

# Executive Summary

## Economic, Monetary and Financial Developments in 2023

**In 2023, global growth slowed amid a challenging economic environment:** Global economic growth moderated to 3.1% (2022: 3.5%). The main contributors to this moderation were tight monetary policies and elevated inflation. The impact of these factors was partially mitigated by robust wage growth and drawdown from excess savings. China's growth rebounded briefly in early 2023 after it re-opened in the aftermath of the COVID-19 pandemic. The rebound was rather short-lived, as economic activity was dampened by a property market downturn and softer external demand. Meanwhile, advanced economies experienced a rather mixed growth performance. The US benefitted from strong consumer spending amid tight labour markets, while the euro area experienced a slowdown due to high energy prices and weak real income growth. Banking stress in the US and Europe during the early part of the year raised concerns about broader contagion risks, prompting swift responses from central banks and supervisory authorities to contain the impact. Of great significance, global trade growth decelerated to 0.4% (2022: 5.2%) amid weaker demand conditions, global technology downcycle, inventory correction and continued spending rotation from goods to services. Nevertheless, softening demand alongside the reopening of economies allowed supply chain conditions to normalise to pre-pandemic levels, while recovery in global tourism activities partially offset the moderation in goods trade.

**Global headline inflation moderated but remained elevated:** Global headline inflation was cooled by lower commodity prices and normalisation of supply chain conditions. Increased production from non-Organization of the Petroleum Exporting Countries (OPEC) helped offset upward pressure to oil prices from the Middle East conflicts and OPEC+ production cuts. Despite the moderation in headline inflation, core inflation remained elevated and persistent. This prompted central banks to continue tightening monetary policy, albeit at a

slower pace than in 2022. Compared to the advanced economies, inflation in emerging market economies moderated faster, returning to their long-term averages. This was attributed to lower demand pressure and less tight labour markets.

**Global financial conditions were highly driven by evolving expectations of policy rate paths of the major economies:** Global financial markets experienced considerable volatility across asset classes, as market expectations diverged with policymakers over the pace and degree of monetary policy tightening, especially in the advanced economies. Initial optimism on China's recovery waned. Markets were roiled following the banking sector stress triggered by the collapses of banks in the US and Switzerland. Recession fears ensued, causing a global stock market correction. In addition, differences in economic prospects between advanced and emerging economies led to an unsynchronised global interest rate path. This led to higher bond yields, tightened financial conditions and significant pressures on emerging market currencies. Geopolitical tensions in the Middle East further added uncertainty, but softer US inflation data eased financial conditions following the anticipated future rate cuts by the US.

**Domestic financial markets were affected by external headwinds, but spillovers were contained:** The Malaysian financial markets experienced shifts in investor sentiment mostly attributable to external factors, leading to volatility primarily through exchange rate fluctuations. Bond market movements generally followed global trends, while non-resident inflows into domestic bonds reflected confidence in Malaysia's sovereign credit quality. On the other hand, the equity market performance was affected by reduced investors' appetite for risky assets amid the global interest rate environment. Nevertheless, improved domestic factors from political stability and key economic plans releases lifted the outlook. The ringgit depreciated against the US dollar and other major trading partners mainly due to the aggressive policy rate hikes by major central banks. However, financial market conditions remained orderly

owing to deep financial markets and a sound banking system. This was supported further by the existing prudential requirements on external borrowing as well as liquidity and foreign exchange operations by BNM.

### **The Malaysian economy continued to expand in 2023**

**despite external headwinds:** The Malaysian economy grew by 3.7% despite facing challenges stemming from weak external demand, disruptions in commodity production and higher cost of living. Growth was mainly supported by resilient domestic demand and recovery in tourism activities. On the external front, exports declined due to subdued global demand, lower commodity prices and shifts towards services spending. Additionally, improving labour market conditions coupled with supportive policy measures helped household spending, especially among the vulnerable households affected by higher cost of living. Private sector capital spending drove overall investment activity, particularly in information technology and electrical and electronics (E&E). In tandem with external trade performance, export-oriented industries saw some moderation in growth. Nonetheless, all sectors continued to expand in 2023.

