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Malaysia's Policy Responses to COVID-19 – Plotting a Recovery to the Next Normal

Introduction

The coronavirus (COVID-19) pandemic has triggered an unprecedented global health and economic crisis, pushing the already slowing trajectory of global growth since 2H 2018 into the worst recession since the Great Depression of the 1930s.

The great lockdowns (both total lockdowns and partial restrictions of movement) instituted around the world in January through May 2020, starting with China and followed by advanced economies and emerging and developing economies caused a "sudden stop" in almost all non-essential businesses. Economic activities ground to a shuddering halt and resulted in a massive loss of employment. The extraordinary pandemic caused immediate and immense shocks to economies, governments, businesses, industries, households, and capital markets worldwide.

Undoubtedly, the economic shock has been sharp and severe. Unprecedented fiscal and monetary interventions were promptly introduced to minimise economic pain for businesses and households as well as to contain the spread of the virus. Governments and central banks have deployed fiscal stimulus in the billions and trillions of dollars, slashed interest rates to historic lows, even into negative territory, and made massive injections of liquidity and purchases of public debt as well as adopting unprecedented financial relief measures, including debt/loan moratoriums.

Recent high frequency data indicate that the global economy has gradually pulled out from the slump, although the pace of recovery is fragile and patchy, amid the welcome news from the distribution of vaccines and vaccination program in some advanced economies towards end-December 2020.

Malaysia rolls out record economic stimulus packages to limit the economic damage

Malaysia, a small and open economy, cannot remain immune to the onslaught of COVID-19 pandemic-induced economic damage and business disruptions. Taking no chances on the long-lasting impact, the government made a painful but critical decision to implement the Movement Control Order (MCO) between 18 March and 3 May to flatten the virus curve. The MCO caused a sudden halt to economic and business activities, especially in non-essential sectors while essential sectors were allowed to operate at a limited capacity. The order was a careful balance between protecting lives and saving the economy.

The economy was reopened in stages with the enforcement of Standard Operating Procedures (SOPs) under the Conditional MCO (CMCO) during the period 4 May to 9 June and under Recovery MCO (RMCO) during the period 10 June to 31 December 2020. The virus containment efforts were commendable during the RMCO as the number of infections was brought under control until the re-emergence of a third wave of virus in late September. To prevent a runaway outbreak, the government reimposed a targeted CMCO and Enhanced MCO (EMCO) starting from mid-October and lasting until 6 December 2020 in almost all states (some states were exempted) while continuing to keep the economy running. As of 7 December 2020, the authorities have lifted stricter protocols in most states.

Starting the year 2021, the rapid rising infection rates and mounting strain on the national healthcare system have left the government with no choice to declare a nationwide state of emergency (12 January to 1 August 2021) and implemented three stages of movement restrictions according to the level of infection risk by states/territories for a two-week period (13-26 January 2021)[1], to curb the virus pandemic.

The government and Bank Negara Malaysia have acted swiftly, deploying a battery of fiscal and monetary stimulus packages, even at the expense of incurring larger fiscal deficit and higher debt, to fend off long-lasting damage and severe contractionary impact on the economic and business eco-system.

Between 27 March and 23 September 2020, record-setting economic and stimulus packages totalling RM305.0 billion or 21.2% of GDP called PRIHATIN, PENJANA and KITA PRIHATIN were rolled out to balance between fighting the virus and saving businesses and households (Table 1). On 18 January 2021, a RM15.0 billion PERMAI Assistance Package was unveiled, mainly involved in reprioritising and enhancement of existing financial assistance programs.

The immediate priority is to ease the financial burden on vulnerable households (B40[2] having household monthly income between RM2,500 and RM4,849), to buoy cash-strapped small and medium-sized enterprises (SMEs), to provide liquidity to financial markets and to aid millions of people who lost their jobs. The fiscal and financial measures are estimated to contribute over 4.0 percentage points to overall GDP growth and contribute 3.5 percentage points to employment growth in 2020.

With its limited fiscal fire power, the federal government's direct fiscal balance sheet injection amounted to only RM55.0 billion or 3.8% GDP while the packages' balance of RM250.0 billion was tapped from public institutions, the national oil company and sovereign funds, including The Employees Provident Fund (EPF), Social Security Organization (SOSCO), PETRONAS, Khazanah Nasional Berhad, the Retirement Fund (Incorporated) or Kumpulan Wang Persaraan (Diperbadankan) (KWAP), financial institutions and government-linked companies (GLCs).

