BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Economic and Monetary Review 2020

EMR

Contents

Foreword

The year 2021 is projected to be a turning point for the global economy, from a period of deep recession that originated from a global COVID-19 pandemic. The worst is likely behind us, as the global economy is poised for a post-pandemic rebound, albeit at an uneven pace across countries. While there are lingering uncertainties, particularly surrounding resurgences in COVID-19 cases and the subsequent re-imposition of lockdowns in some countries, the deployment of vaccines is expected to pave the way for some normalisation in economic activities worldwide. Additionally, the ongoing expansionary monetary policy and loose financial conditions globally would continue to ease domestic financial conditions, particularly in emerging market economies, further supporting the economic recovery.

For Malaysia, the expectation is for the economy to recover in 2021, with growth ranging from 6.0 - 7.5%. The path of recovery will be gradual and uneven across economic sectors, and it may encounter speedbumps along the way. Growth will be underpinned by stronger external demand and higher public and private expenditure. The rollout of the domestic COVID-19 vaccination programme will also lift sentiments and support economic activities. Malaysia's integration in fast growing segments of global value chains and diversified external trade structures, along with continued policy support and its effective execution would be the key factors in driving the rebound in economic growth in 2021.

Despite the positive outlook, downside risks to growth remain. Of immediate concern is the unpredictable course of the pandemic globally and domestically. We cannot rule out the risk of COVID-19 becoming persistent and the country having to withstand the pandemic longer than expected. This is subject to how quickly Malaysia can achieve herd immunity and how the virus evolves. Aside from the pandemic, the uneven growth recovery could risk larger permanent job losses and business closures, particularly in high-touch services sectors. This economic scarring can have a more lasting consequence on the economy, and could prevent a quicker return to a pre-pandemic growth trajectory when economic activity normalises.

In this environment of heightened downside risks to growth, the immediate policy focus of the Bank is to facilitate a quick and sustainable recovery and minimise permanent output losses. Thus, the thrust of monetary policy in 2021 is to remain accommodative to ensure supportive conditions for sustainable economic growth. While headline inflation is expected to rise, it will be driven mainly by supply side factors. Underlying price pressures, on the other hand, will remain subdued, amid continued spare capacity in the economy. In this instance, monetary policy will not be the most appropriate tool to manage supply-driven inflation. The Bank will continue to closely monitor the emergence of signs of a more entrenched and sustainable economic recovery in the period ahead, while remaining vigilant against a build-up of financial imbalances.

The Bank has been, and will continue to be, in a good position to utilise its policy levers as appropriate. Even with the Overnight Policy Rate (OPR) at its current historical low of 1.75%, monetary policy space remains adequate to provide additional support to the economy if needed. This is complemented by the availability of the Bank's various liquidity management tools, targeted financial policies and regulatory flexibilities. These policies allow the Bank sufficient flexibility to respond to risks using the most appropriate policy tool. In addition, coordination with other macroeconomic policies, such as fiscal and labour market policies, will further increase the likelihood of securing a sustainable recovery while avoiding the overburdening of any single policy tool. This effectively reduces the need for the Bank to resort to unconventional monetary policies, which require further assessment on its appropriateness, effectiveness and long-term consequences for the Malaysian economy. What is certain is that we will not rush into untested policy options that could have large unintended consequences on the well-being of the economy and the *rakyat* over the long term.

Going forward, the unpredictable nature of shocks and crises warrants preparing ahead, especially in building policy buffers and using these resources judiciously. This involves two important policy considerations. First, as economic growth becomes more entrenched, the rebuilding of overall policy space, including monetary, financial and fiscal buffers, is necessary to ensure that we have adequate room to manoeuvre if the economy faces another shock. Second, limited policy resources make it imperative to pay greater attention towards allocating them efficiently for the economy to recover and return to its full potential. This should ensure that segments of the society that need the support have access to it, while allowing market forces to work in facilitating the reallocation of resources in a way that will optimise growth prospects. A scenario to avoid is where policy actions inadvertently lead to negative externalities and distortions, such as higher overall indebtedness, imprudent financial behaviours or artificially supporting inefficient or "zombie" firms. This in turn could lower overall productivity, crowd out investment and exacerbate vulnerabilities in the economy, which would ultimately weigh on the economy's future growth potential. These considerations have underpinned the Bank's shift from broad-based to more targeted financial policies.

Beyond its cyclical impact on growth, the pandemic has fundamentally reshaped the economy and the way we conduct our businesses and daily affairs. Importantly, it has sharpened the focus on critical areas of structural policy that call for renewed urgency. On the one hand, it has accelerated the shift towards the adoption of technology and sustainability agendas. On the other hand, it has accentuated gaps in our labour market and social protection system. We must take this opportunity, as a nation, to accelerate the execution of long-term structural reforms and pivot towards a more sustainable, resilient and agile economy. The Bank is committed to continue participating and collaborating closely with relevant stakeholders on various national policy platforms to advance and shape the crucial reforms necessary to secure long-term growth that is both durable and inclusive.

Accelerating the adoption of technology and innovation has become more relevant in this new normal and will drive and sustain future growth. During the pandemic, the ability of economic agents to quickly adapt and change their business models despite movement restrictions was owed partly to the success of previous policies to install key infrastructures and promote digital adoption in the economy. These include efforts to accelerate the adoption of electronic payments. Going forward, there is a need to accelerate the rollout of new critical enablers, including fast and reliable digital connectivity as well as secure data sharing infrastructures, and encourage greater diffusion of technology in the economy to open up new sources of growth while raising future productivity and incomes. Forays into digitalisation can also anchor Malaysia's growth narrative and attract high quality investments into the country. More importantly, focus can be directed at industrialising digital technology, capitalising on Malaysia's comparative strengths, for example in digital healthcare technology, to position Malaysia as a regional developer of high value-add digital solutions.

At the same time, there needs to be greater efforts to strengthen our economic resilience to climate and environmental risks, and manage an orderly transition towards sustainable development goals. A climate crisis can have a similar, if not more severe and irreversible impact on the Malaysian economy. Pursuing the green agenda, by creating a conducive ecosystem and coherent national policies, and attracting investment in climate resilient infrastructures and green technology, can boost employment while increasing economic and environmental resilience for decades to come.

The new normal also imposes a more challenging operating environment in the labour market. Workers are subject to various risks from widespread automation and technological enhancement, with a disproportionate impact on the informal and low skilled segments. Hence, a holistic labour market policy framework is needed to create a resilient and agile workforce that can adapt well to changing labour market conditions. Policy strategies include enhancing upskilling and reskilling programmes, as well as improving employment services and matching mechanisms to facilitate the reallocation of workers to more productive and high-growth areas. The design and formulation of labour and education policies would require continuous and cohesive participation of players from the industry, academia and the Government.

Finally, the pandemic has revealed deep-seated issues regarding Malaysia's existing social protection framework. These include fragmented and overlapping social protection programmes, gaps in coverage, and inadequacy of programmes to comprehensively address vulnerabilities. Undertaking reforms to address these issues will be crucial to ensure that more vulnerable groups are well protected from sudden shocks to their employment status or income, and will encourage access to better opportunities through active labour market policies.

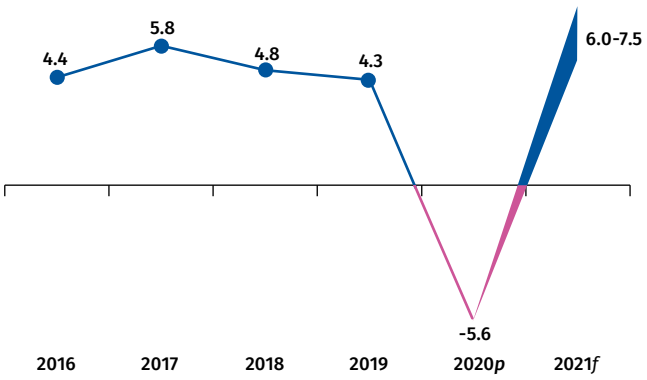
We are not yet out of the woods, but I firmly believe that with sound policies and effective implementation of key structural reforms, Malaysia will emerge stronger from this global health crisis. Achieving a durable economic recovery requires focus on the bigger picture and a 'whole-of-nation' approach. This is where everyone has a role to play – from individuals observing standard operating procedures to the institutions that shape the policies. On the Bank's part, we are dedicated towards this shared objective and will remain unwavering in serving the needs and the interest of the country.

Nor Shamsiah Yunus
31 March 2021

Key Highlights on
Economic Development and Outlook

Malaysia's GDP to rebound in 2021

Real GDP Growth (Annual Change, %)



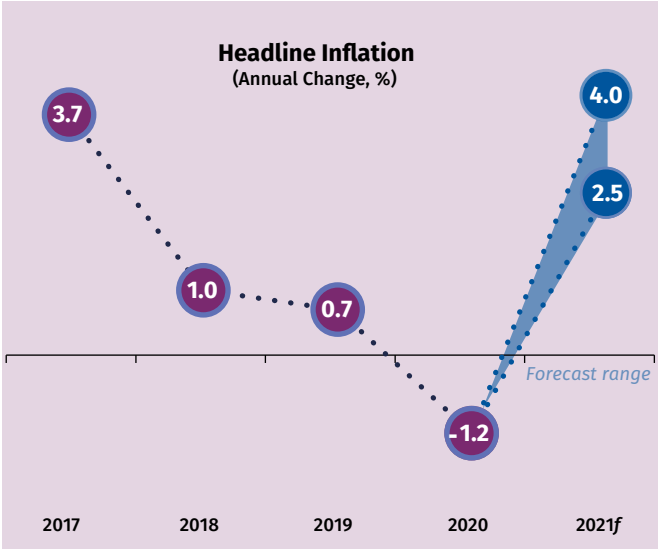
Key Factors Supporting Growth Recovery

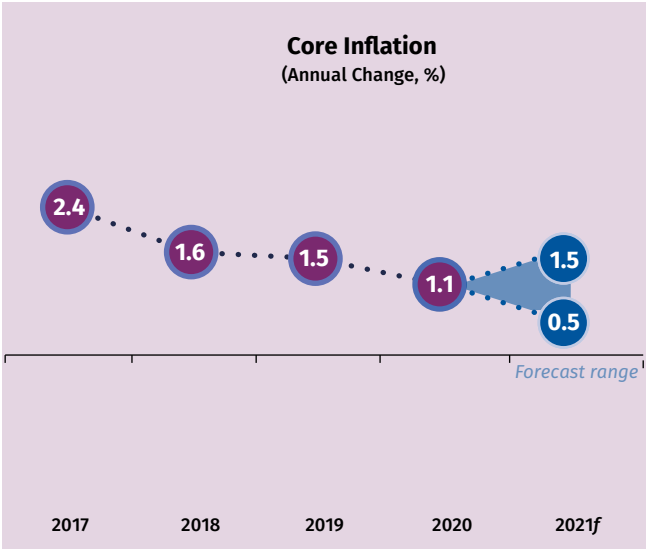
- Improving external demand amid technology upcycle
- Less stringent containment measures and COVID-19 vaccine rollout
- Gradual improvement in labour market conditions
- Pickup in production from new and existing manufacturing and mining facilities

Comprehensive and complementary policy support has been and will remain central in supporting the economy

	Key Policy Measures	Key Policy Outcomes
Fiscal injection	• Direct cash handouts • Tax relief and incentives • Wage subsidies	• Reinvigorate spending and economic activities • Reduce borrowing costs and ensure sufficient liquidity to support continued credit intermediation • Ease cash flow constraints • Facilitate pivot to the new normal
Monetary stimulus	• OPR reduction of 125 basis points • Statutory Reserve Requirement ratio reduction of 100 basis points and compliance flexibility	
Financial assistance	• Targeted Repayment Assistance • Special funds and credit guarantees	
Other measures	• EPF cash withdrawals • Accelerated digitalisation initiatives • Promote workforce upskilling	

Higher headline inflation amid increase in global oil prices, while underlying inflation will remain subdued





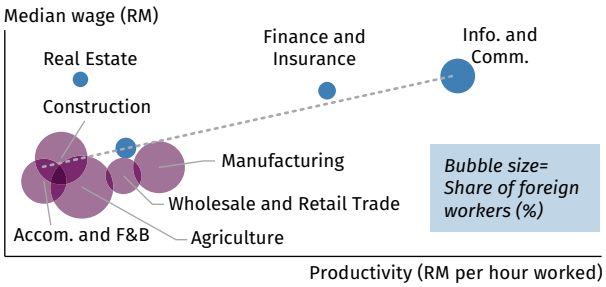
f forecast
p preliminary

Key Highlights on
Box Articles

Getting the Great Reset Right: Structural Labour Market Issues in the Post-COVID-19 World

Prevailing structural impediments weigh on future job and income prospects

Low-cost production model



Insufficient high-skilled job creation

86k
Net employment gains in high-skilled jobs*

151k
Graduate entry into labour force*

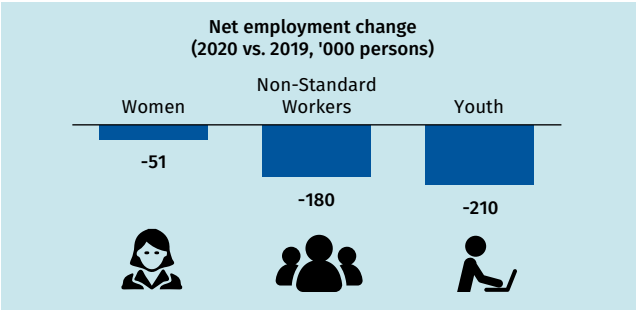
*Average annual change, 2010-2019

Skills mismatches

Skill shortages reported by employers

- **Oral expression and writing**
- **Social perceptiveness**
- **Critical thinking**

COVID-19 pandemic has impacted vulnerable segments of the labour market disproportionately



Note: Non-standard employment is proxied by own account workers, unpaid family workers, and employers. Youth refers to ages 15-24

Policy priorities geared towards enhancing workforce agility and resilience

- **Encourage demand for high-skilled workers**
- **Improve training and matching mechanisms**
- **Enhance labour market resilience**

A Vision for Social Protection in Malaysia

Reforms to social protection pillars

Pillar 1: Social Safety Nets

- Streamlining of programmes
- Enhanced targeting mechanism
- Ensuring complementarities with ALMPs

Pillar 2: Social Insurance

- Incentivising private retirement schemes
- Addressing gaps in coverage for the self-employed and underemployed

Pillar 3: Active Labour Market Policies (ALMPs)

- Boosting synergy between stakeholders
- Introducing training and upskilling conditionalities

Accompanying multi-pillar reforms

- **Formulation of a roadmap for all social protection reforms**
- **Establishment of a centralised social protection database**
- **Establishment of a one-stop centre for all social protection programmes**

Key Highlights on
Box Articles

Asset Purchases by Central Banks

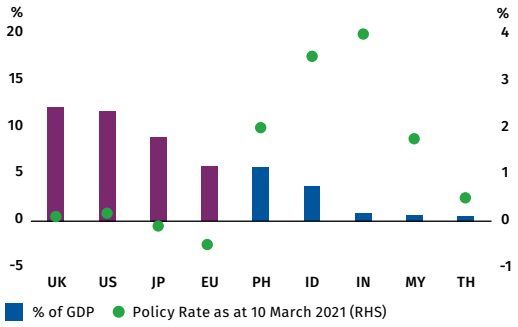
Distinct objectives and scale of asset purchase

Advanced Economies (AE)	Emerging Market (EME)
• Monetary accommodation to support growth amid limited space in conventional monetary policy	• Address market dislocation, excessive volatility and illiquidity • Some stepped in for deficit financing
• Larger scale: 6% to 12% of GDP	• Smaller scale: 0.6% to 6% of GDP

While asset purchases is a legitimate policy option, its utilisation requires careful consideration of potential long term adverse impacts

- Negative impact on central banks' credibility and independence
- Large balance sheets expose central banks to market risk with potential capital loss
- Hindering effective price discovery in the market

Purchases by AE notably larger than regional EME in 2020 as policy rates in AE remain low

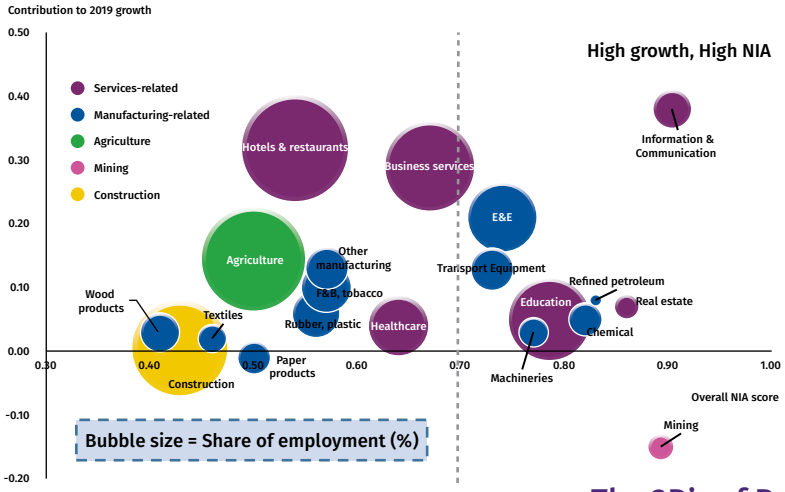


BNM purchased RM9.4 bil of government bonds between Mar and Dec 2020 in order to...

- Ensure market remains orderly for effective financial intermediation by addressing excessive volatility and illiquid conditions
- Manage banking system liquidity
- Build inventory for repo and securities lending operations

Innovation Malaysia: Towards Higher Quality Growth in a Post-Pandemic Future

Industries with high NIAs can propel Malaysia forward



Quality Investment and Innovation-led Growth

- Adoption of National Investment Aspirations (NIAs*)
- Investment in knowledge and tech -intensive activities
- Diversifying into more complex products
- A mission-based investment approach

The 3D's of Reforms

Accelerate Digitalisation

- Strengthening digital enablers
- Digitalising existing industries
- Catalysing new digital industries

Rethink Downstreaming

- Higher palm oil product complexity
- Leader in sustainable practices
- Enhance R&D for specialty products

Reduce Distortion

- Tailor incentives to right activities
- Align with NIAs for quality investment
- Attain allocative efficiency

*NIAs are overarching strategic developmental objectives, namely: to increase economic complexity, create high-value jobs, extend domestic industry linkages, develop new and existing clusters, as well as improve inclusivity.

Executive Summary

Executive Summary

Economic and Financial Developments in 2020

In 2020, the global economy experienced its deepest recession since the Great Depression. This was a culmination of economic disruptions resulting from the containment measures implemented in response to the Coronavirus Disease 2019 (COVID-19), and heightened risk aversion. Consequently, labour market conditions weakened amid a decline in firms' production activities, which weighed on countries' domestic demand, external trade and global growth, particularly in the second quarter of 2020. This triggered unprecedented global policy responses, including large fiscal stimuli, accommodative monetary policies and quantitative easing measures. The quick and significant policy responses averted a deeper downturn in global economic activities. In the second half of the year, as containment measures were gradually lifted, global growth showed signs of recovery, albeit at an uneven and gradual pace. While heightened risk aversion triggered a massive flight to safety at the onset of the COVID-19 outbreak in March 2020, global financial markets have since recovered in a synchronised manner across asset classes amid significant liquidity injections and low-for-long monetary policy commitments by major central banks. For the year as a whole, the global economy and trade contracted by 3.5% and 9.6%, respectively.

Amid a highly challenging global and domestic operating environment, the Malaysian economy contracted by 5.6% in 2020, the lowest since 1998 (-7.4%). This was due to broad-based weaknesses in exports, production and domestic demand, arising from adverse external spillovers and the introduction of stringent domestic containment measures to combat COVID-19. The weaker domestic economic activities led to a deterioration in labour market conditions and income losses, thereby impacting consumer spending. Private investment activity was affected by adverse business confidence and the slower implementation of projects. Public expenditure was also affected mainly by the initial implementation of the Movement Control Order. The impact was the largest in the second quarter of 2020, with GDP contracting by 17.1%. Growth gradually improved in the second half of the year, partly supported by the improvement in external demand and reopening of the domestic economy amid a more targeted approach to containment measures. Lingering uncertainties surrounding the development of the pandemic, however, continued to weigh on Malaysia's growth recovery. Headline inflation was negative at -1.2% (2019: 0.7%), primarily due to the decline of global oil prices. Underlying inflation remained subdued at 1.1% (2019: 1.5%) amid spare capacity in the economy and weaker labour market conditions. Domestic financial market developments were broadly in tandem with global financial market movements. The flexibility in the ringgit exchange rate has been crucial to absorb and mitigate adverse spillovers from external shocks to the domestic economy.

Overall, Malaysia has adopted a comprehensive and complementary policy response to the crisis. This played a significant role in cushioning the economic impact of the COVID-19 pandemic on the domestic economy and supporting a growth recovery. A series of stimulus packages worth RM305 billion (20% of Malaysia's GDP) was unveiled to support the economy throughout the crisis. Significant and immediate fiscal support, such as cash transfers, tax incentives and wage subsidies, coupled with financial measures, including a six-month automatic loan moratorium for households and small- and medium-sized enterprises (SMEs) as well as the establishment of various financing facilities for SMEs, provided immediate relief to households and businesses. These policy measures eased cash flow constraints and helped reduce job losses. The Monetary Policy Committee (MPC) reduced the OPR by a cumulative 125 basis points to a historical low of 1.75% in 2020 to provide support to the economy. In addition, the reduction of the Statutory Reserve Requirement (SRR) ratio

from 3.00% to 2.00% in March 2020, alongside a temporary flexibility to recognise holdings of Malaysian Government Securities (MGS) and Malaysian Government Investment Issues (MGII) by banking institutions as part of the SRR compliance, have eased liquidity conditions. With various policy support measures, overall financing activities were broadly sustained. Supply-side policies, such as active labour market measures to promote workforce upskilling and reskilling, and initiatives to accelerate digitalisation, were implemented to sustain growth momentum and assist vulnerable segments of the economy.

Outlook and Policy in 2021

In 2021, the global economy is expected to continue its gradual and uneven recovery path from the second half of 2020. Global growth prospects will continue to be shaped by developments surrounding the COVID-19 pandemic, particularly the rollout of vaccines, ongoing structural shifts in the economy, and the extent of scarring in labour markets. Notwithstanding the expected global recovery, continued policy support will be vital to sustain the overall growth momentum amid elevated uncertainty. Global monetary policy is also expected to remain supportive of growth. The commitment towards a 'low-for-longer' interest rate environment in major advanced economies and implementation of accommodative monetary policies in major EMEs will support demand. Despite the surge in long-term government bond yields in the US which began in January 2021 and the increased global financial market volatility, major central banks have continued to maintain the stance that monetary policy will remain accommodative amid considerable economic slack, transitory inflationary pressures, and high uncertainties on the strength of growth recoveries. On balance, risks to global growth remains tilted to the downside, as pandemic-related downside risks could dampen the prospects of a global recovery. These include the re-imposition of strict and widespread containment measures due to COVID-19 resurgences, slower-than-expected rollout of vaccines or major mutations in the COVID-19 virus that could render the existing vaccines less effective. More severe economic scarring, arising from extensive permanent job losses and business closures, could also weaken long-term global growth. Nevertheless, there is some upside potential to the outlook. Global growth could outperform expectations with a faster rollout and wider outreach of vaccines, especially in EMEs.

The Malaysian economy is projected to rebound to between 6.0% and 7.5% in 2021. Growth will be underpinned by the recovery in global demand and the gradual improvement in domestic economic activity. The growth trajectory will be mainly influenced by the COVID-19 developments, particularly the extent and duration of containment measures and the rollout of vaccines.

Labour market conditions are expected to improve gradually as broad economic activity picks up, along with the ongoing policy support in place to facilitate labour mobility and minimise long-term dislocations or scarring in the labour market. The improvement in labour market conditions is expected to play a key role in the recovery of private consumption.

In addition, policy measures remain in place to support the growth momentum while still assisting the vulnerable segments. These include the extension of measures introduced in 2020, the 2021 Budget, as well as the *PERMAI* and *PEMERKASA* assistance packages. Notable measures to ease financial constraints for affected individuals include the *Bantuan Prihatin Nasional, Bantuan Prihatin Rakyat* and *Bantuan Kehilangan Pendapatan* cash transfers, the Employee Provident Fund *i-Sinar* and *i-Lestari* cash withdrawals, and the Targeted Loan Repayment Assistance. Various tax relief and incentives will also lift overall consumer spending. For businesses, special grants, wage subsidies and the Targeted Relief and Recovery Facility are extended to firms in the services sector, which is the hardest-hit sector. The continued accommodativeness of monetary policy and supportive financing conditions will further maintain a conducive environment for a recovery in domestic demand as the adverse impact from the COVID-19 crisis gradually subsides.

In this highly uncertain environment, the risks to Malaysia's growth projection are tilted to the downside. Key downside risks include the escalation in COVID-19 cases leading to further rounds of containment measures, albeit targeted, and the slower-than-expected rollout or ineffectiveness of vaccines which could result in stronger precautionary behaviour. Heightened global and domestic economic uncertainty could lead to greater financial market volatility, triggering a tightening of domestic financial conditions. Despite this, upside risks to the growth outlook may emanate from a higher-than-expected global growth, faster-than-expected rollout of

vaccines, stronger-than-expected impact from policy support, and the realisation of pent-up demand following the lifting of containment measures.

In 2021, headline inflation is projected to average higher, between 2.5% – 4.0%, due mainly to cost-push factors such as the expected increase in global oil and commodity prices, as well as the lapse in the effect from the tiered electricity tariff rebate introduced in April 2020. In terms of trajectory, headline inflation is anticipated to temporarily spike in the second quarter of the year, following the lower base from the low domestic retail fuel prices during the corresponding period in 2020, before moderating by the second half of the year as this base effect dissipates. Underlying inflation, as measured by core inflation, is expected to remain subdued, averaging between 0.5% and 1.5% amid the continued spare capacity in the economy. As a whole, underlying inflation is likely to remain muted, barring unforeseen cost factors, until a more entrenched recovery in demand conditions translates to higher prices. The overall inflation outlook, however, is dependent on global oil and commodity price developments.

Malaysia's highly open domestic financial markets is exposed to risks of heightened volatility due to global factors. This includes the recent rise in long-term Government bond yields in advanced economies, which has also led to higher bond yields in EMEs including Malaysia in the recent months. The Bank's monetary policy and operations will, however, continue to promote orderly market conditions and ensure sufficient domestic liquidity to support the financial intermediation. In addition, the flexibility of the ringgit exchange rate would continue to act as a shock absorber by facilitating necessary adjustments in the economy to ensure sustained resilience against external shocks. Importantly, domestic monetary and financial conditions are expected to remain conducive given the accommodative monetary policy and other ongoing policy support, providing a firm foundation for economic recovery.

Monetary policy in 2021 will remain accommodative to promote the sustainability of the economic recovery. Given the uneven pace of recovery and the downside risks to the outlook, a sufficiently accommodative monetary policy stance will be maintained to support an entrenched economic recovery while ensuring that price pressures remain manageable. The MPC will be mindful to avoid a premature withdrawal of policy support. The MPC will continue to closely monitor the emergence of signs of a more entrenched and sustainable economic recovery in the period ahead, while remaining vigilant against a build-up of financial imbalances. Some signposts underlying such recovery would include, among others, sustained periods of steady improvement of economic performance amid a narrowing of the output gap and an environment of price stability; sustainable growth of private consumption and investment driven by fundamentals without over-reliance on policy support; a stronger labour market underpinned by rising incomes; as well as healthy access to financing for viable borrowers.

The right mix of monetary, financial and fiscal policies is needed to ensure overall effectiveness in securing a sustainable economic recovery. This includes the use of more targeted and sector-specific measures. The Bank will continue to utilise all its policy levers, as deemed necessary, to foster enabling conditions for the purpose of ensuring continued financial intermediation. Coherent structural policies will also be crucial to enable Malaysia to emerge stronger from the pandemic with an innovation-led growth, resilient workforce, as well as enhanced social protection framework for those in need. This is facilitated by the introduction of a diverse source of funds to spur high-tech private investments, and complemented by upskilling and reskilling programmes to ensure that the labour force is equipped with the necessary skills to take on the high-skilled, high-productivity jobs. Finally, initiatives to strengthen social protection in Malaysia, such as the widening of social insurance coverage, are vital as a safeguard against socioeconomic vulnerabilities going forward. These efforts would accelerate digitalisation and enhance productivity in the economy, improve standards of living, and further strengthen growth recovery in a sustainable manner.

Economic, Monetary and Financial Developments in 2020

Economic, Monetary and Financial Developments in 2020

2020: AN UNPRECEDENTED CRISIS; A GRADUAL AND UNEVEN RECOVERY

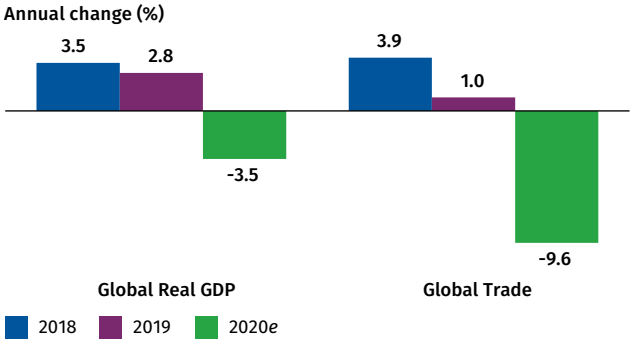
Deepest global recession since the Great Depression, accompanied by unprecedented global policy responses

The global economy experienced a deep recession in 2020 as real GDP contracted by 3.5% (2019: 2.8%), with uneven and gradual recovery paths in an environment of elevated uncertainty (Chart 1.1). The developments surrounding the COVID-19 pandemic and the unprecedented policy responses to cushion the resulting economic shocks had shaped the global growth trajectory.

At the beginning of the year, expectations were for global growth and trade to expand moderately amid the easing of US-PR China trade relations. However, this was quickly derailed by the unexpected outbreak of COVID-19. The disease was first identified in December 2019 and later declared a pandemic on 11 March 2020 by the World Health Organisation as cases spread globally. The subsequent economic disruptions due to the introduction of containment measures in response to the pandemic, and heightened risk aversion among economic agents culminated in a sharp decline in economic growth. Global trade also contracted by 9.6% in 2020 (2019: 1.0%) (Chart 1.1). The downturn in 2020 was the most severe since the Great Depression in the 1930s.

At the start of the pandemic, many economies adopted stringent containment measures to break the COVID-19 transmission in the quickest possible way (Charts 1.2 and 1.3). The measures, such as full or partial lockdowns, physical distancing rules, bans on public gatherings and border closures, led

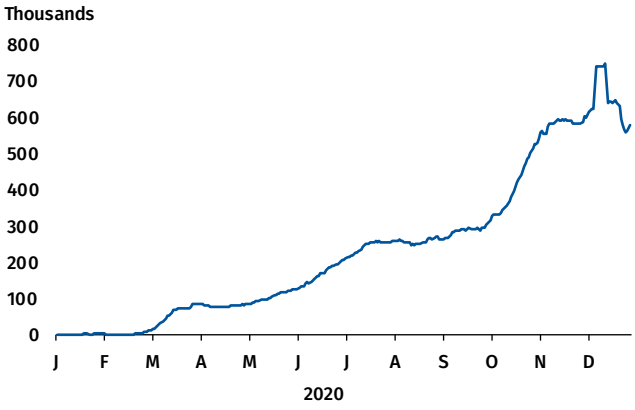
Chart 1.1: Global Real GDP and Trade Growth



e Estimate

Source: International Monetary Fund (IMF) January 2021 World Economic Outlook (WEO)

Chart 1.2: Daily New Global COVID-19 Cases (7-Day Moving Average)



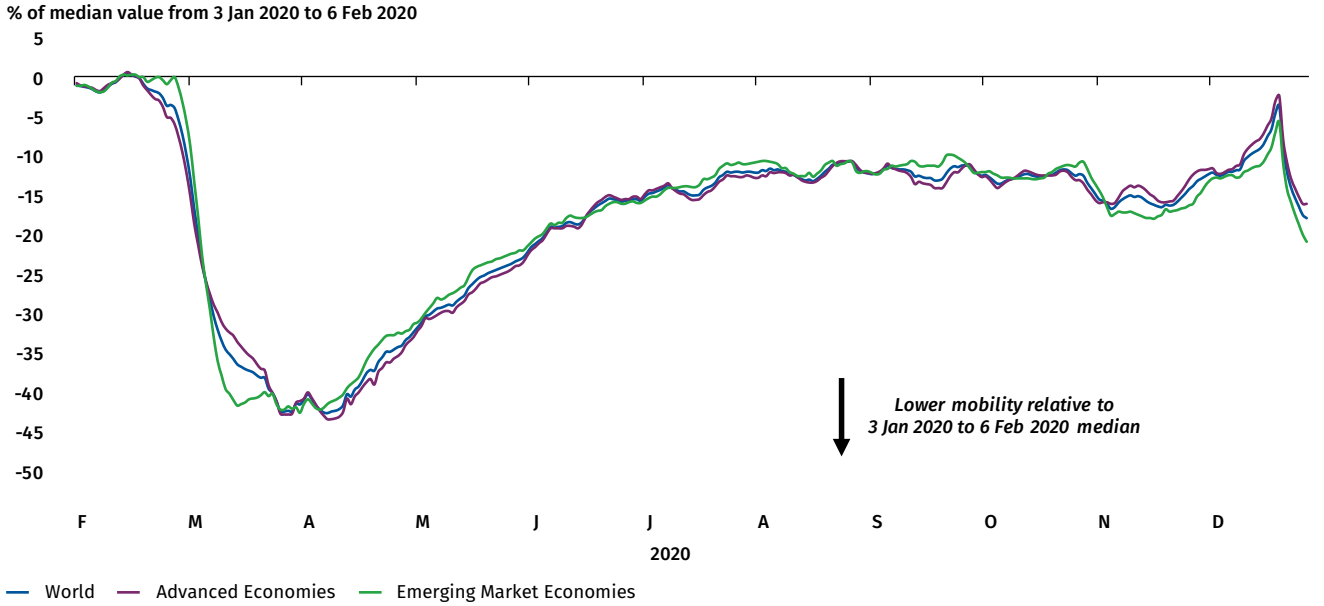
Source: Johns Hopkins Coronavirus Resource Center

to a sudden stop in the mobility of individuals and non-essential business operations (Chart 1.4). These manifested in severe production disruptions and a collapse in demand, particularly in the consumer- and tourism-related industries. As a result, firms' profitability declined sharply. Labour markets weakened in tandem as unemployment rates surged

Chart 1.3: Global PPP-Weighted Stringency Index

Source: Oxford Government Response Tracker, International Monetary Fund (IMF) and Bank Negara Malaysia calculations

Chart 1.4: Mobility to Retail, Recreational and Grocery Locations



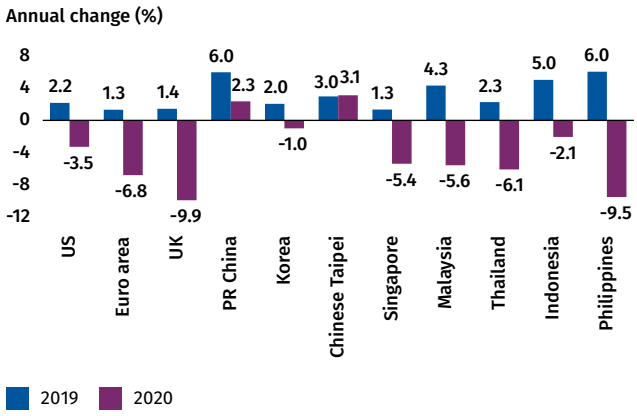
Source: Google, International Monetary Fund (IMF) and Bank Negara Malaysia calculations

and income conditions worsened. These induced sizeable adverse spillovers to domestic demand, weighing further on global growth, particularly in the second quarter of 2020.

The economic impact of containment measures was more pronounced in countries with more stringent lockdowns, which occurred mainly in the second quarter[1], thus contributing to relatively slower annual growth in these economies (Chart 1.5). Meanwhile, growth in countries that successfully managed the

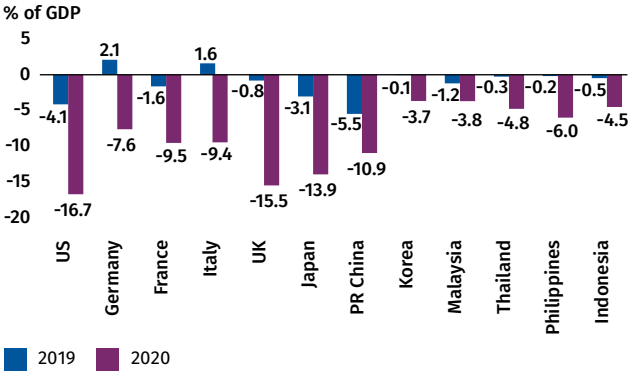
[1] Studies in the October 2020 World Economic Outlook Report (International Monetary Fund, 2020) found that countries with more stringent lockdowns experienced sharper declines in GDP in the first half of 2020 relative to the pre-pandemic forecasts. Examples include countries such as the United Kingdom (UK), euro area and the Philippines.

Chart 1.5: Real GDP Growth



Source: National authorities

Chart 1.6: Primary Fiscal Balance



Source: International Monetary Fund (IMF) October 2020 World Economic Outlook (WEO) Database and Ministry of Finance Malaysia

pandemic with less extreme containment measures, particularly the Advanced Asian economies[2], outperformed other major and regional economies, except for PR China. For instance, Korea adopted mass and rapid testing, comprehensive contact tracing, targeted quarantines, and extensive physical distancing rules to curb the rapid spread of COVID-19, thereby allowing its domestic economic activity to continue during the year. For PR China, the early aggressive lockdowns resulted in a sharp GDP contraction of 6.8% in the first quarter of 2020. However, swift control of the pandemic partly led to a faster growth rebound in the rest of 2020, bringing its GDP growth for the full year to 2.3%.

Beyond the slowdown in domestic demand, trade- or commodity-reliant economies also experienced a sharp decline in external demand. Following the slowdown in global demand, global crude oil prices dropped to an average of USD43.2 per barrel in 2020 (2019: USD64.2 per barrel)[3]. While this kept inflation low, it resulted in lower export revenues for commodity exporters. Furthermore, the imposition of international border restrictions compounded the impact on trade in goods and services as global supply chain operations and cross-border tourism activities were disrupted.

The adverse economic shocks arising from the pandemic triggered global economic policy responses of unprecedented scale (Chart 1.6), which were crucial in averting a deeper downturn in global economic activity. These responses focused on relief measures to support household incomes, sustain firms' cash flows, minimise firm closures and bankruptcies, safeguard jobs, and reduce risks of economic scarring. Common measures across major and regional economies included direct cash transfers, grants, wage subsidies, expanded unemployment benefits, tax reliefs, and credit guarantees to facilitate lending from financial institutions (Table 1.1).

On the monetary policy front, central banks in advanced and emerging economies also took swift and aggressive actions with large policy rate cuts (Chart 1.7). Notably, the US, euro area, and the UK reduced their respective policy rates by between 50 and 100 basis points within the first week of the lockdowns in March 2020. Supervisory authorities also allowed the drawdown of capital and liquidity buffers by banks to support the economy. Quantitative easing (QE) measures, such as large-scale asset purchase programmes and lending facilities, were implemented in major economies where policy rates are near zero or negative, including by the Bank of Japan and the US Federal Reserve. These measures led to a sizeable increase in the balance sheets of these central banks. By the end of 2020, the Bank of Japan's total assets increased by 28.9%, driven primarily by purchases of exchange-traded funds (ETFs) and government bonds. In the US, the Federal Reserve's balance sheet rose by 11.9%. The Federal Reserve instituted direct lending facilities to corporates, in addition to the purchase of assets in the secondary market which was first introduced during the post-Global Financial Crisis (GFC) period. Emerging Market Economies (EMEs) also

[2] Refers mainly to Chinese Taipei, Korea, and Hong Kong SAR which did not introduce wide and stringent lockdowns.
[3] Refers to the average of Brent spot prices.

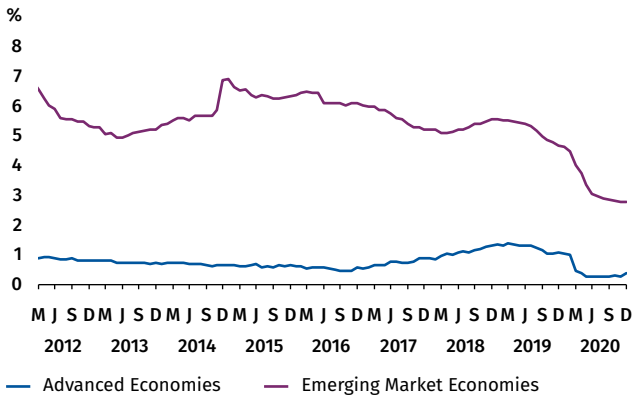
Table 1.1: Key Economic Policy Measures in Selected Major and Regional Economies

Country	Measures to support households	Measures to support businesses
USA	• USD600 direct payments to individuals • Enhanced unemployment benefits of USD300 weekly	• Loan forgiveness and guarantees for small businesses to help retain workers[4] • Liberalised rules for the deduction of net operating losses for corporate tax filing
Germany	• Expanded access to the short-time work subsidy (Kurzarbeit) to supplement wages of workers • Expanded duration of unemployment insurance and parental leave benefits	• Grants to small businesses and the self-employed • Expanded credit guarantees for exporters and export-financing banks • Revenue compensation of up to 75% of revenue
PR China	• Accelerated disbursement of unemployment insurance • Extension of unemployment insurance to migrant workers • Tax relief and waived social security contributions	• Tax relief and waived social security contributions
Singapore	• Cash handouts to all Singaporean households, with additional payments to lower-income and unemployed individuals	• Grants and subsidies for the self-employed and industries directly affected by the pandemic (e.g., tourism, transportation, aviation)
Thailand	• Monthly income support for non-farm workers outside the social security system • Soft loans and tax relief for individuals	• Subsidies for tourists and small- and medium-sized enterprises (SMEs) in the tourism sector • Soft loans and tax relief for businesses

[4] Under the Paycheck Protection Programme introduced within the CARES Act, loans can be forgiven only through applications to convert them into grants within a stipulated timeframe. This is also on the condition that (i) employee and compensation levels are maintained, and (ii) at least 60% of the loan proceeds are spent on payroll costs such as salaries, wages, commissions and employee benefits

Source: National authorities

Chart 1.7: Average Policy Rates



Source: National authorities and Bank Negara Malaysia calculations

engaged in QE measures for the first time in history, reflecting the severity of the downturn. Central banks in countries such as Chile and India purchased government bonds from the secondary market and issued long-term refinancing options, respectively.

As the global economy progressed through the second half of 2020, global growth showed signs of recovery, albeit uneven and gradual.

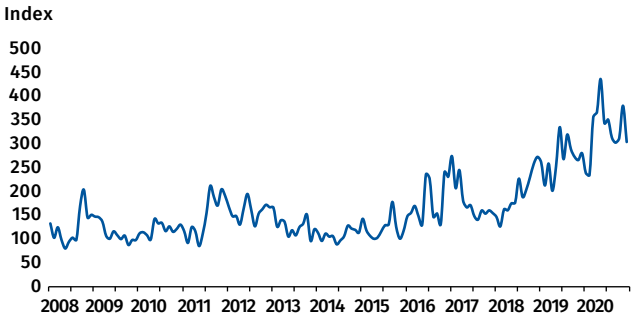
With containment measures gradually lifted, supply-side constraints eased and supported the gradual improvement in labour market conditions globally. Economies with more flexible labour markets experienced a faster recovery in both unemployment and labour force participation rates. The improvement in cross-border trade and investment largely favoured economies with deeper linkages in the manufacturing global value chain, augmented by the surge in digitalisation due to growing preference for low-touch services, higher demand for medical-related products, and strong growth recovery in PR China.

Nonetheless, in late 2020, the resurgence of cases and the emergence of new virus variants in Europe and South Africa warranted the re-imposition of containment measures in some countries. As the degree of containment measures remained a primary factor affecting the strength of economic activity, economies that continued to employ lockdowns to contain resurgences, such as the euro area, experienced brief growth moderations in the fourth quarter of 2020. By contrast, economies that relied on less stringent non-pharmaceutical interventions (NPIs), such as physical distancing rules with enhanced standard operating procedures (SOPs) and MRR (mass, rapid, random) testing, primarily the advanced Asian economies[5] and the US, broadly experienced stronger-than-expected and sustained recoveries.

The pace of global economic recovery had also been gradual due to heightened risk aversion amid elevated uncertainty (Chart 1.8) and continued financial market volatility (Chart 1.9). Key sources of uncertainty emanated from the variability in COVID-19 developments and other country-specific factors.

Given the dynamic evolution of the pandemic, the risk of resurgence and renewed containment measures continued to affect trade and investment activities. While there was news of successful vaccine trials towards the end of 2020, vaccine rollout remained limited to selected countries that expedited approvals for emergency use, such as in the US and UK. Apart from this, the build-up of debt and external sector imbalances resulted in more pronounced risks of unwinding in vulnerable EMEs. These manifested in volatile financial markets and

Chart 1.8: Global PPP-Weighted Economic Policy Uncertainty Index



Source: Davis (2016)

Chart 1.9: Chicago Board Options Exchange (CBOE) Volatility Index (VIX)

Source: Bloomberg

[5] Refers to Korea, Chinese Taipei, and Hong Kong SAR.

tighter domestic financial conditions. Meanwhile, episodes of domestic political unrest in some major economies led to increased business uncertainties, affecting economic activities. Finally, while aggressive policy responses supported global growth during the year, the continuity of policy support itself was a source of uncertainty, such as in the US. These weighed down mainly on business sentiments, as firms feared the possibility of premature withdrawals of fiscal stimulus.

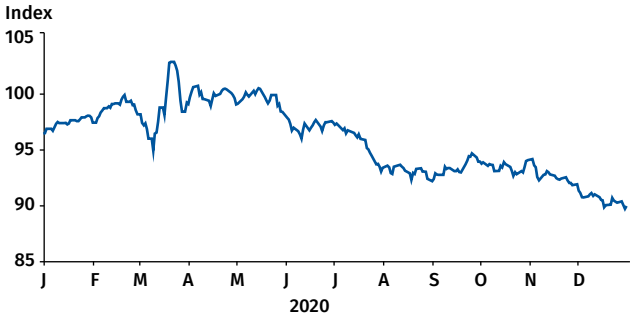
Unprecedented global policy action averted a global financial crisis

Given the unparalleled shock to the global economy in 2020, the performance of global financial markets was highly synchronised across asset classes, including currencies, bonds and equities. Developments throughout the year can be delineated into two distinct phases, namely, the initial global reaction to the COVID-19 outbreak and the subsequent recovery in financial markets given the unprecedented magnitude of global policy stimulus. In the first phase (first quarter of 2020), despite a positive start for global markets, investor sentiments reversed towards the end of January 2020 as the imposition of a strict lockdown in Wuhan, PR China, signalled rising health and economic uncertainties surrounding the COVID-19 outbreak. As the COVID-19 situation intensified globally, it became clear to investors that the health crisis would have major implications on the global economy.

Consequently, global sentiments deteriorated significantly in March 2020, triggering a massive flight to safety as investors' risk aversion peaked. In particular, the US dollar strengthened against most major currencies (Chart 1.10), while EME currencies faced sharp depreciation pressures amid large and volatile portfolio outflows. The US dollar strengthened as there was greater demand for US dollars from global banks, corporates and fund investors given its safe-haven status. This resulted in disruptions in global US dollar funding markets, with significant spillovers to the US Treasury market as well. As a result, bond markets were affected by the ensuing global liquidity crunch, with yields in both advanced and EMEs surging temporarily during the month (Chart 1.11). At the same time, global equity markets experienced a sharp contraction, with the Chicago Board Options Exchange Volatility Index (VIX) peaking at 82.69 on 16 March 2020. The severe drop in global oil prices during the period also reflected investors' expectations that global demand would be severely affected by the pandemic containment measures.

