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Bank Negara Malaysia (BNM)'s Economic and Monetary Review 2020 Financial Stability Review, Second Half 2020

Turning the Corner for Next Take-off

31 March 2021

Key Messages

Global economy to rebound in 2021

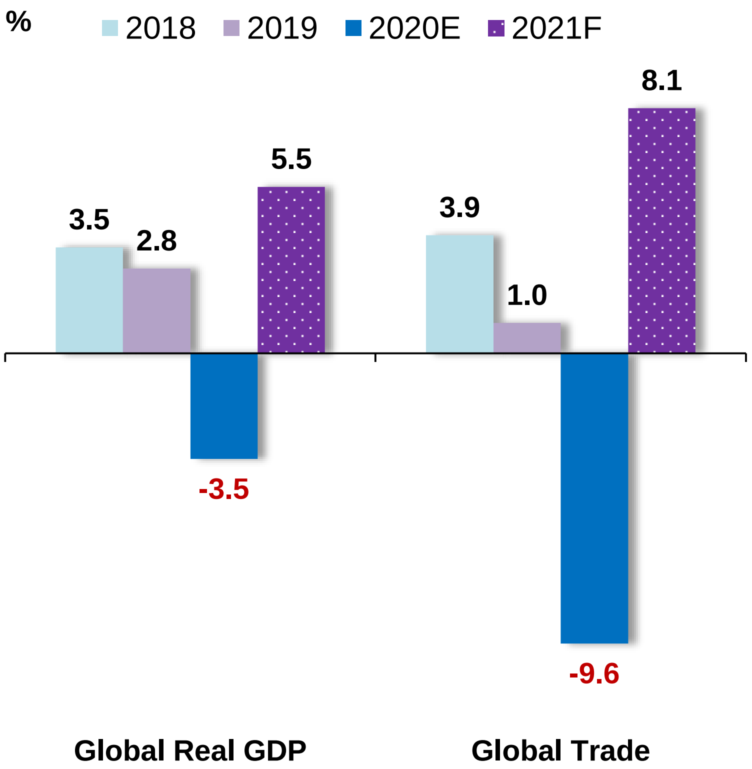
The Malaysian economy is turning around

Malaysia needs reset to emerge stronger

Economic and financial issues

A gradual and uneven global recovery amid uncertainties

Global real GDP and trade growth



- The global economy is expected to continue its **gradual and uneven recovery path in 2021**, shaped by the embarking on vaccination program in major advanced economies; the ongoing global structural shifts; and the extent of economic scarring from the renewed movement restrictions in some countries in Europe.
- The IMF expects the **global economy to turnaround by 5.5% in 2021** from estimated -3.5% in 2020.
- Notwithstanding the expected global recovery, **continued policy support will be vital** to sustain overall growth momentum amid elevated uncertainties
- Global monetary and financial conditions are expected to remain supportive of growth recovery despite continued bouts of financial market volatility.

Source: IMF World Economic Outlook Update (January 2021)

Key risk factors to global growth

Downside risks

Primary source of downside risk remains **pandemic-related**, includes the **re-imposition** of strict and widespread **containment measures** due to the COVID-19 resurgences, leading to economic disruptions as well as the **effectiveness of the rollout of nationwide vaccination programmes** across countries.

Heightened global financial market volatility could contribute to **capital flow reversals from emerging economies**, leading to sharp exchange rate adjustments and the tightening of financial conditions, especially in vulnerable emerging economies with elevated private sector debt.

Extreme weather conditions may result in sudden disruptions to production and incomes, disproportionately affecting low-income economies amid more limited policy space.

Rising protectionist measures and deglobalisation of global supply chains could also adversely affect productivity and hinder global growth recovery.

Upside risks

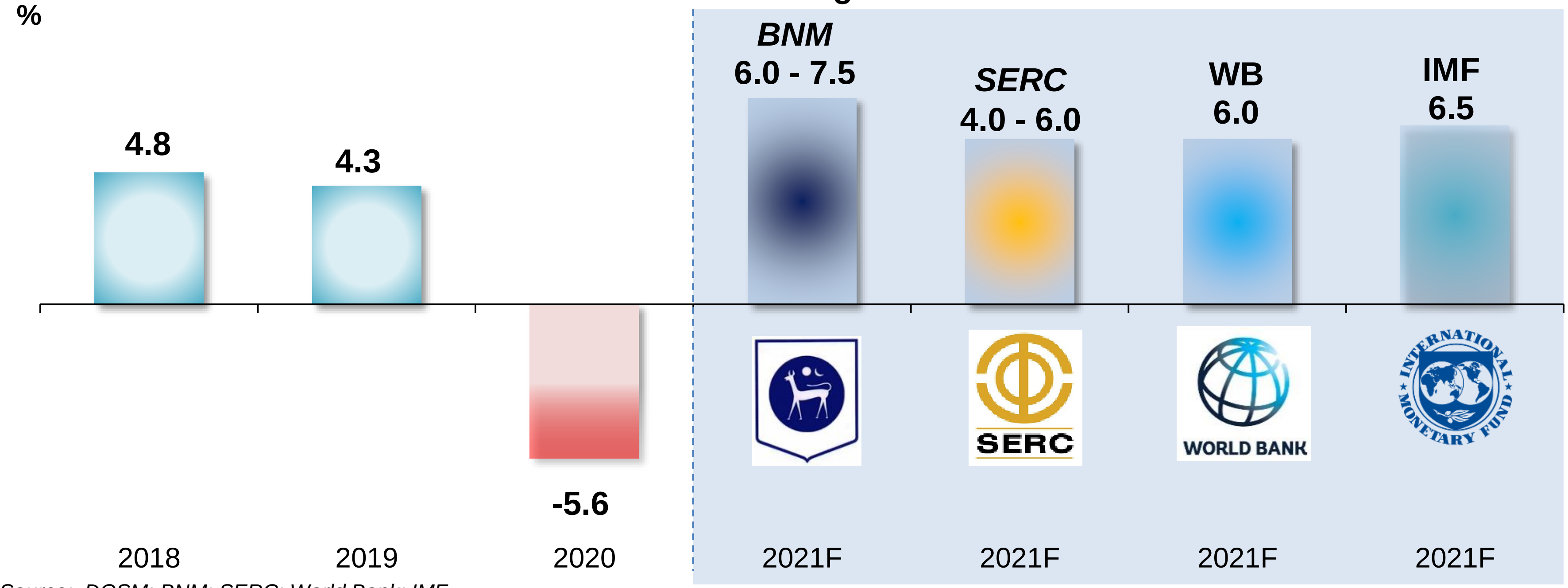
Faster rollout and wider outreach of vaccines, leading to a faster pace of phasing out containment measures in more countries and set in positive sentiments earlier and stronger.

Prolonged or larger-than-expected fiscal support would underpin a faster recovery in demand, or cushion any unexpected economic shocks.

The Malaysian economy to rebound in 2021, helped by strong external demand and revived domestic demand

- BNM estimates **real GDP to grow strongly by between 6.0% and 7.5% (point estimates of 7.0%) in 2021** (-5.6% in 2020), supported largely by a low base effect as well as external and domestic factors: (i) **Improving external demand riding on strong technology upcycle;** (ii) **Less restrictive containment measures and the rollout of immunisation program;** (iii) **Gradual improvement in labour market conditions; and** (iv) **Continued policy support for households and businesses**.
- 2021's GDP estimate was tweaked at the lower bound from 6.5%-7.5% estimated earlier in Feb 2021 and also from 2021 Budget's estimates (6.5-7.5%) made in November 2020.

Real GDP growth



Source: DOSM; BNM; SERC; World Bank; IMF

Risks to 2021's baseline growth prospect

Upside risks

- ▲ Higher-than-expected global growth
- ▲ Pent-up demand from consumers & businesses after the relaxation of containment measures
- ▲ Stronger-than-expected impact from policy support

BNM's baseline assessment for GDP growth in 2021: **+6.0 to +7.5%**

Downside risks

- ▼ Escalation in COVID-19 cases leading to further containment measures globally and domestically
- ▼ Slower-than-expected rollout of vaccines or ineffectiveness of vaccines
- ▼ Commodity supply shocks
- ▼ Greater financial market volatility

Demand outlook: Growth mainly supported by private sector

Private consumption

2021F: 8.0% (2020: -4.3%)

% share of GDP (2021): 60.1

- Supported by less stringent mobility restrictions, an improvement in consumer sentiment, thanks to the vaccine rollout, continued income growth amid improving economy activity and targeted policy support for households, such as *i-Sinar and lower EPF contribution as well as accumulated savings*)

Private investment

2021F: 5.4% (2020: -11.9%)

% share of GDP (2021): 15.4

- Underpinned by the progress of ongoing large projects, especially in the civil engineering sub sector, the continued investment intentions, especially in the manufacturing sector and the implementation of key projects to spur the development of the digital economy.

Public consumption

2021F: 4.4% (2020: 4.1%)

% share of GDP (2021): 13.1

- Continued expansion in Federal Government's budgetary spending, largely the COVID-19 related expenditure, including the vaccine procurement and logistics spending.

Public investment

2021F: 15.2% (2020: -21.4%)

% share of GDP (2021): 5.6

- Continued progress of the large-scale infrastructure projects *(e.g. ECRL and MRT2),* the improvement of nationwide digital infrastructure and connectivity, implementation of small-scale projects under the Budget 2021 and PEMERKASA package as well as the government's fixed asset spending.

Net exports

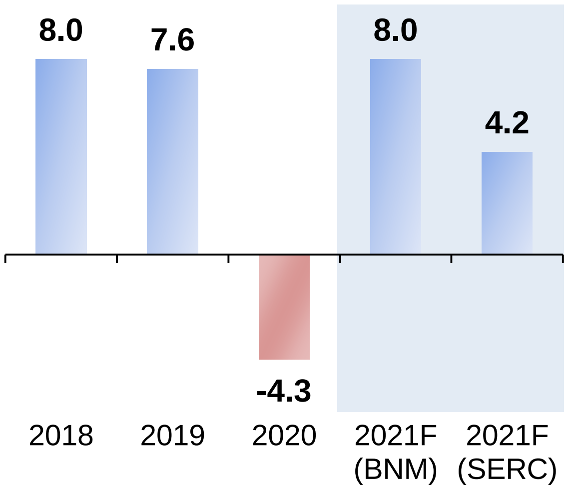
2021F: 4.8% (2020: -12.3%) *% share of GDP (2021): 6.4*

- Net external sector is expected to grow by 4.8% in 2021 (-12.3% in 2020) (real exports (13.1% vs. -8.8% in 2020) and real import (14.1% vs. -8.3% in 2020)), driven primarily by the improvement in external demand, especially from Malaysia's key export partners.
- Services exports are expected to remain subdued, due mainly to lower travel receipts as international border restrictions are expected to remain in place.

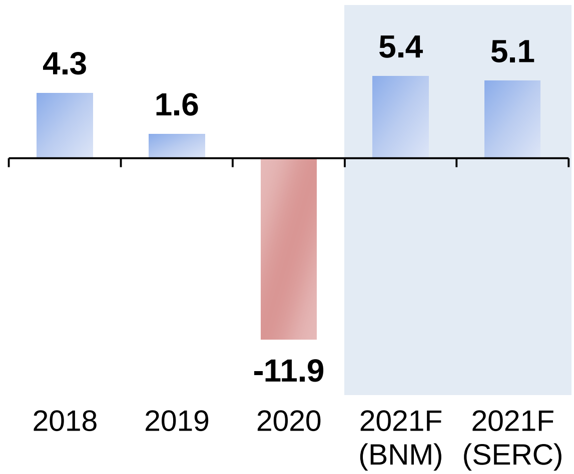
Domestic demand is the key driver of growth rebound in 2021

%

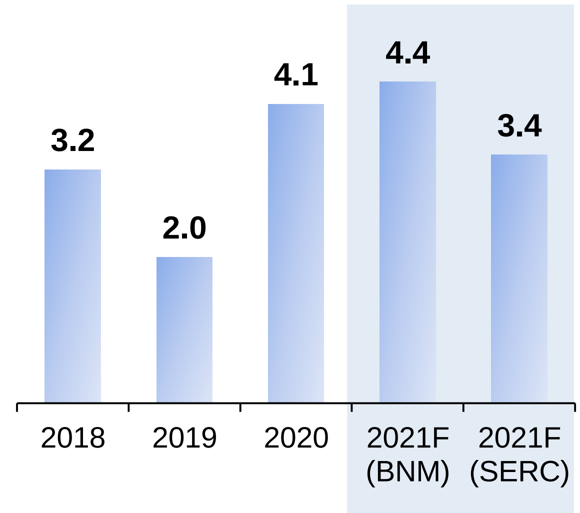
Private consumption (60.1% of GDP)



