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Research Update:

Malaysia 'A-/A-2' Foreign Currency And 'A/A-1' Local Currency Ratings Affirmed; Outlook Stable

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Overview

- The affirmation is predicated on our expectations that the 1MDB issues and the upcoming change in Bank Negara Malaysia leadership will not diminish the effectiveness of policymaking either in the executive branch or at the central bank.
- We believe the government has taken sufficient offsetting measures to compensate for lost hydrocarbon-related fiscal revenue. In addition, the country's strong external position and fairly diverse economy can absorb some weakness in the oil and gas sector.
- We are affirming our 'A-/A-2' foreign currency and 'A/A-1' local currency sovereign credit ratings on Malaysia. We are also affirming our 'axAAA/axA-1+' ASEAN regional scale rating on Malaysia.
- The outlook remains stable, reflecting our view that Malaysia's strong external asset position and high monetary flexibility would reduce the likelihood of a downgrade to less than one-in-three over the next 24 months.

Rating Action

On March 28, 2016, Standard & Poor's Ratings Services affirmed its 'A-' long-term and 'A-2' short-term foreign currency sovereign credit ratings on Malaysia. At the same time, we affirmed our 'A' long-term and 'A-1' short-term local currency sovereign credit ratings on Malaysia. The outlook on the long-term ratings remains stable. We also affirmed our 'axAAA/axA-1+' ASEAN regional scale rating on Malaysia.

Rationale

The sovereign credit ratings on Malaysia reflect the country's strong external position and considerable monetary flexibility. We weigh these strengths against Malaysia's less strong public finances. In affirming the ratings, we assume that corruption allegations in relation to 1Malaysia Development Bhd (1MDB) will not impede the ability of the executive branch to promote sustainable public finances and balanced economic growth. Similarly, we expect that the credibility of monetary policy and operational independence of Bank Negara Malaysia (BNM, the central bank) will not diminish upon the retirement of long-standing Governor Dr. Zeti Akhtar Aziz in April. The BNM has an established track record in controlling inflation and supervising closely its banking system. Malaysia also has a deep domestic bond market, compared with its peers', which reduces its reliance on external financing and provides domestic corporations with alternative means of finance.

Malaysia's external position, a result of years of current account surpluses, is a key rating strength. We believe this position can withstand the slump in the oil and gas sector over the next two years. Our assumptions for Brent oil price per barrel (bbl) is US$40 for the remainder of 2016, US$45/bbl in 2017, and US$50/bbl thereafter (see Related Research section below). We envisage Malaysia's external indicators will remain broadly unchanged, given our projection that Malaysia's current account will remain in surplus. For 2016, the depreciation of the ringgit should help the competitiveness of manufactured goods exports, offsetting some of the impact of weaker terms of trade for Malaysia's energy exports.

Malaysia's fiscal performance has consolidated after weakening to accommodate the shock of the global financial crisis. The annual increase in general government debt had averaged 6% of GDP over 2009-2012. Deficits have since narrowed, and we project the average annual increase in debt at 2.8% of GDP over 2016-2019. The administration still aspires to balance the budget by 2020 despite the sharp decline in oil-related fiscal revenues--a task that we believe will be challenging.

High subsidy spending and dependence on energy-related revenues had weighed on Malaysia's fiscal position. The removal of oil subsidies in December 2014 and the introduction of a 6% goods and services tax (GST) in April 2015 alleviated some of those pressures. In response to lower-than-expected crude oil prices, the government revised the budget in 2015 and 2016 to maintain its fiscal deficit targets. We view these measures as signs that Malaysia's budgetary policy is proactive. We expect public finances to remain in check as recent political leadership challenges play out. Specifically, we estimate that net general government debt peaked at about 49% of GDP in 2015 and we project the ratio to decline modestly as growth remains buoyant.

Malaysia's general government fiscal position also carries contingent risks from its public enterprises and financial sector. These contingent risks include guarantees on debts and letters of support (including the US$3 billion letter of support for 1MDB, which we regard as a direct financial obligation of the government). Malaysia's public enterprises have diverse financial profiles--some with strong free cash flows and sizable liquid assets that, at times, have been used to support other parts of the public sector and engage in quasi-fiscal activities. Within our forecast horizon, we do not expect contingent liabilities of the weaker public enterprises to crystalize in a material manner on the central government balance sheet.

