

Economic, Monetary and Financial Developments in 2020

2020: AN UNPRECEDENTED CRISIS; A GRADUAL AND UNEVEN RECOVERY

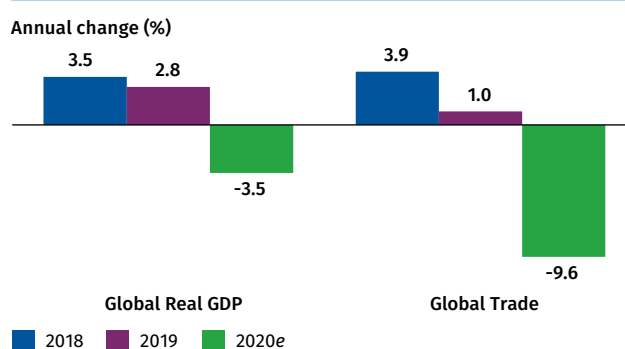
Deepest global recession since the Great Depression, accompanied by unprecedented global policy responses

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

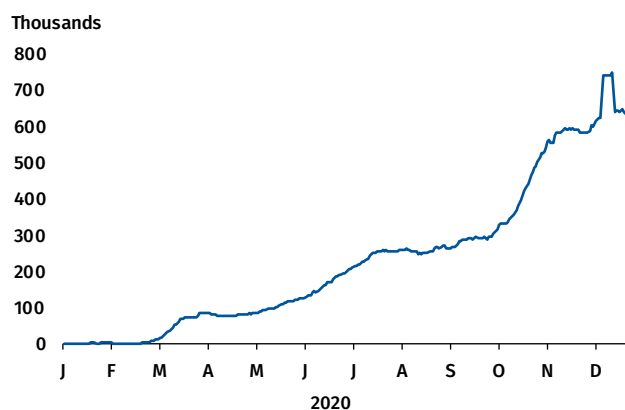
Chart 1.1: Global Real GDP and Trade Growth



e Estimate

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

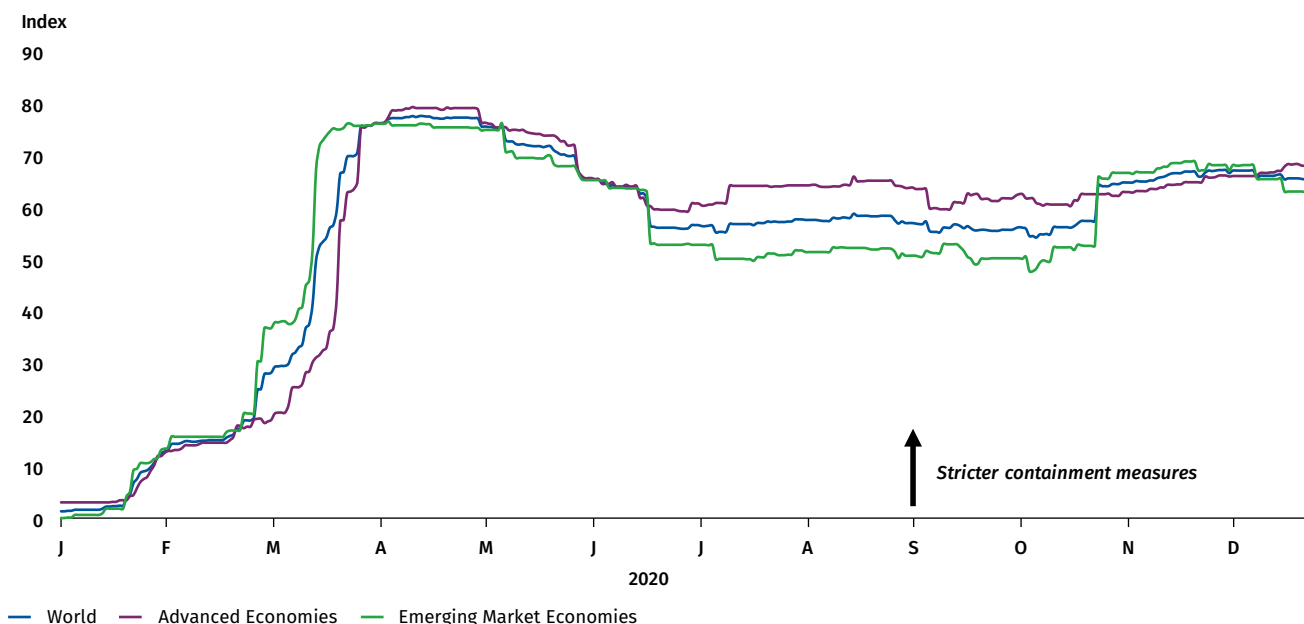
Chart 1.2: Daily New Global COVID-19 Cases (7-Day Moving Average)



Source: Johns Hopkins Coronavirus Resource Center

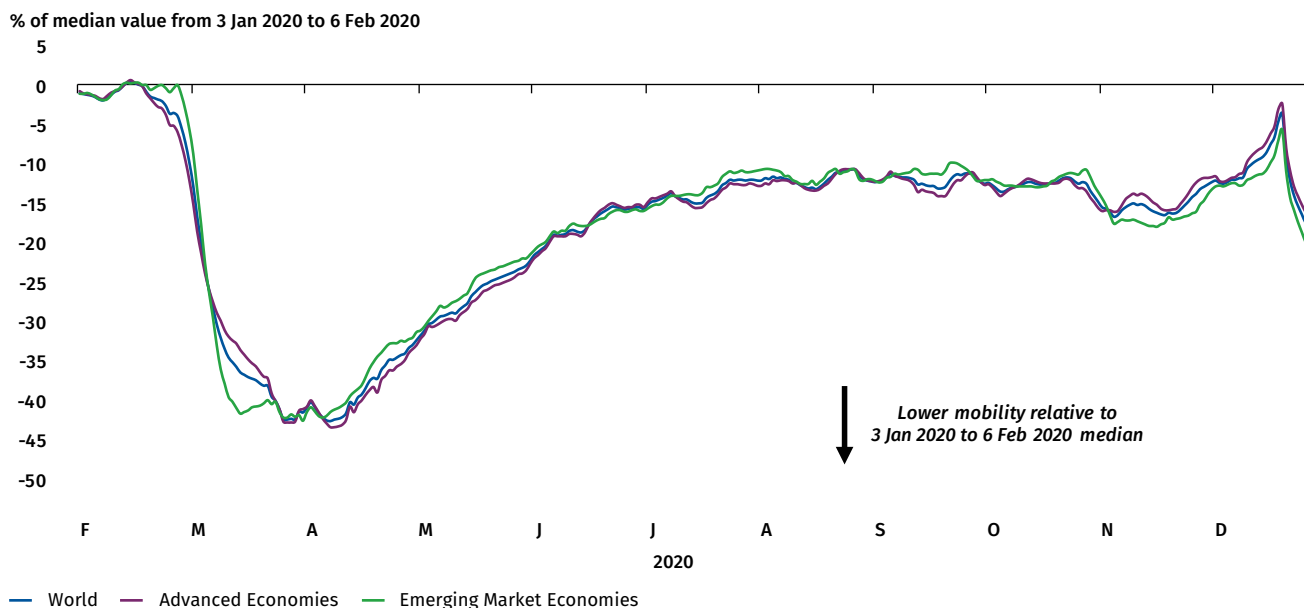
to a sudden stop in the mobility of individuals and non-essential business operations (Chart 1.4). These manifested in severe production disruptions and a collapse in demand, particularly in the consumer- and tourism-related industries. As a result, firms' profitability declined sharply. Labour markets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

