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OUTLOOK
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Banking System Outlook – Malaysia

Higher economic growth and strong capitalization support stable outlook

Our outlook for Malaysia's banking system remains stable, supported by higher economic growth and banks' strong capitalization. Robust domestic demand will continue to drive growth amid healthy employment conditions. Malaysian banks' asset quality and profitability will remain stable, and we expect capitalization to remain strong. While Malaysian banks are more susceptible to changes in liquidity conditions due to greater use of market funds, the banks have access to liquidity from the central bank when required. We also expect loan growth to be broadly in line with deposit growth.

Exhibit 1

OVERVIEW OF KEY DRIVERS

Driver	Outlook		
Operating environment	●	=	Strong domestic demand and favorable labor market conditions underpin stable operating environment for banks
		=	Weaker global growth will limit the contribution of net exports to GDP but key exports of electronics and semiconductors will see a cyclical recovery
		–	Real estate sectors face persistent oversupply. The number of unsold housing units is high despite a gradual decline. Commercial properties continue to see depressed rental rates and occupancies
Asset risk	●	+	Asset quality will be broadly stable, supported by the improvement in retail borrowers' repayment capacity, due to favorable labor market conditions and modest inflation
		–	Asset quality is at risk for certain sectors under stress, including small and medium enterprises and the real estate and construction sectors
		=	Loan loss reserves have declined but remained above pre-pandemic levels
Capital	●	=	Internal capital generation will be in line with capital consumption
		=	Banks will maintain prudent dividend policies
Profitability and efficiency	●	=	Pressure on net interest margin will moderate as repricing of deposits is limited while competition is easing
		–	Credit costs will increase in 2024 as low provisions in 2023 were partly supported by the depletion of existing reserves
Funding and liquidity	●	–	Banks have increased reliance on market funds amid intense competition for deposits
		=	Liquidity will remain stable with loan growth expected to be broadly in line with deposit growth
Government support	●	=	The Malaysian government's willingness and capacity to support banks in times of need will remain strong
		=	The government is unlikely to adopt a bail-in regime in the next 12 to 18 months

● IMPROVING ● STABLE ● DETERIORATING

Source: Moody's Ratings

Stable outlook underpinned by higher economic growth and strong capitalization

Economic growth will improve, driven by domestic demand. We expect Malaysia's real GDP growth to improve to 4.5% in 2024 from 3.7% in 2023. This reflects resilient domestic demand in the face of a challenging global environment and risks to the agricultural sector and inflation posed by El Niño. Favorable labor market conditions will support household consumption, while government policies such as the National Energy Transition Roadmap and New Industrial Master Plan will underpin private and public investments, along with investment flows related to shifting regional supply chains. Meanwhile, weaker global growth will limit the contribution of net exports to GDP, even as we expect a cyclical recovery in electronics and semiconductors. At the same time, the property market has remained weak. The number of unsold housing units has declined gradually but stays elevated, while persistent oversupply issues continue to depress rental rates and occupancy of office and retail space. We expect the central bank to maintain current monetary policy settings at broadly neutral levels in 2024, which will not constrain credit demand. Systemwide credit will grow at 5.5%, broadly stable from the year before.

Asset quality will be stable. We expect asset quality of banks to be broadly stable, with nonperforming loans ratio around 1.5%-2.0% in 2024 from 1.6% as of December 2023, supported by the improvement in retail borrowers' repayment capacity, due to favorable labor market conditions and modest inflation. Retail loans with elevated credit risk and weaker repayment capacity have also decreased. As of June 2023, 4.6% of retail loans were classified as Stage 2, lower than 6.7% as of December 2022. Meanwhile, certain sectors in Malaysia continue to face stress and we expect small and medium enterprises (SME) to be the most vulnerable borrowers. Also, loans to the real estate and construction sectors remain a risk to banks' asset quality, although exposure has decreased gradually over the past two years. While asset-weighted loan loss reserves for rated banks have declined to 120.8% as of September 2023, from 147.1% as of December 2022, we consider them adequate as impaired loans secured by properties – which we expect to have low loan losses and higher recovery rate – accounted for 42% of total impaired loans.

