Government of Malaysia – A3 stable

Summary

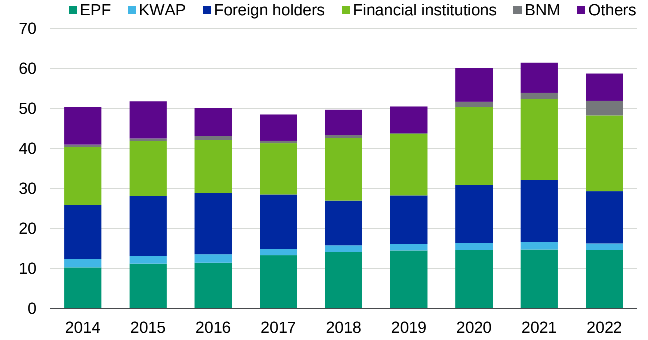
Moody's views Malaysia's credit profile as being supported by its large, diversified and competitive economy, higher growth potential than rating peers, ample natural resources, and robust institutions that allow effective macroeconomic policymaking and financial supervision. Supportive fundamentals and policies have, over time, generated a large pool of domestic savings, which reduces the government's liquidity risk, anchors its borrowing costs, and fosters a conducive environment for growth in Islamic finance. Balanced against these strengths are the government's narrow revenue base that limits fiscal flexibility, and its relatively high debt burden and weak debt affordability compared with peers. Volatile politics also have the potential to distract the government from its policy priorities, particularly longer-term reforms.

Malaysia is the most active sovereign issuer of sukuk, underpinned by an advanced regulatory framework for Islamic finance that has been continuously developing since 1983. Since issuing the world's first sukuk in 1990, the country's sukuk market has grown to become the largest globally, accounting for 36% of total sukuk issuance as of June 2022. Malaysia was also the first sovereign to issue green sukuk in 2017, and issued its first sovereign international sustainability sukuk in April 2021. The government is one of the few sovereigns globally for which sukuk is an important instrument for meeting deficit financing needs.

Exhibit 1

Diverse and ample sources of finance support government liquidity

Federal government debt by holder, % of GDP



EPF is the compulsory savings and retirement fund for the private sector, while KWAP provides the same function for public sector employees; BNM is Bank Negara Malaysia, Malaysia's central bank

Sources: BNM and Moody's Investors Service

Exhibit 2

Fiscal deficits will drive sovereign sukuk issuance

Federal government fiscal indicators, % of GDP

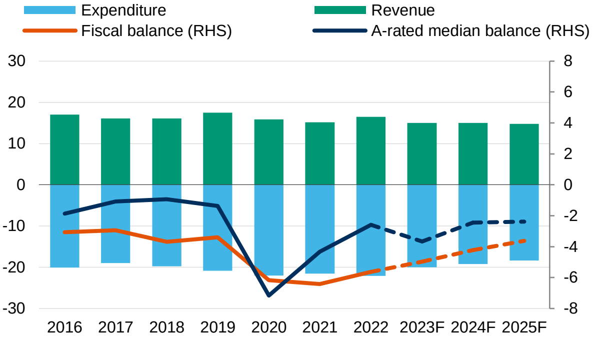


Exhibit 3

	2018	2019	2020	2021	2022E	2023F	2024F	2025F
Real GDP (% change)	4.8	4.4	-5.5	3.1	8.7	4.5	4.7	5.0
Nominal GDP ($ bln)	358.8	365.2	337.3	373.0	406.3	432.9	464.8	502.9
Gen. Gov. Financial Balance (% GDP)	-3.7	-3.4	-6.2	-6.4	-5.6	-5.0	-4.2	-3.6
Gen. Gov. Debt (% GDP)	54.6	55.2	64.9	66.0	61.8	61.5	61.6	61.2
Gross Borrowing Requirements (% GDP)	10.7	10.0	13.9	11.7	12.4	11.7	11.0	10.4

*Sources: Department of Statistics, Ministry of Finance and Moody's Investors Service. *Debt figures incorporate the liabilities of 1Malaysia Development Berhad, Suria Strategic Energy Resources and SRC International, whose borrowings Moody's deems to be explicit liabilities of the federal government.*

Discussion on recent developments and implications for sukuk issuance

- Moody's affirmed Malaysia's A3 rating with a stable outlook in April 2023, reflecting expectations that the country's economic diversification and competitiveness, and the government's access to robust sources of domestic financing will persist. This will mitigate fiscal risks that have risen following the coronavirus pandemic, including an increased debt burden and weakened debt affordability.
- Moody's expects Prime Minister Anwar Ibrahim's heightened focus on alleviating economic hardships and cost of living pressures for low-income households to underpin a gradual withdrawal of fiscal accommodation following three years of expansionary support during the pandemic. Malaysia's fiscal deficit is likely to narrow slowly to 3.6% of GDP by 2025 from 5.0% of GDP in 2023, despite elevated oil prices. Wide fiscal deficits will support annual sovereign sukuk issuance volumes of $20 billion-$25 billion through 2025.
- In his inaugural budget, Anwar announced several initiatives to promote further growth of the Islamic Finance sector, including a segregation of Shariah savings from conventional savings invested by the Employees Provident Fund (EPF), the national private sector pension fund, which will generate stronger returns for Shariah accountholders. EPF is the single largest holder of Malaysian government debt.
- In 2022, Malaysian Government Investment Issues (MGII, government sukuk) comprised 49.6% of the government's total long-term domestic issuance, down from a peak of 56.7% in 2018 but still above 44.6% a decade ago. Consequently, the stock of MGII has steadily grown to 44.9% of total domestic debt outstanding from 29.6% in 2012. In addition, all of the government's outstanding foreign-currency debt has been issued in sukuk, providing a benchmark for private-sector issuers looking to diversify sources of funding.