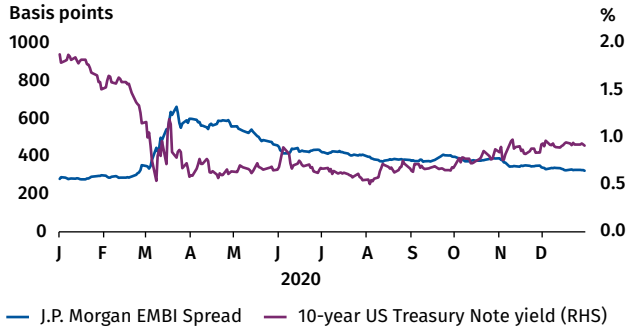
Unlike the GFC in 2008, which originated from vulnerabilities within the financial system, the financial sector in most economies entered the crisis from a position of strength. This enabled global policy measures that aimed to provide credit and liquidity support to households and businesses to be implemented swiftly, thereby ensuring that the economic crisis did not evolve into a global financial crisis. The unprecedented scale of various market interventions and liquidity injections by major central banks in response to stresses in financial markets helped to ensure continuous market functioning and supported the transmission of monetary policy to the rest of the financial system and economy. Following the deployment of such policies, the stresses in global financial markets eased towards the end of March 2020.

Chart 1.10: US Dollar Index



Source: Bloomberg

Chart 1.11: Bond Indices

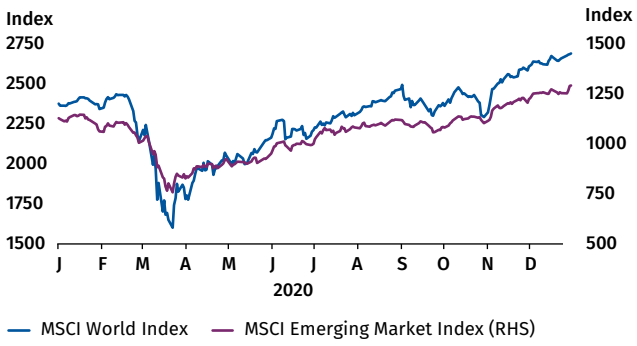


Source: Bloomberg

The second distinct phase of global financial markets in 2020 was a synchronised rebound from the second quarter onwards, despite a global growth recovery that was more gradual and uneven. Key factors that drove the rebound in financial market performance were the massive liquidity injections and low-for-long monetary policy commitments by major central banks.

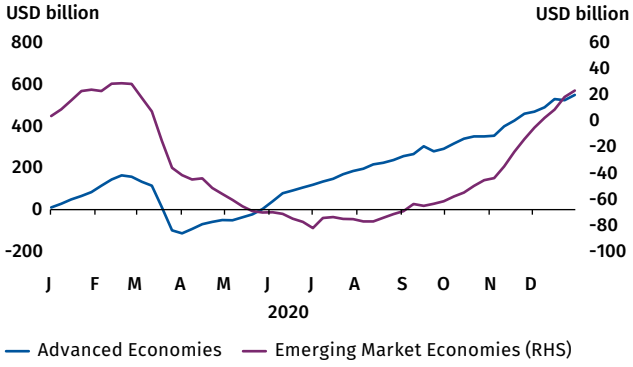
However, this phase was punctuated by the occasional re-emergence of concerns over the economic impact of the pandemic due to the resurgence of COVID-19 infections and the re-imposition of lockdowns in some economies. Nevertheless, in the last quarter, news of successful vaccine trials and the beginning of vaccination programmes in selected major economies contributed to positive sentiments and an improved outlook for the health crisis. The outcome of the US presidential election and its expected positive implications for US economic and foreign policies also boosted investors' risk appetite. Throughout this phase, investors increased allocations to riskier and higher-yielding assets, including equities and EME financial assets (Charts 1.12 and 1.13). The rebound was particularly strong in equity markets, where investors began repositioning again into *value stocks*[6] as the encouraging vaccine developments strengthened expectations for the eventual normalisation of economic activities. In line with the improved risk appetite and broad weakening of the US dollar (Chart 1.10), portfolio flows to EMEs recovered especially in sovereign debt markets, resulting in an appreciating trend for these currencies.

Chart 1.12: Equity Indices



Source: Bloomberg

Chart 1.13: Cumulative Portfolio Flows to Advanced & Emerging Market Economies



Note : Emerging Market Economies comprise a total of 102 countries across different regions (e.g Latin America, Asia), as designated under the category by EPFR Global

Source: EPFR Global

During this economic crisis, ample global liquidity has played an important role in ensuring that financial markets remained supportive of an economic recovery. The overall improvement in financial market conditions in both advanced and EMEs facilitated continued intermediation in capital markets, which helped alleviate the liquidity strains on banks' balance sheets. Together, these have ensured the continued flow of credit to households and businesses throughout the year despite the challenging economic environment.

Conditions in the domestic financial markets improved amid positive investor sentiments

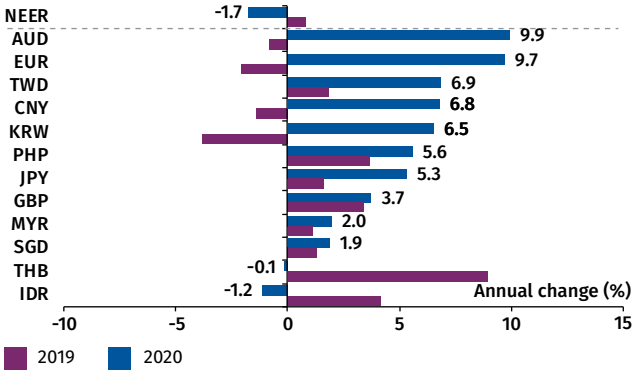
For Malaysia, the overall improvement in domestic financial market conditions was in tandem with global financial market developments, despite several domestic risk events. As such, market developments in 2020 were broadly consistent with the two distinct phases of global financial markets. During the first phase (first quarter of 2020), heightened risk aversion in line with the intensification of the global health crisis resulted in net non-resident portfolio outflows of RM26.2 billion. In line with regional economies, these outflows were mainly from the domestic bond and equity markets. This, in turn, led to a 4.9% depreciation in the ringgit exchange rate against the US dollar during the first quarter. However, in the second phase, the intensity of non-resident portfolio outflows declined gradually before turning into a net inflow, following the resumption in investors' risk appetite.

[6] Value stocks refer to companies which are assessed to be undervalued relative to their earnings potential. In this case, they refer to the economically sensitive and/or vulnerable segments, which have experienced sharply lower valuations due to the crisis environment.

Consequently, the ringgit exchange rate reversed the depreciation in the first phase, leading to an overall appreciation of 2.0% to close at RM4.0130 against the US dollar for the year (Chart 1.14). Notwithstanding the bilateral appreciation against the US dollar, the Nominal Effective Exchange Rate (NEER) depreciated by 1.7% during the year, reflecting the depreciation of the ringgit against the currencies of Malaysia's key trading partners such as the renminbi and the euro.

The performance of domestic bond and equity markets also mirrored global trends during the year. While non-resident portfolio outflows from the bond market in March and April 2020 were significantly large at RM14.7 billion, there has since been a resumption of inflows following the gradual improvement in global investor sentiments. In line with the Overnight Policy Rate (OPR) reductions, yields in both the sovereign and corporate bond

Chart 1.14: Performance of Major and Regional Currencies against the US Dollar and Ringgit Nominal Effective Exchange Rate (NEER)



Note: (+) indicates an appreciation of currencies against the US dollar. NEER shows the value of the ringgit against a trade-weighted basket of Malaysia's major trading partners' currencies.

Source: Bank Negara Malaysia and Reuters

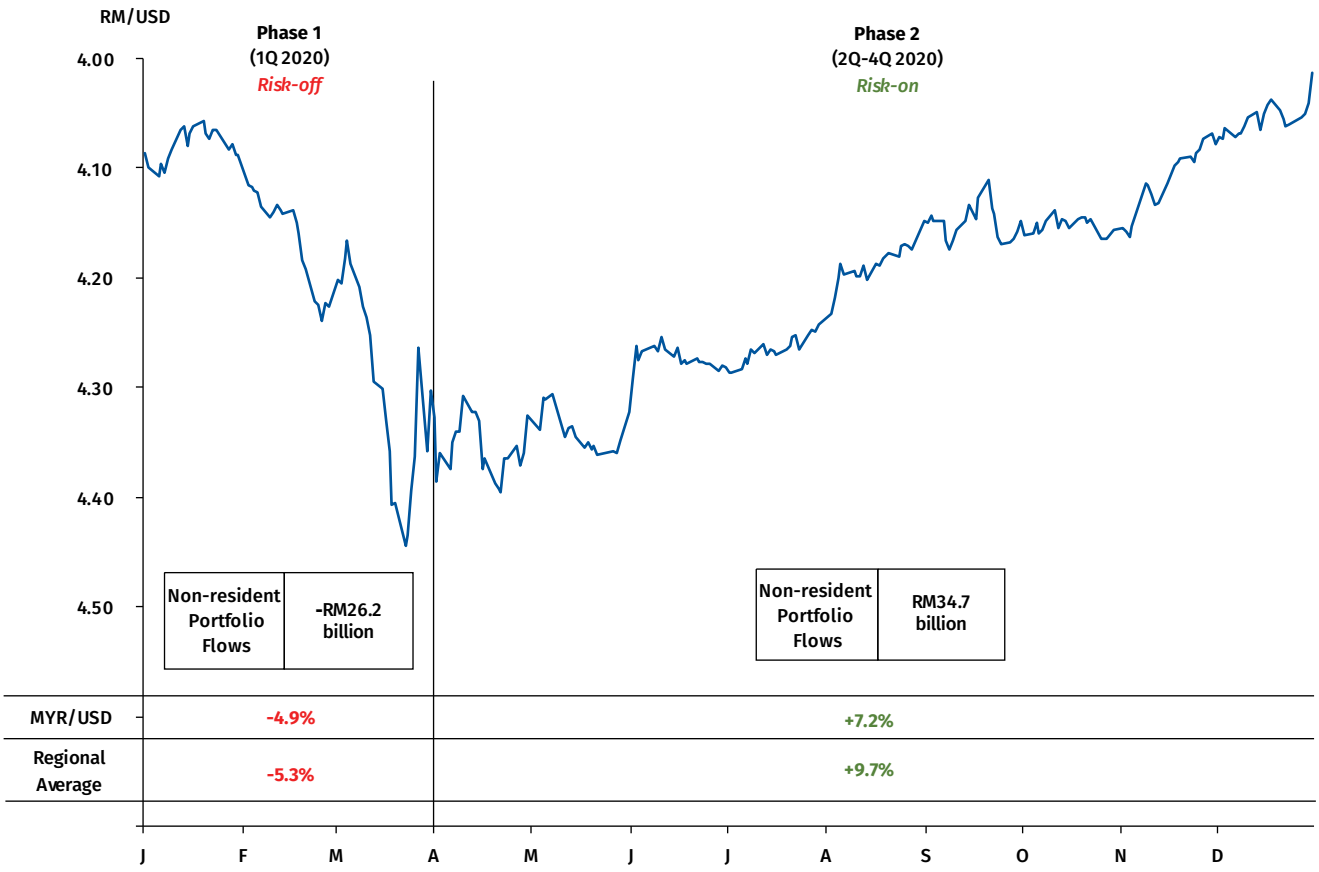
Flexibility in the ringgit exchange rate served to limit spillovers to the domestic economy

Movements in the ringgit exchange rate continued to be market determined and consistent with the global financial market developments in 2020. During the year, the ringgit exchange rate experienced both depreciation and appreciation pressures (phases one and two, respectively), consistent with its flexibility in adjusting to external shocks (Chart 1). The flexibility in the ringgit exchange rate has served the Malaysian economy well by facilitating the appropriate adjustments in the external sector, thereby helping to cushion the domestic economy from adverse global shocks in the current economic recession.[7]

Within a flexible exchange rate framework, bouts of high exchange rate volatility are inevitable. During the height of the financial market stress in March 2020, the 1-month RM/USD implied volatility spiked to average around 6.3%, which was considerably higher than the longer-term average of 4.2% between 2017 and 2019. The Bank remains cognisant of the risks from excessive volatility and manages such risks through targeted foreign exchange intervention operations to ensure orderly market conditions. Along with the Bank's ongoing efforts to enhance market access and develop more hedging instruments, market participants are also continuously encouraged to proactively manage their foreign exchange risks. Going forward, while the medium-term performance of the ringgit exchange rate is expected to reflect Malaysia's economic fundamentals, uncertainties surrounding the pandemic and economic prospects will continue to affect ringgit exchange rate movements in the immediate term. Greater two-way capital flows will continue to be a key feature affecting domestic financial markets and adjustments in the ringgit exchange rate. Given such circumstances, exchange rate flexibility will be crucial to mitigate any adverse spillovers from external shocks to the domestic economy.

[7] The impact of the exchange rate on the economy is captured via both export competitiveness gains and expenditure switching effects. When the exchange rate depreciates, exports and domestically produced goods become cheaper relative to imports. This will incentivise an increase in exports relative to imports, thereby improving the trade balance. Consequently, these external adjustments will trigger the appropriate demand adjustments within the domestic economy via an increase in consumption, investment and inflation. The opposite applies for an appreciation in the exchange rate. Broadly, the strength of such transmission will depend on the responsiveness of the price and volume of traded goods to the exchange rate, the relative share of the tradable sector and the extent of financial frictions in the domestic economy.

Chart 1: Movement of Ringgit against the US dollar and Non-resident Portfolio Flows in 2020



Note: Regional average reflects the movements of selected regional currencies against the US dollar, which comprises the Chinese renminbi, Indonesian rupiah, Korean won, Philippine peso, Singapore dollar, New Taiwan dollar and Thai baht

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

markets declined during the year. Risk premia in the bond market also moderated, particularly during the second half of the year (Chart 1.15).[8] While Fitch Ratings downgraded Malaysia's sovereign rating to BBB+ in December 2020, the impact to the domestic bond market from this downgrade was muted[9].

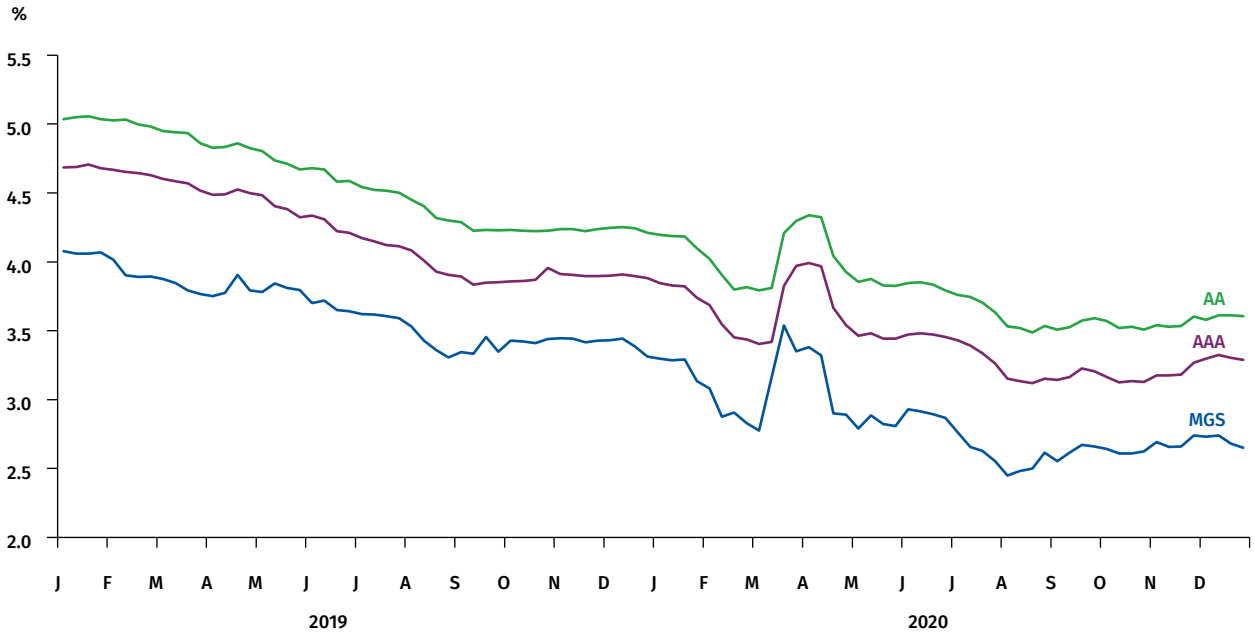
For domestic equities, despite the 15.0% decline in the FBM KLCI during the first quarter, its performance improved by 2.4% to close at 1627.2 points for the year (Chart 1.16). Throughout the year, however, the domestic equity market recorded persistent non-resident outflows in line with regional trends. The impact to equity prices from these outflows were offset by the support from both domestic institutional investors and higher domestic retail participation. In particular, while the share of trading value by domestic retail investors increased to 37.5% as at December 2020 (December 2019: 23.4%), the rise was not driven by bank borrowings[10]. The rebound in the equity market during the year was attributed to the stronger performance of healthcare stocks given the improved outlook in global demand for products and services from this sector. By November 2020, positive news about vaccines supported the improvement in domestic stocks that are typically more sensitive to the broader macroeconomic outlook, namely in the financial services, transportation and logistics sectors.

[8] The 10-year MGS-OPR spread, a measure of risk premia, peaked at 109 basis points at the height of the global risk aversion in March 2020, and moderated during the second half of the year to average at 88 basis points.

[9] Following Fitch Ratings' downgrade on Malaysia's sovereign rating on 4 December 2020, the 10-year MGS yield trended slightly higher by 4.1 basis points to end the week at 2.74% on 11 December 2020. Nonetheless, as the domestic bond market continued to receive non-resident inflows amid improved global risk appetite, the 10-year MGS yield subsequently moderated to close at 2.65% in 2020.

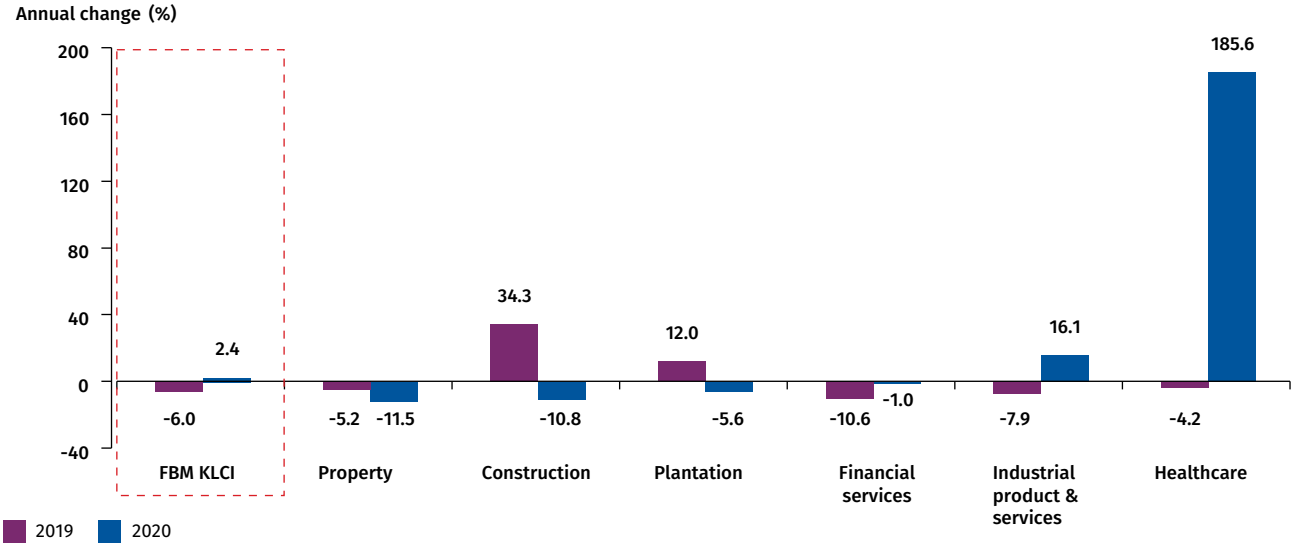
[10] As at end-2020, household loans for the purchase of quoted shares remained small at 0.5% of total banking system loans.

Chart 1.15: 10-year MGS and 10-year Corporate Bond Yields



Source: Bank Negara Malaysia

Chart 1.16: Perfomance of Sectoral Equity Indices



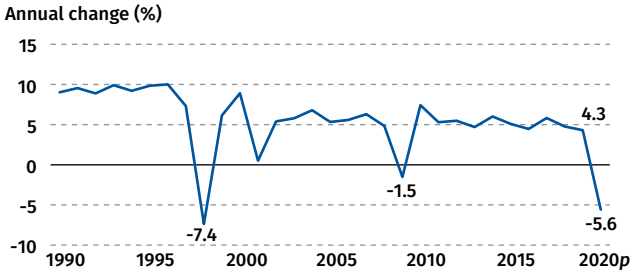
Source: Bloomberg

The Malaysian economy contracted by 5.6% in 2020 amid a highly challenging global and domestic operating environment

As with most countries globally, the unprecedented economic shocks emanating from the pandemic resulted in a sharp decline in Malaysia's GDP growth, the lowest since 1998 (Chart 1.17). Following a moderate start to the year, the escalating pandemic by mid-March 2020 dampened domestic economic growth. Adverse external spillovers and the introduction of stringent local containment measures to curb the rise in COVID-19 cases contributed to broad-based weaknesses in exports, production, and domestic demand. The largest impact was felt in the second quarter of 2020, with GDP contracting by 17.1%. Growth improved gradually thereafter from its trough towards the second half of the year as the economy was gradually re-opened, and economic and social activities partially resumed. In response, policymakers implemented sizeable and timely stimulus measures to mitigate the adverse economic impact at the onset of the crisis and support the growth recovery.

The global pandemic had resulted in weaker global growth, trade, and commodity prices, which weighed on Malaysia's gross exports (2020: -1.4%, 2019: -0.8%). Subdued economic conditions in advanced and regional economies resulted in lower demand from key trade partners. The disruptions to the global manufacturing supply chains further affected export activity in the second quarter of 2020. Given the nature of the crisis, only selected export products, such as electrical and electronics (E&E) and rubber products, were more resilient during the year. These reflected the higher demand for work from home equipment and medical-related products. Meanwhile, export of services contracted significantly by 46.0% due mainly to the sharp fall in tourist arrivals (2020: 4.3 million persons, 2019: 26.1 million persons) as international borders were closed since March 2020.

Chart 1.17: Malaysia's Real GDP Growth (1990-2020)



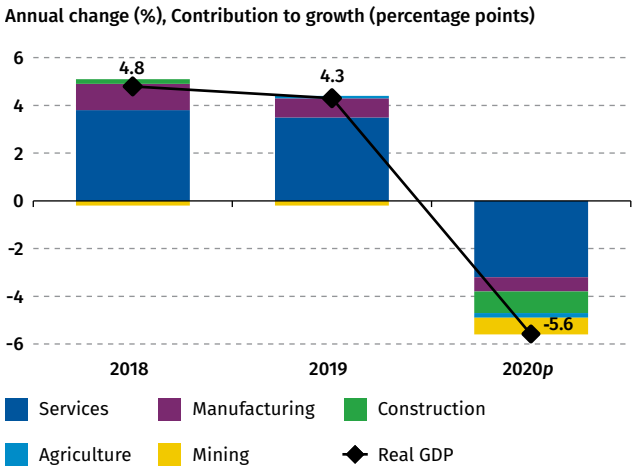
p Preliminary

Source: Department of Statistics, Malaysia

The domestic economy was further impacted by the introduction of strict local containment measures[11]. While these measures were key in successfully curbing the initial rise in domestic COVID-19 cases, they also led to concurrent supply and demand shocks to the Malaysian economy.

Production came to a halt (Chart 1.18), particularly during the Movement Control Order (MCO) period, where non-essential industries were not allowed to operate. While essential activities, such as the production of food and beverages, transport, and financial services continued, sizeable labour capacity and operating hour restrictions alongside tight SOPs due to physical distancing rules contributed to domestic supply constraints. Other sector-specific factors, such as dry weather conditions and maintenance closures in mining facilities, weighed further on overall production activity.

Chart 1.18: Real GDP by Economic Sectors



p Preliminary

Source: Department of Statistics, Malaysia

[11] Local containment measures in 2020 included the (i) Movement Control Order (MCO) from 18 March to 3 May, (ii) Conditional Movement Control Order (CMCO) from 4 May to 9 June, and the (iii) Recovery Movement Control Order (RMCO) from 10 June onwards. CMCO and Enhanced MCO were implemented in the fourth quarter of 2020, albeit targeted to selected districts and states due to the resurgence in COVID-19 cases.

Table 1.2

Malaysia - Key Economic Indicators

	2018	2019	2020*p*	2021*f*
Population (million persons)	32.4	32.5	32.7	32.8
Employment (million persons)	14.8	15.1	15.1	15.4
Unemployment (as % of labour force)	3.3	3.3	4.5	4.6
Per Capita Income (RM)	43,307	45,212	42,531	46,524
(USD)	10,732	10,914	10,118	11,512[3]
NATIONAL PRODUCT (% change)				
Real GDP at 2015 prices	4.8	4.3	-5.6	6.0 ~ 7.5
(RM billion)	1,362.8	1,421.5	1,342.0	1,436.4
Agriculture, forestry and fishery	0.1	2.0	-2.2	4.2
Mining and quarrying	-2.2	-2.0	-10.0	3.1
Manufacturing	5.0	3.8	-2.6	8.8
Construction	4.2	0.1	-19.4	13.4
Services	6.8	6.1	-5.5	6.6
Nominal GNI	5.2	4.9	-5.5	9.8
(RM billion)	1,402.4	1,470.4	1,388.9	1,525.6
Real GNI	4.1	4.8	-4.9	6.3
(RM billion)	1,334.6	1,398.9	1,330.5	1,414.0
Real aggregate domestic demand[1]	5.5	4.3	-5.7	7.4
Private expenditure	7.1	6.2	-6.0	7.4
Consumption	8.0	7.6	-4.3	8.0
Investment	4.3	1.6	-11.9	5.4
Public expenditure	0.0	-2.8	-4.6	7.4
Consumption	3.2	2.0	4.1	4.4
Investment	-5.0	-10.8	-21.4	15.2
Gross national savings (as % of GNI)	27.0	25.1	24.5	23.2
BALANCE OF PAYMENTS (RM billion)				
Goods balance	114.6	123.3	139.1	161.7
Exports	830.1	815.5	778.2	872.1
Imports	715.5	692.1	639.1	710.5
Services balance	-17.5	-10.9	-48.0	-57.7
Primary income, net	-45.1	-40.3	-26.2	-41.6
Secondary income, net	-19.7	-21.3	-2.8	-18.1
Current account balance	32.3	50.9	62.1	44.3
(as % of GDP)	2.2	3.4	4.4	2.5 ~ 3.5
Bank Negara Malaysia international reserves, net[2]	419.5	424.0	432.3	-
(in months of retained imports)	7.4	7.5	8.5	-
PRICES (% change)				
Consumer Price Index (2010=100)	1.0	0.7	-1.2	2.5 ~ 4.0
Producer Price Index (2010=100)	-1.1	-1.4	-2.7	-

[1] Exclude stocks
[2] All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in the Bank Negara Malaysia's audited accounts
[3] Based on average USD exchange rate for the period of January-February 2021

p Preliminary
f Forecast

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 1.3

Malaysia - Financial and Monetary Indicators

FEDERAL GOVERNMENT FINANCE (RM billion)	2018	2019	2020*p*
Revenue	232.9	264.4	225.1
Operating expenditure	231.0	263.3	224.6
Net development expenditure	55.3	52.6	50.1
COVID-19 Fund	-	-	38.0
Overall balance	-53.4	-51.5	-87.6
Overall balance (% of GDP)	-3.7	-3.4	-6.2
Public sector net development expenditure	144.5	132.4	126.3
Public sector overall balance (% of GDP)	-2.9	-3.6	-7.2
EXTERNAL DEBT			
Total debt (RM billion)	923.0	945.4	958.5
Medium- and long-term debt	518.0	554.2	591.0
Short-term debt	405.0	391.2	367.5
Debt service ratio[1] (% of exports of goods and services)			
Total debt	11.8	12.8	13.8
Medium- and long-term debt	11.3	12.2	13.4

	Change in 2018		Change in 2019		Change in 2020	
MONEY AND BANKING	**RM billion**	**%**	**RM billion**	**%**	**RM billion**	**%**
Money supply M1	4.9	1.2	24.8	5.8	71.1	15.7
M3	158.1	9.1	67.0	3.5	79.4	4.0
Banking system deposits	163.2	9.2	55.5	2.9	89.1	4.5
Banking system loans[2]	121.4	7.7	65.8	3.9	59.6	3.4
Loan to fund ratio (%, end of year)[3,4]	83.1		83.2		82.5	
Loan to fund and equity ratio (%, end of year)[3,4,5]	72.6		72.8		72.0	

INTEREST RATES (%, AS AT END-YEAR)	2018	2019	2020
Overnight Policy Rate (OPR)	3.25	3.00	1.75
Interbank rates (1-month)	3.45	3.08	1.82
Commercial banks			
Fixed deposit 3-month	3.15	2.90	1.58
12-month	3.33	3.09	1.75
Savings deposit	1.07	0.97	0.48
Weighted average base rate (BR)	3.91	3.68	2.43
Base lending rate (BLR)	6.91	6.71	5.49
Malaysian Treasury Bills (3-month)[6]	3.29	2.98	1.72
Malaysian Government Securities (1-year)[6]	3.45	2.96	1.73
Malaysian Government Securities (5-year)[6]	3.78	3.18	2.12
EXCHANGE RATES (AS AT END-YEAR)	**2018**	**2019**	**2020**
Movement of Ringgit (%)			
Change against SDR	-0.2	1.9	-1.8
Change against USD	-1.8	1.1	2.0

[1] Excludes prepayment of medium- and long-term debt
[2] Includes loans sold to Cagamas
[3] Loans exclude loans sold to Cagamas and loans extended to banking institutions. Beginning July 2015, loans exclude financing funded by Islamic Investment accounts
[4] Funds comprise deposits (excluding deposits accepted from banking institutions and Bank Negara Malaysia) and all debt instruments (including subordinated debt, debt certificates/sukuk issued, commercial paper and structured notes)
[5] Equities comprise ordinary and preferred shares, share premium and retained earnings
[6] Refers to data from Fully Automated System for Issuing/Tendering (FAST), Bank Negara Malaysia

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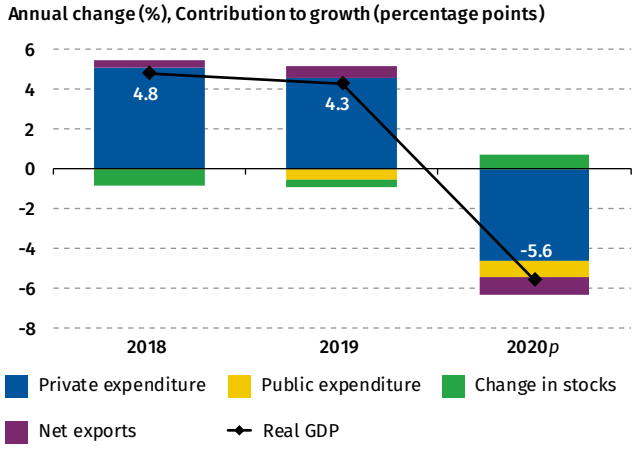
Source: Ministry of Finance, Malaysia and Bank Negara Malaysia

The movement restrictions also adversely affected private sector spending (Chart 1.19). As the pandemic prolonged, firms' profits declined and labour market conditions deteriorated in line with weaker economic activities. These led to a contraction in consumption and investment activity. Consumer spending was impacted by large income losses as the labour market experienced its worst downturn in more than three decades[12]. Consumer sentiments were also weak due to heightened risk aversion amid fears of COVID-19 contagion and job uncertainties. Similarly, private investment activity was weighed down by low business confidence and the slower implementation of projects. Meanwhile, public expenditure was also affected mainly by the initial implementation of the MCO, particularly public investments.

The decline in external and domestic demand collectively resulted in a further contraction in imports in 2020 (-6.3%; 2019: -3.5%). Intermediate imports registered a sharp contraction in tandem with lower manufacturing production and exports. Capital and consumption imports also declined during the year due to weak investment and consumer spending.

Chart 1.19: Real GDP by Expenditure



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Source: Department of Statistics, Malaysia

The larger import compression relative to exports resulted in a higher goods surplus, contributing to a higher current account surplus of RM62.1 billion or 4.4% of GDP in 2020 (2019: RM50.9 billion or 3.4% of GDP). The primary income deficit narrowed during the year due to more moderate income that accrued to foreign investors in Malaysia amid the subdued global environment. However, these were partly offset by the decline in travel receipts.

Following the trough in the second quarter of 2020, there were incipient signs of gradual growth recovery, albeit rather uneven, towards the second half of the year. As the containment measures were gradually eased from the second quarter, economic activities partially resumed, and labour market conditions improved. COVID-19-resilient industries[13] experienced a quicker recovery given impetus from the global surge in digitalisation and shift in consumer preferences. In line with these developments, the export-oriented industries also benefitted from the improving external demand, particularly for E&E products. By contrast, COVID-19-vulnerable sectors, such as tourism-related industries, experienced slower recoveries due to continued risk aversion and restrictions on international travel, resulting in an uneven and gradual growth recovery.

As 2020 came to an end, Malaysia's growth recovery remained highly contingent on the course of the pandemic. In the fourth quarter, the tightening of containment measures to restrain the resurgence in cases dented the pace of the economic recovery. Employment and income conditions were similarly affected. Nonetheless, as a more targeted approach was adopted through state-specific containment and less stringent supply restrictions, the adverse impact to economic activity was less severe than before. This reflected efforts to balance between managing public health concerns and livelihoods during this pandemic.

[12] See white box on "Disruptions in the Malaysian Labour Market in 2020" for more details.

[13] Refers mainly to sectors such as food and beverages, communication, and utilities as people stay and work from home more often.

Both domestic and external demand contracted in 2020

In 2020, domestic demand was shaped by the uncertainties and the responses undertaken by the authorities to contain the COVID-19 pandemic. The domestic containment measures, implemented beginning March, had weighed significantly on private expenditure. In particular, household spending was affected by the softer labour market conditions and weak consumer sentiments, while investment activity was impacted by dampening business confidence amid the weaker external environment. However, public sector spending on COVID-19 related measures under the economic stimulus packages provided positive support to growth. On the external front, net exports recorded a contraction, as exports declined at a faster rate vis-à-vis imports. The decline in exports was in line with the lower global growth as well as trade and tourism activity, while imports were generally affected by weaker domestic demand conditions.

Table 1

Real GDP by Expenditure (2015=100)

	2020*p*	2019	2020*p*	2019	2020*p*
	% of GDP	Annual change (%)		Contribution to growth (percentage point)	
Domestic Demand[1]	**93.9**	**4.3**	**-5.7**	**4.1**	**-5.4**
Private sector expenditure	75.2	6.2	-6.0	4.6	-4.5
Consumption	59.5	7.6	-4.3	4.3	-2.5
Investment	15.7	1.6	-11.9	0.3	-2.0
Public sector expenditure	18.7	-2.8	-4.6	-0.5	-0.8
Consumption	13.4	2.0	4.1	0.3	0.5
Investment	5.2	-10.8	-21.4	-0.8	-1.3
Gross Fixed Capital Formation	20.9	-2.1	-14.5	-0.5	-3.4
Change in stocks	**-0.4**			**-0.4**	**0.7**
Net Exports of Goods and Services	**6.5**	**9.7**	**-12.3**	**0.6**	**-0.9**
Exports	61.6	-1.3	-8.8	-0.9	-5.6
Imports	55.1	-2.5	-8.3	-1.5	-4.7
Real Gross Domestic Product (GDP)	**100.0**	**4.3**	**-5.6**	**4.3**	**-5.6**

[1] Excluding stocks
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Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

For the first time since the Asian Financial Crisis, private consumption registered a contraction of 4.3% in 2020. Household expenditure was affected by a decline in the fundamental drivers to spending, namely income and employment. Physical spending was limited by the strict movement restrictions to contain the spread of COVID-19, particularly in the first half of the year. Throughout this period and as movement restrictions gradually eased in the second half of the year, essential spending remained firm, while communication-related expenditure was boosted by the rise in work from home arrangements. Meanwhile, expenditure on discretionary items, such as leisure- and travel-related services, remained weak amid subdued consumer sentiments and heightened risk aversion, as well as continued border closures. Nevertheless, the timely rollout of unprecedented policy support cushioned the shocks to household spending, primarily through the *Bantuan Prihatin Nasional* cash transfers, deferment or reduction in loan repayments, Employee Provident Fund cash withdrawals (*i-Lestari*), and wage subsidy programme. Furthermore, the acceleration in online spending partly mitigated the shocks to consumption during the year.

Gross fixed capital formation (GFCF) declined by 14.5% in 2020. This reflected weaker capital spending by both the private and public sectors. By type of asset, the large contraction in capital spending in both structures (2020: -18.3%; 2019: -0.6%) and machinery and equipment (M&E) (2020: -8.6%; 2019: -5.5%) had lowered overall investment growth. Both structures and M&E investment were broadly weak due to the implementation of containment measures and uncertainties surrounding the pandemic, which had affected the commencement and progress of investment projects across all sectors.

Private investment declined by 11.9% as firms faced lower profitability and heightened uncertainties. The mobility restrictions particularly in the first half of the year and border closures had led to delays in the implementation of investment projects and the delivery and installation of M&E. Nevertheless, investment intentions, particularly in the *manufacturing* sector remained encouraging during the year, given the strong demand especially in the export-oriented industries, with investment approvals mainly in the high-value added industries such as E&E and petroleum products[14]. Furthermore, rising demand for industries related to the new normal, such as telecommunication, rubber and medical-related sectors led to further capacity expansions, which provided some support to growth.

Public investment declined by 21.4%, as capital spending by both the General Government and public corporations remained subdued throughout the year, due to slower project progress and weaker demand conditions in most sectors, including oil and gas and utilities. Nevertheless, continued progress in large infrastructure projects such as the East Coast Rail Link (ECRL), Mass Rapid Transit Putrajaya Line (MRT2) and Pan Borneo Highway provided some support to public investment growth in the second half of 2020 as the economy gradually reopened.

Public consumption growth improved to 4.1%, driven by higher Federal Government spending on both supplies and services and emoluments. Spending on COVID-19 related measures under the economic stimulus packages, such as the procurement of medical equipment and services, and special allowances to front liners, provided further support to growth.

[14] Approved manufacturing investments was at RM91.3bn in 2020 (2019: RM82.7bn). (Source: Malaysian Investment Development Authority).

Contraction in all economic sectors

In 2020, all economic sectors registered a contraction in growth. While the containment measures aided Malaysia's efforts to rein in the outbreak, the tighter operating procedures (e.g. operating hours, capacity limit on premise, activity restrictions), mobility restrictions and supply-chain disruptions affected economic activity, particularly in the second quarter of the year when the measures were at their strictest. Industries that faced difficulties in adapting to remote working arrangements were disproportionately affected, while outbreaks in crowded and confined accommodation of foreign workers led to pockets of labour shortages in certain industries. Additionally, most industries also faced weaker demand conditions – both domestic and external, which further weighed on production and business activities.

For the *services* sector, growth contracted by 5.5% (2019: 6.1%) as the pandemic and containment measures disproportionately affected domestic consumer-oriented industries. Operational and mobility restrictions, on top of subdued consumer sentiments led to weaker spending and business activities in the wholesale and retail trade, as well as real estate and business services sub-sectors. Nonetheless, the exemption of the Sales and Services Tax (SST) on passenger cars spurred a strong recovery in motor vehicle sales in the second half of 2020 and partially mitigated this contraction. In addition, international border and mobility restrictions significantly disrupted tourism activity in Malaysia. This in turn affected its key services such as the food and beverage and accommodation sub-sectors, as well as air travel. Meanwhile, the finance and insurance sub-sector recorded positive growth for the year with sustained net interest income amid loan and deposit growth in the second half of 2020, despite higher credit costs and losses from loan modifications. The information and communication subsector also continued to expand, supported by stronger demand for broadband data as e-commerce and e-payment activities grew amid greater digitalisation and remote working arrangements.

Table 1

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

	2020*p*	2019	2020*p*	2019	2020*p*
	% of GDP	Annual change (%)		Contribution to growth (ppt)[1]	
Services	57.7	6.1	-5.5	3.5	-3.2
Manufacturing	23.0	3.8	-2.6	0.8	-0.6
Mining and quarrying	6.8	-2.0	-10.0	-0.2	-0.7
Agriculture	7.4	2.0	-2.2	0.1	-0.2
Construction	4.0	0.1	-19.4	0.0	-0.9
Real Gross Domestic Product (GDP)	**100.0**[1]	**4.3**	**-5.6**	**4.3**	**-5.6**

[1] Figures may not necessarily add up due to rounding and exclusion of import duties component
p Preliminary

Source: Department of Statistics, Malaysia

Similarly, growth in the *manufacturing* sector also contracted by 2.6% (2019: 3.8%) as restriction on operations, supply-chain disruptions and subdued demand conditions weighed on production activities. Nevertheless, the E&E, primary, and consumer-related clusters witnessed a quick rebound in production activity once operating restrictions were lifted towards the end of the second quarter with growth turning positive by the third quarter of 2020. In particular, Malaysia's E&E industry benefited from greater demand associated with remote working, e-commerce, cloud-based services and healthcare products. This led to a surge in global demand for semiconductor equipment in telecommunication, medical devices, and cloud computing, all of which are segments that Malaysia is well plugged-into. Meanwhile, production in the primary and consumer-related clusters was supported by stronger pandemic-induced demand (e.g. rubber gloves, pharmaceuticals) and fiscal support (e.g. SST exemption for purchase of passenger cars).

The *agriculture* sector contracted by 2.2% (2019: 2.0%) mainly due to weaker oil palm output. A key contributing factor was the lingering effects of the severe dry weather conditions in the earlier part of the year and cutbacks in fertiliser application. Continued labour shortages due to the hiring freeze on foreign labour and international border closure further affected oil palm harvesting activities. On top of this, growth in the natural rubber, forestry, and fisheries sub-sectors also declined mainly due to operational constraints induced by the containment measures. Fisheries and rubber tappers were unable to sell their produce as wet-markets and activities dealing in rubber were affected during the MCO period, while logging activities were allowed to continue but subject to minimum manpower.

The *mining* sector recorded a continued contraction in growth of 10.0% (2019: -2.0%) as crude oil and natural gas production were impacted by maintenance closures and weak external demand for commodities. Production activities in the other mining segments were also disrupted due to the tighter restrictions from containment measures.

The *construction* sector contracted by 19.4% in 2020 (2019: 0.1%) reflecting reduced work capacity in compliance to containment measures, labour shortages due to international border closures, supply chain disruptions and site shutdowns following the COVID-19 outbreak. Growth in the second quarter of the year was mainly weighed by the suspension of almost all construction work in March and April. Despite some relaxation in operating constraints in May, most project sites remained idle, as developers experienced financial, compliance, and supply-chain challenges in resuming work. Nonetheless, activity improved in the second half of 2020 given better clarity and compliance with operating guidelines, more pervasive COVID-19 testing on workers and extended hours for construction activity. In addition, the rollout of stimulus packages supported many small-scale projects, and spurred growth in the special trade subsector in the second half of 2020. Activity in the residential and non-residential subsectors benefitted from new housing projects and ramp up in progress of projects due for completion respectively in the second half of 2020, while the civil engineering subsector was supported by continued progress in large infrastructure projects.

Disruptions in the Malaysian labour market in 2020

Labour market conditions were significantly impacted in 2020 by restrictions imposed throughout the year to curb the spread of the pandemic. Employment growth contracted by 0.2% (2019: 2.1%), amounting to a net employment loss of 30,000 persons, while the unemployment rate rose to 4.5% of the labour force, the highest in the past 30 years (2019: 3.3%). The COVID-19 pandemic also had a particular impact on time-related underemployment, which increased to 367 thousand persons, or 2.3% of the labour force (2019: 191 thousand persons or 1.2%)[15], mainly due to the imposition of movement and labour restrictions during the MCO in the second quarter. The situation eased towards the end of the year as some of these workers were re-absorbed into full employment when restrictions were lifted, while other segments of the labour force have yet to see a recovery. Consequently, the labour force participation rate declined slightly during the year, to 68.5% of the working age population (2019: 68.7%).

Table 1

Selected Labour Market Indicators

	2016	2017	2018	2019	2020*p*
Employment ('000 persons)	14,180	14,459	14,810	15,126	15,096
Annual change (%)	1.3	2.0	2.4	2.1	-0.2
Unemployment rate (% of labour force)	3.4	3.4	3.3	3.3	4.5
Labour force participation rate (% of working age population)	67.7	68	68.3	68.7	68.5
Retrenchments (persons)	37,699	35,097	23,168	29,605	104,432
Non-Malaysian citizens employment ('000 persons)	2,205	2,244	2,183	2,237	2,310

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Note: Annual employment growth figures were sourced from the Labour Productivity Statistics publication

Source: Department of Statistics, Malaysia and Ministry of Human Resources

The contraction in employment growth resulted from the net loss of employment in mid and low-skilled occupations, which declined by 1.3% and 5.3%, respectively. The decline was partially offset by growth in the high-skilled occupations at 4.6%. Nonetheless, mid-skilled workers continued to account for the largest share of total employed persons at 58.8% (2019: 59.5%), followed by high-skilled workers at 28.9% (2019: 27.6%). From a sectoral perspective, the decline in employment growth was driven mainly by sectors that were heavily affected by the COVID-19 pandemic, namely, the *construction* and *tourism-related services* sectors. In particular, employment in the *construction* sector declined by 4.4%, following postponed implementation of multiple projects, while the food, beverages and accommodation subsector recorded a contraction of 0.4%. Meanwhile, retrenchments rose to 104,432 persons per annum (2019: 29,605 persons).

Following these developments, aggregate nominal wages in the private sector[16] declined by 2.4% in 2020 (2019: 4.4%). The *services* sector recorded a contraction in wage growth of 3.1% (2019: 4.1%), led by the fall in wages of *tourism-related* sectors such as transportation and storage, accommodation and food and beverages. Wages in the *manufacturing* sector also declined, albeit at lower rate of 1.1%, attributable to both domestic-oriented and export-oriented sectors. Meanwhile, public sector wages increased modestly, by 2.0% (2019: 3.7%). Overall, growth of wages per worker was flat in 2020 (-0.01%; 2019: 3.0%).

Labour productivity growth, as measured by real value-added per hour worked, increased to 3.4% in 2020 (2019: 2.2%), with improvements in all sectors except for *construction*. The increase in productivity was primarily due to the larger decline in total hours worked relative to output, amid the imposition of movement restrictions. *Services* sector productivity grew by 3.2% (2019: 2.7%), led by gains in the information and communication and

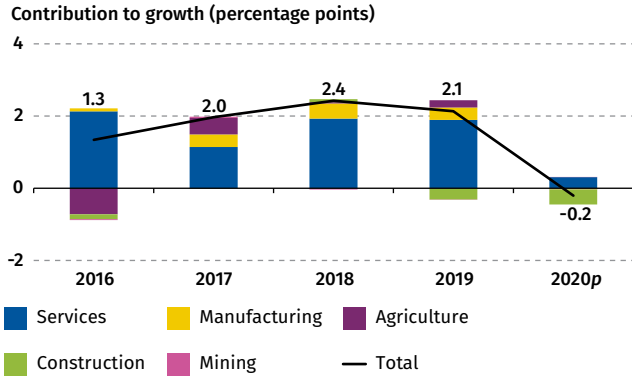
[15] Time-related underemployment rate was estimated based on the quarterly averages of 2019 and 2020 figures, respectively, from the Department of Statistics Malaysia's Labour Force Survey. These figures do not include workers who could not work at all due to labour restrictions in the second quarter.

[16] Private sector wages are derived from the salaries and wages data published in the Monthly Manufacturing Statistics and Quarterly Services Statistics by the Department of Statistics Malaysia. It covers 66% of total employment.

the finance and insurance sub-sectors. Productivity growth in the *manufacturing* sector also expanded by 7.0% (2019: 2.5%) due largely to the improvement in the E&E subsector.