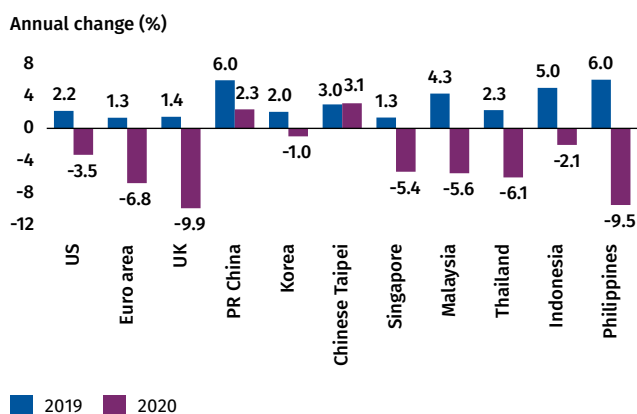
and income conditions worsened. These induced sizeable adverse spillovers to domestic demand, weighing further on global growth, particularly in the second quarter of 2020.

The economic impact of containment measures was more pronounced in countries with more stringent lockdowns, which occurred mainly in the second

quarter¹, 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

pandemic with less extreme containment measures, particularly the Advanced Asian economies², 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%.

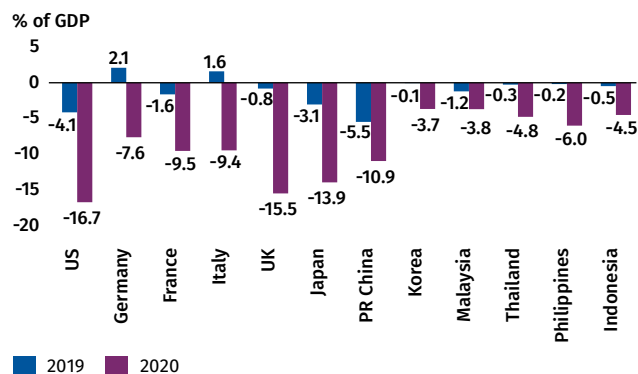
Beyond the slowdown in domestic demand, trade- or commodity-reliant economies also experienced a sharp decline in external demand. Following the slowdown in global demand, global crude oil prices dropped to an average of USD43.2 per barrel in 2020 (2019: USD64.2 per barrel)³. While this kept inflation 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

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.

Chart 1.6: Primary Fiscal Balance



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

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

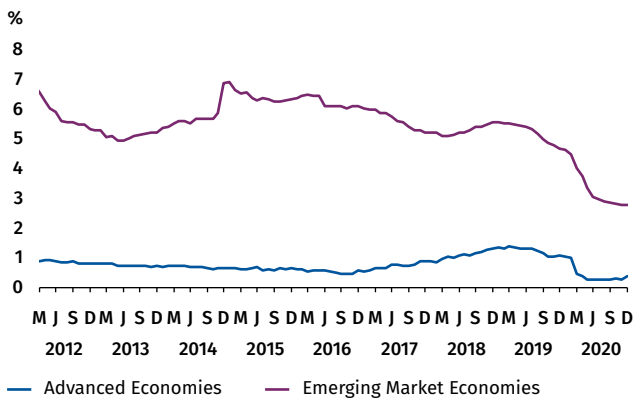
Table 1.1: Key Economic Policy Measures in Selected Major and Regional Economies

Country	Measures to support households	Measures to support businesses
USA	<ul style="list-style-type: none"> • USD600 direct payments to individuals • Enhanced unemployment benefits of USD300 weekly 	<ul style="list-style-type: none"> • Loan forgiveness and guarantees for small businesses to help retain workers⁴ • Liberalised rules for the deduction of net operating losses for corporate tax filing
Germany	<ul style="list-style-type: none"> • Expanded access to the short-time work subsidy (Kurzarbeit) to supplement wages of workers • Expanded duration of unemployment insurance and parental leave benefits 	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Accelerated disbursement of unemployment insurance • Extension of unemployment insurance to migrant workers • Tax relief and waived social security contributions 	<ul style="list-style-type: none"> • Tax relief and waived social security contributions
Singapore	<ul style="list-style-type: none"> • Cash handouts to all Singaporean households, with additional payments to lower-income and unemployed individuals 	<ul style="list-style-type: none"> • Grants and subsidies for the self-employed and industries directly affected by the pandemic (e.g., tourism, transportation, aviation)
Thailand	<ul style="list-style-type: none"> • Monthly income support for non-farm workers outside the social security system • Soft loans and tax relief for individuals 	<ul style="list-style-type: none"> • 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.

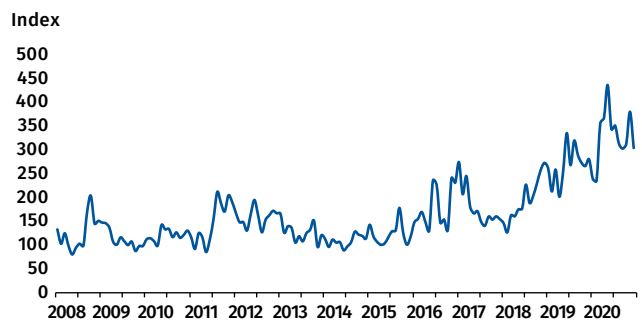
Nonetheless, in late 2020, the resurgence of cases and the emergence of new virus variants in Europe and South Africa warranted the re-imposition of containment measures in some countries. As the degree of containment measures remained a primary factor affecting the strength of economic activity, economies 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 economies⁵ 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.

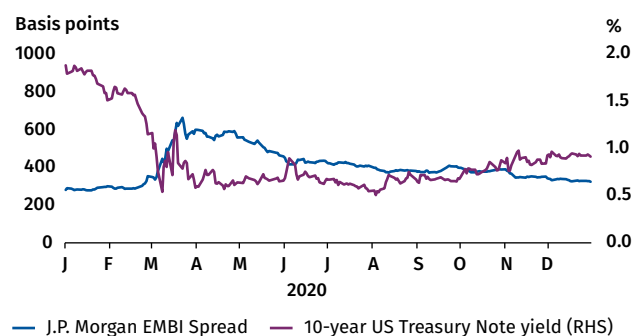
Unlike the GFC in 2008, which originated from vulnerabilities within the financial system, the financial sector in most economies entered the crisis from a position of strength. This enabled global policy measures that aimed to provide credit and liquidity support to households and businesses to be implemented 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.