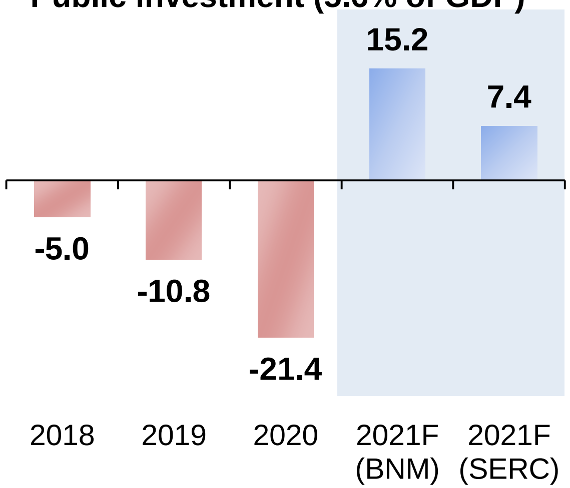
Private investment (15.4% of GDP)



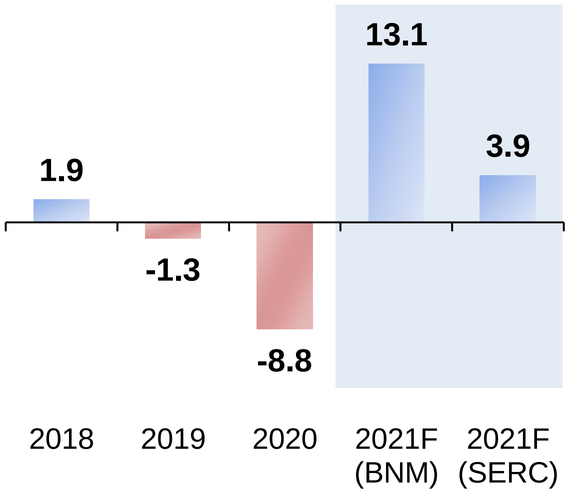
Public consumption (13.1% of GDP)



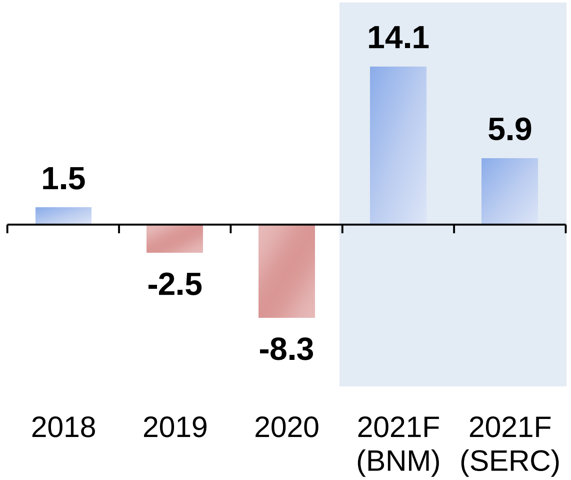
Public investment (5.6% of GDP)



Real Export (65.1% of GDP)



Real Import (58.7% of GDP)



Source: DOSM; SERC

Sectoral outlook: All economic sectors are back on track

Services

2021F: 6.6% (2020: -5.5%)
% share of GDP (2021): 57.5

- Supported by demand of digital solutions, especially in e-commerce and e-payment continues to accelerate.
- Tourism-related industries remain challenging ahead due to the closure of Malaysia's international borders.

Manufacturing

2021F: 8.8% (2020: -2.6%)
% share of GDP (2021): 23.3

- Robust growth mainly from the structural shift towards digitalisation, spurring demand for telecommunication, cloud computing and medical device products.
- Others from increased production of refined petroleum, positive multiple effect channelled by large infrastructure projects and recovery in consumption activity.

Agriculture

2021F: 4.2% (2020: -2.2%)
% share of GDP (2021): 7.2

- Oil palm production is expected to recover due to La Nina phenomenon (BNM's estimates: RM2,800-RM2,300/mt).
- A strong expansion in livestock production due to continued growth in household spending.

Construction

2021F: 13.4% (2020: -19.4%)
% share of GDP (2021): 4.2

- Further progress in the implementation of transport-related projects *(e.g. ECRL, MRT2, LRT3 and Pan Borneo Highway)* and affordable housing projects.
- Implementation of small-scale projects worth RM5 billion.

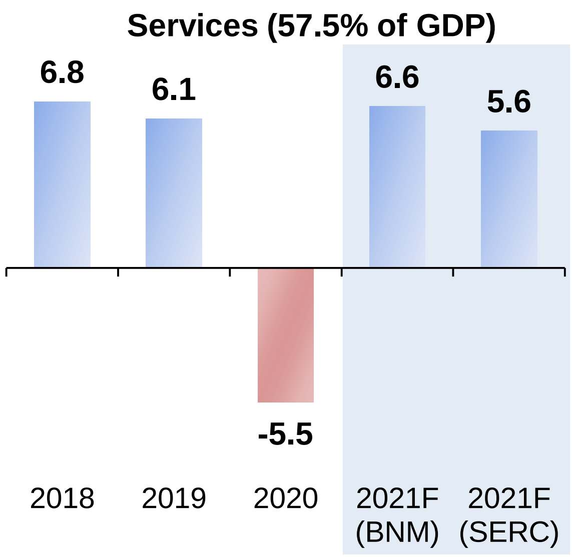
Mining

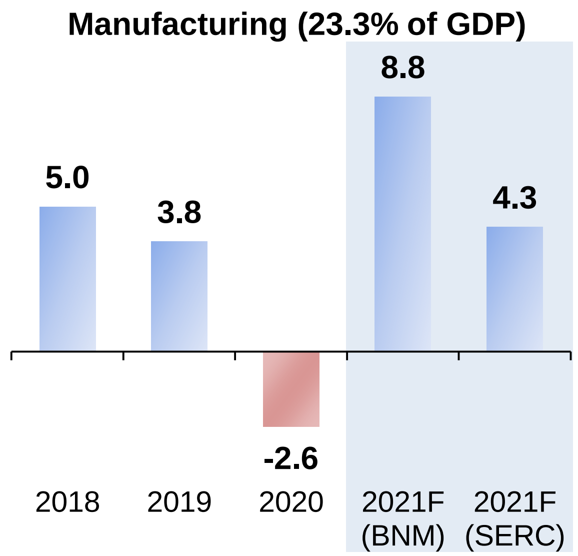
2021F: 3.1% (2020: -10.0%)
% share of GDP (2021): 6.6

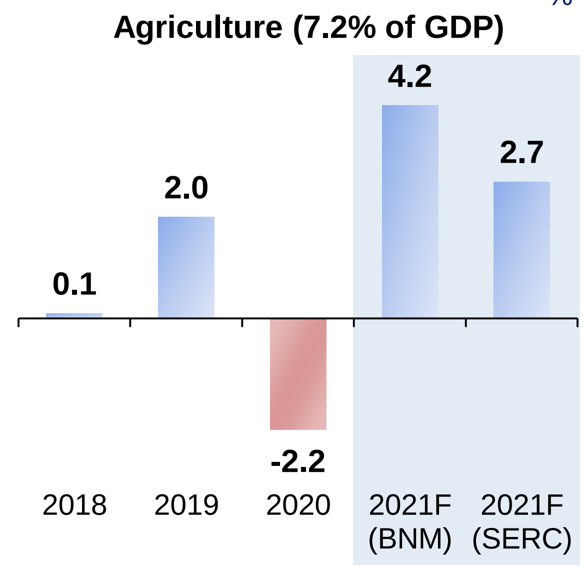
- Rebound in crude oil and LNG prices (BNM's estimates: US$52-US$62 per barrel for Brent crude oil and RM1,380-RM1,480 per tonne for LNG).
- Growth is expected in 2H 2021 as the operationalisation of new gas fields along with the ramp-up of the PFLNG2 facility in East Malaysia will lead to higher production of natural gas.

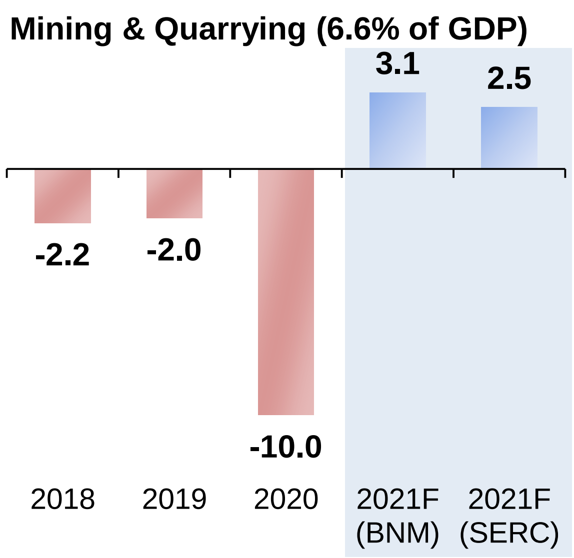
All economic sectors will turnaround in 2021

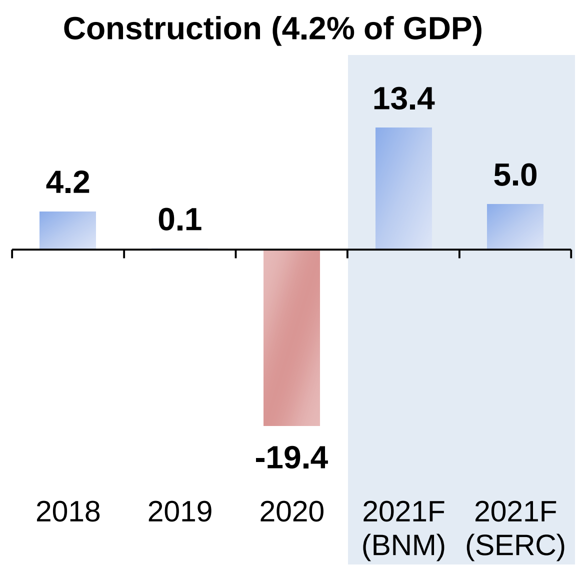
%







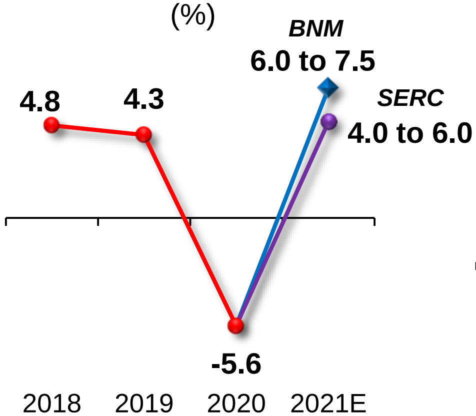




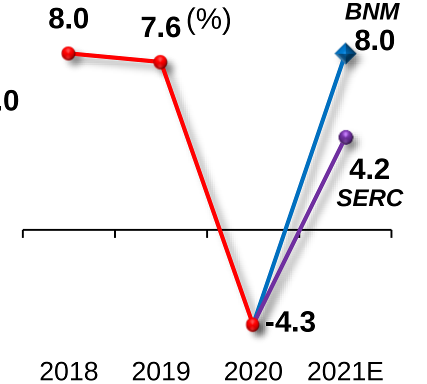
Source: DOSM; SERC

Malaysia’s key economic indicators

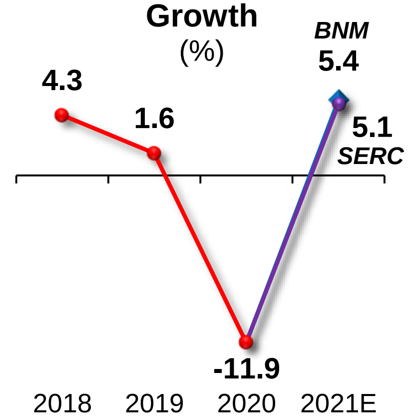
Real GDP Growth
(%)



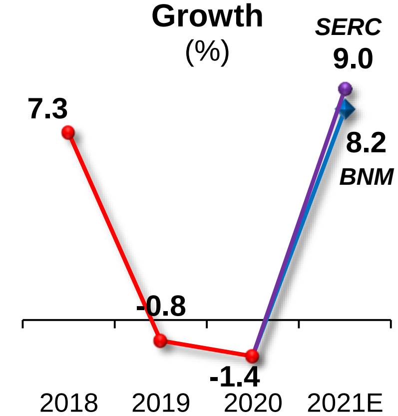
Private Consumption Growth
(%)



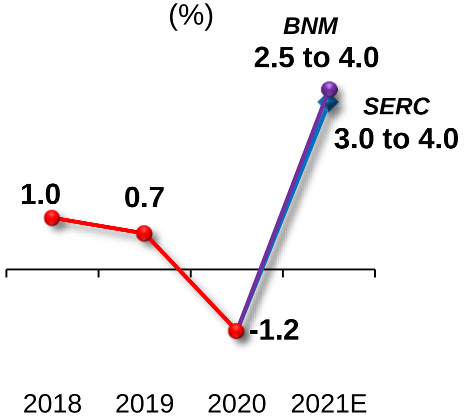
Private Investment Growth
(%)



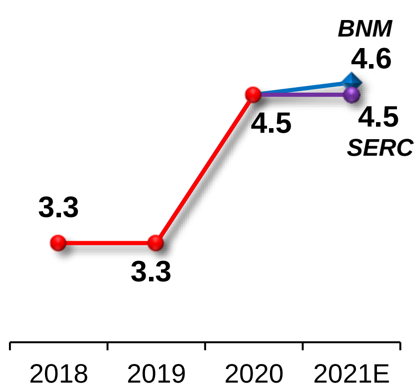
Gross Export Growth
(%)