The COVID-19 health crisis continues to be an on-going challenge for the economy and the labour market, and has impacted the vulnerable segments of the labour force more acutely. The restrictions on movement and economic activities presented particular challenges for workers in non-standard employment, youth and women, among others (Please refer to the box article on "Getting the Great Reset Right: Structural Labour Issues in the Post-COVID-19 World").

Chart 1: Employment Growth by Sector, 2016 - 2020



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Source: Labour Productivity Statistics published by the Department of Statistics, Malaysia

Malaysia's external sector remained resilient

Malaysia's external position remained resilient despite the challenging global and domestic economic landscape in 2020. The current account of the balance of payments recorded a surplus of RM62.1 billion or 4.4% of GDP (2019: RM50.9 billion or 3.4% of GDP), supported by higher goods surplus and lower deficits in the primary and secondary income accounts. From a savings-investment perspective, the higher surplus reflected a sharper decline in investment.

In the goods account, imports contracted sharply relative to exports resulting in a higher goods surplus of RM139.1 billion (2019: RM123.3 billion). This had offset the lower commodities surplus following the sharp decline in prices of major commodities exports. Malaysia's merchandise exports declined in the first half of 2020, reflecting the sharp contraction in global demand and trade volumes. The services account recorded a larger deficit of RM48.0 billion in 2020 (2019: -RM10.9 billion), the largest deficit ever recorded since records began in 1961. This mainly reflected the sharp decline in travel and air transportation services exports due to the imposition of international travel restrictions. Of note, Malaysia's travel account registered a deficit of RM7.8 billion, driven by the sharp decline in tourism receipts to RM12.7 billion (2019: RM86.1 billion) as tourist arrivals declined sharply. This is the first travel account deficit registered since 1999.

In the income account, the primary income deficit narrowed to RM26.2 billion (2019: -RM40.3 billion), due mainly to lower direct investment income accrued to foreign companies in Malaysia (2020: RM43.2 billion; 2019: RM58.7 billion), particularly in the *mining* and *services* sectors amidst the challenging global environment. Income from direct investments abroad had also moderated, particularly in the *commodities* sector. The deficit in the secondary income account narrowed significantly to RM2.8 billion (2019: -RM21.3 billion). This was due to transfers received as part of a settlement related to a wholly-owned subsidiary of the Minister of Finance (Incorporated) in the third quarter of 2020, and lower remittances by foreign workers amid subdued economic activity during the year.

Table 1

Balance of Payments[1]

Item (Net)	2018	2019	2020*p*
	RM billion		
Current account	**32.3**	**50.9**	**62.1**
Goods[2]	114.6	123.3	139.1
Services	-17.5	-10.9	-48.0
Primary income	-45.1	-40.3	-26.2
Secondary income	-19.7	-21.3	-2.8
Capital account	**-0.1**	**0.3**	**-0.4**
Financial account	**11.4**	**-33.8**	**-79.1**
Direct investment	10.1	5.6	-0.2
Portfolio investment	-49.4	-29.0	-49.1
Financial derivatives	1.0	-0.5	1.6
Other investment	49.7	-9.9	-31.4
Net errors and omissions[3]	**-35.9**	**-9.0**	**-2.0**
Overall balance	**7.8**	**8.4**	**-19.4**

[1] In accordance with the Balance of Payments and International Investment Position Manual, Sixth Edition (BPM6) by the International Monetary Fund (IMF)
[2] Adjusted for valuation and coverage of goods for processing, storage and distribution
[3] As at 1Q 2018, the net E&O excludes reserves revaluation changes. This practice is backdated to 1Q 2010

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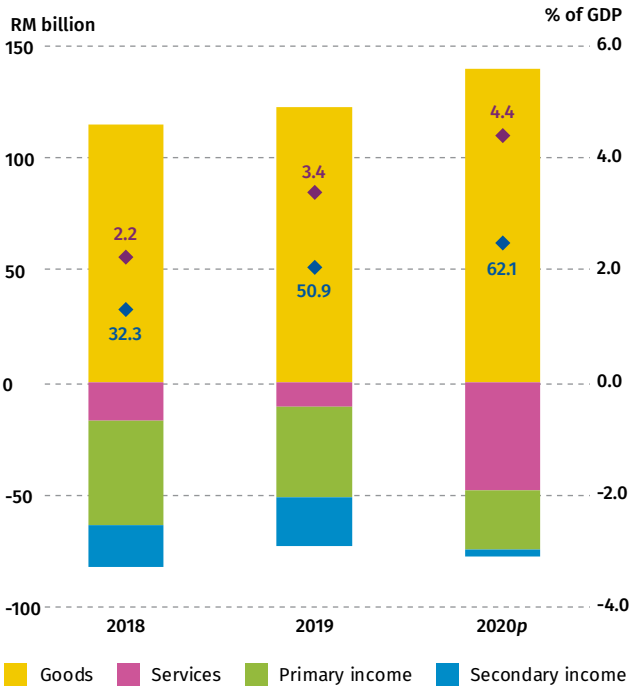
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1: Current Account Balance



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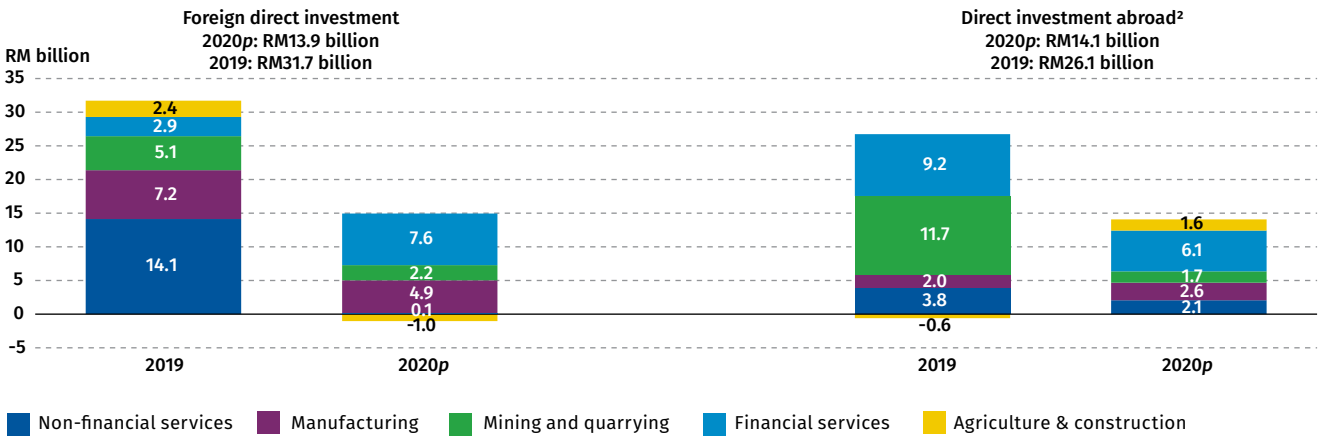
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

In 2020, the financial account recorded a higher net outflow of RM79.1 billion (2019: -RM33.8 billion). This was due mainly to higher outflows in the portfolio and other investment accounts.

Chart 2: Net Foreign Direct Investment and Direct Investment Abroad[1] by Sector



[1] Foreign direct investment and direct investment abroad as defined according to the Balance of Payments and International Investment Position Manual, Fifth Edition (BPM5) by the International Monetary Fund (IMF)
[2] Negative values refer to net inflows

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Note: Figures may not necessarily add up due to rounding

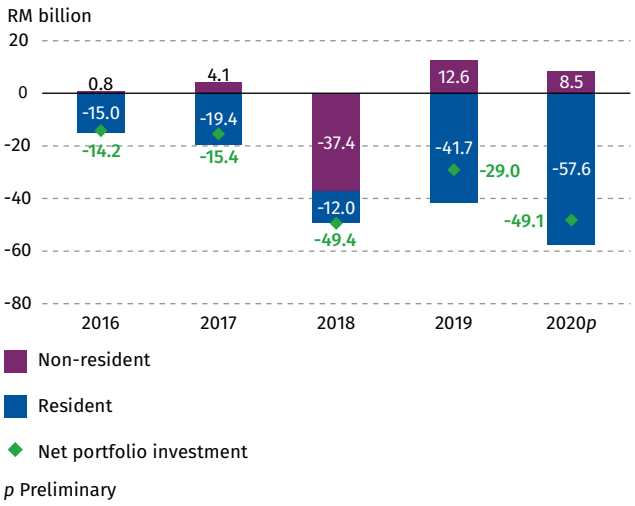
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The direct investment account registered a marginal net outflow of RM0.2 billion (2019: +RM5.6 billion) as net FDI inflows moderated to RM13.9 billion, equivalent to +1.0% of GDP (2019: +RM31.7 billion; +2.1% of GDP) amid the contraction in global economic activity, domestic lockdown measures to contain the pandemic and low

commodity prices. In the third quarter of the year, FDI recorded its first net outflow since 4Q 2009, driven by the significant outflows from debt instruments. Nevertheless, this was temporary as FDI recorded net inflows in the following quarter, supported by higher equity injections and inflows from debt instruments. Singapore (30.1% of net FDI for the year), Thailand (24.7%) and PR China (16.9%) were the top contributors to FDI for the year. By economic activity, the moderation in net FDI inflows was broad-based, driven mainly by the real estate and professional services industries as well as *manufacturing* and *mining* sectors. Despite the moderation in overall FDI, there were pockets of improvement for selected industries, most notably in the financial services and information and communication.

DIA outflows were lower at RM14.1 billion; -1.0% of GDP (2019: -RM26.1 billion; -1.7% of GDP). These investments abroad were mainly channelled into the financial services and information and communication services sub-sectors as well as *manufacturing* and *mining* sectors. Canada (30.7% of net DIA for the year), the United Kingdom (29.4%) and Indonesia (24.3%) were the major recipients of DIA in 2020.

Chart 3: Portfolio Investments



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Source: Department of Statistics, Malaysia and Bank Negara Malaysia

The portfolio investment account registered a higher net outflow of RM49.1 billion (2019: -RM29 billion), due mainly to higher resident investments abroad (-RM57.6 billion; 2019: -RM41.7 billion). These investments were driven by domestic institutional investors in both equity and debt securities, in line with their continued efforts to diversify risk exposures and enhance portfolio returns. Meanwhile, non-resident portfolio investment registered a smaller net inflow of RM8.5 billion (2019: +RM12.6 billion) as non-residents liquidated domestic equity securities amid significant global uncertainties during the COVID-19 crisis. This trend was also observed in other regional equity markets. This was partly offset by higher non-resident portfolio inflows in the domestic debt market, driven by the easing of global financial conditions and improvement in investor sentiment following the unprecedented policy support to address the adverse economic impact of the pandemic.

The other investment account recorded a net outflow of RM31.4 billion (2019: -RM9.9 billion), due to the net repayment of interbank borrowings and the withdrawals of deposit placements from the banking sector. This reflected lower external liquidity needs of onshore banks amid a sharp contraction in global and domestic economic activities and maturing back-to-back intragroup/branch borrowing and lending transactions by banks in the Labuan International Business and Financial Centre. Some domestic banks also benefitted from higher domestic foreign currency deposits, thus reducing the need for interbank funding from non-residents. Errors and omissions (E&O) amounted to -RM2.0 billion or -0.1% of total trade (2019: -RM9 billion, or -0.5% of total trade) during the year.

Malaysia's international investment position improved

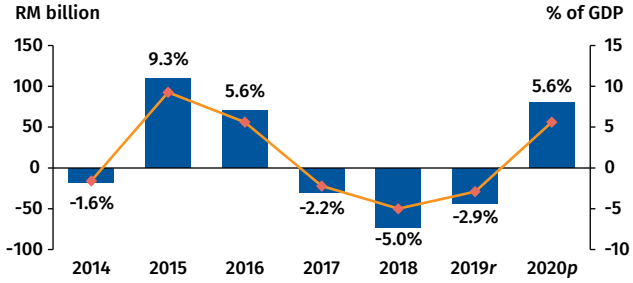
Malaysia's international investment position (IIP) turned around to register a net asset position of RM79.6 billion, equivalent to 5.6% of GDP as at end-2020 (2019: net liabilities of RM44.1 billion or -2.9% of GDP). On an annual basis, Malaysia last recorded a net external asset position in 2016 of RM70.2 billion or 5.6% of GDP.

Malaysia's external assets increased by RM139.6 billion in 2020, largely in the form of portfolio and direct investments by banks and corporates. Meanwhile, external liabilities increased by RM15.9 billion. The smaller increase in external liabilities reflected the net repayment of interbank borrowings, lower non-residents deposits and lower market revaluations of equity securities held by non-resident during the year due mainly to the adverse impact of the COVID-19 pandemic on equity prices.

The currency composition of Malaysia's IIP remained favourable in 2020. The net foreign currency (FCY) external asset position, that is, external assets denominated in FCY less FCY external liabilities, increased to RM1.1 trillion, or 75.1% of GDP (2019: RM930 billion, or 61.5% of GDP). Hence, periods of ringgit exchange rate depreciation will result in a larger increase in external assets compared to external liabilities, thus enhancing Malaysia's external position.

Banks and corporates registered a net external asset position, supported primarily by their large net FCY assets. These entities also held sizable liquid external assets amounting to RM700.9 billion (2019: RM617.8 billion), which can be drawn upon immediately to meet their external debt obligations.

Chart 1: Net International Investment Position (IIP)



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Source: Department of Statistics, Malaysia

Malaysia's external debt increased to RM958.5 billion as at end-2020, or 67.7% of GDP (2019: RM945.4 billion or 62.6% of GDP). The higher external debt reflected primarily net issuance of bonds and notes by corporates and higher non-resident holdings of domestic debt securities. These were partially offset by the lower interbank borrowings and non-resident deposits.

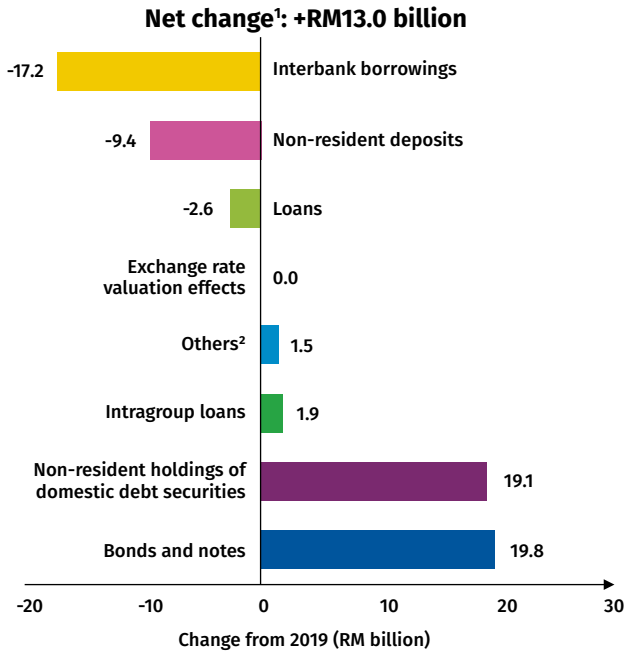
Risks surrounding Malaysia's external debt remained manageable in 2020 and were well contained given its more favourable maturity and currency profiles, coupled with the Bank's prudential and hedging requirements[17]. As at end-2020, the external debt-at-risk for corporates[18] and banks[19] amounted to RM26.4 billion and RM62.1 billion, respectively. Cumulatively, these amounted to 9.2% of Malaysia's total external debt and equivalent to 20.5% of international reserves.

[17] For more information on Malaysia's external debt management, please refer to "Malaysia's Resilience in Managing External Debt Obligations and the Adequacy of International Reserves" box article in BNM's Annual Report 2018 on external debt.

[18] Based on the assessment on about 70% of offshore loans raised and bonds issued by corporates. Debt-at-risk refers to debt for which estimated earnings and cash buffers are insufficient to repay their interest obligations.

[19] Refers to the portion of banks' external debt that were more susceptible to sudden withdrawal shocks. These include interbank borrowings (RM42.6 billion), financial institutions' deposits (RM15.9 billion) and other short-term debt (RM3.7 billion) from unrelated counterparties.

Chart 2: Changes in External Debt



[1] Changes in individual debt instruments exclude exchange rate valuation effects
[2] Comprises trade credits, IMF allocation of SDRs and other debt liabilities

Note: Figures may not add up due to rounding

Source: Ministry of Finance Malaysia and Bank Negara Malaysia

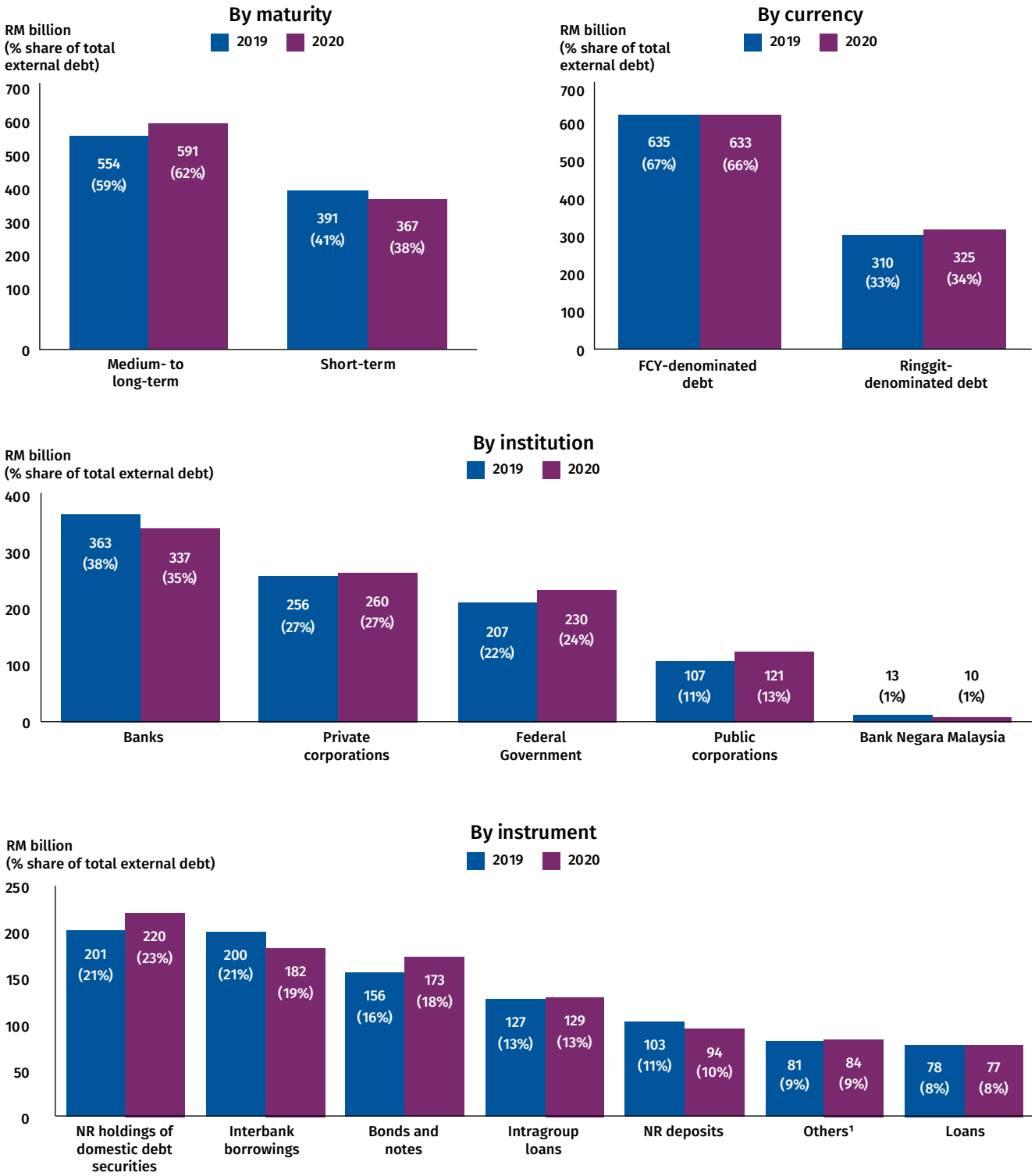
Proceeds from the net issuance of international long-term bonds and notes in 2020 were channelled primarily to finance the acquisition of assets abroad that would generate future income streams. Some of these issuances also reflected prudent and strategic capital management efforts by corporates to refinance at lower rates while extending the debt maturity profiles, amid the highly accommodative global and monetary conditions. This partly contributed to the rising share of medium- to long-term external debt during the year (end-2020: 61.7% share of total external debt; 2019: 58.6% share), thus further reducing rollover risks.

Slightly more than one-third of external debt was denominated in ringgit (33.9%; 2019: 32.8%), and therefore not affected by fluctuations in the ringgit exchange rate. The remainder of external debt that was denominated in FCY was largely subject to prudential requirements on liquidity and funding risk management[20]. Moreover, intragroup borrowings among banks and corporates accounted for 42.3% of FCY external debt, which are generally more stable and on concessionary terms. As highlighted earlier, banks and corporates held sizeable FCY external assets amounting to RM1.4 trillion. This further reinforced the repayment capacity of these entities to meet their external obligations.

BNM's international reserves in US dollar terms increased by USD4.0 billion to USD107.6 billion as at end-2020 (2019: USD103.6 billion), and was largely attributed to positive investment returns and revaluation gains on the Bank's reserve assets amounting to USD10.3 billion in 2020. The reserves position was sufficient to finance 8.5 months of retained imports and was 1.2 times the short-term external debt[21]. In 2020, the gross short position of FCY swaps declined to USD5.8 billion (2019: USD13.7 billion), reflecting the Bank's operations to manage liquidity in the domestic financial system.

[20] Including requirements imposed on banks under local banking regulations.
[21] For more information on BNM's international reserves, please refer to "Building Buffers: Roles and Functions of BNM's International Reserves" feature article in the Bank's Annual Report 2020.

Chart 3: Profile of Malaysia's External Debt (% share)

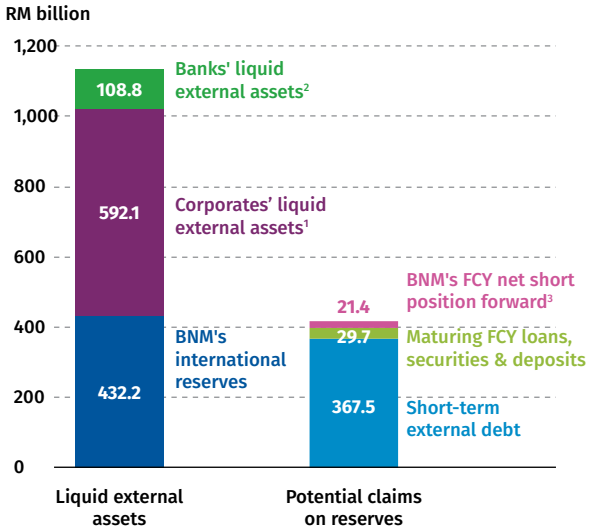


[1] Includes trade credits, IMF allocation of SDRs and miscellaneous, such as insurance claims yet to be disbursed and interest payables on bonds and notes

Notes: NR refers to non-resident
Figures may not necessarily add up due to rounding

Source: Bank Negara Malaysia

Chart 4: Liquid External Assets and Potential Claims on International Reserves



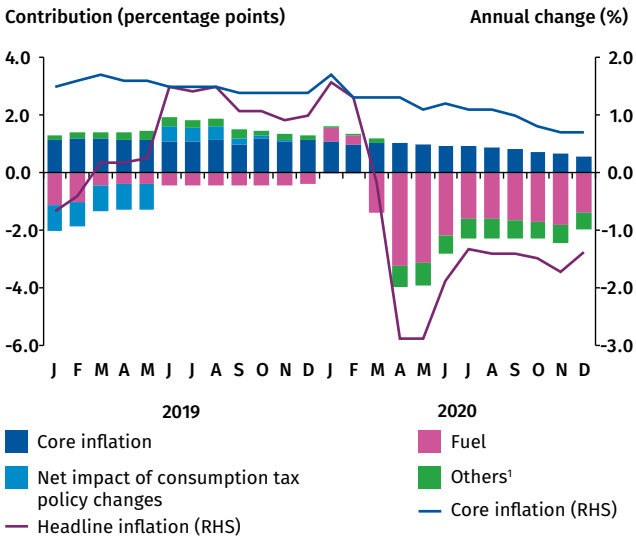
[1] Consist of portfolio investments, and currency and deposits
[2] Consist of deposits and interbank placements, bonds and notes and money market instruments
[3] Including the forward leg of currency swaps

Source: Bank Negara Malaysia

Lower headline inflation was primarily due to the decline in global oil prices

Headline inflation[22] was negative in 2020, averaging at -1.2% for the year. The negative headline inflation reflected the substantially lower retail fuel prices amid weaker global oil prices, and the implementation of the tiered electricity tariff rebate beginning in April till end-2020 (Chart 1.20). Despite the disruptions to economic activity during the year, the decline in prices was not broad-based. This was reflected by the limited share of Consumer Price Index (CPI) items recording month-on-month price declines during the year (2020 average: 19%; 2010-2019 average: 21%) (Chart 1.21). Underlying inflation, as measured by core inflation[23], remained subdued throughout the year, averaging at 1.1% (2019: 1.5%), amid spare capacity in the economy and weaker labour market conditions.

Chart 1.20: Contribution to Headline Inflation by Component

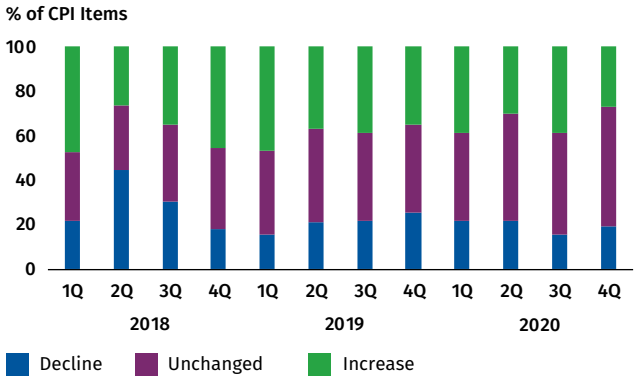


[1] Others include price-volatile items and other price-administered items

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

[22] Measured by the annual percentage change in the Consumer Price Index (CPI).
[23] Core inflation is computed by excluding price-volatile and price-administered items. It also excludes the estimated direct impact of consumption tax policy changes.

Chart 1.21: Month-on-Month Price Changes of CPI Items*



* Based on the month-on-month inflation for 125 CPI items at the 4-digit level

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

Unprecedented stimulus and policy measures played a crucial role to cushion the COVID-19 shocks to the Malaysian economy and to support growth recovery

Recognising the significant economic impact of the pandemic, Malaysia adopted a comprehensive and complementary policy approach during the crisis. This included the deployment of fiscal, monetary, financial, and other relevant measures (Table 1.4). Throughout this crisis, a series of stimulus packages worth a record-high amount of RM305 billion (20% of GDP) was unveiled to support the economy[24].

At the height of the crisis, the measures provided immediate relief to households and businesses by reducing the strain on their financial positions and safeguarding jobs. Direct fiscal support included cash transfers, tax incentives, and wage subsidies, while financial measures included the six-month automatic loan moratorium, the Targeted Repayment Assistance (TRA), credit guarantees, such as the Danajamin PRIHATIN Guarantee Scheme (DPGS), as well as various financing facilities for small- and medium-sized enterprises (SMEs). These were complemented by other initiatives such as the Employee Provident Fund (EPF) cash withdrawals (*i-Lestari*) and lower employee EPF contribution rate.

As the economy gradually improved, policy measures were geared towards supporting growth momentum, while still assisting the vulnerable segments. Notably, to reduce the risks of longer-term economic scarring and restore productivity growth, active labour market measures were implemented to upskill and reskill the unemployed into COVID-19-resilient industries via public-private collaborations and training subsidies. The Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) Act 2020 ("COVID Act") was also enforced in Malaysia since October 2020 to address firms' and individuals' inability to fulfil certain contractual obligations during this period of distress. Together with measures such as the extension of wage subsidies and various incentives to reinvigorate the tourism, automotive and property markets, they contributed towards preventing widespread business closures in the near- and medium-term.

Throughout the pandemic, the rapid shift in the way consumers spend and businesses operate meant that critical structural reforms needed to be expedited, particularly in automation and digitalisation, for the economy to adjust swiftly to the new normal. As a start, several initiatives were implemented towards the end of 2020 to support this agenda. These included the rollout of the national digital infrastructure plan (JENDELA), diverse sources of funds to spur digital investments, and the launching of the Micro and SMEs (MSME) E-Commerce Campaign to onboard these firms to online marketplaces.

[24] Refers to the PRIHATIN, PRIHATIN PLUS, PENJANA and KITA PRIHATIN stimulus packages. Further details can be found at the official online portal of the Ministry of Finance (https://www.treasury.gov.my/).

Table 1.4: Key Policy Measures during the COVID-19 Crisis in Malaysia

Policy Responses	Key Measures
Fiscal injection to ease cash constraints, support labour market conditions and reinvigorate spending and economic activities	• Bantuan Prihatin Nasional cash transfers to households • Wage Subsidy Programmes • Various tax incentives and relief – Individuals: Reduction in sales tax for passenger cars, tax relief for equipment for flexible working arrangements (FWA) and domestic travel, stamp duty and real property gains tax exemptions under the Home Ownership Campaign – Businesses: Accelerated capital allowance and tax deduction for specific purposes, automatic deferment of monthly tax instalment payments, tax incentive to attract relocation of businesses by foreign firms into Malaysia • Special payments and allowances (e.g. frontliners, gig workers)
Monetary stimulus to support domestic demand, reduce borrowing costs and facilitate continued credit intermediation	• Reduced OPR by 125 basis points between January to July 2020 to 1.75% • Reduced Statutory Reserve Requirement (SRR) ratio by 100 basis points to 2.00% • Flexibility for banking institutions to use Malaysian Government Securities (MGS) and Malaysian Government Investment Issues (MGII) to meet the SRR compliance
Comprehensive **financial** assistance across all segments of the economy to ease cash flow constraints and support growth	• Automatic loan moratorium for households and SMEs between April to September 2020 • Targeted Repayment Assistance (TRA) for vulnerable borrowers from October 2020 • Enhance access to financing and sustain cash flows of SMEs and microenterprises: – Special Relief Facility (SRF) – Micro Enterprises Facility (MEF) – Targeted Relief and Recovery Facility (TRRF) particularly for hard-hit firms in the *services* sector – PENJANA SME Financing (PSF) – Guarantee Scheme-PRIHATIN (GGS-PRIHATIN) • Promote reforms to boost quality investments and support viability in the new normal: – High Tech Facility-National Investment Aspirations (HTF-NIA) – Automation and Digitalisation Facility (ADF) for SMEs – PENJANA Tourism Financing (PTF) • Government Agrofood Facility (AF) – Increase agrofood production for Malaysia and for exports purposes • Danajamin PRIHATIN Guarantee Scheme (DPGS) for medium to large businesses
Other measures to support consumption and investment, enable firms to swiftly pivot and adapt to the new normal, and prepare the workforce for the future of jobs	• Raise individual disposable income – EPF *i-Lestari* Withdrawal between April 2020 – March 2021 – EPF employee contribution rate reduction from 11% to 7% • Accelerate digitalisation efforts – SME Digitalisation Matching Grant and SME Technology Transformation Fund – Rollout of a national digital infrastructure plan (JENDELA) to improve digital connectivity in Malaysia and build the foundation for the adoption of 5G technology • Promote workforce upskilling and training – Higher training allowance under the Employment Insurance Scheme (Training fee ceiling raised to RM6,000, RM30 training allowance per day) – RM100 million matching grant to HRDF under the Skills Training Fund – Global Online Workforce (GLOW) programme by MDEC (training to become freelancers for jobs in the digital economy, including programming, creative design, business and administrative support, and language-based roles)

Source: Prime Minister's Office, Bank Negara Malaysia and various news flows

Accommodative monetary policy supported domestic monetary conditions

In response to the economic crisis, the Monetary Policy Committee (MPC) of the Bank reduced the OPR by a cumulative 125 basis points to a historical low of 1.75% in 2020. The high degree of monetary accommodativeness was warranted given the highly challenging economic environment during the year.

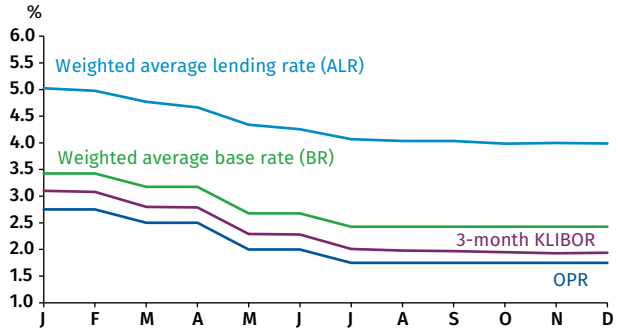
The pass-through of the OPR reductions to money market rates was strong and immediate across all tenures, which was supported by stable liquidity conditions in the interbank market (Chart 1.22). In navigating through periods of market volatility and uncertainty, the Bank's monetary operations were integral in facilitating orderly market conditions by ensuring sufficient liquidity to support the financial intermediation process. Arising from the increased volatility in capital flows and uncertainties in the domestic economic environment, banking institutions' practices in managing their liquidity profile shifted towards shorter maturities to better manage their liquidity needs. Consequently, the Bank shortened the tenure of its liquidity operations, with the average duration of liquidity absorbed by the Bank declining to 9.7 days as at end-2020, compared to 14.0 days as at end-2019. The reduction of the Statutory Reserve Requirement (SRR) ratio and additional flexibility for SRR compliance[25] further increased the liquidity available to banks. In safeguarding the orderly functioning of domestic money markets, the Bank also increased liquidity injection operations through the outright purchase of Government bonds and reverse repos. Despite net portfolio outflows for the year, total liquidity in the system remained sufficient at RM147.0 billion (2019: RM168.9 billion) (Chart 1.23). At the institutional level, all banking institutions maintained surplus liquidity positions with the Bank as at end-2020.

In line with lower rates in the wholesale market, banks also adjusted the deposit rates. As a result, fixed deposit (FD) rates for tenures between 1 to 12 months ranged between 1.51% and 1.75% as at end-2020. Nevertheless, despite lower nominal deposit rates, depositors continued to receive positive real rates of return throughout the year given the low and negative inflation.

Consequently, given the lower cost of funds, banks responded by lowering retail lending rates to households and businesses. With the reduced interest cost on floating rate loans, this improved the cash flows of existing borrowers given the lower debt-servicing burden.[26] In particular, the benchmark lending rate for retail loans, as measured by the weighted average Base Rate (BR) of commercial banks, was reduced by 125 basis points, from 3.68% to 2.43% by end-2020 (Chart 1.22).

New borrowers also benefitted from the low interest rate environment, given the broad-based decline in lending rates on new loans to both households and businesses across sectors and purpose. With the re-pricing of new and existing loans, the weighted average lending rate (ALR) on outstanding loans stood at 3.99% as at end-2020 (2019: 5.16%) (Chart 1.22). The low interest rate environment, in turn, provided a supportive environment for financing activity.

Chart 1.22: Policy, Interbank and Lending Rates (at end-period)

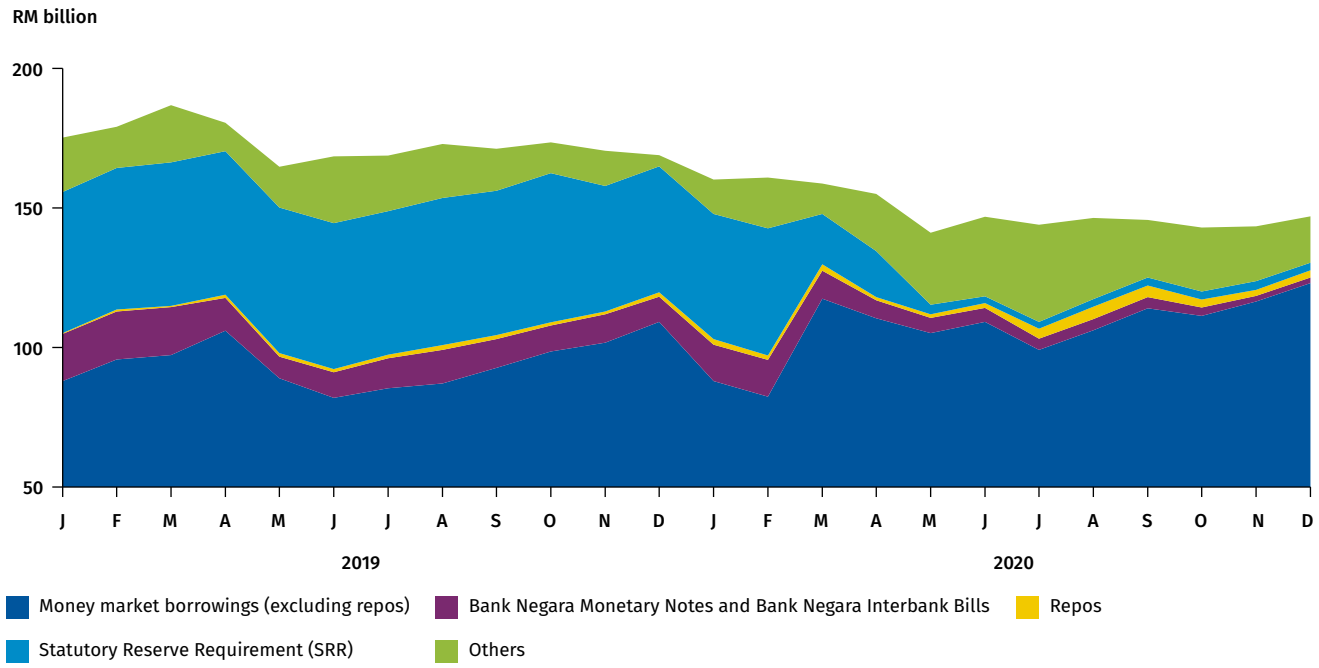


Source: Bank Negara Malaysia and Bloomberg

[25] The flexibility was initially provided to Principal Dealers (PDs) only in March 2020 where each PD could recognise Malaysian Government Securities (MGS) and Malaysian Government Investment Issues (MGII) of up to RM1 billion as part of the SRR compliance. However, the flexibility was extended to all banking institutions in May 2020, with no limit on the amount of MGS and MGII that could be recognised for SRR compliance. The flexibility would be available until 31 May 2021. In January 2021, this flexibility was extended until 31 December 2022.

[26] Existing borrowers under automatic loan moratorium or repayment assistance still benefitted from the lower interest costs and enjoyed lower instalment payments when repayments resumed.

Chart 1.23: Outstanding Ringgit Liquidity Placed with Bank Negara Malaysia (at end-period)



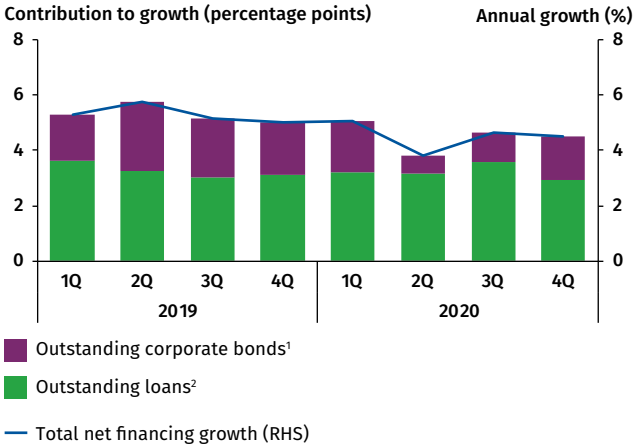
Source : Bank Negara Malaysia

Overall financing activities were broadly sustained amid various policy support

Financing activity continued to expand in 2020, despite the challenging economic environment. The sound banking system and continued functioning of capital markets ensured that credit intermediation continued throughout the crisis. The flow of credit to the private sector was supported by the low interest rate environment, sufficient liquidity and extensive stimulus measures. Financing activity troughed in April and May 2020 as demand for financing declined in tandem with significant disruptions in economic activity. The movement restrictions and adjustment to new working norms also led to some initial delays to the administrative aspects of the loan application and approval processes. Nevertheless, financing gained momentum in June 2020 as business activity resumed, supported by additional measures put in place to ensure continued access to funds for all segments of the economy. The rebound in financing activity was particularly strong for the household segment. For the year, net financing grew by 4.5% (2019: 5.0%) (Chart 1.24), with the growth in outstanding loans broadly sustained at 3.9% (2019: 4.1%) (Chart 1.25). Outstanding corporate bonds, however, grew at a slower rate of 6.5% (2019: 8.0%).

Outstanding household loans recorded a growth of 5.5% in 2020 (2019: 5.5%). The support to the sustained growth was two-pronged: lower repayments given the six-month automatic loan moratorium; and the strong rebound in loan disbursements since June 2020, supported by low lending rates and the Government's stimulus measures. Measures targeted for the household

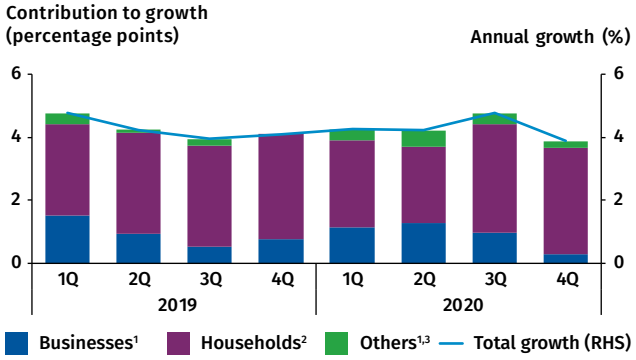
Chart 1.24: Total Net Financing through Banks, Non-Bank Financial Institutions and Corporate Bonds



[1] Excludes issuances by Cagamas and non-residents
[2] Loans from the banking system, development financial institutions (DFIs) and major non-bank financial institutions (NBFIs)

Source: Bank Negara Malaysia

Chart 1.25: Outstanding Loans by Borrowers



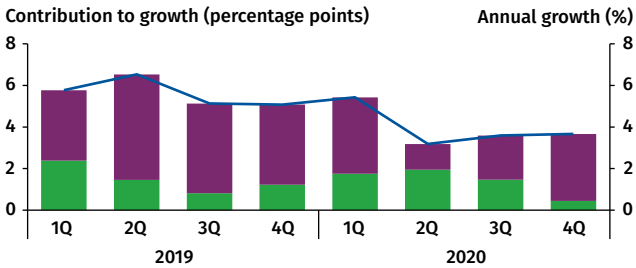
[1] Loans from the banking system and development financial institutions (DFIs) only
[2] Loans from the banking system, DFIs and major non-bank financial institutions (NBFIs)
[3] Includes loans of financial institutions, NBFIs, Government, domestic other entities, and foreign entities

Source: Bank Negara Malaysia

segment included the Home Ownership Campaign and the sales tax relief on new vehicles. The effectiveness of the measures was apparent as loans extended for the purchase of residential property and passenger cars saw the strongest growth among all loan purposes.

In contrast to the household segment, the growth in financing to businesses was more moderate. Net financing extended to businesses through the banking system and the corporate bond market grew at a slower pace of 3.7% (2019: 5.1%) (Chart 1.26). Overall, amid the uncertainties surrounding the weaker economic environment, businesses scaled down their operational capacity and postponed their expansion plans, thereby

Chart 1.26: Businesses: Net Financing through Banks, Development Financial Institutions and Corporate Bonds



[1] Excludes issuances by Cagamas and non-residents

Source: Bank Negara Malaysia

reducing their financing demand, particularly for investment activities.

The crisis led to severe disruptions to businesses' cash flow and profitability, which resulted in increased uncertainty over their longer-term viability. Given the increased challenges in accurately assessing the credit profile of the borrowers,[27] as well as risks of higher defaults and a more protracted recovery, banks became more cautious in extending financing to higher-risk segments, particularly for borrowers and sectors that were hardest hit by the pandemic. Nonetheless, the banking industry has continued to support viable borrowers throughout this period, by undertaking additional measures to complement credit risk assessments, including more extensive background checks, the use of alternative information sources, as well as more frequent engagements to better assess the borrowers' financial and operating conditions. Financial buffers built over the years also helped preserve the ability of banks to support lending, while reducing risk aversion that could amplify stresses in the economy. In line with this, the Bank accorded regulatory flexibilities to allow banks to draw down on the capital conservation buffer of 2.5%, operate below the minimum liquidity coverage ratio of 100%, and utilise regulatory reserves that were previously set aside.

In recognising that access to financing is paramount to support economic recovery, various measures were introduced to ensure the continued flow of financing to all segments of the economy. The measures (Table 1.4) included a variety of special funds for SMEs and credit guarantees for both SMEs and corporates. For instance, at the onset of the crisis, there was high demand for working capital financing as disruptions to business operations due to the MCO increased the cash flow needs of businesses. To this end, to provide support for viable SMEs that faced tighter financing conditions in sustaining their business operations and safeguard jobs, the Bank established the Special Relief Facility (SRF) to provide working capital financing at concessionary rates to affected SMEs. The SRF was paired with credit guarantees[28] to further incentivise bank lending to

[27] A key challenge for banks in monitoring credit risk developments in 2020 was due to the absence of borrowers' repayment information given the extensive coverage of the loan moratorium.
[28] The credit guarantees were provided by *Syarikat Jaminan Pembiayaan Perniagaan* (SJPP) and Credit Guarantee Corporation Malaysia Berhad (CGC), with a guarantee coverage of 80% at a subsidised guarantee fee of 0.5% per annum. The 80% guarantee coverage took into consideration the optimal risk-sharing practices to ensure that the coverage was sufficiently high to encourage banks to lend, while retaining some risks on banks' balance sheet to curtail potential moral hazard issues.

the affected segments amid the heightened risk environment. This was further supplemented with funds such as the PENJANA SME Financing (PSF) and PENJANA Tourism Financing (PTF) schemes, as well as the Targeted Relief and Recovery Facility (TRRF) towards the end of the year to provide further relief and support the recovery for affected SMEs. The DPGS was also established by the Government to provide support for medium to large businesses. Collectively, these measures yielded positive results. Loans continued to be disbursed to COVID-19-vulnerable sectors, such as the wholesale and retail trade, and restaurants and hotels sectors. As sentiments improved, there were incipient signs of a modest and gradual recovery in demand for investment financing during the second half of the year. Activity in the corporate bond market also increased towards the end of the year, supported by favourable market conditions.

The Bank's Monetary Policy Considerations

Frontloading of monetary stimulus through swift and sizable OPR reductions ensured accommodative monetary conditions to cushion the COVID-19 economic impact and support economic recovery

The OPR was reduced by a cumulative 125 basis points on four occasions[29] in 2020, bringing it to a historical low of 1.75%. The thrust of monetary policy throughout the year was to provide support and minimise long-term scarring effects to the economy amid the unprecedented global health crisis. The pre-emptive 25 basis point reduction in the OPR in January 2020, which was undertaken to secure the growth trajectory amid price stability in view of the downside risks to the global and domestic growth outlook, provided some support to the economy as it entered the crisis. As shocks from the pandemic culminated in a global economic crisis, the OPR was further reduced by 25 and 50 basis points in March and May 2020 respectively to cushion the economic impact on businesses and households. The easing of monetary policy was necessary given the severe disruption in economic activity following the imposition of the MCO to contain the outbreak. In an environment where incomes were affected by the slowdown in economic activity, the OPR reductions helped ease debt-servicing burdens and total borrowing costs, thus alleviating cash constraints and providing support to financing for households, SMEs, and corporates. This was crucial to mitigate the impact of the large shock on economic activity and minimise the risks of job displacements.

While the domestic economy had begun to recover from the trough in the second quarter of 2020, the OPR was further reduced by 25 basis points in July to accelerate the pace of economic recovery. In the fourth quarter of the year, the resurgence in COVID-19 infections led to the re-imposition of containment measures in some states. Nevertheless, growth for the year 2020 was expected to be within the earlier forecasted range and economic activity was projected to improve further in 2021. Considering the sizeable monetary policy easing earlier in the year, as well as the positive impact from other financial and regulatory relief measures by the Bank and the substantial fiscal stimulus, the MPC considered the prevailing monetary policy stance to be appropriate and sufficiently accommodative. As such, the OPR was left unchanged for the remainder of 2020. Nevertheless, given the downside risks to the growth outlook amid the ongoing global and domestic uncertainties surrounding the pandemic, the MPC would continue to be vigilant in assessing the evolving conditions and their implications on the overall outlook for domestic inflation and growth.

