

Foreword

The year 2022 is set to be a watershed year as most countries progressively transition towards endemic management of COVID-19. The outcomes from the economic disruptions over the past two years have led to new challenges that require a rethinking of policy strategies. At present, there remains great uncertainty surrounding the medium-term outlook for the global economy, stemming mainly from the extent of economic scarring and how these would eventually interact with post-pandemic structural shifts such as greater digital adoption. The transition path towards a greener economy will also have an important bearing on the outlook. In the near-term, such shifts may lead to some trade-offs between short-term growth and inflation in order to secure a more sustainable growth in the medium-term. As the global economy is expected to continue its recovery path, policymakers will have to adjust their policy settings against a background of rapidly evolving uncertainties, including the military conflict in Ukraine which began in February. This complicates the task of assessing the economic and financial implications of such developments. These uncertainties have also resulted in heightened global financial market volatility, with significant implications on emerging market economies. Policy formulation will, therefore, continue to be data-dependent as developments evolve.

For Malaysia, the pace of economic recovery is projected to gather further momentum amid the reopening of the economy and international borders. While we are not yet out of the woods, we are better prepared now. The better COVID-19 management and higher vaccination rates will help mitigate the adverse impact from future resurgences and thus protect our healthcare system from being overwhelmed. With these factors in mind, we expect less disruption to economic activity and spending in the event of resurgences. As an open economy, Malaysia will continue to benefit from the expansion in global demand, which would support both investment activity and the labour market. Overall, for 2022, growth is expected to expand between 5.3% and 6.3%.

Monetary policy will remain accommodative to support a sustainable economic recovery while ensuring price stability. The unprecedented conditions that warranted the significant monetary support during the height of the pandemic have since abated. With the policy rate at its historical low, we are cognisant of the consequences of keeping interest rates low for an extended period. Global experience has shown that this could lead to an unhealthy build-up in financial imbalances. As the recovery is gaining strength, we must have the discipline and foresight to begin rebuilding policy buffers for future shocks. Recently, there have also been concerns surrounding the risks to domestic inflation stemming from elevated commodity prices amid prolonged supply disruptions and the military conflict in Ukraine. Given that the outlook for inflation remains largely supply-driven, we are closely looking out for any signs of potential second-round effects, where price pressures could become more entrenched as domestic demand recovers. Ultimately, any potential adjustments to the degree of accommodation will remain data-dependent and be undertaken in a measured and gradual way that is commensurate with the appropriate level of support needed by the economy.

In securing a durable recovery, it is imperative that the overall configuration of the Bank's policies does not lose sight of longer-term economic sustainability. This underpins the Bank's policy considerations in discharging its monetary and financial stability mandates. Policies are forward looking and pre-emptively calibrated with the aim of managing immediate risks and minimising future vulnerabilities to ensure sustainable growth across economic and business cycles. Equally important is for the Bank to ensure that it continues to have sufficient policy space that can be utilised over time to deliver on its mandates. Over the past two years, the Bank, together with the financial sector, have stepped up to provide various forms of financial support, including repayment and financial assistance to affected groups who may need more time to get back on their feet. With the targeted assistance still in place, small- and medium-sized enterprises (SMEs) and other affected groups will continue to have access to financial support as they resume their activities. As the domestic economic

recovery takes hold, strategies must now evolve to account for the medium-to-long run implications of current policy settings. We must learn from the past experiences of other economies that suffered from the lost decade phenomenon, which underscore the importance of timely recalibration of policies, as well as cohesion in overall policy settings. The failure to account for such risks could be very costly for long run economic growth. Moving forward, policy measures should aim to reinstate market mechanisms to foster business dynamism and refocus on strengthening Malaysia's long-term growth prospects. Importantly, gains from past financial sector reforms which have proven crucial in supporting the economy through this challenging period must not be eroded to secure future financial and monetary stability.

Looking beyond 2022, the economic and financial landscape is likely to evolve and test the resilience of our existing policy frameworks. The Bank is currently reviewing its monetary policy framework to ensure that it remains relevant in safeguarding price stability that continues to promote sustainable growth. The health crisis has led to behavioural and structural shifts among households and businesses, with important implications to economic and financial linkages. Key elements of change on the horizon include the accelerated pace of digital technology and the shift towards greater market-based financing. As such, the review will deep dive into key areas that would have implications to the conduct of monetary policy such as the digitalisation of finance, monetary policy communications and outreach, and climate change among others. Ultimately, this review is expected to provide refinements to elements of our existing monetary policy framework to enhance the Bank's ability to achieve its monetary stability mandate across time.

Going forward, well executed structural reforms are needed to address the critical challenge of reinvigorating growth opportunities and strengthening our economic fundamentals. We must also remember that economic policies do not exist in a vacuum. Policies that are in place today will impact the future economic landscape and have a bearing on the efficacy of counter-cyclical policies, including monetary policy. For example, existing policies, such as the price ceiling on domestic retail fuel prices and price controls on selected fresh food items, have undoubtedly provided temporary relief to cost pressures. However, such policies have long run costs as artificially depressed prices will eventually distort consumption and production decisions and have adverse implications to longer-term productivity. Such measures will also weigh on the Government's fiscal position and involve trade-offs to spending on other important development areas. To address these issues, longer-term solutions that enhance productivity and incomes must be in place to help the Malaysian economy maximise on such efficiency gains. From this example, it is clear that the Bank's monetary and financial policies alone would not be sufficient to accelerate these underlying drivers of growth, which are more dependent on other forms of economic policies to secure broader macroeconomic outcomes.

For Malaysia to emerge stronger and more resilient, it is important for us to maintain focus and prioritise on the key areas of structural reforms. The shift towards higher quality investments is essential and must be done in tandem with the development of a future-ready workforce, acceleration of social protection reforms, and rapid adoption of automation and digitalisation. The continued push to adopt the Environmental, Social and Governance (ESG) agenda is also critical, particularly to ensure Malaysia remains globally competitive, whilst building a more sustainable and resilient future. It is commendable that the Government has initiated efforts on these fronts, particularly in the Twelfth Malaysia Plan (12th MP) and 2022 Budget. We welcome these efforts and see strong potential to accelerate the implementation of these reforms in the immediate horizon. As Malaysia continues to respond and recover from the effects of the pandemic, it is vital to nudge the process of creative

destruction as businesses seek to pivot and reconfigure in these post-pandemic times. The existing approach of adopting blanket measures could potentially result in a loss of future growth in years to come. Such risks could become imminent if we do not stay focused and expedite our efforts on these reforms. Our experience with instituting financial sector reforms after the Asian Financial Crisis (AFC) has shown that it is possible to push through difficult but necessary reforms which have enabled us to reap the benefits today.

In carrying out structural reforms, the Bank acknowledges the realities confronting domestic policymakers. The challenge lies in balancing the need to continue providing policy support amid an uneven economic recovery, and rebuild policy buffers, while expediting structural reforms that require strong commitments from all stakeholders. Given this, Malaysia urgently needs a comprehensive roadmap on the prioritisation, sequencing and execution of reforms that cuts across both public and private sectors. The Bank's role in supporting these structural reforms is to ensure that the financial system can facilitate the intermediation needs of transformation, which has been reflected in the recently announced Financial Sector Blueprint 2022-2026.

I firmly believe that the Malaysian economy would be able to continue to prosper. Our prospects remain highly contingent upon our policy actions today. By ensuring an enabling and competitive economic environment, Malaysia will be well-positioned to benefit from new growth opportunities, which will prepare us to face new challenges in a post-pandemic world.



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