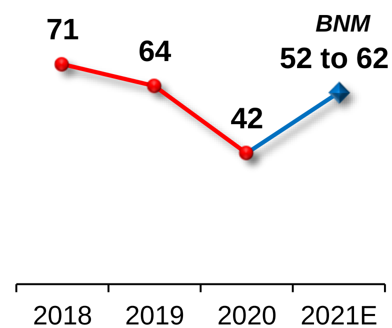
Inflation Rate
(%)



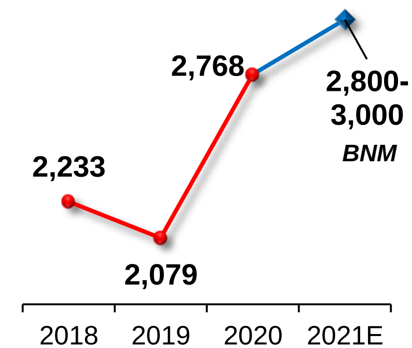
Unemployment Rate
(%)



Brent Crude Oil Prices
(US$/barrel)



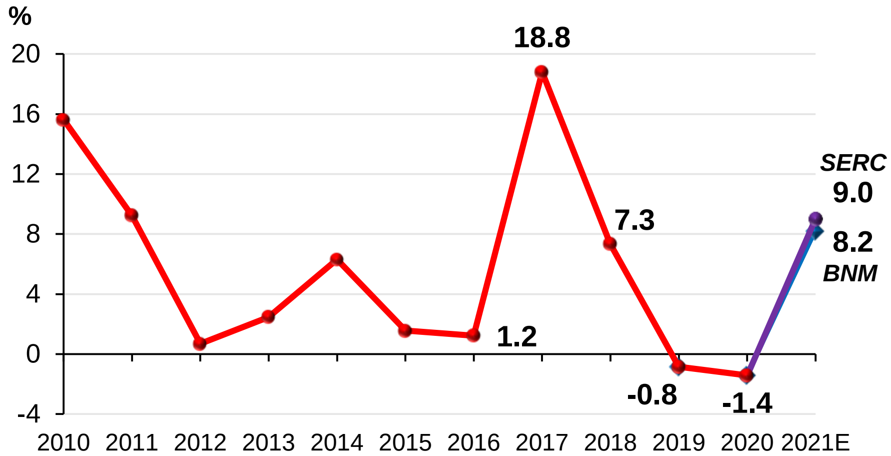
Crude Palm Oil Prices
(RM/metric tonne)



Source: DOSM; World Bank; MPOB; BNM; SERC

Export growth to rebound; current account to remain in surplus

Exports is expected to expand by 8.2% in 2021 after two consecutive years of decline

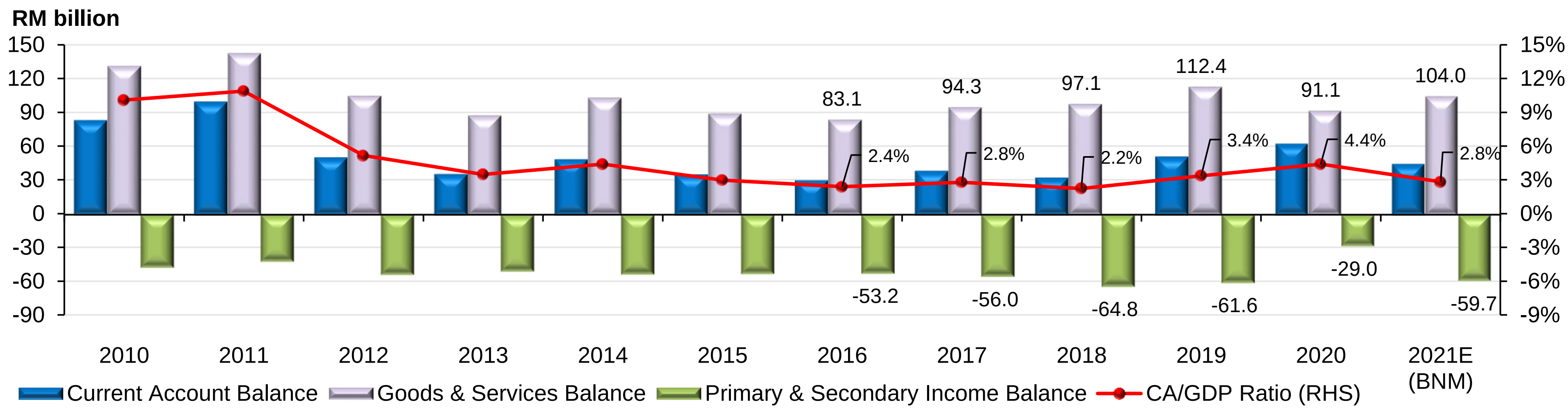


Mixed performance of export products in 2020s

Major export products	RM billion	% Growth
Electrical & electronic products [39.4%]	386.1	3.5
Petroleum products [6.3%]	61.9	-13.4
Chemical and chemical products [5.2%]	50.7	-11.8
Palm oil [4.7%]	45.7	16.7
Rubber products [4.4%]	43.6	68.9
Optical & scientific equipment [4.2%]	41.5	4.1
Machinery & equipment [4.0%]	39.4	-5.4
Manufactures of metal [3.8%]	36.8	-11.3
Liquefied natural gas [2.9%]	28.8	-32.1

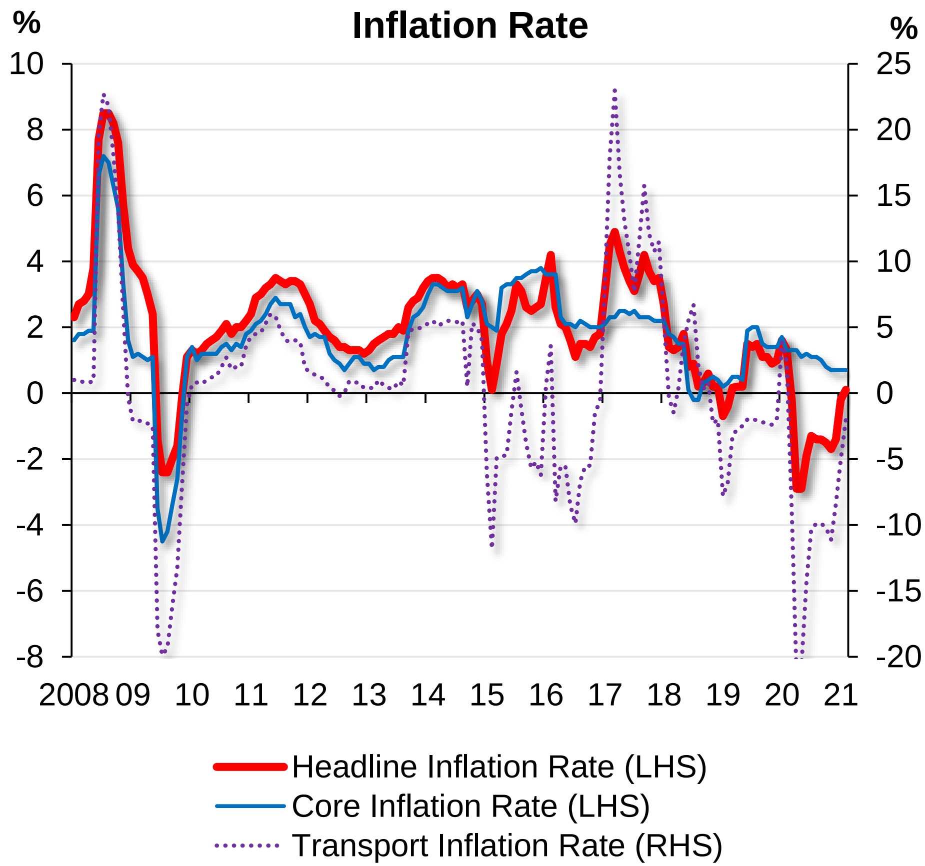
Figure in parenthesis indicates % share of gross exports in 2020

Current account is projected to remain in surplus, albeit lower at 2.5%-3.5% of GDP in 2021



Source: DOSM; BNM; SERC

Headline inflation climbs higher to 2.5-4.0% in 2021



- BNM expects **headline inflation** to **average between 2.5% and 4.0% in 2021** (SERC: 3.0%-4.0%) (-1.2% in 2020), mainly due to **cost-push factors,** such as the expected increase in global oil prices and the lapse in effect from the tiered electricity tariff rebate introduced last year. Inflation will spike to 5% in 2Q 2021 due to a low base effect last year.
- Brent crude oil spot price rose to US$60.82/bbl (average 1 Jan 2021 to 22 Mar 2021) from average U$42.30/bbl in 2020. Nevertheless, the Government has set the ceiling retail prices for RON95 petrol and diesel at RM2.05 and RM2.15 per litre respectively. The Government spend about RM3.0 billion on fuel subsidy.
- **Core inflation** is forecasted to **average of 0.5%-1.5% in 2021** (1.1% in 2020) given continued spare capacity in the economy and weak labour market conditions.

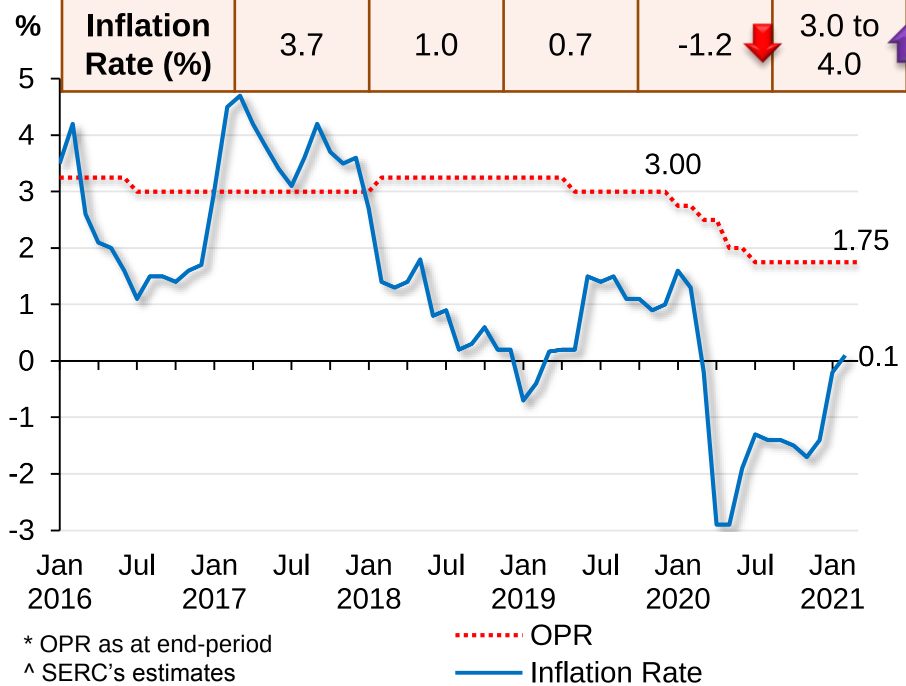
Note: Core inflation in 2008-2014 excludes food and non-alcoholic beverages only.
Source: BNM; DOSM

Interest rate to hold steady at 1.75% for now

- **BNM is expected to keep the overnight policy rate (OPR) at 1.75% in 2021** to ensure a durable economic recovery despite the short-term spike in cost-driven headline inflation. The Monetary Policy Committee (MPC) will be mindful to avoid a premature withdrawal of policy support.
- Given the subdued price pressures amid continued spare capacity in the economy, **BNM reaffirmed that monetary policy will not be the most appropriate tool to manage supply-driven inflation**.