### **Headline and core inflation moderated in 2023:**

Headline inflation moderated in 2023 to an average of 2.5% (2022: 3.3%), largely on account of lower food, non-alcoholic beverages and fuel inflation. Some subsidy rationalisation measures were introduced, namely through the revision of electricity tariffs and removal of price ceilings for chicken. The impact on CPI inflation was rather muted given the relatively smaller weights of these items in the CPI basket. In addition, upward pressure on import prices from the sustained strength of the US dollar against the ringgit was offset by the moderating global cost environment. Existing price controls and subsidies on key expenditure items as well as the relatively stable firms' pricing behaviour also partially mitigated exchange rate pass-through effects. Meanwhile, core inflation averaged at 3% (2022: 3%). The more gradual disinflation pace was partly due to persistent demand pressure, particularly in the first half of 2023. Core inflation steadily converged to its long-term average in the second half. Overall, price pressures were generally less pervasive in 2023. The share of CPI items recording monthly price increases trended lower, approaching their respective long-term average levels.

### **Monetary policy was further normalised amid resilient domestic growth prospects:**

The Overnight Policy Rate (OPR) was increased by 25 basis points to 3.00%, marking the complete withdrawal of the monetary stimulus introduced in 2020 aimed at promoting the economic recovery from the pandemic. The Monetary Policy Committee (MPC) paused for the initial two meetings in 2023 to assess prior adjustments' impacts, considering potential over-tightening risks. Subsequently, in May, the MPC increased the OPR by another 25 basis points, noting resilient domestic growth while remaining vigilant on upside risks to inflation from domestic policy changes, financial market developments and global commodity prices. Of note, domestic monetary and financing conditions continued to be supportive to financial intermediation. Following BNM's liquidity operations to reduce the high overnight balances aimed at enhancing price discovery in the interbank market, interbank trading volume increased. Notwithstanding the elevated interbank rates towards end-2023 in anticipation of year-end deposit competition, spillovers to broader credit conditions were limited.

### **Continued credit flow to the private non-financial**

**sector:** Financing activities remained sustained, in tandem with the pace of domestic economic growth. Credit growth to the private non-financial sector increased to 4.8% (2022: 4.7%), driven by higher outstanding loans growth, while outstanding corporate bond recorded a more moderate pace of expansion at 4.2% (2022: 4.6%). Household loans, particularly for home and car purchases, were the key drivers of loan growth. They were supported by steady employment and government incentives such as extended stamp duty exemptions. On the other hand, business loans moderated in the first half of 2023 due to slower non-small and medium enterprises' (SMEs) working capital financing growth, but rebounded thereafter by end-2023 supported by the improvement in business outlook. Despite the weaker loan growth among non-SMEs, funding activities remained broadly sustained amid favourable conditions as reflected by narrowing bond spreads. Overall, credit conditions remained supportive of economic activity. This was underpinned by a stable loan approval rate, continued prudent lending standards and availability of financing support facilities in ensuring continuous credit flow to the economy.

## Outlook and Policy in 2024

### **Sustained global growth amid moderating inflation:**

In 2024, global growth is expected to be sustained, supported by moderating inflation, resilient labour markets and a rebound in global trade. These factors would cushion the headwinds from continued tight monetary policy and withdrawal of fiscal support. Global trade growth is expected to rebound in 2024, driven by the technology upcycle, tourism recovery and low base effects in 2023. Despite this, ongoing trade restrictions, continued spending rotation from goods to services and supply chain disruptions could weigh on the recovery. Thus, despite the comparatively better performance than in 2023, global trade growth is likely to remain below its long-term average. Global inflation is expected to continue moderating mainly due to disinflation in the advanced economies, providing room for central banks to ease monetary policy. However, uncertainties surrounding the trajectory of global monetary policy easing could contribute to financial market volatility, particularly with diverging views on the timing, magnitude and pace of policy adjustments. Nonetheless, the expected easing of global financial conditions may induce portfolio rebalancing towards emerging market economies, potentially improving capital flows into economies in the region. Global growth outlook remains subject to downside risks, arising from higher-than-expected inflation, tighter financial conditions and geopolitical escalations. Conversely, stronger consumer spending in advanced economies and fiscal support in China pose upside risks to global growth.

