

## Malaysia's Newfound Stability



TALES FROM THE EMERGING WORLD | EMERGING MARKETS EQUITY TEAM | October 2024

After four years of political turmoil, Malaysia's recent stability and steady growth are paving the way for its government to implement critical reforms, including the overhaul of costly fuel and power subsidies. As a key beneficiary of the China Plus One strategy, Malaysia is well-positioned for increased investments, particularly in its expanding data center sector, capitalizing on the ongoing "tech war" between the U.S. and China.

From its independence in 1957 until 2018, Malaysia enjoyed the political stability of being governed by just six prime ministers, until the \$4.5 billion corruption scandal at 1MDB (1Malaysia Development Berhad) led voters to oust the ruling party, United Malays National Organization. This upheaval then brought a rapid succession of four prime ministers in a mere four years. The 2022 elections marked a turning point with veteran politician Anwar Ibrahim rallying former rivals into joining a unity government comprised of 19 different parties. With the coalition now controlling two-thirds of parliamentary seats, the administration has a four-year window before facing major elections in 2028.

Malaysia has been a forgotten market among foreign investors for more than two and half decades. The former Asian tiger was once the largest Asian emerging market by weight in the MSCI index prior to the Asian Financial Crisis in 1997. Over the years it has struggled to regain its former glory, being overshadowed by larger Asian markets like China and India, and the tech prowess of both Korea and Taiwan. Even neighboring Indonesia drew more investor interest as it focused on "down-streaming" in its mining industry.

We believe Malaysia is worth another look. Political stability has encouraged much-needed reforms, while Ekonomi Madani, a 10-year development plan launched in July 2023, aims to reduce red tape, promote economic growth of regions outside Peninsular Malaysia and enhance the efficiency of government-related enterprises.

The country's \$400 billion economy has averaged 4.5% growth over the past two decades, doubling GDP (gross domestic product) per capita to around \$12,000. In the second quarter of 2024, GDP climbed to 5.9%, following a 4.2% rise in the first quarter. This economic momentum has spurred job creation

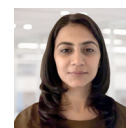
### AUTHORS



**AMAY HATTANGADI**  
*Portfolio Manager*  
*Emerging Markets*  
*Equity Team*



**UDAY THARAR**  
*Vice President*  
*Emerging Markets*  
*Equity Team*



**AAYUSHI KUKREJA**  
*Vice President*  
*Emerging Markets*  
*Equity Team*

with unemployment rates declining from the peaks seen during the COVID-19 lockdowns. The narrowing gap between labor costs and labor productivity, which had surged during the pandemic, is making Malaysia more competitive in the region.

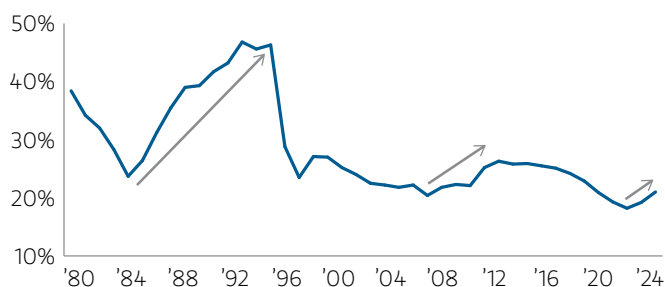
We expect inflation to remain under control, allowing Bank Negara Malaysia to hold its policy interest rate at 3%. We believe the central bank will be in no hurry to adjust its monetary policy and will hold rates steady for the remainder of the year.

Despite a slight dip in consumer confidence, retail sales and lending activity continue to gain momentum, indicating a resilient consumer base. Domestic consumption now accounts for 60% of GDP, up from 44% in 2008. Additionally, the government's plan to increase the salaries of 1.6 million civil servants by between 7% and 15%, starting in December, will further boost consumption growth.

#### DISPLAY 1

### The Start of Malaysia's Third Investment Cycle

Gross fixed capital formation as a percentage of GDP



Source: Haver and Department of Statistics, Malaysia. As of 6/30/2024.

Budgetary discipline is at the forefront. Post-pandemic, Malaysia's fiscal deficit widened to 5.8% of GDP compared to 3.3% in the previous five years, elevating government debt to 64% of GDP from 52%. The Fiscal Responsibility Act (FRA), introduced last year, aims to lower the fiscal deficit to 3% of GDP and keep government debt levels to under 60% over the next five years. The law also requires annual development expenditure to be at least 3% of GDP.

