

ASIAN Tiger 2.0

The Revival Of the Malaysian Tiger

Of late, investors have been incrementally bullish on Malaysia's prospects as stable politics and supportive government policies have renewed investor confidence. Some quarters are now suggesting that the recent revival bears resemblance to the mid 1990s where Malaysia was deemed as one of the emerging Asian Tiger nations.

Have we seen this trend before in ASEAN? Can Malaysia revive its Tiger status again? What does it take to get there?

ASIAN Tiger 2.0 aims to be a series of thought leadership pieces to delve into selective trends in Asia. This piece aims to compare and contrast Indonesia's journey in the last decade under the Jokowi administration, offering insights that can be drawn for Malaysia's journey to becoming an Asian Tiger once again.

From the CIO Desk

Malaysia today and parallels to Indonesia's reforms

Following a few challenging years battling the pandemic and political changes, PM Anwar's administration has ushered in much-needed stability to the country, with economic reforms and policies aimed at restoring investor confidence and reinvigorating growth. In our view, we see several parallels between these early signs and that of the Indonesian economy under President Joko Widodo (Jokowi).

Indonesia – the journey since 2015

The Jakarta Composite Index initially fell 18% in Jokowi's first year in office as the groundwork was laid for his policy agenda. However, since 2015, the index has surged over 40%, while the ASEAN Index remained relatively flat. As GDP growth held steady around 5% YoY during this period, GDP per capita increased nearly 40% from USD3,500 in 2014 to USD4,900 in 2023, accompanied by a modest improvement in income equality.

Opening the economy to investment

In 2014, President Jokowi inherited an Indonesian economy that experienced strong growth the decade prior, fueled by the commodity boom. However, as commodity prices weakened, it became apparent that this was not a sustainable growth model. Protectionist measures that heavily restricted foreign ownership in key industries were partially lifted in 2016 but saw limited success. It was not until further liberalisation in 2021, which removed almost all restrictions, that direct inflows increased substantially. Quarterly FDI inflows nearly doubled to USD12-13bn since, mainly driven by the manufacturing sector. Policies that banned the export of raw materials such as nickel also helped the country to shift towards higher value exports.

Infrastructure push via public-private partnerships

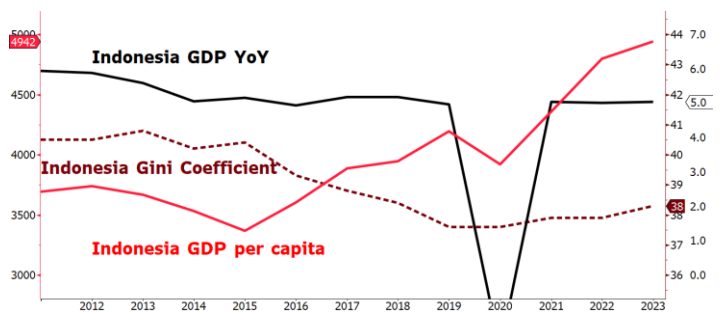
Previous bureaucratic inefficiencies often delayed infrastructure projects in Indonesia, but changes to land acquisition laws in 2015 overhauled this process by enabling private entities to acquire land and be later reimbursed from the state budget, greatly accelerating project delivery timelines. Since 2015, more than 2,100km of toll roads have been constructed, now representing more than 70% of the country's network. By the end of Jokowi's first term, over 18 seaport and 13 railway projects were on the table, including the flagship Jakarta-Bandung high-speed rail and Jakarta transit lines which began during his time as governor. The removal of investment restrictions enabled many of these projects to receive more financing from foreign capital, such as the high-speed rail which received 85% of its funding from China.

