

Foreword

The Malaysian economy emerged from the health and economic crisis with a strong recovery in 2022. This has been on the back of substantial policy support, sound macroeconomic fundamentals and a strong financial system. Buffers built during good times preceding the pandemic enabled the economy to weather the crisis. With the pandemic now mostly behind us, we must rebuild these buffers to serve as a source of strength against future shocks, as they did in this crisis. In addition, measures to further strengthen the foundations of our economy and enhance our economic potential in a post-pandemic world will be critical to deliver sustainable and inclusive growth over the long term.

On the global front, Malaysia can expect to benefit from the reopening of China, resilient labour markets supporting demand in major economies, and the recovery in tourism activity. Nevertheless, 2023 will remain challenging and uncertain for most economies. Global growth is expected to expand at a slower pace amid an environment of high inflation and tight monetary policy. The banking stress seen recently in some advanced economies has added to the uncertainty. As a small, open economy, Malaysia will inevitably be affected by slower external demand and turbulent global financial markets. Domestically, elevated cost pressures could weigh on spending by households and firms. While all economic sectors are expected to improve further, some sectors would still remain below pre-pandemic levels this year given lingering frictions such as labour shortages, high building material costs and more significant shocks from the pandemic that have affected tourism-related segments.

Despite these headwinds, the Malaysian economy is expected to expand between 4.0% and 5.0% this year, and is not at risk of entering a recession. Household spending will remain strong, given improving labour market conditions. This will see unemployment trending lower and income prospects remaining positive. The lift from the continued recovery in tourism-related activities will also support growth. Our financial system will continue to be a key source of strength for the economy. The flexibility in the ringgit exchange rate – which helps buffer the impact to the domestic economy from the rapid and sizeable global monetary tightening – will continue to facilitate appropriate macroeconomic adjustments in the face of external shocks. Importantly, the orderly functioning of financial markets, as well as the strength of financial institutions, will support continued financial intermediation activities to meet the needs of the economy.

Recent shifts in inflation dynamics have increased uncertainties over the path of inflation. This in turn has had an important influence in shaping the direction of monetary policy globally. For Malaysia, inflationary pressure was initially attributed to supply shocks. As the economy recovered, the strengthening of demand factors has also contributed to more persistent underlying inflation. The confluence of these factors requires us to carefully balance the risks to both our domestic inflation and growth. Overadjustments in monetary policy would negatively impact growth, while undershooting could lead to inflation expectations becoming unhinged with damaging effects on consumers' purchasing power and the sustainability of economic growth.

In this environment, and consistent with the Bank's legal mandate to promote price stability while giving due regard to developments in the economy, the Monetary Policy Committee (MPC) of the Bank raised the Overnight Policy Rate (OPR) in a measured and gradual pace. Given that monetary policy works with a lag, the recent pauses allow the MPC to assess the impact of successive OPR adjustments, along with evolving conditions that affect the outlook of growth and inflation. We remain watchful over the persistency of price pressures. Our near-term strategy is to ensure that the OPR remains at an appropriate level to manage inflationary pressures, which will allow us to achieve sustainable growth over a longer term.

To ensure that we remain effective in delivering on our monetary stability mandate, the Bank has embarked on a multi-year exercise to review its monetary policy framework. This aims to reflect changes in the post-pandemic operating environment and the resulting shifts in inflation dynamics which are presenting new challenges for the conduct of monetary policy. It will also examine the implications of longer-term shifts – such as the transition to a more decarbonised economy, changes in demographics, and the digitalisation of finance – that can further alter the efficacy and transmission of monetary policy.

The pandemic has reduced Malaysia's buffers and exacerbated prevailing vulnerabilities, including those stemming from elevated debt levels. As the economy gains a firmer footing, it will be important to rebuild the household, small and medium-sized enterprise (SME) and policy buffers that were drawn down during the pandemic in order to secure our economic resilience. For households, future-proofing the social protection system is crucial, especially given Malaysia's ageing society. There is also a need to replenish and increase retirement savings. The recalibration of monetary policy further supports the rebuilding of savings buffers through higher real returns on savings, in addition to preserving policy space and avoiding the build-up of longer-term risks. A focus on enhancing the dynamism of SMEs – by helping firms move up the value chain – will develop greater resilience to future shocks, while increasing their contribution to growth and employment. On the fiscal side, support measures that continue to be more targeted will enable the country to preserve fiscal buffers and make continued progress towards sustainable fiscal consolidation. Importantly, resources can be better allocated towards productive and high-impact growth areas to optimise spending without adding to inflationary pressure. All of this will put us in a better position to manage risks of any negative shocks and spillovers in future.

Ongoing megatrends in the global economy are also presenting Malaysia with new prospects. Malaysia is well positioned to benefit from the reconfiguration of global value chains. To make the most of this opportunity, we must ensure that we can continue to attract high-quality investments that boost our economic competitiveness and create high-value jobs. It is therefore imperative that we implement the New Investment Policy in a timely fashion. At the same time, the transition towards a greener, low-carbon future will have far reaching implications for our economy. A comprehensive domestic policy roadmap encompassing climate change adaptation and mitigation measures to achieve an orderly transition is key – both to address risks from climate events that are already present, and to avoid costly dislocations associated with climate transition. As these measures will take time to impact climate outcomes, we must act decisively and we must act now to mitigate climate-related physical and transition risks.

In all of this, the Malaysian financial sector will continue to have a critical role in supporting the financing needs for Malaysia's transformation into a high-income, high value-added and low-carbon economy. A strong financial sector is also paramount to support its countercyclical role in the face of future economic shocks. On our part, the Bank will continue to drive efforts towards advancing the priority areas set out in the Financial Sector Blueprint 2022-2026. Our regulatory efforts will continue to foster a conducive environment for efficient market functioning and dynamism that would also support sustainable development outcomes. This includes working with industry players to promote a funding ecosystem that is supportive of dynamic, innovation-led growth.

The careful sequencing of critical structural reforms will be important to deliver sustainable growth with price stability, while minimising transitory costs. This should prioritise structural policies that yield immediate positive impacts to the economy and enhance our future growth potential, such as active labour market policies, investment reforms and infrastructure projects to improve connectivity. A careful consideration of the interdependencies and interactions between policies is also crucial to maximise potential synergies and complementarities, while averting unintended consequences. Monetary, financial, fiscal and structural policies should be coherent and avoid counteracting each other. In managing inflationary pressures, monetary policy works best when accompanied by targeted fiscal measures that do not worsen inflation, in conjunction with supply-side and income-related policies that improve productivity and directly address the root causes driving higher living costs. Importantly, we must continue to support those adversely affected, such as workers and businesses who may be temporarily displaced, to help them adapt and benefit from reforms in line with the vision of greater shared prosperity for all. More broadly, a firm commitment to pursuing the necessary adjustments and reforms that will reinforce Malaysia's sound macroeconomic fundamentals and deliver more sustainable and inclusive growth remains key to realising this vision.



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