

# Foreword

## Where we've been

The Malaysian economy surpassed initial projections and demonstrated marked resilience amid global uncertainties in 2024. Growth was higher at 5.1% compared with 3.6% in 2023. This outperformance was due in large part to the highest investment growth we have seen in a decade, in addition to better exports and continued expansion in household spending. In the foreign exchange (FX) market, while external developments caused volatility earlier in the year, the ringgit rebounded following strong domestic economic performance and monetary policy easing by the US Federal Reserve (the Fed). Coordinated actions by Bank Negara Malaysia (BNM) and the Government provided further support by ensuring more balanced and healthy flows in the FX market. Against this backdrop, the Government continued its steady rollout of structural reforms. Notably, while some policy measures (such as the implementation of targeted diesel subsidies, higher electricity and water tariffs, and increase on sales and service tax (SST) rates) raised prices for selected goods and services, overall inflation remained modest at 1.8% for the year. Mitigation measures which accompanied these policy measures helped to contain spillovers on the broader economy.

A key factor which contributed to economic strength during the year was the advancement of the third investment upcycle – a topic we expand upon in more detail in the box article titled 'Deciphering Investment Cycles in Malaysia'. Malaysia's compelling investment narrative, combined with initiatives laid out in various strategy documents such as the New Industrial Master Plan (NIMP) and National Energy Transition Roadmap (NETR), enabled the country to leverage on catalytic investment opportunities. Global megatrends such as artificial intelligence (AI), data storage and cloud computing, as well as renewable energy provided strong tailwinds to the resurgence in both private and public investments. These investments will enhance the productivity of our domestic economy, taking us closer to becoming a high-income economy. The Government's progress of fiscal consolidation under the Medium-Term Fiscal Framework (MTFF), having surpassed its fiscal deficit target for 2024, further strengthened investor optimism in the economic stewardship of the country, and positioned the country as an attractive investment destination.

## Where we are

Looking to 2025, we anticipate an increasingly challenging external environment. Heightened uncertainties surrounding the resurgence of protectionist actions, alongside continuing geopolitical conflicts, pose headwinds to Malaysia as a small and open economy. The strength of global demand in particular will depend on developments in trade restrictions and countermeasures imposed by major economies. Risks to growth could arise from strained trade relationships affecting the global trade momentum, geopolitical developments potentially disrupting supply chains, and heightened financial market volatility. These considerable uncertainties and rapidly unfolding events present significant challenges for forecasting the 2025 outlook. In pre-empting some of these uncertainties, BNM formulated several global economic scenarios to assess their potential impacts to our economy. As a small, open economy, we will not be totally insulated. Nevertheless, there are reasons to be cautiously optimistic about domestic prospects. Our domestic sources of growth, combined with a diversified export structure will help the economy withstand challenges in the year ahead. Investment activity, driven by multi-year projects, remains a key bright spot while positive labour market conditions and income-boosting policies provide continued support to household spending. Consequently, the Malaysian economy is projected to grow between 4.5% and 5.5% in 2025.

The ringgit, like other regional currencies, would continue to be influenced by external developments, particularly from potential policy shifts in major economies. Nevertheless, narrowing interest rate differentials between the US and other economies, should the Fed continue easing monetary policy, will lend support to the ringgit. In the longer term, Malaysia's solid economic prospects and ongoing reforms will provide more enduring support to the ringgit.

Easing global costs and steady demand will help keep price pressures at bay. Recent labour market policies will support household incomes, but their impetus to prices is expected to be contained. Continued efforts on fiscal reforms, with the RON95 subsidy rationalisation and SST expansion to be implemented in 2025, are anticipated to result in some short-term price increases. Nevertheless, we assess their effects on underlying inflation to be limited and temporary. Our simulations on various policy scenarios suggest that headline inflation will remain between 2% and 3.5% in 2025, even under conservative assumptions, before eventually reverting lower as policy effects fade.

There are valid concerns that some household segments may be affected by the price increases as a result of these policy reforms. The Government has, therefore, factored these concerns into the design and implementation of policy adjustments, with the aim of minimising spillovers. Most importantly, these reforms will pay off over the long term. They are intended to remove deep distortions in the economy and free up fiscal resources for more productive spending, such as on social protection, education, health, and infrastructure, ultimately lifting growth and improving the income and well-being of the *rakyat*.

While inflation has trended lower, rising cost of living remains a salient issue. This is primarily due to the fact that in the past several years, wages have grown at a slower pace relative to price increases and productivity gains. Post-pandemic, although productivity has increased modestly, real wages have remained relatively flat. Recent policies to ensure commensurate wages and efforts to attract investments that create high paying jobs are promising steps forward. Yet, employers also need to ensure their workers are compensated fairly and adequately for their contributions.

On monetary policy, BNM will continue to stand firm on our mandate of maintaining price stability conducive to sustainable growth in Malaysia. Given the considerable uncertainties in the operating environment, risks to growth loom large in our considerations. At the same time, we acknowledge that the continued domestic policy reforms will affect prices as economic agents adjust. Our approach to monetary policy will necessarily remain data-driven and forward-looking, informed by thorough assessments on the evolving risks to domestic inflation and growth prospects. Towards this end, we will keep a close watch on global developments and potential spillovers of ongoing domestic policy reforms. This entails continuous assessments on the persistence and pervasiveness of inflation, while considering external shocks and the overall trajectory of the Malaysian economy.

