CREDENDO

MALAYSIA: LONG-TIME OPPOSITION LEADER BECOMES NEW PM IN A DIVIDED COUNTRY AND AMID ECONOMIC DIFFICULTIES

Event

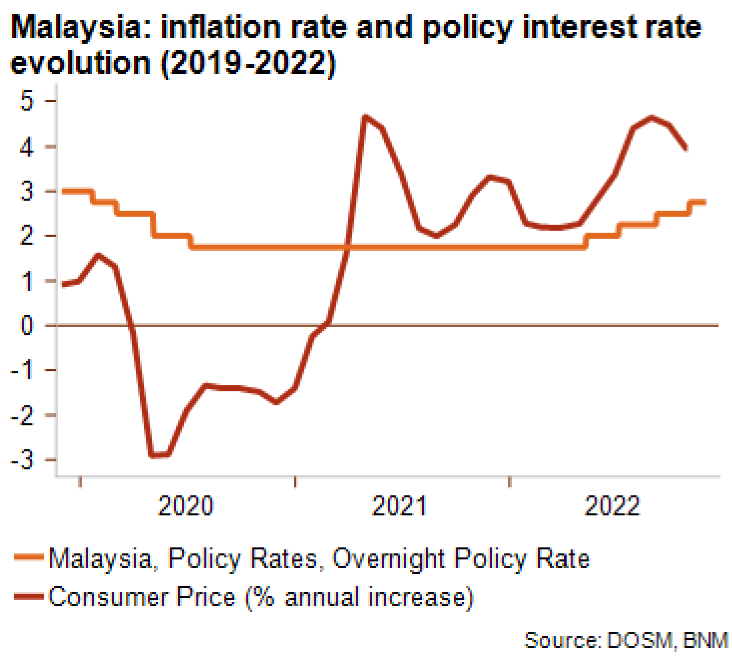
On 19 November, Malaysia's general elections delivered no clear outcome, with a hung parliament putting the main parties in a position in which they were unable to form a government. Five days later and after the king's intervention, Anwar Ibrahim, long-time former opposition leader, was chosen to become the Prime Minister of a more progressive and multi-ethnic coalition. Still, after years of unprecedented political instability, this unity government looks very fragile, especially over a 5-year term, thereby clouding political stability prospects in a challenging economic environment.

Impact

Some key lessons may be drawn from the latest elections. First, the political landscape has never been so fragmented, with several parties collecting a low to moderate level of support. Anwar Ibrahim's opposition Pakatan Harapan (PH) coalition won the most seats (82 out of 222), ahead of ex-PM Muhyiddin Yassin's Perikatan Nasional (PN) coalition. The long-ruling Barisan Nasional (BN) coalition saw its weight further erode, with barely 30 seats, by far its most disappointing outcome ever, as a result of past huge financial scandals. Second, 75-year-old Anwar Ibrahim's PM position is a landmark achievement, rewarding his perseverance after two decades of constant opposition – including many years in prison on disputed sentences, while he managed to keep a good level of popularity. Third, recent political developments confirm the rejection of political elites – which started with the historical power transfer from the BN coalition's six-decade rule to the opposition in the 2018 general elections – after decades of high political stability and succession of corruption scandals. However, the new unity government is, in essence, fragile and depends upon difficult political compromises – especially with the BN coalition, whose likely volatile support has given the parliamentary majority to the government. Moreover, Anwar's objective to curb corruption and ease religious tensions could face a rising Islamisation push, as highlighted by the electorally successful dominant Islamic Party (49 seats), and persisting pro-Malay pressures in any socio-economic dimensions. That being said, Anwar's moderate, balanced and investor-friendly stance is welcome given today's divided society and economic slowdown.

The challenging economic situation will not facilitate the government's start of rule. Rising inflation (4.5% in September) and slowing growth (from 5.4% expected in 2022 to 4.4% forecast next year), amid a darkening global economic outlook in key US and EU markets, are hitting domestic and external demand in the export-led economy. Hence, Anwar's

Malaysian ringgit to a historic low (-7.5% against the US dollar between January and 24 November 2022). While interest rates raised from 1.75% to 2.75% this year to fight inflation, inflation pressures are expected to ease gradually in 2023.



Moreover, improving public finances is in the government's cards as Covid-19 supportive measures, complemented by heightened food subsidies, more than doubled the fiscal deficit to around 5% of GDP in 2021-2022, thereby elevating public debt from 57% of GDP in 2019 to a level expected to flirt with 70% this year. Therefore, tax increases are likely not only to bring the fiscal deficit down but also to finance higher social and infrastructure spending.

Regarding risk ratings, the business environment risk (C/G) is not expected to change in the coming months and highlights that risks remain relatively low amid still solid real GDP growth, relatively low inflation and moderate depreciation pressure. As for Malaysia's strong short-term political risk rating (2/7), risks are also at a relatively low level but might be under pressure next year. Indeed, foreign exchange reserves are down to their 2020 level on the back of capital outflows and a shrinking current account surplus. Given the surge in imports, their import cover is now less than 4 months, i.e. a 20-year low level, and might continue to suffer from high commodity prices.

Analyst: Raphaël Cecchi – r.cecchi@credendo.com

6/12/2022