Table 1: PRIHATIN, PENJANA and KITA PRIHATIN Economic Stimulus and Recovery Packages

Economic Stimulus Packages	Initiatives (Selected Measures)	RM Million
RIHATIN (RM250 Billion) and PRHATIN SME+ (RM10 Billion)	**Healthcare**	**1,508**
	People and Welfare	**15,132**
	• *Bantuan Prihatin Nasional*	*10,000*
	Business	**185,950**
	• *Wage Subsidy Programme*	*13,800*
	• *Loan Repayment Moratorium*	*100,000*
	• *Guarantee Scheme Facilities (Danajamin)*	*50,000*
	Fortifying Economy	**2,000**
	Other (e.g., withdrawal from EPF Account 2 (i-Lestari))	**40,410**
	Economic Stimulus Package announced on 27 February 2020	**20,000**
PENJANA (RM35 Billion)	**Empower People**	**13,233**
	• *Wage Subsidy Programme*	*5,300*
	Propel Business	**9,655**
	• *PENJANA SME Financing (PSF)*	*2,000*
	• *PENJANA Tourism Financing (PTF)*	*1,000*
	• *SME-Go Scheme*	*1,600*
	Stimulate the Economy	**7,182**
	• *Dana PENJANA Nasional*	*1,200*
	• *Tourism Sector Support*	*1,800*
	BNM Special Relief Facility	**5,000**
KITA PRIHATIN (RM10 Billion)	**Bantuan Prihatin Nasional 2.0**	**7,000**
	Wage Subsidy Programme 2.0	**2,400**
	Prihatin Special Grant (GKP)	**600**
Total		**305,000**

Source: Ministry of Finance, Malaysia

The fiscal reduction path was temporarily halted

Concerns over the fiscal deficit and debt were put on the back burner as the government acted fast and to do whatever it took to battle the tremendous pandemic-inflicted economic shock.

Following eight successive years of trimming the fiscal deficit from 6.7% of GDP in 2009 to 2.9% of GDP in 2017, the fiscal stimulus packages and measures have pushed the overall fiscal deficit substantially higher to an estimated 6.0% of GDP in 2020 from -3.7% of GDP in 2018, the highest level since the 2008-09 Global Financial Crisis. Direct public debt also increased to RM874.3 billion or 60.7%[3] of GDP at the end of September 2020 from RM793.0 billion or 52.5% of GDP at the end of December 2019 (50.8% GDP at end-December 2009).

Another year of targeted expansionary deficit budget in 2021

Given the unknown risks and challenges ahead, the Minister of Finance has budgeted for 2021 a targeted expansionary fiscal stimulus of RM322.5 billion or 20.6% of GDP, an increase of 2.5% from RM314.7 billion (21.9% of GDP in 2020) and translating into a deficit of 5.4% of GDP. This includes RM17.0 billion in the COVID-19 Fund (RM38.0 billion in 2020). It is a directional budget to revitalise the economy from the pandemic slump while keeping the deficit and debt manageable.

Of the total expenditure in 2021, development expenditure (4.4% of GDP) is budgeted to increase strongly by 38% to RM69.0 billion, the highest level on record, to make up 21.4% of total expenditure. The aim is to cement sustainable economic recovery through the implementation of projects and programs with high multiplier effects to promote economic growth and investment in the areas of education, healthcare, housing, transportation and public utilities, trade, and industry. Amongst the earmarked projects are upgrading, expansion, and maintenance of highways, roads, railways, bridges, ports and airports.

The 2021 Budget measures and initiatives are two-pronged, balancing short-term needs and long-term goals and setting the stage for medium-term growth. For example, they support continued financial assistance and facilitation of consumer spending to strengthen sustained economic revival and business sustainability and at the same time they encourage digitalisation, automation, innovation and technology as well as investment in high-tech industries to build a diversified economy and businesses, and especially to upgrade the digital skills of the workforce and help SMEs develop new capabilities in digital technologies.

The key risk is implementation capacity. Timely and critical steps need to be taken to ensure the projects and programs are implemented quickly and effectively.

Creating fiscal room via a temporarily higher statutory debt ceiling

The revised, self-imposed statutory debt limit[4] of 60% of GDP until end-2022, up from 55% previously, looks manageable and appears to be a prudent limit to provide more headroom for fiscal flexibility to buffer against any unexpected risks down the road. The increased debt-to-GDP ratio should not be a cause for alarm as Malaysia registered a debt-to-GDP ratio between 60.1% and 93.1% during the period 1982-1991. We believe that the government will balance the higher debt binding limit and the erosion of fiscal credibility over the medium-term.

We believe that global rating agencies[5] will give Malaysia some breathing space as long as the government pledges a firm commitment to resume its fiscal consolidation path when the pandemic crisis is over. Rebuilding fiscal buffers are needed through a gradual reduction in the deficit level over next 2-3 years as the economy recovers.

A track record of fiscal responsibility

Malaysia has a good track record of delivering on its promises for fiscal consolidation and strengthening fiscal space through the two-pronged approach of revenue enhancement, including revenue efficiency and rationalisation and optimisation of non-critical expenditures, including subsidies. In two distinct periods, the government had achieved five successive years of budget surpluses between 0.2% and 2.4% of GDP in 1993-1997 and over eight years trimmed the fiscal deficit progressively from -6.7% of GDP in 2009 to -2.9% of GDP in 2017.

Establish a credible fiscal stability Framework

The government must pursue the Medium-Term Fiscal Framework[6] (MTFF) for 2021-2023 as a tool for medium-term fiscal planning with renewed vigour. In our view, fiscal discipline and governance must be observed when the economy stabilises and recovers. Fiscal targets should be set to provide ample ability to meet any fiscal challenges created by any future deep economic shock or financial crisis.