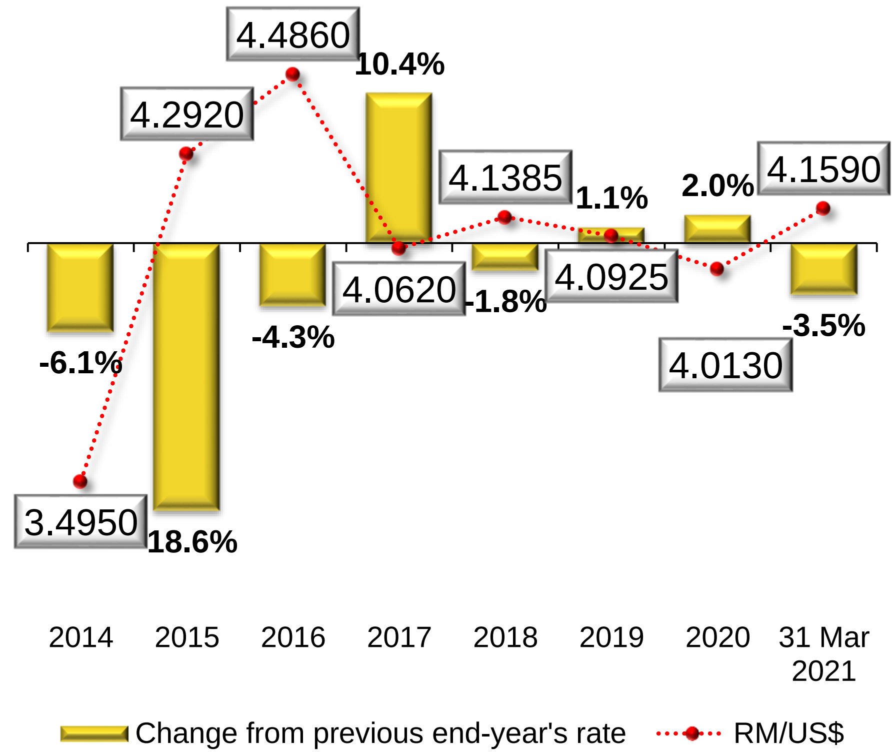
Higher oil prices-induced inflation in 2021

Year	2017	2018	2019	2020	2021E^
OPR (%)*	3.00	3.25	3.00	1.75 ↓	1.75
Inflation Rate (%)	3.7	1.0	0.7	-1.2 ↓	3.0 to 4.0 ↑



* OPR as at end-period
^ SERC's estimates

Ringgit outlook: RM3.95-RM4.00 per US dollar at end-2021

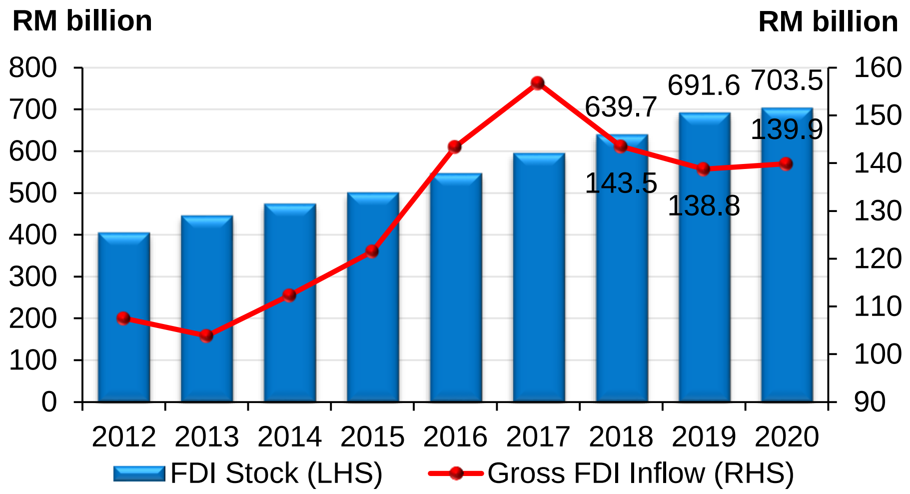


Source: DOSM; BNM

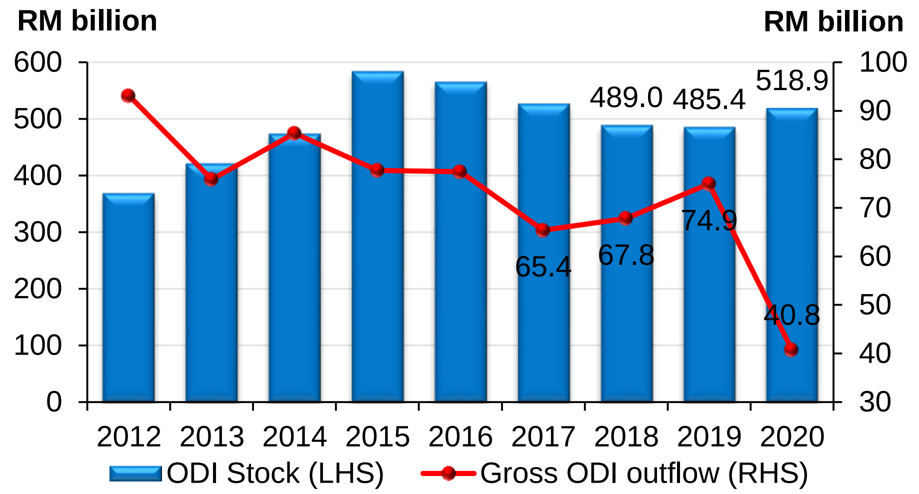
Note: Exchange rate (12:00 rate) as at end-period

Moderating net inflows of direct investment

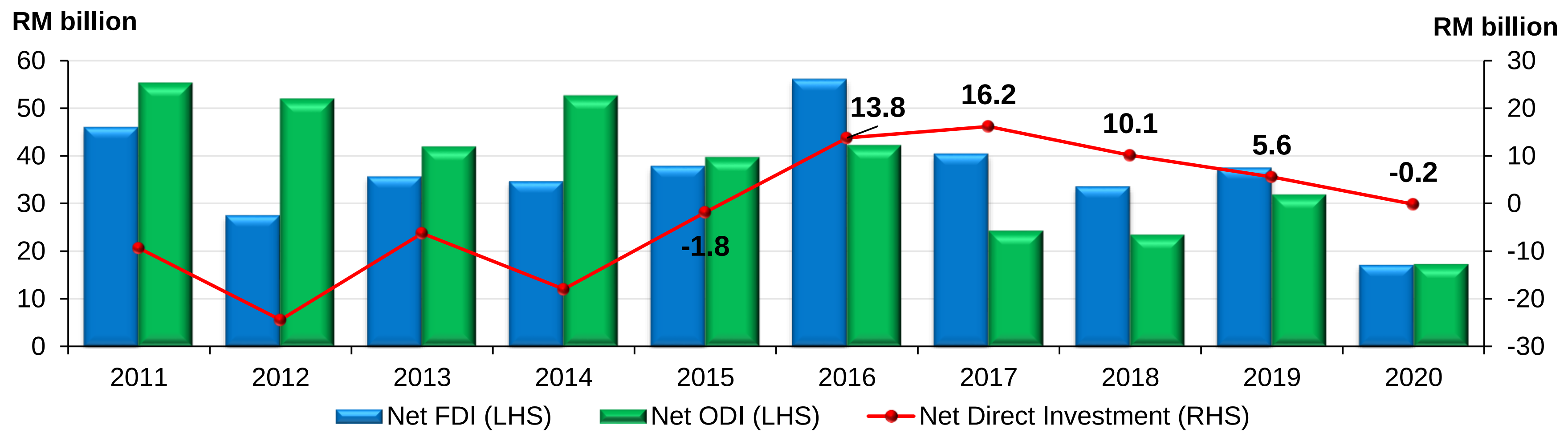
Gross FDI inflows remained broadly unchanged



Gross ODI flows shrunk significantly in 2020



Net direct investment slipped marginally in 2020 given a sharp decline in net FDI inflows



Source: BNM

FDI = Foreign direct investment; ODI = Outward direct investment

Foreign exchange liberalisation to enhance Malaysia's FDI destination and a global supply chain hub

Foreign Exchange Policy Liberalisation effective 15 April 2021

Removal of export conversion rule
Exporters may now manage the conversion of export proceeds according to their foreign currency cash flow needs

Exporters can settle domestic trade in foreign currency with other residents operating in the global supply chain[1]
Facilitate natural hedge for exporters and their business partners along the global supply chain to better manage FX risk

Exporters are allowed to net-off export proceeds against permitted foreign currency obligations[2]
Enhance business efficiency and cash flow management of exporters

Exporters can extend the period for export repatriation beyond 6 months under exceptional circumstances[3]
Exempt exporters from seeking the Bank's approval to extend export proceeds beyond 6-month period for reasons beyond the exporters' control

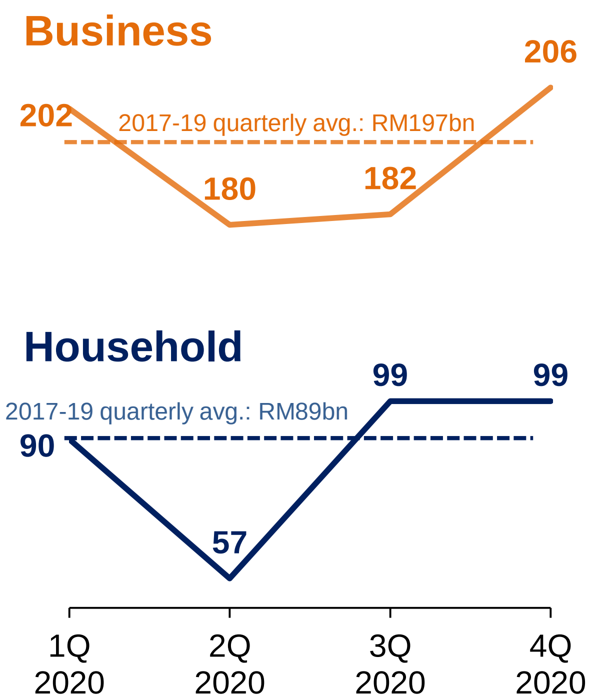
Corporates are free to undertake commodity derivatives hedging directly with non-resident counterparties
Broaden avenues and options for corporates to hedge their commodity price risk

[1] Global supply chain is defined as a business activity where resident importers purchase goods or services from overseas to support production or distribution of goods or services by resident exporters for their export activities.
[2] Such as netting of export receivables against import payables with the same overseas buyer and supplier
[3] Defined as instances where exporters have no control over the delay in receiving the export proceeds e.g. buyers in financial difficulties.

Financing remains supportive of economic activity

Credit flows improved towards the end of 2020…

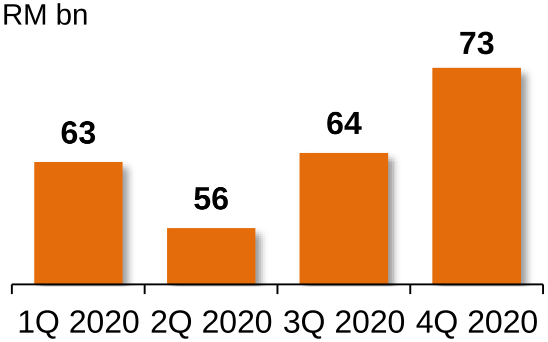
Business and Household Loan Disbursements
RM bn



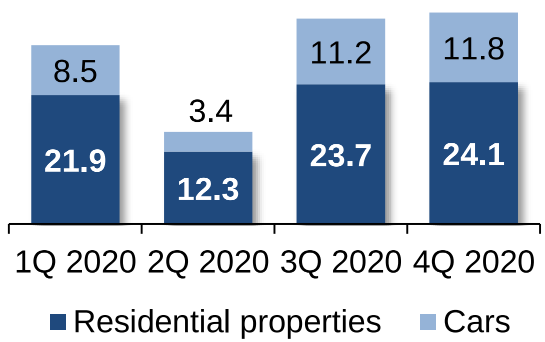
Note: Data from banking system and development financial institutions (DFI)
Source: BNM

… with higher disbursements to SMEs and to households for purchasing homes and passenger cars…

SME Loan Disbursements

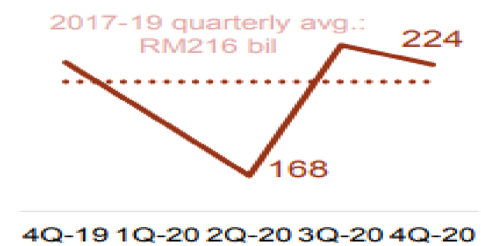


Household Loan Disbursement by Selected Purpose

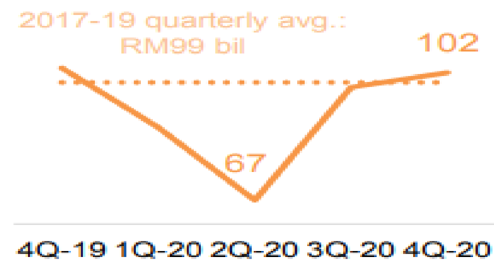


In 2021, accommodative financing conditions would continue to support loan demand supply

Total Loan Applications (RM bn)*



Total Loan Approvals (RM bn)*



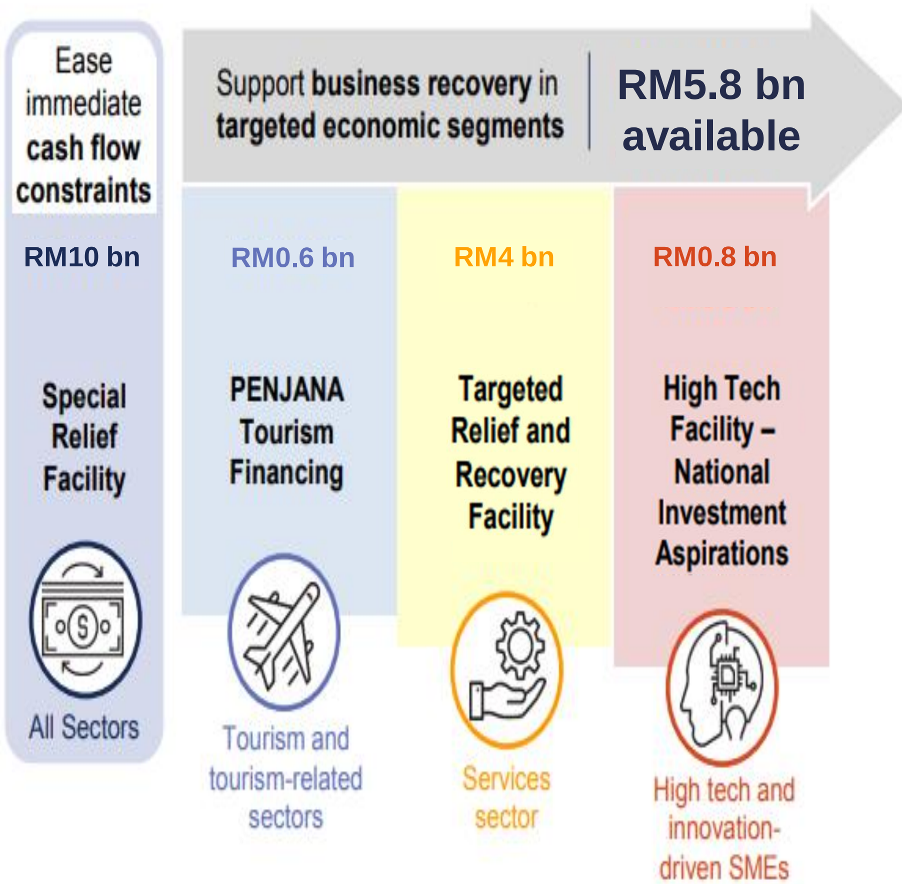
- Lower financing costs following 125bps OPR reductions in 2020
- Various measures supporting financing activities *(e.g. SST exemption, Home Ownership Campaign, guarantee schemes, BNM funds)*