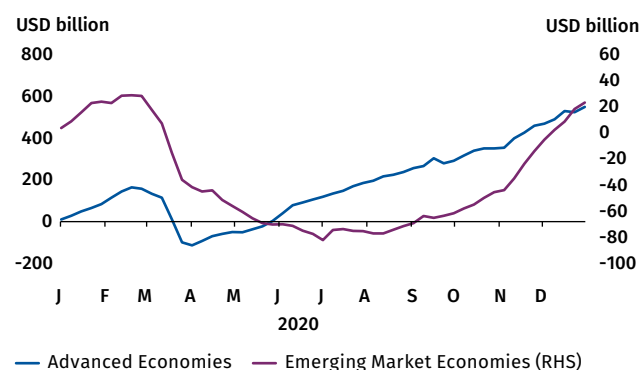
Chart 1.12: Equity Indices



Source: Bloomberg

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.

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.

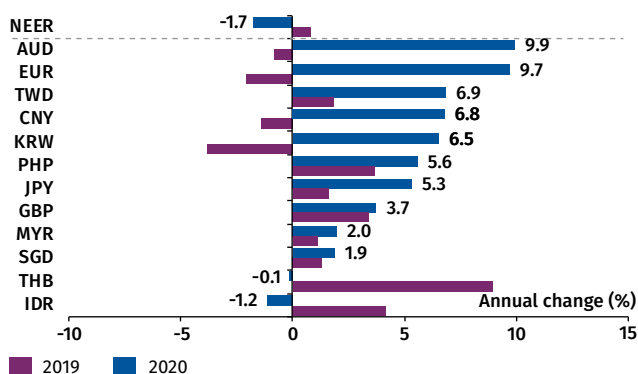
Conditions in the domestic financial markets improved amid positive investor sentiments

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.

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

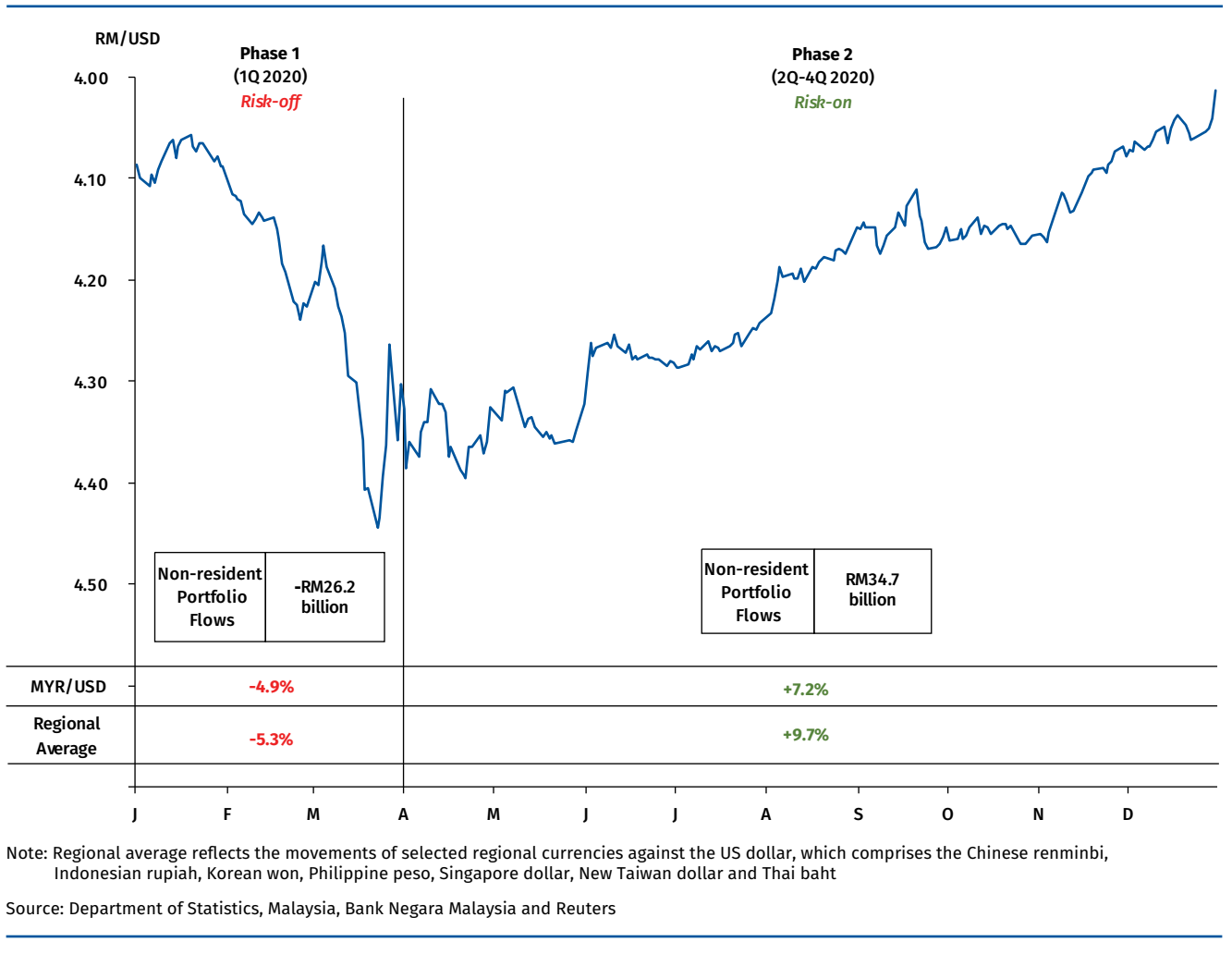
Flexibility in the ringgit exchange rate served to limit spillovers to the domestic economy

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



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 muted⁹.