The Bank adjusted the SRR to support financial intermediation activity

The SRR was adjusted as part of the Bank's continuous effort to ensure sufficient liquidity in the system to safeguard the financial intermediation process. The SRR is an instrument to manage liquidity and is not a signal on the stance of monetary policy. The adjustments were made at the onset of the crisis in March and May 2020, which included a 100 basis points reduction in the SRR ratio from 3.00% to 2.00%, alongside temporary flexibility for banking institutions to recognise MGS and MGII as part of SRR compliance. The liquidity released through these combined measures, which amounted to approximately RM46 billion, allowed greater flexibility for banking institutions in their liquidity management, and to some extent, supported the continued smooth functioning of the domestic bond market. The SRR adjustments, coupled with the Bank's other liquidity-injecting operations, enabled banking institutions to continue to effectively perform their role in the credit intermediation process.

[29] 25 basis points each in January, March, and July; and 50 basis points in May.

A Vision for Social Protection in Malaysia

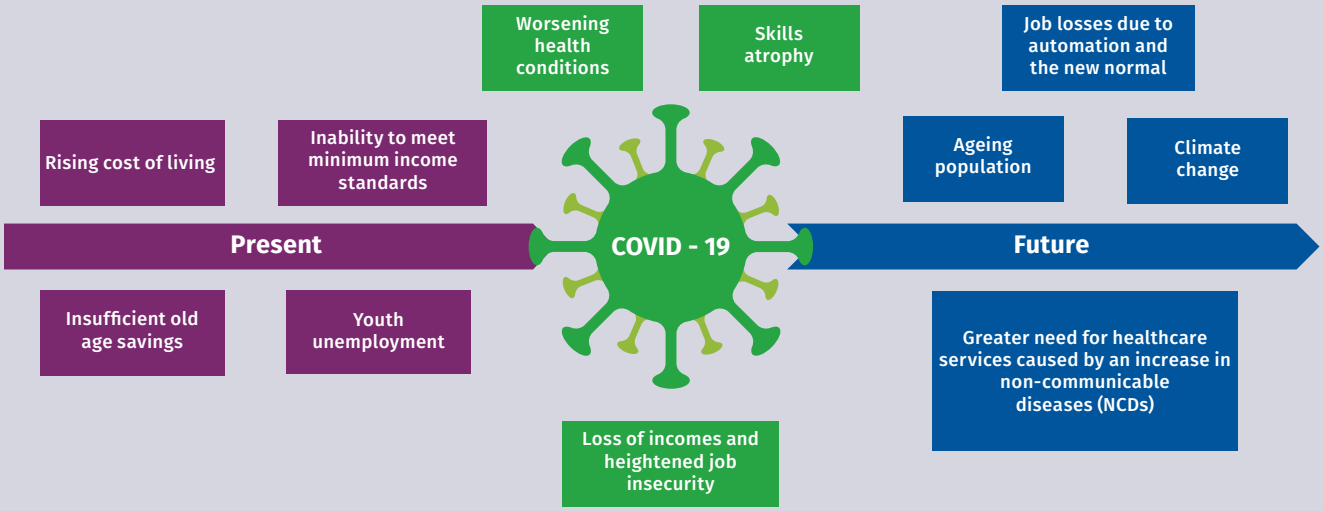
Social protection as a safeguard against socioeconomic vulnerabilities

Social protection, broadly, includes all public policies designed to provide protection for individuals against economic and social distress. There are three types of policies that fall under social protection,[1] namely, social safety nets, social insurance, and active labour market policies (ALMPs).[2] Besides reducing society's vulnerabilities to various economic risks, social protection policies also serve as important macroeconomic stabilisation tools.

The COVID-19 pandemic and the economic crisis that ensued have damaged people's lives and livelihoods around the world. In response to the health and economic crises, most governments around the world have strengthened their social protection policies. Much-needed support was channelled to the most vulnerable groups. The unprecedented scale and impact of the pandemic, however, have pushed current social protection systems in many countries to their limits, necessitating ad-hoc fiscal support to supplement them.[3]

Malaysia's social protection system was not spared from these challenges. The pandemic has unearthed deep structural issues surrounding the prevailing social protection framework in the country. Critical issues include, fragmented and overlapping programmes,[4] gaps in overall coverage, inadequacy of programmes to comprehensively address socioeconomic vulnerabilities,[5] and fiscal challenges. Implementing reforms to narrow these gaps is therefore vital to address these fundamental issues that affect a sizeable proportion of our population and residents of this country (Diagram 1). This would strengthen the foundations to future-proof the social protection system and help individuals secure access to better opportunities to protect and enhance their well-being. Reforms would also enhance the counter-cyclicality of policy support for the economy

Diagram 1: Socioeconomic vulnerabilities faced by Malaysians



Source: Bank Negara Malaysia

[1] Refer to Table 1 in the mini box on the global evolution and landscape of social protection.
[2] Active labour market policies (ALMPs) refer to all social spending (other than on education) aimed at enhancing the employability of workers or increasing their earnings capacity (simplified definition based on the Organisation for Economic Co-operation and Development (OECD) and International Labour Organization (ILO)).
[3] According to the United Nations (UN), in response to the COVID-19 impact, over 1,400 social protection measures have been deployed, many of which are short-term measures (UN Special Rapporteur, 2020). The ad-hoc nature of these responses indicates that social protection systems were insufficient in providing support and resilience against the pandemic.
[4] World Bank, 2015.
[5] Even in the years leading up to the COVID-19 pandemic, the World Bank highlighted the need to address under-coverage and low adequacy of social protection in Malaysia, particularly for the elderly (World Bank, 2015). The COVID-19 pandemic also emphasised the need to increase coverage for self-employed and informal sector workers.

in facing future health, environment, social, and economic shocks. This article aims to provide an overview of the evolution and landscape of social protection systems (refer to the mini box), examines the current state of social protection in Malaysia, and provides several ideas on the design of a more effective social protection system for Malaysia.

The Global Landscape of Social Protection

In essence, the three main pillars of social protection comprise protection, prevention, and promotion, or universally known as the 3Ps (Table 1). The 3Ps aim to ensure basic needs are met, resilience against poverty is achieved, and economic potential is maximised. The 3Ps collectively play a significant role in macroeconomic stabilisation, especially in minimising the impact of scarring during economic downturns. A risk that many countries face is an over-reliance on social safety net policies, which fall under 'Protect'. While these are politically popular and relatively easier to implement, an over-reliance on social safety net policies would undermine or even nullify the primary goal of ensuring poverty eradication. Protection of the vulnerable could also be compromised due to the heavy strain on public finances arising from over-spending on social safety nets. Research and cross-country experience have predominantly shown that a more balanced approach that draws on the complementarities of the 3Ps would result in a more effective and holistic social protection system (Diagram 2).

Table 1: The 3Ps of Social Protection

	Social Safety Net	Social Insurance	Labour Market Policies
Definition	Non-contributory* interventions designed to reduce poverty and vulnerability	Contributory* interventions that improves people's ability to protect themselves against shocks to income	Contributory or non-contributory* interventions designed to promote efficient labour market outcomes
Primary objective	**Protect:** Ensuring basic needs/rights are met (e.g. housing, health, education) and eradicating poverty	**Prevent:** Providing resilience to individuals and families from shocks to prevent poverty	**Promote:** Enhancing economic opportunities and potential of individuals
Available tools	Cash transfers, in-kind benefits (e.g. free schooling), and housing benefits	Pensions, income insurance schemes	**Active**: Job placement programmes, job incentives **Passive**: Minimum wage, worker protection laws
Policy considerations	While it is universal and should be prioritised by Low Income Countries (LICs) and Emerging Market Economies (EMEs), these policies tend to strain fiscal resources	Balances fiscal sustainability with comprehensive support; should be prioritised if citizens are able to make contributions	Passive policies should be implemented universally, with active policies complementing to boost labour productivity in the long-run
Key strengths	Provides basic needs universally and directly	Comprehensive support provided with the least impact to fiscal coffers	Passive labour policies provide protections for workers, while active policies facilitate labour mobility and encourage upskilling to increase productivity of workforce
Key drawbacks	Heavy strain on fiscal position results in unsustainability if relied on exclusively in the long-term	Requires citizens to be able to make contributions and does not immediately protect the most vulnerable	While policies are typically universally available, they do not directly alleviate critical vulnerabilities (e.g. poverty)
Fiscal strain	Typically high, especially for LICs and EMEs	Small fiscal strain since policies are contributory in nature	Moderate fiscal strain to fund active labour market policies (ALMPs) as most are market-financed

*The definition of contributory and non-contributory will be defined in the subsequent paragraphs

Source: Bank Negara Malaysia, World Bank, ILO

Diagram 2: Benefits of complementarities of 3Ps in social protection

* Active labour market policies (ALMPs) refer to all social spending (other than on education) aimed at enhancing the employability of workers or increasing their earnings capacity (simplified definition based on the OECD and ILO)

Source: Bank Negara Malaysia

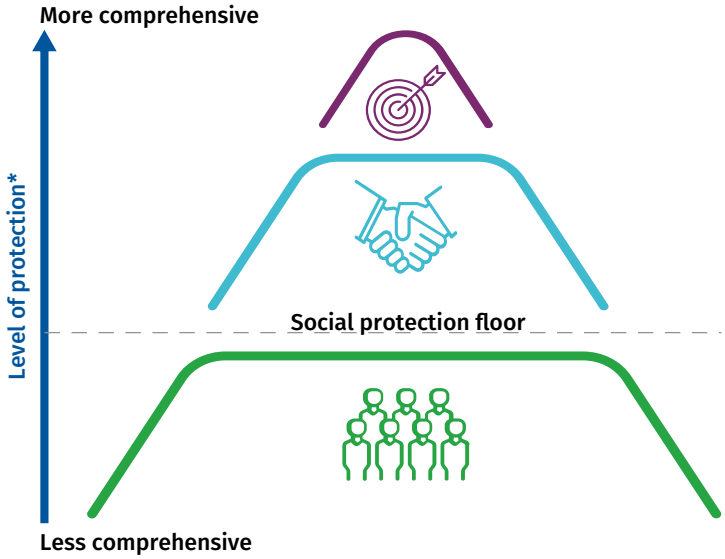
For each of the pillars in the 3Ps, the coverage of protection would differ depending on how they are funded (Diagram 3). The first stage consists of basic needs or is also known as the social protection floor and is mainly provided by the Government. This includes access to essential health care and basic income security to prevent individuals from falling into poverty. This is followed by protection provided by mandatory contributions, where individuals pay a small percentage of their wages towards injury and income security schemes. The mandatory nature of these policies ensures that there is a large pool of contributors with mixed levels of risk. This is a crucial aspect of mandatory contributory schemes as it allows individuals who have relatively low wages to obtain income and injury protections.

As these policies only provide basic injury[6] and income protection, the private sector can supplement them with more comprehensive coverage. Voluntary contributions, however, involve a higher premium relative to the mandatory schemes and would thus rely on workers having higher incomes to afford them. These policies thus go beyond alleviating poverty to increasing income resilience at higher levels.

A comprehensive social protection system would also account for the unique vulnerabilities faced at different life stages (Diagram 4). Typically, policies would tend to gravitate towards the provision of contingencies during a person's working years, as this is the stage of life when most people are

[6] Injury protections in this context refer to protections for injuries in the workplace, such as those provided by Social Security Organisation (SOCSO) in Malaysia.

Diagram 3: Level of coverage for social protection policies based on funding



Funding mechanism

Voluntary contributions

Take-up of private insurance and/or retirement schemes to complement mandatory public-driven protections

Mandatory contributions

Mandatory social insurance and/or social security benefits for contributors (e.g. pensions, income insurance, injury protection)

Basic needs, usually provided by the Government.

The ILO highlights four essential guarantees that should be provided to residents:

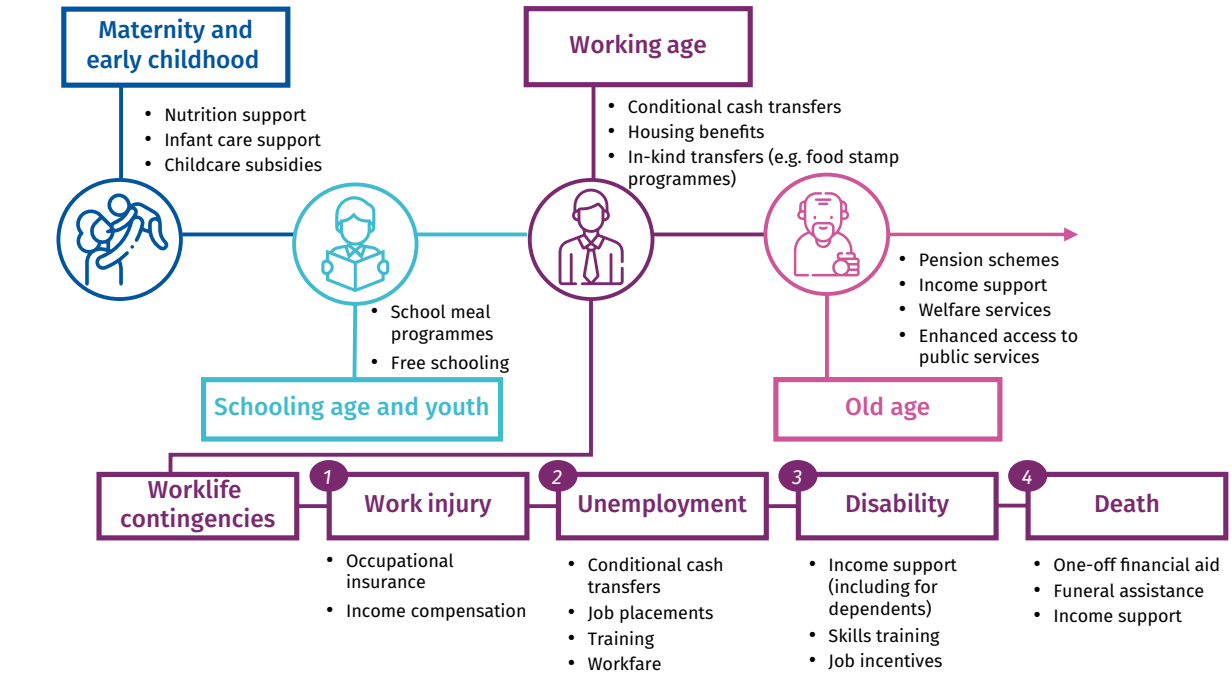
1. Access to essential health care (e.g. health services, sanitation, portable water, shelter);
2. Basic income security for children, access to nutrition, education, care and any other necessities;
3. Basic income security for working-age individuals with insufficient incomes, especially if due to sickness, unemployment, maternity and/or disability;
4. Basic income security for the elderly.

* Level of protection refers to the coverage of social protection. However, this depends on the funding mechanism. Beyond the basic needs, which is typically provided by the Government, the coverage of social protection could expand as the funding mechanism broadens to include mandatory and voluntary contributions

Source: Bank Negara Malaysia, ILO and UN framework for Social Protection Floor

income-earners with financial dependents. However, vulnerabilities ought to be optimally addressed not only during working years but also in different stages in life. This would ensure equal economic opportunity, quality of life, and social cohesion (Diagram 4).

Diagram 4: Life cycle approach to social protection



Source: Bank Negara Malaysia, ILO

Finally, the design of a robust social protection system should also ensure long-term sustainability and continuity. Design considerations must therefore be comprehensive and focus on the specific conditions and priorities of a particular economy. For example, countries that are able to design social protection systems that are both universal and efficient rely on the government having ample and sustainable revenue-generating capacity. Should governments find themselves with less capacity for revenue-generation, trade-offs must be made in the policy design. To illustrate, the various European social protection modalities in existence today can provide insights on this balancing act (Table 2).

Table 2: Cross-comparison of different welfare models in Europe

	Nordic	Anglo-Saxon	Continental / Bismarckian	Mediterranean / Southern
Poverty level	Low	Low	Moderate	High
Taxation level	High	Moderate	Moderate	Weak collection
Key identifiers of welfare model	Generally universal support from government	Some universal protection (e.g. healthcare), though generally provides more means-tested assistance	Some universal protection (e.g. childcare support), but emphasises job security with social insurance and labour regulations	Welfare is largely family-oriented, though government provides generous protection to elderly (e.g. pensions, early retirement)
Principal source of social protection support	Government and local authorities; redistributive taxation	Government redistribution for the unemployed, social insurance for the employed	Market-driven, with additional reliance on social insurance	Market-driven; local governments; family and self-support
Strengths	Highly egalitarian and progressive	Comprehensive support with only moderate taxation	Workers enjoy a high level of support	Comprehensive care for elderly (e.g. pensions, public services)
Weaknesses	Could be difficult to implement in less wealthy countries	Implementation challenges such as long wait times and funding shortages	Reliance on social insurance entails less benefits for those contributing less or facing employment challenges	Generally insufficient protection provided to the overall population

Source: Adapted from Popova et al. (2013)

The Nordic model of social protection is generally the most generous and comprehensive. Support is universally provided across almost all vulnerable groups, financed by substantial revenues from the high taxation rates of its high-income residents. Countries with less revenue-generating capacity than Nordic countries could face problems adopting this model. Internalising this lower taxation appetite, the Anglo-Saxon model provides for universal healthcare but relies on a means-tested approach for other forms of assistance. The Bismarckian model utilised by Germany, focuses primarily on social protection provided via the labour market. Lastly, the Mediterranean model is an example of how governments can still provide support despite significant resource limitations. Countries that adopt this model (e.g. Italy and Spain) leverage largely on welfare, and especially healthcare, being family-oriented (for example, by providing tax or cash transfer benefits for family care).[7]

These models highlight the need for trade-offs in policy design to ensure social protection systems remain sustainable in the long-term, unless broader revenue collection enhancements can be made. For Malaysia, while our current approach is closer to the Anglo-Saxon model, the coverage is comparatively more limited. This underscores the need for a policy review and a redesign of social protection policies.

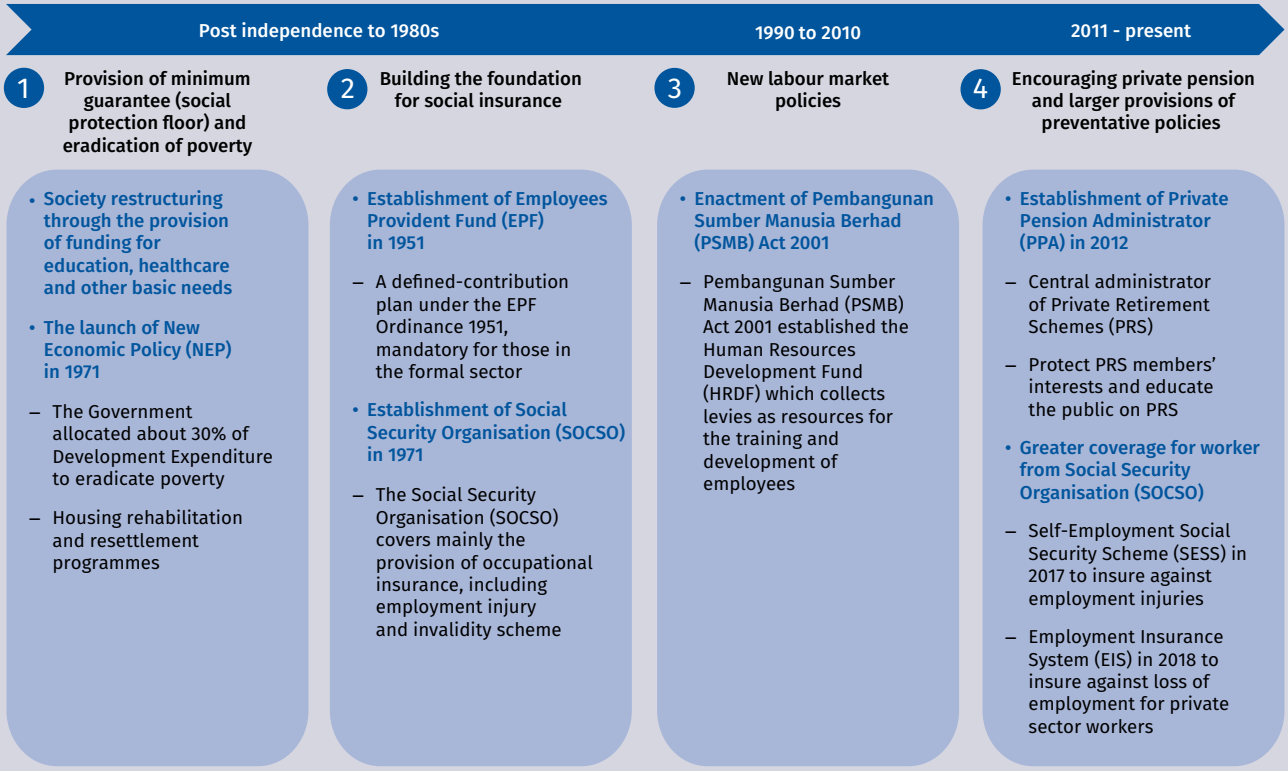
[7] This multi-generational approach to social protection with the family unit as a source of security can also be seen in Eastern Europe. For details on the 'Familistic' welfare model of Italy and Spain, refer to Leon and Migliavacca (2013).

Giving the Malaysian Social Protection System a New Lease of Life

The evolution of Malaysia's social protection system

Similar to other developing countries, the social protection system in Malaysia began as early as the post-independence period. Social protection was first provided via public programmes which focused on social safety nets through the provision of basic needs such as education, healthcare, and sanitation facilities. This was subsequently complemented by the development of the foundations for both social insurance policies and active labour market policies (ALMPs) (Diagram 5). While these were important strides towards developing a comprehensive social protection system in Malaysia, most of the measures were somewhat episodic, introduced in response to periods of economic stress. A systematic, thorough, and holistic review of the social protection system is therefore warranted to ensure social protection policies are more comprehensive, inclusive, sustainable, and equipped to meet its intended objectives.

Diagram 5: Evolution of social protection policies in Malaysia



Source: Bank Negara Malaysia

The New Economic Policy (NEP), which was introduced in 1971, provided monumental strides towards the eradication of poverty.[8] These efforts resulted in a sharp decline in absolute poverty,[9] from 12.9% of the total population in the early 1980s to around 0.2% of the total population in 2015, in comparison to the global poverty ratio, which stood at 26.6% of the total global population in 2015. While remarkable strides have been made in terms of eradicating absolute poverty, the measurement of relative poverty,[10] which stood at 16.9% of the total

[8] The Government spent almost a third of its Development Expenditure on poverty eradication measures (Mansor and Awang, 2002).
[9] Based on World Bank's poverty headcount ratio at $3.20 a day (2011 PPP).
[10] Unlike absolute poverty, which is measured based on affordability of basic necessities, relative poverty is measured against the median income of households. A household is considered to be in relative poverty if the total household income is less than half of the median income of all households, which stood at RM5,873 in 2019 (Source: DOSM). The number of households in relative poverty could be reduced, for example, by ensuring income growth of those below and slightly above the poverty line is higher than the income growth of those at the higher end of the income spectrum. Further details can be found in Khazanah Research Institute's (KRI) publication "The Absolute vs Relative Poverty Conundrum" in 2019.

households in 2019, shows that significant improvements can still be made. This highlights the importance of complementing income support with active labour market policies (ALMPs) to sustainably enhance productivity and boost incomes, particularly for low-income groups.

The foundations for a social insurance system were also built through the establishment of the EPF in 1951 and SOCSO in 1971. While public sector employees are protected by the Government's pension scheme, employees in the private sector as well as their employers are mandated by the EPF Act 1991 to contribute to the EPF private sector retirement scheme. This, together with SOCSO's occupational insurance schemes and more recently the Self-Employment Social Security Scheme (SESS)[11] introduced in June 2017 as well as the Employment Insurance System (EIS) in January 2018, have bridged some of the gaps in Malaysia's social insurance landscape. The Government's focus over the past decade in encouraging private retirement schemes, for example by establishing the Private Pension Administrator (PPA) and introducing the tax incentives for Private Retirement Scheme (PRS) and deferred annuity products in 2012, will further enhance the robustness of social protection. There were also efforts to enhance the mobility of Malaysia's labour force. In 2001, the Government established the Human Resources Development Fund (HRDF) to retain and upgrade the skills of local employees, apprentices and trainees to be in line with business needs.

In response to the economic impact of both the COVID-19 pandemic and the subsequent movement restrictions, the social protection system has proved vital in ensuring vulnerable groups were protected. The processes and databases built by various Government entities facilitated an efficient deployment of stimulus measures. For example, SOCSO's existing infrastructure laid the groundwork for the disbursement of wage subsidies, while the database created for disbursement of Bantuan Sara Hidup (BSH, now known as Bantuan Prihatin Rakyat or BPR) through Lembaga Hasil Dalam Negeri (LHDN)[12] allowed for cash handouts to be distributed directly and seamlessly to those in need.

As effective as this infrastructure was, the magnitude and scale of the pandemic revealed critical gaps in the social protection system. These gaps came in the form of effectiveness, implementation, as well as sustainability, involving all pillars of the social protection. A holistic review of the entire social protection system is needed to ensure its continued ability to act as an automatic stabiliser during crisis periods. Emphasis needs to be given to ensure more efficient delivery, better coverage of the most vulnerable, and improved labour mobility in order to reduce the over-reliance on social safety nets.[13]

Social safety nets: Over-reliance on social safety net programmes with weak targeting and verification capacity risks undermining policy effectiveness

Currently, most of the fiscal outlay for social protection programmes in Malaysia goes towards social safety nets. This is predominantly the result of fragmented policies managed by multiple agencies at both Federal and State Government levels.[14] Despite the sizeable expenditure of RM17.1 billion in 2019 (1.1% of GDP[15]), the payout amounts under each programme tended to be small and insufficient to ensure that the most vulnerable households were able meet minimum income and living standards, as allocations are spread over more than 60 programmes. The fragmentation also resulted in overlapping and identical assistance being provided (e.g. education support) and managed by several different ministries (Table 3). Inadvertently, this together with the existence of numerous databases[16] managed by multiple agencies[17] made verification and enforcement particularly challenging and has led to leakages (e.g. double-dipping issues).

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[11] SESS mandated contributions from self-employed workers in 20 sectors (e.g. passenger transportation, online business, and fisheries) on 1 June 2017, while the EIS came into effect on 1 January 2018 and provided unemployment benefits.
[12] LHDN (Inland Revenue Board of Malaysia in English) is Malaysia's tax collection authority.
[13] A different perspective along with policy recommendations on this topic can be found in the Box Article: "Getting the Great Reset Right: Structural Labour Market Issues in the Post-COVID-19 World".
[14] The ministries in charge of managing social safety net programmes include the Ministry of Women, Family, and Community Development; Ministry of Health; Ministry of Education; Ministry of Human Resources; Ministry of Rural and Regional Development; Ministry of Housing and Local Government; Ministry of Agriculture and Agro-Based Industry; and other public departments and agencies (Samad and Shahid, 2018).
[15] Based on the World Bank's Atlas of Social Protection Indicators of Resilience and Equity (ASPIRE), regional countries have spent similar amounts on social safety nets. Based on latest available data, this includes Vietnam (2016: 1.9% of GDP), Cambodia (2015: 0.9% of GDP), the Philippines (2016: 0.7% of GDP), Indonesia (2016: 0.7% of GDP) and Thailand (2011: 0.5% of GDP).
[16] Additionally, records for some of these social safety net programmes are also still managed manually.
[17] The high level of bureaucracy and the lack of central coordination would also reduce efficiency of disbursements as qualifying recipients must make applications through several entities, each with their own verification process.

Table 3: Social Protection Programmes in 2019

	Social Welfare Department	MOE	MoF/IRBM	Department of Orang Asli Development	Others
Social Safety Net	**9**	**8**	**3**	**1**	**1**
Disability benefit	3				
Education support	1	5	2	1	
Family benefit	2				
Housing benefit	1				1
Income support	1		1		
Old age support	1				
Nutritional support		3			
Social Insurance					**4**
Pension schemes					2
Occupational insurance					2
Active Labour Market Policies	**4**	**3**			**9**
Education support		3			
Job incentive	2				
One-off assistance	1				
Training/Enterpreneurship	1				5
Passive policy					3
Job matching					1
Others	**3**	**5**	**1**		**9**
Education support		5			
One-off assistance	3				
Consumer subsidy			1		
Affordable housing					9

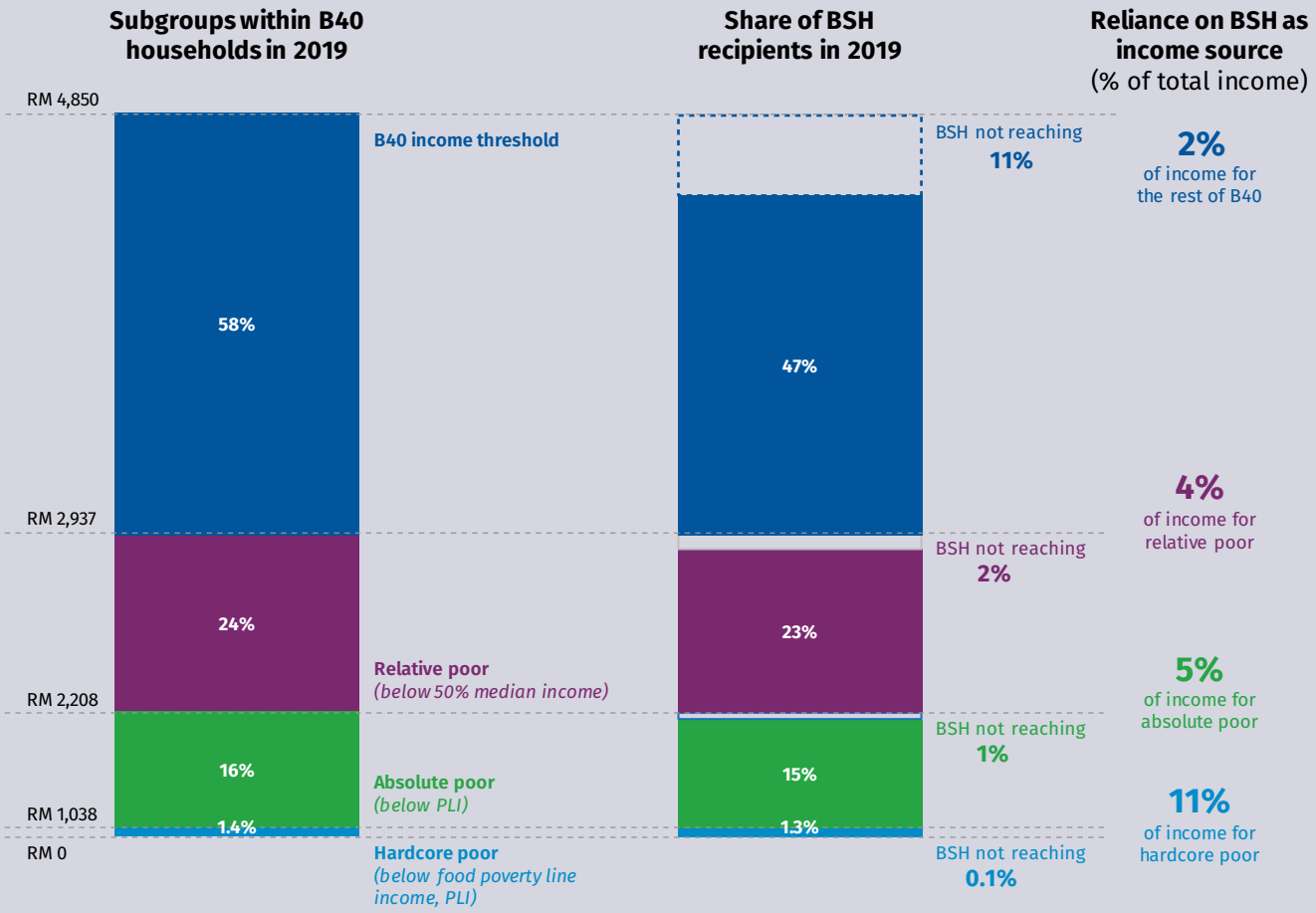
Acronyms refer to Ministry of Education (MOE), Ministry of Finance (MoF) and Inland Revenue Board of Malaysia (IRBM)

Source: Bank Negara Malaysia compilation of publicly available data, which is not exhaustive

The targeting mechanism of many of these programmes to the bottom-40 income group (B40) also requires a thorough reassessment. Based on the Household Income and Expenditure Survey (HIES), households under the Poverty Line Income (PLI)[18] threshold received the smallest percentage of BSH allocation in 2019. While accounting for 17.4% of households in the B40, this group received only 12% of the total allocation that year.[19] Weak verification capacity[20] also led to relatively high occurrences of both inclusion and exclusion errors (Chart 1).[21] For instance, verification to determine eligibility for BSH were based primarily on LHDN data, which captured only those in formal employment, making it challenging to validate the eligibility of the self-employed and workers in the informal sector. The effectiveness of these programmes was also limited by the lack of mechanisms for recipients to graduate from the social safety net programmes as they were not integrated and linked with active labour market policies (ALMPs). This indirectly increased the over-reliance of beneficiaries on social safety net programmes as a source of income and may not have helped to address intergenerational poverty in the long run.[22]

[18] In 2019, the PLI stood at RM2,208.
[19] This is based on the Bank's staff estimates based on HIES 2019 data.
[20] World Bank (2015).
[21] Inclusion errors refers to provision of aid to those who do not qualify, whereas exclusion errors imply failure to reach the needy which results in under-coverage (Source: Wheeler, Hurrell, & Devereux, 2015).
[22] Khazanah Research Institute's (KRI) publication "Climbing the Ladder: Socio-Economic Mobility In Malaysia" in 2016 emphasised the importance of access to education and having parents with savings, in achieving upward socio-economic mobility. However, their discussion paper in 2019 titled "A rising tide lifts all boats? Intergenerational social mobility in Malaysia", highlighted the gaps in data in making intergenerational economic analysis. This should be considered as an area for improvement moving forward.

Chart 1: Breakdown of households receiving BSH in 2019



Source: Household Income and Expenditure Survey (HIES) 2019 from the Department of Statistics, Malaysia; BNM estimates

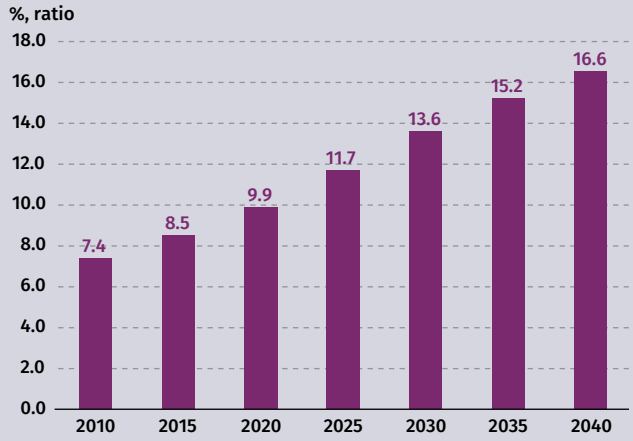
The efforts to strengthen our social protection would benefit immensely from the formulation of a roadmap for reforms which includes the development of a unified database for Malaysia's social protection system. This approach to social protection reform has been undertaken by countries such as Brazil, the Philippines, and Chile, among others. As there are currently more than 60 programmes under several agencies and ministries, serious considerations should be made to consolidate the social safety net programmes under the flagship BPR programme, and complemented with more granular categorisation.[23] The smaller number of programmes with narrower criteria based on income and household size would likely allow for more targeted and effective disbursements and further boost the progressivity[24] of these policies. Critically, the consolidation of programmes would allow for higher disbursements to the most vulnerable without undermining fiscal sustainability. To minimise inclusion and exclusion errors, the verification capacity could be improved by introducing compulsory registration at LHDN for all citizens regardless of income levels, which would further widen the coverage of LHDN's database. To complement social safety net programmes and encourage graduation from the programmes, conditionalities could also be imposed in order to be eligible for the benefits, such as for recipients to enroll in reskilling and upskilling training under active labour market policies (ALMPs) or school attendance requirements for their children.[25]

[23] More granularity is needed in BPR recipient categorisation. Under the current scheme, two households with monthly incomes of RM2,501 and RM3,999 would receive identical assistance, even though the extent of their vulnerability would be different.
[24] For example, making the priority of benefits as a bridge to address the current gap in meeting minimum income and living standards. An outcome of this could be creating more tiers in the disbursement of social safety net policies to ensure the most vulnerable households receive the most support.
[25] Setting school attendance for the children of beneficiaries as a conditionality has seen success in Brazil, which has this requirement in their conditional cash transfer programme, Bolsa Familia.

Social insurance: Inadequate pensions coverage and increasing fiscal burden of public pensions

Social insurance in Malaysia faces several challenges particularly in terms of sufficiency and sustainability. This is further compounded by Malaysia's ageing population.[26] Sufficiency of retirement income is a critical issue for private sector employees as Malaysia moves towards an 'aged nation' status[27] with the old-age dependency ratio expected to increase to 16.6% by 2040 from 8.5% in 2015 (Chart 2).[28] Based on a study conducted by EPF in 2018, two out of three active EPF contributors are projected to have insufficient retirement savings to meet a minimum pension of RM1,000 per month.[29] Private retirement schemes, on the other hand, provide limited support in addressing this issue, since less than 3% of Malaysia's workforce (aged 20-59) have a Private Retirement Scheme (PRS) account.[30] Furthermore, the capacity of the B40 working population to withstand income shocks, such as permanent disability and the death of a breadwinner, is inadequate given the low private insurance penetration rate for this segment at 24.9%[31] as at 2017. For employees in the public sector, there will be an issue of fiscal sustainability following rising liabilities from the defined-benefit pension scheme. As at 2019, the share of pension liabilities of the total Federal Government Operating Expenditure has increased to 9.8% from 6.5% in 2009.[32]

Chart 2: Old-age dependency ratio



Note: Old-age dependency ratio is defined as the ratio of older dependents (people older than 64 years old) to the working-age population (people aged 15–64)

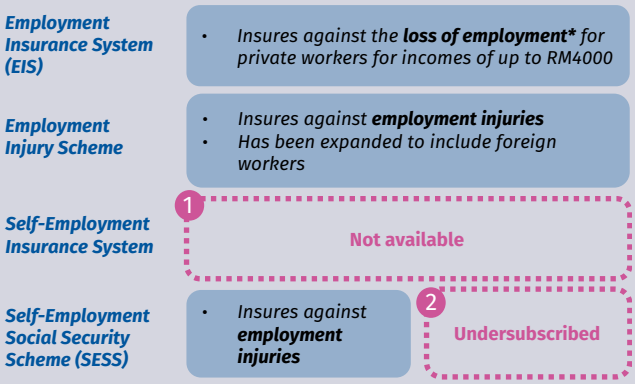
Source: Department of Statistics, Malaysia (DOSM) population projection, 2016

Social insurance: Lack of coverage for workers in the informal sector and the self-employed

In addition to sufficiency and sustainability, there is also inadequate coverage for workers in the informal sector and the self-employed (Diagram 6). The design of the current social security scheme provides protection only to employees who are within SOCSO's database, consisting of those in the formal sector. This creates challenges in providing coverage to self-employed individuals. While SOCSO attempted to address this issue with the introduction of the SESS in 2017, the programme remains undersubscribed.[33] Gaps in the social security ecosystem's coverage also arises from the absence of an EIS-equivalent for workers in the informal sector and self-employed workers, as well as for underemployed workers.[34]

[26] The definition of an ageing population is one where the share of people aged 65 and over is between 7% and 13% of the total population.
[27] Share of people aged 65 and over is above 14% of the total population.
[28] The pace at which Malaysia transitions from an ageing nation to an aged nation is also important. To illustrate, France experienced this transition over 115 years, while Malaysia is expected to experience this transition in 25 years.
[29] This is based on EPF's "Social Protection Insight" Volume 3 in 2018.
[30] Manulife Investment Management (2019). "A zoom into Asia's pension reform journey: Different perspectives of a multi-pillar approach".
[31] This figure is calculated as the percentage of B40 individuals who own an individual life insurance policy or family takaful certificate, after eliminating duplicates from multiple policies. The Bantuan Rakyat 1Malaysia (BR1M) recipient segment is used as a proxy for the B40 segment.
[32] For example, in the case of Thailand, to promote transition to defined-contribution scheme for civil servants in 1997, the Government automatically enrolls all new hires into a defined-contribution scheme but retained the lifetime pension scheme with a lower benefit.
[33] In February 2020, at the onset of the first wave of the COVID-19 pandemic in Malaysia, an estimated 47,000 individuals (compared to the 2.7 million workers who are self-employed) registered for the SESS, of which 92% were from the passenger transport sector.
[34] According to the ILO, underemployment refers to the underutilisation of the productive capacity of the employed population.

Diagram 6: SOCSO coverage for occupational insurance schemes

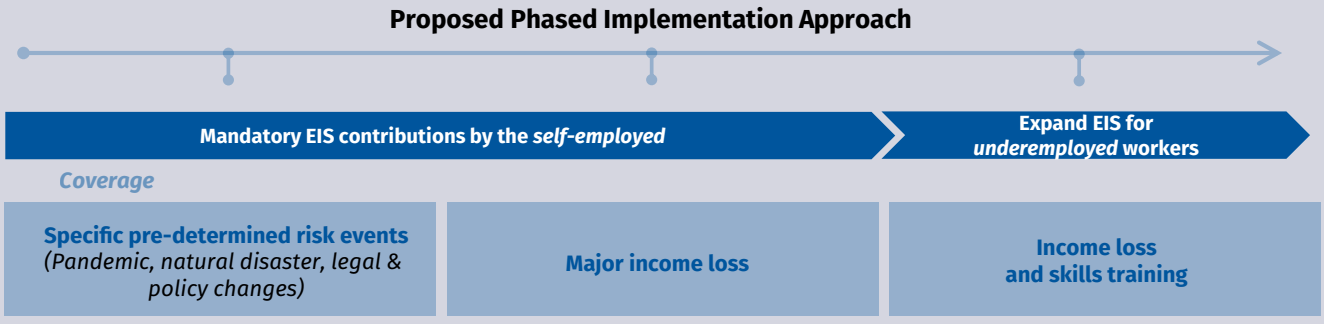


*Provides benefits including a job search allowance (for up to 6 months), reduced income allowance, training fee, training allowance and others

Source: SOCSO, Labour Force Survey, Informal Workforce Survey, Bank Negara Malaysia

Social insurance should also place great emphasis in building resilience against economic and financial shocks. Priority could be accorded to expanding the coverage of social insurance schemes. However, due to the infancy of the social insurance system and the potential operational and implementation challenges, this expansion could be approached in a gradual manner (Diagram 7). In the immediate term, addressing the lack of retirement savings for employees in the private sector will be vital. Incentives such as Matching Defined Contribution (MDC)[35] could be introduced to nudge interest towards private retirement schemes. For the public sector, a move towards a defined-contribution scheme for new hires needs to be prioritised given the burden posed by the prevailing system on the Government's fiscal position. This would, however, present its own set of challenges, particularly in ensuring continued interest to pursue a career in the public service.

Diagram 7: A phased implementation approach can be adopted, prioritising the most urgent need for coverage



Source: Bank Negara Malaysia

Active labour market policies (ALMPs): Fragmented policies resulting in low accessibility and training not meeting industry demand

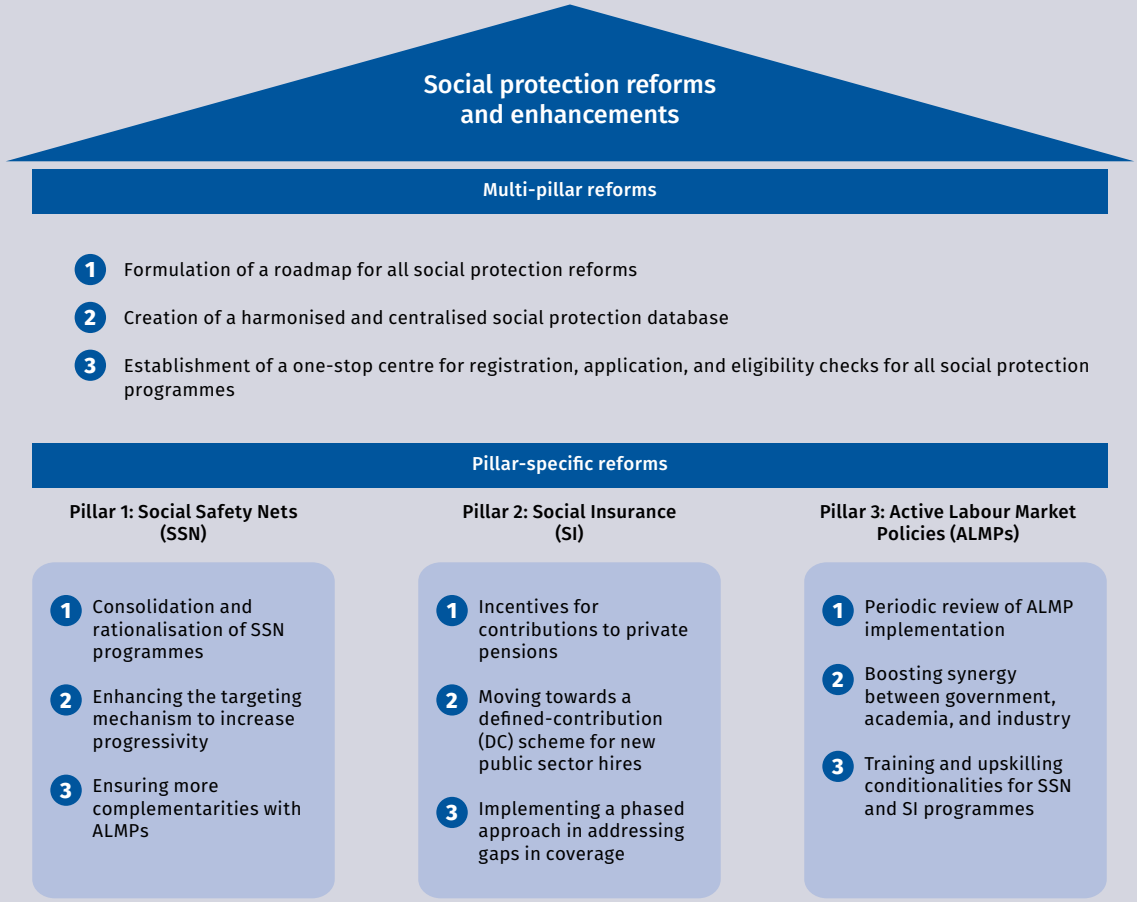
In order to enhance labour mobility and reduce frictions in the job search and placement process, several impediments in the implementation and design of ALMPs need to be addressed. Similar to the problem faced by social safety nets, there is duplication and fragmentation,[36] which has resulted in weak linkages

[35] For example, MDC incentives are used by governments to incentivise private retirement scheme contributions. The OECD has argued in favour of MDC as a tool to nudge workers in the informal sector to contribute to private retirement schemes in Latin America. Given Malaysia's relatively high number of informal sector workers, this could also be considered (OECD, 2010).