Although Malaysia's high household debt poses some risks, we believe that risks to the government are contained by the buffer of high banking sector capitalization and the BNM's regulatory record. Our Bank Industry Country Risk Assessment for Malaysia is '4', with '1' being the strongest assessment and '10' the weakest (see Banking Industry Country Risk Assessment: Malaysia, published to RatingsDirect, Nov. 26, 2015).

Just over a quarter of Malaysia's ringgit-denominated government bonds are held by nonresidents. Although the foreign ownership could reduce if--contrary to our expectations--Malaysia's institutional settings worsen, we believe the country's sound budgeting, a deep local capital market, the BNM's floating exchange rate regime, and its 6.4 months of foreign exchange reserve coverage of current account payments attenuate the risks.

We project Malaysia's GDP per capita to be just under US$10,000 as of the end of 2016, lower than that of most peers in the same rating category. The economy is diversified with a large manufacturing and services base. However, the declining percentage of non-energy exports to GDP suggests that the government's efforts to improve competitiveness and move toward higher-margin exports have yet to bear fruit.

We do not expect the weak energy prices to reduce real economic growth materially over the next 24 months, given that production of crude oil and liquefied natural gas account for only about 10% of GDP. We project Malaysia's average annual growth in real GDP per capita to be 3.7% over 2016-2019. Exports of manufactured goods and growth in private consumption and investment are likely to drive this expansion.

Outlook

The stable outlook is based on our expectation that Malaysia's strong external asset position and high monetary flexibility reduce the likelihood of a downgrade to less than one-in-three over the next 24 months. We also believe Malaysia's credit fundamentals can withstand some stress in the oil and gas sector during that period. We don't expect to raise the sovereign ratings on Malaysia this year or next.

We may lower the ratings (or eliminate the gap between the foreign and local currency ratings) if we assess Malaysia's public finances or institutional settings have weakened. Such a change could come about, for example, should the government dilute its recent fiscal measures or the incoming leadership at the central bank lead us to believe the conduct of monetary policy will be less effective than it has been in the past. We may also lower the ratings if contingent liabilities crystalize on the government's balance sheet materially or if we perceive that their future loss content has increased markedly from current levels.

Key Statistics

Table 1

Malaysia -- Selected Indicators									
(Mil. MYR)	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
ECONOMIC INDICATORS (%)									
Nominal GDP (bil. LC)	912	971	1,019	1,107	1,157	1,243	1,336	1,435	1,541