Indonesian stocks outperformed ASEAN since 2015



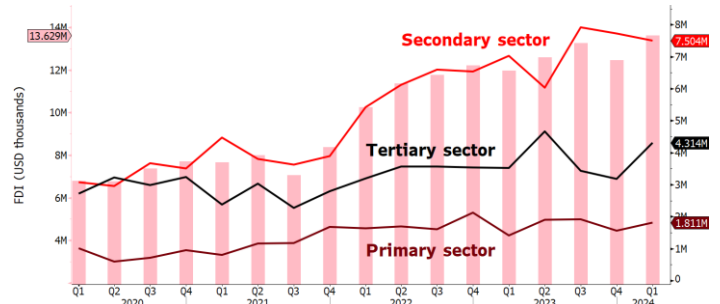
Source: Bloomberg

Indonesian economy grew steadily along with income levels



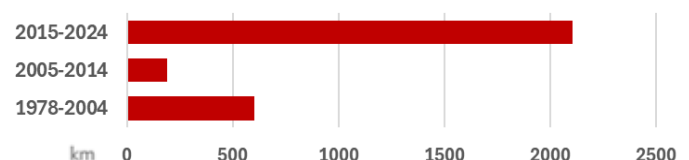
Source: Bloomberg, IMF, World Bank

Indonesian FDI growth was driven by the manufacturing sector



Source: Bloomberg

Over 70% of Indonesia's toll roads were built the past decade



Source: Indonesia Toll Road Authority (BPJT)

Bottom-line: Opening the economy to foreign investment and prioritising infrastructure were two key policy pillars that helped Indonesia gain the confidence of markets, paving the way for economic growth that was less reliant on commodities.

Execution – the stumbling block for Indonesia

In early 2015, fuel subsidy cuts by the Indonesian government reduced total subsidy expenditure by 53% that year. As a result, the government revised the 2015 budget to increase capital expenditure to 18% of total spending. However, this level was not maintained, as capex declined in the years that followed. Furthermore, despite substantial investment into physical infrastructure, trade logistics continue to present a challenge. The Logistics Performance Index by the World Bank reveals that although Indonesia improved its overall world rank in 2018, it fell back to 61st place in 2023, still behind regional peers such as Malaysia (26), Thailand (34), and Vietnam (43).

Where is Malaysia now?

Much like Jokowi’s first term, markets took time to digest the implication of Anwar’s policy agenda, as the KLCI Index fell 6.4% through his first year in office, underperforming MSCI ASEAN. However, the KLCI has rebounded since then to climb over 20%, while GDP growth accelerated to 5.9% YoY last quarter. Our growth estimates for 2024 and 2025 remain strong at 5.2% and 4.7%, while inflation is expected to be manageable at just over 2%.

Record levels of investment continue this year

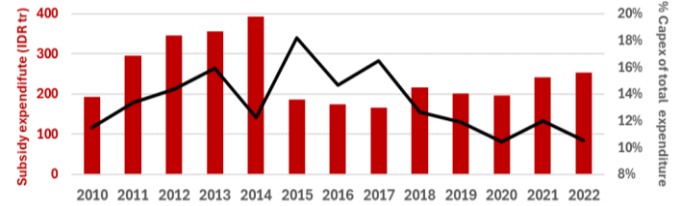
Record-high levels of investment into Malaysia continued its momentum into 1H 2024 as investments increased 18% YoY, driven largely by the manufacturing sector which saw a 33.9% rise, while the services sector also grew 14.5%. As the country emerges as a leading hub for semiconductor and tech-related investments in ASEAN, its E&E exports are expected to rise following a pickup in global semiconductor demand. This comes as the government recently unveiled RM25bn in incentives under its national semiconductor strategy, while tax allowances and other economic incentives further bolster manufacturing investments.

Malaysia’s neutral geopolitical stance aids its structural advantages

Malaysia benefits from an attractive value chain, anchored by its relatively developed infrastructure, abundant resources, and skilled labour force. In a move that emulates Jokowi’s diplomatic approach, Anwar has strategically positioned the country at the convergence of East and West, providing a practical alternative for companies looking to diversify their supply chains away from China, while strengthening ties with the BRICS bloc.

