Box Article

Malaysia's Trade Resilience in the Post-Pandemic Era

Introduction

Covid-19 was a watershed moment for the global community. Many lost their lives while many livelihoods were severely affected. It caused unprecedented disruptions to most economies around the globe. Remarkably, following measures to manage the spread of the pandemic and support incomes and jobs, the global economy returned to the path of recovery, with advanced economies (AEs) leading the way. Global trade rebounded sharply on strong demand especially for durable goods. This benefited emerging market economies (EMEs), including Malaysia.

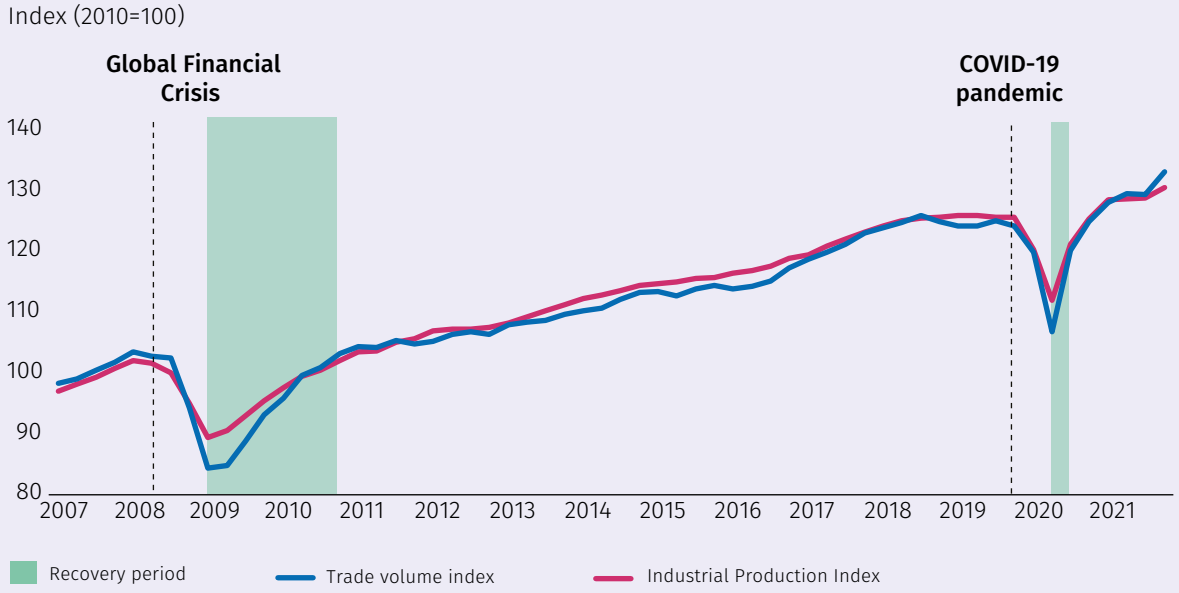
This article seeks to address three main questions: First, what are the factors that influenced Malaysia's trade resilience during and post-pandemic? Second, what are the post-pandemic trends that could influence Malaysia's trade over the medium term? Third, what policy lessons could we infer from the crisis to enhance the country's trade resilience?

Spillover impact of Covid-19 on Malaysia's trade: From breaking point to rebound

The Covid-19 pandemic was a sizeable shock to the global trade and economy. In the World Economic Outlook in April 2020, the IMF projected that the global economy would contract by 3%. This was the worst downturn since the Great Depression in 1930s. Back in 2009 when the world output contracted by 0.1%, trade volumes collapsed by 13%. During the pandemic, global trade volume plummeted by 14% in 2Q 2020 (Chart 1).