Table 1

Malaysia -- Selected Indicators (cont.)									
(Mil. MYR)	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Nominal GDP (bil. $)	298	314	323	338	296	302	324	348	374
GDP per capita (000s $)	10.3	10.7	10.7	11.1	9.6	9.6	10.2	10.8	11.4
Real GDP growth	5.3	5.5	4.7	6.0	5.0	4.8	5.0	5.5	5.5
Real GDP per capita growth	3.6	3.9	2.3	4.7	3.6	3.4	3.5	3.9	3.9
Real investment growth	6.4	19.0	8.2	4.8	3.7	3.7	4.0	4.5	4.5
Investment/GDP	23.2	25.7	25.9	25.0	25.1	28.2	28.5	27.0	25.5
Savings/GDP	34.1	30.9	29.4	29.3	28.0	30.9	31.5	30.8	30.3
Exports/GDP	85.3	79.3	75.6	73.8	71.0	66.6	64.6	63.6	62.7
Real exports growth	4.2	(1.7)	0.3	5.1	0.7	0.7	2.8	3.7	3.7
Unemployment rate	3.1	3.0	3.1	2.9	3.2	3.2	3.0	3.0	3.0
EXTERNAL INDICATORS (%)									
Current account balance/GDP	10.9	5.2	3.5	4.3	2.9	2.7	3.0	3.8	4.9
Current account balance/CARs	11.9	6.1	4.3	5.4	3.9	3.8	4.4	5.6	7.2
Trade balance/GDP	15.4	11.6	9.5	10.2	9.4	7.8	7.9	8.8	9.7
Net FDI/GDP	(1.0)	(2.5)	(0.6)	(1.7)	0.0	0.5	0.5	0.5	0.0
Net portfolio equity inflow/GDP	2.9	6.6	(0.3)	(3.5)	(2.4)	(1.5)	(1.5)	(1.0)	(1.5)
Gross external financing needs/CARs plus usable reserves	82.7	84.8	85.8	88.5	89.7	90.5	89.5	87.8	86.0
Narrow net external debt/CARs	(5.2)	(3.5)	4.1	6.8	6.5	5.2	3.4	2.6	2.6
Net external liabilities/CARs	(3.5)	5.8	1.0	(7.7)	(31.1)	(36.1)	(39.3)	(42.3)	(46.7)
Short-term external debt by remaining maturity/CARs	27.0	33.6	35.8	38.3	39.7	34.1	31.8	29.7	28.0
Reserves/CAPs (months)	5.3	6.4	6.7	6.4	6.4	5.5	5.3	5.2	5.2
FISCAL INDICATORS (%, General government)									
Balance/GDP	(7.8)	(7.7)	(7.0)	(6.0)	(5.1)	(4.0)	(3.8)	(3.6)	(3.6)
Change in debt/GDP	5.4	4.8	3.8	3.9	3.4	3.2	2.9	2.7	2.5
Primary balance/GDP	(5.9)	(5.7)	(5.0)	(4.0)	(3.0)	(1.9)	(1.7)	(1.5)	(1.5)
Revenue/GDP	16.0	17.0	17.4	16.9	17.1	17.2	17.4	17.5	17.8
Expenditures/GDP	23.8	24.7	24.4	22.9	22.2	21.2	21.2	21.1	21.4
Interest /revenues	12.1	11.8	11.7	12.1	12.4	12.3	12.0	12.0	11.8
Debt/GDP	50.1	51.8	53.1	52.8	53.9	53.4	52.6	51.7	50.6
Debt/Revenue	313.3	304.8	305.9	312.5	315.4	310.5	302.2	295.2	284.2
Net debt/GDP	43.2	45.0	47.5	47.2	48.8	48.6	48.1	47.5	46.7
Liquid assets/GDP	6.9	6.8	5.7	5.6	5.2	4.8	4.5	4.2	3.9
MONETARY INDICATORS (%)									
CPI growth	3.2	1.7	2.1	3.1	2.1	2.9	3.2	3.0	3.0
GDP deflator growth	5.4	1.0	0.2	2.5	(0.4)	2.5	2.4	1.8	1.8
Exchange rate, year-end (LC/$)	3.18	3.06	3.28	3.50	4.29	4.12	4.12	4.12	4.12
Banks' claims on resident non-gov't sector growth	12.2	11.9	10.6	8.8	8.3	7.0	7.5	8.0	8.0
Banks' claims on resident non-gov't sector/GDP	117.5	123.5	130.2	130.5	135.2	134.7	134.7	135.4	136.2

Table 1

Malaysia -- Selected Indicators (cont.)									
(Mil. MYR)	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Foreign currency share of claims by banks on residents	1.8	1.7	2.1	2.2	2.3	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	5.0	5.6	5.0	5.7	8.1	7.0	7.0	7.0	7.0
Real effective exchange rate growth	0.4	(0.3)	0.5	(0.7)	(8.0)	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Ratings Score Snapshot	
Key rating factors	
Institutional assessment	Neutral
Economic assessment	Neutral
External assessment	Strength
Fiscal assessment: flexibility and performance	Neutral
Fiscal assessment: debt burden	Neutral
Monetary assessment	Strength

Standard & Poor's analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of Standard & Poor's "Sovereign Rating Methodology," published on Dec. 23, 2014 , summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with Standard & Poor's sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Standard & Poor's National And Regional Scale Mapping Tables, Jan. 19, 2016
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Sovereign Rating Methodology, Dec. 23, 2014
- Methodology: Criteria For Determining Transfer And Convertibility

Assessments, May 18, 2009

Related Research

- Asia-Pacific Sovereign Rating Trends, January 2016, Jan. 18, 2016
- Global Sovereign Rating Trends 2016, Jan. 6, 2016
- GDP Per Capita Thresholds For Sovereign Rating Criteria, Dec. 21, 2015
- Sovereign Risk Indicators, Dec. 14, 2015
- Sovereign Rating And Country T&C Assessment Histories, March 15, 2016
- Sovereign Ratings And Country T&C Assessments, March 14, 2016
- Banking Industry Country Risk Assessment: Malaysia, Nov. 26, 2015
- S&P Lowers Its Hydrocarbon Price Deck Assumptions On Market Oversupply; Recovery Price Deck Assumptions Also Lowered, Jan. 12, 2016.

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that the key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed

Malaysia	
Sovereign Credit Rating	
Foreign Currency	A-/Stable/A-2
Local Currency	A/Stable/A-1
ASEAN Regional Scale	axAAA/--/axA-1+

Malaysia	
Senior Unsecured	A
Malaysia Sovereign Sukuk Bhd.	
Senior Unsecured	A-
Wakala Global Sukuk Bhd.	
Senior Unsecured	A-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.