Malaysia should not wait till the market pressures us to undertake fiscal and economic reforms. We should draw up a clear and credible 5-year fiscal consolidation plan for returning to sound fiscal and debt sustainability. This would help to bolster investor confidence as well as to safeguard the country's sovereign ratings.

The pace of fiscal adjustment should not be frontloaded but take into consideration economic and business conditions and provide adequate social safety nets for vulnerable groups. It is believed that the sequencing and pacing of fiscal reforms will allow the economy to adjust without creating significant distortions and disruptions for businesses and households.

Putting the country on a more stable fiscal footing requires firm commitments to constrain the growth in spending and to broaden the narrowed revenue base. This can be achieved through optimisation of non-critical expenditures, including, first, by rationalising the 5.3% per annum growth in operating expenditure, which took almost 100% of total federal revenue in 2010-19. This could involve such steps as right-sizing the bloated workforce of 1.6 million public servants which comprised 10.6% of total employment with a RM80.5 billion wage bill using 30.5% of total revenue in 2019 and a progressive entitlement reform of statutory pension payment, supplies and services. Reducing the growth in operating expenditures would also include continued rationalisation of subsidy and the consolidation of cash transfers and aid as well as revenue enhancement initiatives, including reintroducing the Goods and Service Tax (GST), reducing the tax gap of about 20% of GDP, plugging the shadow economy estimated at 18.2% of GDP, and taxing the sharing and gig economy.

As part of the MTFF, the government is in the process of drafting its Fiscal Responsibility Act, which will be ready in 2021. The plan is to have the Government Procurement Act in place by 2023 to ensure transparency and open competition, accompanied by open tender practices and punitive action for any abuse of power in relation to contract issuance.

Malaysia's Economic Growth Scenario in 2020–2021

Faced with unusual levels of uncertainty, the extraordinary measures being taken are necessary, ambitious and appropriate to constrain the depth and persistence of the recession.

The worst of the economic slump, with GDP crashing at a record annual rate of 17.1% in 2Q 2020 due to the MCO-induced "sudden stop" in economic and business activities, is now behind us, although the path ahead remains uncertain. This improved situation is thanks to the reopening of the economy in stages in compliance with the SOP and augmented by the fiscal cash transfers to targeted households and individuals, the wage subsidy program, the loan moratorium, and the soft loan facilities and guarantees for specific sectors and SMEs as well as financial grants for micro enterprises.

These economic stabilisation and revival packages have generated measurable impacts including: 2.8 million jobs saved; at least 10.6 million individuals supported via cash transfers, loan moratoriums and the EPF's i-Lestari[7]; and 23,234 SMEs provided with RM10.8 billion in various soft loans under PRIHATIN[8].

The Socio-Economic Research Centre (SERC) assesses that the "shock" pandemic economic contraction hit a trough in 2Q 2020 (-17.1% year-on-year GDP growth vs. +0.7% in 1Q). Early signs of stabilisation have started to trickle in since June, with high frequency economic indicators (exports, consumer spending, manufacturing production, and retail sales) showing tentative, albeit uneven, recovery (either slowing rates of decline or moderate increases) (Figures 1 and 2). Real GDP has improved markedly, contracting only 2.7% yoy in 3Q 2020, thanks to a recovery in domestic demand and exports. However, some sectors, namely, travel and tourism, hospitality, and aviation, as well as small businesses may take longer to get back firmly on track, probably beyond 2021.

A gradual improvement in labour market conditions is aiding consumer spending. After hitting a record high of 5.3% in May, the unemployment rate con-