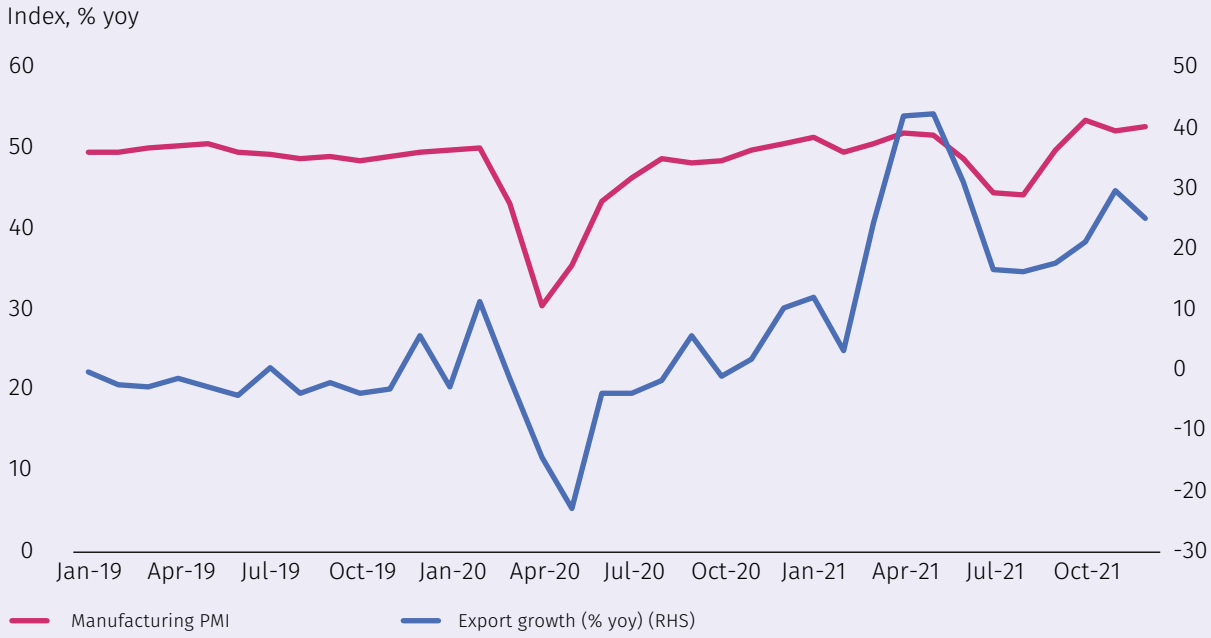
Rather unexpectedly, such concerns about global trade rapidly subsided when trade flows rebounded in 2H 2020 onwards. Although the decline in trade volume were about similar in depth compared to the Global Financial Crisis (GFC), the rebound was much quicker and sharper. At the core of this turnaround was the success of the early containment measures in China. Moreover, the rapid development and roll-out of vaccines especially in AEs allowed gradual resumption of economic activities. The recovery in global economic activity was also characterised by the shift in consumption pattern away from contact-intensive service industries towards durable goods. This led to robust demand for manufactured goods, with exporters that are deeply integrated in the GVCs, such as ASEAN, were amongst the main beneficiaries (Chart 2). The resilience in global trade reflected the agility of manufacturers to adapt their supply chain networks against the pandemic-induced disruptions. Policymakers also played a pivotal role as monetary, financial and fiscal policies were deployed at an unprecedented scale and speed. For instance, the exceptionally accommodative monetary policy and liquidity measures by major central banks helped to keep trade finance flowing, better than during the GFC.

C1 World Merchandise Trade Volume Index and Industrial Production Index



Note: Recovery period refers to quarters for the trade volume to return to the pre-crisis level
Source: CPB Netherlands Bureau for Economic Policy Analysis

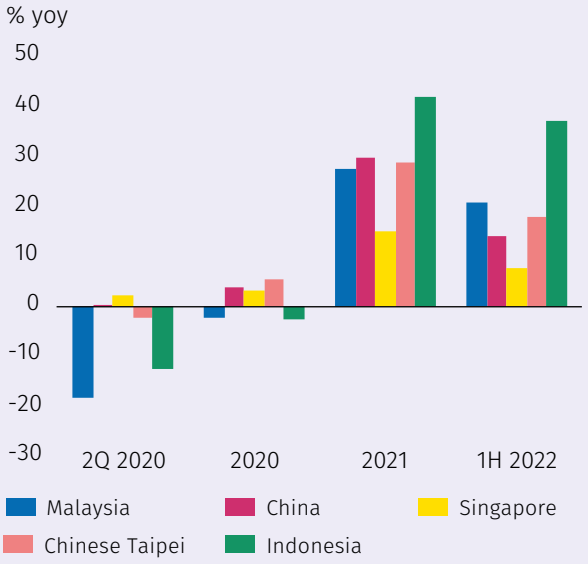
C2 ASEAN Manufacturing PMI and Export Growth