** Refer to data from the banking system only*

BNM's Fund for SMEs complement bank's financing to SMEs

More targeted facilities by BNM amid continued challenging environment…

Selected BNM's Fund for SMEs

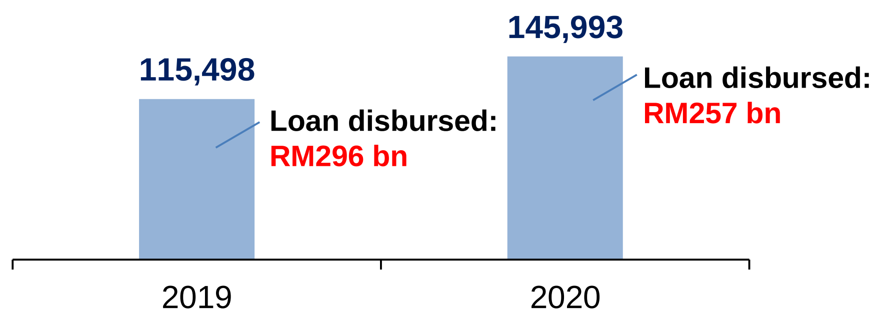


Note: As at 26 March 2020, reflecting reallocation between facilities
Source: BNM

… complemented banks' role in providing financing to SMEs

SME Loan Indicators*

Loan approved (No. of Accounts)



Bank continue to support to new customers and underserved segments in 2020

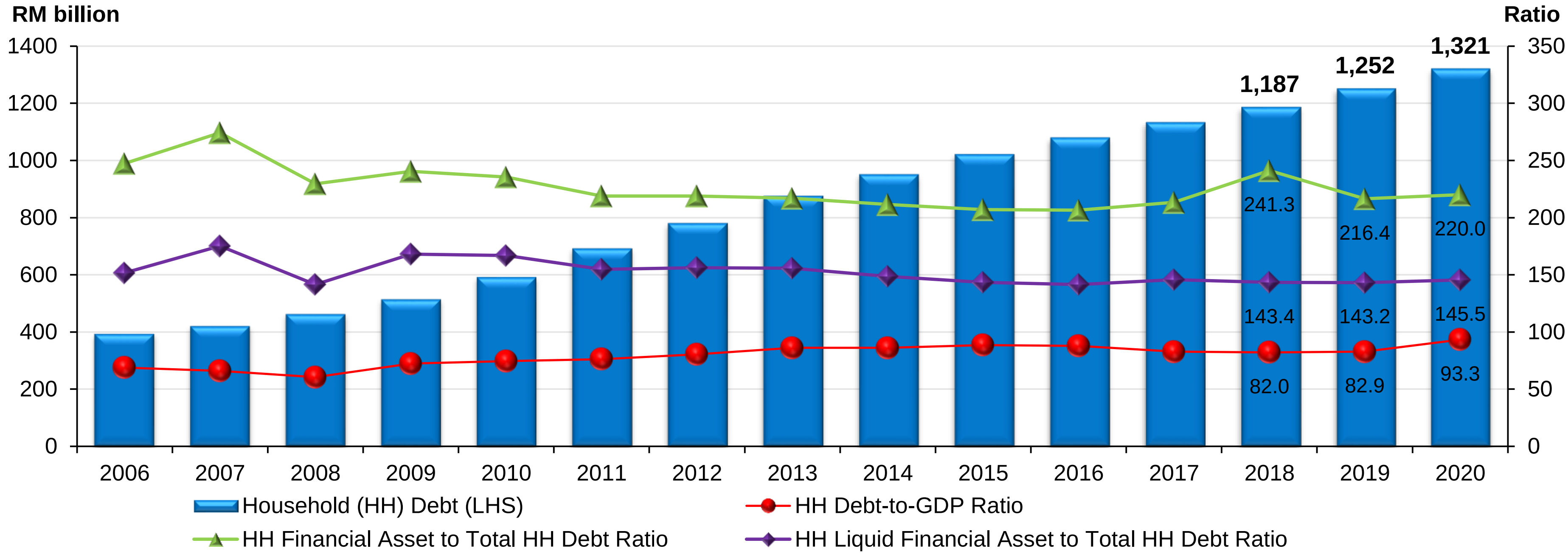
33% *of approved applications were to* ***new-to-bank customers***

46% *Increase in financing approved* ***"young" SMEs***

** Banking system and DFIs*
*** Growth in the number of accounts approved in 2020 over 2017-2019 average.*
'Young' SMEs defined as SMEs established not more than 3 years
Source: CCRIS and BNM

Household debt-to-GDP ratio rose to a new peak of 93.3%

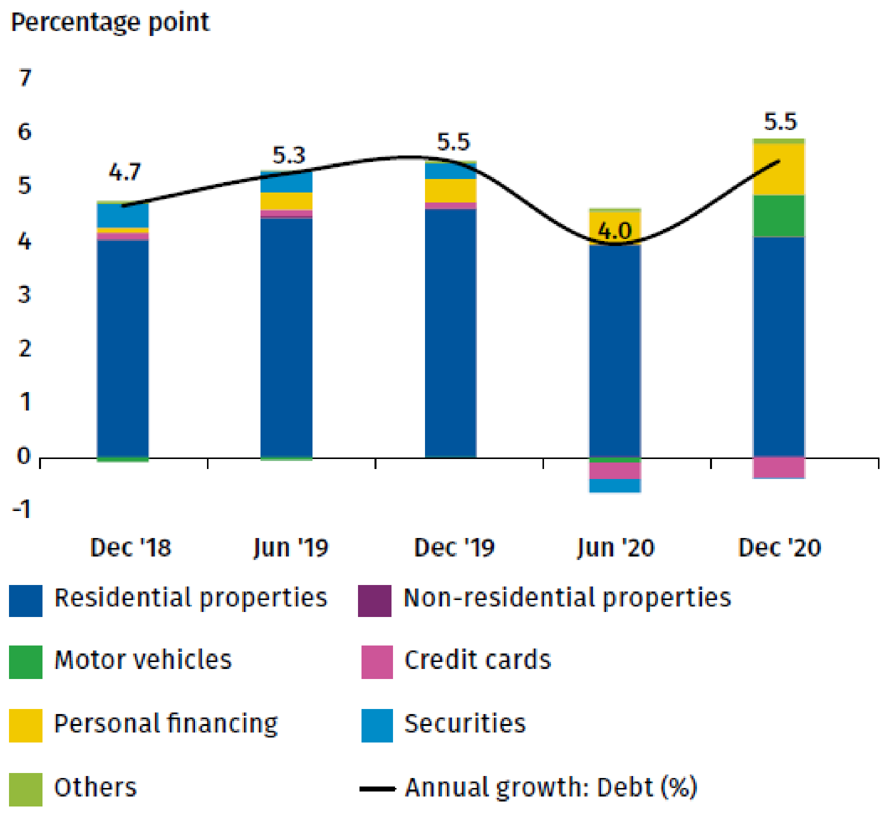
- **Household debt increased by 5.5% to RM1,320.6 billion in 2H 2020** from RM1,251.8 billion in 2H 2019, mainly driven motor vehicle loans (buoyed by sales tax exemption on passenger cars), personal financing, home loan (spurred by home-ownership campaign) and the suspension of repayment during blanket loan repayment moratorium.
- With a lower level of GDP in 2020, **household debt-to-GDP ratio surged to a new peak of 93.3% in 2H 2020 from 82.9% in 2H 2019**. Nevertheless, the overall household sector has remained resilient throughout the crisis as **household financial assets and liquid financial assets remained broadly stable at 220.0% and 145.5% of debt** respectively.



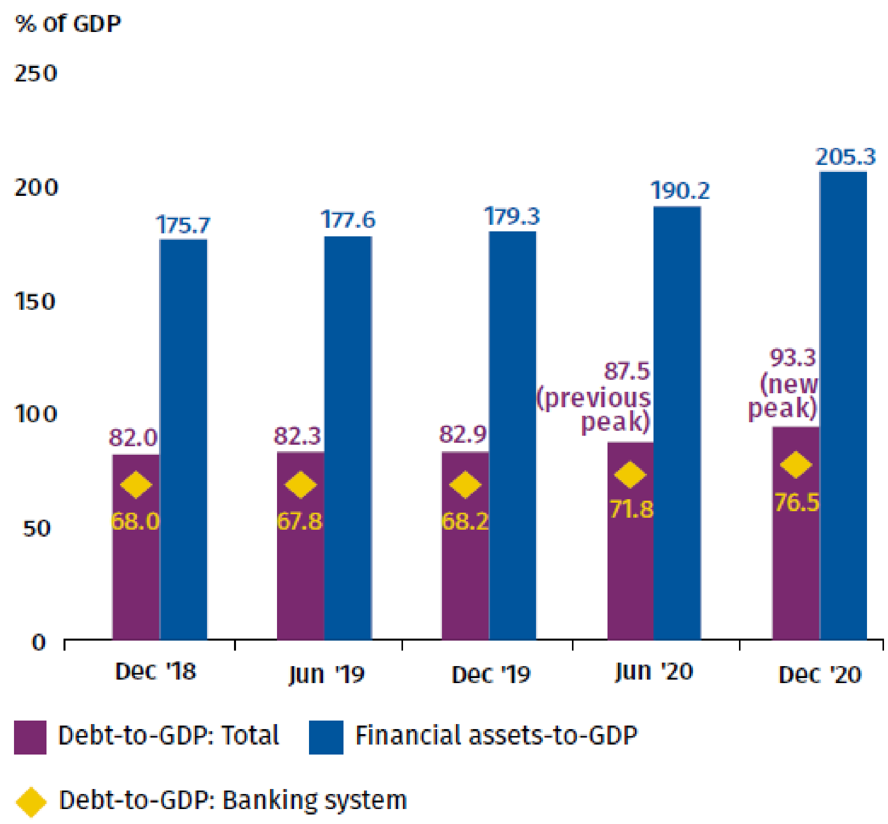
Source: BNM

Household sector debt conditions

Household Sector – Annual Growth of Debt



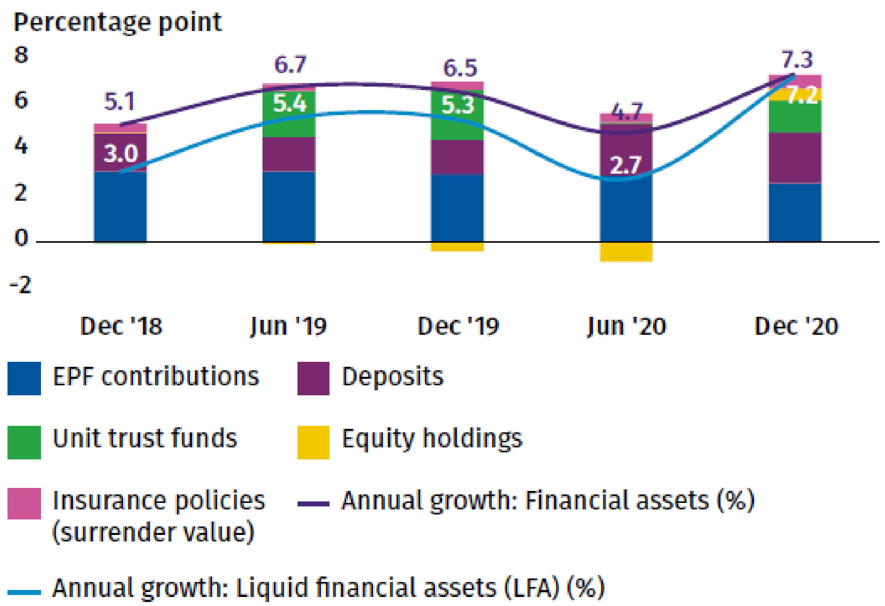
Household Sector – Key Ratios



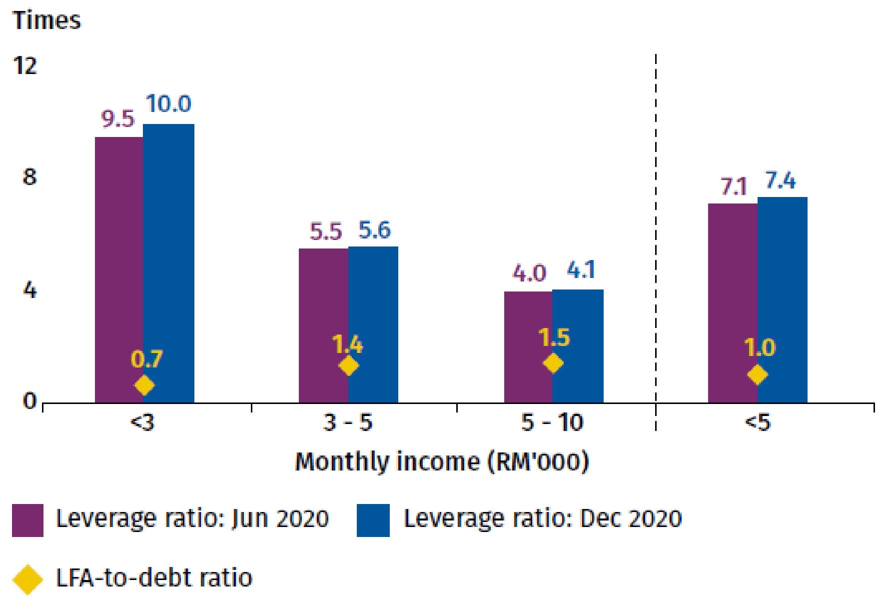
Source: BNM

Household sector debt conditions (cont.)