Capital will remain strong. We expect capital ratios to remain stable in 2024 as internal capital generation will keep pace with capital consumption. We also expect banks to maintain prudent dividend policies and offer dividend reinvestment plans to shareholders to support capitalization if necessary. As of November 2023, Common Equity Tier 1 ratio of the Malaysian banking system was at 14.5%, stable from 14.3% a year earlier.

Profitability will remain stable. Stable net interest margins and mildly higher credit costs will keep the profitability of Malaysian banks largely stable in 2024. We expect repricing of deposits to be limited this year and competition for deposits to moderate as the overnight policy rate remains stable. At the same time, we expect credit costs to increase in 2024 as low provisions in 2023 were partly supported by the consumption of existing credit reserves.

Funding and liquidity will be stable. Malaysian banks are more susceptible to changes in liquidity conditions due to their greater use of market funds. Nonetheless, we expect banks to maintain strong liquidity buffers. As of 30 October 2023, the systemwide liquidity coverage ratio remained strong at 151%, above 141% a year earlier. We also expect loan growth to be broadly in line with deposit growth.

Probability of government support remains high. The Malaysian government's willingness and capacity to support banks when needed will remain strong.

Exhibit 2

Aggregate key indicators for rated Malaysian banks

KEY RATIOS	Sep-23	2022	2021	2020	2019
Problem loans / Gross loans	1.6%	1.6%	1.8%	1.9%	1.9%
Tangible Common Equity / Risk Weighted Assets	17.0%	17.3%	16.9%	15.8%	16.4%
Net Income / Tangible Assets	1.1%	1.0%	0.9%	0.7%	1.1%
Market Funds / Tangible Banking Assets	13.5%	12.5%	10.3%	11.1%	11.3%
Liquid Banking Assets / Tangible Banking Assets	28.3%	28.2%	27.8%	27.7%	27.4%
ADDITIONAL RATIOS	**Sep-23**	**2022**	**2021**	**2020**	**2019**
Loan loss Reserves / Problem Loans	120.8%	147.1%	162.8%	124.0%	85.2%
Loan Loss Provisions / Average Gross Loans	0.2%	0.2%	0.4%	0.8%	0.2%
Net Interest Margin	1.5%	1.6%	1.6%	1.5%	1.6%
Net Income / Average RWA	2.0%	1.8%	1.7%	1.3%	1.9%
PPI / Average RWA	2.8%	3.0%	2.8%	2.7%	2.7%
Cost / Income	43.5%	42.9%	43.5%	44.0%	45.4%
Shareholders' Equity / Total Assets	9.6%	9.6%	9.9%	10.0%	10.1%

Note: Figures are based on asset-weighted averages for rated commercial banks.
Source: Moody's Ratings