[36] For example, technical vocational education are provided by three separate ministries namely the Ministry of Education, Ministry of Human Resources and Ministry of Youth and Sports.

between the upskilling and reskilling programmes offered by the Government with industry demand.[37] There is also limited incentive to enroll in ALMPs which are not linked to other pillars of social protection. Planning, monitoring, and access to ALMPs could be improved by enforcing a periodic review of the policies,[38] guided by long-term strategic national initiatives such as the upcoming 12th Malaysia Plan and the National Job Creation Strategic Plan. This is to ensure ALMPs in Malaysia would fulfil not just existing but also future skills demand by industries. The establishment of the National Employment Council (NEC) in 2020 is a step in the right direction in coordinating and harmonising labour-related policies, including to enhance implementation and management of ALMPs. Going forward, there remains a need to secure continuous and cohesive collaboration and enhance the synergy between key stakeholders (i.e. Government, industry, and course providers). Potentially, those in charge of ALMPs could work closely with TalentCorp to ensure that the outcomes of the Critical Occupations List (COL)[39] guide the planning of course offerings.[40] As synergies between stakeholders develop and course offerings improve in their quality and ability to cater to industry demand, eligibility for social safety net and social insurance programmes could be made conditional on meeting training and upskilling objectives.[41] Social safety nets (e.g. cash handouts) could also act as income replacement and incentivise workers

Diagram 8: Social protection reforms and enhancements



Source: Bank Negara Malaysia

[37] HRDF stated in a report that their processes in identifying and analysing training needs remain weak.
[38] The National Employment Council could subsume this role.
[39] TalentCorp is an agency under the Ministry of Human Resources (MOHR) driving the agenda on developing and retaining Malaysia's talent. The COL is an annual publication led by TalentCorp and the Institute of Labour Market Information and Analysis (ILMIA) to identify skills imbalances in the labour market and lay the foundation for broader human capital policy strategies.
[40] Singapore's Skills Framework (SFw), for example, collates pertinent information on careers and skills in various sectors from a multitude of stakeholders and publishes findings online. This information, which includes career pathways, specific job roles, existing and emerging skills, and available training programmes allows employees, employers, and course providers to make more informed decisions based on emerging skills.
[41] Conditionalities for social safety net and social insurance prorammes have been shown to increase enrollment in active labour market policies. However, research on the overall effectiveness of welfare conditionalities when considering its trade-offs is still inconclusive and is heavily dependent on policy design. In any case, its design must prioritise the efficient disbursement of support to the most vulnerable groups.

to attend courses, particularly those who are unable to take leave as they are paid daily wages. For these complementarities between social protection pillars to work, it is key to ensure the establishment of a one-stop website for registration, application, and eligibility checks for all social protection programmes. This would enhance the outreach of existing programmes and thus allow beneficiaries to also be aware of the potential complementarities.

Conclusion

The COVID-19 pandemic, which has seen unprecedented loss of incomes and heightened economic insecurity, has provided a litmus test for the effectiveness of the current social protection system. Immediate reforms to the social protection framework would not only enhance protection for the vulnerable but also strengthen the resiliency of Malaysia's economy. These reforms must be carried out in a holistic and coordinated manner to boost efficiency and effectiveness in the long-term. The design of social protection programmes should serve a counter-cyclical role by ensuring their quick and effective deployment during economic downturns. Ultimately, the programmes should reinforce economic security as a foundation for building a society that is socially cohesive, economically inclusive, and that promotes equitable opportunity for all.

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Outlook and Policy in 2021

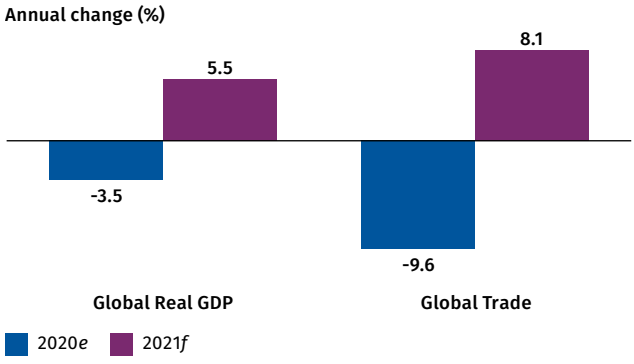
Outlook and Policy in 2021

2021: A GRADUAL, UNEVEN RECOVERY WHILE UNCERTAINTY ABOUNDS

Global growth recovery amid vaccine rollout and continued policy support

In 2021, the global economy is expected to continue its gradual and uneven recovery path (Chart 2.1). Global growth prospects will continue to be shaped by major developments surrounding the COVID-19 pandemic, particularly the rollout of vaccines, the ongoing global structural shifts, and the extent of economic scarring. Thus far, high-frequency production and trade indicators suggest that the global growth recovery remains broadly on track (Charts 2.2 and 2.3), despite the resurgences of COVID-19 cases and the re-imposition of tighter containment measures in some economies. Notwithstanding the expected global recovery, continued policy support will be vital to sustain overall growth momentum amid elevated uncertainty.

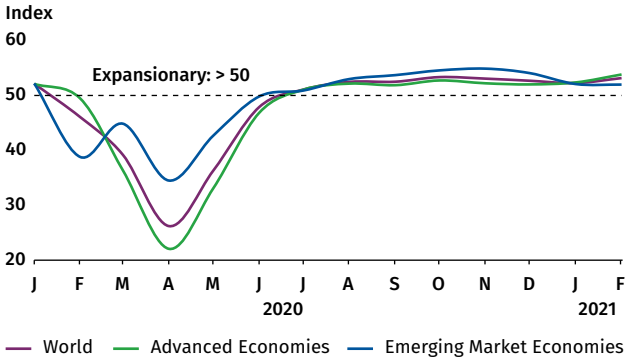
Chart 2.1: Global Real GDP and Trade Growth



e Estimate
f Forecast

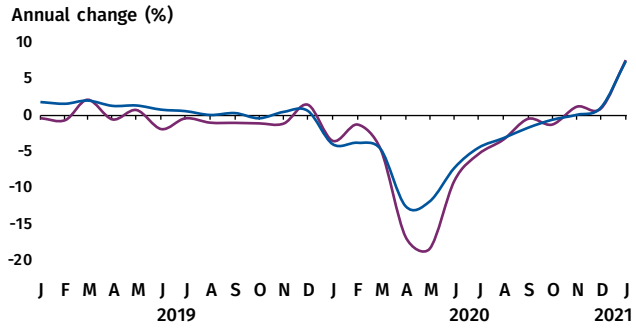
Source: International Monetary Fund (IMF) January 2021 World Economic Outlook

Chart 2.2: Composite Purchasing Managers Index (PMI)



Source: IHS Markit

Chart 2.3: Global Exports of Goods and Industrial Production Growth



Source: CPB Netherlands Bureau for Economic Policy Analysis

The rollout of the COVID-19 vaccines will lend support to global growth in 2021. Nonetheless, the impact will vary across economies due to differences in the timing, speed and scale of the distribution. As the vaccination rollout progresses across countries, containment measures are expected to be gradually eased. This will facilitate the restart of previously constrained activities, lower supply constraints and lift spending. International borders are also expected to reopen in phases, beginning with travel bubble arrangements among economies with

manageable COVID-19 situations towards the end of 2021. This would spur a rebound in cross-border tourism activities, but will likely remain below 2019 levels. The vaccine rollout is also expected to lift sentiments as the fear of COVID-19 gradually dissipates. The pace of country-specific growth recoveries will depend on countries' ability to manage vaccine-related logistical and procurement challenges amid some supply constraints and prioritisation of domestic needs in vaccine-producing economies, particularly at the early stages of vaccine production. Countries with first-hand access and strong logistical capabilities to ensure the timely and effective rollout of vaccines, mainly in the advanced economies (AEs) and vaccine-producing emerging market economies (EMEs), such as PR China, India, and Russia, are expected to experience faster growth recoveries.

Beyond vaccines, ongoing global structural shifts are expected to support a gradual improvement in cross-border investment and trade. In the near-term, rising demand for remote working equipment and the digitalisation of businesses could lead to an upswing in the technology cycle. This will benefit manufacturing production, investments, and exports for economies that are part of the electrical and electronics (E&E) global value chain, particularly the regional economies. In AEs, the EU-UK Trade and Cooperation Agreement has removed a key downside risk to EU-UK trade activity from a "no-deal Brexit" scenario. Reflecting the improving demand outlook, global commodity prices are expected to trend higher. Net commodity exporting countries stand to benefit from higher revenues, with potential spillovers to sectors with close linkages to the commodities sector. Higher commodity prices and recovery in demand may also lead to some inflationary pressures across economies, but only to a marginal extent, as some economic slack is expected to remain in 2021.

In line with improving economic activity, labour market conditions are projected to improve, albeit unevenly and partially, owing to the varying degree of scarring across economies. The recovery in unemployment and labour force participation rates, although partial, is likely to be faster in countries with more flexible labour markets, for instance in most advanced and some regional economies[1]. As firms face less hiring frictions, there is a lower risk of individuals entering long-term unemployment after being retrenched. This limits scarring from permanent job and income losses. Continued policy support will also facilitate a gradual normalisation in labour market conditions. Prominent examples include the additional fiscal support in the US and strong automatic stabilisers in the euro area, such as the wage replacement schemes in Germany and France. Despite some policy support in other EMEs, these economies are likely to experience a slower improvement in labour market conditions as less flexible labour markets delay the pace of job creation and is impeded further by higher long-term exits of retrenched workers from the labour force. Overall, the recovery in economic activity is expected to still outpace the recovery in labour market conditions.

Following a sharp decline in 2020, a resumption of private domestic demand is expected, but the pace of recovery across economies will depend on the degree of improvement in labour market conditions and firms' ability to leverage on opportunities in the new normal. Private consumption in major and regional economies will be anchored by a faster recovery in income conditions, in addition to improving sentiments due to the vaccine rollout. Firms in selected sectors, such as the E&E and information and communication technology (ICT)-related industries, are expected to invest in capacity expansions to meet demand, thus lending support to global investments. For example, in the region, the acceleration of 5G infrastructure rollouts[2] will provide impetus to investments. While prevailing household and non-financial corporate debt is elevated across both AEs and EMEs, the expected improvement in income conditions should help sustain spending and debt financing needs.

[1] Inferred from the labour market flexibility index in Miller, Roberts, and Kim (2020). The index has seven components – (i) ratio of minimum wage to the average value added per worker, (ii) hindrance to hiring new workers, (iii) hours rigidity, (iv) difficulty of firing workers, (v) legally mandated notice period, (vi) mandatory severance pay, and (vii) labour force participation. Advanced economies (excluding the euro area), such as the US and Japan and regional economies, such as Singapore, Malaysia, and Thailand, have more flexible labour markets than other major emerging economies.

[2] Mobile operators in the Asia Pacific will spend approximately USD331 billion in capital expenditure between 2020 and 2025 on 5G deployments. Nine countries, including Thailand and Singapore have launched commercial mobile 5G services, while twelve countries, including Indonesia and Malaysia, have announced plans to launch 5G (Global System for Mobile Communications Association, 2020).

Aggressive policy actions have prevented more severe adverse growth outcomes in 2020. Continued policy support, which will remain responsive to pandemic developments, is expected to sustain the global growth recovery in 2021. In Japan and the US, new stimulus packages were introduced due to a resurgence of COVID-19 cases. More broadly, however, policy is expected to be recalibrated based on the pace of economic recovery, resulting in smaller fiscal stimuli compared to 2020. This is in line with expectations for a smaller drag from COVID-19 as economies begin to respond to further outbreaks in ways that minimise disruptions in production activity. For example, PR China adopted targeted mobility restrictions and mass, rapid, random (MRR) testing to tackle the resurgence of cases in its North and Northeastern regions in January 2021, thus limiting supply disruptions. Nevertheless, as the full extent of economic scarring from the pandemic remains difficult to gauge, policymakers may opt to sustain current policy support in a more targeted manner, with a gradual recalibration of policy space over the medium-term. For instance, the EU has suspended rules on limiting public debt and fiscal deficits in the Stability and Growth Pact beyond 2021 until economic activity in its Member States have reached pre-crisis levels, to ensure flexibility in refining fiscal policy to support economic recovery.

Global monetary and financial conditions are expected to remain supportive of growth recovery despite continued bouts of financial market volatility

Broadly, global monetary policy is also expected to remain supportive of growth. The commitment towards a 'low-for-longer' interest rate environment in major AEs, such as the US and euro area, may keep global monetary and financial conditions favourable for an extended period. In major EMEs, accommodative conventional and unconventional monetary policies[3] will support demand. These would mitigate the risk of a premature tightening of financial conditions, which could weigh on the recovery in private sector spending.

[3] Unconventional monetary policies use tools other than the calibration of the policy interest rate to influence financing conditions, such as forward guidance, asset purchases, and term funding facilities.

Notwithstanding this, long-term government bond yields in the US began to surge in January 2021, driven by higher inflation expectations in anticipation of a faster economic recovery. This has led to the steepening of government bond yield curves in other AEs and EMEs. Global financial market volatility has also increased, and could continue intermittently going forward. Against this backdrop, there is a need to ensure orderly adjustments in financial markets and conducive financial conditions that will support a more entrenched economic recovery.

Despite recent developments, major central banks have continued to maintain the stance that monetary policy will remain accommodative amid considerable economic slack, transitory inflationary pressures, and high lingering uncertainties on the strength of growth recoveries. Hence, the generally loose monetary and financial conditions globally should continue to support favourable domestic financial conditions in EMEs. Easy financial conditions amid an exuberance in investors' risk appetite, however, could also contribute to a concurrent build-up in financial and external sector imbalances, potentially increasing countries' susceptibility to external shocks. Policymakers need to be vigilant against these risks as they could affect the sustainability of growth recovery.

Balance of risks to global growth remains tilted to the downside amid continued economic uncertainty

Notwithstanding the expected global recovery, uncertainty remains elevated arising from various sources, notably the effectiveness of the rollout of nationwide vaccination programmes across countries and the duration of policy support. This could weigh on global growth due to precautionary behaviour among firms and households.

The primary source of downside risk remains pandemic-related. This includes the re-imposition of strict and widespread containment measures due to COVID-19 resurgences leading to economic disruptions. Furthermore, the slower-than-expected rollout of vaccines due to logistical challenges or slower delivery by vaccine providers could affect sentiments and lead to more severe

containment measures. Finally, major mutations in the COVID-19 virus could render the existing vaccines less effective and renew risks of the reintroduction of strict lockdowns. More severe economic scarring, arising from extensive permanent job losses and business closures, could also weaken long-term global growth.

Downside risks to global growth extend beyond pandemic-related factors. Heightened global financial market volatility could contribute to capital flow reversals from EMEs, leading to sharp exchange rate adjustments and the tightening of domestic financial conditions. Financial conditions could tighten further should prevailing financial sector imbalances[4] unwind, especially in vulnerable EMEs with elevated private sector debt. In addition, if inflation expectations in major economies become unanchored, this could precipitate disorderly adjustments in global financial markets. Other risk factors such as extreme weather conditions may result in sudden disruptions to production and incomes, disproportionately affecting low-income economies amid more limited policy space. Finally, rising protectionist measures and deglobalisation of global supply chains could also adversely affect productivity and hinder global growth recovery.

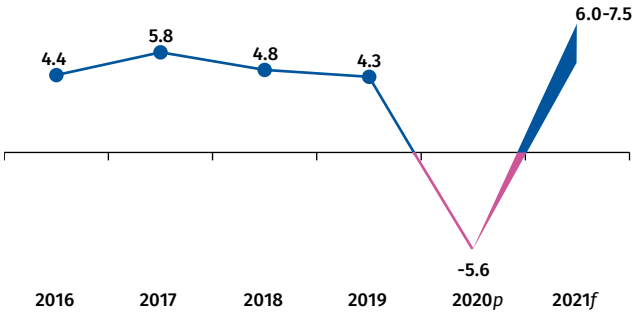
Nevertheless, there is some upside potential to the global growth outlook. Global growth could outperform expectations with a faster rollout and wider outreach of vaccines, especially in EMEs. The global economy could benefit on two counts. Firstly, containment measures may be phased out in more countries at a faster pace, which alleviates the drag on business activities and risk aversion due to pandemic fears. Secondly, positive sentiments could set in earlier and stronger, boosting the recovery in private sector spending. Another source of upside risk is a more prolonged or larger-than-expected fiscal support which would underpin a faster recovery in demand, such as in the US, or cushion any unexpected economic shocks.

The Malaysian economy is projected to rebound to between 6.0% and 7.5% in 2021

Recovery in the domestic economy, which began in the second half of 2020, is expected to continue in 2021. The recovery, nevertheless, is expected to be uneven and will be shaped by several factors, including the course of the COVID-19 pandemic and vaccine rollout, the extent of external spillovers, sector-specific developments, and the degree of improvement in labour market conditions. Amid a highly uncertain operating environment, continued and targeted policy measures will remain central in supporting growth going forward.

COVID-19 developments remain key in influencing Malaysia's growth trajectory in 2021, particularly the extent and duration of containment measures and the rollout of vaccines. Malaysia entered the year with the tightening of containment measures in most states with a resurgence in cases since late last year[5]. The corresponding restrictions and weakness in sentiments amid the uncertain progress of the pandemic will likely weigh further on spending in the early part of 2021. Nevertheless, the overall impact for the year is expected to be smaller than in 2020, owing to a less restrictive and more targeted approach to contain the COVID-19

Chart 2.4: Malaysia's GDP Growth



p Preliminary

f Forecast

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

[4] The January 2021 Global Financial Stability Review (GFSR) noted several financial vulnerabilities that were evident before the pandemic or have emerged since the pandemic, including rising corporate and sovereign debt, non-bank financial institutions sector fragilities, as well as declining banking sector profitability in some economies (International Monetary Fund, 2021).

[5] The Movement Control Order (MCO) 2.0 was initially imposed in five states, namely Selangor, Penang, Johor, Malacca, and Sabah, as well as the federal territories of Kuala Lumpur, Putrajaya and Labuan from 13 to 26 January 2021. This was later imposed in Kelantan and Sibu, Sarawak. As cases remained high, MCO 2.0 was extended further until 4 March 2021 for Selangor, Penang, Johor and Kuala Lumpur, and until 18 February 2021 for all other states and federal territories, except Sarawak.

resurgence. In particular, the flexibility for more economic sectors to operate should lessen supply and demand disruptions. Firms and consumers are also better adapted to physical distancing requirements and other operating procedures to contain the spread of infections.

Concurrently, the rollout of vaccines domestically beginning February 2021 will provide some lift to consumer sentiments and spending. However, as mass vaccination to induce herd immunity is expected to occur in a phased manner, the improvement in sentiments is expected to be gradual. As such, international tourism activities for Malaysia are unlikely to resume in a meaningful way, to limit community transmission and imported cases.

Notwithstanding the COVID-19 situation, a positive development is on the external spillovers from the broader recovery in global demand. This will sustain domestic production, investment, and export activity. Firms in the export-oriented industries and the supporting sectors are poised to benefit from improving domestic demand in key trade partner economies and the global technology upcycle. Of note, the rising demand for remote working equipment and medical-related products augurs well for firms in the manufacturing industry, particularly E&E as Malaysia forms an integral part of the global value chain. Beyond these, the recovery in global commodity prices and demand should lift commodity production and export revenues.

Other domestic sector-specific factors, such as higher production from new and existing manufacturing and mining facilities, and the pick-up of large infrastructure projects, would provide further impetus to overall economic activity. Meanwhile, high-touch services are expected to recover more slowly owing to a more gradual improvement in consumer sentiments and limited foreign tourist spending, thus contributing to an uneven recovery across sectors. To this end, many firms have adjusted their business models, including shifting to online e-commerce platforms to cater to the changing consumer preferences to shop more online. These would enable firms to meet demand in the near-term and importantly, lead to higher productivity gains over the longer term.

As broad economic activity picks up, labour market conditions are expected to improve gradually, with policy measures in place to facilitate labour mobility and minimise long-term dislocation or scarring in the labour market. Following the elevated number of retrenchments and income declines during the height of the COVID-19 crisis in 2020, there have been encouraging signs of re-employment[6] and a recovery in income levels that are expected to persist in 2021. Targeted policy measures remain in place to sustain this recovery by supporting labour demand and reducing labour market frictions as unemployed individuals seek re-employment. This will particularly benefit affected workers in COVID-19-vulnerable industries, such as the retail- and tourism-related industries. Key measures to safeguard the employment of these workers include the targeted wage subsidy programmes, various upskilling and reskilling opportunities, as well as extensions to the Employment Insurance System (EIS) jobless claims allowance for those retrenched.

An improvement in labour market conditions is expected to play a key role in the recovery of private consumption. While pockets of households will remain more vulnerable to the adverse impact from the pandemic, continued policy assistance for these groups is expected to support spending. Equally crucial to the growth recovery is the projected pick-up in investment activity going forward. Improving capital spending by firms, particularly in critical areas such as digitalisation, automation, and transportation, will boost near-term growth and future productive capacity. Reflecting the expansion in domestic consumption and investment activity, as well as external demand, imports is expected to observe a broad-based increase.

In addition, policy measures remain in place to support the growth momentum while still assisting the vulnerable segments that are particularly affected by the COVID-19 developments. These include the extension of measures introduced in 2020, the 2021 Budget, as well as the *PERMAI* and *PEMERKASA* assistance packages. Notable measures to ease financial constraints for affected individuals include *Bantuan Prihatin Nasional, Bantuan Prihatin Rakyat* and *Bantuan Kehilangan Pendapatan* cash transfers, the

[6] Higher job placement rates were observed in the second half of last year (31 placements per 100 jobless claims, 1H2020: 15).

Employee Provident Fund (EPF) *i-Sinar* and *i-Lestari* cash withdrawals[7], and the Targeted Repayment Assistance. Furthermore, various tax relief and incentives will also lift overall consumer spending. For businesses, special grants, wage subsidies and the Targeted Relief and Recovery Facility, are extended to firms in the services sector, which is the hardest-hit sector. Complementary to these measures are the continued accommodativeness of monetary policy and supportive financing conditions, which will maintain an environment that is conducive for a recovery in domestic demand as the adverse impact from the COVID-19 crisis gradually subsides.

In a highly uncertain and rapidly evolving environment, the risks to Malaysia's growth projection are tilted to the downside. Key downside risks include the escalation in COVID-19 cases leading to further rounds of containment measures, albeit targeted, and the slower-than-expected rollout or ineffectiveness of vaccines, which could result in stronger precautionary behaviour. Continued susceptibility to domestic commodity production shocks could also weigh on baseline growth. Moreover, heightened global and domestic economic uncertainty could lead to greater financial market volatility, triggering a tightening of domestic financial conditions. Despite this, upside risks to the growth outlook may emanate from a higher-than-expected global growth, faster-than-expected rollout of vaccines, stronger-than-expected impact from policy support, and the realisation of pent-up demand following the lifting of containment measures.

Domestic demand to remain the key driver of economic growth

In 2021, growth is expected to improve, underpinned by the recovery in the global economy and better domestic economic activity. However, given the rise in COVID-19 cases since late last year, growth is expected to be affected in early 2021 due to the impact from domestic containment measures. Notwithstanding this, growth would be supported by higher domestic demand, particularly private sector spending. The improvement in the global economy, meanwhile, is expected to translate into a rebound in external demand, and benefit Malaysia's exports during the year. The performance would also be lifted by the implementation of infrastructure projects, particularly in the transport-related projects. Furthermore, growth will also be supported by the continued accommodative monetary policy and the targeted assistance from fiscal and financing measures.

Private consumption growth is expected to rebound to 8.0% in 2021, supported by the gradual improvement in overall income and employment growth, as well as relatively less stringent mobility restrictions compared to 2020. Consumer sentiment is also expected to improve gradually as the vaccination programme is rolled out, particularly towards the second half of the year. Furthermore, targeted policy measures remain available to support spending, especially for vulnerable households. These include the EPF *i-Sinar* and *i-Lestari* withdrawals, disbursement of the *Bantuan Prihatin Nasional, Bantuan Prihatin Rakyat* and *Bantuan Kehilangan Pendapatan* cash transfers, various tax relief and incentives, as well as the Targeted Repayment Assistance. Going forward, household expenditure will also be characterised by shifting consumption trends. The divergent pace of recovery between spending in essential goods and services, and discretionary items is expected to continue in 2021, as leisure-related spending is likely to remain modest. The acceleration in online shopping since the onset of the pandemic is also likely to persist, partly mitigating a decline in physical spending when targeted movement restrictions remain in place. To this end, firms' ability to shift their business models towards meeting growing demand in the new normal and reinvigorate discretionary spending will partly help to sustain private consumption.

Gross fixed capital formation (GFCF) is projected to rebound to 7.8% (2020: -14.5%), supported by the rise in capital spending by the private and public sectors. The higher capital spending would be driven by the recovery in both structures and machinery and equipment (M&E) investments, amid improvement in global and domestic economic activity.

[7] These facilities allow EPF members to withdraw a share of funds from their savings accounts to alleviate cash flow constraints, particularly for individuals affected during the course of the COVID-19 crisis.

Table 1

Real GDP by Expenditure (2015=100)

	2020p	2020p	2021f	2020p	2021f
	% of GDP	Annual change (%)		Contribution to growth (percentage point)	
Domestic Demand[1]	**93.9**	**-5.7**	**7.4**	**-5.4**	**7.0**
Private sector expenditure	75.2	-6.0	7.4	-4.5	5.6
Consumption	59.5	-4.3	8.0	-2.5	4.8
Investment	15.7	-11.9	5.4	-2.0	0.8
Public sector expenditure	18.7	-4.6	7.4	-0.8	1.4
Consumption	13.4	4.1	4.4	0.5	0.6
Investment	5.2	-21.4	15.2	-1.3	0.8
Gross Fixed Capital Formation	20.9	-14.5	7.8	-3.4	1.6
Change in stocks	**-0.4**			**0.7**	**-0.3**
Net Exports of Goods and Services	**6.5**	**-12.3**	**4.8**	**-0.9**	**0.3**
Exports	61.6	-8.8	13.1	-5.6	8.1
Imports	55.1	-8.3	14.1	-4.7	7.8
Real Gross Domestic Product (GDP)	**100.0**	**-5.6**	**6.0 ~ 7.5**	**-5.6**	**6.0 ~ 7.5**

[1] 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

Private investment growth is expected to improve to 5.4% (2020: -11.9%) following the gradual recovery in external demand as vaccines begin to roll-out on a wider scale. Growth will also be supported by the progress of ongoing large projects especially in the civil engineering sub sector, and the continued investment intentions, particularly in the manufacturing sector. This is observed from the sustained investment approvals in the manufacturing of E&E, petroleum products, and metal products. Furthermore, the measures announced in 2021 Budget including investment incentives, tax allowances and the implementation of key projects to spur the development of the digital economy such as under the Malaysia Digital Economy Blueprint (MyDigital), will provide further support to private investment activity.

Similarly, **public investment** is projected to register an expansion of 15.2% (2020: -21.4%). This will be driven by improvement in both General Government and public corporations spending, amid further progress of large-scale infrastructure projects, such as ECRL, MRT2, and Pan Borneo Highway. With less restrictive containment measures in the first quarter of 2021 compared to in 2020, and further pick-up in economic activity from the second quarter onwards, progress of most infrastructure projects are expected to be on track, or even ahead of schedule. For example, the ECRL project which was 20% completed as at end-2020, was slightly ahead of schedule, and is targeted to reach 30% completion rate by end-2021[8]. The Government's fixed asset spending will be channelled mainly towards transportation, education, public utilities, housing and healthcare projects. In addition, investment to improve digital infrastructure and connectivity nationwide, as well as the implementation of small-scale projects as announced under the 2021 Budget and *PEMERKASA* package, will provide further lift to growth.

Public consumption growth is expected to continue to expand at 4.4% (2020: 4.1%), in line with continued expansion in Federal Government spending, largely supported by COVID-19 related expenditure, including the vaccine procurement and logistics spending.

[8] Malaysia Rail Link website, 6 January 2021.

Growth expansion in all economic sectors

All economic sectors are projected to record positive growth in 2021. The improving growth trajectory will be supported by stronger external demand, especially in digital products and services as the world continues to adapt to the "new normal". In addition, the gradual resumption in economic activities as businesses adapt to the COVID-19 Standard Operating Procedures (SOPs), and nationwide vaccinations are also expected to provide broad impetus to growth. Nonetheless, the pace of recovery across industries will vary depending on its exposure to the COVID-19 outbreak and operational restrictions arising from the containment measures. Most industries are only expected to record positive growth beginning second quarter of the year given the imposition of MCO 2.0 in the first quarter.

Table 1

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

	2020*p*	2020*p*	2021*f*	2020*p*	2021*f*
	% of GDP	Annual change (%)		Contribution to growth (ppt)[1]	
Services	57.7	-5.5	6.6	-3.2	3.8
Manufacturing	23.0	-2.6	8.8	-0.6	2.0
Mining and quarrying	6.8	-10.0	3.1	-0.7	0.2
Agriculture	7.4	-2.2	4.2	-0.2	0.3
Construction	4.0	-19.4	13.4	-0.9	0.5
Real Gross Domestic Product (GDP)	**100.0**[1]	**-5.6**	**6.0 ~ 7.5**	**-5.6**	**6.0 ~ 7.5**

[1] 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 expected to register a growth recovery in 2021. The information and communication, as well as finance and insurance sub-sectors are poised to lead the recovery as demand for digital solutions, especially in e-commerce and e-payment continues to accelerate. Nonetheless, the re-imposition of the MCO 2.0 in the early part of the year will weigh on activities in the wholesale and retail sub-sector. Additionally, the closure of Malaysia's international borders will continue to affect tourism-related industries (e.g. food and beverage, accommodation and air travel).

The *manufacturing* sector is expected to record robust growth as the COVID-19 pandemic accelerates the structural shifts towards digitalisation, spurring demand for telecommunications, cloud computing and medical device products. Malaysia's E&E cluster will stand to benefit as it is well integrated in these global value chains. Growth in the primary-related cluster is also expected to benefit from increased production of refined petroleum and petrochemical from the large petrochemical facilities in Johor. On the domestic-front, production in the construction-related manufacturing clusters are also expected to be supported by the pick-up in construction of large infrastructure projects. Growth in the consumer-related *manufacturing* cluster is also expected to improve, in tandem with the recovery in consumption activity, as most major consumer industries and their supply chain are expected to operate, while observing the SOPs. Additionally, the Government's extension of tax exemptions for car sales will likely boost support for car production.

Growth in the *agriculture* sector is expected to expand, primarily due to a recovery in oil palm production. Slightly higher-than-average rainfall in the beginning of the year due to the La Nina phenomenon is expected to improve oil palm yields particularly towards the later part of the year. Meanwhile, higher natural rubber prices will support increased tapping activities, while continued growth in household spending will support a strong expansion in livestock production.

Activities in the *mining* sector are projected to recover, despite planned maintenance closures in the first half of the year following the continuation of voluntary supply adjustments by PETRONAS. The offsetting support to growth is expected to materialise in the second half of the year as the operationalisation of new gas fields along with the ramp-up of the PFLNG2 facility in East Malaysia will lead to higher production of natural gas.

Growth in the *construction* sector is also expected to rebound, driven by resumption of activities across all subsectors. In the civil engineering subsector, growth is expected to recover in line with the ramp up of construction activity in large infrastructure projects. Meanwhile, launches of affordable housing projects in the previous years will continue to provide support for activity in the residential subsector. Growth in the special trade subsector is expected to strengthen further with support from solar power projects, *Jalinan Digital Negara* (JENDELA), small-scale projects under the 2021 Budget and *PEMERKASA* measures, as well as end-works from the completion of large projects. However, completion of large commercial projects is expected to weigh on growth in the non-residential subsector.

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 its prevailing factors of production (i.e. labour, capital) and level of productivity.

In 2020, potential output growth is estimated to have moderated to 3.3% (2019: 4.8%, 2011-2019 average: 4.9%). Firstly, investment activity registered a contraction in 2020 (-14.5%; 2019: -2.1%), as a result of weak demand conditions, softer business sentiments and heightened uncertainty amid the COVID-19 pandemic. Subdued investment activity is expected to result in weaker total factor productivity (TFP) growth as firms undertake less investments in productive capital (e.g. machinery & equipment and ICT). Secondly, participation in the labour force declined marginally (4Q 2020: 68.5%, 2019: 68.7%), due to weaker job market prospects amid rising unemployment during the year. Additionally, the MCO period and the associated SOPs negatively impacted labour productivity, which are also expected to adversely affect the TFP.

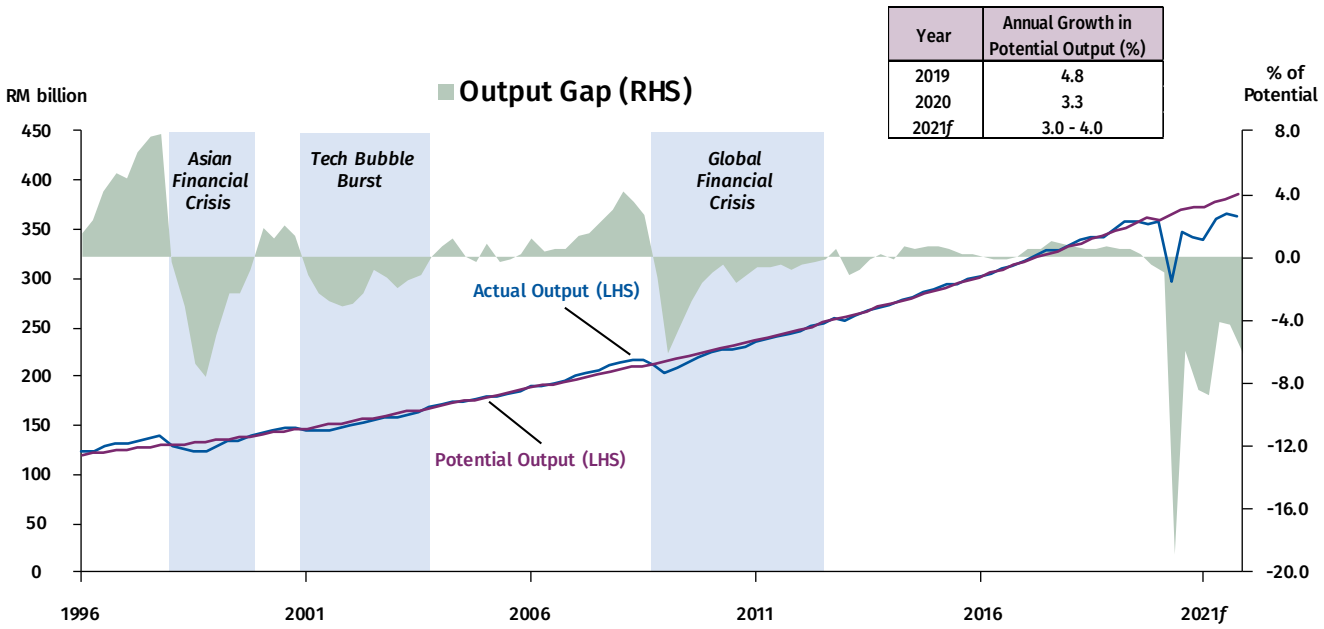
The actual output growth of -5.6% in 2020 was significantly below the potential output growth of 3.3%. This was due to the concurrent supply and demand shocks that led to an underutilisation of the economy's resources. On the supply side, capacity restrictions introduced especially during the MCO period and physical distancing measures resulted in lower production activities. On the demand side, subdued domestic and external demand conditions led to a contraction in private consumption and exports growth during the year.

Consequentially, the output gap turned negative (-8.5%, 2019: 0.2%) as actual output fell below potential output[9]. This reflects slack in the economy from the underutilisation of factors of production. The slack in the economy led to further easing of price pressures as the inflation rate decreased to -1.2% (Core inflation: 1.1%).

Going forward, the negative output gap is projected to narrow in 2021. This is due to the expected rebound of actual output growth to 6.0%-7.5%, which is above the potential output growth that is estimated to remain subdued at 3-4%. A slower recovery in selected industries, such as tourism-related sectors, due to international travel restrictions and the re-imposition of the MCO 2.0, is expected to result in only a gradual improvement in the output gap.

[9] The output gap is formally defined as $\frac{\text{(Actual output level- Potential output level)}}{\text{Potential output level}} \times 100\%$.

Chart 1 : Actual and Potential Output



f Forecast

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

Export growth to rebound in 2021

Malaysia's export growth is expected to rebound to 8.2% in 2021 (2020: -1.4%), following two consecutive years of contraction. The expansion will be driven primarily by the improvement in external demand, especially from Malaysia's key export partners, such as the US and PR China. Malaysia's exports will also benefit from firm global demand for E&E products, and higher commodity prices and production.

Manufactured exports is expected to expand by 8.4% in 2021 (2020: 0.8%), supported by broad-based improvement across both the E&E and non-E&E segments. Capacity expansion and commencement of new E&E production facilities will enable firms to benefit from the stronger global demand for semiconductors.

In the non-E&E sector, export growth will be supported by selected segments. These include rubber-related products such as gloves and Personal Protective Equipment (PPE). In addition, exports of construction-related products, namely iron and steel and manufactures of metals will be supported by the recovery in investment activity in PR China. Commodities exports are projected to rebound (3.3%; 2020: -12.5%), driven by both higher commodity prices and production. Mineral exports are expected to recover due to higher prices of crude oil and natural gas. The expected operationalisation of new gas fields in the second half of 2021 will also support natural gas export volumes.

Import growth to recover

Gross imports is projected to rebound to 9.1% in 2021 (2020: -6.3%), driven mainly by a turnaround in intermediate imports in line with higher manufactured exports. Capital import growth is also expected to rebound driven mainly by higher investment in the manufacturing sector as well as the implementation of large scale infrastructure projects. Consumption imports will be driven primarily by demand for imported food and beverages.

Current account to remain in surplus

The current account balance is projected to remain in surplus, albeit lower at 2.5 – 3.5% of GDP in 2021 (2020: 4.4% of GDP). The goods surplus is expected to increase in 2021 as goods exports are expected to outpace the recovery in imports and benefit from higher commodity prices.

Services exports is expected to remain subdued, due mainly to lower travel receipts as international border restrictions are expected to remain in place. Payments for professional and technical services are expected to rise as investment activity recovers. As a result, the services deficit is expected to widen in 2021.

The income account is projected to record a wider deficit, attributable to the higher FDI income payment accrued to foreign investors in Malaysia as manufacturing activity improves. The higher FDI income payment is expected to outpace the increase in income accrued to Malaysian firms investing abroad. The secondary income account is expected to register a larger deficit. This reflects the increase in outward remittances by foreign workers as economic activity improves and the large base effect from the settlement received related to a wholly-owned subsidiary of the Minister of Finance (Incorporated) in third quarter of 2020.

Table 1

External Trade

	2015-2019 average	2020*p*	2021*f*
	Annual change (%)		
Gross exports	**5.6**	**-1.4**	**8.2**
of which:			
Manufactured	7.6	0.8	8.4
Agriculture	-0.6	8.7	-1.2
Mining	-3.1	-29.6	8.9
Gross imports	**4.7**	**-6.3**	**9.1**
of which:			
Capital goods	1.2	-9.8	4.6
Intermediate goods	3.1	-9.5	12.2
Consumption goods	8.4	-0.3	6.9
Trade balance (RM billion)	**109.5**	**184.8**	**192.2**

p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table 2

Current Account of the Balance of Payments[1]

Item (Net)	2020p	2021f
	RM billion	
Goods	139.1	161.7
Services	-48.0	-57.7
Primary income	-26.2	-41.6
Secondary income	-2.8	-18.1
Current account balance	**62.1**	**44.3**
% of GDP	4.4	2.5 - 3.5

[1] 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

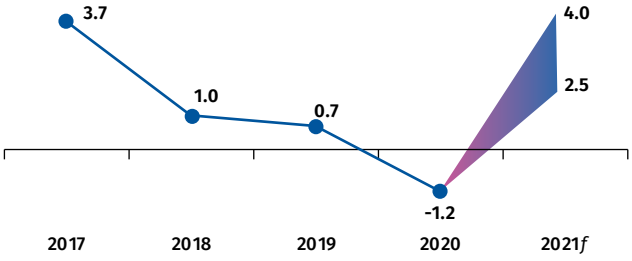
Headline inflation to average higher, between 2.5% and 4.0%, while underlying inflation to remain subdued in 2021

In 2021, headline inflation is projected to average higher, between 2.5% and 4.0%, due mainly to cost-push factors such as the expected increase in global oil prices, as well as the lapse in the effect from the tiered electricity tariff rebate introduced in April 2020 (Chart 2.5). In terms of trajectory, headline inflation is anticipated to temporarily spike in the second quarter of the year, due mainly to the lower base from the low domestic retail fuel prices[10] during the corresponding period in 2020. Nevertheless, headline inflation is expected to moderate by the second half of the year as this base effect dissipates.

Underlying inflation is expected to remain subdued amid the continued spare capacity in the

[10] 2Q2020 average domestic retail fuel price (RON95): RM1.37/litre; Year-to-date (up to 31st March 2021): RM1.96/litre.

Chart 2.5: Malaysia's Headline Inflation, Annual Change (%)



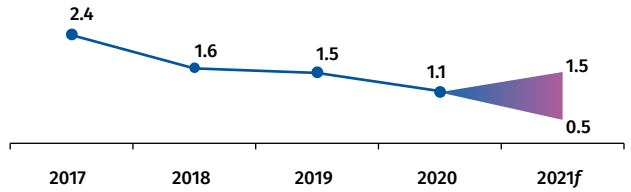
f Forecast

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

economy. Core inflation is forecasted to average between 0.5% and 1.5% in 2021 (Chart 2.6). Despite the improvement in economic conditions, the output gap is still projected to remain negative this year, in part due to continued weakness in selected industries. As a whole, underlying inflation is likely to remain muted, barring unforeseen cost factors, until a more entrenched recovery in demand conditions translates to higher prices.

The overall inflation outlook, however, is dependent on global oil and commodity price developments. It is also subject to downside risks, including further rounds of containment measures, albeit targeted, which could weigh on demand. A slower-than-expected rollout of vaccines could also affect the extent of the economic recovery, thereby further tempering inflationary pressures. Nevertheless, upside risks also remain, stemming

Chart 2.6: Malaysia's Core Inflation, Annual Change (%)



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Note: Core inflation is computed by excluding price-volatile and price-administered items. It also excludes the estimated direct impact of consumption tax policy changes.

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

from cost factors such as higher fresh food inflation and disruptions to global supply lines.

With the pandemic, structural changes are taking place in regards to shifts in consumer spending habits and competitive dynamics among firms. As we enter the phase of a new normal, the extent to which such changes evolve and remain will pose as a great challenge in assessing inflation dynamics.[11]

Domestic monetary and financial conditions to remain supportive of intermediation activity in 2021

Domestic monetary and financial conditions are expected to remain conducive given the accommodative monetary policy and other ongoing policy support. Following the significant reductions in the Overnight Policy Rate (OPR) in 2020, the accommodative conditions will continue to provide broad-based support to the economy. In particular, the flow of credit to the private sector will be underpinned by the sound banking system and well-functioning capital markets. Banks continue to have adequate lending capacity to support financing needs as the economy recovers, given their healthy capital and liquidity buffers.

Nevertheless, the prevailing uncertain economic conditions and outlook, along with the higher credit risks and rising impairments, could increase banks' risk aversion and intensify some of the frictions in credit flows. Banks may be less willing to lend to segments or activities deemed to be more risky, and credit may not be allocated efficiently and productively across economic segments. To some extent, these frictions may affect the translation of lower interest rates to higher bank lending. Meanwhile, the highly open domestic financial markets remain exposed to risks of heightened volatility and financial spillovers due to global factors. For instance, expectations of higher inflationary pressures and faster economic recovery in the US could lead to further increase in the long-term government bond yields in EMEs, including Malaysia, which has materialised to some extent in the recent months.

[11] See Second Quarter 2020 BNM Quarterly Bulletin box article titled "COVID-19: Impact on Inflation".

The Bank's monetary policy and operations will, however, continue to provide an enabling environment and ensure sufficient domestic liquidity to support the financial intermediation process. Existing liquidity operations and measures, including among others, reverse repos and the flexibilities provided for the Statutory Reserve Requirement (SRR) compliance, will remain in place throughout the year. These measures would also continue to support the smooth functioning of the domestic money and bond markets. In line with this, the flexibility of the ringgit exchange rate would continue to act as a shock absorber by facilitating necessary adjustments in the economy to ensure sustained resilience against external shocks.

Together with the other targeted Government and BNM measures, including the special funds for small- and medium-sized enterprises (SMEs), credit guarantee schemes, Targeted Repayment Assistance programmes and the regulatory flexibilities extended, the series of policy measures are expected to collectively facilitate credit flows to the economy and provide a firm foundation to support economic recovery.

Monetary policy in 2021 will remain accommodative to promote the sustainability of the economic recovery

Monetary policy in 2021 will focus on supporting a sustainable economic recovery amid modest price pressures. Decisions on monetary policy will continue to be data-driven, given the fast-evolving conditions and lingering uncertainties, such as the strength of the economic recovery and the degree to which the re-imposition of containment measures and the rollout of vaccines, both globally and domestically, will affect economic activity.

Given the uneven pace of recovery and the downside risks to the outlook, a sufficiently accommodative monetary policy stance will be maintained to support an entrenched economic recovery while ensuring that price pressures remain manageable. The MPC will be mindful to avoid a premature withdrawal of policy support. The MPC will continue to closely monitor the emergence of signs of a more entrenched and sustainable economic recovery in the period ahead, while remaining vigilant against a build-up of financial imbalances. Some signposts underlying such recovery would include, among others, sustained periods of steady improvement of economic performance amid a narrowing of the output gap and an environment of price stability; sustainable growth of private consumption and investment driven by fundamentals without over-reliance on policy support; a stronger labour market underpinned by rising incomes; as well as healthy access to financing for viable borrowers.

The right mix of monetary, financial and fiscal policies is needed to ensure overall effectiveness in securing a sustainable economic recovery

The gravity and scope of the COVID-19 shock necessitates the complementary use of monetary, fiscal and financial sector policies, which includes the use of more targeted and sector-specific measures for the affected segments of the economy to support and secure a sustainable economic recovery. The optimisation among these policies also avoids overburdening any single policy. In this regard, the Bank will continue to utilise all its policy levers, as deemed necessary, to foster enabling conditions for the purpose of ensuring continued financial intermediation to support economic recovery. These include liquidity operations, appropriate regulatory and supervisory measures, the establishment of financing facilities and other complementary financial sector policies that serve to ensure orderly market conditions, preserve the smooth functioning of the financial intermediation process and encourage financing to the real economy.

Coherent structural policies will also be crucial to enable Malaysia to emerge stronger from the pandemic with an innovation-led growth, resilient workforce, as well as enhanced social protection framework for those in need[12]. Firstly, it is important to improve economic dynamism and to capitalise on emerging technologies by attracting quality investments. This is facilitated by the introduction of a diverse source of funds to spur high-tech private investments, such as the High Tech Facility-National Investment

[12] Refer to box articles on "Getting the Great Reset Right: Structural Labour Market Issues in the Post-COVID-19 World", "Innovation Malaysia: Towards Higher Quality Growth in a Post-Pandemic Future" and "A Vision for Social Protection in Malaysia".

Aspirations (HTF-NIA) funds, as well as various SME digitalisation grants and loans. This can be complemented by upskilling and reskilling programmes to redeploy redundant workers into new growth areas and ensure that the labour force is equipped with the necessary skills to take on the high-skilled, high-productivity jobs generated by these investments. Finally, initiatives to strengthen social protection in Malaysia, such as the widening of social insurance coverage, are vital as a safeguard against socioeconomic vulnerabilities going forward. Taken together, these efforts would accelerate digitalisation and enhance productivity in the economy, improve standards of living, and further strengthen growth recovery in a sustainable manner.

The collective impact of these policies would provide the needed countercyclical and longer-term support to enhance Malaysia's economic dynamism towards a sustainable economic recovery. To this end, efforts will continue to focus towards ensuring an optimal policy configuration for the economy to stand on a solid base for recovery.

Innovation Malaysia: Towards Higher Quality Growth in a Post-Pandemic Future

Introduction

The year 2020 was a challenging period for the global and the Malaysian economy. In an effort to manage the COVID-19 pandemic, the Government implemented various forms of movement control orders (MCO), restricting mobility and economic activity. Consequently, both private consumption and private investment declined sharply. The synchronised deployment of fiscal, monetary and financial policies helped to cushion the overall adverse impact on growth.