### **Where we must venture**

We are now at an important juncture for the nation. To navigate the increasingly complex economic environment and steer the economy towards high-income status, it is imperative to deepen our efforts for structural reforms. Positive economic momentum from the past year provides us with firm footing to carry the momentum forward. We have seen the successes of thoughtful policy design paired with timely implementation. The first phase of reforms reflected our most urgent priorities, such as affirming our commitment to fiscal discipline and enhancing the national investment ecosystem. While we continue to build on these successes, we must also intensify our focus on other critical areas of deep reforms.

Foremost among these is strengthening our national social protection system. A comprehensive and inclusive social protection system is critical to provide a safety net for vulnerable segments of the *rakyat*. In turn, this ensures that everyone can benefit from economic growth. A well-designed social protection system also promotes upward social mobility and labour market dynamism through active labour market policies (ALMPs) and strengthens household and labour market resilience to economic shocks. One of the prevailing issues with Malaysia's social protection system is the gaps in the coverage for certain groups, such as workers in the informal sector. Steps have been taken to address these gaps, including measures by the Social Security Organisation (SOCSO) to directly pursue bilateral agreements with employers whose workers were not previously covered. Still, more lasting improvements could be achieved by taking measures such as automatic enrolments to the social security system. Additionally, gains made by the Government in optimising expenditure can be re-channelled towards initiatives to streamline and improve the quality of social security programmes, ensuring the sustainability of the system in the long term. Collectively, these efforts will strengthen the resilience of households by reducing inclusion and exclusion errors and enhancing protection for the vulnerable.

Complementary to developing a comprehensive social protection framework are areas of deeper and longer-term reforms: Ensuring the provision and quality of basic needs such as education and healthcare amid evolving socio-

economic shifts. A high-skilled workforce is the backbone of a dynamic economy. Although Malaysia has made significant gains in educational attainment in general, findings from recent surveys on Trends in International Mathematics and Science Study (TIMSS) show mathematics and science skills deteriorating among Malaysian students. Moreover, gaps in critical expertise in the local labour force and readiness of graduates continue to be cited as key concerns by employers and prospective investors. Significant rethinking of Malaysia's education system and life-long learning ecosystem are needed. Periodic reviews must be undertaken to ensure the curriculum remains relevant and evolves in tandem with technological advances. A key priority here is to improve students' proficiency in science, technology, engineering and mathematics (STEM) subjects, which is essential to drive innovation and competitiveness in high-value industries. Additionally, there is room for industry involvement in education policy to ensure that students are equipped with the right skillsets for the workforce of tomorrow.

Looking ahead, in view of demographic shifts towards an aging society, steps should be taken to advance Malaysia's healthcare system. As it stands, the healthcare system in Malaysia is one of the most accessible in the world. Recent challenges, however, have highlighted capacity constraints and issues with uneven distribution of resources among the public and private healthcare sectors. Meanwhile, rising medical costs amid subdued wage growth in 2024 have exacerbated cost of living issues for some households. In line with the reform agenda outlined by the Ministry of Health (MOH), concerted actions should focus on transforming delivery of healthcare services and enhancing public health functions, while ensuring sustainable and equitable financing in the healthcare system.

As Malaysia assumes the ASEAN Chairmanship this year, the regional bloc stands at a pivotal point in an increasingly multipolar world where major economies vie for economic supremacy. The shifts in global supply chains amid rising protectionism have made the region vulnerable. Global industries such as semiconductors are becoming more bifurcated along geopolitical lines. Therefore, it is crucial to carefully rethink our approach to economic resilience. In addition to continuing our collaboration with multinational corporations, we must further nurture local startups and mid-sized players to fortify our ecosystem. Enhancing resilience also requires an advanced financial system capable of withstanding shocks. Aligned with Malaysia's ASEAN Chairmanship theme, 'Inclusivity and Sustainability', BNM will steer financial sector initiatives to support ASEAN's post-2025 vision of a future-ready economy. Along with greater regional integration, ASEAN and its global partners must find win-win solutions to grow sustainably together.

Beyond this, Malaysia must continue to support open and fair trade by advocating for effective functioning of the rules-based trading system. Building on Malaysia's diversified trade and investment structure, we must remain steadfast to deepen cooperation with existing trade partners, explore new markets and advance Malaysia's global competitiveness. Free trade agreements, investment guarantee agreements and international cooperation initiatives remain relevant and important tools to support the attainment of these goals.

Whilst we benefit from the positive momentum of 2024, it is clear there are significant hurdles ahead. The external environment is highly fluid and unpredictable, and we cannot rest on our laurels. One of the best recourses against uncertainty is committed and coordinated action. Deeper and continuous reforms will lay the foundations needed to build inclusive and sustained growth. The design, timing and sequence of these reforms remain key. At its core, the long-term aim of these reforms is about people, about creating systems that uplift and enhance the wellbeing of the *rakyat* in the future. Transforming challenges into opportunities require not just a whole-of-nation approach, but also close integration with our regional peers. On our part, BNM remains committed to maintaining vigilant monetary and financial policies, ensuring stability while supporting sustainable economic growth. We will continue to monitor global and domestic developments closely, ready to adjust our policies as needed to uphold the nation's economic resilience and advance our vision of becoming a high-income economy.



**Abdul Rasheed Ghaffour**

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