

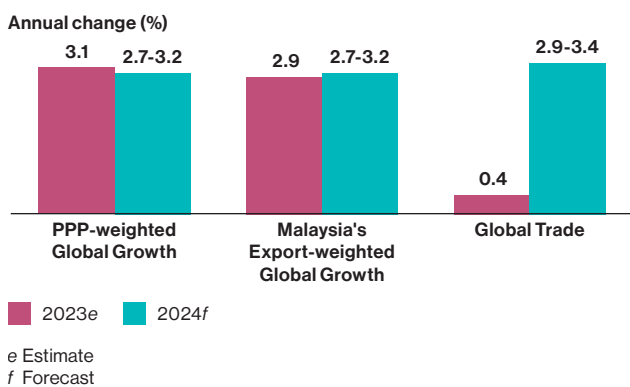
# Outlook and Policy in 2024

## 2024: FURTHER ECONOMIC EXPANSION DESPITE HEADWINDS

### Sustained global growth amid moderating inflation

In 2024, global growth is expected to be sustained (Chart 2.1). Headwinds from continued tight monetary policy and withdrawal of fiscal support are expected to be cushioned by supporting factors such as moderating inflation, resilient labour markets and a rebound in global trade.

Chart 2.1: Global Real GDP and Trade Growth



Notes: 1. PPP-weighted global growth is the aggregate global growth weighted by the purchasing power parity (PPP) exchange rate, the rate at which the currency of one country would have to be converted into that of another country to buy the same amount of goods and services in each country.  
2. Export-weighted global growth is the aggregate growth of Malaysia's key trading partners, as weighted by their shares in Malaysia's exports. This measure of global growth is more reflective of Malaysia's exports and growth prospects.

Source: Bank Negara Malaysia estimates

In advanced economies, despite domestic demand being more resilient than expected in 2023, signs of moderation are evident. Tight labour market has been gradually easing, with excess savings steadily depleting. Therefore, domestic demand is expected to soften in the first half of 2024 amid the lagged impact of monetary policy

tightening. In contrast, the second half of the year will likely see a gradual improvement as the lagged impact of monetary policy tightening begins to dissipate.

Most regional economies are expected to see stronger growth in 2024, supported by a rebound in global trade. In addition, domestic demand is expected to be less restrained, as the degree of monetary tightening and inflationary pressure are significantly less compared to major advanced economies. Meanwhile, China's growth in 2024 is expected to soften, where the property market will continue to be a significant drag to growth, constraining consumer sentiments and spending. Nevertheless, growth in China will be supported by the rebound in global trade, new growth areas,<sup>1</sup> and expansionary monetary and fiscal policy, including a substantial portion of the RMB1 trillion government bond issuance.<sup>2</sup>

Global trade growth is expected to rebound in 2024 (2.9%–3.4%; 2023: 0.4%), driven by the global technology upcycle, further recovery in tourism activity and low base from 2023. The global technology upcycle is projected to be driven by the replacement cycle of consumer electronics and global inventory correction, as firms replenish depleting stocks. Structural factors will lend further support, including rising demand for electric vehicles, industrial automation, and the incorporation of artificial intelligence in consumer and industrial goods. The World Semiconductor Trade Statistics (WSTS) is projecting global semiconductor sales to grow by 13.1% in 2024 (2023: -8.2%). Sustained global demand is also expected to underpin the expansion of non-electrical and electronic (non-E&E) exports, particularly machinery and equipment, petrochemicals as well as vehicles. Additionally, global tourist arrivals are already close to pre-pandemic levels toward end-2023,<sup>3</sup> but the recovery

<sup>1</sup> Referring to production and sales of green-related products, namely electric vehicles, lithium batteries and solar cells.

<sup>2</sup> The funds will be used for infrastructure investment, focusing on post-disaster reconstruction and disaster prevention. The funds will also indirectly re-capitalise local government financing vehicles (LGFVs) and vulnerable local banks since the responsibility of infrastructure investment has been shifted to the central government.

<sup>3</sup> According to the United Nations World Tourism Organisation (UNWTO) Tourism Barometer (January 2024), international tourist arrivals have reached 88% of pre-pandemic levels in 2023.

remains gradual for the Asia Pacific region, which reopened later and more cautiously. Regardless, global tourist arrivals are on track to recover to pre-pandemic levels by 2024, supported by the continued rise in flight capacity, remaining pent-up travel demand and better tourism recovery in Asia. Despite the lift from the global technology upcycle and tourism recovery, global trade continues to face persistent headwinds. These stem from ongoing trade restrictions, continued spending rotation from goods to services and shipping disruptions in the Red Sea. Hence, despite the expected strong recovery, global trade growth will remain below its long-term average (2011–19 average: 3.7%).

Global inflation is expected to continue moderating in 2024, mainly attributable to disinflation among advanced economies, as some emerging market economies<sup>4</sup> are experiencing inflation trending below long-term averages. This is expected to provide room for major central banks to begin easing monetary policy in 2024. The disinflation among advanced economies will be underpinned by easing labour market tightness and pass-through effects from earlier declines in commodity prices. Global food prices are projected to continue declining, as supply conditions are expected to remain adequate. However, global energy prices are projected to average higher, albeit remaining below their 2022 peaks, following additional voluntary cuts by major global oil producers. Inflationary pressures on commodity prices could be exacerbated by prolonged geopolitical conflicts and more adverse effects from El Niño weather conditions which could disrupt food production and supply chains, thus posing upside risks to inflation.

The trajectory of monetary policy by major central banks is likely to continue as a key factor influencing global financial market conditions in 2024. As inflationary pressures have broadly shown signs of easing, central banks in major advanced economies have signalled that policy rates have reached their peaks. While a restrictive global monetary policy stance may continue if inflation remains stubborn, global central banks have also made clear their intentions to ease monetary policy once the trajectory of inflation steadily converges to their respective targets. Against this backdrop, the magnitude and pace of monetary policy easing will only become clearer once the strength of underlying demand and the persistence of inflation can be ascertained. Importantly, uncertainty surrounding the trajectory of global monetary policy easing could be a source of volatility,

especially if the divergence between central banks' and financial market participants' expectations widens.

Should the US Federal Reserve commence its monetary policy easing cycle, the narrower yield differentials between the US and other economies, amongst others, may dampen the strength in the US dollar observed since 2022. This may induce portfolio rebalancing towards assets in emerging market economies, which could potentially result in a more favourable capital flow outlook for economies in the region.

### Global growth outlook remains subject to downside risks

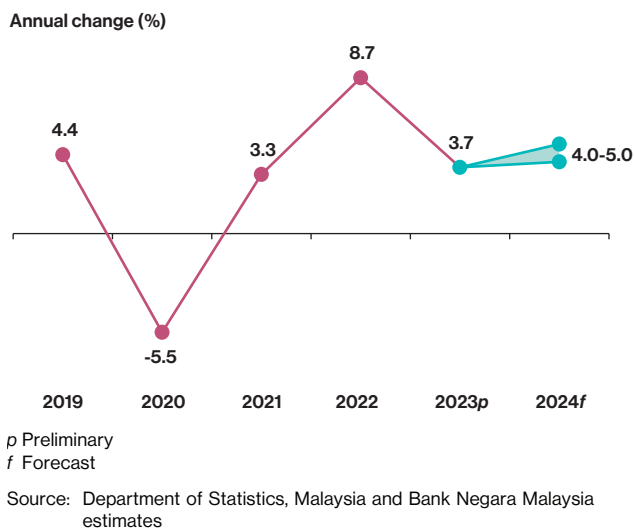
Downside risks to the global outlook could emanate from several factors. Higher-than-expected inflation could keep interest rates high for longer and dampen consumer spending. Higher-than-expected inflation could stem from unexpected rises in commodity prices and stronger-than-expected wage growth. Furthermore, high-for-longer rates in advanced economies, coupled with further stress in the banking sector and spillovers from China's economic slowdown, could lead to a sharp tightening in financial conditions, including in emerging market economies. A larger-than-expected lagged impact of existing rate hikes could even trigger recessions in the advanced economies. In addition, further escalation of geopolitical tensions in the Middle East and Ukraine could disrupt supply chains and global trade, as well as trigger financial market volatility and higher commodity prices. A worsening of the US–China relationship could also lead to further trade fragmentation globally. In contrast, upside risks to global growth could arise from stronger-than-expected consumer spending in advanced economies and fiscal support in China.

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

Growth will be driven mainly by resilient domestic expenditure, with additional support emanating from the expected recovery in exports. Continued employment and wage growth will remain supportive of household spending. Tourist arrivals and spending are expected to improve further. Investment activity would be driven

<sup>4</sup> These refer to emerging Asian economies, namely China, India, Thailand, Indonesia and Vietnam.

Chart 2.2: Malaysia's Real GDP Growth



by continued progress of multi-year projects in both the private and public sectors, with some support from implementation of catalytic initiatives under the national master plans.

Trade activity is expected to recover gradually in tandem with a rebound in global trade. Gross exports are expected to expand (2024<sup>f</sup>: 5%; 2023: -8%), driven by the recovery in global trade and the technology upcycle, supporting E&E and non-E&E exports, as well as higher commodity prices underpinning commodity exports. Gross imports, which contracted in 2023, are also projected to increase. This is attributable mainly to higher intermediate imports and stronger domestic demand for consumption goods, alongside continued expansion in imports of capital goods in tandem with investment growth. Further recovery in international travel is projected to drive growth in tourism-related sectors. Of note, Tourism Malaysia targets 27.3 million tourist arrivals in 2024,<sup>5</sup> surpassing 2019 levels of 26.1 million persons (2023: 20.1 million). This will be spurred by improved flight connectivity and Government measures, such as more tourism promotion activities abroad as well as the 30-day visa-free travel for nationals from China and India. Furthermore, higher overall spending and a diversified source of tourists will also lift tourism activities in the year.

Domestic demand is expected to remain the main driver of growth. Household spending is projected to expand at a faster pace (2024<sup>f</sup>: 5.7%; 2023: 4.7%) supported by improving labour market conditions amid higher income

growth and targeted Government assistance. These will partly cushion the impact of higher cost of living, the implementation of low-value goods (LVG) tax, and increase in sales and services tax (SST) on household spending. Private investment is expected to improve (2024<sup>f</sup>: 6.1%; 2023: 4.6%), lifted by further progress in the implementation of multi-year projects, as well as ongoing efforts in automation and digitalisation amid continued capacity expansions. Of significance, the progress of approved projects in recent years is well on track, with 74% of manufacturing projects approved from 2021 to 2023 having been implemented in various stages. Continued public investments in large-scale transport and digital infrastructure projects will also support growth, in addition to ongoing reform efforts by the Government to enhance the investment ecosystem and the implementation of initiatives under the strategic master plans. For example, catalytic projects under the National Energy Transition Roadmap (NETR) such as the Kasawari Carbon Capture and Storage (CCS) by PETRONAS, the Hybrid Hydro-Floating Solar (HHFS) Photovoltaic project by Tenaga Nasional Berhad and installation of Electric Vehicle (EV) charging stations led by Gentari are in progress, and will lend support to investments well beyond 2024.