Figure 1: Change in Industrial Production and Retail Sales in 2020

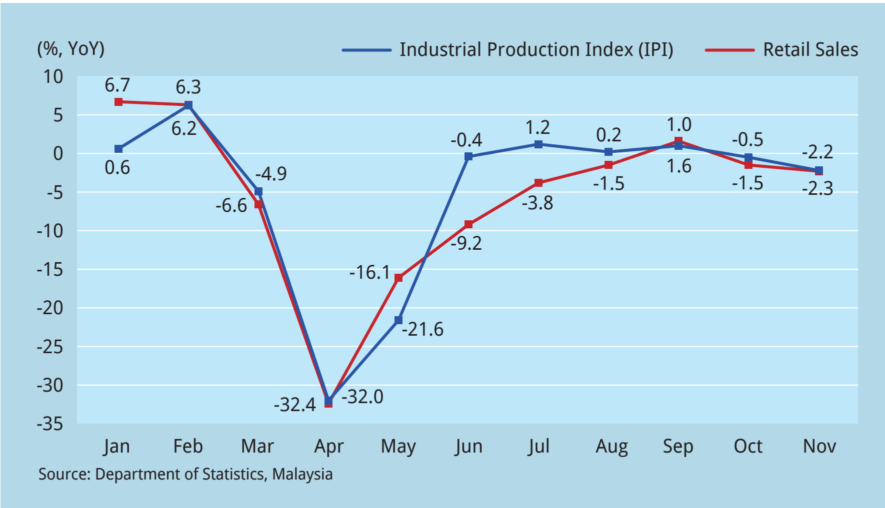


Figure 2: Change in Exports and Imports in 2020

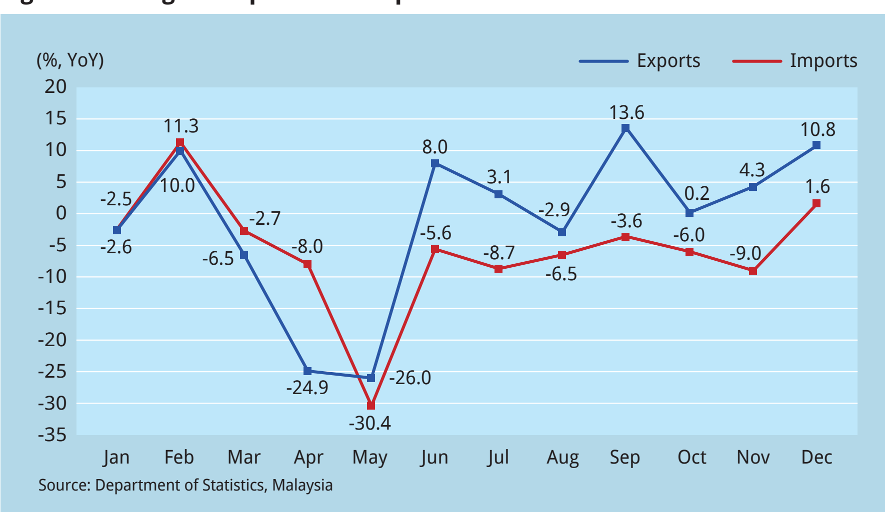
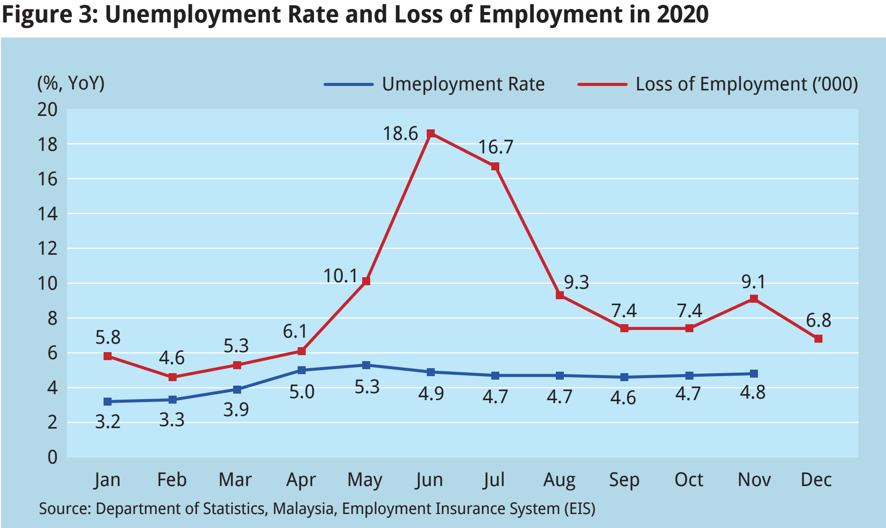


Figure 3: Unemployment Rate and Loss of Employment in 2020



tinued to ease to 4.6% (737,500 persons) in September after stabilising at 4.7% in July and August, although it remains far below the pre-pandemic level of 3.3-3.4% (an average of 516,450 persons in 2018-2019) (Figure 3). However, the jobless rate has inched up to 4.7% in October and 4.8% in November, due to the re-implementation of CMCO. Data from the Employment Insurance System (EIS), SOSCO indicates that that loss of employment has declined from the peak of 18,579 persons in June to reach 6,805 persons in December 2020 with a cumulative employment loss of 107,024 persons for the period Jan – Dec 2020.

Recovery is slowly underway amid considerable uncertainties

With downside risks weighing more than upside risks, on balance, we are taking the cautious view that Malaysia's real GDP will show a larger pace of decline in 4Q 2020. With real GDP already having contracted by 6.4% from January to September, SERC estimates the economy will decline by 5.8% given that the third wave of virus has tempered the strength of recovery.

For 2021, we have resisted the temptation of presenting a robust estimate of GDP growth, putting it 4.0-5.0% (base case) and 6.0% (best case) in 2021. We remain wary about the virus prognosis and the strength of recovery in advanced economies as well as the effectiveness of the government's capital spending in 2021 amid lingering concerns about domestic political developments. Households' and businesses' confidence in the containment of the virus and the availability of vaccines[9] is needed for a full-fledged recovery and must be supported by fiscal stimulus and accommodative monetary policy to revitalise and sustain economic revival.

The factors underpinning our forecast are: the "sudden stop" in activity in 2020 will normalise in 2021 amid some permanent loss in output and capacity; a "sharp" bounce back in 2021 to be boosted by the low base effects as a result of a sharp contraction in 2020; services and tourism-related sectors will be revitalised as tourist arrivals resume gradually towards the end of 2021; exports will rebound as global trade picks up, helping to lift export-oriented industries in the manufacturing sector; and the construction sector will be revived by on-going and new public infrastructure projects[10].