Balancing fiscal sustainability and managing public discontent will be challenging, though. Subsidies peaked at 4.3% of GDP in 2023, accounting for almost 25% of total government expenditure. This year's budget projects a reduction in subsidies by over 30%. The government has already removed support from chicken and eggs and applied targeted subsidies on diesel and electricity. The real test will come with the rationalization of RON95 (octane) gasoline prices, which accounted for around 60% of subsidies in 2023. To mitigate inflation spikes and political backlash, the increase in RON95 gasoline prices will likely be phased in, starting later this year or early in 2025.

In a positive turn for Malaysia's economic landscape, the country is witnessing a resurgence in foreign direct investment (FDI) after years of stagnation. Since 2021, Malaysia has attracted \$24 billion in data-related investments helping the country promote itself as Asia's data center hub. With affordable land, electricity and water along with a stable geological environment outside of earthquake zones, it has become an attractive destination for tech companies.

That should bolster Malaysia's ringgit, which historically appreciates against the U.S. dollar during investment growth periods. Further, efforts to repatriate funds by Government-Linked Investment Companies (GLICs), in which the state has a controlling stake, and private corporations should also support the currency.

More investments should come from special economic zones. Johor, known as the southern gateway of Malaysia, is promoting the planned Johor-Singapore Special Economic Zone that will offer streamlined licensing, tax incentives and passport-free travel. Separately, the Forest City Special Financial Zone, also in Johor, aims to create a global finance hub tapping into Singapore's international financial market. A planned high-speed rail link connecting Kuala Lumpur to Singapore, will bring improved connectivity between the two nations.

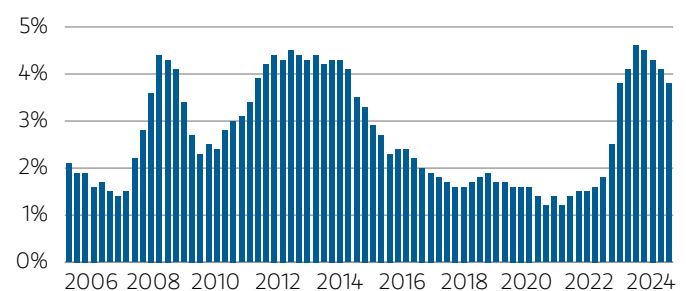
Manufacturing remains central to Malaysia's economic strategy, contributing 23% to its GDP – higher than most emerging market countries – and accounting for over 80% of its exports. The first investment wave in the 1980s helped transform Malaysia from a commodity-based economy to a manufacturing-based one. Penang, a key beneficiary of that early FDI, has attracted technology giants like Intel, Advanced Micro Devices and Hewlett-Packard. The state is now focusing on microchip design and wafer fabrication.

We believe Malaysian stocks are poised for their strongest year in over a decade, driven by improving industrial activity and resilient consumer spending. Equity market liquidity

#### DISPLAY 2

### Reducing Subsidies Is Key to Malaysia's 2024 Budget

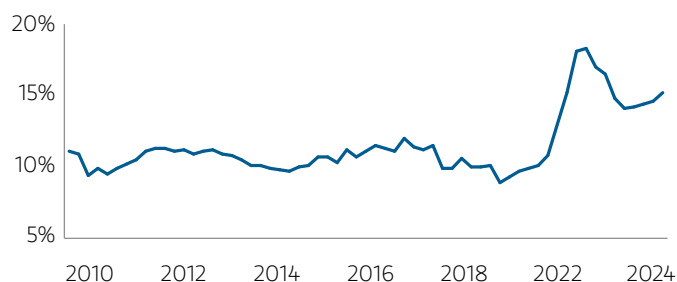
Government subsidies as a percentage of GDP



Source: Haver, Bank Negara Malaysia. As of 6/30/2024.

**DISPLAY 3****Malaysia Is Attracting Significant Foreign Direct Investment Flows Post-Covid**

FDI Inflows as a percentage of GDP



Source: Haver and Bank Negara Malaysia. As of 6/30/2024.

is improving, spurred by domestic institutional investors, particularly the GLICs. With macro fundamentals improving,

there is a strong case for Malaysian equities to return to pre-pandemic levels.

But what could go wrong? Anwar's coalition needs to navigate a complex political landscape where compromise is essential. Although Anwar had flagged anti-corruption as a priority for his government, the administration has dropped graft charges against coalition members to ensure their loyalty.