Improving labour market conditions will continue to provide support to household spending. Employment will continue to expand, with growth trending closer to its historical average, supported by sustained demand for workers amid the ongoing recovery in tourism-related sectors and external trade activity. Coupled with continued expansion in labour force, the unemployment rate is expected to stabilise around its historical average of 3.3%. In line with continued employment growth and stronger production activity to fulfil rising demand, wages are also expected to increase further in 2024.

The growth outlook remains subject to downside risks. On the external front, downside risks emanate mainly from weaker-than-expected global growth and further escalation of geopolitical conflicts which could dampen Malaysia's trade performance. On the domestic front, more severe shocks on commodity production due to adverse weather events and prolonged field maintenance could weigh on the growth outlook. While the implementation of subsidy rationalisation can put downward pressure on growth, this could be partially offset by targeted cash assistance from the Government. Meanwhile, upside risks to growth stem mainly from greater spillover from the tech upcycle, more robust tourism activity, and faster implementation of existing and new investment projects.

<sup>5</sup> 'Tourism Malaysia confident of achieving target of 27.3 million foreign tourist arrivals in 2024', Bernama, 11 February 2024.

## Headline inflation is expected to average between 2% and 3.5% in 2024, largely reflecting potential upside from domestic subsidy rationalisation

In 2024, headline inflation is expected to remain moderate amid contained cost pressures. Firms face lower production cost pressures from the easing of global supply conditions as broader cost pressures from higher global commodity prices have largely dissipated, with prices expected to moderate further. This would likely lead to more gradual cost pass-through, thus keeping domestic production costs contained. In addition, the impact of exchange rate depreciation to inflation would be manageable, as it will be partly limited by administered prices and relatively stable firm pricing behaviour. However, some pressures could arise in anticipation of various domestic policy measures. Tax changes and adjustments to utility tariffs that have either taken place or are scheduled to take place in 2024 are expected to have a marginal impact on headline inflation in 2024. The direct impact is minimal as the affected items from both policy changes only account for a small share of the CPI<sup>6</sup> basket. Specifically for the tax changes, major service segments such as food and beverages are excluded and although some pressures may arise indirectly from higher logistical costs, the impact is likely to remain limited.

Core inflation is also expected to be moderate in 2024, albeit remaining above its long-term average. This is amid continued expansion in domestic demand, coupled with further expected increases in wages. Nonetheless, upward pressures to underlying inflation are expected to be contained as there are limited demand pressures and stable near-term sentiments on economic conditions. In addition, the expected moderate wage increases that are in line with productivity growth would also limit the upward pressures on underlying inflation.

On balance, headline and core inflation in 2024 are projected to average between 2% to 3.5%, and 2% to 3% respectively. The wider forecast range has incorporated

<sup>6</sup> The Consumer Price Index (CPI) is a monthly publication by DOSM, which presents statistics on the cost of purchasing 13 main groups of goods and services. This is consistent with the classification according to the United Nations' 'Classification of Individual Consumption According to Purpose' (COICOP). Malaysia's CPI is compiled based on prices that are collected on either on a monthly basis (for all items) or weekly basis (for perishable food items). Rents are collected once in a quarter.

Chart 2.3: Malaysia's Headline Inflation, Annual Change (%)

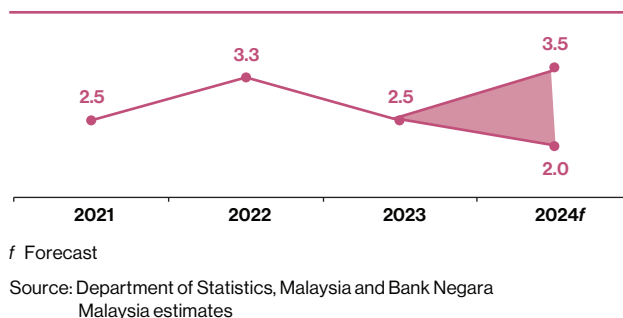
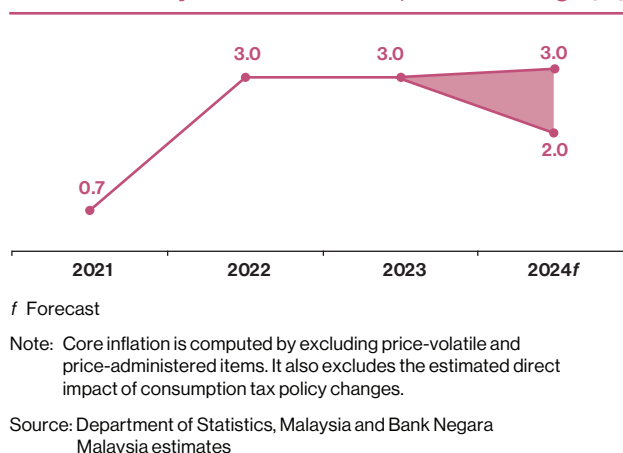


Chart 2.4: Malaysia's Core Inflation, Annual Change (%)



some potential upside on inflation that could arise from the implementation of fuel subsidy rationalisation.

The outlook for inflation remains highly subject to upside risks from both domestic policy factors and external forces. Domestically, the potential price adjustments to essential items would induce higher prices on the affected items, particularly those related to energy and food. Of note, the inflation outlook hinges on the potential adjustment to the blanket fuel subsidies. Given the sizeable share of fuel in the CPI basket, fuel price adjustments would directly lead to an increase in headline inflation. This direct impact from a one-off fuel price adjustment on headline inflation will likely dissipate within one year as base effects diminish. However, the extent of upside risks would depend on the knock-on effects of the policy adjustment, where firms raise prices to cover increases in costs, leading to broader price pressures on other goods. Additionally, wage-price dynamics can also pose a tail risk to inflation, although the risk of such second-round effects is assessed to be small in Malaysia as wage increases are aligned with productivity growth.

Nonetheless, the short-term impact of fuel subsidy rationalisation on inflation and growth will also depend on the size and timing of the price adjustments. Additionally, the scope of targeted assistance<sup>7</sup> accompanying the rationalisation of subsidies is also important as it would mitigate the impact from higher costs on vulnerable populations amid the transition.

Externally, exchange rate and global commodity price developments could further exacerbate the cost pressure to inflation. Notably, segments that are sensitive to import prices such as food and transport would see a more material impact from exchange rate pass-through. On top of risks from exchange rate pass-through, upward pressure on food inflation could also emanate from other lingering risks such as geopolitical tensions and weather disruptions. Nonetheless, downside risks to inflation would stem primarily from weaker global growth, which could weigh on commodity prices and thus, cost pressures.

## Domestic monetary and financial conditions to remain conducive to financial intermediation activities

Amid the tapering of the effect of OPR increases on wholesale and retail interest rates, domestic monetary and financial conditions are expected to remain conducive to financial intermediation activities, providing support for economic growth. Credit flows are expected to remain forthcoming in 2024 amid a well-functioning capital market and banks' continued willingness to lend. Banks' healthy liquidity and capital buffers will also help ensure a sustained supply of credit to finance consumption and investment activities. On the demand side, continued expansion of economic activity and the improvement in labour conditions are expected to contribute towards sustained demand for financing, especially for households and small and medium enterprises (SMEs).

As global financial conditions continue to ease – especially when central banks in advanced economies start to ease their monetary policy stance – yield differentials between advanced and emerging economies are expected to narrow. Against this backdrop, emerging economies including those

within the region, stand to gain from capital inflows as investors rebalance their portfolios. While MGS yields are expected to stay low in line with most global yields, a potential moderation in the USD strength as a result of the expected lower policy rates in the US could boost domestic currency returns, subsequently increasing total returns of domestic bonds. Meanwhile, continued confidence by global investors as well as steady progress of key infrastructure projects are expected to further support the positive momentum of Malaysian equities observed since the start of the year. Bringing this together, achieving meaningful progress in transforming the economy and comprehensive investor relations efforts are therefore crucial in attracting capital inflows as any delay or backtracking in policy implementation will hamper investor sentiments.

Given Malaysia's positive growth prospects, the current ringgit level is undervalued. While prevailing challenges in global markets have led to short-term volatility of the ringgit, financial markets expect pressure on the ringgit to abate as uncertainties in the external environment subside. These include the trajectory of global monetary policy and solid growth in regional partners. These are expected to provide support to the ringgit to more closely reflect Malaysia's economic fundamentals.

Any adverse spillovers from the global financial markets to domestic financial conditions and exchange rates will be manageable. Malaysia's economy has the ability to weather external shocks given its resilience as exemplified by, among others, a net external creditor position, a manageable level of external debt and current account surplus. In addition, to support the orderly functioning of the domestic financial markets and ensure the ringgit remains stable, Bank Negara Malaysia (BNM) continues to monitor developments and ensure sufficient liquidity in the domestic financial system. In addition, BNM and the Government are undertaking coordinated actions to ensure sustained flows into the foreign exchange market. To this end, BNM has raised engagements 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 a highly promising destination for investment and business.

<sup>7</sup> Include cash transfers for households through Sumbangan Tunai Rahmah (announced in Belanjawan 2024) and fleet card programme for the transportation sector (announced by Communications Minister Fahmi Fadzil on 31 January 2024).

## **Monetary policy will remain conducive to a sustainable economic growth while ensuring an environment of price stability**

Having normalised to pre-pandemic levels in 2023, monetary policy in 2024 will focus on maintaining a stance that is conducive to sustainable growth while managing risks to inflation.

Moderate inflation and better economic growth in 2024 provide an appropriate landscape for the implementation of key policies as announced by the Government. These include the Government's efforts to broaden and diversify its revenue base, subsidy rationalisation and other domestic policies such as the progressive wage model. Given the extent of the potential changes to be implemented, as well as any associated mitigation measures, the MPC will continue to assess how these factors will affect inflation dynamics and demand conditions.

Beyond domestic policies, the MPC is also mindful of other upside risks to the inflation outlook including global commodity prices and financial market developments. Though growth is expected to improve in 2024, the outlook remains subject to downside risks. These include weaker-than-expected external demand and larger declines in commodity production. Nevertheless, upside risks to growth could also materialise, emanating from positive spillovers from the tech upcycle, more robust tourism activity, and faster implementation of existing and new projects.

The MPC aims 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.