Bottom-line: In an era of heightened geopolitical uncertainty, Malaysia has leveraged the China+1 policy to benefit from arising tensions, attracting more investment and strengthening its place as a tech and E&E hub in ASEAN.

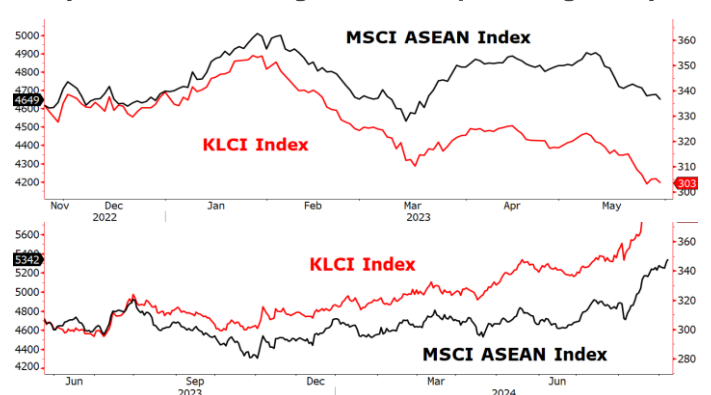
Indonesia’s subsidy expenditure halved 2015 onwards, but higher capex was not sustained



Source: MOF Indonesia

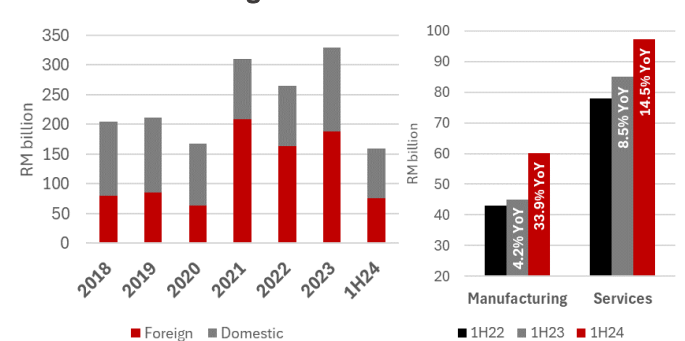
Bottom-line: Despite great promise from early reforms, the sustainment and execution of policies continue to be a challenge for Indonesia.

Malaysian stocks have surged after underperforming initially



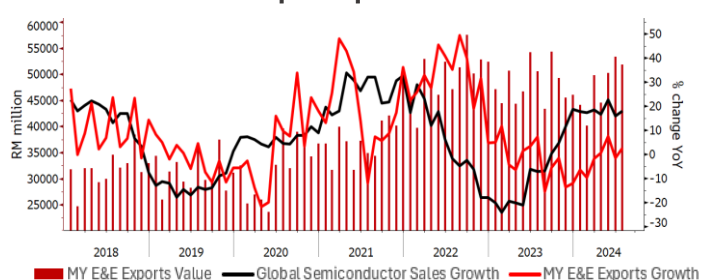
Source: Bloomberg

Approved investments reach record high in 2023, with momentum continuing into 1H24



Source: MIDA

Malaysian E&E exports expected to rise further as global semiconductor demand picks up



Source: Bloomberg, MIDA

Jokowi and Anwar – a story of fiscal discipline early on

In Indonesia, the reappointment of esteemed economist Sri Mulyani as Finance Minister in 2016 bolstered confidence in the country's fiscal reform agenda. Following years of rising deficits, the government stabilised its current account balance, leading to a period of rupiah stability. As a result, foreign investment in Indonesian government bonds more than doubled during Jokowi's first term (see chart on next page). These positive fiscal measures contributed to upgrades in Indonesia's credit ratings from BB+ (S&P) and Baa3 (Moody's) in 2015, to BBB and Baa2 by 2019.