We caution that the fragile domestic economic recovery remains susceptible to shocks or events that could temper the global recovery. These include: uncertainty about the future path of the virus and the multiple waves of new strains mutation; enactment of a longer duration of MCO and wide-scale targeted CMCO and EMCO to break the chain of virus contagion; a prolonged drag in global recovery; longer time required to repair damage in some domestic sectors; households' ability to repair their balance sheet and rebuild savings amid high indebtedness; and a slow and lagging recovery in the jobs market.

Financial System Soundness and Resilience

Malaysia's banking system and capital market entered this period of economic hardship from a position of strength which is containing the financial system's vulnerability to financial and economic damage inflicted from the pandemic while preserving financial stability.

Financial institutions have strong capitalisation, ample liquidity and sound risk management. Deep and liquid domestic financial markets will continue to support intermediation of capital flows.

Prompt financial stabilisation measures to contain market dislocation and stem excessive volatility

In response to the heightened volatility and significant capital outflows at the onset of the COVID-19 shock, Bank Negara Malaysia, the Securities Commission (SC) and Bursa Malaysia have undertaken prompt policy interventions to smooth excessive volatility and maintain orderly conditions in the foreign exchange, bond, equity, and money markets.

In the banking sector, measures were focused on: extending immediate cashflow relief in the form of loan moratoriums to individuals and businesses to save operations and preserve jobs and livelihoods; providing appropriate regulatory and operational flexibility for banking institutions (such as allowing drawdown of the capital conservation buffer of 2.5%, operating below the minimum liquidity coverage ratio of 100%, and reducing regulatory reserves against expected losses to 0%); and preserving the smooth functioning of the financial intermediation process to support economic recovery and post-COVID-19 economic restructuring and reforms.

Various financing schemes and facilities amounting to RM25.1 billion were established to ease lending and financing conditions for viable SMEs during this challenging period. These funds and schemes, which offer reasonable interest rates and credit guarantees as well as access to financing for SMEs in all economic sectors, and to tourism, automation and digitalisation, and agro-food sectors in particular.

In the capital market, several key measures to safeguard and ensure continuous trading and market operations included: the suspension of short-selling activities until the end of December 2020; flexibilities in margin financing to allow brokers' discretion to not make margin calls or impose haircuts on collateral and securities; waiver of the SC annual licensing fees for 2020; waiver of listing-related fees for 12 months for companies with market capitalisation of less than RM500 million seeking listing on the Main Market as well as for companies seeking to list on the LEAP and ACE Markets; and extension of deadlines for market participants who are required to comply with regulatory filings and submissions to the SC.

The COVID-19 pandemic inflicted significant market volatility, albeit briefly

Both domestic equity and bond markets experienced extreme price volatility in March and April 2020 due partly to external factors as investors' fears of a deep global recession during the heightened uncertainties surrounding the prolonged deepening impact of the pandemic combined with the global demand shock and supply chain disruptions inflicted by the lockdowns in countries around the world as well as the tightening of global financial conditions.

Domestic concerns also played a part as the implementation of MCO–"Total Lockdown" to contain the spread of the virus led to a sudden stop in economic activities and the domestic demand shocks coupled with a sharp contraction in external demand caused a historic contraction of the economy by 17.1% year over year in 2Q and by 8.3% in 1H 2020. With the recovery track in 3Q, the decline in GDP narrowed to 2.7%.

The domestic equity market continued to suffer persistent net outflows of foreign portfolio, amounting to RM24.8 billion (USD5.9 billion [11]) up to the end of December 2020, on investors' heightened concerns over the duration and depth of the pandemic's economic impact.

The flooding of retail liquidity and historically low interest rates as well as the loan moratoriums have spurred a record participation of domestic retailers in the local bourse. Retail participation in terms of trading value and volume has outpaced that of domestic institutional investors since April 2020 and hence both helped to offset the impact on equity prices from the net selling by foreigners and buffered a strong rally in healthcare and technology stocks.

At the end of July 2020, market capitalisation on the local bourse had risen by 23.5% to RM1,703 billion (USD401 billion[12]) from RM1,379 billion (USD321 billion[13]) at the end of March 2020. The benchmark FBM KLCI rebounded strongly by 32.1% to 1,611.42 points on July 29, 2020 from its decade low of 1,219.72 points on March 19, 2020, and turned in the best performance among emerging markets in ASEAN. Since August, profit-taking has been taking place, leading to some price correction. In November, optimism among some buying interests emerged on the back of US president Biden's victory and vaccine developments. The FBM KLCI peaked on December 11, 2020 at 1,684.58 points before closed the year at 1,627.21. Overall, the domestic equity market remains susceptible to the future path of COVID-19, policy and event risks such as the unsettled disputes between the US and China on trade and technology as well as domestic macro-narratives and political uncertainty.

The domestic bond market also experienced a temporary spike in bond yields, induced by significant outflows of RM22.4 billion (USD5.2 billion[14]) of government bonds (Malaysian Government Securities (MGS) and Malaysian Government Investment Issues (MGII)) between February and April as risk-adverse foreign investors fled to quality on concerns about the potential worsening of the domestic economic outlook, the widening budget deficit and aggressive monetary easing.