## Domestic demand remains the anchor of growth

Malaysia's economic growth in 2024 is expected to be supported by resilient domestic demand and a recovery in exports. Household spending is projected to be supported by improving labour market conditions and continued Government assistance programmes. Investment activity is expected to be underpinned by the ongoing implementation of multi-year projects in both the private and public sectors, as well as progress of catalytic initiatives under the national master plans. Investments will also be lifted by the implementation of newly approved investment, both foreign and domestic. The external sector is expected to benefit from better global trade and further recovery in tourism activity.

Private consumption is projected to grow by 5.7% in 2024 (2023: 4.7%) underpinned by the continued improvement in labour market conditions. Employment growth is expected to continue expanding, supported by sustained demand for workers. The unemployment rate is projected to decline to 3.3%. Meanwhile, income growth is projected to be driven by higher wages in the manufacturing and service sectors. Government measures, including the expansion of Sumbangan Tunai Rahmah and the early incentive payment for civil servants, are also expected to support household spending.

Gross fixed capital formation (GFCF) is expected to grow by 6.2% (2023: 5.5%). The higher growth is driven by improvement in structures and machinery and equipment (M&E) investments to meet increasing demand. Catalytic projects and focus areas under the major national master plans (i.e. New Industrial Master Plan 2030 (NIMP 2030) and the National Energy Transition Roadmap (NETR)<sup>8</sup>) are expected to lend some support to investment activity. These include infrastructure projects, as well as investment in industries such as electrical and electronics (E&E), chemical, pharmaceutical, advanced materials, renewable energy and electric vehicles. Furthermore, the realisation of investments promoted under these master plans will span across several years, thus providing continued positive spillovers to the economy going forward.

**Table 1**

### Real GDP by Expenditure (2015=100)

	2023p	2023p	2024f	2023p	2024f
	% of GDP	Annual change (%)		Contribution to growth (percentage point)	
<b>Domestic Demand<sup>1</sup></b>	<b>94.1</b>	<b>4.8</b>	<b>5.4</b>	<b>4.4</b>	<b>5.1</b>
Private Sector Expenditure	76.2	4.7	5.8	3.6	4.4
Consumption	60.8	4.7	5.7	2.8	3.5
Investment	15.5	4.6	6.1	0.7	1.0
Public Sector Expenditure	17.8	5.1	4.0	0.9	0.7
Consumption	13.3	3.9	3.2	0.5	0.4
Investment	4.6	8.6	6.2	0.4	0.3
Gross Fixed Capital Formation	20.1	5.5	6.2	1.1	1.2
<b>Change in Stocks</b>	<b>1.2</b>			<b>-0.1</b>	<b>-0.7</b>
<b>Net Exports of Goods and Services</b>	<b>4.7</b>	<b>-11.3</b>	<b>2.1</b>	<b>-0.6</b>	<b>0.1</b>
Exports	66.3	-7.9	4.0	-5.9	2.6
Imports	61.6	-7.6	4.1	-5.3	2.5
<b>Real Gross Domestic Product (GDP)</b>	<b>100.0</b>	<b>3.7</b>	<b>4.0 - 5.0</b>	<b>3.7</b>	<b>4.0 - 5.0</b>

<sup>1</sup> Excluding stocks

*p* Preliminary

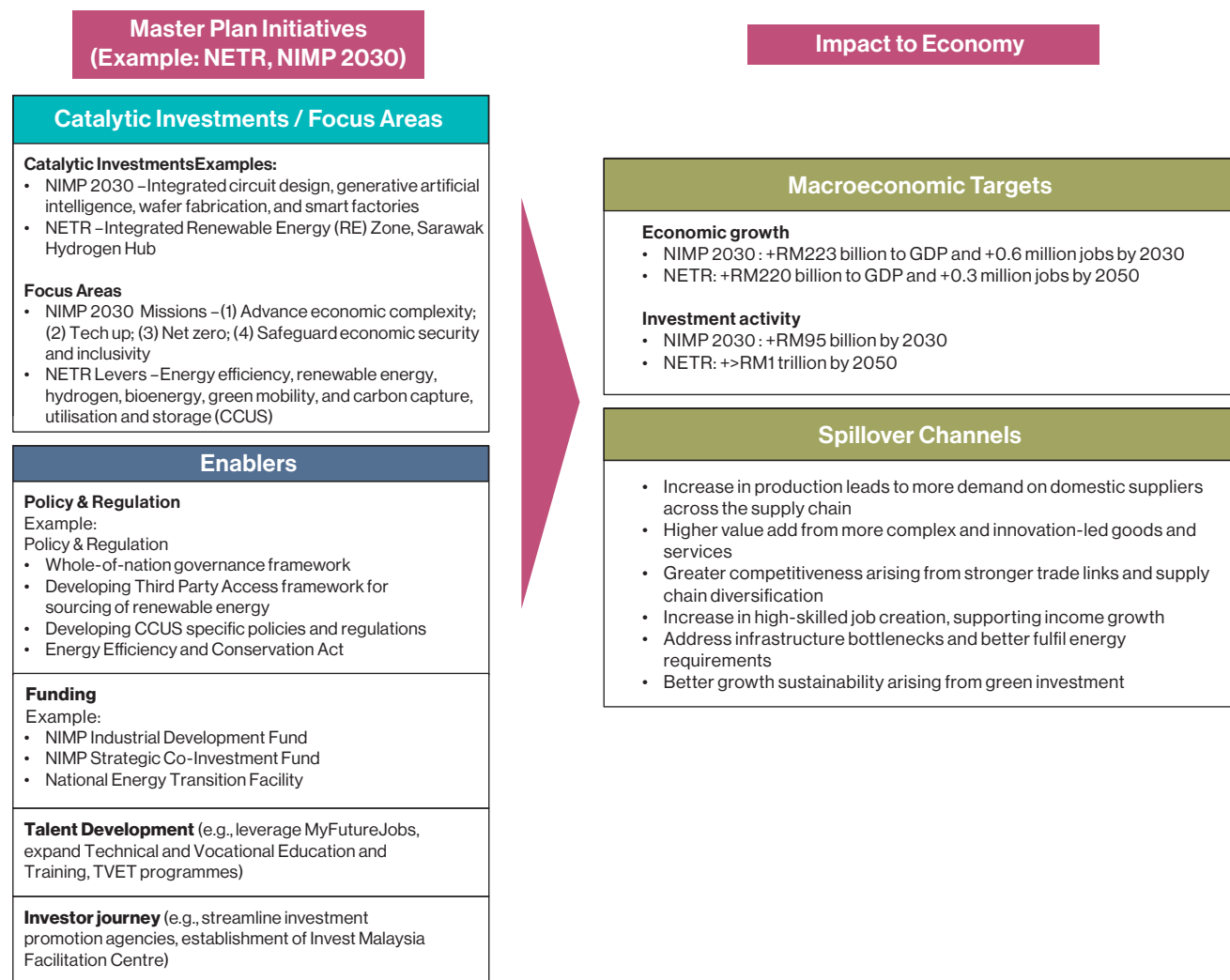
*f* Forecast

Note: Figures may not necessarily add up due to rounding.

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

<sup>8</sup> There are ten flagship catalyst projects under the NETR, spanning across six energy transition levers: energy efficiency, renewable energy, hydrogen, bioenergy, green mobility, as well as carbon capture, utilisation and storage. These projects are expected to attract more than RM25 billion worth of investment.

Diagram 1: Positive spillovers from catalytic investment and focus areas under major national master plans



References: National Energy Transformation Roadmap (NETR), New Industrial Master Plan 2030 (NIMP 2030), news flows, Bank Negara Malaysia

Note: The list of NETR and NIMP initiatives are not exhaustive

Private investment is projected to improve by 6.1% (2023: 4.6%). Growth is expected to be supported by the realisation of new and ongoing investment projects amid the better global and domestic outlook. Notably, investment intentions remain positive, as reflected by the high approved investment amounting to RM330 billion in 2023 (2022: RM268 billion). This is concentrated mainly in the E&E products and information and communications (ICT) sub-sectors. Of significance, the progress of approved projects in recent years is well on track, with 74% of manufacturing projects approved from 2021 to 2023 being implemented or completed. Furthermore, the high value of early-stage construction work done (2023: RM31.5 billion; 2022: RM26.3 billion) suggests positive investment prospects ahead.

For the third consecutive year, public investment is projected to expand above its pre-COVID-19 average growth (2024f: 6.2%; average 2011–19: -0.2%). This is expected to be driven by both the General Government and public corporations. The investment includes ongoing large-scale infrastructure projects, such as the East Coast Rail Link (ECRL), Pan Borneo Highway and Rapid Transit System Link (RTS Link). The Government’s fixed assets spending is channelled mainly towards transportation, education and healthcare projects. In addition, catalytic investments under the NETR in areas such as renewable energy, green mobility, and carbon capture, utilisation and storage (CCUS) would provide further support to growth.

Public consumption is estimated to expand by 3.2% (2023: 3.9%). Growth will remain supported by emoluments spending amid annual salary increment for civil servants and new hirings in the public sector. The supplies and services expenditure, however, is expected to grow at a more moderate pace, in line with the Government's commitment to improve efficiency of spending.

## Expansion in most economic sectors

On supply side, most sectors are projected to grow in 2024. The *services* and *manufacturing* sectors will be the key drivers to overall growth.

**Table 1**

### Real GDP by Kind of Economic Activity (2015 = 100)

	2023p	2023p	2024f	2023p	2024f
	% of GDP	Annual change (%)		Contribution to growth (ppt) <sup>1</sup>	
Services	59.2	5.3	5.5	3.1	3.3
Manufacturing	23.4	0.7	3.5	0.2	0.8
Agriculture	6.4	0.7	-0.5	0.0	0.0
Mining and quarrying	6.2	1.0	3.5	0.1	0.2
Construction	3.6	6.1	6.7	0.2	0.2
<b>Real Gross Domestic Product (GDP)</b>	<b>100.0<sup>1</sup></b>	<b>3.7</b>	<b>4.0 - 5.0</b>	<b>3.7</b>	<b>4.0 - 5.0</b>

<sup>1</sup> Figures may not necessarily add up due to rounding and exclusion of import duties component.

p Preliminary

f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The *services* sector is projected to grow by 5.5% (2023: 5.3%), driven mainly by improvement in the business-related subsectors. The recovery in external demand and ongoing implementation of private and public construction projects will support the real estate and business services as well as the transport and storage subsectors. In addition, further rollout of 5G network coverage and its increased subscriptions will drive growth in the information and communication subsector. Consumer-related subsectors will continue to benefit from further recovery in tourism activities, partly supported by the 30-day visa-free travel for China and India nationals, as well as resilient household spending amid improving labour market conditions.