Household Sector – Annual Growth of Financial Assets



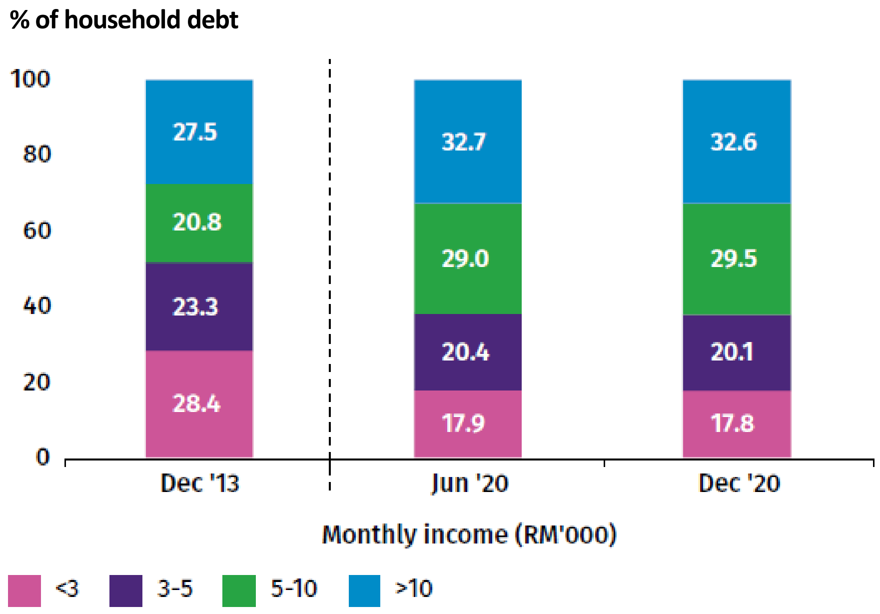
Household Sector – Leverage and LFA-to-Debt Ratios



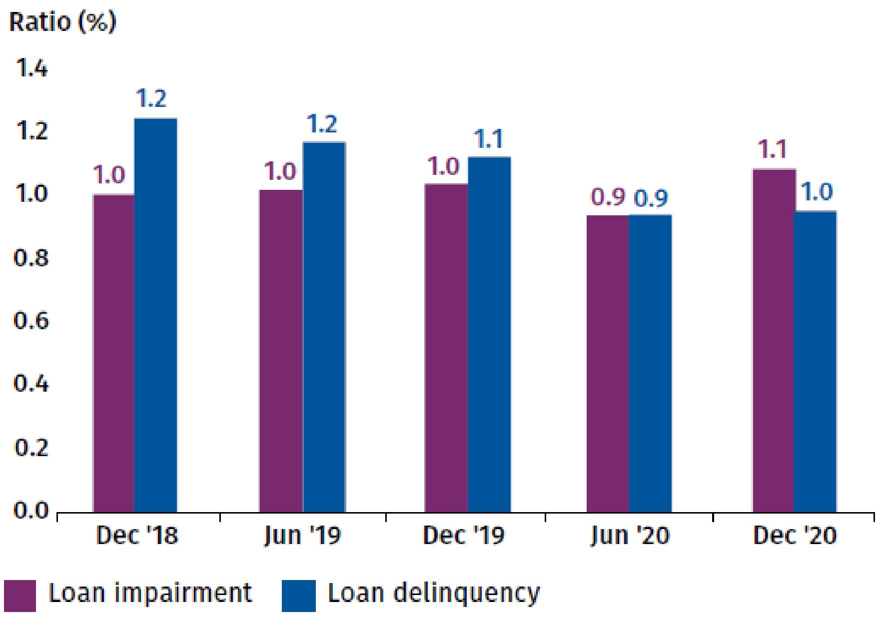
Source: BNM

Household sector debt conditions (cont.)

Household Sector – Debt by Monthly Income Group



Household Sector – Loan Impairment and Delinquency Ratios in the Banking System



Source: BNM

Household sector debt conditions (cont.)

Household Sector – Profile of Accounts Under Loan Moratorium

Number of accounts

630,550 accounts

(5.2% of total household loan accounts)

- **54%** Extended to borrowers earning less than RM5,000 per month
- **84%** For loans to purchase cars and houses as well as personal financing
- **52%** Of housing loans were for affordable houses (<RM300,000)

Outstanding amount

RM61.7 billion

(5.3% of total household loans)

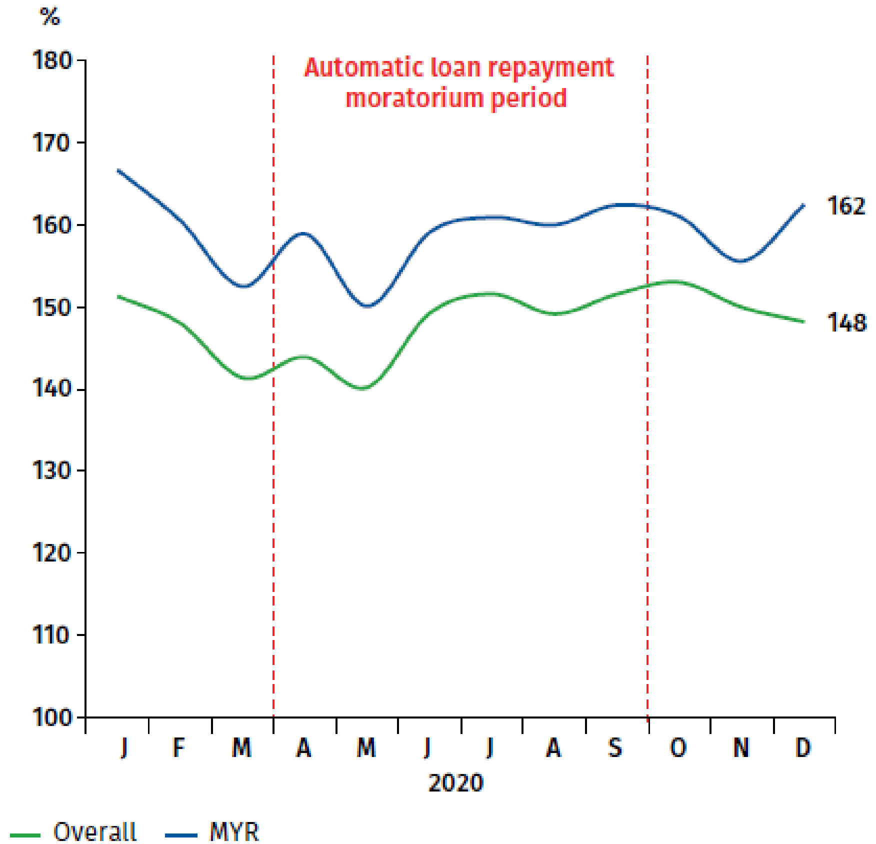
- **60%** Extended to borrowers earning more than RM5,000 per month
- **81%** For loans to purchase houses and cars
- **79%** Of housing loans were for houses priced above RM300,000

Note: Loan moratorium extended by commercial and Islamic banks as well as major development financial institutions

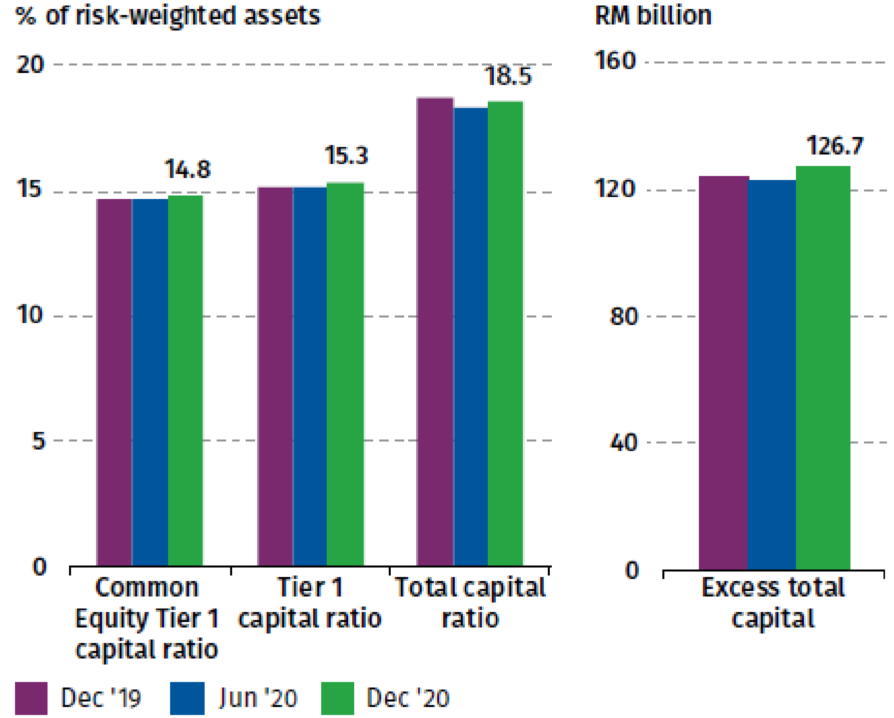
Source: BNM

Financial system remains resilient to support financial intermediation

Banking System – Liquidity Coverage Ratio



Banking System – Capital Ratios

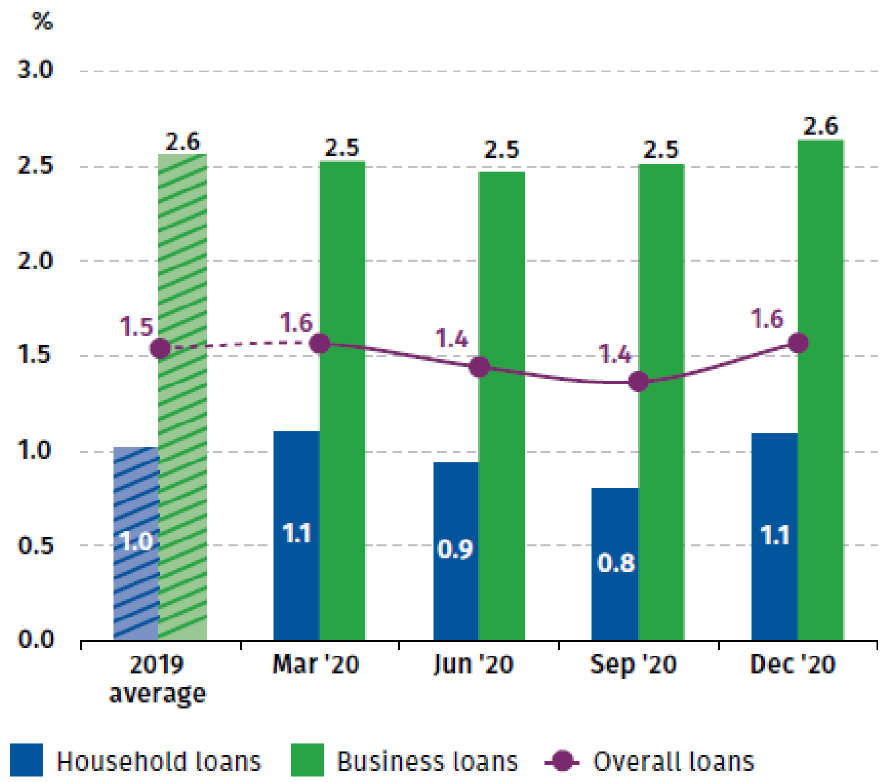


Note: Excess total capital refers to total capital above the regulatory minimum, which includes the capital conservation buffer requirement of 2.5% and bank-specific higher minimum requirements