### **The Malaysian economy is projected to grow between 4%–5% in 2024, underpinned by continued expansion in domestic demand and improvement in external demand:**

Growth will be driven by resilient domestic expenditure, with additional support from the expected recovery in exports. Tourism is expected to improve further, while the implementation of new and ongoing multi-year projects by both the private and public sectors would support investment activity. Nevertheless, domestic growth remains subject to downside risks from both external and domestic factors. External factors include a weaker-than-expected global growth and further escalation of geopolitical conflict. Domestically, more severe shocks on commodity production and the implementation of subsidy rationalisation could also

weigh on the growth outlook, although this could be partially offset by targeted cash assistance from the Government. Greater spillover from the tech upcycle, stronger-than-expected tourism activity, and faster implementation of existing and new investment projects would provide upside risks to the domestic growth.

### **Headline inflation is expected to average between 2% and 3.5% in 2024:**

Headline inflation is expected to remain moderate amid contained cost pressures from easing global supply conditions. Price pressures from tax changes and utility tariffs are assessed to have a marginal impact on headline inflation. Additionally, the impact of exchange rate depreciation on inflation will be contained by administered prices and relatively stable firm pricing behaviour. Core inflation is also expected to moderate, but remaining above its long-term average. Limited demand pressures, stable near-term sentiments on economic conditions and wage growth that is in line with productivity increases, will likely contain upward pressure to underlying inflation. Inflation outlook remains highly subject to upside risks due to potential price adjustments on food and energy items, as well as external pressures from exchange rate and global commodity price developments. Of note, the inflation forecast range has incorporated some potential upside from the implementation of fuel subsidy rationalisation. The direct impact on headline inflation will likely dissipate within a year, but there are upside risks from knock-on effects and wage-price dynamics. Nevertheless, the short-term impact will depend on the size, timing and scope of targeted assistance. On the other hand, downside risks to inflation outlook emanate from weaker global growth weighing on commodity prices and cost pressures.

### **Domestic monetary and financial conditions to remain conducive of financial intermediation activities:**

Credit supply is expected to remain forthcoming, supported by continued willingness to lend amid a healthy capital market. Credit demand will also be supported by improving economic and labour market conditions. As global financial conditions ease amidst monetary policy loosening in advanced economies, capital inflows to regional economies may increase following narrowing yield differentials. Global investors' confidence and steady progress of key infrastructure projects are also expected to further support the positive momentum in Malaysian equities. Given Malaysia's strong fundamentals and positive growth prospects, the current ringgit level is undervalued. In addition, financial markets

expect the pressure on the ringgit to decline as external uncertainties abate. Any adverse spillovers from the global financial markets to domestic financial conditions and exchange rates will continue to be manageable. BNM remains vigilant to market developments, while ensuring sufficient liquidity and orderly functioning of the domestic financial market. Beyond conducting foreign exchange operations, BNM is actively engaging with government-linked companies (GLCs) and government-linked investment companies (GLICs) to encourage more consistent repatriation and conversion of their foreign investment income into ringgit. BNM is also stepping up engagements with international investors to highlight Malaysia's positive prospects and attractiveness as an

investment destination. These actions are contributing to greater inflows, lending support to the ringgit.

**Monetary policy will remain conducive to a sustainable economic growth while ensuring an environment of price stability:** In 2024, MPC will continue to aim to ensure a monetary policy stance that is supportive of the economy and consistent with the current assessment of the inflation and growth prospects, on the back of potential domestic policy changes and a challenging external environment. Given the degree of uncertainty, the MPC remains vigilant of ongoing developments and their implications on the balance of risks surrounding domestic inflation and growth.