The *manufacturing* sector is expected to expand by 3.5% (2023: 0.7%), supported by the recovery in the export-oriented industries and sustained growth in the domestic-oriented cluster. E&E production is projected to stage a modest rebound in the first half of the year, with a stronger recovery anticipated in the second half of the year. This will be driven by the upswing in the global technology cycle, amid improving external demand for integrated circuits and semiconductors related to technological megatrends such as digitalisation, Internet of Things (IoT), 5G network, and electric vehicles (EV). The primary-related cluster is expected to grow steadily. This will be underpinned by improving upstream supply conditions coupled with production ramp-up in one of the major oil refineries in Johor. Growth of the consumer-related cluster will remain supported by continued recovery in tourism activities, amid normalising vehicle sales. Meanwhile, the construction-related cluster is expected to benefit from the continued progress of multi-year investment projects.

The *agriculture* sector, however, is expected to contract by 0.5% (2023: 0.7%), as dry weather conditions associated with the El Niño and the effects of previous years' under-fertilisation would lead to lower oil palm production. Nevertheless, the continuous training of migrant workers would support output through higher productivity. The unfavourable weather could also affect other agriculture subsectors, such as paddy farming and fisheries.

The *mining* sector is estimated to expand at a faster pace (3.5%; 2023: 1%), driven by an increased production in existing oil and gas fields. Ramp-up in key oil fields in Sarawak will drive higher oil production. Concurrently, production enhancements in Block SK320 and commencement of a new field in Sarawak will drive higher natural gas production. This will more than offset the output losses from maintenance-related closures and production declines in maturing fields.

Higher growth is expected in the *construction* sector (6.7%; 2023: 6.1%), driven by continued activities in the civil engineering, special trade and residential subsectors. This will be supported by new and ongoing large infrastructure and small-scale projects under the Budget 2024, NIMP 2030 and NETR. Meanwhile, growth in residential subsector will be driven by new housing launches amid further improvement in housing demand.

## Export and import growth to rebound in 2024

Malaysia's gross exports is expected to turn around, recording growth of 5% in 2024 (2023: -8%). This rebound is underpinned by higher global trade activities, the recovery in global technology cycle and higher commodity prices.

Manufactured exports, which account for 85% of Malaysia's total exports, are projected to grow by 4.7% (2023: -6.7%). This is supported by improving E&E and non-E&E segments. The recovery of E&E exports will be driven mainly by the rebound in global technology cycle.<sup>9</sup> This is in line with higher demand for integrated circuits and semiconductors amid ongoing adoption of technological megatrends (e.g. artificial intelligence, electric vehicles, 5G). The rebound of non-E&E exports will be underpinned by improving demand from regional economies and improving domestic supply conditions.<sup>10</sup>

Commodities exports are expected to grow by 6.5% in 2024 (2023: -16.2%). Agricultural exports will be driven mainly by higher crude palm oil prices as global palm oil supply is affected by adverse weather conditions, notably from the El Niño weather phenomenon. Mineral export growth will be supported by higher price and production of oil and gas.

**Table 1**

### External Trade

	2015-2019 average	2023 <sup>p</sup>	2024 <sup>f</sup>
	Annual change (%)		
Gross exports			
<i>of which:</i>	<b>5.6</b>	<b>-8.0</b>	<b>5.0</b>
Manufactured	7.6	-6.7	4.7
Agriculture	-0.6	-22.1	9.7
Minerals	-3.1	-10.1	3.6
Gross imports			
<i>of which:</i>	<b>4.7</b>	<b>-6.4</b>	<b>5.4</b>
Capital goods	1.2	7.1	7.7
Intermediate goods	3.1	-12.1	5.6
Consumption goods	8.4	0.1	4.6
<b>Trade balance (RM billion)</b>	<b>109.5</b>	<b>214.1</b>	<b>220.3</b>

<sup>p</sup> Preliminary

<sup>f</sup> Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

<sup>9</sup> In November 2023, WSTS projected a growth of 13.1% for global semiconductor sales in 2024 (2023: -8.2%; 2011–19 average: 4.1%).

<sup>10</sup> These include the completion of plant maintenance and ramp-up of production capacity in both upstream and downstream segments in East Malaysia and Johor, supporting exports of petrochemicals products.

The export projections are subject to downside risks. These stem mainly from slower-than-expected economic activities among key trading partners, unexpected domestic disruptions for commodity production and further escalation of geopolitical conflict. However, stronger-than-expected spillover from the global tech upcycle could provide an additional lift to Malaysia's exports.

Gross imports are projected to grow by 5.4% in 2024 (2023: -6.4%) in tandem with higher exports and improving domestic demand. The expansion of intermediate imports is underpinned by the rebound of manufactured exports' growth. Meanwhile, imports of consumption and capital goods will continue to grow, supported by higher consumption and investment activities.

## The current account of the balance of payments to register a higher surplus

The current account of the balance of payments is expected to record a higher surplus of 1.8%–2.8% of GDP in 2024. This would be an improvement from 1.2% of GDP in 2023, which was the lowest recorded current account balance since 1997 (-5.9%). The improvement is driven mainly by higher goods surplus amid lower deficit in services account.

The goods account is projected to record a higher surplus, as exports growth recovery more than offsets the rebound in imports growth. Meanwhile, the services account is expected to register a smaller deficit. This is mainly due to a higher surplus in the travel account as tourist arrivals continue to recover to pre-pandemic levels in 2024. Nonetheless, the overall services account is expected to remain in deficit. This reflects the continued reliance on foreign services particularly in the transportation segment.

The improvement in goods and services accounts is expected to outweigh the continued deficit in the primary income, which is driven by the continued income payment accrued to foreign investors in Malaysia amid improving exports earnings. Similarly, the secondary income account is expected to remain in deficit, due mainly to sustained outward remittances by foreign workers.

**Table 2**

<b>Current Account of Balance of Payments<sup>1</sup></b>		
Item (Net)	2023p	2024f
	RM billion	
Goods	132.9	163.8
Services	-41.9	-40.9
Primary income	-55.1	-68.3
Secondary income	-13.2	-13.2
<b>Current account balance</b>	<b>22.8</b>	<b>41.5</b>
<i>% of GDP</i>	<i>1.2</i>	<i>1.8-2.8</i>

<sup>1</sup> In accordance with the Balance of Payments and International Investment Position Manual, Sixth Edition (BPM6) by the International Monetary Fund (IMF).

*p* Preliminary  
*f* Forecast

Note: Figures may not necessarily add up due to rounding.

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

## Potential output and the output gap of the Malaysian economy

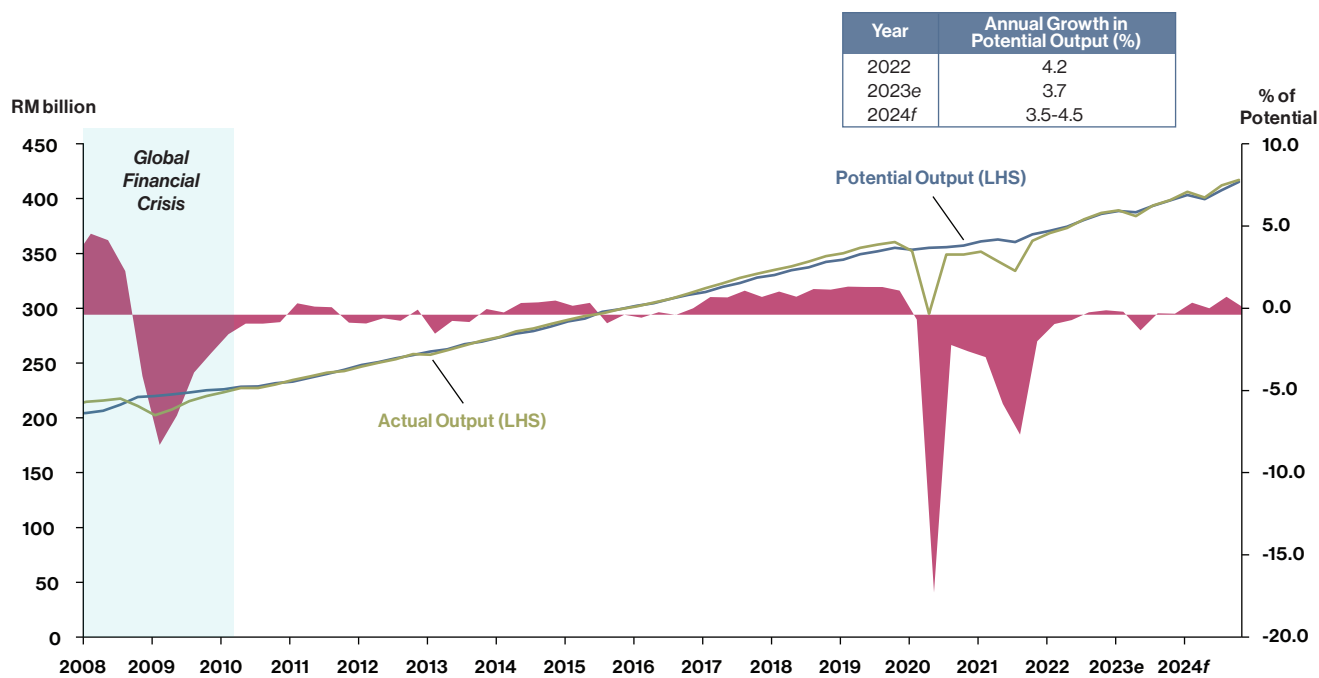
Potential output is the highest non-inflationary level of output that can be produced in an economy. It indicates the economy’s sustainable growth path, based on prevailing factors of production (i.e. labour and capital) and productivity.

In 2023, potential output<sup>10</sup> expanded by 3.7% (2022: 4.2%; 2011–19 average: 4.9%). The moderation was driven by slower capital accumulation in line with more modest investment activity (2023: 5.5%; 2022: 6.8%), as well as lower total factor productivity (TFP) growth. This was partially offset by the expansion in labour force participation (2023: 70%; 2022: 69.3%), as the unemployment rate normalised to pre-pandemic level.

Output gap remained negative in 2023 (-0.2%; 2022: -0.1%)<sup>11</sup> despite actual output recording a growth of 3.7% (2022: 8.7%), similar to the growth in potential output. This is mainly attributed to the higher level of potential output relative to the level of actual output.

Going forward, the output gap is expected to turn positive in 2024. While potential output is projected to grow between 3.5%–4.5%, actual output growth of 4%–5% is projected to grow at a faster pace, underpinned by continued expansion in domestic demand and improvement in external demand. Over the medium term, potential output will remain supported by higher investments and improvements in productivity amid continued implementation of multi-year investment projects as well as national masterplan such as NIMP 2030 and NETR with a projected growth rate of 4%–5%, reverting to the pre-crisis level.