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

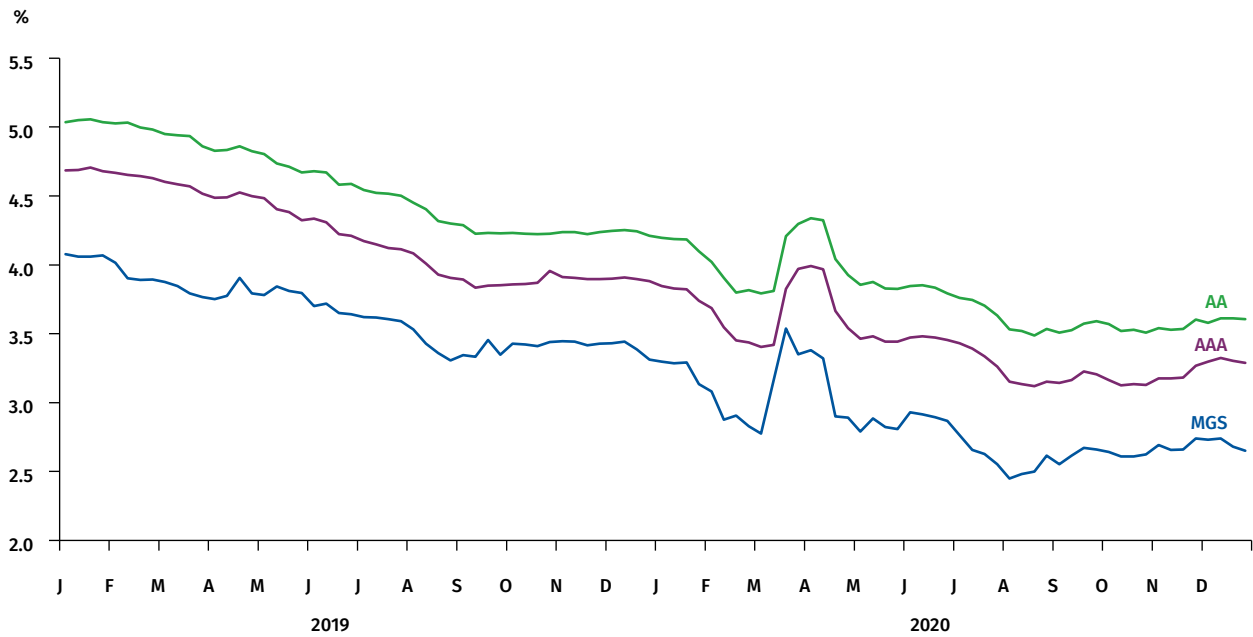
non-resident outflows in line with regional trends. The impact to equity prices from these outflows were offset by the support from both domestic institutional investors and higher domestic retail participation. In particular, while the share of trading value by domestic retail investors increased to 37.5% as at December 2020 (December 2019: 23.4%), the rise was not driven by bank borrowings¹⁰. 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.

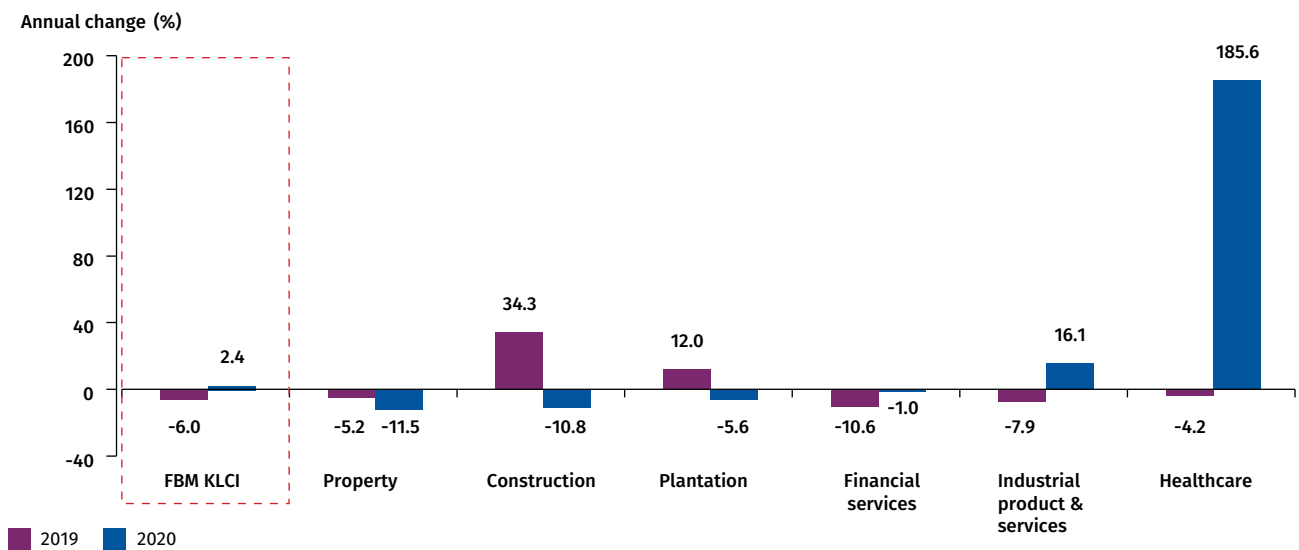
¹⁰ As at end-2020, household loans for the purchase of quoted shares remained small at 0.5% of total banking system loans.

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



Source: Bank Negara Malaysia

Chart 1.16: Performance of Sectoral Equity Indices



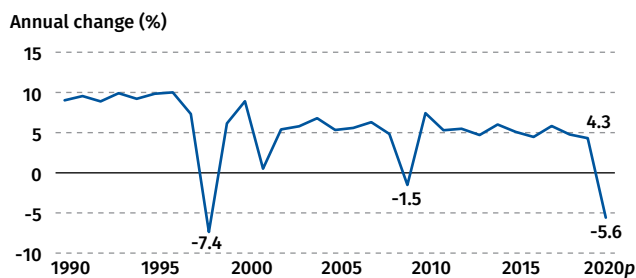
Source: Bloomberg

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

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



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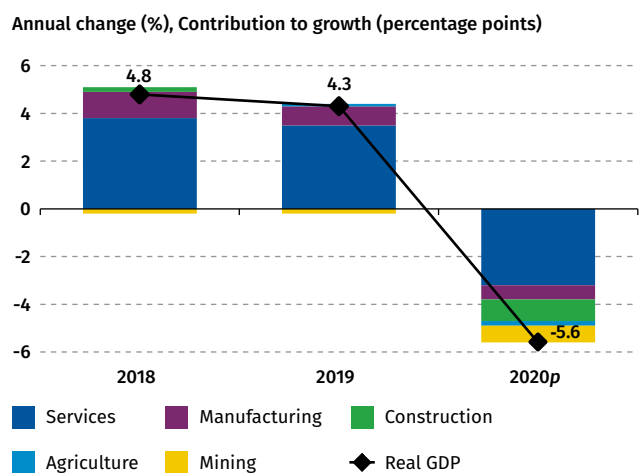
Source: Department of Statistics, Malaysia

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.