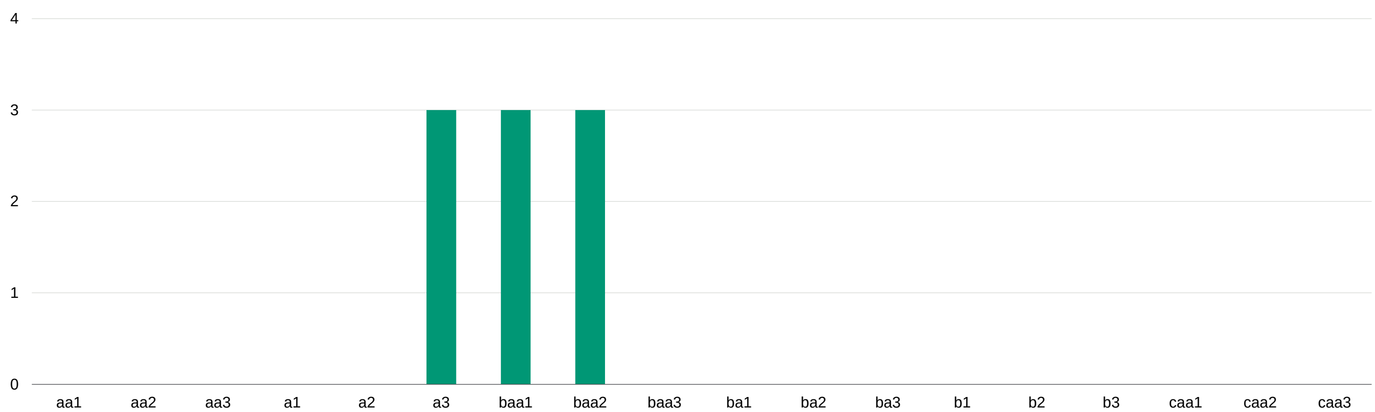
Rating universe

We rate eight conventional commercial banks, one Islamic bank, one investment bank, a mortgage corporation and one development financial institution in Malaysia. Their Baseline Credit Assessments (BCA), a measure of banks' standalone credit strength, range from a3 to baa2. The weighted averages of rated banks' long-term deposit ratings and BCAs are A3 and baa1, respectively.

For details on Islamic banking in Malaysia, please click here.

Exhibit 3

Malaysian banks' Baseline Credit Assessment distribution as of February 2024



Note: CIMB Group and CIMB Investment Bank do not have BCAs. Moody's withdrew BCAs of Cagamas Berhad and Export Import Bank of Malaysia following the publication of the updated Government-Related Issuers Methodology on 25 January 2024.
Source: Moody's Ratings

Exhibit 4

Rated financial institutions in Malaysia as of September 2023

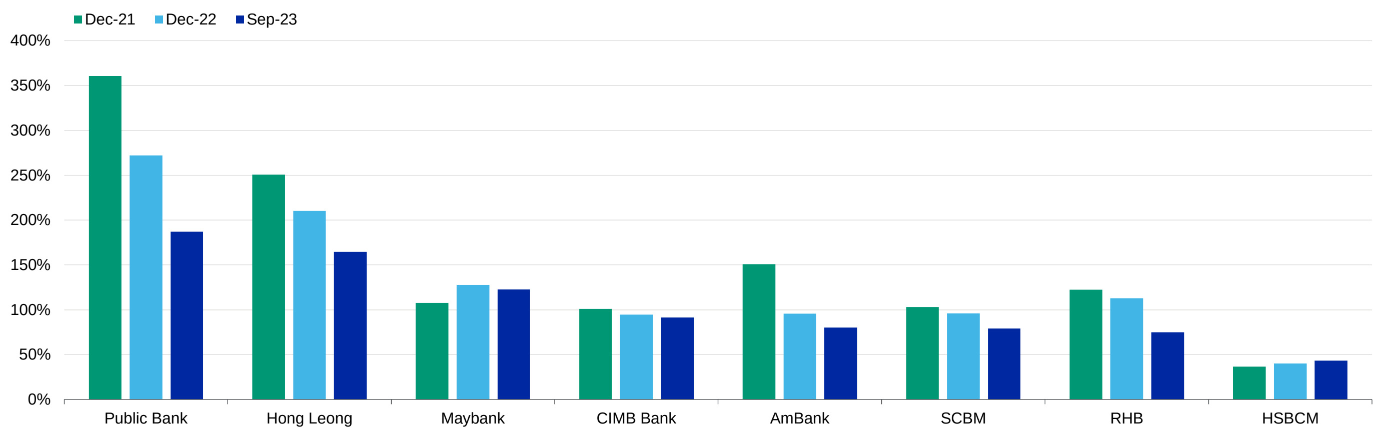
Entity Name	Total Assets (MYR billion)	Market Share (Loans / Assets)	Baseline Credit Assessment	Adjusted Baseline Credit Assessment	Long-term Bank Deposit Rating (Local Currency)	Issuer/Senior Unsecured Rating (Local Currency)	Outlook
Malayan Banking Berhad	979	18%/28%	a3	a3	A3	A3	STA
CIMB Group Holdings Berhad	715	13%/20%	-	-	-	Baa1	STA
CIMB Bank Berhad	607	13%/17%	baa2	baa2	A3	A3	STA
Public Bank Berhad	508	18%/15%	a3	a3	A3	-	STA
RHB Bank Berhad	323	9%/9%	baa1	baa1	A3	A3	STA
Hong Leong Bank Berhad	283	8%/8%	a3	a3	A3	-	STA
CIMB Islamic Bank Berhad	151	6%/4%	baa2	baa2	A3	A3	STA
AmBank (M) Berhad	135	4%/4%	baa2	baa2	A3	A3	STA
HSBC Bank Malaysia Berhad	96	2%/3%	baa1	a2	A2	-	STA
Standard Chartered Bank Malaysia Berhad	54	2%/2%	baa1	baa1	Baa1	-	STA
CIMB Investment Bank Berhad	4	-/0%	-	-	-	A3	STA
Cagamas Berhad	51	1%/1%	-	-	-	A3	STA
Export-Import Bank of Malaysia	7	0%/0%	-	-	-	A3	STA