**Chart 1: Actual and Potential Output**



■ Output Gap (RHS)

e Estimate  
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

<sup>10</sup> Potential output is derived through an average of several methodologies including Production Function, Laubach-Williams model, Real Business Cycle model, Kalman Filter and DSGE model.

<sup>11</sup> The output gap is formally defined as  $\frac{(\text{Actual output level} - \text{Potential output level})}{\text{Potential output level}} \times 100\%$ .

## The Case for Labour Market Reforms in Malaysia: Challenges and Opportunities

Malaysia's ambition to become a high-productivity, high-income nation faces a significant hurdle: persistent structural issues in its labour market. Existing efforts to address these challenges, while commendable, may be insufficient. More decisive action is needed. Emerging and ongoing megatrends, as well as the implementation of various national strategic initiatives make the labour market reforms more urgent.

This article discusses the case for labour market reforms in Malaysia. It begins with an overview of the labour market landscape in Malaysia, contrasting between the pre- and post-COVID-19 period. Next, it highlights the key megatrends that will present both challenges and opportunities in the coming years. This article concludes with a discussion on the key structural policy reforms to address existing challenges and prepare the labour market for the future.

### Part I: Labour market landscape in the pre- and post-COVID-19 period

The pandemic had caused significant disruptions to the labour market with the unemployment rate peaking at 5.1% in the second quarter of 2020. These effects were particularly acute for vulnerable segments of the economy, such as women and youth. Since containment measures were fully lifted in 2022, the Malaysian labour market has shown a steady recovery.

By end-2023, the unemployment rate had returned to its pre-pandemic (2015–19 average) rate at 3.3%. In addition, the labour force participation rate has breached a historical high. This positive development has been driven mainly by a significant increase in participation rate for men. In part, this reflects the increased opportunity in location-based gig work, such as food delivery and e-hailing services. Meanwhile, women labour force participation rate has also surpassed pre-COVID-19 levels and continues to trend upwards, although the pace of increase was slower<sup>1</sup> compared to the men's participation rate.

**Table 1**

**Labour Force Participation Rate (% of working age population)**

	Overall	By gender		By education attainment	
		Male	Female	Secondary	Tertiary
Pre-pandemic (2017–19 average)	68.3	80.4	55.2	68.1	69.0
Post pandemic (2021–22 average)	69.0	81.4	55.7	67.5	72.7

Source: Labour Force Report by Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Of significance, there has been higher demand for high-skilled<sup>2</sup> workers post-COVID-19.<sup>3</sup> Between fourth quarter of 2019 and fourth quarter of 2023, the number of employed high-skilled workers has increased by 6.6% from 2.05 million persons to 2.19 million persons. Correspondingly, the share of high-skilled workers in employment has also inched higher since the pandemic (2021–23 average: 24.9%; 2017–19 average: 24.3%). This trend has been driven by the services sector, specifically in the wholesale and retail trade subsector. This can be attributed to rising demand for professionals in business and administration,<sup>4</sup> as more firms launch e-commerce platforms, use social media for marketing, explore data analytics for efficiency and adopt automation and digital systems.

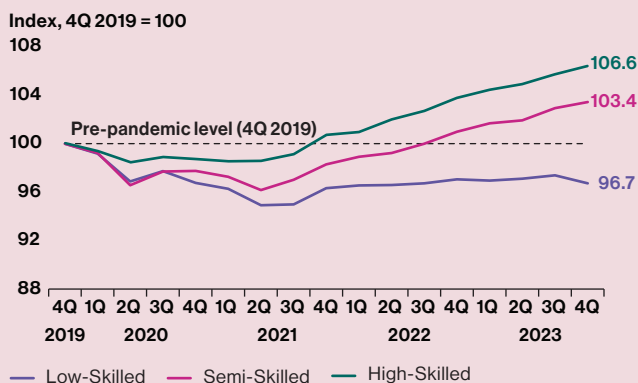
<sup>1</sup> This can be attributed to the higher representation of women in consumer-facing and contact-intensive services sectors, as well as the increased need for provision of family and childcare during the pandemic.

<sup>2</sup> Defined as jobs that require tertiary education (Source: Malaysia Standard Classification of Occupations (MASCO) 2020).

<sup>3</sup> The analysis on employment by skill and sector presented in this article is based on Employment Statistics published by the Department of Statistics, Malaysia, which provides the necessary data dimensions for the assessment.

<sup>4</sup> Examples include finance, human resource development, public relations, marketing, sales, information and communication technology, and management.

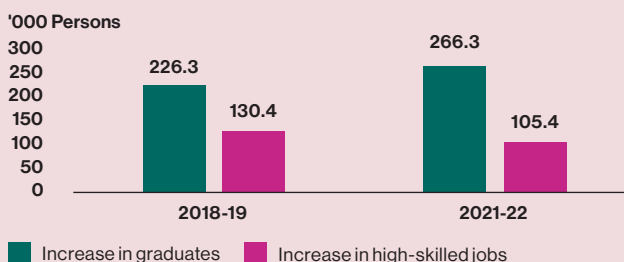
**Chart 1: Filled Jobs by Skill Level**



Source: Employment Statistics by Department of Statistics, Malaysia and Bank Negara Malaysia

Despite the growing demand, the low creation of high-skilled jobs in Malaysia continues to persist. The pace of increase in high-skilled jobs still lags the average number of new graduates in the labour force. Between 2018 and 2019, new graduates in the labour force were about twice the increase in high-skilled jobs. This gap has widened post-pandemic (Chart 2). Malaysia also lags behind select advanced and regional economies in terms of share of high-skilled jobs (Chart 3).

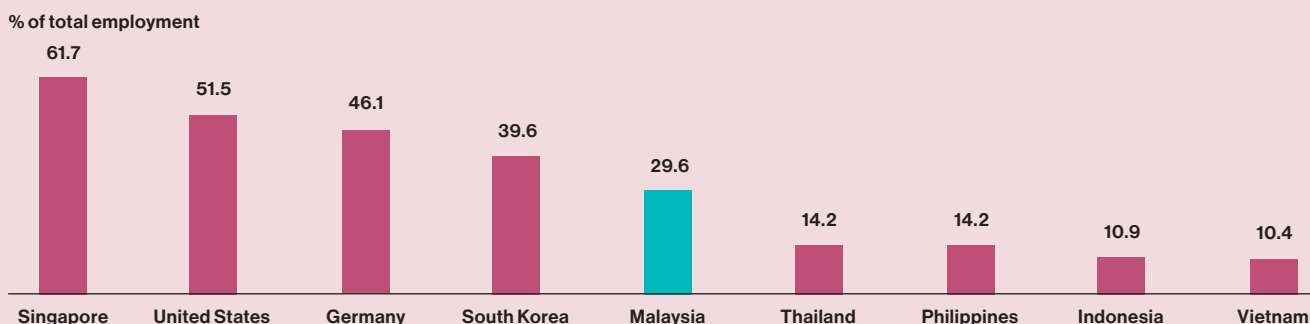
**Chart 2: Increase in Graduates in the Labour Force and High-skilled Job Creation**



Note: High-skilled job creation is defined as the increase in number of persons who are employed as managers, professionals or technicians and associate professionals.

Source: Labour Force Survey Report and Graduate Statistics by Department of Statistics, Malaysia and Bank Negara Malaysia estimates

**Chart 3: High-skilled Jobs as a Share of Total Employment in 2022**

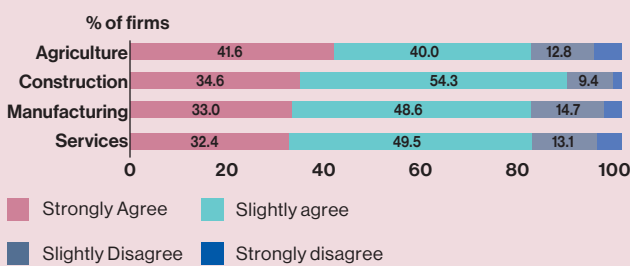


Source: ILOSTAT, Labour Force Survey Report by Department of Statistics, Malaysia and Bank Negara Malaysia estimates

Of great concern, a large number of the existing pool of graduates is assessed to be unsuitable to take on the available high-skilled jobs. Firms continue to face difficulties in filling existing high-skilled jobs (Chart 4) across various sectors of the economy. This suggests mismatches in the area of study, or a lack of soft skills that are needed for the job, but not necessarily obtainable from formal education and academic qualifications (World Bank, 2023). For example, 55.7% of firms reported that they had difficulty finding employees with good interpersonal and communication skills (Chart 5).

Together, insufficient high-skilled job creation and skills mismatch have contributed to the prevalence of high skills-related underemployment (2021–22 average: 38.4%; 2018–19 average: 33.8%),<sup>5</sup> which refers to those with tertiary education but working in the semi-skilled and low-skilled categories. Overall, employment remains primarily concentrated in semi-skilled<sup>6</sup> segments post-COVID-19. More than 70% of the jobs in the agriculture, construction and manufacturing sectors are in the semi-skilled category.

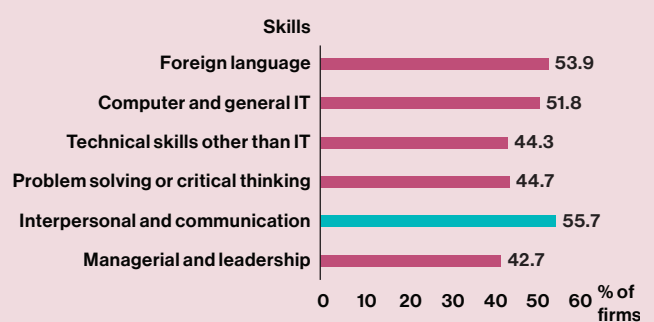
**Chart 4: Share of Firms Citing Difficulty to Satisfy Demand for High-skilled Labour, by Economic Activity**



Note: The agriculture sector refers to commercial agriculture, defined as economic activities along the agricultural value chain that have market orientation.