The domestic economy was further impacted by the introduction of strict local containment measures¹¹. 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 stocks² 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 accounts³ 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	
		RM billion	%	RM billion	%
MONEY AND BANKING					
Money supply	M1	4.9	1.2	24.8	5.8
	M3	158.1	9.1	67.0	3.5
Banking system deposits		163.2	9.2	55.5	2.9
Banking system loans ²		121.4	7.7	65.8	3.9
Loan to fund ratio (% , end of year) ^{3,4}		83.1		83.2	
Loan to fund and equity ratio (% , end of year) ^{3,4,5}		72.6		72.8	
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

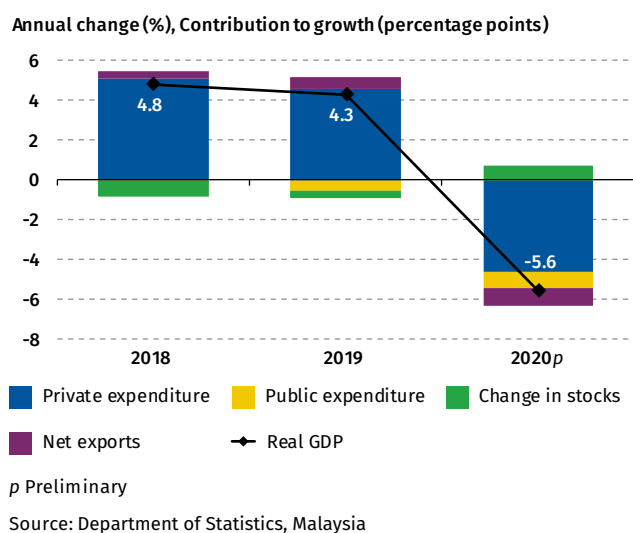
^p Preliminary

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 decades¹². 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



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 industries¹³ 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 Demand¹	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

^p Preliminary

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 products¹⁴. 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)

	2020p	2019	2020p	2019	2020p
	% 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)	100.0¹	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	2020p
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

p Preliminary

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 sector¹⁶ 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

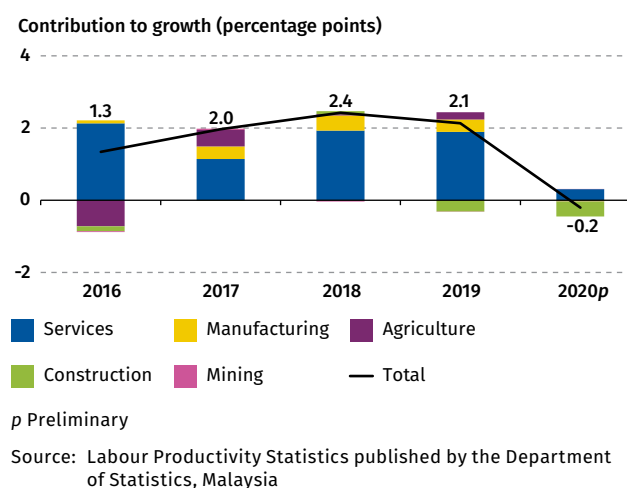
¹⁵ Time-related underemployment rate was estimated based on the quarterly averages of 2019 and 2020 figures, respectively, from the Department of Statistics Malaysia's Labour Force Survey. These figures do not include workers who could not work at all due to labour restrictions in the second quarter.

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



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 Payments¹

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 omissions³	-35.9	-9.0	-2.0
Overall balance	7.8	8.4	-19.4

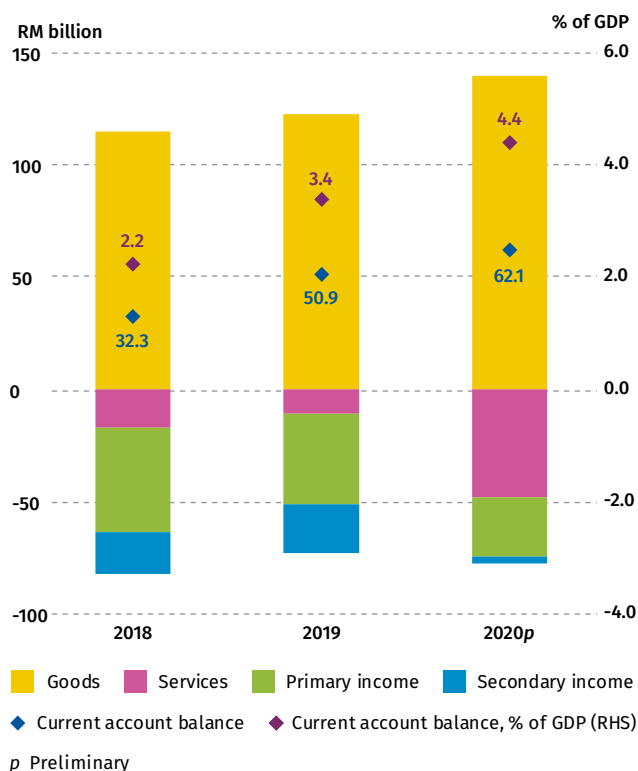
¹ In accordance with the Balance of Payments and International Investment Position Manual, Sixth Edition (BPM6) by the International Monetary Fund (IMF)

² Adjusted for valuation and coverage of goods for processing, storage and distribution

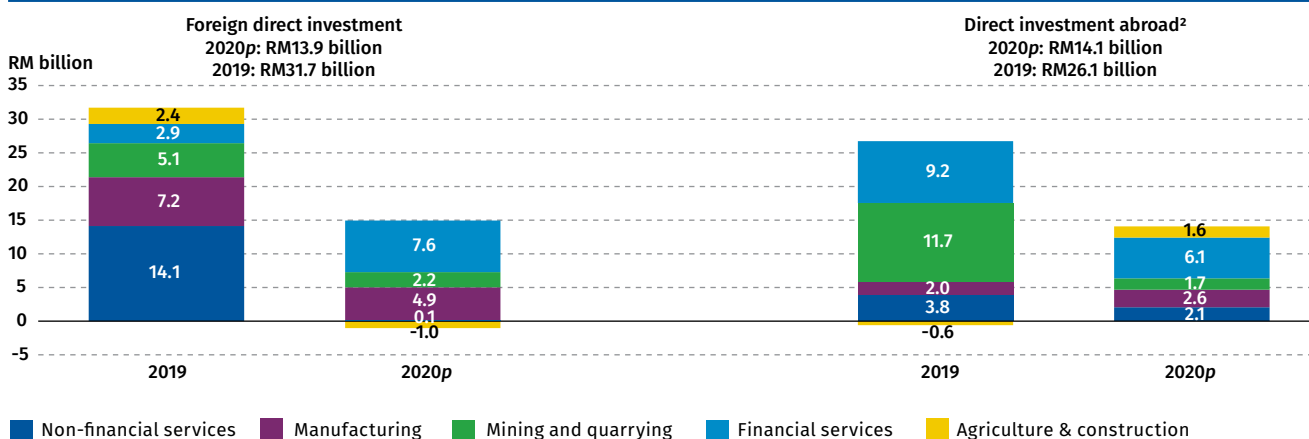
³ As at 1Q 2018, the net E&O excludes reserves revaluation changes. This practice is backdated to 1Q 2010

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Chart 1: Current Account Balance