Source: S&P Global, CEIC

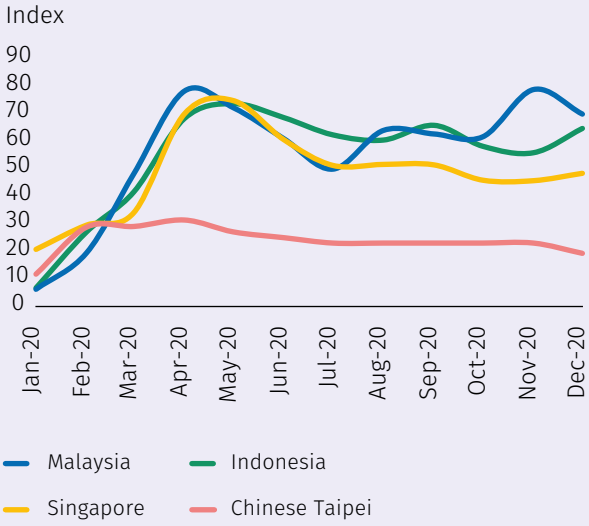
As a small and open economy, Malaysia was not spared from this global shock. Merchandise exports collapsed by -14.9% in 2Q 2020. This was the sharpest decline since 3Q 2009 (-21.9%). Despite this, exports of rubber products surged given the robust demand due to the pandemic. Compared to many other regional economies, Malaysia's exports declined by a larger magnitude in 2Q 2020 and remained relatively more sluggish for the rest of the year (Chart 3). This could be partially traced to the somewhat stricter and longer lockdowns in Malaysia than some other regional economies (Chart 4). As a result, there were higher frictions and impediments in restarting production activity. As these restrictions were gradually eased, export growth rebounded strongly and was broadly in line with regional economies, surpassing pre-pandemic levels.[1] The recovery in trade was rather broad-based across products. Some products recorded exceptional growth due to robust external demand (Chart 5). E&E products, which account for more than a third of Malaysia's exports, grew particularly strong due to robust demand for work-from-home equipment as well as cloud computing.[2] Recovery in commodity prices also supported commodity-related exports.

C3 Export Growth of Selected Regional Economies (in USD terms)



Source: National authorities

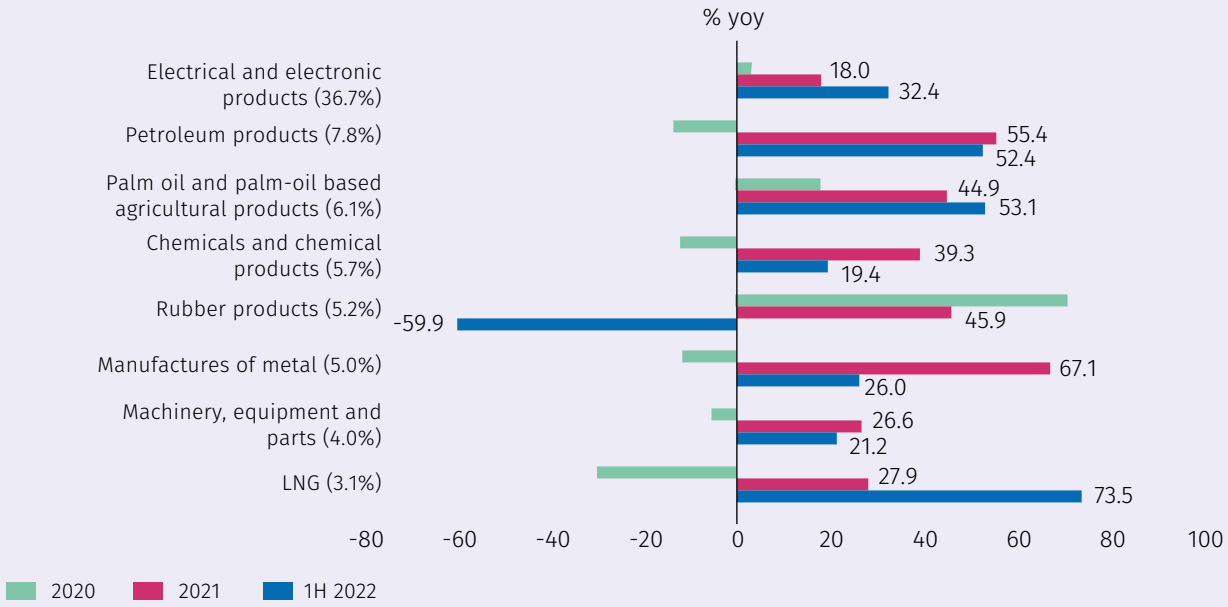
C4 Stringency Index of Selected Regional Economies



Note: Higher index indicates stricter containment measures
Source: Oxford Government Response Tracker

[1] The 2021 export level surpassed the 2019 level for Malaysia and most regional countries.
[2] For more detailed analysis on impact of global chip shortages to Malaysia's E&E sector, please refer to the box article titled 'The Global Chip Shortage: Implications and Opportunities for Malaysia' in the BNM Quarterly Bulletin in 2Q 2021.

C5 Growth of Malaysia's Top Export Products



Note: Values in parentheses refer to share of exports in 2021
Source: Department of Statistics, Malaysia

Malaysia's deep integration into GVCs and rapid adaptability enhanced Malaysia's trade resilience

Malaysia's diversified export structure across products and markets has been the main source of export strength and resilience. In addition, Malaysia's integration in the GVCs helped to support trade recovery in tandem with strong external demand for durable goods. While trade recovery was driven by external demand, the impact was reinforced by firms' rapid adaptability to various production constraints and challenges arising from the pandemic shock.

