

Foreword

The Malaysian economy continued to show strength and resilience in 2023. Despite the challenging external environment, the economy grew by 3.7%. This was supported by resilient domestic demand, a rebound in tourism and improvement in labour market conditions. We also saw both headline and core inflation gradually moderating and converging towards their long-term averages. The pre-emptive and measured Overnight Policy Rate (OPR) increases in 2022 and 2023 have helped to maintain a good balance between supporting growth whilst managing inflationary pressures.

Looking to 2024, there is room for optimism even as the external environment remains highly uncertain. The Malaysian economy is projected to expand between 4%–5%. This will be supported by the improvement of external demand, with the rebound in global trade, and the technological upcycle being a bright spot for Malaysia given our significant role in the semiconductor supply chain. This will provide positive spillovers to our exports and production. Meanwhile, the tourism sector in Malaysia will benefit from the recovery of global tourism to pre-pandemic levels.

In addition to the more favourable external demand, resilient domestic demand will remain a driving force for growth. Household spending will be underpinned by improving labour market conditions given the ongoing recovery in tourism-related sectors, as well as higher production and trade activities. Sustained financial buffers among households will also support spending, with targeted policy measures assisting vulnerable households. Meanwhile, investment growth will be supported by the continued progress of multi-year projects across the public and private sectors, as well as catalytic initiatives under strategic masterplans such as the New Industrial Master Plan 2030 (NIMP 2030) and the National Energy Transition Roadmap (NETR).

That said, we are mindful of the downside risks that loom ahead of us. As a small and open economy, Malaysia will be affected by developments in the global economy. Prolonged high interest rates, especially in advanced economies, could weigh on global growth. Escalation of geopolitical conflicts could disrupt global trade, dampening Malaysia's exports and production. Despite these challenges, the fundamentals of the Malaysian economy will allow us to weather the storm. Nonetheless, there are also opportunities for Malaysia's growth prospects. These include positive spillovers from the global tech upcycle, stronger tourism activity and faster implementation of existing and new investment projects.

We expect core and headline inflation to remain moderate against the backdrop of stable demand conditions and contained cost pressures. Upside risks include external drivers such as geopolitical tensions and weather disruptions impacting global commodity prices as well as changes in domestic policies related to subsidies and price controls. While the rationalisation of subsidies may have short-term implications on growth and inflation, well-planned and well-executed implementation strategies alongside targeted cash assistance can help mitigate these effects.

On our part, Bank Negara Malaysia's (BNM) monetary policy will continue to be forward-looking with a focus on the trajectory of growth and inflation. Our approach to monetary policy will remain data-driven and ready to respond to the evolving economic landscape. In the context of supply shock scenarios, such as those linked to subsidy rationalisation, it is crucial to differentiate between short-term impacts and potential longer-term effects on inflation and growth. When relative price adjustments are transitory and likely to normalise over a reasonable period of time, it may not require a monetary policy response. On the other hand, there may arise circumstances that necessitate monetary policy action to ensure that the medium-term prospects for price stability and sustainable growth are not jeopardised. This could happen when price increases become noticeably pervasive and persistent. It could also happen when signs emerge of inflation expectations becoming de-anchored, risking a wage-price spiral, or when cash assistance that comes with supply shocks is expected to lead to excessive demand. Persistently higher inflation in these instances will create more uncertainty and further erode purchasing power. This will subsequently affect consumption and investment growth. Ultimately, before formulating any monetary policy response, we will need to carefully assess the effects of subsidy rationalisation on the pervasiveness and persistence of price increases, as well as its implications for growth.

On the foreign exchange market, it must be said that over the longer term, ringgit movements are anchored by the fundamentals of the economy. However, in the short term, factors such as interest rate differentials, geopolitical developments, as well as fluctuations in domestic and global economic activity and sentiments, can lead to the deviation of the ringgit from its fair value. This has been the case recently, where global events weighed heavily on the ringgit. Along with other regional currencies, the ringgit experienced depreciation pressures due mainly to the aggressive monetary policy tightening in advanced economies. This persisted into 2023, driven by the further rise in global interest rates, China's economic slowdown and geopolitical tensions in the Middle East. While most advanced and some regional economies aggressively increased interest rates, we maintained a more gradual increase in the OPR. This was appropriate to our situation given the more moderate price and demand pressures domestically, amid early monetary policy recalibration.