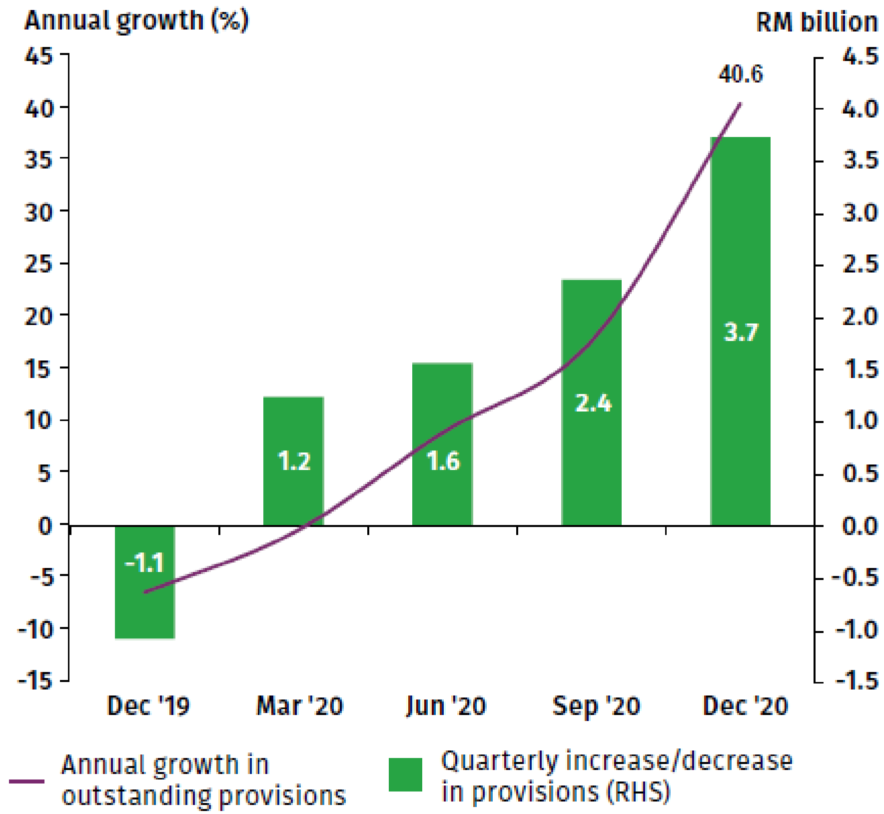
Source: BNM

Credit risk expected to remain in focus in 2021

Banking System – Gross Impaired Loans Ratio

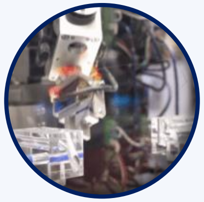


Banking System – Provisions



Source: BNM

Spotlights on selected BNM's Box Articles



1. Attract quality investments

2. Resilient and agile workforce

3. Social protection reform

4. Malaysia's need of central bank digital currency

1. Innovating Malaysia towards higher quality growth

- 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.

Quality investment and innovation-led growth

- Malaysia is adopting **the National Investment Aspirations (NIAs)**, a forward-looking national policy aimed at attracting the right investments, building innovation capacity and increasing both productivity and growth

The Five National Investment Aspirations (NIAs)

1 Increase economic complexity
- Development of sophisticated products and services
- High local R&D and innovation intensity

2 Create high-value jobs
- High-skilled, high-income employment for locals

3 Extend domestic linkages
- High use of domestic inputs
- Increased breadth and depth of domestic supply chain

4 Develop new and existing clusters
- Development of high-productivity sectors
- Development of new products and services locally

5 Improve inclusivity
- Increase development in underserved areas and communities

Source: BNM; World Bank

1. Innovating Malaysia towards higher quality growth (cont.)

Identifying the right activities

1. Quality investments in activities that meet the NIAs

- Investments need to be targeted more toward knowledge-intensive and tech-intensive activities.
- 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.

2. Diversifying into more complex products

- Malaysia could adopt a balanced growth strategy 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

3. Employing a mission-based investment approach

- Leverages on private sector R&D and investment spending across multiple sectors into new, high growth areas of the economy.
- Malaysia should consider utilising this approach as an investment strategy in innovation by identifying the next 'moon-shot' for frontier technology and innovative activities.

1. Innovating Malaysia towards higher quality growth (cont.)

The 3D's of Reforms

1. Accelerating Digitalisation: Embracing Digitalisation Nationwide

Strengthening Enablers	Digitalising Industries	Industrialising Digital
Conducive and enabling ecosystem	**Transforming existing industries**	**Catalysing new digital industries**
Digital Connectivity (JENDELA)	Micro & SME E-Commerce Campaign, Shop Malaysia Online	National Technology & Innovation Sandbox
Digital Government initiatives	100 GoDigital Program	Penjana Kapital
Cyber Resilience (Malaysia) Cyber Security Policy	Business Digitalisation Grants	Global Accelerator Program (GAIN)

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

2. Rethinking Downstreaming: Producing Higher Value Add Palm Oil Products

Higher palm oil product complexity

Leader in sustainable practices

Enhance R&D for speciality products

1. Innovating Malaysia towards higher quality growth (cont.)

The 3D's of Reforms (cont.)

3. Reducing Distortion: Better allocative efficiencies in attracting quality investments

Tailor incentives to right activities

- A more holistic approach that links incentives to specific activities aligned with NIAs would significantly strengthen prospects for attracting quality investment.

Align with NIAs for quality investment

- A timely and effective implementation of the Government's ongoing review on investment incentives would be critical to realise the positive impact from providing a more competitive, transparent and attractive tax incentive framework.

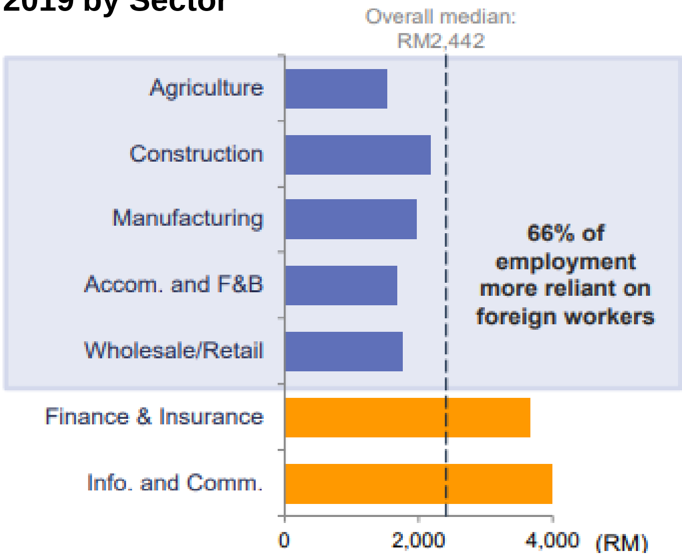
Attain efficient allocation of resources

- A more effective tax incentive system will also mitigate the inefficient allocation of resources.
- Providing tax incentives for firms to undertake these quality investments effectively turns the Government into a 'silent and solid' partner in these investments

2. Structural labour market issues in post-COVID-19 world

The COVID-19 crisis has exacerbated structural challenges in the Malaysian labour market

Median Monthly Salaries and Wages in 2019 by Sector



Insufficient high-skilled job creation and skills mismatch

86K*

Net employment gains in high-skilled jobs

151K*

Graduate entry into labour force

Source: BNM

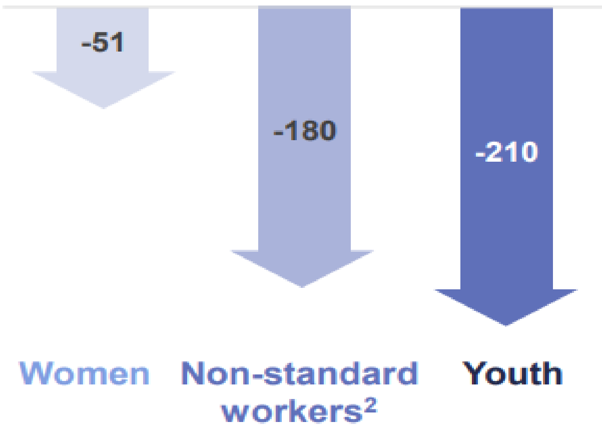
*Average annual change, 2010-2019

1. **Prevailing Structural Issues**
   - Prevailing structural impediments weigh on future job and income prospects.
   - 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, thus deterring the creation of high-skilled and high-paying jobs.
2. **Low Creation of High-skilled Jobs**
   - **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.
   - 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.
3. **Mismatch issues**
   - Significant mismatches between skills required by industry and those that workers possess.
   - Skill shortages reported by employers: **Oral expression and writing, Social perceptiveness and Critical thinking**

2. Structural labour market issues in post-COVID-19 world (cont.)

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

Fall in employment between 2020 and 2019 ('000 persons)



In Q2 2020:

Non-standard Employment: Decline of around 252,000 persons

Youth Unemployment: Increased to 12.5% (10.9% in 2019)

Women's Employment: Negative growth rate of 0.1% (2020)

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

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.**

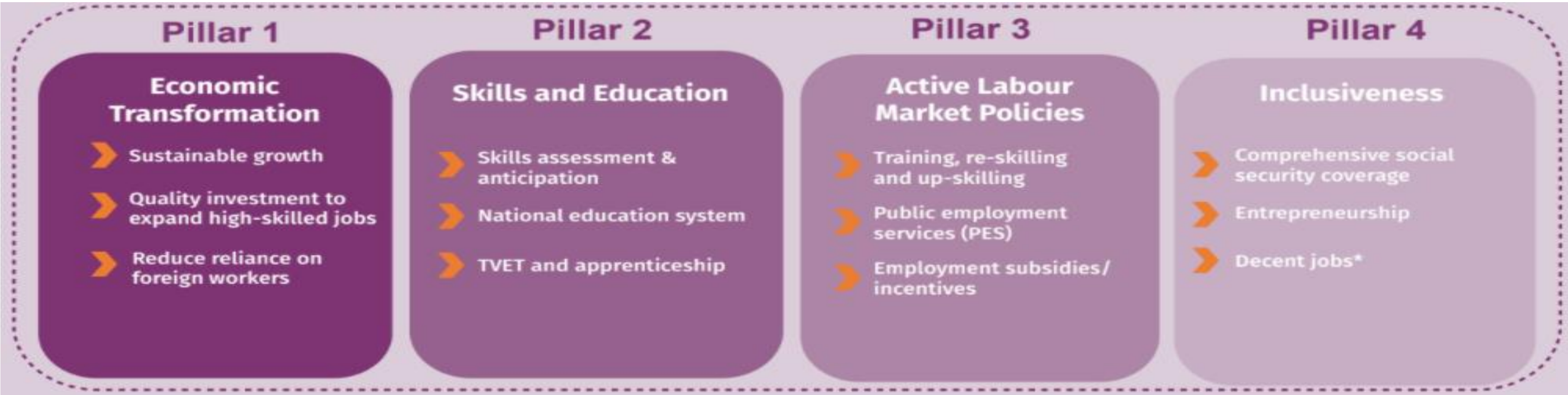
The pandemic continued to harm **vulnerable segments** of the labour market:

- **Non-standard employment** continues to suffer from slower demand conditions and further restrictions.
- **Younger workers** face very challenging labour market conditions immediately upon entry into the workforce.
- **Working women** are disproportionately impacted by the pandemic. (In 2020, 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%)

Source: BNM

2. Labour-related policy priorities to complement innovation reforms

Four Main Pillars of the Labour Policy Framework



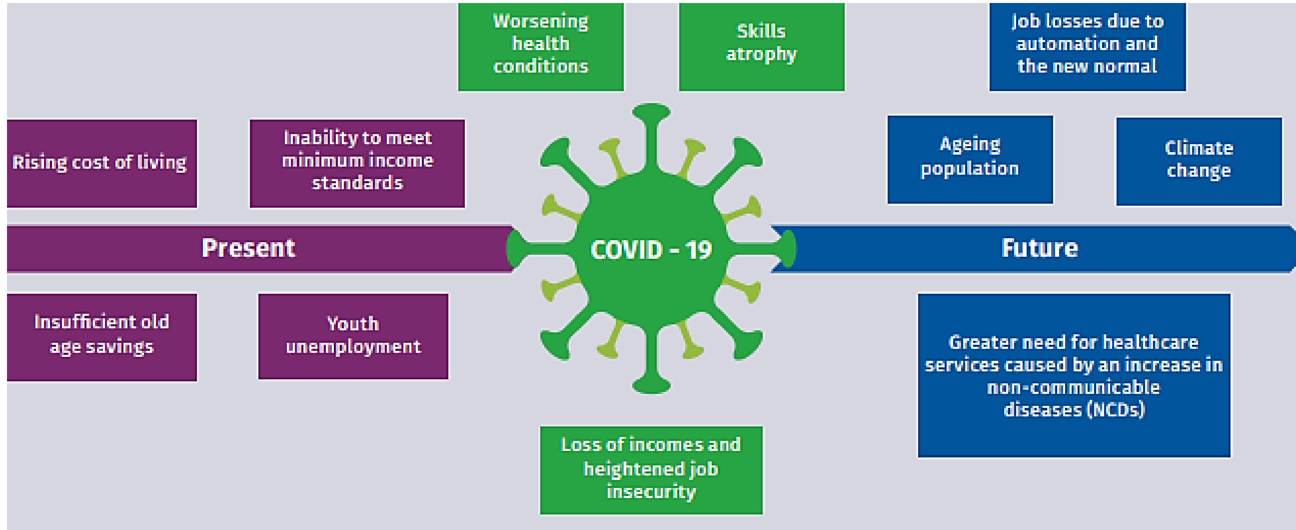
Labour Policy Priorities

Encourage demand for high-skilled workers	Improve training & matching mechanisms	Enhance labour market resilience
Reinvigorate investments through NIAs	Enhance education & training ecosystems	Close gaps in social security and insurance programmes
Transition into high-value production	Cohesive participation of industry, academia and civil society	Extend coverage of re-skilling & up-skilling programmes
Reduce reliance on foreign workers	Enhancement of Active Labour Market Policies (ALMPs)	Consolidate social protection programmes

Source: BNM

3. A vision for social protection in Malaysia

COVID-19 has magnified the socioeconomic vulnerabilities faced by Malaysians, despite some of the vulnerabilities exist before the pandemic and remain challenging in the future.