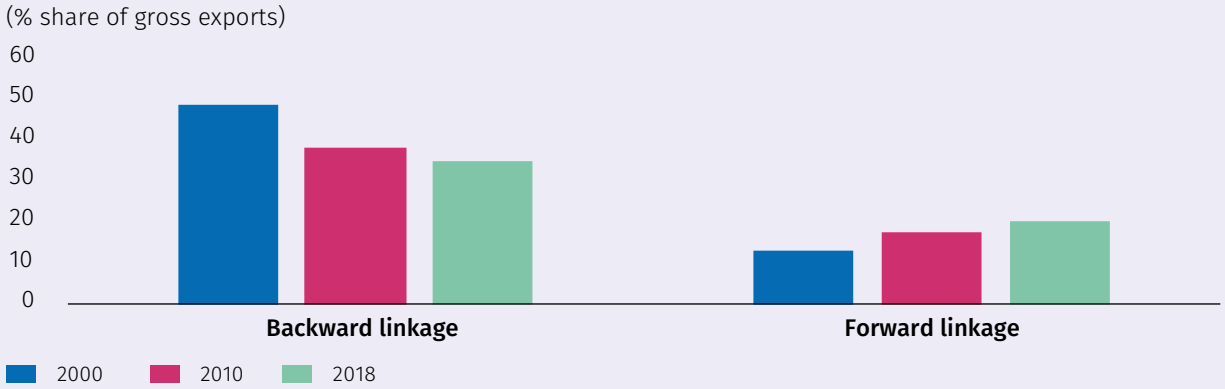
(1) Malaysia's role in GVCs was supported by strong manufacturing ecosystem that has advanced steadily over the decades

Malaysia's position in the GVCs[3] has improved over the years with higher contribution of domestic value-added in our exports as seen in the rising forward linkage (Chart 6). In addition, reliance on foreign inputs for exports has also been declining as reflected in the lower backward linkage. Given Malaysia's higher domestic value-added contributions in GVCs, stronger demand in other parts of the world was quickly transmitted to our economy. In particular, the investment and development of E&E ecosystem enabled Malaysia to be deeply integrated into the global semiconductor value chain. The E&E industry in Malaysia has become more sophisticated over the years, evolving from mainly assembly-related work to expand towards R&D activities (Chart 7). A well-developed infrastructure and proficient talent pool provided the impetus for a rich and diversified ecosystem for production and exports. This turned Malaysia into a key player in the global E&E manufacturing hub including in high value-added sectors such as medical, aerospace and automotive. Malaysia is currently the 12th largest exporter of E&E and the 6th largest semiconductor exporter in the world.[4]

[3] Backward and forward linkages can be used to characterise the position of a country's GVC participation. World Trade Organization defines backward GVC participation as the ratio of the foreign value-added content of exports to the economy's total gross exports. Meanwhile, forward GVC participation captures the domestic value added contained in inputs sent to third economies for further processing and export through supply chains.

[4] Source: IHS Markit.

