economically and politically. Strains also emerged on the social climate. Rising Covid cases are emerging at a time when the number of individuals being vaccinated is also on the uptrend.

- Owing to the indefinite extension of the national lockdown, the government unveiled another stimulus package, Pemulih, on 28 June. The RM150 billion package includes RM10 billion in direct fiscal spending by the government in the form of wage subsidies, unemployment assistance and financial aid.

- While providing special grants for micro, small and medium-sized enterprises (MSMEs), the programme also aims to increase the capacity and expedite the provisions of vaccines, including RM400 million for vaccine purchases. Since 2020, the government has introduced eight stimulus packages, totalling RM530 billion or 37% of GDP to support the economy from the pandemic's impact.

- With the various stimulus measures, the government has raised its public debt ceiling to 60% from 55% previously with the fiscal deficit-to-GDP ratio increasing to 6.2% from 6.0%. There were some concerns then that the country's risk would be downgraded by rating agencies like Moody's, S&P and Fitch. However, the rating agencies reaffirmed the country's ratings with Moody's retaining Malaysia's credit profile at 'A3' with a stable outlook in April. S&P maintained its 'A-' long-term and 'A-2' short-term sovereign credit ratings, and 'A' long-term and 'A-1' short-term local currency

ratings with a negative long-term outlook in June while Fitch affirmed Malaysia's long-term foreign-currency issuer default rating (IDR) at 'BBB+' with a stable outlook in July.

- However, the recent lockdown that was extended into July with some states put under the EMCO has dented our initial growth projection. As result, we reduced Malaysia's GDP growth for 2021 to 4.0%–4.5% from the previous 5.5%–6.0%. Added with the recent additional counter-cyclical stimulus measures of RM150 billion, these would further undermine the country's already strained fiscal and debt settings.

- Higher fiscal deficits in 2020 and this year, alongside a more muted near-term economic recovery, will keep the government's net indebtedness well above the current 60% debt ceiling. Coupled with the downwards revision to the economic growth, a further upwards revision to public debt ceiling is on the cards.

- Besides, a heightened political uncertainty compounds the challenges that the government will face as it rapidly consolidates its finances over the next two to three years. This has raised some concerns on a potential downwards revision on our ratings.

- The downward pressure on Malaysia's ratings could emerge over the next 12 to 24 months if the economic growth suffers a deeper or more prolonged downturn than expected, or if a weaker commitment to fiscal consolidation is evident. Both situations could result in a faster accumulation of net general government debt. This could be indicated by a change in net general government debt surpassing 4% on a sustained basis, net indebtedness crossing 80% of GDP, or interest paid by the general government exceeding 15% of revenue.

- The downward ratings pressure by international rating agencies could also intensify if political stability deteriorates to such that policymaking becomes materially less predictable, or if our external position weakens to such an extent that the economy's gross external financing needs surpass its current account receipts plus usable reserves.

- Meanwhile, we expect a growth reduction in the second quarter of 2021 from the impact of the tightened MCO. We expect the economy to recover at a gradual pace in the third quarter from the cautious reopening that the government has indicated. Some economic sectors will be allowed to operate with strict safety procedures. They will not be affected to the same extent as during the first MCO in the second quarter of 2020. Also, the economic recovery will gain pace as the national vaccination plan progresses, and targets are met for a border reopening of activities. These will provide some buffer to the ratings downgrade stress.

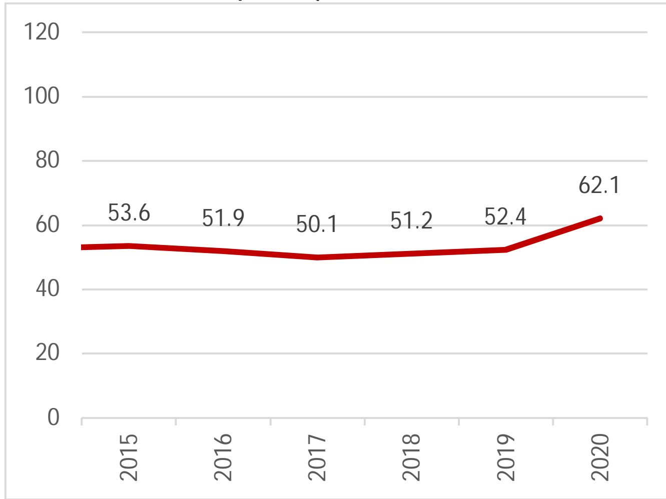
- Looking at the next 12 to 24 months, if the economy expands at a credible rate of between 5% and 6%, and the policy environment becomes more conducive to credible fiscal consolidation, this will produce a stronger fiscal performance than expected. It will lead to a quicker stabilisation of government finances and hence will even open the door for an upwards re-rating.

- Also, further enhancements to the institutional framework to raise governance standards and better policy credibility and effectiveness, including in the management of public finances supported by potential growth, would be credit positive.