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 Abroad¹ 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

p Preliminary

Note: Figures may not necessarily add up due to rounding

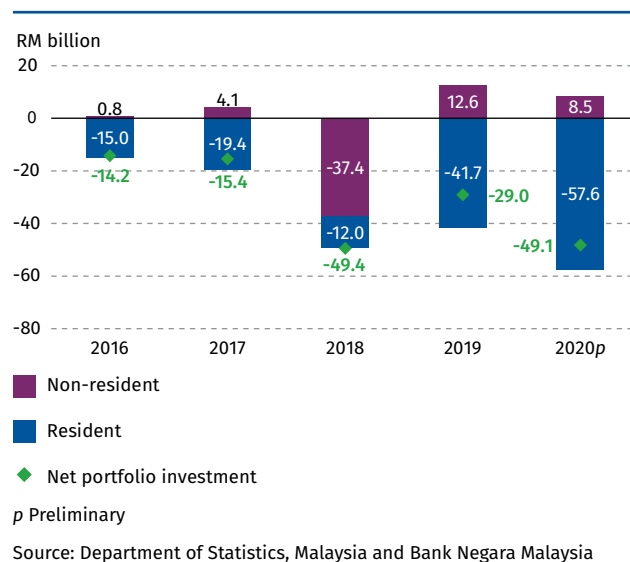
Source: Department of Statistics, Malaysia and Bank Negara Malaysia

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



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

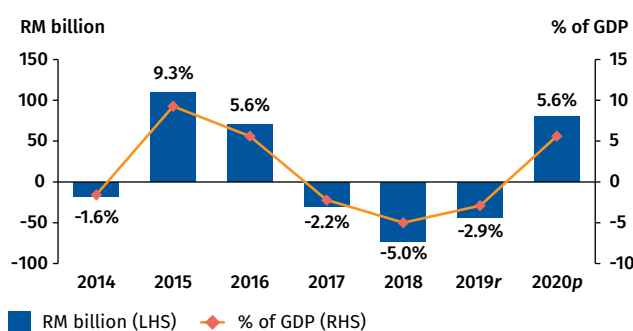
Malaysia's international investment position (IIP) turned around to register a net asset position of RM79.6 billion, equivalent to 5.6% of GDP as at end-2020 (2019: net liabilities of RM44.1 billion or -2.9% of GDP). On an annual basis, Malaysia last recorded a net external asset position in 2016 of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



p Preliminary

r Revised

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.

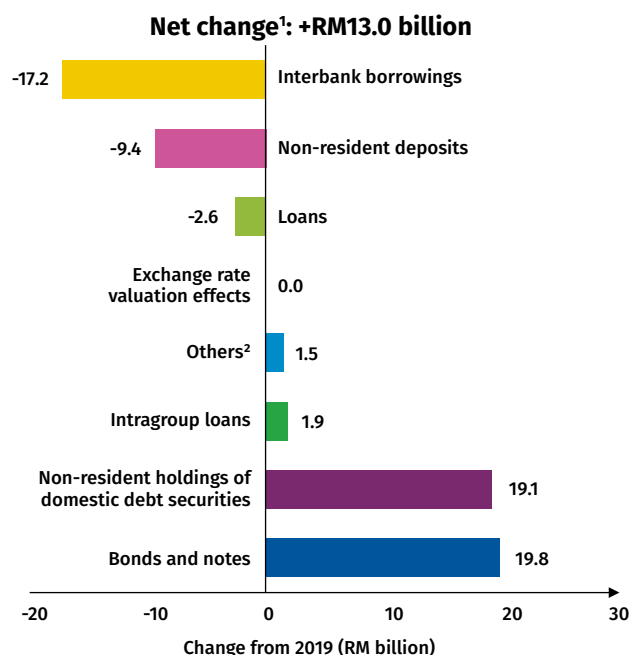
Risks surrounding Malaysia's external debt remained manageable in 2020 and were well contained given its more favourable maturity and currency profiles, coupled with the Bank's prudential and hedging requirements¹⁷. As at end-2020, the external debt-at-risk for corporates¹⁸ and banks¹⁹ amounted to RM26.4 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.

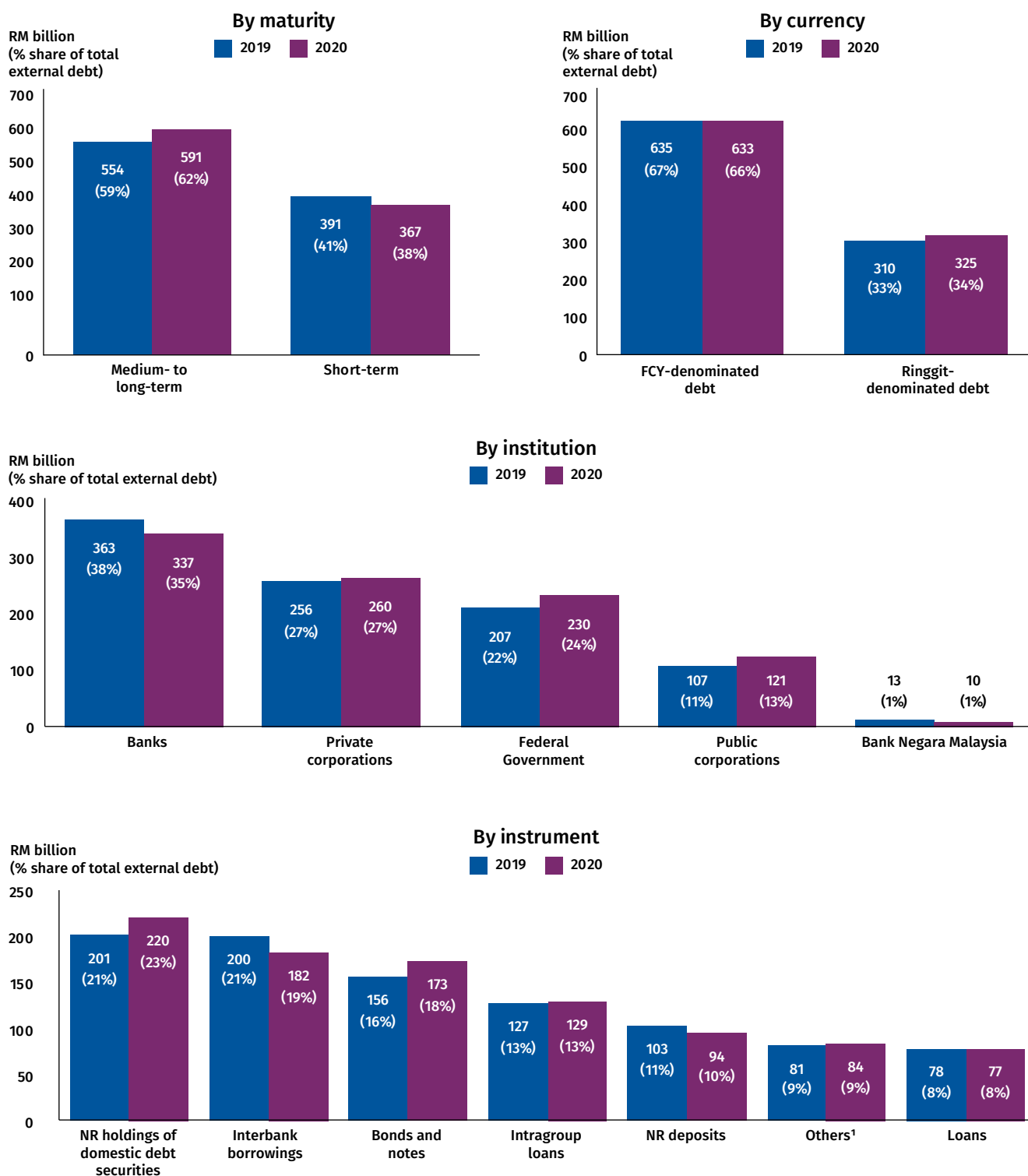
Slightly more than one-third of external debt was denominated in ringgit (33.9%; 2019: 32.8%), and therefore not affected by fluctuations in the ringgit exchange rate. The remainder of external debt that was denominated in FCY was largely subject to prudential requirements on liquidity and funding risk management²⁰. 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 debt²¹. 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)