Source: World Bank Business Pulse Surveys 2022

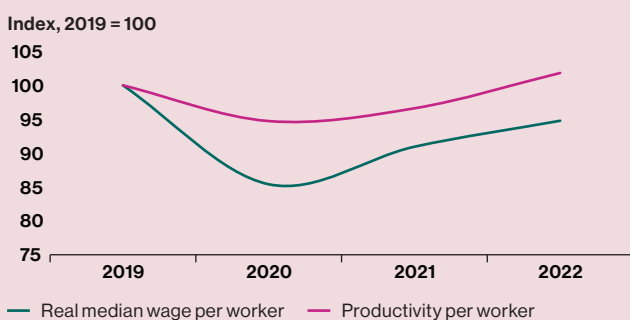
**Chart 5: Share of Firms with Difficulty Finding Employees with Specific Skills**



Source: World Bank's Productivity of the Investment Climate Private Enterprise Surveys (PICS)-3 2019-20

Since the pandemic, the real median wage per worker has lagged productivity growth (Chart 6). This significant productivity-wage gap is accounted mostly by the services sector. Furthermore, the compensation of employees share of income in Malaysia is much lower than in most advanced economies, suggesting that a relatively smaller share of the economic pie is going to workers (Chart 7).<sup>7</sup>

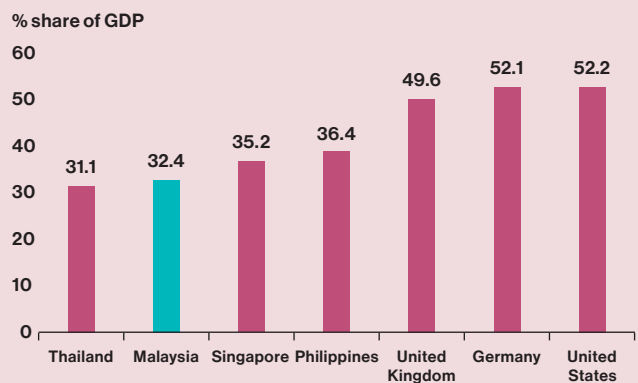
**Chart 6: Real Median Wage vs Productivity per Worker**



Note: Real median wage is estimated by deflating nominal median wage with Consumer Price Index. Productivity is defined as real value added per worker.

Source: Salaries and Wages Survey Report, Consumer Price Index and Labour Productivity Statistics by the Department of Statistics, Malaysia and Bank Negara Malaysia estimates

**Chart 7: Compensation of Employees in 2022**



Note: Data as at 6th March 2024. GDP data is subject to revisions.

Source: CEIC, Department of Statistics, Malaysia, national authorities, and Bank Negara Malaysia estimates

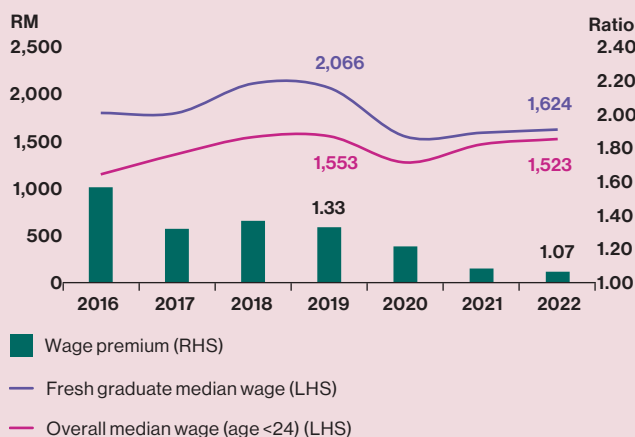
<sup>5</sup> Refers to underemployed persons out of total employed persons with tertiary education.

<sup>6</sup> Defined as jobs that require secondary or post-secondary education (Malaysian Skills Certificate level 1 and level 2 or equivalent) (Source: MASCO 2020).

<sup>7</sup> For further details, please refer to the box article 'Are Malaysian Workers Paid Fairly?: An Assessment of Productivity and Equity' in Bank Negara Malaysia's Annual Report 2018.

Developments relating to fresh graduates<sup>8</sup> wages are even more worrisome. Post-pandemic, the median starting salary was more than 20% lower compared to the 2019 level (2019: RM 2,066; 2022: RM 1,624). This implies that the wage premium<sup>9</sup> for fresh graduates has declined sharply post-COVID-19 (Chart 8). This may partly reflect the existing high skill underemployment of graduates (discussed earlier), which has worsened the low bargaining power of workers.

**Chart 8: Median Wages of Fresh Graduates & All Workers Aged below 24 (in RM) and Fresh Graduate Wage Premium**

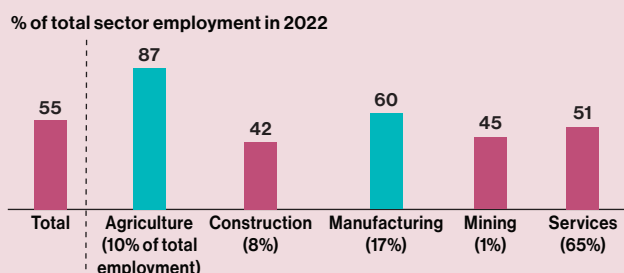


Source: Salaries and Wages Survey Report, and Graduate Statistics by the Department of Statistics, Malaysia and Bank Negara Malaysia estimates

## Part II: Key megatrends affecting the labour market

Several global and domestic key megatrends could disrupt and exacerbate some of the prevailing labour market issues in Malaysia. Technological advancement would transform the way people work – certain jobs will be eliminated or modified and new jobs could be created. In the short- and medium-term, greater adoption of automation and generative artificial intelligence (AI) could displace low-skilled jobs, and routine tasks at all skill levels. It is estimated that by 2030, automation could displace up to 4.5 million jobs in Malaysia (Mckinsey & Company, 2020). For Malaysia, the risk of displacement due to automation is highest in the agriculture and manufacturing sectors (Chart 9). Meanwhile, generative AI is expected to affect white collar knowledge workers who undertake tasks involving data analytics, pattern recognition and routine decision making (Mckinsey Global Institute, 2023).

**Chart 9: Share of Workers in Jobs that Face High Risk of Automation**



Note: Estimates of automation risk are adopted from the methodology developed by Frey and Osborne (2013). These estimates are upper bounds of the automation risk as the methodology assumes the automatability of an entire job, rather than the automatability of different tasks in a job. A job with automation risk of 70% and above is considered facing high risk of automation.

Source: Bank Negara Malaysia estimates using data from the Labour Force Survey by Department of Statistics, Malaysia and Frey and Osborne (2013)

<sup>8</sup> Proxied by graduates aged below 24 years old.

<sup>9</sup> Calculated as the ratio of the median wage of graduates below 24 years old over the median wage for all workers below 24 years old.

Notwithstanding the potential job disruptions, technology advancement also has positive spillovers on jobs. A wide variety of high-skilled jobs that are complemented by AI<sup>10</sup> have a vast potential for productivity enhancements. Moreover, automation of repetitive tasks allows workers to focus on higher value tasks. New jobs, especially those that require highly specialised skills to manage technology and AI, will be created. New technologies also facilitate the rise of flexible working arrangements which encourage higher labour force participation, particularly among female, and promote greater labour mobility. These positive outcomes will result in higher income for the country.

A more recent megatrend is the reconfiguration of supply chains. The COVID-19 pandemic spurred firms to undergo 'nearshoring' or 'reshoring'<sup>11</sup> to reduce their risks to supply chain disruptions (International Labour Organization, 2022). The impact of the shift in supply chains on the labour market is unclear for now and depends on a host of factors.<sup>12</sup> For exporting countries such as Malaysia, employment in the manufacturing sector will be impacted, especially low-skilled machine operators and technicians in low value-added and labour-intensive industries (Barcia de Mattos, Dasgupta, Jiang, Kucera, & Schiavone, 2020). These workers are most at risk of being displaced as they cannot easily transition to other jobs if firms move their production out at a massive scale.

As the world strives to decarbonise, Malaysian industries need to reduce the reliance on fossil fuels and improve energy efficiency to maintain trade competitiveness.<sup>13</sup> As polluting or carbon-intensive industries decline, the predominantly less-skilled workforce in these industries are likely to be unable to transition quickly into the green economy. In the US, empirical evidence shows that for non-green workers, transitioning into a green job is challenging as it requires a fundamentally different skillset (Bergant, Mano, & Shibata, 2022). On the other hand, there will be creation of high-skilled and highly specialised jobs to cater to the green economy.<sup>14</sup> Mid- to high-skilled jobs with adjacent skills and tasks will also be augmented.<sup>15</sup>

Socio-demographic changes will also shape the future of the labour market. Malaysia is rapidly ageing and is expected to be an aged society in about two decades from now.<sup>16</sup> This could lead to human capital constraints, as the prime working age population shrinks, and the old age dependency ratio doubles<sup>17</sup> in the next 30 years. If the majority of workforce remains employed in semi-skilled jobs with no accompanying rise in technological adoption, a shrinking workforce<sup>18</sup> that is not met through immigration, could lead to slower or even negative potential growth.

Conversely, an aging population could also lead to rising opportunities in the care economy, such as professionals in senior care centres and management of social services. Several aged, more advanced economies such as South Korea, Germany and Japan are already seeing rise in formal long-term care employment (Chart 10) (Jones, 2020; OECD, 2021).

To capitalise on these opportunities, there are several key questions that policymakers will need to reflect on. What will the future of work look like in terms of occupations and skills? How can help be provided for workers to adapt to the ongoing economic shifts? And how can workers' livelihoods be secured in this economic climate?

<sup>10</sup> Jobs with a high exposure to AI include lawyers, accountants and auditors (Kochhar, 2023; Webb, 2019).

<sup>11</sup> 'Nearshoring' is when companies relocate production closer to the final customer to better accommodate contingencies from unexpected shocks.

'Reshoring' means relocation to primary domestic production sites, especially in manufacturing.

<sup>12</sup> The factors include, among others, availability of productivity-enhancing technology in origin countries, protection of intellectual property, quality control, market access and minimisation of risks (Barcia de Mattos, Dasgupta, Jiang, Kucera, & Schiavone, 2020).

<sup>13</sup> For further details, please refer to the box article 'Navigating Malaysia's Economic Transition towards a Decarbonised Future' in Bank Negara Malaysia's Economic and Monetary Review 2022.

<sup>14</sup> Examples include climate change specialists.

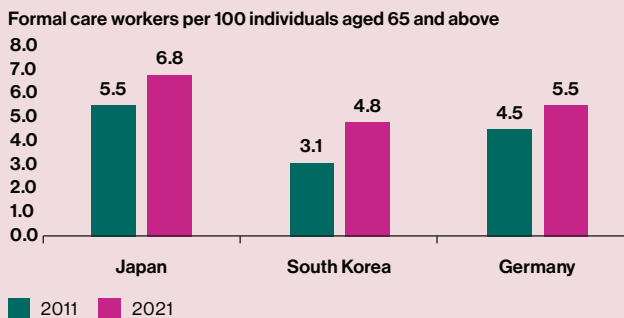
<sup>15</sup> Examples include architects equipped with green building knowledge and skillsets.

<sup>16</sup> Based on the United Nations (UN), 'ageing population' is defined as when 7% of the population is aged ≥65 years old, while 'aged population' is when the share is 14%. Using UN data, Malaysia reached ageing population in 2021 and expected to reach aged population in 2042 (Source: United Nations, World Bank, Department of Statistics, Malaysia).