- All things considered; it will not significantly alter the view that the economy remains vulnerable. A future rating downgrades by any one of the international rating agencies could still happen. More so, with the increasing possibility of a further upwards revision on the current public debt ceiling of 60%.

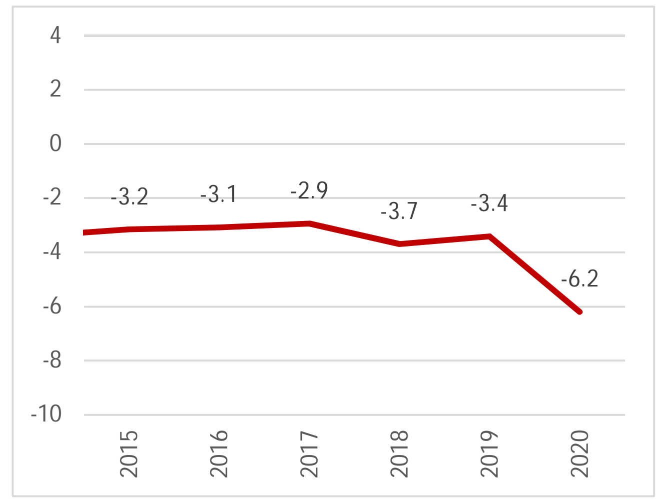
- However, this possible downwards revision could be mitigated by a healthy external position, monetary policy flexibility and sustainable economic growth. Instead, an upward pressure on the ratings would emerge if prospects for fiscal consolidation were to improve significantly, particularly through measures that broaden the currently narrow revenue base, pointing to a sustained decline in the government debt burden and improvement in debt affordability.

Chart 1: Public Debt (% GDP)



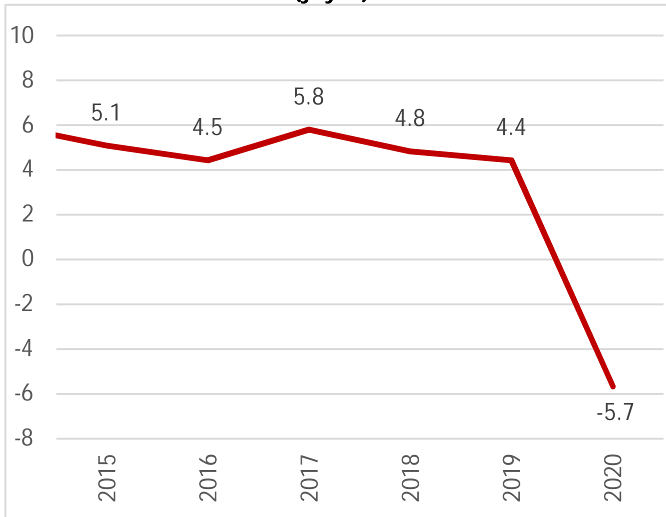
Source: CEIC/AmBank Research

Chart 2: Fiscal Balance % GDP



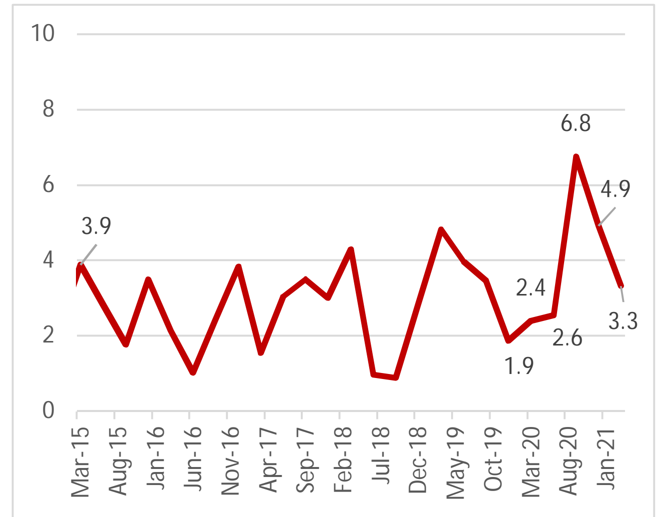
Source: CEIC/AmBank Research

Chart 3: Annual Real GDP (y/y %)



Source: CEIC/AmBank Research

Chart 4: Current Account BOP % GDP



Source: CEIC/AmBank Research

Table 1: Malaysia's Rating

		2015	2016	2017	2018	2019	2020	2021
Moody's	Rating	A3	A3	A3	A3	A3	A3	A3
	Outlook	Positive	Stable	Stable	Stable	Stable	Stable	Stable
Fitch	Rating	A-	A-	A-	A-	A-	A-	BBB+
	Outlook	Stable	Stable	Stable	Stable	Stable	Negative	Stable
S&P	Rating	A-	A-	A-	A-	A-	A-	A-
	Outlook	Stable	Stable	Stable	Stable	Stable	Stable	Negative

Source: Rating Agencies/AmBank Research

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