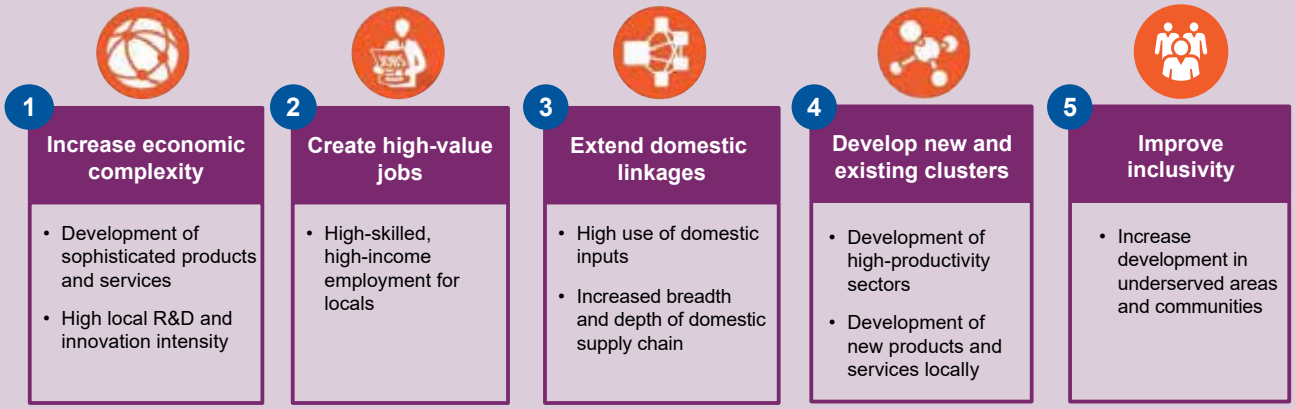
A recovery from the depth of the pandemic is now underway with continued targeted support from the Government. Alongside this recovery, it is an opportune time to recalibrate the country's aspirations in order to face new challenges and seize new growth opportunities. This box article discusses (i) the imperatives for quality investment and innovation-led growth; and (ii) potential reforms aimed at fostering these investments.

Quality Investment and Innovation-led Growth

Within the context of the economy's unique experience, Malaysia is adopting the National Investment Aspirations (NIAs)[1], a forward-looking national policy aimed at attracting the right investments, building innovation capacity and increasing both productivity and growth (Diagram 1).

Some promising steps have been taken by the Government. Notably in Budget 2021, higher development expenditure has been allocated to fund high value-added technology as well as research and development (R&D) in sectors such as aerospace and electronics. In addition, Bank Negara Malaysia has also established the High Tech Facility-National Investment Aspirations (HTF-NIA) to provide financing support to high technology and innovative SMEs to remain competitive in the global supply chain[2].

Diagram 1: The Five National Investment Aspirations



Source: World Bank and Bank Negara Malaysia

[1] For more information, please refer to BNM's EMR 2019 Box Article titled "Securing Future Growth through Quality Investments" at https://www.bnm.gov.my/o/annual-report/html/files/emr2019_en_box1.pdf

[2] Details of the HTF-NIA facility can be found at https://www.bnm.gov.my/o/covid-19/FAQ-HTF-ENG.pdf

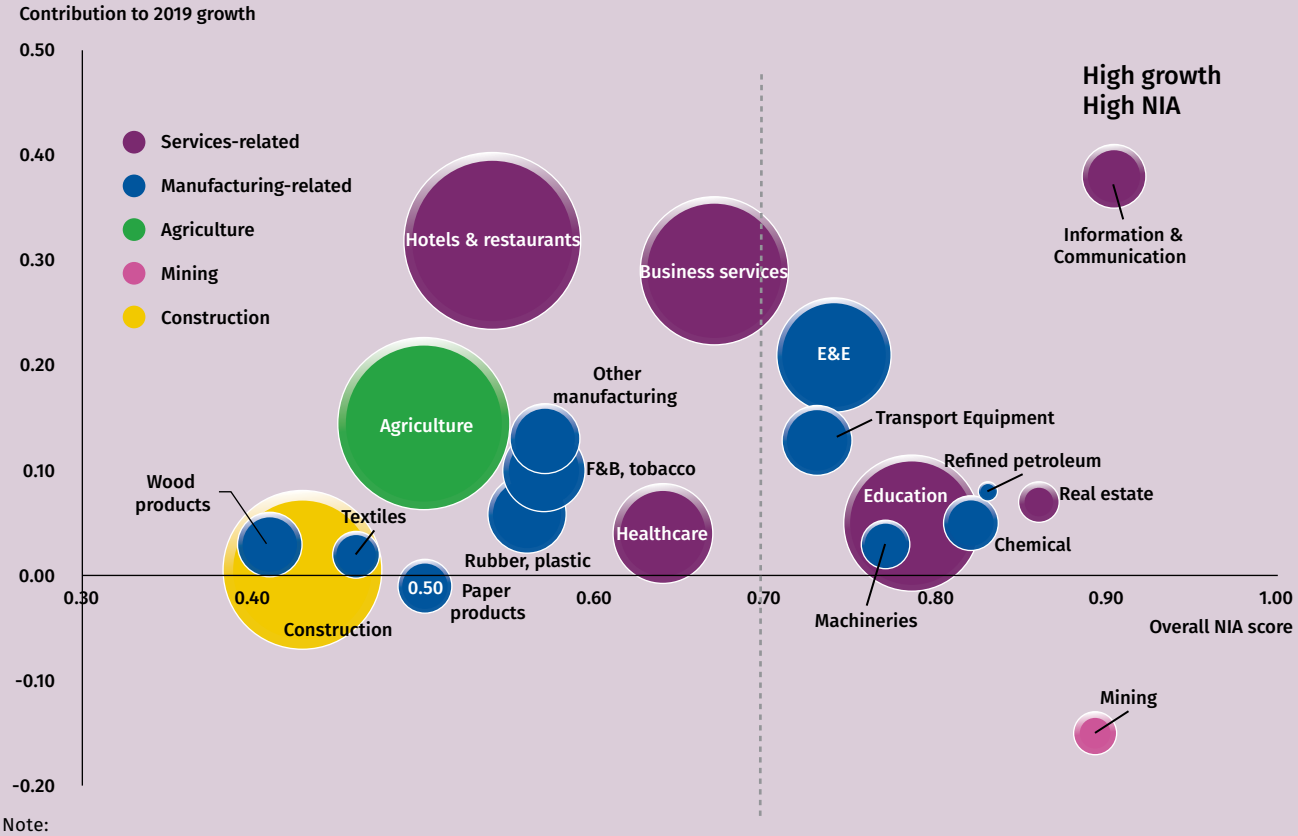
Identifying the Right Activities

Moving beyond a sectoral focus, Malaysia needs to invest in activities and acquire knowledge and capabilities that increases sophistication and income levels over time. This can be undertaken by (i) strengthening activities that meet the NIAs; (ii) diversifying into more complex products and (iii) employing a mission-based investment approach (see Sub Box on Mission-based Investment Approach) that harnesses cross-industrial contributions towards a single economic objective.

i) Quality investments in activities that meet the NIAs

Building on the overarching focus on quality investments outlined under the NIAs, investments need to be targeted more toward knowledge-intensive and tech-intensive activities. These include information and communication technology (ICT), manufacturing of E&E products, chemical-related products, renewable energy, refined petroleum, machineries and transport equipment (Chart 1). Notably, downstream chemical and ICT industries demonstrated not only high NIA scores, but also significant industrial linkages that generate greater spillovers to the wider economy (Chart 2). Investments should aim to facilitate the "functional upgrading" of Malaysia's business proposition in global value chains, in particular by deepening the contribution from business services activities, including R&D, design and development and engineering services.

Chart 1: Sectoral Contribution to Growth, NIA Scores and Share of Employment



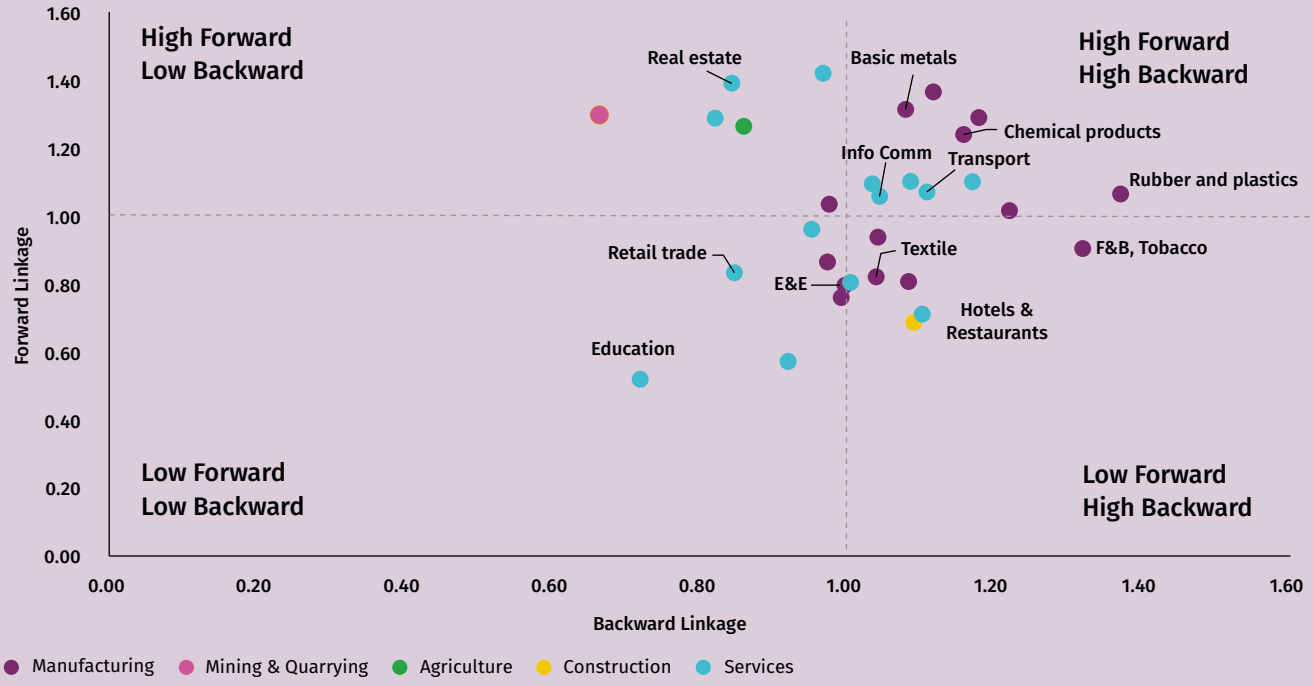
Note:

1. Size of bubble denotes share of employment in 2019.
2. Subsectors with NIA score of 0.7 and above are considered as high performing subsectors, with highest propensity to innovate, involved complex products and have relatively high productivity levels.
3. Within subsectors with NIA scores below 0.7, there are activities that by themselves have NIA scores above 0.7. Examples include 'hospital, medical and dental activities' in healthcare and 'scientific and R&D activities' in business services.

* The NIA score is computed using 10 indicators for the 5 NIA aspects of increasing economic complexity, creating high-value jobs, extending domestic linkages, improving inclusivity as well as developing new and existing clusters.

Source: Department of Statistics, Malaysia, Asian Development Bank and Staff calculation*

Chart 2: Sectoral Forward and Backward Linkages



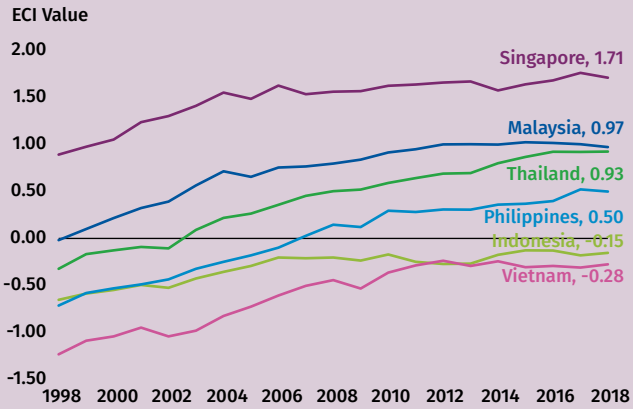
* The Forward and Backward linkages are derived from the Input-Output analysis using data by Asian Development Bank (2018)

Source: Department of Statistics, Malaysia, Asian Development Bank and Staff calculation*

ii) Diversifying into More Complex Products

One of the NIAs calls for Malaysia to continue to expand its product mix and deepen its product complexity. The Malaysian economy has improved over the past 20 years in terms of economic complexity, ranking 26th in 2018 (1998: 52nd) with an Economic Complexity Index (ECI) of 0.97, though the value has been broadly unchanged in recent years (Chart 3).

Chart 3: Regional Comparison on Economic Complexity Index (ECI)



Source: Observatory of Economic Complexity. MIT (2018)

For Malaysia, there are ample opportunities to strengthen its ECI further, given its existing exports strength and capabilities. The Atlas of Economic Complexity outlines many potential growth opportunities. Malaysia could adopt a balanced growth strategy[3] by focusing on (i) exploiting 'low hanging fruits' from existing know-hows and production capabilities established over the years; and (ii) concurrently taking 'long jumps' by encouraging domestic firms to upgrade their technological capabilities and venture into areas that develop new competitive advantages (Table 1). While this is typically a high-risk strategy, it can be more rewarding in the long-run as it deepens Malaysia's contribution within global supply chains and advances partnerships with leading academia and industry leaders for knowledge diffusion.

Table 1: Dual Track Strategy to Accelerate Product Complexity in Malaysia*

Strategy 1: 'Low Hanging Fruits'	How to get there?	Strategy 2: 'Long Jumps'
• Opportunities **closer** to existing know-how • Lower risk as economy already has capacity	→	• Opportunities **further** from existing know-how • Higher risk and require calculated strategy
Examples of product opportunities*		
Liquid crystal devices Apparatus and equipment for photographic laboratories Flat-rolled alloy steel products	**Machinery**	Instruments for physical or chemical analysis Tools for hand working pneumatic, hydraulic motors
Video recording apparatus	**Electronics**	Electric soldering machines
Oxygen-function amino compounds Industrial acids Silicones in primary forms Phenols, phenol alcohol	**Chemicals**	Polyamides Nucleic acids and their salts Orthopaedics Lubricants

* As recommended by the Atlas of Economic Complexity as of 2018

Source: The Atlas of Economic Complexity

Mission-based Investment Approach: Harnessing cross-industrial contributions towards a single economic objective

A 'mission-oriented approach' to organising an investment collaboration network in Malaysia can create a higher economic multiplier than funding for a single technology or sector. It leverages on private sector R&D and investment spending across multiple sectors into new, high growth areas of the economy. This supports the establishment of a constellation of innovative firms across different sectors instead of a single national champion (O'Riain, 2004). The mission-oriented approach is particularly relevant for systemic public policies that draw on frontier knowledge to attain specific goals, or "big science deployed to meet big problems" (Mazzucato, 2018 and Ergas, 1987). Such mission-oriented strategies characterised some of the success observed in countries such as the US, with the iconic NASA space mission to the moon in the late 1960s. This momentous mission required participation by multiple sectors, from semiconductors to advanced materials in the textile industry.

[3] According to Atlas of Economic Complexity by the Growth Lab at Harvard University, a country can diversify into highly complex and gain new product opportunities by implementing a dual growth strategy based on its existing export profile, namely 'low hanging fruits' and 'long jumps'. Under 'low hanging fruits', potential new products are of closest proximity to existing capabilities in the country, and are deemed 'low risk'. 'Long jumps' refer to new products that needs additional competencies and require higher risks.

A mission-oriented approach identifies a specific issue as well as the related solutions to address it. An example of this is the European Commission's mission to address climate change by having 100 carbon neutral cities across the EU by 2030 announced in September 2020 (European Commission, 2020), necessitating new investment across multiple sectors, such as energy, food, transportation and real estate.

There are 5 key characteristics in a mission-based approach (Mazzucato, 2018):

(i) bold and inspirational with wide societal relevance;
(ii) clear timeframe with targeted, measurable and time-bound action;
(iii) ambitious, realistically feasible and incorporates feedback effects between basic and applied research;
(iv) framed to spark multi-disciplinary innovation, across different industrial sectors and different types of actors; and
(v) bottom-up experimentation involving a portfolio of research and innovation projects.

Key US government agencies such as the Defense Advanced Research Project Agency (DARPA) and NASA's Jet Propulsion Laboratory (JPL) were major examples of using a mission-oriented approach in the development of critical technologies prevalent today, such as the Internet, global positioning system (GPS), robotic technology and a global satellite system (Mazzucato, 2015). Recognising this, other countries in recent years, including the UK, Japan, India and China have embedded a mission-oriented approach in their industrial strategy, largely anchored in the overarching goal of creating an innovation ecosystem.

Based on these principles, Malaysia should consider utilising a mission-oriented approach as an investment strategy in innovation by identifying the next 'moon-shot'[4] for frontier technology and innovative activities. Potential frontier technology areas for Malaysia include bioscience technology, neurotechnology, advanced pharmacology, augmented reality, additive manufacturing, artificial intelligence, robotics, battery technology, big data analytics, Internet of Things (IoT), additive manufacturing, and other advance manufacturing systems.[5]

The 3D's of Reforms

Malaysia can emerge stronger in the post-pandemic future by accelerating strategies to address the three D's of supply side reforms: Accelerating **D**igitalisation, Rethinking **D**ownstreaming, and Reducing **D**istortion.

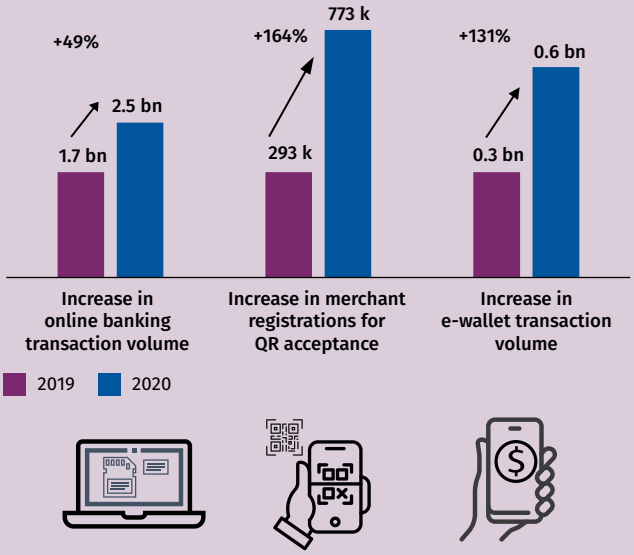
Reform 1

Accelerating Digitalisation: Embracing Digitalisation Nationwide

Over the years, Malaysia has been accelerating its digital adoption, being ranked as one of the top 20 countries in terms of digital skills (WEF, 2019), with digital-related activities accounting for a 19% share to GDP as of 2019 (DOSM, 2020). The growing momentum of digitalisation seen in 2020 amid the COVID-19 pandemic has lent further support to the economy, with Malaysia ranked as the fourth largest market in South East Asia (SEA) for e-commerce penetration[6]. More individuals and businesses are now embracing digital solutions to future-proof their businesses. For instance, the number of merchants who signed up for e-commerce and QR payments had more than doubled compared to the previous year (Chart 4).

[4] YAB PM's speech to the Youth Economic Forum 2021 (March 2021)
[5] Eligible activities under BNM High Tech Facility-National Investment Aspiration (HTF-NIA). Please see https://www.bnm.gov.my/-/establishment-of-rm1-billion-high-tech-facility-national-investment-aspirations-htf-nia-1
[6] JP Morgan eCommerce Payment Trends: Malaysia (2020)

Chart 4: Rising Use of Digital Solutions in Malaysia



Source: Bank Negara Malaysia

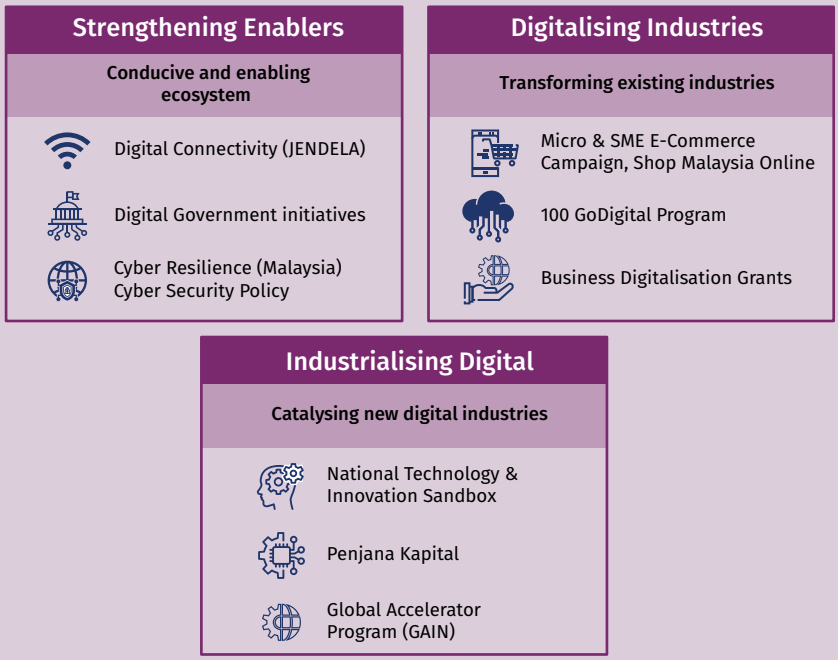
Moving forward, the Government and the private sector will continue to intensify efforts to catalyse nationwide digital transformation and strengthen its competitive position regionally, as stated in the 'MyDigital' Digital Economy Blueprint launched in February 2021. The Blueprint includes various measures to drive Malaysia towards become a digitally-driven high-income nation, accelerate the roll-out of key ecosystem enablers, digitalise existing industries and develop new digital industries as future growth drivers of the economy as Malaysia transitions to the Fourth Industrial Revolution (4IR). The latter includes industries built around frontier technologies, biotechnology solutions to rising healthcare needs, as well as greening the economy to better manage climate change risks.

The Blueprint, covering the period between 2021 and 2030, leverages on the momentum of digital growth. It outlines a three-pronged strategy, namely (i) accelerating the deployment of critical digital enablers; (ii) digitalising existing industries to raise productivity and unlock new strategic growth engines; and (iii) industrialising digital sectors as a key growth driver of Malaysia's economy (Diagram 2).

Execution of the 'MyDigital' plan is key in ensuring the effective rollout and implementation of digital enablers. These include digital connectivity of a nationwide fibre network and 5G as outlined under the National Digital Network (Jalinan Digital Negara or JENDELA), digital government initiatives such as a national digital ID database system, as well as a strong data governance framework supported by the implementation of a national cybersecurity policy. 5G connectivity, with an initial rollout by the end of 2021, ensures data acceleration, with greater volume, higher speed, low latency and high reliability required to meet the demands of modern life. The National Digital ID (NDI) database, to be rolled out in 2025, would accelerate the acceptance of digital signatures and electronic ID for secured authentication and seamless delivery of public services. This is in addition to e-Know Your Customer (e-KYC) usage by financial institutions as well as Government social services schemes for the lower-income population.

Digitalising existing industries is also essential in sharpening Malaysia's competitive edge, especially in boosting productivity in key sectors. The PENJANA Micro and Small-and-Medium-Sized-Enterprises (MSMEs) E-commerce Campaign launched in June 2020 has successfully on-boarded 45,000 MSMEs in e-commerce

Diagram 2: Accelerating Malaysia's Digital Transformation



Source: "MyDIGITAL" Digital Economy Blueprint, Malaysia Digital Economy Corporation and Bank Negara Malaysia

platforms and helped over 200,000 MSMEs adopt digitalisation solutions. Meanwhile, the Shop for Malaysia Online campaign successfully generated sales of almost RM900 million, and benefitted 213,000 local sellers nationwide as of October 2020[7]. The SME Business Digitalisation Grant and SME Automation and Digitalisation Facility were also made available to businesses to improve digital accessibility to consumers.

A critical area in need of digital transformation is the agriculture sector to boost productivity and enhance the nation's food security. The agriculture sector's value added per worker in Malaysia was only 45 percent of the average among high-income countries. Furthermore, 70% of Malaysian farmers are more than 60 years old[8]. In 2020, Malaysia was ranked 43rd out of 113 countries in the Global Food Security Index[9]. By leveraging on agriculture technology or AgTech through the use of advanced data analytics and drones for nutrient measurement techniques, pest disease control, worker productivity management and land consolidation, agro industries can become more economically efficient. As an example, utilising AgTech in paddy planting can potentially result in the doubling of yields in Malaysia[10]. The digitalisation of key information on competitive pricing, monitored crops, disease prevention tips, and disaster mitigation support could help transform the agriculture sector, improving income, production and market demand.

Malaysia also needs to catalyse new digital industries to unlock new sources of growth and seize the opportunities in the post-pandemic era. Priority should be given to develop home-grown tech champions and position Malaysia as a regional hub for new technology industries. This would leverage on Malaysia's existing strength as the 11th top emerging start-up ecosystem in the world and host to a third of the top 100 Forbes companies[11]. Policy measures that can be considered include supporting technology adopters with emerging technologies and the use of effective public procurement policies to stimulate innovative activities, shape

[7] LAKSANA Report (2020)
[8] World Bank (2019)
[9] Global Food Security Index, Economist Intelligence Unit (2020)
[10] Khazanah Research Institute (2019) and McKinsey (2018)
[11] Global Start-up Ecosystem Report (2020)

transformation of production systems, and foster industrial renewal (Crespi and Guarascio, 2019). For Malaysia, the Government is supporting local emerging tech companies under initiatives such as the National Technology and Innovation Sandbox (NTIS), Penjana Kapital and Global Accelerator Program.

Malaysia should also encourage innovation by strengthening domestic start-ups in developing critical technologies. For example, the pandemic has catalysed opportunities for 'mobility-as-a-service' technology solutions, including autonomous delivery vehicles and multi-modal transportation solutions. The global automotive industry has been increasingly driven by innovative communication-based technologies for autonomous driving, with high value-added sensors such as LiDAR (light detection and ranging), and RFID (radio frequency identification). This encourages synergies between the mobility and semiconductor ecosystems in Malaysia, thereby leveraging on Malaysia's comparative advantages. For a start, the Malaysian Automotive, Robotics and IoT Institute (MARii) has recently established partnerships with domestic start-ups to develop advanced car navigation systems for autonomous vehicles.

A new digital industry where Malaysia already has an ecosystem at present is in digital healthcare solutions. The industry is well positioned to further accelerate the post-pandemic future. These include areas such as emergency response systems, remote healthcare-monitoring, 3D printing, medical diagnostics kits and pandemic intelligence systems. Currently, Malaysia has a leading position, with 30% of global personal protective equipment (PPE)[12] production capacity, the 7th largest global exporter of E&E[13] and the 2nd largest medical devices exporter in ASEAN[14].

Reform 2

Rethinking Downstreaming: Producing Higher Value Add Palm Oil Products

The palm oil industry has contributed significantly to the Malaysian economy, creating jobs and lifting incomes, particularly for those in the rural areas. Nonetheless, more can be done to propel the industry forward towards high value creation and higher productivity.

Upstream palm oil activities in Malaysia face various challenges, including low value add creation, limited land banks for planting, declining competitiveness with neighbouring countries and higher susceptibility to supply disruptions due to climate change. To improve productivity and sustainability in the upstream sector in the post-pandemic era, Malaysia can differentiate its value proposition by playing a leading role in accelerating adoption of sustainable practices through the Roundtable on Sustainable Palm Oil (RSPO) certification for all oil palm plantations. This will enable Malaysia to distinguish itself from its direct competitors and other vegetable oils.

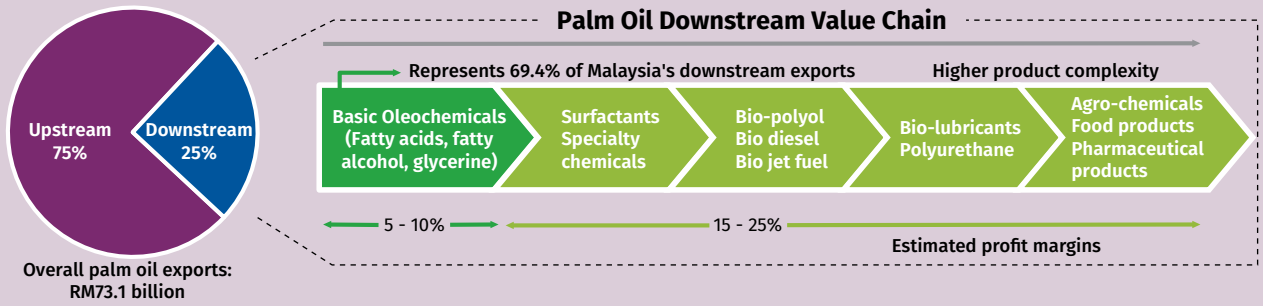
At the same time, advancement in the palm oil downstream segment has been hampered in recent years by the low operating margin amid the over-reliance in basic oleochemicals exports (Diagram 3). Furthermore, the high potential in R&D for the downstream segment in Malaysia has yet to be fully realised, largely due to the high capital outlays and long gestation period required.

To advance the sector, a rethink of downstreaming for palm oil, particularly in increasing quality investment, high value creation and retention within Malaysia, is vital. Adopting higher value downstreaming would accelerate the manufacturing of products with higher product complexity further up the palm oil value chain (Table 2).

[12] UN Comtrade Database (2020)
[13] Malaysia Investment Development Authority (MIDA) (2020)
[14] WITS, World Bank (2019)

Recognising the complementarity to the upstream segment, Malaysia could promote the use of RSPO-certified crude palm oil (CPO) in the higher value downstream segment. This will create greater demand, achieve economies of scale and reduce the price premium compared to non-certified palm oil. By adopting the global certification standards for sustainable palm oil, Malaysia could attract global multinational manufacturers in food and consumer goods to locate their production base in Malaysia and use the RSPO certified domestic palm oil products as inputs. At the same time, these MNCs could tap into the growing consumer demand for sustainable products not only globally but also within the Asian region by being closer to the market. For example, to service the Asia-Pacific region, two major MNC food manufacturers had located their facilities in Negeri Sembilan. One produces halal snacks, while the other centralises its malt beverage manufacturing activities. Both facilities are sourcing only RSPO-certified palm oil in their production, which measures up to the respective MNC's global sustainability policy.

Diagram 3: Downstream Value Chain in Palm Oil



Source: Malaysian Palm Oil Board and Bank Negara Malaysia

Table 2: Product Complexity Index of Selected Palm Oil Products

Selected Palm Oil Products	PCI (2017)	Rank (out of 6218 products)
Upstream		
- Crude palm oil	-2.466	6183
- Refined palm oil	-2.151	6125
Downstream: Basic oleochemicals		
- Fatty acids	-1.270	5449
- Glycerine	-0.088	3523
- Fatty alcohols	+0.042	3260
Downstream: Oleo-derivatives & specialty chemicals		
- Palmitic acid/Methyl ester (Biodiesel)	+0.320	2629
- Polyurethanes	+0.950	1099
- Vitamin E & derivatives	+1.222	621
- Lubricants	+1.651	184

Note: PCI measures the relative knowledge intensity of the product by considering the knowledge intensity of its exporters. The higher the rank, the more complex the product is relative to its exporters

Source: The Observatory of Economic Complexity (2017), MIT

On specialty downstream palm oil products, a venture capital approach could be an efficient method in pooling financial resources and minimising the concentration risks in undertaking R&D activities or investing in R&D start-ups. This can be driven through public-private partnerships in providing lead funding for R&D activities in advanced products such as specialty oleochemicals. The selection of R&D start-ups to receive capital venture financing must undergo thorough assessment of its commercialisation potential.

Additionally, Malaysia can also lead the efforts at environmental sustainability and 'greening the economy' by advancing the 'circular economy' model into the palm oil value chain. A 'circular economy' optimises wastage from palm oil production by recycling it into palm biomass and palm fibre. The latter has been used in construction materials, furniture as well as pulp and paper production, while the former has produced value-added products such as renewable energy pellets and briquettes. While Malaysia has over the years encouraged firms to enhance these activities through various tax incentives and grants, more can be done. This is particularly important given the global imperative on sustainability ahead of the 26th United Nations Climate Change Conference ('COP26') in Glasgow, United Kingdom scheduled in November 2021.

Reform 3

Reducing Distortion: Better allocative efficiencies in attracting quality investments

Malaysia stands to gain from minimising distortions in investment incentives by revamping the existing structure of tax incentives[15] to attract quality activities in line with the NIAs[16]. A timely and effective implementation of the Government's ongoing review on investment incentives[17] would be critical to realise the positive impact from providing a more competitive, transparent and attractive tax incentive framework.

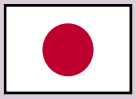
Tailoring investment incentives to key activities under NIAs is important. A more holistic approach that links incentives to specific activities aligned with NIAs would significantly strengthen prospects for attracting quality investment. For example, eligible firms engaging in activities such as cutting-edge R&D and advanced production techniques could receive an extended period for temporary tax incentives. In doing so, firms willing to invest in Malaysia can reduce potential uncertainties. Additionally, introducing an automatic appraisal system for standard, cost-based incentives would encourage greater efficiency and expedite investment decisions by firms.

A more effective tax incentive system will also mitigate the inefficient allocation of resources. This is particularly important as the cost of tax incentives distributed to firms by the Government is revenue forgone that could have been utilised to lower the nation's fiscal deficit or for use in other development projects. Furthermore, providing tax incentives for firms to undertake these quality investments effectively turns the Government into a 'silent and solid' partner in these investments. This reflects the Government's equity in incurring part of the capital expenditure in return for enabling the firms' return to growth[18].

Meanwhile, in the near term, investment promotion agencies (IPAs) throughout the world have taken steps to adapt their focus and engagements with the investment community in response to the crisis (Table 3). Malaysia has also been proactive by facilitating investment applications through the recently launched Project Acceleration and Coordination Unit (PACU). Additionally, it had announced an automatic 12-month extension for implementation of approved manufacturing projects in 2020 and 2021, and created a one stop centre for processing business travellers into Malaysia.

[15] For more information, please see the BNM QB 3Q 2017 Box Article "Rethinking Investment Incentives", available at https://www.bnm.gov.my/documents/20124/770509/p3_ba1.pdf
[16] For more information, please see the BNM EMR 2019 Box Article "Securing Future Growth through Quality Investments", available at https://www.bnm.gov.my/o/annual-report/html/files/emr2019_en_box1.pdf
[17] Feature Article on Tax Reform Committee in Budget 2021. Official website: http://belanjawan2021.treasury.gov.my/index.php/en/
[18] Wen, J. F. (2020). 'Temporary Investment Incentives'.

Table 3: Best Practices by Investment Promotion Agencies during COVID-19

Country	Agency	Actions
Germany 	Germany Trade and Invest	• Developed a special pandemic website to ensure the investment community has up-to-date information on financial support for businesses. • Provided industry-specific updates, highlighting information on sectors where the pandemic has generated increased demand such as digital solutions in education, logistics and health.
Japan 	Japan External Trade Organisation	• Established 'Invest in Japan' hotline and conducted an emergency survey to better gauge the impact of the pandemic on foreign-affiliated companies. • Launched the Digital Transformation Partnership Programme, which fosters open innovation between Japanese and foreign companies to prepare the country for accelerated digitalisation.
India 	Invest India	• Launched comprehensive portal devoted to pandemic-related news and tools targeted at the investment community. • Established dedicated communication lines for pandemic-related investor queries, facilitates strategic collaboration to identify and fill shortages in the supplies required to fight COVID-19, and actively engages key audiences in social media.

Source: *UNCTAD*

Conclusion

The 3D's of supply side reforms will enable Malaysia to emerge stronger in the post-pandemic future, with the right investment strategy and the right activities. Accelerating **D**igitalisation is an essential policy thrust amid the rapid technological changes today and in the coming years. These include sectoral initiatives focused on embracing digitalisation within the consumer-related, agricultural, mobility and healthcare industries. Rethinking **D**ownstream is also vital, particularly for Malaysia's palm oil industry, as higher value add through enhancing product complexity provides new growth opportunities. Finally, Reducing **D**istortion in providing investment incentives by tailoring these incentives to activities under NIAs will result in better allocative efficiencies by attracting quality investments.

A forward-looking pivot toward investment-led growth requires a bold strategy in attracting quality investments centred around innovation and the creation of highly complex products. In the post-pandemic future, these 3D's of reforms can propel Malaysia to attain greater policy adaptability and flexibility to accommodate the rapid shifts in trends. This in turn will provide businesses with an environment that is conducive for dynamism and creativity to capture new growth opportunities. Strong execution and follow through is key to ensure Malaysia achieves the desired goals from these strategies.

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Getting the Great Reset Right: Structural Labour Market Issues in the Post-COVID-19 World

Road to a Resilient and Agile Workforce

Over the past decade, the quest for productivity growth has spurred rapid technological progress and adoption, as well as the onset of the Fourth Industrial Revolution. This article seeks to discuss how the COVID-19 pandemic accelerated these shifts, and highlights structural impediments within Malaysia's labour market landscape. Going forward, while labour market conditions are expected to improve, these structural issues - combined with the uneven economic rebound - might hinder an entrenched recovery. This sentiment is echoed around the globe. In a recent update, the International Labour Organization (ILO) warned of an uncertain and incomplete recovery, given significant disruption to the labour market and impact on vulnerable segments of workers.[1] Nevertheless, the pandemic provides an opportunity for Malaysia's economy and labour market to "build back better" from the crisis, in what has been described as "The Great Reset"[2] in policy circles. This article concludes with a discussion of policy priorities to enhance the resilience and agility of the workforce, and strategies for building a more robust labour market ecosystem.

Part I: Prevailing Structural Issues

Over the years, Malaysia's labour market has been subject to various structural impediments. Even before the pandemic, these issues posed a challenge to national aspirations of becoming a high-income economy.

First, the prevalence of the low-cost production model and high dependence on low-skilled foreign workers discourages productivity enhancements, depresses wages, and encourages the creation of low-skilled jobs.[3] This is evidenced by the fact that industries which employ a higher share of low-skilled foreign workers tend to have lower productivity levels[4], relying on longer working hours to produce output. Furthermore, unchecked reliance on low-skilled foreign workers potentially introduces distortions to wage-setting mechanisms, leading to a suppression of local market wages[5]. Notably, industries which are more reliant on low-skilled foreign workers also tend to have lower median salaries and wages (Chart 1). Of greater concern, over the long run, continued reliance on labour-intensive, low-cost business models run the risk of de-coupling wage gains from improvements in overall productivity[6] and deterring the creation of high-skilled and high-paying jobs.

Despite the savings, a low-cost, labour-intensive production model is an untenable long-term strategy, particularly with Malaysia's peers actively in the process of innovating and upgrading themselves (Chart 2). In the World Intellectual Property Organization's (WIPO) Global Innovation Index 2020, Malaysia ranked eighth among 17 South East Asian, East Asian, and Oceanian economies. Relative weaknesses identified include high cost of redundancy[7], low business sophistication, and poor creative, knowledge and technology outputs. Comparatively, the top three economies in the region were Singapore, South Korea, and Hong Kong.

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1 International Labour Organization (2021). ILO Monitor: COVID-19 and the world of work, 7th Edition.

2 The phrase "The Great Reset" was first popularised as the title of Richard Florida's 2010 book, written in the aftermath of the 2008-09 Global Financial Crisis. In essence, it is the idea of leveraging on crises to reinvent and reboot. Crises set the stage for an overhaul of the economy, supported by technological advances which enable new ways of getting things done. This term has also been used by the International Monetary Fund (IMF) and World Economic Forum (WEF) in the context of discussing policy priorities for growth and the labour market in the post-pandemic recovery.

3 Please refer to previous discussion in "Low-Skilled Foreign Workers' Distortions to the Economy" in the Bank Negara Malaysia 2017 Annual Report.

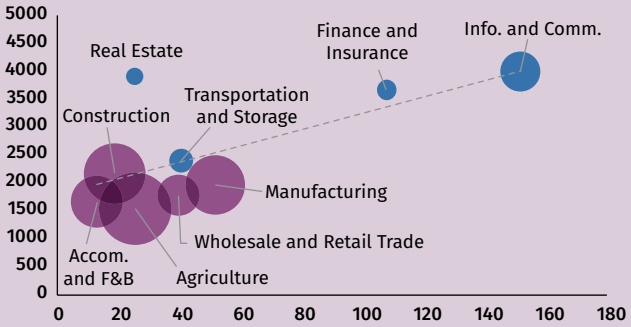
4 In this article, labour productivity refers to the ratio of gross domestic product to the total number of hours worked.

5 Whether immigration and foreign labour suppress employment and wage opportunities for local workers is a much-debated issue. At the forefront, in the context of the US, are George Borjas and David Card. Card (1990) found that the large influx of Cuban migrants during the "Mariel boat lift" had no negative effect on the wage trend for low-skilled workers in the US. In 2015, Borjas, using the same set of data, found that the drop in low-skilled wages in 1979-1985 was as much as 30 percent. Ultimately, findings on both sides are contentious as data relating to immigration studies is imperfect and sensitive to different configurations and comparisons. In the Malaysian labour market, the World Bank (2015) found the increase in migrant workers to be a net positive for GDP and wages overall, but reduces wages of low-skilled workers, or "least educated Malaysians", and existing migrant workers in the country.

6 The link between wage and productivity in the Malaysian labour market is further detailed and examined in "Are Workers Paid Fairly? An Assessment of Productivity and Equity" in the Bank Negara Annual Report 2018.

7 In accordance with the World Bank's "Doing Business" publication series, redundancy costs measure the cost of advance notice requirements and severance payments due when terminating a redundant worker, expressed in weeks of salary.

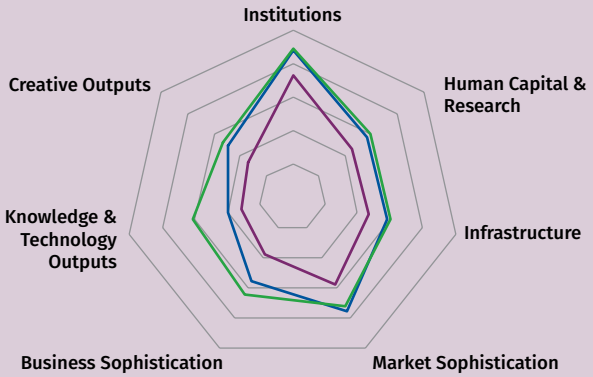
Chart 1: Productivity and Median Monthly Salaries and Wages by Industry, 2019



Note: X-axis - annual labour productivity (value added per hour worked, RM); Y-axis - median monthly salaries and wages of employees (RM); bubble size - share of non-citizen employed persons to total employment in respective sectors (%). Chart does not include *mining* sector (productivity: RM548.50 per hour worked; median salary and wage: RM3,968 per month; share of non-citizen workers: 5.6% of total employment in the *mining* sector).

Source: Bank Negara Malaysia estimates using data from Labour Productivity Statistics, Salaries & Wages Survey Report, and Labour Force Survey Report published by the Department of Statistics, Malaysia

Chart 2: Malaysia's Scores in the Seven Pillars of the WIPO's Global Innovation Index 2020



Source: Global Innovation Index 2020 Report published by the World Intellectual Property Organization

Furthermore, in the Bloomberg Innovation Index 2021, Malaysia ranked 29th out of 60 economies, dropping two spots from the previous year. Malaysia performed below average in criteria such as productivity, pervasiveness of tertiary education, and researcher concentration. In comparison, South Korea and Singapore ranked first and second, respectively.

The second structural issue is the low creation of high-skilled[8] jobs, which has lagged behind the supply of graduates[9] (Chart 3). Malaysia's share of high-skilled job creation declined to an average of 27% in the period 2010-2019, from approximately 51% in the previous decade. This corresponds to 86,200 employment gains per annum between 2010-2019, while the number of graduates in Malaysia has increased by an average of 151,000 persons per annum over the same period.[10] These figures complement findings from a Khazanah Research Institute study[11], which showed that 95% of young workers in unskilled jobs and 50% in low-skilled non-manual jobs were over-qualified for the occupations they were in. The most recent Graduate Tracer Study by the Ministry of Higher Education (MOHE)[12] suggests a similar story, revealing that approximately one-third of graduates end up in mid-skilled and low-skilled occupations. Ultimately, this suggests that the economy has not been creating sufficient high-skilled jobs to absorb the number of graduates entering the labour force, leading to skill-related underemployment[13].

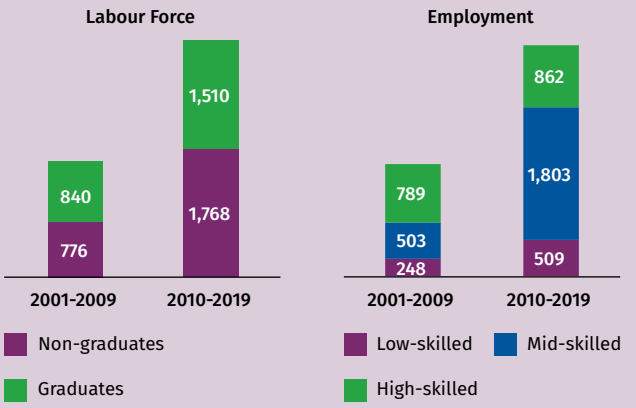
Third, there appear to be significant mismatches between skills required by industry and those that workers possess. According to an Organisation for Economic Co-operation and Development (OECD) study[14] on skills imbalances in Malaysia, employers reported shortages in communication skills (e.g. oral expression and writing), social skills (e.g. social perceptiveness and social orientation), and physical abilities (e.g. static strength and stamina). These findings are broadly consistent with hiring difficulties reported by Malaysian

[8] High-skilled occupations include major occupation groups like managers, professionals and technicians and associate professionals. Mid-skilled occupations include clerical support workers; service and sales workers; skilled agricultural, forestry, livestock and fishery workers; craft and related trades workers; and plant and machine operators and assemblers. Low-skilled occupations include elementary occupations.
[9] Graduates refer to individuals aged 15 years and over with the highest certificate obtained from universities, colleges, polytechnic, recognised bodies or equivalent, where duration of study is at least two years. Graduates are classified into two categories, namely diploma graduates and degree graduates.
[10] Authors' estimates based on statistics from the Labour Force Survey Report, 2019, Department of Statistics, Malaysia.
[11] Khazanah Research Institute (2018). "The School-to-Work Transition of Young Malaysians".
[12] Ministry of Higher Education (2019). Graduate Tracer Study.
[13] According to the Department of Statistics, Malaysia (DOSM), skill-related underemployment is measured as those with tertiary education working in semi/mid-skilled and low-skilled occupations.
[14] OECD (2019). "Reducing Skills Imbalances to Foster Productivity Growth of Malaysia," OECD Working Paper.

employers in the past, with an additional shortage of high-level cognitive skills (e.g. critical thinking, problem solving).[15] Additionally, separate insights from the Critical Occupations List (COL)[16] highlighted mismatches for occupational skills. Notably, occupations such as Information and Communication Technologies (ICT) managers, software developers, and electronic engineers have consistently appeared in every COL since it was first published in 2015, indicating continued demand and difficulty to fill these positions. Evidently, there is room for improvement in terms of ensuring the quality of the labour supply is on par with recruiters' wish lists. This is exacerbated by the reportedly passive collaboration between industry and education and training institutions in human capital development and recruitment initiatives[17].

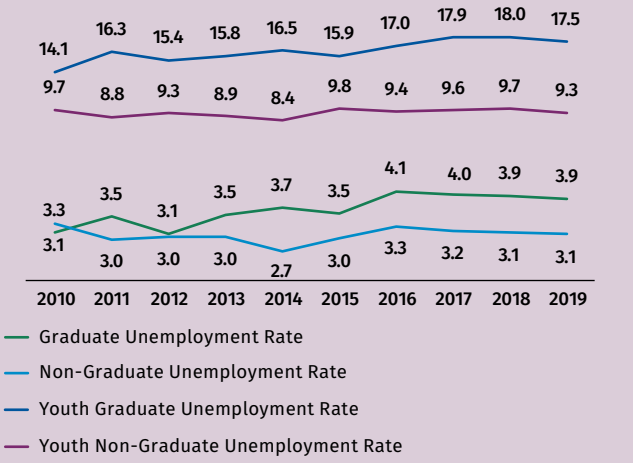
Consequently, these three structural issues have resulted in weak labour market outcomes, especially for youth and graduates. Historically, the youth unemployment rate has consistently been two to three times higher relative to overall unemployment.[18] In 2019, the youth graduate unemployment rate remained elevated at 17.5%, with the overall youth unemployment rate at 10.5%. Meanwhile, the unemployment rate for graduates has been consistently higher than that of non-graduates in the past decade (Chart 4). With regards to income, there are potential signs of diminishing returns to education, as entry-level salaries and wages for graduates have remained concerningly low. In fact, starting salaries for graduates have been stagnant when taking into account corresponding movements in consumer prices. In 2018, a graduate would have received an average estimated starting salary of only RM1,983 in real terms, a slight decline from RM1,993 in 2010[19].