The balancing act between economic future and political stability will be pivotal in unlocking the country's full potential. Structural reforms underway should the fiscal deficit and restore investor confidence. Anwar has four years before he must face the voters again. If he keeps doing the responsible thing, Malaysia's prospects look promising.

**Risk Considerations**

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by a portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. In general, **equities securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, market and liquidity risks. The risks of investing in **emerging market countries** are greater than the risks generally associated with investments in foreign developed countries.

**IMPORTANT DISCLOSURES****Past performance is no guarantee of future results.**

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market.

**A separately managed account may not be appropriate for all investors. Separate accounts managed according to the particular Strategy may include securities that may not necessarily track the performance of a particular index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing. A minimum asset level is required.**

**For important information about the investment managers, please refer to Form ADV Part 2.**

The views and opinions and/or analysis expressed are those of the author or the investment team as of the date of preparation of this material and are subject to change at any time without notice due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all investment personnel at Morgan Stanley Investment Management (MSIM) and its subsidiaries and affiliates (collectively "the Firm"), and may not be reflected in all the strategies and products that the Firm offers.

Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors or the investment team. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific strategy or product the Firm offers. Future results may differ significantly depending on factors such as changes in securities or financial markets or general economic conditions.

This material has been prepared on the basis of publicly available information, internally developed data and other third-party sources believed to be reliable. However, no assurances are provided regarding the reliability of such information

and the Firm has not sought to independently verify information taken from public and third-party sources.

This material is a general communication, which is not impartial and all information provided has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The information herein has not been based on a consideration of any individual investor circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

This material is not a product of Morgan Stanley's Research Department and should not be regarded as a research material or a recommendation.

The Firm has not authorised financial intermediaries to use and to distribute this material, unless such use and distribution is made in accordance with applicable law and regulation. Additionally, financial intermediaries are required to satisfy themselves that the information in this material is appropriate for any person to whom they provide this material in view of that person's circumstances and purpose. The Firm shall not be liable for, and accepts no liability for, the use or misuse of this material by any such financial intermediary.

This material may be translated into other languages. Where such a translation is made this English version remains definitive. If there are any discrepancies between the English version and any version of this material in another language, the English version shall prevail.

The whole or any part of this material may not be directly or indirectly reproduced, copied, modified, used to create a derivative work, performed, displayed, published, posted, licensed, framed, distributed or transmitted or any of its contents disclosed to third parties without the Firm's express written consent. This material may not be linked to unless such hyperlink is for personal and non-commercial use. All information contained herein is proprietary and is protected under copyright and other applicable law.

Eaton Vance is part of Morgan Stanley Investment Management. Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

## DISTRIBUTION

This material is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

MSIM, the asset management division of Morgan Stanley (NYSE: MS), and its affiliates have arrangements in place to market each other's products and services. Each MSIM affiliate is regulated as appropriate in the jurisdiction it operates. MSIM's affiliates are: Eaton Vance Management (International) Limited, Eaton Vance Advisers International Ltd, Calvert Research and Management, Eaton Vance Management, Parametric Portfolio Associates LLC and Atlanta Capital Management LLC.

This material has been issued by any one or more of the following entities:

### EMEA

This material is for Professional Clients/Accredited Investors only.

In the EU, MSIM and Eaton Vance materials are issued by MSIM Fund Management (Ireland) Limited ("FMIL"). FMIL is regulated by the Central Bank of Ireland and is incorporated in Ireland as a private company limited by shares with company registration number 616661 and has its registered address at 24-26 City Quay, Dublin 2, DO2 NY19, Ireland.

Outside the EU, MSIM materials are issued by Morgan Stanley Investment Management Limited (MSIM Ltd) is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

In Switzerland, MSIM materials are issued by Morgan Stanley & Co. International plc, London (Zurich Branch) Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland.

Outside the US and EU, Eaton Vance materials are issued by Eaton Vance Management (International) Limited ("EVM") 125 Old Broad Street, London, EC2N 1AR, UK, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority.

**Italy:** MSIM FMIL (Milan Branch), (Sede Secondaria di Milano) Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy. **The Netherlands:** MSIM FMIL (Amsterdam Branch), Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands.