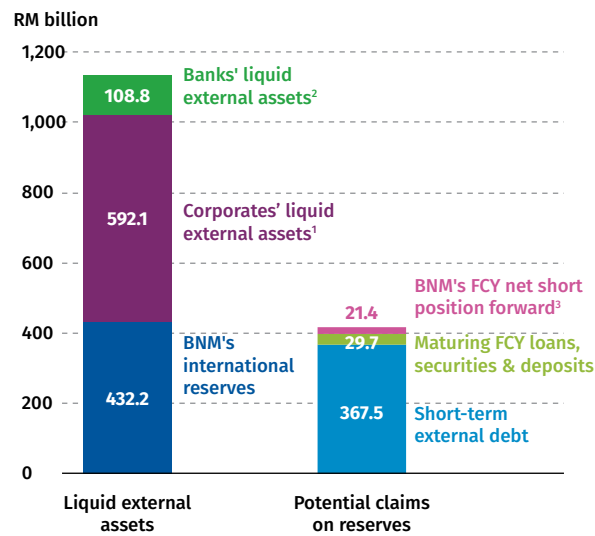


¹ Includes trade credits, IMF allocation of SDRs and miscellaneous, such as insurance claims yet to be disbursed and interest payables on bonds and notes

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



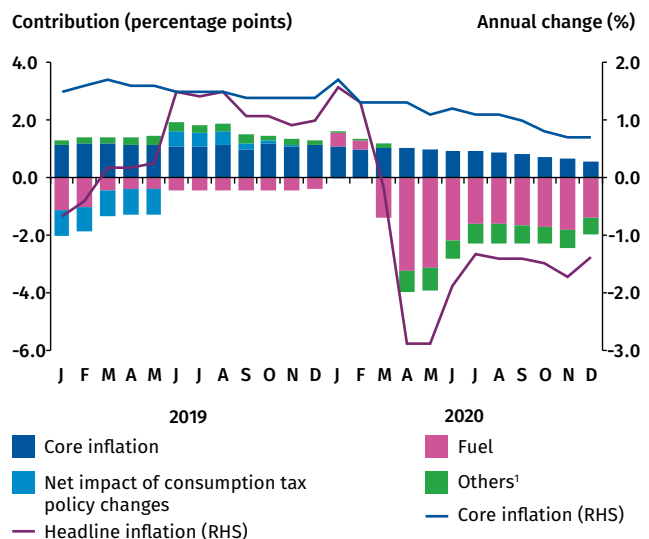
¹ Consist of portfolio investments, and currency and deposits
² Consist of deposits and interbank placements, bonds and notes and money market instruments
³ Including the forward leg of currency swaps

Source: Bank Negara Malaysia

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

Headline inflation²² 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 inflation²³, 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

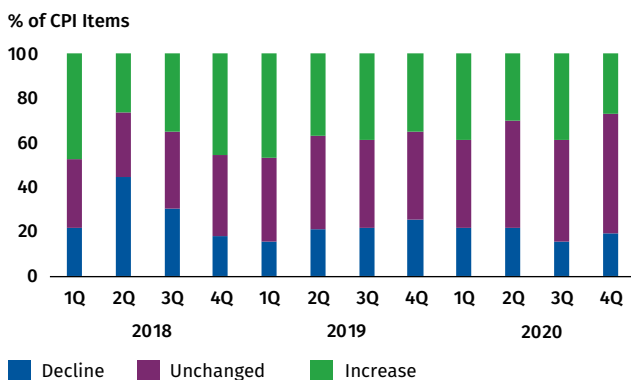


¹ Others include price-volatile items and other price-administered items
 Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

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 economy²⁴.

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
<p>Fiscal injection to ease cash constraints, support labour market conditions and reinvigorate spending and economic activities</p>	<ul style="list-style-type: none"> • Bantuan Prihatin Nasional cash transfers to households • Wage Subsidy Programmes • Various tax incentives and relief <ul style="list-style-type: none"> – 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)
<p>Monetary stimulus to support domestic demand, reduce borrowing costs and facilitate continued credit intermediation</p>	<ul style="list-style-type: none"> • 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
<p>Comprehensive financial assistance across all segments of the economy to ease cash flow constraints and support growth</p>	<ul style="list-style-type: none"> • 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: <ul style="list-style-type: none"> – 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: <ul style="list-style-type: none"> – High Tech Facility-National Investment Aspirations (HTF-NIA) – Automation and Digitalisation Facility (ADF) for SMEs – PENJANA Tourism Financing (PTF) • Government Agrofood Facility (AF) <ul style="list-style-type: none"> – Increase agrofood production for Malaysia and for exports purposes • Danajamin PRIHATIN Guarantee Scheme (DPGS) for medium to large businesses
<p>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</p>	<ul style="list-style-type: none"> • Raise individual disposable income <ul style="list-style-type: none"> – EPF <i>i-Lestari</i> Withdrawal between April 2020 – March 2021 – EPF employee contribution rate reduction from 11% to 7% • Accelerate digitalisation efforts <ul style="list-style-type: none"> – 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 <ul style="list-style-type: none"> – 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.