<sup>17</sup> Estimated as the ratio of the number of elderly people at an age when they are generally economically inactive (i.e. aged 65 and over), compared to the number of people of working age (i.e. 15-64 years old).

<sup>18</sup> Malaysia's working age population share (age 15-64) is forecasted to decline from 70% in 2023 to 66% of the total population by 2050. This reflects larger old age population due to increasing longevity, amid declining fertility rate (Source: United Nations).

**Chart 10: Formal Long-term Care Employment**



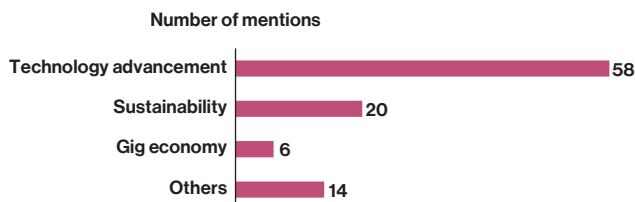
Source: OECD

## Firm-level Insights from Bank Negara Malaysia’s (BNM) Industrial Engagements

### Technology as the key disruptive megatrend for future of work

- Based on BNM’s industrial engagements,<sup>19</sup> more than half of the firms identified technological advancements (such as automation and AI) as the most important megatrend over the next three to five years (Chart 11).
  - This was most prominent among the manufacturing, mainly in the E&E cluster, and services sectors.
  - Meanwhile, sustainability was principally cited by firms across construction, agriculture and mining sectors – coincidentally some of the hard-to-abate industries.<sup>20</sup>

**Chart 11: The Most Important Megatrends that Could Affect Workforce**



Note: Other megatrends included work-life balance, ageing population, female labour force participation, brain drain and trade regionalisation.

Source: Regional Economic Surveillance, Bank Negara Malaysia

### Mixed responses regarding the impact of megatrends on firms’ future demand for labour

- Overall, most firms either believed that megatrends could destroy jobs (43%) or have no impact (43%) on firms’ demand for workers in the next five years.
- Most firms that quoted job destructions were in the manufacturing sector, citing pivots away from labour-intensive and administrative tasks.
  - For example, in E&E industry, AI and automated test equipment could replace the current manual inspection of final products by workers.

<sup>19</sup> Based on field interviews and engagements with 61 firms. Most were in the services (51%) and manufacturing (33%) sectors, and non-SMEs (87%).

<sup>20</sup> Industries where decarbonisation is difficult due to heavy reliance on fossil fuel as feedstock and for energy in their manufacturing processes. Based on the International Energy Agency (IEA), the three criteria to identify hard-to-abate sectors are: (i) long-lived capital assets; (ii) high temperature requirements for their production process; and (iii) trade considerations. For Malaysia, the sectors identified comprise oil and gas, palm oil, construction, steel, cement and chemicals industries.

- However, many firms in the services sector anticipated no impact on a net basis. This was prominent in the hospitality and retail industries, where human interaction would remain crucial.

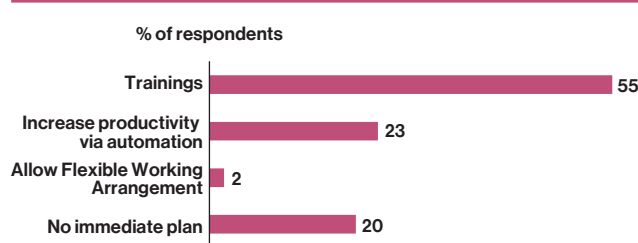
### Proliferation of new roles and skillsets on demand following megatrends

- With technology cited as the key megatrend, firms anticipated rising demand for IT skills and digital literacy moving forward, resulting in the creation of new tech-related roles.
  - For example, niche engineering professionals, programmers or technicians to operate advanced technology or software.
  - Others cited the greater need for data analysts and data scientists for supply chain management and production optimisation in the logistics and manufacturing industries.
- Some firms expected higher demand for Environmental, Social and Governance (ESG) related roles, such as green building consultants (construction sector), carbon trading experts (mining sector) and more broadly, an in-house corporate sustainability team.

### Firms continued to rely on internal training curricula to prepare for the future of work

- In the transition towards new workforce needs, most firms would train staff to reskill or upskill so that they can be rotated to other positions if needed, thus minimising the risks of being displaced.
- Nevertheless, some firms (20%) have not embarked on any pivot strategy as they did not foresee immediate changes to the workforce due to the megatrends (Chart 12).
- In this regard, more can be done to assist firms in taking proactive measures to prepare for the future of work amid emerging megatrends, which may significantly impact firms’ future business operations and hiring strategies.

**Chart 12: Current and Future Strategies to Manage Workforce's Transition**



Note: Based on responses from field interviews and engagements with 44 firms.

Source: Regional Economic Surveillance, Bank Negara Malaysia

## Part III: Labour market policy reforms

It is imperative to roll out reform measures carefully and strategically to tackle existing structural issues, and minimise transitory costs while maximising opportunities from the megatrends. This section discusses five key strategies that would facilitate the transition to an agile, resilient and future-ready workforce.

### Strategy 1: Address skills mismatch in the labour market

One effective method to address skills mismatch is to promote greater collaboration between the Government, industry and academia in enhancing the quality of higher education syllabus and workforce training. In particular, the industry should be encouraged and provided the opportunities to play a greater role. This is as they are more up to date with the latest industry trends, technologies and products, as well as critical skills that workers should have to meet industry needs. These insights are crucial in revamping the higher education curriculum to produce graduates who not only have solid technical skills, but also strong cognitive and soft skills.

The Penang Skills Development Centre (PSDC), a tripartite training programme in the E&E industry in Malaysia which adopts a collaborative framework in workforce upskilling and reskilling, has proven effective<sup>21</sup> in raising the quality of training and productivity. Under this framework, the Government provides accreditation to training programmes and funding for selected PSDC initiatives; the industry identifies skills and learning outcomes to guide the content of training modules and workshops; and the academia collaborates with industry to reskill and train prospective workers for subsequent hiring. This model can be expanded and emulated across other sectors. Similarly, the Selangor Human Resource Development Centre (SHRDC) is another tripartite partnership model that focuses on developing talent for the Fourth Industrial Revolution (4IR). In this model, the training is provided by SHRDC directly to firms' employees. There is also merit in encouraging more large firms to share their know-how with small and medium enterprises (SMEs). For instance, in South Korea, the National Human Resources Development Consortium provides financial incentives for large companies, business associations and universities to set up consortiums with SMEs and share their expertise in vocational training, equipment and training facilities (OECD, 2020).

While efforts are directed to developing the requisite training programmes, structured assessment framework should be in place to evaluate the effectiveness of the training initiatives. This allows policymakers to identify ineffective programmes, refine and improve existing ones as well as help design new programmes to address existing gaps (Dar, 2002).

### **Strategy 2: Upskill the workforce for the future**

Given the ongoing economic shifts, upskilling policies should enable workers to pivot and adapt, and promote lifelong learning. Hence, a universal individual-centric training system could be established to ensure that every working-age individual has access to training courses, even without formal attachment to an employer. This can complement an employer-centric training model, whereby the employer makes training decisions based on business needs. For example, Singapore's SkillsFuture Credit, a subsidy provided to all Singaporeans aged 25 years and above, promotes lifelong learning by providing workers with easy access to training and education for all ages and stages of career, even during crisis periods.

Additionally, it is crucial to develop a data-driven approach to identify emerging skills and jobs to meet the rapidly-evolving economic needs. Analysis from advanced economies is also beneficial to anticipate the possible future disruptions in the domestic labour market. Such efforts are critical to guide shifts in training programmes to remain relevant, and individuals in identifying the skills or knowledge to acquire to meet the emerging economic needs. Currently, there are existing initiatives which outline the types of skills and knowledge required for different occupations.<sup>22</sup> These initiatives are useful but can be further harmonised through the creation of a single national competency standards for skills and knowledge. More importantly, the competency standards need to be continuously updated to include emerging industry needs.

### **Strategy 3: Create high-skilled jobs**

In the short-term, it is critical to encourage more widespread adoption of automation and digitalisation among firms, especially SMEs. Efforts to automate and digitalise will directly create more high-skilled jobs such as technicians and IT professionals. Furthermore, greater technological adoption will increase firms' productivity and promote their ability to pivot to higher value-added activities, which will in turn create more high-skilled, high-paying jobs.

Looking at a longer time horizon, it is also key to attract high quality investments for a more sustainable and organic creation of high-skilled jobs. The government has introduced various blueprints, including the New Investment Policy (NIP), New Industrial Master Plan (NIMP) 2030<sup>23</sup> and National Energy Transition Roadmap (NETR). These national strategic initiatives will promote economic activities with higher complexity and higher productivity. However, to realise this, the implementation of these national plans would need to be expedited, with proper monitoring and periodic reviews, to ensure the desired outcomes are achieved.

<sup>21</sup> In 2021, 41% of PSDC graduates successfully secured employment (Penang2030, 2022).

<sup>22</sup> For example, SOCSO's Malaysian Skills, Occupation, Qualification and Competencies (MSOC) taxonomy for different occupations, HRD Corp's Industrial Skills Framework for select industries and National Skills Registry by TalentCorp.

<sup>23</sup> Under the NIMP, Mission 2 outlines specific strategies to provide practical and firm-specific end-to-end automation and digitalisation solutions that are aligned to the state of readiness and needs of SMEs.

**Strategy 4: Design policies on foreign workers that are in line with development needs**

In the short-term, the key challenge is to reduce the country's dependency on low-skilled, low-wage foreign workers. The government intends to address this issue with the Multi-Tier Levy Mechanism (MTLM).<sup>24</sup> However, this transition needs to be orderly to avoid significant disruptions in business activities. Hence, complementary measures to support firms to automate and adopt technology are crucial during the transition period.

In the medium- to long-term, a comprehensive rethink of immigration policies is necessary to ensure that Malaysia's labour needs can be fulfilled. The lack of certain high-skilled professionals such as mining engineers and ICT professionals may constrain expansion in select high growth areas. A targeted policy to attract high-skilled foreign talent to fill gaps in sectors where the supply of high-skilled workers is insufficient may be required. Parallel to this, the creation of more high-skilled jobs (as elaborated in Strategy 3), and transfer of knowledge from foreign to local workers will safeguard the interest of local workers.

**Strategy 5: Fair compensation and social protection for workers**

Efforts are also needed to ensure that workers are paid fairly commensurate with their productivity. Existing wage policies would need to be enhanced. In its current form, the minimum wage is unable to lift wages of high-skilled workers, especially graduates, amid issues of mismatches and underemployment. Exploring a differentiated minimum wage by skill level, which could accord graduates a higher minimum wage, may be an option. For instance, in Slovakia, jobs are divided into six categories by skill level, with higher minimum wages paid to workers in higher-skilled jobs.