Gaps in Social Protection

Pillar 1: Social Safety Nets	Pillar 2: Social Insurance	Pillar 3: Active Labour Market Policies (ALMPs)*
- Over-reliance on social safety net programmes	*- Increasing old-age dependency ratio*	
➢ Small and overlapping programmes with weak targeting and verification capacity ➢ Minimal complementarities with ALMPs*	➢ Inadequate pensions coverage and increasing fiscal burden of public pensions ➢ Lack of coverage for workers in the informal sector and the self-employed	➢ Fragmented policies resulting in low accessibility and lack of linkages with industry demand

** Active Labour Market Policies (ALMPs) refer to all social spending (other than on education) aimed at enhancing employability of workers or increasing their earnings capacity*

3. A vision for social protection in Malaysia (cont.)

Social protection reform is vital as a safeguard against socioeconomic vulnerabilities with 3Ps

Social protection reforms and enhancements

Multi-pillar reforms

1. Formulation of a roadmap for all social protection reforms
2. Creation of a harmonised and centralised social protection database
3. Establishment of a one-stop centre for registration, application, and eligibility checks for all social protection programmes

Pillar-specific reforms

Pillar 1: Social Safety Nets (SSN)

(Protect)

1. Consolidation and rationalisation of SSN programmes
2. Enhancing the targeting mechanism to increase progressivity
3. Ensuring more complementarities with ALMPs

Pillar 2: Social Insurance (SI)

(Prevent)

1. Incentives for contributions to private pensions
2. Moving towards a defined-contribution (DC) scheme for new public sector hires
3. Implementing a phased approach in addressing gaps in coverage

Pillar 3: Active Labour Market Policies (ALMPs)

(Promote)

1. Periodic review of ALMP implementation
2. Boosting synergy between government, academia, and industry
3. Training and upskilling conditionalities for SSN and SI programmes

These reforms will build the necessary foundations to future-proof Malaysia's social protection system and facilitate in building human capital by ensuring access to better opportunities

4. Evaluating Malaysia's need for Central Bank Digital Currency (CBDC)

What is the difference between flat currency, e-money and digital assets?

	Issued and backed by a sovereign body	Privately-issued and backed by assets		Privately-issued and not backed by assets
			Digital assets	
Instrument	**Fiat currency** 1. Bank notes and coins 2. Central Bank Digital Currency (CBDC)	**Electronic money** *(E-money)* *e.g., Boost, GrabPay, Setel, ShopeePay, and Touch 'n Go*	**Stablecoin** *(e.g., Tether, USD Coin)*	1. Exchange tokens[1] *(e.g., Bitcoin, Ethereum)* 2. Security tokens[2] 3. Utility tokens[3]
Store of value	Value is backed by a sovereign body (e.g., Government, central bank)	Value is backed by fiat currency	Value is backed by assets (e.g., fiat currency, commodity)	No formal backing for its value and subject to market forces
Medium of exchange	▪ Widely used as a means of payments ▪ Some countries are exploring the feasibility of issuing CBDC (digital form of fiat currency)	Widely used as a means of payment	May potentially be used as a means of payment subject to effectiveness of value stabilisation mechanism	Not widely used as a means of payment due to various limitations (e.g., high price volatility, vulnerability to cyber threats, scalability issue)
Unit of account	Widely used for pricing of goods and services	Denominated in fiat currency	May be denominated in fiat currency (for stablecoins backed by fiat currency)	Not widely used for pricing of goods and services

[1]*Used as a means of exchange or for investment*
[2]*May provide rights, e.g., ownership, repayment of a sum of money, or entitlement to future profits*
[3]*Can be redeemed for access to a specific product or service*
Note: Examples are meant to be illustrative and do not amount to any form of endorsement
Source: Bank Negara Malaysia, Financial Action Task Force, Bank for International Settlements (BIS), Cryptoassets Taskforce

4. Evaluating Malaysia's need for Central Bank Digital Currency (CBDC) (cont.)

Clarification of digital assets

- **Digital assets are only one of the many applications of distributed ledger technology (DLT).** DLT allows users to transfer digital assets to another person directly without the need of a central authority or intermediaries.
- **Digital assets**, such as Bitcoin, **suffer from various limitations** (*e.g., high price volatility, vulnerability to cyber threats, scalability issue*) **which reduce their suitability as a means of payment.**
- While CBDC may adopt the same underlying technology (*e.g., blockchain or DLT*), **CBDC differs from digital assets as CBDC is a legal tender and backed by a claim on the central bank unlike digital assets that are not legal tender and have no intrinsic value**.

Source: BNM; BIS

CBDC issuance

- **Benefits**: Faster settlement easier accessibility, and better system resilience
- **Risks:**
  a) Trigger financial stability risk if it leads to large shifts of bank deposits to CBDC;
  b) CBDC issued by a foreign central bank that is denominated in foreign currency may undermine the effectiveness of monetary policy transmission, if it is widely used a means of payment in Malaysia

Malaysia's context and approach to CBDC

- At the moment, **the Bank does not have any immediate plans to issue CBDC**. In Malaysia, the financial system continues to support the functioning of economy while meeting the needs of individuals and businesses.
- Given that this is a rapidly evolving situation, CBDC issuance should complement existing payment instruments, including physical cash to ensure that all Malaysians have continued access safe and efficient payment solutions.
- Hence, Bank Negara Malaysia is actively building internal capacity to support informed decisions on CBDC issuance, including by conducting proof-of-concepts (POC).

SERC's commentaries

- Overall, BNM expects a strong economic rebound (**GDP growth estimate of 6.0-7.5%, equivalent to mid estimates of 7.0**%) in 2021 from -5.6% in 2020, helped by a significantly low base due to the Movement Control Order in 2020, higher expansion of trade and manufacturing as well as strong recovery in services and construction sectors.
- The expected sharp GDP rebound in 2021 would mark the highest since 2010 when the economy expanded by 7.4%. Nevertheless, this current estimate was tweaked lower from BNM's initial growth forecast (6.5%-7.5%) made in February this year and also from Ministry of Finance's Budget 2021 estimate of 6.5%-7.5%.
- **On the growth trajectory in 2021**, BNM expects the third wave of virus and MCO 2.0's scarring effects will cause a similar magnitude of economic output decline as in 4Q 2020 (-3.4% yoy) or could be higher in 1Q 2021, and a positive turnaround will start from 2Q onwards.
- **BNM is confident that GDP will achieve pre-pandemic level by mid-2021**. It must be noted that the country's potential output is estimated at 3.0-4.0% this year, meaning that the estimated higher GDP growth is largely boosted by a low base as well as one-off fiscal stimulus and booster measures, such as cash assistance, EPF withdrawals, targeted loan repayment assistance program for households and businesses.

SERC's commentaries (cont.)

- **SERC maintains its GDP growth estimates of 4.0% (base case) and 6.0% (upside) for 2021** amid continued economic scarring effects from the movement restrictions and restricted inter-state travel ban. We will revisit our estimates after the release of 2021's 1Q GDP in May 2021.

- The on-going national immunization program holds the key to lift a sustained revival in consumer sentiment. Some travel and tourism-related sub-services sectors would recover gradually and may take a longer while to fully restore their growth traction, depending on a complete lifting of inter-travel restriction and the reopening of Malaysia's international borders to travellers and tourists.

- **On private consumption growth estimate of 8.0% in 2021 (-4.3% in 2020)**, while the pent-up demand and consumption booster measures, such as EPF withdrawals, cash handout as well as the draw down of savings would help to shore up consumer spending, but a slow and moderate recovery in the labour market (BNM estimates unemployment rate at 4.6% in 2021 vs. 4.5% in 2020) would cap spending. In addition, the wearing off effect of consumption-fuelled catalysts would pull the brake on consumer spending towards end-year and in 2022.

- **On public investment**, **BNM's estimated growth of 15.2% in 2022** (-21.4% in 2020) is critically dependent on the speed and effectiveness of the 2021 Budget's spending programs as well as non-financial public enterprises. Delays in the tendering process and disbursement as well as shortfall in spending would drag down the overall economy.

SERC's commentaries (cont.)

- Overall, we see the **challenge ahead is to ensure the continued pace of economic growth in 2022**, net off the low base effect as well as the dissipating of one-off financial assistance and cash flow relief measures. In this regard, **targeted fiscal and monetary support are needed** to manage a gentle normalisation of economic growth path.
- **Are domestic inflation expectations well anchored now?** We contend that higher fuel prices at the pump may cause public to begin behave as though inflation is occurring given a sharp rise in the price of Brent crude oil since the last quarter of 2020. The base effect of rising energy costs will work on the transport prices. Headline consumer price index (CPI) will be getting normal from a depressed base in 2020. Much of short-term inflation pressure is a gradual normalisation of unusual disparities in supply and demand brought about by the COVID-19 pandemic, as domestic demand and economic activity recovers. **Cost-push inflation will be calling the shots in 2021** amid still mending domestic demand.
- Although economic activity has recovered gradually, the economy is likely to have spare capacity as a result of the COVID-19 pandemic as the economy's output to remain below its potential level for some time. A number of factors will influence how that spare capacity affects inflation, including the frequency of price changes across different sectors.

SERC's commentaries (cont.)

- Core inflation number and other price indicators bear close tracking. The central bank has to keep a watchful eye on cost-push inflation for now, to anchor forward inflation expectations. This is to safeguard against the occurrence of unrelenting wage demand inflation when the workers ask for wage rise to compensate for rising cost of living.

- **BNM reaffirms no change in the monetary policy stance**. Despite the projected higher cost-driven inflation (2.5%-4.0%), albeit temporary in 2021, **we expect Bank Negara Malaysia to hold the overnight policy rate steady at 1.75% till end-2021**. Given the subdued price pressures amid continued spare capacity in the economy, BNM reaffirmed that monetary policy will not be the most appropriate tool to manage supply-driven inflation.

- **Decisions on monetary policy will continue to be data-driven**. 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.

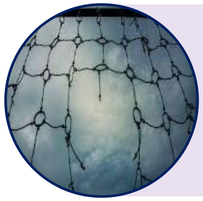
SERC's commentaries (cont.)

- **Malaysia needs a reset in order to emerge stronger from the pandemic**. Hence, the longer term structural reforms are crucial to ensure sustainable and durable economic growth.
- BNM has outlined **four key actions to reset and seize new growth opportunities**, (i) **Attract quality investments**; (ii) **Build innovation capacity**; (iii) **Enhance economic complexity**; and (iv) **Social protection reform**. At the same time, BNM also listed three areas for a **sustainable economic recovery**: (i) **Resilient and agile workforce**; (ii) **Innovation-led growth**; and (iii) **Social protection for vulnerable groups**.
- As Malaysia has long remained trapped in the upper middle-income, **bold and radical changes in our approach to national socioeconomic development are urgently needed to move Malaysia forward**. We have to right the wrongs of the past and undertake the necessary recourse to ensure the country's economic development will be sustainable over the long-term to deliver **a fair, equitable and inclusive economic dividend** to all Malaysians.
- Post the COVID-19 world, there remain considerable challenges to our national socioeconomic development journey ahead. Domestic issues and challenges come from how the Government and public institutions would ensure equitable growth and distribution as well as inclusiveness of development and income policies to all Malaysians. **Pressures from external are getting more complex in the aspects of competitiveness, talent and skilled manpower, drawing high quality investment.**

SERC's commentaries (cont.)

- It is no longer a choice but a must take re-transformation. **Strong political conviction is needed and all stakeholders are committed towards making a TOTAL NATIONAL RESET to secure a better future for all Malaysians**. We concur BNM's reset initiatives and strategies, and outline the following four areas that require reforms.

✓ **The reconstruction of public delivery services**



✓ **Fragmented and ineffective social protection system**

✓ **Upgrading of human resources; innovation and digital technology capacity**

✓ **Redefining Malaysia's industry and business competitiveness**

社会经济研究中心

SOCIO-ECONOMIC RESEARCH CENTRE

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THANK YOU

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