C6 Malaysia's Backward and Forward GVC Participation

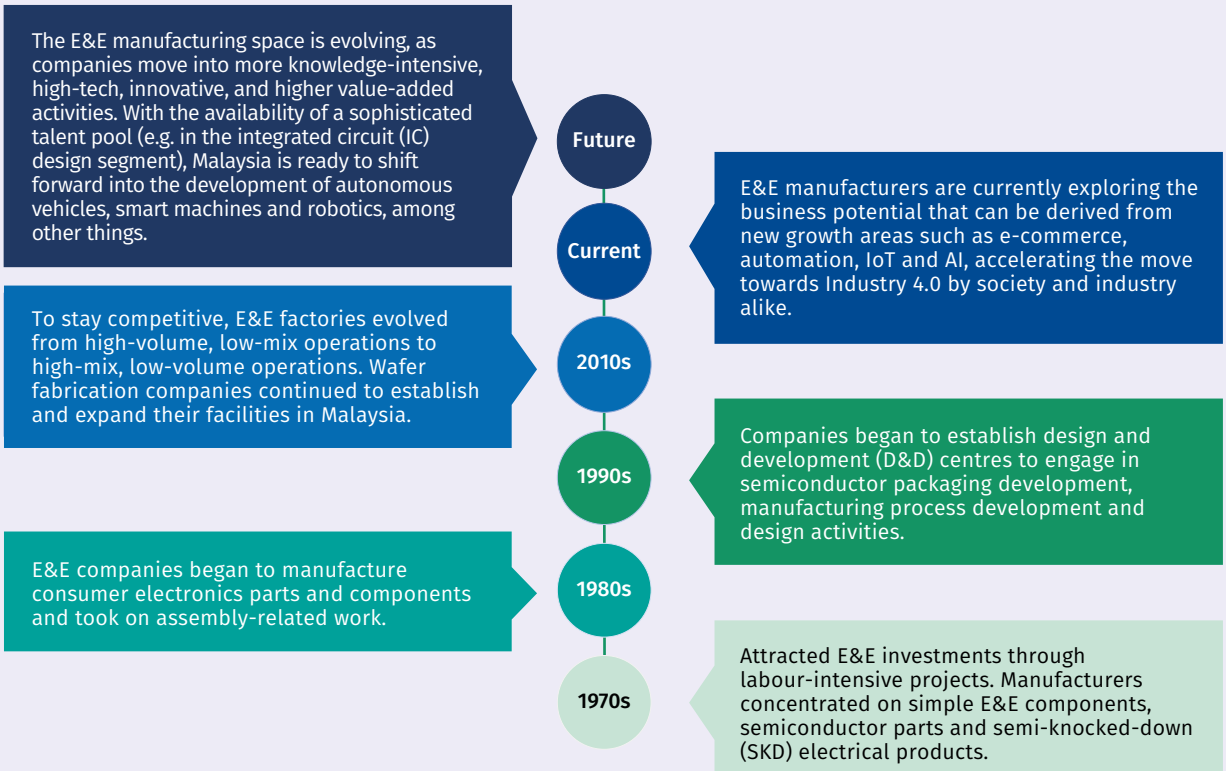


Source: Trade in Value Added, Organisation for Economic Co-operation and Development

(2) Rapid adaptability by firms allowed them to ride on strong external demand

Firms' adaptability and agility to mitigate the disruptions and to capture high global demand have also contributed to the resilience of Malaysia's trade. Local garment-makers quickly transformed themselves into manufacturers of protective gowns and face masks to respond to high global and domestic demand. Airline companies mobilised its passenger aircraft as a cargo-only fleet to transport in-demand medical supplies and e-commerce goods. Firms, including smaller businesses also quickly adapted to switching their business operations to online platforms (Chart 8).

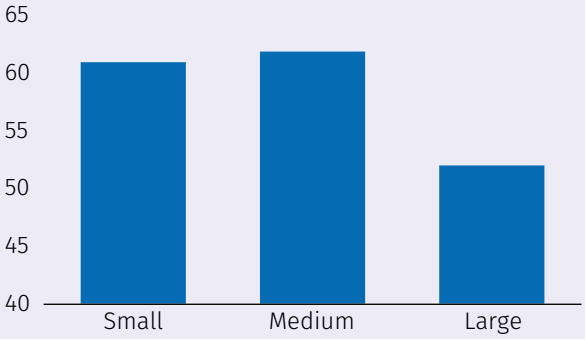
C7 Evolution of Malaysia's E&E Industry



Source: Malaysian Investment Development Authority

C8a Increased Use of Digital Platforms in Malaysia

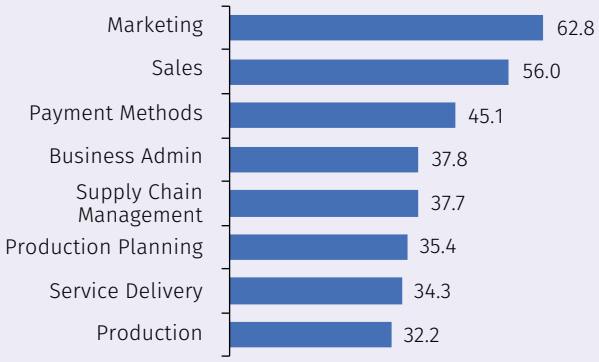
(% share of firms)



Source: World Bank's COVID-19 Business Pulse Survey Round 1, December 2020

C8b Use of Digital Platforms by Business Function in Malaysia

(% share among firms that increased use in digital platforms)



Source: World Bank's COVID-19 Business Pulse Survey Round 1, December 2020

Firms' adaptability to COVID-19 disruptions continued to pay significant dividends as global supply chain disruptions persisted beyond 2021. Malaysian firms employed several strategies to mitigate the impact of supply chain disruptions. This include building inventories by placing advanced bookings to secure supplies as well as expanding production capacity by investing in new plants and machinery. In addition, some firms opted to use alternative modes of transport, such as air cargo or land trucking to avoid shipment delays. Firms have also taken proactive steps to negotiate with their clients to spread out orders, while others have diversified their supplier base.