Chart 3: Labour Force Gains by Highest Certificate Obtained vs. Employment Gains by Occupations ('000 persons)



Source: Bank Negara Malaysia estimates using data from Labour Force Survey and Graduate Statistics Reports published by the Department of Statistics, Malaysia

Chart 4: Unemployment Rate of Graduates and Non-Graduates (% of respective labour force)



Source: Bank Negara Malaysia estimates using data from Labour Force Survey Report published by the Department of Statistics, Malaysia

Part II: Impact of COVID-19 on the Labour Market

The movement and labour restrictions implemented to contain the pandemic resulted in a sharp and unprecedented deterioration in economic activities and labour market conditions. High-frequency data from the Employment Insurance System (EIS), showed that jobless claims increased in March and peaked in June 2020, amid a drop in the job placement rate[20] (Chart 5). Official Labour Force Survey (LFS) figures confirmed

[15] World Bank (2014). "Boosting Trade Competitiveness," Malaysia Economic Monitor. Based on the report, firms consistently pointed out a deficit in desirable soft skills among fresh graduates, particularly communication skills (81% of surveyed firms), creative or critical thinking (56%), analytical skills (51%), problem solving (49%), and ability to work independently (47%).

[16] The COL is collated and updated by a committee led by TalentCorp on an annual basis. It is a set of occupations in demand that identifies skills imbalances across 18 economic sectors in Malaysia.

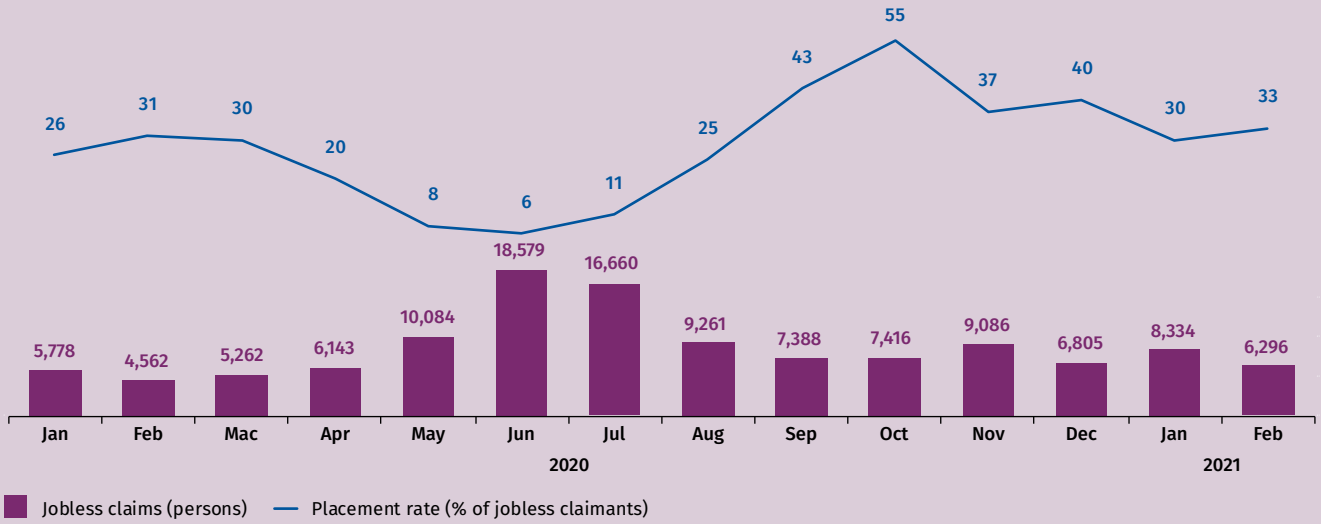
[17] Bank Negara Malaysia (2016). "Youth Unemployment in Malaysia: Developments and Policy Considerations," Annual Report. The analysis quoted insights from a 2014 TalentCorp survey which reported that 34% of companies have never collaborated with universities and 53% of firms surveyed have never engaged with career centres while recruiting for new candidates.

[18] This is not a phenomenon unique to Malaysia. Singapore, Vietnam, Korea and US also recorded youth unemployment rates that are two to three times higher than the overall unemployment rate.

[19] Authors' estimates based on findings from the MEF Salary Surveys for Executives and Non-Executives.

[20] Placement rate refers to the number of new job placements per 100 jobless claims. New job placements are proxied by Early Re-employment Allowance (ERA) claims, whereas jobless claims are measured using Job Search Allowance (JSA) claims. Both allowances are provided as benefits under the EIS by the Social Security Organisation (SOCSO).

Chart 5: Placement Rates and Jobless Claims



Source : Employment Insurance System data from the Social Security Organisation

that employment declined significantly from 15.1 million persons in 2019 to 14.9 million persons in the second quarter of 2020, as workers were laid off and did not have their contracts renewed while small businesses were impacted. In the same quarter, the unemployment rate increased to 5.1% (791,800 persons), the highest recorded since the commodity price crisis in the mid-1980s. This translated to an increase of 283,600 unemployed persons (2015-2019 increase: +57,900 persons), despite the decline in labour force participation during the quarter, which partially offset the rise in unemployment levels. Total hours worked per worker also recorded a reduction of 27.3%, leading to a significant increase in (time-related) underemployment.[21] Consequently, underemployed workers as a share of the total labour force increased from 1.2% (191,100 persons) in 2019 to 2.6% (413,500 persons) in the second quarter of 2020[22] (2017-2019 average: 1.4%). Both the higher unemployment and underemployment rates resulted in a substantial rise in the underutilised labour force to 7.7%[23]. Altogether, these developments led to workers losing part or all of their income, as reflected in the first contraction of quarterly services and manufacturing wage growth over the past eight years (Chart 6).

A partial recovery commenced as the restrictions on movements and labour were eased and economic activity resumed during the Conditional and Recovery Movement Control Order (CMCO & RMCO, respectively) periods in May to August 2020. This was mainly driven by the recovery in private sector employment, as standard employment registered a net gain of around 256,300 persons by the third quarter of 2020, and underemployment recovered as workers returned to full-time work during the quarter. EIS data showed a decline in jobless claims amid a rise in the job placement rate between June to October 2020, as layoffs were halted and workers were re-employed following a brief uptick in domestic travel. The re-impositions of CMCO 2.0 in mid-October 2020 and Movement Control Order (MCO) 2.0 in early January 2021, however, led to a further weakening of labour market conditions in the fourth quarter of 2020 and in the first quarter of 2021. This coincided with a modest rise in jobless claims amid a deterioration in job placement rates over November 2020 to January 2021.

[21] According to DOSM, time-related underemployment is defined as relating to those who are employed less than 30 hours per week (due to the nature of their work or because of insufficient work) and are able and willing to accept additional hours of work.
[22] Quarterly data on time-related and skill-related underemployment can be obtained from the Labour Market Review and Quarterly Labour Force Survey Report published by DOSM.
[23] Underutilisation is a broader concept of untapped capacity in the labour market. In this article, the underutilisation rate is measured as the sum of the number of persons unemployed and underemployed, expressed as a percentage of the labour force.

Chart 6: Selected Labour Market Indicators

Source: Labour Force Survey Report, Manufacturing Statistics, and Services Statistics published by the Department of Statistics, Malaysia

While overall employment conditions improved slightly from the trough in the second quarter of 2020, wage conditions remained weak, and the pandemic continued to have a negative impact on vulnerable segments of the labour market:

i) Non-standard employment continues to suffer from slower demand conditions and further restrictions

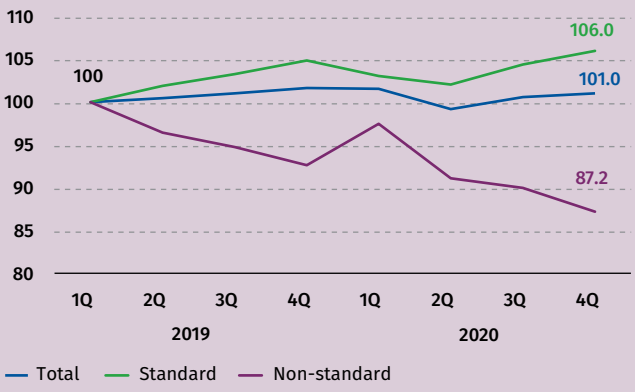
Although standard employment has begun to recover from the crisis, for non-standard workers[24] (such as the self-employed, gig workers, and owners and employees of small and family-owned businesses), employment has yet to see a rebound (Chart 7). In the second quarter of 2020, non-standard employment recorded a steep decline of around 252,000 persons and continued to experience a net decline in employment for the remainder of the year. The continued job losses stemmed from the concentration of these workers in *high-touch* sectors that remained affected by the pandemic, containment measures, as well as the "New Normal" standard operating procedures (SOPs) to ensure physical distancing in social spaces and business premises. The more severe impact on non-standard workers is also partially due to the fact that workers in non-standard employment arrangements are more likely to belong to micro and small businesses, which are more vulnerable to economic shocks relative to larger enterprises. Moreover, weak domestic demand conditions contributed to more limited employment and income opportunities for this segment of the workforce. They are also made more vulnerable due to their limited access to social protection and exclusion from coverage of social insurance programmes.

[24] In this article, non-standard employment is proxied by three categories of employment: own account workers, unpaid family workers, and employers. This is guided by ILO's examples of "diverse employment arrangements which deviate from standard employment", including temporary employment, multiparty employment relationships, dependent self-employment, and features prominently in the gig economy. On the other hand, standard employment refers to salaried employment that is continuous, with a direct relationship between employer and employee.

ii) Younger workers face very challenging labour market conditions immediately upon entry into the workforce

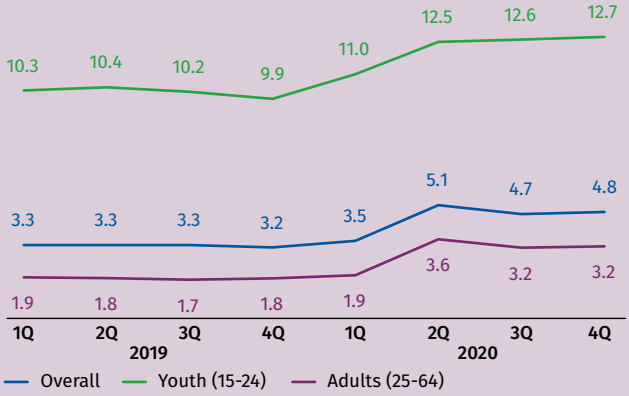
The youth unemployment rate, which has already been elevated for some time, increased from 10.9% in 2019 to 12.5% during the MCO in the second quarter of 2020, and remained elevated for the rest of the year (Chart 8). The lack of recovery in the youth segment alludes to relative disadvantages that younger workers face in the labour market. Firstly, youths tend to have a lack of work history, experience and career networks, and thus tend to have a harder time finding suitable employment, relying more on job-matching mechanisms like job search portals, career centres, and employment services. Second, younger workers may not have job-ready skills and require higher investments in initial training, making them less attractive to employers.[25] While these factors are already a challenge in normal times, fewer job opportunities, lower vacancies and higher financial pressures on businesses during a crisis make finding and holding down jobs significantly more difficult for younger workers. In addition, youths tend to hold employment in the mid-skilled occupations (72% of youth were employed in mid-skilled occupations in 2019; adults: 58%), while the pandemic has led to a net loss of around 176,900 mid-skilled jobs. Moreover, new graduates who were trained in *high-touch and tourism-related services* sectors may also find it more challenging to gain employment in industries less affected by the pandemic, especially in an environment where there are more experienced jobseekers in the labour market. Prolonged unemployment among the youth segment gives rise to a host of issues, including structural skills mismatches and skills atrophy, ultimately weighing on their long-term income prospects. Empirical evidence from previous studies in other countries shows that for fresh graduates, entering the labour market during a downturn can reduce earnings for up to 10 years post-graduation.[26] This reinforces the notion that closer policy focus is warranted to limit long-term scarring effects, particularly on the youth.

Chart 7: Total, Standard and Non-Standard Employment Indexed Levels (1Q 2019 = 100)



Source: Bank Negara Malaysia estimates using data from Labour Force Survey Report published by the Department of Statistics, Malaysia

Chart 8: Unemployment Rate by Age Segment (% of respective labour force)



Source: Bank Negara Malaysia estimates using data from Labour Force Survey Report published by the Department of Statistics, Malaysia

iii) Working women are disproportionately impacted by the pandemic

The downturn triggered by the pandemic has led to larger employment losses for women compared to men. This is in contrast to previous crises in Malaysia's history. Notably, in 2020, women's employment registered a negative growth rate of 0.1%, while men's employment registered a positive growth of 0.3% (Chart 9). While men's employment levels recovered by the fourth quarter of 2020, women's employment levels have yet to recover.[27] Furthermore, the women's labour force participation rate, which has historically been significantly lower than that for men (2010-2019 average for women: 52.5%; Men: 80.3%),

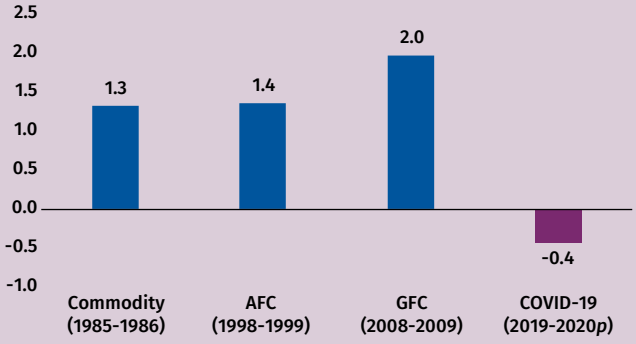
[25] Morsy, H. (2012). "Scarred Generation". Finance and Development, IMF.

[26] Kahn, L B (2010). "The long-term labor market consequences of graduating from college in a bad economy," Labour Economics 17(2): 303-316; Genda, Y, A Kondo and S Ohta (2010). "Long-term effects of a recession at labor market entry in Japan and the United States", Journal of Human Resources 45(1): 157-196., and; Oreopoulos, P, T von Wachter, and A Heisz (2012). "The Short- and Long-Term Career Effects of Graduating in a Recession", American Economic Journal: Applied Economics 4(1): 1-29

[27] Employment levels for women recorded 5,888.6 thousand persons in the fourth quarter of 2020, versus 5,871.0 thousand in 2019. For men, employment levels were 9,273.1 thousand persons in the fourth quarter of 2020, and 9,202.4 thousand in 2019.

decreased significantly during the onset of the crisis and stagnated after restrictions were lifted (Chart 10). This unwinds the steady increases observed over the past few years, and if unaddressed, may set back the progress of encouraging higher labour force participation among women. These patterns arise in the current crisis due to two factors: (i) Higher representation of women in *consumer-facing, contact-intensive services* subsectors[28]; and (ii) The provision of familial and childcare needs brought on by closure of schools and care facilities being largely borne by women[29]. Left unattended, Malaysia risks losing out on benefits from narrowing gender gaps in the labour market, including a significant boost to GDP, higher productivity, and higher incomes overall.[30]

Chart 9: Difference in Percentage Points between Women's and Men's Employment Growth, Malaysian Crises from 1986 to 2020



p Preliminary

Note: *AFC* Asian Financial Crisis
GFC Global Financial Crisis

Source: Bank Negara Malaysia estimates using data from Labour Force Survey Report published by the Department of Statistics, Malaysia

Chart 10: Women's Labour Force Participation Rate from 1Q 2018 to 4Q 2020 (% of working-age women)

Source: Labour Force Survey Report published by the Department of Statistics, Malaysia

While economic activity is expected to recover once the pandemic is contained, the recovery is likely to be uneven across sectors. COVID-vulnerable sectors, particularly *high-touch, high-contact, and tourism- and travel-related services* subsectors, are expected to recover at a slower pace, having been hit hard by repeated disruptions throughout 2020. The uneven recovery across sectors would, in turn, likely increase long-term unemployment in the near-to-medium term. This presents a risk to the labour force, as longer and repeated unemployment spells can worsen the degree of scarring on skills and incomes[31]. Taking a longer-term view, the COVID-19 pandemic also potentially induces further structural shifts in the economy and the labour market, particularly in view of accelerated adoption of technology, digitalisation, and organisational transformation. There are concerns that these shifts may result in a slower-than-expected recovery in employment following the crisis, leading to persistent unemployment, with accompanying impact on income and wages. In labour economics, this is often referred to as "hysteresis", or the "jobless recovery" phenomenon.

[28] Women constitute 53% of workers employed in *accommodation, food and beverage services activities* (share of women employed in the economy overall: 39% of total employment). Source: DOSM (2019). Labour Force Survey Report.

[29] In 2019, 3,023.1 thousand persons cited housework and family responsibility as their reason for remaining out of the labour force and not seeking work; 97.4% of these were women. Source: DOSM (2019). Labour Force Survey Report.

[30] In the long run, with the removal of economic barriers for women, Malaysia's income per capita could grow by 26.2%, translating into an average annual income gain of RM9,400. Source: World Bank (2019). "Breaking Barriers: Toward Better Economic Opportunities for Women in Malaysia," The Malaysia Development Experience Series.; Lagarde, C and J D Ostry (2019). "When more women join the workforce, everyone benefits. Here's why," World Economic Forum.

[31] Arulampalam, W. (2001) using data from the British Household Panel Survey, found that an unemployed individual, when returning to work, will face a ~5.7% wage penalty during the first year of employment. This increases to ~13.5% during the next three years. Subsequent spells of unemployment also carry a "wage scar", albeit not as large. Huckfeldt, C. (2016) documented that large and persistent earning losses from retrenchment were concentrated among workers who switched occupations after job displacement, which occur more frequently during recessions. In a survey of OECD countries, Quintini and Venn (2013) also report workers' earnings tended to fall significantly in the years following job losses, although the effect differs significantly across countries, gender, age groups and educational attainment.

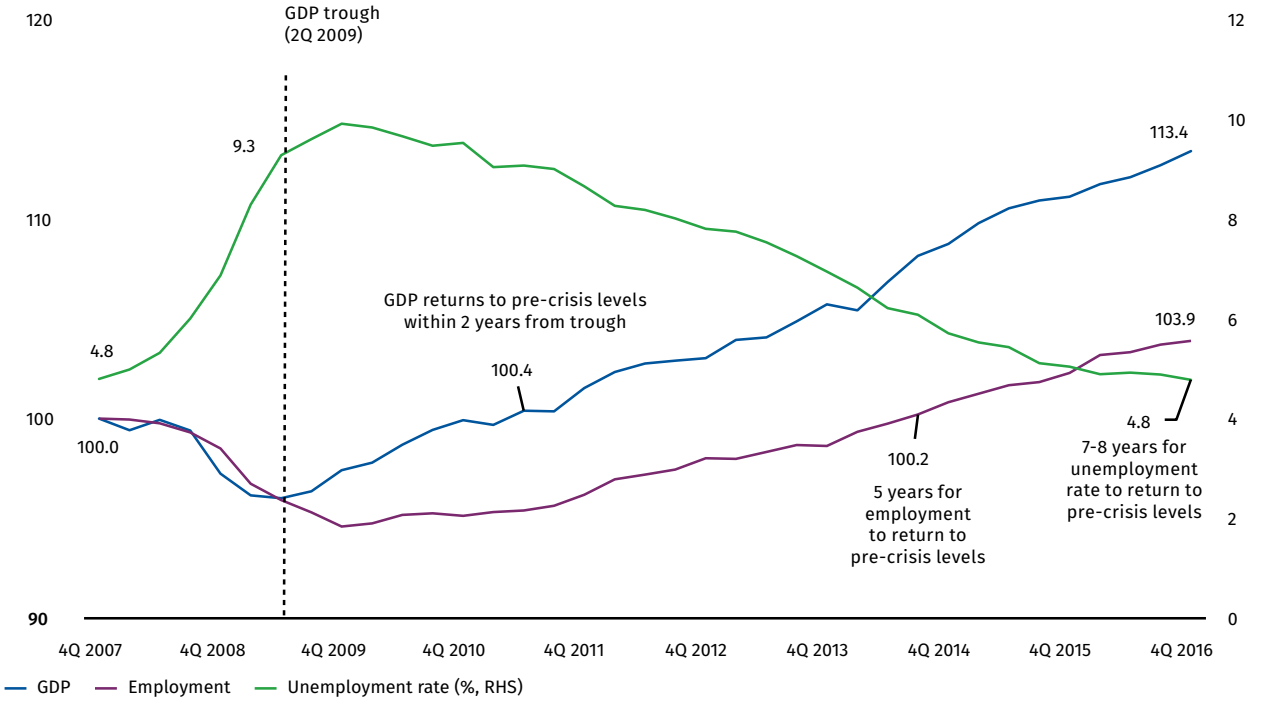
Jobless Recovery: What Is It and What Does It Look Like?

Definition

A jobless recovery is a situation where economic recovery occurs without a corresponding improvement in employment. Formally, it can be defined to occur when employment growth significantly lags behind output after a recession[32], also resulting in elevated unemployment long after the economic recovery.

A well-known case of a jobless recovery is in the US labour market following the 2008-2009 Global Financial Crisis (GFC), where the rebound in US output following the crisis was accompanied by a tepid recovery in employment. While quarterly output recovered to pre-crisis levels within two years from the trough, it took five years for employment and seven to eight years for the unemployment rate to return to pre-crisis levels (Chart 11). Discussion on jobless recoveries often revolve around the following three factors: i) Efficiency improvements; ii) Job polarisation[33], and; iii) Imperfect labour mobility.

Chart 11: US GDP, Employment and Unemployment Trends During the GFC (4Q 2007 = 100)



Source: Bank Negara Malaysia estimates using data from CEIC

Efficiency improvements: Changes in production modes and processes

Major recessions have instigated changes in the way companies organise themselves, produce goods, and provide services. In literature, this is dubbed as the "cleansing effect" of recessions[34], which stems from the Schumpeterian concept of "creative destruction"[35]. During a recession, outdated processes and

[32] Schreft, S L and A Singh (2003). "A Closer Look at Jobless Recoveries", Federal Reserve Bank of Kansas City, Economic Review vol. 88.
[33] The term "job polarisation" was first coined by Goos and Manning (2007). It is the phenomenon in which the share of employment in occupations in the middle of the skill distribution declines, while increasing on the lower and upper ends.
[34] This term was coined by Caballero and Hammour (1994) in their paper "The Cleansing Effect of Recessions", which investigates the response of industries to cyclical variations in demand within a framework of a creative destruction model.
[35] "Creative destruction" refers to the process of incessant innovation in which new production units replace outdated ones. Joseph Schumpeter popularised the concept, and originally described creative destruction as innovations in the manufacturing process that increase productivity.

production units with inferior technology are more easily scrapped in favour of newer, more efficient ones. This intertemporal reallocation towards productivity-enhancing activities could result in significant productivity gains over the medium to long term. To the extent that these efficiency enhancements stem from the substitution of workers with machinery or technology, significant shifts in production methods and processes may lead to slower employment growth following a crisis[36].

Job polarisation: Shrinking opportunities for mid-skilled occupations

Job polarisation refers to increasing concentration of employment in the highest- and lowest-skilled occupations, as job opportunities in mid-skill occupations disappear following structural shifts in the economy. Routine tasks tend to be concentrated in mid-skilled occupations[37], which are thought to be particularly susceptible to automation and technological replacement[38]. While this phenomenon has been observed steadily over the past few decades, recessions may also result in an acceleration of permanent job destructions in the mid-skilled occupations. Job polarisation has been cited as another potential contributing factor to a jobless recovery, given that mid-skilled jobs make up the largest portion of the labour force in most economies.

Imperfect labour mobility: Re-allocation of labour towards growth sectors

Recessions are typically associated with a reallocation of resources in the economy (i.e. capital and labour), from low-productivity to high-productivity activities and sectors. While the reallocation of resources can be a positive feature of the economy over the long term, in the short run, the reallocation of labour across sectors could be disruptive and costly to resolve, both in terms of time and resources. This is especially the case when the skills that workers have accumulated from previous occupations in a contracting sector do not match skills and occupations in demand in expanding sectors. Resolving these frictions during a crisis may take significantly more time (to find occupations that fit current skill sets, due to more limited employment opportunities), or resources (to cater to large-scale re-skilling or up-skilling programmes, amid other urgent priorities), resulting in slower employment growth following a crisis[39].

Malaysia's Experience

While the current health crisis has resurfaced concerns over the prospect of a jobless recovery, historically, Malaysia has never experienced such a phenomenon. During the Asian Financial Crisis (AFC), for example, the unemployment rate increased to 3.2% in 1998 (1997: 2.4%), but employment levels did not suffer a significant decline (1997: 8.57 million persons; 1998: 8.60mn; 1999: 8.84mn). During the GFC in 2008-2009, the Malaysian labour market exhibited similar developments; employment never dipped significantly below pre-crisis while the unemployment rate recovered relatively quickly, as labour market conditions rebounded strongly following robust growth post-GFC (Chart 12).

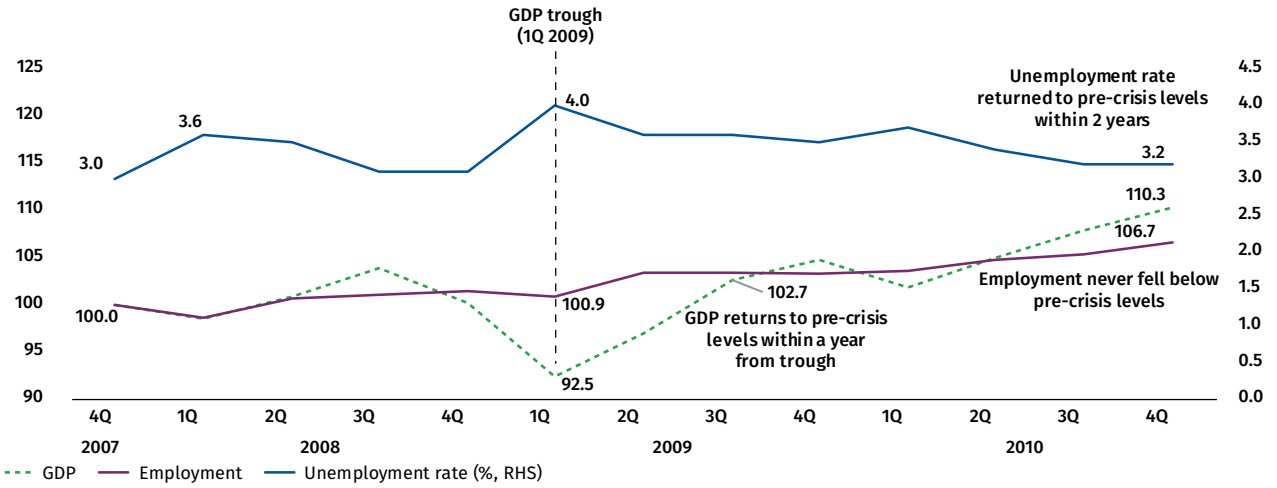
[36] Automation affects employment through two channels, the "productivity effect" and the "reinstatement effect". The former involves displacement of labour due to productivity-enhancing technologies; the latter involves the creation of new tasks in which labour has a comparative advantage. Source: Acemoglu, D and P Restrepo (2019). "Automation and New Tasks: How Technology Displaces and Reinstates Labour," Journal of Economic Perspectives, Vol. 33, No. 2, pp. 3-30.

[37] While routine tasks exist through out the skills distribution, these are characteristics of many mid-skilled jobs, such as bookkeeping, clerical work, and repetitive production and monitoring. Because the core tasks of these jobs follow precise, well-understood procedures, they can be codified in computer software and performed by machines. Source: OECD (2020). "Worker Security and the COVID-19 Crisis," Employment Outlook; Keister, R and P Lewandowski (2016). "A Routine Transition? Causes and Consequences of the Changing Content of Jobs in Central and Eastern Europe," IBS Policy Paper 05/2016.

[38] Jaimovich, N and Siu H (2018). "Job Polarization and Jobless Recoveries," National Bureau of Economic Research Working Paper.

[39] Aaronson et al (2004). "Can sectoral reallocation explain the jobless recovery?" Chicago Fed, Economic Perspectives, 2004, 2nd Quarter; Borio et al (2015). "Labour reallocation and productivity dynamics: financial causes, real consequences," BIS Working Papers; Bartelsman et al (2019). "Labour reallocation in Recession and Recovery: Evidence for Europe," National Institute Economic Review.

Chart 12: Malaysia's GDP, Employment and Unemployment Trends During the GFC (4Q 2007 = 100)



Source: Bank Negara Malaysia estimates using National Account and Labour Force Survey Report published by the Department of Statistics, Malaysia

This underscores the importance of policy intervention in reducing the severity of economic shocks to the labour market. For Malaysia, the impact of the pandemic was mitigated by a slew of measures to soften the economic burden of lockdowns on households, businesses and workers. Key policies under *PRIHATIN*, *PENJANA*, Budget 2021, *PERMAI*, and *PEMERKASA* packages include the Wage Subsidy Programmes (WSP 1.0, 2.0 and 3.0), increased access to the Micro Credit Scheme and micro-SME special grants, as well as enhanced hiring incentives under the *PENJANA Kerjaya* initiative. Continued policy support remains important to prevent economic and labour market scarring while the economy recovers from the pandemic.

Part III: Policy Priorities and Imperatives

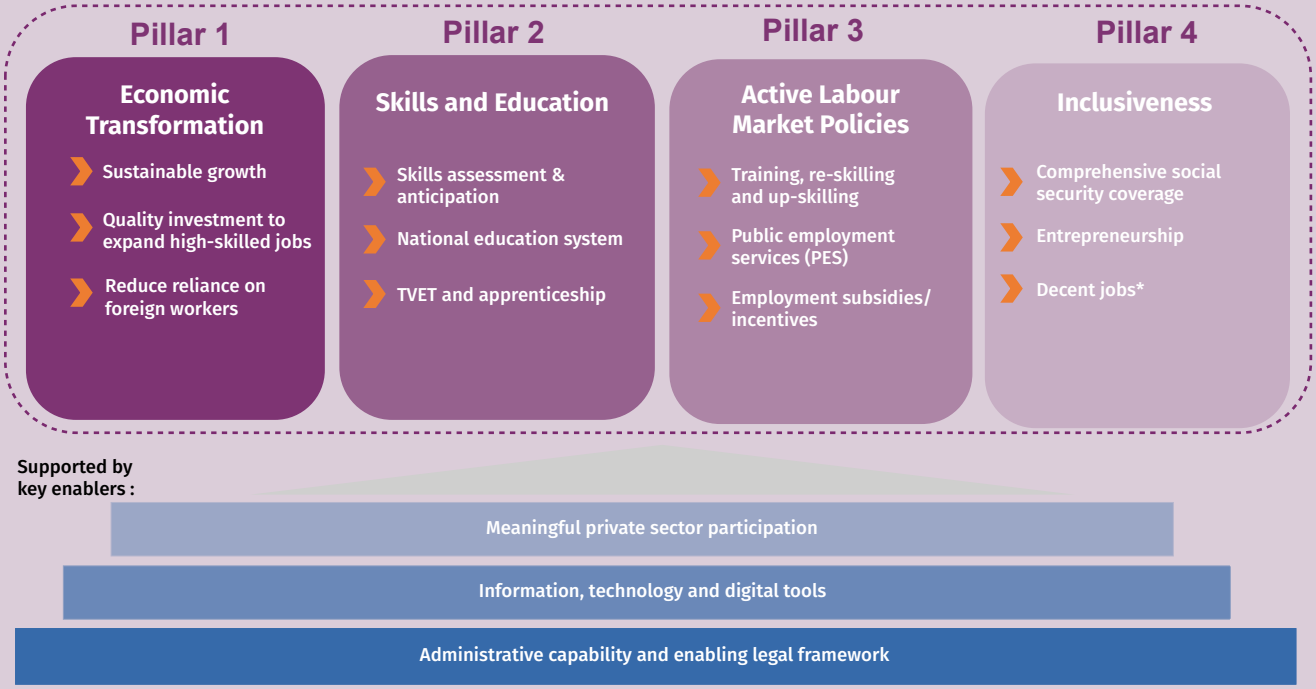
In November 2020, the Government formed the National Employment Council (NEC), which aims to coordinate and harmonise policies related to the labour market, with job creation as a key focus area. This is a welcome effort to strengthen prospects for an entrenched recovery, while ensuring effective implementation of key Government measures in the labour market. Among others, key initiatives outlined by the NEC include a long-term, strategic plan for the creation of employment opportunities, covering issues related to skills and labour shortages in key sectors, and equitable opportunities for vulnerable groups.

Notwithstanding the swiftness of the Government's response to the current crisis, Malaysia must not lose sight of the necessity to implement important long-term structural reforms. A holistic labour market policy framework could be considered, to guide policymakers in building a robust labour market ecosystem (Diagram 1).

Broadly, this framework encompasses policies to catalyse economic transformation, enhancing skills, training and education systems, strengthening Active Labour Market Policies (ALMPs), and promoting inclusive labour market outcomes. These policies should be supported by key enablers such as active private sector participation, comprehensive labour market data, and appropriate legal frameworks and administrative capabilities. Drawing from this policy paradigm, the following three policy strategies could be considered.

First, there is an urgent need to introduce policies and economic reforms that would ultimately lead to the higher creation of and demand for high-skilled and knowledge-based workers. At the top of the list, a holistic review of the current investment policy framework and incentives ecosystem is critical to reinvigorate investments. In this respect, adopting a clear vision and strategic direction is key. In the Bank's 2019 Economic and Monetary Review, the article on "Securing Future Growth through Quality Investments" outlined the "National Investment Aspirations" (NIAs) - five key criteria for quality investments which are aligned with

Diagram 1: Four Main Pillars of the Labour Market Policy Framework



* Jobs that meet conditions of security, dignity and equality

Note: Adapted from ILO's framework of labour market policies in response to the COVID-19 pandemic

Source: Bank Negara Malaysia

overarching national development goals[40]. These entail investments that: i) Increase economic complexity; ii) Create high-value jobs; iii) Extend domestic industrial linkages; iv) Develop new and existing clusters, and; v) Improve inclusivity. Moreover, a forward-looking, comprehensive and coherent plan to reduce reliance on foreign workers would nudge industries to gradually adjust and shift away from the low-cost production model. These reforms would ultimately enable the economy to transition into high-value production and more sophisticated and complex economic activities, and generate high-skilled jobs that command higher wages. Furthermore, the increased demand for high-skilled workers would ease the current excess of graduates in the labour market.

Second, efforts to enhance skills and facilitate the reallocation of workers to more resilient, productive, and high-growth areas must be intensified, with more focus towards the "future of work"[41]. These involve a broad range of policies to enhance the education and training ecosystems, as well as initiatives to improve the matching mechanisms in the labour market. This must include a systematic and sustained strategy to facilitate the continuous and constructive participation of industry, academia, and civil society in the design, formulation and implementation of labour, skills, and education policies[42]. In advanced economies such as Germany, Australia, and South Korea, as well as neighbouring economies like Singapore, policymakers, industry members, academics, and community leaders collaborate within Councils to identify skill needs, design frameworks to bring skills and qualifications up to standards, update academic and training curricula, and generally promote the enhancement of knowledge and skill levels of the workforce. This is critical for the workforce to meet evolving industrial needs and ongoing economic challenges. The permanent establishment of such a platform for collaboration in Malaysia would greatly aid current efforts to enhance the national education system, reform the national training ecosystem, and ensure strategic development plans are aligned with the evolving needs

[40] For further details on quality investments in activities that meet the NIAs, diversifiying into more complex products , and employing a mission-based investment approach, please refer to the box article titled "Innovation Malaysia: Towards Higher Quality Growth in a Post Pandamic Future"

[41] According to the OECD, the "future of work" revolves around digitalisation and globalisation, which spark radical shifts in how we live and work.

[42] Among OECD countries, about 75% of social partners and 30% of ministries cited lack of consultation with all relevant stakeholders as a significant barrier to conducting skill needs assessments. Source: OECD (2016). "Getting Skills Right: Assessing and Anticipating Changing Skills Needs".

of industry and community. In addition, enhancements to the implementation of ALMPs and capabilities of national employment services would further facilitate the adjustment of firms and workers to changing labour market conditions.

Active Labour Market Policies (ALMPs) in Malaysia

Definition

Active Labour Market Policies (ALMPs) are government policies that intervene in the labour market to help jobseekers (unemployed, self-employed, and employed) find re-skilling and up-skilling opportunities, apprenticeship, vocational and skills training, and ultimately work. The four main features of ALMPs are: (1) Assistance in job search process; (2) Recommendation of training and apprenticeship schemes; (3) Wage subsidies, public employment services, and public works programmes; and (4) Provision of support to micro-entrepreneurs and the self-employed.

As pointed out recently by the World Bank[43], even though Malaysia has made significant progress in its skills development system since the 2000s, there exists duplication and fragmentation in Malaysia's ALMPs. Specifically, implementation and deployment are spread over multiple agencies, leading to inefficiency and high administration costs. As a result, this manifests in relatively lower levels of programme spending and fewer beneficiaries. This fragmentation in the ALMP system also results in a lack of overarching strategy and importantly, weak linkages between training and employment support with the needs of industry.

[43] World Bank (2020). "Surviving the Storm," Malaysia Economic Monitor.

Third, initiatives to enhance labour market resilience should be intensified, beginning with closing gaps in, and enhancing access to, social security and insurance. The COVID-19 pandemic has highlighted the gaps in coverage of social protection in many countries. Of note, large segments of women, self-employed, and younger workers have low access to employment insurance, or social savings. There are also gaps in the coverage of training, re-skilling and up-skilling programmes. For instance, in Malaysia, training schemes for the self-employed and gig economy workers are not well-established or widely accessible. In a recent economic survey, OECD reported that older adults, workers in micro-enterprises, workers in the informal sector and women have limited access to training opportunities.[44] Thus, while workers in standard employment were provided with temporary income relief during the depths of the pandemic, many other workers were unable to access these funds and training schemes. In addition, specialised funds for vulnerable segments were limited, and information on

Table 1: Selected Key Policy Strategies and Priorities

Encourage demand for high-skilled workers	Improve training and matching mechanisms	Enhance labour market resilience
Reinvograte investments through NIAs	Enhance education and training ecosystems	Close gaps in social security and insurance programmes
Transition into high-value production	Secure cohesive participation of industry, academia, and civil society	Extend coverage of re-skilling and up-skilling programmes
Reduce reliance on foreign workers	Enhancement of ALMPs	Consolidate social protection programmes to widen accessibility

[44] OECD (2019). OECD Economic Surveys: Malaysia.

social protection programmes is fragmented and difficult to navigate.[45] These programmes also have different eligibility criteria under the charge of distinct Ministries and agencies. While the Government recognised these gaps and provided specialised assistance early on in the pandemic, broadening coverage and enhancing the reach of the social protection infrastructure to vulnerable segments would greatly increase the resilience of the labour force to future economic shocks.[46]

Conclusion

This article discussed key structural issues inhibiting the Malaysian labour market. First, there is an over-reliance on the low-cost production model. Second, the supply of fresh graduates far outpaces the creation of high-skilled jobs. Third, there are significant skills mismatches between graduates and industry needs. In the presence of these long-standing structural issues, the impact of COVID-19 is likely to exacerbate these problems. In addition, changes brought about by the pandemic are likely to accelerate the impact of technological advancement, with potential implications on the jobs recovery coming out of the crisis, as well as the types of jobs created in the future.

The health and economic crisis brought on by the COVID-19 pandemic can be viewed as a turning point - an opportunity to reset and build stronger fundamentals for the economy following the crisis. Over the long term, economic policies should be geared towards creation of high-skilled, high-paying jobs, with complementary focus on advancing skills enhancement, enhancing search and matching mechanisms in the labour market, and promoting more inclusive outcomes for vulnerable segments of the labour market. Current efforts by the Government to enhance the labour market statistics landscape are also welcome, as comprehensive, granular, and timely data on developments in the labour market is key in enabling quality analysis and the formulation of impactful policies.

[45] These include social safety net policies (e.g. *Bantuan Prihatin Rakyat*, MyGovernment), social insurance policies (e.g. *perlindungan tenang*, SOCSO), and ALMPs (e.g. platforms to facilitate job search and gig workers, like MYFutureJobs and MDEC's GLOW Programme; the training schemes under Human Resources Developement Fund (HRDF)/*PENJANA)*.

[46] For further reading, please refer to the box article entitled "A Vision for Social Protection in Malaysia" in this report.

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Asset Purchases by Central Banks

What are asset purchase programmes by central banks? Are they similar to quantitative easing (QE)? When is the appropriate time for asset purchases? This box article provides an overview of asset purchases by central banks globally. It examines the differences between purchases in advanced economies (AE) and emerging market economies (EME), and provides some key considerations in the context of Malaysian financial markets.

Background on asset purchases by central banks in AE and EME

An asset purchase programme refers to the purchase of financial assets (e.g. domestic government bonds, corporate bonds or asset-backed securities) by central banks via the creation of central bank reserves. This leads to an expansion of the central bank's balance sheet as it injects liquidity into the financial system. During the onset of the Global Financial Crisis (GFC), central banks in AE deployed large scale asset purchase (LSAP) programmes to mitigate the impact of the tightening of financial conditions on the financial markets and economy, conditions in which credit could also be restricted by excessive volatility and illiquidity in the financial markets. These programmes were then retained post-GFC as a tool for monetary easing to support economic activity given the persistent weakness in economic growth, commonly known as QE. The primary objective of these QE programmes were to encourage household spending and business investment by lowering long-term interest rates and signalling the central banks' commitment to retain monetary accommodation for an extended period. In conventional monetary policy, central banks typically aim to achieve a price-based operational target, say an interest rate target. LSAP programmes are deemed an unconventional quantity-based monetary policy tool[1] as they expand the balance sheet size of the central bank to achieve further monetary accommodation (Borio and Zabai, 2016). They are typically undertaken when short term rates cannot be lowered further due to constraints from the zero-lower bound/ effective lower bound (International Monetary Fund (IMF), 2013). As global economic activity came to a halt following the COVID-19 pandemic, central banks in AE, whose policy rates remained close to zero, once again embarked on larger LSAP programmes to support the economy.

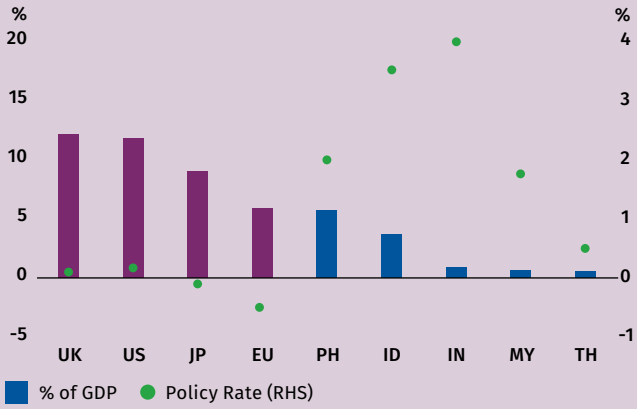
LSAP is less commonly deployed by EME central banks

In contrast, asset purchase programmes have not been commonly used by EME central banks in past crises such as the GFC as there was sufficient policy space for conventional monetary policy to support economic recovery. However, following the severe impact of the COVID-19 outbreak on the domestic financial markets and economy, some EME central banks have initiated asset purchases, primarily focusing on government bonds.

In comparison with the LSAP programmes by AE central banks, these asset purchases by EME central banks are different in terms of their objective and scale. Based on a Bank of International Settlement (BIS) study (Arslan, Drehmann and Hofmann, 2020) on 13 EME central banks, the stated objectives of EME asset purchases were primarily to reduce temporary illiquidity conditions in the domestic financial markets and address market dislocation and excessive volatility as opposed to providing further monetary accommodation to spur economic growth. Meanwhile, some central banks have also stepped in to moderate the impact on bond yields from the significant increase in financing needs by their respective governments (Carson, Kondo and Goyal, 2020). In these instances, the central banks took due considerations to avoid the perception of sustained deficit financing so as to preserve the independence of the central bank. These measures are largely in line with EME central banks' objectives to ensure that the financial markets are able to intermediate funds effectively to support the real economy while ensuring the well-functioning of the local bond market. Consequently, EME central banks' asset purchase programmes are notably smaller (Chart 1) and temporary in nature compared to the sustained LSAP programmes implemented in AE.

[1] Besides LSAP, other forms of unconventional monetary policy tools available to central banks include forward guidance and longer-term liquidity injections with incentives to encourage bank lending. Examples of these long-term liquidity facilities include the Targeted Long-term Refinancing Operations (TLTRO) by ECB and the Term Funding Scheme with Additional Incentives for SMEs (TFSMEs) by BOE.

Chart 1: AEs and Regional EMEs 2020 Asset Purchase Size

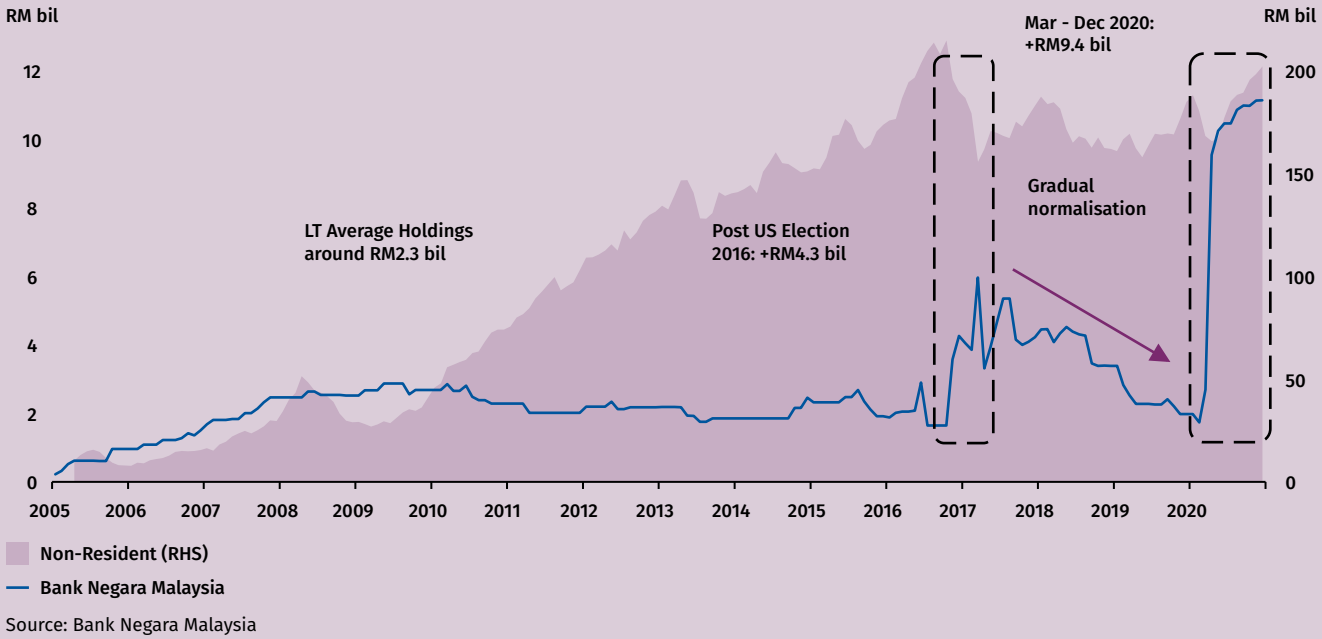


Source: IMF Global Financial Stability Report October 2020, Bloomberg
(Policy rates as at 10 March 2021)

Asset Purchases by Bank Negara Malaysia

Outright purchases of government securities have long been a part of the Bank's instruments for open market operations (OMO) in the bond market. The primary objective is to manage the banking system liquidity, whereby the Bank purchases government securities to inject temporary liquidity into the system as well as to build inventory for repo operations. The Bank's inventory is also used for its securities lending operations with the aim of promoting active two-way market making activities, particularly by Principal Dealers. As part of the Bank's mandate to ensure orderly functioning of the market, the Bank also steps in to purchase government securities during periods of excessive volatility and illiquidity. For example, after the US presidential election in 2016, RM4.3 billion in government bonds was purchased to smoothen excessive volatility and facilitate orderly price adjustment following large non-resident outflows. This was crucial to preserve the smooth functioning of the financial intermediation process and investors' confidence in the Malaysian financial market. Nonetheless, the Bank typically pares back its holdings (Chart 2) gradually as market stress subsides so as to minimise distortion to asset prices.