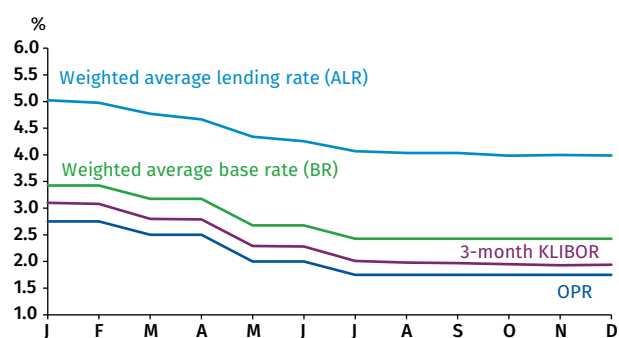
The pass-through of the OPR reductions to money market rates was strong and immediate across all tenures, which was supported by stable liquidity conditions in the interbank market (Chart 1.22). In navigating through periods of market volatility and uncertainty, the Bank's monetary operations were integral 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 compliance²⁵ 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)

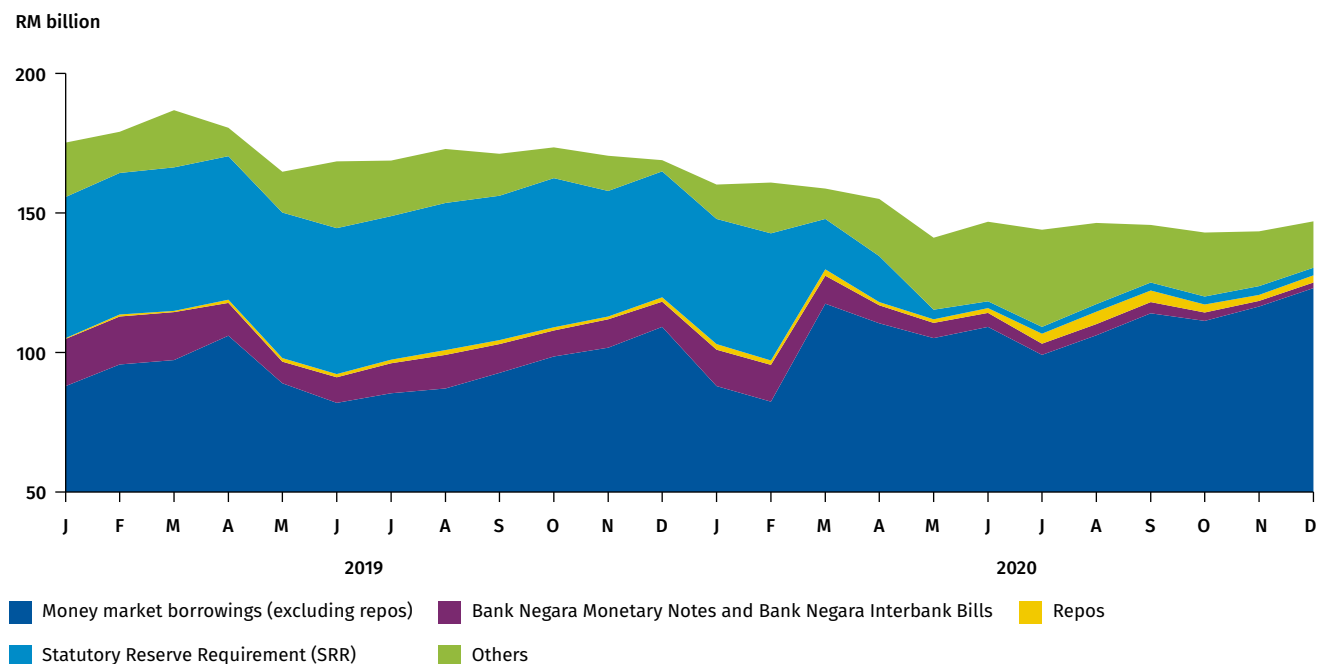


Source: Bank Negara Malaysia and Bloomberg

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)



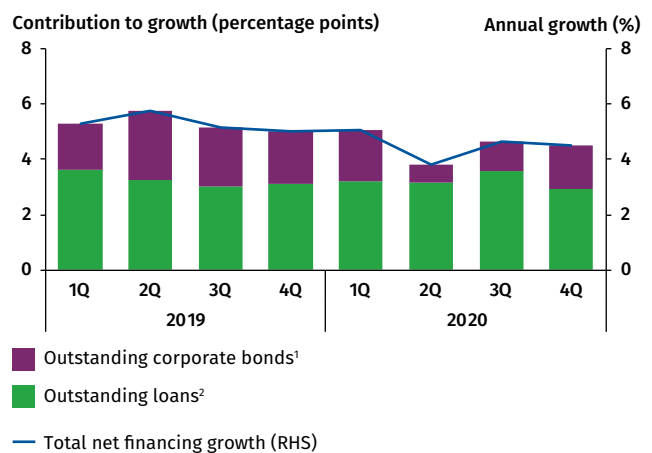
Source : Bank Negara Malaysia

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%).

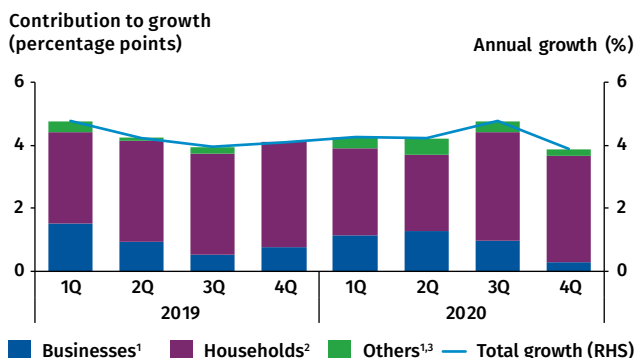
Outstanding household loans recorded a growth of 5.5% in 2020 (2019: 5.5%). The support to the sustained growth was two-pronged: lower repayments given the six-month automatic loan moratorium; and the strong rebound in loan disbursements since June 2020, supported by low lending rates and the Government's 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-residents² 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



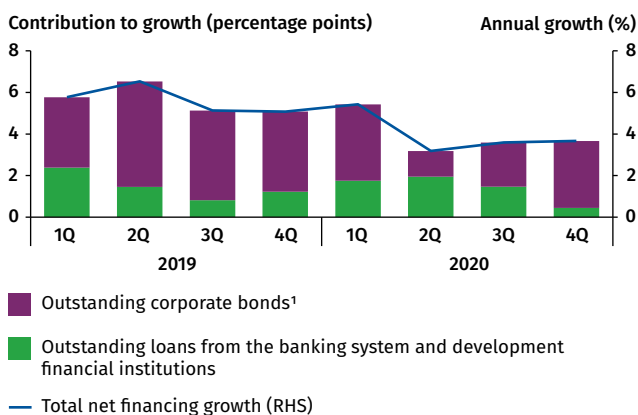
¹ Loans from the banking system and development financial institutions (DFIs) only
 ² Loans from the banking system, DFIs and major non-bank financial institutions (NBFIs)
 ³ Includes loans of financial institutions, NBFIs, Government, domestic other entities, and foreign entities

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 guarantees²⁸ 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 occasions²⁹ 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.