Government policies were also crucial in ensuring firms could quickly and successfully adapt in the fast-changing operating environment. Throughout the various phases of the movement control order (MCO) in 2020 and 2021, manufacturing firms integral to the global supply chains were allowed to operate[5] amid strict but practical standard operating procedures. On this front, ground-level insights gained from the Bank's continuous engagement with firms provided vital information for policy design and interventions. This included early identification of potential risks to the economic outlook, which enabled policies to be more nimble, timely and ultimately, effective.[6]

[5] Thirteen industries including electronics, chemical and pharmaceutical companies could operate at 60% workforce capacity during the strictest phases of the lockdowns, while five other industries including automotive, iron and steel could still operate at 10% capacity.

[6] For more detailed analysis on the importance of ground-level insights during the pandemic, please refer to the box article titled 'Taking the Pulse of the Economy During the Pandemic' in the BNM Annual Report 2021.

What to look out for? Key drivers that will shape Malaysia's trade over the medium term and policy imperatives

The COVID-19 shock is yet another example of the country's agility to capitalise on the surge in global demand. Exporters of selected products have benefited immensely from their investments in retooling and rolling out new product lines as well as leveraging on their deep integration in the GVCs. Moving forward, Malaysia could benefit from riding on emerging megatrends to ensure our continued competitiveness.

(1) Reshoring of GVCs by major economies

The pandemic revealed that over-reliance on GVCs can increase the economy's exposure to systemic risks from geopolitical, environment, economic and health disruptions. A clear example of this is the shortage of microchips creating knock-on effects globally across many durable goods sectors such as automotive and consumer electronics. In response, major economies have considered and even embarked on protectionist measures. This includes reshoring of production for key manufacturing inputs such as microchips, medical supplies and food. The move towards self-sufficiency was part of a new strategy to strengthen economic resiliency against global supply disruptions (Table 1).

T1 Notable reshoring policies by governments

Country/Region	Actions
United States	• Planned USD52 billion in federal investments for the domestic semiconductor research, design and manufacturing provisions (2021). • Introduced legislation to establish a tax credit for investments in constructing, expanding and upgrading semiconductor manufacturing facilities and equipment in the U.S. (2021).
European Union	• Approved USD3.5 billion European Battery Innovation project to subsidize Tesla, BMW and other companies to produce lithium-ion batteries in Europe (2021).
India	• Government offered USD2.5 billion in subsidies for battery production to support a "Make-In-India" strategy (2021).
Japan	• Allocated a fund of 248.6 billion yen (USD2.33 billion) in its economic emergency plan to support the relocation of manufacturing activities to Japan.

Source: News flows, country authorities

The reshoring of manufacturing production, however, could pose even higher and new risks to production and economic activity. According to an IMF study,[7] there is already over-concentration of intermediate inputs in home countries. As a result, reshoring could increase vulnerability to disruptions through higher concentration risk. Another study by the World Bank (Chepeliev et al, 2022) shows that in a world where countries re-shore their production, global trade would decline by as much as 17 percent by 2030, with adverse effects on incomes and welfare.

[7] World Economic Outlook April 2022, Chapter 4: Global Trade and Value Chains during the Pandemic.

It is also difficult to disentangle or reconfigure the GVCs due to their positive externalities and efficiency gains to participating countries. Firms have made significant investments in infrastructure, relationships and networks spanning suppliers, producers, consumers and local communities. As benefits of GVCs continue to outweigh potential costs,[8] firms will find it very hard and costly to abandon these investments or shift to alternative modes. Studies have shown that during the Covid-19 crisis, strong trade relationship along the value chain helped to cushion the impact of economic shocks. Espitia et al. (2021) shows that the export performance of sectors that are integrated in the GVCs are less negatively impacted than sectors that primarily rely on domestic inputs. Through involvement in GVCs, firms benefit from greater diversifications and are less susceptible to domestic shocks.

Diversification remains a key strategy in mitigating risks. Rather than advancing protectionist measures, the global community would be better served by focusing on stronger risk management in global trade to enhance trade resilience. Greater GVCs diversification for example, could increase inputs substitutability, lift production and logistical efficiency and reduce dependency on the demand from a specific economy. To enhance logistical and production efficiency, firms could also transform their production processes to make it easier to substitute inputs provided by different suppliers across geographical locations. Tesla reconfigured its software so they can use chips that were less affected by the semiconductor shortage. IMF (2022) estimates that greater product substitutability can reduce economic impact by around four-fifths in the receiving countries following a supply disruption in a large supplier country.

Venturing into new trade agreements with selected strategic partners[9] is one way to enhance diversification. This will open up new opportunities for Malaysian firms as outlined in the National Trade Blueprint 2022-2025. One of the global trends identified in the Blueprint is the rapid population growth in the African continent, which currently accounts for only 2.5% of Malaysian exports.