Foreign investors' trimming of their holdings of Malaysian government bonds which began in February peaked in March 2020, and they recorded net inflows of RM36.4 billion (USD8.7 billion[15]) between May and December 2020. The factors underpinning the revival of investors' interest in Malaysian bonds and debt securities were the gradual improvement in global investor sentiment and the easing concern about the country's budget deficit and sovereign ratings as well as the assessment by FTSE Russell of bond market accessibility[16].

At the end of December 2020, foreign shareholding of MGS made up 40.6% of the total, amounting to RM177.3 billion (USD44.2 billion[17]). A diversified and long-term stable base of investors have been the key holders of Malaysia's government bonds, including as of the end of December 2019, asset management firms (41.3%), central banks (28.2%), pension funds (18.2%), banks (9.3%) and others (3.0%).

Vigorous stress tests have affirmed resilience of financial system

Since the 1997-98 Asian Financial Crisis, the country's financial institutions have built strong capital positions and ample liquidity buffers, at a level more than twice that seen during the 2008-09 Global Financial Crisis (Figure 4).

The strengthening of risk management practices, the quality of banks' loan books and adequate provisioning have helped in preserving debt service capacity and mitigating credit losses. While it is reckoned that banks' earnings would come under some pressure during the economic downturn, mainly arising from higher credit losses and loan impairments, the rise in loan loss is not expected to reach a level that will threaten their financial stability.

Bank Negara Malaysia's vigorous stress tests have affirmed the resilience of the financial system and its ability to withstand extreme macroeconomic and financial shocks. Macro simulations project the total capital ratio in the banking system will stand at 17.1% at the end of December 2020 and at 16.3% at the end of December 2021, well above the minimum requirement of 8%. Bottom-up stress tests also reaffirmed the financial institutions' loss-absorbing capacity under more severe conditions with banks comfortably withstanding shocks of up to 8 times their historic default rates.

While domestic financial stability would be preserved, we must keep close vigilance against a number of on-going risks: continued heightened external and domestic financial volatility; a slower-than-expected domestic economic recovery; a prolonged third wave of virus outbreak compelling wide-scale precautionary measures and restrictions of movement; a worsening of business sustainability for the travel and tourism and the hospitality sectors; sustained weakening of income and employment, leading to broader declines in house prices.

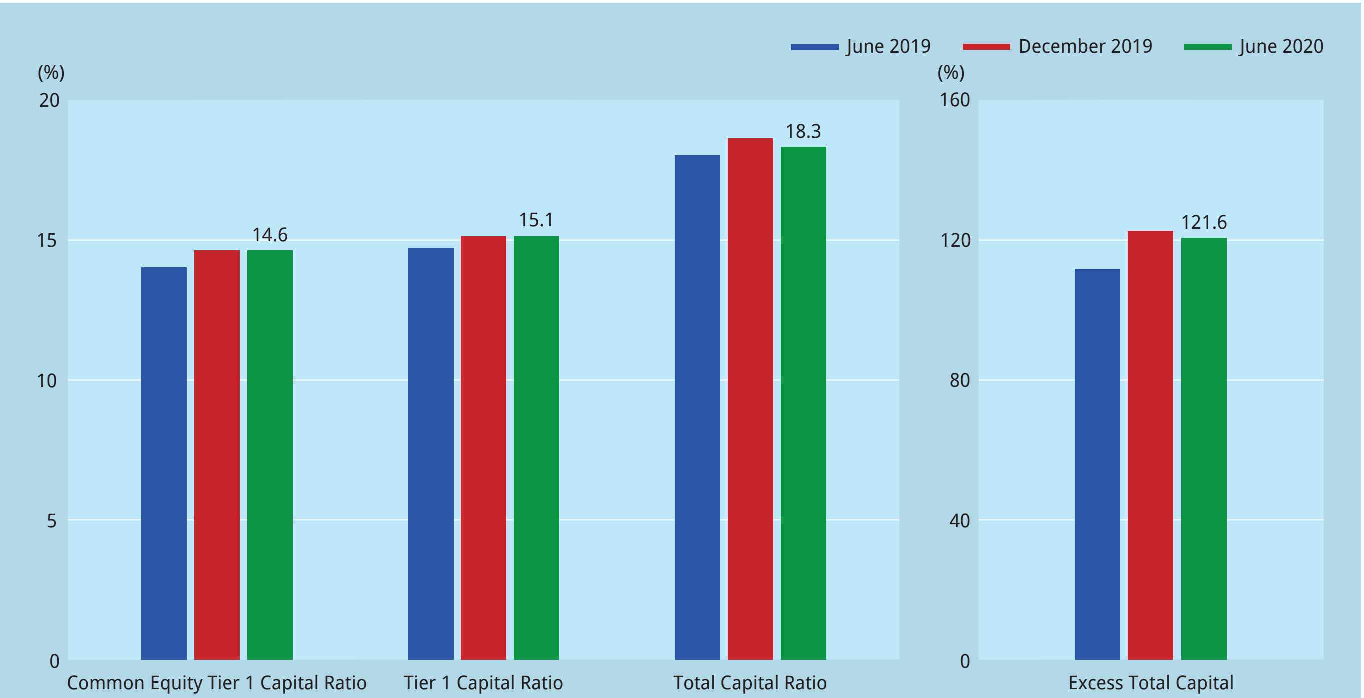
Financial system moving forward post COVID-19 landscape

After the COVID-19 pandemic, the banking sector will continue to support the economic and business recovery while managing the pressure from lower profitability (low interest rates and high capital reserves) and credit losses as well as tackling challenges and competitive pressures from digital entrants (digital financial services and platforms).