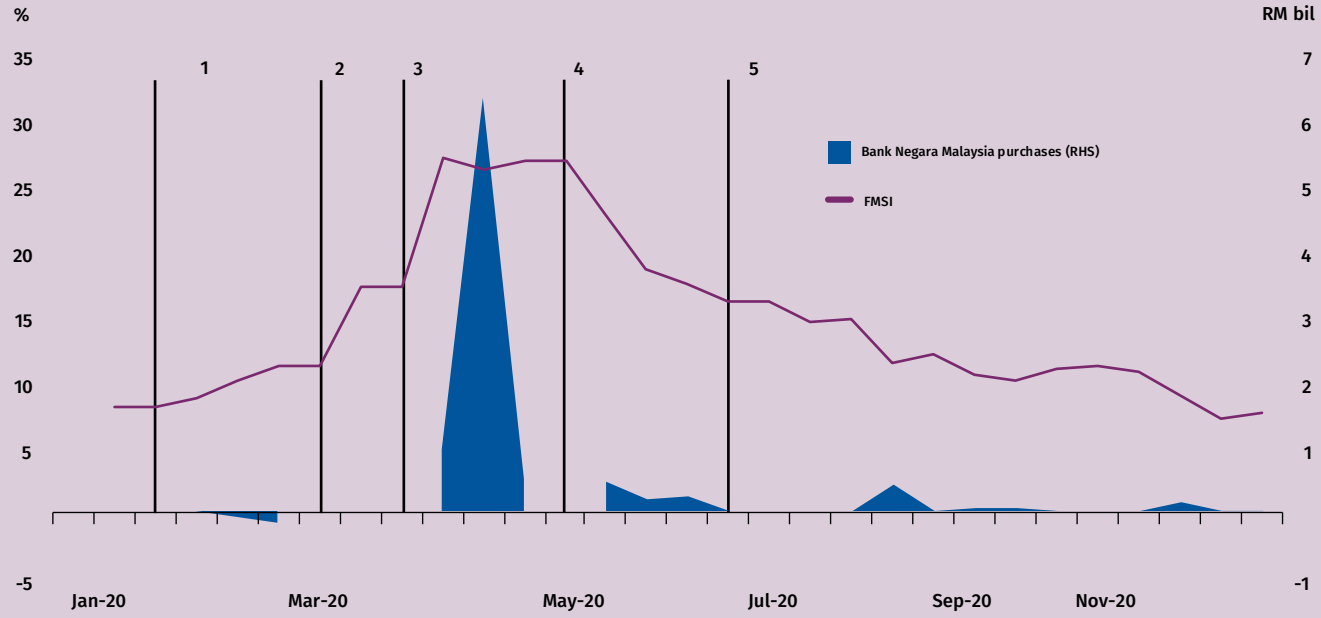
Chart 2: Bank Negara Malaysia and non-residents' Government Bond Holdings



Source: Bank Negara Malaysia

During the COVID-19 pandemic in 2020, domestic financial markets once again came under pressure amid large outflows by non-residents. Like other central banks, the Bank pre-emptively stepped in to provide liquidity through its reverse repo operation, reduction in Statutory Reserve Requirement (SRR) ratio and government bond purchases. From March to December 2020, the Bank has conducted outright purchases of government bonds amounting to RM9.4 billion, which is the highest amount purchased to date. The Bank's purchases were mainly in the secondary market (94%) while primary market purchases constituted a small percentage (6%) of total purchases, with total holdings of government bonds at RM11.1 billion as at end-2020. These purchases provided sufficient liquidity in the market and facilitated orderly price adjustments amid earlier signs of market stress. In addition, it ensured the Bank's readiness to use purchased securities for open market operations. Consequently, the stress in the financial market subsided, as measured by the Financial Market Stress Index (Chart 3), and the Bank was able to taper its government bond purchases.

Chart 3: Financial Market Stress Index (FMSI) and Central Bank's Policy Response during COVID-19 Period



Note:
1. OPR cut of 25 bps (22 Jan 2020)
2. OPR cut of 25 bps (3 Mar 2020)
3. SRR cut of 100 bps and recognition of up to RM1.0 billion of MGS/MGII as part of SRR compliance by Principal Dealers (19 Mar 2020)
4. OPR cut of 50 bps and recognition of MGS/MGII to fully meet SRR compliance by banking institutions (5 May 2020)
5. OPR cut of 25 bps (7 Jul 2020)

Source : Bank Negara Malaysia

Domestic bond market remained resilient during times of stress

Overall, the Malaysian bond market weathered the crisis and remained well-functioning throughout 2020. The Government and corporates were able to tap the domestic bond market for funding in 2020 amid the historically low yield environment with a total net issuance of RM118.7 billion. Demand for government auctions continued to be well-supported with an average bid-to-cover ratio of 2.2x (5-year average: 2.3x). This was despite the larger gross issuance size amounting to RM148.8 billion compared to RM115.7 billion in 2019. Credit spreads for corporate bonds swiftly normalised towards historical average levels with sustained net issuances in the months following the peak crisis period. Meanwhile, yield volatility remained manageable and below that observed among regional peers as the bond market, with the presence of large domestic institutional investors, has the capacity to absorb large sales from non-residents.

Table 1: Comparison of 10 years government bond yield volatility with regional peers

	Peak to Trough Movement (bps)	Peak 30D Yield Volatility (%)
Malaysia	+77	44
Regional Average*	+95	75

*Includes Korea, Philippines, Indonesia, India and Thailand

Source: Bloomberg

Asset purchases is a legitimate policy option for central banks with limited conventional monetary policy space

Based on a recent study by the IMF (Sever, Goel, Drakopoulos and Papageorgiou, 2020), asset purchase programmes by EME central banks have contributed to the stabilisation of domestic financial markets as bond yields trended lower upon asset purchase announcements, without significant short-term impact on the exchange rate. Nonetheless, the study highlighted various significant risks relating to weakening of central banks' credibility, fiscal dominance, intensification of capital outflow pressures as well as market dynamics distortion if the "large-scale and open-ended purchase programs are deployed beyond the current pandemic-related state" (Sever, Goel, Drakopoulos and Papageorgiou, 2020, p.16).

An Introduction to Conventional Monetary Policy Space and Effective Lower Bound

Part A: The Zero Lower Bound (ZLB) has traditionally formed the basis of monetary policy space

Historically, it is believed that the limit of conventional monetary policy is at zero percent, and this concept is known as the zero lower bound (ZLB). According to this view, monetary policy cannot go below zero because should negative nominal interest rates prevail, investors, businesses and households would simply hoard cash, disrupting lending and borrowing activities. The concern is that it would result in counterproductive effects to the economy. Thus, when short-term interest rates approach zero, it is traditionally argued that central banks cannot stimulate demand by further lowering short-term interest rates, resulting in the economy entering a liquidity trap.

Part B: Cross-country experience in the past decade suggests that the effective lower bound can be above or below zero percent

Nevertheless, global experience in the past decade suggests that the effective lower bound (ELB) to monetary policy is not necessarily zero – it can be above or below zero (Table 2). It is usually characterised by a point below which policy rate cuts would result in net negative effects to the economy, with commonly-cited symptoms including a contraction in lending and economic activity (Brunnermeier and Koby, 2019, Vieghe, 2019; Carney, 2019). These symptoms could be caused by factors that go beyond concerns over the flight to cash (See "Part C: Factors that determine the ELB"). They could materialise even when the policy rate is above zero. Conversely, a few central banks have adopted negative nominal interest rate policy with arguably some success (IMF, 2017), suggesting that the ELB could be negative in certain economies.

Given this development, the standard term currently used to describe the limit of conventional monetary policy has evolved from the ZLB to the ELB (Bernanke, 2017). Given the prevailing policy rate, an economy with a higher ELB would have limited conventional policy space because there are only so many policy rate reductions that can be undertaken to stimulate demand. Conversely, a lower ELB means that central banks have greater conventional policy space at their disposal.

Table 2: Cross-country ELB

ELB is positive or negative?	Country (policy rate as at early March 2021)	Published ELB		
Positive or near zero	Brazil (2.00%)	"Nobody is quite sure where the lower bound is" **"ELB is dynamic" and "significantly higher in emerging economies"** (June & May 2020, Reuters citing the President and Copom members of Banco Central do Brasil)		
	Canada (0.25%)	**0.25%** (2009-Present, cited in the Bank of Canada's press releases of monetary policy decisions)		
	Republic of Korea (0.50%)	**Close to 0.50%** (May 2020, Bloomberg citing the Governor of the Bank of Korea)		
	Thailand (0.50%)	**Above zero & depends on the prevailing economic and financial environment** (June 2015, cited in the Bank of Thailand's Monetary Policy Report)		
	United Kingdom (0.10%)	**Exploring negative rates** (May 2020, cited in interviews with the Bank of England's Monetary Policy Committee members)	"Close to but above zero" (2016-2020, cited in speeches by the Bank of England's Monetary Policy Committee members)	0.50% (2009-2016, cited in speeches by the Bank of England's Monetary Policy Committee members)
Negative	**Median rates among currently negative rate countries[1]: -0.6%**			

[1] Refers to Switzerland, Denmark and Japan, based on BIS data series on central bank policy rates, last updated on 17 February 2021

Source: Central bank websites, notes and press conferences, Reuters.com (2016), (2020a), (2020b), (2020c), Bloomberg (2020)

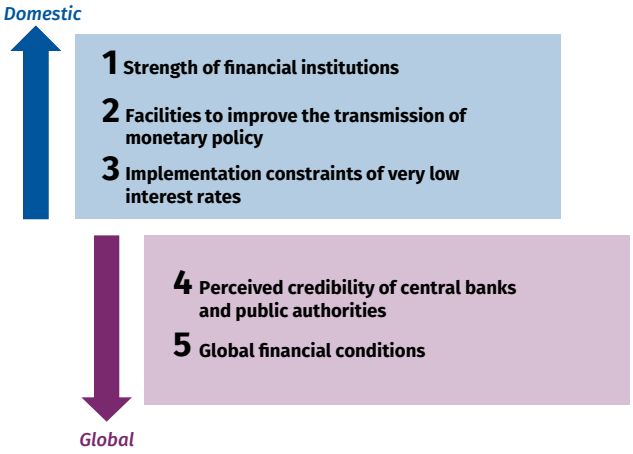
To prevent the economy from falling into a liquidity trap when the policy rate reaches the ELB, some central banks have utilised unconventional monetary policy tools such as LSAP of private or public debt securities, yield curve control and forward guidance.

Part C: Factors that determine the ELB

The ELB is highly dynamic, and can change depending on the interplay between many factors. Due to its dynamic nature, attempts to estimate the ELB solely based on a narrowly-defined partial equilibrium setting may have adverse consequences to policy decisions. As a result, many central banks rely primarily on the judgment of their monetary policy decision-making body, supplemented by cost-benefit analysis and model estimates. For example, the Bank of England has revised its ELB a number of times over the last ten years, reflecting changes in the factors and the judgment of its monetary policy committee members (Carney, 2019; Vieghe, 2019; Reuters.com, 2020c). The factors affecting the ELB can be loosely categorised into domestic factors, which domestic authorities have relatively more control over, and global factors, which may not be directly under the influence of domestic authorities (Chart 4).

Sound financial institutions' balance sheets would result in a low ELB, resulting in greater policy space for central banks. Policy rate reductions could negatively affect financial institutions' net worth in the medium term, insofar as lower rates lead to losses in net interest income that outweigh capital gains. As net worth reaches near its regulatory capital constraint, financial institutions may excessively reduce risk-taking activities to protect their capital by rebalancing their credit portfolio towards safer loans or shifting focus towards non-interest income. Consequently, lending activities in the economy may contract. At some point, monetary policy is at its "reversal rate" or the ELB, whereby further reductions of the policy rate below this level would be counterproductive to lending and the economy (Brunnermeier and Koby, 2019). In this framework, financial institutions with sufficient buffers may be less likely to encounter this issue, providing greater space for policy rate reductions.

Chart 4: Key factors influencing the ELB and monetary policy space



Other considerations: Changing consumption-saving dynamics, and physical constraints of holding cash

Source: Central bank websites, notes and press conferences, Reuters.com (2016), (2020a), (2020b), (2020c)

The introduction of certain facilities by the central bank can lower the ELB. Facilities such as Funding for Lending programmes were introduced by some central banks[2] to support effective transmission of monetary policy at very low rates. These funding schemes provide financial institutions with funding at rates that are low and close to the policy rate, thereby allowing financial institutions to lower lending rates on loans to their customers without significant compression in net interest margins (Nardi et al, 2018). This minimises disruptions to lending activities which could arise from compressions in margins and capital buffers. Consequently, central banks are able to ease policy to very low rates, while reducing counterproductive consequences to the economy.

In some countries, operational limitations and concerns over interruptions in financial markets have resulted in the authorities setting the ELB above zero. Many operational designs of global financial markets were not intended with near-zero or negative nominal interest rates in mind. For instance, there were rules governing the auction process for new US Treasury securities which do not permit bids associated with negative nominal interest rates. In the US, there were also rules which make it difficult for money market mutual funds to pay negative nominal rates to their investors (Keister, 2011). In principle, these limitations could be amended and removed, although such changes may take significant time to implement and could transfer disruptions to other markets (Keister, 2011). Meanwhile, other countries may not have such explicit rules and limitations, but have great concerns over the uncertainty about the impact of very low rates to the functioning of financial markets and incentives of their participants. The uncertainty has led some central banks to exercise caution by prescribing an ELB that is above zero (Bank of Canada, 2015).

For many EMEs, how low interest rates can go is also affected by global factors. **These include the perceived credibility of central banks and public authorities.** Credibility plays a role in global investors' confidence when determining their investment decisions. It could be derived from a track record of institutional reforms, good economic fundamentals and stronger policy frameworks, which allow countries to be in a more robust position when a crisis strikes. In its presence, Shin (2020) argued that credibility allows EMEs to loosen monetary policy more forcefully without undermining investors'

[2] For example, the Bank of England's Term Funding Schemes, European Central Bank's Targeted Long-Term Refinancing Operations and Reserves Bank of Australia's Term Funding Facility.

confidence. This would provide space for the authorities to lower monetary policy to a greater extent without significant concerns over destabilising capital outflows and unwelcome exchange rate depreciation. Conversely, in the absence of credibility, certain EMEs in the past were limited in their ability to manoeuvre policy rate during a crisis. In exceptional cases, some central banks were forced to raise interest rates sharply in the face of currency depreciation and capital outflows, sharply limiting their policy space (Shin, 2020).

Another important factor for EMEs is prevailing global financial conditions (Cavallino and Sandri, 2019; Rey, 2015). In the past, during periods of stress, domestic and external factors tended to interact in a perverse way, restraining policy space (BIS, 2021). For instance, amid global investors' flight to safe haven assets, some central banks in EMEs had to increase policy rates to stem capital outflows and unwelcome exchange rate depreciation, which would tighten domestic financial conditions and worsen economic outcomes. In contrast, during easy global financial conditions, such trade-offs would be less apparent. In this environment, EMEs are relatively shielded from foreign investor retrenchment, which allows for more aggressive easing in policy without disruption in external factors.

There are other considerations which may arise over a longer horizon. When interest rates are persistently low, **considerations on changing consumption and saving behaviour could come into play.** If people begin to worry that the low returns on savings will continue and expect insufficient savings to support their living after retirement, they may respond by increasing savings and reducing consumption (Borio and Hofmann, 2017; Hannoun, 2015; White, 2012). As a result, the stimulating effect of lower monetary policy on consumption diminishes and could even reverse.[3]

Another consideration, which only becomes relevant as policymakers are deciding between zero and negative nominal policy rate, is the physical constraints of holding cash. In principle, nominal interest rates cannot be below zero because investors, businesses or households would simply convert their deposits to cash. In practice, storing a large amount of cash entails significant costs such as for safe storage space. Holding cash is also inconvenient especially for large businesses to run their operations. As a result, some countries have set modestly negative policy rates without observing the flight to cash or the disruption of the intermediation process (IMF, 2017).

Part D: ELB in Malaysia

The ELB in Malaysia is currently assessed to be low and slightly above zero, providing sufficient conventional space going forward to weather further shocks. The low ELB reflects the strong fundamentals of financial institutions, which provide buffers for margin compression from policy rate reductions without substantially hampering risk-taking behaviour needed to stimulate the economy.

Externally, in the medium-term, the limited possibility of policy normalisation in AEs provides the assurance for possible further policy rate reductions in some EMEs including Malaysia without necessarily triggering destabilising outflows. In the near-term, receding global risk aversion and a benign external financial environment have also lent support to a low ELB, as risks of sudden stops in capital flows are assessed to be contained.

Nevertheless, the ELB is dynamic in nature, and future assessments of the ELB will consider the interaction between domestic and global factors. Should global factors dominate, as is likely the case for many EMEs, conventional monetary policy space may change in line with changes in external conditions or global investors' confidence.

[3] Currently, the formalisation of the consumption-saving dynamics in the context of monetary policy space is relatively scarce in the academic literature, but it is an argument that is important and often put forth in public and policy discourse (Borio and Hoffmann, 2017).

Prolonged large scale asset purchases pose several potential adverse long-term impacts

There are long-term adverse effects which may arise from asset purchases and these must be taken into account when deciding whether to deploy these policies. Firstly, the credibility and independence of a central bank may be compromised as its policy decisions may be influenced by its debt holdings and perception could arise that it may be financing fiscal deficits. Prolonged LSAP by central banks may also hinder the effective price discovery in domestic markets by supressing risk premiums. Additionally, a small and open economy like Malaysia may encounter complications in the execution of large scale asset purchases. For instance, lower interest rate differentials relative to EME peers resulting from expanded asset purchases may lead to capital outflows and pressure on the exchange rate, resulting in the tightening of financial conditions instead. Lastly, the effectiveness of LSAP in a bank-based economy such as Malaysia may be subject to multiple transmission layers with retail lending rates not typically benchmarked directly against long term bond yields.

Policy objectives and conventional monetary policy space are key considerations in deployment of unconventional policy tools such as large scale asset purchases

Due to the different policy objectives arising under specific circumstances, central banks will have different considerations in selecting the most effective tools to achieve their mandates. As observed in EMEs during the COVID-19 pandemic, asset purchases were deployed as part of open market operations, albeit at a smaller scale and temporary in nature to provide liquidity and ensure the continued smooth functioning of the financial markets during periods of heightened stress. Unconventional monetary policies, with larger scale asset purchases as a means for further monetary accommodation, are typically deployed when conventional monetary policy is deemed insufficient. For Malaysia, at the current juncture, there remains room in conventional monetary policy space for the purpose of further monetary accommodation to support economic growth. This negates the immediate need to deploy larger scale asset purchases for the purpose of monetary accommodation.

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Annex

Annex

CONTENTS

Key Economic and Financial Statistics

Table A.1

Gross Domestic Product by Kind of Economic Activity at Constant 2015 Prices

	2017	2018	2019	2020*p*	2021*f*
	RM million				
Agriculture	99,509	99,579	101,549	99,331	103,531
Mining and quarrying	105,838	103,512	101,438	91,342	94,188
Manufacturing	290,464	304,843	316,320	308,054	335,128
Construction	63,522	66,194	66,266	53,406	60,570
Services	723,361	772,685	820,069	774,857	826,121
Plus: Import duties	18,076	16,002	15,812	15,037	16,882
GDP at purchasers' prices[1]	**1,300,769**	**1,362,815**	**1,421,454**	**1,342,027**	**1,436,421**
	Annual change (%)				
Agriculture	5.9	0.1	2.0	-2.2	4.2
Mining and quarrying	0.4	-2.2	-2.0	-10.0	3.1
Manufacturing	6.0	5.0	3.8	-2.6	8.8
Construction	6.7	4.2	0.1	-19.4	13.4
Services	6.3	6.8	6.1	-5.5	6.6
Plus: Import duties	13.0	-11.5	-1.2	-4.9	12.3
GDP at purchasers' prices	**5.8**	**4.8**	**4.3**	**-5.6**	**6.0 ~ 7.5**

[1] Numbers may not necessarily add up due to rounding
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.2

Growth in Manufacturing Production (2015=100)

	2017	2018	2019	2020	2018	2019	2020
	Index				Annual change (%)		
Electronics and electrical products cluster	**115.7**	**122.4**	**126.3**	**128.6**	**5.8**	**3.2**	**1.8**
Electronics	120.5	128.5	131.9	135.7	6.6	2.6	2.9
Electrical products	110.2	115.4	120.0	120.3	4.7	4.0	0.3
Primary-related cluster	**109.7**	**113.5**	**116.6**	**113.5**	**3.5**	**2.7**	**-2.7**
Chemicals and chemical products	109.5	114.4	116.8	112.1	4.4	2.1	-4.0
Petroleum products	106.7	110.2	113.2	101.3	3.4	2.7	-10.6
Textiles, wearing apparel and footwear	115.3	120.2	126.6	110.3	4.3	5.3	-12.8
Wood and wood products	110.7	115.7	121.6	109.2	4.6	5.1	-10.2
Rubber products	110.5	115.8	123.9	189.7	4.8	7.0	53.1
Off-estate processing	114.1	114.1	112.4	108.3	0.0	-1.5	-3.7
Paper products	110.3	114.7	119.6	115.0	4.1	4.2	-3.9
Construction-related cluster	**109.3**	**114.7**	**119.5**	**104.9**	**4.9**	**4.2**	**-12.2**
Non-metallic mineral products	109.1	115.1	120.3	103.1	5.5	4.5	-14.3
Basic iron & steel and non-ferrous metal	107.6	112.1	116.6	111.0	4.2	4.0	-4.8
Fabricated metal products	110.5	116.0	120.7	102.7	4.9	4.0	-14.9
Consumer-related cluster	**107.0**	**113.6**	**120.2**	**117.7**	**6.1**	**5.8**	**-2.1**
Food products	111.7	119.1	127.4	133.2	6.6	7.0	4.6
Transport equipment	101.0	107.7	114.8	110.3	6.7	6.5	-3.9
Beverages	119.8	123.7	127.5	108.9	3.3	3.1	-14.6
Tobacco products	105.4	107.3	113.6	95.4	1.8	5.8	-16.0
Others	107.7	114.4	117.6	112.8	6.3	2.7	-4.1
Total	**110.7**	**116.0**	**120.1**	**116.9**	**4.8**	**3.6**	**-2.7**

Source: Department of Statistics, Malaysia, Bank Negara Malaysia

Table A.3

Services Sector Performance at Constant 2015 Prices

	2017	2018	2019	2020*p*	2017	2018	2019	2020*p*
	Annual change (%)				Share to GDP (%)			
Services	**6.3**	**6.8**	**6.1**	**-5.5**	**55.6**	**56.7**	**57.7**	**57.7**
Intermediate services	6.7	6.9	6.3	-4.9	20.3	20.7	21.1	21.3
Finance and insurance	*4.7*	*5.4*	*4.6*	*2.7*	*6.5*	*6.5*	*6.6*	*7.1*
Real estate and business services	*7.6*	*7.6*	*7.8*	*-15.2*	*4.5*	*4.7*	*4.8*	*4.3*
Transport and storage	*6.2*	*6.4*	*6.8*	*-21.9*	*3.6*	*3.7*	*3.8*	*3.1*
Information and communication	*8.6*	*8.3*	*6.6*	*6.0*	*5.6*	*5.8*	*5.9*	*6.7*
Final services	6.1	6.8	6.0	-5.9	35.3	36.0	36.6	36.5
Wholesale and retail trade	*7.2*	*8.2*	*6.7*	*-6.1*	*16.1*	*16.7*	*17.0*	*17.0*
Food & beverages and accommodation	*7.5*	*9.0*	*9.6*	*-26.5*	*3.2*	*3.3*	*3.5*	*2.7*
Utilities	*2.9*	*4.9*	*6.0*	*-1.3*	*2.6*	*2.6*	*2.7*	*2.8*
Government services	*4.9*	*4.5*	*3.7*	*4.5*	*8.4*	*8.4*	*8.4*	*9.3*
Other services	*5.1*	*5.5*	*5.5*	*-10.5*	*4.9*	*4.9*	*5.0*	*4.7*

p Preliminary
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Table A.4

GNI by Demand Aggregates

	2017	2018	2019	2020*p*	2021*f*
	at Current Prices (RM million)				
Consumption	927,466	1,004,285	1,080,393	1,045,540	1,154,284
Private consumption	*760,146*	*831,334*	*903,720*	*861,509*	*961,493*
Public consumption	*167,320*	*172,951*	*176,673*	*184,031*	*192,791*
Investment	343,942	350,388	346,844	296,387	323,606
Private investment	*234,520*	*245,842*	*252,471*	*222,150*	*236,977*
Public investment	*109,422*	*104,546*	*94,374*	*74,237*	*86,629*
Change in stocks[1]	6,647	-4,327	-28,957	-17,912	-14,654
Exports of goods and services	960,778	992,511	985,283	869,931	964,711
Imports of goods and services	866,524	895,405	872,871	778,784	860,737
GDP at purchasers' value	1,372,310	1,447,451	1,510,693	1,415,163	1,567,211
Balance of primary income	-38,658	-45,082	-40,267	-26,227	-41,629
GNI	1,333,652	1,402,369	1,470,426	1,388,936	1,525,582
	at Constant 2015 Prices (RM million)				
Consumption	883,152	945,482	1,008,142	979,193	1,050,873
Private consumption	*718,702*	*775,851*	*835,065*	*798,986*	*862,737*
Public consumption	*164,450*	*169,631*	*173,077*	*180,207*	*188,136*
Investment	331,093	335,614	328,412	280,719	302,660
Private investment	*225,594*	*235,351*	*239,027*	*210,470*	*221,762*
Public investment	*105,499*	*100,263*	*89,385*	*70,249*	*80,898*
Change in stocks[1]	1,032	-9,050	-14,649	-5,226	-8,620
Exports of goods and services	900,064	917,462	905,807	826,529	934,714
Imports of goods and services	814,571	826,694	806,258	739,189	843,206
GDP at purchasers' value	1,300,769	1,362,815	1,421,454	1,342,027	1,436,421
Balance of primary income	-19,050	-28,237	-22,533	-11,527	-22,437
GNI	1,281,719	1,334,578	1,398,921	1,330,500	1,413,984

[1] Includes statistical discrepancy
p Preliminary
f Forecast

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Table A.5

Savings-Investment Gap

	2016	2017	2018	2019	2020*p*
	RM million				
Gross national savings	354,773	388,885	378,356	368,738	340,595
(as % of GNI)	29.2	29.2	27.0	25.1	24.5
Gross domestic capital formation	324,865	350,589	346,061	317,888	278,475
(as % of GNI)	26.7	26.3	24.7	21.6	20.0
Balance on current account	29,907	38,296	32,295	50,850	62,120
(as % of GNI)	2.5	2.9	2.3	3.5	4.5

p Preliminary

Source: Department of Statistics, Malaysia

Table A.6

Balance of Payments[1]

Item (Net)	2016	2017	2018	2019	2020*p*	2021*f*
	RM million					
Goods[2]	**102,046**	**117,113**	**114,621**	**123,334**	**139,133**	**161,655**
Services	**-18,917**	**-22,859**	**-17,515**	**-10,922**	**-47,985**	**-57,681**
Transportation	-23,459	-29,622	-27,688	-25,903	-27,538	-30,540
Travel	31,515	32,470	30,218	30,818	-7,756	-19,778
Other services	-26,309	-24,308	-19,287	-15,126	-12,089	-6,761
Government goods and services n.i.e.	-665	-1,398	-758	-711	-603	-602
Balance on goods and services	**83,128**	**94,255**	**97,106**	**112,412**	**91,147**	**103,974**
Primary income	**-34,592**	**-38,658**	**-45,082**	**-40,267**	**-26,227**	**-41,629**
Compensation of employees	-5,606	-4,848	-7,657	-9,122	-7,976	-9,074
Investment income	-28,986	-33,811	-37,425	-31,145	-18,251	-32,555
Secondary income	**-18,629**	**-17,300**	**-19,729**	**-21,294**	**-2,800**	**-18,066**
Balance on current account	**29,907**	**38,296**	**32,295**	**50,850**	**62,120**	**44,278**
% of GDP	*2.4*	*2.8*	*2.2*	*3.4*	*4.4*	*2.5 ~ 3.5*
Capital account	**102**	**-26**	**-89**	**331**	**-415**	**-**
Financial account	**-249**	**-4,730**	**11,430**	**-33,796**	**-79,121**	**-**
Direct investment	13,792	16,171	10,103	5,578	-162	-
Assets	*-42,246*	*-24,234*	*-23,431*	*-31,908*	*-17,265*	-
Liabilities	*56,038*	*40,405*	*33,535*	*37,486*	*17,103*	-
Portfolio investment	-14,203	-15,358	-49,396	-29,026	-49,124	-
Assets	-15,009	*-19,442*	*-11,984*	-41,666	*-57,584*	-
Liabilities	*806*	*4,084*	*-37,411*	12,640	*8,459*	-
Financial derivatives	-802	-197	981	-478	1,614	-
Other investment	964	-5,346	49,742	-9,870	-31,448	-
Assets	*-6,260*	*-18,081*	*6,527*	*-19,245*	*-6,234*	-
Liabilities	*7,225*	*12,735*	*43,215*	*9,375*	*-25,214*	-
Balance on capital and financial accounts	**-148**	**-4,756**	**11,341**	**-33,465**	**-79,536**	**-**
Net errors and omissions[3]	**-23,899**	**-17,132**	**-35,878**	**-8,969**	**-1,990**	**-**
Overall balance	**5,860**	**16,409**	**7,758**	**8,416**	**-19,406**	**-**
Bank Negara Malaysia international reserves, net[4]						
USD million	94,488	102,431	101,429	103,599	107,621	-
RM million	423,874	414,591	419,511	424,032	432,313	-
Foreign exchange revaluation gain (+) / loss (-)	8,918	-25,691	-2,838	-3,895	-1,079	-
Reserves as months of retained imports	8.7	7.2	7.4	7.5	8.5	-

[1] In accordance with the Balance of Payments and International Investment Position Manual, Sixth Edition (BPM6) by the International Monetary Fund (IMF)
[2] Adjusted for valuation and coverage of goods for processing, storage and distribution
[3] As at 1Q 2018, the net E&O excludes reserves revaluation changes. This practice is backdated to 1Q 2010
[4] All assets and liabilities in foreign currencies have been revalued into ringgit at rates of exchange ruling on the balance sheet date and the gain/loss has been reflected accordingly in Bank Negara Malaysia's audited accounts

p *Preliminary*

f *Forecast*

n.i.e. Not included elsewhere
Note: Numbers may not add up due to rounding
Assets: (-) denotes outflows due to the acquisition of assets abroad by residents
Liabilities: (+) denotes inflows due to the incurrence of foreign liabilities

Source: Department of Statistics Malaysia and Bank Negara Malaysia

Table A.7

Gross Exports

	2018	2019	2020*p*	2018	2019	2020*p*	2019	2020*p*
	RM million			Annual change (%)			% share	
Manufactures	**837,071**	**840,586**	**847,664**	**9.3**	**0.4**	**0.8**	**84.5**	**86.4**
of which:								
Electrical and electronic products	381,545	373,118	386,112	11.2	-2.2	3.5	37.5	39.4
Semiconductors	*220,355*	*221,709*	*239,109*	*23.7*	*0.6*	*7.8*	*22.3*	*24.4*
Office machines and automatic data processing equipment	*62,387*	*49,347*	*45,399*	*-0.5*	*-20.9*	*-8.0*	*5.0*	*4.6*
Electrical machinery, apparatus and appliances, and parts	*57,977*	*59,750*	*57,374*	*-0.5*	*3.1*	*-4.0*	*6.0*	*5.8*
Telecommunications and sound-recording and reproducing equipment	*40,825*	*42,312*	*44,230*	*-7.1*	*3.6*	*4.5*	*4.3*	*4.5*
Petroleum products	76,161	71,511	61,898	6.1	-6.1	-13.4	7.2	6.3
Chemicals and chemical products	57,715	57,477	50,688	22.4	-0.4	-11.8	5.8	5.2
Manufactures of metal	44,664	41,490	36,805	17.7	-7.1	-11.3	4.2	3.8
Machinery, equipment and parts	40,668	41,599	39,367	1.3	2.3	-5.4	4.2	4.0
Optical and scientific equipment	36,563	39,905	41,545	12.9	9.1	4.1	4.0	4.2
Rubber products	26,491	25,841	43,640	0.7	-2.5	68.9	2.6	4.4
Palm oil-based manufactured products	22,783	23,338	20,920	-4.2	2.4	-10.4	2.3	2.1
Processed food	19,414	21,773	21,238	-1.5	12.2	-2.5	2.2	2.2
Transport equipment	18,033	19,143	18,475	15.6	6.2	-3.5	1.9	1.9
Agriculture	**67,001**	**65,958**	**71,677**	**-14.2**	**-1.6**	**8.7**	**6.6**	**7.3**
of which:								
Palm oil and palm oil-based agricultural products	44,733	44,208	52,334	-17.2	-1.2	18.4	4.4	5.3
Sawn timber and moulding	4,526	4,251	3,081	-4.5	-6.1	-27.5	0.4	0.3
Natural rubber	3,774	3,773	3,286	-20.1	0.0	-12.9	0.4	0.3
Minerals	**89,907**	**81,520**	**57,391**	**9.9**	**-9.3**	**-29.6**	**8.2**	**5.9**
of which:								
Liquefied natural gas (LNG)	42,322	42,484	28,835	2.2	0.4	-32.1	4.3	2.9
Crude petroleum	36,649	26,346	18,864	29.7	-28.1	-28.4	2.6	1.9
Others	**9,608**	**7,007**	**4,256**	**4.9**	**-27.1**	**-39.3**	**0.7**	**0.4**
Total	**1,003,587**	**995,072**	**980,988**	**7.3**	**-0.8**	**-1.4**	**100.0**	**100.0**

p Preliminary

Source: Department of Statistics, Malaysia

Table A.8

Gross Imports

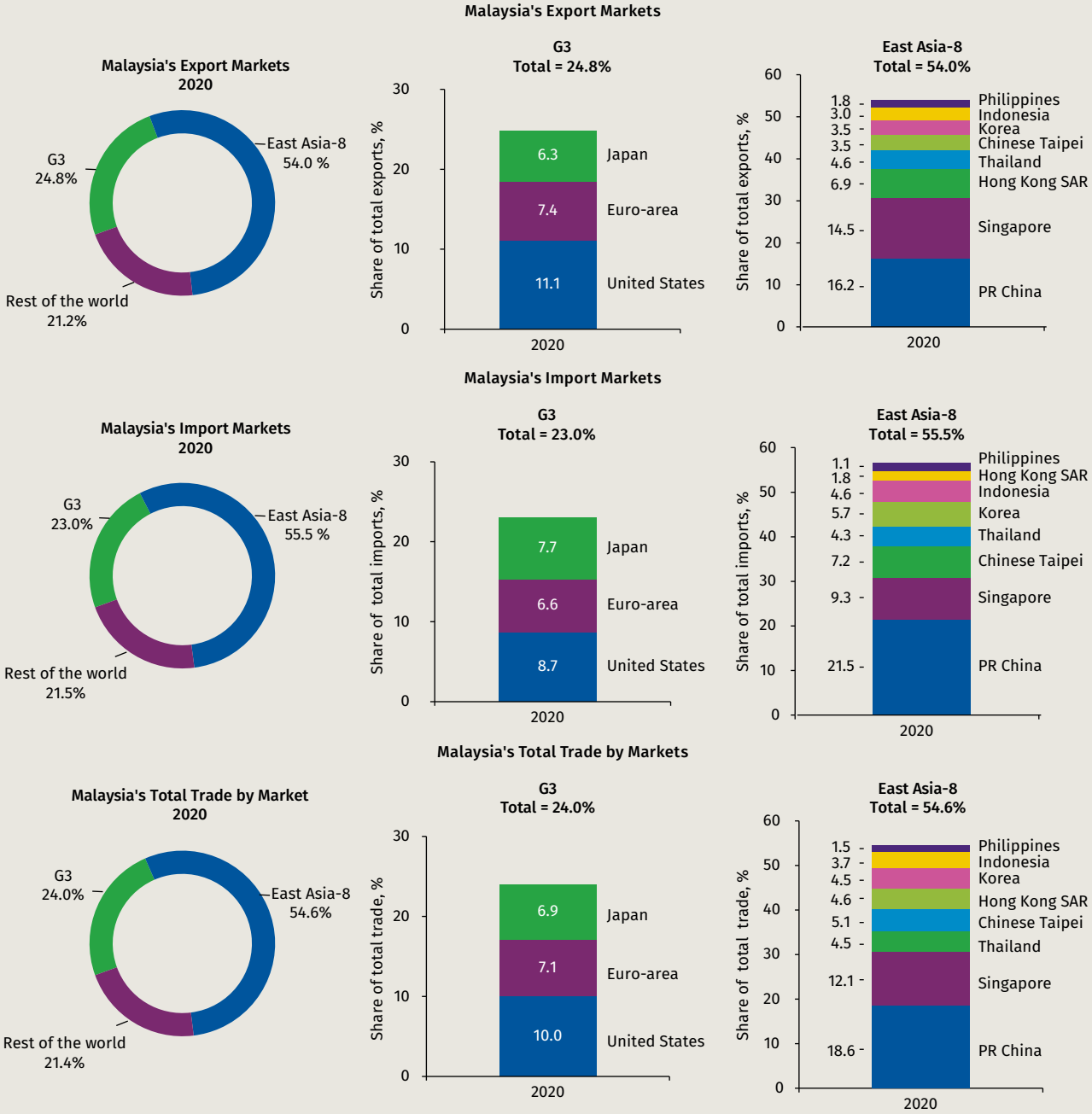
	2018	2019	2020*p*	2019	2020*p*	2020*p*
	RM million			Annual change (%)		% share
Capital goods	**112,453**	**100,179**	**90,380**	**-10.9**	**-9.8**	**11.4**
Capital goods (except transport equipment)	96,475	91,762	90,993	-4.9	-0.8	11.4
Transport equipment industrial	15,978	8,417	-613	-47.3	-107.3	-0.1
Intermediate goods	**462,212**	**467,211**	**422,910**	**1.1**	**-9.5**	**53.1**
Food and beverages, mainly for industry	17,777	18,050	20,655	1.5	14.4	2.6
Industrial supplies	215,123	220,877	199,441	2.7	-9.7	25.0
Fuel and lubricants	56,132	57,091	43,597	1.7	-23.6	5.5
Parts and accessories of capital goods (except transport equipment)	143,121	138,674	134,800	-3.1	-2.8	16.9
Parts and accessories of transport equipment	30,060	32,519	24,417	8.2	-24.9	3.1
Consumption goods	**73,053**	**74,155**	**73,908**	**1.5**	**-0.3**	**9.3**
Food and beverages, mainly for household consumption	29,366	30,782	32,585	4.8	5.9	4.1
Transport equipment non-industrial	803	1,017	1,075	26.7	5.7	0.1
Consumer goods, n.e.s	42,884	42,356	40,247	-1.2	-5.0	5.1
Others	**232,086**	**207,866**	**208,996**	**-10.4**	**0.5**	**26.2**
of which:						
Dual use goods	30,019	32,482	17,264	8.2	-46.8	2.2
Re-exports	199,252	171,588	187,237	-13.9	9.1	23.5
Total	**879,804**	**849,411**	**796,194**	**-3.5**	**-6.3**	**100.0**

p Preliminary
n.e.s. Not elsewhere specified
Note: Numbers may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

Chart A.9

Malaysia's Trading Partners



Source: Department of Statistics, Malaysia

Table A.10

Outstanding External Debt and Debt Servicing

	2016	2017	2018	2019	2020*p*
	RM million (unless stated otherwise)				
Total external debt	**914,464**	**885,218**	**923,029**	**945,419**	**958,456**
USD million equivalent	*201,900*	*215,902*	*220,507*	*228,335*	*235,563*
% of GDP	*73.2*	*64.5*	*63.8*	*62.6*	*67.7*
Annual change (%)	*9.3*	*-3.2*	*4.3*	*2.4*	*1.4*
By instrument					
Bonds and notes	165,709	151,364	152,589	155,852	172,978
Interbank borrowings	170,977	172,199	204,759	199,505	182,078
Intragroup loans	139,234	131,341	136,246	126,924	128,587
Loans	55,010	53,680	72,206	78,426	76,647
NR holdings of domestic debt securities	212,767	207,389	180,224	201,015	220,103
NR deposits	86,274	92,025	98,109	102,928	94,497
Others[1]	84,492	77,221	78,896	80,767	83,566
Maturity profile					
Medium- and long-term	536,418	533,402	517,995	554,179	590,968
Short-term	378,046	351,816	405,034	391,240	367,487
Currency composition (% share)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Ringgit	*34.0*	*33.9*	*30.3*	*32.8*	*33.9*
US dollar	*53.9*	*50.6*	*55.3*	*51.1*	*51.0*
Japanese yen	*2.4*	*2.2*	*2.2*	*3.0*	*3.3*
Others	*9.7*	*13.3*	*12.2*	*13.1*	*11.9*
Total servicing (including short-term interest payment)	**206,719**	**146,763**	**116,938**	**126,378**	**119,884**
of which:					
Medium- and long-term debt	**204,659**	**144,213**	**111,860**	**120,498**	**116,900**
Repayment[2]	**191,142**	**130,631**	**95,936**	**104,192**	**100,802**
of which:					
Redemption of matured domestic debt securities held by NR	24,403	27,105	22,012	19,731	14,489
Interest payment	**13,517**	**13,582**	**15,924**	**16,306**	**16,098**
of which interest payment on:					
NR holdings of domestic debt securities	7,409	6,089	8,170	7,255	7,998
Debt service ratio (% of exports of goods and services)					
Total debt	**24.8**	**15.3**	**11.8**	**12.8**	**13.8**
Medium- and long-term debt of which:	24.5	15.0	11.3	12.2	13.4
NR holdings of domestic debt securities	3.8	3.5	3.0	2.7	2.6

[1] Comprises trade credits, IMF allocation of SDRs and other debt liabilities
[2] Excludes prepayment
p Preliminary
Note: Numbers may not necessarily add up due to rounding
NR refers to non-residents

Source: Ministry of Finance Malaysia and Bank Negara Malaysia

Table A.11

Consumer Price Index

	Weights (%) (2010=100)	2017	2018	2019	2020
		Annual change (%)			
Total	**100.0**	**3.7**	**1.0**	**0.7**	**-1.2**
Food and non-alcoholic beverages	29.5	4.0	1.6	1.7	1.3
Alcoholic beverages and tobacco	2.4	0.2	-0.1	1.5	0.3
Clothing and footwear	3.2	-0.3	-2.0	-2.0	-0.8
Housing, water, electricity, gas and other fuels	23.8	2.2	2.0	1.9	-1.7
Furnishings, household equipment and routine household maintenance	4.1	2.1	0.3	1.4	0.3
Health	1.9	2.5	0.8	0.7	1.1
Transport	14.6	13.2	1.6	-3.1	-10.0
Communication	4.8	-0.4	-1.7	0.4	1.1
Recreation services and culture	4.8	1.9	-0.4	0.7	0.4
Education	1.3	1.7	1.1	1.4	1.0
Restaurants and hotels	2.9	2.5	1.6	1.2	0.5
Miscellaneous goods and services	6.7	1.2	-1.4	0.4	2.7

Source: Department of Statistics, Malaysia

Table A.12

Producer Price Index

	Weights (%) (2010=100)	2017	2018	2019	2020
		Annual change (%)			
Total	**100.0**	**6.7**	**-1.1**	**-1.4**	**-2.7**
Crude materials for further processing	16.4	14.8	2.6	-3.9	-12.3
Foodstuffs and feedstuffs	*3.2*	*6.2*	*-2.0*	*0.2*	*-3.7*
Non-food materials	*13.2*	*17.9*	*3.7*	*-4.7*	*-14.2*
Intermediate materials, supplies and components	56.1	6.7	-1.9	-1.4	-0.5
Materials & components for manufacturing	*29.6*	*5.6*	*-5.2*	*-3.7*	*1.9*
Materials & components for construction	*2.9*	*2.0*	*-1.4*	*0.1*	*-0.5*
Processed fuel & lubricants	*11.9*	*15.3*	*8.7*	*2.3*	*-7.0*
Containers	*0.6*	*5.5*	*2.3*	*1.6*	*-1.3*
Supplies	*11.2*	*0.3*	*-3.8*	*0.5*	*0.3*
Finished goods	27.5	0.9	-2.4	0.6	-0.1
Finished consumer goods	*11.5*	*1.7*	*-2.2*	*-1.4*	*0.4*
Capital equipment	*16.0*	*0.5*	*-2.5*	*2.0*	*-0.5*

Source: Department of Statistics, Malaysia

Table A.13

Movements of the Ringgit

	RM to one unit of foreign currency[1]			Annual change (%)		Change (%)
	2005	2019	2020	2019	2020	21 Jul. '05 - Dec. '20
	21 Jul.[2]	End-Dec.				
SDR	5.5049	5.6509	5.7560	1.9	-1.8	-4.4
US dollar	3.8000	4.0925	4.0130	1.1	2.0	-5.3
Singapore dollar	2.2570	3.0387	3.0354	-0.2	0.1	-25.6
100 Japanese yen	3.3745	3.7655	3.8891	-0.5	-3.2	-13.2
Pound sterling	6.6270	5.3722	5.4653	-2.2	-1.7	21.3
Australian dollar	2.8823	2.8660	3.0896	2.0	-7.2	-6.7
Euro	4.6212	4.5852	4.9324	3.2	-7.0	-6.3
100 Thai baht	9.0681	13.683	13.399	-7.2	2.1	-32.3
100 Indonesian rupiah	0.0386	0.0295	0.0286	-2.9	3.2	35.3
100 Korean won	0.3665	0.3540	0.3698	5.1	-4.3	-0.9
100 Philippine peso	6.8131	8.0720	8.3569	-2.5	-3.4	-18.5
100 New Taiwan dollar	11.890	13.644	14.297	-0.8	-4.6	-16.8
Chinese renminbi	0.4591	0.5866	0.6143	2.6	-4.5	-25.3

[1] US dollar rates are the average of buying and selling rates at noon in the Kuala Lumpur Interbank Foreign Exchange Market. Rates for foreign currencies other than US dollar are cross rates derived from rates of these currencies against the US dollar and the RM/US dollar rate.
[2] Ringgit was unpegged against the US dollar

Source: Bank Negara Malaysia

Table A.14

Consolidated Public Sector Finance

	2017	2018	2019	2020p
	RM billion			
Revenue[1]	230.6	241.0	248.1	245.8
% growth	*3.7*	*4.5*	*2.9*	*-0.9*
Operating expenditure	251.5	266.0	298.1	266.4
% growth	*6.4*	*5.8*	*12.1*	*-10.6*
Current balance of NFPCs[2]	103.3	128.2	127.5	83.1
Total public sector current balance	**82.4**	**103.2**	**77.5**	**62.5**
% of GDP	***6.0***	***7.1***	***5.1***	***4.4***
Development expenditure[3]	131.8	144.5	132.4	126.3
% growth	*-5.2*	*9.7*	*-8.3*	*-4.7*
General Government[4]	49.2	63.7	57.1	57.9
NFPCs	82.6	80.8	75.3	68.4
COVID-19 Fund				38.0
Overall balance	**-49.4**	**-41.3**	**-54.9**	**-101.8**
% of GDP	***-3.6***	***-2.9***	***-3.6***	***-7.2***

[1] Excludes transfers within General Government
[2] Refers to 28 NFPCs from 2017 onwards
[3] Adjusted for transfers and net lending within public sector
[4] Comprises Federal Government, state and local governments, and statutory bodies
p Preliminary

Note: Numbers may not add up due to rounding

Source: Ministry of Finance, Malaysia and Non-Financial Public Corporations (NFPCs)