Malaysia's fiscal reforms kick-off cycle of inflows

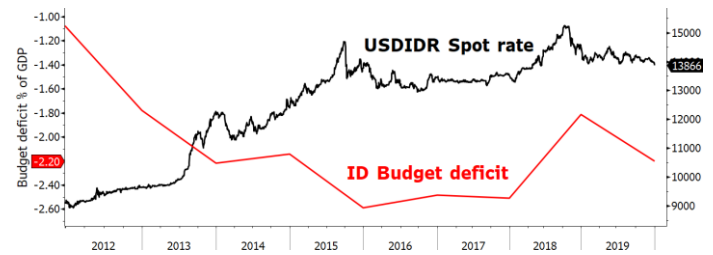
Comparably, the appointment of technocrats to key ministerial positions under the Anwar administration has also boosted confidence in Malaysia's fiscal reform agenda. Deterioration in the country's fiscal position under the previous administrations saw the ringgit fall to 25-year lows, but the ongoing fiscal consolidation has helped reverse that. The fuel subsidy rationalisation currently underway is seen as a critical step in further narrowing the deficit, while efforts to increase government revenue have come in revisions to income and service tax rates. Legislative reforms have also reinforced the fiscal deficit target at 3% and the debt-to-GDP ceiling at 60%.

This recent appreciation is driven by more than just broad dollar weakening. During a period of high global interest rates, BNM remained prudent, maintaining the policy rate at 3.00% as domestic inflation remained manageable. This interest rate differential contributed to a weaker ringgit that hit 25-year lows earlier this year. However, strong coordination between the government and the central bank, including directives for government-linked companies to repatriate funds, helped to shore up the local currency. This policy has seemingly paid off as Malaysia is expected to maintain its policy rate at 3.00% throughout the year ahead while the U.S. Fed embarks on its rate cut cycle following the first 50bps.

Foreign holdings of Malaysian Government Securities (MGS) have surged by over RM11bn in the past two months, driven by this expectation of a reversal of the ringgit to its fair value. Despite underperforming earlier in the year, the ringgit has emerged as Asia's top performer, appreciating over 10% year-to-date.

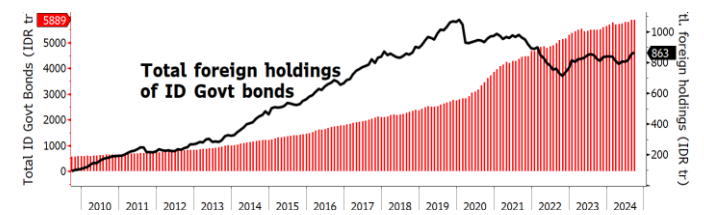
Bottom-line: Fiscal reforms have played a big factor in ringgit strengthening, initiating a cycle of inflows and investment. As purchases of Malaysian government bonds increase and global interest rates decline, Malaysian equity markets are poised to benefit. Amid current political stability and supportive government policies, Malaysia's growth outlook remains strong, with the key to sustained growth lying in effective implementation and execution.

Rupiah stabilised along with Indonesia's fiscal position



Source: Bloomberg, MOF Indonesia

Foreign holdings of Indonesian government bonds more than doubled in Jokowi's first term



Source: Bloomberg, MOF Indonesia

Malaysia's improving fiscal position and the Fed's long awaited rate cuts are driving ringgit strength



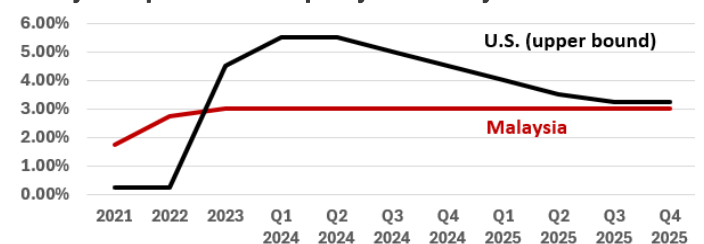
Source: Bloomberg

Foreign investors snap up Malaysian Government Securities



Source: Bank Negara Malaysia

Malaysia expected to hold policy rate steady as the Fed cuts



Source: CIMB Treasury & Markets Research

Conclusion: Stay overweight Malaysian equities and selective fixed income.

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