The COVID-19 crisis will accelerate pre-crisis trends to digitalise, which will increase the contestability of financial services for the traditional banking business model. While these digital financial services provide many choices and delivery efficiencies, they also carry new risks (cybersecurity and data privacy theft) that will require regulatory responses, and, crucially, a level playing field between incumbents and new entrants. Regulators must adapt to digital disruption by balancing the facilitation of competition and the benefits of innovation with the protection of financial stability.

The volatile shifts in global liquidity remain a potent risk to emerging markets, including Malaysia in both domestic equity and bond markets. Hence, the resiliency of the domestic capital market must be backed by sound macroeconomic policies

Figure 4: Banking System's Capital Ratios



Source: Bank Negara Malaysia

and financial conditions, strong regulatory and governance structures, a deep and liquid market as well as a diversified investor base. Besides domestic corporations, we have also seen foreign issuers from Asia, Europe and the Middle East, as well as multilateral institutions, tap the local bond market for their financing needs. While the Ringgit bond markets reduce currency mismatches, they remain vulnerable to foreign outflows and the tightening of financial conditions.

Moving forward, there are good prospects and growing demand for market-based instruments and investments focused on environmental, social, and governance (ESG), including those involved with environmental protection, climate change, the circular economy, and social-health sustainable products.

With growing recognition of ESG by businesses, corporations and investors, there is a need to enhance market regulations to support the emergence of buoyant green investment and finance. We expect the Malaysian corporate bond market will see more diversified issuer types and issuance sizes, with investment in low-carbon economic growth, greener infrastructure, more climate-resilient projects, renewable energy as well as the healthcare sector. The financing program for the 12th Malaysia Plan's development expenditure programs, including public infrastructure projects, calls for more issuance of government bonds and government guarantees as well as additional bank financing.

Rebooting Malaysia

As the country emerges cautiously from the COVID-19 pandemic and moves on to the recovery and revitalisation stage, it is an opportune time for and incumbent on the government to review the sustainability of our economic and social systems and environment as we step up efforts to restore normal economic and business activity. Political stability is key to macroeconomic stability and growth.

The COVD-19 pandemic may lead to new economic, fiscal and reform priorities to direct the country's future. The 2021 budget focusses on immediate and short-term measures and initiatives to stimulate economic growth, revive consumer spending and facilitate businesses' sustainability after the pandemic crisis. It is expected that defining strategic economic and industrial policies will be formulated in the Economic Recovery Plan, the New Industrial Master Plan and the 12th Malaysia Plan (2021-2025).

We must look at opportunities that capitalise on Malaysia's strengths and comparative advantages in resource- and non-resource-based industries. Our regional competitors are fast catching up and becoming more competitive in terms of product and service offerings, market share, participation in global supply chains, financial flows, foreign long-term capital investment and labour mobility.

Policy Recommendations

The following six issues require our attention and policy commitment:

First: The government must plug leaks in affirmative action policy to ensure that the most vulnerable members regardless of race will be given priority in a new social safety protection system which integrates mandates and incentives to help households invest in human capital. We can consider experimenting with the Universal Basic Income program for communities considered economically disadvantaged. Subsidies and financial assistance programs need to be well targeted.

Second: How can we reboot and realise the potential of our human capital? The advent of digital and disruptive technologies continues to change the nature of work and means that the transformation of workers' skills is central to our current and future development. Skilled labour currently makes up 29.1% of total employment (3Q 2020), while the target in the 11th Malaysia Plan is at least 30.1%.

Malaysian human capital must be effectively nurtured and developed to raise productivity and become more agile through reskilling and upskilling as well as industry training, with a premium on improving cognitive skills and creative and innovative capabilities. We need at least 60% of students to get into STEM (Science, Technology, Engineering and Mathematics) fields compared to the current 44% of students. Technical and vocational education and training (TVET) must be revamped to be digitally viable and given the same importance as mainstream education and also integrated with STEM because of its focus on innovation and problem-solving.

Third: The government and industry need to be more committed to address the issue that the estimated 5-7 million documented and undocumented foreign workers have been undermining our industrial restructuring and skill transformation. We need to seriously reconsider and better execute workable solutions toward a phased reduction of foreign workers by encouraging automation and going digital.

Fourth: The challenge is to ramp up digital infrastructure and fix the technology gap as well as strengthen cybersecurity. We need to enhance the speed, reliability, and coverage of the digital experience to narrow the urban-rural digital divide.

The current e-government system is probably 30%-40% complete, meaning that the process of digitalising public delivery services must be more comprehensive and accelerated. With the government leading the e-curve, businesses and people will adjust and adopt it accordingly. Digitalizing also includes accelerating towards a cashless economy.