Ultimately, given the intense competition among GVC players, efforts to strengthen Malaysia's position should be a key priority. Malaysia needs to move away from reliance on low-cost production models to higher value-added activities. Resiliency factors like logistics, inventory management and access to substitutable inputs, flexibility and skills of workforce will be key in driving the country's competitive edge. Quality investments that are aligned with the National Investment Aspirations (NIAs) can deepen Malaysia's contribution that will also increase economic complexity, expand domestic-linkages, develop new economic clusters, create high-value jobs and improve inclusivity. Also, by aiming for sectors that are knowledge-driven, tech-intensive and low carbon, these investments would encourage R&D and innovation, which would incentivise horizontal and downstream diversification into more complex export products. This is particularly relevant for the palm oil sector, which has a high potential to advance into higher value-added downstream segments such as agrochemicals and food products.[10]

[8] In 'Global value chains: Efficiency and risks in the context of COVID-19', OECD (2021) uses computable general equilibrium (CGE) trade model and found that most economies are better off interconnected via GVCs than in localised regime in terms of efficiency and vulnerability against shocks.

[9] Malaysia has entered into several bilateral and multilateral Free Trade Agreements. The most recent ratification was the Regional Comprehensive Economic Partnership (RCEP) on 18 March 2022.

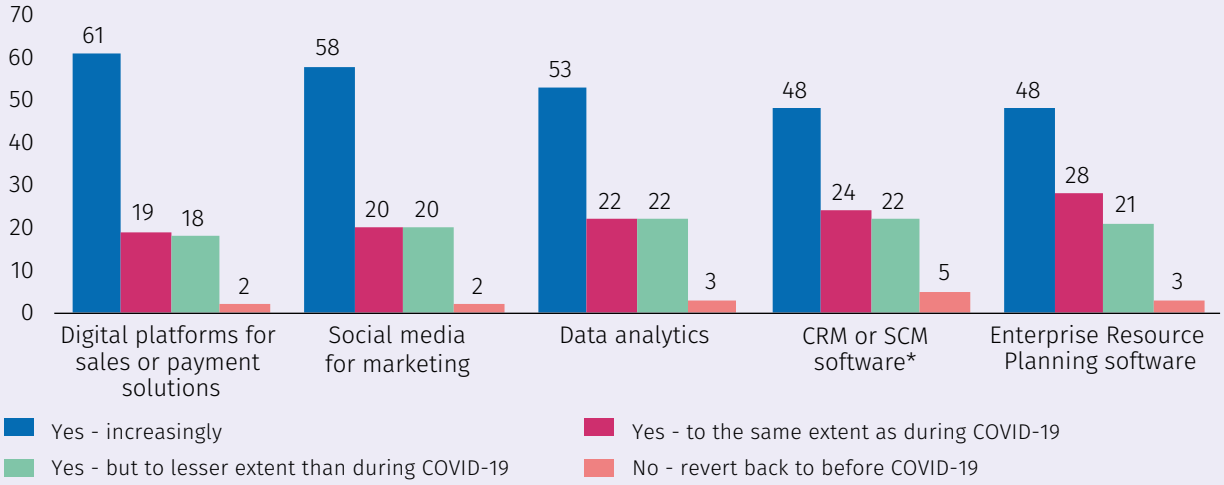
[10] In BNM's Economic and Monetary Review 2020 Box Article "Innovation Malaysia: towards higher Quality growth in a Post-Pandemic Future", it highlights that accelerating downstream palm oil activities is one of the key imperatives for Malaysia to emerge stronger post-pandemic.

(2) Technology and digital services present significant opportunities for future sources of growth and exports

Firms' adoption of digitalisation and e-commerce accelerated during the pandemic, even among smaller enterprises. The use of online platforms is likely to be a persistent trend (Chart 9). The automation of industrial processes allowed firms to meet low-touch and social distancing requirements while ensuring production continuity. For example, through remote monitoring capability, engineers in Malaysia were able to guide the staff in Beaumont, Texas for an orderly shutdown of its facility before being impacted by Hurricane Laura in August 2020 (Greenfield, 2021). Additionally, usage of digital technology such as Internet of Things (IoT) and cloud computing has effectively become the new norm. Other than production, technology was also deployed in sales and marketing, payment methods, supply chain management and production planning. This also means bigger opportunities for small and medium-sized enterprises (SMEs) to participate in the GVCs.[11]

C9 Expected Use of Digital Technologies Post-Pandemic in Malaysia

(% share of firms who started or increased use)



* CRM = customer relationship management; SCM = supply chain management

Source: World Bank's COVID-19 Business Pulse Survey Round 4, March 2022

Adoption of new technologies into GVCs can improve efficiency while providing new growth opportunities. For instance, blockchain technology is increasingly being employed to record transactions in shipping logistics, thus improving bureaucratic efficiency. By automating forms and bills of lading,[12] this would expedite the administrative processes and customs procedures and clearance. Importantly, it will minimise errors and delays as well as reduce revenue leakages for the Government. Recently, it was reported that the Royal Malaysian Customs Department has begun using the blockchain-enabled 'TradeLens' platform in Malaysia to modernise the shipping processes. This should create the pathway towards greater transparency, more efficient trade activities and higher customer satisfaction.[13]

[11] Companies adopting digitalisation using high-speed internet and website adoption are 6–10 percent more likely to participate in GVCs (Gopalan, Reddy and Sasidharan, 2022).