**France:** MSIM FMIL (Paris Branch), 61 rue de Monceau 75008 Paris, France.

**Spain:** MSIM FMIL (Madrid Branch), Calle Serrano 55, 28006, Madrid, Spain.

**Germany:** MSIM FMIL, Frankfurt Branch, Grosse Gallusstrasse 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Denmark:** MSIM FMIL (Copenhagen Branch), Gorrissen Federspiel, Axel Towers, Axelstorv2, 1609 Copenhagen V, Denmark.

### MIDDLE EAST

**Dubai:** MSIM Ltd (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)4 709 7158).

This document is distributed in the Dubai International Financial Centre by Morgan Stanley Investment Management Limited (Representative Office), an entity regulated by the Dubai Financial Services Authority (DFSA). It is intended for use by professional clients and market counterparties only. This document is not intended for distribution to retail clients, and retail clients should not act upon the information contained in this document.

This document relates to a financial product which is not subject to any form of regulation or approval by the DFSA. The DFSA has no responsibility for reviewing or verifying any documents in connection with this financial product. Accordingly, the DFSA has not approved this document or any other associated documents nor taken any steps to verify the information set out in this document, and has no responsibility for it. The financial product to which this document relates may be illiquid and/or subject to restrictions on its resale or transfer. Prospective purchasers should conduct their own due diligence on the financial product. If you do not understand the contents of this document, you should consult an authorised financial adviser.

### U.S.

**NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT**

## LATIN AMERICA (BRAZIL, CHILE COLOMBIA, MEXICO, PERU, AND URUGUAY)

This material is for use with an institutional investor or a qualified investor only. All information contained herein is confidential and is for the exclusive use and review of the intended addressee, and may not be passed on to any third party. This material is provided for informational purposes only and does not constitute a public offering, solicitation or recommendation to buy or sell for any product, service, security and/or strategy. A decision to invest should only be made after reading the strategy documentation and conducting in-depth and independent due diligence.

### ASIA PACIFIC

**Hong Kong:** This material is disseminated by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this material have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this material shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong.

**Singapore:** This material is disseminated by Morgan Stanley Investment Management Company and should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"); (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This publication has not been reviewed by the Monetary Authority of Singapore. **Australia:** This material is provided by Morgan Stanley Investment Management (Australia) Pty Ltd ABN 22122040037, AFSL No. 314182 and its affiliates and does not constitute an offer of interests. Morgan Stanley Investment Management (Australia) Pty Limited arranges for MSIM affiliates to provide financial services to Australian wholesale clients. Interests will only be offered in circumstances under which no disclosure is required under the Corporations Act 2001 (Cth) (the "Corporations Act"). Any offer of interests will not purport to be an offer of interests in circumstances under which disclosure is required under the Corporations Act and will only be made to persons who qualify as a "wholesale client" (as defined in the Corporations Act). This material will not be lodged with the Australian Securities and Investments Commission.

**Japan:** For professional investors, this material is circulated or distributed for informational purposes only. For those who are not professional investors, this material is provided in relation to Morgan Stanley Investment Management (Japan) Co., Ltd. ("MSIM")'s business with respect to discretionary investment management agreements ("IMA") and investment advisory agreements ("IAA"). This is not for the purpose of a recommendation or solicitation of transactions or offers any particular financial instruments. Under an IMA, with respect to management of assets of a client, the client prescribes basic management policies in advance and commissions MSIM to make all investment decisions based on an analysis of the value, etc. of the securities, and MSIM accepts such commission. The client shall delegate to MSIM the authorities necessary for making investment. MSIM exercises the delegated authorities based on investment decisions of MSIM, and the client shall not make individual instructions. All investment profits and losses belong to the clients; principal is not guaranteed. Please consider the investment objectives and nature of risks before investing. As an investment advisory fee for an IAA or an IMA, the amount of assets subject to the contract multiplied by a certain rate (the upper limit is 2.20% per annum (including tax)) shall be incurred in proportion to the contract period. For some strategies, a contingency fee may be incurred in addition to the fee mentioned above. Indirect charges also may be incurred, such as brokerage commissions for incorporated securities. Since these charges and expenses are different depending on a contract and other factors, MSIM cannot present the rates, upper limits, etc. in advance. All clients should read the Documents Provided Prior to the Conclusion of a Contract carefully before executing an agreement. This material is disseminated in Japan by MSIM, Registered No. 410 (Director of Kanto Local Finance Bureau (Financial Instruments Firms)), Membership: the Japan Securities Dealers Association, The Investment Trusts Association, Japan, the Japan Investment Advisers Association and the Type II Financial Instruments Firms Association.