Fifth: Malaysia needs to enhance global as well as regional collaboration and linkages in trade, services, investment, technology, and financial and capital markets.

An important priority is to foster competitiveness through developing specific skillsets, relevant technologies and markets, and promoting public-private partnerships to generate quality investments and derive synergies to upgrade investment, innovate, and diversify domestic production structures.

We must invest in "new smart infrastructure" for high-tech, digitalisation and sustainable purposes (healthcare, renewable energy, climate change, eco-green, clean energy technologies, extractive industries, maritime, aerospace, agriculture and food security).

Sixth: There is clearly still room for Malaysia to improve its 12th place ranking in the World Bank's Ease of Doing Business Index (2020). We should look for ways to further streamline impediments to investment in Malaysia.

Notes

1 (i) MCO in Penang, Selangor, Federal Territory (Kuala Lumpur, Putrajaya and Labuan), Malacca, Johor and Sabah; (ii) Conditional MCO in Pahang, Perak, Negeri Sembilan, Kedah, Terengganu and Kelantan; and (iii) Recovery MCO (Perlis and Sarawak). It was subsequently implemented MCO 2.0 uniformly in almost all states until 4 February.

2 B40 designates those households with median monthly income in the bottom 40%.

3 Based on the statutory limit calculation which comprises outstanding Malaysia Government Securities (MGS), Malaysia Government Investment Issues (MGII) and Malaysia Islamic Treasury Bills (MITB), the debt-to-GDP ratio stood at 56.5% at the end of September 2020.

4 The last time Malaysia raised its debt ceiling was in July 2009 during the 2008-09 Global Financial Crisis, when it increased its maximum borrowings by 10 percentage points to 55% of GDP.

5 On 5 December, Fitch Ratings downgraded our rating to BBB+ from A-, citing lingering political uncertainty that weighs on the policy outlook as well as prospects for further improvement in governance standards.On 28 January 2021, Moody's Investors Service reaffirmed Malaysia's sovereign debt rating of A3 with stable outlook.

6 The framework provides macro-fiscal projections for a three-year period by setting targets and ceilings for revenue and expenditure as well as the overall deficit. These projections will be revised annually on a rolling basis to reflect medium-term forecasts for revenue and expenditure as well as macro-economic assumptions. It includes assumptions of real GDP growth between 4.5% and 5.5% (nominal GDP growth between 5.5% and 6.5%) and oil prices between USD45 and USD55 per barrel. The overall fiscal deficit is targeted to average 4.5% of GDP for three years.

7 EPF members can now withdraw a maximum of RM500 per month from their second account for a period of 12 months.

8 Refer to Special Relief Facility (SRF), Automation & Digitalisation Facility (ADF), All-Economic Sector Facility (AES) and Agrofood Facility (AF) funds.

9 The Ministry of Health (MOH)'s National Pharmaceutical Regulatory Agency (NPRA) has approved the registration of the COVID-19 vaccine produced by the pharmaceutical company Pfizer and Malaysia is expected to receive the supply of Pfizer vaccine for the first phase at the end of February 2021. The government has signed a preliminary agreement with Covax, Pfizer and AstraZeneca for the procurement of COVID-19 vaccine to guarantee coverage of 40% of the population.

10 These include the East Coast Rail Link (ECRL), the revival of the Bandar Malaysia project, Mass Rapid Transit Line 3 (MRT3) , and construction of the Johor Bahru–Singapore Rapid Transit System.

11 Exchange calculated @Average RM4.2016/USD1.

12 End-period July: RM4.2425/USD1.

13 End-period March: RM4.3025/USD1.

14 @Average RM4.2751/USD1.

15 @Average RM4.1885/USD1.

16 FTSE Russell decided to keep Malaysia's bonds on its negative watch list following the annual review process while acknowledging the country's measures to improve liquidity and accessibility of both bond and forex markets.

17 End-period September: RM4.0130/USD1.

LEE HENG GUIE

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Lee Heng Guie has 30 years' experience as an economist, including almost 12 years at Bank Negara Malaysia and 18 years in financial services. Since July 2016, Mr. Lee was appointed Executive Director of the Socio-Economic Research Centre (SERC), an independent research centre of the Associated Chinese Chambers of Commerce and Industry of Malaysia (ACCCIM). He is currently an independent member of the Investment Committee of Opus Asset Management Sdn Bhd and a member of the Economic Committee (EC) of the Malaysia Competition Commission.

He actively contributes economic commentary to print and electronic media as well as participates in seminars and conferences as a resource person.

Mr. Lee is the recipient of many awards. In the Edge Polls, he was voted Best Economist twice and ranked among the top three economists four times from 2000-2008. Asset Magazine Hong Kong-Local Currency Bond Market of Malaysia named him Best Economist in 2007. He also led CIMB's Macroeconomic research team which ranked among the top three in the Asiamoney Polls for nine consecutive years (2005-13).

Mr. Lee holds a BA (Hons) in Economics from the University of Malaya, Malaysia and a Master's degree in Development Economics from Williams College, USA.