Note: Cagamas Berhad as of June 2023, Export Import Bank of Malaysia as of December 2022
Source: Moody's Ratings

Appendix

Exhibit 5

Loan loss reserves are at a healthy level
Loan loss reserves as % of problem loans

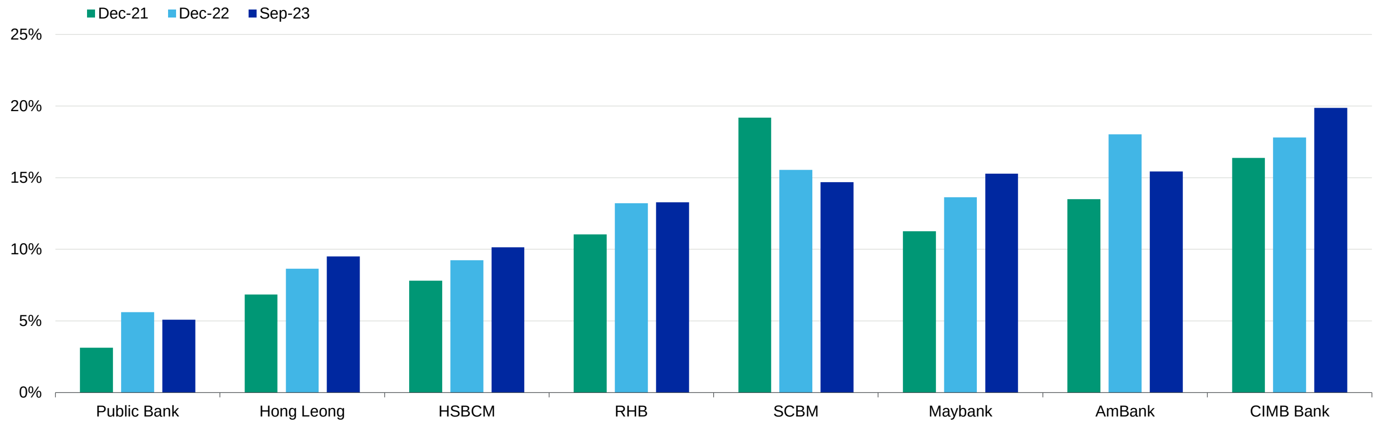


Source: Moody's Ratings

Exhibit 6

Malaysian banks have increased reliance on market funds

Market funds as % of tangible banking assets



Source: Moody's Ratings

Banking System Outlook definition

The Banking System Outlook reflects our view of credit fundamentals in the banking sector over the next 12 to 18 months. Banking sector outlooks are distinct from rating outlooks, which, in addition to sector dynamics, also reflect issuers' specific characteristics and actions.

The outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of rating outlooks.

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