With these factors in mind, we strongly view that the movement of the ringgit in recent times neither reflects Malaysia's economic fundamentals nor positive economic prospects. As the global monetary policy tightening cycle has likely peaked, financial markets expect pressure on the ringgit to abate. However, the road ahead may still be bumpy. On and off, we may see changing and differing market expectations regarding the monetary policy trajectory of advanced economies. This, in turn, will affect the ringgit. That being so, we are mindful that a persistent and material undervaluation of the ringgit, if not addressed, could have permanent implications on the economy.

In light of this, collective actions are vital in safeguarding the value of the ringgit. BNM is committed to playing its part to preserve confidence in the ringgit. To this end, we have collaborated with the Government to increase inflows that would allow the ringgit to appropriately reflect the fundamentals and prospects of the Malaysian economy. Government-Linked Companies (GLCs) and Government-Linked Investment Companies (GLICs) have been encouraged to consistently repatriate foreign investment income and convert it to ringgit. Furthermore, BNM has stepped up engagements with exporters and international investors to further promote conversions and to underscore Malaysia's investment appeal. At the same time, we remain committed to maintaining orderly conditions in domestic financial markets through our liquidity and foreign exchange operations, while continuing to undertake measures to further enhance market efficiency, liquidity and accessibility. We will also continue to provide a favourable environment for global investors to invest in Malaysia. Dynamic hedging flexibilities remain available for investors, allowing them to take positions while protecting their investments.

The private sector should also do its part. By increasing focus on domestic investments, corporate Malaysia can be part of the nation's push towards key transformative growth areas, especially those in high-value and innovation-driven sectors. We also need businesses to invest in and level up on skills and innovation, while being mindful of global trends such as the growing emphasis on sustainability, which is set to impact global production chains, trade and investment, and technologies. If we get this right, as a country we will be able to increase our productivity and strengthen our fundamentals. Then, we will be able to secure more enduring strength in the ringgit as well as a stronger and more competitive Malaysia.

Beyond this, the positive growth trajectory and moderate inflation provides a window of opportunity for Malaysia to accelerate key structural policies to meet the challenges of the future. These include promoting quality investments towards high value-added activities and a decarbonised future, as well as addressing long-standing structural issues such as mismatches in the labour market and social protection gaps. Importantly, we must also sustain the momentum towards longer-term fiscal sustainability. The Government's effort to reallocate fiscal resources from blanket subsidies to targeted assistance for vulnerable households is necessary to improve the efficiency and efficacy of government spending. The resulting savings can be rechannelled towards other effective means of improving public welfare. All these reforms will strengthen our growth potential and competitiveness, further bolstering confidence in Malaysia's economic prospects. The improving prospects and strengthening investor sentiments on our economy will also help reinforce the value of the ringgit and ensure that it appropriately reflects our strong domestic fundamentals.

The financial sector will continue to play a key role to support the Malaysian economy. BNM is committed to ensuring a stable and resilient financial sector, thereby providing strong foundations to sustain future growth. At the same time, we will continue to advance efforts that align the financing environment with the evolving needs of the economy. These include on-going strategic initiatives to advance value-based finance, and to strengthen the financial sector's climate resilience and catalytic role in supporting Malaysia's adaptation to climate change and orderly transition to a greener economy. We will also continue to facilitate on-going efforts to digitalise finance, especially to ensure a safe and well-regulated environment for digital financial services.

As we move forward, the coherence between monetary, financial, fiscal and structural policies will be vital to foster sustainable growth and financial stability. As reforms are rolled out, careful design and sequencing will enable complementarities to be optimised across macroeconomic and structural policies. The successful execution of initiatives will require close cooperation among policymakers to avoid policy missteps, while undertaking effective communication with the public.

We can be cautiously confident that a good year is ahead of us. But for us to secure our future in the years to come, the time is now for Malaysia to implement vital structural reforms. With decisive and collective action, Malaysia's favourable economic recovery since the COVID-19 pandemic thus far can be firmly established into long-term prosperity. No doubt, there will be transition pains, but these reforms are investments for our future, and for the generations to come.



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20 March 2024