Foreword

The year 2021 is projected to be a turning point for the global economy, from a period of deep recession that originated from a global COVID-19 pandemic. The worst is likely behind us, as the global economy is poised for a post-pandemic rebound, albeit at an uneven pace across countries. While there are lingering uncertainties, particularly surrounding resurgences in COVID-19 cases and the subsequent re-imposition of lockdowns in some countries, the deployment of vaccines is expected to pave the way for some normalisation in economic activities worldwide. Additionally, the ongoing expansionary monetary policy and loose financial conditions globally would continue to ease domestic financial conditions, particularly in emerging market economies, further supporting the economic recovery.

For Malaysia, the expectation is for the economy to recover in 2021, with growth ranging from 6.0 - 7.5%. The path of recovery will be gradual and uneven across economic sectors, and it may encounter speedbumps along the way. Growth will be underpinned by stronger external demand and higher public and private expenditure. The rollout of the domestic COVID-19 vaccination programme will also lift sentiments and support economic activities. Malaysia's integration in fast growing segments of global value chains and diversified external trade structures, along with continued policy support and its effective execution would be the key factors in driving the rebound in economic growth in 2021.

Despite the positive outlook, downside risks to growth remain. Of immediate concern is the unpredictable course of the pandemic globally and domestically. We cannot rule out the risk of COVID-19 becoming persistent and the country having to withstand the pandemic longer than expected. This is subject to how quickly Malaysia can achieve herd immunity and how the virus evolves. Aside from the pandemic, the uneven growth recovery could risk larger permanent job losses and business closures, particularly in high-touch services sectors. This economic scarring can have a more lasting consequence on the economy, and could prevent a quicker return to a pre-pandemic growth trajectory when economic activity normalises.

In this environment of heightened downside risks to growth, the immediate policy focus of the Bank is to facilitate a quick and sustainable recovery and minimise permanent output losses. Thus, the thrust of monetary policy in 2021 is to remain accommodative to ensure supportive conditions for sustainable economic growth. While headline inflation is expected to rise, it will be driven mainly by supply side factors. Underlying price pressures, on the other hand, will remain subdued, amid continued spare capacity in the economy. In this instance, monetary policy will not be the most appropriate tool to manage supply-driven inflation. The Bank will continue to closely monitor the emergence of signs of a more entrenched and sustainable economic recovery in the period ahead, while remaining vigilant against a build-up of financial imbalances.

The Bank has been, and will continue to be, in a good position to utilise its policy levers as appropriate. Even with the Overnight Policy Rate (OPR) at its current historical low of 1.75%, monetary policy space remains adequate to provide additional support to the economy if needed. This is complemented by the availability of the Bank's various liquidity management tools, targeted financial policies and regulatory flexibilities. These policies allow the Bank sufficient flexibility to respond to risks using the most appropriate policy tool. In addition, coordination with other macroeconomic policies, such as fiscal and labour market policies, will further increase the likelihood of securing a sustainable recovery while avoiding the overburdening of any single policy tool. This effectively reduces the need for the Bank to resort to unconventional monetary policies, which require further assessment on its appropriateness, effectiveness and long-term consequences for the Malaysian economy. What is certain is that we will not rush into untested policy options that could have large unintended consequences on the well-being of the economy and the *rakyat* over the long term.

Going forward, the unpredictable nature of shocks and crises warrants preparing ahead, especially in building policy buffers and using these resources judiciously. This involves two important policy considerations. First, as economic growth becomes more entrenched, the rebuilding of overall policy space, including monetary, financial and fiscal buffers, is necessary to ensure that we have adequate room to manoeuvre if the economy faces another shock. Second, limited policy resources make it imperative to pay greater attention towards allocating them efficiently for the economy to recover and return to its full potential. This should ensure that segments of the society that need the support have access to it, while allowing market forces to work in facilitating the reallocation of resources in a way that will optimise growth prospects. A scenario to avoid is where policy actions inadvertently lead to negative externalities and distortions, such as higher overall indebtedness, imprudent financial behaviours or artificially supporting inefficient or “zombie” firms. This in turn could lower overall productivity, crowd out investment and exacerbate vulnerabilities in the economy, which would ultimately weigh on the economy’s future growth potential. These considerations have underpinned the Bank’s shift from broad-based to more targeted financial policies.

Beyond its cyclical impact on growth, the pandemic has fundamentally reshaped the economy and the way we conduct our businesses and daily affairs. Importantly, it has sharpened the focus on critical areas of structural policy that call for renewed urgency. On the one hand, it has accelerated the shift towards the adoption of technology and sustainability agendas. On the other hand, it has accentuated gaps in our labour market and social protection system. We must take this opportunity, as a nation, to accelerate the execution of long-term structural reforms and pivot towards a more sustainable, resilient and agile economy. The Bank is committed to continue participating and collaborating closely with relevant stakeholders on various national policy platforms to advance and shape the crucial reforms necessary to secure long-term growth that is both durable and inclusive.

Accelerating the adoption of technology and innovation has become more relevant in this new normal and will drive and sustain future growth. During the pandemic, the ability of economic agents to quickly adapt and change their business models despite movement restrictions was owed partly to the success of previous policies to install key infrastructures and promote digital adoption in the economy. These include efforts to accelerate the adoption of electronic payments. Going forward, there is a need to accelerate the rollout of new critical enablers, including fast and reliable digital connectivity as well as secure data sharing infrastructures, and encourage greater diffusion of technology in the economy to open up new sources of growth while raising future productivity and incomes. Forays into digitalisation can also anchor Malaysia’s growth narrative and attract high quality investments into the country. More importantly, focus can be directed at industrialising digital technology, capitalising on Malaysia’s comparative strengths, for example in digital healthcare technology, to position Malaysia as a regional developer of high value-add digital solutions.

At the same time, there needs to be greater efforts to strengthen our economic resilience to climate and environmental risks, and manage an orderly transition towards sustainable development goals. A climate crisis can have a similar, if not more severe and irreversible impact on the Malaysian economy. Pursuing the green agenda, by creating a conducive ecosystem and coherent national policies, and attracting investment in climate resilient infrastructures and green technology, can boost employment while increasing economic and environmental resilience for decades to come.

The new normal also imposes a more challenging operating environment in the labour market. Workers are subject to various risks from widespread automation and technological enhancement, with a disproportionate impact on the informal and low skilled segments. Hence, a holistic labour market policy framework is needed to create a resilient and agile workforce that can adapt well to changing labour market conditions. Policy strategies include enhancing upskilling and reskilling programmes, as well as improving employment services and matching mechanisms to facilitate the reallocation of workers to more productive and high-growth areas. The design and formulation of labour and education policies would require continuous and cohesive participation of players from the industry, academia and the Government.

Finally, the pandemic has revealed deep-seated issues regarding Malaysia's existing social protection framework. These include fragmented and overlapping social protection programmes, gaps in coverage, and inadequacy of programmes to comprehensively address vulnerabilities. Undertaking reforms to address these issues will be crucial to ensure that more vulnerable groups are well protected from sudden shocks to their employment status or income, and will encourage access to better opportunities through active labour market policies.

We are not yet out of the woods, but I firmly believe that with sound policies and effective implementation of key structural reforms, Malaysia will emerge stronger from this global health crisis. Achieving a durable economic recovery requires focus on the bigger picture and a 'whole-of-nation' approach. This is where everyone has a role to play – from individuals observing standard operating procedures to the institutions that shape the policies. On the Bank's part, we are dedicated towards this shared objective and will remain unwavering in serving the needs and the interest of the country.

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