[12] A bill of lading is a document issued by a carrier to acknowledge receipt of cargo for shipment.

[13] News Straits Times (2020).

Policies that encourage digitalisation as outlined under the 'MyDigital' initiative will enable more local players, particularly MSMEs to participate in GVCs. To complement this, a highly-skilled and digital-ready workforce is required to supply firms with the talents needed for them to digitalise their operations and increase productivity. Hence, there needs to be collaboration between firms, educational institutions and the Government to supply a market-ready, high-skilled employment base.[14] In Norway, social partners participate as external members in the governing boards of domestic higher educational institutions (OECD, 2019). This allows social partners with close links to the labour market to contribute to the institutions' strategy for education and research activities. Malaysia's own industry-led Penang Skills Development Centre (PSDC) has demonstrated commendable achievements in training and developing high-skilled workforce especially for the E&E industry. This tripartite initiative which brings the industry, Government and academia including polytechnic institutions should be emulated in other industries to develop digital-savvy and future-ready talent that will enable Malaysia to undertake more complex and higher value-added activities.

(3) Making trade greener and sustainable into the future

The post-pandemic era also presents opportunities to accelerate the shift towards the green and sustainability agenda. As the pandemic exposed fragilities in the global economy, there has been greater focus to 'build back better' by paving the way towards a greener and sustainable recovery. In the automotive sector, more countries are shifting towards energy efficient vehicles (EEV) such as hybrid cars and electric vehicles (EVs). Global sales of EVs doubled in 2021 from the previous year to a new record of 6.6 million (International Energy Agency, 2022). In addition, demand for green technology such as solar panels, electric vehicles and lithium batteries has seen a strong increase. In 2021, renewable electricity capacity additions increased by 6% globally, reaching a record-high of 295 gigawatts (GW) and is expected to increase by over 8% in 2022. Solar photovoltaic is forecast to account for 60% of the increase in global renewable capacity this year, a 25% gain from last year (International Energy Agency, 2022). Increasing demand for cleaner energy sources also implies new market opportunities for biofuel exports. This provides opportunities for Malaysia to shift towards exporting more renewable energy.

Therefore, there should be greater emphasis towards green and sustainability compliance across export industries with clear environmental, social and governance (ESG) targets and measurable outcomes moving forward. To encourage the transition to low carbon practices for SMEs, the Bank has established the Low Carbon Transition Facility (LCTF). The implementation of the Government Green Procurement policy and the provision of alternative financing such as green sukuk are also encouraging developments. Beyond this, there should be increased coordination between agencies to attract investments in low carbon industries. Measures to enhance export capacity and branding and promotion strategies for green products are also paramount. For example, palm oil products in the downstream segments that promote RSPO-certified crude palm oil could expand opportunities to tap into the global markets for sustainable products. Furthermore, effective policies including targeted incentives could also encourage businesses and exporters to adopt green practices. On that note, the policy implementation should be well-calibrated to align ESG ambitions with different ESG risk levels for different export sectors. Overall, these efforts should enhance Malaysia's trade competitiveness.

[14] For more information, please refer to BNM's Economic and Monetary Review 2020 Box Article titled "Getting the Great Reset Right: Structural Labour Market Issues in the Post-COVID-19 World".

Conclusion

Since its trough in the second quarter of 2020, Malaysia's trade has rebounded swiftly in 2021 supported by strong external demand for goods. Malaysia has been able to withstand the impact of global supply chain disruptions considerably well, given our diversified export structure and firms' adaptability as well as supportive policy measures. However, the global post-pandemic trade climate presents new challenges and growth opportunities for Malaysia. A prioritisation towards the implementation of policies that strengthen trade resilience would be critical for Malaysia, given the importance of exports to the Malaysian economy. Policies focusing on sustainability, technology, innovation and inclusivity will be the key underpinnings of a more sustainable growth. The role of the Government is paramount, particularly on strategic direction and administrative capacities to implement key structural reforms. This includes revitalising quality investments through NIAs, digitalisation of the economy, creating highly-skilled and future-ready workforce as well as enhancing trade competitiveness and market access (Chart 10).

C10 **Existing Policies that can Enhance Malaysia's Trade Resilience**



Source: EPU, MITI, MATRADE, Bank Negara Malaysia

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