An enhancement of the current Productivity-Linked Wage System (PLWS), which aims to establish a closer link between wages and productivity, is equally important. Given the low take-up rate,<sup>25</sup> adoption of a star-rating system<sup>26</sup> to PLWS employers could improve the attractiveness of the policy and promote competition among firms. In addition, frequent and consistent reviews must be conducted to ensure that the measure between wage and productivity is up to date with industry benchmarks and standards of living.

The Progressive Wage Model (PWM), which will begin its pilot in June 2024, could also help lift wages. It helps address market failures by nudging private firms to pay more competitively, including for fresh graduates by encouraging higher entry-level pay. Nevertheless, this solution is only temporary. To increase wages sustainably in the long-term, long-standing issues affecting labour demand and supply need to be addressed. This includes creation of high-skilled jobs and addressing skills mismatch, as elaborated in the earlier strategies.

Finally, the current social protection framework should consider new forms of employment in the informal sector, such as flexible work arrangements and gig work. Universal registration into social insurance schemes, such as those under EPF and SOCSO, can be a precursor for greater penetration of social insurance in the informal sector.

<sup>24</sup> As mentioned in Budget 2024, a multi-tiered levy system for foreign workers will be implemented to reduce dependency on foreign workers. Higher levy rates will be imposed for employers with a large foreign workforce.

<sup>25</sup> Currently, the PLWS system covers only around 6 million workers, or about 39% of total employment.

<sup>26</sup> Firms would be rated on various criteria, including having best and fair practices in wage-setting. This will serve as a signal to prospective employees and help attract workers.

## Lessons from the Global Economy on Labour Market Reforms

As Malaysia embarks on a journey of labour market reforms, it will be important for policymakers to also learn from the best practices of other countries. This will help ensure the success of the reforms.

**Table 2: Cross-country Example of Policies Related to Labour Market**

Country	Cross-country Policies
<b>Strategy 1: Address skills mismatch in the labour market</b>	
<b>Korea</b> 	<p><b>National Human Resources Development Consortium</b> (also known as the CHAMP programme) promotes greater collaboration between the industry, academia and the Government.</p> <ul style="list-style-type: none"> <li>Provides financial incentives for large companies, business associations and universities to set up consortiums with SMEs and share their know-how in vocational training, equipment and training facilities.</li> </ul>
<b>Strategy 2: Upskill the workforce for the future</b>	
<b>Singapore</b> 	<p><b>SkillsFuture Singapore</b> creates and updates training programmes guided by emerging trends across industries.</p> <ul style="list-style-type: none"> <li>A national initiative to equip Singaporeans with the skills and knowledge needed for the future of work through a range of programmes such as training, career guidance and job transition mapping.</li> </ul>
<b>UK</b> 	<p><b>UK's National Occupational Standards</b> serves as a national standard of competency that is specified by industry and frequently updated.</p> <ul style="list-style-type: none"> <li>A document that describes the skills, knowledge and understanding, as well as performance criteria to be competent at a job. This list is regularly updated for emerging trends and compiled in consultation with the industry.</li> </ul>
<b>Strategy 3: Create high-skilled jobs</b>	
<b>Singapore</b> 	<p><b>SMEs Go Digital</b> programme assists SMEs that are digitalising their businesses with tailored support.</p> <ul style="list-style-type: none"> <li>Provides tailored solutions to SMEs that are at different stages of development. <i>SMEs who are new to digitalisation, are provided with basic digitalisation solutions such as accounting and payroll software. More advanced SMEs are provided with sophisticated initiatives, such as to participate in e-commerce platforms to expand their market overseas without a need for physical presence.</i></li> <li>Provide SMEs with access to a shared pool of digital consultants, for digital advisory and project management services. <i>These services range from digital needs analysis, basic cybersecurity risk advisory, establishing the digitalisation project implementation plan and managing the progress of the project.</i></li> </ul>
<b>Germany</b> 	<p><b>Mittelstand 4.0 Centres of Excellence</b> provide highly accessible and practical assistance to SMEs nationwide.</p> <ul style="list-style-type: none"> <li>Create a regional point of contact for SMEs from start to finish in their digitalisation journey. <i>The Centres of Excellence help to develop firm-specific digitalisation roadmaps, support firms as they implement the strategies and provide technical advice on the economic viability of strategies deployed by firms.</i></li> <li>All learning and demonstration are modelled upon real companies with real outcomes. <i>Each of the 29 centres in different regions across Germany has demonstration factories that allow firms to test their own technical solutions, such as production chain controlled by software. This feature enables firms to gain a realistic impression of how digital technologies could transform their operations.</i></li> </ul>
<b>Strategy 4: Design policies on foreign workers that are in line with development needs</b>	
<b>Australia</b> 	<p><b>Australia's Migration Strategy</b> introduces immigration policies that are aligned to Australia's priorities and attracts skilled migration.</p> <ul style="list-style-type: none"> <li>Migration strategy that is guided by important national objectives, including to raise living standards of the people. <i>The Migration Strategy aims to introduce new visa pathways that will allow immigration to raise productivity, tackle needs of ageing population, green and digital transition by encouraging skilled migrant workers.</i></li> <li>Migrant policies that create fair play in the labour market. <i>The income threshold of the Temporary Skilled Migration was increased, which ensures that firms do not abuse it to hire low-skilled workers. There are also plans to introduce work visas that are not tied to an employer, which will allow migrant workers to change jobs when there is illegal exploitation.</i></li> </ul>
<b>Strategy 5: Fair compensation and social protection for workers</b>	
<b>India</b> 	<p><b>Aadhar</b> improves the inclusivity and coverage of social protection by leveraging on national-ID linked digital accounts for assistance coverage and delivery.</p> <ul style="list-style-type: none"> <li>Auto-enrollment of national Indian citizens into Aadhar facilitated mobilisation of assistance to informal and remote workers. The programme has a penetration rate of 99% of the population and interoperable across 29 datasets for delivery of multiple public service programmes.</li> </ul>

Source: National authorities

## Conclusion

The COVID-19 experience has shown that labour market dislocations can accelerate within a short period of time, especially during economic shocks. At the same time, emerging megatrends are both augmenting and disrupting the labour market. The negative impact of these forces on employment and income prospects can be more severe given the prevailing structural impediments in the labour market.

Conversely, the megatrends also present various opportunities for workers, including raising their income, provided the structural issues are addressed. As such, this calls for an urgent need for a comprehensive reform to Malaysia's labour market. The policy strategies should aim to reduce skills mismatch, upskill the workforce for the future, create high-skilled jobs, reduce dependency on low-skill, low-wage foreign workers, attract foreign high-skilled talent and ultimately, lift wages and income of the people.

The way forward is to expedite the implementation of national strategic initiatives that will provide high-paying employment opportunities. Concurrently, initiatives that enhance workforce resilience are needed given the highly challenging economic prospects. Inevitably, there will be short-term transitory costs and challenges. Recognising this, measures can be put in place to assist those who are affected or vulnerable to changes arising from the labour market reforms.

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## The Ringgit in Perspective

Exchange rate movements are influenced by a complex interplay of short-term and long-term factors. In the short run, cyclical fluctuations in the domestic and global economies, interest rate differentials and geopolitical developments can affect the exchange rate. Over the longer term, however, exchange rates are anchored by more fundamental determinants, such as a nation's relative labour productivity, investment environment, and overall economic competitiveness.

When looking at the recent movements of the ringgit since 2022, the ringgit has been predominantly influenced by cyclical factors. The dominant short-term factor has been the aggressive monetary policy tightening by the US Federal Reserve (Fed) and shifting financial market expectations surrounding the outlook for US monetary policy. The Fed raised its policy rate by a cumulative 525 basis points over the 2022–23 period to address the higher inflationary pressures in the post-pandemic environment. Consequently, demand for US dollars rose significantly, leading to a rapid and strong appreciation of the US dollar, and a depreciation of most regional currencies, including the ringgit.<sup>1</sup> Many other countries, including those in the region, also increased policy interest rates by a larger magnitude than Malaysia, resulting in some appreciation of their currencies against the ringgit.

During this two year period, Malaysia's economic fundamentals have remained sound. Malaysia has achieved resilient economic growth with a declining inflation trend. Additionally, Malaysia's external sector has demonstrated resilience, as evidenced by a current account surplus, manageable external debt levels, a net external asset position, and adequate international reserves. Consequently, at the current level, the ringgit is deemed to be undervalued.

As these external factors are only short-term in nature, financial markets expect the pressure on the ringgit to abate. The Government, in collaboration with Bank Negara Malaysia (BNM) have intensified efforts to encourage repatriation and conversion of foreign investment income by Government-Linked Companies (GLCs) and Government-Linked Investment Companies (GLICs). The GLICs and GLCs should also hedge their foreign currency assets to better manage their foreign currency exposure. This is in addition to stepping up engagements with investors and corporates. BNM actively engages with resident exporters and monitors their conversion of export proceeds to ringgit, because conversion behaviour has an impact on the exchange rate. These actions are contributing to greater and sustained inflows, lending support to a firmer ringgit. BNM also continues to advocate greater use of local currency when settling export or import payments either via the Local Currency Settlement Framework or normal correspondent banking channels to reduce US dollar dependence. More broadly, BNM has also intensified engagements with various stakeholders – including business owners, financial market analysts and politicians – to further deepen our understanding of challenges faced in this environment, as well as to share BNM's perspectives and responses to manage the pressures on the ringgit.

Beyond these short-term measures, the Government is pursuing structural reforms that will ensure fiscal sustainability, new growth areas and thus increased growth potential, as well as enhanced labour productivity and competitiveness. Most of these have been clearly articulated in the Government's economic framework, the Federal Government Budget documents and in Malaysia's economic master plans, namely the New Industrial Master Plan 2030 (NIMP 2030) and National Energy Transition Roadmap (NETR). The Government is also committed to ensuring fiscal sustainability through several fiscal reform initiatives, including the Public Finance and Fiscal Responsibility Act (FRA) and the Medium-Term Fiscal Framework (MTFF), as well as efforts to broaden and diversify its revenue base and expenditure optimisation, such as through a more targeted subsidy approach. The execution of these reforms should bring in more investment flows into Malaysia, and thus provide more enduring support for the ringgit in the long run.

<sup>1</sup> The US Dollar Index (DXY) which measures the value of the US dollar against the euro, Japanese yen, pound sterling, Canadian dollar, Swedish krona and Swiss franc, appreciated by 5.9% over the 2022–23 period.